



Focus
Ukraine

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

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Weekly Insight

Official FX reserves down on debt repayment

Key messages of the today's comments

WEDNESDAY, 11 APRIL 2018

Domestic liquidity and bonds market

Refinancing risk increases for July

Last week, the MoF offered only three-month bonds, selling less than UAH200m. Next month, the MoF will avoid offering similar bonds.

Liquidity volatile at around UAH100bn

Last week, liquidity was very volatile around UAH6bn. And this volatility was mostly caused by lack of balance in Treasury operations, in particular on Monday and Thursday.

Foreign exchange market

UAH strengthened thanks to deferred FX supply

The hryvnia hit a one-month high against a backdrop of increased FX supply from both the general population and agrarians. The UAH strengthening trend should persist for the next two to three months.

Economics

Budget revenue fell short of target in 1Q18

Central government budget revenues fell short of the planned amount to UAH193.58bn in 1Q18, which is 3.1% or UAH6.19bn less than expected. Taking into account the current trend in revenues and the high probability of nonfulfillment of the privatization plan, the 2018 budget deficit may exceed the target.

Official FX reserves down on debt repayment

Ukraine's official FX reserves declined by US\$219m or 1.2% MoM, and amounted to US\$18.2bn as of 1 April 2018. Despite recent decrease, we expect that official FX reserves will rise to US\$20bn by the end of 2018.

Banks' reserves market (10 April 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU rate (%) ¹	17.00	+0bp	+300bp
ON rate (%)	15.80	-20bp	+320bp
ON \$ swap (%)	15.97	+8bp	+355bp
Reserves (UAHm) ²	44,367	+8.02	+11.24
DepCerts (UAHm) ³	26,849	-55.40	-63.56

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) (10 April 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU	350,325	+0.00	-8.07
Banks	349,099	-0.33	+22.32
Residents	27,820	-2.08	+21.05
Individuals	2,406	+3.35	+861.24
Non-res ⁴	14,349	-0.19	+164.90
Total	744,000	-0.23	+7.03

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

FX market indicators (10 April 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	25.9750	-1.35	-3.37
EUR/USD	1.2356	+0.64	+16.61
DX ²	89.587	-0.62	-11.32
UAH TWI ³	117.952	+2.94	+7.74

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

Gov't bond quotes¹ (11 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

Refinancing risk increases for July

Last week, the MoF offered only three-month bonds, selling less than UAH200m. Next month, the MoF will avoid offering similar bonds.

After very active auctions at the end of March, the debut offering in April was only for three-month bonds. This auction received 22 bids amounting to UAH302.2m. Interest rates ranged from 17.0% and up to 17.5%; however, the MoF kept the cut-off rate at 17.44% and weighted-average rate at 17.33%, the same as last week. The Ministry rejected only three bids, but accepted less than two-third of demand at par value. The MoF sold UAH192.2m of bonds, received UAH184.3m of financing, and refinanced less than a half of debt principal repayments did last week.

Redemption of last week's issues will be at the beginning of July when total monthly debt repayments in local currency will exceed UAH13bn. The MoF will need to take refinancing risk into account and be ready to use different budget sources, especially in July, when refinancing the entire amount due may be a problem.

ICU view: The MoF is using different bond maturities to finance budget needs, and taking advantage of the large demand for short-term bonds. However, the Ministry needs to stagger the maturities and spread out its large debt burden. The MoF excluded the nine-month bonds from auctions schedule for 2Q18, and also scheduled offerings of three-month bonds only each second week.

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Liquidity volatile at around UAH100bn

Last week, liquidity was very volatile around UAH6bn. And this volatility was mostly caused by lack of balance in Treasury operations, in particular on Monday and Thursday.

Liquidity during the first week of April was UAH103.3bn. Through to Friday, it fell to UAH96.5bn with a significant decline in CDs outstanding, which fell on Wednesday and Thursday by UAH10bn to UAH49.5bn. At the same time, part of this withdrawal was allocated to reserves, increasing banks' correspondent accounts balances to UAH47.7bn with a slight recovery on Friday.

Last week, net outflow from the Treasury's accounts was above UAH3bn. A large amount of funds were received into the budget through revenues of various Ministries and authorities, including payments for new licenses for 4G mobile communication after the tenders that were held in March, 2018. Last week saw a large part of these payments, but not the full amount, so these revenues should continue.

Before Easter, banks increased the exchange of reserves into cash, which amounted to UAH6.6bn last week. Also, Privatbank repaid UAH2.3bn of a loan received at the beginning of the year, and also paid UAH95m in interest.

Only the NBU caused net inflows in liquidity last week through the FX market. Last Thursday and Friday, the NBU held FX auctions and purchased more than US\$100m. Through best quote request, the NBU provided about UAH5.2bn of local currency funds via its FX operations.

ICU view: As expected, liquidity was volatile. The NBU's purchases of FX injected new local-currency funds. This week, liquidity should stay below UAH100bn, due to possible payments of the last 4G communications standard licenses.

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Chart 1. Banks reserves usages over last week(UAHm)

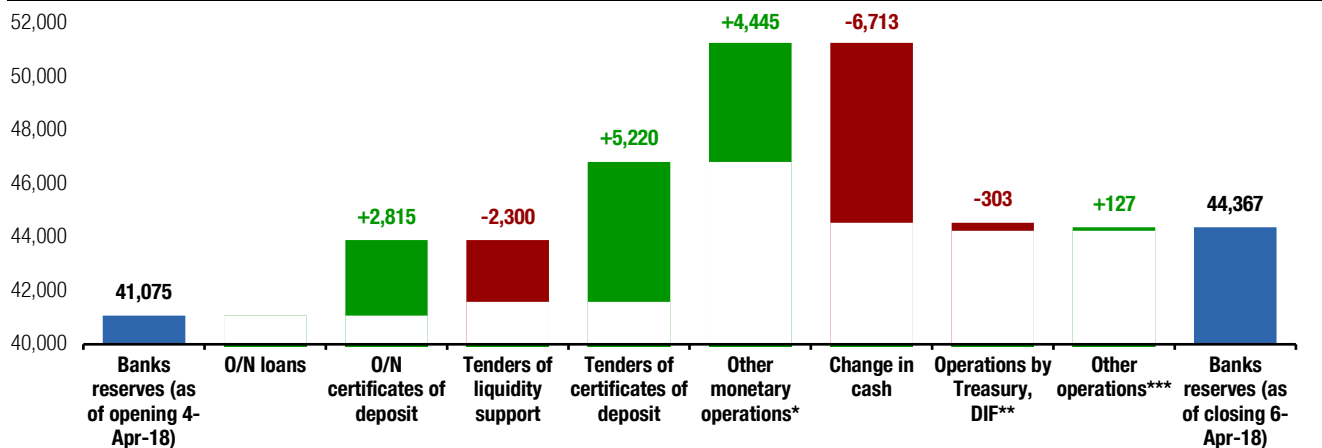
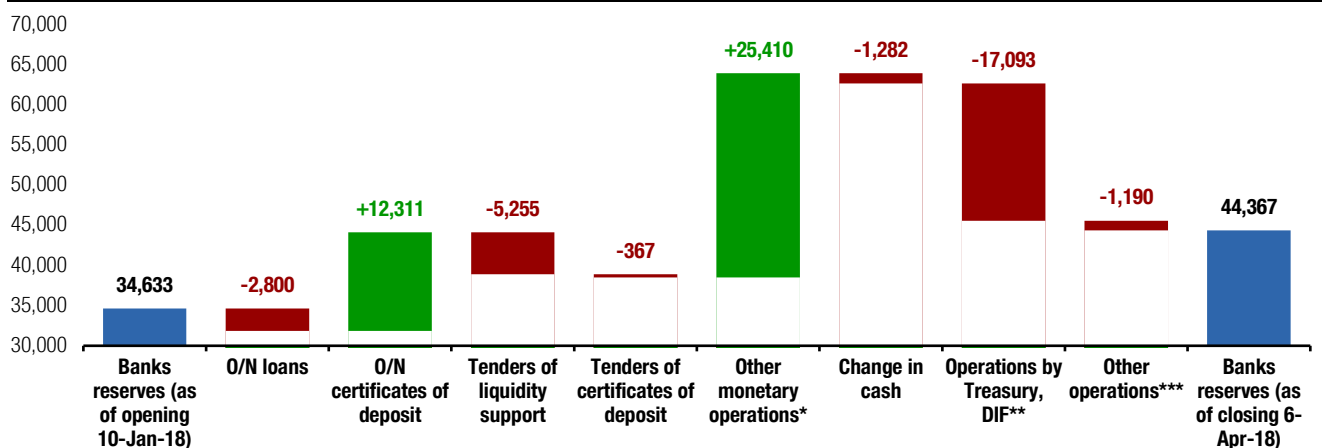


Chart 2. Banks reserves usages over last 90-day period (UAHm)



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

UAH strengthened thanks to deferred FX supply

The hryvnia hit a one-month high against a backdrop of increased FX supply from both the general population and agrarians. The UAH strengthening trend should persist for the next two to three months.

Last week, the key driver of the hryvnia's strengthening was deferred FX supply from agrarians, who did not sell foreign currency because of the protracted winter. However, as weather conditions improved, agrarians started to sell more foreign currency in order to finance planting. At the same time, the general population increased FX supply in the run-up to the holidays.

The NBU prevented the hryvnia from excessive appreciation, conducting two currency auctions on Thursday and Friday, buying US\$100.7m. At the same time, taking into account

the volume of monetary operations, we conclude that the NBU bought additional foreign currency through best quote requests.

Thus, the hryvna appreciated 1.1% in the past week to 26 UAH/USD. Its CPI-based real trade-weighted index rose 1.7% to 116.34 for the period; in year-on-year terms, it is up 7.41% from 108.32 last year.

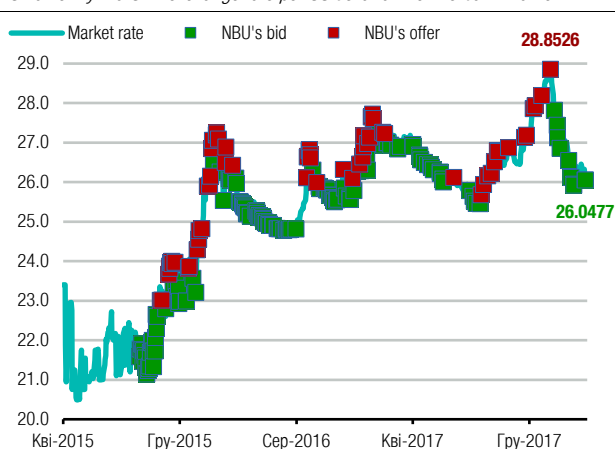
ICU view: Without significant events, we expect the hryvnia to be stable this week, while the strengthening trend should persist for the next two to three months.

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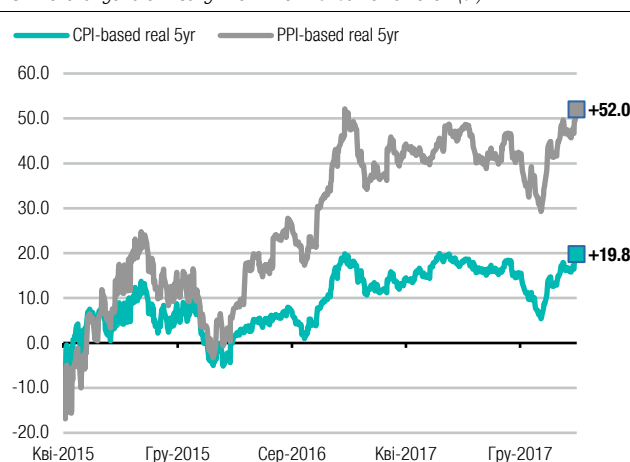
Chart 3. FX market indicators, 3-year history

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 misalignment¹ from fundamental level² (%)



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

Economics

Budget revenue fell short of target in 1Q18

Central government budget revenues fell short of the planned amount to UAH193.58bn in 1Q18, which is 3.1% or UAH6.19bn less than expected. Taking into account the current trend in revenues and the high probability of nonfulfillment of the privatization plan, the 2018 budget deficit may exceed the target.

Revenues from tax authorities (excluding VAT refunds) amounted to UAH 92.5bn (+1.6% YoY), which is UAH4.4bn or 4.6% less than the planned amount. Revenues from custom authorities fell short by UAH1.7bn, or 2.3%, and amounted to UAH74.9bn (+12% YoY). Revenues from other government agencies amounted to UAH6.78bn (+85.9% YoY), which is UAH2.74bn or 26.7% less than expected.

At the same time, revenues of the special fund, which is included in total revenues, amounted to UAH18.1bn (+47.3% YoY), which was UAH2.5bn or 15.9% more than projected. In 1Q18, VAT was reimbursed to the amount of UAH33.6bn (+25% YoY).

ICU view: Considering 1) the high probability of nonfulfillment of the 2018 privatization plan, proceeds from which are expected at UAH21.3bn, 2) the probability of lower-than-expected tax and custom revenues, and 3) the possible upward revision of expenditures because of higher social payments, there is a probability that the 2018

budget deficit may exceed the expected target of UAH81.8bn (2.4% of GDP). Regardless, the primary budget balance will remain in surplus, as expenditures to service state debt amount to more than UAH100bn, which means that the public debt level is set to decrease, assuming real GDP growth materializes at the consensus rate of at least +3% YoY.

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In March, the NBU bought US\$510m, while it sold only US\$134m. Thus, net purchases on the interbank market amounted to US\$376m. At the same time, US\$669.5m and EUR123.3M were received from the domestic placement of government bonds denominated in foreign currency. On the flip-side, Ukraine paid US\$1.5bn to service state and guaranteed debt, including 1) US\$562.3m paid to service Eurobonds, 2) US\$678.8m to service and repay FX-denominated domestic government bonds, and 3) US\$186m paid to the IMF.

Revaluation of financial instruments had a positive impact on FX reserves: an increase of US\$43.2m was booked by the central bank thanks to this effect. Now, official FX reserves are covering 3.4 months of future imports.

ICU view: Our in-house calculations show that this year, the NBU and the MoF have to pay approximately US\$5.9bn (including both principle and interest) to meet their FX liabilities (i.e. FX-denominated domestic government bonds, Eurobonds and payments to the IMF). However, thanks to 1) the planned Eurobond placement, 2) another tranche from the IMF, 3) placements of domestic government bonds denominated in foreign currency, and 4) possible macro-financial assistance from the EU, we expect FX reserves will increase to US\$20bn by the end of 2018.

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