

Weekly Insight

The IMF approved new program for Ukraine

Key messages of the today's comments

FRIDAY, 21 DECEMBER 2018

Domestic liquidity and bonds market

MoF changes his view on primary auctions

Last week was usual for primary market, but this week the Ministry increased rates for the shortest bills and next week it will probably sell bills at new rates.

Liquidity increases

Liquidity rose last week receiving support from the Treasury and NBU, and this week it hit the UAH100bn level. We expect it to stay at this level for the next several days.

Foreign exchange market

Hryvnia continues to fluctuate

Hryvnia weakened last week, losing 0.5%, but this week, it recovered and became stronger. Until the end of the month, it could weaken again due to lower FX supply and be closer to UAH28/US\$.

Economics

Real GDP rises 2.8% YoY in 3Q18

The State Statistics Service confirmed its estimate of real GDP growth in 3Q18 at 2.8% YoY and 0.4% QoQ SA. Economic growth will accelerate in 4Q18 thanks to the record harvest and further growth of consumer demand, bringing the full-year reading to 3.5% growth.

The IMF approved new program for Ukraine

In December, Ukraine has already received \$2bn from the IMF and the EU, as well as \$750m credit guarantees from the World Bank. IMF program's approval significantly increases the chance of Ukraine to meet FX obligations in 2019, and thus will support the financial and macroeconomic stability of the country.

Banks' reserves market (20 December 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+350bp
ON rate (%)	16.78	-74bp	+318bp
ON \$ swap (%)	16.25	-85bp	+312bp
Reserves (UAHm) ²	55,395	-15.93	+4.83
DepCerts (UAHm) ³	35,759	+62.21	+14.94

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) (20 December 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,100	+0.00	-3.46
Banks	360,546	+2.15	+7.17
Residents	18,532	-2.08	-14.15
Individuals	5,802	-1.63	+374.86
Non-res ⁴	6,250	-0.22	+19.81
Total	739,230	+0.97	+1.96

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (20 December 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.5500	-1.34	-1.11
EUR/USD	1.1446	+1.24	-3.58
DXY ²	96.276	-1.20	+3.18
UAH TWI ³	118.436	+0.92	+8.62

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (21 December 2018)

Maturity	Bid	Ask
6m	20.50	19.00
12m	20.50	19.00
2y	20.50	18.50
3y	20.50	18.00
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

MoF changes his view on primary auctions

Last week was usual for primary market, but this week the Ministry increased rates for the shortest bills and next week it will probably sell bills at new rates.

At the previous auction, the budget borrowed just UAH1.6bn, but this week, budget financing amounted to UAH20bn. This amount is the result of accepting a large amount of demand, which was submitted at 20.5%. There were bills with two to four-month maturities, and they provided main part of local-currency borrowings.

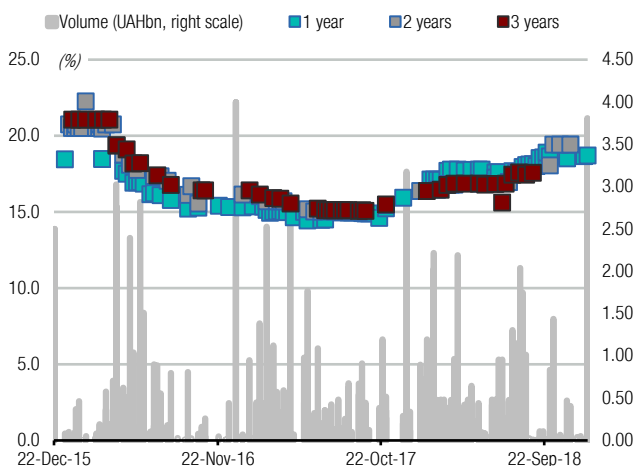
For FX-denominated bills, rates remained steady in the range 6.5–7.5%. All bids for these bonds were accepted and borrowings in FX exceeded US\$300m.

ICU view: The MoF's decision was quite unexpected, but current market conditions dictated such a decision in case of large needs for financing. At the same time, the Minister called this level of rates as temporary. Obviously, introducing new refinancing rules by the NBU starting 11 January 2019 should have a positive impact on the cost of funding at the market, and should decrease rates for bills later in January.

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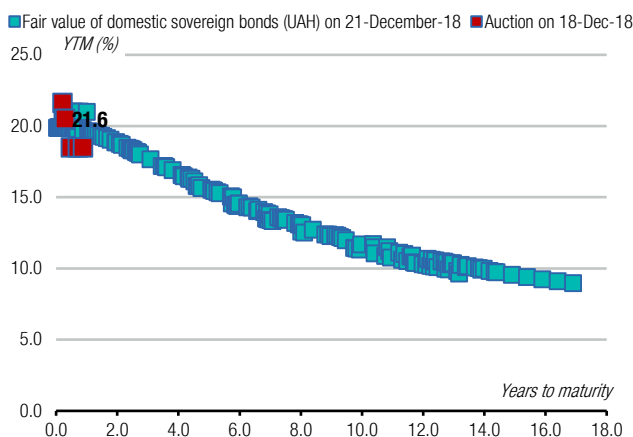
Chart 1. Local-currency bonds

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.

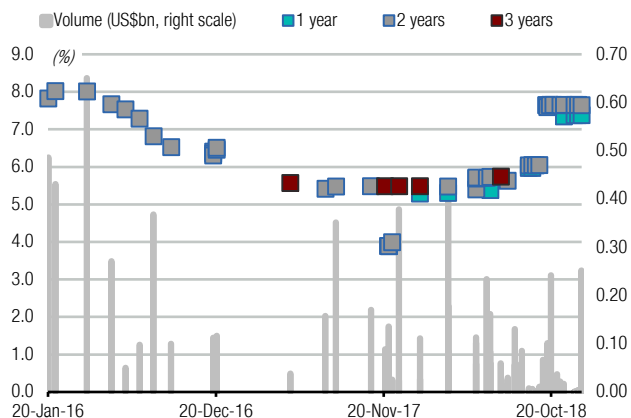
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

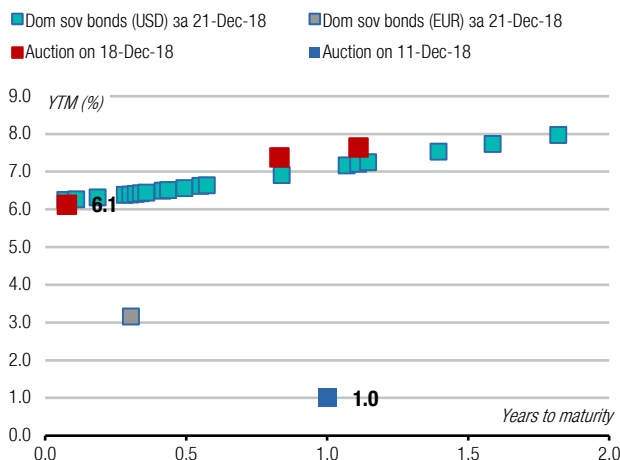
Chart 2. FX-denominated bonds

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 increases

Liquidity rose last week receiving support from the Treasury and NBU, and this week it hit the UAH100bn level. We expect it to stay at this level for the next several days.

Last week, the Treasury made large expenditures, and the balance of its operations was positive for liquidity, as the Treasury injected more than UAH16bn into the banking system. Additionally, the NBU injected via the FX market UAH1bn last week and so far this week UAH2.3bn. Additionally, the NBU provided banks with UAH6.1bn of 77-day loans last week, and this week UAH4.5bn of ON loans. Outflow was seen only via reserves exchange in cash.

But the Treasury changed the direction of its balance this week, and absorbed UAH14bn in three days. So, liquidity declined once more after reaching UAH101bn on Tuesday.

ICU view: Liquidity recovered with inflows from the Treasury and NBU, but stayed below UAH101bn. Additionally, the NBU's purchases of FX also supported liquidity, but total liquidity also depends on other factors that influence the Treasury's operations. There are month-end tax payments, and withdrawals of deposits by local budgets. This could decrease liquidity in the banking system, although budget expenditures should accelerate and could compensate outflows keeping liquidity at around UAH100bn.

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

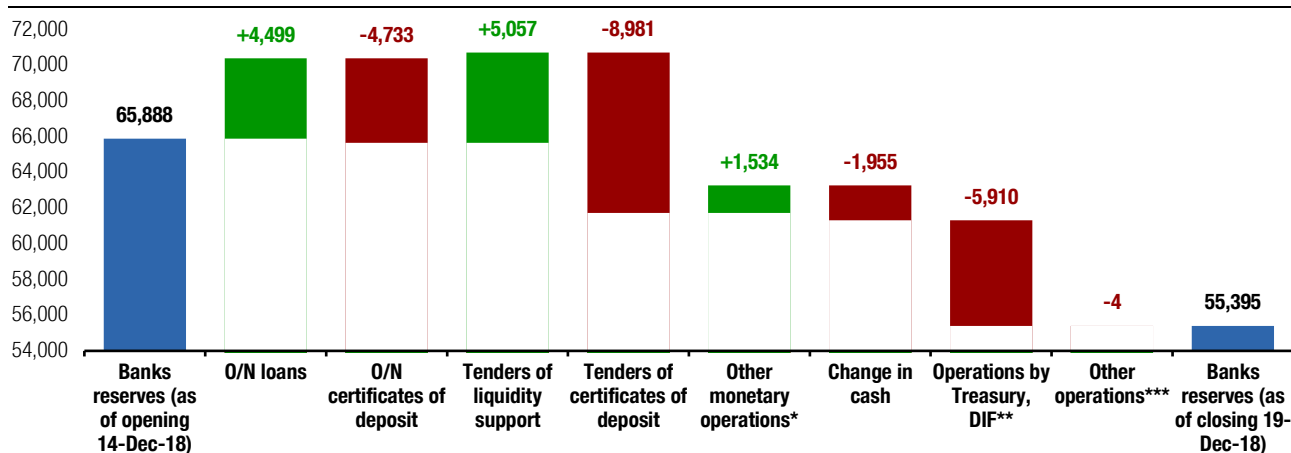
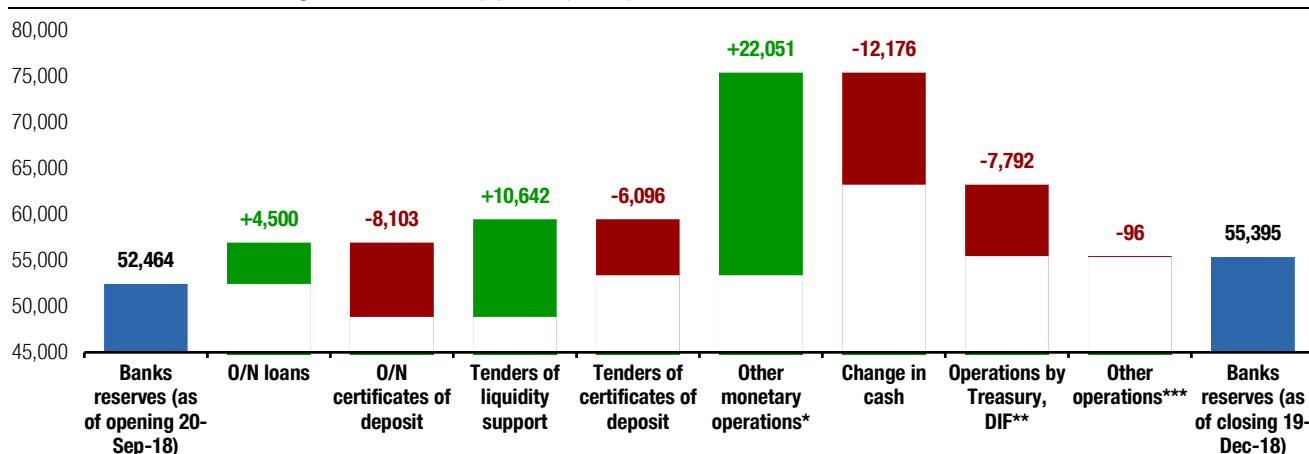


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Hryvnia continues to fluctuate

Hryvnia weakened last week, losing 0.5%, but this week, it recovered and became stronger. Until the end of the month, it could weaken again due to lower FX supply and be closer to UAH28/US\$.

Last week, the hryvnia weakened and NBU had to change its intervention direction on Wednesday and sell FX. But on Thursday, it returned to FX purchases. Despite purchasing FX, the hryvnia appreciated sufficiently. This week, the NBU also purchased about US\$90m of FX. Despite this, the hryvnia appreciated. For today the NBU set the official rate at UAH27.58/USD, while the interbank market closed yesterday at better level at UAH27.55/USD.

Finally, last week, the hryvnia lost 1.58% weakening to UAH28.1975/USD but this week returned to the mid-August level, appreciating so far in December by 2.35% to UAH27.55/USD

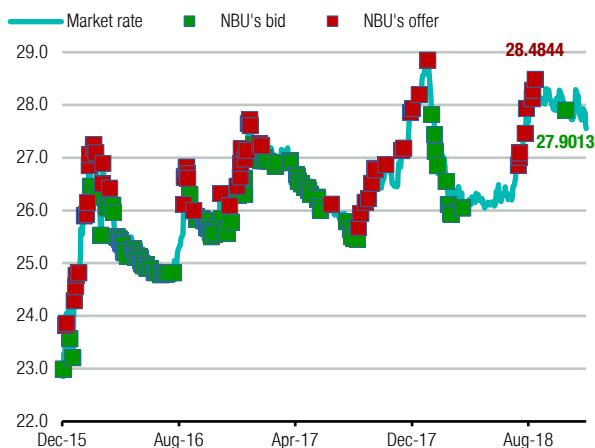
ICU view: The hryvnia received sufficient support from exporters, which continued to sell FX revenues. But this week Naftogaz should become more active in FX selling to pay dividends to the budget. This week, Naftogaz paid about UAH5bn of dividends,

and it looks like for at least the next two payments, the company could sell FX. But in a few days the impact from this factor will end and due to the holidays, the supply of FX will become lower. So, we anticipate a weakening of the hryvnia to the range of UAH28.0-28.5/USD at the end of this year.

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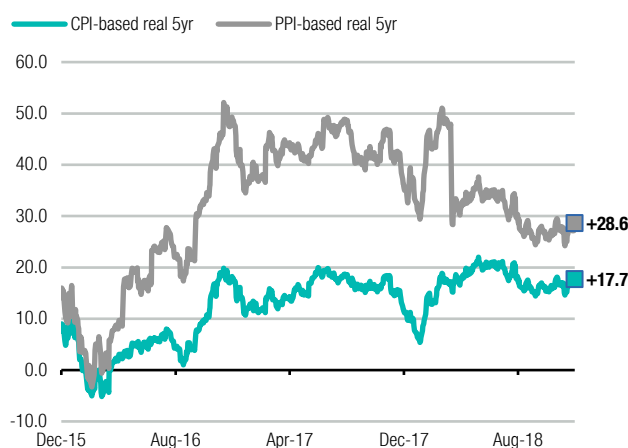
Chart 5. FX market indicators, 3-year history

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 rises 2.8% YoY in 3Q18

The State Statistics Service confirmed its estimate of real GDP growth in 3Q18 at 2.8% YoY and 0.4% QoQ SA. Economic growth will accelerate in 4Q18 thanks to the record harvest and further growth of consumer demand, bringing the full-year reading to 3.5% growth.

On the production side, almost all sectors posted growth except for healthcare (-3.3% YoY). The key drivers were 1) wholesale and retail trade (+6.2% YoY), 2) the agricultural sector (+3% YoY), and 3) real estate operations (+5.9% YoY).

On the demand side, the main growth boosters remained household consumption (+9.7% YoY) and investment activity (+9.7% YoY), while a decrease in government consumption (-6.7% YoY) and real exports (-5.2% YoY) as well as higher real imports (+5.1% YoY) substantially constrained real GDP growth.

Nominal GDP rose 19.4% YoY to UAH994bn, while the GDP deflator was 16.1% YoY. On a 12-month rolling basis, nominal GDP increased to UAH3.4tn, which is the equivalent of US\$126bn.

ICU view: Thanks to the record grain harvest (70mt), which also will boost exports, and further growth of consumer demand, real GDP growth will accelerate to est. 3.6% YoY in 4Q18, bringing the full-year growth to 3.5%. For 2019, we expect economic growth to slow to 2.3% due to tight fiscal and monetary policies, and less favourable external conditions.

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The IMF approved new program for Ukraine

In December, Ukraine has already received \$2bn from the IMF and the EU, as well as \$750m credit guarantees from the World Bank. IMF program's approval significantly increases the chance of Ukraine to meet FX obligations in 2019, and thus will support the financial and macroeconomic stability of the country.

The IMF Board of Directors approved the stand-by assistance (SBA) 14-month programme for Ukraine, totalling \$3.9bn. Today, the NBU announced that the first \$1.4bn tranche has already been transferred to Ukraine, which results in the country's FX reserves rising to \$20.1bn.

According to the MoF, the IMF will decide on further tranches in May and November 2019, depending on Ukraine's success in fulfilling the terms of the memorandum.

According to the NBU's statement, the approved programme focuses on the continuation of reforms, the implementation of which has ensured macroeconomic and financial stability in the country in recent years, in particular the inflation targeting regime and the flexible hryvnia exchange rate.

The Memorandum on Economic and Financial Policies, which Ukraine plans to follow during the SBA programme's implementation in 2018-2020, contains eight structural benchmarks (Table 1):

Table 1. Structural benchmarks of Ukraine's cooperation with the IMF on the SBA program

	Structural benchmark	Term of implementation
1	Increase of heating tariffs from January 1, 2019	End of December 2018
2	Changing NBU rules for reducing regulatory capital by volume of loans granted to related parties	End of December 2018
3	Passing the so-called Split law that will revise the distribution of supervision powers on regulating financial intermediaries	End of March 2019
4	Publication of the first report on the progress of asset recovery and litigation processes involving the four state-owned banks	End of March 2019
5	Consolidation of divisions of the State Fiscal Service (SFS) into two separate legal entities, the Tax Service and the Customs Service	End of April 2019
6	Appointment of at least 35 anti-corruption judges by the Supreme Council of Justice to work at the Highest Anticorruption Court	End of April 2019
7	Appropriate supervisory measures of the NBU against banks that do not meet capital requirements	End of June 2019
8	Completion of the external audit of the National Anticorruption Bureau of Ukraine conducted by a group of experts with international experience	End of July 2019

Sources: Ministry of Finance of Ukraine

Last week, the EU allocated the first tranche of EUR500m under the fourth macrofinancial assistance programme. These funds were provided before the IMF decision on the SBA programme and the allocation of the first tranche.

Also, a few hours before the IMF's decision, the World Bank approved a decision to grant Ukraine a \$750m guarantee, which will allow the government to borrow an estimated \$1bn for a period of four to 10 years, with part of the funds planned to be raised this year.

ICU view: Approval of the new IMF programme significantly improves the chances of the Ukraine to pay US\$9.2bn in FX debt in 2019, and thus should support financial and macroeconomic stability in the country. In particular, the program's approval has unlocked financial assistance from the other two key lenders, the EU and the World Bank, which have a working IMF programme as one of their key prerequisites.

Consequently, the EUR500m already transferred by the EU and US\$1bn of loans that the government plans to take under the World Bank's guarantees should be enough for Ukraine to pay off FX obligations until May 2019. If Ukraine receives the second EUR500m tranche of EU assistance next year, the government will secure debt payment financing until September 2019. But by September, which will be one of the months with peak debt payments in 2019, Ukraine will need to look for opportunities to enter external financial markets.

The political uncertainty related to the double elections, as well as the likely unfavourable market conditions make issuing sovereign Eurobonds next year a very challenging task. In the worst case, the government may be forced to seek IMF approval to redirect the next tranche directly to the state budget.

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