



Focus
Ukraine

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

Research team
Sergiy Nikolaychuk
Alexander Martynenko
Taras Kotovych

Weekly Insight

Retail sales pick up

Key messages of the today's comments

Domestic liquidity and bonds market

Holdings of domestic government paper decline

Investors are not in hurry to increase their holdings of Ukrainian government domestic bills. After debt redemption last week, most portfolios declined. This week, we expect new purchases despite a lack of debt redemptions, with a possible increase in portfolios, especially for banks.

Liquidity stays above UAH150bn

Despite quarterly tax payments, total amount of banking-sector liquidity fluctuated in the range of UAH150–160bn last week. We anticipate liquidity to fluctuate within the same range this week.

Foreign exchange market

Hryvnia stabilizes after tax payments are completed

As expected, the need for local-currency liquidity for tax payments provided support for hryvnia exchange rate, but it was short-lived. We expect the exchange rate to fluctuate at around UAH27.5/US\$ this week.

Economics

Retail sales pick up

In July, retail trade surged by 8.5% YoY, exceeding pre-pandemic levels and reflecting a recovery in household income and switch in consumer demand from foreign tourism. Other indicators of economic activity showed a mixed picture. Wholesale turnover decreased after a significant jump in June. Freight and passenger turnover continue to recover after the decline during the lockdown, but both are still much lower than before the pandemic. Agricultural production is significantly lower than last year due to the later start of the harvest.

TUESDAY, 25 AUGUST 2020

Banks' reserves market (21 August 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	6.00	+0bp	-1,100bp
ON rate (%)	5.23	-5bp	-1,104bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	64,250	+169.89	+47.85
CDs (UAHm) ³	94,229	+3.13	+117.11

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) (21 August 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.71
Banks	413,273	-2.17	+20.70
Residents	27,907	+2.71	+4.60
Individuals	7,446	-1.39	-24.30
Foreigners ¹	88,568	-1.37	-1.80
Total	861,770	-1.12	+6.90

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (21 August 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.4488	+0.42	+9.10
EUR/USD	1.1797	-0.38	+6.42
DXY	93.247	+0.16	-5.14
UAH TWI ¹	123.334	+0.38	-6.15

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (25 August 2020)

Maturity	Bid	Ask
6m	10.00	8.00
12m	10.50	9.00
2y	11.00	10.00
3y	11.50	10.50
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

Holdings of domestic government paper decline

Investors are not in hurry to increase their holdings of Ukrainian government domestic bills. After debt redemption last week, most portfolios declined. This week, we expect new purchases despite a lack of debt redemptions, with a possible increase in portfolios, especially for banks.

Last Tuesday, the MoF sold just UAH2.5bn (US\$91m) of new bills, including UAH0.8bn (US\$30.9m) in hard currency (see details in [auction review](#)). However, debt repayments last week amounted to UAH9bn (US\$330m) in local and US\$159m in hard currency.

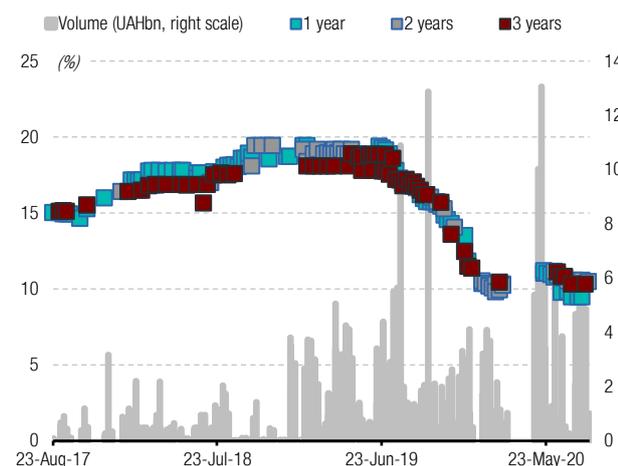
As the result of this difference, only non-bank investors increased holdings by UAH0.7bn (US\$26m) to UAH27.6bn (US\$1bn), which is 3.2% of total domestic bonds outstanding. The largest decline in holdings was for banks: their portfolios decreased by UAH8.9bn (US\$325m) to UAH413.6bn (US\$15bn), which is 48% of total bonds outstanding. Foreigners decreased their portfolios, as well, but by UAH1.2bn (US\$44m) to UAH88.2bn (US\$3.2bn), while their share in total bonds outstanding was rather steady at 10.24%.

ICU view: There are no debt redemptions this week. The Ministry of Finance sold today a portion of four-month bills due this December. Therefore, new purchases can partially compensate the decline in portfolios seen last week. However, foreigners may slightly decrease their portfolios.

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

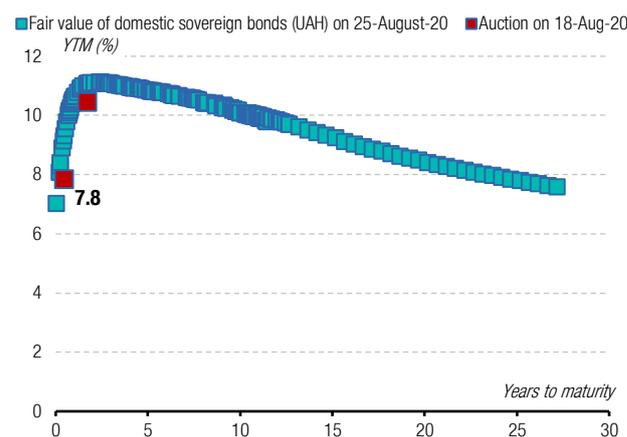
Chart 1. Local-currency bonds

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.

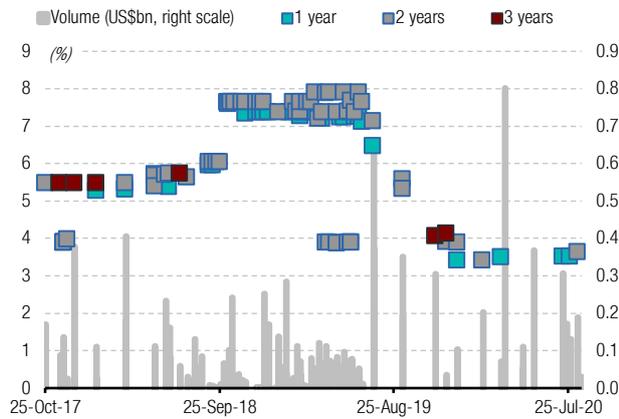
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

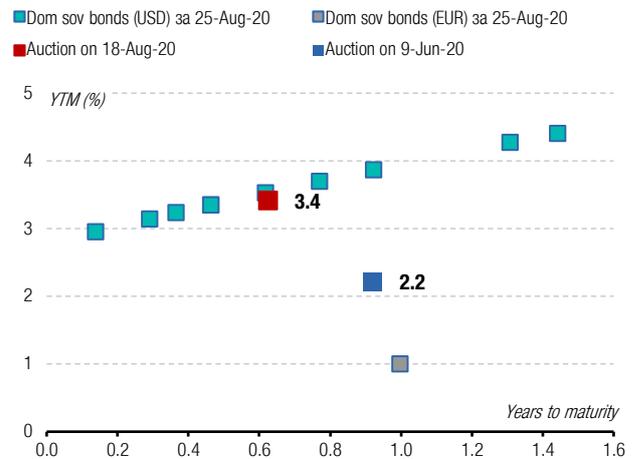
Chart 2. FX-denominated bonds

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 stays above UAH150bn

Despite quarterly tax payments, total amount of banking-sector liquidity fluctuated in the range of UAH150–160bn last week. We anticipate liquidity to fluctuate within the same range this week.

Over the past week, the impact of Treasury operations on liquidity has changed dramatically: on Monday and Tuesday there was liquidity outflow to budget accounts through tax payments of UAH10.4bn, while on Wednesday, most of this outflow was compensated through debt repayments. The net balance of Treasury operations last week was at UAH0.4bn.

Banks exchange of reserves in cash was not active, causing just UAH2.6bn of outflows from liquidity. Therefore, NBU's purchases of hard currency supported liquidity, especially last Tuesday, providing UAH3.5bn of funds in banking-sector liquidity through the FX market.

ICU view: Liquidity in the banking system ended the week at UAH161bn, just UAH1bn more than the week before. We expect similar fluctuations in liquidity within the range of UAH150–160bn this week, in response to month-end tax payments, VAT refunds, and new government borrowings.

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

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

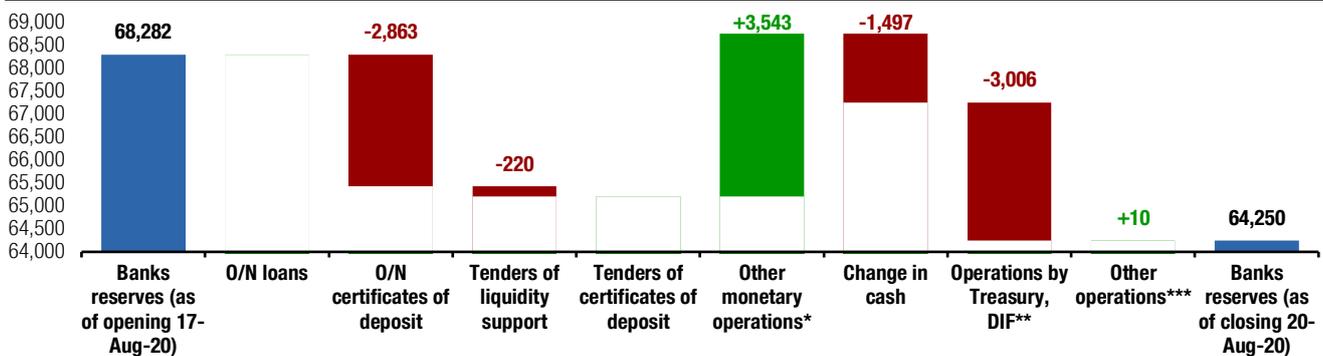
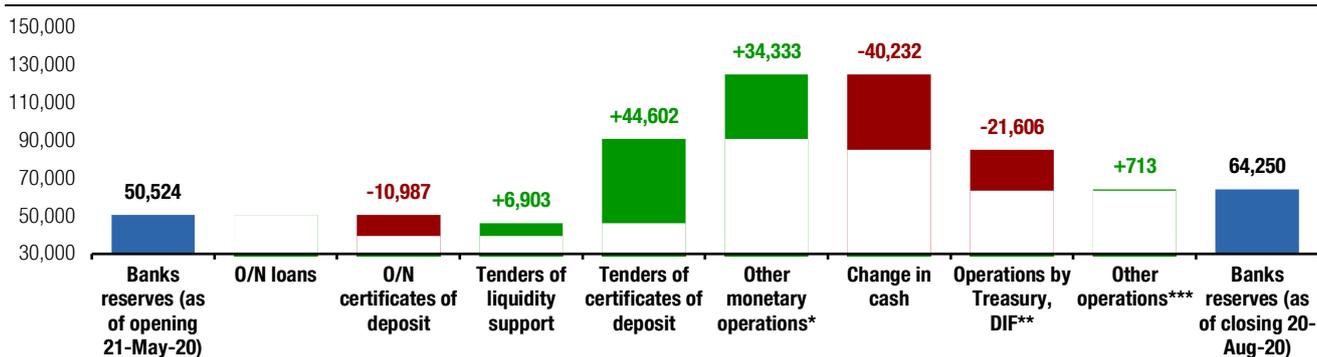


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 stabilizes after tax payments are completed

As expected, the need for local-currency liquidity for tax payments provided support for hryvnia exchange rate, but it was short-lived. We anticipate the exchange rate to fluctuate at around UAH27.5/US\$ this week.

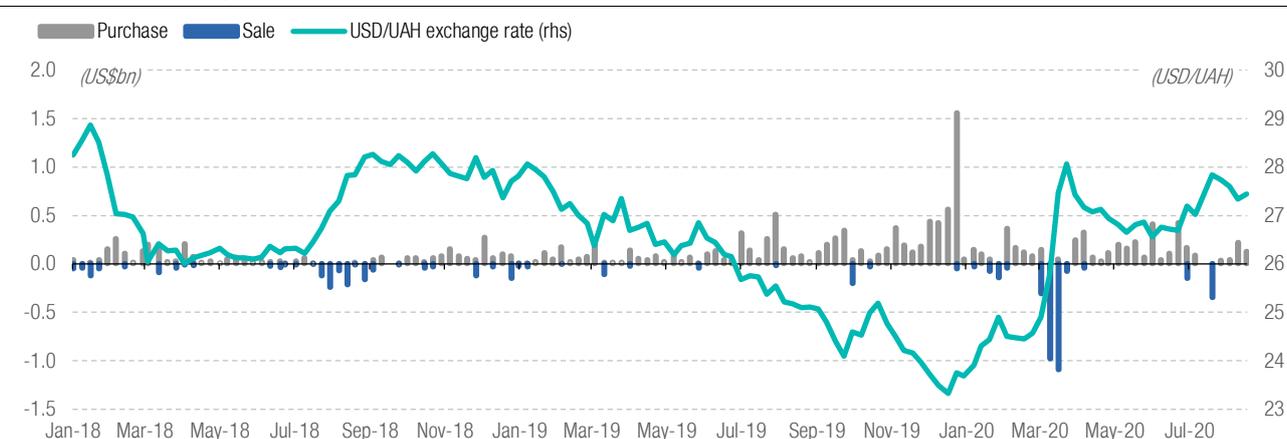
In fact, most quarterly tax payments were paid last Tuesday, allowing the FX market to mostly self-balance, with hard currency supply lower than before. As a consequence, later in the week, the exchange rate slightly weakened to UAH27.45/US\$ or just 0.4% weaker than a week before.

ICU view: We do not anticipate material changes in the FX market this week, and expect a self-balancing market. Likely, the NBU will participate in the market with purchases to replenish international reserves. The hryvnia exchange rate should fluctuate at around UAH27.5/US\$ under the impact of month-end tax payments, VAT refunds, and new government borrowings.

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

Retail sales pick up

In July, retail trade surged by 8.5% YoY, exceeding pre-pandemic levels and reflecting a recovery in household income and switch in consumer demand from foreign tourism. Other indicators of economic activity showed a mixed picture. Wholesale turnover decreased after a significant jump in June. Freight and passenger turnover continue to recover after the decline during the lockdown, but both are still much lower than before the pandemic. Agricultural production is significantly lower than last year due to the later start of the harvest.

Retail trade continued to grow rapidly in comparison with the previous months—by 12.1% MoM in July after 8.8% MoM in June—and, in seasonally adjusted terms, exceeded the pre-pandemic level of January–February by about 5%. Such a sharp recovery in retail trade was ensured, first of all, by the fast lifting of lockdown restrictions and the resumption of real wage growth (4.8% YoY in June). In addition, limited foreign tourism has largely supported domestic spending. For example, the NBU estimated money spent by Ukrainians abroad in June at only US\$185m compared with US\$792m a year ago. Also, the high growth rate in July can be partly explained by the realization of deferred demand and the purchase of goods, which has increased as a reaction to social distancing, such as household appliances and cars, especially in the budget segment.

The decline in wholesale trade deepened to 1.3% YoY for 7M20 from 0.5% YoY in January–June. According to our estimates, in July, wholesale trade turnover fell by 6% YoY after the surge by 12% YoY in June.

Passenger turnover, although significantly improved compared with previous months, in July was only 41% of last year's level. In particular, for public transport in cities, this ratio was 70–80%. For passenger turnover of rail and air transport, it amounted to only 38% and 18%, respectively.

Freight turnover continued to grow compared with previous months, but nonetheless has contracted by 15% YoY. However, the lion's share of this decline was caused by pipeline transport, which turnover decreased by 33% YoY. In contrast, freight turnover by rail transport almost recovered to last year's level, the rate of decline shrinking to 1.7% YoY.

The later start of grain harvesting compared with last year continued to determine the performance of agriculture, which production declined by 5.8% YoY in July and by 11.2% YoY in 7M20.

ICU view: The sharp growth of retail trade was to some extent the result of substitution of consumer spending both internationally (from abroad to inside the country) and intertemporally (realization of deferred demand and preparation for the new business season in anticipation of continued social distancing). However, consumer sentiment remains depressed even as incomes recover. Therefore, it is unlikely that the growth of retail trade will continue at the same rapid pace.

But even if it slows, such a recovery in domestic demand and household income justifies the upside revision of our forecast for GDP decline this year (6.7%), despite the growing cases of COVID-19 in recent weeks and increased risks due to the start of the school year.

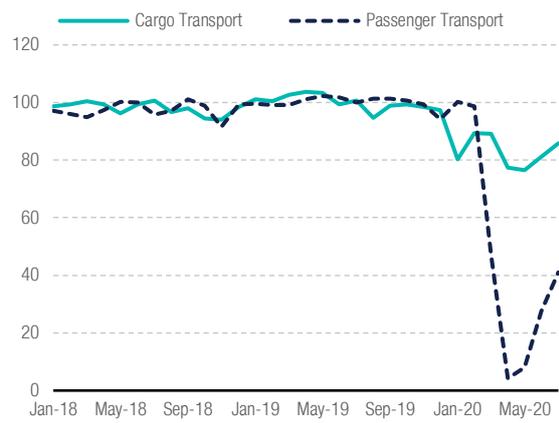
Sergiy Nikolaychuk, Kyiv, (044) 377-7040 ext.721

Chart 6. Retail trade and real wages, % YoY



Source: Ukrstat, ICU.

Chart 7. Freight and passenger turnover, SA levels, 2019=100



Source: Ukrstat, ICU.

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

This research publication has been prepared by Investment Capital Ukraine LLC solely for information purposes for its clients. It does not constitute an investment advice or an offer or solicitation for the purchase or sale of any financial instrument. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, Investment Capital Ukraine makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of Investment Capital Ukraine LLC. All rights are reserved. Any investments referred to herein may involve significant risk, are not necessarily available in all jurisdictions, may be illiquid and may not be suitable for all investors. The value of, or income from, any investments referred to herein may fluctuate and/or be affected by changes in exchange rates. Past performance is not indicative of future results. Investors should make their own investigations and investment decisions without relying on this report. Only investors with sufficient knowledge and experience in financial matters to evaluate the merits and risks should consider an investment in any issuer or market discussed herein and other persons should not take any action on the basis of this report.

Additional information is available upon request.

