Focus
Ukraine

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

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Weekly Insight

FX cash market calmer

Key messages of the today's comments

Ukrainian bond market

Activity migrates to FX bills

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Eurobond prices remain low

Eurobonds remain mostly at levels close to 20 cents even through russia's escalation of the war continues to generate negative sentiment.

Foreign exchange market

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Last week, the balance in the cash market improved, and the hryvnia exchange rate on the cash market stabilized at the level around UAH41/US$. At the same time, in the non-cash market, the balance shifted even more in favor of demand, forcing the NBU to increase sale interventions.

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MONDAY, 3 OCTOBER 2022

Banks' reserves market (30 September 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	25.00	+0bp	+1,650bp
ON rate (%)	9.76	+0bp	+241bp
Reserves (UAHm)[2]	60,862	-3.01	+0.15
CDs (UAHm)[3]	265,332	+6.48	+95.91

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) (30 September 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	619,570	+0.00	+98.20
Banks	500,890	-0.30	+0.02
Residents	68,298	+2.26	+32.91
Individuals	31,689	+0.22	+44.60
Foreigners[1]	68,106	+0.18	-30.77
Total	**1,289,570**	**+0.02**	**+30.91**

Source: NBU, ICU.

FX market indicators (30 September 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.8670	+0.41	+38.73
EUR/USD	0.9802	+1.19	-15.35
DXY	112.117	-0.95	+18.98
UAH TWI[1]	116.367	-0.50	-9.43

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

Market gov't bond quotes[1] (3 October 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

Activity migrates to FX bills

For several weeks, trading in FX-denominated bills on the secondary market has been increasing. Last week, it was the largest since the beginning of the year, the equivalent of UAH9.5bn (about US$260m).

Trading volumes of UAH bonds on the secondary market were up to UAH4.8bn (US$131m) compared to steady UAH2–3bn (US$50-80m) turnover per week for two months. Interest in UAH military bills decreased even more last week to just UAH74m (US$2m) compared with UAH307m (US$8m) a week before. The rest of the volume was for ordinary (non-military) government bonds.

On the other hand, FX-denominated bills are increasingly attracting investors. In the primary market demand remains low. Last week, the Ministry of Finance sold only US$4.7m worth of USD-denominated securities (see the auction review) and US$12.3m (par value) a bit earlier. However, on the secondary market, trading activity has been increasing since the end of August. Last week was the highest since the beginning of the year, UAH9.5bn in equivalent (about US$260m). The number of deals rose to 407 after stayed in the range of 200–300 per week earlier in September.

The key trading activity last week originated from non-banking institutions and individuals. While the portfolios of UAH bonds of these groups of investors have been volatile, the portfolios of FX-denominated bills have been increasing for 11 weeks.

ICU view: The interest of individuals in FX instruments is increasingly growing, which can be explained by several reasons. In July, the Ministry of Finance raised interest rates on USD-denominated bills in the primary market from 3.5–3.7% to 4–4.5%, which led to a slight increase of YTMs in secondary bond market. Since late August, FX-denominated bills became available on the secondary market, including bills issued before February 24. In addition, there is currently no reasonable alternative to FX securities on the domestic market, as banks' deposit rates are lower than the yields on FX-denominated bills. Other instruments for investing hard currency funds are unavailable. Therefore, it is likely that the FX-denominated part in the portfolio of individuals will continue to grow.

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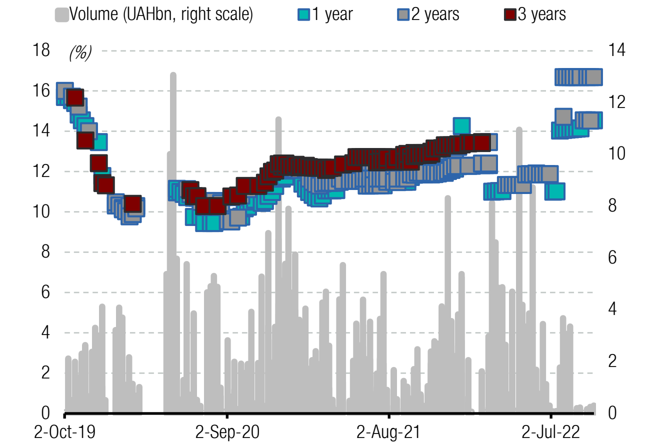
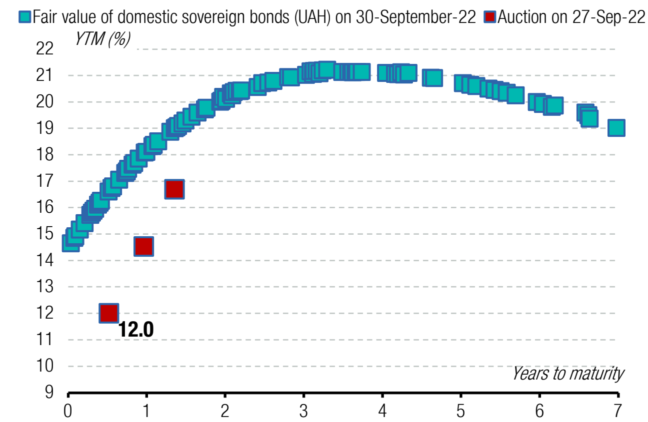
Chart 1. Local-currency bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: MFU, ICU.

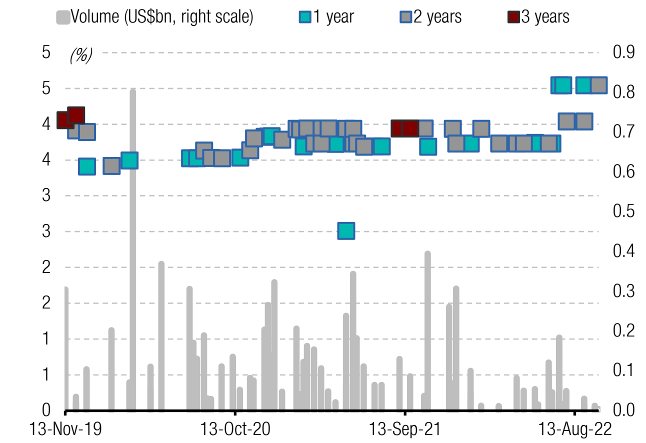
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

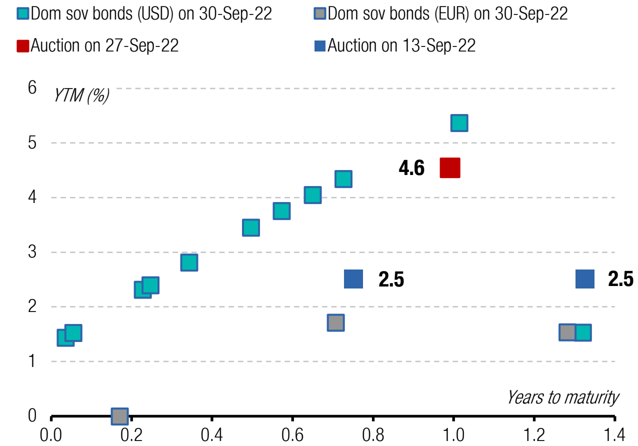
Chart 2. FX-denominated bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: MFU, ICU.

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



Source: NBU, MFU, ICU.

Eurobond prices remain low

Eurobonds remain mostly at levels close to 20 cents even through russia's escalation of the war continues to generate negative sentiment.

Eurobond prices decreased last week, as pressure remained. Still, despite active mobilization in russia, sham referendums, and russia's attempt to annex part of Ukrainian territories, they remained close to 20 cents. For short-term bonds maturing in 2024–2026 (in the first half of 2026), the decline was 2–4% or 0.3–1.1 cents to 21–28 cents. However, for instruments maturing from November 2026 to 2035, the decline was more significant, by 5–8% or 1.5–1.7 cents, to 18–21 cents. The biggest price drop was for issues maturing in 2031 and 2035 (2029 and 2033 before the deferral) by 1.7 cents or above 8%.

ICU view: It seems that the market has already fully priced-in the recent successes of the Ukrainian army, as well as russia's steps to escalate the war. So, there are currently no factors that could significantly affect Eurobond prices, and they are likely to remain close to current levels awaiting important news.

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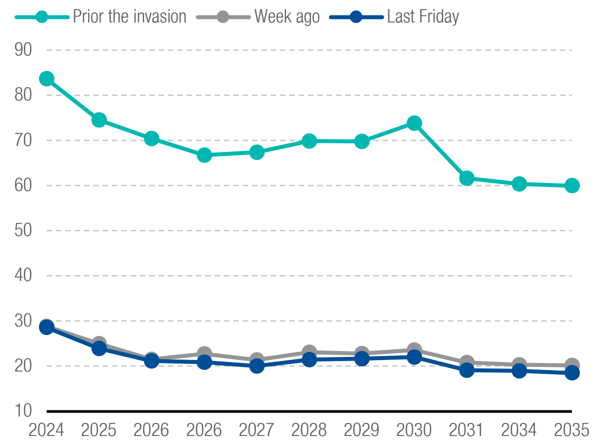
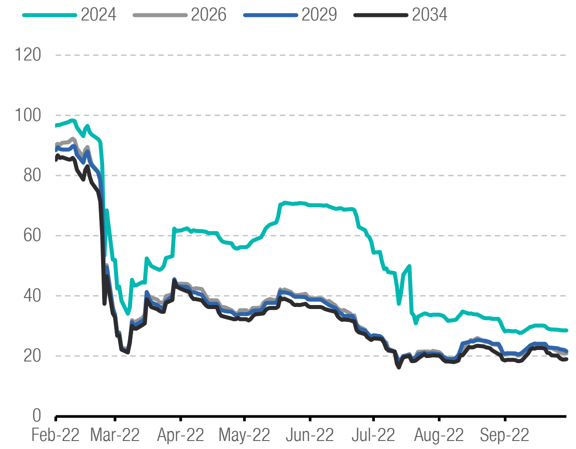
Chart 3. Ukrainian Eurobonds prices

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



Source: Bloomberg, ICU.

Last eight-month historical data



Source: Bloomberg, ICU.

Foreign exchange market

FX cash market calmer

Last week, the balance in the cash market improved, and the hryvnia exchange rate on the cash market stabilized at the level around UAH41/US$. At the same time, in the non-cash market, the balance shifted even more in favor of demand, forcing the NBU to increase sale interventions.

In the cash market, the hyped demand subsided a bit, and in the leading retail banks, the hryvnia rate even strengthened by Friday to UAH40.4–41.4/US$ from UAH40.6–41.6/US$ a week ago.

But in the interbank market, demand for hard currency increased. Among banks clients' daily demand for hard currency substantially exceeded the supply, up to US$155m last Wednesday. Therefore, the NBU had to increase interventions further and sell net US$862m last week—the largest volume since early July.

ICU view: The temporary improvement of the balance in the cash market contributed to the stabilization of the hryvnia exchange rate and even a slight strengthening. But negative news can lead to new fluctuations in the cash market and even greater demand for non-cash hryvnia. At the same time, business demand for hard currency is growing, which causes an increase in NBU interventions. Increased demand may also result from fears that the NBU may weaken the official exchange rate again. But the National Bank denies such plans and believes that it has enough resources to maintain the exchange rate at the current level.

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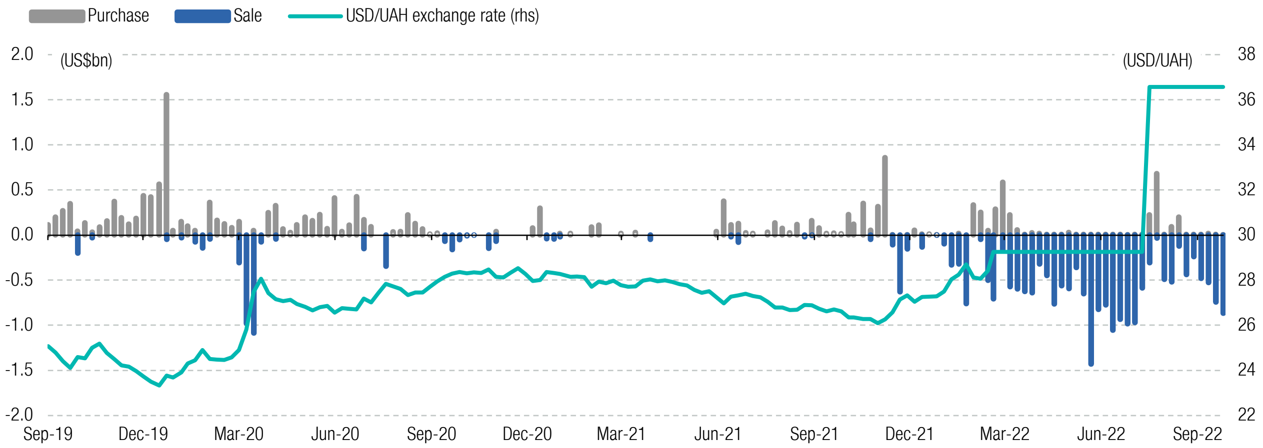
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Ukraine's public debt increases 1.3% in August

Ukraine's public debt increased 1.3% in August to $98bn.

The increase came on the back of external loans, including EUR1bn from the EU and US$0.6bn combined from Canada and Italy.

ICU view: Ukraine's public debt will continue to grow rapidly through end-2022 driven by loans from Ukraine's allies and government borrowings from the NBU. The debt-to-GDP ratio will reach 85-90% range by the end of the current year.

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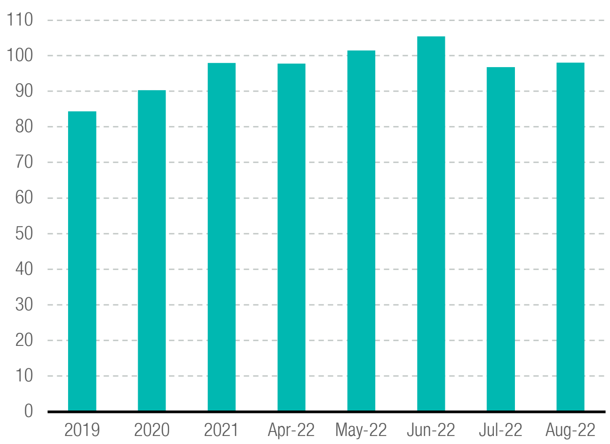
Chart 5. Ukraine's public debt, $bn

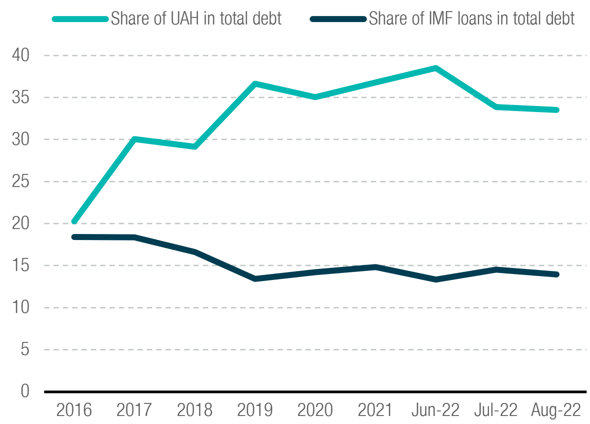
Public debt increased 1.3% in August



Source: MoF, ICU.

Chart 6. Share of UAH and IMF loans* in total debt, %

The structure of public debt changed only marginally in August



* includes IMF SDR allocation

Source: MoF, ICU.

Current account surplus surges in August

Ukraine's monthly current account surplus reached US$2.0bn in August thanks to a grant from the US.

Ukraine's trade-in-goods deficit narrowed to US1.6bn in August from US$2.0bn in July as export of grains and oil crops restarted via the Black Sea ports. The deficit of trade in services remained little changed at US$1.1bn. Migrant remittances strengthened 18% YoY and reached US$1.3bn, thus offsetting a significant portion of the trade deficit. However, the decisive factor was a US$3.0bn grant from the US which brought the 12-month C/A surplus to US$4.0bn.

Financial account turned positive in August at US$1.2bn thanks to external loans from Ukraine's partners. Meanwhile, two largest sources of capital outflows via financial account remained intact: the stock of trade credits was up US$0.7bn in August (US$0.8bn in July, US$1.7bn in June) and outflows of FX cash from banks totaled US$0.9bn (nearly the same in June and July).

Excellent BoP numbers in August helped increase NBU reserves 14% MoM to US$25.4bn.

ICU view: The one-step hryvnia depreciation that the NBU carried out in late July had little positive effect on BoP. The trade-in-goods deficit narrowed insignificantly and this improvement came on the back of higher exports of grain and oil seed crops. Outflows of capital via financial account also remained unabated.

The August BoP date combined with the recent increase in the volume of FX sale interventions by the NBU implies the July's hryvnia depreciation provided only temporary relief. Imbalances of external account continue to grow and the NBU has to keep selling reserves in large volumes. At this point, the inflows of international financial assistance are more than enough for the NBU to maintain its reserves at a safe level. However, should pressures in the FX market increase further, the NBU may be facing another tough decision regarding the exchange rate by the end of the year.

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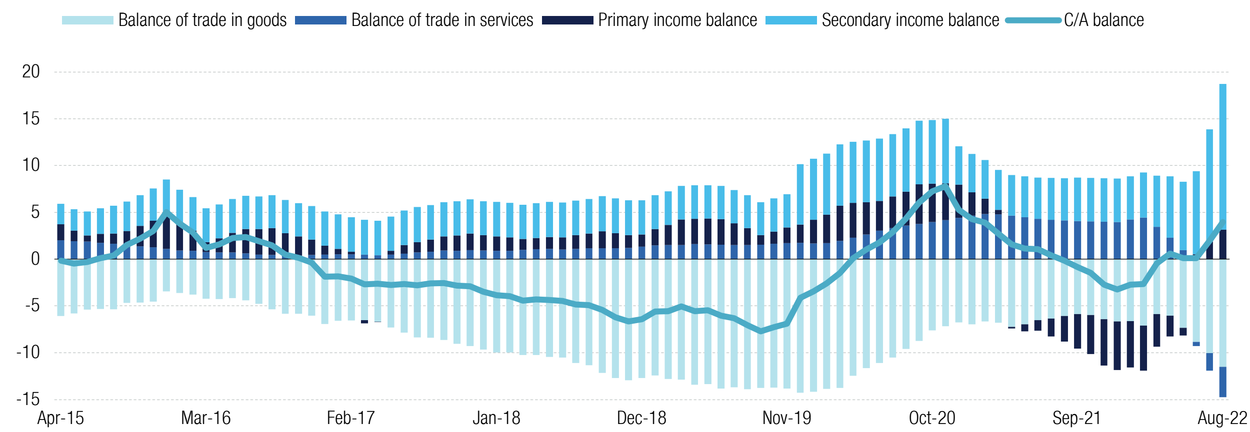
Chart 7. Current account, 12-month trailing, $bn

Current account remains in hefty surplus thanks to grants from foreign governments



Source: MoF, ICU.

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