



Focus
Ukraine

Markets
**Domestic liquidity,
government bonds, FX
market, and macro**

Research team
**Alexander Valchyshen
Alexander Martynenko
Taras Kotovych
Artem Gladchenko**

Weekly Insight

Real GDP in 1Q18 confirmed at 3.1% YoY

Key messages of the today's comments

TUESDAY, 26 JUNE 2018

Domestic liquidity and bonds market

Government's borrowings could rise

The state budget may receive less funds from state property privatization than planned, and the MoF may increase borrowings.

FX debt repayments refinanced

In June, the MoF refinanced all its FX-denominated principal repayments. So, today the MoF offers only local-currency instruments.

UAH liquidity in banks remains high

Last week, liquidity declined to UAH113bn under pressure from non-monetary operations. This week, liquidity steady due to VAT refunds.

Foreign exchange market

Hryvnia regained 0.5%

This week, hryvnia's volatility is likely to rise on the backdrop of the month ending and the ongoing positive trend.

Economics

Real GDP in 1Q18 confirmed at 3.1% YoY

The State Statistics Service confirmed real GDP growth in 1Q18 at 3.1% YoY, which supports our forecast for economic expansion in full-year 2018 at 3.5%.

Industrial production decelerated to 2.5% YoY in May

Industrial production posted 2.5% YoY growth in May, decelerating from 3% expansion in April. The sector will continue to grow underpinned by investments and consumer-demand expansion.

Grain harvest is to reach at least 2017 level

Despite unfavorable weather conditions this spring and at the beginning of summer, Ministry of Agriculture keeps its crops forecast at more than 60mt.

Parliament approved the formal establishment of the Anti-corruption Court

The full set of HACC legislation is still to be determined, and needs the approval of the IMF.

Banks' reserves market (25 June 2018)

| | Last | Weekly chg (%) | YoY chg (%) |
|------------------------------|--------|----------------|-------------|
| NBU rate (%) ¹ | 17.00 | +0bp | +450bp |
| ON rate (%) | 15.60 | +0bp | +440bp |
| ON \$ swap (%) | 15.20 | +7bp | +399bp |
| Reserves (UAHm) ² | 51,711 | -9.97 | +4.66 |
| DepCerts (UAHm) ³ | 66,301 | +10.00 | +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) (25 June 2018)

| | Last | Weekly chg (%) | YoY chg (%) |
|----------------------|----------------|----------------|---------------|
| NBU | 350,325 | +0.00 | -6.08 |
| Banks | 357,736 | +2.29 | +27.54 |
| Residents | 23,569 | -0.93 | +5.29 |
| Individuals | 3,204 | +4.32 | +375.25 |
| Non-res ⁴ | 10,162 | -2.37 | +3,072.38 |
| Total | 744,996 | +1.04 | +10.07 |

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

FX market indicators (25 June 2018)

| | Last | Weekly chg (%) | YTD chg (%) |
|----------------------|---------|----------------|-------------|
| USD/UAH | 26.1650 | -1.04 | +0.50 |
| EUR/USD | 1.1704 | +0.98 | +4.56 |
| DX ² | 94.289 | -0.76 | -3.06 |
| UAH TWI ³ | 123.204 | +0.43 | +7.20 |

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

Gov't bond quotes¹ (26 June 2018)

| Maturity | Bid | Ask |
|----------|-------|-------|
| 6m | 17.50 | 17.00 |
| 12m | 17.85 | 17.25 |
| 2y | 17.75 | 16.75 |
| 3y | 17.50 | 16.50 |
| 12m (\$) | 5.50 | 4.85 |
| 2y (\$) | 5.70 | 5.00 |

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

Domestic liquidity and bonds market

Government's borrowings could rise

The state budget may receive less funds from state property privatization than planned, and the MoF may increase borrowings.

Ms. O. Markarova, Acting Minister of Finance, said in an interview with *Economichna Pravda* that to obtain the best results from privatizations, a lot of work is necessary, which consists of choosing investment advisers, planning roadshows, and, eventually, negotiations with potential investors. Markarova expects to spend a considerable amount of time this year in preparation for eventual auctions. In July, "small privatizations" will start wherein the government will offer for sale about 700 facilities with a price below UAH250m.

The Acting Minister said that they expect to receive less funds from privatization this year than was planned. This shortfall will be covered by additional borrowings, according to the Budget Code.

ICU view: Currently, budget financing from the domestic bond market is ahead of schedule. So far, the MoF has received more than UAH80bn out of UAH123.8bn included in the budget law for 2018. However, the MoF may have to cover from domestic sources financing not received from privatizations or from external sources, e.g. Eurobonds. There will be a great need for FX, as by the end of the year the MoF will have to pay about US\$3.2bn in FX debt repayments.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

FX debt repayments refinanced

In June, the MoF refinanced all its FX-denominated principal repayments. So, today the MoF offers only local-currency instruments.

Last week, three issues of local-currency paper were sold with two, five, and nine-month maturities. For all these bonds, the cut-off rates slid 1-5bp. Demand for local-currency bills amounted to UAH1.6bn (par value), which was mostly satisfied.

At the same time, interest rates for FX-denominated instruments continued to rise and were in the range of 5.2–5.65% with maturities from eight months to two years.

Finally, the MoF received UAH9.5bn of proceeds last week (FX-denominated proceeds at the NBU exchange rate), and increased proceeds in FX to US\$539m or US\$8m more than was repaid in FX-denominated domestic bond principal repayments during this month.

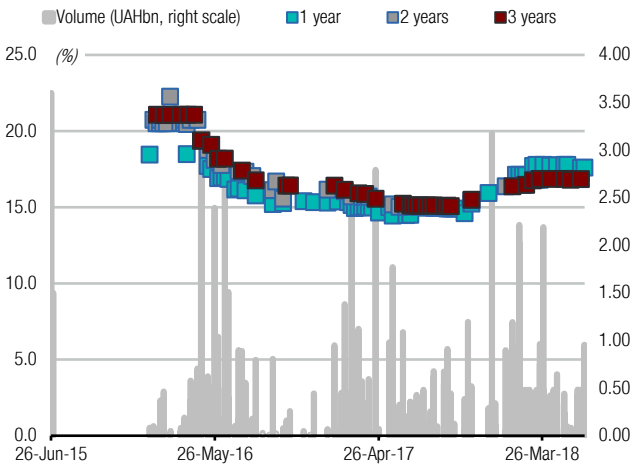
According to the NBU, last week, FX-denominated bills were mostly purchased by local banks, which increased bond portfolios by UAH7bn. Non-banks and individuals increased portfolios insufficiently. The portfolios of individuals rose to UAH3.2bn, while foreign investors' portfolios slid UAH0.3bn. Also last week, a new issue of CLN was issued with local-currency notes as the base asset amounted to UAH100m, and the maturity was 2023.

ICU view: Local investors continued to prefer FX-denominated instruments, which was partially due to reinvesting redemptions received in June. At the same time, foreign investors prefer local-currency debt with maturities mostly in 2020–2023. So, this week, demand for three-year and five-year notes could be seen from foreign investors.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

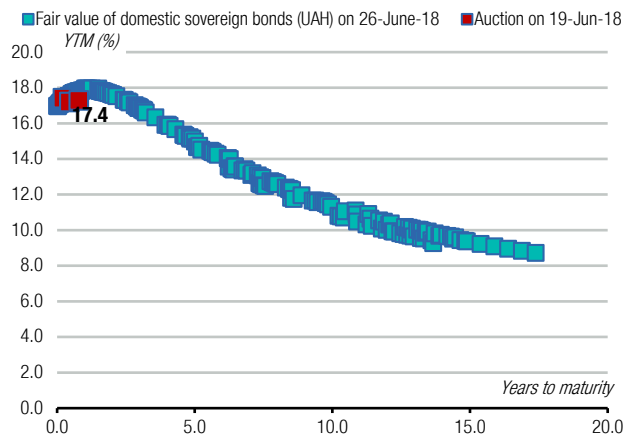
Chart 1. Local-currency bonds

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.

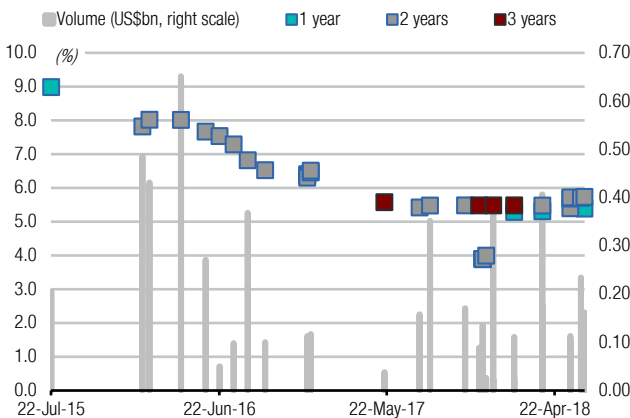
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

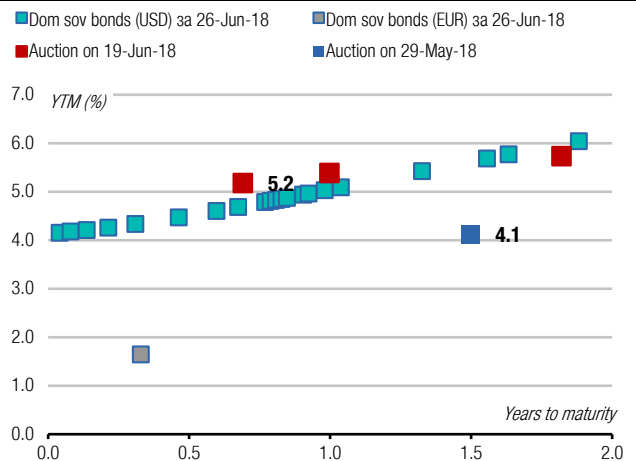
Chart 2. FX-denominated bonds

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.

UAH liquidity in banks remains high

Last week, liquidity declined to UAH113bn under pressure from non-monetary operations. This week, liquidity steady due to VAT refunds.

Last week through Saturday, except in the government bond portfolio, liquidity declined by UAH5bn to UAH133.3, most of which was invested in CDs. Total CDs outstanding rose to UAH65.4bn, while banks' correspondent accounts declined to UAH47.8bn.

Outflow through non-monetary operations was UAH4.7bn, out of which UAH2.8bn was absorbed by the Treasury and UAH1.9bn of reserves were exchanged in cash. Usually exchange of cash in reserves takes place in the second half of the month, but last week's activity could be the result of summer vacations and the coming four-day weekend. Also, the NBU absorbed just UAH0.1bn of liquidity, as bought and sold FX in approximately the same amount. Only last Saturday Treasury injected UAH4.3bn increased banks' correspondent accounts balance to UAH51.3bn and total amount of liquidity to UAH117.6bn.

ICU view: *There will be significant cash flow in the current week, as there will be month-end tax payments and also VAT refunds. As a result, liquidity will stay above UAH110bn with low volatility. Through the end of month, we expect about UAH6bn of VAT refunds, which will support liquidity.*

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

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

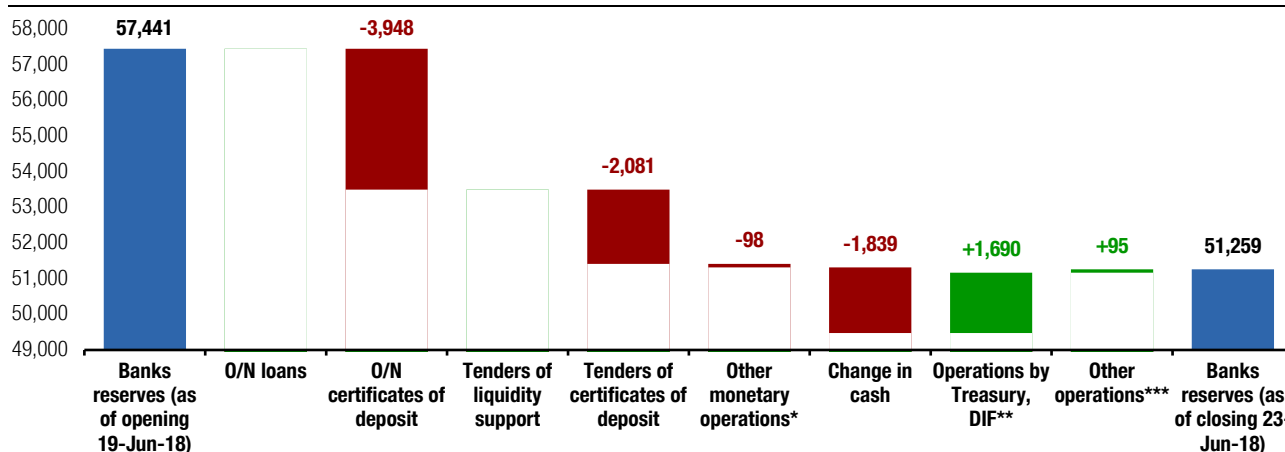
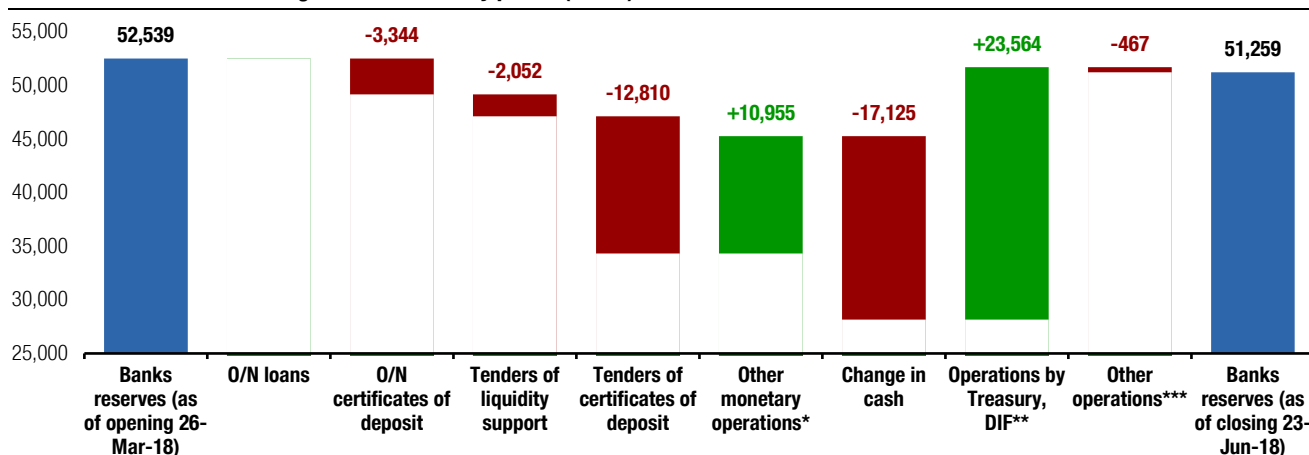


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Hryvnia regained 0.5%

This week, hryvnia's volatility is likely to rise on the backdrop of the month ending and the ongoing positive trend.

Last week, the hryvnia traded in a quite a wide range, and mostly lost its positions, especially on Tuesday and Wednesday, which was due to increased foreign currency demand. To satisfy excess demand, the NBU sold almost UAH800m of foreign currency, which maintained the exchange rate under 26.5 USD/UAH. However, the supply-demand balance shifted on Wednesday, and provided appreciation of the hryvnia on Thursday and Friday, which allowed the NBU to buy back about UAH800m. In the end, the hryvnia appreciated by 0.5% to 26.235 USD/UAH last week.

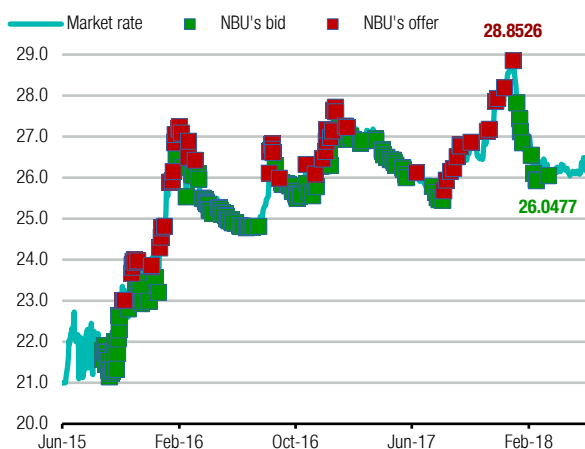
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries trade partners of Ukraine) increased 0.4% to 122.96 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 6.6% and 13.3%, respectively, which implies faster prices growth in Ukraine compared with its main trade partners.

ICU view: A short work week will contribute to increased volatility in the local currency market, as the main volume of VAT refunds and tax payments to the budget will all take place in just three days. Overall, we expect balanced supply and demand with insignificant appreciation trend of the national currency.

Artem Gladchenko, Kyiv, (044) 377-7040 ext.737

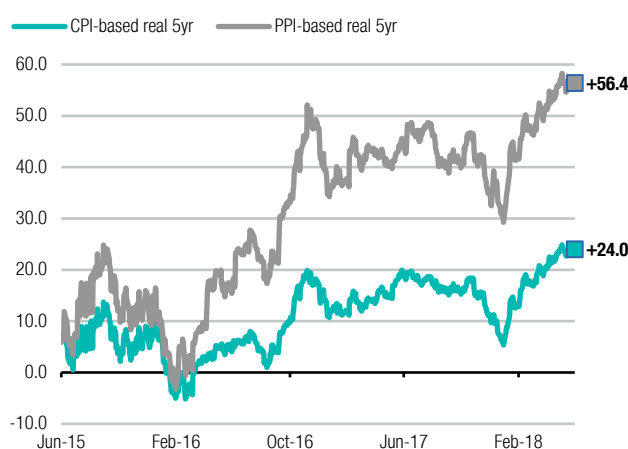
Chart 5. FX market indicators, 3-year history

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 in 1Q18 confirmed at 3.1% YoY

The State Statistics Service confirmed real GDP growth in 1Q18 at 3.1% YoY, which supports our forecast for economic expansion in full-year 2018 at 3.5%.

The main contributors to GDP expansion, according to production approach, were trade and vehicles repair, which added 5.8% (accounting for 14.5% of GDP); the processing industry increased 2.7% (12% of GDP), real estate operations grew 3.7% (6.5% of GDP), and mining added 2.1% (6.3% of GDP).

By expenditure approach, domestic consumption remains the main driver of economic growth, which was supported by increased real income and consumer lending. Household consumption increased 5.6% YoY, while gross capital formation added 17%.

ICU view: GDP growth in 1Q18 exceeded our forecast of 2.5% YoY growth; however, nominal GDP came in lower at UAH700bn compared with our estimates of UAH711bn. We expect consumer demand to be the main driver of economic growth along with investments expansion. We retain our GDP forecast for full-year 2018 at 3.5%.

Artem Gladchenko, Kyiv, (044) 377-7040 ext.737

Industrial production decelerated to 2.5% YoY in May

Industrial production posted 2.5% YoY growth in May, decelerating from 3% expansion in April. The sector will continue to grow underpinned by investments and consumer-demand expansion.

Industrial production increased 2.2% MoM SA and 2.6% YTD. The processing industry accelerated to 3.2% YoY after a moderate 0.8% increase in April. In MoM terms, it increased 6.5% and 1.1% MoM SA.

The mining industry was volatile and declined 1.9% YoY and 0.2% MoM in May. According to SA data, the decline was 2.5% MoM. And insignificant increase YoY (+0.4%) was observed only in coal production. The utilities sector increased 8.6% YoY, but declined 6.4% MoM and added only 0.2% MoM SA.

ICU view: We keep our forecast of 3.5% growth for industrial production for full-year 2018, which will be supported by increased investment activity and domestic consumption.

Alexander Valchyshen, Kyiv, (044) 377-7040 ext.721

Artem Gladchenko, Kyiv, (044) 377-7040 ext.737

Grain harvest is to reach at least 2017 level

Despite unfavorable weather conditions this spring and at the beginning of summer, Ministry of Agriculture keeps its crops forecast at more than 60mt.

According to Interfax-Ukraine, as of 20 June, of current marketing year (July 2017–June 2018), Ukraine exported 38.6mt of grain, which is 9.8% lower compared with the corresponding period of the previous year, including wheat exports of 16.8mt, corn 17.4mt, and barley 4.2mt.

On the other hand, the winter wheat crop is expected to be 8-10% lower compared with last year at around 23mt. Approximately 15% of agro-territories are in drought, which is a decrease from 30% after precipitation two weeks ago, according to UNIAN.

Drought during the spring season will have a negative impact on the grain crop this year, but Minagroprod keeps its yield forecast for 2018 at 60+mt, with the possibility of exceeding last year's numbers.

ICU view: The return of rainy weather in June has reduced the threat of significant losses of spring crops due to drought, which allows us to expect this year's grain harvest in Ukraine not lower than the 2017 level.

At the same time, taking into account bad weather conditions in other grain regions, mainly Russia and the EU, grain prices could increase in the 5–10% range in 2018, which will be positive for Ukrainian exports and foreign currency inflows.

Alexander Martynenko, Kyiv, (044) 377-7040 ext.726

Artem Gladchenko, Kyiv, (044) 377-7040 ext.737

Parliament approved the formal establishment of the Anti-corruption Court

The full set of HACC legislation is still to be determined and needs the approval of the IMF.

According to Interfax-Ukraine, Verkhovna Rada passed the bill to establish the High Anti-corruption Court (HACC) with 265 votes. This law will allow the formal creation the HACC. At the same time, Parliament has not cancelled the amendment to the HACC law that allows examination of appeals on litigation already open in the courts of general jurisdiction, and not

in the HACC. Ukraine's anticorruption watchdogs, such as the National Anti-corruption Bureau, Transparency International Ukraine, and the Anticorruption Center, have already declared that the amendment significantly restricts the HACC's authority and called on Parliament to cancel it. [The IMF](#) and [the U.S. Department of State](#) have joined the criticism. Also, the head of the EU delegation in Ukraine, Hughes Mingarelli, believes that the HACC law needs improvement, since it contains some dubious terms. However Mingarelli did not specify when the EU will provide its official view on the bill.

The Chairman of the Parliamentary Committee on Legal Policy and Justice, and member of the parliament faction of the Petro Poroshenko bloc, Ruslan Kniazhevich, opined that the amendment on appeals is properly formulated, but suggested its cancelation is possible in case of the respective agreement (source: Interfax-Ukraine). Parliament Speaker, Andrey Parubiy, also hinted at the possibility of the amendment's cancelation (source: UNIAN).

ICU view: Ukraine has made another critical step towards the creation and functioning of the HACC. To complete the process, it is necessary to bring the HACC law into accordance with the Law on the Judiciary and Status of Judges. Also, most likely, the Council has to cancel the amendment to the HACC law about appeals. Verkhovna Rada still has one session in the beginning of July to accomplish this before summer break. It is still possible that the anti-corruption watchdogs will find additional dubious provisions in the bill. Further, the IMF still has to give its final word.

Alexander Martynenko, Kyiv, (044) 377-7040 ext.726

This page is intentionally left blank



11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kyiv, 01030 Ukraine
Phone/Fax +38 044 3777040

WEB www.icu.ua



INVESTMENT ADVISORY

Makar Paseniuk, CFA, Managing Partner
makar.paseniuk@icu.ua

Ivan Shvydanenko, Director
ivan.shvydanenko@icu.ua

Roman Nikitov, ACCA Director
roman.nikitov@icu.ua


Yuriy Kamarytskyi, Vice President
yuriy.kamarytskyi@icu.ua

Ruslan Kilmukhametov, Director
ruslan.kilmukhametov@icu.ua


Ruslan Patlavsky, Director
ruslan.patlavsky@icu.ua

ASSET MANAGEMENT

Grigoriy Ovcharenko, Director
Head of Local Asset Management
grigoriy.ovcharenko@icu.ua

Liliya Kubytovych 
Head of Marketing and Sales
liliya.kubytovych@icu.ua


TRADE OPERATIONS

Konstantin Stetsenko 
Managing Partner
konstantin.stetsenko@icu.ua

Vlad Sinani, Director
Strategy and Business Development
vlad.sinani@icu.ua


Sergiy Byelyayev
Head of Fixed-Income Trading
sergiy.byelyayev@icu.ua

Yevgeniya Gryshchenko
Head of Brokerage Services Department
yevgeniya.gryshchenko@icu.ua

Vitaliy Sivach 
Trader, Fixed-Income & Forex
vitaliy.sivach@icu.ua


Bogdan Vorotilin 
bogdan.vorotilin@icu.ua

RESEARCH

Alexander Valchyshen 
Head of Research
alexander.valchyshen@icu.ua

Taras Kotovych 
Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Alexander Martynenko 
Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv 
Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Dmitriy Dyachenko
Junior financial analyst
dmitriy.dyachenko@icu.ua

Artem Gladchenko
Junior financial analyst
artem.gladchenko@icu.ua

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (license numbers: dealer activity AE 263019, broker activity AE 263018, underwriting activity AE 263020 dated 11 April 2013).

DISCLAIMER

This research publication has been prepared by Investment Capital Ukraine LLC solely for information purposes for its clients. It does not constitute an investment advice or an offer or solicitation for the purchase or sale of any financial instrument. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, Investment Capital Ukraine makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of Investment Capital Ukraine LLC. All rights are reserved. Any investments referred to herein may involve significant risk, are not necessarily available in all jurisdictions, may be illiquid and may not be suitable for all investors. The value of, or income from, any investments referred to herein may fluctuate and/or be affected by changes in exchange rates. Past performance is not indicative of future results. Investors should make their own investigations and investment decisions without relying on this report. Only investors with sufficient knowledge and experience in financial matters to evaluate the merits and risks should consider an investment in any issuer or market discussed herein and other persons should not take any action on the basis of this report.

Additional information is available upon request.

