

Weekly Insight

Economic activity slowly recovering

Key messages of the today's comments

Domestic liquidity and bonds market

T-bills rates decline

Last week, the MoF sold all six bills it offered with lower interest rates. This week, due to shortage in liquidity market activity is low, stabilizing interest rates.

Liquidity falls

After a large outflow of liquidity caused by Privatbank dividend payment, last week, liquidity declined once more. This week, we do not expect large outflows but instead, slight recovery in banking-sector liquidity.

Foreign exchange market

Hryvnia stays in range

Large hard-currency purchases by the NBU kept the hryvnia exchange rate within the usual range of UAH26.5–27.0/US\$ with some fluctuations. By the end of last week, the hryvnia appreciated to UAH26.7/US\$ and this week it should stay within the same range.

Economics

Economic activity slowly recovering

Based on data published last week by UkrStat, we estimate the decline in GDP to slow to 10% YoY in May from 13% YoY in April. Due to the gradual lifting of quarantine restrictions, retail trade has largely resumed, and industry performance has improved slightly. At the same time, passenger transport remained almost completely paralyzed, significantly holding back a larger rebound.

WEDNESDAY, 1 JULY 2020

Banks' reserves market (30 June 2020)

| | Last | Weekly chg (%) | YoY chg (%) |
|------------------------------|---------|----------------|-------------|
| NBU rate (%) ¹ | 6.00 | +0bp | -1,150bp |
| ON rate (%) | 5.70 | -74bp | -967bp |
| ON \$ swap (%) | N/A | ... | ... |
| Reserves (UAHm) ² | 45,245 | -20.61 | -24.12 |
| CDs (UAHm) ³ | 104,754 | -18.29 | +0.00 |

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's certificates of deposit.

Source: NBU, Bloomberg, ICU.

Breakdown of govt bond holders (UAHm) (30 June 2020)

| | Last | Weekly chg (%) | YoY chg (%) |
|-------------------------|----------------|----------------|---------------|
| NBU | 324,577 | +0.00 | -3.72 |
| Banks | 417,269 | +1.75 | +18.84 |
| Residents | 30,512 | -0.16 | +29.33 |
| Individuals | 7,634 | +1.48 | -15.01 |
| Foreigners ¹ | 100,581 | -0.54 | +70.51 |
| Total | 880,573 | +0.77 | +12.92 |

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (30 June 2020)

| | Last | Weekly chg (%) | YoY chg (%) |
|----------------------|---------|----------------|-------------|
| USD/UAH | 26.7088 | +0.10 | +2.12 |
| EUR/USD | 1.1234 | -0.15 | -1.22 |
| DXY | 97.391 | +0.25 | +1.31 |
| UAH TWI ¹ | 128.063 | +0.57 | +3.77 |

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (1 July 2020)

| Maturity | Bid | Ask |
|----------|-------|-------|
| 6m | 10.50 | 7.00 |
| 12m | 10.70 | 9.25 |
| 2y | 11.25 | 10.00 |
| 3y | 11.50 | 10.50 |
| 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

T-bills rates decline

Last week, the MoF sold all six bills it offered with lower interest rates. This week, due to shortage in liquidity market activity is low, stabilizing interest rates.

After the NBU key policy rate decrease, the Ministry of Finance has gradually decreased interest rates for all issues offered at the auction. Last week, the Ministry decreased rates for all maturities from three-months up to three-years, with larger cuts for short-term paper where the Ministry offered limited amounts. For bills with maturities up to six months, rates declined below 8%, while for bills up to one year, the rates were below 10%. More details in our [auctions review](#).

Banks purchased most of the bills sold last week, with only a small portion used to obtain NBU loans on Friday. However, banks' portfolios rose to UAH417bn last week or to 47% of total government domestic bills.

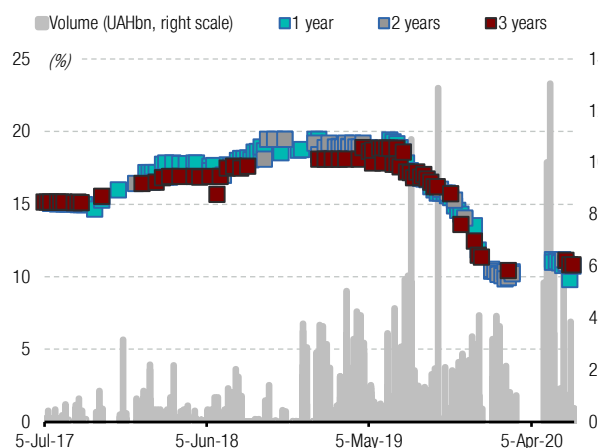
At the same time, foreigners' portfolios continued to decline. Last week, they decreased portfolios by UAH0.9bn, to slightly above UAH100bn.

ICU view: The large premium to the NBU key policy rate for bills with nine-month maturities or longer increased their attractiveness. Premium tightening below 200bp for bills up to six months will stabilize rates at 7–8%. The rates for longer bills will continue to decline and should soon fall below 10% for two and three-year maturities.

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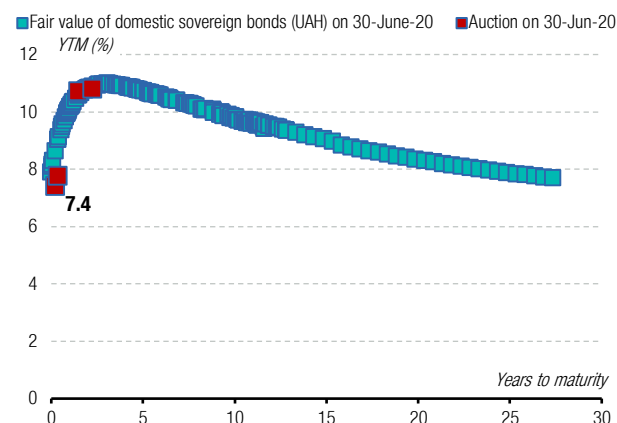
Chart 1. Local-currency bonds

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.

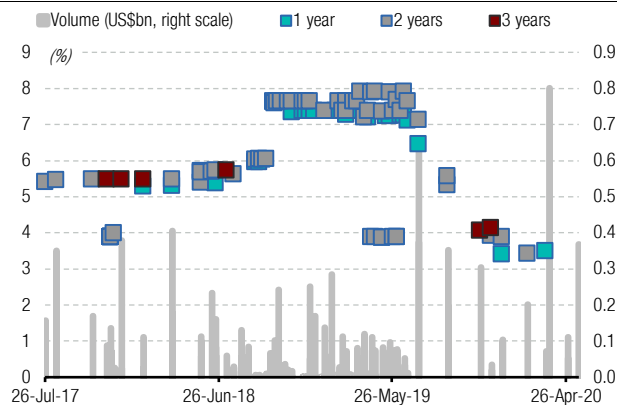
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

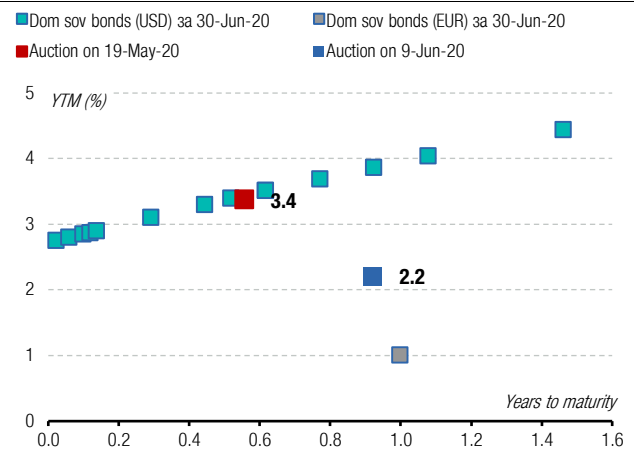
Chart 2. FX-denominated bonds

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 falls

After a large outflow of liquidity caused by Privatbank dividend payment, last week, liquidity declined once more. This week, we do not expect large outflows but instead, slight recovery in banking-sector liquidity.

Generally, the situation with banking-sector liquidity after Privatbank paid dividends to the state budget has been steady, while banks become more active in purchasing government bills (see comment above). However, last Friday Naftogaz paid its dividends to the budget, decrease banking sector liquidity to UAH150bn, the lowest level this year.

Funds outflows to the budget accounts due to month-end tax payments and new bill purchases were mostly compensated by NBU through hard currency purchases and loans. However, last Friday outflow to budget rose to UAH31bn. In total, last week, the Treasury absorbed UAH40bn of liquidity while the NBU injected UAH11.3bn into liquidity through the FX market. Therefore, last week ended with UAH150bn of banking sector liquidity including UAH105bn in NBU CDs.

ICU view: *The new month will start off with larger reserves exchange in cash, but most important for liquidity will be transactions with the state budget, as there may come new borrowings and new expenditures. Therefore, we expect liquidity to increase slightly.*

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

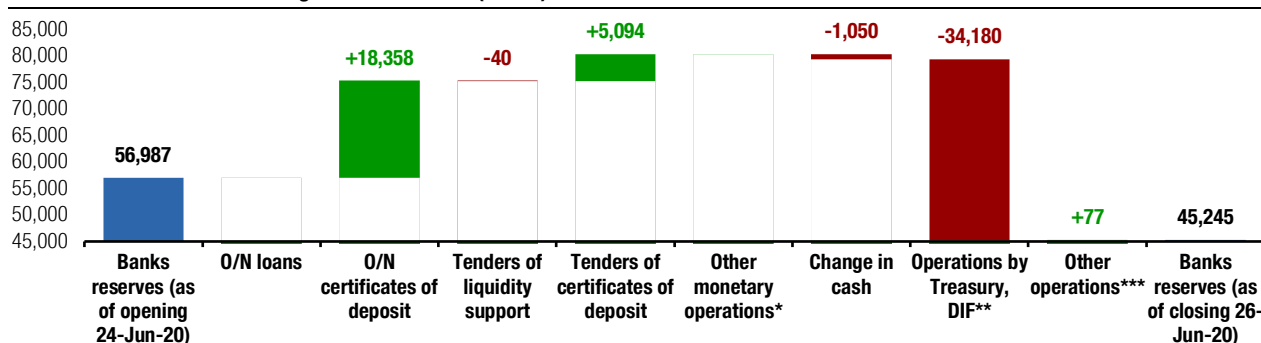
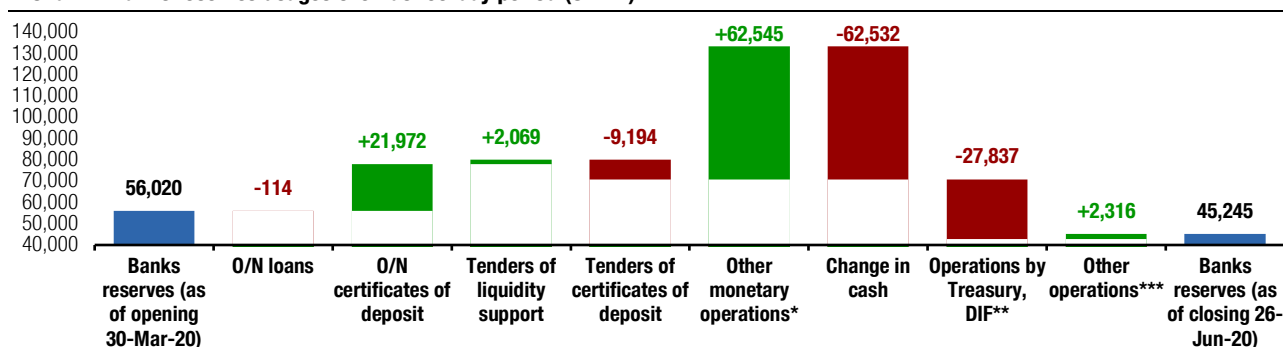


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 stays in range

Large hard-currency purchases by the NBU kept the hryvnia exchange rate within the usual range of UAH26.5–27.0/US\$ with some fluctuations. By the end of last week, the hryvnia appreciated to UAH26.7/US\$ and this week it should stay within the same range.

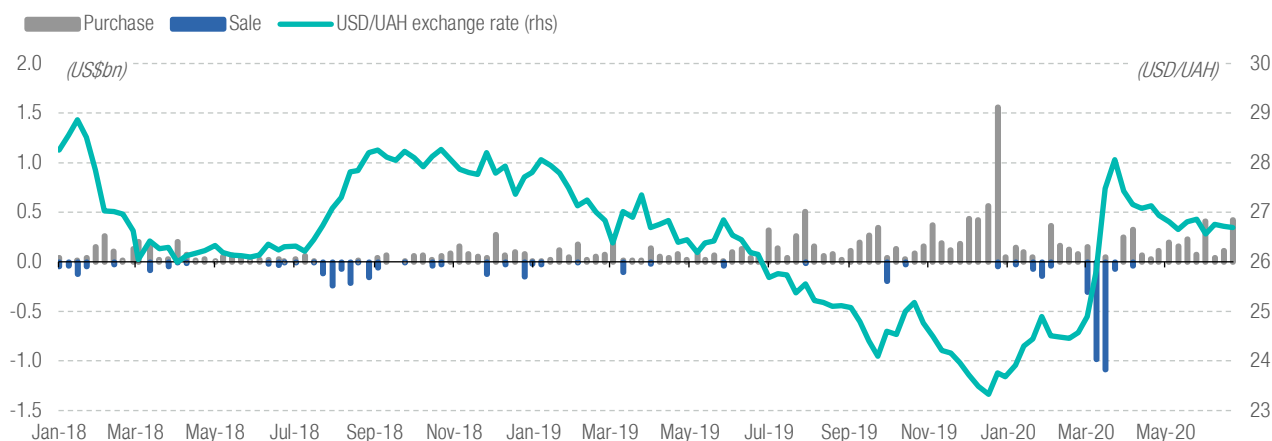
Last week, the NBU purchased US\$424.5m in the market, mostly on Tuesday. Hard currency likely was not sold by foreigners, as they continued to decrease their government bills portfolios. This seller likely was Naftogaz selling hard currency for dividends. Most important was NBU's participation in the market with purchases of extra supply to smooth exchange rate fluctuations.

ICU view: After June's month-end tax payments and VAT refunds end, we do not expect volatility in the FX market as the NBU will continue its smoothing interventions. Therefore, the hryvnia will stay within the same range of UAH26.5–27.0/US\$ this week.

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Chart 5. FX market indicators, 3-year history

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market and NBU interventions (weekly data)



Source: NBU, Bloomberg, ICU.

Economics

Economic activity slowly recovering

Based on data published last week by UkrStat, we estimate the decline in GDP to slow to 10% YoY in May from 13% YoY in April. Due to the gradual lifting of quarantine restrictions, retail trade has largely resumed, and industry performance has improved slightly. At the same time, passenger transport remained almost completely paralyzed, significantly holding back a larger rebound.

UkrStat data on trade, transport, and industry in May showed that the economy began to recover slowly from April's bottom.

Trade is recovering most rapidly. The decline in retail trade slowed to 3.1% YoY from 23% YoY in April, and the decrease in wholesale trade turnover decelerated to 2.8% YoY for 5M20 from 4.0% YoY in January-April (according to our estimates, in May wholesale trade turnover increased by 2.2% YoY).

In May, the decline in industrial output decelerated to 12.2% YoY compared with 16.2% YoY bringing the 5M20 decline to 8.7% YoY. Thus, the industrial output started its recovery from the bottom in April growing by 2.8% MoM SA. The main rebound was observed in energy generation and the processing industry where output grew by 6.8% and 3.8% MoM SA, respectively. E.g., the production of machinery increased by 21.5% MoM and metallurgical output rose by 13.5% MoM. However, the annual pace of decline in the production of these products remained high—22.4% and 19.0%, respectively—which was the main contribution to the decline in the industry. As in previous months, the only industry where production grew was pharmaceuticals, by 8.8% YoY.

In transport, the depth of the fall remained significant, decreasing only marginally compared with April. The fall in freight turnover slowed to 26.0% YoY from 27.3% YoY in April, and passenger turnover decelerated to 92.2% YoY from 96.0% YoY in April. As in previous months, the main negative contribution to freight turnover was provided by pipeline transport, which turnover decreased by 39.2% YoY (40.9% YoY for 5M20). In addition, in May, as in April, the decline in freight turnover by rail and road transport remained significant, by 19.4% YoY and 23.2% YoY, respectively.

The situation in animal breeding deteriorated somewhat, with production falling by 4.0% YoY compared with a decrease of 0.2% YoY in April (and by 2.0% YoY for 5M20). Output continues to decline in the production of milk and meat of cattle and pigs, while the production of chicken and eggs is increasing, although slowly.

ICU view: *The May data confirmed our assumption about the beginning of economic recovery from the bottom in April. The start of easing quarantine restrictions on May 11 had the biggest impact on retail trade, as sales of non-essential goods in shopping malls and work in food markets were allowed. At the same time, a quite rapid recovery may be partially explained by the realization of deferred demand, while still depressed consumer sentiment and a sharp decline in household incomes (primarily in wages and remittances from abroad) had a significant restrictive effect.*

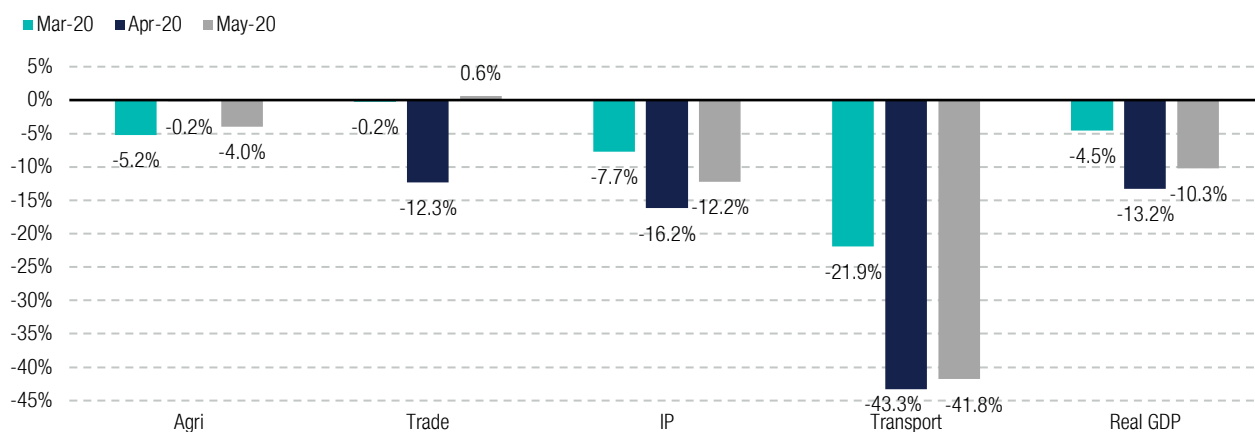
The easing of restrictions on passenger traffic in most regions and for most modes of transport began only at the end of the month and had a marginal positive effect on both passenger transport performance and related activities.

During the first half of June, the easing of quarantine restrictions accelerated significantly both in Ukraine and around the world. Business activity is recovering, as evidenced in particular by various high-frequency indicators. For example, according to the web site opendatabot.ua, 86% of restaurants and cafes from the pre-quarantine number have resumed operation in recent weeks, while in April that share was only 32–35%, and increased to 69% in May. At the same time, their revenue was still only 76% of the pre-quarantine level.

As a result, we expect economic activity to continue to improve in June and GDP to fall by about 10% YoY in 2Q20.

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Chart 6. Real GDP and output of activities, % YoY



Source: UkrStat, ICU.

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