



Focus
Ukraine

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

Research team
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Weekly Insight

GDP rises 3.2% in 2019

Key messages of the today's comments

Domestic liquidity and bonds market

Foreigners' portfolios increase despite rates decline

Despite the decline in interest rates by 20-72bp to 9.5-10.1% in the primary bond market, foreigners continued to increase their portfolios of UAH-denominated government bonds. This week, we expect that their portfolios will continue to increase, probably to UAH130bn (US\$5.3bn).

Increases in liquidity continues

Absorption of extra hard-currency supply, and mostly balanced Treasury operations caused a further increase in banking-sector liquidity to above UAH248bn last week. This week, the amount of liquidity will depend on FX purchases by the NBU, but acceleration in quarterly tax payments may avoid an increase in liquidity.

Foreign exchange market

Hryvnia exchange rate stabilizes

Last week, the hryvnia gained just 0.1%, as a result of the NBU's hard currency purchases and the low level of quarterly tax payments. But this week exporters can accelerate selling of hard currency for tax payments creating a new opportunity for appreciation, although the NBU is likely to keep the rate above UAH24.3/US\$.

Economics

GDP rises 3.2% in 2019

This year, real GDP growth rates will be close to 2019's level, while the key growth drivers will remain household consumption and investments.

Inflation slows to 3.2% YoY in January

Lower world energy prices and a stronger YoY UAH will continue to constrain consumer-prices growth in the following months.

MONDAY, 17 FEBRUARY 2020

Banks' reserves market (14 February 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	11.00	+0bp	-700bp
ON rate (%)	9.32	+1bp	-726bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	64,719	+6.62	+16.22
DepCerts (UAHm) ³	182,512	-1.93	+221.11

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) (14 February 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	328,427	-0.53	-3.01
Banks	322,517	-0.95	-14.70
Residents	24,948	+0.59	-2.03
Individuals	8,833	-5.06	+24.92
Non-res ⁴	128,922	+1.43	+829.51
Total	813,646	-0.41	+6.63

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (14 February 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.4800	-0.09	-10.15
EUR/USD	1.0831	-1.05	-4.11
DX ²	99.124	+0.45	+2.21
UAH TWI ³	136.286	+0.38	+13.54

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (17 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' portfolios increase despite rates decline

Despite the decline in interest rates by 20-72bp to 9.5-10.1% in the primary bond market, foreigners continued to increase their portfolios of UAH-denominated government bonds. This week, we expect that their portfolios will continue to increase, probably to UAH130bn (US\$5.3bn).

Last week, the Ministry of Finance sold not only local-currency instruments, but also offered USD-denominated bills, which are popular among local investors. New USD-denominated paper was purchased mostly by Ukrainian banks, so foreigners' share in the bonds still below 16%. But they continued to purchase local-currency paper despite the further decline in interest rates (see our [auction comment](#)).

Weighted-average rates at last weeks' auction stayed at or declined below 10%; the three-month bills declined to 9.46%. At the same time, for mid-term instruments, the weighted-average rates rose, despite a small decline in cut-off rates.

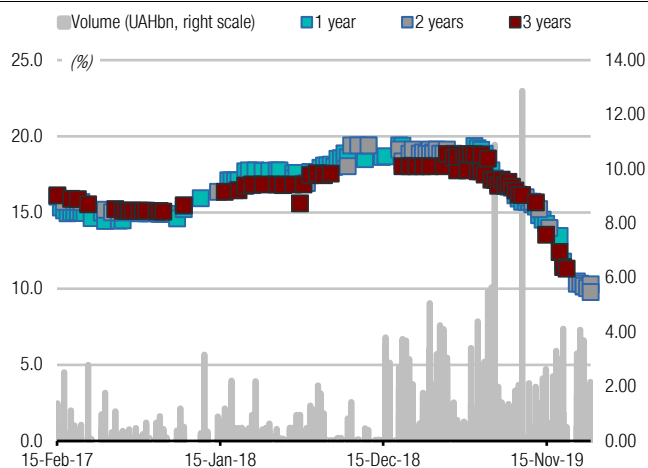
As a result, last week, banks' portfolios declined by UAH2.9bn (US\$118m), due to partial refinancing of FX-denominated bills redemption last Wednesday. But after last Wednesday's debt repayment and new purchases, foreigners reduced their positions in FX-denominated bills by UAH265m (US\$11m), while UAH-denominated portfolios rose by UAH2.1bn (US\$86m). So, last week, in total, foreigners' portfolios rose to UAH129bn (US\$5.3bn), and their market share increased to 15.85%.

ICU view: This year, foreigners' portfolios rose by UAH11.2bn (US\$458m), including UAH2.1bn (US\$86m) last week. Foreigners decreased amounts of new investments, but maintain their interest in local-currency paper. So, we anticipate that this week foreigners will continue to increase their portfolios by around UAH1-1.5bn (US\$40-60m), to about UAH130bn (US\$5.3bn) or above this level.

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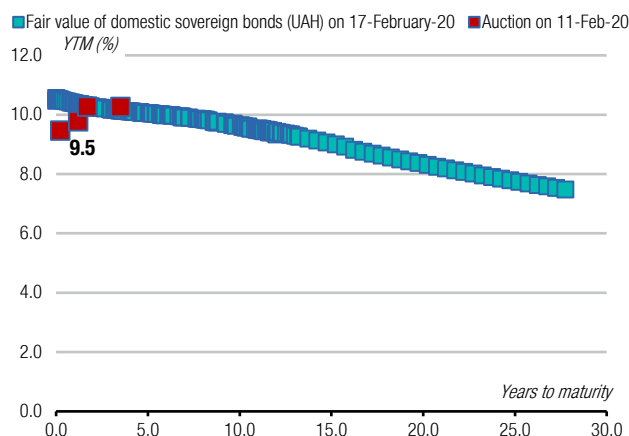
Chart 1. Local-currency bonds

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.

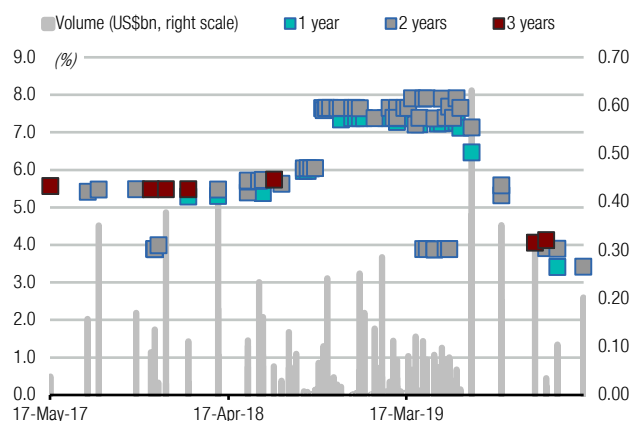
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

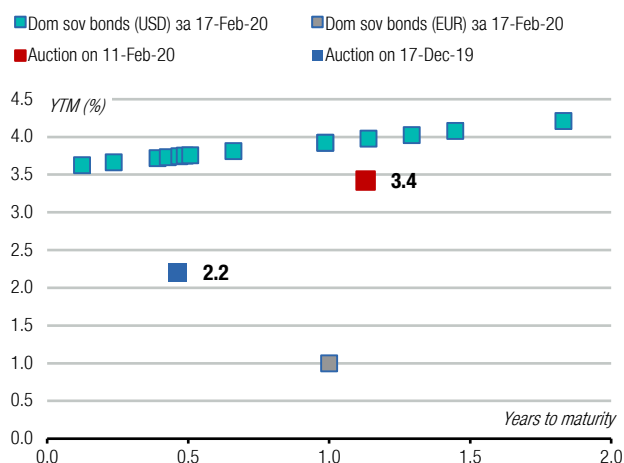
Chart 2. FX-denominated bonds

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.

Increases in liquidity continues

Absorption of extra hard-currency supply, and mostly balanced Treasury operations caused a further increase in banking-sector liquidity to above UAH248bn last week. This week, the amount of liquidity will depend on FX purchases by the NBU, but acceleration in quarterly tax payments may avoid an increase in liquidity.

Last week, the net impact of Treasury operations was UAH2.9bn, which, with inflow through other non-monetary operations (UAH0.5bn) and outflow via reserves exchange in cash (UAH4.1bn), had a negative impact of non-monetary operations of UAH0.7bn. But hard-currency purchases by the NBU, and its injections in liquidity through the FX market of UAH4bn compensated non-monetary outflows and caused an increase in liquidity to a new record high of UAH248bn last Thursday.

ICU view: We don't expect liquidity to increase this week, despite possible inflows from the NBU. The Treasury can absorb a considerable amount of liquidity through quarterly tax payments and low VAT refunds. So, liquidity can stay high above UAH240bn, although it is not likely to make new records.

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

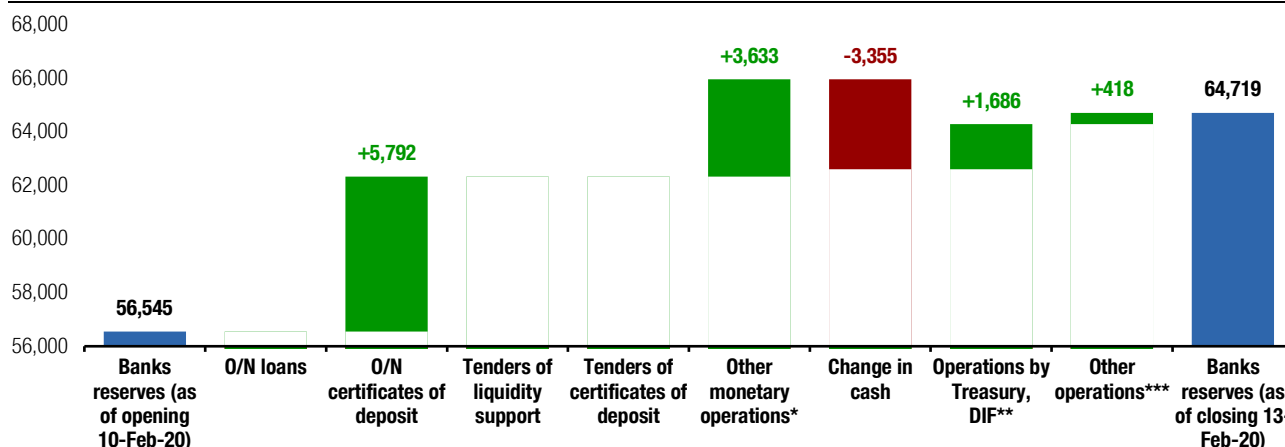
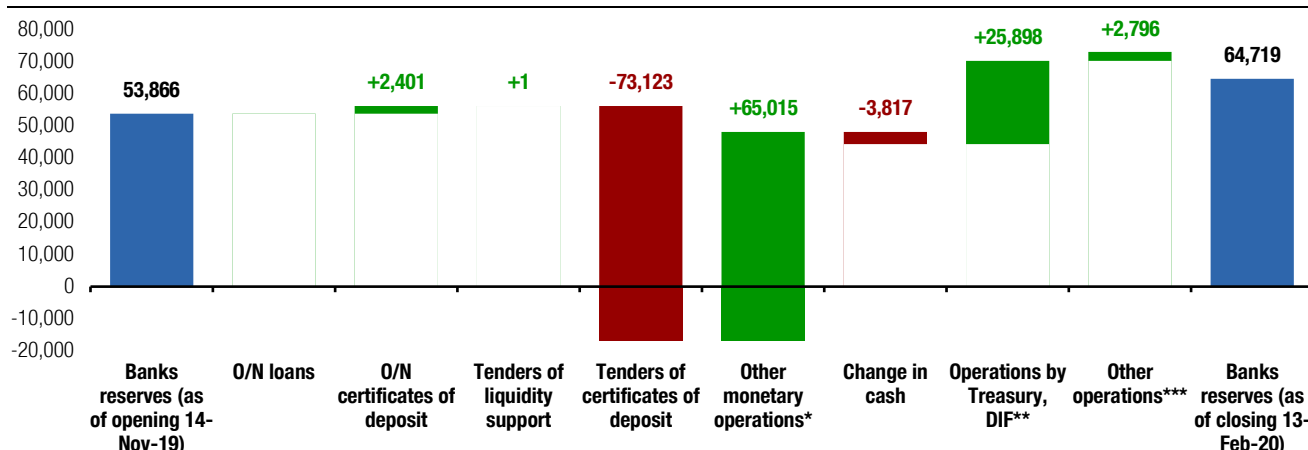


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 stabilizes

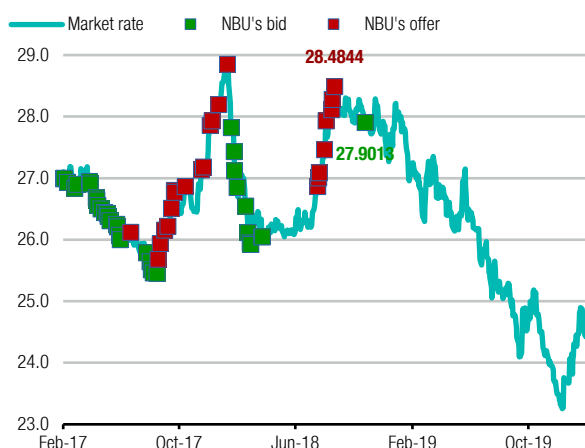
Last week, the hryvnia gained just 0.1%, as a result of the NBU's hard currency purchases and the low level of quarterly tax payments. But this week exporters can accelerate selling of hard currency for tax payments creating a new opportunity for appreciation, although the NBU is likely to keep the rate above UAH24.3/US\$.

Last week, the tax authorities collected just UAH4.3bn of taxes, so most quarterly tax payments will take place this week. This can add some supply to the FX market, but the NBU will maintain its presence in the market and absorb extra supply similar to last week. Only large FX selling by foreigners and exporters on one day would make the hryvnia stronger.

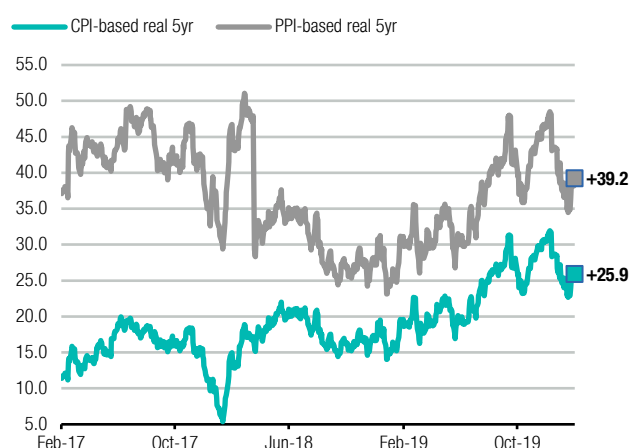
In total, last week, the NBU purchased US\$166m, which was twice what foreigners invested in local-currency debt, but 2x less than a week ago. So, the hryvnia appreciated by just 0.1% to UAH24.48/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.4% to 136.3, while in YoY terms, it was up 13.5%.

ICU view: *This week, we expect larger hard-currency supply than last week, as the last day of quarterly tax payments will match the day foreigners purchase local-currency bills. The NBU will be able to restrain appreciation, but not avoid it altogether. With such conditions, the hryvnia may appreciate, but the NBU will probably not allow it to cross the level of UAH24.3/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

GDP rises 3.2% in 2019

This year, real GDP growth rates will be close to 2019's level, while the key growth drivers will remain household consumption and investments.

Real GDP grew 0.1% QoQ SA and 1.5% YoY in 4Q19, having slowed from 4.1% YoY in 3Q19, per preliminary estimate from the Ukrstat. Our calculations based on Ukrstat data show that the economy expanded 3.2% in full-year 2019. The detailed breakdown of the GDP components will be released on the 20 March.

ICU view: Full-year 2019 real GDP growth is in line with our estimate of 3.2% growth. The slowdown of economic growth in 4Q19 was caused by contraction of agricultural and industrial output, while the main growth driver was consumer demand. For FY20, we expect the economy to grow 3.2% supported by lower interest rates, and solid consumer and investment demand, albeit subject to the implementation success of the reforms.

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Inflation slows to 3.2% YoY in January

Lower world energy prices and a stronger YoY UAH will continue to constrain consumer-prices growth in the following months.

In January, headline inflation slowed to 3.2% YoY from the 4.1% YoY seen in December, which is the lowest reading since February 2014, while in MoM terms, prices rose 0.2%. Growth rates of consumer prices slowed in all major subcategories, but the main positive impact on inflation slowdown was deceleration of the growth of food prices to 3.1% YoY. At the same time, prices on transport fell for the fourth month (-1.4% YoY), while prices on utilities fell for the second month (-2.8% YoY). Core inflation fell to 3.3% YoY. NBU forecasts inflation of 4.8% YoY by YE20.

ICU view: The stronger YoY hryvnia and lower YoY natural gas prices will continue to constrain consumer-prices growth in the following months, while inflation will remain close to the lower part of the band of the NBU's target range of 5+1%. We expect that

the vanishing effect of the strong UAH, solid consumer demand, and further growth of wages will bring inflation to 5.3% by YE20.

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