



Focus
Ukraine

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

Research team
**Vitaliy Vavryshchuk
Alexander Martynenko
Taras Kotovych**

Weekly Insight

Inflation pressure eases further in June

Key messages of the today's comments

Ukrainian bond market

Foreigners change composition of bond portfolios

Last week, the portfolios of foreign investors remained almost unchanged, however, they actively traded bonds in the secondary market.

Eurobond rally resumes

Interest in Ukrainian Eurobonds resumed last week and their prices increased significantly.

Foreign exchange market

FX market balance improves

The deficit in the market shrank last week, and so did NBU FX sale interventions.

Economics

Inflation pressure eases further in June

Ukraine's annual inflation decelerated markedly to 12.8% in June, down from 15.3% in May, highlighting that the NBU's key policy rate is excessively high.

MONDAY, 17 JULY 2023

Banks' reserves market (14 July 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+0bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm) ²	191,266	-2.01	+201.34
CDs (UAHm) ³	496,084	+3.67	+208.63

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) (14 July 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	691,846	+0.00	+30.88
Banks	558,312	+2.16	+6.28
Residents	118,458	+1.58	+76.59
Individuals	43,481	+2.43	+49.11
Foreigners ¹	49,155	+1.06	-30.97
Total	1,463,286	+1.08	+19.75

Source: NBU, ICU.

FX market indicators (14 July 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9671	+0.01	+24.94
EUR/USD	1.1228	+2.38	+12.08
DX	99.914	-2.31	-7.95
UAH TWI ¹	110.670	-1.33	-21.97

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes (17 July 2023)

Maturity	Bid	Ask
6m	18.00	16.00
12m	20.00	18.00
2y	22.00	20.00
3y	22.50	20.50
12m (\$)	6.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Foreigners change composition of bond portfolios

Last week, the portfolios of foreign investors remained almost unchanged, however, they actively traded bonds in the secondary market.

The MoF more than doubled borrowings last Tuesday compared the previous week, to UAH13.6bn (US\$374m). The greatest buyer interest was in military bills, especially those maturing next year. See details in the auction review.

Secondary market trading in UAH paper almost doubled to UAH7.1bn (US\$195m). Trades were concentrated in bonds maturing in February 2025—UAH3.7bn (US\$100m)—which represent a significant share of foreigners' portfolios. Bonds with coupon payments in November this year were also actively traded.

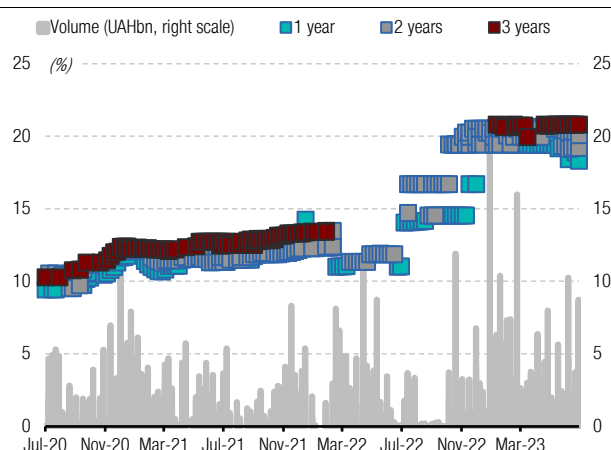
All groups of investors increased their portfolios, but foreign investors and municipalities only marginally.

ICU view: NBU data on bond portfolios and the secondary market trades show that foreigners continued to change the term structure of their portfolios. The recently published FX-market liberalization strategy dashes any hopes that full repatriation of investments into government bonds will be possible soon. Now, foreigners can only repatriate coupon payments on bonds they have held in their portfolios for at least three months. Therefore, the change in the term structure of their portfolios likely reflects efforts to maximize the repatriation of invested funds.

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

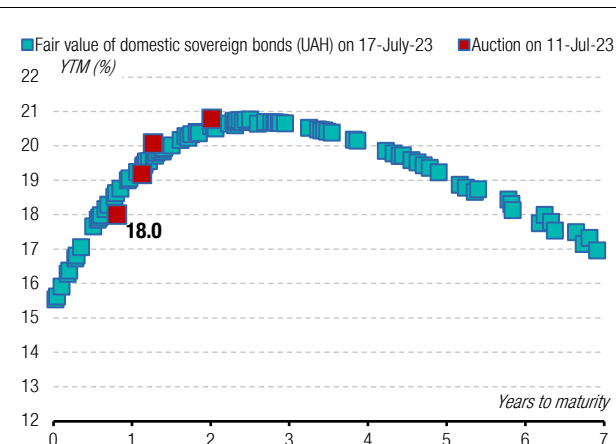
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

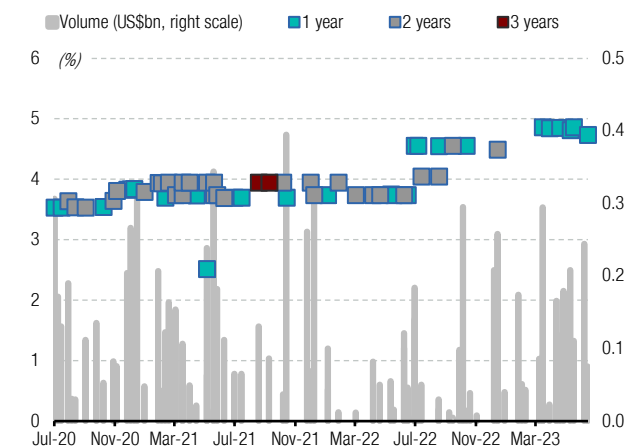
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

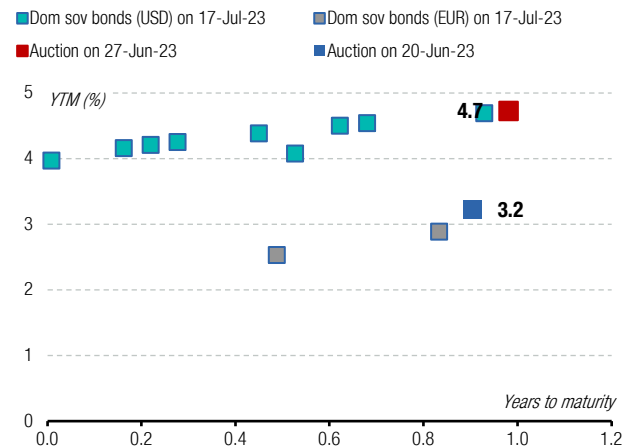
Chart 2. FX-denominated bonds

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 rally resumes

Interest in Ukrainian Eurobonds resumed last week and their prices increased significantly.

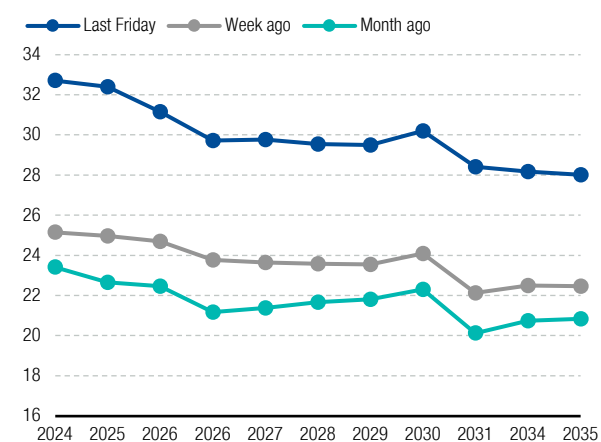
After a short pause, the rally in the Ukrainian Eurobond market resumed with even greater force. Over the past week, Ukrainian USD Eurobonds prices rose by about 26% to 28-33 cents per dollar. The range of prices for instruments with different maturities widened from 6.4% to 7.9%. VRIs rose by 16% to above 45 cents, just 2 cents less than their price prior to the full-scale invasion.

ICU view: Investor sentiment on risky assets improved last week, as the EMBI index rose by 2.7%. In addition, investors had a generally positive assessment of the results of the NATO summit for Ukraine. Ukraine received guarantees of military support from allies and an indication of the possibility to join NATO via simplified procedure after the war is over. The G7 countries also made an important decision regarding frozen russian assets—they committed to keep them frozen until russia compensates Ukraine for damages. At the same time, international mechanisms for compensation will also continue to be developed. The combination of these favourable developments inspired investors, raising the assessment of the present value of Ukrainian debt.

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

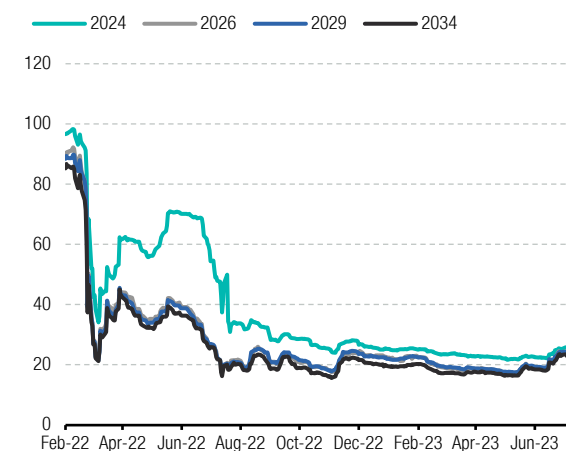
Chart 3. Ukrainian Eurobonds prices

Prices of USD-denominated Eurobonds as of last Friday, a week and a month ago



Source: Bloomberg, ICU.

Historical data since February, 2022



Source: Bloomberg, ICU.

Foreign exchange market

FX market balance improves

The deficit in the market shrank last week, and so did NBU FX sale interventions.

On the interbank market, for four business days last week, bank clients (legal entities) increased the sale of hard currency by 4%, and decreased purchases by as much as 13%. Therefore, the NBU sold US\$401m last week, 16% less than in the previous week.

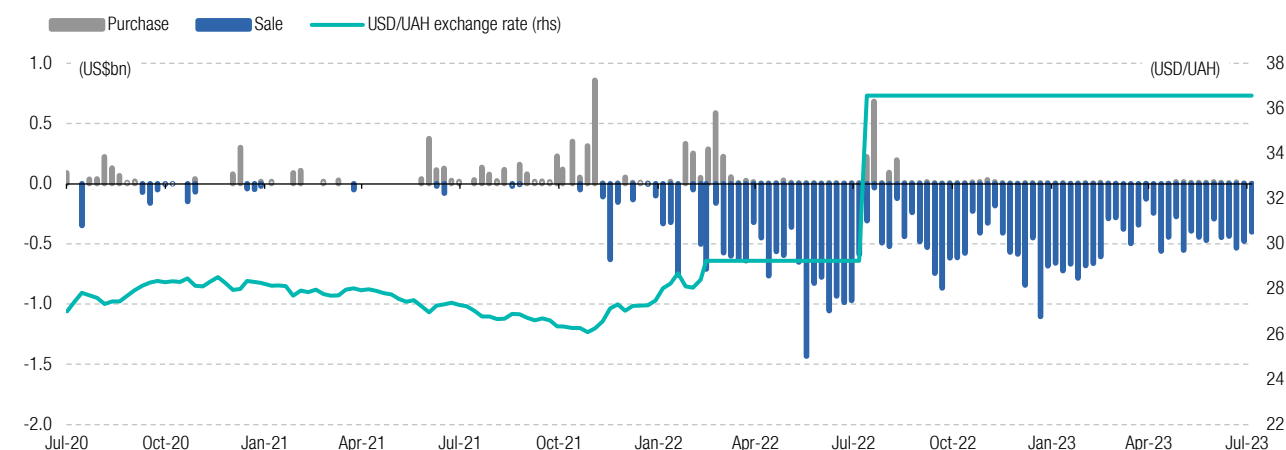
The hryvnia cash exchange rate in systemically important banks remained at UAH36.6–37.4/US\$.

ICU view: Volumes of hard currency purchases in the interbank market decreased, allowing the NBU to reduce the volume of interventions further. Since the cash exchange rate is nearly equal to the official one, we see very little further room for the strengthening of cash hryvnia.

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

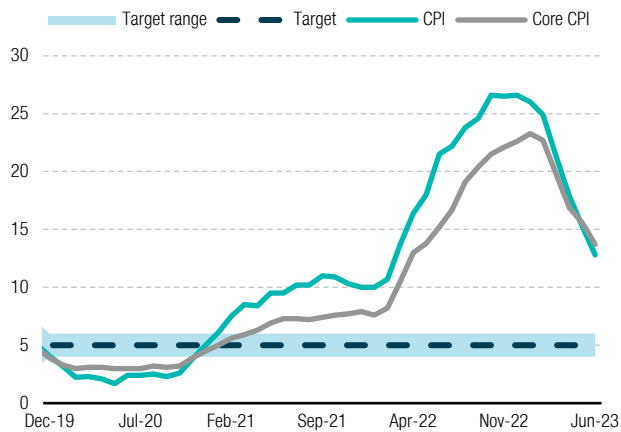
Inflation pressure eases further in June

Ukraine's annual inflation decelerated markedly to 12.8% in June, down from 15.3% in May, highlighting that the NBU's key policy rate is excessively high.

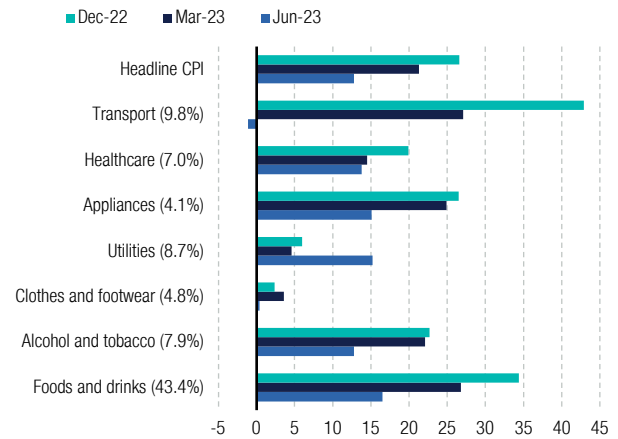
Significant deceleration in annual price growth was seen for two important components of the consumer basket: food price growth slowed to 16.1% YoY from 19.7%, and transportation prices were down 1.1% YoY vs a 10.9% increase a month earlier. A noticeable exception was prices for utilities, which sped up to 15.2% YoY from 3.6% in May on a 70% hike in regulated electricity tariffs for households.

ICU view: The disinflationary trend is set to remain robust in the coming months as improved safety situation and logistics make the domestic consumer market fully saturated and keep monthly increases in prices much smaller than in 2022. Slower inflation is also helped by a 20% YoY decline in gas prices. These positive factors outweighed a hike in electricity tariffs last month. July inflation numbers will be affected by a significant increase in excise tax and VAT on gas as the authorities re-established the tax rates that were effective before Russia's full-scale invasion. However, despite this, we see good chances that annual inflation will keep decelerating until October before reversing thereafter. Overall, annual inflation is going to be below our current projection of 15.4%. The current level of inflation and its expected downward trend imply NBU's current key policy rate of 25% is inappropriately high, and we expect the central bank will start easing monetary conditions as soon as in two weeks.

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

Chart 5. CPI, core CPI and target, YoY, %*Annual inflation continued to decelerate sharply in June*

Source: Ukrstat, NBU, ICU.

Chart 6. CPI and its main components, YoY, %*Prices for transportation were down YoY*

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

Source: Ukrstat, 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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