



Focus
Ukraine

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

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Weekly Insight

Industry growing again

Key messages of the today's comments

Domestic liquidity and bonds market

Interest rates for local-currency debt increase

Last week, at the first auction after the NBU hiked the key policy rate to 7.5% the MoF agreed to increase interest rates for UAH-denominated bonds. Tomorrow, interest rates will rise for maturities that were not offered last Tuesday.

Liquidity above UAH200bn

The total amount of banking-sector liquidity is still fluctuating above UAH200bn with low impact from non-monetary operations. This week, fluctuation can be larger due to month-end tax payments and VAT refunds.

Foreign exchange market

FX market is self-balanced

For the third consecutive week, the FX market was self-balanced, while the NBU allowed wide fluctuations in the exchange rate. Nonetheless, the hryvnia appreciated a bit last week. With month-end tax payments this week and foreigners slower to withdraw funds from local-currency debt, the hryvnia will be supported, and it can appreciate toward UAH27.5/US\$.

Economics

Industry growing again

In March, industrial production grew by 2.1% YoY after weak performance in the first 2M21. In addition, the growth of retail trade accelerated noticeably to 13.1% YoY. So, as we expected earlier, despite the tightening of quarantine restrictions, economic activity intensified significantly in March. As a result, we assess the rate of decline in GDP to remain at about 0.5% YoY in 1Q21, and we expect double-digit economic growth in 2Q21.

MONDAY, 26 APRIL 2021

Banks' reserves market (23 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	7.50	+0bp	-50bp
ON rate (%)	6.59	-22bp	-233bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	53,658	-36.80	-2.33
CDs (UAHm) ³	156,962	+22.45	+13.68

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) (23 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	320,977	-0.34	-1.11
Banks	527,516	+0.91	+54.72
Residents	45,783	+3.25	-11.82
Individuals	15,728	+1.25	+84.17
Foreigners ¹	97,164	-1.22	-14.73
Total	1,007,443	+0.40	+19.94

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (23 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.9186	-0.26	+3.48
EUR/USD	1.2097	+0.95	+12.25
DXY	90.859	-0.76	-9.53
UAH TWI ¹	120.557	-0.24	-8.05

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (26 April 2021)

Maturity	Bid	Ask
6m	10.00	9.00
12m	12.25	11.25
2y	13.25	12.00
3y	13.75	12.50
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

Interest rates for local-currency debt increase

Last week, at the first auction after the NBU hiked the key policy rate to 7.5% the MoF agreed to increase interest rates for UAH-denominated bonds. Tomorrow, interest rates will rise for maturities that were not offered last Tuesday.

Generally, the hike in interest rates was small, just 20-40bp, except the three-month bills, where the rate was up 73bp. But for the latter, there are quite clear reasons for such an increase. Two weeks earlier, three-month bills were sold at 7.77%, which was at a 127bp premium to the key policy rate and rate for seven-day CDs. Therefore, after the NBU hiked the key rate to 7.5%, rates for three-month bills were up to 8.5%, giving banks a premium of just 100bp. More details about last week's auction in our review.

However, the amount of borrowings rose, partially due to foreigner's slower pace in selling bonds. In total last week, they sold UAH0.96bn of local-currency bills, or almost three times less than a week before. There has been very important improvement in market sentiment after the risk of escalating hostilities in the east of Ukraine declined, with immediate increase in Eurobonds' and VRIs' prices.

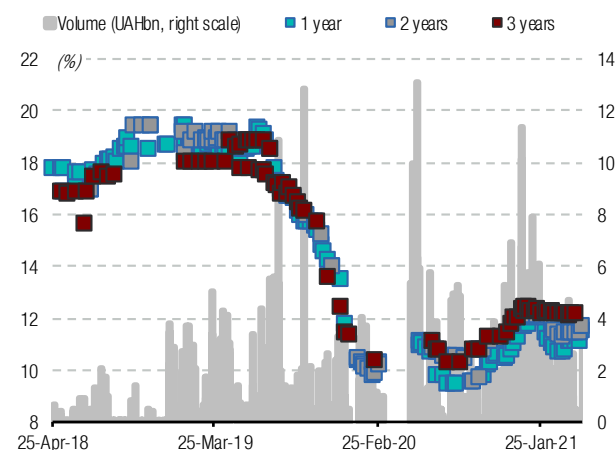
ICU view: Large debt redemption of UAH11bn is scheduled for this week, and demand is unlikely to be enough to refinance it in full. Therefore, we assume that investors' portfolios will decline slightly. However, partial refinancing will not cause problems for the MoF, as last week, the NBU transferred UAH24bn of its profit from 2020 to the state budget, and the MoF will have enough funds for these debt repayments.

At the same time, we expect to see further increases in rates at the primary bond market, especially for maturities that were not offered last week, e.g. half year, two and three-year papers, where interest rates should move up to smoothen the yield curve. The largest increase likely will be for the half-year paper, at least by 50bp to 9%, which will give banks less premium to the key policy rate than before. Two and three-year paper rates should rise by about 30bp.

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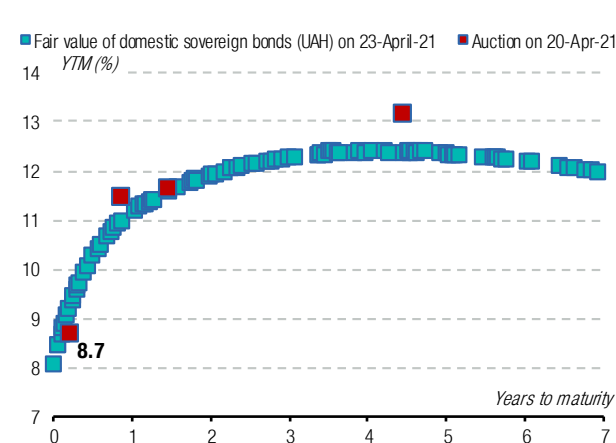
Chart 1. Local-currency bonds

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.

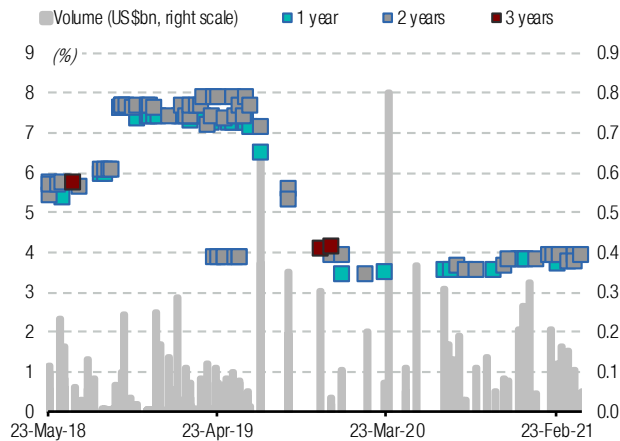
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

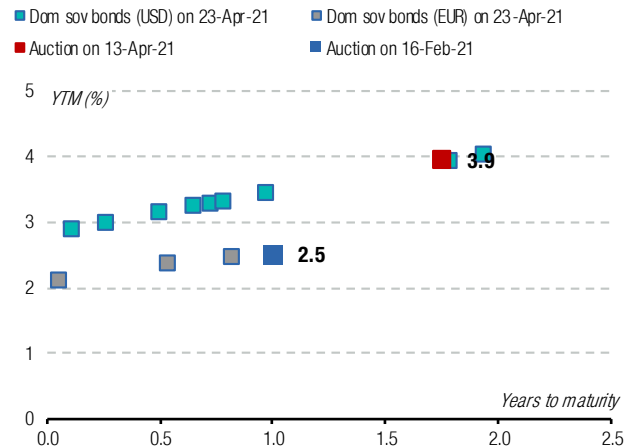
Chart 2. FX-denominated bonds

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 above UAH200bn

The total amount of banking-sector liquidity is still fluctuating above UAH200bn with low impact from non-monetary operations. This week, fluctuation can be larger due to month-end tax payments and VAT refunds.

Last week, the Treasury caused outflow from liquidity at UAH3.7bn while banks exchanged in cash just UAH2.5bn. NBU's impact was low; it did not intervene in the FX market and new loans to banks were insignificant UAH204m.

ICU view: Most month-end tax payments and VAT refunds will take place this week. They can be not matched and, therefore, will cause additional liquidity fluctuations. However, in total, liquidity will stay above UAH200bn.

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

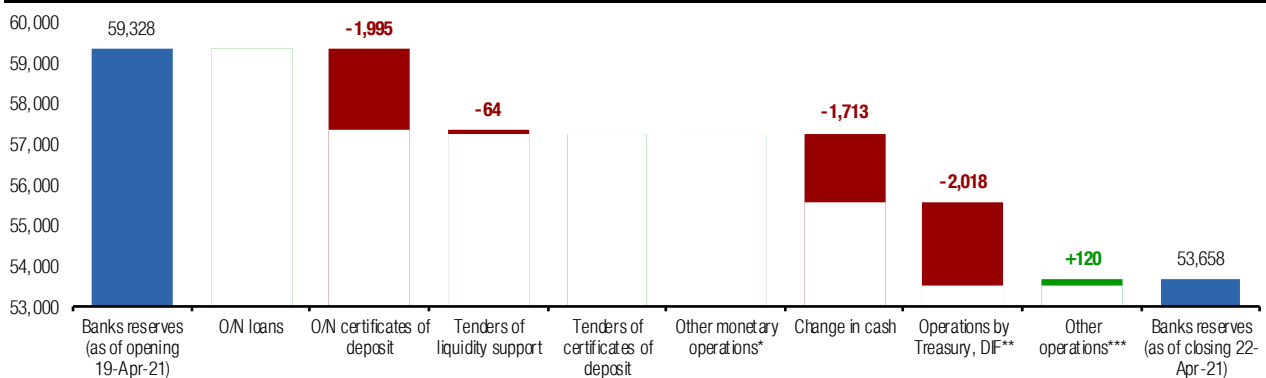
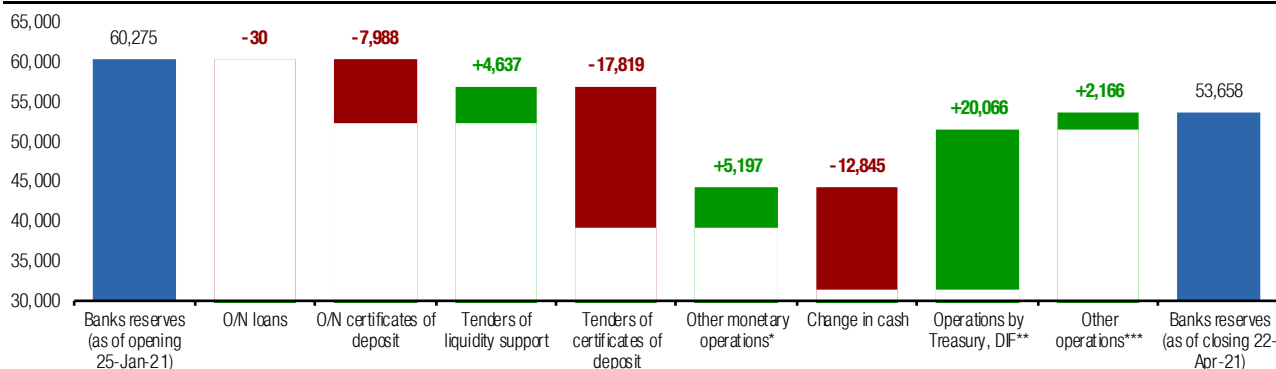


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

FX market is self-balanced

For the third consecutive week, the FX market was self-balanced, while the NBU allowed wide fluctuations in the exchange rate. Nonetheless, the hryvnia appreciated a bit last week. With month-end tax payments this week and foreigners slower to withdraw funds from local-currency debt, the hryvnia will be supported, and it can appreciate toward UAH27.5/US\$.

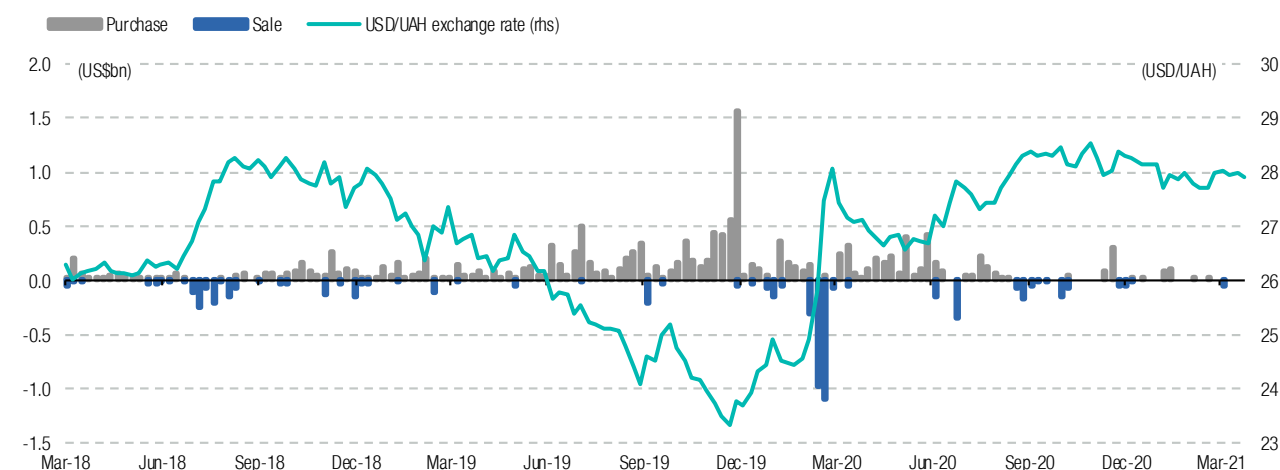
Better news from eastern Ukraine came last Thursday, which changed market sentiment immediately, increasing prices of Ukrainian Eurobonds and VRI's. In the local market, foreigners slowed the pace of funds withdrawal (see comment above). With lower demand for hard currency, the hryvnia appreciated by 0.3% to UAH27.92/US\$.

ICU view: Lower demand for hard currency, requirements for local-currency liquidity for month-end tax payments and for other expenses prior to the long period of holidays in May, will give additional support to the hryvnia. Therefore, we anticipate that the hryvnia will continue to appreciate slightly towards UAH27.5/US\$.

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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

Industry growing again

In March, industrial production grew by 2.1% YoY after weak performance in the first 2M21. In addition, the growth of retail trade accelerated noticeably to 13.1% YoY. So, as we expected earlier, despite the tightening of quarantine restrictions, economic activity intensified significantly in March. As a result, we assess the rate of decline in GDP to remain at about 0.5% YoY in 1Q21, and we expect double-digit economic growth in 2Q21.

In March, industrial production returned to YoY growth, while the seasonally adjusted indicator increased by 2.4% MoM and returned to the level of November–December. High prices and demand on global markets stimulated iron ore mining (+3.2% YoY) and metallurgical production (+5.2% YoY), output of the machine-building industry increased (+7.6% YoY) thanks to stable domestic demand, and energy production accelerated to 7.3% YoY. At the same time, as in previous months, due to poor harvests of the previous year, the food industry continued to decline (by 6.2% YoY in March).

In total for 1Q21, industrial production decreased by 1% QoQ SA and by 2% YoY, the most in the processing industry by 3.3% YoY.

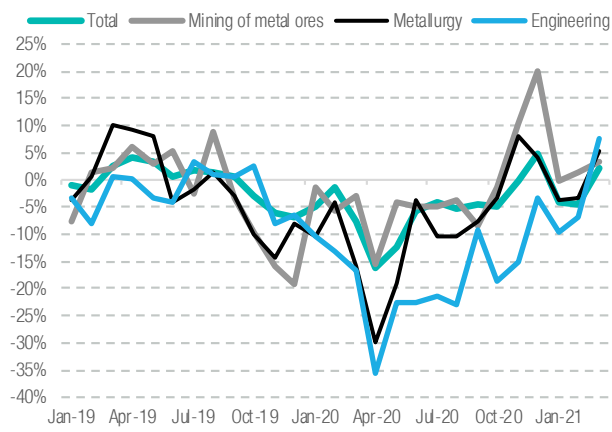
In 1Q21, retail sales increased by 7.5% YoY compared with 13.6% YoY in 4Q20, but decreased by 2.3% QoQ SA. The decline occurred in the first months of the year, but by March, retail trade rebounded considerably, despite the deterioration with the COVID-19 pandemic and the introduction of additional quarantine restrictions. This happened against a continuing high rate of income growth, while consumer sentiment remained quite depressed.

ICU view: March performance for industry and retail sales were consistent with our expectations based on leading indicators and confirmed the insignificant impact of the new quarantine restrictions on economic activity. Factors such as logistical complications due to weather conditions, the impact of poor harvests of the previous year, and the effect of an "extra" day in leap-year 2020, played a key role in slowing economic activity at the beginning of the year.

As a result, according to our estimates, in 1Q21, GDP decreased by 0.5% YoY and by 0.6% QoQ SA. In 2Q21, despite the ongoing surge in Covid-19 cases and the introduction of new quarantine restrictions at the regional level, we expect consequential economic growth to resume and double-digit growth rates on an annual basis. This will be facilitated by the further recovery of the global economy due to rapid vaccination rollout and the resilience of domestic demand. Meanwhile, geopolitical tensions with Russia, a slow pace of vaccination within the country, and the spread of new strains of coronavirus pose downside risks.

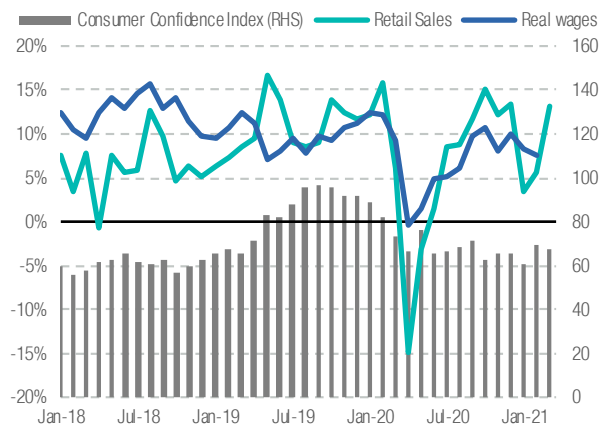
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Chart 6. Industrial output, % YoY



Source: UkrStat, ICU.

Chart 7. Retail sales and real wages (% YoY), and consumer sentiment



Source: UkrStat, Info Sapience, ICU.

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