

Weekly Insight

Foreigners ramp up bond purchases

Key messages of the today's comments

Domestic liquidity and bonds market

Foreigners ramp up bond purchases

After a long break, foreigners increased their portfolios of UAH-denominated debt last week. This week, they may be the key investors in new five-year note.

Foreign exchange market

Hryvnia continues to appreciate

Balance in the FX market moved to the supply side, and the hryvnia appreciated last week despite interventions by the NBU. We expect the hryvnia will continue to appreciate toward UAH27/US\$, and may reach that level this week.

Economics

The government approved a budget declaration and macroeconomic forecast

The Cabinet of Ministers approved a three-year budget declaration for the first time. It envisages gradual fiscal consolidation and reduction of the budget deficit to 2.7% of GDP. At the same time, the government approved a macroeconomic forecast for 2022–24, which assumes an acceleration of economic growth to 5% in 2024. If this forecast is implemented, public debt could fall from the expected 64% of GDP this year to 51% of GDP in 2024.

MONDAY, 7 JUNE 2021

Banks' reserves market (4 June 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	7.50	+0bp	-50bp
ON rate (%)	6.42	-33bp	-85bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	53,040	-6.12	+9.77
CDs (UAHm) ³	148,492	+6.99	+8.67

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) (4 June 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	318,777	+0.00	-1.79
Banks	499,853	-3.15	+25.10
Residents	43,099	-6.66	-18.64
Individuals	16,125	-5.73	+102.76
Foreigners ¹	99,995	+1.71	-5.06
Total	978,045	-1.87	+9.85

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (4 June 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.2389	-0.97	+2.21
EUR/USD	1.2167	-0.21	+7.31
DXY	90.136	+0.12	-6.77
UAH TWI ¹	121.966	+1.03	-4.06

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (7 June 2021)

Maturity	Bid	Ask
6m	10.00	8.50
12m	12.00	11.00
2y	12.75	11.50
3y	13.00	12.00
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 ramp up bond purchases

After a long break, foreigners increased their portfolios of UAH-denominated debt last week. This week, they may be the key investors in new five-year note.

After bond settlement last Wednesday and refinancing just half of redemptions, all investor groups except foreigners decreased their portfolios. Foreign investors purchased last week UAH2bn of new bills in addition to reinvesting funds they received from redemptions.

Active participation in the primary auction was the main reason that turnover in the secondary bond market declined to UAH4.9bn from UAH7bn a week before, while the number of transactions rose to 628 from 531. The most activity was with bills due in May 2024 with 96 deals amounted to UAH0.5bn, while the largest amount of secondary market trading registered for bills due to May 2023, at almost UAH0.8bn.

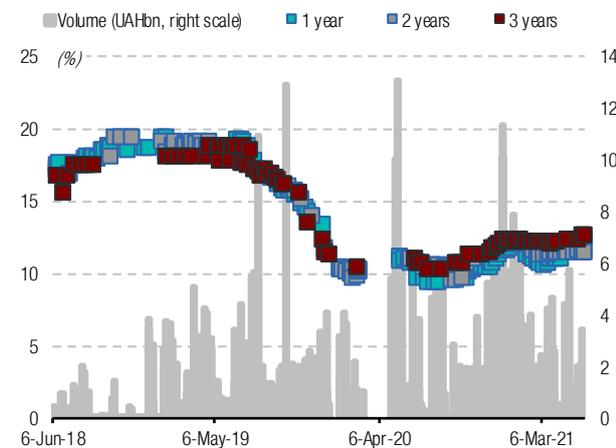
Changes in interest rates were varied, but mostly declined by 10-25bp. According to NBU data, weighted-average yields at the end of last week were within the range of 7.8–13%.

ICU view: This week, we again expect elevated demand from foreigners in the primary auction, as the MoF plans to offer a new five-year note. This paper can be the next candidate to be included in the JPMorgan GBI-EM index. Therefore, we expect that demand and new local-currency borrowings will at least be at the same level as last week (see auction overview) with interest rates set for the new paper at about 12.5%.

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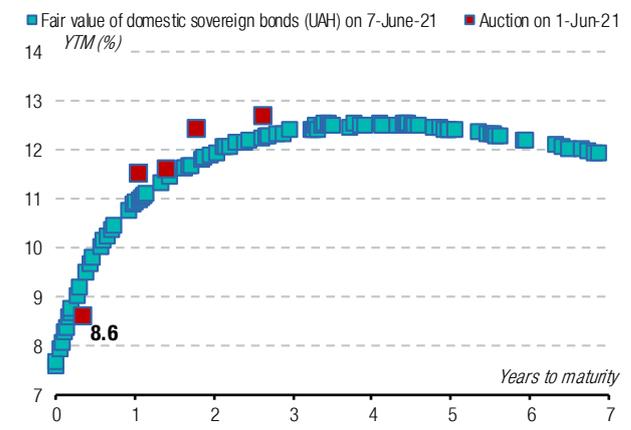
Chart 1. Local-currency bonds

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.

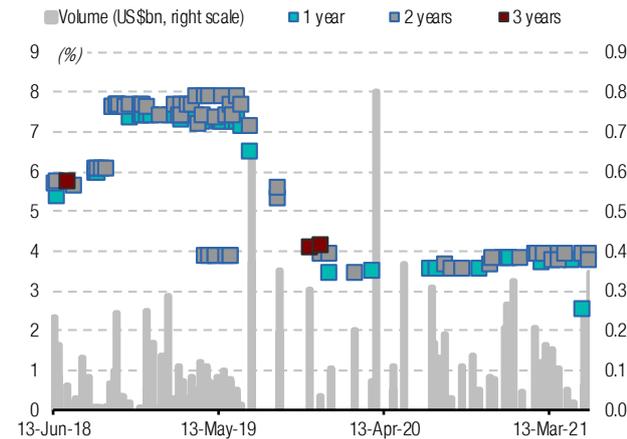
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

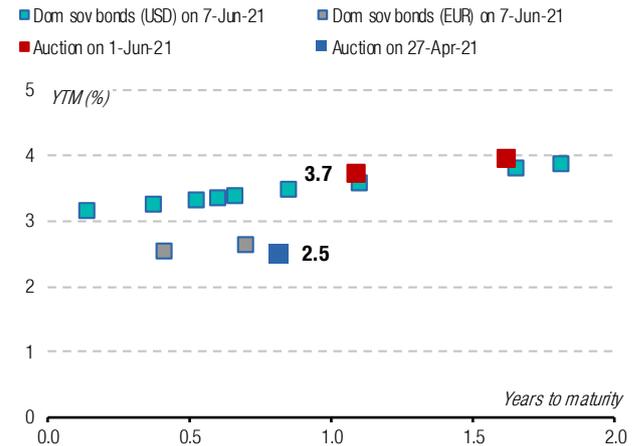
Chart 2. FX-denominated bonds

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.

Foreign exchange market

Hryvnia continues to appreciate

Balance in the FX market moved to the supply side, and the hryvnia appreciated last week despite interventions by the NBU. We expect the hryvnia will continue to appreciate toward UAH27/US\$, and may reach that level this week.

Since supply was greater than demand for hard currency last week, the hryvnia appreciated by 1% for the week and by 4.3% YTD, ending the week at UAH27.24/US\$, the strongest level for this year.

The supply of hard currency was heavily supported by foreigners, as they increased activity in the bond market, with additional supply coming from investors in FX-denominated bills, as they could sell some of the funds they received last week as redemptions.

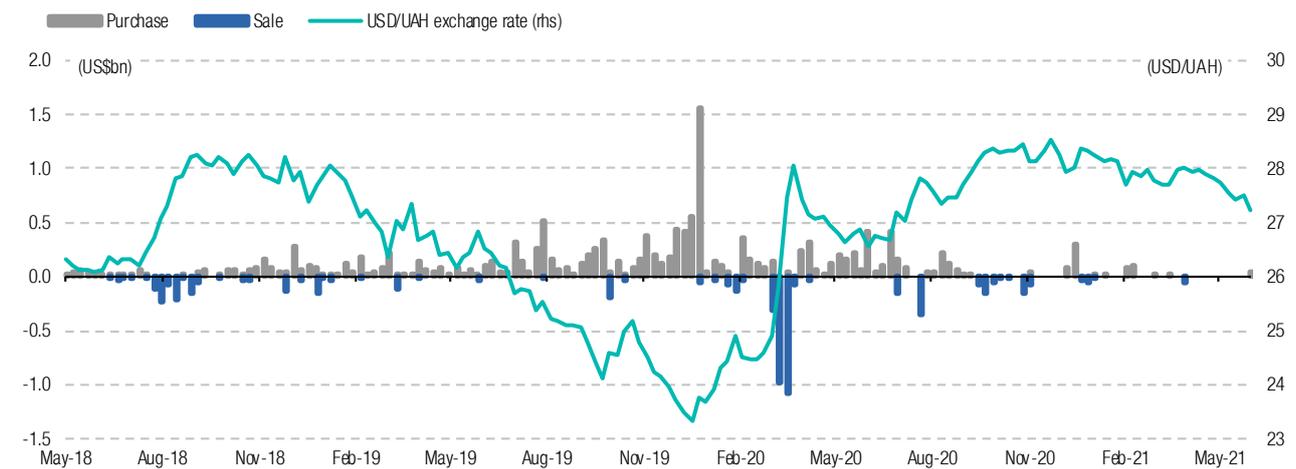
However, this increase in supply induced NBU to renew its interventions in the FX market with hard currency purchases after an almost three-month break.

ICU view: Generally, the FX market has been positive for the hryvnia and can cause further appreciation towards UAH27/US\$. This level can be reached this week, if foreigners invest a large amount in new five-year note. The NBU can intervene with its usual US\$20m daily purchases just to smooth out appreciation.

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Chart 3. 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

The government approved a budget declaration and macroeconomic forecast

The Cabinet of Ministers approved a three-year budget declaration for the first time. It envisages gradual fiscal consolidation and reduction of the budget deficit to 2.7% of GDP. At the same time, the government approved a macroeconomic forecast for 2022–24, which assumes an acceleration of economic growth to 5% in 2024. If this forecast is implemented, public debt could fall from the expected 64% of GDP this year to 51% of GDP in 2024.

As part of the medium-term budget planning framework, the government for the first time approved the Budget Declaration for 2022–2024 and submitted it to parliament. The Budget Declaration envisages a rather rapid reduction of the state budget deficit next year to UAH188bn (3.5% of GDP) from UAH 247bn (5.5% of GDP) this year and further gradual reduction to UAH180bn (2.7% of GDP) in 2024. In addition, the Declaration assumes the reduction of GDP redistribution through the budget—for example, state budget revenues have to fall from 25.5% of GDP in 2020, to 21.6% of GDP in 2024.

The government's macroeconomic forecast predicts that GDP will grow by 3.8% next year and growth will accelerate further to 4.7% in 2023, and 5% in 2024. Meanwhile, growth in exports of goods and services is projected at 6.5% in 2022, and speeding up further to 7.7% in 2023, and to 7.9% in 2024. CPI inflation in 2022 is projected to be slightly higher than the NBU target range, namely 6.2%, but in the next two years, it will be close to the 5% inflation target.

ICU view: The government's approval of the Budget Declaration is undoubtedly an important step to ensure fiscal sustainability in the medium term. The next litmus test for the government's capacity in this area will be the preparation by the government and the approval by parliament of next year's budget, consistent with this declaration.

At the same time, an important unknown variable in this process is the new tax initiatives of the government or, for instance, the presidential intention to build a new university, which have not yet been reflected in the Budget Declaration. The implementation of such initiatives may have a significant impact on certain parameters of the budget plan, but we assume that the budget deficit indicators set out in the Budget Declaration will be adhered to.

Accordingly, the fiscal consolidation envisaged in the Budget Declaration amid the government's macroeconomic forecast should reduce public debt to 51% of GDP in 2024, and return it to the pre-pandemic level at the end of 2019, after the planned increase to 64% of GDP this year.

Meanwhile, the macroeconomic forecast underlying this plan is moderately optimistic from our point of view. First of all, it applies to the rate of economic growth of about 5% in 2023–24, while estimate for next year of +3.8% looks quite realistic. For instance, the IMF predicts the slowdown of world GDP growth from 4.4% in 2022 to 3.4-3.5% in 2023–24. Against this global background, the Ministry of Economy explains their estimates for the acceleration of Ukraine's GDP by 1) expected strengthening of investment demand fuelled by bank lending recovery and state programmes, and 2) the revival of exports thanks to measures to promote Ukraine in foreign markets and reduce barriers to trade. In our opinion, such a scenario has some probability to be implemented, but it would be more appropriate to use more conservative assumptions in the forecast underpinning the Budget Declaration.

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