

Weekly Insight

UAH budget financing still far from plan

Key messages of the today's comments

Domestic liquidity and bonds market

Despite recent upturn, UAH budget financing still far from plan

After a decline in April and May, last month, the MoF improved local-currency budget financing and increased net financing YTD to above UAH19bn. But to meet budget requirements, the Ministry has to borrow significantly more.

Liquidity still high

In June, banking-sector liquidity reached a record high for the year amid large NBU's FX interventions and budget expenditures. We do not expect material changes in liquidity in July due to more balanced budget transactions and less active NBU interventions in the FX market.

Foreign exchange market

Hryvnia slightly weakens

Two long weekends in Ukraine decreased business activity especially from the sell side in the FX market, which caused further hryvnia weakening. But this week, the balance will move to the sell side and cause the hryvnia to appreciate toward UAH27/US\$, as was already seen yesterday.

TUESDAY, 6 JULY 2021

Banks' reserves market (5 July 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	7.50	+0bp	+150bp
ON rate (%)	6.50	+7bp	+88bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	51,018	-5.26	+12.04
CDs (UAHm) ³	164,845	+1.73	+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 gov't bond holders (UAHm) (5 July 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	317,277	+0.00	-2.25
Banks	505,942	-0.25	+41.43
Residents	48,197	-0.55	-4.73
Individuals	18,277	+0.39	+117.17
Foreigners ¹	110,396	-0.19	-1.01
Total	1,000,151	-0.18	+17.27

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (5 July 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.2999	+0.26	+0.41
EUR/USD	1.1864	-0.28	+5.48
DXY	92.212	+0.18	-5.10
UAH TWI ¹	123.684	-0.02	-1.77

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (6 July 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

Despite recent upturn, UAH budget financing still far from plan

After a decline in April and May, last month, the MoF improved local-currency budget financing and increased net financing YTD to above UAH19bn. But to meet budget requirements, the Ministry has to borrow significantly more.

In our April [macro review](#), we assumed that all debt repayments for FX-denominated domestic debt will be refinanced and domestic financing of the budget deficit will be covered by local-currency borrowings. In 1H21, the MoF refinanced most redemptions in hard currency and with a lower amount of redemptions in 2H21, most likely the MoF will be able to refinance them in full.

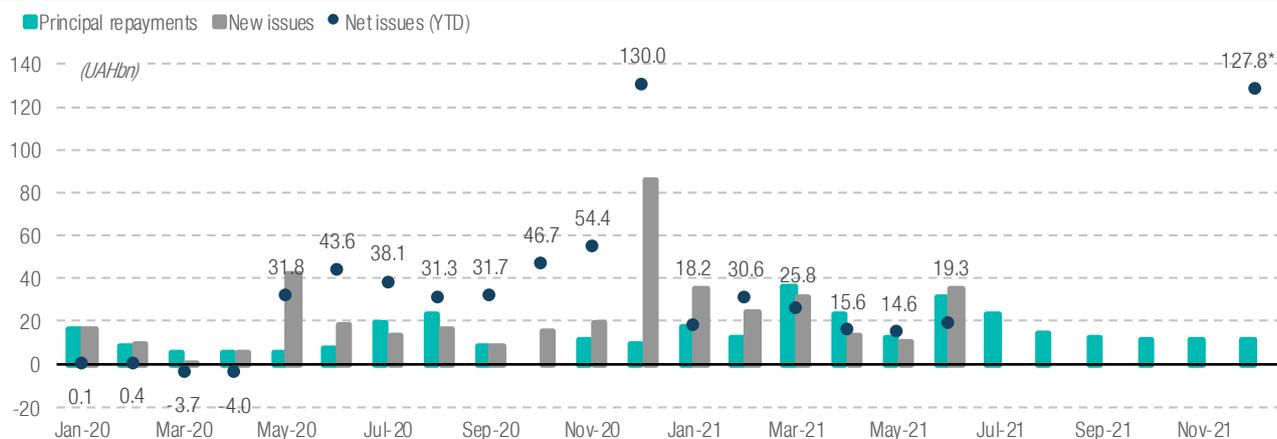
However, for local-currency debt, net financing is very slow. For instance, last weeks' auction was the weakest in June, likely due to the impact of a long weekend, negative news from the NBU, the published minutes of NBU's monetary policy meeting, and corresponding foreigners' reaction enhanced by portfolios' adjustment at the end of the half of the year. Therefore, given these conditions, borrowings of UAH2.5bn without changes in interest rates look like a not so poor result. More about this auction in [our review](#).

During the second half of June, foreigners weakened their activity and last week, portfolios declined by UAH215m. It was very slow withdrawal taking in to account all the news flows, especially since in June they increased portfolio by at least UAH12bn.

It helped the MoF to borrow on the net basis UAH19.3bn in 1H21, while it amounts to only 15% of the annual plan of UAH128bn of net budget financing domestically. Therefore, to borrow these funds, this year, the MoF has to borrow about UAH108bn (net) or about UAH18bn per month more than it redeems in local currency. This goal looks difficult to reach currently.

Chart 1. UAH-denominated debt redemptions and new borrowings

Monthly, 2020 and 2021



* Assumed amount of local-currency budget financing to meet budget requirements

Source: NBU, Bloomberg, ICU.

ICU view: One of the main reasons for low borrowings in local currency is the lower activity of foreigners and their partial withdrawal of funds from end-March to mid-June. Since then, foreigners became more active, which allowed the MoF to improve

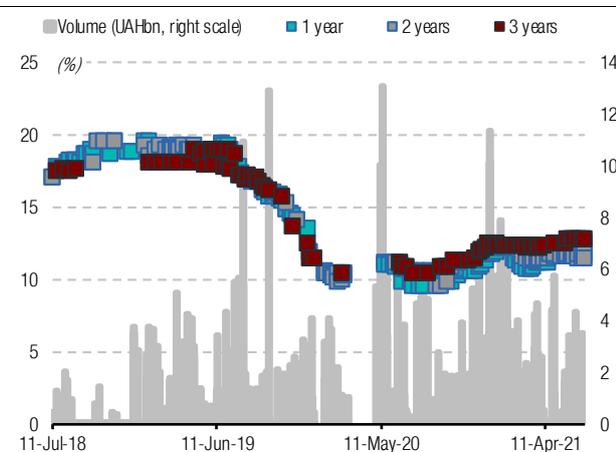
financing, but this inflow was too low to compensate the decline in banks' portfolios, as state-owned banks needed funds for dividends.

However, we expect conditions will improve going forward. Relatively high interest rates on UAH bonds both in nominal and real terms make these assets attractive to both non-residents and domestic investors. And some adjustment of the exchange rate during the last weeks against the background of a steady current account surplus and favorable terms of trade improved the conditions for non-residents. Meanwhile, closer to the end of the year, the needs of the Ministry of Finance in attracting hryvnia financing will traditionally increase, which will encourage it to raise the interest rates, strengthening the bonds' attractiveness for local banks. High level of banking-sector liquidity and further growth of deposits will provide the necessary preconditions.

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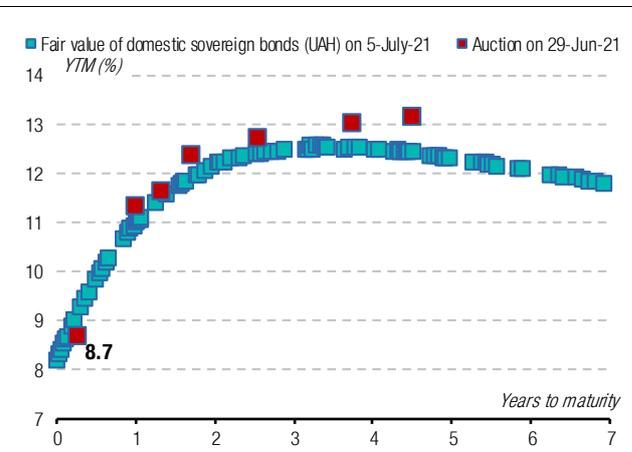
Chart 2. Local-currency bonds

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.

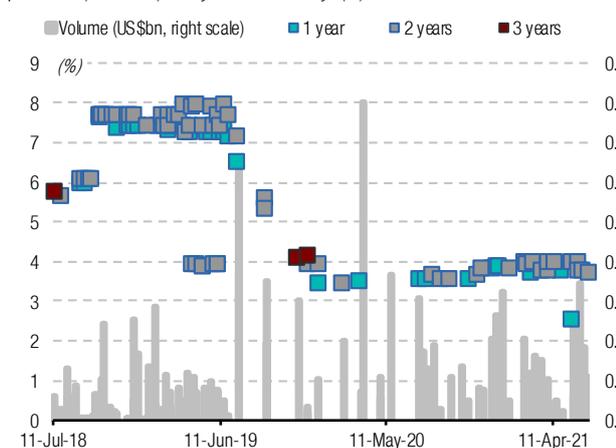
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

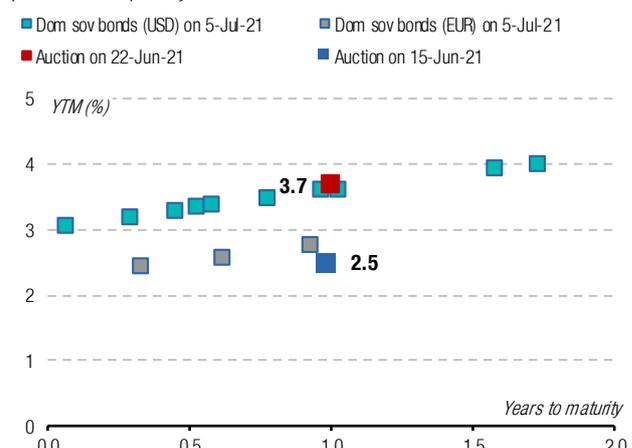
Chart 3. FX-denominated bonds

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.

Liquidity still high

In June, banking-sector liquidity reached a record high for the year amid large NBU's FX interventions and budget expenditures. We do not expect material changes in liquidity in July due to more balanced budget transactions and less active NBU interventions in the FX market.

During June, the NBU spent more than UAH16bn on hard currency purchases, while budget expenditures were larger than revenues by UAH4bn. Most of these funds were not stored in the banking system, however. Banks repaid UAH4.6bn of loans (net) and UAH9.6bn were exchanged in cash. As the result, in June, banking-sector liquidity was up by just UAH6.4bn, hovering most of the month above UAH210bn.

ICU view: In July, balance in the banking sector will be achieved through more moderate fiscal policy as the government had just UAH10.4bn in treasury accounts, or less than half it had a month ago. Likely, the NBU will purchase less hard currency and allow the hryvnia to appreciate if foreigners become more active in the bond market. In that case, liquidity will remain high, allowing the banks to pay more attention to the bond market.

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

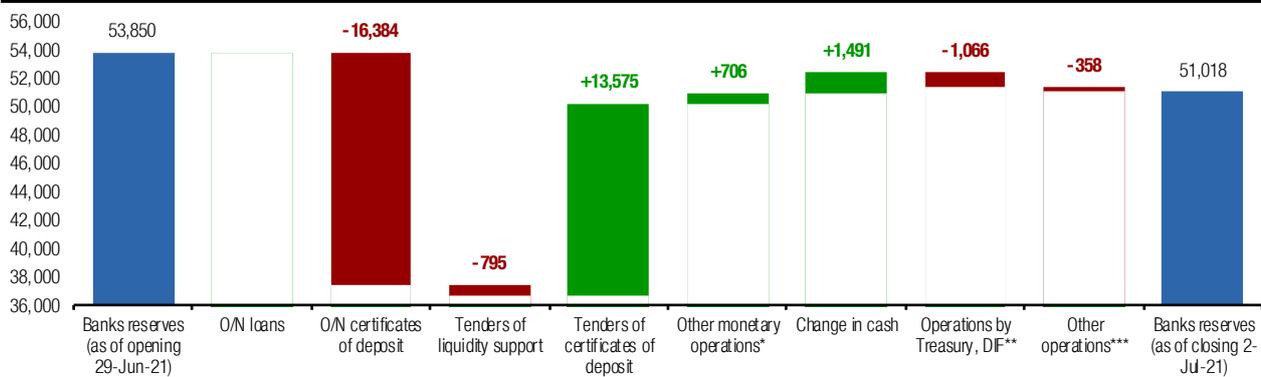
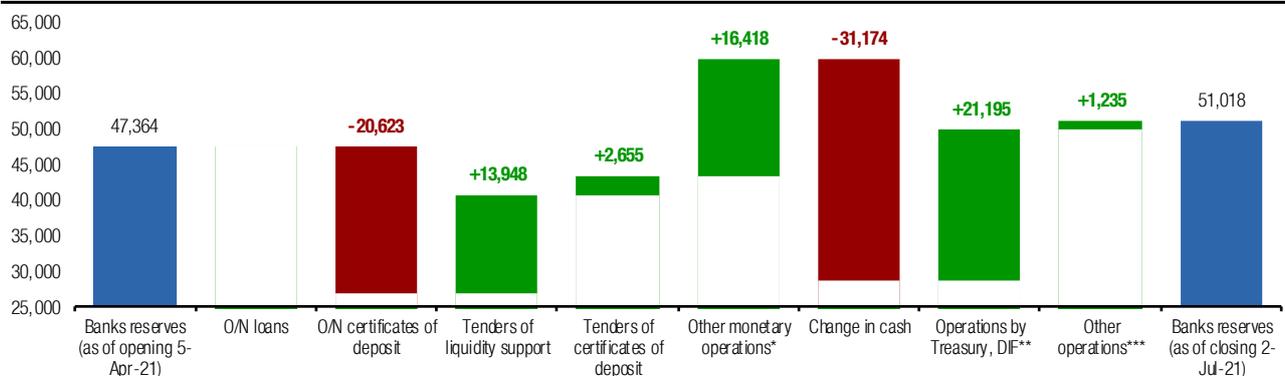


Chart 5. Banks reserves usages over last 90-day period (UAHm)



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 slightly weakens

Two long weekends in Ukraine decreased business activity especially from the sell side in the FX market, which caused further hryvnia weakening. But this week, the balance will move to the sell side and cause the hryvnia to appreciate toward UAH27/US\$, as was already seen yesterday.

Two short business weeks and vacations decreased business activity in Ukraine, which added some fluctuations in the FX market due to lower supply of hard currency. Foreigners slowed purchases of new local-currency debt due to negative news and the Fed's rhetoric. Therefore, demand from banks' clients tended to exceed supply, but the difference was lower last week than it was a week before.

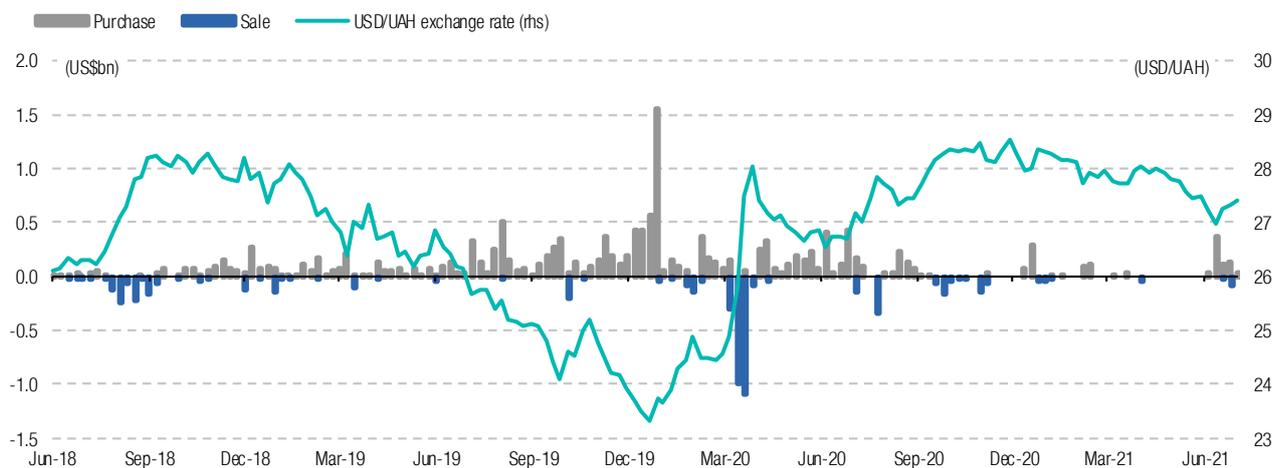
The FX market was mostly self-balanced last week, and the NBU made purchases of just US\$26m, restraining fluctuations. But the NBU's interventions could cause lower activity from sellers. By the end of last week, the hryvnia weakened by 0.2% to UAH27.39/US\$.

ICU view: Generally, the balance in the FX market should improve this week, as the break in foreign investments in local-currency debt should come to the end and their participation in the auction today should rise. Yesterday, the USD/UAH exchange rate corrected to UAH27.3/US\$, most likely due to foreigners preparing for the auction. Therefore, through this week, the hryvnia should move towards UAH27/US\$, while the speed and direction of movement will depend mostly on foreigners' participation in the bond market and changes in their portfolios.

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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.

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