

Weekly Insight

Investment sentiment toward Ukraine improves

Key messages of the today's comments

Domestic liquidity and bonds market

Investment sentiment toward Ukraine improves

Last week, prices for Ukrainian Eurobonds and VRIs rose, in line with an increase in the local-currency bond portfolios held by foreigners. This is the result of slight improvement in sentiment toward Ukraine, leading to anticipation of positive changes in investment in Ukrainian assets.

Budget absorbs liquidity

In May, the budget received quarterly tax payments and dividends from state-owned banks. These payments caused a decline in liquidity to almost UAH190bn. In June, liquidity will stay within UAH190–200bn.

Foreign exchange market

Hryvnia maintains appreciating trend

At the beginning of last week, the hryvnia appreciated to UAH27.4/US\$, but on Wednesday, it corrected to UAH27.5/US\$ where it stayed through the end of last week. We expect this correction to be short-lived, and in June, the hryvnia should appreciate toward UAH27/US\$.

Economics

Economic recovery continues

In April, most economic indicators showed high YoY growth rates due to the low statistical base of comparison. SA industrial production increased significantly compared with 1Q21, while trade and transport were negatively affected by the tightening of quarantine restrictions. In the coming months, we expect a further recovery in economic activity amid the improving situation with the COVID-19 pandemic.

MONDAY, 31 MAY 2021

Banks' reserves market (28 May 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	7.50	+0bp	-50bp
ON rate (%)	6.75	+1bp	-17bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	56,498	+15.28	+9.05
CDs (UAHm) ³	138,796	-2.65	+11.18

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) (28 May 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	318,777	+0.00	-1.79
Banks	516,128	+0.57	+30.33
Residents	46,173	+3.70	-13.46
Individuals	17,104	+1.24	+114.94
Foreigners ¹	98,319	+1.07	-7.59
Total	996,697	+0.58	+12.19

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (28 May 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.5054	+0.27	+2.22
EUR/USD	1.2192	+0.08	+10.07
DXY	90.031	+0.02	-8.49
UAH TWI ¹	120.727	-0.42	-5.60

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (31 May 2021)

Maturity	Bid	Ask
6m	10.00	8.50
12m	12.00	11.00
2y	12.75	11.50
3y	13.00	12.00
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

Investment sentiment toward Ukraine improves

Last week, prices for Ukrainian Eurobonds and VRIs rose, in line with an increase in the local-currency bond portfolios held by foreigners. This is the result of slight improvement in sentiment toward Ukraine, leading to anticipation of positive changes in investment in Ukrainian assets.

Spreads to the benchmark tightened by 10-30bp last week for Ukrainian USD-denominated Eurobonds. The yield-curve moved down to 2-6.6% with prices up to 101-119. Prices for VRIs rose, too, to 111c.

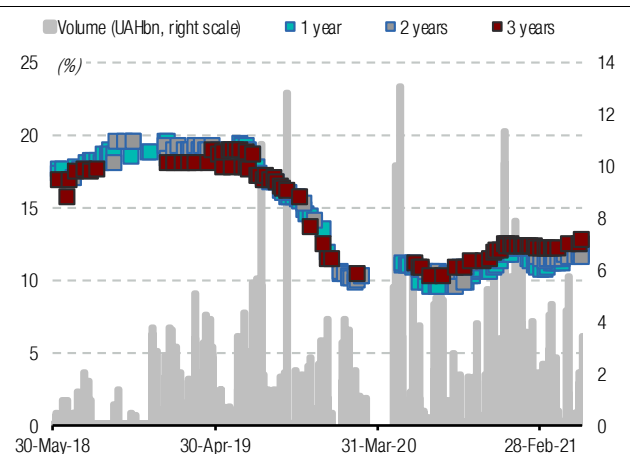
In the local market, foreigners improved their view on UAH-denominated debt. High interest rates and improving outlook for the exchange rate attracted new investment by foreigners. After the decline in portfolios in April followed by steady portfolio levels for most of May, last week, foreigners increased their portfolios by UAH1bn (or they likely bought about a sixth of last weeks' bond issues).

ICU view: Large debt repayments are scheduled for June, including for issues held by foreign investors. We expect that they will not only reinvest repayments in new bonds, but will slightly increase portfolios with new purchases. We expect a slight increase in prices of Ukrainian Eurobonds, too.

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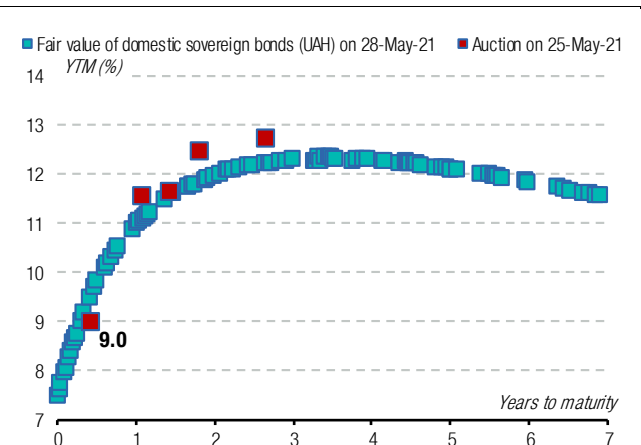
Chart 1. Local-currency bonds

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.

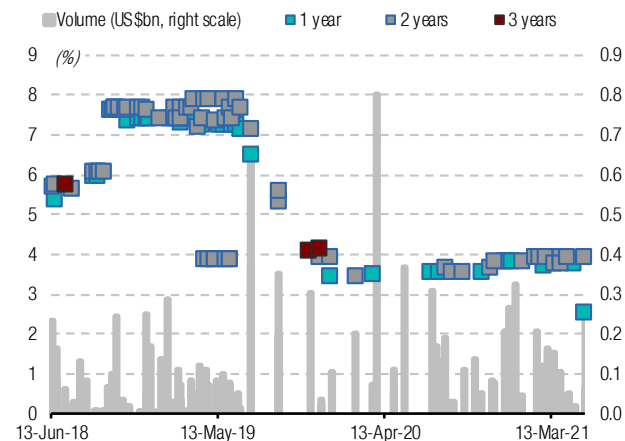
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

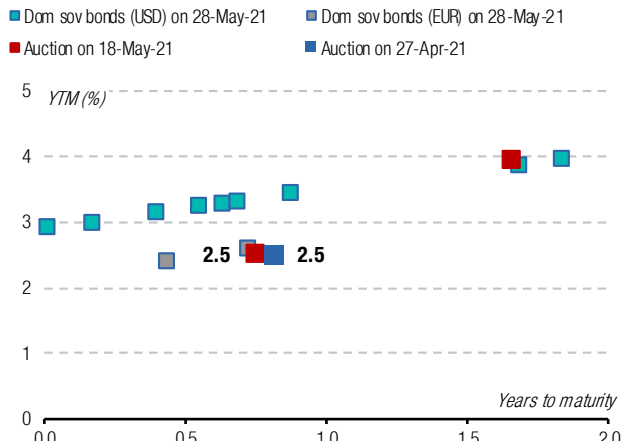
Chart 2. FX-denominated bonds

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.

Budget absorbs liquidity

In May, the budget received quarterly tax payments and dividends from state-owned banks. These payments caused a decline in liquidity to almost UAH190bn. In June, liquidity will stay within UAH190–200bn.

On three separate days in May, the budget received UAH13bn through tax administration, including dividends and quarterly tax payments. Larger expenditures compensated just part of these funds. In total, the state budget absorbed UAH6.7bn during May. Just with new loans from NBU amounted to UAH9bn liquidity was up temporarily to UAH209bn in mid-May.

During the month, demand for cash forced banks to exchange net UAH2.2bn in cash. Partially, this was due to selling of hard currency by individuals.

ICU view: Traditionally, liquidity is rather steady in June. Of course, redemptions of local-currency bonds with possible NBU interventions can increase liquidity

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

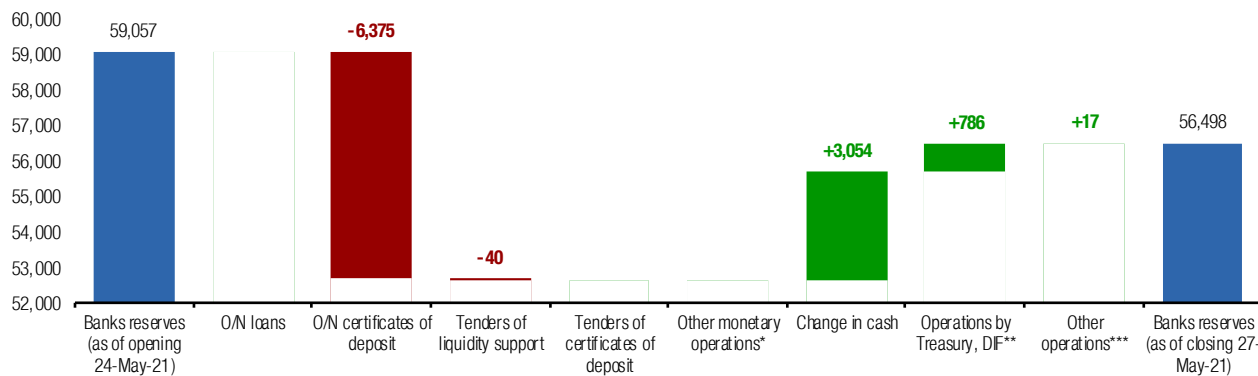
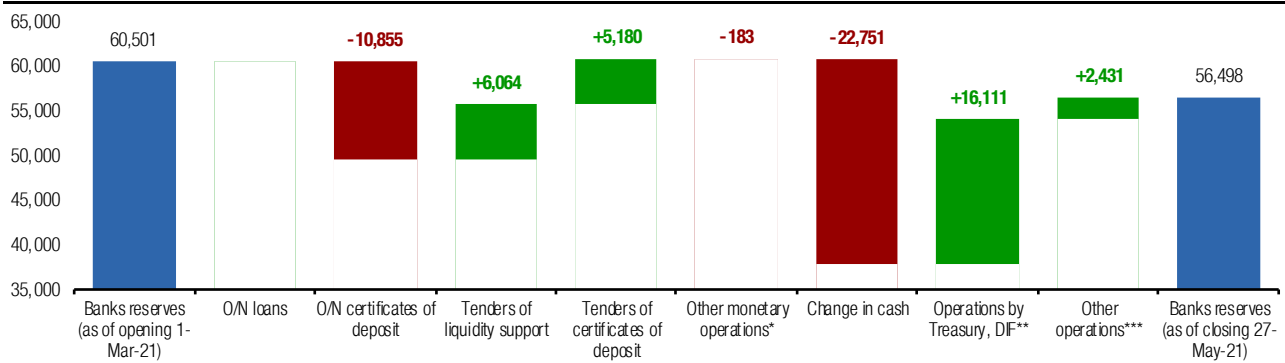


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 maintains appreciating trend

At the beginning of last week, the hryvnia appreciated to UAH27.4/US\$, but on Wednesday, it corrected to UAH27.5/US\$ where it stayed through the end of last week. We expect this correction to be short-lived, and in June, the hryvnia should appreciate toward UAH27/US\$.

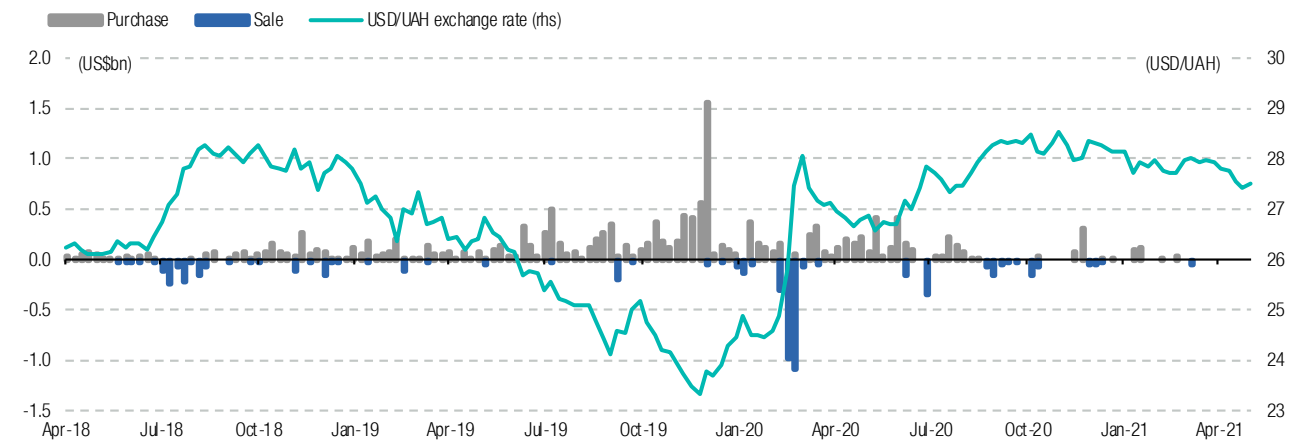
After large quarterly tax payments and new bond purchases by foreigners at the beginning of last week, on Wednesday, the hryvnia corrected to UAH27.51/US\$. It ended the week at this level or weakened by 0.3%. This was caused by a decline in demand for local-currency liquidity and a decline in the supply of hard currency.

ICU view: International sentiment toward Ukraine has improved, as has international trade. Combined, it is anticipated that the supply of hard currency in the market will be large, while demand may be lower. Locals will prefer to spend their money on local tourism rather than to purchase new imported goods. Therefore, we anticipate that after a slight correction at the end of May, the hryvnia will continue to appreciate slightly toward UAH27/US\$ in June. This appreciation will happen mostly during tax payments and when the MoF offers bonds with tenors that are attractive to foreigners.

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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

Economic recovery continues

In April, most economic indicators showed high YoY growth rates due to the low statistical base of comparison. SA industrial production increased significantly compared with 1Q21, while trade and transport were negatively affected by the tightening of quarantine restrictions. In the coming months, we expect a further recovery in economic activity amid the improving situation with the COVID-19 pandemic.

In April, industrial production increased by 13% YoY, the highest pace since 2011. The rapid acceleration was expected amid a very low statistical base of comparison of last year's April, caused by the COVID-19 pandemic. Meanwhile, industrial production also grew rapidly in sequential terms, thus the SA indicator in April exceeded the average of 1Q21 by 4.2%.

In addition, the growth of retail trade accelerated to 34.3% YoY amid improving consumer sentiment and rapid growth rates of real wages of 19.7% YoY. The volume of wholesale trade turned up by 0.9% YoY in 4M21, after decreasing by 3% YoY in 1Q21. Also, the YoY changes in passenger and freight turnover indicators have improved significantly. However, in April compared with 1Q21, transport and trade indicators slightly worsened due to tighter quarantine restrictions at the regional level.

ICU view: Among sub-sectors, the performance of light industry, production of furniture and wood products, metallurgy, and machinery have significantly improved. Mainly, it was caused by the recovery of demand for consumer and investment products both domestically and in global markets. Moreover, many markets are currently experiencing product shortages due to the negative impact of the COVID-19 pandemic on production chains, the reorientation of global demand, and weak investment in the previous pandemic year. In particular, this shortage factor is now one of the main drivers of global inflation. It seems that in such conditions the low capacity utilization of Ukrainian industry can become an important competitive advantage.

At the same time, restrictions on the supply of raw materials continue to negatively affect the food industry, whose output was still 3.4% lower in April than last year. Given the high weight of this sub-sector within the industrial output (more than 20% last year), this had a significant impact on the overall indicator. The expected high yields

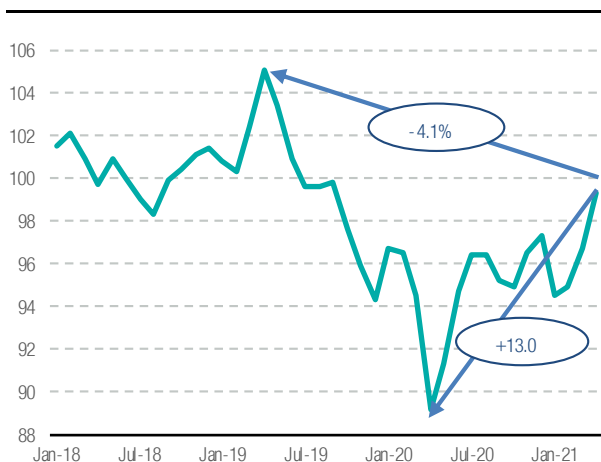
of grains, oilseeds, and other crops should contribute to improving the performance of the food industry in 2H21.

The improving situation with the COVID-19 pandemic resulting in the weakening of quarantine restrictions and the growth of business activity in May gives reason to expect further economic recovery. This, together with strong April performance, provides additional support for our moderately optimistic forecasts for this year, which are higher than consensus estimates.

Thus, we expect industrial production to grow by 3.9% in 2021 (consensus is 3.4%), which implies acceleration compared with 1.5% for 4M21. And we project GDP growth of 5.2% compared with 4.2% of consensus and NBU's forecast of 3.8%.

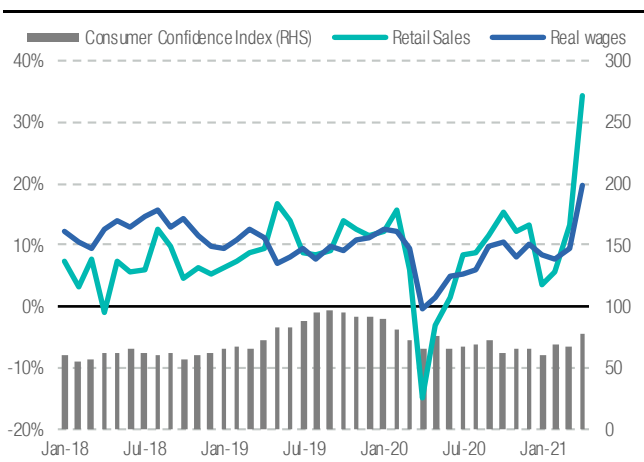
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Chart 6. Industrial output, SA level, 2019=100



Source: UkrStat, ICU.

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



Source: UkrStat, Info Sapiencie, ICU.

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