

Weekly Insight

Annual inflation speeds up significantly

Key messages of the today's comments

MONDAY, 15 JULY 2024

Ukrainian bond market

Bond market in quiet summer mode

The Ministry of Finance borrowed UAH12.6bn last week, nearly half of which was in USD. The MoF was able to sell planned amount of only 14-month UAH bills.

Restructuring talks ongoing

The Ukrainian Eurobond market was likely driven by rumours about restructuring talks last week. New rumours likely improved investor sentiment.

Foreign exchange market

NBU allows hryvnia to weaken further

The hard currency deficit in the FX market narrowed, but the NBU still allowed the hryvnia to weaken further with the official exchange rate crossing UAH41/US\$ line for the first time.

Economics

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Ukraine's annual inflation sped up to 4.8% in June from 3.3% in May, but still remains significantly below the NBU projection.

Banks' reserves market (12 July 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	13.00	+0bp	-1,200bp
ON rate (%)	13.00	+0bp	-700bp
Reserves (UAHm) ²	244,948	+7.7	+27.5
CDs (UAHm) ³	532,043	-2.4	+8.1

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 gov't bond holders (UAHm) (12 July 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-2.1
Banks	716,716	+1.0	+31.4
Residents	163,066	+3.5	+39.3
Individuals	61,528	+3.1	+43.0
Foreigners	34,471	-0.6	-29.4
Total	1,653,929	+0.9	+14.3

Source: NBU, ICU.

FX market indicators (12 July 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	40.8680	+0.7	+10.7
EUR/USD	1.0907	+0.6	-2.0
DXY	104.093	-0.7	+3.6

Source: Bloomberg, ICU.

Market gov't bond quotes (15 July 2024)

Maturity	Bid (%)	Ask (%)
6 months	14.50	12.50
12 months	15.75	14.75
2 years	16.50	15.50
3 years	17.50	16.50
12 months (\$)	5.00	4.50
2 years (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Bond market in quiet summer mode

The Ministry of Finance borrowed UAH12.6bn last week, nearly half of which was in USD. The MoF was able to sell planned amount of only 14-month UAH bills.

In the primary market, the MoF offered the usual UAH bonds and 13-month USD-denominated bills. Such a combination allowed the MoF to increase borrowings. The MoF attracted UAH15.7bn (US\$386m) of demand, of which almost half was for US-denominated paper. Only for 14-month UAH bills did demand exceed the supply cap – UAH7.4bn (US\$181m) vs UAH4bn (US\$98m). Finally, the MoF raised UAH12.6bn (US\$311m) of budget proceeds, including US\$189m (UAH7.7bn) in hard currency. See details in the [auction review](#).

In the secondary bond market, the total turnover almost doubled to UAH11.9bn (US\$290m). The most traded bonds were those maturing in February 2027 and February 2025. Total trades of FX-denominated bills amounted to UAH733bn (US\$18m), 19% less than a week before.

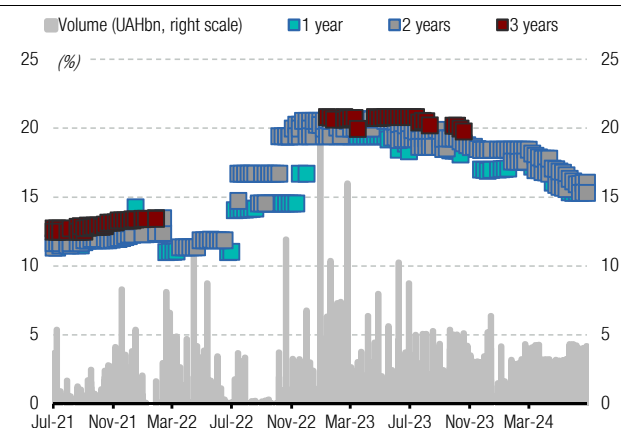
Households continued to increase their bond portfolios including USD-denominated bills in the primary bond market. Their portfolios rose by 3% last week to UAH61.7bn (US\$1.5bn), mostly due to new purchases and a revaluation of FX-denominated instruments due to the weakening hryvnia. However, total portfolios remained below the all-time high of UAH64.3bn (US\$1.6bn) of a month ago.

ICU view: The MoF no longer plans to offer FX-denominated bills this summer, which incentivised investors to bid at last week’s auction. Even so, the demand for FX paper was still below the supply limit of US\$200m. New issue of FX-denominated bills had a negligible impact on the secondary bond market, which is unusual as secondary trading typically intensifies after primary placements are made. The bond market remains in a summer lull, and we will not see material changes in demand nor in interest rates this week.

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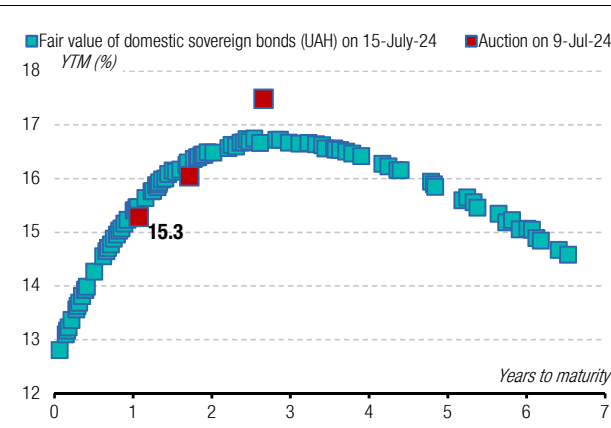
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

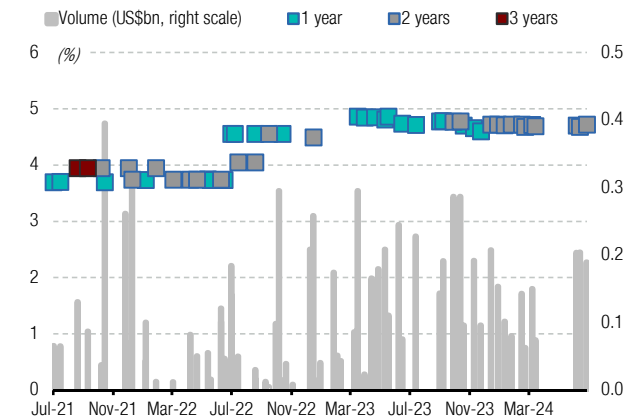
YTM of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

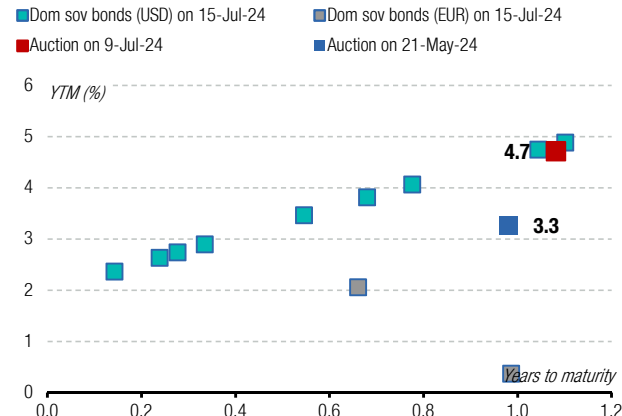
Chart 2. FX-denominated bonds

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



Source: MFU, ICU.

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



Source: NBU, MFU, ICU.

Restructuring talks ongoing

The Ukrainian Eurobond market was likely driven by rumours about restructuring talks last week. New rumours likely improved investor sentiment.

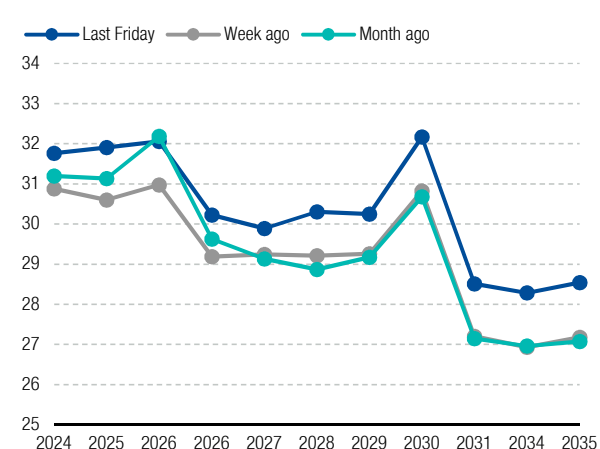
Eurobonds prices were up by 4%, to 28.3-32.2, and the range of prices for instruments with different maturities narrowed to 6.4%. The price of VRIs rose by 3.8% to 49.5 cents per dollar of notional value. The EMBI index was up 1.1% last week.

ICU view: No new official information about the negotiations was released last week, and the consultations are ongoing. Yet, the market, most likely, was affected by rumours about possible mutual concessions of the two parties. As the critical deadline is nearing, and positive rumours emerge, investor sentiment slightly improved, which pushed the Eurobond prices up.

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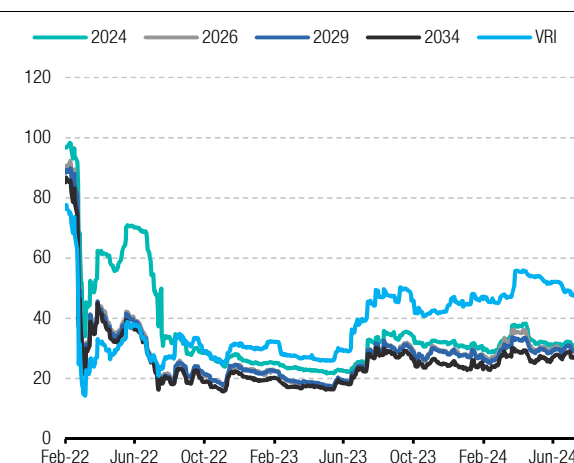
Chart 3. Ukrainian Eurobonds and VRI prices

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



Source: Bloomberg, ICU.

Historical data since February, 2022



Source: Bloomberg, ICU.

Foreign exchange market

NBU allows hryvnia to weaken further

The hard currency deficit in the FX market narrowed, but the NBU still allowed the hryvnia to weaken further with the official exchange rate crossing UAH41/US\$ line for the first time.

Trading in the interbank FX market decreased in four business days last week. Bank clients (legal entities) sold US\$870m of foreign currency (+9% compared with the same period of the previous week) and purchased US\$969m (-7%). Therefore, net hard currency purchases halved to US\$99m. In the retail segment, hard currency trading declined. Households purchased 7% less hard currency than the week before and sold 3% less. Net purchases fell by 14% to US\$166m.

The total hard currency deficit fell by 40% to US\$265m, allowing the NBU to decrease weekly interventions by 16% to 532m. For the first time in three months, weekly interventions were below the average YTD.

However, the official hryvnia exchange rate weakened by 1.2% to UAH41.04/US\$ and the cash exchange rate in systemically important banks weakened by 1% to UAH40.8-41.3/US\$.

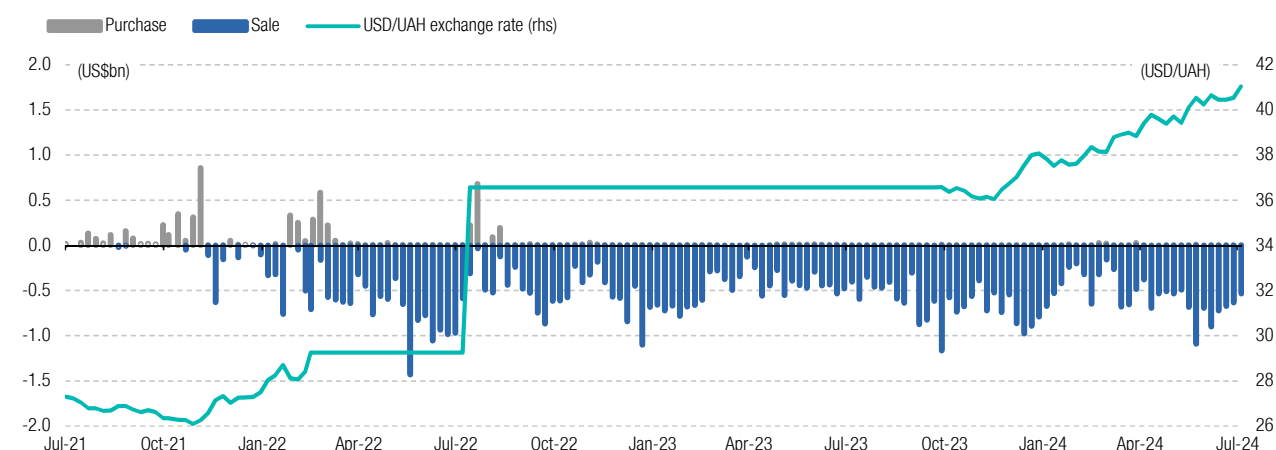
Last week, the NBU approved some new minor FX liberalization measures related to external obligations of businesses.

ICU view: New liberalization measures were broadly symbolic and are unlikely to have any visible impact on the FX market. The deficit in the FX market declined, but it remains significant. Despite the narrowing deficit, the NBU allowed the hryvnia to weaken above UAH41/US\$ line for the first time. This is a clear signal the NBU is determined to weaken the hryvnia gradually further. By the end of the year, we expect the UAH exchange rate in the range of UAH42-43/US\$.

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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

Annual inflation speeds up significantly

Ukraine’s annual inflation sped up to 4.8% in June from 3.3% in May, but still remains significantly below the NBU projection.

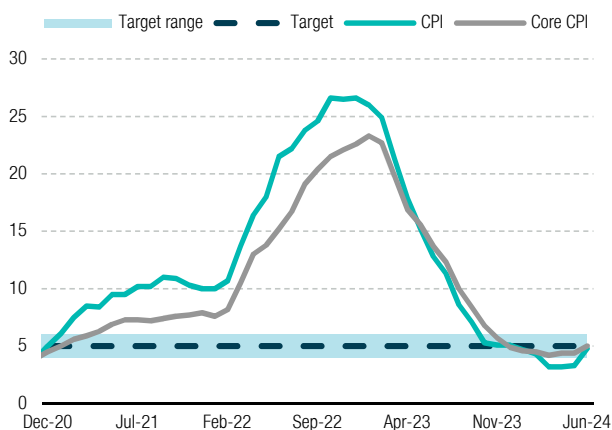
Monthly inflation came in at 2.2% in June. While inflation was fully expected to accelerate in June, the pickup is above market and our expectations. The acceleration of prices was mostly driven by a revision of electricity tariffs for households, which were hiked 64% MoM (+64% YoY) by the government. An additional factor was a 10% MoM (+3% YoY) increase in tariffs for railway passenger transportation. The monthly increase in food prices was 0.5% in June, but the annual change was -0.4%. Core inflation accelerated to 5.0% YoY from 4.4% in June.

ICU view: June inflation came in higher than expected, but this does not imply that fundamental inflationary pressures are getting stronger than previously expected. The larger part of the June increase in prices can be explained by an upward revision of administratively regulated prices for electricity and passenger transportation. The pace of price growth for the majority of the consumer basket components remains subdued. July and August are likely to see the usual monthly deflation trend, although it’s very unlikely to match a significant drop in prices seen in the same months last year (-0.6% in July and -1.4% in August). This implies that annual inflation is going to accelerate in every month and may approach 6% by the end of 3Q. We confirm our end-2024 inflation projection at 6-7% and see it accelerating further to 8% in 2025. The current inflation rate is still below the NBU projection (4.8% vs projected 5.4% as of June) and the end-3Q forecast of the NBU (CPI at 8.4% YoY) also looks too pessimistic. We thus expect the NBU to update its inflation forecast marginally in July’s Inflation Report and deliver another 0.5pp cut in key policy rate by the end of the month.

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

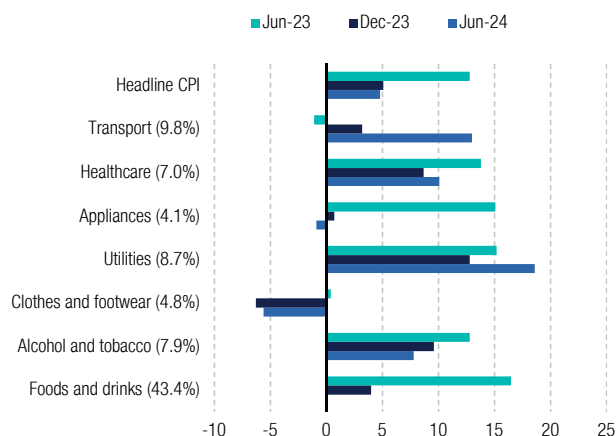
Annual inflation accelerates significantly in June



Source: Ukrstat, NBU, ICU.

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

Tariffs for utilities are the key inflation driver in June



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

Source: Ukrstat, ICU.

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