



Focus
Ukraine

Markets
**Domestic liquidity,
government bonds, FX
market, and macro**

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Weekly Insight

Public debt fell 0.7% MoM in March

Key messages of the today's comments

Domestic liquidity and bonds market

Individuals add bonds to portfolio

Last week, individuals and banks increased their bond portfolios, while non-banks and non-residents decreased investments in Ukrainian sovereign bonds.

Liquidity continues to increase

A positive balance of Treasury operations supported banking-sector liquidity, which hit this year's record high of UAH112.6m. Liquidity should stay at this high level for at least a week.

Foreign exchange market

UAH stable

This week, the hryvnia should remain stable in low trading activity at the beginning of the month and given the short workweek.

Economics

Industrial production rose 1% YoY NSA in March

Although growth rates of industrial output slowed for the third consecutive month, the sector posted growth of 2.4% YoY in 1Q18. Industrial production will continue to grow this year thanks to strong consumer demand and higher domestic business and public investments.

Public debt fell 0.7% MoM in March

The total amount of public and publicly guaranteed debt of Ukraine fell 0.7% MoM or UAH15.2bn, and amounted to UAH2.05tn (66% of GDP) in March. Thanks to further GDP growth and a sustained primary budget surplus, the public debt level will end up below the 70% of GDP threshold by December 2018.

THURSDAY, 3 MAY 2018

Banks' reserves market (2 May 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU rate (%) ¹	17.00	+0bp	+400bp
ON rate (%)	15.70	-30bp	+450bp
ON \$ swap (%)	15.26	-55bp	+293bp
Reserves (UAHm) ²	50,902	+9.32	+12.75
DepCerts (UAHm) ³	60,514	-4.96	+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) (2 May 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU	350,325	+0.00	-7.30
Banks	349,951	+0.64	+23.48
Residents	27,010	-0.42	+23.26
Individuals	2,564	+1.59	+839.06
Non-res ⁴	11,889	+0.08	+123.45
Total	741,739	+0.29	+7.68

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

FX market indicators (2 May 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.1475	-0.22	-1.50
EUR/USD	1.1951	-1.26	+9.34
DX ²	92.512	+1.04	-6.53
UAH TWI ³	120.996	+1.48	+9.41

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

Gov't bond quotes¹ (3 May 2018)

Maturity	Bid	Ask
6m	17.50	16.50
12m	17.75	16.75
2y	17.50	16.50
3y	17.50	16.50
12m (\$)	5.10	4.70
2y (\$)	5.30	5.00

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

Domestic liquidity and bonds market

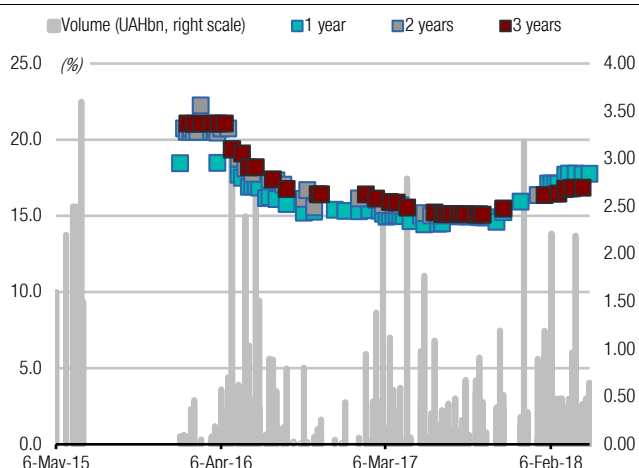
Individuals add bonds to portfolio

Last week, individuals and banks increased their bond portfolios, while non-banks and non-residents decreased investments in Ukrainian sovereign bonds.

Last Wednesday, the MoF repaid UAH4.3bn in bond redemptions. The largest decline in portfolios after this redemption was non-banking investors (excluding individuals) and non-residents. This group likely were the main buyers of three-month bonds at the end of January and in February of this year. Only UAH1/1bn of these repayments were refinanced with issues of new local-currency bonds (for details see our [overview of last weeks' auction](#)).

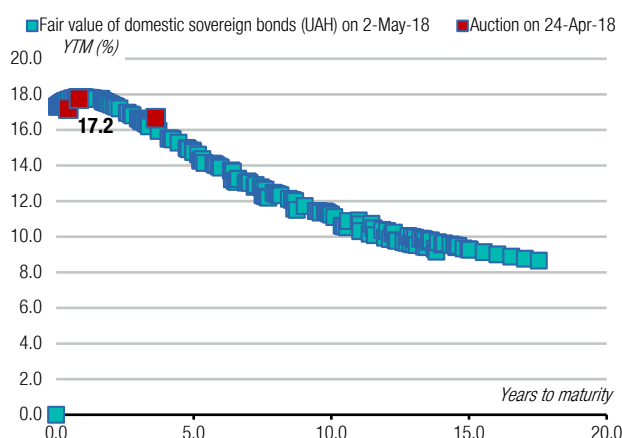
Chart 1. Local-currency bonds

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.

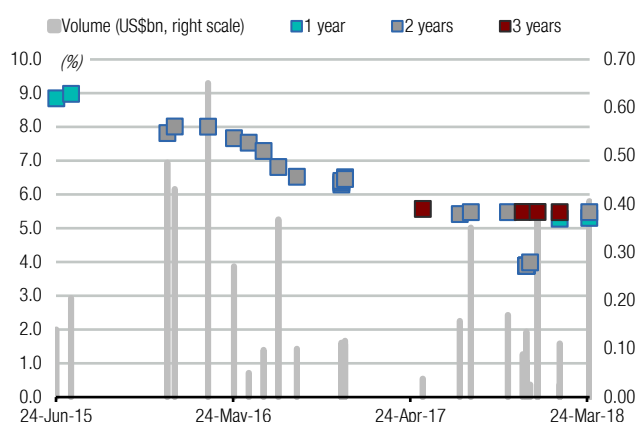
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

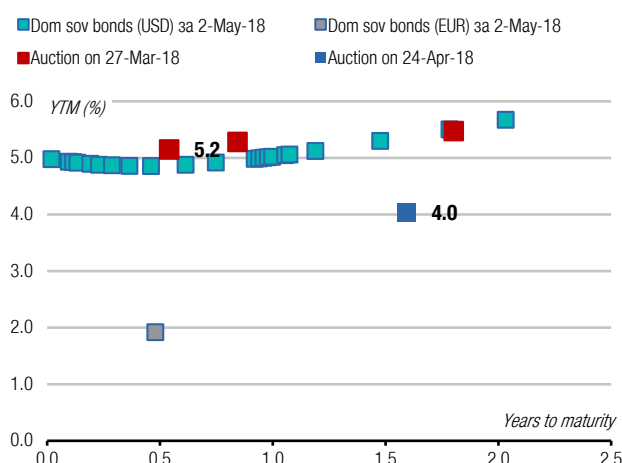
Chart 2. FX-denominated bonds

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.

Also last week, bonds denominated in euros were accumulated in banks' portfolios, with only EUR1m purchased by individuals. Individuals also added bonds to their portfolios last week in euros, US dollars, and hryvnia.

ICU view: This week, the Ministry of Finance will not hold primary auctions and debt repayments will be low at UAH1.4bn and US\$1.4m. Without refinancing, these repayments will not cause problems for the budget. Bond-portfolio movements will be in the secondary market only.

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Liquidity continues to increase

A positive balance of Treasury operations supported banking-sector liquidity, which hit this year's record high of UAH112.6m. Liquidity should stay at this high level for at least a week.

Last week, the Treasury paid UAH7.4bn in VAT refunds, and provided more than UAH5bn for debt repayments. The MoF refinanced only a fifth of debt repayments through the issuance of new bonds in local currency. So, the net inflow to the banking system from the Treasury amounted to UAH8.3bn.

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

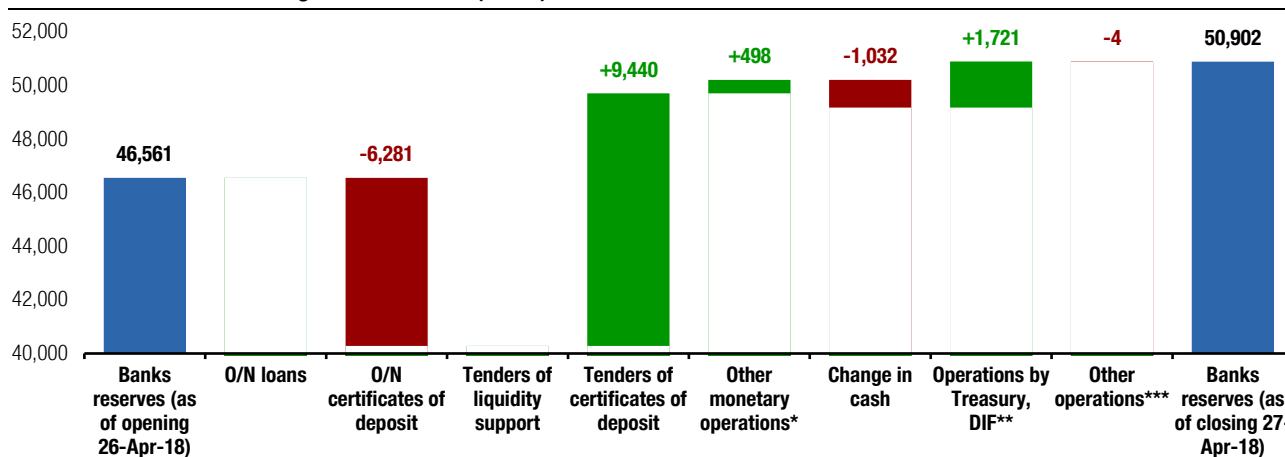
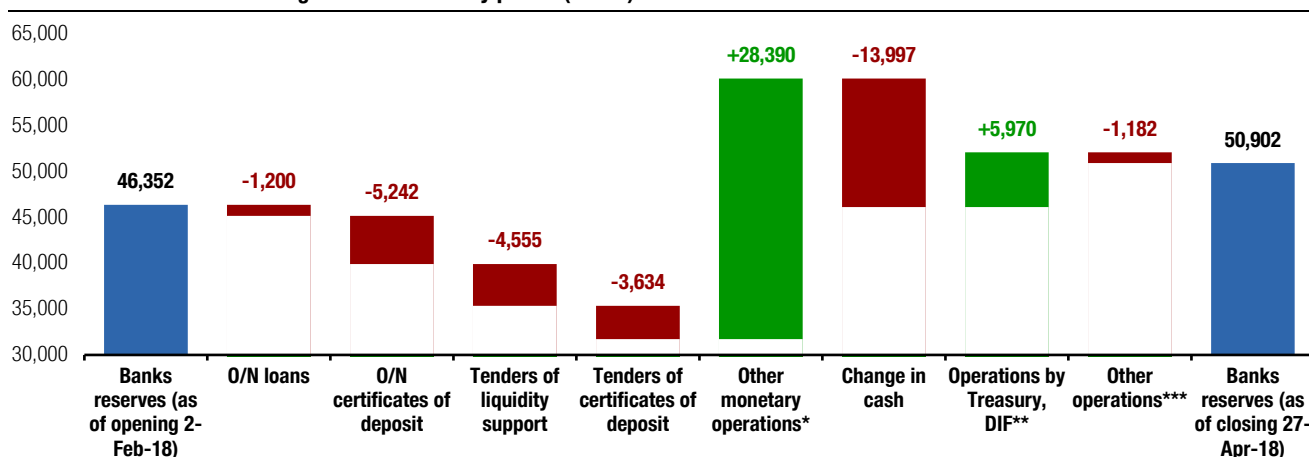


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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.

Additional funds were mostly accumulated in CDs, which hit this year's high at UAH64.9bn last Thursday. At the same time, banks' correspondent accounts with the NBU were volatile: the week began with UAH48bn in reserves, declined to UAH43.6bn by Wednesday, and ended the week at UAH50.9bn.

ICU view: Last week's issuance of EUR-denominated bonds plus large debt repayments did not create extra demand for FX nor did they cause volatility in the

hryvnia exchange rate. As the result, the NBU purchased net US\$30m of FX without impact on liquidity. Additional funds were absorbed by the NBU using CDs. This week, market activity will be low without significant volatility in liquidity.

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Foreign exchange market

UAH stable

This week, the hryvnia should remain stable in low trading activity at the beginning of the month and given the short workweek.

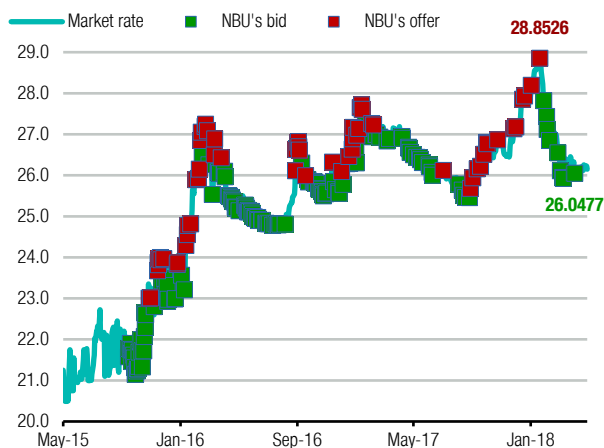
There was considerable volatility in the national currency last week. The high volume of tax payments to the budget caused appreciation of the UAH at the beginning of the week. It was gradually offset by VAT refunding and significant UAH-denominated domestic government bond redemptions, which lead to insignificant depreciation of the hryvnia by the end of the week.

The hryvnia depreciated 0.2% in the past week to 26.215 UAH/USD. Its CPI-based real trade-weighted index increased 0.8% to 118.7 for the period mainly due to appreciation of the US dollar, and against major currencies of developed and BRIC-countries (Brazil, Russia, India, and China).

The DXY index, which reflects the value of the US dollar relative to a basket of major currencies of developed countries, appreciated 1.4% in the last week. At the same time, the USD gained against the currencies of BRIC countries in the range of 0.8-1.5%. According to DXY index, the last week the USD had its best performance since 21 December 2016, when this indicator showed more than 2% growth in a week. Not least, such situation on the currency market may be explained by widening concerns about the slow pace of growth in the Eurozone, particularly in Germany in 1Q18, which had a negative impact on the EUR.

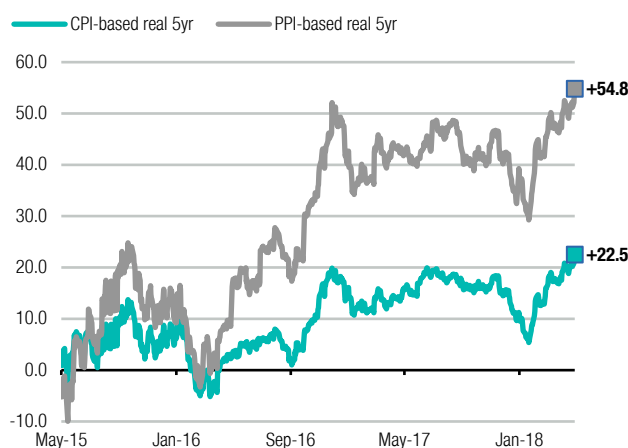
Chart 5. FX market indicators, 3-year history

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.

In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 8.7% and 11.6%, respectively, which implies faster prices growth in Ukraine compared with its main trade partners.

ICU view: We expect a stable hryvnia this week, which will be supported by a short workweek and discreet trading volume at the beginning of the month. At the same time, the strengthening trend of the national currency in the next few months should be maintained.

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Economics

Industrial production rose 1% YoY NSA in March

Although growth rates of industrial output slowed for the third consecutive month, the sector posted growth of 2.4% YoY in 1Q18. Industrial production will continue to grow this year thanks to strong consumer demand and higher domestic business and public investments.

In calendar-adjusted terms, industrial production grew 1.6% YoY, but fell to 1.4% MoM SA. Unlike previous months, when the processing industry was the main driver of the total industrial output's growth, in March, it dropped 4.6% YoY and 3.6% MoM SA. In contrast, the mining and quarrying sector rose 3.3% YoY and fell 2.1% MoM SA, while the utilities subsector surged 22.8% YoY and 7% MoM SA.

Energy output soared 16.2% YoY, while other industrial groups posted declines: non-durable goods by 7% YoY, investment goods by 5.2% YoY, durable goods by 5.1% YoY, and intermediate goods by 1.3% YoY.

ICU view: Growth of industrial production will likely accelerate in the following months thanks to 1) strong consumer demand (the processing industry was the main driver of growth for the last 10 months except for March 2018), 2) increased government expenditure on infrastructure projects, and 3) higher output volumes in the mining industry against the backdrop of increased investments in the sector and the low-base effect due to the trade blockade of temporarily occupied territories. We maintain our forecast of 3.5% growth for the industrial sector in 2018.

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Public debt fell 0.7% MoM in March

The total amount of public and publicly guaranteed debt of Ukraine fell 0.7% MoM or UAH15.2bn, and amounted to UAH2.05tn (66% of GDP) in March. Thanks to further GDP growth and a sustained primary budget surplus, the public debt level will end up below the 70% of GDP threshold by December 2018.

The decrease in public and publicly guaranteed debt was primarily thanks to a stronger hryvnia and increase in placements of UAH-denominated domestic government bonds. Public debt declined 0.5% MoM to UAH1.77tn, while publicly guaranteed debt fell 2.4% MoM and amounted to UAH280.8bn.

In US dollar terms, the total amount of public and publicly guaranteed debt rose 0.8% MoM or US\$0.6bn to US\$77.4bn. As of 1 April 2018, 41.2% of total public debt is denominated in US dollars, 31.7% in UAH, and 17.9% in SDRs.

ICU view: Public and publicly guaranteed debt declined to 66% of GDP as of 1 April 2018, down from 72% of GDP at the end of 2017. Given 1) the projected acceleration of real GDP growth, 2) double-digit inflation this year, as well as 3) the central government's commitment to a primary surplus. We expect that even after Ukraine

enters the international debt market and receives the next tranche from the IMF (our baseline scenario), public and publicly guaranteed debt will remain below 70% of GDP by the end of 2018.

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