

# Weekly Insight

## Weak start of 1Q20

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Hryvnia bonds not favoured

Last week's proceeds from domestic borrowings were low, just UAH1.6bn, but these borrowings represented new inflows from both local and foreign investors. This week, all bondholders' portfolios will decline, except where UAH-denominated redemptions will be replaced with new EUR-denominated bills.

##### Liquidity declines

Last week started with an increase in liquidity to UAH251.4bn, but tax payments and absorption by the NBU caused a decline to UAH239bn. This week, due to large debt repayments, liquidity can rise above UAH240bn.

#### Foreign exchange market

##### Hryvnia under pressure

Reticence of investors to purchase local-currency debt and the closing of the month-end tax payments period caused a new wave of pressure on the hryvnia exchange rate, which weakened to UAH24.57/US\$ last week. This week, large debt repayments will increase pressure, pushing it above UAH25/US\$.

#### Economics

##### Weak start of 1Q20

Retail sales keep rising at solid rates, but contraction in other real sectors of economy point to a weaker-than-expected 1Q20.

### TUESDAY, 3 MARCH 2020

#### Banks' reserves market (2 March 2020)

|                              | Last    | Weekly chg (%) | YoY chg (%) |
|------------------------------|---------|----------------|-------------|
| NBU rate (%) <sup>1</sup>    | 11.00   | +0bp           | -700bp      |
| ON rate (%)                  | 10.00   | +66bp          | -646bp      |
| ON \$ swap (%)               | 8.28    | +10bp          | -598bp      |
| Reserves (UAHm) <sup>2</sup> | 56,790  | -15.28         | +14.60      |
| DepCerts (UAHm) <sup>3</sup> | 182,172 | -0.52          | +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) (2 March 2020)

|                      | Last           | Weekly chg (%) | YoY chg (%)  |
|----------------------|----------------|----------------|--------------|
| NBU                  | 325,527        | +0.00          | -3.44        |
| Banks                | 322,785        | +0.86          | -11.08       |
| Residents            | 27,274         | +4.86          | +14.52       |
| Individuals          | 8,779          | +1.03          | +19.65       |
| Non-res <sup>4</sup> | 128,276        | -1.02          | +825.41      |
| <b>Total</b>         | <b>812,641</b> | <b>+0.35</b>   | <b>+8.88</b> |

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

#### FX market indicators (2 March 2020)

|                      | Last    | Weekly chg (%) | YTD chg (%) |
|----------------------|---------|----------------|-------------|
| USD/UAH              | 24.8483 | +1.44          | -7.41       |
| EUR/USD              | 1.1134  | +2.32          | -2.03       |
| DXY <sup>2</sup>     | 97.360  | -1.62          | +0.86       |
| UAH TWI <sup>3</sup> | 134.125 | -2.22          | +10.75      |

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

#### Gov't bond quotes<sup>1</sup> (3 March 2020)

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

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

# Domestic liquidity and bonds market

## Hryvnia bonds not favoured

Last week's proceeds from domestic borrowings were low, just UAH1.6bn, but these borrowings represented new inflows from both local and foreign investors. This week, all bondholders' portfolios will decline, except where UAH-denominated redemptions will be replaced with new EUR-denominated bills.

Large debt repayments are scheduled this week, UAH4.2bn in principal and UAH3.3bn in interest repayments in local currency. We anticipate that repayments will be for all groups of investors except the NBU. Some investors will use funds from repayments to purchase new bills, probably at the primary auction. Nonetheless, most UAH-denominated portfolios will decline for all groups of investors.

A large part of repayments will be made to foreigners. We expect the budget will pay to this group around UAH3bn, including about UAH1bn in principal and more than UAH2bn in interest repayments.

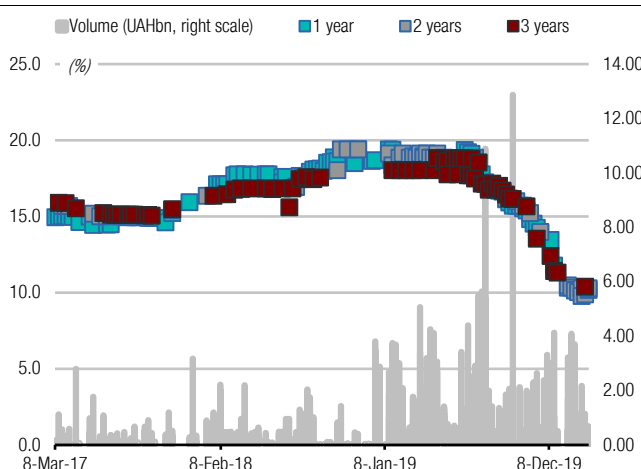
The offering of EUR-denominated bills, which was added to the originally planned issues, should allow local investors to replace some repayments in hryvnia with FX-denominated bills, providing the MoF with additional financing.

**ICU view: This week, the MoF decided to replace maturities above one year with FX-denominated bills. We expect this issue will receive the most demand and allow an increase in budget financing. For UAH-denominated issues, we expect a slight decline in rates for 6-month bills by 10–30bp to 9.7-9.9%, while for EUR-denominated issue it will be not higher than 2%.**

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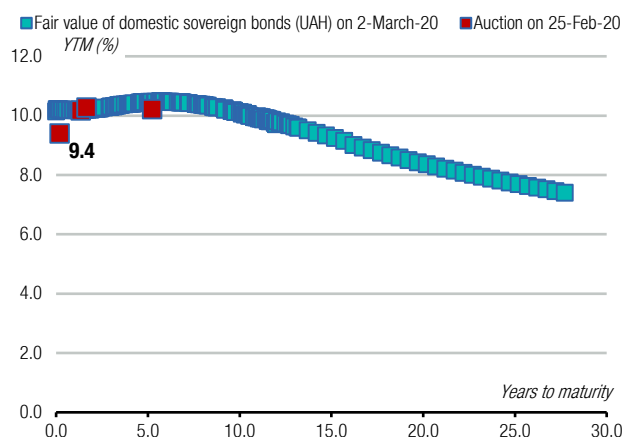
**Chart 1. Local-currency bonds**

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.

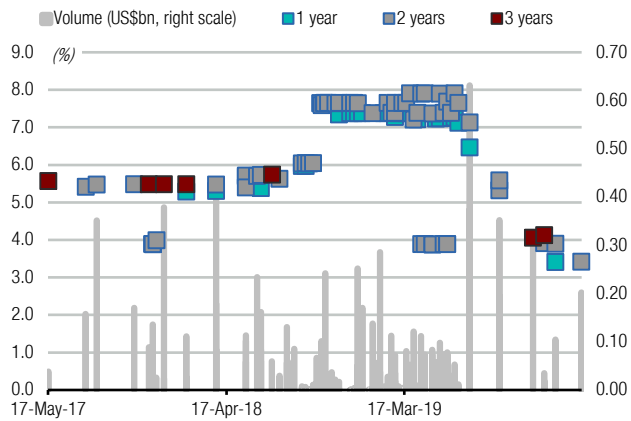
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

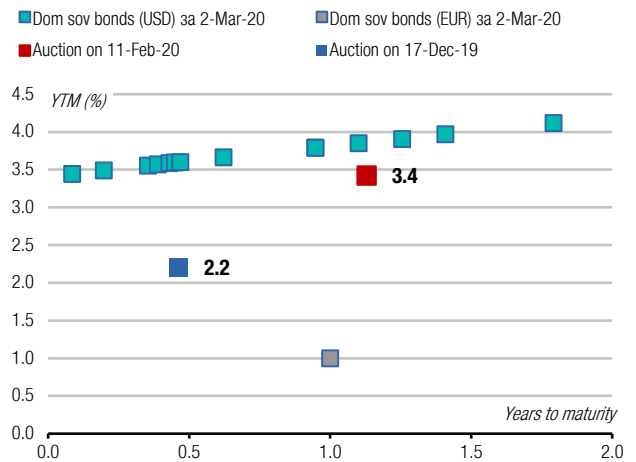
**Chart 2. FX-denominated bonds**

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 declines**

Last week started with an increase in liquidity to UAH251.4bn, but tax payments and absorption by the NBU caused a decline to UAH239bn. This week, due to large debt repayments, liquidity can rise above UAH240bn.

Cash exchange in reserves was probably the main source for the liquidity increase at the beginning of last week, but the slowing of this inflow with funds absorption by the Treasury reversed the impact of non-monetary operations to negative. Later in the week, Treasury absorption increased, and the NBU also had a negative impact on liquidity.

Liquidity set a new record high at UAH251.4bn last Tuesday, but from Wednesday it started to decline. By the end of last week, it slid to UAH239bn. However, the amount of NBU CDs in banks' portfolios remained large, above UAH180bn.

**ICU view: Debt repayments this week will be UAH7.5bn in local currency, and will be the main source for inflows into liquidity. It will be compensated by NBU absorption via the FX market. So, just part of these funds will stay in the banking system, slightly increasing liquidity above UAH240bn.**

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

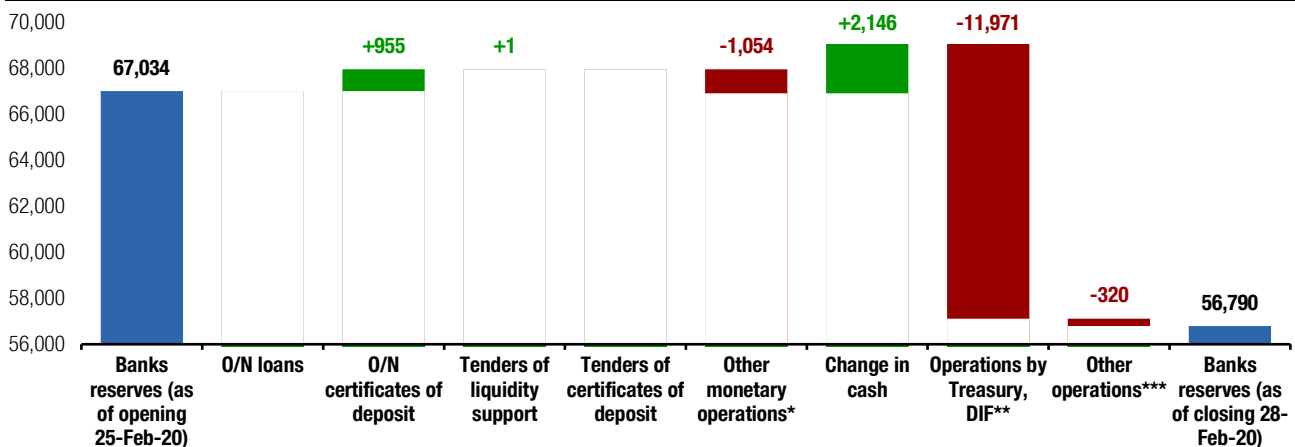
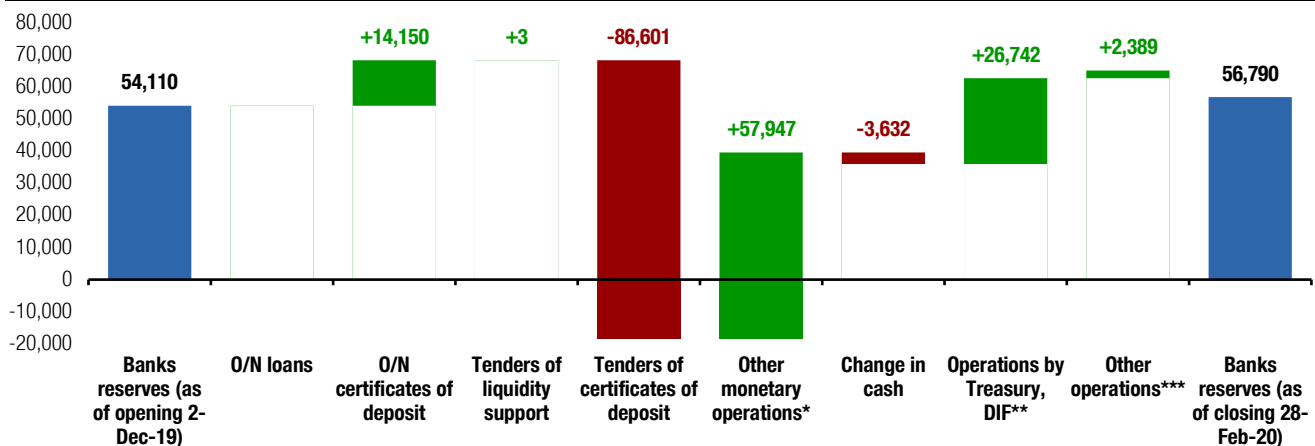


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

### Hryvnia under pressure

Reticence of investors to purchase local-currency debt and the closing of the month-end tax payments period caused a new wave of pressure on the hryvnia exchange rate, which weakened to UAH24.57/US\$ last week. This week, large debt repayments will increase pressure, pushing it above UAH25/US\$.

Despite active tax payments, last week (see comment above), the hryvnia exchange rate came under pressure, but without NBU's selling of hard currency. Only some of this pressure was from foreigners who sold UAH-denominated bills, as their portfolio slid by just US\$15m. Most demand could come from importers and dividends repatriation.

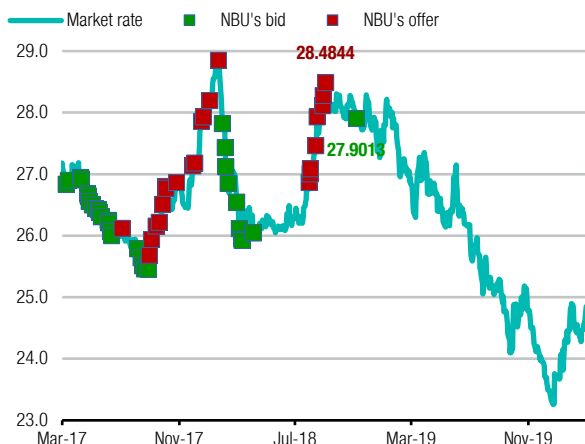
Finally, last week, the hryvnia weakened 0.47% to UAH24.57/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) slid 0.25% to 136.6, while in YoY terms, it was up 13.3%.

**ICU view: The hryvnia will be under significant pressure this week, which started last Friday. But demand will be concentrated in the second part of the week, as debt repayments will amount to UAH7.5bn, and probably at least UAH3bn will be paid to foreigners. Only part of debt repayments can be reinvested in new bills, while most of funds foreigners can spent in the FX market to withdraw funds from Ukraine. Additional demand for hard currency will come from local investors who would like to buy EUR-denominated bills instead of local-currency paper. NBU will restrain weakening, selling some FX from reserves. We do not anticipate significant hryvnia weakening, just to around UAH25-25.2/US\$.**

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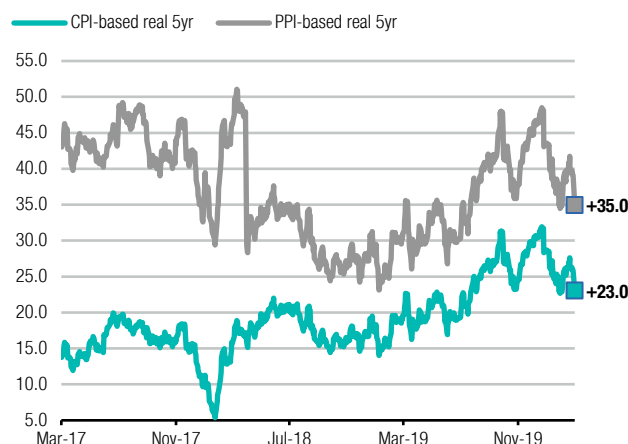
**Chart 5. FX market indicators, 3-year history**

*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 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

### Weak start of 1Q20

Retail sales keep rising at solid rates, but contraction in other real sectors of economy point to a weaker-than-expected 1Q20.

In January, retail sales expanded at a robust 12.1% YoY, construction rose 3.6% YoY, and passenger transportation turnover rose 0.6% YoY, per data from the Ukrstat. However, wholesale turnover declined by 2% YoY, industrial production by 5.1% YoY, agricultural output by 0.7% YoY, while cargo transportation turnover dropped 20.7% YoY. At the same time, the Ukrstat revised data for industrial production performance in 2019 to a 0.5% YoY contraction vs. the previous estimate of 1.8% contraction.

***ICU view: Robust expansion of retail sales implies still-solid consumer demand, which likely will be reflected in the performance of the services sector. However, unusually warm winter as well as lower prices and demand for metallurgical output and machinery and equipment result in the contraction of industrial output, while cargo transportation turnover declines due to lower transit volumes of Russian gas. While performance of the real sectors of economy point to weaker-than-expected 1Q20 growth, the current situation in world financial and commodity markets due to COVID-19 and expectations of a lower harvest this year create downside risks for our forecast of 2020 full-year real GDP growth, which we currently retain at 3.2%***

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