



Focus
Ukraine

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

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Weekly Insight

NBU increased key rate to 18%

Key messages of the today's comments

TUESDAY, 11 SEPTEMBER 2018

Domestic liquidity and bonds market

Yields likely to rise

NBU's key rate hike last week should push hryvnia-denominated bond yields to a new level, which the MoF will set today.

Liquidity at about UAH70bn

NBU's FX selling and funds accumulating in budget accounts caused a decline in liquidity to UAH70.8bn. There was a slight recovery after an increase in budget expenditures and NBU's loans to banks.

Foreign exchange market

IMF mission supports the UAH

This week, the hryvnia will be supported by the start of the IMF mission, which increases the likelihood of continuing cooperation with the Fund, and receiving the next tranche.

Economics

NBU increased key rate to 18%

In the wake of the IMF mission arrival, the NBU continued the interest rate hike cycle it started back in October 2017.

Banks' reserves market (10 September 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+50bp	+550bp
ON rate (%)	16.75	-63bp	+485bp
ON \$ swap (%)	16.82	+61bp	+472bp
Reserves (UAHm) ²	40,724	-16.90	-12.50
DepCerts (UAHm) ³	29,712	+36.11	+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) (10 September 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,104	+0.00	-4.23
Banks	372,512	-0.27	+21.66
Residents	20,189	-3.61	-10.53
Individuals	4,540	-0.28	+499.69
Non-res ⁴	7,372	-1.60	+325.21
Total	752,717	-0.25	+8.34

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

FX market indicators (10 September 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	28.1625	-0.99	+8.05
EUR/USD	1.1594	+0.10	-3.67
DX ²	95.150	-0.30	+4.16
UAH TWI ³	117.303	+1.68	+4.85

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

Gov't bond quotes¹ (11 September 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.
Source: ICU.

Domestic liquidity and bonds market

Yields likely to rise

NBU's key rate hike last week should push hryvnia-denominated bond yields to a new level, which the MoF will set today.

Over the two previous weeks, demand for local-currency bills was at their lowest level this year with insufficient movements of yields at primary auctions, as the market waited for the NBU decision on the key rate (see [last week's auction comments](#)). Position of members of the Monetary Committee supported this anticipation, so the recent hike was expected.

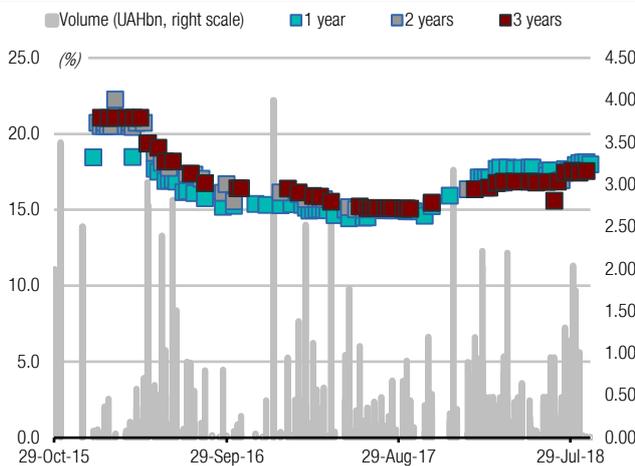
Each time the NBU increases the key rate, demand in the next auction comes with higher rates, although the decision is the MoF's to determine the new level of bond interest rates. Nevertheless, at today's auction, cut-off rates for new bills should move up by about 50bp, the same as the key rate.

ICU view: Having large, new financing needs, the MoF will have to accept expensive bids at higher rates than before, which will move forward the key rate. At the same time, the Ministry will choose new cut-off rates from received bids, so the increase may not be equivalent. Most likely, however, the new rates will be increased by 50bp, the same as key rate.

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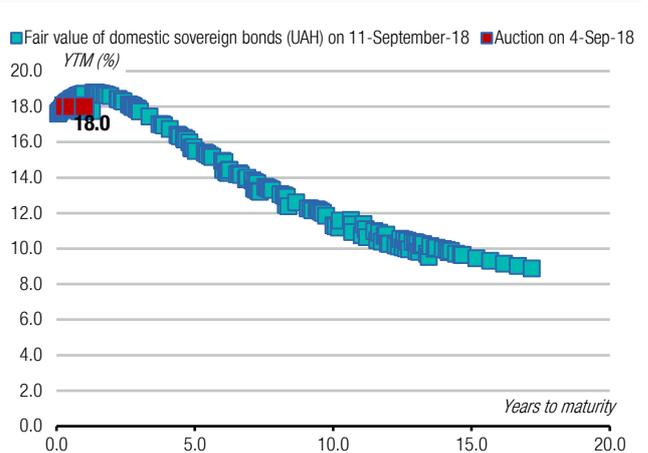
Chart 1. Local-currency bonds

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.

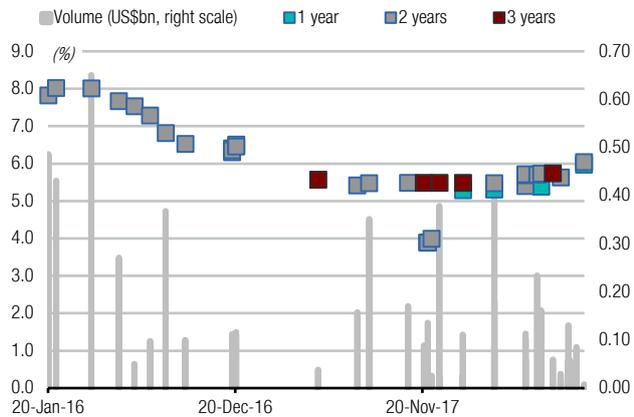
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

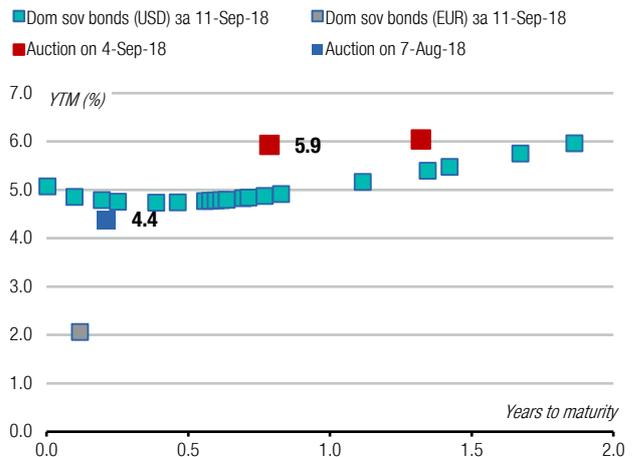
Chart 2. FX-denominated bonds

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 about UAH70bn

NBU's FX selling and funds accumulating in budget accounts caused a decline in liquidity to UAH70.8bn. There was a slight recovery after an increase in budget expenditures and NBU's loans to banks.

Last week, liquidity set a new record low at UAH70.8bn on Monday and Tuesday, after banks repaid ON loans to NBU. Only significant budget expenditures last Wednesday (UAH4.3bn) and the NBU's purchase of FX (UAH1.3bn) with UAH2bn of new ON loans moved liquidity up to UAH74.7bn.

UAH exchange-rate stabilization could support and steady liquidity with lower FX selling by the NBU and with FX purchase back to reserves. Also, this week and next week, budget expenditures could exceed collection of funds as there will be no large tax payments.

ICU view: This week, liquidity should become steady above UAH70bn and even receive a boost. But generally, liquidity will stay slightly above UAH70bn. Recently collected revenues will be mostly accounted in Treasury accounts without large debt repayments, and, likely, there will be an increase in new borrowings at new rates.

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

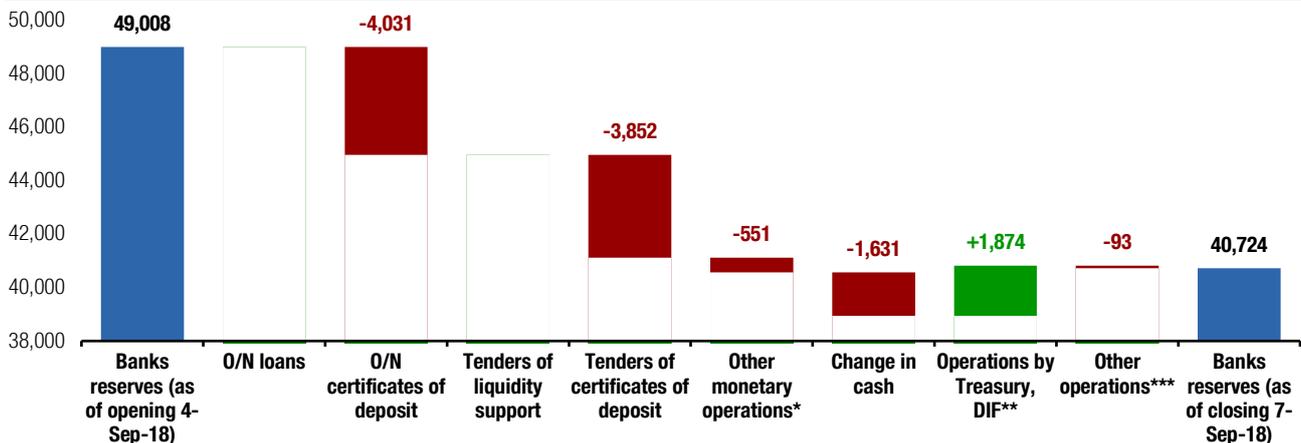
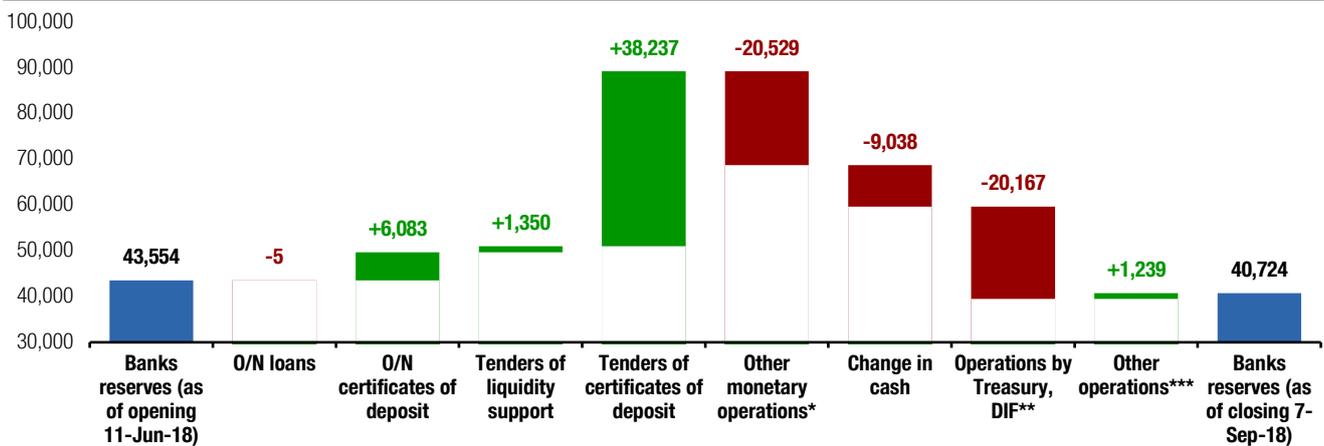


Chart 4. Banks reserves usages over last 90-day period (UAHm)


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

IMF mission supports the UAH

This week, the hryvnia will be supported by the start of the IMF mission, which increases the likelihood of continuing cooperation with the Fund, and receiving the next tranche.

The UAH began last week weakening due to increased FX demand for dividend payments to foreign investors among other things. The NBU sold US\$50m on Tuesday to satisfy excess FX demand, which helped reverse the trend, and then bought back US\$40m on Thursday. Thus, last week, the hryvnia slightly weakened to 28.2560 UAH/USD.

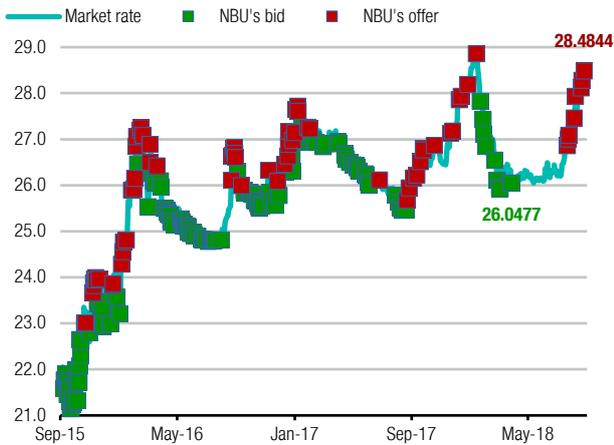
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 1.6% to 117.1 for the period, while in year-on-year terms it increased 4.7%.

ICU view: The arrival of the IMF mission will provide psychological support to the hryvnia this week. It increases positive expectations for continued cooperation with the Fund, and receiving the next tranche. This, in turn, will be a positive signal for other international lenders, and will contribute to the additional inflow of the USD into the country.

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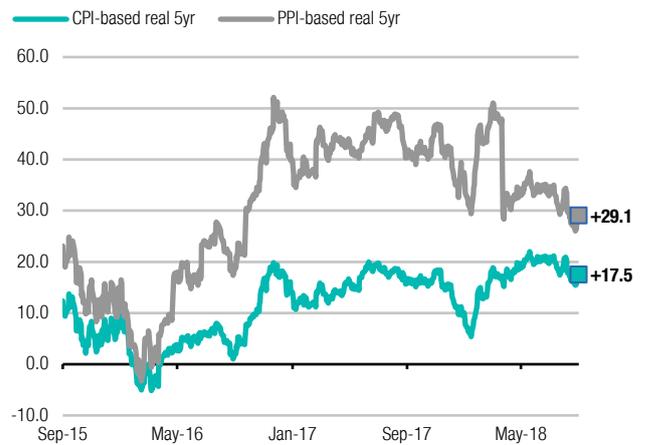
Chart 5. FX market indicators, 3-year history

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 misalignment¹ from fundamental level² (%)



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

Economics

NBU increased key rate to 18%

In the wake of the IMF mission arrival, the NBU continued the interest rate hike cycle it started back in October 2017.

In response to the turbulence in emerging markets that resulted in the recent devaluation of the hryvnia, the NBU has increased the key rate by 50 bps to 18%. The Regulator expressed concern over inflation, which, despite currently being within the target range, has the potential to accelerate.

ICU view: *Should the IMF programme get back on track and result in a tranche disbursement in October, and assuming no additional pressure from international markets, NBU is likely to halt the cycle of raising rates until the mid-2019 when it might start to gradually decrease them. However, in the case of negative scenarios, the Regulator will not hesitate to further increase the rate.*

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