

Weekly Insight

Government continues active borrowing

Key messages of the today's comments

TUESDAY, 12 JANUARY 2021

Domestic liquidity and bonds market

Government continues active borrowing

Since the Treasury started the year with low funds in its local-currency accounts, the MoF vigorously started selling new bills last week. The government will remain active in borrowing to cover debt repayments and for budgetary needs.

Liquidity above UAH200bn

Once again, the year started with liquidity above UAH200bn but last Wednesday liquidity sharply declined and will continue to slightly decline due to outflows to budget accounts and in cash.

Foreign exchange market

Hryvnia one step from appreciation

Last week, the hryvnia exchange rate was rather steady, and slightly appreciated. This week, hard currency supply can rise, giving additional support for the hryvnia, but the exchange rate will stay within the range of UAH28–28.5/US\$.

Economics

Current account runs a surplus, capital flows reverse due to public borrowing

In November, the C/A again showed a significant surplus (US\$0.9bn), and capital outflows under the F/A continued. In December, massive government borrowings and the impact of favourable terms of trade boosted reserves to an eight-year peak.

Banks' reserves market (11 January 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	6.00	+0bp	-750bp
ON rate (%)	4.78	+0bp	-698bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	44,624	+7.33	-29.76
CDs (UAHm) ³	146,770	-10.28	-6.88

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) (11 January 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.71
Banks	522,918	+0.40	+57.01
Residents	58,032	-0.26	+120.05
Individuals	11,115	-0.75	+11.32
Foreigners ¹	85,581	+0.46	-26.68
Total	1,002,408	+0.22	+21.73

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (11 January 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.1383	-0.66	+17.68
EUR/USD	1.2151	-1.20	+9.26
DXY	90.465	+1.15	-7.08
UAH TWI ¹	118.363	+1.48	-13.15

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (12 January 2021)

Maturity	Bid	Ask
6m	10.50	9.00
12m	12.00	10.50
2y	12.25	11.00
3y	12.50	11.25
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

Government continues active borrowing

Since the Treasury started the year with low funds in its local-currency accounts, the MoF vigorously started selling new bills last week. The government will remain active in borrowing to cover debt repayments and for budgetary needs.

The Ministry held the debut auction immediately after the New Year, on the first Tuesday, and borrowed UAH8.7bn (US\$0.3bn) without rates changes. Most of these funds were borrowed for just 10 weeks and should improve the budget balance without hard currency exchange or with a low amount of exchange. More details about last week's auction in our [overview](#).

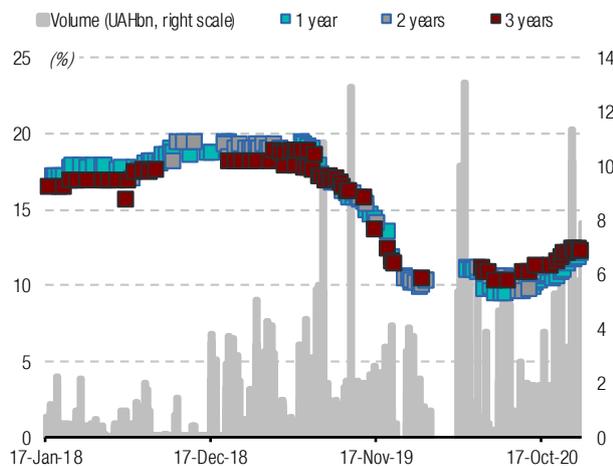
Local banks continue to be big buyers of government debt, and last week they increased portfolios of UAH-denominated bonds by UAH8.3bn (US\$0.3bn) to UAH523bn (US\$18.4bn). Local banks remain the largest investors in domestic government debt with a 52% share in the total bonds outstanding. However, at the debut auction, foreigners were not active in new purchases of bills or notes with maturity up to 3.5 years. Lack of offered four-year or longer-maturity notes likely was the reason why foreigners purchased just UAH310m (US\$11m) of new paper last week.

ICU view: This week, the MoF will sell bills starting from half-year maturity, but again no longer than up to May 2024. Hence, it remains questionable whether foreigners will participate in the auction. However, local banks may be interested in half-year and longer bills, as well as in USD-denominated 12-month bills. As the result, the Ministry can obtain local-currency funds for budget needs and refinance at least part of USD bills repaid last week.

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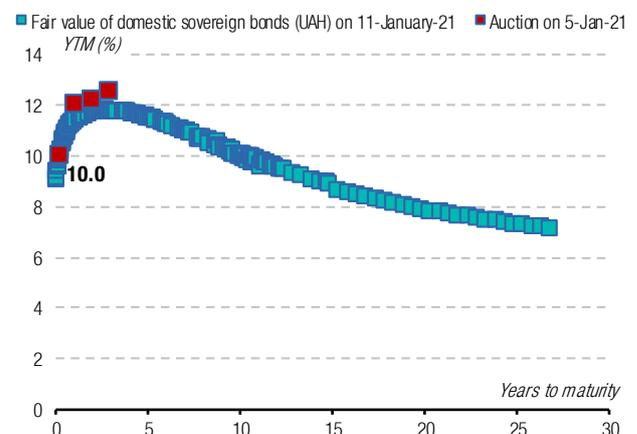
Chart 1. Local-currency bonds

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.

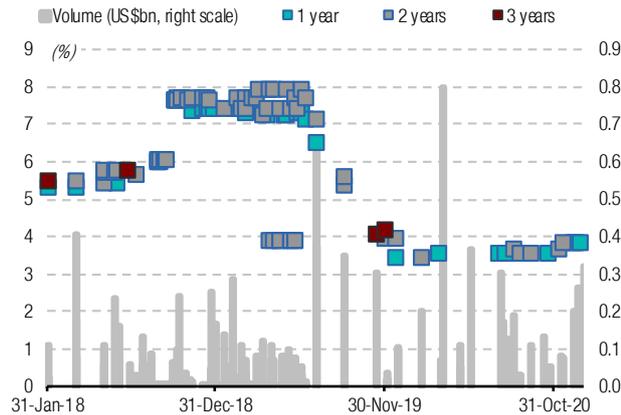
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

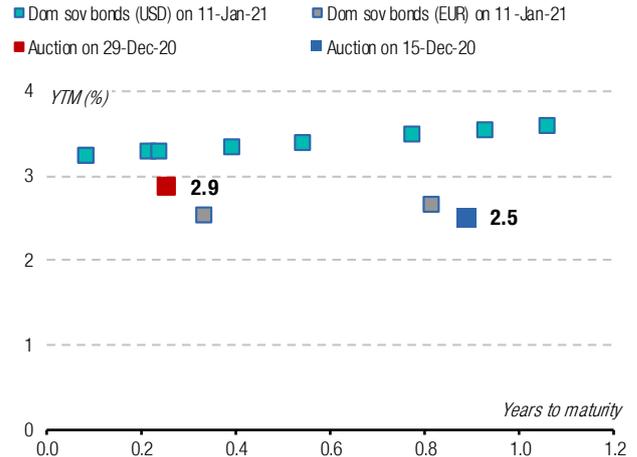
Chart 2. FX-denominated bonds

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 above UAH200bn

Once again, the year started with liquidity above UAH200bn but last Wednesday liquidity sharply declined and will continue to slightly decline due to outflows to budget accounts and in cash.

The banking system received large inflows from Treasury at the end of last year—UAH29bn in December. In total last year, the Treasury injected just UAH36bn into liquidity. With this inflow and NBU's injections through hard currency purchases and refinancing loans, liquidity was up to UAH201bn as of the end of 2020. These funds were mostly invested in NBU CDs, as their outstanding rose to above UAH160bn, and just slightly more than UAH40bn were in the banks' correspondent accounts with the NBU.

ICU view: This week, the Treasury may absorb a portion of liquidity to accumulate funds for budget expenditures and next week's debt repayments. Also, reserves exchange in cash will likely rise.

The Treasury started the year with just UAH12bn in the budget accounts, and received just UAH6.2bn of revenues to the state budget last week. Therefore, we do not expect active budget expenditures this week, since for debt repayments scheduled later this month the government has to accumulate more than UAH20bn.

As a result, the NBU will be able to support liquidity through the FX market and new loans. Most likely, liquidity will continue to decline slightly.

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

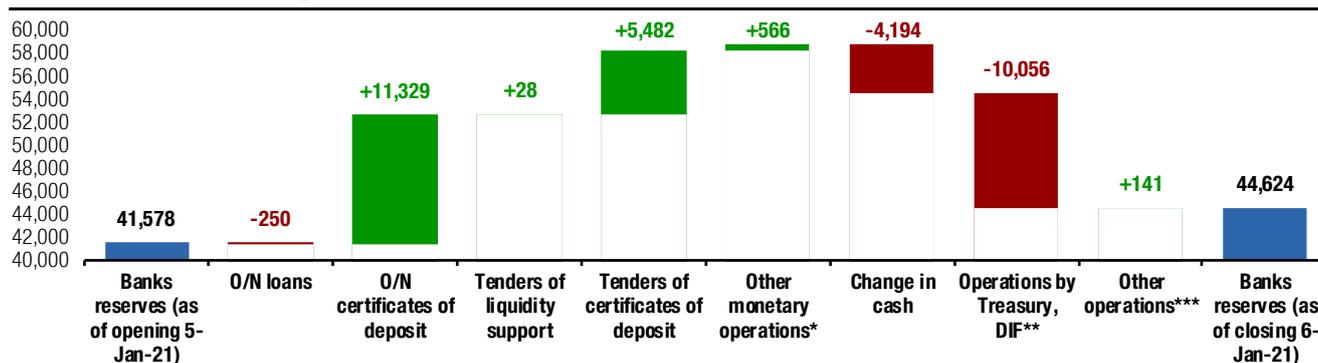
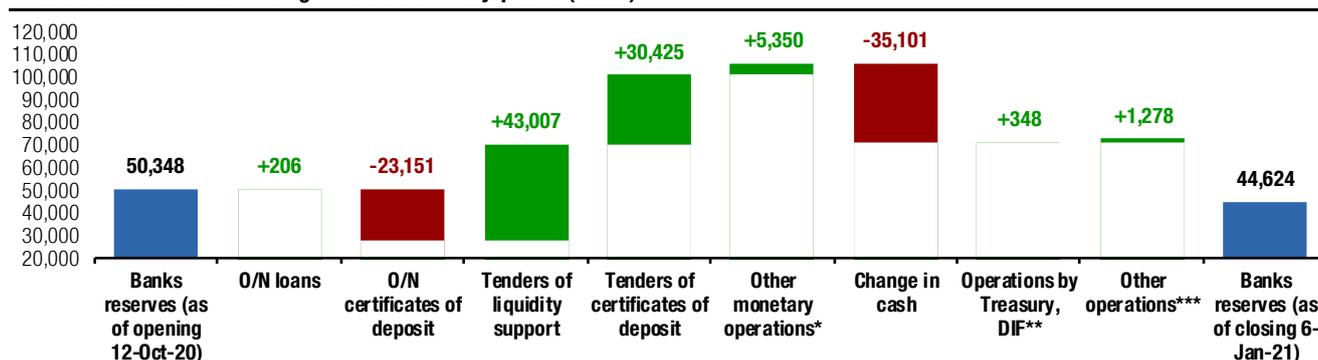


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 one step from appreciation

Last week, the hryvnia exchange rate was rather steady, and slightly appreciated. This week, hard currency supply can rise, giving additional support for the hryvnia, but the exchange rate will stay within the range of UAH28–28.5/US\$.

Last week, the NBU intervened in the FX market twice, but with zero net effect, as it sold US\$20m on Monday and purchased the same US\$20m on Wednesday. Therefore, the market was mostly self-balanced without active supply from foreigners due to low participation in the bond market.

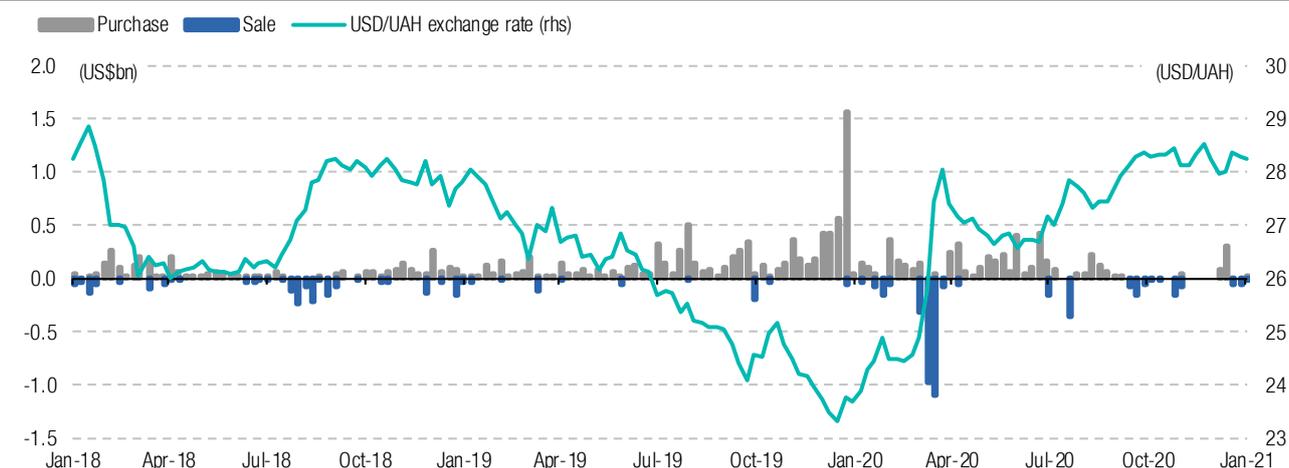
However, during the short business week, the hryvnia rate was steady with just 0.2% appreciation to UAH28.27/US\$.

ICU view: Foreigners can increase activity in the bond market, while the banking system will not receive additional funds from the budget. Therefore, the supply of hard currency should rise prior to or immediately after the primary bond auction, providing support for the hryvnia, which can appreciate a bit while staying within the UAH28–28.5/US\$ range.

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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 flows reverse due to public borrowing

In November, the C/A again showed a significant surplus (US\$0.9bn), and capital outflows under the F/A continued. In December, massive government borrowings and the impact of favourable terms of trade boosted reserves to an eight-year peak.

For a second month in a row, the current account surplus was close to one billion USD. The foreign trade balance hovered around zero, while remittances from abroad almost returned to pre-pandemic levels, steadily exceeding US\$1bn per month since July.

In November, annual growth of G&S was positive (2.3% YoY) for the first time since February. In particular, the value of iron ore exports surged sizably, both thanks to prices and volumes, and it was supported by the continued steady growth of IT services proceeds and higher export of agricultural products.

Meanwhile, the pace of decline in imports of G&S slowed to 11% YoY as non-energy merchandise imports showed a positive growth rate (1.3% YoY) for the first time since January. However, travel and energy expenses remained significantly lower than last year.

The C/A surplus for the last 12 months grew to US\$9.0bn (est. 6% of GDP). Over the past 12 months, the merchandise trade deficit decreased to US\$6.8bn (est. 4.6% of GDP), while the services trade surplus increased to US\$4.3bn (est. 2.9% of GDP), and remittances were almost unchanged at US\$12.1bn (est. 8% of GDP) since a beginning of the year.

In November, capital outflow under the F/A remained high, almost US\$1bn. More than half of it was contributed by capital flight to foreign assets, including the conversion into FX cash by the population of US\$0.7bn.

As a result of the overall BoP close to zero, in November, international reserves were virtually unchanged at US\$26.1bn.

ICU view: In December, capital flows rapidly improved as evidenced by a surge of international reserves by US\$3bn to US\$29.1bn. It was primarily caused by massive government borrowing, both from official sources and from international markets. In

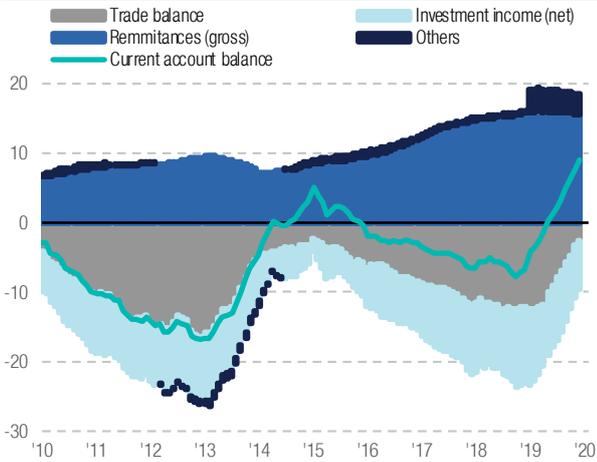
addition, foreigners increased their holdings of local currency government bonds. The terms of trade and demand factors remained favourable for C/A flows.

In the coming months, we expect the external environment will remain supportive for Ukraine's BoP flows, thus appreciation pressure on FX market will prevail while the central bank will smooth it with FX interventions only partially.

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Chart 6. Current account

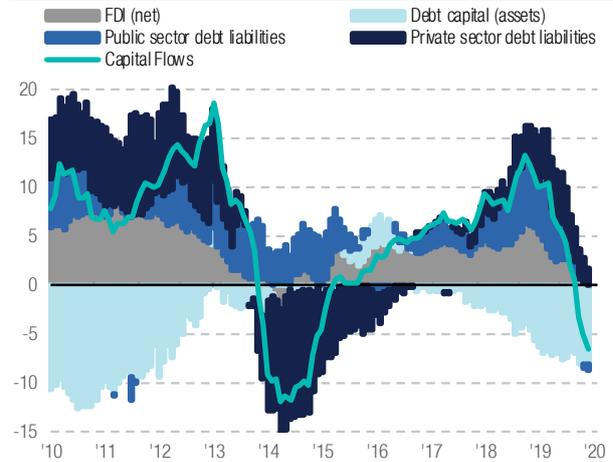
US\$ bn, 12m trailing



Source: NBU, ICU.

Chart 7. Capital flows

US\$ bn, 12m trailing



Source: NBU, ICU.

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