

Weekly Insight

Russia restricts exports to Ukraine

Key messages of the today's comments

WEDNESDAY, 24 APRIL 2019

Domestic liquidity and bonds market

Foreign investors invest \$1.1bn in govt bills

Last week, foreign investors purchased UAH5.4bn of local-currency bills, and increased their portfolios by UAH4.9bn to UAH30.5bn or US\$1.1bn. Investments will rise this week also.

Liquidity volatility increases

Reaching UAH110bn a week ago, liquidity continued to increase until the Treasury intervened, but remained above UAH100bn. This week, liquidity should stay above UAH100bn with volatility.

Foreign exchange market

Hryvnia slightly weakens

Last week, the hryvnia lost 0.3% and weakened to UAH26.835/US\$, and could continue to lose ground.

Economics

Russia restricts exports of petroleum products, oil, and coal to Ukraine

A complete ban of Russian energy exports to Ukraine is unlikely, because it will cause considerable export revenue losses for Russian businesses. In such a worst-case scenario, Ukraine will be able to find substitutes, albeit at higher prices.

Banks' reserves market (23 April 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+100bp
ON rate (%)	N/A
ON \$ swap (%)	14.71	-18bp	-131bp
Reserves (UAHm) ²	54,023	-6.22	+12.47
DepCerts (UAHm) ³	49,329	-11.79	-12.86

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) (23 April 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,103	+0.00	-3.77
Banks	358,813	-0.05	+3.10
Residents	25,997	-0.58	-6.55
Individuals	8,368	+2.49	+241.14
Non-res ⁴	30,371	+19.22	+120.40
Total	760,651	+0.63	+2.46

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

FX market indicators (23 April 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.7040	-0.27	+2.26
EUR/USD	1.1227	-0.61	-8.04
DX ²	97.636	+0.65	+7.36
UAH TWI ³	121.905	+0.65	+4.65

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

Gov't bond quotes¹ (24 April 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.
Source: ICU.

Domestic liquidity and bonds market

Foreign investors invest \$1.1bn in govt bills

Last week, foreign investors purchased UAH5.4bn of local-currency bills, and increased their portfolios by UAH4.9bn to UAH30.5bn or US\$1.1bn. Investments will rise this week also.

On Tuesday, the Ministry of Finance sold UAH8bn of UAH-denominated bills. The main part of this amount was purchased by foreign investors. Foreign investors increased their portfolios faster than expected. The MoF sold four-month and two-year bills for the most part, and raised smaller amounts with six and 12-month bills, and one three-year. More about this auction in our [overview](#).

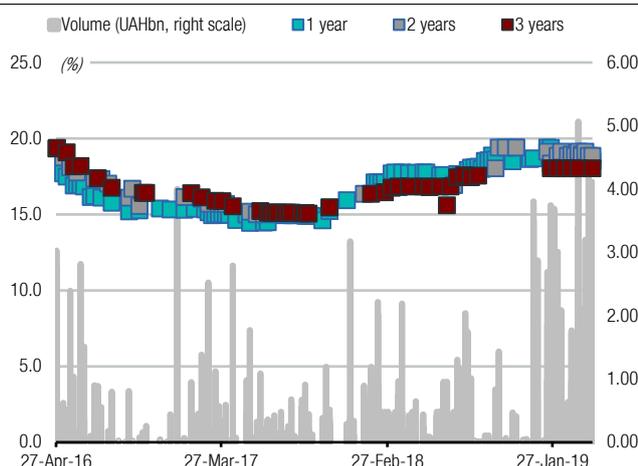
Since they were purchased in the primary market, these bills were accounted in foreign investors' accounts directly, without secondary market deals. We assume that investments were distributed between all instruments, but were concentrated in the four-month and two-year bills. According to Bloomberg Data, Citigroup issued a number of CLN with UAH-denominated bills as the reference asset, which amounted to UAH1bn, most with maturities in October 2019, and June 2020.

ICU view: We expect that demand from foreigners will be seen this week too, and portfolios will rise. But further portfolio dynamics will depend on the political situation in Ukraine and hryvnia exchange-rate movements.

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

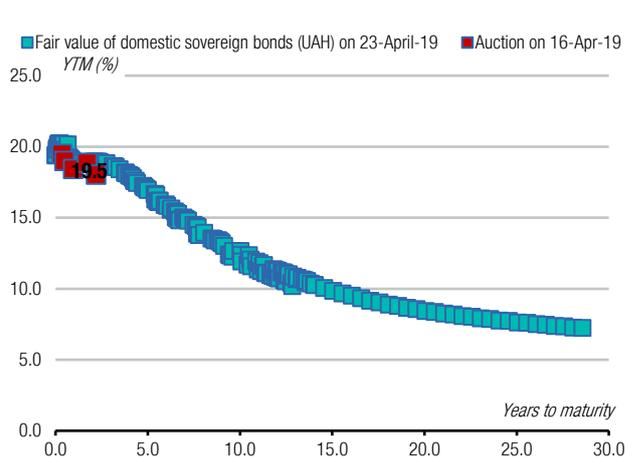
Chart 1. Local-currency bonds

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.

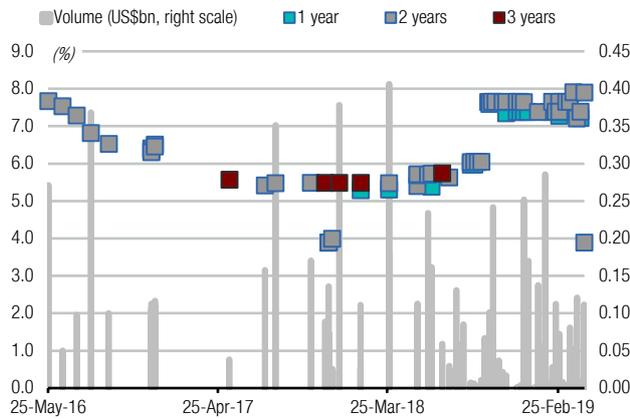
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

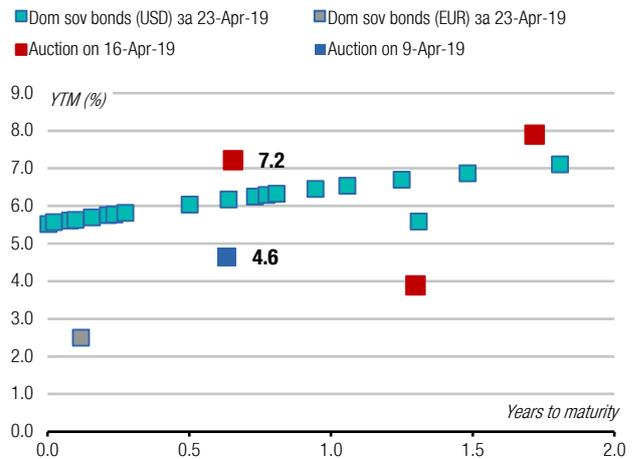
Chart 2. FX-denominated bonds

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 volatility increases

Reaching UAH110bn a week ago, liquidity continued to increase until the Treasury intervened, but remained above UAH100bn. This week, liquidity should stay above UAH100bn with volatility.

Last week, liquidity rose to UAH113.5bn with inflows from Treasury and NBU, but after bills purchases on Wednesday (see comment above), liquidity fell sufficiently, and by the end of last week it was at UAH106.5bn. Funds were almost equally divided between banks' accounts with the NBU and CDs.

Last week, the Treasury absorbed UAH3.3bn and reserves exchange in cash amounted to UAH5bn, while the NBU injected only UAH1.2bn via FX market.

ICU view: This week, liquidity should be steady with volatility due to cash flow offsets. The Treasury will collect month-end tax payments, but it also has to pay VAT refunds. Currently, it has only refunded one-third of the average monthly amount. These payments will be concentrated this week due to upcoming long holidays with the next business day in May.

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

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

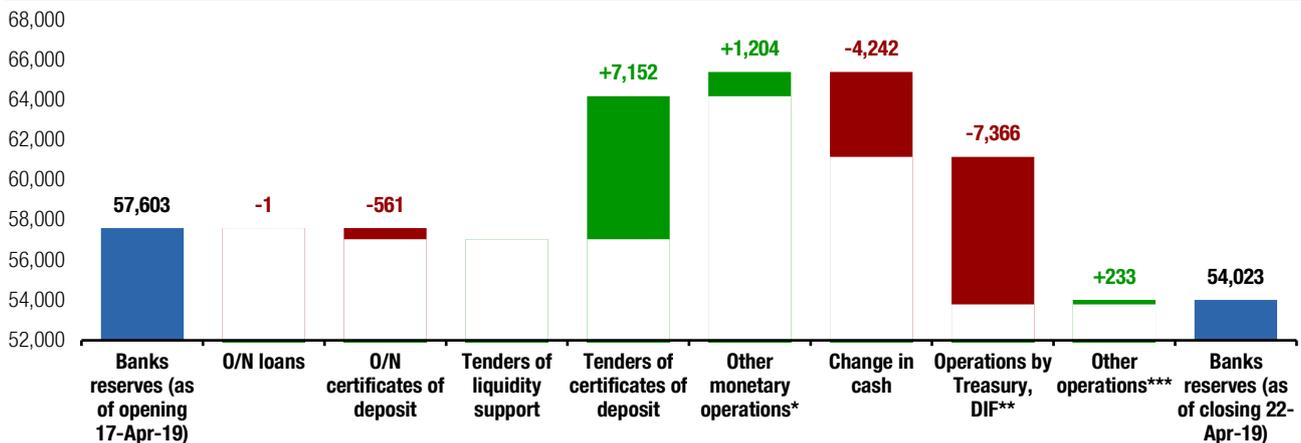
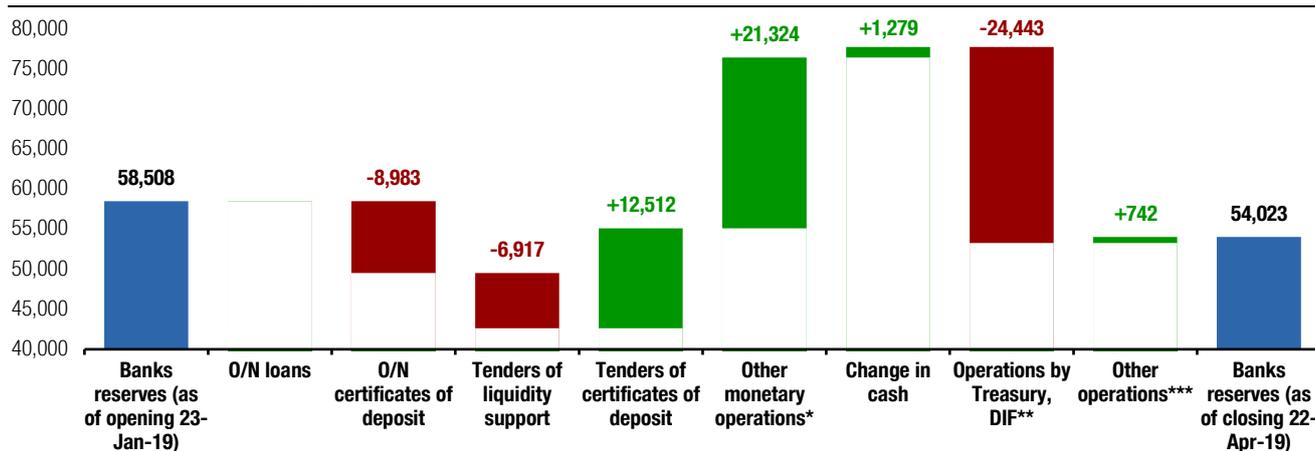


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 slightly weakens

Last week, the hryvnia lost 0.3% and weakened to UAH26.835/US\$, and could continue to lose ground.

Last week, the NBU did not participate much in the FX market, but the hryvnia lost a portion of its gains from the beginning of the month. Inflows of FX from foreign investors could rise, as last week they purchased about US\$200m of new bills. This did not have an impact on the market possibly due to a lower supply of FX from exporters and additional demand for FX from importers and the government to cover FX outflows from its accounts prior to large external debt repayments in May.

The market was similar to the previous week, and the NBU purchased just US\$45m. So, demand for FX was usually high.

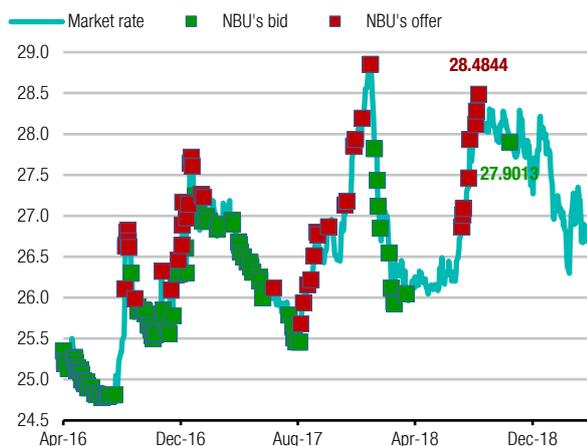
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) declined 0.2% to 121.2, while in YoY terms, it was up 5.6%.

ICU view: The hryvnia should receive support this week from taxpayers who do not have enough local-currency liquidity, and who will not receive VAT refunds. This can support the hryvnia, but without significant appreciation. The Ukrainian currency will stay slightly volatile closer to the bottom of or inside the range of UAH26.7–27.3/US\$.

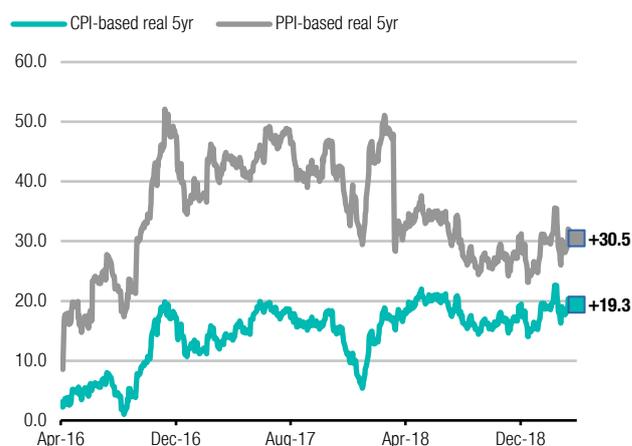
Taras Kotovych, Kyiv, (044) 377-7040 ext.724

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

Russia restricts exports of petroleum products, oil, and coal to Ukraine

A complete ban of Russian energy exports to Ukraine is unlikely, because it will cause considerable export revenue losses for Russian businesses. In such a worst-case scenario, Ukraine will be able to find substitutes, albeit at higher prices.

As TASS [reported](#), the Russian Federation imposed limits on the export of oil, petroleum products, and coal to Ukraine. [Starting](#) from July 1, 2019, these energy products can be exported to Ukraine only on the basis of individual permits.

The Russian government also forbade imports of certain types of Ukrainian goods, including the products of machine building, consumer goods, and metal processing with total value of \$250m.

ICU view: For now, Russia's actions are more likely to escalate the stand-off in the form of informational noise without any real consequences. This decision has just expanded the scope of the regime of special permits, which has already been enacted for export supplies of diesel fuel and liquefied gas to Ukraine.

If Russia's decides to apply a ban on fuel and energy products, Ukraine will be able to find suitable substitutes. However, this could lead to higher import costs as well as rising domestic prices. According to a number of estimates of fuel market participants, prices for diesel and liquefied gas may increase by 3-5% and 15-20%, respectively. We also estimate that the growth in costs of importing anthracite will be insignificant, as it will be offset by the general decline in world prices for coal and the further reduction of anthracite consumption at Ukrainian TPPs due to the use of gas coal grades. At the same time, the replacement of Russian supplies may increase the cost of imports of coking coal by Ukrainian steelmakers by 20-30%.

We consider the scenario of a total ban on the export of Russian energy products unlikely. In this case, Russian exporters will suffer considerable losses of their export revenues: about \$2bn in sales of fuel and \$400m in sales of coal. Losses for exporters of coking coal would be the most substantial, since sales to Ukraine account for about 10% of their total exports.

Alexander Martynenko, Kyiv, (044) 377-7040 ext.726

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

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

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

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

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