

Weekly Insight

Record-breaking foreign investment

Key messages of the today's comments

Domestic liquidity and bonds market

Record-breaking foreign investment

Last week, foreign investors increased their portfolios of Ukrainian domestic bills to over UAH20bn, after purchasing new bills at the primary auction. Despite the elections, we expect investments to rise this week also.

Liquidity recovers above UAH100bn

Banking-sector liquidity recovered to above UAH100bn last week. The main support came from VAT refunds and cash exchange in reserves. This week, we expect outflows to budget and reserves exchange in cash, which will have negative impact on liquidity.

Foreign exchange market

Volatility in the hryvnia market

Last week, the hryvnia was under pressure from the demand side and lost 1.7%, weakening to UAH27.35/US\$. New foreign investments in local-currency debt did not support the Ukrainian currency. With a possible increase in FX supply this week, the hryvnia can be expected to strengthen.

Economics

C/A deficit rose to 3.4% of GDP in February

Lower world energy prices and slower consumer imports growth will support Ukraine's current account balance in 2019.

MONDAY, 1 APRIL 2019

Banks' reserves market (28 March 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+100bp
ON rate (%)	16.33	-23bp	+83bp
ON \$ swap (%)	14.55	-2bp	-125bp
Reserves (UAHm) ²	53,979	-1.12	+8.43
DepCerts (UAHm) ³	51,723	+20.34	+2.43

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 March 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,107	+0.00	-3.77
Banks	367,259	-0.29	+9.88
Residents	25,243	-2.86	-9.18
Individuals	7,963	+2.23	+274.18
Non-res ⁴	20,302	+11.71	+41.48
Total	757,874	+0.06	+3.98

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

FX market indicators (28 March 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.3500	+1.70	+3.48
EUR/USD	1.1218	-0.74	-8.80
DX ²	97.284	+0.65	+7.91
UAH TWI ³	119.662	-1.04	+4.26

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

Gov't bond quotes¹ (1 April 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

Record-breaking foreign investment

Last week, foreign investors increased their portfolios of Ukrainian domestic bills to over UAH20bn, after purchasing new bills at the primary auction. Despite the elections, we expect investments to rise this week also.

Demand in the primary market continues to be concentrated in medium-term bills vs. shorter-term maturities. Expectations of a cut in the key policy rate are driving this demand locally, but equally important is interest on the part of foreign investors for this tenor. This category of investors supported MoF in its debt refinancing. For more details, see our [auction review](#).

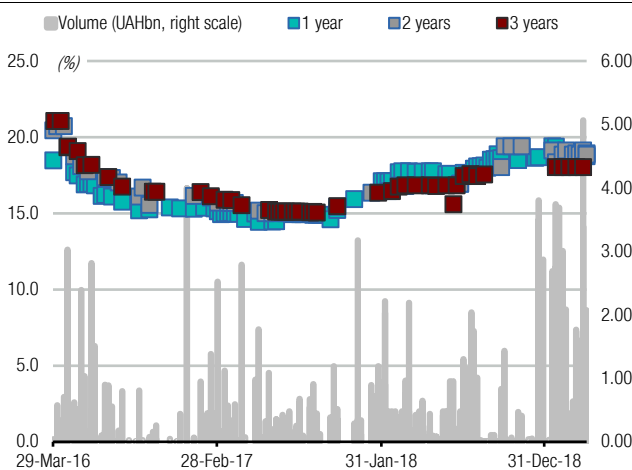
By the end of last week, the greatest increase, by UAH2.1bn, was in foreign investors' portfolios. Private investors added UAH0.2bn to their portfolio in all currencies. Also, banks' portfolios rose by UAH0.3bn, while non-banks decreased investments by UAH0.7bn. Also significant was a revaluation of FX-denominated bills due hryvnia weakening.

ICU view: This week, demand should remain stable due to large repayments, which likely will be reinvested in new bills, although perhaps less from foreign investors. Expectations for a cut in NBU's key rate will support demand for longer bills. At the same time, we do not anticipate sufficient movements of rates at primary auctions.

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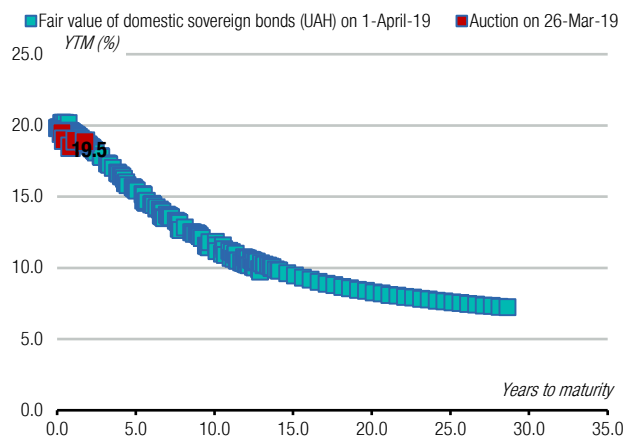
Chart 1. Local-currency bonds

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.

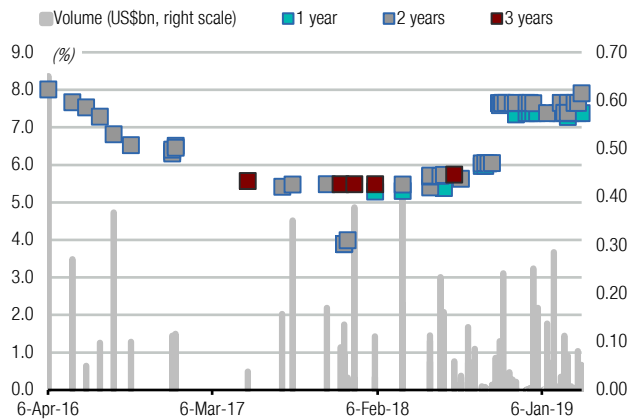
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

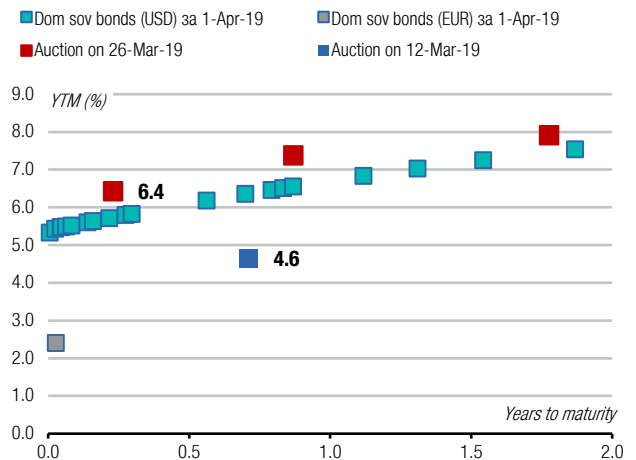
Chart 2. FX-denominated bonds

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 above UAH100bn

Banking-sector liquidity recovered to above UAH100bn last week. The main support came from VAT refunds and cash exchange in reserves. This week, we expect outflows to budget and reserves exchange in cash, which will have negative impact on liquidity.

The largest support for liquidity was from cash exchange in reserves, which provided UAH4.4bn in banking sector-liquidity. Treasury operations also provided liquidity with UAH1.4bn of funds as last week UAH8.5bn was paid in VAT refunds. NBU operations had a low impact on the FX market, with inflows less than UAH0.4bn.

ICU view: At the beginning of month, liquidity usually meets with pressure due to the need for cash and payments to the budget. This can have a negative impact on liquidity this week, but liquidity should not decline below UAH100bn.

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

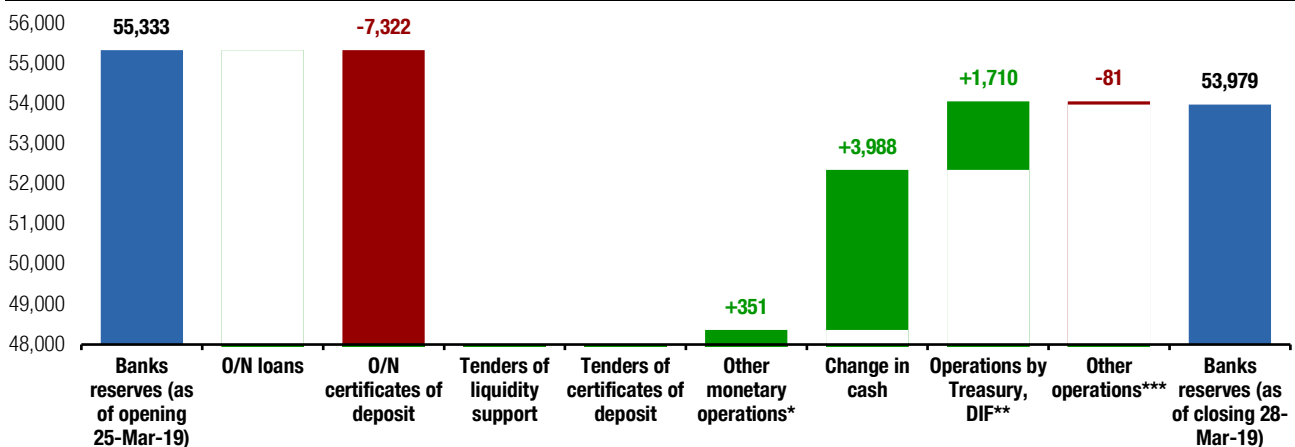
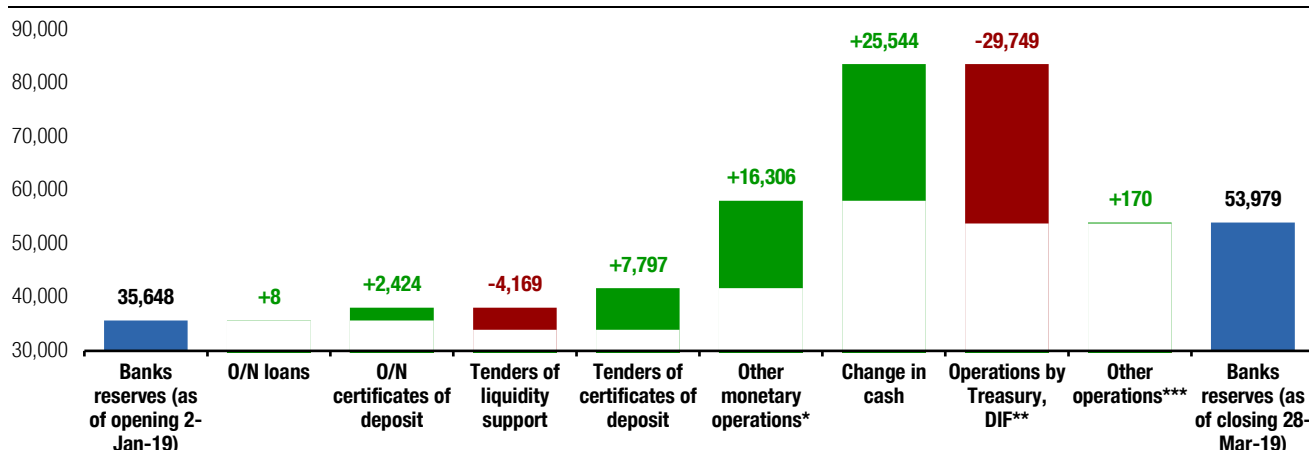


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Volatility in the hryvnia market

Last week, the hryvnia was under pressure from the demand side and lost 1.7%, weakening to UAH27.35/US\$. New foreign investments in local-currency debt did not support the Ukrainian currency. With a possible increase in FX supply this week, the hryvnia can be expected to strengthen.

New foreign investments in local-currency debt last week did not support the hryvnia, which weakened slightly, being volatile due market-based factors. Last week, particularly on Thursday and Friday, a large amount in VAT refund was paid, which decreased the supply of FX, leading to the hryvnia weakening. The NBU purchased its usual US\$15m on Monday, and did not participate in the market until the end of the week.

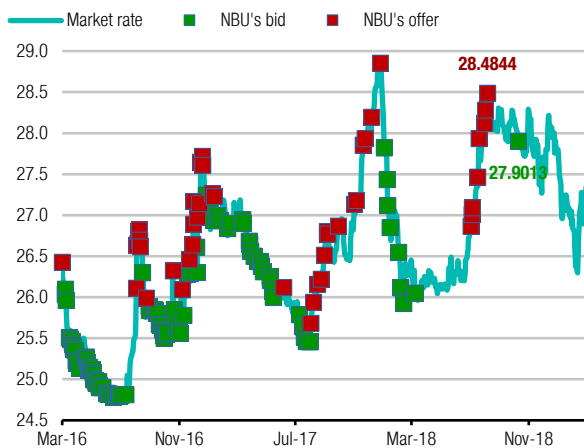
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) declined 1% to 119.7, while in YoY terms, it was up 4.3%.

ICU view: The market would be different this week, with a lower impact from local-currency inflows related to VAT refund and exporters. At the same time, demand for local-currency bills from foreign investors should remain stable and provide inflows in FX to the market. We expect that the hryvnia will remain above UAH27/US\$ with slight appreciation compared with last week.

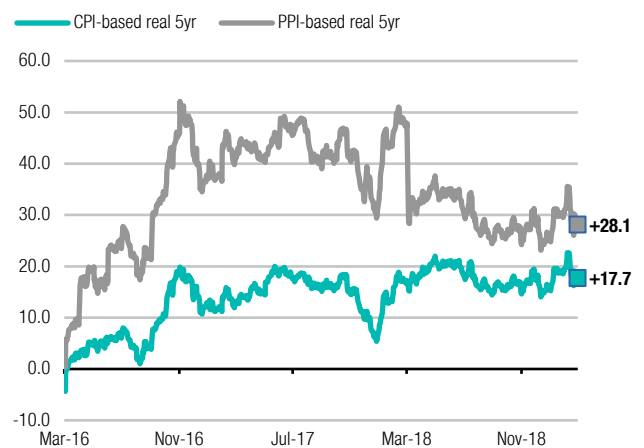
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Chart 5. FX market indicators, 3-year history

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

C/A deficit rose to 3.4% of GDP in February

Lower world energy prices and slower consumer imports growth will support Ukraine's current account balance in 2019.

The annualized C/A deficit expanded to US\$4.6bn (est. 3.4% of GDP) in February, up from revised US\$4.1bn (est. 3.1% of GDP) in January, per data from the NBU. This was caused by resumed growth of imports in February (+14.9% YoY, to US\$4.6bn) after a 0.2% YoY decline in January, which was boosted by machinery and equipment (+39% YoY), and mineral products (+14% YoY).

Exports of goods rose 7.3% YoY and totaled US\$3.6bn in February, mostly thanks to higher agricultural exports (+27% YoY). At the same time, metallurgical exports, which were the main driver of export growth last year, dropped 18% YoY. Thus, the 12-month trailing merchandise-trade-balance deficit amounted to US\$12.6bn (+27% YoY, 9.5% of GDP). The 12-month trailing services-trade-balance surplus rose 49% YoY to US\$1.4bn.

ICU view: Thanks to lower volumes of energy imports supported by decreased world energy prices, further increase of remittances, slower growth of consumer imports, and further growth of Ukraine's economy, the C/A deficit will contract to 3.3% of GDP in 2019 (US\$4.8bn), down from an estimated 3.5% of GDP in 2018 (US\$4.5bn).

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