



Focus
Ukraine

Markets
**Domestic liquidity,
government bonds, FX
market, and macro**

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Weekly Insight

Ukraine's new government

Key messages of the today's comments

Domestic liquidity and bonds market

Foreign investors' rotation

Foreign investors' portfolios did not change significantly in August, having increased after the primary auctions, and then declining during the week. This week, in addition to on-going rotation, portfolios declined due to large debt redemption.

Budget collecting funds

The total amount of local-currency funds in Treasury accounts rose to UAH64.8bn, after a large amount of funds was absorbed by the Treasury during August. This week, with large debt repayments and lower tax payments, some funds will be paid to the banking system, allowing liquidity to rise above UAH100bn.

Foreign exchange market

Hryvnia weakening

With the increase in banking-sector liquidity and low issuance of new T-bills, we expect the hryvnia to end the first week of September around UAH25.4/US\$.

Economics

C/A fell to 2.5% of GDP in July

This year, Ukraine's current account will receive support from lower world energy prices and another expected record harvest.

Ukraine's new government

The newly formed Rada appointed Oleksiy Honcharuk (35) to replace Volodymyr Groysman as the country's Prime Minister. New cabinet has good starting positions but will face several big challenges ahead.

THURSDAY, 5 SEPTEMBER 2019

Banks' reserves market (4 September 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	17.00	+0bp	-50bp
ON rate (%)	16.18	+16bp	-120bp
ON \$ swap (%)	14.81	-5bp	-140bp
Reserves (UAHm) ²	57,257	-3.08	+16.83
DepCerts (UAHm) ³	39,246	+10.46	+79.79

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) (4 September 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,065	+0.00	-3.17
Banks	337,439	-0.65	-10.38
Residents	25,545	-1.34	+20.42
Individuals	9,511	+0.76	+108.91
Non-res ⁴	87,116	-1.66	+1,048.69
Total	796,676	-0.52	+5.01

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

FX market indicators (4 September 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	25.2700	+0.26	-11.16
EUR/USD	1.1035	-0.20	-4.72
DXY ²	98.451	-0.06	+3.16
UAH TWI ³	131.735	-0.39	+14.19

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

Gov't bond quotes¹ (5 September 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

Foreign investors' rotation

Foreign investors' portfolios did not change significantly in August, having increased after the primary auctions, and then declining during the week. This week, in addition to on-going rotation, portfolios declined due to large debt redemption.

In early August, non-resident portfolios reached a local high, exceeding UAH87bn, and did not change significantly during the rest of the month. Volatility ranged around UAH1.5bn from UAH86.2bn to UAH87.7bn. The increase was based on the results of the primary auctions and bond settlement, after a decrease during the previous week.

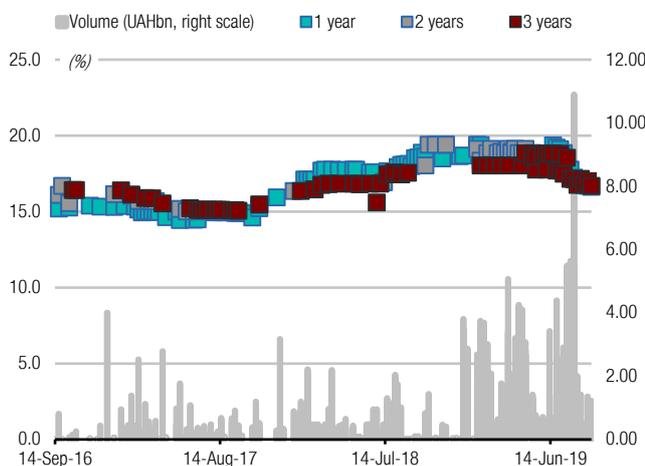
Such portfolio dynamics appear to be rotation of investors and bonds within their portfolios. Some investors sold bonds, and this selling was offset by the purchases of new bonds in the primary market by other foreigners. Likely, short-term bonds were replaced by longer maturities, which receive greater demand at primary auctions (see [last week's overview of the primary auction](#)).

ICU view: Foreign investors' portfolios continue to be volatile around UAH87bn with periodic rotation. Due to debt redemption, portfolios slightly declined.

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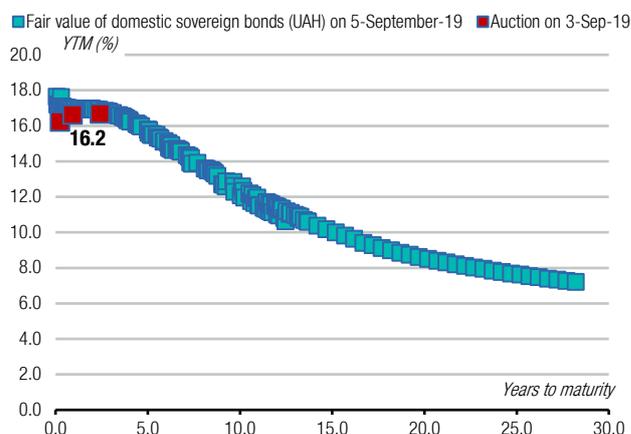
Chart 1. Local-currency bonds

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.

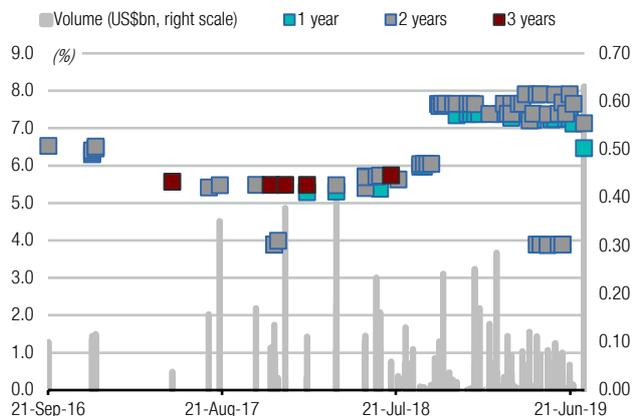
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

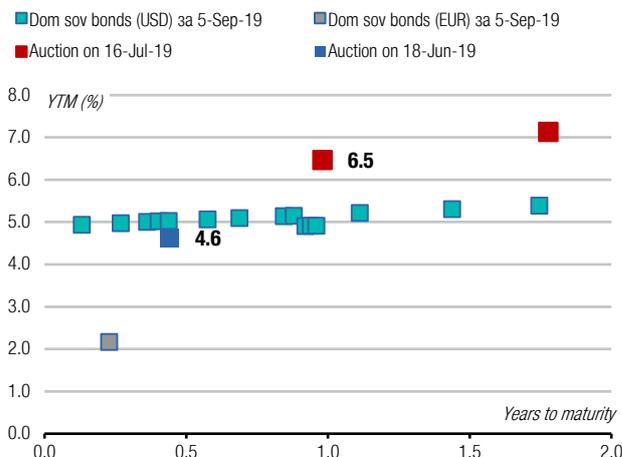
Chart 2. FX-denominated bonds

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.

Budget collecting funds

The total amount of local-currency funds in Treasury accounts rose to UAH64.8bn, after a large amount of funds was absorbed by the Treasury during August. This week, with large debt repayments and lower tax payments, some funds will be paid to the banking system, allowing liquidity to rise above UAH100bn.

Last month, the total amount of funds in budget accounts rose UAH12.9bn to UAH61.8bn, slightly below the record amount seen two years ago at UAH63.2bn. This is the result of absorbing funds from the banking system, which amounted to UAH5.6bn last week and UAH14.5bn during August.

As a result, liquidity fell to about UAH90bn, recovering to UAH97.5bn just last week, partially due to additional 14-day loans from NBU for UAH2.5bn, which were issued last Friday. VAT refunds, which could compensate outflows to budget accounts, were paid at UAH11.3bn, partially supported the recovery in liquidity.

ICU view: Quarterly tax payments and the low level of budget expenditures caused a new wave of funds collection in Treasury accounts that increased liquidity in the banking system, and which can be spent in September. Local-currency debt repayments at UAH8.7bn with only partial refinancing. This source pushed liquidity to above UAH100bn.

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

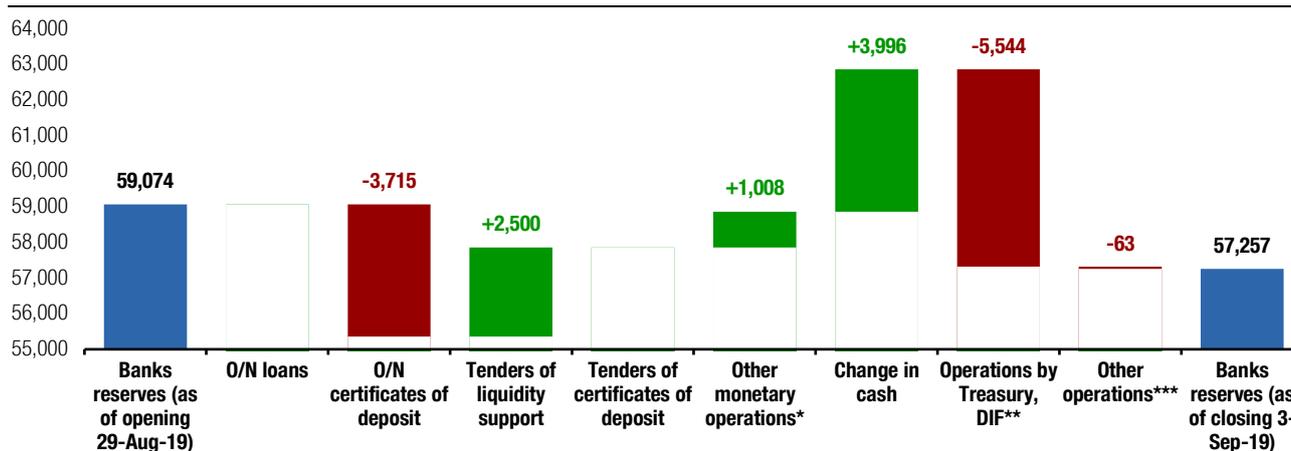
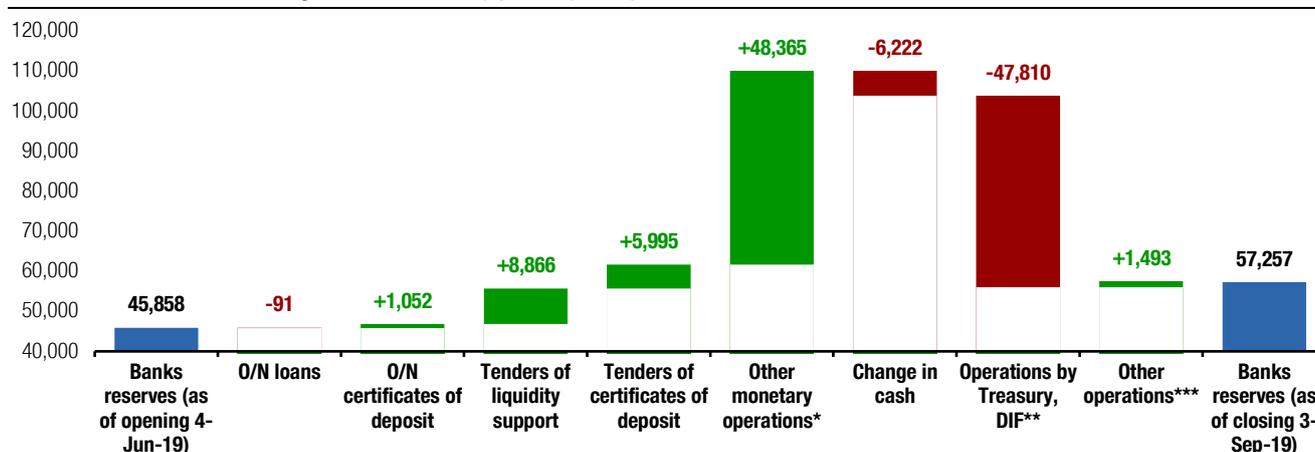


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 weakening

With the increase in banking-sector liquidity and low issuance of new T-bills, we expect the hryvnia to end the first week of September around UAH25.4/US\$.

At the end of August, the hryvnia was UAH25.11/US\$, slightly weaker than the previous week (UAH25.10/US\$), but 11% stronger than a year ago. Last month, the hryvnia was supported by foreign investors who purchased new bills at primary auctions, and from locals due to tax payments. The need to pay quarterly income tax caused an increase in the supply of hard currency, which satisfied demand, and allowed the NBU to buy some in FX reserves.

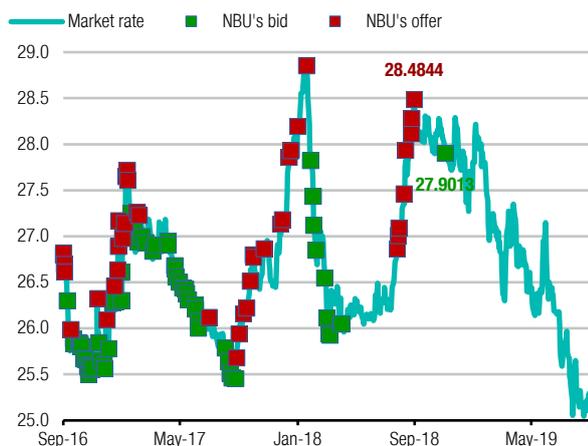
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 1.1% to 133.2, while in YoY terms, it was up 15.1%.

ICU view: *The beginning of autumn will bring lower tax payments and large debt repayments, which will result in a liquidity increase. With low demand for local-currency bills from foreign investors, supply of hard currency at local market can be low to keep exchange rate at August's levels. As the result, hryvnia should slightly weaken to about UAH25.4/US\$ at the end of this week.*

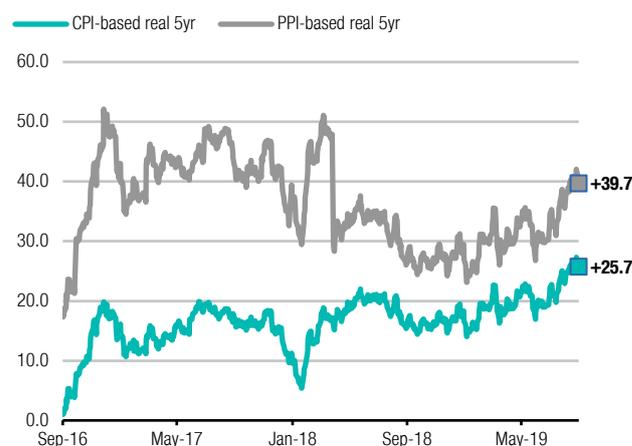
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Chart 5. FX market indicators, 3-year history

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

C/A fell to 2.5% of GDP in July

This year, Ukraine's current account will receive support from lower world energy prices and another expected record harvest.

In 7M19, the C/A deficit fell two times YoY to US\$864m. In annualized terms, it remained at the level of July 2018, but declined 10% MoM to US\$3.5bn (est. 2.5% of GDP), per data from the NBU. In July, merchandise exports surged 20% YoY, mainly thanks to a 36% YoY growth in agricultural exports (accounts for almost 70% of the total growth), mineral products (+38% YoY), and machinery and equipment (+45% YoY). In 7M19, exports of goods rose 8% YoY to US\$26.4bn. Imports of goods rose 10% YoY driven primarily by a 36% YoY increase in machinery and equipment, while energy imports declined 10% YoY. In 7M19, imports of goods rose 9% YoY to US\$33.2bn. On a 12-month trailing basis, the merchandise-trade-balance deficit was US\$13.4bn (+21% YoY) in July, while the services-trade-balance surplus soared 65% YoY to US\$1.8bn.

ICU view: Lower world energy prices, a further increase in remittances, and another expected record harvest will continue to support the C/A balance of Ukraine. We put our forecast of the 2019 C/A balance on review; it will be improved vs. previously expected deficit of 3.3% of GDP.

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Ukraine's new government

The newly formed Rada appointed Oleksiy Honcharuk (35) to replace Volodymyr Groysman as the country's Prime Minister. New cabinet has good starting positions but will face several big challenges ahead.

Ukrainian Parliament has changed all but two ministers in the government, which appears to be reform-oriented. One of the two is Minister of Finance Oksana Markarova who is supposed to ensure the continuity of the IMF talks. Despite the hostile rhetoric from the election winners toward their predecessors, the new ministers acknowledged the reforms already made.

Several of the new ministers served in the previous administration. Honcharuk stated that “the country was moving in the right direction over the previous five years, but way too slow.”

ICU view: The seemingly young and inexperienced new cabinet has good starting positions in terms of continuous GDP growth, macroeconomic stability, and inflow on foreign money into government bonds. However, it will face several big challenges in the upcoming months: a new IMF programme, introduction of the agricultural-land market, privatization, a new labour code, and the need to spur economic growth.

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