

Weekly Insight

April C/A ran significant surplus

Key messages of the today's comments

Domestic liquidity and bonds market

MoF is trying to extend bills maturity at coming auction

The MoF announced that tomorrow it will offer four bills with maturities up to one year limited offering for 3-month and 6-month bills. However, without local-currency debt redemptions this week, demand could be low with quite high interest rates.

Liquidity recovers slightly

Lower demand for new government bills and an increase in budget expenditures allowed liquidity to recover to almost UAH180bn. However, with an increase in new borrowings, liquidity can decline once more. Support can come from NBU if there is a large supply of hard currency in the market.

Foreign exchange market

Hryvnia exchange rate remains within UAH26.5–27/US\$ range

For most of last week, the FX market was self-balanced without NBU participation within the range of UAH26.5–27/US\$. This week, we do not expect material changes in the market, despite a possible increase in demand for hard currency due to banks' preparation for foreigners' exchange of debt redemptions in hard currency next week.

Economics

April current account ran significant surplus

Favourable terms of trade and stronger resilience of exports compared with imports caused a record foreign-trade surplus since 2004, which, together with remittances, more than offset the still ongoing, albeit smaller, capital outflow.

MONDAY, 1 JUNE 2020

Banks' reserves market (29 May 2020)

| | Last | Weekly chg (%) | YoY chg (%) |
|------------------------------|---------|----------------|-------------|
| NBU rate (%) ¹ | 8.00 | +0bp | -950bp |
| ON rate (%) | 6.92 | -61bp | -940bp |
| ON \$ swap (%) | 6.45 | +0bp | -795bp |
| Reserves (UAHm) ² | 54,417 | +10.31 | +6.64 |
| CDs (UAHm) ³ | 126,581 | -1.73 | +152.61 |

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) (29 May 2020)

| | Last | Weekly chg (%) | YoY chg (%) |
|-------------------------|----------------|----------------|---------------|
| NBU | 324,577 | +0.00 | -3.72 |
| Banks | 395,881 | +0.99 | +8.51 |
| Residents | 53,263 | +0.26 | +103.07 |
| Individuals | 7,945 | +1.62 | -16.70 |
| Foreigners ¹ | 106,098 | -2.24 | +141.48 |
| Total | 887,764 | +0.19 | +13.56 |

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (29 May 2020)

| | Last | Weekly chg (%) | YoY chg (%) |
|----------------------|---------|----------------|-------------|
| USD/UAH | 26.8580 | +0.20 | +0.46 |
| EUR/USD | 1.1101 | +1.83 | -0.27 |
| DXY | 98.344 | -1.52 | +0.20 |
| UAH TWI ¹ | 127.822 | -1.51 | +3.69 |

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (1 June 2020)

| Maturity | Bid | Ask |
|----------|-------|-------|
| 6m | 10.50 | 9.50 |
| 12m | 12.00 | 11.00 |
| 2y | 12.50 | 11.25 |
| 3y | 12.50 | 11.25 |
| 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

MoF is trying to extend bills maturity at coming auction

The MoF announced that tomorrow it will offer four bills with maturities up to one year limited offering for 3-month and 6-month bills. However, without local-currency debt redemptions this week, demand could be low with quite high interest rates.

Last week, the Ministry borrowed only UAH1bn, and rejected three-quarters of demand due to the limited offering and the high cost of borrowing for the budget. In that auction, interest rates declined to 10.19–10.33% for the two shortest maturities. More details in the [auction review](#).

On one hand, low demand was a result of large issues earlier in May and a decline in banking-sector liquidity. On the other, there was a large offering of local-currency instruments from foreign investors, as they increased sales of UAH-denominated debt.

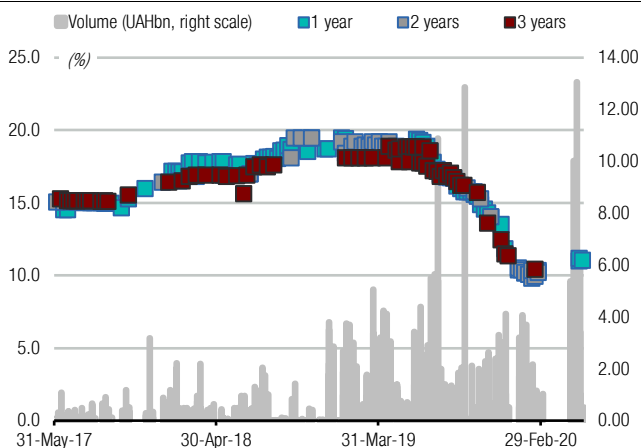
Last week, foreigners decreased portfolios of local-currency bills by UAH1.8bn. Their activity could increase due to lower interest rates, which decreases losses from selling bills. This offering competed with the primary market, and satisfied part of demand from locals.

ICU view: This week, foreigners will continue to sell local-currency bills, although very likely less actively, and wait for bill redemptions next week. With lower offerings from foreign investors, local banks may be interested in longer maturities at the primary auction. However, the result will depend on the level of interest rates in bids and the MoF's readiness to accept this level.

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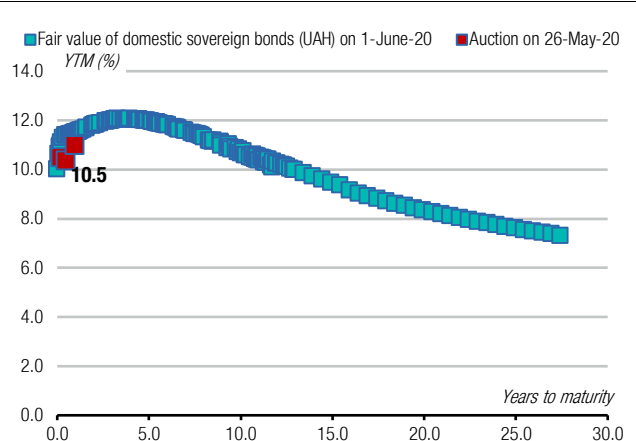
Chart 1. Local-currency bonds

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.

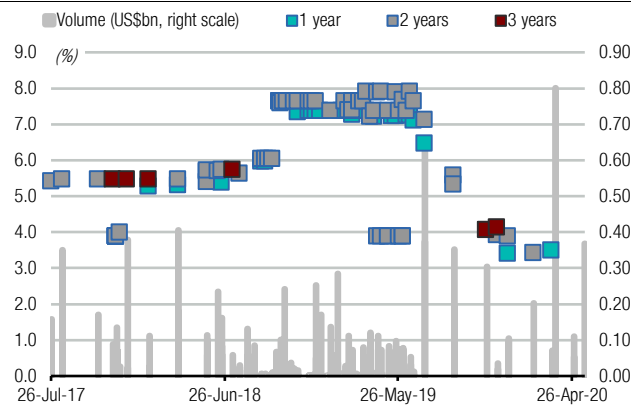
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

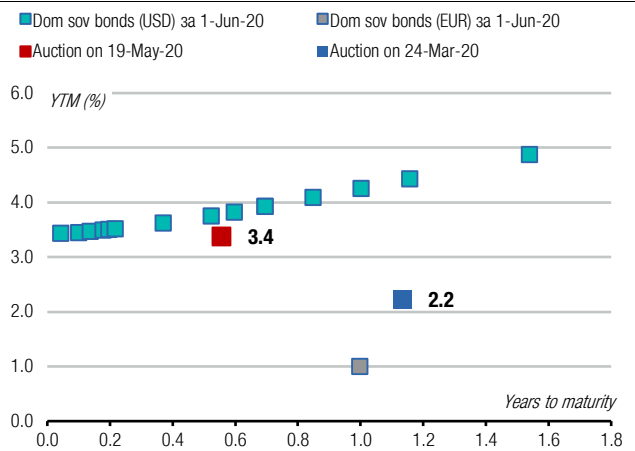
Chart 2. FX-denominated bonds

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 recovers slightly

Lower demand for new government bills and an increase in budget expenditures allowed liquidity to recover to almost UAH180bn. However, with an increase in new borrowings, liquidity can decline once more. Support can come from NBU if there is a large supply of hard currency in the market.

Last week, banking-sector liquidity rose UAH4.4bn to almost UAH180bn by Friday. The budget increased expenditures at the end of last week including VAT refunds. Additionally, banks increased exchange of cash in reserves. In total, the impact of non-monetary operations was positive for liquidity at UAH2.4bn. NBU added UAH1.9bn, and purchased US\$72bn from the FX market last week.

The increase in liquidity supported interbank interest rates, as they remained below 7% for ON loans, and incented banks to increase portfolios of CDs by UAH9bn to UAH132bn.

ICU view: The beginning of the month is usually met with a new wave of reserves exchange in cash, while NBU can increase support through the FX market. Therefore, we do not expect material changes in liquidity, as it will fluctuate at around UAH180bn.

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

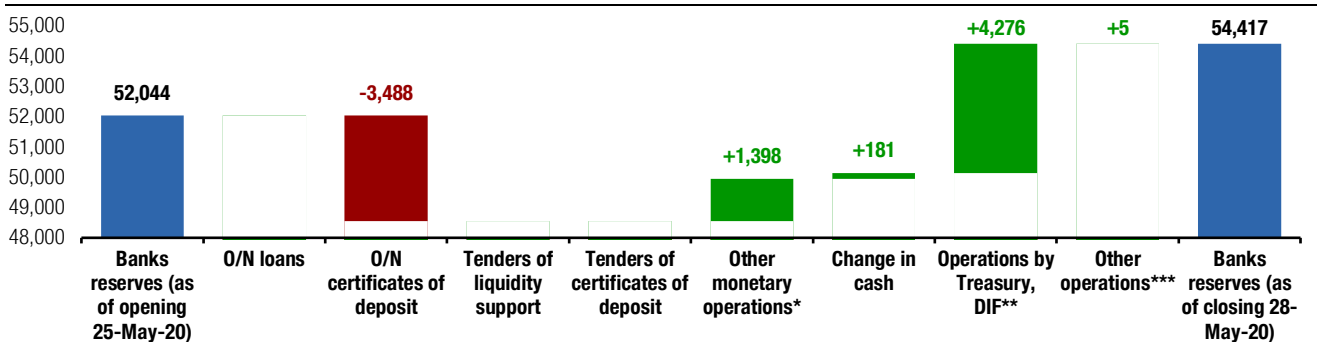
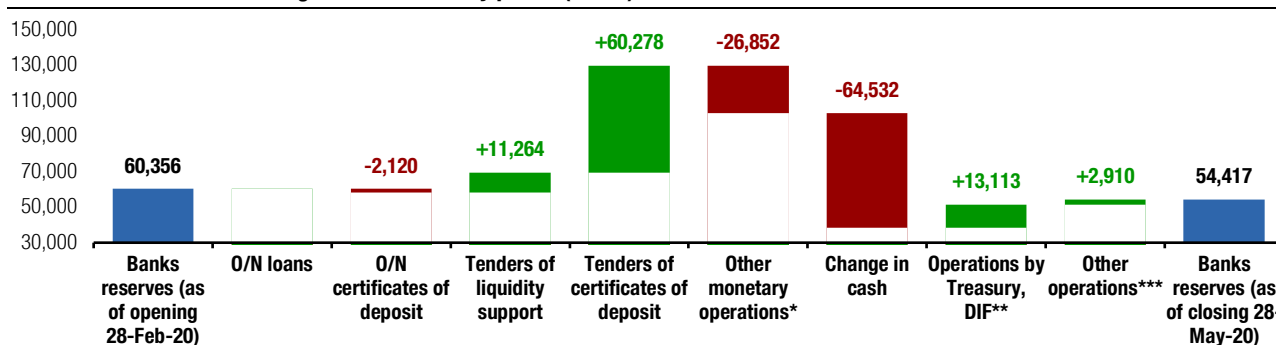


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 exchange rate remains within UAH26.5–27/US\$ range

For most of last week, the FX market was self-balanced without NBU participation within the range of UAH26.5–27/US\$. This week, we do not expect material changes in the market, despite a possible increase in demand for hard currency due to banks' preparation for foreigners' exchange of debt redemptions in hard currency next week.

The increase in foreigners' activity in funds withdrawal from local-currency debt just after quarterly tax payments, and in line with the increase in VAT refunds, changed the market balance to the demand side and moved the exchange rate to the top of the UAH26.5–27/US\$ range. The exchange rate briefly crossed the UAH27/US\$ level.

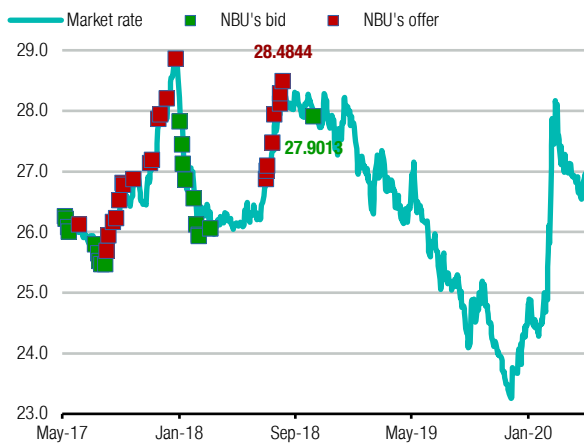
However, later last week due to month-end tax payments, hard currency supply increased and was greater than demand. This induced the NBU to intervene and purchase US\$72m, which restrained appreciation and kept the exchange rate above the middle of the expected range of UAH26.5–27/US\$.

ICU view: UAH8bn of local-currency repayments are scheduled for next week, of which we estimate about UAH2bn to be paid to foreigners. This would increase demand for hard currency and put pressure on hryvnia exchange rate. However, we do not anticipate that the exchange rate will significantly exceed the range of UAH26.5–27/US\$. Nevertheless, IMF approval of the new stand-by programme for Ukraine will add positive sentiment and will support the hryvnia.

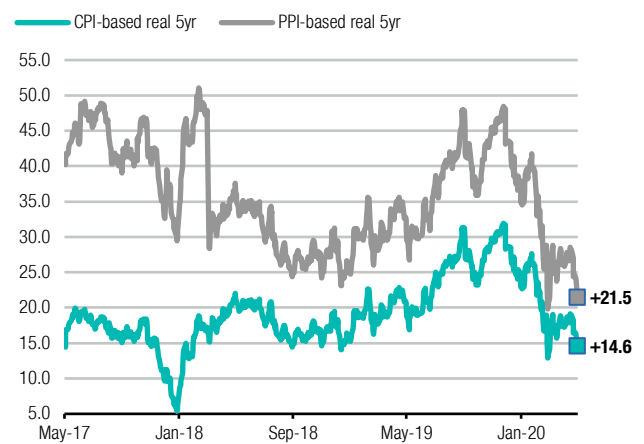
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Chart 5. FX market indicators, 3-year history

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

April current account ran significant surplus

Favourable terms of trade and stronger resilience of exports compared with imports caused a record foreign-trade surplus since 2004, which, together with remittances, more than offset the still ongoing, albeit smaller, capital outflow.

In April, the current account (C/A) turned to a significant surplus of US\$1.4bn (compared with a deficit of US\$292m in March), leading to a C/A surplus of US\$1.8bn for 4M20 (compared with a deficit of US\$242m for 4M19).

Despite the spread of the coronavirus and the lockdowns worldwide and in Ukraine, exports of goods and services decreased by only 7.5% YoY in April. The main contribution was provided by falling revenues from metallurgical products (by 18% YoY), travel (by 96% YoY), pipeline transport services (by 47% YoY), and aviation (by 61% YoY). Meanwhile, export of food, mineral products (mainly iron ore), and IT services continued to grow at a fairly high pace (by 6.6% YoY, 12.1% YoY, and 19.9% YoY respectively). At the same time, imports of goods and services plummeted by almost a third. This was primarily due to a drop in imports of mineral products (by 34% YoY) and machinery (by 29% YoY), travel expenses (by 72% YoY), and an almost complete cessation of informal imports.

According to our estimates, based on NBU data, remittances decreased slightly in April by 16.5% YoY to US\$794m, but for 4M20, they increased by 1.6% YoY to US\$3.7bn.

As a result, the C/A for the last 12 months turned to a surplus of US\$0.7bn (est. 0.4% of GDP according). Over the past 12 months, the trade deficit decreased to US\$12.5bn (est. 7.9% of GDP), while the trade surplus increased to US\$2.7bn (est. 1.7% of GDP), and remittances were almost unchanged at US\$12.1bn (est. 7.7% of GDP).

The financial account shows capital outflows falling to US\$0.7bn (from US\$1.5bn in March). First of all, this was due to a decrease in the net repayment of external debt by the private sector to US\$97m from US\$633m in March. Other items did not change sizably compared with March. Thus, the public sector lowered its external obligations (by US\$346m in April) thanks to a reduction in domestic bonds in non-residents' portfolios; residents accumulated

foreign assets (by US\$301m), primarily in the form of foreign cash, and there was almost no direct investment.

ICU view: Favourable terms of trade, relative resilience of exports and remittances, a sharp decline in imports and dividend payments provided a sharp improvement in the C/A. This offset the still-ongoing capital outflow, which halved compared with the local high in March. In fact, the March balance of payments crisis turned out to be very short-lived and relatively small in scale compared with previous episodes of crisis.

In the coming months, we expect some recovery in imports as the economy exits from quarantine, but the C/A will remain in surplus. We project the return to a C/A deficit in the fall. Meanwhile, on the financial account, we anticipate a gradual return to capital inflows. For full-2020, we forecast a small current account surplus and a consolidated balance of payments balance close to zero.

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