



Focus  
**Ukraine**

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

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# Weekly Insight

## Real GDP rises 2.4% YoY in 1Q19 – NBU

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Foreign investors' portfolios rise to UAH36bn

At the last primary auction in April, foreign investors invested an additional UAH6bn in local-currency bills, increasing their portfolios to UAH36.3bn. This week, we expect portfolios to rise further.

##### Liquidity volatile during holidays

During the last week of April, there were significant liquidity outflows, with a decline to UAH93bn. However, the month of May began with liquidity up to UAH110bn, and this week it should stay above UAH100bn.

#### Foreign exchange market

##### Hryvnia stable and strong

At the end of April, the hryvnia appreciated to UAH26.4/US\$, and at the beginning of May, lost only part of these gains. With investments in bills, the current week should allow the hryvnia to stay at around UAH26.4/US\$ with slight volatility.

#### Economics

##### C/A deficit inched down to 3.3% of GDP in March

Lower world energy prices and slower consumer imports growth will support Ukraine's current account balance in 2019.

##### Real GDP rises 2.4% YoY in 1Q19 – NBU

In 2019, Ukraine's real GDP growth will slow to 2.5% due to tight monetary and conservative fiscal policies, as well as less favourable external conditions, per the NBU.

##### NBU lowers key rate to 17.5% and increases FX purchases

The regulator shows optimism by reducing monetary policy and buying more dollars into reserves. We expect it to further decrease rate to 16.0% by the end of 2019.

WEDNESDAY, 8 MAY 2019

#### Banks' reserves market (3 May 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	17.50	+0bp	+50bp
ON rate (%)	16.45	+0bp	+132bp
ON \$ swap (%)	14.30	-79bp	-120bp
Reserves (UAHm) <sup>2</sup>	60,648	+25.70	+27.18
DepCerts (UAHm) <sup>3</sup>	49,608	+2.89	-22.22

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) (3 May 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,089	+0.00	-3.78
Banks	354,221	-1.69	+1.13
Residents	24,540	-7.70	-7.17
Individuals	8,442	-1.32	+227.50
Non-res <sup>4</sup>	35,923	-0.65	+203.52
<b>Total</b>	<b>760,215</b>	<b>-1.10</b>	<b>+2.55</b>

Notes: [1] non-residents

Source: NBU, ICU.

#### FX market indicators (3 May 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.4500	+0.19	+0.88
EUR/USD	1.1198	+0.42	-6.59
DX <sup>2</sup>	97.520	-0.50	+5.53
UAH TWI <sup>3</sup>	123.947	-0.30	+5.59

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

#### Gov't bond quotes<sup>1</sup> (8 May 2019)

Maturity	Bid	Ask
6m	19.00	18.00
12m	19.50	18.00
2y	19.75	18.00
3y	19.25	17.50
12m (\$)	7.50	5.50
2y (\$)	7.50	5.75

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

Source: ICU.

# Domestic liquidity and bonds market

## Foreign investors' portfolios rise to UAH36bn

At the last primary auction in April, foreign investors invested an additional UAH6bn in local-currency bills, increasing their portfolios to UAH36.3bn. This week, we expect portfolios to rise further.

According to our estimates, at the end of April, foreign investors purchased mostly medium-term bills. Short-term bills were a lower share of their portfolios. After last week redemptions of issue sold in January amounted to UAH6.4bn, foreign investors' portfolios slid by UAH0.4bn.

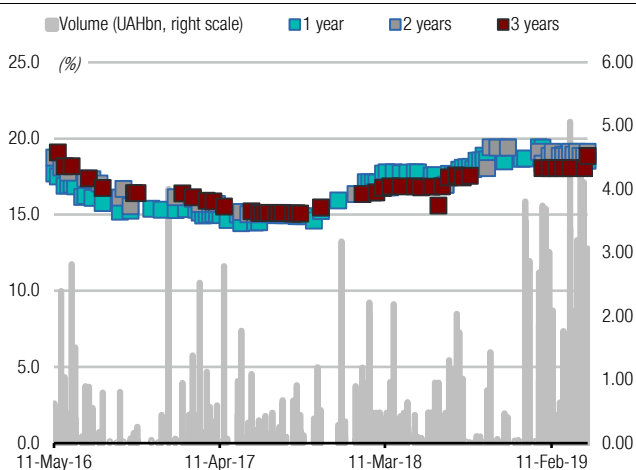
There was break in auctions due to last week's holidays. Yesterday the MoF offered local-currency bills with maturities from four months and up to four years. The shortest bills, those with four-month and six-month maturities, were limited to UAH1.5bn each. With these limits, the MoF is trying to stimulate interest in longer maturities. The Ministry will also try to decrease cut-off rates for these bills.

**ICU view: We expect that demand from foreign investors will continue, despite a possible decline in rates after the key policy rate was cut to 17.5% in April. But rates will decline mostly for short-term bills while for longer maturities, the decline will be slower and less significant.**

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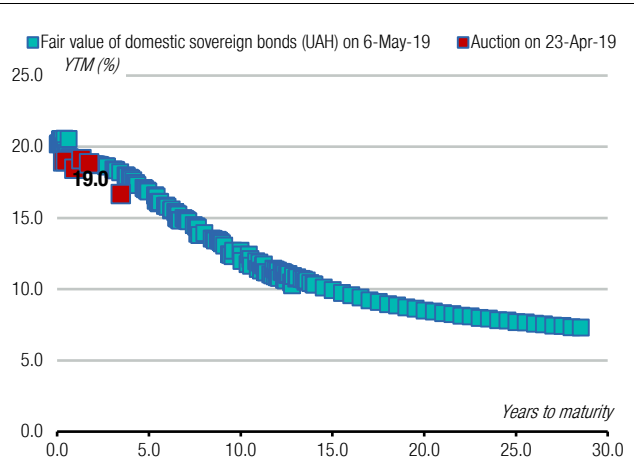
**Chart 1. Local-currency bonds**

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.

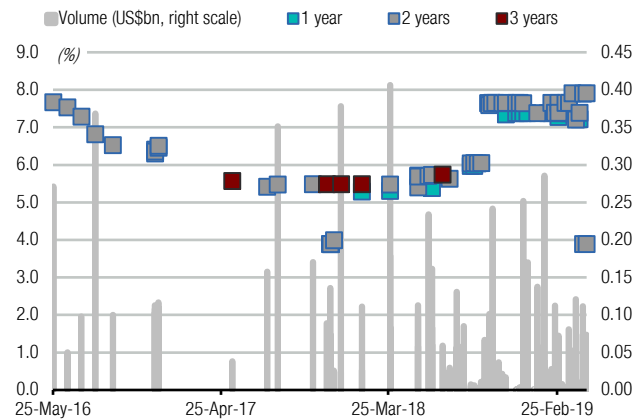
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

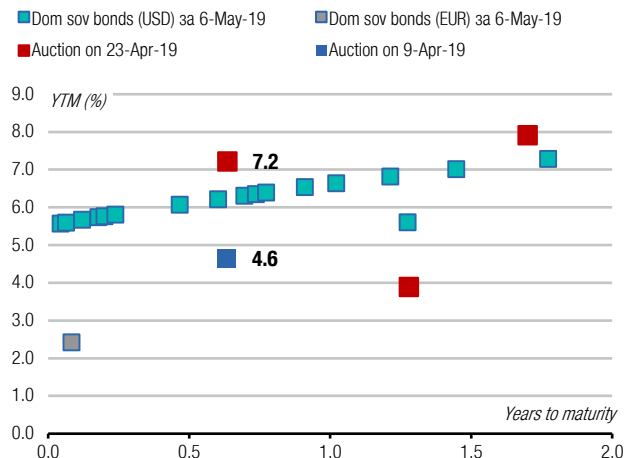
## Chart 2. FX-denominated bonds

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 volatile during holidays

During the last week of April, there were significant liquidity outflows, with a decline to UAH93bn. However, the month of May began with liquidity up to UAH110bn, and this week it should stay above UAH100bn.

Significant needs for cash and tax payments concentrated in one week caused significant fund outflows, while the NBU had low impact on liquidity. During the week, the Treasury absorbed UAH7.6bn, and banks exchanged UAH5.7bn of reserves in cash, to be ready for cash distribution for at least five days during the holidays. At the same time, the NBU purchased low amounts of FX from the market, providing just UAH2.1bn of funds.

The first business days in May changed situation in the banking sector, as cash was mostly exchanged back into reserves. The Treasury made large expenditures, including redemption of bills, which, added together, created UAH12bn of liquidity. But outflows forced banks to turn to the NBU for UAH7bn in loans, which increased liquidity to UAH110.3bn.

**ICU view:** This week, we will see lower volatility in liquidity. The budget has enough funds for expenditures after receiving UAH47.6bn from the NBU as extra revenues from last year, with no large outflows expected. So, this week, we expect that liquidity will stay above UAH100bn despite possible repayments of UAH6bn of loans.

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

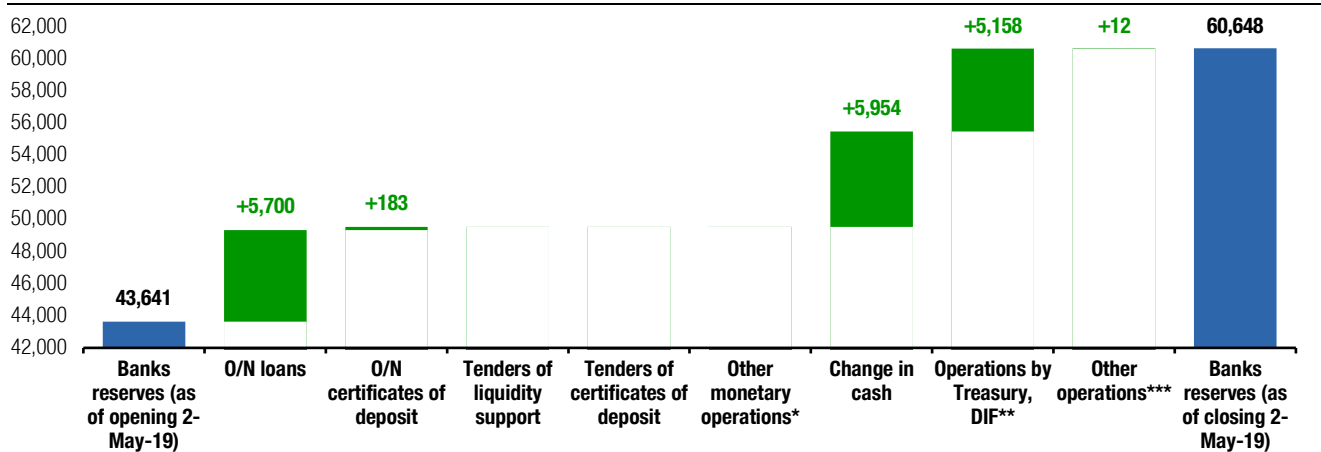
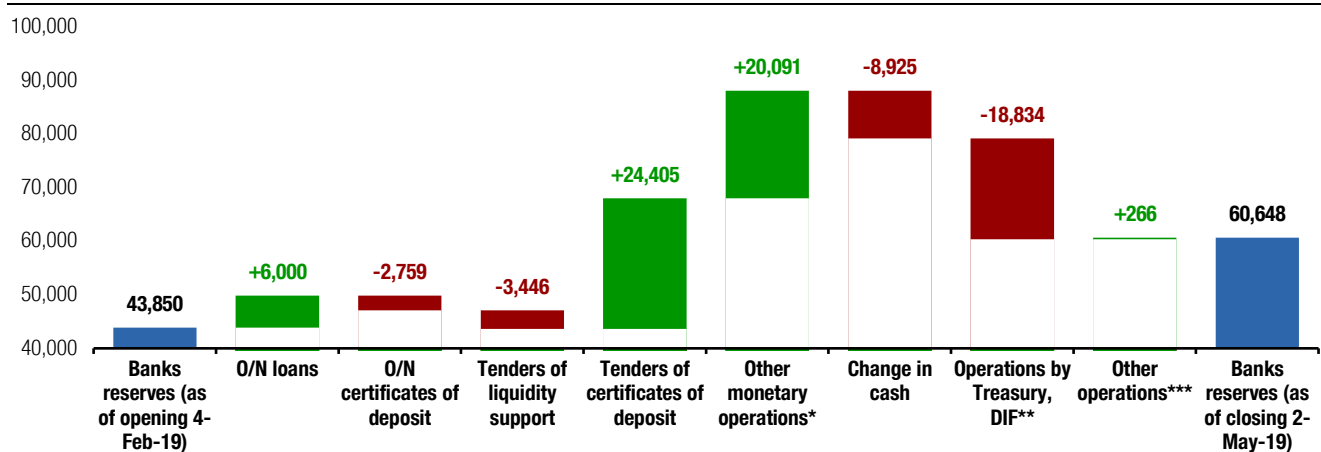


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

### Hryvnia stable and strong

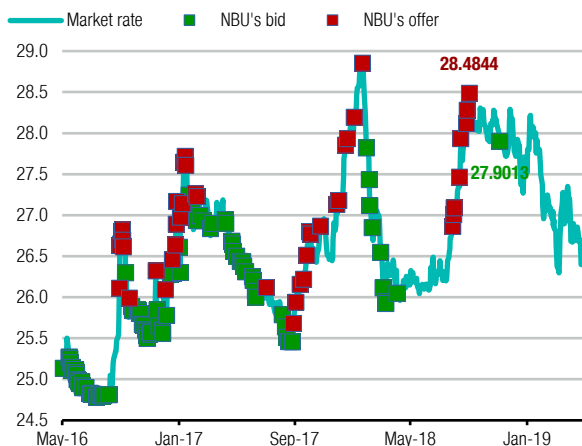
At the end of April, the hryvnia appreciated to UAH26.4/US\$, and at the beginning of May, lost only part of these gains. With investments in bills, the current week should allow the hryvnia to stay at around UAH26.4/US\$ with slight volatility.

Inflow of US\$200m in local-currency bills with a decline in liquidity supported the hryvnia's appreciation through the end of April to UAH26.4/US\$. After bills redemption on 2 May, the hryvnia weakened slightly, just 0.2% to UAH26.45/US\$. Last week, the NBU purchased only US\$20m, which allowed the hryvnia to remain steady with insufficient movements.

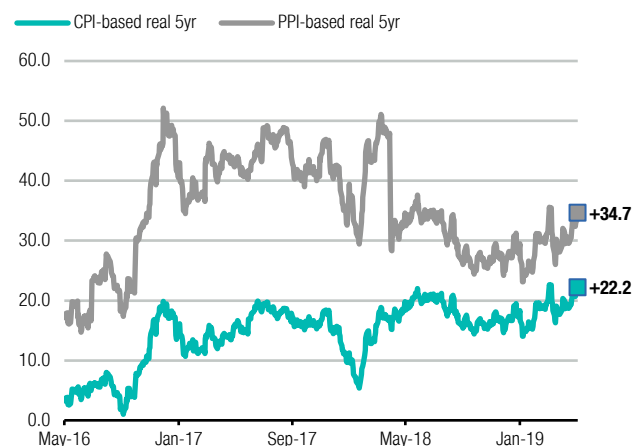
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) declined 0.3% to 123.95, while in YoY terms, it was up 5.6%.

**ICU view:** This week, the key impact will be demand from foreign investors for bills at the primary auction. Quarterly corporate tax payments will start next week, which will force exporters to sell more FX to pay taxes. So, the NBU can increase purchases of FX to prevent the hryvnia from further appreciation.

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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

### C/A deficit inched down to 3.3% of GDP in March

Lower world energy prices and slower consumer imports growth will support Ukraine's current account balance in 2019.

In 1Q19, the C/A deficit amounted to US\$422m (-20% YoY), while in annualized terms, it slightly declined to US\$4.4bn (est. 3.3% of GDP) from US\$4.5bn (3.4% of GDP) as of the end-2018, per data from the NBU. In the three months to March, exports of goods rose 8% YoY and totaled US\$11.3bn. The key growth driver was food products (+23% YoY), accounting for 47% of total exported goods. On the flip-side, metallurgical exports declined 7% YoY, accounting for 24% of total exports. Imports of goods rose 6.8% YoY to US\$13.4bn, driven primarily by machinery and equipment (24% YoY, 31% of total imports). Imports of energy products declined 7% YoY to US\$2.6bn, accounting for 19% of total imports.

In 1Q19, the merchandise-trade-balance deficit was US\$2.1bn (flat YoY), while on a 12-month trailing basis, it rose 23% YoY to US\$12.6bn (est. 9.4% of GDP). The 12-month trailing services-trade-balance surplus rose 35% YoY to US\$1.4bn.

**ICU view: Thanks to lower volumes of energy imports supported by decreased world energy prices (primarily natural gas), a further increase of remittances, slower growth of consumer imports, and further growth of Ukraine's economy, the C/A deficit will contract to 3.3% of GDP in 2019 (US\$4.8bn), down from 3.4% of GDP in 2018 (US\$4.5bn).**

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### Real GDP rises 2.4% YoY in 1Q19 – NBU

In 2019, Ukraine's real GDP growth will slow to 2.5% due to tight monetary and conservative fiscal policies, as well as less favourable external conditions, per the NBU.

The National Bank of Ukraine estimates real GDP growth at 2.4% YoY in 1Q19, down from 3.5% YoY in 4Q18. The slowdown was due to 1) slower growth rates in agriculture because of the vanishing effect of a record harvest in 2018, and 2) weak industrial production

performance mostly due to weak energy output, and, to a lesser extent, maintenance works at large chemical and metallurgical plants. The growth drivers remained consumer demand against the backdrop of further growth in real incomes of households, and solid investment activity. The NBU confirmed its 2019 inflation forecast of 6.3% by YE2019, but worsened its C/A deficit forecast to US\$4.9bn from US\$4.5bn earlier.

**ICU view: Our 1Q19 real GDP estimate of 2.6% YoY growth is slightly higher than the NBU's, but the slowdown drivers (lower contribution from agriculture and weak industrial production) and growth drivers (consumer demand and solid investment activity) are the same. In addition, we estimate that higher export growth rates (+7.8% in 1Q19 in nominal terms) compared with those of imports (+7.3% in 1Q19 in nominal terms) also had a positive impact on real GDP growth. All in all, the NBU's forecasts for 2019 are more optimistic compared with our expectations: real GDP growth at 2.3%, CPI at 8.5%, and a C/A deficit of US\$4.8bn (3.3% of GDP).**

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### **NBU lowers key rate to 17.5% and increases FX purchases**

The regulator shows optimism by reducing monetary policy and buying more dollars into reserves. We expect it to further decrease rate to 16.0% by the end of 2019.

The NBU started the new cycle of key rate decreases by lowering it from 18.0% where it stood since September 2018. This is the first rate cut in almost two years. Subsequently, the regulator announced that daily FX purchases will increase from \$15m to \$20m. This was the second increase this year after February's increase from \$10m. The net YTD FX increase amounts to \$0.9bn, down 13% from a year ago.

**ICU view: The NBU clearly has a positive view on the key rate being lower than it was at the beginning of the year, which allowed it to slightly relax monetary policy and boost net FX purchases. However, our base-case scenario assumes that cooperation with the IMF continues, along with the absence of major external shocks. In case of successful negotiation on the new tranche and continuing decline of the CPI, the NBU is likely to cut the rate again during June meeting (-50 bps) eventually lowering it to 16.0% by the end of the year.**

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