



Focus  
**Ukraine**

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

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# Weekly Insight

## Fitch upgrades Ukraine to "B"

### Key messages of the today's comments

TUESDAY, 10 SEPTEMBER 2019

### Domestic liquidity and bonds market

#### Fitch upgrades Ukraine to "B"

Taking into account recent positive developments, Fitch Ratings upgraded Ukraine to "B" with positive outlook from "B-" with stable outlook.

#### Banks repay loans

Large debt repayments together with budget expenditures allowed liquidity to rise above UAH100bn until last Friday when it declined below this level. This week, the main impact will be from budget operations and the NBU.

### Foreign exchange market

#### NBU increases FX purchases

Last week, the hryvnia exchange rate once more was very close to UAH25/US\$, and NBU had to increase purchasing hard currency from US\$20m to US\$74.5m. This week, support for the hryvnia will continue due to an increase in foreign investor purchases of T-bills.

### Economics

#### Inflation inched down to 8.8% YoY in August

Tight monetary and a restrictive fiscal policy, as well as lower world energy prices will contribute to the further slowdown of inflation.

#### NBU Cuts Key Policy Rate 50 bps to 16.5%

The regulator's decision was in line with its forecast despite indications that it would cut rates more rapidly.

### Banks' reserves market (9 September 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	16.50	-50bp	-150bp
ON rate (%)	15.29	-95bp	-146bp
ON \$ swap (%)	13.90	-71bp	-295bp
Reserves (UAHm) <sup>2</sup>	48,239	-16.89	-9.72
DepCerts (UAHm) <sup>3</sup>	47,545	+21.61	+0.00

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) (9 September 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,065	+0.00	-3.17
Banks	333,918	-1.10	-10.41
Residents	25,209	-1.21	+25.24
Individuals	9,291	-1.89	+106.37
Non-res <sup>4</sup>	86,194	-1.06	+1,069.09
<b>Total</b>	<b>791,678</b>	<b>-0.64</b>	<b>+5.16</b>

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

### FX market indicators (9 September 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.9000	-1.37	-11.88
EUR/USD	1.1048	+0.67	-4.37
DXY <sup>2</sup>	98.281	-0.73	+3.06
UAH TWI <sup>3</sup>	133.376	+0.64	+14.30

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

### Gov't bond quotes<sup>1</sup> (10 September 2019)

Maturity	Bid	Ask
6m	17.50	15.50
12m	17.50	16.00
2y	17.25	16.00
3y	17.25	16.00
12m (\$)	5.50	4.50
2y (\$)	5.50	4.50

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

## Domestic liquidity and bonds market

### Fitch upgrades Ukraine to "B"

Taking into account recent positive developments, Fitch Ratings upgraded Ukraine to "B" with positive outlook from "B-" with stable outlook.

In its report, Fitch cites a number of reasons for the upgrade: Ukraine demonstrates macroeconomic stability and declining public indebtedness, the country now has timely access to financing, and snap elections resulted in a quick appointment of the new government where key policy makers, such as Minister of Finance Oksana Markarova, remain in their positions.

Fitch expects negotiations with the IMF will be successful and will unlock macrofinancial aid from the EU and multilateral financing, which will bring better access to, and improved conditions for borrowing in external markets.

Fitch anticipates GDP growth at 3.6% in 2020 and 3.2% in 2021, they expect decline in the debt-to-GDP ratio to 47.9% (55.8% including guarantees) by end-2019, and to 44.4% by 2021.

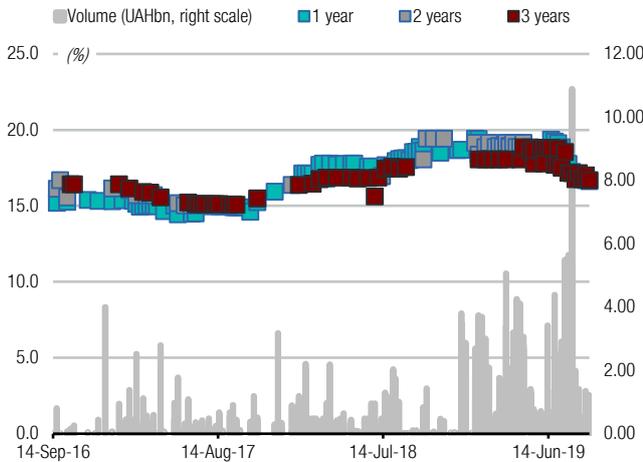
Despite a significant debt burden, including public debt amortization, which according to the report rises to US\$4.8bn in 2020 and to US\$4.6bn in 2021, Fitch anticipates that official financing, favourable markets, and continued foreign investments in T-bills will allow Ukraine to obtain financing to fulfil all debt repayments.

***ICU view: Fitch upgraded Ukraine to the same level as November 2013, but with a positive outlook (in 2013 it was negative). Fitch is the first of the three rating agencies to upgrade Ukraine. It is very likely that S&P and Moody's will review Ukraine after the 2020 budget is passed, and the government has entered into a new agreement with the IMF. The Fitch decision was welcomed by markets, resulting in increased Ukrainian Eurobonds prices, and decreased YTMs to about 6.6% at the long end of the yield curve. Five-year CDS declined to 426bp. We expect this upgrade will encourage foreign investments in local-currency debt.***

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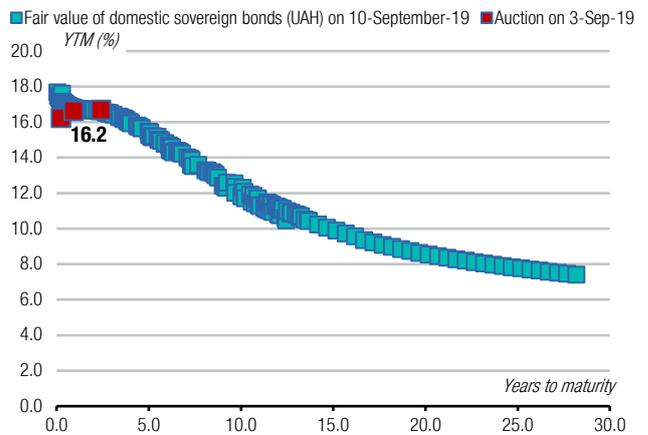
**Chart 1. Local-currency bonds**

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.

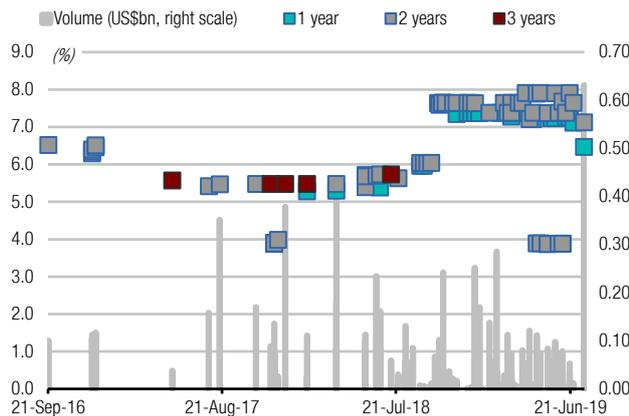
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

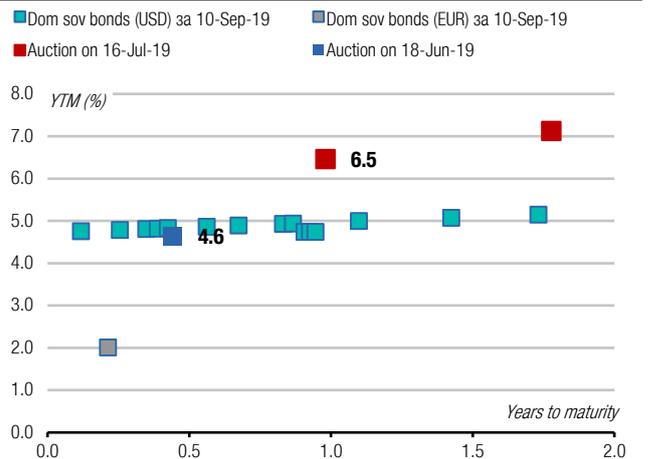
**Chart 2. FX-denominated bonds**

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.

**Banks repay loans**

Large debt repayments together with budget expenditures allowed liquidity to rise above UAH100bn until last Friday when it declined below this level. This week, the main impact will be from budget operations and the NBU.

Since 23 July, liquidity has remained below UAH100bn, setting a year low in August at UAH86.9bn. This was the result of lower FX purchases by the NBU, and less significant expenditures compared with revenue collection. Last Wednesday, thanks to large debt repayment with only partial refinancing (see [auction comment](#)), liquidity received support and rose to UAH105.9bn. Also, the NBU purchased US\$114.5m last week and injected UAH2.9bn into liquidity.

However, outflows from liquidity were seen on other days. Banks increased reserves exchange in cash, which caused UAH1.5bn of outflows. The impact from the Treasury side was also negative by the end of last week with UAH4.2bn of outflows on Thursday and Friday combined. Additionally, one bank repaid a UAH5bn NBU loan early, which caused liquidity to

decline below UAH100bn. Only the NBU injected UAH2.9bn into liquidity purchased US\$114.5m last week.

**ICU view:** This week, the budget expenditures will be important as a source for banking sector liquidity. Debt repayments this week are low, and new borrowings will exceed their amount, causing outflows. NBU can continue with hard currency purchases, but these inflows will be partially absorbed by the primary bond market. So, liquidity will very likely stay below UAH100bn.

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

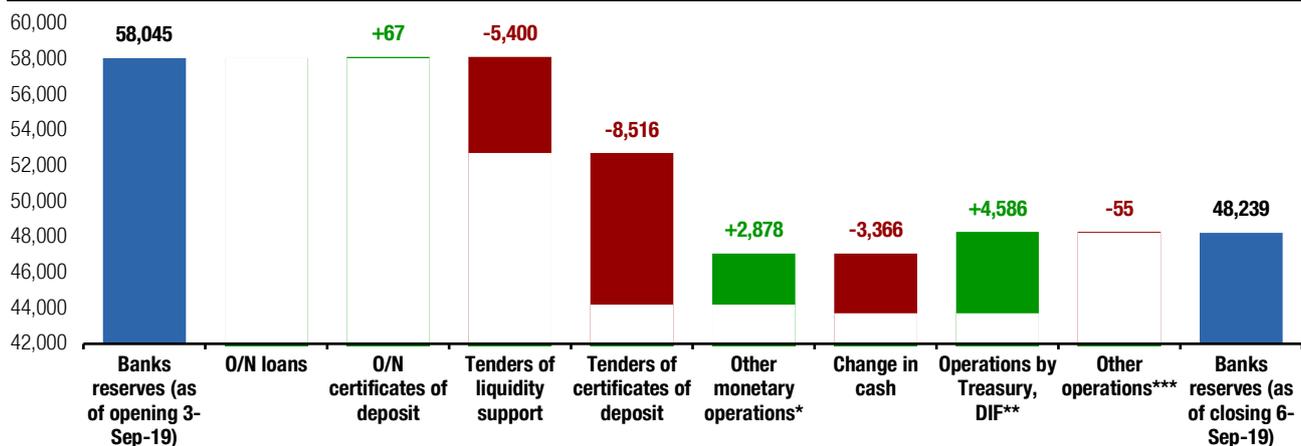
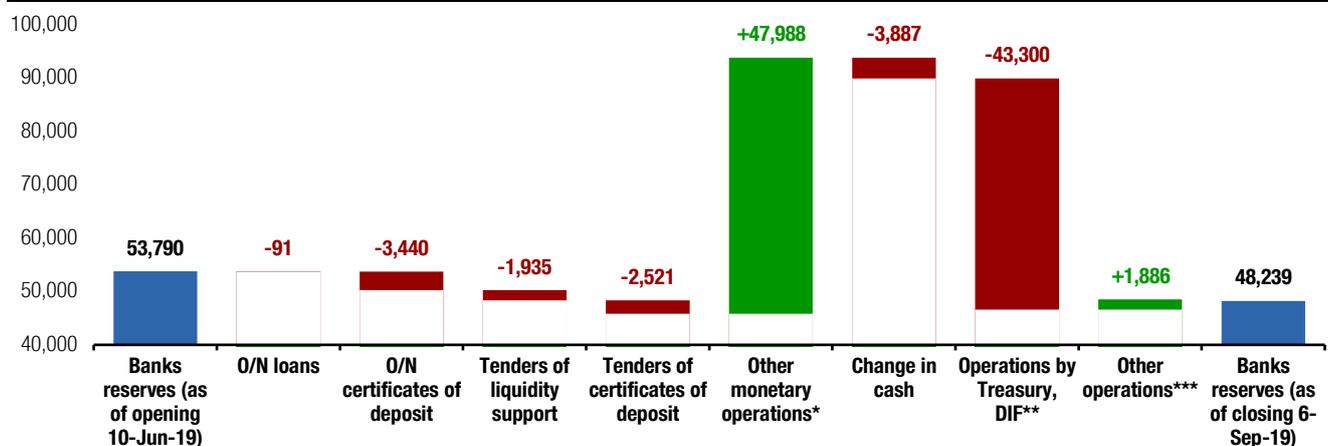


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting [https://bank.gov.ua/control/uk/publish/article?art\\_id=38643651&cat\\_id=40807142](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

### NBU increases FX purchases

Last week, the hryvnia exchange rate once more was very close to UAH25/US\$, and NBU had to increase purchasing hard currency from US\$20m to US\$74.5m. This week, support for the hryvnia will continue due to an increase in foreign investor purchases of T-bills.

The hryvnia weakened to UAH25.29/US\$ last Monday, but during the week, it strengthened by 0.14% to UAH25.075/US\$, which took place despite large debt repayments, including to foreign investors. During the second half of last week, the supply of hard currency exceeded

demand forcing the NBU to increase its purchases. Last week, the NBU purchased US\$114.5m, US\$20m on Tuesday and Thursday, and US\$74.5m last Friday.

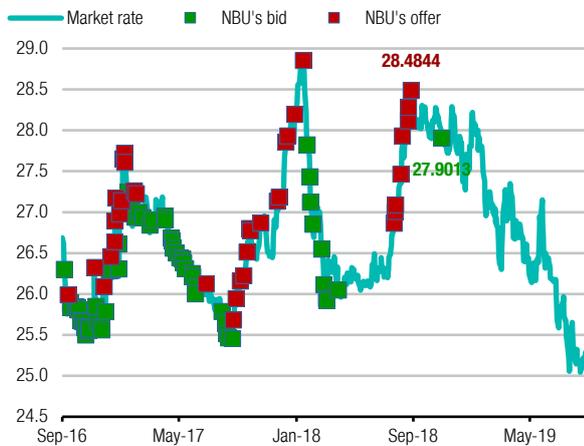
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) slid 0.5% to 132.6, while in YoY terms, it was up 13.9%.

**ICU view: The rating upgrade by Fitch likely will increase demand for UAH-denominated bills from foreign investors, providing additional support for hryvnia. The hard currency supply from exporters will be supported by a portion of FX from foreign investors, which should cause low volatility of the hryvnia exchange rate at around UAH25/US\$.**

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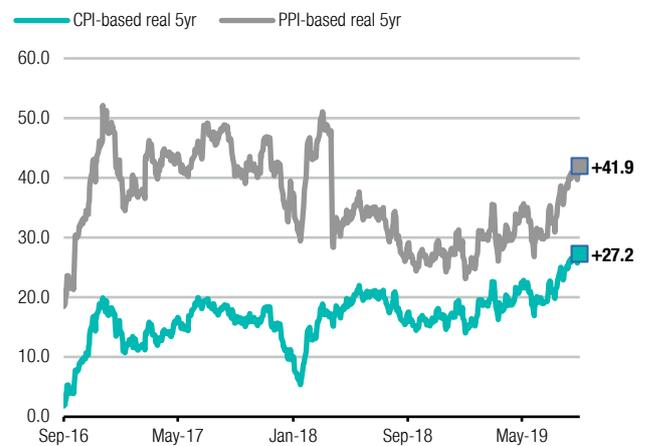
Chart 5. FX market indicators, 3-year history

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 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

### Inflation inched down to 8.8% YoY in August

Tight monetary and a restrictive fiscal policy, as well as lower world energy prices will contribute to the further slowdown of inflation.

In August, headline inflation inched down to 8.8% YoY from 9.1% YoY seen in July, while in MoM terms, prices fell 0.3%, which matches our August CPI forecast. Inflation slowdown was thanks to slower growth in the price of utilities, and particularly a decline in prices for natural gas (-5.7% YoY in August). At the same time, growth in prices for food products accelerated to 10.2% YoY accounting for 45% of the consumer basket, and this remains the main inflation driver. Core inflation fell to 7.2% YoY. The NBU forecasts headline CPI at 6.3% YoY by the end of 2019.

**ICU view: Solid consumer demand, the shifting of some costs to final customers due to further growth of wages, and the higher cost of sowing this year will continue inflationary pressure. However, given lower world energy prices as well as still-tight monetary and a restrictive fiscal policy, we expect inflation to slow to 8% by YE2019.**

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## NBU Cuts Key Policy Rate 50 bps to 16.5%

The regulator's decision was in line with its forecast despite indications that it would cut rates more rapidly.

The national bank resisted political pressure for a bigger cut, as inflation remains above the forecast. A steep increase in domestic demand driven by wage growth and an increase in remittances remain the two main risks for reaching the inflation target in 2020. It is crucial that Ukraine should reach a deal with the IMF before rates will be cut again. Another significant outstanding risk is the nationalization of Privatbank, which has not been resolved for some time.

***ICU view: There are two rate revisions left this year, and NBU expects a 50 bps cut in October and 100 bps cut in December. This is our base-case scenario, and it will depend heavily on the new IMF programme. After the government and the Fund come to an agreement, the NBU will be able to start cutting the rate by 100 bps in December and in 1Q20.***

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