

Weekly Insight

Inflation picks up to 26.6% in October

Key messages of the today's comments

MONDAY, 14 NOVEMBER 2022

Ukrainian bond market

Individuals remain most stable investors in domestic bills

The activity of the bond market remained low last week, with bond portfolios of individuals increasing more than others.

Ukrainian Eurobonds respond to positive global sentiment

Sentiment for debt, especially emerging market Eurobonds, improved last week. Thanks to this, Ukrainian Eurobonds prices were up.

Foreign exchange market

FX market maintains a safety margin

The hryvnia cash exchange rate remained close to UAH40/US\$ with slight weakening, but the interbank market still needed NBU interventions.

Economics

Inflation picks up to 26.6% in October

Annual inflation accelerated to 26.6% YoY in October from 24.6% in September. Core CPI accelerated to 21.5% YoY from 20.4%.

NBU reserves increase in October due to international aid

The NBU gross international reserves increased 5.5% in October to \$25.2bn on inflows of international financial aid.

Banks' reserves market (11 November 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+1,650bp
ON rate (%)	9.76	+0bp	+135bp
Reserves (UAHm) ²	82,137	+48.69	+11.22
CDs (UAHm) ³	322,117	-3.69	+107.04

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 November 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	644,570	+0.00	+106.19
Banks	493,516	-0.01	-1.05
Residents	67,479	+1.01	+27.03
Individuals	30,607	+3.05	+32.17
Foreigners ¹	60,280	-1.50	-36.56
Total	1,297,131	+0.05	+32.00

Source: NBU, ICU.

FX market indicators (11 November 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.7560	-0.17	+40.92
EUR/USD	1.0347	+3.92	-9.64
DXY	106.292	-4.14	+11.68
UAH TWI ¹	113.716	-1.72	-13.60

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes¹ (14 November 2022)

Maturity	Bid	Ask
6m	23.00	18.00
12m	24.00	19.00
2y	28.00	20.00
3y	25.50	21.00
12m (\$)	6.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Individuals remain most stable investors in domestic bills

The activity of the bond market remained low last week, with bond portfolios of individuals increasing more than others.

In the absence of redemptions, the activity in the primary market remains low. Last week, the Ministry of Finance managed to attract only UAH44m, one of the smallest amounts this year. Interest rates on all bonds remained unchanged, but demand shifted slightly toward ordinary bonds, which offer investors YTM of more than 19%. See details in the [auction review](#).

The secondary market remains more active, but is still notably fragmented between military and ordinary (non-military) bonds. A lot of small deals were with military bills, and fewer, but larger, deals were with ordinary bills. So, last week, 6,211 deals worth UAH147m were concluded with military securities, and 1,675 deals worth UAH3.5bn with ordinary paper.

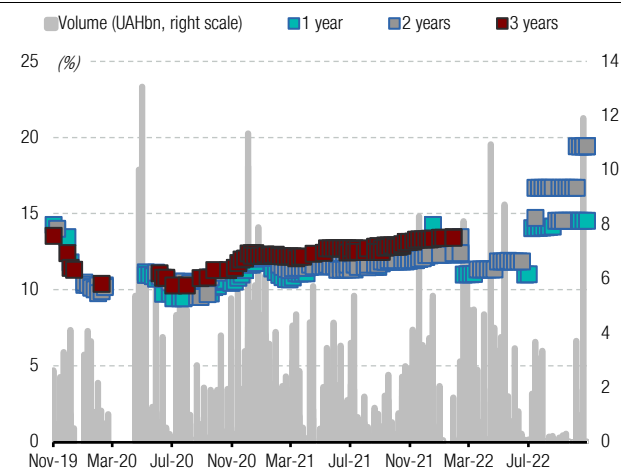
Individuals were the most active in the secondary market in buying bills. They have increased their portfolios almost every week, except for the weeks with large redemptions. Last week, individuals added UAH0.8bn to their portfolios, raising them to almost UAH30.7bn. Non-banking institutions also increased investments by UAH0.7bn to UAH67.5bn. On the other hand, banks' portfolio was up only due to revaluation of EUR-denominated bonds and foreigners reduced their portfolios by selling bonds to other market participants.

ICU view: The total amount of liquidity in the banking system exceeds UAH400bn, but banks are in no hurry to buy government bonds, preferring higher-yielding, short-term NBU CDs. They purchase large volumes of bonds once in a while on the primary market, receiving ad hoc higher interest rates from the government compared with earlier auctions. The rest of the investors, except foreigners who decreased their portfolios, prefer non-military bonds bought on the secondary market.

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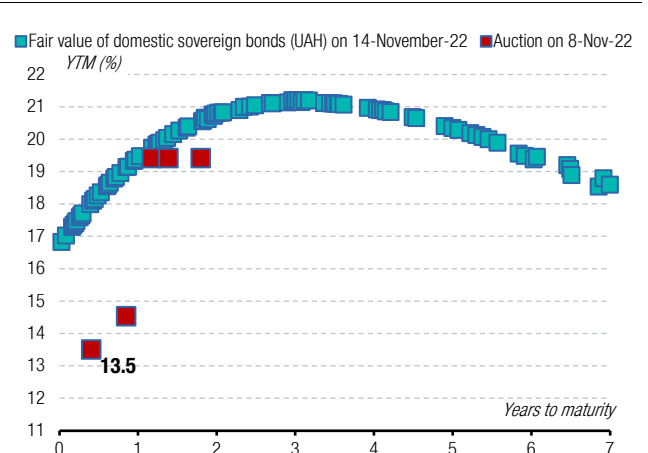
Chart 1. Local-currency bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: MFU, ICU.

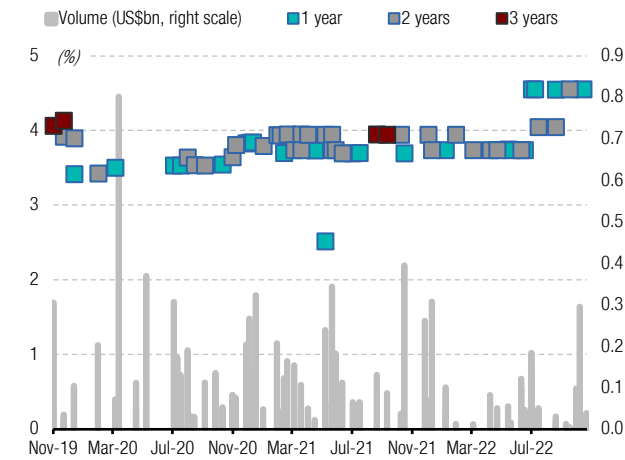
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

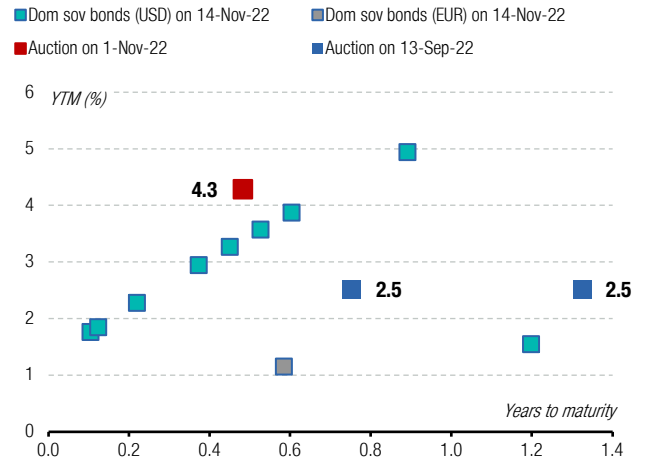
Chart 2. FX-denominated bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: MFU, ICU.

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



Source: NBU, MFU, ICU.

Ukrainian Eurobonds respond to positive global sentiment

Sentiment for debt, especially emerging market Eurobonds, improved last week. Thanks to this, Ukrainian Eurobonds prices were up.

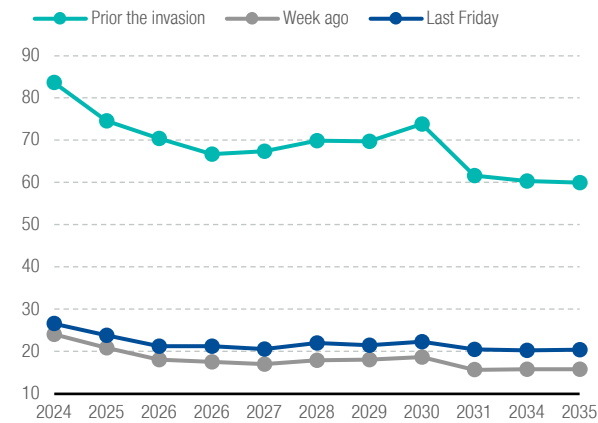
News that inflation slowed in the US led to a rise in prices of US Treasuries. Spreads of Ukrainian Eurobonds to the benchmark narrowed by 270–680 bps, which had an even greater impact on Eurobond prices. During the week, the prices of Ukrainian Eurobonds increased by 10–29% to 20–27 cents. VRIs also rose in price by 13% to 28.5 cents per dollar of notional value.

ICU view: *The improvement of global sentiment on slowing inflation in the USA was decisive for the prices of Ukrainian Eurobonds. The news positively affected the prices of Eurobonds of developing countries and, therefore, Ukrainian paper. Important news from the front regarding the retreat of the russian forces to the left bank of the Dnipro River and the liberation of Kherson had a much less noticeable impact on investors' assessment of Ukraine's sovereign risk.*

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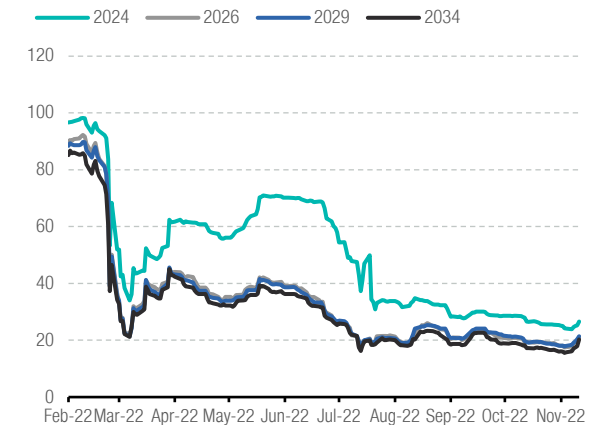
Chart 3. Ukrainian Eurobonds prices

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



Source: Bloomberg, ICU.

Last eight-month historical data



Source: Bloomberg, ICU.

Foreign exchange market

FX market maintains a safety margin

The hryvnia cash exchange rate remained close to UAH40/US\$ with slight weakening, but the interbank market still needed NBU interventions.

In the cash market, the hryvnia continued to weaken to the US dollar for the second week in a row, but less actively. In the leading retail banks, it weakened only from UAH39.5–40.3/US\$ to UAH39.8–40.5/US\$.

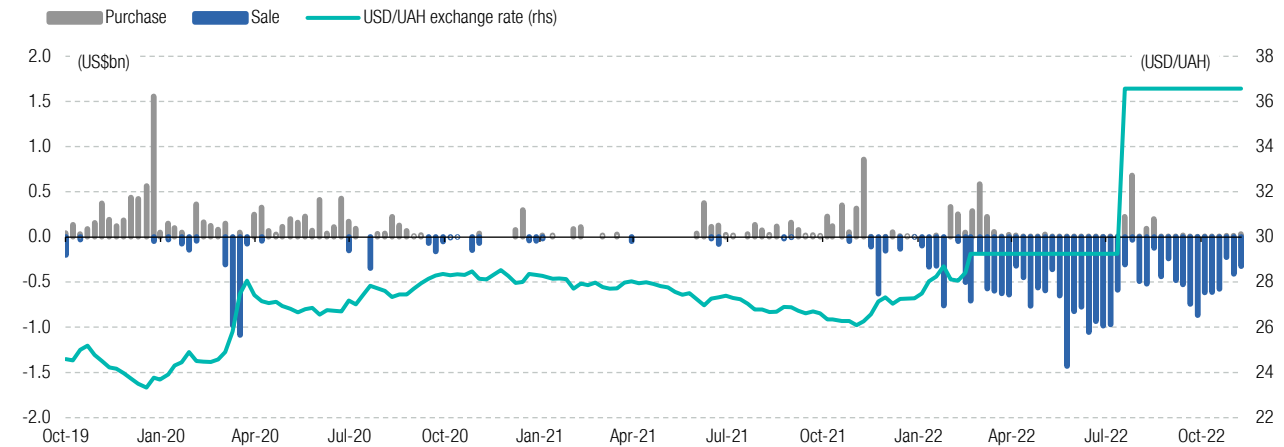
The interbank FX market remains in deficit, and the NBU FX sale interventions remain significant. Last week, the NBU sold US\$326m. However, last Wednesday, there was a larger-than-usual sale of hard currency by bank clients (probably by the Ministry of Finance), which forced the NBU to buy the excess supply to balance the market. As a result, the NBU's net interventions amounted to US\$295m last week.

ICU view: The cash FX market remained broadly balanced. So, the hryvnia cash rate remains stable with a slight weakening of less than 1% during the week for the second time in a row. Such a change, of course, is not uncommon during war. The interbank market remains under the complete control of the NBU.

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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

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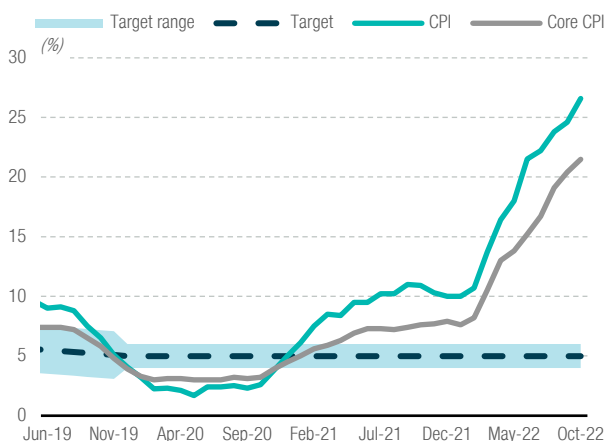
Food prices remained the key CPI growth driver as they were up 4.2% MoM (only partly due to seasonal factors) and 36.1% YoY. Noteworthy, gasoline prices remained stable in October, but were still 62% higher in YoY terms.

ICU view: Supply-side factors continue to play the decisive role in pushing up consumer inflation. Destruction of production chains have led to limited supply of some food products. Eggs were a noticeable story in October, as the prices for them surged 61% MoM and 81% YoY. We expect inflation will keep accelerating to above 32% YoY in February 2023 on supply disruptions and growing production costs, but price growth may start to decelerate since March on a high comparison base.

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

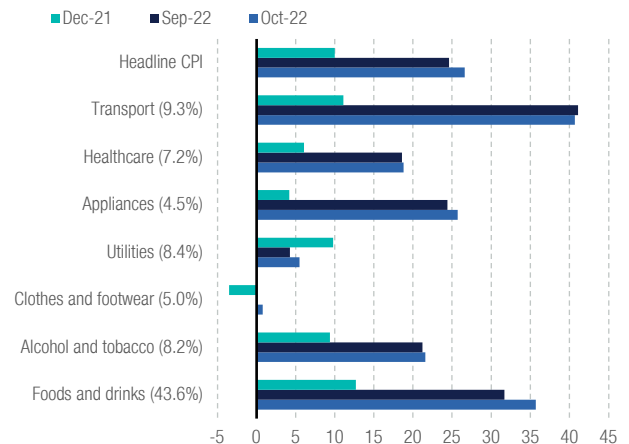
Inflation expectedly accelerates further



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 increase in October due to international aid

The NBU gross international reserves increased 5.5% in October to \$25.2bn on inflows of international financial aid.

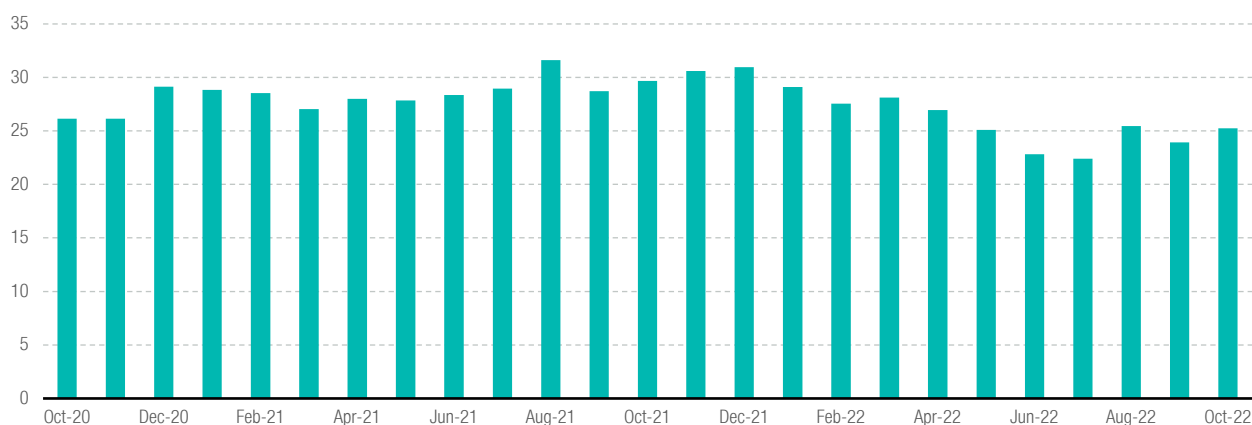
Last month, Ukraine received a EUR2.0bn loan from the EU, US\$1.3bn loan from the IMF, and a US\$0.5bn loan from the World Bank. Repayments of FX debt by the government and the NBU were minimal last month. At the same time, large FX sale interventions by the NBU of US\$2.0bn were a drag on reserves.

ICU view: *As Ukraine’s international allies are ramping up their financial aid to Ukraine, NBU gross international reserves are back on a growth trend. With new generous commitments of grants and loans for the remainder of 2022 and for 2023, international reserves are likely to remain on an upward trend in the coming quarters. Another positive factor is stabilization of FX sale interventions by the NBU. Those are still large, but far below the inflow of international financial assistance to Ukraine.*

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

NBU reserves up on international financial aid



Source: NBU, ICU.

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