
Disclaimer. This is a translation of the original Ukrainian version of the Macroeconomic Radar October issue from 11 Nov 2020

In October, the IMF, the World Bank and the NBU have updated their macroeconomic forecasts. Analysts' consensus estimates have also changed slightly. Currently, the greatest uncertainty for the forecasts is the surge in morbidity and potential reactions of the authorities and the population. As a result, the forecasts for the recovery of the Ukrainian economy next year differ significantly – from 1.5% GDP growth by the World Bank to 4.2% by the NBU. Instead, in the monetary sphere, everyone is almost unanimous – the exchange rate is expected in the range of 28-30 UAH/USD by the end of next year, reserves will gradually increase, inflation will be close to the NBU target. Although the National Bank sees serious pro-inflationary risks for the next year and is ready to respond by raising the key policy rate again. The market does not fully believe in this, so the new NBU management team will be forced to regain confidence in its monetary policy.

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Economy: under the influence of a pandemic

Ukrainian economy has been hit hard by the COVID-19 outbreak in 2020: in the second quarter, GDP fell by 11.4% YoY, in the first half of 2020 – by 6.5% YoY. Rapid recovery during the summer months was followed by significant slowdown in the fall due to an increase in the number of infections. Therefore, most forecasters still predict a fall in GDP by about 5% this year.

This is much better than the IMF spring prediction - a decline of 8.2%. During the autumn meeting, the Fund improved its forecast, but it is still much more pessimistic than national forecasts – GDP is expected to fall by 7.2%. To implement such a forecast, the fourth quarter must be a failure, which requires not only strict quarantine, but also a significant reduction in demand of businesses and the population. The IMF experts explain the likelihood of such a scenario by depleting the financial resources of Ukrainians during the first lockdown. However, high wage growth rate and stable remittances indicate a low probability of such a course of events.

More probable are the forecasts of the World Bank and the NBU – a fall in GDP this year by 5.5% and 6% respectively.

At the same time, the outbreak of the infection and new quarantine restrictions in Ukraine and around the world threaten the rapid recovery of the domestic economy next year. Thus, the consensus national forecast of GDP growth in 2021 have decreased slightly – to about 4%, and close to them is the updated forecast of the NBU – 4.2%. The IMF has significantly improved its forecast, although it is still below the others - 3%. All these forecasts are based on the assumption of no strict quarantine restrictions both in Ukraine and in the world. The new assessment of the World Bank is much more pessimistic –

the Ukrainian economy will recovery by only 1.5%, due to the impact of the second wave of the pandemic and the slowdown in reforms.

Inflation: The NBU does not deny its goals, MFIs and the market trust it

Low inflation in Ukraine in September (2.3% YoY) came as a surprise to most analysts. However, their forecasts for this year remain in the range of 4-5%, as well as forecasts of the NBU and the World Bank. The IMF's one is slightly higher (5.2%), unlike the forecast of the Cabinet of Ministers', which in July still had expected the inflation of almost 6%.

The next year situation is more interesting. On the one hand, the government's plans for a rapid increase in the minimum wage and a significant budget deficit (6% of GDP), together with the continued weakening of the exchange rate, are important pro-inflationary factors. On the other hand, the current low inflation and deteriorating prospects for the recovery of aggregate demand may continue to restrain price growth. However, as we predicted last time, the first group of factors has a predominant impact on analysts - consensus forecast has risen to 5.4-6.2%.

However, the new NBU forecast is likely to have a significant impact on the further change in estimates, which envisages a slight excess of the inflation target in 2021 (6.5%) in order to maintain monetary incentives for economic recovery. The NBU forecasts a return to the 5% target in 2022.

The IMF has raised its forecast for the next year to 5.9%, which is in line with the NBU's target range. This is logical, given that the IMF has slightly more pessimistic expectations about Ukraine's economic recovery. The World Bank has full confidence in the NBU's monetary policy – 5% for the next two years.

The Cabinet'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).

Key policy rate: NBU announces a new cycle of increase

Although the NBU allows the inflation rate to exceed its target range, but only for a relatively short period of time. To return the inflation rate to the target, the NBU is ready to raise it again after a sharp reduction in the key policy rate (from 18% to 6%), at least in accordance with its updated forecast. According to it, the NBU will continue to keep the key policy rate at 6% by the end of this year and in the second quarter of the next year will increase it – to 7.5% overall by the end of 2021.

By the way, the NBU's decision not to change the rate at its regular monetary policy meeting in October did not come as a surprise to the market and was expected by the vast majority of analysts due to the

predominance of pro-inflationary factors on the forecast horizon. However, some concerns about politically motivated mitigation remained.

Probably, these fears lead to the fact that the consensus estimates of the rate for this year are still lower than 6%, and for the next year, they are growing very slowly and are currently in the range of 6-7%. Therefore, the new NBU management will have to convince the market of its technocracy and commitment to achieving inflation targets.

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

Consensus estimates of the current account surplus in 2020 are gradually increasing – up to 2.4-3.1% of GDP. This is due to improved terms of trade, stable demand for export products and reduced imports against the background of imposed quarantine restrictions. Another factor in the current account surplus is a decrease in payments on reinvested earnings due to the deterioration of financial results of enterprises. In 2021, it is expected to return to the current account deficit (about 2% of GDP) against the background of the resumption of economic activity, growing consumer demand, the realization of deferred investment demand, deteriorating trade conditions and declining gas transit.

The NBU forecasts are quite similar: current account surplus of \$4.3 billion this year and a deficit of \$3.5 billion in 2021. The IMF expects much larger current account surplus this year: \$6.2 billion and the next year's deficit - \$ 4.5 billion.

International reserves: forecasts are improving, but it is unlikely to continue

Consensus forecast for reserves have been improving recently: now the consensus for the end of this year is \$27-28 billion, and for the end of the next one is \$28-30 billion. NBU forecasts \$29.1 billion in 2020 and \$29.5 billion in 2021 due to continued cooperation with the IMF and the gradual resumption of debt capital inflows.

At the same time, given the decline in reserves in September to \$26.5 billion, the low probability of receiving new tranches from the IMF and other official creditors this year, it is likely that these forecasts will be revised downwards in the coming months.

Exchange rate: devaluation sentiment prevails

As we expected last time, the predominance of the devaluation trend and unfavorable news cause the exchange rate forecasts to change in the direction of a weaker hryvnia. Thus, now the consensus estimates are about 28.5 UAH/USD at the end of this year and up to 29-30 UAH/USD at the end of the next year. By the way, the IMF sets an average rate of UAH 28.1 UAH/USD next year.

Conclusion

The new forecasts of the IMF, the World Bank, the NBU and analysts are generally unanimous in anticipation of a gradual economic recovery from the crisis, albeit at different speeds, while maintaining monetary and financial stability. At the same time, the "constitutional crisis" and the deteriorating prospects of receiving a tranche from the IMF and other official creditors in the upcoming months, the surge in morbidity and the introduction of new restrictions around the world increase the likelihood of worsening economic recovery and macrofinancial stability. Another important element of uncertainty in the coming months is the consideration of the budget in parliament. It is likely that its adoption will be a much more complex process than in the last year, which may also have a negative impact on macroeconomic forecasts in the near future.

Annex. Forecasts of key macroeconomic indicators of Ukraine

Yearly forecasts												
		2019	2020					2021				
			Cons	Gov	NBU	IMF	WB	Cons	Gov	NBU	IMF	WB
				29.07.20	22.10.20	07.10.20	07.10.2020		29.07.20	22.10.20	07.10.20	07.10.2020
Activity												
Real GDP	YoY, %	3.2	-5.3 -4.5	-4.8	-6.0	-7.2	-5.5	3.6-4.2	4.6	4.2	3.0	1.5
Nominal GDP	UAHbn	3 975	3 898	3 975	3 925	3 870		4 318	4 506	4 360	4 205	
Nominal GDP	US\$bn	155.2	144					152	155			
Unemployment	%	8.2	10.2	9.4	9.4	11.0		9.2	9.2	8.6	9.6	
Inflation												
Headline inflation	YoY, %, e.o.p.	4.1	4.5-4.7	5.9	4.1	5.2	4.8	5.4-6.2	7.3	6.5	5.8	5.0
Headline inflation	YoY, %, avg.	7.9	3.0	2.8	2.6	3.2		5.8	8.7	6.1	6.0	
GDP deflator	YoY, %	8.1	3.6	5.1	5.1	4.9		6.3	8.4	6.6	5.5	
Exchange rates												
UAH/USD	e.o.p.	23.8	28.3-28.8	28.3				28.7-30.0	28.8			
UAH/USD	avg.	25.8	27.0	27.0		27.2		28.7	29.1		28.1	
External balances												
C/A balance	US\$bn	-1.3	1.2-3.4		4.3	6.2		-4.1 -2.8	-4.8	-3.5	-4.5	
C/A balance	% of GDP	-0.9	2.4-3.1			4.3	1.5	-2.3 -1.8	-3.1		-3.0	
Reserves	US\$bn	25.3	27.0-28.3		29.1			28.1-29.6		29.5		
Interest rates												
NBU's key policy rate	%, e.o.p.	13.5	5.9	6.5	6.0			6.1-6.9	8.0	7.5		
Fiscal Sector												
Budget balance	% of GDP	-2.1	-7.2	-7.5	-6.5	-7.8	-5.0	-4.4	6.0	-4.0	-5.3	
Public debt	% of GDP	50.6	63.6	59.7		65.7	62.0	62.2	57.1		64.3	

Do you have any comments or questions?
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