Focus

Ukraine

Markets

Domestic liquidity, government bonds, FX market, and macro

Research team

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Weekly Insight

IMF completes first EFF program review

Key messages of the today's comments

MONDAY, 5 JUNE 2023

Ukrainian bond market

Refinancing of local debt up in May

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Foreigners resume investments in UAH bills

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Eurobond price range stabilizes

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Foreign exchange market

Cash hryvnia slightly strengthens

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Economics

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Ukraine's public debt increased 3.6% in US$ terms in April to US$124bn.

Banks' reserves market (2 June 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	25.00	+0bp	+1,500bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm)[2]	199,383	-5.86	+324.83
CDs (UAHm)[3]	418,516	+2.31	+145.39

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) (2 June 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	694,346	+0.00	+62.00
Banks	547,183	-0.14	+0.84
Residents	116,416	+4.10	+57.97
Individuals	40,533	+5.33	+39.96
Foreigners[1]	49,055	+12.34	-32.23
Total	**1,450,947**	**+0.80**	**+26.59**

Source: NBU, ICU.

FX market indicators (2 June 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9482	-0.01	+25.67
EUR/USD	1.0708	-0.14	-0.36
DXY	104.015	-0.18	+2.15
UAH TWI[1]	111.749	+0.26	-18.29

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

Market gov't bond quotes (5 June 2023)

Maturity	Bid	Ask
6m	**18.00**	**16.00**
12m	**21.00**	**18.00**
2y	**23.00**	**20.00**
3y	**23.50**	**20.50**
12m ($)	**6.00**	**4.50**
2y ($)	**N/A**	**N/A**

Source: ICU.

Ukrainian bond market

Refinancing of local debt up in May

In May, the Ministry of Finance increased borrowings in all currencies, maintaining the debt refinancing rate above 100% and even improving it for FX-denominated bills.

In May, the MoF raised UAH68.7bn (US$1.9bn) in the primary market, including UAH29.4bn (US$0.8bn) in local currency and UAH39.3bn in hard currency (US$616m and EUR418m). The level of refinancing in May stood at 114% for UAH instruments, 197% for USD, and 109% for euros. For 5M23, the level of refinancing was 137% in UAH, 123% in USD, and 132% in euros.

ICU view: The Ministry of Finance managed to increase borrowings and debt refinancing ratios, especially in hard currency, by offering FX-denominated bills every week and increasing the interest rate EUR-denominated bills to 3.15%. Thanks to active borrowings, the Ministry can use May's proceeds to partly repay debt due in June. The following week, EUR142mn bills are scheduled to be repaid and US$431m follows a week later.

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Foreigners resume investments in UAH bills

Foreign investors upped their purchases of UAH debt last week after a short pause.

After the NBU toughened the requirements for repatriation of coupons on government bonds, a significant amount of bonds were redeemed by foreigners. Last week, they restarted purchases of bonds in both the primary and secondary markets.

At last Tuesday's primary auction, the highest demand was for UAH bills maturing in March 2024: UAH6bn (US$165.4m) of par value. Overall, the Ministry raised UAH11.3bn (US$308,8m) last week, including US$110.6m (UAH4bn) in hard currency. See details in the auction review.

The portfolios of foreign investors increased by UAH5bn (US$135m) over the past week, including by UAH4.5bn (US$132m) after the primary auction settlement. On the secondary market, the most actively traded bills were the ones due on March 2024 with a coupon payment on September 13 (UAH3.7bn - US$102m) or 40% of all trades in UAH bonds for the week. Other popular papers included those with maturity and coupon payments on September 27 of this year (UAH1.9bn - US$51m) at 19% of total volume.

ICU view: The pattern of trades clearly indicates that foreigners had interest in bills with a maturity in March 2024 and a coupon payment in September this year, both on the primary market and on the secondary market. These bonds qualify for coupon repatriation under the new NBU rules. Foreigners also likely bought bonds maturing at the end of September. Foreign investors hope that the NBU will not change the regulations in the future so they can start accumulating bonds that offer coupons eligible for repatriation.

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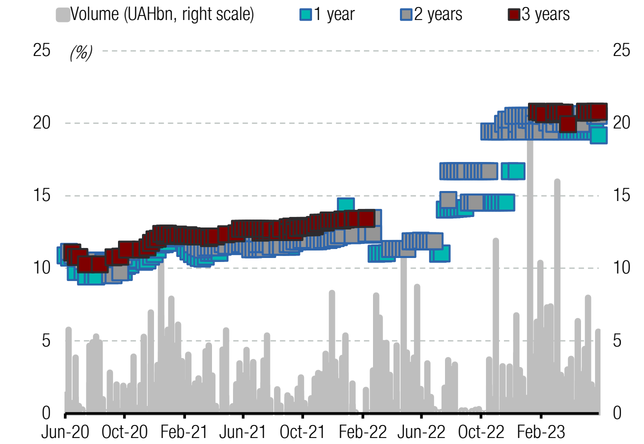
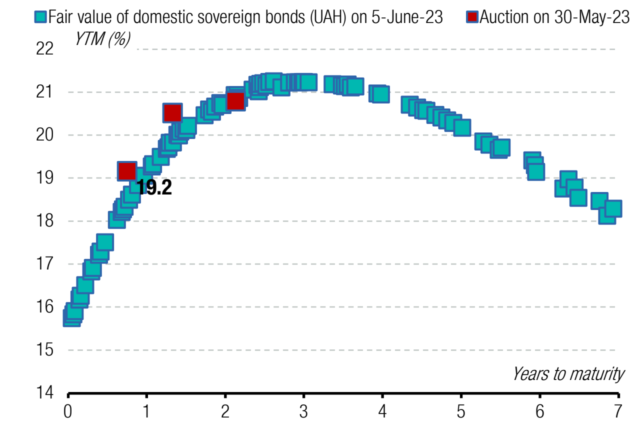
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

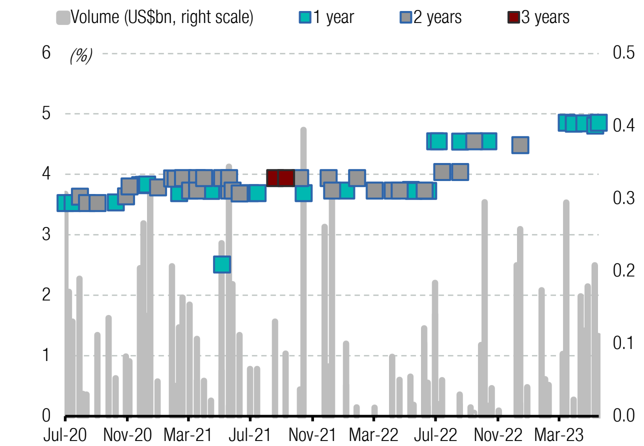
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

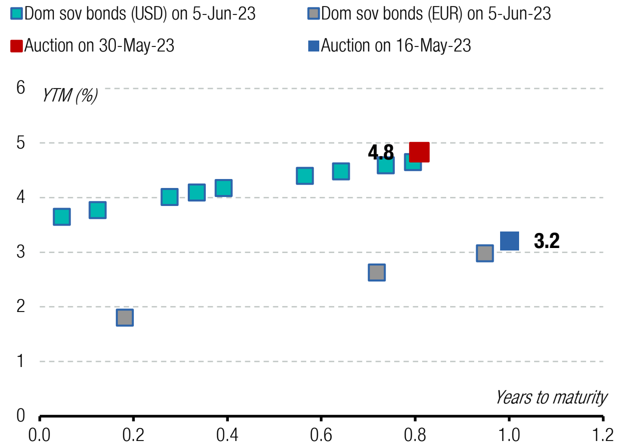
Chart 2. FX-denominated bonds

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 price range stabilizes

The prices of Ukrainian Eurobonds decreased for the second straight week, but the range of prices across different maturities remained close to 10%.

Over the past week, the Ukrainian Eurobonds lost 1–2% in price. The range of prices for different maturities remained nearly unchanged, at slightly above 10%. The price of VRIs remained at the level of 29 cents.

ICU view: Although situational demand has dried up, Eurobond prices are holding on to some gains made at the end of May. Positive macroeconomic news, particularly about the successful first review of the IMF EFF program for Ukraine, had no noticeable effect on investor sentiment. The movement of prices occurs mainly due to situational factors when large institutional investors reduce or increase their exposure to Ukraine depending on their personal long-term expectations regarding further course of the war.

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Foreign exchange market

Cash hryvnia slightly strengthens

Over the past week, the hryvnia cash exchange rate strengthened, but the bid–offer spread widened marginally.

The hryvnia cash exchange rate in systemically important banks strengthened from UAH37.09–37.65/US$ to UAH36.91–37.52/US$ or by about 0.15%. The bid–offer spread widened by UAH0.05 to UAH0.61, mainly due to a more significant strengthening of the bid rate. Overall, cash hryvnia strengthened by almost 8% YTD.

The volume of hard currency trading on the retail market increased in May. Purchases of hard currency by households increased by 13% to US$1.77bn, and sales were up by 20% to US$1.61bn.

In general, the situation has not changed in the interbank market. The volume of hard currency trading for four days remained close to the similar period of the previous week, and the volume of NBU interventions amounted to US$469m, which is only 6% more than the previous week.

ICU view: The retail FX market remains saturated, particularly thanks to the flow of FX from bank accounts into the cash market. The increase in the volume of hard currency trading in the retail FX market was mostly due to more business days in May. The interbank market remains under the control of the NBU, with the usual volume of weekly interventions at a level close to US$500m.

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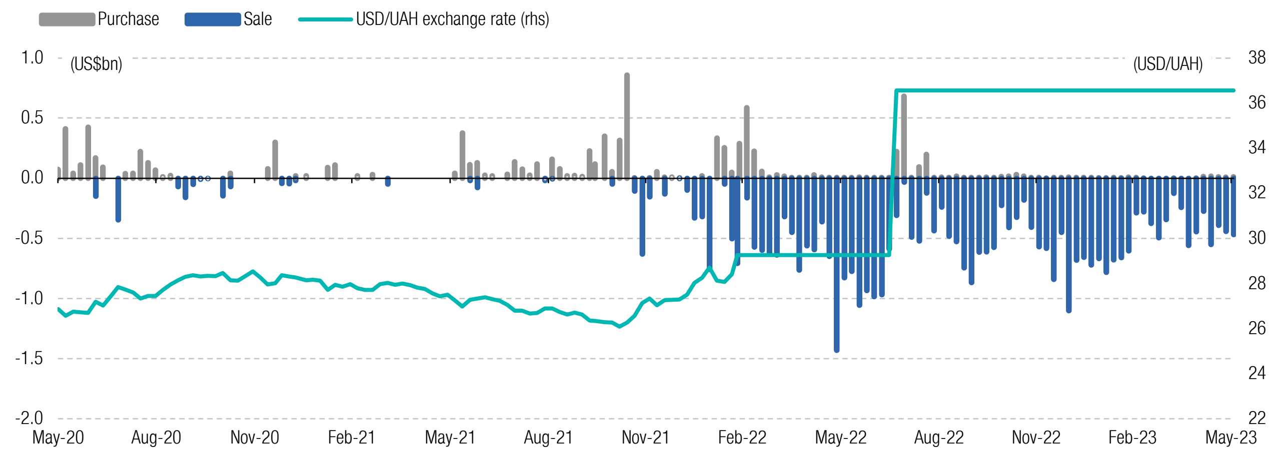
Chart 3. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

IMF successfully completes first EFF program review for Ukraine

Last week, Ukraine reached a staff-level agreement with the IMF on a successful first review under the EFF program.

The IMF Head of Mission noted that all quantitative performance criteria for end-April and structural benchmarks through end-May were met. The review results are still subject to approval by the IMF Board, which is expected in June.

ICU view: The success of the first review under the IMF EFF program comes as no surprise and was fully expected by the market. It opens a path for a second IMF loan tranche of US$900mn. The IMF EFF four-year program was launched in late March and envisages a total lending amount of US$15.6bn as a part of a broader US$115bn financial aid package offered by Ukraine's allies.

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Current account in surplus thanks to foreign aid

Ukraine's current account turned into surplus in March and remained in positive territory at US$285mn in April.

The deficit of trade in goods remained huge but little changed MoM, while the deficit of trade in services improved somewhat due to lower gap in travel component. The external trade deficit was fully offset by income of migrants and, to a larger extent, by budgetary grants and humanitarian aid. The 12-month trailing current-account balance thus remained in surplus at US$4.1bn as of April.

The financial account saw net positive inflows of funds of US$1.1bn, largely thanks to a loan provided to the government by the EU. Cash outflow from banks (withdrawal of FX deposits and withdrawal of FX cash abroad of accounts in hryvnia) was the main source of capital outflow. It remained little changed MoM.

A combination of a positive current account and financial account helped the NBU accumulate reserves. In addition, NBU reserves were boosted by the receipt of the first tranche of the IMF loan that was reported below the line in the BoP statistics. NBU reserves were up 13% to nearly US$36bn in April.

ICU view: The balance of payments data remain without any major surprises. Net of international financial aid, capital outflows via current and financial accounts remain huge, but foreign loans and grants ensure that the external accounts gap is fully closed and the NBU keeps accumulating reserves. We don't see any risks that the inflow of foreign aid may subside any time soon, and we expect it will keep serving as a cushion against risk. Against this backdrop, we are becoming increasingly confident the NBU will not be forced to change the official exchange rate this year.

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Chart 4. Key balance of payment components, $m

Current account balance positive for second month in a row

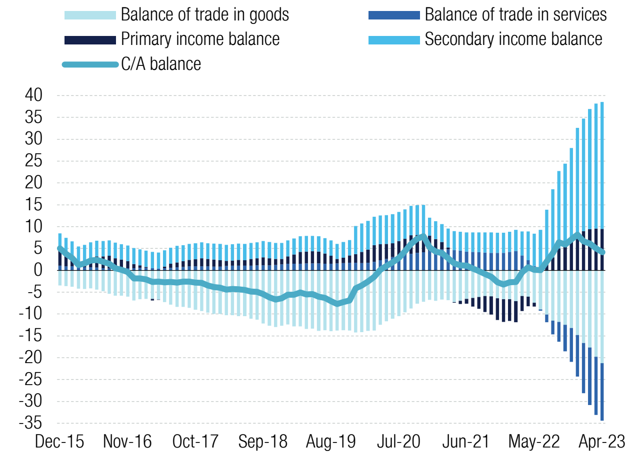
	Apr 2023	Mar 2023	Apr 2022
Current account	285	373	1,210
Trade in goods	-1,787	-1,793	-431
Trade in services	-661	-794	-894
Primary income	724	809	855
incl. migrant income	994	1,026	1,086
Secondary income	2,009	2,151	1,680
incl. transfers to government	1,425	1,407	958
Financial account*	-1,090	-3,019	1,996
Change in trade credits	-71	-955	1,556
Increase in cash out of banks	1,041	1,159	868
Net loans to government	-1,575	-3,323	-879

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

Source: MoF, ICU.

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

12-month current account balance still positive



Source: NBU, ICU.

Ukraine’s public debt up 4% in April

Ukraine’s public debt increased 3.6% in US$ terms in April to US$124bn.

Since the start of russia’s full scale invasion of Ukraine in February 2022, debt is up by 33% in US$ terms. In April, the debt grew on the back of significant external borrowings including a US$2.7bn loan from the IMF and a EUR1.5bn loan from the EU.

ICU view: Ukraine’s public debt expectedly continues to grow at a rapid pace as the country’s huge fiscal gap is primarily covered by external loans from Ukraine’s allies. The public debt-to-GDP ratio is likely to rise close to 90% by the end of 2023, up from 78.5% at the end of 2022. This is a high ratio indicating Ukraine’s public debt is hardly sustainable. However, high indebtedness doesn’t imply any near-term liquidity pressures on the Ukrainian government thanks to extension of maturities and suspension of all debt servicing payments (except on loans from IFIs) agreed with the official and private creditors.

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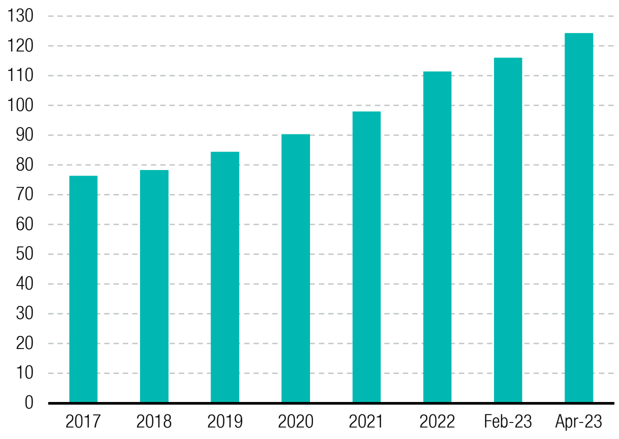
Chart 6. Ukraine's public debt, $bn

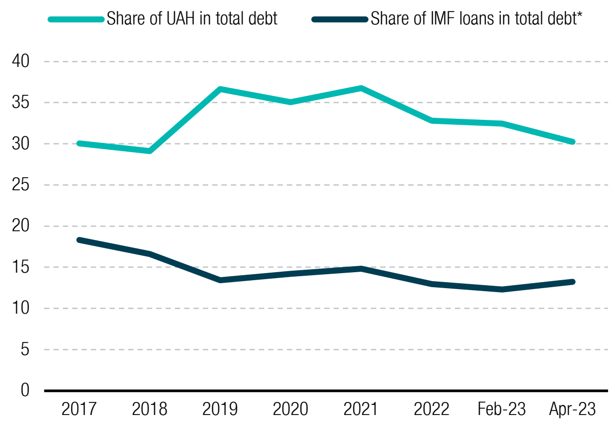
Public debt increases 4% in April



Source: MoF, ICU.

Chart 7. Share of UAH and IMF loans* in total debt, %

Share of hryvnia debt continues to decline due to heavy external borrowings



* includes IMF SDR allocation

Source: MoF, ICU.

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