

Weekly Insight

IMF expects Ukraine's GDP to fall 7.7%

Key messages of the today's comments

WEDNESDAY, 22 APRIL 2020

Domestic liquidity and bonds market

Auctions remain cancelled

For the fourth consecutive week, the Ministry of Finance cancelled auctions after consultations with primary dealers. Therefore, this week, once again, possible demand from locals will absorb some supply from foreigners, as they continue to decrease their UAH-denominated portfolios, but at a slower pace.

Liquidity steady due to budget expenditures

The positive balance of budget expenditures has allowed banking-sector liquidity to remain steady and slightly increase. This week, the balance of Treasury operations can become more neutral due to the increase in tax payments, so we do not anticipate an increase in liquidity.

Foreign exchange market

Hryvnia in standby mode

Last week, the hryvnia exchange rate was mostly in the range of UAH27-27.5/US\$ with small NBU interventions. We do not expect significant volatility this week, but due to month-end tax payments, supply of hard currency may be greater and the hryvnia may appreciate to less than UAH27/US\$.

Economics

IMF expects Ukraine's GDP to fall 7.7% in 2020

Following a significant contraction this year, Ukraine's economy will rise 3.6% in 2021, according to the Fund's expectations.

Banks' reserves market (21 April 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	15.50	+0bp	-250bp
ON rate (%)	9.16	+21bp	-723bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	59,919	-10.09	+9.85
DepCerts (UAHm) ³	136,234	+6.86	+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) (21 April 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	340,296	+0.27	-5.97
Residents	51,929	+0.71	+95.93
Individuals	8,515	+0.17	-0.75
Non-res ⁴	114,712	-1.32	+258.13
Total	840,029	-0.02	+9.60

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

FX market indicators (21 April 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.0838	-0.74	+0.93
EUR/USD	1.0858	-0.48	-3.44
DXY ²	100.258	+0.80	+2.96
UAH TWI ³	130.956	+1.74	+8.00

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

Gov't bond quotes¹ (22 April 2020)

Maturity	Bid	Ask
6m	18.00	15.00
12m	18.00	15.00
2y	18.00	15.00
3y	18.00	15.00
12m (\$)	5.00	3.00
2y (\$)	6.00	3.50

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

Domestic liquidity and bonds market

Auctions remain cancelled

For the fourth consecutive week, the Ministry of Finance cancelled auctions after consultations with primary dealers. Therefore, this week, once again, possible demand from locals will absorb some supply from foreigners, as they continue to decrease their UAH-denominated portfolios, but at a slower pace.

There has been a break in primary auctions since the end of March, while according to the schedule, the MoF planned to offer only short-term bills, up to six-months in maturity. After consultations with the primary dealers, the Ministry decided to cancel this week's auction too. Likely, demand for new bills is low, but also likely, it comes with significantly higher rates than before the lockdown.

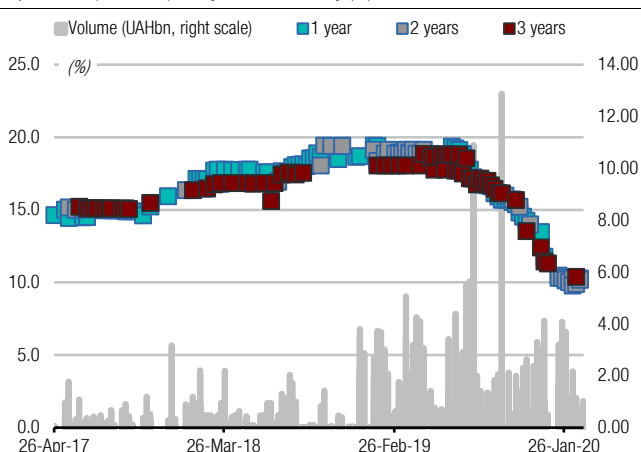
Demand met supply from foreigners, as they decreased portfolios during the last 30 days by UAH9.2bn (US\$340m). Last week, they sold just UAH1.3bn (US\$48m) of UAH-denominated bills, while YTD, they decreased portfolios by only UAH4bn (US\$148m).

ICU view: Without debt redemptions, the decline in foreigners' portfolio slowed, and this week, it can slow once again. Local demand for government bills is low, mostly from banks. Therefore, for the MoF, it is not necessary to hold new auctions and increase rates, as budget proceeds would be low. At the same time, the budget has enough funds for expenditures, thanks to the NBU's transfer of its profit from last year. Consequently, the break in auctions can last at least until the end of April without negative consequences.

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

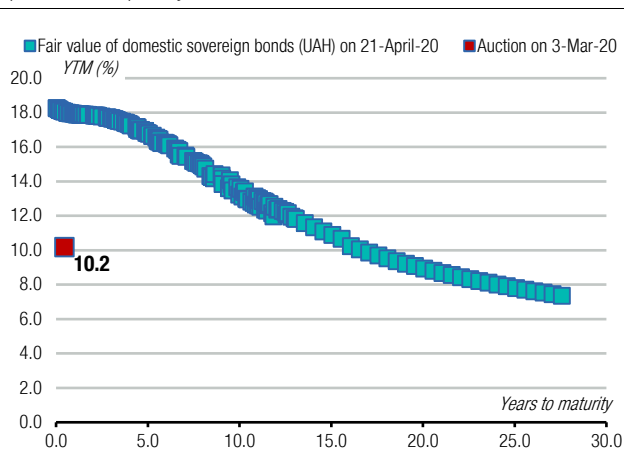
Chart 1. Local-currency bonds

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.

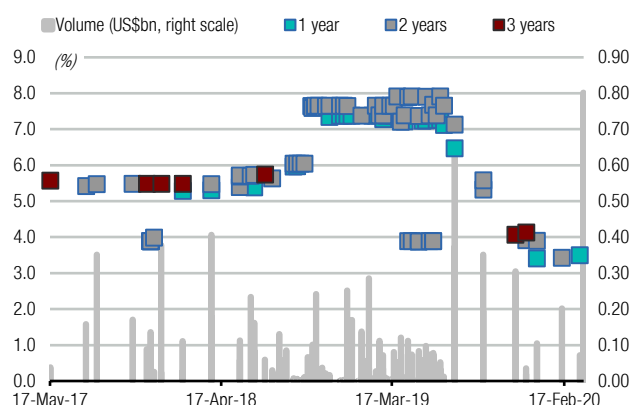
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

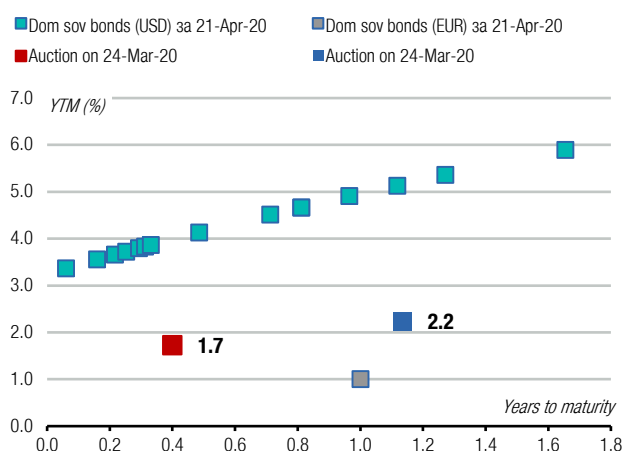
Chart 2. FX-denominated bonds

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 steady due to budget expenditures

The positive balance of budget expenditures has allowed banking-sector liquidity to remain steady and slightly increase. This week, the balance of Treasury operations can become more neutral due to the increase in tax payments, so we do not anticipate an increase in liquidity.

Last week, NBU's participation in FX market was low, as it purchased extra supply on only two days, in total US\$67.5m, injecting banking-sector liquidity with just UAH1.8bn. The main support for liquidity was provided by the Treasury, which used funds received earlier this month from the NBU. Through budget transactions, banking-sector liquidity received UAH12bn of additional funds.

In total, this month, the budget injected UAH35bn into the banking system, just UAH7.7bn less than the NBU transferred to the budget as its profit from 2019. Inflows from the state budget compensated for banking-sector liquidity outflows through reserves exchange in cash, which amounted to UAH24.2bn this month, where UAH9.2bn of outflows was seen last week.

Last week, banking-sector liquidity was up UAH5.3bn to UAH196bn, where the main impact came from non-monetary operations, balanced at UAH3.4bn of inflows into liquidity.

ICU view: Generally, banking-sector liquidity will see low volatility this week, slightly above UAH190bn. But the factors that impact it can be different from last week. Inflows from NBU can rise due to an increase of hard-currency supply in the FX market from exporters for month-end tax payments. The Treasury's impact on liquidity will become more neutral due to an increase in tax payments and less funds from NBU's transactions. So, liquidity will depend on banks' operations with cash, which traditionally increase liquidity during the second half of the month. But due to the lockdown, banks can continue to exchange reserves in cash, maintaining a negative impact on liquidity.

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

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

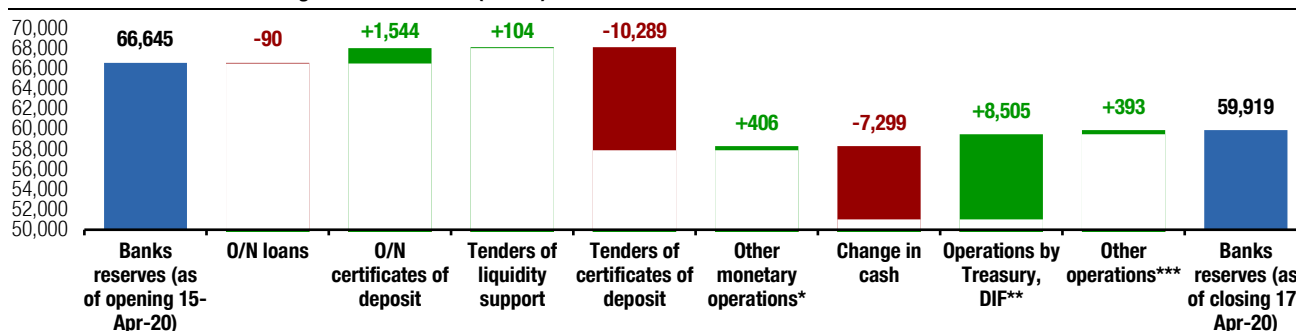
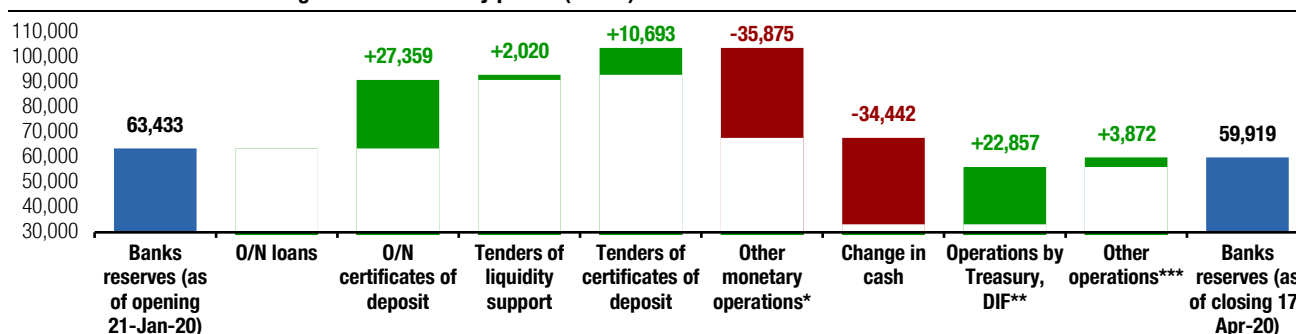


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 in standby mode

Last week, the hryvnia exchange rate was mostly in the range of UAH27-27.5/US\$ with small NBU interventions. We do not expect significant volatility this week, but due to month-end tax payments, supply of hard currency may be greater and the hryvnia may appreciate to less than UAH27/US\$.

The NBU decreased interventions to US\$67.5m last week, which was concentrated over just two days. On the other three days, the market balanced without the regulator, maintaining a range of UAH27-27.5/US\$. Demand for hard currency from foreigners also declined due to lower selling of UAH-denominated bills.

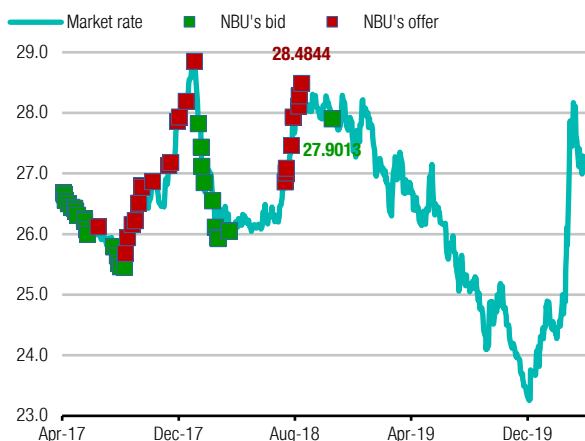
Finally, last week, the hryvnia appreciated by 0.3% to UAH27.08/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.7% to 129.6, while in YoY terms, it was up 7%.

ICU view: *This week, we do not anticipate significant changes in market balance with other than a decline in demand from foreigners. NBU will keep its interventions at a low level, enough to flatten volatility. Most likely, NBU's interventions will be directed to restrain hryvnia appreciation, caused by hard currency selling by exporters to make month-end tax payments. Therefore, the hryvnia may appreciate to slightly below UAH27/US\$.*

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

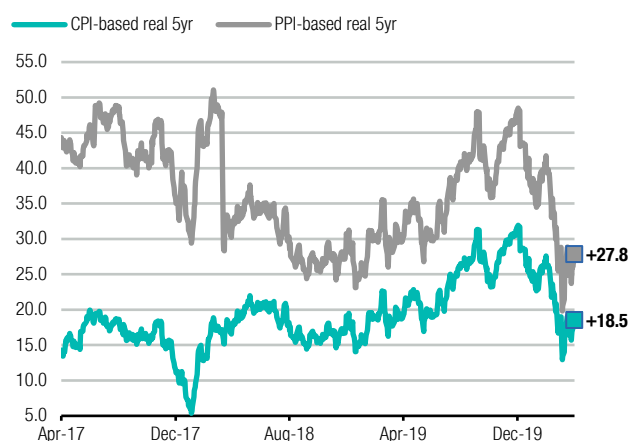
Chart 5. FX market indicators, 3-year history

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

IMF expects Ukraine's GDP to fall 7.7% in 2020

Following a significant contraction this year, Ukraine's economy will rise 3.6% in 2021, according to the Fund's expectations.

The IMF expects inflation acceleration to 7.7% by YE20 (vs. 2.3% YoY in March) with some slowdown to 5.9% by YE21. The Fund forecasts the C/A deficit to contract to 2% of GDP in 2020 and 2.4% in 2021 from 2.7% in 2019 (adjusted for \$2.9bn received from Gazprom). Unemployment will increase to 10.1% in 2020 and 9.3% in 2021, while the budget deficit will surge to 8.2% of GDP in 2020 and 5.3% in 2021.

ICU view: *The updated IMF forecast is in line with [our optimistic base-case scenario](#), which envisages 1) real GDP contraction by 6-8% in 2020 due to significant decrease in consumption and investments, which will, to some extent, be mitigated by rising net exports, 2) a C/A deficit of 1% of GDP vs. 2.7% in 2019 (adjusted for \$2.9bn received from Gazprom) thanks to a substantial drop in energy and consumer imports and resilient exports of food products and IT services, and 3) inflation acceleration to 6-8% by YE20 due to rising food prices as well as a likely worse harvest. Given extremely high uncertainties of the quarantine's duration, the economy's reaction to it, the pace of recovery, and the possibility of another wave of the virus, this forecast is subject to high risks skewed to the downside.*

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

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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

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