Focus
Ukraine

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

Research team
Alexander Martynenko
Taras Kotovych
Sergiy Nikolaychuk

Weekly Insight

Ukraine switches to SBA with the IMF

Key messages of the today's comments

TUESDAY, 12 MAY 2020

Domestic liquidity and bonds market

Refinancing of Debt Repayments

The MoF held a successful primary auction last week, refinanced all local-currency debt repayments, and even raised additional funds for expenditures. This week, due to smaller repayments, demand could be lower. However, with access to NBU loans, banks can increase their purchase of new bills.

Liquidity close to UAH200bn

All last week, liquidity was in the range of UAH190–200bn, and just last Friday rose above UAH200bn. This week liquidity will fluctuate at around this level depending on Treasury operations.

Foreign exchange market

Hryvnia appreciates

Last week, the hryvnia slightly appreciated, despite increase in demand from foreigners and probably due to demand for UAH liquidity from locals and from sectors that were preparing for easing of the lockdown. This week, we should see a mostly strong hryvnia, especially since there are no large repayments of local-currency debt.

Economics

Consumer inflation keeps surprising to the downside

In April, annual headline inflation unexpectedly decelerated providing additional reasons for the NBU to continue its easing cycle at a high pace.

Ukraine switches to SBA with the IMF

Ukraine and the IMF shifted their talks from EFF to SBA, which is shorter, lighter in conditionality and less focused on growth-friendly reform agenda.

Banks' reserves market (8 May 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	8.00	+0bp	-950bp
ON rate (%)	7.26	+102bp	-896bp
ON $ swap (%)	6.46	-27bp	-775bp
Reserves (UAHm)[2]	47,812	-28.49	+12.06
CDs (UAHm)[3]	148,827	+10.67	+131.22

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's certificates of deposit.
Source: NBU, Bloomberg, ICU.

Breakdown of govt bond holders (UAHm) (8 May 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	357,772	+4.67	+0.51
Residents	50,586	-2.84	+100.06
Individuals	8,429	-1.45	-2.69
Foreigners[1]	110,877	-1.42	+188.34
Total	**852,241**	**+1.52**	**+11.34**

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

FX market indicators (8 May 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	26.8137	-0.37	+2.24
EUR/USD	1.0839	-1.29	-3.15
DXY	99.734	+0.66	+2.16
UAH TWI[1]	130.944	+0.74	+4.42

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

Gov't bond quotes[1] (12 May 2020)

Maturity	Bid	Ask
6m	13.00	11.00
12m	13.50	12.00
2y	13.50	12.00
3y	13.50	12.00
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

Refinancing of Debt Repayments

The MoF held a successful primary auction last week, refinanced all local-currency debt repayments, and even raised additional funds for expenditures. This week, due to smaller repayments, demand could be lower. However, with access to NBU loans, banks can increase their purchase of new bills.

The MoF sold more than UAH10bn (US$372m) of three-month bills last week, with an unchanged cut-off rate of 11.3% (more details in auction review). These bills were mostly purchased by local banks, evidenced by their portfolios increasing by UAH6.7bn (US$250m) to UAH359bn (US$13.4m) for the week. Other groups decreased their portfolios, especially foreigners.

Debt redemption had an impact on portfolios, as the total decrease in foreigners' portfolio was UAH2.3bn (US$86m), or more than doubled since a week before.

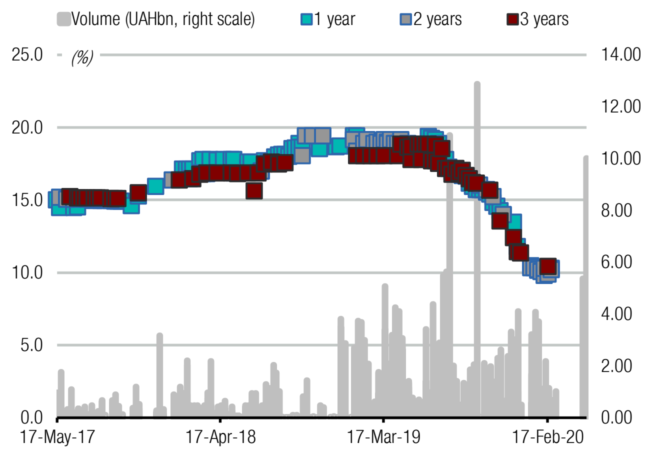
The main buyers of new bills were banks, but despite the high likelihood that these bills were purchased to obtain new loans from the NBU, the amount of refinancing was significantly lower.

ICU view: Today the MoF is offering three-month and six-month bills with redemptions in July and November. These months have lower debt burdens, and with huge demand, the Ministry will have a range to maneuver how much to borrow. However, all these borrowings will not cover financing needs, as they will have to be refinanced later this year. We anticipate that for three-month bills, rates will be the same at around 11.3%, while for six-month bills, the rate can be set at 11.5–11.6%.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

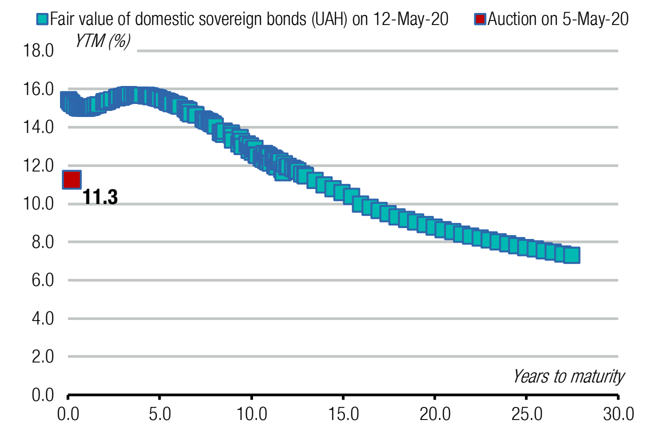
Chart 1. Local-currency bonds

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.

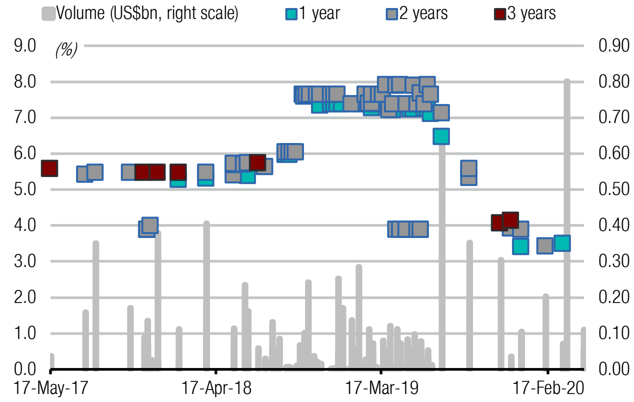
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

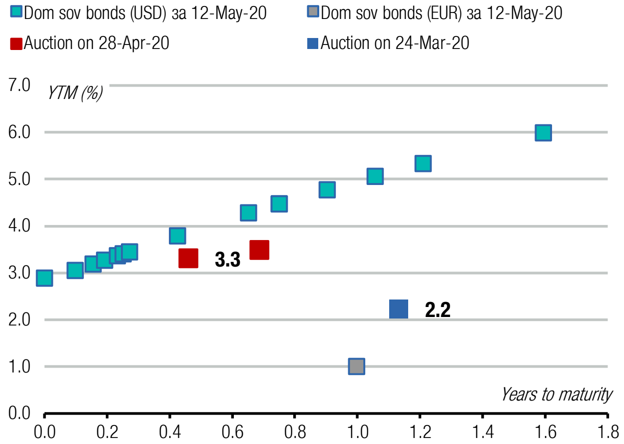
Chart 2. FX-denominated bonds

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 close to UAH200bn

All last week, liquidity was in the range of UAH190–200bn, and just last Friday rose above UAH200bn. This week liquidity will fluctuate at around this level depending on Treasury operations.

NBU participation in the FX market and the purchase of extra supply increased positive impact of non-monetary operations. The NBU purchased hard currency for UAH5.3bn, while through non-monetary operations banks received UAH1bn.

Outflows were seen through banks' exchange reserves in cash of UAH10.1bn. This is the usual trend for the beginning of the month, but unusual for May. Probably it is due to the impact of lockdown and larger expenses of households for current needs. At the same time, Treasury operations were mostly balanced until Friday, when Treasury increased expenditures. Finally last week Treasury injected in liquidity UAH11.1bn, covered reserves exchange in cash.

Additional support for liquidity was provided by the NBU. With new loans, liquidity rose to UAH206bn. The total amount of loans was UAH2.8bn: UAH0.5bn for one month and more than UAH2.3bn for up to five years. Despite the high level of liquidity, rates for ON loans rose, and for some days, it was above the NBU key policy rate.

ICU view: This week, the main impact will come from Treasury, while NBU operations with hard currency and banks' operations with cash will be less important. Budget transactions will depend on expenditures due to the starting period of quarterly tax payments with large outflows to budget accounts. Therefore, liquidity may stay above the UAH200bn level or close to it, but for a short period of time.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

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

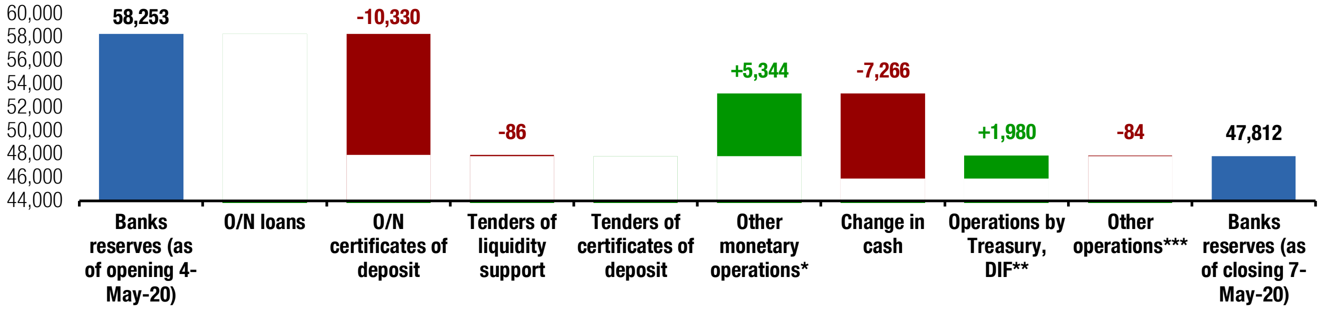
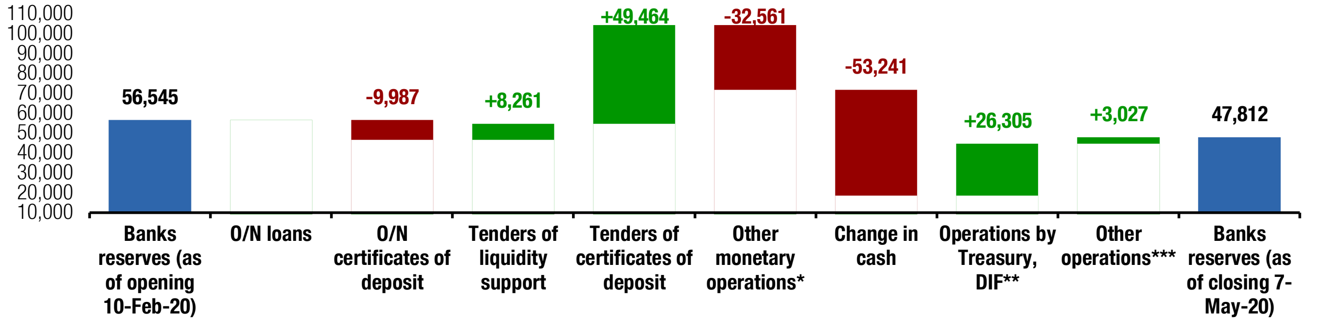


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Last week, the hryvnia slightly appreciated, despite increase in demand from foreigners and probably due to demand for UAH liquidity from locals and from sectors that were preparing for easing of the lockdown. This week, we should see a mostly strong hryvnia, especially since there are no large repayments of local-currency debt.

Last week, the Cabinet of Ministers decided to ease the lockdown for some sectors, and likely these businesses started to prepare for the easing to take effect. Their preparations required extra expenses and very likely they had to sell additional hard currency. Therefore, there was prevailing supply in the FX market, and debt repayments and withdrawal of funds by foreigners from bills did not have important impact on the exchange rate.

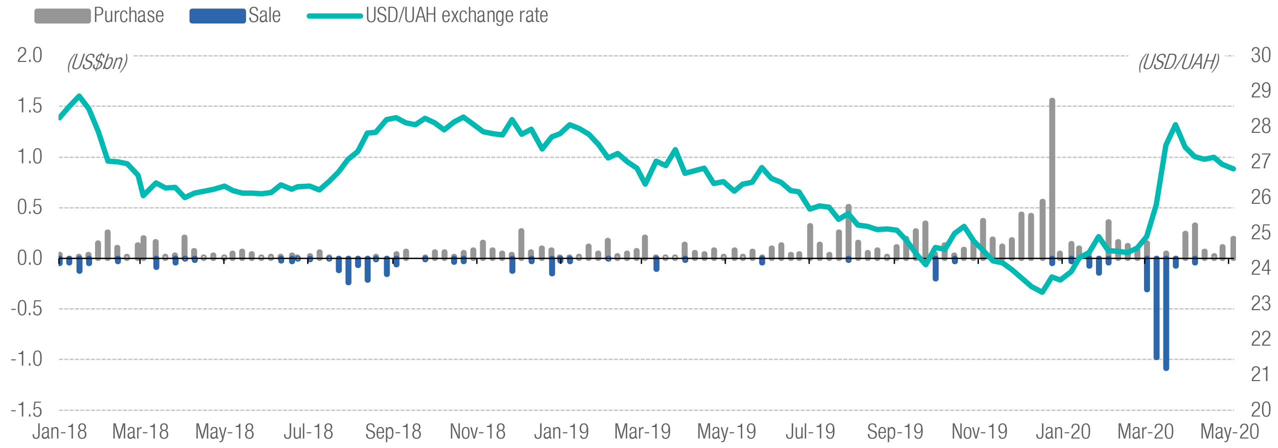
Finally, last week, the hryvnia appreciated 0.4% to UAH26.81/US$. It happened despite the NBU purchasing US$199m last week, the largest amount in the last four weeks.

ICU view: This week, we do not anticipate exchange-rate volatility, but slight appreciation with some fluctuations due to NBU's participation in the market with purchasing of extra supply. Easing of the lockdown will increase hard currency selling from the business side and from households to pay for services. However, the main supply of hard currency will be from tax payers, to pay quarterly tax payments. Therefore, the exchange rate will stay in the UAH26.5–27/US$ range with slight appreciation.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

Chart 5. FX market indicators, 3-year history

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market and NBU interventions (weekly data)



Source: NBU, Bloomberg, ICU.

Economics

Consumer inflation keeps surprising to the downside

In April, annual headline inflation unexpectedly decelerated providing additional reasons for the NBU to continue its easing cycle at a high pace.

Consumer prices increased by 0.8% MoM in April, far below consensus and our forecast (1.8% Bloomberg vs 1.5% ICU). Annual inflation decreased from 2.3% in March to 2.1% in April, the lowest since 2013, thus remaining below the target range of 5% +/-1 pp for the fourth month in a row.

Meanwhile, such a result was mostly determined by very low inflation (or even deflation for headline CPI) during the period from Sep-19 to Feb-20 while Mar and Apr-20 showed recovery of price growth at a pace close to the 5% inflation target when measured by the MoM seasonally adjusted annualized rate (SAAR).

The breakdown shows a modest increase in food inflation to 2.5% driven by fruits and sugar prices and in pharmaceuticals, while utilities and fuel pulled the headline down with sharp price declines last month. In addition, the YoY decrease of clothes and footwear prices deepened over the previous months.

Annual core inflation figure was benign at 3.1%, remaining almost unchanged since January. However, its MoM SAAR measure jumped to 6.1% showing sizeable acceleration compared with the period of stagnant growth rate from Sep-19 to Feb-20.

ICU view: Price changes were broadly in line with the expectations due to the pandemic and lockdown effects, namely a surge in food and pharmaceutical prices where a rush of demand was observed and pass-through from the fall of global energy prices into local ones (fuel, gas, utilities). However, it seems that overall contraction of aggregate demand so far exceeds the fading effect of recent UAH depreciation.

Going forward, factoring in relatively stable exchange rate performance and still depressed demand amid gradual relaxation of quarantine measures in coming months, we see the prevailing downside risks for the inflation outlook (both we and the NBU expect inflation to accelerate to 6% by the end of 2020). Meanwhile, the high share of the food component in the CPI basket and unclear lockdown effects on its

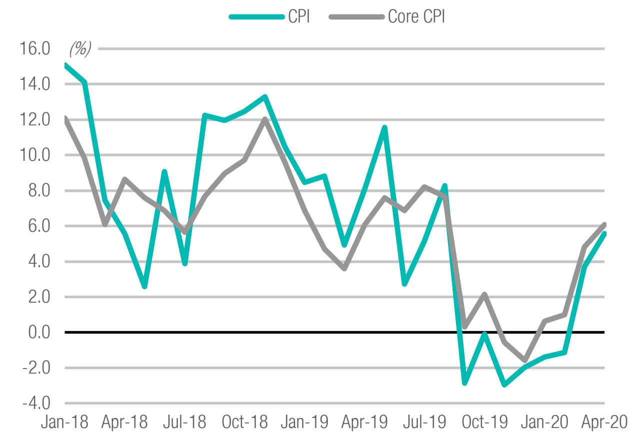
supply make these projections and their risk assessment the object of extremely high uncertainty this year.

Current inflation momentum reinforced the position of the NBU to continue the easing in June. Moreover, should inflation remain stubbornly low in May, we see more risks that the NBU may be pushed to cut its key policy rate below its estimate of a neutral level of 7% in order to speed up inflation to the target.

Sergiy Nikolaychuk, Kyiv, (044) 377-7040 ext.721

Chart 6. CPI and Core CPI, MoM SAAR, %

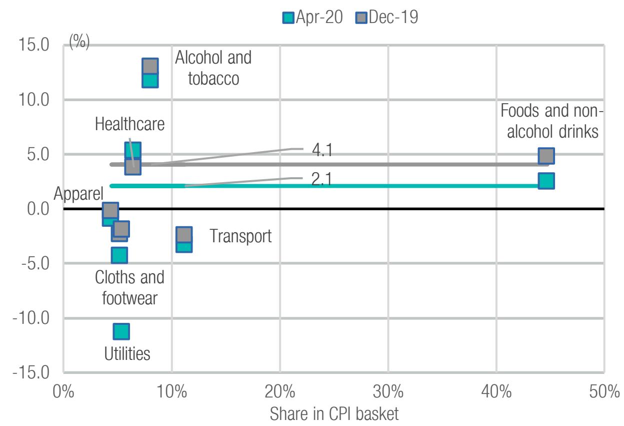
Seasonally adjusted annualized rate of growth compared with the previous month



Source: Ukrstat, ICU.

Chart 7. CPI and its main components, YoY changes, %

Annual changes of prices reflected on axis Y while the shares of the components are reflected on axis X



Source: Ukrstat, ICU.

Ukraine switches to SBA with the IMF

Ukraine and the IMF shifted their talks from EFF to SBA, which is shorter, lighter in conditionality and less focused on growth-friendly reform agenda.

During his regular press-briefing, IMF spokesman Gerry Rice revealed that discussions with Ukraine switched to an 18-month Stand-by Arrangement (SBA) from a three-year Extended Fund Facility (EFF) “given the unprecedented uncertainty surrounding the economic and financial outlook, and the need to focus policy priorities on near-term containment and stabilization.” Meanwhile, he added, “When a recovery is in place, the focus could shift back to addressing Ukraine’s longer-term structural reform needs to foster stronger and more inclusive growth.”

Both the Ministry of Finance and Ukraine’s representative to the IMF Vladyslav Rashkovan confirmed that the financing volume for the next 18 months remains the same (US$ 5 bn).

Simultaneously, Ivanna Vladkova-Hollar has been appointed as head of the IMF Mission in Ukraine replacing Ron van Rooden from 1 May 2020. She is a Bulgarian economist with IMF experience in Moldova and North Macedonia.

ICU view: The shift to a shorter programme is fully justified by the development of the global crisis due to pandemic with lockdowns and related huge uncertainty. We do not think that the conditionality for the launch of the programme has shifted: approving the banking law remains the major prerequisite. But the new framework may ease the authorities’ task to keep the programme on track and get the next tranches. However, the retreat from the EFF framework with a stronger focus on structural reforms may testify the slowdown or even backtracking on the growth-friendly reform agenda.

Sergiy Nikolaychuk, Kyiv, (044) 377-7040 ext.721

This page is intentionally left blank

11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kyiv, 01030 Ukraine
Phone/Fax +38 044 3777040
WEB www.icu.ua

RESEARCH

Sergiy Nikolaychuk
Head of macro research
sergiy.nikolaychuk@icu.ua

Taras Kotovych
Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Dmitriy Dyachenko
Junior financial analyst
dmitriy.dyachenko@icu.ua

Alexander Martynenko
Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv
Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (license numbers: dealer activity AE 263019, broker activity AE 263018, underwriting activity AE 263020 dated 11 April 2013).

DISCLAIMER

Additional information is available upon request.