

Weekly Insight

Hryvnia weakens as liquidity flows in

Key messages of the today's comments

MONDAY, 10 JANUARY 2022

Domestic liquidity and bonds market

Active budget borrowings could be behind us

At the end of 2021, the Ministry of Finance increased borrowings through the domestic bond market, but the beginning of the year will be less active with smaller borrowings than last month.

Foreign exchange market

Hryvnia weakens as liquidity flows in

VAT refunds and local-currency debt redemptions partially in favour of foreign investors increased demand-side pressures in the FX market and weakened the hryvnia exchange rate. This week, economic activity will begin to gradually recover after the holidays that may cause new exchange rate fluctuations.

Banks' reserves market (6 January 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	9.00	+0bp	+300bp
ON rate (%)	8.23	-6bp	+345bp
ON \$ swap (%)	N/A
Reserves (UAHm) ²	41,542	-43.78	-4.48
CDs (UAHm) ³	215,648	+23.91	+33.73

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) (6 January 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	312,606	+0.00	-3.69
Banks	539,728	-1.35	+3.81
Residents	82,217	-1.10	+41.50
Individuals	24,962	-0.79	+122.51
Foreigners ¹	90,852	-1.94	+6.52
Total	1,050,442	-0.97	+5.12

Notes: [1] non-residents

Source: NBU, ICU.

FX market indicators (6 January 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	27.4938	+0.77	-2.75
EUR/USD	1.1297	-0.64	-8.36
DXY	96.320	+0.68	+7.58
UAH TWI ¹	129.291	+0.05	+10.90

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Gov't bond quotes¹ (10 January 2022)

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

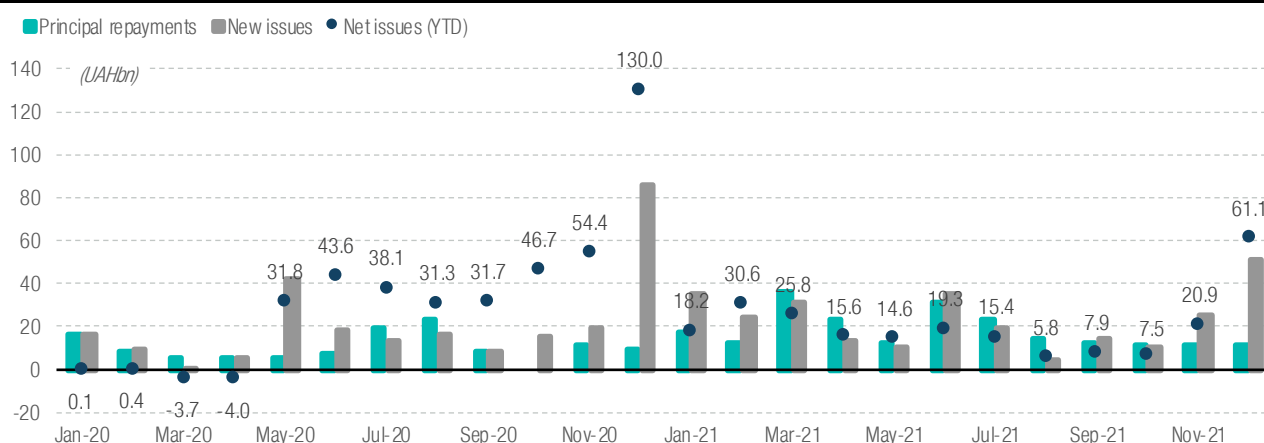
Active budget borrowings could be behind us

At the end of 2021, the Ministry of Finance increased borrowings through the domestic bond market, but the beginning of the year will be less active with smaller borrowings than last month.

In December, the MoF raised almost UAH63bn from primary bond auctions. The amount raised in the auction held on 21 December was a record high last year, and a total of UAH390bn was raised by the MoF last year. In local currency, net borrowings (or financing of budget deficit) amounted to UAH61bn. But in hard currency, the MoF was not able to refinance all FX-denominated domestic redemptions in full. Borrowings were the equivalent of UAH109bn, when full-year principal repayments amounted to UAH122bn.

Chart 1. UAH-denominated debt redemptions and new borrowings

Monthly, 2020 and 2021



* Assumed amount of local-currency budget financing to meet budget requirements

Source: NBU, Bloomberg, ICU.

The increase in borrowings and acceleration in budget deficit financing were facilitated by the offering of short-term bills and raising interest rates on UAH-denominated paper.

In total, domestic bonds outstanding were up by UAH62bn last year, including UAH48bn increase in December. Only the NBU decreased its portfolio by UAH12bn last year, while all other groups of investors increased their portfolios. Banks increased portfolio by UAH27.6bn and non-banking institutions by UAH25.2bn. Individuals more than doubled their portfolio adding UAH14bn in local-currency bonds. The share of UAH-denominated bonds in the total bond portfolio of individuals thus increased to 47% from 33% at the beginning of the last year.

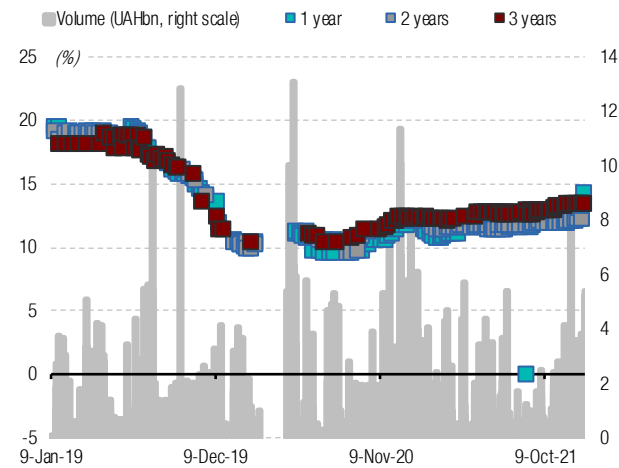
Foreign investors increased their holdings of bonds in 1H21 and decreased their presence in the market and exposure in 2H21. Therefore, last year their portfolio rose by only UAH7.4bn to UAH92.6bn or stood at 8.6% in total domestic bonds outstanding at the end of 2021.

ICU view: Although the Ministry of Finance plans to offer short-term bills in January, large borrowings should not be expected as most of redemptions scheduled for January were already paid last week. The Ministry of Finance will not offer FX-denominated bills this week and plans hard-currency borrowings next week to refinance redemptions in US dollars scheduled for this Wednesday.

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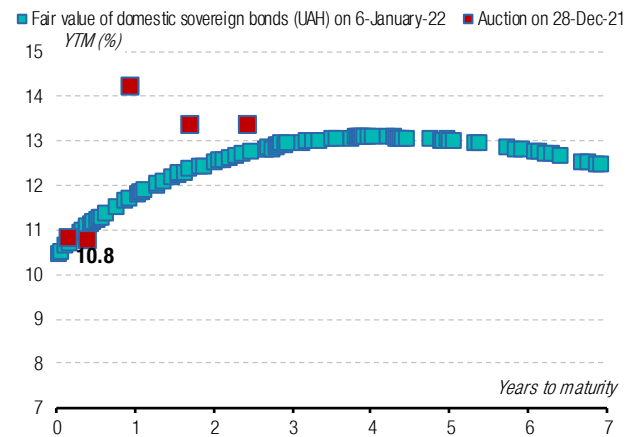
Chart 2. Local-currency bonds

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.

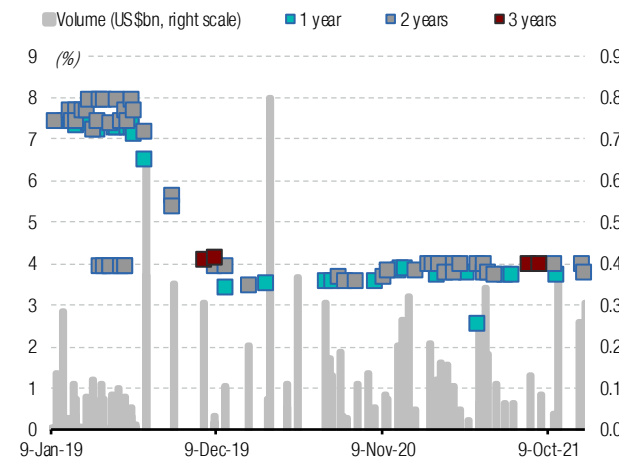
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

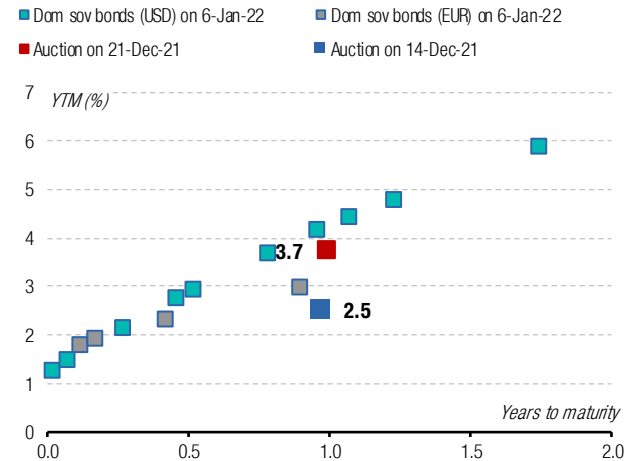
Chart 3. FX-denominated bonds

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.

Foreign exchange market

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VAT refunds and local-currency debt redemptions partially in favour of foreign investors increased demand-side pressures in the FX market and weakened the hryvnia exchange rate. This week, economic activity will begin to gradually recover after the holidays that may cause new exchange rate fluctuations.

In December, VAT refunds again exceeded UAH17bn, but considerable amount of local-currency liquidity was absorbed to budget through local-currency borrowings. Therefore, the hryvnia exchange rate fluctuations at the end of the year were low, in the range of UAH27.2–27.3/US\$.

But in early January, there was a redemption of UAH-denominated debt of about UAH10bn, of which more than UAH1.8bn was paid to foreigners. This repayment, in general, increased

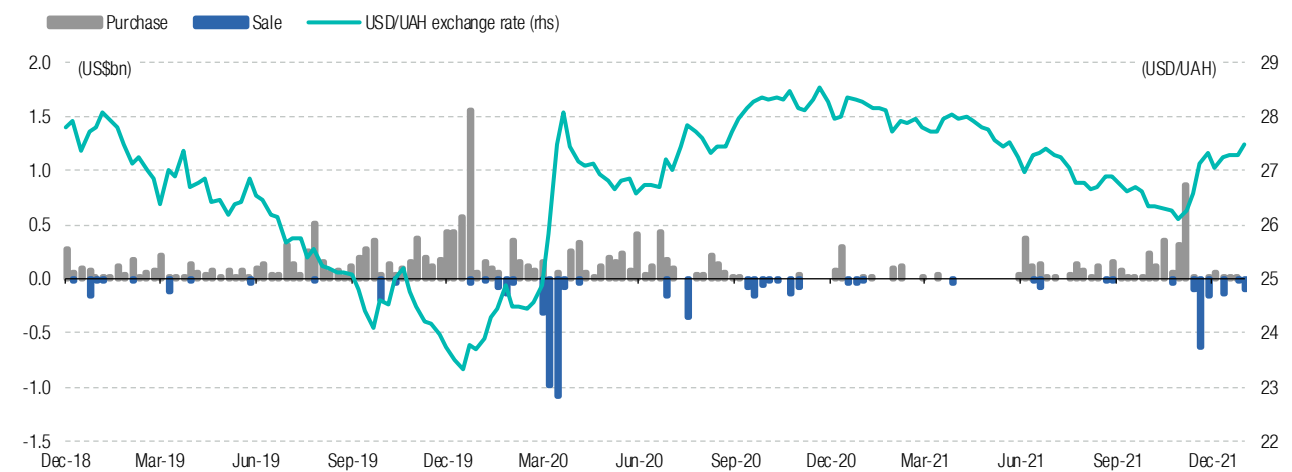
both hryvnia liquidity and demand for hard currency. To meet excess demand, the NBU sold US\$100m from reserves, which was the first intervention in the FX market in 2022.

ICU view: There will be no UAH-denominated debt repayments this week implying no extra demand for hard currency from foreign investors. On the contrary, US\$170m will be redeemed in local USD-denominated bills this Wednesday, satisfying part of banks' clients' needs in hard currency. Economic activity will begin to recover this week, so imbalances in the FX market will persist, causing exchange rate fluctuations. Nevertheless, we expect the hryvnia exchange rate will be close to UAH27.5/US\$ this week.

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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.

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