

# Weekly Insight

## MoF will not offer 5-year notes again this year

### Key messages of the today's comments

TUESDAY, 8 OCTOBER 2019

### Domestic liquidity and bonds market

#### MoF will not offer five-year notes again this year

At the end of September, the MoF sold more than UAH12bn of five-year notes. Since, it has revised the auction schedule for 4Q19 to include only bills with maturities of up to three years. So, demand and borrowings fell, and will be low for the following weeks.

#### Liquidity above UAH100bn

After reaching UAH112bn last month, banking-sector liquidity slightly declined the first week in October, but remained above UAH100bn. We do not expect significant volatility in liquidity, and it will stay at around current levels.

### Foreign exchange market

#### Hryvnia showing signs of weakening

The hryvnia had a large wave of appreciation in September due to foreign investor inflows into T-bills. But due to a change in balance in favor of demand, last week, the hryvnia started to weaken, moving closer to UAH25/US\$, where it will stay this week, too.

### Economics

#### C/A widens to 2.9% of GDP in August

This year, Ukraine's current account is supported by lower world energy prices and another expected record harvest.

### Banks' reserves market (7 October 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	16.50	+0bp	-150bp
ON rate (%)	14.97	+8bp	-306bp
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	44,821	-10.31	-10.72
DepCerts (UAHm) <sup>3</sup>	59,289	-0.93	+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) (7 October 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,061	+0.00	-3.17
Banks	350,244	+0.58	-4.74
Residents	26,485	+1.40	+26.11
Individuals	10,371	+2.88	+123.73
Non-res <sup>4</sup>	96,928	-0.55	+1,238.64
<b>Total</b>	<b>821,090</b>	<b>+0.26</b>	<b>+9.68</b>

Notes: [1] non-residents

Source: NBU, ICU.

### FX market indicators (7 October 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.8900	+1.55	-11.43
EUR/USD	1.0971	+0.35	-4.80
DX <sup>2</sup>	98.967	-0.16	+3.50
UAH TWI <sup>3</sup>	133.652	-1.82	+14.74

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

### Gov't bond quotes<sup>1</sup> (8 October 2019)

Maturity	Bid	Ask
6m	17.50	16.00
12m	17.50	16.00
2y	17.50	16.00
3y	17.50	16.00
12m (\$)	5.50	4.50
2y (\$)	5.50	4.50

Notes: [1] Actual quotes you can see at [www.icu.ua](http://www.icu.ua).

Source: ICU.

# Domestic liquidity and bonds market

## MoF will not offer five-year notes again this year

At the end of September, the MoF sold more than UAH12bn of five-year notes. Since, it has revised the auction schedule for 4Q19 to include only bills with maturities of up to three years. So, demand and borrowings fell, and will be low for the following weeks.

The last primary auction in September provided the budget with UAH13.2bn of proceeds, including UAH12.9bn from five-year notes (see [comment](#) about this auction). After this auction, the total outstanding of this maturity rose to slightly below UAH34bn (US\$1.4bn), which made it eligible to be included in the GBI-EM index. But after reaching the required amount of approximately US\$1bn, the Ministry has now excluded this maturity from the schedule, and the longest maturity offered will now be the three-year note.

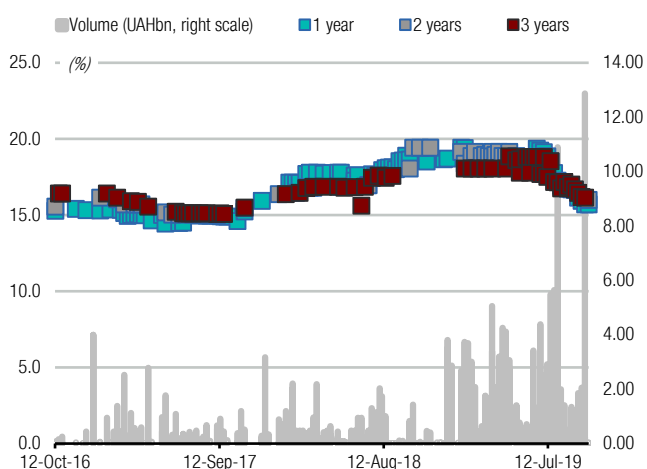
The lack of five-year or longer maturities in the MoF's offerings will have a negative impact on demand from foreign investors, and significantly cut the amount of budget proceeds collected. September's last auction demonstrated rapid falling in demand to the lowest amount this year (see auction [comment](#)). Also, foreign investors' portfolios showed slight decline, as local-currency bonds outstanding in these portfolios slid UAH0.9bn last week.

**ICU view: Taking into account the plans described by Y. Butsa, Government Commissioner for Public Debt Management, at the Ukrainian Financial Forum (see UFF-19 [overview](#)), until the end of this year, the MoF will borrow about UAH50bn (US\$2bn). With this limit, the Ministry does not have to hurry to borrow, and will not try to borrow large amounts every week. Hryvnia weakening will not support demand for UAH-denominated bills. So, we do not expect a new wave of activity from foreigners. Instead, likely there will be a slight decline in foreign investors' portfolios after redemption of short-term bills.**

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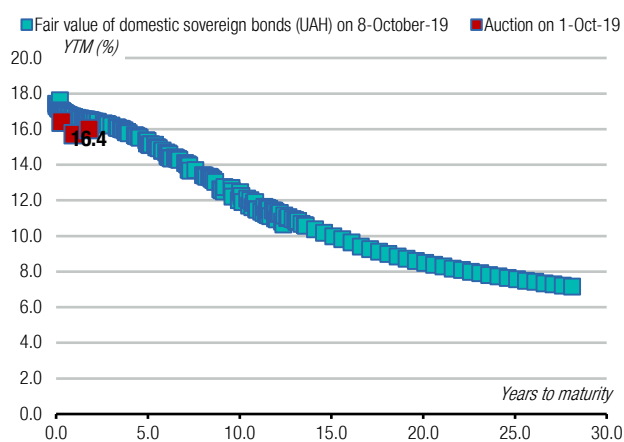
**Chart 1. Local-currency bonds**

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.

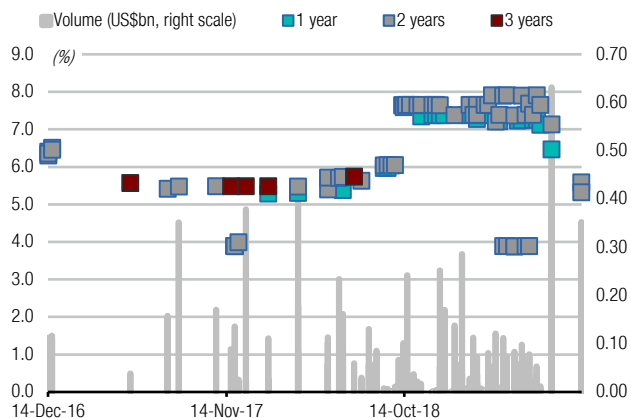
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

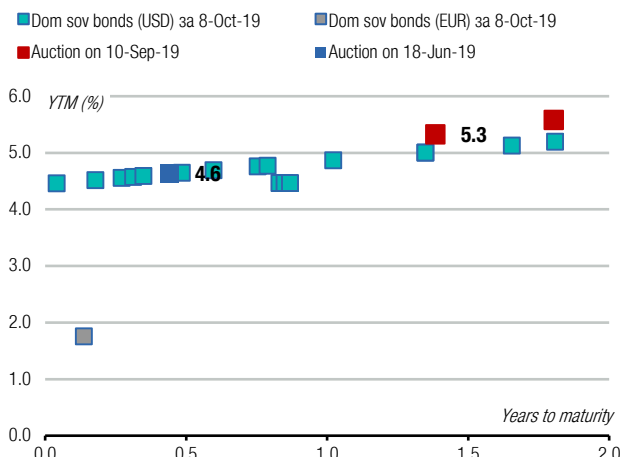
**Chart 2. FX-denominated bonds**

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 above UAH100bn**

After reaching UAH112bn last month, banking-sector liquidity slightly declined the first week in October, but remained above UAH100bn. We do not expect significant volatility in liquidity, and it will stay at around current levels.

At the end of September, the NBU continued to purchase hard currency from the market and provided banks with additional liquidity. During the last week of September, the NBU provided banks with UAH7.8bn of additional liquidity through the FX market. But, as most of these funds were spent for the purchase of local-currency bills, they were absorbed by the Treasury.

For October, we expect to see liquidity outflows. NBU had to sell hard currency last week, absorbing nearly UAH5bn. Banks increased the amount of cash by reserves exchange, decreasing liquidity by UAH1.1bn.

Thanks to large borrowings in September, the balance of Treasury accounts in local currency remained steady, and slid a mere UAH0.2bn. But in October, despite high balances, the Treasury continued accumulating funds, and absorbed an additional UAH2.5bn. Later this month, we expect expenditures to increase, but some funds will be reserved for debt repayments to the NBU in November.

**ICU view: Reserves exchange in cash usually happens at the beginning of the month, which will have a negative impact on liquidity. Also, the NBU's operations with hard currency may also have a negative impact, as demand from foreign investors for T-bills will decline (see comment above). Together with restrained budget expenditures, liquidity will stay above UAH100bn, but not rise much higher.**

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

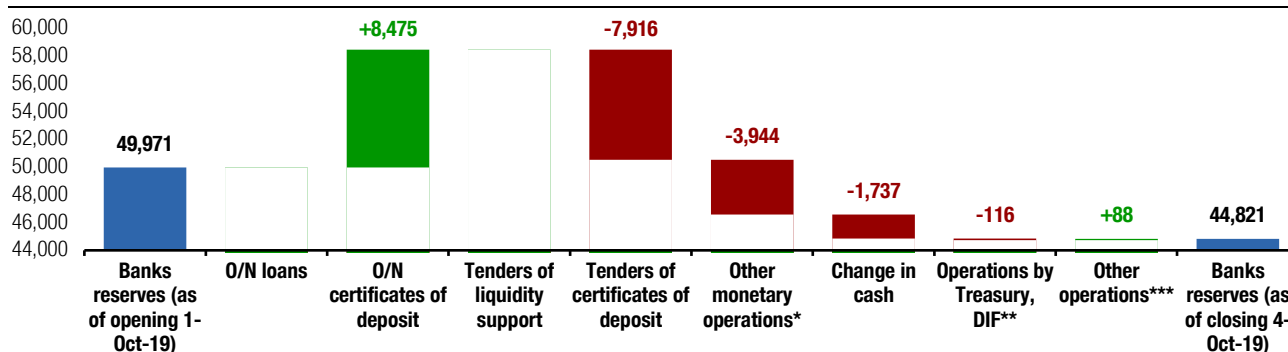
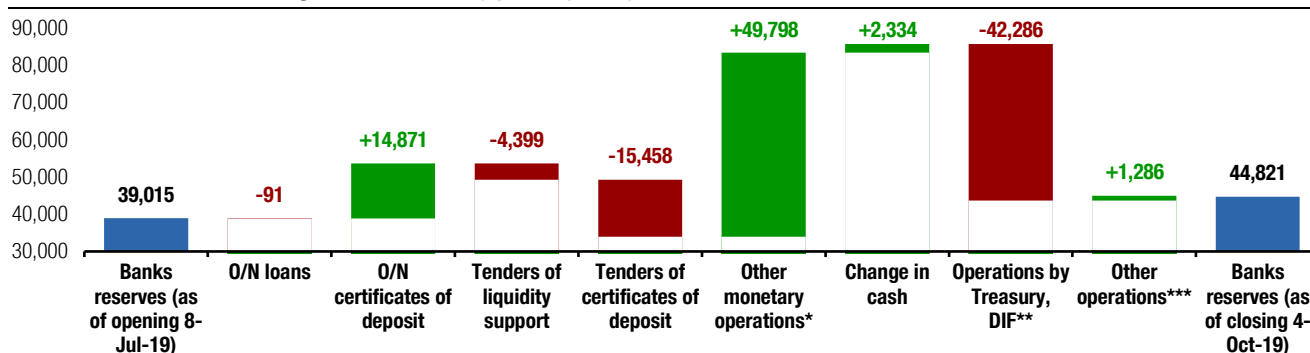


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting [https://bank.gov.ua/control/uk/publish/article?art\\_id=38643651&cat\\_id=40807142](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 showing signs of weakening

The hryvnia had a large wave of appreciation in September due to foreign investor inflows into T-bills. But due to a change in balance in favor of demand, last week, the hryvnia started to weaken, moving closer to UAH25/US\$, where it will stay this week, too.

On 27 September, the hryvnia closed at UAH24.10/US\$, which is 1.25% appreciation for the week and 14.9% since the beginning of the year. The most important participants in this market were foreign investors, who purchased government bonds and sold hard currency. The NBU purchased US\$348.2m during the last week of September, similar to the amount foreigners invested in government bonds at that time.

But last week, the hryvnia lost 2.05% to UAH24.595/US\$ with high probability of weakening to UAH25/US\$ due to prevailing demand for hard currency over supply. The NBU had to sell US\$200m last Wednesday to satisfy extra demand, while foreigners sold just US\$20m of local-currency bills that day. However, last Friday, the NBU purchased US\$42.5m of hard currency.

According to the schedule of primary auctions, investment activity will not rise. Foreign investors may continue to decrease their holdings by selling short maturities, which would add to demand in the FX market. Bond redemptions will have a negative impact also. As the

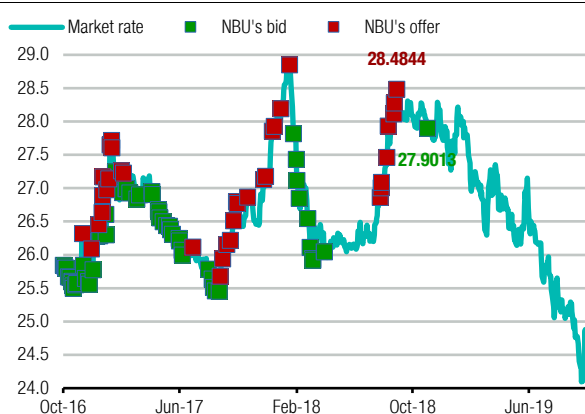
result, we expect that hryvnia weakening will continue and bring the exchange rate closer to UAH25/US\$.

**ICU view: This week, the hard currency market will be dominated by demand, which will put pressure the hryvnia, which should weaken closer to UAH25/US\$. Foreigners have currently frozen new investments and their portfolios of UAH-denominated bills declined slightly, but without a key role for demand for hard currency.**

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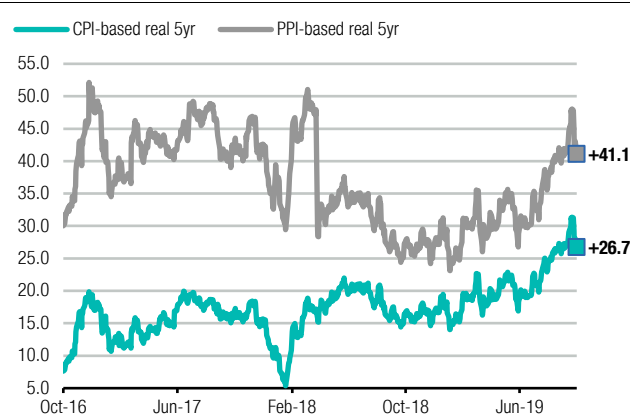
**Chart 5. FX market indicators, 3-year history**

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<sup>1</sup> from fundamental level<sup>2</sup> (%)



Notes: [1] "+" overvalued, "-" undervalued; [2] based on the UAH's CPI- and PPI-based real TWIs. Source: ICU.

## Economics

### C/A widens to 2.9% of GDP in August

This year, Ukraine's current account is supported by lower world energy prices and another expected record harvest.

The NBU revised the balance of payments data for 2018-2019. According to the revised data, the C/A deficit amounted to US\$1.3bn in 7M19 (vs. previous estimate of US\$0.9bn), and expanded to US\$1.8bn in 8M19 (-12% YoY). The deficit rose due to higher estimate of imports of goods (+US\$0.2bn) and lower remittances (-US\$0.2bn) in 7M19. In annualized terms, the C/A deficit widened to 2.8% of GDP (vs. previous estimate of 2.5% of GDP), and in August, it rose further to 2.9% of GDP (US\$4.1bn).

In August, merchandise exports rose 5.6% YoY, driven by agricultural exports (+20% YoY) and mineral products (+38% YoY). In 8M19, exports of goods rose 7.6% YoY to US\$30.4bn. Imports of goods rose 8.2% YoY thanks to a 25% YoY increase in machinery and equipment, while energy imports remained flat YoY. In 8M19, imports of goods rose 9.3% YoY to US\$38.7bn. On a 12-month trailing basis, the merchandise-trade-balance deficit was US\$13.8bn (+22% YoY, 9.6% of GDP) in August, while the services-trade-balance surplus soared 51% YoY to US\$1.8bn.

**ICU view: Lower world energy prices, another expected record harvest, and lower volumes of dividend repatriation will continue to support the C/A balance of Ukraine. We put our forecast of the 2019 C/A balance on review; it will be improved vs. the previously expected deficit of 3.3% of GDP.**

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