



Focus  
Ukraine

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

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# Weekly Insight

## NBU predictably kept key rate unchanged

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### MoF increases FX borrowings

Low demand for local-currency bonds forced the MoF to increase its offering of FX-denominated instruments, which were added to the auctions schedule for the last two weeks of May.

##### Liquidity up on VAT refunds

Large payments in VAT refunds supported liquidity, which rose above UAH110bn, but this week could see a decline.

#### Foreign exchange market

##### UAH unchanged, likely to keep appreciation trend

On the last week of May, the hryvnia should be relatively stable with a slight appreciation trend due to exporters' demand.

#### Economics

##### NBU predictably kept key rate unchanged

The NBU left its benchmark rate unchanged for the second consecutive month at 17%, which did not come as a surprise to the market.

##### Retail sales increased 7.6% YoY in April

Retail sales continue to grow and will remain an important component of GDP expansion.

##### Industrial production rose 3% YoY NSA in April

Growth rates of industrial output accelerated to 3% YoY in April, up from 1% YoY in March. Solid consumer demand and high investment activity will support further growth of the industrial sector.

WEDNESDAY, 30 MAY 2018

#### Banks' reserves market (29 May 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU rate (%) <sup>1</sup>	17.00	+0bp	+250bp
ON rate (%)	16.20	-50bp	+340bp
ON \$ swap (%)	15.55	-55bp	+0bp
Reserves (UAHm) <sup>2</sup>	54,778	+7.86	+14.10
DepCerts (UAHm) <sup>3</sup>	61,795	+15.70	+6.36

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) (29 May 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU	350,325	+0.00	-2.84
Banks	352,457	+1.29	-2.31
Residents	24,789	-2.21	+11.63
Individuals	2,882	+9.00	+96.35
Non-res <sup>4</sup>	10,768	-2.31	+106.30
<b>Total</b>	<b>741,221</b>	<b>+0.53</b>	<b>-1.21</b>

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

#### FX market indicators (29 May 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.1150	+0.12	-6.96
EUR/USD	1.1540	-1.34	-3.87
DXY <sup>2</sup>	94.820	+0.87	+2.93
UAH TWI <sup>3</sup>	123.733	+1.08	+15.64

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

#### Gov't bond quotes<sup>1</sup> (30 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 (\$)	5.50	4.80
2y (\$)	5.70	5.00

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

# Domestic liquidity and bonds market

## MoF increases FX borrowings

Low demand for local-currency bonds forced the MoF to increase its offering of FX-denominated instruments, which were added to the auctions schedule for the last two weeks of May.

Last week, the MoF offered three USD-denominated papers, which allowed the Ministry to increase budget financing, compared with the beginning of the month. For this week, only one offering of a EUR-denominated bond is scheduled.

At the primary auction last week, the MoF received less than UAH500m of demand for local-currency bills with three-month and three-year maturities, but sold only UAH165m of these bonds, and it received a similar amount of funds to the budget.

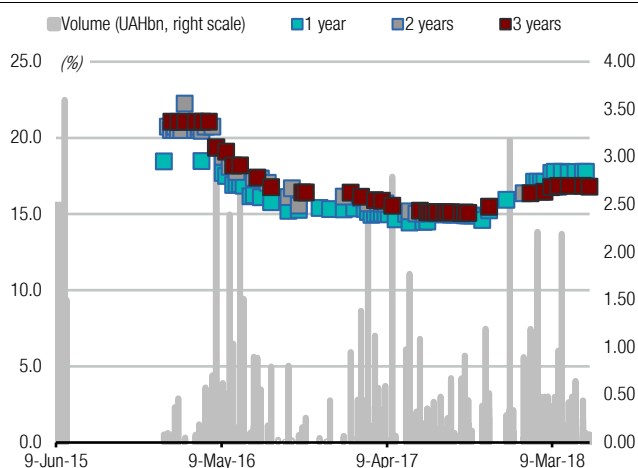
In order to sell USD-denominated bonds, the MoF had to increase cut-off rates by 20-25bp. For two-year bonds, the cut-off rate was set at 5.65%, for bills with maturities in February, 2020 – at 5.60%, and only for bills with 1.5-year maturity rate was set at the usual 5.40%. This allowed the MoF to borrow more than UAH7bn, a large amount for the last two months.

**ICU view: Offering of FX-denominated bonds allows the budget to receive additional financing, but also increases FX risk. At the same time, taking into the account low needs in FX for debt repayments, borrowed FX will be sold at the market or to the NBU, allowing funds to be used for current budget needs.**

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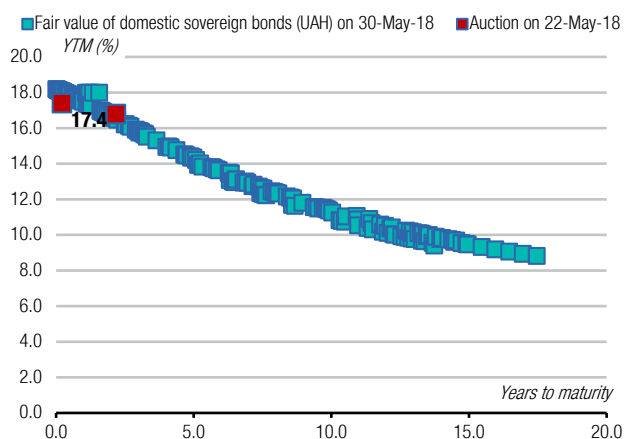
**Chart 1. Local-currency bonds**

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.

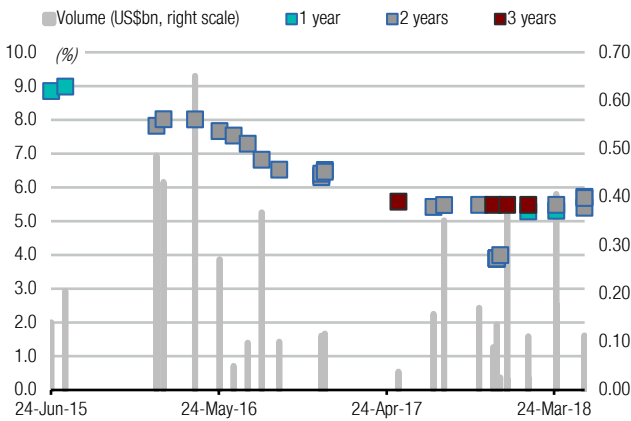
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

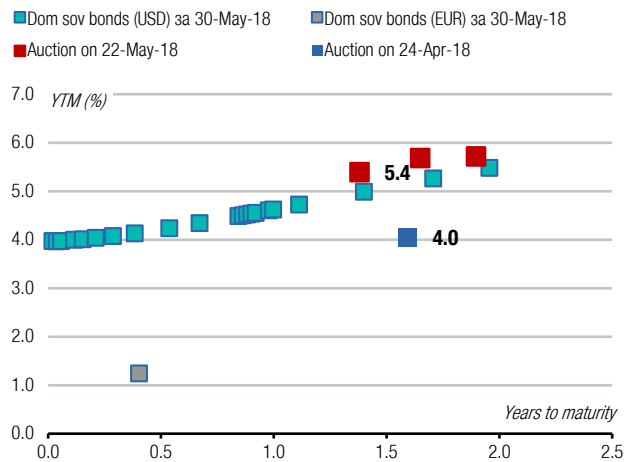
**Chart 2. FX-denominated bonds**

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 up on VAT refunds**

Large payments in VAT refunds supported liquidity, which rose above UAH110bn, but this week could see a decline.

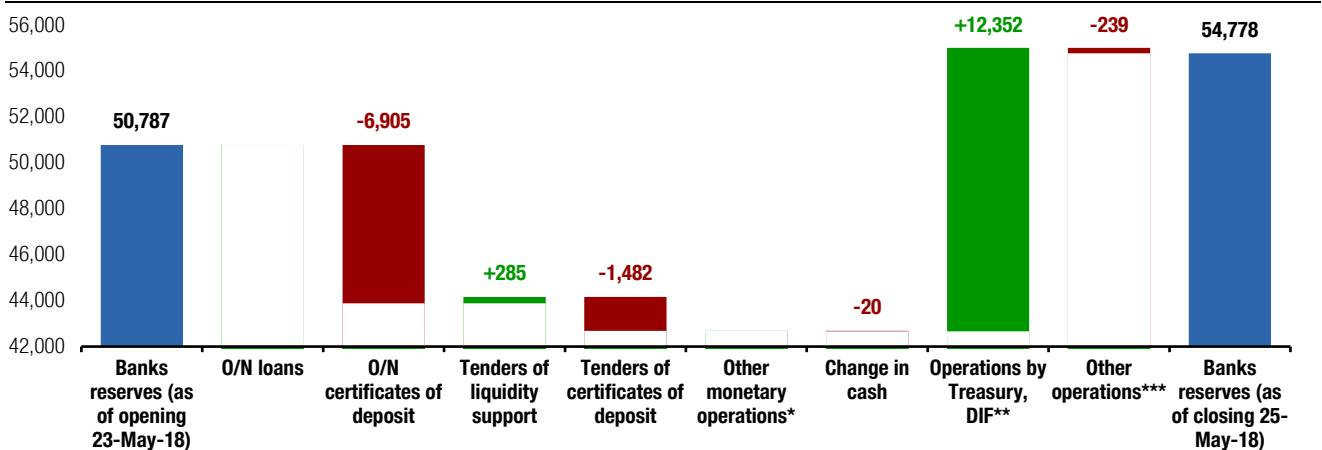
Last week, the Treasury paid VAT refunds in excess of UAH9bn, most of it occurring on Thursday. This allowed liquidity to rise to UAH116.6bn. Funds were divided between reserves and CDs, and by Friday, there were UAH54.8bn of reserves and UAH61.8bn in CDs.

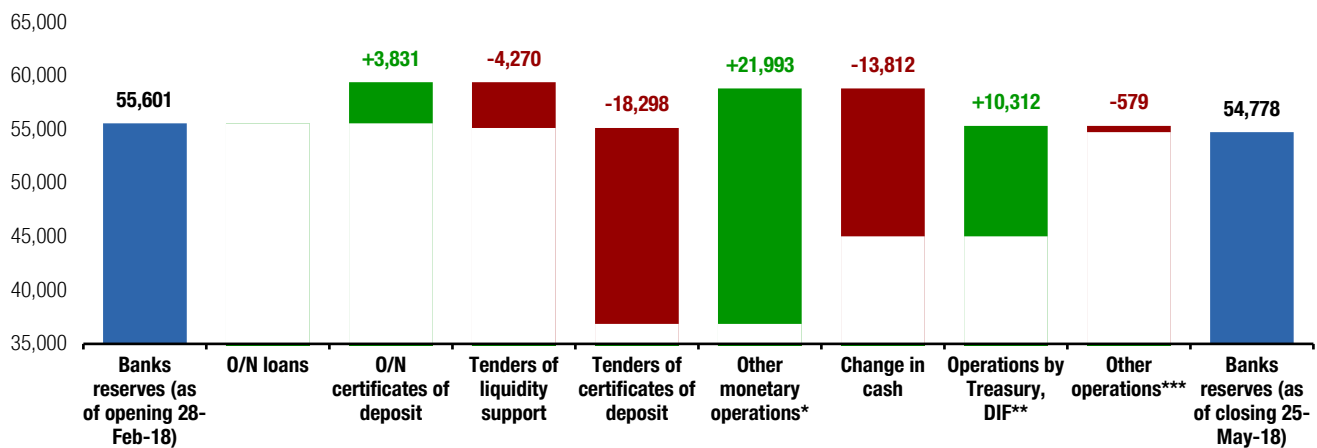
VAT refunds and budget expenditures covered outflows via tax payments, leaving a positive balance of Treasury operations at UAH10.4bn. Additional inflows to liquidity came from cash exchange in reserves and NBU's operations at FX market.

**ICU view:** During last few days of the month, liquidity will be under pressure from month-end tax payments, when there may not be sufficient payments from the budget in VAT refunds. So, liquidity will be at high, and probably will slid below UAH110bn, with high volatility.

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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

### UAH unchanged, likely to keep appreciation trend

On the last week of May, the hryvnia should be relatively stable with a slight appreciation trend due to exporters' demand.

Last week, the hryvnia moved under influence of tax payments to the budget and VAT refunding. In the beginning of the last week the positive effect of tax payments on UAH prevailed, but the NBU's purchases of the USD contained appreciation of the hryvnia. Furthermore, in the last few days of the previous week, liquidity inflows from VAT refunding caused decline of the UAH.

Thus, national currency remained unchanged on the last week at 26.13 UAH/USD. Its CPI-based real trade-weighted index (which includes currencies of 27 countries trade partners of Ukraine) increased 0.8% to 123 for the period. In year-on-year terms, real trade-weighted indices (CPI- and PPI-based) increased 11.6% and 17%, respectively, which implies faster prices growth in Ukraine compared with its main trade partners.

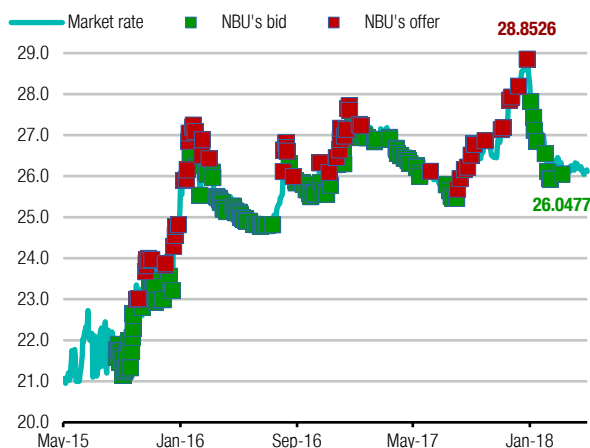
**ICU view: This week we expect persistence of supply-demand balance in the currency market on the back of ending of the tax payments and VAT refunding period. At the same time, demand for hryvnia from Ukrainian exporters will keep supporting the national currency. Therefore, the UAH will be relatively stable with a slight appreciation trend.**

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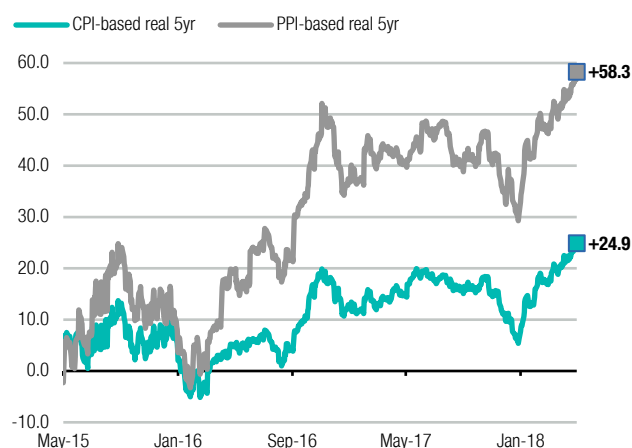
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Chart 5. FX market indicators, 3-year history

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

### NBU predictably kept key rate unchanged

The NBU left its benchmark rate unchanged for the second consecutive month at 17%, which did not come as a surprise to the market.

Headline consumer inflation slightly slowed in April to 13.1% YoY from 13.2% YoY in March. The National Bank has maintained its forecast of 8.9% YoY for end-of-year inflation and expects a significant slowdown in May to below 12%, due to lower food prices, in particular, vegetables and fruits.

**ICU view: There is a significant probability of a further increase of the key rate in case the actual inflation rates substantially exceed NBU forecasts. Such a scenario is possible due to a number of key risks, including the cessation of cooperation with the IMF for an indefinite period, significant government expenditures in the pre-election year, or negative external factors including high oil prices.**

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### Retail sales increased 7.6% YoY in April

Retail sales continue to grow and will remain an important component of GDP expansion.

In April, retail sales in Ukraine grew 7.6% YoY. However, in MoM terms, there was a decline of 2.9%. For January-April period of 2018, retail sales increased 7% and accounted for UAH283bn in nominal terms. In seasonally adjusted terms, retail sales in April declined 1.3% YoY, and in last three months, the contraction was 2.8% QoQ as there was a significant increase of retail sales at the end of the previous year and at the beginning of the current.

**ICU view: Rising disposable incomes will continue driving household consumption and, as a result, retail turnover this year. This will also be the key driver of Ukraine's economic growth in 2018. The increase in household consumption will keep being supported by retail loans, which rose 47% YoY in March 2018.**

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## Industrial production rose 3% YoY NSA in April

Growth rates of industrial output accelerated to 3% YoY in April, up from 1% YoY in March. Solid consumer demand and high investment activity will support further growth of the industrial sector.

In seasonally adjusted (SA) terms, industrial production declined 0.6% MoM. Still-weak performance was posted by the processing industry, which was the main driver of the sector's growth in 2017 and at the beginning of 2018. In April, this subsector rose only 0.8% YoY after a 4.6% YoY decline in March. At the same time, it was almost flat compared with March in SA terms.

In contrast, the mining and quarrying sector rose 5.6% YoY and 1.2% MoM SA, mainly thanks to higher coal (+13.2% YoY), and iron ore output (+9% YoY). The utilities subsector rose 8.6% YoY but declined 5.9% MoM SA. In 4M18, industrial production rose 2.6% YoY.

***ICU view: Industrial production will continue to increase in the following months thanks to: 1) solid consumer demand, 2) higher output volumes in the mining industry against the backdrop of increased investments in the sector, and 3) increased government expenditure on infrastructure projects. We maintain our forecast of 3.5% growth for the industrial sector in 2018.***

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