



# Weekly Insight

## Economic recovery is shifting into lower gear

### Key messages of the today's comments

MONDAY, 28 SEPTEMBER 2020

### Domestic liquidity and bonds market

#### Borrowings down, rates up

Demand at the primary auction remains cautious. In a move toward market sentiment, the MoF increased rates. However, this week, we expect to see rising competition among buyers, and a pause in rates increasing.

#### Liquidity increases

Banking sector liquidity most of last week remained slightly above UAH160bn with sharp increase last Friday to UAH171bn. Large debt repayments can support liquidity at about UAH170bn this week.

### Foreign exchange market

#### Hryvnia weakening continues

The Ukrainian hryvnia continues to weaken above UAH28/US\$. This week due to increase in demand for hard currency, including from foreigners, the hryvnia can weaken to above UAH28.5/US\$.

### Economics

#### Economic recovery is shifting into lower gear

Based on data published last week by UkrStat, we estimate the decline in GDP to slow to about 5% YoY in August. It was caused mainly by a continuous rebound of railway and aviation transport. On the other hand, other sectors' performance expectedly points to a slower pace of recovery amid the escalating outbreak of COVID-19 cases in Ukraine and the rest of the world. The latest activity data is consistent with our forecast of GDP decline this year by 5.7%.

### Banks' reserves market (25 September 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	6.00	+0bp	-1,050bp
ON rate (%)	5.16	-54bp	-979bp
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	57,660	-2.03	+5.91
CDs (UAHm) <sup>3</sup>	105,967	-2.91	+83.98

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 gov't bond holders (UAHm) (25 September 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.71
Banks	426,702	+0.27	+22.70
Residents	31,197	+1.00	+18.24
Individuals	8,322	+0.86	-17.45
Foreigners <sup>1</sup>	84,382	-1.05	-7.77
<b>Total</b>	<b>875,180</b>	<b>+0.07</b>	<b>+7.69</b>

Notes: [1] non-residents

Source: NBU, ICU.

### FX market indicators (25 September 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.2880	+0.52	+17.40
EUR/USD	1.1631	-1.77	+6.29
DXY	94.642	+1.85	-4.44
UAH TWI <sup>1</sup>	122.115	+1.36	-11.44

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

### Gov't bond quotes<sup>1</sup> (28 September 2020)

Maturity	Bid	Ask
6m	10.00	8.00
12m	10.50	9.00
2y	11.00	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](http://www.icu.ua).

Source: ICU.

# Domestic liquidity and bonds market

## Borrowings down, rates up

Demand at the primary auction remains cautious. In a move toward market sentiment, the MoF increased rates. However, this week, we expect to see rising competition among buyers, and a pause in rates increasing.

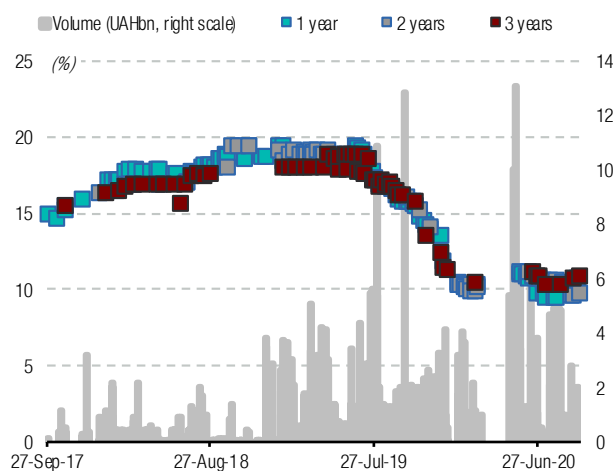
Last week, the Ministry rejected three-quarters of low demand, but increased the cut-off rate for 12-month bills by 21bp. Borrowings last week amounted to UAH0.3bn (US\$12m) (see details in [auction review](#)). This increase was not the first during recent weeks, as the Ministry already increased rates for two-year and three-year instruments.

**ICU view: This week, the Ministry has to repay about UAH10.8bn (US\$380m), including UAH8.2bn (US\$290m) in principal repayments and UAH2.6bn (US\$90m) in interest. Potentially, demand in the primary market this week can amount to about half of repayments, with increased competition for the new paper. But the Ministry may suspend rate hikes, refinancing a smaller amount of debt repayments.**

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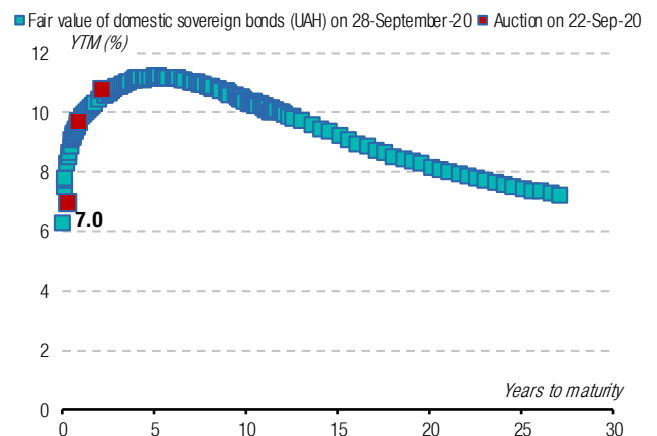
**Chart 1. Local-currency bonds**

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.

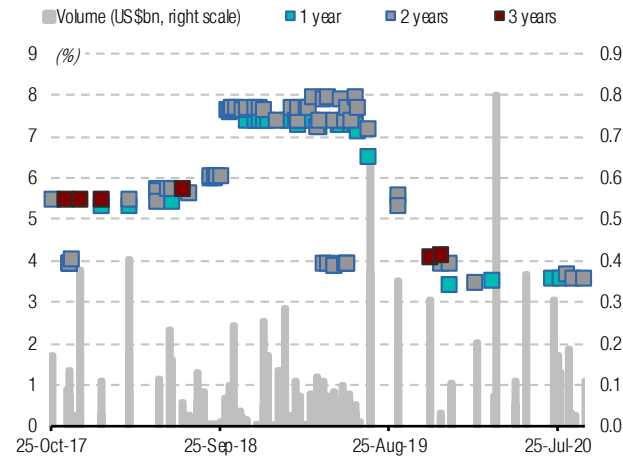
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

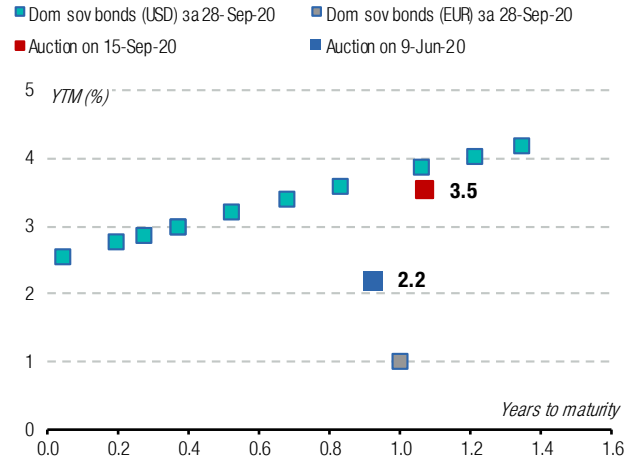
**Chart 2. FX-denominated bonds**

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 increases

Banking sector liquidity most of last week remained slightly above UAH160bn with sharp increase last Friday to UAH171bn. Large debt repayments can support liquidity at about UAH170bn this week.

Banks exchange of reserves in cash was mostly balanced caused inflow at UAH0.6bn in liquidity. VAT refund at UAH7bn last Friday caused UAH6.8bn of inflows into liquidity through treasury operations with budget funds.

Only the NBU absorbed a portion of liquidity, satisfying extra demand for hard currency in the FX market. Last week, outflow to the NBU amounted to UAH3.9bn.

**ICU view:** This week, given NBU interventions and absorption of funds, liquidity should receive large inflows from budget accounts. This inflow will be due to the partial refinancing of debt repayments.

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

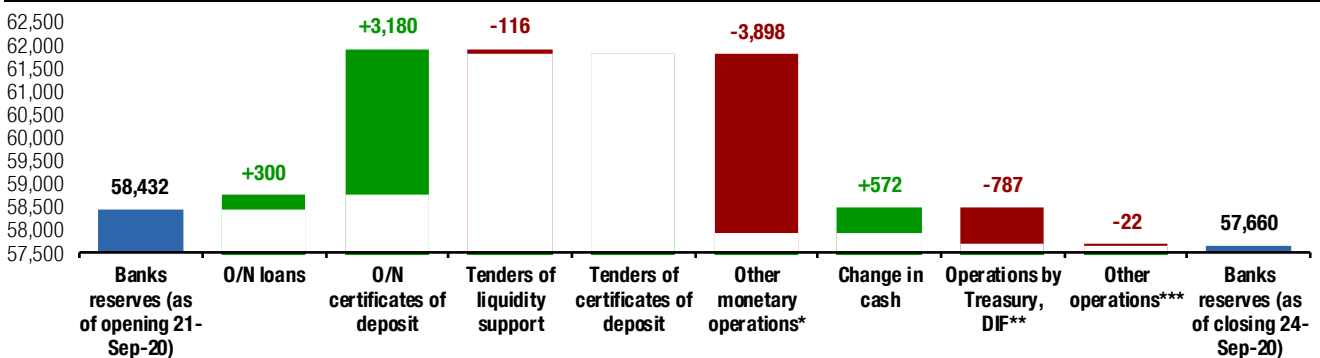
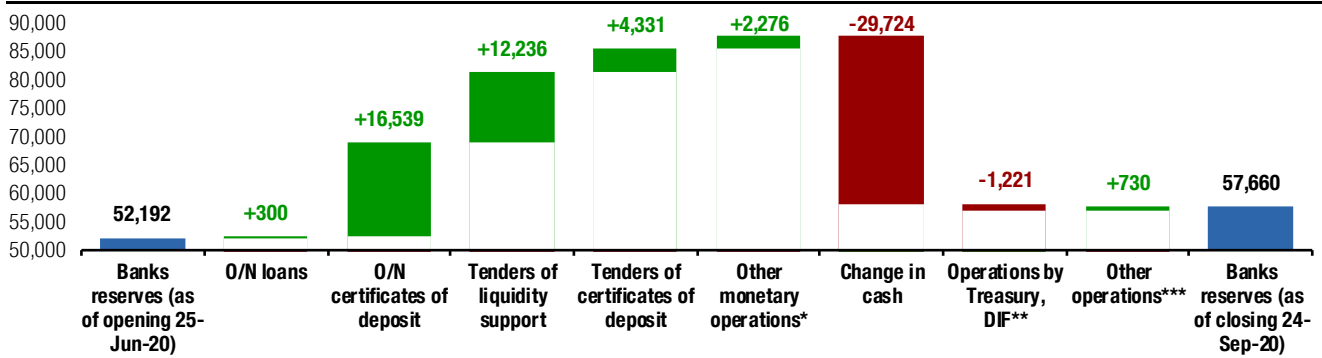


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

### Hryvnia weakening continues

The Ukrainian hryvnia continues to weaken above UAH28/US\$. This week due to increase in demand for hard currency, including from foreigners, the hryvnia can weaken to above UAH28.5/US\$.

Last week, the hryvnia lost 0.5% weakening to UAH28.29/US\$ by the end of the week. As usual, the NBU participated in the market, selling US\$160.5m, more than doubled the amount of interventions a week before.

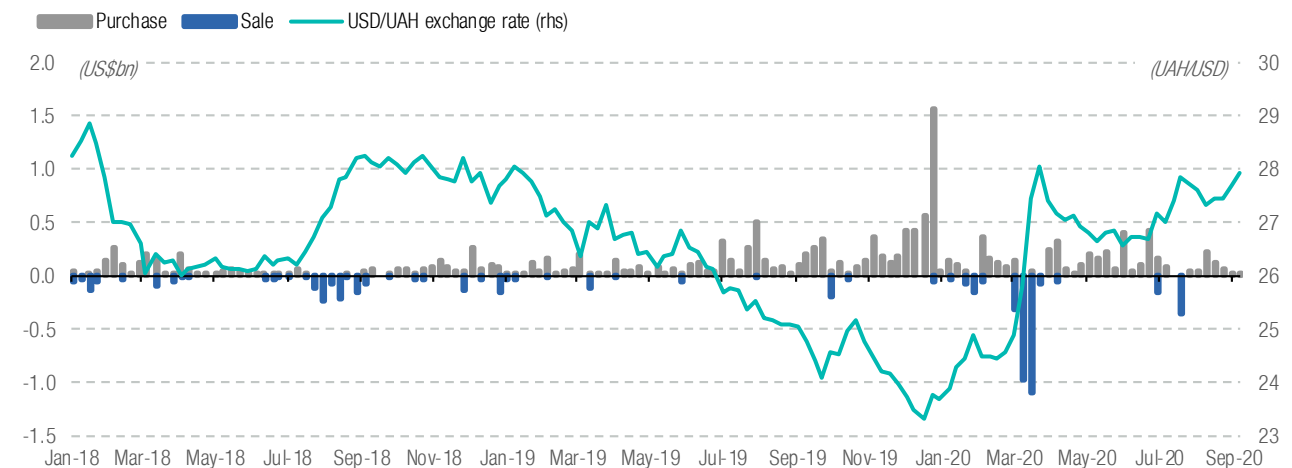
Foreigners are selling fewer local-currency bills; however, banks could accumulate hard currency in advance of large debt repayments scheduled for this Wednesday.

**ICU view: Increase in VAT refunds last Friday and demand for hard currency from foreigners after debt repayments will not be in favour for hryvnia exchange rate. We expect NBU to participate in the market with interventions, but the hryvnia will continue to weaken to above UAH28.5/US\$ by the end of 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 recovery is shifting into lower gear

Based on data published last week by UkrStat, we estimate the decline in GDP to slow to about 5% YoY in August. It was caused mainly by a continuous rebound of railway and aviation transport. On the other hand, other sectors' performance expectedly points to a slower pace of recovery amid the escalating outbreak of COVID-19 cases in Ukraine and the rest of the world. The latest activity data is consistent with our forecast of GDP decline this year by 5.7%.

In August, the decline in industrial production deepened to 5.3% YoY compared with 4.2% YoY in July, while output contracted by 0.1% MoM SA after three months of strong rebound from April's bottom. This result was mostly determined by worsened performance of food production and electricity generation.

August figures brought the 8M20 outcome to -7.4% YoY. The largest contribution to the decline came from a decrease in the output of metallurgy by 13.2% YoY and machinery by 22.1% YoY, coal mining by 17.7% YoY, and electricity generation by 5.3% YoY. At the same time, the output of the chemical industry grew by 8.6% YoY. Instead, production of chemicals grew by 7.5% YoY and pharmaceuticals by 2.3% YoY.

Agricultural production remains lower than last year, by 5.5% YoY in August compared with 5.8% YoY in June, and by 9.8% YoY in 8M20. First of all, this decline is due to the later start of harvest and lower yields of early cereals. In addition, livestock volumes continued to decline, by 2.4% YoY over 8M20.

In August, annual growth of retail sales remained high the second month in a row, 8.7% YoY. While the seasonally adjusted level of retail trade contracted by 0.6% MoM, it was almost 5% higher than its pre-pandemic level in January–February. Such a sharp recovery in retail trade was ensured, first of all, by the rebound of population's income, fueled by high, real wage growth (about 5% YoY in June–July). In addition, limited foreign tourism has largely supported domestic spending. For example, the NBU estimated money spent by Ukrainians abroad in June–July at only US\$0.5bn compared with US\$1.6bn a year ago.

The decline in wholesale trade slowed to 0.2% YoY for 8M20 from 1.3% YoY in January–July.

Transport indicators strongly improved compared with previous months, although they still lag significantly behind last year's figures. In particular, the decline in passenger turnover weakened to 45% YoY (from 58% YoY in July). This was mainly due to an increase in rail and air transport volumes, up to 51% and 43% of last year's figures, respectively. However, the indicators of public transport in cities did not change much compared with July, remaining at about 70-80% of last year's levels.

The fall in freight turnover slowed to 4.2% YoY in August from 15% YoY in July. This was due to a surge of rail freight by 12% YoY caused by an increase in transportation of construction materials against the intensification of "Great Construction" projects. As before, the volumes of pipeline transport remain significantly lower than last year.

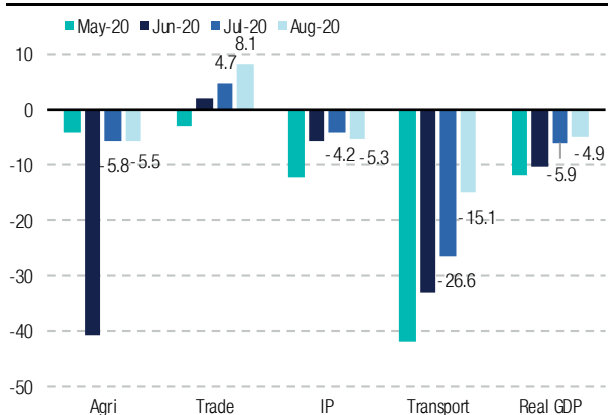
**ICU view: Some correction in industry and retail trade was anticipated due to the increase in COVID-19 cases in Ukraine and the rest of the world. In addition, in previous months, the impact of deferred demand was felt; this factor already had a much smaller contribution in August.**

**In the coming months, new outbreaks of coronavirus, the return of certain restrictions and more cautious behaviour of consumers and firms will slow the rebound in business activity. In addition, the recovery of the global economy appears to be slow, which will restrain export-oriented sectors. Additional negative effects may come from worsening weather conditions for harvesting cereals and other crops.**

**At the same time, some potential for post-pandemic recovery remains in transport. Also, additional impetus will be generated by large-scale construction projects and high demand for IT products. Overall, the latest data and expected trends are in line with our forecast for a decline in GDP this year by 5.7%.**

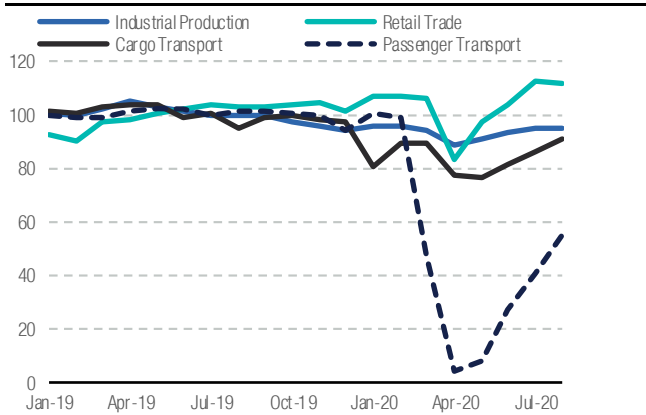
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Chart 6. Real GDP and output of activities, % YoY



Source: Ukrstat, ICU.

Chart 7. Real GDP and output of activities, SA levels, 2019=100



Source: Ukrstat, ICU.

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