Focus
Ukraine

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

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Weekly Insight

FX market stabilizes gradually

Key messages of the today's comments

Ukrainian bond market

Reduction in bond rates continues

The Ministry of Finance continued to reduce interest rates on UAH bonds. This trend started in June, and last week, it accelerated following NBU's cut of the key policy rate.

Eurobond prices decline

Last week, Ukrainian Eurobonds fell in price, reflecting the global trend towards emerging markets.

Foreign exchange market

FX market stabilizes gradually

After a sharp weakening at the end of July, the hryvnia cash exchange rate strengthened last week, and the buy/sell balance in retail market improved.

Economics

Ukraine's external accounts in hefty surplus in 1H23

Ukraine's external accounts closed with a significant surplus in 1H23, enabling the NBU to boost its reserves.

MONDAY, 7 AUGUST 2023

Banks' reserves market (4 August 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	22.00	+0bp	-300bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm)[2]	203,897	+60.72	+334.90
CDs (UAHm)[3]	495,023	-14.56	+134.19

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) (4 August 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	691,846	+0.00	+24.41
Banks	559,482	-0.32	+7.39
Residents	120,347	+1.67	+84.54
Individuals	45,952	+1.99	+56.87
Foreigners[1]	51,088	+0.28	-26.79
Total	**1,470,880**	**+0.09**	**+18.47**

Source: NBU, ICU.

FX market indicators (4 August 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9275	-0.01	+0.92
EUR/USD	1.1006	-0.09	+7.42
DXY	102.017	+0.39	-3.48
UAH TWI[1]	112.137	+0.21	-1.05

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

Market gov't bond quotes (7 August 2023)

Maturity	Bid	Ask
6m	**18.00**	**16.00**
12m	**20.00**	**18.00**
2y	**20.50**	**19.00**
3y	**21.00**	**19.50**
12m ($)	**6.00**	**4.50**
2y ($)	**N/A**	**N/A**

Source: ICU.

Ukrainian bond market

Reduction in bond rates continues

The Ministry of Finance continued to reduce interest rates on UAH bonds. This trend started in June, and last week, it accelerated following NBU's cut of the key policy rate.

At the first primary auction in July, the MoF borrowed only UAH3bn while decreasing interest rates on local-currency bonds. The Ministry reduced cut-off interest rates for all offered maturities of ordinary and military bills by 50bp to 17.8% and 18.35%, respectively, and for "reserve" notes by 25bp to 19.5%. See details in the auction review.

The MoF sold ordinary and military bills with similar maturities at 18.5% and 19.5% until the end of May 2023 and "reserve" bonds due in 2026 at 19.75% until the end of July.

In the secondary market, investor activity remains low. During the week, 7,634 deals with UAH government bonds were concluded for UAH3.5bn, which is 5% less than the previous week and almost twice less than the average weekly trading volume YTD. Ordinary bills due in February 2025 (UAH475m) and "reserve" notes due in August 2025 (UAH693m) were traded the most.

ICU view: The MoF began to selectively lower interest rates on UAH bonds at the beginning of June as the market started to expect an imminent first cut in the key policy rate that the NBU eventually delivered in late July. The absence of large redemptions last week was the main reason for investor's low activity in the primary market. However, this did not prevent the MoF from rejecting almost a third of the demand and setting new, significantly lower rates for UAH bonds. The lack of large redemptions also affected activity in the secondary market. We do not expect high investor activity until August 23, when the nearest significant redemption of UAH bonds is scheduled. At the same time, the MoF can again use a wide range of interest rates bid for the auction to further reduce cut-off rates in anticipation of further cuts in the key policy rate in September.

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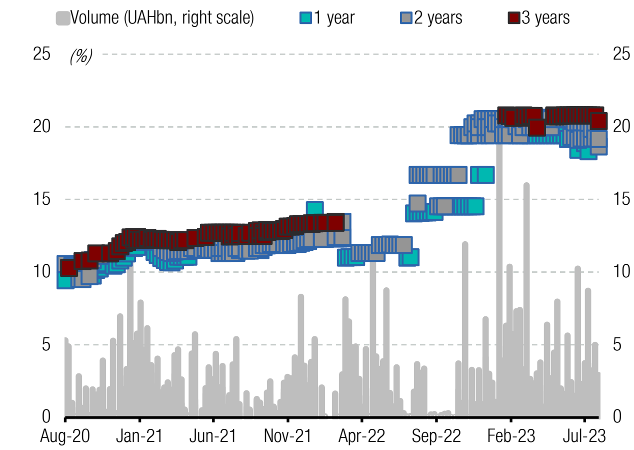
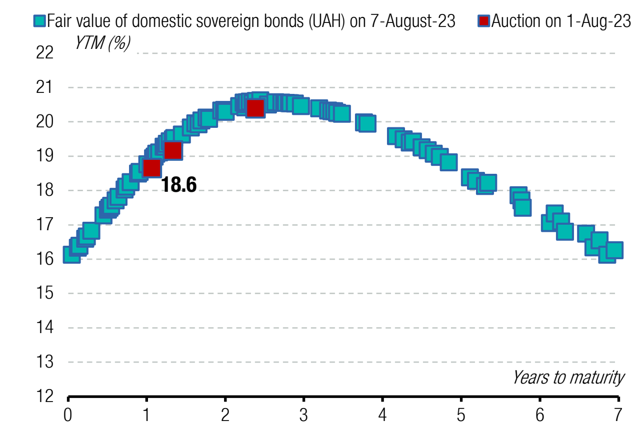
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

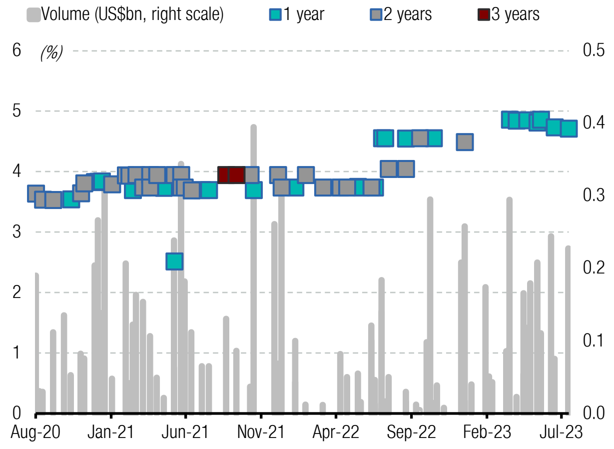
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

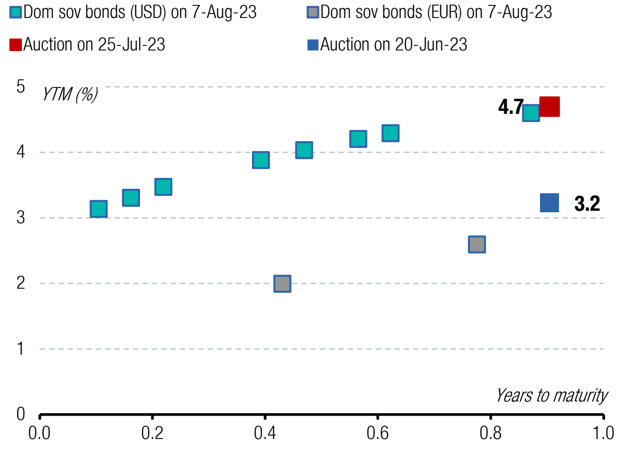
Chart 2. FX-denominated bonds

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 decline

Last week, Ukrainian Eurobonds fell in price, reflecting the global trend towards emerging markets.

Ukrainian Eurobond prices over the past week declined by an average of almost 7% to 27-32 cents per dollar, with the widening of the price range for instruments with different maturities from 6.2% to 8%. The price of VRIs declined by almost 5% to 47 cents per dollar of notional value. The EMBI index slid by 1.5%.

ICU view: The temporary positive effect of the new NBU macro forecasts has run out, and with the release of negative news about grain exports, Ukrainian Eurobond prices declined most of last week. The decline broadly followed the trend of the EMBI index, but with increased amplitude. The price range remains narrow in anticipation of the debt restructuring announced for next year.

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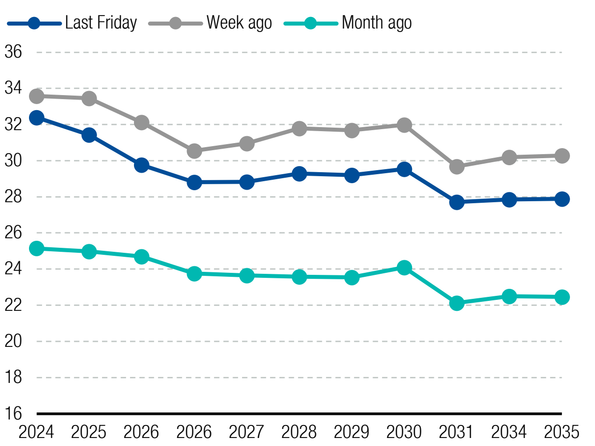
Chart 3. Ukrainian Eurobonds prices

Prices of USD-denominated Eurobonds as of last Friday, a week and a month ago



Source: Bloomberg, ICU.

Historical data since February, 2022

Source: Bloomberg, ICU.

Foreign exchange market

FX market stabilizes gradually

After a sharp weakening at the end of July, the hryvnia cash exchange rate strengthened last week, and the buy/sell balance in retail market improved.

On the cash market, the hryvnia exchange rate in systemically important banks strengthened by about 0.5% over the past week to UAH36.8–37.6/US$. During the four working days of last week, households purchased US$5.5m hard currency more than they sold, which is half as much as during the same period of the previous week.

On the interbank market, bank clients (legal entities) during the four working days of last week bought hard currency for US$1bn, which is 13% more than in the same period of the previous week. The NBU increased the weekly volume of interventions to sell hard currency by a third to US$460m.

ICU view: The FX market is gradually returning to its mid-July status, but several factors prevent a faster return. The interbank market gradually adapts to the absence of the Black Sea grain corridor. Still, the agricultural sector, the largest supplier of FX to the market, remains under the risk of new obstacles to exports due to russia's repeated strikes on port infrastructure. The cash market remains under the influence of psychological speculative factors, which prevent the cash exchange rate from returning to mid-July levels. Households are still buying more hard currency than they sell, but the imbalance is gradually shrinking and may reverse soon.

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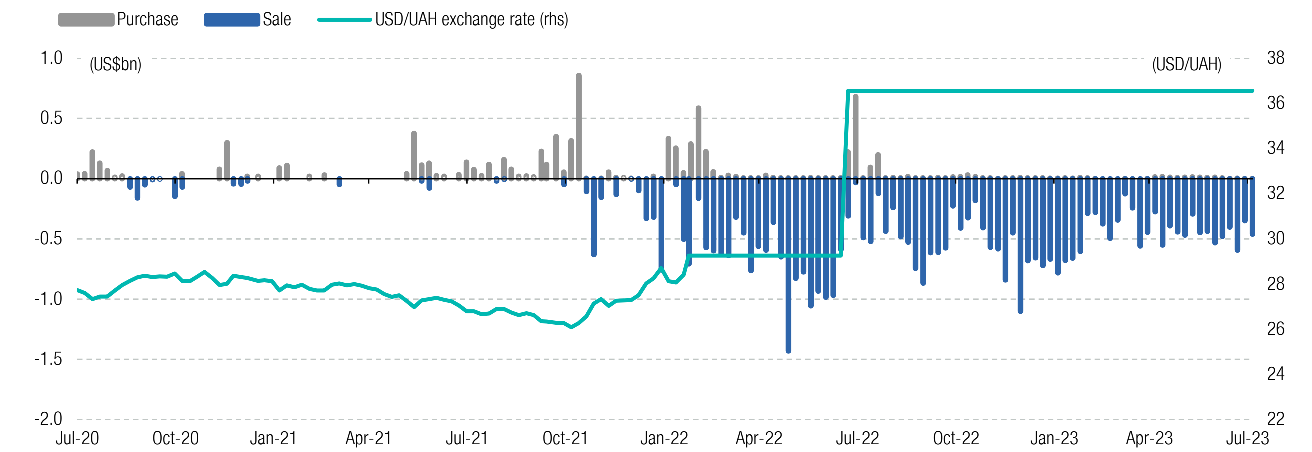
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Ukraine's external accounts in hefty surplus in 1H23

Ukraine's external accounts closed with a significant surplus in 1H23, enabling the NBU to boost its reserves.

The current account was marginally positive in June for the fourth month in a row, but negative numbers in winter imply the full 1H23 result was a deficit of US$1.3bn. Ukraine saw substantial growth in the external trade deficit over the period, largely due to rapid growth in the import of goods while exports remain stagnant. Import is upheld by deliveries of military equipment and growing demand for consumer goods. The deficit of trade in services started to contract in recent months, but the full 1H23 gap was still substantial, driven largely by refugees' expenditures abroad. The huge trade deficit was, to a large extent, offset with migrants' incomes abroad, budgetary grants to the government, and humanitarian aid, so that the current account deficit remained fully reasonable.

Net inflows via the financial account stood at nearly US$9.0bn—considerably above the current-account deficit. These significant inflows came on the back of loans to the government sector from IFIs and foreign governments—US$12.2bn. Outflows of FX cash from the banking sector were the only significant source of private capital flight in 1H23. FX cash outflows fell significantly in June to US$0.7bn from a monthly average of US$1.0bn in 5M23, but it's too early to say if this decline if sustainable.

Thanks to a hefty financial-account surplus and a reasonable current-account deficit, the NBU managed to increase its reserves by 37% in 1H23 to US$39bn, which is the highest value on record.

ICU view: We expect much of the same balance-of-payments pattern in 2H. The current-account deficit is set to grow to be in the range of 2–3% of GDP, but the financial-account surplus will remain comfortably high to offset the deficit and enable the NBU to accumulate reserves further.

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Chart 5. Key balance of payment components, $m

Current account deficit remains reasonable in 1H23

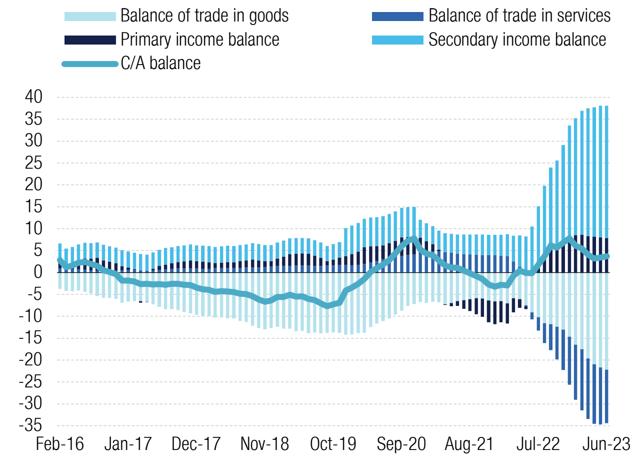
	1H23	1H22
Current account	**-1,275**	**2,904**
Trade in goods	-12,027	-4,493
Trade in services	-4,942	-3,742
Primary income	3,141	3,561
incl. migrant income	5,802	6,469
Secondary income	12,553	7,578
incl. transfers to government	8,445	4,073
Financial account*	**-8,975**	**11,076**
Change in trade credits	-1,725	8,481
Increase in cash out of banks	5,919	5,141
Net loans to government	-12,235	-5,644

* 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.

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