



Focus
Ukraine

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

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Weekly Insight

January lockdown slows economic activity

Key messages of the today's comments

Domestic liquidity and bonds market

Active budget financing continues

In February, borrowings were about the same as in January, which resulted in a high amount of net borrowings to finance the budget deficit. Due to large debt redemptions, the amount of borrowings in March can be larger.

Low fluctuations in liquidity

With an increase in cash exchange in reserves, banking-sector liquidity slightly recovered to almost UAH194bn last week. The first week of March should see a slight decline due to outflows to the budget and cash.

Foreign exchange market

Hryvnia appreciation postponed

Last week, the hryvnia was within the UAH27.5–28/US\$ range with slight weakening. This week, movements in the hryvnia exchange rate will depend on foreigners' activity in the bond market.

Economics

January lockdown slows economic activity

The impact of the January lockdown restrictions on economic activity was quite significant, affecting retail sales, industry, and passenger transport. However, given the favourable external environment, the expiration of the lockdown, and robust domestic demand, we expect economic growth to recover in the coming months.

MONDAY, 1 MARCH 2021

Banks' reserves market (26 February 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	6.00	+0bp	-500bp
ON rate (%)	5.11	-32bp	-402bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	55,017	-12.20	-20.37
CDs (UAHm) ³	139,594	+9.12	-23.42

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) (26 February 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	322,077	+0.00	-1.06
Banks	525,330	+0.34	+63.18
Residents	59,526	-2.47	+125.95
Individuals	13,876	+3.98	+59.48
Foreigners ¹	102,677	-0.18	-19.99
Total	1,023,752	+0.06	+26.26

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (26 February 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.9700	+0.39	+13.83
EUR/USD	1.2075	-0.36	+10.97
DXY	90.879	+0.57	-8.20
UAH TWI ¹	119.538	+0.45	-12.67

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (1 March 2021)

Maturity	Bid	Ask
6m	9.50	8.00
12m	11.50	10.00
2y	12.00	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

Active budget financing continues

In February, borrowings were about the same as in January, which resulted in a high amount of net borrowings to finance the budget deficit. Due to large debt redemptions, the amount of borrowings in March can be larger.

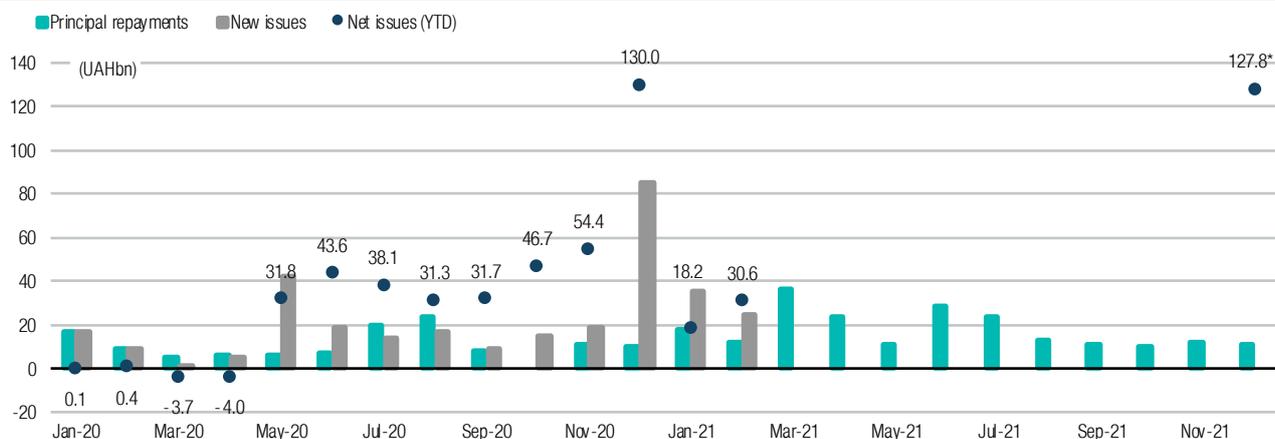
In total in February, the MoF borrowed UAH37bn (US\$1.3bn) in local and hard currencies, most of which, almost UAH25bn (US\$0.9bn), was in hryvnia. The MoF's efforts were successful despite caps on short maturities and a sizable decline in interest rates, especially last week (see [auction comment](#)).

Approximately UAH9.5bn (US\$0.3bn) was new money for the budget. However, in hryvnia it was UAH12.4bn (US\$0.4bn) while in USD, more was redeemed than borrowed.

Foreigners were active, increasing their portfolios by UAH6.5bn (US\$0.2bn), and banks provided UAH6.3bn (US\$0.2bn) of new funds for the budget. In addition, non-banks and especially individuals increased their investments. The latter focused on adding the UAH-denominated part to their portfolios.

Chart 1. UAH-denominated debt redemptions and new borrowings

Monthly, 2020 and 2021



Source: NBU, Bloomberg, ICU.

Note: * expected amount of net UAH bonds issues at the end of 2021

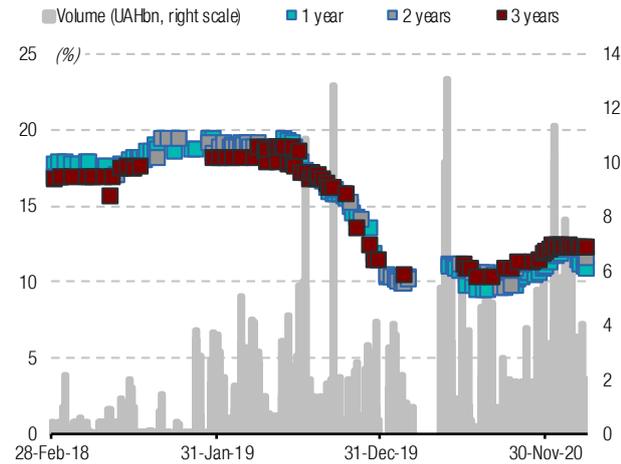
ICU view: During March, the MoF has to repay UAH36bn (US\$1.3bn), all in local currency. This is the reason why Ministry revised caps for the debut auction in March, increasing the offered amount for 12-month bills and decreasing caps for 16-month paper. Most likely, they expect large demand from local banks for 12-month bills.

However, we anticipate a further decline in rates due to large demand and caps. For three-month bills, rates can decline below 9%, while for longer paper, the decline should be less material.

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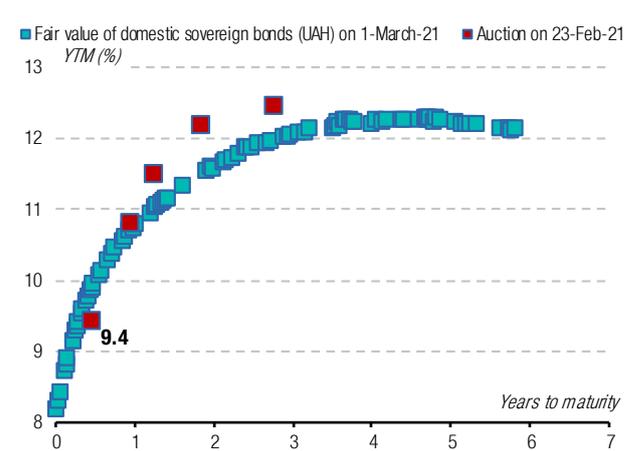
Chart 2. Local-currency bonds

Three-year history of domestic government bond placements at primary market: proceeds (in UAHbn) and yields-to-maturity (%)



Source: Ministry of Finance of Ukraine, ICU.

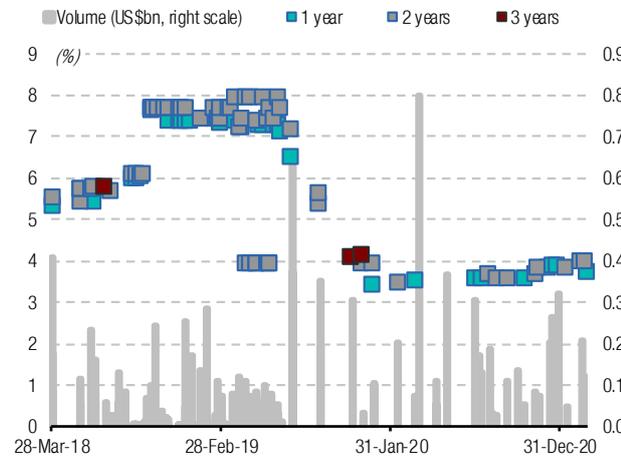
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

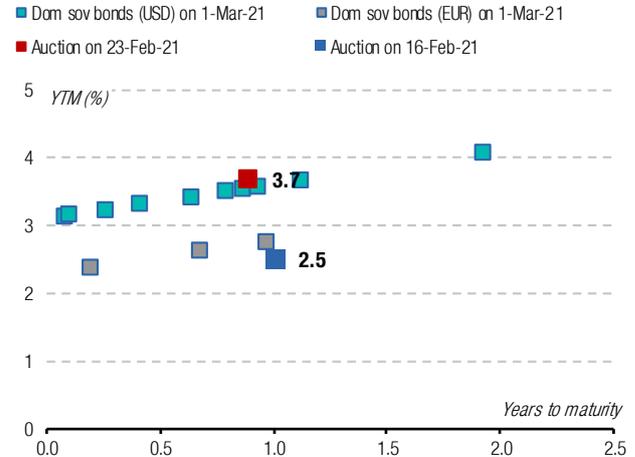
Chart 3. FX-denominated bonds

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.

Low fluctuations in liquidity

With an increase in cash exchange in reserves, banking-sector liquidity slightly recovered to almost UAH194bn last week. The first week of March should see a slight decline due to outflows to the budget and cash.

The largest inflow last week was provided by banks with cash exchange in reserves of UAH3.9bn, but budget operations had low impact on liquidity. After a few days of absorption, last Wednesday, budget expenditures accelerated and caused outflow at just UAH0.2bn.

NBU did not have a material impact on liquidity. For the second week in a row, the NBU did not intervene in the FX market and provided banks with UAH0.4bn of new loans vs redemption of UAH0.2bn of old loans.

Finally, banking-sector liquidity rose UAH3bn to UAH193.6bn last week.

ICU view: This week, budget expenditures can slow while tax collection accelerates, especially due to taxes on salaries. However, the balance of Treasury operations will depend on the MoF's decision on new borrowings, and on refinancing the redemption

in the amount of UAH11.5bn, which will be due on Wednesday. With partial refinancing, liquidity will stabilize around UAH190bn.

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Chart 4. Banks reserves usages over last week(UAHm)

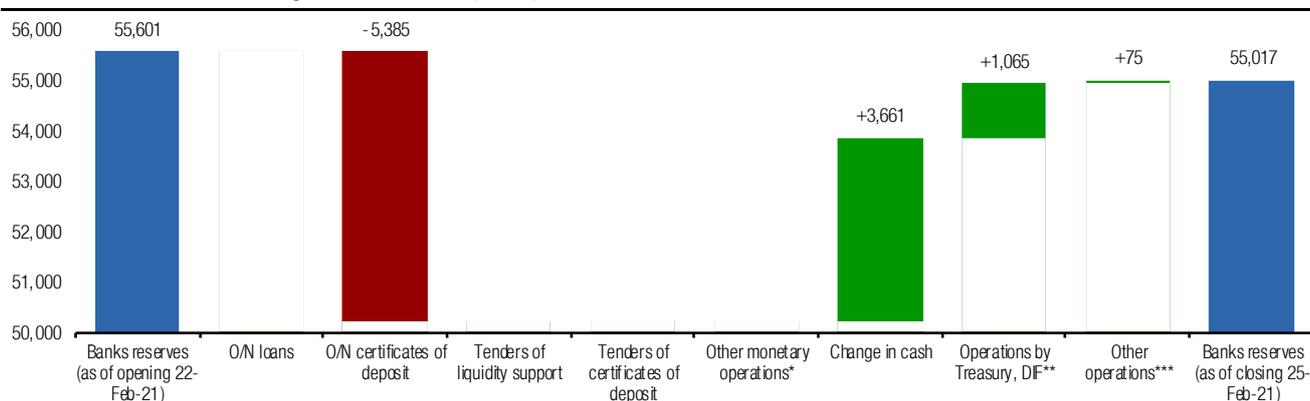
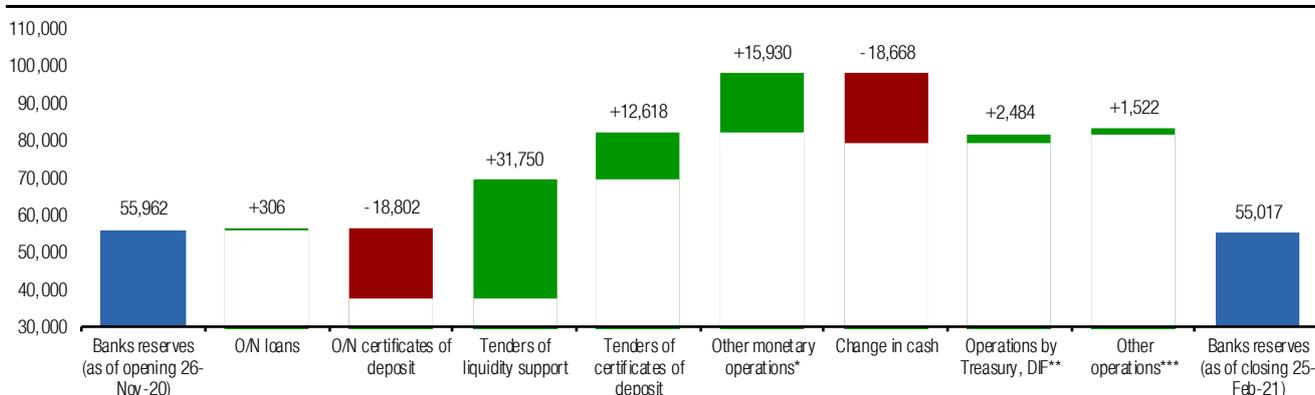


Chart 5. Banks reserves usages over last 90-day period (UAHm)



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 appreciation postponed

Last week, the hryvnia was within the UAH27.5–28/US\$ range with slight weakening. This week, movements in the hryvnia exchange rate will depend on foreigners' activity in the bond market.

Lower inflows from foreigners with large demand for hard currency caused a slight weakening of the hryvnia.

Last week, foreigners' portfolios declined slightly, while during the February, the increase in portfolio was sizable (see comment above). However, slowing investments caused a decline in supply of hard currency. In addition, VAT refunds caused exporters to sell less hard currency for tax payments.

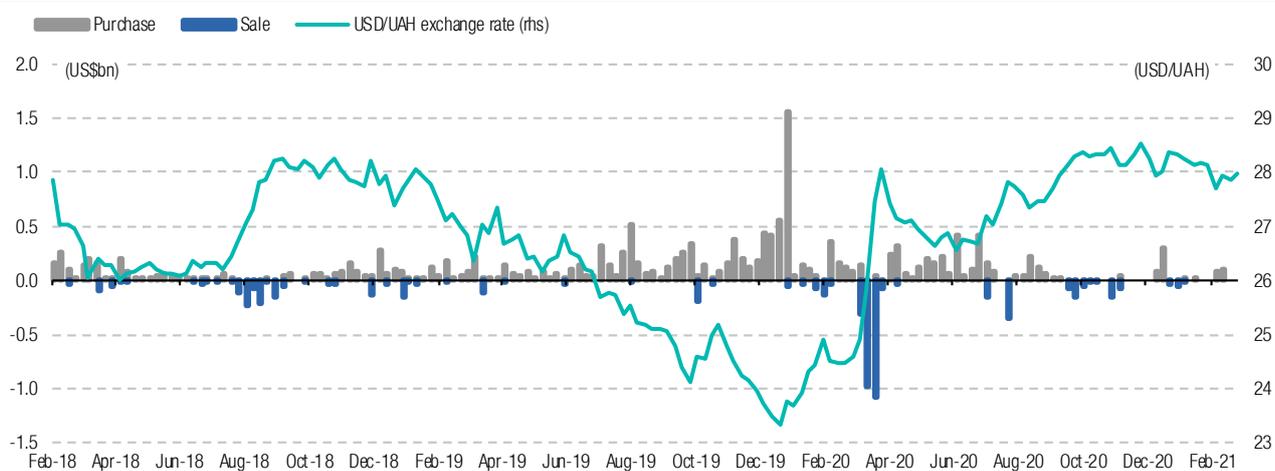
However, FX market was self-balanced without NBU interventions, caused the hryvnia to weaken a mere 0.4% to UAH27.97/US\$.

ICU view: Despite lower activity of foreign investors in local-currency debt, we still are waiting for seasonal appreciation and gradual movement towards UAH27.5/US\$ during March. An exchange rate at this level will be attractive for new investments from abroad, but a global increase in rates for less risky assets is not in favour of Ukrainian debt. At the same time, we expect seasonal appreciation caused by agrarians as they make preparations for spring fields.

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Chart 6. 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

January lockdown slows economic activity

The impact of the January lockdown restrictions on economic activity was quite significant, affecting retail sales, industry, and passenger transport. However, given the favourable external environment, the expiration of the lockdown, and robust domestic demand, we expect economic growth to recover in the coming months.

In January, industrial production plummeted by 4.0% YoY after strong rebound 4.8% YoY in December. The seasonally adjusted indicator fell by 3.3% MoM, bringing the SA volume to the lowest level since mid-2020.

The outcome was determined by the January lockdown, which caused sizable shrinking of output in consumption-oriented industries like food and textile production, and machinery. In addition, iron ore extraction and steel production moderately deteriorated after strong performance in previous months. Probably, logistics complications due to frozen seaports amid the cold winter provide the explanation for this weakness despite still robust global demand.

Also, the January lockdown harmed retail sales, where growth slowed to 3.5% YoY compared with 13.5% YoY on average in 4Q20. In addition, the mobility of the population in cities decreased: passenger turnover of public transport was 54–55% of last year's figures, while in 4Q20 it was 61–66%. However, due to an increase in railway and road transport, the decline in total passenger turnover (52% YoY) in January was approximately at the 4Q20 level.

At the same time, the decline in freight turnover in January almost stopped (only 0.7% YoY), while in 4Q20 it was almost 8% YoY. The sharp decline in the volume of transportation by rail and road was almost completely offset by an increase in the volume of pipeline transport. In all cases, cold weather was a key factor.

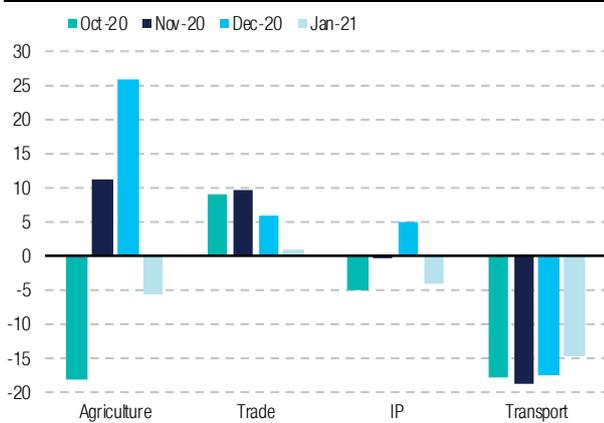
Also, the volume of wholesale trade decreased slightly (by 0.6% YoY) and the decline in livestock deepened (to 5.7%).

ICU view: Looking ahead, we expect that in coming months industry will offset January losses amid global recovery, still robust domestic demand, and regained price competitiveness.

The same factors, against the background of lifted severe quarantine restrictions, should help to improve the situation in trade and transport. In addition, the statistical effect of the last year's low comparison base will be felt already in March. Thus, despite a weak start of the year, we expect that as soon as 1Q21 the economy will return to positive GDP YoY growth rates.

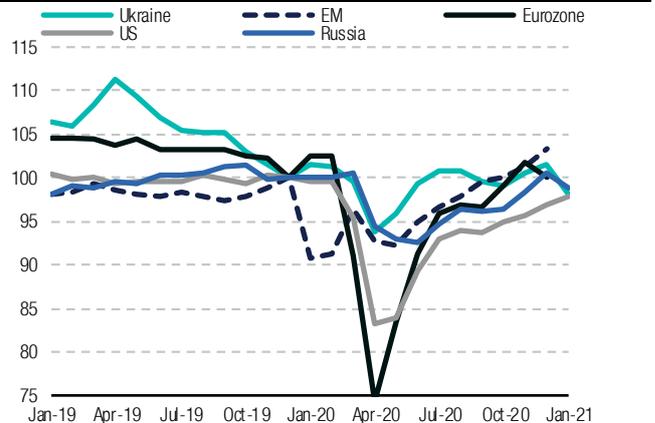
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Chart 7. Output of various activities, % YoY



Source: UkrStat, ICU.

Chart 8. Industrial output, SA, Dec 2019 =100



Source: Bloomberg, UkrStat, ICU..

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