

Weekly Insight

IMF may exchange Ukraine's programme

Key messages of the today's comments

WEDNESDAY, 19 SEPTEMBER 2018

Domestic liquidity and bonds market

Bonds rates up

As expected, the NBU's key rate hike caused an increase in government local-currency bond rates. Until the next monetary committee at the end of October, this level of rates should be steady and be benchmark for the market.

Liquidity at record low

Despite NBU's purchasing FX last week, loan repayment and outflows to cash left liquidity at its lowest level this year.

Foreign exchange market

Hryvnia exchange rate under the influence of international creditors

This week, the exchange rate of the national currency will be supported by expectations of a positive decision from the IMF mission.

Economics

Inflation inched up marginally to 9% in August

Seasonal weakening of the UAH, robust consumer demand, and a probable hike in gas prices for the population will put pressure on consumer prices in the following months.

IMF may exchange Ukraine's financial aid programme

Exchange of the current EFF programme with a stand-by facility significantly lowers risk of Ukraine's ability to service external debt in 2018-19.

Ukraine wins appeal against Russia in English court

Last Friday, the Court of Appeal in London ruled that the dispute between Ukraine and Russia over the US\$3bn Eurobonds issue will have to be adjudicated through a full trial.

Forecast of grain yield increased to 63.1 mt

Growth in yields in combination with higher world grain prices reinforces our expectations of an increasingly positive impact of agricultural exports on Ukraine's trade balance in 2018-19.

Banks' reserves market (18 September 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+550bp
ON rate (%)	18.20	-21bp	+670bp
ON \$ swap (%)	17.14	+58bp	+481bp
Reserves (UAHm) ²	56,120	-0.52	+7.53
DepCerts (UAHm) ³	20,972	+7.58	-16.31

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 gov't bond holders (UAHm) (18 September 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,104	+0.00	-3.90
Banks	369,545	-0.51	+20.27
Residents	20,045	-1.72	-11.78
Individuals	4,636	+2.81	+518.92
Non-res ⁴	7,461	+0.97	+233.56
Total	749,791	-0.27	+7.85

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

FX market indicators (18 September 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD-UAH	28.1300	+0.23	+7.35
EUR/USD	1.1667	+0.35	-2.30
DXY ²	94.640	-0.17	+3.00
UAH TWI ³	115.872	-0.92	+3.25

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

Gov't bond quotes¹ (19 September 2018)

Maturity	Bid	Ask
6m	19.75	17.75
12m	19.75	17.75
2y	19.50	17.50
3y	19.50	17.25
12m (\$)	5.50	5.00
2y (\$)	5.70	5.15

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

Domestic liquidity and bonds market

Bonds rates up

As expected, the NBU's key rate hike caused an increase in government local-currency bond rates. Until the next monetary committee at the end of October, this level of rates should be steady and be benchmark for the market.

Hiking the key rate by 50bp to 18% caused the same increase in local-currency bonds rates, which were up 50bp to 18.5% at last week's primary auction for bills with maturities up to one year (see our comment [here](#)). Now, the short-term end of yield curve is at 18.5%.

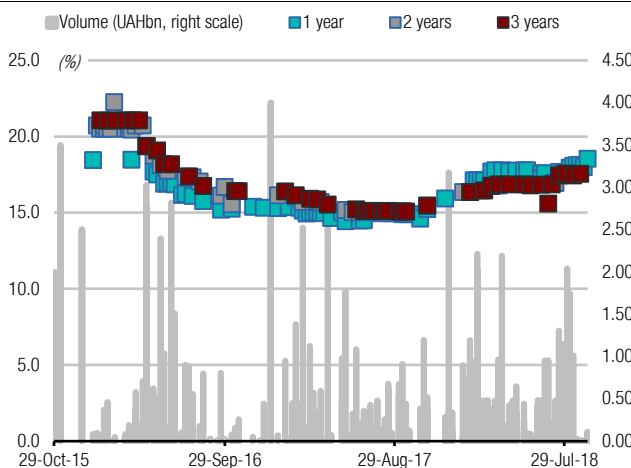
At the same time, USD-denominated bills held steady at a cut-off rate of 5.95%, as demand was very low to push up rates, which resulted in low amounts of FX-denominated funds being raised. Last week, just 10% of FX-denominated domestic debt repayments were refinanced, increasing pressure on FX accounts and the government's ability to repay FX-denominated debt.

ICU view: Demand for local-currency bills rose, but it was above the cut-off rate set by the MoF. So, this week, part of last week's rejected demand was corrected to 18.5% and accepted. At the same time, low demand for FX-denominated bills and MoF's disinclination to increase the cost of these borrowings decreased its ability to repay FX-debt. This is important due to large repayments scheduled for October of US\$532m and EUR215m.

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

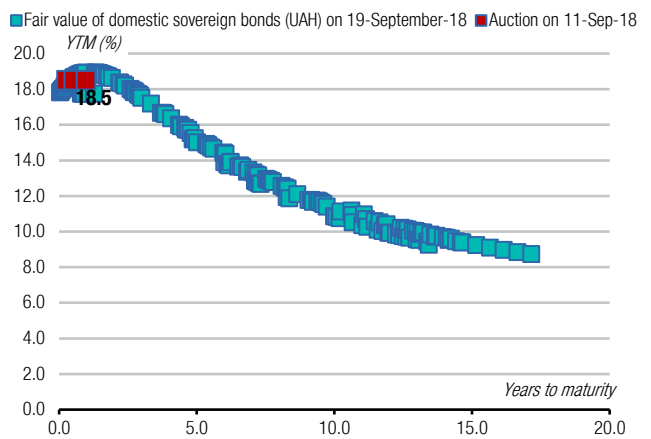
Chart 1. Local-currency bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)

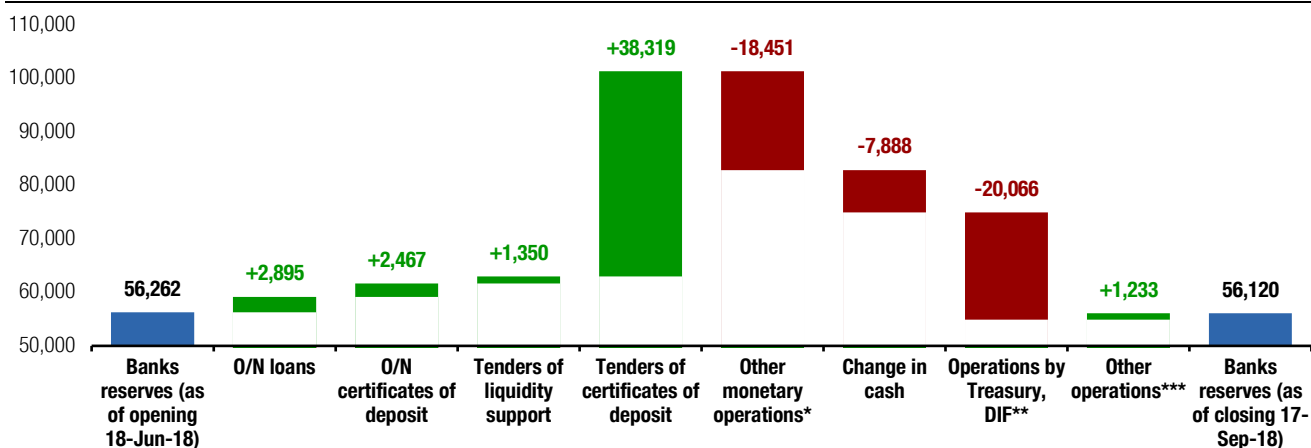


Source: Ministry of Finance of Ukraine, ICU.

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 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 exchange rate under the influence of international creditors

This week, the exchange rate of the national currency will be supported by expectations of a positive decision from the IMF mission.

After the IMF mission arrived, last week, the hryvnia began to strengthen against the US dollar. This happened against the backdrop of the NBU's key policy rate hike, and shifting the supply and demand balance, which allowed the regulator to repurchase foreign currency from the market in a total amount of US\$70m over two days. This did not allow the hryvnia to strengthen above 28 UAH/USD, but the national currency increased by 0.5% to 28.1175 UAH/USD.

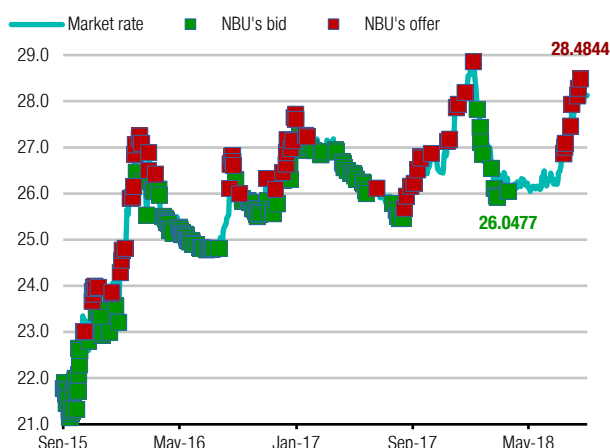
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) decreased 0.4% to 116.2 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 3.4% and decreased 1.3%, respectively.

ICU view: Appreciation of the local-currency and positive expectations that the IMF mission will be successful will encourage greater use of the foreign currency to finance activities rather than attracting more hryvnia funding. This increases the supply of foreign currency, and allows the NBU to partially recover reserves. At the beginning of the week, the hryvnia will receive support from the expectation of a positive decision by the IMF mission to provide another tranche. On the other hand, the NBU will continue to redeem excess foreign currency from the market, not allowing a significant increase of the hryvnia exchange rate, while at the same time reducing the range of fluctuations in the exchange rate.

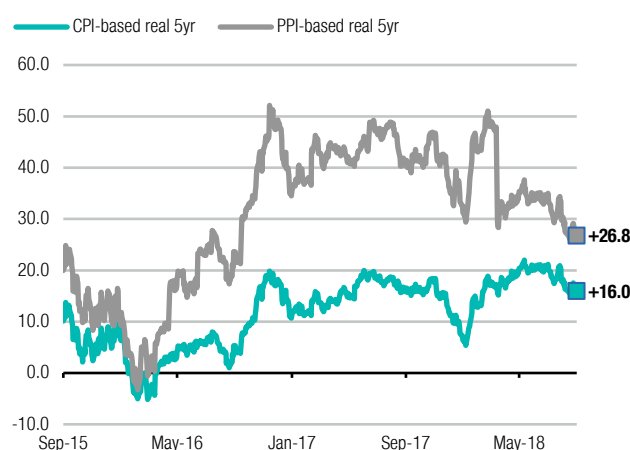
Artem Gladchenko, Kyiv, (044) 377-7040 ext.737

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 misalignment¹ from fundamental level² (%)

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

Economics

Inflation inched up marginally to 9% in August

Seasonal weakening of the UAH, robust consumer demand, and a probable hike in gas prices for the population will put pressure on consumer prices in the following months.

The acceleration in inflation happened mainly due to higher growth rates in prices on transport, which accelerated for the fourth consecutive month to 16.2% YoY in August. On the flip-side, there was some slowdown in the growth rates of prices on alcoholic beverages and tobacco products to 17.9% YoY, while growth of food prices stabilized at 7.1% YoY. Core inflation inched down to 8.7% YoY. The NBU forecasts headline CPI at 8.9% YoY for the end of 2018.

ICU view: *Despite approaching the NBU's target in July and August, headline inflation will be under pressure from the following factors: 1) robust consumer demand, 2) probable increase in gas prices for the population, 3) seasonal weakening of the UAH, and 4) high world energy prices. Thus, we maintain our CPI forecast at 10.2% YoY for the end of 2018.*

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

IMF may exchange Ukraine's financial aid programme

Exchange of the current EFF programme with a stand-by facility significantly lowers risk of Ukraine's ability to service external debt in 2018-19.

According to MP Iryna Lutsenko as cited by [Interfax Ukraine](#), the International Monetary Fund exchanged the EFF programme with a stand-by facility.

Also, as reported in [Ukrainian News](#), the programme exchange would allow Ukraine to avoid a sharp increase in gas prices for the population. According to the information agency, the planned hike in gas prices will be 23.5% in October. The new credit facility will amount to \$4-5bn and will last for 1.5 years. Ukraine and the IMF are reportedly going to sign a new programme memorandum as soon as the government raises gas prices. The new memorandum is reported to raise again the issue of opening the land market in Ukraine. Prime Minister Volodymyr Groysman has already stated he is against the full liberalization of the land market in Ukraine.

ICU view: The programme exchange should allow Ukraine to lower financial risks in the election year of 2019: 1) while the current EFF program ends in March 2019, a stand-by facility would enable Ukraine to receive money from the IMF during the entire year of 2019; 2) stand-by credit capacity will exceed the remaining EFF tranche of \$1.9bn by 2–2.5 times.

Also, the programme exchange mitigates the issue of rising gas tariffs for the population in the critical period of elections. According to the recent decision of the government, the current price for industry is in the range of UAH12,300–13,300/tcm, versus the UAH6,960/tcm price for the population. Therefore, to eliminate the price difference as per the basic requirement of the IMF, the government would have to hike gas prices for the population by 76–91%. The possible 23.5% price rise reported by Ukrainian News is in line with our expectations.

At the same time, the key discerning feature of the stand-by facility is the much shorter term for repayment, which may substantially increase debt repayments in 2021–22.

Alexander Martynenko, Kyiv, (044) 377-7040 ext.726

Ukraine wins appeal against Russia in English court

Last Friday, the Court of Appeal in London ruled that the dispute between Ukraine and Russia over the US\$3bn Eurobonds issue will have to be adjudicated through a full trial.

The Court of Appeal ruled against the lower court's decision to throw out claims brought by Ukraine claiming that the contract with Russia was concluded under circumstances that could potentially amount to duress. The Court rejected other grounds of the appeal. "Ukraine has lost on the issues of capacity, authority, implied terms, and countermeasures, as well as on the issue as to whether there are any other compelling reasons for the case to go to trial", but "the Summary Judgment of the first-instance English Court is set aside in full", the Ministry [said on its web-site](#). The Ministry also said that it expects the final court judgement at the end of 2019.

ICU view: This judgement postpones probable claims from Russia for the repayment of US\$3bn debt. Taking into account the likely timing of the new trial, we assume that the resolution of this debt could be postponed at least until the end of 2019.

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

Forecast of grain yield increased to 63.1 mt

Growth in yields in combination with higher world grain prices reinforces our expectations of an increasingly positive impact of agricultural exports on Ukraine's trade balance in 2018-19.

According to updated data from the Ministry of Agrarian Policy and Food of Ukraine, the yield of grain crops in the 2018/19 marketing year is expected at 63.1 mt.

The increase in the grain-yield forecast is provided by late grains, since yields have been better than previous expectations. Accordingly, the forecast for grain exports has increased to 42 mt, which is 6.6% higher than the results of the last marketing period.

ICU view: The updated forecast of the Ministry of Agrarian Policy reflects the growing likelihood of a better grain harvest in Ukraine, which means a 2% increase in grain production compared with the 2017/18 marketing year. In addition, we expect world prices for wheat and maize to grow by 7-10% and 3-5%, respectively, in 2018. This confirms our expectations of the increasing positive impact of the agro-industrial complex on exports and the trade balance of Ukraine in 2018-19.

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

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



INVESTMENT ADVISORY

Makar Paseniuk, CFA, Managing Partner
makar.paseniuk@icu.ua

Ivan Shvydanenko, Director
ivan.shvydanenko@icu.ua

Roman Nikitov, ACCA Director
roman.nikitov@icu.ua


Yuriy Kamarytskyi, Vice President
yuriy.kamarytskyi@icu.ua

Ruslan Kilmukhametov, Director
ruslan.kilmukhametov@icu.ua


Ruslan Patlavsky, Director
ruslan.patlavsky@icu.ua

ASSET MANAGEMENT

Grigoriy Ovcharenko, Director
Head of Local Asset Management
grigoriy.ovcharenko@icu.ua

Liliya Kubytovych 
Head of Marketing and Sales
liliya.kubytovych@icu.ua

TRADE OPERATIONS

Konstantin Stetsenko 
Managing Partner
konstantin.stetsenko@icu.ua

Vlad Sinani, Director
Strategy and Business Development
vlad.sinani@icu.ua


Sergiy Byelyayev
Head of Fixed-Income Trading
sergiy.byelyayev@icu.ua

Yevgeniya Gryshchenko
Head of Brokerage Services Department
yevgeniya.gryshchenko@icu.ua

Vitaliy Sivach 
Trader, Fixed-Income & Forex
vitaliy.sivach@icu.ua


Bogdan Vorotilin 
bogdan.vorotilin@icu.ua

RESEARCH

Alexander Valchyshen 
Head of Research
alexander.valchyshen@icu.ua

Taras Kotovych 
Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Alexander Martynenko 
Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv 
Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Dmitriy Dyachenko
Junior financial analyst
dmitriy.dyachenko@icu.ua

Artem Gladchenko
Junior financial analyst
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.

