

Weekly Insight

Real GDP rises 2.5% YoY in 1Q19

Key messages of the today's comments

TUESDAY, 25 JUNE 2019

Domestic liquidity and bonds market

Waiting for new long-term offerings

Last week, foreign investors increased their bond portfolios by UAH2.4bn (US\$90m) to UAH51.2bn (US\$1.95bn), purchasing both UAH and EUR-denominated paper. This week, we anticipate mostly local-currency investments.

Liquidity above UAH100bn

Banking-sector liquidity was above UAH100bn for the entire week, and received support from the budget and NBU. This week liquidity can rise further due to VAT refunds.

Foreign exchange market

Hryvnia continued appreciation

Thanks to the inflow of FX from foreign investors to purchase local-currency debt, the hryvnia strengthened by 0.95% to UAH26.19/US\$, just UAH0.07 weaker than the strongest level seen this year a month ago. This week, the hryvnia may weaken slightly to the range of UAH26.3–26.5/US\$.

Economics

The Constitutional Court confirmed the legality of early dissolution of Parliament

The Constitutional Court confirmed compliance with the constitution of the Decree on the dissolution of Parliament and early elections on 21 July. The court's decision increases Ukraine's chances of reaching an agreement with the IMF and obtaining financial resources from the Fund and other lenders in 2019.

Real GDP rises 2.5% YoY in 1Q19

The State Statistics Service of Ukraine revised upward its estimate of real GDP growth to 2.5% YoY, up from its previous estimate of 2.2% YoY growth. In SA QoQ terms, the economy grew 0.3%.

Retail trade turnover rises 8.2% YoY in May

Thanks to further growth of real incomes, household consumption will remain the key growth driver of Ukraine's economy in this and in coming years.

Banks' reserves market (24 June 2019)

| | Last | Weekly chg (%) | YoY chg (%) |
|------------------------------|--------|----------------|-------------|
| NBU rate (%) ¹ | 17.50 | +0bp | +50bp |
| ON rate (%) | 16.09 | -23bp | -11bp |
| ON \$ swap (%) | 14.50 | -6bp | +0bp |
| Reserves (UAHm) ² | 57,357 | -10.39 | +11.90 |
| DepCerts (UAHm) ³ | 45,321 | +21.38 | -31.64 |

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) (24 June 2019)

| | Last | Weekly chg (%) | YoY chg (%) |
|----------------------|----------------|----------------|--------------|
| NBU | 337,088 | +0.00 | -3.78 |
| Banks | 351,464 | -1.59 | -1.75 |
| Residents | 23,958 | -4.44 | +1.65 |
| Individuals | 8,885 | -6.18 | +177.69 |
| Non-res ⁴ | 51,228 | +4.60 | +404.10 |
| Total | 772,623 | -0.66 | +3.71 |

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

FX market indicators (24 June 2019)

| | Last | Weekly chg (%) | YTD chg (%) |
|----------------------|---------|----------------|-------------|
| USD/UAH | 26.1825 | -0.68 | -0.20 |
| EUR/USD | 1.1399 | +1.83 | -2.16 |
| DXY ² | 95.980 | -1.70 | +1.54 |
| UAH TWI ³ | 123.001 | -0.71 | +2.83 |

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

Gov't bond quotes¹ (25 June 2019)

| Maturity | Bid | Ask |
|----------|-------|-------|
| 6m | 18.75 | 18.00 |
| 12m | 19.25 | 18.00 |
| 2y | 19.00 | 18.00 |
| 3y | 19.00 | 17.00 |
| 12m (\$) | 7.50 | 6.00 |
| 2y (\$) | 7.90 | 6.50 |

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

Domestic liquidity and bonds market

Waiting for new long-term offerings

Last week, foreign investors increased their bond portfolios by UAH2.4bn (US\$90m) to UAH51.2bn (US\$1.95bn), purchasing both UAH and EUR-denominated paper. This week, we anticipate mostly local-currency investments.

After redeeming the equivalent of UAH0.6bn (US\$23m) in USD-denominated bills from their portfolios, foreign investors purchased bills in euro in the amount of EUR50m or UAH1.5bn equivalent. With investments in local-currency bills at UAH1.5bn (US\$57m) portfolios rose to UAH51.2bn. Foreigners' share in total domestic bonds outstanding rose to 6.6%.

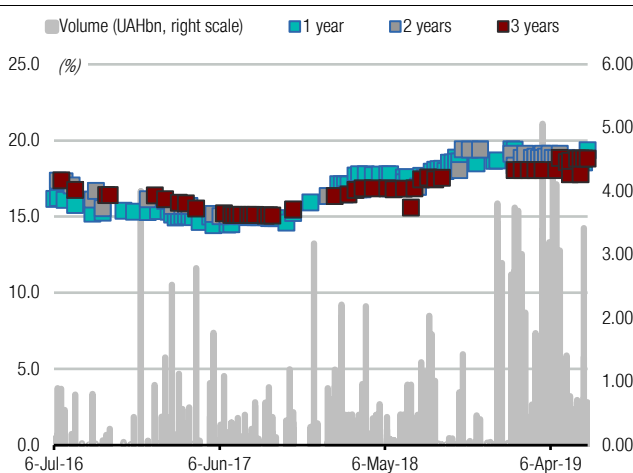
At today's auction, the largest demand came in for the six-year note, which also drew heavy interest two weeks ago (our estimate is UAH2.5bn). We anticipate concentration of demand from foreign investors in this maturity to continue, including large demand for three-year notes as well.

ICU view: Taking into account the offered maturities, this week, demand will likely be concentrated in local-currency instruments, with an increase in foreign investors' portfolios. We estimate that their portfolios will exceed US\$2bn this week.

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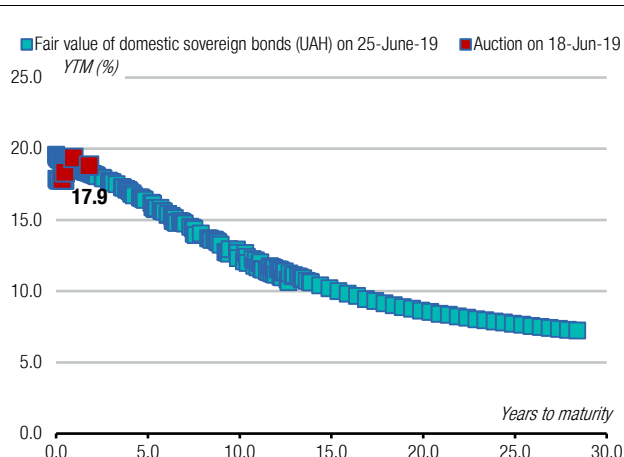
Chart 1. Local-currency bonds

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.

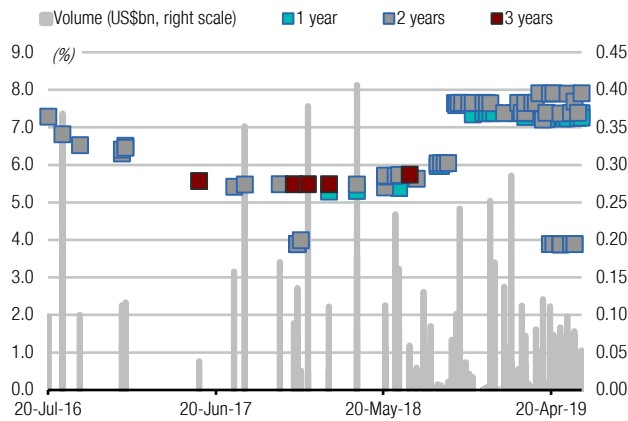
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

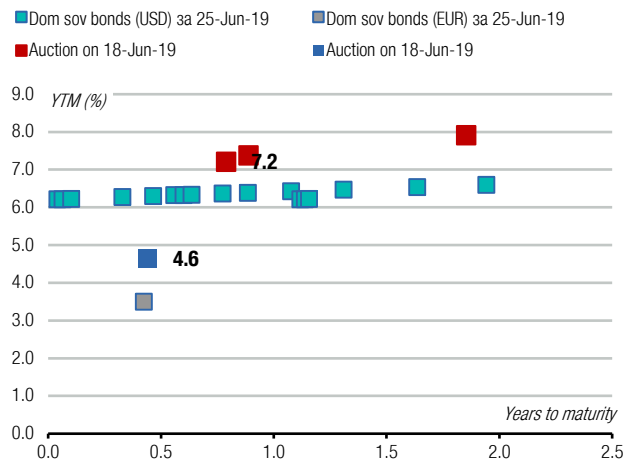
Chart 2. FX-denominated bonds

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 above UAH100bn

Banking-sector liquidity was above UAH100bn for the entire week, and received support from the budget and NBU. This week liquidity can rise further due to VAT refunds.

Treasury expenditures exceeded collected revenues by UAH6.1bn, which provided the main support for liquidity. Additionally, the NBU provided UAH1.1bn through FX purchases. These two factors provided enough funds to keep liquidity steady above UAH100bn.

ICU view: This week, the Treasury will continue to support liquidity, increasing VAT refunds. By the end of last week, only UAH3bn was paid in refunds, while the monthly amount usually exceeds UAH10bn. So, we anticipate liquidity will stay above UAH100bn.

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

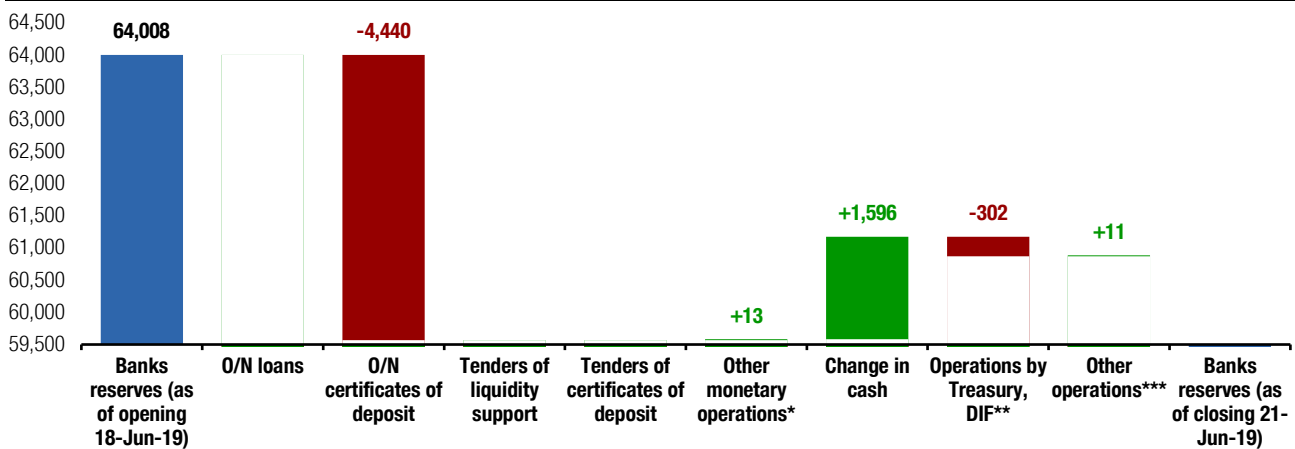
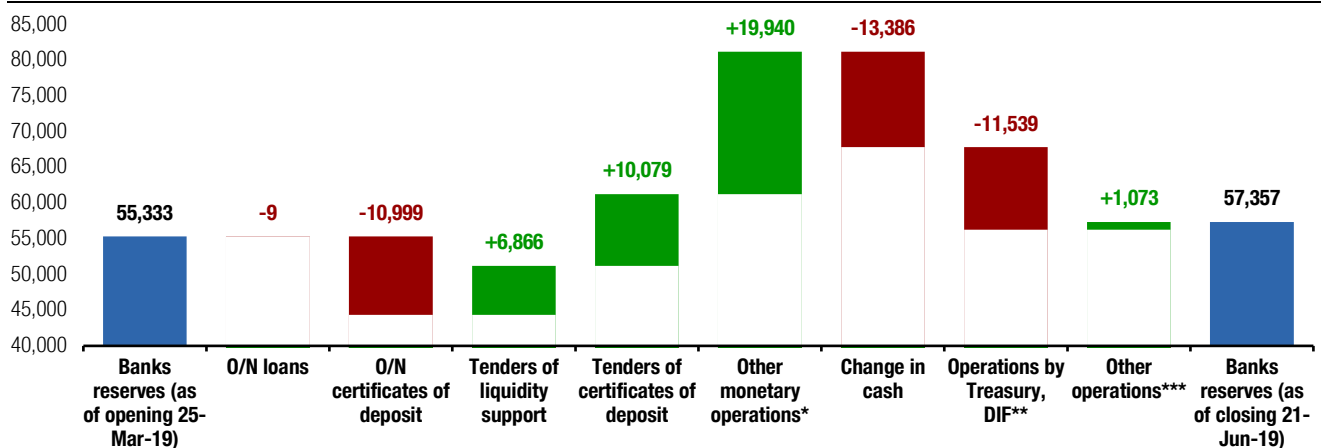


Chart 4. Banks reserves usages over last 90-day period (UAHm)


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 continued appreciation

Thanks to the inflow of FX from foreign investors to purchase local-currency debt, the hryvnia strengthened by 0.95% to UAH26.19/US\$, just UAH0.07 weaker than the strongest level seen this year a month ago. This week, the hryvnia may weaken slightly to the range of UAH26.3–26.5/US\$.

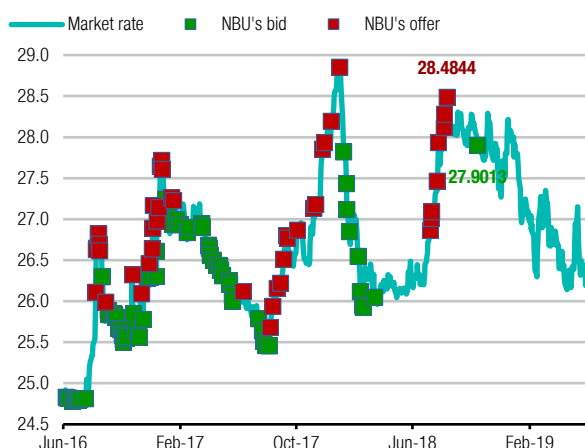
Last week, foreign investors purchased the new local-currency bills offered (see comment above). To pay for them, they had to sell FX, which forced the NBU to buy US\$40.5m of FX. The extra supply of FX continued to provide support for the hryvnia, while the NBU's activity decreased the impact.

ICU view: *This week may be less positive for hryvnia, due large VAT refunds (UAH7bn expected for the week), and likely a lower supply of FX from foreign investors, as they can reinvest debt repayments with a low amount of new investments. As a result, hryvnia could weaken to the range of UAH26.3–26.5/US\$.*

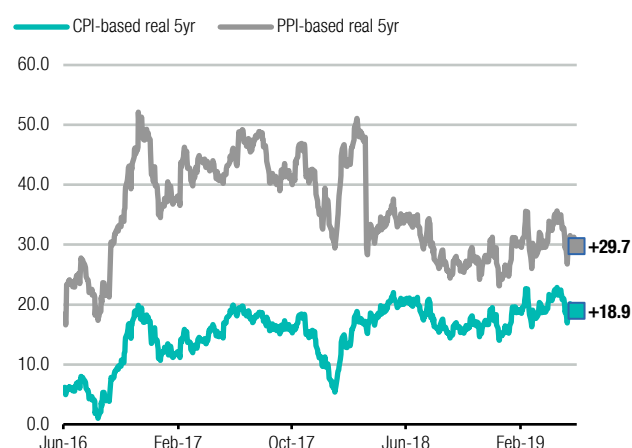
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Chart 5. FX market indicators, 3-year history

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

The Constitutional Court confirmed the legality of early dissolution of Parliament

The Constitutional Court confirmed compliance with the Constitution of the Decree on the dissolution of Parliament and early elections on 21 July. The court's decision increases Ukraine's chances of reaching an agreement with the IMF and obtaining financial resources from the Fund and other lenders in 2019.

The Presidential decree issued on 21 May to dissolve parliament, and the announcement of snap elections on 21 July was appealed in the constitutional court by a group of 62 members of Parliament. On the 10th day of the proceeding, the court made its decision that the decree is legal and elections will take place on 21 July. According to the court decision, the constitutional conflict between president and parliament regarding dissolution of parliament does not have a legal solution, and should be solved by the Ukrainian people through elections in July.

ICU view: Our base-case scenario is that snap elections in July should provide the ability to create a new coalition by the end of August or in September, and a new government can be appointed in September or October. This should allow enough time to pass the new budget for 2020 and to reach an agreement with the IMF about a new programme, and obtain the first tranche from Fund by the end of this year.

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Real GDP rises 2.5% YoY in 1Q19

The State Statistics Service of Ukraine revised upward its estimate of real GDP growth to 2.5% YoY, up from its previous estimate of 2.2% YoY growth. In SA QoQ terms, the economy grew 0.3%.

The main growth drivers remain household consumption (+10.7% YoY) and investments (+17.4% YoY), while government consumption plunged 8.3% YoY. By economic activity, the

highest growth rates were in construction (+26.8% YoY) and health care (+6.6% YoY). Nominal GDP amounted to UAH807.8bn, while the GDP deflator was 11.7% YoY.

ICU view: *The revised estimate is close to our estimate of 2.6% YoY growth. As we expected, besides solid household consumption and investment activity, some positive impact on real GDP growth came from higher growth rates of exports (+6.8% YoY) compared with imports (+6.5% YoY), which meant a less negative contribution from net exports. The slowdown from 3.5% YoY growth in 4Q18 was attributed to a decrease in industrial production and the vanishing effect of the record harvest of late crops in 2018. It should also be mentioned that government consumption declined four out of the five last quarters in YoY terms. A 8.3% YoY decrease in 1Q19 was the highest since 2011, which is due to high debt payments in 2019, and lower-than-planned budget revenues in 1Q19 (95% from the plan).*

Given solid performance of the real sectors of economy in April–May, high investment demand, and the highest consumer confidence since 2013 (per data from Info Sapiens), we expect real GDP growth to accelerate to 2.8% YoY in 2Q19. At the same time, higher-than-expected consumer and investment demand and expected record harvest in 2019 pose upside risks to our full-year 2019 real GDP forecast, which we currently retain at 2.3%.

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Retail trade turnover rises 8.2% YoY in May

Thanks to further growth of real incomes, household consumption will remain the key growth driver of Ukraine's economy in this and in coming years.

Retail-turnover growth slowed to 8.2% YoY in May, down from 9.1% YoY in April, the highest growth rate since January 2018 (+9.6% YoY), per data from the State Statistics Service of Ukraine. In 5M19, growth was 9.6% YoY. By region, the highest growth in retail trade was observed in the Vinnytsya region (+18% YoY) and the Cherkasy region (+16% YoY).

ICU view: *Consumer demand was the main driver of real GDP growth in 1Q19 (see the previous comment), and will continue to support economic growth in 2019 and 2020 thanks to solid growth in real household income against the backdrop of rising real wages (+11% YoY in 4M19, ICU estimate), a 9.6% YTD increase in the average pension payment in nominal terms (to UAH2,899), and further growth of remittances.*

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