

Weekly Insight

State budget performance improved

Key messages of the today's comments

TUESDAY, 2 OCTOBER 2018

Domestic liquidity and bonds market

Primary bond market

The low level of liquidity in the banking system and expensive local-currency funding pushed bonds yields up. However, this trend is meeting with MoF resistance.

Liquidity recovering

The last week of September had insufficient impact from the NBU and usual VAT refunds, which allowed liquidity to rise above UAH80bn on Wednesday where it could stay most of October.

Foreign exchange market

The beginning of October is not favourable to the hryvnia

This week, the hryvnia will be under pressure due to demand for foreign currency to pay dividends abroad and significant redemption of government bonds.

Economics

State budget performance improved

As of the end of August, state budget execution has improved significantly compared with the first half of 2018. We expect that by the end of the year, the government will be able to keep the budget deficit within the planned 2.5% of GDP.

Banks' reserves market (1 October 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+550bp
ON rate (%)	18.80	+96bp	+780bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	49,328	-5.09	+16.41
DepCerts (UAHm) ³	28,529	+17.53	+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) (1 October 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,104	+0.00	-3.90
Banks	369,872	+0.04	+19.97
Residents	21,101	+4.00	-7.10
Individuals	4,804	+1.04	+527.44
Non-res ⁴	7,275	-0.10	+159.95
Total	751,155	+0.13	+7.80

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (1 October 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	28.2050	+0.66	+5.87
EUR/USD	1.1578	-1.61	-2.00
DX ²	95.298	+1.24	+2.39
UAH TWI ³	114.858	-0.27	+2.99

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (2 October 2018)

Maturity	Bid	Ask
6m	19.75	18.00
12m	19.75	18.00
2y	19.50	17.50
3y	19.50	17.25
12m (\$)	6.00	5.00
2y (\$)	6.00	5.15

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

Source: ICU.

Domestic liquidity and bonds market

Primary bond market

The low level of liquidity in the banking system and expensive local-currency funding pushed bonds yields up. However, this trend is meeting with MoF resistance.

Last week's primary auction was usual. The Ministry of Finance, which may be close to exceeding this year's limit for government debt servicing, likely is not able to pay more for local-currency funding, and they are trying to keep the yield curve at the current level. At the same time, the high cost of credit resources (above 20% per annum) makes investments in T-bills unsatisfactory when there is a need for liquidity. Therefore, at the primary auctions, the volume of demand for yields that meet the MoF's expectations remains small, and most bids are rejected.

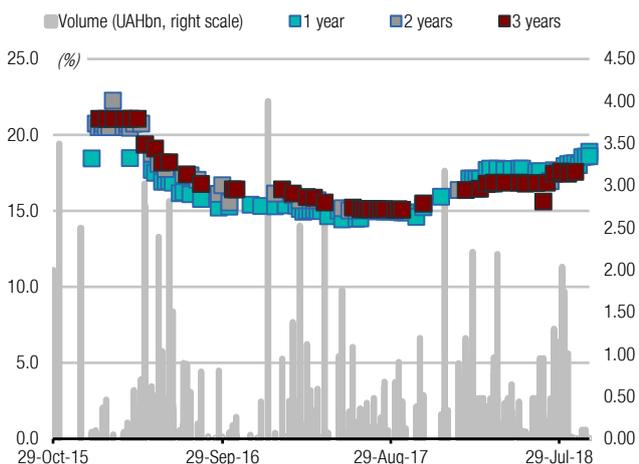
The situation is similar with FX-denominated bills, where, as we mentioned last week, the Ministry of Finance is not ready to pay a higher price for small volumes of funds. Therefore, it's holding the yield at 5.95%, the same level for most maturities.

ICU view: In the near future, the MoF will continue to use the available funds on its accounts to meet its obligations, but FX debt repayments in the second half of October, and hryvnia repayments in November could force it to change its policy on yields. This is especially true if the NBU decides to increase the key rate again in October. Therefore, this week, significant payouts for T-bills exceeding UAH 5 billion can be refinanced only partially.

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

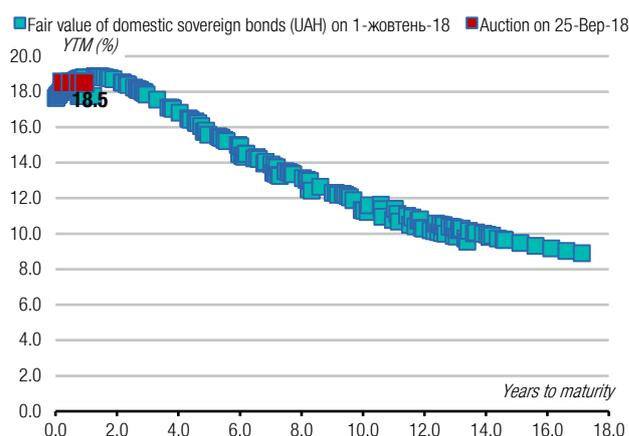
Chart 1. Local-currency bonds

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.

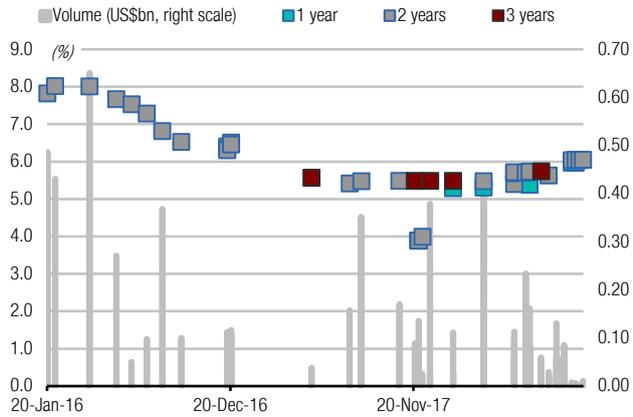
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

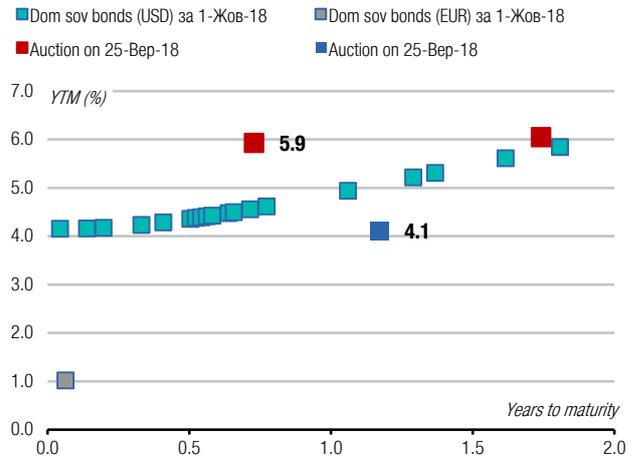
Chart 2. FX-denominated bonds

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 recovering

The last week of September had insufficient impact from the NBU and usual VAT refunds, which allowed liquidity to rise above UAH80bn on Wednesday where it could stay most of October.

VAT refunds amounted to above UAH12bn, the largest amount this year, including UAH9bn of refunds paid last week. But despite large expenditures, the net balance of Treasury operations was negative at UAH0.6bn of outflows. Actually, only cash exchange in reserves amounting to UAH2.6bn supported liquidity, especially due to the low impact from NBU, which amounted to UAH0.3bn of inflows.

Liquidity was above UAH80bn just one night, and last Thursday, liquidity declined due to Ukreximbank’s early repayment of UAH2.9bn of its NBU loan. But liquidity did not react to the new ON loan issued last Friday to one bank in the amount of UAH3bn. This week started out with UAH77.9bn of liquidity.

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

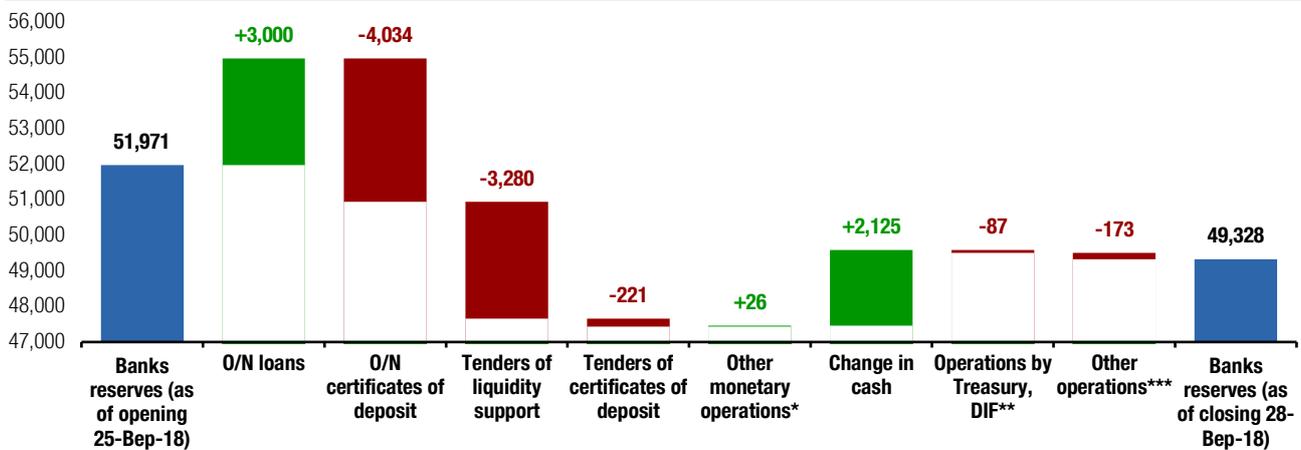
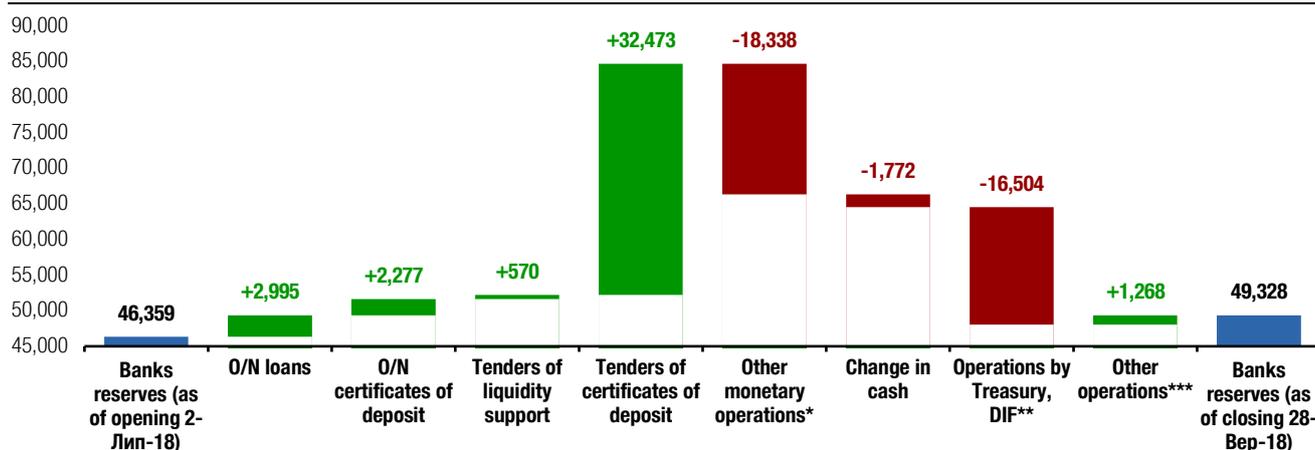


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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.

ICU view: Liquidity is improving, but its level remains low and unstable. This has caused the cost of funding to rise. ON loans are about 18%, and NBU refinancing loans are at 20% per annum. Large local-currency debt repayments this week could support liquidity, as banks will not be in a hurry to buy new bonds.

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

Foreign exchange market

The beginning of October is not favourable to the hryvnia

This week, the hryvnia will be under pressure due to demand for foreign currency to pay dividends abroad and significant redemption of government bonds.

Last week, the hryvnia weakened against the US dollar against the backdrop of imbalances in supply and demand on the local currency market. So, with VAT refunds for Tuesday and Wednesday amounting to more than UAH8bn, the national currency began to depreciate, and only slightly recovered on the last day of the week. Thus, by the end of the week, the national currency weakened by 0.65% to UAH/USD 28.232.

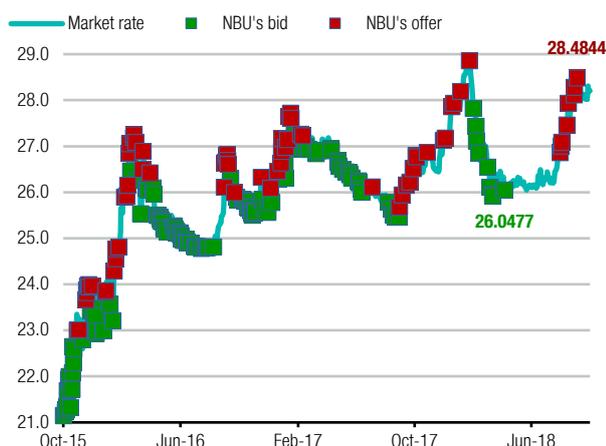
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) decreased 0.4% to 114.9 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 2.2% and decreased 2.5%, respectively.

ICU view: Against the backdrop of increased demand for foreign currency by affiliated foreign companies to pay dividends, and redemption of more than UAH5bn of government bonds (only a part of which can be refinanced), the hryvnia will be under pressure. However, we do not expect significant market volatility.

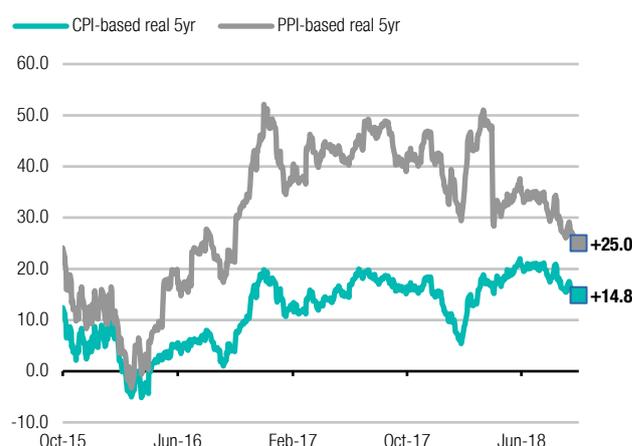
Artem Gladchenko, Kyiv, (044) 377-7040 ext.737

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

State budget performance improved

As of the end of August, state budget execution has improved significantly compared with the first half of 2018. We expect that by the end of the year, the government will be able to keep the budget deficit within the planned 2.5% of GDP.

The state budget for January–August came in with a surplus of UAH11.8bn, and the general fund of the state budget has a surplus of UAH7.4bn. It is significantly better compared with the results of budget execution in 1H18, where it had a deficit of UAH9.7bn and UAH12.9bn, respectively.

For the first eight months of the year, the general fund of the state budget received UAH551.6bn or 97% of the plan for this period, and more than 65% of the plan for this year. Of the bulk of budget revenues, 43% was provided by VAT and 13% by income tax. The revenues from excise tax provided 9.5% of the general fund revenues of the state budget.

At the same time, income tax revenue accounted for 120% of the plan for the period, and 88% of the plan for the year. Compared with the budget execution in the 1H18, a somewhat improved collection of VAT from imported goods was reported, which amounted to 97.6% of plan for the period, while in the six months, this figure was 96% of plan. Also, excise tax collection increased. The performance of these revenues for eight months amounted to 88% of the plan for the period, which is 5% higher than the first half-year.

Regarding expenditures, the under-execution of plan played a major role in shaping the budget surplus. Despite the increase in revenue collection, expenditures remained at the same level as in 1H18. Thus, expenditures of the general fund of the state budget amounted to 91.5% of plan for the period (91.2% for the first half year), and 60% of plan for the year. The highest level of expenditures were social expenditures, defense, and education expenditures, at 98.3%, 93.4%, and 92.1% of plan for the period, respectively. In debt servicing, just 91.4% of the plan was paid for the eight months. The lowest level of expenditures was health care at 52.5%, which may be due, in particular, to a change in the financing system of the industry.

ICU view: Budget performance was better due to quarterly tax payments and a stable level of expenditures financing as in 1H18. Hryvnia weakening did not have sufficient positive impact on revenues from VAT and import duties, and made revenues from excise tax quite better. A bit weaker hryvnia in September could have a positive impact on revenues from these taxes due to the strict relationship of exchange rates of hryvnia to foreign currencies. So, this year, we expect revenues of the state budget could be collected in an amount close to 100% of plan depending on tax collection and quarterly tax payments in November. At the same time, expenditures could also rise.

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

This page is intentionally left blank



11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kyiv, 01030 Ukraine
Phone/Fax +38 044 3777040

WEB www.icu.ua



INVESTMENT ADVISORY

Makar Paseniuk, CFA, Managing Partner
makar.paseniuk@icu.ua

Ivan Shvydanenko, Director
ivan.shvydanenko@icu.ua

Roman Nikitov, ACCA Director
roman.nikitov@icu.ua

Yuriy Kamarytskyi, Vice President
yuriy.kamarytskyi@icu.ua

Ruslan Kilmukhametov, Director
ruslan.kilmukhametov@icu.ua

Ruslan Patlavsky, Director
ruslan.patlavsky@icu.ua

ASSET MANAGEMENT

Grigoriy Ovcharenko, Director
Head of Local Asset Management
grigoriy.ovcharenko@icu.ua

Liliya Kubytovych 
Head of Marketing and Sales
liliya.kubytovych@icu.ua

TRADE OPERATIONS

Konstantin Stetsenko 
Managing Partner
konstantin.stetsenko@icu.ua

Vlad Sinani, Director
Strategy and Business Development
vlad.sinani@icu.ua

Sergiy Byelyayev
Head of Fixed-Income Trading
sergiy.byelyayev@icu.ua

Yevgeniya Gryshchenko
Head of Brokerage Services Department
yevgeniya.gryshchenko@icu.ua

Vitaliy Sivach 
Trader, Fixed-Income & Forex
vitaliy.sivach@icu.ua

Bogdan Vorotilin 
bogdan.vorotilin@icu.ua

RESEARCH

Alexander Valchyshen 
Head of Research
alexander.valchyshen@icu.ua

Taras Kotovych 
Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Alexander Martynenko 
Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv 
Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Dmitriy Dyachenko
Junior financial analyst
dmitriy.dyachenko@icu.ua

Artem Gladchenko
Junior financial analyst
artem.gladchenko@icu.ua

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (license numbers: dealer activity AE 263019, broker activity AE 263018, underwriting activity AE 263020 dated 11 April 2013).

DISCLAIMER

This research publication has been prepared by Investment Capital Ukraine LLC solely for information purposes for its clients. It does not constitute an investment advice or an offer or solicitation for the purchase or sale of any financial instrument. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, Investment Capital Ukraine makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of Investment Capital Ukraine LLC. All rights are reserved. Any investments referred to herein may involve significant risk, are not necessarily available in all jurisdictions, may be illiquid and may not be suitable for all investors. The value of, or income from, any investments referred to herein may fluctuate and/or be affected by changes in exchange rates. Past performance is not indicative of future results. Investors should make their own investigations and investment decisions without relying on this report. Only investors with sufficient knowledge and experience in financial matters to evaluate the merits and risks should consider an investment in any issuer or market discussed herein and other persons should not take any action on the basis of this report.

Additional information is available upon request.

