

Weekly Insight

Ukraine linked to Clearstream

Key messages of the today's comments

Domestic liquidity and bonds market

Ukraine linked to Clearstream

Starting yesterday, investors in Ukraine domestic government bonds will be able to use Clearstream for trade settlement. As a result, we expect a gradual increase in foreign investors' activity.

Liquidity below UAH100bn

Banking-sector liquidity, as expected, remained below UAH100bn most of last week. It could be higher this week due to VAT refunds and new foreign investments in local-currency debt.

Foreign exchange market

Hryvnia increases volatility

Last week, the hryvnia/US dollar exchange rate did not move significantly, slid 0.2%, although there was significant volatility, greater than the previous week. This week, the hryvnia should stay in the range of UAH26.3-26.6/US\$, also with significant volatility.

Economics

Retail trade turnover rises 9.1% YoY in April

Thanks to further growth of real incomes, household consumption will remain the key growth driver of Ukraine's economy in this and in coming years.

Industrial production rises 5.2% YoY in April

Industrial output will receive further support from rising household consumption and an increase in the mining industry.

TUESDAY, 28 MAY 2019

Banks' reserves market (24 May 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	17.50	+0bp	+50bp
ON rate (%)	16.21	+19bp	-29bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	51,583	-7.63	-7.40
DepCerts (UAHm) ³	44,764	-13.46	-16.27

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) (24 May 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,088	+0.00	-3.78
Banks	360,998	+0.02	+4.72
Residents	25,312	+2.23	+3.30
Individuals	9,184	+2.03	+235.15
Non-res ⁴	41,441	+4.36	+273.36
Total	774,023	+0.34	+5.54

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

FX market indicators (24 May 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.4250	+0.17	+1.17
EUR/USD	1.1203	+0.40	-4.41
DXY ²	97.613	-0.39	+4.09
UAH TWI ³	124.173	-0.56	+4.00

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

Gov't bond quotes¹ (28 May 2019)

Maturity	Bid	Ask
6m	19.00	18.00
12m	19.25	18.00
2y	19.25	18.00
3y	19.00	17.00
12m (\$)	7.50	5.50
2y (\$)	7.50	5.75

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

Domestic liquidity and bonds market

Ukraine linked to Clearstream

Starting yesterday, investors in Ukraine domestic government bonds will be able to use Clearstream for trade settlement. As a result, we expect a gradual increase in foreign investors' activity.

An agreement between Clearstream and the NBU was signed at the beginning of this year, and the service should be operational now, providing foreign investors with a direct link to the Ukrainian market. Having access to Clearstream will lower expenses for investors in local-currency bills as well as save time. For those who already invested using CLN or GDN, a link to Clearstream will allow easier reinvestment of repayments.

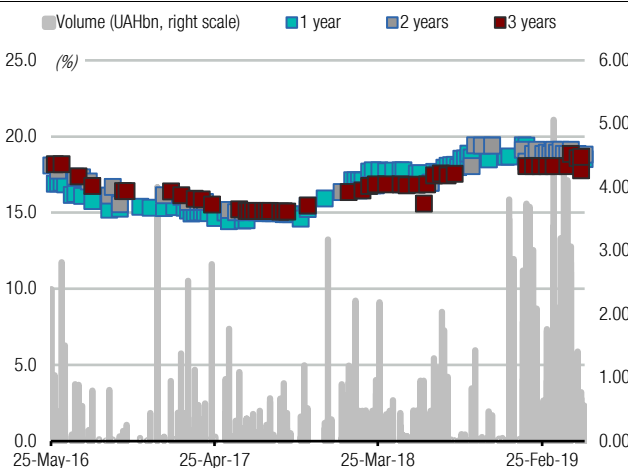
In recent weeks, there has been an uptick in foreign activity in government securities. Last week, foreigners purchased UAH1.7bn of new bills, or three times more than the week before. It was probably the four-year note at the primary auction that attracted foreign interest last week, as it usually does.

ICU view: Development of Ukraine's financial infrastructure should attract increased interest in local-currency debt. On the other hand, this increase can have low impact on bond portfolios due to reinvestment of debt repayments coming in large amounts in June and July.

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

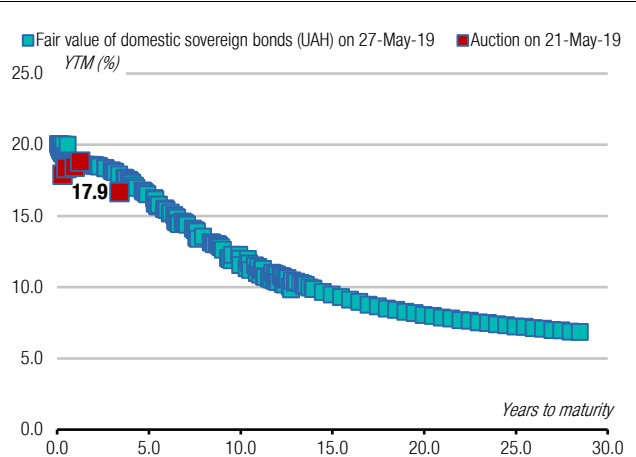
Chart 1. Local-currency bonds

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.

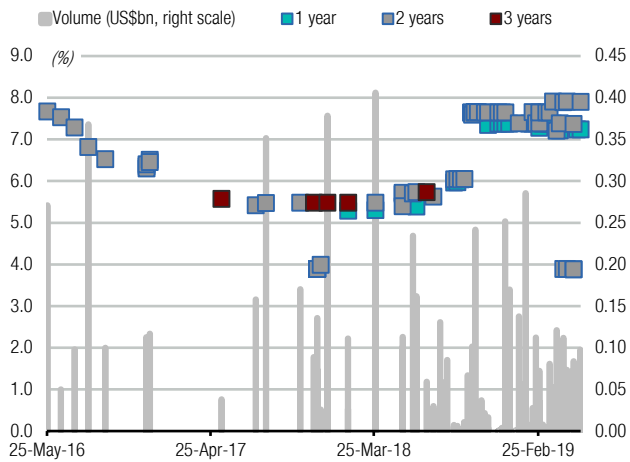
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

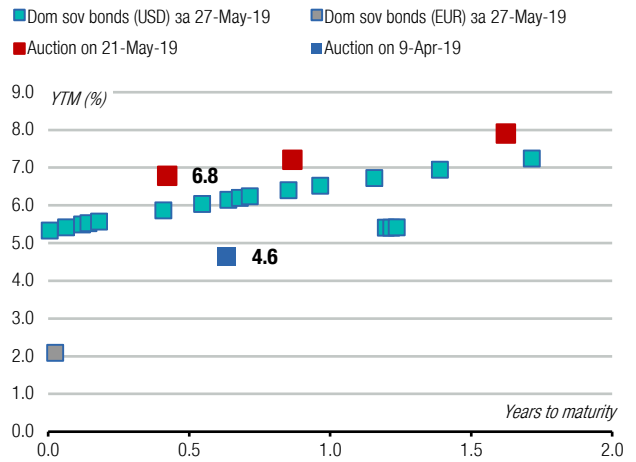
Chart 2. FX-denominated bonds

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.

Liquidity below UAH100bn

Banking-sector liquidity, as expected, remained below UAH100bn most of last week. It could be higher this week due to VAT refunds and new foreign investments in local-currency debt.

Last week, liquidity remained under the impact of budget operations and outflows to Treasury accounts. Outflows amounted to UAH1.2bn. Banks increased exchange of cash in reserves, providing liquidity with UAH2bn of inflow. Additionally, NBU purchased US\$70m of FX at the market, which provided UAH1.8bn of inflow. These inflows returned liquidity above UAH100bn.

ICU view: VAT refunds should amount to not less than UAH3bn, which will support an increase in liquidity. Additionally, the NBU can provide liquidity through the FX market, should there be an increase of foreign investment in local-currency debt, which could keep liquidity over UAH100bn.

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

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

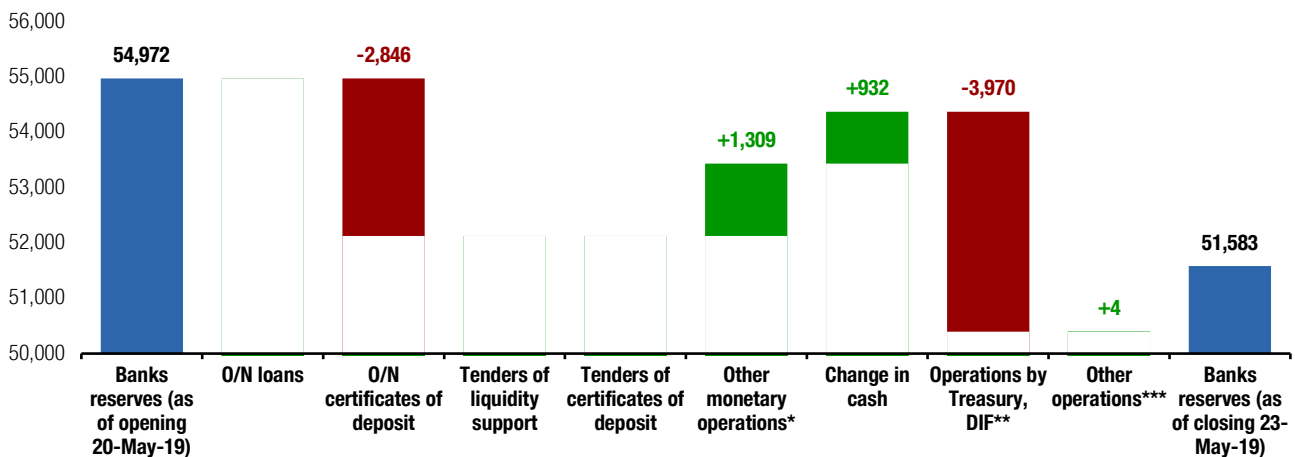
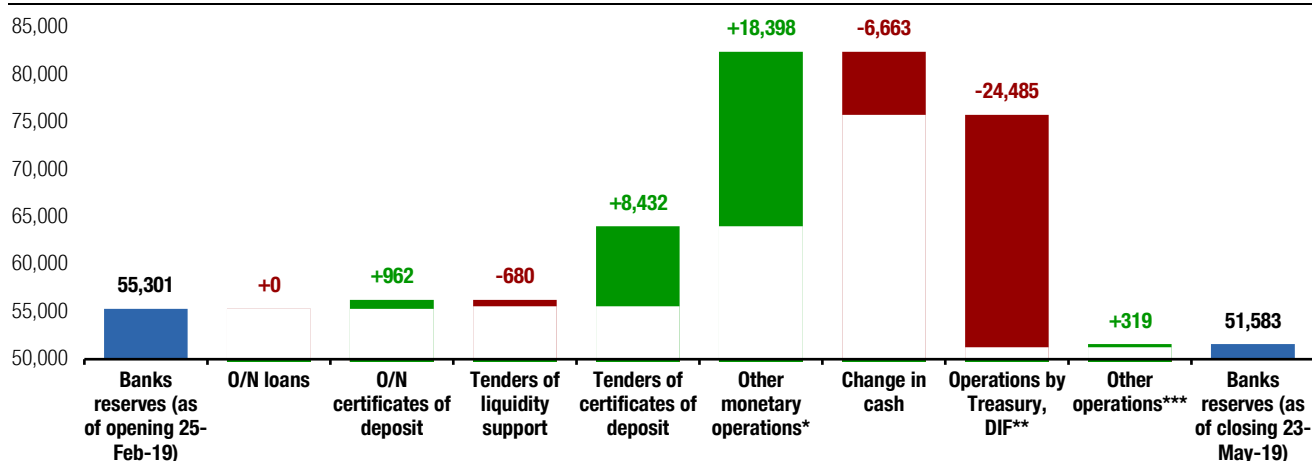


Chart 4. Banks reserves usages over last 90-day period (UAHm)


Notes: [1] data from the NBU's daily reporting https://bank.gov.ua/control/uk/publish/article?art_id=38643651&cat_id=40807142 ;

* 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

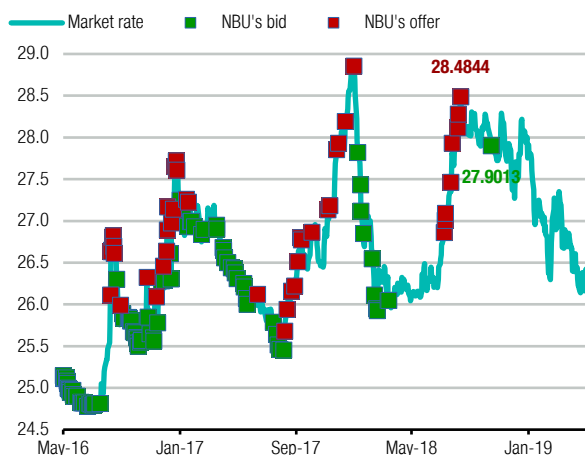
Hryvnia increases volatility

Last week, the hryvnia/US dollar exchange rate did not move significantly, slid 0.2%, although there was significant volatility, greater than the previous week. This week, the hryvnia should stay in the range of UAH26.3-26.6/US\$, also with significant volatility.

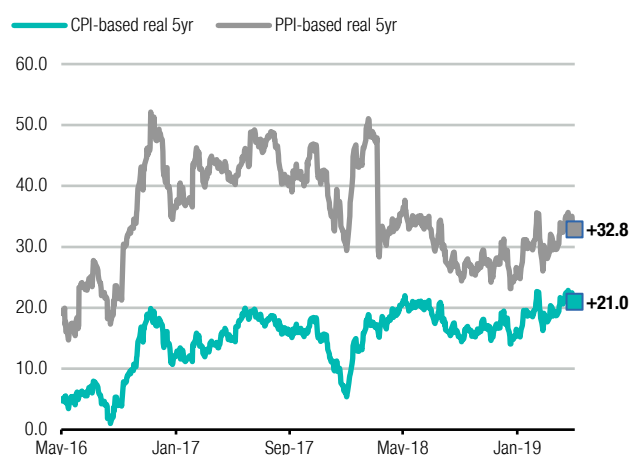
Appreciation at the beginning of last week was caused by the inflow of FX from locals for corporate tax payments and from foreign investors to buy additional local-currency bills. This forced the NBU to buy additional FX from the market, US\$50m on Monday, and US\$20m on Tuesday. The hryvnia appreciated to UAH26.12/\$ on Monday and slid to UAH26.16/\$ on Tuesday. By Wednesday, the hryvnia started to weaken. On Friday, it reached UAH26.5/\$, but by the end of trading session, it returned close to the level of the previous week of UAH26.425/\$.

ICU view: *This week, we expect a new wave of volatility. The link to Clearstream will increase investments in bonds, which will have a positive impact on the hryvnia. At the same time, VAT refunds will have a negative impact on the exchange rate. Nonetheless, we do not expect the hryvnia to move outside the range of UAH26.3-26.6/USD, but volatility could be UAH0.2–0.3 in both directions.*

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

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 9.1% YoY in April

Thanks to further growth of real incomes, household consumption will remain the key growth driver of Ukraine's economy in this and in coming years.

Retail-turnover growth accelerated to 9.1% YoY in April, the highest growth rate since January 2018 (+9.6% YoY), per data from the State Statistics Service of Ukraine. In 4M19, growth was 7.9% YoY. By region, the highest growth in retail trade was observed in the Vinnytsya region (+13.5% YoY), the Kyiv region (+10.9% YoY), and the Donetsk region (+10% YoY).

ICU view: Consumer demand keeps rising thanks to solid growth in real household income (in 1Q19, real wages 10.9% YoY, ICU estimate). Further growth of wages, a 9.6% YTD increase in average pension payment in nominal terms (to UAH2,899), as well as remittances and expected inflation slowdown will continue to support consumer demand, which will remain the key driver of economic growth this and next year.

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

Industrial production rises 5.2% YoY in April

Industrial output will receive further support from rising household consumption and an increase in the mining industry.

Industrial-production growth accelerated to 5.2% YoY in April, up from 2.1% YoY in March, bringing 4M19 growth to 0.9% YoY. In SA terms, industrial output grew 0.9% compared with March. The key growth driver was the processing industry (+7.4% YoY) thanks to robust growth in the chemical industry (+15% YoY), engineering (+11% YoY), and metallurgy (+10% YoY). The mining sector expanded 2.7% YoY, while the growth in the utilities sector was almost flat (+0.3% YoY).

ICU view: Consumer demand, which remains the main driver of Ukraine's economic growth (see the previous comment), as well as higher growth rates in the mining

industry thanks to expanding gas extraction and higher world prices for iron ore, will support industrial production this year. We maintain our forecast of 1.9% growth in full-year 2019.

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

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

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

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

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

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