National Bank of Ukraine

Monthly Macroeconomic and Monetary Review

January 2024

Monetary Policy and Economic Analysis Department

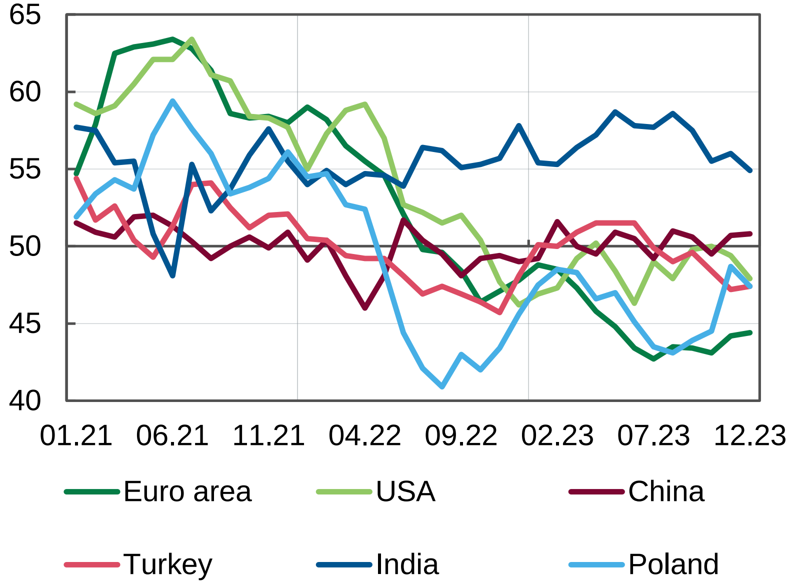
Summary

- **Economic growth in Ukraine's main trading partners (MTPs) remained weak, but inflationary pressures intensified due to logistical problems.** Energy prices fluctuated within a narrow range, with the available supply, including stocks, being sufficient to meet weak demand. Expectations that major CBs would start cutting interest rates soon have grown, while EM central banks continued to ease moderately
- **Consumer inflation in Ukraine continued to decelerate** (headline inflation to 5.1% yoy, core inflation to 5.7% yoy in November) due to further reduction of pressure from business costs, the effects of larger harvests in 2023, as well as a sustainable situation in the FX market. The latter along with improved expectations also helped ease underlying inflationary pressures. According to the NBU estimates, inflation continued to decline in December too
- In December, **economic activity weakened, mainly seasonally**. The shift of winter holidays played a certain role, which, on one hand, led to the weakening of activity in the service sectors, while on the other hand underpinned the revival of retail trade. High harvests of late crops and their processing supported the food industry, orders from the defense sector and railways supported engineering, and the further expansion of sea freight supported transportation
- The **labor market also experienced a seasonal slowdown** in both job search and recruitment. Meanwhile, w**ages continued growing** thanks to both budget payments and resources of businesses. The number of migrants abroad increased slightly at the end of the year
- **The state budget deficit reached a new record high both in December and the entire year**. The annual deficit, however, was below the targeted level. International aid and domestic borrowings were the primary sources of deficit financing
- In November, the **negative balance of trade in goods declined** due to increased export supplies through a new sea route and lower imports amid the impact of the blockade. However, **the current account deficit widened** given a delay in the grant assistance from the US. Meanwhile, thanks to international aid inflows reserves decreased marginally in November and resumed their growth in December, reaching USD 40.5 bn by the end of the year
- **The situation in the FX market in December has remained under control**, despite the seasonal increase in FX demand and uncertainty over external financing disbursements. As a result, the NBU increased volumes of interventions to USD 3.6 bn. **The yields on hryvnia assets in real terms remained positive** despite the reduction of the key policy rate to 15%

External Environment

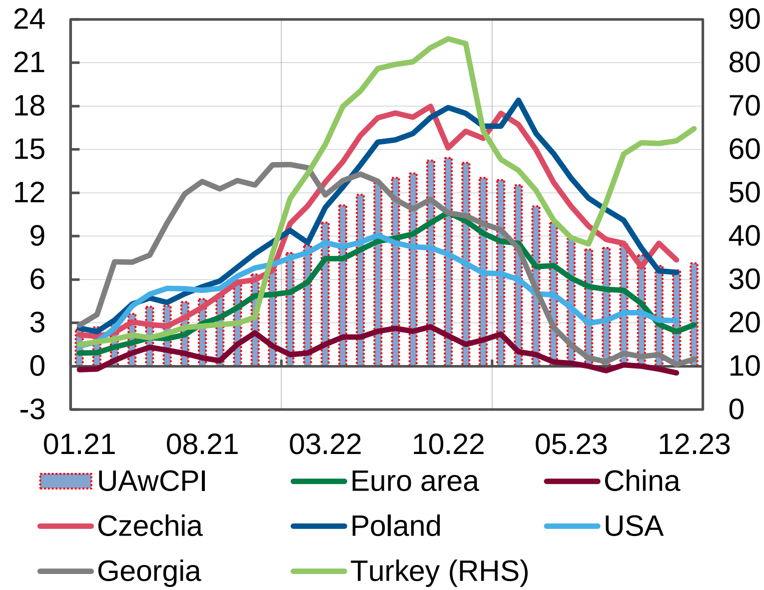
Economic growth in Ukraine's MTPs remained weak, but inflationary pressures intensified due to logistical problems

Manufacturing PMI of selected countries



Source: S&P Global.

CPI growth in selected countries and a change in UAwCPI (price index in MTPs of Ukraine), % yoy

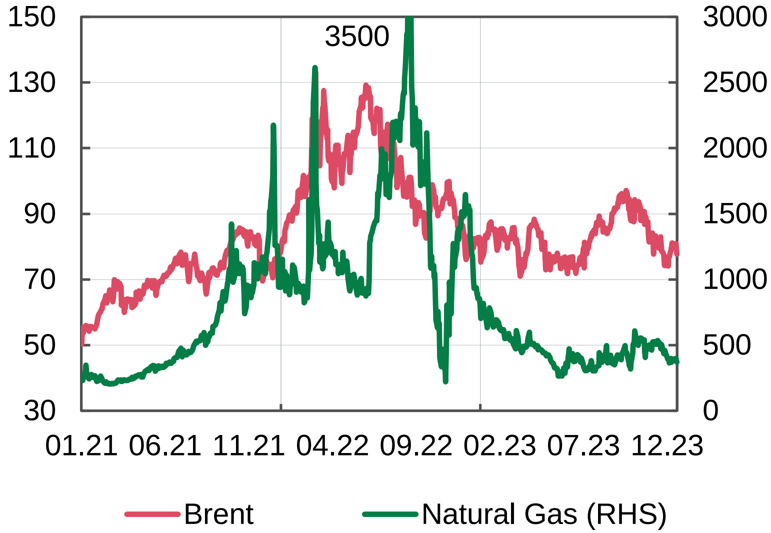


Source: national statistical offices, NBU staff estimates.

- Leading indicators showed weak demand in most of Ukraine's MTPs, which was accompanied by a decline in new orders and, consequently, a decrease in purchases of raw materials. There were only completing backlogs of work and the continued use of inventories that supported the manufacturing
- International trade flows also narrowed. In addition to weak demand, they were affected by problems with maritime transportation, including difficulties with the passage of ships through the Suez Canal
- At the same time, this affected the growth of input costs fueling inflationary pressures. Therefore, the decline in inflation in Ukraine's MTP countries (UAwCPI) has stalled

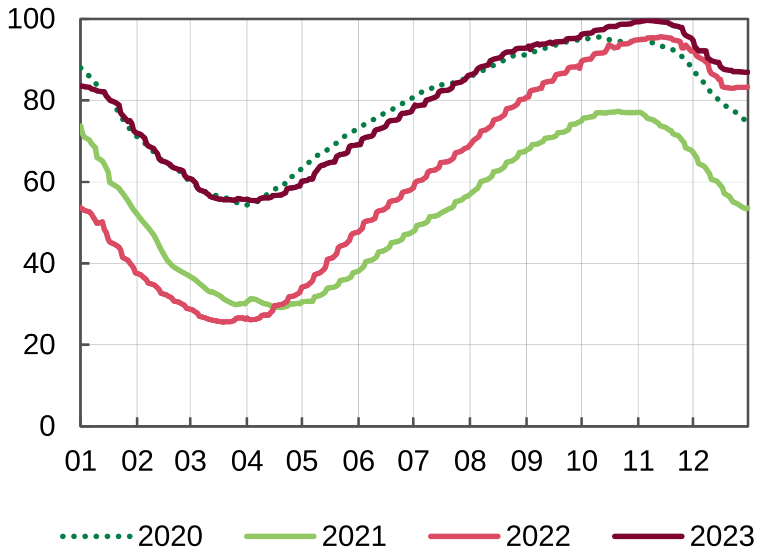
Energy prices fluctuated within a narrow range, with the available supply being sufficient to meet weak demand

World Brent oil prices (USD/bbl) and Netherlands TTF natural gas prices (USD/kcm)



Source: Refinitiv.

EU gas storage inventories in the corresponding year, % full

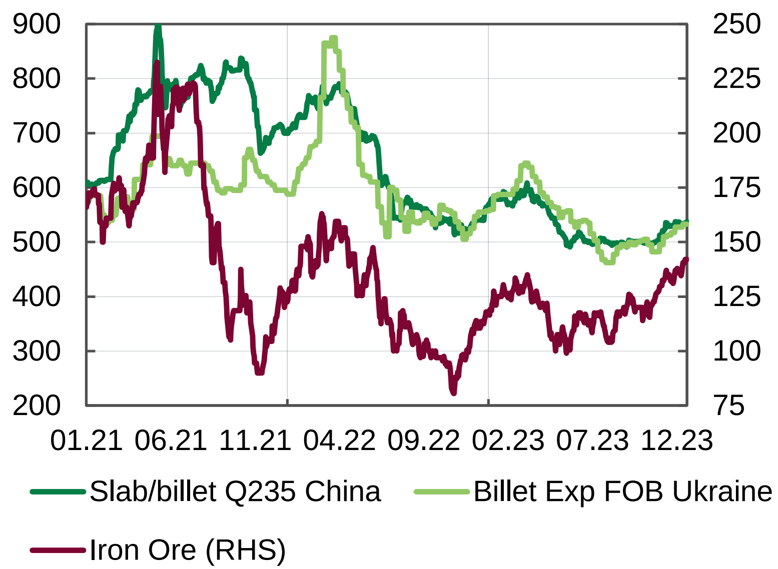


Source: Refinitiv.

- **Global oil prices.** Production cuts under the OPEC+ deal, additional restrictions by Saudi Arabia and russia, and concerns about supply disruptions due to attacks on ships in the Red Sea put an upward pressure on prices. At the same time, record US production volumes, the temporary lifting of oil sanctions against Venezuela, Angola's withdrawal from OPEC, and weak global demand restrained price growth
- **Gas prices in Europe.** Relatively warm weather for this time of year, increased supplies from Norway, and steady production of liquefied natural gas in the US amid high gas reserves in Europe put a downward pressure on prices. However, increased demand from Asian countries and possible supply disruptions due to conflicts in the Middle East kept prices from falling

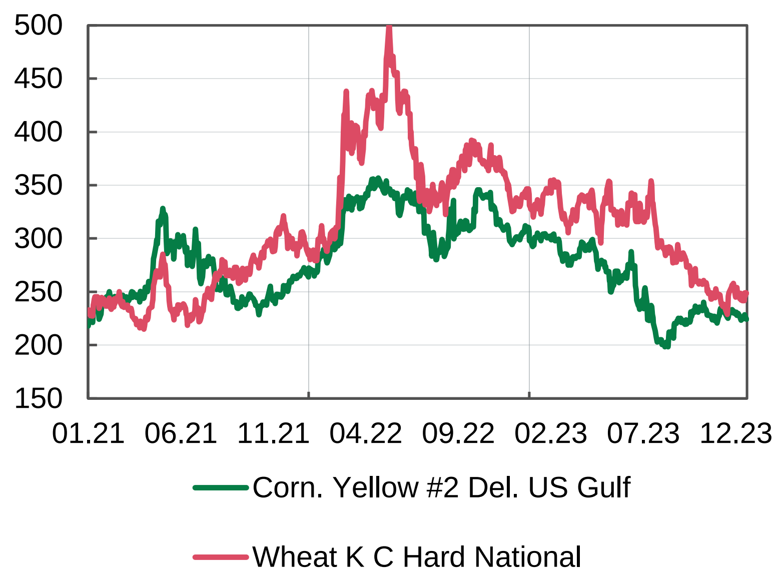
Steel and iron ore prices rose due to financial stimulus in China. Grain prices stabilized

Global steel and iron ore prices, USD/MT



Source: Refinitiv, Delphica.

Global grain prices, USD/MT

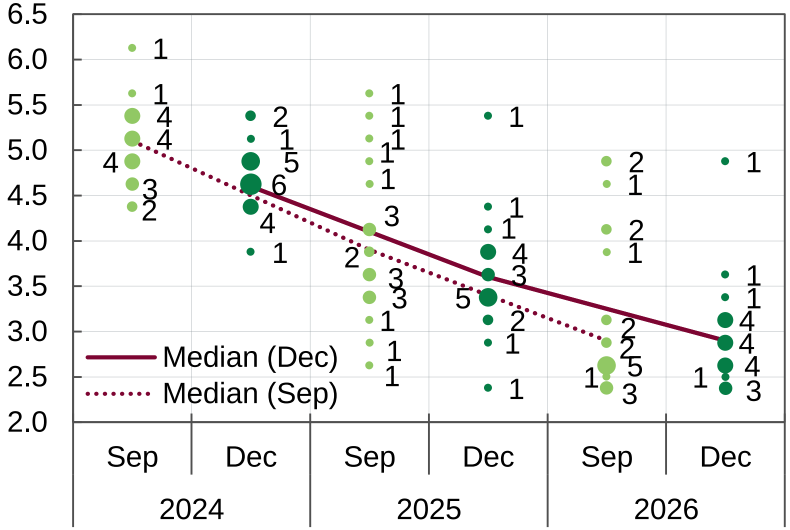


Source: Refinitiv.

- **Steel and iron ore prices** rose due to China's increased efforts to support economic growth, including government funding for the real estate sector and lower bank rates. Additional factors supporting prices were a decline in billet production in China due to the shutdown of a number of facilities (due to air pollution control) amid relatively stable demand in the Persian Gulf countries
- **Wheat and corn prices** fluctuated within a narrow range: improved weather conditions in the major exporting countries of these crops amid good harvests in the Black Sea region, Latin America and the U.S. fully met the growing demand from Asia and the Middle East

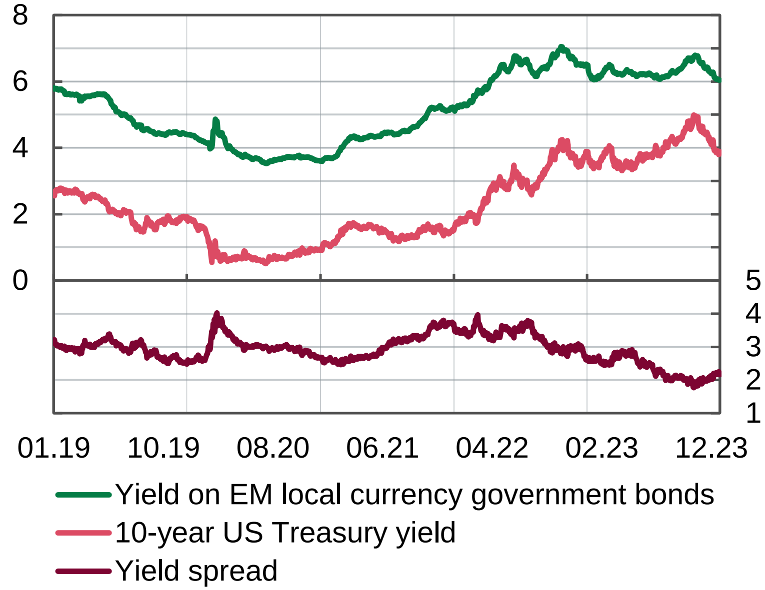
Expectations that major CBs will soon start cutting rates have grown

The number of FOMC members that expect the respective policy rate*



* - at the end of the specified calendar year
Source: Fed (meetings in September and December 2023).

Yields on 10-year U.S. bonds and EM* government bonds in local currencies, %

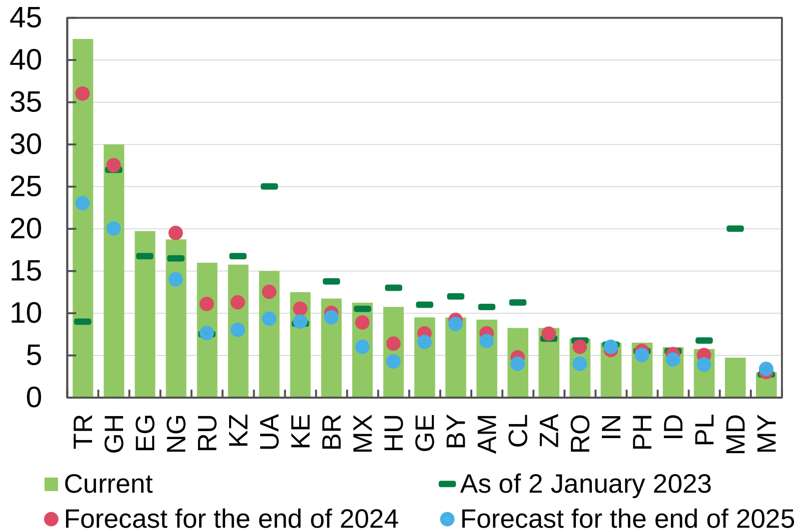


* EM – 18 countries (including CEE)
Source: Bloomberg.

- **The Fed** has begun discussing future monetary policy easing and is forecasting rate cuts by a total of 75 bps during 2024 (probably, starting from H2). At the same time, financial markets are pricing in rate cuts of about 150 bps (the first one – in March)
- Concurrently, **the ECB** policymakers rejected the possibility of discussing rate cuts in the near future. However, investors expect the first cut in April and a total of 140 bps during 2024
- Against the backdrop of growing expectations that major CBs will soon start cutting rates, yields on government securities decreased, but remained at still quite high levels

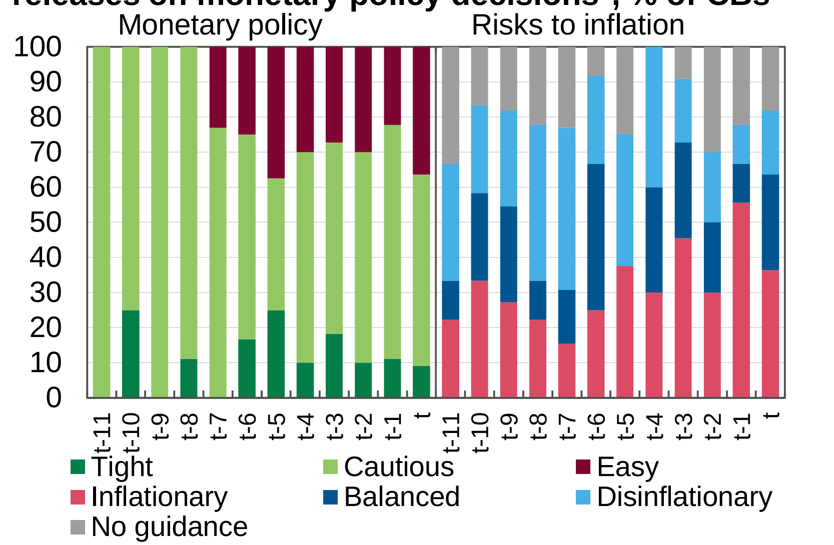
EM CBs continued to ease monetary policy moderately

Key policy rates in selected EM countries, %



Source: official web pages of central banks, Focus Economics, Oxford Economics, as of 29.12.23.

Balance of CBs' sentiments according to press releases on monetary policy decisions*, % of CBs



* t – meeting in Dec, t-1 – Nov, t-2 – Oct, t-3 – Sep, t-4 – Aug, t-5 – Jul, t-6 – Jun, t-7 – May, t-8 – Apr, t-9 – Mar, t-10 – Feb, t-11 – Jan.

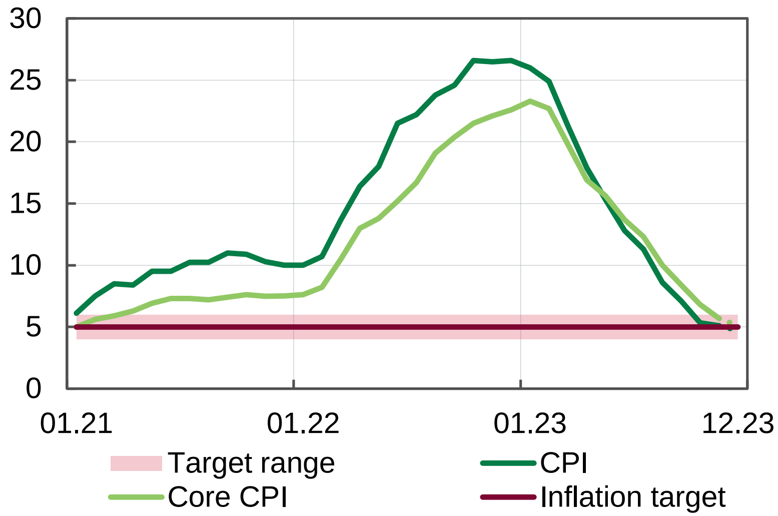
Source: official web pages of central banks.

- The CBs of **Czechia** (currently classified as a developed country, for the first time in more than 3 years) and **Colombia** have started a gradual rate reduction. Although the former is ready to suspend or end the easing process if inflation does not slow as forecasted
- The CB of **Indonesia** is expected to cut the interest rate in the second half of 2024. Further monetary policy easing by the CB of **China** is also foreseen in 2024
- In contrast, the CB of **Turkey** continued to increase its interest rate, albeit at a slower pace. The tightening cycle is anticipated to be completed ‘as soon as possible’, after which the monetary tightness will be maintained for ‘as long as needed’

Ukraine: Inflation

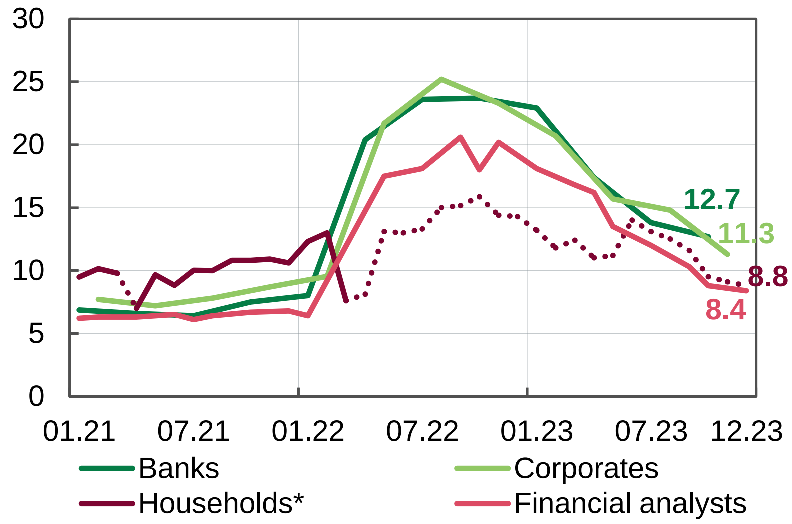
Consumer inflation continued to decelerate

Inflation* and inflation target, % yoy



* Data for December reflects nowcast.
Source: SSSU, NBU staff estimates.

Inflation expectations for the next 12 months, %

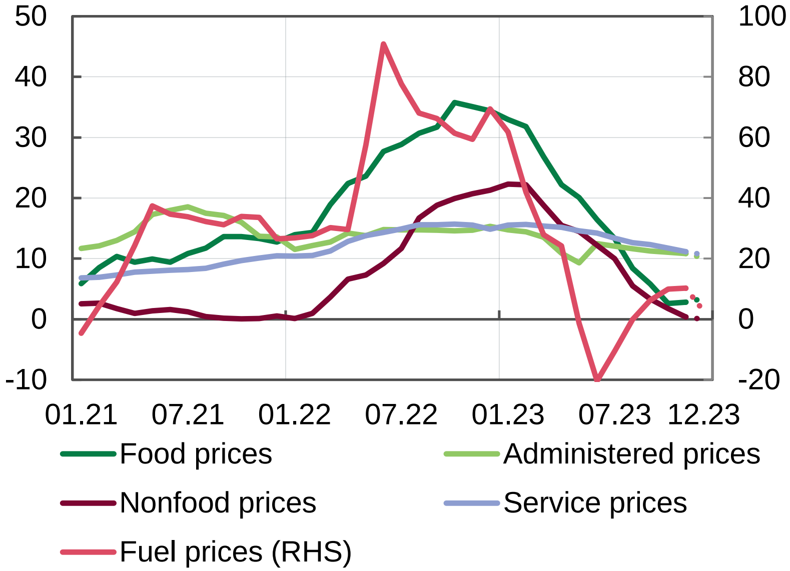


* The dotted line indicates a change in the method of survey for a telephone interview.
Source: NBU, GfK Ukraine, Info Sapiens.

- The actual rates of price growth in November were somewhat below the trajectory of the NBU's forecast published in the October 2023 Inflation Report
- Inflation continued to slow down due to the further easing of pressure from business costs, primarily due to cheaper raw food inputs, as well as improved expectations amid preserved exchange rate sustainability
- The same factors contributed to easing of underlying inflationary pressures
- According to the NBU's estimates, inflation continued to decline in December

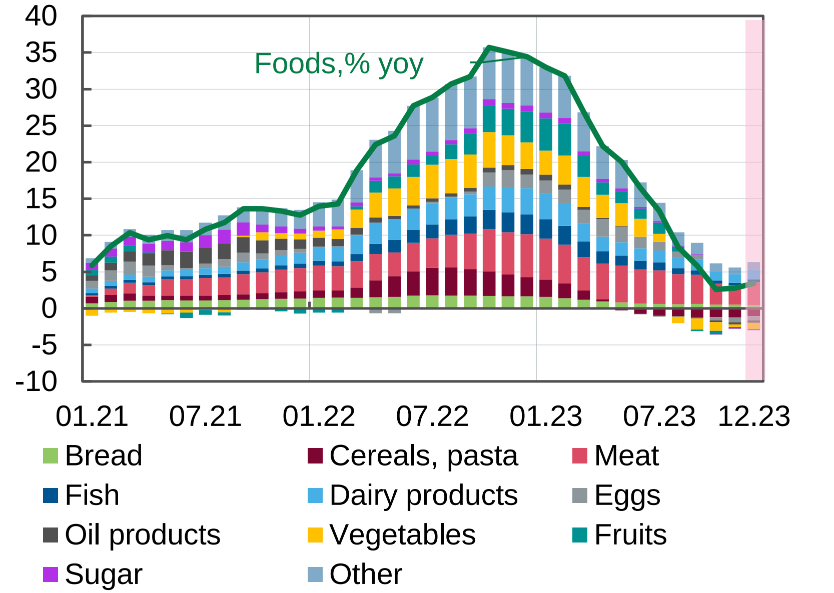
The growth rates of prices for both nonfood products and services have decreased, while those for foods remained low

Selected CPI components*,% yoy



* Data for December reflects nowcast.
Source: SSSU, NBU staff estimates.

Contributions to the annual change in food prices*, pp

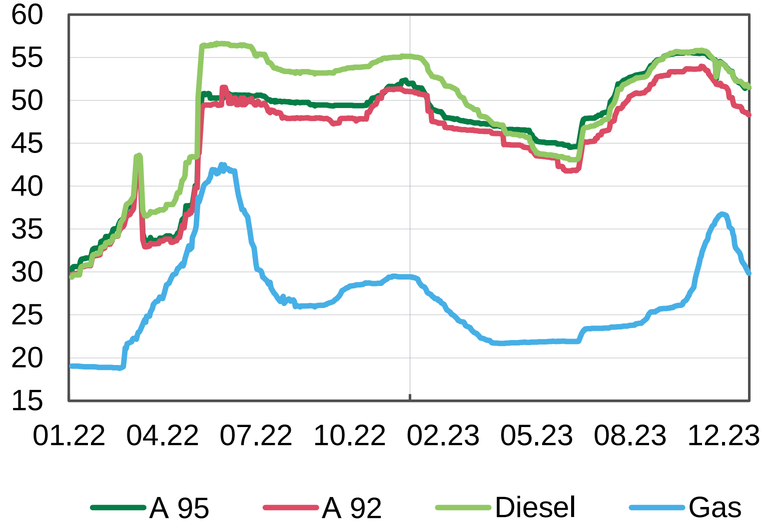


* Data for December reflects nowcast.
Source: SSSU, NBU staff estimates.

- The growth of prices for services, nonfood goods and products with a high import share in their cost slowed down due to improved expectations amid a controlled situation in the FX market
- An additional factor was eased pressure from business costs, in particular due to cheaper raw food inputs amid larger harvests in 2023
- The growth rate of food prices remained low, although they increased slightly due to a reduction in the supply of lower-quality products (especially potatoes) and a shift to more expensive greenhouse products (tomatoes and cucumbers)
- The blockade of western border crossings also had a certain contribution to the growth of food prices

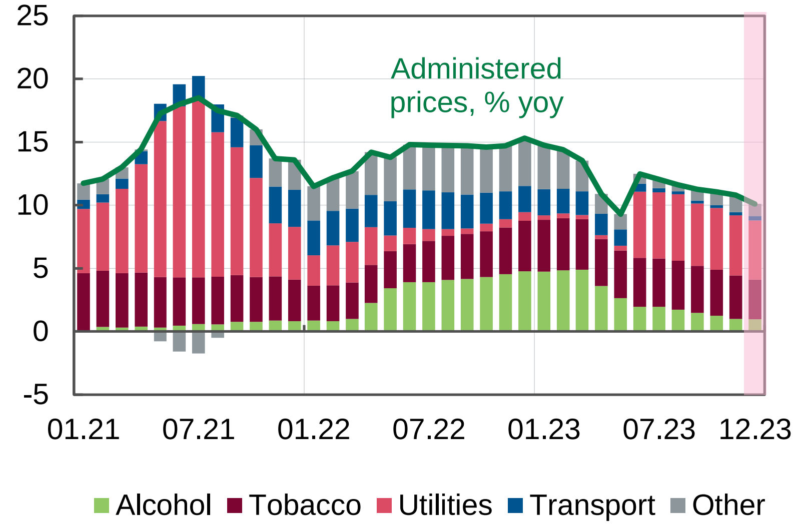
The increase in fuel and administered prices slowed down

Fuel prices, UAH / L



Source: minfin.com.ua, NBU staff calculations.

Contributions to the annual change in administered prices, pp



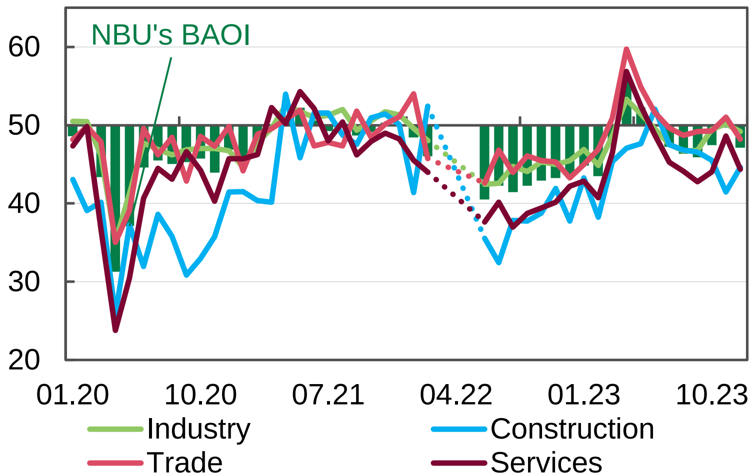
* Data for December reflects nowcast.
Source: SSSU, NBU staff estimates.

- After accelerating in November amid supply chain disruptions, fuel prices slowed down in December thanks to lower global oil prices and alternative fuel supply routes that offset the effects of the blockade of western border crossings
- The growth in prices for alcoholic beverages slowed further on the back of a weaker increase in production costs amid pressure from the shadow market supply and improved expectations
- The moratorium on increase in tariffs for several utility services also restrained administered inflation

Ukraine: Economic activity

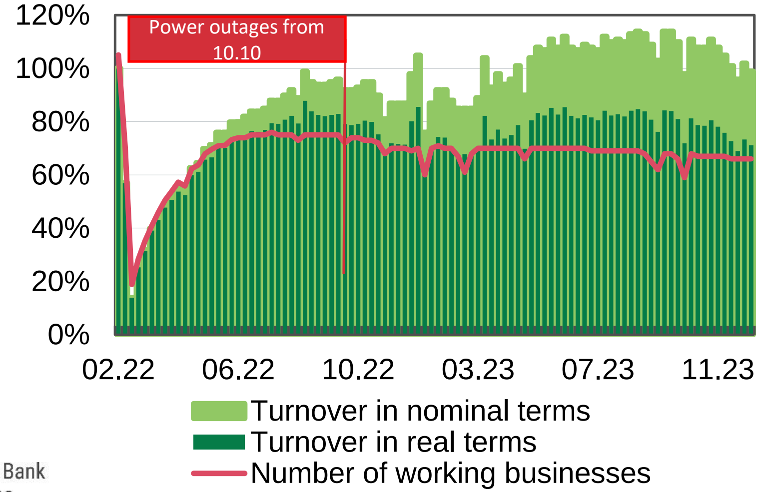
In December, economic activity weakened seasonally, particularly in the service sector

NBU's business activity outlook index (BAOI), sa, p



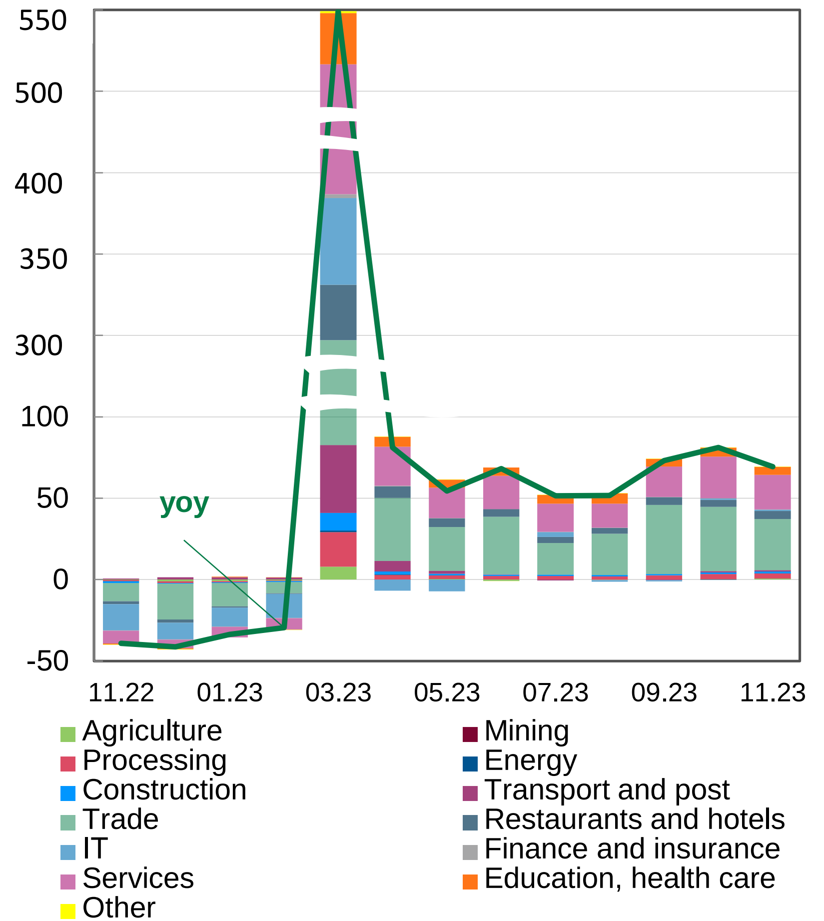
Survey was not conducted from March to May 2022.
Source: NBU.

Performance indicators of the restaurant industry, %



Source: SSSU, Poster, NBU staff estimates.

Contributions to the annual increase in the number of new individual entrepreneurs by type of activity*, pp

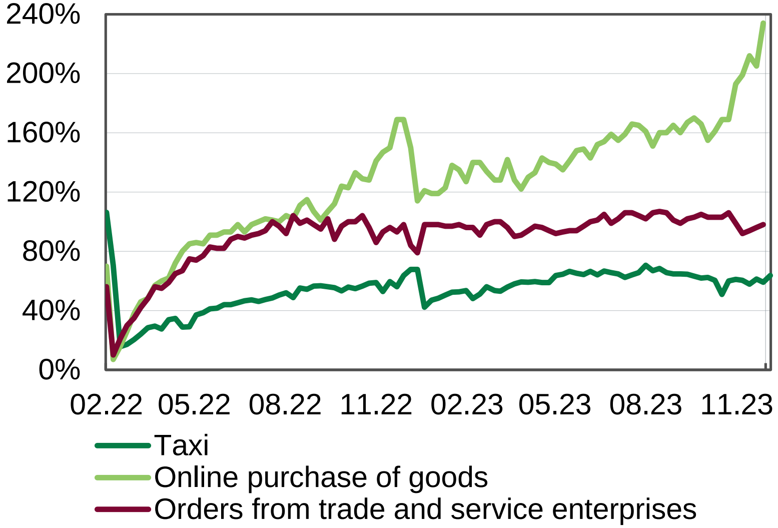


* In order to improve visual perception, the official names of types of economic activity according to the Classification of Types of Economic Activity were shortened.
Source: opendatabot.ua; NBU calculations.

National Bank of Ukraine

The shift of the winter holidays supported retail trade

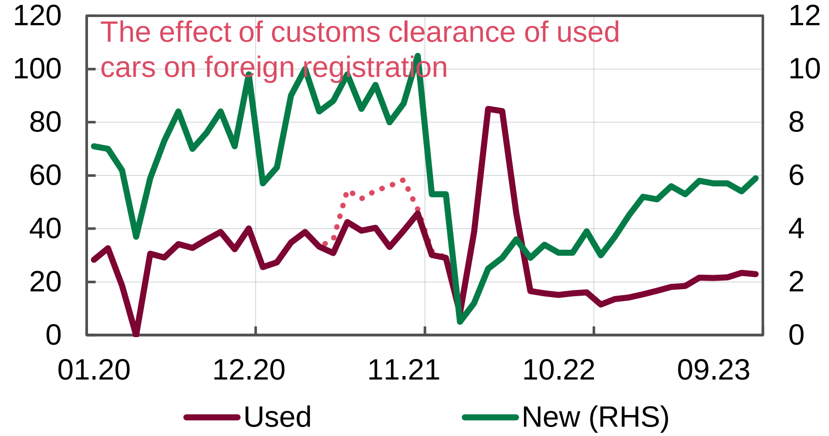
The number of taxi orders and online purchases of goods, % to pre-war level



Source: Opendatabot (Bond taxi service and Khoroshop service).

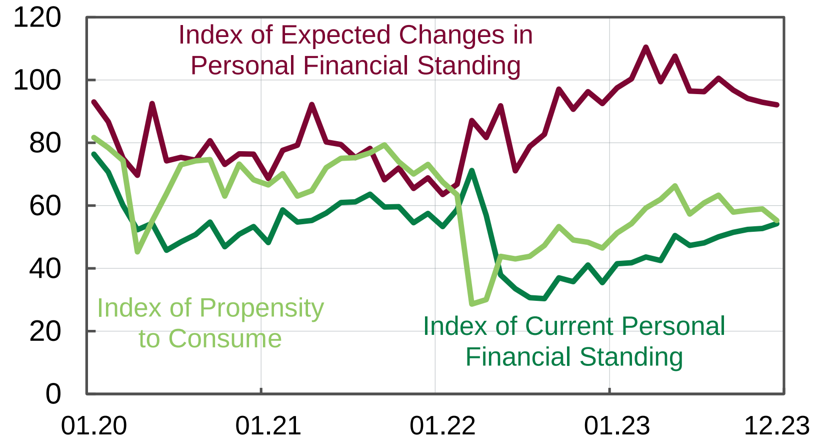
- The shift of the winter holidays supported retail sales in December, particularly its online segment
- According to the results of the year, retail trade has almost recovered to pre-war levels, while further growth was restrained by a lack of workers
- Sales of new passenger cars in December increased by 9% mom and by 53% yoy

The first registration of passenger cars, thousand units



Source: Ukravtoprom.

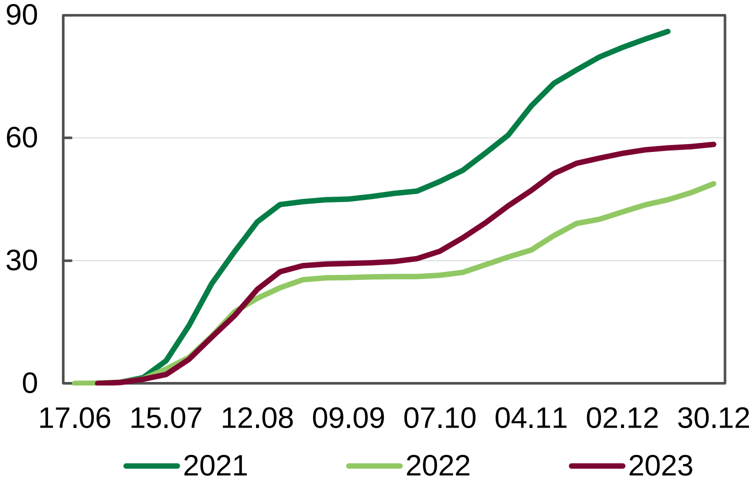
Components of the consumer sentiment index, p



From March 2023, the survey method was changed from face-to-face to telephone interviews.
Source: Info Sapiens.

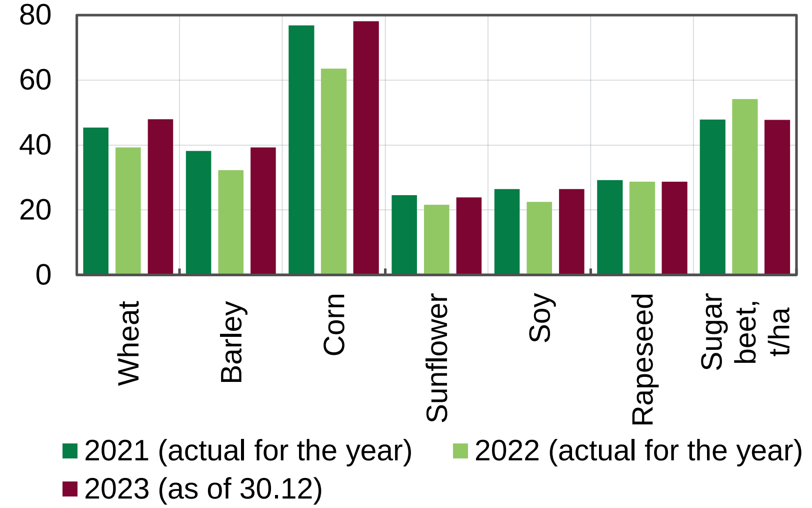
High harvests ensured increase in the workload of businesses in food processing

Volumes of harvested grains and legumes, million tons, cumulative



Source: MinAgro.

Productivity of the main agricultural crops, centner/ha

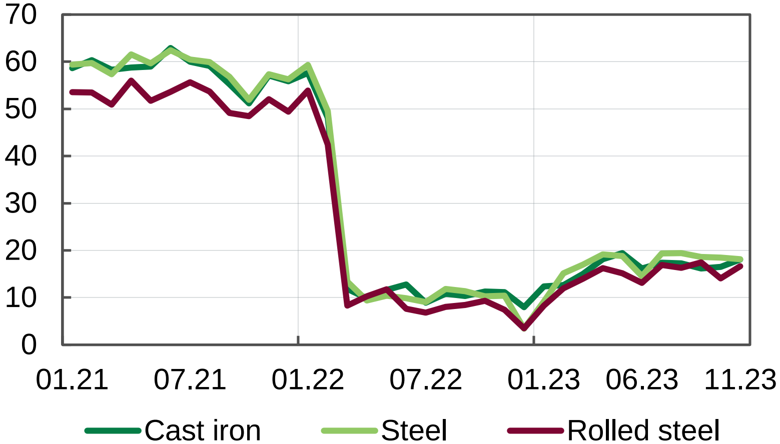


Source: MinAgro.

- The harvest of late crops was almost over. Harvest volumes in 2023, thanks to favorable weather and high yields, exceeded those of last year: wheat - by 8%, barley - by 5%, sunflower - by 6%, soybeans - by 39%, rapeseed - by 21%. The sugar beet harvest increased by 20% due to the increase in sown areas. The corn crops, the harvesting of which is not yet over (89% of the sown areas have been harvested), are already 8% higher than last year
- In 2023, meat production increased slightly, particularly due to poultry, although it still remained below the pre-war 2021 year; at the same time, milk production continued to decrease
- In December, rising prices for raw inputs and a seasonal decrease in demand restrained dairy processing; at the same time, meat processing revived due to the shift of holidays
- The workload in sunflower and rapeseed processing was increasing against the backdrop of a higher harvest; investments in the industry were increasing. Thanks to the high sugar beet harvest, sugar production also increased

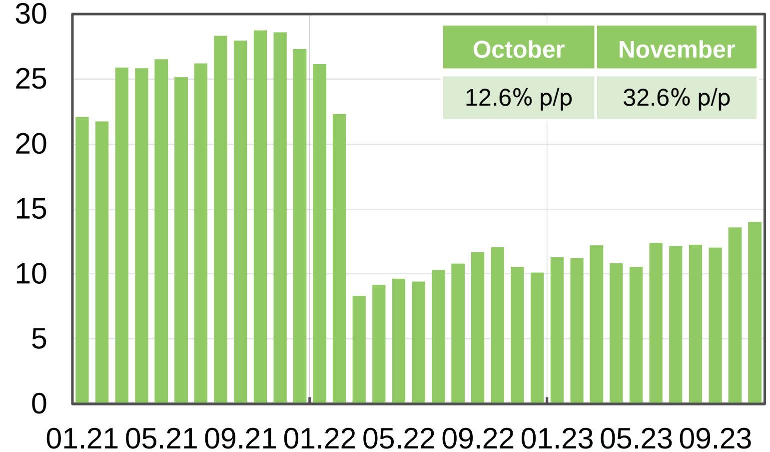
Orders from the defense and railway sectors supported industry, while sea shipping supported transportation

Average daily production of steel, cast iron and rolled steel, thousand tons



Source: Ukrmetalurgprom.

Rail freight transportation, million tons



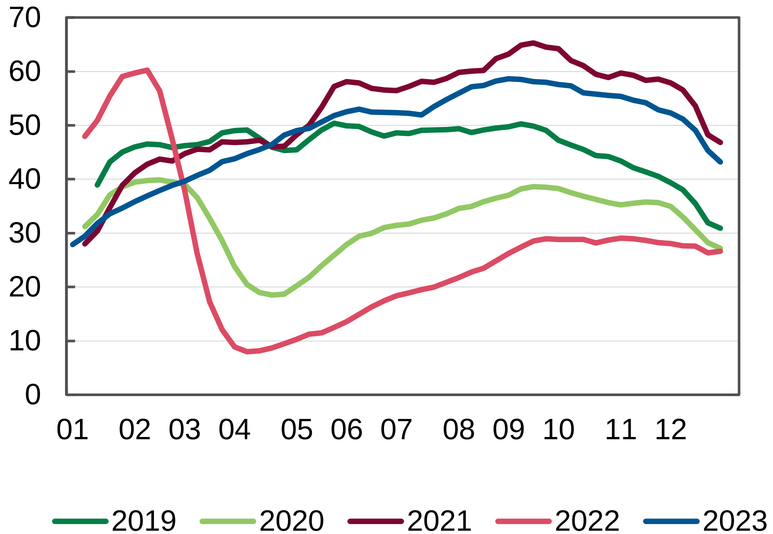
Source: SSSU, Rail.insider, UZ

- The construction of defense fortifications supported the construction industry and loading of metallurgical enterprises
- Shelling of mines worsened coal production in December, and scheduled equipment repairs held back iron ore mining; gas production decreased in December due to the suspension of work at the Sakhalin field, which was partially compensated by the introduction of new facilities
- The production of wagons and buses, as well as the increase in the production of weapons and drones supported the loading of machine-building enterprises
- Road transportation of agricultural products continued to decrease in December (-17% mom), in particular due to the blocking of certain checkpoints on the western border. At the same time, thanks to the expansion of export transportation via sea routes the average daily number of wagons moving towards Black Sea ports has increased, despite constant air-raid alarms and storms that slowed down shipments

Ukraine: Labor market

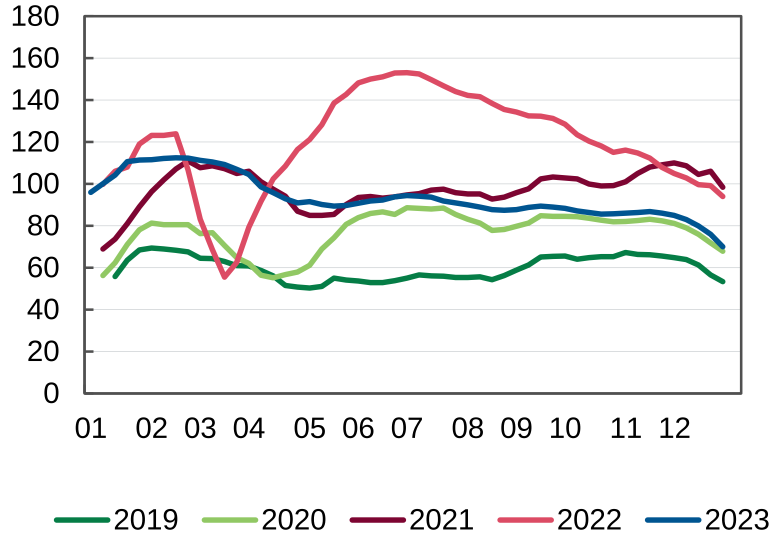
The labor market experienced a seasonal slowdown by the end of the year

Number of new job openings, four-week moving average, thousands



Source: work.ua, NBU calculations.

Number of new resumes, four-week moving average, thousands

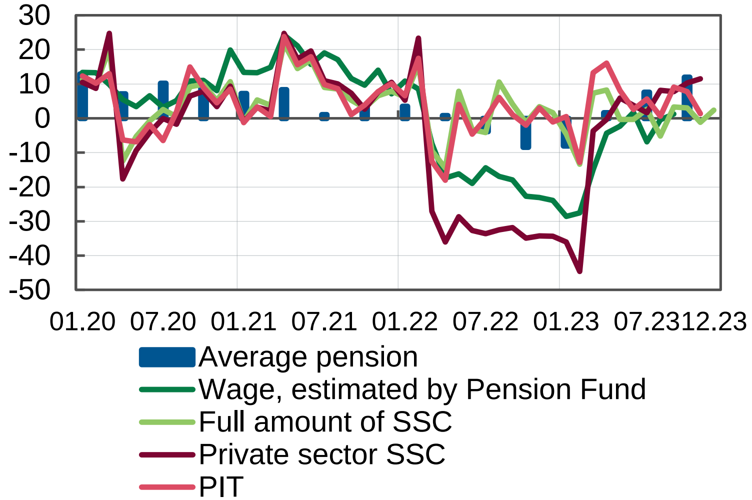


Source: work.ua, NBU calculations.

- As is typical for the end of the year, both job search and recruitment activity of businesses have weakened
- At the same time, at the end of the year, the number of new vacancies almost reached the level of December 2021, although the number of resumes remained significantly lower than in 2021
- Significant imbalances in the labor market persisted, both by region and by occupational group, with higher demand for workers in retail and healthcare. Businesses continued to report pressure from a shortage of skilled labor, according to surveys

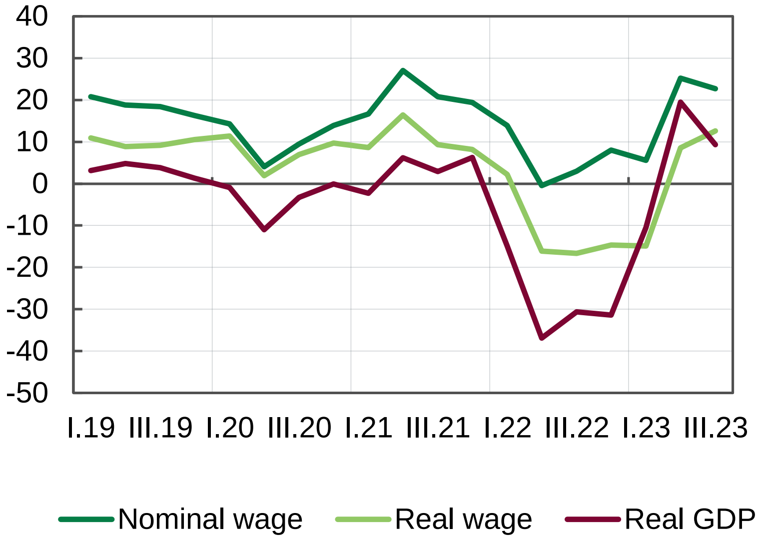
Real wages resumed growth not only due to budget payments, but also due to the resources of businesses

Indirect indicators for estimating real household income*, % yoy



* Deflated by CPI. ** The private sector SSC is calculated as the difference between total SSC and SSC on wages from the consolidated budget.
Source: Pension Fund of Ukraine, STSU, SSSU, NBU calculations.

Average wages, % yoy

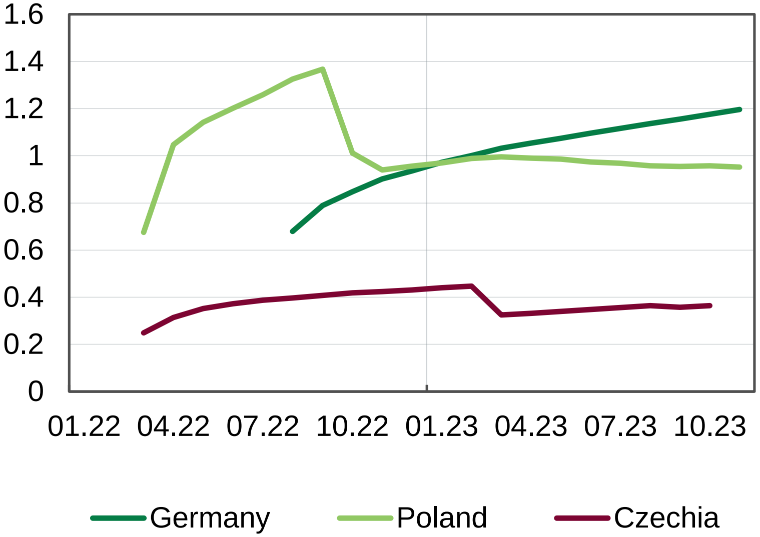


Source: SSSU, NBU calculations.

- The economic recovery and slowing inflation led to a resumption of real wage growth starting from Q2 2023 (according to the official data from the SSSU). Wage growth is estimated to have continued in Q4
- However, wage growth was uneven by type of activity: in Q3 2023, average real wages in trade, IT, and several other types of economic activity exceeded the levels of Q3 2021 (i.e., before the full-scale invasion). At the same time, wages in some service sectors, construction, education, and transportation remained below those levels
- Budget payments, in particular compensations to the military, pensions, and social benefits, remained a significant source of household income growth

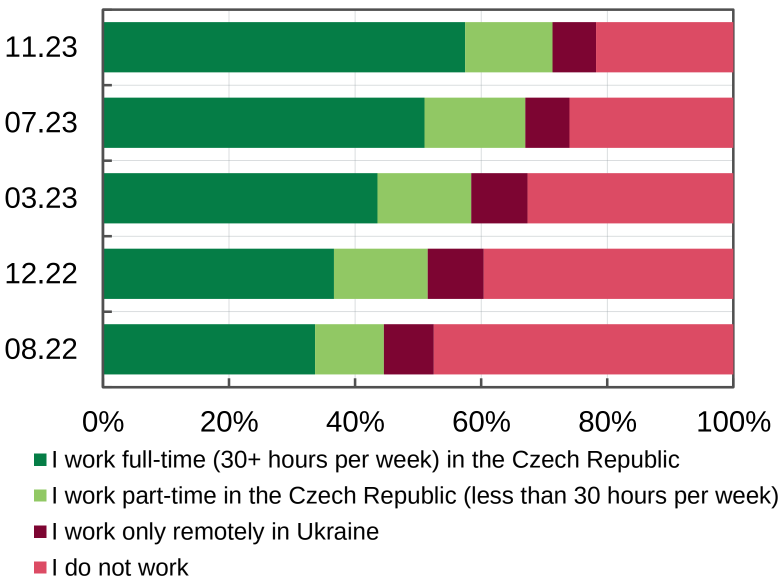
The number of migrants abroad has increased marginally. Their adaptation continues

Number of migrants from Ukraine granted temporary protection status in selected EU countries, million persons



Source: Eurostat.

Employment status of economically active migrants in the Czech Republic, % of responses



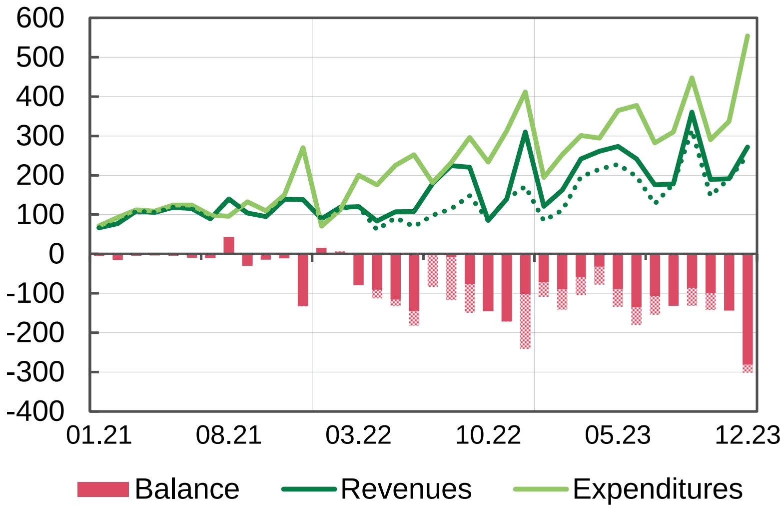
Source: PAQ Research.

- The number of migrants outside of Ukraine, as expected, increased slightly in December (by ≈30 thousand to 6.34 million persons, according to the UNHCR), while the number of IDPs stabilized at 3.7 million (as of November, according to IOM). As of November, Germany (1.2 million), Poland (0.95 million), and the Czech Republic (0.4 million) provided the largest number of temporary protection statuses in the EU
- According to a survey of Ukrainian migrants in the Czech Republic in November 2023, the majority of migrants (75% of men and 69% of women) were employed, with the majority of them (58%) working full-time. The main barriers to employment were poor language skills and having young children (2-6 years old)

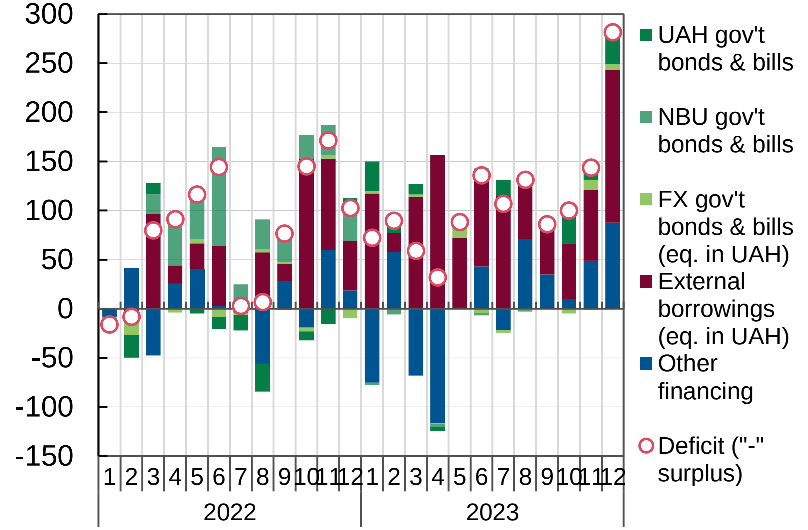
Ukraine: Fiscal sector

The state budget deficit reached a new record high both in December and the entire year

Main state budget indicators* (monthly), UAH bn



State budget balance financing, UAH bn**

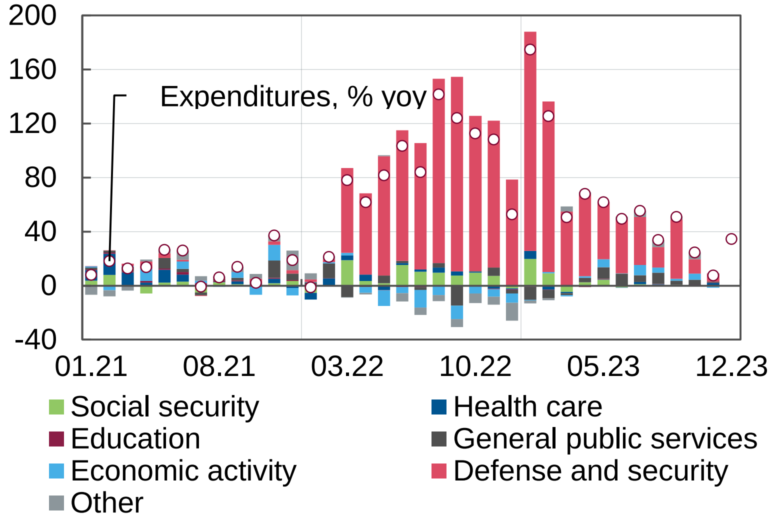


* Dotted and patterned fillings show relevant indicators excluding grants. Balance includes net lending. ** Debt transactions are net borrowings. Other financing represents active operations (in particular, includes the change in volumes of gov`t funds) and privatization proceeds.
December – preliminary and high-frequency data from the MFU website. NBU calculations based on information from the MoF's web-site. Source: Treasury, MoF, NBU staff calculations.

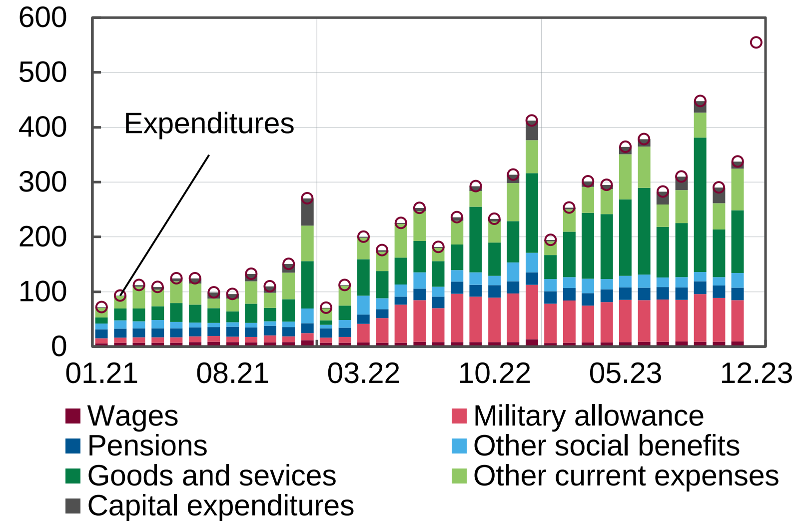
- In December, the deficit traditionally widened, driven by the catch-up in expenditures. For the entire 2023, the deficit exceeded UAH 1,330 bn, reaching UAH 1,750 bn excluding grants from revenues. At the same time, the annual deficit was lower than the planned amount (UAH 2,010 bn)
- International aid remained the key source for financing budget needs, with direct budget support totaling USD 42.6 bn since the beginning of the year
- In December, activity in the domestic borrowing market remained high. The year-end results revealed that domestic borrowings more than doubled compared to the previous year, primarily due to the issue of government securities in hryvnia. This was facilitated by both the attractive yields on government securities and the implementation of the benchmark domestic debt securities to meet reserve requirements for banks

The expenditures in December rose to the highest level in Ukraine's history

Contributions to annual changes in expenditures of the state budget*, pp (functional classification)



Expenditures of the state budget, UAH bn (economic classification)

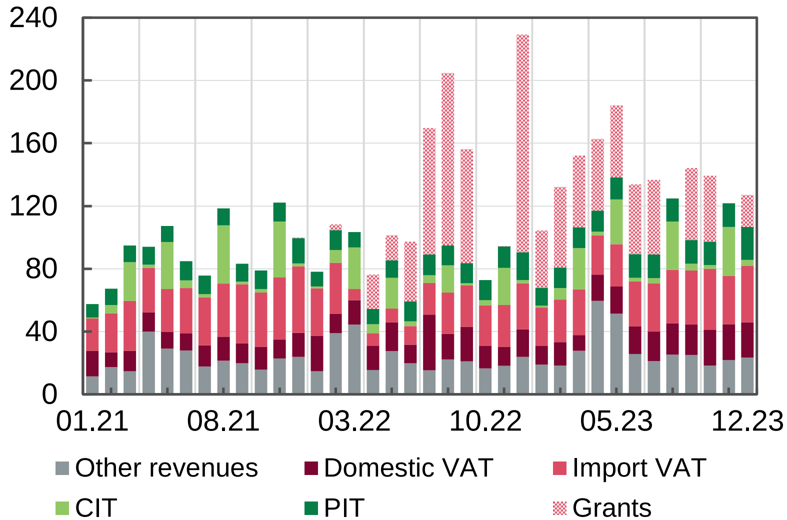


* December – preliminary data from the MFU website. NBU calculations based on the MoF's data.
Source: Treasury, MoF, NBU staff calculations.

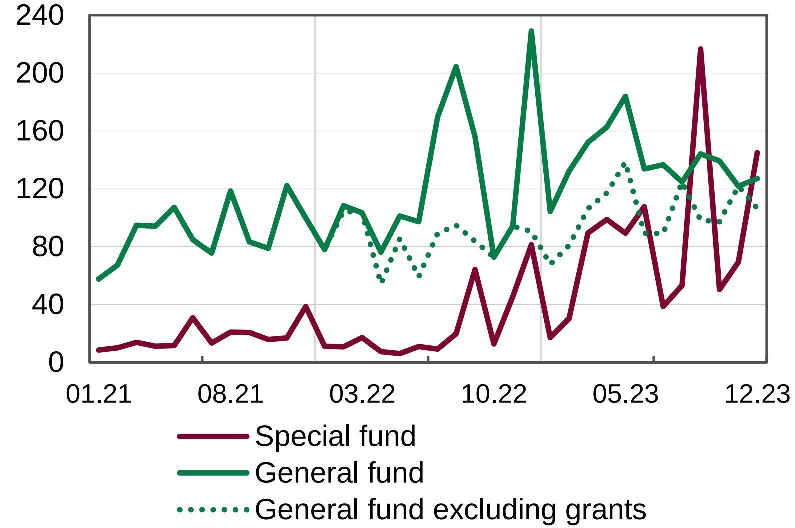
- In December, expenditures reached an unprecedented level. For 2023 as a whole, expenditure increased by about 50% yoy, despite the significant comparison base of the previous year
- Defense and security, as well as social care, were predictably the priority spending directions
- Additionally, capital expenditures are likely to have increased in December after a certain slowdown in the previous month. This may be related to the implementation of infrastructure projects and repair works, along with compensations to citizens for damaged property

Revenues grew noticeably amid the resource base strengthening due to economic recovery and administrative measures

Revenues* of the state budget's general fund, UAH bn



Revenues of the state budget, UAH bn



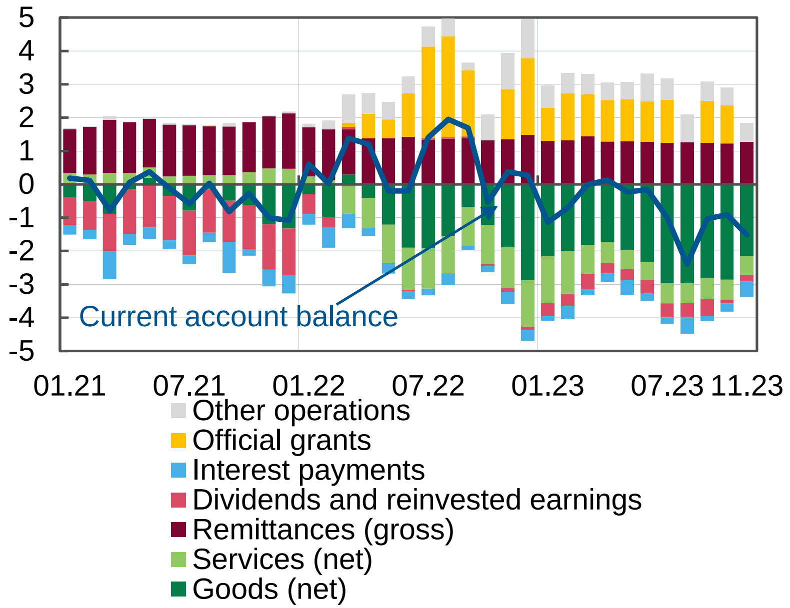
* December – preliminary and high-frequency data from the MoF website. NBU calculations based on the MoF data.
Source: Treasury, MoF, NBU staff calculations.

- Revenues (excluding grants) increased by more than 70% in 2023, driven by the economic recovery, as well as administrative measures, e.g. the reinstatement of the taxation policies in place until February 2022. Despite the strengthening of the resource base, own revenues covered only about 55% of expenses
- In December, revenue growth (excluding grants) accelerated to more than 46% yoy, despite the negative impact of the border blockade. It is also expected that the special fund revenues increased in November-December due to the inclusion of the "military" PIT, previously directed to local budgets. The own income of budget institutions was likely substantial as well

Ukraine: Balance of Payments

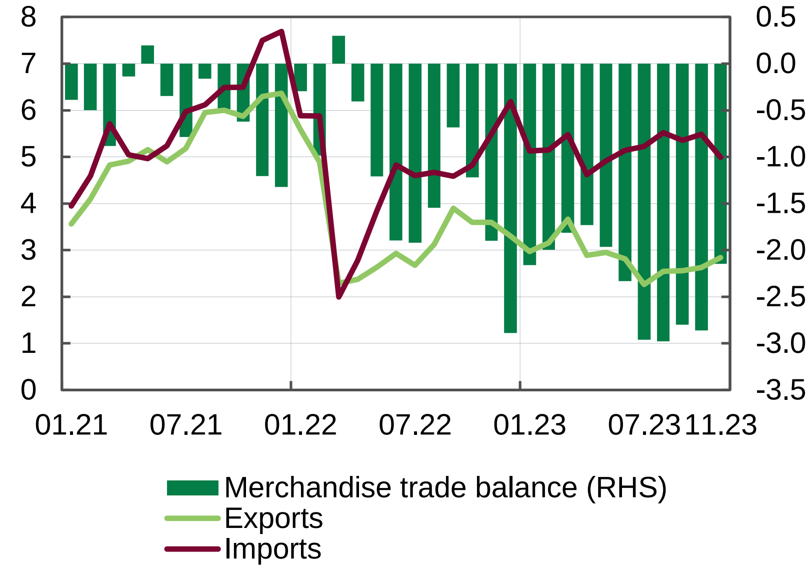
In November, the negative balance of trade in goods declined, but the current account deficit widened

Current account balance, USD bn



Source: NBU staff calculations.

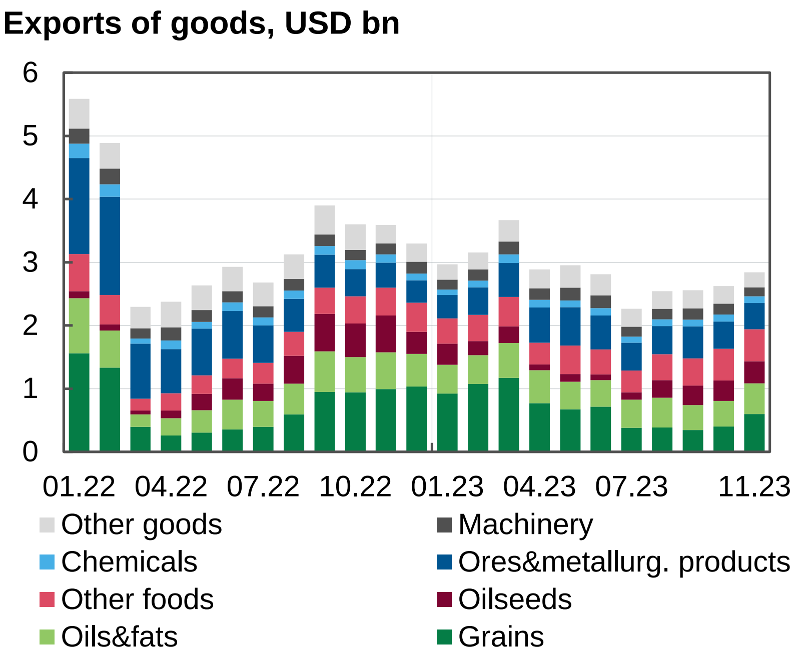
Merchandise trade, USD bn



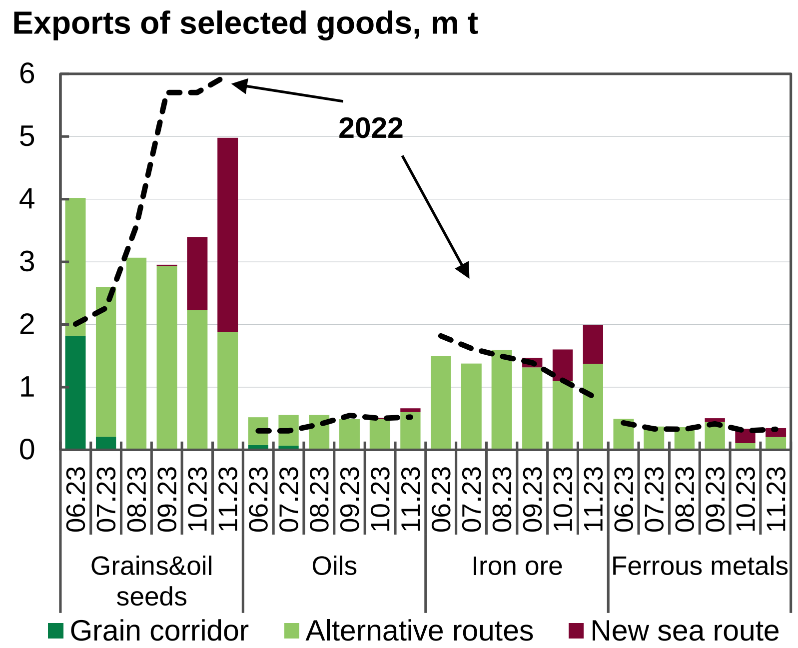
Source: NBU staff calculations.

- In November, despite the blockade of certain border crossing points on the western borders, the exports of Ukrainian goods increased compared to the previous month, thanks to the expanded operations of a new sea route. In the meantime, the blockade had caused a significant reduction in the imports of goods
- However, the current account deficit widened due to a delay in the grant assistance from the US

Exports of goods increased primarily due to an increase in the sea shipments of foods, ores, and metallurgical products



Source: NBU staff calculations.

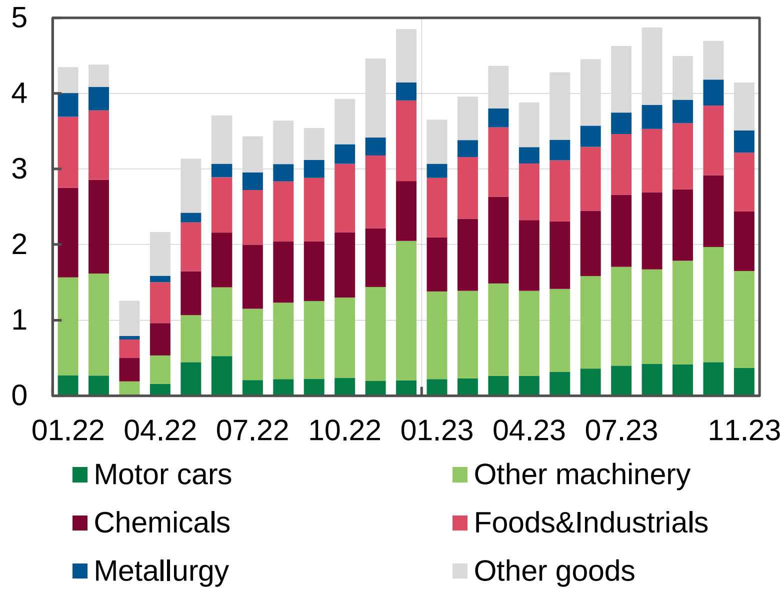


Source: SCSU, Ministry of Infrastructure, NBU staff estimates.

- According to the NBU's estimates, in November, the blockade of selected land crossing points along Ukraine's western borders resulted in export losses amounting to USD 160 million. Goods exported by trucks (processed food products, wood and industrial goods) were primarily affected by this disruption. Nevertheless, both export and import losses are expected to be smaller in December due to a certain reorientation of trade flows to railways and other transport routes
- Nevertheless, the negative impact of the blockade on exports of goods was counterbalanced by an increase in the sea shipments of foods, ores, and metallurgical products through a new route. Consequently, exports of goods even surpassed October level
- In December, the volume of goods transshipped by sea continued to grow. According to preliminary estimates, shipments exceeded the largest volumes recorded during the operation of the grain corridor

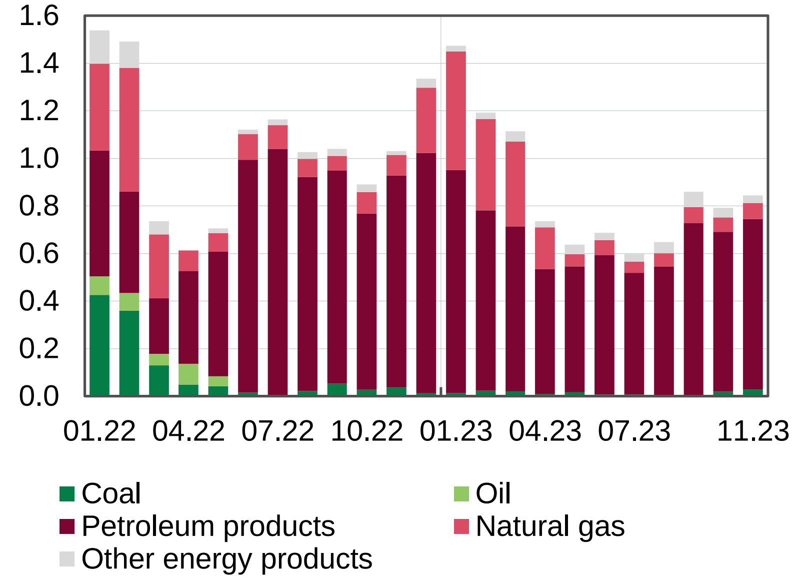
Imports decreased across most product groups due to the blockade of freight transport

Non-energy imports, USD bn



Source: NBU staff calculations.

Imports of energy products, USD bn

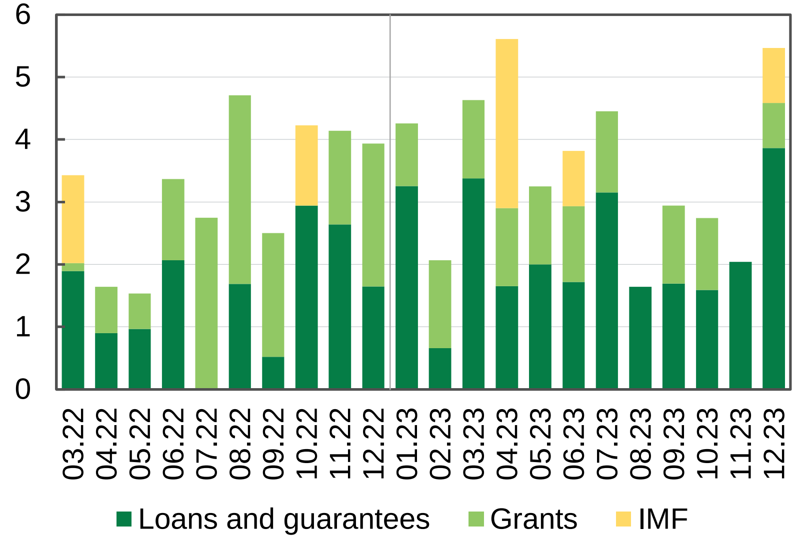


Source: NBU staff calculations.

- According to the NBU estimates, import losses due to the blockade of the largest crossing points across the border with Poland and the threat of similar actions on the border with Slovakia were more significant compared to exports and amounted to about USD 700 million. Purchases of non-energy goods were most affected, including machinery (motor cars, household appliances and agricultural machinery, selected industrial equipment), chemicals (fertilizers, plastics, tires), and consumer goods (food and industrial products)
- Meanwhile, the imports of petroleum products did not experience losses thanks to the reorientation to railway transportation. Compared to October, the physical volumes of their purchases increased by 12%

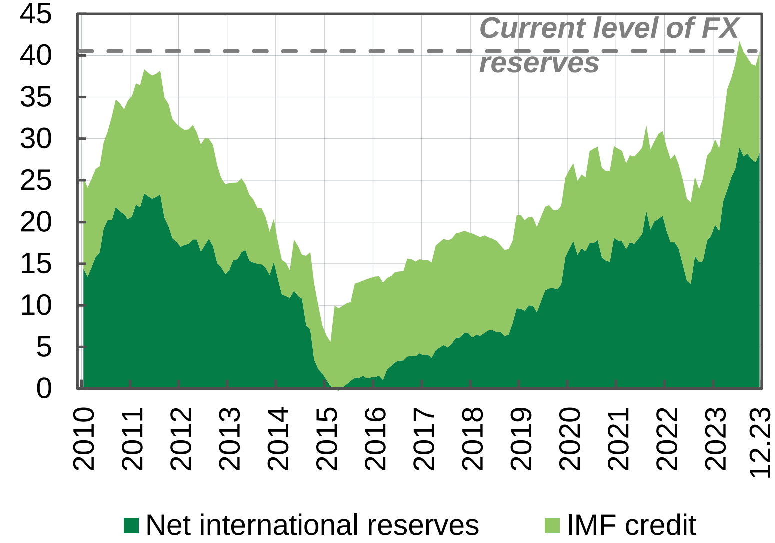
After a short-term decline, international reserves resumed growth in December thanks to international aid

International financial assistance since the beginning of the full-scale war, USD bn



Source: NBU, MFU, open sources data.

International reserves, USD bn



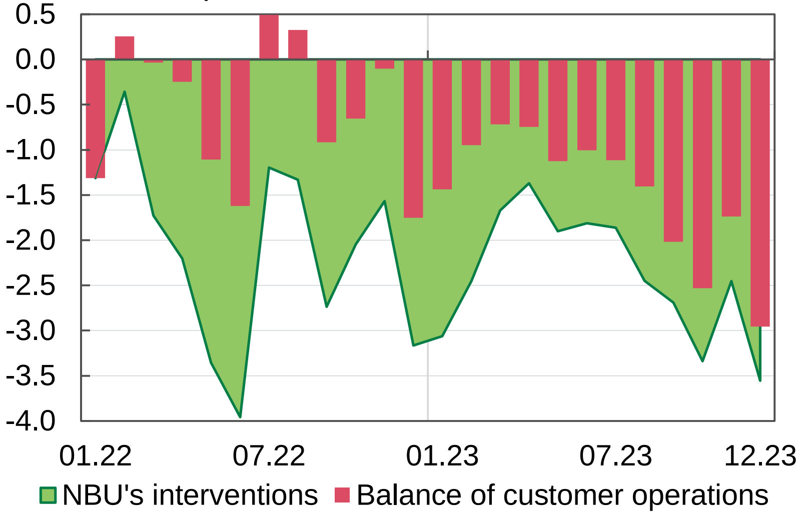
Source: NBU.

- The widening of the current account deficit in November was partially compensated by the increase in the inflow of loan financing from international partners. As a result, reserves decreased only slightly
- In December, thanks to an increase in the financial assistance disbursement, including USD 2.1 bn from Japan, USD 1.8 bn from the EU and USD 0.9 bn from the IMF, reserves resumed growth. As of the end of the year, reserves amounted to USD 40.5 bn, having increased by USD 12 bn in 2023 or 42%

Ukraine: Monetary sector

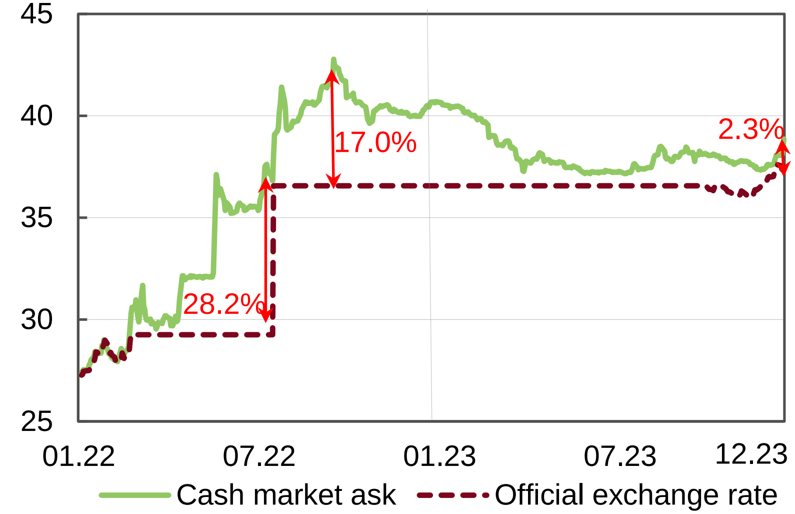
The situation in the FX market remained under control, despite the seasonal increase in demand for foreign currency

Bank clients' FX transactions* and NBU interventions, USD bn



* Net sale and purchase of noncash and cash foreign currency by bank clients (Tod, Tom, Spot).
Source: NBU.

Hryvnia exchange rates, UAH per USD

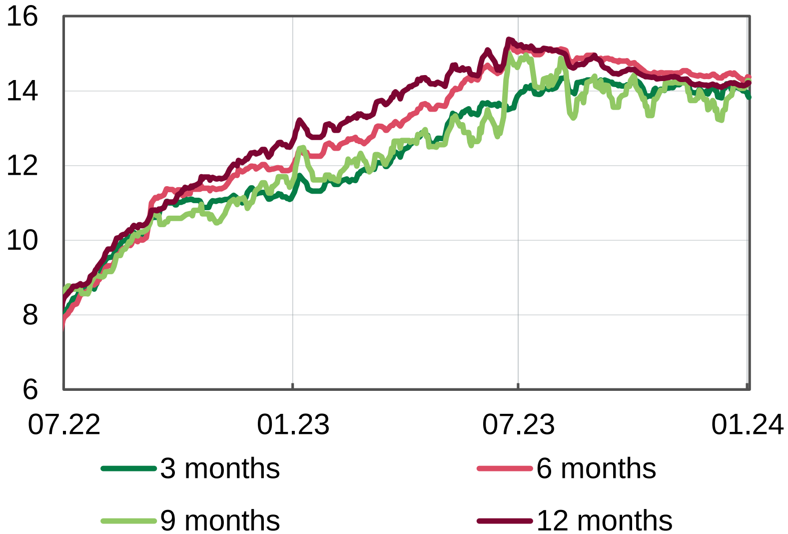


Source: NBU, open data sources.

- Significant budget expenditures at the end of the year and increased uncertainty over external financing disbursements led to an increase in demand for foreign currency
- Demand for foreign currency from importers of foods and household goods, fuel, and electricity also grew
- With the exception of the last few days, the spread between the cash market and the official exchange rates has been narrowing throughout December, in particular due to the lifting of restrictions for the banks and non-bank financial institutions to sell cash foreign currency to households
- In response to these factors, the NBU increased the volume of interventions to USD 3.6 bn. Sufficient volumes of interventions and positive yields on hryvnia assets in real terms ensured that the FX market remained under control

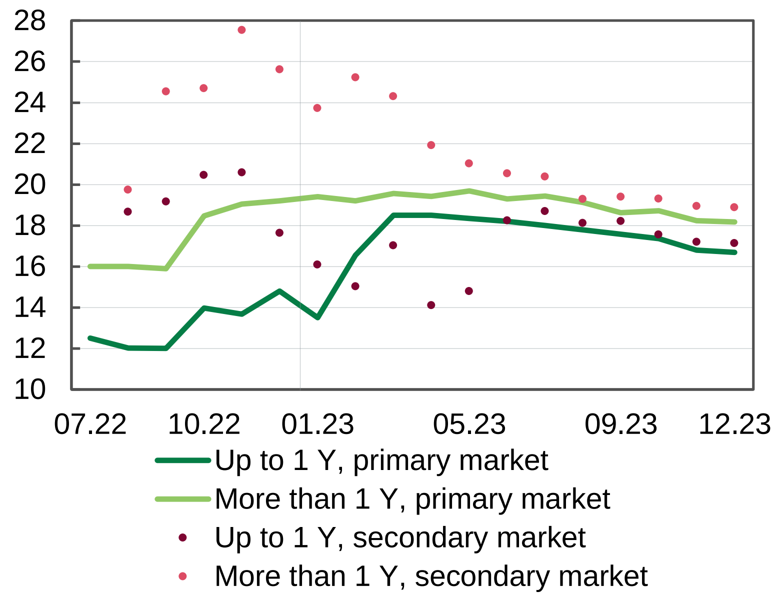
The yields on hryvnia instruments remained positive in real terms

Ukrainian Index of retail deposit rates*, %



* 5-day moving average.
Source: Thomson Reuters.

Yields on hryvnia domestic government T-bills & bonds, % per annum



Source: NBU.

- Despite a decrease in nominal interest rates, the yields on hryvnia assets in real terms remained positive amid a decline in inflation and improved inflation expectations
- Transactions with three-month certificates of deposit encouraged banks to compete for depositors and ensuring a smooth reduction in rates on hryvnia term deposits
- Market demand for debt securities remained high, despite the downward shift in the yield curve