

Weekly Insight

Inflation keeps falling

Key messages of the today's comments

Ukrainian bond market

Foreigners change term structure of bond portfolios

Foreign investors continued to increase their investments in UAH instruments while changing their term structure.

Eurobond prices almost unchanged

Last week, Ukrainian Eurobonds continued to be quoted at levels set the week before.

Foreign exchange market

Cash hryvnia remains strong

The FX market did not move following the news about the natural disaster caused by explosion of the dam.

Economics

Inflation keeps falling

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NBU reserves up 3.8% in May

NBU gross international reserves were up 3.8% to US\$37.3bn in May on steady inflow of international financial aid.

GDP stats better than expected in 1Q23

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MONDAY, 12 JUNE 2023

Banks' reserves market (9 June 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+0bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm) ²	201,037	+0.83	+366.88
CDs (UAHm) ³	434,930	+3.92	+192.02

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 June 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	694,346	+0.00	+62.00
Banks	548,950	+0.32	+1.08
Residents	116,752	+0.29	+57.61
Individuals	41,542	+2.49	+41.81
Foreigners ¹	50,485	+2.91	-30.29
Total	1,455,587	+0.32	+26.83

Source: NBU, ICU.

FX market indicators (9 June 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9312	-0.05	+24.99
EUR/USD	1.0749	+0.38	+1.24
DXY	103.557	-0.44	+0.32
UAH TWI ¹	112.170	+0.38	-18.31

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes (12 June 2023)

Maturity	Bid	Ask
6m	18.00	16.00
12m	21.00	18.00
2y	23.00	20.00
3y	23.50	20.50
12m (\$)	6.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Foreigners change term structure of bond portfolios

Foreign investors continued to increase their investments in UAH instruments while changing their term structure.

Last week, the domestic bond market was relatively inactive in both primary and secondary segments. The primary auction brought only UAH4.8bn (US\$131m) to the budget, the smallest volume in almost two months. Most of the funds raised were via placement of 1.0- and 1.5-year bills. See details in the [auction review](#). On the secondary market, the volume of trades almost halved to UAH5.3bn (US\$145m) and was concentrated in bonds with the nearest coupon payment in September this year—34% of all trades in UAH government bonds.

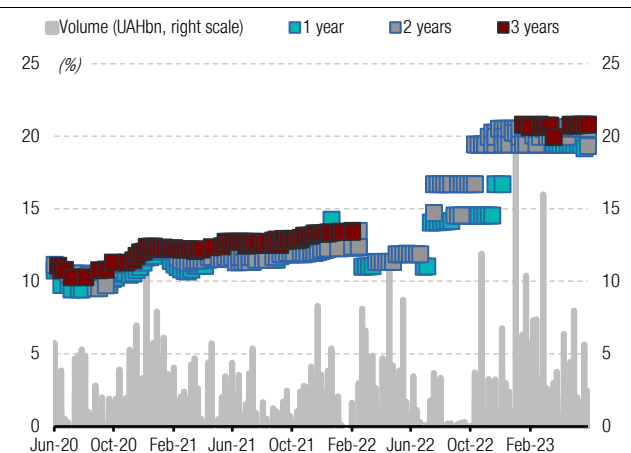
Foreign investors were active in the market. On Wednesday, their portfolios increased by almost UAH2bn (US\$54m). But their portfolios declined on all other days of the week so that the net increase over the week was UAH1.2bn (US\$33m).

ICU view: Foreigners traded bonds actively last week, selling bills that carry coupons payable in the summer, and which are, thus, not eligible for repatriation, and buying securities with coupons in September or later. The growth of the portfolios on Wednesday combined with other secondary market statistics indicate that foreigners could buy bonds both at the primary auction and in the secondary market. On the secondary market, a large volume of deals was in bills with the coupon payment scheduled for September of this year, and this income foreign investors will be able to repatriate.

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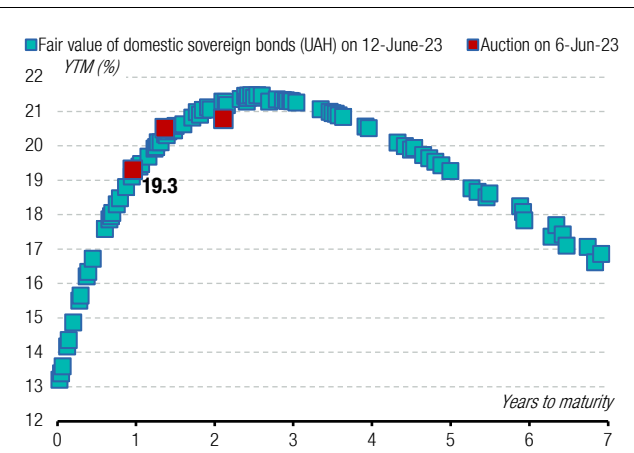
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

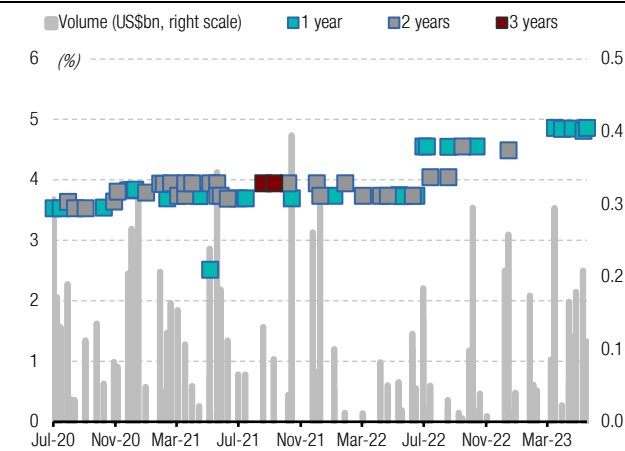
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

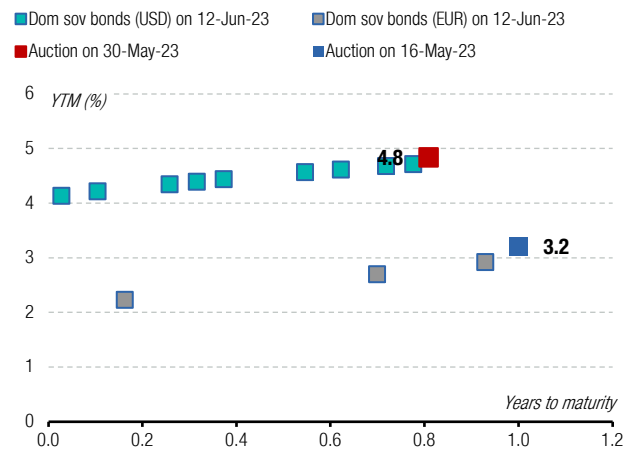
Chart 2. FX-denominated bonds

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.

Eurobond prices almost unchanged

Last week, Ukrainian Eurobonds continued to be quoted at levels set the week before.

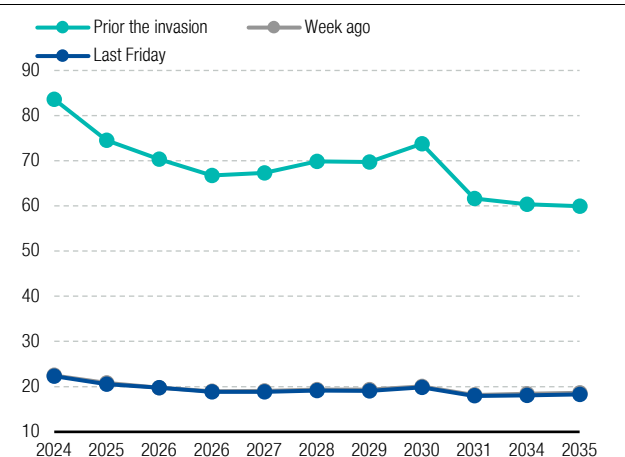
Over the past week, the prices of Ukrainian Eurobonds decreased by approximately 1% and remained in the range of 18–22 cents, with the price range slightly widening to almost 11%. VRIs also fell in price by about 1% and were quoted last Friday slightly below 29 cents per dollar of notional value.

ICU view: Insignificant price movements generally align with the global trend of emerging markets, as there were little fluctuations in the EMBI index. The evolving natural disaster caused by the occupiers' detonation of the Kakhovska HPP had practically no effect on the prices of Eurobonds. Western media reports about the beginning of a counteroffensive of the Ukrainian army did not change the sentiment of investors either.

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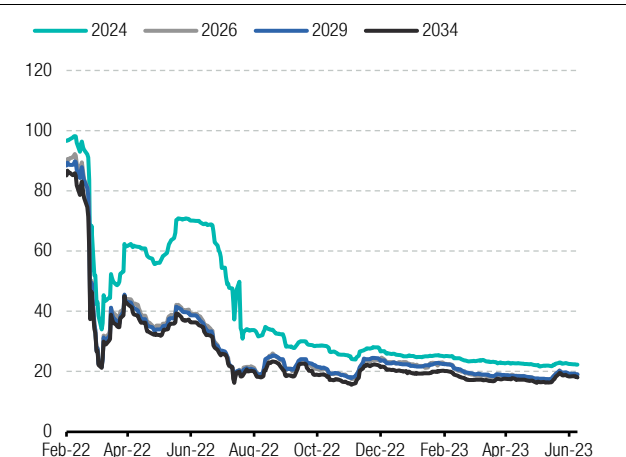
Chart 3. Ukrainian Eurobonds prices

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



Source: Bloomberg, ICU.

Historical data since February, 2022



Source: Bloomberg, ICU.

Foreign exchange market

Cash hryvnia remains strong

The FX market did not move following the news about the natural disaster caused by explosion of the dam.

Trading in the interbank FX market was nearly the same as during the previous week. Over the four days of last week, the amount of hard currency purchases by bank clients (legal entities) slid by 2%, and sales increased by 0.7% compared with the same period of the previous week. NBU interventions decreased by nearly a third to US\$292m.

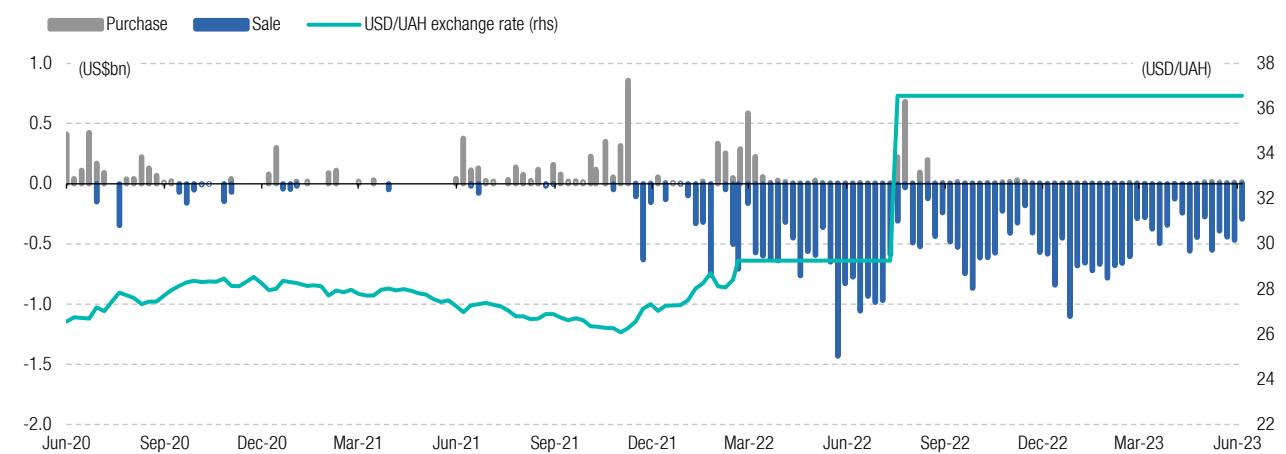
The retail market ended last week with another slight strengthening of the hryvnia exchange rate. On average, in 15 systemically important banks, the hryvnia appreciated by another 0.1% to UAH36.8–37.4/US\$. Since the beginning of the year, strengthening of the hryvnia exchange rate already exceeds 8%.

ICU view: The cash exchange rate has nearly reached banks' exchange rates for card transactions, while the balance of purchase and sale of hard currency by households changed insignificantly. Therefore, the hryvnia exchange rate remains strong with minor fluctuations. Interbank FX market remains steady with NBU interventions that remain at an acceptable level.

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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 keeps falling

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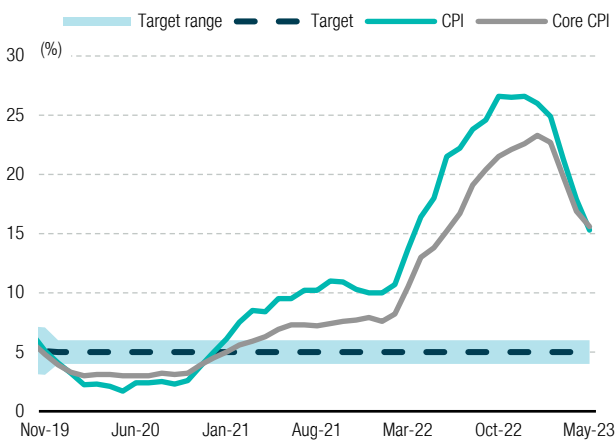
Monthly inflation largely returned to its usual pre-war levels and stood at 0.5% in May, which implies a noticeable deceleration in annual inflation as prices were surging in spring last year due to war-related effects. Price deceleration was seen across nearly all groups in the consumer basket, most notably for transportation services, to 10.9% YoY in May from 23.6% in April. The only exception was healthcare where prices sped up somewhat.

ICU view: We expect inflation will continue to decelerate in the coming months and may temporarily approach 12% by the end of summer before picking up again in autumn. Weak consumer demand, a strengthening cash hryvnia exchange rate, improved logistics, and relatively stable utility tariffs are the key factors behind deceleration of consumer prices. Meanwhile, a hike in electricity tariffs for households since June and motor fuel taxes since July will prevent even stronger deceleration of consumer prices. The key unknown at this point is the adverse effects of the Kakhovka dam explosion. It will likely have a noticeable effect on supply of fruits and vegetables from the region, but the effects on inflation are hard to quantify at this point. We now see upward risks to our end-2023 CPI projection that currently stands at 15–16%.

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

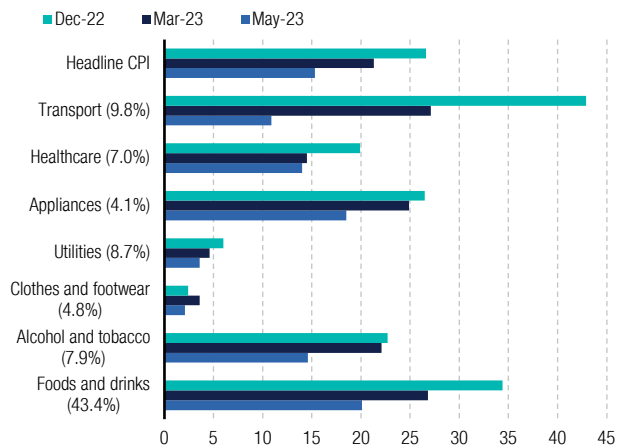
Annual inflation continues to decelerate sharply



Source: Ukrstat, NBU, ICU.

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

Price deceleration seen across the board



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

Source: Ukrstat, ICU.

NBU reserves up 3.8% in May

NBU gross international reserves were up 3.8% to US\$37.3bn in May on steady inflow of international financial aid.

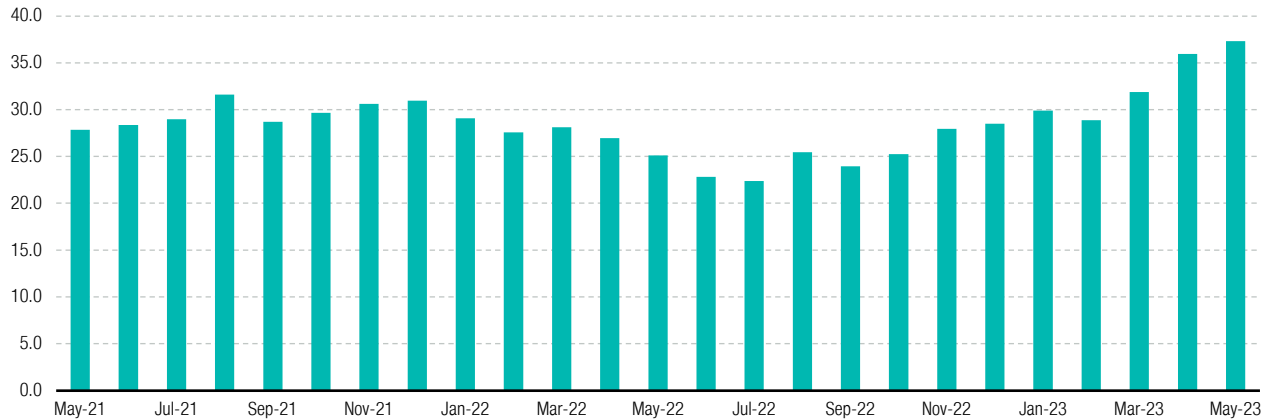
Last month, Ukraine received a EUR1.5bn loan from the EU, a US\$1.25bn grant from the US, and a US\$0.4bn loan from the World Bank. The government also managed to raise net US\$0.3bn via FX-denominated local bonds. Meanwhile, NBU net FX-sale interventions were at US\$1.9bn—a reasonable amount compared with the monthly average since the start of the full-scale war.

ICU view: NBU reserves are outperforming all forecasts made at the beginning of the year. The inflow of international financial assistance remains sizable and steady, while the need for NBU interventions are significantly below what the country receives each month. The NBU now has a good chance to have reserves above US\$35bn through end-2023.

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

NBU reserves up 3.8% in May



Source: NBU, ICU.

GDP stats better than expected in 1Q23

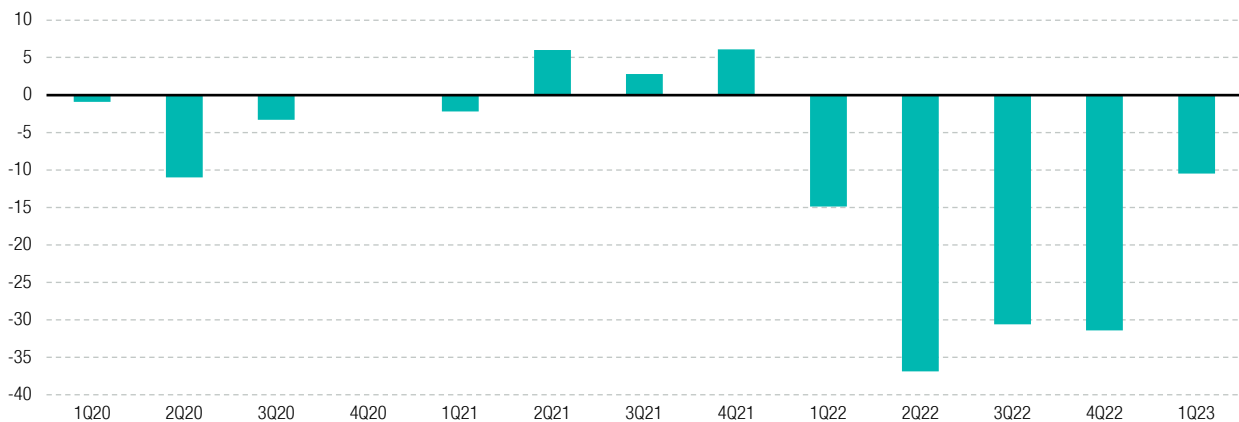
In 1Q23, Ukraine's GDP increased 2.4% QoQ in seasonally-adjusted terms, but was down 10.5% YoY.

ICU view: *Economic growth numbers for 1Q23 are somewhat above our expectations. A noticeable recovery in QoQ terms signals the economy is gradually returning on track thanks to the improved safety situation. Quick reconstruction of electricity generation and the supply network following massive missile attacks by Russia during the winter also provided critical support for the economy. We maintain our GDP growth projection for full 2023 at 2%, but risks to our projections are now clearly tilted to the upside.*

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Chart 8. Real quarterly GDP, chg, YoY

Real GDP down 10.5% YoY in 1Q23



Source: Ukrstat, ICU.

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