

# Weekly Insight

## Real GDP rises 3.2% in 2019

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Increase in FX-denominated paper outstanding

Changes in the structure of portfolios continued last week, where the main impact came from FX-denominated bills. New issues last Tuesday and hryvnia weakening increased the FX-denominated component of portfolios. This week, the same dynamic will continue, especially due to new issues.

##### Decline in liquidity continues

The necessity to manage exchange rate volatility through hard currency selling from FX reserves caused a new wave of local-currency liquidity outflow to from the NBU. Other sources only partially compensated this outflow. By the end of last week, banking-sector liquidity fell to UAH184bn, and can decline this week, too.

#### Foreign exchange market

##### Pressure on hryvnia eases

The hryvnia continued to weaken last week. On Friday, the UAH/USD exchange rate crossed the UAH28/US\$ level, but due to NBU interventions and a changing market balance in favor of supply, the currency slightly appreciated to UAH27.5/US\$ by the end of the trading session. This week, demand for local currency will increase, resulting in slight volatility of the hryvnia exchange rate at around UAH28/US\$.

#### Economics

##### Real GDP rises 3.2% in 2019

Following a four-year period of growth, Ukraine's economy will contract this year against the backdrop of spreading COVID-19, and the world economic crisis caused by this virus.

##### Retail turnover rises 15.7% YoY in February

Spreading COVID-19 and enforced quarantine will result in contraction of consumer demand and a decrease of retail trade in the following months.

TUESDAY, 24 MARCH 2020

#### Banks' reserves market (23 March 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	10.00	+0bp	-800bp
ON rate (%)	11.08	-381bp	-548bp
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	88,553	+84.94	+62.21
DepCerts (UAHm) <sup>3</sup>	95,403	-39.65	+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) (23 March 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	341,218	+2.19	-7.74
Residents	28,856	+4.21	+9.31
Individuals	9,240	+1.92	+16.33
Non-res <sup>4</sup>	124,180	-0.72	+564.13
<b>Total</b>	<b>828,071</b>	<b>+0.96</b>	<b>+8.93</b>

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

#### FX market indicators (23 March 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.4530	+1.40	+2.08
EUR/USD	1.0726	-2.46	-5.10
DX <sup>2</sup>	102.487	+2.92	+6.04
UAH TWI <sup>3</sup>	130.692	+1.90	+8.09

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

#### Gov't bond quotes<sup>1</sup> (24 March 2020)

Maturity	Bid	Ask
6m	22.00	15.00
12m	22.00	15.00
2y	22.00	15.00
3y	22.00	15.00
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

## Increase in FX-denominated paper outstanding

Changes in the structure of portfolios continued last week, where the main impact came from FX-denominated bills. New issues last Tuesday and hryvnia weakening increased the FX-denominated component of portfolios. This week, the same dynamic will continue, especially due to new issues.

Actually, last week, only foreign investors' portfolios declined. Revaluation of a small amount of FX-denominated bills in their portfolios did not compensate for the selling of local-currency paper. Total portfolios declined by UAH0.8bn (US\$29m) to UAH124bn (US\$4.5bn), while the local-currency portion of portfolios slid by UAH0.9bn (US\$32m) to UAH124bn (US\$4.4bn). This decline is not critical; this month they sold UAH5.5bn (US\$0.2bn) of local-currency bills, so the pace of selling is slowing.

For local investors, the main impact was the revaluation of FX-denominated instruments. Last week, the MoF sold US\$74m of new bills (par value). Demand for this issue was low, but was mostly accepted with unchanged cut-off rate and slightly increased by 11bp weighted-average rate; both were set at 3.5% (see details of this auction [here](#)).

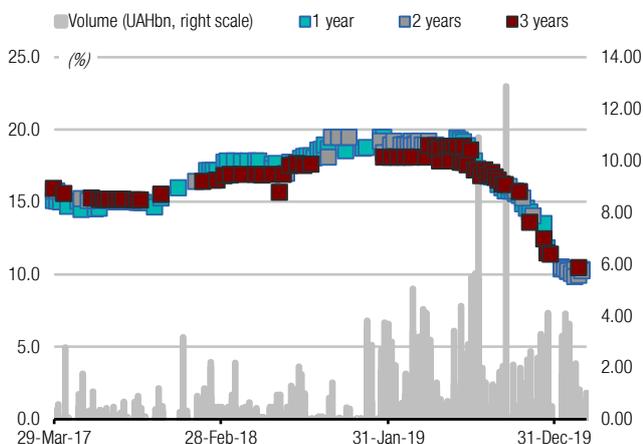
These bills and the purchase of some local-currency bills from foreigners allowed banks to increase portfolios by UAH7.6bn (US\$0.3bn) to UAH341bn (US\$12bn), with their share in total outstanding increasing to 41.2%. Non-banks also purchased UAH-denominated bills in the secondary market, the same as individuals, who purchased UAH-denominated paper last week after weeks of selling.

**ICU view: This week, the MoF offers three-month bills in US dollars and 13-month bills in euro. Most likely, the key impact on portfolios will have the issuance of FX-denominated bills and their revaluation with the actual exchange rate.**

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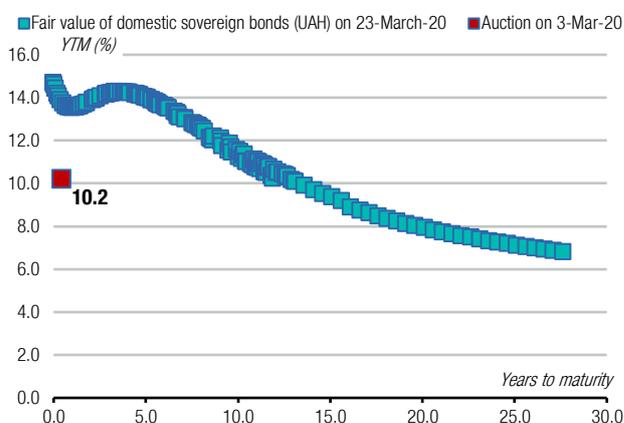
**Chart 1. Local-currency bonds**

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.

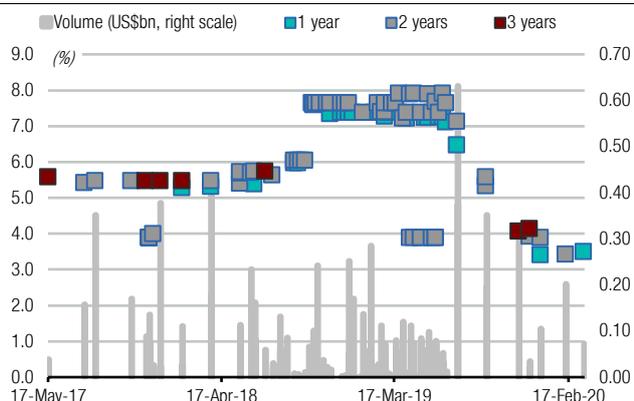
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

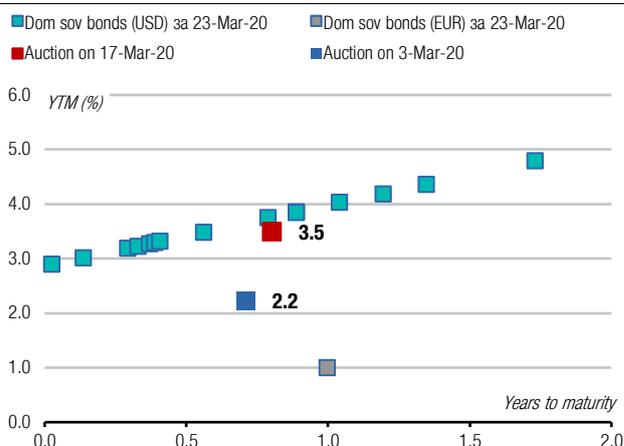
**Chart 2. FX-denominated bonds**

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.

**Decline in liquidity continues**

The necessity to manage exchange rate volatility through hard currency selling from FX reserves caused a new wave of local-currency liquidity outflow to from the NBU. Other sources only partially compensated this outflow. By the end of last week, banking-sector liquidity fell to UAH184bn, and can decline this week, too.

Through operations in the FX market, last week, the NBU absorbed about UAH29bn, causing the main outflow from liquidity. Additional outflow was caused by reserves exchange in cash, which banks' clients, probably individuals, spent on FX purchases or to create food reserves due to the quarantine. Through these operations, liquidity lost an additional UAH4bn.

Treasury operations slightly compensated outflows. Their balance was just UAH1.2bn, significantly less than outflows. Therefore, banks requested support from the NBU, step-by-step increasing the amount of ON loans to UAH11bn, which were mostly converted to monthly loans, at UAH7bn last Friday.

Banks also decreased the amount of NBU CDs they held. Banks invested just UAH66bn in seven-day CDs after redemption of UAH148bn of two-week certificates last Friday.

The week began with UAH184bn of banking-sector liquidity, as we expected, including UAH95bn in NBU CDs and UAH89bn in banks' correspondent accounts with the NBU.

The decline in banking-sector liquidity resulted in an increase in interest rates in the capital markets, with an increase in ON loans to about 15%. Such rates were probably the main reason that banks requested NBU support, while exporters could sell some hard currency instead of taking new loans (see comment below).

**ICU view: This week, we expect less intervention by the NBU in the FX market, but later this week, outflows from liquidity could come to the Treasury due to month-end tax payments. As a result, liquidity can continue to decline slightly, to around UAH170bn by the end of the week.**

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

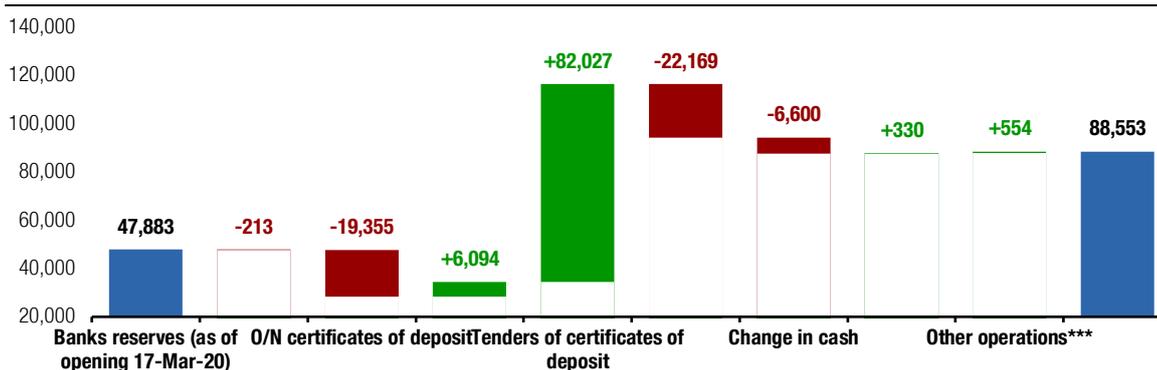
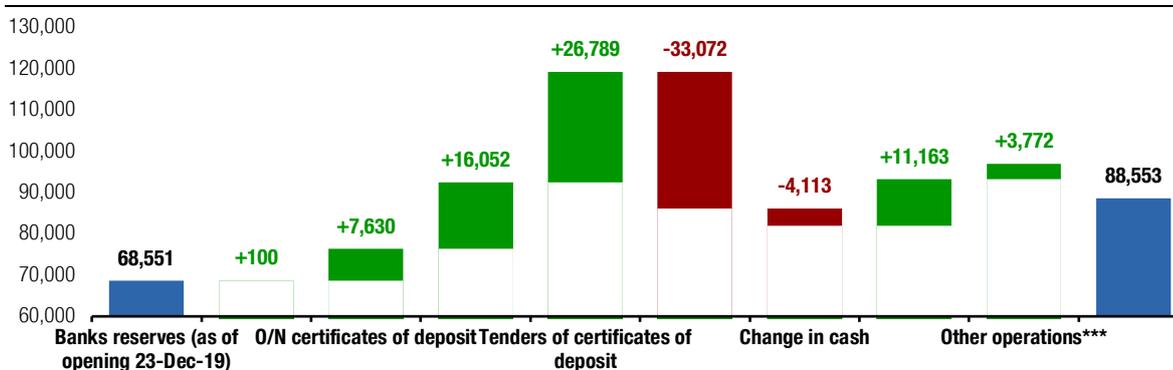


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

### Pressure on hryvnia eases

The hryvnia continued to weaken last week. On Friday, the UAH/USD exchange rate crossed the UAH28/US\$ level, but due to NBU interventions and a changing market balance in favor of supply, the currency slightly appreciated to UAH27.5/US\$ by the end of the trading session. This week, demand for local currency will increase, resulting in slight volatility of the hryvnia exchange rate at around UAH28/US\$.

Large demand for hard currency forced the NBU to sell more than US\$1bn from reserves. Last Monday, the NBU held a third-in-a-row FX auction, but it likely did not help to restrain weakening or satisfy extra demand. So, later last week, the NBU used other ways to intervene such as selling at a fixed rate or choosing a better price.

Again, demand for hard currency did not come from foreigners. Foreign investors in local-currency debt and sold only about UAH1bn of bills, causing demand for only US\$40m during the week.

A decline in liquidity and an increase in local-market rates increased the attractiveness of selling FX instead taking on new short-term loans. Likely, the selling of hard currency by exporters was the main reason for reversing the direction of the exchange rate to appreciation last Friday, which incited the NBU to buy extra supply. Finally, the NBU sold US\$1.1bn last

week and US\$2.2bn this month from reserves, buying back US\$0.2bn in March, including US\$50m last Friday.

So, last week, the hryvnia lost 6.4%, weakening to UAH27.47/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) slid 1.3% to 130.5, while in YoY terms, it was up 10.6%.

**ICU view: Need for local-currency funds will be the key support for the hryvnia this week. Month-end tax payments and financing spring farm work should create demand for local-currency funds, and increase the selling of hard currency. Without external shocks, we do not anticipate significant further hryvnia weakening, which may result in slight volatility at around UAH28/US\$.**

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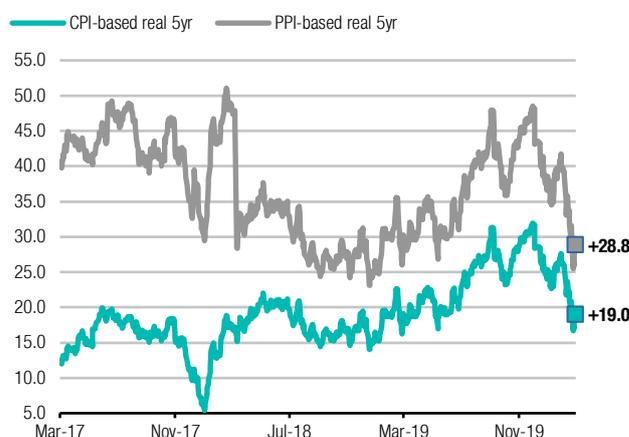
Chart 5. FX market indicators, 3-year history

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market



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 3.2% in 2019

Following a four-year period of growth, Ukraine's economy will contract this year against the backdrop of spreading COVID-19, and the world economic crisis caused by this virus.

The growth of Ukraine's economy slowed to 3.2% in 2019 from 3.4% YoY in 2018, per data from Ukrstat. The production approach shows that key growth drivers were construction (+23% YoY), trade (+3.6% YoY), real estate activities (+7.5% YoY), and the IT-sector (+3.5% YoY). According to the consumption approach, growth was driven by households consumption (+11.9% YoY), and fixed-capital investments (+14.2% YoY). Government consumption contracted 4.9% YoY, and net imports rose 4.8% YoY. Nominal GDP rose 12% YoY to UAH3,975bn, which is equivalent to US\$155bn (+19% YoY). The GDP deflator was 8.1% vs. 15.4% in 2018.

**ICU view: Actual 2019 real GDP growth was in line with our estimate. We believe that the spreading COVID-19 in Ukraine and across the globe will cause significant contraction of Ukraine's economy in 2020. Consumer demand, the key growth driver of Ukraine's economy in last years, will drop significantly due to the imposed quarantine, falling incomes of households, weaker UAH, and a worsening of consumer**

*expectations. Investment activity will also fall, mainly due to a decrease in construction against the backdrop of lower investments in green energy projects and lower government spending due to low budget revenues and the need of large debt payments this year. It should be mentioned that international capital markets are now closed for developing countries, while foreign investors will abstain from investing in Ukraine's local government bonds against the backdrop of turmoil on financial markets. At the same time, contracting economies of Ukraine's key trading partners, particularly the EU, will decrease demand for Ukraine's exports, while expected lower harvest may even worsen the situation. Given uncertainty with the spreading COVID-19, quarantine duration, and possible new measures to contain the spreading of the coronavirus, it is hard now to estimate the depth of contraction of Ukraine's economy this year.*

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### **Retail turnover rises 15.7% YoY in February**

Spreading COVID-19 and enforced quarantine will result in contraction of consumer demand and a decrease of retail trade in the following months.

In February, retail turnover rose 15.7% YoY and fell 0.7% MoM, per data from Ukrstat. In 2M20, growth was 13.5% YoY. Retail sales rose 10.5% in 2019 and 6.2% in 2018.

***ICU view: Quarantine enforcement, the weaker UAH, lower household incomes and worsening consumer expectations will result in contraction of consumer demand, the key growth driver of Ukraine's economy in last years, and will lead to real GDP contraction this year (see ICU view for the previous comment).***

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