



Focus
Ukraine

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

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Weekly Insight

Hryvnia set new appreciation records

Key messages of the today's comments

Domestic liquidity and bonds market

Foreign investors' activity remains high

During recent weeks, foreign investors increased their holdings in government bills to 8% of outstandings, and increased the value of their portfolios to UAH61.6bn (\$2.4bn). Despite the hryvnia's appreciation we, expect foreigner's bond portfolios to increase.

Liquidity will stay near UAH100bn

Despite the NBU's large purchases of FX, liquidity was mostly below UAH100bn, due to outflows to budget accounts and reserves exchange in cash. This week, liquidity will be slightly volatile at around UAH100bn.

Foreign exchange market

Hryvnia set new appreciation records

Last week, the hryvnia appreciated to UAH25.68/US\$, a new record for 2019 and 2018. This week, we should continue to see appreciation due to FX inflows from foreign investors in local-currency debt, and a low level of NBU participation in the market.

Economics

NBU revises C/A balance upward

Following the revision, the annualized C/A deficit in April was improved to 2.8% of GDP vs. the previous estimate of 3.4%. In May, it declined further to 2.6% of GDP.

TUESDAY, 9 JULY 2019

Banks' reserves market (8 July 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	17.50	+0bp	+50bp
ON rate (%)	16.73	+68bp	+123bp
ON \$ swap (%)	13.60	-50bp	-169bp
Reserves (UAHm) ²	39,015	-10.61	-19.17
DepCerts (UAHm) ³	64,171	+19.75	+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) (8 July 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,088	+0.00	-3.78
Banks	342,052	-1.48	-4.42
Residents	23,285	+1.98	+5.23
Individuals	8,945	-0.76	+181.14
Non-res ⁴	61,562	+7.60	+512.73
Total	772,932	-0.05	+3.95

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (8 July 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	25.5875	-2.25	-2.78
EUR/USD	1.1214	-0.63	-4.53
DX ²	97.384	+0.68	+3.64
UAH TWI ³	127.132	+2.86	+6.72

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (9 July 2019)

Maturity	Bid	Ask
6m	19.00	18.25
12m	19.50	18.25
2y	19.25	18.00
3y	19.00	17.00
12m (\$)	7.50	6.00
2y (\$)	7.90	6.50

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

Source: ICU.

Domestic liquidity and bonds market

Foreign investors' activity remains high

During recent weeks, foreign investors increased their holdings in government bills to 8% of outstandings, and increased the value of their portfolios to UAH61.6bn (\$2.4bn). Despite the hryvnia's appreciation we, expect foreigner's bond portfolios to increase.

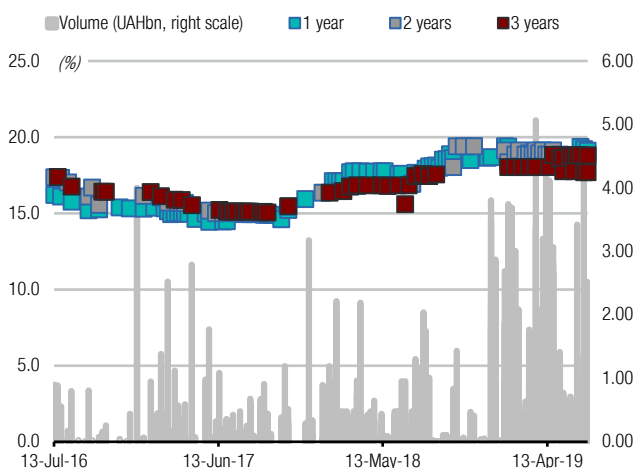
At the end of June, foreigners purchased UAH5bn of new bills. Last week, they bought an additional UAH4.3bn (US\$167m), increasing their share in the market to 8%, and their portfolios to UAH61.6bn (\$2.4bn). For the most part, they purchased local-currency debt, which comprises 97% of their portfolios. Their preference is for long maturities offered by the MoF. In June, they preferred six-year notes; last week, they purchased two and three-year bills, the longest maturities offered in the auction.

ICU view: *Despite the risk of hryvnia devaluation, high interest rates of UAH-denominated paper offer higher income than less-risky assets, making local-currency debt attractive. We don't think foreigner's portfolios are maxed out, and we expect continued investment, but likely lower activity. However, we still expect weekly increases of about UAH1–2bn.*

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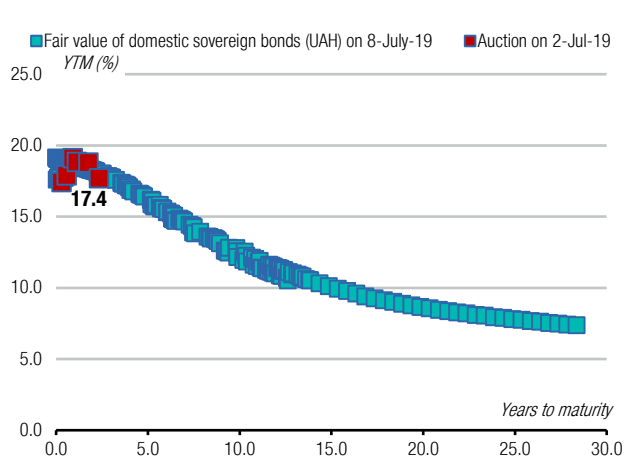
Chart 1. Local-currency bonds

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.

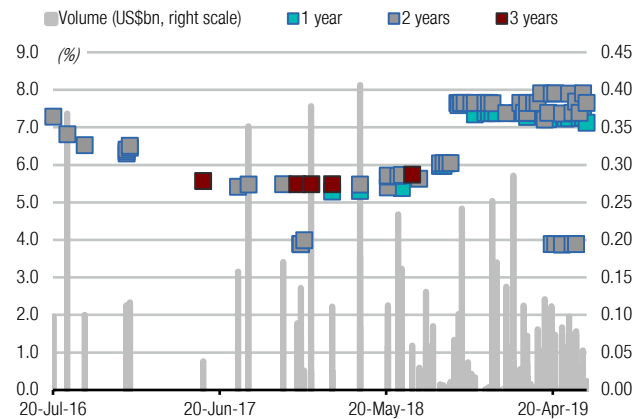
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

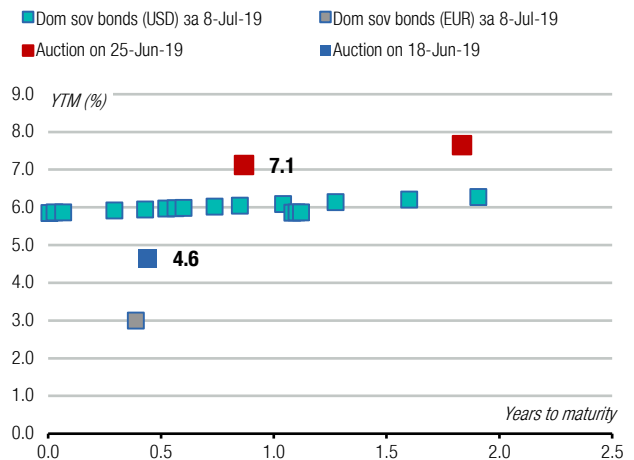
Chart 2. FX-denominated bonds

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 will stay near UAH100bn

Despite the NBU's large purchases of FX, liquidity was mostly below UAH100bn, due to outflows to budget accounts and reserves exchange in cash. This week, liquidity will be slightly volatile at around UAH100bn.

On the last business day in June, banks repaid UAH4bn of loans, and decreased liquidity below UAH100bn where it remained until Friday. Only purchases of large amounts of FX last Friday and an additional UAH4.7bn of loans issued to three banks on the same day allowed liquidity to recover above UAH100bn, as the Treasury increased absorption of funds.

Total outflows to budget accounts last week amounted to UAH6bn and reserves exchange in cash was UAH0.4bn. These outflows were covered by UAH8.3bn of inflows from NBU via the FX market and UAH4.7bn via loans to banks. So, after declining at the beginning of last week to UAH96.7bn, by the end of the week, liquidity recovered to UAH103.2bn.

ICU view: *The low balance in Treasury accounts seen of UAH13bn at the beginning of July forced the government to collect more funds and make fewer expenditures. So, we expect that outflows from Treasury accounts will continue, and, as is usual for the first half of the month, reserves will be exchanged in cash. As a result, usual FX purchases by the NBU will be not enough to compensate these outflows, and liquidity will be volatile around UAH100bn.*

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

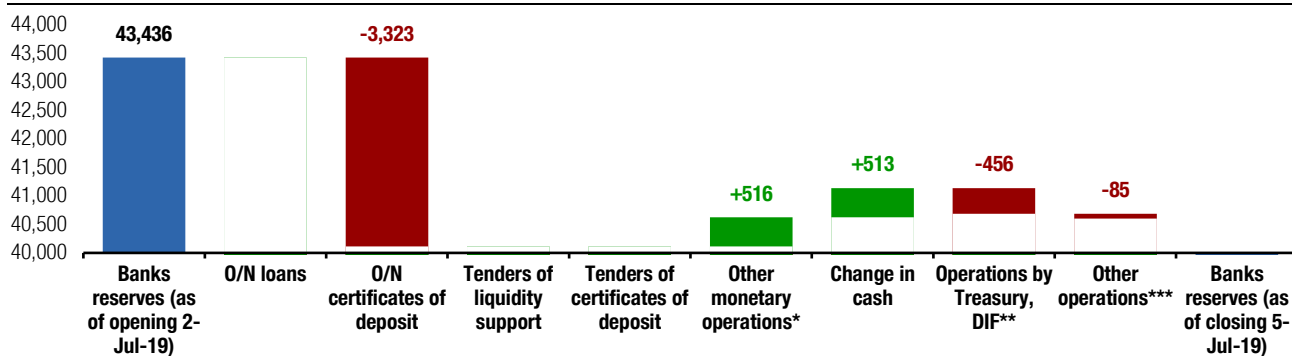
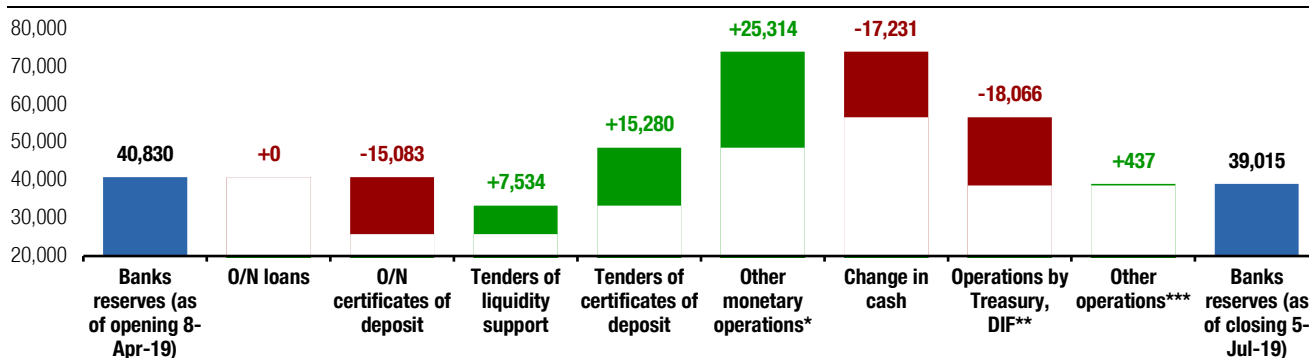


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Hryvnia set new appreciation records

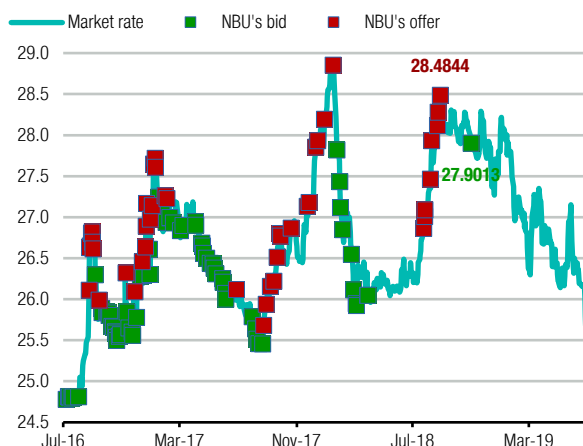
Last week, the hryvnia appreciated to UAH25.68/US\$, a new record for 2019 and 2018. This week, we should continue to see appreciation due to FX inflows from foreign investors in local-currency debt, and a low level of NBU participation in the market.

A number of factors last week allowed the hryvnia to appreciate to a level not seen since the summer of 2017. The additional holiday at the end of June moved some deals to Monday when foreigners started to sell FX to participate in primary auctions on Tuesday. But after auction settlement, on Thursday there was a holiday in US, which had an impact on the FX market, and moved some deals to last Friday.

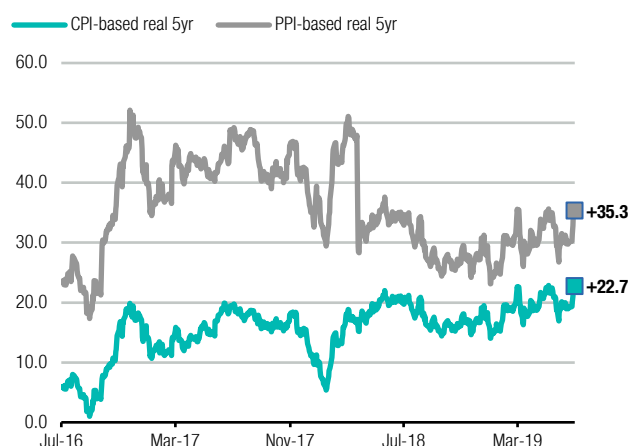
At the same time, during most of last week, the NBU purchased small amounts of FX, which allowed the hryvnia to strengthen. In total last week, the NBU purchased US\$321m, including US\$230m last Friday.

ICU view: Last week, the hryvnia appreciated by 1.8% to 25.68/US\$. It's possible we'll see a new record this week. This appreciation will be the result of: high activity of foreign investors, as MoF is going to offer three-year and six-year notes, and low activity of the NBU in FX market with FX purchases.

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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

NBU revises C/A balance upward

Following the revision, the annualized C/A deficit in April was improved to 2.8% of GDP vs. the previous estimate of 3.4%. In May, it declined further to 2.6% of GDP.

Thanks to the NBU's revision of the components of the balance of payments, the C/A deficit for full-year 2018 declined by US\$0.2bn to US\$4.3bn (3.3% of GDP), primarily because of a higher estimate of remittances (+2% to US\$11.1bn). In 4M19, the C/A recorded a surplus of US\$8m vs. a previously estimated deficit of US\$0.4bn. The improvement was thanks to the better estimate of services trade balance (+US\$0.3bn) and primary incomes (+US\$0.2bn).

In May, merchandise-exports growth rates accelerated to 14% YoY from 2% YoY seen in April, mainly thanks to a surge in exports of food products (+34% YoY) and mineral products (+41%). In 5M19, exports of goods rose 8% YoY to US\$19.2bn. Imports of goods rose 8% YoY in May, driven by a 17% YoY increase in imports of machinery and equipment. In 5M19, imports of goods rose 8.9% YoY to US\$23.1bn. On a 12-month trailing basis, the merchandise-trade-balance deficit was US\$13.1bn (+25% YoY), while the services-trade-balance surplus rose 49% YoY to US\$1.7bn.

ICU view: Given revised C/A balance data, low world natural gas prices (which will be partially offset by higher volumes), and better dynamics of primary and secondary incomes, we improve our forecasts of C/A deficit in FY2019 to 2.9% of GDP from 3.3% earlier. The risks for our forecast are higher volumes of dividend repatriation and a significant increase in prices on energy products in 2H19.

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