

Weekly Insight

Mixed start for the economy in 4Q19

Key messages of the today's comments

TUESDAY, 26 NOVEMBER 2019

Domestic liquidity and bonds market

Investors waiting for longer-term notes

Last week, there was little change in bondholders' portfolios, as redemptions and new borrowings mostly offset each other. Demand at the primary auction declined, probably because investors are waiting for today's four-year notes.

Liquidity stabilizes and can rise due to VAT refunds

Due to quarterly tax payments, the total amount of banking-sector liquidity declined, but with VAT refunds this week, liquidity can receive additional support and rise to UAH130bn.

Foreign exchange market

Hryvnia appreciation continues

Quarterly tax payments caused additional support for the hryvnia last week, which continued to appreciate. This week, it could cross UAH24/US\$ due to new foreign investments in local-currency notes.

Economics

Mixed start for the economy in 4Q19

Robust consumer and investment demand will continue to support Ukraine's economic growth. However, due to lower YoY harvest in 4Q19, real GDP growth will slow by year-end.

Banks' reserves market (25 November 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+0bp
ON rate (%)	13.95	-1bp	-488bp
ON \$ swap (%)	13.39	+39bp	-527bp
Reserves (UAHm) ²	55,619	-2.25	+9.50
DepCerts (UAHm) ³	70,406	-0.24	+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) (25 November 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,063	+0.00	-3.17
Banks	337,780	+0.06	-5.89
Residents	26,604	+0.81	+37.30
Individuals	10,041	-0.78	+79.36
Non-res ⁴	104,702	-0.37	+1,481.33
Total	816,189	-0.01	+10.50

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

FX market indicators (25 November 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.0600	-0.53	-13.33
EUR/USD	1.1014	-0.58	-2.85
DX ²	98.323	+0.48	+1.45
UAH TWI ³	137.290	+0.98	+16.75

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

Gov't bond quotes¹ (26 November 2019)

Maturity	Bid	Ask
6m	15.50	14.00
12m	15.50	14.00
2y	15.25	13.75
3y	14.75	13.00
12m (\$)	5.00	3.00
2y (\$)	5.00	3.50

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

Domestic liquidity and bonds market

Investors waiting for longer-term notes

Last week, there was little change in bondholders' portfolios, as redemptions and new borrowings mostly offset each other. Demand at the primary auction declined, probably because investors are waiting for today's four-year notes.

Last week, local-currency debt redemption was UAH1.8bn. Most of it was refinanced with new UAH1.3bn borrowings (see auction [comment](#)). However, new borrowings were less than half of what was possible, as demand was significantly lower than the offered amount.

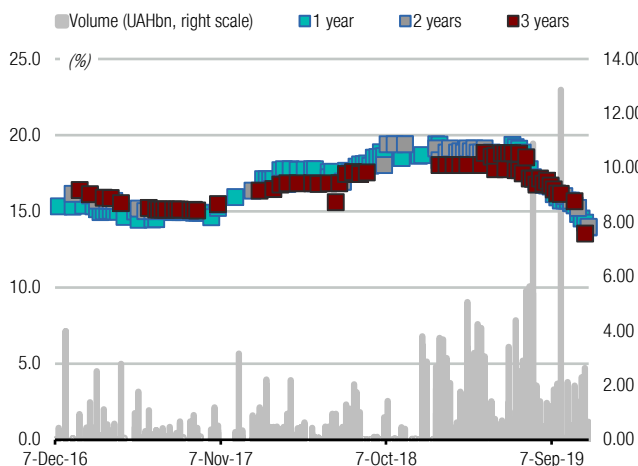
Therefore, portfolios of key bondholder groups saw slight changes due to redemptions and new issues, and also due to movements in the hryvnia exchange rate.

ICU view: Today, the MoF offers four-year notes, which three weeks ago were five times oversubscribed. So, this week without any local-currency debt redemptions, some portfolios could rise, which most likely will be foreigners', as they usually are the main investors in longer-term maturities.

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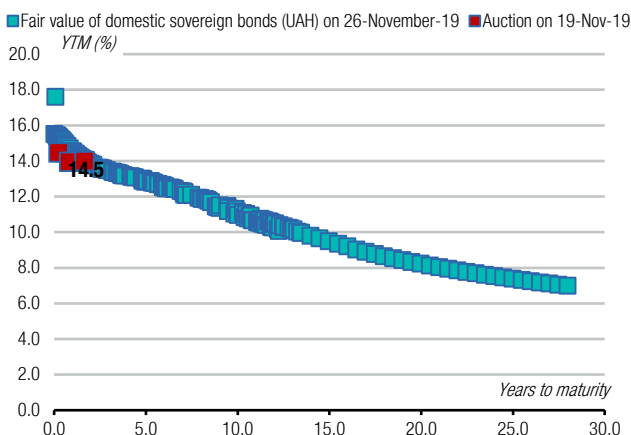
Chart 1. Local-currency bonds

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.

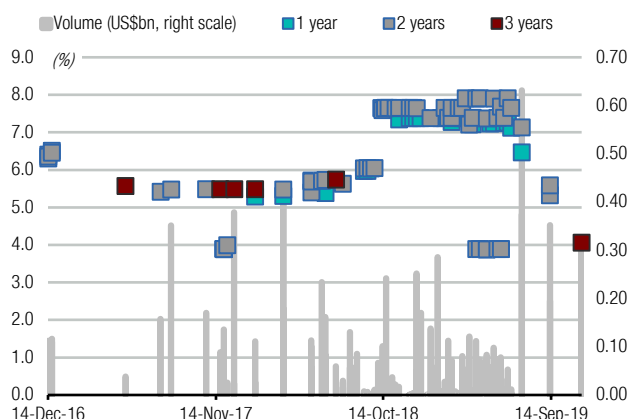
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

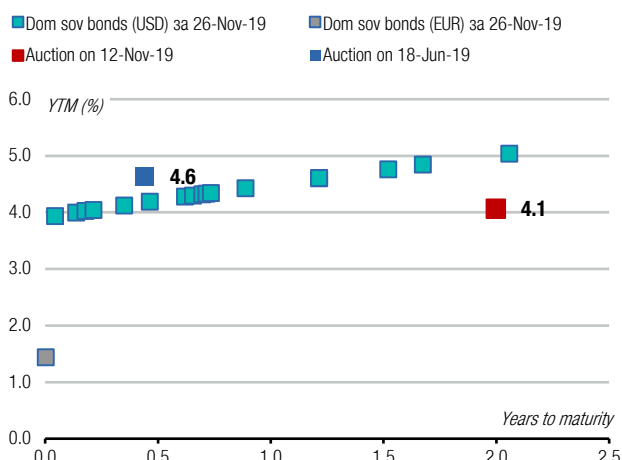
Chart 2. FX-denominated bonds

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 stabilizes and can rise due to VAT refunds

Due to quarterly tax payments, the total amount of banking-sector liquidity declined, but with VAT refunds this week, liquidity can receive additional support and rise to UAH130bn.

The Treasury absorbed UAH17.2bn during the first two days of last week, but starting Wednesday, budget expenditures exceeded revenues, and in total, last week, the budget absorbed UAH14.6bn. Outflows were partially compensated by cash exchange in reserves and NBU injections via FX market.

Last Tuesday, liquidity hit the lowest level this month, UAH121.1bn, but by the end of the week, it slightly recovered to UAH126bn due to FX purchases by NBU of UAH2.2bn, and UAH2.7bn of inflows from non-monetary operations.

ICU view: This week, VAT refunds will cause inflows above UAH6bn, which should compensate outflows via month-end tax payments. With FX purchases, the NBU can support liquidity to about UAH130bn and even above this level.

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

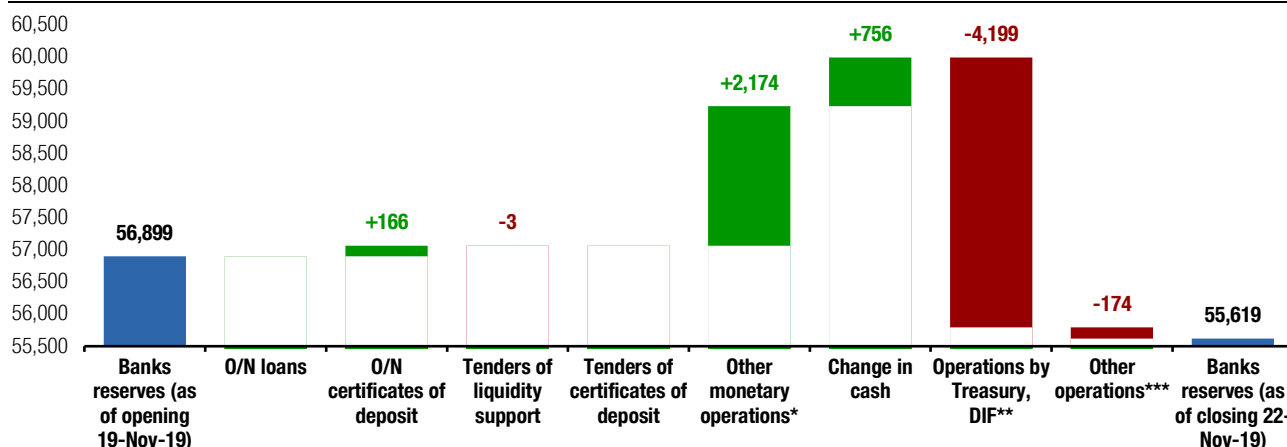
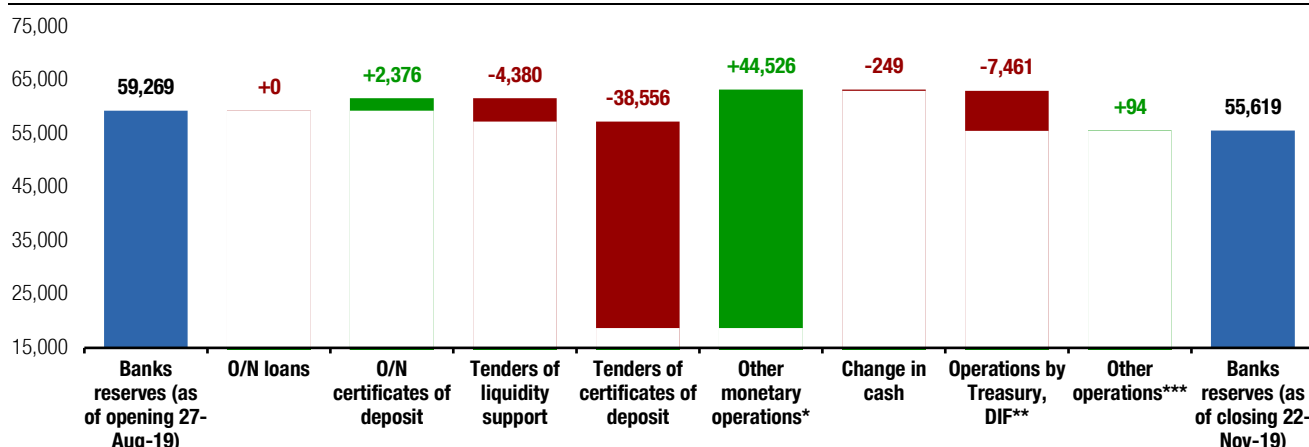


Chart 4. Banks reserves usages over last 90-day period (UAHm)


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 appreciation continues

Quarterly tax payments caused additional support for the hryvnia last week, which continued to appreciate. This week, it could cross UAH24/US\$ due to new foreign investments in local-currency notes.

Tax payments started last week, and possibly exporters increased the supply of hard currency and supported the hryvnia. However, even after taxes were paid, the hryvnia continued to appreciate, to UAH24.16/US\$ or by 0.24% during the week.

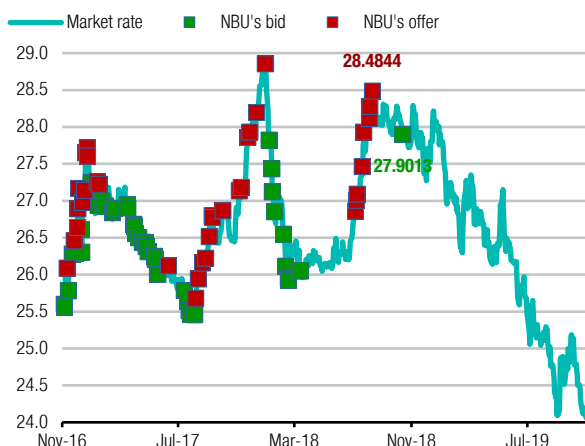
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.5% to 136.5, while in YoY terms, it was up 16.8%.

ICU view: This week, the hryvnia strengthened, and with possible active demand for the four-year notes today, the supply of FX in the market should exceed demand. This supply can be enough to cause hryvnia to cross UAH24/US\$, although this appreciation can be short-lived.

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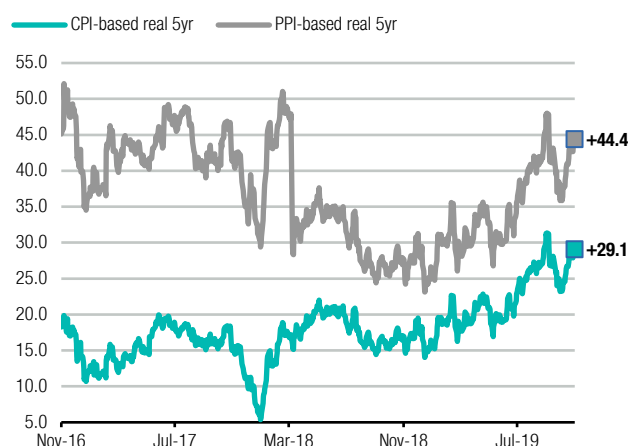
Chart 5. FX market indicators, 3-year history

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 misalignment¹ from fundamental level² (%)



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

Economics

Mixed start for the economy in 4Q19

Robust consumer and investment demand will continue to support Ukraine’s economic growth. However, due to lower YoY harvest in 4Q19, real GDP growth will slow by year-end.

Industrial production slowed for the fifth consecutive month. In October it fell 2.4% MoM SA and 5% YoY, while decline was in all major subsectors. Agricultural output declined 6.7% YoY in October due to lower YoY harvest of sunflower seeds, sugar beet and soy beans. On the flip-side, retail growth accelerated to 11% YoY (vs. 8.6% YoY in September), and construction grew 14% YoY (vs. 12.2% YoY in September). Improved dynamics was also in transport sector, where cargo turnover rose 5% YoY, and passenger turnover increased 8.3% YoY (ICU est.).

ICU view: Industrial production decline (-5% YoY) and lower agricultural output (-6.7% YoY) will have a negative impact on the 4Q19 real GDP reading, as these two sectors account for about 33% of nominal GDP in the fourth quarter. At the same time, accelerated growth in retail sales and construction imply that consumer and investment demand remain solid and will keep driving economic growth in 4Q19.

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