

Weekly Insight

Consumer inflation accelerates

Key messages of the today's comments

TUESDAY, 17 AUGUST 2021

Domestic liquidity and bonds market

Low activity in bond market

Last week's debt redemption was only partially refinanced, which led foreigners to withdraw a significant amount of funds from UAH-denominated assets, as well caused low activity in the market overall. Turnover in the secondary market may increase this week due to the exit of foreigners.

Foreign exchange market

NBU allows hryvnia to appreciate

Last week, the hryvnia fluctuated mostly within 10 kopecks, but ended the week stronger. The NBU did not interfere with fluctuations and actually allowed the hryvnia to strengthen by the end of the week. We expect similar dynamics of the hryvnia exchange rate this week, especially in the end of the week due the finishing quarterly tax payment period.

Economics

Consumer inflation accelerates to 10.2% in July

Inflation acceleration is in line with our expectations and NBU forecasts. However, there is a rising risk of a double-digit CPI growth lasting longer than the central bank expects. This may nudge the NBU to hike the key policy rate more decisively during the rest of 2021 compared to the NBU's own forecast of +0.5 p.p.

Banks' reserves market (16 August 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	8.00	+0bp	+200bp
ON rate (%)	7.27	-16bp	+199bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	64,759	+35.36	+20.78
CDs (UAHm) ³	148,809	-7.26	+0.00

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) (16 August 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	316,106	+0.00	-2.61
Banks	494,116	-1.20	+16.89
Residents	49,339	-0.25	+83.44
Individuals	19,379	-0.38	+156.64
Foreigners ¹	101,485	-2.71	+13.47
Total	980,424	-0.91	+12.54

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (16 August 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	26.7487	-0.15	-2.14
EUR/USD	1.1778	+0.49	-0.54
DXY	92.628	-0.46	-0.50
UAH TWI ¹	126.363	-0.47	+2.85

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (17 August 2021)

Maturity	Bid	Ask
6m	10.00	8.50
12m	12.00	11.00
2y	12.75	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.

Source: ICU.

Domestic liquidity and bonds market

Low activity in bond market

Last week's debt redemption was only partially refinanced, which led foreigners to withdraw a significant amount of funds from UAH-denominated assets, as well caused low activity in the market overall. Turnover in the secondary market may increase this week due to the exit of foreigners.

The primary bond auction did not attract much demand, only UAH2.6bn, which was just slightly more than a week before. Due to unchanged interest rates, the market remained largely unattractive, even for reinvesting the funds received from redemptions, please see more details in the [auction review](#). Foreigners stay not interested in new bills either. They bought a small amount of bonds on Thursday and Friday, but due to large redemptions, their holdings shrank by UAH2.9bn in a week bringing them down close to UAH100bn.

Other investor groups reduced holdings of UAH-denominated bonds as well. Banks cut their portfolios by UAH5.5bn, non-banks by UAH52mn, and individuals by UAH153m.

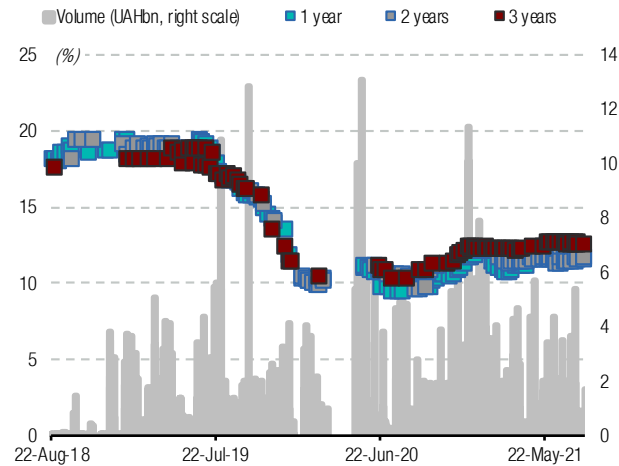
Therefore, the secondary market was not very active. Foreigners received redemptions, so they sold fewer bonds and even made a few purchases. Residents do not seem to mind waiting for the Ministry of Finance to raise rates. Therefore, in the secondary market, YTM almost did not change, and trading volume for the week amounted to UAH6.6bn, which is UAH1.5bn less than a week earlier. The most traded bills were those with maturities in 2022 and 2023.

ICU view: Locals do not find new bills very attractive given the current level of interest rates. And given probable seasonal hryvnia weakening during autumn, neither do foreigners. Therefore, the MoF was only able to refinance a quarter of redemptions, but that situation could improve today. This week, the Ministry will pay redemptions just to the NBU, and investors can buy new bonds using funds from last week's redemption. However, we do not expect high activity in the primary or secondary markets.

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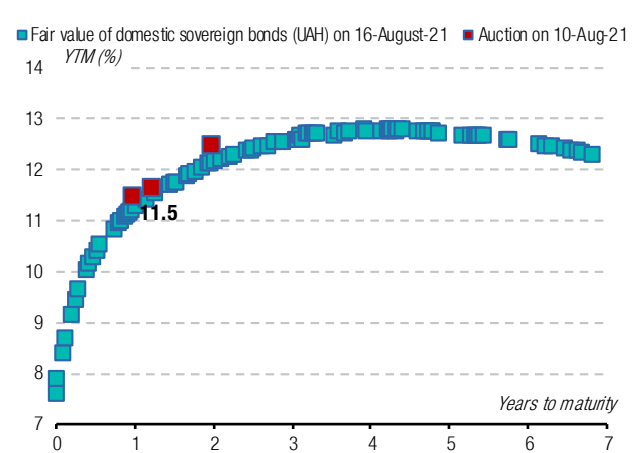
Chart 1. Local-currency bonds

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.

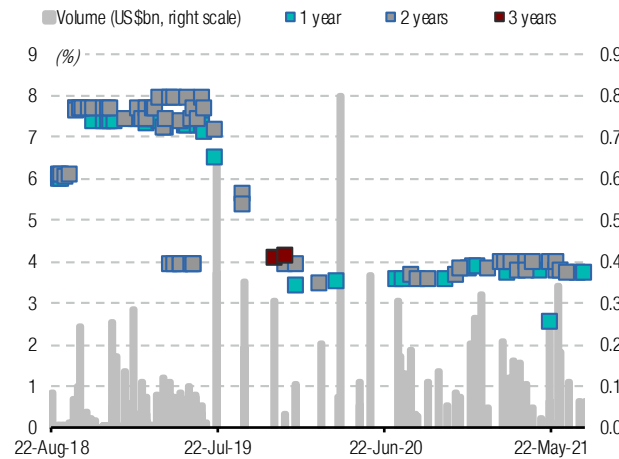
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

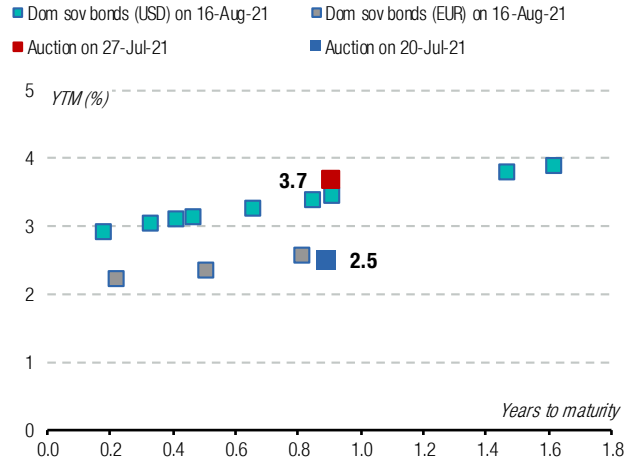
Chart 2. FX-denominated bonds

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.

Foreign exchange market

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Last week, the hryvnia fluctuated mostly within 10 kopecks, but ended the week stronger. The NBU did not interfere with fluctuations and actually allowed the hryvnia to strengthen by the end of the week. We expect similar dynamics of the hryvnia exchange rate this week, especially in the end of the week due the finishing quarterly tax payment period.

Last week, the NBU intervened in the FX market daily, but at a minimum of an average of US\$5mn per day, and purchased US\$25.5mn last week from the market. Such volumes of interventions had almost no effect on the balance of supply and demand in the market, where despite the exit of foreigners from UAH-denominated bills, the supply of currency prevailed. Among the operations of bank customers in the FX market there were more sales, although on Wednesday, when the hryvnia weakened to UAH26.8/US\$, demand was slightly higher

because after UAH bonds redemption foreigners could bought hard currency of more than UAH3bn equivalent.

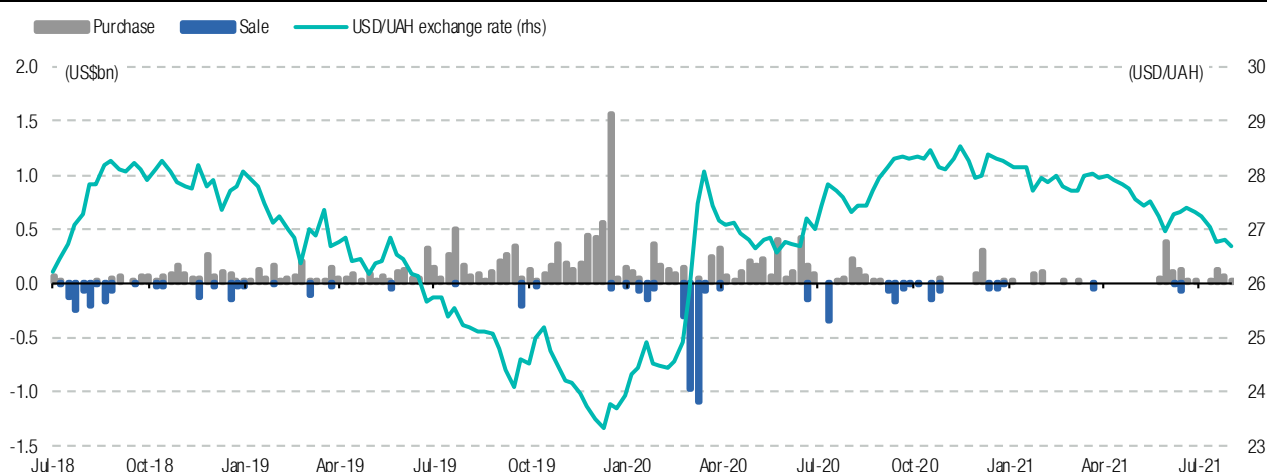
Therefore, under such conditions, with an excess supply of hard currency and minimal interventions of the NBU, the hryvnia exchange rate appreciated by 0.5% to UAH26.67/\$ last week.

ICU view: NBU's maintaining the similar intervention tactics this week will allow the market to balance on its own, but supply will continue to prevail. The period of quarterly tax payments will end on Friday, so exporters will sell even more hard currency for payments to the budget. Therefore, we expect that the hryvnia exchange rate will continue to fluctuate, but will ultimately appreciate towards UAH26.5/\$.

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Chart 3. 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

Consumer inflation accelerates to 10.2% in July

Inflation acceleration is in line with our expectations and NBU forecasts. However, there is a rising risk of a double-digit CPI growth lasting longer than the central bank expects. This may nudge the NBU to hike the key policy rate more decisively during the rest of 2021 compared to the NBU's own forecast of +0.5 p.p.

CPI rose to 10.2% YoY in July from 9.5% YoY in June, with growth thus entering the double-digit territory for the first time since November 2018. Monthly inflation slowed to 0.1% MoM but has not turned negative, which is uncommon for this period of the year.

The key drivers boosting inflation were rising internal demand, higher costs of domestic producers and elevated commodity prices in the world market. As a result, prices for raw and processed food products accelerated to 8.2% YoY and 12.3% YoY, respectively. Growth in service prices and regulated prices (mostly in the segment of alcohol and transportation) sped up to 8.2% YoY and 18.5% YoY, respectively.

The NBU expects consumer inflation to remain above 10% YoY in 3Q21 and slow down afterwards to 9.6% YoY by YE2021.

ICU view: Above-10% inflation was incorporated in the NBU's decision to hike the key policy rate by 50 bps to 8% in July, and the central bank expects another 50 bps hike in September. However, the double-digit inflation may last longer than the NBU expects due to stronger domestic demand and steadier elevated world prices for fuels and food products. As a result, the NBU may decide to hike the key rate more aggressively in 2021 versus its own forecast.

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