



Focus
Ukraine

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

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Weekly Insight

PrivatBank wins in English Court of Appeal

Key messages of the today's comments

WEDNESDAY, 16 OCTOBER 2019

Domestic liquidity and bonds market

Foreigners continue to purchase UAH-denominated bills

Despite the MoF not offering five-year notes, foreign investors' portfolios continue to increase. Last week, their portfolios rose by UAH1.7bn (about US\$68m), mostly due to purchasing bills at the primary auction. This week, activity declined due to shorter maturities being offered at the primary market.

Liquidity volatile at around UAH100bn

After declining below UAH100bn at the beginning of last week, liquidity rose to UAH112bn, and should stay above UAH100bn with a possible temporary decline below this level.

Foreign exchange market

Hryvnia exchange rate volatility increases

In October, volatility of the hryvnia exchange rate rose significantly, with a weakening during the first week of the month, and appreciation last week. This week, we expect a new wave of weakening, probably to about UAH25/US\$.

Economics

Inflation slowed to 7.5% YoY in September

Lower world energy prices and a stronger UAH thanks to tight monetary policy will continue to constrain consumer-prices growth this year.

PrivatBank wins in English Court of Appeal

The Court of Appeal confirmed that the English court has jurisdiction over PrivatBank's litigation against its former shareholders. The worldwide freezing order has been reinstated.

Banks' reserves market (15 October 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	16.50	+0bp	-100bp
ON rate (%)	15.39	+31bp	-276bp
ON \$ swap (%)	14.13	-78bp	-277bp
Reserves (UAHm) ²	61,896	+49.73	+17.87
DepCerts (UAHm) ³	50,175	-13.47	+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) (15 October 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,061	+0.00	-3.17
Banks	344,559	-1.63	-7.21
Residents	26,199	-2.10	+29.46
Individuals	10,551	+0.29	+117.44
Non-res ⁴	98,586	+1.70	+1,261.61
Total	816,957	-0.56	+8.67

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

FX market indicators (15 October 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.8450	+0.57	-11.06
EUR/USD	1.1033	+0.57	-4.72
DXY ²	98.288	-0.84	+3.40
UAH TWI ³	133.161	-1.08	+14.51

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

Gov't bond quotes¹ (16 October 2019)

Maturity	Bid	Ask
6m	17.25	15.75
12m	17.25	15.75
2y	17.25	15.75
3y	17.25	15.75
12m (\$)	5.50	4.50
2y (\$)	5.50	4.50

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

Domestic liquidity and bonds market

Foreigners continue to purchase UAH-denominated bills

Despite the MoF not offering five-year notes, foreign investors' portfolios continue to increase. Last week, their portfolios rose by UAH1.7bn (about US\$68m), mostly due to purchasing bills at the primary auction. This week, activity declined due to shorter maturities being offered at the primary market.

Last week, the Ministry offered three-year notes, which collected 1.5x greater demand than the Ministry's offered amount (see [auction comment](#)). After auction settlement, foreign investors' portfolios rose UAH1.2bn (about US\$49m). So, they probably purchased at least this amount at the auction, as last week saw large debt redemptions, and they likely received a portion of it.

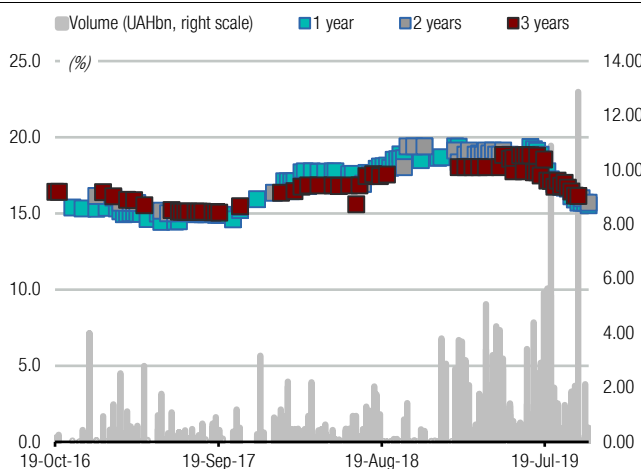
After auction settlement, foreigner's portfolios continued to increase. They purchased about UAH0.4bn (US\$16m) in the secondary market, increasing portfolios to a new record high of UAH98.6bn (US\$4bn) in total, and UAH95.8bn (US\$3.9bn) in local currency. The most active were likely the three-year and five-year notes. Yesterday, the Ministry offered T-bills with three-month, one-year, and two-year maturities, but received lower demand, which may have been due to less interest from foreigners (see [yesterday's auction overview](#)).

ICU view: Demand from foreigners is mostly concentrated in the longer maturities. This resulted in low demand for two-year bills, less than the MoF offered. Short-term bills (below one year) are more attractive for locals. Foreigners can purchase small amounts at the auction or in the secondary market. We anticipate a further increase in portfolio amounts, but less than last week.

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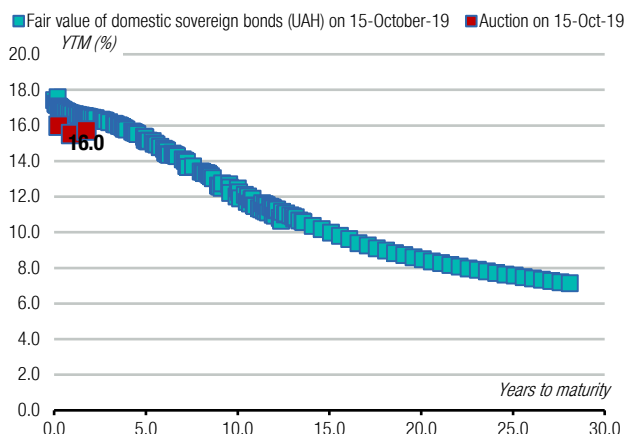
Chart 1. Local-currency bonds

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.

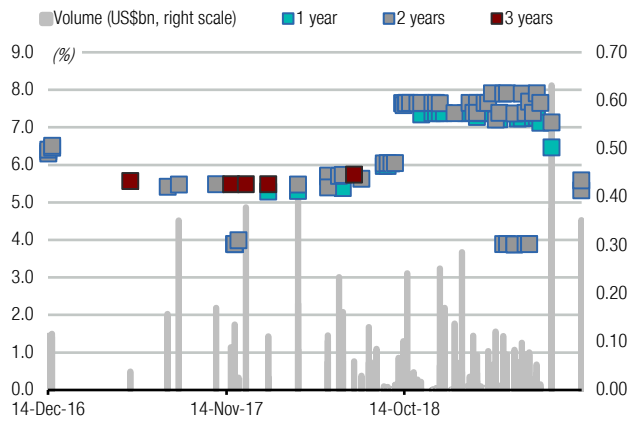
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

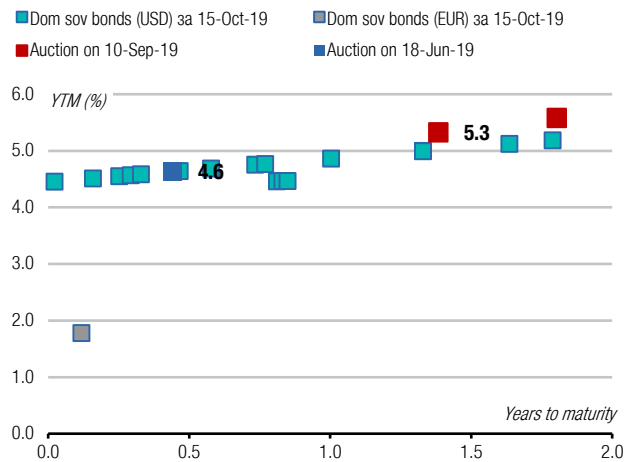
Chart 2. FX-denominated bonds

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 volatile at around UAH100bn

After declining below UAH100bn at the beginning of last week, liquidity rose to UAH112bn, and should stay above UAH100bn with a possible temporary decline below this level.

Significant outflow to Treasury accounts last Monday of UAH5.4bn caused liquidity to decline to UAH98.1bn, but with the NBU’s purchases of FX and large debt repayments, liquidity recovered above UAH100bn. With the increase in budget expenditures, later in the week liquidity rose to UAH112bn, a comfortable level for most banks.

Generally, the NBU and Treasury provided a positive impact on liquidity. Through FX purchases, the NBU provided UAH3.3bn of liquidity, and Treasury injected UAH9.3bn through debt repayments and budget expenditures. At the same time, reserves exchange in cash cut liquidity by UAH4.5bn

ICU view: *This week, we do not expect active selling of FX by foreigners to purchase new bills, and the main impact on liquidity will have to come from the Treasury. The budget can continue to return banking-system liquidity, which it absorbed in August and did not spend during September. As the result, we expect a high level of liquidity with possible temporary declines.*

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

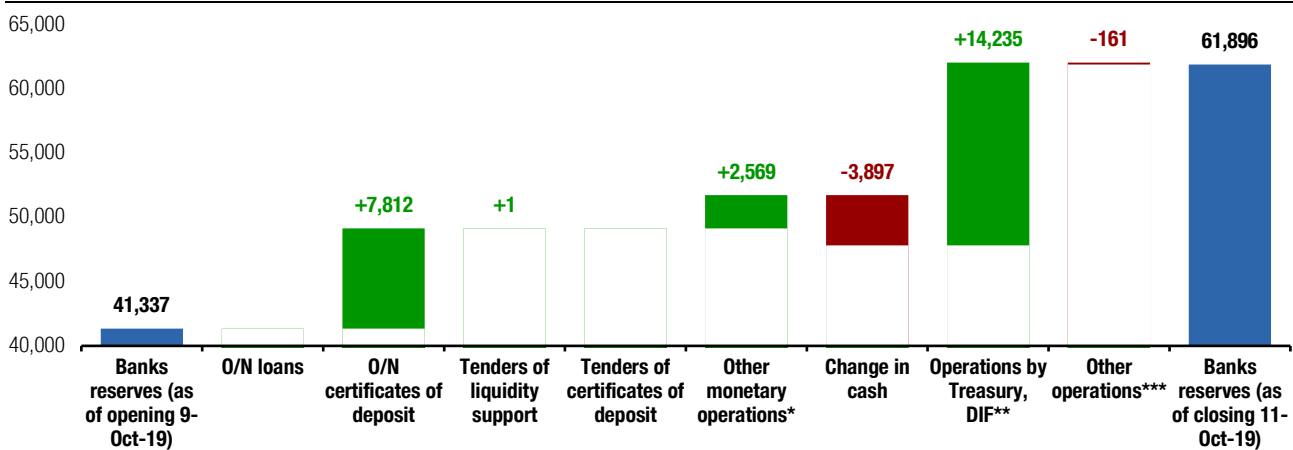
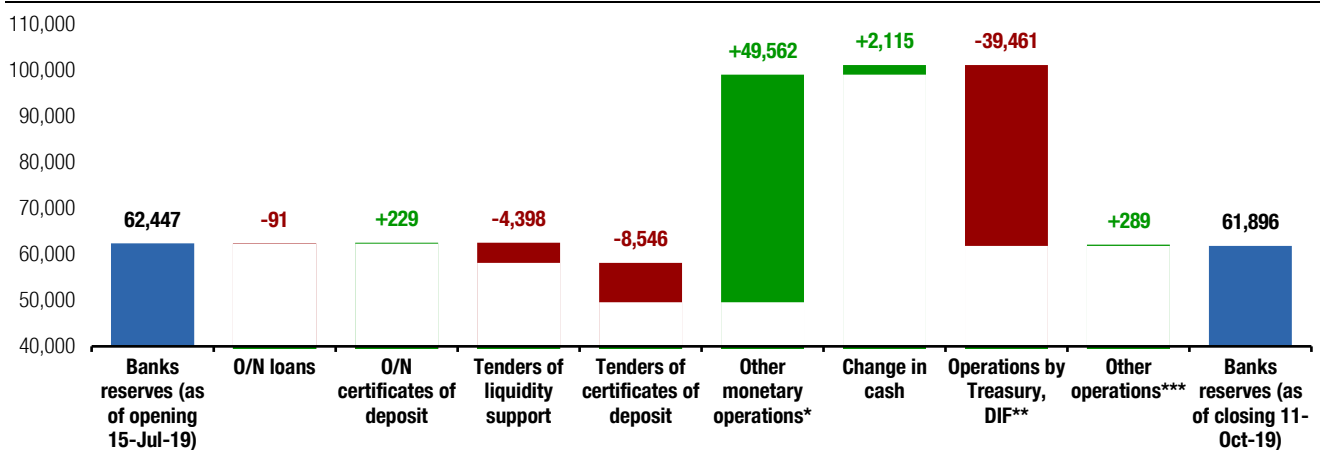


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 exchange rate volatility increases

In October, volatility of the hryvnia exchange rate rose significantly, with a weakening during the first week of the month, and appreciation last week. This week, we expect a new wave of weakening, probably to about UAH25/US\$.

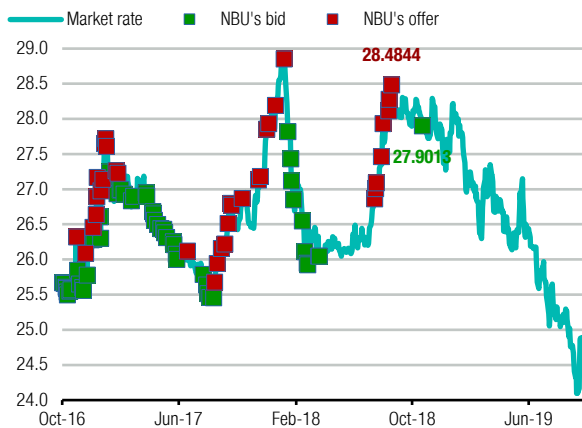
Last week, the hryvnia appreciated by 0.24% to UAH24.535/US\$, as the result of selling three-year notes, and the NBU satisfying extra demand a week before. But the less active primary auction this week caused negative impact and hryvnia began to weaken.

ICU view: Last week, the NBU purchased US\$134.5m, which softened appreciation and decreased exchange-rate volatility. So, this week, the hryvnia can weaken to levels of the first week of this month and probably more, to about UAH25/US\$.

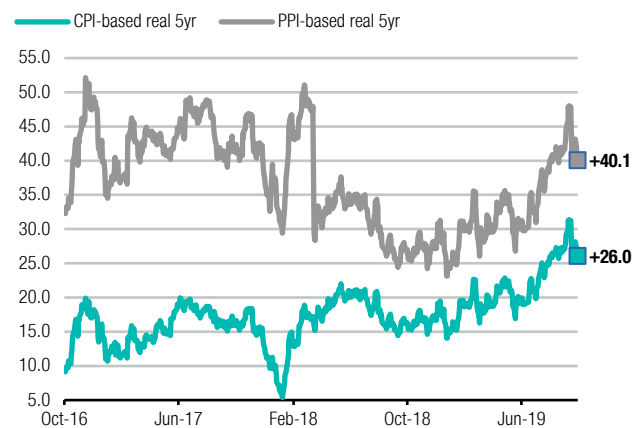
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Chart 5. FX market indicators, 3-year history

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

Inflation slowed to 7.5% YoY in September

Lower world energy prices and a stronger UAH thanks to tight monetary policy will continue to constrain consumer-prices growth this year.

In September, headline inflation slowed to 7.5% YoY from the 8.8% YoY seen in August, which is the lowest reading since June 2016, while in MoM terms, prices rose 0.7%. Inflation is slowing, primarily thanks to a stronger UAH and low world energy prices. Growth in prices for food products decelerated to 8.8% YoY, while prices for transport rose only 1.3% YoY (the lowest growth since March 2016). This allowed a decrease in the inflation reading by 0.6ppt and 0.4ppt, respectively, out of a total decline of 1.3ppt. Core inflation fell to 6.5% YoY. The NBU forecasts headline CPI at 6.3% YoY by the end of 2019.

ICU view: The stronger UAH and lower world energy prices create downside risks for our current CPI forecast of 8% YoY growth in 2019.

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PrivatBank wins in English Court of Appeal

The Court of Appeal confirmed that the English court has jurisdiction over PrivatBank's litigation against its former shareholders. The worldwide freezing order has been reinstated.

PrivatBank's appeal to overturn the previous judgment that denied the bank the ability to sue former shareholders in the English court was successful. The bank is ready to move forward in the case to seek the recovery of US\$1.9bn (US\$3.0bn including interest).

ICU view: This is clearly a positive decision for Ukrainian authorities who seek compensation for the UAH155bn injected into PrivatBank since its nationalization in 2016. However, the Economic Court of Kyiv will have another hearing on 17 October on the Ministry of Finance acquiring PrivatBank's shares. We do not expect a decision to be made on Thursday. Nevertheless, if the court rules in favour of former shareholders, we expect it to have a negative impact on country's currently positive sentiment. Any decision is very likely to be appealed by the losing side.

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