



Focus
Ukraine

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

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Weekly Insight

Industrial production continues to recover

Key messages of the today's comments

Domestic liquidity and bonds market

Government bond portfolios steady

A low amount of new borrowings and the lack of redemptions caused only slight changes in bond portfolios for all investors. In the following weeks, most of the impact we will see on portfolios will come from primary auctions and the secondary market.

Liquidity stays at UAH160bn

NBU's participation in the FX market and banks' exchange of cash in reserves supported banking-sector liquidity at UAH160bn last week. This week, we do not expect large movements in liquidity.

Foreign exchange market

Hryvnia steady

The hryvnia exchange rate saw slight fluctuations last week around UAH27.5/US\$. We will see similar fluctuations this week, too.

Economics

Strong consumer demand supports industrial production

Industrial production continued to grow, and in July, the seasonally adjusted level was 7.2% higher than in April and only 0.5% lower than in January–February. Further growth of industrial production is projected to slow due to the negative impact of new outbreaks of coronavirus infection in Ukraine and in the world on consumption and investment.

Wages pick up sharply, especially in healthcare and IT

Wages continue to rise rapidly after the slump in March–April. The seasonally adjusted indicator already exceeded February's level by 1.7%, while in real terms remained lower by 0.5%. In the following months, we expect additional impulse thanks to an increase in the minimum wage, but the potential for strong growth of real wages will weaken.

MONDAY, 31 AUGUST 2020

Banks' reserves market (28 August 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	6.00	+0bp	-1,100bp
ON rate (%)	5.21	-6bp	-1,096bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	56,331	+0.05	-8.76
CDs (UAHm) ³	105,203	+0.59	+206.57

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 gov't bond holders (UAHm) (28 August 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.71
Banks	414,864	+0.32	+22.00
Residents	27,820	+1.39	+9.95
Individuals	7,606	+2.15	-20.79
Foreigners ¹	87,649	-1.02	-1.42
Total	862,516	+0.11	+7.69

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (28 August 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.4478	+0.00	+8.83
EUR/USD	1.1903	+0.90	+7.45
DXY	92.371	-0.94	-5.95
UAH TWI ¹	122.854	-0.39	-7.04

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (31 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

Government bond portfolios steady

A low amount of new borrowings and the lack of redemptions caused only slight changes in bond portfolios for all investors. In the following weeks, most of the impact we will see on portfolios will come from primary auctions and the secondary market.

Last week, there were only slight changes in government bond portfolios. Banks increased portfolios by 0.25% or UAH1bn (US\$36m) to UAH414.6bn (US\$15.1bn), non-banks increased investments by 2.4% or UAH0.7bn (US\$25.5m) to UAH28.3bn (US\$1bn), and individuals added UAH179m (US\$6.5m) to portfolios, increasing them to UAH7.6bn (US\$277m) or by 2.4%. However, foreigners continued to decrease their investments, last week by 0.6% or UAH0.6bn (US\$22m) to UAH87.7bn (US\$3.2bn).

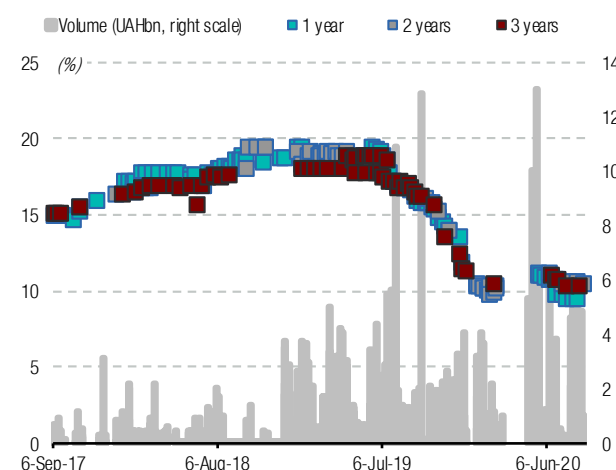
The primary auction had only a very slight impact on bonds portfolios, as MoF rejected 93% of demand for local-currency bills. More details in auction review. Note that the amount of borrowings fell below UAH1bn (US\$36m), a bit higher than the lowest amount this year UAH313m (US\$11.4m) seen in July, 2020.

ICU view: This week, demand should slightly increase. But without redemptions, the MoF will only be able to borrow new funds without reinvesting. Therefore, portfolios will see slight changes after secondary market trading, and only banks will increase portfolios after the primary auction.

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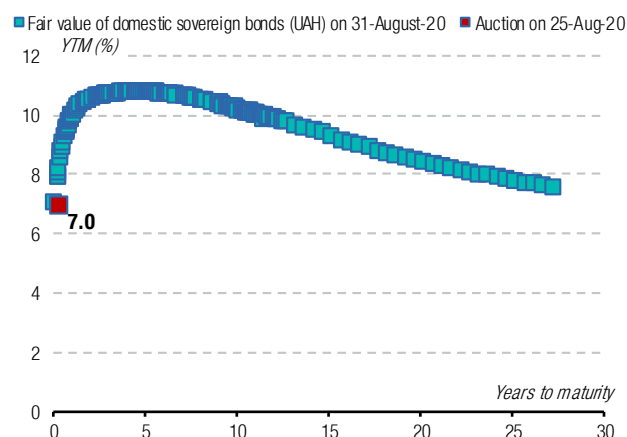
Chart 1. Local-currency bonds

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.

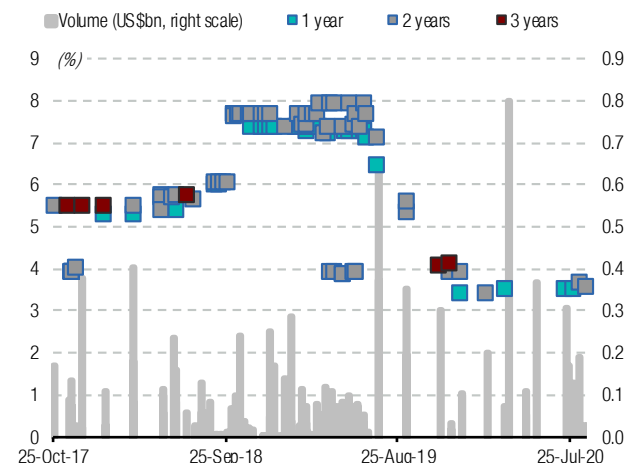
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

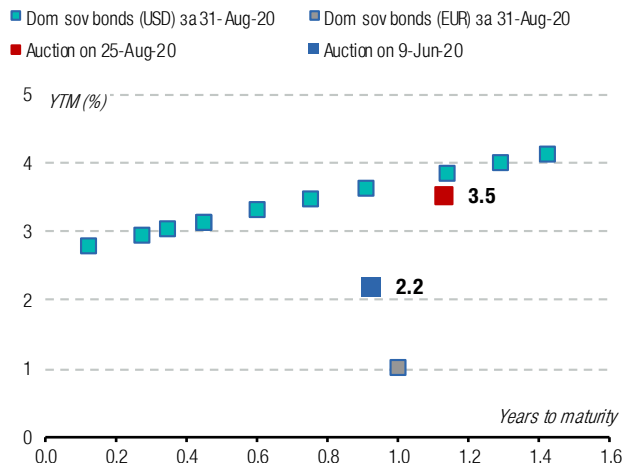
Chart 2. FX-denominated bonds

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 stays at UAH160bn

NBU's participation in the FX market and banks' exchange of cash in reserves supported banking-sector liquidity at UAH160bn last week. This week, we do not expect large movements in liquidity.

Last week the NBU paid UAH1.9bn for purchases of hard currency, a key factor for liquidity support. Another was a change in the direction of banks' transaction with cash, exchanging UAH2.7bn in cash reserves. With the outflow of funds in budget accounts at UAH6.5bn, two key factors compensated large part of outflows keeping liquidity at UAH160bn.

However, banks just slightly changed structure of liquidity, decreased banks' accounts with the NBU from UAH56-57bn to UAH48bn last Friday, increased NBU CDs outstanding from UAH105bn to about UAH112bn that day, mostly with one-week tenors.

ICU view: This week, we do not expect material changes in liquidity due to the lack of debt repayments and low activity in VAT refunds. Only purchases of a large portion of new government bills would cause outflows to budget accounts, which the Treasury can compensate with large expenditures.

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

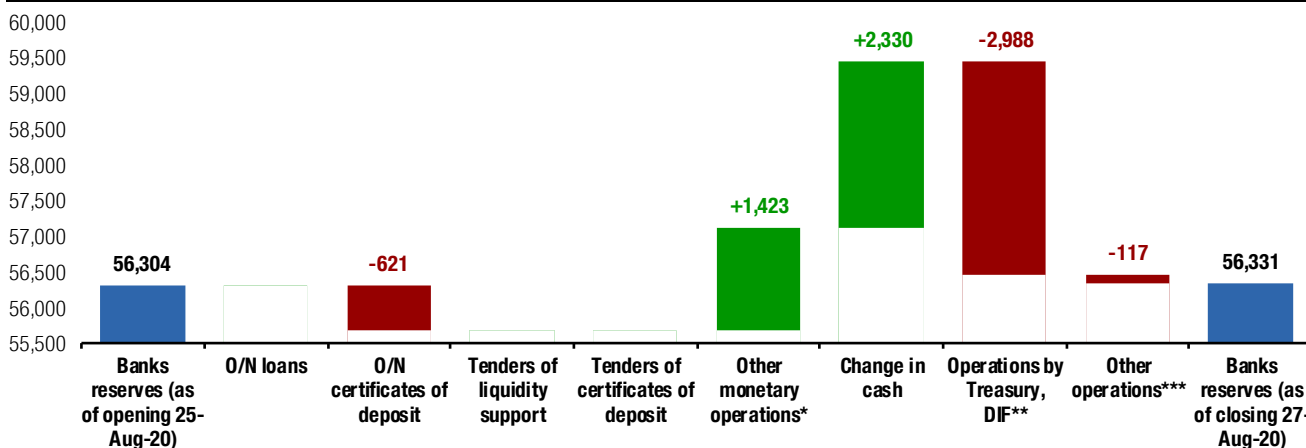
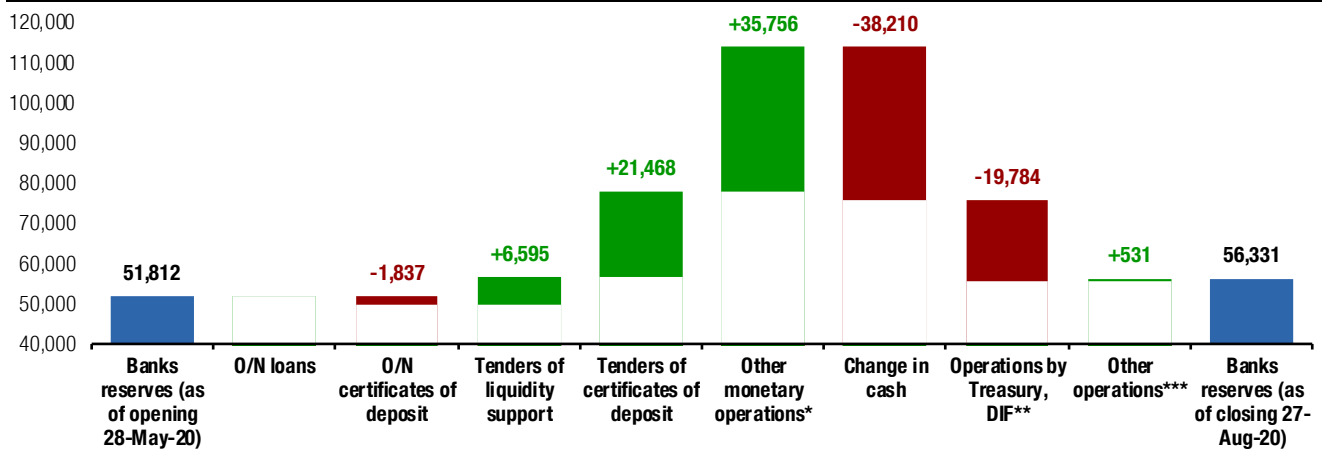


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 steady

The hryvnia exchange rate saw slight fluctuations last week around UAH27.5/US\$. We will see similar fluctuations this week, too.

The FX market was mostly self-balanced last week. The NBU only once purchased more than US\$20m in a day, and did not participate in the market on Thursday. Last Friday, the NBU purchased less than usual US\$20m. The normal level of banking-sector liquidity and active VAT refund were enough for the market, as there was not extra supply of hard currency, while foreigners did not require extra hard currency due to the low pace of T-bill selling.

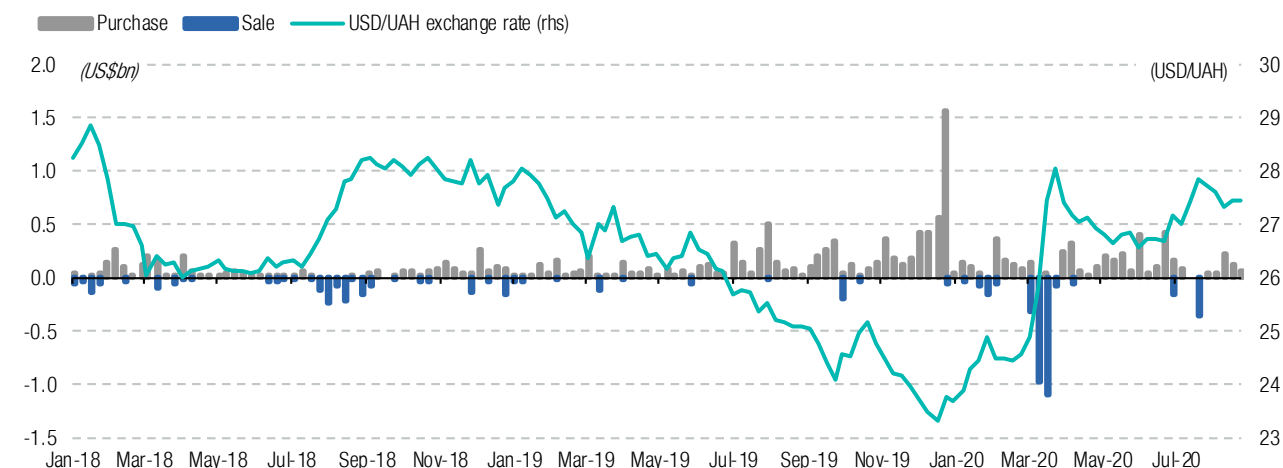
With such conditions, the hryvnia exchange rate fluctuated within the UAH27.35–27.5/US\$ range. Therefore, last week, the hryvnia ended at the same level as the week before, at UAH27.45/US\$.

ICU view: We do not expect material changes in the FX market this week. The hryvnia will fluctuate not far from UAH27.5/US\$ level and the FX market will be mostly self-balanced with NBU participation to replenish FX reserves.

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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

Strong consumer demand supports industrial production

Industrial production continued to grow, and in July, the seasonally adjusted level was 7.2% higher than in April and only 0.5% lower than in January–February. Further growth of industrial production is projected to slow due to the negative impact of new outbreaks of coronavirus infection in Ukraine and in the world on consumption and investment.

In July, the decline in industrial production slowed to 4.2% YoY (from 5.6% YoY in June), while industrial output grew by 1.4% MoM SA.

In 7M20, industrial production decreased by 7.7% YoY. The largest contribution to the decline came from a decrease in the output of metallurgy (by 13.6% YoY) and machinery (by 22.1% YoY), coal mining (by 20.3% YoY), and electricity generation (by 5.3% YoY). At the same time, the output of the chemical industry grew by 8.6% YoY.

ICU view: The recovery of domestic consumer demand, supported by rising wages and restrictions on foreign tourism, plays an important role in supporting industrial output. In particular, in July, the production of consumer durables was only 0.6% lower than last year, while the production of non-durable consumer goods grew by 1.1% YoY. To a large extent, such figures reflected an acceleration of food production by 4.6% YoY and a slowdown in the decline in light industry to 1.4% YoY.

Meanwhile, investment demand remains weak, so the production of capital goods contracted by 21.7% YoY, in particular, by 21.3% YoY for machinery. The production of intermediate goods also remained below last year's levels, by 5.6% in July. While the decline in metallurgy deepened significantly to 10.6% YoY, largely explained by the effect of the statistical base, coal mining grew by 4.7% YoY.

Looking ahead, we expect a weakening of the recovery in consumer demand, in particular against the background of a new outbreak of COVID-19. This will slow further growth in consumer-goods production. In addition, the outlook for a rebound of investment demand and, accordingly, the purchase of intermediate goods both in Ukraine and abroad remain sluggish. Therefore, further growth in industrial production

compared with July's level is projected to be very slow. However, even in these conditions, industrial production should reach a positive annual growth rate in 4Q20. In general, for the full year, the decline in industrial output is forecast at about 5%.

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Wages pick up sharply, especially in healthcare and IT

Wages continue to rise rapidly after the slump in March–April. The seasonally adjusted indicator already exceeded February's level by 1.7%, while in real terms remained lower by 0.5%. In the following months, we expect additional impulse thanks to an increase in the minimum wage, but the potential for strong growth of real wages will weaken.

According to Ukrstat data, growth of nominal and real wages in July accelerated to 7.6% YoY and 5.1% YoY, respectively; seasonally adjusted nominal and real wages grew by 3.2% MoM, both. Expectedly, the highest growth rates were in healthcare (+17.9% YoY) and the IT sector (+14.4% YoY). Also, in the last three months, wages picked up sharply in industry and trade, causing an acceleration of annual growth rates to 7.0% YoY and 3.8% YoY, respectively.

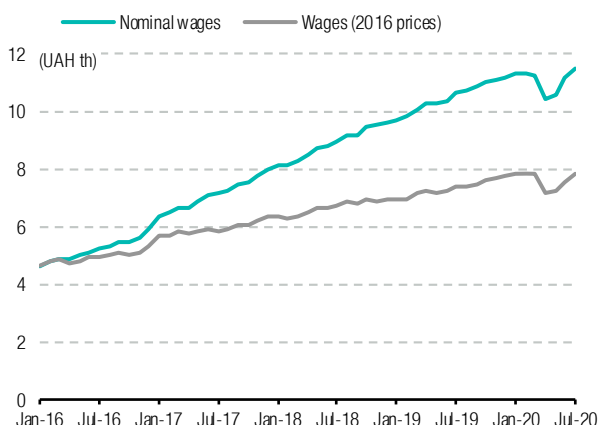
Meanwhile, wages in hospitality and transport, while recovering slightly in the last two months, were still lower in July 2020 than a year ago, by 15% and 4%, respectively.

ICU view: The recovery of wages confirms a quite rapid exit of the labour market from the coronavirus-induced recession. The rebound of workers' income is also evidenced by the high growth rates of retail trade and production of consumer goods. However, in some areas, such as hospitality and transport, the effects of the pandemic are still being felt and are likely to persist as long as the population adheres to some form of social distancing.

In the face of the ongoing outbreak of the coronavirus, we expect real wage growth to slow. Eliminating the salary ceiling of UAH47 th in the public sector and the increase of the minimum wage in September by 6% MoM may give a short-term boost. However, further weakening of productivity-growth potential due to social distancing and limited labour mobility will constrain the ability of companies to raise wages at a high rate.

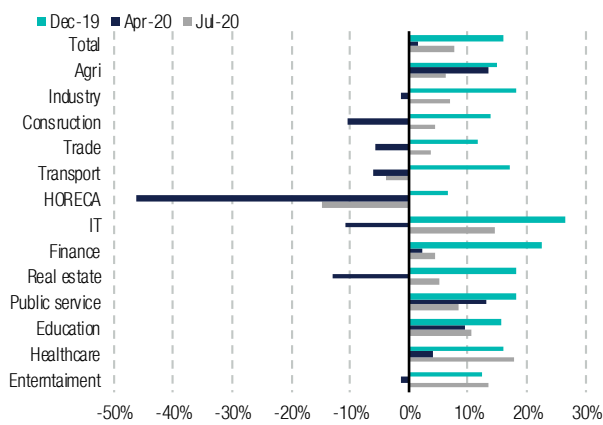
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Chart 6. Nominal and real wages, SA, UAH th



Source: Ukrstat, ICU.

Chart 7. Average wages, YoY, %



Source: Ukrstat, ICU.

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