

Weekly Insight

Cash hryvnia is weakening again

Key messages of the today's comments

MONDAY, 19 SEPTEMBER 2022

Ukrainian bond market

Bond market activity low

Despite the increase in borrowings at the primary auction, the activity of the secondary bond market remains low, especially in the segment of military bills.

Investors welcome the military successes of the Ukrainian Army

Investors positively evaluated the successful counteroffensive actions of the Ukrainian Army, and the Eurobonds prices increased.

Foreign exchange market

Hryvnia cash exchange rate is weakening again

Last week, the hryvnia weakened again despite the NBU's efforts to reduce the cash deficit.

Economics

Government submits 2023 draft budget to Parliament

Last week, the Ukrainian government submitted a draft budget for 2023 to parliament, budget deficit seen at 20% of GDP.

Banks' reserves market (16 September 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+1,650bp
ON rate (%)	9.76	+0bp	+191bp
Reserves (UAHm) ²	71,949	+18.67	+15.50
CDs (UAHm) ³	245,974	-2.15	+97.76

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) (16 September 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	619,570	+2.48	+98.20
Banks	503,008	+0.06	-0.23
Residents	66,312	+0.67	+26.96
Individuals	31,254	+1.33	+47.85
Foreigners ¹	68,061	+0.08	-28.71
Total	1,288,961	+1.28	+30.80

Source: NBU, ICU.

FX market indicators (16 September 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.7918	+0.20	+37.88
EUR/USD	1.0016	-0.26	-14.88
DXY	109.764	+0.70	+18.11
UAH TWI ¹	114.617	+0.15	-9.38

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes¹ (19 September 2022)

Maturity	Bid	Ask
6m	21.00	16.00
12m	21.00	17.00
2y	23.00	18.00
3y	25.00	19.00
12m (\$)	6.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Bond market activity low

Despite the increase in borrowings at the primary auction, the activity of the secondary bond market remains low, especially in the segment of military bills.

At last Tuesday's auction, the Ministry of Finance sold a new 1.5-year bond issue for UAH166m (US\$4.5m). This amount is quite large compared with the previous auctions, but very small to cover budget needs or even rolling over the current debt redemptions. Since the beginning of the year, the volume of debt in local currency that the government was not able to refinance exceeded UAH88bn (US\$2.4bn). That excludes loans from the National Bank, which increased by UAH15bn (US\$0.4bn) to UAH315bn (US\$8.6bn) last week.

FX-denominated bills helped to attract more funds last week, especially EUR-denominated bills with a put option. In total, the state budget received UAH1.43bn (US\$39m), including the equivalent of UAH1.25bn in euros (EUR33.9m). See details in the [auction review](#).

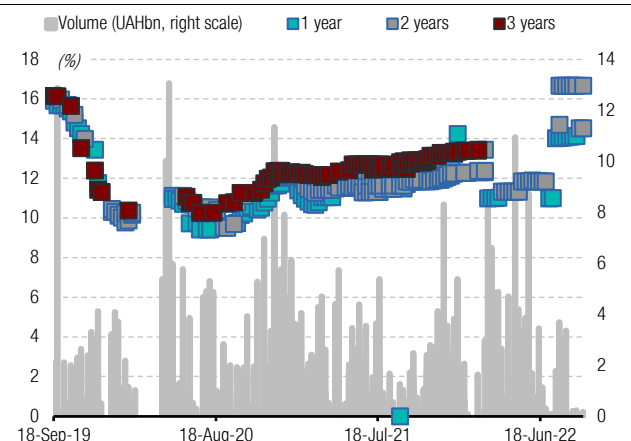
More significant borrowings did not improve the activity in the secondary market. The total volume of transactions with UAH bonds fell to UAH2bn (US\$55m) due to a reduction in activity with ordinary (non-military) bonds to UAH1.9bn (US\$52m), while activity with military bills remained at the usual level of UAH120m (US\$3.3m).

ICU view: The Ministry of Finance continues to rely more on the help of international partners and loans from the NBU, attracting small amounts in local currency and slightly more in hard currency in the domestic bond market. Low interest rates on military bills do not contribute to the activity of the secondary market where individuals and foreign investors are the key players. Individuals continue to buy mostly military bills in small amounts, while foreigners are interested in ordinary (non-military) instruments that have not been offered for more than half a year. The choice of instruments for foreigners is narrowing, as old issues are gradually being paid off, and the new issues from the Ministry of Finance include only military bonds. At the same time, foreigners might have an interest in purchasing new securities maturing shortly after April 1, 2023, when they can repatriate the received funds (as per current NBU regulation).

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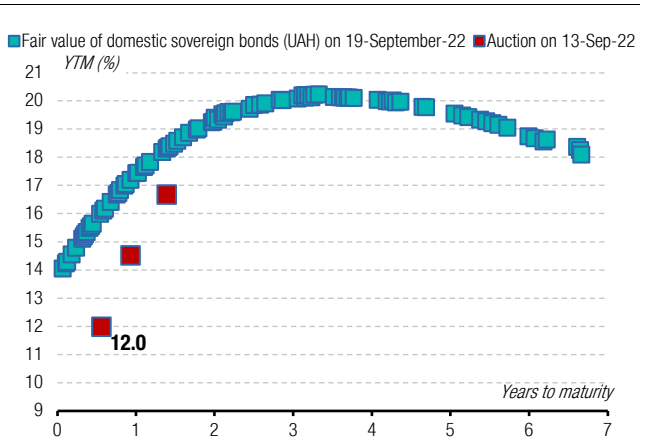
Chart 1. Local-currency bonds

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.

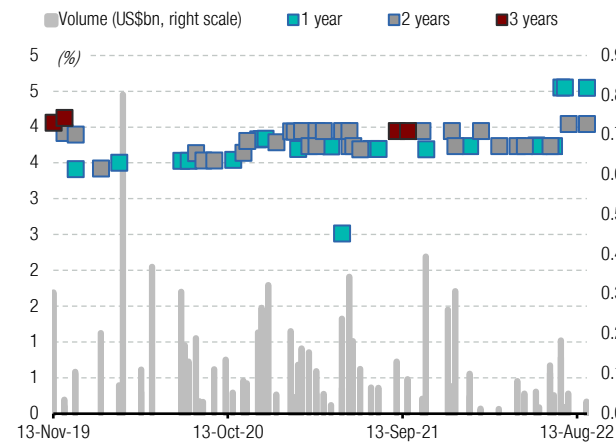
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



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

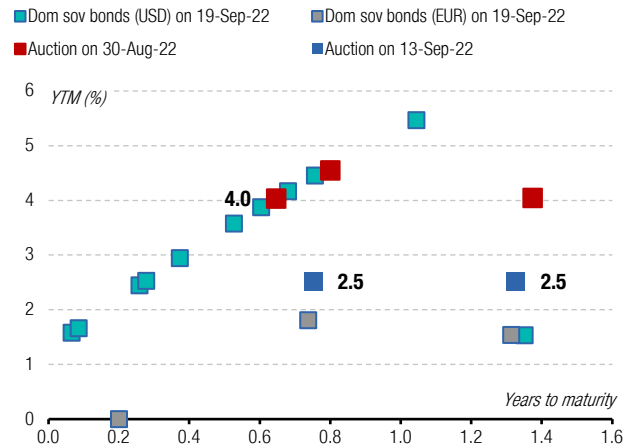
Chart 2. FX-denominated bonds

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.

Investors welcome the military successes of the Ukrainian Army

Investors positively evaluated the successful counteroffensive actions of the Ukrainian Army, and the Eurobonds prices increased.

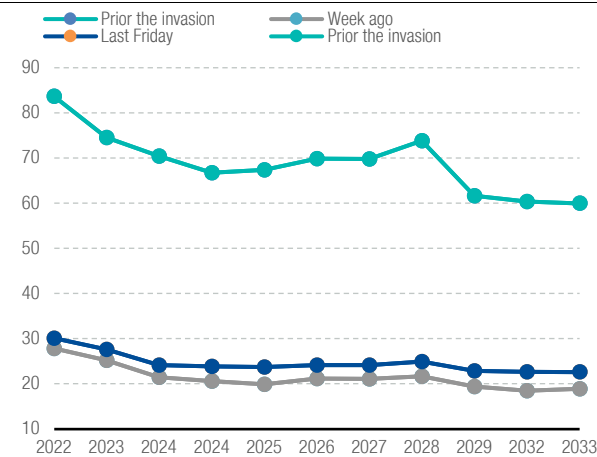
Over the past week, the prices of Eurobonds rose noticeably by 2–4 cents to 23–28 cents per dollar and VRIs by almost three cents to 33 cents per dollar of notional value. At the same time, spreads on Ukrainian Eurobonds tightened noticeably to the benchmark by 200–500bps. This happened due to both a decrease in yields on Ukrainian bonds and an increase in yields on US Treasuries.

ICU view: *Price moves show investors' positive assessment of the news from the battlefield, but prices have not reached even levels of mid-August, when Ukraine completed its Eurobond restructuring and bearish sentiment on global markets had not yet intensified. Low interest in emerging market debt does not contribute to further price growth. The successes of the Ukrainian military in liberating the territories occupied by Russia increased the optimism of investors, but at the moment, they are convinced that the war can continue for a long time and payments on Eurobonds should not be expected in the near future.*

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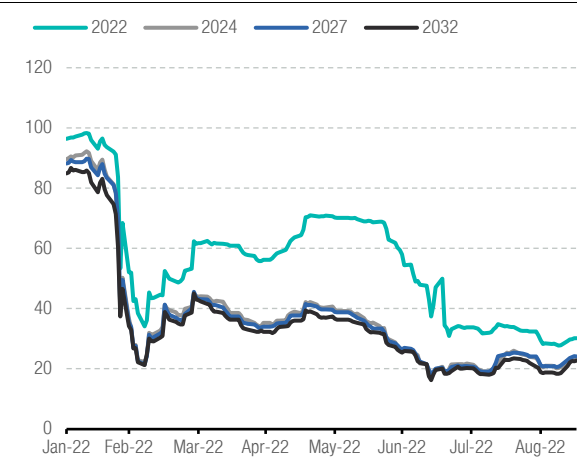
Chart 3. Ukrainian Eurobonds prices

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



Source: Bloomberg, ICU.

Last six-month historical data



Source: Bloomberg, ICU.

Foreign exchange market

Hryvnia cash exchange rate is weakening again

Last week, the hryvnia weakened again despite the NBU's efforts to reduce the cash deficit.

After several auctions for the sale of cash hard currency, the exchange rate of the hryvnia to the US dollar in the leading retail banks weakened from UAH39.3-40.3/US\$ to UAH39.4-40.4/US\$. Therefore, the NBU had to announce an auction for the sale of US\$100m and EUR100m for today.

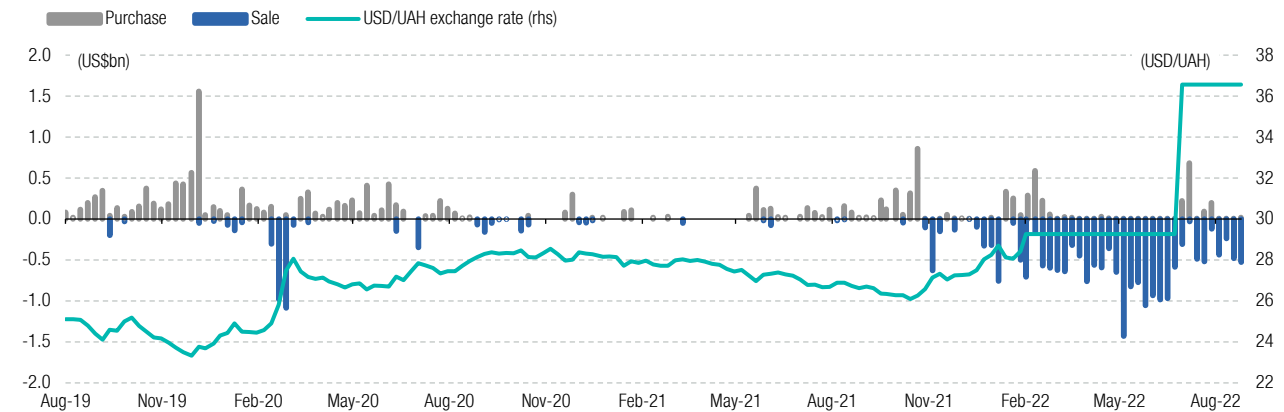
The interbank market has not seen any major changes. Bank clients' demand for hard currency significantly exceeds supply, and the NBU sold about US\$0.5bn through interventions last week.

ICU view: *The shortage of cash hard currency remains a key factor in the weakening of the hryvnia. Contrary to our expectations, the NBU offer of cash hard currency to banks in the previous weeks did not help stabilize the hryvnia exchange rate. The NBU will, thus, offer more FX cash this week as it believes the current cash FX rate is unacceptably high. But the high demand for hard currency will continue to put pressure on the hryvnia exchange rate, and it is unlikely to allow it to strengthen even a little in the near future.*

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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

Government submits 2023 draft budget to Parliament

Last week, the Ukrainian government submitted a draft budget for 2023 to parliament, budget deficit seen at 20% of GDP.

The document foresees a state budget deficit being equal to its projected revenues at UAH1,280bn (US\$30.3bn at the average-of-the-year UAH/US\$ exchange rate projected by the government). This amounts to about 20% of 2023F GDP by government estimates. The deficit is planned to be covered with net external borrowings of US\$35.5bn, while net repayment of local debt will be US\$5.3bn. Officials additionally noted that the government does not plan to rely on direct financing from the NBU next year.

Table 1. Key 2023 draft state budget parameters

The size of deficit is going to equal the size of budget revenues

	UAH bn	US\$ bn*
Revenues	1,279	30
incl. tax revenues	1,156	27
Expenditures	2,514	60
Net lending	45	1
Deficit	1,280	30
incl. net external borrowings	1,497	35
incl. net domestic borrowings	-225	-5
incl. other sources	8	0

* based on average-of-the-year ER projection from the government

Source: MoF, ICU.

ICU view: *The submitted document should be treated as a reflection of government's best-case scenario, whereby Ukraine's international partners are ready to provide as much financing as the government earmarked in the document. This scenario looks optimistic, in our view, and we think foreign financial assistance from both IFIs and foreign governments is going to be significantly lower. We, thus, expect the actual mix of budget financing sources is going to be different with the NBU still playing a substantial role in patching the fiscal gap, albeit, volumes of government debt purchases by the NBU will more than halve vs. 2022 (expected UAH500bn).*

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