Focus
Ukraine

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

Research team
Sergiy Nikolaychuk
Alexander Martynenko
Taras Kotovych

Weekly Insight

Balance of payments runs a sizable surplus

Key messages of the today's comments

MONDAY, 1 FEBRUARY 2021

Domestic liquidity and bonds market

Foreigners renew interest in UAH bonds

Foreign investments in UAH-denominated debt have risen for two consecutive months. With expectations that the hryvnia will appreciate and the high level of interest rates, foreign participation can rise in February, too.

Liquidity steady

Last week, the total amount of banking-sector liquidity fluctuated near UAH190bn thanks to active budget expenditures at the end of the month. This week, Treasury operations will remain the key factor in the liquidity dynamic.

Foreign exchange market

Hryvnia may appreciate

Last week, hryvnia appreciation was subdued, to just UAH28.13/US$, but this week the large supply of hard currency from foreigners and seasonality can push the hryvnia to appreciate.

Economics

Wage growth remains robust

In December, wages continued to grow at a pre-pandemic pace. At the beginning of the year, wages will receive a new impetus from raising the minimum wage, but in some areas, the January quarantine may be a drag.

Balance of payments runs a sizable surplus

In December, the C/A remained in surplus, although non-energy imports have already increased significantly. Besides, for the first time in six months, capital inflows under F/A were recorded thanks to government borrowings. At the beginning of the year, favorable terms of trade and the seasonal factor will determine the maintenance of the C/A surplus, while capital flows will be weak.

Banks' reserves market (29 January 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	6.00	+0bp	-750bp
ON rate (%)	5.19	+29bp	-650bp
ON $ swap (%)	N/A	...	...
Reserves (UAHm)[2]	61,646	-8.05	+13.85
CDs (UAHm)[3]	129,837	+5.40	-29.22

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) (29 January 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-2.99
Banks	520,672	-0.74	+57.52
Residents	59,411	+0.82	+141.21
Individuals	12,388	+3.49	+26.32
Foreigners[1]	95,368	+4.90	-23.00
Total	**1,012,602**	**+0.15**	**+22.98**

Notes: [1] non-residents
Source: NBU, ICU.

FX market indicators (29 January 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.1300	-0.11	+13.34
EUR/USD	1.2136	-0.29	+10.23
DXY	90.584	+0.38	-7.56
UAH TWI[1]	118.488	+0.24	-10.76

Notes: [1] UAH trade-weighted index.
Source: Bloomberg, ICU.

Gov't bond quotes[1] (1 February 2021)

Maturity	Bid	Ask
6m		
12m		
2y		
3y		
12m ($)		
2y ($)		

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

Domestic liquidity and bonds market

Foreigners renew interest in UAH bonds

Foreign investments in UAH-denominated debt have risen for two consecutive months. With expectations that the hryvnia will appreciate and the high level of interest rates, foreign participation can rise in February, too.

In January, the MoF borrowed almost UAH37bn (US$1.3bn) for budget financing; in hard currency, borrowings amounted to a mere UAH1.4bn (US$48m). Large demand allowed the MoF to not only refinance all debt redemptions last month, but also to borrow UAH13bn (US$460m) of additional funds.

Foreign participation has been important. Foreigners increased their portfolio of Ukrainian bonds by UAH10bn. Nearly half of this amount was purchased last week, UAH4.5bn (US$160m). At the beginning of February, portfolios of foreigners amount to UAH95.4bn (US$3.4m). Their position in total domestic bonds outstanding is now 9.4%.

Individuals were very active in new investments last week. They increased portfolios by UAH0.4bn (US$14m) last week, and by UAH1.3bn (US$46m) this year. Their purchases are very similar to the increase in non-bank portfolios, which rose by the same UAH1.3bn (US$46m) in January.

ICU view: This week, we expect foreigners and individuals will remain active, increasing investments in government bonds and preferring longer maturities. Contributing factors include higher interest rates for longer than 12m tenors, which are now above 11%, and fear that the MoF can reject bids due to high rates or because the offered amount for shorter maturities will be exceeded.

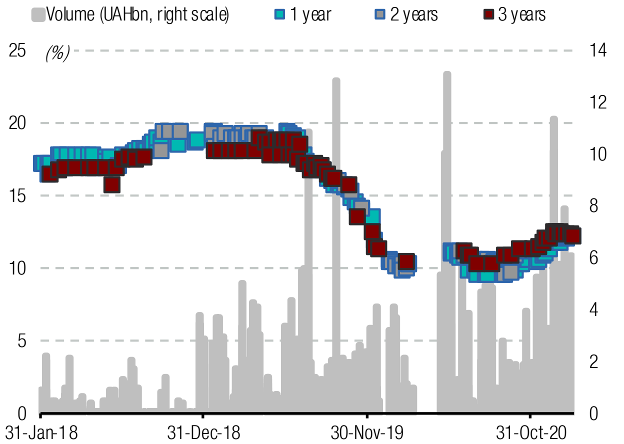
The MoF decided to extend a number of maturities, which will be offered with caps on the amount. Tomorrow they are going to sell just UAH500m of three-month and UAH1bn of 12-month bills. This will allow the MoF to continue to decrease interest rates and reduce the premium to the NBU key policy rate for short-term bills.

However, we expect that the amount of new borrowings will remain large. This week, foreigners could buy about UAH3bn (US$1.1bn), matching in February what they bought in January and December 2020, or about UAH10bn.

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

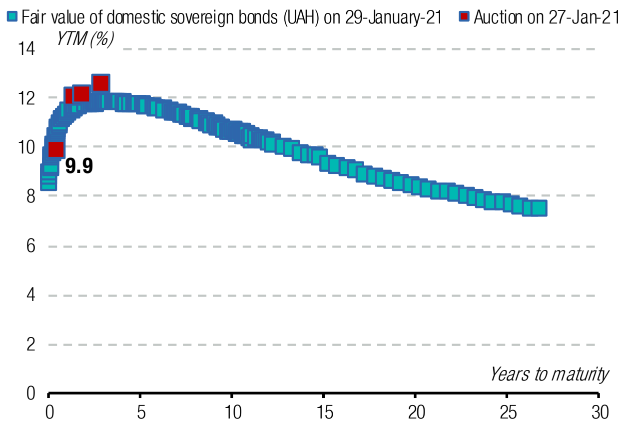
Chart 1. Local-currency bonds

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.

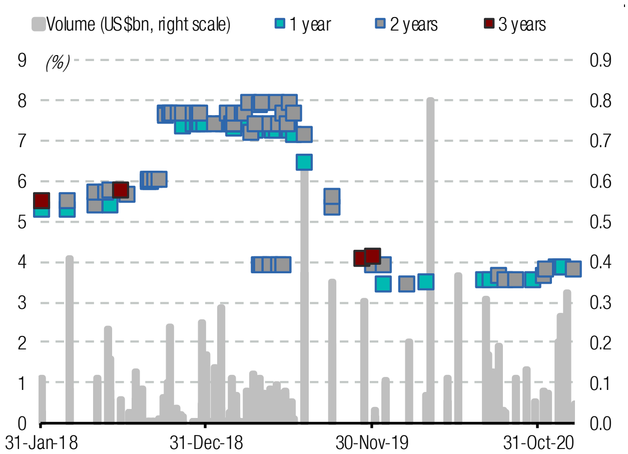
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

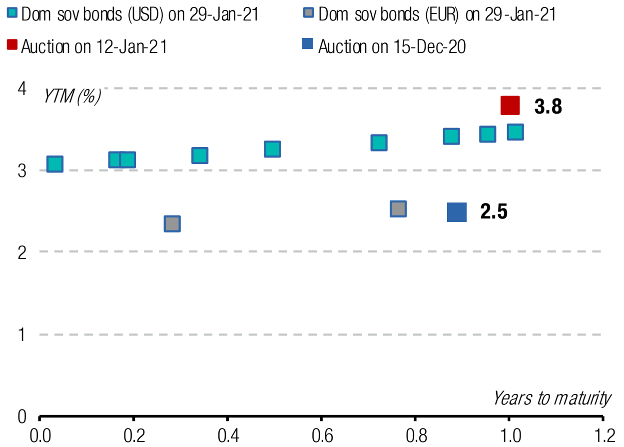
Chart 2. FX-denominated bonds

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 steady

Last week, the total amount of banking-sector liquidity fluctuated near UAH190bn thanks to active budget expenditures at the end of the month. This week, Treasury operations will remain the key factor in the liquidity dynamic.

Last week, the amount of tax payments rose, being just partially compensated by VAT refunds. Therefore, the large outflow was compensated by budget expenditures, and, finally, the outflow from liquidity to budget accounts was at just UAH0.6bn last week.

Demand for cash continued to decline, which induced banks to exchange cash in reserves of UAH2.8bn last week and UAH3.2bn last month.

NBU did not intervene in the FX market last week, and provided just UAH0.7bn of new loans for three banks. Liquidity was mostly impacted by non-monetary operations, with a UAH0.8bn increase last week to UAH192bn.

ICU view: This week, budget transactions will remain key for liquidity fluctuations. On one hand, the MoF can borrow a large amount of funds, while paying a low amount of debt interest (just UAH1.8bn). But on the other hand, budget expenditures can be

larger than revenues. Therefore, liquidity will remain high with fluctuations around UAH190bn.

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

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

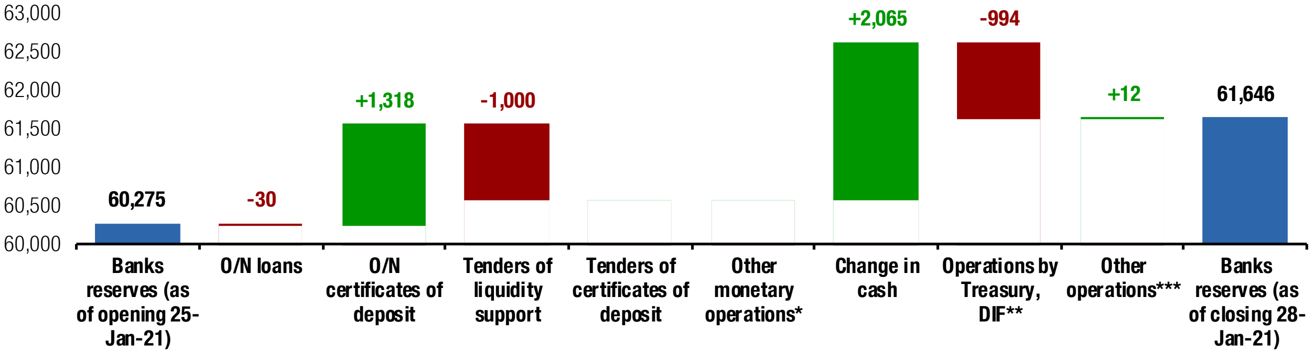
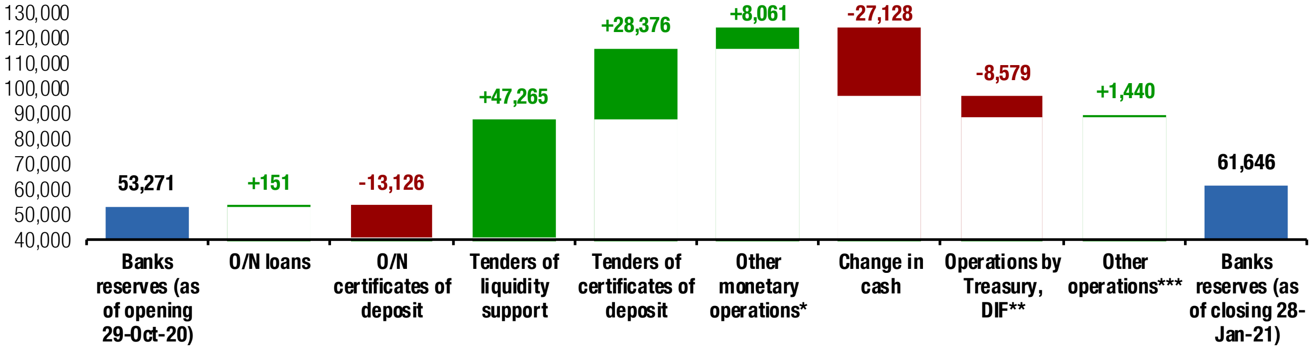


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 may appreciate

Last week, hryvnia appreciation was subdued, to just UAH28.13/US$, but this week the large supply of hard currency from foreigners and seasonality can push the hryvnia to appreciate.

Last week, the hryvnia appreciated by just 0.11% and by 1.14% YTD, as last month it fluctuated within the UAH28–28.5/US$ range. This is quite unusual for January when depreciation pressure prevails, and it was due to foreigners providing a supply of hard currency. They compensated extra demand, which was caused by massive budget expenditures at the end of last year.

The hryvnia begins this month at UAH28.13/US$. A high level of activity from foreigners in the bond market may provide additional support to seasonal appreciation due to exports pattern and FX sales by agricompanies, as they prepare for spring planting.

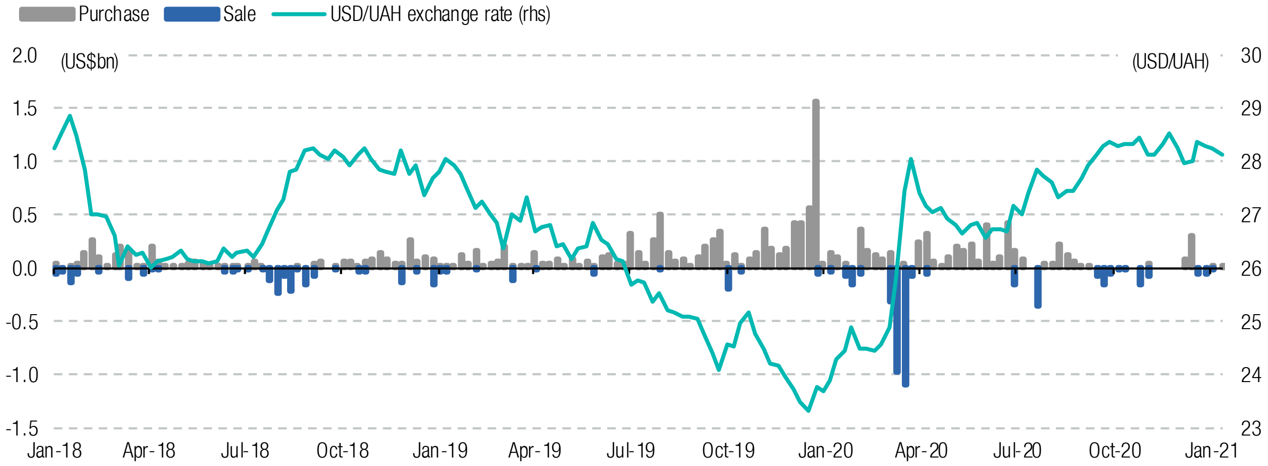
ICU view: We expect that this week the hryvnia can appreciate to about UAH28/US$, and under impact of high prices for Ukrainian exports, foreigners' activity in the bonds

market, and preparations for spring planting, can continue strengthening. By the end of February, the hryvnia can appreciate to about UAH27.5/US$.

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

Wage growth remains robust

In December, wages continued to grow at a pre-pandemic pace. At the beginning of the year, wages will receive a new impetus from raising the minimum wage, but in some areas, the January quarantine may be a drag.

According to Ukrstat data, in December, the growth of nominal wages accelerated to 15.6% YoY, and to 10.1% YoY for real wages.

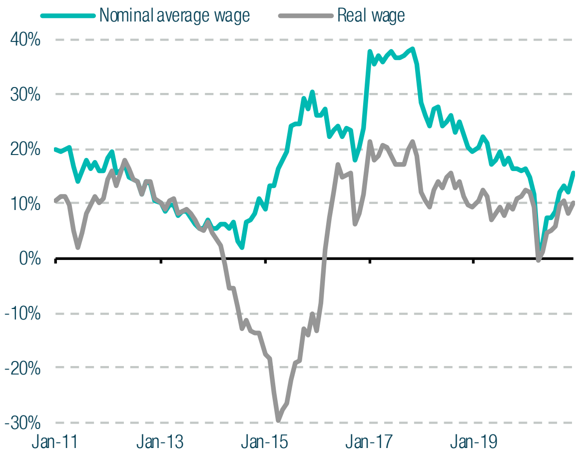
Expectedly, the highest growth rate of nominal wages was observed in medicine, with 51% YoY in December. Growth in arts and education also accelerated to 23% and 20% YoY, respectively. The fall in wages in transport in previous months was replaced by an increase of 12% YoY. On the other hand, the hotel and restaurant business still suffered from pandemic and quarantine restrictions. In December, wages were 6.1% YoY lower than last year.

ICU view: An increase of COVID-19 cases and stricter quarantine restrictions had little effect on wage growth in December. Wages continued to grow rapidly, reflecting both the effects of administrative measures (increase in the minimum wage in September, bonuses for healthcare workers) and a return to labour shortages in most segments of the labour market.

An increase in the minimum wage by 20% to UAH6,000 in January 2021 will give additional impetus to wage growth. At the same time, salaries in some sectors (for example, the hotel and restaurant business and retail trade) will be negatively affected by the January lockdown. However, the continued recovery of the economy against the background of a favorable external environment and the reduction of COVID-19 cases should keep the growth rate of average wages elevated.

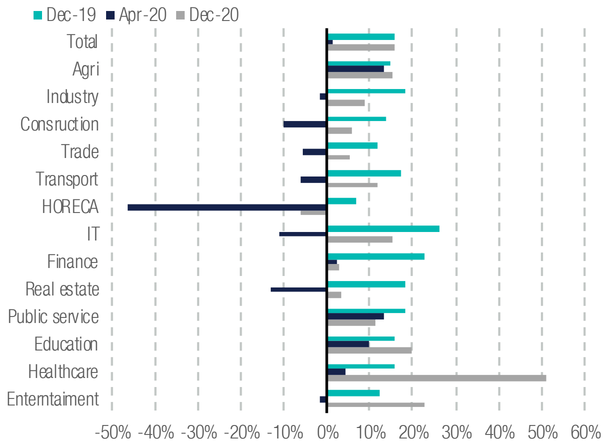
Sergiy Nikolaychuk, Kyiv, (044) 377-7040 ext.721

Chart 6. Nominal and real wages, YoY, %



Source: Ukrstat, ICU.

Chart 7. Average wages, YoY, %



Source: Ukrstat, ICU.

Balance of payments runs a sizable surplus

In December, the C/A remained in surplus, although non-energy imports have already increased significantly. Besides, for the first time in six months, capital inflows under F/A were recorded thanks to government borrowings. At the beginning of the year, favorable terms of trade and the seasonal factor will determine the maintenance of the C/A surplus, while capital flows will be weak.

In December, the C/A continued to run a surplus, but it was much lower than in previous months – US $113m. Due to favourable terms of trade, the growth of G&S exports accelerated to 12.2% YoY. This was mainly due to an increase in receipts from the supply of mineral products (especially iron ore), almost double, and from metallurgical products by 31%.

At the same time, due to robust domestic demand, the growth of non-energy imports accelerated to 8.4% YoY (in February-October it fell by 12% YoY). In particular, imports of machinery, chemicals, and timber products grew by impressive 11% YoY, 21% YoY, and 71% YoY, correspondingly. However, thanks to a further sizable fall in energy supplies and expenditures on foreign travel, G&S imports continued to decline by 3.6% YoY.

In total, in 2020, the C/A surplus amounted to US$6.6bn (est. 4.5% of GDP) after four years of deficit. The merchandise trade deficit decreased to US$6.3bn (est. 4.3% of GDP), while the services trade surplus increased to US$4.6bn (est. 3.2% of GDP). Remittances remained almost unchanged at US$12.1bn (est. 8.3% of GDP).

After five-months of outflows, in December, net capital flows under the F/A were positive and amounted to US$2.7bn. It was almost entirely formed by the public sector via borrowings from official and commercial sources, placement of Eurobonds, and purchase of domestic bonds by non-residents.

In total, in 2020, for the first time since 2015, the F/A showed capital outflow of US$4.6bn. First of all, it reflected an increase in FX cash outside of banks by US$5.5 bn and in other foreign assets amid subdued attraction of foreign capital. Thus, the inflow of debt capital (US$2.1bn) was much lower than in the previous years. In addition, direct investments showed an outflow of US$0.4bn due to a decrease in reinvested earnings caused by losses of enterprises with foreign capital.

ICU view: At the beginning of the year, favourable terms of trade should contribute to the further growth of G&S exports at a relatively high pace. At the same time, we expect

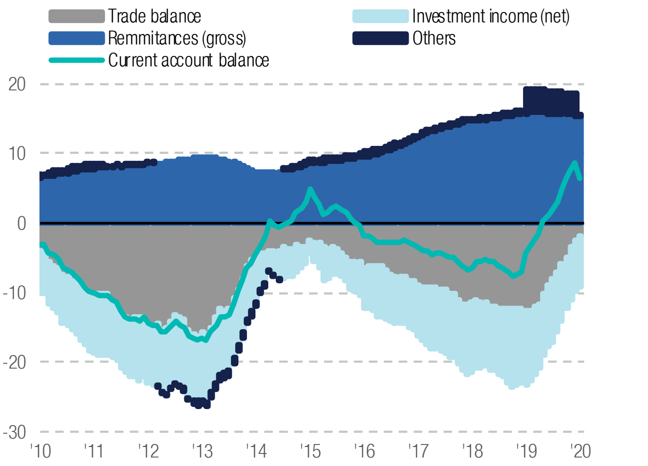
the resumption of consumer and investment imports. Higher energy prices will also increase the cost of imports. Instead, due to the worsening pandemic situation globally, traveling abroad will remain depressed. Taking into account the seasonal factor, the current account is likely to remain in surplus in 1Q21.

At the same time, capital inflows will be restrained both in the private and public sectors. Meanwhile, we expect a gradual decline in demand for FX cash amid the use of stocks accumulated last year and fading depreciation expectations.

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

Chart 8. Current account

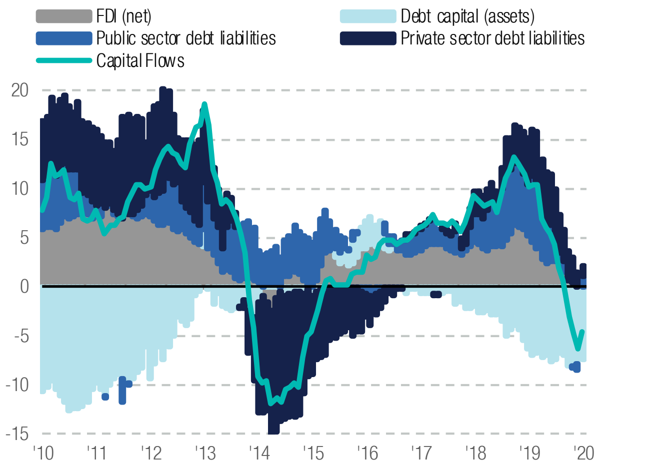
US$ bn, 12m trailing



Source: NBU, ICU.

Chart 9. Capital flows

US$ bn, 12m trailing



Source: NBU, ICU.

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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