



Focus
Ukraine

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

Research team
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Weekly Insight

New Macro review from ICU

Key messages of the today's comments

TUESDAY, 22 DECEMBER 2020

Domestic liquidity and bonds market

Record large primary auction

Last week, the MoF sold more than UAH51bn (US\$1.8bn) of new government bonds. These instruments were purchased by different groups of investors. This week, activity will be lower.

Liquidity down due to new bill purchases

Last week, the total amount of banking-sector liquidity was down to UAH161bn due to outflow to budget accounts. This week, MoF will increase expenditures using funds collected last week.

Foreign exchange market

Hryvnia supported by demand from foreigners

Foreigners' activity in the bond market continued to support hryvnia exchange rate. Due to a large supply of hard currency, the hryvnia appreciated during most of last week. This week, we expect weakening of hryvnia due to larger budget expenditures and lower foreigners' activity due to volatility in the financial markets.

Economics

ICU Macroeconomic Review – Rising hopes from a shot in the arm

Last week, we issued our updated macroeconomic review on Ukraine's economy.

Banks' reserves market (21 December 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	6.00	+0bp	-750bp
ON rate (%)	5.15	-107bp	-600bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	65,781	+5.44	+16.02
CDs (UAHm) ³	95,237	-17.84	-2.51

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) (21 December 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.71
Banks	492,077	+6.87	+49.11
Residents	39,370	+6.53	+51.34
Individuals	10,062	+14.08	+4.53
Foreigners ¹	83,224	+7.75	-29.03
Total	949,434	+4.55	+15.81

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (21 December 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.0786	+1.42	+20.37
EUR/USD	1.2244	+0.77	+10.52
DXY	90.043	-0.48	-7.83
UAH TWI ¹	118,326	-1.31	-15.85

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (22 December 2020)

Maturity	Bid	Ask
6m	10.50	9.00
12m	12.00	10.50
2y	12.25	11.00
3y	12.50	11.25
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

Record large primary auction

Last week, the MoF sold more than UAH51bn (US\$1.8bn) of new government bonds. These instruments were purchased by different groups of investors. This week, activity will be lower.

Large and wide offering of bonds met a huge demand from investors, divided among different instruments. As usual, foreigners were more interested in longer maturities; locals prefer short-term bills and issues denominated in hard currency. Thanks to this distribution, not all issues saw an increase in interest rates (see [auction comment](#) for details).

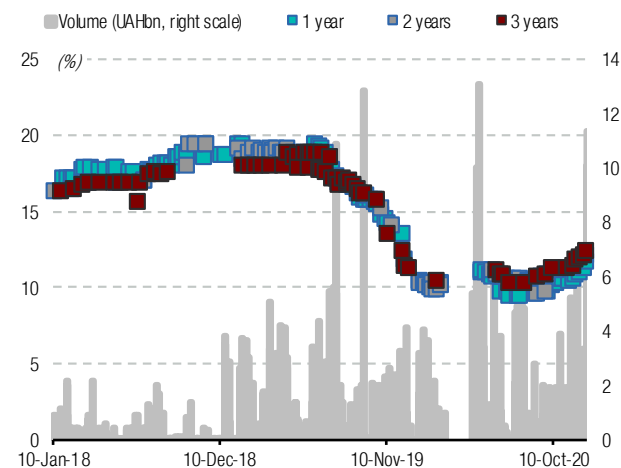
Foreigners purchased longer paper and we assume they purchased most of the three-year and four-year notes and a smaller amount of the shorter bills. Banks purchased mostly shorter papers, mainly using funds from NBU CDs.

ICU view: We anticipate active demand this week although a lower amount of proceeds for the budget. On the one hand, government has already financed most of its needs for this year. On the other hand, demand will be lower. Banks have already reinvested a large amount of funds from CDs and will likely not sizably increase the amount of NBU refinancing loans (see comment below). Foreigners' activity will decline too, with new wave of volatility in the global financial markets caused by new coronavirus strain found in the UK.

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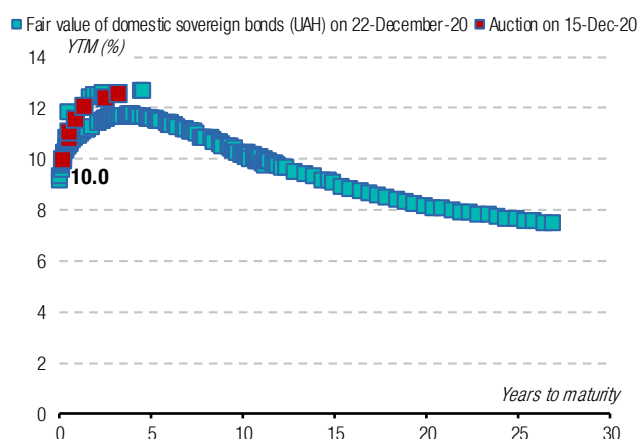
Chart 1. Local-currency bonds

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.

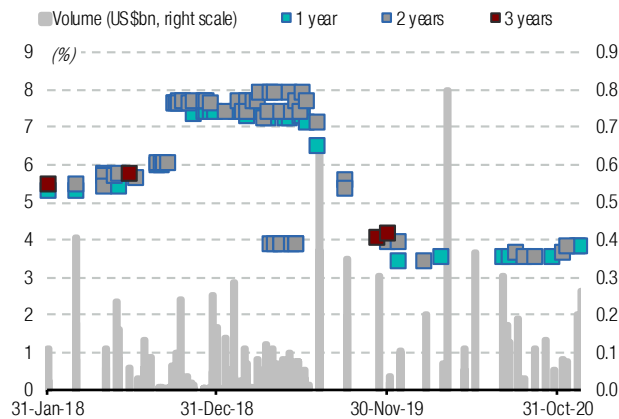
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

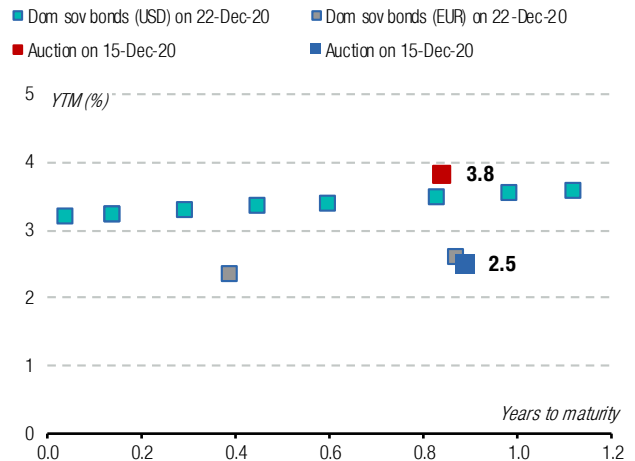
Chart 2. FX-denominated bonds

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 down due to new bill purchases

Last week, the total amount of banking-sector liquidity was down to UAH161bn due to outflow to budget accounts. This week, MoF will increase expenditures using funds collected last week.

After purchases of new government paper, the Treasury absorbed UAH28bn from the banking system and UAH27bn of outflow last week. Also, banks' exchange of reserves in cash caused outflow of UAH5bn last week.

However, NBU actively supported liquidity: UAH8.3bn was compensated through the FX market and UAH9.3bn through loans to five banks for 84 days.

Therefore, in the end, banking-sector liquidity declined by UAH14bn. The most important was a decline in the NBU CDs outstanding, as part of these funds was invested in government bonds.

ICU view: This week, operations with budget funds will cause inflows to the banking system due to lower borrowings and larger expenditures. Therefore, we expect a gradual increase in banking sector liquidity.

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

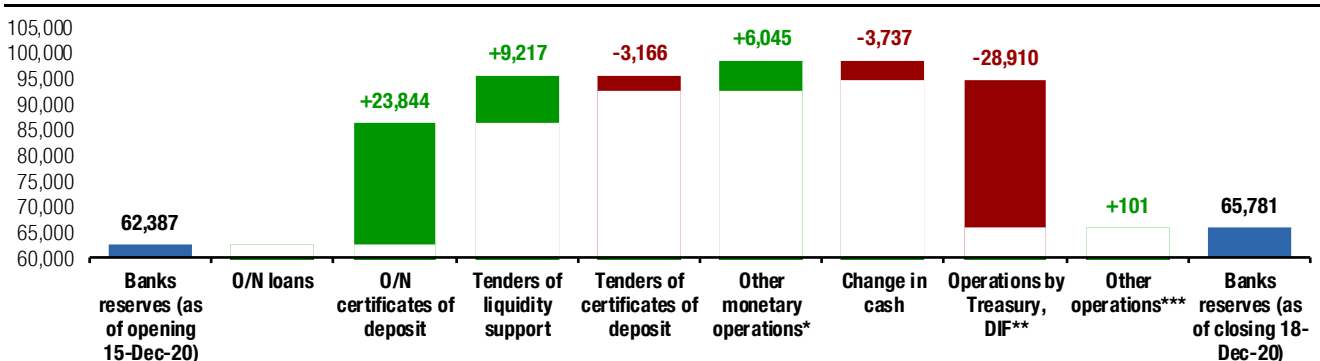
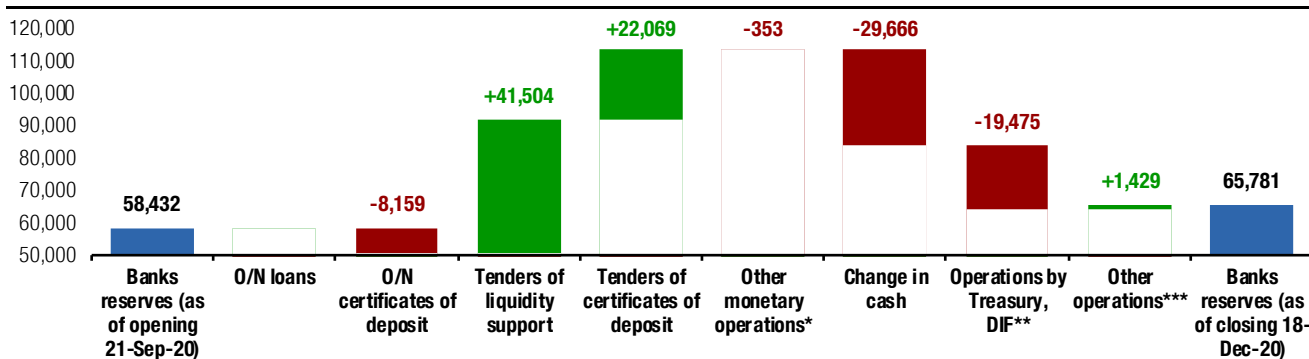


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 supported by demand from foreigners

Foreigners' activity in the bond market continued to support hryvnia exchange rate. Due to a large supply of hard currency, the hryvnia appreciated during most of last week. This week, we expect weakening of hryvnia due to larger budget expenditures and lower foreigners' activity due to volatility in the financial markets.

Recovery in foreigners' demand for local-currency debt increased the supply of hard currency, and the NBU responded by purchasing hard currency into reserves. In total, the NBU purchased almost US\$300m last week, most of it on Tuesday and Wednesday, when the hryvnia appreciated to UAH27.68/US\$.

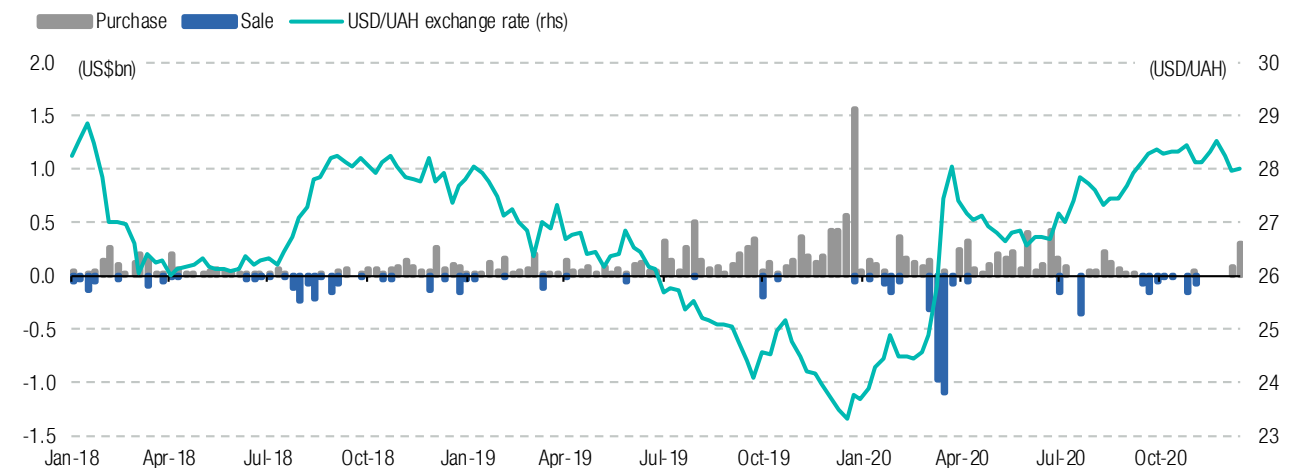
As all payments closed last Thursday, at the end of last week, the FX market balance moved to the demand side. Therefore, by the end of the week, the hryvnia weakened by 0.2% to UAH28.01/US\$.

ICU view: While a week ago on Friday, there was a large supply of hard currency likely in advance for the last week's primary auction, by Friday last week, the balance was in favour of demand. Likely, foreigners do not expect the MoF will be as generous as before with unlimited supply, and will cut rates more radically this week. In addition, new coronavirus strain was found last week, causing decline in demand for risky assets. Therefore, we expect hryvnia weakening 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

ICU Macroeconomic Review – Rising hopes from a shot in the arm

Last week, we issued our updated macroeconomic review on Ukraine's economy.

We reiterate our optimistic view for 2021 catch-up growth of +5.6%. This, even from a higher statistical base, as we improve our GDP estimate for 2020 to -4.8%. As before, we consider that the economy copes with the COVID-19 crisis quite well due to its structure, with a high share of agri and IT, and a strengthened financial system after the 2014–15 crisis. However, the results could be better if fiscal and monetary stimuli are larger this year.

However, stimuli have been limited due to the lack of financial resources; Ukraine remained without the second tranche from the IMF this year. But last weeks, authorities' efforts to resolve outstanding issues and their willingness to cooperate with Western partners were encouraging, and on Monday IMF mission started its work for first review of SBA in remote mode. We believe that in 1H21, Ukraine will finally receive financing from the IMF and other IFIs.

As a result of more official funding and returning foreign flows into government debt, state budget constraints will be eased, and the 2021 budget deficit should remain c.5% of GDP.

Monetary conditions will remain loose, as inflationary pressures grow rather slowly. We expect that in 2021, despite a sharp rise in the minimum wage, inflation will fluctuate close to the upper limit of the target range, 6%. Therefore, NBU is likely to delay the first interest rate hike until July, and we expect the rate to be raised in 2H21 by only 100bps to 7%.

Ukraine's external accounts should remain solid in 2021, and returning capital flows will be sufficient not only to finance the current account deficit, but also further accumulate reserves up to \$31bn by end-2021.

Under such conditions, the hryvnia will strengthen to UAH27–27.5/USD by mid-2021 and then will end 2021 within UAH27.5–28/USD.

Please see our new [Macroeconomic Review](#) for more details.

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