

Weekly Insight

MoF offered FX-denominated bills again

Key messages of the today's comments

TUESDAY, 17 SEPTEMBER 2019

Domestic liquidity and bonds market

MoF offered FX-denominated bills again

After a two-month hiatus, last week, the Ministry of Finance offered FX-denominated bills, significantly increased budget proceeds, and replenished hard currency accounts after external debt repayments. Today, only UAH-denominated government bonds will be placed, so the volume of new funds will decline. We expect that the main participants of the placement will be foreigners, so their portfolio will continue to grow.

Budget accelerates expenditures

Last Friday, banking-sector liquidity exceeded UAH100bn for the second time in September. This was the result of an increase in budget expenditures, as well as a significant purchase of hard currency by the NBU. This week, liquidity has the potential to remain above UAH100bn.

Foreign exchange market

Hryvnia remains stronger than UAH25/US\$

Last week, the hryvnia ended at UAH24.79/US\$ due to hard currency supply exceeding demand. Demand for UAH-denominated bills from foreign investors will continue to add supply of hard currency and support the hryvnia, which we expect to remain strong, below UAH25/US\$ this week.

Banks' reserves market (16 September 2019)

| | Last | Weekly chg (%) | YoY chg (%) |
|------------------------------|--------|----------------|-------------|
| NBU rate (%) ¹ | 16.50 | +0bp | -150bp |
| ON rate (%) | 15.72 | +8bp | -219bp |
| ON \$ swap (%) | 14.26 | -17bp | -242bp |
| Reserves (UAHm) ² | 61,224 | +38.15 | +22.47 |
| DepCerts (UAHm) ³ | 43,649 | -20.18 | +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) (16 September 2019)

| | Last | Weekly chg (%) | YoY chg (%) |
|----------------------|----------------|----------------|--------------|
| NBU | 337,065 | +0.00 | -3.17 |
| Banks | 345,754 | +3.69 | -6.38 |
| Residents | 25,469 | +0.84 | +27.21 |
| Individuals | 9,958 | +7.25 | +116.90 |
| Non-res ⁴ | 88,090 | +2.21 | +1,080.70 |
| Total | 806,336 | +1.91 | +7.58 |

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

FX market indicators (16 September 2019)

| | Last | Weekly chg (%) | YTD chg (%) |
|----------------------|---------|----------------|-------------|
| USD/UAH | 24.7750 | -0.99 | -11.89 |
| EUR/USD | 1.1001 | -0.38 | -5.37 |
| DX ² | 98.610 | +0.29 | +3.88 |
| UAH TWI ³ | 133.436 | +0.58 | +14.80 |

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

Gov't bond quotes¹ (17 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.
Source: ICU.

Domestic liquidity and bonds market

MoF offered FX-denominated bills again

After a two-month hiatus, last week, the Ministry of Finance offered FX-denominated bills, significantly increased budget proceeds, and replenished hard currency accounts after external debt repayments. Today, only UAH-denominated government bonds will be placed, so the volume of new funds will decline. We expect that the main participants of the placement will be foreigners, so their portfolio will continue to grow.

Last week, the Ministry of Finance placed UAH2.8bn of new local-currency bills, which were largely purchased by non-residents. Last week, their portfolios of UAH-denominated bills grew by UAH1.9bn to UAH85.4bn, another record high. Total portfolios grew to UAH88.1bn, which is also the largest in history.

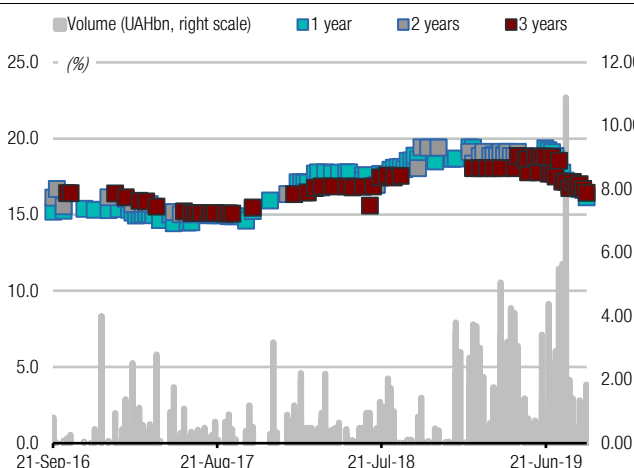
The Ministry of Finance placed FX-denominated bills last week after an almost two-month break, so demand for them had accumulated and was considerable even with the rate reduction. Most were bought by banks, and only a small part by individuals. Their portfolios increased by UAH12bn and UAH0.3bn, respectfully. With the purchase of FX-denominated bills, banks again became the largest owners of government bonds, and the portfolios of individuals approached close to UAH10bn.

ICU view: Likely, part of FX-denominated bills will be resold by banks to individuals or other clients, as there are not any new offerings scheduled soon. Therefore, today's proceeds will decline to below UAH3bn, due to the offerings being capped at this level. We anticipate that nearly half of today's bills will be purchased by foreign investors.

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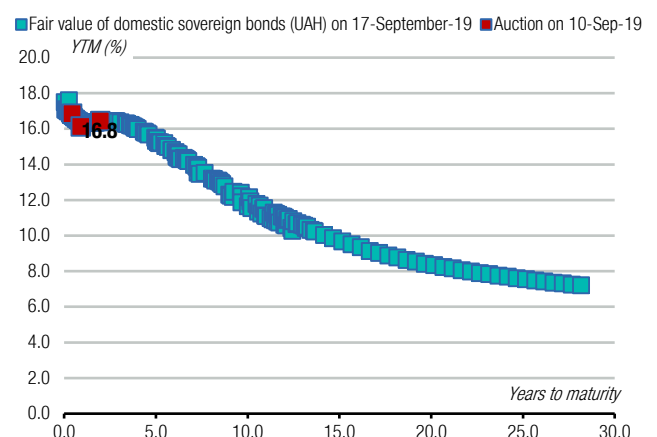
Chart 1. Local-currency bonds

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.

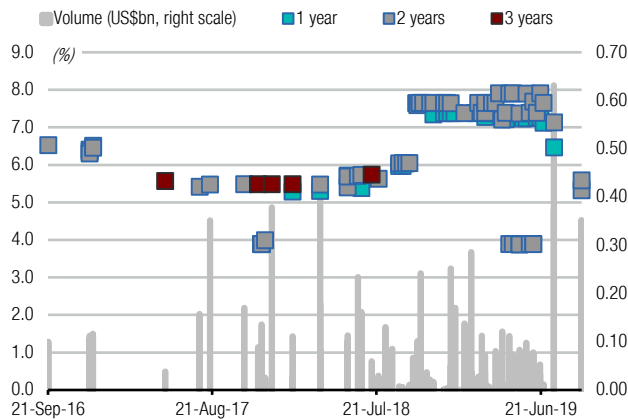
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

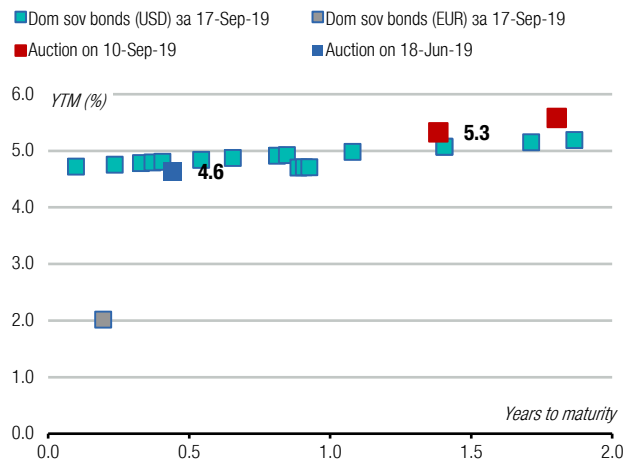
Chart 2. FX-denominated bonds

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 accelerates expenditures

Last Friday, banking-sector liquidity exceeded UAH100bn for the second time in September. This was the result of an increase in budget expenditures, as well as a significant purchase of hard currency by the NBU. This week, liquidity has the potential to remain above UAH100bn.

Having declined below UAH100bn by last Monday, banking-sector liquidity was below this level until last Friday, receiving support from the NBU and budget, but not enough to cross this level. Just last Friday, the budget significantly increased expenditures, which covered revenues collection, increasing liquidity to UAH104.9bn.

Last week, reserves exchange in cash caused decreased liquidity, while other components provided additional funds. Reserves exchange in cash caused liquidity to decline by UAH2.8bn, which was compensated by an injection from the NBU via hard currency purchases at UAH4.9bn. Last week, additional inflow provided by the Treasury via budget expenditures in the amount of UAH8.5, including UAH5.3bn on Friday.

ICU view: Large amounts of hard currency purchases were likely due to other activities, not only purchases of UAH-denominated bills, since this amount was exceeded. Therefore, only part of funds that the NBU will inject into liquidity this week can be transferred to Treasury accounts. Additionally, after accumulating significant reserves, the government has started to spend more, and this week, it can spend more than collected revenues. Therefore, we do not expect a significant decline in liquidity, which will stay above UAH100bn.

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

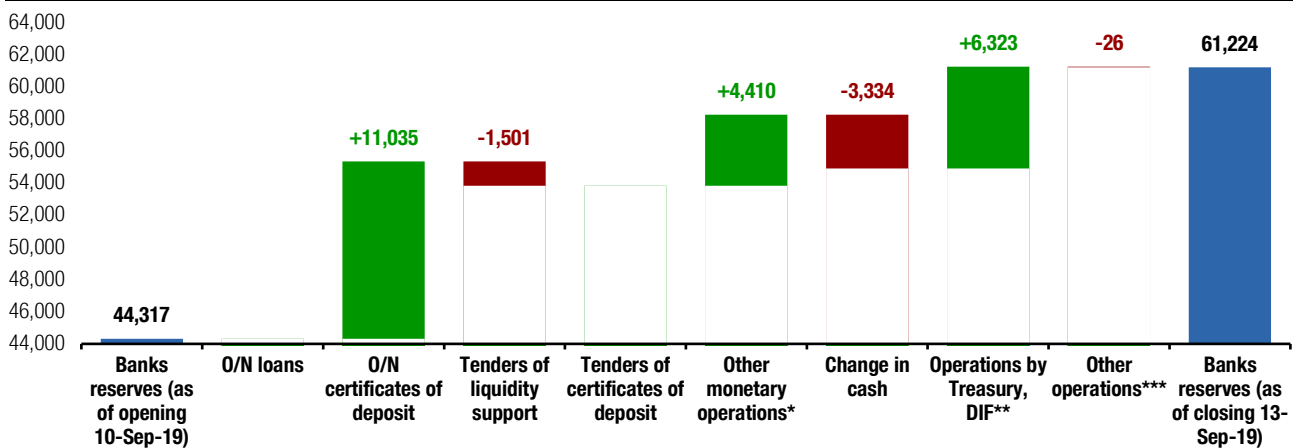
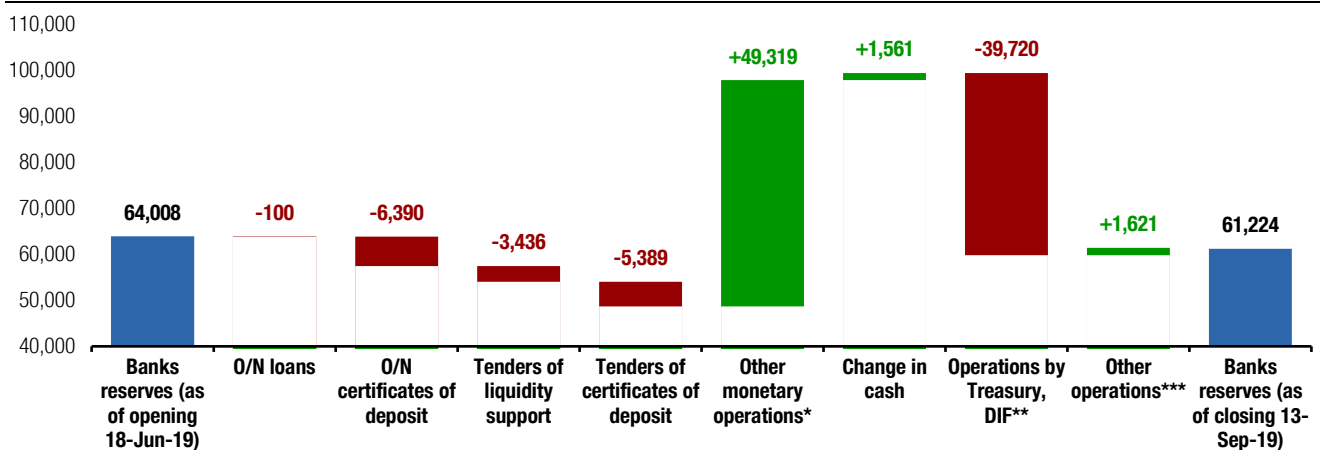


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 remains stronger than UAH25/US\$

Last week, the hryvnia ended at UAH24.79/US\$ due to hard currency supply exceeding demand. Demand for UAH-denominated bills from foreign investors will continue to add supply of hard currency and support the hryvnia, which we expect to remain strong, below UAH25/US\$ this week.

The hryvnia began last week with an unsuccessful attempt to weaken above UAH25/US\$, crossing this level last Tuesday. But on Wednesday, which was settlement day for government bills sold at Tuesday's auction, the exchange rate once more strengthened, and by the end of last week was below UAH25/US\$. Last week the hryvnia added 1.14%, appreciating to UAH24.79/US\$.

NBU allowed these movements, since between Monday and Wednesday, they purchased US\$20m per day from the market, and increased that amount to approximately US\$60m last Thursday and US\$80m last Friday. In total, last week, the NBU purchased US\$198m from the market.

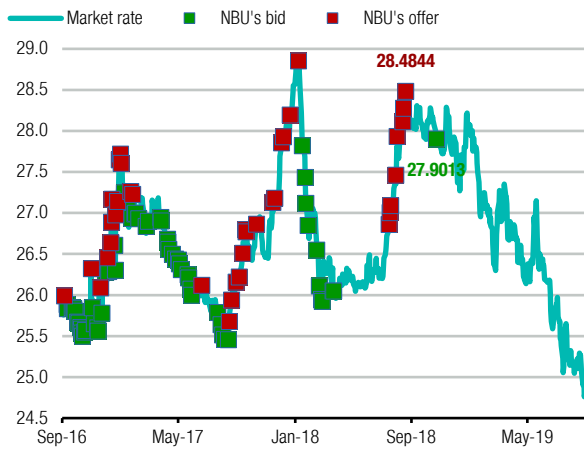
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.35% to 133, while in YoY terms, it was up 14.9%.

ICU view: This week, we expect an increase in the supply of FX partially absorbed by the NBU, although not enough to affect the hryvnia exchange rate, which should hold below UAH25/US\$. Support will be provided by exporters with additional demand for the hryvnia from foreign investors as they continue to increase their holdings of local-currency bills.

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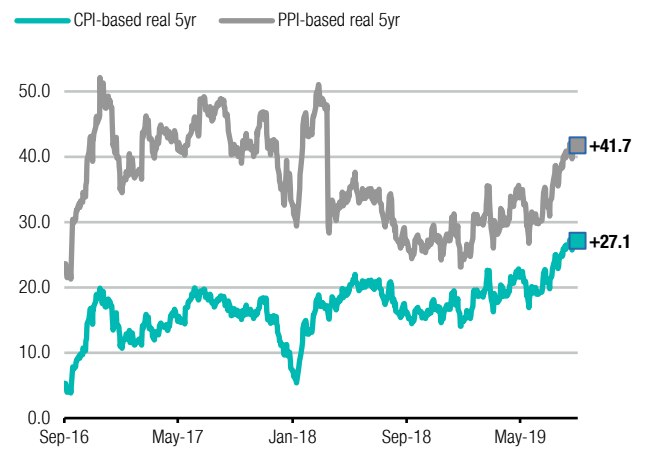
Chart 5. FX market indicators, 3-year history

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.

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