



Focus
Ukraine

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

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Weekly Insight

Staff level agreement with the IMF reached

Key messages of the today's comments

Domestic liquidity and bonds market

Banks purchase new T-bills

Banks continue to increase portfolios of government bonds, only partially financing the purchases through NBU loans. This week, we anticipate a further increase in banks' portfolios with a slight reallocation of funds from NBU CDs into government bills.

Liquidity declines

Due to banks' purchases of new bills and tax payments, liquidity declined to UAH175bn last week. With low budget expenditures and large new borrowings, liquidity will decline this week too.

Foreign exchange market

Hryvnia remains in the UAH26.5-27/US\$ range

Last week, the hryvnia exchange rate attempted to appreciate to UAH26.5/US\$, but after the quarterly tax payments period ended, it returned close to the middle of the UAH26.5–27/US\$ range. This week, the hryvnia will fluctuate within this range, with a probability of appreciating to UAH26.5/US\$.

Economics

A sharp fall in economic activity in April

Based on data published last week by UkrStat, we estimate the decline in GDP to deepen to 12% YoY in April from 4.5% YoY in March. Passenger transportation plummeted; industrial production, and trade and cargo transportation accelerated their decline, while agriculture remained resilient.

Staff level agreement with the IMF reached

The president signed the banking bill into law making way for a new Stand-By Arrangement to Help to Address the COVID-19 Pandemic.

TUESDAY, 26 MAY 2020

Banks' reserves market (25 May 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	8.00	+0bp	-950bp
ON rate (%)	7.53	+59bp	-868bp
ON \$ swap (%)	6.78	+71bp	+0bp
Reserves (UAHm) ²	52,044	-11.85	+0.89
CDs (UAHm) ³	123,093	-7.46	+0.00

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) (25 May 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	392,355	+6.36	+7.76
Residents	53,245	+3.43	+106.29
Individuals	7,846	+6.50	-16.86
Foreigners ¹	107,786	-1.76	+144.21
Total	885,810	+2.77	+13.44

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (25 May 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	26.8675	+1.23	+1.67
EUR/USD	1.0898	-0.23	-2.72
DX	99.863	+0.50	+2.31
UAH TWI ¹	129.476	-1.37	+4.27

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (26 May 2020)

Maturity	Bid	Ask
6m	11.00	10.00
12m	12.00	11.00
2y	12.00	11.00
3y	12.00	11.00
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

Banks purchase new T-bills

Banks continue to increase portfolios of government bonds, only partially financing the purchases through NBU loans. This week, we anticipate a further increase in banks' portfolios with a slight reallocation of funds from NBU CDs into government bills.

At last week's auction, the Ministry of Finance sold UAH21bn of new bills, including UAH11.4bn (US\$0.4bn) in local currency and US\$369m of USD-denominated instruments. Interest rates for UAH-denominated bills that mature this year declined to 10.5–10.78%. More details in the [auction review](#).

Most new bills were purchased by local banks; they increased portfolios last week by UAH22.2bn (US\$0.9bn). A large portion of new bills was purchased using funds from NBU CDs, as interest rates are more favourable for government bills.

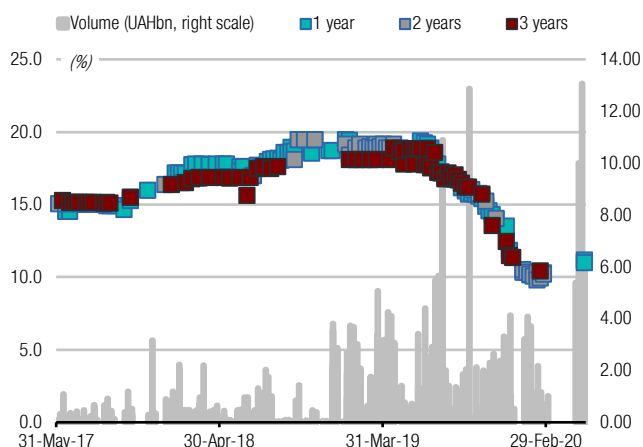
Bills purchased from foreigners was only a small portion of the increase in banks' portfolios. Last week, foreigners sold UAH1.4bn (US\$0.05bn, two times more than a week before).

ICU view: Today, the MoF will offer the same maturities of local-currency bills, with a limited amount offered for bills with maturities this year to UAH0.5bn (US\$19m). The limited supply of short-term maturities should cause a further decline in interest rates and an increase in the average maturity of new borrowings, although probably less material than last week. We expect new borrowings to amount to UAH10bn (US\$0.4bn), most of which will mature next year, which will improve budget financing. Most new bills will be purchased by local banks, as they have a large amount of liquidity in NBU CDs and can apply for NBU loans when they need extra liquidity.

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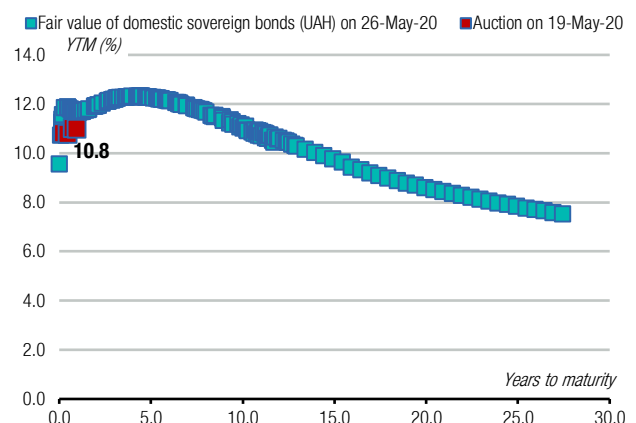
Chart 1. Local-currency bonds

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.

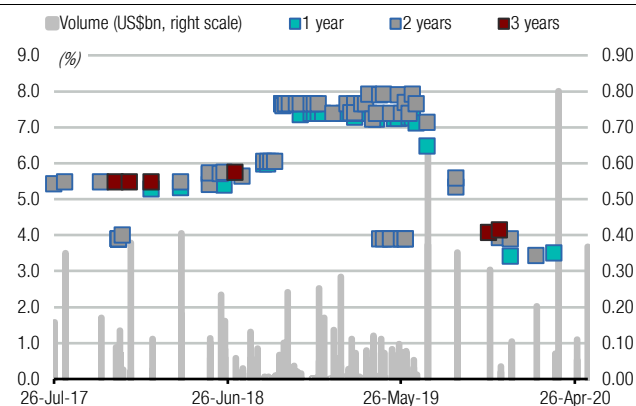
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

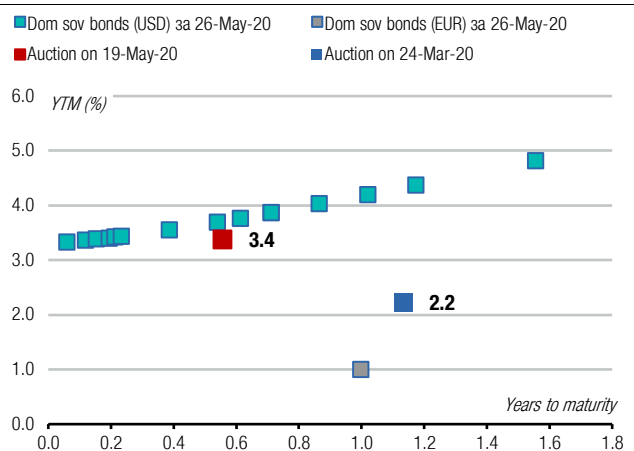
Chart 2. FX-denominated bonds

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

Due to banks' purchases of new bills and tax payments, liquidity declined to UAH175bn last week. With low budget expenditures and large new borrowings, liquidity will decline this week too.

In addition to large tax payments, Ukrainian banks continued to purchase new bills (see comment above), increasing outflows of funds from the banking system to budget accounts. While tax collection was not large, lower than during May the last two years, budget expenditures were low, causing a negative impact on banking-sector liquidity.

After bills settlement on Wednesday, outflow to budget accounts from the banking system was UAH12.2bn, and in total last week, it was UAH24.8bn. On the contrary, outflows through reserves exchange in cash slowed to UAH2.8bn from UAH5.2bn a week before.

Decline in liquidity mostly is reflected on NBU CDs outstanding, which fell by UAH6.9bn to UAH123bn last week. Together with the decline in banks' correspondent account balances with the NBU, this resulted in a decline in liquidity to UAH175bn last week, the lowest level since the beginning of April.

ICU view: Banks' activity in the bond market increased, causing a further decline in liquidity due to the purchase of bills in addition to month-end tax payments. Last week, the NBU injected UAH6bn in banking-sector liquidity through the FX market, and this week it will also offer support for banks with loans. Banks will continue to decrease their portfolios of CDs, but this decline in liquidity will not have a material impact on interbank ON interest rates, which last week were below 7% (UIIR).

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

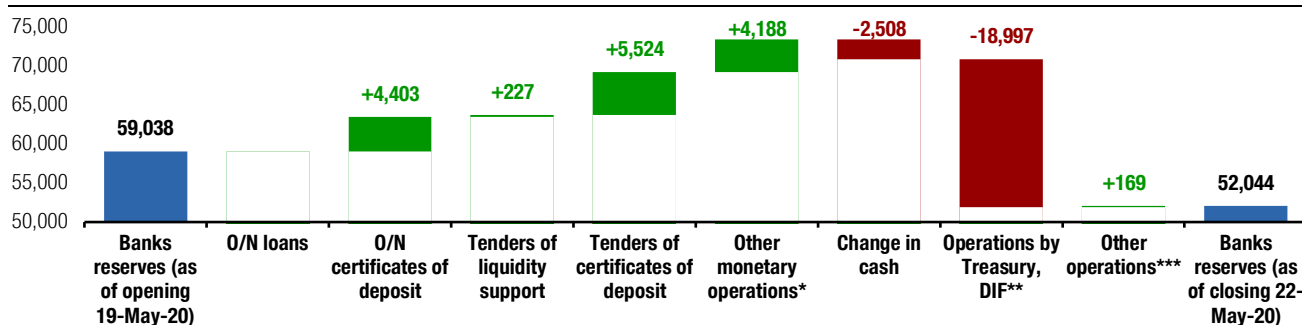
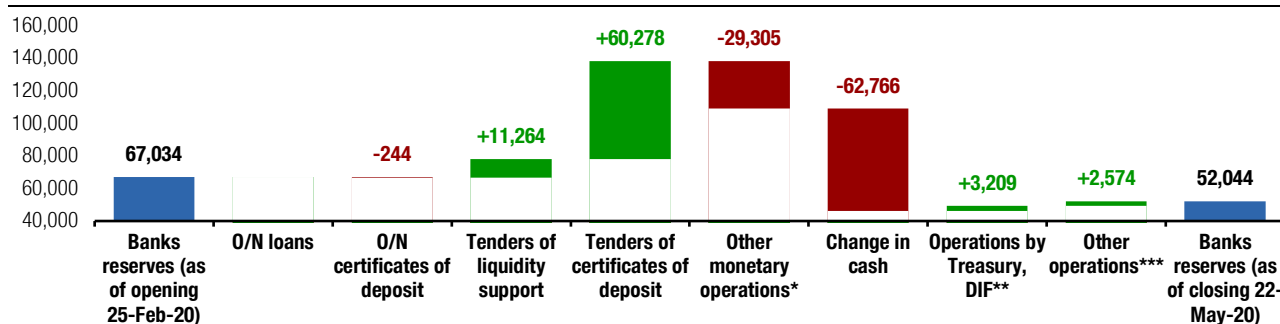


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 remains in the UAH26.5-27/US\$ range

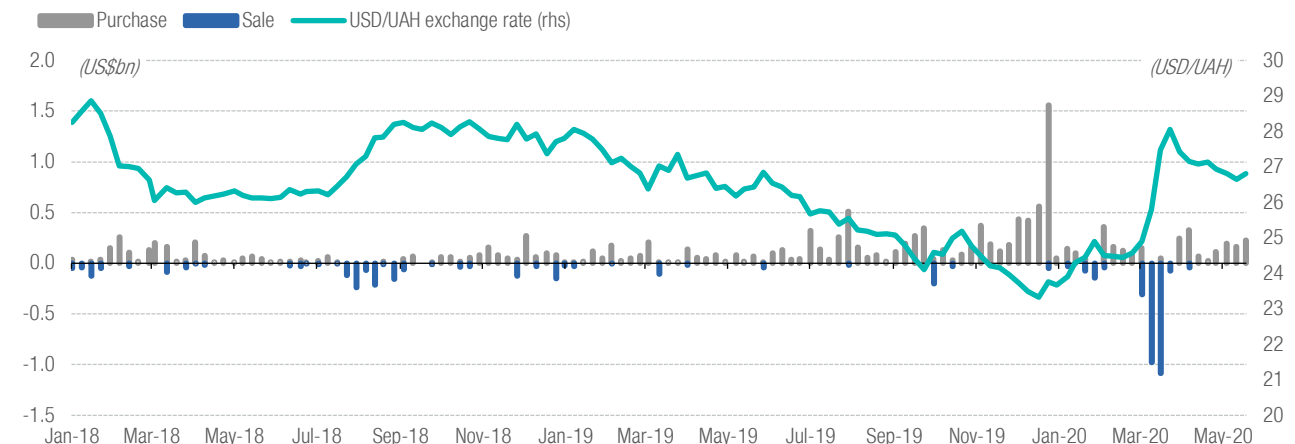
Last week, the hryvnia exchange rate attempted to appreciate to UAH26.5/US\$, but after the quarterly tax payments period ended, it returned close to the middle of the UAH26.5–27/US\$ range. This week, the hryvnia will fluctuate within this range, with a probability of appreciating to UAH26.5/US\$.

Low economic activity and the requirement to pay quarterly tax payments for 1Q20 induced exporters to sell hard currency, which significantly supported the hryvnia at the beginning of last week. A large supply of hard currency forced the NBU to purchase US\$228m. But with the end of quarterly tax payments, the market balance changed, and the hryvnia weakened to above the middle of the UAH26.5–27/US\$ range, where the NBU's interventions were not needed.

Finally, last week, the hryvnia weakened to UAH26.8/US\$ or just 0.56% compared with the previous week.

ICU view: We do not anticipate exchange-rate volatility this week, with just slight appreciation to about UAH26.5 later this week due to the month-end tax payments. Foreigners' exit from local-currency bills will likely persist without material impact on the FX market. Hard currency supply from exporters and for tax payments will cover the usual demand and sometimes induce the NBU to intervene the market with hard currency purchases to restrain 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 and NBU interventions (weekly data)*

Source: NBU, Bloomberg, ICU.

Economics

A sharp fall in economic activity in April

Based on data published last week by UkrStat, we estimate the decline in GDP to deepen to 12% YoY in April from 4.5% YoY in March. Passenger transportation plummeted; industrial production, and trade and cargo transportation accelerated their decline, while agriculture remained resilient.

In April, the fall in industrial production deepened to 16.2% YoY (from 7.7% YoY in March), while seasonally adjusted output declined by 6.0% MoM. The April outcome was determined by poor performance of coal and iron ore mining (-35% YoY and -16% YoY), metallurgy (-30% YoY), and production of investment and durable consumer goods. For instance, the production of textile, machinery and furniture plunged by 30-40% YoY. Meanwhile, pharmaceutical and chemical industries continued to outperform increasing the output by 17.1% YoY and 6.5% YoY respectively.

In April, retail trade plunged by 23% YoY (compared to 6.1% YoY growth in March). Wholesale trade continued to decline by 4.0% YoY in January-April (2.8% YoY in 1Q20).

In January-April, the contraction in passenger turnover deepened to 39.6% YoY (from 18.8% in 1Q20). Cargo transportation decreased by 18.2% YoY (compared with a 14.9% YoY fall in 1Q20).

The sharp deterioration in retail trade and passenger transportation was caused by the introduction of preventive measures to combat the pandemic in March. The largest restrictions were on passenger traffic, which stopped almost completely from March 17. We estimate the plunge of passenger turnover to have been approximately 96% YoY in April. Retail turnover, though affected by restrictions for non-essential trade, was supported by demand for food, hygiene products, drugs and medical devices. Wholesale trade and cargo transportation indicators did not change so dramatically compared with the 1Q20 indicator, which showed their relative resistance to the effects of quarantine.

Even better resilience was showed by agriculture where the decline in livestock production decelerated to 1.4% YoY in January-April (from 1.8% YoY in 1Q20). Such outcome was determined by recovering poultry and egg production due to lifting of export restrictions for domestic producers.

ICU view: April data confirmed the toll from the pandemic and prolonged restrictions on travels and non-essential trade. Accounting for a gradual easing of the quarantine domestically, and the earlier-than-expected opening of economies worldwide in May, it seems that the Ukrainian economy has, hopefully, passed its trough in April. Business activity is back and there are signs of life in the recovery in high-frequency indicators such as electricity production, distances moved on foot and by cars, number of vacancies, etc. But “unfreezing the economy” is still heavily confined by the restrictions on public transportation and remaining social distancing measures.

Looking ahead, we expect that the leading role in causing the economic downturn is switching from containment measures to depressed demand. Losses in incomes of consumers and businesses combined with precautionary behavior going forward amid the limited fiscal stimulus and the threat of a “second wave” will prevent a strong recovery. As a result, we expect the decline in GDP to be around 10% YoY in 2Q20.

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Staff level agreement with the IMF reached

The president signed the banking bill into law making way for a new Stand-By Arrangement to Help to Address the COVID-19 Pandemic.

After numerous attempts to derail and postpone adoption of the new banking bill, it was finally signed. The IMF has concluded discussions and announced it reached a Staff Level Agreement with Ukraine. A new Stand-By Arrangement assumes disbursement of US\$5bn during next 18 months.

ICU view: The loan will be used at least to partially cover the increased budget deficit, which is planned to reach 7.5% of GDP in 2020. Any attempts to kill the law in the Constitutional court are likely to occur after the first tranche is disbursed in the course of the next few weeks.

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