Focus
Ukraine

Markets
Government bonds, FX market, and macro

Research team
Vitaliy Vavryshchuk
Alexander Martynenko
Taras Kotovych

Weekly Insight

Food prices lift CPI above expectations

Key messages of the today's comments

Ukrainian bond market

MoF changes structure of UAH bonds offering

The MoF paused the offering of two and three-year UAH bonds despite huge demand and their addition to the list of reserve bonds by the NBU.

Foreign exchange market

NBU forced to increase interventions

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Economics

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MONDAY, 14 OCTOBER 2024

Banks' reserves market (11 October 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	13.00	+0bp	-700bp
ON rate (%)	13.00	+1bp	-300bp
Reserves (UAHm)[2]	308,800	+28.7	+45.1
CDs (UAHm)[3]	389,150	-16.5	-15.0

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) (11 October 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-1.9
Banks	800,660	+2.6	+39.5
Residents	167,691	-0.8	+40.1
Individuals	68,530	-3.8	+52.1
Foreigners	24,302	+0.8	-48.3
Total	**1,739,560**	**+1.0**	**+17.7**

Source: NBU, ICU.

FX market indicators (11 October 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	41.1733	+0.0	+12.7
EUR/USD	1.0937	-0.4	+3.0
DXY	102.890	+0.4	-2.8

Source: Bloomberg, ICU.

Market gov't bond quotes (14 October 2024)

Maturity	Bid (%)	Ask(%)
6 months	15.00	14.00
12 months	15.75	15.00
2 years	16.75	15.50
3 years	17.75	16.50
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

READ FIRST THE DISCLOSURES SECTION (ON LAST PAGE) FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATION

Ukrainian bond market

MoF changes structure of UAH bonds offering

The MoF paused the offering of two and three-year UAH bonds despite huge demand and their addition to the list of reserve bonds by the NBU.

Last week, the MoF borrowed about UAH30bn, including US$150m. Demand was the largest for reserve bonds, which were 6x–7x oversubscribed. The MoF also offered three military bills, and only two of them were marginally oversubscribed. As a result, due to oversubscription, interest rates for reserve bonds were down by 45–50bp to 15.1% and 16.1% for two and three-year maturities, respectively. However, to satisfy almost all demand for military bills, the MoF had to increase cut-off rates by 15bp to 15.25% and 16.25% for 1.5 and 2.5-year instruments. See details in the auction review.

Considering the last week's demand structure, the Ministry decided to stop offering reserve bonds at least until the end of October and removed them from the auction calendar. The MoF will now offer three types of military bills with one, 1.5, and 2.5-year maturities, regular notes due in February 2028, and 12-month US$-denominated bills.

Total turnover in the secondary bond market fell by 24% to UAH8.6bn. The share of FX-denominated bills rose to 58%. The most traded were USD-denominated bills due in November 2024 and January 2025.

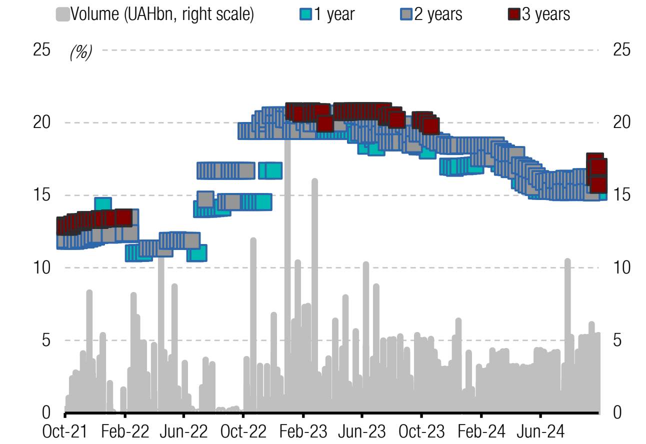
The next bond redemption is scheduled for next week when the MoF will have to repay US$400m of USD-denominated bonds and UAH8.1bn of indexed bonds (with a nominal value of UAH2.9bn) that were issued to recapitalize Oschadbank in 2014.

ICU view: The MoF decided to pause the placement of reserve bonds and plans to renew their offering in November. The likely reason is that once banks reach the limits to which reserve bonds can be included into mandatory reserves, they will stop growing their bond portfolios. The Ministry will, thus, not be able to meet its net borrowing target of about UAH200bn in 4Q24. The Ministry likely believes that by pausing placement of reserve bonds they will maximize borrowings via placement of ordinary bonds. There is a high chance this approach will be corrected quite soon if demand for ordinary bonds dries up in the coming weeks.

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

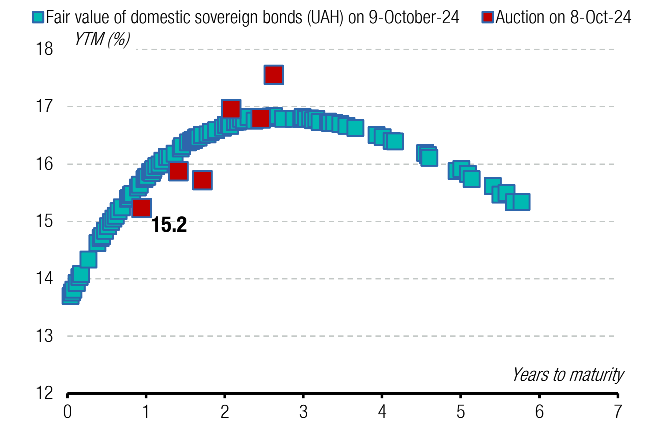
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

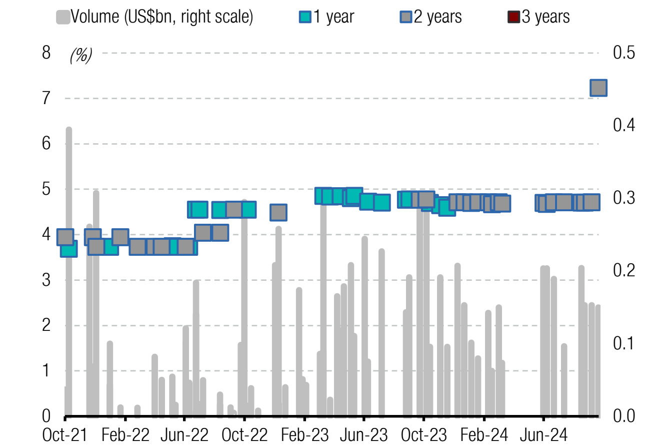
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

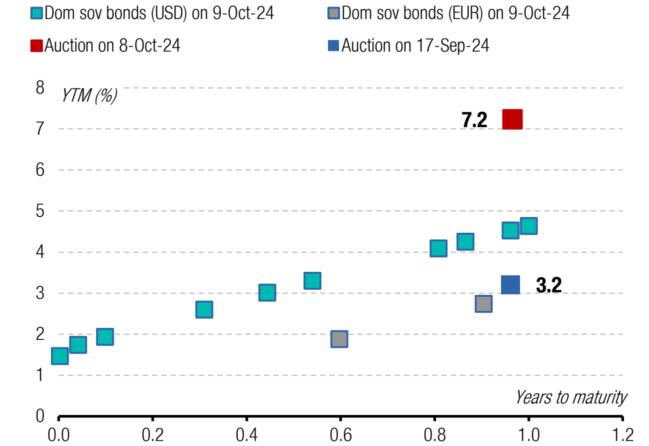
Chart 2. FX-denominated bonds

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



Source: MFU, ICU.

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



Source: NBU, MFU, ICU.

Foreign exchange market

NBU forced to increase interventions

The NBU upped its weekly FX interventions to a three-month high to keep the hryvnia exchange rate stable last week.

Net hard currency purchases declined last week (in four business days) by 9% to US$500m. In the interbank FX market, net purchases fell by 10% to US$234m, and in the retail segment they were down by 8% to US$266m.

However, NBU's interventions jumped by 22% to US$877m, the largest amount since July when the NBU stepped up its sale interventions to prevent the hryvnia from weakening above UAH41.5/US$.

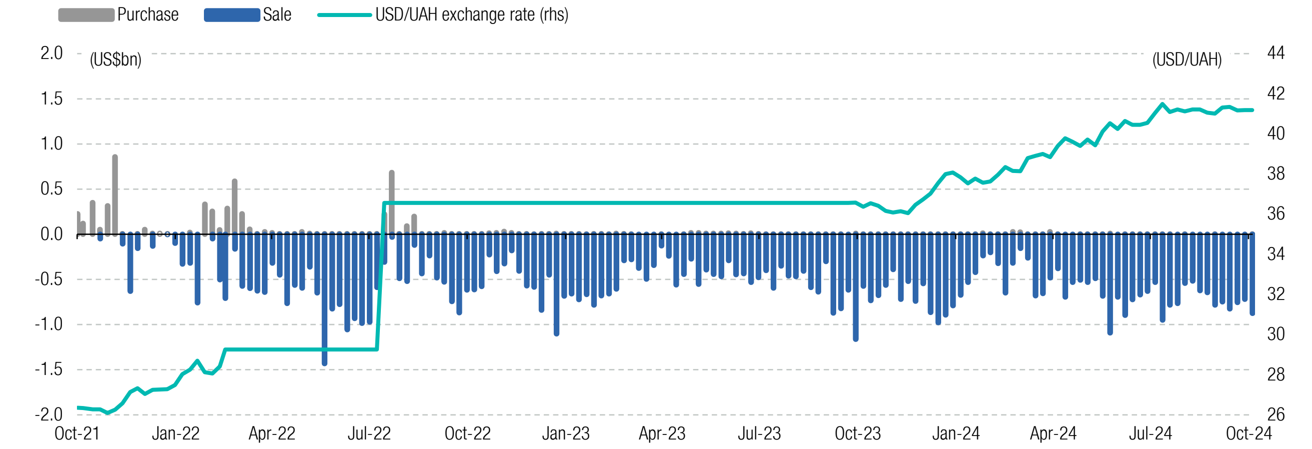
Thanks to massive interventions, the hryvnia official exchange rate stayed at UAH41.19/US$ and the cash exchange rate remained unchanged at UAH41–41.5/US$.

ICU view: Demand for foreign currency remains huge, forcing the NBU to intervene heavily and spend international reserves. The NBU's current steps clearly indicate it is determined to keep the hryvnia exchange rate close to the current level and postpone weakening of the national currency to later periods. Disposable international reserves remain sufficiently high and they allow the NBU to maintain its managed flexible exchange rate policy to better control inflation in the coming months. As long as the inflows of international aid remain regular and sufficient, the NBU will remain determined to avoid a significant depreciation of the hryvnia and pursue a very moderate and controlled weakening of the currency.

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

Chart 3. 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

Food prices lift CPI above expectations

Consumer prices were up 1.5% MoM in September on the surging cost of food, lifting the annual inflation to 8.6% from 7.5% in August.

September inflation came in above our expectations as prices for food continued to accelerate considerably. They rose by 8.5% YoY in September after annual growth was close to zero over March–July. Prices were up across a wide range of food items, but vegetable prices grew at the fastest rate of 56% YoY. Dairy products followed with 11–21% price increases, the prices of fruits were up 16% and the price of bread was up 13% YoY. Utility tariffs growth stood at 18.7% YoY, which implies only a marginal acceleration from the 18.6% increase in July when a major 64% hike in electricity tariffs for households was approved by the government. The price growth for the vast majority of the consumer basket components were also little changed in YoY terms of the past couple of months, including for basket components that are import-heavy.

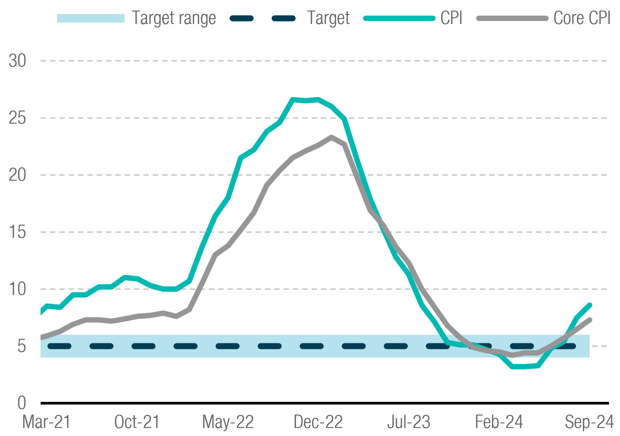
ICU view: A significant decline in the harvest of grains, oilseeds, fruits, and vegetables due to a severe summer draught in Ukraine has remained the major driver of inflation over the past couple of months. High prices of agricultural products are driving up prices of both raw food and processed food. Processed food prices are also affected by more expensive electricity and higher labor costs. Yet, the most important observation from September statistics is that the price growth for the majority of consumer basket components have remained relatively steady, including for

education, communication, restaurants, clothes and footwear, alcohol, and tobacco. This likely implies that fundamental price pressures are not substantially higher than they used to be since the start of the year and once the effects of this year's meagre harvest fully make their way to consumer prices, inflationary pressure will start to ease quickly. With September statistics on hand, we expect that our current end-2024 CPI forecast of 7.8% will be exceeded. However, we now see good chances of end-2025 inflation being below our forecast of 8.0% if adverse weather conditions are not repeated next year. An important implication of high CPI numbers is that the NBU will remain in a wait and see mode for another couple of months to better assess the roots of high inflation. We don't think that higher inflation on the back of food prices will prompt the central bank to tighten its monetary policy.

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

Chart 4. CPI, core CPI and target, YoY, %

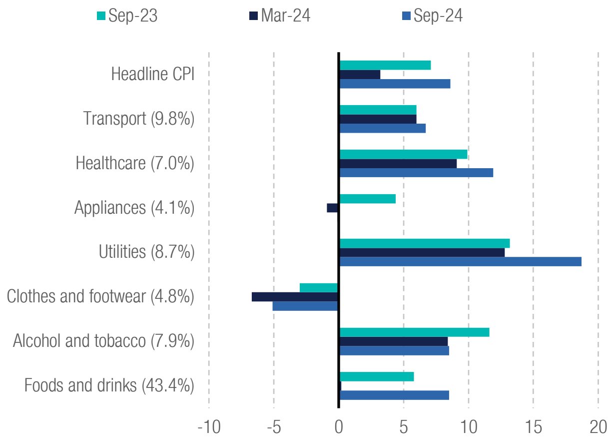
Annual inflation accelerates more than expected



Source: Ukrstat, NBU, ICU.

Chart 5. CPI and its main components, YoY, %

Food prices are now the key inflation driver



* 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
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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