Focus
Ukraine

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

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Weekly Insight

NBU reserves up in March

Key messages of the today's comments

MONDAY, 11 APRIL 2022

Ukrainian bond market

Investors interested in EUR-denominated bills

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Eurobond prices decline

During the last week, fluctuations in Eurobond prices were lower than in previous weeks, but they declined by 3-8%.

Economics

Inflation accelerates significantly in March

Consumer prices rose 4.5% MoM in March, implying a significant acceleration in yearly inflation to 13.7% YoY from 10.7% in February.

NBU reserves marginally up in March

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Banks' reserves market (8 April 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	10.00	+0bp	+350bp
ON rate (%)	9.76	+0bp	+405bp
Reserves (UAHm)[2]	50,674	+6.19	+16.60
CDs (UAHm)[3]	162,003	+14.25	+7.56

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) (8 April 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	330,106	+0.00	+2.49
Banks	543,070	+0.92	+1.18
Residents	80,003	+0.14	+71.64
Individuals	26,006	+1.05	+63.58
Foreigners[1]	74,820	+0.00	-26.40
Total	**1,054,109**	**+0.51**	**+3.02**

Source: NBU, ICU.

FX market indicators (8 April 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	29.5410	+0.22	+5.81
EUR/USD	1.0877	-1.50	-8.70
DXY	99.796	+1.18	+8.40
UAH TWI[1]	133.698	+0.53	+9.55

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

Market gov't bond quotes[1] (11 April 2022)

Maturity	Bid	Ask
6m	...	...
12m	...	...
2y	...	...
3y	...	...
12m ($)	...	...
2y ($)	...	...

Source: ICU.

Ukrainian bond market

Investors interested in EUR-denominated bills

Last week, the interest of investors in the primary market shifted to FX-denominated bills in euros. The state budget received EUR143m, which was the largest borrowing in hard currency this year.

The last time we saw a significant demand for FX-denominated bills was in mid-January, when the country security background was still relatively calm. However, on the eve of the russian invasion, an attempt to sell bonds in euros failed. Only EUR7m was raised two days prior to the invasion despite the fact that investors had previously received more than EUR353m in principle repayment and coupons on domestic debt. Also investors were not interested in FX-denominated bills in mid-March, when the budget was able to raise less than US$12m.

Last week, investors in FX-denominated bills became more active again. Of the UAH5.6bn of borrowed funds, UAH4.6bn or EUR143m, came from FX-denominated bills. Demand for UAH-denominated paper amounted to almost a UAH1bn. More details in the auction review.

ICU view: Such interest in FX-denominated bills was probably due to a rather long pause in the placement of euro-denominated paper. It was only the second offering this year. Demand could have been supported by positive news about the liberation of some Ukrainian territories and more positive prospects in the peace negotiations. If the positive trends continue, then next week the demand may shift again to FX-denominated securities. Tomorrow, though, only UAH-denominated bills will be offered. Demand for them will be restrained due to limited liquidity, as there have been no repayments of UAH-denominated debt since March 9.

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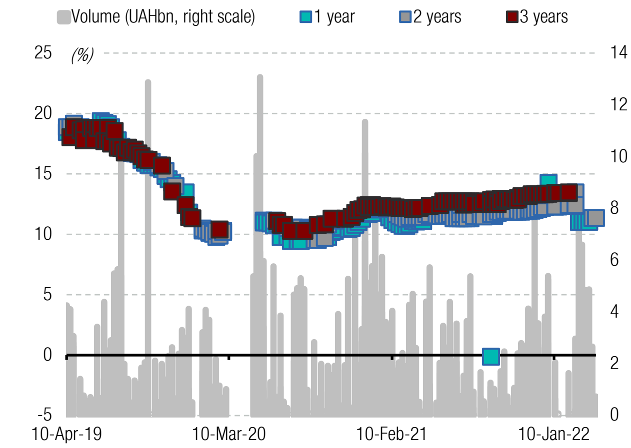
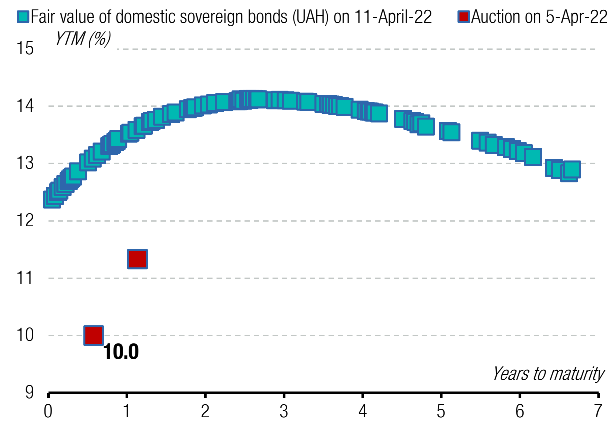
Chart 1. Local-currency bonds

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.

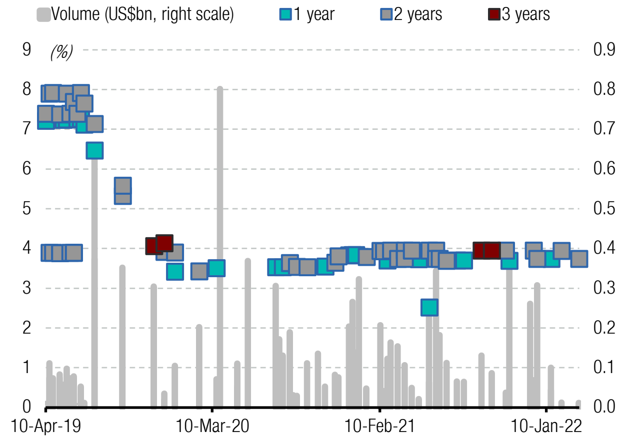
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

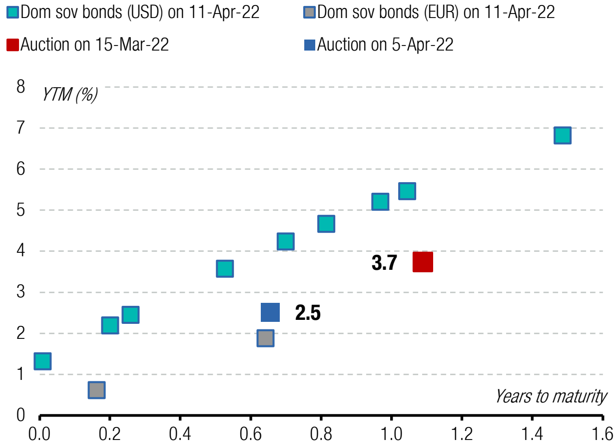
Chart 2. FX-denominated bonds

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.

Eurobond prices decline

During the last week, fluctuations in Eurobond prices were lower than in previous weeks, but they declined by 3-8%.

The liberation of some territories and positive expectations from the peace talks helped stabilize Eurobond prices. At the same time, investors are still pricing in the the deterioration of Ukraine's ability to service its debts due to the war. Investors continue to price Ukrainian Eurobonds maturing in 2023-2033 at 39-49 cents per dollar, which is 2-4 cents less than a week earlier. Such prices correspond to a yield to maturity of 22-72%. Eurobonds maturing this year are valued at 62 cents per dollar, equivalent to a yield of 171%. This is evidence that foreign investors are not convinced that these bonds will be repaid on schedule.

ICU view: Foreign investors' assessment of the state of the Ukrainian economy remains cautious. Therefore, they are in no hurry to improve the pricing of Ukrainian Eurobonds. Statements by foreign intelligence and the Ukrainian military about the enemy's accumulation of forces for a new strike in the east of the country led to a moderate decline in prices. Price adjustments may continue if large-scale hostilities resume at the front after a brief lull.

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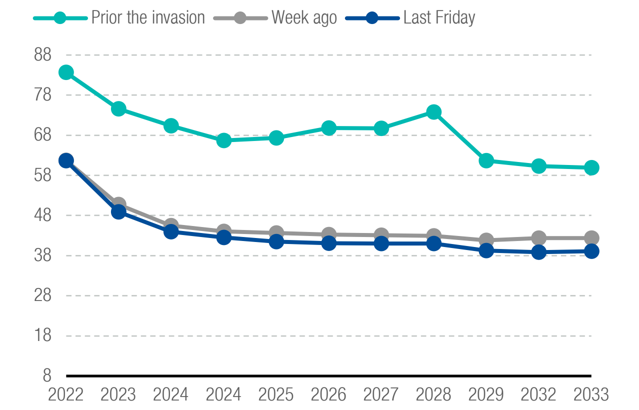
Chart 3. Ukrainian Eurobonds prices

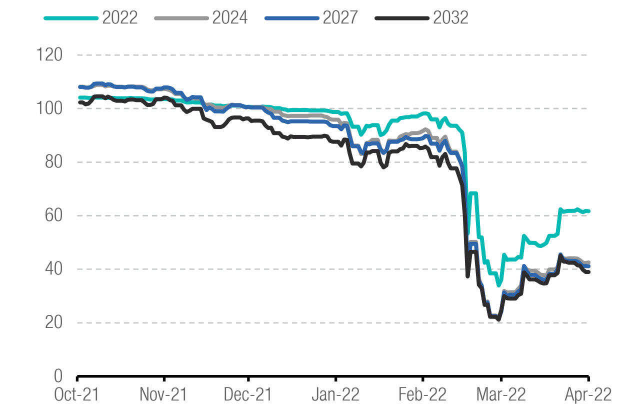
Prices of USD-denominated Eurobonds as of last Friday, a week ago and prior the russian invasion



Source: Bloomberg, ICU.

Chart 4. Prices of selected Ukrainian Eurobonds

Last six-month historical data



Source: Bloomberg, ICU.

Economics

Inflation accelerates significantly in March

Consumer prices rose 4.5% MoM in March, implying a significant acceleration in yearly inflation to 13.7% YoY from 10.7% in February.

Food prices were up 19.6% YoY in March (vs. 14.9% in February) and were the key inflation driver. The prices for transportation (+16.4%) and medical services (+12.1) also accelerated substantially. Core inflation also sped up to 10.5% YoY from 8.2%.

CPI is the only macroeconomic indicator within the realm of UkrStat that continues to be disclosed during current war-time conditions. Collection and publication of other statistical data by UkrStat, including the producer price index, is temporarily suspended due to inability of businesses in the warzone to provide the data.

ICU view: A significant acceleration of inflation since the start of the war was fully expected, primarily due to numerous supply-side bottlenecks. After the intensity of the russia's missile strikes subsided and russia's troops retreated from the northern regions of Ukraine, many local companies restarted or upscaled production. In addition, logistics improved. This means that supply-side pressures on prices may somewhat ease—but definitely not disappear—in the coming months.

Limited import of consumer goods is also fueling inflation. Current FX regulations allow hard-currency purchases for critical imports only, and they are unlikely to be softened anytime soon. Damages to oil and gas storage facilities caused by missiles attacks, even in areas that are distant from the war zone, are another major contributor to higher consumer prices as higher transportation costs are passed on consumers.

Meanwhile, the authorities implemented a number of measures to ease price pressures:

- The official US dollar exchange rate has remained fixed at UAH29.3/$ since the start of the war. Recently, an NBU official communicated the exchange rate will remain flat until the end of the war. This provides an anchor for the prices of imported goods.

- Parliament approved a reduction of indirect taxes that are collected by small and medium businesses, a full removal of the excise tax, and a reduction in the VAT on motor fuel.

- Gas and electricity prices for households and producers of social goods are very likely to stay broadly fixed in the foreseeable future.

Ironically, logistical difficulties that complicate the export of grains and vegetable fats ensure sufficient supplies of soft commodities in the local market and relative stability of prices.

Overall, we expect consumer prices will continue to accelerate albeit at a slower pace than in March. We maintain our forecast that CPI may reach 25-30% in autumn driven by supply-side factors. Inflation can hardly be tackled by monetary policy instruments in the current circumstances, and we don't expect the NBU will adhere to its pre-war monetary policy framework in the coming months.

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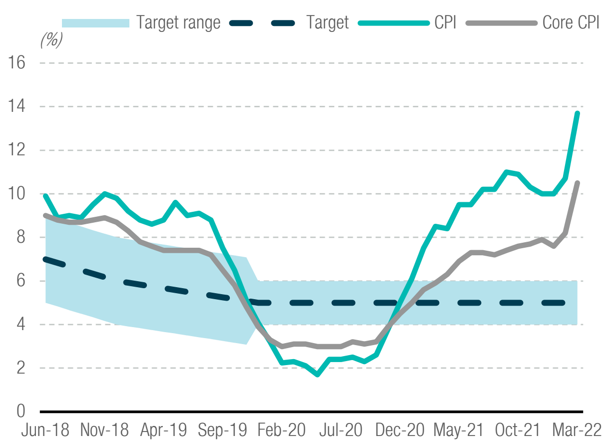
Chart 5. CPI, core CPI and target, YoY, %

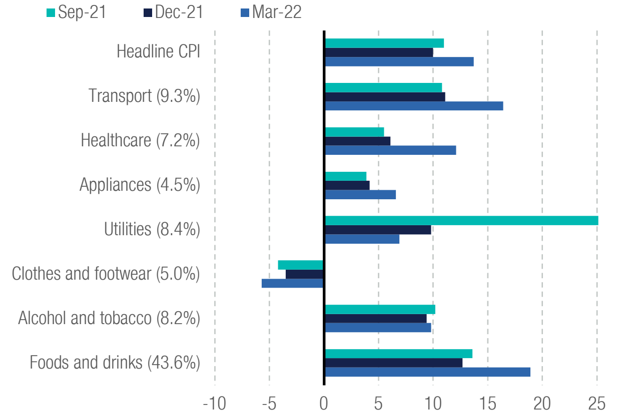
Headline inflation expectedly surges in March



Source: Ukrstat, NBU, ICU.

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

Food prices are the key inflation driver



Source: Ukrstat, ICU.

NBU reserves marginally up in March

NBU gross international reserves increased 2% m/m in March to $28.1bn thanks to international concessional funding.

Ukraine received about $3.3bn in international financial support last month, including a $1.4bn loan from the IMF, $0.7bn from the European Investment Bank, $0.65bn from the EU, and $0.45bn from the World Bank. Meanwhile, Ukraine spent about $1.0bn to repay its FX debt, including $0.7bn in debt to the IMF. Also, the NBU had to spend net $1.7bn to meet the demand for foreign currency from the market.

ICU view: The news of NBU reserves increasing in the time of war is encouraging and adds to the confidence that some of the macroeconomic risks can be reasonably contained. However, the current volume of NBU sale interventions implies the stability of the NBU reserves is fully dependent on the size of financial assistance that is provided by the IFIs and foreign governments to Ukraine. At this point, the amount of committed assistance seems sufficient for the next couple of months. However, it must definitely be upscaled to ensure Ukraine has a sufficient FX liquidity cushion in the medium term.

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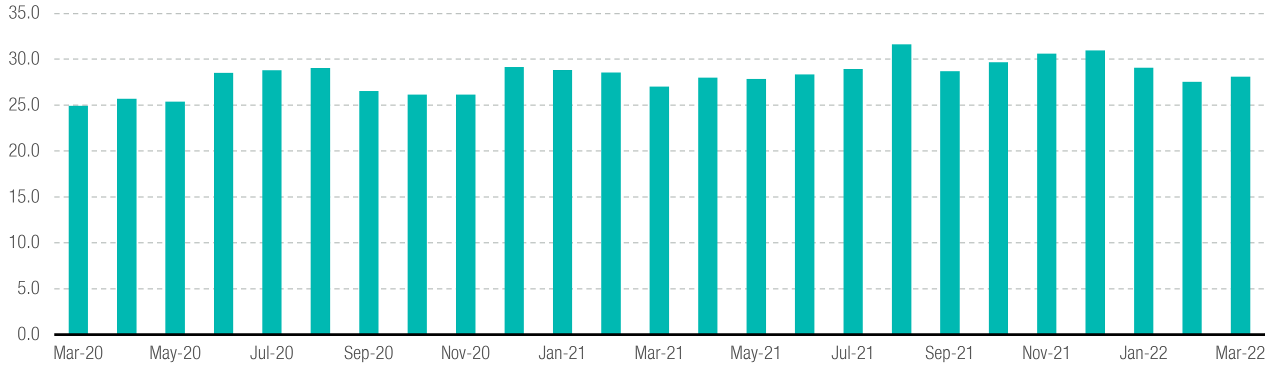
Chart 7. NBU gross international reserves, US$bn

NBU reserves up 2% in March



Source: ICU, NBU.

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