Focus
Ukraine

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

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Weekly Insight

NBU makes FX purchases easier in retail

Key messages of the today's comments

MONDAY, 4 SEPTEMBER 2023

Ukrainian bond market

MoF keeps refinancing high in August

During August, the Ministry of Finance refinanced all UAH redemptions, but only a part of those in euros.

Gains from recent Eurobond rally erased

Last week, the price of Eurobonds fell back to the level of mid-July, losing all the gains of the rally in late July and early August.

Foreign exchange market

NBU makes FX purchases easier in retail

Last Monday, the NBU increased the limit for the purchase of hard currency that households can place on three-month deposits and also allowed the purchase of FX online without freezing money on deposit for three months.

Economics

Current account worsens in July on drop in exports

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Banks' reserves market (1 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	22.00	+0bp	-300bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm)[2]	195,713	-0.84	+193.24
CDs (UAHm)[3]	501,009	-3.92	+132.90

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) (1 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	690,693	+0.00	+17.15
Banks	558,585	+0.30	+11.44
Residents	122,572	+3.47	+87.82
Individuals	48,343	+2.70	+61.90
Foreigners[1]	48,426	-0.56	-30.04
Total	**1,470,941**	**+0.47**	**+17.14**

Source: NBU, ICU.

FX market indicators (1 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9182	+0.01	+0.21
EUR/USD	1.0780	-0.15	+8.39
DXY	104.236	+0.15	-4.97
UAH TWI[1]	113.434	+0.06	-0.95

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

Market gov't bond quotes (4 September 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 ($)	**N/A**	**N/A**
2y ($)	**N/A**	**N/A**

Source: ICU.

Ukrainian bond market

MoF keeps refinancing high in August

During August, the Ministry of Finance refinanced all UAH redemptions, but only a part of those in euros.

At the end of August, the Ministry of Finance held a successful primary auction, attracting almost UAH7.3bn to the budget (see details in the auction review). These new proceeds imply the MoF had a successful August. It borrowed UAH25.8bn while redeeming only UAH20.8bn. Therefore, the refinancing of UAH instruments stood at 124% in August and 140% YTD, which is only 3pp less than in 7m23.

There were no borrowings or repayments in US dollars last month, so the refinancing of USD-denominated debt remains at 106% YTD.

In August, the Ministry refinanced only a part of the redemptions denominated in euros. It repaid EUR57.5m while raising EUR20m. However, the level of refinancing of EUR repayments slid by only 8pp to 114% in 8M23 and from 122% in 7m23.

ICU view: In August, the MoF redeemed the last EUR paper due in 2023, so it is unlikely to be active in this segment through end-2023. Any new proceeds will be used to finance current budget expenditures. At the same time, more than US$1.2bn in redemptions are scheduled by the end of the year, so the MoF will definitely aim to raise this money to keep the refinancing ratio at above 100%.

As for UAH borrowings, the Ministry has received significant demand for the longest of the offered instruments ("reserve" bonds) for several weeks in a row. Most likely, interest in such notes will remain high in the coming weeks. "Reserve" bonds are now attractive not only for banks, but also for other investors who seek to lock in high YTMs in anticipation of a further decrease in the NBU key policy rate and interest rates for UAH securities. Therefore, in September, the level of refinancing of UAH redemptions may even increase, given that the MoF needs to repay only UAH14bn this month.

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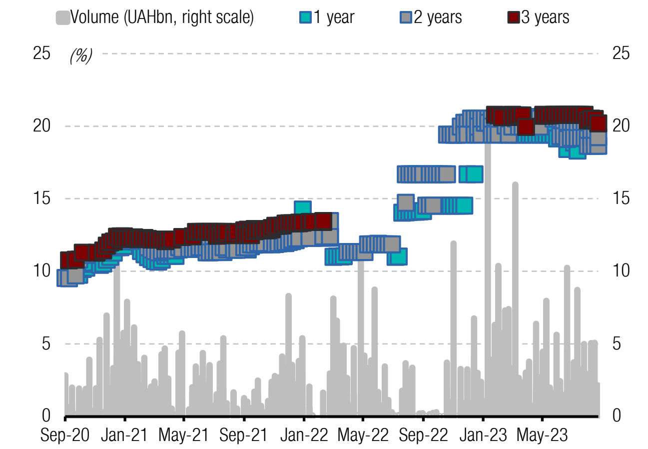
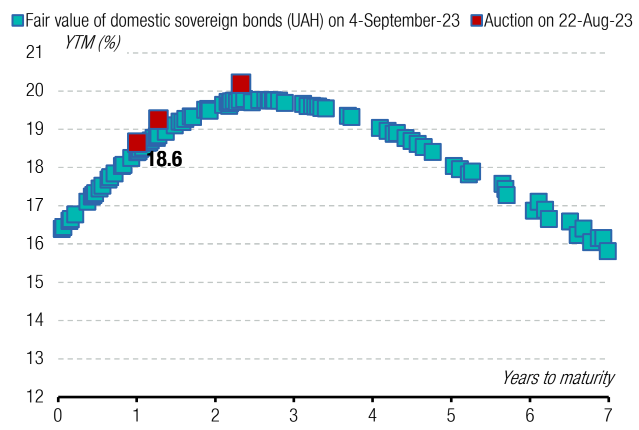
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

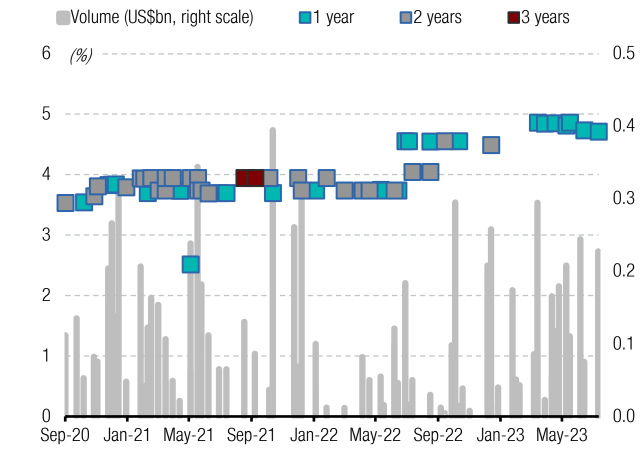
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

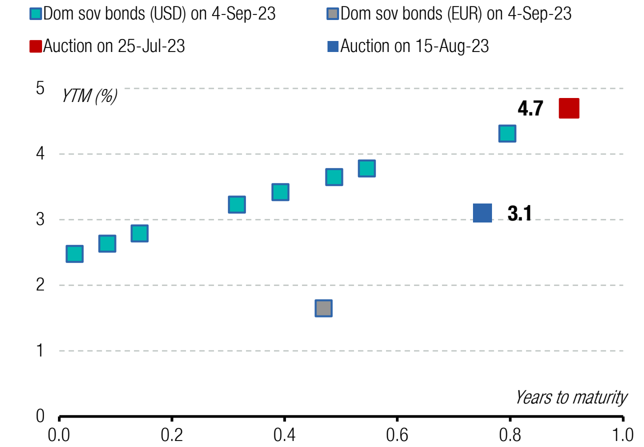
Chart 2. FX-denominated bonds

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.

Gains from recent Eurobond rally erased

Last week, the price of Eurobonds fell back to the level of mid-July, losing all the gains of the rally in late July and early August.

Eurobond prices closed in the range of 27–33 cents, close to mid-July levels. The price range for instruments with different maturities widened from 8% in July to more than 11% last Friday. The cumulative decline in prices for the past three weeks was about 10%.

VRIs are down 8% from their August high and, last Friday, were priced just above 45 cents per dollar of notional value. That's nearly three cents below prices in early August and also in line with mid-July.

ICU view: The demand for Eurobonds dried up in late summer, and prices increasingly reflect the lack of important news and expectations of commercial debt restructuring in 1h24. In the autumn, investors will focus on several key topics, including the pace of Ukraine's counteroffensive and important economic events, specifically the approval of the state budget for 2024, and the upcoming second review under the Ukraine-IMF EFF program.

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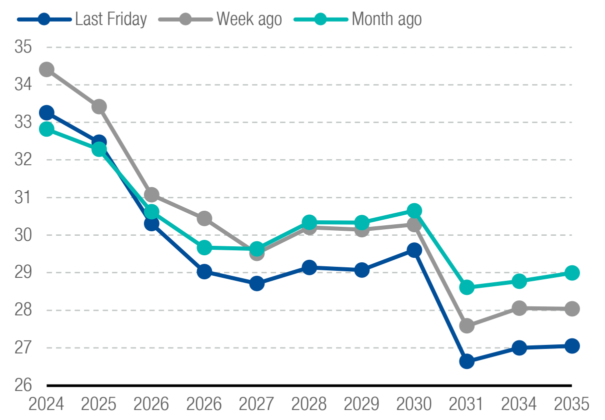
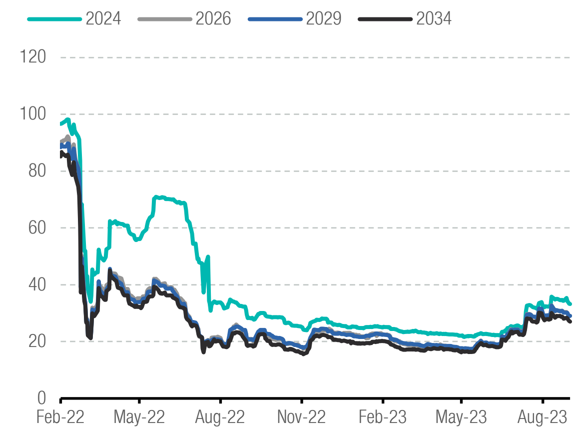
Chart 3. Ukrainian Eurobonds prices

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

NBU makes FX purchases easier in retail

Last Monday, the NBU increased the limit for the purchase of hard currency that households can place on three-month deposits and also allowed the purchase of FX online without freezing money on deposit for three months.

Last week, the NBU allowed households to buy hard currency online for the first time since the start of the full-scale war. The NBU set the limit at UAH50'000 in one bank per month. Households are not obliged to keep this money on deposit for three months to have access to it. The NBU also doubled the limit for purchasing non-cash hard currency to UAH200'000 per month (with further placements on three-month deposits).

The NBU decision had an immediate but subtle effect. The hryvnia cash exchange rate in systemically important banks strengthened by more than 1% to UAH37.4–38.2/US$ by the end of last week.

At the same time, on the interbank market, NBU's interventions amounted to US$638m last week, up 8% WoW. The higher need for interventions likely came on the back of higher household demand for hard currency. This was the largest weekly volume since mid-February this year.

ICU view: The NBU's decision to ease FX market restrictions was, among other things, aimed at reducing the difference between the official exchange rate and the cash exchange rate that increased significantly in August prior the NBU decision. Even though this decision had a quick effect on the market, the gains in the cash UAH exchange rate are unlikely to be substantial and long-lasting. Most market participants expect more clarity about when the NBU will decide to move to a flexible exchange rate regime. The expectation of the NBU abandoning the fixed exchange rate will weigh on the market in the coming months.

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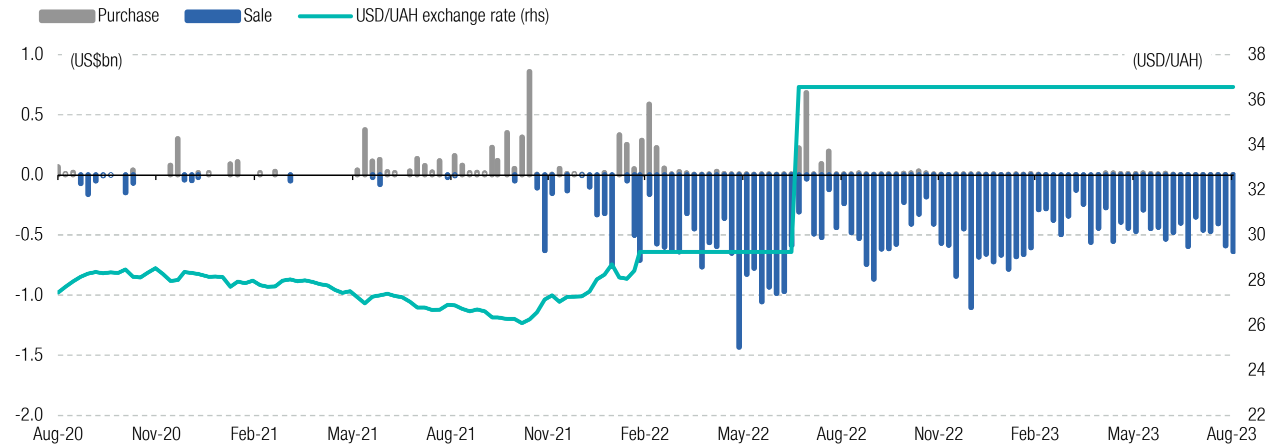
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Current account worsens in July on drop in exports

Ukraine's current account gap was significant in July at -US$0.8bn, but the balance was still positive for the past 12 months.

The monthly balance of the current account turned negative in July after four consecutive months of surplus. The deterioration came on the back of a fall in export of goods, which stood at just US$2.2bn—the lowest monthly volume since the start of the full-scale war. Weaker exports were largely due to new logistical bottlenecks, as russia refused to extend the Black Sea grain deal in mid-July. Monthly import of goods was close to average volumes. The deficit of trade in services remained relatively stable in July vs. June. Migrant remittances and international budgetary transfers to the Ukrainian government were not sufficient to offset the deficit of external trade. The current account balance still remained in surplus at US$1.6bn for the 12 months till July.

The financial account saw a significant net inflow of US$3.3bn thanks to official loans to the government. Specifically, Ukraine received EUR1.5bn loan from the EU and US$1.5bn in loan guaranteed by Japan. FX cash outflows from the banking sector subsided in July thanks to a stable exchange rate.

Significant capital inflows exceeded the current account deficit, which enabled the NBU to grow its reserves 7% MoM in July to US$41.7bn, the highest volume on record.

ICU view: Ukraine's current account is likely to be negative every month till the end of 2023 as exports are getting weaker on lower grain supplies while imports remain robustly high. Also, budgetary transfers from Ukraine's allies are going to decline. We, thus, expect a current account deficit close to 3% of GDP for the full 2023. Yet, net capital inflows via the financial account will remain just sufficient to offset the C/A shortfall. Therefore, we expect only marginal growth in NBU gross international reserves through year-end.

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Chart 5. Key balance of payment components, $m

Current account balance turns negative in July

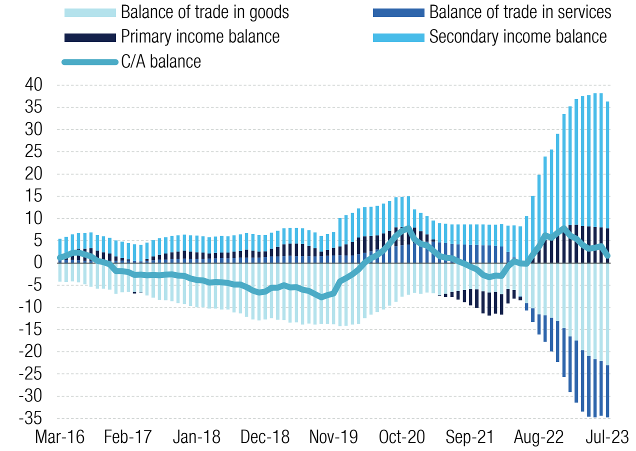
	Jul 2023	Jun 2023	Jul 2022
Current account	-777	210	1,398
Trade in goods	-2,843	-2,327	-1,919
Trade in services	-614	-462	-1,213
Primary income	669	742	879
incl. migrant income	976	988	1,029
Secondary income	2,011	2,257	3,651
incl. transfers to government	1,475	1,416	3,082
Financial account*	-3,343	-751	1,720
Change in trade credits	-506	204	813
Increase in cash out of banks	593	754	776
Net loans to government	-3,119	-1,669	32

* 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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