Focus
Ukraine

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

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Weekly Insight

Official FX reserves drop by 1.1% MoM in June

Key messages of the today's comments

Domestic liquidity and bonds market

Foreigners maintain levels in bond portfolios

Last week, total bonds outstanding slightly tightened, but portfolios of foreign investors remained steady. This week, their portfolios could decline slightly.

Liquidity recovers slightly

The total amount of banking-sector liquidity last week recovered slightly to UAH110.6bn, and this week it should stay above UAH110bn.

Foreign exchange market

Hryvnia unchanged

The hryvnia will be stable against a backdrop of balanced supply and demand in the local-currency market.

Economics

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TUESDAY, 10 JULY 2018

Banks' reserves market (9 July 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	17.00	+0bp	+450bp
ON rate (%)	15.30	-60bp	+400bp
ON $ swap (%)	N/A	...	...
Reserves (UAHm)[2]	46,909	-1.05	+16.92
DepCerts (UAHm)[3]	63,703	+3.36	+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) (9 July 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	350,325	+0.00	-5.57
Banks	357,126	-0.49	+31.94
Residents	22,178	-4.27	+6.41
Individuals	3,385	+5.05	+408.57
Non-res[4]	10,026	-0.20	+177,036.04
Total	**743,040**	**-0.35**	**+12.04**

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

FX market indicators (9 July 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.3200	+0.10	+1.06
EUR/USD	1.1751	+0.80	+3.07
DXY[2]	94.077	-0.54	-2.01
UAH TWI[3]	122.211	-0.86	+6.17

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

Gov't bond quotes[1] (10 July 2018)

Maturity	Bid	Ask
6m	17.50	17.00
12m	17.85	17.25
2y	17.75	16.75
3y	17.50	16.50
12m ($)	5.50	4.85
2y ($)	5.70	5.00

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

Domestic liquidity and bonds market

Foreigners maintain levels in bond portfolios

Last week, total bonds outstanding slightly tightened, but portfolios of foreign investors remained steady. This week, their portfolios could decline slightly.

Last week, bond portfolios of foreign investors were at UAH10bn despite a decline of total bonds outstanding by UAH2bn during the week. Most of the decline was seen in banks' portfolios and portfolios of the non-banking sector. Bonds owned by individuals slid by UAH0.1bn.

This week, the Ministry of Finance has scheduled for redemption 12-month bills sold last August. These bonds were sold during a period when foreign investors were starting to buy UAH-denominated debt. But, at that time, they used CLN to enter the market. The CLN's were issued with a two-year maturity using similar, two-year, local-currency instruments as a reference asset. So, it looks like debt repayments scheduled for this week will be for domestic bondholders.

ICU view: This week, changes in foreign investors' portfolios will be small, while local investors will prefer FX-denominated debt. Tomorrow, the MoF is going to sell two-year USD-denominated bills, which will take the bulk of auction proceeds. We could see refinancing of principal repayments on debt issued two years ago at US$97.8m.

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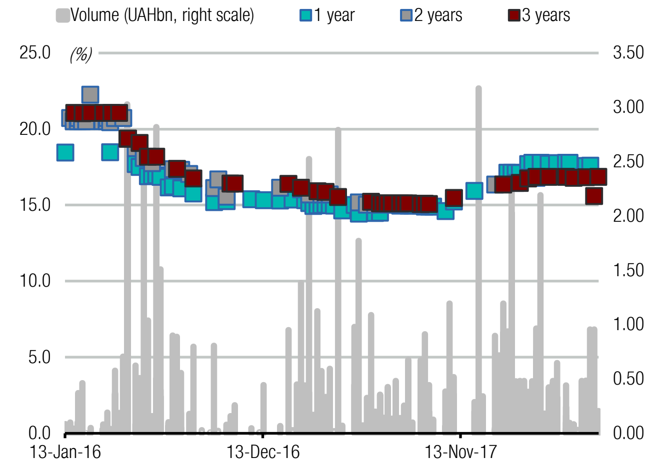
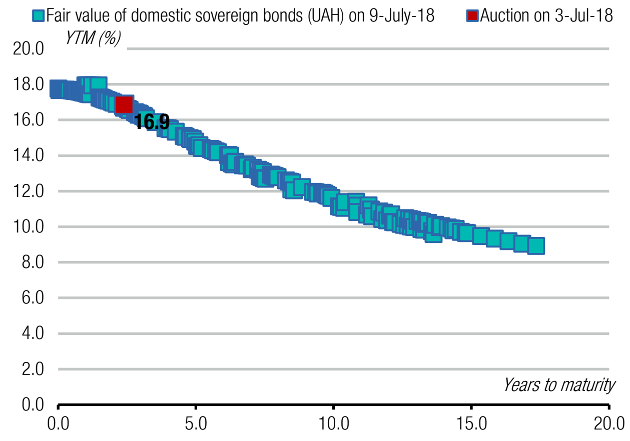
Chart 1. Local-currency bonds

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.

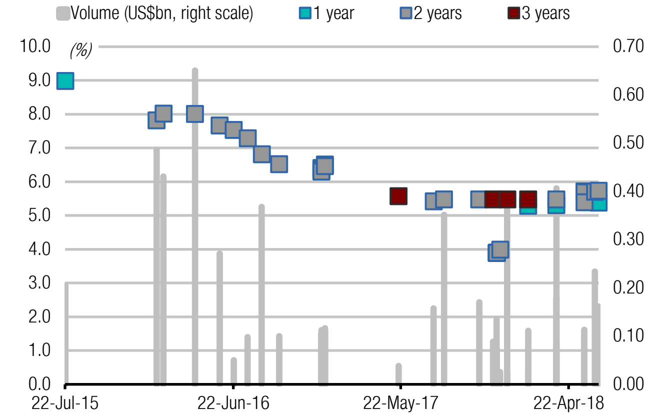
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

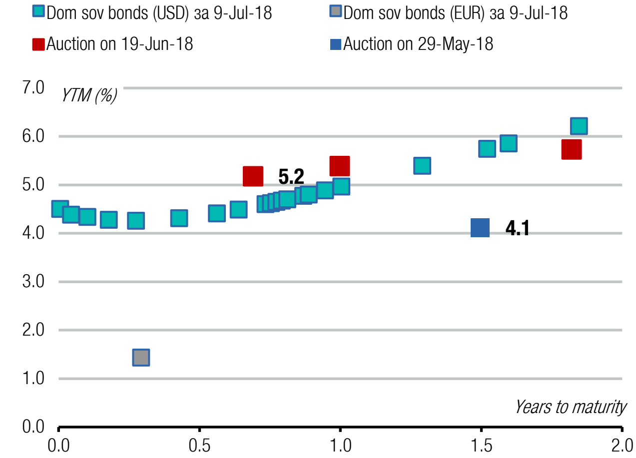
Chart 2. FX-denominated bonds

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 recovers slightly

The total amount of banking-sector liquidity last week recovered slightly to UAH110.6bn, and this week it should stay above UAH110bn.

At the beginning of the week, total banking-sector liquidity was UAH109.6bn, declining to UAH108.8bn on Wednesday. By Friday, the Treasury injected UAH6.4bn, and liquidity recovered to UAH114.4bn, including UAH66.2bn invested in the NBU's CDs. However, the Treasury caused another decline to UAH110.6bn last Friday. NBU's impact on liquidity was insufficient with a low level of transactions in the FX market.

The current week should not be very volatile, and liquidity should stay above UAH110bn. Local-currency debt principal repayments will not be fully reinvested in new bonds, and this will cause additional inflow to the banking system. At the same time, we do not anticipate large cash flow from the Treasury or high volatility in the FX market, which could cause FX selling by the NBU (see comment below).

ICU view: Liquidity in the banking sector should stay above UAH110bn, the usual level for recent months; we do not anticipate a significant decline in the following weeks. Free funds will be mostly allocated to CDs.

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

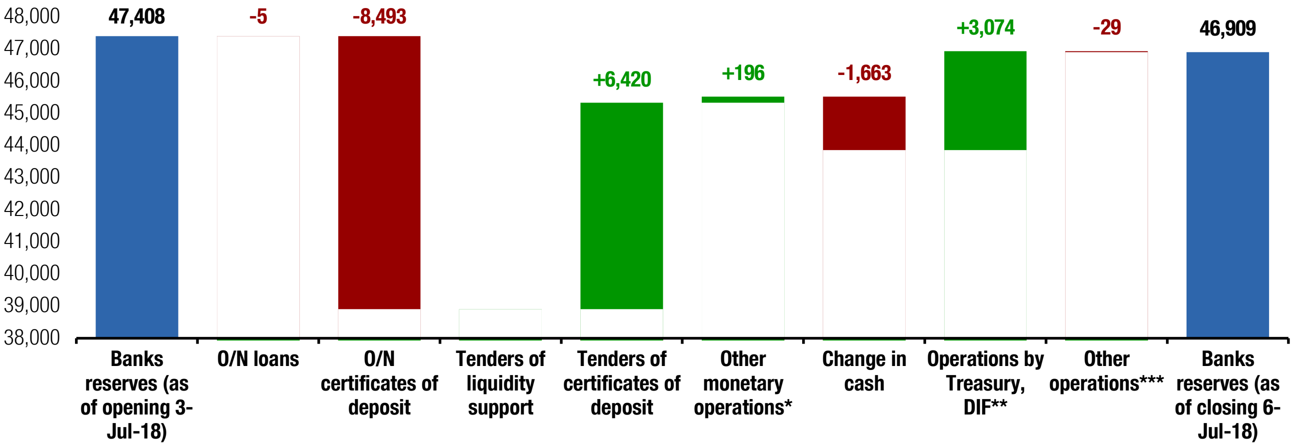
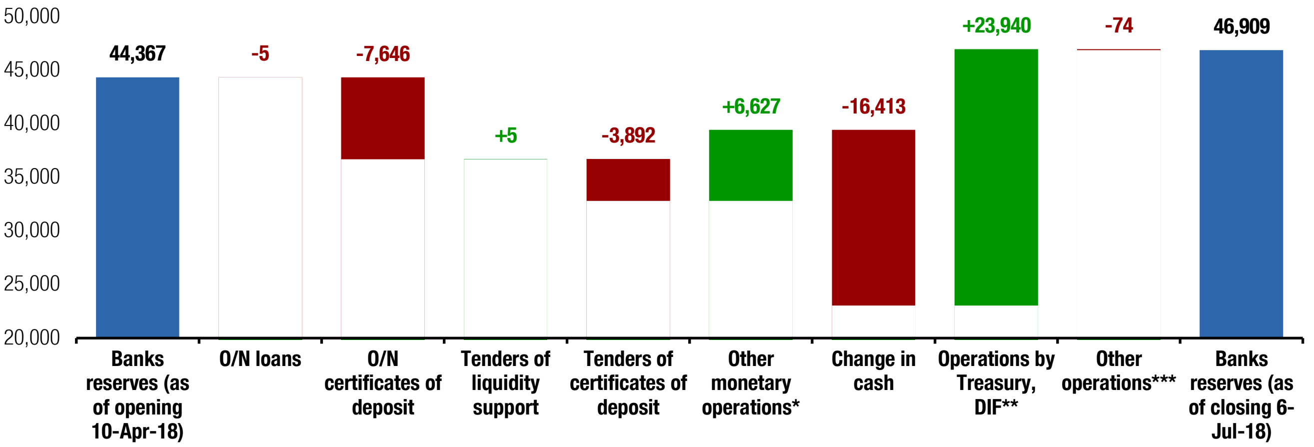


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

The hryvnia will be stable against a backdrop of balanced supply and demand in the local-currency market.

There were significant spikes in the national currency's exchange rate last week; however, the hryvnia remained almost unchanged, and finished trading at 26.32 UAH/USD. Thus, after brief appreciation last Monday, the UAH depreciated significantly on Tuesday and Wednesday due to the holiday in the US, which caused increased demand for foreign currency. Nevertheless, there was a correction of the exchange rate during the last days of the previous week toward appreciation, and a balancing of supply and demand for foreign currency.

The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries trade partners of Ukraine) decreased 0.3% to 122.4 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 6.3% and 10.7%, respectively, which implies faster prices in growth in Ukraine compared with its main trade partners.

ICU view: The National Bank did very little intervention in the market, which self-stabilized after the weekend in the United States. This week, we do not expect

significant fluctuations of the UAH exchange rate, which will allow the hryvnia to remain relatively stable. Demand and supply on the local currency market will be balanced. However, at the end of the month, this trend may change, which will not play in favour of the national currency.

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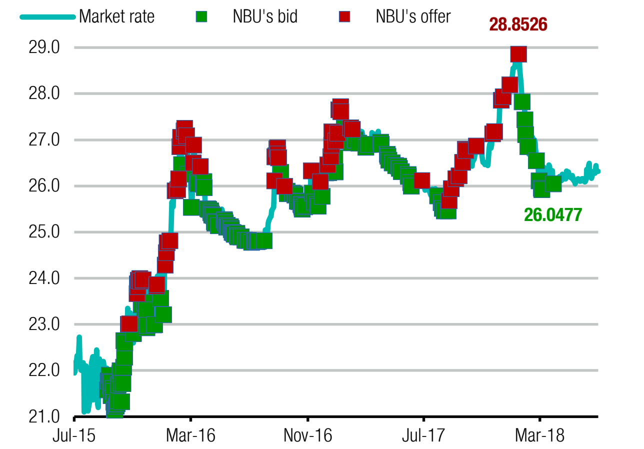
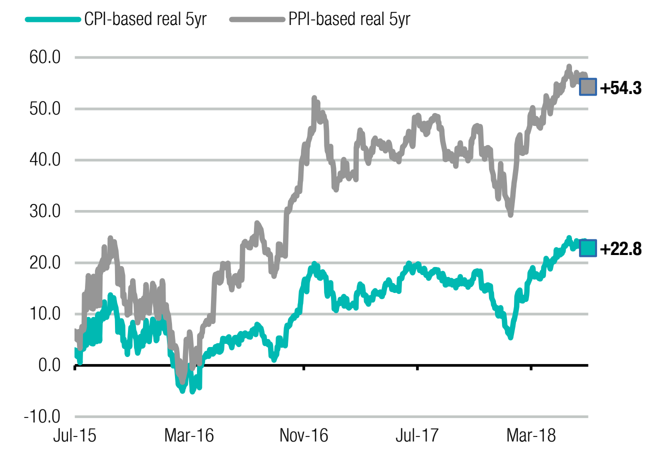
Chart 5. FX market indicators, 3-year history

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[1] from fundamental level[2] (%)



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

Economics

Official FX reserves drop by 1.1% MoM in June

International reserves continued to decline due to repayment of government debt and accrued interest. The amount of reserves covers 3.2 months of future imports, but further cooperation with official creditors is crucial for keeping them at a sufficient level.

International reserves shrank by 1.1% in June to $ 18.0 bn. This was due to government debt payments, in particular, $162m in favour of the IMF. The surplus of FX supply, which was observed in previous months, actually decreased to zero in June. The volumes of net purchases of the USD by the National Bank amounted to only $24m.

ICU view: Given the upcoming volumes of public debt payments ($ 2.5 billion) and less favourable interventions in the currency market in the second half of the year, the holding of reserves at a sufficient level is unlikely without the next tranches from the IMF and EU Macro Financial Assistance.

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