

# Weekly Insight

## NBU estimates real GDP at +2.3% YoY in 1Q18

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Low activity at primary market

After very active primary auctions in 1Q18, in April, investors' activity slowed, and the MoF was only partially able to refinance its debt repayments.

##### Liquidity high

Positive Treasury operations allow liquidity to stay above UAH100bn, and until the end of month, it should not decline significantly.

##### Ukraine is to place US\$2bn in Eurobonds in 2018

The Ministry of Finance may enter the Eurobond market prior to reaching a deal with the IMF.

#### Foreign exchange market

##### UAH's volatility on the back of domestic government bond repayments

This week, the hryvnia should continue to be under pressure from VAT refunds and the redemption of domestic government bonds.

#### Economics

##### IMF worsened Ukraine's real GDP outlook for 2019-20

The IMF expects Ukraine's economy to expand 3.3% in 2019 and 3.5% in 2020. Nominal GDP will increase to US\$126.7bn in 2019, which implies that payments under VRI will begin in 2021.

##### NBU estimates real GDP at +2.3% YoY in 1Q18

Economic growth accelerated to 2.3% YoY in 1Q18, up from 2.2% YoY in 4Q17, per data from the NBU. In QoQ terms growth remained at 0.6% QoQ SA (ICU's estimate as implied by NBU's 1Q18 year-on-year estimation). Solid consumer demand and high fixed investment will continue to push up real GDP growth.

TUESDAY, 24 APRIL 2018

#### Banks' reserves market (23 April 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU rate (%) <sup>1</sup>	17.00	+0bp	+400bp
ON rate (%)	15.60	-50bp	+320bp
ON \$ swap (%)	16.02	-17bp	+458bp
Reserves (UAHm) <sup>2</sup>	48,033	+0.42	-5.58
DepCerts (UAHm) <sup>3</sup>	56,612	+2.68	+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) (23 April 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU	350,325	+0.00	-7.30
Banks	348,040	-0.43	+22.35
Residents	27,818	+3.22	+28.95
Individuals	2,453	+1.47	+816.51
Non-res <sup>4</sup>	13,780	-4.78	+152.59
<b>Total</b>	<b>742,416</b>	<b>-0.17</b>	<b>+7.63</b>

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

#### FX market indicators (23 April 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.1150	+0.12	-2.21
EUR/USD	1.2209	-1.30	+13.80
DX <sup>2</sup>	90.946	+1.60	-9.03
UAH TWI <sup>3</sup>	118.819	+0.69	+8.66

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

#### Gov't bond quotes<sup>1</sup> (24 April 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](http://www.icu.ua).  
Source: ICU.

# Domestic liquidity and bonds market

## Low activity at primary market

After very active primary auctions in 1Q18, in April, investors' activity slowed, and the MoF was only partially able to refinance its debt repayments.

Last week, demand at the auction rose compared with the two previous weeks. However, to borrow UAH945.6m, the cost of borrowing increased. The cut-off rate for three-month bonds remained steady at 17.44%, while the six-month bonds rose 10bp to 17.20%. At the same time, the weighted-average cost of borrowings rose 3bp to 17.36% and 17.13%, respectively.

The total amount of debt repayments (including FX-denominated bonds) last week was UAH3.5bn, including redemption of local-currency bonds at UAH2.2bn. The amount borrowed allowed the MoF to refinance only 42% of principal repayments.

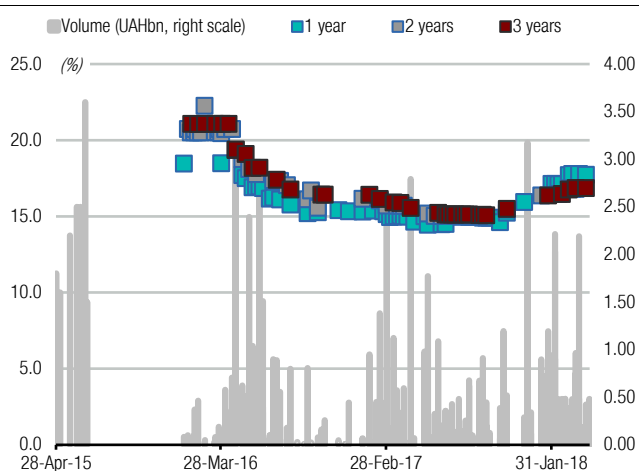
Total bonds outstanding declined last week, but within portfolios there was a slight reallocation: banks and non-residents decreased their portfolios, while non-banks and individuals purchased additional bonds, UAH0.6bn and UAH37m, respectively.

**ICU view: This week, the MoF has to redeem bonds, part of which were sold at the beginning of the year. The total amount of debt repayments will amount to UAH5.4bn, including more than UAH4bn in principal repayments. We expect that part of the repayments will be invested in new bonds, while some funds will be spent on FX purchase.**

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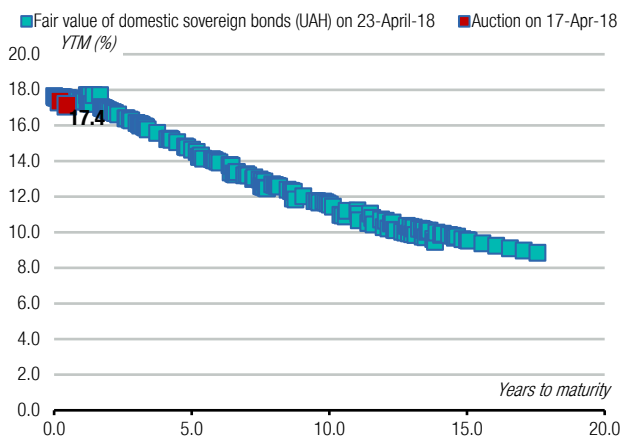
**Chart 1. Local-currency bonds**

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.

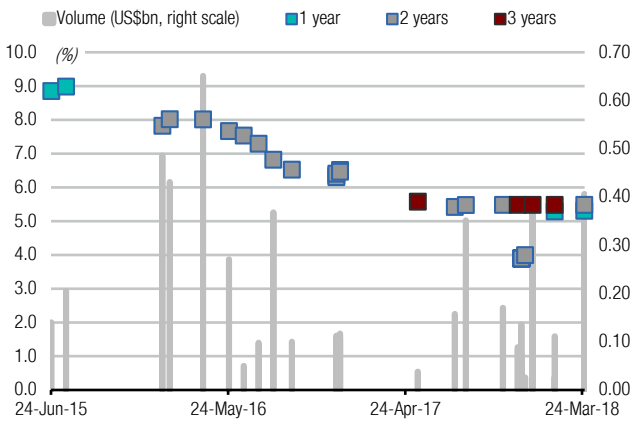
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

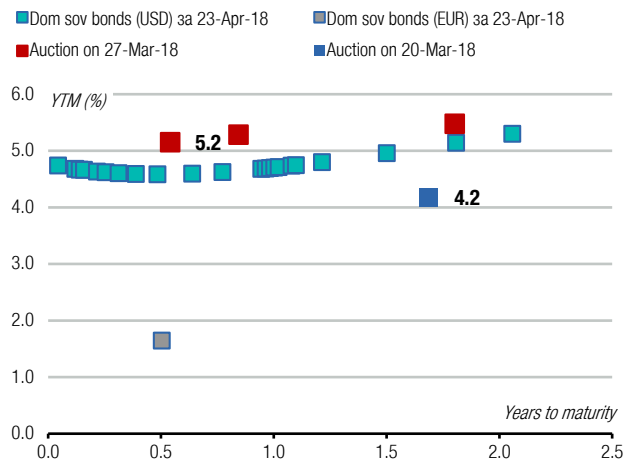
**Chart 2. FX-denominated bonds**

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 high**

Positive Treasury operations allow liquidity to stay above UAH100bn, and until the end of month, it should not decline significantly.

Last Wednesday, liquidity rose to a record high in the month of April, but by Friday, it declined slightly on outflows to budget. The liquidity structure was usual, evenly divided between reserves and CDs. NBU did not support liquidity last week using loans, purchasing only UAH366m of FX. At UAH0.5bn, the net amount of reserves exchanged into cash was insufficient.

**ICU view:** Since the beginning of the month, VAT refunds paid out of the budget were just UAH2.5bn or about one-quarter of the monthly amount. So, this week month-end tax payments should be compensated with VAT refunds and liquidity will remain above UAH100bn. At the same time, volatility could rise, with short-lived liquidity decline below UAH100bn, should these operations be done on different days.

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

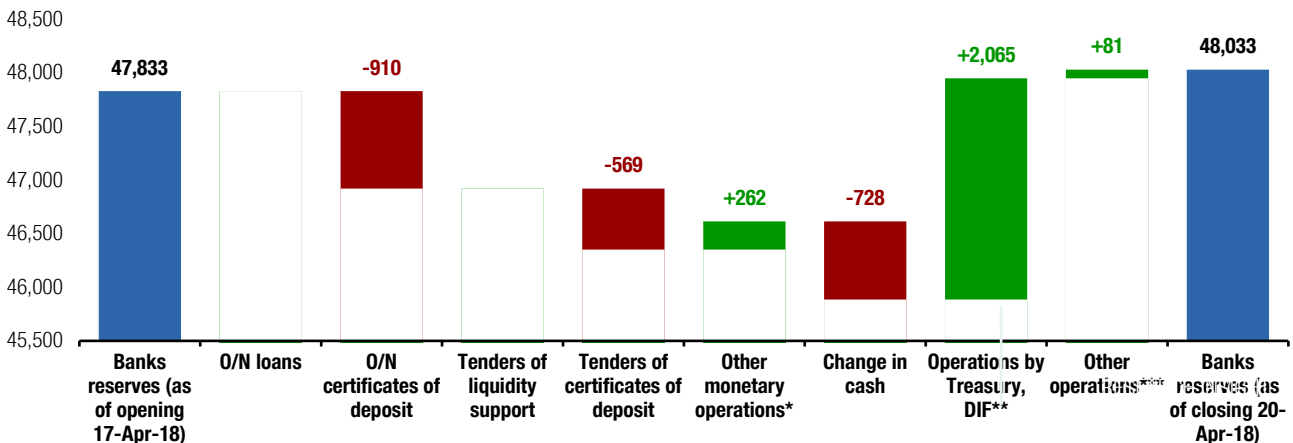
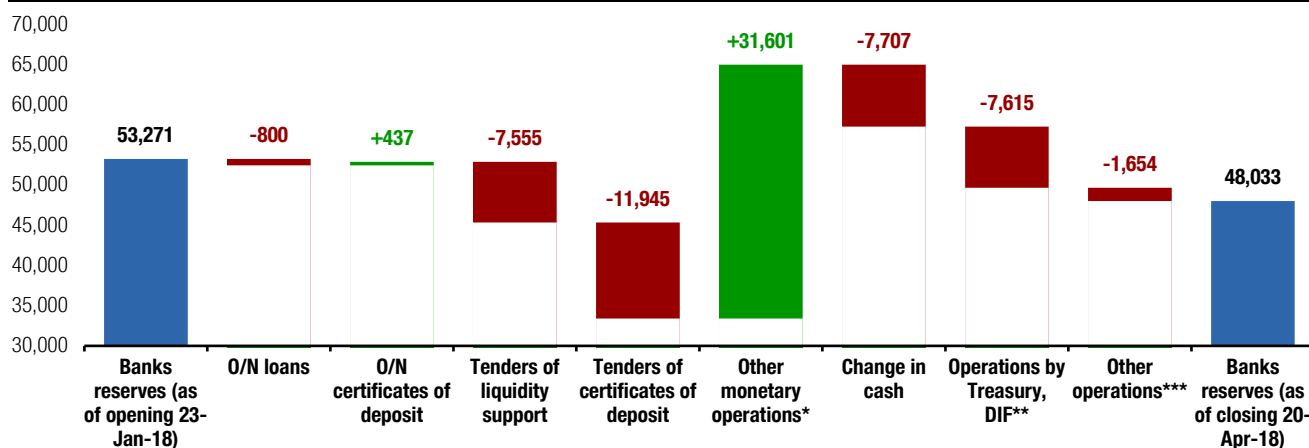


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting [https://bank.gov.ua/control/uk/publish/article?art\\_id=38643651&cat\\_id=40807142](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.

## Ukraine is to place US\$2bn in Eurobonds in 2018

The Ministry of Finance may enter the Eurobond market prior to reaching a deal with the IMF.

According to Finance Minister Oleksandr Danyliuk, the majority of Eurobonds will be placed after reaching an agreement with the IMF, but the Ministry of Finance closely monitors the market conditions, and may test it by placing a smaller part of the issue "a bit earlier."

The Finance Minister is optimistic about the anti-corruption court law but cannot predict how long it will take to adopt it. The next step should be the completion of negotiations with the IMF regarding the price of gas for the population. Danyliuk hopes that Ukraine will be able to meet the requirements of the IMF by early summer, which will allow unlocking the next tranche of IMF in the amount of US\$1.9bn. Meanwhile, the NBU expects that Ukraine will place US\$2.5bn in Eurobonds in 2018, and US\$1.5bn in 2019.

**ICU view: The market expected Ukraine to enter the Eurobond market in 2018, but the government's intention to place part of the issue before reaching a deal with the IMF on the next tranche was unexpected. We believe further cooperation with the IMF is a key issue for Ukraine, as the government has to pay a total of US\$13.2bn in 2018-2019.**

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## Foreign exchange market

### UAH's volatility on the back of domestic government bond repayments

This week, the hryvnia should continue to be under pressure from VAT refunds and the redemption of domestic government bonds.

On Wednesday, the Ministry of Finance retired domestic government bonds in the amount of UAH2.2bn, while only a part of the funds were refinanced into new instruments (see the comment above). Thus, after a slight strengthening in the beginning of the week and against the backdrop of an increased supply of the national currency on Wednesday, the UAH exchange rate changed direction. However, due to correction in the UAH/USD pair, the hryvnia pared most losses by the end of the week.

Last week, the hryvna declined 0.2% to 26.18 UAH/USD. Its CPI-based, real trade-weighted index fell 0.7% to 117.8 for the period. In year-on-year terms, real trade-weighted indices (CPI- and PPI-based) increased 8% and 10.9%, respectively, which implies faster prices growth in Ukraine compared with its main trade partners.

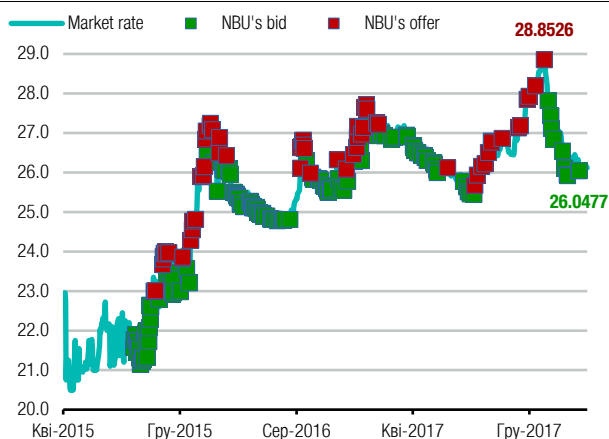
**ICU view: This week, there will be significant volumes of VAT refunds (about UAH8bn, according to our estimates), and the repayments of domestic government bonds will be more than UAH4bn. Given that only a part of these funds will be used for paying taxes, we expect some pressure on the hryvnia due to increased supply of local currency on the market. Nevertheless, we expect that the strengthening trend of UAH should persist for the next two to three months.**

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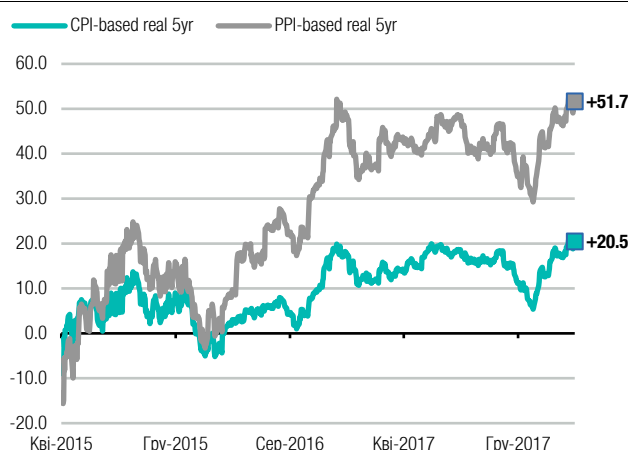
**Chart 5. FX market indicators, 3-year history**

*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 misalignment<sup>1</sup> from fundamental level<sup>2</sup> (%)*



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

## Economics

### IMF worsened Ukraine's real GDP outlook for 2019-20

The IMF expects Ukraine's economy to expand 3.3% in 2019 and 3.5% in 2020. Nominal GDP will increase to US\$126.7bn in 2019, which implies that payments under VRI will begin in 2021.

The IMF continues to expect Ukraine's real GDP to grow by 3.2% in 2018, but it worsened the forecast for the average annual inflation rate from 10% to 11% in 2018 and to 8% in 2019; the previous estimate was 7%. Growth of consumer prices is expected at 9% YoY by the end of 2018, which is 2ppt above the previous forecast, and 6.5% at the end of 2019; the forecast is unchanged.

The current account deficit is expected at 3.7% and 3.5% of GDP in 2018 and 2019, respectively. It seems that the IMF did not take into account updated data from the NBU, according to which the current account deficit was 1.4% of GDP in 2016, and 1.9% in 2017. Previous estimates were 3.7% of GDP in both 2016 and 2017. Nominal GDP is expected at UAH3.3tn in 2018 and UAH3.7tn in 2019, while the unemployment rate will be at 9.2% and 8.8%, respectively.

**ICU view:** *The IMF's new estimate of US-denominated nominal GDP in 2019 (US\$126.7bn) is positive for VRI holders. If the forecast turns out to be correct, payments under VRI will start based on the results of 2019. Even under less optimistic circumstances, given the new forecast of 3.3% real GDP growth in 2019 vs. previous estimate of 3.5% growth, the payments under VRI will start sooner and will be larger. Our in-house calculations show that the first payment will amount to US\$50m and is expected in May 2021. However, this is relatively small amount compared with US\$4.5bn of external state debt repayment, which Ukraine will have to make in 2021. For more information on VRIs and their impact on public debt repayments, see our [blog \(in Ukrainian\)](#).*

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### **NBU estimates real GDP at +2.3% YoY in 1Q18**

Economic growth accelerated to 2.3% YoY in 1Q18, up from 2.2% YoY in 4Q17, per data from the NBU. In QoQ terms growth remained at 0.6% QoQ SA (ICU's estimate as implied by NBU's 1Q18 year-on-year estimation). Solid consumer demand and high fixed investment will continue to push up real GDP growth.

Higher incomes thanks to increased minimum wages starting in 2018, and the increase in pension payments at the end of last year, supported consumer demand, which was the main driver of the growth. Other important drivers were: 1) supportive external conditions, 2) the low base effect due to the trade blockade of temporarily occupied territories in Eastern Ukraine, and 3) solid investment activity.

Real GDP growth was negatively affected by higher growth rates of consumer imports compared with those of exports, the NBU stated. At the same time, due to bad weather conditions, there was lower economic activity in the transport and construction sectors.

**ICU view:** *We expect that real GDP growth will be close to 3.5% in full-year 2018 thanks to: 1) a further increase in private and government investments, 2) a supportive external environment, and 3) expanding household consumption as the government resumes efforts to bring wages' share back to a normal level of 45-50% of GDP after a drop to 36% in the wake of the recession in 2014-15. At the same time, economic growth rates are relatively low, especially given the low base of comparison due to a significant decline in GDP in 2014-2015, as well as the effect of the trade blockade of temporarily occupied territories. In our opinion, further implementation of IMF-prescribed reforms, particularly the fight against corruption and the protection of investors' rights, are key to the financial markets' perception on the growth of Ukraine's economy and improving welfare of Ukraine's population.*

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