

Weekly Insight

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Key messages of the today's comments

MONDAY, 11 SEPTEMBER 2023

Ukrainian bond market

New wave of foreigners' demand

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Sentiment toward Eurobonds improves

Last week, the decrease in Ukrainian Eurobond prices stopped, and they rose slightly at the end of the week.

Foreign exchange market

FX market is gradually adapting to new rules for households

The effect of NBU's decision to allow larger volumes of non-cash FX purchases for households was much less visible in the retail FX market last week.

Economics

Inflation stats deliver another positive surprise

Ukraine's annual inflation decelerated markedly to 8.6% YoY in August from 11.3% in July. The annual inflation rate has been consistently and steeply falling since December and reached single-digits for the first time since mid-2021.

NBU reserves decline first time since February

NBU's gross international reserves were down 3.2% in August to US\$40.4bn. This is the first monthly decline since February.

Banks' reserves market (8 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	22.00	+0bp	-300bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm) ²	189,222	-3.32	+239.09
CDs (UAHm) ³	505,296	+0.86	+97.71

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) (8 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	690,693	+0.00	+14.25
Banks	561,417	+0.28	+11.50
Residents	123,888	+1.99	+89.90
Individuals	49,108	+1.58	+59.71
Foreigners ¹	49,145	+1.48	-27.76
Total	1,476,573	+0.38	+16.06

Source: NBU, ICU.

FX market indicators (8 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9223	+0.01	+0.32
EUR/USD	1.0700	-0.74	+7.03
DXY	105.090	+0.82	-4.21
UAH TWI ¹	114.369	+0.82	-0.11

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes (11 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 (\$)	5.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

New wave of foreigners' demand

After their portfolios declined over August, foreign investors significantly increased their holdings of UAH bonds last week, buying them both in the primary and secondary markets.

Last week, the MoF placed UAH3.5bn of a new issue of military bills maturing in June 2025. Although demand exceeded UAH8bn, the Ministry rejected high rates and set a cut-off point at 18.35%, the same as for the 1.5-year paper a week ago. See details in the [auction review](#).

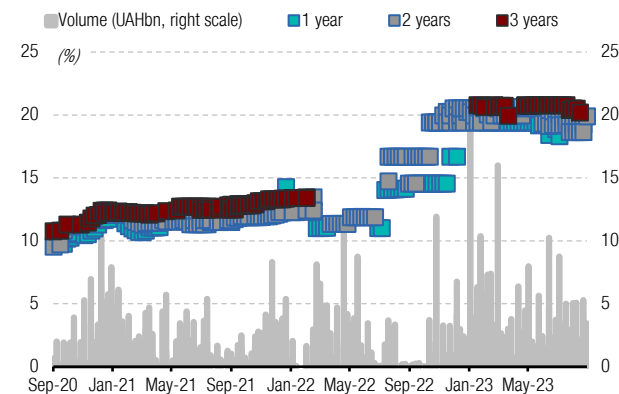
Excluding banks, it was foreigners who increased their UAH bond portfolios the most over the past week, by UAH0.9bn, after a decline by UAH2.6bn in four previous weeks.

ICU view: The new military paper will have its first coupon payment this December, which is in slightly more than 90 days. This means foreigners will be able to repatriate the first coupon on this bond if they purchased it last week or will do so this week. Therefore, foreigners likely represented a significant part of the excess demand at the auction, causing x2 oversubscription. We expect foreign investors to buy new military bills this week, too.

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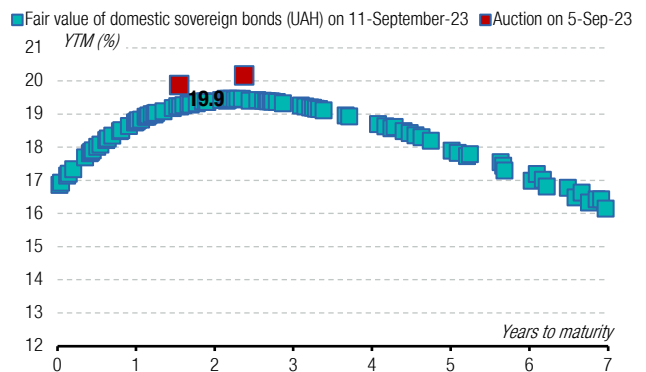
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

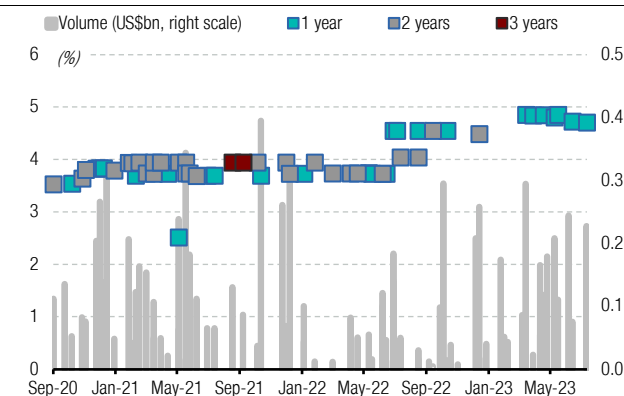
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

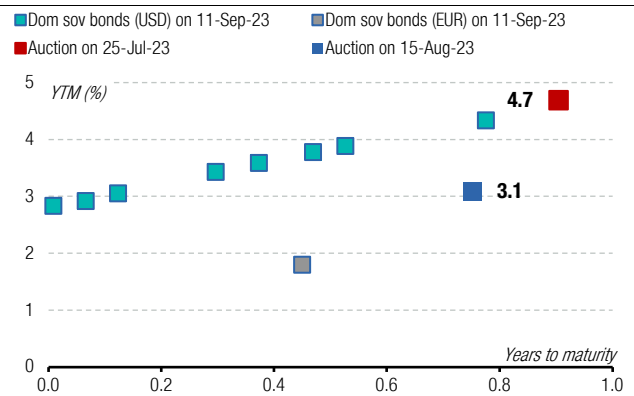
Chart 2. FX-denominated bonds

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.

Sentiment toward Eurobonds improves

Last week, the decrease in Ukrainian Eurobond prices stopped, and they rose slightly at the end of the week.

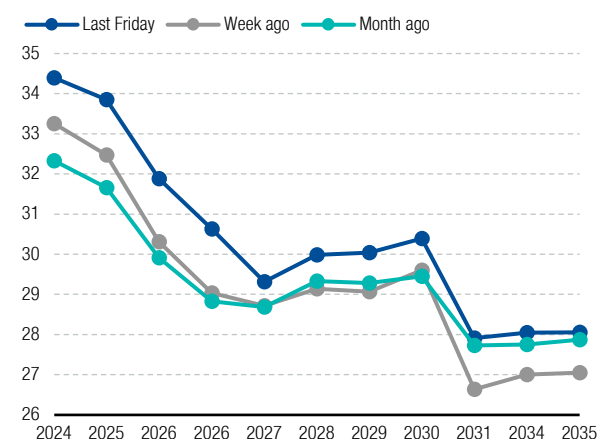
Prices of Ukrainian Eurobonds rose by an average of almost 4% to 28–34 cents. Both Eurobonds maturing in 2026 rose in price the most, by about 5%. The price of VRIs rose by 10% to above 50 cents per dollar of notional value.

ICU view: Prices of Ukrainian Eurobonds and VRIs started to rise on Wednesday when US Secretary of State Antony Blinken visited Ukraine. His statements about good progress in the counteroffensive and a new aid package could have fueled some demand. In addition, there was news about the White House's efforts to speed up approval of a new aid package for Ukraine by Congress. Eurobond prices will remain volatile over the coming months as investors reassess their fair value by factoring in all new information about the economy, Ukraine's external financial support, and potential debt restructuring terms.

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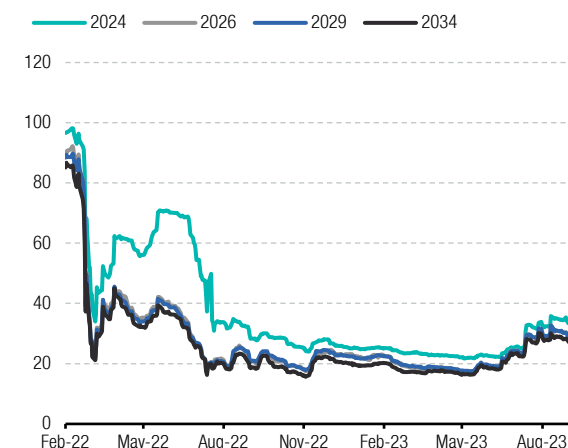
Chart 3. Ukrainian Eurobonds prices

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 is gradually adapting to new rules for households

The effect of NBU's decision to allow larger volumes of non-cash FX purchases for households was much less visible in the retail FX market last week.

On average, the hryvnia cash exchange rate in systemically important banks weakened marginally last week—to UAH37.4-38.2/US—as households demand in the cash segment remains almost unchanged.

On the interbank market, the NBU halved the volume of interventions to US\$303m due to significantly improved balance in operations of banks clients (legal entities): hard currency selling rose by 20%, while purchases declined by 10% (in four business days compared with same period of the previous week).

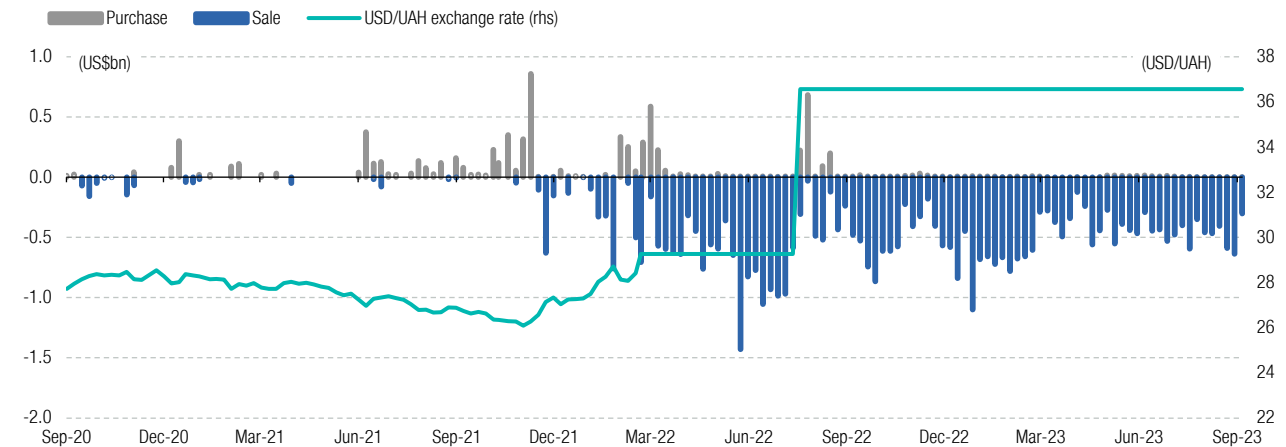
ICU view: The NBU's permission for households to buy hard currency online without placing it on deposit and to double the limit for FX purchases for three-month deposits

had only a short-term effect. Demand for non-cash FX from households was substantially down last week, prompting (along with more balanced segment for legal entities) a substantial reduction in NBU FX sale interventions.

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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

Inflation stats deliver another positive surprise

Ukraine's annual inflation decelerated markedly to 8.6% YoY in August from 11.3% in July. The annual inflation rate has been consistently and steeply falling since December and reached single-digits for the first time since mid-2021.

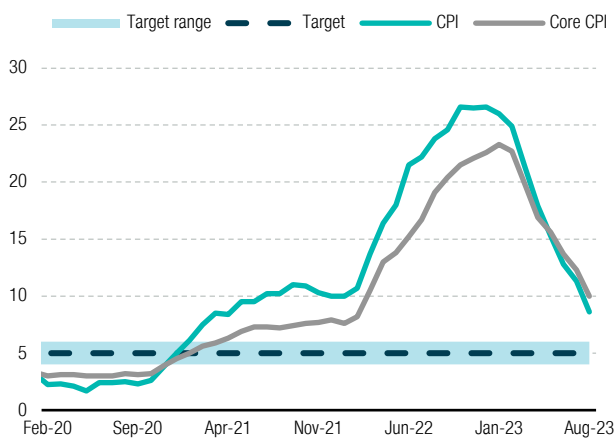
In monthly terms, consumer prices were down by an impressive 1.4% following a 0.6% decline in July. An abundant supply of grains, fruits, and vegetables was the main driver of monthly deflation in the past two summer months. Food prices, thus, declined 3.9% in August following a 2.1% decrease in July. The effects were reinforced by a long period of stable exchange rates even though end of August saw some turbulence in the FX cash market. The effects of growing motor fuel prices on the back of higher excise tax and VAT were massively overwhelmed by declining food prices.

ICU view: *The significant deceleration in consumer prices beats everyone's expectations, and Ukraine is certain to end 2023 with single digit inflation, probably in the range of 8–9%. Yet, we expect price pressure will increase somewhat next year due to a combination of factors: gradual hryvnia depreciation, gradual increase in motor fuels prices and utility tariffs, and low probability of repetition of this year's bumper harvest. We, thus, see consumer inflation picking up to 10–11% by the end of 2024. Against this backdrop, we see little choice for the NBU but to keep reducing its key policy rate, and we expect a cut of 200–300bps to 19-20% in September.*

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Chart 5. CPI, core CPI and target, YoY, %

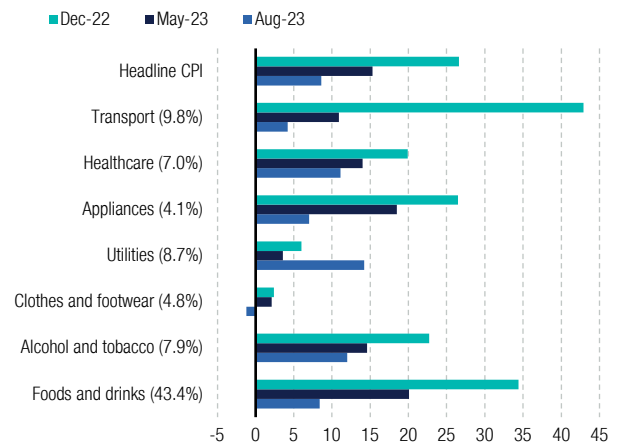
Annual inflation slips to single-digits



Source: Ukrstat, NBU, ICU.

Chart 6. CPI and its main components, YoY, %

Price for food decelerated considerably



* numbers in brackets indicate the share of the component in consumer basket

Source: Ukrstat, ICU.

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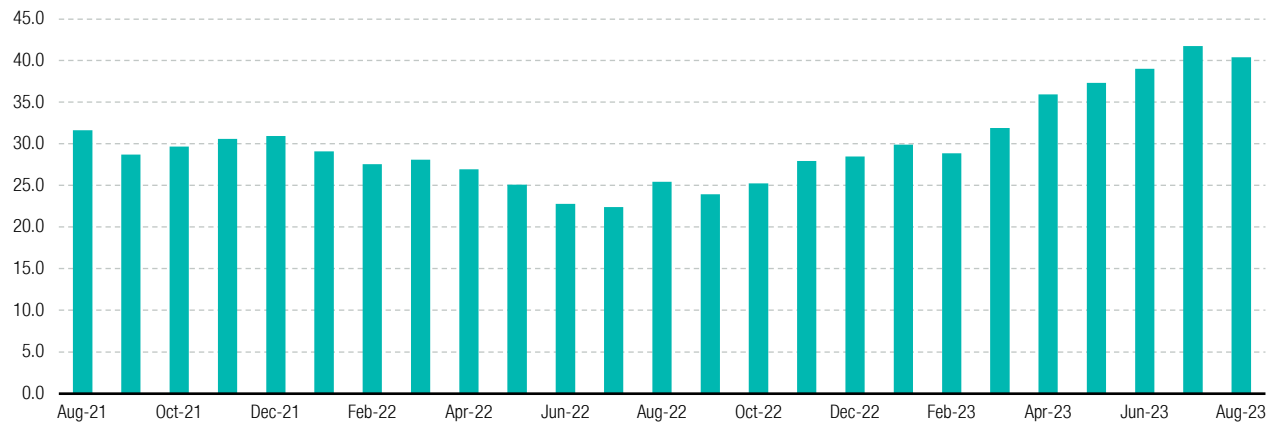
The volume of international financial support that Ukraine received in August was significantly down vs previous months. From external sources, Ukraine received only a EUR1.5bn loan from the EU. The US did not provide a grant in August even though grants of at least US\$1.0bn were given to Ukraine every month in 2023 till July. Meanwhile, the NBU sold net US\$2.4bn on FX interventions, and the authorities repaid US\$0.7bn in external loans to the WB and the IMF.

ICU view: While there is high confidence the EU will keep sending EUR1.5bn in financial support to Ukraine every month through 2023, the prospects for grants from the US are much less clear in terms of volumes and timing. We remain of the view that financial aid from the US will not diminish significantly in the coming quarters, which will enable the NBU to increase its reserves close to US\$44bn by the end of the year. The pace of reserve accumulation will subside considerably in 2024, and we expect an increase only to US\$49bn due to higher imbalances of external accounts.

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Chart 7. NBU gross international reserves, US\$bn

NBU reserves down first time since February



Source: NBU, ICU.

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