

Weekly Insight

Real GDP rises 4.6% YoY in 2Q19

Key messages of the today's comments

TUESDAY, 24 SEPTEMBER 2019

Domestic liquidity and bonds market

Individuals have invested UAH10bn in T-bills

The bond portfolios of individuals set a new historical high last week, exceeding UAH10bn. However, appreciation of the hryvnia had a negative impact on their portfolios, so we do not anticipate any important changes soon.

Liquidity stabilizes above UAH100bn

Increase in hard currency purchased by NBU and significantly lower amounts of new T-bills purchased by foreign investors increased banking-sector liquidity to UAH109bn last week. Increase in VAT refunds will provide additional support for liquidity at a time when foreigners will increase purchases of local-currency bills this week.

Foreign exchange market

Hryvnia continues to appreciate

Hard currency supply, which exceeds demand, continues to support the hryvnia moving toward new record highs for the last three years. The offering of five-year notes will add some additional supply and support for hryvnia, and move it to about UAH24/US\$. However, by the end of the month, we expect some correction and slight weakening.

Economics

Real GDP rises 4.6% YoY in 2Q19

The State Statistics Service of Ukraine confirmed its estimate of Ukraine's real GDP growth in 2Q19 at 1.6% QoQ SA and 4.6% YoY. Real GDP growth rates will slow in 2H19 due to lower growth of real incomes of households, and the high base effect of a record harvest last year.

Economic growth slows in August

Following strong performance in July, most real sectors of economy posted slower or negative growth rates in August, implying slowdown of economic growth in 3Q19.

Banks' reserves market (23 September 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	16.50	+0bp	-150bp
ON rate (%)	15.13	-35bp	-288bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	57,128	-4.47	+3.93
DepCerts (UAHm) ³	51,921	+12.52	+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) (23 September 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,065	+0.00	-3.17
Banks	345,605	-0.10	-6.45
Residents	25,882	+1.57	+28.06
Individuals	9,963	-0.12	+111.40
Non-res ⁴	89,125	+1.17	+1,094.17
Total	807,641	+0.13	+7.70

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

FX market indicators (23 September 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.3225	-1.67	-13.29
EUR/USD	1.0993	-0.72	-6.43
DXY ²	98.599	+0.34	+4.65
UAH TWI ³	136.168	+2.03	+18.04

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

Gov't bond quotes¹ (24 September 2019)

Maturity	Bid	Ask
6m	17.00	15.50
12m	17.00	15.50
2y	17.50	16.00
3y	17.00	15.75
12m (\$)	5.50	4.50
2y (\$)	5.50	4.50

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

Domestic liquidity and bonds market

Individuals have invested UAH10bn in T-bills

The bond portfolios of individuals set a new historical high last week, exceeding UAH10bn. However, appreciation of the hryvnia had a negative impact on their portfolios, so we do not anticipate any important changes soon.

Last week, after primary auction settlement, individuals' portfolios rose to above UAH10bn. At the beginning of the year, the portfolios of individuals amounted to about UAH6bn and until the last they added an additional UAH4bn.

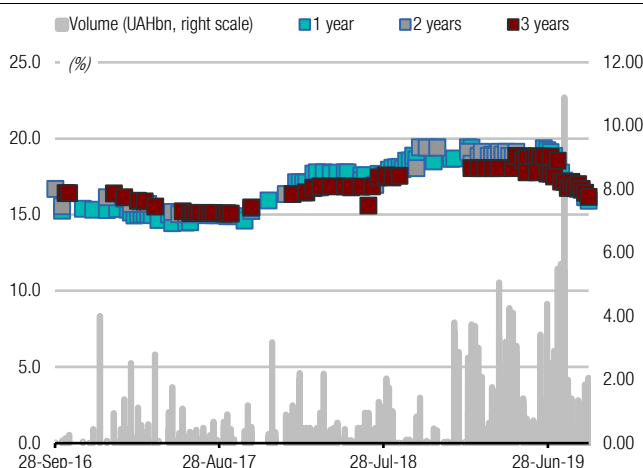
Individuals started the year with UAH6.1bn in portfolios, including only UAH1.4bn of UAH-denominated bills. But at the end of last week, portfolios reached UAH10bn including UAH3.2bn of local-currency bills. The main part of their portfolios is denominated in hard currencies. Keep in mind that the NBU recalculates outstandings daily using the actual official exchange rate. The recent appreciation of the hryvnia significantly decreases bonds outstanding in hryvnia-equivalent terms, even if the face value increases.

ICU view: Recalculation of the FX-denominated part of portfolios decreases total bonds outstanding in most portfolios. Therefore, the amount invested by individuals will not be maintained at UAH10bn, although portfolios will continue to show growth in original currencies.

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

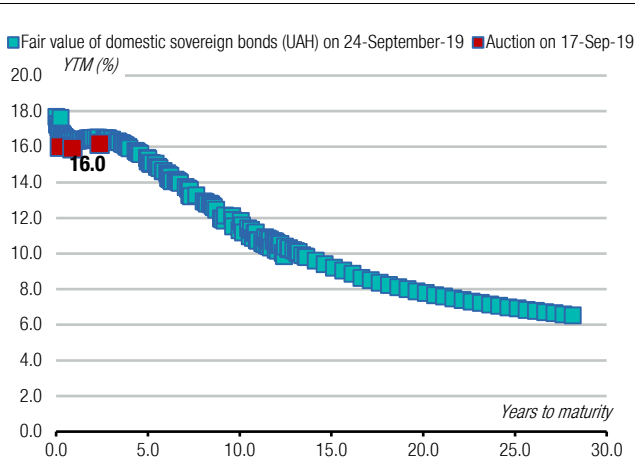
Chart 1. Local-currency bonds

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.

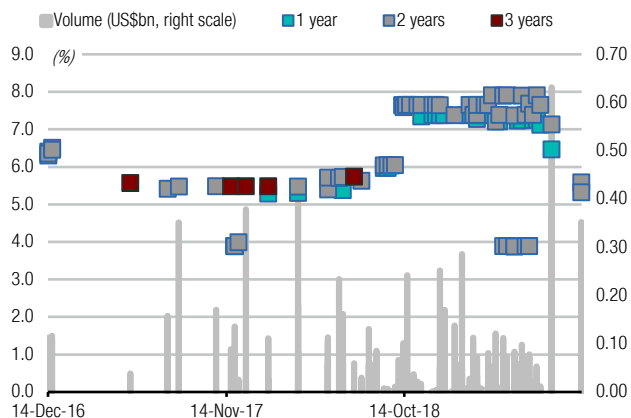
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

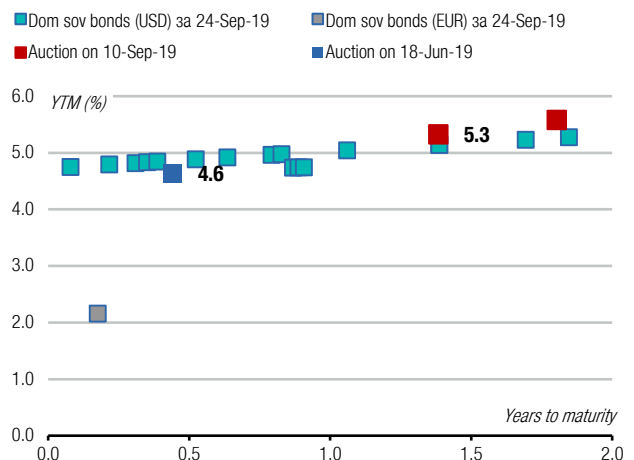
Chart 2. FX-denominated bonds

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 stabilizes above UAH100bn

Increase in hard currency purchased by NBU and significantly lower amounts of new T-bills purchased by foreign investors increased banking-sector liquidity to UAH109bn last week. Increase in VAT refunds will provide additional support for liquidity at a time when foreigners will increase purchases of local-currency bills this week.

Last week, total banking-sector liquidity rose UAH4.2bn reaching UAH109bn, the largest amount since 16 July 2019. More than one third of these funds, UAH37.7bn, were invested in two-week NBU CDs last Friday, and an additional UAH14.2bn in ON CDs. Another UAH57.1bn was in banks' correspondent accounts with the NBU.

Only NBU interventions at the FX market provided liquidity with new funds. In total, NBU injected UAH6.6bn bought hard currency, but non-monetary operations caused outflows, and decreased inflows to UAH4.2bn. The Treasury absorbed UAH1.3bn last week, and banks exchanged reserves in cash for UAH1bn. At the same time, VAT refunds were at a low level, and until the end of last week, only UAH2.9bn was paid, less than one-quarter of the average monthly amount of refunds.

ICU view: This week, liquidity will see support from the NBU via FX market and purchases of additional hard currency. On the other hand, VAT refunds should accelerate. While the NBU will mostly cause an increase in liquidity, VAT refunds will compensate outflows caused by new T-bill purchases.

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

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

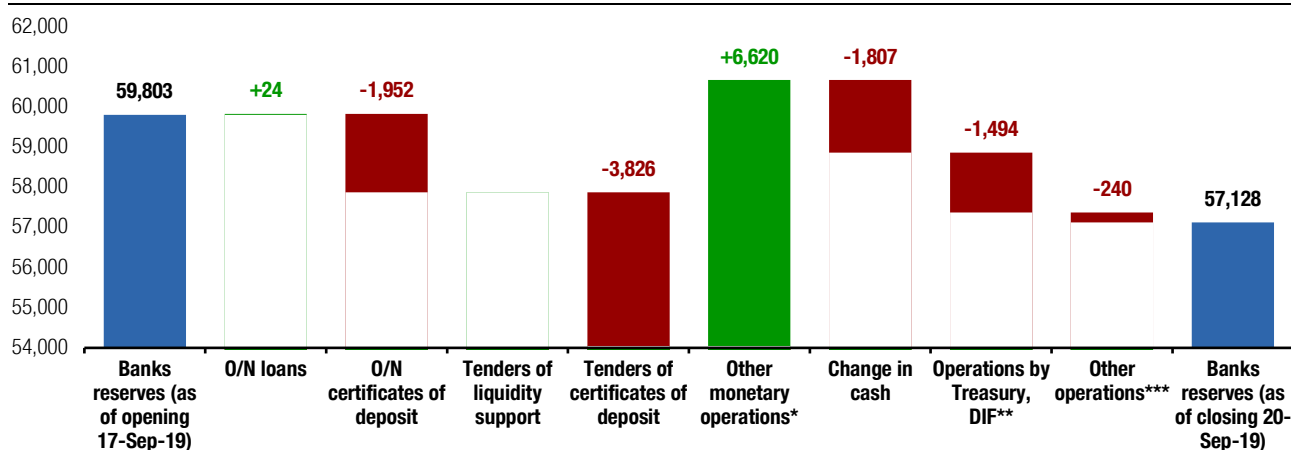
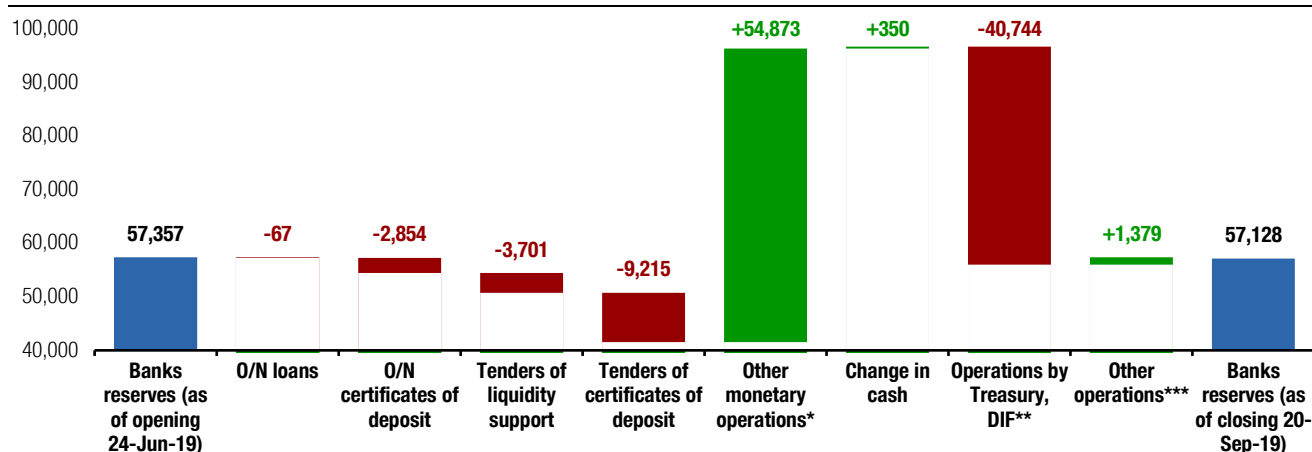


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Hryvnia continues to appreciate

Hard currency supply, which exceeds demand, continues to support the hryvnia moving toward new record highs for the last three years. The offering of five-year notes will add some additional supply and support for hryvnia, and move it to about UAH24/US\$. However, by the end of the month, we expect some correction and slight weakening.

Last week, the hryvnia added 1.55% ending the week at UAH24.4055/US\$. This is the strongest level in three years. It was last at this level at the beginning of 2016. The NBU intervened with purchases of US\$269.6m of hard currency last week, just to slow appreciation. This year, the NBU has purchased US\$3.6bn in FX reserves.

The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 1.88% to 135.5, while in YoY terms, it was up 17.67%.

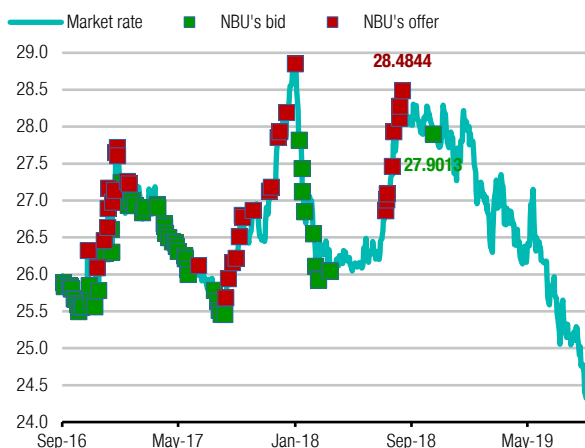
ICU view: During the last two weeks, foreign investors in UAH-denominated bills were not the only sellers of FX at the market, as compared with US\$467.6m of FX purchased by the NBU, foreigners purchased T-bills in the equivalent of US\$120m. This week, the situation can reverse with less FX supply, but investments in T-bills should rise with the offering of a five-year note. In any case, the hryvnia will continue its appreciation

towards UAH24/US\$ most of this week. Due to VAT refunds, it can weaken a bit by the end of this month to around UAH24.2-24.5/USD.

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

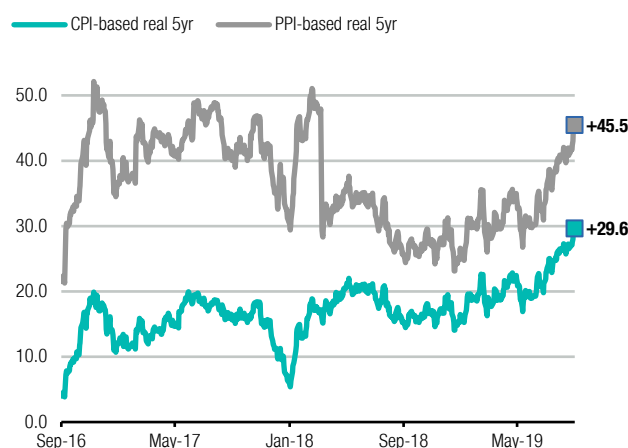
Chart 5. FX market indicators, 3-year history

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

Real GDP rises 4.6% YoY in 2Q19

The State Statistics Service of Ukraine confirmed its estimate of Ukraine's real GDP growth in 2Q19 at 1.6% QoQ SA and 4.6% YoY. Real GDP growth rates will slow in 2H19 due to lower growth of real incomes of households, and the high base effect of a record harvest last year.

Nominal GDP in 2Q19 amounted to UAH827.8bn (+14.4% YoY), while the GDP deflator was 9.4% YoY. In annualized terms, nominal GDP rose 16.5% to UAH3,778bn, which is equivalent to US\$138.4bn (+13.4%). Household consumption remained the key driver of economic growth. In 2Q19, it rose 11.8% YoY, up from 10.7% YoY seen in 1Q19. Fixed capital investments rose 7.9% YoY (the lowest reading since 2Q16), which can be explained by uncertainty during the election period. At the same time, government consumption declined for the fourth consecutive quarter (-6.4% YoY) against the backdrop of large amounts of external debt repayments in 2019 and 2020. Exports of goods and services rose 4.4% YoY thanks to agricultural products and iron ore. Imports surged 9.1% YoY driven primarily by machinery and equipment.

Production approach shows that the key drivers of growth were trade (+4.5% YoY), construction (+20.5% YoY), industrial production (+1.7% YoY), and agriculture (+7.3% YoY). Among services the highest contribution to economic growth was made by financial and insurance activities (17.9% YoY), while net taxes rose 4.2% YoY.

ICU view: In August, consumer sentiment rose to the highest level since 2007, which means that household consumption should remain at a solid level. However, 1) slowing growth rates of real incomes of households — real wages rose 8.8% YoY in 2Q19 vs 10.9% YoY in 1Q19, while remittances growth slowed to 5.4% YoY in 2Q19 vs 20% in 2018 — will have a negative impact on consumer demand, which along with 2)

the high base effect of a record harvest last year will result in slower growth rates of real GDP in 2H19.

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

Economic growth slows in August

Following strong performance in July, most real sectors of economy posted slower or negative growth rates in August, implying slowdown of economic growth in 3Q19.

In August, retail turnover rose 6.7% YoY, down from 9% YoY in July, which is the lowest growth rate since the beginning of the year. Agricultural output dropped 11.8% YoY vs. 18.3% YoY growth in July. The decrease was mostly due to the lower harvested area (-40% YoY), as the harvesting period started earlier this year, while the average crop yield in August rose 8% YoY to 4.3 t/ha.

Industrial production contracted for the third consecutive month (-1.7% YoY in August), as a result of a 4.1% YoY decline in manufacturing production, where all subsectors posted a decrease in YoY terms. At the same time, the mining sector expanded 2% YoY, while the utilities sector rose 2.9% YoY. Construction rose 8.9% YoY in August, down from 25.5% YoY seen in the previous month.

ICU view: Slower or negative growth rates of real sectors of the economy in August point to lower real GDP growth in 3Q19. Retail sales were one of the major drivers of economic growth in 2Q19; however, given slowing growth of real incomes of households (see the previous comment), we expected them to slow expansion in 2H19. We also expect moderate growth rates of agricultural output in the following months due to the high base effect of a record harvest of late crops last year. At the same time, given three consecutive months of contraction in industrial production, we cut our forecast of industrial production growth in 2019 to 0.6% vs. 1.9% previously.

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



RESEARCH

Alexander Martynenko

Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv

Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Taras Kotovych

Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Dmitriy Dyachenko

Junior financial analyst
dmitriy.dyachenko@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.

