Focus
Ukraine

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

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Weekly Insight

Public debt below 50% of GDP at end-2021

Key messages of the today's comments

MONDAY, 31 JANUARY 2022

Domestic liquidity and bonds market

Foreigners leave local-currency debt market

General negative sentiment due to Russia's possible invasion of Ukraine and expectations of further interest rates increases for local-currency debt prompted foreigners to further reduce their exposure to Ukraine and decrease UAH-denominated bills in their portfolios.

The Eurobond market is hot again

Last week began with another sharp jump in Eurobond yields, but with the gradual change in the Kremlin's rhetoric, the market calmed down a bit.

Foreign exchange market

The hryvnia at seven-year low

Last week, the hryvnia temporarily weakened to a seven-year low and repeatedly crossed the level of UAH29/US$ on Thursday. But Russia's calming rhetoric helped strengthen the hryvnia on Friday. Hryvnia continued to strengthen on Monday morning.

Economics

Public debt below 50% of GDP at end-2021

Ukraine's public debt (direct and guaranteed) increased 8.5% YoY in 2021 to $98bn. This is just below 50% of 2021 GDP based on our estimates, a decline from 60.8% of GDP in 2020.

Banks' reserves market (28 January 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	10.00	+0bp	+400bp
ON rate (%)	9.43	+13bp	+426bp
ON $ swap (%)	N/A	...	...
Reserves (UAHm)[2]	49,673	-36.18	-23.15
CDs (UAHm)[3]	141,253	-0.23	+9.16

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) (28 January 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	310,106	+0.00	-4.46
Banks	557,172	+1.08	+6.64
Residents	84,754	+1.82	+42.36
Individuals	26,026	+0.17	+111.57
Foreigners[1]	81,838	-3.81	-13.29
Total	**1,060,076**	**+0.42**	**+4.61**

Source: NBU, ICU.

FX market indicators (28 January 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	28.7049	+1.60	+1.95
EUR/USD	1.1151	-1.70	-8.01
DXY	97.270	+1.70	+7.53
UAH TWI[1]	124.920	-0.43	+5.30

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

Market gov't bond quotes[1] (31 January 2022)

Maturity	Bid	Ask
6m	**13.50**	**10.75**
12m	**15.00**	**12.00**
2y	**15.50**	**13.00**
3y	**16.50**	**13.50**
12m ($)	**4.00**	**3.00**
2y ($)	**4.50**	**3.25**

Source: ICU.

Domestic liquidity and bonds market

Foreigners leave local-currency debt market

General negative sentiment due to Russia's possible invasion of Ukraine and expectations of further interest rates increases for local-currency debt prompted foreigners to further reduce their exposure to Ukraine and decrease UAH-denominated bills in their portfolios.

Foreigners' portfolios of UAH-denominated debt continue to shrink with slight acceleration. Over the past week, their portfolios decreased by another UAH3bn, and since the beginning of the year, portfolios have declined by UAH11bn to UAH81.5bn. According to the NBU, for the second week in a row, notes due 2025, which were very popular among foreigners, were the most traded on the secondary market. Over the past week, the volume of transactions with this instrument amounted to more than UAH4.3bn, or more than a third of the total turnover of UAH-denominated bonds in the secondary market.

High activity in the secondary bond market and the sale of bonds by foreign investors decreased investors' interest in the primary auctions. Of the four securities offered last week, two were not sold because the MoF decided it was not worth it to raise rates for small amounts of money. Less than UAH3bn was attracted to the budget from three-month bills with an increase in the cut-off rate of 55bp to 11.5%. More details in the auction review.

ICU view: Currently, the situation is not favourable for increasing foreign investors' investments in UAH-denominated debt, and we expect their portfolios to continue to shrink in the coming weeks. Threats of a possible Russia's aggression, as well as the general shift of investors' interest to dollar assets are among the key factors that play a role here.

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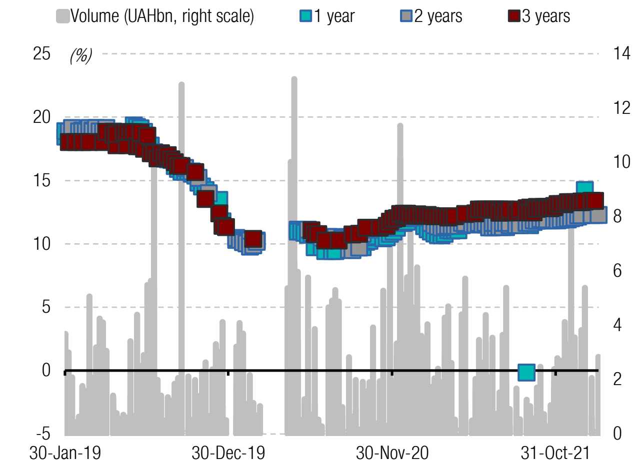
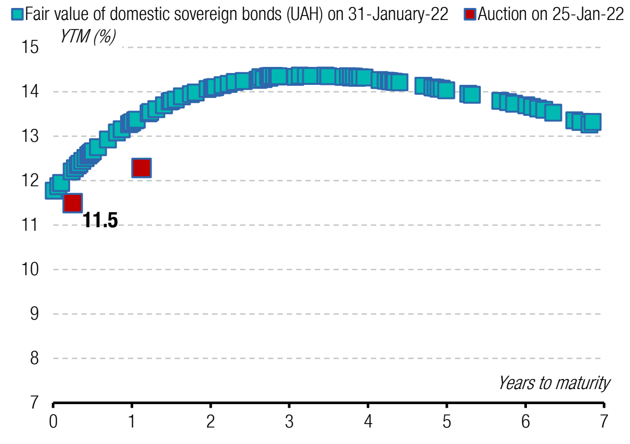
Chart 1. Local-currency bonds

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.

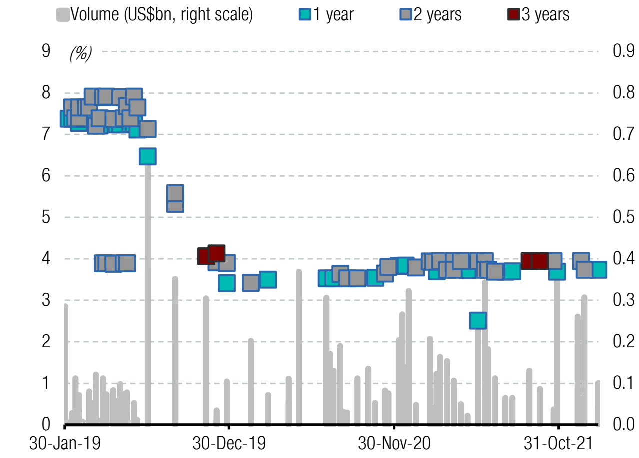
YTMs of domestic government bonds calculated by NBU versus placements via primary market auctions



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

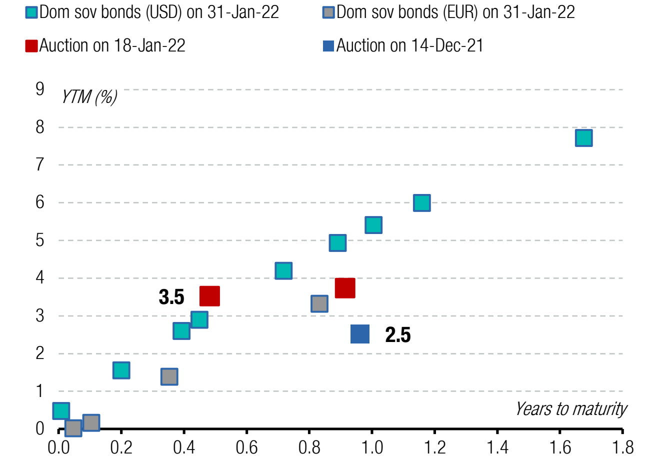
Chart 2. FX-denominated bonds

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.

YTMs of domestic government bonds calculated by NBU versus placements via primary market auctions



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

The Eurobond market is hot again

Last week began with another sharp jump in Eurobond yields, but with the gradual change in the Kremlin's rhetoric, the market calmed down a bit.

On Monday, the yield on Eurobonds due this September rose to 26% — higher than a week earlier — however, longer maturities reacted less dramatically to the news. Therefore, after a meeting in The Normandy Format and a US-provided written response to Russia over its security requests, market sentiment improved. Russia changed its rhetoric to be less aggressive. The Russian Foreign Ministry representative said that Russia was not going to attack Ukraine and considered war between the two nations to be unacceptable. This helped to reduce yields on Friday to 9.7-16%.

ICU view: Further developments in the Eurobond market will depend on Russia's actions and statements. As the next meeting in The Normandy Format is scheduled for the next week, no special changes are expected this week. Eurobond yields will remain high and volatile and will be very sensitive to any news or statements about Ukraine by Russia, the United States, or NATO.

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Foreign exchange market

The hryvnia at seven-year low

Last week, the hryvnia temporarily weakened to a seven-year low and repeatedly crossed the level of UAH29/US$ on Thursday. But Russia's calming rhetoric helped strengthen the hryvnia on Friday. Hryvnia continued to strengthen on Monday morning.

Last week, the hryvnia exchange rate mostly weakened and reached UAH28.92/US$ on Thursday, and there were risks during the day that the exchange rate could close at above UAH29/US$. Russia's less aggressive rhetoric and significant NBU interventions played in favour of the local currency. No less important were payments of month-end taxes, and VAT refunds seemed to have already been paid on Wednesday and would no longer provide local-currency liquidity for exporters at the end of the week.

Increased demand last week required large intervention by the NBU, and US$760m was sold from reserves in four days, the largest amount since March 2020, the start of the COVID-19 related crisis, when sales of hard currency from reserves exceeded US$1bn in one week.

After Wednesday, when the supply of hard currency among banks' clients was lower than demand by US$346m, the sale of hard currency intensified at the end of Thursday and likely increased on Friday. Therefore, the hryvnia ended the week on a positive note and weakened just by 1.6% to UAH28.7/US$.

ICU view: This week, the hryvnia exchange rate will continue to be shaped mostly on external information flows. Relieving rhetoric and improving expectations will help normalize supply and reduce the imbalance between supply and demand among bank clients. Most likely, the hryvnia exchange rate will not break last week's record of weakening in the near future.

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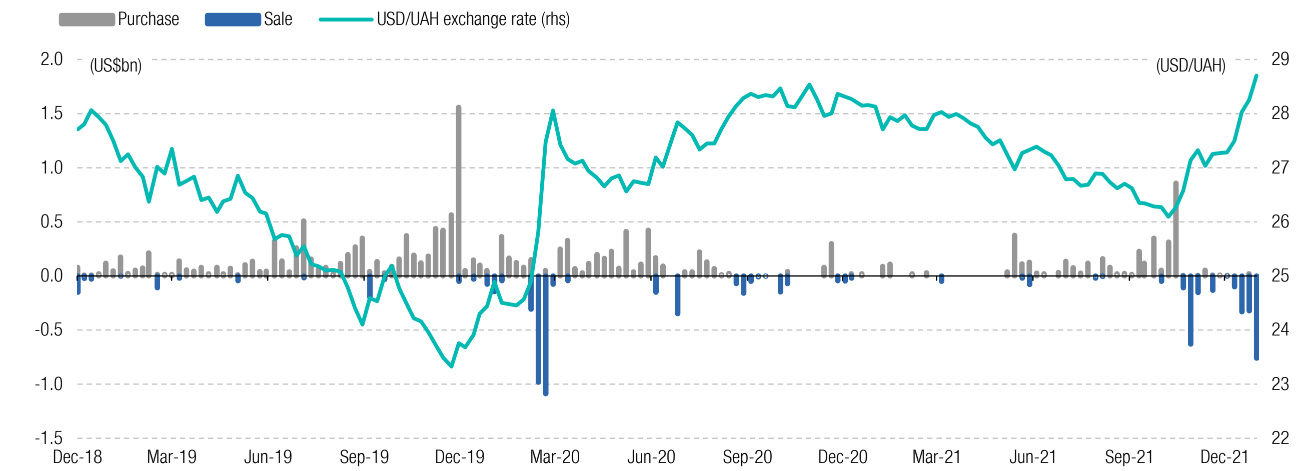
Chart 3. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Public debt below 50% of GDP at end-2021

Ukraine’s public debt (direct and guaranteed) increased 8.5% YoY in 2021 to $98bn. This is just below 50% of 2021 GDP based on our estimates, a decline from 60.8% of GDP in 2020.

External debt accounted for 58%, while FX debt (both external and domestic) for 63% of the total end-2021 debt stock. Total debt servicing expenditures stood at 11.8% of state budget revenues last year. Loans from the IMF made up 14.8% of the debt.

ICU view: A significant reduction in debt-to-GDP ratio was primarily driven by a 28% YoY growth in nominal GDP in USD terms due to high inflation against the backdrop of a relatively stable exchange rate. The rapid reduction of indebtedness is a very positive signal of Ukraine’s improved solvency position. However, a still high share of FX debt is the key risk as hryvnia depreciation may push up the ratio significantly again. We think the chances are high that Ukraine’s public debt-to-GDP ratio will remain below 50% throughout 2022 if the hryvnia doesn’t depreciate considerably from the current level.

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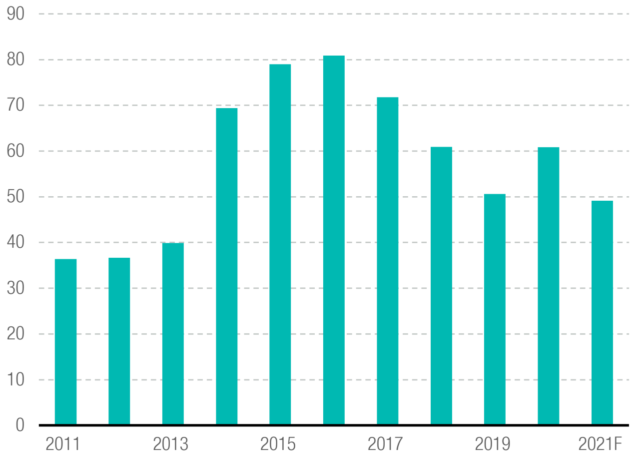
Chart 4. Public debt, % of GDP

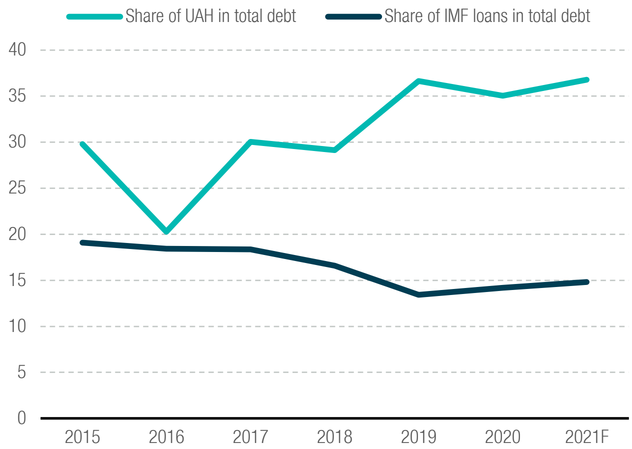
Public debt-to-GDP ratio slipped to below 50% in 2021



Source: MoF, ICU.

Chart 5. Share of UAH and IMF loans in total debt, %

Share of UAH debt increased slightly last year



Source: MoF, ICU.

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