Focus
Ukraine

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

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Weekly Insight

Inflation slowed in February

Key messages of the today's comments

Domestic liquidity and bonds market

Foreign investors more active

Last week, the Ministry of Finance borrowed UAH5.7bn mostly in the form of local-currency bills, at least 13% of which were purchased by foreign investors. This trend should continue this week.

Budget collecting funds

Banking-sector liquidity was down UAH13bn last week due to the Treasury absorbing funds and large reserves exchange in cash. This week, liquidity should be close to UAH100bn.

Foreign exchange market

Hryvnia continues to appreciate

Movements in the Ukrainian hryvnia continued to be positive, receiving support from foreign investments, which should continue this week as well.

Economics

Inflation slowed to 8.8% YoY in February

Tight monetary and fiscal policies along with lower energy prices will bring about further inflation slowdown throughout 2019.

C/A deficit slid to 3.3% of GDP in January

Thanks to lower world energy prices, slower consumer imports growth, and further economic growth, the C/A deficit will contract in 2019.

TUESDAY, 12 MARCH 2019

Banks' reserves market (11 March 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	18.00	+0bp	+100bp
ON rate (%)	16.47	-4bp	+77bp
ON $ swap (%)	14.88	+8bp	-70bp
Reserves (UAHm)[2]	49,099	+8.19	+15.63
DepCerts (UAHm)[3]	52,378	-20.78	+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) (11 March 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,107	+0.00	-4.86
Banks	361,004	-0.44	+5.30
Residents	24,326	+2.52	-8.25
Individuals	7,299	+1.46	+279.98
Non-res[4]	14,034	+5.92	+1.69
Total	**743,770**	**-0.02**	**+0.58**

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

FX market indicators (11 March 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.2980	-1.24	+0.73
EUR/USD	1.1245	-0.56	-8.63
DXY[2]	97.215	+0.36	+7.91
UAH TWI[3]	124.218	+1.59	+7.24

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

Gov't bond quotes[1] (12 March 2019)

Maturity	Bid	Ask
6m	**20.00**	**18.50**
12m	**20.00**	**18.25**
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

Foreign investors more active

Last week, the Ministry of Finance borrowed UAH5.7bn mostly in the form of local-currency bills, at least 13% of which were purchased by foreign investors. This trend should continue this week.

Foreign investors were very active in January and at the beginning of February, but later slowed, and they held their portfolios steady with insufficient movements. This changed last week when foreigners purchased more than UAH0.7bn of new bills, increasing their portfolios to above UAH14bn.

According to Bloomberg, Citi Group issued a new portion of CLN, two new issues UAH52m and UAH400m, with maturities in September 2019, and January 2021, respectively. So, more than half of the bonds purchased last week by foreign investors had maturities in 2021.

ICU view: Recent investments in Ukrainian debt could promote bills once more, and investments could rise further. It is important to note that unlike in January, investments are mostly longer, and this will decrease refinancing needs this year.

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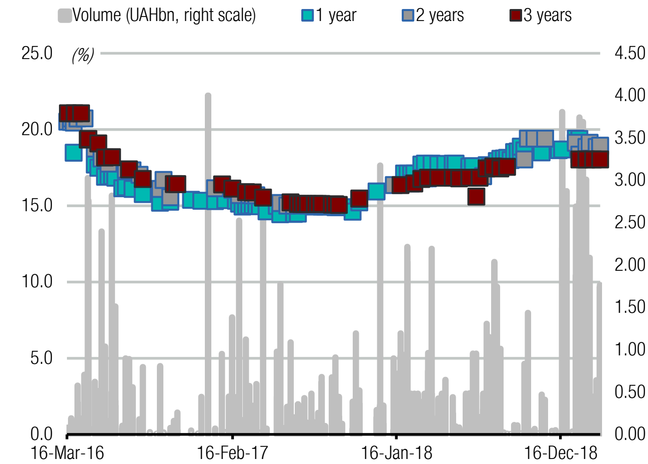
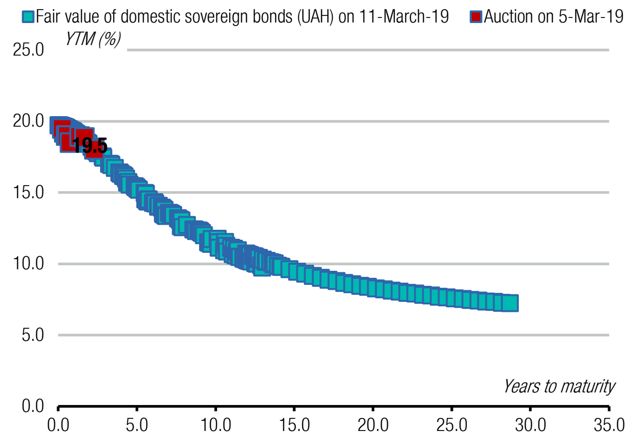
Chart 1. Local-currency bonds

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.

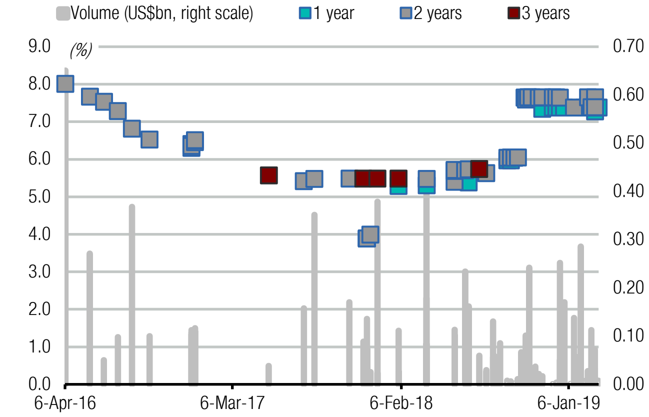
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

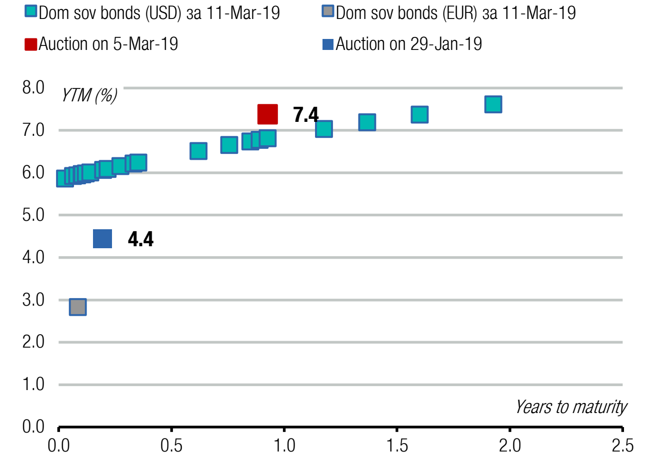
Chart 2. FX-denominated bonds

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.

Budget collecting funds

Banking-sector liquidity was down UAH13bn last week due to the Treasury absorbing funds and large reserves exchange in cash. This week, liquidity should be close to UAH100bn.

Liquidity was under pressure last week from corporate profit tax payments. Yesterday was the last day of tax payments from this source based on income received in 2018. As the result, liquidity declined to UAH101.5bn last week due to outflows to Treasury accounts. Last week, the budget absorbed UAH11.1bn, including funds paid for new bills. Also, banks exchanged UAH6.5bn of reserves in cash, which had a negative impact on liquidity.

At the same time, the NBU increased purchases of FX in the market to improve the balance due increased supply from foreign investors. Last week, the NBU paid UAH5.6bn for FX purchases, which supported liquidity.

ICU view: Last week, the budget received more than UAH26bn of revenues, which is sufficiently larger compared with the same period in February, and which caused a liquidity decline. This week, liquidity will be under the same pressure from the last day of profit tax payments, and the beginning of a new wave of outflows due to other taxes. So, liquidity will depend on budget expenditures and FX inflows from foreign investors.

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

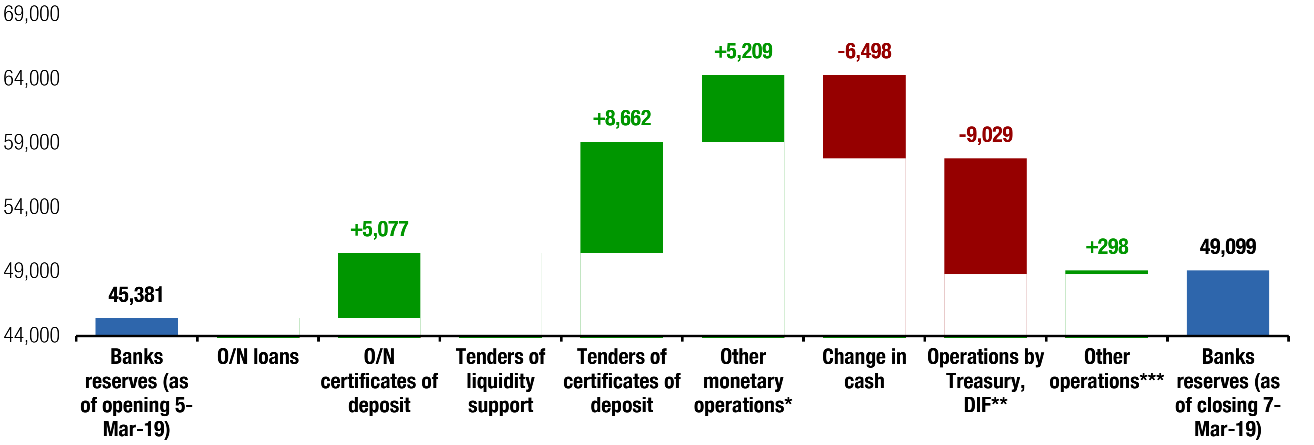
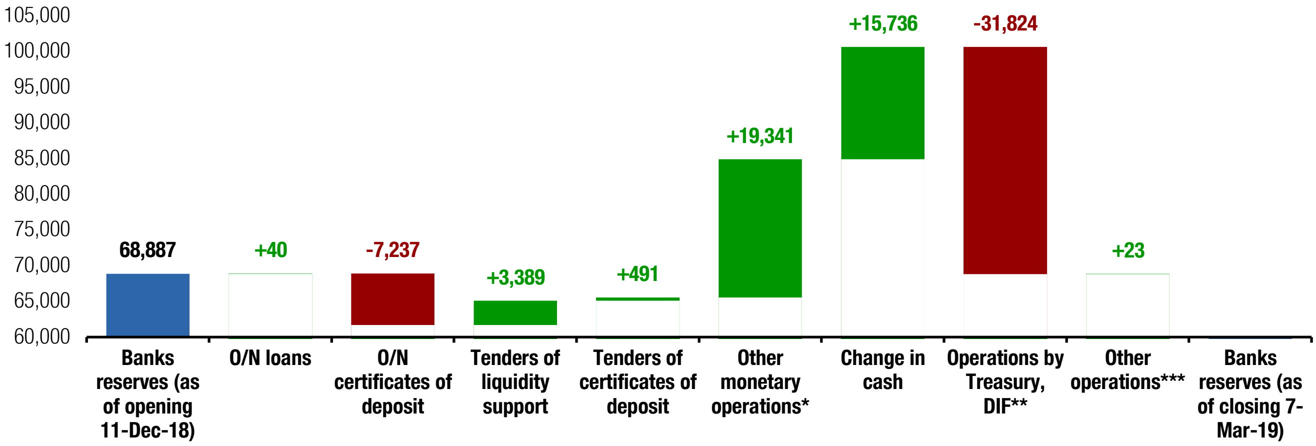


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 continues to appreciate

Movements in the Ukrainian hryvnia continued to be positive, receiving support from foreign investments, which should continue this week as well.

Corporate profit tax payments required additional funds in local currency, which likely increased the supply of FX in the market. But the main push affecting the exchange rate came from foreign investors who purchased UAH0.7bn of new bills. Last week, the NBU purchased US$211.7m, mostly on Wednesday, which was settlement day for the primary auction. However, this purchase of FX by the NBU only decreased pressure, it didn't avoid it.

Finally, last week, the hryvnia added 1.7%, appreciating to UAH26.38/US$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 2.6% to 124.2 while in YoY terms, it was up 7.4%.

ICU view: The decline in liquidity should cause a further increase in the cost of funding in local currency, and increase the supply of FX at the market to pay taxes and finance business activities. This trend could be supported by new wave of foreign investments in local-currency debt, moving the hryvnia closer to UAH26/US$.

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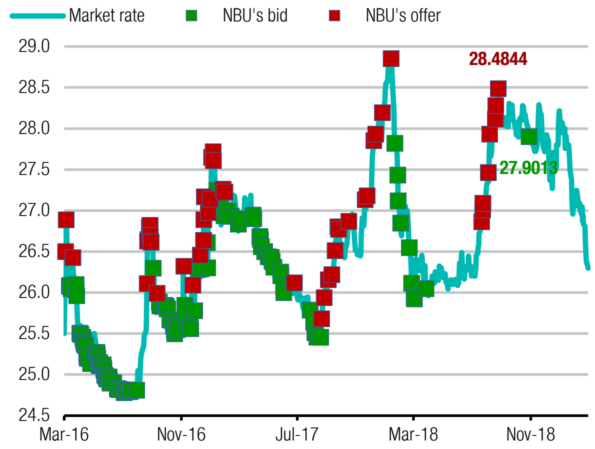
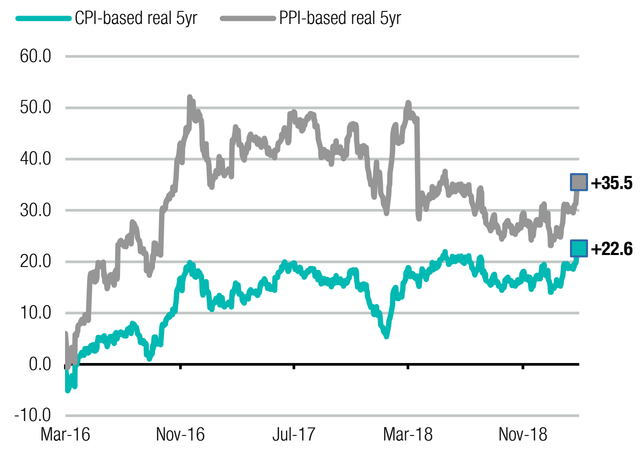
Chart 5. FX market indicators, 3-year history

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

Inflation slowed to 8.8% YoY in February

Tight monetary and fiscal policies along with lower energy prices will bring about further inflation slowdown throughout 2019.

In February, consumer-prices growth slowed to 8.8% YoY and 0.5% MoM, down from 9.2% YoY seen in January, per data from the State Statistics Service of Ukraine. As in the previous month, the inflation slowdown in February was primarily thanks to decelerated growth rates in transport prices to 6% YoY vs. 7.7% in January and 12.9% YoY in December. The contribution of this particular category fell by 0.2ppt to 0.7ppt out of 8.8% in February. Among other categories, the acceleration was posted only in prices on communication, while inflation in other categories was flat or slightly declined. Core inflation fell by 0.5ppt to 7.8% YoY. The NBU forecasts headline CPI at 6.3% YoY for the end of 2019.

ICU view: Due to tight monetary and fiscal policies, slowing economic growth, and lower prices for oil and natural gas, inflation is set to decelerate to 8.5% YoY by YE2019. Still, solid consumer demand, high inflationary expectations, and rising nominal wages will put upward pressure on consumer prices.

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C/A deficit slid to 3.3% of GDP in January

Thanks to lower world energy prices, slower consumer imports growth, and further economic growth, the C/A deficit will contract in 2019.

The annualized C/A deficit contracted to US$4.3bn (3.3% of GDP) in January, down from US$4.7bn (est. 3.6% of GDP) in December, per data from the NBU. The key reasons for annualized C/A deficit contraction were much lower import growth rates in January 2019 (+1.2% YoY) vs. 11.9% YoY in full-year 2018 and 31.4% YoY in January 2018, against the backdrop of a 10% YoY decrease in energy imports and a 9.3% YoY decrease in imports of chemical products.

Exports of goods rose 9.1% YoY and totaled US$3.7bn, mostly thanks to higher agricultural exports (+22.9% YoY) against the backdrop of a record grain harvest in 2018, and metallurgical exports (+7.8% YoY). Thus, the 12-month trailing merchandise-trade-balance deficit amounted to US$12.7bn (+27% YoY, 9.7% of GDP). The 12-month trailing services-trade-balance surplus rose 59% YoY to US$1.5bn.

ICU view: Our baseline forecast envisages the C/A deficit contracting to 3.3% of GDP in 2019 (US$4.8bn), down from an estimated 3.6% of GDP in 2018 (US$4.7bn) thanks to 1) lower volumes of energy imports supported by decreased world energy prices, 2) further growth of remittances (we forecast a 10-12% YoY increase in 2019 vs. est. +19% YoY in 2018 and +23% YoY in 2017), 3) slower growth of consumer imports, and 4) further growth of Ukraine's economy.

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