



Focus
Ukraine

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

Research team
Vitaliy Vavryshchuk
Alexander Martynenko
Taras Kotovych

Weekly Insight

Inflation to keep decelerating rapidly

Key messages of the today's comments

MONDAY, 13 MARCH 2023

Ukrainian bond market

Banks have strong interest in reserve bonds

Last week, primary-dealer banks purchased UAH15bn (US\$410m) of bonds that are allowed to cover required reserves, part of which they resell to other banks.

Eurobond prices fluctuate under influence of global sentiment

Ukrainian Eurobonds remain influenced by the traditional combination of global sentiment toward emerging markets and purely Ukrainian factors.

Foreign exchange market

Hryvnia exchange rate continues to strengthen

The FX market maintains a positive sentiment; the hryvnia continues to appreciate in the cash segment while NBU interventions in the interbank market remain relatively low.

Economics

Inflation to keep decelerating rapidly

Ukraine's annual inflation decelerated to 24.9% in February, down from 26.0% in January and is likely to stay firm on a downward trajectory in the coming months.

NBU reserves down 3.4% in February

NBU gross international reserves decreased 3.4% to US\$28.9bn in February as inflow of international financial assistance was less substantial compared with January.

Banks' reserves market (10 March 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+1,500bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm) ²	150,320	-3.06	+154.12
CDs (UAHm) ³	383,390	+4.20	+154.44

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) (10 March 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	696,970	+0.00	+111.14
Banks	531,148	+2.70	+0.99
Residents	110,516	+0.64	+40.52
Individuals	33,590	+2.94	+34.96
Foreigners ¹	55,674	-1.20	-25.58
Total	1,431,008	+1.06	+38.33

Source: NBU, ICU.

FX market indicators (10 March 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9294	-0.01	+25.60
EUR/USD	1.0643	+0.08	-3.12
DXY	104.576	+0.05	+6.16
UAH TWI ¹	111.670	+0.10	-16.65

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes¹ (13 March 2023)

Maturity	Bid	Ask
6m	20.00	15.00
12m	24.00	18.00
2y	25.00	21.00
3y	25.00	21.00
12m (\$)	6.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Banks have strong interest in reserve bonds

Last week, primary-dealer banks purchased UAH15bn (US\$410m) of bonds that are allowed to cover required reserves, part of which they resell to other banks.

At the primary auction, the Ministry of Finance sold a new portion of bills that banks can use to meet mandatory reserve requirements. Initially, the MoF planned to sell UAH9bn (US\$246m) of these securities, but later increased the limit to UAH15bn (US\$410m), and they were sold in full (see details in the [auction review](#)).

Trading in the secondary market more than doubled to UAH11bn (US\$301m) thanks to deals in "reserve" bonds totalling UAH6.2bn (US\$169m). The second-most traded paper, at UAH2.3bn (US\$63m), was the bond maturing in February 2025. In total, there were 46 deals with "reserve" bonds and 508 deals with bonds due February 2025.

As expected, portfolios of UAH bonds owned by banks increased by UAH14.9bn (US\$407m). Non-banking institutions increased investments in local-currency securities by UAH145m (US\$4m) and individuals by UAH0.7bn (US\$19m). Only foreigners reduced investments in UAH government bonds by UAH0.7bn (US\$19m).

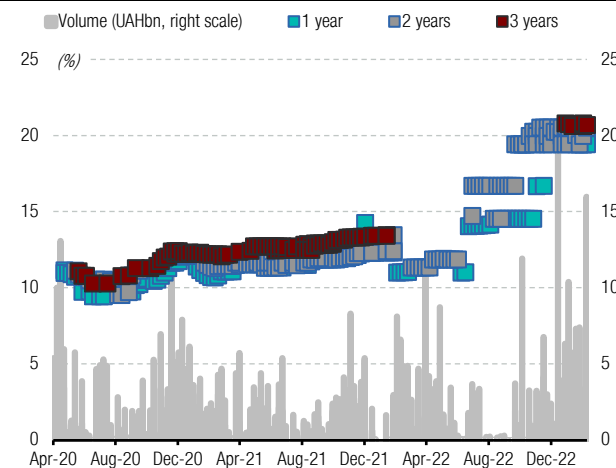
ICU view: Most likely, banks bought the entire issue of "reserve" notes and traded them on the secondary market last Wednesday. However, individuals and non-banking institutions seem to have bought the majority of the offer in bonds maturing in February 2025. Foreigners reduced their investments in hryvnia instruments for the sixth week in a row and sold bonds maturing in February 2025, in particular.

It seems that the Ministry of Finance will no longer offer bonds maturing in November 2025, and tomorrow will offer UAH10bn worth of paper maturing in August 2025. Banks need at least UAH15bn (US\$410m) of bonds to fully utilise their limits. So, next week, the MoF may offer "reserve" bonds, but with maturity in April 2025, to distribute the debt burden evenly.

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

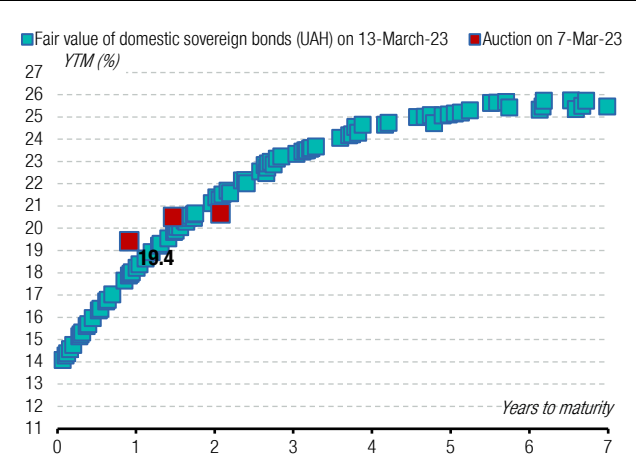
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

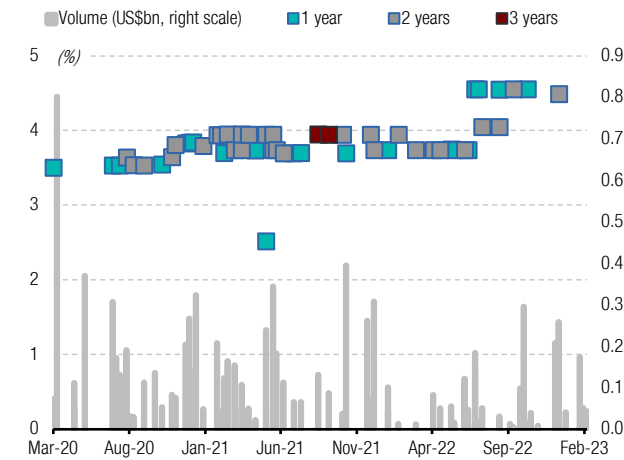
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

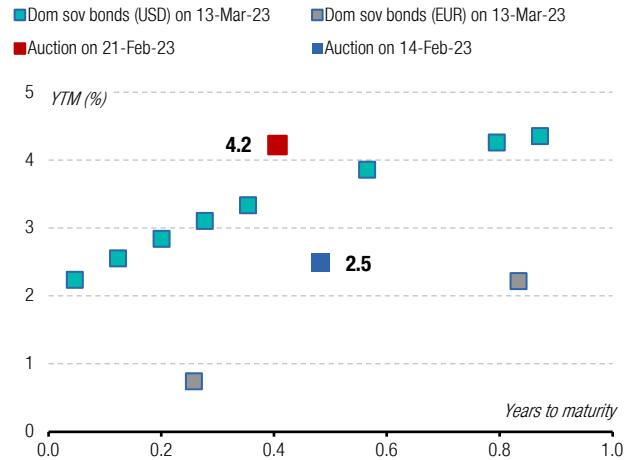
Chart 2. FX-denominated bonds

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.

Eurobond prices fluctuate under influence of global sentiment

Ukrainian Eurobonds remain influenced by the traditional combination of global sentiment toward emerging markets and purely Ukrainian factors.

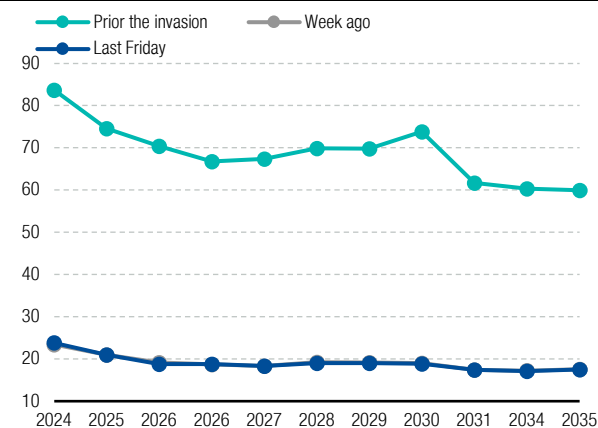
Prices were little changed last week, with a slight increase from 17–23 cents to 17–24 cents on the back of a small price increase at the short end of the curve of about half a percent. VRIs continued to be traded slightly above 27 cents per dollar of notional value.

ICU view: US Treasuries—the benchmark for Ukrainian Eurobonds—rose last week, but weak interest in emerging markets offset their impact. Ukrainian factors remained almost unchanged. The upcoming start of the new IMF lending program seems to be fully priced in by the market.

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

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.

Historical data since February, 2022



Source: Bloomberg, ICU.

Foreign exchange market

Hryvnia exchange rate continues to strengthen

The FX market maintains a positive sentiment; the hryvnia continues to appreciate in the cash segment while NBU interventions in the interbank market remain relatively low.

Individuals are gradually reducing the volume of hard currency purchases, causing strengthening of the hryvnia exchange rate in the leading retail banks by another 0.3% to UAH37.9–38.8/US\$, compared with UAH38.2–39.2/US\$ a week before. Accordingly, cash hryvnia appreciated 5% vs US dollar YTD. The bid-offer spread narrowed by UAH0.05 to UAH0.93 due to a larger decline in the offer exchange rate.

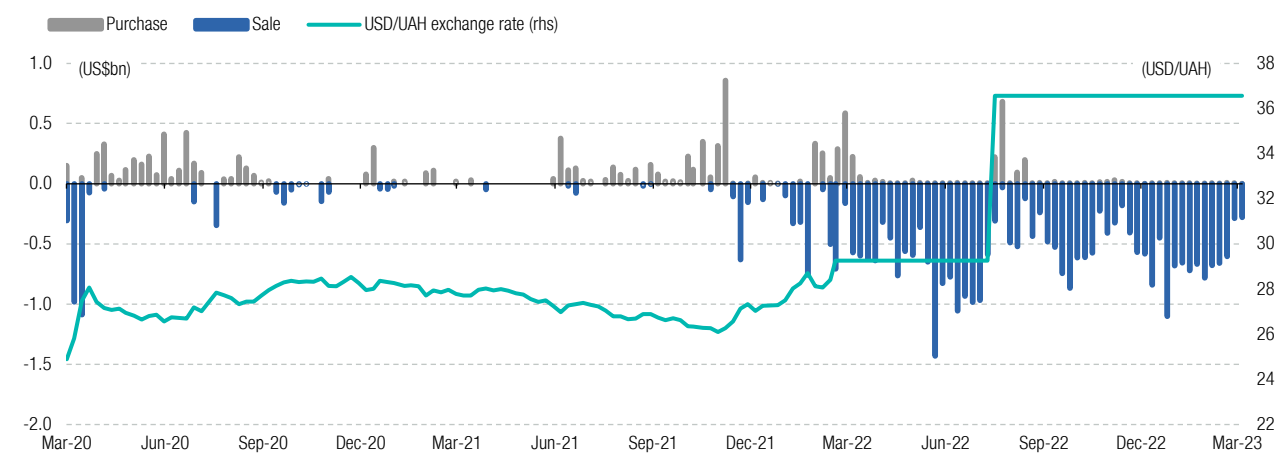
On the interbank market, clients (legal entities) of banks again actively sold hard currency. In four days, they sold US\$65m more than they bought. Therefore, NBU interventions on the sale of hard currency slid to US\$280m.

ICU view: The FX market is under the positive influence of farmers' selling FX to fund spring field work, as well as the general improvement of exchange rate expectations of the population and business. Long-term strengthening of the cash hryvnia reduces retail clients' demand for FX, including for deposits. At the same time, banks are still cautiously watching the trend and keeping the bid-offer spread quite wide.

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

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 to keep decelerating rapidly

Ukraine's annual inflation decelerated to 24.9% in February, down from 26.0% in January and is likely to stay firm on a downward trajectory in the coming months.

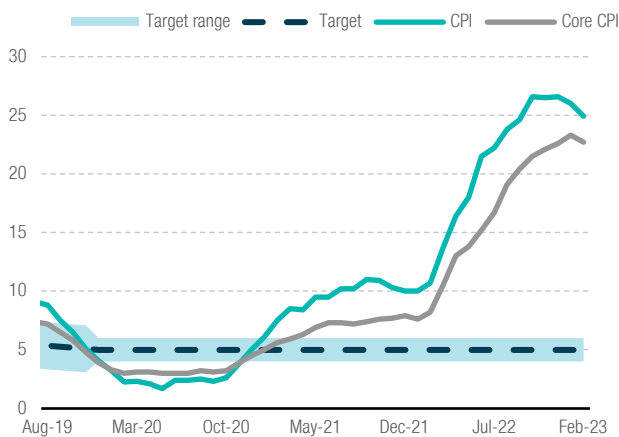
Monthly growth in consumer prices has been 0.7–0.8% since November, which is much lower than inflation over the same period a year ago. The largest deceleration in the annual growth rate has been registered for transportation services (33.6% vs. 41.0% in Jan). Prices for food, the largest component of the consumer basket, decelerated to 31.5% from 32.8%. Noteworthy, while headline inflation has been trending down since December, core inflation also reversed its accelerating trend since February.

ICU view: We expect a very strong base effect to come into play in March as last year consumer prices were surging amid the unfolding of russia’s invasion, which disrupted logistics and reduced the supply of goods and services. Annual inflation will, thus, decelerate even more rapidly. Overall, disinflationary factors clearly prevail at the moment, including weak domestic demand, stable utility tariffs, and fixed exchange rate. We see a good chance of CPI decelerating to 15–16% by the end of 2023, more significantly than envisaged by the current NBU projection (18.7% YoY).

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

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

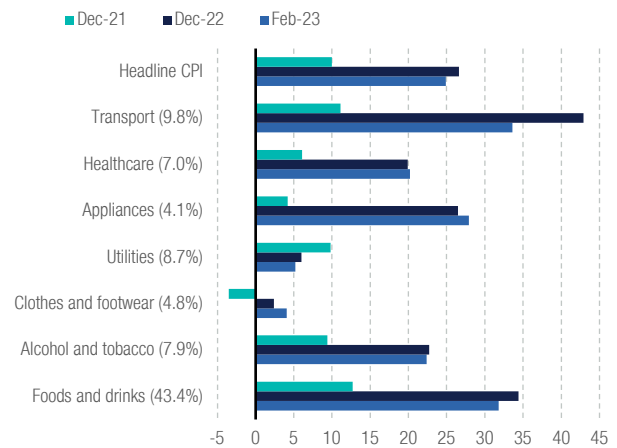
Annual inflation decelerates sharply in February



Source: Ukrstat, NBU, ICU.

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

Prices for food and transport decelerated notably



* numbers in brackets indicate the share of the component in consumer basket

Source: Ukrstat, ICU.

NBU reserves down 3.4% in February

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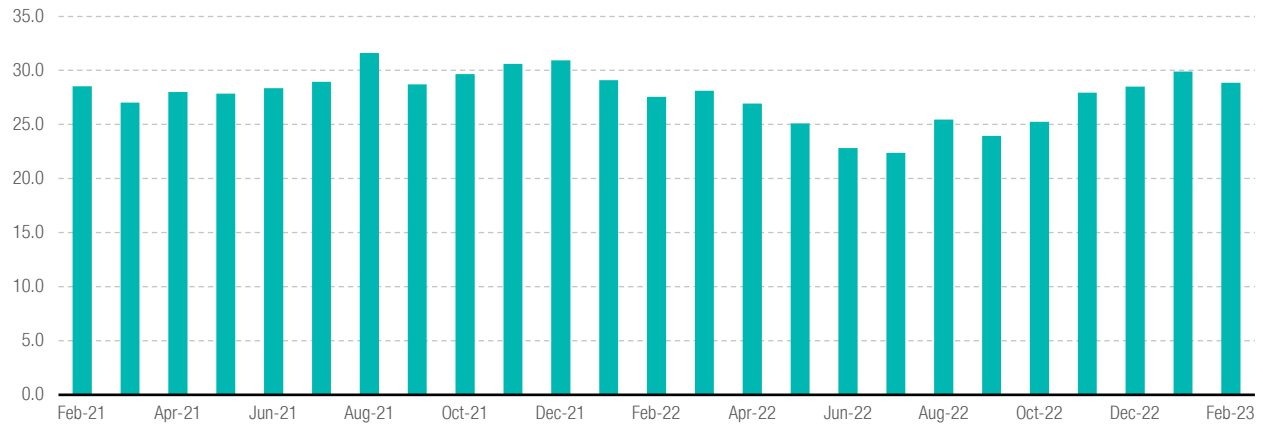
Last month, Ukraine received US\$2.1bn from the WB, including US\$1.25bn in grant funds from the US (via WB trust fund). Meanwhile, the central bank had to sell US\$2.5bn in the interbank market to keep the hryvnia exchange rate stable. Also US\$450mn debt was repaid to the IMF and the WB.

ICU view: NBU reserves will remain volatile through 2023, as the inflow of international financial assistance may not be smooth. Nevertheless, we expect gross reserves will exceed US\$30bn at year-end thanks to generous grants and loans from Ukraine’s international partners.

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

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

NBU reserves down 3.4% in February



Source: NBU, ICU.

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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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