

Weekly Insight

Markets in anticipation of restructuring

Key messages of the today's comments

MONDAY, 1 AUGUST 2022

Ukrainian bond market

Unusual bills increase borrowings

Last week, the Ministry of Finance raised UAH9.9bn for the budget, mainly in hard currency. This was facilitated by the offer of unusual types of bills and selective rate increases.

Eurobond market in anticipation of decision for debt restructuring

After the government announced negotiations to defer payments on Eurobonds, prices stabilized and even edged up. VRIs rose in price by almost two cents to 27 cents on the dollar of notional value.

Foreign exchange market

Turbulence intensifies in cash FX market

After the NBU revised the official exchange rate of the hryvnia to the US dollar and other currencies, the cash market remains extremely volatile due to psychological factors.

Economics

Significant capital outflows continued in June, BoP data show

Ukraine's current account (C/A) remained marginally positive in June, but outflows through the financial account (F/A) remained unabated.

Banks' reserves market (29 July 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+1,700bp
ON rate (%)	9.76	+0bp	+242bp
Reserves (UAHm) ²	48,912	-28.85	-15.40
CDs (UAHm) ³	207,714	+33.64	+27.87

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) (29 July 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	556,106	+2.30	+75.92
Banks	532,046	+1.10	+5.68
Residents	64,734	-1.35	+32.86
Individuals	29,466	-4.56	+56.01
Foreigners ¹	71,067	-0.41	-34.36
Total	1,253,961	+1.28	+25.98

Source: NBU, ICU.

FX market indicators (29 July 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.5920	-0.34	+36.18
EUR/USD	1.0220	+0.07	-14.02
DXY	105.903	-0.77	+15.28
UAH TWI ¹	113.583	+0.38	-9.42

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes¹ (1 August 2022)

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

Source: ICU.

Ukrainian bond market

Unusual bills increase borrowings

Last week, the Ministry of Finance raised UAH9.9bn for the budget, mainly in hard currency. This was facilitated by the offer of unusual types of bills and selective rate increases.

The Ministry of Finance offered several unusual instruments at the auction last week. First, there were two issues of 1.5-year FX-denominated securities, in USD and euros, as well as 14-month government paper denominated in local currency.

A distinctive feature of the FX-denominated bills is a put option. Holders can request full principal redemption and half of the accrued interest at any time. Accordingly, the MoF set the same yield as for six-month USD-denominated and 12-month EUR-denominated paper, which was a logical move.

For UAH bills, 14-month paper had an unusual tenor, as the MoF typically issues for 12 and 18-month bills. In addition, the rate for this paper was set at 16%, which is 200bp higher than for a 12-month instrument. There was only one buyer for this paper – a bank – but for the sizable amount of UAH3.5bn.

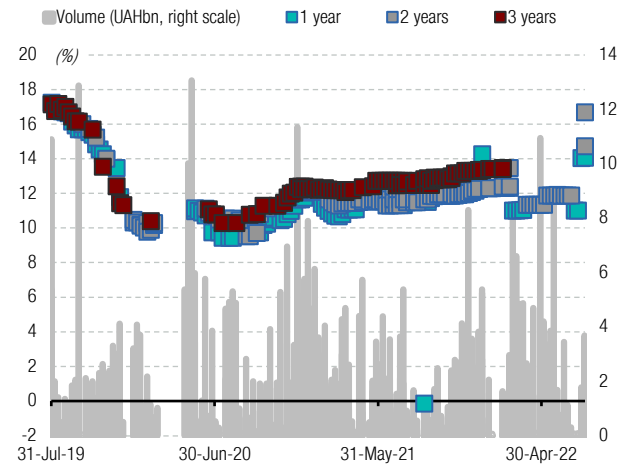
The government also started placing a new two-year instrument with a yield of 14%, but the demand was insignificant at this first auction. The interest rate was higher than before the Russian invasion and for the 12 or 18-month securities sold after the start of full-scale war. More details see in the [auction overview](#).

ICU view: All of the bills with unusual features were purchased by a small number of bidders, which did not contribute to increased activity in the secondary bond market. The trading volume of local-currency bills rose but solely due to active trading with short-term bills maturing this autumn. In contrast trading for FX-denominated bills sharply decreased. Although market participants welcomed a recent increase in yield, they largely expect that trend to continue so that yields get closer to the NBU key policy rate. The 16% yield on a 14-month bill that will be offered tomorrow may attract some banks and retail investors. However, without a further hike in yields, demand for new bills will remain muted.

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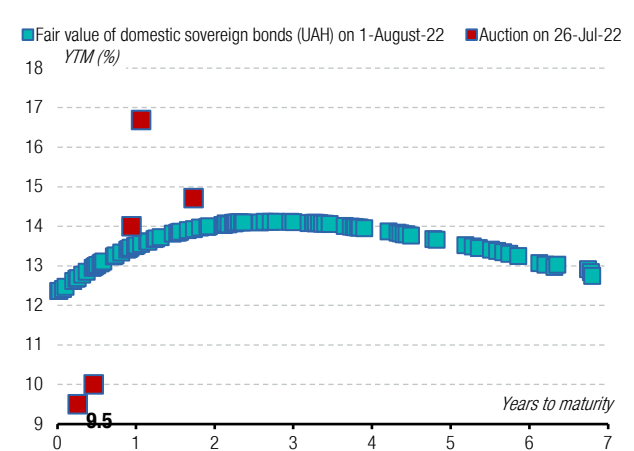
Chart 1. Local-currency bonds

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.

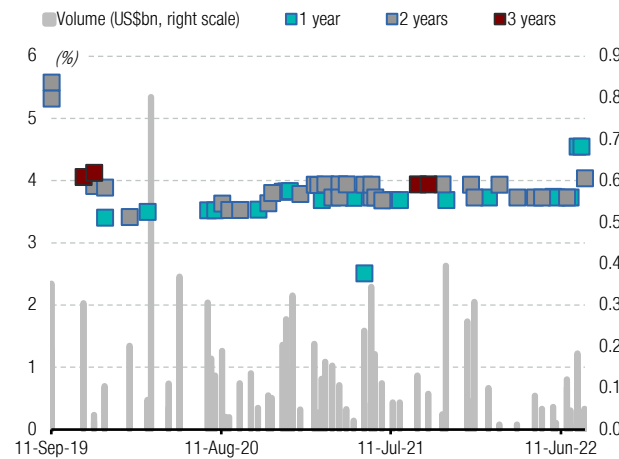
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

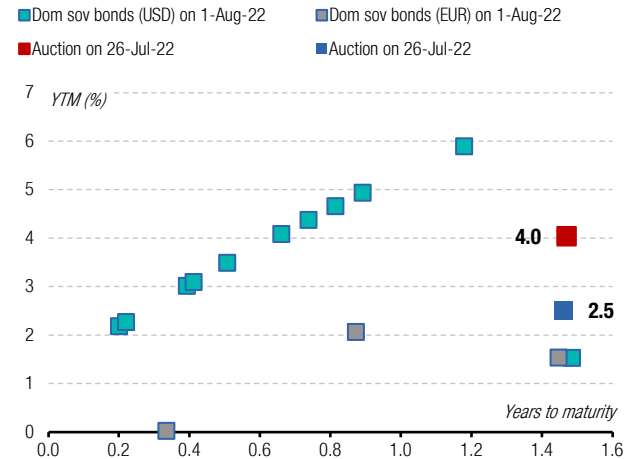
Chart 2. FX-denominated bonds

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 market in anticipation of decision for debt restructuring

After the government announced negotiations to defer payments on Eurobonds, prices stabilized and even edged up. VRIs rose in price by almost two cents to 27 cents on the dollar of notional value.

Nearly all Eurobonds are trading in the range of 20–22 cents per dollar. Only two issues stand out: the Eurobond maturing in September 2023 is quoted at 25 cents, and the one maturing in a month is traded at 34 cents.

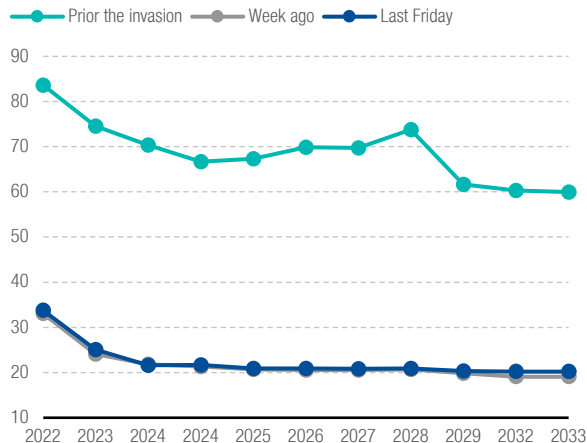
ICU view: *The Ukrainian Eurobond market lives in anticipation of whether investors will approve restructuring terms, which should become known in the middle of next week. Fairly stable Eurobonds prices indicate that investors believe that the decision will be predictable and the conditions proposed by Ukraine will be agreed to. A slightly higher price for Eurobonds that are scheduled to be redeemed in a month reflects the hope that this issue will still be repaid if investors vote against the restructuring of this particular series. Holders of these Eurobonds may be motivated to vote against the*

restructuring, as the government has repeatedly and unambiguously communicated as recently as June that it planned to repay this debt on time and in full.

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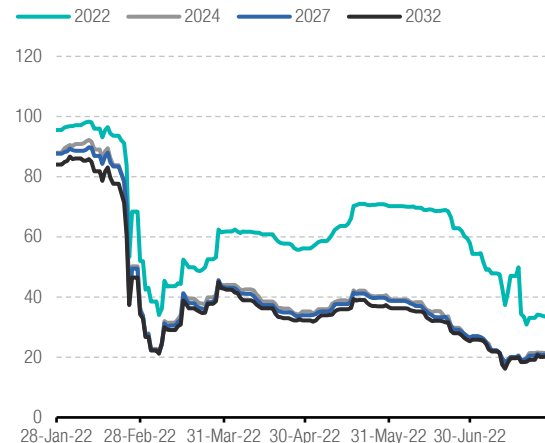
Chart 3. Ukrainian Eurobonds prices

Prices of USD-denominated Eurobonds as of last Friday, prior the Russian invasion and the lowest prices seen on 7 March, 2022



Source: Bloomberg, ICU.

Last six-month historical data



Source: Bloomberg, ICU.

Foreign exchange market

Turbulence intensifies in cash FX market

After the NBU revised the official exchange rate of the hryvnia to the US dollar and other currencies, the cash market remains extremely volatile due to psychological factors.

Last week was the first full calendar week after the NBU reset the official USD/UAH exchange rate. A significant one-time devaluation of the hryvnia had an immediate and noticeable effect: the interbank market became almost balanced.

A calm interbank market also contributed to stabilization of banks' FX rates for card transactions. In general, the US dollar rate did not change significantly during the week: it rose marginally from UAH36.73–37.16/US\$ to UAH36.78–37.24/US\$ on average in 10 banks that are the largest issuers of cards in Ukraine.

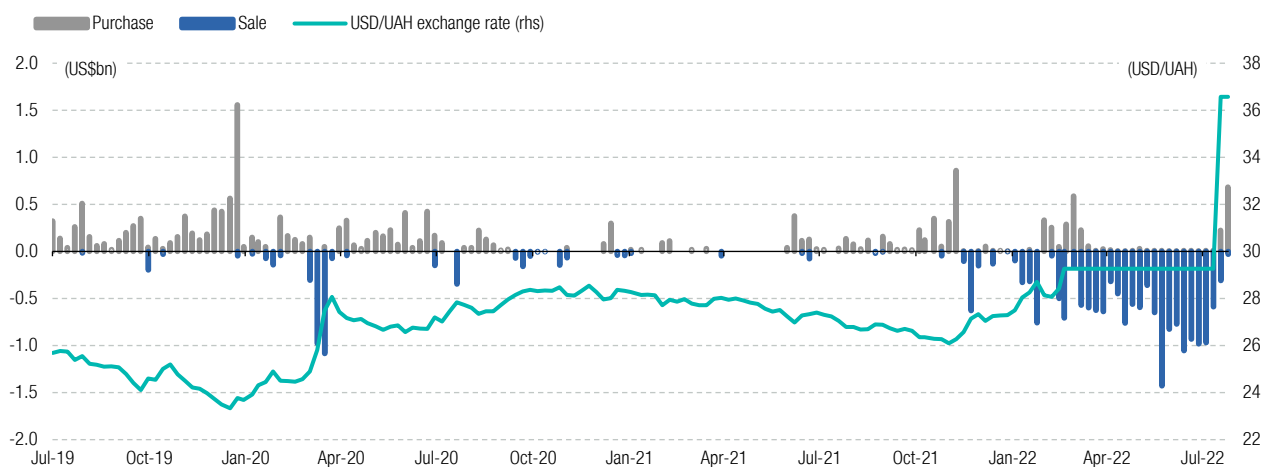
In contrast, in the cash market, the frantic demand for hard currency persists, driving the cash FX exchange rates significantly above the official rate. Over the week, the US dollar rate increased from UAH37.84–39.05/US\$ to UAH39.11–40.53/US\$. Some large banks even offered the US dollar at UAH41.5–42.5.

ICU view: The fact that the official interbank FX market remained broadly balanced last week is a positive signal that the devaluation of the hryvnia achieved its expected positive effect. It is unlikely that this effect will be long-lasting, however. Probably in a few weeks the market will again be in deficit, and the NBU will be forced to restart the sale of hard currency. The rapid devaluation of the hryvnia in the cash segment is mainly due to psychological factors. Individuals and businesses were worried about the sharp one-time devaluation of the hryvnia against the dollar.

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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

Significant capital outflows continued in June, BoP data show

Ukraine's current account (C/A) remained marginally positive in June, but outflows through the financial account (F/A) remained unabated.

The C/A was in a small surplus at US\$0.2bn in June and US\$0.7bn for the 12-month period to June. June's surplus was largely a consequence of significant inflows of grants and humanitarian aid (BoP secondary income component), primarily the US\$1.3bn grant provided by the US to the Ukrainian government. Also, migrant remittances recovered to pre-war levels. Meanwhile, the trade balance was significantly negative at US\$3.0bn in June alone, as imports of goods nearly recovered to last year's level (-9% YoY) and imports of services nearly doubled on expenditures of Ukrainian refugees.

Financial account numbers indicate continued capital outflow via two main channels: i) withdrawal of FX cash abroad from hryvnia accounts (US\$0.9bn in June) and ii) increase in the stock of trade credits (US\$1.4bn). Both represent typical capital flight due to huge economic uncertainties and a subsidized official exchange rate that remained in place in June.

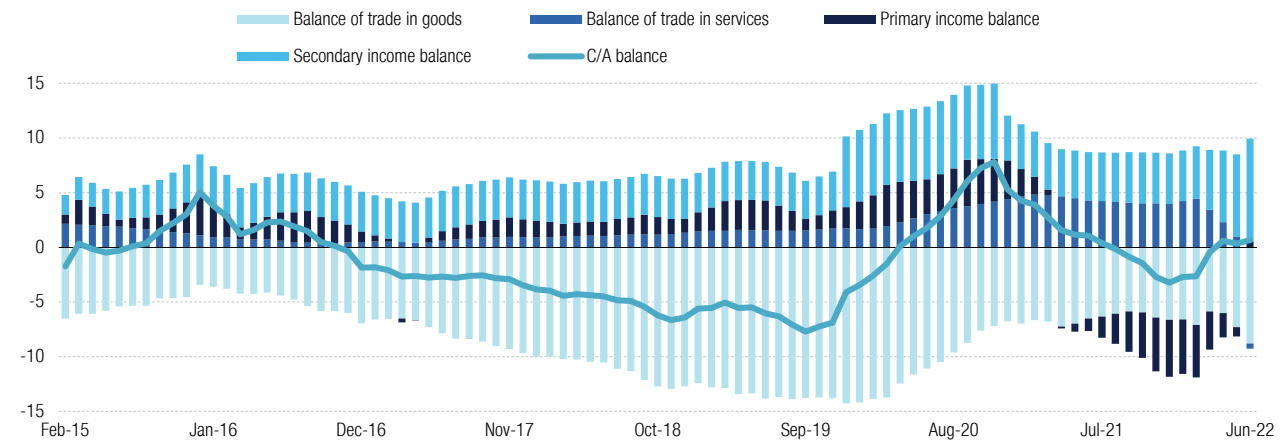
NBU reserves fell by US\$2.3bn in June to US\$22.8bn, as the NBU had to sell hard currency to cover the imbalances.

ICU view: June was the last full calendar month when the NBU maintained the pre-crisis hryvnia exchange rate vs. the US dollar. BoP data clearly indicate the significant imbalances that were to a large extent brought about by a subsidized exchange rate. Those imbalances prompted the NBU to carry out a one-off hryvnia devaluation vs. the US dollar by 20% in late July. We expect the weaker hryvnia will help decrease the negative gaps of external accounts for a while; however, it is very unlikely to alleviate them in a sustainable manner. The FX market imbalances are likely to return in the coming weeks, albeit their volumes should be significantly smaller.

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Chart 5. Current account, 12-month trailing, \$bn

Current account in small surplus thanks to grants from foreign governments



Source: NBU, ICU.

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