



Focus
Ukraine

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

Research team
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Weekly Insight

Current account balanced in May

Key messages of the today's comments

MONDAY, 3 JULY 2023

Ukrainian bond market

Domestic debt refinancing remains high

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Rally continues; Eurobonds price range narrowing

Positive news and situational demand supported the further increase in Ukrainian Eurobond prices, which continued to converge across maturities.

Foreign exchange market

NBU approves FX liberalization strategy

The NBU has approved a strategy for easing FX restrictions, which it has promised to publish this week.

Households' FX sales exceed purchases first time since mid-2022

Households sold more hard currencies than they bought in June for the first time since July last year.

Economics

Current account balances in May

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Ukraine's public debt up 1% in May

Ukraine's public debt increased 1.0% in US\$ terms in May to US\$125.6bn.

Banks' reserves market (30 June 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+0bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm) ²	191,987	-4.00	+235.71
CDs (UAHm) ³	484,685	+0.90	+165.69

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 June 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	691,846	-0.36	+30.27
Banks	547,189	+0.27	+4.02
Residents	117,044	+1.74	+75.65
Individuals	41,862	+9.24	+50.69
Foreigners ¹	51,694	-0.02	-28.27
Total	1,453,297	+0.32	+18.77

Source: NBU, ICU.

FX market indicators (30 June 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9313	+0.00	+25.61
EUR/USD	1.0909	+0.14	+4.05
DXY	102.912	+0.01	-1.69
UAH TWI ¹	112.380	+0.26	-19.17

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes (3 July 2023)

Maturity	Bid	Ask
6m	18.00	16.00
12m	20.00	18.00
2y	22.00	20.00
3y	22.50	20.50
12m (\$)	6.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Domestic debt refinancing remains high

The Ministry of Finance refinanced most of the domestic debt redemptions in June, keeping the overall refinancing ratio above 100% YTD.

Borrowings in local currency in June amounted to UAH28.3bn (US\$0.8bn), which was 15% more than redemptions. The MoF borrowed UAH45.2bn (US\$1.2bn) or 33.5% more than it repaid in 1H23.

The MoF borrowed almost US\$320m in June, 26% less than redemptions of USD-denominated bonds. But thanks to significant USD proceeds in May, the overall level of debt refinancing declined slightly from 123% in 5M23 to 111% in 1H23.

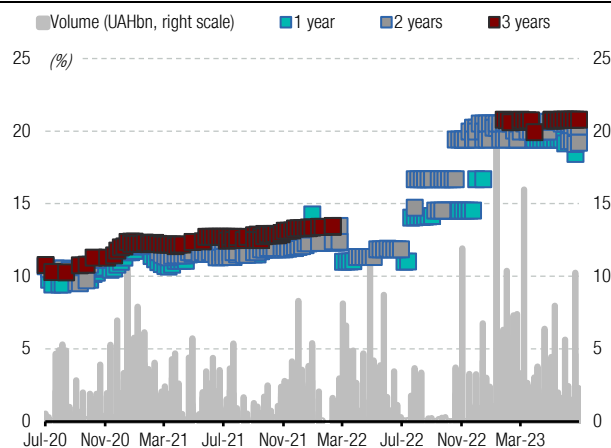
In euros, the Ministry of Finance refinanced almost the entire volume of redemptions in June (EUR142.8m) by borrowing EUR136m. So, the level of refinancing decreased to 122% in 1H23 compared with 132% in 5M23.

ICU view: The Ministry of Finance achieved full refinancing in local currency only in June. Hard-currency debt redemptions were refinanced only partially, but were covered by hefty borrowings in May. Therefore, the overall level of debt refinancing remained significantly above 100% YTD. This month, the Ministry of Finance is likely to secure full refinancing of the domestic debt as debt redemptions scheduled for July are much less significant.

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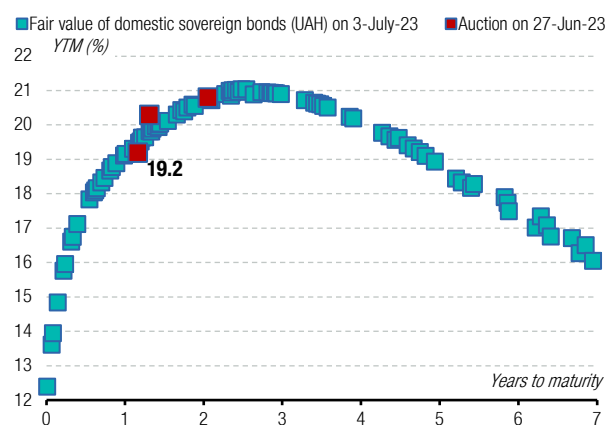
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

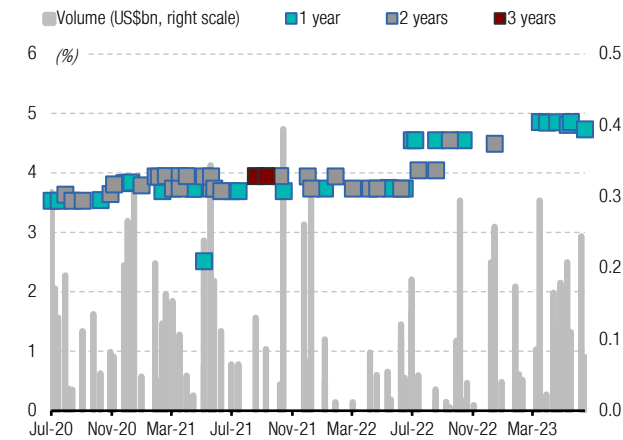
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

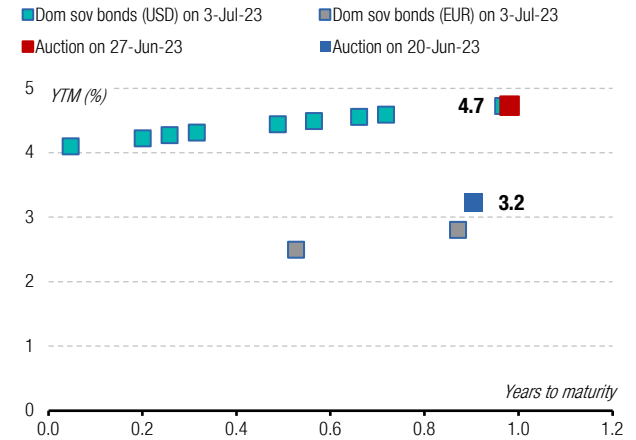
Chart 2. FX-denominated bonds

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.

Rally continues; Eurobonds price range narrowing

Positive news and situational demand supported the further increase in Ukrainian Eurobond prices, which continued to converge across maturities.

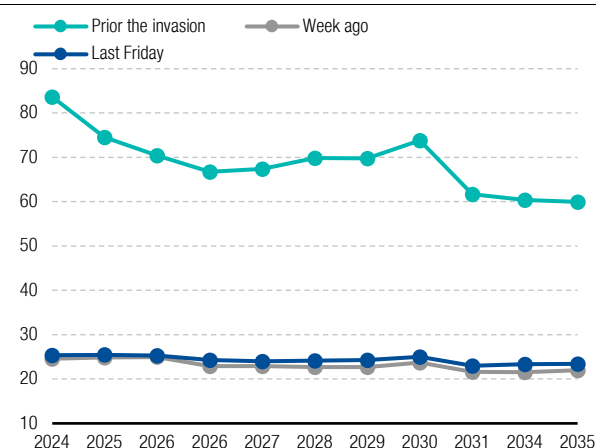
Over the past week, sovereign Eurobonds rose in price mostly by 5-8% and shifted to 23–26 cents. The price range narrowed to 5.1%. VRI's price is up just 2% to slightly below 39 cents.

ICU view: A number of high-level political events were held in Europe last week to discuss security guarantees for Ukraine and sources of financing for reconstruction. The news of the IMF Board approving the first EFF program review added more positive sentiment. Ukraine now expects US\$890m for budget support from the IMF. Loans from the EU and grants from the USA are also getting to the budget on schedule. Moreover, the NBU reserves likely increased significantly in June. All this news combined provided excellent background for the recovery of Eurobond prices. The convergence of prices across maturities likely signals that investors expect the debt restructuring terms that will result in very similar NPVs across the board.

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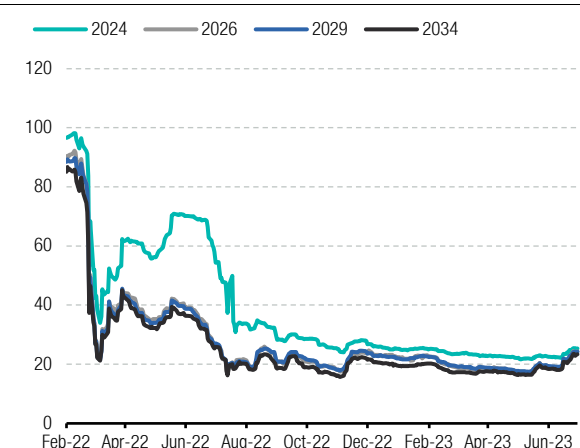
Chart 3. Ukrainian Eurobonds prices

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

NBU approves FX liberalization strategy

The NBU has approved a strategy for easing FX restrictions, which it has promised to publish this week.

The strategy approved on Thursday consists of three main areas: an easing of FX restrictions, a transition to a flexible exchange rate regime, and a return to the principles of inflation targeting. The National Bank plans to implement the strategy gradually, subject to the necessary prerequisites.

ICU view: Approval of the strategy is one of the structural milestones of the current IMF EFF program. The NBU did not hint at how ambitious the liberalization roadmap will be, its priorities, or timeline. However, the fact that recent FX liberalization steps by the NBU were nominal implies the regulator will pursue a very cautious approach and any major breakthrough is very unlikely in the coming months.

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Households' FX sales exceed purchases first time since mid-2022

Households sold more hard currencies than they bought in June for the first time since July last year.

From August 2022 to May 2023, purchases exceeded sales in FX retail, with excesses hitting over US\$0.5bn per month in January and February. June was the first month since mid-2022 that saw positive net FX sale by households, even though marginal.

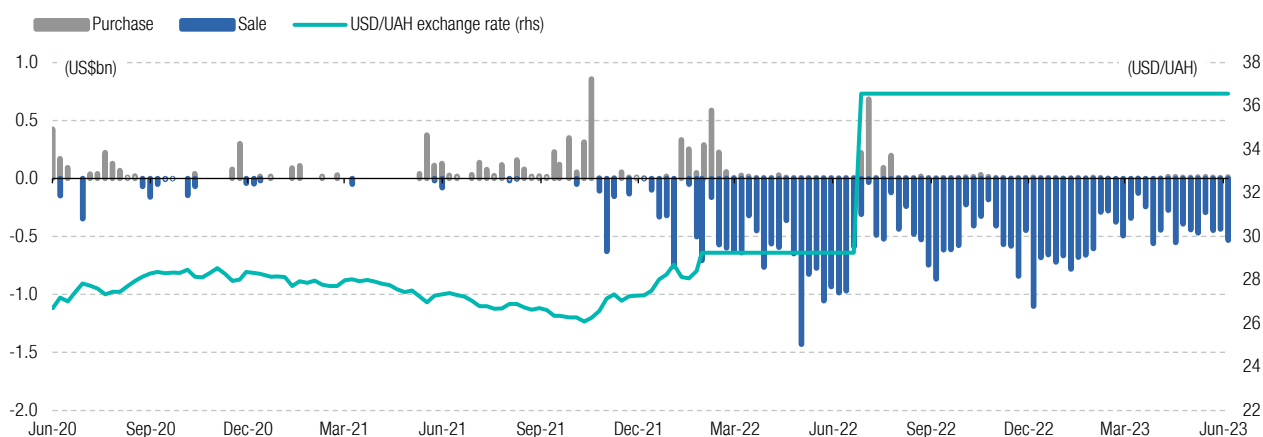
The hryvnia exchange rate in systemically important banks weakened by 0.2% last week to UAH36.66–37.46/US\$. However, it strengthened by 0.5% in June and by more than 8% YTD.

ICU view: Unprecedented amounts of international aid, which the NBU used for interventions and gradual saturation of the cash segment, were instrumental in balancing the retail FX market and bringing the cash exchange rate closer to the official one. The fixed official exchange rate, the rapid growth of the NBU reserves, and the high interest rates on UAH deposits helped reduce FX demand in the retail segment.

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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

Current account balanced in May

Ukraine's current account was nearly balanced in May while the 12-month tally was still positive at US\$3.4bn.

The economy continues to face a huge-trade-in-goods deficit, which stood at US\$2.0bn in May and US\$21.7bn over the past 12 months. Meanwhile, the deficit of trade-in-services improved visibly in recent months to US\$0.5bn in May from a monthly average US\$1.1bn in 1Q23 on lower imports of tourism. Import of tourism is largely a reflection of spending that Ukrainian refugees make abroad. However, this improvement may also be related to the NBU closing gaps that allowed shadow flows of hard currency via payment systems. Earnings of migrants abroad remain at a healthy monthly level of US\$0.9–1.0bn and offset a significant part of the trade deficit. The remaining gap was fully closed thanks to humanitarian aid and budgetary transfers to the Ukrainian government (secondary income).

The financial account saw significant net inflows of currency of US\$1.5bn in May largely thanks to a new tranche of the EU Macro-Financial Assistance facility. The change in trade credits was minimal indicating the private sector is no longer using this channel to siphon money out of the country. However, outflows of FX into cash (withdrawal of foreign currency from bank accounts) remain the key drag on the financial account.

ICU view: The BoP data remain broadly in line with our projections, and we don't expect any significant positive or negative surprises through end-2023. We see the current-account deficit ending at 2–3% of GDP for the full 2023, but this shortfall will be fully covered with FX inflows via the financial account. This bodes well for the stability of the local currency and NBU FX reserves.

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

Current account balance close to zero in May

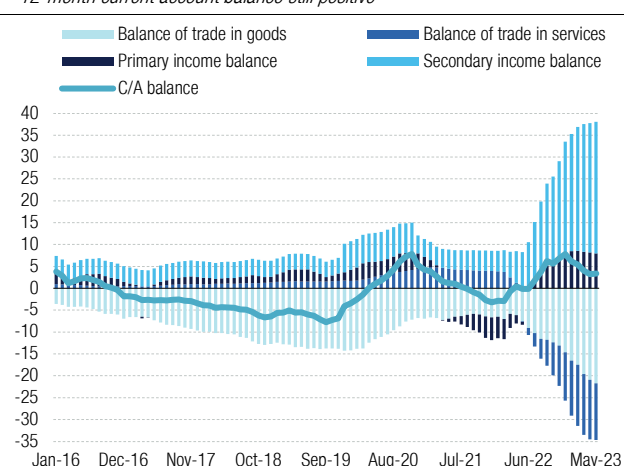
	May 2023	Apr 2023	May 2022
Current account	-21	380	-173
Trade in goods	-2,032	-1,719	-1,209
Trade in services	-501	-591	-1,132
Primary income	529	679	754
incl. migrant income	955	952	1,049
Secondary income	1,983	2,011	1,414
incl. transfers to government	1,435	1,426	774
Financial account*	-1,545	-995	1,751
Change in trade credits	-131	28	1,838
Increase in cash out of banks	1,047	1,014	1,089
Net loans to government	-1,925	-1,575	-937

* 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 still positive



Source: NBU, ICU.

Ukraine's public debt up 1% in May

Ukraine's public debt increased 1.0% in US\$ terms in May to US\$125.6bn.

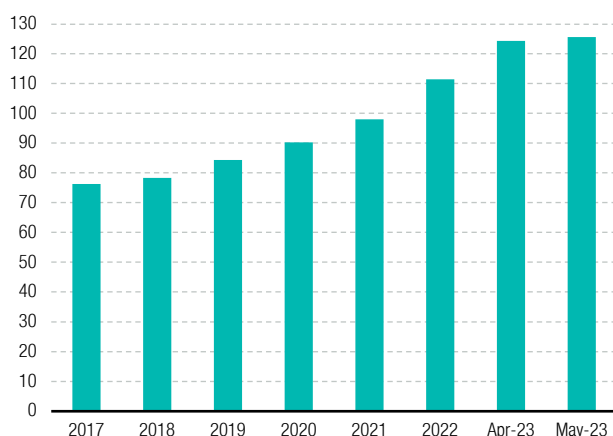
Debt is up 12.7% in 5M23, and 34.6% since the start of Russia's full-scale invasion of Ukraine in February 2022. In May, growth in debt was driven by a new EUR1.5bn tranche of the EU Macro-Financial Assistance facility and, to a lesser extent, by local borrowings.

ICU view: Ukraine's public debt is set to grow fast over the next couple of years on inflow of concessional debt from Ukraine's allies. We expect public debt-to-GDP to reach 90% by the end of 2023, up from 78.5% at the end of 2022. However, the high level of debt doesn't lead to significant liquidity pressures at the moment since the current rollover of domestic debt is above 100% and the payment schedule for external debt is benign thanks to restructurings that Ukraine managed to secure since the start of the full-fledged war.

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

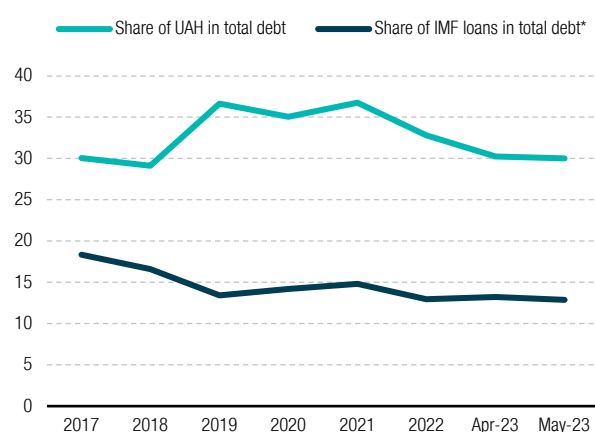
Public debt increases 1% in May



Source: MoF, ICU.

Chart 8. 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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