

# Weekly Insight

## Four-year T-note offering sees high demand

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Four-year T-note offering sees high demand

Last week, foreign investors' portfolios rose close to UAH100bn (US\$4bn). With high demand for four-year notes yesterday, it is likely that foreigners' portfolios will be announced tomorrow to rise above this level.

##### Liquidity above UAH120bn and may further rise

Month-end tax payments last week did not cause a significant decline in liquidity, which remained above UAH120bn. This week, banking-sector liquidity will slightly increase with NBU support and due to collection of funds prior to quarterly tax payments.

#### Foreign exchange market

##### Foreign demand for T-notes supported hryvnia

Demand for the government's new local-currency debt from foreigners once more supported the hryvnia exchange rate. However, during upcoming weeks, volatility can increase due to tax payments and hard currency purchases for dividends repatriation.

#### Economics

##### C/A deficit fell to 2.5% of GDP in September

Lower world energy prices will continue to support Ukraine's C/A balance this year. However, due to lower harvest of late crops and sunflower seed this year, the C/A deficit will increase moderately in the following months.

WEDNESDAY, 6 NOVEMBER 2019

#### Banks' reserves market (5 November 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	15.50	+0bp	-250bp
ON rate (%)	13.88	-16bp	-359bp
ON \$ swap (%)	12.67	-6bp	-462bp
Reserves (UAHm) <sup>2</sup>	51,319	+3.90	+2.28
DepCerts (UAHm) <sup>3</sup>	57,707	-19.35	+83.74

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) (5 November 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,061	+0.00	-3.17
Banks	336,739	-0.44	-7.85
Residents	26,104	+0.22	+28.73
Individuals	9,890	+0.06	+87.01
Non-res <sup>4</sup>	99,892	+1.30	+1,285.55
<b>Total</b>	<b>809,686</b>	<b>-0.02</b>	<b>+8.51</b>

Notes: [1] non-residents

Source: NBU, ICU.

#### FX market indicators (5 November 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.7100	-1.14	-11.77
EUR/USD	1.1075	-0.68	-2.91
DX <sup>2</sup>	97.983	+0.35	+1.77
UAH TWI <sup>3</sup>	132.871	+1.35	+14.13

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

#### Gov't bond quotes<sup>1</sup> (6 November 2019)

Maturity	Bid	Ask
6m	16.00	14.25
12m	16.00	14.25
2y	16.00	14.25
3y	16.00	14.00
12m (\$)	5.50	3.50
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

## Four-year T-note offering sees high demand

Last week, foreign investors' portfolios rose close to UAH100bn (US\$4bn). With high demand for four-year notes yesterday, it is likely that foreigners' portfolios will be announced tomorrow to rise above this level.

Foreign investors continued to increase portfolios of local-currency bills, which now stand at UAH97bn (US\$3.9bn). Their total portfolios, including FX-denominated bills, rose to slightly below UAH100 (US\$4bn). Last week, foreigners added UAH1.4bn (US\$0.56bn) to their portfolios, while total bonds outstanding rose only UAH1.5bn (US\$0.6bn). So, they are still key investors in new bond issues.

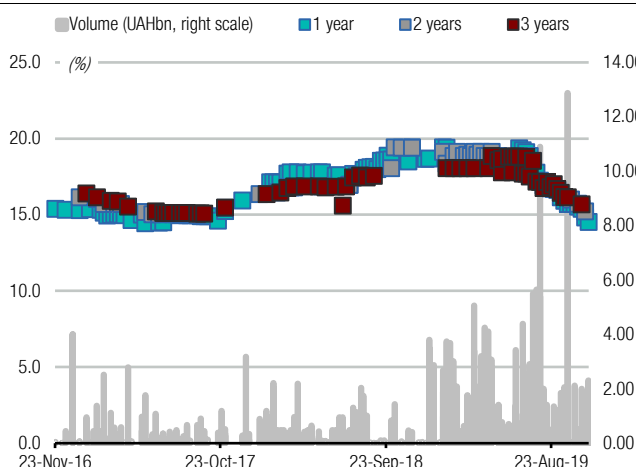
At yesterday's auction demand for local-currency bills was UAH13.8bn, and was concentrated in the four-year maturity, where demand exceeded supply by five times (see auction [comment](#)). Most likely, the main part of demand was from foreigners, which would bring their portfolios above UAH100bn (US\$4bn). At the same time, with redemption of UAH4bn of existing paper, total outstandings of domestic bonds will decline, which will result in a further increase of foreign investors' share in Ukraine debt.

**ICU view: Demand for new local-currency instruments from foreigners is still strong, despite having been slightly lower than for the five-year note at the end of September 2019. This could be because the offerings were capped, and, therefore not attractive for investors with large funds under management. We expect foreign-investors' portfolios to rise further, while other groups of investors will decrease their portfolios due to redemptions exceeding new purchases.**

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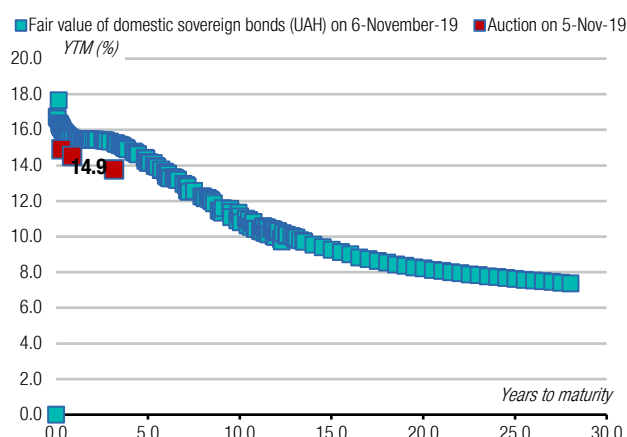
**Chart 1. Local-currency bonds**

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.

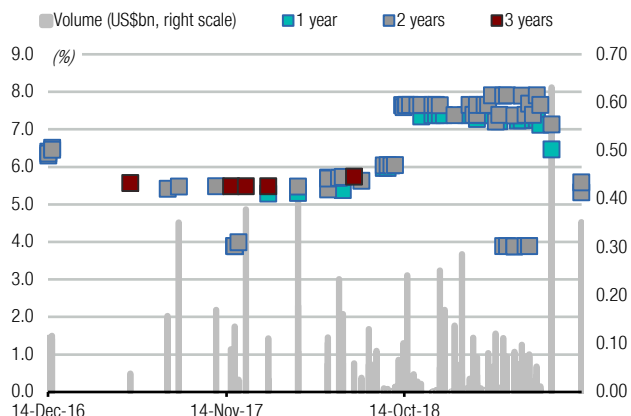
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

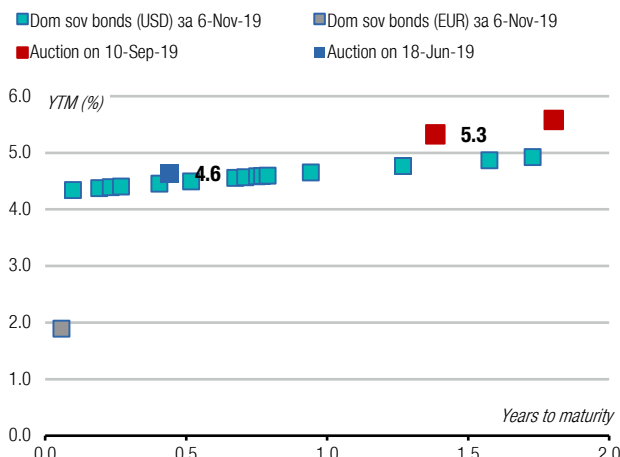
**Chart 2. FX-denominated bonds**

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 UAH120bn and may further rise**

Month-end tax payments last week did not cause a significant decline in liquidity, which remained above UAH120bn. This week, banking-sector liquidity will slightly increase with NBU support and due to collection of funds prior to quarterly tax payments.

The Treasury absorbed UAH11.9bn last week; however, liquidity remained above UAH120bn. Outflows from budget accounts were partially compensated by cash exchange in reserves and NBU purchases of hard currency from the market, UAH3.3bn and UAH3.6bn, respectively.

Last Friday, nearly half of this liquidity was invested in two-week CDs with maturity on 15 November. This falls within the period of quarterly tax payments, and high liquidity should therefore support banks in transactions with the budget.

**ICU view:** *Due to increased demand from foreign investors for new notes, liquidity will receive additional support from the NBU through the FX market this week, while the Treasury can return part of collected funds to the banking system. Only banks could create a negative impact, increasing reserves exchange to cash, as it traditionally happens at the beginning of the month. So, liquidity can stay above UAH120bn this week with a possible slight increase, but below any record level.*

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

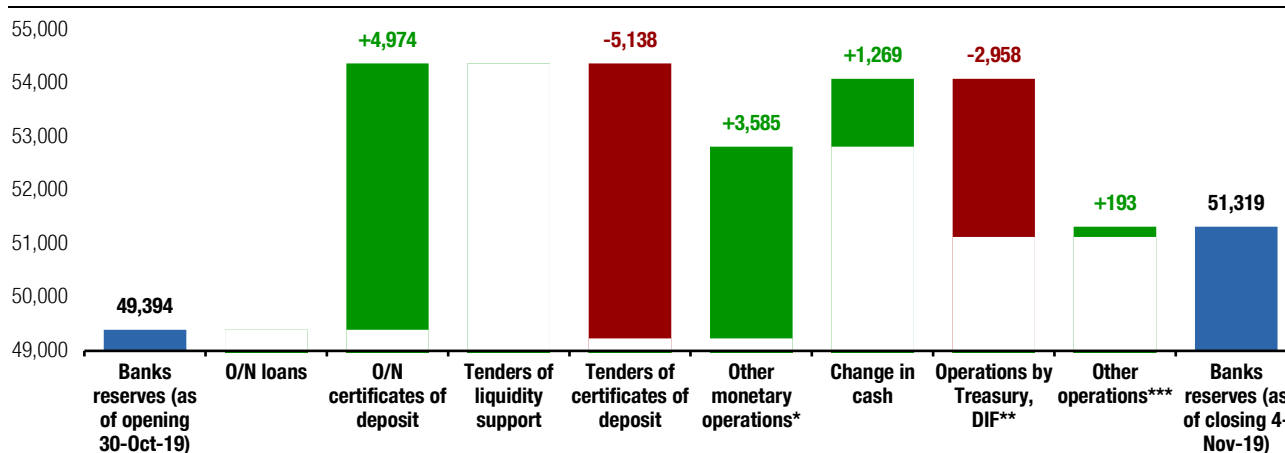
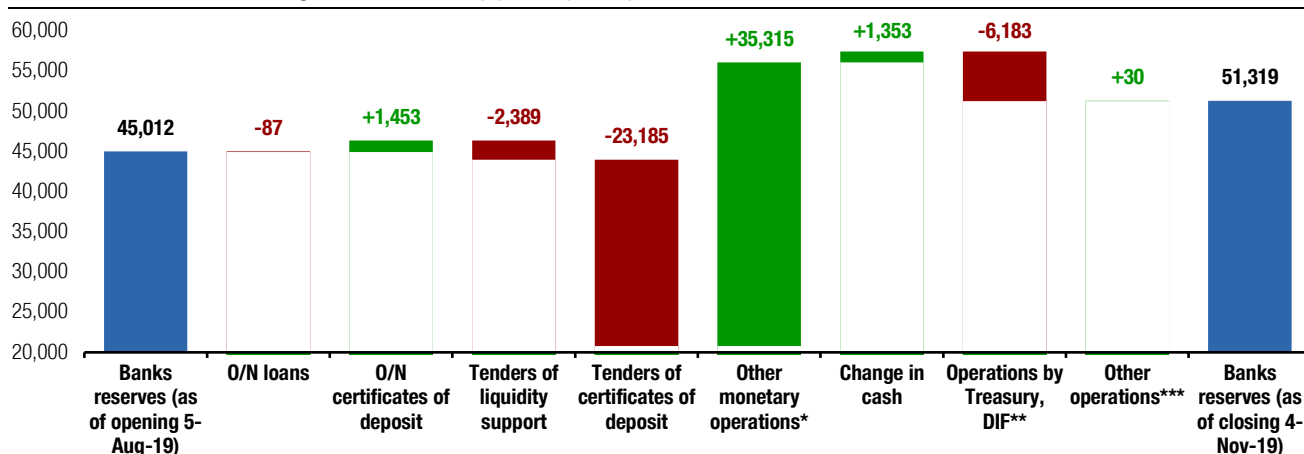


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

### Foreign demand for T-notes supported hryvnia

Demand for the government's new local-currency debt from foreigners once more supported the hryvnia exchange rate. However, during upcoming weeks, volatility can increase due to tax payments and hard currency purchases for dividends repatriation.

Last week, the MoF offered only bills with maturities up to two years; but foreign investors continued to invest new money into local-currency debt. They added a portion of hard currency supply to the market at a time when demand did not exceed supply from exporters to pay month-end tax payments. As a result, last week, the hryvnia appreciated by 1.6% to UAH24.77/US\$.

To restrain appreciation, NBU purchased US\$156.9m of hard currency, accepted extra supply, and increased FX reserves.

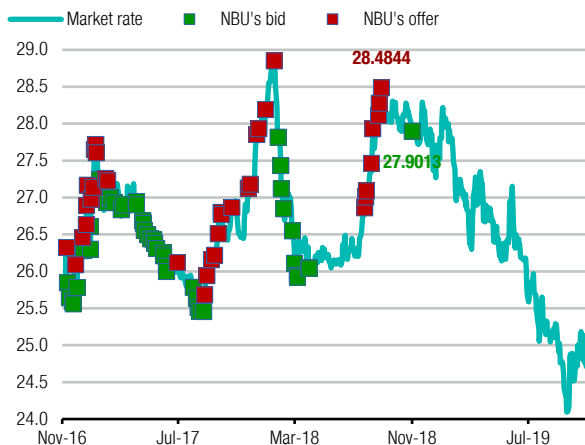
**ICU view:** This week, we anticipate similar supply of hard currency from foreigners, as the MoF sold four-year notes at UAH2.5bn (US\$100m) par value yesterday with settlement today. This should keep the exchange rate below UAH25/US\$. At the same time, we anticipate an increase in demand for FX for dividends repatriation, which later can be compensated by FX supply for quarterly tax payments, and purchase of four-

**year T-notes at the end of the month. Mismatch of demand and supply can increase volatility in the FX market during November.**

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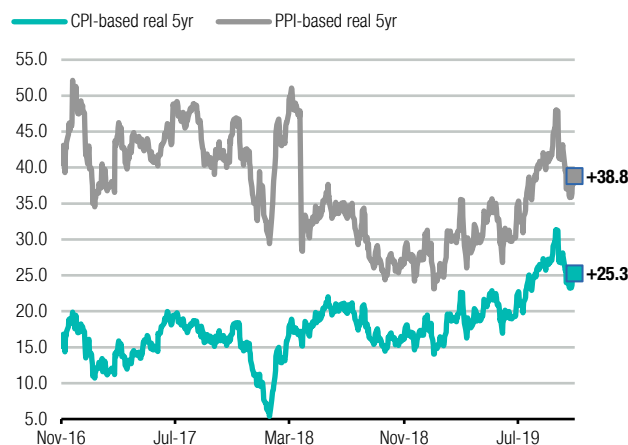
**Chart 5. FX market indicators, 3-year history**

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 deficit fell to 2.5% of GDP in September

Lower world energy prices will continue to support Ukraine's C/A balance this year. However, due to lower harvest of late crops and sunflower seed this year, the C/A deficit will increase moderately in the following months.

In 9M19, the C/A deficit fell 21% YoY to US\$2.7bn, while in annualized terms, it declined 15% YoY to US\$3.7bn (est. 2.5% of GDP), per data from the NBU. In September, merchandise exports rose 11.9% YoY, mainly thanks to 29% YoY growth in agricultural exports (accounts for almost all YoY growth on a net basis), mineral products (+15% YoY), and machinery and equipment (+31% YoY). In 9M19, exports of goods rose 8% YoY to US\$31.1bn. Imports of goods rose only 2% YoY driven primarily by a 16% YoY increase in machinery and equipment, while energy imports dropped 19% YoY. In 9M19, imports of goods rose 8.3% YoY to US\$43.8bn, while energy imports declined 4% YoY. On a 12-month trailing basis, the merchandise-trade-balance deficit was US\$13.5bn (+11 YoY, 9.3% of GDP) in September, while the services-trade-balance surplus soared 48% YoY to US\$1.8bn.

**ICU view: Lower world energy prices and a further increase in remittances (+10% YoY in 3Q19 per our estimates vs. 4.8% YoY in 1H19) will continue to support Ukraine's C/A balance this year. However, due to further decline in steel prices as well as the lower harvest of late crops and sunflower seed this year, the C/A deficit will increase moderately in the following months.**

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