

Weekly Insight

Real GDP growth accelerates in 2017

Key messages of the today's comments

Domestic liquidity and bonds market

Local-currency-bond portfolios up

Last week, local-currency bonds outstanding rose to UAH632.51bn due to an increase of investments from the non-banking sector. At the same time, most of banks' investments were in FX-denominated bonds. A similar structure of investments could be seen this week, too.

Liquidity remained steady

Last week, liquidity was steady at about UAH97bn, rising to UAH102.67bn last Friday due to VAT refunds. Through the end of the week, outflows to the budget via month-end tax payments were partially compensated by new tranches of VAT refunds.

Foreign exchange market

Increased foreign-currency supply supported the hryvnia

Against the backdrop of minor VAT refunds last week, exporters increased sales of FX currency, which had a positive impact on the hryvnia exchange rate. This week, the hryvnia may weaken slightly due to a decrease in the supply of foreign currency in the market on the back of high liquidity, and its subsequent replenishment with VAT refunds.

Economics

Real GDP growth accelerates in 2017

Ukraine's real GDP exceeded the preliminary estimate of 2.2% growth and accelerated to 2.5% in full-year 2017, up from revised 2.4% in 2016.

Industrial production rose 1.9% YoY in February

Growth of industrial output slowed to 1.9% YoY in February, down from 3.6% YoY in January. This particular sector will continue to grow this year, supported by higher government and private investments, as well as solid domestic demand.

TUESDAY, 27 MARCH 2018

Banks' reserves market (26 March 2018)

| | Last | Weekly chg (%) | YTD chg (%) |
|------------------------------|--------|----------------|-------------|
| NBU rate (%) ¹ | 17.00 | +0bp | +300bp |
| ON rate (%) | 15.60 | -70bp | +320bp |
| ON \$ swap (%) | 16.18 | +31bp | +363bp |
| Reserves (UAHm) ² | 52,539 | -6.33 | +13.63 |
| DepCerts (UAHm) ³ | 50,147 | +21.72 | +0.00 |

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's short-term bonds.
Source: NBU, Bloomberg, ICU.

Breakdown of govt bond holders (UAHm) (26 March 2018)

| | Last | Weekly chg (%) | YTD chg (%) |
|----------------------|----------------|----------------|--------------|
| NBU | 351,729 | +0.00 | -8.42 |
| Banks | 346,891 | +1.08 | +21.41 |
| Residents | 28,545 | +4.21 | +26.49 |
| Individuals | 2,145 | +3.44 | +747.02 |
| Non-res ⁴ | 14,631 | +1.17 | +169.92 |
| Total | 743,941 | +0.69 | +6.58 |

Notes: [1] non-residents
Source: NBU, ICU.

FX market indicators (26 March 2018)

| | Last | Weekly chg (%) | YTD chg (%) |
|----------------------|---------|----------------|-------------|
| USD/UAH | 26.2775 | -0.22 | -3.12 |
| EUR/USD | 1.2444 | +1.65 | +15.24 |
| DX ² | 89.027 | -1.49 | -10.64 |
| UAH TWI ³ | 113.919 | -0.75 | +6.30 |

Notes: [1] UAH trade-weighted index.
Source: Bloomberg, ICU.

Gov't bond quotes¹ (27 March 2018)

| Maturity | Bid | Ask |
|----------|-------|-------|
| 6m | 17.50 | 16.50 |
| 12m | 17.75 | 16.75 |
| 2y | 17.50 | 16.50 |
| 3y | 17.50 | 16.50 |
| 12m (\$) | 5.10 | 4.70 |
| 2y (\$) | 5.30 | 5.00 |

Notes: [1] Actual quotes you can see at www.icu.ua.
Source: ICU.

Domestic liquidity and bonds market

Local-currency-bond portfolios up

Last week, local-currency bonds outstanding rose to UAH632.51bn due to an increase of investments from the non-banking sector. At the same time, most of banks' investments were in FX-denominated bonds. A similar structure of investments could be seen this week, too.

At last week's primary auction, the MoF borrowed UAH2.35bn in local-currency bonds and EUR123.31m in FX-denominated bonds. FX-denominated bonds were mostly in banks' portfolios, while a significant portion of local-currency bonds were purchased by non-banks, individuals, and non-residents. Non-residents purchased only local-currency bonds, individuals invested half of funds in FX-denominated bonds, while non-banks purchases included two-thirds of local-currency bonds and only one-third were FX-denominated.

The yield curve in the primary market remained mostly unchanged. Despite an increase of three-month bonds offered, the cut-off and weighted-average rates slid 6bp to 17.44%. But for nine-month bonds, the cut-off rate increased by 10bp to 17.10%. This resulted in only a 1bp increase in the weighted-average cost of borrowing, to 17.01%. Rates for other local-currency bonds remained unchanged.

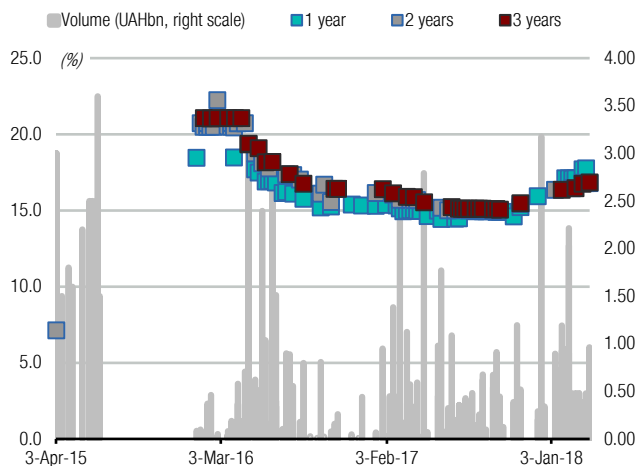
An offering of 20-month EURO-denominated bonds was not originally scheduled for last week. However, the MoF was able to attract EUR123.3m at a weighted-average rate of 4.12%, while the highest rate accepted last week was 4.17%. These rates are 17-22bp above the rate for 1.5-year bonds sold at the end of last year.

ICU view: The Ministry has been increasing FX-borrowings since March, adding FX to its accounts, and increased budget financing. At the same time, the MoF increased proceeds from local-currency bonds. Today, USD-denominated bonds will be offered, in addition to the usual offerings of local-currency bonds. The yield-curve looks to stay at the recent level, with insufficient changes around 17.00%.

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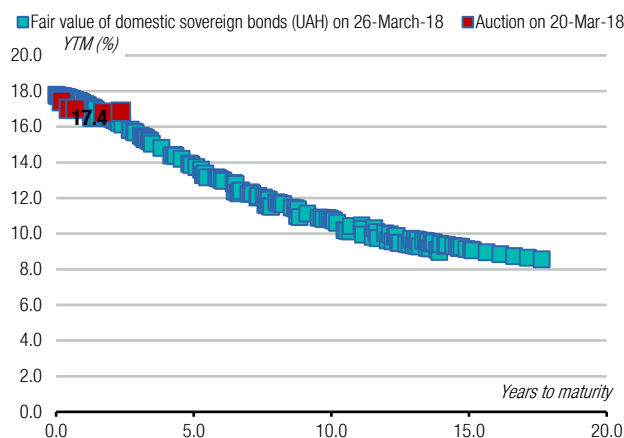
Chart 1. Local-currency bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: Ministry of Finance of Ukraine, ICU.

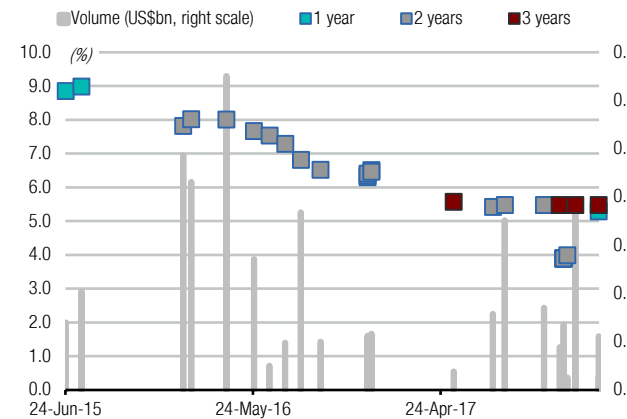
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

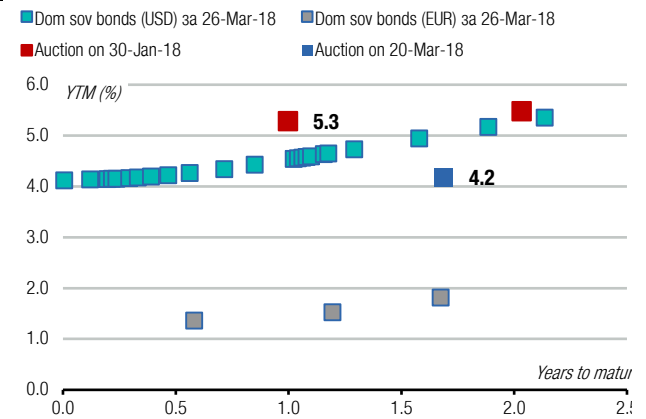
Chart 2. FX-denominated bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: Ministry of Finance of Ukraine, ICU.

Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

Liquidity remained steady

Last week, liquidity was steady at about UAH97bn, rising to UAH102.67bn last Friday due to VAT refunds. Through the end of the week, outflows to the budget via month-end tax payments were partially compensated by new tranches of VAT refunds.

For the most part, last week, reserves and CDs outstanding were flat at UAH55bn and UAH42bn, respectively. Last Thursday, banks reallocated funds to CDs, and on Friday, increased CDs outstanding to UAH50.15bn.

The Treasury provided positive impact on liquidity last week, mostly on Friday, when VAT refunds were made without large tax payments. NBU monetary operations did not have an important impact on liquidity.

ICU view: Through the end of last week, the total amount of VAT refund was only about half the monthly amount, and this week, VAT refunds could bring in an additional UAH5bn. This will compensate part of outflows to Treasury accounts. Therefore, this week liquidity could be volatile but, by month-end, it should resume levels seen last week.

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Chart 3. Banks reserves usages over last week(UAHm)

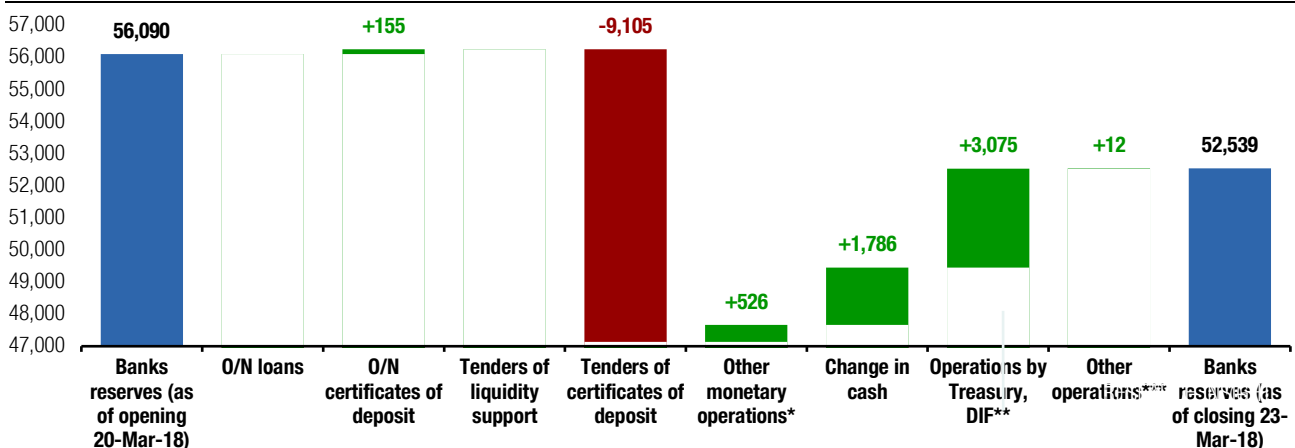
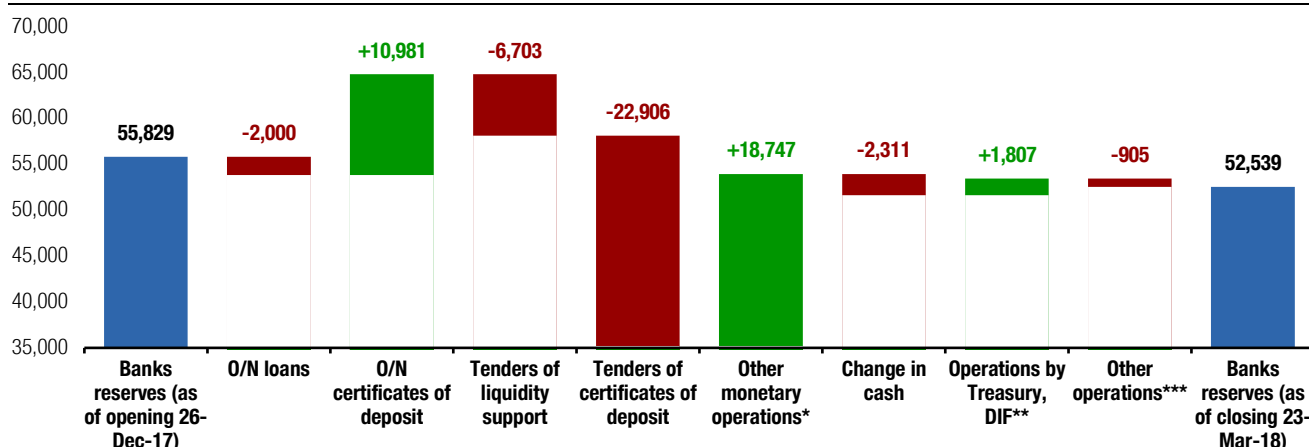


Chart 4. Banks reserves usages over last 90-day period (UAHm)


Notes: [1] data from the NBU's daily reporting https://bank.gov.ua/control/uk/publish/article?art_id=38643651&cat_id=40807142 ;

* operations repo, purchase and sale of government bonds, FX market interventions, stabilisation loans, FX swap agreements; ** DIF – deposit insurance fund;

*** interest payments on NBU's loans and on NBU's certificates of deposit, other operations. Source: NBU, ICU.

Foreign exchange market

Increased foreign-currency supply supported the hryvnia

Against the backdrop of minor VAT refunds last week, exporters increased sales of FX currency, which had a positive impact on the hryvnia exchange rate. This week, the hryvnia may weaken slightly due to a decrease in the supply of foreign currency in the market on the back of high liquidity, and its subsequent replenishment with VAT refunds.

In the absence of significant events in the currency market and minor activity of non-residents who bought only UAH173m of local-government bonds, the main factors influencing the hryvnia were the actions of exporters. The Treasury reimbursed VAT in the amount of UAH5.63bn in March, half of which took place last Friday. Exporters were forced to increase sales of foreign currency for tax payments in February, and to finance preparations for spring field works.

Thus, the hryvnia strengthened 0.57% last week to 26.2650 UAH/USD. Its CPI-based real trade-weighted index rose 0.33% to 112.78 for the period; in year-on-year terms, it is up 5.12% from 107.29 last year.

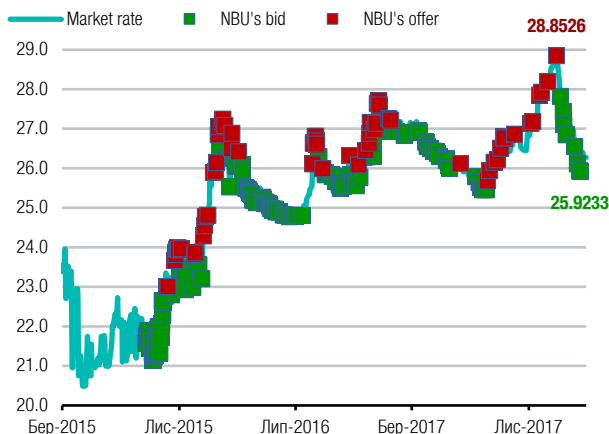
ICU view: *This week, VAT refunds will continue for exporters, but a significant part of the funds will be used to pay monthly taxes, resulting in a balance of cash flows affecting the supply and demand in the foreign currency market. Thus, there may not be additional inflows of foreign currency into the market for replenishment of hryvnia accounts and payment of taxes this week. Therefore, the supply of foreign currency may be less than demand, which may lead to a slight weakening of the hryvnia.*

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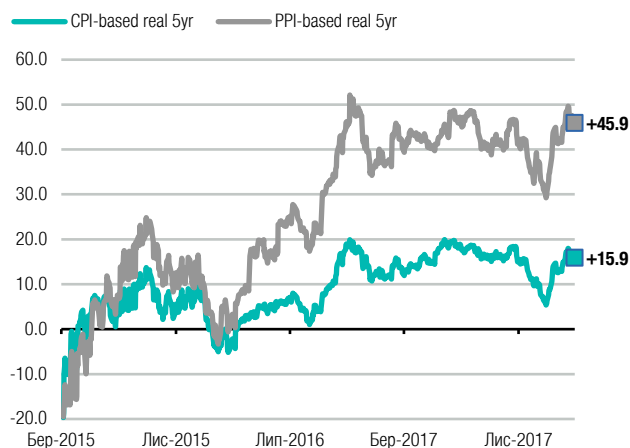
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Chart 5. FX market indicators, 3-year history

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market



Notes: the chart provides labels for the average exchange rate at last two NBU auctions (one on buying FX from the market and one on selling it). Source: NBU, Bloomberg, ICU.

UAH exchange rate misalignment¹ from fundamental level² (%)

Notes: [1] "+" overvalued, "-" undervalued; [2] based on the UAH's CPI- and PPI-based real TWIs. Source: ICU.

Economics

Real GDP growth accelerates in 2017

Ukraine's real GDP exceeded the preliminary estimate of 2.2% growth and accelerated to 2.5% in full-year 2017, up from revised 2.4% in 2016.

The State Statistics Service revised upward readings for all quarters in 2017: to 2.8% YoY from 2.5% YoY in 1Q17; to 2.6% YoY from 2.33% YoY in 2Q17; to 2.4% YoY from 2.1% YoY in 3Q17, and to 2.2% YoY from 1.8% YoY in 4Q17.

In full-year 2017, the biggest contribution to economic growth was made by trade (+5% YoY) and construction (+26.9% YoY), which both added by 0.6 ppt out of registered 2.5% growth. On the flip-side, the biggest negative contribution was made by agriculture (-2.5% YoY) and the mining and quarrying sector (-5.9% YoY), each by 0.3 ppt.

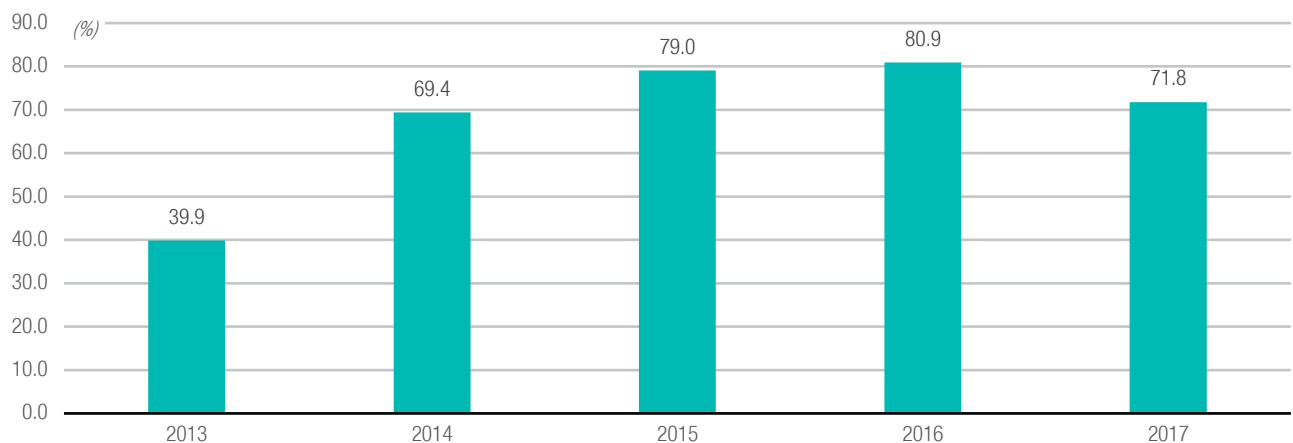
Nominal GDP increased by 25.1% to UAH2.98tn in 2017, up from UAH2.39tn in 2016. GDP deflator was 22%. The debt-to-GDP ratio declined to 71.8% of GDP in 2017, down from 80.9% in 2016, and is close to the target stated in the cooperation program (EFF) with the IMF, which is 70% of GDP for 2020. The 2017 reading turned out to be better than the IMF's forecast released at the beginning of 2017 (89.9% of GDP). The decline was thanks to GDP growth and fewer-than-expected tranches received from the IMF.

ICU view: Increased household consumption (+7.8% YoY) on the back on rising real incomes, higher fixed investment (+18.2% YoY), and higher government expenditures (+3.3% YoY) were the key drivers of economic growth in 2017 and mitigated the negative impact from external trade. We expect that solid household demand will continue to boost Ukraine's economy in 2018, while real GDP growth will accelerate to 3%.

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Chart 6. Debt to GDP ratio



Source: State Statistics Service of Ukraine, MoF, ICU.

Industrial production rose 1.9% YoY in February

Growth of industrial output slowed to 1.9% YoY in February, down from 3.6% YoY in January. This particular sector will continue to grow this year, supported by higher government and private investments, as well as solid domestic demand.

In calendar-adjusted terms, industrial production grew 2% YoY, but fell and 2% MoM SA. The key driver of growth remained manufacturing production, which rose +3.4% YoY in calendar-adjusted terms, but contracted 3.9% MoM SA. The mining and quarrying sector rose 2.3% YoY and fell 3% MoM SA.

Production of investment goods rose 11.2% YoY, production of durable goods rose 9.1% YoY, while production of intermediate goods rose 4.3% YoY. At the same time, production of non-durable goods fell 3.2% YoY, while energy output declined 2.3% YoY.

ICU view: Despite some slowdown of industrial production growth in February, the sector expanded 2.8% YoY in 2M18, which are positive dynamics compared with a decline of 0.1% in full-year 2017. We expect that industrial production will continue to increase in the following months, supported by solid household consumption (the processing industry is the main booster of growth), and thanks to increased government expenditure on infrastructure projects.

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