Focus
Ukraine

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

Research team
Sergiy Nikolaychuk
Alexander Martynenko
Taras Kotovych

Weekly Insight

Construction keeps growing

Key messages of the today's comments

MONDAY, 8 FEBRUARY 2021

Domestic liquidity and bonds market

Demand exceeds financing needs

The MoF continued to cap its bond offerings and reject expensive bids. Last week, the Ministry accepted less than 70% of demand, and it may reject more demand going forward.

Liquidity slightly less than UAH190bn

Operations with budget accounts caused short-term volatility in liquidity, while other factors had low impact. Since quarterly tax payments start this week, liquidity can decline again.

Foreign exchange market

Hryvnia appreciation continues

As we expected the hryvnia appreciates and last week, exchange rate crossed the UAH28/US$ level. It should continue to appreciate this week toward UAH27.5/US$ with active intervention by the NBU to restrain this movement.

Economics

Construction keeps growing

After falling during 1H20 against the background of the coronacrisis, construction has been steadily increasing since August, mainly due to public financed road infrastructure projects. In 2021, we expect the role of construction as a growth driver to move to the private sector.

Banks' reserves market (5 February 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	6.00	+0bp	-500bp
ON rate (%)	5.21	-3bp	-426bp
ON $ swap (%)	N/A	...	...
Reserves (UAHm)[2]	47,946	-22.22	-27.22
CDs (UAHm)[3]	140,696	+8.36	-17.51

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 govt bond holders (UAHm) (5 February 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-2.35
Banks	522,031	+0.26	+60.11
Residents	59,720	+0.52	+141.27
Individuals	12,682	+2.37	+35.63
Foreigners[1]	97,026	+1.74	-22.65
Total	**1,016,222**	**+0.36**	**+24.24**

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

FX market indicators (5 February 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.7110	-1.49	+12.48
EUR/USD	1.2046	-0.74	+9.52
DXY	91.042	+0.51	-7.38
UAH TWI[1]	120.283	+1.51	-10.24

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

Gov't bond quotes[1] (8 February 2021)

Maturity	Bid	Ask
6m	**10.00**	**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

Demand exceeds financing needs

The MoF continued to cap its bond offerings and reject expensive bids. Last week, the Ministry accepted less than 70% of demand, and it may reject more demand going forward.

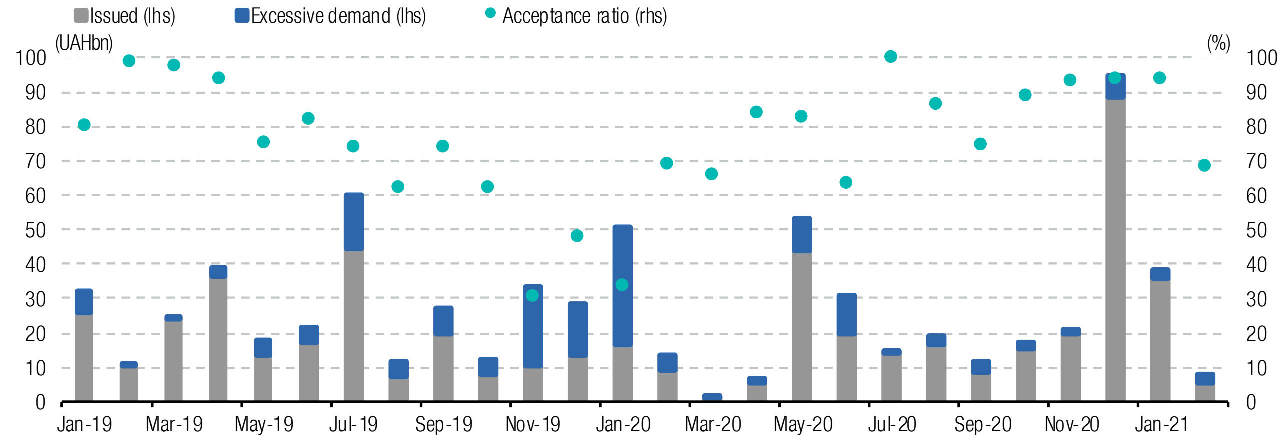
Last month, the Ministry set caps for three-month and six-month bills, but this month, a cap was set for the 12-month paper, too. This is the reason why MoF rejected more than two-thirds of demand for this paper and accepted just 68% of demand for the auction overall.

Historically, the Ministry has used such mechanisms when they saw extra demand and/or did not need to make large borrowings. In addition, caps provided the MoF with the ability to decrease the cost of borrowings and to reallocate some bids to longer instruments without caps. However, when the budget needs large borrowings, the MoF accepted more than 90% of demand, as was seen last December.

In January, the Ministry issued UAH bonds two times more than it had to repay in principal repayments in local currency. Last week, borrowings amounted to UAH5bn or a bit less than a half of debt repayments scheduled for February.

Chart 1. Demand for UAH bonds and its acceptance by the MoF

2021 and two previous years



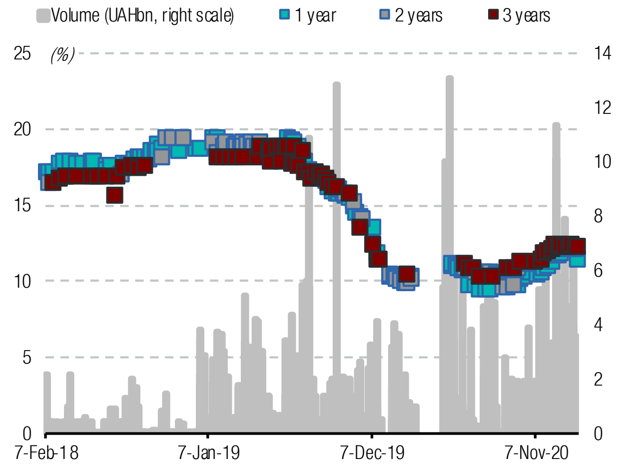
Source: NBU, Bloomberg, ICU.

ICU view: With low needs for borrowings to refinance principal repayments, the MoF continued to cap the amount of offered bills with maturities up to one year. So, this week, we expect part of demand will be rejected due to caps and high interest rates for longer instruments. The Ministry will likely continue to decrease the cost of borrowings.

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

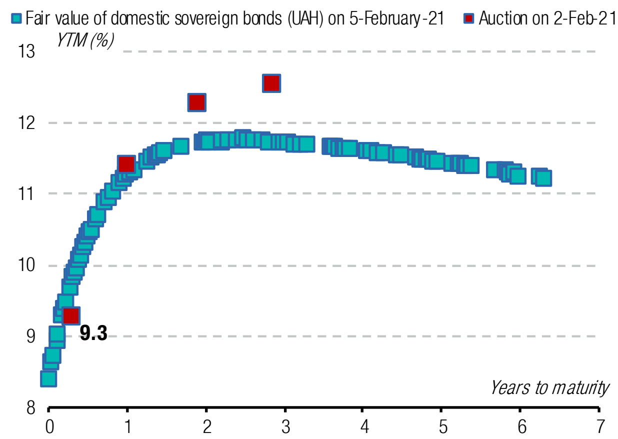
Chart 2. Local-currency bonds

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.

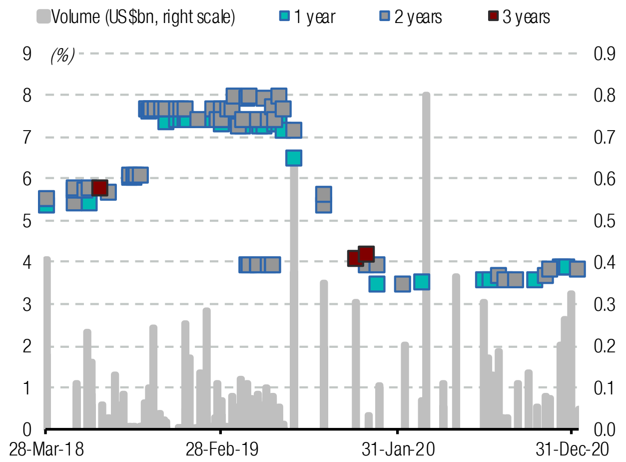
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

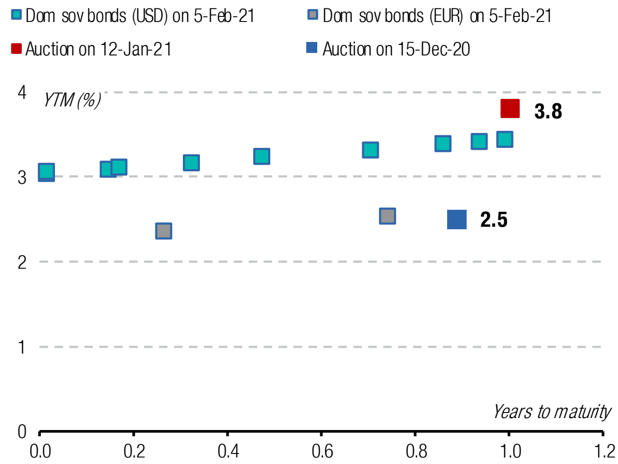
Chart 3. FX-denominated bonds

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 slightly less than UAH190bn

Operations with budget accounts caused short-term volatility in liquidity, while other factors had low impact. Since quarterly tax payments start this week, liquidity can decline again.

Last week started with a three-day outflow to budget accounts at UAH11bn as a result of tax payments and new bill purchases. But with an increase in budget expenditures last Thursday, liquidity in the banking system saw outflow of just UAH3.6bn by the end of the week.

However, demand for cash is low and banks exchanged reserves in cash last week just UAH0.4bn, while YTD UAH2.9bn of cash were exchanged in reserves.

NBU had low impact on liquidity, too, and caused inflow in liquidity slightly above UAH2bn, purchased hard currency of UAH2.5bn but provided banks with less loans than they redeemed.

ICU view: Treasury operations with budget funds remain the key to liquidity fluctuations. This week, borrowings will cause a new wave of outflows and later this week, quarterly tax payments will begin. In February, ordinarily, quarterly tax

payments are not very large, but they will cause extra pressure on liquidity. Additional hryvnia appreciation and foreigners' activity in the bond market will require larger NBU interventions and cause inflows of funds into banking-sector liquidity.

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

Chart 4. Banks reserves usages over last week (UAHm)

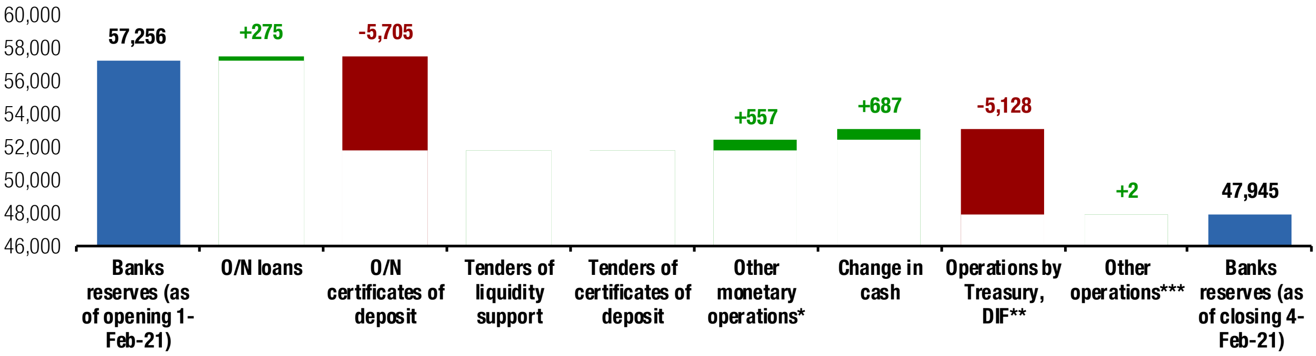
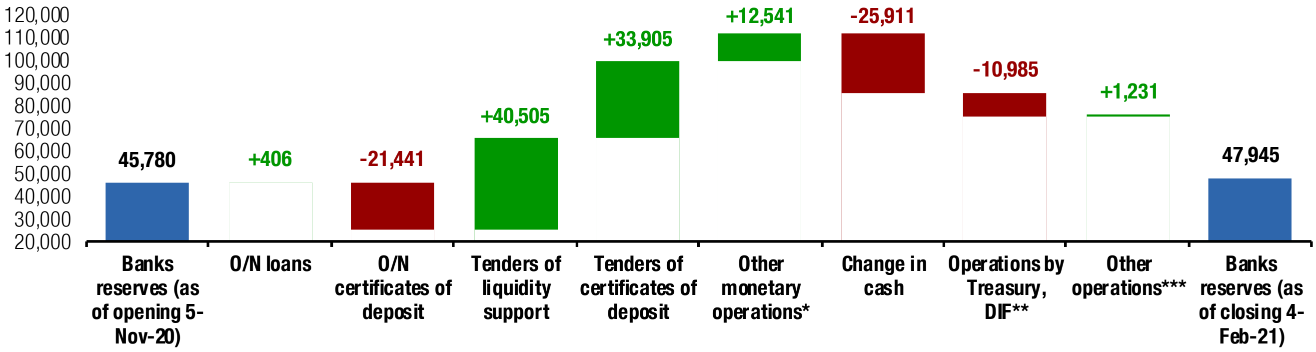


Chart 5. Banks reserves usages over last 90-day period (UAHm)



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 appreciation continues

As we expected the hryvnia appreciates and last week, exchange rate crossed the UAH28/US$ level. It should continue to appreciate this week toward UAH27.5/US$ with active intervention by the NBU to restrain this movement.

Last week, the hryvnia appreciated by 1.5% to UAH27.71/US$ as a result of the market balance tilting to the supply side. Taking into the account the low amount of new bonds purchased by foreigners, a large amount of hard currency was sold by locals. Likely, favourable conditions on global commodity markets cause an increase of export proceeds.

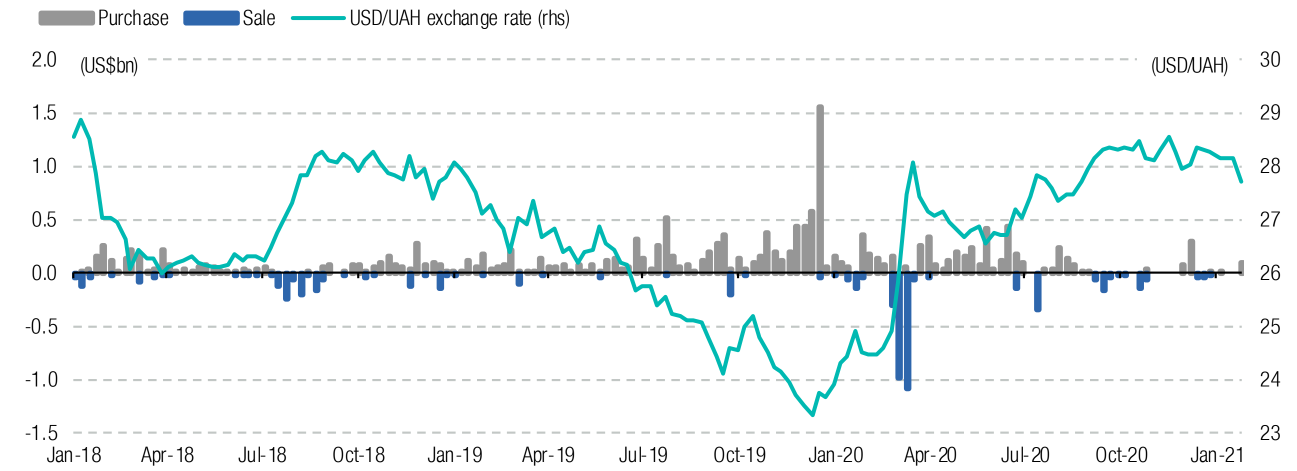
The NBU came back to the FX market with interventions after almost a month-long break and purchased US$20m last Thursday and US$70m last Friday. These purchases restrained hryvnia appreciation, but did not change the main trend of seasonal appreciation.

ICU view: We maintain our expectations for further hryvnia appreciation and gradual movement to UAH27.5/US$ this week and to UAH27.0/US$ by the end of February under the pressure from both foreigners and locals, including needs of local-currency liquidity for tax payments. Positive sentiment in global markets for Ukrainian exports and high prices for these commodities, along with improved sentiment in financial markets will support increased hard currency inflow into Ukraine and supply in the FX market.

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

Chart 6. 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

Construction keeps growing

After falling during 1H20 against the background of the coronacrisis, construction has been steadily increasing since August, mainly due to public financed road infrastructure projects. In 2021, we expect the role of construction as a growth driver to move to the private sector.

In December, the growth of construction volumes remained elevated, 9.9% YoY. As in previous months, the main driver was the construction of infrastructure facilities (+31.4% YoY), primarily roads. Instead, the decline in construction of residential buildings (26.9% YoY) and non-residential buildings (12.1% YoY) deepened, which was primarily due to bad weather conditions.

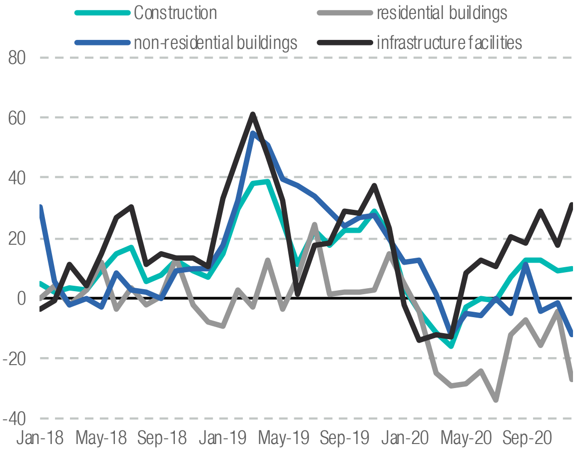
In general, in 2020, construction grew by 4% YoY, which was the lowest rate since 2016. Growth was caused by a significant surge in road construction (2.3 times YoY in nominal terms), the share of which in total construction increased to 31% compared with an average of 16% over the previous three years. Other construction was weaker than in 2019; in particular, housing construction fell the most sizably, by 18.5% YoY.

ICU view: Construction was one of the few activities that showed positive growth rates last year, restraining the decline in overall GDP. First of all, this happened due to a significant increase in budget expenditures for road works. According to NBU estimates, these expenditures, taking into account indirect effects, had a positive impact on the GDP growth rate of 1.4–1.5 p.p.

In 2020, the share of construction in GDP is likely to increase to 2.9% compared with 2.7% in 2019. This is still significantly lower than the EU average of 5%. And given the significant underinvestment of the domestic economy, particular in transport infrastructure, in coming years, we anticipate outpacing growth in construction. This year, we expect that public investment in infrastructure will remain at a high level of 2020, and the role of the main driver of construction growth will move to the private sector, in particular in the areas of logistics and new industrial facilities in the iron ore extraction and steel sector.

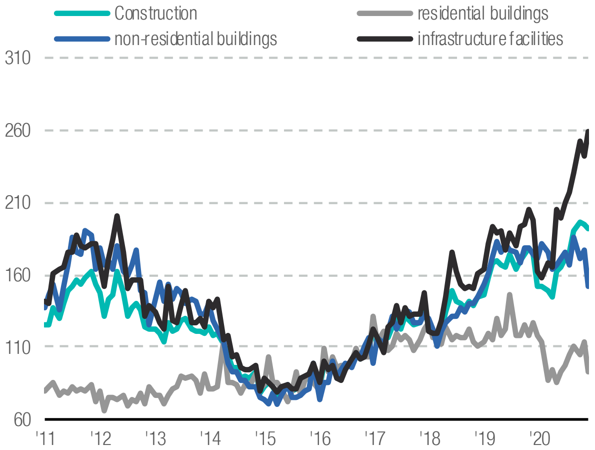
Sergiy Nikolaychuk, Kyiv, (044) 377-7040 ext.721

Chart 7. Construction, YoY, %



Source: Ukrstat, ICU.

Chart 8. Construction, SA index, 2016=100%



Source: Ukrstat, ICU.

This page is intentionally left blank

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

Alexander Martynenko
Head of corporate research
alexander.martynenko@icu.ua

Taras Kotovych
Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Mykhaylo Demkiv
Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Dmitriy Dyachenko
Junior financial analyst
dmitriy.dyachenko@icu.ua

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (license numbers: dealer activity AE 263019, broker activity AE 263018, underwriting activity AE 263020 dated 11 April 2013).

DISCLAIMER