Focus
Ukraine

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

Research team
Alexander Martynenko
Taras Kotovych
Dmytro Dyachenko

Weekly Insight

NBU estimates real GDP at +3.1% YoY in 3Q18

Key messages of the today's comments

TUESDAY, 6 NOVEMBER 2018

Domestic liquidity and bonds market

Borrowing at limit

After the successful Eurobonds issue, the MoF has fulfilled all financing requirements using borrowings. However, the Ministry should continue to issue local bills to replace funds not yet received from privatizations and for current budget needs.

Liquidity steady

Despite the Treasury accumulating funds for debt repayments, liquidity remained slightly above UAH80bn with support from the NBU. This week, pressure on liquidity from the budget should continue.

Foreign exchange market

Hryvnia recovered from NBU intervention

Last week, the hryvnia appreciated despite the NBU purchases of FX from the market. By the end of the week, it returned to UAH28.07/USD, near the level seen two weeks ago. This week, the hryvnia exchange rate should be close to the current level due to funds accumulating for tax payments.

Economics

C/A deficit widened to 3.8% of GDP

The 12-month rolling C/A deficit widened to 3.8% of GDP or US$4.8bn (+2.9x YoY) in September. Thanks to an increase in agricultural exports and further growth of inflows of remittances, the C/A deficit will contract in 4Q18.

NBU estimates real GDP at +3.1% YoY in 3Q18

Economic growth slowed to 3.1% YoY in 3Q18, down from 3.8% YoY in 2Q18, per data from the NBU. In QoQ terms, growth was 1% QoQ SA (ICU's estimate as implied by the NBU's 3Q18 year-on-year estimate).

Banks' reserves market (5 November 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	18.00	+0bp	+450bp
ON rate (%)	17.97	+18bp	+577bp
ON $ swap (%)	17.30	+6bp	+505bp
Reserves (UAHm)[2]	50,173	-1.50	+19.05
DepCerts (UAHm)[3]	31,407	+7.63	+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) (5 November 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,100	+0.00	-3.46
Banks	364,965	+0.20	+15.83
Residents	20,275	+0.58	-8.38
Individuals	5,288	+0.90	+485.46
Non-res[4]	7,212	+0.02	+50.87
Total	**745,840**	**+0.12**	**+6.02**

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

FX market indicators (5 November 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	28.0075	-0.58	+3.90
EUR/USD	1.1407	+0.55	-1.73
DXY[2]	96.279	-0.75	+1.41
UAH TWI[3]	116.421	+0.26	+2.61

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

Gov't bond quotes[1] (6 November 2018)

Maturity	Bid	Ask
6m	19.75	18.50
12m	19.75	18.10
2y	19.50	18.00
3y	19.50	17.50
12m ($)	7.50	5.00
2y ($)	7.50	5.20

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

Domestic liquidity and bonds market

Borrowing at limit

After the successful Eurobonds issue, the MoF has fulfilled all financing requirements using borrowings. However, the Ministry should continue to issue local bills to replace funds not yet received from privatizations and for current budget needs.

During the first two weeks of November, the Ministry has to repay UAH16.5bn, most of which are interest repayments to the NBU. So, for these repayments, the MoF can use funds from the Treasury account without additional borrowings. This source for payments will be used because liquidity in the banking system is low (see comment below), and banks will be not able to buy a significant amount of new debt.

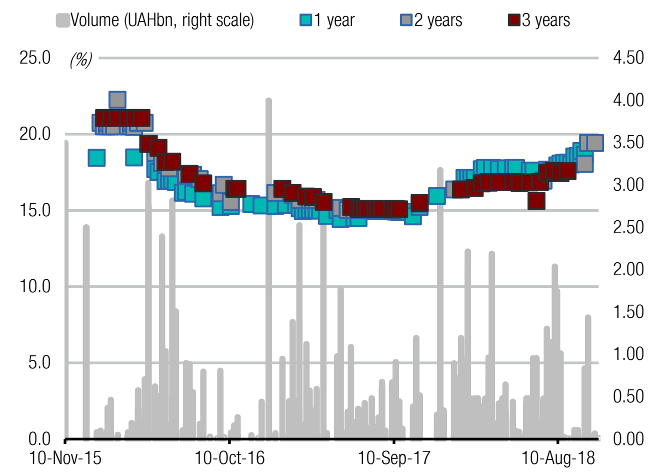
The Ministry actually exceeded the limit of borrowings allowed by the state budget with last week's issuance of US$2bn in Eurobonds (see last week's note), and can only borrow the equivalent amount of funds that are due and not received from privatizations, or less than UAH20bn. However, it should be preferable for the government to borrow in FX, as this source is needed to refinance debt repayments in November and December.

ICU view: This week, the MoF has announced offerings of local-currency bills with maturities from three months up to one year and 14-month USD-denominated bills maturing in January 2020. But despite high current needs of local-currency funds, it is unlikely that the MoF will increase interest rates. As the result, Ministry may postpone other expenditures for the second half of November, and use available funds for debt repayments. It can also use FX received last week, sold at the market to finance debt repayments.

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

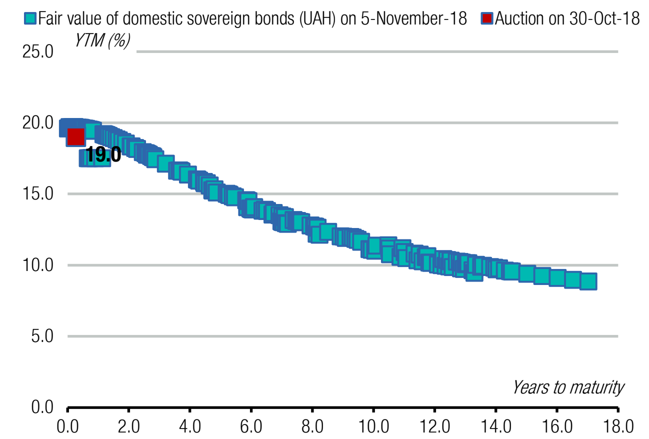
Chart 1. Local-currency bonds

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.

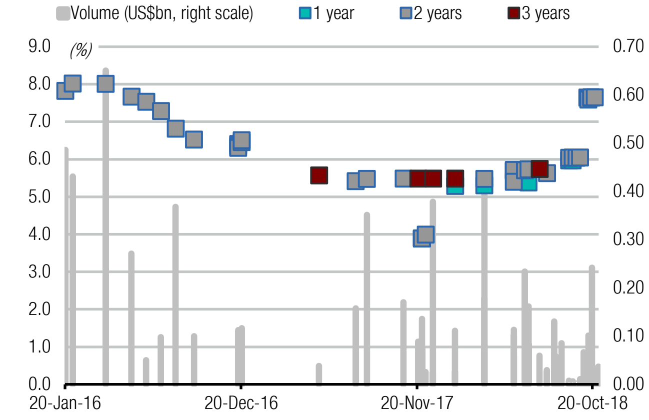
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

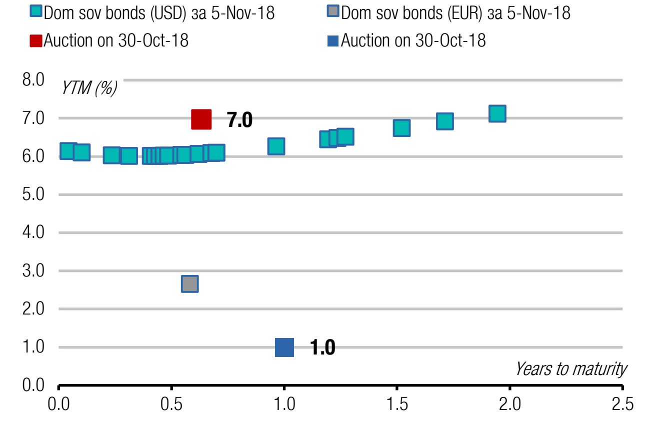
Chart 2. FX-denominated bonds

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.

Liquidity steady

Despite the Treasury accumulating funds for debt repayments, liquidity remained slightly above UAH80bn with support from the NBU. This week, pressure on liquidity from the budget should continue.

Last week, the Treasury had a negative impact on liquidity after absorbing UAH6.9bn. But with this action, the balance in Treasury accounts declined at the end of October to UAH14.65bn, down UAH6.7bn during October.

But despite significant outflow to Treasury accounts, liquidity remained slightly above UAH80bn, receiving support from the NBU via the FX market and from cash exchanges. The NBU attempted to flatten the hryvnia exchange rate and purchased extra FX from the market, injecting UAH2.4bn in liquidity. Also, banks exchanged UAH3.1bn of cash in reserves.

ICU view: During the next two weeks, the MoF will need UAH16.5bn of funds for debt repayments; it had only UAH14.6bn at the beginning of the month. So, to make these payments, the Treasury will accumulate funds and maintain a negative impact on liquidity. As the result, liquidity will stay at low levels, while budget expenditures could be postponed until the second half of November.

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

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

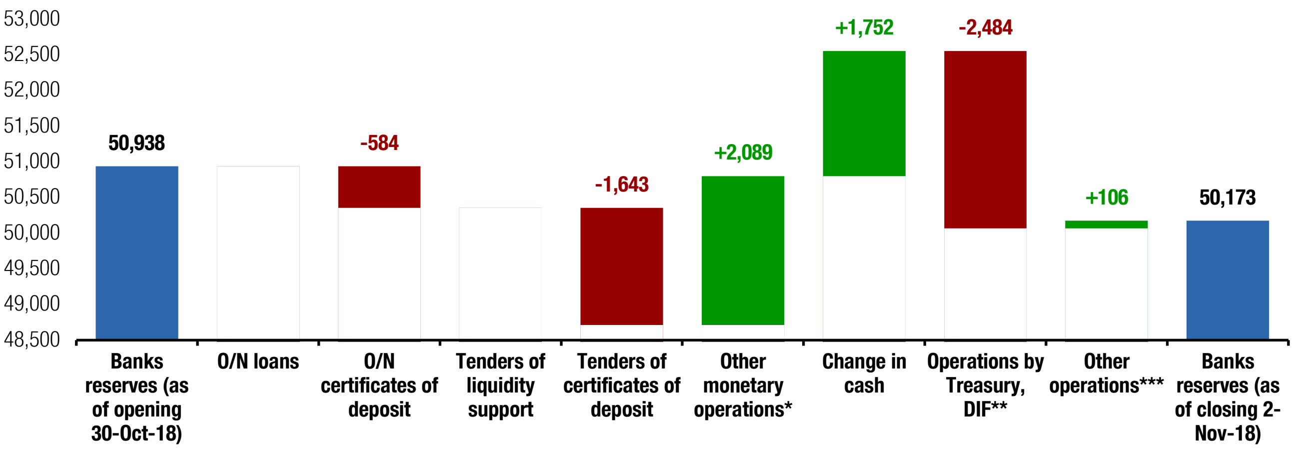
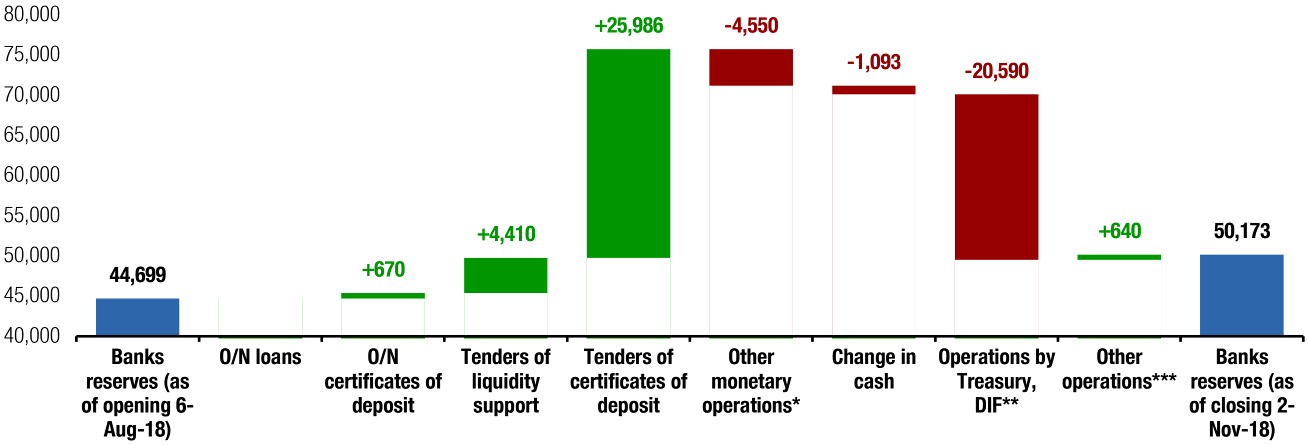


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 recovered from NBU intervention

Last week, the hryvnia appreciated despite the NBU purchases of FX from the market. By the end of the week, it returned to UAH28.07/USD, near the level seen two weeks ago. This week, the hryvnia exchange rate should be close to the current level due to funds accumulating for tax payments.

With all VAT refunds having been paid, the supply and demand balance of FX in the market shifted to the offer side. This forced the NBU to purchase extra FX to restrain hryvnia appreciation and decrease volatility. In total, last week, the NBU purchased US$85.2bn, which controlled appreciation of the hryvnia. As a result, at the end of last week, the hryvnia rose by 0.7% to UAH28.0675/USD, and over the last two weeks, rose just 0.2%.

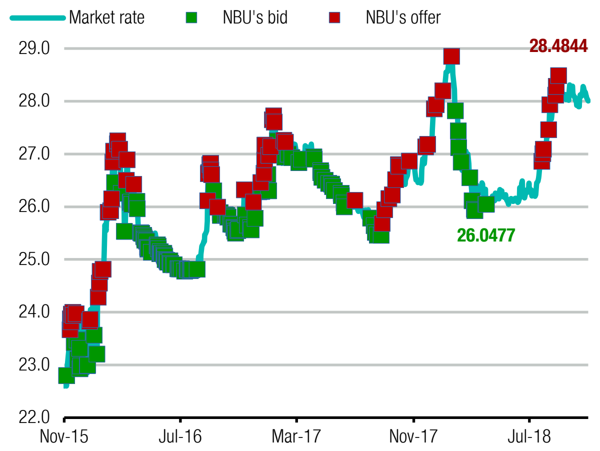
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.7% to 116.3, while in YoY terms, it was up 3.1%.

ICU view: Quarterly tax payments are due in the second half of November. Corporate income tax, in particular, requires a lot of liquidity. During this period, the Treasury will not make large budget expenditures (see comment about liquidity). As the result, we could see an increase in FX selling this week, which should exceed demand. We expect the hryvnia to slightly appreciate.

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

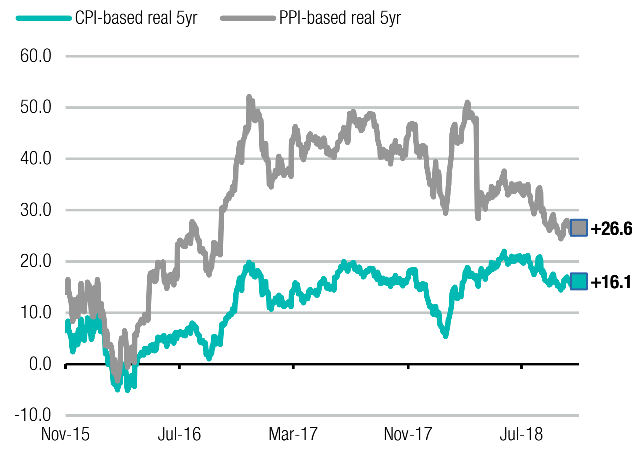
Chart 5. FX market indicators, 3-year history

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[1] from fundamental level[2] (%)



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

Economics

C/A deficit widened to 3.8% of GDP

The 12-month rolling C/A deficit widened to 3.8% of GDP or US$4.8bn (+2.9x YoY) in September. Thanks to an increase in agricultural exports and further growth of inflows of remittances, the C/A deficit will contract in 4Q18.

According to the NBU, the C/A gap was US$3.9bn (+2.5 times YoY) in 9M18, having increased from US$2.2bn in 8M18, primarily due to higher growth rates of imports compared with those of exports, and large payments on external debt servicing.

Imports of goods into Ukraine rose 15.6% YoY to US$40.6bn. The key growth drivers were machinery and equipment (+16% YoY), energy imports (+16% YoY), and chemical products (+11% YoY). Growth rates of exports slowed to 9.9% YoY in 9M18 (vs. 11.7% YoY in 8M18) to US$31.5bn. The main contributors to export growth were metals (+26% YoY), which account for 64% of the increase in exports, chemical products (+24% YoY), and wood and wood products (+25% YoY).

The services-trade-balance surplus dropped 26% YoY to US$0.4bn in 9M18, bringing the total trade-balance deficit to US$8.6bn (+48% YoY). Still, an increase of 28% YoY of remittances to US$8.5bn (ICU estimate) gave significant support to C/A balance.

ICU view: An increase in agricultural exports, higher-than-expected steel prices, and rising inflows of remittances will bring about contraction of the C/A deficit in 4Q18. However, high world energy prices and rising consumer imports are the key risks for our full-year C/A deficit forecast of 3% in 2018. Should C/A dynamics not improve in October, our forecast will be downgraded.

Dmytro Dyachenko, Kyiv, (044) 377-7040 ext.738

NBU estimates real GDP at +3.1% YoY in 3Q18

Economic growth slowed to 3.1% YoY in 3Q18, down from 3.8% YoY in 2Q18, per data from the NBU. In QoQ terms, growth was 1% QoQ SA (ICU's estimate as implied by the NBU's 3Q18 year-on-year estimate).

Slowdown of economic growth was due to 1) worsening of the performance of the real sectors of economy, 2) deteriorating external conditions against the backdrop of looming trade wars between the US and China, and 3) the diminishing effect of the low base of comparison due to the severance of economic ties with the temporarily occupied territories last year, according to the NBU in its October inflation report.

At the same time, high investment activity and solid consumer demand thanks to higher incomes from increased wages, pensions, and further growth of remittances remained the key drivers of the real GDP growth.

In general, the NBU has kept its forecast for economic growth at 3.4% in 2018, and 2.5% in 2019. The C/A deficit is expected at US$3bn in 2018, with headline inflation at 10.1% YoY.

ICU view: Our estimate of real GDP growth in 3Q18 is somewhat more optimistic: 3.5% YoY and 1% QoQ SA. But growth drivers are in line with the NBU's position: higher consumer demand and higher investment activity (imports of machinery and equipment rose 19.7% YoY in nominal terms in 3Q18). The updated NBU estimates of the C/A deficit (US$3.4bn in 2018), and headline inflation (10.1% YoY by the year-end) are in line with our forecasts – US$3.8bn (3% of GDP) and 10% YoY, respectively. However, in our view, real GDP growth will not exceed 2% in 2019, as external refinancing needs increase, and there is a less steep rise of wages and social security payments than there was in 2017–18.

Dmytro Dyachenko, Kyiv, (044) 377-7040 ext.738

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

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

Ruslan Kilmukhametov, Director
ruslan.kilmukhametov@icu.ua

Ivan Shvydanenko, Director
ivan.shvydanenko@icu.ua

Yuriy Kamarytskyi, Vice President
yuriy.kamarytskyi@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

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

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

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

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

Bogdan Vorotilin
bogdan.vorotilin@icu.ua

RESEARCH

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

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

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

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

Mykhaylo Demkiv
Financial analyst (Banks)
mykhaylo.demkiv@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

Additional information is available upon request.