



Focus
Ukraine

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

Research team
**Alexander Martynenko
Taras Kotovych
Dmytro Dyachenko**

Weekly Insight

Economy rises 3.3% in 2018

Key messages of the today's comments

Domestic liquidity and bonds market

Foreign investments increase

Foreign investment in Ukrainian domestic debt set a new record high of UAH18.6bn, or UAH4bn more than the same time last year. This week, total investments could decline due to debt repayments despite new purchases.

Liquidity declines

Significant purchases of new bills caused a decline in liquidity, which was not compensated from other sources, such as NBU's FX purchases or budget expenditures. Without purchase of FX by the NBU and with debt repayments being refinanced, liquidity should decline further.

Foreign exchange market

Investments in bonds supported hryvnia

The FX market changed to positive for the hryvnia, which appreciated slightly by 0.5% to UAH26.89/US\$. But this week, volatility may rise, and the hryvnia may weaken to above UAH27/US\$.

Economics

Economy rises 3.3% in 2018

In 2019, the real GDP growth rate is set to slow due to conservative fiscal and tight monetary policies, as well as less favourable external conditions.

Retail trade turnover grew 7.2% YoY in February

Household consumption increased 8.9% in 2018, and it will remain the key driver of economic growth this year thanks to further growth of real incomes.

Industrial production fell 1.8% YoY in February

Solid consumer demand and an increase in the mining industry will support industrial output this year.

TUESDAY, 26 MARCH 2019

Banks' reserves market (25 March 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+100bp
ON rate (%)	16.56	+9bp	+56bp
ON \$ swap (%)	14.31	-28bp	-189bp
Reserves (UAHm) ²	55,333	-0.86	+9.82
DepCerts (UAHm) ³	44,401	-6.78	+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 March 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,107	+0.00	-4.16
Banks	366,796	+0.34	+5.76
Residents	25,977	+0.63	-8.98
Individuals	7,784	+1.59	+263.10
Non-res ⁴	18,168	+24.85	+24.18
Total	755,832	+0.69	+1.61

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

FX market indicators (25 March 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.9250	-1.28	+2.51
EUR/USD	1.1312	-0.35	-8.43
DXY ²	96.566	+0.19	+7.97
UAH TWI ³	120.269	+1.44	+4.19

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

Gov't bond quotes¹ (26 March 2019)

Maturity	Bid	Ask
6m	20.00	18.50
12m	20.00	18.25
2y	19.75	18.00
3y	19.50	17.50
12m (\$)	7.50	5.25
2y (\$)	7.50	5.50

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

Domestic liquidity and bonds market

Foreign investments increase

Foreign investment in Ukrainian domestic debt set a new record high of UAH18.6bn, or UAH4bn more than the same time last year. This week, total investments could decline due to debt repayments despite new purchases.

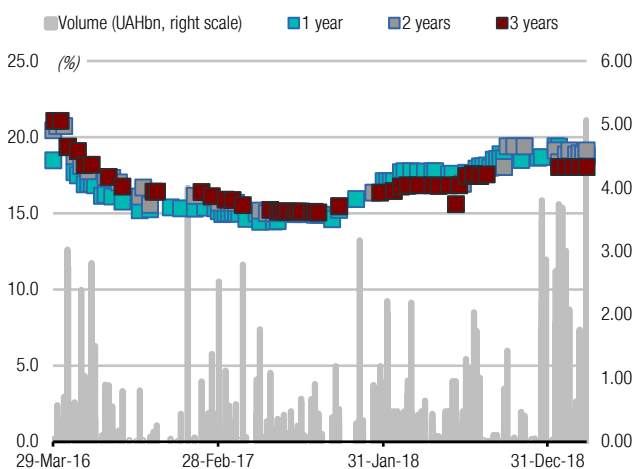
UAH10bn of local-currency bills were sold at last week’s auction, and, according to NBU statistics, UAH4bn was purchased by foreign investors, mostly at primary auctions. Secondary-market turnover was significantly lower, at just about UAH1.7bn. It appears that foreign investors purchased three-month bills and likely part of the two-year bills offered, which were sold at UAH5.1bn and UAH3.4bn respectively.

ICU view: Foreigners once more became active, setting a new record high. This week, nearly UAH6bn in domestic UAH-denominated debt will be repaid, with part likely being paid to foreign investors, decreasing their portfolios. However, new foreign investments in bills are likely this week.

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

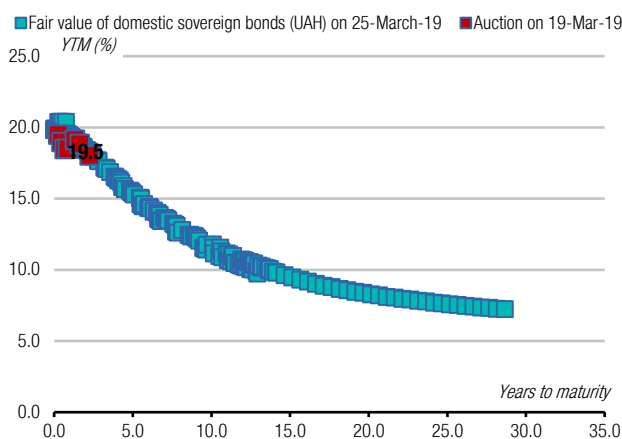
Chart 1. Local-currency bonds

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.

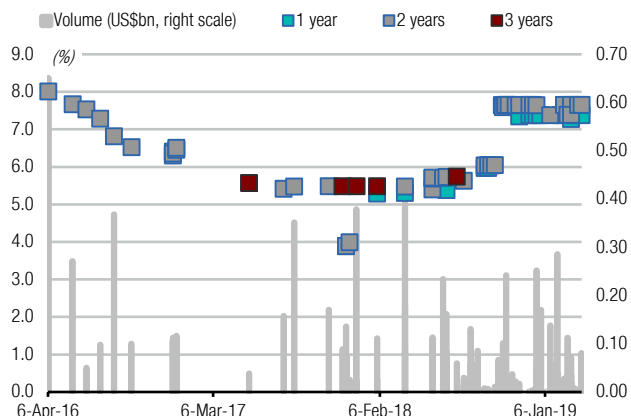
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

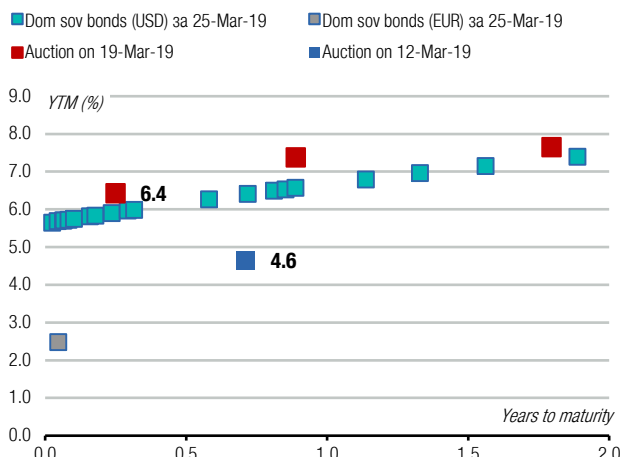
Chart 2. FX-denominated bonds

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 declines

Significant purchases of new bills caused a decline in liquidity, which was not compensated from other sources, such as NBU’s FX purchases or budget expenditures. Without purchase of FX by the NBU and with debt repayments being refinanced, liquidity should decline further.

For the second consecutive week, liquidity declined below UAH100bn, falling to UAH97.6bn last week. The NBU did not intervene in the FX market despite the hryvnia becoming a bit stronger, until a purchase of US\$15m on Friday.

Last week, non-monetary operations caused UAH2.2bn of liquidity outflows. This was primarily due to the purchase of new bills on Wednesday, the settlement day after the auction, when net outflows to treasury accounts were above UAH6bn, and during last week – UAH4.7bn. Absorption of funds by the Treasury was partially compensated by cash exchange in reserves, which amounted to UAH2.3bn.

ICU view: This week, we may see nearly UAH6bn of VAT refunds and UAH6bn of debt repayments. These inflows should support liquidity. At the same time, month-end tax payments are due, and investors could buy new bonds at the auction on Tuesday. So, without new inflows, liquidity could remain below UAH100bn and slightly decline.

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

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

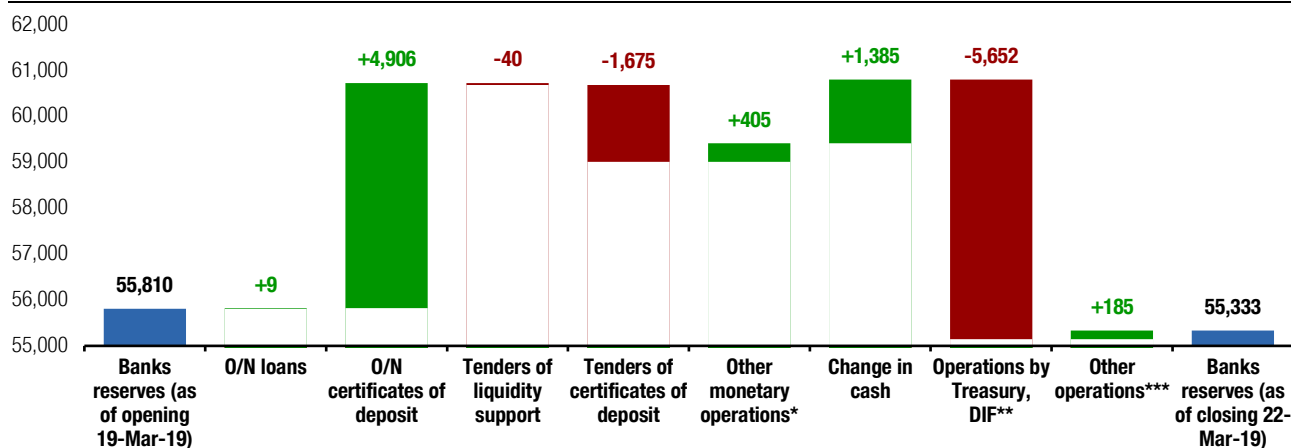
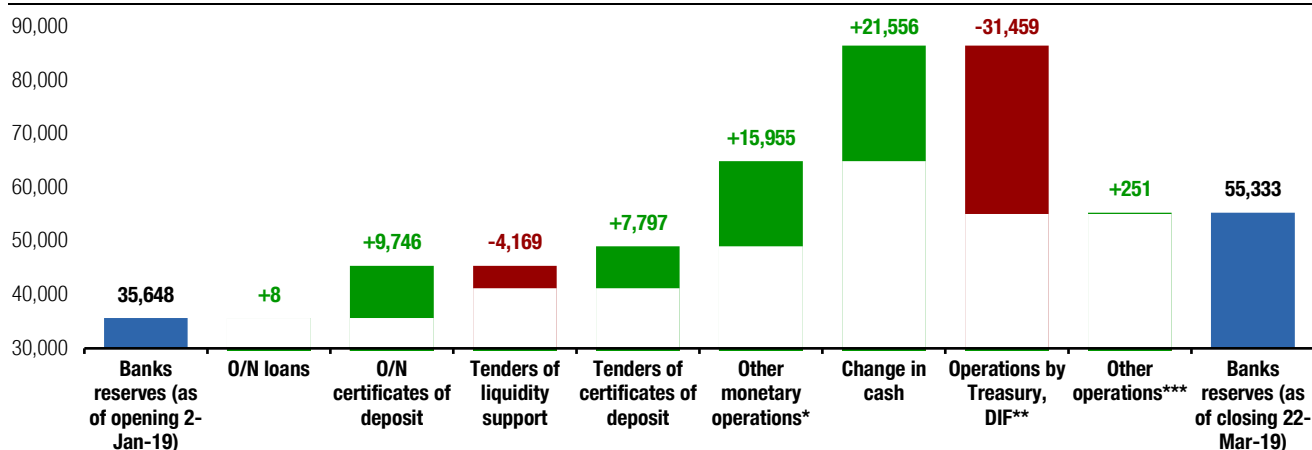


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Investments in government bonds supported hryvnia

The FX market changed to positive for the hryvnia, which appreciated slightly by 0.5% to UAH26.89/US\$. But this week, volatility may rise, and the hryvnia may weaken to above UAH27/US\$.

New foreign investment in domestic debt was the key positive last week, as investors sold FX to buy new bills. This supply likely satisfied all extra demand for FX and avoided negative pressure on the hryvnia, allowing it to move below UAH27/US\$.

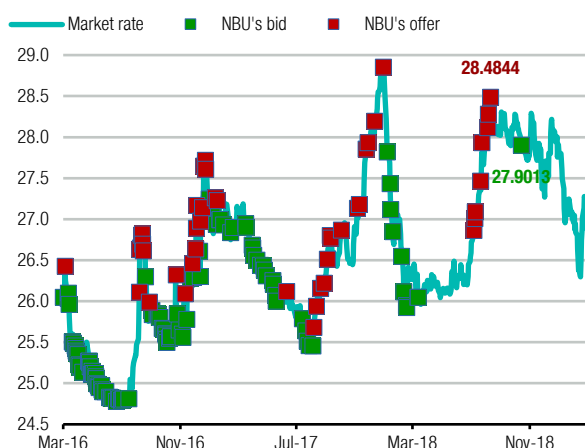
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.7% to 120.9, while in YoY terms, it was up 4.6%.

ICU view: *This week, we expect volatility in the exchange rate. On one hand, we expect liquidity decline, which will cause additional FX supply. But on the other, this week the main portion of VAT refunds should be paid, which will decrease FX supply from exporters. In addition, there are scheduled debt repayments, which may be partially exchanged in FX. As the result, this week, the hryvnia is likely to weaken a bit to above UAH27/US\$, but probably less significantly than last Tuesday.*

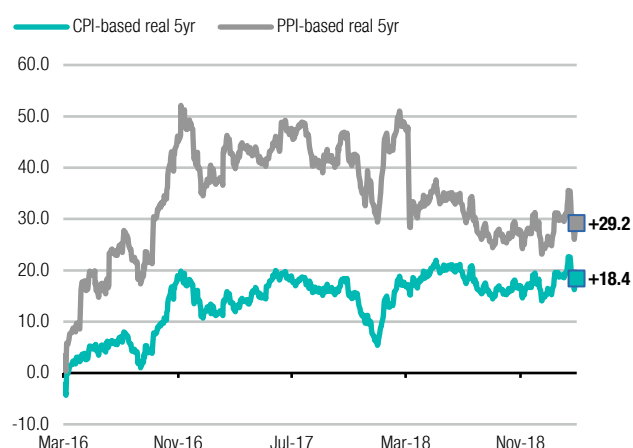
Taras Kotovych, Kyiv, (044) 377-7040 ext.724

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 misalignment¹ from fundamental level² (%)

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

Economics

Economy rises 3.3% in 2018

In 2019, the real GDP growth rate is set to slow due to conservative fiscal and tight monetary policies, as well as less favourable external conditions.

Real GDP growth accelerated to 3.3% in 2018, up from 2.5% seen in 2017, per data from the State Statistics Service of Ukraine. Nominal GDP rose 19.3% to UAH3.56tn, which amounts to US\$131bn, while the deflator was 15.4%. The agency also improved its estimate of 4Q18 real GDP growth by 0.1ppt to a 3.5% YoY growth.

On the supply side, key drivers of real GDP growth in 2018 were agriculture (+7.8%), wholesale and retail trade (+3.7%), and financial and insurance activity (+12.4%). These categories account for almost 50% of total economic growth. The only sectors that posted a decline were education (-1.1%), and health care (-1.7%). On the demand side, growth was driven by household consumption (8.9%), and investments (+14.3%). Real exports declined 1.6%, while real imports rose 3.2%.

ICU view: Our baseline scenario envisages real GDP growth to slow to 2.3% in 2019 due to less favourable external conditions, tight monetary and restrictive fiscal policies, as well as the double elections, which negatively impact business expectations.

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

Retail trade turnover grew 7.2% YoY in February

Household consumption increased 8.9% in 2018, and it will remain the key driver of economic growth this year thanks to further growth of real incomes.

Retail-turnover growth accelerated to 7.2% YoY in February, up from 6.3% YoY in January, bringing the 2M19 growth to 6.8% YoY, per data from the State Statistics Service of Ukraine. By region, the highest growth in retail trade was observed in the Zakarpattya region (+15% YoY), the Kyiv region (+11% YoY), and the Vinnytsya region (+10% YoY).

ICU view: Real wages growth, further increase in remittances, and inflation slowdown will support domestic demand, which will remain the key driver of economic growth this year. In addition, wages' share of nominal GDP increased to 41.5% in 2018, up from 38.9% in 2017, and will continue moving towards the pre-crisis level of 50% in the following years, which is also supportive of consumer demand.

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

Industrial production fell 1.8% YoY in February

Solid consumer demand and an increase in the mining industry will support industrial output this year.

Industrial production contracted for the fourth consecutive month—in February it fell 1.8% YoY after a 3.3% YoY drop in January. In SA terms, industrial output fell 0.6% compared with January. The processing industry fell 2.5% YoY, mainly due to decreased output in the chemical industry (-19.5% YoY), engineering (-4.3% YoY), and metallurgy (-3.7% YoY). The utilities sector contracted 4.9% YoY, and 3.5% MoM SA. The only sector that posted growth was the mining industry (+1.7% YoY, flat MoM SA), where all subcategories increased. In 2M19, industrial production fell 2.5% YoY.

ICU view: Consumer demand, which remains the main driver of Ukraine's economic growth, as well as higher growth rates in the mining industry thanks to expanding gas extraction and higher world prices on iron ore because of the tragedy in Brazil, will support industrial production this year. We maintain our forecast of 1.9% growth in full-year 2019.

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

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
sergij.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.

