

Daily Insight

Hryvnia extends its lengthy upward stride

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Liquidity steady with reallocation 2

Since the beginning of the week, banking system liquidity (excluding funds in government bonds), was rather steady, staying at UAH94.7bn. During Tuesday, liquidity slid a mere UAH0.15bn with fund reallocations to banks' correspondent accounts with the NBU from CDs. Total reserves rose UAH0.18bn to UAH48.44bn, while total CDs outstanding declined UAH1.95bn to UAH46.21bn this Tuesday. Banks decreased investments in 14-day CDs by UAH2.22bn while they increased ON CDs by UAH0.26bn.

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Hryvnia extends its lengthy upward stride 3

The Ukrainian currency strengthened for the tenth consecutive sessions -- this cements a widely-held perception that macro stability has been achieved. Thus, on Wednesday, the hryvnia hit a new year's high, having closed up 0.1% to 25.5727 USD/UAH. The UAH sold for 25.51 USD/UAH versus 25.72 USD/UAH to buy in the Ukrainian cash market. The hryvnia's CPI-based real trade-weighted index fell 0.12% to 109.84, while in year-on-year terms, up 10.6% from 99.31 last year. Also, yesterday, Goldman Sachs published a report on the UAH forecasting an enduring strengthening trend to extend beyond this December and through the end of 2018 (at 24.8/USD). It may boost positive sentiment toward UAH going forward. At the same time, our in-house analysis signals that a steady increase in the real trade-weighted indices (both CPI- and PPI-based) indicates a market turnaround of the Ukrainian currency is rather possible. Hence, we are skeptical of the possibility of a steady upward trend for the hryvnia lasting over the next 12 months.

Appendix #1: Domestic liquidity 4

THURSDAY, 17 AUGUST 2017

Ukraine's hryvnia exchange rate per US dollar
(three months through 16 August 2017)



Source: Bloomberg.

Selected indicators of the financial markets
(three months through 16 August 2017)

| | Last | Daily chg (%) | YTD chg (%) |
|---|----------|------------------|----------------|
| DOMESTIC LIQUIDITY | | | |
| NBU key policy rate (%) | 12.50 | +0bp | -150bp |
| Overnight rate (interbank) | 11.40 | +20bp | +80bp |
| Banks reserves (UAHm) | 48,439 | +3.86 | -2.60 |
| Deposit certificates* (UAHm) | 46,208 | -4.06 | -25.76 |
| FOREIGN EXCHANGE MARKET | | | |
| UAH per US dollar | 25.5500 | -0.16 | -5.72 |
| Total trade volume (US\$m) | 298.86 | +55.99 | +76.20 |
| UAH index CPI-based | 109.842 | -0.12 | +1.70 |
| UAH index PPI-based | 169.292 | -0.12 | +0.55 |
| UKRAINE SOVEREIGN EUROBOND MARKET | | | |
| CDS 5yr | 550bp | +0bp | -103bp |
| GLOBAL FINANCIAL MARKET INDICATORS | | | |
| S&P 500 | 2,468.11 | +0.14 | +10.24 |
| MSCI EM | 1,060.27 | +0.74 | +22.96 |
| US dollar index (DXY) | 93.541 | -0.33 | -8.48 |
| EUR / USD | 1.1767 | +0.27 | +11.89 |
| Crude oil WTI (US\$/bbl) | 46.78 | -1.62 | -12.92 |
| Crude oil BRENT (US\$/bbl) | 50.27 | -1.04 | -11.53 |
| CRB, commodities index | 175.36 | -0.54 | -8.91 |
| Gold (US\$/ounce) | 1,283.27 | +0.92 | +11.37 |

Notes: * NBU's short-term bonds.

Source: Bloomberg, ICU.

Domestic liquidity

Liquidity steady with reallocation

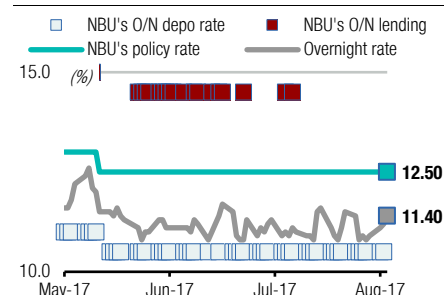
Since the beginning of the week, banking system liquidity (excluding funds in government bonds), was rather steady, staying at UAH94.7bn. During Tuesday, liquidity slid a mere UAH0.15bn with fund reallocations to banks' correspondent accounts with the NBU from CDs. Total reserves rose UAH0.18bn to UAH48.44bn, while total CDs outstanding declined UAH1.95bn to UAH46.21bn this Tuesday. Banks decreased investments in 14-day CDs by UAH2.22bn while they increased ON CDs by UAH0.26bn.

Transactions with CDs on Tuesday amounted to UAH2.72bn, having the most impact. Moreover, the NBU provided UAH0.77bn of funds via other monetary operations, mostly in FX. At the same time, non-monetary operations caused fund outflows of UAH0.92bn, mainly to Treasury accounts (UAH0.84bn) while a small portion of funds was exchanged in cash and spent for interest payments on NBU loans. Despite large monetary operations, demand for reserves rose as the interbank ON rate index was up for the third consecutive day.

Investment implications: Total liquidity slid insufficiently, just ahead of quarterly tax payments and amidst outflows to the budget recently which were not offset by budget expenditures. Additional pressure on reserves had yesterday's settlement on government bonds as banks purchased a large amount of new bonds versus small repayments from the budget. A reallocation of liquidity occurred yesterday with possible outflows to the budget. Increased UIIR yesterday showed an increase in needs for short-term funds for tax payments.

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Interest rates in the banks' reserves market (three months through 16 August 2017)



Source: Bloomberg, ICU.

Key indicators (as of 16 August 2017)

| | Last | Daily | Weekly | Monthly | YTD |
|---|----------------|--------------|--------------|--------------|---------------|
| | chg (%) | chg (%) | chg (%) | chg (%) | chg (%) |
| BANKS' RESERVES MARKET (%) | | | | | |
| NBU rate ¹ | 12.50 | +0bp | +0bp | +0bp | -150bp |
| ON rate | 11.40 | +20bp | +50bp | +10bp | +80bp |
| ON \$ swap | 11.93 | +12bp | +24bp | +49bp | +46bp |
| DOMESTIC LIQUIDITY (UAH MILLION) | | | | | |
| Reserves ² | 48,439 | +3.86 | +8.51 | +12.53 | -2.60 |
| DepCerts ³ | 46,208 | -4.06 | -3.75 | -16.38 | -25.76 |
| Total | 94,647 | -0.16 | +2.16 | -3.72 | -15.47 |
| BREAKDOWN OF GOVT BOND HOLDERS (UAH MILLION) | | | | | |
| NBU | 365,704 | +0.00 | -0.11 | -1.43 | +2.68 |
| Banks | 295,835 | -0.04 | -0.02 | +0.93 | +71.66 |
| Residents | 22,424 | -0.02 | -0.71 | +3.99 | +43.03 |
| Non-res ⁴ | 11 | +0.00 | +7.25 | +816.5 | -99.83 |
| Total | 683,975 | -0.02 | -0.09 | -0.25 | +24.24 |
| IMPLIED YIELDS OF THE UAH NDF MARKET (%) | | | | | |
| 1 month | 12.42 | +117bp | +43bp | -256bp | -989bp |
| 3 months | 11.85 | +18bp | +57bp | +221bp | -10ppt |
| 6 months | 11.85 | +9bp | +7bp | -115bp | -620bp |
| 1 year | 11.68 | +10bp | +9bp | -10bp | -430bp |
| UKRAINE SOVEREIGN EUROBOND MARKET | | | | | |
| CDS 5yr | 550 | +0bp | +1bp | -35bp | -103bp |

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's short-term bonds; [4] non-residents.

Source: Bloomberg, ICU.

Foreign exchange markets

Hryvnia extends its lengthy upward stride

The Ukrainian currency strengthened for the tenth consecutive sessions -- this cements a widely-held perception that macro stability has been achieved. Thus, on Wednesday, the hryvnia hit a new year's high, having closed up 0.1% to 25.5727 USD/UAH. The UAH sold for 25.51 USD/UAH versus 25.72 USD/UAH to buy in the Ukrainian cash market. The hryvnia's CPI-based real trade-weighted index fell 0.12% to 109.84, while in year-on-year terms, up 10.6% from 99.31 last year. Also, yesterday, Goldman Sachs published a report on the UAH forecasting an enduring strengthening trend to extend beyond this December and through the end of 2018 (at 24.8/USD). It may boost positive sentiment toward UAH going forward. At the same time, our in-house analysis signals that a steady increase in the real trade-weighted indices (both CPI- and PPI-based) indicates a market turnaround of the Ukrainian currency is rather possible. Hence, we are skeptical of the possibility of a steady upward trend for the hryvnia lasting over the next 12 months.

In the global FX markets, a report by the ECB said that Mario Draghi will not deliver new messages about the future of the QE program at the ECB's meeting next week. The EUR/USD pair was flat ahead of the ECB's report, but just after the report, the euro plunged 0.5% to 1.1692 EUR/USD. At the same time, according to another report, the Eurozone's real GDP rose 0.6% QoQ meeting expectations, but this data did not influence the euro. In the second part of the trading session the euro managed to recover losses thanks to political turmoil in the USA, having closed up 0.3% to 1.1767 EUR/USD.

The greenback was volatile on Wednesday, as it was bolstered on Tuesday thanks to strong retail sales statistics which rose for the fastest pace since the beginning of the year (0.6% MoM). On Wednesday, the US Commerce Department said the number of housing starts and building permits fell 4.8% MoM SA and 4.1% MoM SA, respectively, which fed into USD weakness, as optimism over the strength of the economy was dampened. In addition, Trump announced he was shuttering the manufacturing council. Just after the announcement the greenback dropped 0.6%. On Wednesday, the DXY index was in the 93.472 – 94.145 range, having closed down 0.3% to 93.54. At the same time, from the US dollar's weakness, it rose as Donald Trump promised to decrease the trade deficit. The weak dollar lead to a simultaneous decrease in imports (as households buy fewer goods from abroad) and growth of exports (goods become cheaper for other countries), which will lower the trade balance deficit.

According to IMF reports, the growth rate of Chinese domestic debt gathers momentum, possibly leading to a credit bubble. At the same time, investors bet against the Chinese currency - the CNY's 1-month risk reversal is near a 3-month high. On Wednesday, the renminbi fell another 0.1%, to 6.6916 USD/CNY.

The API reported that US oil inventories decreased by 9.2 million barrels last week. After the report, oil prices rose, this supporting the ruble. The Russian currency received additional support from August tax payments which started earlier this week. On Wednesday, the ruble strengthened against the USD by 0.5% to 59.3775 USD/RUB.

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Readers may follow the ICU trade-weighted indices of the local-currency, the hryvnia (UAH), on the ICU [website](#).

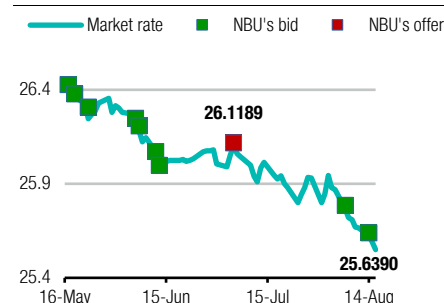
Key indicators (as of 16 August 2017)

| | Last | Daily | Weekly | Monthly | YTD |
|---|----------|---------|---------|---------|---------|
| | chg (%) | chg (%) | chg (%) | chg (%) | chg (%) |
| EXCHANGE RATES (PER US DOLLAR, EXCEPT EURO, POUND) | | | | | |
| UAH | 25.5500 | -0.16 | -0.62 | -1.79 | -5.72 |
| USD ¹ | 93.541 | -0.33 | -0.01 | -1.69 | -8.48 |
| EUR | 1.1767 | +0.27 | +0.07 | +2.59 | +11.89 |
| JPY | 110.1900 | -0.43 | +0.11 | -2.08 | -5.79 |
| GBP ² | 1.2891 | +0.17 | -0.87 | -1.58 | +4.47 |
| CNY | 6.6916 | +0.09 | +0.26 | -1.24 | -3.65 |
| RUB | 59.3836 | -0.54 | -1.17 | +0.63 | -3.50 |

Notes: [1] DXY, US dollar index; [2] British pound.

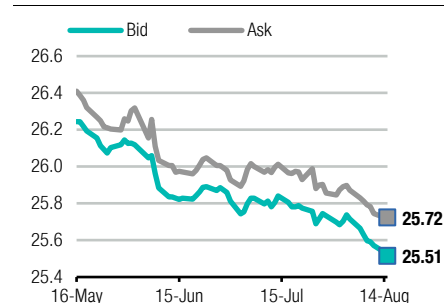
Source: Bloomberg, ICU.

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market (three months through 16 August 2017)



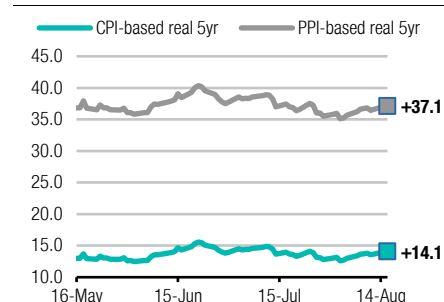
Notes: the chart provides labels for the average exchange rate at last two NBU auctions (one on buying FX from the market and one on selling it). Source: NBU, Bloomberg, ICU.

Ukraine hryvnia UAH exchange rate per US dollar at the cash market (three months through 16 August 2017)



Source: NBU.

UAH exchange rate misalignment¹ from fundamental level² (%) (three months through 16 August 2017)



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

Appendix #1: Domestic liquidity

Chart 1. Banks reserves usages over last reporting date (UAHm)

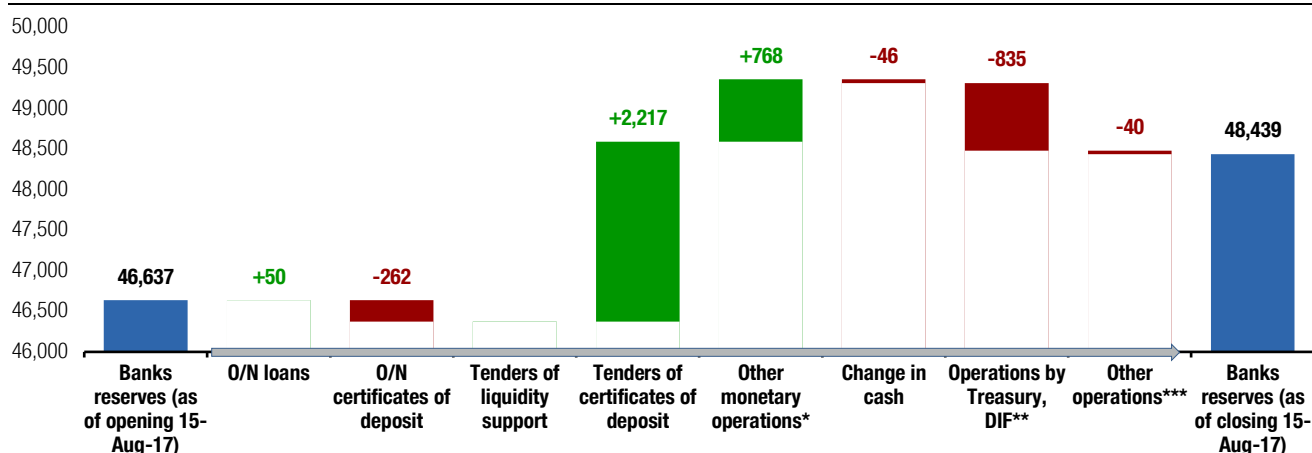
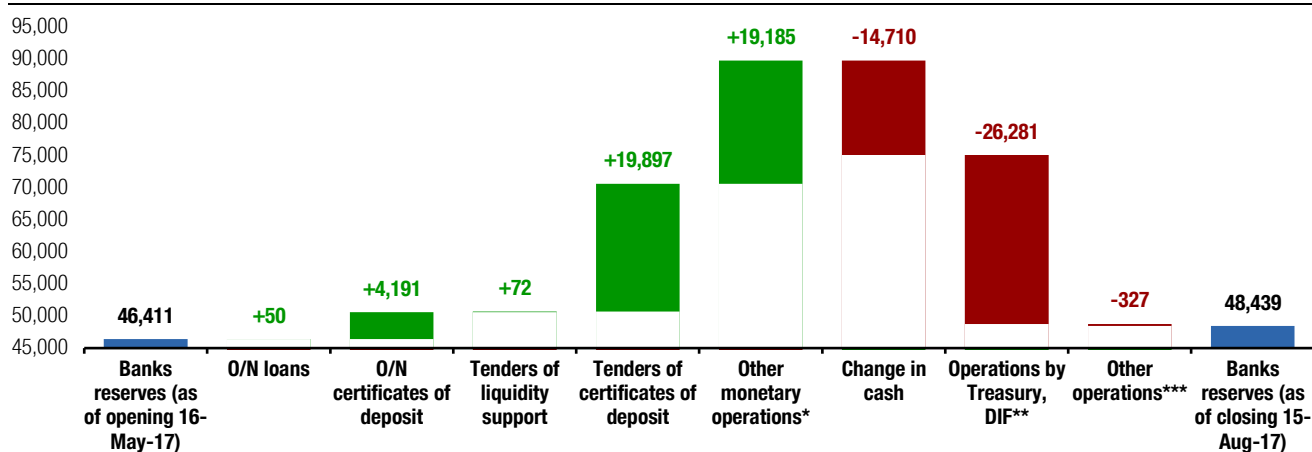


Chart 2. Banks reserves usages over last 90-day period (UAHm)

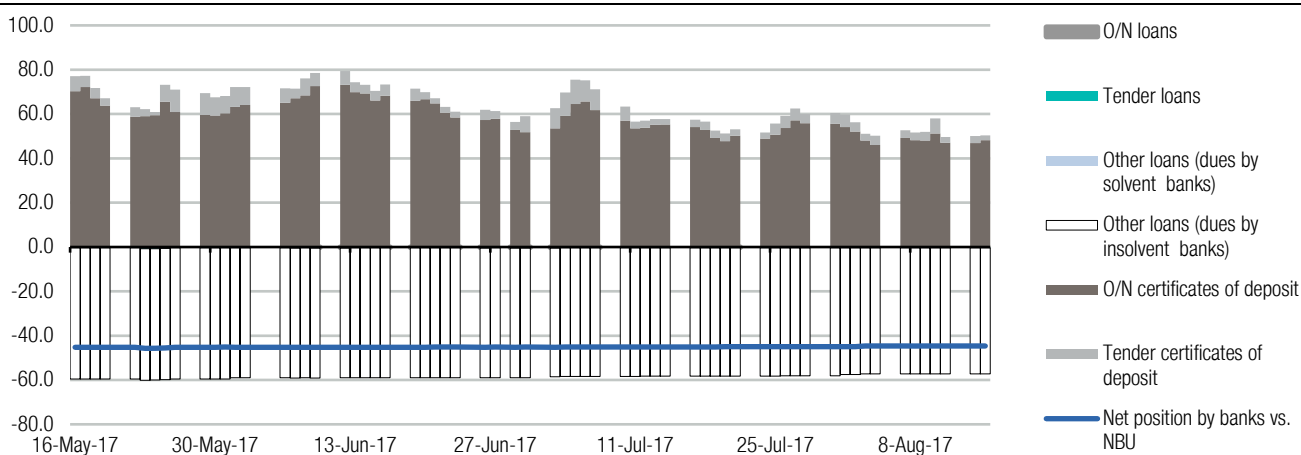


Notes: [1] data from the NBU's daily reporting https://bank.gov.ua/control/uk/publish/article?art_id=38643651&cat_id=40807142 ;

* 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.

Chart 3. Stocks of NBU's monetary instruments and net position by banks versus NBU (UAHbn)



Source: NBU, ICU.

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