

Weekly Insight

Retail sales rise 12.1% YoY in January

Key messages of the today's comments

TUESDAY, 25 FEBRUARY 2020

Domestic liquidity and bonds market

Auctions may heat up

Last week, the MoF sold just UAH1.5bn (US\$62m) of bills to refinance principal repayments to the market, but the amount collected was less than the offering. So this week, the Ministry has announced an auction without cap for 7-year note in an effort to attract greater demand, although likely with higher rates.

Liquidity stable

Due to low quarterly tax payments total banking-sector liquidity remained high and rose very close to UAH250bn by the end of last week. This week, we do not expect any material changes in liquidity.

Foreign exchange market

Hryvnia slightly volatile at around UAH24.5/US\$

Last week, the hryvnia exchange rate was fluctuating around UAH24.5/US\$. But this week, with a primary auction without cap for 7-year note, we expect an increase in hard currency supply, which would cause slight hryvnia appreciation, but not to exceed UAH24.4/US\$.

Economics

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Consumer demand will be the key growth driver of Ukraine's economy in 2020.

Banks' reserves market (24 February 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	11.00	+0bp	-700bp
ON rate (%)	9.34	+19bp	-744bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	66,863	+0.76	+20.85
DepCerts (UAHm) ³	182,891	+0.25	+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) (24 February 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	325,527	-0.88	-3.44
Banks	321,431	-0.18	-13.95
Residents	26,261	+4.54	+0.85
Individuals	8,678	-2.48	+13.21
Non-res ⁴	128,630	-0.32	+831.38
Total	810,526	-0.37	+6.91

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

FX market indicators (24 February 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.4719	+0.56	-9.37
EUR/USD	1.0854	+0.57	-4.24
DX ²	99.359	-0.08	+2.96
UAH TWI ³	136.967	-0.43	+13.78

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

Gov't bond quotes¹ (25 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

Auctions may heat up

Last week, the MoF sold just UAH1.5bn (US\$62m) of bills to refinance principal repayments to the market, but the amount collected was less than the offering. So this week, the Ministry has announced an auction without cap for 7-year note in an effort to attract greater demand, although likely with higher rates.

So far this year, all auctions have had caps for each issue. However, last week, demand for all offered bills was below the offered amount, and proceeds significantly declined, while weighted-average cost of borrowings rose 10-27bp to 9.63-10.11%. See [auction comment](#) for details.

For this week, the Ministry announced an auction without cap for 7-year note, which should have a positive result. On one hand, it will not worsen the bid-to-cover ratio, if demand is low. On the other, unlimited offering can induce some investors to participate with larger bids, probably with higher interest rates.

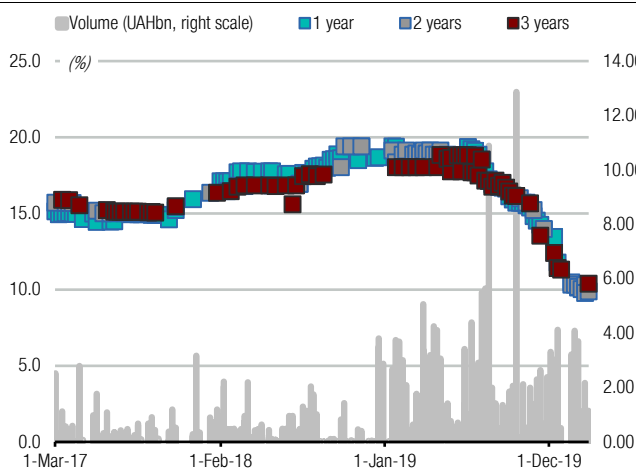
An auction without cap can increase state budget proceeds and would signal the MoF's flexibility and readiness to not only decrease, but also to increase rates in response to demand.

ICU view: It is very likely that demand will be high, especially due to the offering of a seven-year note without cap. But we do not expect booming demand. We can see an increase in interest rates accepted by the MoF for two-year and seven-year paper, similar to last week's auction, by 10-30bp compared with previous offerings of these instruments.

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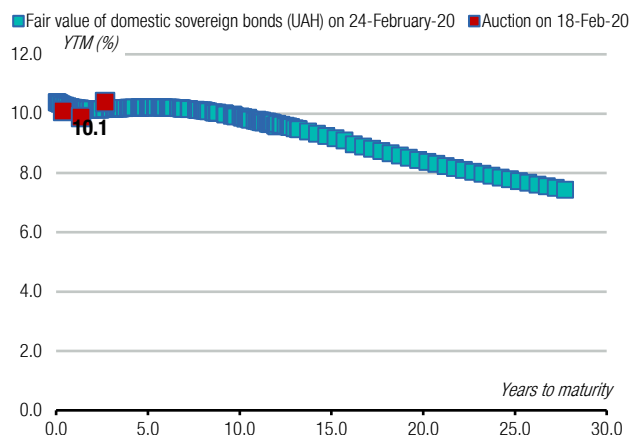
Chart 1. Local-currency bonds

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.

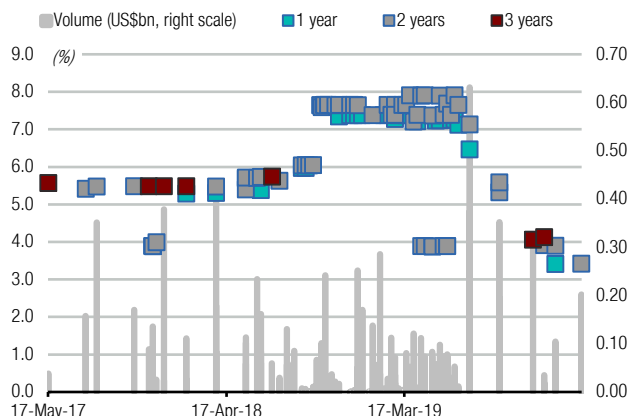
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

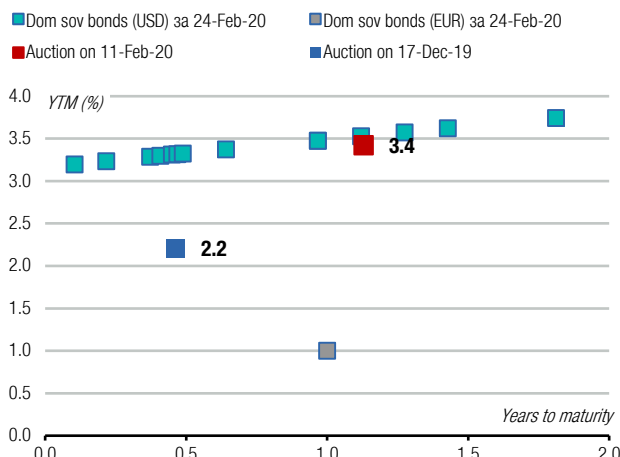
Chart 2. FX-denominated bonds

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 stable

Due to low quarterly tax payments total banking-sector liquidity remained high and rose very close to UAH250bn by the end of last week. This week, we do not expect any material changes in liquidity.

Last week, the balance of Treasury operations was negative, with an absorption of UAH3.3bn, while cash exchange in reserves partially compensated outflows by UAH1.2bn. An additional UAH3.1bn of liquidity was provided by the NBU by purchasing hard currency, causing liquidity to rise slightly to UAH249.8bn at the end of last week.

Treasury operations had a negative impact on liquidity due to low expenditures, not large tax collections. At the same time, the VAT refund was large, and so far this month, refunds are UAH6.8bn.

ICU view: This week, we expect on balance Treasury operations will still be negative for liquidity, but cash exchange in reserves and the NBU's purchase of hard currency will compensate outflows supporting liquidity to remain high and probably exceed UAH250bn.

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

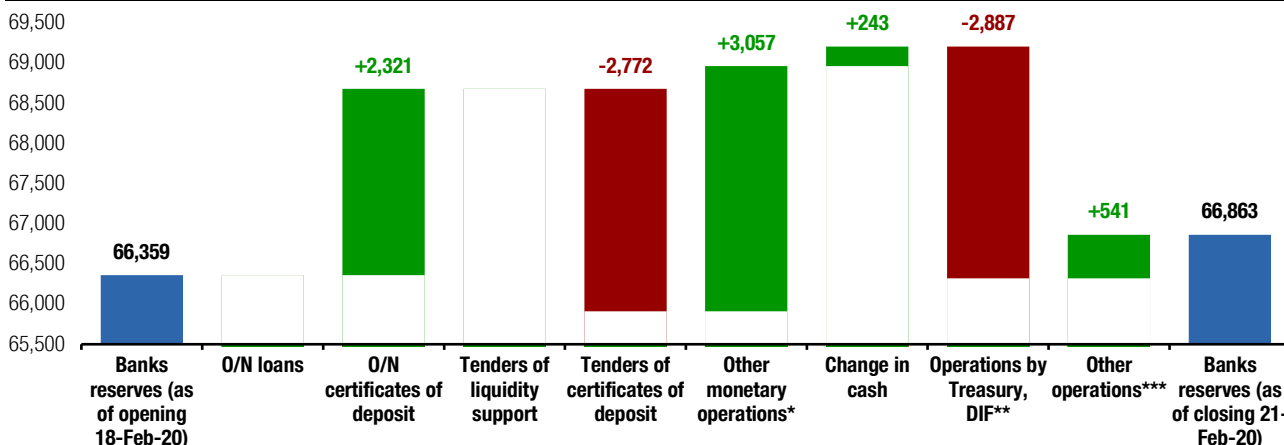
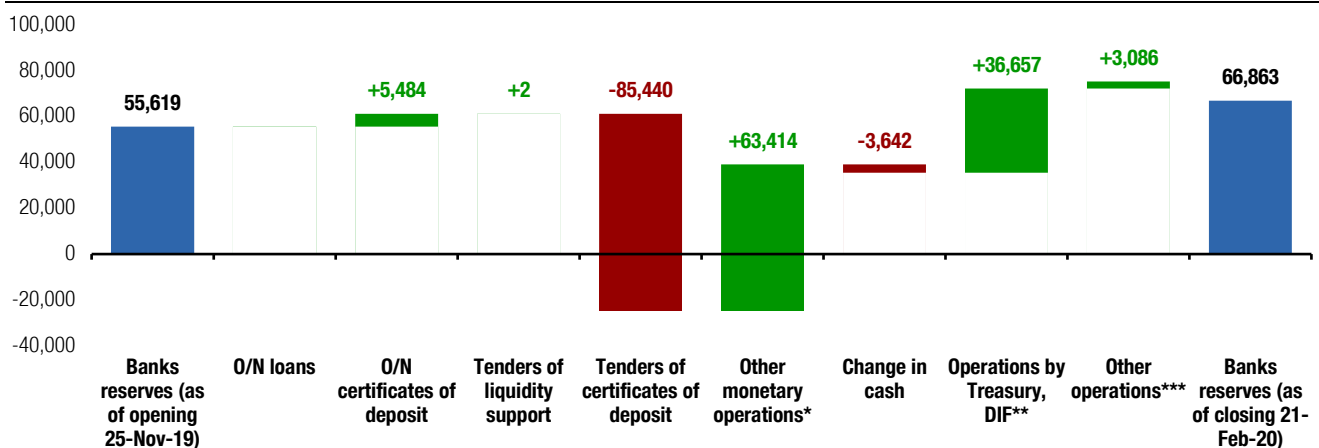


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 slightly volatile at around UAH24.5/US\$

Last week, the hryvnia exchange rate was fluctuating around UAH24.5/US\$. But this week, with a primary auction without cap for 7-year note, we expect an increase in hard currency supply, which would cause slight hryvnia appreciation, but not to exceed UAH24.4/US\$.

Low demand for new bills from foreigners last week, together with a low amount of quarterly tax payments, caused supply of hard currency to be equal to demand. Just US\$125m of extra supply was purchased by the NBU, less than the week before.

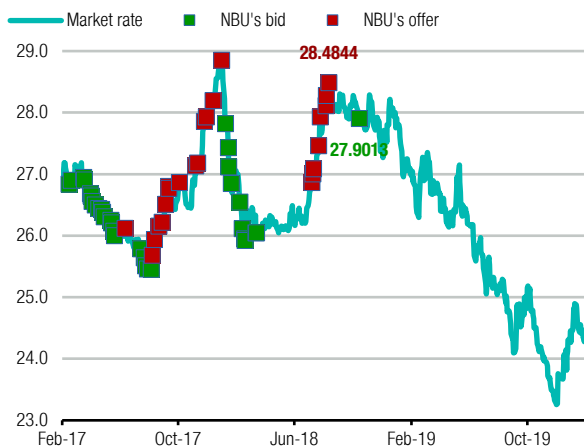
As the result, last week, the hryvnia appreciated by 0.1% to UAH24.455/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.5% to 136.9, while in YoY terms, it was up 14%.

ICU view: The current week may see an increase in supply of hard currency from both exporters and foreign investors in government debt. On one hand, there are month-end tax payments, and on the other, the MoF is offering 7-year note without cap, which can increase investments from foreigners. With large hard currency supply hryvnia may appreciate to about UAH24.4/US\$.

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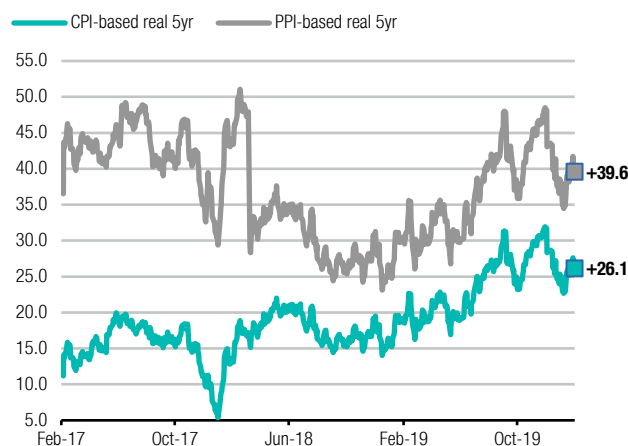
Chart 5. FX market indicators, 3-year history

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 sales rise 12.1% YoY in January

Consumer demand will be the key growth driver of Ukraine's economy in 2020.

Retail sales growth slightly slowed to 12.1% YoY in January 2020 from 12.5% YoY in December 2019, but far exceeded the growth rates seen in January 2019 (+6.3% YoY), per data from the Ukrstat.

ICU view: Retail sales were one of the key growth drivers of Ukraine's economy in 2019, having expanded 10.5%. We believe that consumer demand will remain the key growth driver of the economy this year also, being supported by further growth of real incomes of households and lower inflation.

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