



Focus
Ukraine

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

Research team
Vitaliy Vavryshchuk
Alexander Martynenko
Taras Kotovych

Weekly Insight

Current account balance plunges in August

Key messages of the today's comments

MONDAY, 2 OCTOBER 2023

Ukrainian bond market

Refinancing of debt repayments continues

Total domestic borrowings in 9m23 exceeded total domestic debt redemptions due in 2023.

Uncertainty with US aid is weighing on Eurobonds

The prices of Ukrainian Eurobonds continued to decline last week, and the price range for different maturities widened.

Foreign exchange market

Nervousness on FX market subsides

Last week, the FX market was calmer compared with previous weeks, and the hryvnia cash exchange rate continued to strengthen.

Economics

Current account balance plunges in August

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Ukraine's public debt was up 0.8% in US\$ terms in August to US\$134bn.

Banks' reserves market (29 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	20.00	+0bp	-500bp
ON rate (%)	9.76	+0bp	+0bp
Reserves (UAHm) ²	200,505	-14.98	+144.07
CDs (UAHm) ³	507,668	+11.07	+110.04

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) (29 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
NBU	690,693	+0.00	+11.48
Banks	572,895	-0.24	+14.46
Residents	118,754	-1.88	+74.55
Individuals	48,319	-1.29	+52.25
Foreigners ¹	47,217	-3.10	-30.65
Total	1,479,375	-0.45	+14.77

Source: NBU, ICU.

FX market indicators (29 September 2023)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	36.9340	-0.04	+0.00
EUR/USD	1.0573	-0.75	+7.72
DXY	106.174	+0.56	-5.42
UAH TWI ¹	115.024	+0.46	-0.92

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

Market gov't bond quotes (2 October 2023)

Maturity	Bid	Ask
6m	18.00	16.00
12m	19.50	18.00
2y	20.00	18.75
3y	20.25	19.25
12m (\$)	5.00	4.50
2y (\$)	N/A	N/A

Source: ICU.

Ukrainian bond market

Refinancing of debt repayments continues

Total domestic borrowings in 9m23 exceeded total domestic debt redemptions due in 2023.

In 9M23, domestic borrowings reached UAH388.2bn, which is UAH 22.4bn more than all of this year's domestic debt redemptions (repaid in 9M23 and planned for 4Q23 in all currencies). At the same time, the situation is different across currencies.

The total amount of UAH borrowings as of early August exceeded the amount of all UAH debt redemptions scheduled for full 2023. In 9M23, the refinancing ratio for UAH instruments stood at 142%.

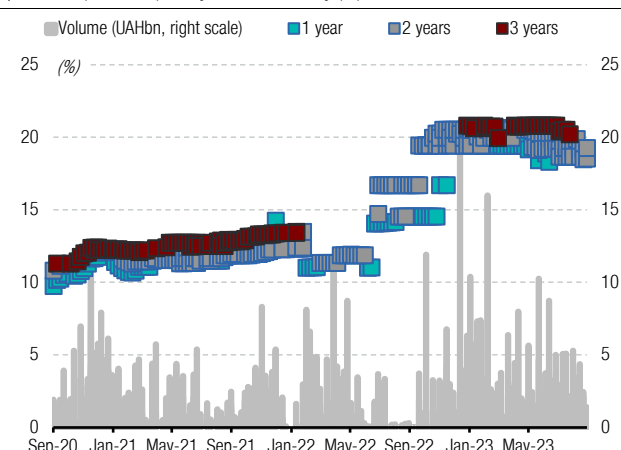
In euros, borrowings for 9M23 are 22% higher than redemptions (there will be no more repayments in euros through the end of the year), and in USD by 3%. However, to maintain 100% refinancing of USD-denominated redemptions, the MoF must borrow at least \$788 million by the end of the year.

ICU view: Although the Ministry of Finance has so far borrowed more than it needs to meet repayments for the entire year, active borrowing continues. The Ministry continues to refinance current payments in local currency and attract additional resources to finance the budget deficit. However, in October, MoF will focus on refinancing US\$700m in redemptions scheduled for this month. Another US\$161m MoF will need to be repaid in December. Therefore, the MoF plans to continue weekly auctions in 4Q23, offering UAH bonds with maturities from one to three years every week and USD-denominated securities in October and December. The MoF may also offer EUR-denominated paper to the current schedule to raise liquidity for redemptions of EUR251m and US\$80m scheduled for January 2024.

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

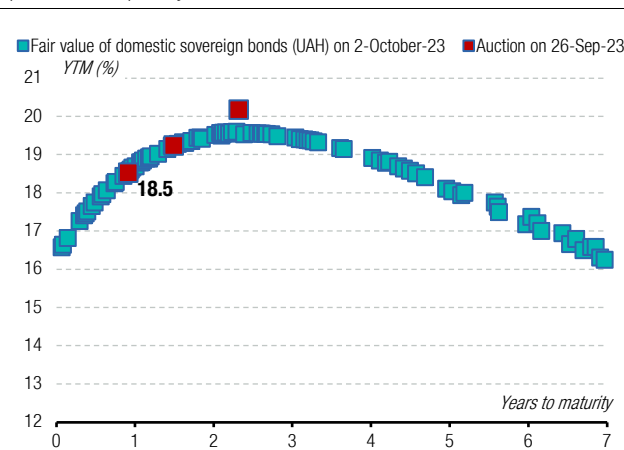
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

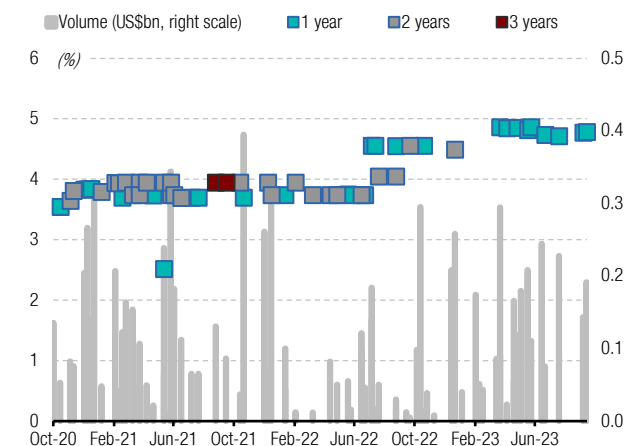
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

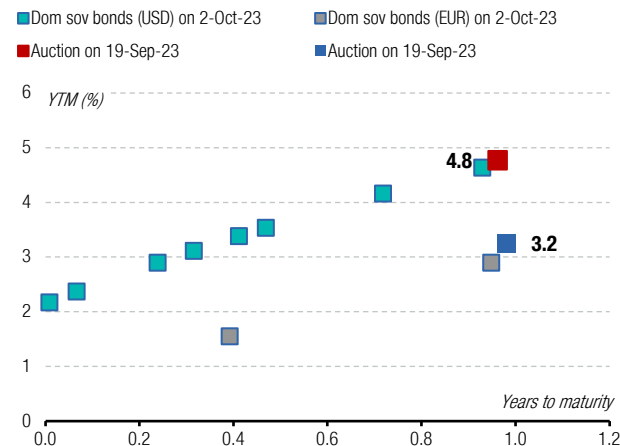
Chart 2. FX-denominated bonds

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.

Uncertainty with US aid is weighing on Eurobonds

The prices of Ukrainian Eurobonds continued to decline last week, and the price range for different maturities widened.

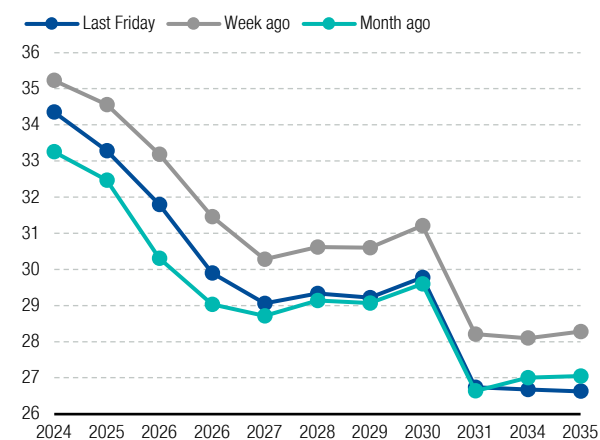
Prices fell by an average of 4% over the past week, although again, the issue that matures next year fell the least, by 2%, and Eurobonds with maturity in 2035 fell the most, by almost 6%. The range of prices for different maturities widened to more than 13%. So, at the end of the week, Eurobonds were quoted in the range of 26–34 cents per dollar. VRIs also fell in price by 6% to slightly below 46 cents per dollar of notional value.

ICU view: Global sentiment towards emerging markets was largely negative last week, with the EMBI index down 1.3% over the period. For Ukraine, tension over the approval of the US budget played a key role. On Saturday, Congress approved a temporary budget for 45 days, which does not contain additional financial support for Ukraine during this period. In the long-term, an absence of financial assistance from the United States may significantly worsen macroeconomic risks for Ukraine, particularly undermining the government's ability to finance the budget deficit. So, in the coming weeks, investors will continue assessing the chances of the US Congress unblocking aid to Ukraine. Therefore, volatility of prices of Ukrainian Eurobonds will likely increase.

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

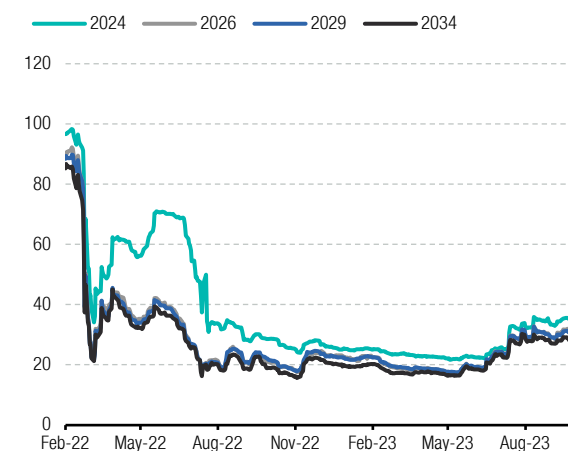
Chart 3. Ukrainian Eurobonds prices

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

Nervousness on FX market subsides

Last week, the FX market was calmer compared with previous weeks, and the hryvnia cash exchange rate continued to strengthen.

On the interbank market, the volume of buying and selling of hard currency decreased over the four business days, as did the imbalance in the market. FX purchases by bank clients (legal entities) exceeded sales by 36%, significantly less than in the previous week when the difference was 64%. The NBU reduced its FX sale interventions by 25% to US\$617m, which is still significantly higher than the average weekly interventions YTD.

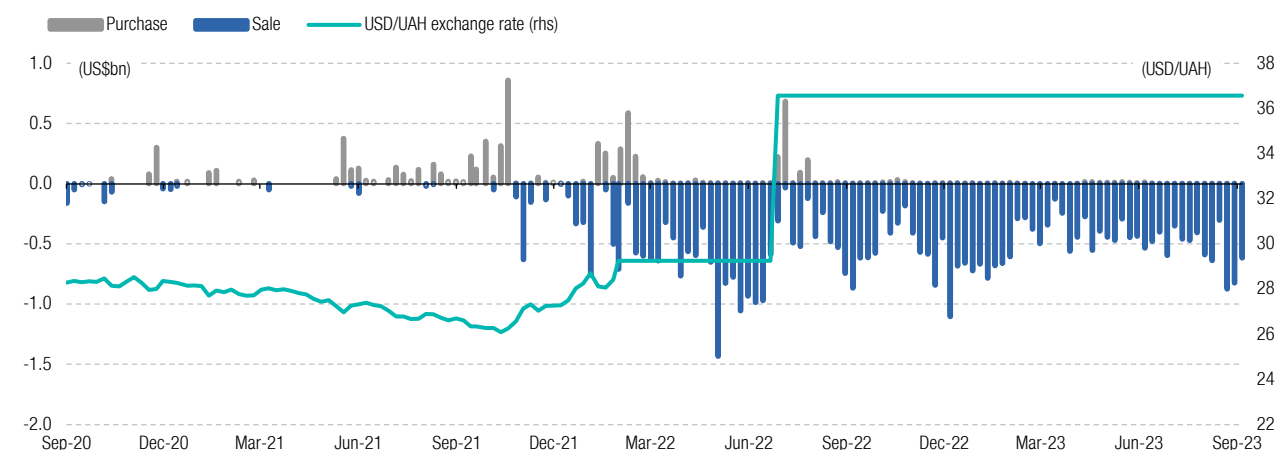
On the cash market, hryvnia appreciated by approximately 0.4% to an average UAH37.3–38.1/US\$ in systemically important banks.

ICU view: Turmoil in the FX market eased last week. On the interbank market, clients (legal entities) purchased significantly less hard currency than in the previous week, reducing the need for NBU interventions. Over the following weeks, the market will be adjusting to a flexible exchange rate regime that the NBU introduces starting tomorrow. We expect heightened volatility of the cash exchange rate, an increase in FX demand in the interbank market and larger NBU interventions.

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

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 balance plunges in August

Ukraine's current account turned significantly negative at US\$2.2bn in August on widening deficit of trade in goods and disruption of grant financing from the US.

The trade-in-goods deficit reached its highest value since the start of the full-fledged war—US\$3.0bn—while the trade-in-services deficit remained little changed compared with the gaps of the previous couple of months. The largest most significant factor for the sharp decline in the current account balance was the lack of regular US funding in the form of grants (registered in the secondary-income line). Given a significant deterioration in August statistics, the 12-month trailing balance of current account turned negative for the first time since June 2022.

The financial account continued to see net inflows thanks to loans that Ukraine's allies provide to the government. However, those loans and net inflows via the financial account were much smaller in August compared with previous months. Overall, the combined current-account and financial-account balance was negative, which led to a 3.2% MoM reduction in NBU reserves to US\$40.4bn.

ICU view: *The continued expansion of the trade-in-goods deficit, although expected, is an increasingly alarming sign. Ukraine's exports continue to stagnate due to logistical bottlenecks while imports keep growing robustly driven by high domestic demand. The disruption with US funding also has had a deeply painful effect on the balance of payments as evident from August statistics. While Ukraine received a grant in September, further financing is at risk due to the budgetary-process impasse in the US Congress. Further delays with financing from the US would imply a need for a significant downgrade of our projections for the current-account deficit (current projection: 2.7% of GDP) and the end-2023 NBU reserves (current projection: US\$44bn).*

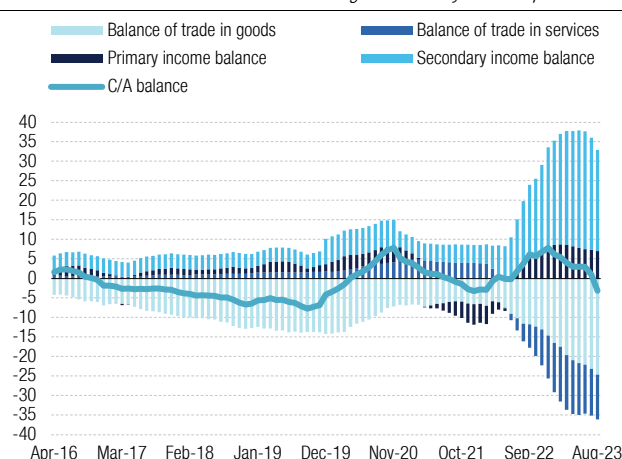
Vitaliy Vavryshchuk, Kyiv, (044) 377-7040 ext.721

Chart 5. Key balance of payment components, \$m*Current-account balance deteriorates dramatically in August*

	Aug 2023	Jul 2023	Aug 2022
Current account	-2,159	-660	1,948
Trade in goods	-3,028	-2,972	-1,546
Trade in services	-608	-610	-1,124
Primary income	468	753	789
incl. migrant income	988	976	1,064
Secondary income	1,009	2,169	3,829
incl. transfers to government	220	1,475	3,082
Financial account*	-988	-3,226	-1,272
Change in trade credits	178	-445	605
Increase in cash out of banks	661	565	771
Net loans to government	-1,537	-3,119	-1,558

* 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 turns negative after a year of surpluses*

Source: NBU, ICU.

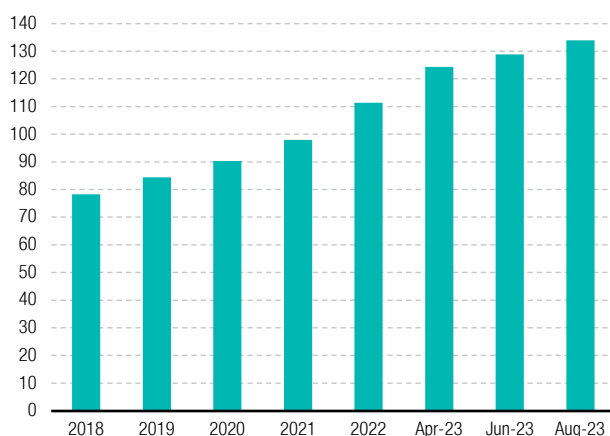
Ukraine's public debt edges up 0.8% in August

Ukraine's public debt was up 0.8% in US\$ terms in August to US\$134bn.

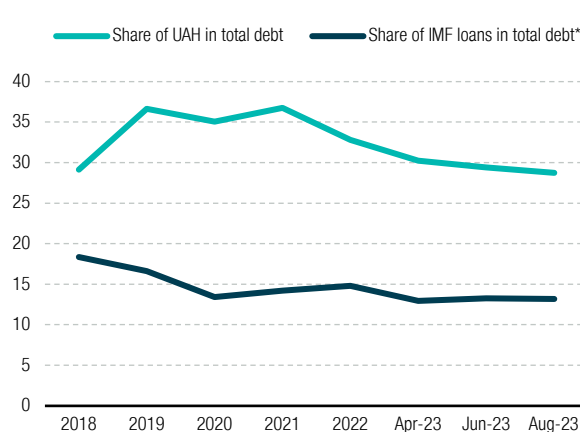
Debt is up 20% over 8M23 and 40% since the start of Russia's full-fledged war. In August, the growth in debt was primarily driven by an EU loan for EUR1.5bn while other external and domestic borrowings were much less significant. Ukraine repaid nearly US\$0.5bn in debt to the WB and the IMF over the month.

ICU view: With data for 8M23 on hand, we now expect that Ukraine is likely to end 2023 with a public debt-to-GDP ratio in the range of 80–85%. This is somewhat better than our previous expectation. This ratio will continue to grow at least for the next three years as fiscal consolidation is unlikely to be fast. However, there are good chances that at its peak value the ratio will not exceed 100%.

Vitaliy Vavryshchuk, Kyiv, (044) 377-7040 ext.721

Chart 7. Ukraine's public debt, \$bn*Public debt increases 0.8% in August*

Source: MoF, ICU.

Chart 8. Share of UAH and IMF loans* in total public debt, %*Share of hryvnia debt continues to decline due to external borrowings*

* includes IMF SDR allocation

Source: MoF, ICU.

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11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kyiv, 01030 Ukraine
Phone/Fax +38 044 3777040

WEB www.icu.ua



RESEARCH

Vitaliy Vavryshchuk

Head of macro research
vitaliy.vavryshchuk@icu.ua

Taras Kotovych

Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Dmitriy Dyachenko, CFA

Financial analyst
dmitriy.dyachenko@icu.ua

Alexander Martynenko

Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv

Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

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