

# Weekly Insight

## Foreigners' exit from UAH bills slows

### Key messages of the today's comments

MONDAY, 14 FEBRUARY 2022

### Ukrainian bond market

#### Foreigners' exit from UAH-denominated debt slows

Last week, temporary improvement in information flow regarding a possible Russian invasion of Ukraine had a positive impact on investors' sentiment toward UAH-denominated debt. Consequently, they have reduced the pace of bond sales.

#### Eurobond market is volatile again

High inflation in the United States, new steps by Russia to increase tensions near the Ukrainian border, and a fruitless meeting in the Normandy format have partially worsened the expectations of investors in Ukrainian Eurobonds.

### Foreign exchange market

#### Hryvnia under pressure again

In the first half of last week, the hryvnia exchange rate appreciated to UAH27.92/US\$, but last Thursday, it came under pressure from new factors, moving back to above UAH28/US\$.

### Economics

#### Inflation stable YoY, core CPI decelerates in January

Consumer prices increased considerably by 1.3% MoM in January, but annual inflation stayed unchanged at 10.0%. Meanwhile, core CPI decelerated in a surprise move to 7.6% YoY.

### Banks' reserves market (11 February 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	10.00	+0bp	+400bp
ON rate (%)	9.27	+42bp	+397bp
Reserves (UAHm) <sup>2</sup>	63,787	+35.96	+10.45
CDs (UAHm) <sup>3</sup>	143,408	-5.41	+7.54

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) (11 February 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	310,106	+0.00	-3.72
Banks	541,095	+0.03	+3.38
Residents	80,735	-0.13	+30.98
Individuals	25,155	+2.84	+93.71
Foreigners <sup>1</sup>	79,229	+0.21	-21.21
<b>Total</b>	<b>1,036,500</b>	<b>+0.09</b>	<b>+1.53</b>

Source: NBU, ICU.

### FX market indicators (11 February 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.0654	-0.21	+2.10
EUR/USD	1.1350	-0.86	-6.43
DXY	96.082	+0.63	+6.27
UAH TWI <sup>1</sup>	126.345	+0.92	+4.80

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

### Market gov't bond quotes<sup>1</sup> (14 February 2022)

Maturity	Bid	Ask
6m	13.50	11.00
12m	14.50	12.00
2y	15.00	13.00
3y	16.50	13.50
12m (\$)	4.00	3.00
2y (\$)	4.50	3.25

Source: ICU.

# Ukrainian bond market

## Foreigners' exit from UAH-denominated debt slows

Last week, temporary improvement in information flow regarding a possible Russian invasion of Ukraine had a positive impact on investors' sentiment toward UAH-denominated debt. Consequently, they have reduced the pace of bond sales.

While in January and early February, foreigners reduced portfolios by UAH2-3bn per week, last week, their portfolios were reduced by a mere UAH0.4bn.

The slowdown in the withdrawal of funds from local-currency assets also affected secondary-market activity. The total volume of transactions decreased to UAH6.2bn last week from UAH10.7bn a week earlier, including deals with three-year notes that declined from UAH2.7bn to UAH1.1bn.

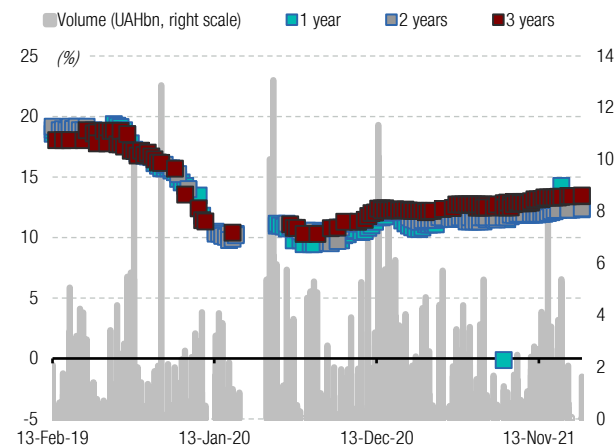
Borrowing in the primary market slightly improved, although this was not due to higher demand from foreign investors. Nonetheless, the amount of borrowings slightly increased because of demand for three-month bills, which amounted to UAH2.1bn last week.

**ICU view: High inflation in the United States, expectations of further growth in risk-free rates, and geopolitical uncertainty will dampen foreigners' interest in Ukrainian assets in the near future. We expect that foreign investors' portfolios will continue to shrink, albeit at a slower pace. At the same time, the Ministry of Finance will not rush to compete by raising rates on UAH-denominated bills to attract large amounts from domestic investors. Instead, they will manage funding needs through higher budget revenues and postponed expenditures.**

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

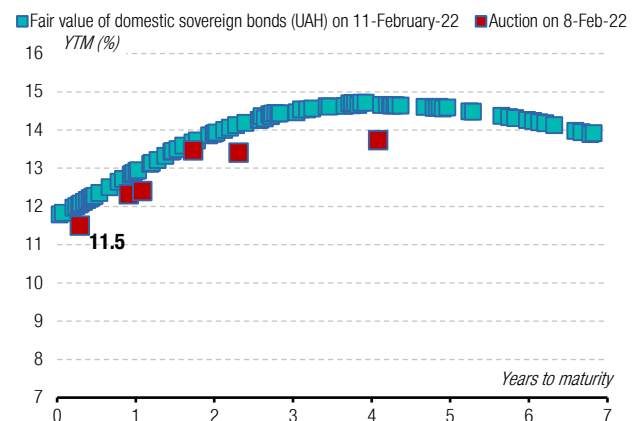
**Chart 1. Local-currency bonds**

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.

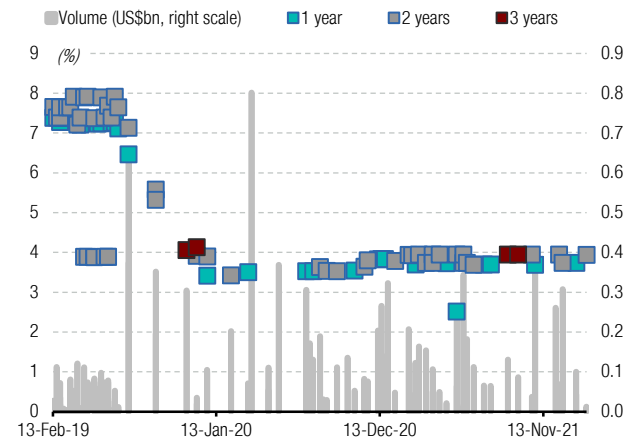
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

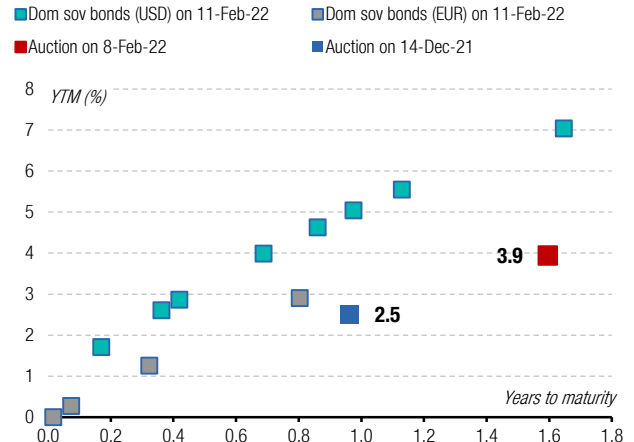
**Chart 2. FX-denominated bonds**

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.

**Eurobond market is volatile again**

High inflation in the United States, new steps by Russia to increase tensions near the Ukrainian border, and a fruitless meeting in the Normandy format have partially worsened the expectations of investors in Ukrainian Eurobonds.

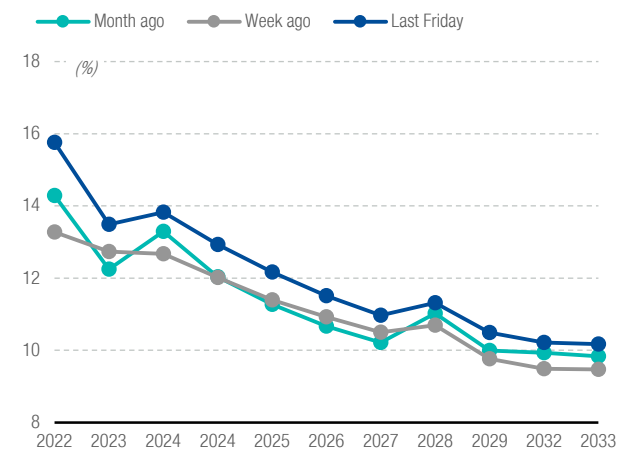
Russia’s announcement that it will block most of the Black and Azov Seas for military manoeuvres, along with statements by Russia about the need to return all weapons that Ukraine has received over the past few weeks, turned investors' sentiment negative. After more than a week of improving conditions in the markets, last Friday, spreads of Ukrainian Eurobonds to benchmarks widened from 755–1050bp to 824–1466bp. Rising US Treasury yields last Thursday on higher-than-expected US inflation caused Ukrainian Eurobond yields to spike to 10.2-15.8%, even higher than a week earlier.

**ICU view: In the current conditions, geopolitical tensions will be the key determinant of the yields of Ukrainian Eurobonds. This week, they will again be under the pressure of negative news about possible invasion of Russia into Ukraine.**

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

**Chart 3. Ukrainian Eurobonds yield curves**

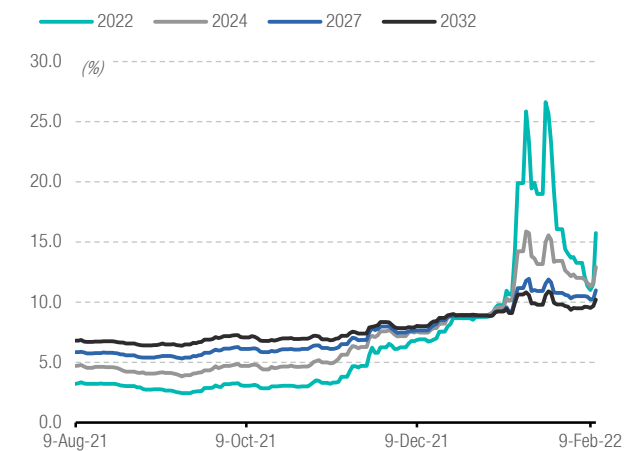
Yield curves of USD-denominated Eurobonds as of last Friday, a week and a month earlier



Source: Bloomberg, ICU.

**Chart 4. YTM of selected Ukrainian Eurobonds**

Last six-month historical data



Source: Bloomberg, ICU.

## Foreign exchange market

### Hryvnia under pressure again

In the first half of last week, the hryvnia exchange rate appreciated to UAH27.92/US\$, but last Thursday, it came under pressure from new factors, moving back to above UAH28/US\$.

News that Russia may block the Black and Azov Seas for a week could negatively affect the mood of exporters, as exports through those seaports are critical for Ukraine. Because of this, they could postpone the sale of hard currency in anticipation of greater clarity about the possibility of ships passing through Ukrainian ports. Therefore, last Thursday, the hryvnia began to weaken, and on Friday, it was above UAH28/US\$.

The meeting of advisers in the Normandy format ended without resolution, which added more uncertainty to the market, as this increases the risk of further hostility on the part of Russia toward Ukraine.

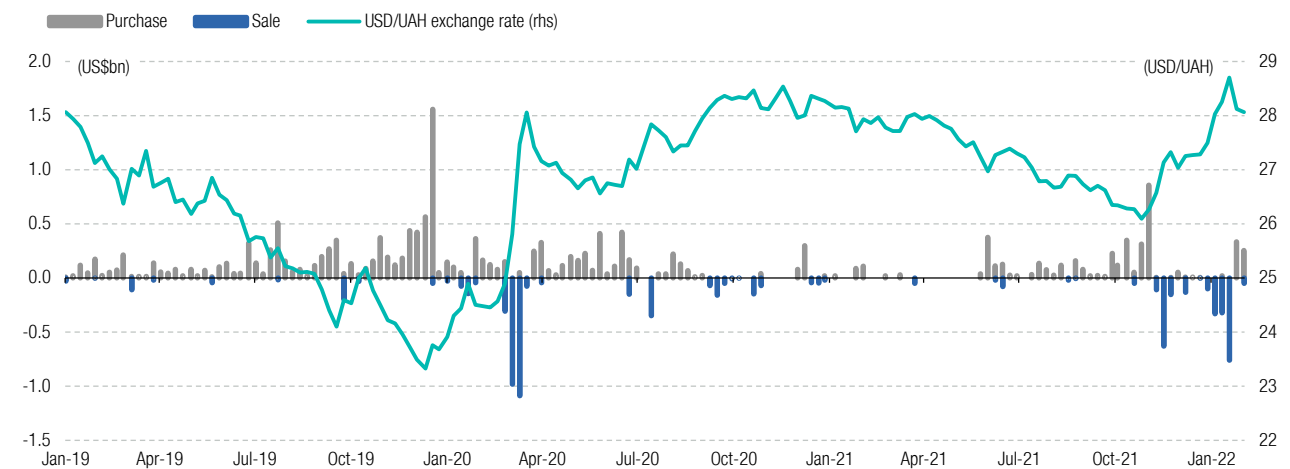
Therefore, the hryvnia exchange rate weakened since Wednesday by 0.5% to UAH28.07/US\$ last Friday. However, overall, the hryvnia strengthened by 0.2% for the week.

**ICU view: The general information context around the possible escalation on the border with Russia will continue to put pressure on the hryvnia exchange rate. However, the weakening will be restrained by the NBU interventions (if needed) and increased sales of hard currency by exporters to pay taxes.**

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

**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 stable YoY, core CPI decelerates in January

Consumer prices increased considerably by 1.3% MoM in January, but annual inflation stayed unchanged at 10.0%. Meanwhile, core CPI decelerated in a surprise move to 7.6% YoY.

Inflation remains driven by food, which makes up 41% of the consumer basket, as its prices were up 2.6% MoM and 14.5% YoY. Another material contributor was transportation (9.3% of the consumer basket) where prices increased 11.4% YoY. Utility tariffs increased only marginally by 4.3% YoY despite surging energy costs due to the government-set caps on gas and electricity prices. Growth in industrial producer prices remains robustly strong; they were up 69.1% YoY in January led by energy sector prices (+196% YoY).

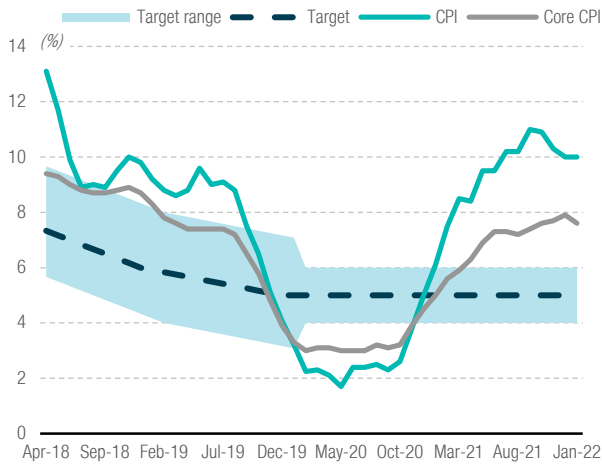
**ICU view: The January reading of CPI is a mixed bag. Food prices accelerated noticeably, which is partly a reflection of high energy prices and a weaker hryvnia that affected the price of imported vegetables. However, on a positive note, prices for other CPI basket components were reasonably stable in January. Core CPI, which excludes prices for raw food, energy, and regulated tariffs, and better catches the broad underlying price pressures, unexpectedly decelerated to 7.6% in January from 7.9% in December.**

**We remain of the view that if geopolitical tensions do not fuel hryvnia weakening, inflationary pressures will gradually fade through end-2022. The trend will be supported by a moderation of global food prices (UN FAO global food index decelerated to 19% YoY in January from 24% in December). Meanwhile, the key risk factor to Ukraine's CPI remains the expected revision of prices for gas and electricity for households that the government committed to do starting from May. We maintain our projection of end-2022 CPI at 7.2%, but upside risks still prevail at this point.**

Vitaliy Vavryshchuk, Kyiv, (044) 377-7040 ext.721

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

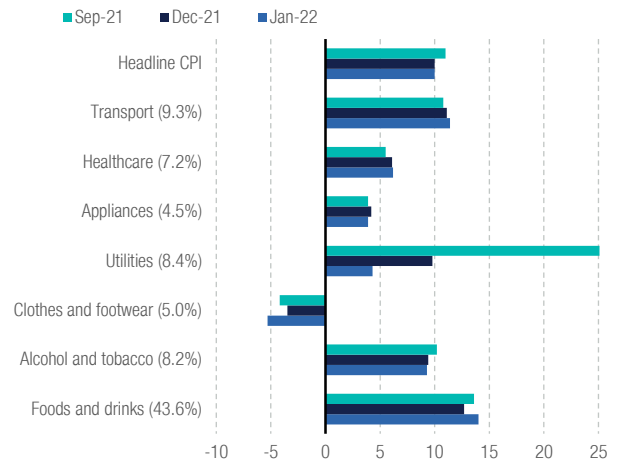
*Headline inflation unchanged in January*



Source: Ukrstat, NBU, ICU.

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

*Food prices are the key inflation driver*



Source: Ukrstat, ICU.

\* numbers in parenthesis indicate share of the respective items in consumer basket

This page is intentionally left blank



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

WEB [www.icu.ua](http://www.icu.ua)




## RESEARCH

**Vitaliy Vavryshchuk**  
Head of macro research  
[vitaliy.vavryshchuk@icu.ua](mailto:vitaliy.vavryshchuk@icu.ua)

**Taras Kotovych**   
Senior financial analyst (Sovereign debt)  
[taras.kotovych@icu.ua](mailto:taras.kotovych@icu.ua)

**Dmitriy Dyachenko, CFA**  
Financial analyst  
[dmitriy.dyachenko@icu.ua](mailto:dmitriy.dyachenko@icu.ua)

**Alexander Martynenko**   
Head of corporate research  
[alexander.martynenko@icu.ua](mailto:alexander.martynenko@icu.ua)

**Mykhaylo Demkiv**   
Financial analyst (Banks)  
[mykhaylo.demkiv@icu.ua](mailto:mykhaylo.demkiv@icu.ua)

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (license numbers: dealer activity AE 263019, broker activity AE 263018, underwriting activity AE 263020 dated 11 April 2013).

## DISCLAIMER

This research publication has been prepared by Investment Capital Ukraine LLC solely for information purposes for its clients. It does not constitute an investment advice or an offer or solicitation for the purchase or sale of any financial instrument. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, Investment Capital Ukraine makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of Investment Capital Ukraine LLC. All rights are reserved. Any investments referred to herein may involve significant risk, are not necessarily available in all jurisdictions, may be illiquid and may not be suitable for all investors. The value of, or income from, any investments referred to herein may fluctuate and/or be affected by changes in exchange rates. Past performance is not indicative of future results. Investors should make their own investigations and investment decisions without relying on this report. Only investors with sufficient knowledge and experience in financial matters to evaluate the merits and risks should consider an investment in any issuer or market discussed herein and other persons should not take any action on the basis of this report.

**Additional information is available upon request.**

