



Focus
Ukraine

Markets
Domestic liquidity,
government bonds, FX
market, and macro

Research team
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Weekly Insight

Borrowings pick up

Key messages of the today's comments

Domestic liquidity and bonds market

Borrowings pick up

Budget financing improved at the end of April. The amount borrowed in the domestic market rose, and for the first time this year, Ukraine was able to tap the international capital markets and issued new Eurobonds in the amount of US\$1.25bn.

New liquidity record high

Last week, the total amount of banking-sector liquidity rose to UAH217bn, the largest amount this year. But due to quarterly tax payments and new borrowings, liquidity should decline slightly.

Foreign exchange market

A month without interventions

NBU allowed the FX market to self-balance for more than a month, and will continue to act with restraint when possible. However, without the NBU's intervention, the hryvnia appreciated at the end of April and could further appreciate toward UAH27.5/US\$ during May.

Economics

Consumer inflation decelerates slightly

After a rapid acceleration over the previous six months, consumer inflation fell slightly in April to 8.4% YoY, mainly due to the last year's statistical base of comparison. As a result of the ongoing upturn in global food prices, in the following months, pro-inflationary factors should prevail, and we see risks as tilted to the upside for our forecast of end-2021 consumer inflation of 7.8%.

TUESDAY, 11 MAY 2021

Banks' reserves market (7 May 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	7.50	+0bp	-50bp
ON rate (%)	6.73	+18bp	-237bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	51,539	-2.23	+0.93
CDs (UAHm) ³	165,683	+2.65	+14.03

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 gov't bond holders (UAHm) (7 May 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	320,977	+0.00	-1.11
Banks	524,596	-0.06	+46.70
Residents	44,266	+0.14	-12.47
Individuals	16,282	+0.90	+93.47
Foreigners ¹	97,460	+0.01	-12.61
Total	1,003,856	-0.01	+17.73

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (7 May 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.7586	-0.20	+3.44
EUR/USD	1.2166	+1.21	+12.29
DXY	90.233	-1.15	-9.67
UAH TWI ¹	120.153	-0.88	-8.41

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (11 May 2021)

Maturity	Bid	Ask
6m	10.00	8.50
12m	12.00	11.00
2y	12.75	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.

Source: ICU.

Domestic liquidity and bonds market

Borrowings pick up

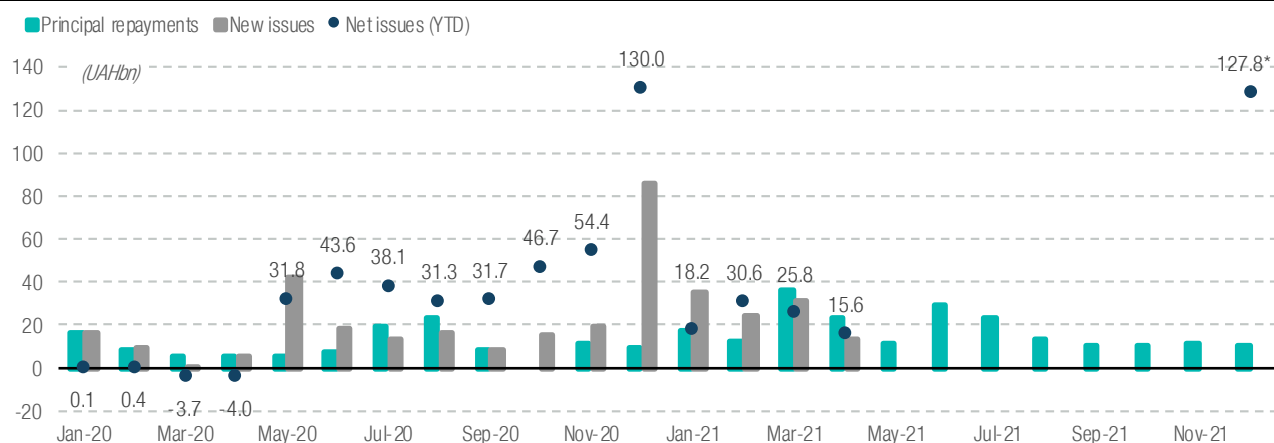
Budget financing improved at the end of April. The amount borrowed in the domestic market rose, and for the first time this year, Ukraine was able to tap the international capital markets and issued new Eurobonds in the amount of US\$1.25bn.

After the NBU hiked its key policy rate, which resulted in a slight increase in interest rates in the primary bonds market, during the last week of April, the MoF was able to borrow more than UAH10bn in different currencies. About 80% of these borrowings were in hryvnia. In April, the MoF borrowed UAH17.6bn, including UAH13.4bn in hryvnia. These funds were borrowed mostly without foreigners' participation, as during most of April, they decreased their portfolios due to concerns of escalating hostilities in the east of Ukraine. Since, market sentiment has improved, the perception of risk is lower, and with positive news about a new Eurobond issue, foreigners stopped withdrawing funds and resumed small purchases.

However, with low activity in the market, net budget financing in hryvnia continued to decline. Banks waited for the MoF's decision about interest rates after the NBU hiked the key policy rate and purchased bonds from foreigners' portfolios. In total, during April, this year's net budget financing declined to UAH15.6bn, as redemptions exceeded new borrowings in local currency by UAH10bn.

Chart 1. UAH-denominated debt redemptions and new borrowings

Monthly, 2020 and 2021



Source: NBU, Bloomberg, ICU.

Overall, total budget financing conditions were favourable in April, as at the end of the month, the MoF tapped the international markets and issued US\$1.25bn Eurobonds at 6.876% interest rate and a 562bp spread to the benchmark. These funds replenished FX accounts to US\$1.6bn at the beginning of May. These funds should be enough to cover FX-denominated debt repayments in May, and with partial refinancing of FX-denominated bills, most of repayments in June.

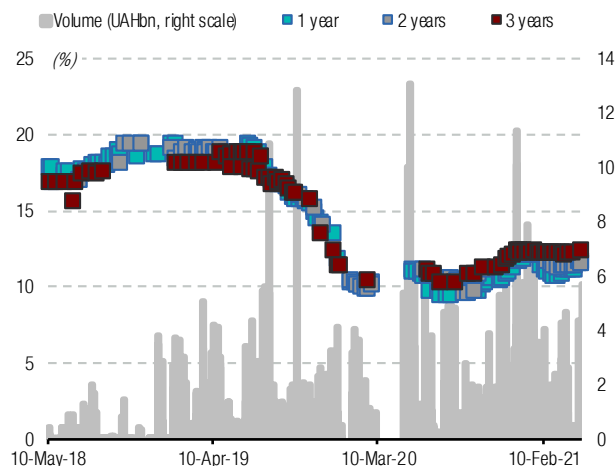
ICU view: This week, the MoF decreased the number of bills offered in the primary auction to three from six. The Ministry excluded the one-and-a-half, two, and six-year instruments. With UAH23bn in the budget accounts at the beginning of the month and a mostly smooth schedule for local-currency repayments in May, the Ministry can borrow small amounts and keep rates unchanged. Additional support for the budget will come from quarterly tax payments, which should start this week. However, we

expect foreigners to abstain from new purchases of local-currency debt in May, but not sell bills and, therefore, keep portfolios steady.

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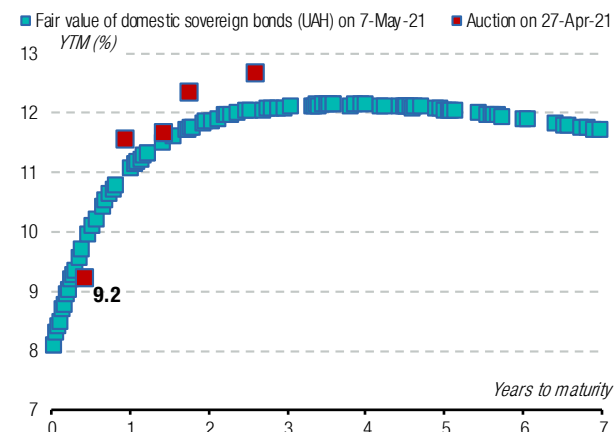
Chart 2. Local-currency bonds

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.

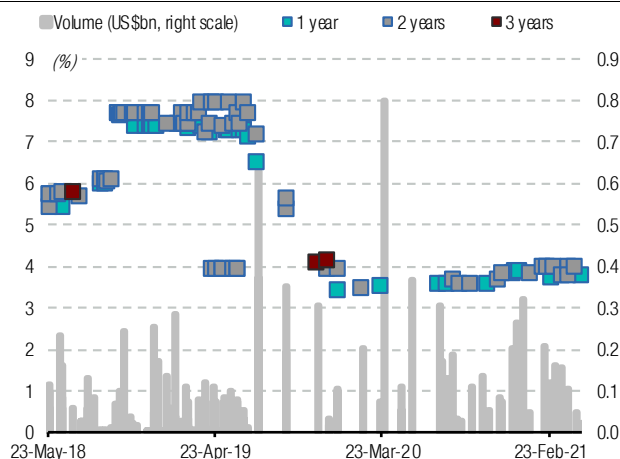
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

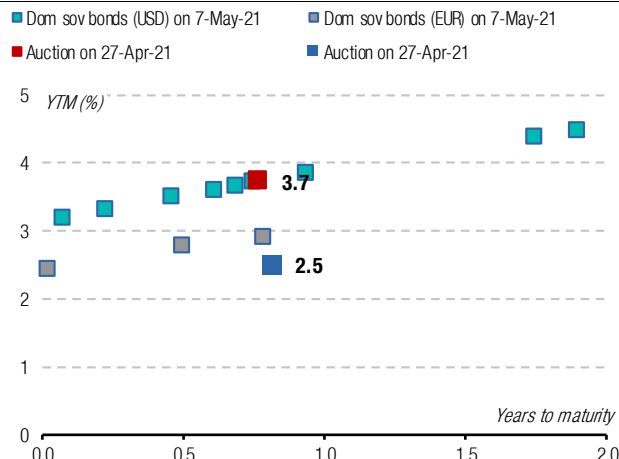
Chart 3. FX-denominated bonds

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.

New liquidity record high

Last week, the total amount of banking-sector liquidity rose to UAH217bn, the largest amount this year. But due to quarterly tax payments and new borrowings, liquidity should decline slightly.

The increase in liquidity was caused by budget expenditures, which last week provided inflow of UAH9.9bn in liquidity vs quite low outflow to cash of UAH1.7bn. Therefore, at the end of last week, banks had UAH162bn of funds in NBU CDs and just UAH53bn in banks' correspondent accounts with the NBU.

ICU view: This week, transactions to budget accounts should rise due to quarterly tax payments, causing outflow of funds from liquidity. Expenditures will be lower than

revenues, partially due to lack of debt redemptions. This should slightly decrease liquidity, but it will stay high, above UAH200bn.

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Chart 4. Banks reserves usages over last week(UAHm)

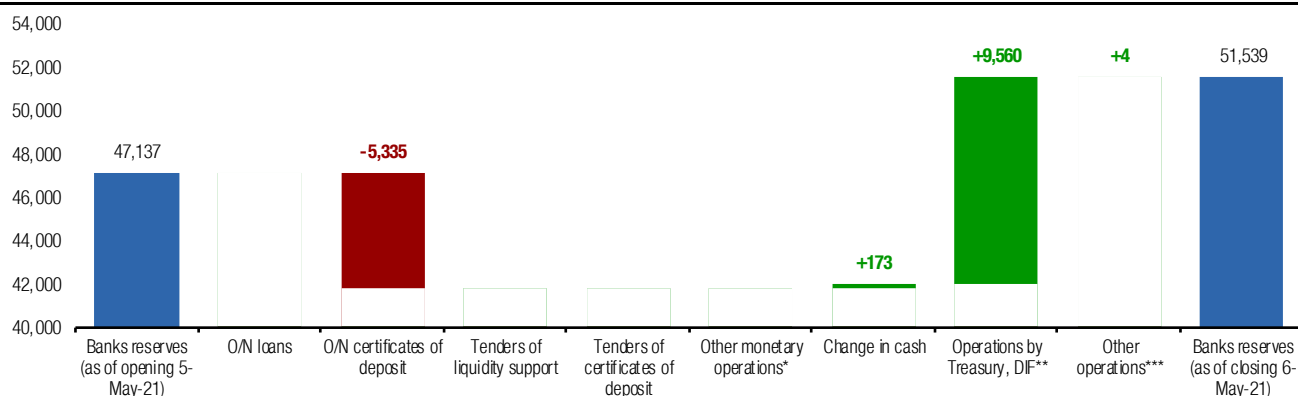
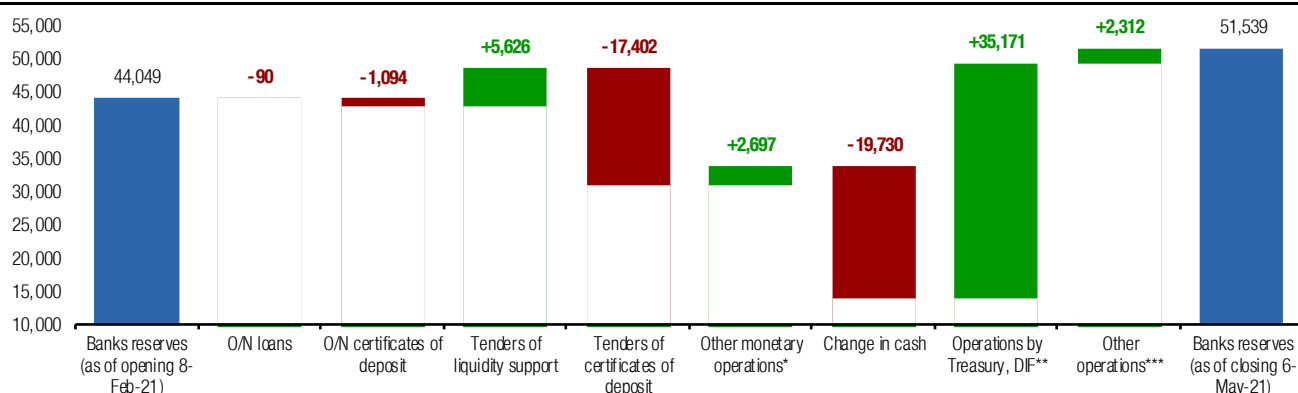


Chart 5. Banks reserves usages over last 90-day period (UAHm)



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

A month without interventions

NBU allowed the FX market to self-balance for more than a month, and will continue to act with restraint when possible. However, without the NBU's intervention, the hryvnia appreciated at the end of April and could further appreciate toward UAH27.5/US\$ during May.

The last time the NBU intervened in the FX market at the beginning of April, it sold US\$50m. This break in interventions is the longest since the end of 2016, when the NBU first published detailed data on banking-sector liquidity, including monetary operations, and later added interventions in the FX market.

During the last two weeks, the hryvnia appreciated by 0.6% to UAH27.76/US\$. There was a positive impact from foreigners' break in withdrawal from local-currency debt, when they stopped selling bonds at the end of April.

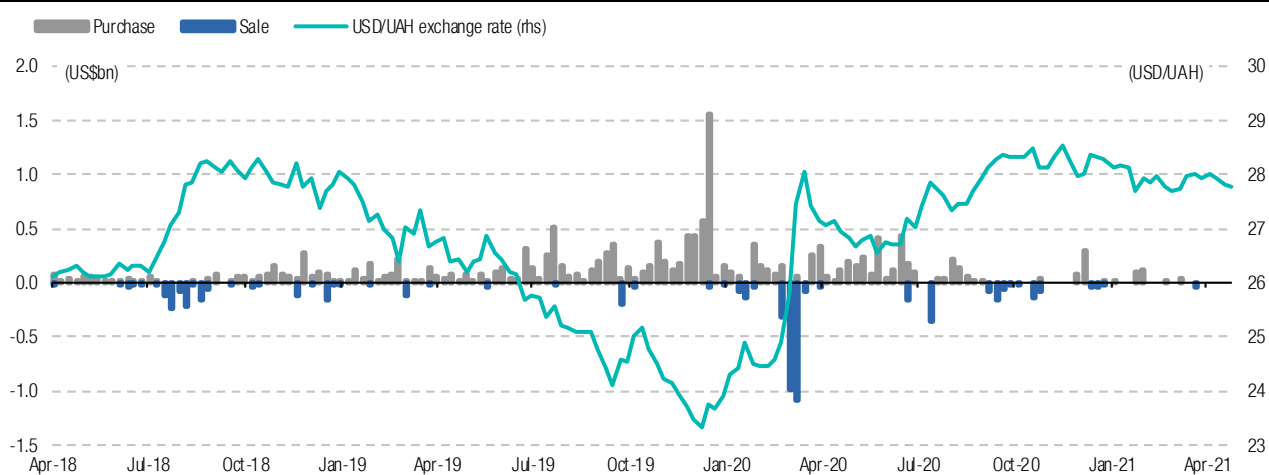
ICU view: In May, the FX market should continue to be mostly self-balanced. The NBU will intervene as a last resort to restrain volatility. Support for the hryvnia will come

from exporters, as they have accumulated good profits due to the positive situation in the global markets and high prices for Ukrainian exports, plus, they will have to sell more hard currency to pay taxes. In addition, the hryvnia will have support from foreigners, as they are not actively selling local-currency debt. As the result, the hryvnia will continue to appreciate slightly towards UAH27.5/US\$.

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Chart 6. 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

Consumer inflation decelerates slightly

After a rapid acceleration over the previous six months, consumer inflation fell slightly in April to 8.4% YoY, mainly due to the last year's statistical base of comparison. As a result of the ongoing upturn in global food prices, in the following months, pro-inflationary factors should prevail, and we see risks as tilted to the upside for our forecast of end-2021 consumer inflation of 7.8%.

In April, consumer prices grew by 0.7% MoM and annual inflation decelerated to 8.4% YoY (from 8.5% YoY in March). The outcome was slightly lower compared with our estimates and Bloomberg consensus (both 8.5% YoY). Core inflation was up to 6.3% YoY from 5.9% YoY in March, as core CPI increased by 0.7% MoM. Thus, core inflation also overshot NBU's target range for the first time since the start of 2019 following headline inflation, which did it in January.

Two groups of factors offsetting each other determined April's outcome. On the one hand, minor MoM increase in prices of oil and gas lead to a sizable acceleration of the corresponding annual growth rate to 24% and 90%, respectively, reflecting the low statistical base from the previous year. On the other hand, food inflation slowed to 9.9% YoY after a surge to 11.0% YoY in March. Such result was mainly caused by a sharp deceleration of egg prices to 90% YoY from 109% YoY in March, while behaviour of other foodstuffs was mixed. In addition, inflation in healthcare fell to 6.2% from 7.4% in March, also reflecting the statistical base from the previous year.

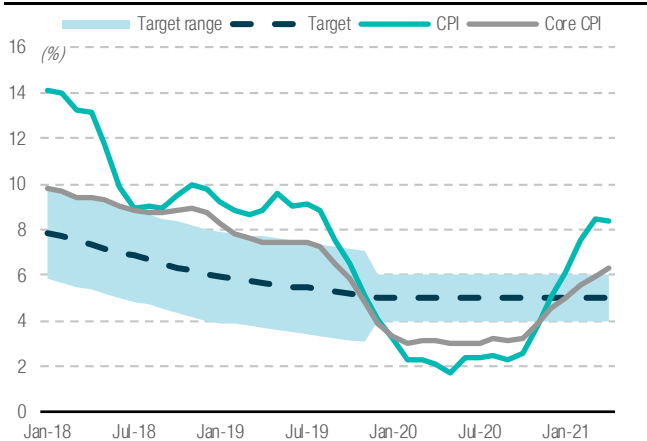
ICU view: Looking ahead, we see additional upside risks stemming from a further rise of global food prices as the April FAO World Food Price index showed the fastest YoY

increase for a decade, of 31%. Since May 2020, food prices surged 33% hitting a seven-year peak. Moreover, oil and gas prices provide additional impetus for domestic inflation. Partially, these global inflation tailwinds are offset by ongoing UAH strengthening, also fuelled by elevated commodity prices. However, its scale is not enough to fully compensate rising global prices, especially accounting for the high share of foodstuffs in the CPI basket (41%). Thus, in the following months, pro-inflationary factors should prevail, and we see risks as tilted to upside for our forecast of end-2021 consumer inflation of 7.8%.

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Chart 7. CPI, core CPI and target, YoY, %

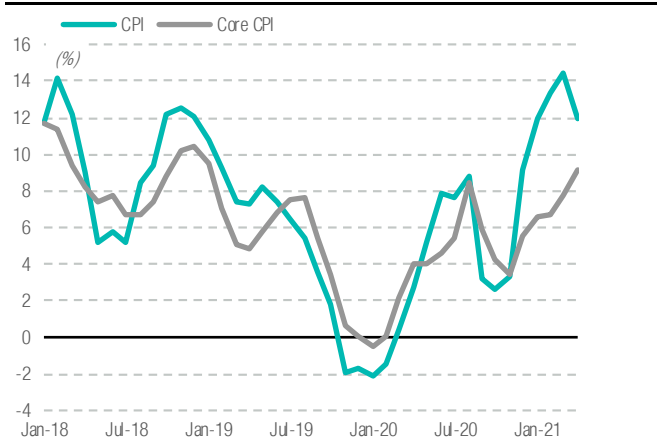
(Core inflation also overshoot NBU's target range for the first time since the start of 2019 following headline inflation (which did it in January))



Source: Ukrstat, NBU, ICU

Chart 8. CPI and Core CPI, 3MA MoM SAAR, %

(Three months moving average of seasonally adjusted annualized rate of growth compared with the previous month)



Source: Ukrstat, ICU.

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