

Weekly Insight

Consumption up, production down

Key messages of the today's comments

TUESDAY, 1 DECEMBER 2020

Domestic liquidity and bonds market

Foreigners cautious with UAH-denominated bills

Last week, the government had a large amount of local-currency bill redemptions, almost UAH10bn (US\$350m). However, it did not cause a decline in foreigners' portfolios. This week, foreign investors can continue to test the local market with new deals to sell and/or purchase bills.

Liquidity gradually recovers

Mostly budget expenditures caused slight recovery in banking-sector liquidity last week. This week, tax payments will have lower impact on liquidity, with the main impact coming from budget expenditures.

Foreign exchange market

Hryvnia exchange rate returns to expected range

The hryvnia continued to weaken last week and returned to the expected range of UAH28.5–29/US\$. This week, the exchange rate may continue weakening towards UAH29/US\$ level.

Economics

Consumption up, production down

In October, economic indicators showed a mixed picture. If retail sales have already returned to a pre-pandemic trajectory, the decline in industrial and agricultural production and transport continued and even deepened compared with previous months. Looking ahead, we expect a small but negative impact from the new quarantine restrictions on economic activity.

Banks' reserves market (30 November 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	6.00	+0bp	-1,200bp
ON rate (%)	5.29	-31bp	-870bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	54,748	-5.16	+2.09
CDs (UAHm) ³	115,207	+19.00	+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 gov't bond holders (UAHm) (30 November 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.71
Banks	460,395	+1.15	+38.64
Residents	33,890	+0.66	+27.43
Individuals	8,860	+0.43	-11.97
Foreigners ¹	75,363	+0.13	-29.03
Total	903,084	+0.63	+11.23

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (30 November 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.4808	+0.44	+18.87
EUR/USD	1.1927	+0.29	+8.25
DXY	91.869	-0.39	-6.52
UAH TWI ¹	118.746	-0.38	-14.09

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (1 December 2020)

Maturity	Bid	Ask
6m	10.50	9.00
12m	11.00	10.25
2y	11.75	10.75
3y	12.00	11.00
12m (\$)	4.50	3.00
2y (\$)	5.00	3.25

Notes: [1] Actual quotes you can see at www.icu.ua.

Source: ICU.

Domestic liquidity and bonds market

Foreigners cautious with UAH-denominated bills

Last week, the government had a large amount of local-currency bill redemptions, almost UAH10bn (US\$350m). However, it did not cause a decline in foreigners' portfolios. This week, foreign investors can continue to test the local market with new deals to sell and/or purchase bills.

For the first time since the end of February, foreigners' portfolios rose during a week, albeit by a small amount. The increase amounted to just UAH182m (US\$6m), which came from net purchases of UAH322m (US\$11m) last Wednesday.

This increase in foreigners' portfolios may not signal a steady recovery in their interest in local-currency bills, but it can be seen as a cautious attempt to enter the market given current conditions. This was due to the increase in interest rates in the primary market last week, especially for short-term bills (see [auction comment](#)).

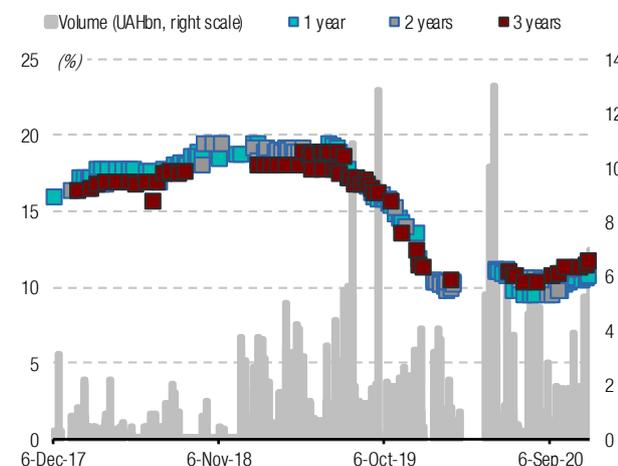
It looks like the main reason for such purchases is an increase in global demand for risk-on assets amid relatively moderate hryvnia exchange-rate fluctuations last weeks. This could provide incentive for some foreigners to purchase bills at primary market given rates started at 10%, in expectation that the hryvnia will not weaken or even appreciate from sizably the current level until maturity.

ICU view: Foreigners may make careful attempts to test the market further, but without material impact. For the most part, it will be local banks that purchase new bills again this week. But without large redemptions during the next few weeks, we will not see sizable demand despite the MoF is ready to increase rates again.

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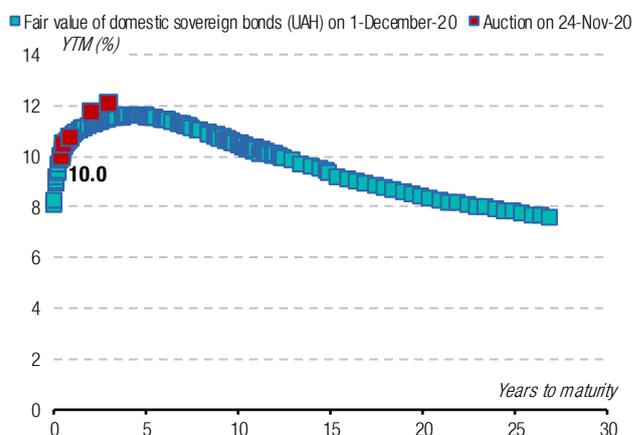
Chart 1. Local-currency bonds

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.

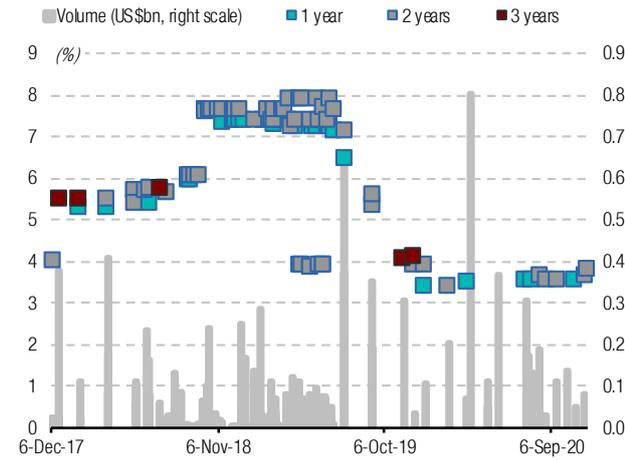
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

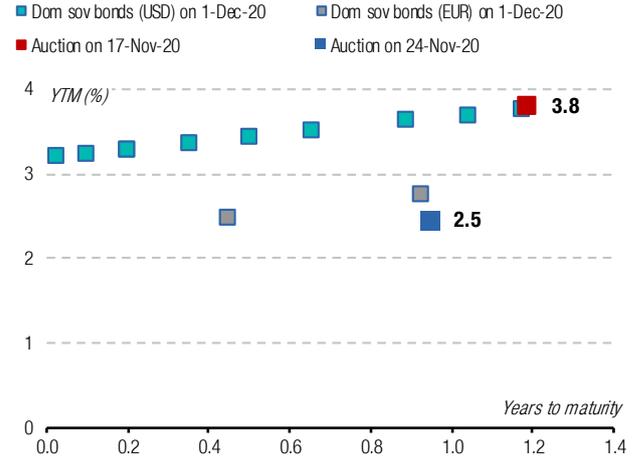
Chart 2. FX-denominated bonds

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 gradually recovers

Mostly budget expenditures caused slight recovery in banking-sector liquidity last week. This week, tax payments will have lower impact on liquidity, with the main impact coming from budget expenditures.

Total banking-sector liquidity was up UAH17.4bn to UAH170bn at the end of last week. Expectedly, the main impact came from budget expenditures. The balance of Treasury operations brought UAH10.5bn into liquidity, with the key impact coming from VAT refunds at UAH8.7bn last week.

Additional support for liquidity was banks' exchange of cash in reserves at UAH1bn. Meanwhile, NBU provided UAH5.8bn of 84-day loans for four banks.

ICU view: This week, liquidity will fluctuate at around UAH170bn due to large budget expenditures and some outflows through reserves exchange in cash.

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

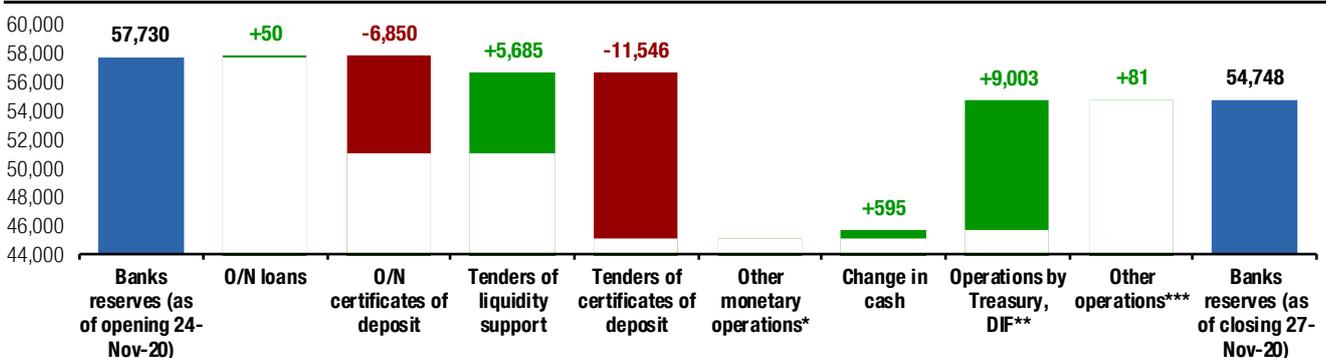
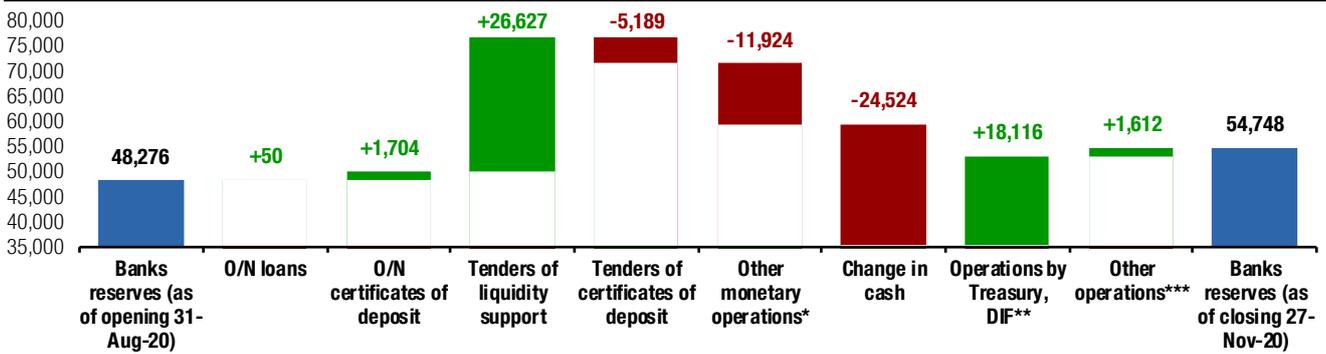


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 exchange rate returns to expected range

The hryvnia continued to weaken last week and returned to the expected range of UAH28.5–29/US\$. This week, the exchange rate may continue weakening towards UAH29/US\$ level.

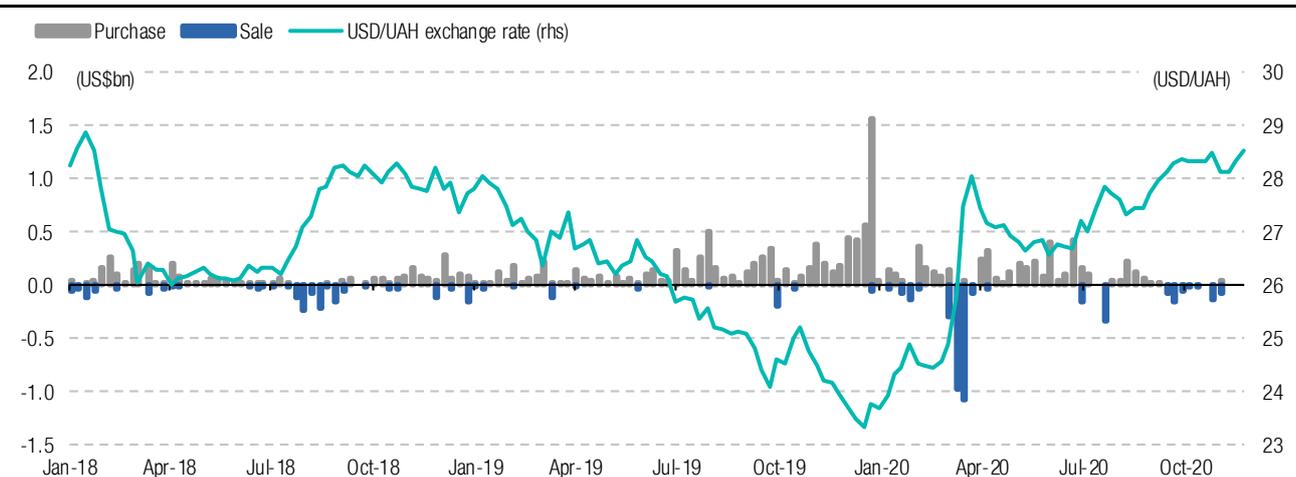
Last week, budget expenditures accelerated, especially through VAT refunds. Such expenses usually cause the supply of FX in the market to drop and slight weakening of the local currency. NBU did not intervene in the market for a third consecutive week, allowing the market to self-balance. So, the hryvnia depreciated by 0.7% to UAH28.53/US\$.

ICU view: The beginning of December will see larger budget expenditures to improve budget performance. But this can result in lower hard currency selling for current needs. So, we will not see hryvnia appreciation. Most likely, the hryvnia will weaken further towards UAH29/US\$ level.

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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

Consumption up, production down

In October, economic indicators showed a mixed picture. If retail sales have already returned to a pre-pandemic trajectory, the decline in industrial and agricultural production and transport continued and even deepened compared with previous months. Looking ahead, we expect a small but negative impact from the new quarantine restrictions on economic activity.

In October, the decline in industrial production deepened to 5.0% YoY from 4.4% YoY in September; in seasonally adjusted terms industrial output decreased by 0.5% MoM and by 1.3% compared with the average level of 3Q20. The main contribution was provided by plummeting output of machinery (-18.6% YoY in October, -20.4% YoY in 10M20). Also, in the last two months, food production was significantly lower than last year (-8% YoY in October) against the background of falling agricultural output. Instead, high demand for commodities from China and the low comparison base of last year led to a significant slowdown in the decline of iron ore mining and metallurgy output (to -1.5% YoY and -3.3% YoY, respectively).

In October, agricultural production remained much lower than last year, by 18.3% YoY, and in 10M20, the decline deepened to 14.2% YoY. First of all, this decline is due to low yields of major agricultural crops: cereals, sugar beets, and sunflower seeds. In addition, livestock volumes continued to decline, by 2.7% YoY over 10M20.

Against the background of an increase in Covid-19 cases, for the second month in a row, passenger transport turnover has contracted. In October, it was less than 50% of last year's level. At the same time, cargo turnover improved slightly reaching the highest level this year, although 10% less than last year. First of all, this is due to the growth of gas transit, which was also the highest this year, but lower by 20% YoY.

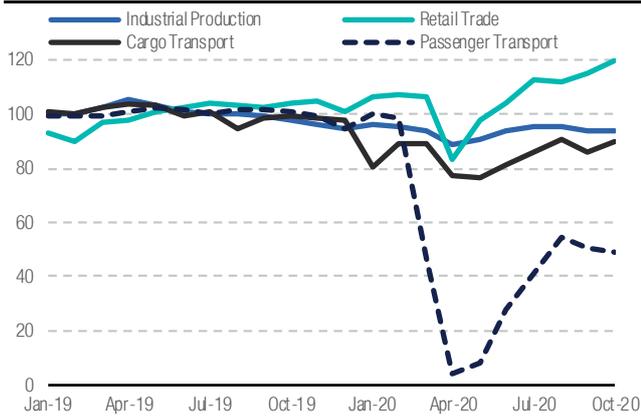
At the same time, the growth of retail sales accelerated to an impressive 15% YoY (and to 7.6% YoY for 10M20). This increase in domestic consumer demand can be largely explained by rising incomes. In particular, in October, the growth rate of real wages accelerated to 10.6% YoY against the background of higher minimum wages and a boost in payments to medics (the average salary in health care was more than 1.5 times higher YoY). The growth rate of remittances from abroad (in real terms) was similar to last month's. Meanwhile, as before, due to limited foreign tourism, the share of Ukrainians' expenditures on goods and services within the country increased dramatically compared with previous years.

ICU view: This difference between production, especially in industry and agriculture, and consumption (retail sales as a proxy) behaviour can be largely explained by favourable terms of trade. After all, world prices for major domestic commodities (grain, sunflower oil, sugar, iron ore, and metals, among others) remain high and have even risen in recent months. At the same time, energy prices remained low. Therefore, even despite the decline in output, the resulting additional financial resources were spent more within the country, stimulating a domestic trade boom.

However, in October, the consumer sentiment index, calculated by Info Sapiens, after two months of upward correction fell again to a lowest level since early 2019. Given the current and potential tightening of quarantine restrictions and growing social distancing, we expect consumer demand to slow significantly in the coming months. However, in general, the negative effects of the lockdown on the economy are to be quite moderate due to the adaptation of business and the population to the new conditions, the fiscal impulse at the end of the year, and improving business expectations thanks to news on vaccines.

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Chart 6. Real GDP and output of activities, SA levels, 2019 =100



Source: Ukrstat, ICU.

Chart 7. Retail sales and real wages, % YoY



Source: Ukrstat, ICU.

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