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Weekly Insight

Hryvnia weakens under demand pressure

Key messages of the today's comments

MONDAY, 8 JANUARY 2024

Ukrainian bond market

Stock of government bonds significantly up in 2023

The Ministry of Finance was able to successfully tap the domestic bond market and borrowed considerably more than it redeemed during the year.

Ukrainian Eurobonds move in line with global trend

Prices of sovereign Eurobonds declined during the holiday season against the background of the lack of positive news and lower investor interest in emerging markets.

Foreign exchange market

Hryvnia weakens under demand pressure

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Economics

NBU reserves up in December, close to all-time high

The NBU gross international reserves increased 4.4% in December to US$40.5bn on massive inflows of foreign financial aid. Reserves were up 42% in 2023.

Banks' reserves market (5 January 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	15.00	+0bp	-1,000bp
ON rate (%)	15.00	+3bp	-798bp
Reserves (UAHm)[2]	185,092	-4.5	+221.7
CDs (UAHm)[3]	639,020	-1.4	+36.9

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) (5 January 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	689,990	+0.0	-2.1
Banks	655,100	-0.5	+34.6
Residents	141,269	+1.5	+31.6
Individuals	53,679	+1.2	+76.0
Foreigners	43,701	-0.5	-24.7
Total	**1,585,771**	**+0.0**	**+14.2**

Source: NBU, ICU.

FX market indicators (5 January 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	38.0867	-0.1	+3.5
EUR/USD	1.0943	-0.9	+4.0
DXY	102.412	+1.1	-2.5

Source: Bloomberg, ICU.

Market gov't bond quotes (8 January 2024)

Maturity	Bid (%)	Ask(%)
6 months	17.50	15.00
12 months	18.00	16.50
2 years	19.50	18.00
3 years	20.00	18.75
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

Stock of government bonds significantly up in 2023

The Ministry of Finance was able to successfully tap the domestic bond market and borrowed considerably more than it redeemed during the year.

The MoF raised UAH553bn (US$15.1bn) from the bond market last year, including UAH389bn (US$10.6bn) in local currency and UAH164bn in hard currencies (US$3.7bn and EUR735.8m). Almost 56% of gross proceeds were from military bills in different currencies and nearly 40% were from "reserve" bills and notes, which banks can use to cover a part of required reserves. The rest of the funds were from regular UAH and USD-denominated instruments.

The MoF made UAH220bn, US$3.3bn, and EUR582m in bond redemptions last year. Therefore, the debt refinancing ratio significantly exceeded 100%: it was 173% for UAH debt, 111% for bonds in US dollars, and 122% for EUR-denominated debt.

Individuals increased their bond portfolios by almost 76% or nearly UAH23bn (US$0.6bn) in all currencies. At end-2023, their portfolios amounted to UAH53.2bn (US$1.4bn), including 48.7% in UAH bonds and 51.3% in FX-denominated securities. Banks increased portfolios by 35% or UAH172bn (US$4.7bn) and non-banking institutions by 29% or UAH31.6bn (US$0.9bn). However, foreigners decreased their portfolios by nearly 25% or by UAH14.4bn (US$0.4bn), and now have about UAH44bn (US$1.1bn) of bonds, or almost UAH10bn (US$266m) less than individuals.

Interest rates on UAH bonds in the primary market gradually declined during last year in response to cuts of the NBU key policy rate. On the long-end of yield-curve the MoF decreased interest rates from 19.5% for 1.5-year bills to the range of 16.5-18.6% for instruments with maturities from six months to three years at the end of last year.

ICU view: Last year was successful for domestic borrowings. A noticeable trend was that government bonds started to become an increasingly common savings instrument for households. Net household investments offset a bigger part of outflows of non-resident money from UAH bonds.

The growth in bond issuance was significantly helped by NBU's decision to increase reserve requirements for banks and to allow them to use several "reserve" bonds to cover part of required reserves. At the beginning of last year, the MoF offered "reserve" bills with a 1.5-year maturity, while at the end of last year, the MoF managed to sell notes with over three-year maturities.

The MoF did not actively borrow in FX last year, therefore, the rollover ratio is lower than for UAH-denominated bonds.

We expect that interest rates may go down somewhat in response to the NBU cut in key policy rate in December but the potential for a further decline is not significant since the NBU's current macroeconomic forecast does not envisage further cut in key policy rate in 2024.

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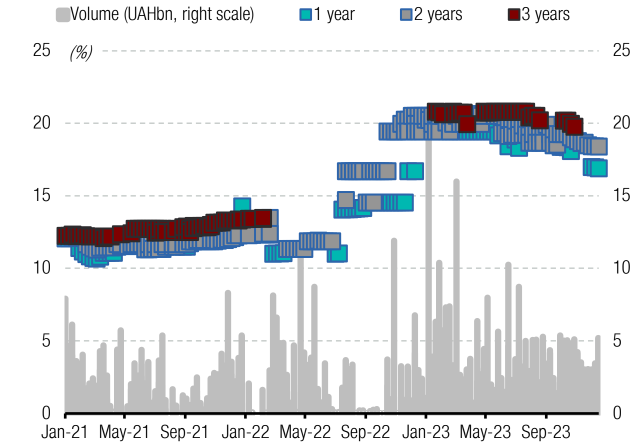
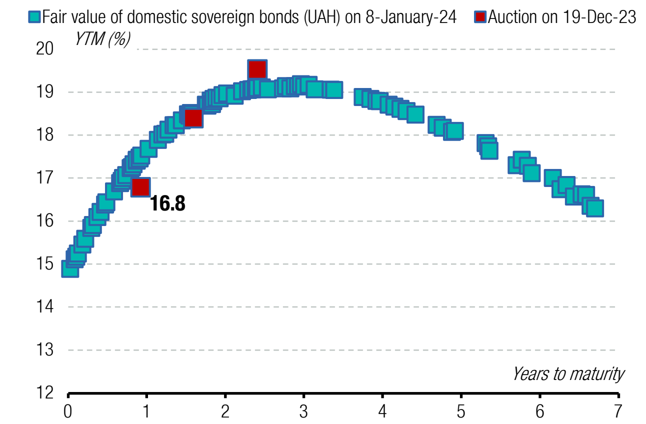
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

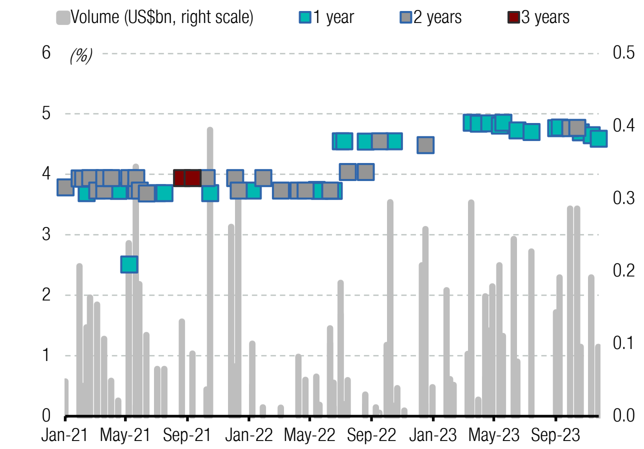
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

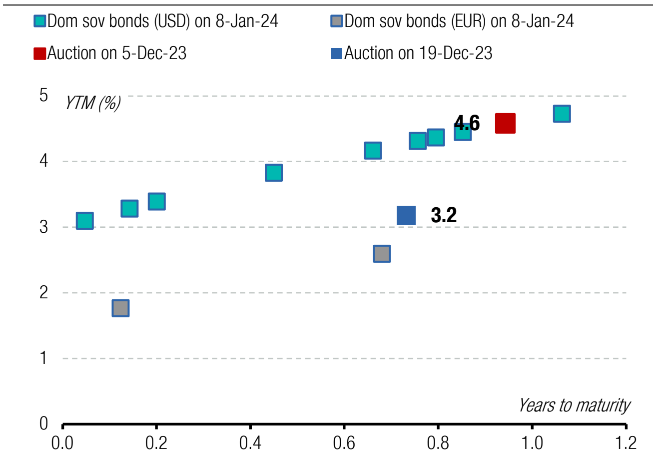
Chart 2. FX-denominated bonds

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



Source: MFU, ICU.

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



Source: NBU, MFU, ICU.

Ukrainian Eurobonds move in line with global trend

Prices of sovereign Eurobonds declined during the holiday season against the background of the lack of positive news and lower investor interest in emerging markets.

During the last two weeks of December, Eurobonds lost about 2.2% on average, moving to 22–31 cents, with the price range of bonds with different maturities widening to 14.6%. The price of VRIs declined by nearly 0.6% below 45 cents per dollar of notional value. EMBI index slid by 1.8%.

ICU view: Low activity in financial markets during the holidays and declining global sentiment toward emerging markets had an impact on prices of Ukrainian Eurobonds. Further, their decline exceeded that of the index due to the uncertainty about timing of approval of financial support from the US and EU.

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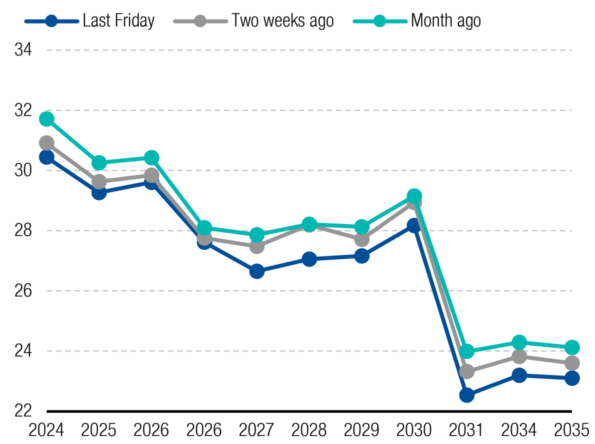
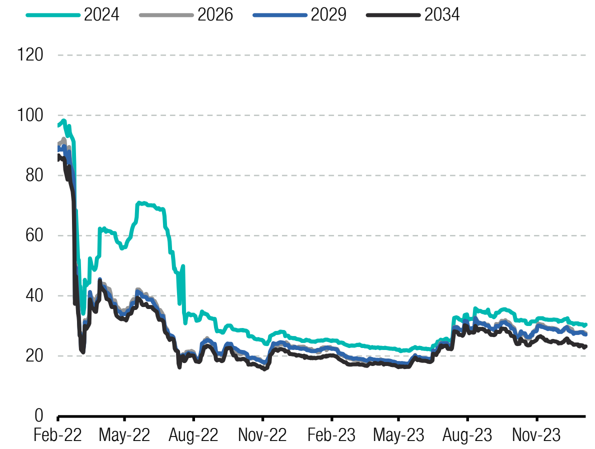
Chart 3. Ukrainian Eurobonds prices

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



Source: Bloomberg, ICU.

Historical data since February, 2022



Source: Bloomberg, ICU.

Foreign exchange market

Hryvnia weakens under demand pressure

During the holiday season, the hryvnia weakened, and the official exchange rate exceeded UAH38/US$.

In the interbank FX market, demand for hard currency from bank clients (legal entities) almost doubled at the end of last year, and exceeded US$500m on several days. On the contrary, clients sold less than US$300m per day. Therefore, the NBU had to sell US$860–980m weekly from international reserves most of last month.

Last week's demand slightly declined compared with the last week of 2023, but it remained significant. During four business days last week, bank clients purchased US$844m of hard currency and sold just US$429m. NBU decreased its interventions by only 12% to US$790m. The official exchange rate reached a new low last Wednesday at UAH38.12/US$, but for today, it was set at UAH38.08/US$.

Households substantially increased FX purchases at the end of last year to about US$100–150m per day and bought US$648m in the last week of 2023. Purchases fell dramatically to US$355m last week (for four business days of last week) or by 35% compared to the same period of the previous week. The cash exchange rate in systemically important banks weakened by 0.8% to UAH38.2–39.0/US$. However, the cash hryvnia remains stronger than a year ago by 4%.

ICU view: At the end of last year, demand for FX from business and government institutions spiked as they had to close contracts. Higher seasonal demand likely led to over-reaction from other market participants, increasing the FX market imbalance and weakening the hryvnia further. The lingering uncertainty about the timing and size of international aid in 2024 was a contributing factor to negative sentiment. We expect the NBU will maintain a strong presence in the FX market and will ensure that exchange-rate fluctuations are balanced.

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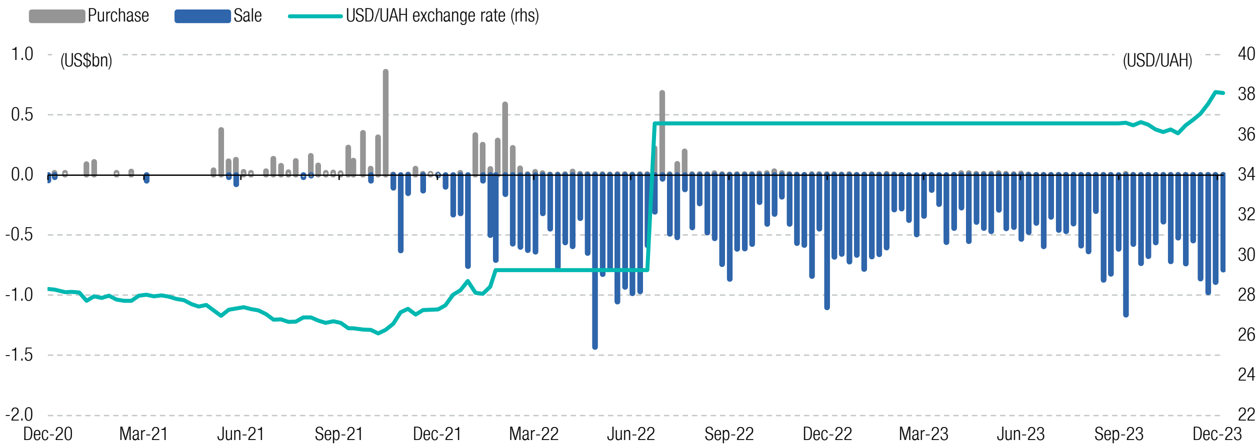
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

NBU reserves up in December, close to all-time high

The NBU gross international reserves increased 4.4% in December to US$40.5bn on massive inflows of foreign financial aid. Reserves were up 42% in 2023.

The December increase in reserves reversed a big part of the decline over the previous four months when international financial aid fell short of the current needs for interventions and debt service. End-2023 reserves are close to an all-time high level of US$41.7bn that the NBU had in July. Last month's growth in reserves was primarily driven by a US$2.2bn loan from Japan (via the World Bank), an EUR1.5bn loan from the EU, a US$0.9bn loan from the IMF, and other less significant borrowings. Meanwhile, the NBU spent US$3.6bn in the FX market to smooth market imbalances. Also US$0.7bn was spent on debt servicing, including a repayment of US$0.4bn to the IMF.

ICU view: Uncertainty about the timing and size of foreign financial aid to Ukraine in 2024 remains. Yet, at this point, we believe Ukraine will manage to secure grants and loans from the US, the EU, and other major donors. We expect more than US$35bn of financial aid inflows over 2024, which implies the gaps of external accounts will be fully covered in 2024. Most likely, reserves may decline by up to 15% from the current level over January–February as Ukraine's partners sort out formalities to restart supporting Ukraine. But reserves are likely to return close to US$40bn when financial aid starts flowing again.

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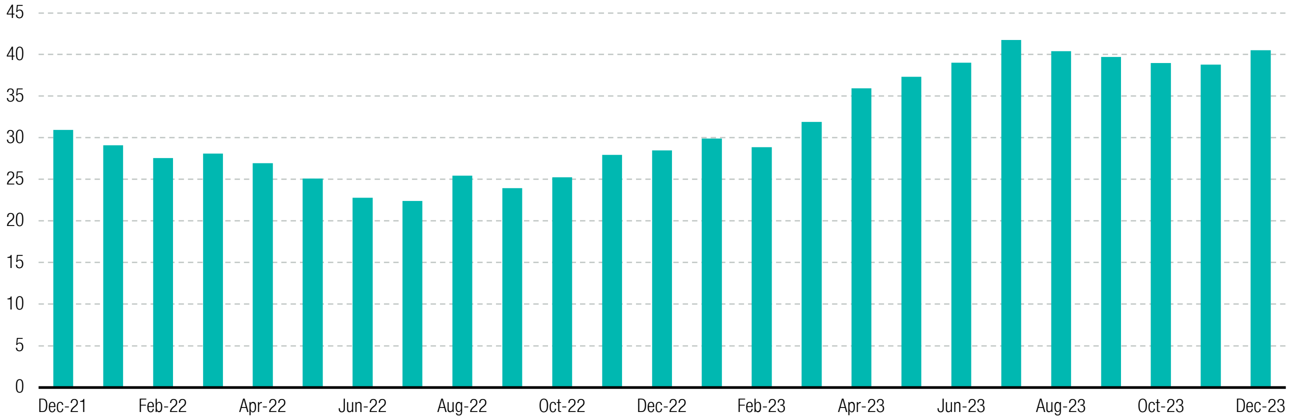
Chart 5. NBU gross international reserves, US$bn

NBU reserves up 42% in 2023



Source: NBU, ICU.

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