

# Weekly Insight

## NBU hikes the rate to 7.5%

### Key messages of the today's comments

#### Domestic liquidity and bonds market

##### Demand moves to secondary market

For two consecutive weeks, the MoF has borrowed low amounts in the primary bond market, as a result of foreigners' withdrawal of funds from UAH-denominated debt amid raising geopolitical risks. We expect gradual recovery of demand at primary auctions by the end of April.

##### Liquidity at record high level

The total amount of banking-sector liquidity set a new record for the year thanks to active budget expenditures. But month-end tax payments that start this week can decrease liquidity.

#### Foreign exchange market

##### Hryvnia fluctuates near UAH28/US\$

The hryvnia exchange rate continues to fluctuate near UAH28/US\$ without NBU interventions. This week, the hryvnia is likely to remain at the same level.

#### Economics

##### NBU hikes the rate to 7.5%

The decisive step by the NBU was determined by a sharp acceleration of inflation and growing geopolitical risks. As does the NBU, we expect that the rate will be kept at the new level for about a year with a further decrease to 7%. As a result of the rate hike, monetary conditions changed from moderately loose to neutral and will remain so until the end of 2022.

**MONDAY, 19 APRIL 2021**

#### Banks' reserves market (16 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	7.50	+100bp	-800bp
ON rate (%)	5.78	-21bp	-335bp
ON \$ swap (%)	N/A	...	...
Reserves (UAHm) <sup>2</sup>	84,896	+71.35	+25.39
CDs (UAHm) <sup>3</sup>	128,188	-12.66	-0.14

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's certificates of deposit.  
Source: NBU, Bloomberg, ICU.

#### Breakdown of govt bond holders (UAHm) (16 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	322,077	+0.00	-0.77
Banks	522,784	-1.59	+53.59
Residents	44,342	+1.64	-14.23
Individuals	15,534	+4.06	+81.98
Foreigners <sup>1</sup>	98,368	-2.83	-14.88
<b>Total</b>	<b>1,003,381</b>	<b>-0.99</b>	<b>+19.34</b>

Notes: [1] non-residents

Source: NBU, ICU.

#### FX market indicators (16 April 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.9925	+0.18	+3.31
EUR/USD	1.1983	+0.71	+10.54
DXY	91.556	-0.66	-8.47
UAH TWI <sup>1</sup>	120.849	-1.04	-6.94

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

#### Gov't bond quotes<sup>1</sup> (19 April 2021)

Maturity	Bid	Ask
6m	9.50	8.00
12m	11.50	10.00
2y	12.50	11.50
3y	13.00	12.00
12m (\$)	4.50	3.00
2y (\$)	5.00	3.25

Notes: [1] Actual quotes you can see at [www.icu.ua](http://www.icu.ua).

Source: ICU.

# Domestic liquidity and bonds market

## Demand moves to secondary market

For two consecutive weeks, the MoF has borrowed low amounts in the primary bond market, as a result of foreigners' withdrawal of funds from UAH-denominated debt amid raising geopolitical risks. We expect gradual recovery of demand at primary auctions by the end of April.

Last week, foreign investors' UAH bonds portfolios declined by UAH2.8bn (US\$100m), partially due to redemption, but major part (UAH2.1bn or US\$75m) was sold in the secondary market. These bonds were bought mostly by banks and non-banks investors, which decreased demand submitted to the primary auction.

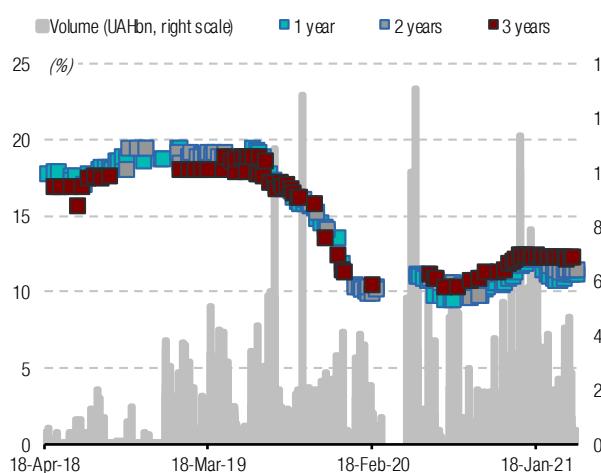
The change in the volume of demand in the primary market amid foreigners decreasing their portfolios was the main reasons for the low amount of proceeds raised, especially in hryvnia (see [auction comment](#)). This is reaction to bad news about the possibility of renewed hostilities and in anticipation of NBU key policy rate hike, delivered last Thursday (see comment below), which can cause increase in interest rates for the short-end yield-curve (below two years maturity) at primary market.

**ICU view:** *Last days, foreigners slowed the pace of selling bonds in anticipation of local market reaction to the NBU's decision to hike the key rate to 7.5%, but they likely to refrain from new purchases for some time. Therefore, this week auction will be again with low demand, which can become more active at the end of this month, when situation in the east of Ukraine can become more predictable.*

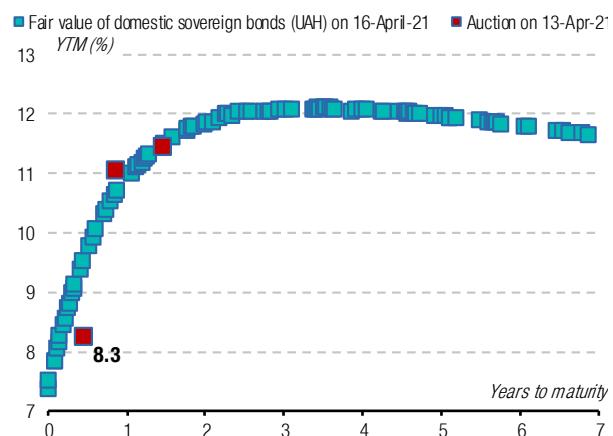
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### Chart 1. Local-currency bonds

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



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

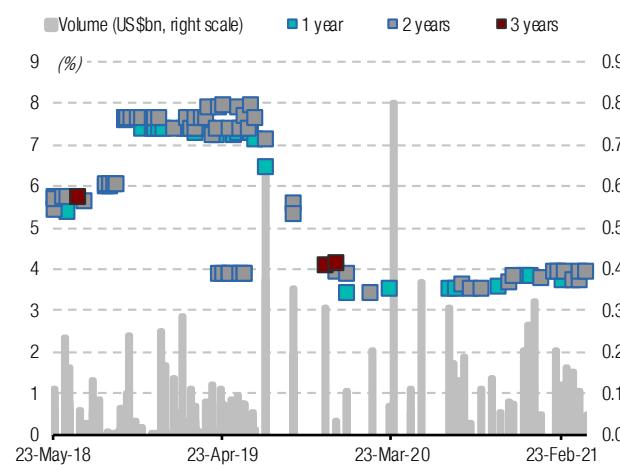


Source: Ministry of Finance of Ukraine, ICU.

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

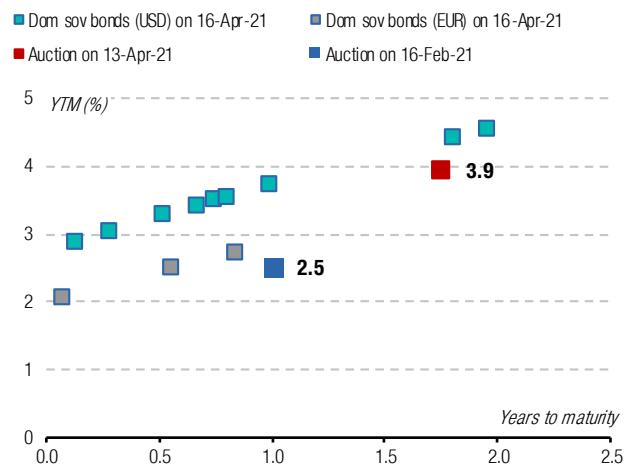
**Chart 2. FX-denominated bonds**

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 at record high level**

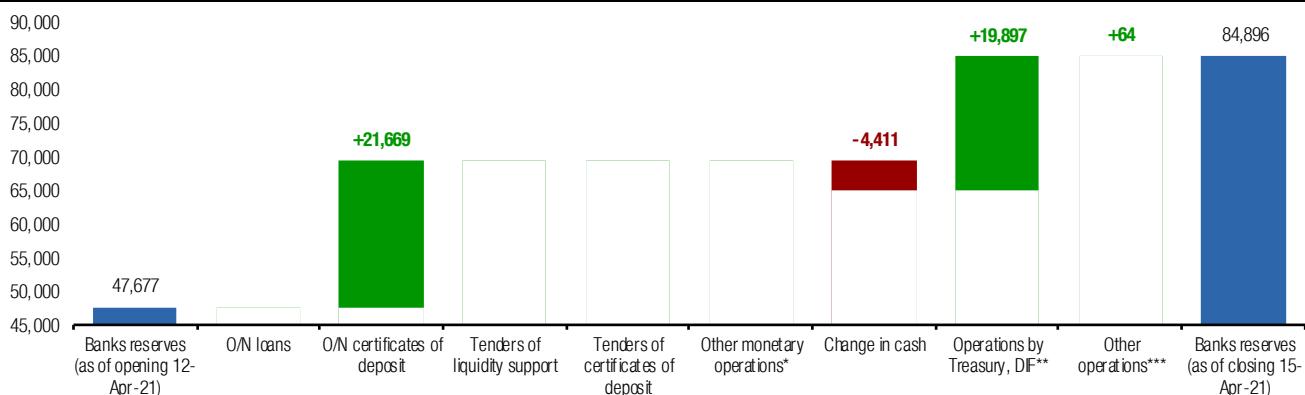
The total amount of banking-sector liquidity set a new record for the year thanks to active budget expenditures. But month-end tax payments that start this week can decrease liquidity.

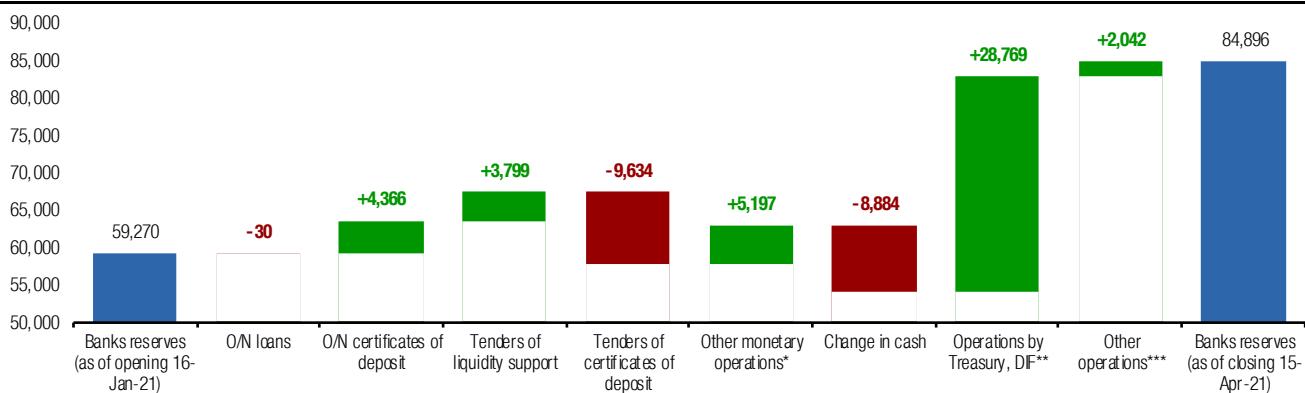
Low borrowings in local currency vs large debt redemptions were the main reason for budget inflow into liquidity seen last week. In total, inflow from budget accounts amounted to UAH22.3bn, where UAH12.9bn was paid last Wednesday.

Instead, banks continued to exchange reserves in cash, which caused outflow from liquidity of UAH5.9bn last week. However, without interventions to the FX market, the NBU had low impact on liquidity, and provided banks with just UAH0.4bn of new loans.

**ICU view:** As month-end tax payments will start this week, the liquidity will slightly decline but remain high. Budget accounts have enough funds for current needs, but will need them for the VAT refunds, which will take place next week.

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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](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 fluctuates near UAH28/US\$

The hryvnia exchange rate continues to fluctuate near UAH28/US\$ without NBU interventions. This week, the hryvnia is likely to remain at the same level.

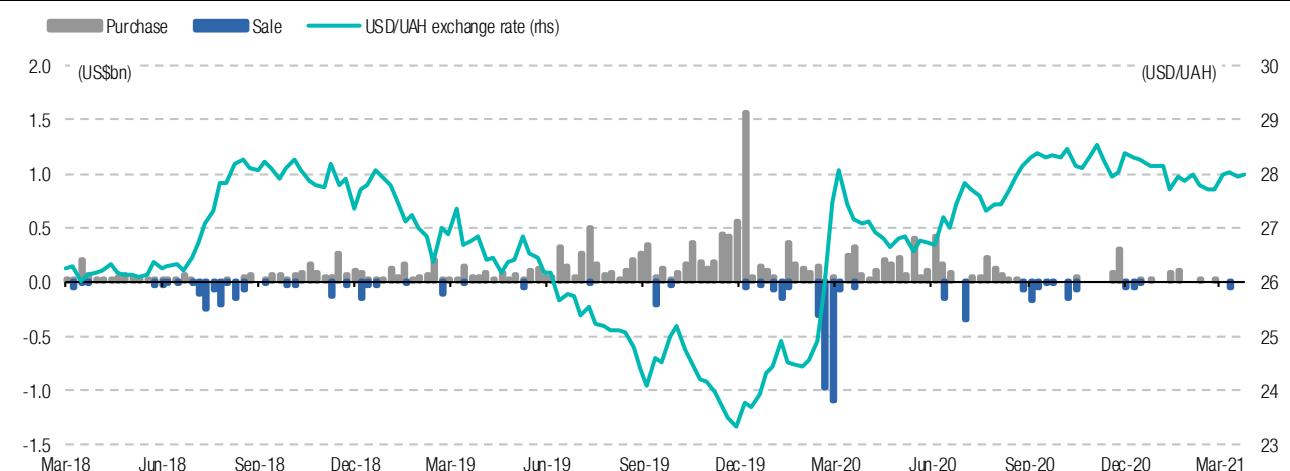
Outflow of funds from foreigners' local-currency bonds portfolio and an increase in imports caused additional demand for hard currency, which balanced the FX market and absorbed seasonal extra supply. The NBU has not intervened in the market for two weeks in a row, although it has demonstrated readiness to smoothen fluctuations. As a result, the hryvnia weakened by a mere 0.2% to UAH27.99/US\$.

**ICU view:** *This week, we do not expect much change in the FX market since foreigners will likely continue to decrease investments in local-currency debt. Therefore, supply of hard currency will not rise, and the hryvnia will continue to fluctuate near UAH28/US\$, mostly slightly below this level.*

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**Chart 5. FX market indicators, 3-year history**

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market and NBU interventions (weekly data)



Source: NBU, Bloomberg, ICU.

# Economics

## NBU hikes the rate to 7.5%

The decisive step by the NBU was determined by a sharp acceleration of inflation and growing geopolitical risks. As does the NBU, we expect that the rate will be kept at the new level for about a year with a further decrease to 7%. As a result of the rate hike, monetary conditions changed from moderately loose to neutral and will remain so until the end of 2022.

The NBU has revised its inflation forecast to 8% this year (compared with 7% in the January forecast) amid rapid global economic recovery and rising inflationary pressures. At the same time, the NBU continues to project inflation returning to the target of 5% in 1H22.

In addition, the NBU revised downward its forecast of real GDP growth from 4.2% to 3.8% in 2021, due to tightening quarantine restrictions. In 2022–2023, economic growth is projected to be close to 4%.

Already this year, the NBU expects the current account to return to deficit (0.8% of GDP), which will significantly expand in the coming years due to deteriorating terms of trade, a decrease in earnings from gas transit, and the recovery of domestic demand. As a result of the planned tranches from the IMF and capital inflows under the financial account, reserves will remain at \$29-30bn.

Forward guidance remained hawkish. The NBU noted the possibility of further rate hikes if underlying inflationary pressures intensify and inflation expectations worsen more significantly.

***ICU view: Although most experts expected the rate to rise by 50 b.p., the NBU's actions did not come as a strong surprise due to the apparent intensification of inflationary pressure. In turn, we expected the rate hike by 50 b.p. during this meeting and up to 7.5% at the next meeting. From our point of view, more gradual tightening was justified by the predominance of non-monetary factors of rising inflation, slowing economic recovery due to tightening of quarantine restrictions, and the importance of restoring lending in the rhetoric of authorities.***

***However, the decision of the NBU once again confirmed that the main focus of monetary policy to bring inflation to the target of 5% remained unchanged even after the change of leadership. We previously wrote that the NBU's reaction to rising inflationary pressures could be a "litmus test" for maintaining the independence of NBU's monetary policy. It seems that the NBU is passing this exam perfectly.***

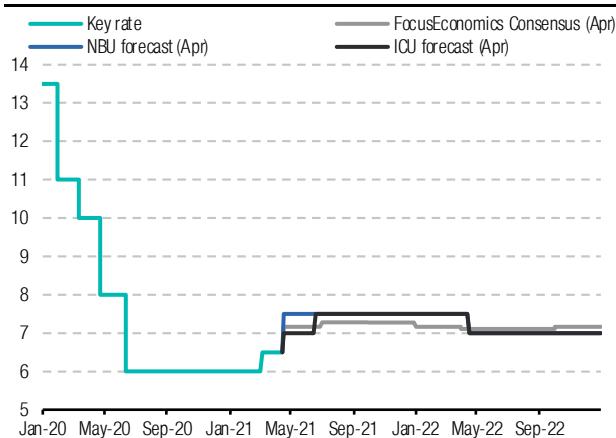
***Our projections for inflation and interest rates almost entirely coincide with the updated NBU forecasts. This will ensure neutral monetary conditions, and the real interest rate in the range of 1-2%, after a period of moderately loose monetary conditions since mid-2020, when the real interest rate fluctuated mainly in the range of 0-1%.***

***In our opinion, the negative effects of quarantine restrictions on economic activity will not be so significant, and at the same time, they will be partially offset by more favourable external conditions. Therefore, the NBU's estimate of GDP growth this year seems to us too conservative. A thorough analysis of the factors of such an estimate can be made after the publication of a full description of the forecast in the "Inflation Report" next Thursday.***

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**Chart 6. NBU rate forecast, %**

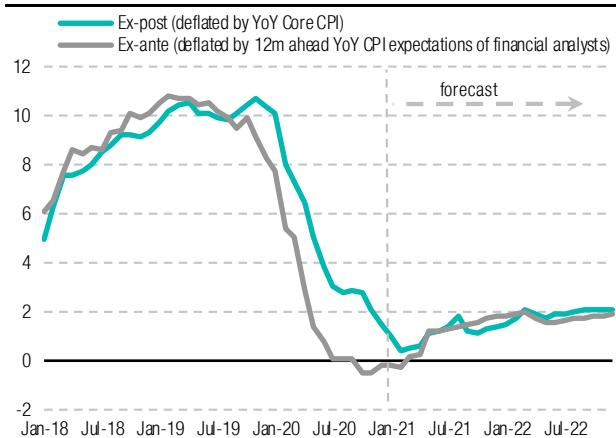
(key rate will remain at the current level about a year and then will be lowered to 7%)



Source: NBU, FocusEconomics, ICU.

**Chart 7. NBU rate in real terms, %**

(monetary conditions switch from moderately loose to neutral and will stay so until end-2022)



Source: NBU, ICU.

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