

Weekly Insight

Economy gaining momentum

Key messages of the today's comments

Domestic liquidity and bonds market

T-bill redemptions refinanced in March

In March, the Ministry of Finance refinanced most domestic debt redemptions, and this week, the MoF should accumulate funds for future repayments.

Liquidity fluctuates around UAH200bn

Last week, expectedly, tax payments decreased liquidity, by almost UAH9bn. This week, budget expenditures should cause inflows and increase liquidity to above UAH200bn.

Foreign exchange market

Hryvnia stays around UAH28/US\$

An increase in imports and foreigners' low activity in the bond market were likely the main reasons for hryvnia fluctuations at around UAH28/US\$ last week. This week, we do not expect material changes in the exchange rate.

Economics

Economy gaining momentum after a weak start of the year

In January-February, economic activity was relatively subdued due to a number of temporary factors. However, March leading indicators reveal economic recovery, even with the worsening of the situation with the pandemic. We expect close to zero YoY GDP change in 1Q21 and double-digit growth in 2Q21 amid further recovery and a low statistical base.

MONDAY, 5 APRIL 2021

Banks' reserves market (2 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	6.50	+0bp	-350bp
ON rate (%)	5.61	+41bp	-430bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	49,036	-19.15	-18.91
CDs (UAHm) ³	146,982	+2.12	+26.57

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) (2 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	322,077	+0.00	-0.77
Banks	533,473	+1.24	+55.59
Residents	45,871	-15.17	-13.03
Individuals	15,721	+3.15	+69.78
Foreigners ¹	104,219	-0.03	-12.26
Total	1,021,637	-0.12	+20.44

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (2 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.0275	+0.19	+1.82
EUR/USD	1.1759	-0.30	+8.30
DXY	93.022	+0.28	-7.15
UAH TWI ¹	122.348	+0.22	-5.20

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (5 April 2021)

Maturity	Bid	Ask
6m	9.50	8.00
12m	11.50	10.00
2y	12.50	11.50
3y	13.00	12.00
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

T-bill redemptions refinanced in March

In March, the Ministry of Finance refinanced most domestic debt redemptions, and this week, the MoF should accumulate funds for future repayments.

March was one of the most difficult months in domestic debt repayments, as redemptions amounted to UAH45bn (US\$1.6bn). These redemptions were mostly refinanced with UAH46bn of budget proceeds amounted to UAH46bn, both in UAH and US\$.

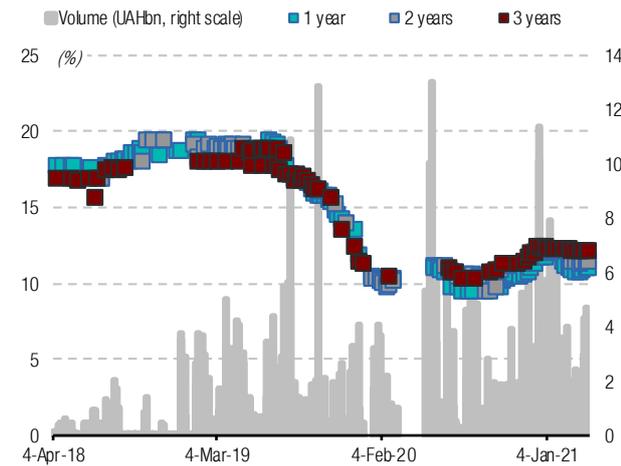
It is worth noting that in March, borrowings in hard currency exceeded redemptions, which compensated net repayments in 2M21. However, in March, less was borrowed in local currency than was repaid. In 3M21 net borrowings were positive and in April, the MoF should accumulate funds for further repayments, as the next peak will be in June.

ICU view: In April, the MoF has to repay UAH34bn (US\$1.2bn) for domestic debt principal, about one-third of this amount in euro. These repayments should be refinanced, and we expect local-currency borrowings will exceed redemptions to finance the budget deficit.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

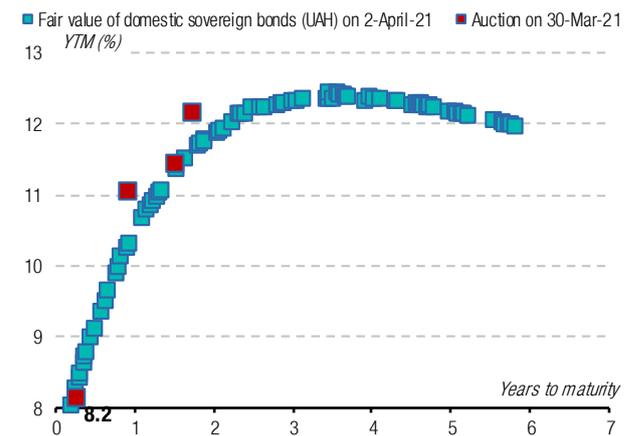
Chart 1. Local-currency bonds

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.

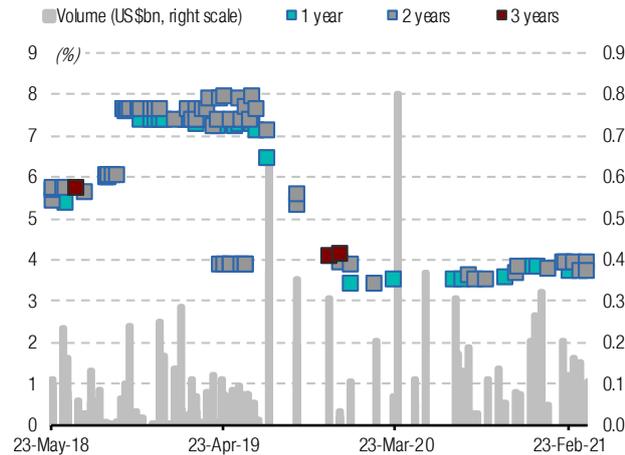
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

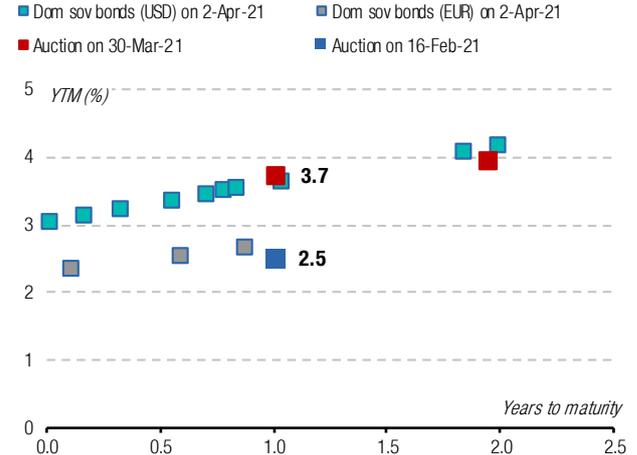
Chart 2. FX-denominated bonds

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 fluctuates around UAH200bn

Last week, expectedly, tax payments decreased liquidity, by almost UAH9bn. This week, budget expenditures should cause inflows and increase liquidity to above UAH200bn.

Last week, the Treasury absorbed UAH9.2bn despite active VAT refund and expenditures. In total, UAH30bn were accumulated in Treasury accounts in local currency, the same amount as a month ago.

Instead, the inflow of funds into liquidity was provided by banks through cash exchange in reserves of UAH1.2bn. The NBU had low impact on liquidity with UAH0.3bn of new loans and UAH1.4bn through selling of hard currency (see comment below).

ICU view: Active cash exchange in reserves should support liquidity to remain high. The Treasury can increase budget expenditures, except Wednesday when new bill purchases will cause liquidity outflows. Therefore, we do not expect material changes in liquidity this week, and it should stay around UAH200bn.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

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

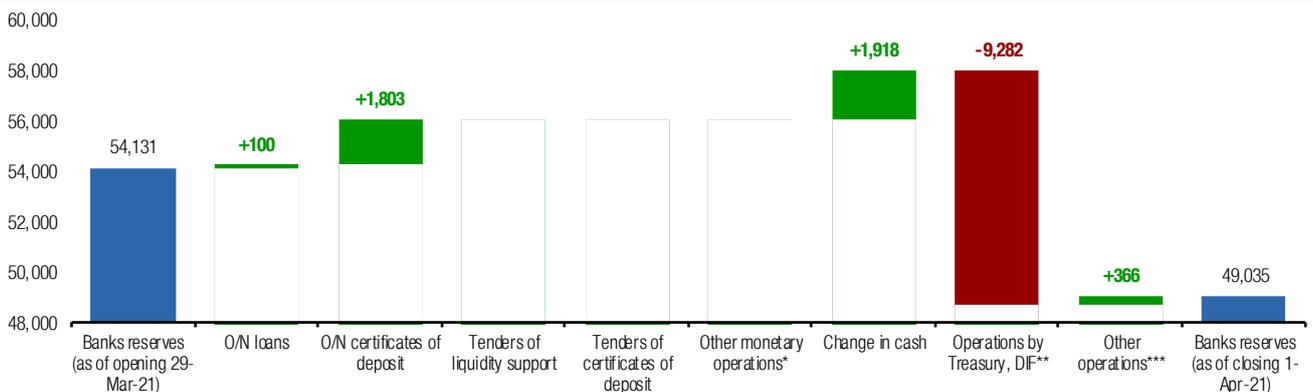
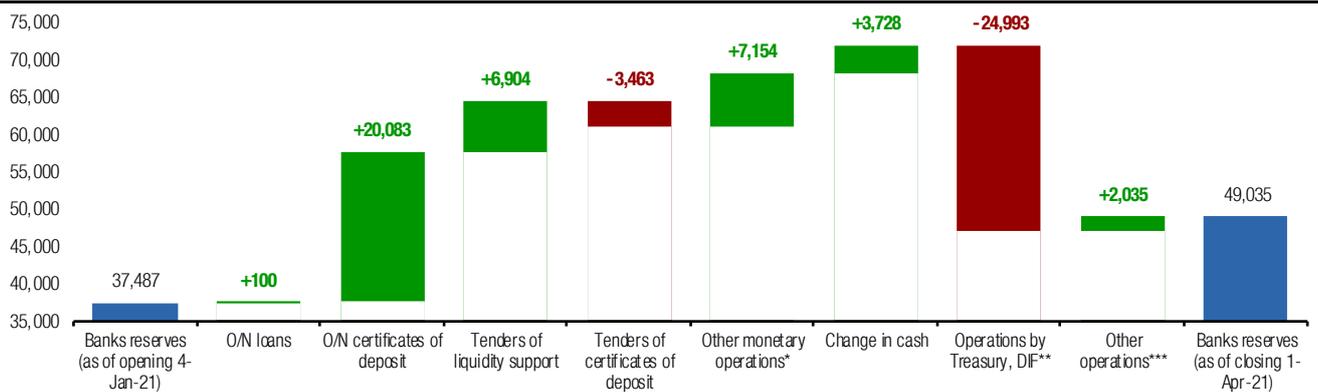


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 stays around UAH28/US\$

An increase in imports and foreigners' low activity in the bond market were likely the main reasons for hryvnia fluctuations at around UAH28/US\$ last week. This week, we do not expect material changes in the exchange rate.

Growth in economic activity and a rebound of imports (see comment below), together with a decline in foreigners' portfolios of local-currency bills caused extra demand for hard currency. These were the main reasons for hryvnia weakening to above UAH28/US\$ at the end of last week.

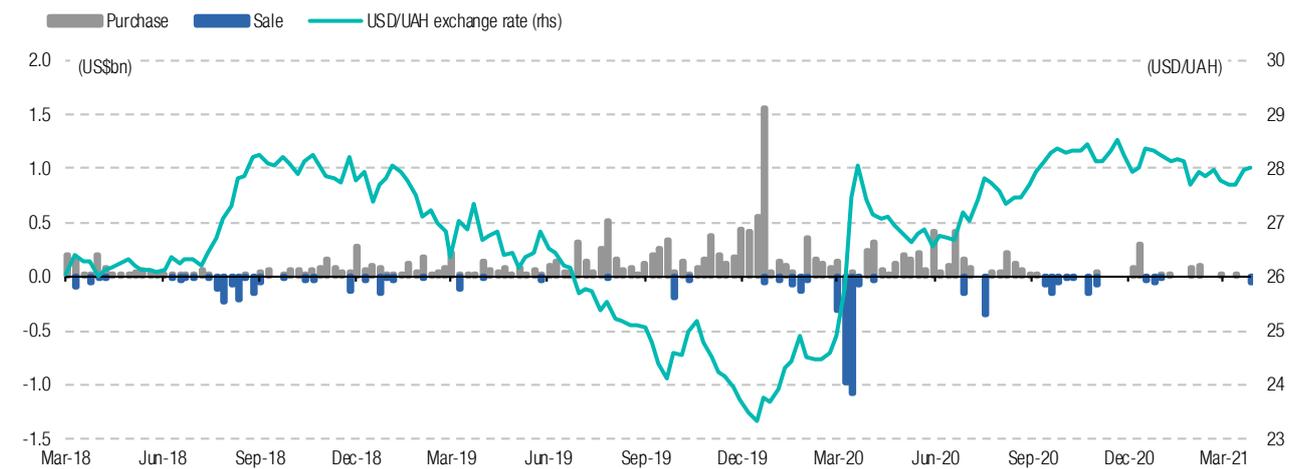
The market was self-balanced most of last week, having enough supply of hard currency to satisfy demand. The NBU has not intervened in the market for two weeks, but last Friday, it had to sell US\$50m to satisfy extra demand for hard currency. In the end, seasonal appreciation was postponed again.

ICU view: We expect the FX market to be self-balanced this week as well, as the hryvnia will make new attempts to appreciate a bit, but demand for hard currency will remain strong. As a result, the hryvnia will continue to fluctuate close to UAH28/US\$. Later, less negative news about the escalation of hostilities in eastern Ukraine and the pandemic situation should result in larger investments in local-currency debt from abroad and slight appreciation towards UAH27.5/US\$ until the end of this month.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

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

Economy gaining momentum after a weak start of the year

In January-February, economic activity was relatively subdued due to a number of temporary factors. However, March leading indicators reveal economic recovery, even with the worsening of the situation with the pandemic. We expect close to zero YoY GDP change in 1Q21 and double-digit growth in 2Q21 amid further recovery and a low statistical base.

According to NBU estimates, in February, the index of key sectors output decreased by 4.3% YoY. This decline was partly due to the calendar effect, since February 2020 had one day more than this year. In addition, difficult weather conditions continued to negatively affect the performance of industry, construction, and transport. The decline in livestock deepened due to the worsening epizootic conditions and the growth of expenses. Instead, a further real wage increase and an improvement of consumer sentiment led to a recovery of high growth rates in retail trade.

Moreover, March leading indicators revealed economic recovery, despite the deteriorating situation with the Covid-19 pandemic. First, the business activity expectations index, according to NBU surveys, exceeded the mark of 50 points for the first time in the last year, reflecting the predominance of optimistic business sentiment. Such behaviour is a reflection of similar trends in the world, where new waves of Covid-19 are already very weakly affecting current indicators of economic activity and business expectations. Second, the sharp increase of imports (to 28% YoY according to customs statistics) of both consumer and investment goods, indicates a rapid recovery in domestic demand. It seems that unlike last year, companies will no longer postpone investment projects, but on the contrary, will adapt them to the new reality. And third, the acceleration of merchandise exports to 27% YoY according to the same customs statistics, shows the availability of financial resources to boost further economic recovery.

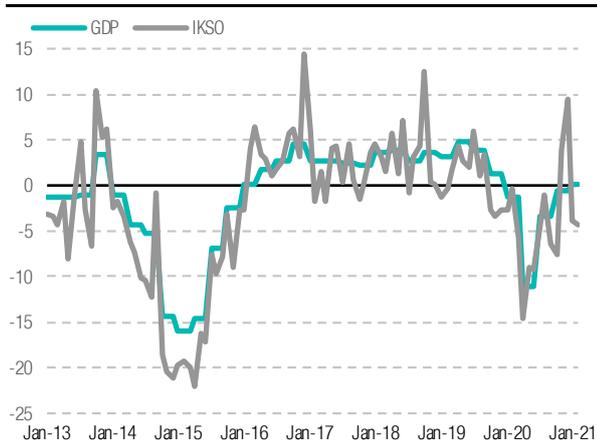
ICU view: *Given the weak results of January-February and the likely rebound in March, we estimate a YoY change in real GDP in 1Q21 close to zero. Although the March quarantine restrictions in response to the spread of Covid-19 began to somewhat restrain population mobility, we consider the impact on economic activity to be minimal. The population and businesses are already quite flexible in adapting to new conditions.*

In 2Q21, economic recovery is likely to continue amid favourable terms of trade and the ongoing global economic recovery. Fuelled by further increases in household incomes, consumer demand should continue to grow, and investment demand will finally begin to make up for losses in previous quarters. Given the low statistical base of comparison, YoY growth rate of GDP in 2Q21 is expected to be double-digit.

Further prospects for economic growth strongly depend on the success of neutralizing the risks of the pandemic, in particular through vaccination, at the rate of which so far Ukraine is lagging behind peers. Also, it is extremely necessary to ensure funding from the IMF, which will provide financing for budget expenditures on comfortable terms. This is particularly important given the expected deterioration in the terms of trade and the global financial conditions for EMs in 2H21. In addition, the risk of escalating military aggression from Russia has increased in recent weeks, which could also worsen business expectations and slow economic recovery.

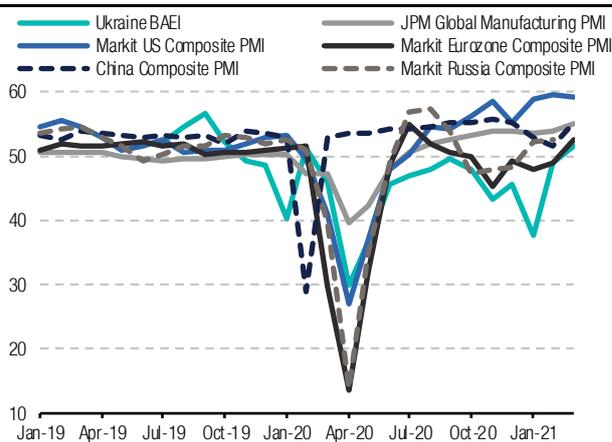
Sergiy Nikolaychuk, Kyiv, (044) 377-7040 ext.721

Chart 6. GDP and Index of key sectors' output, % YoY



Source: UkrStat, NBU, ICU .

Chart 7. Ukraine and world: indexes of business sentiment



Source: NBU, Bloomberg, Info Sapiencie, ICU.

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11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kyiv, 01030 Ukraine
Phone/Fax +38 044 3777040

WEB www.icu.ua



RESEARCH

Sergiy Nikolaychuk

Head of macro research
sergiy.nikolaychuk@icu.ua

Taras Kotovych

Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Dmitriy Dyachenko

Junior financial analyst
dmitriy.dyachenko@icu.ua

Alexander Martynenko

Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv

Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

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