Focus
Ukraine

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

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Weekly Insight

Inflation slows to 26.0% in January

Key messages of the today's comments

Ukrainian bond market

Issuance of "reserve" bonds remains limited

The Ministry of Finance continues to offer "reserve" bonds in limited volumes. At the same time, and for the second week in a row, foreigners continued to sell UAH-denominated bonds.

Eurobond prices decline

Last week, Ukrainian Eurobonds fell in price 3-9% due to the negative news.

Foreign exchange market

Cash hryvnia continues to appreciate

Over the past week, the hryvnia cash exchange rate strengthened even more, although it remains close to UAH40/US$.

Economics

Inflation slowed considerably to 26.0% in January

Consumer inflation considerably decelerated to 26.0% YoY in January from 26.6% in December, which is a significant positive surprise.

NBU reserves up 5% in January to above pre-war level

The NBU gross international reserves increased 5.0% to US$29.9bn in January, which is above the volume the NBU had before russia's invasion.

MONDAY, 13 FEBRUARY 2023

Banks' reserves market (10 February 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	25.00	+0bp	+1,500bp
ON rate (%)	9.76	+0bp	+46bp
Reserves (UAHm)[2]	121,417	-9.51	+202.72
CDs (UAHm)[3]	369,642	+6.82	+123.59

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) (10 February 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	699,470	+0.00	+125.56
Banks	519,287	+1.45	-4.11
Residents	109,437	+1.67	+35.53
Individuals	32,128	+10.28	+29.30
Foreigners[1]	62,795	-0.86	-20.66
Total	**1,425,694**	**+0.83**	**+37.54**

Source: NBU, ICU.

FX market indicators (10 February 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.8592	-0.20	+31.98
EUR/USD	1.0678	-1.08	-6.56
DXY	103.630	+0.69	+8.45
UAH TWI[1]	111.634	+0.81	-11.21

Notes: [1] UAH trade-weighted index.
Source: Bloomberg, ICU.

Market gov't bond quotes[1] (13 February 2023)

Maturity	Bid	Ask
6m	**20.00**	**15.00**
12m	**24.00**	**18.00**
2y	**25.00**	**21.00**
3y	**25.00**	**21.00**
12m ($)	**6.00**	**4.50**
2y ($)	**N/A**	**N/A**

Source: ICU.

Ukrainian bond market

Issuance of "reserve" bonds remains limited

The Ministry of Finance continues to offer "reserve" bonds in limited volumes. At the same time, and for the second week in a row, foreigners continued to sell UAH-denominated bonds.

Last week, the Ministry of Finance sold another UAH5.5bn of "reserve" bonds, although demand was in excess of UAH32bn. Demand for other UAH instruments was low. See details in the auction review.

Over UAH12bn of local-currency bonds will be redeemed this week, so the MoF plans to offer four UAH-denominated bills tomorrow, including a "reserve" bond with a volume cap of UAH7bn. The refinancing of the larger part of the upcoming redemptions should be guaranteed.

The volume of trades in the secondary market decreased sharply to UAH3.5bn. The largest share of trades, for UAH1.8bn, was nothing but a resale of "reserve" bonds after the auction. Another UAH1.4bn was the trade in bills maturing in 2025–2026, of which foreign investors have a large holding. At the same time, foreigners likely (surprisingly) abstained from buying securities with maturities after April 1, when they will have the opportunity to repatriate the redemptions, and the volume of trades in bills with maturity in April and May this year fell to UAH160m.

Over the past week, banks increased their portfolios of UAH bonds by UAH5.3bn thanks to "reserve" bills. Non-banking institutions and individuals also continued to grow their portfolios steadily albeit in small volumes, and foreigners reduced their portfolios by UAH248bn.

ICU view: Banks are primarily interested in "reserve" bills so as to invest the required reserves into interest-earning assets. Hence, the demand for this paper will significantly exceed supply. But the Ministry of Finance will continue to sell such bills in small amounts and is unlikely to revise the offered amount tomorrow. Therefore, as in previous weeks, competition among bidders is expected to be high, and some may lower the interest rates in bids. Therefore, the MoF will be able to refinance more than half of this week's redemption with this bond.

Foreigners are likely among the owners of the bond that MoF redeems this week. We do not expect them to be active in the primary auction, and most likely, they will try to buy bonds maturing in April or shortly thereafter to be able to repatriate their funds. At the same time, last week's most actively traded bonds were those maturing in 2025 and 2026, and may have been the sell-off by foreign investors.

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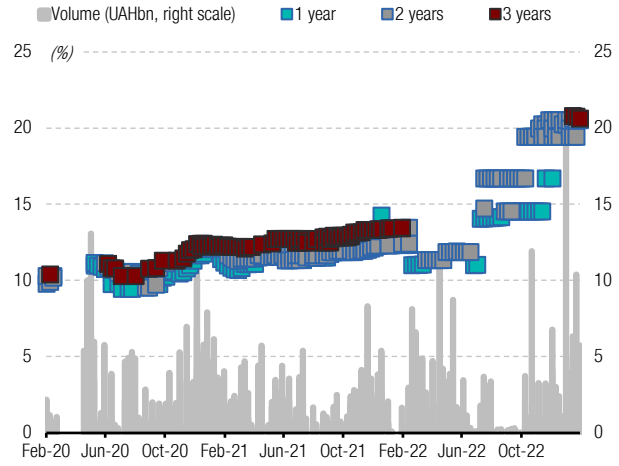
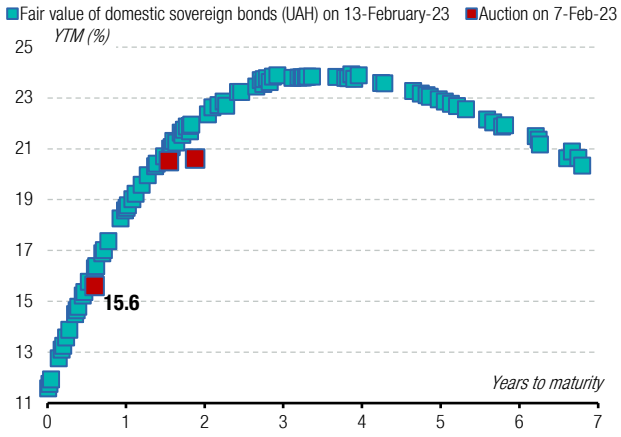
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

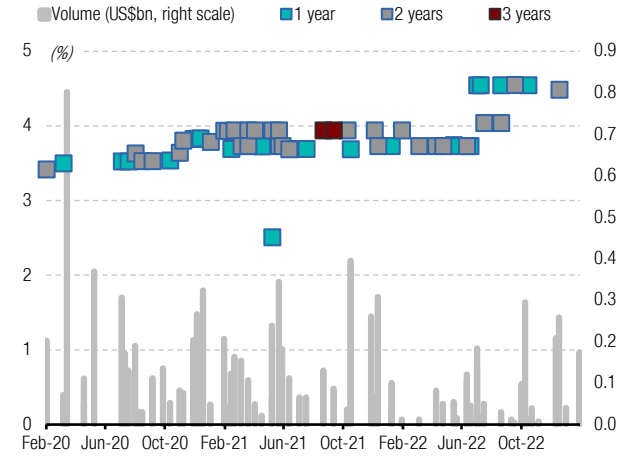
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, 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: MFU, ICU.

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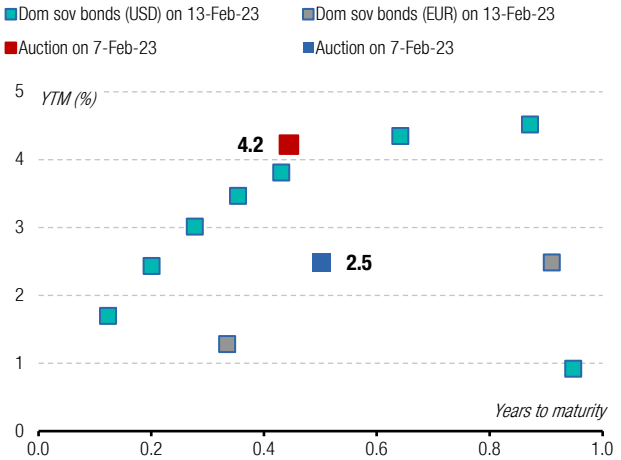

Source: NBU, MFU, ICU.

Eurobond prices decline

Last week, Ukrainian Eurobonds fell in price 3-9% due to the negative news.

In general, Eurobond prices declined by about one-two cents. Currently, prices range from 18 to 24 cents, down from 20–25 during the previous few weeks. VRIs lost almost 13% in price, fell to 28 cents of notional value from 32 cents a week ago.

ICU view: In general, the correction in price for Ukraine paper is a reflection of the weakening of interest in emerging markets globally. But last Friday, Ukrainian risks increased further due to news that a new potential offensive by the russian army was in the offing and its partial successes in some areas on the battlefield. It is very likely that this week market will see additional pressure due to Moody's decision to downgrade Ukraine's sovereign rating to Ca from Caa3.

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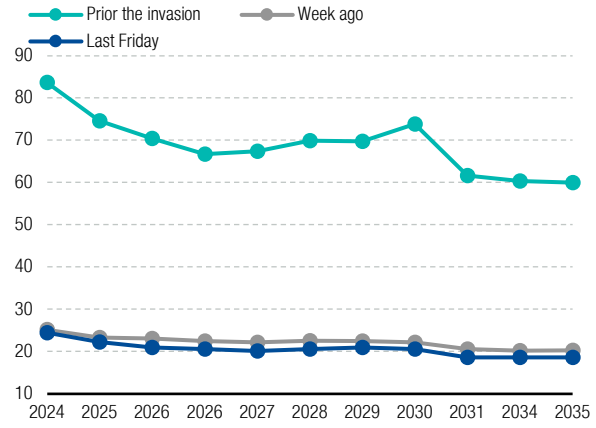
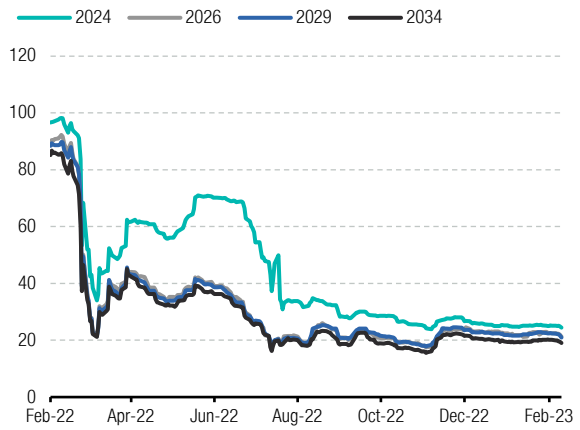
Chart 3. Ukrainian Eurobonds prices

Prices of USD-denominated Eurobonds as of last Friday, prior the russian invasion and a week before



Source: Bloomberg, ICU.

Historical data since February, 2022



Source: Bloomberg, ICU.

Foreign exchange market

Cash hryvnia continues to appreciate

Over the past week, the hryvnia cash exchange rate strengthened even more, although it remains close to UAH40/US$.

The cash rate at the leading retail banks strengthened further last week by 0.3% from UAH39.6–40.3/US$ to UAH39.4–40.2/US$.

At the same time, the NBU reduced interventions on the interbank market to US$679m.

ICU view: The dynamics of household hard currency purchases remain within the usual amounts and currently have no impact on the cash exchange rate. Part of their FX purchase transactions gradually shifted from cash to the non-cash segment, where they buy hard currency to replenish their US dollar and euro deposits. The deficit in the interbank market remains within the expected volumes, and NBU's interventions fully cover it. Decline in last week's interventions cased by lower imbalances in bank clients' transactions.

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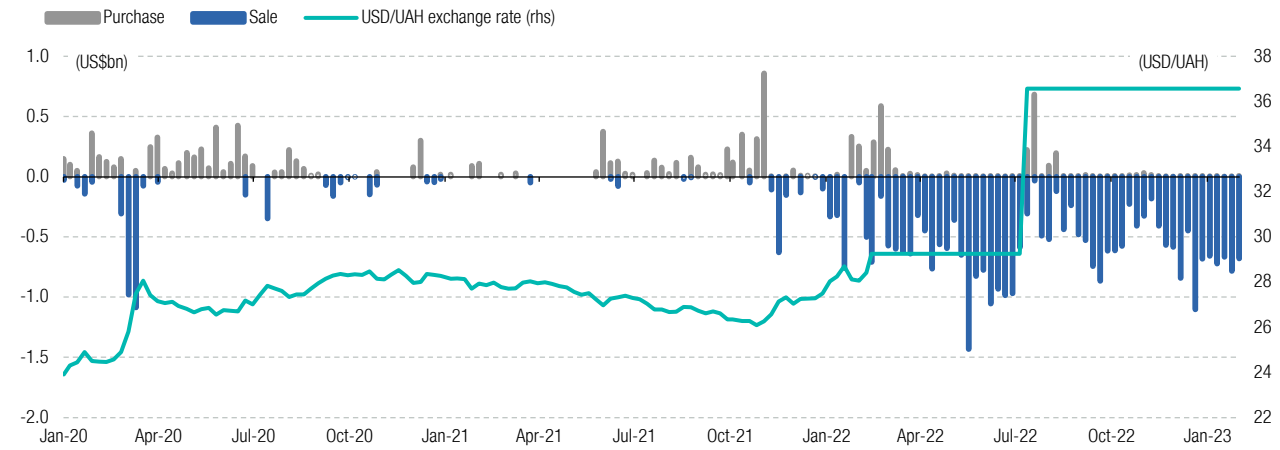
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Inflation slows considerably to 26.0% in January

Consumer inflation considerably decelerated to 26.0% YoY in January from 26.6% in December, which is a significant positive surprise.

Annual price growth for food slowed to 32.5% from 34.4% and for gasoline to 61.8% from 69.4%. Those are the two components of the consumer basket that have the largest contribution to inflation. Other less significant components had a mixed dynamic. The annual price growth for utilities, clothing, and education continues to remain in single digits.

ICU view: Monthly inflation has been relatively stable at 0.7–0.8% since November 2022, which we take as a clear indication the inflationary pressures have started to ease. Earlier, we expected annual inflation would embark on a firm decelerating trend starting in March, so a sharp deceleration in January is a great positive surprise. We believe nearly all preconditions are now in place for a slowdown in annual CPI throughout 2023. Global food prices are declining, and energy prices also fell back from their highs and remain relatively stable. The hryvnia exchange rate is likely to remain broadly stable at least in 1H23, and government is very unlikely to revise utility tariffs for households up significantly. Consumer inflation will, thus, nearly certainly decelerate to below 20% YoY by the end of 2023.

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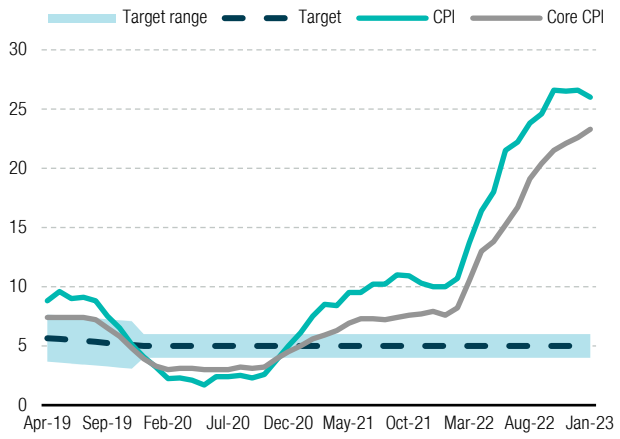
Chart 5. CPI, core CPI and target, YoY, %

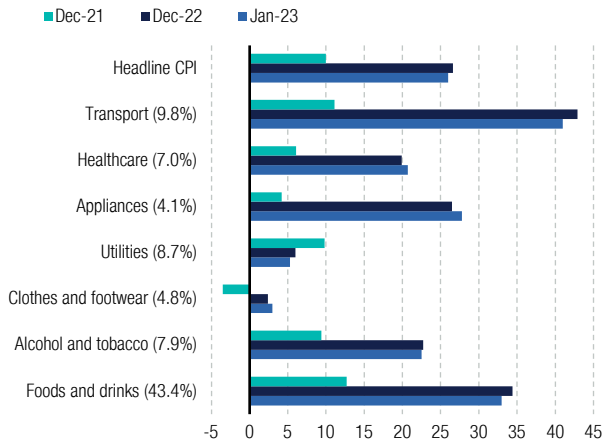
Annual inflation decelerates sharply in January



Source: Ukrstat, NBU, ICU.

Chart 6. CPI and its main components, YoY, %

Prices for food and transport decelerated notably



* numbers in brackets indicate the share of the component in consumer basket

Source: Ukrstat, ICU.

NBU reserves up 5% in January to above pre-war level

The NBU gross international reserves increased 5.0% to US$29.9bn in January, which is above the volume the NBU had before russia's invasion.

The boost in reserves came on the back of a EUR3.0bn loan from the EU and a US$1.0bn grant from the US. Meanwhile, the NBU had to sell US$3.1bn to close the gap on the FX interbank market.

ICU view: The NBU is in a position to keep accumulating reserves gradually through 2023 thanks to significant commitments of international financial aid from foreign governments and IFIs. The inflow of foreign grants and loans is unlikely to be even through the year, while a significant gap on the interbank market, and the NBU sale interventions will remain steady. Thus, NBU reserves might see some month-to-month fluctuations. All in, there is very good chance that end-2023 reserves will be in the range of US$30–35bn.

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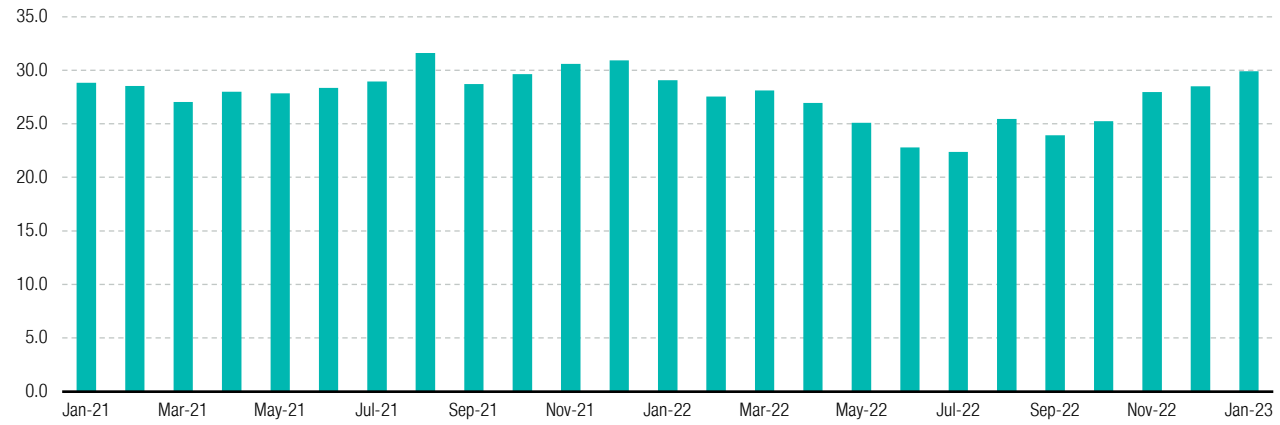
Chart 7. NBU gross international reserves, US$bn

NBU reserves up 5% in January



Source: NBU, ICU.

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