Ukraine:
Macroeconomic Radar

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Over the past month, forecasts have not changed much. As before, most analysts expect the economy to fall this year by 5-6% and recover next by about 4.0-4.5%. Inflation will be close to the NBU target of 5% this year and will accelerate due to a sharp rise in the minimum wage and a softer fiscal policy next year. However, the market has so far hardly set an increase of key policy rate in response to such a rise in inflationary pressure. At the same time, analysts are increasingly taking into account in their forecasts the better situation with the current account balance - they improved the forecasts for international reserves, whereas the exchange rate forecasts remained unchanged. The latter do not anticipate significant changes compared to the current level, which significantly contrasts with the deterioration of exchange rate expectations in recent months. In October, we expect the publication of new forecasts by the IMF and the NBU, as well as, the discussion of the draft budget in the Parliament. The results of these events will determine the macroeconomic landscape next year to much extent.

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Economy: rebound next year after falling this year

Over the last four months, consensus forecasts for GDP have hardly changed — analysts project a decline of 5-6% this year and next year's growth of about 4-4.5%. The Government's estimate for next year is slightly more optimistic - 4.6%. Meanwhile, the NBU stays more conservative, with a 6.0% drop this year and a 4.0% increase next year. On the one hand, GDP forecasts were positively affected by the rapid exit of the economy from quarantine in the summer and favorable trade conditions, primarily high prices for iron ore and steel. On the other hand, the increase in coronavirus infections over the last month and the growing uncertainty about the Government's economic policies, as well as the receipt of official financing from the IMF and other partners, are hampering a more rapid improvement in expectations. In a month, the IMF should update its forecast during the Annual Meeting. So far, the IMF's estimates (an 8% drop in GDP this year and a 1% recovery next year) look surprisingly pessimistic.

Inflation: close to target this year and increase next — however, how far depends on NBU’s decisions

The downward trend in inflation forecasts for this year has continued. Currently, consensus estimates (4.6-4.8%) are slightly below the NBU target. Instead, this trend stopped for the following year, and forecasts began to grow gradually — up to 5-6%. However, hardly all analysts have already taken into account the Government's plans for the rapid rise of the minimum wage next year. Therefore, in the coming months, we expect a revision of the forecasts upwards, as analysts from Dragon Capital and ICU did synchronously last week (up to 6.8% and 6.5%, respectively).

The Government's inflation forecast remains significantly higher than the "market" — 7.3% (and 8.7% on average, which assumes annual inflation of about 9-10% within the year). At the end of October, the NBU has to publish its new forecast, taking into account the sharp increase in the minimum wage. And the main intrigue is the choice of a baseline scenario by the new NBU leadership — either to agree with the Government's vision or to pursue tighter policies to keep inflation within the target range.

Key policy rate: rather up than down

The NBU's choice of its baseline scenario and the degree of softness/rigidity of its monetary policy will determine the further trajectory of the key policy rate. For now, the key policy rate will remain at the current level of 6% until the middle of next year and then will be increased to 6.5% according to the July forecast. At the September meeting of the MPC, all its members supported maintaining the key policy rate at 6%. According to the protocol, the possibility of the reduction of the key policy rate was discussed. However, arguments against such a decision were too convincing.

Apparently, because of this "dove" tendency of the new NBU leadership, analysts are not in a hurry to change their forecasts. Therefore, the consensus remains in the range of 5.5-6.0% for this year, and in the range of 6.0-6.5% for the next year. Also, it is likely that not all analysts have taken into account in their forecasts the effects of a sharp increase in the minimum wage next year, as well as a softer fiscal policy. Therefore, there is a high probability that in the coming months, both the NBU and market analysts will slightly raise their forecasts. As analysts at Dragon Capital and ICU did last week, who now expect a rate of 7% next year.

Current account: a surplus this year and a return to the deficit next year

A number of factors led to the transition to a current account surplus this year ($7bn in the first 7 months of the year). On the one hand, it was the stability of exports of the major export items (agricultural products and MMC, IT services) and remittances. And on the other — the fall in imports of goods and travel expenses abroad. In addition, the NBU began to take into the reinvested earnings of corporations with foreign capital, as result, their losses this year are reflected in the current account. Therefore, analysts continue to improve their forecasts — the average surplus is expected to be about $1bn by the end of the year. While in its latest forecast, the NBU projects it at the level of $6.5bn. We tend to trust the NBU's estimates more, as foreign analysts, in particular, do not seem to be following Ukraine's external accounts very closely. At the same time, next year, both the NBU and analysts expect a return to the current account deficit — up to $4.5bn and $ 3.3bn, respectively.

International reserves: forecasts are improving, however, are still under the NBU's optimism

The current account surplus continues to create opportunities for the NBU to buy currency on the market, albeit in not very large amounts due to the outflow of capital from the financial account. As a result, reserves at the beginning of September have already exceeded $29bn. This allowed analysts to improve their forecasts of international reserves, which average at $26-29bn at the end of this year, and $27.5-30bn at the end of next. As with the current account forecast, foreign analysts stay less optimistic than domestic.

So far, most analysts expect the level of international reserves to be much lower than the NBU forecast, according to which they should grow by the end of the year to almost $30bn. This forecast is traditionally based on the assumption that loans from the IMF and other official partners will be received in the full amount. However, the possibility of such a scenario has deteriorated over the past month due to a number of factors. These include court rulings, regular attacks on anti-corruption bodies and the start of discussions in Parliament on a budget that has not yet been approved by the IMF. By the way, the budget proposed by the Government with a deficit of 6% of GDP is a surprise for the market. Since on average, analysts included in their forecasts a budget deficit of 4.2% of GDP, close to the NBU's estimates (4% of GDP), in the IMF forecast the deficit was 5.3% of GDP.

The exchange rate will strongly depend on future NBU policy

The strong current account position against the background of deteriorating expectations for the receipt of official funding determines the forecasts for the exchange rate almost unchanged in recent months. In particular, analysts expect 28.0-28.5 UAH/USD for the end of this year, and 28.5-29.5 UAH/USD for the end of next. Given the weakening of the national currency in recent weeks, forecasts are likely to be revised towards a weaker hryvnia in the near future. In this context, the Government's exchange rate forecast for next year (28.8 UAH/USD by the end of the year, 29.1 UAH/USD on average) does not raise any special questions.

Висновки

There have been no significant changes in macroeconomic forecasts over the past month. In October, the IMF (as part of its Annual Meeting) and the NBU (based on the results of the monetary policy decision and the publication of the Inflation Report) should update their forecasts. The IMF is likely to bring its forecasts closer to consensus. However, in this regard, it will be important to agree on a budget deficit forecast with the Government and Parliament, which will work actively with it in the coming months. In respect to the NBU forecast, the monetary policy response, that will be included in the baseline scenario due to the significant increase in inflationary pressures compared to July estimates (as a result from a sharp rise in the minimum wage and a budget deficit of 6% of GDP), stays the biggest intrigue. Information on the prospects of receiving tranches from the IMF and the reaction of the NBU will significantly affect the macroeconomic forecasts of private sector analysts.

Annex. Forecasts of key macroeconomic indicators of Ukraine

Yearly forecasts												
		2019	2020					2021				
			Cons	Gov	NBU	IMF	WB	Cons	Gov	NBU	IMF	WB
				29.03.20	23.07.20	09.06.20	08.06.20		29.07.20	23.07.20	09.06.20	08.06.20
Activity												
Real GDP	*YoY, %*	*3.2*	*-5.3 -5.0*	*-4.8*	*-6.0*	*-8.2*	*-4.5*	*4.2-4.5*	*4.6*	*4.0*	*1.1*	*5.0*
Nominal GDP	*UAHbn*	*3 975*	*3 912*	*3 986*	*3 910*	*3 908*		*4 468*	*4 506*	*4 300*	*4 277*	
Nominal GDP	*US$bn*	*155.2*	*146*					*158*				
Unemployment	*%*	*8.2*	*10.4*	*9.4*	*10.0*	*12.6*		*9.2*	*9.2*	*9.0*	*12.0*	
Inflation												
Headline inflation	*YoY, %, e.o.p.*	*4.1*	*4.6-4.8*	*11.6*	*4.7*	*7.7*		*5.0-6.0*	*7.3*	*5.5*	*5.9*	
Headline inflation	*YoY, %, avg.*	*7.9*	*3.2*	*6.8*	*2.9*	*4.5*		*5.7*	*8.7*	*5.8*	*7.2*	
GDP deflator	*YoY, %*	*8.1*	*3.9*	*5.3*	*4.7*	*7.1*		*9.6*	*8.1*	*5.7*	*8.2*	
Exchange rates												
UAH/USD	*e.o.p.*	*23.8*	*28.0-28.5*					*28.5-29.4*	*28.8*			
UAH/USD	*avg.*	*25.8*	*26.7*					*28.2*	*29.1*			
External balances												
C/A balance	*US$bn*	*-1.3*	*1.1*		*6.5*	*-2.2*		*-3.3*		*-4.5*	*-2.9*	
C/A balance	*% of GDP*	*-0.9*	*0.7*			*-1.7*		*-2.1*			*-2.0*	
Reserves	*US$bn*	*25.3*	*26.4-29.0*		*29.8*	*19.3*		*27.5-30.0*		*32.7*	*23.4*	
Interest rates												
NBU's key policy rate	*%, e.o.p.*	*13.5*	*5.7-5.8*		*6.0*			*6.0-6.6*		*6.5*		
Fiscal Sector												
Budget balance	*% of GDP*	*-2.1*	*-7.2*		*-7.5*	*-7.7*		*-4.2*		*-4.0*	*-5.3*	
Public debt	*% of GDP*	*50.6*	*63.9*			*65.4*		*62.9*			*62.7*	

Do you have any comments or questions?
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