

Weekly Insight

Inflation inched down

Key messages of the today's comments

Domestic liquidity and bonds market

MoF ready for repayments

Last week, the MoF held two primary auctions, and after two weeks collected more than US\$400m. Together with available reserves from the Eurobonds issue in August, this should be enough for this week's debt repayments.

Liquidity up with NBU support

Last week, liquidity was below UAH80bn, but after receiving support from the NBU, it rose close to this month's high, exceeding UAH77.8bn.

Foreign exchange market

A quiet week for the hryvnia

A short week will not bring surprises for the national currency, so we expect the hryvnia to be around 28 UAH/USD.

Economics

IMF updates economic outlook for Ukraine

The IMF improved its 2018 real GDP forecast by 0.3ppt to growth of 3.5%. However, its 2019 real GDP forecast was worsened to 2.7% (vs. 3.3% previously), while for 2020, the Fund expects growth of 3% (vs. 3.5% previously).

Inflation inched down to 8.9% YoY in September

Consumer prices will be under pressure from a number of factors, including seasonal UAH weakening, robust consumer demand, and a probable hike in gas prices for population in 4Q18.

WEDNESDAY, 17 OCTOBER 2018

Banks' reserves market (16 October 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+550bp
ON rate (%)	17.88	+2bp	+628bp
ON \$ swap (%)	17.03	+3bp	+0bp
Reserves (UAHm) ²	55,444	+45.28	+13.97
DepCerts (UAHm) ³	30,534	-25.57	+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) (16 October 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,100	+0.00	-3.46
Banks	370,972	+2.42	+21.82
Residents	20,358	-3.37	-9.98
Individuals	4,856	+3.55	+514.98
Non-res ⁴	7,240	+0.02	+138.00
Total	751,526	+1.12	+8.75

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

FX market indicators (16 October 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.8975	-0.40	+5.19
EUR/USD	1.1574	+0.47	-1.88
DXY ²	95.048	-0.48	+1.86
UAH TWI ³	116.206	-0.74	+3.17

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

Gov't bond quotes¹ (17 October 2018)

Maturity	Bid	Ask
6m	19.75	18.50
12m	19.75	18.10
2y	19.50	18.00
3y	19.50	17.50
12m (\$)	7.50	5.00
2y (\$)	7.50	5.20

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

Domestic liquidity and bonds market

MoF ready for repayments

Last week, the MoF held two primary auctions, and after two weeks collected more than US\$400m. Together with available reserves from the Eurobonds issue in August, this should be enough for this week's debt repayments.

Increasing interest rates for FX-denominated bills in October to 7% and for some issues to 7.5% allowed the MoF to receive US\$303m last week, and an additional EUR30m for next week's repayments. New bonds were mostly purchased by banks, and only a small portion were purchased by non-banks and individuals.

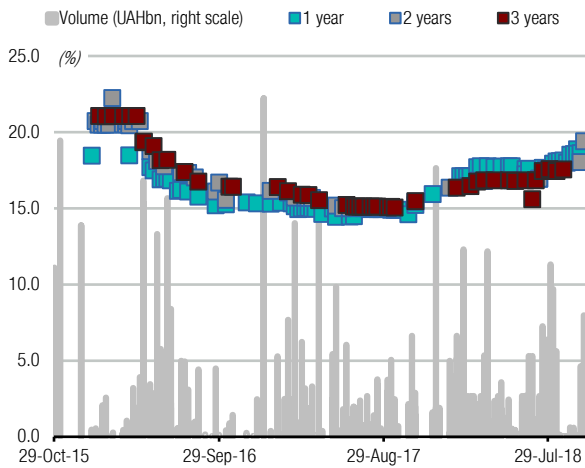
Despite the scheduled redemptions of CLNs last week, foreign investors' portfolios remained steady. So, these investments could be closed earlier, and bonds that were the reference asset sold as new bills are purchased on Wednesday.

ICU view: Having enough funds for FX-denominated debt repayments, the MoF rejected expensive bids due low demand for offered bonds. Debt repayments were already made.

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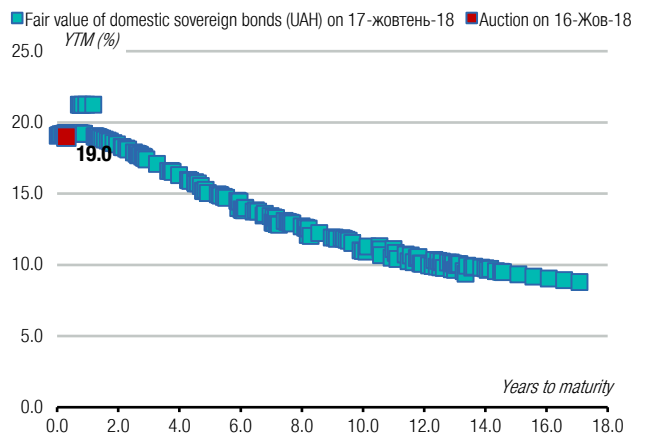
Chart 1. Local-currency bonds

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.

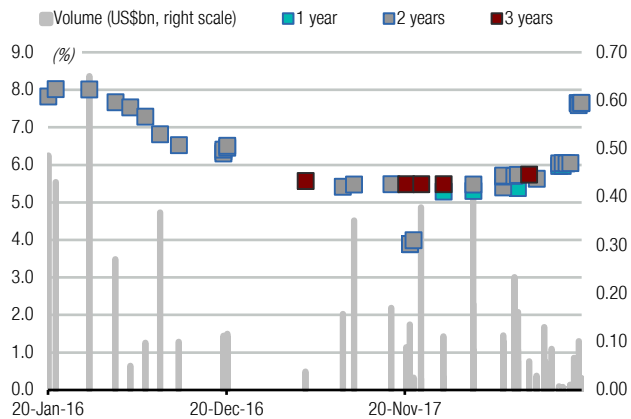
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

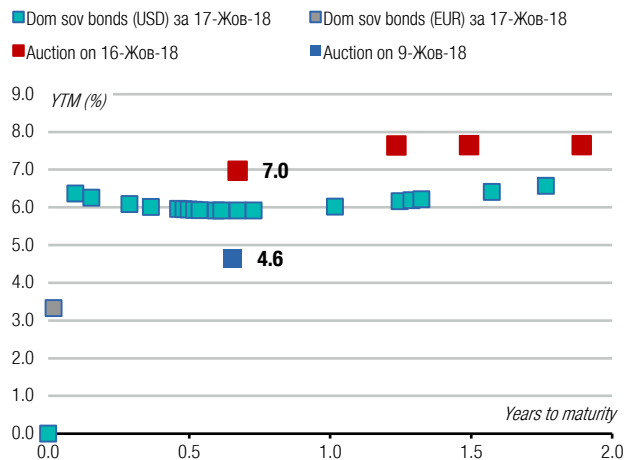
Chart 2. FX-denominated bonds

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 up with NBU support

Last week, liquidity was below UAH80bn, but after receiving support from the NBU, it rose close to this month's high, exceeding UAH77.8bn.

Last week, the NBU purchased extra FX at the market and provided with UAH1.8bn of liquidity for the banking system. Also on Wednesday, the NBU issued a UAH2.5bn ON loan for one bank. It was extended last Thursday and last Friday was increased to UAH3bn and exchanged for a two-week loan. These two sources were main reasons for the liquidity increase. Additionally, the Treasury provided UAH7.5bn of funds, but this impact was cut by reserves exchange in cash at UAH5.1bn.

ICU view: This week, liquidity should stay at around UAH80bn with support from NBU via the FX market and FX purchases. The Treasury can also provide funds via expenditures and create additional support, but the total amount of liquidity is unlikely to exceed UAH80bn.

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

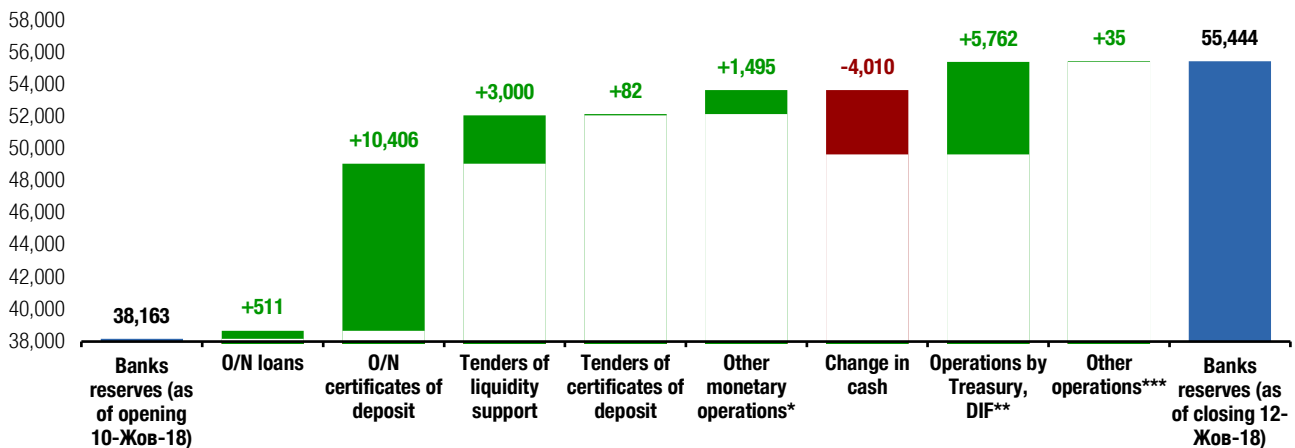
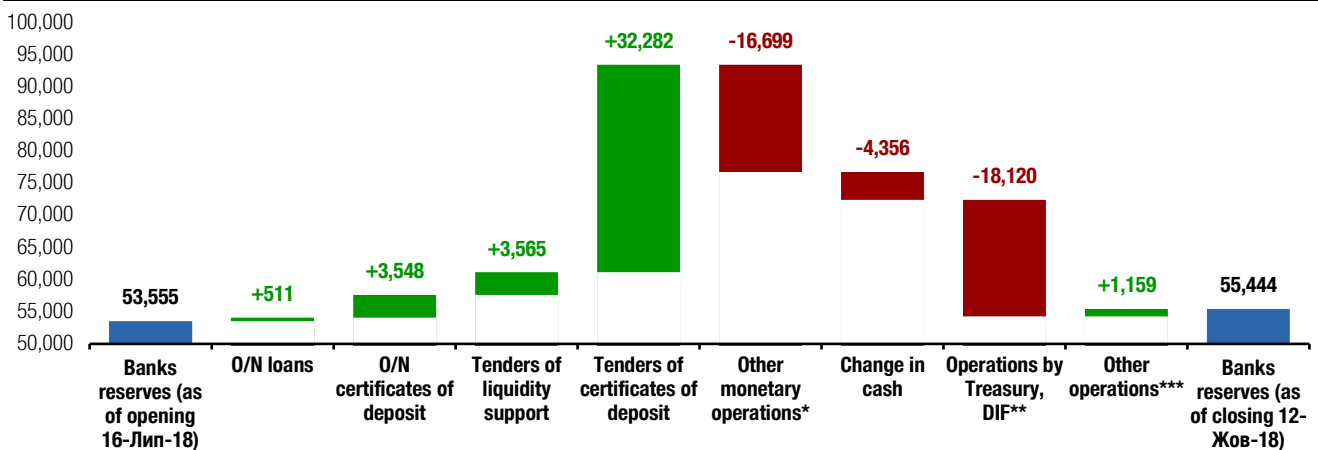


Chart 4. Banks reserves usages over last 90-day period (UAHm)


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

A quiet week for the hryvnia

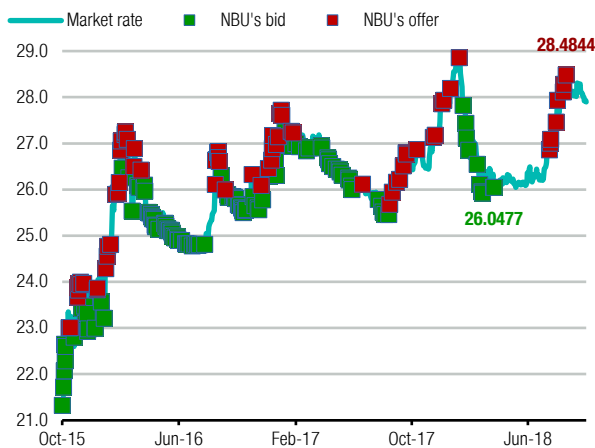
A short week will not bring surprises for the national currency, so we expect the hryvnia to be around 28 UAH/USD.

Last week, the hryvnia strengthened against the American currency due to the high supply of dollars on the local-currency market. This situation allowed the regulator to enter the market and buy back US\$65.5m. Thus, a combination of factors such as excess supply of foreign currency in the local market and a weakening of the US dollar in the global market led to a 0.65% increase in hryvnia last week to 27.92 UAH/USD.

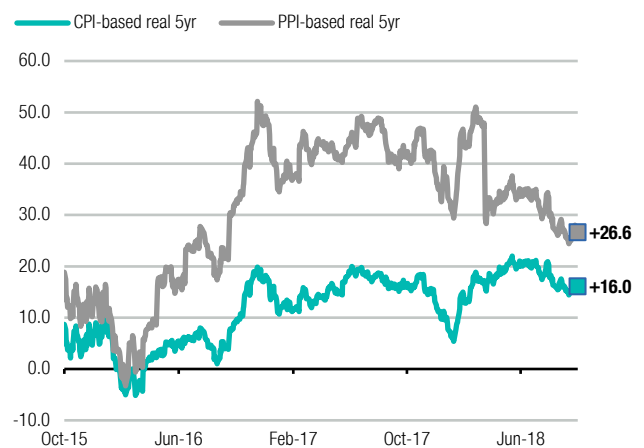
The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) decreased 0.2% to 116.7 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 3.7% and decreased 1.7%, respectively.

ICU view: This week should be calm for the hryvnia, so the exchange rate will be in the range of 27.9–28.1 UAH/USD. At the same time, the situation on the global currency market may introduce some adjustments due to movement of the EUR/USD currency pair.

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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 misalignment¹ from fundamental level² (%)


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

Economics

IMF updates economic outlook for Ukraine

The IMF improved its 2018 real GDP forecast by 0.3ppt to growth of 3.5%. However, its 2019 real GDP forecast was worsened to 2.7% (vs. 3.3% previously), while for 2020, the Fund expects growth of 3% (vs. 3.5% previously).

According to the IMF, Ukraine's nominal GDP is set to expand to UAH3,421bn in 2018, which amounts to US\$126.4bn, and to increase to UAH3,809bn or US\$132.9bn in 2019. This implies that the IMF has improved its forecast of the year-average exchange rate to 28.7 UAH/USD (vs. 29.3 UAH/USD previously).

Headline inflation is expected at 9% YoY by the end of 2018, and will decelerate to 6.2% YoY by the end of 2019. The C/A deficit will be 3.1% of GDP in 2018, and is set to widen to 3.9% of GDP in 2019. At the same time, the IMF improved its estimate of Ukraine's public debt (both direct and guaranteed) to 70.5% of GDP in 2018 and 68.8% of GDP in 2019.

ICU view: The IMF's updated 2018 economic forecasts are generally in line with our estimates: 1) real GDP growth at 3.5%, 2) C/A deficit at 3% of GDP, 3) headline CPI at 10% YoY (see the next comment). However, in our view, for 2019, growth is seen slowing towards less than +2% YoY, as fiscal stimulus fades, interest rates remain high, the main trading partner economies slow, and external refinancing needs increase.

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Inflation inched down to 8.9% YoY in September

Consumer prices will be under pressure from a number of factors, including seasonal UAH weakening, robust consumer demand, and a probable hike in gas prices for population in 4Q18.

The key drivers of slowing inflation in September were lower growth rates in food prices (6.7% YoY vs. 7.1% YoY in August), and in prices of alcoholic beverages and tobacco products

(15.7% YoY vs. 17.9% YoY in August). The combined contribution of these two categories declined 0.4ppt MoM to 4.2% out of the total reading of 8.9% in September.

On the flip-side, solid growth acceleration was posted in prices on transport (17.7% YoY vs. 16.2% YoY in August) due to a significant increase in world oil prices. The contribution of this category rose 0.2ppt MoM to 2.1% out of the total reading. Among other categories, the highest growth was in prices on communication (10.9% YoY vs. 9% YoY in August). Core inflation remained unchanged at 8.7% YoY. The NBU forecasts headline CPI at 8.9% YoY for the end of 2018.

ICU view: Headline inflation remains close to the NBU's target for the third consecutive month. However, in our view, growth of consumer prices will somewhat accelerate in 4Q18 due to 1) seasonal UAH weakening, 2) a probable gas price hike for population in 4Q18, 3) robust growth of world oil prices, and 4) further growth of consumer demand. Thus, we maintain our CPI forecast at 10% YoY for the end of 2018.

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