



Focus
Ukraine

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

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Weekly Insight

Headline inflation at 13.1% YoY in April

Key messages of the today's comments

Domestic liquidity and bonds market

MoF continues borrowings in hryvnia

Last week, the Ministry of Finance borrowed about UAH1bn and may borrow similar amounts or more through the end of the month, as domestic debt repayments are rising.

Liquidity remains high

Banking-sector liquidity remained above UAH110bn. But with start of the tax-payments period, liquidity could move down if Treasury operations balance are negative.

Foreign exchange market

UAH appreciated 0.5%

This week, the hryvnia may receive support on the back of quarterly tax payments.

Economics

Headline inflation at 13.1% YoY in April

Headline inflation slowed to 0.8% MoM in April, down from 1.1% MoM in March, while in YoY terms, it remained almost unchanged at 13.1%. Consumer prices will remain under pressure from high consumer demand, rising oil prices, inflationary expectations and expansionary fiscal policy.

EBRD forecasts Ukraine's real GDP growth at 3% in 2018

The EBRD kept the 2018 real GDP outlook unchanged at 3% and expects growth rates to persist in 2019. Although growth is expected to accelerate from the 2.5% seen in 2017, growth rates remain subdued.

TUESDAY, 15 MAY 2018

Banks' reserves market (14 May 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU rate (%) ¹	17.00	+0bp	+400bp
ON rate (%)	16.20	+50bp	+470bp
ON \$ swap (%)	15.74	-27bp	+0bp
Reserves (UAHm) ²	54,520	+40.18	+9.68
DepCerts (UAHm) ³	59,847	-17.81	+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) (14 May 2018)

	Last	Weekly chg (%)	YTD chg (%)
NBU	350,325	+0.00	-7.30
Banks	348,025	-0.55	+22.97
Residents	26,858	+0.08	+22.73
Individuals	2,584	-0.70	+769.72
Non-res ⁴	11,406	-3.38	+115.00
Total	739,199	-0.31	+7.38

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

FX market indicators (14 May 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.1750	-0.48	-1.11
EUR/USD	1.1927	+0.53	+9.11
DX ²	92.587	-0.57	-6.72
UAH TWI ³	120.476	-0.21	+8.58

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

Gov't bond quotes¹ (15 May 2018)

Maturity	Bid	Ask
6m	17.50	16.50
12m	17.75	16.75
2y	17.50	16.50
3y	17.50	16.50
12m (\$)	5.10	4.70
2y (\$)	5.30	5.00

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

Domestic liquidity and bonds market

MoF continues borrowings in hryvnia

Last week, the Ministry of Finance borrowed about UAH1bn and may borrow similar amounts or more through the end of the month, as domestic debt repayments are rising.

At last week's auction, the MoF sold all five bonds with only slight movements of a few basis points in interest rates. Cut-off rates for most of the bonds remained unchanged from recent auctions, and only the weighted-average rates moved. Cost of borrowings rose for three-month bonds by 4bp and for 12-month bonds by 5bp, while for six-month and three-year bonds, the weighted-average rate remained at the previous level. For nine-month bonds only, the cut-off rate decreased by 5bp to 17.25% and the weighted-average rate slid 8bp to 17.22%.

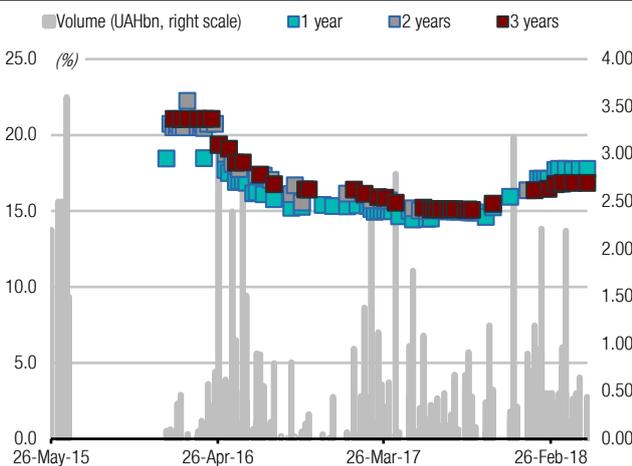
This week, domestic debt repayments will amount to about UAH2bn and mostly to the market: there will be redemptions of UAH1.5bn of three-month bonds that were sold in March, and only about UAH50m of bonds issued in 2013, which most likely are in the NBU's portfolio. Also, there will be about UAH0.5bn of interest repayments for other bond issues.

ICU view: *This week's bond auction could be similar to last week, and cut-off rates could stay at the same level. But weighted-average rates for bonds could rise due to a tightening of the spread between rates in demand closer to cut-off rates. Amount of demand could be larger; however, it is unlikely that the MoF will increase cut-off rates.*

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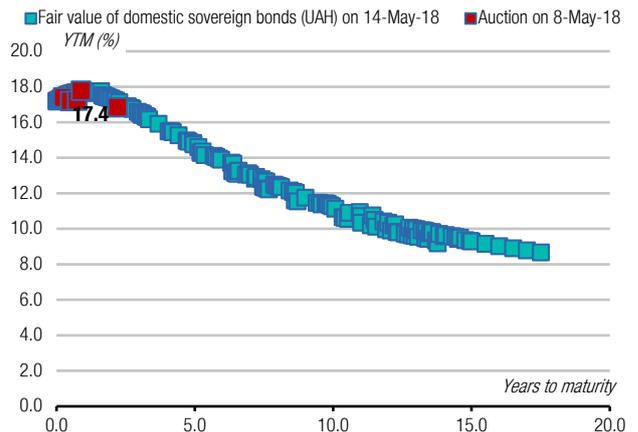
Chart 1. Local-currency bonds

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



Source: Ministry of Finance of Ukraine, ICU.

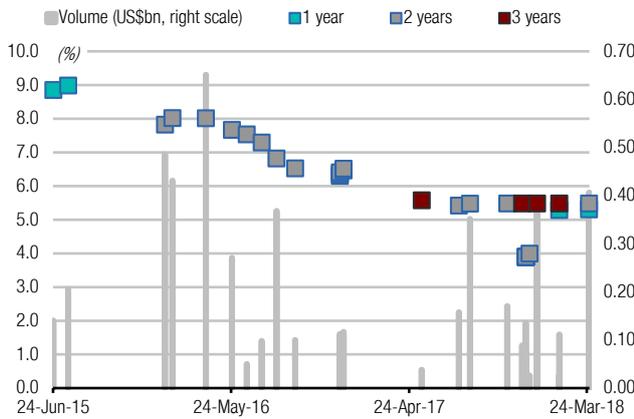
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

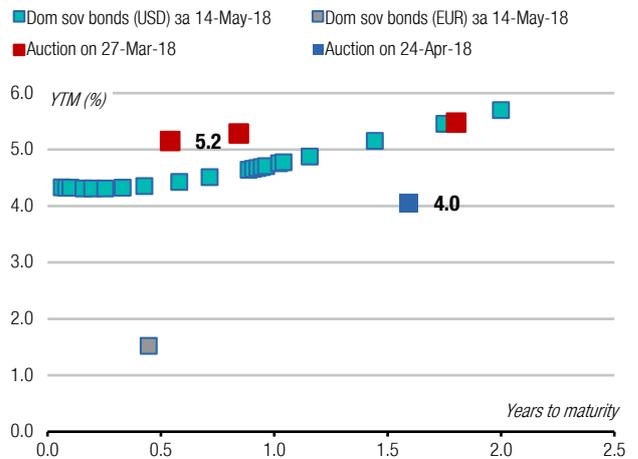
Chart 2. FX-denominated bonds

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 remains high

Banking-sector liquidity remained above UAH110bn. But with start of the tax-payments period, liquidity could move down if Treasury operations balance are negative.

Last week started with a new record high for the year, as total banking-sector liquidity rose to UAH115.8bn and was concentrated in CDs, as total CDs outstanding amounted to UAH75.3bn. By the end of last week, a large portion of funds were reallocated to reserves: total CDs outstanding fell to UAH59.9bn and banks' correspondent accounts balances with the NBU rose to UAH54.5bn, while the total amount of banking-sector liquidity was at UAH114.4bn.

Funds outflow was mostly caused by reserves exchange in cash, which amounted to UAH5.2bn. The Treasury injected UAH1.9bn and the NBU purchased US\$52m and injected UAH1.4bn of liquidity.

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

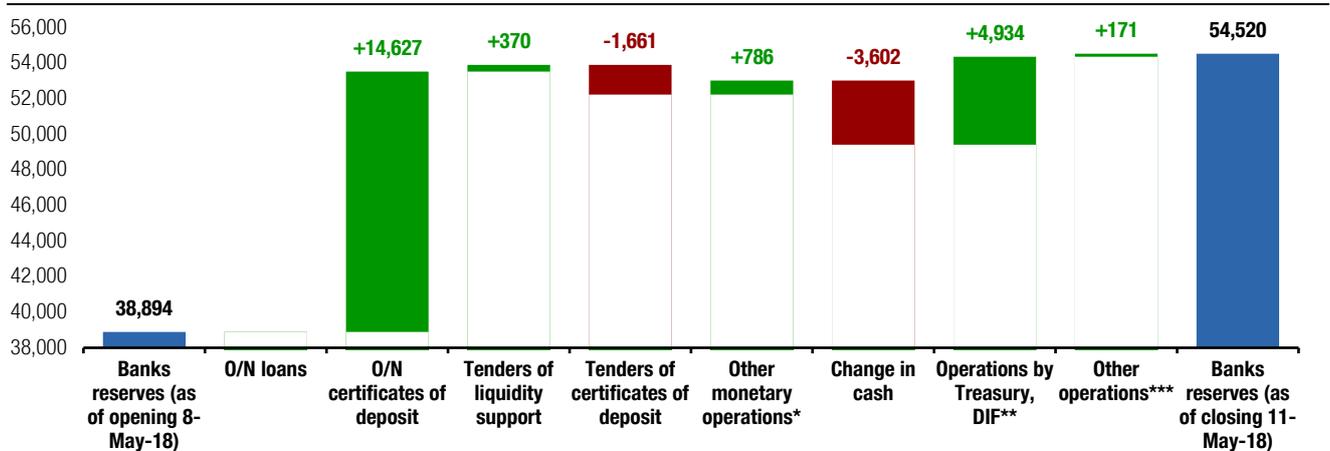
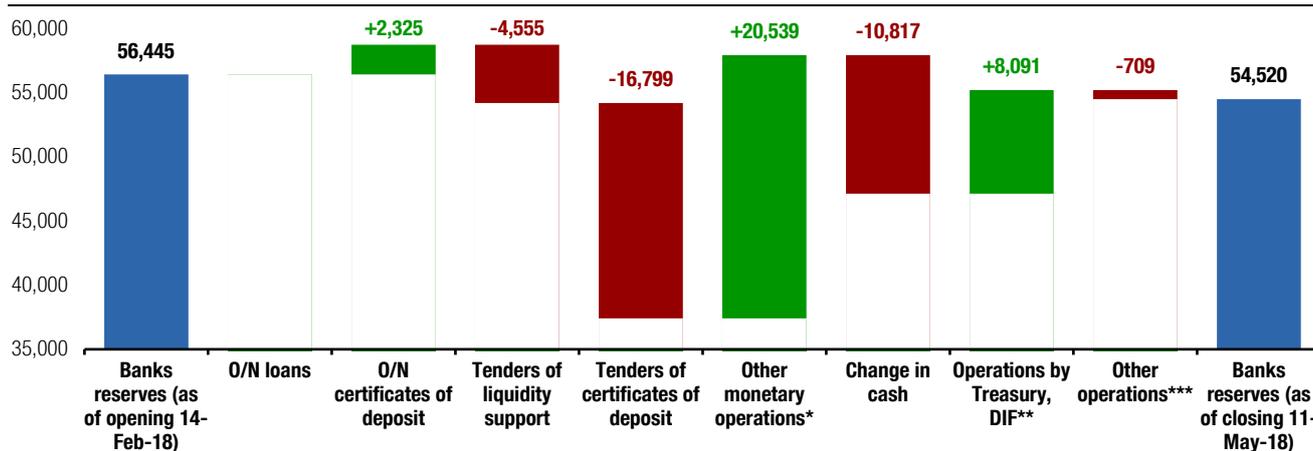


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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.

ICU view: This week, outflows from Treasury accounts could rise and operations balance could be negative for liquidity, due to possible accumulation of funds in Treasury accounts. At the same time, banks reallocated funds from CDs to reserves to be ready to make payments for their clients.

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Foreign exchange market

UAH appreciated 0.5%

This week, the hryvnia may receive support on the back of quarterly tax payments.

Increased demand for the national currency before the day off on Wednesday contributed to appreciation of the UAH against the US dollar during the first two days of the last week. The hryvnia was relatively stable and in a tight range on the last two days of the previous week, influenced by situational demand and supply. Depreciation of the dollar against the major currencies, including developed and some of BRIC countries' currencies, which began on 8 May, created positive background for the UAH/USD.

The hryvnia appreciated 0.5% in the past week to 26.2025 UAH/USD. Its CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) increased 0.5% to 120.2 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 7.8% and 13%, respectively, which implies faster prices growth in Ukraine compared with its main trade partners.

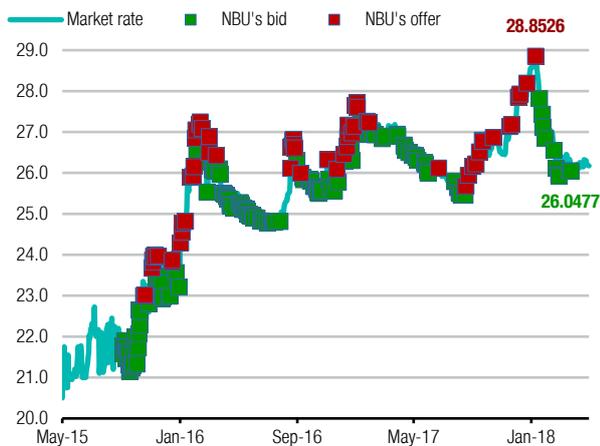
ICU view: This week, we expect insignificant appreciation of the hryvnia on the back of quarterly tax payments. Moreover, such a trend may continue to the end of the month, but will be defined by VAT refund volumes, the amount of tax payments to the budget, and correlation between supply and demand for foreign currency from the big players on the local market.

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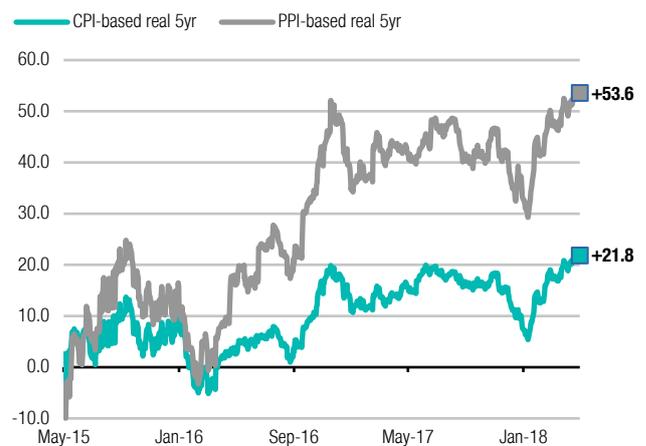
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Chart 5. FX market indicators, 3-year history

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

Headline inflation at 13.1% YoY in April

Headline inflation slowed to 0.8% MoM in April, down from 1.1% MoM in March, while in YoY terms, it remained almost unchanged at 13.1%. Consumer prices will remain under pressure from high consumer demand, rising oil prices, inflationary expectations and expansionary fiscal policy.

Significant growth of food and soft-beverage prices (+17.2% YoY) remains the key driver of inflation. In April, the contribution of this particular category amounted to 7.3ppt out of a total of 13.1%. Significant growth (+20.5% YoY) was seen in prices for alcoholic beverages and tobacco products with a contribution of 1.7ppt.

At the same time, the growth of transport prices decelerated to 13.6% YoY in April, down from 14.9% YoY in March. A downward trend was also seen in prices of utilities; in April, growth slowed to 5.6% YoY. Core inflation remained at 9.4% YoY in April. The NBU forecasts CPI at 8.9% YoY for the end of 2018.

ICU view: Tight monetary policy—and as a result, a stronger hryvnia (+6.8% YTD in nominal terms)—helped stop inflation growth, while the better harvest in 2018 will help to lower growth rates of food price—the main component of inflation—in the following months. However, taking into account the following inflationary risks: 1) solid domestic demand against the backdrop of an increase in consumer lending and rising wages (currently wages' share is around 40% of GDP, and we expect it to increase to 43-45% by the end of 2018, and 45-47% by the end of 2019); 2) the pass-through effect of manufacturing costs to consumer prices, 3) rising oil prices, and 4) expansionary fiscal policy, we expect inflation at 11.5% YoY for the end of 2018, which is slightly better than our previous forecast of 12.5%.

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EBRD forecasts Ukraine's real GDP growth at 3% in 2018

The EBRD kept the 2018 real GDP outlook unchanged at 3% and expects growth rates to persist in 2019. Although growth is expected to accelerate from the 2.5% seen in 2017, growth rates remain subdued.

The bank stresses the following risks for Ukraine's economy: 1) uncertainty over the next tranche from the IMF as well as with further cooperation with the Fund due to slow implementations of reforms, 2) large amounts of state debt repayments denominated in foreign currency in 2018-2020, and 3) political tensions in the lead-up to the presidential elections in 2019.

According to the EBRD, real GDP growth rates are relatively low and can slow down to 2% in the absence of progress on reforms.

ICU view: EBRD's forecast for 2018 is slightly lower than ICU's forecast of 3.5% growth. The Bank's position is well-defined and stresses the importance of further cooperation with the IMF and accelerating the implementation of reforms (first of all, the fight against corruption and protection of investors' rights) for the further growth of the Ukrainian economy. Our more positive forecast for the current year is based on the assumption of solid growth of consumer lending compared with last year, indicating greater economic activity in the private sector, although the government and central bank are carrying out "tighter" policy to reduce public debt and strengthen external creditworthiness. Our forecast for 2019 is a bit more cautious due to still-high dollarisation.

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