



Focus
Ukraine

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

Research team
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Weekly Insight

NBU reserves reach all-time high

Key messages of the today's comments

Ukrainian bond market

Trading concentrates in two bonds

Last week, trading on the secondary market was concentrated in several bonds that are attractive to individuals and foreigners.

Eurobond rally ends

Prices of Ukrainian Eurobonds fell slightly last week after a two-week rally.

Foreign exchange market

NBU publishes FX liberalization strategy

The National Bank has released a public version of the strategy aimed at easing FX restrictions, a gradual shift to a flexible exchange rate regime, and a return to inflation targeting.

FX market remains steady

Volumes of hard currency trading changed insignificantly, allowing the hryvnia cash exchange rate to strengthen slightly.

Economics

NBU reserves reach all-time high

The NBU gross international reserves were up 4.5% to US\$39bn in June—the highest level on record.

MONDAY, 10 JULY 2023

Banks' reserves market (7 July 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	25.00	+0bp	+0bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm) ²	195,182	+1.66	+377.81
CDs (UAHm) ³	478,534	-1.27	+144.48

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) (7 July 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	691,846	+0.00	+30.27
Banks	546,618	-0.32	+3.73
Residents	116,374	+0.15	+75.20
Individuals	42,451	+1.41	+46.43
Foreigners ¹	48,815	-5.54	-31.67
Total	1,447,825	-0.38	+18.21

Source: NBU, ICU.

FX market indicators (7 July 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9635	+0.09	+25.10
EUR/USD	1.0967	+0.53	+7.94
DXU	102.272	-0.62	-4.53
UAH TWI ¹	112.163	-0.19	-20.35

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes (10 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

Trading concentrates in two bonds

Last week, trading on the secondary market was concentrated in several bonds that are attractive to individuals and foreigners.

The total volume of trades in UAH bonds on the secondary market decreased by 18% to UAH3.9bn (US\$107m), and in FX-denominated bills remained at UAH3.8bn (US\$103m). The largest amount of trades was in UAH bills due in April next year (44% of all trades in UAH bonds), and in USD-denominated paper maturing in September this year (65% of all trades in FX-denominated bills). Two other bills were the most frequently traded. Almost half of the 9,842 deals were with UAH military bills due in September 2023 and June 2024, but only for UAH249m (US\$7m) or 6% of the total volume.

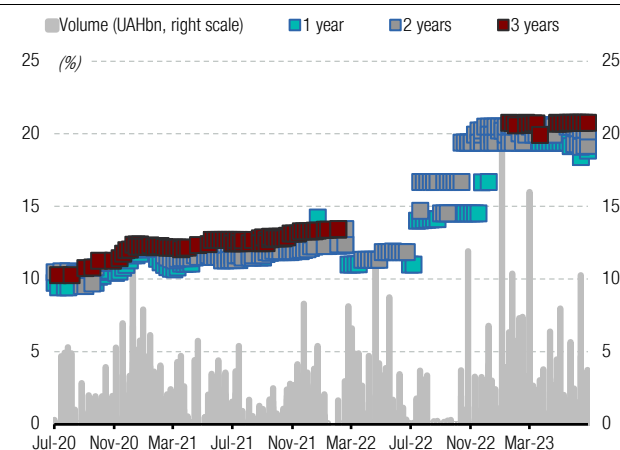
The foreign-investor and municipality portfolios decreased the most over the past week, by UAH2.3bn (US\$62m) and UAH1.9bn (US\$53m), respectively.

ICU view: Deals were concentrated in a few bills likely due to the partial reinvestment of UAH10bn of last week's redemption. Individuals likely bought different military bills in small volumes, reinvesting funds from the last week's redemption in other bonds. Foreign investors probably purchased securities maturing in April 2024, with the nearest coupon payments in November 2023.

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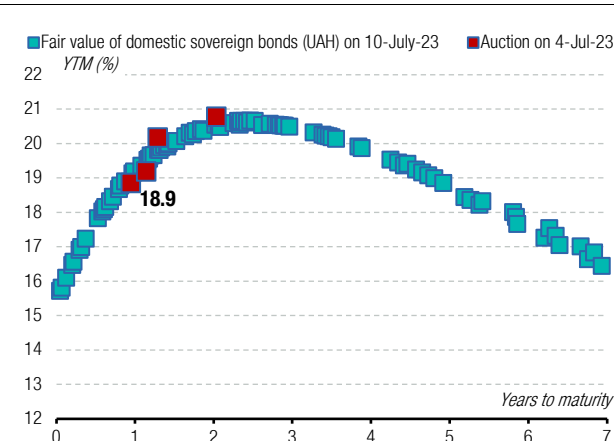
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

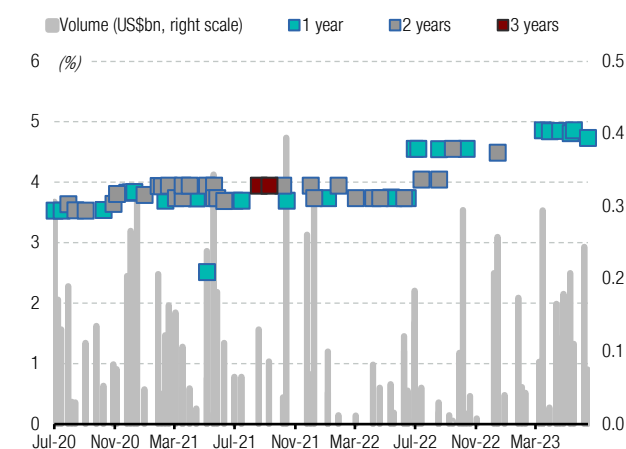
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



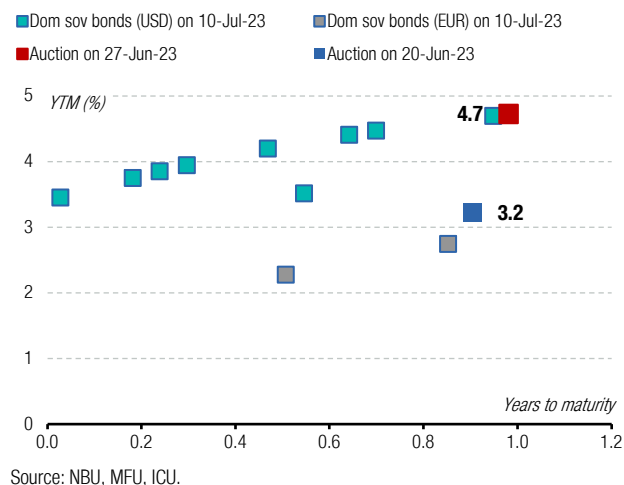
Source: NBU, MFU, ICU.

Chart 2. FX-denominated bonds

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



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



Eurobond rally ends

Prices of Ukrainian Eurobonds fell slightly last week after a two-week rally.

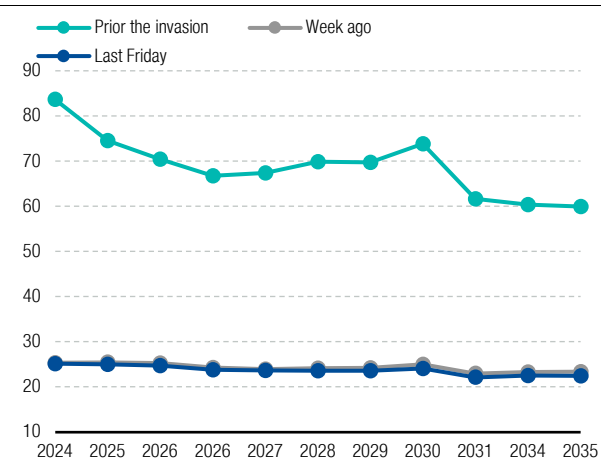
Prices peaked on Tuesday at 23.2–25.7, and VRIs almost reached 40. But by the end of the week, prices slid by 2–4% to 22–25, with the price range for different maturities widening to 6.4% from 5.2% on Tuesday. VRI prices declined by only 1.5% to slightly above 39 cents.

ICU view: The rally came on the back of a stream of positive news about security guarantees for Ukraine and funding commitments to support reconstruction of the country's economy. Last week, no major news came out that could prolong the rally. The market is now awaiting possible positive signals about the prospects for Ukraine's NATO membership from the NATO Summit in Vilnius this week.

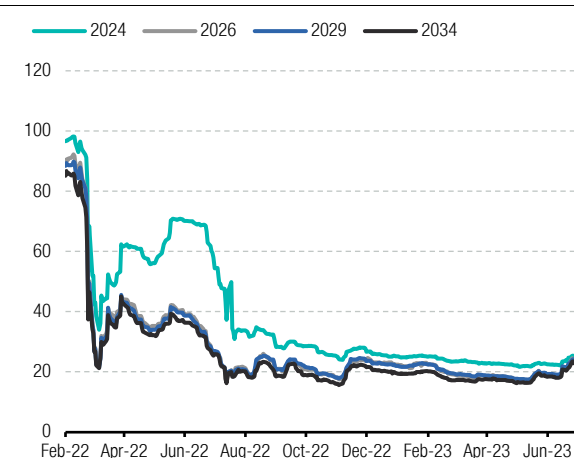
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Chart 3. Ukrainian Eurobonds prices

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



Historical data since February, 2022



Foreign exchange market

NBU publishes FX liberalization strategy

The National Bank has released a public version of the strategy aimed at easing FX restrictions, a gradual shift to a flexible exchange rate regime, and a return to inflation targeting.

The public version of the strategy contains a general description of priorities, principles, and prerequisites for three policy areas: the easing of FX restrictions, the transition to exchange rate flexibility, and the return to inflation targeting.

The roadmap for FX liberalization sets three stages: 1) steps to minimize the use of multiple exchange rates and liberalize trade operations, 2) liberalization of trade financing, cross-border payments of interest and dividends on "old" loans and investments, and 3) repatriation of invested capital, including loans and FDI, liberalization of rules for retail clients, and transactions with derivatives.

In addition to easing FX restrictions, the NBU plans to gradually move to a flexible exchange rate regime, but no timeline was provided for this decision. The NBU promised to keep tight monetary conditions in the foreseeable future so that UAH assets remain attractive.

The key takeaway from the document for foreign investors is that repatriation of investments is set to be a stage 3 action. This likely covers repatriation of investments into local government bonds. The announced prioritisation implies any permission to repatriate investments into government bonds is unlikely to happen in 2023.

ICU view: The document reflects the NBU's public statements made over the past few months and provides very little new information for the market. Such a format is fully expected since the NBU will need time to weigh carefully its future steps given the high security and macroeconomic risks. Its steps will also critically depend on new information about the economy, the external sector, and cooperation with international partners that will emerge in the future. However, judging by NBU's recent FX liberalization decisions, it is fair to say the regulator follows a conservative approach in this area.

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FX market remains steady

Volumes of hard currency trading changed insignificantly, allowing the hryvnia cash exchange rate to strengthen slightly.

In the interbank market, the volume of currency trading rose slightly. Purchase of hard currency by bank clients (legal entities) in four business days increased by 7%, and sales increased by 12% compared with the same period of the previous week. NBU interventions decreased by 10% to \$479 million.

The retail market in four days saw a slight increase in hard currency sales by 0.4% and a decline in purchases by 0.7%.

The cash exchange rate at systemically important banks continued to strengthen slightly. Over the past week, the hryvnia appreciated by another 0.1% to UAH36.6–37.4/US\$. The strengthening of the hryvnia is already approximately 8.3% YTD.

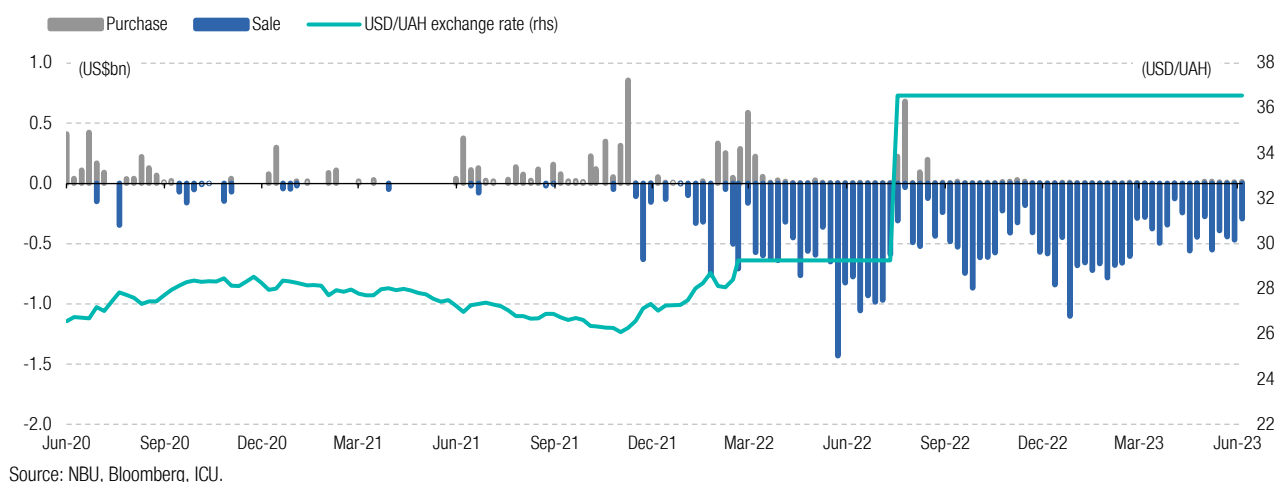
ICU view: The retail market remains fairly balanced and highly saturated with hard currency cash, which contributes to the further convergence of cash and official exchange rates. The NBU now has a record amount of international reserves (see

comment below) and remains in a fully comfortable position to maintain FX sale interventions without any limits.

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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)



Economics

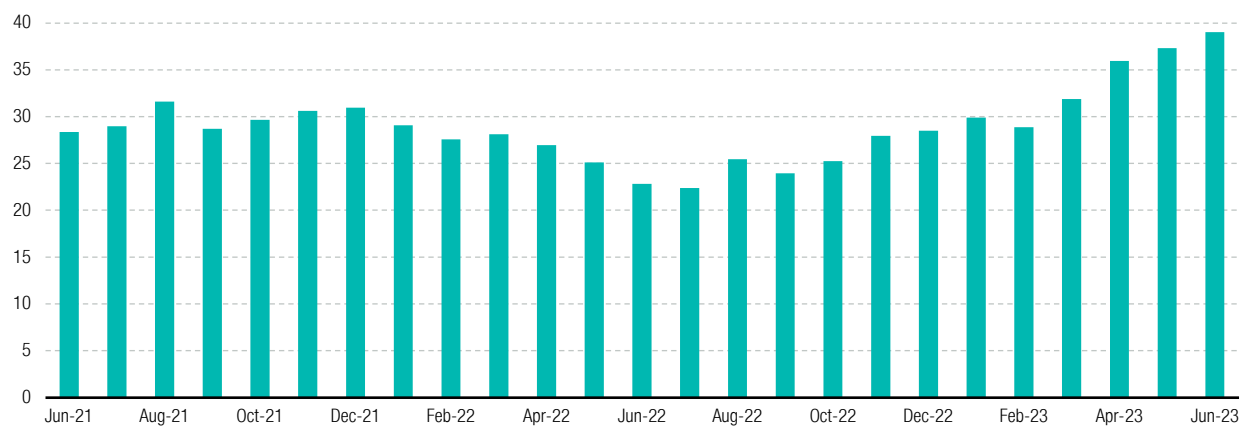
NBU reserves reach all-time high

The NBU gross international reserves were up 4.5% to US\$39bn in June—the highest level on record.

Ukraine continues to benefit from the steady inflow of international financial assistance from its allies. In June alone, Ukraine received a EUR1.5bn tranche of Macro-Financial Assistance from the EU, US\$1.2bn grant from the US, US\$0.9bn second loan tranche from the IMF, and several smaller loans. Meanwhile, the NBU spent net US\$1.8bn on FX sale interventions and another net US\$0.4bn was spent by the NBU and the government on FX debt servicing/repayments.

ICU view: NBU reserves are significantly outperforming our and other forecasters' projections. We expect the reserves to keep growing in the coming quarters, thus providing a significant cushion against possible external shocks. Also, record high reserves put the NBU in a good position when it decides to move to a flexible exchange rate regime in the future.

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Chart 5. NBU gross international reserves, US\$bn*NBU reserves up 4.5% in June*

Source: NBU, ICU.

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