

Weekly Insight

Short-term financing shrinks

Key messages of the today's comments

Domestic liquidity and bonds market

Short-term financing shrinks

Due to capped offerings of short-term bills, the share of short-term financing in total borrowings declined YTD to 61% from 97%. With today's issue of five-year notes, the share of short-term financing will decline further.

Liquidity needs support

Quarterly income tax payments caused banking-sector liquidity to fall to around UAH90bn (US\$3.6bn), where it was last week despite support from the NBU. To recover to a comfortable UAH100bn (US\$4bn), liquidity will require additional support, which can come from VAT refunds, budget expenditures, and the FX market.

Foreign exchange market

Hryvnia resists seasonality

The UAH exchange rate continues to resist the seasonality that has been seen recent years, last week once more trying to cross below UAH25/US\$. Despite possible high demand for T-notes today, this level will not be crossed.

Economics

Retail trade turnover rises 9% YoY in July

Due to lower growth rates of real incomes in 2H19, retail trade turnover will also slow, but will remain one of the main growth drivers of Ukraine's economy this and next year.

Agricultural output rises 12% YoY in 7M19

In 3Q19, Ukraine's economy will receive a boost from solid growth of agricultural production, but its growth rates are to slow in the following months.

TUESDAY, 27 AUGUST 2019

Banks' reserves market (23 August 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	17.00	+0bp	-50bp
ON rate (%)	16.71	+94bp	-69bp
ON \$ swap (%)	15.46	+71bp	-48bp
Reserves (UAHm) ²	47,209	-11.94	-6.28
DepCerts (UAHm) ³	43,532	-6.09	+65.98

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 August 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,066	+0.00	-3.17
Banks	335,895	-1.10	-9.21
Residents	25,231	-2.20	+20.09
Individuals	9,338	-2.95	+119.63
Non-res ⁴	86,588	-1.24	+1,066.86
Total	794,118	-0.71	+5.78

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

FX market indicators (23 August 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	25.1000	-0.32	-9.85
EUR/USD	1.1144	+0.49	-3.43
DX ²	97.640	-0.51	+2.06
UAH TWI ³	131.763	+0.35	+12.35

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

Gov't bond quotes¹ (27 August 2019)

Maturity	Bid	Ask
6m	17.75	16.25
12m	17.75	16.25
2y	17.75	16.25
3y	17.75	16.25
12m (\$)	6.75	5.25
2y (\$)	7.25	5.85

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

Domestic liquidity and bonds market

Short-term financing shrinks

Due to capped offerings of short-term bills, the share of short-term financing in total borrowings declined YTD to 61% from 97%. With today's issue of five-year notes, the share of short-term financing will decline further.

During the first months of this year, most financing came from short-term bills. At the end of February, 97% was received from bills up to 12-months in maturity, and 87% with redemptions this year. With expectations of NBU key-policy rate cuts and the increase in foreign investors' portfolio of T bills, the share of short-term borrowings noticeably declined.

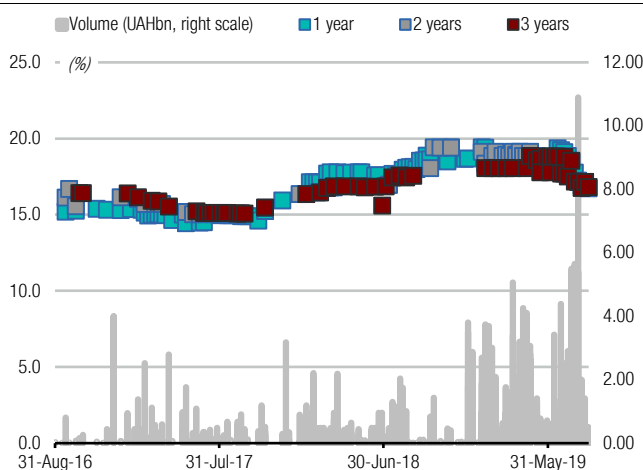
At present, the share of short-term financing declined to 61%, and bonds maturing this year to 42%. Today's offering of five-year notes is very important since it should attract large demand from foreigners. This offering will not be capped by the MoF, so the result of this auction will depend on the amount of demand and the proposed rates in participants' bids.

ICU view: Today, we anticipate additional inflow of funds from foreign investors from the five-year note, similar to the same offering at the end of July. In July, the share of short-term financing shrank rapidly to 39%, which was 62% since the beginning of the year. According to our estimates, the MoF has to attract nearly UAH50bn (US\$2bn) of domestic financing by the end of this year, and MoF will do its best to do this through the use of five-year notes.

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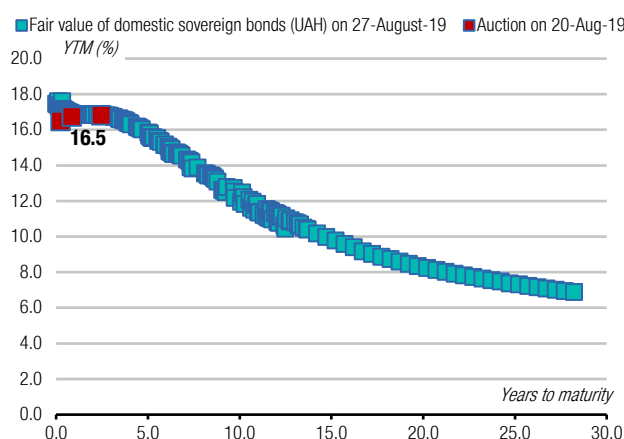
Chart 1. Local-currency bonds

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.

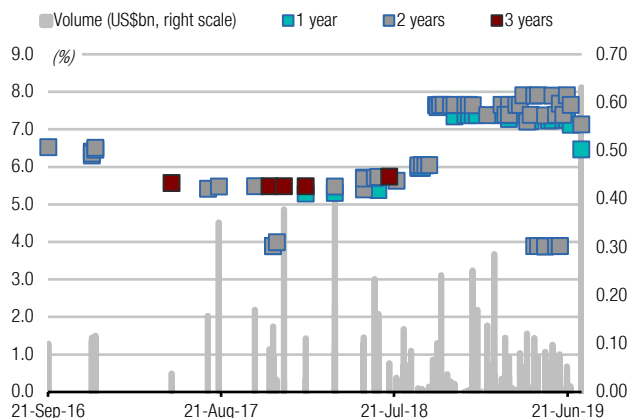
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

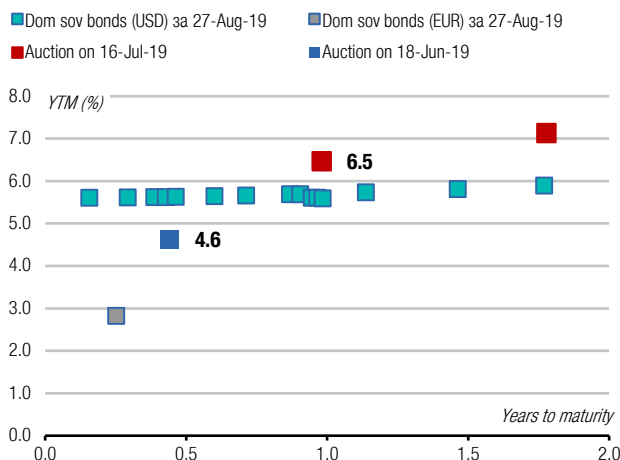
Chart 2. FX-denominated bonds

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 needs support

Quarterly income tax payments caused banking-sector liquidity to fall to around UAH90bn (US\$3.6bn), where it was last week despite support from the NBU. To recover to a comfortable UAH100bn (US\$4bn), liquidity will require additional support, which can come from VAT refunds, budget expenditures, and the FX market.

Last week started off with a significant outflow from budget accounts, which amounted to UAH13bn (US\$0.52bn), causing liquidity to fall to UAH87bn (US\$3.5bn). With large T-bill redemptions and hard currency purchases by the NBU, liquidity slightly recovered to above UAH90bn (US\$3.6bn). But to recover to a comfortable UAH100bn (US\$4bn), liquidity will require additional inflows from the NBU, but most important, from budget accounts.

This month, the net balance of Treasury operations is minus UAH8.9bn (US\$0.35bn), which can be returned to the banking system this week through VAT refunds, which, until the end of last week, amounted to UAH4bn (US\$0.16bn). This is low compared with the average monthly amount UAH13.4bn (US\$0.54bn), and July's UAH10bn (US\$0.4bn). So, about UAH6bn (US\$0.24bn) can enter liquidity this week from budget accounts.

ICU view: Liquidity will gradually recover with VAT refunds, while funds from hard-currency purchases by the NBU will be spent on bond purchases, decreasing the positive impact of inflows. As a result, liquidity will stay in the range of UAH90-100bn (US\$3.6-4bn) with slight recovery. The key point will be budget expenditures, which currently are significantly lower than funds collection.

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

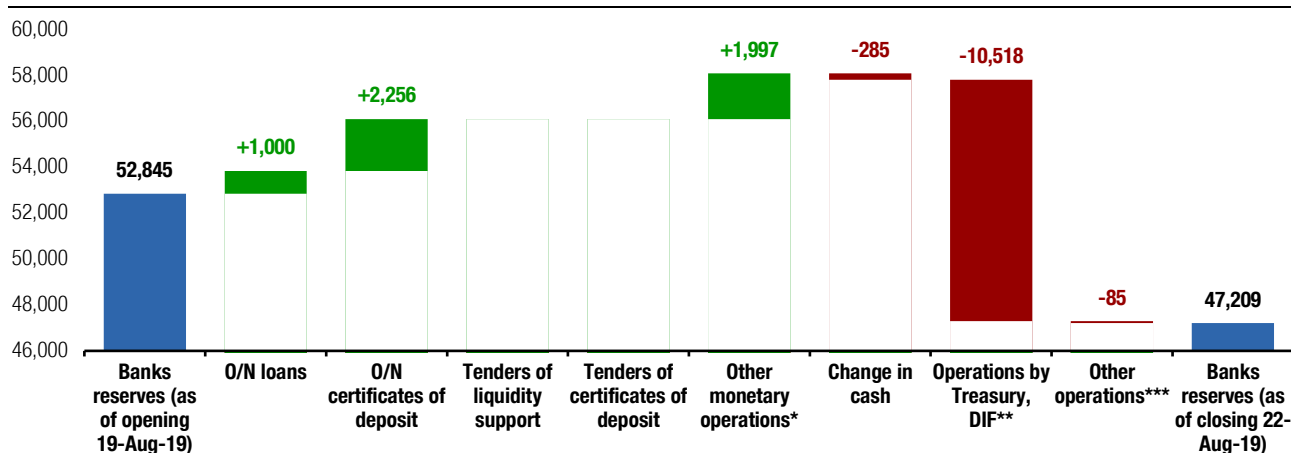
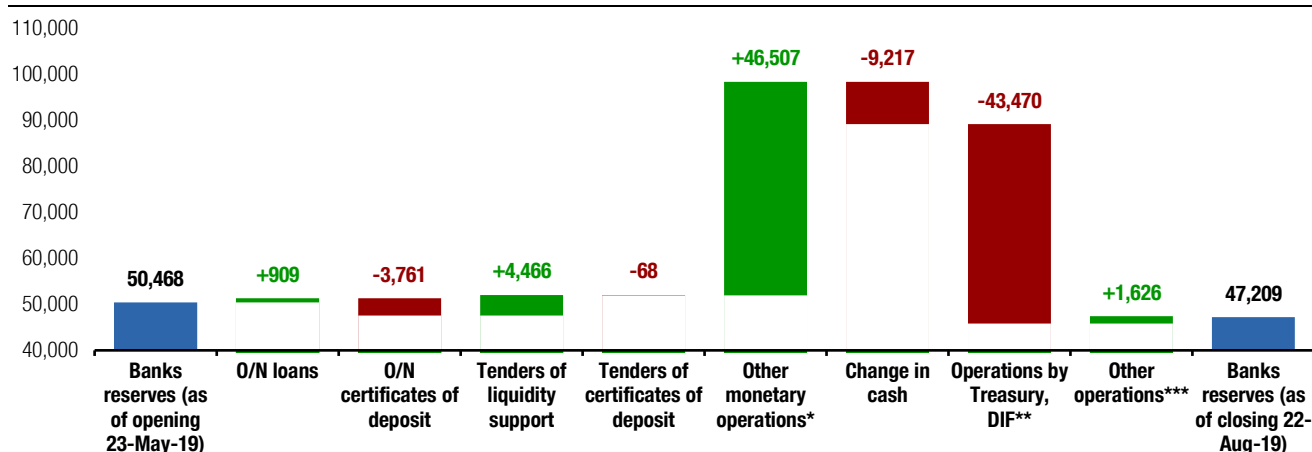


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 resists seasonality

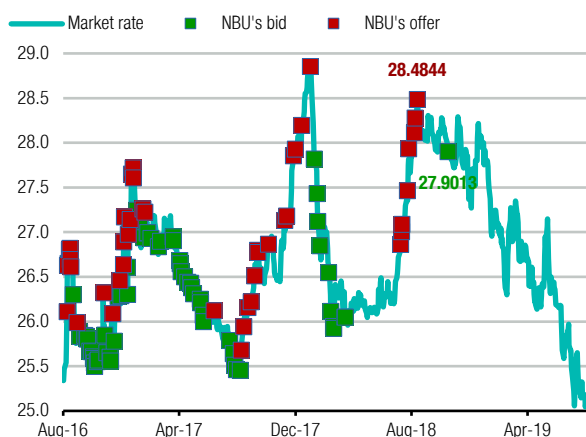
The UAH exchange rate continues to resist the seasonality that has been seen recent years, last week once more trying to cross below UAH25/US\$. Despite possible high demand for T-notes today, this level will not be crossed.

The last days of quarterly income tax payments occurred last week, which provided additional support for the hryvnia, and later support came from foreign investors. The offering of five-year notes announced for today attracted additional attention from foreign investors. Selling of hard currencies rose last week, which, in addition to low liquidity, added support for hryvnia exchange rate.

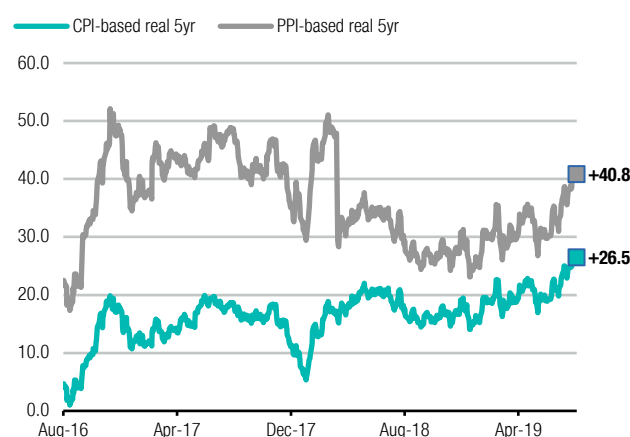
Therefore, the hryvnia continued to resist seasonal weakening, which last year started in July. Instead, it could repeat the dynamic of 2017, when weakening started at the end of August.

ICU view: This week we anticipate that the hryvnia will stay slightly above UAH25/US\$. But after the government paper auction, the support of hryvnia from foreign investors' demand will significantly weaken. By the end of the week, the hryvnia can weaken to around UAH25.3-25.5/US\$.

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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 rises 9% YoY in July

Due to lower growth rates of real incomes in 2H19, retail trade turnover will also slow, but will remain one of the main growth drivers of Ukraine's economy this and next year.

Retail-turnover growth slowed to 9% YoY in July, down from 13.6% YoY in June, the highest growth rate since December 2017 (+15.7% YoY), per data from the State Statistics Service of Ukraine. In 7M19, growth was 10.1% YoY. By region, the highest growth in retail trade was observed in the Vinnytsya region (+18% YoY), the Ternopil region (+17% YoY), and the Cherkasy region (+16% YoY).

ICU view: Retail trade was one of the main drivers of economic growth in 2Q19 having risen 13.3% YoY (ICU estimate). Nevertheless, we expect lower growth rates of retail turnover in 2H19 as real incomes growth decelerates. We estimate that real wages grew 8.8% YoY in 2Q19 vs. 10.9% YoY in 1Q19, and 13% YoY in 2Q18, while remittances rose 5.3% YoY in 2Q19 vs. 7.5% YoY in 1Q19, and 20% YoY in 2Q18. Still, retail trade will continue to support economic growth in 2019 and 2020 thanks to solid consumer demand and further growth of real incomes, albeit at a slower pace.

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Agricultural output rises 12% YoY in 7M19

In 3Q19, Ukraine's economy will receive a boost from solid growth of agricultural production, but its growth rates are to slow in the following months.

In June–July, Ukraine harvested 33.5mt of grain, which is 33% YoY higher thanks to a 14% YoY growth in harvested area, and a 17% YoY increase in the average grain yield (3.86 t/ha). Rapeseed output grew 23% YoY to 3.2mt primarily thanks to a 29% YoY higher harvested area, while the average yield fell 5.5% YoY to 2.57 t/ha. Thus, in June–July, crop output rose 20.4% YoY, while animal production rose 2.2% YoY since the beginning of the year.

ICU view: Given that agriculture accounted for 17–18% of Ukraine's 3Q nominal GDP in recent years, an 18.3% YoY increase in agricultural output in July should boost a 3Q19 real GDP growth. We expect the growth rates of agricultural output will gradually

slow in the following month due to high base effect of the last year's record harvest of late crops.

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