

Weekly Insight

Inflation slowed to 9.2% in January

Key messages of the today's comments

Domestic liquidity and bonds market

Activity declines

The debut auction in February provided lower demand for new bills and lower budget proceeds than in January. We expect similar demand in the following weeks, likely due to lower demand from foreign investors.

Liquidity high prior to tax payments

The total amount of banking-sector liquidity remained high last week, but we expect a slight decline this week due to quarterly payments of corporate profit tax.

Foreign exchange market

Hryvnia stronger, volatility up

Last week, the hryvnia hit a new level for the year, crossing UAH27/US\$, but did not stop there. Thanks to foreign investment in government bills and corporate tax payments, this week, the hryvnia has another chance to cross this level below 27.

Economics

Inflation slowed to 9.2% in January

Lower energy prices, as well as tight monetary and fiscal policies will prompt further inflation slowdown throughout 2019.

TUESDAY, 12 FEBRUARY 2019

Banks' reserves market (11 February 2019)

| | Last | Weekly chg (%) | YoY chg (%) |
|------------------------------|--------|----------------|-------------|
| NBU rate (%) ¹ | 18.00 | +0bp | +200bp |
| ON rate (%) | 16.48 | +10bp | +88bp |
| ON \$ swap (%) | N/A | ... | ... |
| Reserves (UAHm) ² | 48,913 | +6.13 | +36.10 |
| DepCerts (UAHm) ³ | 64,156 | -6.62 | +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) (11 February 2019)

| | Last | Weekly chg (%) | YoY chg (%) |
|----------------------|----------------|----------------|--------------|
| NBU | 340,724 | -0.41 | -4.36 |
| Banks | 372,805 | -0.19 | +6.39 |
| Residents | 24,433 | +7.36 | -0.80 |
| Individuals | 6,802 | +2.81 | +329.61 |
| Non-res ⁴ | 13,418 | +9.48 | +11.29 |
| Total | 758,182 | +0.12 | +1.78 |

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (11 February 2019)

| | Last | Weekly chg (%) | YTD chg (%) |
|----------------------|---------|----------------|-------------|
| USD/UAH | 27.0504 | -0.29 | +0.08 |
| EUR/USD | 1.1276 | -1.14 | -7.97 |
| DX ² | 97.057 | +1.03 | +7.31 |
| UAH TWI ³ | 120.787 | +1.13 | +7.78 |

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (12 February 2019)

| Maturity | Bid | Ask |
|----------|-------|-------|
| 6m | 20.00 | 18.50 |
| 12m | 20.00 | 18.50 |
| 2y | 19.75 | 18.00 |
| 3y | 19.50 | 17.50 |
| 12m (\$) | 7.50 | 5.25 |
| 2y (\$) | 7.50 | 5.50 |

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

Source: ICU.

Domestic liquidity and bonds market

Activity declines

The debut auction in February provided lower demand for new bills and lower budget proceeds than in January. We expect similar demand in the following weeks, likely due to lower demand from foreign investors.

For May 2019, the government has scheduled large debt repayments, including external and domestic debt repayments, in both local and foreign currencies. Currently, it looks like the Ministry is going to keep the amount of debt repayments unchanged at UAH23.6bn and US\$262m, and they have started to offer longer instruments.

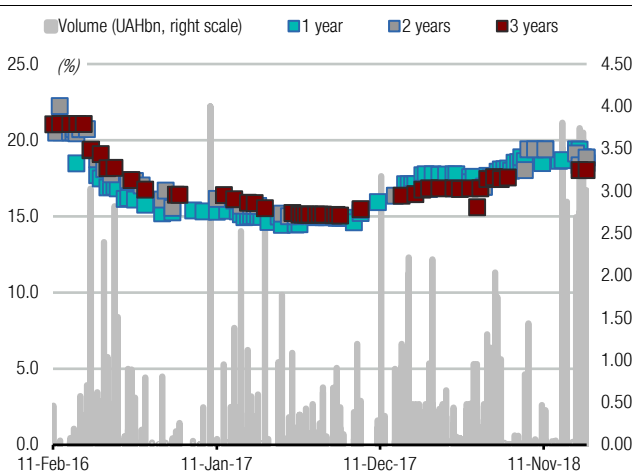
At the end of January, the MoF began offering bills with maturities in May 2019. This week, they moved the maturity of the new shortest bills to June 2019. But new maturities may be not so popular with foreign investors because of the upcoming presidential elections.

ICU view: Foreigners decreased activity last week by more than double compared with previous auctions, and they could keep their activity at the same level this week also. But additional demand could come from local budgets, as they start to purchase new bills. As a result, decline in demand from foreign investors and the increase in maturities should not have a sufficient negative impact on budget financing, although it could force the government to use budget revenues for debt repayments.

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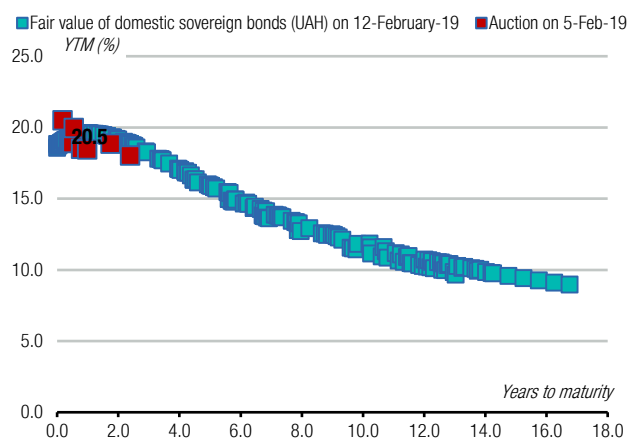
Chart 1. Local-currency bonds

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.

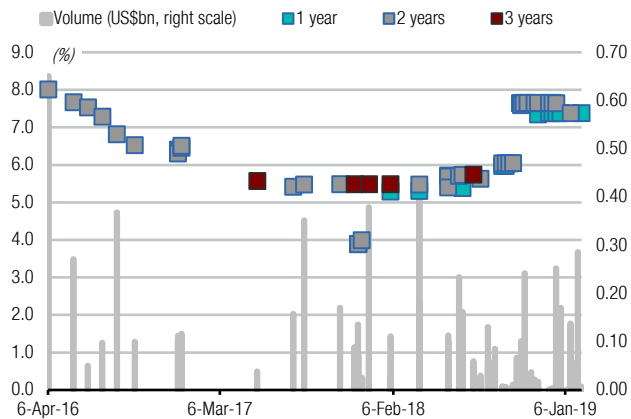
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

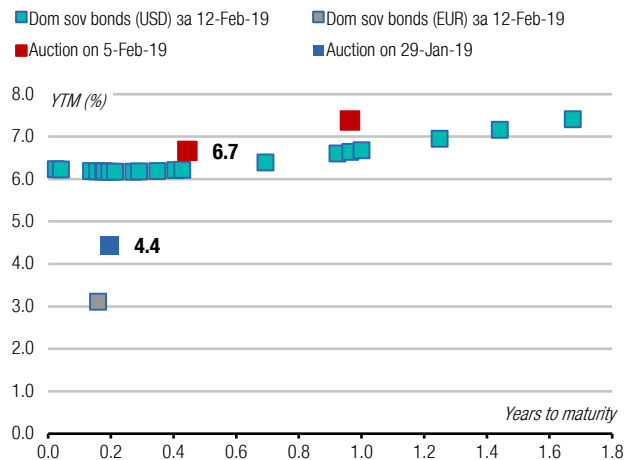
Chart 2. FX-denominated bonds

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 high prior to tax payments

The total amount of banking-sector liquidity remained high last week, but we expect a slight decline this week due to quarterly payments of corporate profit tax.

Last week, non-monetary operations continued to have negative impact on liquidity, this being the second consecutive week the Treasury played this key role. Last week, the Treasury absorbed UAH4.1bn, and this impact was increased by reserves exchange in cash for UAH2.9bn. Only NBU compensated a large portion of outflows, injecting UAH4.7bn in the banking sector via the FX market.

ICU view: Quarterly payments of corporate profit tax usually fall in the second ten-days period of February, and banks prepare for an increase in outflows by reducing the amount of funds invested in CDs. Outflows could be concentrated at the end of this week and next, so liquidity could remain above UAH100bn.

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

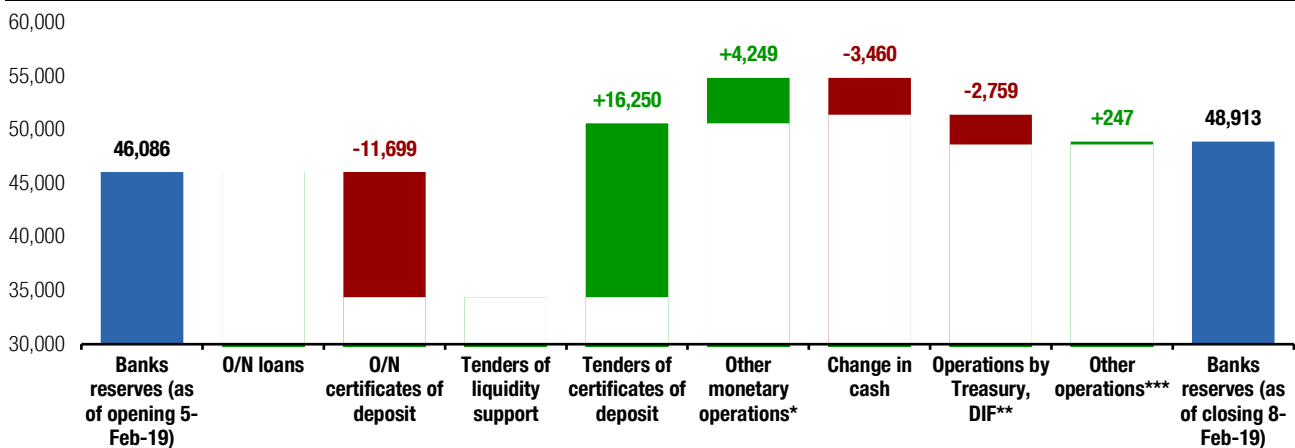
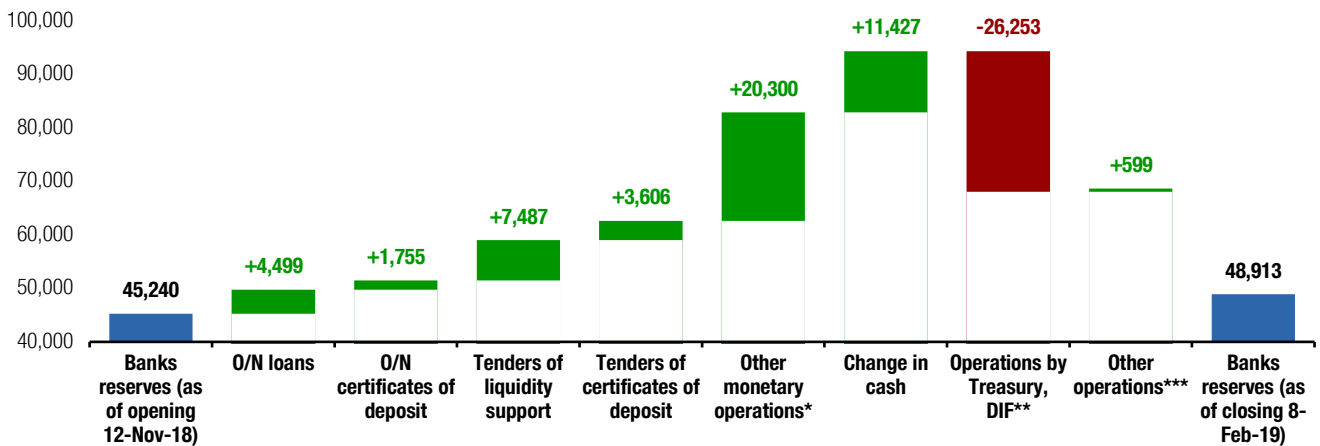


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 stronger, volatility up

Last week, the hryvnia hit a new level for the year, crossing UAH27/US\$, but did not stop there. Thanks to foreign investment in government bills and corporate tax payments, this week, the hryvnia has another chance to cross this level below 27.

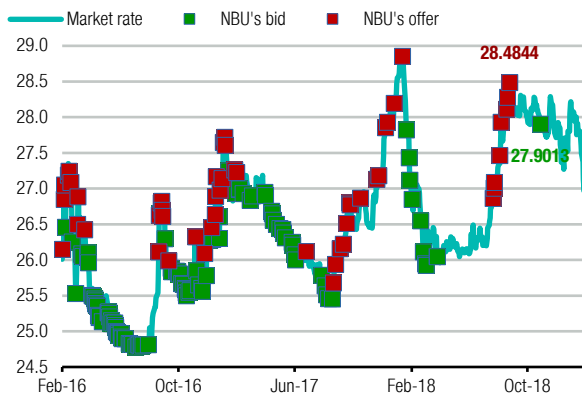
Last week, the hryvnia appreciated by 1.4% to 27.125/US\$, the same level seen on 8 February 2018. Last week, the hryvnia was stronger, hitting UAH26.96/US\$ on Thursday. But by Friday, the balance at the market moved to the demand side, and the hryvnia weakened somewhat.

ICU view: Quarterly tax payments could increase demand for the hryvnia, and increase selling of FX, providing additional support. As a result, the hryvnia could appreciate this week, and with demand for new bills from foreign investors, could stay below UAH27/US\$.

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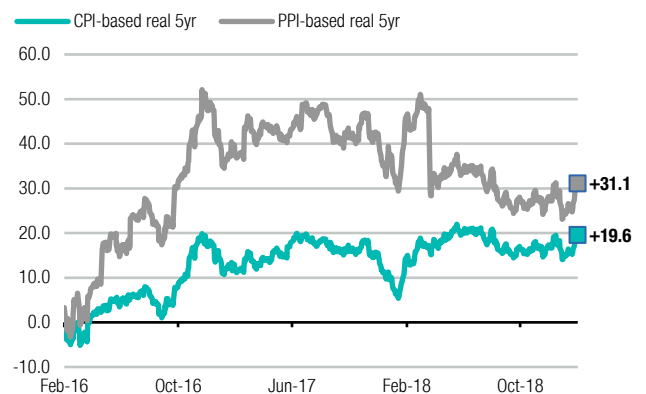
Chart 5. FX market indicators, 3-year history

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 slowed to 9.2% in January

Lower energy prices, as well as tight monetary and fiscal policies will prompt further inflation slowdown throughout 2019.

In January, consumer-prices growth slowed to 9.2% YoY and 1% MoM, down from 9.8% YoY seen in December, per data from the State Statistics Service of Ukraine. The inflation slowdown in January was primarily thanks to decelerated growth rates in transport prices to 7.7% YoY vs. 12.9% YoY in December. The contribution of this particular category fell by 0.6ppt to 0.9ppt out of 9.2% in January. On the flip-side, the growth of utility prices accelerated to 13.1% YoY due to an increase in the heating tariff since 1 January 2019. Core inflation inched down by 0.4ppt to 8.3% YoY. The NBU forecasts headline CPI at 6.3% YoY for the end of 2019.

ICU view: Due to tight monetary and fiscal policies, slowing economic growth, and lower prices for oil and natural gas, inflation is set to decelerate to 8.5% YoY by YE2019. Still, solid consumer demand, high inflationary expectations, and rising nominal wages will put upward pressure on consumer prices.

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