

# Weekly Insight

## Landslide victory for presidential party

### Key messages of the today's comments

WEDNESDAY, 24 JULY 2019

### Domestic liquidity and bonds market

#### Foreigners diversify bond portfolios

At the end of last week, foreign investors' portfolios rose to UAH69bn. The share of local-currency paper declined to 96.2%. This week, portfolios should continue to grow, and will exceed UAH70bn.

#### Banks repay loans to NBU

The high level of banking-sector liquidity, which exceeded UAH113bn last week, allowed banks to repay loans to the NBU. This week, total banking-sector liquidity will be volatile at around UAH100bn.

### Foreign exchange market

#### Hryvnia marginally weakens

Last week, the hryvnia was about to weaken further, but by Friday recovered to the level seen a week before. We expect that this week, the hryvnia will receive support from demand for local-currency bills.

### Economics

#### NBU updates Ukraine's economic outlook

The regulator improved 2019 real GDP forecasts by 0.5ppt to 3% growth, and expects economic growth to accelerate to 3.2% in 2020.

#### NBU cuts rate by 50 bps to 17.0%.

Bullish rhetoric from the National Bank continued cycle of lowering rates

#### Landslide victory for presidential party

The Servant of the People (SoP) party is projected to win 250 seats or 56% of the total seats in the next parliament.

### Banks' reserves market (23 July 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	17.00	-50bp	-50bp
ON rate (%)	15.66	-42bp	-64bp
ON \$ swap (%)	13.96	-9bp	-239bp
Reserves (UAHm) <sup>2</sup>	50,800	-10.76	-14.27
DepCerts (UAHm) <sup>3</sup>	45,206	-13.55	-9.62

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 July 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,086	+0.00	-3.78
Banks	343,489	+4.36	-3.91
Residents	25,277	+7.41	+14.10
Individuals	9,283	+4.51	+153.97
Non-res <sup>4</sup>	69,084	+6.46	+610.54
<b>Total</b>	<b>784,219</b>	<b>+2.71</b>	<b>+5.50</b>

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

### FX market indicators (23 July 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	25.6750	-0.82	-3.06
EUR/USD	1.1152	-0.64	-4.62
DXY <sup>2</sup>	97.705	+0.50	+3.25
UAH TWI <sup>3</sup>	126.689	+1.15	+6.34

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

### Gov't bond quotes<sup>1</sup> (24 July 2019)

Maturity	Bid	Ask
6m	17.75	16.50
12m	18.00	17.00
2y	18.15	17.15
3y	17.75	16.75
12m (\$)	6.50	5.75
2y (\$)	7.00	6.00

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

# Domestic liquidity and bonds market

## Foreigners diversify bond portfolios

At the end of last week, foreign investors' portfolios rose to UAH69bn. The share of local-currency paper declined to 96.2%. This week, portfolios should continue to grow, and will exceed UAH70bn.

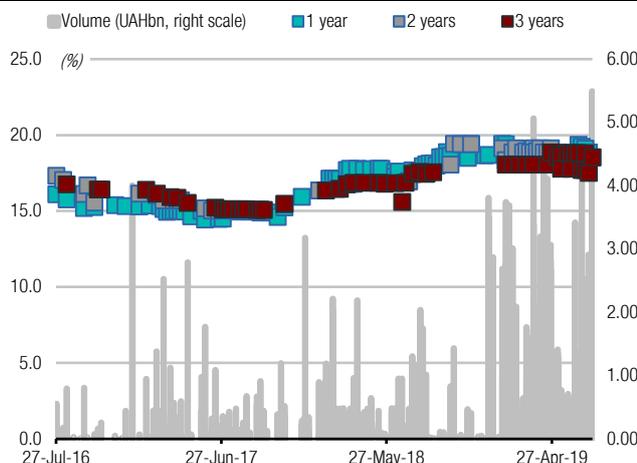
Last week, foreigners increased investment in domestic bills by UAH4bn, but nearly one-quarter was in USD-denominated instruments. Total portfolios amounted to UAH69.1bn, including UAH66.5bn in UAH-denominated bills and UAH2.6bn of FX-denominated bills. UAH1.1bn of FX-denominated bills were purchased last week decreasing the share of local-currency bills by 155bp to 96.2%, showing that some foreign investors prefer to diversify investments and decrease hryvnia exposure.

**ICU view: The victory for the presidential party in Parliament elections (see comment below) had a positive effect on Ukraine's image and will attract more foreign investment. We expect that foreigners' portfolios will exceed UAH70bn this week with an increased share of local-currency bills in their portfolios.**

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

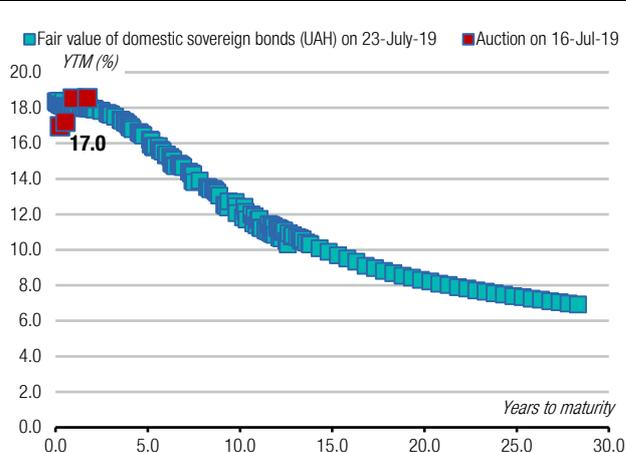
**Chart 1. Local-currency bonds**

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.

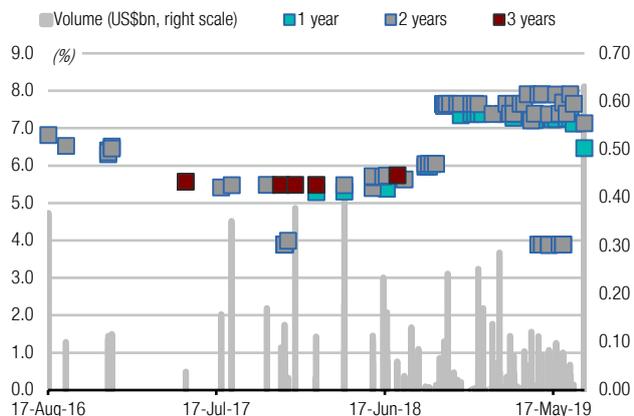
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

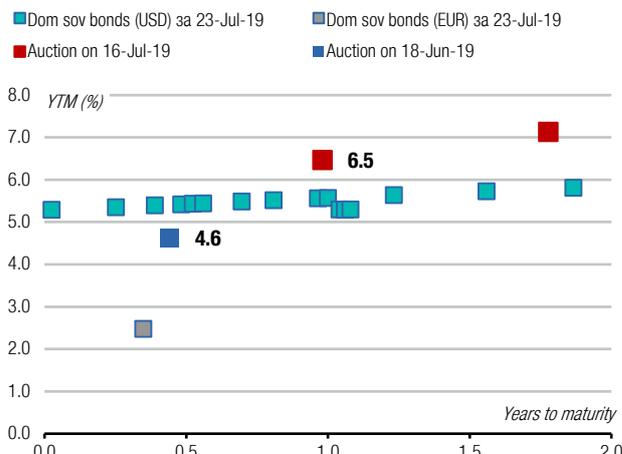
**Chart 2. FX-denominated bonds**

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.

**Banks repay loans to NBU**

The high level of banking-sector liquidity, which exceeded UAH113bn last week, allowed banks to repay loans to the NBU. This week, total banking-sector liquidity will be volatile at around UAH100bn.

Last Monday, liquidity rose to UAH113.1bn, which, by Friday, allowed banks to repay UAH7.6bn of loans that had been received from the NBU two weeks before. With the negative impact of non-monetary operations, which amounted to UAH2.1bn, liquidity fell to UAH104bn by the end of last week. Outflows to Treasury accounts occurred last Wednesday, which was settlement day after Tuesday’s auction (see our special comment).

**ICU view: As month-end tax payments and VAT refunds most likely will take place next week, the last three days of the month, we do not expect significant liquidity movements this week. So, volatility will stay around UAH100bn.**

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

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

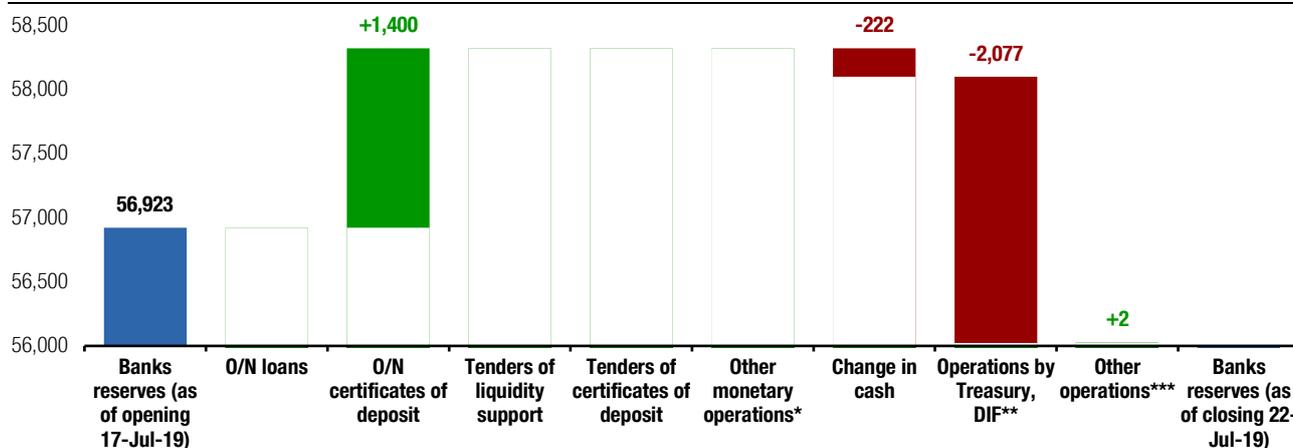
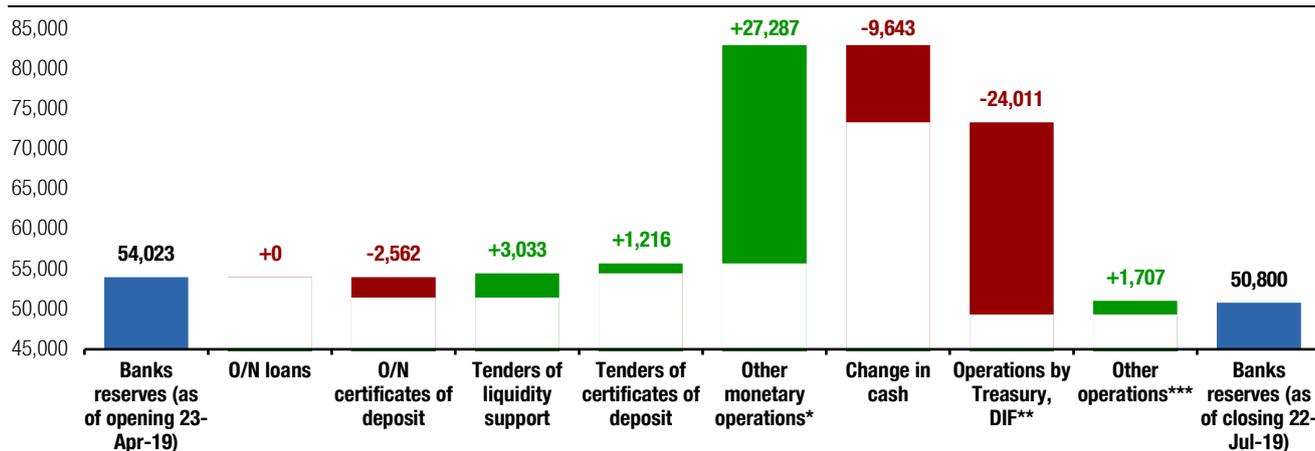


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 marginally weakens

Last week, the hryvnia was about to weaken further, but by Friday recovered to the level seen a week before. We expect that this week, the hryvnia will receive support from demand for local-currency bills.

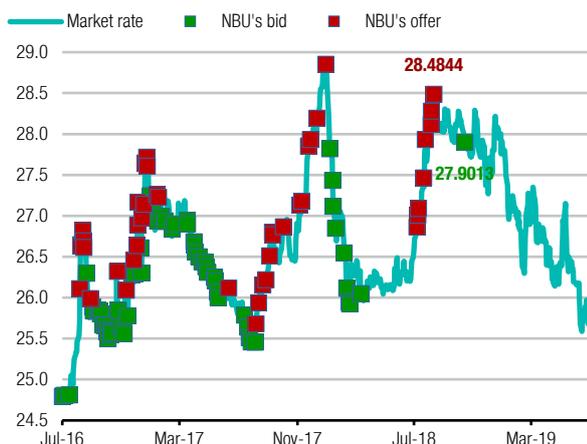
Last week, the hryvnia weakened by 0.1% to UAH25.76/US\$. On Thursday, it was very close to the cross level of UAH26/US\$. This weakening was despite large amounts of new bills purchased by foreign investors, with settlement on Wednesday and Thursday. Demand for FX was larger than supply, as it was needed to pay for new FX-denominated bills. However, by Friday, the market balanced with a stronger hryvnia.

**ICU view: The hryvnia may slightly appreciate this week as foreigners purchase new bills and there is demand for the hryvnia for tax payments. VAT refunds will cause a negative impact later this month. This week, the hryvnia may be in the range of UAH25.4–25.8/US\$.**

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

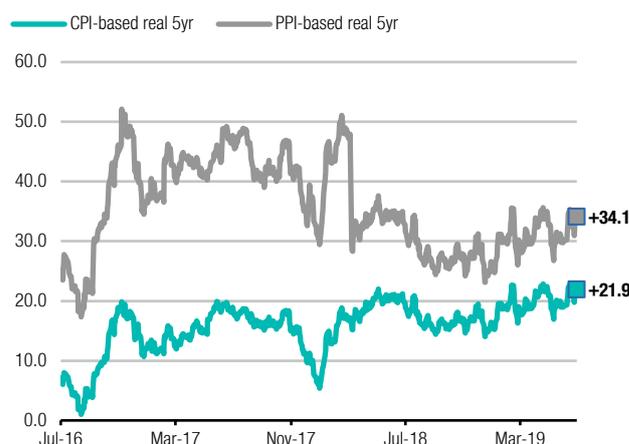
**Chart 5. FX market indicators, 3-year history**

*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 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

### NBU updates Ukraine's economic outlook

The regulator improved 2019 real GDP forecasts by 0.5ppt to 3% growth, and expects economic growth to accelerate to 3.2% in 2020.

The improvement of the forecast was thanks to firmer domestic demand, better trade terms, and expected better harvest this year. The NBU kept unchanged inflation forecasts at 6.3% in 2019, and 5% in 2020. The C/A deficit is expected at 2.6% of GDP in 2019 (vs. 3.3% previously), and 2.9% of GDP in 2020 (vs. 3.6% previously). The NBU is expected to cut the key policy rate to 16% by YE2019, and further to 9.5-10% by YE2020. FX reserves are expected at US\$21.7bn and US\$22.8bn by the end of 2019 and 2020, respectively.

**ICU view: NBU's new outlook is more positive compared with the updated forecasts from ICU: real GDP growth of 2.7% in 2019, headline inflation at 8% by YE2019, and a current-account deficit of 2.9% of GDP for full-year 2019. Risks to our forecast are firmer consumer and investment demand in 2H19, and an overall better harvest this year.**

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

### NBU cuts rate by 50 bps to 17.0%.

Bullish rhetoric from the National Bank continued cycle of lowering rates

Political risk regarding the new coalition, government, and their intentions to resume cooperation with the IMF remain high while the Privatbank nationalization/denationalization story continues in both Ukrainian and foreign courts. However, the continuing rise of the real interest rate (8.5% in June), appreciation of the local currency, and steady inflow of foreign money into the UAH-denominated 'borscht bonds' outweighed the risks.

The regulator will launch a new practice of key rate forecast. It maintains the goal of lowering inflation to 5%, which will allow a decrease of the key rate to 8% by the end of 2021. While the exact quarterly forecast will be published in a week, the NBU stated it expects the most drastic rate decrease to happen in 2020.

***ICU view: We expect two more 50 bps key rate cuts in 2019, assuming the new government resumes cooperation with the IMF.***

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

### **Landslide victory for presidential party**

The Servant of the People (SoP) party is projected to win 250 seats or 56% of the total seats in the next parliament.

Ukrainian parliamentary elections yielded results close to the previously published poll, which is yet another sign of the country being a vibrant democracy. The president's party has been given an unprecedented amount of power in Ukraine's recent history, as many of its candidates who are absolutely unknown and have no political experience managed to win against strongmen who had been elected by their constituencies for years.

The official results may not be published until August, as the outcomes of some electorates may be contested. However, the coalition-forming process is underway.

***ICU view: Despite being able to form a majority with their own, SoP is very likely to seek allies among the independent MPs and other parties such as Golos or even Batkivschyna. A single-party majority is also possible, but it would be an undesirable outcome, as it would result in a shaky majority. The Ukrainian parliament achieves far from 100% attendance, and, historically, MPs have a tendency to quit the coalition.***

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

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

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

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

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