

Weekly Insight

Inflation slowed to 6.5% YoY in October

Key messages of the today's comments

TUESDAY, 12 NOVEMBER 2019

Domestic liquidity and bonds market

Foreigners' portfolios rose above UAH100bn

After purchase of four-year notes last week, foreign investors' portfolios increased above UAH100bn. This week, foreigners should continue to increase investments in local-currency paper.

Liquidity at new record high

After significant NBU purchases of hard currency and large budget expenditures, liquidity rose to a new record high, where it could stay this week despite possible outflows to budget accounts.

Foreign exchange market

Hryvnia appreciates

Last week, the NBU could not prevent the hryvnia from further appreciation, despite significantly replenishing FX reserves. This week, the NBU will continue to buy hard currency as supply will remain large.

Economics

Inflation slowed to 6.5% YoY in October

Lower world energy prices and a stronger UAH thanks to tight monetary policy will continue to constrain consumer-prices growth this year.

Banks' reserves market (11 November 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	15.50	+0bp	-250bp
ON rate (%)	13.95	-7bp	-323bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	N/A
DepCerts (UAHm) ³	N/A

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) (11 November 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,063	+0.00	-3.17
Banks	332,073	-1.39	-7.78
Residents	26,421	+1.22	+31.84
Individuals	9,711	-1.81	+79.75
Non-res ⁴	102,015	+2.12	+1,327.88
Total	807,284	-0.30	+8.98

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (11 November 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	24.5050	-0.83	-12.05
EUR/USD	1.1033	-0.38	-2.67
DX ²	98.200	+0.22	+1.34
UAH TWI ³	134.459	+1.20	+13.86

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (12 November 2019)

Maturity	Bid	Ask
6m	16.00	14.25
12m	16.00	14.25
2y	16.00	14.25
3y	16.00	14.00
12m (\$)	5.50	3.50
2y (\$)	5.50	4.00

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

Source: ICU.

Domestic liquidity and bonds market

Foreigners' portfolios rose above UAH100bn

After purchase of four-year notes last week, foreign investors' portfolios increased above UAH100bn. This week, foreigners should continue to increase investments in local-currency paper.

Last week, foreign investors' portfolios rose by UAH2.2bn to above UAH100bn, reaching UAH102bn (US\$4.16bn). The local-currency portion of their portfolios rose to UAH99.2bn (US\$4.05bn), and this week portfolios can rise above UAH100bn after today's issuance of three-year notes.

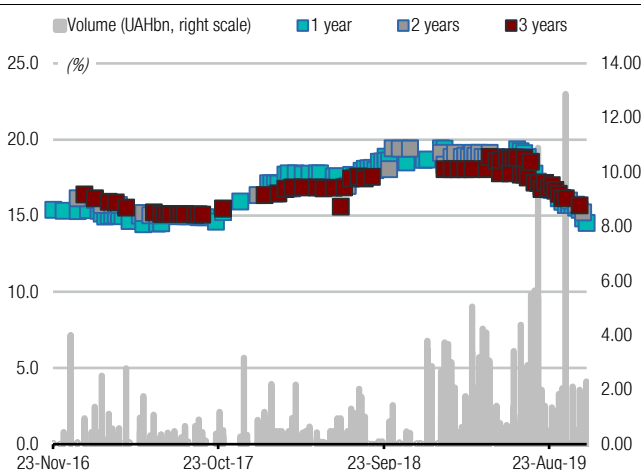
After redemption of UAH4.1bn last week and new issues in lower amounts, foreign investors' share in bonds outstanding rose to 12.6%. The NBU's share rose to 41.8%, and non-banks' to 3.3%. But banks' share slid to 41.1%, and individuals' share declined to 1.2%. It seems like these two groups were the main holders of the issues that matured last Wednesday, and they purchased less new paper.

ICU view: It looks like foreigners are still the main buyers of bills and notes with maturities above 12 months, which has caused a significant decline in interest rates. This week, the MoF offers three-year notes, which once more will be mostly purchased by foreigners, and USD-denominated bills, which will be bought by banks and individuals. Taking into the account the offered amounts, most likely the greatest increase will be in foreigners' portfolios, and their portfolios of local-currency bills should rise above UAH100bn.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

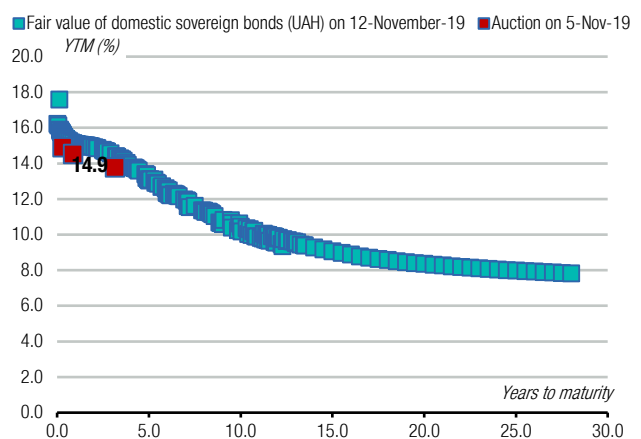
Chart 1. Local-currency bonds

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.

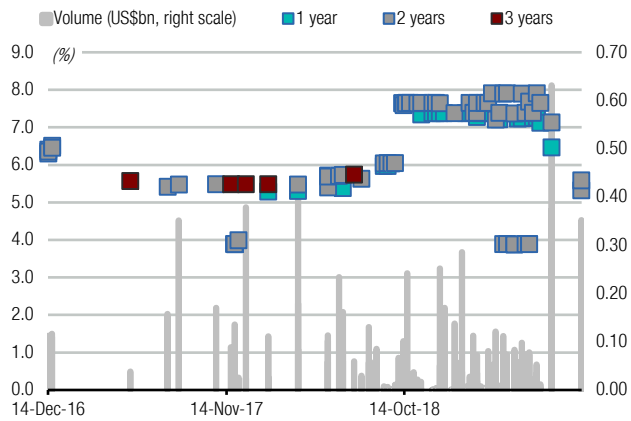
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

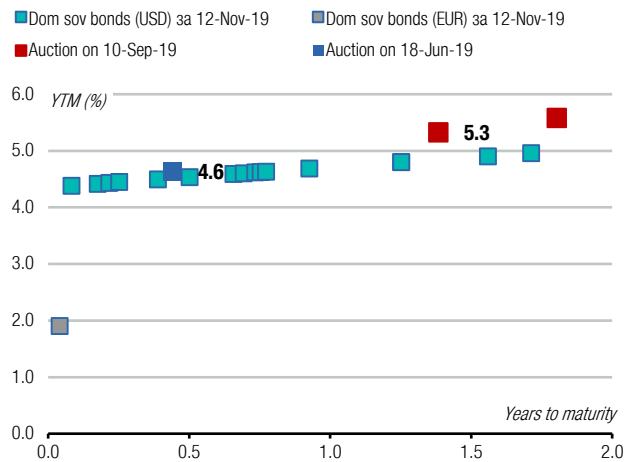
Chart 2. FX-denominated bonds

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 at new record high

After significant NBU purchases of hard currency and large budget expenditures, liquidity rose to a new record high, where it could stay this week despite possible outflows to budget accounts.

Last week, the NBU spent UAH9.1bn on FX purchases, allowing banking-sector liquidity to rise to UAH133.7bn, a new record high. The positive balance of Treasury operations at UAH6.5bn compensated outflows caused by reserves exchange in cash, which amounted to UAH5.2bn. Additional outflows of UAH0.3bn were caused by other non-monetary operations.

Probably to absorb extra liquidity, the NBU offered banks seven-day CDs last Friday, and increased outstandings of CDs to UAH88.5bn. Of that amount, UAH73.5bn have redemption this Friday. Part of these repayments will be reinvested in new 14-day CDs, but part of the funds will be used for quarterly tax payments.

ICU view: *This week, we expect the supply of hard currency will require NBU participation in the market and extra supply will be purchased by the NBU. So, there will be a new injection of liquidity from the NBU, which should compensate outflows to the budget through quarterly tax payments, keeping liquidity steady at around UAH130bn.*

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

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

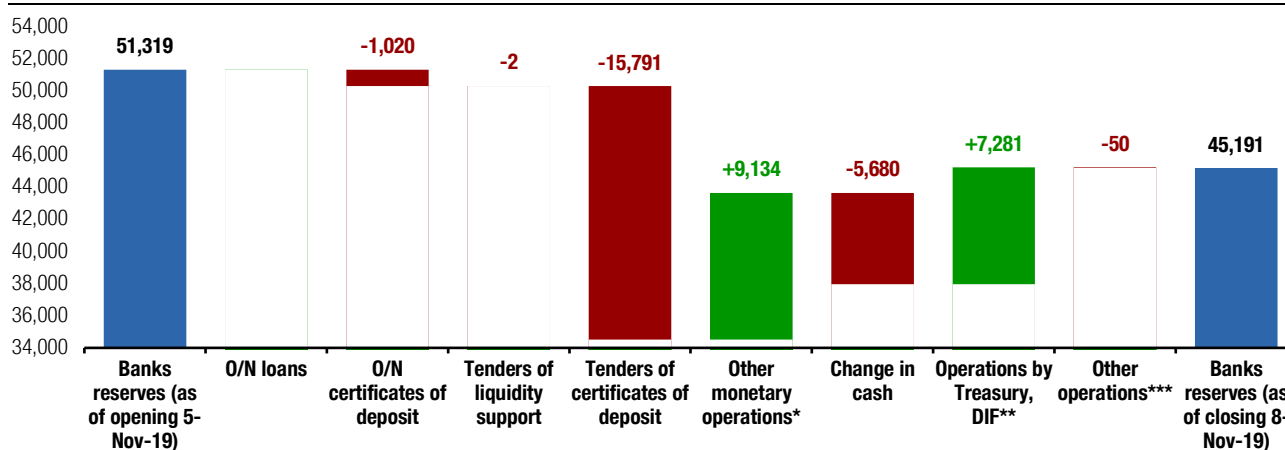
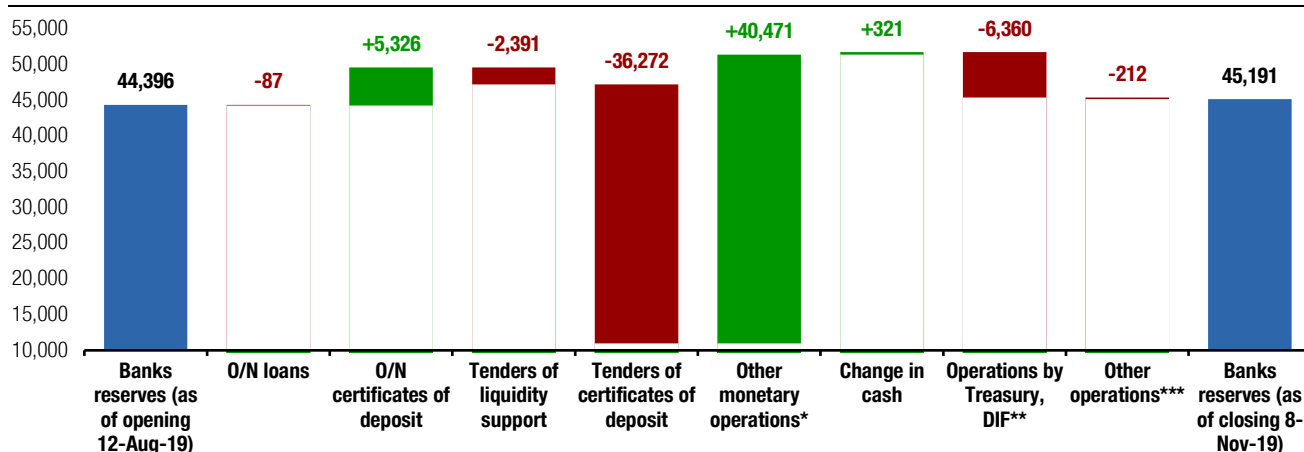


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Hryvnia appreciates

Last week, the NBU could not prevent the hryvnia from further appreciation, despite significantly replenishing FX reserves. This week, the NBU will continue to buy hard currency as supply will remain large.

Last week, the NBU purchased US\$372m, the second largest weekly amount in the last two years. There were larger purchases at the end of July at US\$510m. At the end of September, foreigners purchased large amounts of local-currency notes, and the NBU purchased just US\$348m. Last week, supply was not only from foreign investors, as they bought four times fewer notes than the NBU purchased in hard currency.

As the result, the NBU barely restrained appreciation of Ukrainian hryvnia, which appreciated by 1.1% to UAH24.5/US\$ at the end of last week. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 1.2% to 134.5, while in YoY terms, it was up 13.9%.

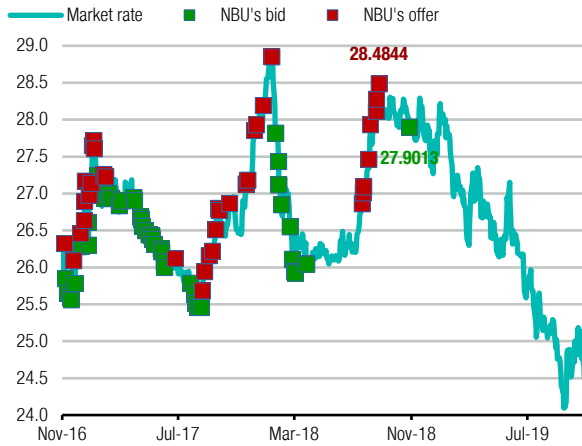
ICU view: This week, we will see hard currency supply from exporters for quarterly tax payments, which, in addition to supply from foreign investors in the government's

local paper, will cause supply to exceed demand. So, this week, the hryvnia may continue its appreciation towards UAH24/US\$, but less aggressively.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

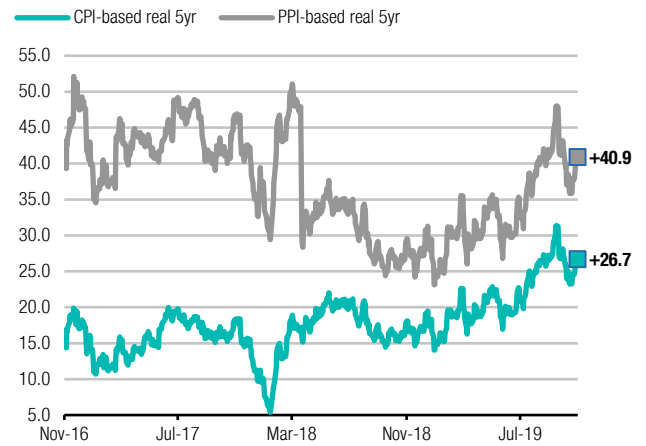
Chart 5. FX market indicators, 3-year history

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

Inflation slowed to 6.5% YoY in October

Lower world energy prices and a stronger UAH thanks to tight monetary policy will continue to constrain consumer-prices growth this year.

In October, headline inflation slowed to 6.5% YoY from the 7.5% YoY seen in September, which is the lowest reading since March 2014, while in MoM terms, prices rose 0.7%. Inflation is slowing, primarily thanks to a stronger UAH and low world energy prices. Prices for transport fell 2.4% YoY, while growth in prices for food products decelerated to 8.2% YoY. This allowed a decrease in the inflation reading by 0.4ppt and 0.3ppt, respectively, out of a total decline of 1ppt. Core inflation fell to 5.8% YoY. The NBU forecasts headline CPI at 6.3% YoY by the end of 2019.

ICU view: A stronger UAH, lower world energy prices, and improvement in inflationary expectations currently constrain consumer-prices growth. Still, rising prices for food products due to a worse YoY harvest in 4Q19, further increase in tariffs for communication because of large expenditures by mobile operators for 3G and 4G licenses and equipment, as well as robust growth of consumer demand will maintain inflationary pressure.

Dmytro Dyachenko, Kyiv, (044) 377-7040 ext.738

This page is intentionally left blank



11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kyiv, 01030 Ukraine
Phone/Fax +38 044 3777040

WEB www.icu.ua



RESEARCH

Alexander Martynenko 

Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv 

Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Taras Kotovych 

Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Dmitriy Dyachenko

Junior financial analyst
dmitriy.dyachenko@icu.ua

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (license numbers: dealer activity AE 263019, broker activity AE 263018, underwriting activity AE 263020 dated 11 April 2013).

DISCLAIMER

This research publication has been prepared by Investment Capital Ukraine LLC solely for information purposes for its clients. It does not constitute an investment advice or an offer or solicitation for the purchase or sale of any financial instrument. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, Investment Capital Ukraine makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of Investment Capital Ukraine LLC. All rights are reserved. Any investments referred to herein may involve significant risk, are not necessarily available in all jurisdictions, may be illiquid and may not be suitable for all investors. The value of, or income from, any investments referred to herein may fluctuate and/or be affected by changes in exchange rates. Past performance is not indicative of future results. Investors should make their own investigations and investment decisions without relying on this report. Only investors with sufficient knowledge and experience in financial matters to evaluate the merits and risks should consider an investment in any issuer or market discussed herein and other persons should not take any action on the basis of this report.

Additional information is available upon request.

