

Weekly Insight

NBU keeps key rate at 8.5%

Key messages of the today's comments

MONDAY, 25 OCTOBER 2021

Domestic liquidity and bonds market

The T-bills market was on the sidelines waiting for the NBU decision

On the eve of the NBU meeting, participants in the local bond market were waiting for a decision on the key policy rate and focused on the secondary market. The primary auctions showed low activity with unchanged interest rates. This week, activity will increase due to refinancing of redemptions.

Foreign exchange market

The hryvnia remains strong, but the market is nervous

The FX market remained under pressure from hard currency supply for most of the last week, but the NBU's decision to keep the key policy rate unchanged added to nervousness and weakened the hryvnia. This week, volatility will continue, but it is unlikely that the hryvnia exchange rate will leave the range of UAH26.2–26.5/US\$.

Economics

NBU keeps key rate at 8.5%

The regulator has decided against further monetary tightening, but sent a clear signal it would not hesitate to increase the rate in December.

Banks' reserves market (22 October 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	8.50	+0bp	+250bp
ON rate (%)	8.25	+4bp	+288bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	54,068	-23.99	-5.29
CDs (UAHm) ³	159,166	+26.68	+44.05

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) (22 October 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	312,606	+0.00	-3.69
Banks	491,617	-2.05	+10.38
Residents	49,995	-4.30	+61.45
Individuals	21,137	-4.89	+165.53
Foreigners ¹	95,774	-1.39	+19.09
Total	971,129	-1.51	+9.22

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (22 October 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	26.2814	-0.23	-7.11
EUR/USD	1.1643	+0.36	-1.48
DXY	93.642	-0.31	+0.74
UAH TWI ¹	129.011	-0.22	+6.98

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (25 October 2021)

Maturity	Bid	Ask
6m	11.00	10.00
12m	11.75	11.25
2y	13.00	12.00
3y	13.50	12.50
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

The T-bills market was on the sidelines waiting for the NBU decision

On the eve of the NBU meeting, participants in the local bond market were waiting for a decision on the key policy rate and focused on the secondary market. The primary auctions showed low activity with unchanged interest rates. This week, activity will increase due to refinancing of redemptions.

Last week, the Ministry of Finance raised UAH2.1bn in the primary auction, where almost half of the funds were from FX-denominated bills (see [auction review](#)). At the same time, interest rates remained unchanged with a rejection of some demand for only one of the offered instruments. The reason for the low activity could be waiting for a decision on the NBU key policy rate because in the event of an increase, interest rates on UAH-denominated bills could be raised tomorrow.

With unchanged key policy rate, tomorrow, the primary auction may be more active with the Ministry of Finance attempting to keep rates unchanged. Last week, US\$661m of FX-denominated bills were redeemed, and this Wednesday, UAH11bn in local currency will be repaid. Much of these funds may be used for bids in tomorrow's auction, although it is unlikely that all of these redemptions will be fully refinanced.

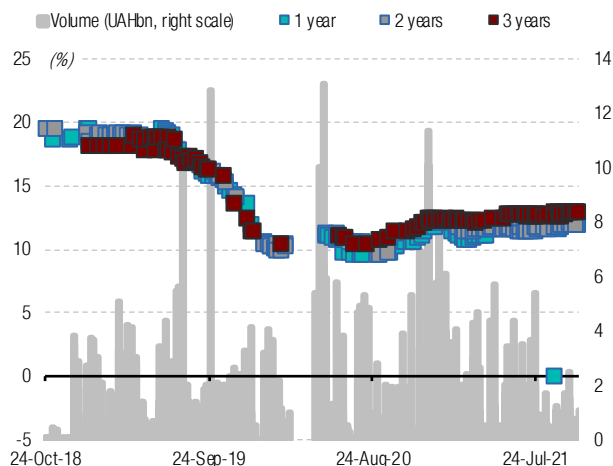
The secondary market was very active last week, as most of the demand was concentrated there. The volume of transactions in UAH-denominated bills for the week amounted to UAH7.6bn, and in hard currency, the amount was the equivalent of more than UAH2.2bn. USD-denominated bills sold last Tuesday were the most actively traded.

ICU view: Large repayments will lead to an increase in demand at the auction tomorrow, although it is unlikely that the Ministry of Finance will be able to refinance all repayments at current interest rates and, especially with the NBU's signal of a possible key policy rate hike in December (see comment below). Therefore, tomorrow demand may focus on short-term investments, since investors will expect higher rates at the end of the year. But this week borrowing volumes will increase, and foreigners may be more active here again, buying six-year securities.

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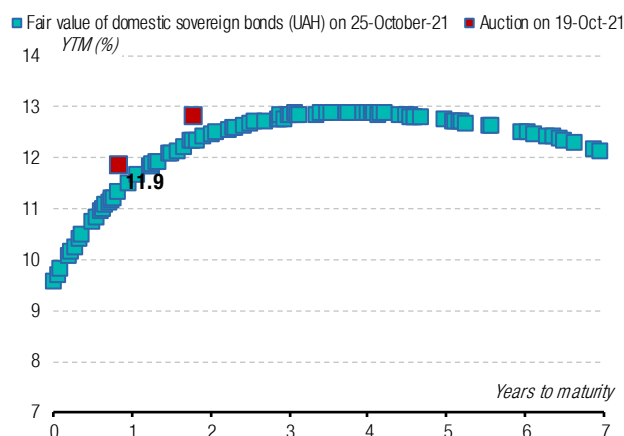
Chart 1. Local-currency bonds

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.

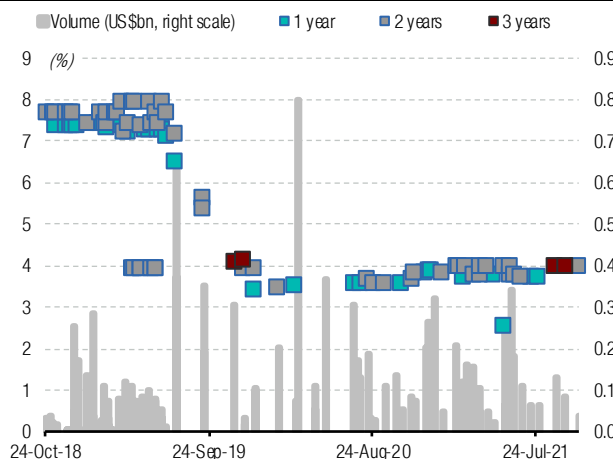
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

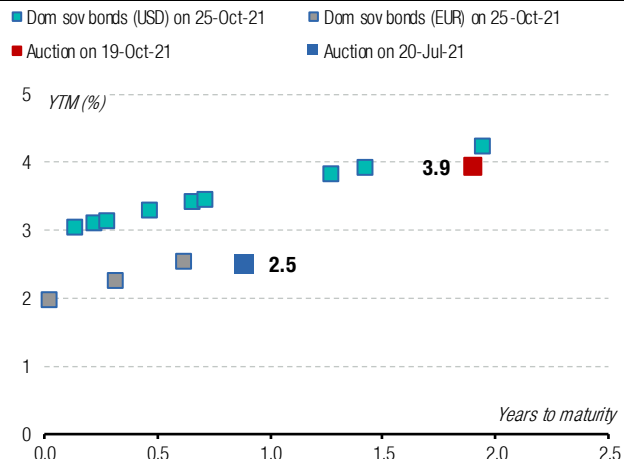
Chart 2. FX-denominated bonds

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

The hryvnia remains strong, but the market is nervous

The FX market remained under pressure from hard currency supply for most of the last week, but the NBU's decision to keep the key policy rate unchanged added to nervousness and weakened the hryvnia. This week, volatility will continue, but it is unlikely that the hryvnia exchange rate will leave the range of UAH26.2–26.5/US\$.

Last Wednesday, the FX market closed at UAH26.18/US\$, but immediately after the announcement of the NBU's decision on the key policy rate, it became sharply weaker and closed at UAH26.37/US\$ on Thursday. Obviously, this decision, although expected by the majority of market participants, did not contribute to greater hard currency sales than if the rate had been raised. But on Friday, the hryvnia exchange rate began to strengthen again, and the NBU continued to buy hard currency in the market.

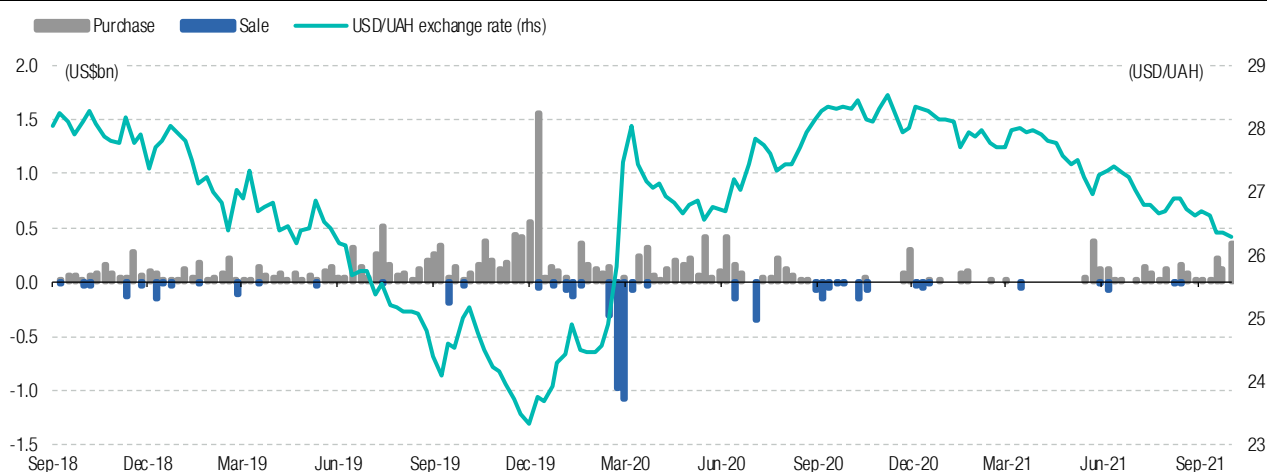
In total, the volume of the NBU interventions last week amounted to US\$350m. This was only US\$25m less than the maximum this year, which was recorded in the second week of June when foreigners were actively buying UAH-denominated bonds. The vast majority of these interventions took place on Monday and Wednesday, approximately US\$150m and US\$120m, respectively.

ICU view: We expect the NBU will continue to intervene in the market keeping the hryvnia from strengthening, but the market will see volatility caused by active sales of hard currency by residents to pay taxes and foreigners to buy six-year notes, as well as VAT refunds that will take place closer to the end of this week. Nevertheless, the hryvnia exchange rate will continue to fluctuate mainly within the range of UAH26.2–26.5/US\$.

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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

NBU keeps key rate at 8.5%

The regulator has decided against further monetary tightening, but sent a clear signal it would not hesitate to increase the rate in December.

NBU maintained its CPI forecast for the end of 2021 and 2022 at 9.6% YoY and 5.0% YoY, respectively. September inflation was slightly lower than NBU predicted (11.0% YoY vs 11.2% YoY) on the back of the strengthening hryvnia and more hawkish monetary policy design. It gave the NBU reason to expect the CPI trajectory to remain close to its forecasts and, therefore, the central bank abstained from increasing the rate.

ICU view: The NBU has given a strong signal to the market emphasizing the possibility that it will increase rate in December despite the unchanged forecast of 8.5% in the updated macro forecast. We interpret it as an attempt to avoid monetary policy tightening at the moment while showing the market its readiness to increase the rate should the inflation not calm down.

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