

Weekly Insight

Inflation slows to 2.3% YoY in March

Key messages of the today's comments

MONDAY, 13 APRIL 2020

Domestic liquidity and bonds market

Government skips another bond auction

The state budget has gone for two consecutive weeks without new local borrowings, only redeeming old issues according to the schedule. Due to redemptions and deals in the secondary market, we saw changes in bondholders' portfolios. There are neither redemptions scheduled this week nor new issues. So, portfolios will change mainly due to transactions in the secondary market and changes in the hryvnia exchange rate.

Banks need cash

Last week, banks actively exchanged reserves in cash, which had a negative impact on liquidity, and restrained recovery. Nonetheless, liquidity remained above UAH190bn, and this week it should rise.

Foreign exchange market

Market becomes balanced

Last week, the hryvnia exchange rate was volatile in the range of UAH27.1–27.5/US\$, which induced the NBU to intervene with both selling and buying USD. This week the NBU is more likely to restrain appreciation than to intervene in the market with hard currency offerings.

Economics

Inflation slows to 2.3% YoY in March

Higher food prices, a weaker hryvnia, and rising social payments will result in inflation acceleration, which to some extent will be reined in by lower oil and gas prices and depressed consumption.

Banks' reserves market (10 April 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	15.50	+0bp	-250bp
ON rate (%)	10.19	-66bp	-635bp
ON \$ swap (%)	9.49	+82bp	-561bp
Reserves (UAHm) ²	36,896	-32.52	-4.63
DepCerts (UAHm) ³	154,041	+21.49	+124.00

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) (10 April 2020)

	Last	Weekly chg (%)	YoY chg (%)
NBU	324,577	+0.00	-3.72
Banks	340,134	-0.20	-7.04
Residents	51,353	-1.20	+93.92
Individuals	8,398	-2.71	+3.92
Non-res ⁴	116,447	-1.76	+389.53
Total	840,910	-0.41	+10.45

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

FX market indicators (10 April 2020)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.1600	-0.97	+0.98
EUR/USD	1.0937	+1.26	-2.99
DXY ²	99.482	-1.09	+2.62
UAH TWI ³	128.696	-0.92	+6.44

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

Gov't bond quotes¹ (13 April 2020)

Maturity	Bid	Ask
6m	19.00	15.00
12m	19.00	15.00
2y	19.00	15.00
3y	19.00	15.00
12m (\$)	5.00	3.00
2y (\$)	6.00	3.50

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

Domestic liquidity and bonds market

Government skips another bond auction

The state budget has gone for two consecutive weeks without new local borrowings, only redeeming old issues according to the schedule. Due to redemptions and deals in the secondary market, we saw changes in bondholders' portfolios. There are neither redemptions scheduled this week nor new issues. So, portfolios will change mainly due to transactions in the secondary market and changes in the hryvnia exchange rate.

Last week, redemptions amounted to UAH1.6bn, without sufficient impact on investors' portfolios. The most noticeable were secondary market transactions, including selling bonds by foreign investors.

All investors reduced their holdings, except banks. However for portfolios of local-currency bills, we saw slight reallocation from foreigners' accounts to banks, and to other investors as well.

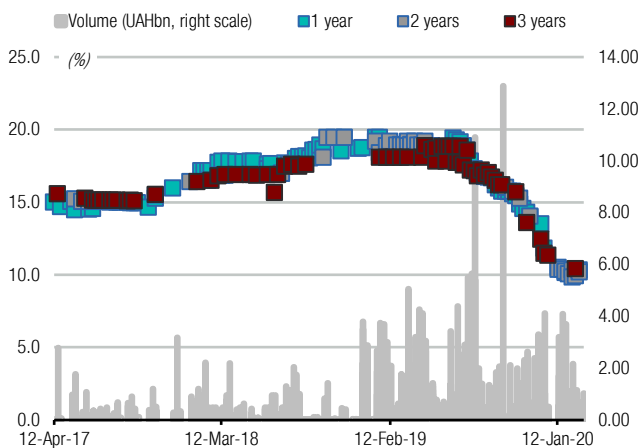
Foreigners' portfolios of local-currency bills declined by UAH1.8bn (US\$67m to UAH113bn (US\$4.2bn), while non-banks and individuals purchased some new bills after redemption on Wednesday. The largest increase was seen in banks' portfolios, by UAH0.8bn (US\$30m) to UAH245bn (US\$9.1bn).

ICU view: This week, a primary auction was cancelled once again, for the third consecutive week. Expectedly, as the Minister of Finance declared that the budget did not need new borrowings in April. Therefore, the main impact on bondholders' portfolios will be from secondary-market trading and revaluation of FX-denominated bills. Most likely, foreigners will continue to sell local-currency bills this week, but at a lower pace due to the lack of scheduled debt redemptions.

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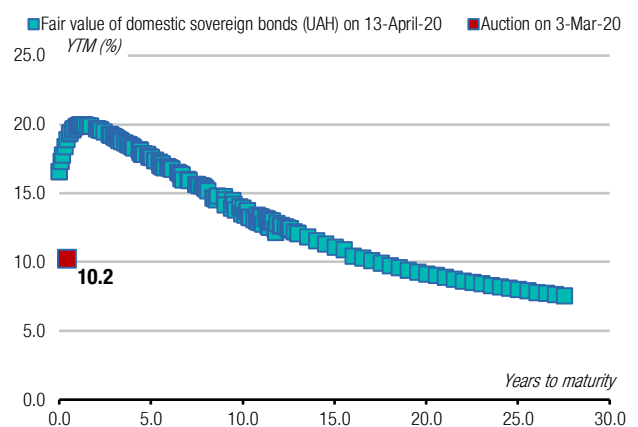
Chart 1. Local-currency bonds

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.

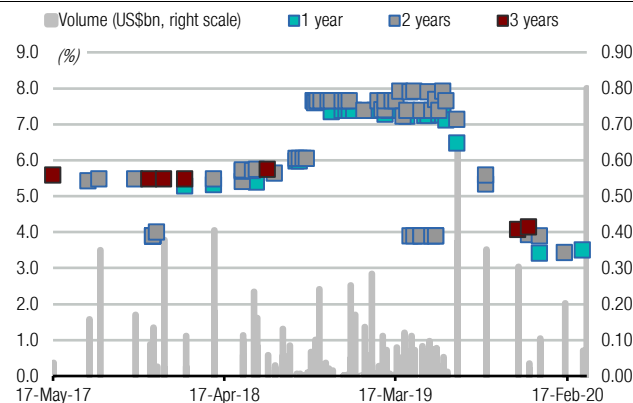
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

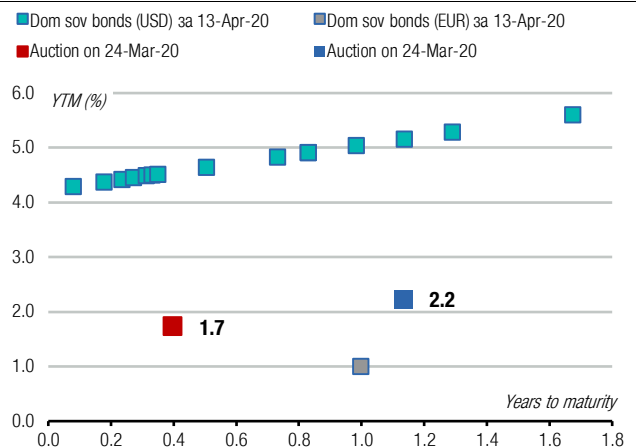
Chart 2. FX-denominated bonds

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.

Banks need cash

Last week, banks actively exchanged reserves in cash, which had a negative impact on liquidity, and restrained recovery. Nonetheless, liquidity remained above UAH190bn, and this week it should rise.

For most of last week, liquidity stayed above UAH193bn, receiving support from the NBU and Treasury. However, after last Thursday, the NBU had to sell hard currency, reserves exchange in cash decreased liquidity to UAH191bn by the end of the week.

In total, the NBU injected UAH7.7bn into the banking sector's liquidity last week, while the Treasury added UAH11.5bn. At the same time, banks actively exchanged reserves in cash and decreased liquidity by UAH12.7bn.

ICU view: This week, banks' liquidity will be volatile at around UAH190bn and can rise slightly when the NBU purchases a large amount of hard currency from the FX market. However, the Treasury can decrease its impact on liquidity to almost neutral.

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

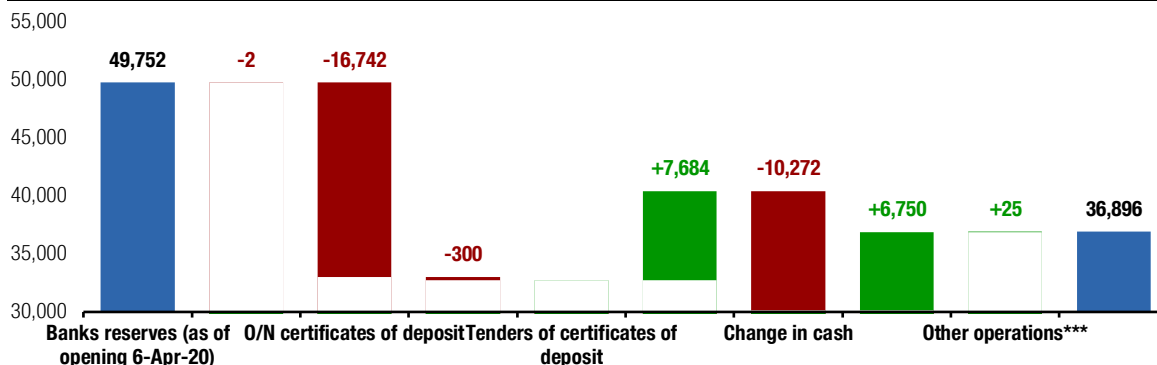
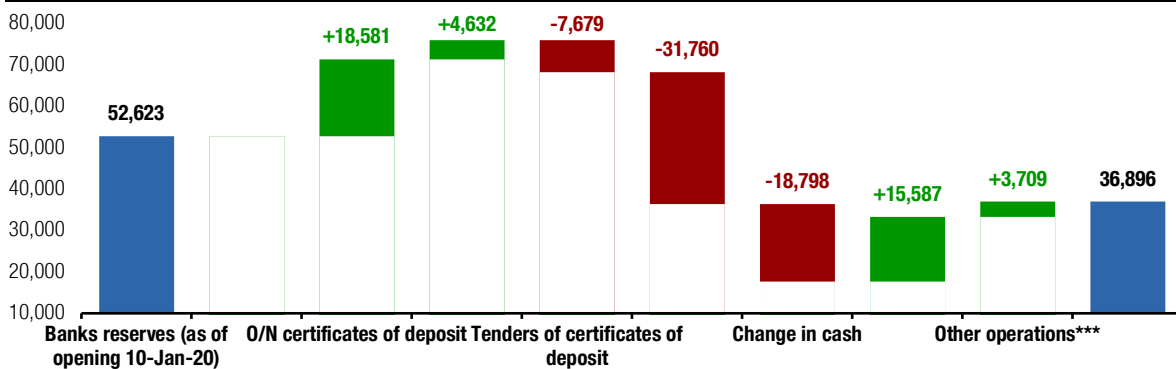


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

Market becomes balanced

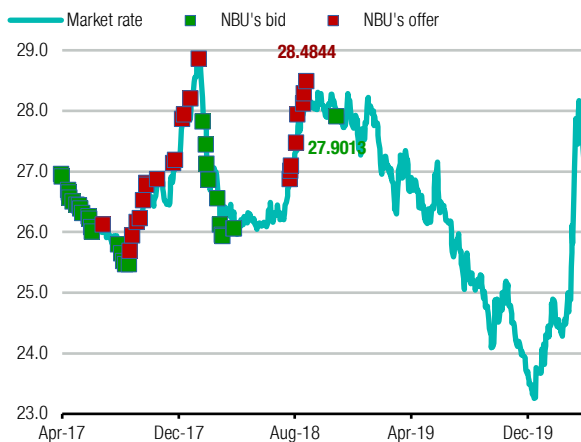
Last week, the hryvnia exchange rate was volatile in the range of UAH27.1–27.5/US\$, which induced the NBU to intervene with both selling and buying USD. This week the NBU is more likely to restrain appreciation than to intervene in the market with hard currency offerings.

The total amount of NBU's interventions last week was US\$283m, purchasing US\$328m at the beginning of the week, but later having to sell on Thursday US\$45m of hard currency to keep the market balanced. The NBU did not intervene during the rest of the week, and the general trend was for hryvnia appreciation.

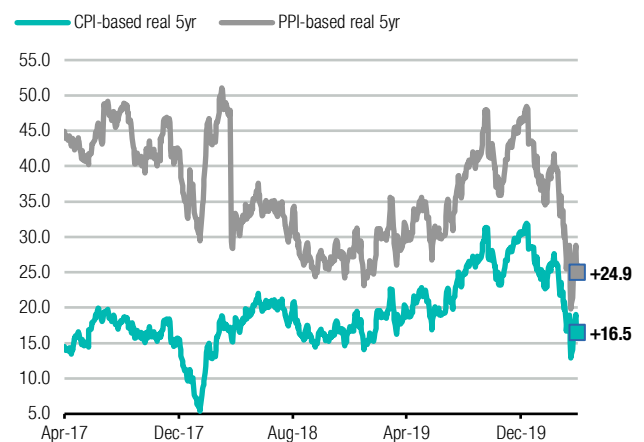
Finally, last week, the hryvnia appreciated by 1% to UAH27.16/US\$. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) slid 1% to 129, while in YoY terms, it was up 6.4%.

ICU view: The general trend of hryvnia appreciation will continue this week, however, depending on news flow. The most important will be news about parliament's decisions needed to continue cooperation with the IMF and obtain financing from IFIs. With positive news, the hryvnia exchange rate may appreciate below the level UAH27/US\$, but most likely, it will remain volatile in the range of UAH27–27.5/US\$

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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

Inflation slows to 2.3% YoY in March

Higher food prices, a weaker hryvnia, and rising social payments will result in inflation acceleration, which to some extent will be reined in by lower oil and gas prices and depressed consumption.

In March, headline inflation slowed to 2.3% YoY from the 2.4% YoY seen in February; the slowdown continues for the eighth consecutive month. However, in MoM terms, prices rose 0.8%. Inflation slowed mainly thanks to an 8.1% YoY decline in prices on utilities due to 39% YoY lower natural gas prices. Growth of prices on food products remained at February's level (+1.8% YoY), while prices on transport fell for the sixth month (-1% YoY). Core inflation was 3.1% YoY. NBU expects inflation to remain in the 5±1% target range, or slightly exceed this range by YE20.

ICU view: Inflation may accelerate to 6–8% by the end of 2020, while the average growth in CPI for 2020 may amount to 5–6% versus 7.9% in 2019. The key driver for inflation will be food prices boosted by limited supply during the lockdown (first of all, due to closed farmers' markets and open-air bazaars and limited logistics), as well as, likely, a worse harvest. A weaker hryvnia and rising social payments to unemployed and low-income citizens will be other key boosters of inflation. Lower oil and gas prices and depressed consumption will restrain inflation.

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