

Weekly Insight

Inflation accelerated to 10% YoY

Key messages of the today's comments

Domestic liquidity and bonds market

Bond portfolios rather steady

There were not sufficient changes in bond portfolios last week. After active withdrawal of funds by foreign investors at the end of November, portfolios become steady and changes were mostly due to the impact of movements in the hryvnia exchange rate.

NBU supported liquidity

Local-currency liquidity in the banking system was, as expected, below UAH80bn, and slightly recovered with NBU support. This week, the NBU will continue to inject liquidity, and the total amount of liquidity will be steady above UAH80bn.

Foreign exchange market

Hryvnia continues to appreciate

The first week of December saw the hryvnia return to the level seen prior to the imposition of martial law. And this week, the hryvnia should close near this level due to a substantial supply of hard currency in the market.

Economics

Inflation accelerated to 10% YoY in November

Inflation will remain close to the current level in December, but due to decelerating economic growth and tight monetary policy, it will slow in 2019.

The EU has transferred first EUR500m tranche of MFA

Obtaining this tranche, as well as \$750m financial guarantees from the World Bank at the beginning of 2019, will allow the government to pay out external debt until May 2019.

WEDNESDAY, 12 DECEMBER 2018

Banks' reserves market (11 December 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	18.00	+0bp	+450bp
ON rate (%)	18.18	-2bp	+588bp
ON \$ swap (%)	17.37	-48bp	+514bp
Reserves (UAHm) ²	68,887	+34.60	+71.69
DepCerts (UAHm) ³	19,447	-14.51	-48.53

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) (11 December 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	348,100	+0.00	-3.46
Banks	353,961	-0.42	+7.32
Residents	19,687	-0.29	-7.65
Individuals	5,810	+2.06	+394.39
Non-res ⁴	6,323	-0.80	+32.13
Total	733,881	-0.20	+2.26

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

FX market indicators (11 December 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	27.7225	-0.77	+2.24
EUR/USD	1.1317	-0.24	-3.84
DXY ²	97.388	+0.33	+3.75
UAH TWI ³	118.014	+1.03	+4.71

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

Gov't bond quotes¹ (12 December 2018)

Maturity	Bid	Ask
6m	19.75	18.50
12m	19.75	18.10
2y	19.50	18.00
3y	19.50	17.50
12m (\$)	7.50	5.00
2y (\$)	7.50	5.20

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

Domestic liquidity and bonds market

Bond portfolios rather steady

There were not sufficient changes in bond portfolios last week. After active withdrawal of funds by foreign investors at the end of November, portfolios become steady and changes were mostly due to the impact of movements in the hryvnia exchange rate.

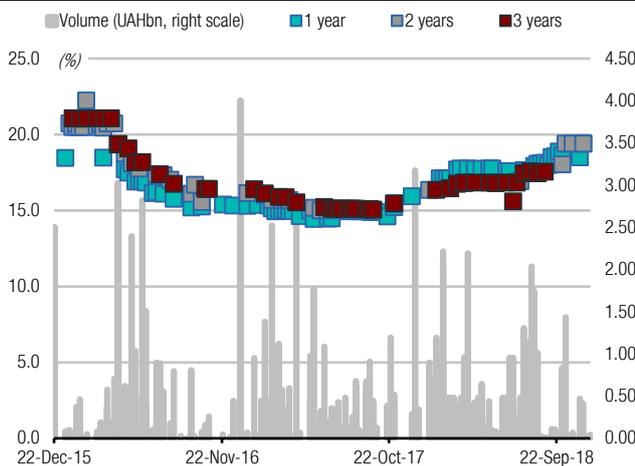
Last week, total bonds outstanding in most portfolios declined due to hryvnia appreciation and revaluation of FX-denominated bonds. But there was not a significant decline due to the selling of bonds or redemptions. Mainly, it was banks' portfolios that declined, which has a lot of FX-denominated bonds. At the same time, portfolios of individuals continued to rise, adding UAH168m despite the revaluation of FX-denominated bonds. Last week, individuals accelerated purchases of both local-currency and FX-denominated bonds for UAH152m and UAH16m, respectively.

ICU view: *The relative calm that we see for a second week in row has given foreign investors the confidence to hold local-currency bills without panicking. However, with only a small amount of new issues, there was insufficient impact from the primary market. So, this week, we will continue to see the impact from the hryvnia exchange rate. The MoF refinanced only half of today's debt repayments at yesterday's auction, so bonds outstanding and some portfolios will continue to decline.*

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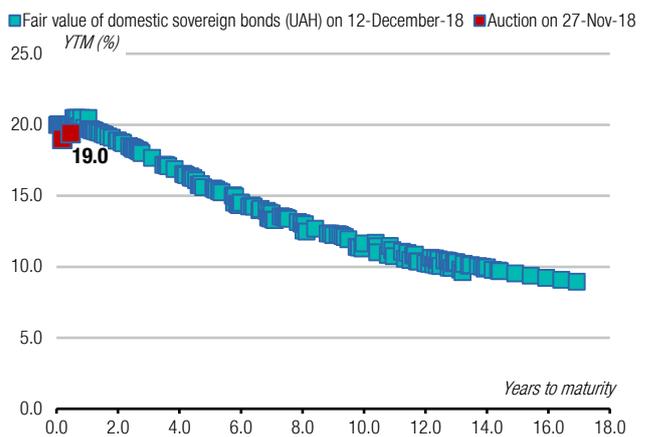
Chart 1. Local-currency bonds

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.

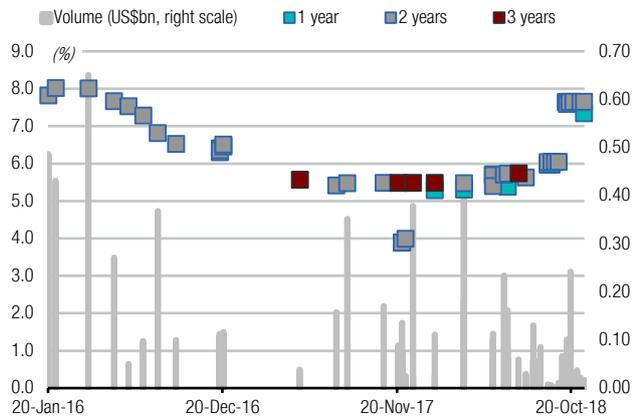
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

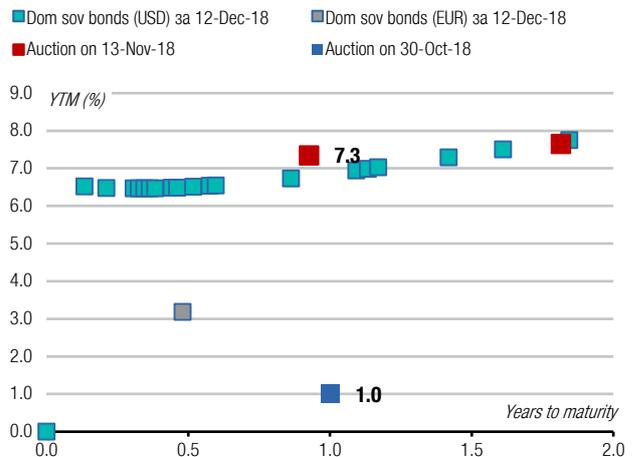
Chart 2. FX-denominated bonds

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.

NBU supported liquidity

Local-currency liquidity in the banking system was, as expected, below UAH80bn, and slightly recovered with NBU support. This week, the NBU will continue to inject liquidity, and the total amount of liquidity will be steady above UAH80bn.

Last week, liquidity received significant support from the NBU, and until this Monday, it rose to UAH79.8bn, the largest amount since mid-November. NBU purchased US\$272m of FX from the market, and injected UAH7.6bn in liquidity. Also, there was support via loans.

Additional support was provided by the Treasury, which increased budget expenditures and had a positive balance of operations, above UAH2bn, which compensated outflow via reserves exchange in cash.

ICU view: This week, liquidity will see additional support from the NBU. A large supply of FX funds forced NBU to keep its presence at the market and buy them providing additional liquidity. At the same time, banks could start to repay loans to the NBU, and liquidity will balance above UAH80bn without sufficient increase.

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

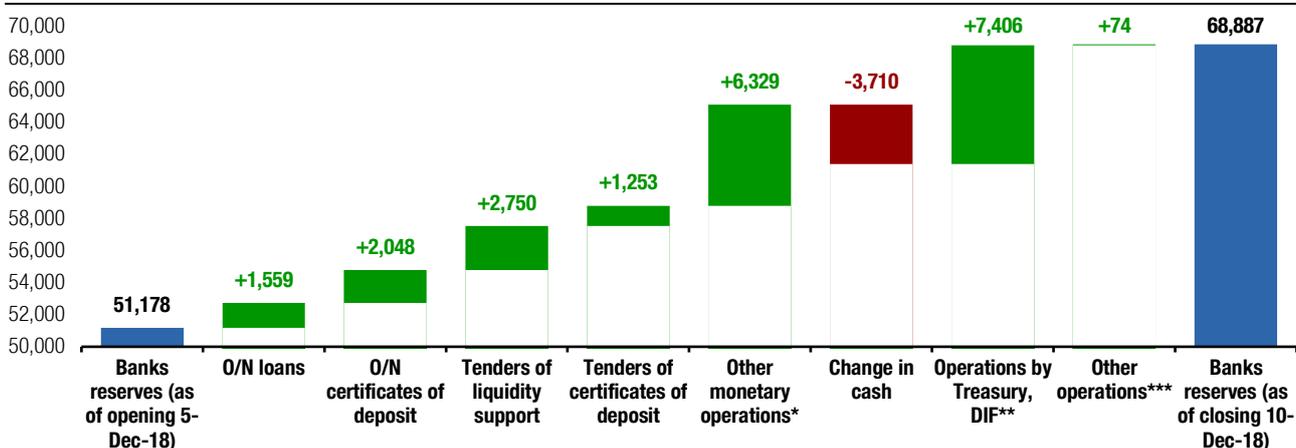
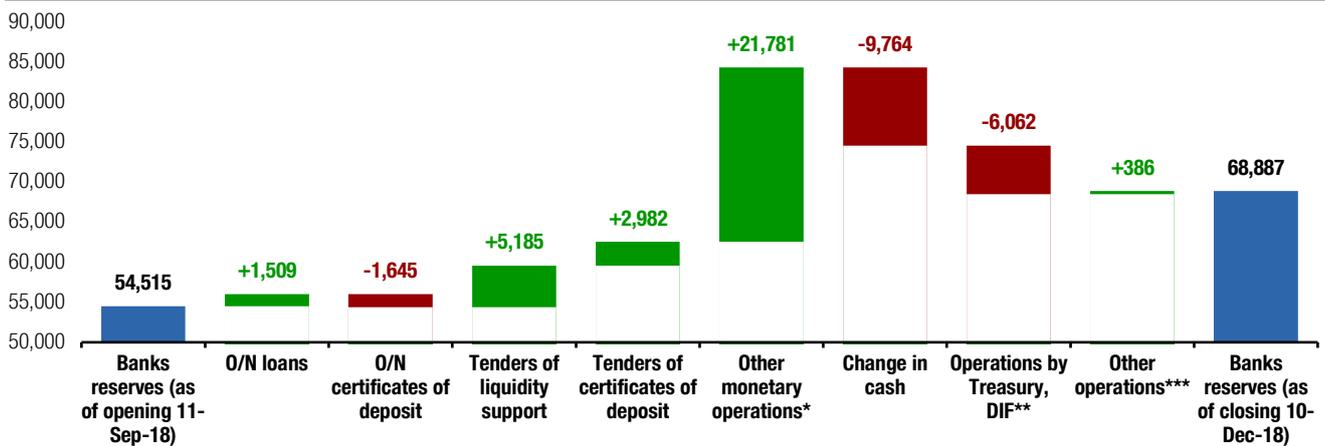


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

The first week of December saw the hryvnia return to the level seen prior to the imposition of martial law. And this week, the hryvnia should close near this level due to a substantial supply of hard currency in the market.

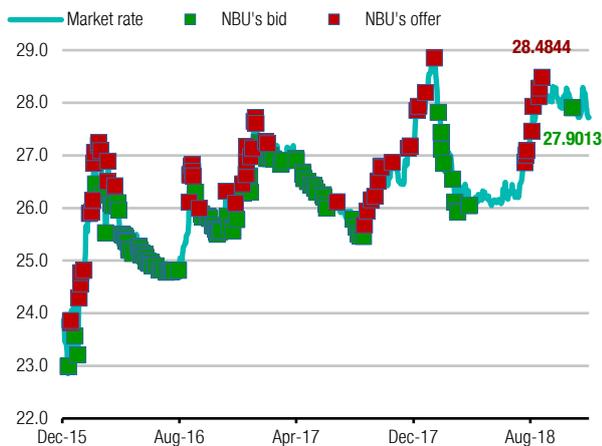
Last week, the hryvnia appreciated by 1.5% to UAH27.787/US\$, and the NBU purchased US\$272m in FX reserves, or about 20% of last week's total market turnover. The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries that are trade partners of Ukraine) rose 1% to 117.3 while in YoY terms, it was up 3.92%.

ICU view: Hard currency supply remains high due to low UAH liquidity, and its high cost. So this week, we should see the hryvnia exchange rate at about UAH27.8/US\$. Furthermore, budget expenditures will accelerate at the end of month, and will therefore decrease the cost of UAH funds, which will mean less selling of FX volumes. We maintain our forecast of the hryvnia weakening to about UAH28.5-29/US\$ by the year end.

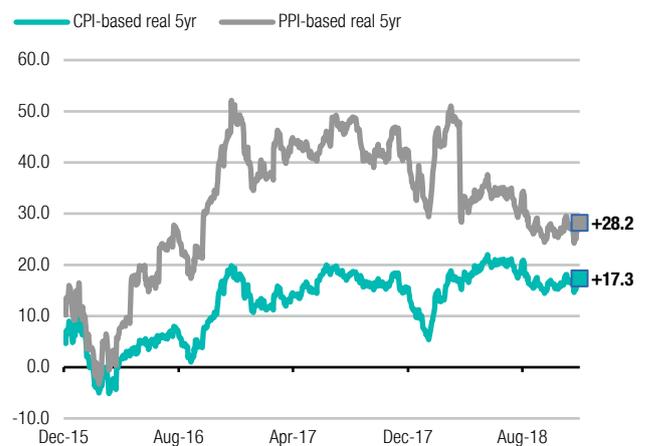
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Chart 5. FX market indicators, 3-year history

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

Inflation accelerated to 10% YoY in November

Inflation will remain close to the current level in December, but due to decelerating economic growth and tight monetary policy, it will slow in 2019.

The key drivers of accelerating inflation in November were higher growth rates in utilities prices (10.2% YoY vs. 4.7% YoY in October) due to an increase in gas prices for population by 23.5% MoM in November, and in prices on food products (7.5% YoY vs. 7% in October), per data from the State Statistics Service. At the same time, a positive impact on inflation had prices on transport, which in November grew 16.8% YoY, vs. 18.5% YoY in October thanks to lower world oil prices. Core inflation inched up by 0.1ppt to 8.9% YoY. The NBU forecasts headline CPI at 10.1% YoY for the end of 2018, and its slowdown to 6.3% YoY by the end of 2019.

ICU view: Robust consumer demand, seasonal UAH weakening, and high inflationary expectations will put pressure on consumer prices in the next months. However, we expect that inflation will decelerate to 8.5% YoY by the end of 2019, due to slowing economic growth, and tight fiscal and monetary policies.

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The EU has transferred first EUR500m tranche of MFA

Obtaining this tranche, as well as \$750m financial guarantees from the World Bank at the beginning of 2019, will allow the government to pay out external debt until May 2019.

The EU has transferred the first EUR500m tranche to Ukraine as a part of the new macro-financial assistance (MFA) programme. The tranche comes in the form of a loan with interest rate of 1.25% and matures in April 2033.

ICU view: Disbursement of the first tranche from the EU proves the progress in Ukraine's implementation of recommendations of the IMF and the European Commission. According to our estimates, the tranche increases the hard currency balance on the accounts of the government to \$1.3bn.

We also expect that the Board of the IMF, as well as the World Bank's Board of Directors, will take positive decisions on the continuation of cooperation with the Ukrainian government on 18 December. As a result, we expect that by the end of the year, Ukraine may receive the first tranche from the IMF in the amount of \$1.9bn. In addition, in 1Q19, the government will be able to issue \$0.8bn of Eurobonds under financial guarantees of the World Bank. Funding from the EU and the World Bank will secure the government's external debt payments until May 2019. However, to ensure the debt payments until September 2019, the Government has to plan additional issuance of Eurobonds no later than May.

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