



Focus  
**Ukraine**

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

Research team  
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Alexander Martynenko  
Taras Kotovych  
Mykhaylo Demkiv**

# Weekly Insight

## Inflation accelerates in August

### Key messages of the today's comments

#### Ukrainian bond market

##### Interest in military bills remains low

Interest in military government bills is very low in both the primary and secondary markets, so the need for budget deficit financing from the National Bank remains.

##### Eurobond prices are unchanged

Over the past week, the situation in the world debt market stabilized, so the prices of Ukrainian Eurobonds remained steady.

#### Foreign exchange market

##### NBU keeps official UAH exchange rate unchanged

Last week, the National Bank confirmed its intention to maintain the fixed official exchange rate of the hryvnia against the dollar at the current level.

#### Economics

##### NBU keeps key rate at 25%

The regulator abstained from changing the key rate, which was in line with the expectations.

##### Inflation accelerates to 23.8% in August

Annual inflation accelerated to 23.8% YoY in August from 22.2% in July. Core CPI accelerated even more significantly to 19.1% YoY from 16.7%.

##### NBU reserves up substantially in August

The NBU gross international reserves increased 14% in August to \$25.4bn thanks to generous international financial assistance.

### MONDAY, 12 SEPTEMBER 2022

#### Banks' reserves market (9 September 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	25.00	+0bp	+1,650bp
ON rate (%)	9.76	+0bp	+248bp
Reserves (UAHm) <sup>2</sup>	60,629	+0.00	+43.58
CDs (UAHm) <sup>3</sup>	251,384	+15.35	+90.79

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) (9 September 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	604,570	+2.54	+93.40
Banks	502,476	-0.21	-0.12
Residents	65,962	-0.01	+26.60
Individuals	30,844	+1.81	+47.51
Foreigners <sup>1</sup>	68,027	-1.29	-29.84
<b>Total</b>	<b>1,272,634</b>	<b>+1.07</b>	<b>+29.11</b>

Source: NBU, ICU.

#### FX market indicators (9 September 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.7171	-0.43	+37.72
EUR/USD	1.0042	+0.88	-15.08
DX	109.003	-0.48	+17.87
UAH TWI <sup>1</sup>	114.450	+0.08	-9.46

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

#### Market gov't bond quotes<sup>1</sup> (12 September 2022)

Maturity	Bid	Ask
6m	21.00	16.00
12m	21.00	17.00
2y	23.00	18.00
3y	25.00	19.00
12m (\$)	6.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

# Ukrainian bond market

## Interest in military bills remains low

Interest in military government bills is very low in both the primary and secondary markets, so the need for budget deficit financing from the National Bank remains.

Last week, the Ministry of Finance raised only UAH47m (US\$1.3m) at the primary auction. This is the smallest amount raised in local currency in more than two years. The MoF offered only two issues of military bills: seven-month bills as semi-annual and 13-month paper. For the latter, the MoF reset the rate to 14%, the same as for 12-month paper, even though last week this issue was sold at 16%. See details in the [auction review](#).

In the secondary market, interest in military bills also decreased. 3,367 deals were concluded last week, but only for UAH126m (US\$3.4m). The number of transactions was up compared with the week before, but volume fell more than twice. At the same time, for ordinary (non-military) securities, the volume of trades on the secondary market has more than doubled to UAH3.4bn (US\$93m).

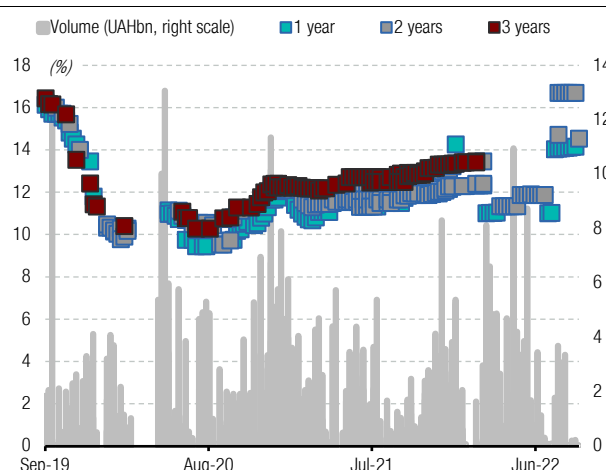
Consequently, the Ministry of Finance issued bonds for the National Bank for UAH15bn (US\$410m) last Monday. The total volume of military bonds purchased by the National Bank reached UAH300bn (US\$8.2bn).

**ICU view: As we noted earlier, at this point, the Ministry of Finance seems to have lost interest in working with the private market. Market participants' expectations that the MoF will continue to increase interest rates for military bills have not been realised. Demand for government debt at current yields will remain almost zero. Therefore, the NBU will continue to play a key role in the internal financing of the budget deficit.**

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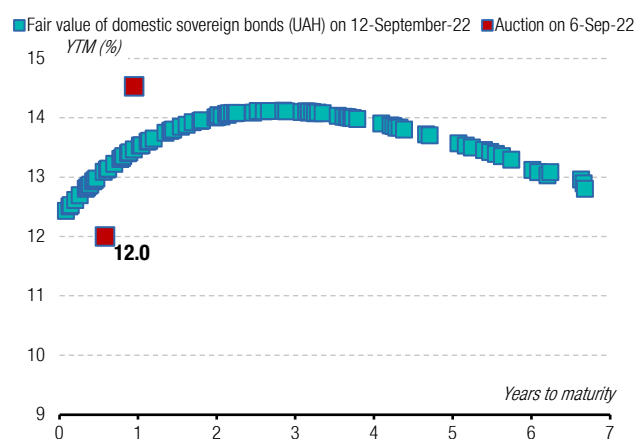
**Chart 1. Local-currency bonds**

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.

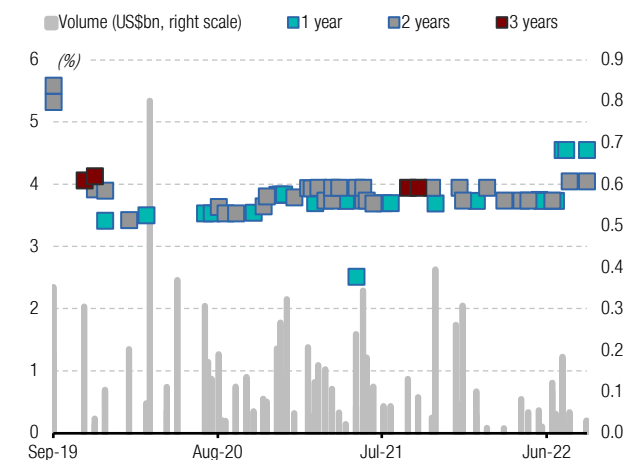
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

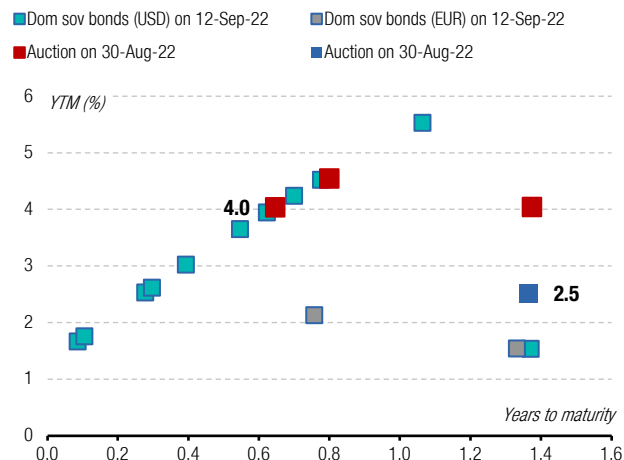
### Chart 2. FX-denominated bonds

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.

### Eurobond prices are unchanged

Over the past week, the situation in the world debt market stabilized, so the prices of Ukrainian Eurobonds remained steady.

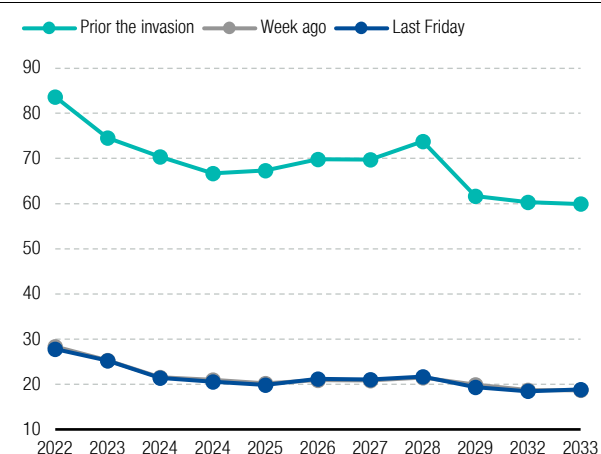
Prices remained at the level of 18–28 cents. Only VRIs fell in price by almost a cent to slightly below 31 cents.

**ICU view: This week, the market will try to assess the significance of Ukraine's military successes. The general positive sentiment will probably drive a slight increase in the value of Eurobonds.**

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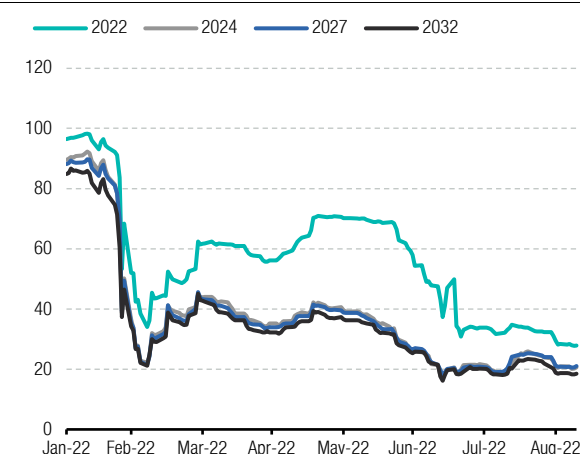
### Chart 3. Ukrainian Eurobonds prices

Prices of USD-denominated Eurobonds as of last Friday, prior the Russian invasion and a week before



Source: Bloomberg, ICU.

Last six-month historical data



Source: Bloomberg, ICU.

# Foreign exchange market

## NBU keeps official UAH exchange rate unchanged

Last week, the National Bank confirmed its intention to maintain the fixed official exchange rate of the hryvnia against the dollar at the current level.

The National Bank believes that international reserves at the level of US\$25.4bn at the end of August are sufficient to maintain the current fixed exchange rate. This decision is supported by the inflow of financial assistance from international partners, the gradual improvement of logistics, and the corresponding growth of export revenue. The NBU continues to conduct interventions on the sale of hard currency. Volume remains at the level of US\$400–500m every week.

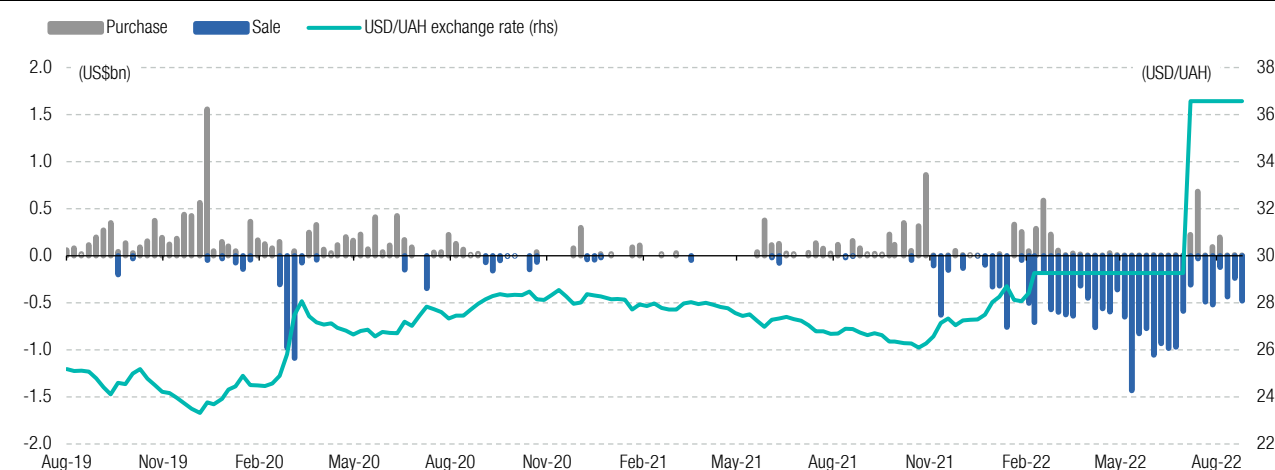
At the same time, the hryvnia exchange rate weakened again on the cash market, crossing the UAH40/US\$ level. The key reason is the lack of FX cash at banks. Therefore, the NBU started supplying banks with cash hard currency last week. On Wednesday, US\$100m was sold to banks, and today an auction will be held to sell cash euros to banks. In addition, since last Tuesday, the NBU has allowed banks to sell the entire amount of non-cash currency purchased by them from April 13, 2022, instead of half of it.

**ICU view:** We expect that the additional supply of hard currency from the National Bank will help stabilize the cash market, and the exchange rate will return closer to UAH40/US\$. However, the gap between the exchange rate for non-cash payments and at bank cash desks will remain, which is explained by banks' additional costs for importing cash.

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**Chart 4. 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 25%

The regulator abstained from changing the key rate, which was in line with the expectations.

Inflation has accelerated to 22.2% YoY in July and 23.8% YoY in August. This is slightly below the forecast published at the previous Monetary Policy Committee meeting. The

regulator has stuck to its forecast that assumes the key rate will remain unchanged until 2Q24.

**ICU view:** *Even though inflation remains lower than expected the NBU can increase the key rate in the future. It is yet unclear what amount of financial aid Ukraine can count on in 2023 to cover the budget deficit, while some fiscal consolidation and reduction of imports are still not achieved. Yet, we see NBU's soft commitment to keep the key policy rate at 25% at least until 2Q24 as totally credible.*

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

## Inflation accelerates to 23.8% in August

Annual inflation accelerated to 23.8% YoY in August from 22.2% in July. Core CPI accelerated even more significantly to 19.1% YoY from 16.7%.

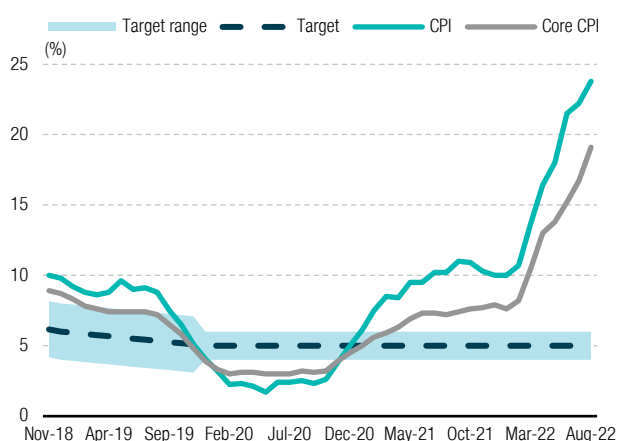
Nearly all components of the consumer basket accelerated, but growth in food prices was again the key contributor to higher CPI. Transportation services were the only exception. YoY growth remained unchanged thanks to improved availability of petrol, the price of which declined almost 4% MoM.

**ICU view:** *Acceleration of prices is fully expected and does not come as a surprise at this point. Growth in consumer prices comes on the back of the higher cost of goods, supply-side constraints in the regions that are close to the war zone, and partly due to hryvnia weakening. We expect CPI to grow close to 30% by the end of the current year, and it will start to gradually decelerate thereafter.*

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**Chart 5. CPI, core CPI and target, YoY, %**

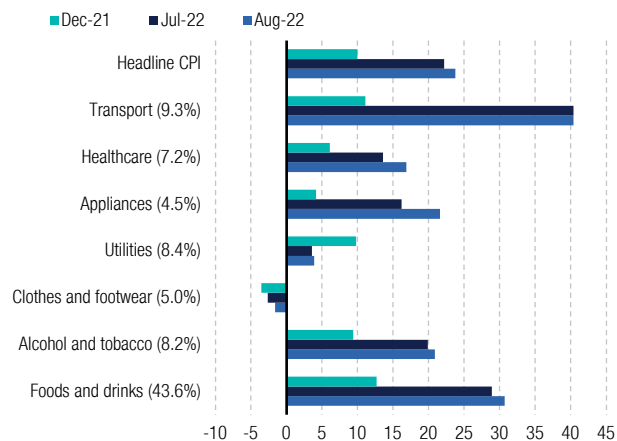
*Inflation expectedly accelerates further*



Source: Ukrstat, NBU, ICU.

**Chart 6. CPI and its main components, YoY, %**

*Prices accelerated for nearly all components of consumer basket*



Source: Ukrstat, ICU.

## NBU reserves up substantially in August

The NBU gross international reserves increased 14% in August to \$25.4bn thanks to generous international financial assistance.

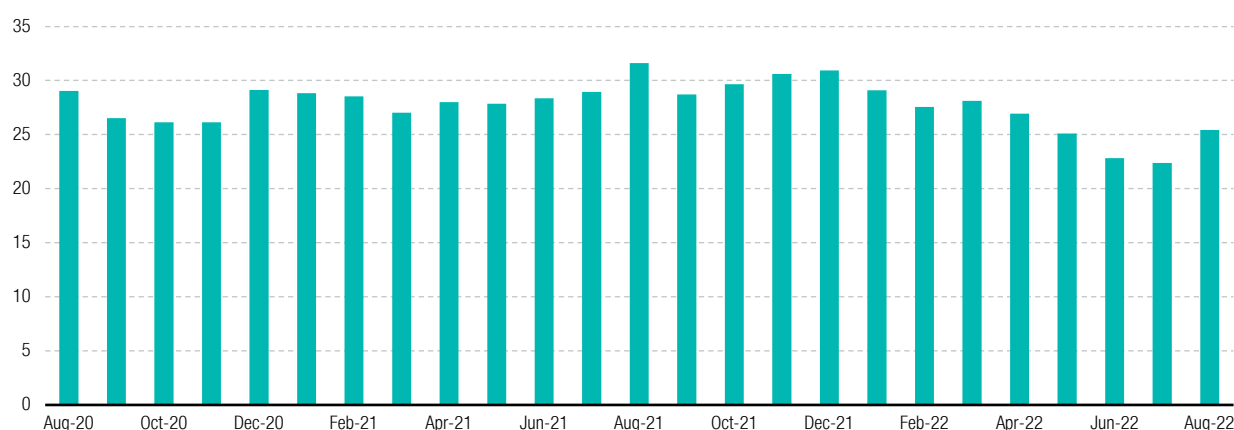
Last month Ukraine received nearly US\$4.8bn in international aid, including US\$3.0bn grant from the US and EUR1.0bn loan from the EU. FX debt redemptions were insignificant in August. The negative factor was a significant volume of FX sales by the NBU to cover the deficit in the market – net US\$1.3bn.

**ICU view:** The NBU reserves were boosted thanks to the generous loans and grants the government received from international allies. In September, the NBU reserves will grow even further as the EU recently approved a EUR5.0bn loan. Meanwhile, the NBU is actively selling hard currency to cover the excess demand, and it maintains weekly sales at the rate of US\$0.4–0.5bn. We expect that by the end of the year, the NBU will need to sell in the market roughly the same amount that Ukraine will receive from international partners. We thus expect end-2022 reserves to be close to US\$23bn.

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**Chart 7. NBU gross international reserves, US\$bn**

*NBU reserves up significantly in August thanks to international aid*



Source: NBU, ICU.

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