

# Weekly Insight

## Real GDP rises 3.3% in 2018

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Demand declines

Last week, demand for local-currency bills sufficiently declined. Given current conditions, including refinancing of FX-denominated debt repayments, it could remain low in the following weeks.

##### Expect outflow of liquidity

The total amount of banking-sector liquidity last week was mostly above UAH114bn. Through the end of this month, liquidity should decline due to tax payments and low inflows from the NBU.

#### Foreign exchange market

##### Increase in hryvnia volatility

After easing FX market regulations, volatility of the hryvnia exchange rate rose, and balance in the market moved to the demand side. Without new foreign investments in new bills, the hryvnia will be slightly above UAH27/US\$ until the end of February.

#### Economics

##### Real GDP rises 3.3% in 2018

Less favourable external conditions, as well as tight monetary and restrictive fiscal policies will cause a slowdown of economic growth in 2019.

MONDAY, 18 FEBRUARY 2019

#### Banks' reserves market (15 February 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	18.00	+0bp	+200bp
ON rate (%)	16.58	+49bp	+198bp
ON \$ swap (%)	16.23	+41bp	+151bp
Reserves (UAHm) <sup>2</sup>	57,964	+49.48	-1.89
DepCerts (UAHm) <sup>3</sup>	56,430	-22.88	+28.25

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) (15 February 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	338,607	-0.62	-4.95
Banks	375,772	+0.69	+8.05
Residents	25,524	+4.76	-2.24
Individuals	7,147	+5.13	+327.45
Non-res <sup>4</sup>	13,529	+1.02	+6.73
<b>Total</b>	<b>760,579</b>	<b>+0.28</b>	<b>+2.16</b>

Notes: [1] non-residents

Source: NBU, ICU.

#### FX market indicators (15 February 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.2460	+0.45	+1.53
EUR/USD	1.1296	-0.24	-9.68
DX <sup>2</sup>	96.904	+0.28	+9.38
UAH TWI <sup>3</sup>	119.933	+0.00	+8.08

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

#### Gov't bond quotes<sup>1</sup> (18 February 2019)

Maturity	Bid	Ask
6m	20.00	18.50
12m	20.00	18.50
2y	19.75	18.00
3y	19.50	17.50
12m (\$)	7.50	5.25
2y (\$)	7.50	5.50

Notes: [1] Actual quotes you can see at [www.icu.ua](http://www.icu.ua).

Source: ICU.

# Domestic liquidity and bonds market

## Demand declines

Last week, demand for local-currency bills sufficiently declined. Given current conditions, including refinancing of FX-denominated debt repayments, it could remain low in the following weeks.

Last week, the MoF replaced bills with two and three-month maturities by re-opening of bills with maturity in June after the presidential elections. This tenor, and appreciation of hryvnia to about UAH27/US\$, decreased the attractiveness of government bills for foreign investors. Last week, they did not increase their portfolios sufficiently.

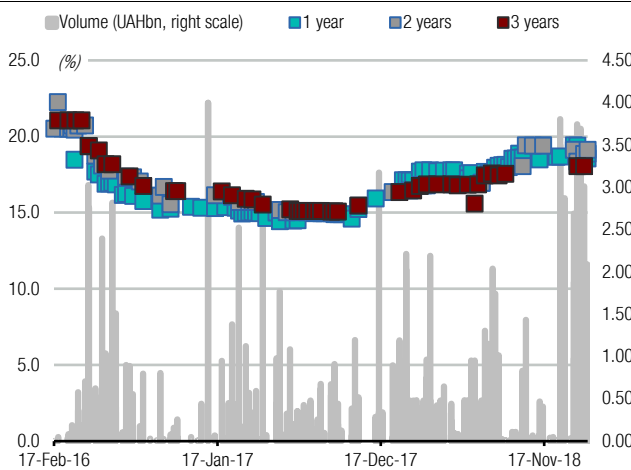
In total last week including FX-denominated bills, the MoF borrowed UAH3.5bn. This amount is less than a week before, and also less than in January. In [last week's auction](#), demand was concentrated at the shortest maturity, the four-month, as usual. Demand was also low for FX-denominated bills.

**ICU view: We do not anticipate sufficient increase in foreign investors' portfolios in the following weeks, as the MoF has scheduled bills that mature in June or later. Domestic demand will stay at around UAH2-3bn for a week, mostly for the shortest maturity. As debt repayments in local currency (except payments to the NBU) this month are low, demand will be mostly in new investments, with refinancing of FX-denominated bill redemption.**

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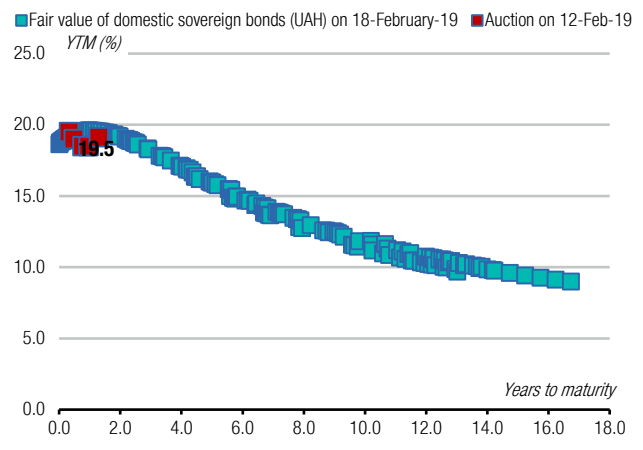
**Chart 1. Local-currency bonds**

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.

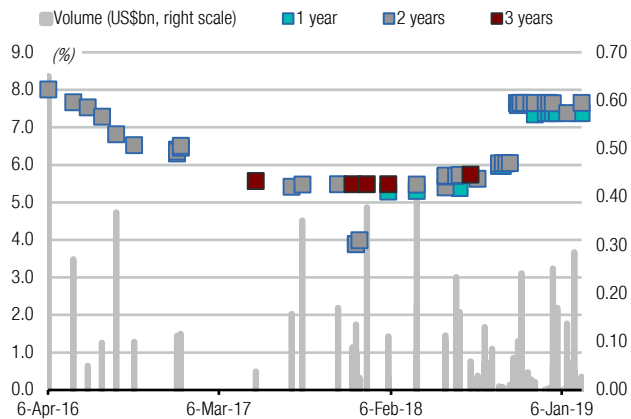
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

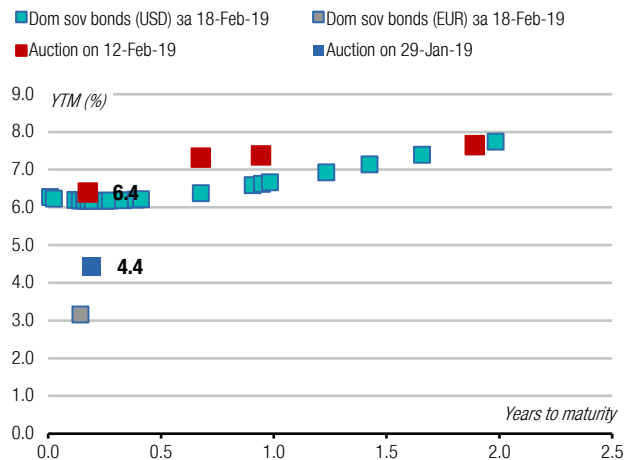
**Chart 2. FX-denominated bonds**

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.

**Expect outflow of liquidity**

The total amount of banking-sector liquidity last week was mostly above UAH114bn. Through the end of this month, liquidity should decline due to tax payments and low inflows from the NBU.

Last week, the Treasury increased expenditures, and injected UAH1.3bn in liquidity in four days' time. But last Friday, the Treasury absorbed UAH0.8bn, which decreased the positive impact on liquidity to UAH0.5bn. At the same time, banks continued to exchange reserves in cash, but were less active, at just UAH1.0bn.

NBU decreased purchases of FX at the market to US\$25m or UAH0.7bn during first two days of last week, and later in the week did not participate in the market. Banks also received UAH3.8bn of two-week loans from the NBU, which is UAH0.7bn less than was repaid the same day.

**ICU view:** Due to quarterly payments of corporate tax and the purchase of new bills, we could see a decline in liquidity, but not a significant one. We expect it will stay above UAH100bn.

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

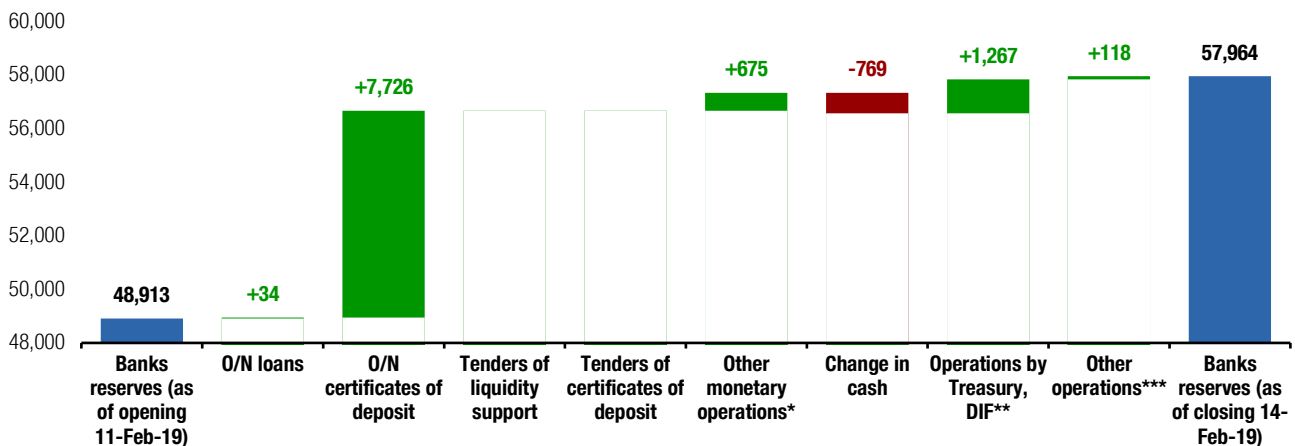
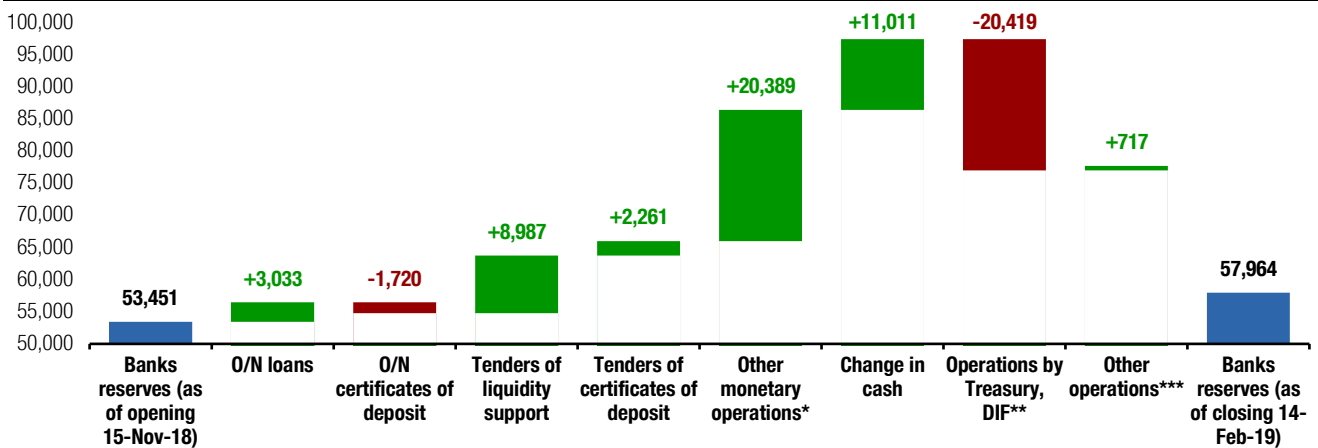


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

### Increase in hryvnia volatility

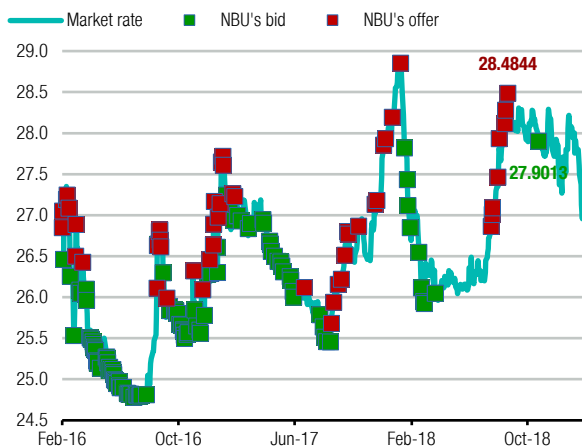
After easing FX market regulations, volatility of the hryvnia exchange rate rose, and balance in the market moved to the demand side. Without new foreign investments in new bills, the hryvnia will be slightly above UAH27/US\$ until the end of February.

Lack of demand from foreign investors at primary auctions last week was the key reason that the hryvnia stopped appreciating, crossing the level of UAH27/US\$ on the downside. Balance at the market slightly moved to the demand side, and the hryvnia was volatile at around UAH27.2/US\$ most of last week. NBU had low impact on the market, having a net balance of operations in the FX market at US\$25m of purchased FX.

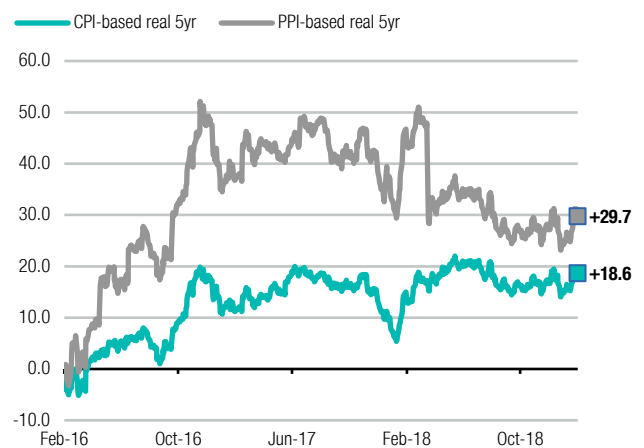
At the end of last week hryvnia weakened 0.45% to UAH27.246/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) remained steady at 119.9 while in YoY terms, it was up 8.1%.

**ICU view: Easier regulations and lack of demand from non-residents have diminished the possibility of further hryvnia appreciation. This week, we will see most of the quarterly corporate tax payments, and next week month-end tax payments are due. But we do not expect a massive sell-off of FX for these payments. We expect the hryvnia to fluctuate within UAH27.1-27.3/US\$ until the end of the month.**

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**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 misalignment<sup>1</sup> from fundamental level<sup>2</sup> (%)*


Notes: [1] "+" overvalued, "-" undervalued; [2] based on the UAH's CPI- and PPI-based real TWIs. Source: ICU.

## Economics

### Real GDP rises 3.3% in 2018

Less favourable external conditions, as well as tight monetary and restrictive fiscal policies will cause a slowdown of economic growth in 2019.

In 4Q18, real GDP growth accelerated to 1.1% QoQ SA and 3.4% YoY, bringing the full-year 2018 reading to growth of 3.3% (ICU calculation), per preliminary data from the Statistics Service of Ukraine. The acceleration of economic growth in 4Q18 was mainly thanks to the record grain harvest, particularly of late crops, which boosted growth of agricultural output to 7.9% YoY in 4Q18 (ICU calculation).

In full-year 2018, the key growth drivers among real sectors of economy were retail sales (+6.1%), agriculture (+7.8%), and construction (+4.4%). We estimate nominal GDP at UAH3.57tn, which is equivalent to US\$131bn.

**ICU view: Real GDP growth in 4Q18 (+3.4% YoY) and in full-year 2018 (+3.3%) was slightly less than our estimates of 3.6% YoY and 3.5% YoY, respectively. This was largely due to weak performance of the real sectors of economy in December (imposition of martial law, and turmoil in world commodity and equity markets), as industrial production fell 3.5% YoY, construction dropped 8.8% YoY, and cargo-transportation turnover was down 6.8% YoY. For 2019, our baseline scenario envisages real GDP growth to slow to 2.3% due to less favourable external conditions, tight monetary and restrictive fiscal policies, as well as the double elections, which negatively impact business expectations.**

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