



Focus
Ukraine

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

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Weekly Insight

Consumer prices decelerate in October

Key messages of the today's comments

Domestic liquidity and bonds market

Demand for UAH debt maintained

Last week, portfolios of local-currency bonds increased for all groups of investors including foreigners, who had reduced their portfolios in the previous five weeks. This week, the Ministry of Finance is again planning to offer six-year notes, so we expect foreign investors to again increase investments in UAH-denominated securities.

Foreign exchange market

Situational volatility of the hryvnia exchange rate

The hryvnia exchange rate last week was under pressure from situational changes in supply and demand, which resulted first in appreciation and then the weakening of the hryvnia at the end of the week. This week, we expect that the supply of hard currency will increase, and the hryvnia exchange rate will strengthen again, approximately in the range of UAH26.1–26.2/US\$.

Economics

Consumer prices decelerate marginally in October, core CPI up

Yearly consumer inflation inched down to 10.9% in October from 11.0% in September. Meanwhile, core CPI accelerated to 7.6% YoY from 7.4% YoY in September, signalling that inflationary pressures remain elevated. Producer prices surged to 57.2% YoY, largely driven by gas and electricity.

MONDAY, 15 NOVEMBER 2021

Banks' reserves market (12 November 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	8.50	+0bp	+250bp
ON rate (%)	7.80	-56bp	+204bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	75,359	+63.66	+27.59
CDs (UAHm) ³	153,657	-6.05	+56.11

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 govt bond holders (UAHm) (12 November 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	312,606	+0.00	-3.69
Banks	501,762	+1.41	+9.98
Residents	53,432	+2.73	+64.25
Individuals	23,300	+3.23	+177.05
Foreigners ¹	96,563	+2.22	+25.84
Total	987,663	+1.15	+9.92

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (12 November 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	26.2640	+0.65	-6.76
EUR/USD	1.1445	-1.05	-3.06
DXV	95.128	+0.86	+2.33
UAH TWI ¹	131.284	+0.49	+8.69

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (15 November 2021)

Maturity	Bid	Ask
6m	11.00	10.00
12m	12.00	11.50
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

Demand for UAH debt maintained

Last week, portfolios of local-currency bonds increased for all groups of investors including foreigners, who had reduced their portfolios in the previous five weeks. This week, the Ministry of Finance is again planning to offer six-year notes, so we expect foreign investors to again increase investments in UAH-denominated securities.

In an effort to create more interest in the primary auctions and increase domestic borrowing, the Ministry of Finance has added to the offering six-year UAH-denominated securities. This issue, maturing in 2027, was in demand among foreigners in previous months, but was offered only once per month. Last Tuesday, after a one-week break, the MoF again offered six-year notes and raised more than UAH2bn from this paper. In total at this auction, the MoF raised UAH6.6bn from local-currency instruments. However, it came with a slight increase in interest rates. See more details in the [auction review](#).

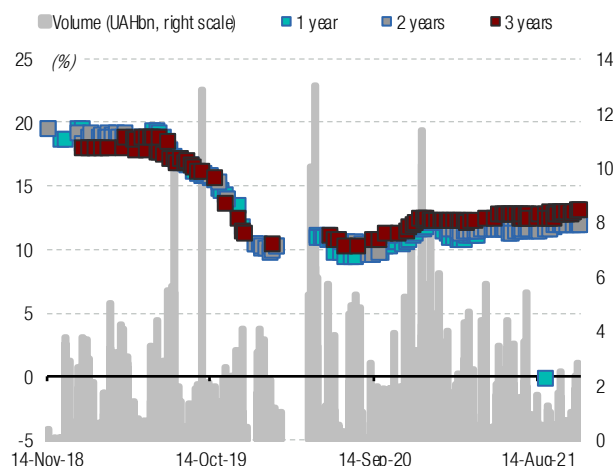
Offering six-year paper received a positive response from investors, and the foreigners' portfolios grew for the first time since the end of September. In addition, portfolios for all groups of investors increased last week, while in the previous six weeks, at least one of the groups was declining, usually foreigners. As the result, trading of UAH-denominated bonds on the secondary market also increased to UAH9.4bn from UAH6.8bn a week earlier.

ICU view: *The Ministry of Finance seems to be trying to increase borrowing now as opposed to waiting until the end of the year. This allows it to gradually increase the cost of borrowing in response to rising demand and reject only small bids with high interest rates. So, tomorrow, we may see demand from foreigners again, but likely they will focus on the long end of the curve, which will probably mean the MoF will need to revise rates upward again.*

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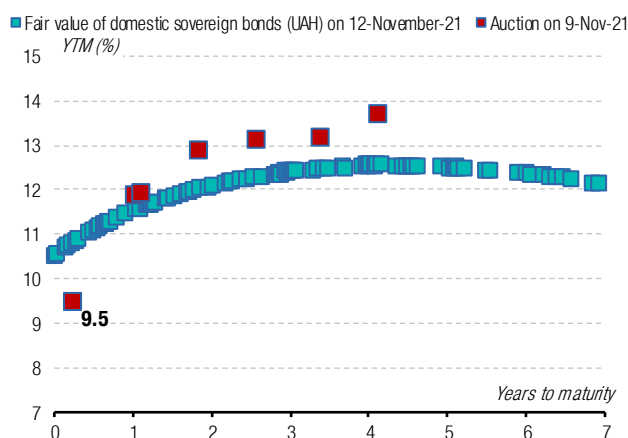
Chart 1. Local-currency bonds

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.

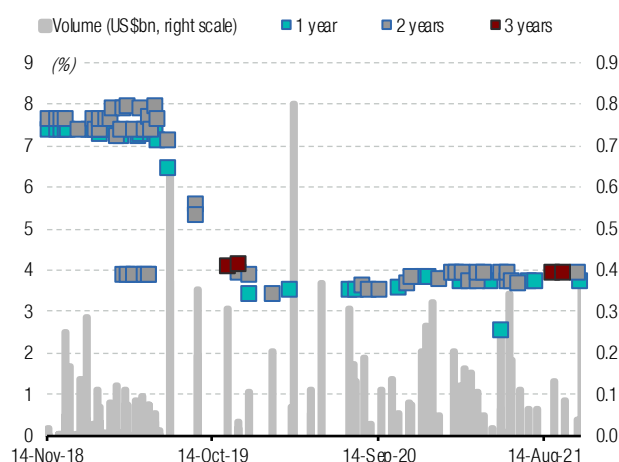
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

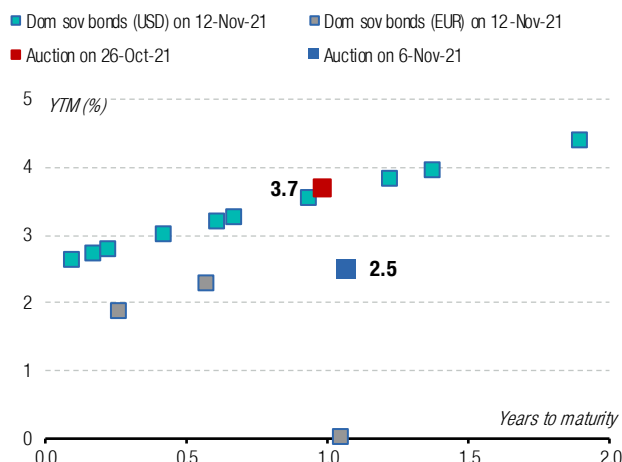
Chart 2. FX-denominated bonds

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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The hryvnia exchange rate last week was under pressure from situational changes in supply and demand, which resulted first in appreciation and then the weakening of the hryvnia at the end of the week. This week, we expect that the supply of hard currency will increase, and the hryvnia exchange rate will strengthen again, approximately in the range of UAH26.1–26.2/US\$.

Ukrenergo's Eurobond settled last Tuesday (see the [previous weekly](#)), and the next day the company decided to sell the hard currency in order to pay its obligations to the State Enterprise "Guaranteed Buyer" in local currency. This step increased the sales of hard currency by bank customers to US\$1.4bn, and market turnover to almost US\$1.5bn, while YTD, the average daily market turnover was US\$0.5bn. Of course, this prompted the NBU to actively intervene in the market and increase purchases of hard currency. Last Wednesday, the NBU bought about US\$755m, and in total last week, NBU purchased US\$858m.

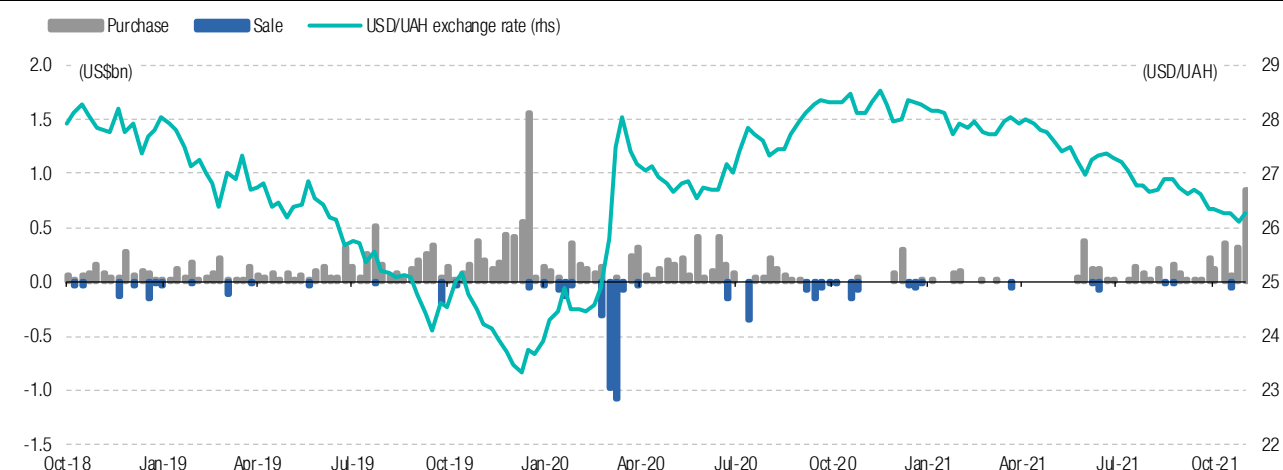
But on Friday, the situation in the FX market changed in favour of demand. Probably, the producers of "green" electricity received funds from the State Enterprise "Guaranteed Buyer" and began to buy hard currency to pay funds to their shareholders. As a result, the hryvnia exchange rate weakened sharply, and depreciated by 0.7% to UAH26.26/US\$ during the week, although it still has appreciated by 7.3% YTD.

ICU view: This week, we expect greater activity of exporters with the sale of hard currency for payments to counterparties in Ukraine and for quarterly taxes. Therefore, this supply must not only cover the increased demand from producers of "green" electricity, but also stabilize the hryvnia exchange rate in the range of UAH26.1–26.2/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

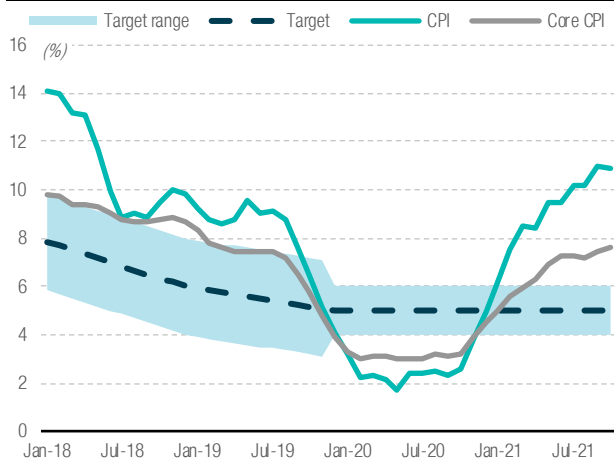
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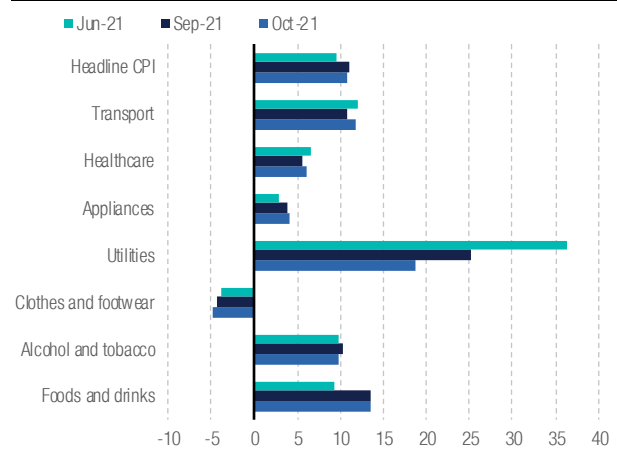
Food prices were up 13.6% YoY in October and remain the key contributor to elevated headline inflation. Utility tariffs decelerated notably to 18.8% YoY last month from 25.1% YoY in September despite surging energy prices. The government's decision to cap utility tariffs for households to pursue social goals was thus the key factor behind the slowdown in consumer prices. Clothes and footwear remain the only consumer basket item with lower YoY prices largely thanks to the strengthened local currency.

ICU view: The October inflation print signals continued strong price pressures driven by a combination of factors on both supply and demand sides. While headline inflation was contained thanks to administrative regulation of tariffs, core inflation and spiking PPI clearly indicate the risks are still present, and it may take months for a firm disinflationary trend to emerge. While there is a good chance headline inflation has peaked, it is unlikely to decelerate to single digits by the end of 2021. The chances for inflation returning to the NBU target band of 5% +/-1% by the end of 2022 are also minimal. This strengthens the case for a possible 0.5% (from the current 8.5%) increase in the NBU's key policy rate in December and / or the key policy rate staying at least at the current level longer, probably until the end of 3Q22.

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Chart 4. CPI, core CPI and target, YoY, %*(Headline inflation eases marginally, core CPI accelerates)*

Source: Ukrstat, NBU, ICU

Chart 5. CPI and its main components, YoY, %*(Food prices are the key inflation driver; utility tariffs see the fastest growth)*

Source: Ukrstat, ICU.

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