

Weekly Insight

Weak economic growth in February

Key messages of the today's comments

Domestic liquidity and bonds market

Domestic FX financing

Last week budget continued to borrow in hard currency to finance state budget deficit. At last week's auction borrowings amount increases, and after settlement was mostly accounted in non-banks group of investors. For this week, MoF cancelled offering of local-currency paper, success of which was in great doubt.

Liquidity stabilizes

After some weeks of active decline in liquidity due to NBU's interventions in FX market, last week liquidity become steady slightly above UAH180bn. Treasury also supported stabilization with positive balance of its operations. With NBU loans redemption, liquidity declined to UAH174bn last Friday, and this week will be slightly volatile at around UAH170-180bn.

Foreign exchange market

Hryvnia fluctuates at around UAH28/US\$

Changes in balance in FX market supported hryvnia exchange rate stabilization and lower NBU's intervention. Finally hryvnia was fluctuating close to our expectations, at around UAH28/US\$, where it can stay this week in the absence of external news and local political issues.

Economics

Weak economic growth in February

Production, transport and retail turnover data might imply some economic growth in February, but the impact of COVID-19 will be felt since March.

TUESDAY, 31 MARCH 2020

Banks' reserves market (30 March 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	10.00	+0bp	-800bp
ON rate (%)	13.48	+313bp	-305bp
ON \$ swap (%)	9.16	-32bp	-539bp
Reserves (UAHm) ²	56,020	-29.04	+3.78
DepCerts (UAHm) ³	117,532	+13.88	+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) (30 March 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	347,060	+1.16	-6.42
Residents	52,968	+83.31	+107.20
Individuals	9,510	+1.37	+17.13
Non-res ⁴	121,140	-2.50	+481.48
Total	855,254	+3.02	+12.17

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

FX market indicators (30 March 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	28.1050	+1.67	+2.76
EUR/USD	1.1048	+2.41	-1.52
DXY ²	99.181	-2.80	+1.95
UAH TWI ³	125.927	-2.33	+5.24

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

Gov't bond quotes¹ (31 March 2020)

Maturity	Bid	Ask
6m	22.00	15.00
12m	22.00	15.00
2y	22.00	15.00
3y	22.00	15.00
12m (\$)	5.00	3.00
2y (\$)	6.00	3.50

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

Domestic liquidity and bonds market

Domestic FX financing

Last week budget continued to borrow in hard currency to finance state budget deficit. At last week's auction borrowings amount increases, and after settlement was mostly accounted in non-banks group of investors. For this week, MoF cancelled offering of local-currency paper, success of which was in great doubt.

At last week's auction, MoF offered two FX-denominated bills, which were successfully sold. 3-month USD-denominated bills were sold at slightly above US\$800m at 3% cut-off rate, while 13-month bills in euro saw lower demand and sold at EUR76m with 2.22% coupon rate. More details in [auction review](#).

As the result of these bills settlement, issue in euro was mostly purchased by local banks, while USD-denominated bills were purchased by non-banks. We assume that this investor can be Naftogas, as it has large amount of funds received from Russia according to court decision. These funds the most likely will be needed during summer to buy gas in reserves for second winter, as prices can be seasonally lower. So, these funds can be used now to earn some profit, higher than at banks' deposits. According to the NBU's data in March, average rate for deposits in hard currency for companies was 1.4%.

Therefore, last week bond holding structure saw slight changes. Banks' share slid by 70bp to 40.6%, while non-banks group share rose from 3.6% to 6.2%. Individuals' share remained steady at 1.1%, but foreign investors continued to sell bills and their share slid by 70bp to 14.2%.

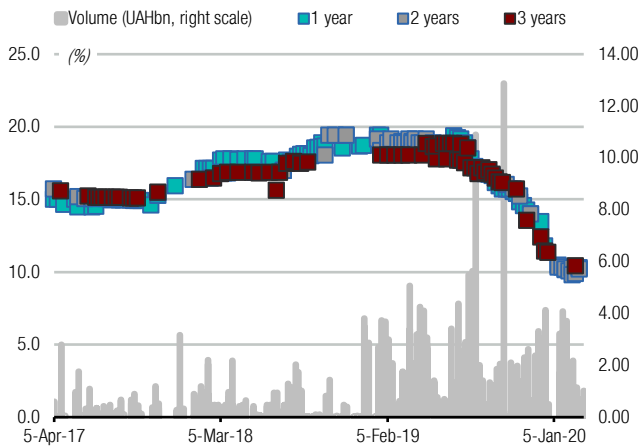
In fact, only foreigners' portfolio declined in par value. They sold UAH3.1bn of local-currency bills (about US\$111m), increased withdrawal from Ukrainian debt to UAH8.5bn during this month (about US\$300m). Their portfolio of UAH-denominated bills declined to UAH118bn (US\$4.2bn).

ICU view: For this week, the MoF decided to cancel primary auction. The decision was made after consultations with primary dealers. Afterwards the MoF is going to perform auctions as usual, but we do not rule out some changes to the schedule. We think this decision came as a result of low or lack of demand for UAH-denominated paper. Interest rates in the secondary market imply auction rates should more than double since February, which the MoF is unlikely to accept, so it was the best choice to cancel this auction, the second time in March.

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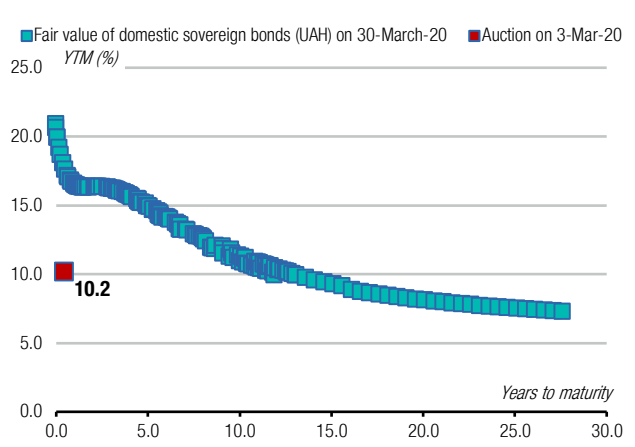
Chart 1. Local-currency bonds

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.

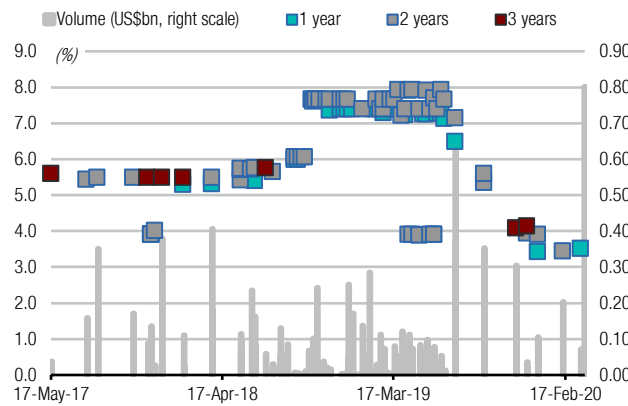
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

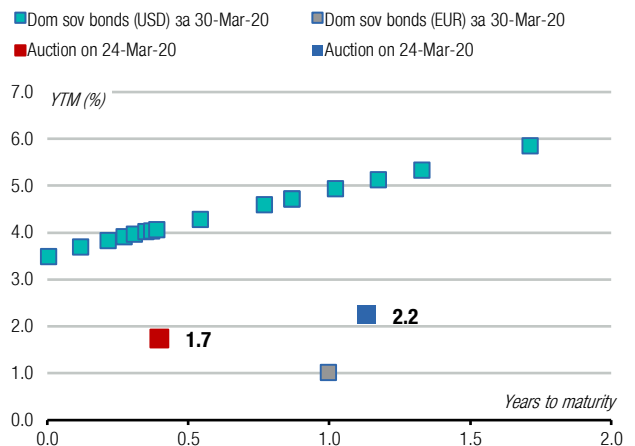
Chart 2. FX-denominated bonds

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 stabilizes

After some weeks of active decline in liquidity due to NBU's interventions in FX market, last week liquidity become steady slightly above UAH180bn. Treasury also supported stabilization with positive balance of its operations. With NBU loans redemption, liquidity declined to UAH174bn last Friday, and this week will be slightly volatile at around UAH170-180bn.

Decline in NBU's FX interventions to US\$77m during last week from US\$1bn a week before, supported liquidity. On the other hand, banks repaid about UAH10bn of refinancing loans, caused liquidity outflow to the NBU at about UAH15bn last week.

However, tax payments just started to increase at the end of last week, keeping Treasury operations balance positive for liquidity. Inflow from budget was at UAH5.4bn.

ICU view: This week liquidity can increase volatility, as at the beginning of this week taxes collection can increase, with compensation through expenditures and debt repayments (UAH5.8bn) the most likely from Wednesday and later this week. Therefore

we do not anticipate liquidity decline and it will stay at around UAH170-180bn at the end of this week.

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

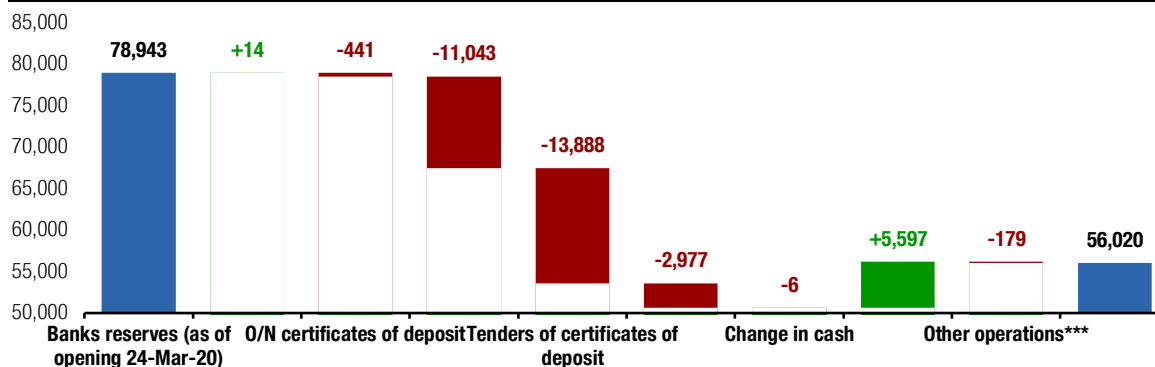
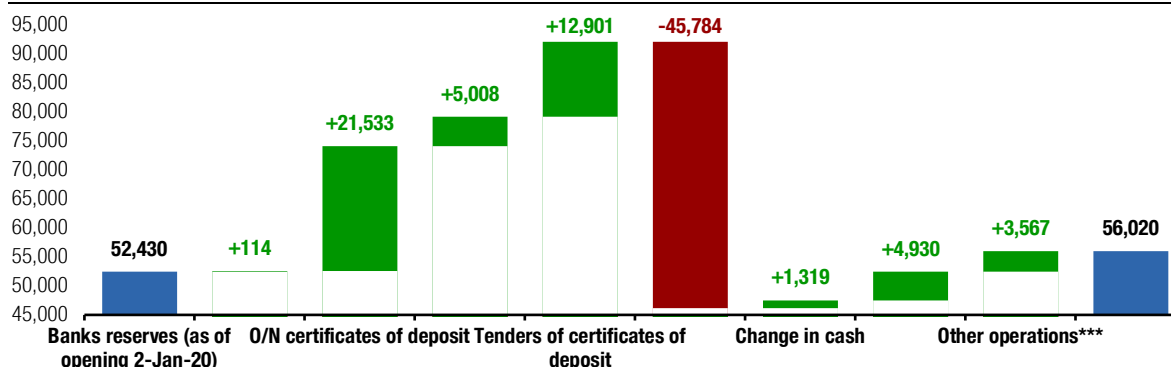


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 fluctuates at around UAH28/US\$

Changes in balance in FX market supported hryvnia exchange rate stabilization and lower NBU's intervention. Finally hryvnia was fluctuating close to our expectations, at around UAH28/US\$, where it can stay this week in the absence of external news and local political issues.

At the beginning of last week hryvnia exchange rate was in a zone of uncertainty, waiting for new government decisions fighting COVID-19 and steps towards IMF program. As last Friday the IMF indicated the main steps which Ukraine has to do to receive the Fund support, the market became quite positive and the exchange rate remained close to UAH28/US\$.

As the result, during last week hryvnia weakened 2.1% to UAH28.06/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) slid 4% to 125.3, while in YoY terms, it was up 4.5%.

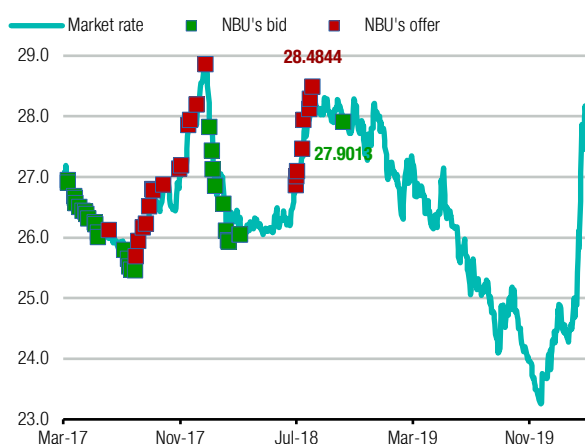
The NBU participated in the market during three out of five business days, sold in total US\$77m to satisfy extra demand. In addition, the NBU sold US\$130m to banks in cash but with payment also in hard currency. The NBU also reported that it saw increase in hard currency supply in excess of demand.

ICU view: This week hryvnia exchange rate will depend on Parliament decisions and news about the IMF program, as they will have main impact on market. With positive newsflow about the IMF, hryvnia will stay close to UAH28/US\$. However, negative news may accelerate the hryvnia's weakening.

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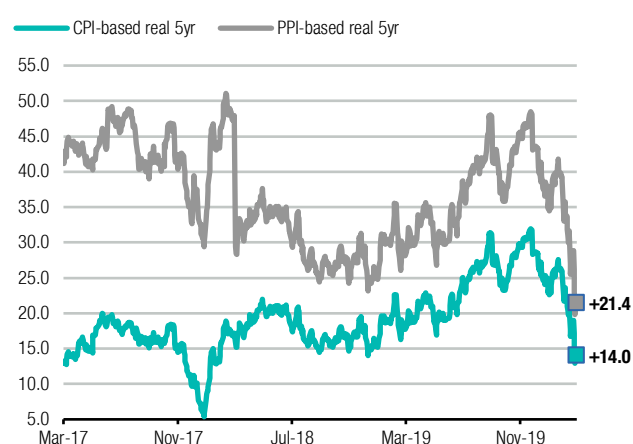
Chart 5. FX market indicators, 3-year history

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

Weak economic growth in February

Production, transport and retail turnover data might imply some economic growth in February, but the impact of COVID-19 will be felt since March.

In February, retail sales growth accelerated to 15.7% YoY and agricultural output rose 1% YoY. The contraction of industrial output slowed to 1.5% YoY in February from 4.9% YoY in January, while the cargo transportation turnover fell 11.1% YoY vs. 20.7% YoY decline in January. Passenger transportation turnover was flat YoY, but construction sector shrank 4.2% YoY vs. 3.6% YoY growth in January.

ICU view: The consumer demand, the key growth driver of Ukraine's economy this and last years, will drop significantly due to imposed quarantine, falling incomes of households, weaker UAH and worsening consumer expectations. Production and services sector will also see a large contraction. The impact of COVID-19 on Ukraine's economy will be partially felt in March, but the main hit is expected to start in April as economic activity of businesses and population will contract substantially.

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