



Focus
Ukraine

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

Research team
**Alexander Martynenko
Taras Kotovych
Mykhaylo Demkiv**

Weekly Insight

NBU raises key policy rate to 9%

Key messages of the today's comments

TUESDAY, 14 DECEMBER 2021

Domestic liquidity and bonds market

Foreigners cautiously return to primary market

Due to a weaker hryvnia and even higher bond rates, foreigners cautiously returned to the primary bond market. Raising the NBU's key policy rate may further increase demand despite the strengthening of the hryvnia.

Foreign exchange market

The hryvnia appreciates again

The hryvnia exchange rate seems to have passed the peak of the autumn weakening and may remain in the range of UAH26.5–27/US\$ in the near future, especially given the intensification of foreign investors in UAH-denominated bond market.

Economics

NBU raises key policy rate to 9%

The regulator increased the key monetary policy rate by 50bps to 9.0%, as inflation remained above the expected level.

Banks' reserves market (13 December 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	9.00	+50bp	+300bp
ON rate (%)	8.17	+36bp	+104bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	70,834	+49.46	+21.43
CDs (UAHm) ³	131,165	-10.69	+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 govt bond holders (UAHm) (13 December 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	312,606	+0.00	-3.69
Banks	520,089	+2.45	+12.64
Residents	79,393	+2.36	+112.41
Individuals	24,467	+0.41	+178.79
Foreigners ¹	91,894	+0.68	+19.28
Total	1,028,450	+1.48	+13.06

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (13 December 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	26.9529	-1.24	-3.60
EUR/USD	1.1284	+0.15	-6.84
DX	96.317	-0.05	+5.87
UAH TWI ¹	131.149	+1.20	+10.33

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (14 December 2021)

Maturity	Bid	Ask
6m	11.25	10.25
12m	12.50	11.50
2y	13.00	12.25
3y	13.50	12.75
12m (\$)	4.00	3.00
2y (\$)	4.50	3.25

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

Source: ICU.

Domestic liquidity and bonds market

Foreigners cautiously return to primary market

Due to a weaker hryvnia and even higher bond rates, foreigners cautiously returned to the primary bond market. Raising the NBU's key policy rate may further increase demand despite the strengthening of the hryvnia.

Over the past week, the dynamics of foreigners' portfolios has indicated a renewed interest in UAH-denominated assets. In general, in the autumn, investors' investments in EM bonds denominated in local currencies declined, including Ukraine. But the weakening of the hryvnia in late November and early December, along with a gradual increase in rates at the primary auctions, seems to have had a positive effect. After all, the hryvnia bottomed out at the same time as positive news came about the possible reduction of tensions on the country's borders.

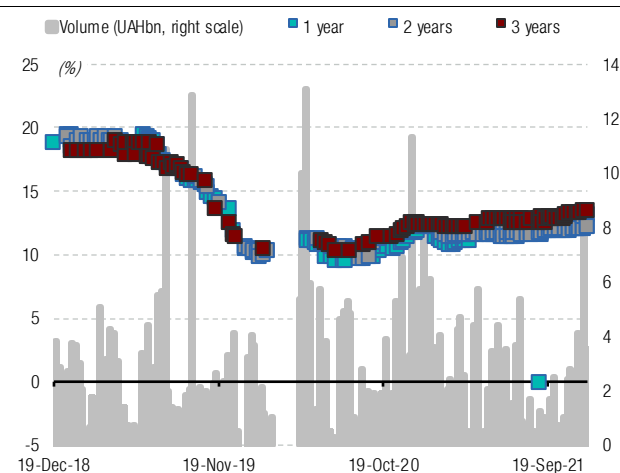
As a result, the Ministry of Finance borrowed more than UAH16bn in the primary auction last week, about half of which was in local currency. Foreigners bought more than a UAH1bn of UAH-denominated bills at this [auction](#). In total, after a three-week break, the portfolios of foreign investors grew last week, albeit by a small UAH0.5bn. This large auction was reflected in the secondary market, where last week the turnover decreased to UAH4.8bn from over UAH11bn the week before.

ICU view: Buying bonds at the auction and not selling bonds by foreigners last Friday is a positive development and raises expectations of increased activity of foreigners in the primary auction today. Last year, they became more active at the same time and in a few weeks bought almost UAH10bn. Such dynamics can have a significant impact on the volume of new borrowings, improving budget funding.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

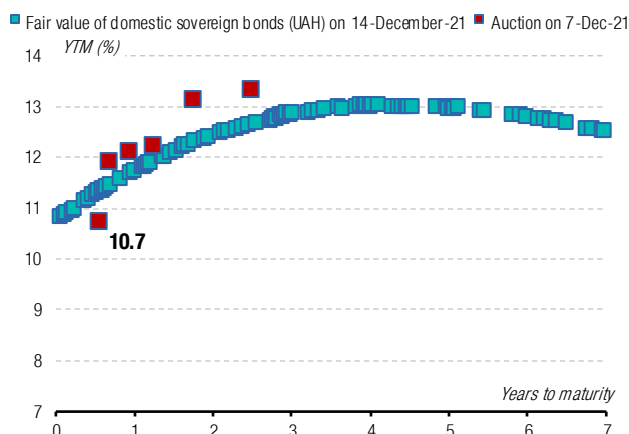
Chart 1. Local-currency bonds

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.

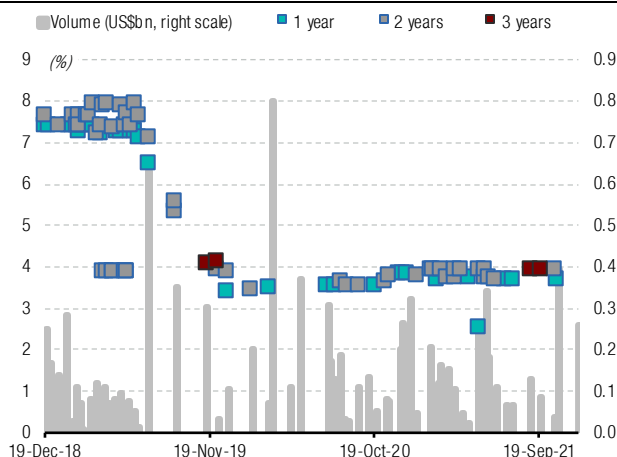
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

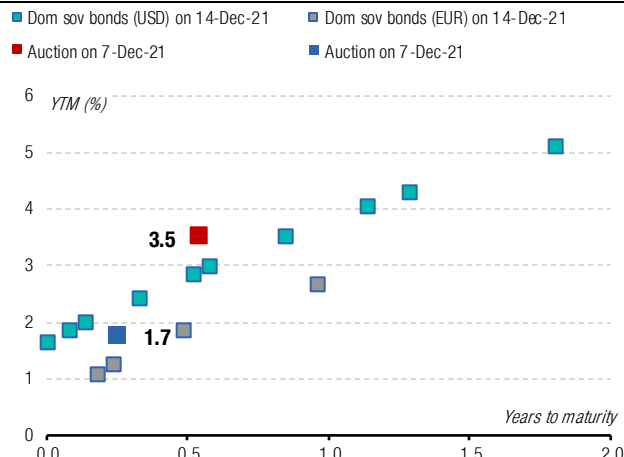
Chart 2. FX-denominated bonds

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 appreciates again

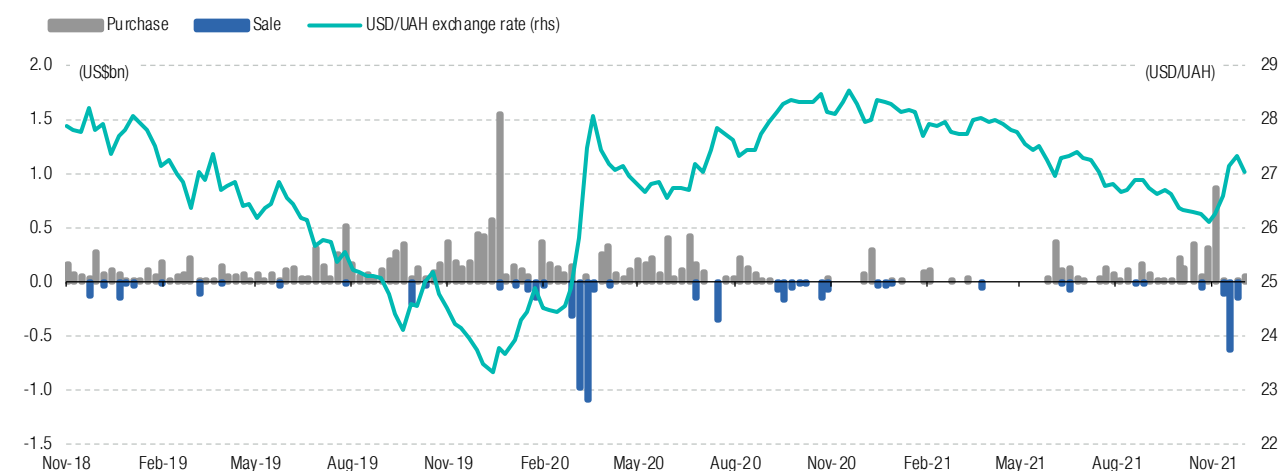
The hryvnia exchange rate seems to have passed the peak of the autumn weakening and may remain in the range of UAH26.5–27/US\$ in the near future, especially given the intensification of foreign investors in UAH-denominated bond market.

Last week, the balance in the FX market improved significantly. Sales of hard currency by bank customers increased and were mostly more than US\$500m per day. And the total market turnover for the first time since 10 November exceeded US\$800m. It appears that exporters who tried to keep hard currency until a better time, already used their hryvnia liquidity reserves and returned to the FX market. After all, foreigners cautiously returned to the bond market (see comment above).

After three weeks of around US\$0.9bn of NBU interventions selling hard currency, the NBU bought US\$54m last week, including US\$44m last Wednesday. This amount is close to the volume by which the portfolio of foreigners grew.

ICU view: The hryvnia exchange rate strengthened by 1.1% to UAH27.04/US\$ last week. It should continue to strengthen on the general improvement of information about the security situation in the country and with the potential intensification of foreign investments in UAH-denominated debt. Therefore, we expect that the exchange rate may gradually strengthen even more, but will remain within the range of UAH26.5–27/US\$.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

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 raises key policy rate to 9%

The regulator increased the key monetary policy rate by 50bps to 9.0%, as inflation remained above the expected level.

NBU's decision to increase the rate was in line with the consensus forecast, but contradicted the regulator's previous forecast that indicated that the rate would remain unchanged at 8.5% until 3Q22. Inflation remains a key concern alongside growing geopolitical tensions with Russia and adverse prices for natural gas. Rate hikes from other emerging market countries create competition for capital, which is another reason in favour of increasing the key rate by the NBU.

ICU view: *The regulator demonstrated its readiness to go for a hike when necessary. Should the immediate military threat from Russia diminish and the FX market stabilize, NBU will likely choose to keep the rate unchanged at least for the first three quarters of 2022, which is the base-case scenario at the moment.*

Mykhaylo Demkiv, Kyiv, (044) 377-7040 ext.723

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11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kyiv, 01030 Ukraine
Phone/Fax +38 044 3777040

WEB www.icu.ua



RESEARCH

Vitaliy Vavryshchuk

Head of macro research
vitaliy.vavryshchuk@icu.ua

Taras Kotovych

Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Dmitriy Dyachenko, CFA

Financial analyst
dmitriy.dyachenko@icu.ua

Alexander Martynenko

Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv

Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

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