

Weekly Insight

Inflation inched up to 9.1% YoY in July

Key messages of the today's comments

Domestic liquidity and bonds market

Bond offerings capped

Since August, the Ministry of Finance extended the list of bills that will be offered with limited amounts. This increases competitiveness at the primary auctions, while, at the same time, it also increases trading in the secondary market. This week, we expect no major changes in portfolios, while rates should continue declining.

Treasury and NBU support liquidity

Last week, banking-sector liquidity returned to above UAH100bn (US\$4bn) due to inflows from the budget and the NBU. Most likely, this increase will be short-term, and this week we expect a decline due to quarterly income-tax payments.

Foreign exchange market

Hryvnia remains strong

The hryvnia appreciated by 1.3% to UAH25.22/US\$ last week due to significant supply of hard currency at the market. This week, we anticipate that supply will remain high allowing the exchange rate to stay near the level seen at the end of last week.

Economics

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Tight monetary and a restrictive fiscal policy, as well as lower world energy prices will contribute to the further slowdown of inflation.

TUESDAY, 13 AUGUST 2019

Banks' reserves market (12 August 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	17.00	+0bp	-50bp
ON rate (%)	15.95	+23bp	-94bp
ON \$ swap (%)	14.33	+25bp	-78bp
Reserves (UAHm) ²	44,396	+0.27	+18.26
DepCerts (UAHm) ³	57,579	+8.83	+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) (12 August 2019)

	Last	Weekly chg (%)	YoY chg (%)
NBU	337,086	+0.00	-3.52
Banks	338,145	-1.41	-8.97
Residents	26,006	-0.31	+15.10
Individuals	9,389	-2.33	+122.95
Non-res ⁴	87,258	-0.46	+1,001.09
Total	797,884	-0.69	+5.60

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (12 August 2019)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	25.1850	-1.33	-7.74
EUR/USD	1.1214	+0.13	-1.74
DX ²	97.380	-0.26	+1.06
UAH TWI ³	130.112	+1.35	+8.25

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (13 August 2019)

Maturity	Bid	Ask
6m	17.50	16.00
12m	17.75	16.25
2y	17.75	16.25
3y	17.75	16.25
12m (\$)	6.75	5.25
2y (\$)	7.25	5.85

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

Source: ICU.

Domestic liquidity and bonds market

Bond offerings capped

Since August, the Ministry of Finance extended the list of bills that will be offered with limited amounts. This increases competitiveness at the primary auctions, while, at the same time, it also increases trading in the secondary market. This week, we expect no major changes in portfolios, while rates should continue declining.

Today will be the second consecutive auction with limited offerings not only for bills with maturities up to one year, but for longer maturities, too. The total amount of offerings is set at UAH3bn, the same as last week. It will be allocated as follows: UAH1bn (US\$0.04bn) for bills with tenors less than one year (UAH500 (US\$19.8m) for six-month and 12-month bills each), and UAH2bn (US\$0.08bn) for two-year bills.

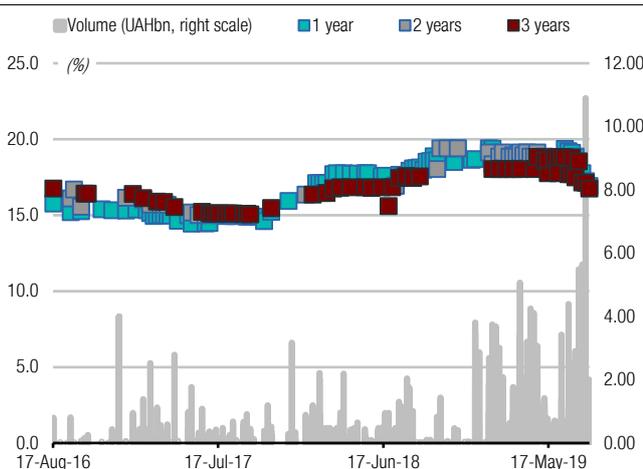
Limited offerings at the primary market mean investors may review their strategy and become more active in the secondary market. That was the likely reason why foreign investors slightly decreased portfolios by UAH0.4bn (US\$0.02bn) last week after reaching the record amount of UAH87.7bn (US\$3.4bn) on Tuesday.

ICU view: We do not anticipate large demand for six-month bills in today's auction. The cut-off rate will likely remain close to 16.5%. For one- and two-year bills, rates can decline by 10bp and 20bp, respectively, to around 16.2% and 16.6%. This decline will be caused by demand from foreign investors, as they will make their bids more attractive for the MoF. The Ministry, in turn, will improve its ability to gather the most attractive bids thanks to the limited offering.

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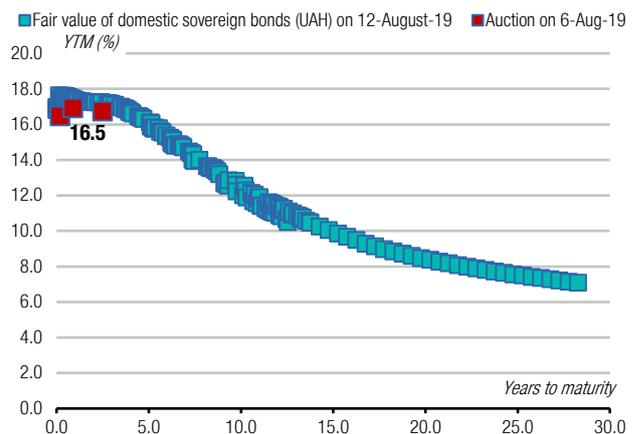
Chart 1. Local-currency bonds

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.

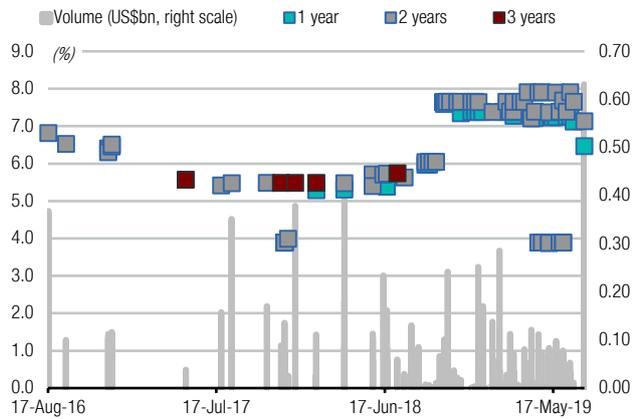
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

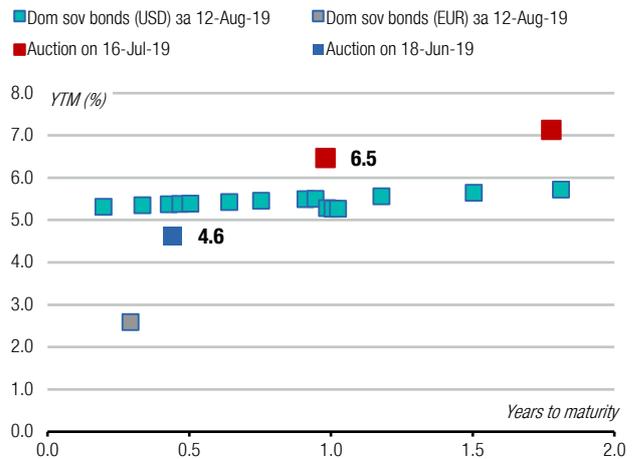
Chart 2. FX-denominated bonds

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.

Treasury and NBU support liquidity

Last week, banking-sector liquidity returned to above UAH100bn (US\$4bn) due to inflows from the budget and the NBU. Most likely, this increase will be short-term, and this week we expect a decline due to quarterly income-tax payments.

Last week, the NBU actively purchased FX from the market, providing UAH4bn (US\$0.16bn) of local-currency liquidity, and UAH3bn (US\$0.12bn) was received from non-monetary operations. The Treasury provided UAH7.5bn (US\$0.3bn) of funds via budget expenditures, but UAH4.6bn (US\$0.18bn) of reserves were exchanged in cash.

ICU view: Quarterly income-tax payments will be paid during the second ten days of August, which usually have a negative impact on liquidity in the banking system. We expect that these payments will exceed budget expenditures, especially due to the low amount of debt repayments this week. These cash-flows will have a negative impact on liquidity, moving it down below UAH100bn (US\$4bn). Support can come from the NBU via the FX market where FX can be sold by foreign investors for purchases of new bills and by exporters to pay income tax.

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

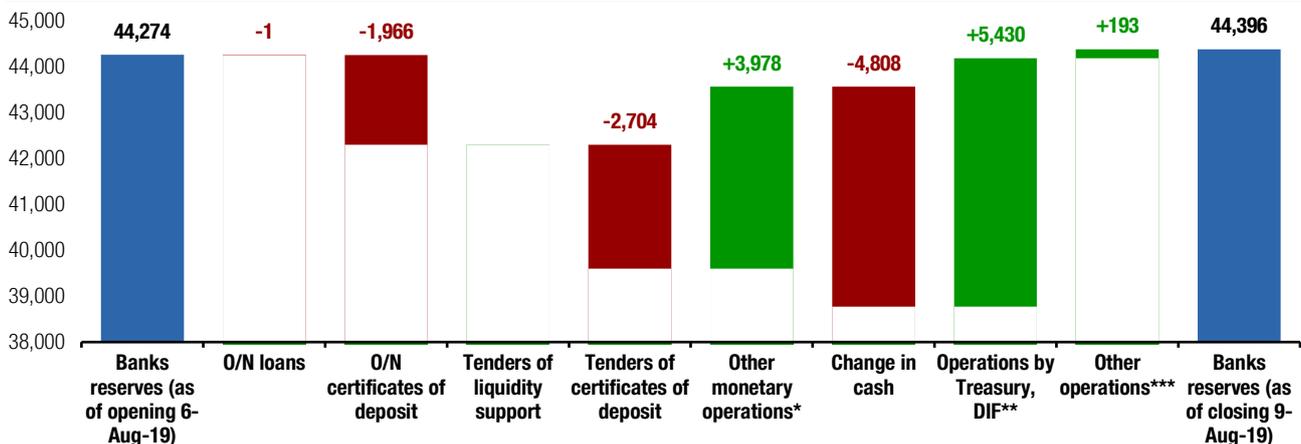
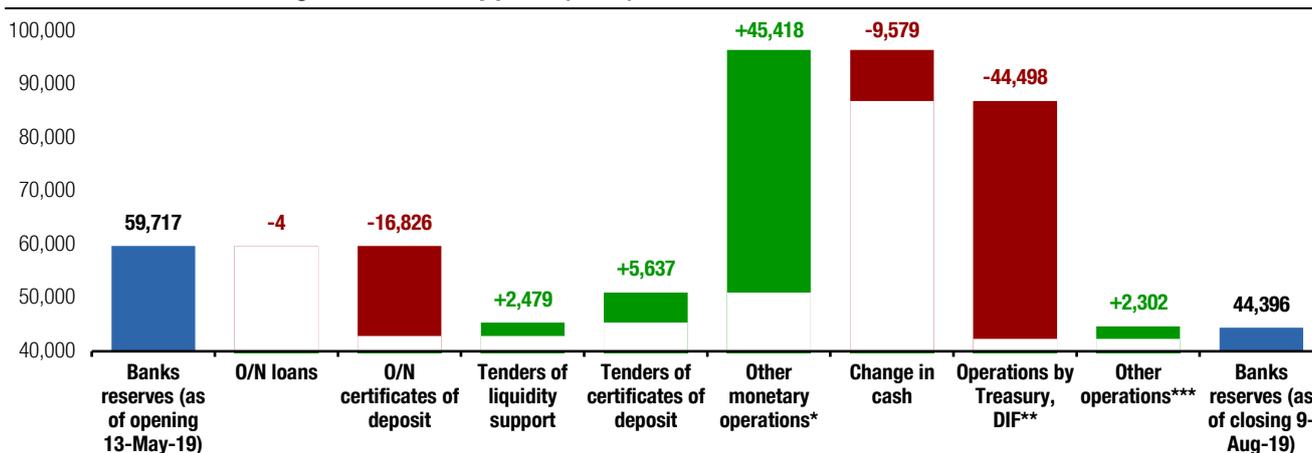


Chart 4. Banks reserves usages over last 90-day period (UAHm)



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 remains strong

The hryvnia appreciated by 1.3% to UAH25.22/US\$ last week due to significant supply of hard currency at the market. This week, we anticipate that supply will remain high allowing the exchange rate to stay near the level seen at the end of last week.

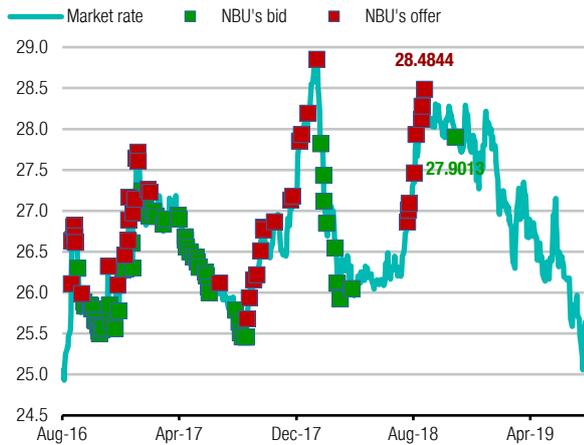
Foreign investors' participation in the local-currency bond market continued to beat all records, and provided key support for hryvnia. But with limited offerings of bills at each auction, inflow of hard currency to buy new bills declined. At the same time, exporters increased their selling of hard currency to pay taxes and finance current activities. Last week, the NBU purchased US\$156.9m of hard currency.

ICU view: This week, exporters will sell hard currency to pay quarterly income-tax payments. This should compensate for the decline in supply of hard currency from foreign investors in government bills. Most likely, this week, the hryvnia will be volatile inside the range of UAH25.1–25.5/US\$.

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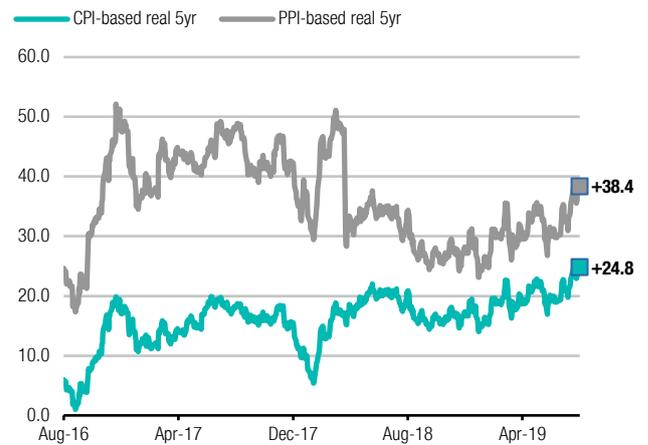
Chart 5. FX market indicators, 3-year history

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 inched up to 9.1% YoY in July

Tight monetary and a restrictive fiscal policy, as well as lower world energy prices will contribute to the further slowdown of inflation.

In July, headline inflation inched up to 9.1% YoY from 9% YoY seen in June, while in MoM terms, prices fell 0.6%. Inflation acceleration was due to faster growth in prices of food products (9.9% YoY vs. 8.5% YoY in June), which account for 45% of the consumer basket. In other categories, YoY growth rates declined or remained at June's level. Core inflation held steady at 7.4% YoY for the fourth consecutive month. The NBU forecasts headline CPI at 6.3% YoY by the end of 2019.

ICU view: Solid consumer demand, the shifting of some costs to final customers due to further growth of wages, and the higher cost of sowing this year will continue inflationary pressure. However, given lower world energy prices as well as still-tight monetary and a restrictive fiscal policy, we expect inflation to slow to 8% by YE2019.

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