



Focus
Ukraine

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

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Weekly Insight

Hryvnia remains strong

Key messages of the today's comments

Domestic liquidity and bonds market

Investors increase portfolios

This is the second consecutive January of increases in foreign investors' activity. This year, portfolios were increased close to UAH10bn. Other investors also increased their portfolios.

Liquidity up on VAT refunds

This January, the government paid a record amount in VAT refunds, which supported banking-sector liquidity in a sufficient increase above UAH120bn, where it likely will remain this week despite month-end tax payments.

Foreign exchange market

Hryvnia remains strong

Last week, the hryvnia continued to appreciate, but, expectedly, remained close to UAH28/US\$. The NBU contained further appreciation, as it purchased extra FX supply, and may apply the same strategy this week.

Economics

Retail trade turnover rises 6.1% YoY in 2018

Household consumption will remain the key driver of economic growth in 2019 being supported by further growth of real incomes.

TUESDAY, 29 JANUARY 2019

Banks' reserves market (28 January 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+200bp
ON rate (%)	16.29	-20bp	+169bp
ON \$ swap (%)	14.75	+31bp	+28bp
Reserves (UAHm) ²	57,907	+0.21	+26.84
DepCerts (UAHm) ³	66,758	+25.95	+27.60

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) (28 January 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	343,774	-0.19	-4.13
Banks	373,399	+1.58	+2.41
Residents	20,815	+1.22	-10.60
Individuals	6,651	+6.30	+331.47
Non-res ⁴	9,631	+24.28	+64.38
Total	754,270	+1.03	+0.06

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

FX market indicators (28 January 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.8030	+0.17	-2.50
EUR/USD	1.1428	+0.60	-8.04
DX ²	95.746	-0.58	+7.50
UAH TWI ³	116.783	-0.61	+12.50

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

Gov't bond quotes¹ (29 January 2019)

Maturity	Bid	Ask
6m	20.00	18.50
12m	20.00	18.50
2y	19.75	18.00
3y	19.50	17.50
12m (\$)	7.50	5.25
2y (\$)	7.50	5.50

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

Domestic liquidity and bonds market

Investors increase portfolios

This is the second consecutive January of increases in foreign investors' activity. This year, portfolios were increased close to UAH10bn. Other investors also increased their portfolios.

At the primary auction last week (see our last week's [overview](#)), nearly UAH10bn of local-currency bills were sold, and a sufficient part of these bills were purchased by foreign investors. As usual, there were short-term bills, mostly with three-month maturities, and they support the Ministry of Finance in budget financing.

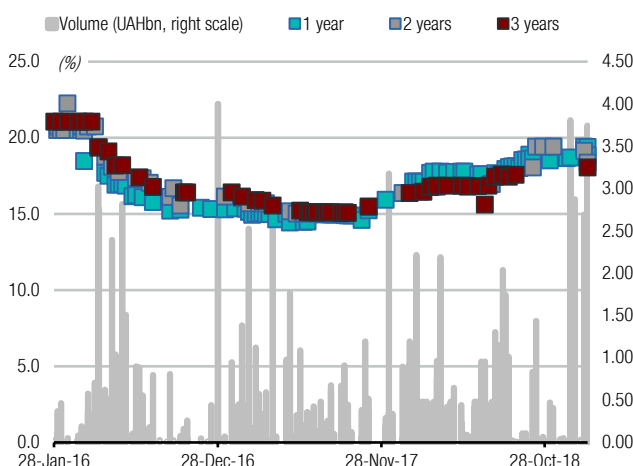
High activity was seen from domestic investors. Last week, the increase in portfolios was less sufficient, but banks, non-banks, and also individuals increased their portfolios. Individuals' portfolio rose by 5.3% to UAH6.6bn, as their portfolios of UAH-denominated bills were increased by UAH278m, while for FX-denominated bills, the increase was just UAH112m.

ICU view: Foreigners buying bills supported the MoF in both financing debt repayments and new budget borrowings. Taking into account that the NBU can start to decrease its key rate this year, raising short-term borrowings permit the MoF to wait for cheaper funds for the longer term.

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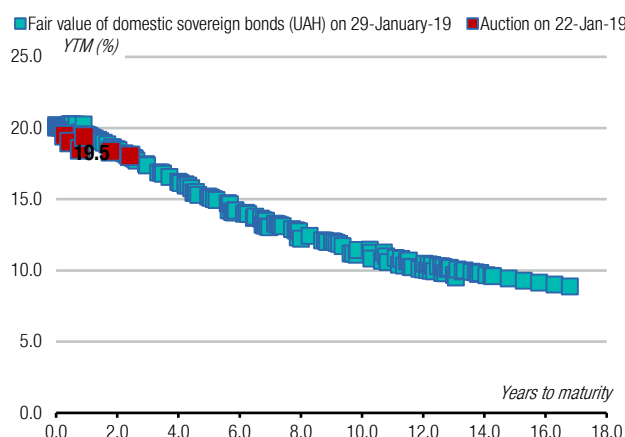
Chart 1. Local-currency bonds

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.

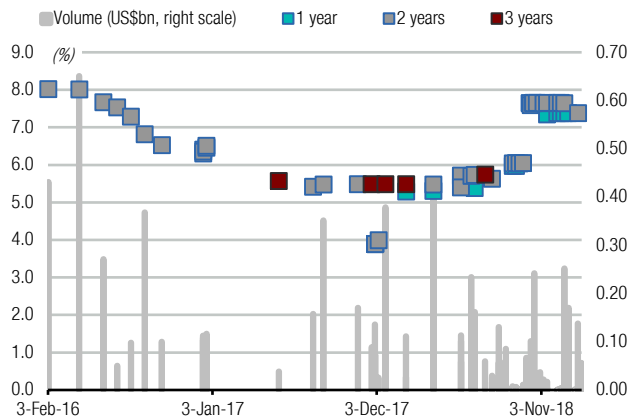
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

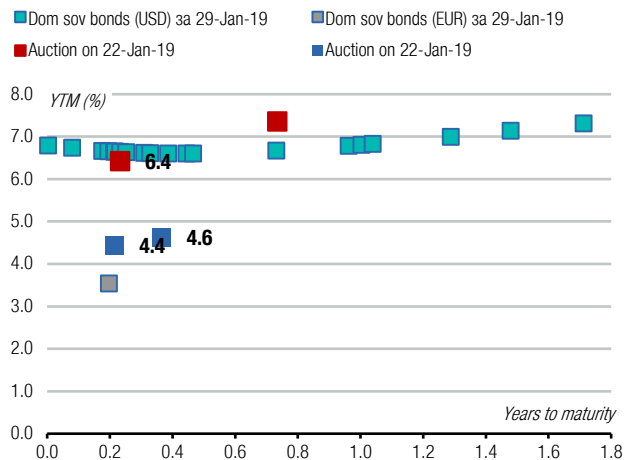
Chart 2. FX-denominated bonds

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

This January, the government paid a record amount in VAT refunds, which supported banking-sector liquidity in a sufficient increase above UAH120bn, where it likely will remain this week despite month-end tax payments.

Last week, liquidity rose to UAH124.6bn, very close to the record high UAH125.3bn that was seen at the end of 2015. This increase was caused by incredibly large VAT refunds, which at the end of last week amounted to UAH19.5bn, a record amount for recent years.

With large amounts of VAT refunds last Thursday and Friday, the net impact on liquidity from the Treasury amounted to UAH5.7bn and UAH6.4bn, respectively. Last week, the Treasury injected UAH6.1bn into the banking system, and with cash exchange in reserves, non-monetary operations provided UAH11bn in banking-sector liquidity. Additionally, the NBU injected UAH3.3bn via FX purchase.

ICU view: This month, the government sufficiently increased VAT refunds, and increased inflows in liquidity from the budget, not through expenditures as is usual. These payments from the budget moved inflows in liquidity from December to end of January via VAT refunds for exporters. This source could be a bit longer and can be invested in CDs, the total outstanding of which rose to about UAH67bn last week.

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

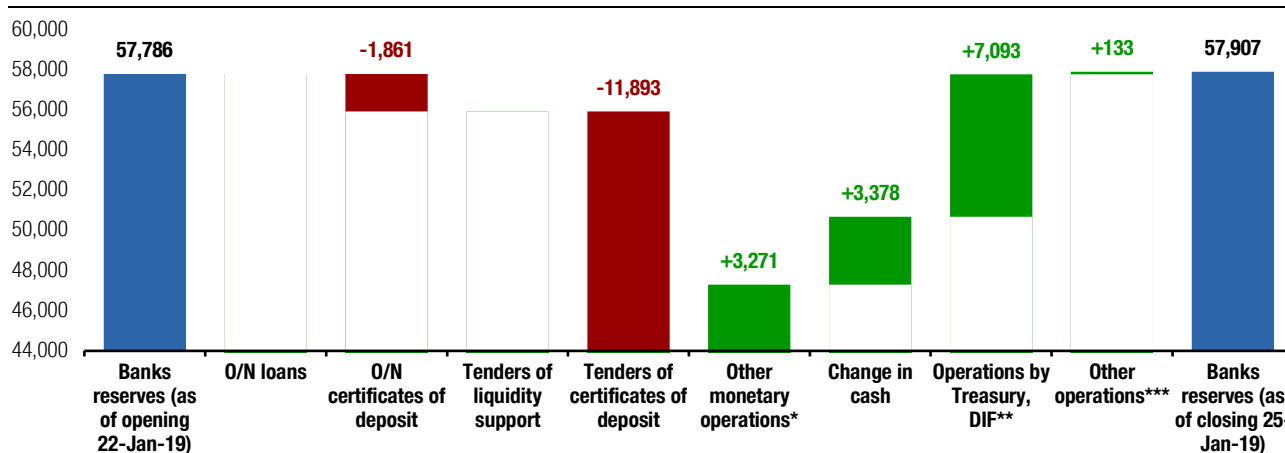
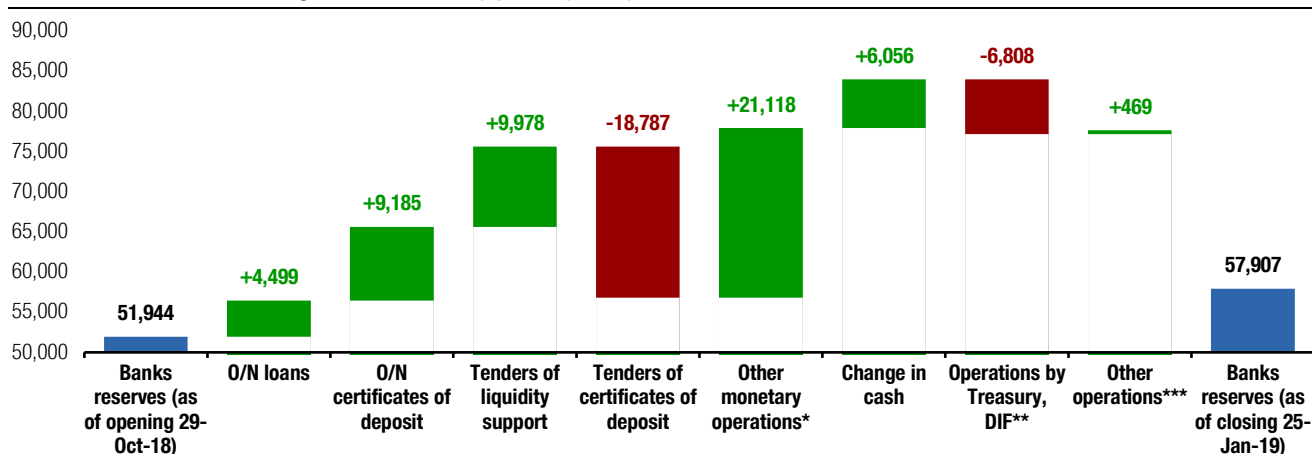


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 remains strong

Last week, the hryvnia continued to appreciate, but, expectedly, remained close to UAH28/US\$. The NBU contained further appreciation, as it purchased extra FX supply, and may apply the same strategy this week.

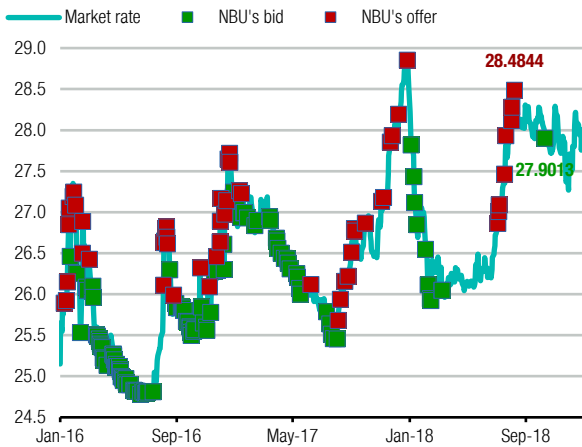
Increase in foreign investors' portfolios of local-currency bills provided additional supply of FX, and provided support keeping the hryvnia stable at the level reached a week before. To maintain the level of the hryvnia, the NBU purchased US\$117.9m of FX, but this purchase was not enough, and hryvnia continued to strengthen. At the end of last week, the hryvnia appreciated by 0.5%, and for the last 12 months by 3.1%. At the same time, the hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.27% to 116.8 while in YoY terms, it was up 13.1%.

ICU view: Foreign investors will maintain their interest in the domestic bond market, and despite significant increase in banking-sector liquidity, the FX supply should remain high. So, the hryvnia should be stronger than UAH28/US\$, and can possibly further appreciate to UAH27.5/US\$ in 2Q19.

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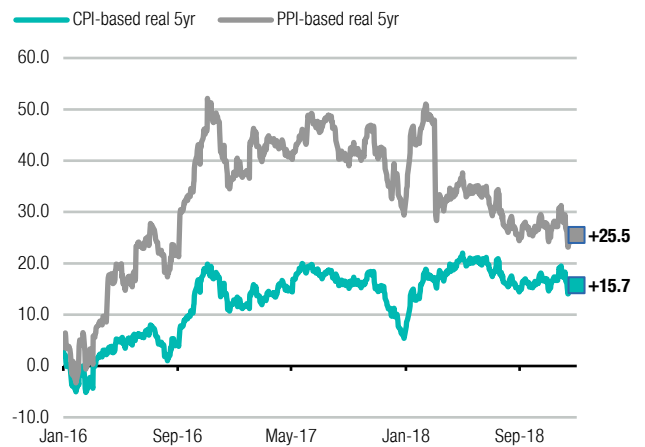
Chart 5. FX market indicators, 3-year history

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 misalignment¹ from fundamental level² (%)



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

Economics

Retail trade turnover rises 6.1% YoY in 2018

Household consumption will remain the key driver of economic growth in 2019 being supported by further growth of real incomes.

Although retail-turnover growth slowed to 4.9% YoY in December, down from 5.6% YoY in November, it still remains robust. By region, the highest growth in retail trade in 2018 was observed in the Luhansk region (+26.8% YoY), the Donetsk region (+14.2% YoY), the Zakarpattya region (+12.7% YoY), and the Poltava region (+12.3% YoY).

ICU view: Consumer demand will remain the key driver of economic growth in 2019 thanks to rising real disposable incomes of households against the backdrop of a 12% minimum wage hike starting in January 2019, a further increase of remittances, and a tight labour market.

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