

Weekly Insight

Yields of Ukrainian bonds rise

Key messages of the today's comments

Domestic liquidity and bonds market

Yields of Ukrainian bonds rise

Last Tuesday, the Ministry of Finance raised interest rates on local-currency bonds by 5-50bp in response to demand from auction participants, as this auction was the first after the increase in the NBU key policy rate. Interest rates may rise tomorrow, too.

Foreign exchange market

Hryvnia is weakening under demand pressure

Demand for hard currency continues to put pressure on the hryvnia exchange rate, causing tension among market participants. The increase in foreigners' investments is not enough to balance the market, so fluctuations will continue this week.

MONDAY, 20 DECEMBER 2021

Banks' reserves market (17 December 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	9.00	+0bp	+300bp
ON rate (%)	8.42	+25bp	+313bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	69,130	+37.45	+13.69
CDs (UAHm) ³	134,552	-10.42	+38.68

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) (17 December 2021)

	Last	Weekly chg (%)	YoY chg (%)
NBU	312,606	+0.00	-3.69
Banks	515,392	-0.85	+6.30
Residents	79,487	-0.11	+102.20
Individuals	23,809	-2.75	+153.78
Foreigners ¹	93,330	+1.06	+14.97
Total	1,024,624	-0.40	+9.06

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (17 December 2021)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.2525	+0.80	-2.08
EUR/USD	1.1240	-0.65	-8.38
DXY	96.565	+0.49	+7.51
UAH TWI ¹	131.241	+0.53	+10.80

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (20 December 2021)

Maturity	Bid	Ask
6m	11.75	10.50
12m	12.50	11.50
2y	13.25	12.25
3y	13.50	12.75
12m (\$)	4.00	3.00
2y (\$)	4.50	3.25

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

Source: ICU.

Domestic liquidity and bonds market

Yields of Ukrainian bonds rise

Last Tuesday, the Ministry of Finance raised interest rates on local-currency bonds by 5-50bp in response to demand from auction participants, as this auction was the first after the increase in the NBU key policy rate. Interest rates may rise tomorrow, too.

Demand in last week's auction was not very high, as some investors likely postponed participation in the primary auction until they see the Ministry's reaction to the key policy rate increase. Only UAH10.8bn was raised for the budget, of which just UAH5.8bn was from UAH-denominated bills. In general, there is a preference in demand for short-term UAH-denominated bills, and longer instruments are also received good demand. The largest increase in rates was for the shortest maturities—the two-month paper—which immediately rose by 50bp to 10.5%, keeping the premium to the NBU key policy rate at 150bp. More details about the auction are in our review.

The investor universe has changed, although not dramatically. Most bills were bought by banks, less by non-banking institutions and individuals, but for the second week in a row, foreigners bought a small amount of new bonds at the auction, increasing their portfolios. This time, they bought approximately UAH1.5bn of securities, likely the ones due in 2023, which the Ministry of Finance sold for UAH1.4bn. Therefore, active purchases of bonds in the primary market again resulted in low activity in the secondary market, where turnover increased by only UAH2.2bn to UAH7bn compared with the previous week.

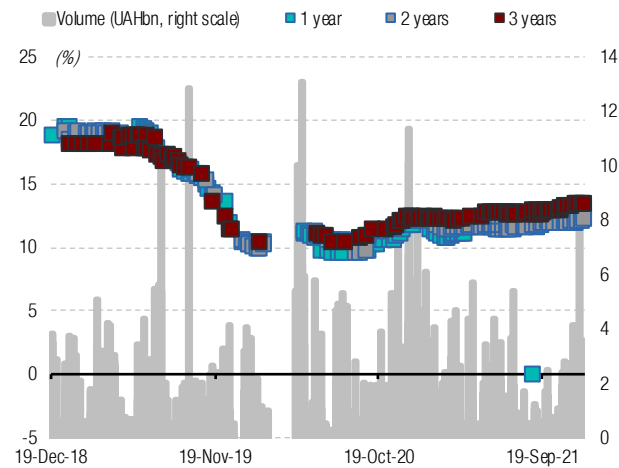
Yields on Ukrainian Eurobonds have also risen, as investors are very wary of information about a possible Russian invasion and about further developments after the Putin-Biden talks. Therefore, evaluating Russia's proposals for NATO non-expansion to the east, they lowered the prices of Eurobonds to 90-103 and pushed yields to 7.7-9.2%.

ICU view: Foreigners continue to cautiously buy UAH-denominated paper, believing that the current exchange rate and interest rates are comfortable to enter hryvnia assets. It is too early to talk about more active investments from this group. In general, information around the security situation on the border with Russia remains largely negative, pushing all yields across Ukraine upwards, and fluctuations will continue this week. However, foreigners may continue to buy UAH-denominated assets in small amounts, as the current hryvnia exchange rate is already more attractive than it was in November.

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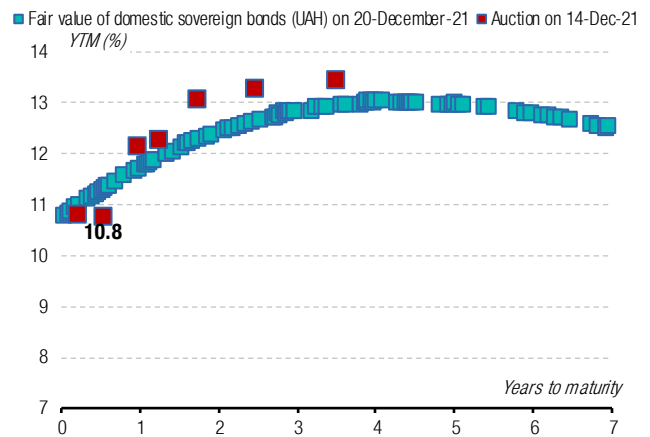
Chart 1. Local-currency bonds

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.

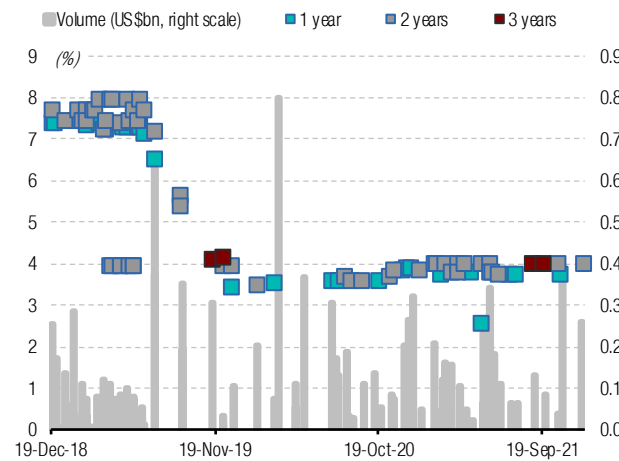
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

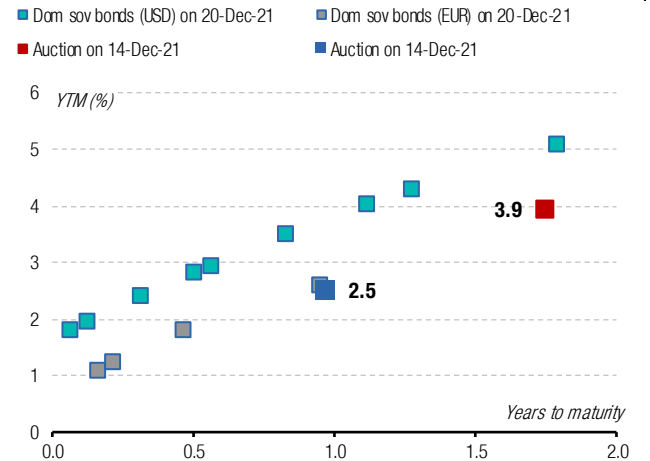
Chart 2. FX-denominated bonds

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.

Foreign exchange market

Hryvnia is weakening under demand pressure

Demand for hard currency continues to put pressure on the hryvnia exchange rate, causing tension among market participants. The increase in foreigners' investments is not enough to balance the market, so fluctuations will continue this week.

Declining temperature and preparations for the winter holidays increase importers' needs for hard currencies, but sellers of hard currency are in no hurry. After all, if demand continues to dominate, the hryvnia exchange rate may weaken, especially in the face of higher budget expenditures and VAT refunds, which may take place this week.

Foreigners' purchase of almost UAH1.5bn of UAH-denominated paper did not help balance the market. The NBU was forced to intervene in the FX market on Tuesday and Wednesday (when non-residents could sell hard currency for bonds purchases) and sold US\$132.5mn to

satisfy demand, as last week the volume of hard currency purchases among banks clients was greater than sales.

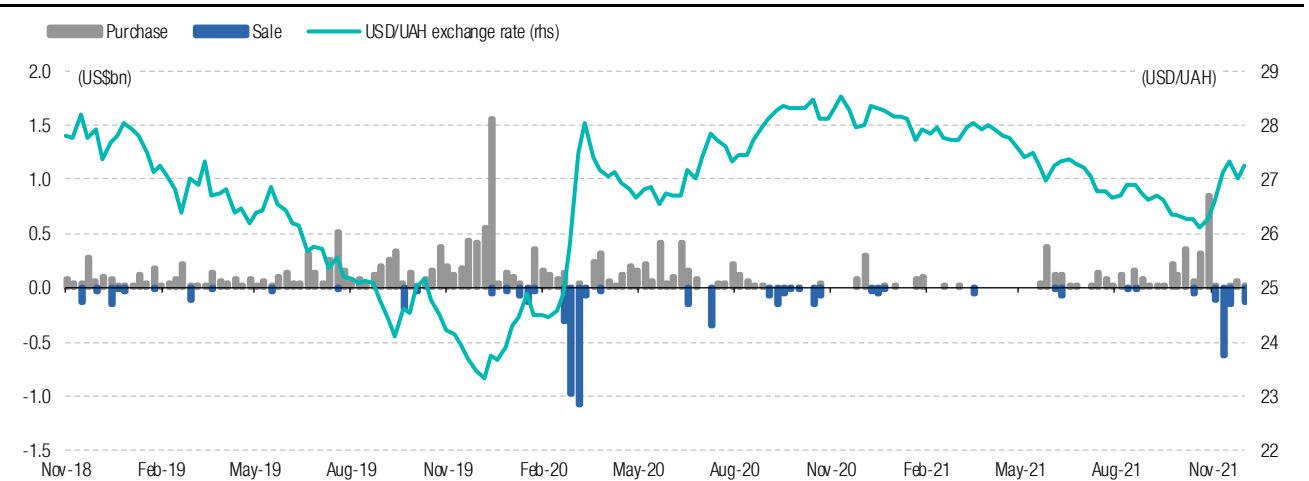
Therefore, at the end of the week, the hryvnia weakened by 0.8% to UAH27.25/US\$, although it has strengthened by 3.8% YTD.

ICU view: Accelerated budget expenditures, VAT refunds and increased imports will continue to put pressure on the hryvnia, but the NBU is unlikely to allow this year the exchange rate to weaken by more than UAH27.5/US\$. Therefore, fluctuations will continue, but inflows from foreign investors and the need of exporters for hryvnia liquidity at the end of the year may help balance the exchange rate within the range of UAH27-27.5/US\$ this week, but closer to UAH27.5/US\$.

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Chart 3. 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.

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