Focus
Ukraine

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

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Weekly Insight

Current account runs sizable surplus

Key messages of the today's comments

TUESDAY, 4 AUGUST 2020

Domestic liquidity and bonds market

Large debt repayments ahead

Ukraine is facing large debt repayments through the beginning of September. After the recent issue of Eurobonds, the most important market event will be refinancing domestic debt repayments.

Liquidity rose to UAH153bn

Liquidity gradually increased last week thanks to cash exchange in reserves and almost neutral impact of budget transactions. This week, liquidity will depend on the amount of debt repayments that are refinanced, and banks' exchange reserves in cash.

Foreign exchange market

Slight appreciation of the hryvnia

Last week, the hryvnia appreciated to UAH27.73/US$, which allowed the NBU to purchase hard currency. This week, the FX market will depend on foreigners' activity in funds withdrawal from local-currency debt, and on debt refinancing.

Economics

Wages continue to rebound

Wages continue to rise sharply after the slump in March-April, but are still lower than in February. In the coming months, we expect further recovery in hospitality, transportation, and public service, but in the medium-run, real wages growth will slow.

Current account runs sizable surplus

In June, the current account surplus was lower than in previous months amid a rebound of imports, but still remained high. The outflow of private capital has stopped, and thanks to the government's receipt of funds from the IMF and the EU, international reserves have reached US$28.5bn.

Banks' reserves market (3 August 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	6.00	+0bp	-1,100bp
ON rate (%)	5.24	+1bp	-1,054bp
ON $ swap (%)	N/A	...	...
Reserves (UAHm)[2]	50,381	-7.90	+4.57
CDs (UAHm)[3]	102,183	+10.06	+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) (3 August 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	425,116	-0.07	+23.20
Residents	27,208	-5.91	+2.84
Individuals	7,223	+2.10	-25.74
Foreigners[1]	92,533	-1.24	+2.11
Total	**876,657**	**-0.34**	**+8.38**

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

FX market indicators (3 August 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.8433	+0.44	+8.98
EUR/USD	1.1762	+0.39	+5.89
DXY	93.542	-0.16	-4.62
UAH TWI[1]	120.777	-0.34	-6.06

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

Gov't bond quotes[1] (4 August 2020)

Maturity	Bid	Ask
6m	**11.00**	**9.50**
12m	**11.50**	**10.25**
2y	**12.00**	**10.50**
3y	**12.25**	**10.75**
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

Large debt repayments ahead

Ukraine is facing large debt repayments through the beginning of September. After the recent issue of Eurobonds, the most important market event will be refinancing domestic debt repayments.

During August, the government has to pay almost UAH29bn (US$1.1bn) in local currency, US$487m in hard currency for domestic investors, and about US$200m for external debt holders. However, in September, with low domestic debt repayments of UAH16bn (US$0.6bn) in local currency, external debt repayments will amount to US$2.2bn, most of which are scheduled for 1 September. With the tranche from the IMF and proceeds from the Eurobond issue, the government should not have any difficulty making external repayments. However, it may encounter some difficulties with refinancing of domestic debt.

ICU view: This month the government started with UAH51.7bn (US$1.9bn) of funds in Treasury accounts in local currency. This will allow for the repayment of local-currency debt without full refinancing and then accounts can be replenished later this month, similar to last week's debt repayment refinancing, which amounted to about half of the redemption. This week, we expect the result of the auction to be the sale of bills with maturities between seven months and up to 1.5 years in low amounts to avoid an increase in interest rates.

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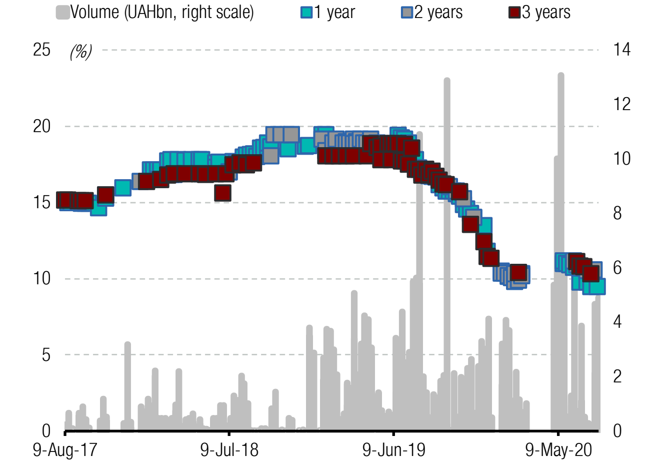
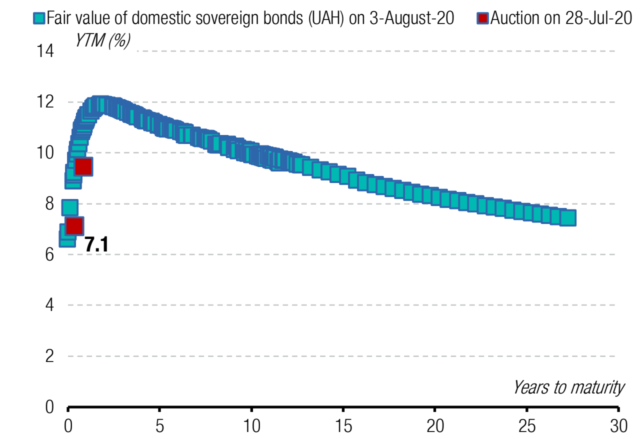
Chart 1. Local-currency bonds

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.

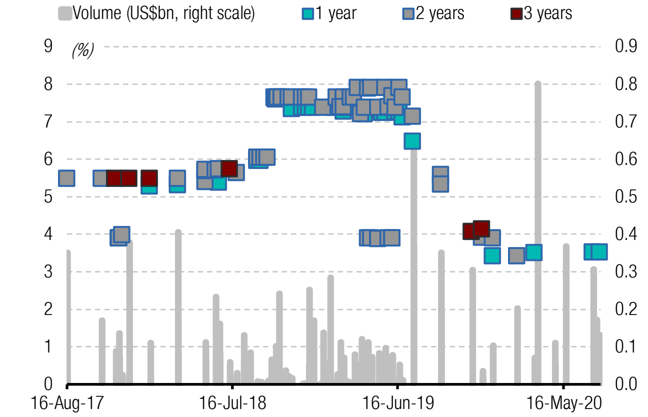
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

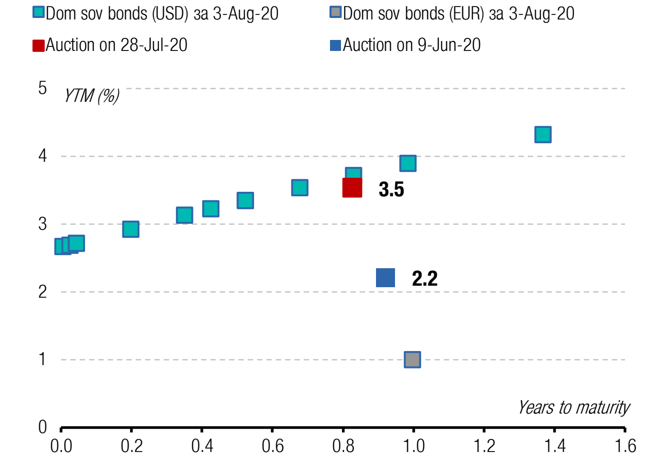
Chart 2. FX-denominated bonds

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 rose to UAH153bn

Liquidity gradually increased last week thanks to cash exchange in reserves and almost neutral impact of budget transactions. This week, liquidity will depend on the amount of debt repayments that are refinanced, and banks' exchange reserves in cash.

Partial refinancing of debt repayments, just UAH7.1bn (US$256m) of new borrowings instead of UAH13.1bn (US$473m) of repayments in local currency, supported the recovery in liquidity to UAH153bn (US$5.5bn). Additional support was provided by payments of VAT refunds, which were concentrated last week over two days: UAH2.9bn (US$105m) paid on Tuesday and UAH1.8bn (US$65m) last Wednesday.

The total impact of Treasury operations was almost neutral with just UAH0.9bn (US$32m) of outflow, as debt repayments and VAT refunds mostly compensated outflows through month-end tax payments.

Very important were banks' operations on cash exchange in reserves at UAH3.6bn (US$130m). NBU's impact on liquidity was low, just UAH1bn (US$36m) of inflows through the FX market and only UAH56m (US$2m) through new loans for banks.

ICU view: This week, liquidity will depend on how the MoF refinances its UAH17.3bn of debt repayments, and how active banks are in reserves exchange in cash, which is usual for the beginning of the month. Additional impact, although likely not material, will be provided by NBU operations on the FX market.

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

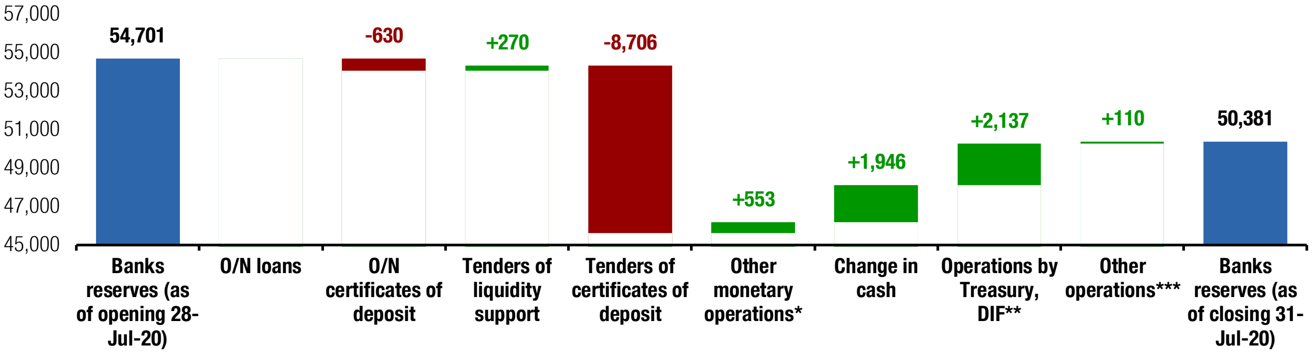
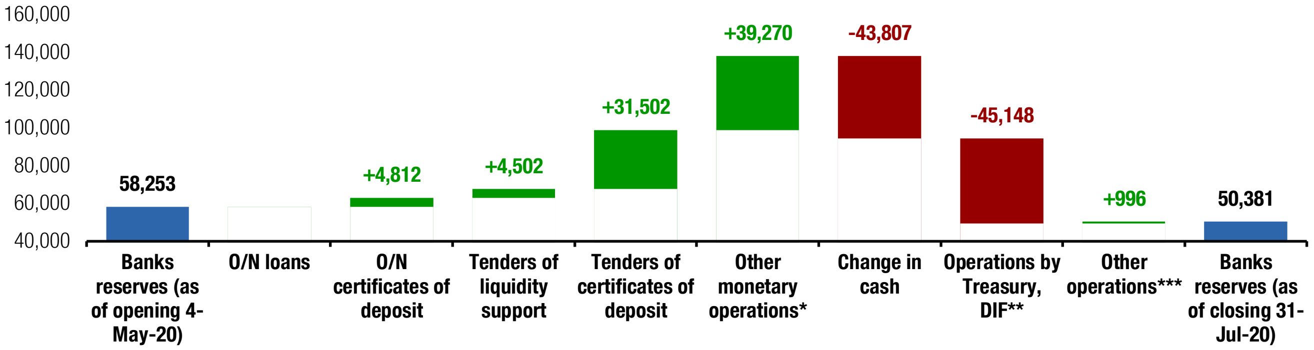


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Slight appreciation of the hryvnia

Last week, the hryvnia appreciated to UAH27.73/US$, which allowed the NBU to purchase hard currency. This week, the FX market will depend on foreigners' activity in funds withdrawal from local-currency debt, and on debt refinancing.

The hryvnia slightly appreciated following the new sovereign Eurobond issue, stabilization in the FX market, and the NBU's decision to keep the key policy rate unchanged. Last week, appreciation was 0.4%. The NBU participated in the market twice with purchases of hard currency to replenish FX reserves restraining appreciation. The total amount of intervention was low, just US$38m and spread over two days, Monday and Wednesday.

This means that funds from debt repayments were not transferred to the FX market. On the other hand, foreigners were not active selling bills, decreasing their portfolios by just UAH528m (US$19m), as they likely were not holders of bills redeemed last week.

ICU view: This week, the MoF has to repay UAH17.3bn in local currency debt, but this issue was sold in May with lack of foreigners' participation. Therefore, we assume that foreign investors will receive just UAH1bn (US$36m) of interest payments this Wednesday for other bill issues. Pressure on FX market can increase from the selling of bills. But most of demand in the FX market will come from locals, who will prefer to

purchase hard currency instead of new bills. We expect the hryvnia exchange rate to fluctuate at about 28/US$ this week.

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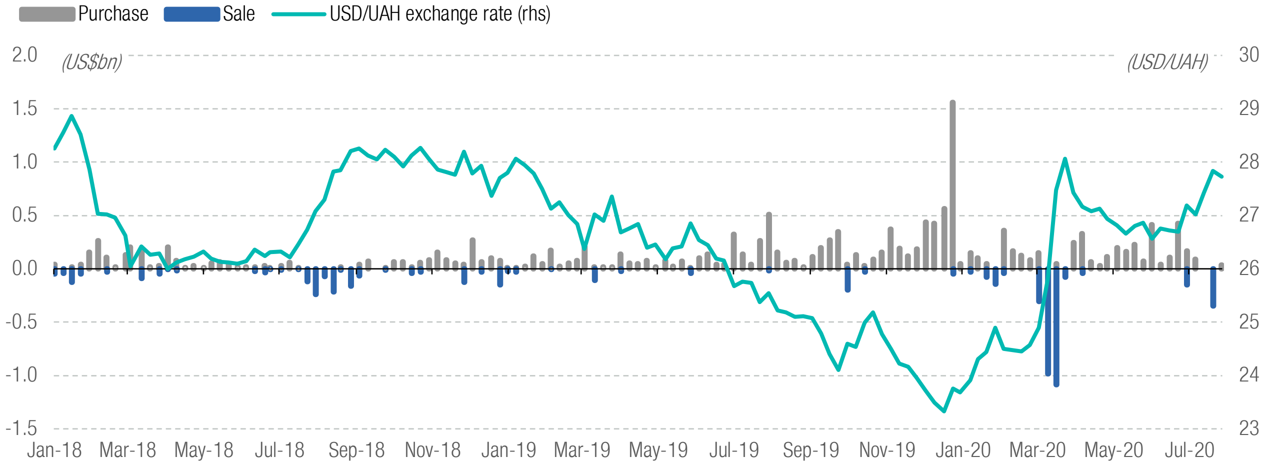
Chart 5. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Wages continue to rebound

Wages continue to rise sharply after the slump in March-April, but are still lower than in February. In the coming months, we expect further recovery in hospitality, transportation, and public service, but in the medium-run, real wages growth will slow.

According to Ukrstat data, growth of nominal and real wages in June accelerated to 7.4% YoY and 4.9% YoY, respectively. However, seasonally-adjusted average nominal wage in June was still 1.4% lower than in February, and the real wage was 3.6% lower based on our estimates.

Compared with February, the largest decrease in seasonally adjusted nominal wages was in hospitality (by 34%), real estate (by 10.7%), the financial sector (by 9.1%), and in transportation (by 8.6%). On the other hand, there was an increase over the same period in wages in medicine (by 6.6%), education (by 1.8%), and agriculture (by 1.7%). Compared with the local minimum in April, average wages increased in almost all sectors, except for public administration, where the dynamic was affected by the restriction of salaries by UAH 47,230 for the quarantine period.

ICU view: The reaction of wages confirms their high flexibility. During the lockdown, businesses quickly adapted to new realities, using such options as reducing the work week, unpaid leave, limiting the payment of bonuses, and the like. Therefore, the negative consequences for the unemployment rate, as during previous crises, should not be as significant as in many other countries.

In the coming months, we expect that real wage growth will receive a positive impetus from the resumption of activities in hospitality and transportation, as well as likely from the lifting of restrictions in the public sector. At the same time, further growth in real wages should slow compared with the pre-pandemic pace due to the relative restrictions for labour migration and the weakening potential for productivity growth.

Sharp increases in the minimum wage will have only short-term effects, which will be further offset by rising inflation and declining business efficiency

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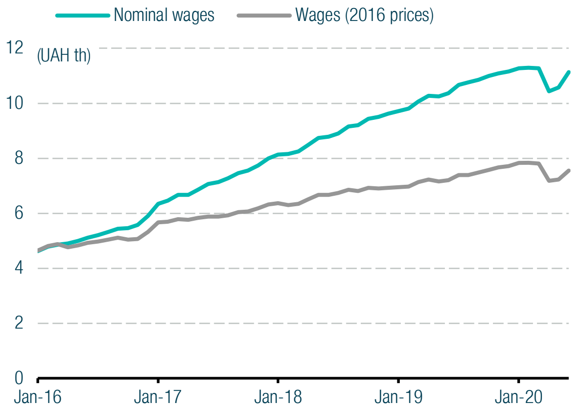
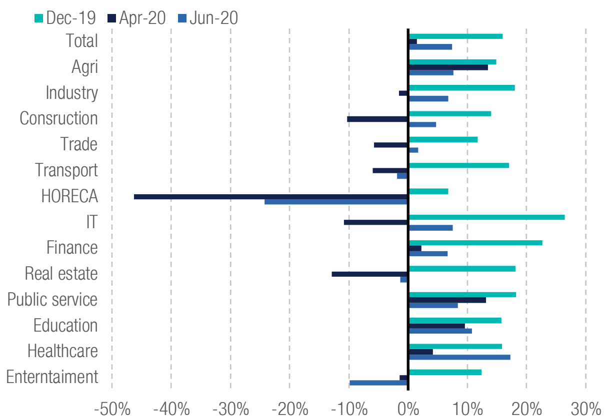
Chart 6. Nominal and real wages, SA, UAH th



Source: Ukrstat, ICU.

Chart 7. Average wages, YoY, %



Source: Ukrstat, ICU.

Current account runs sizable surplus

In June, the current account surplus was lower than in previous months amid a rebound of imports, but still remained high. The outflow of private capital has stopped, and thanks to the government's receipt of funds from the IMF and the EU, international reserves have reached US$28.5bn.

In June, the current account surplus (US$0.8bn) was about twice lower than in the previous two months, but still quite high. As a result, the 6M20 surplus reached US$6.7bn compared with the US$1.9bn deficit in 6M19. This was because remittances were quite stable, US$5.4bn in 6M20 (less by only 4% YoY), while the foreign trade balance shifted to a small surplus compared with a deficit of US$4.8 bn for 6M19 due to greater resilience of exports to the corona crisis, and investment income payments were minimal, as opposed to US$4.7bn in 6M19, due to weak financial results of companies with foreign capital.

In June, the decline in exports of G&S slowed to 9.2% YoY compared with 25% YoY in May. This was mainly due to increased supplies of iron ore and chemical products. At the same time, the decline in imports of G&S decelerated to 25.4% YoY compared with 40.1% YoY in May. First of all, this was due to a significant recovery in demand for imports of machinery, agricultural, and chemical products. However, travel and energy expenses remained significantly lower than last year.

As a result, the C/A surplus for the last 12 months grew to US$4.3bn (est. 3% of GDP). Over the past 12 months, the merchandise trade deficit decreased to US$11bn (est. 5.2% of GDP), while the services trade surplus increased to US$3.5bn (est. 2.4% of GDP), and remittances were almost unchanged at US$11.7bn (est. 8% of GDP).

In June, the financial account showed capital inflows of US$0.2bn after three months of outflow. This was mainly due to the government receiving EUR500m in macro-financial assistance from the EU. Also, the private sector attracted foreign debt capital unlike in the previous three months, but FDI declined due to losses of companies with foreign capital. Taking into account the disbursement of the IMF loan, international reserves increased to US$28.5bn.

ICU view: Favorable terms of trade, resilience of remittances and exports of IT services and agricultural products, and a sharp decline in imports and investment income payments continue to contribute to a significant current account surplus. In the coming months, we still expect imports to recover amid the economy's exit from the lockdown and a return to a current account deficit. However, the 2020 current account surplus is likely to be higher than our June forecast of US$1.5bn (1.0% of GDP).

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