

# Weekly Insight

## NBU leaves the key rate unchanged

### Key messages of the today's comments

WEDNESDAY, 20 MARCH 2019

### Domestic liquidity and bonds market

#### Ukraine taps 10y Eurobond

Ukraine re-opened 10-year Eurobonds issue, issued last November with maturity in 2028 with a 9.75% coupon rate. US\$350m of new borrowings should provide the government with enough FX to cover FX debt repayments until the end of April.

#### Liquidity is about UAH100bn

Banking-sector liquidity was slightly volatile at around UAH100bn last week, with one day below this level. This week, we do not expect significant volatility.

### Foreign exchange market

#### Hryvnia weakens

After a few weeks of appreciation, at the end of last week, the hryvnia weakened to UAH27.02/US\$. This week, the Ukrainian currency is likely to continue to weaken slightly.

### Economics

#### Key rate unchanged ahead of elections

NBU may start the cycle of lowering the key rate in 2Q19, if it sees political risks declining after presidential elections.

### Banks' reserves market (19 March 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	18.00	+0bp	+100bp
ON rate (%)	16.49	-2bp	+49bp
ON \$ swap (%)	14.59	-19bp	-136bp
Reserves (UAHm) <sup>2</sup>	55,810	-5.81	-3.45
DepCerts (UAHm) <sup>3</sup>	47,632	+7.59	+22.06

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) (19 March 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,107	+0.00	-4.16
Banks	365,547	+1.35	+6.57
Residents	25,815	+5.42	-5.23
Individuals	7,662	+4.61	+269.91
Non-res <sup>4</sup>	14,551	+3.68	+0.65
<b>Total</b>	<b>750,681</b>	<b>+0.95</b>	<b>+1.65</b>

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

### FX market indicators (19 March 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.2750	+1.99	+3.37
EUR/USD	1.1352	+0.22	-7.97
DX <sup>2</sup>	96.383	-0.17	+7.37
UAH TWI <sup>3</sup>	118.561	-2.45	+2.98

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

### Gov't bond quotes<sup>1</sup> (20 March 2019)

Maturity	Bid	Ask
6m	20.00	18.50
12m	20.00	18.25
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](http://www.icu.ua).  
Source: ICU.

# Domestic liquidity and bonds market

## Ukraine taps 10y Eurobond

Ukraine re-opened 10-year Eurobonds issue, issued last November with maturity in 2028 with a 9.75% coupon rate. US\$350m of new borrowings should provide the government with enough FX to cover FX debt repayments until the end of April.

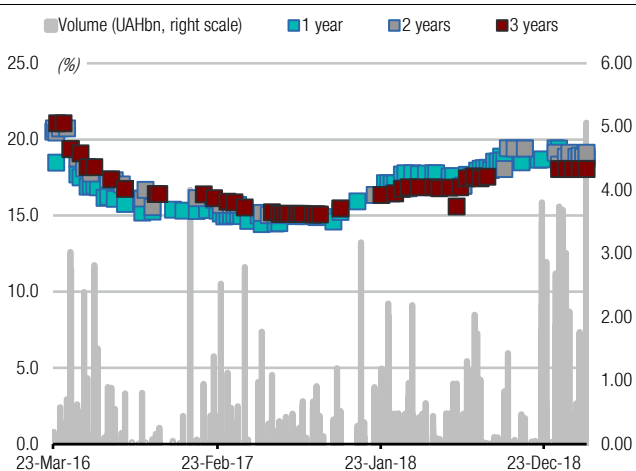
However, the rate of this tap has not been announced yet. At the pricing, these bonds were trading close to par at the market and slightly above, so the interest rate should be very close to coupon rate. This deal was underwritten by JP Morgan as the sole lead manager, with settlement scheduled for 21 March.

**ICU view: This deal is the part of this year's scheduled US\$4.2bn of external borrowings. The government is avoiding uncertainty over the elections by tapping the market now. Receipt of these funds should provide the government with enough FX to cover FX debt repayments until the end of April, plus refinancing domestic FX-denominated bills for a longer period of time.**

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

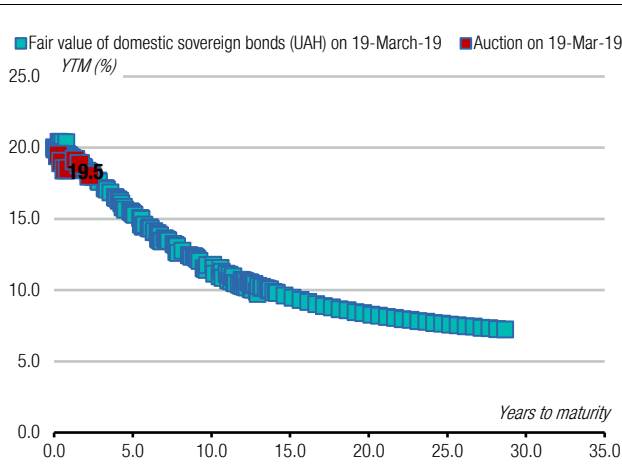
**Chart 1. Local-currency bonds**

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.

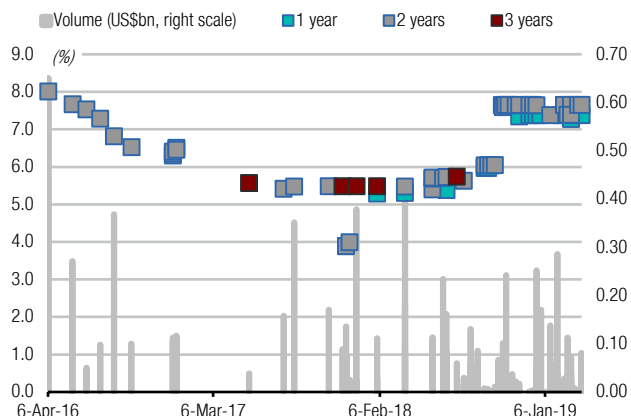
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

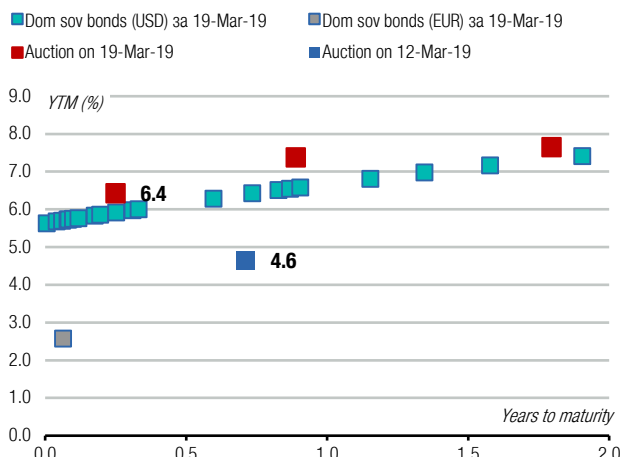
**Chart 2. FX-denominated bonds**

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 is about UAH100bn**

Banking-sector liquidity was slightly volatile at around UAH100bn last week, with one day below this level. This week, we do not expect significant volatility.

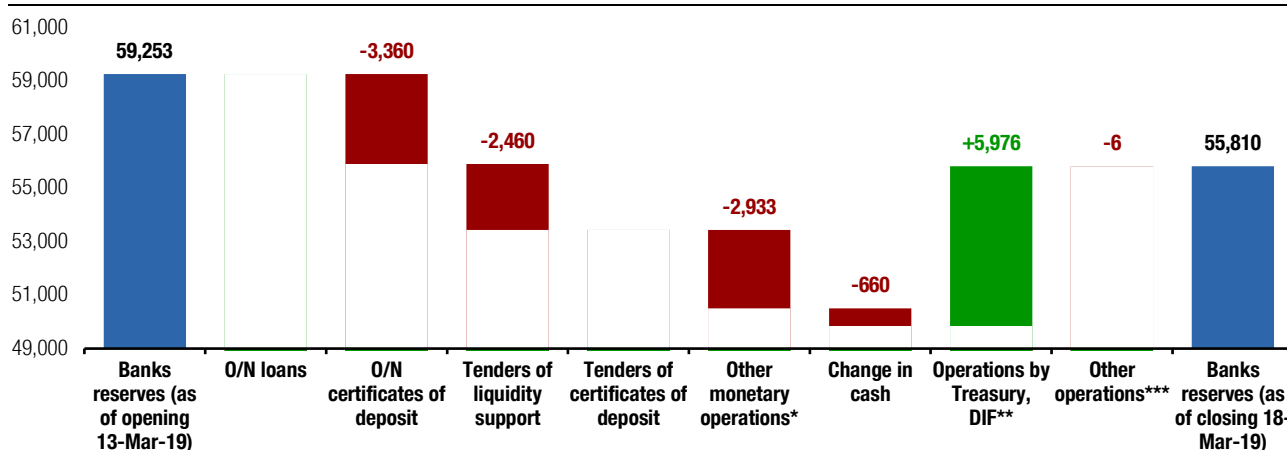
Last week, liquidity was mostly steady and outflows to NBU via the FX market were compensated by budget expenditures. The largest outflow was seen on Wednesday when there was FX selling from reserves, which was increased by outflows to the budget via bond purchases, causing liquidity to decline to UAH98.3bn. By Friday, liquidity recovered to UAH101.5bn.

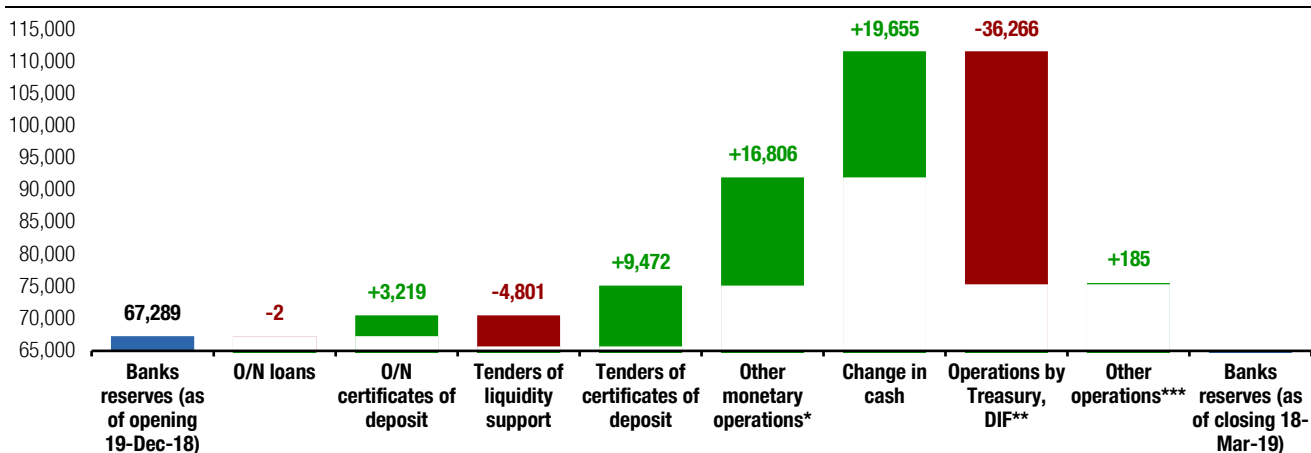
The NBU absorbed UAH2.5bn last week via the FX market, while banks exchanged UAH1.9bn of reserves in cash. These outflows were compensated by the Treasury with net inflows at UAH6.9bn last week, despite banks repaying loans to the NBU.

**ICU view: This week, we do not anticipate significant impact from the FX market on liquidity, or outflows to the budget. However, the government may raise VAT refunds, which in this case would cause tangible liquidity inflows.**

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](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 weakens

After a few weeks of appreciation, at the end of last week, the hryvnia weakened to UAH27.02/US\$. This week, the Ukrainian currency is likely to continue to weaken slightly.

After tax payments and a new wave of foreign investment in government debt, the FX market moved to the demand side. After the NBU purchased US\$211m a week ago, last week, it had to sell a net US\$94.5m, which satisfied extra demand and calmed the market.

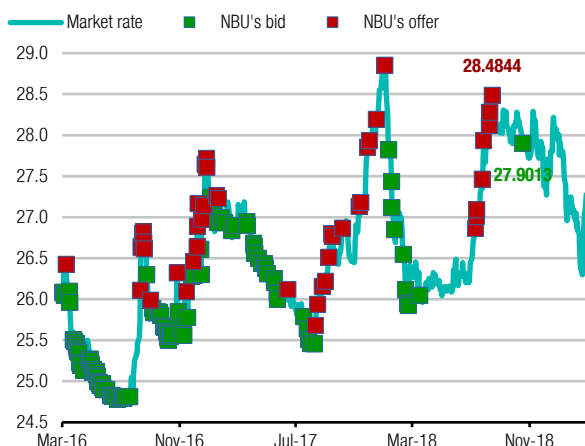
As a result, last week, the hryvnia lost 2.45%; YoY it lost 2.66%. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) declined 3.2% to 120.04, while in YoY terms, it was up 4.1%.

**ICU view: The significant volatility during recent weeks decreased after the NBU entered the market by selling and purchasing FX. We expect the hryvnia to continue weakening to about UAH27.2-27.3/US\$ by the end of March.**

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

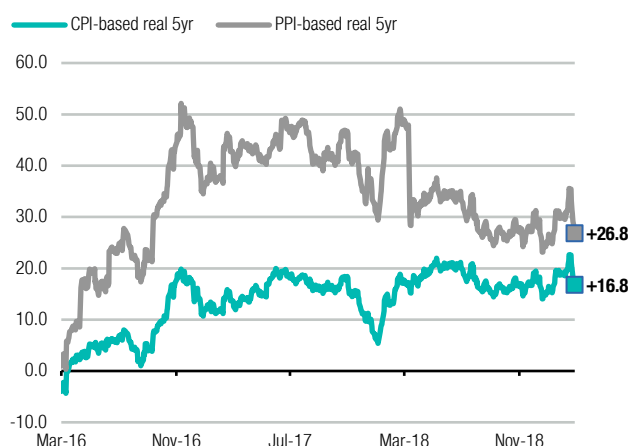
**Chart 5. FX market indicators, 3-year history**

*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 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

### Key rate unchanged ahead of elections

NBU may start the cycle of lowering the key rate in 2Q19, if it sees political risks declining after presidential elections.

The regulator chose to maintain its key policy rate at 18% despite decreasing inflation and the favourable situation in FX market for hryvnia. The combination of increases in social payments and the monetization of utility subsidies ahead of the elections still poses a threat for meeting the inflation target.

**ICU view:** *The real interest rate increases as the key rate remains at 18% since September 2018, while inflation gradually diminishes. Such tight monetary policy negatively impacts both lending and economic growth. Yet risks both political and economic look too high for the regulator. Only one out of 10 members of the Monetary Policy Committee voted in favour of lowering the interest rate during the meetings in December and January; the results of the March meeting are yet to be published. We believe the NBU may decide to start the cycle of lowering the interest rates on 25 April or 6 June if the elections outcome decreases political risk rather than amplifies it. June is the more probable date if the increased social payments materially impact the inflation.*

**Mykhaylo Demkiv, Kyiv, (044) 377-7040 ext.723**

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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](http://www.icu.ua)



## INVESTMENT ADVISORY

**Makar Paseniuk, CFA**, Managing Partner  
[makar.paseniuk@icu.ua](mailto:makar.paseniuk@icu.ua)

**Ivan Shvydanenko**, Director  
[ivan.shvydanenko@icu.ua](mailto:ivan.shvydanenko@icu.ua)

**Roman Nikitov, ACCA** Director  
[roman.nikitov@icu.ua](mailto:roman.nikitov@icu.ua)

**Yuriy Kamarytskyi**, Vice President  
[yuriy.kamarytskyi@icu.ua](mailto:yuriy.kamarytskyi@icu.ua)

**Ruslan Kilmukhametov**, Director  
[ruslan.kilmukhametov@icu.ua](mailto:ruslan.kilmukhametov@icu.ua)


**Ruslan Patlavsky**, Director  
[ruslan.patlavsky@icu.ua](mailto:ruslan.patlavsky@icu.ua)

## ASSET MANAGEMENT

**Grigoriy Ovcharenko**, Director  
Head of Local Asset Management  
[grigoriy.ovcharenko@icu.ua](mailto:grigoriy.ovcharenko@icu.ua)

**Liliya Kubytovych**   
Head of Marketing and Sales  
[liliya.kubytovych@icu.ua](mailto:liliya.kubytovych@icu.ua)


## TRADE OPERATIONS

**Konstantin Stetsenko**   
Managing Partner  
[konstantin.stetsenko@icu.ua](mailto:konstantin.stetsenko@icu.ua)

**Vlad Sinani**, Director  
Strategy and Business Development  
[vlad.sinani@icu.ua](mailto:vlad.sinani@icu.ua)


**Sergiy Byelyayev**  
Head of Fixed-Income Trading  
[sergij.byelyayev@icu.ua](mailto:sergij.byelyayev@icu.ua)

**Yevgeniya Gryshchenko**  
Head of Brokerage Services Department  
[yevgeniya.gryshchenko@icu.ua](mailto:yevgeniya.gryshchenko@icu.ua)

**Vitaliy Sivach**   
Trader, Fixed-Income & Forex  
[vitaliy.sivach@icu.ua](mailto:vitaliy.sivach@icu.ua)


**Bogdan Vorotilin**   
[bogdan.vorotilin@icu.ua](mailto:bogdan.vorotilin@icu.ua)

## RESEARCH

**Alexander Valchyshen**   
Head of Research  
[alexander.valchyshen@icu.ua](mailto:alexander.valchyshen@icu.ua)

**Taras Kotovych**   
Senior financial analyst (Sovereign debt)  
[taras.kotovych@icu.ua](mailto:taras.kotovych@icu.ua)

**Alexander Martynenko**   
Head of corporate research  
[alexander.martynenko@icu.ua](mailto:alexander.martynenko@icu.ua)

**Mykhaylo Demkiv**   
Financial analyst (Banks)  
[mykhaylo.demkiv@icu.ua](mailto:mykhaylo.demkiv@icu.ua)

**Dmitriy Dyachenko**  
Junior financial analyst  
[dmitriy.dyachenko@icu.ua](mailto:dmitriy.dyachenko@icu.ua)

**Artem Gladchenko**  
Junior financial analyst  
[artem.gladchenko@icu.ua](mailto:artem.gladchenko@icu.ua)

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