



Focus
Ukraine

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

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Weekly Insight

Shevchenko appointed new NBU Governor

Key messages of the today's comments

TUESDAY, 21 JULY 2020

Domestic liquidity and bonds market

Foreigners' portfolios continue to decline

This month, foreigners' portfolios of local-currency bills declined by UAH4.1bn (US\$150m), including UAH2.2bn (US\$80m) last week. This week, with no debt redemptions, portfolio can decline by about UAH1.5-2bn (US\$50-70m).

Liquidity stabilizes above UAH160bn

Total banking-sector liquidity has been fluctuating slightly above UAH160bn without the NBU's support and with low injections from the Treasury. We expect to see a similar level of liquidity this week, with positive impact from Treasury being compensated by further increase in demand for cash.

Foreign exchange market

FX market nervous

The appointment of new NBU governor Kyrylo Shevchenko did not have positive impact on the FX market. Last week, the hryvnia weakened to UAH27.4/US\$. We expect further hryvnia weakening this week as market participants are waiting to see what steps the new NBU governor will take, especially since the NBU will review its key policy rate this week.

Economics

Shevchenko appointed new NBU Governor

The Former head of the state-owned bank will have to prove NBU's independence while delivering on the president's agenda to boost corporate and mortgage lending.

Banks' reserves market (20 July 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	6.00	+0bp	-1,100bp
ON rate (%)	5.59	+9bp	-1,005bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	52,726	-9.97	-5.19
CDs (UAHm) ³	110,518	+7.62	+0.00

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's certificates of deposit.

Source: NBU, Bloomberg, ICU.

Breakdown of govt bond holders (UAHm) (20 July 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	413,177	+2.87	+18.82
Residents	29,083	+3.37	+13.44
Individuals	7,373	+4.57	-22.75
Foreigners ¹	94,524	-2.76	+30.44
Total	868,732	+1.19	+9.63

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (20 July 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.5714	+1.77	+7.14
EUR/USD	1.1448	+0.42	+2.02
DXY	95.832	-0.44	-1.36
UAH TWI ¹	122.865	-1.99	-2.47

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (21 July 2020)

Maturity	Bid	Ask
6m	12.50	9.00
12m	13.00	10.50
2y	13.25	10.75
3y	13.50	11.00
12m (\$)	5.00	3.00
2y (\$)	6.00	3.50

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

Source: ICU.

Domestic liquidity and bonds market

Foreigners' portfolios continue to decline

This month, foreigners' portfolios of local-currency bills declined by UAH4.1bn (US\$150m), including UAH2.2bn (US\$80m) last week. This week, with no debt redemptions, portfolio can decline by about UAH1.5-2bn (US\$50-70m).

Foreigners decreased portfolios of local-currency bills to UAH93.2bn (US\$3.4bn) as of this morning. It is 12.3% of total local-currency bills par value or 21.5% excluding NBU portfolio.

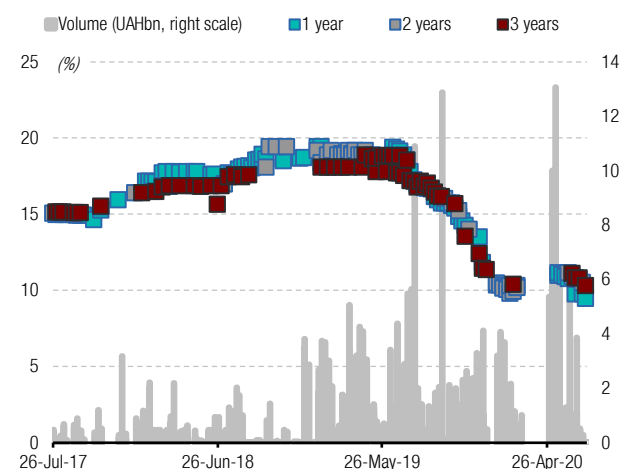
Foreigners' portfolio declines since mid-February, when was seen the largest amount of investments at UAH127.6bn (US\$5.2bn). During recent months the portfolio has been decreasing by UAH6-8bn per month.

ICU view: There will be no debt redemptions this week, which should cause the decline in portfolios by about UAH1.5-2bn (US\$50-70m). This withdrawal of funds will not have a substantial impact on the FX market, while the MoF will not be able to borrow a large amount of funds.

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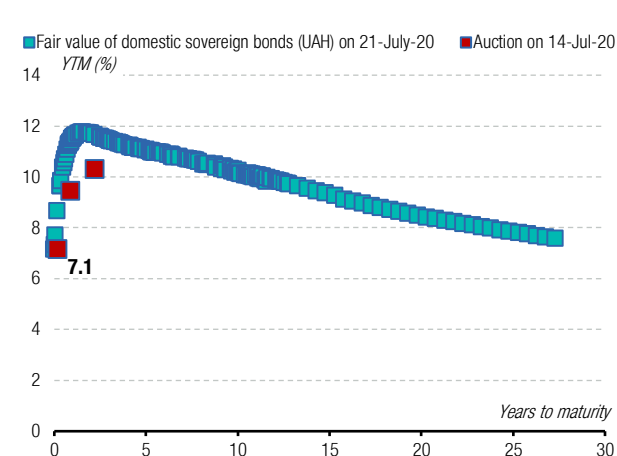
Chart 1. Local-currency bonds

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.

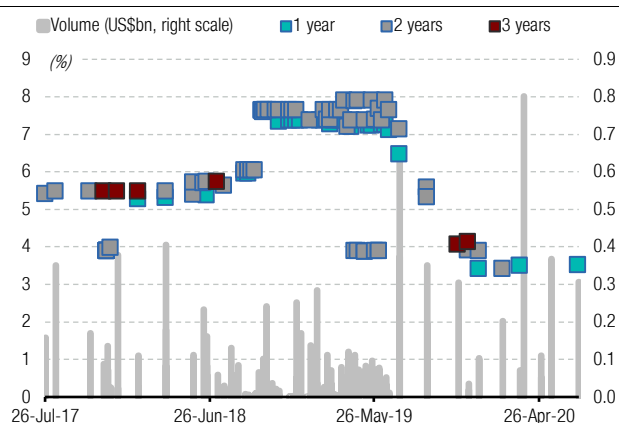
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

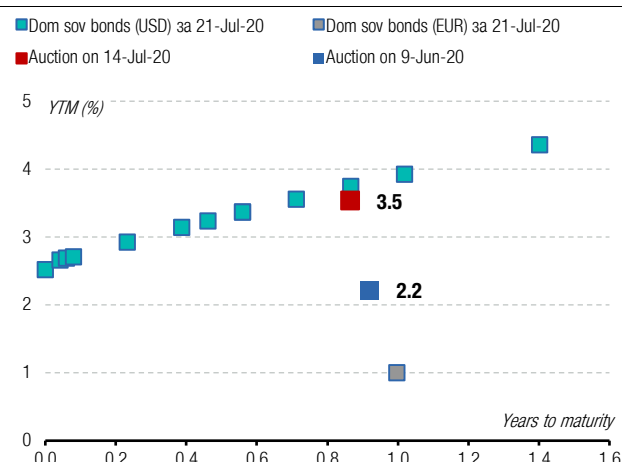
Chart 2. FX-denominated bonds

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 stabilizes above UAH160bn

Total banking-sector liquidity has been fluctuating slightly above UAH160bn without the NBU's support and with low injections from the Treasury. We expect to see a similar level of liquidity this week, with positive impact from Treasury being compensated by further increase in demand for cash.

The banking system ended last week with liquidity at UAH163bn or just UAH0.7bn more than a week before. UAH52.7bn were in banks' correspondent accounts with the NBU and UAH110.5bn in NBU CDs, where just UAH19bn was in ON CDs.

Without the NBU's interventions in the FX market, its impact on liquidity was close to zero. However, the main impact was from non-monetary operations. The Treasury injected UAH4.3bn in liquidity, while banks' reserves exchange in cash was at UAH4bn, neutralized inflow from Treasury.

ICU view: *Lack of debt redemptions, possible low demand in the primary auction, with the need to reserve funds for debt repayments later this month will not support an increase in budget expenditures. Therefore, reserves exchange in cash once more will neutralize a positive impact of budget expenditures, and will constrain liquidity increase.*

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

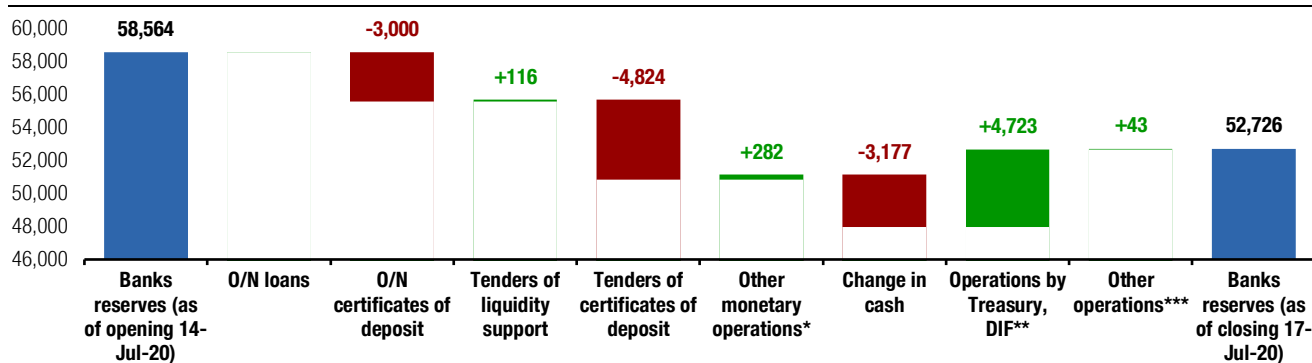
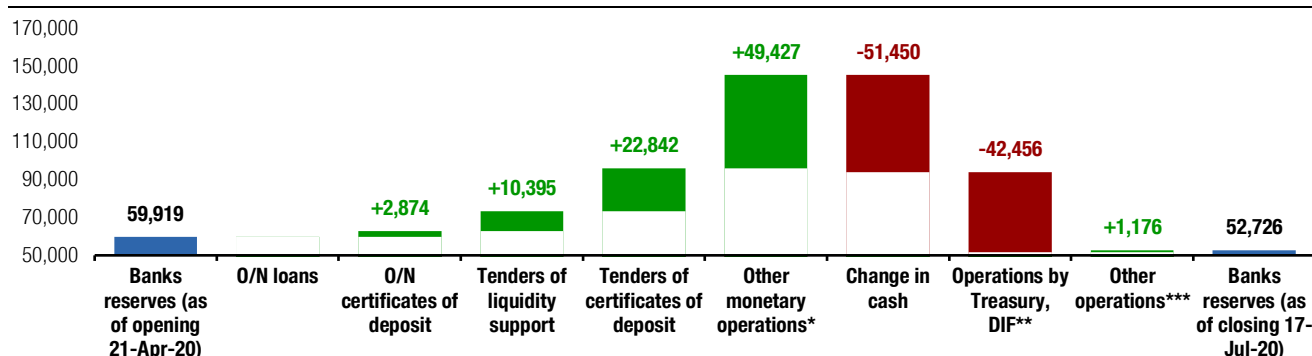


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

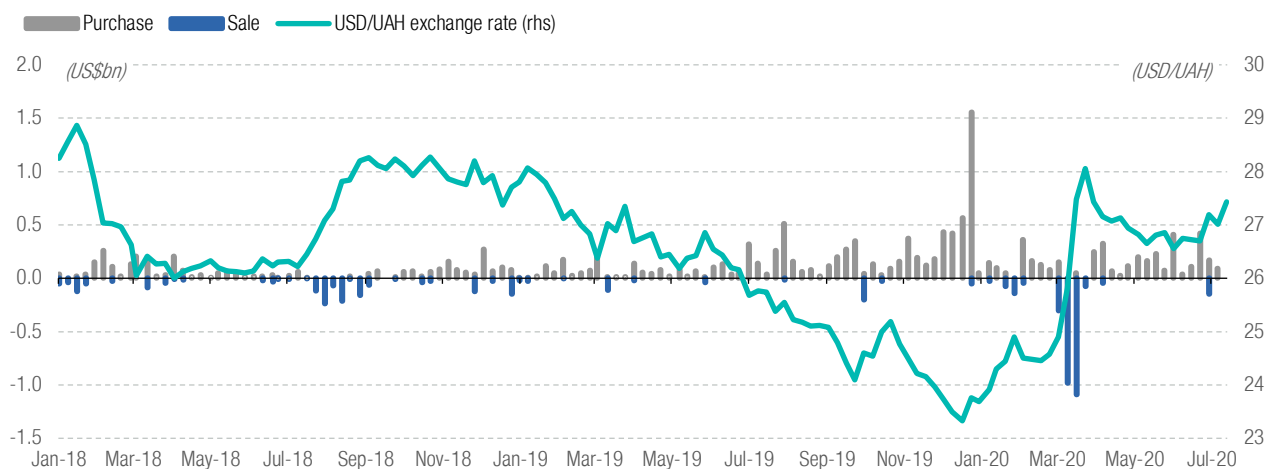
FX market nervous

The appointment of new NBU governor Kyrylo Shevchenko did not have positive impact on the FX market. Last week, the hryvnia weakened to UAH27.4/US\$. We expect further hryvnia weakening this week as market participants are waiting to see what steps the new NBU governor will take, especially since the NBU will review its key policy rate this week.

Lack of NBU interventions last week and the market reaction on new appointment caused the hryvnia to weaken by 1.5% from a week before.

ICU view: The anxiety of market participants will continue this week waiting for the Monetary Policy Committee meeting and the NBU Board decision on the key policy rate this Thursday. If the NBU does not continue to participate in the foreign exchange market, the hryvnia exchange rate will continue to weaken due to increased demand for foreign currency from both businesses and individuals. Therefore, we do not rule out that the hryvnia may reach 28 UAH/\$ by 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 and NBU interventions (weekly data)


Source: NBU, Bloomberg, ICU.

Economics

Shevchenko appointed new NBU Governor

The Former head of the state-owned bank will have to prove NBU's independence while delivering on the president's agenda to boost corporate and mortgage lending.

Rada approved the president's nomination of Kyrilo Shevchenko as the next governor of the NBU to replace Smoliy who resigned on 1 July citing political pressure. Shevchenko was the first head of the state-owned Ukgasbank appointed after a contest back in 2015, the first of such kind. Under his leadership, the bank more than doubled its loan portfolio while the rest of the banking sector decreased lending. Therefore, his candidacy looks logical from the president's point of view, since weak lending is one of the key issues he wants to tackle. Mortgages in local currency at a rate of 10% might be another area the president expects the NBU to facilitate.

ICU view: *The key concern is whether the NBU—a well-known champion of the recent reforms—will remain independent of political influence and remain a reformist institution rather than returning to its pre-2014 “yes man” role. The new NBU leadership, including Mr. Shevchenko, will, in our opinion, abstain from populist measures demanded by fractions within the parliament and will continue cooperation with the IMF.*

The next key rate review on 23 July will be the first challenge for new leadership in terms of monetary policy. Currently, economic signals are mixed and what the regulator's decision will be is not clear yet. Inflation remains low and weak demand puts little pressure on it. The hryvnia remains relatively stable on lower FX spending, especially from tourism. On the other hand, there is sign of worsening inflation and devaluation expectations while the government has announced plans for a significant hike of the minimum wage. This increases the possibility of a rate increase in 2021, which we expected even before changes at the NBU. While current conditions, in our opinion, allow for a decrease, NBU has to decide whether to go for a cut now and then increase it by a higher margin in the future, or not. The decision the NBU has to make in 2021 might be a much greater test for the regulator and its willingness to restrain inflation.

In our opinion, there is 50% chance for a 25 bps cut, a 20% chance of a larger 50-100 bps cut, and a 30% probability that the key rate remains unchanged.

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