



Focus  
**Ukraine**

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

Research team  
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Alexander Martynenko  
Taras Kotovych**

# Weekly Insight

## Wage growth is accelerating

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Net borrowings increase

Net borrowings from UAH-denominated bills rose to UAH47bn (US\$1.8bn) during 10M20, partially due to a lack of redemptions in October. The Ministry of Finance has not refinanced all repayments for FX-denominated bills this year. Therefore, it has two offerings planned for November in US dollars and euros.

##### Liquidity remains high

During October, the total amount of banking-sector liquidity fluctuated around UAH170bn, and at the end of the month, it was UAH178bn. This month, most likely, liquidity will fluctuate close to the same level.

#### Foreign exchange market

##### Hryvnia continues to weaken

During most of October, the hryvnia exchange rate was steady, slightly above the UAH28.3/US\$ level. It was weakest at the end of the month at about UAH28.5/US\$. In November, we anticipate further hryvnia weakening and fluctuations within the UAH28.5–29/US\$ range.

#### Economics

##### Wage growth is accelerating

In September, the growth rates of real wages almost approached pre-pandemic levels. We expect a slowdown in growth in the coming months, but in January, another increase in the minimum wage will provide additional impetus.

##### Twin deficit for both the current and financial account

In September, the overall BoP was in deficit due to repayments of public-sector debt, interest under the C/A, and the principal under the F/A. Looking ahead, the pace of domestic demand recovery will determine the size of the C/A deficit, and the sentiments of the population, businesses, and investors—the direction of capital flows under the F/A.

**TUESDAY, 3 NOVEMBER 2020**

#### Banks' reserves market (2 November 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	6.00	+0bp	-950bp
ON rate (%)	4.84	-89bp	-917bp
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	64,895	+23.04	+32.67
CDs (UAHm) <sup>3</sup>	122,729	+5.43	+65.23

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) (2 November 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-4.74
Banks	447,766	+0.31	+19.24
Residents	31,987	+0.29	+28.89
Individuals	8,335	+0.68	+20.36
Foreigners <sup>1</sup>	79,058	-1.15	+474.63
<b>Total</b>	<b>891,721</b>	<b>+0.07</b>	<b>+17.06</b>

Notes: [1] non-residents

Source: NBU, ICU.

#### FX market indicators (2 November 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.6567	+0.99	+15.68
EUR/USD	1.1641	-1.31	+4.25
DXY	94.129	+1.28	-3.20
UAH TWI <sup>1</sup>	121.635	+0.67	-7.85

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

#### Gov't bond quotes<sup>1</sup> (3 November 2020)

Maturity	Bid	Ask
6m	10.00	8.00
12m	11.00	10.25
2y	11.75	10.75
3y	12.25	11.25
12m (\$)	4.50	3.00
2y (\$)	5.00	3.25

Notes: [1] Actual quotes you can see at [www.icu.ua](http://www.icu.ua).

Source: ICU.

# Domestic liquidity and bonds market

## Net borrowings increase

Net borrowings from UAH-denominated bills rose to UAH47bn (US\$1.8bn) during 10M20, partially due to a lack of redemptions in October. The Ministry of Finance has not refinanced all repayments for FX-denominated bills this year. Therefore, it has two offerings planned for November in US dollars and euros.

Total net borrowings amounted to UAH40.4bn (US\$1.4bn) during 10M20. Net local-currency borrowings amounted to UAH46.7bn (US\$1.8bn). For FX-denominated paper, the Ministry has repaid UAH6.4bn (US\$0.2bn) on a net basis.

This material increase in local-currency net borrowings was partially due to a lack of debt redemptions in local currency plus new borrowings of UAH15.5bn (US\$0.5bn). At the same time, during October, repayments in FX were US\$200m, or US\$11m more than new borrowings.

The total amount of domestic bills outstanding rose by UAH15.3bn (US\$0.5bn) in October and by UAH64bn (US\$2.3bn) during 10M20, including revaluation of FX-denominated instruments due to the weakening of the hryvnia. In addition to new borrowings, the government used local-currency instruments to increase the share capital of state-owned Ukreximbank by UAH6.8bn (US\$0.2bn). UAH47bn (US\$1.8bn) of increase came from the primary bond market placement.

The largest increase in portfolios during 10M20 was those of banks, by UAH111bn to UAH448bn (US\$3.9bn, and US\$15.8bn, respectively). Foreigners have decreased their portfolios this year by UAH38.7bn (US\$1.4bn) and individuals by UAH1.4bn (US\$50m). NBU decreased its portfolio, too, by UAH12.5bn (US\$0.4bn), due to redemptions of old issues, as the NBU did not purchase any new bills from the market.

The increase in banks' portfolios during October was induced by higher interest rates in the primary auctions and possibility to use bills for refinancing loans with the NBU for up to five years. In September, interest rates were 7–10.5% (for bills from three months and up to three years); in October, rates rose to 7.3–10.95% for the same range of maturities.

Compared with the pre-COVID-19 auctions, for the shortest maturities, rates declined by 210bp, while for the long-term end of yield-curve, they rose by about 80bp.

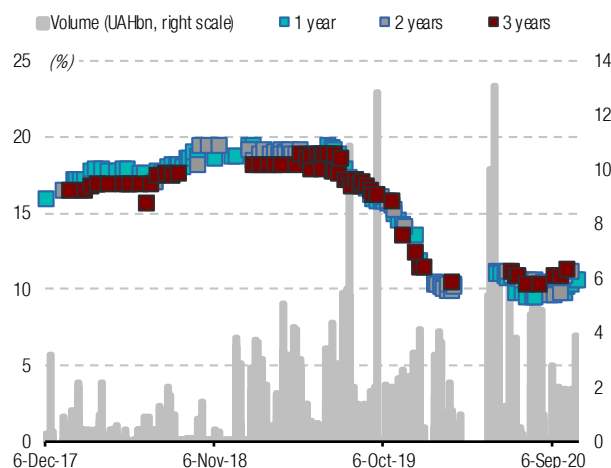
**ICU view: During November, the MoF has to pay UAH11.3bn (US\$0.4bn) and EUR200m of principal. These amounts are not critical for the budget, and taking into account borrowings done in October, they can be fully refinanced. As the local-currency repayment is scheduled for the end of this month, most likely the Ministry will accumulate UAH-denominated funds from auctions, offering bills with maturities up to 3.5 years. We also expect that to accumulate the amount needed, the Ministry will increase interest rates by at least 20–30bp.**

**For the FX-denominated bills, the Ministry will try to improve the situation with net proceeds this month by offering two bills in hard currency. Next week, the MoF is scheduled to offer USD-denominated paper. For the last week of this month, the schedule includes bills denominated in euros to attract into the budget funds that will be repaid in this currency a week before the offering.**

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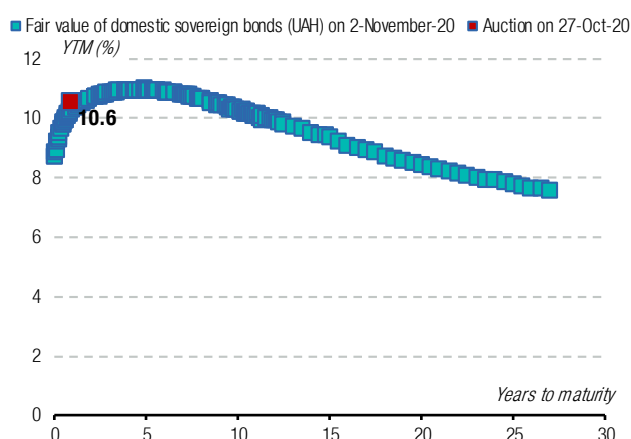
### Chart 1. Local-currency bonds

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.

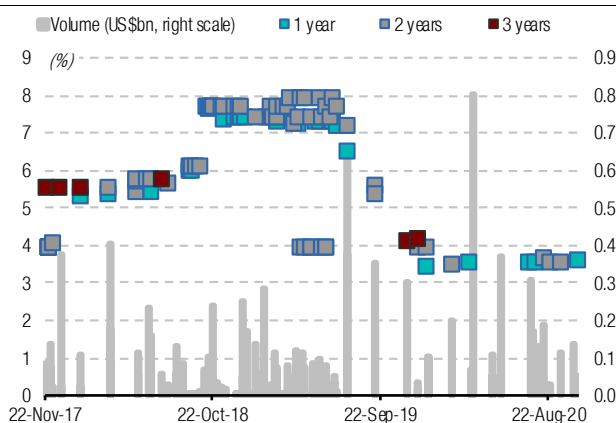
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

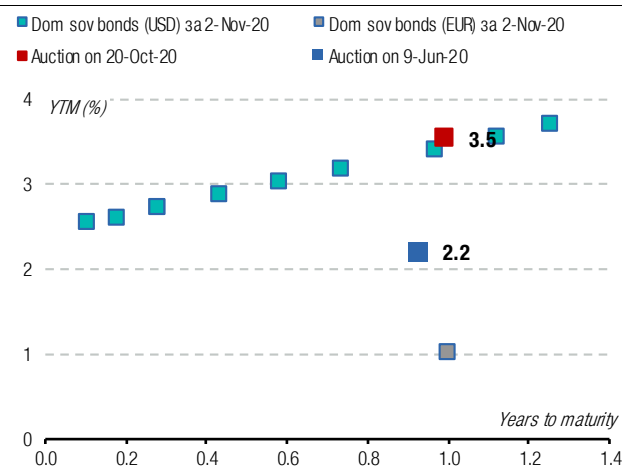
### Chart 2. FX-denominated bonds

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 remains high

During October, the total amount of banking-sector liquidity fluctuated around UAH170bn, and at the end of the month, it was UAH178bn. This month, most likely, liquidity will fluctuate close to the same level.

The banking system began the year with liquidity above UAH200bn, and at the end of February, it rose to UAH251bn.

After the COVID-19 lockdown started, liquidity declined mostly due to reserves exchange in cash. So far this year, banks exchanged almost UAH99bn of reserves in cash.

Although during 10M20 the net impact on liquidity from NBU's other monetary operations was positive of UAH13bn, from time to time the NBU absorbed liquidity through FX selling. During October 2020, the NBU absorbed UAH5.3bn through its operations, mostly with hard currency.

An increase in budget expenditures supported liquidity this year. Net inflow from Treasury operations has been UAH18.8bn for the 10M20 and UAH5.1bn in October.

At the end of October, banks held a large amount of funds with the NBU in correspondent accounts, decreasing CDs outstanding. As of yesterday, banks held UAH122.7bn of NBU CDs and UAH55.6bn in correspondent accounts with the NBU, or 69% and 31% of total amount of banking sector liquidity.

**ICU view:** During November, there will be material fluctuations in liquidity. At the beginning of the month, the NBU can continue to absorb funds through the FX market. In the middle of the month, the need for liquidity will rise for quarterly and month-end tax payments, which requires additional hard currency selling by exporters that can be purchased by the NBU. This inflow in liquidity may be absorbed by the Treasury, which is then only partially returned to the banking system through budget expenditures.

Therefore, we will not see a material increase in liquidity; it will fluctuate at around UAH170bn this month, too.

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

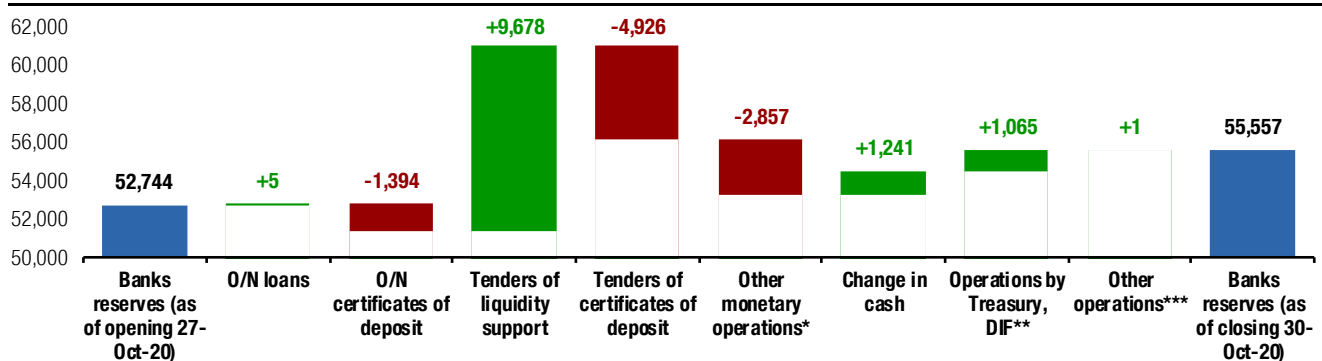
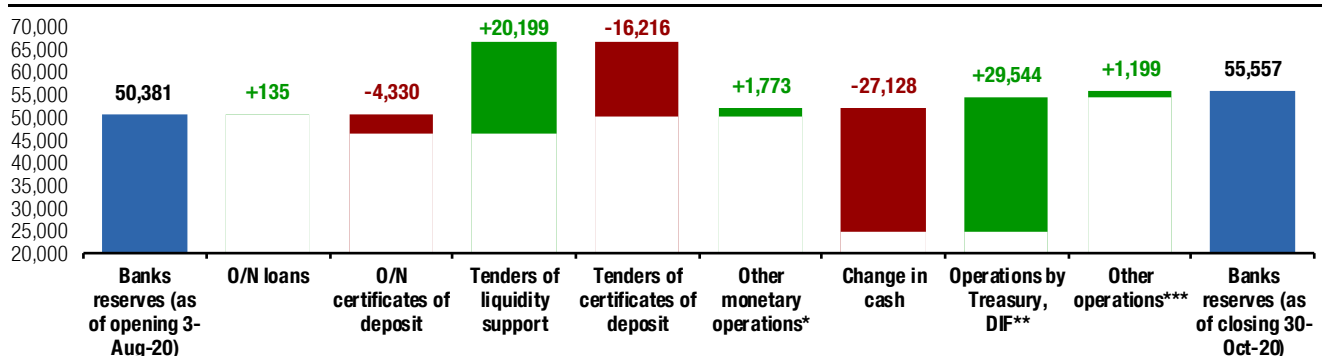


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting [https://bank.gov.ua/control/uk/publish/article?art\\_id=38643651&cat\\_id=40807142](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 continues to weaken

During most of October, the hryvnia exchange rate was steady, slightly above the UAH28.3/US\$ level. It was weakest at the end of the month at about UAH28.5/US\$. In November, we anticipate further hryvnia weakening and fluctuations within the UAH28.5–29/US\$ range.

The last week of October saw a new wave of fluctuations in the FX market, caused by the decision of Constitutional Court over illicit enrichment. So, after weeks of fluctuations slightly above UAH28.3/US\$, last week, the hryvnia lost 0.5% and weakened to UAH28.47/US\$.

The current level of the exchange rate is the lowest for the year, which started with a rate of UAH23.68/US\$, thus the hryvnia lost 20.2% YTD.

NBU intervened in the FX market rather frequently during October, but with low amounts. The last week of the month changed the situation. The NBU sold US\$210m of hard currency in October, with US\$150m sold last week.

However, so far this year, the NBU purchased more hard currency than it sold from reserves. For the 10M20, net purchases amounted to US\$778, as the NBU purchased US\$4.5bn this year and sold a bit more than US\$3.7bn.

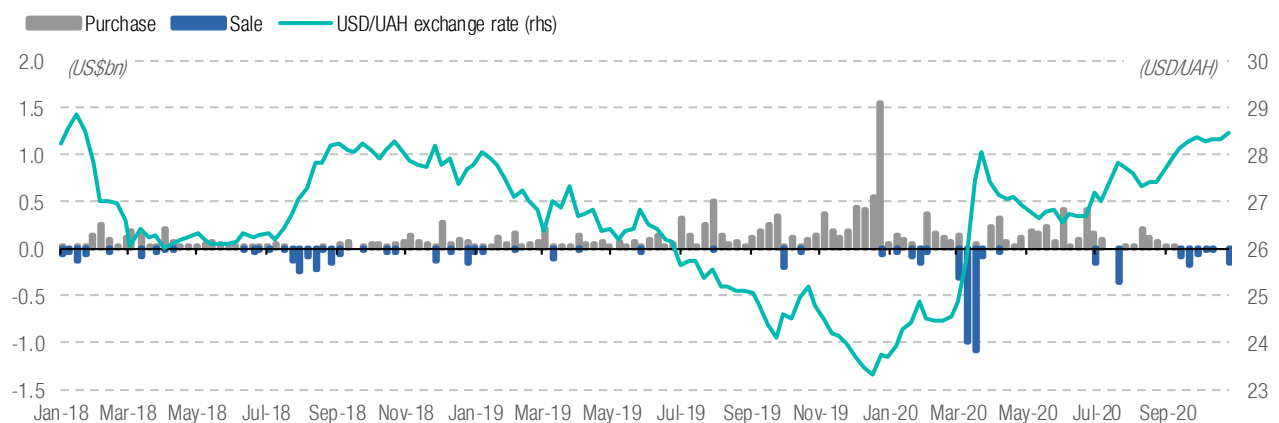
**ICU view: During November, the hryvnia will continue to weaken. The crisis after the Constitutional Court decision will add pressure from the demand side, and NBU will have to sell hard currency to restrain weakening. After the weakening to above UAH28.5/US\$ this week, the rest of this month, hryvnia will fluctuate within the range of UAH28.5–29/US\$.**

**Next week, the hryvnia will start to receive support from exporters and other companies through hard currency selling to accumulate funds for quarterly tax payments, and at the end of the month for monthly tax payments. This hard currency supply should restrain further weakening and keep the hryvnia within the above-mentioned range without hard currency supply from the NBU, although it may purchase some hard currency to replenish international 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

## Wage growth is accelerating

In September, the growth rates of real wages almost approached pre-pandemic levels. We expect a slowdown in growth in the coming months, but in January, another increase in the minimum wage will provide additional impetus.

According to Ukrstat data, in September, the growth of nominal and real wages accelerated to 12.3% YoY and 9.7% YoY, respectively. Compared with August, nominal wages grew by 4.4% MoM SA, and real wages surged by 4.9% MoM SA.

The increase in the minimum wage by almost 6% to UAH 5,000 was a significant factor in the acceleration of the growth of average wages in medicine, education, and in public administration and defence, up to 29% YoY, 21% YoY, and 10% YoY, respectively. In addition, wages continued to rise rapidly in the IT sector by 18% YoY. There is a gradual recovery of wages in sectors that have been significantly affected by lockdown restrictions: transport (+3.6% YoY), and hospitality (here salaries were only 3.3% YoY lower).

**ICU view:** *The labour market has almost completely recovered from the lockdown and it has adapted to new conditions. As expected, the dynamics of wages differ significantly across sectors, reflecting the growth in labour demand in some areas (IT, healthcare) and a decline in others (hospitality, transport).*

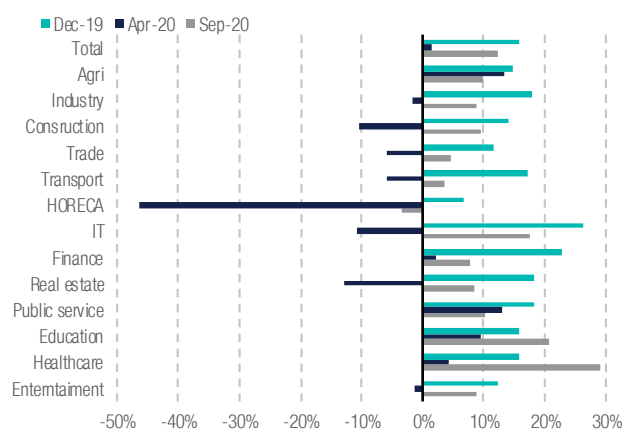
*A new outbreak of the coronavirus may further deepen this differentiation. In addition, the growth of aggregate demand will decelerate, accordingly restraining a further rise of wages. However, the planned increase in the minimum wage in January to UAH 6,000 may provide a new powerful impetus to the growth of the average wage and the payroll fund. In conditions of slow economic recovery, this could lead to a drop in demand for labour from businesses and, consequently, an increase in unemployment.*

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Chart 6. Nominal and real wages, YoY, %



Chart 7. Average wages, YoY, %



## Twin deficit for both the current and financial account

In September, the overall BoP was in deficit due to repayments of public-sector debt, interest under the C/A, and the principal under the F/A. Looking ahead, the pace of domestic demand recovery will determine the size of the C/A deficit, and the sentiments of the population, businesses, and investors—the direction of capital flows under the F/A.

In September, the C/A returned to deficit (US\$0.2bn), which was significantly lower than last year (US\$1.8bn). Mainly, the deficit was formed due to interest payments on sovereign Eurobonds of more than \$1bn. Instead, remittances (US\$1.1bn) continue to exceed the trade deficit (US\$0.4bn).

In 9M20, the C/A surplus reached US\$4.2bn versus the US\$5.6bn deficit in 9M19, while the trade deficit amounted to just US\$1bn compared with US\$9bn for 9M19. Ukraine's 9M20 exports declined by 6% YoY, driven mostly by lower prices and sales volume of steel, as well as by depressed transportation services and travel. However, the 9M20 decline in imports was much sharper, by 17% YoY, with a fall of imports of energy products, machinery and equipment, and travel services having made the greatest contribution. In addition, investment income payments fell by US\$3bn due to weak financial results of Ukrainian companies with foreign capital. Meanwhile, private remittances were surprisingly steady as they declined only 2.5% YoY.

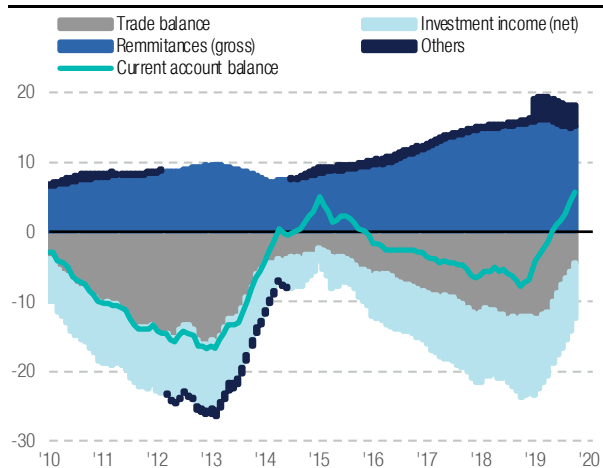
In September, the capital outflows under the financial account increased to US\$1.7bn, primarily due to the repayment of government bonds. In addition, the accumulation of FX cash outside banks grew to US\$0.5bn, which reflected a deterioration in devaluation expectations. Instead, for the sixth month in a row, FDI and private-sector debt continued to see capital inflows, albeit in small amounts.

In September, the significant balance of payments deficit and the IMF loan repayment reduced international reserves to US\$26.5bn. However, this level was still higher than at the beginning of the year.

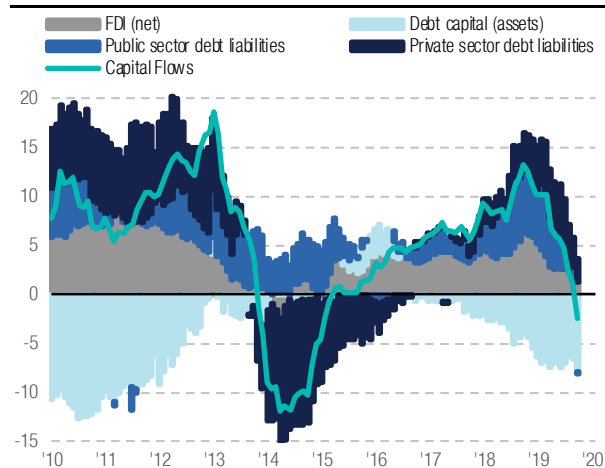
***ICU view: Favourable terms of trade, the resilience of remittances and IT services proceeds, and a sharp decline in investment income payments determined a C/A surplus in 3Q20, even despite significant interest payments on government bonds. In 4Q20, we expect a deficit to return due to the recovery of domestic demand and household incomes. At the same time, the outbreak of Covid-19 cases creates risks for the implementation of this scenario.***

***On the financial account, depreciation expectations continue to deteriorate due to a number of factors. Therefore, even in the absence of significant repayments of external liabilities of the public sector, further flight into FX assets is likely. This increases the downward risks for our September projection of international reserves for the end of the year of US\$28.6 bn.***

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**Chart 8. Current account***US\$ bn, 12m trailing*

Source: NBU, ICU.

**Chart 9. Capital flows***US\$ bn, 12m trailing*

Source: NBU, ICU.



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