

# Weekly Insight

## Ukraine issues Eurobonds at 4.375%

### Key messages of the today's comments

MONDAY, 27 JANUARY 2020

### Domestic liquidity and bonds market

#### Ukraine issues Eurobonds at 4.375%

Today, Ukraine will receive funds from last week's Eurobonds issue, which was priced at the record low rate of 4.375%. This level is lower than for some countries with higher credit ratings.

#### Investors wait for seven-year notes

Last week, three-year notes did not see large demand, while total demand for the auction fell more than two times compared with the debut auction this year. Likely, investors postponed investments in new government paper waiting for the MoF to offer seven-year notes this week.

#### Liquidity remains above UAH230bn

Despite a negative balance of NBU and Treasury operations, liquidity stayed slightly at UAH237bn. However, this week we could see a decline in liquidity due to bond purchases and month-end tax payments.

### Foreign exchange market

#### Hryvnia volatility increases

Last week, the hryvnia traded actively against the US dollar, but the range was not large. NBU's participation in the market curbed weakening, but not volatility. This week, volatility will continue as a reaction to foreigners' investments in bonds as well as tax payments, with possible appreciation to slightly above UAH24/USD.

### Economics

#### Weak 4Q19 to hurt FY19 GDP growth

A sizable drop in industrial production and agricultural output implies a significant slowdown of real GDP growth in 4Q19 as well as lower-than-expected FY19 economic growth.

### Banks' reserves market (24 January 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	13.50	+0bp	-450bp
ON rate (%)	11.30	-37bp	-511bp
ON \$ swap (%)	10.27	+0bp	-460bp
Reserves (UAHm) <sup>2</sup>	55,104	-4.85	-0.17
DepCerts (UAHm) <sup>3</sup>	176,094	+0.73	+222.02

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) (24 January 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	334,565	-0.74	-2.68
Banks	328,282	+1.28	-11.57
Residents	24,033	-1.64	+19.85
Individuals	9,570	+1.66	+48.98
Non-res <sup>4</sup>	121,611	+2.09	+1,164.98
<b>Total</b>	<b>818,061</b>	<b>+0.47</b>	<b>+8.97</b>

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

### FX market indicators (24 January 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.4400	+0.56	-12.43
EUR/USD	1.1025	-0.60	-2.47
DX <sup>2</sup>	97.853	+0.25	+1.30
UAH TWI <sup>3</sup>	134.411	+0.06	+15.14

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

### Gov't bond quotes<sup>1</sup> (27 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](http://www.icu.ua).  
Source: ICU.

# Domestic liquidity and bonds market

## Ukraine issues Eurobonds at 4.375%

Today, Ukraine will receive funds from last week's Eurobonds issue, which was priced at the record low rate of 4.375%. This level is lower than for some countries with higher credit ratings.

Expected at the beginning of the year, last Wednesday, the Ministry of Finance closed a deal to raise EUR1.25bn of external financing. Demand for the new EUR-denominated bond came in at about EUR7bn, allowing the rate to be set at 4.375%, down from the initial target of 5%.

This level is unusual for countries with ratings of "B" from S&P and Fitch, and "Caa1" from Moody's. Ukraine's bonds priced better than that day were trading 10-year EUR-denominated bonds issued by countries with better ratings, such as "B" countries with 10-year bonds, Egypt and Cote d'Ivoire. They have ratings of "B+" from Fitch and from Moody's "B2" and "Ba3," respectively. But their bonds were trading at 4.8% and 4.6% respectively.

**ICU view: With this issue, the MoF received nearly one-third of planned external financing for the state budget, receiving just a part of about US\$9bn of hard currency needed for debt repayments. Hard currency, which will be available for the MoF after this issue, according to our estimate, will cover debt repayments scheduled for 1Q20. So, we expect that the MoF will add some FX-denominated bills in its auctions schedule, and will make a second attempt to raise money externally later in March.**

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## Investors wait for seven-year notes

Last week, three-year notes did not see large demand, while total demand for the auction fell more than two times compared with the debut auction this year. Likely, investors postponed investments in new government paper waiting for the MoF to offer seven-year notes this week.

Last week's three-year note offering received demand lower than the offered amount (see our [auction comment](#)). Total demand fell more than 50% compared with the auction held on 14 January, and was mostly concentrated in shorter maturities, those for six and 14 months. As a result, last week, foreigners increased their portfolios by UAH2.4bn to UAH121.8bn, and their share in total bonds outstanding increased to 14.9%.

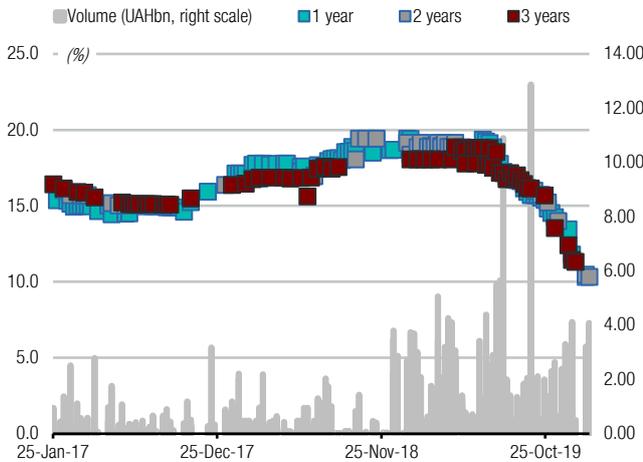
Most likely, the decline in demand for the three-year maturity was due to investors waiting for the seven-year note that will be offered this week. This paper will mature in May 2027. We expect strong interest from foreigners, who will form the bulk of demand for the government's local-currency instruments.

**ICU view: We expect that demand will exceed offered amounts, including the seven-year note, enabling the MoF to cut rates and set the coupon for the seven-year below 10%. Otherwise, we do not anticipate a significant decline in rates tomorrow, as the potential decrease in NBU's key policy rate this week was already priced in at the two previous auctions.**

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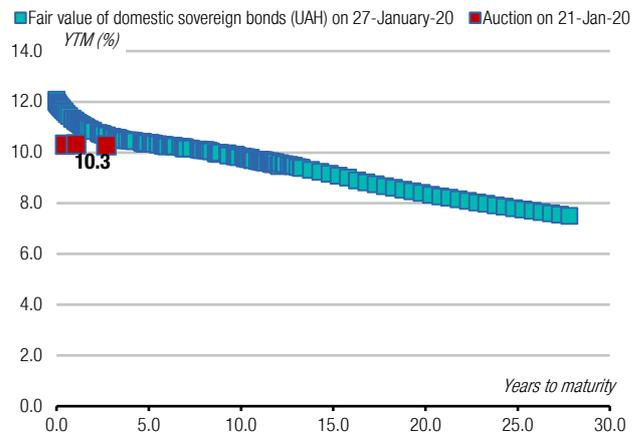
**Chart 1. Local-currency bonds**

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.

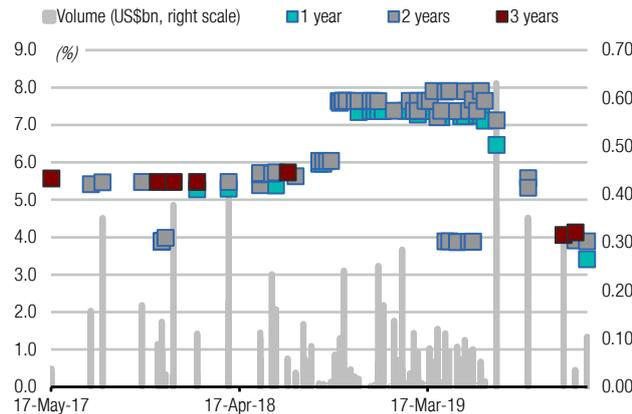
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

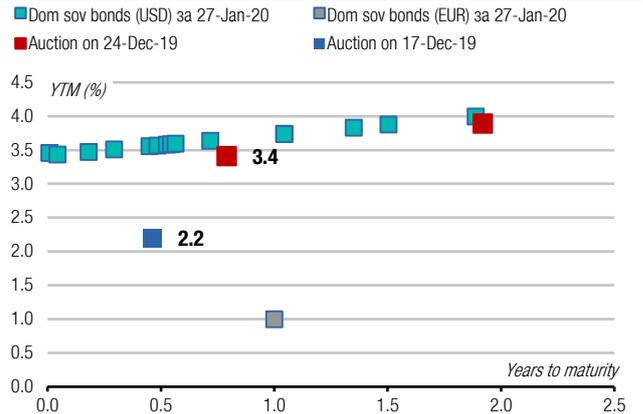
**Chart 2. FX-denominated bonds**

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 remains above UAH230bn**

Despite a negative balance of NBU and Treasury operations, liquidity stayed slightly at UAH237bn. However, this week we could see a decline in liquidity due to bond purchases and month-end tax payments.

Last week, the NBU had to change the direction of its operations in the FX market, selling net US\$26.5m, and absorbing UAH0.7bn of banking-sector liquidity.

Also, the Treasury had a negative impact on liquidity as it absorbed UAH1.6bn last week when it received funds from a bond issue and through month-end tax payments. Last Thursday and Friday, tax payments amounted to UAH13bn.

Cash exchange in reserves compensated outflows, provided banking sector-liquidity with UAH3.7bn, steadily returning funds exchanged in cash last December.

**ICU view: This week, we expect liquidity will continue to decline, as bonds can be sold in larger amounts than debt repayments, and tax payments will be more active than last week. But liquidity should remain high and steady above UAH230bn**

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

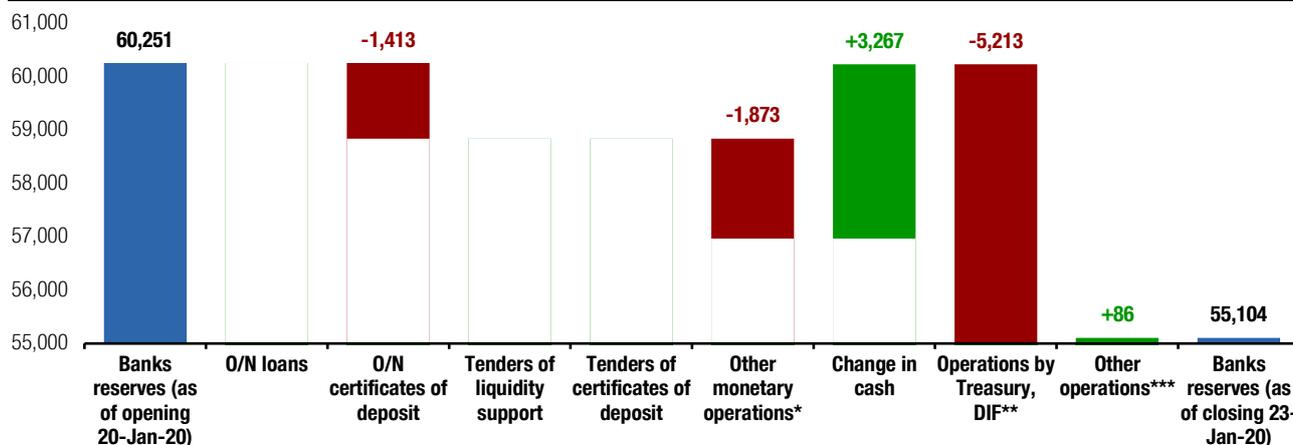
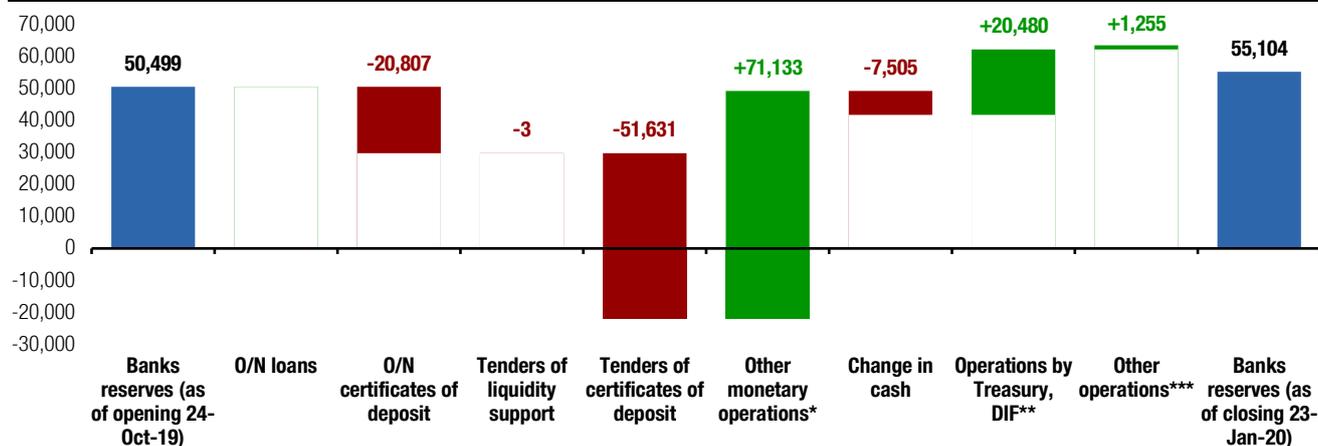


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

### Hryvnia volatility increases

Last week, the hryvnia traded actively against the US dollar, but the range was not large. NBU's participation in the market curbed weakening, but not volatility. This week, volatility will continue as a reaction to foreigners' investments in bonds as well as tax payments, with possible appreciation to slightly above UAH24/USD.

Last week, the hryvnia lost 0.6% after a few days of divergent dynamics. Market conditions were mostly against the hryvnia, moving the exchange rate towards UAH25/USD. But NBU's attempts to restrain this movement and satisfy extra demand increased volatility.

Last Thursday, the NBU accepted extra demand, but later exporters started to sell hard currencies to pay taxes, causing the hryvnia to appreciate to better level than was seen at the end of last week. But last Friday, the hryvnia started to weaken again, with the NBU's participation in the market as buyer of hard currency.

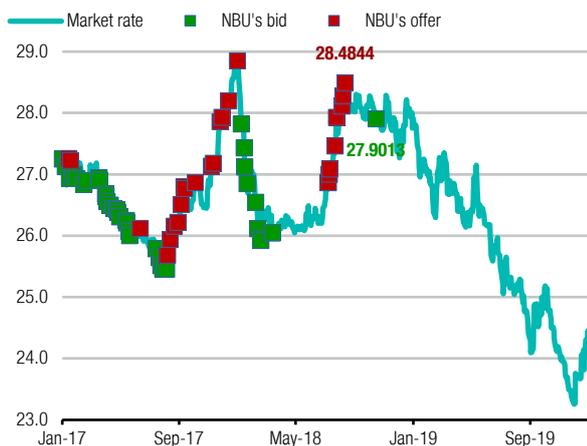
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.1% to 134.4, while in YoY terms, it was up 15.1%.

**ICU view: This week, we expect hard currency inflows from foreigners and exporters, decreasing the necessity of the NBU to intervene. With an active supply of hard currency in the market, the hryvnia could appreciate to slightly above UAH24/USD. Opposite impact can have VAT refund which can happen this week.**

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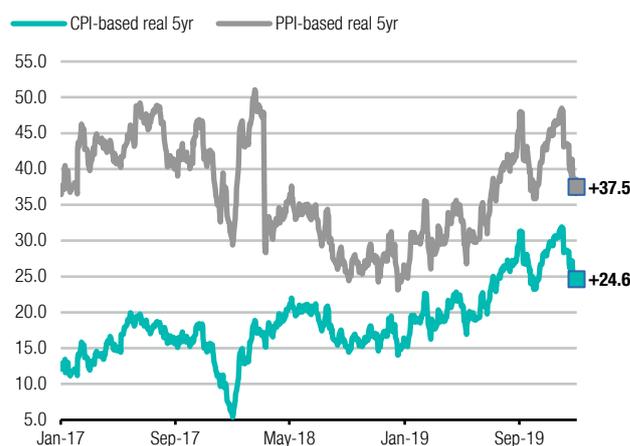
**Chart 5. FX market indicators, 3-year history**

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 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

### Weak 4Q19 to hurt FY19 GDP growth

A sizable drop in industrial production and agricultural output implies a significant slowdown of real GDP growth in 4Q19 as well as lower-than-expected FY19 economic growth.

Last week, Ukrstat released statistics on the performance of real sectors of the economy in December. Industrial production dropped further by 7.3% YoY and 1.1% MoM SA. A decrease in output was seen in all major subsectors — mining (-8.5% YoY), processing industry (-5.4% YoY), and utilities sector (-15.7% YoY). Agricultural output contracted 14.4% YoY, while cargo turnover fell 0.8% YoY. On the flip-side, still positive performance was posted by retail turnover (+12.5% YoY), construction (+7.4% YoY), and passenger turnover (+1.8% YoY).

**ICU view: Our calculations based on the Ukrstat data show that industrial production contracted 7.5% YoY in 4Q19 as 1) unusually warm weather in autumn and winter caused a decrease in coal mining and electricity production, while 2) the processing industry saw a broad-based decline, with the largest hit coming from a lower metallurgical sector against the backdrop of lower world steel prices, higher iron ore prices, and the stronger UAH. We also estimate 4Q19 agricultural output plunged 12% YoY due to lower sunflower and sugar beet harvest and animal production. On the flip-side, retail sales rose a robust 12.6% YoY supported by high consumer confidence, falling inflation and the stronger UAH, while construction rose 18.5% YoY prompted by investments in alternative energy. Some improvement was seen in the transport sector, which expanded an estimated 2.7% YoY vs. 0.6% YoY in 3Q19.**

**While retail sales and high consumer confidence point to strong performance of services sector, a more significant plunge (vs our expectations) in industrial**

*production and agricultural output will cause 4Q19 real GDP to slow more significantly vs. our expectations of 3% YoY growth to below 2% YoY, bringing the FY19 reading close to 3.2% growth. For FY20, we still expect the economy to grow 3.2% supported by lower interest rates, solid consumer and investment demand, albeit subject to the implementation success of the reforms.*

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