



Focus
Ukraine

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

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Weekly Insight

Foreign banks to trade UAH

Key messages of the today's comments

Domestic liquidity and bonds market

Foreigners' interest maintained

Despite a decline in interest rates, foreigners continued to increase local-currency bonds in their portfolios, which reached UAH127bn last week. This week, we expect the increase in portfolios to continue due to the offering of four-year notes at the auction.

Record-high liquidity

Last week, total banking-sector liquidity set a new record at UAH246.8bn. This was due to a large hard-currency purchase by the NBU and an increase in budget expenditures. But this week, liquidity can decline if depending on how much FX exporters sell for tax payments.

Foreign exchange market

Hryvnia exchange rate reversed

After more than a month of weakening, the new month began with the hryvnia reversing direction and appreciating by 1.6%. This week, having additional support from exporters due to tax payments, the hryvnia can move closer to UAH24.2/US\$.

Foreign banks to trade UAH

NBU has allowed foreign banks to trade UAH against FX with both Ukrainian and foreign banks.

MONDAY, 10 FEBRUARY 2020

Banks' reserves market (7 February 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	11.00	+0bp	-700bp
ON rate (%)	9.49	+57bp	-699bp
ON \$ swap (%)	7.96	-75bp	-875bp
Reserves (UAHm) ²	60,702	+33.42	+51.88
DepCerts (UAHm) ³	186,113	-0.98	+147.63

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 February 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	330,177	-0.66	-3.10
Banks	325,277	-0.57	-13.57
Residents	24,981	+1.45	+1.31
Individuals	9,304	+0.16	+40.06
Non-res ⁴	127,102	+1.70	+825.54
Total	816,841	-0.19	+7.19

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (7 February 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.5030	-1.58	-9.10
EUR/USD	1.0946	-1.33	-3.48
DXY ²	98.684	+1.33	+2.26
UAH TWI ³	135.767	+2.40	+12.39

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (10 February 2020)

Maturity	Bid	Ask
6m	12.00	10.00
12m	11.50	9.75
2y	11.00	9.50
3y	11.00	9.50
12m (\$)	4.00	2.75
2y (\$)	4.50	3.20

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

Source: ICU.

Domestic liquidity and bonds market

Foreigners' interest maintained

Despite a decline in interest rates, foreigners continued to increase local-currency bonds in their portfolios, which reached UAH127bn last week. This week, we expect the increase in portfolios to continue due to the offering of four-year notes at the auction.

Last week's auction saw low activity overall, attracting demand just UAH160m larger than the offering. It was concentrated in the shorter maturities, while the three-year note received demand significantly lower than the cap. As a result, the MoF borrowed just UAH2.3bn with 10-10.15% cut-off and 9.6-9.84% weighted-average rates. More details in the [auction review](#).

The low amount of bonds sold vs just UAH2.2bn of bond redemptions from the NBU's portfolio resulted in increased portfolios for most classes of bondholders. Only the portfolios of local banks declined, but this was due to the revaluation of FX-denominated paper.

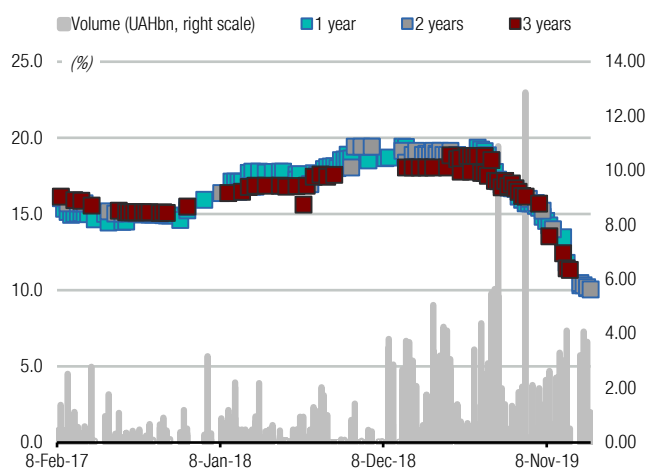
Foreigners maintained their activity in the local-currency paper market. Last week, their investments in these instruments rose UAH1.9bn to UAH125.5bn, and total portfolios rose to UAH127.1bn. Now their share in total bonds outstanding is 15.6%.

ICU view: This week, we anticipate higher activity from foreigners despite low interest rates. Currently, rates provide a real rate above 5%, which supports, if not a large, then a steady demand for new bills. As a result, this week, we could see a UAH1.5–2bn increase in foreigners' portfolios approaching UAH130bn.

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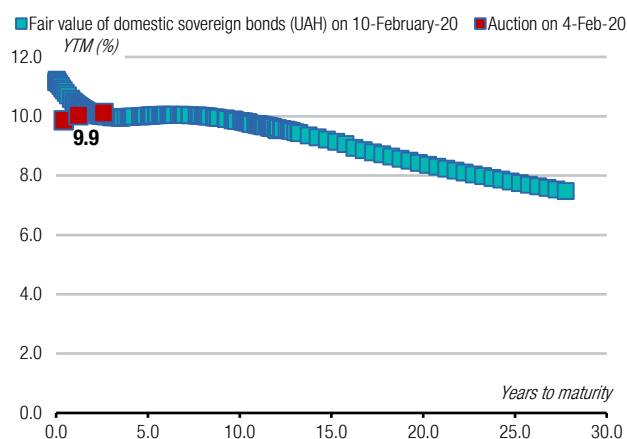
Chart 1. Local-currency bonds

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.

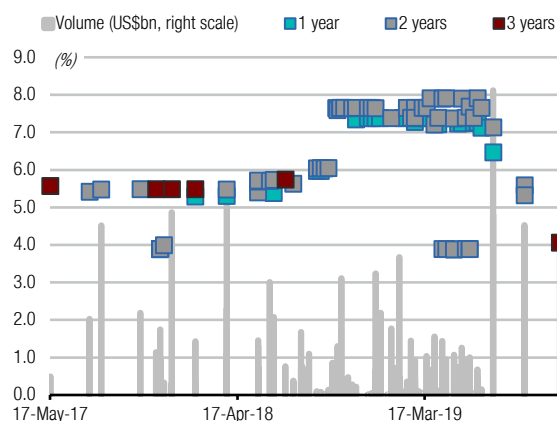
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

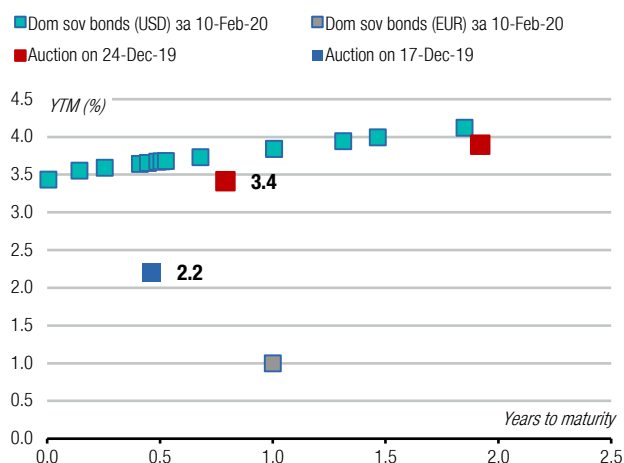
Chart 2. FX-denominated bonds

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.

Record-high liquidity

Last week, total banking-sector liquidity set a new record at UAH246.8bn. This was due to a large hard-currency purchase by the NBU and an increase in budget expenditures. But this week, liquidity can decline if depending on how much FX exporters sell for tax payments.

Last week, most components of liquidity made a positive impact. To restrain a new wave of appreciation, the NBU actively purchased hard currency, at US\$317.5m, which added UAH7.8bn to liquidity. Treasury operations also provided liquidity of UAH4.9bn. Only reserves exchange in cash had a negative impact at UAH3.1bn.

In total last week, liquidity received UAH10.4bn of inflows and by Thursday reached a new record high of UAH246.8bn.

ICU view: The total amount of banking-sector liquidity can slid this week, as exporters may use local-currency funds they accumulated earlier for quarterly tax payments. However, if they start selling FX for tax payments, the NBU will be forced to buy an extra supply, which will add new funds to liquidity, and new records will be seen.

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

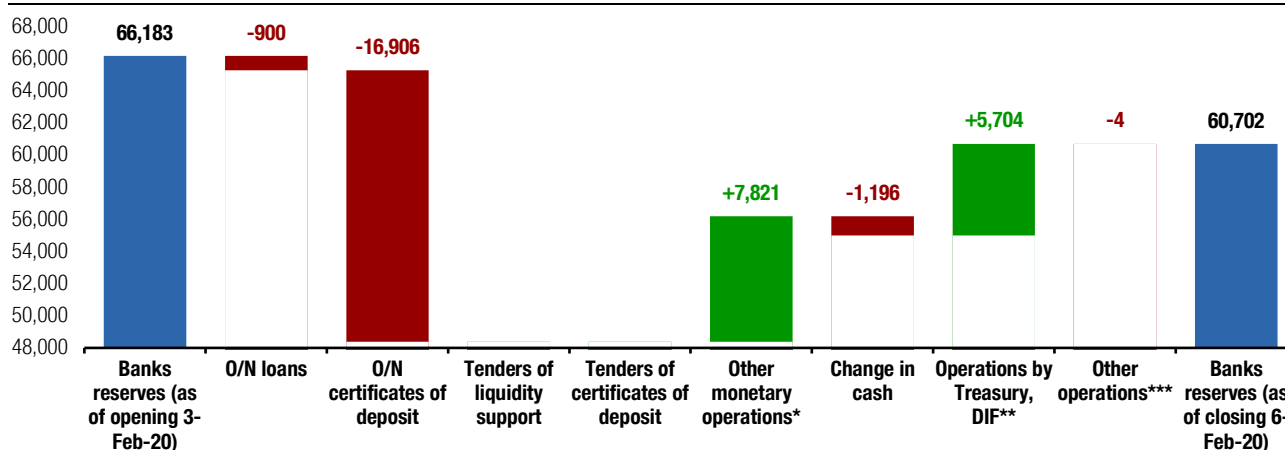
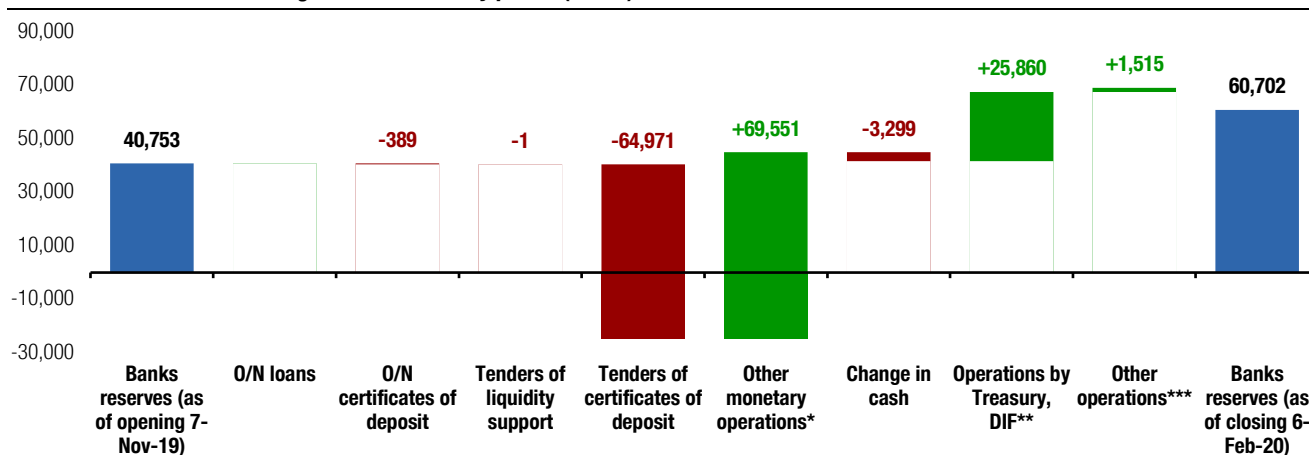


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 reversed

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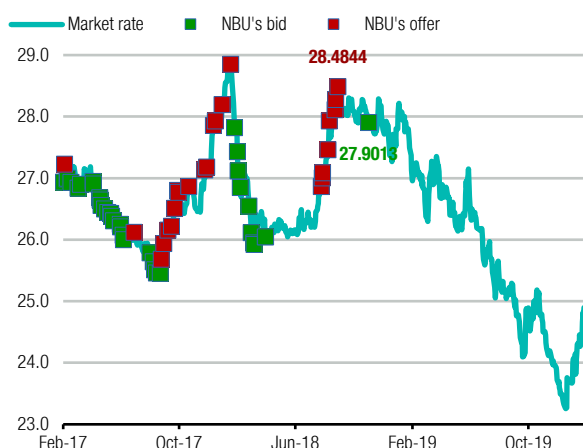
Extra supply of FX helped the hryvnia to appreciate during the first week of February, which partially compensated by losses seen in January. FX supply was large, as last week the NBU purchased US\$362m, although last Monday it had to sell US\$45m. The NBU's net purchase of US\$317.5m restrained appreciation, as without the NBU's interventions, the hryvnia could move very close to UAH24/US\$.

Foreigners were not key suppliers of hard currency, as they purchased only UAH1.9bn (US\$77.5m), significantly less than NBU's purchases. On the other hand, demand for FX from importers and for dividend repatriation could fall, also having an impact on the market balance.

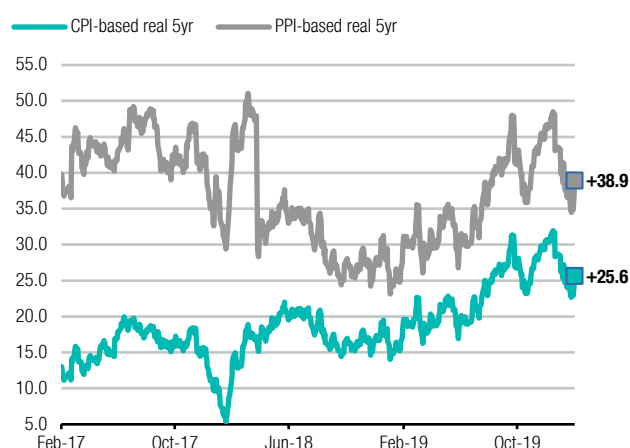
As the result, the hryvnia appreciated last week by 1.6% to UAH24.5/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 2.4% to 135.8, while in YoY terms, it was up 12.4%.

ICU view: This week, quarterly tax payments start and the market will depend on the supply of hard currency. Exporters can use hryvnia-denominated funds they acquired earlier or sell additional hard currency. We anticipate an additional supply of hard currency from exporters and foreign investors in T-bills, as debt repayments will be low. For new purchases, they will have to sell new FX. So, hryvnia movements will depend on the NBU's participation in the market, but with slight appreciation probably toward UAH24.2/US\$ by the end of this week.

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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.

Foreign banks to trade UAH

NBU has allowed foreign banks to trade UAH against FX with both Ukrainian and foreign banks.

Another round of FX control relaxation amid the volatility of UAHUSD. Foreign banks will be able to trade UAH with other banks using the correspondent account in Ukrainian bank but are not limited to trading with it.

ICU view: NBU follows its path towards FX liberalization. We expect the increase of liquidity in the market as the result of improvements in infrastructure.

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