



Focus
Ukraine

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

Research team
Alexander Martynenko
Taras Kotovych
Mykhaylo Demkiv
Dmytro Dyachenko

Weekly Insight

Inflation slows to 5.1% YoY in November

Key messages of the today's comments

TUESDAY, 10 DECEMBER 2019

Domestic liquidity and bonds market

Foreigners still active

Domestic bonds continue to attract demand from foreigners, and last week, total portfolios outstanding rose to a new record high, UAH106bn or US\$4.5bn equivalent. This week, we could see portfolios rise to nearly UAH110bn (US\$4.6bn).

Liquidity sets new record

NBU's purchase of hard currency and the increase in budget expenditures caused liquidity to hit a new record level. And we could see liquidity rise this week as well.

Foreign exchange market

Hryvnia continues to appreciate

After appreciation at the end of November, the hryvnia strengthened during the first week of December. This week can set a new record high for recent years, and appreciate to UAH23.6/US\$.

Economics

Inflation slowed to 5.1% YoY in November

Lower world energy prices and a stronger UAH will continue to constrain consumer-prices growth this year and in next years.

Staff level agreement with IMF reached

If approved by the Fund's management Ukraine will get up to \$5.5bn.

Banks' reserves market (9 December 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	15.50	+0bp	-250bp
ON rate (%)	13.18	-35bp	-398bp
ON \$ swap (%)	12.44	-24bp	+0bp
Reserves (UAHm) ²	44,991	-25.19	-12.01
DepCerts (UAHm) ³	102,549	+41.39	+0.00

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's short-term bonds.
Source: NBU, Bloomberg, ICU.

Breakdown of govt bond holders (UAHm) (9 December 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,065	+0.00	-3.17
Banks	327,010	-0.66	-7.71
Residents	26,145	-1.01	+32.97
Individuals	9,677	-1.66	+66.77
Non-res ⁴	106,054	+1.91	+1,573.88
Total	805,951	-0.08	+9.77

Notes: [1] non-residents
Source: NBU, ICU.

FX market indicators (9 December 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	23.6700	-1.13	-14.82
EUR/USD	1.1064	-0.16	-2.77
DXY ²	97.644	-0.10	+1.17
UAH TWI ³	139.327	+1.06	+18.81

Notes: [1] UAH trade-weighted index.
Source: Bloomberg, ICU.

Gov't bond quotes¹ (10 December 2019)

Maturity	Bid	Ask
6m	15.75	14.25
12m	15.50	13.75
2y	15.25	13.50
3y	14.75	12.70
12m (\$)	5.00	3.00
2y (\$)	5.00	3.50

Notes: [1] Actual quotes you can see at www.icu.ua.
Source: ICU.

Domestic liquidity and bonds market

Foreigners still active

Domestic bonds continue to attract demand from foreigners, and last week, total portfolios outstanding rose to a new record high, UAH106bn or US\$4.5bn equivalent. This week, we could see portfolios rise to nearly UAH110bn (US\$4.6bn).

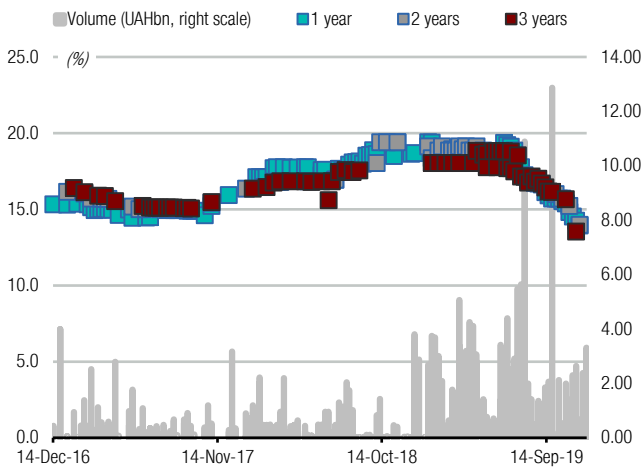
Last week, the MoF sold UAH3bn of notes with a 3.5-year maturity, and today they offer 2.5-year note along with new four-year notes, with total par value UAH4bn. Last week, the net increase in foreigners' portfolio was UAH1.7bn or US\$71.8m. That means that more than half of new notes were purchased by foreigners, while this week the purchased amount could be larger.

ICU view: We expect the offering of four-year notes capped at UAH3bn (US\$126m) will be mostly purchased by foreigners, the same as the 2.5-year note. So, we expect to see their portfolios rise by about UAH3bn (US\$126m), very close to UAH110bn (US\$4.6bn)

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

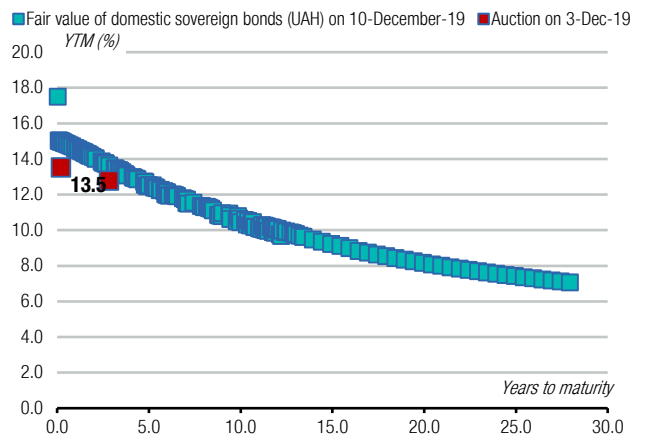
Chart 1. Local-currency bonds

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



Source: Ministry of Finance of Ukraine, ICU.

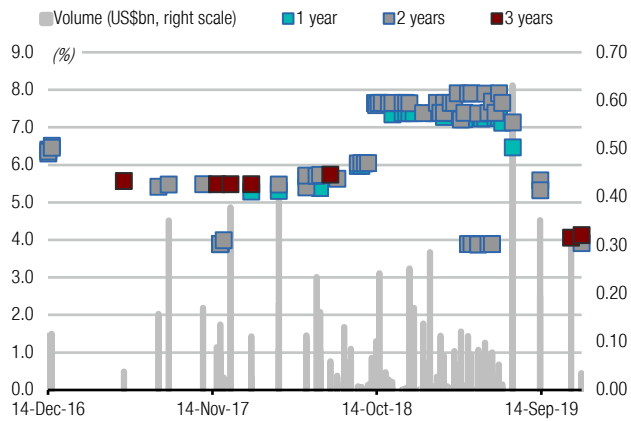
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

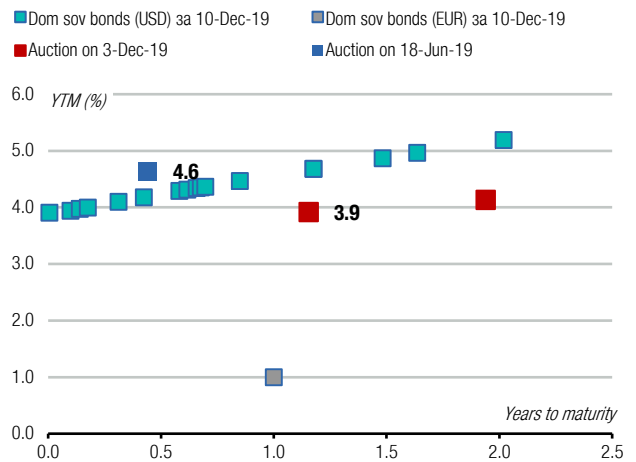
Chart 2. FX-denominated bonds

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



Source: Ministry of Finance of Ukraine, ICU.

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



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

Liquidity sets new record

NBU's purchase of hard currency and the increase in budget expenditures caused liquidity to hit a new record level. And we could see liquidity rise this week as well.

Last week, the NBU paid UAH10.4bn for hard currency, which was the key reason for the liquidity increase. At the same time, budget expenditures increased. On one hand, the budget paid more in debt interest and principal repayments than was raised through new borrowings. On the other, VAT refunds were UAH3.2bn (US\$130m) last week, which was unusual since during the first week of refunds, the usual amount is UAH0.3-1.5bn.

The Treasury's net impact on liquidity was UAH7.6bn of inflows, while outflows from reserves in cash and other non-monetary operations was UAH1.1bn and UAH0.6bn respectively. As the result, liquidity rose UAH16.2bn (US\$684m) to UAH147.5bn (US\$6.2bn).

With inflows of large amounts of liquidity, banks increased outstandings of NBU CDs by UAH25bn to UAH102.5bn, using new funds and funds from correspondent accounts with the NBU, decreasing their balances to UAH45bn.

ICU view: This week, we expect active new investments in government debt with NBU's purchase of an extra supply of hard currency, while the budget will absorb some funds due to larger borrowings compared with repayments, UAH4bn instead UAH1bn of repayments. With this imbalance, the budget can pay more in VAT refunds and liquidity will be able to rise above UAH150bn.

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

Chart 3. Banks reserves usages over last week(UAHm)

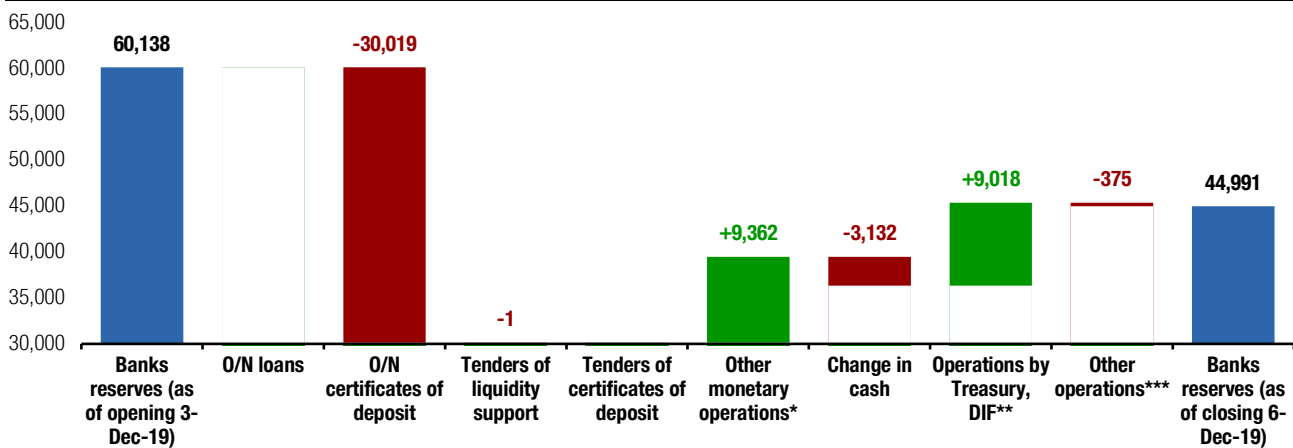
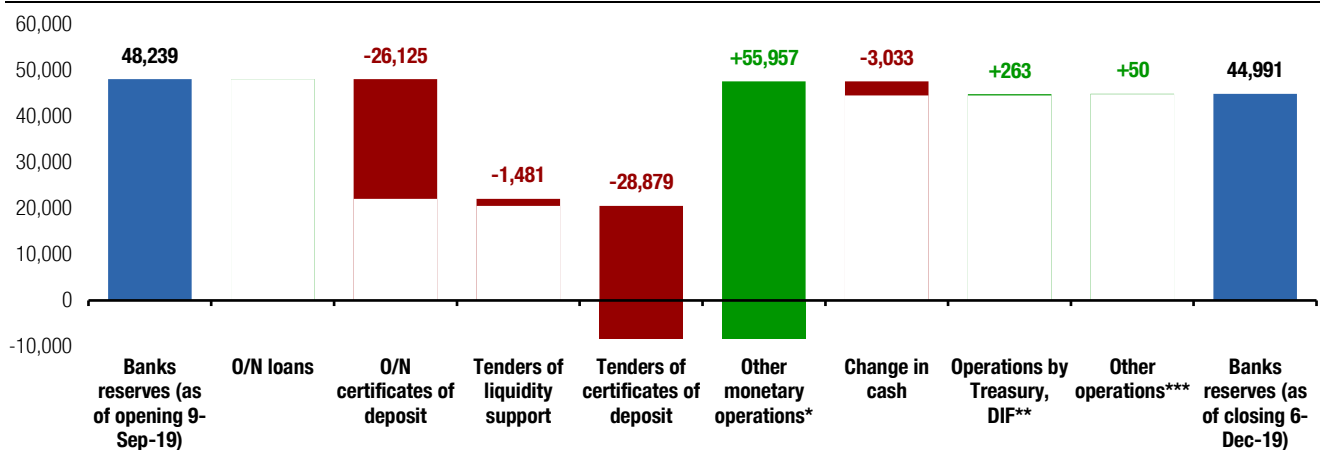


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting https://bank.gov.ua/control/uk/publish/article?art_id=38643651&cat_id=40807142 ;

* operations repo, purchase and sale of government bonds, FX market interventions, stabilisation loans, FX swap agreements; ** DIF – deposit insurance fund;

*** interest payments on NBU's loans and on NBU's certificates of deposit, other operations. Source: NBU, ICU.

Foreign exchange market

Hryvnia continues to appreciate

After appreciation at the end of November, the hryvnia strengthened during the first week of December. This week can set a new record high for recent years, and appreciate to UAH23.6/US\$.

We could see some weakening of the hryvnia at the beginning of this month, but budget financing needs and the lack of demand for FX-denominated bills (see auction [comment](#)) induced the Ministry to change its auction schedule and offer longer notes with larger caps. This caused an increase in hard currency supply and larger purchases by the NBU, but again more just to restrict appreciation. Last week, the NBU purchased US\$436.6m of hard currency, the second largest weekly amount this year.

In total, last week, the hryvnia appreciated by 1% to UAH23.7215/US\$, and on a trailing 12-month basis, by 14.89%. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 0.6% to 139, while in YoY terms, it was up 18.7%.

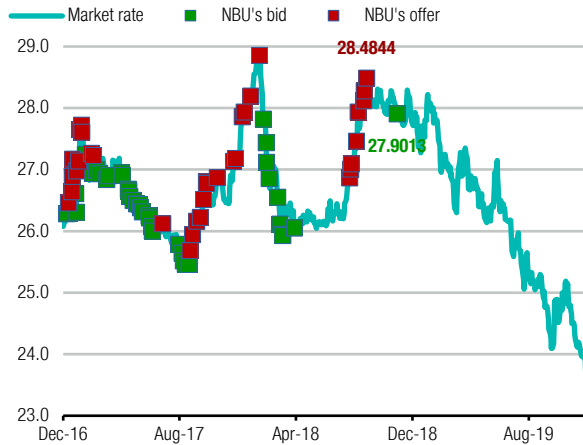
ICU view: New investments in local-currency notes by foreigners will increase the supply of hard currency, which should not only keep the exchange rate below

UAH24/US\$, but can strengthen the hryvnia to around UAH23.6/US\$. VAT refunds and larger budget expenditures alone can increase demand for hard currency and weaken hryvnia a little.

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

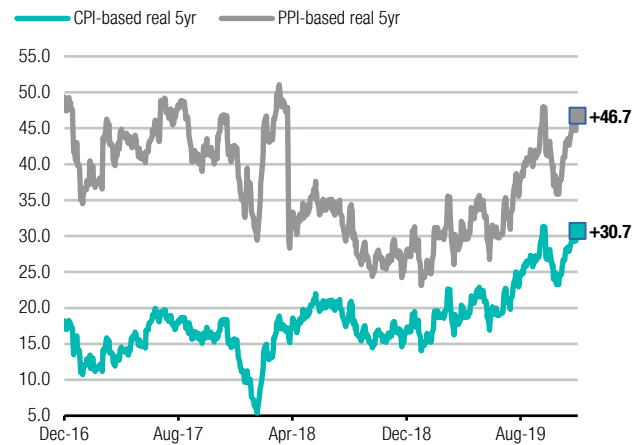
Chart 5. FX market indicators, 3-year history

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market



Notes: the chart provides labels for the average exchange rate at last two NBU auctions (one on buying FX from the market and one on selling it). Source: NBU, Bloomberg, ICU.

UAH exchange rate misalignment¹ from fundamental level² (%)



Notes: [1] "+" overvalued, "-" undervalued; [2] based on the UAH's CPI- and PPI-based real TWIs. Source: ICU.

Economics

Inflation slowed to 5.1% YoY in November

Lower world energy prices and a stronger UAH will continue to constrain consumer-prices growth this year and in next years.

In November, headline inflation slowed to 5.1% YoY from the 6.5% YoY seen in October, which is the lowest reading since March 2014, while in MoM terms, prices rose 0.1%. Growth rates of consumer prices slowed in all major subcategories, but the main positive impact on inflation slowdown was deceleration of growth on food prices to 6.6% YoY. At the same time, prices on transport fell for the second month—by 3.2% in November, while prices on utilities grew only 1.1%. Core inflation fell to 4.8% YoY.

ICU view: A stronger UAH, lower world oil and gas prices, and improvement in inflationary expectations currently constrain consumer-prices growth. The inflation will likely remain in the NBU's target range of 5±1% by YE19

Dmytro Dyachenko, Kyiv, (044) 377-7040 ext.738

Staff level agreement with IMF reached

If approved by the Fund's management Ukraine will get up to \$5.5bn.

The IMF staff has reached an agreement with Ukrainian authorities on a new three-year, SDR 4 billion (about US\$ 5.5 billion) arrangement under the Extended Fund Facility. Final approval for the programme is conditional on meeting a list of prior actions in the areas of the rule of law and integrity of the judiciary, reduction of vested interests, and preserving the gains of the banking-sector reform.

ICU view: We expect the new programme to be approved in early 2020. However, it is far from being a done deal, considering the ambiguity of the new administration on the banking-sector reforms. However, such a move is important support for Ukraine ahead of the Normandy meeting.

Mykhaylo Demkiv, Kyiv, (044) 377-7040 ext.723

This page is intentionally left blank



11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kyiv, 01030 Ukraine
Phone/Fax +38 044 3777040

WEB www.icu.ua



RESEARCH

Alexander Martynenko 

Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv 

Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Taras Kotovych 

Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Dmitriy Dyachenko

Junior financial analyst
dmitriy.dyachenko@icu.ua

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (license numbers: dealer activity AE 263019, broker activity AE 263018, underwriting activity AE 263020 dated 11 April 2013).

DISCLAIMER

This research publication has been prepared by Investment Capital Ukraine LLC solely for information purposes for its clients. It does not constitute an investment advice or an offer or solicitation for the purchase or sale of any financial instrument. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, Investment Capital Ukraine makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of Investment Capital Ukraine LLC. All rights are reserved. Any investments referred to herein may involve significant risk, are not necessarily available in all jurisdictions, may be illiquid and may not be suitable for all investors. The value of, or income from, any investments referred to herein may fluctuate and/or be affected by changes in exchange rates. Past performance is not indicative of future results. Investors should make their own investigations and investment decisions without relying on this report. Only investors with sufficient knowledge and experience in financial matters to evaluate the merits and risks should consider an investment in any issuer or market discussed herein and other persons should not take any action on the basis of this report.

Additional information is available upon request.

