

Weekly Insight

Public debt up substantially in January

Key messages of the today's comments

MONDAY, 6 MARCH 2023

Ukrainian bond market

Offer of reserve bonds expends

The Ministry of Finance again expanded its bond offerings with three new bills, which will likely be added to the list of paper eligible to meet reserve requirements.

Eurobond prices stabilized by combination of factors

Last week, the prices of Ukrainian Eurobonds remained broadly stable due to several coincident factors.

Foreign exchange market

Hryvnia supported by farmers' sale of hard currency

The situation in the FX market is increasingly improving for the hryvnia both in the cash and non-cash segments.

Economics

Ukraine's current account worsens on larger trade deficit

Ukraine's current account balance turned negative on the larger gap in external trade, but capital inflows via financial account were at a high level.

Ukraine's public debt up substantially in January

Ukraine's public debt increased 4.6% in US\$ terms in January to US\$116.4bn.

Banks' reserves market (3 March 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+1,500bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm) ²	155,063	-8.22	+36.99
CDs (UAHm) ³	367,928	+7.88	+261.65

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) (3 March 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	696,970	+0.00	+124.75
Banks	517,197	-2.48	-3.10
Residents	109,810	+0.54	+36.30
Individuals	32,632	-1.23	+27.79
Foreigners ¹	56,348	-3.70	-24.66
Total	1,416,067	-1.04	+38.17

Source: NBU, ICU.

FX market indicators (3 March 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9317	+0.20	+25.60
EUR/USD	1.0635	+0.82	-3.89
DXY	104.521	-0.66	+6.89
UAH TWI ¹	111.562	-0.77	-15.09

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes¹ (6 March 2023)

Maturity	Bid	Ask
6m	20.00	15.00
12m	24.00	18.00
2y	25.00	21.00
3y	25.00	21.00
12m (\$)	6.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Offer of reserve bonds expands

The Ministry of Finance again expanded its bond offerings with three new bills, which will likely be added to the list of paper eligible to meet reserve requirements.

At the primary auction, the Ministry of Finance sold three new bills last week that mature in 2025 with YTM at 20.6–20.8% (see details in the [auction review](#)). The MoF has already included these bonds in the list of benchmark securities and following a similar endorsement by the NBU, banks will be allowed to use them to meet reserve requirements.

Last week, most groups of investors reduced their UAH bonds portfolios. Banks' portfolios decreased the most, by UAH11.4bn (US\$311m), individuals foreigners significantly less, by UAH0.6bn (US\$16m) and UAH2.3bn (US\$63m), respectively, while non-banking institutions increased portfolio by UAH0.4bn (US\$11m).

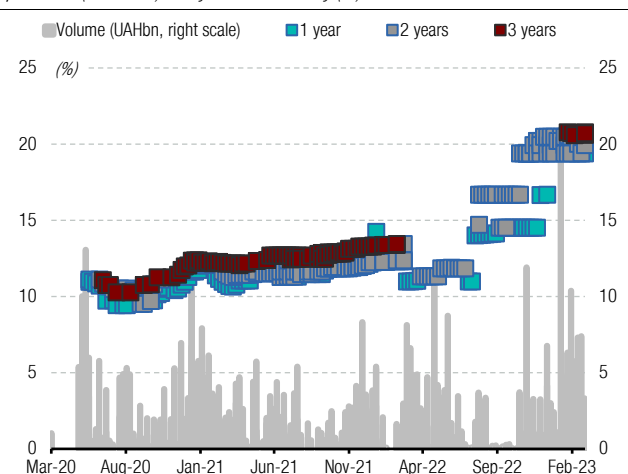
On the secondary market, trading increased to UAH4.7bn (US\$128m), and the most traded bonds were those maturing in February 2025 (UAH2.6bn (US\$71m)) and in May of this year (UAH0.8bn (US\$22m)).

ICU view: The situation remains favourable for the Ministry of Finance because banks still have not fully used their limits to invest up to 50% of required reserves into bonds. So far, they purchased just below UAH70bn (US\$1.9bn), while the total amount of required reserves is currently UAH220bn (US\$6bn). At tomorrow's auction, one of the new reserve bonds due in November 2025, first sold last week, will be offered in the amount of UAH9bn (US\$246m). So, banks likely will actively compete for this bond at the primary auction. By placing these reserve bonds, the MoF will be able to offset cash outflows due to last week's redemptions. Meanwhile, foreigners continue to reduce their portfolios, including via sale of bonds maturing in February 2025 on the secondary market.

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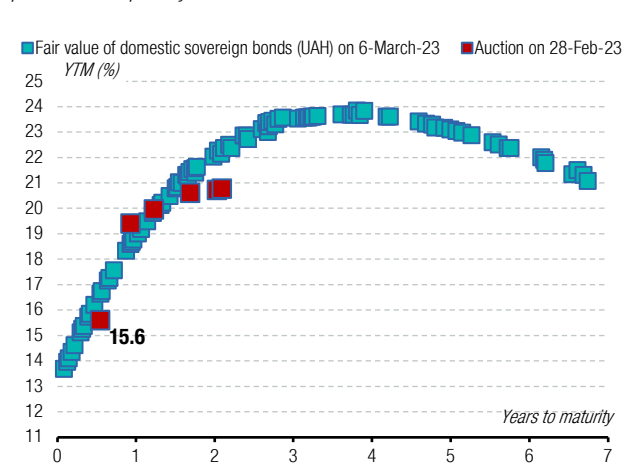
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

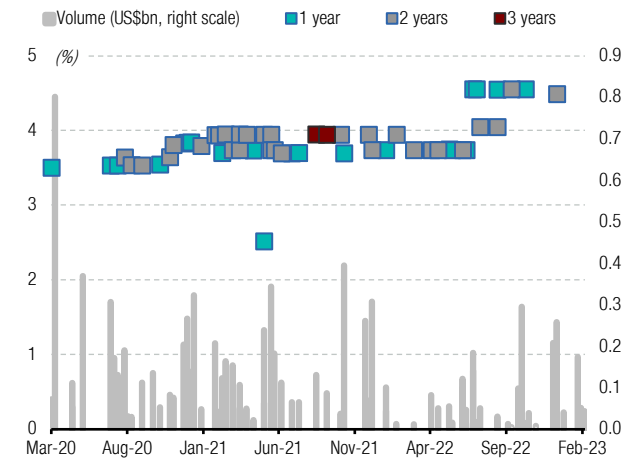
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

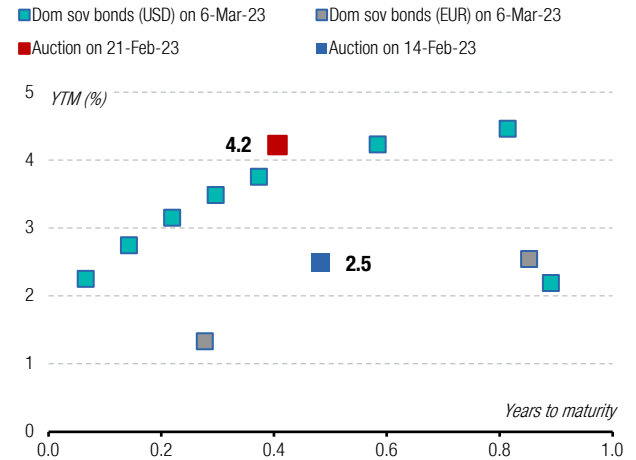
Chart 2. FX-denominated bonds

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 stabilized by combination of factors

Last week, the prices of Ukrainian Eurobonds remained broadly stable due to several coincident factors.

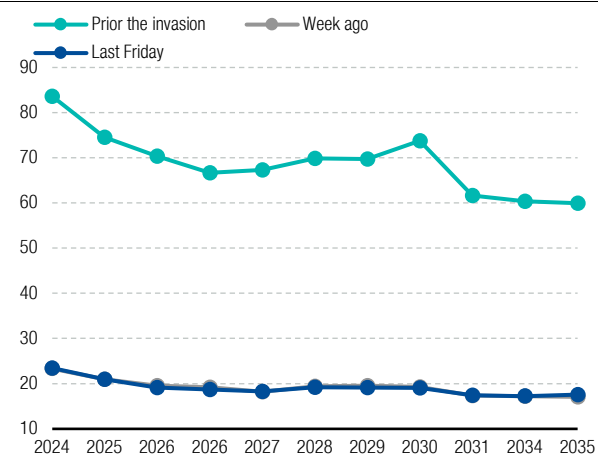
During the past week, prices of Ukrainian Eurobonds fluctuated insignificantly and, in the end, remained virtually unchanged. They continued to trade in the range of 17–23 cents. The price of VRIs decreased slightly, but remained above 27 cents per dollar of notional value.

ICU view: Rising yields of US Treasuries—the benchmark—was offset by a partial reduction in Ukraine’s spread to the benchmark. This may be related to the news about the possible rapid launch of the IMF program in the coming weeks.

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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.

Historical data since February, 2022



Source: Bloomberg, ICU.

Foreign exchange market

Hryvnia supported by farmers' sale of hard currency

The situation in the FX market is increasingly improving for the hryvnia both in the cash and non-cash segments.

In the interbank market, the supply of hard currency from bank clients (legal entities) increased, and they sold net US\$36m over four days last week, including US\$62m on Monday. Increased hard currency supply from bank clients prompted a sharp reduction of NBU sale interventions by more than half, to US\$289m, which was the lowest level of net weekly interventions since mid-November 2022.

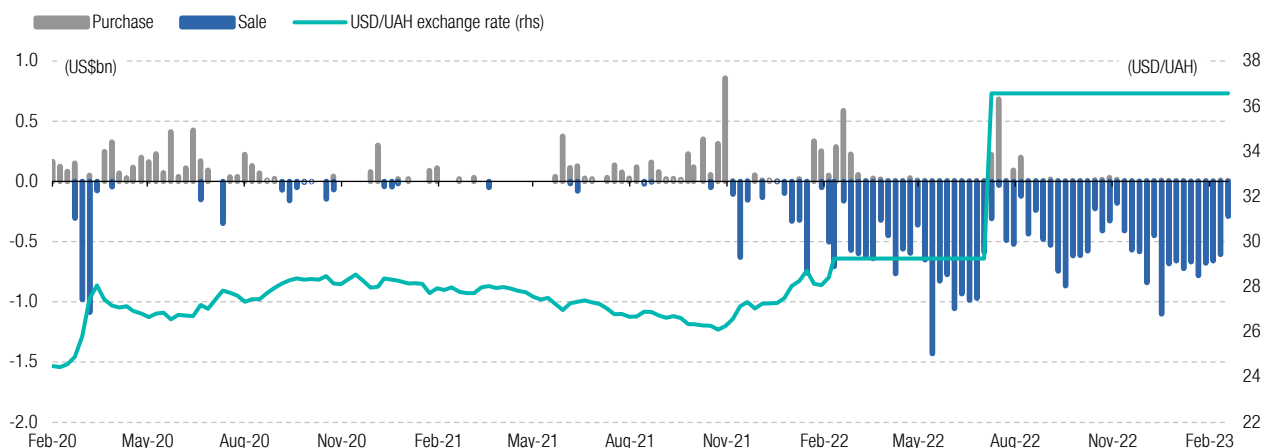
The hryvnia cash rate strengthened sharply by approximately 2% during the week, from UAH39.12–39.79/US\$ to UAH38.18–39.16/US\$. The spread between buying and selling rates widened from UAH0.67 to UAH0.98, due to a greater strengthening of the buying rate over selling, 2.4% vs 1.6%, respectively.

ICU view: It looks like farmers began preparation for the spring sowing campaign, which caused the rapid strengthening of the hryvnia. Large agricultural producers sold more hard currency on the interbank market, while small farmers sold cash currency to buy fuel, equipment, and the like. This led to an increase in the supply of FX in all market segments. The widening of the bid-offer spread means that banks are in no rush to lower the bid rate, indicating they probably are not sure that exchange-rate strengthening is a sustainable trend.

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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 current account worsens on smaller inflow of grants

Ukraine's current account balance turned negative on the smaller inflow of budgetary grants, but capital inflows via financial account were at a high level.

Ukraine's balance of trade in goods remained deeply negative in January as the economy increased its reliance on imports amid lengthy power blackouts that continued at the beginning of the year. The gap in trade in services also deteriorated to record-high levels.

Migrant remittances, humanitarian aid, and budgetary grants were not sufficient to offset the trade deficit.

Capital inflows via the financial account were at a decent level thanks to a EUR3.0bn loan from the EU to the Ukrainian government. Importantly, private capital flight subsided in January, and there was a reduction in the stock of trade credits for the first time since the start of the full-fledged war. Trade credits often indicate at shadow leakage of hard currency from the economy. Meanwhile, a rapid increase in foreign cash out of banks remained unabated and is largely a reflection of retail clients converting their UAH savings into FX cash.

ICU view: We expect Ukraine's current account balance will turn slightly negative in 2023 on larger deficit of trade in goods and smaller inflow of budgetary grants vs. 2022. Meanwhile, net inflows via the financial account are likely to be positive (with IMF loans included). All in, the balance of Ukraine's external accounts is expected to be slightly positive. This bodes well for the stability of hryvnia and the NBU international reserves that we expect will grow in 2023.

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Chart 5. Key balance of payment components, \$m

Current account worsens on larger trade deficit

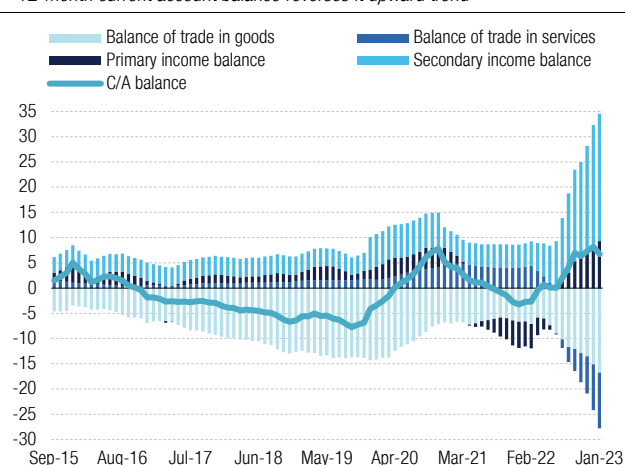
	Jan 2023	Dec 2022	Jan 2022
Current account	-762	60	769
Trade in goods	-2,027	-2,899	-365
Trade in services	-1,398	-1,225	539
Primary income	850	787	265
incl. migrant remittances	1,050	1,135	1,159
Secondary income	1,813	3,397	330
incl. transfers to government	1,088	2,377	74
Financial account*	-1,969	-467	2,530
Change in trade credits	-99	521	868
Increase in cash out of banks	1,042	779	854
Net loans to government	-3,050	-1,572	-400

* negative numbers in financial account indicate increase in liabilities (cash inflow)

Source: MoF, ICU.

Chart 6. Current account, 12-month trailing, \$bn

12-month current account balance reverses its upward trend



Source: NBU, ICU.

Ukraine's public debt up substantially in January

Ukraine's public debt increased 4.6% in January to US\$116.4bn.

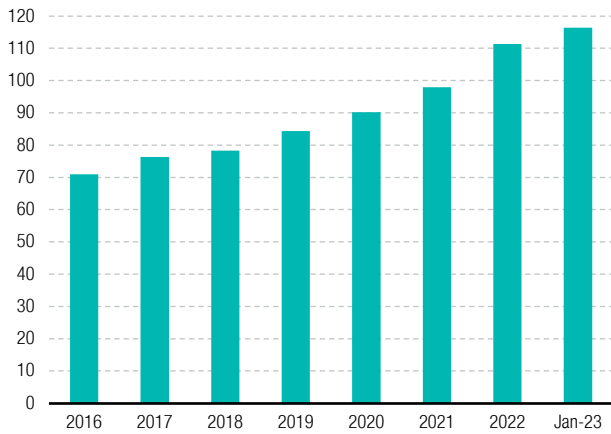
More than four-fifths of the total increase in the stock of debt is driven by external borrowings, primarily by a EUR 3.0bn concessional loan from the EU. Growth in domestic debt contributed just below a fifth to the total increase in public debt, and it came on the back of high demand for local bonds that banks can use to meet a part of NBU reserve requirements.

ICU view: All looks on track now for Ukraine to receive US\$35–40 bn in international financial assistance in 2023, of which over US\$20bn will come in the form of long-term concessional loans. Ukraine's total public debt will, thus, increase substantially in monetary terms. However, the debt-to-GDP ratio is unlikely to surge and is projected to be just above 90% by end-2023. High growth in nominal GDP due to inflation and a relatively stable exchange rate will prevent the debt-to-GDP metric from increasing significantly.

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Chart 7. Ukraine's public debt, \$bn

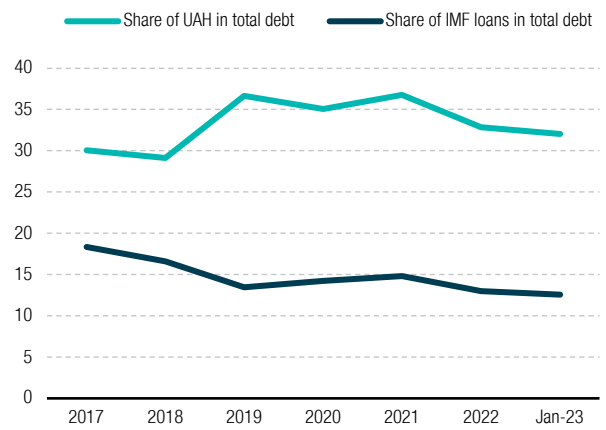
Public debt increases 4.6% in January



Source: MoF, ICU.

Chart 8. Share of UAH and IMF loans* in total debt, %

Share of hryvnia debt continues to decline



* includes IMF SDR allocation

Source: MoF, ICU.

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