

Weekly Insight

Inflation inched up to 8.8% YoY in April

Key messages of the today's comments

Domestic liquidity and bonds market

Investment in UAH-denominated debt increased

Last week, total domestic government debt outstanding rose to UAH770bn; bills denominated in UAH increased to 85%. With new bond issues coming this week, and due to the strong hryvnia, the local-currency share of domestic debt will be steady with a possible slight increase.

Liquidity needs support

As expected, last week, liquidity was above UAH100bn, but with significant volatility. This week, liquidity will be under pressure from quarterly tax payments, and it can decline to the range of UAH90-100bn.

Foreign exchange market

Hryvnia continues to appreciate

All last week, the hryvnia continued to strengthen, and appreciated to UAH26.19/US\$, the highest this year. Thanks to foreign investors' purchases of local-currency debt and quarterly tax payments, the hryvnia can appreciate by an additional UAH0.10-0.15 this week.

Economics

Inflation inched up to 8.8% YoY in April

Lower natural gas prices, tight monetary, and constrained fiscal policies will contribute to the inflation slowdown this year.

MONDAY, 13 MAY 2019

Banks' reserves market (10 May 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	17.50	+0bp	+50bp
ON rate (%)	16.14	-67bp	+14bp
ON \$ swap (%)	18.00	+370bp	+202bp
Reserves (UAHm) ²	42,155	-30.49	+0.58
DepCerts (UAHm) ³	59,798	+20.54	-16.14

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) (10 May 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,088	+0.00	-3.78
Banks	355,500	+1.49	+2.82
Residents	24,977	+1.97	-6.74
Individuals	8,685	+2.88	+233.92
Non-res ⁴	39,147	+9.03	+233.29
Total	765,397	+1.23	+3.83

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (10 May 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	N/A
EUR/USD	N/A
DX ²	N/A
UAH TWI ³	N/A

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (13 May 2019)

Maturity	Bid	Ask
6m	19.00	18.00
12m	19.50	18.00
2y	19.75	18.00
3y	19.25	17.50
12m (\$)	7.50	5.50
2y (\$)	7.50	5.75

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

Source: ICU.

Domestic liquidity and bonds market

Investment in UAH-denominated debt increased

Last week, total domestic government debt outstanding rose to UAH770bn; bills denominated in UAH increased to 85%. With new bond issues coming this week, and due to the strong hryvnia, the local-currency share of domestic debt will be steady with a possible slight increase.

Last week, investments rose for both local and foreign-currency bills, and during May, the structure has been steady. However, since the beginning of the year, the share of local-currency bills increased from 82% to 85%. Demand from foreign investors for local-currency bills has been an important contribution to this change in preference. Foreign investors currently hold UAH39.2bn of bills.

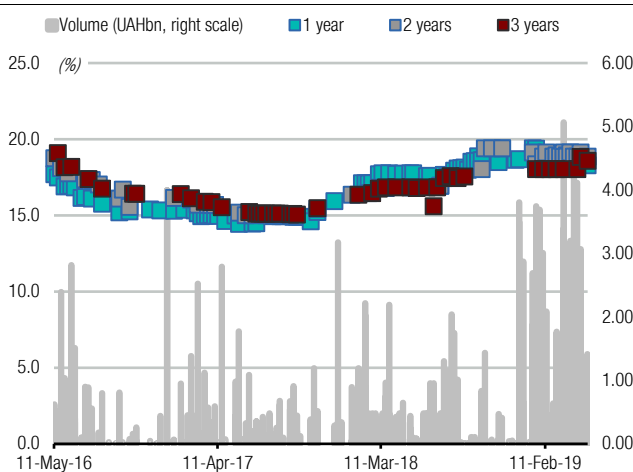
Banks and non-banks also purchased local-currency bills, reinvesting redemptions at the beginning of the month. In addition, they purchased US\$164m of FX-denominated bills in May, with proceeds exceeded domestic repayments in FX.

ICU view: As the NBU decreased key policy rate moderately, investments in local-currency debt will continue and the share of local-currency bonds will also rise. Foreign investors should increase their portfolios to above UAH40bn. Additionally, the strong hryvnia appreciated to UAH26.19/US\$ last week will keep FX-denominated bills outstanding at the same level.

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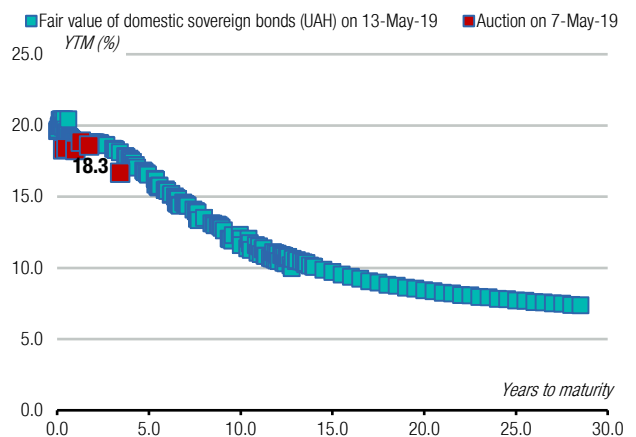
Chart 1. Local-currency bonds

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.

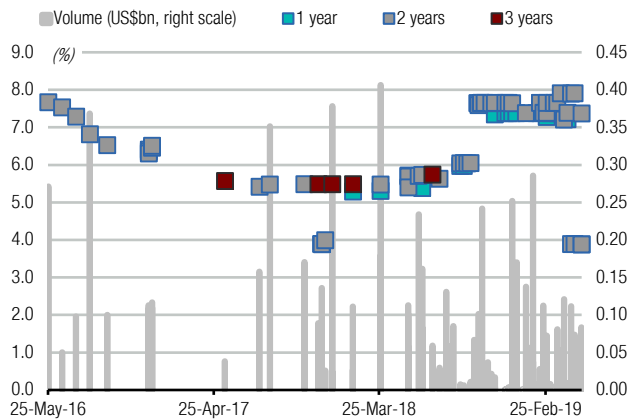
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

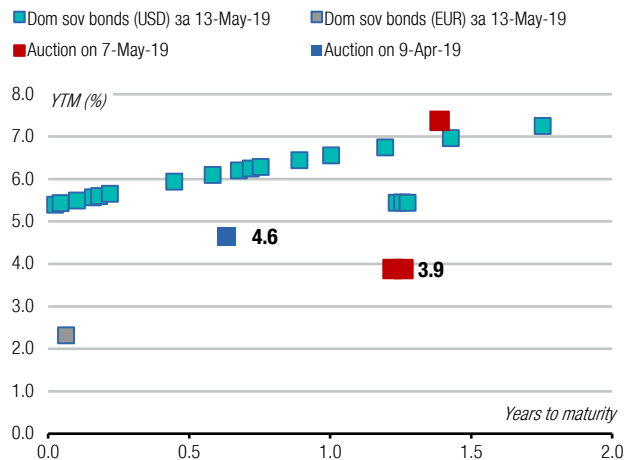
Chart 2. FX-denominated bonds

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 needs support

As expected, last week, liquidity was above UAH100bn, but with significant volatility. This week, liquidity will be under pressure from quarterly tax payments, and it can decline to the range of UAH90-100bn.

Last week, banks decreased the amount of ON loans from the NBU. Last Monday, banks repaid half of their loans, decreasing them to UAH3bn. Over the next two days, these loans were repaid. Instead, during this redemption, three banks took out new loans for two weeks totaling UAH3.1bn.

Last Tuesday and Wednesday, the Treasury absorbed UAH6.2bn, while inflows from the NBU were just UAH1bn these days. As a result of these cash flows, liquidity approached the UAH100bn level, declining to UAH102bn. But last Friday and Saturday due to inflows from the Treasury and new loans from the NBU, liquidity rose to UAH111.6bn.

ICU view: This week, pressure will come from quarterly payments of corporate income tax, which usually causes a decline in liquidity. So, without support from the NBU via extra FX purchases or ON loans, the Treasury will cause a decline in liquidity larger than last week's outflows to the budget accounts. As a result, liquidity may decline below UAH100bn, but will be in the range of UAH90-100bn, which could cause a slight increase in the cost of local-currency funding.

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

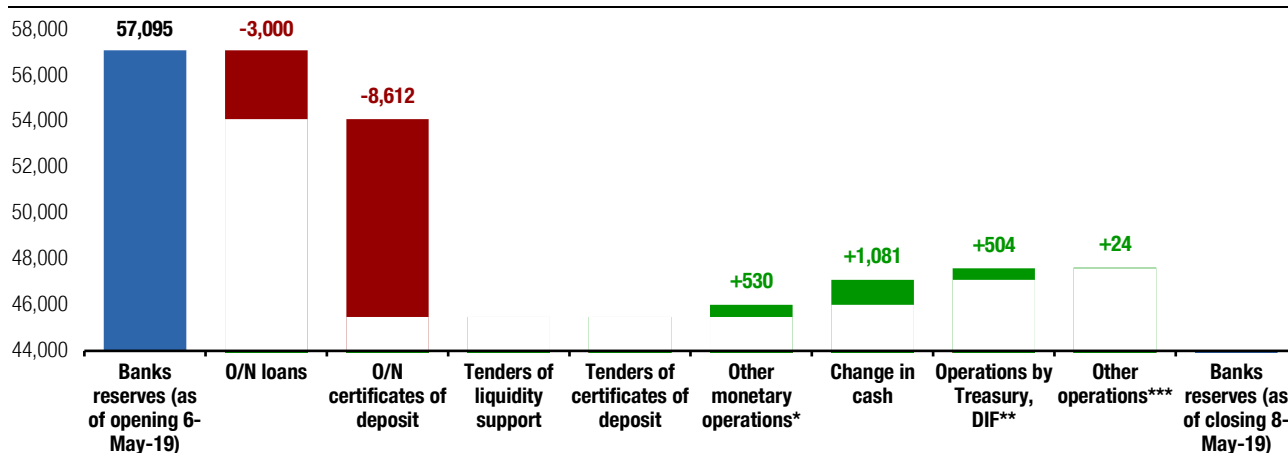
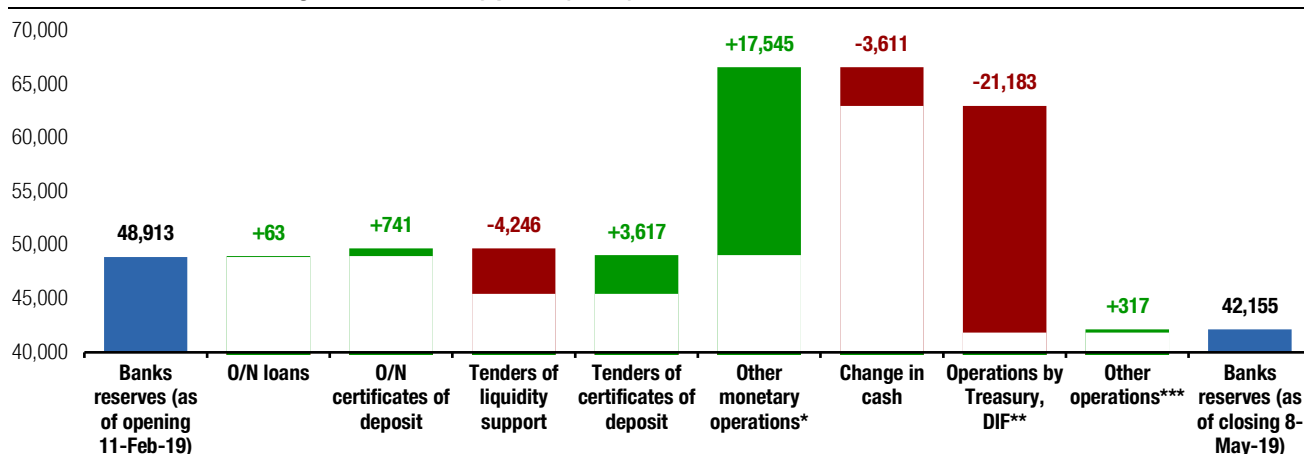


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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

All last week, the hryvnia continued to strengthen, and appreciated to UAH26.19/US\$, the highest this year. Thanks to foreign investors' purchases of local-currency debt and quarterly tax payments, the hryvnia can appreciate by an additional UAH0.10-0.15 this week.

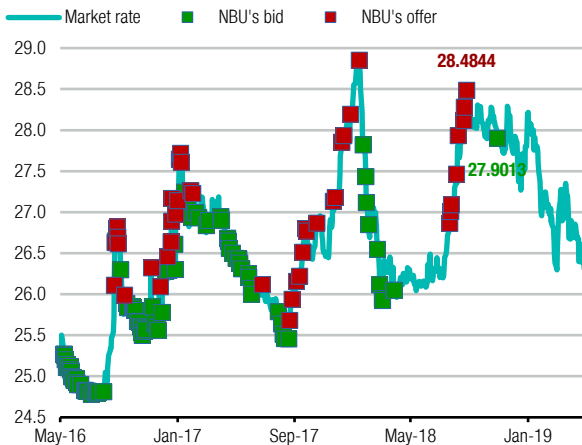
Last week, foreign investors purchased UAH3bn of new local-currency bills, but only part of FX sold for these purchases was absorbed by the NBU. The NBU purchased only US\$80m from the market, which decreased the impact of extra FX supply, but allowed hryvnia to appreciate.

ICU view: We anticipate that foreign investment in local-currency bills will continue, but will probably be less active. This will maintain the extra supply of FX in the market, and domestic players will add a portion to supply this week. The period of quarterly corporate income tax payments usually increases the supply of FX from exporters, and creates extra pressure on the hryvnia exchange rate. At the same time, the NBU most likely will not allow the hryvnia to appreciate as it did last week, and will keep it above UAH26/US\$ with appreciation of UAH0.10-0.15 during the week.

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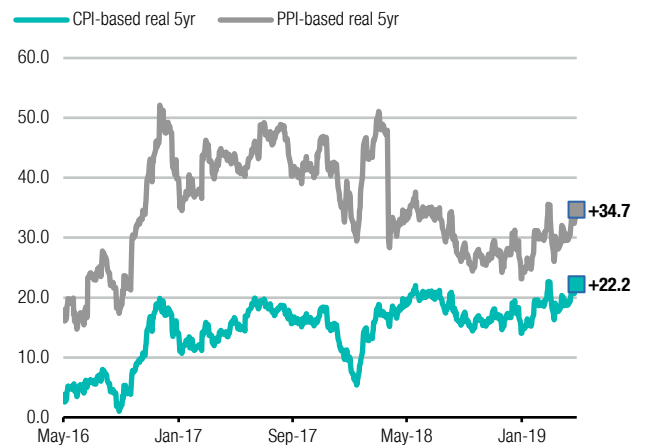
Chart 5. FX market indicators, 3-year history

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 inched up to 8.8% YoY in April

Lower natural gas prices, tight monetary, and constrained fiscal policies will contribute to the inflation slowdown this year.

In April, headline inflation accelerated to 1% MoM and 8.8% YoY, up from 8.6% YoY seen in March. The acceleration was due to higher growth rates in prices on transport (+8.1% YoY), and food products and non-alcoholic beverages (+7.4% YoY). These two categories account for 57% of the consumer basket. The growth rates of prices in other categories slowed compared with March. Core inflation fell by 0.2ppt to 7.4% YoY. The NBU forecasts headline CPI at 6.3% YoY for the end of 2019.

ICU view: Tight monetary and fiscal policies, lower world prices on natural gas, as well as decelerating economic growth of Ukraine will continue to contain consumer price growth in 2019. Still, solid consumer demand and rising nominal wages will continue to put pressure on consumer prices. We maintain our CPI forecast at 8.5% YoY growth by YE2019.

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