



Focus
Ukraine

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

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Weekly Insight

Bond portfolios steady

Key messages of the today's comments

Domestic liquidity and bonds market

Bond portfolios steady

Despite bond redemptions and partial refinancing, the portfolios of government bondholders saw little change. A large redemption of FX-denominated bills is scheduled this week, which will have a negative impact on portfolios.

Liquidity is close to a record high

For two consecutive weeks, liquidity received support through budget operations and rose very close to UAH120bn. VAT refunds before the peak in month-end tax repayments can provide additional support and increase liquidity to record high levels.

Foreign exchange market

Hryvnia volatile at around UAH25/US\$

Last week's volatility had negative effects on the hryvnia, which weakened to about UAH25/US\$. However, due to tax payments and demand for three-year notes, the hryvnia exchange rate should remain below this level depending on VAT refunds.

Economics

Retail-trade turnover rises 8.6% YoY in September

Due to lower growth rates of real incomes in 2H19, retail-trade turnover will also slow, but will remain one of the main growth drivers of Ukraine's economy this and next year.

TUESDAY, 22 OCTOBER 2019

Banks' reserves market (21 October 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	16.50	+0bp	-100bp
ON rate (%)	15.03	-24bp	-334bp
ON \$ swap (%)	13.97	-16bp	-307bp
Reserves (UAHm) ²	57,109	-7.73	+6.83
DepCerts (UAHm) ³	62,529	+24.62	+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) (21 October 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,061	+0.00	-3.17
Banks	345,433	+0.22	-4.74
Residents	26,244	+0.39	+25.94
Individuals	10,751	+1.89	+108.10
Non-res ⁴	98,202	-0.60	+1,251.04
Total	817,691	+0.06	+9.88

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (21 October 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	25.0100	+0.66	-11.06
EUR/USD	1.1150	+1.06	-3.16
DX ²	97.328	-0.98	+1.69
UAH TWI ³	131.236	-1.45	+13.59

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (22 October 2019)

Maturity	Bid	Ask
6m	17.00	15.50
12m	17.00	15.50
2y	17.00	15.50
3y	17.00	15.50
12m (\$)	5.50	4.00
2y (\$)	5.50	4.00

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

Source: ICU.

Domestic liquidity and bonds market

Bond portfolios steady

Despite bond redemptions and partial refinancing, the portfolios of government bondholders saw little change. A large redemption of FX-denominated bills is scheduled this week, which will have a negative impact on portfolios.

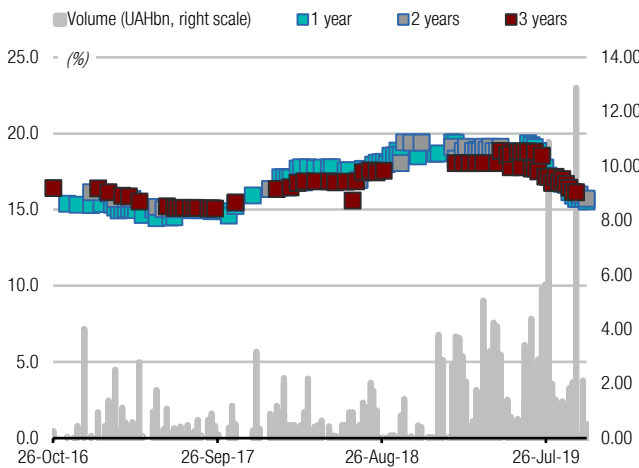
Last week, portfolios had only minor changes. Foreign investors' portfolios slid UAH0.4bn, while other portfolios rose slightly. Changes were the result of redemptions, new issues, and hryvnia weakening (see comment below). Banks increased their portfolios by UAH0.9bn, the non-banking sector increased portfolios by UAH45m, and private investors increased portfolios by UAH0.2bn. Portfolios of individuals rose due to exchange-rate changes, while the increase in bank portfolios was due to the purchase of new bills in addition to the exchange rate impact.

ICU view: Today, the MoF will offer three-year notes, which should attract demand from foreigners. However, in general, all portfolios may decline as the result of the large redemption of FX-denominated bills tomorrow, nearly US\$0.5bn. This paper is in the portfolios of all groups. Large redemptions will not be compensated by new issues, as the offering is capped at just at UAH3bn.

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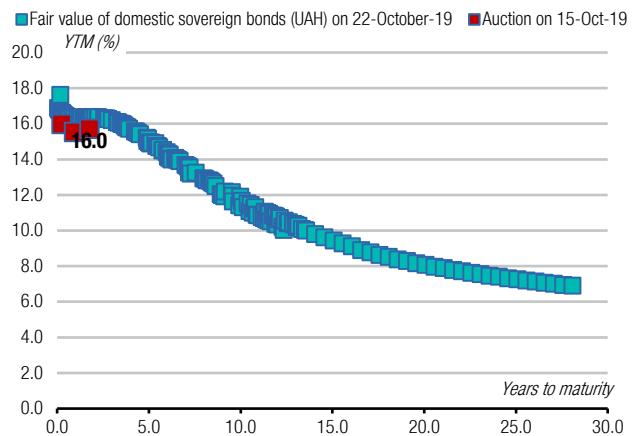
Chart 1. Local-currency bonds

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.

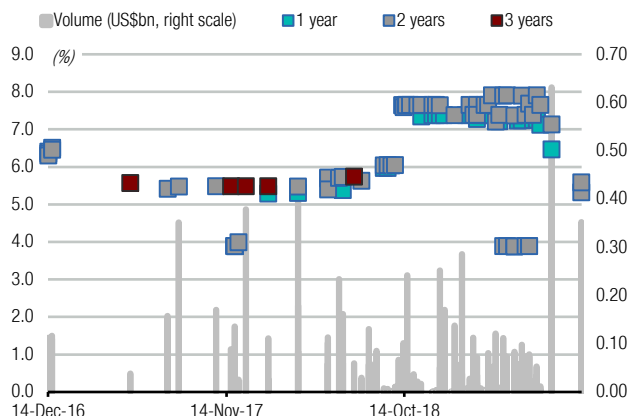
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

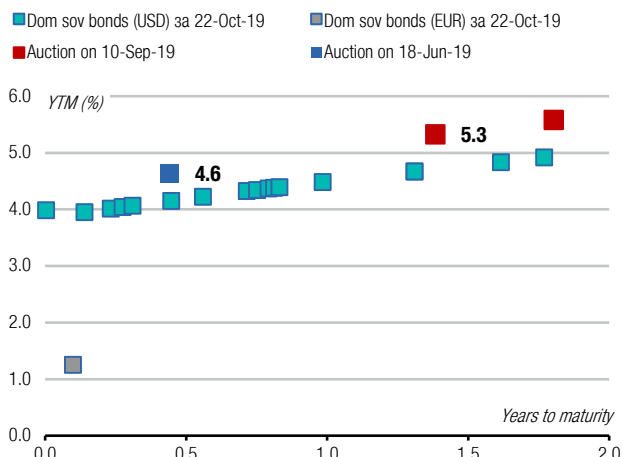
Chart 2. FX-denominated bonds

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 is close to a record high

For two consecutive weeks, liquidity received support through budget operations and rose very close to UAH120bn. VAT refunds before the peak in month-end tax repayments can provide additional support and increase liquidity to record high levels.

Last week, banking-sector liquidity rose UAH7.6bn to UAH119.6bn, just UAH5bn below the record high for the last four years, which was seen at the end of January 2019, at UAH124.7bn. Liquidity was the highest at the end of 2015 at UAH125.3bn.

Last week, liquidity received support from Treasury operations, which provided the banking sector with UAH6bn of additional funds. Also, banks increased exchange of cash in reserves, usual for second half of the month, which increased liquidity by an additional UAH1bn. Other non-monetary operations provided banks with UAH0.6bn of funds.

ICU view: *This week, we could see outflows due to beginning of month-end tax payments, and inflows through VAT refunds. While tax payments can be concentrated at the end of the month, or next week, VAT refunds can take place this week. With other kinds of cash flows steady, liquidity has a chance to rise to a new record high this week.*

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

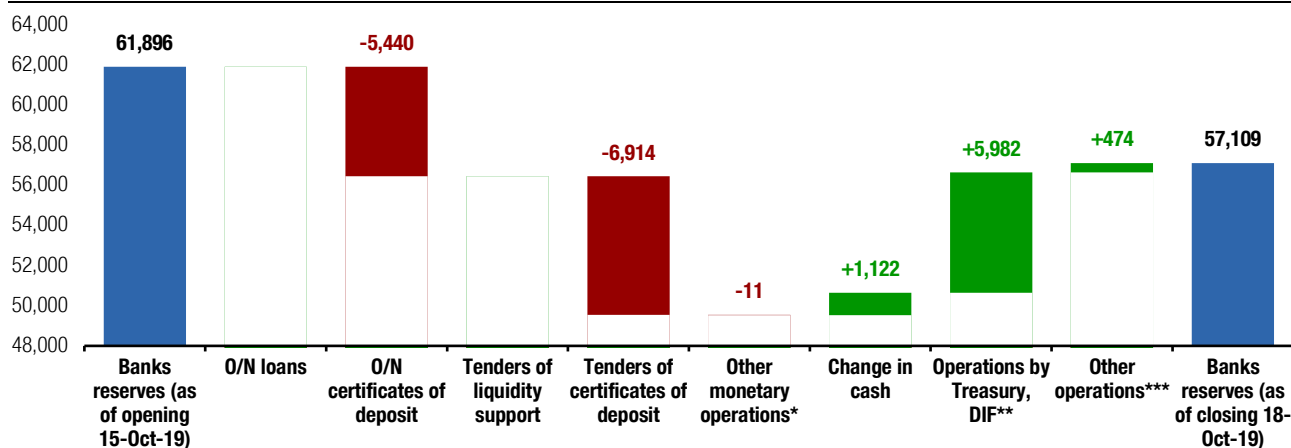
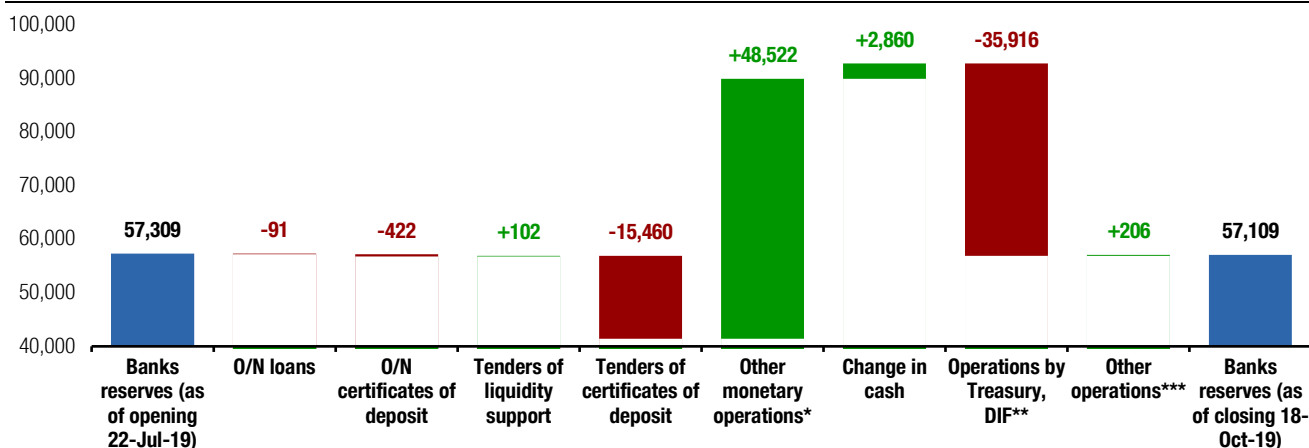


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 volatile at around UAH25/US\$

Last week's volatility had negative effects on the hryvnia, which weakened to about UAH25/US\$. However, due to tax payments and demand for three-year notes, the hryvnia exchange rate should remain below this level depending on VAT refunds.

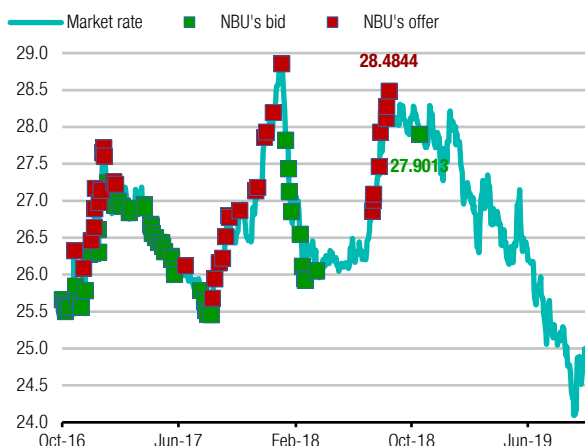
By the end of last week, the hryvnia weakened to UAH24.995/US\$, losing 1.87% during the week. But yesterday, it appreciated to about UAH24.9/US\$, probably as a result of preparation for today's offering of three-year notes, as foreign investors sell hard currency to submit bids. VAT refunds can have a negative impact, decreasing offerings of hard currency in the market, as exporters will offer less.

ICU view: We expect VAT refunds this week, which will provide exporters with additional funds, and decrease hard-currency offerings in the market, as exporters will use these funds for tax payments, and will sell less FX. The exchange rate should remain volatile at around UAH25/US\$ until the end of this week, and probably until the end of this month, with possible weakening above UAH25/US\$.

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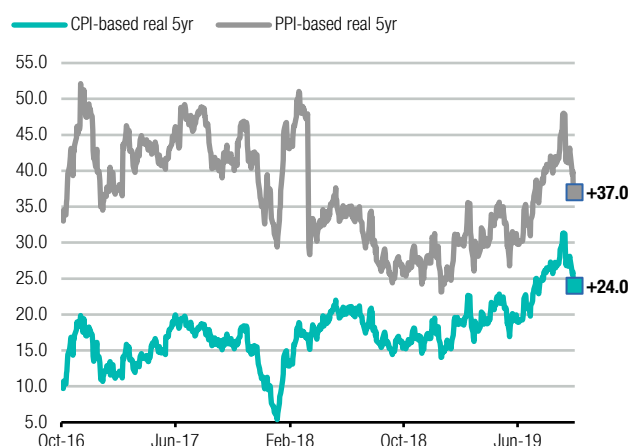
Chart 5. FX market indicators, 3-year history

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

Retail-trade turnover rises 8.6% YoY in September

Due to lower growth rates of real incomes in 2H19, retail-trade turnover will also slow, but will remain one of the main growth drivers of Ukraine's economy this and next year.

Retail-turnover growth accelerated to 8.6% YoY in September, up from 6.7% YoY in August, per data from the State Statistics Service of Ukraine. In 9M19, growth was 9.8% YoY. However, our calculations (based on Ukrstat data) show that retail-trade turnover growth slowed to 8.8% YoY in 3Q19 from 13.4% YoY in 2Q19.

ICU view: We expected some slowdown of retail sales growth due to deceleration of growth rates in real incomes of households. We estimate that real wages grew 8.8% YoY in July-August 2019 vs. 9.8% YoY in 1H19, and 12.6% YoY in 2018, while remittances rose 1.3% YoY in July-August vs. 4.8% YoY in 1H19, and 20% YoY in 2018. Still, retail trade will continue to support economic growth in 2019 and 2020, thanks to solid consumer demand and further growth of real incomes, albeit at a slower pace.

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