



Focus
Ukraine

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

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Weekly Insight

Demand for FX prevailing

Key messages of the today's comments

Domestic liquidity and bonds market

Foreigners share of T-bills near 15%

Resumption of auctions for primary bonds increases the possibility for foreigners to invest new funds in T-bills. Their share of total bonds outstanding increased to 14.7%, and, this week, we could see their share rise above 15%.

Liquidity rose due to VAT refunds

Last week, banking-sector liquidity set a new record high, reaching UAH234.9bn. This was the result of active VAT refunds, partially postponed from last December. This week, liquidity can slightly decline as it will depend on hard currency purchases by the NBU and month-end tax payments that started this week.

Foreign exchange market

Demand for FX prevailing

Last week, the hryvnia lost 1.7%, losing some of last year's gains. But month-end tax payments and demand for local-currency paper from foreigners should support the hryvnia and prevent it from weakening.

TUESDAY, 21 JANUARY 2020

Banks' reserves market (20 January 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	13.50	+0bp	-450bp
ON rate (%)	11.67	+12bp	-504bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	60,251	-7.11	+12.61
DepCerts (UAHm) ³	174,681	+7.68	+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) (20 January 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,065	+0.00	-2.14
Banks	323,636	-1.58	-11.87
Residents	24,480	-9.26	+16.18
Individuals	9,446	-4.15	+50.12
Non-res ⁴	119,402	+3.63	+1,440.34
Total	814,030	-0.47	+8.97

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (20 January 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.3262	+2.14	-12.94
EUR/USD	1.1095	-0.30	-2.36
DX ²	97.606	+0.24	+1.32
UAH TWI ³	134.178	-1.89	+15.21

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (21 January 2020)

Maturity	Bid	Ask
6m	12.00	10.00
12m	12.00	9.75
2y	11.75	9.50
3y	11.50	9.25
12m (\$)	4.00	2.75
2y (\$)	4.50	3.20

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

Source: ICU.

Domestic liquidity and bonds market

Foreigners share of T-bills near 15%

Resumption of auctions for primary bonds increases the possibility for foreigners to invest new funds in T-bills. Their share of total bonds outstanding increased to 14.7%, and, this week, we could see their share rise above 15%.

As the result of last week’s debut primary auction (see our [auction comment](#)), foreigners’ portfolio of government bonds rose by UAH4bn (US\$165m), while UAH6bn (US\$250m) of new paper was sold vs. redemption of UAH3.5bn (US\$145m) of old paper seen last week. So, foreign investors could purchase a larger amount of notes by reinvesting funds received from redemption.

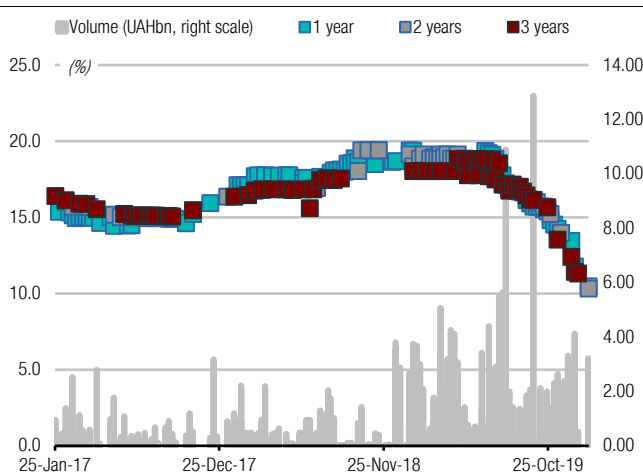
After redeeming existing bills and new purchases, banks’ share slid to 39.8%, the first time since February 2017, below 40% of total bonds outstanding. At the same time, NBU’s portfolio remained steady, but its share rose to 41.4%.

ICU view: This week, we anticipate that most new issues will be purchased by foreigners, and their share will continue to increase. It is very likely that portfolios will rise by UAH5bn (US\$200m) with their share in total bonds outstanding increasing above 15%, as there will be redemptions from the NBU’s portfolio.

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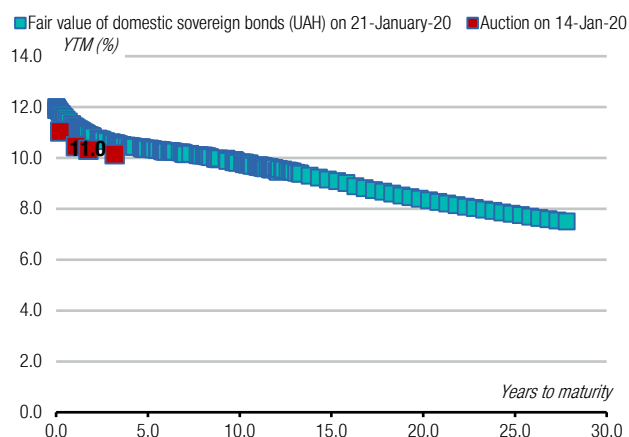
Chart 1. Local-currency bonds

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.

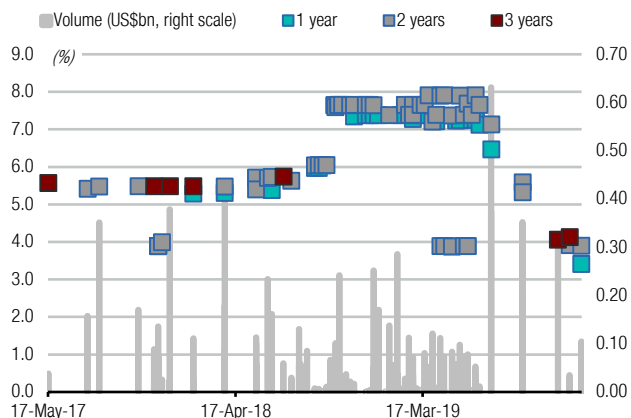
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

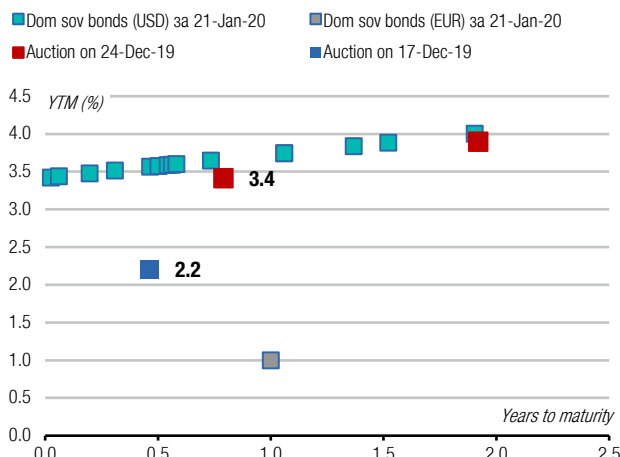
Chart 2. FX-denominated bonds

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 rose due to VAT refunds

Last week, banking-sector liquidity set a new record high, reaching UAH234.9bn. This was the result of active VAT refunds, partially postponed from last December. This week, liquidity can slightly decline as it will depend on hard currency purchases by the NBU and month-end tax payments that started this week.

During December, the government paid just UAH9.8bn in VAT refunds, less than in previous months. But this year, during the first two weeks of January, VAT refunds amounted to UAH6.5bn. According to Treasury data, a large part of last week’s VAT refunds were approved last October and November, but were not paid.

Such large payments increased the positive impact of Treasury operations this year to UAH12.7bn, and last week’s inflow amounted to UAH6.5bn. Additional funds were injected by the NBU by purchasing US\$100m from the market, and UAH0.5bn of liquidity increase was provided by cash exchange in reserves.

So, last week, liquidity rose to UAH234.9bn, including UAH174.7bn of NBU CDs, where UAH125bn of CDs have 14-day maturities.

ICU view: *This week, we expect the net impact of Treasury operations will be negative, as there will be bond purchases and month-end tax payments. This impact can be partially compensated by the NBU through purchases of additional hard currencies in the FX market.*

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

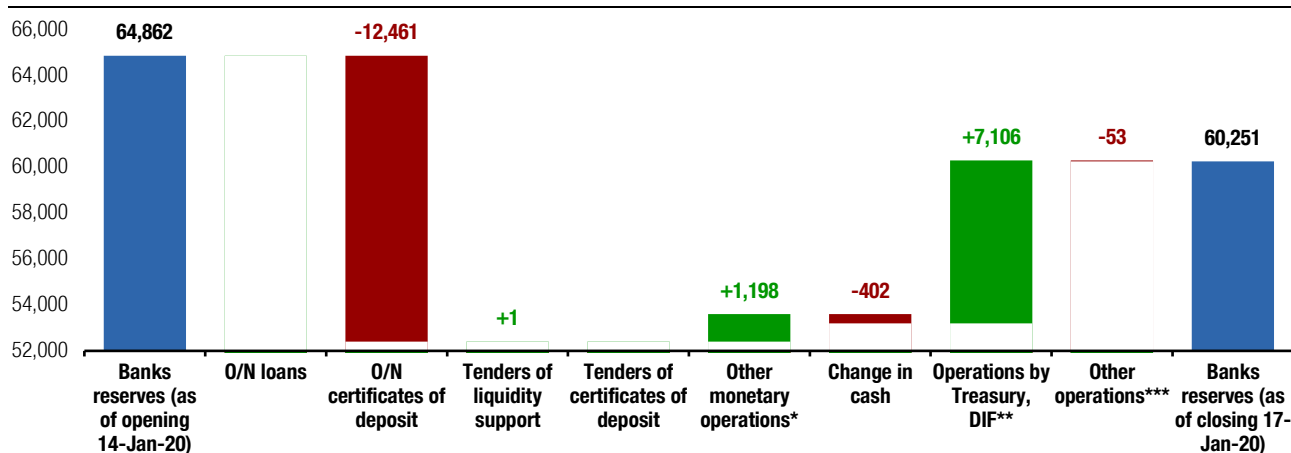
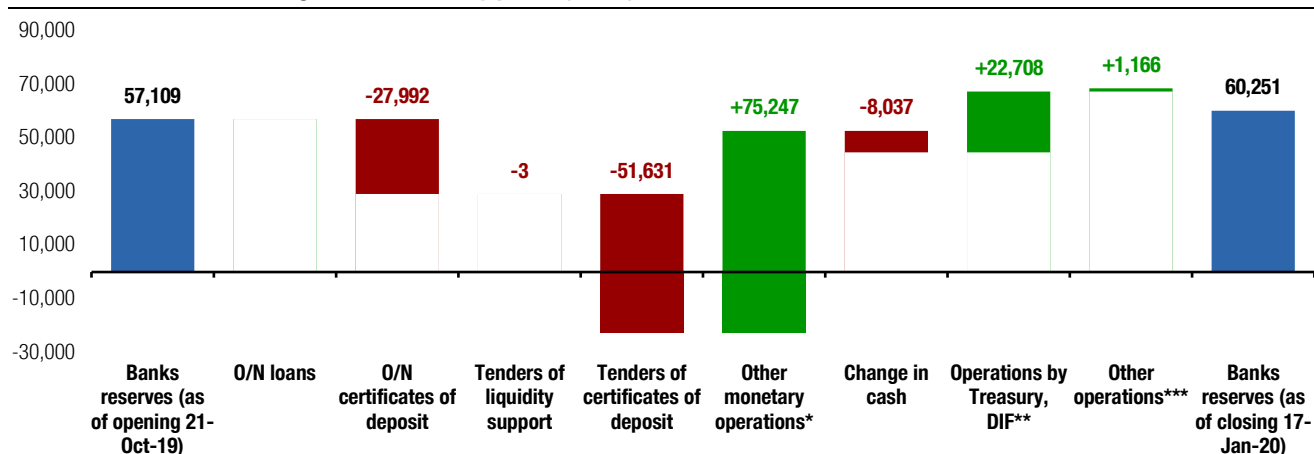


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Demand for FX prevailing

Last week, the hryvnia lost 1.7%, losing some of last year's gains. But month-end tax payments and demand for local-currency paper from foreigners should support the hryvnia and prevent it from weakening.

The hryvnia ended last week at UAH24.30/USD, weakening by 1.65% last week and by 2.24% YTD. But compared with levels one year ago, the hryvnia has appreciated by 14%. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) declined 1.4% to 134.3, while in YoY terms, it was up 15.6%.

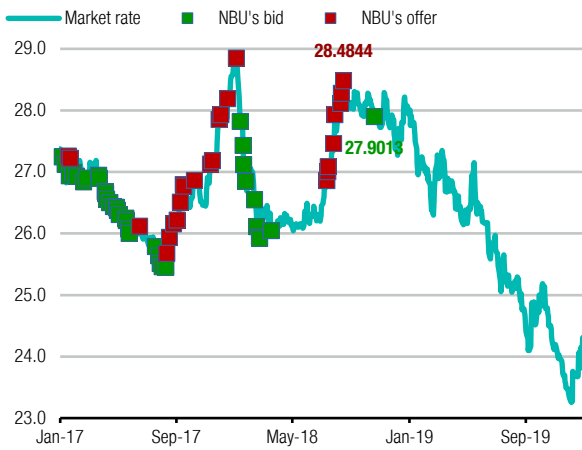
The weakening was caused by a low supply of hard currencies from exporters and foreign investors in government bonds, as offerings for bonds are still capped. Active VAT refund (see comment above) also had a negative impact on USD, as it weighed on hard currency supply from exporters. Additionally, last week, foreigners could reinvest some funds from debt repayments, and sell less FX than usual. This year, the daily turnover in the FX market was about US\$370m, or nearly 15% lower than during 2H19, when it was above US\$430m per day.

ICU view: This week, we expect more active FX selling by foreigners after the primary auction. Exporters likely will become more active, too, since they'll need liquidity for month-end tax payments. They can add hard currency supply to the FX market and increase daily turnover, making the hryvnia's exchange rate steadier or even stronger later this month.

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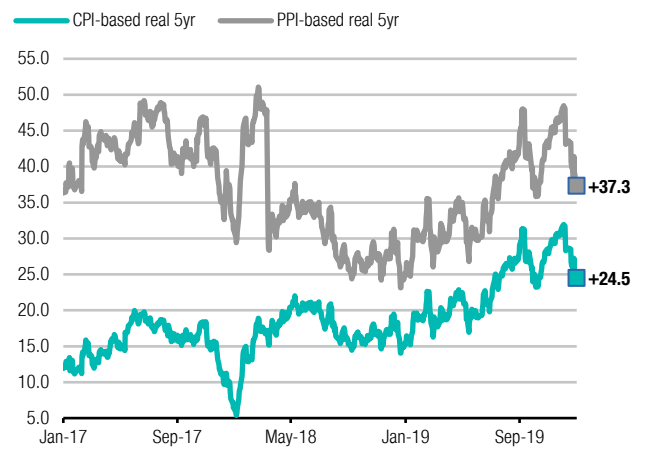
Chart 5. FX market indicators, 3-year history

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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