

Weekly Insight

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Key messages of the today's comments

MONDAY, 16 JANUARY 2023

Ukrainian bond market

Bond market activity increases

The year began with active primary placements of bonds and an increase in the volume of trades on the secondary market. The most significant contribution was made by bonds that banks can use to meet mandatory reserve requirements.

"Reserve" bills most popular with the market

The increased reserve requirements for banks and the possibility to use government bonds as part of the reserves increased demand in the primary market. Still, the Ministry of Finance satisfied less than half of total demand.

Eurobond market holiday break coming to an end

Over the previous few weeks, the Ukrainian Eurobond market was largely inactive with minimal effects on prices.

Foreign exchange market

Hryvnia exchange rate weakens over holiday season

During the winter holiday season, the hryvnia weakened slightly on the cash market and the NBU increased interventions on the interbank market.

Economics

Inflation reaches 26.6% in 2022

End-2022 annual headline inflation sped up to 26.6%, up from 26.5% in November, but was still below the consensus projection and our forecast.

NBU reserves down 8% YoY in 2022

The NBU gross international reserves increased 1.9% to US\$28.5bn in December but were still down nearly 8% for the full 2022.

Banks' reserves market (13 January 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+1,600bp
ON rate (%)	9.76	+0bp	+157bp
Reserves (UAHm) ²	122,809	+99.31	+124.68
CDs (UAHm) ³	382,894	-17.83	+114.58

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 January 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	704,570	+0.00	+125.39
Banks	500,251	+2.87	-8.30
Residents	108,791	+1.18	+32.03
Individuals	31,473	+2.64	+22.70
Foreigners ¹	57,642	-0.43	-35.34
Total	1,404,518	+1.13	+33.08

Source: NBU, ICU.

FX market indicators (13 January 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.8757	+0.34	+32.19
EUR/USD	1.0830	+1.75	-5.46
DXY	102.204	-1.61	+7.82
UAH TWI ¹	110.566	-1.24	-12.44

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes¹ (16 January 2023)

Maturity	Bid	Ask
6m	23.00	18.00
12m	24.00	19.00
2y	25.00	20.00
3y	25.50	21.00
12m (\$)	6.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Bond market activity increases

The year began with active primary placements of bonds and an increase in the volume of trades on the secondary market. The most significant contribution was made by bonds that banks can use to meet mandatory reserve requirements.

Last week, the Ministry of Finance attracted UAH23.5bn to the budget, of which almost UAH21bn was in local currency. Via two auctions in 2023, the MoF borrowed UAH22bn, US\$40m, and EUR29m. The largest proceeds were thanks to "reserve" bills, an issue that banks can use to form part of their obligatory reserves. These bonds brought UAH21.6bn to the budget in two weeks. See details in the comment below.

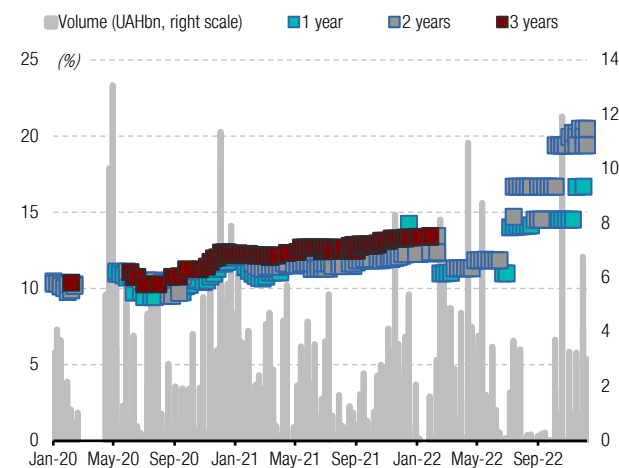
The secondary market also became more active. Over the past week, 5,993 deals worth more than UAH6.8bn were concluded. This is the largest volume of trading in almost a year. Almost half of last week's trades was with the "reserve" bills.

ICU view: Thanks to the new reserve requirements that the NBU introduced in mid-December, the Ministry of Finance has already refinanced all January repayments in just two weeks. The remaining funds that have already been raised, as well as what will be attracted by the end of January, can be used for current budget needs. Thus, the Ministry of Finance has adjusted the auction schedule and excluded the paper maturing in August 2024 (that can be included into reserves) from upcoming placements. Therefore, active placement and trading can be an infrequent phenomenon.

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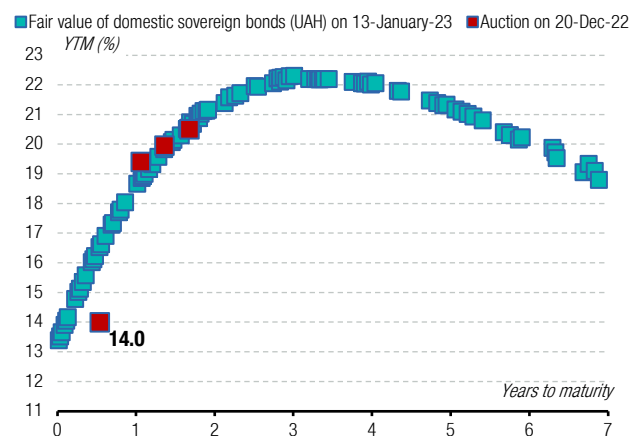
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

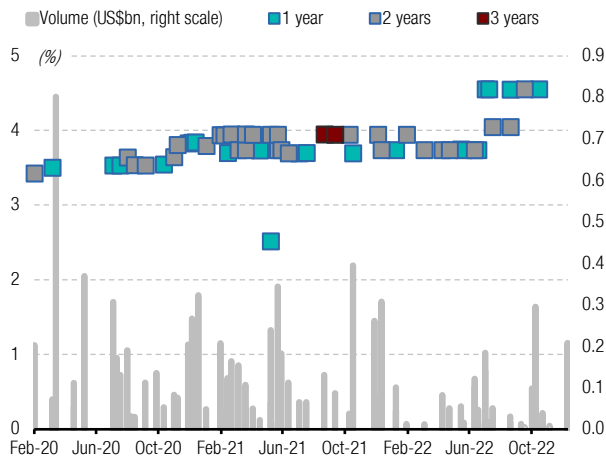
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

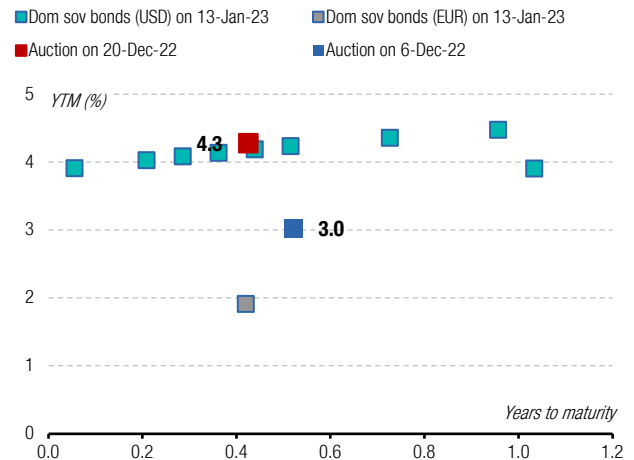
Chart 2. FX-denominated bonds

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.

"Reserve" bills most popular with the market

The increased reserve requirements for banks and the possibility to use government bonds as part of the reserves increased demand in the primary market. Still, the Ministry of Finance satisfied less than half of total demand.

The total volume of bids for "reserve" bonds—the only issue currently allowed to be included into reserves—amounted to UAH45.4bn in 42 bids last Tuesday, which could provide the budget with about UAH49bn. But the lack of an urgent need to refinance the debt due to relatively small repayments in January led the MoF to offer only UAH19bn worth of bonds (par value). So, demand more than twice exceeded the supply. As a result, only some participants who submitted bids with rates below the auction cap received the full requested amount, while the rest received the remaining volume split pro rata to the size of their bids.

A large part of these bonds was traded on the secondary market last Wednesday. There were 31 deals for UAH4.7bn, or almost a quarter of the placed volume.

ICU view: Last Tuesday, demand for this issue demonstrated the potential amount of funds banks can invest in "reserve" bonds. Therefore, the next paper that will be allowed to be included in reserves potentially can collect at least UAH25–30bn in demand. But such placements are unlikely to be frequent. The secondary market will be affected by these bonds only immediately after the auction when primary dealers will sell them to other banks. After all, banks will buy such bills for their own portfolios and mostly hold them until maturity.

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Eurobond market holiday break coming to an end

Over the previous few weeks, the Ukrainian Eurobond market was largely inactive with minimal effects on prices.

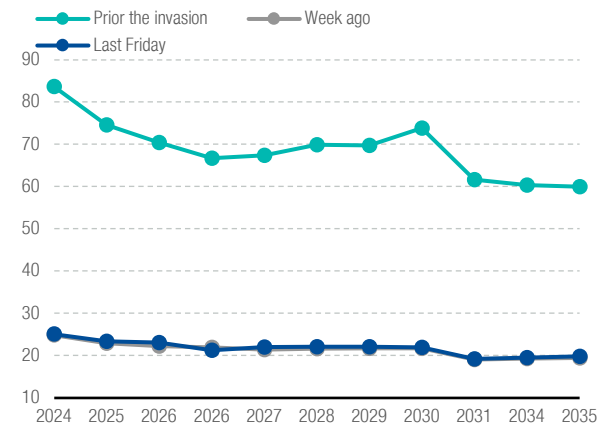
The pre-holiday decline in activity became noticeable as early as mid-December, and interest in Ukrainian Eurobonds declined. Over a few weeks, the prices fell by 1–1.5 cents or 4–7%, depending on the issue of Eurobonds, from 21–26 cents per dollar to 19–25 cents. But as of last week, prices have gradually corrected by about 1–2% or less than half a cent, so they're mostly in the 19–23 cent range for now, with only bonds maturing in 2024 valued at more than 25 cents.

ICU view: The current situation in the Ukrainian Eurobond market remains under the impact of the war and global sentiment towards emerging markets. Even as the activity gradually recovers, the price volatility of the Ukrainian paper is unlikely to increase substantially.

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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

Hryvnia exchange rate weakens over holiday season

During the winter holiday season, the hryvnia weakened slightly on the cash market and the NBU increased interventions on the interbank market.

The hryvnia cash rate has been modestly weakening since mid-December. The hryvnia ER declined by less than 1% per week, and at the beginning of this year, the trend levelled. Generally, the bids of leading retail banks did not exceed UAH40/US\$, and the offer rate reached only UAH40.7/US\$. But by last week, the hryvnia exchange rate in these banks strengthened to UAH39.9–40.6/US\$.

On the interbank market, the activity of sellers during this festive season was relatively low. The market was nearly balanced only on one day, and on other days demand prevailed. During the two days before the New Year, client activity peaked when they bought US\$543m. But since the beginning of January, the daily gap was below US\$100m.

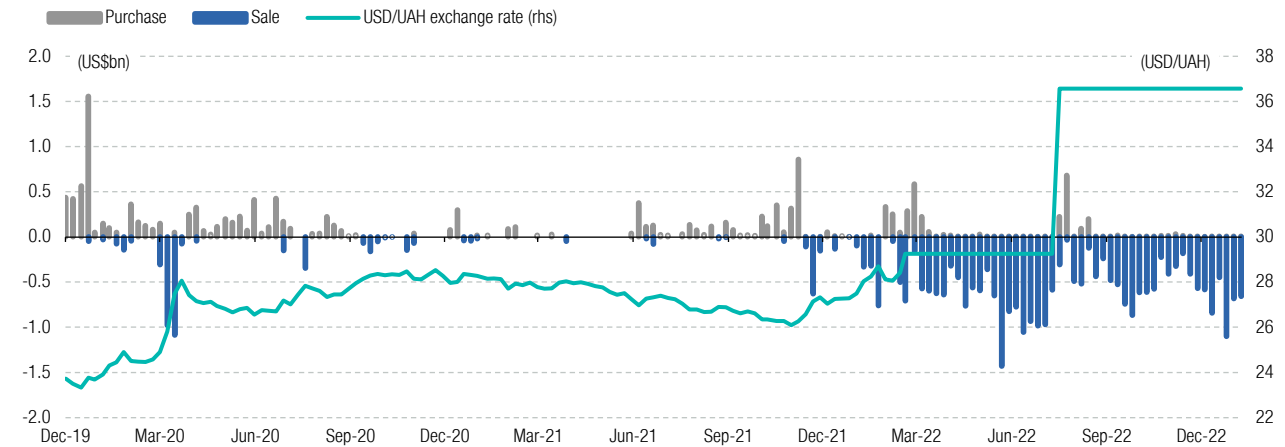
As a result, the NBU increased the volume of interventions to US\$1.1bn in the week before the New Year, but by the first week of the new year, the volume of interventions fell to US\$683m, and last week slid to US\$659m.

ICU view: The cash market remains stable with low volatility. An increase in the activity of sellers may once again contribute to the strengthening of the hryvnia exchange rate. Still, it will continue fluctuating at a level close to UAH40/US\$. The imbalance in the interbank market will remain significant, and the NBU will be ready to sell hard currency from its reserves when needed.

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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

Inflation reaches 26.6% in 2022

End-2022 annual headline inflation sped up to 26.6%, up from 26.5% in November, but was still below the consensus projection and our forecast.

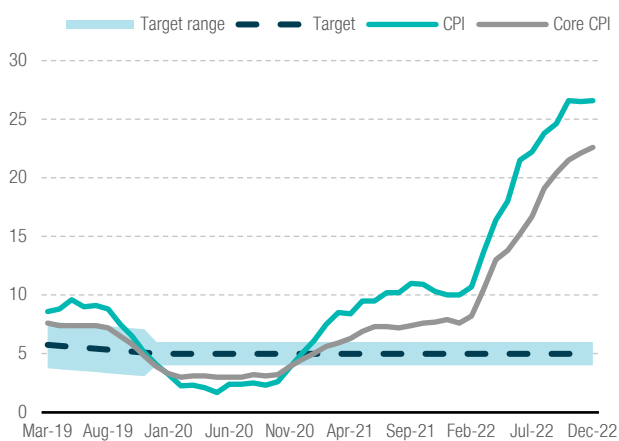
Consumer inflation was largely driven by the prices for food staples that increased 34.4% last year. Transportation services were the second largest contributor to headline inflation – their prices were up 42.9%.

ICU view: Last year, growth in consumer prices was primarily driven by supply-side bottlenecks due to damages to production facilities and impaired logistics. A surge in fuel prices was also a material headwind. Meanwhile, the falling incomes and purchasing power of the majority of the Ukrainian population substantially eased demand-side inflationary pressures. Weak consumer demand will keep inflation on a sustainable decelerating trend since March 2023. The supporting factors will be a stable hryvnia exchange rate and fixed utility tariffs. Under favourable circumstances, the CPI may slow to below 20% in 2023.

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

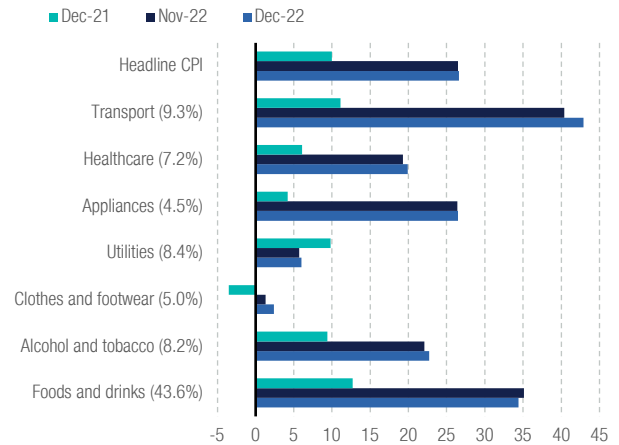
Inflation inches up in December



Source: Ukrstat, NBU, ICU.

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

Growth in food prices continues to decelerate



Source: Ukrstat, ICU.

NBU reserves down 8% YoY in 2022

The NBU gross international reserves increased 1.9% to US\$28.5bn in December but were still down nearly 8% for the full 2022.

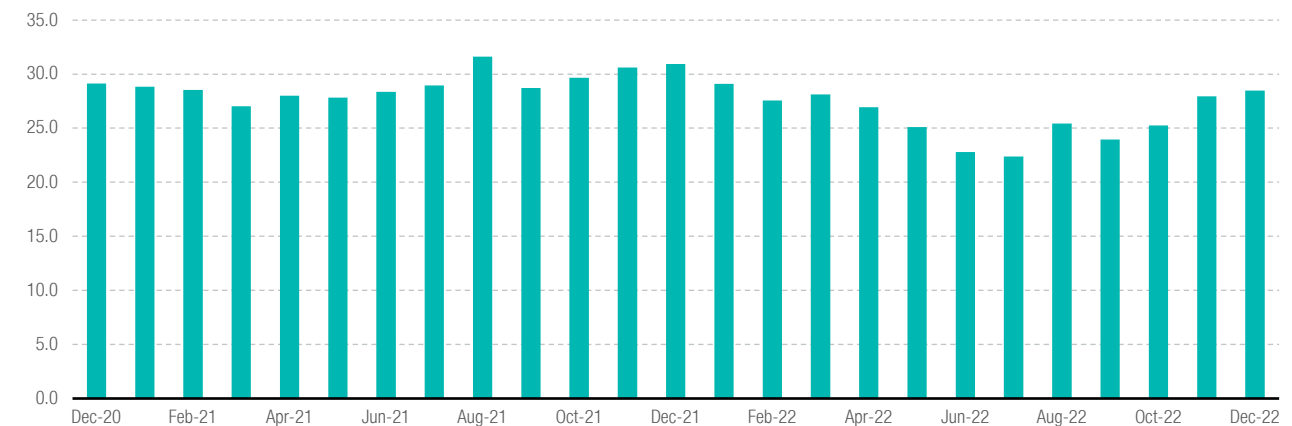
Last year, the NBU reserves were supported by significant inflows of international financial aid. The total volume of foreign loans and grants that landed at NBU reserves stood at US\$32.1bn. This was more than enough to offset the NBU’s FX sale interventions that skyrocketed last year and reached US\$25.0bn.

ICU view: The level of NBU reserves will remain comfortable, likely at above US\$30bn, over the larger part of 2023 thanks to continued inflow of international financial assistance that may reach USD35-40bn over the next 12 months. Like in 2022, the greater part of new inflows will be spent to keep the FX market balanced and the hryvnia exchange rate relatively stable. As government managed to delay nearly all of its external debt payments beyond 2023, the sovereign debt redemptions will not put significant pressure on reserves.

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

NBU reserves down 8% in 2022



Source: NBU, ICU.

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