Focus
Ukraine

Markets
Domestic liquidity, government bonds, FX market, and macro

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Weekly Insight

GDP sharply rebounds in 3Q20

Key messages of the today's comments

MONDAY, 23 NOVEMBER 2020

Domestic liquidity and bonds market

Restrained activity prior to redemptions

Last week, activity in the bond market was restrained awaiting redemptions this Wednesday. Primary placements and changes in bondholders' portfolios were small. This week, activity should rebound, with larger demand in the primary market and more important changes in bond portfolios.

Liquidity close to a bottom

The total amount of banking-sector liquidity once more declined without material support from the NBU. This week, liquidity can decline further without sizable expenditures from the state budget.

Foreign exchange market

FX market remains self-balanced

For the second consecutive week, the NBU did not intervene in the FX market. However, this week, demand for hard currency can rise, requiring a low amount to be supplied by the NBU.

Economics

GDP: Strong recovery in 3Q20, but outlook bumpy

8.5% QoQ SA rebound in Ukraine's GDP in 3Q20 still left output 3.5% lower than a year ago. Moreover, the recovery lost significant momentum throughout the quarter—we expect this trend to continue in 4Q20 and 1Q21.

Banks' reserves market (20 November 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	6.00	+0bp	-1,200bp
ON rate (%)	5.76	+5bp	-822bp
ON $ swap (%)	N/A	...	...
Reserves (UAHm)[2]	52,808	+79.00	-0.45
CDs (UAHm)[3]	98,829	-8.28	+45.15

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) (20 November 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.71
Banks	455,048	-0.22	+33.76
Residents	33,639	+3.50	+25.95
Individuals	8,706	+3.21	-15.54
Foreigners[1]	75,179	-2.03	-29.88
Total	**897,149**	**-0.12**	**+9.22**

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

FX market indicators (20 November 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.3241	+0.73	+17.07
EUR/USD	1.1857	+0.19	+7.08
DXY	92.392	-0.39	-5.66
UAH TWI[1]	119.377	-1.23	-12.24

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

Gov't bond quotes[1] (23 November 2020)

Maturity	Bid	Ask
6m	**10.00**	**8.00**
12m	**11.00**	**10.25**
2y	**11.75**	**10.75**
3y	**12.00**	**11.00**
12m ($)	**4.50**	**3.00**
2y ($)	**5.00**	**3.25**

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

Domestic liquidity and bonds market

Restrained activity prior to redemptions

Last week, activity in the bond market was restrained awaiting redemptions this Wednesday. Primary placements and changes in bondholders' portfolios were small. This week, activity should rebound, with larger demand in the primary market and more important changes in bond portfolios.

Last week, the MoF borrowed just UAH2.5bn (US$89m), with only UAH374m (US$13m) in local currency (see auction review). Low demand can be the result of shrinking liquidity in the banking system.

Activity was weak in the secondary market, too, especially in deals with foreigners. There was redemption of euro-denominated bills last week, only EUR200m, so changes in portfolios were not material. Banks purchased just UAH702m (US$25m) of UAH-denominated bills and individuals UAH7m (US$0.3m), while non-banks and foreigners sold just UAH61m (US$2m) and UAH244m (US$9m), respectively.

ICU view: This week, the MoF will sell a wide range of instruments in local currency from five months and up to 3.5 years. This should increase activity for local-currency bills, as the Ministry will repay more than UAH10bn (about US$350m) this week. For FX-denominated bills, activity should improve, too, as last week, the Ministry redeemed EUR200m of bills. Therefore, demand at the primary auction should be active, allowing the refinance of most repayments. However, this will not avoid further rates increases for UAH-denominated bills, especially for short-term maturities where we will see a concentration of demand.

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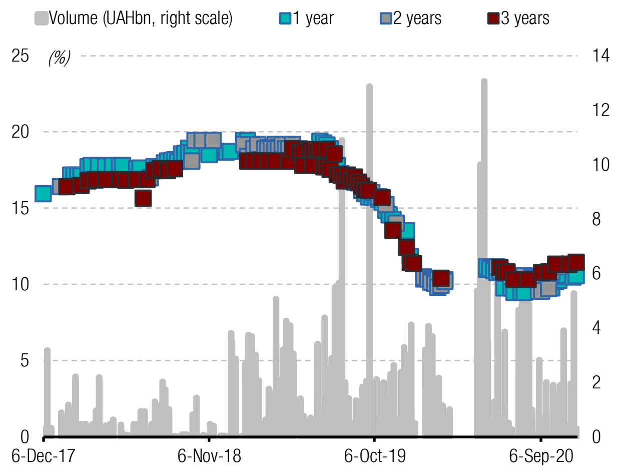
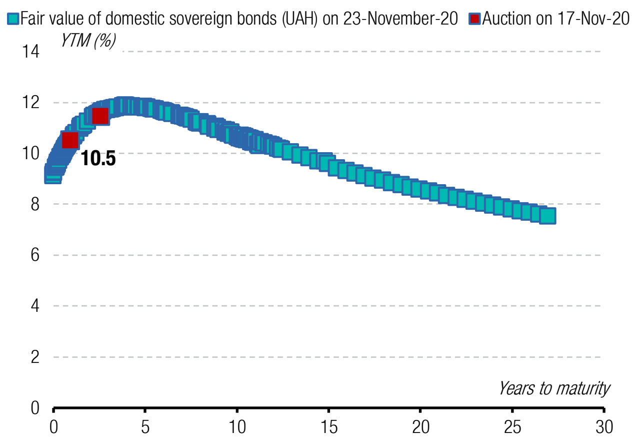
Chart 1. Local-currency bonds

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.

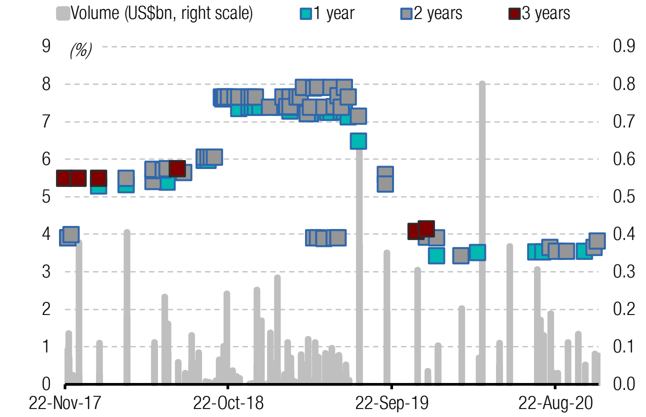
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

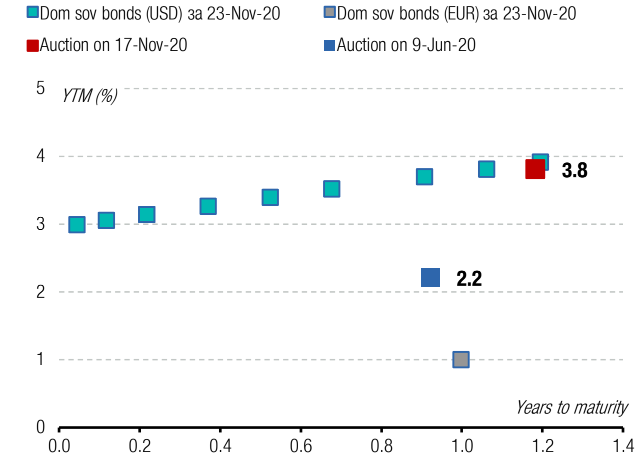
Chart 2. FX-denominated bonds

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 close to a bottom

The total amount of banking-sector liquidity once more declined without material support from the NBU. This week, liquidity can decline further without sizable expenditures from the state budget.

During most of last week, the budget collected quarterly tax payments. Tax revenues to the state budget amounted to UAH22bn according to Treasury data. This collection resulted in outflows from liquidity of UAH17bn.

Additionally, banks continued to exchange reserves in cash, causing UAH1.3bn of outflows.

NBU did not intervene FX market last week, having low impact on liquidity. Banks repaid UAH930m of loans to the NBU while NBU provided some banks with UAH600m of new loans and UAH266m of inflows through other monetary operations.

As a result, banking-sector liquidity fell to UAH153bn last Thursday, the lowest level this month and just UAH9bn more than the lowest level of this year, seen in July.

ICU view: Quarterly tax payments ended last week while month-end tax payments usually have lower impact on liquidity. Therefore, the net impact of the Treasury, especially this Wednesday (when the MoF will redeem UAH10bn of UAH-denominated bills) can be different from last week, and will cause at least lower outflows. Most likely budget expenditures will rise, supporting a recovery.

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

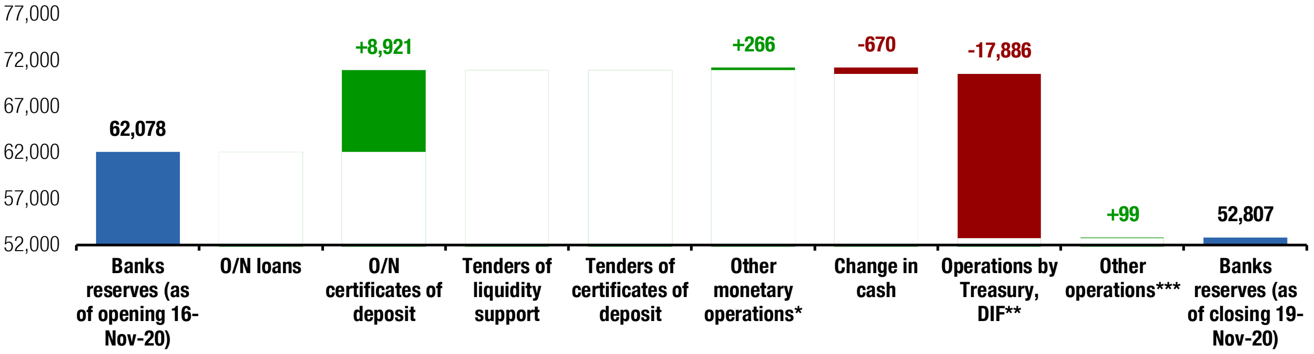
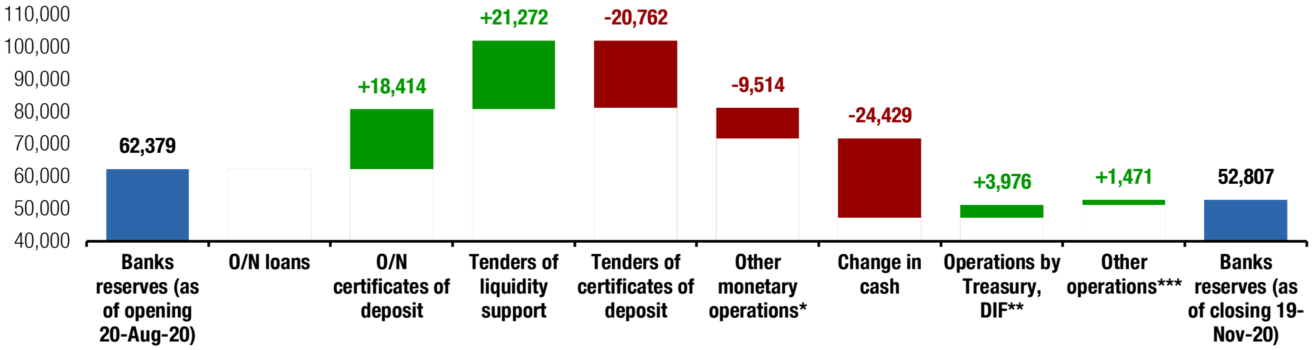


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

FX market remains self-balanced

For the second consecutive week, the NBU did not intervene in the FX market. However, this week, demand for hard currency can rise, requiring a low amount to be supplied by the NBU.

As balance in the FX market tilted to the demand side, at the end of last week, the hryvnia weakened a bit, to UAH28.32/US$ losing 0.7%. This weakening was without NBU interventions for a second week in a row.

The key support for hryvnia could have come from the selling of hard currency to pay quarterly tax payments, but after the needed amount was accumulated, balance moved to the demand side. Without material increase in demand for hard currency, including demand from foreign investors in local-currency debt, the FX market was self-balanced and gradually moved to weakening the hryvnia.

ICU view: This week, demand for hard currency can rise after redemption of local-currency bills, while supply can be lower than a week before. NBU can allow the market to attempt to be self-balanced, while standing by to intervene. So, the hryvnia exchange rate can continue to weaken to about UAH28.5/US$ and at the end of the month be within the range of UAH28.5–29/US$

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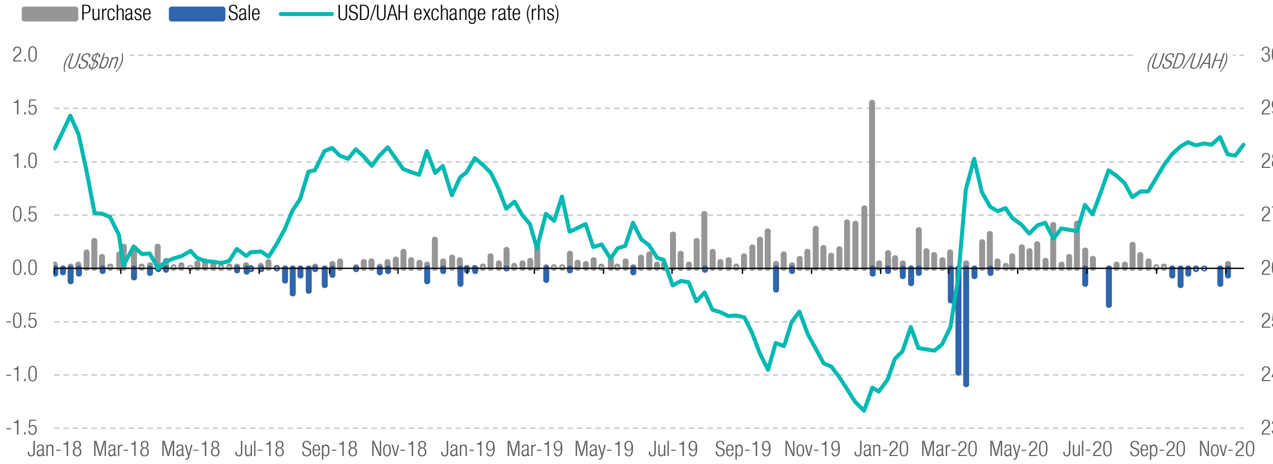
Chart 5. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

GDP: Strong recovery in 3Q20, but outlook bumpy

8.5% QoQ SA rebound in Ukraine's GDP in 3Q20 still left output 3.5% lower than a year ago. Moreover, the recovery lost significant momentum throughout the quarter—we expect this trend to continue in 4Q20 and 1Q21.

Flash estimates released last week showed strong recovery after a plunge by 9.9% QoQ SA and 11.4% YoY in 2Q20. The upturn was stronger than expected (Bloomberg consensus: -4.5% YoY; ICU: -5% YoY, NBU: -6.2% YoY), while in line with recent Ministry of Economy estimate (3.6% YoY).

UkrStat will publish the breakdown for GDP and the nominal values on 21 December.

ICU view: Like in most other countries around the globe, the main factor of such sharp recovery was easing the containment measures. Moreover, Ukraine moved from one of the toughest restrictions in the world during April-May to a quite loose stance in 3Q20, determining better performance compared with many peers (see Chart 5). Moreover, as we stressed earlier, the Ukrainian economy's features fitted the current crisis quite well (high share of IT and agri, low share of contact services, etc.), terms of trade improved, and macrofinancial resilience was rather strong due to prudent monetary, banking supervision, and fiscal policies in the previous years. However, during the crisis, fiscal stimulus were relatively modest and focused mostly on automatic stabilizers and construction spending. In addition, weak agricultural performance due to the later start of corn harvesting provided a significant negative contribution (about 1.5 p.p.) in the 3Q20 GDP growth outcome.

Moreover, the recovery lost significant momentum through the quarter. E.g., in September, SA industrial production was lower slightly than in July, and SA transport volumes fell compared with August.

It appears that the earlier gains from re-opening the economy were fizzling out and further gains are proving much harder to come by. This trend is likely to continue over the coming months or even reverse. Indeed, new COVID-19 cases continue to grow fast, suggesting that the recently introduced weekend lockdown may be replaced with even more stringent restrictions.

On the other hand, private consumption seems to continue growing fast supported by return of incomes to pre-pandemic trajectory, and public infrastructure projects offset the weakness of private investment as evidenced by strong construction data. In addition, monetary policy stance remains relatively loose, and we expect sizable fiscal impulse at the end of the year albeit lower than envisaged in budget law.

All told, we think that Ukraine's GDP growth in sequential terms will be bumpy and much slower in 4Q20 and 1Q21 while still positive. Overall, the economy is likely to contract by around 5% in 2020 (compared with 5.7% in our September forecast). While this would bring GDP below the level of 2018, it would still make Ukraine a better-performing economy compared with the most of its peers.

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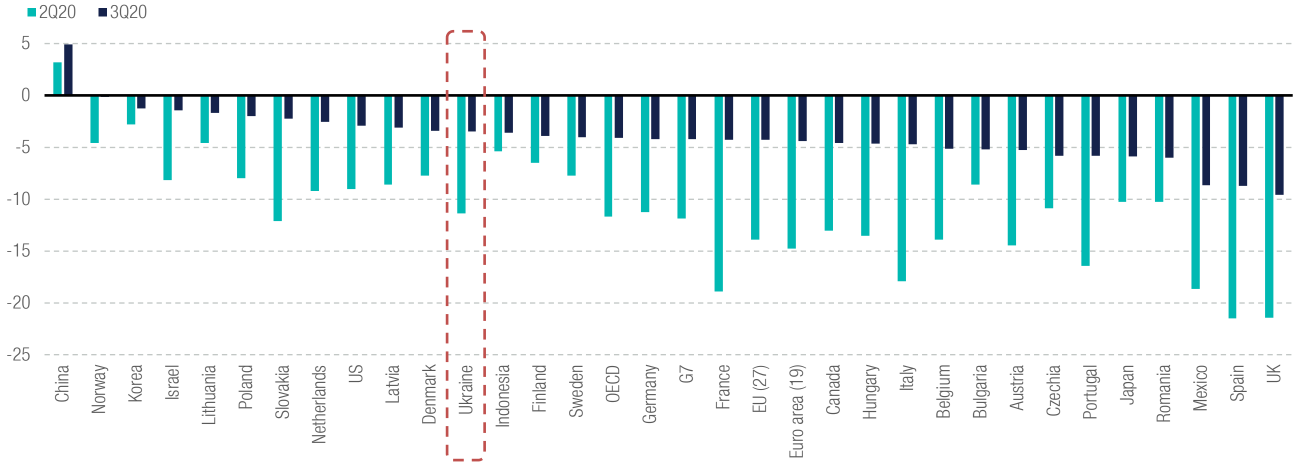
Chart 6. Real GDP (YoY, %)



Source: OECD, State Statistics Service of Ukraine, ICU.

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