

# Weekly Insight

## Inflation slowed to 8.9% YoY in July

### Key messages of the today's comments

TUESDAY, 14 AUGUST 2018

### Domestic liquidity and bonds market

#### Liquidity decline

A negative impact from non-monetary operations caused a decline in liquidity below UAH100bn. Due to increased funds outflows from the budget this week, the liquidity decline continues.

### Foreign exchange market

#### Quarterly tax payments temporarily support the UAH

This week, the hryvnia will be supported by quarterly tax payments. However, the trend for hryvnia weakening in the second half of the year gains momentum.

### Economics

#### Inflation slowed to 8.9% YoY in July

Headline inflation decelerated to 8.9% YoY in July, while in MoM terms, consumer prices declined 0.7%. Solid consumer demand and weakening of the UAH will bring about the acceleration of inflation in 2H18.

#### Official FX reserves cover three months of future imports

Ukraine's official FX reserves declined by US\$230m or 1.3% MoM, and amounted to US\$17.7bn as of 1 August 2018, now covering only three months of future imports.

### Banks' reserves market (13 August 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	17.50	...	...
ON rate (%)	N/A	...	...
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	54,898	+21.14	+12.83
DepCerts (UAHm) <sup>3</sup>	42,075	-27.05	+0.00

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's short-term bonds.  
Source: NBU, Bloomberg, ICU.

### Breakdown of govt bond holders (UAHm) (13 August 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	349,373	+0.00	-4.47
Banks	372,619	+3.41	+26.53
Residents	22,810	+2.49	+4.64
Individuals	4,306	+5.47	+492.49
Non-res <sup>4</sup>	7,814	-6.19	+73,275.89
<b>Total</b>	<b>756,922</b>	<b>+1.70</b>	<b>+10.91</b>

Notes: [1] non-residents  
Source: NBU, ICU.

### FX market indicators (13 August 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.3630	+1.42	+6.62
EUR/USD	1.1410	-1.63	-3.48
DX <sup>2</sup>	96.391	+1.27	+3.57
UAH TWI <sup>3</sup>	120.468	+2.18	+5.72

Notes: [1] UAH trade-weighted index.  
Source: Bloomberg, ICU.

### Gov't bond quotes<sup>1</sup> (14 August 2018)

Maturity	Bid	Ask
6m	18.50	17.75
12m	18.70	17.40
2y	18.00	16.75
3y	18.00	16.75
12m (\$)	5.50	5.00
2y (\$)	5.70	5.15

Notes: [1] Actual quotes you can see at [www.icu.ua](http://www.icu.ua).  
Source: ICU.

# Domestic liquidity and bonds market

## Liquidity decline

A negative impact from non-monetary operations caused a decline in liquidity below UAH100bn. Due to increased funds outflows from the budget this week, the liquidity decline continues.

The net impact of Treasury operations last week was negative and amounted to UAH0.5bn, which, with outflows from reserves to cash, increased the negative impact of non-monetary operations to UAH4bn. Additionally the NBU absorbed UAH1.9bn via the FX market and sold FX.

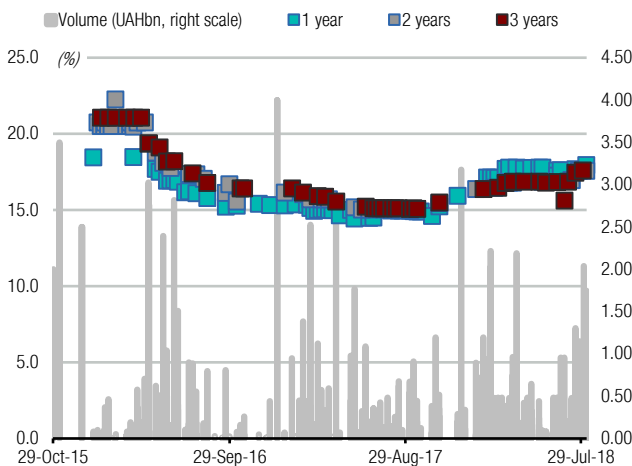
As a result of the abovementioned operations, total banking-sector liquidity fell to UAH97bn and the total amount of CDs outstanding remained steady at around UAH60bn. Outflows were mostly from banks' correspondent accounts with the NBU, and this balance fell to UAH37.5bn last Friday.

**ICU view: Quarterly tax payments, which will be mostly done this week, most likely will have a negative impact on liquidity. Additional negative impact will cause reserves exchange in cash and liquidity absorption by the NBU via the FX market. So, until the end of this month, liquidity could decline to about UAH90bn with a slight recovery due to an increase in budget expenditures.**

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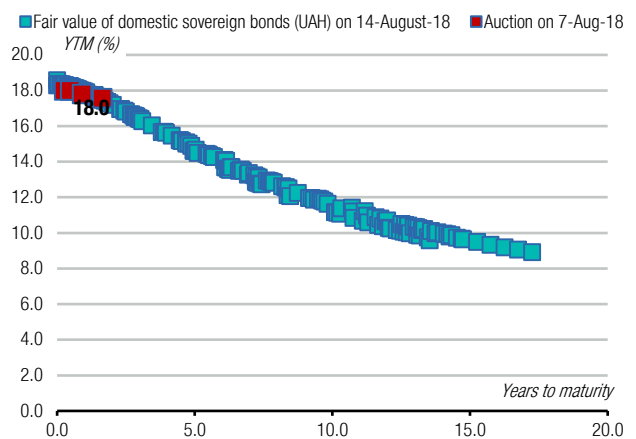
**Chart 1. Local-currency bonds**

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.

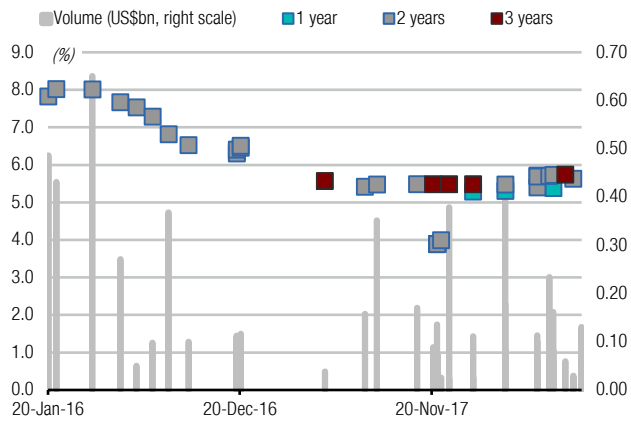
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

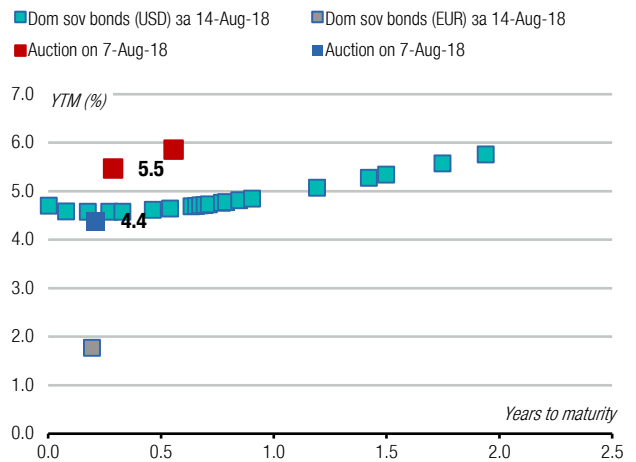
**Chart 2. FX-denominated bonds**

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



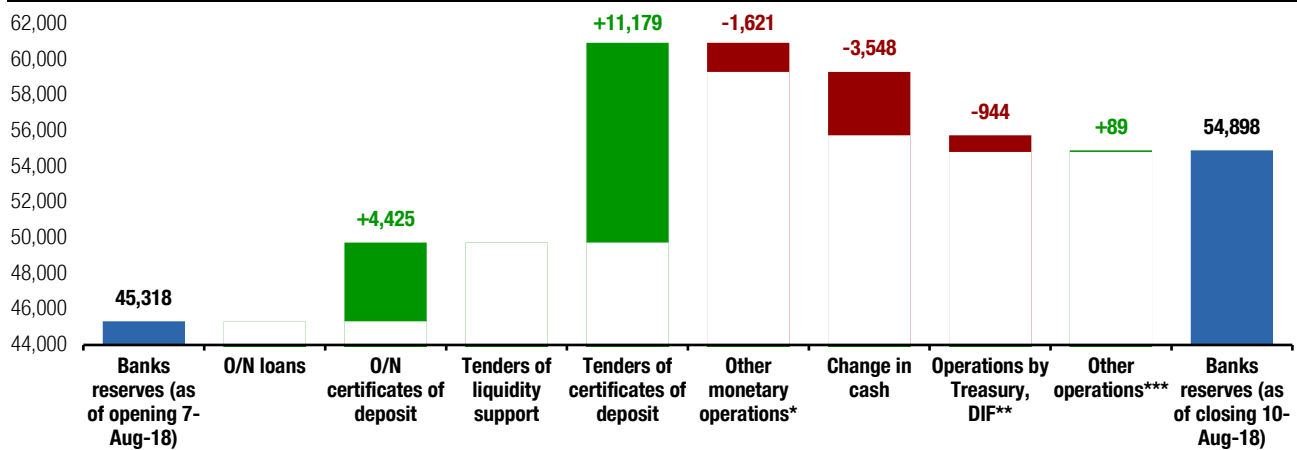
Source: Ministry of Finance of Ukraine, ICU.

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

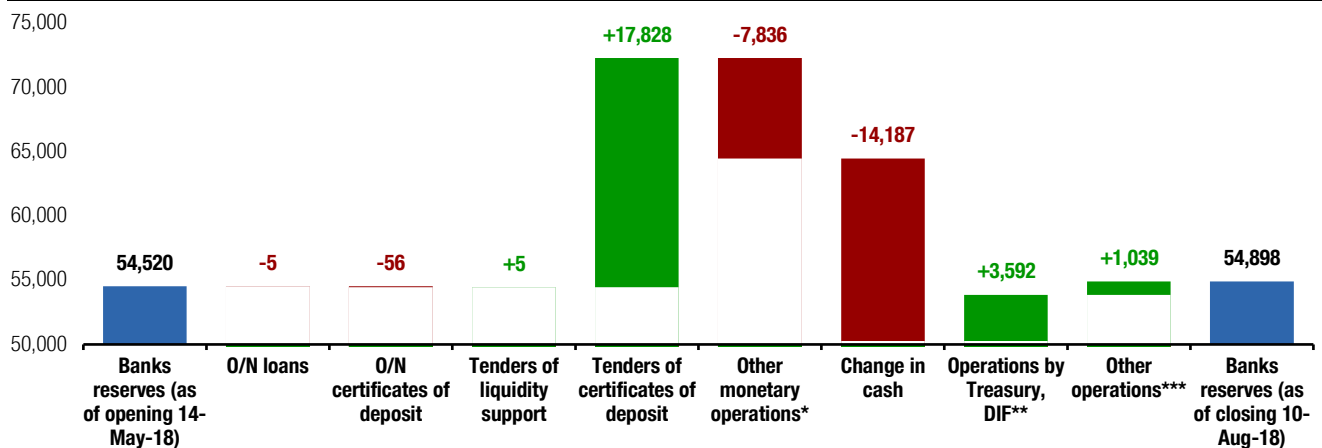


Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

**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](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

## Quarterly tax payments temporarily support the UAH

This week, the hryvnia will be supported by quarterly tax payments. However, the trend for hryvnia weakening in the second half of the year gains momentum.

Last week, the UAH remained under pressure due to imbalances in FX supply and demand as there was excess FX demand for making dividend payments to foreign investors. In addition, the UAH was negatively affected by global weakening of EM currencies on the back of a strengthening US dollar (DXY index rose 1.3% in the previous week). Thus, the hryvnia declined 0.8% against the USD, to 27.30 UAH/USD.

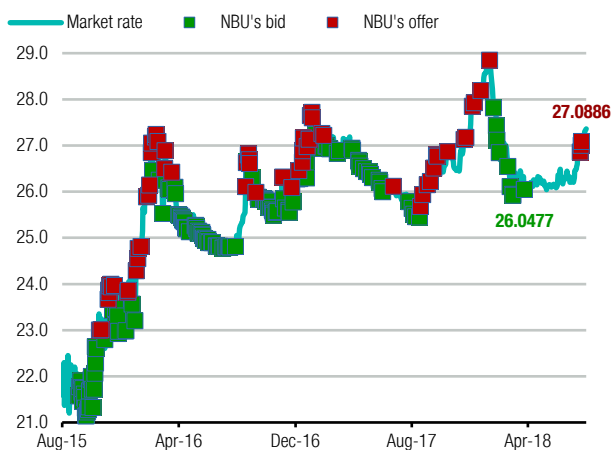
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) increased 2.4% to 120.2 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 5.3% and decreased 1.5%, respectively.

**ICU view: This week, the hryvnia will receive support thanks to quarterly tax payments, which will likely encourage exporters to sell foreign currency to make those payments. At the same time, the tendency towards seasonal weakening of the hryvnia in the second half of the year begins to gain momentum against the backdrop of 1) rising imports of consumer goods, 2) the accumulation of foreign currency by small farmers, 3) an increase in volumes of energy imports, as well as 4) high devaluation expectations.**

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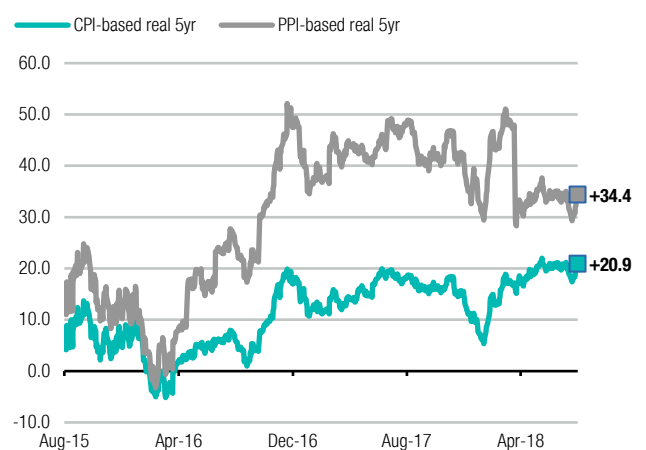
**Chart 5. FX market indicators, 3-year history**

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market



Notes: the chart provides labels for the average exchange rate at last two NBU auctions (one on buying FX from the market and one on selling it). Source: NBU, Bloomberg, ICU.

UAH exchange rate misalignment<sup>1</sup> from fundamental level<sup>2</sup> (%)



Notes: [1] "+" overvalued, "-" undervalued; [2] based on the UAH's CPI- and PPI-based real TWIs. Source: ICU.

## Economics

### Inflation slowed to 8.9% YoY in July

Headline inflation decelerated to 8.9% YoY in July, while in MoM terms, consumer prices declined 0.7%. Solid consumer demand and weakening of the UAH will bring about the acceleration of inflation in 2H18.

The slowdown in headline inflation was caused primarily by a deceleration of growth rates in prices for food products to 7.1% YoY in July, down from 17.7% YoY in December. Thanks to a good harvest of early fruits and vegetables, and a decline in prices for meat and milk, the contribution of this particular category decreased to 34% of the total reading of 8.9% YoY in July vs. 55% in December. Growth of prices on healthcare slowed to 8.2% YoY, while prices on clothing and footwear slowed to 2.2% YoY. However, transport prices accelerated to 15.4% YoY. Core inflation inched down to 8.8% YoY. The NBU forecasts headline CPI at 8.9% YoY for the end of 2018.

***ICU view: The inflation slowdown in May-July was expected because of the good harvest of fruits and vegetables this year and the stronger UAH. Still, the following factors will put pressure on consumer prices in 2H18: 1) solid consumer demand, 2) high world energy prices, 3) weakening of the UAH, and 4) a probable increase in gas prices for population. Hence, we maintain our CPI forecast at 10.2% YoY by the end of 2018.***

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### Official FX reserves cover three months of future imports

Ukraine's official FX reserves declined by US\$230m or 1.3% MoM, and amounted to US\$17.7bn as of 1 August 2018, now covering only three months of future imports.

Official FX reserves grew by US\$131m and EUR61m in July as a result of the successful placement of domestic government bonds denominated in foreign currency. However, Ukraine paid US\$322m to service state and guaranteed debt (both principal and interest), including US\$232m to service FX-denominated domestic government bonds, which was the primary reason of a decrease in official FX reserves in July, according to the NBU data. In addition, the NBU sold US\$64m on a net basis to support the hryvnia against the backdrop of excess FX demand.

***ICU view: Official FX reserves cover three months of future imports and may decline further due to payments on external debt at the end of August. Without loans from official lenders to the government and the National Bank, it will be very difficult to hold reserves above the psychological level of three months of future imports.***

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