

# Weekly Insight

## Government submits budget draft to parliament

### Key messages of the today's comments

#### Ukrainian bond market

##### Activity concentrates in longer maturities

The prospect of a gradual decrease in yields on hryvnia instruments fuels investor interest in bonds, with a focus on longer maturities.

##### Eurobond sentiment remains positive

Ukrainian Eurobond prices increased gradually last week, but remained below the level reached in August.

#### Foreign exchange market

##### Autumn weakening of hryvnia continues

The hryvnia cash exchange rate continued to weaken last week, and the interbank market once again needed significant NBU interventions.

#### Economics

##### No surprise with the NBU rate cut

NBU cut the key monetary policy rate by 200bps, to 20%, in line with the expectations.

##### Government submits 2024 budget draft to parliament

Last week, the Ukrainian government submitted its 2024 draft budget law to parliament. The document reveals plans for gradual fiscal consolidation, but government plans for external borrowings/grants remain ambitious.

### MONDAY, 18 SEPTEMBER 2023

#### Banks' reserves market (15 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	20.00	-200bp	-500bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm) <sup>2</sup>	154,696	-18.25	+116.51
CDs (UAHm) <sup>3</sup>	532,398	+5.36	+118.03

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) (15 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	690,693	+0.00	+11.48
Banks	568,697	+1.10	+13.07
Residents	119,013	-3.51	+80.59
Individuals	46,871	-4.55	+50.32
Foreigners <sup>1</sup>	48,880	-0.56	-28.20
<b>Total</b>	<b>1,476,477</b>	<b>-0.02</b>	<b>+14.64</b>

Source: NBU, ICU.

#### FX market indicators (15 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9333	+0.03	+0.30
EUR/USD	1.0657	-0.40	+6.56
DXY	105.322	+0.22	-4.03
UAH TWI <sup>1</sup>	114.493	+0.11	-0.15

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

#### Market gov't bond quotes (18 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

## Activity concentrates in longer maturities

The prospect of a gradual decrease in yields on hryvnia instruments fuels investor interest in bonds, with a focus on longer maturities.

The Ministry of Finance has been raising most UAH funds over the past month by selling securities maturing in 2025 and 2026, while bills maturing next year saw only tiny demand. Last week, the bids for the shortest tenors accounted for just 11% of total demand, and two weeks ago, there were no bids at all. Investors were primarily interested in military bills maturing in June 2025, but demand for "reserve" notes was also considerable. Last week, the MoF attracted UAH14.3bn (US\$390m), including US\$143m (UAH5.2bn) from USD-denominated bonds. Military bills brought UAH4.2bn (US\$114m) to the budget, and "reserve" notes UAH4.4bn (US\$119m). See details in the [auction review](#).

The same issues of military and "reserve" bonds were among three the most traded instruments in the secondary market: 17% and 30% of the total volume of UAH bond trades last week. Trading in the secondary market was concentrated in bonds maturing in 2025 and 2026, 77% of all trades in UAH bonds.

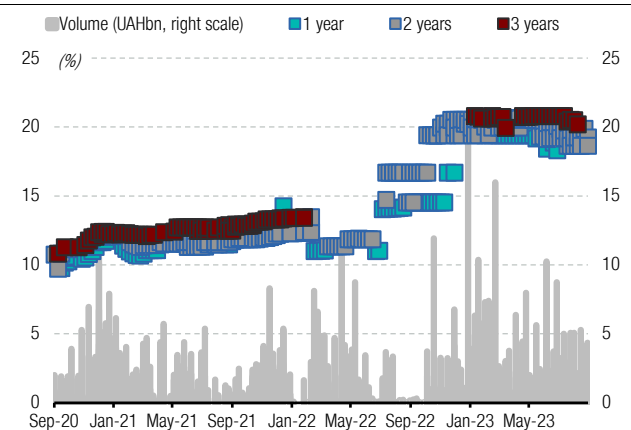
Portfolios of UAH-denominated securities were little changed last week, except for those of banks that bought almost the entire volume of bonds at the primary auction. At the same time, the portfolios of FX-denominated bonds decreased significantly after redemptions, especially among non-bank investors (legal entities) and individuals, as they have approximately a 20% and 50% share of FX-denominated bonds in their portfolios.

**ICU view: Investors broadly expected a new cut in the NBU key policy rate last week (see [comment below](#)). Therefore, they preferred to lock in high interest by buying bonds maturing no earlier than February 2025. The Ministry of Finance may try to reduce interest rates at the primary auction this week, following a 200bp cut in the NBU policy rates, but the reduction will likely be gradual.**

**Taras Kotovych, Kyiv, (044) 377-7040 ext.724**

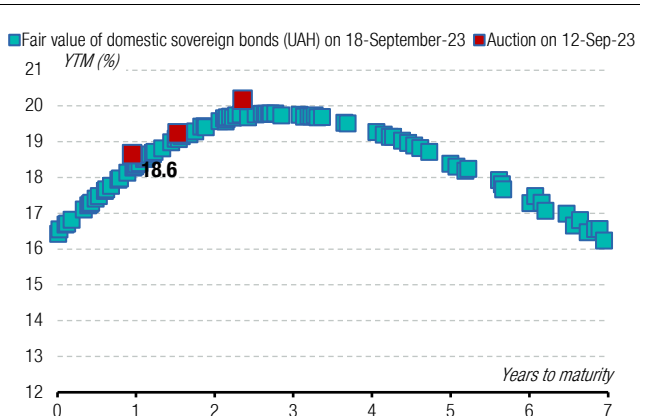
**Chart 1. Local-currency bonds**

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



Source: MFU, ICU.

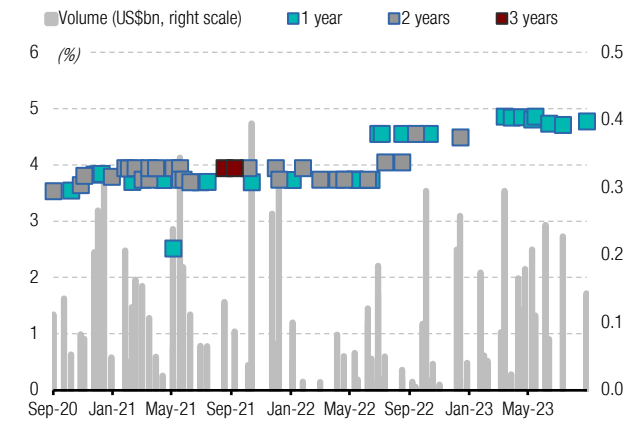
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

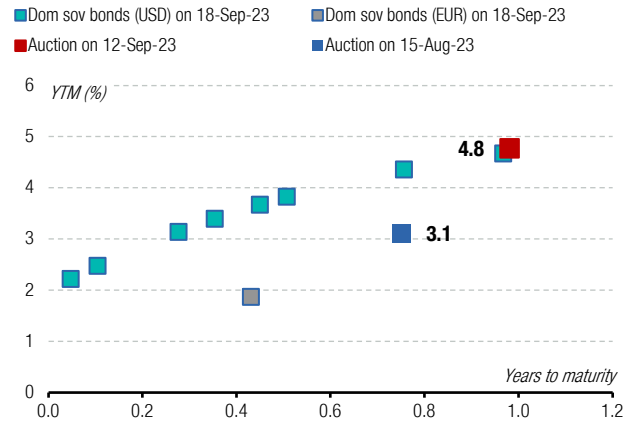
**Chart 2. FX-denominated bonds**

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 sentiment remains positive**

Ukrainian Eurobond prices increased gradually last week, but remained below the level reached in August.

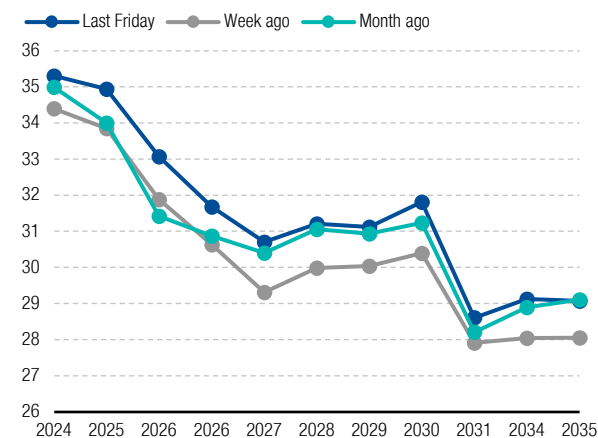
Over the past week, Eurobond prices rose by about 4% to 29–35 cents, but remain about 3–5%, or on average one cent below the peak after the summer rally. The price of VRIs slid a mere 1% to slightly below 50 cents per dollar of notional value.

**ICU view: Sentiment for Ukrainian Eurobonds remained broadly positive last week. This week, investors will evaluate the parameters of the state budget draft for 2024, as well as government plans to attract domestic and external financing. Government plans to raise about US\$43bn next year via loans and grants, which looks ambitious. If the sources of funding are confirmed later in the year, this will provide a huge relief for the economy. However, the key funding risk at the moment is the start of a new election cycle in the US and possible delays in approval of US financial aid to Ukraine.**

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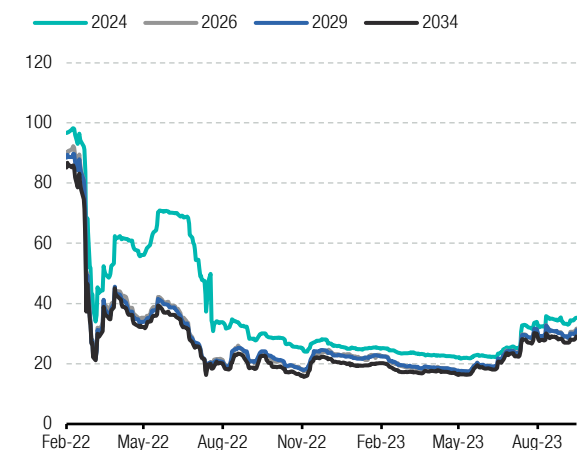
**Chart 3. Ukrainian Eurobonds prices**

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

## Autumn weakening of hryvnia continues

The hryvnia cash exchange rate continued to weaken last week, and the interbank market once again needed significant NBU interventions.

The demand for hard currency in the retail market increased again. The hryvnia cash exchange rate weakened by about 0.5% in the cash market to UAH37.6–38.4/US\$.

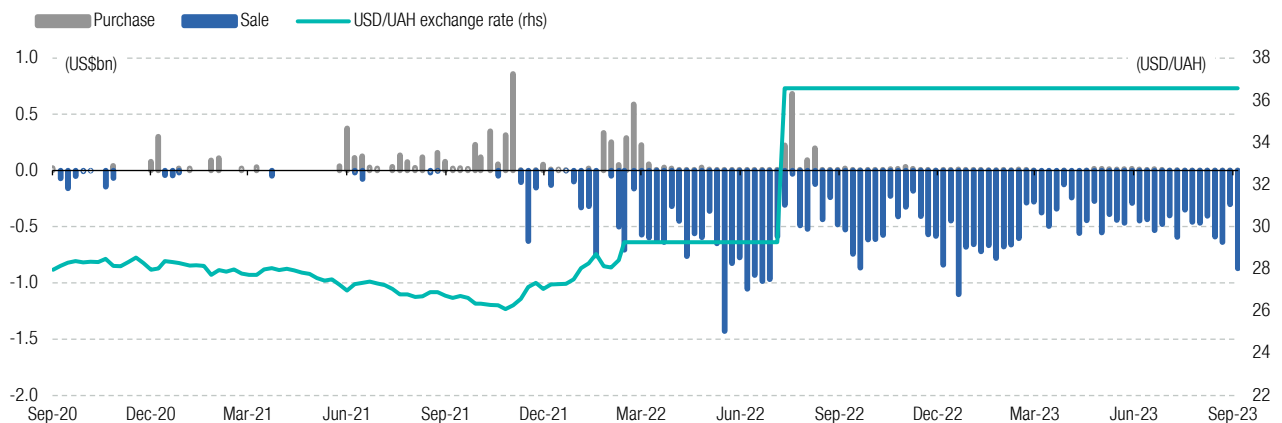
On the interbank market, bank clients (legal entities) also significantly increased hard currency purchases. In four business days, they bought US\$1.3bn, which is 32% more than in the same period of the previous week. At the same time, they also reduced the sale of hard currency by 15%. As a result, the NBU had to sell US\$873m of hard currency from international reserves, the largest weekly volume YTD.

**ICU view: Anticipation of a switch of the NBU FX policy to a flexible exchange rate regime likely prompted a significant increase in demand for FX from households and businesses. In its communications following a monetary decision last week, the NBU provided no further details about possible timing of abandoning the fixed exchange rate, but sent a positive signal it will remain committed to maintain significant sale interventions in the market under any scenario. In the coming weeks and months, the sentiment in the FX market will remain volatile due to increased seasonal demand for FX and expectations of an imminent NBU departure from fixed exchange rate.**

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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

### No surprise with the NBU rate cut

NBU cut the key monetary policy rate by 200bps, to 20%, in line with the expectations.

The regulator abstained from any major changes on monetary policy design – interest rates on three month CDs will continue to be equal to the key rate while overnight CDs remain 400 bps below it.

**ICU view: Despite the lower-than-expected inflation figures, NBU decided to stick to its previous forecast rather than cutting the rate lower. Given plans to gradually relax**

***FX controls, the regulator will be reluctant to go for rapid easing of the monetary policy, trying to keep the yields on UAH assets attractive.***

***Mykhaylo Demkiv, Kyiv, (044) 377-7040 ext.723***

## Government submits 2024 budget draft to parliament

Last week, the Ukrainian government submitted its 2024 draft budget law to parliament. The document reveals plans for gradual fiscal consolidation, but government plans for external borrowings/grants remain ambitious.

The plan for next year's central budget shows expenditures will remain elevated, close to 41% of GDP. This is significantly above 27% of GDP in pre-war 2021, but substantially below 50%+ in 2022 and 2023. Total revenues are expected to grow 23% next year, including 29% growth in tax revenues. This growth is somewhat above the expected growth of nominal GDP. Budget tax and non-tax revenues are expected to cover 53% of expenditures, which is a substantial improvement from 2022 and 2023. The budget draft law envisages a state budget deficit of UAH1.6bn (US\$39bn based on the average official exchange rate projected by the government). This is an equivalent of 20% of the expected nominal GDP in 2024, which is considerably narrower than in 2022 and 2023. The state budget is supposed to be fully funded with external loans and grants. Government plans precisely a 100% rollover rate for local debt, implying no funding from the local market.

***ICU view: The draft budget broadly assumes that expenditures will remain little changed in 2024 vs 2023 and also implies no growth in outlays on defense and national security. Apparently, if Russia's war against Ukraine continues through 2024, the numbers may be subject to substantial revisions, similar to 2023. We believe government's plan to raise US\$43bn in external funding in 2024 looks quite ambitious, but if sources are confirmed, this will provide significant support for the economy. The key external funding risk at the moment is the start of a new election cycle in the US and related delays in the approval of financial aid from Ukraine's key ally. The funding from the EU is likely to remain little changed in 2024 vs the current level of EUR1.5bn/month.***

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**Table 1. Government FX debt payments and their funding, 2019 (US\$bn)**

	2021	2022	2023 (current law)	2023 (upcoming changes)	2024 (draft law)
Total revenues (before grants)	1,296	1,306	1,390	1,409	1,740
incl. tax revenues	1,107	950	1,196	1,196	1,538
Expenditures	1,491	2,705	3,076	3,393	3,309
Net lending	5	-3	34	34	31
Budget deficit (before grants)	-200	-1,396	-1,720	-2,017	-1,600
Total revenues / expenditures	87%	48%	45%	42%	53%
Tax revenues / expenditures	74%	35%	39%	35%	46%
Total revenues / GDP*	24%	25%	21%	21%	21%
incl. tax revenues / GDP*	20%	18%	18%	18%	19%
Expenditures / GDP*	27%	52%	47%	51%	41%
Deficit / GDP*	-4%	-27%	-26%	-31%	-20%

\* 2023 and 2024 numbers are based on ICU projections of nominal GDP

Source: MFU, ICU.

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