

# Weekly Insight

## Real GDP rose 3.6% YoY in 2Q18

### Key messages of the today's comments

WEDNESDAY, 22 AUGUST 2018

### Domestic liquidity and bonds market

#### MoF repays debt

Last week, the MoF repaid UAH4.5bn and US\$389.2m of domestic debt after accumulating funds for these repayments over the last few weeks. The weeks ahead have a low domestic debt burden.

#### Liquidity at low level

Under pressure from quarterly tax payments, banking-sector liquidity fell to its lowest level this year, and through to the end of month, it will stay below UAH90bn due month-end tax payments.

### Foreign exchange market

#### NBU restrained excess demand for foreign currency

This week should be relatively calm for the national currency against the backdrop of balancing tax payments to the budget and VAT refunds. However, the psychological factor of the devaluation expectations may still be strong and adds uncertainty.

### Economics

#### Real GDP rose 3.6% YoY in 2Q18

Ukraine's economy expanded 0.9% QoQ SA and 3.6% YoY in 2Q18, per preliminary data from the State Statistics Service. Thanks to favourable external conditions, solid consumer demand, and rising investments, real GDP growth will be close to 3.5% this year.

#### Trade-balance deficit surged 13.4 times YoY in 1H18

The trade-balance deficit of goods and services expanded to US\$0.7bn in 1H18. Resumed gas imports against the backdrop of high energy prices combined with solid consumer imports will bring about a further widening of the deficit.

#### IMF mission comes to Ukraine in September

The IMF statement on visiting Ukraine means significant progress in negotiations on the key conditions for Ukraine to receive the \$1.9bn tranche and significantly higher chances to obtain another \$4bn from other international creditors.

### Banks' reserves market (21 August 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	N/A	...	...
ON rate (%)	N/A	...	...
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	48,319	-16.64	+17.31
DepCerts (UAHm) <sup>3</sup>	24,870	-26.33	-37.84

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) (21 August 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,104	-0.36	-4.55
Banks	368,754	-1.60	+21.01
Residents	21,038	-8.08	-3.76
Individuals	4,114	-5.40	+460.40
Non-res <sup>4</sup>	7,511	-5.20	+1,474.08
<b>Total</b>	<b>749,521</b>	<b>-1.28</b>	<b>+8.23</b>

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

### FX market indicators (21 August 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.7165	+1.30	+8.75
EUR/USD	1.1571	+2.07	-2.07
DXY <sup>2</sup>	95.256	-1.56	+2.32
UAH TWI <sup>3</sup>	117.185	-2.29	+2.45

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

### Gov't bond quotes<sup>1</sup> (22 August 2018)

Maturity	Bid	Ask
6m	18.50	17.75
12m	18.70	17.40
2y	18.00	16.75
3y	18.00	16.75
12m (\$)	5.50	5.00
2y (\$)	5.70	5.15

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

# Domestic liquidity and bonds market

## MoF repays debt

Last week, the MoF repaid UAH4.5bn and US\$389.2m of domestic debt after accumulating funds for these repayments over the last few weeks. The weeks ahead have a low domestic debt burden.

Since the beginning of the month, the MoF accelerated borrowings with additional FX-denominated bonds offerings, as it had at the beginning of August FX in the equivalent of UAH20.9bn. During August and September, the MoF has scheduled about US\$1.5bn of debt repayments, US\$0.5 domestically and US\$1bn abroad. During the first half of August, debt repayments amounted to US\$650m, which were more than one-third of the abovementioned repayments.

The MoF held four auctions so far this month, which allowed the Ministry to refinance UAH6.9bn out of UAH8.3bn of local-currency repayments and most of the FX-repayments. The MoF borrowed US\$375m in FX while repaying US\$389m of principal and interest of FX-denominated domestic bonds.

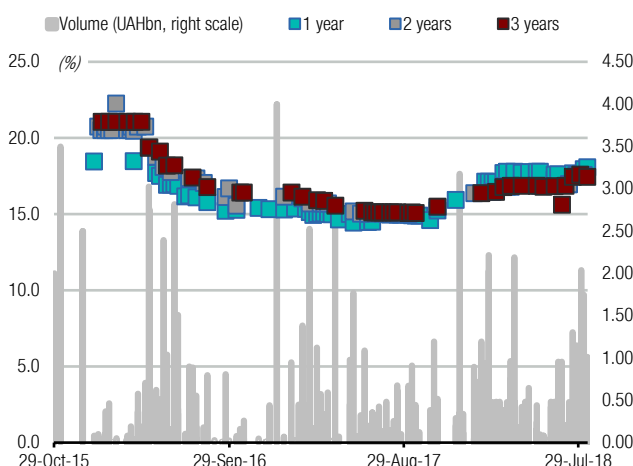
As a result, after last week's large repayments, most of the decline was in portfolios of banks and non-banks for UAH3.1bn and UAH1.7bn, respectively, while individuals and foreign investors' portfolios declined by UAH0.2bn and UAH0.3bn, respectively. Currently, foreign investors' portfolios are nearly 90% in bonds purchased using CLN; only UAH0.3bn of CLN should be redeemed by the end of this year.

**ICU view: With significant needs in FX, the MoF offered yesterday two bills in FX, including one in euros. The lack of external financing forced the MoF to borrow FX from other sources, as it has to meet on 1 September a payment of US\$444m of interest on Eurobonds issued in 2015 under the restructuring, and on 12 September US\$103m on domestic FX-denominated bonds. At the same time, we do not anticipate an increase in interest rates ([see our last week's auction review](#)).**

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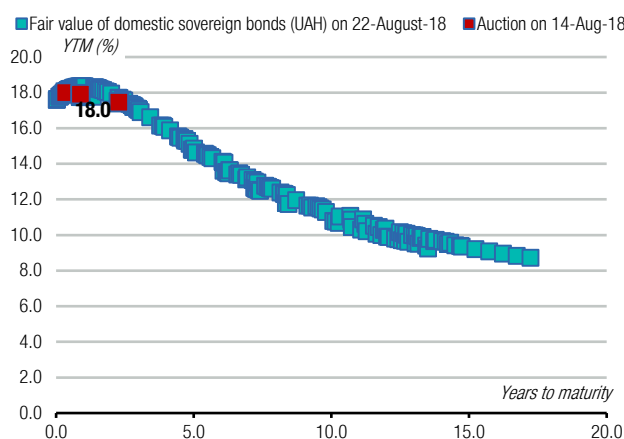
**Chart 1. Local-currency bonds**

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.

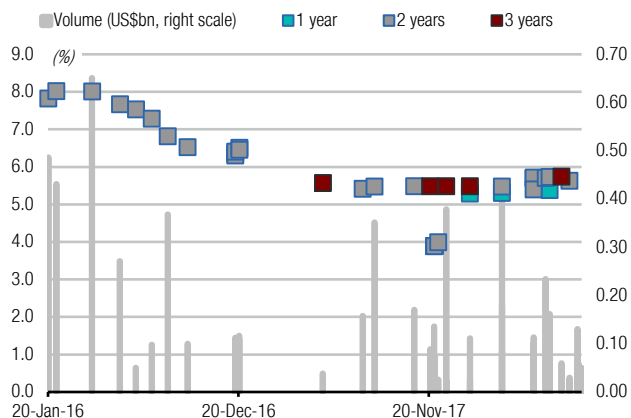
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

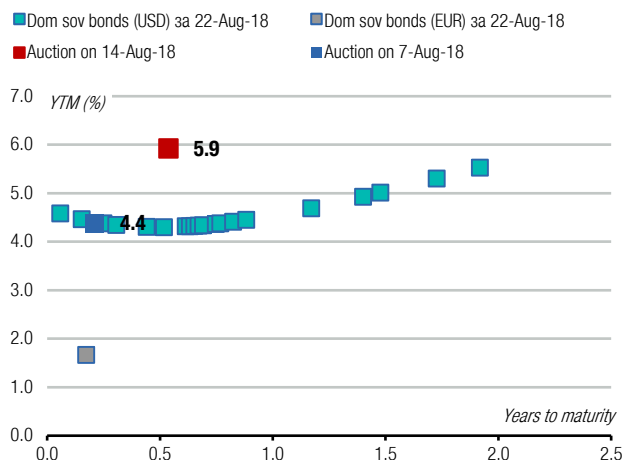
**Chart 2. FX-denominated bonds**

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 at low level**

Under pressure from quarterly tax payments, banking-sector liquidity fell to its lowest level this year, and through to the end of month, it will stay below UAH90bn due month-end tax payments.

Last Thursday, the government budget received more than UAH11bn or nearly one-quarter of all revenues received this month (through last Thursday). Only a small portion of these funds was spent immediately and the net negative impact of Treasury operations amounted to UAH8.4bn. This was the main outflow last week. In total, the Treasury absorbed UAH16.2bn last week while other non-monetary operations caused outflows amounting to just UAH0.8bn. Additionally, the NBU absorbed via the FX market UAH5.9bn, selling US\$214.8m, including US\$91m via FX auctions.

Significant absorption caused liquidity to fall to UAH76.6bn last Friday, the lowest level this year, similar to last year's level in August, which held most of the rest of last year with slight volatility. Also, similar to last August, banks' correspondent accounts are steady at around UAH50bn, and total CDs outstanding fell below UAH30bn last Friday.

**ICU view: Liquidity declining in mid-August is to be expected due to quarterly tax payments; month-end tax payments started this week should continue the pressure on liquidity. At the same time, this year, the Treasury did not accumulate funds in its accounts, using funds for expenditures. We expect that part of accumulated funds will be returned to the banking system, including VAT refunds. Through to the end of month, liquidity will recover slightly, but not above UAH90bn.**

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

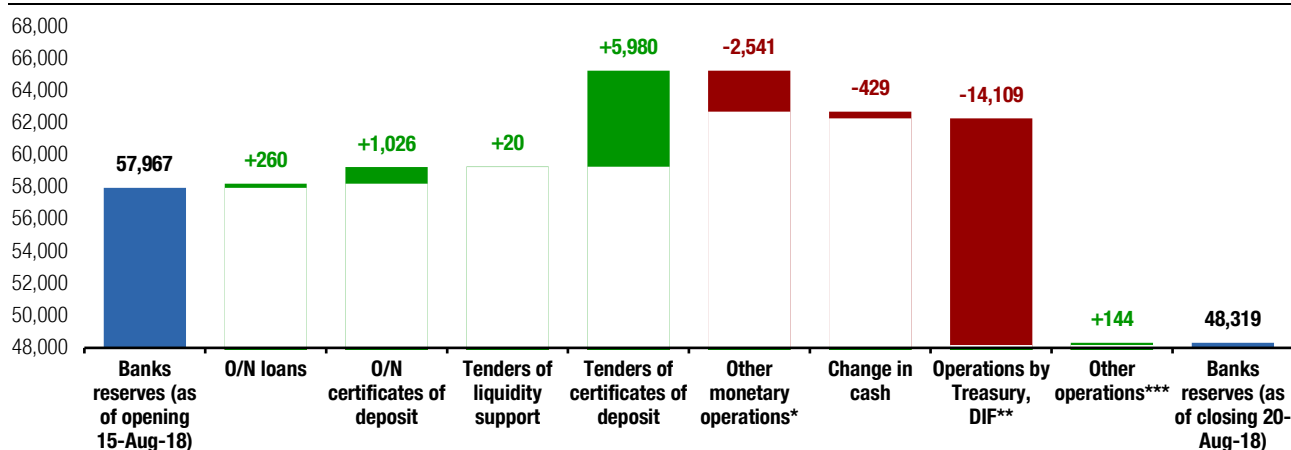
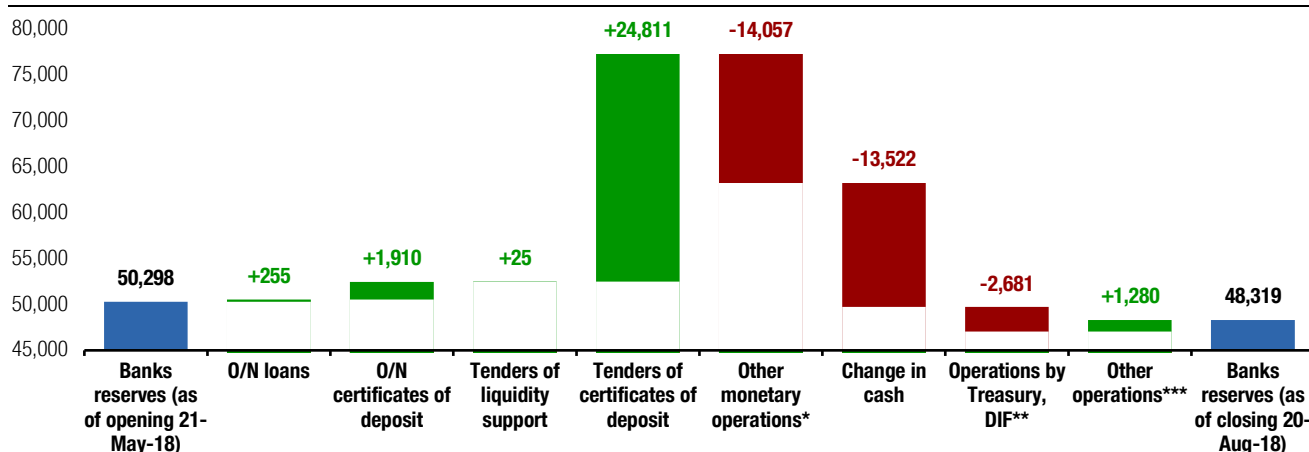


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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.

## Foreign exchange market

### NBU restrained excess demand for foreign currency

This week should be relatively calm for the national currency against the backdrop of balancing tax payments to the budget and VAT refunds. However, the psychological factor of the devaluation expectations may still be strong and adds uncertainty.

Last week, the national currency continued to decline against the US dollar and quarterly tax payments did not prevent that. The psychological factor in the market was decisive and pushed the rate to 28 UAH/USD due to increased demand for foreign currency. In order to meet excess demand during the week, the NBU entered the market with sales of foreign currency both in the form of an auction and through other mechanisms, and sold US\$215m in total. Through such actions, the NBU kept further depreciation of hryvnia below 28 UAH/USD on Friday. Accordingly, in the past week, the hryvnia weakened by 1.9% to 27.82 UAH/USD.

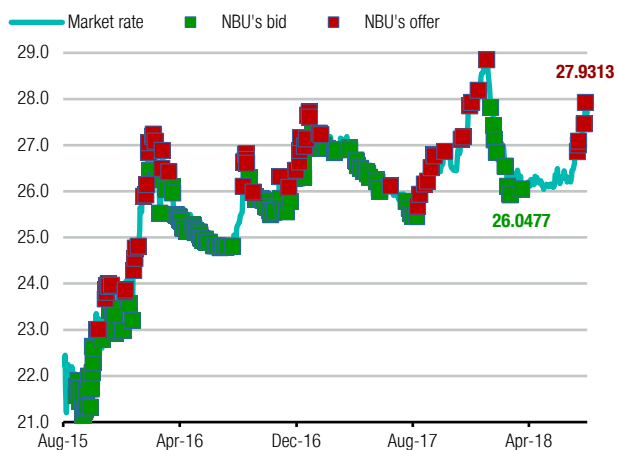
The hryvnia's CPI-based real trade-weighted index (which includes the currencies of 27 countries that are trade partners of Ukraine) decreased 2.3% to 117.4 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI-based) increased 2.4%, and decreased 4.1%, respectively.

**ICU view:** As the demand for USD from incoming VAT refunds should be mostly balanced by supply from exporters scheduled to pay taxes, there will be a lack of strong drivers for currency this week. Hence, we do not expect significant exchange rate fluctuations. At the same time, the devaluation expectations may continue putting pressure on the hryvnia.

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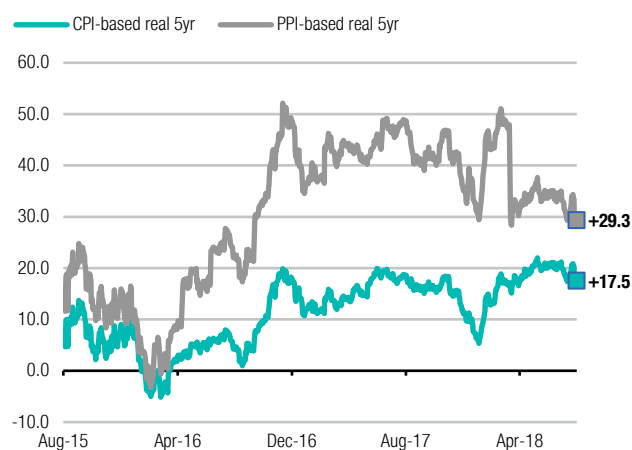
**Chart 5. FX market indicators, 3-year history**

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

### Real GDP rose 3.6% YoY in 2Q18

Ukraine's economy expanded 0.9% QoQ SA and 3.6% YoY in 2Q18, per preliminary data from the State Statistics Service. Thanks to favourable external conditions, solid consumer demand, and rising investments, real GDP growth will be close to 3.5% this year.

According to our estimates, the key drivers of economic growth in 2Q18 were 1) robust households' consumption (retail sales rose 4.8% YoY) against the backdrop of rising real incomes, 2) high investment activity (imports of machinery and equipment grew 12.7% YoY), 3) an earlier start of the grain harvesting season, and 4) the low base effect due to the trade blockade of Donbas since March 2017.

**ICU view:** Real GDP growth in 2Q18 exceeded the NBU's estimate (+3.2% YoY), but was in line with the ICU forecast (+3.5% YoY). We expect economic growth to accelerate thanks to the following: 1) robust consumer demand against the backdrop of rising real incomes, and further expansion in consumer lending (+44.4% YoY in June), 2) a further increase in private and government investment, and 3) favourable external conditions. We maintain our forecast of 3.5% real GDP growth for 2018.

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## Trade-balance deficit surged 13.4 times YoY in 1H18

The trade-balance deficit of goods and services expanded to US\$0.7bn in 1H18. Resumed gas imports against the backdrop of high energy prices combined with solid consumer imports will bring about a further widening of the deficit.

The merchandise-trade balance deficit rose 32.9% YoY to US\$2.7bn in 1H18, per data from the State Statistics Service of Ukraine. Export of goods rose 12.7% YoY or US\$2.2bn, to US\$23.3bn. The largest contributors to this increase were metals at 57.4% (US\$1.5bn), electric machines at 11.8% (US\$0.3n), and wood and articles of wood at 8.2% (US\$0.2bn).

Merchandise imports totaled US\$25.9bn, which is 15.3% YoY or US\$2.8bn higher compared with 1H17. The largest contribution to this increase was made by machinery and equipment (25.2%), mineral products (14.2%), and products of the chemical and allied industries (11.2%).

Exports of services rose 5.7% YoY to US\$5.4bn, mainly thanks to processing of materials (+16.1% YoY), and IT services (+16.4% YoY). Imports of services rose 4.9% YoY and amounted US\$2.6bn. The drivers were transport services (+13.5% YoY) and travelling (+36.1% YoY).

***ICU view: Imports of goods and services will continue to rise faster than exports due to solid consumer demand and higher volumes of energy imports against the backdrop of high energy prices. At the same time, exports growth rates will be constrained by declining steel prices and a worse-than-expected harvest this year.***

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## IMF mission comes to Ukraine in September

The IMF statement on visiting Ukraine means significant progress in negotiations on the key conditions for Ukraine to receive the \$1.9bn tranche and significantly higher chances to obtain another \$4bn from other international creditors.

IMF mission will visit Kiev during 6–19 September, as the Fund's Resident Representative in Ukraine, Goesta Ljungman, stated in a press release. During the visit, the mission will discuss recent economic developments and policies. The mission will also discuss its next steps, including financial assistance from the IMF in support of policies to maintain macroeconomic stability and keep the economy on a path toward sustainable and decisive growth.

Also, according to Interfax-Ukraine, at the request of the Ukrainian government, the World Bank is currently preparing a guarantee in the amount of \$650m to support reforms in Ukraine. To obtain this financial assistance, Ukrainian authorities should resume cooperation with the IMF, as well as put into force the law on the improvement of the funding of the financial sector and changes to the law on the renewal of lending.

***ICU view: The visit of the IMF mission to Ukraine means that the sides have achieved considerable progress with regard to the remaining conditions for Ukraine to receive the tranche, namely bringing the gas tariffs for the population in line with market prices and balancing the 2018 state budget deficit below 2.5% GDP. In addition to the \$1.9bn tranche from the IMF, this means fulfilling the key condition for Ukraine not only to obtain a \$650m guarantee from the World Bank, but also the \$1bn macrofinancial aid from the EU. Furthermore, this significantly increases the chances of Ukraine to successfully issue \$2bn of Eurobonds, as the government had planned. All these FX inflows will help Ukraine to finance FX debt services of \$3bn of in 2H18 and \$7bn in 2019.***

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