



Focus
Ukraine

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

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Weekly Insight

Real GDP growth slowed

Key messages of the today's comments

Domestic liquidity and bonds market

Market takes a break

The primary bond market took a break after high activity in April and the beginning of May. Purchases of new bonds declined to the amount of debt repayments. We expect a new wave of activity in June prior to the key policy rate review and before large debt repayments begin.

Liquidity under pressure from tax payments

Last week, liquidity fell to UAH99.1bn, below UAH100bn as we expected. However, this week's tax payments will cause a further decline in liquidity.

Foreign exchange market

FX supply tightened

The hryvnia weakened after the supply of FX from foreign investors declined. Without an increase of supply from exporters to finance tax payments, the hryvnia weakened by 0.7%.

Economics

Real GDP growth slowed to 2.2% YoY in 1Q19

Slower-than-expected growth rate of Ukraine's economy in 1Q19 confirms our expectations about the slowdown of real GDP growth to 2.3% in full-year 2019.

TUESDAY, 21 MAY 2019

Banks' reserves market (20 May 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	17.50	+0bp	+50bp
ON rate (%)	16.03	-16bp	-47bp
ON \$ swap (%)	14.28	-5bp	-214bp
Reserves (UAHm) ²	54,972	-2.10	+46.12
DepCerts (UAHm) ³	44,169	-19.68	+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) (20 May 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,088	+0.00	-3.78
Banks	361,165	+0.60	+3.73
Residents	25,179	+0.52	-1.21
Individuals	9,041	+2.47	+243.16
Non-res ⁴	39,702	+1.28	+254.75
Total	772,176	+0.39	+4.66

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

FX market indicators (20 May 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.1900	-0.61	+0.23
EUR/USD	1.1165	-0.35	-5.16
DX ²	97.938	+0.42	+4.59
UAH TWI ³	125.586	+0.66	+5.47

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

Gov't bond quotes¹ (21 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.
Source: ICU.

Domestic liquidity and bonds market

Market takes a break

The primary bond market took a break after high activity in April and the beginning of May. Purchases of new bonds declined to the amount of debt repayments. We expect a new wave of activity in June prior to the key policy rate review and before large debt repayments begin.

Demand for local-currency bills fell to UAH2.7bn last week, a quarter of the amount raised the week before. The MoF was not able to decrease rates any further, and kept the cut-off rates unchanged. More details in the auction [review](#).

Foreign investors' purchases had the greatest impact on demand. In previous weeks, they purchased UAH3-5bn of paper per week, but last week, they increased portfolios by only UAH0.5bn. Last week's auction had insufficient impact on bondholders' portfolios, as new issues covered redemptions.

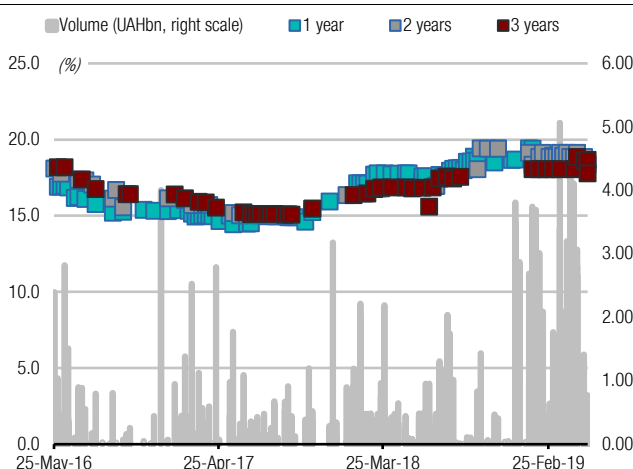
The largest increase last week was in banks' portfolios, at UAH2.4bn. Individual's portfolios rose by UAH110m, and foreign investors increased holdings by UAH0.5bn. Portfolios of domestic investors rose due to purchases of FX bills, and their repricing was due to the hryvnia weakening.

ICU view: The next review of the key policy rate is scheduled for 6 June, and after this date large debt repayments (above UAH15bn in June and more than UAH17bn in July) start. So, the market will become more active at the beginning of June. Key points to watch are: expectations for a cut in the key policy rate, and reinvestments of debt repayments in new bills. The wildcard will be foreign investors' reaction to hryvnia exchange rate.

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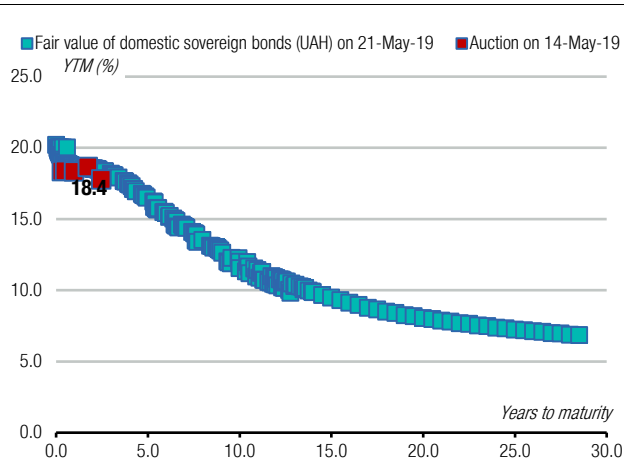
Chart 1. Local-currency bonds

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.

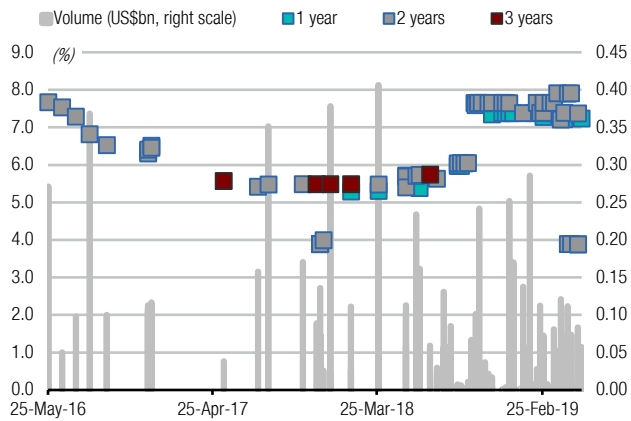
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

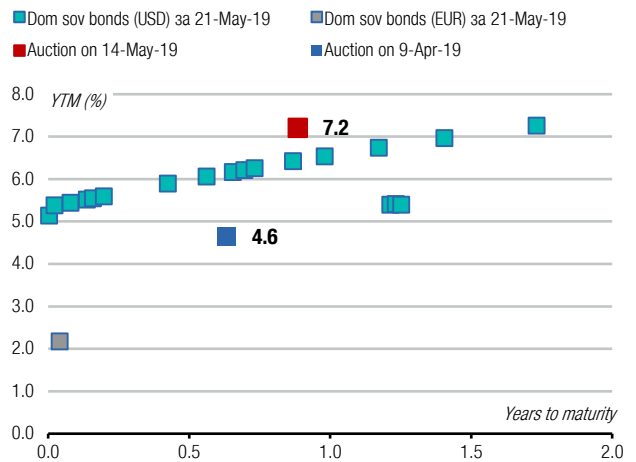
Chart 2. FX-denominated bonds

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 under pressure from tax payments

Last week, liquidity fell to UAH99.1bn, below UAH100bn as we expected. However, this week's tax payments will cause a further decline in liquidity.

Lower demand for UAH-denominated bills, which only covered reinvestment of debt repayments, caused a positive balance of Treasury operations through Wednesday. But daily increases in corporate tax payments brought about a decline, and by the end the week, the net impact of Treasury operations was negative, amounting to UAH11.4bn of outflows. Additional outflows caused reserves exchange in cash at UAH2bn. The NBU provided banks with just UAH0.6bn purchased US\$22m at the FX market.

ICU view: This week, we do not expect significant inflows from NBU via the FX market. As the result, liquidity will be slightly below UAH100bn with possible support from banks, which could start to exchange cash into reserves.

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

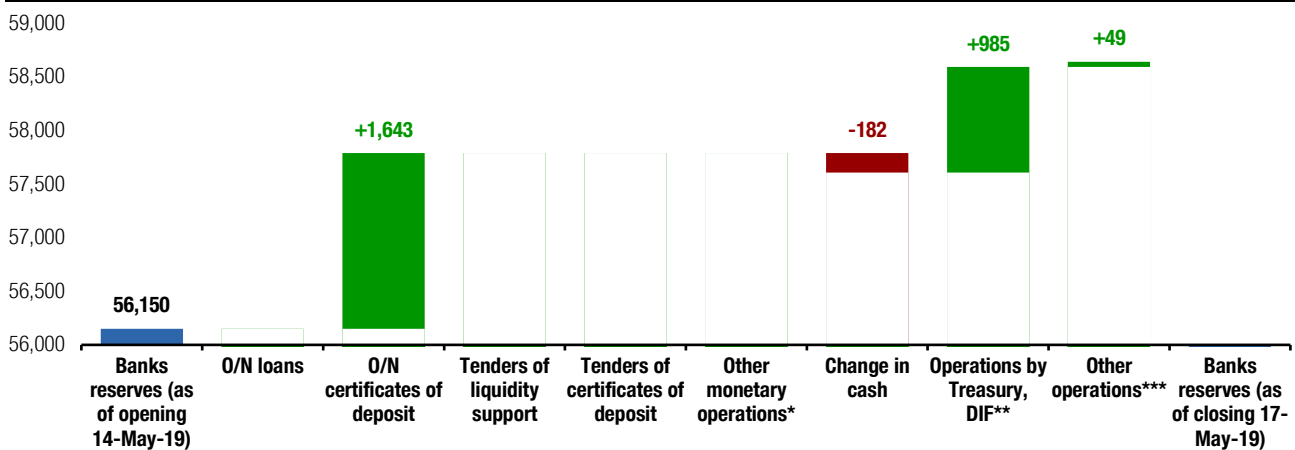
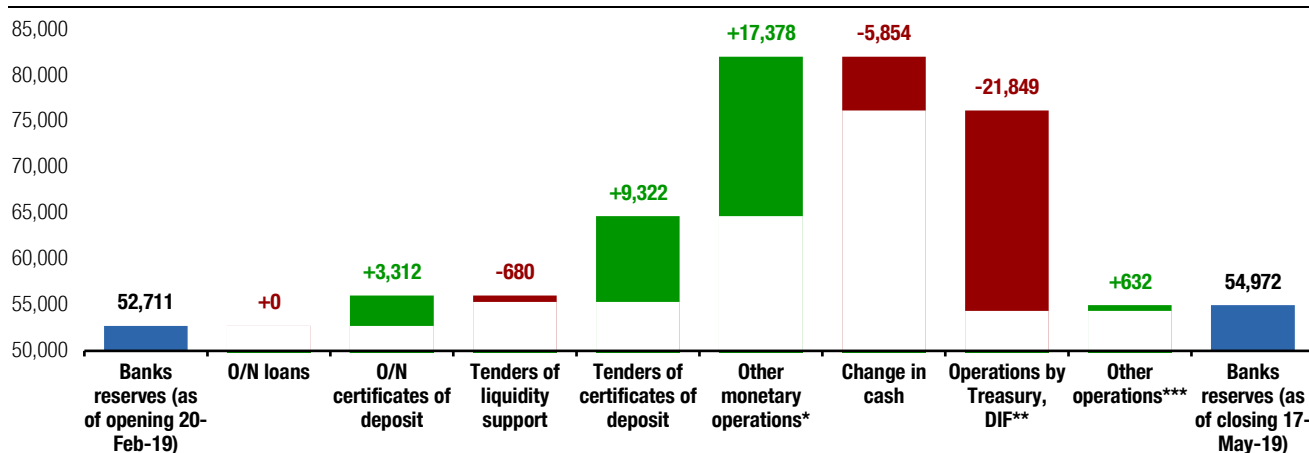


Chart 4. Banks reserves usages over last 90-day period (UAHm)


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

FX supply tightened

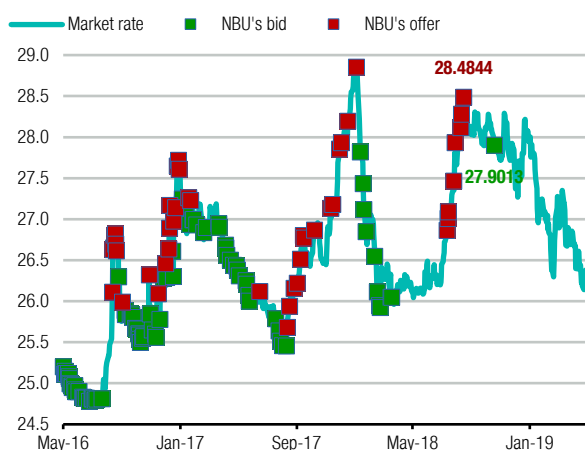
The hryvnia weakened after the supply of FX from foreign investors declined. Without an increase of supply from exporters to finance tax payments, the hryvnia weakened by 0.7%.

The hryvnia appreciated at the beginning of last week to UAH26.14/US\$, but by the end of the week, it weakened to UAH26.38/US\$. The balance moved to the demand side as a result of lower demand for local-currency bills from foreign investors (see comment above), which was six-fold lower than the week before. The supply of FX could receive support from exporters who will sell FX to raise local currency funds for tax payments. Last week only a portion of taxes were paid. The remainder will be transferred this week, likely with selling more FX.

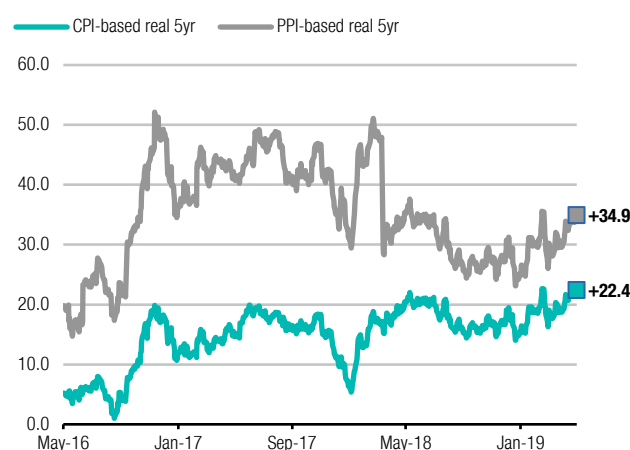
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) declined 0.3% to 124.9, while in YoY terms, it was up 5.3%.

ICU view: The hryvnia is now stable, where it could remain without large demand for local-currency debt from foreigners. This week the hryvnia started with appreciation, but later will likely trade in the range of UAH26.3-26.6/US\$. We do not expect further appreciation any time soon.

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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 growth slowed to 2.2% YoY in 1Q19

Slower-than-expected growth rate of Ukraine's economy in 1Q19 confirms our expectations about the slowdown of real GDP growth to 2.3% in full-year 2019.

In 1Q19, real GDP growth slowed to 0.2% QoQ SA and 2.2% YoY, down from 3.5% YoY growth in 4Q18, per preliminary estimate from the State Statistics Service of Ukraine. We estimate that robust domestic demand remained the key driver of economic growth (retail sales rose 7.4% YoY) thanks to rising real disposable income of households (real wages grew est. 10.9% YoY). In addition, investment activity remained firm as evidenced by the substantial growth of construction (+24.3% YoY) and a 8.7% YoY increase in imports of machinery and equipment in nominal terms.

On the flip-side, the slowdown was due to 1) slower growth rates in agriculture (+3.4% YoY) because of the vanishing effect of a record harvest in 2019, and 2) weak industrial production performance (-0.9% YoY) mostly due to weak energy output, and, to a lesser extent, maintenance works at large chemical and metallurgical plants.

ICU view: Slowdown of real GDP growth was widely expected, but turned out to be less than our forecast (+2.6% YoY), Bloomberg and Thompson Reuters consensus-forecasts (+2.6% YoY), as well as the NBU's estimate (+2.4% YoY). This confirms our view that Ukraine's economic growth will slow to 2.3% in full-year 2019 due to tight monetary and conservative fiscal policy, less favourable external conditions, and uncertainty due to double elections this year.

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