

# Weekly Insight

## MoF receives external financing

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### MoF receives external financing

Last week, the MoF issued a new, short-term Eurobond, receiving today about US\$693m, which should allow it to cover most external debt repayments scheduled through the end of this year.

##### Budget collects FX

Last week, the MoF continued to borrow FX in the local market in anticipation of external debt repayments in the following weeks.

##### Liquidity at UAH80bn

Significant outflows via tax payments, NBU's selling FX at the market, and the low level of budget expenses caused significant tightening of liquidity last week with slight recovery above UAH80 at the end of last week.

#### Foreign exchange market

##### The UAH is volatile, but should remain close to the current level

This week, the hryvnia will be under pressure from VAT refunds, but at the same time, it will receive support from tax payments for July, and should not undergo significant changes.

#### Economics

##### Industrial production rose 2.9% YoY in July

Growth rates of industrial output inched up to 2.9% YoY in July, from 2.2% YoY in June, bringing the 7M18 reading to growth of 2.6% YoY. The growth of industrial sector will be supported by solid household consumption and higher investment activity.

##### Retail sales rose 6.6% YoY in July

In 7M18, retail turnover increased by 6% YoY. Solid household consumption against rising real incomes will continue to support retail trade in 2H18.

TUESDAY, 28 AUGUST 2018

#### Banks' reserves market (27 August 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	17.50	+0bp	+500bp
ON rate (%)	17.41	+62bp	+581bp
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	58,578	+21.23	+21.80
DepCerts (UAHm) <sup>3</sup>	23,727	-11.31	+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) (27 August 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,104	+0.00	-4.55
Banks	371,817	+0.83	+22.14
Residents	21,195	+0.74	-4.79
Individuals	4,401	+6.97	+500.63
Non-res <sup>4</sup>	7,419	-1.23	+1,474.91
<b>Total</b>	<b>752,935</b>	<b>+0.46</b>	<b>+8.71</b>

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

#### FX market indicators (27 August 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.9355	+0.79	+9.32
EUR/USD	1.1678	+0.92	-2.06
DXY <sup>2</sup>	94.779	-0.50	+2.20
UAH TWI <sup>3</sup>	115.875	-1.12	+2.30

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

#### Gov't bond quotes<sup>1</sup> (28 August 2018)

Maturity	Bid	Ask
6m	18.75	17.75
12m	19.00	17.70
2y	18.50	16.75
3y	18.50	16.75
12m (\$)	5.50	5.00
2y (\$)	5.70	5.15

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

## Domestic liquidity and bonds market

### MoF receives external financing

Last week, the MoF issued a new, short-term US\$725m Eurobond, which should allow it to cover most external debt repayments scheduled through the end of this year.

The new zero-coupon Eurobond with six-month maturity and a call-option were priced last Thursday. Bills were sold at 95.551, resulting in budget proceeds of US\$693m. According to Bloomberg, Goldman Sachs International was involved as the placement agent.

The yield of this issue will be 9.11% at maturity. But if it uses the call option of this bill, the budget will pay a premium based on the call date. For the first three months, the price is set at 98.55, and for second three-month period, the price is set at par.

**ICU view: According to our assumptions, at the end of last week, the MoF had around US\$500m, which allowed it to pay a coupon on the Eurobonds issued in 2015, but it was not enough for the coupon on UKRAIN'32, and payments on the IMF loans received to the budget. Current market conditions in international capital markets are not suitable for a new public placement, as this would result in a higher yield for longer time. YTM of UKRAIN'23 is about 8% and UKRAIN'32 is 9%, which could provide a final yield for the new issue above 9–10%. Funds received today should cover most external debt repayments scheduled through the end of this year, if all FX-denominated domestic bonds repayments for this period are refinanced. This would provide time for meeting the IMF requirements, and to continue negotiations for the next tranche, and also allow time to wait for better market conditions.**

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

### Budget collects FX

Last week, the MoF continued to borrow FX in the local market in anticipation of external debt repayments in the following weeks.

At last week's auction, the MoF borrowed an additional US\$85m (see [our separate comment](#)), which should help with debt repayments scheduled for September. Because of the new Eurobond issue last week (see comments above), today, the MoF announced only offerings of local-currency bonds with maturities from five months and up to five years: bills with five and 10 months maturities, and notes with three-year and five-year maturities.

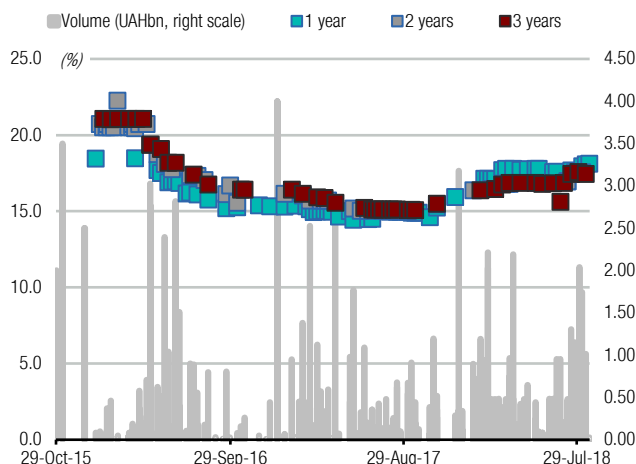
Last week, banks continued to purchase new debt denominated in all currencies. In the secondary market, banks purchased bonds mostly from non-banks and foreign investors, who also purchased new bonds. In total, portfolios of foreign investors declined by UAH86m, while non-banks increased portfolios outstanding mostly due to FX-denominated bonds revaluation while local-currency bond portfolios remained steady. Individuals purchased UAH82m of local-currency bonds last week.

**ICU view: Currently, we see a slight decline in foreign investors' activity in the bond market with portfolios in decline, while other groups increased their FX-denominated bond portfolios. These changes are very slow, and most large movements are seen after large new borrowings. The recent volatility of UAH/USD exchange rate increased outstanding of FX-denominated bonds after revaluation. This week, because of the recent Eurobond issue, the MoF will not sell FX-denominated bills, and we expect low demand at today's auction with concentration in short-term maturities.**

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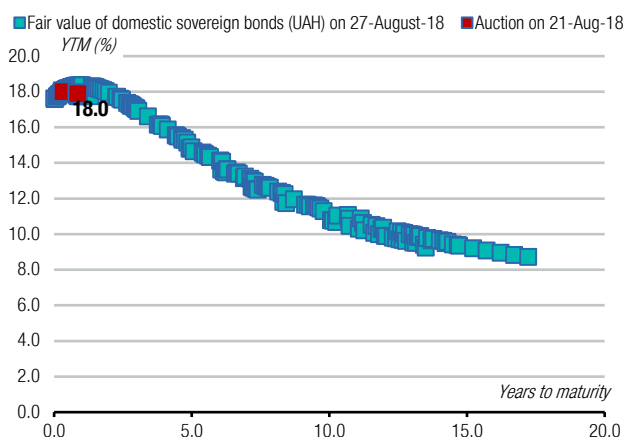
**Chart 1. Local-currency bonds**

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.

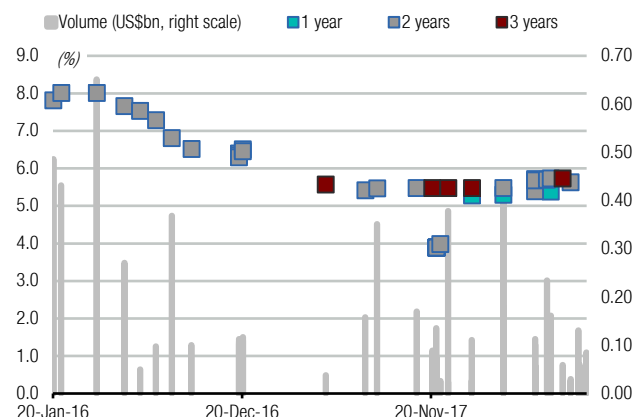
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

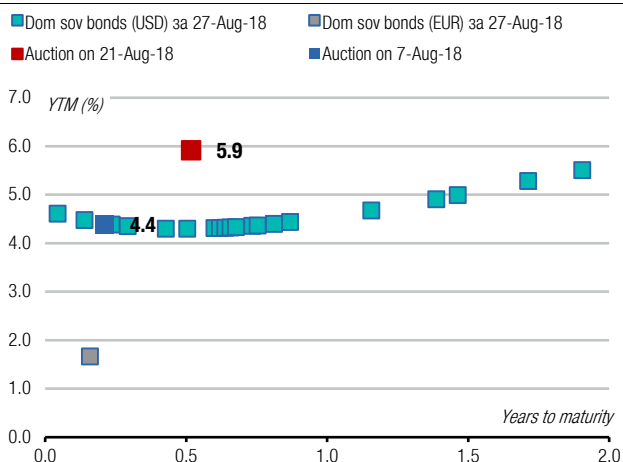
**Chart 2. FX-denominated bonds**

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 at UAH80bn**

Significant outflows via tax payments, NBU's selling FX at the market, and the low level of budget expenses caused significant tightening of liquidity last week with slight recovery above UAH80bn.

Banking-sector liquidity began last week at UAH74.6bn, including UAH27.3bn invested in NBU CDs. But last Tuesday, outflows caused liquidity to decline to UAH73.6bn, the lowest level of this year. This liquidity tightening caused additional financing needs, and on 17 August, NBU started to provide loans first to a single bank, on Wednesday it issued an additional UAH3bn of ON loans to another bank, and last Thursday, they issued another UAH1.3bn of three-month loans to two more banks. With these loans and the increase in VAT refunds, this week started with UAH82.3bn.

The main impact on liquidity was due to Treasury and NBU operations. From Monday through Wednesday, Treasury outflows amounted to UAH0.9bn, and only on Thursday they were covered by a significant injection at UAH4.5bn. The NBU purchased FX last Monday, but had

to sell on Tuesday, with the net impact amounting to UAH0.2bn of inflows. Reserves exchange in cash and other non-monetary operations had a low impact on liquidity, UAH0.3bn of outflow and UAH0.1bn of inflow, respectively.

**ICU view: Pressure from tax payments seen a week ago should continue this week, but last Wednesday, the Treasury started to pay VAT refunds, paying UAH1.5bn on Wednesday and UAH3bn on Thursday, increasing the monthly amount to UAH7.5bn. These cash flows should offset each other, but could increase liquidity volatility. Additional pressure could cause repayment of ON loans.**

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

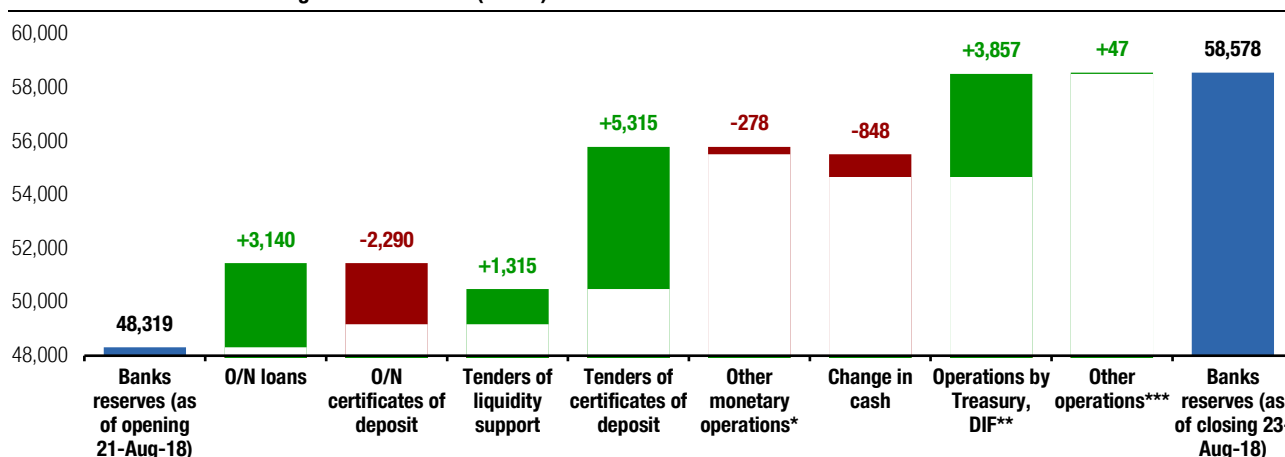
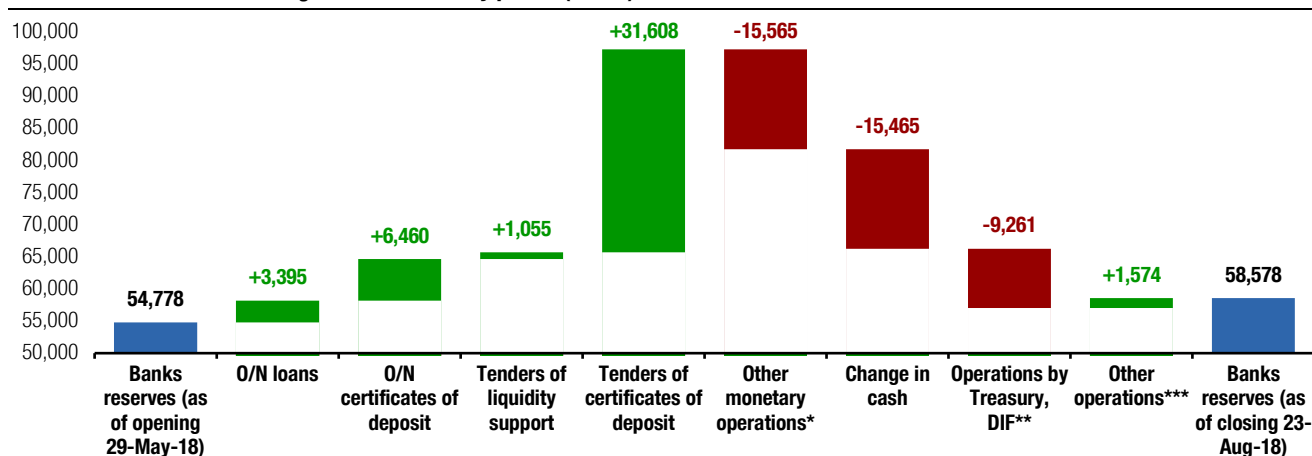


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting [https://bank.gov.ua/control/uk/publish/article?art\\_id=38643651&cat\\_id=40807142](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 UAH is volatile, but should remain close to the current level

This week, the hryvnia will be under pressure from VAT refunds, but at the same time, it will receive support from tax payments for July, and should not undergo significant changes.

The hryvnia started last week strengthening thanks to the drop in hryvnia liquidity to the minimum of the year, namely UAH74.6bn. However, due to a pause between monthly and quarterly tax payments, and the VAT refund in the amount of UAH4.5bn on Wednesday and

Thursday, the UAH exchange rate returned to the level of last week, slightly lowering by 0.3% to 27.90 UAH/USD.

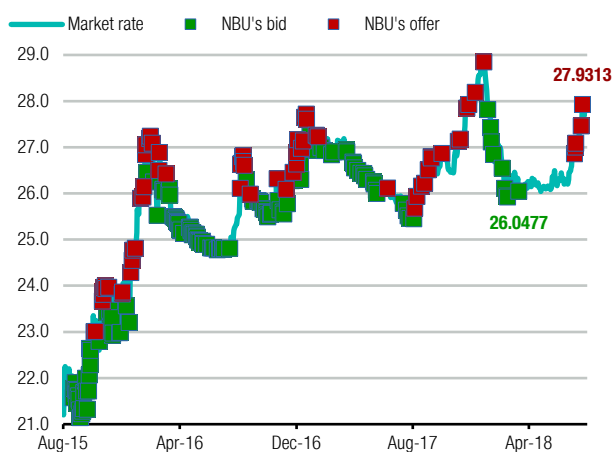
The hryvnia's CPI-based, real trade-weighted index (which includes the currencies of 27 countries that are trade partners of Ukraine) decreased 1.1% to 115.9 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 2.9%, and decreased 3.7%, respectively.

**ICU view: This week, the hryvnia will be influenced by two opposing factors: 1) the continuation of VAT refunds, which will reduce the FX supply from exporters, and 2) monthly tax payments, which should increase the demand for the hryvnia. Thus, the hryvnia exchange rate will fluctuate within the week, but we do not expect a significant deviation from last week's level.**

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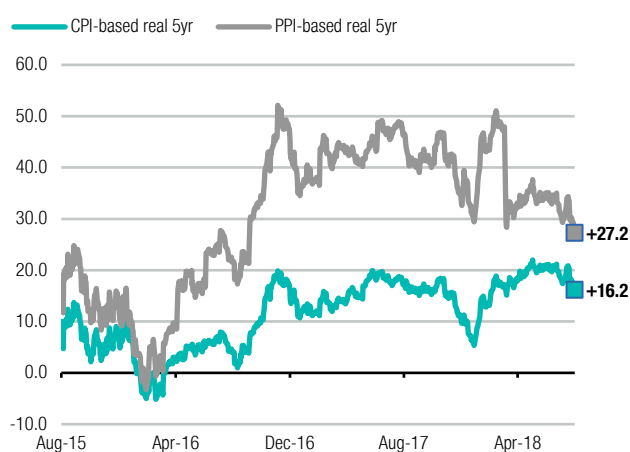
**Chart 5. FX market indicators, 3-year history**

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<sup>1</sup> from fundamental level<sup>2</sup> (%)



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

## Economics

### Industrial production rose 2.9% YoY in July

Growth rates of industrial output inched up to 2.9% YoY in July, from 2.2% YoY in June, bringing the 7M18 reading to growth of 2.6% YoY. The growth of industrial sector will be supported by solid household consumption and higher investment activity.

In seasonally-adjusted terms, industrial production contracted 1.3% MoM in July. Processing industry growth slowed to 2.3% YoY, down from 2.8% YoY in June, while it fell 2.9% MoM SA. The highest growth rates were posted in metallurgy (+5.6% YoY), and the chemical industry, which growth slowed to 9.5% YoY vs. 30.3% YoY in June due to the high base effect, as in July 2017, chemical plants of the OSTCHEM Group resumed their operations.

The mining and quarrying sector rose 4.5% YoY and 1.4% MoM SA after two months of contracting, while the utilities sector rose 3.2% YoY and contracted 0.6% MoM SA.

**ICU view: Industrial production will continue to grow in 2H18 supported by solid household consumption, acceleration of government expenditure on infrastructure projects, and higher output in the mining subsector. However, the growth rates of**

***industrial output turned out to be lower than our baseline forecast due to lower production of food products against the backdrop of the worse-than-expected grain harvest and lower volumes of coal output. Thus, we downgrade our forecast for industrial production to a growth of 3% in 2018, vs. 3.5% previously.***

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### **Retail sales rose 6.6% YoY in July**

In 7M18, retail turnover increased by 6% YoY. Solid household consumption against rising real incomes will continue to support retail trade in 2H18.

At the same time, seasonally adjusted data reveal a 1.3% MoM decrease in retail turnover in July. Among regions, the highest growth rates were posted by the Luhansk region (+23.4% YoY), the Zakarpattia region (+10.9% YoY), the Poltava region (+10.5% YoY), and the Donetsk region (+10.3% YoY).

***ICU view: Thanks to further increase of real incomes of households against the backdrop of 1) an increase in minimum wages and pension payments, and 2) rising remittances, as well as the significant growth of UAH loans to individuals (+44.4% YoY in June), retail trade will continue to rise at solid pace in 2H18 and will remain one of the key drivers of economic growth in 2018.***

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