

Weekly Insight

Decline in construction is deepening

Key messages of the today's comments

Domestic liquidity and bonds market

Foreigners continue to exit UAH bills

Last week, foreigners' portfolios of Ukrainian local-currency bills declined to UAH102.5bn (US\$3.9bn), and this week they can slid below UAH100bn (US\$3.8bn) after debt redemption on Wednesday.

Liquidity increases

The positive balance of Treasury operations and large supply of hard currency in the market caused banking-sector liquidity to increase to UAH194bn at the end of last week. This week large debt redemptions of UAH-denominated bills will support liquidity, which can rise to about UAH200bn.

Foreign exchange market

Hryvnia remains strong

The supply of hard currency in the market rose last week, causing the NBU to purchase the extra supply to restrain hryvnia appreciation. But despite the NBU entering the market, the hryvnia moved close to the bottom level of expected range. This week, we expect that the hryvnia exchange rate can cross the level of UAH26.5/US\$.

Economics

Decline in construction is deepening

The contraction in demand for residential real estate and reduced investment in alternative energy were compounded by falling demand for commercial real estate due to the pandemic and lockdown effects.

TUESDAY, 9 JUNE 2020

Banks' reserves market (5 June 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	8.00	+0bp	-950bp
ON rate (%)	7.28	+117bp	-872bp
ON \$ swap (%)	6.58	+13bp	+0bp
Reserves (UAHm) ²	50,065	-8.00	+13.70
CDs (UAHm) ³	138,008	+9.03	+162.95

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) (5 June 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	392,537	-0.90	+6.60
Residents	53,302	+0.05	+99.87
Individuals	7,865	-1.00	-20.39
Foreigners ¹	105,316	-0.88	+134.54
Total	883,597	-0.51	+12.29

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (5 June 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	26.5607	-1.11	-1.15
EUR/USD	1.1292	+1.72	+0.63
DXY	96.937	-1.43	-0.39
UAH TWI ¹	127.577	-0.19	+4.63

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (9 June 2020)

Maturity	Bid	Ask
6m	10.00	9.00
12m	11.50	10.50
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

Foreigners continue to exit UAH bills

Last week, foreigners' portfolios of Ukrainian local-currency bills declined to UAH102.5bn (US\$3.9bn), and this week they can slid below UAH100bn (US\$3.8bn) after debt redemption on Wednesday.

Foreigners' selling of UAH-denominated bills had slowed last week to UAH0.8bn (US\$30m) two times lower than the week before. This slowing could be caused by waiting for debt redemption this week and an increase in amounts purchased in the primary auction.

On one hand, the MoF accepted a larger amount of demand at the primary auction last week, which decreased the potential amount of bills local banks could buy from foreigners. On the other hand, foreign investors could postpone selling the shortest bills due to their redemption on Wednesday. We expect that foreigners will receive about UAH1.5bn of principal repayments this week.

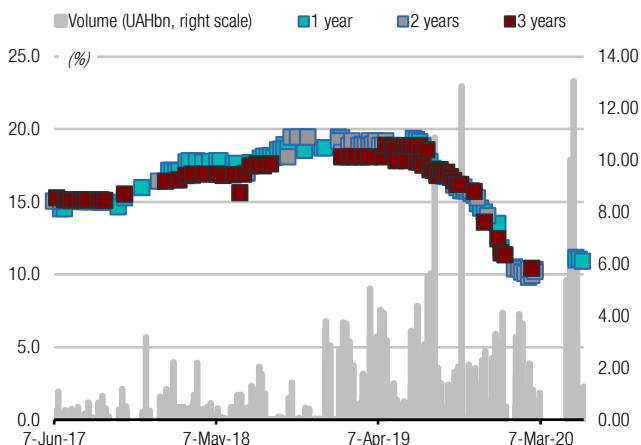
ICU view: As foreigners continue to sell longer bills in line with debt redemption this week, their outflow from UAH-denominated bills can amount to UAH2bn (US\$75m), decreasing the total amount of UAH-denominated bills in their portfolios to about UAH100bn (US\$3.8bn).

At the same time, local investors can submit large demand at the primary auction and compensate redemptions with new purchases. Today, the MoF will offer the usual bills with maturities up to one year, together with a second attempt to sell 1.5-year bills. Additionally, the Ministry will offer 11-month bills in euros, probably to replenish FX accounts from last week's debt redemption.

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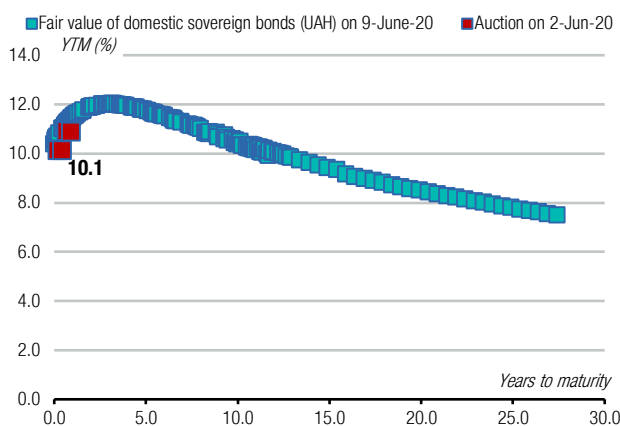
Chart 1. Local-currency bonds

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.

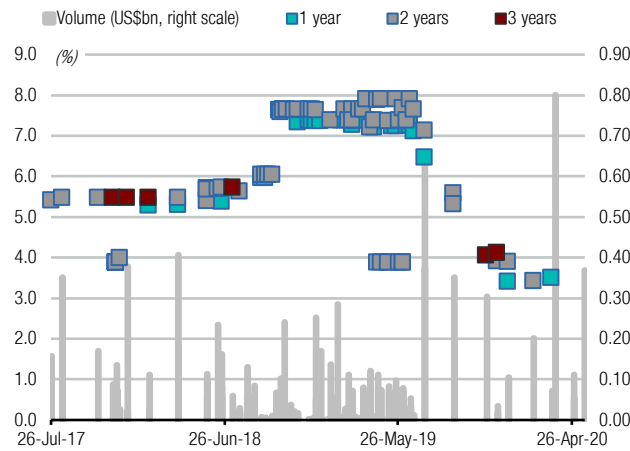
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

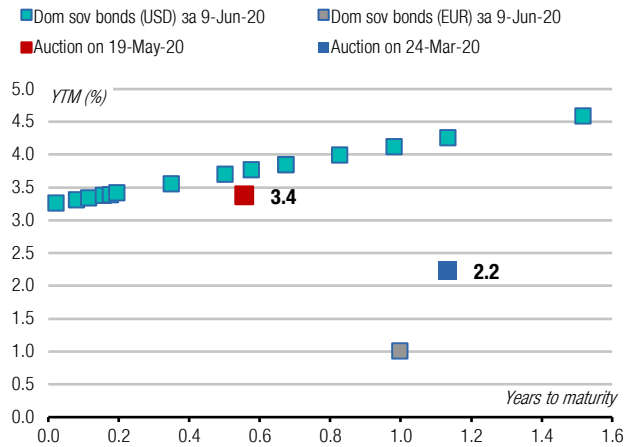
Chart 2. FX-denominated bonds

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 increases

The positive balance of Treasury operations and large supply of hard currency in the market caused banking-sector liquidity to increase to UAH194bn at the end of last week. This week large debt redemptions of UAH-denominated bills will support liquidity, which can rise to about UAH200bn.

The budget increased expenditures, expecting that the IMF will soon approve the new stand-by programme for Ukraine and provide the debut tranche to the state budget. As a result, the inflow of funds from the budget was UAH8.6bn last week. NBU injected a larger amount of funds into the banking system, UAH11bn, through purchase a large amount of hard currency in FX reserves (see comment below).

As is usual for the beginning of the month, banks increased reserves exchange in cash, decreasing liquidity by UAH5.1bn last week.

Finally, last week banking-sector liquidity rose, reaching UAH194bn.

ICU view: *In total, the balance of banking-sector liquidity remained steady with a slight increase to UAH200bn level. With this level of liquidity, interbank ON rates will remain low, and after NBU key policy rate revision, they should decline further. Therefore, we anticipate an increase in demand for local-currency government bills and a slight reallocation of funds from NBU CDs to the state budget, with these funds used for budget expenditures.*

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

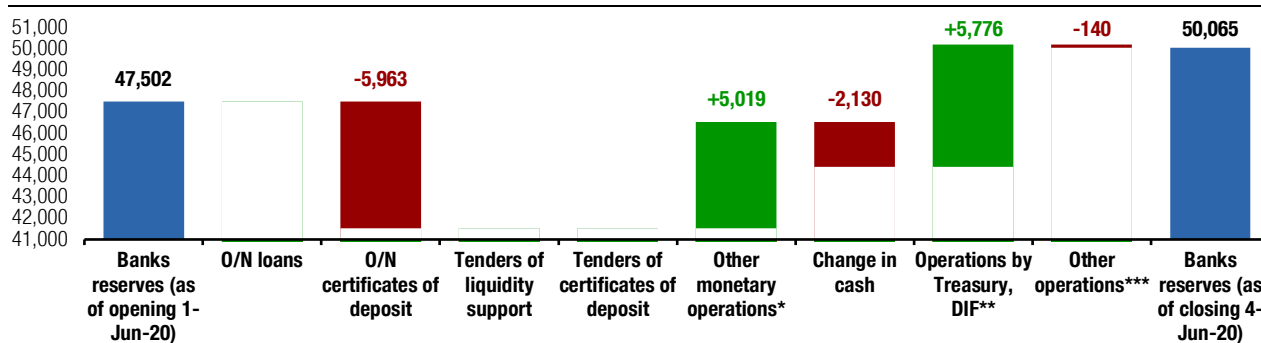
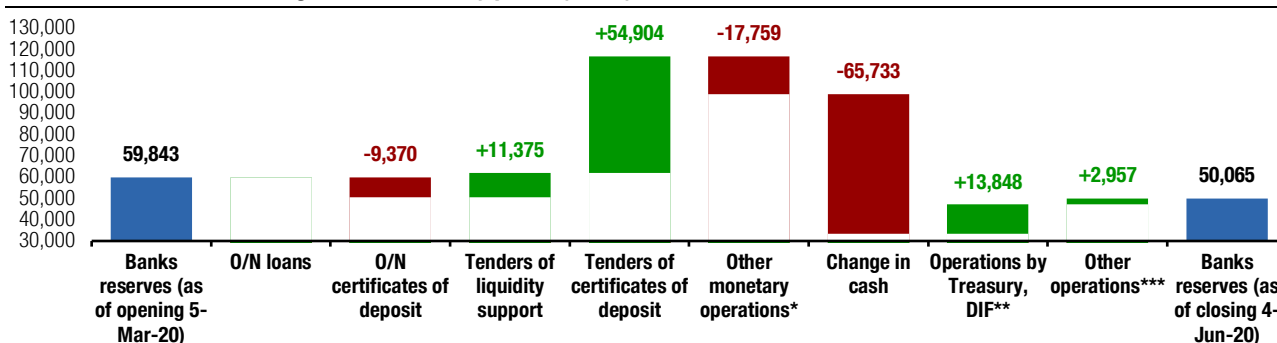


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 strong

The supply of hard currency in the market rose last week, causing the NBU to purchase the extra supply to restrain hryvnia appreciation. But despite the NBU entering the market, the hryvnia moved close to the bottom level of expected range. This week, we expect that the hryvnia exchange rate can cross the level of UAH26.5/US\$.

The NBU increased purchases of hard currency each day last week, which resulted in record purchases for this year, US\$410.7m, more than half of this amount was purchased last Friday. These purchases barely restrained appreciation and left the exchange rate within the range of UAH26.5-27/US\$.

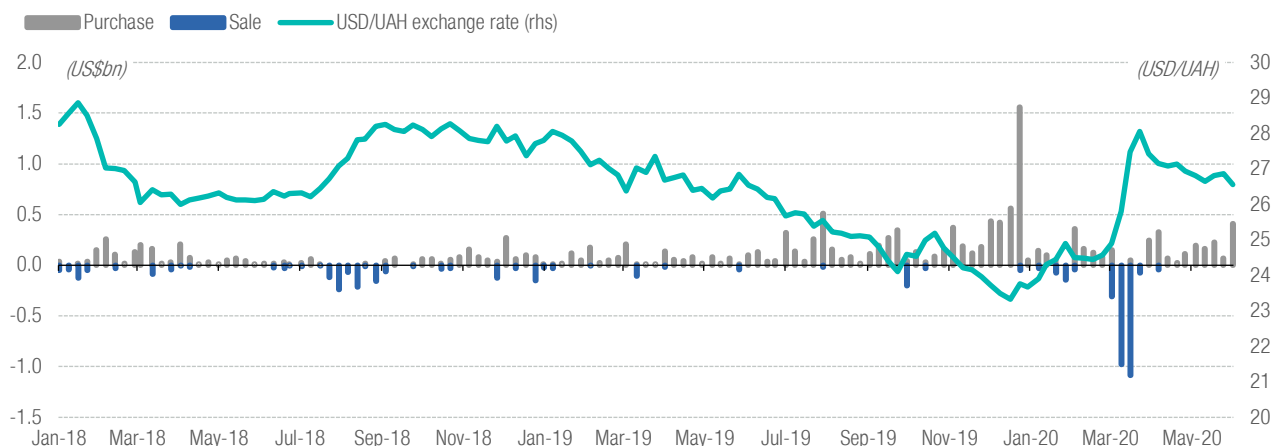
Overall, last week the hryvnia appreciated by 1.1% to UAH26.56/USD.

ICU view: This week, with a huge supply of hard currency in excess of demand, the hryvnia could continue to appreciate despite the NBU's attempts to restrain it. The hryvnia exchange rate can cross the level of the UAH26.5/USD with slight movement towards UAH26/US\$.

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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

Decline in construction is deepening

The contraction in demand for residential real estate and reduced investment in alternative energy were compounded by falling demand for commercial real estate due to the pandemic and lockdown effects.

In April, the decline in construction deepened to 16.0% YoY (compared with 11.6% YoY in March). For 4M20, construction decreased by 8.7% YoY compared with an increase of 32% YoY for 4M19.

Against the background of low demand from the population for residential real estate, construction of residential buildings decreased the most, by 28.9% YoY in April and 15.7% YoY for 4M20. In addition, construction of infrastructure facilities declined by 12.6% YoY in April and 11.1% YoY for 4M20. This is largely due to a significant reduction in the construction of alternative energy facilities. Also quite low are the volumes of construction of roads and bridges—3.2 billion UAH for 4M20—which is only 11% of the annual figure for 2019. This was partially offset by investment projects in the mining sector.

In addition, in contrast to 1Q20, the construction of non-residential buildings deteriorated significantly; falling in April by 12.1% YoY (+7.0% YoY in 1Q20). Probably, the lockdown and general uncertainty have significantly undermined investment demand for commercial real estate.

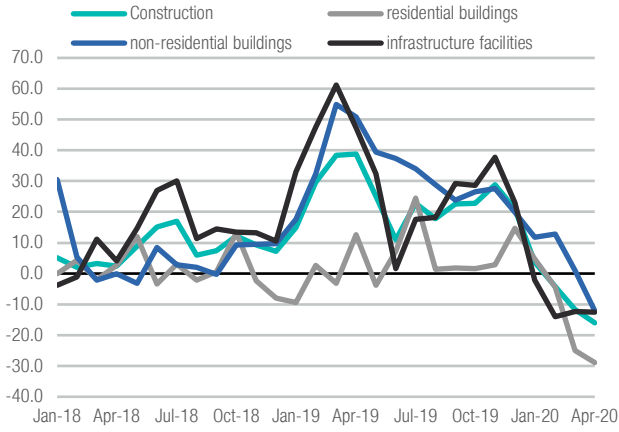
ICU view: Using seasonally adjusted indices, in April construction decreased by 19% compared with the local maximum in November 2019. By comparison, the decline for the period from January 2014 to April 2015 was twice as large, by 38%. Meanwhile, the contribution of the pandemic and lockdown was not decisive in this decline; a greater role was played by the contraction in demand for residential real estate and reduced investment in alternative energy, which was already evident.

Although we expect economic activity to recover gradually as the economy opens again, investment demand and, consequently, construction will lag behind. Fall in incomes of the population and businesses due to the lockdown, the general uncertainty about the economic outlook, and declining demand for commercial real estate due to the active transition to remote working and e-commerce can put a significant drag on the sector. Partially, it will be offset by the expected intensification

of “Great Construction” projects, primarily related to the construction and repair of roads and bridges. In general, we expect construction to fall by 12-15% this year

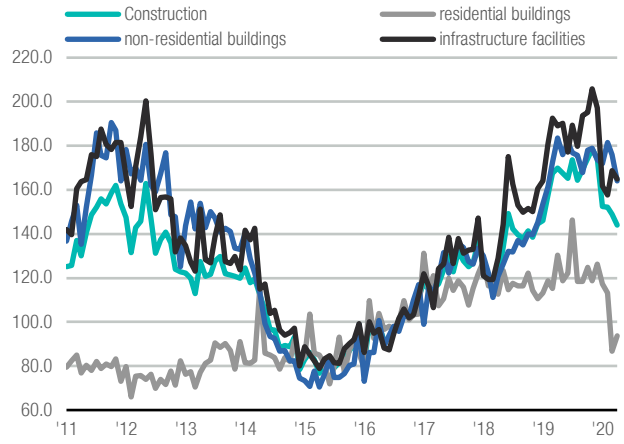
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Chart 6. Construction, YoY, %



Source: Ukrstat, ICU.

Chart 7. Construction, seasonally adjusted index, 2016=100%



Source: Ukrstat, ICU.

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