

Weekly Insight

Retail trade slows

Key messages of the today's comments

Domestic liquidity and bonds market

Ministry of Finance needs FX financing

Last week, the Ministry of Finance only partially refinanced debt repayments, so the key goal of keeping a positive balance of FX in the government's accounts remains. This week, the MoF may attract new loans under the World Bank guarantee.

Slight decline in liquidity

As expected, banking-sector liquidity declined, due to supporting payments to the budget. This week, liquidity could decline further, but will be volatile at slightly below UAH110bn.

Foreign exchange market

Hryvnia strengthens

Last week, the hryvnia strengthened. Tax and non-tax payments caused extra FX selling, but further appreciation is unlikely.

Economics

Retail trade turnover rose 6.3% YoY in January

Household consumption will remain the key driver of economic growth in 2019 being supported by a further increase in real incomes of households, albeit at a slower pace.

MONDAY, 25 FEBRUARY 2019

Banks' reserves market (22 February 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+200bp
ON rate (%)	16.82	+42bp	+182bp
ON \$ swap (%)	14.64	-159bp	-39bp
Reserves (UAHm) ²	55,327	-4.55	+11.47
DepCerts (UAHm) ³	54,441	-3.52	+10.38

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) (22 February 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,107	-0.44	-4.86
Banks	370,724	-1.29	+6.29
Residents	25,595	-0.45	-4.96
Individuals	7,524	+5.28	+312.05
Non-res ⁴	13,465	-0.47	+2.47
Total	754,415	-0.81	+1.27

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

FX market indicators (22 February 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.0030	-0.89	-0.19
EUR/USD	1.1335	+0.35	-8.07
DX ²	96.507	-0.41	+7.55
UAH TWI ³	120.379	+0.37	+8.48

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

Gov't bond quotes¹ (25 February 2019)

Maturity	Bid	Ask
6m	20.00	18.50
12m	20.00	18.50
2y	19.75	18.00
3y	19.50	17.50
12m (\$)	7.50	5.25
2y (\$)	7.50	5.50

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

Domestic liquidity and bonds market

Ministry of Finance needs FX financing

Last week, the Ministry of Finance only partially refinanced debt repayments, so the key goal of keeping a positive balance of FX in the government’s accounts remains. This week, the MoF may attract new loans under the World Bank guarantee.

Last week, the MoF offered 29-day USD-denominated bills, likely with the expectation that investors would reinvest funds received from the redemption of three-week bills sold at the end of January. However, there was only partial refinancing, and the MoF received only a little more than one-third of the repayments, which resulted in a decline in its FX accounts.

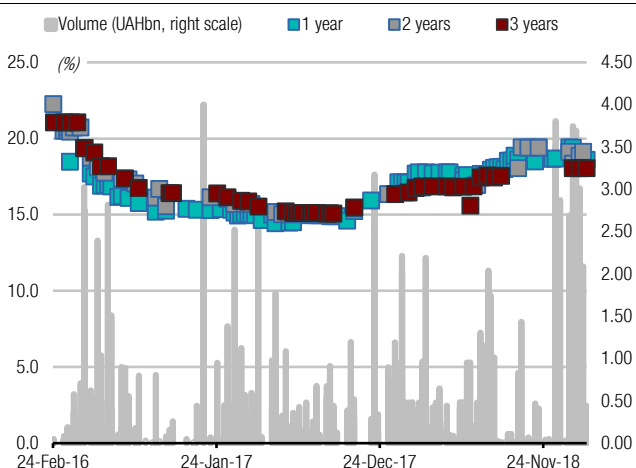
Since FX-denominated bills did not receive significant demand and did not cover the government’s needs in FX, the MoF has to find alternative sources of financing. The Cabinet of Ministers last week approved conditions for loans under the WB guarantee. The yield ceiling is 5.9%, and the organizing fee is 0.8%. Financing will be received in two tranches with amortizing repayments for four and 10 years; the 10-year loan will have grace period of 4.5 years.

ICU view: The need for FX prompted the MoF to look for alternative sources to obtain FX and provide proper repayments of FX-denominated debt. Through the end of the presidential elections, we do not anticipate material changes in borrowing costs, and the sovereign risk premium will still be high. Using a guarantee now looks like the government will not be able to postpone new external borrowings.

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

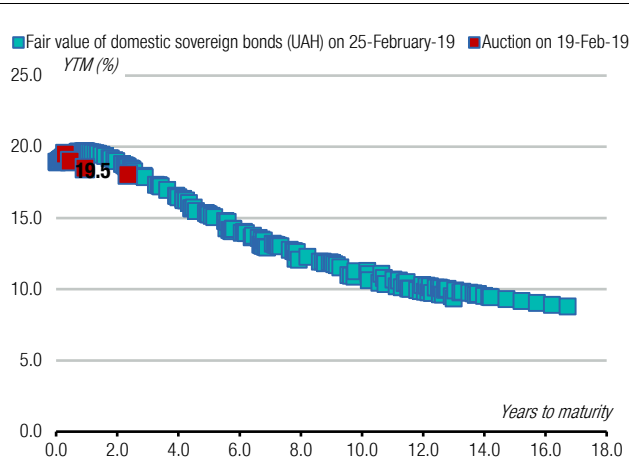
Chart 1. Local-currency bonds

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.

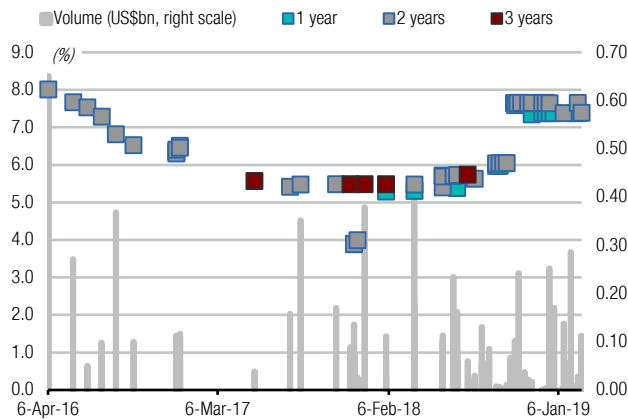
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

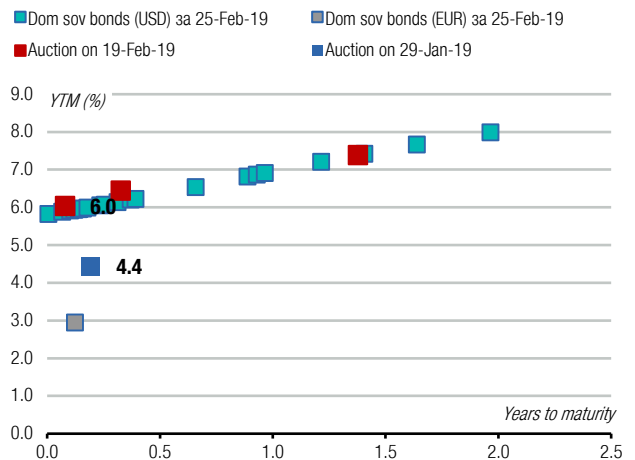
Chart 2. FX-denominated bonds

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.

Slight decline in liquidity

As expected, banking-sector liquidity declined, due to supporting payments to the budget. This week, liquidity could decline further, but will be volatile at slightly below UAH110bn.

Both tax and non-tax payments to the budget created a negative impact on liquidity. The Treasury absorbed UAH8.3bn, mostly at the beginning of last week, and these outflows were partially compensated from other sources. Banks started to increase reserves with cash exchange, compensated UAH3.5bn, and the NBU spent UAH1.4bn to purchase FX.

As the result, last Tuesday, liquidity declined below UAH110bn, and should remain around this level until the end of the week. At the same time, liquidity was nearly equally divided between banks' accounts and CDs.

ICU view: VAT refunds, which usually fall at the end of the month, should finally compensate month-end tax payments. So, we do not anticipate significant changes in liquidity this week, but volatility could rise due a mismatch of these cash-flows.

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

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

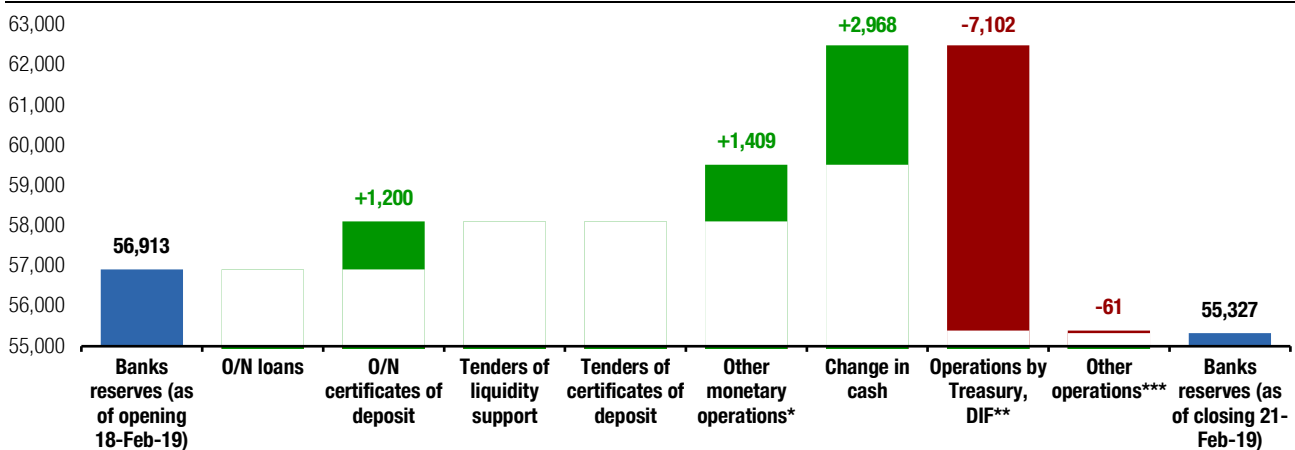
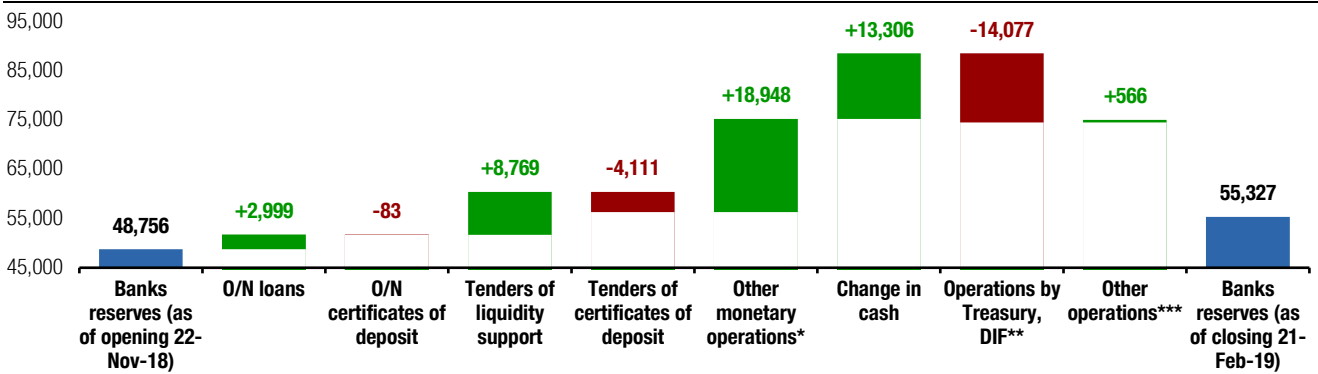


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Hryvnia strengthens

Last week, the hryvnia strengthened. Tax and non-tax payments caused extra FX selling, but further appreciation is unlikely.

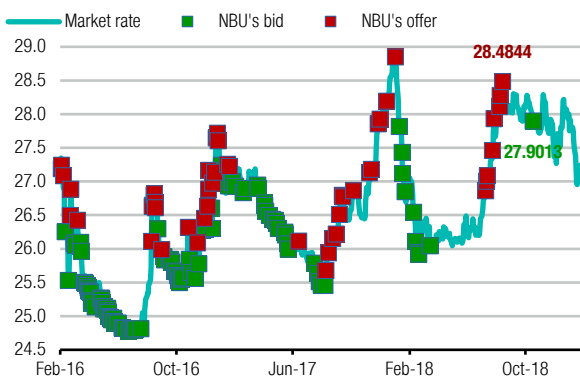
Last week, the hryvnia appreciated by 0.9% to UAH27.003/US\$, using the need for local-currency funds for payments to the budget, which compensated for the low activity of foreign investors in the bond market. The hryvnia's appreciation was restrained by the NBU, which purchased US\$52m last week.

ICU view: This week we could see the main portion of VAT refunds, which could amount to UAH7-8bn. This injection of local-currency funds could decrease the supply of FX, and also increase demand for it. As the result, the hryvnia could weaken a bit to the range of UAH27.1–27.3/US\$. A new wave of volatility could be seen starting 1 March, as the mandatory rate of FX selling for businesses will be decreased from 50% to 30%, and could result in a decline in the supply of FX.

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

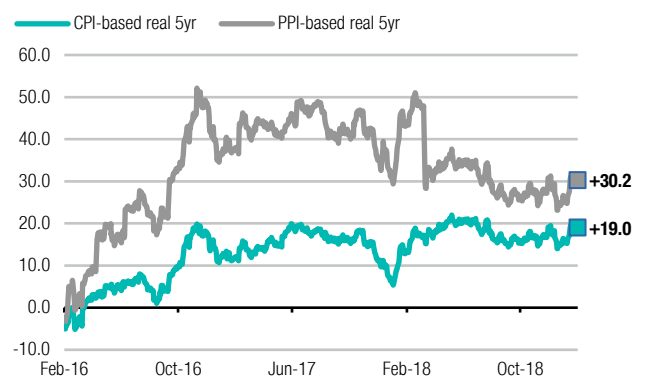
Chart 5. FX market indicators, 3-year history

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

Retail trade turnover rose 6.3% YoY in January

Household consumption will remain the key driver of economic growth in 2019 being supported by a further increase in real incomes of households, albeit at a slower pace.

Retail-turnover growth accelerated to 6.3% YoY in January 2019, up from 4.9% YoY in December 2018, per data from the State Statistics Service. However, growth rates were still lower than 9.6% YoY seen in January 2018. By region, the highest growth in retail trade was observed in the Kyiv region (+11.3% YoY), the Ivano-Frankivsk region (+10.8% YoY), and the Donetsk region (+9.8% YoY).

ICU view: Consumer demand will remain the key driver of economic growth in 2019 thanks to the rising real disposable income of households against the backdrop of 1) a further increase of remittances by 11% YoY to US\$12.2bn (vs. US\$11bn, +18% YoY in 2018, estimate and forecast of ICU), 2) a 12% minimum wage hike starting in January 2019, and still tight labour market, and 3) inflation slowdown to 8.5% YoY by YE2019.

Dmytro Dyachenko, Kyiv, (044) 377-7040 ext.738

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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
sergij.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

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