Focus

Ukraine

Markets

Domestic liquidity, government bonds, FX market, and macro

Research team

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Weekly Insight

Annualized C/A deficit up

Key messages of the today's comments

TUESDAY, 3 APRIL 2018

Domestic liquidity and bonds market

Demand divided between two currencies

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Liquidity steady

During the last week of March, liquidity was quite balanced. The total amount of banking-sector liquidity remained above UAH100bn, increasing at the end of the month. This week, liquidity could see a short-lived decline due to FX purchase.

Foreign exchange market

The hryvnia slightly appreciated

Over the course of last week, movement in the national currency was the result of VAT refunding on the one hand, and by tax payments to the budget on the other. Additionally, the market was influenced by holidays on Friday and Monday in the US. This week, the hryvnia should trade in a tight range, and continue a gradual appreciating trend.

Economics

Annualized C/A deficit up 3.4 times in February

Annualized C/A deficit declined 6.3% MoM to US$2.1bn, but surged 3.4 times compared with February 2017, per revised data from the NBU. The C/A deficit is to widen further this year due to rising imports of consumer goods, higher oil prices and an expected decrease in steel prices.

Banks' reserves market (2 April 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU rate (%)[1]	17.00	+0bp	+300bp
ON rate (%)	15.50	-70bp	+240bp
ON $ swap (%)	15.52	-34bp	+282bp
Reserves (UAHm)[2]	43,807	-12.31	+3.26
DepCerts (UAHm)[3]	59,454	+16.76	+0.00

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's short-term bonds.
Source: NBU, Bloomberg, ICU.

Breakdown of govt bond holders (UAHm) (2 April 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU	350,329	-0.40	-8.54
Banks	350,291	+0.72	+22.78
Residents	28,239	-0.89	+23.06
Individuals	2,326	+8.33	+709.71
Non-res[4]	14,357	-1.94	+165.33
Total	**745,544**	**+0.10**	**+6.96**

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

FX market indicators (2 April 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.1400	-0.60	-3.44
EUR/USD	1.2302	-0.81	+15.49
DXY[2]	90.052	+0.76	-10.26
UAH TWI[3]	115.231	+1.00	+6.94

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

Gov't bond quotes[1] (3 April 2018)

Maturity	Bid	Ask
6m	**17.50**	**16.50**
12m	**17.75**	**16.75**
2y	**17.50**	**16.50**
3y	**17.50**	**16.50**
12m ($)	**5.10**	**4.70**
2y ($)	**5.30**	**5.00**

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

Domestic liquidity and bonds market

Demand divided between two currencies

Last week, the MoF slightly changed bonds yields, receiving more than UAH20bn of budget proceeds, but the majority of the proceeds came from FX-denominated bonds. For the next few weeks, the MoF plans to borrow only in local currency.

Four local-currency bonds were offered in last week's auction, and three bonds were denominated in US dollars. All of them received bids, but the five-year bond was not sold due to a lack of competitive bids.

For the three-month maturities, the cut-off yield remained the same at 17.44%, but the weighted-average rate declined 11bp to 17.33%. With a limited offering of UAH0.5bn, the MoF received UAH0.48bn from this issue. At the same time, for the nine-month maturities, the MoF again increased the cut-off rate, which was set last week at 17.30% or 20bp above the previous auction. The weighted-average rate for the nine-month maturities was also increased to 17.30%, and the MoF received UAH2.19bn in proceeds, the largest amount from nine-month maturities this year.

Demand for FX-denominated bonds amounted to US$0.66bn, with interest rates ranging from 5.00% to 5.50%; only a few insufficient bids were rejected. The state budget received US$0.67bn of the proceeds, the majority of which was with a repayment scheduled for October, 2018.

All bondholders' portfolios saw changes last week. Non-residents received redemption of FX-denominated bonds and insufficiently, by UAH1m, increased holdings of local-currency bonds. The largest increase was seen in banks' portfolios, as banks refinanced repayments and purchased additional USD-denominated bonds, which amounted to the equivalent of UAH2bn. Non-banks changed the structure of their portfolios, decreasing their holdings of FX-denominated bonds and purchasing hryvnia-denominated bonds.

Individuals increased their bond portfolios in all available currencies: by UAH0.04bn in hryvnia, by UAH0.1bn in US dollars, and by UAH0.02bn in euros.

ICU view: The Ministry refinanced most FX-denominated repayments last week and received additional local-currency proceeds for the budget. The MoF is not offering FX-denominated bonds in the auctions scheduled for the next two months. Likely, it will try to borrow money with repayments scheduled for the autumn and following years: three-month maturities will be offered at each second week, and nine-month maturities are not scheduled to be offered at all. During April, the MoF has to repay more than UAH10bn in local currency, and refinancing these repayments at current yields could be quite difficult.

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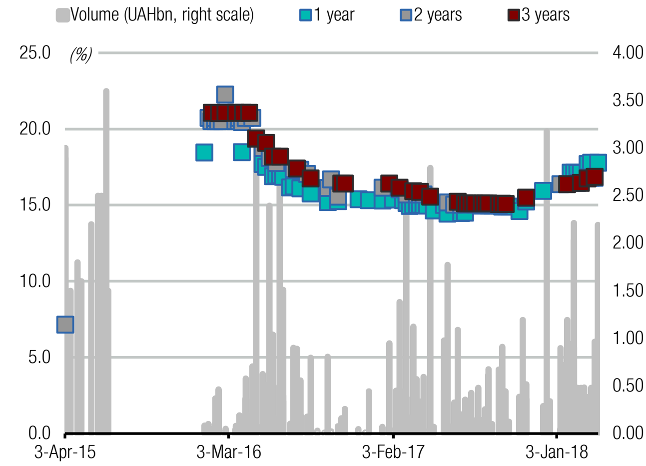
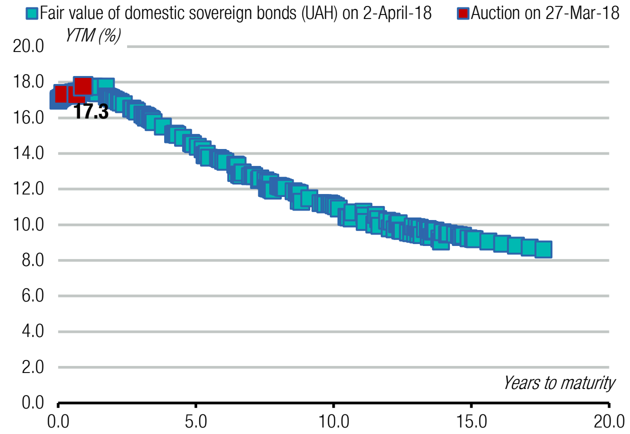
Chart 1. Local-currency bonds

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.

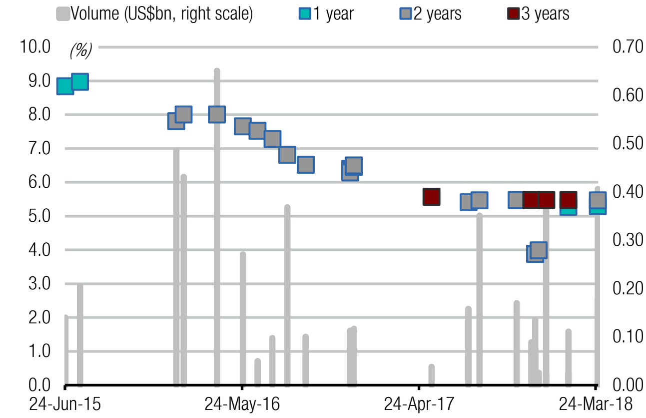
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

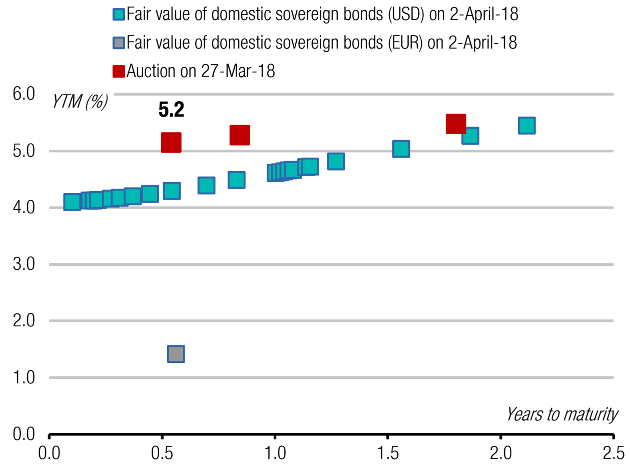
Chart 2. FX-denominated bonds

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 steady

During the last week of March, liquidity was quite balanced. The total amount of banking-sector liquidity remained above UAH100bn, increasing at the end of the month. This week, liquidity could see a short-lived decline due to FX purchase.

Last Monday, liquidity was UAH102.69bn, declining UAH0.47bn by Friday morning to UAH100bn. Banks divided liquidity mostly equally between reserves and CDs, but at the end of week, the total amount of CDs increased to above UAH53bn.

Liquidity was supported by balanced cash-flow, especially from Treasury operations. VAT refund payments were flat, which compensated outflows to the budget via new tax payments. NBU only twice absorbed funds from the banking system through FX, but the final negative impact was insufficient at UAH1.2bn.

ICU view: This week liquidity may decline due to FX purchases for dividend payments abroad, but this decline will be insufficient and short-lived. The main source for

compensation will be budget expenditures, and liquidity should be slightly volatile at around UAH100bn.

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

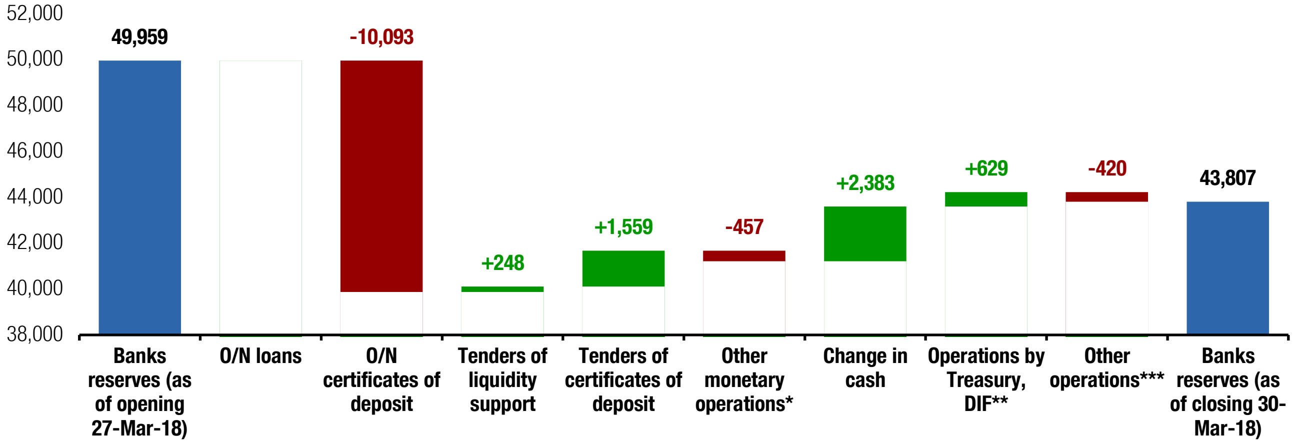
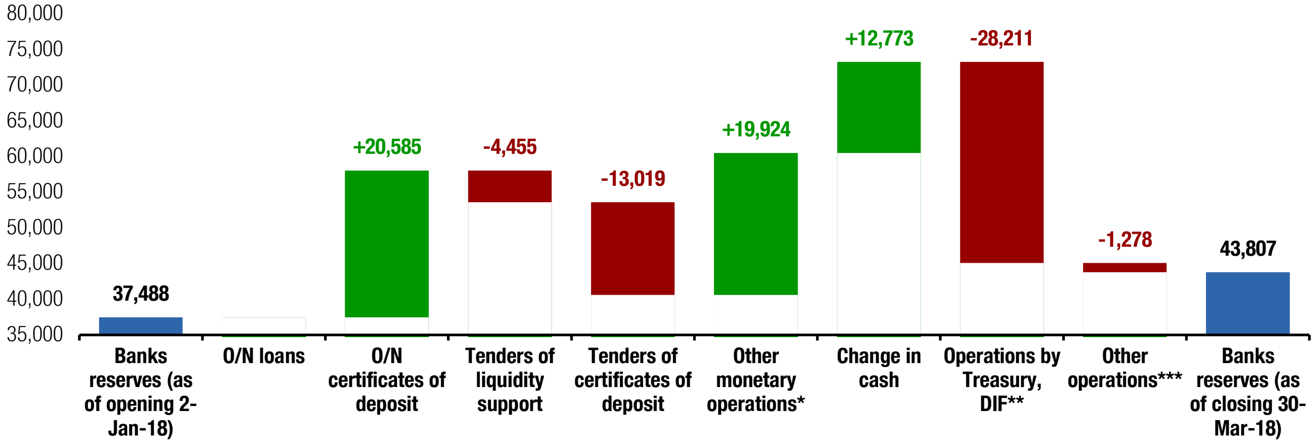


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

The hryvnia slightly appreciated

Over the course of last week, movement in the national currency was the result of VAT refunding on the one hand, and by tax payments to the budget on the other. Additionally, the market was influenced by holidays on Friday and Monday in the US. This week, the hryvnia should trade in a tight range, and continue a gradual appreciating trend.

Last week, the UAH mostly depreciated against the US dollar. Wednesday saw significant pressure on the national currency, when it lost 15 cents, which forced the NBU to enter the market and sell US$46m through the best quote request. But on Friday, the situation reversed, as obligatory selling of foreign currency by exporters and the US holiday eased demand on the dollar. This supported the hryvnia, and provided a 20 cent appreciation. Potentially, the hryvnia could have appreciated more if the NBU had not entered the market to prevent it.

Thus, the hryvna appreciated 0.1% in the past week to 26.265 UAH/USD. Its CPI-based real trade-weighted index declined 0.11% to 114.4 for the period; in year-on-year terms, it is up 5.91% from 108.02 last year.

ICU view: This week, the hryvnia should maintain gradual appreciating trend. In addition, the supply of foreign currency from households may increase this week due to the coming Easter holiday. Also, warm weather may bolster preparation for spring seed time, which may increase the supply of the foreign currency from the agriculture sector and support the hryvnia. At the same time, recent growth of oil prices could increase pressure in the FX market, and slow appreciation of the national currency.

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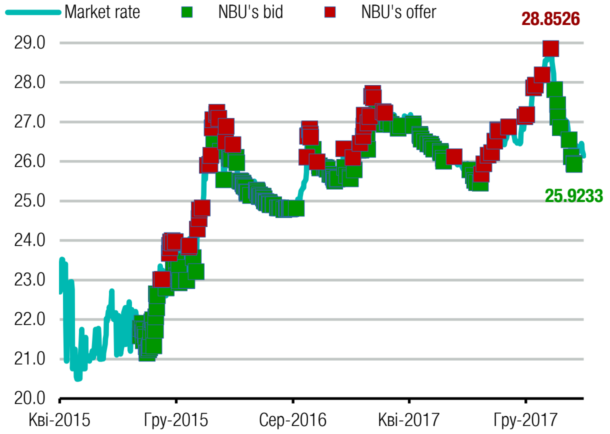
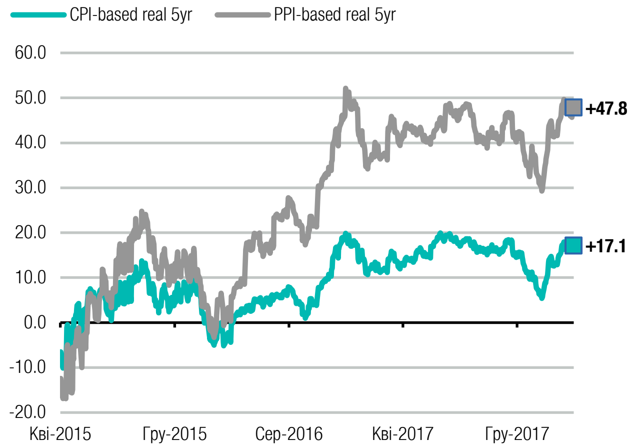
Chart 5. FX market indicators, 3-year history

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market



Notes: the chart provides labels for the average exchange rate at last two NBU auctions (one on buying FX from the market and one on selling it). Source: NBU, Bloomberg, ICU.

UAH exchange rate misalignment[1] from fundamental level[2] (%)



Notes: [1] "+" overvalued, "-" undervalued; [2] based on the UAH's CPI- and PPI-based real TWIs. Source: ICU.

Economics

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Annualized C/A deficit declined 6.3% MoM to US$2.1bn, but surged 3.4 times compared with February 2017, per revised data from the NBU. The C/A deficit is to widen further this year due to rising imports of consumer goods, higher oil prices and an expected decrease in steel prices.

The key driver of deficit growth was higher volumes of merchandise imports, which increased US$8.8bn or 21.1% YoY in February in annualized terms and totaled US$50.3bn. The most imported goods were 1) machinery and equipment, which account for 27.9% of total imports and rose 30.2% YoY, and 2) mineral goods, which soared 36.9% YoY, accounting for 23.7% of total imports. Annualized merchandise exports rose US$5.6bn or 16% YoY and amounted to US$40.6bn. The increase in export growth was primarily thanks to 1) a 12% YoY increase in the export of food products, which accounts for 44.1% of total exports, and 2) an increase of 20.4% YoY in metallurgical exports, accounting for 25.2% of total exported goods. The negative impact on the C/A balance of the merchandise deficit was to some extent mitigated by higher primary income balance (+86.3% YoY, totaling $3.2bn) and an increase of 56.7% YoY in the services trade balance surplus to US$0.8bn.

ICU view: Following the personal remittances data revision by NBU, the C/A deficit narrowed to 1.9% of GDP in 2017, compared with the previous estimate of a 3.7% deficit. However, despite the positive revision, the C/A deficit increased by 0.5ppt over the course of 2017, up from a deficit of 1.4% of GDP seen in 2016. Our base-case scenario envisages that due to rising imports of consumer goods, lower steel prices and higher oil prices, the C/A deficit will widen further this year.

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