



Focus
Ukraine

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

Research team
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Weekly Insight

Current account runs a surplus

Key messages of the today's comments

TUESDAY, 8 DECEMBER 2020

Domestic liquidity and bonds market

Foreigners are still waiting for the entry point

After small purchases of local-currency bills two weeks ago, last week, foreigners' portfolios slightly declined. Therefore, we anticipate that new bills will be purchased by local investors, mostly banks.

Liquidity stabilizes

Banking-sector liquidity was stable last week, with some fluctuations around UAH170bn. Due to restrained budget expenditures, liquidity can slightly decline due to reserves exchange in cash this week.

Foreign exchange market

Hryvnia appreciates again

The FX market was mostly self-balanced last week and hryvnia exchange rate was more under the impact of external, not Ukrainian factors. Therefore, the hryvnia appreciated a bit, but this appreciation could be short-lived. Given the increase in uncertainty over a new lockdown and growing demand for hard currency, the hryvnia is poised to weaken.

Economics

Current account runs a surplus; capital outflow continues

In October, the C/A returned to a significant surplus (US\$0.8bn), and capital outflows under the F/A continued. Looking ahead, we expect the situation with capital flows to improve and the C/A surplus to fade gradually.

Banks' reserves market (7 December 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	6.00	+0bp	-950bp
ON rate (%)	4.68	-287bp	-850bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	55,379	+7.44	-12.36
CDs (UAHm) ³	114,116	-3.36	+11.28

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 gov't bond holders (UAHm) (7 December 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	+0.00
Banks	461,720	+0.24	+7,311.46
Residents	34,940	+2.91	+1,897.84
Individuals	8,910	+0.41	+34,801.72
Foreigners ¹	75,208	-0.09	+3,195.19
Total	905,478	+0.24	+8,702.53

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (7 December 2020)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.0650	-1.52	+18.31
EUR/USD	1.2109	+0.31	+9.48
DXY	90.792	-0.57	-7.07
UAH TWI ¹	118.774	+0.82	-14.57

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (8 December 2020)

Maturity	Bid	Ask
6m	10.50	9.00
12m	11.00	10.25
2y	11.75	10.75
3y	12.00	11.00
12m (\$)	4.50	3.00
2y (\$)	5.00	3.25

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

Source: ICU.

Domestic liquidity and bonds market

Foreigners are still waiting for the entry point

After small purchases of local-currency bills two weeks ago, last week, foreigners' portfolios slightly declined. Therefore, we anticipate that new bills will be purchased by local investors, mostly banks.

The low amount of new bonds sold last week once more was in line with an increase in rates, although the MoF did reject some demand (see [auction comment](#)). New bonds purchased last week were mostly distributed between banks and non-banking investors, with individuals taking a small amount, and foreigners decreasing their portfolios.

Last Wednesday, which was the settlement day, banks increased holdings of UAH-denominated bonds by UAH1.5bn (US\$53m) and non-banks by UAH1.2bn (US\$42m), while individuals increased theirs by just UAH9m (US\$0.3m).

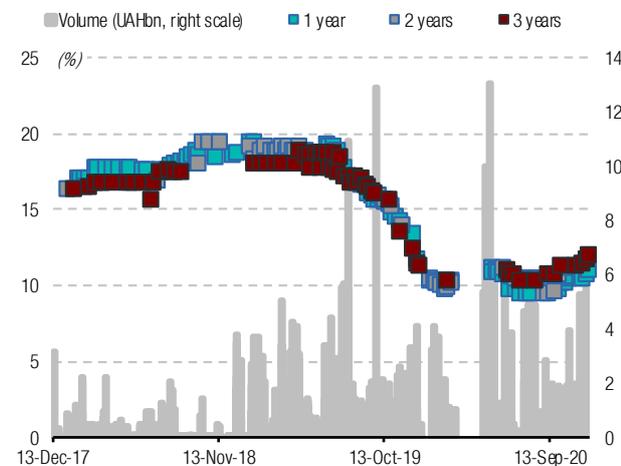
In contrast, last week, foreigners sold UAH172m of local-currency paper with low impact on their portfolios. However, this was an indication that it is too early for foreigners to be actively making new investments. Just last Friday they increased portfolio by a mere UAH3m (US\$0.1m).

ICU view: Likely, foreigners are monitoring the market and watching the trend in rate increases, waiting for the optimal time to make new investments. That could be when the increase in rates stops and the hryvnia exchange rate appears to bottom out. We can expect foreigners to again purchase new issues, on the background of increase in the appetite of portfolio investors to EM assets.

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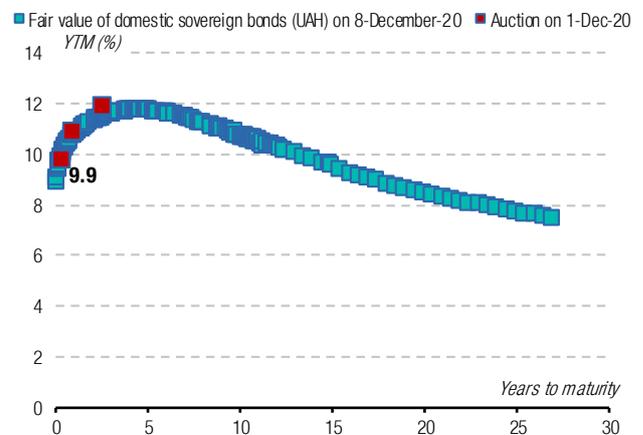
Chart 1. Local-currency bonds

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.

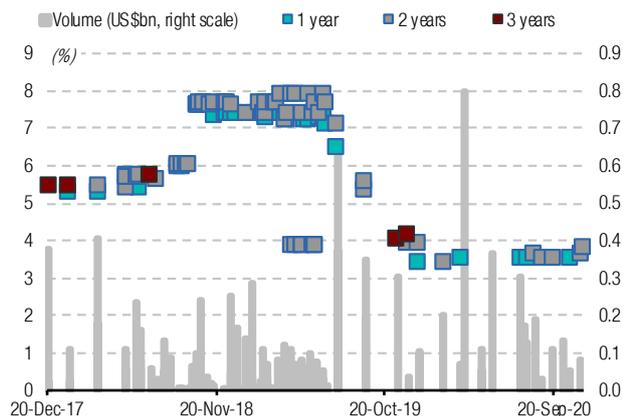
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

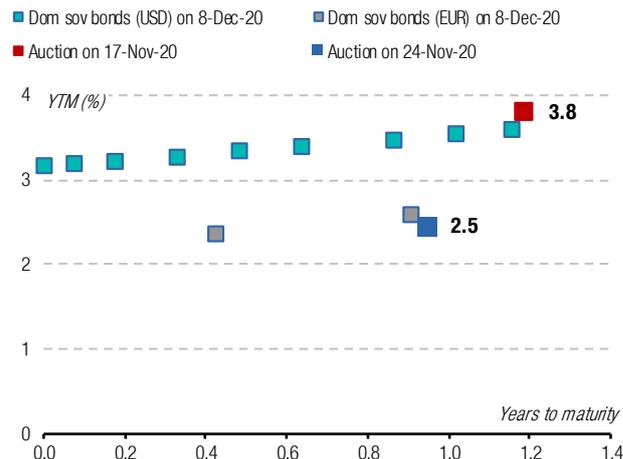
Chart 2. FX-denominated bonds

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

Banking-sector liquidity was stable last week, with some fluctuations around UAH170bn. Due to restrained budget expenditures, liquidity can slightly decline due to reserves exchange in cash this week.

Last week, the NBU supported banking-sector liquidity only through loans, starting with UAH50-110m in O/N loans, and on Friday, issuing UAH1bn of three-month loans for six banks. But it was too low to cover UAH5.5bn of early repaid loans that day. In addition, banks exchanged reserves in cash of UAH1.9bn.

However, such outflow was compensated by Treasury operations with budget funds of UAH6bn.

Therefore, banking-sector liquidity was unchanged, with a UAH0.5bn decline to UAH169.5bn at the end of last week.

ICU view: This week, we expect budget expenditures will remain subdued, with low inflows into the banking system. According to the Ministry of Finance, they will control spending of budget funds ensuring targeted and efficient use. This indicates potential delay and deferral of certain expenses, which will reduce the inflow of funds into the banking system.

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

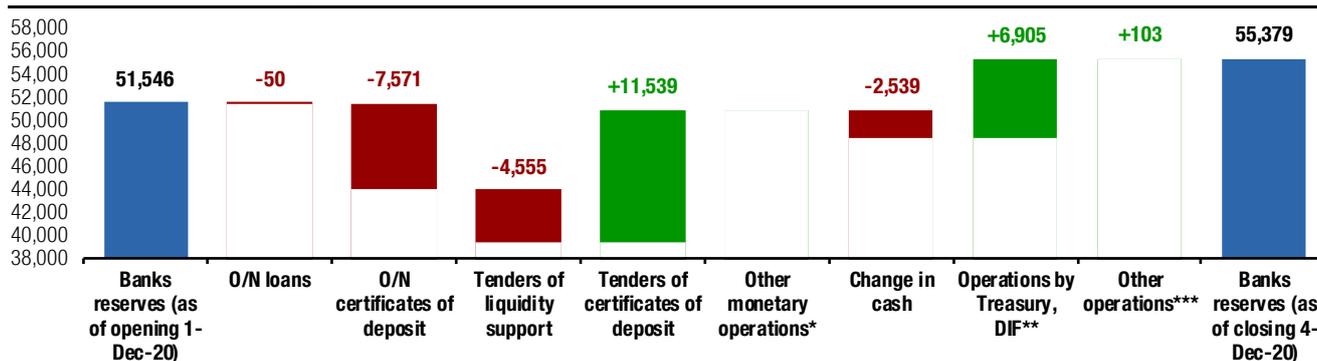
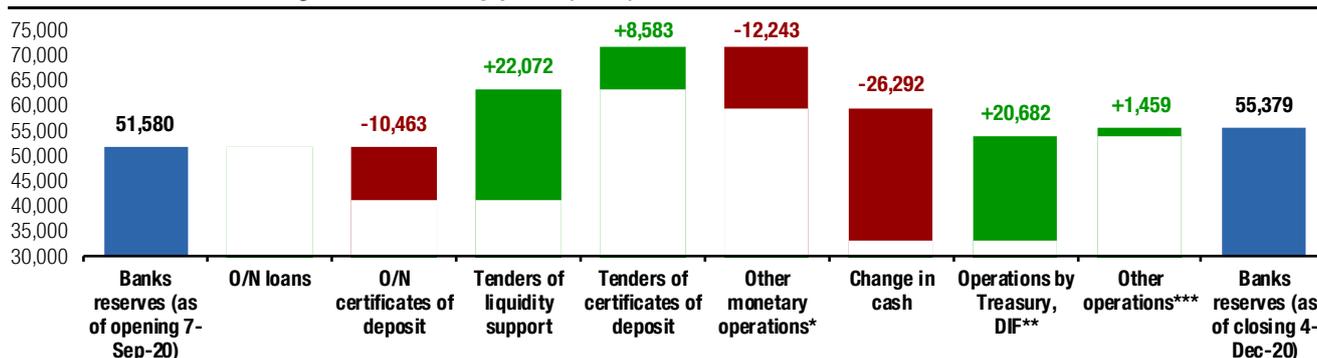


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 appreciates again

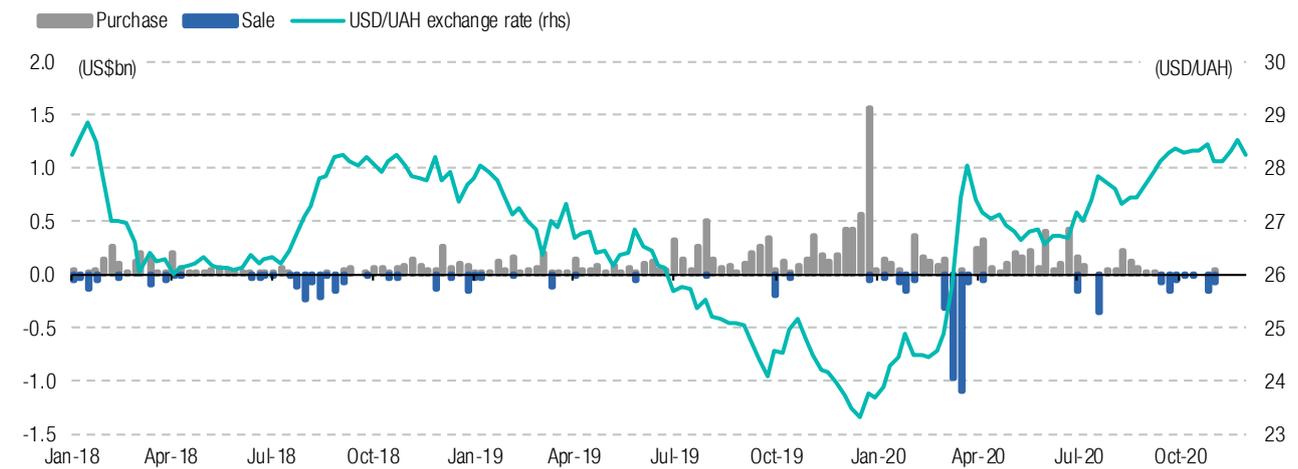
The FX market was mostly self-balanced last week and hryvnia exchange rate was more under the impact of external, not Ukrainian factors. Therefore, the hryvnia appreciated a bit, but this appreciation could be short-lived. Given the increase in uncertainty over a new lockdown and growing demand for hard currency, the hryvnia is poised to weaken.

Last week, the US dollar weakened slightly relative to other hard currencies, which had an impact on hryvnia exchange rate as well. Since the beginning of the month, the hryvnia appreciated by 0.9% to UAH28.3/US\$. However, the hryvnia weakened slightly against the euro.

Under such conditions, the NBU did not intervene in the market, taking into account its balanced stance and the influence of external factors

ICU view: This week, the hryvnia exchange rate relative to the US dollar will depend again more on external factors and exchange rate of US dollar against other currencies. Most likely, the hryvnia will weaken a bit moving towards the range of UAH28.5–29/US\$, where it will remain until the end of the year.

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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

Current account runs a surplus; capital outflow continues

In October, the C/A returned to a significant surplus (US\$0.8bn), and capital outflows under the F/A continued. Looking ahead, we expect the situation with capital flows to improve and the C/A surplus to fade gradually.

The highest current account surplus in six months was because the foreign trade deficit fell to almost zero, while remittances from abroad almost returned to pre-pandemic levels, steadily exceeding US\$1bn per month since July.

The decline in exports of goods and services (G&S) slowed to 2.7% YoY. In particular, the value of iron ore exports increased significantly, thanks both to prices and volumes. Combined with the continued steady growth of the export of IT services, this almost offset the decline in the export of agricultural products and transport services.

At the same time, the pace of decline in imports of G&S continued to exceed 20% YoY for the seventh month in a row. As before, the largest contribution was provided by the reduction of expenditures on energy, machinery, and foreign tourism.

The C/A surplus for the last 12 months grew to US\$7.2bn (est. almost 5% of GDP). Over the past 12 months, the merchandise trade deficit decreased to US\$7.5bn (est. 5% of GDP), while the services trade surplus increased to US\$4.4bn (est. 2.9% of GDP), and remittances were almost unchanged at US\$11.7bn (est. 7.7% of GDP) for a half year.

In October, the capital outflow under the F/A remained high, US\$1.2bn. About half of it was contributed by capital flight to foreign assets, including the conversion of cash into FX by the population of US\$0.5bn. Also, in contrast to the previous five months, banks and corporations repaid more debt than they borrowed through new loans by US\$0.3bn.

As a result of the overall BoP deficit, international reserves fell to US\$26.1bn in October.

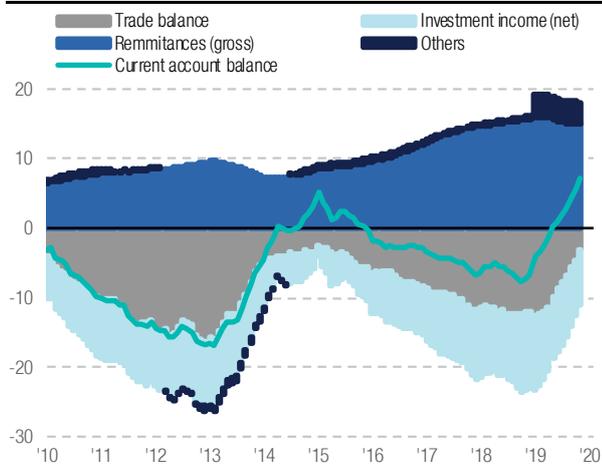
ICU view: Fundamental factors continued to be favourable for the domestic BoP, while negative sentiment fuelled capital outflows. In the coming months, the current account surplus will decline due to rising prices and seasonal demand for energy. However, this will happen rather slowly, as the new quarantine restrictions will restrain demand for merchandise imports and foreign tourism.

Meanwhile, against the background of positive news about the vaccines and Biden's apparent victory in the US presidential election, the appetite of foreign investors for EM assets is sharply improving. Therefore, we can expect a gradual reversal of capital flows, and a return of portfolio investment inflows.

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Chart 6. Current account

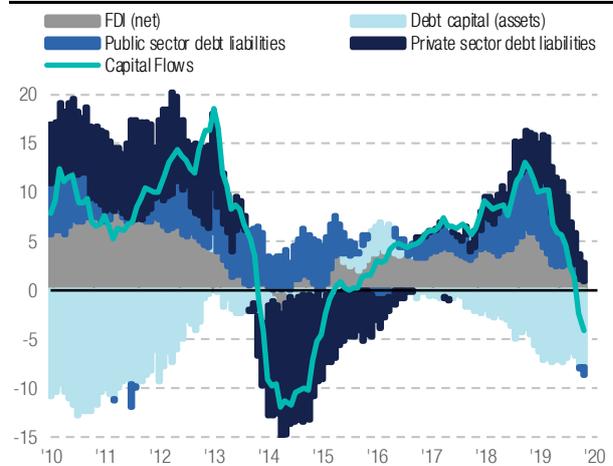
US\$ bn, 12m trailing



Source: NBU, ICU.

Chart 7. Capital flows

US\$ bn, 12m trailing



Source: NBU, ICU.

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