

# Weekly Insight

## Economic growth accelerates in 2Q19

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Domestic bonds outstanding rose to UAH790bn

After last week's primary auction, total bonds outstanding rose to UAH790bn, mostly due to bond purchases by foreign investors. We expect that their participation in the market will continue to increase.

##### Liquidity steady below UAH100bn

Due to Naftogaz of Ukraine's dividend payments to the state budget, liquidity declined below UAH100bn where it remained at the end of last week. This week, liquidity can return above UAH100bn due to FX purchases by the NBU.

#### Foreign exchange market

##### Record-breaking hryvnia appreciation

Last week, the hryvnia appreciated to UAH25.38/US\$ due to increased FX inflows from foreign investors into domestic debt. This week, it should continue to move forward to the level of UAH25/USD.

#### Economics

##### Economic growth accelerates in 2Q19

Significant growth of retail sales (+14% YoY) and agriculture (+12% YoY) in June as well as overall better performance of real sectors of economy in April-June point to an acceleration of economic growth in 2Q19.

TUESDAY, 30 JULY 2019

#### Banks' reserves market (29 July 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	17.00	+0bp	-50bp
ON rate (%)	15.70	+6bp	-100bp
ON \$ swap (%)	13.89	-7bp	-223bp
Reserves (UAHm) <sup>2</sup>	52,960	+4.25	+3.44
DepCerts (UAHm) <sup>3</sup>	46,469	+2.79	+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) (29 July 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,086	+0.00	-3.78
Banks	343,513	+0.01	-3.79
Residents	25,919	+2.54	+17.11
Individuals	9,425	+1.53	+140.57
Non-res <sup>4</sup>	74,026	+7.15	+744.55
<b>Total</b>	<b>789,967</b>	<b>+0.73</b>	<b>+6.44</b>

Notes: [1] non-residents

Source: NBU, ICU.

#### FX market indicators (29 July 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	25.2250	-1.75	-5.63
EUR/USD	1.1145	-0.06	-4.39
DX <sup>2</sup>	98.044	+0.35	+3.57
UAH TWI <sup>3</sup>	129.138	+1.93	+9.39

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

#### Gov't bond quotes<sup>1</sup> (30 July 2019)

Maturity	Bid	Ask
6m	18.00	16.50
12m	18.50	17.00
2y	18.50	17.00
3y	18.00	16.50
12m (\$)	6.75	5.25
2y (\$)	7.25	5.85

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

Source: ICU.

# Domestic liquidity and bonds market

## Domestic bonds outstanding rose to UAH790bn

After last week’s primary auction, total bonds outstanding rose to UAH790bn, mostly due to bond purchases by foreign investors. We expect that their participation in the market will continue to increase.

As a result of the [auction](#), total bonds outstanding rose to UAH790.3bn, but by the end of last week, this amount declined by UAH334m when FX-denominated paper was revalued due to hryvnia appreciation.

However, not all classes of investors increased their bond portfolios. Banks’ portfolios declined due to the revaluation of FX-denominated instruments. The amount of UAH-denominated paper in banks’ portfolios increased, but due to the stronger hryvnia, portfolios declined to UAH343.5bn or 43.5% of total bonds outstanding due to the revaluation of FX-denominated paper.

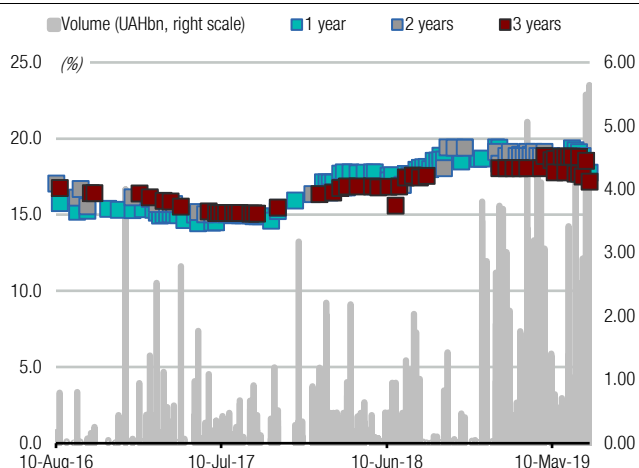
Other investors’ portfolios did not react as much to exchange-rate movements, and rose slightly. Non-banks increased portfolios to UAH25.9bn (3.3% of bonds outstanding), individuals’ portfolios were up to UAH9.4bn (1.2%). The largest increase was in foreign investors’ portfolios, as they purchased an additional UAH4.9bn of bills last week and increased portfolios to UAH74bn. Their share of total bonds outstanding increased to 9.4%.

**ICU view: Today’s offering of six-year notes could cause a new wave of foreign investments in local-currency debt. There is a high possibility that their portfolios will continue to increase, and their share in the market could rise above 10% this week. These investments can put additional pressure on the hryvnia exchange rate, and with its appreciation, other portfolios would decline.**

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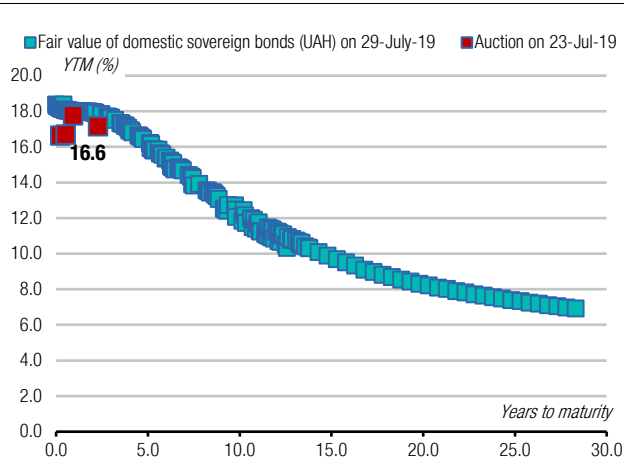
**Chart 1. Local-currency bonds**

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.

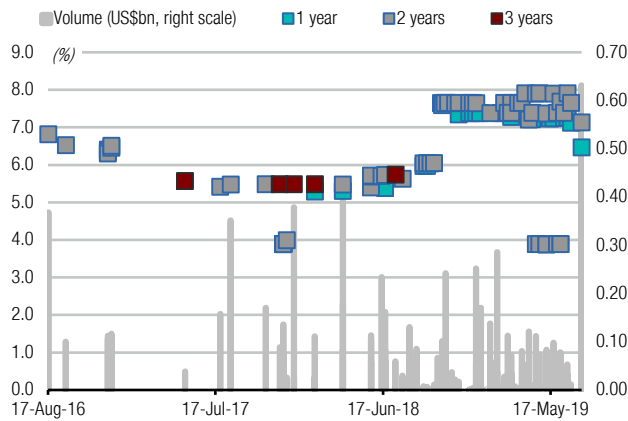
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

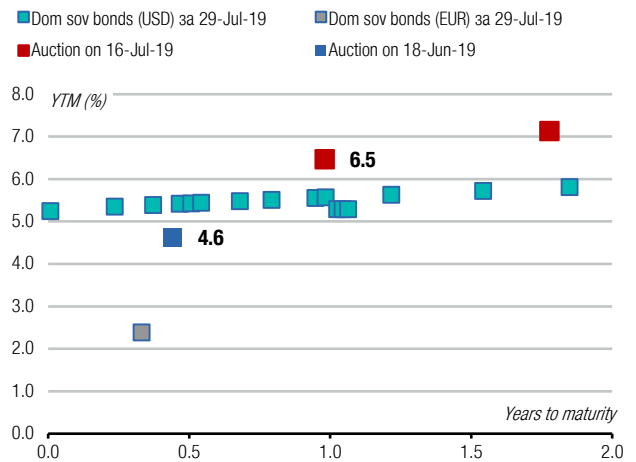
**Chart 2. FX-denominated bonds**

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 steady below UAH100bn**

Due to Naftogaz of Ukraine’s dividend payments to the state budget, liquidity declined below UAH100bn where it remained at the end of last week. This week, liquidity can return above UAH100bn due to FX purchases by the NBU.

Last Monday, Naftogaz of Ukraine paid UAH8.2bn in 2018 dividends, but this payment was only part of the outflow to budget accounts. Month-end tax payments started last week, and despite VAT refunds, the budget absorbed UAH15.4bn. At the same time, cash exchange in reserves and NBU purchases of FX compensated only part of outflows: UAH4bn and UAH6.7bn, respectively.

**ICU view:** This month through the end of last week, UAH10bn of VAT refund was paid from the budget, but this week, this source will not compensate outflows via tax payments. So, the main source for liquidity inflows will be NBU’s purchase of FX from the market, and later this week liquidity can be supported by increased budget expenditures. These funds could allow liquidity to recover above UAH100bn.

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

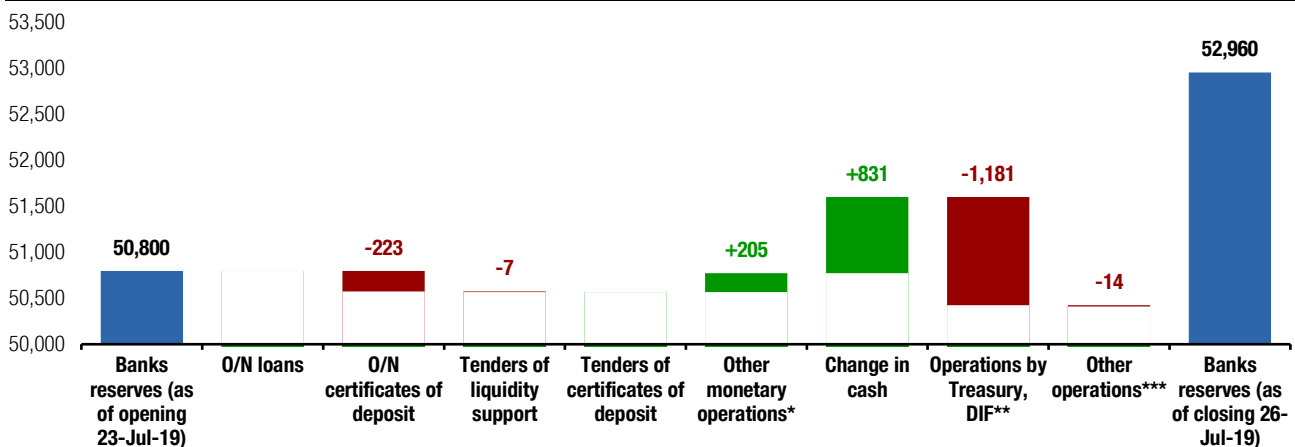
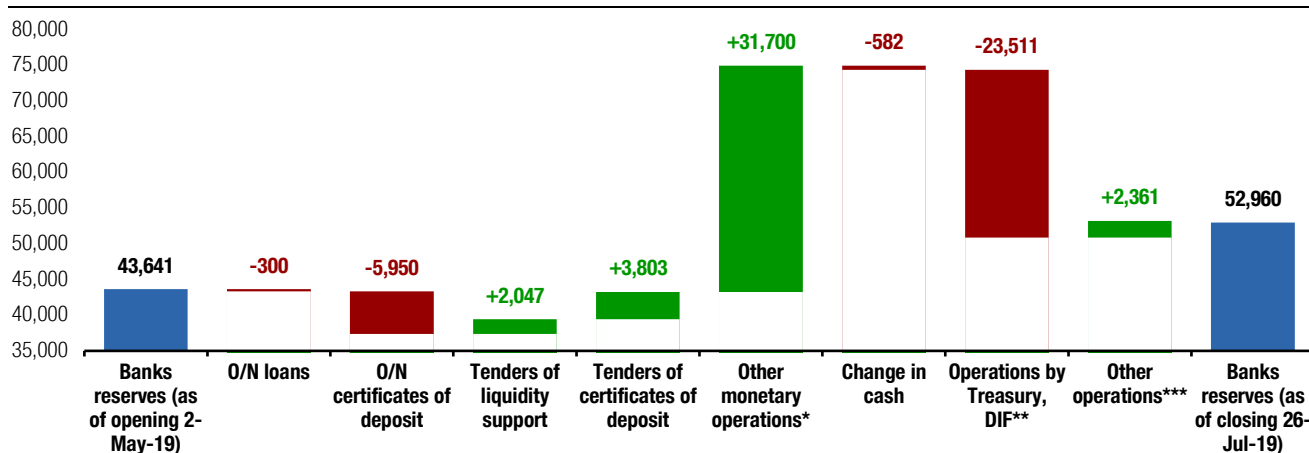


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting [https://bank.gov.ua/control/uk/publish/article?art\\_id=38643651&cat\\_id=40807142](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

### Record-breaking hryvnia appreciation

Last week, the hryvnia appreciated to UAH25.38/US\$ due to increased FX inflows from foreign investors into domestic debt. This week, it should continue to move forward to the level of UAH25/USD.

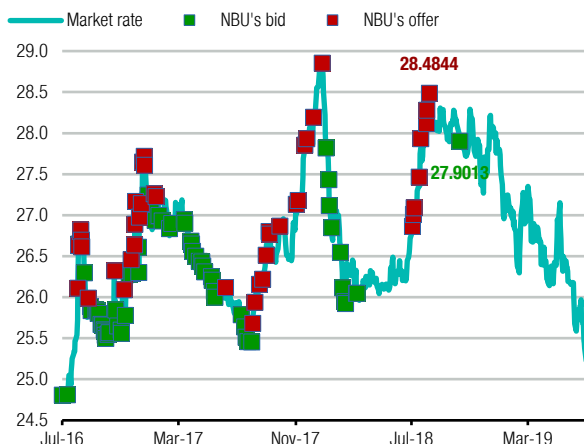
New foreign investments in local-currency debt continued to put pressure on the UAH/USD exchange rate. Despite the NBU purchasing US\$261.2m from the market last week, the exchange rate continued to appreciate, setting new records since summer 2016. Actually, the NBU purchased most of the FX that was sold by foreign investors, as their portfolios rose by about US\$190m. Additional support could provide a decline in liquidity due to Naftogaz's dividend payments to the budget and demand for local-currency funds for month-end tax payments.

**ICU view:** *This week, we expect slight volatility in liquidity due to the last days for month-end tax payments. This should support hryvnia appreciation caused by new investments in local-currency bills. We expect that the hryvnia will continue its appreciation and movement towards the UAH25/US\$ level, setting new records.*

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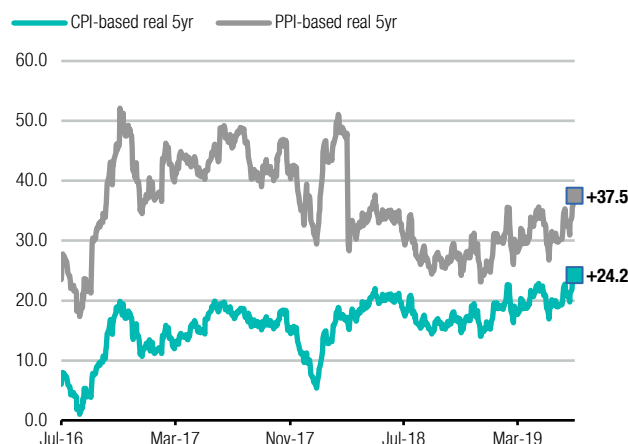
**Chart 5. FX market indicators, 3-year history**

*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

### Economic growth accelerates in 2Q19

Significant growth of retail sales (+14% YoY) and agriculture (+12% YoY) in June as well as overall better performance of real sectors of economy in April-June point to an acceleration of economic growth in 2Q19.

In June, the growth of retail sales surged 13.6% YoY (vs. 8.2% YoY in May), while agricultural output rose 12.2% YoY (vs. 0.8% YoY in May). Less solid growth rates were posted in construction (+1.7% YoY), and cargo turnover (+0.2% YoY), but 2Q growth rates improved. However, industrial production fell 2.3% YoY (after growth of 1.6% YoY in May, and 5.2% YoY in April) due to a 6.1% YoY decrease in the processing industry.

**ICU view:** Given 1) the significant surge in retail trade and agricultural output in June, 2) overall better dynamics of the real sectors of economy in 2Q (according to our estimates), particularly retail sales (13% YoY vs. 7.4% YoY in 1Q), agriculture (8% YoY vs. 3.4% YoY in 1Q), industrial production (+1.8% YoY vs. -0.9% YoY in 1Q), cargo turnover (3.9% YoY vs. 2.3% YoY in 1Q), and solid growth of construction (+18% YoY), as well as 3) consumer confidence that is the highest since 2013, which implies positive dynamics in the services sector, we estimate the 2Q19 real GDP growth at 3.3–3.5% YoY, which exceeds our forecast of 2.8% YoY growth. Still, we keep unchanged our full-year 2019 real GDP forecast at 2.7% YoY growth, as we expect weaker economic activity in 2H19. Risks for our forecast are better consumer demand and harvest in 2H19.

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