



Focus
Ukraine

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

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Weekly Insight

Ukraine closer to IMF deal

Key messages of the today's comments

Domestic liquidity and bonds market

Bond portfolios decline

Without primary auctions, and due to debt repayments and hryvnia appreciation, all bondholder groups saw a decline in government bond holdings. This week, due to a cancelled auction, we can see just slight changes in all portfolios.

NBU and Treasury support liquidity

The liquidity dynamic become positive last week after falling to UAH170bn on Tuesday. By the end of the week liquidity recovered to UAH187bn. This week, we will see a positive balance of Treasury and NBU operations, with a liquidity increase towards UAH200bn.

Foreign exchange market

Hryvnia appreciates

After the initial panic due to the coronavirus pandemic and quarantine regime, the FX market has calmed down and the hryvnia appreciated by 2.3% last week. With positive news flow and progress in Parliament's voting for bills needed for the IMF programme, the hryvnia should continue to slightly appreciate, and this week can cross the level of UAH27/US\$.

Economics

C/A deficit at 0.7% of GDP in February

Lower world prices for oil and natural gas and a drop in consumer imports will compensate for the contraction in metallurgical exports and remittances.

Ukraine closer to IMF deal

Rada passed a land reform bill in the second reading and is preparing to vote on the banking law, which will open the way for a new IMF deal.

TUESDAY, 7 APRIL 2020

Banks' reserves market (6 April 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	15.50	+550bp	-250bp
ON rate (%)	10.86	+151bp	-558bp
ON \$ swap (%)	7.34	-183bp	-707bp
Reserves (UAHm) ²	49,752	-8.31	+8.21
DepCerts (UAHm) ³	137,299	+18.75	+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) (6 April 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	339,749	-2.11	-7.78
Residents	51,878	-2.48	+102.21
Individuals	8,591	-9.40	+6.22
Non-res ⁴	118,117	-2.44	+398.11
Total	842,911	-1.46	+10.47

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

FX market indicators (6 April 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.1138	-1.83	+1.61
EUR/USD	1.0793	-2.16	-3.77
DXY ²	100.685	+1.65	+3.38
UAH TWI ³	131.164	+2.49	+7.06

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

Gov't bond quotes¹ (7 April 2020)

Maturity	Bid	Ask
6m	20.00	15.00
12m	20.00	15.00
2y	20.00	15.00
3y	20.00	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

Bond portfolios decline

Without primary auctions, and due to debt repayments and hryvnia appreciation, all bondholder groups saw a decline in government bond holdings. This week, due to a cancelled auction, we can see just slight changes in all portfolios.

The largest decline was seen in the portfolios of banks, as they received redemptions from both UAH and USD-denominated paper; other bills in FX were repriced with a new and stronger hryvnia exchange rate. Banks' portfolios declined by UAH7.3bn (US\$267m) to UAH340bn (US\$12.5bn). The portfolios of individuals slid by UAH0.9bn (US\$33m) to UAH8.6bn (US\$315m).

Non-banking investors purchased the new portion of UAH-denominated bills, but their investments were not enough to compensate for redemption and the decline in FX-denominated portfolios due to the stronger hryvnia. Their portfolios slid by UAH1bn (US\$37m) to UAH51.9bn (US\$1.9bn).

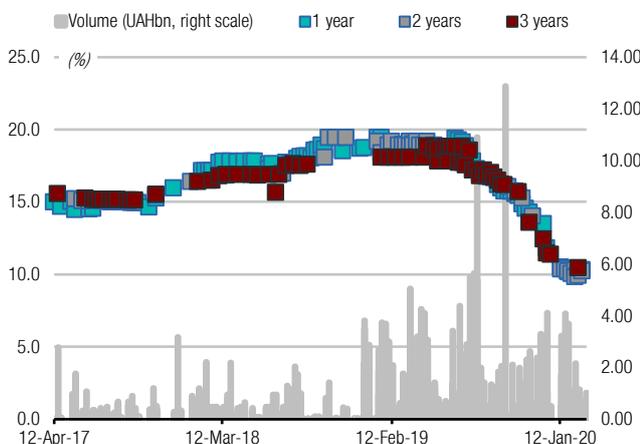
Most of the decrease in foreigners' portfolios was in UAH-denominated instruments. Last week, their UAH portfolios declined by UAH2.8bn (US\$103m) to UAH115.5bn (US\$4.2bn). Our best guess is that the decline was mostly due to debt redemptions, not selling bills in the secondary market. This group's total portfolios declined by UAH3bn (US\$110m) to UAH118bn (US\$4.3bn), which in UAH terms is larger than this year's low of UAH2bn seen on 8 January at UAH116bn. But in US\$ terms, it is slightly below this level due to today's weaker hryvnia by US\$0.6bn.

ICU view: The general outlook on Ukrainian debt remains restrained. We expect foreigners will continue to reduce holdings in local-currency bills. However, Ukrainian banks can buy some paper from foreigners, especially due to lack of primary auctions.

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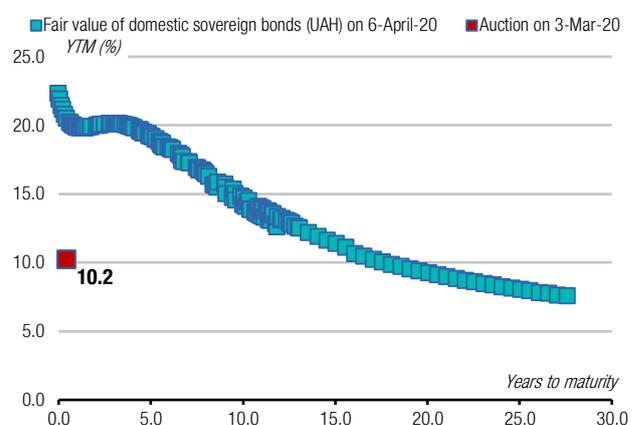
Chart 1. Local-currency bonds

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.

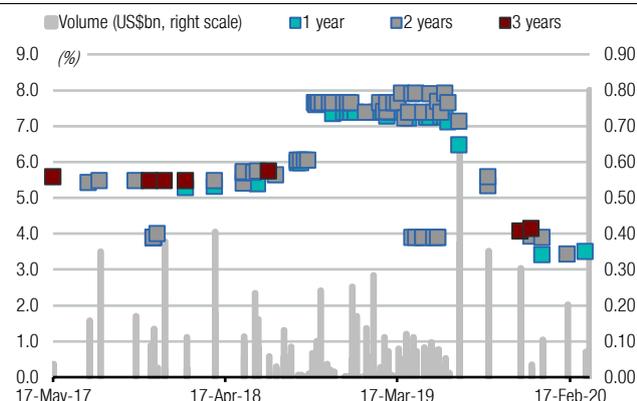
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

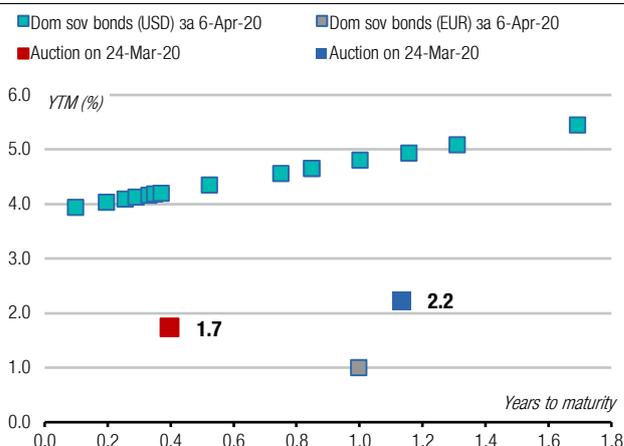
Chart 2. FX-denominated bonds

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.

NBU and Treasury support liquidity

The liquidity dynamic become positive last week after falling to UAH170bn on Tuesday. By the end of the week liquidity recovered to UAH187bn. This week, we will see a positive balance of Treasury and NBU operations, with a liquidity increase towards UAH200bn.

FX market conditions turned positive (see comment below), and the NBU purchased extra supply of hard currency injecting UAH6.8bn into banking-sector liquidity. At the same time, banks exchanged UAH1.6bn of reserves in cash.

However, NBU paid to the budget UAH42.7bn of its profit from 2019, which allowed the Treasury to increase expenditures. In total last week, expenditures exceeded revenues by UAH8.3bn, having a positive impact on liquidity.

Thanks to these injections, banking-sector liquidity was up UAH17bn from it's lowest level of UAH170bn seen last Tuesday, before rising at the end of the week to UAH187bn.

ICU view: This week, we anticipate a positive impact from NBU and Treasury's operations and a further increase in liquidity. The total amount of liquidity will move towards and close to UAH200bn.

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

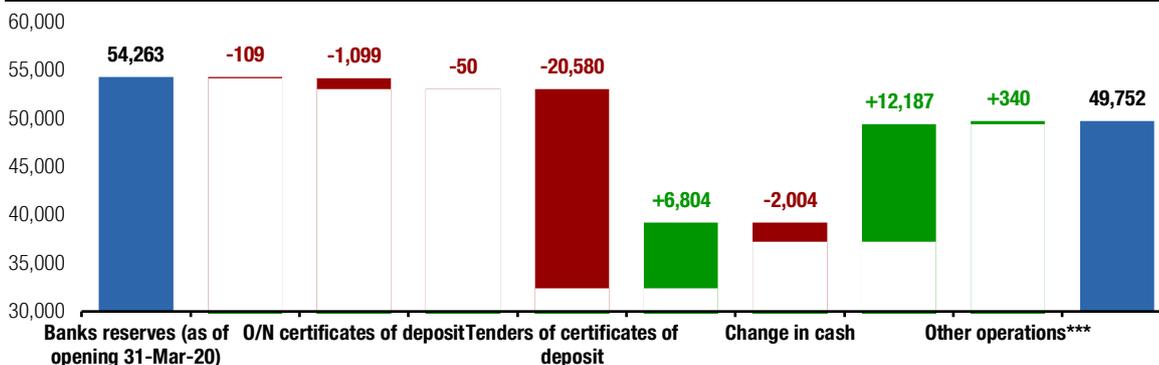
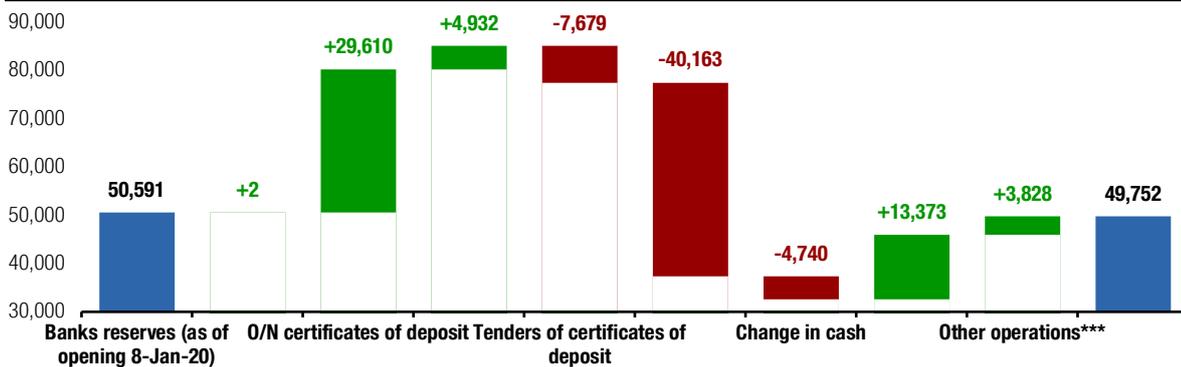


Chart 4. Banks reserves usages over last 90-day period (UAHm)


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 appreciates

After the initial panic due to the coronavirus pandemic and quarantine regime, the FX market has calmed down and the hryvnia appreciated by 2.3% last week. With positive news flow and progress in Parliament's voting for bills needed for the IMF programme, the hryvnia should continue to slightly appreciate, and this week can cross the level of UAH27/US\$.

After a significant decline in NBU's selling of hard currency a week ago, last week, the NBU intervened with a hard currency purchase in the amount of US\$248m, partially compensating reserves spent on interventions earlier this year. The total balance of NBU's interventions this year at the end of last week was US\$1.2bn of sold hard currency from FX reserves.

Also, to restore confidence and provide banks with hard currency cash, the NBU twice held auctions selling cash of US\$421m to banks.

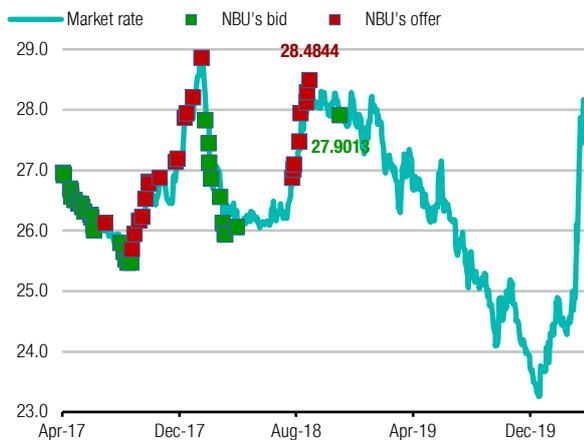
Finally, last week, the hryvnia appreciated by 2.3% to UAH27.43/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 3.7% to 130, while in YoY terms, it was up 7.8%.

ICU view: Improvement in FX market sentiment and the rising chance of the IMF deal supported the hryvnia. We anticipate gradual appreciation of the hryvnia to continue this week, too. We also expect this week's unscheduled session in Parliament to unlock land reform and adopt a banking law (see comment below), which should be positive for the market's mood and news flow. Under these conditions, the hryvnia may appreciate to below UAH27/US\$ this week, while the NBU will intervene in order to smooth out that appreciation.

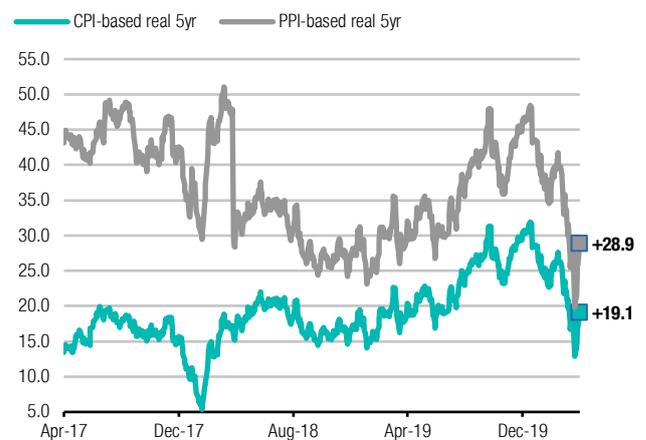
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Chart 5. FX market indicators, 3-year history

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

C/A deficit at 0.7% of GDP in February

Lower world prices for oil and natural gas and a drop in consumer imports will compensate for the contraction in metallurgical exports and remittances.

In 2M20, the C/A surplus rose 50% YoY to US\$0.6bn, while in annualized terms, the deficit declined 72% YoY to 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 (est. 2.6% of GDP). In February, merchandise exports rose 1.2% YoY, driven by ores (+14% YoY), machinery and equipment (+12% YoY), and agricultural products (+1% YoY). Imports of goods declined 4.7% YoY mainly thanks to a 13% YoY decline in imports of machinery and equipment (due to the high-base effect of customs clearance of imported used cars last year) and a 13% YoY decline in the import of energy products. On a 12-month trailing basis, the merchandise-trade-balance deficit was US\$13.9bn (+8% YoY, 8.9% of GDP) in February, while the services-trade-balance surplus rose 34% YoY to US\$2.1bn.

ICU view: Decreased world oil and natural gas prices, lower consumer imports, as well as the national lockdown (in 2019 Ukrainians spent US\$8.6bn travelling, while in 2M20 already US\$1.2bn) should compensate for the drop in metallurgical exports and remittances. In addition, the relative resilience of food product exports, which accounts for 31% of total Ukraine's exports, should also support the C/A balance.

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Ukraine closer to IMF deal

Rada passed a land reform bill in the second reading and is preparing to vote on the banking law, which will open the way for a new IMF deal.

Rada has finally adopted the land bill despite thousands of amendments submitted to filibuster it as long as possible. The agreed upon version of land reform is not nearly as liberal as the one initially submitted by the previous government. Only individuals will be able to purchase up to 100 ha starting 1 July 2021. The legal entities can buy as much as 10,000 ha

starting 1 January 2024 while foreigners and foreign-owned companies will not be granted the right to buy land plots until the referendum decides otherwise. Such restrictions will limit the reform's economic effect to negligible, but should qualify for the IMF deal. Still, Parliament has to unblock the law for the final signing by its speaker and president.

Banking-sector law is another fiercely debated item in parliament's agenda. Rada has to pass it in the second reading to finally kickstart the IMF deal.

ICU view: If Parliament adopts the banking law in the final reading, Ukraine will meet the IMF prior actions and can expect the first tranche of a new programme. While the amount is negotiable, we expect it to be at least US\$8bn with a significant portion being used to finance the expanded budget deficit. Government also expects the EU funds and World Bank guarantee to follow the IMF deal, providing an additional source of funding for the government. However, the banking law has significant political implications, so there are high risks that it will be delayed or derailed completely.

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