



Focus  
**Ukraine**

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

Research team  
**Alexander Martynenko  
Taras Kotovych  
Mykhaylo Demkiv  
Dmytro Dyachenko**

# Weekly Insight

## NBU cut rate to 15.5%

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### MoF will offer 4-year notes for foreigners

The portfolios of foreign investors remain slightly volatile at around UAH98bn with moderate changes in structure due to purchases of three-year local-currency notes. This week, portfolios can decline once again in anticipation of the offering of three-year and four-year notes in November.

##### Liquidity at historical high

The total amount of banking-sector liquidity continued to increase last week and reached a new historical high. But, due to month-end tax payments, liquidity will decline slightly this week, being close to UAH120bn.

#### Foreign exchange market

##### Hryvnia weakening

Last week, the hryvnia weakened to UAH25.185/US\$ as a result of lower amounts of new bills purchased by foreign investors, the same as the increase in VAT refunds. This week, support for the hryvnia can be provided by needs for local-currency funds for tax payments, with hryvnia appreciation to around UAH25/US\$.

#### Economics

##### Economic growth slows in 3Q19

Despite better performance of real sectors of the economy in September, overall growth decreased in 3Q19, pointing to slower real GDP growth last quarter.

##### NBU cut rate to 15.5%

NBU has cut the rate by 100 bps – 50 bps above consensus amid the abating of inflation. The rate is likely to go down by another 100bps during the next meeting in December.

WEDNESDAY, 30 OCTOBER 2019

#### Banks' reserves market (29 October 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	15.50	-100bp	-250bp
ON rate (%)	13.97	-119bp	-381bp
ON \$ swap (%)	12.65	-120bp	-476bp
Reserves (UAHm) <sup>2</sup>	51,944	-5.59	+0.00
DepCerts (UAHm) <sup>3</sup>	72,655	+9.65	+134.59

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) (29 October 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,061	+0.00	-3.17
Banks	337,887	-2.02	-7.29
Residents	25,986	-1.03	+28.52
Individuals	9,837	-8.38	+87.44
Non-res <sup>4</sup>	98,457	+0.62	+1,273.81
<b>Total</b>	<b>809,228</b>	<b>-0.92</b>	<b>+8.59</b>

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

#### FX market indicators (29 October 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	25.1400	+1.00	-10.67
EUR/USD	1.1112	-0.16	-2.29
DX <sup>2</sup>	97.690	+0.20	+1.15
UAH TWI <sup>3</sup>	130.704	-0.88	+12.40

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

#### Gov't bond quotes<sup>1</sup> (30 October 2019)

Maturity	Bid	Ask
6m	16.25	15.25
12m	16.75	15.25
2y	16.50	15.25
3y	16.50	14.75
12m (\$)	5.50	4.00
2y (\$)	5.50	4.00

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

# Domestic liquidity and bonds market

## MoF will offer 4-year notes for foreigners

The portfolios of foreign investors remain slightly volatile at around UAH98bn with moderate changes in structure due to purchases of three-year local-currency notes. This week, portfolios can decline once again in anticipation of the offering of three-year and four-year notes in November.

Last week, foreigners maintained outstanding of FX-denominated bills and decreased investments in local-currency paper, which decreased their share of UAH-denominated instruments to 96.6%. But after redemptions of USD-denominated bills last Wednesday and the issue of new three-year notes, the hryvnia share rose to 97.1% by the end of last week.

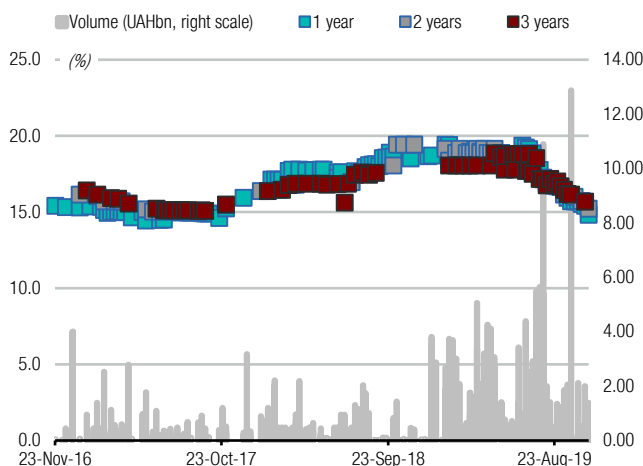
To increase attractiveness of UAH-denominated instruments for foreign investors, Ministry of finance included in the schedule for November offerings of four-year notes. This instrument can meet mostly demand from foreigners and increase share of UAH-denominated paper in their total portfolio, with slight increase in portfolio outstanding.

**ICU view: This week, the MoF offered only bills with maturities up to two years, which are not attractive to foreigners, resulted in low impact on their portfolio. But till the end of this year MoF has to borrow at least UAH40bn, while demand is mostly for mid-term notes from foreigners. This can be the main reason for the Ministry to review schedule of the primary auctions for November and to add 4-year notes to it. Also, to attract demand from local investors Ministry added 2-year USD-denominated paper.**

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

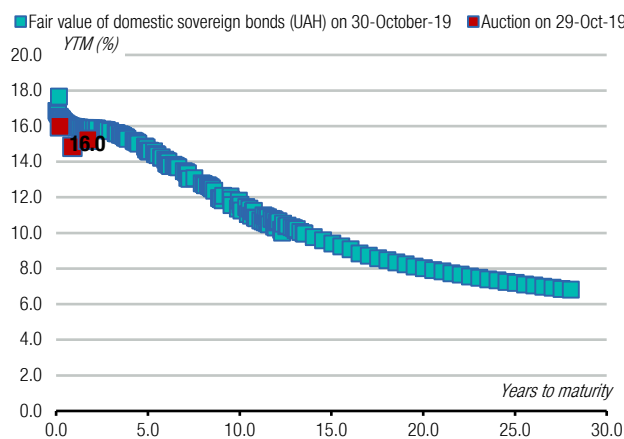
**Chart 1. Local-currency bonds**

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.

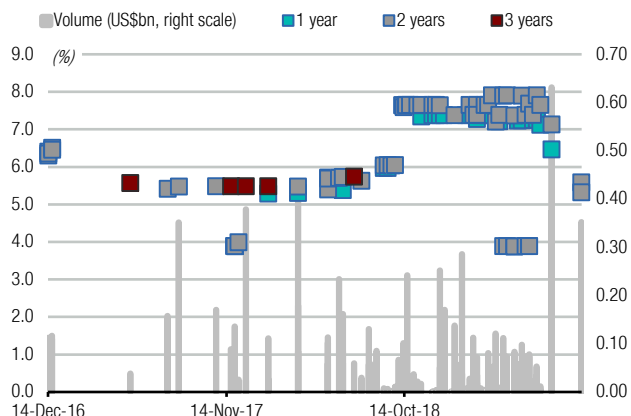
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

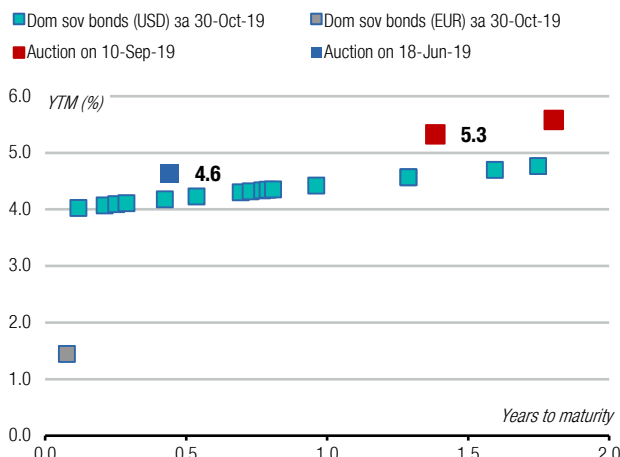
**Chart 2. FX-denominated bonds**

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 at historical high**

The total amount of banking-sector liquidity continued to increase last week and reached a new historical high. But, due to month-end tax payments, liquidity will decline slightly this week, being close to UAH120bn.

Last week, liquidity rose by UAH9bn, and set a new record high last Thursday at UAH128.9bn. This is a record large amount of liquidity in the banking system of Ukraine. Banks allocated most of this liquidity to NBU CDs, about UAH80.4bn. A larger amount of CDs was seen at the beginning of 2016, at UAH89.6bn, but banks' correspondent accounts with the NBU were only UAH28.3bn.

VAT refunds from the Treasury were key to liquidity having risen so significantly, which amounted to UAH7.5bn last Thursday. This inflow covered outflows from tax payments, and, at the same time, other injections increased liquidity. As a result, last week's net inflows from the Treasury amounted to UAH3.3bn, the NBU injected UAH2.2bn via the FX market, and liquidity received UAH3.2bn through cash exchange in reserves last week.

**ICU view: VAT refunds will be insufficient this week to impact liquidity; tax payments and the NBU's operations in the FX market will play larger roles. This week, we expect a lower supply of hard currency, smaller purchases by the NBU or selling from reserves, along with higher outflows to budget accounts and reserves exchange into cash. So, liquidity should stay at around UAH120bn.**

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

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

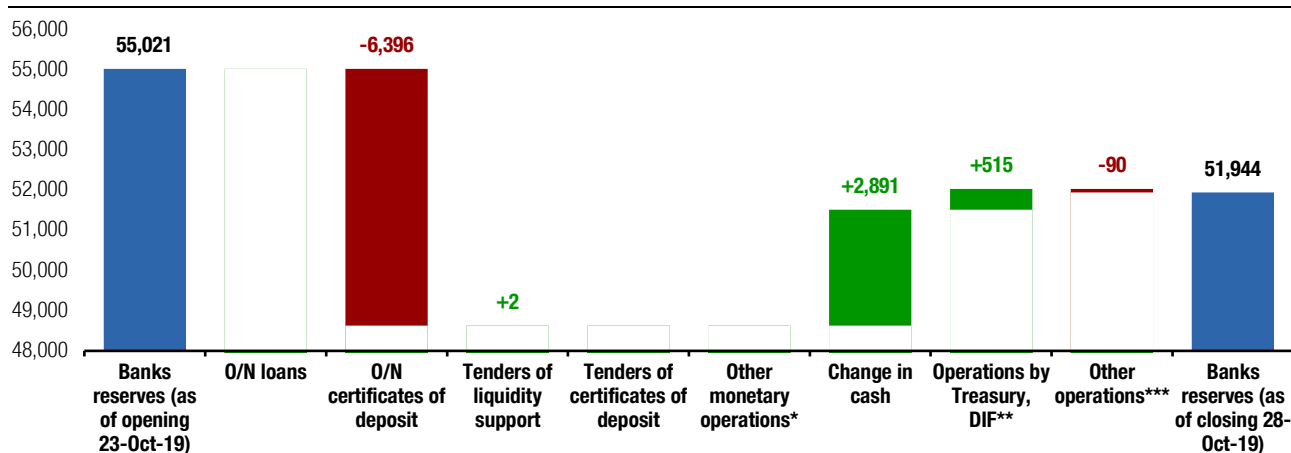
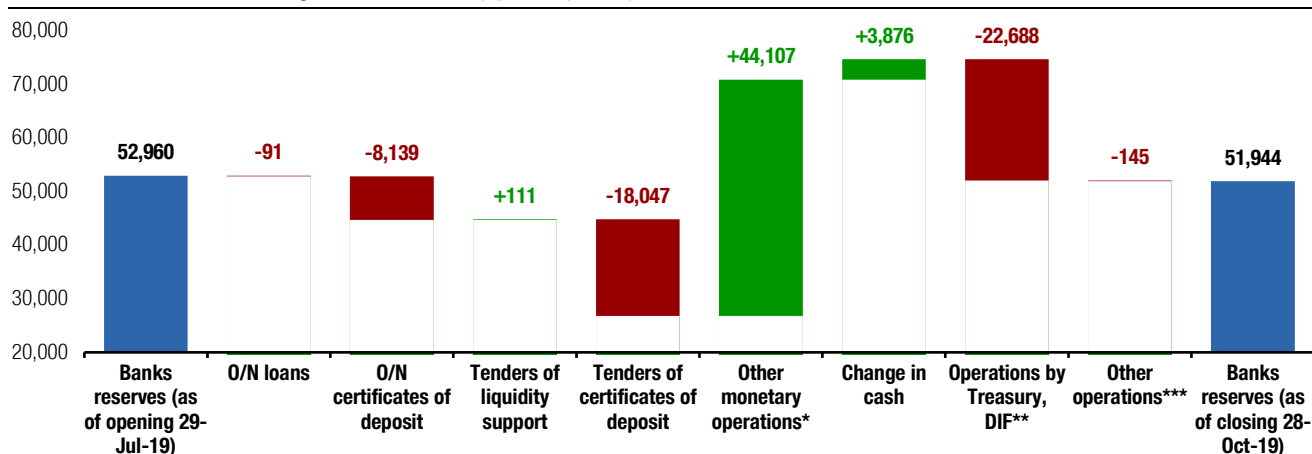


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Last week, the hryvnia weakened to UAH25.185/US\$ as a result of lower amounts of new bills purchased by foreign investors, the same as the increase in VAT refunds. This week, support for the hryvnia can be provided by needs for local-currency funds for tax payments, with hryvnia appreciation to around UAH25/US\$.

Last week began with the hryvnia weakening above UAH25/US\$, but due to inflows of FX from foreigners for new notes, it appreciated for a few days below this level. Additional hard-currency supply forced the NBU to purchase US\$90m of hard currency to smooth volatility. But after the needed amount of local currency was accumulated, the hryvnia resumed weakening.

VAT refunds reversed the trend to weakening, as last Thursday UAH7.5bn was paid, which decreased the supply of FX of exporters. In all, the hryvnia lost 0.76% last week.

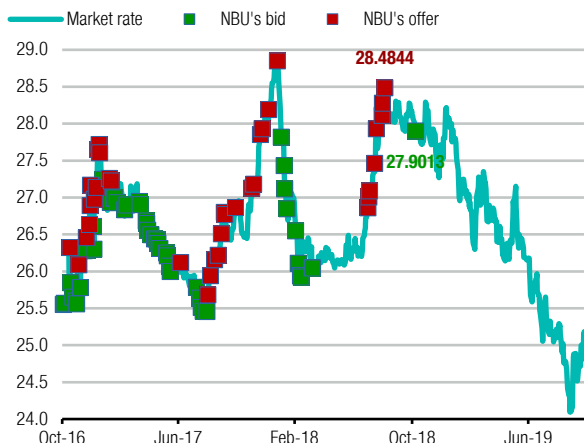
**ICU view:** Since the MoF offered yesterday only bills with maturities up to two years, hard currency from foreigners is not expected. However, additional FX supply can be provided from month-end tax payments. So, we do not anticipate significant

**movements of the hryvnia exchange rate, and it should be slightly volatile at around UAH25/US\$.**

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

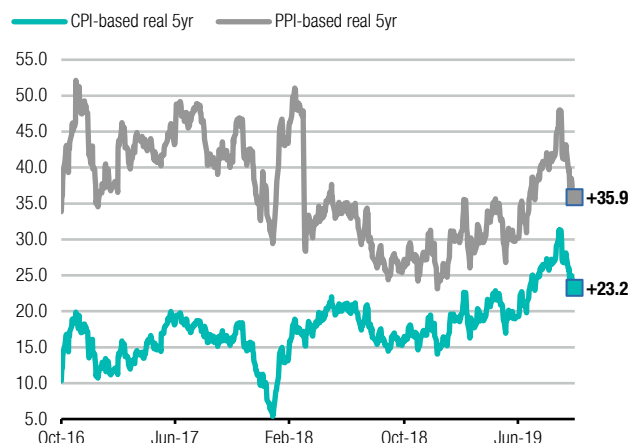
**Chart 5. FX market indicators, 3-year history**

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<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

### Economic growth slows in 3Q19

Despite better performance of real sectors of the economy in September, overall growth decreased in 3Q19, pointing to slower real GDP growth last quarter.

In September, retail sales growth accelerated to 8.6% YoY from 6.7% YoY in August, while agricultural output rose 9% YoY after a 10.8% YoY decline in August, per data from Ukrstat. The construction sector grew 12.2% YoY (vs. 8.9% YoY in August), while cargo-transportation turnover rose 1.2% YoY after a 2.2% YoY decline in August. However, passenger-transportation turnover fell 2.2% YoY after a 5.2% YoY growth in August, while industrial output declined for the fourth consecutive month — by 1.1% in September due to the contraction of production in all major subsectors.

**ICU view: Our calculations, which are based on Ukrstat data, point to deceleration in growth of real sectors of the economy in 3Q19 vs 2Q19. Construction-sector growth slowed to 19.2% YoY vs. 19.4% YoY in 2Q19, retail and wholesale trade rose 8.4% YoY vs. 8.9% YoY in 2Q19, agricultural output rose 5.5% YoY vs. 6.3% YoY in 2Q19, and the transport sector rose only 0.6% YoY vs. 3.9% YoY in 2Q19. These four sectors account for about 38% of Ukraine's nominal GDP in 3Q19. Industrial production, which accounts for 20% of nominal GDP, declined 1.4% YoY after a 1.1% YoY growth in 2Q19. Still, despite some slowdown in the real sectors of the economy, consumer confidence in 3Q19 was at the highest level since 2008, which should have boosted services sector. Hence, we estimate real GDP growth to be close to 3.4% YoY in 3Q19.**

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

### **NBU cut rate to 15.5%**

NBU has cut the rate by 100 bps – 50 bps above consensus amid the abating of inflation. The rate is likely to go down by another 100bps during the next meeting in December.

The declining cycle for interest rates continues as the regulator cut the rate from 16.5% to 15.5%, more than expected. Inflation declined 20 bps below the previous NBU forecast, which allowed it to further ease the monetary policy. Resumption of the IMF programme remains the base case assumption while possible Privatbank denationalization still is the key threat for financial stability.

***ICU view: Reaching a deal with the IMF will allow the NBU to cut rate more aggressively and ease monetary policy. Current cuts reflect only the slowdown in inflation, while the real rate remains as high as 8% based on September's inflation rate of 7.5% YoY. We expect regulator to lower the rate further in December – to 14.5%.***

*Mykhaylo Demkiv, Kyiv, (044) 377-7040 ext.723*

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11th floor, LEONARDO Business Centre  
19-21 Bogdan Khmelnytsky Street  
Kyiv, 01030 Ukraine  
Phone/Fax +38 044 3777040

**WEB** [www.icu.ua](http://www.icu.ua)



## RESEARCH

**Alexander Martynenko** 

Head of corporate research  
[alexander.martynenko@icu.ua](mailto:alexander.martynenko@icu.ua)

**Mykhaylo Demkiv** 

Financial analyst (Banks)  
[mykhaylo.demkiv@icu.ua](mailto:mykhaylo.demkiv@icu.ua)

**Taras Kotovych** 

Senior financial analyst (Sovereign debt)  
[taras.kotovych@icu.ua](mailto:taras.kotovych@icu.ua)

**Dmitriy Dyachenko**

Junior financial analyst  
[dmitriy.dyachenko@icu.ua](mailto:dmitriy.dyachenko@icu.ua)

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