Research team
Alexander Martynenko
Taras Kotovych
Dmytro Dyachenko

Weekly Insight

IMF is awaiting new government

Key messages of the today's comments

WEDNESDAY, 5 JUNE 2019

Domestic liquidity and bonds market

Total govt bonds outstanding rose to UAH777bn

During last week total outstanding of domestic government bonds rose to UAH777bn, just partially due to the hryvnia weakening. This week we do not expect significant movements.

Liquidity volatile at around UAH100bn

Total amount of banking sector liquidity slightly declined to UAH98.5bn, as the result of NBU and Treasury operations. This week liquidity will depend on FX market situation.

Foreign exchange market

Hryvnia weakened without foreign investors

During last week hryvnia weakened by 1.6%, as the result of lower FX supply from foreign investors and locals. But changes in market infrastructure should be positive for the hryvnia, and this week it will be slightly below UAH27/US$.

Economics

IMF continues to support Ukraine, awaiting new government

The IMF is ready to resume discussions with Ukraine's authorities after Rada elections and formation of the government. The IMF expects Ukraine to follow the current benchmarks, but assumes to discuss their conditionality with the new government, with an agreement on a new program likely to follow.

Russia sharply reduces the supply of motor fuel to Ukraine

The growing restrictions on the import of diesel fuel and LPG from Russia will force Ukrainian importers to switch to substitutes and will cause higher prices for these products.

C/A deficit inched up to 3.4% of GDP in April

This year the Ukraine's current account will receive support from lower world energy prices and slower consumer imports growth.

Banks' reserves market (4 June 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	17.50	+0bp	+50bp
ON rate (%)	16.19	-13bp	+29bp
ON $ swap (%)	N/A	...	...
Reserves (UAHm)[2]	45,858	-10.14	-5.52
DepCerts (UAHm)[3]	31,392	-37.35	-52.60

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) (4 June 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,088	+0.00	-3.78
Banks	362,893	+0.52	+2.38
Residents	26,011	+1.64	+5.41
Individuals	9,538	+2.76	+221.76
Non-res[4]	42,250	+2.00	+291.42
Total	**777,780**	**+0.44**	**+4.65**

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

FX market indicators (4 June 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.1500	+1.55	+3.98
EUR/USD	1.1252	+1.09	-3.82
DXY[2]	97.072	-1.09	+3.23
UAH TWI[3]	120.497	-2.25	+1.14

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

Gov't bond quotes[1] (5 June 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

Total govt bonds outstanding rose to UAH777bn

During last week total outstanding of domestic government bonds rose to UAH777bn, just partially due to the hryvnia weakening. This week we do not expect significant movements.

Bonds outstanding rose during all five months of this year, and according to the NBU exceeded UAH777bn as of the end of May 2019. This rise was due to increase of investments in domestic local-currency bills, which met significant demand from foreign investors, while hryvnia appreciation reduced outstanding FX-denominated bills.

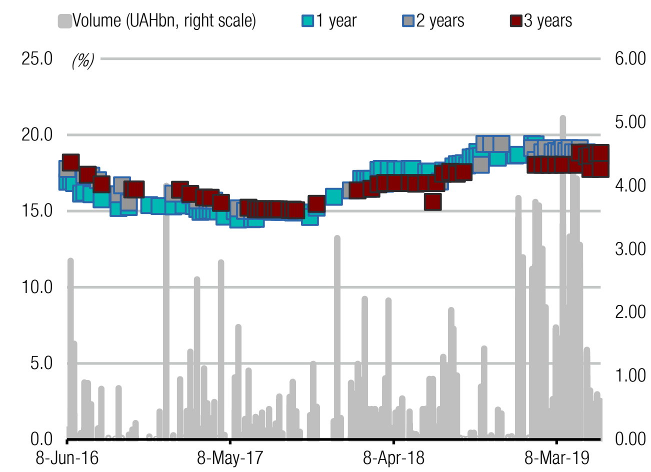
In total, this year's increase amounted to UAH21.6bn, including the following movements: decline of NBU portfolio and banks' portfolio by UAH11bn each, while other investors' portfolios rose. Non-banks added UAH5bn of bills, individual's portfolio rose by UAH3.5bn, but the most important was increase in investments from foreign investors, who purchased UAH36bn of additional bills. All the groups (excluding NBU) increased their holdings of local-currency bills.

ICU view: This week we do not expect significant movements. Most market players do not expect that the NBU will cut its key policy rate once again. Although a link to Clearstream was launched in Ukraine last week, only small deals were done so far. The bonds outstanding may be also impacted by a slight hryvnia depreciation that took place last week.

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

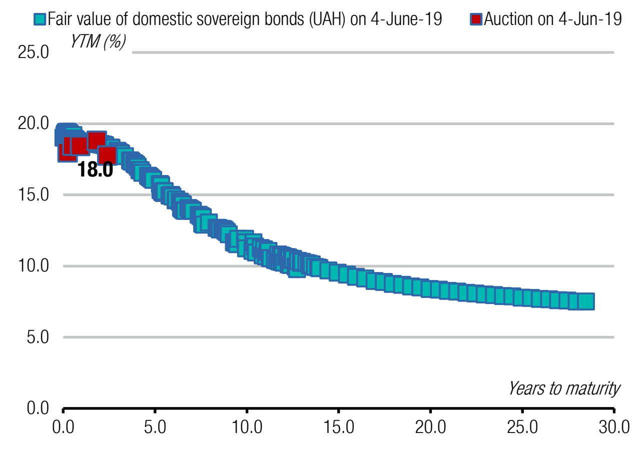
Chart 1. Local-currency bonds

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.

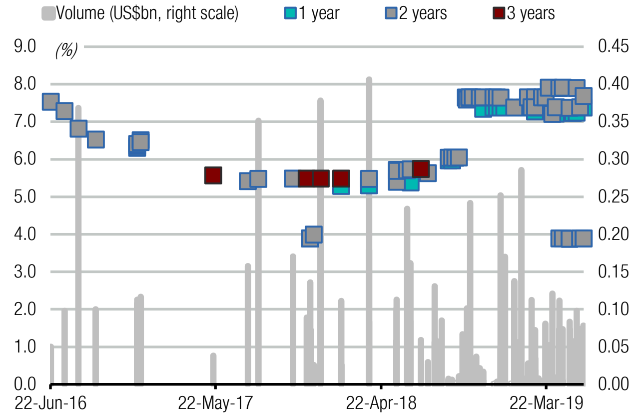
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

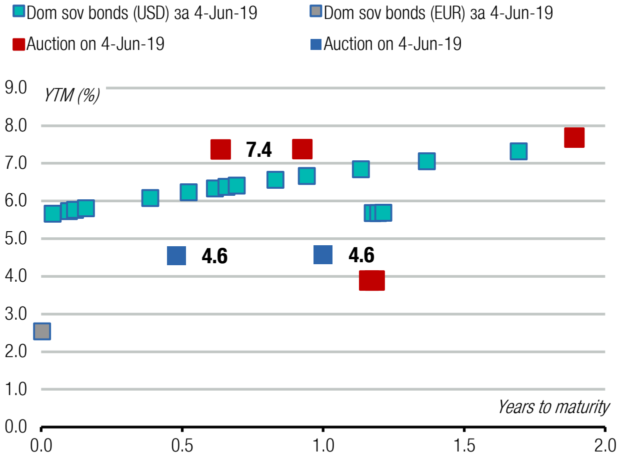
Chart 2. FX-denominated bonds

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 volatile at around UAH100bn

Total amount of banking sector liquidity slightly declined to UAH98.5bn, as the result of NBU and Treasury operations. This week liquidity will depend on FX market situation.

Despite VAT refund, Treasury operations had mostly negative impact on liquidity, absorbing UAH5.6bn. Additionally, the NBU had to sell FX and therefore increased negative impact on liquidity. During last week NBU absorbed UAH3.9bn, including UAH0.9bn via FX market and UAH3bn via loan redemptions from banks.

As the result, liquidity was supported only by banks via cash exchange in reserves, which is usual for the end of month, and therefore compensated UAH5bn of outflows.

ICU view: With more foreign investments coming to bills and more FX purchases by the NBU, liquidity may rise this week. Nevertheless, we expect that liquidity will continue to be slightly volatile at around UAH100bn this week.

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

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

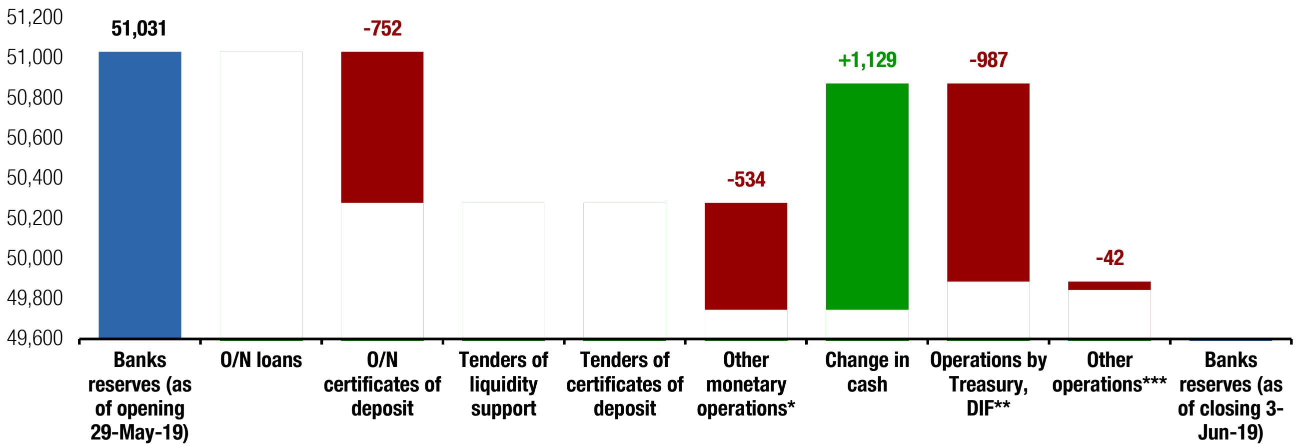
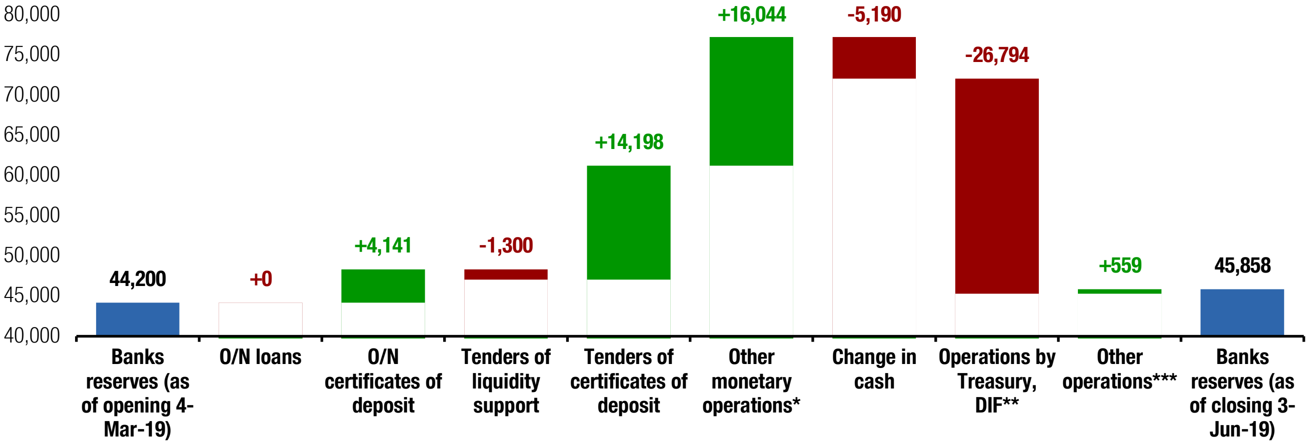


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 weakened without foreign investors

During last week hryvnia weakened by 1.6%, as the result of lower FX supply from foreign investors and locals. But changes in market infrastructure should be positive for the hryvnia, and this week it will be slightly below UAH27/US$.

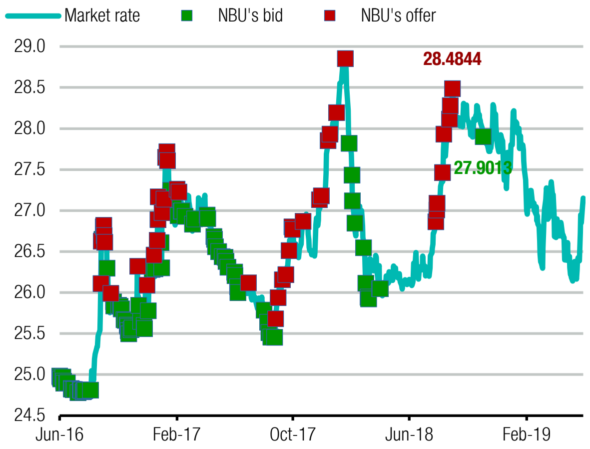
Increase in VAT refund to UAH6.1bn during last week increased negative impact on FX market due lower supply of FX from foreign investors, who significantly decreased investments in local-currency debt. Last Thursday hryvnia weakened very close to cross the UAH27/US$ level, however appreciated slightly to UAH26.85/US$ on Friday.

ICU view: This week we anticipate a new wave of volatility, as foreign investors can become more active at the bonds market using the Clearstream link, step up from test deals to real investments in new bills. This should increase supply of FX at the market, and the hryvnia will be slightly below UAH27/US$.

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

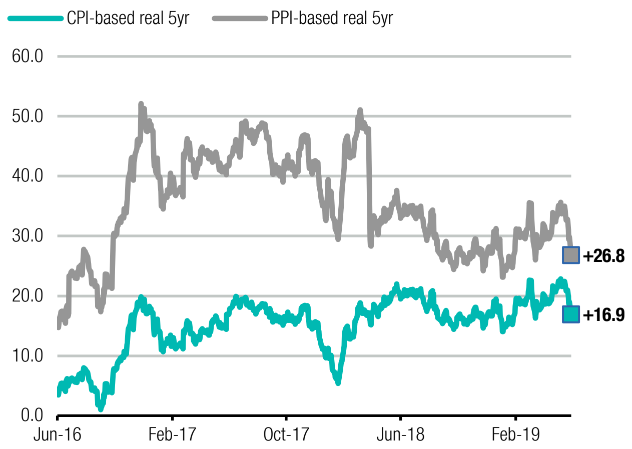
Chart 5. FX market indicators, 3-year history

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 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

IMF continues to support Ukraine, awaiting new government

The IMF is ready to resume discussions with Ukraine's authorities after Rada elections and formation of the government. The IMF expects Ukraine to follow the current benchmarks, but assumes to discuss their conditionality with the new government, with an agreement on a new program likely to follow.

Last Wednesday, the Ministry of Finance of Ukraine, together with a representative of the IMF mission in Ukraine, Ron Van Rooden, organized a conference call with investors on the results of discussions between representatives of the Fund and the Ukrainian authorities, as well as further plans of the Ministry. The IMF is satisfied with the current fiscal and monetary policy of Ukraine and assured of further support of Ukraine. The IMF is ready to continue the discussion on the program of financial assistance to Ukraine after the parliamentary elections and the formation of a new government. The IMF expects that the Ukrainian authorities will continue to comply with the Fund's recommendations agreed under the current SBA program, including the resumption of criminal liability for illegal enrichment and compliance of gas tariffs for the population in accordance with market prices and the import parity. At the same time, the IMF is ready to return to discussing conditionality of these recommendations with the new government.

The IMF praised the statement of the President's representatives that Ukraine's default is not an option and there is no reason for Ukraine to default. Also, the IMF is watching the ongoing judicial case on Privatbank with concern and reiterates that Privatbank had been deeply insolvent at the moment of its nationalization and the $5.5bn gap in its balance sheet was liquidated at the cost of Ukrainian people. The IMF is particularly concerned about NBU independence and regulatory abilities currently being challenged by Ukrainian courts

In turn, the Finance Minister Oksana Markarova said that her Ministry would do everything possible to comply with the IMF's recommendations, as well as quickly ensure the continuity of this process with the advent of a new government. The Ministry expects Ukraine to be able to receive the IMF tranche later this year. At the same time, the Finance Minister believes that the current monetary balance of the government, further revenues, as well as the NBU's foreign exchange reserves are sufficient for Ukraine's ability to service external debt, even in the event of possible delays in macro-financial assistance this year.

ICU view: Joint conference call of the Ministry of Finance of Ukraine and the IMF with investors sent a significant positive signal to the financial markets. Despite the fact that Ukraine can receive the next tranche not earlier than late autumn, and most likely in a new, longer-term program, investors have received assurances from both sides of their desire to continue cooperation. The existing short, 14-month program was due to end in late 2019. The decision on early parliamentary elections changed the situation, and the most logical option for the IMF is to choose to continue cooperation with the new parliament and government. In order to reduce the uncertainty that arose as a result of such decisions, the IMF has made a rather strong verbal intervention, which supported pricing of Ukrainian Eurobonds.

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

Russia sharply reduces the supply of motor fuel to Ukraine

The growing restrictions on the import of diesel fuel and LPG from Russia will force Ukrainian importers to switch to substitutes and will cause higher prices for these products.

From 1 June, Russian sanctions on oil and petroleum products delivery to Ukraine came into force. From now on, volumes of Russian diesel fuel and LPG deliveries to Ukraine are subject to approval with the Ministry of Economic Development and Trade of the Russian Federation on a monthly basis. Earlier, the Federal Service for Customs and Export Control approved export volume limits for the year.

Enkorr.com.ua reports that in June 2019, the Ministry of Economic Development of the Russian Federation issued permits for the supply of Russian diesel fuel and LPG to Ukraine, having reduced the relevant volumes by 30-50% from the previous monthly levels.

According to *Consulting Group A-95*, in 2018, the diesel and LPG markets of Ukraine depended on imports from Russia at 40%. Market participants suspect that Russia will try to generate high volatility of prices by changing monthly volume limits. Currently, in the last week of May, according to *UPECO*, retail prices for LPG increased by 0.5%, while wholesale already surged by 30%. Also, since the end of 2018, unstable supplies of diesel fuel from Belarus and the Russian Federation have raised its prices up to the level of gasoline prices.

ICU view: Russia's introduction of new regime of monthly approval of motor oil supply to Ukraine could lead to higher prices for diesel and LPG, as well as to higher price volatility. Russian fuel can be substituted with supplies from Belarus, Poland and Lithuania via the western border, as well as imports from other countries through the Black Sea ports. However, this will mean an increase in prices for diesel fuel by 2-4% and LPG by 10-20%. The increase in fuel prices remains one of the factors that will hinder the slowing of inflation.

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

C/A deficit inched up to 3.4% of GDP in April

This year the Ukraine's current account will receive support from lower world energy prices and slower consumer imports growth.

In 4M19, the C/A deficit amounted to US$388m (+10% YoY), while in annualized terms, it surged 1.8 times to US$4.5bn (est. 3.4% of GDP), per data from the NBU. In April, merchandise exports growth rates slowed to 2.3% YoY, mainly due to a 14% YoY decline in metallurgical exports. In 4M19, exports of goods rose 6.6% YoY to US$15bn. Imports of goods surged 14.4% YoY driven by a 30% YoY increase in energy imports as Ukraine started buying gas in preparing for a heating season, and a 17% YoY growth in imports of chemical products. In 4M19, imports of goods rose 8.9% YoY to US$18.1bn. On a 12-month trailing basis the merchandise-trade-balance deficit was US$13.2bn (+29 YoY) in April, while the services-trade-balance surplus rose 42% YoY to US$1.5bn.

ICU view: Thanks to lower volumes of energy imports supported by decreased world energy prices (primarily natural gas), a 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 3.4% of GDP in 2018 (US$4.5bn).

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

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

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

Ruslan Kilmukhametov, Director
ruslan.kilmukhametov@icu.ua

Ivan Shvydanenko, Director
ivan.shvydanenko@icu.ua

Yuriy Kamarytskyi, Vice President
yuriy.kamarytskyi@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

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

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

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

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

Bogdan Vorotilin
bogdan.vorotilin@icu.ua

RESEARCH

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

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

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

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