



Focus  
**Ukraine**

Markets  
**Domestic liquidity,  
government bonds, FX  
market, and macro**

Research team  
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# Weekly Insight

## Inflation surges to 8.5% YoY

### Key messages of the today's comments

MONDAY, 12 APRIL 2021

### Domestic liquidity and bonds market

#### Investors at a crossroads

Last week, foreigners decreased their UAH-denominated bond portfolios. However, the good news that Ukrainian notes are on the watch list for inclusion to the J.P. Morgan GBI-EM index can partially compensate other negatives and slow outflows from UAH-denominated debt.

#### Liquidity stabilizes

After recovery to about UAH200bn at the end of March, banking-sector liquidity stabilized and fluctuated in April slightly below this level. Partial refinancing of debt repayments should support liquidity to rise above UAH200bn.

### Foreign exchange market

#### Hryvnia exchange rate steady

Last week, the hryvnia remained steady, slightly below UAH28/US\$. This week, the FX market should not change sizably fluctuating slightly below the highest level of the UAH27.5–28/US\$ range.

### Economics

#### Inflation surges to 8.5% YoY

As in previous months, the acceleration of inflation was primarily driven by food and fuel prices, while fundamental pressures remain relatively moderate. This Thursday, the NBU is likely to raise the key policy rate by 50 bp to 7% and in the new forecast will envisage a further increase to 7.5% during the next meetings.

### Banks' reserves market (9 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	6.50	+0bp	-900bp
ON rate (%)	5.71	+32bp	-448bp
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	49,545	+1.04	+28.62
CDs (UAHm) <sup>3</sup>	146,762	-0.15	-5.38

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) (9 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	322,077	+0.00	-0.77
Banks	531,251	-0.42	+56.55
Residents	43,627	-4.89	-14.86
Individuals	14,929	-5.04	+77.94
Foreigners <sup>1</sup>	101,228	-2.87	-13.52
<b>Total</b>	<b>1,013,388</b>	<b>-0.81</b>	<b>+20.55</b>

Notes: [1] non-residents

Source: NBU, ICU.

### FX market indicators (9 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.9425	-0.30	+2.54
EUR/USD	1.1899	+1.19	+8.87
DXY	92.163	-0.92	-7.39
UAH TWI <sup>1</sup>	122.113	-0.19	-5.04

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

### Gov't bond quotes<sup>1</sup> (12 April 2021)

Maturity	Bid	Ask
6m	9.50	8.00
12m	11.50	10.00
2y	12.50	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](http://www.icu.ua).

Source: ICU.

# Domestic liquidity and bonds market

## Investors at a crossroads

Last week, foreigners decreased their UAH-denominated bond portfolios. However, the good news that Ukrainian notes are on the watch list for inclusion to the J.P. Morgan GBI-EM index can partially compensate other negatives and slow outflows from UAH-denominated debt.

At last weeks' auction, the MoF borrowed only UAH1.1bn (see auction comment) for budget deficit financing, a reflection of negative news raising investors' fears to invest in UAH debt. Last week, foreigners sold UAH2.7bn of bills to banks and non-banks, decreased demand at the primary bonds auction.

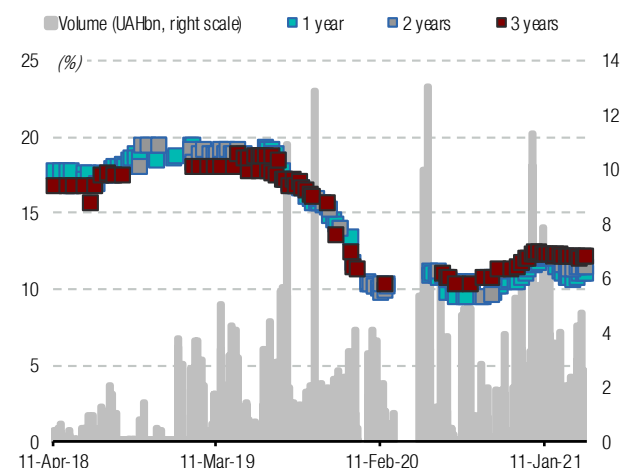
Sentiment changed at the end of the week when J.P. Morgan announced it was including the Ukrainian note due 2025 to the watch list to be added to the GBI-EM index. This bond will be monitored for index-criteria compliance for the next six months, after which it could be added to the index.

**ICU view: Demand for Ukrainian papers should pick up due to the large upcoming redemption and reinvesting the proceeds in new issues. However, the decline in foreigners' portfolios puts the MoF in competition with them, which may result in being unable to completely refinance the redemption. Only FX-denominated bills would increase borrowings due to the reinvestment of the last weeks' redemptions.**

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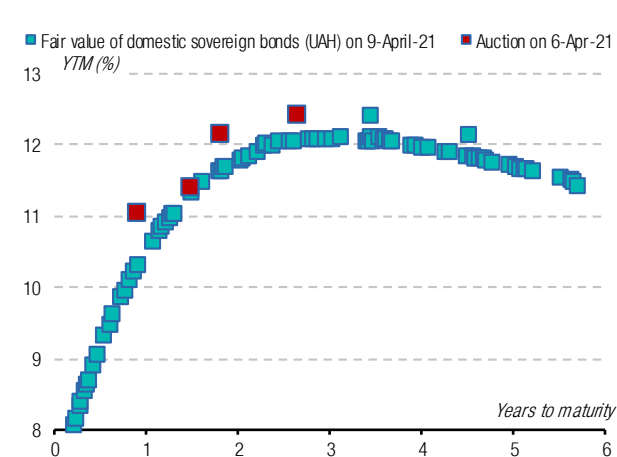
**Chart 1. Local-currency bonds**

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.

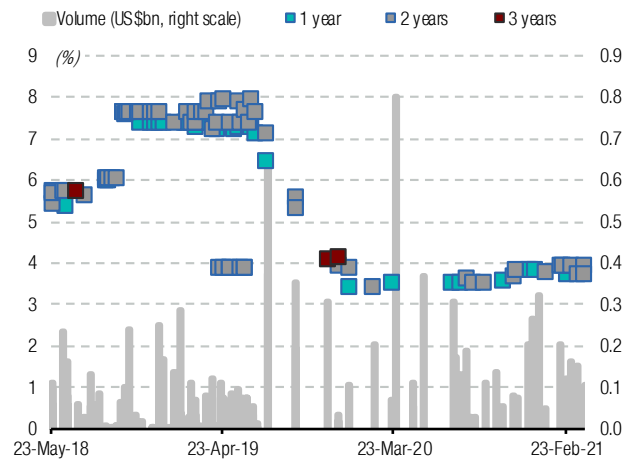
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

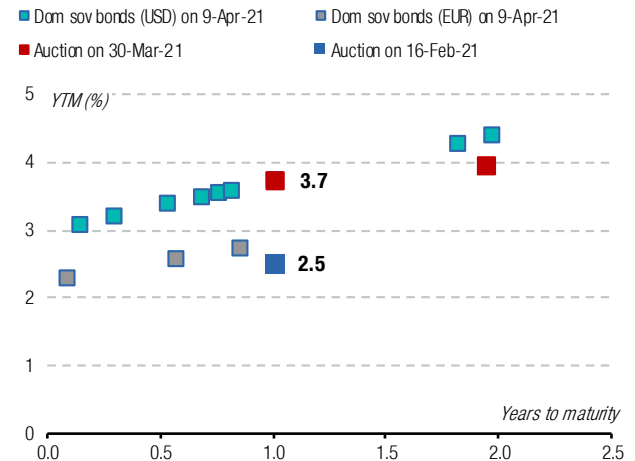
**Chart 2. FX-denominated bonds**

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.

**Liquidity stabilizes**

After recovery to about UAH200bn at the end of March, banking-sector liquidity stabilized and fluctuated in April slightly below this level. Partial refinancing of debt repayments should support liquidity to rise above UAH200bn.

Last week, liquidity fluctuated around UAH195bn with last Fridays' increase to UAH197bn due to budget expenditures and loans the NBU made to some banks. Budget transactions caused inflow to the banking sector of UAH7.7bn, while the NBU provided banks with UAH3.4bn of new three-month and five-year loans.

Liquidity outflows were seen just through reserves exchange in cash, the usual dynamic for the beginning of the month, but this month it was accelerated by the lockdown and news about the possibility of renewed hostilities. In total, banks exchanged UAH7.6bn of reserves in cash last week.

**ICU view: We expect that liquidity will stay high with possible increase above UAH200bn due to partial debt repayment refinancing and lack of the large tax payments.**

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

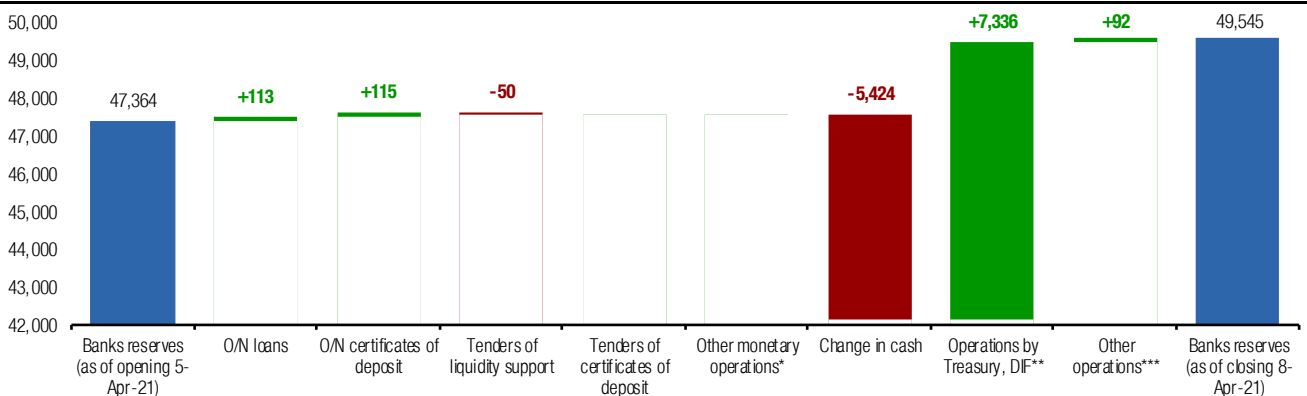
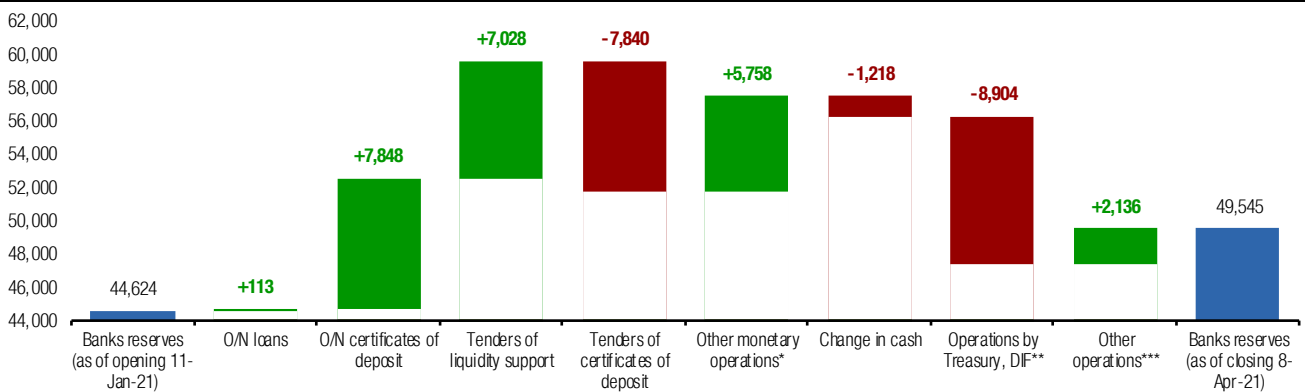


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting [https://bank.gov.ua/control/uk/publish/article?art\\_id=38643651&cat\\_id=40807142](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 exchange rate steady

Last week, the hryvnia remained steady, slightly below UAH28/US\$. This week, the FX market should not change sizably fluctuating slightly below the highest level of the UAH27.5–28/US\$ range.

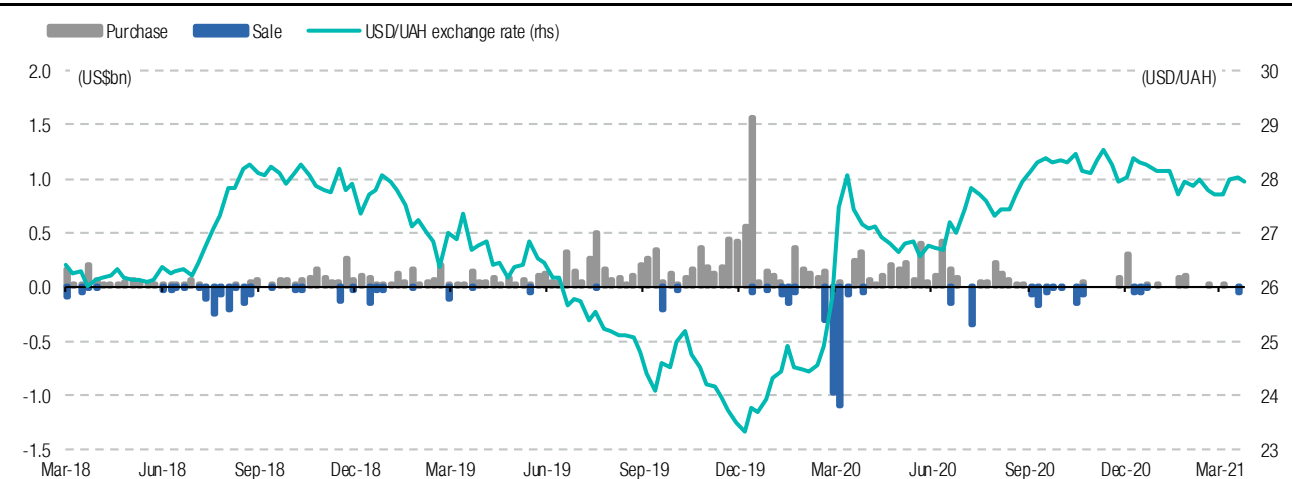
After last week's interventions, the NBU allowed the market to self-balance at around UAH28/US\$, with appreciation of 0.3% to UAH27.94/US\$. Despite active bond selling to locals, the supply of hard currency was enough to cover demand from foreigners even without NBU interventions.

**ICU view: Overall, negative news was detrimental to interest in UAH-denominated debt so the market will have to depend on activity from locals to support the bond and currency markets. We do not expect much change this week, with hryvnia exchange rate fluctuations slightly below the highest level of the UAH27.5–28/US\$ range.**

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Chart 5. 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.

# Economics

## Inflation surges to 8.5% YoY

As in previous months, the acceleration of inflation was primarily driven by food and fuel prices, while fundamental pressures remain relatively moderate. This Thursday, the NBU is likely to raise the key policy rate by 50 bp to 7% and in the new forecast will envisage a further increase to 7.5% during the next meetings.

In March, consumer prices grew by 1.7% YoY, while annual inflation accelerated to 8.5% YoY (compared with 7.5% YoY in February), moving even further from the NBU's target of 5%. The outcome exceeded the estimates of all experts (Reuters consensus - 8.0% YoY, ICU estimate - 8.2% YoY). At the same time, the acceleration of core inflation to 5.9% YoY (from 5.6% YoY in February) was slightly lower than our expectations.

As before, the main contribution to accelerating inflation was provided by fuel (12% YoY), bread (15% YoY), sunflower oil (49% YoY), sugar (65% YoY), and eggs (109% YoY), reflecting the poor harvests of the previous year and relevant trends in the global markets. The pass-through effect to the prices of other food products is also strengthening and is reflected in confectionery products, meat and meat products, and dairy products, among others.

Instead, due to the relative strengthening of the UAH exchange rate and the economy's still capacity underutilization, the fundamental inflationary pressure remains moderate and core inflation continues to be within the target range of the NBU. This, even despite the fact that the spike in sunflower oil prices provided contribution in YoY core inflation (5.9%) of more than 1 pp.

***ICU view: Looking ahead, we expect that the CPI growth rate will remain close to the current level. On one hand, food prices, which have risen rapidly in recent months, are already beginning to stabilize. In particular, in March, the FAO grain and sugar price indexes even declined compared with February amid expectations of good harvests and increased supply. On the other hand, the prices of other food products, especially those with a higher level of value added, will continue to grow at a high pace due to the increase in the cost of their production.***

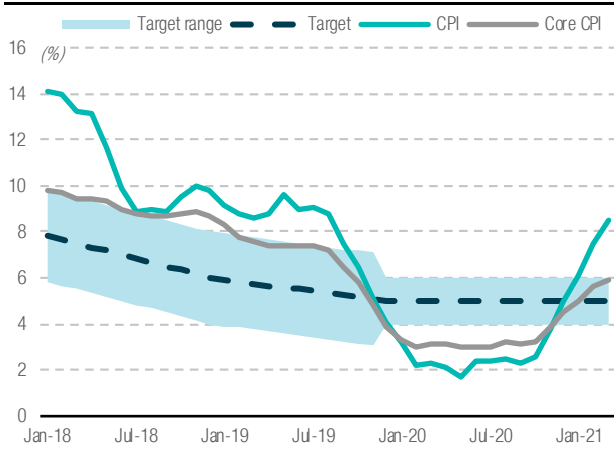
***In 2H21, amid a gradual economic recovery and increased capacity utilization, fundamental inflationary pressures should intensify. At the same time, the entry of a new crop into the market should help reduce food inflation.***

***Given the potential effect of a sharp rise in food prices on inflation expectations, we are revising our forecast of the NBU's response. According to the results of 1Q21, inflation significantly exceeded the NBU's January forecast (7.6% YoY), although the core inflation rate did not differ much from the expected 5.6% YoY, especially when the contribution of sunflower oil is considered. In January, the NBU, like us in December, predicted an increase in the key policy rate this year to 7%. This Thursday, the NBU is likely to raise the rate by 50 bp to 7% and in the new forecast to envisage further hikes to 7.5%, and possibly even to 8% during the next meetings. This revision of the interest rate path is also justified by rising US Treasury yields, the global deterioration in risk appetite, which is exacerbated by growing geopolitical risks for Ukraine, and the lack of significant progress with the IMF.***

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**Chart 6. CPI, core CPI and target, YoY, %**

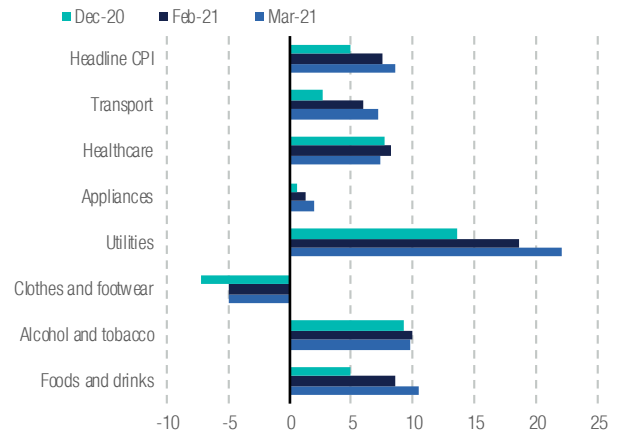
*(Both headline and core inflation accelerate sharply since October 2020)*



Source: Ukrstat, NBU, ICU.

**Chart 7. CPI and its main components, YoY, %**

*(Prices of food, fuel, and utilities accelerated sharply since the beginning of the year)*



Source: Ukrstat, ICU.

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