

Weekly Insight

Bond auctions on hold

Key messages of the today's comments

Domestic liquidity and bonds market

Bond auctions on hold

Last week, the MoF collected UAH6.6bn from domestic T-bills. Banks' portfolios rose due to the placement of FX-denominated bills, but other bondholders decreased their portfolios, as there was a UAH4.2bn redemption. There will not be a primary auction this week, so we expect a decline in the portfolios of foreign investors.

Liquidity declines

After large tax payments at the end of February, March started with large budget expenditures, which caused an increase in liquidity, and its recovery above UAH240bn. But last Friday new wave of tax payments about UAH13bn caused liquidity decline to UAH228.5bn and it will slide this week to about UAH220bn.

Foreign exchange market

NBU supports hryvnia

Transitioning from month to month, the decline in foreigners' portfolios, and large debt repayments did not have substantial negative impact on the hryvnia. This week, due to worsened conditions in global markets, hryvnia will remain under pressure, with volatility inside range UAH25-25.5/US\$.

Economics

Real GDP fell 0.5% in January — Ministry of Economy

The spread of COVID-19 is hurting the world economy, and will have negative impact on Ukraine's economy in 1H20.

C/A deficit at 0.7% of GDP in January

Lower world price for oil and natural gas will continue to support Ukraine's C/A balance this year. However, strong consumer imports and a lower expected harvest will bring about some C/A deficit widening this year.

TUESDAY, 10 MARCH 2020

Banks' reserves market (6 March 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	11.00	+0bp	-700bp
ON rate (%)	9.42	-58bp	-705bp
ON \$ swap (%)	8.29	+7bp	-629bp
Reserves (UAHm) ²	57,757	-4.31	+21.25
DepCerts (UAHm) ³	186,977	+1.21	+197.06

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) (6 March 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	325,527	+0.00	-3.44
Banks	328,013	+2.24	-9.52
Residents	27,336	+0.12	+12.51
Individuals	8,735	-0.52	+19.30
Non-res ⁴	126,074	-2.50	+819.13
Total	815,686	+0.49	+9.36

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

FX market indicators (6 March 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.8959	+1.33	-5.95
EUR/USD	1.1284	+2.34	-0.20
DX ²	95.951	-2.22	-0.95
UAH TWI ³	133.683	-2.13	+8.63

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

Gov't bond quotes¹ (10 March 2020)

Maturity	Bid	Ask
6m	13.75	11.00
12m	13.75	11.00
2y	13.75	11.00
3y	13.75	11.00
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

Bond auctions on hold

Last week, the MoF collected UAH6.6bn from domestic T-bills. Banks' portfolios rose due to the placement of FX-denominated bills, but other bondholders decreased their portfolios, as there was a UAH4.2bn redemption. There will not be a primary auction this week, so we expect a decline in the portfolios of foreign investors.

The MoF resolved the low funding problem last week by offering FX-denominated bills for the second time this year. Last week, the Ministry decided to cancel the offering for 1.5-year and three-year paper. All demand was concentrated in six-month bills with slight changes in rates. The cut-off rate remained steady at 10%, while the weighted-average rate rose 8bp to 9.9%. However, for bills denominated in euros, the movements were the opposite. The cut-off rate declined by 5bp to 2.25%, while the weighted-average rate remained steady at 2.22%. More details in the [auction review](#).

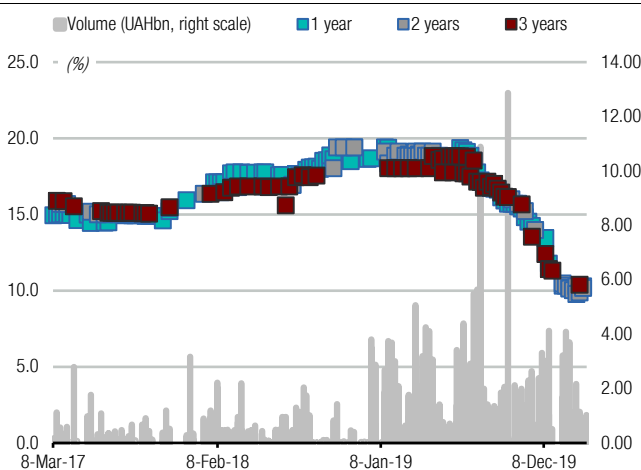
As FX-denominated bills usually are purchased by local banks, after last week's auction, only their portfolios rose. They now have UAH329.6bn in bills or 40.4% of all domestic bills. Nevertheless, at the same time, foreigners decreased their portfolios after redemptions and selling in the secondary market. Our assumption is that at least UAH0.5bn of redemption was paid to foreign investors. Last week, their portfolios declined by UAH1.8bn to UAH125.3bn, and their overall share slid to 15.4%, as some local-currency bills were replaced in portfolio with new EUR-denominated paper.

ICU view: Due to high volatility in global capital markets and falling demand for risky assets of emerging markets, foreigners slightly decreased their portfolios of local-currency bills. These bills were purchased by local investors, which made new primary auctions unnecessary, especially prior to the revision of NBU's key policy rate. Therefore, the Ministry decided to cancel this week's auction.

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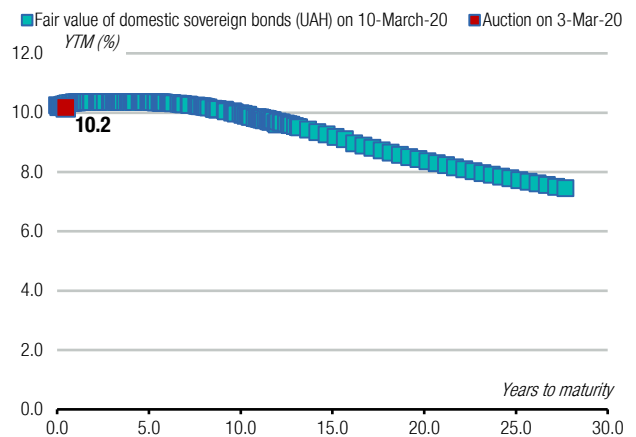
Chart 1. Local-currency bonds

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.

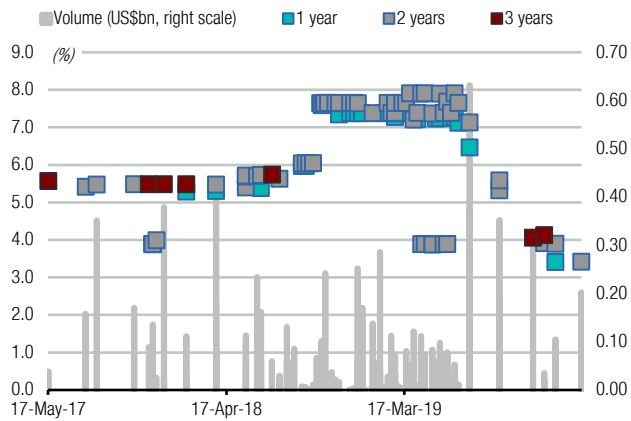
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

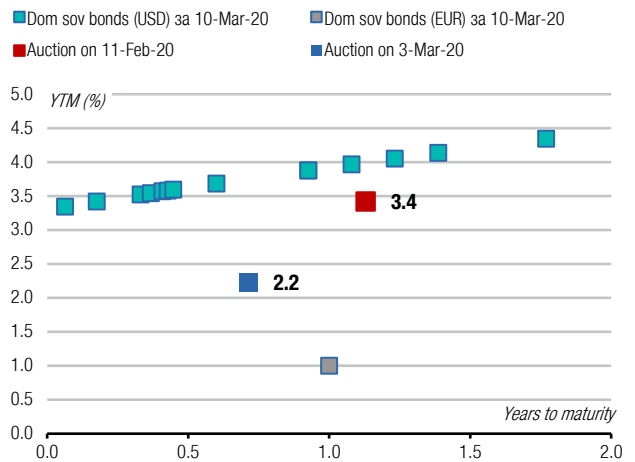
Chart 2. FX-denominated bonds

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

After large tax payments at the end of February, March started with large budget expenditures, which caused an increase in liquidity, and its recovery above UAH240bn. But last Friday new wave of tax payments about UAH13bn caused liquidity decline to UAH228.5bn and it will slide this week to about UAH220bn.

Last Wednesday, the Treasury increased budget expenditures, thus boosting liquidity, but last Friday most of these funds were absorbed back, decreasing positive impact just to UAH1.3bn. The largest outflow was caused by reserves exchange in cash at UAH8.5bn during last week. Additionally, NBU absorbed UAH4bn through FX market. As the result, liquidity declined by UAH10.5bn to UAH228.5bn, the lowest level since mid of January, 2020.

Banks still kept liquidity in NBU CDs. After last week's tender of two-week CDs, their outstandings slid to UAH148.5bn, while another UAH25.6bn was invested in ON CDs. An additional UAH54.4bn of liquidity was on banks' correspondent accounts with the NBU.

ICU view: *This week, the government will maintain a positive impact on liquidity, spending more than it collects in revenues. Therefore, we anticipate liquidity to be slightly volatile, but due to NBU absorption through FX market, liquidity can decline to UAH220bn.*

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

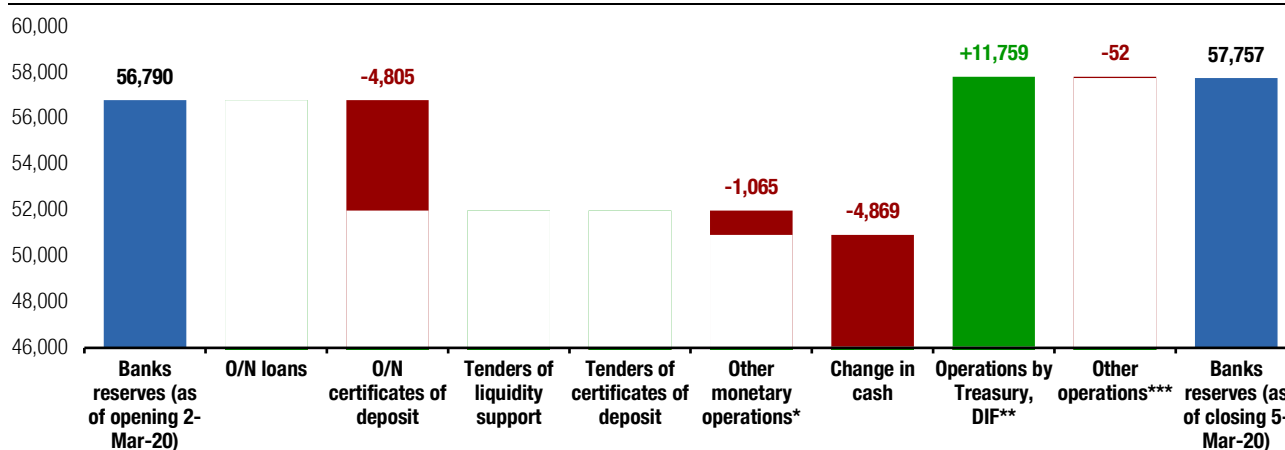
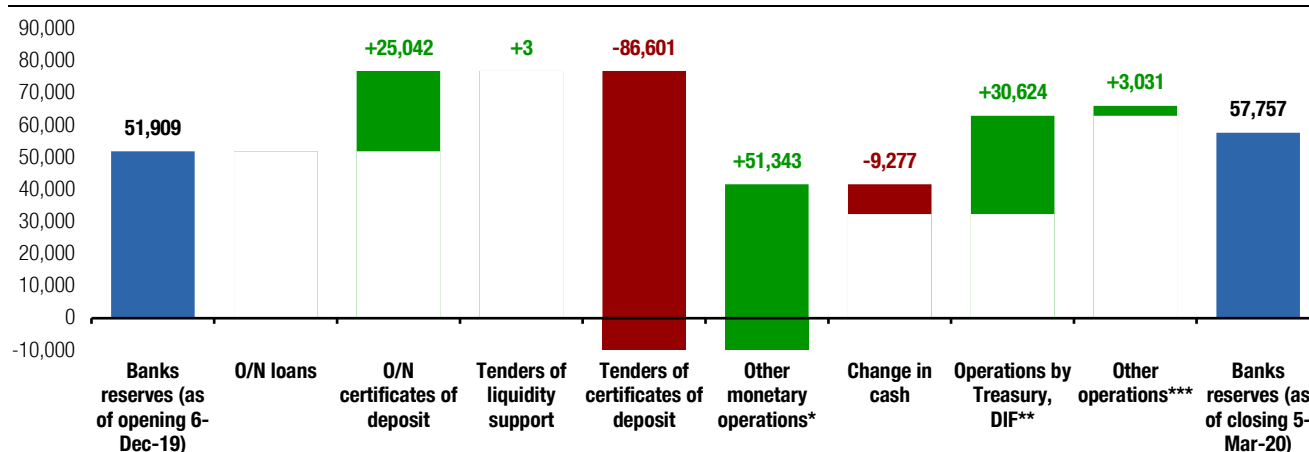


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

NBU supports hryvnia

Transitioning from month to month, the decline in foreigners' portfolios, and large debt repayments did not have substantial negative impact on the hryvnia. This week, due to worsened conditions in global markets, hryvnia will remain under pressure, with volatility inside range UAH25-25.5/US\$.

Last week, the MoF paid UAH4.2bn to redeem local-currency bonds along with an additional UAH3.3bn in interest payments. We assume that at least UAH3bn was paid to foreigners.

The weakening at the end of February and at the beginning of March could be due to the purchases of hard currency to support repayments of debt to foreigners. In line with preparing for redemptions, some selling of local-currency bills was seen by foreigners. After weakening at the beginning of last week to UAH25/US\$, on Wednesday and Thursday the hryvnia made an attempt to strengthen to UAH24.7/US\$, but last Friday returned to UAH24.9/USD.

All these movements of the exchange rate were with the NBU's participation in the market. It sold US\$307m and purchased US\$150m, but net interventions were to support the hryvnia and satisfy extra demand, which restrained significant weakening.

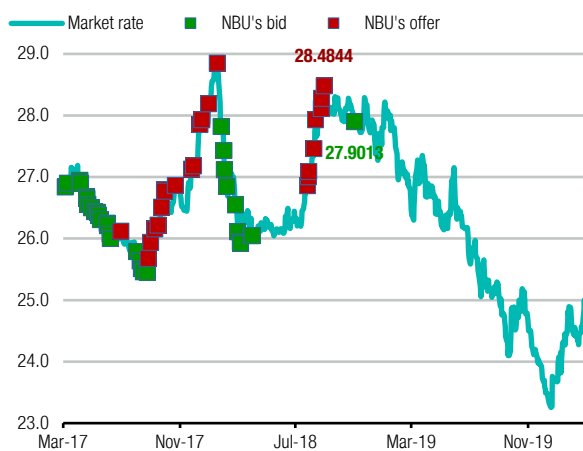
As a result, last week, the hryvnia weakened by 1.3% to UAH24.9/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) slid 2.1% to 133.7, while in YoY terms, it was up 8.6%.

ICU view: Debt repayments and selling of bills by foreigners in the secondary market caused additional pressure on the hryvnia exchange rate, which induced the NBU to sell hard currency from reserves. This week, we anticipate that pressure on hryvnia will remain, or slightly increase due to situation in global markets. With NBU's interventions hryvnia should be volatile inside the range of UAH25.0-25.5/US\$.

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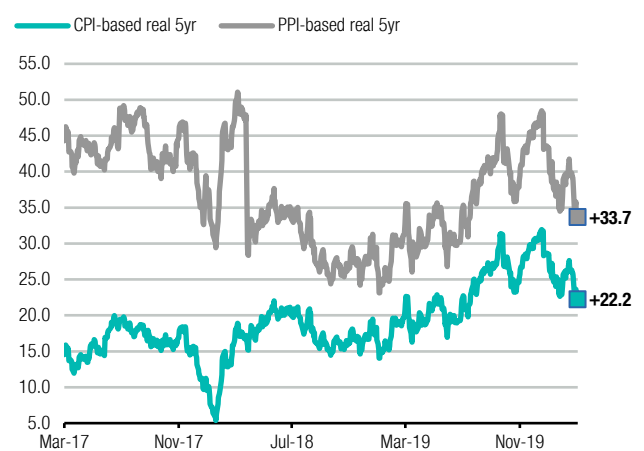
Chart 5. FX market indicators, 3-year history

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

Real GDP fell 0.5% in January — Ministry of Economy

The spread of COVID-19 is hurting the world economy, and will have negative impact on Ukraine's economy in 1H20.

The Ministry of Economy estimates that the Aggregate Production Index fell 2.6% YoY in January, which implies a 0.5% YoY decline in real GDP. Most industries included in the index posted a contraction in January — industrial production declined by 5.1% YoY, agricultural output by 0.7% YoY, and the transport sector by 4% YoY. The growth was in trade (+2.7% YoY) and construction (+3.6% YoY).

ICU view: While January's performance of different industries points 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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C/A deficit at 0.7% of GDP in January

Lower world price for oil and natural gas will continue to support Ukraine's C/A balance this year. However, strong consumer imports and a lower expected harvest will bring about some C/A deficit widening this year.

In January, the C/A surplus remained virtually flat YoY at US\$0.6bn, while in annualized terms there was a C/A deficit of US\$1.1bn (est. 0.7% of GDP), per data from the NBU. When adjusted for a US\$2.9bn payment from Gazprom received in December 2019, the annualized C/A deficit amounted to US\$4bn (2.6% of GDP). In January, merchandise exports rose 2.3% YoY, driven by agricultural products (+14% YoY), ores (+18%), and machinery and equipment (+34% YoY). Exports of metals dropped 26% YoY. Imports of goods declined 1.7% YoY mainly thanks to a 19% YoY decline in imports of energy products. On a 12-month trailing basis, the merchandise-trade-balance deficit was US\$13.8bn (+11% YoY, 8.9% of GDP) in January, while the services-trade-balance surplus rose 15% YoY to US\$1.8bn.

ICU view: Lower world energy prices will continue to support Ukraine's C/A balance this year. At the same time, consumer imports remain strong, while the expected lower harvest this year combined with lower metal and ores prices will cause C/A deficit widening to 2.7% of GDP in 2020 vs. 2.6% in 2019 (adjusted for \$2.9bn payment from Gazprom in December 2019).

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