

# Weekly Insight

## Market awaits rate hike

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Market awaits rate hike

New domestic bond issues fell to a minimum in anticipation of monetary policy decisions to be made at the NBU's board meeting scheduled for this Thursday, and the possibility that the key policy rate could be increased once more.

##### Decline in free hryvnia volumes continues

Satisfying demand for FX and large tax payments to the budget caused a decline in banking-sector liquidity to a new record low, and this week it could stay close to this level.

#### Foreign exchange market

##### Hryvnia below 28/USD

This week, pressure on the hryvnia should somewhat decrease against the backdrop of the beginning of the month, and because the exuberant demand for foreign currency was satisfied last week. However, foreign currency may still be in demand from affiliated foreign companies that pay dividends abroad.

#### Economics

##### C/A deficit at 2.8% in July

The 12-month rolling C/A deficit widened to US\$3.5bn or 2.8% of GDP in July, up from 2.2% of GDP in December. The C/A deficit is set to widen further due to decreasing metal prices and high energy prices.

TUESDAY, 4 SEPTEMBER 2018

#### Banks' reserves market (3 September 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	17.50	+0bp	+500bp
ON rate (%)	17.16	+42bp	+546bp
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	49,217	-10.34	+8.64
DepCerts (UAHm) <sup>3</sup>	23,466	-3.19	+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) (3 September 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,104	+0.00	-4.23
Banks	372,985	+0.24	+22.24
Residents	20,978	-0.76	-6.48
Individuals	4,530	+2.24	+511.58
Non-res <sup>4</sup>	7,491	+0.96	+1,180.45
<b>Total</b>	<b>754,088</b>	<b>+0.12</b>	<b>+8.91</b>

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

#### FX market indicators (3 September 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	28.3900	+1.40	+10.12
EUR/USD	1.1619	-0.65	-2.03
DX <sup>2</sup>	95.140	+0.44	+2.51
UAH TWI <sup>3</sup>	115.151	-0.60	+0.95

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

#### Gov't bond quotes<sup>1</sup> (4 September 2018)

Maturity	Bid	Ask
6m	18.75	17.75
12m	19.00	17.70
2y	18.50	16.75
3y	18.50	16.75
12m (\$)	5.50	5.00
2y (\$)	5.70	5.15

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

# Domestic liquidity and bonds market

## Market awaits rate hike

New domestic bond issues fell to a minimum in anticipation of monetary policy decisions to be made at the NBU's board meeting scheduled for this Thursday, and the possibility that the key policy rate could be increased once more.

Last week, foreign investors paused withdrawing funds from local-currency bonds and other groups reallocated investments from local currency into FX-denominated instruments. Total bonds outstanding and portfolios outstanding were up last week, mostly due to hryvnia weakening, but foreign investors purchased some local-currency bills. Demand for hryvnia-denominated bonds fell to a minimum (see our overview of [last week's auction](#)) in anticipation of another hike in the key policy rate at the NBU board meeting scheduled for this Thursday.

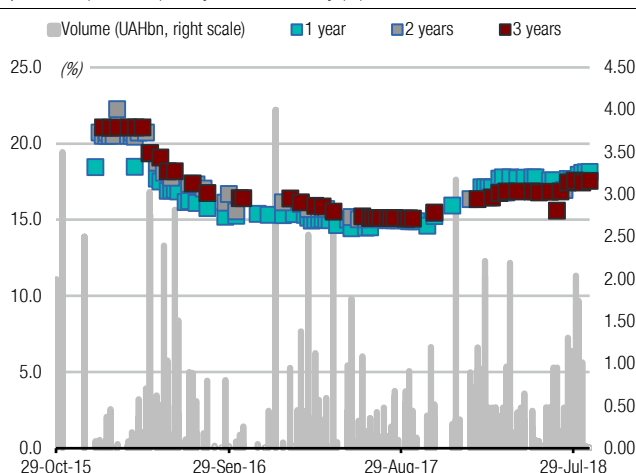
**ICU view: During the last few weeks, the hryvnia weakened despite NBU's attempts to decrease negative pressure by selling FX from reserves (US\$153m over two weeks). So, as secondary market deals usually are done at a higher rate than in the FX market, demand for FX bonds declined awaiting today's primary FX-denominated bond offering, where these instruments could be purchased without a premium to the current exchange rate. As of this week, a new mechanism of bonds' purchase from the MoF is going into effect, and dealers will be able to submit their clients' bids to auction, which should increase demand.**

**Also, taking into account that in July, due to negative inflation expectations, most members of the monetary committee voted for a larger increase in the key rate than the NBU board did, a new hike is very likely this week. So, this week, we could see an increase in demand for FX-denominated debt, and next week an increase in demand for local-currency bills.**

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

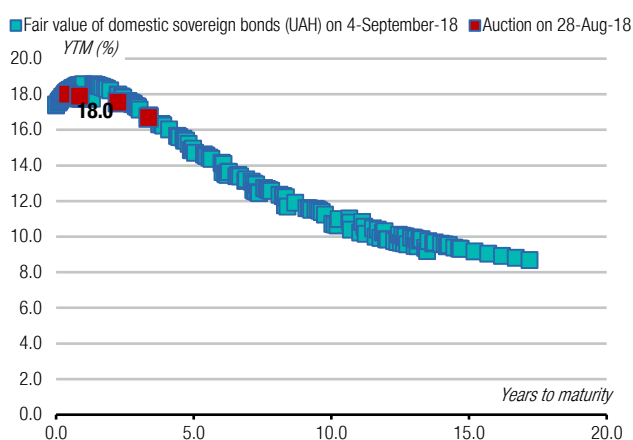
**Chart 1. Local-currency bonds**

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.

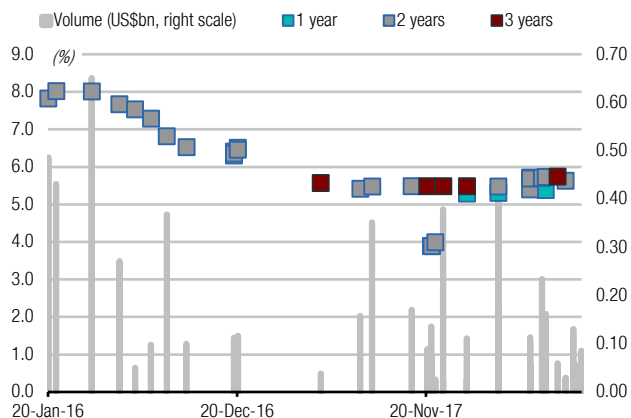
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

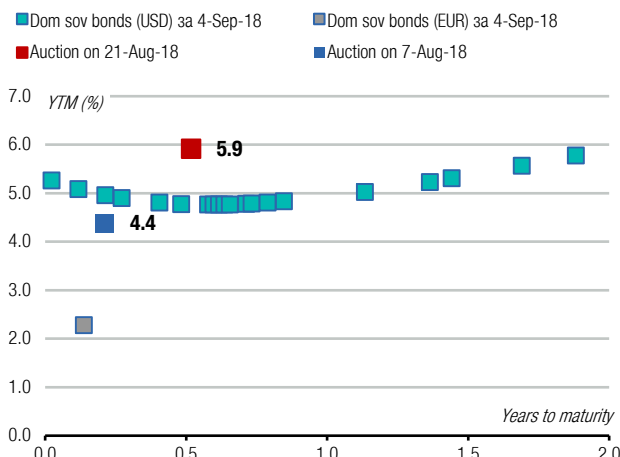
**Chart 2. FX-denominated bonds**

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.

**Decline in free hryvnia volumes continues**

Satisfying demand for FX and large tax payments to the budget caused a decline in banking-sector liquidity to a new record low, and this week it could stay close to this level.

Last week, the NBU absorbed UAH4.5bn, and the Treasury UAH9.2bn, which provided budget expenditures in a lower amount than collected revenues. So, only part of these outflows was compensated by cash exchange in reserves, which amounted to UAH7bn. At the beginning of last week, banks paid back ON loans in the amount of UAH3.4bn, which increased pressure on liquidity. So, despite three-month loans received a week ago by Alfa-bank and Bank Pivdenny (UAH835m and UAH480m, respectively) and an additional two-week loan for UAH400m made to an unnamed bank, total liquidity fell last Thursday to UAH72.3bn, and slightly recovered last Friday to UAH72.7bn.

**ICU view:** Lack of local-currency sources could force some banks to sell FX, and possibly increase deposit rates for individuals. Long time rates were mostly steady despite the increase in the key rate, providing a negative motivation for new deposits, and a decline in consumption. So, this week, liquidity will be at a low level with a possible slight increase. For the following the dynamics of NBU operations with FX and deposits rates revision, the most important event this week will be the decision about the key rate.

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

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

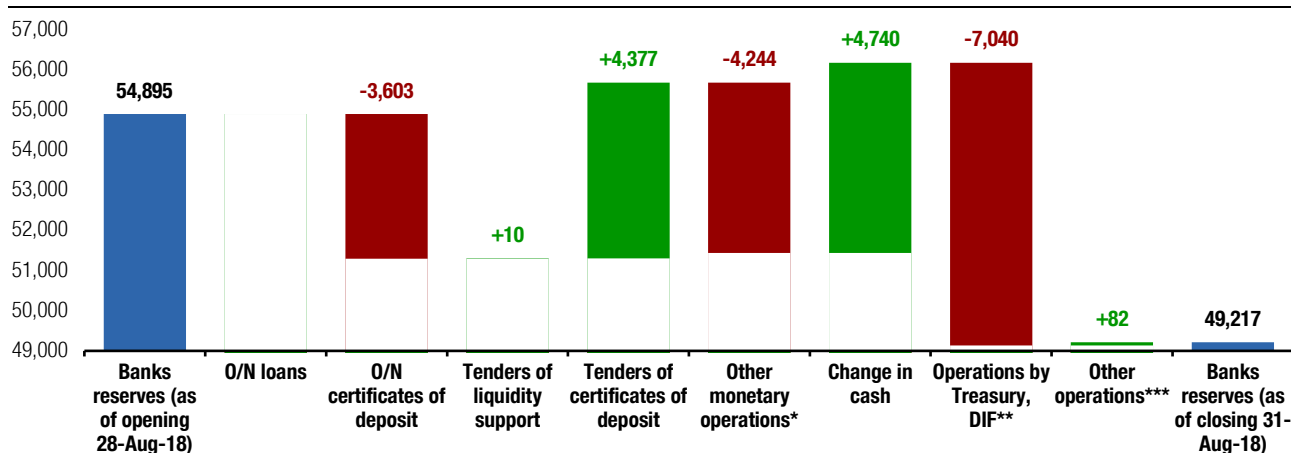
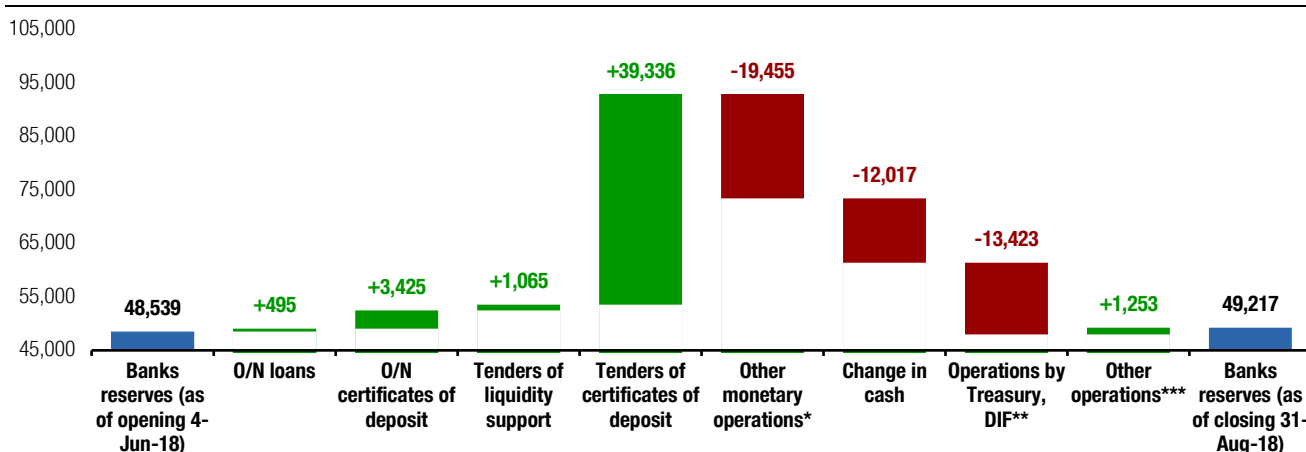


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting [https://bank.gov.ua/control/uk/publish/article?art\\_id=38643651&cat\\_id=40807142](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 below 28/USD

This week, pressure on the hryvnia should somewhat decrease against the backdrop of the beginning of the month, and because the exuberant demand for foreign currency was satisfied last week. However, foreign currency may still be in demand from affiliated foreign companies that pay dividends abroad.

Since the beginning of last week, the hryvnia continued to decline against the US dollar against the backdrop of VAT refunds (about US\$2.4bn), and increased demand for foreign currency. In order to satisfy the excess demand, the NBU continued to spend its reserves, including through a public auction, and sold around US\$159.7m in total over the week. This stopped the weakening of the national currency on Thursday; nonetheless, as of the past week, the hryvnia depreciated by 1.1% to 28.2 UAH/USD.

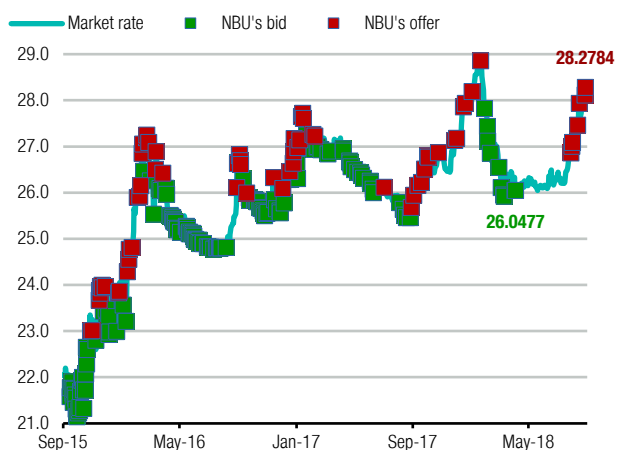
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) decreased 0.3% to 115.76 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 2.8% and decreased 3.7%, respectively.

**ICU view: Payment of dividends abroad by affiliated foreign companies may slightly change the balance of supply and demand for foreign currency this week. However, the shortage of hryvnia liquidity may increase the supply of foreign currency by exporters, and the hryvnia exchange rate should stabilize.**

**Artem Gladchenko, Kyiv, (044) 377-7040 ext.737**

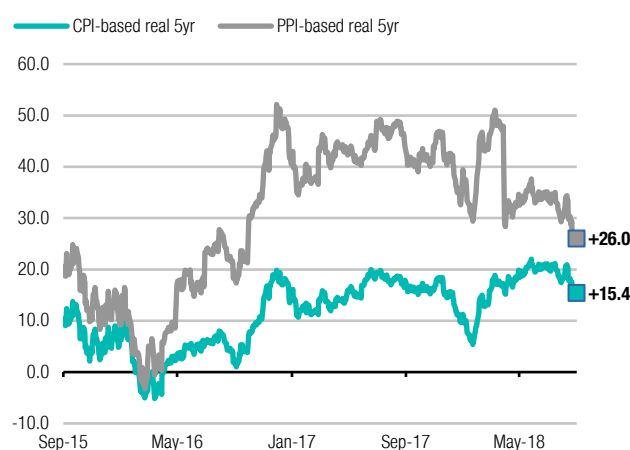
**Chart 5. FX market indicators, 3-year history**

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

### C/A deficit at 2.8% in July

The 12-month rolling C/A deficit widened to US\$3.5bn or 2.8% of GDP in July, up from 2.2% of GDP in December. The C/A deficit is set to widen further due to decreasing metal prices and high energy prices.

According to the NBU, the C/A gap was US\$1.7bn (+2.5 times YoY) in 7M18, having increased from US\$0.6bn in 1H18, primarily due to higher growth rates of imports compared with those of exports.

Imports of goods into Ukraine rose 15.6% YoY to US\$30.5bn. The key growth drivers were machinery and equipment (+14% YoY), energy imports (+12% YoY), and chemical products (+13% YoY). Ukraine's exports of goods rose 11.8% YoY and amounted to US\$24.5bn. The main contributors to export growth were metals (+31% YoY), which account for 64% of the increase in exports, chemical products (+30% YoY), and wood and wood products (+30% YoY).

In 7M18, the merchandise-trade balance deficit surged 34% YoY to US\$6bn, while the services-trade balance surplus grew 51% YoY to US\$0.5bn, bringing the total trade-balance deficit to US\$5.5bn (+33% YoY).

**ICU view: Decreasing prices on metals, the key driver of the Ukraine's exports in 7M18, as well as rising consumer imports and higher energy prices will bring about a further widening of the C/A deficit, which, by our estimates, will be close to US\$3.8bn or 3% of GDP in 2018.**

**Dmytro Dyachenko, Kyiv, (044) 377-7040 ext.738**

This page is intentionally left blank



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

WEB [www.icu.ua](http://www.icu.ua)



## INVESTMENT ADVISORY

**Makar Paseniuk, CFA**, Managing Partner  
[makar.paseniuk@icu.ua](mailto:makar.paseniuk@icu.ua)

**Ivan Shvydanenko**, Director  
[ivan.shvydanenko@icu.ua](mailto:ivan.shvydanenko@icu.ua)

**Roman Nikitov, ACCA** Director  
[roman.nikitov@icu.ua](mailto:roman.nikitov@icu.ua)


**Yuriy Kamarytskyi**, Vice President  
[yuriy.kamarytskyi@icu.ua](mailto:yuriy.kamarytskyi@icu.ua)

**Ruslan Kilmukhametov**, Director  
[ruslan.kilmukhametov@icu.ua](mailto:ruslan.kilmukhametov@icu.ua)


**Ruslan Patlavsky**, Director  
[ruslan.patlavsky@icu.ua](mailto:ruslan.patlavsky@icu.ua)

## ASSET MANAGEMENT

**Grigoriy Ovcharenko**, Director  
Head of Local Asset Management  
[grigoriy.ovcharenko@icu.ua](mailto:grigoriy.ovcharenko@icu.ua)

**Liliya Kubytovych**   
Head of Marketing and Sales  
[liliya.kubytovych@icu.ua](mailto:liliya.kubytovych@icu.ua)


## TRADE OPERATIONS

**Konstantin Stetsenko**   
Managing Partner  
[konstantin.stetsenko@icu.ua](mailto:konstantin.stetsenko@icu.ua)

**Vlad Sinani**, Director  
Strategy and Business Development  
[vlad.sinani@icu.ua](mailto:vlad.sinani@icu.ua)


**Sergiy Byelyayev**  
Head of Fixed-Income Trading  
[sergij.byelyayev@icu.ua](mailto:sergij.byelyayev@icu.ua)

**Yevgeniya Gryshchenko**  
Head of Brokerage Services Department  
[yevgeniya.gryshchenko@icu.ua](mailto:yevgeniya.gryshchenko@icu.ua)


**Vitaliy Sivach**   
Trader, Fixed-Income & Forex  
[vitaliy.sivach@icu.ua](mailto:vitaliy.sivach@icu.ua)


**Bogdan Vorotilin**   
[bogdan.vorotilin@icu.ua](mailto:bogdan.vorotilin@icu.ua)

## RESEARCH

**Alexander Valchyshen**   
Head of Research  
[alexander.valchyshen@icu.ua](mailto:alexander.valchyshen@icu.ua)

**Taras Kotovych**   
Senior financial analyst (Sovereign debt)  
[taras.kotovych@icu.ua](mailto:taras.kotovych@icu.ua)

**Alexander Martynenko**   
Head of corporate research  
[alexander.martynenko@icu.ua](mailto:alexander.martynenko@icu.ua)

**Mykhaylo Demkiv**   
Financial analyst (Banks)  
[mykhaylo.demkiv@icu.ua](mailto:mykhaylo.demkiv@icu.ua)

**Dmitriy Dyachenko**  
Junior financial analyst  
[dmitriy.dyachenko@icu.ua](mailto:dmitriy.dyachenko@icu.ua)

**Artem Gladchenko**  
Junior financial analyst  
[artem.gladchenko@icu.ua](mailto:artem.gladchenko@icu.ua)

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (license numbers: dealer activity AE 263019, broker activity AE 263018, underwriting activity AE 263020 dated 11 April 2013).

## DISCLAIMER

This research publication has been prepared by Investment Capital Ukraine LLC solely for information purposes for its clients. It does not constitute an investment advice or an offer or solicitation for the purchase or sale of any financial instrument. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, Investment Capital Ukraine makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of Investment Capital Ukraine LLC. All rights are reserved. Any investments referred to herein may involve significant risk, are not necessarily available in all jurisdictions, may be illiquid and may not be suitable for all investors. The value of, or income from, any investments referred to herein may fluctuate and/or be affected by changes in exchange rates. Past performance is not indicative of future results. Investors should make their own investigations and investment decisions without relying on this report. Only investors with sufficient knowledge and experience in financial matters to evaluate the merits and risks should consider an investment in any issuer or market discussed herein and other persons should not take any action on the basis of this report.

Additional information is available upon request.

