Focus
Ukraine

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

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Weekly Insight

IMF memorandum envisages Eurobond restructuring

Key messages of the today's comments

Ukrainian bond market

Domestic borrowings significantly exceed repayments in 1Q23
In 1Q23, the Ministry of Finance borrowed more in the domestic bond market than it spent to redeem bonds, primarily thanks to "reserve" bonds.

IMF memorandum envisages Eurobond restructuring
The Ukraine–IMF Cooperation Program memorandum envisages restructuring of sovereign commercial debt, particularly Eurobonds, in 2024, fully consistent with the government's statements made a week ago.

Foreign exchange market

Hryvnia continues to strengthen
The hryvnia cash rate has strengthened since the beginning of the year by more than 6%.

Economics

Ukraine's current account marginally negative in February
Ukraine's current account balance improved slightly in February, but still remained marginally negative. The financial account also registered net FX outflows.

Ukraine's public debt unchanged in February
Ukraine's public debt stayed virtually flat in February at US$116bn.

MONDAY, 3 APRIL 2023

Banks' reserves market (31 March 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	25.00	+0bp	+1,500bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm)[2]	190,375	-2.09	+339.03
CDs (UAHm)[3]	354,769	-0.10	+134.31

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) (31 March 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	696,970	+0.00	+111.14
Banks	537,921	+0.07	+0.63
Residents	112,584	-0.21	+40.63
Individuals	36,049	+1.90	+40.80
Foreigners[1]	56,408	+4.27	-24.29
Total	**1,443,042**	**+0.19**	**+38.03**

Source: NBU, ICU.

FX market indicators (31 March 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.8741	-0.15	+24.85
EUR/USD	1.0905	+1.35	-2.28
DXY	102.144	-0.94	+4.45
UAH TWI[1]	110.571	-0.46	-16.27

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

Market gov't bond quotes[1] (3 April 2023)

Maturity	Bid	Ask
6m	22.00	17.00
12m	23.00	18.00
2y	25.00	21.00
3y	26.00	22.00
12m ($)	6.00	4.50
2y ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

Domestic borrowings significantly exceed repayments in 1Q23

In 1Q23, the Ministry of Finance borrowed more in the domestic bond market than it spent to redeem bonds, primarily thanks to "reserve" bonds.

Since the beginning of the year, the Ministry of Finance has stepped up domestic borrowing and attracted almost UAH137.7bn in local and hard currencies to cover the budget deficit. In particular, they received UAH97.7bn, US$785.1m (UAH28.7bn), and EUR86.9m (UAH3.4bn). During the same period, the MoF repaid UAH52.8bn and US$748.7m in bond redemptions. Net borrowings amounted to almost UAH45bn and US$36.3m. Therefore, the debt refinancing (rollover) ratio for 1Q23 is 185% for UAH securities and 105% for USD-denominated bills.

"Reserve" bonds brought the most funds to the budget—UAH97.4bn. Placement of UAH-denominated military bills stood at UAH10.4bn and ordinary UAH bills at only UAH3.1bn. Bonds denominated in USD and EUR were mostly military papers and provided the state budget with the equivalent of UAH32.1bn of proceeds.

Banks, expectedly, were the key investors with the portfolio up by UAH51.9bn. Non-banking institutions (+UAH5bn), individuals (+UAH5.5bn), and municipalities (+UAH1.2bn) increased their portfolios as well. Only foreign investors reduced their portfolios by UAH1bn YTD.

ICU view: New reserve requirements imposed by the NBU and the possibility to cover a part of mandatory reserves with government debt encouraged banks to actively invest in government bonds. This allowed the Ministry of Finance to borrow a large amount of local-currency funds during 1Q23. To ensure a high level of refinancing, the Ministry of Finance raised interest rates on USD-denominated bills last week (see auction review).

According to the memorandum with the IMF, net financing of the budget deficit from the domestic capital market should be UAH31bn this year. The recently voted amendments to the 2023 budget set a slightly less ambitious target for the government for a full refinancing of debt repayments (zero net borrowing for the year). Therefore, going forward, the Ministry of Finance will have to ensure debt refinancing at 100%.

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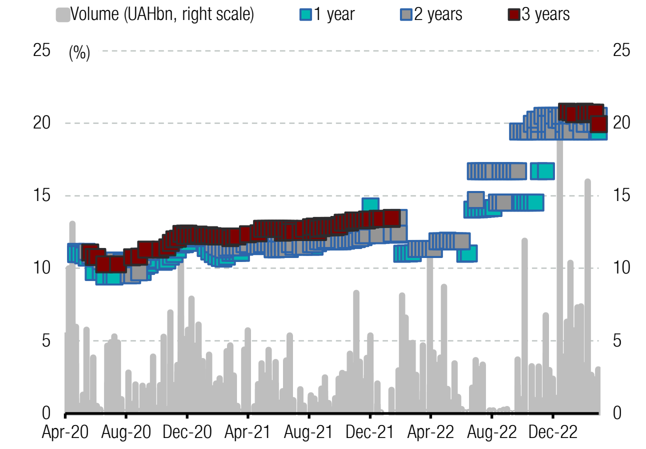
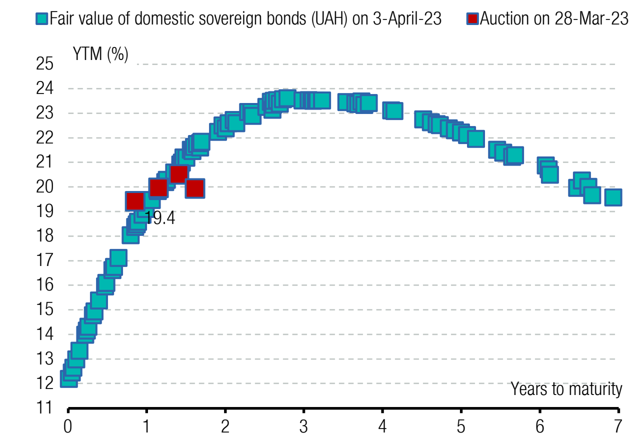
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

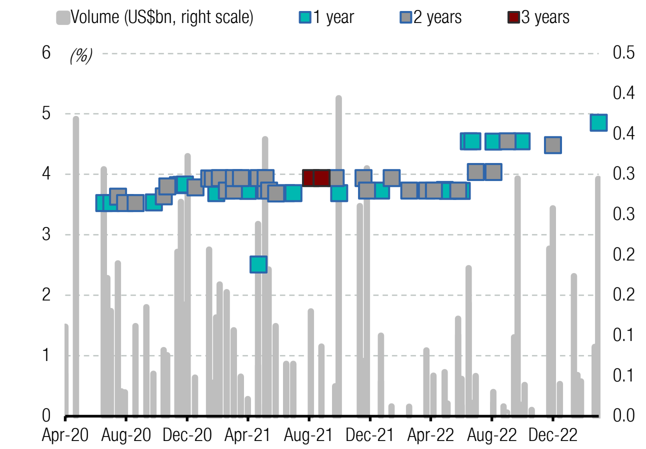
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

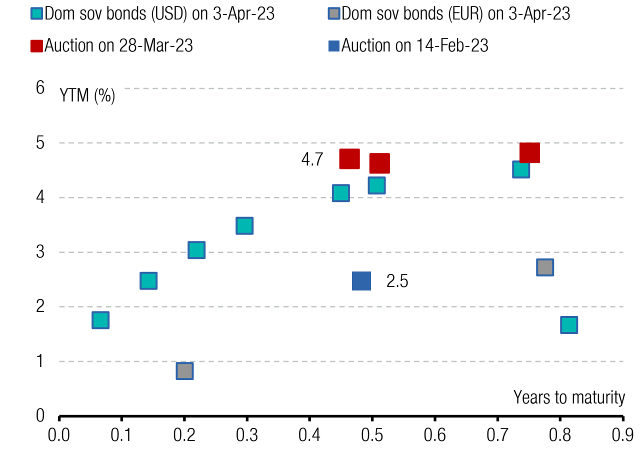
Chart 2. FX-denominated bonds

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.

IMF memorandum envisages Eurobond restructuring

The Ukraine–IMF Cooperation Program memorandum envisages restructuring of sovereign commercial debt, particularly Eurobonds, in 2024, fully consistent with the government's statements made a week ago.

During the past week, Ukrainian Eurobonds traded in the usual range of 17–23 cents per dollar. GDP warrants traded a little cheaper than 27 cents per dollar of nominal value.

ICU view: The memorandum with the IMF does not give any indication of the terms of a possible restructuring, but it stipulates that the terms for official and commercial debt should be similar. The goal of external debt restructuring will be to reduce the debt burden in the future to 60–65% of GDP, which will be impossible without a debt haircut. Detailed restructuring parameters will depend on macro indicators and their forecast in early 2024, when the government plans to launch the process as per its recent announcement.

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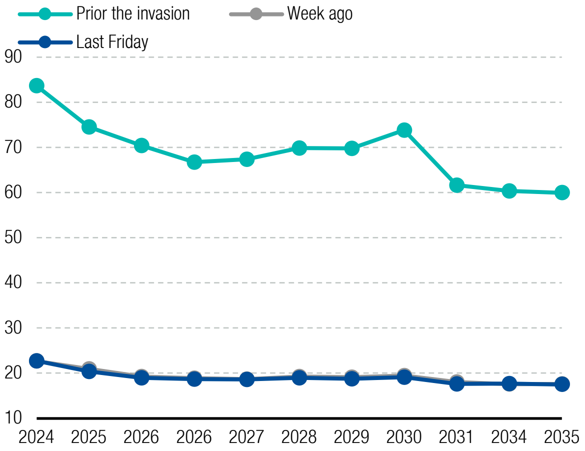
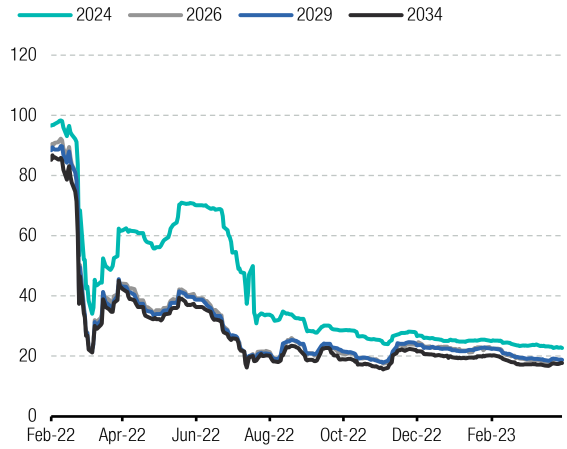
Chart 3. Ukrainian Eurobonds prices

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 continues to strengthen

The hryvnia cash rate has strengthened since the beginning of the year by more than 6%.

During the past week, the hryvnia cash exchange rate in leading retail banks strengthened by more than one percent to UAH37.4–38.2/US$, and bid–offer spread tightened by UAH0.06 to UAH0.80. During 1Q23, the hryvnia exchange rate strengthened by more than 6%, and the bid–offer spread narrowed by UAH0.15.

On the interbank market, the FX purchases of bank clients (legal entities) exceeded sales. Still, the imbalance remains small, and the NBU's interventions decreased last week to US$343m.

ICU view: Demand for hard currency in the retail market remains strong, but activity is shifting towards cash. Households are in no hurry to buy non-cash hard currency for deposits, as the non-cash and cash rates have converged significantly. To keep household demand for non-cash FX stable, banks started to decrease their FX sale rates, which may indicate a consolidation of the trend towards a stronger hryvnia. The interbank market remains under the control of the NBU with an acceptable level of weekly FX sale interventions.

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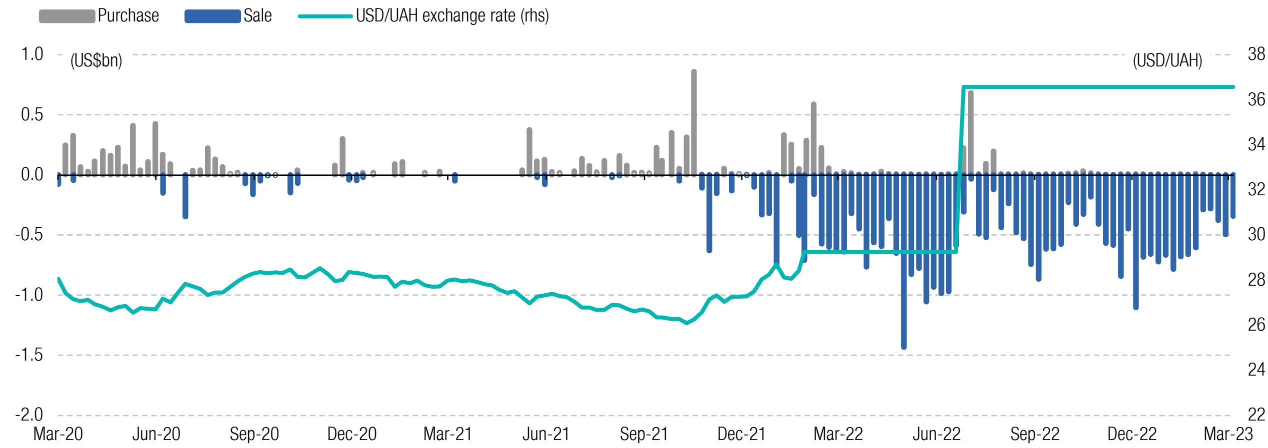
Chart 4. FX market indicators, 3-year history

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 marginally negative in February

Ukraine's current account balance improved slightly in February, but still remained marginally negative. The financial account also registered net FX outflows.

Ukraine saw a slight improvement in its trade-in-goods and trade-in-services deficits in February vs. January. The total trade deficit remained hugely negative at US$3.1bn, but it was nearly covered with migrant income and official budgetary transfers. Monthly migrant income has been little changed for over a year and remains a significant contributor offsetting the trade gap. Official budgetary transfers exceeded US$1.5bn in February thanks to a timely receipt of a US$1.25bn grant from the US.

The financial account registered a net US$0.53bn capital outflow mainly due to withdrawal of FX from local banks. The stock of trade credits (the key channels of private capital outflows) was down for the second consecutive month, which might signal that businesses have less and less incentive to channel money out of the country at any cost.

ICU view: We continue to project a reasonable (2-3% of GDP) current-account deficit in 2023, which is a deterioration vs. 5.4% of GDP surplus in 2022. Meanwhile, the financial account is likely to see significant net capital inflows, unlike last year, and this will more than offset the current-account gap. Overall, we expect that thanks to generous international funding, the NBU will be able to maintain its reserves at above US$30bn in 2023, while selling the needed hard currency to maintain stability of the FX market.

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Chart 5. Key balance of payment components, $m

Current account improves marginally in February

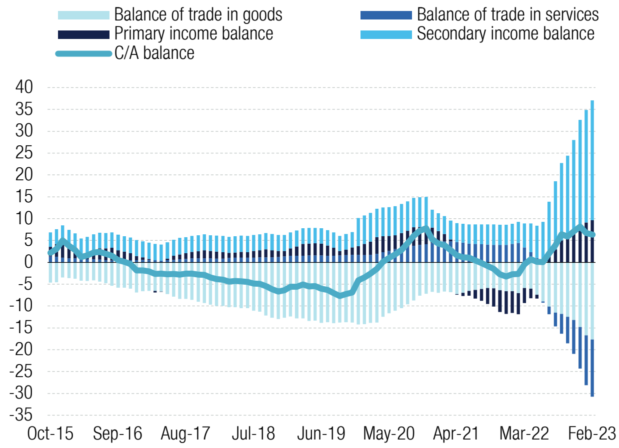
	Feb 2023	Jan 2023	Feb 2022
Current account	-216	-815	4
Trade in goods	-1,952	-2,215	-1,055
Trade in services	-1,176	-1,352	169
Primary income	659	850	249
incl. migrant incomes	1,068	1,051	1,138
Secondary income	2,253	1,902	641
incl. transfers to government	1,597	1,164	319
Financial account*	532	-2,011	1,565
incl. change in trade credits	-539	-117	-666
incl. increase in cash out of banks	1,065	1,039	943
incl. net loans to government	-511	-3,218	102

* 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 it upward trend



Source: NBU, ICU.

Ukraine's public debt unchanged in February

Ukraine's public debt stayed virtually flat in February at US$116bn.

In February, the external budgetary support was mainly provided in the form of grants, leaving the total stock of debt nearly intact. The structure of public debt was also little changed, with the only noticeable transactions being repayment of a US$0.3bn debt to the IMF, receipt of a net USD0.6bn loan from the WB, and a slight increase in domestic debt due to active purchases of government bonds by local banks.

ICU view: Ukraine will continue to rely heavily on external borrowings to finance its state budget deficit, while in the domestic market, government will likely seek to ensure just 100% debt rollover. The country's nominal public debt will, thus, increase significantly by the end of 2023 and land at just above 90% relative to GDP. While this level of debt is hardly sustainable per se, it does not pose any visible near-term risks in terms of liquidity thanks to creditors' concessions. Looking longer-term, the debt will be subject to restructuring with a view of bringing its level and structure in line with the IMF program goals (see the comment above).

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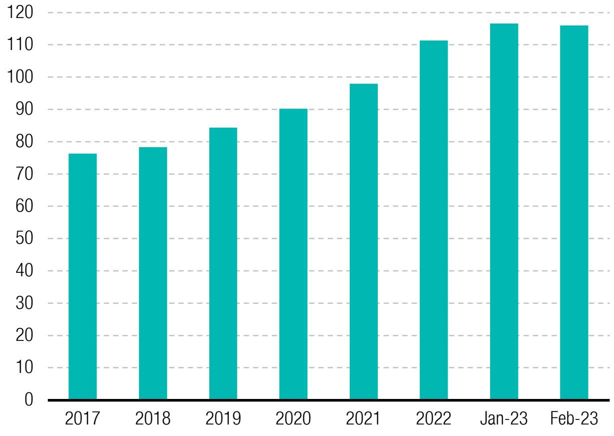
Chart 7. Ukraine's public debt, $bn

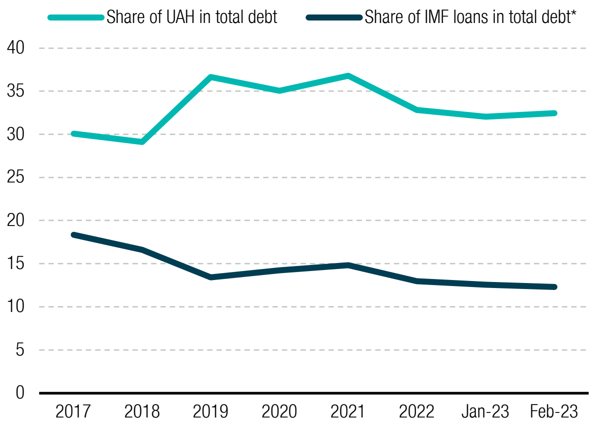
Public debt unchanged in February



Source: MoF, ICU.

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

Share of debt to IMF continued to trend down in February



* includes IMF SDR allocation

Source: MoF, ICU.

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