Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

NBU restrains hryvnia appreciation

Key messages of the today's comments

Ukrainian bond market

Debt redemptions refinanced; rollover different across currencies

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Approval of EU aid provides only temporary support for Eurobonds

Ukrainian Eurobond prices slid last week despite the EU approval of EUR50bn financing support for Ukraine.

Foreign exchange market

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Economics

Government borrowings fully cover current account gap in 2023

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Ukraine's public debt up 30% in 2023

Ukraine's public debt was up 3.2% in US$ terms in December and 30% in 2023 to US$145bn.

MONDAY, 5 FEBRUARY 2024

Banks' reserves market (2 February 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	15.00	+0bp	-1,000bp
ON rate (%)	15.00	+0bp	-800bp
Reserves (UAHm)[2]	227,093	-5.9	+62.8
CDs (UAHm)[3]	553,956	+0.1	+60.7

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) (2 February 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	687,490	+0.0	-1.7
Banks	661,623	-0.1	+28.2
Residents	146,791	+0.9	+31.2
Individuals	58,088	+1.5	+76.8
Foreigners	43,807	-0.5	-31.4
Total	**1,599,914**	**+0.1**	**+12.2**

Source: NBU, ICU.

FX market indicators (2 February 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	37.5273	-0.8	+2.0
EUR/USD	1.0788	-0.6	-1.1
DXY	103.922	+0.5	+2.1

Source: Bloomberg, ICU.

Market gov't bond quotes (5 February 2024)

Maturity	Bid (%)	Ask(%)
6 months	17.00	15.00
12 months	18.00	17.00
2 years	19.25	18.25
3 years	20.00	19.00
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

Debt redemptions refinanced; rollover different across currencies

The Ministry of Finance fully refinanced debt redemptions in January. However, for the debt denominated in euro, the rollover rate was below 100%.

Last week, the MoF borrowed just UAH1.6bn (US$41.2m), selling only UAH-denominated bonds for the first time this year. There were no debt redemptions last week.

Overall, in January, the MoF borrowed UAH32bn (US$845m) in all currencies, twice more than what was redeemed. The rollover rate was 180% in local currency, 119% in US dollars, but just 92% in euro.

In January, the share of FX-denominated bonds in secondary market trading rose to 20%. The most traded were military bills due in October 2025, and two-year "reserve" paper (18% and 29% of trades in UAH bonds). Among FX-denominated bills, the most traded was USD paper with redemption at the end of this month, which was 34% of trades.

In January, the largest increase in portfolios was recorded for retail investors (+8.8%) and non-banking institutions (+5.6%). Foreign investors' portfolios rose by just 0.5%.

ICU view: As inflows of foreign financial aid was paused in January, the MoF was active in the domestic market and, specifically, increased offerings of FX-denominated bills. Even though rollover of EUR-denominated debt fell short of 100%, large borrowings in US dollars imply a total refinancing for FX debt well above 100%. Individuals maintained a high interest in domestic bonds, preferring FX-denominated instruments. Since foreigners cannot repatriate funds from bond redemptions, they keep rebalancing their portfolios to be able to repatriate interest repayments.

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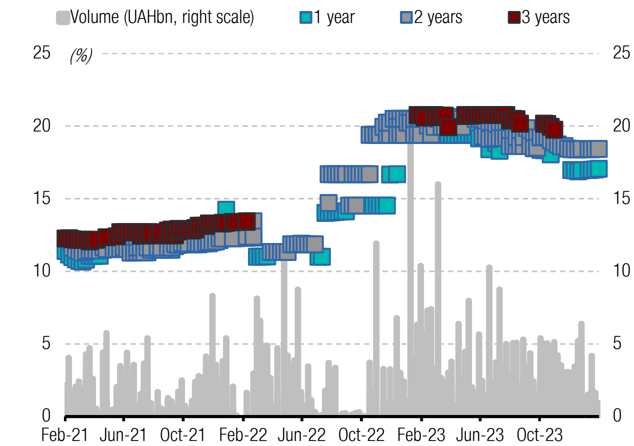
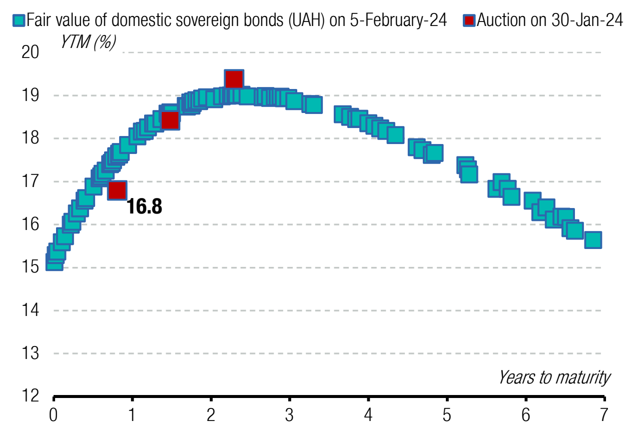
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

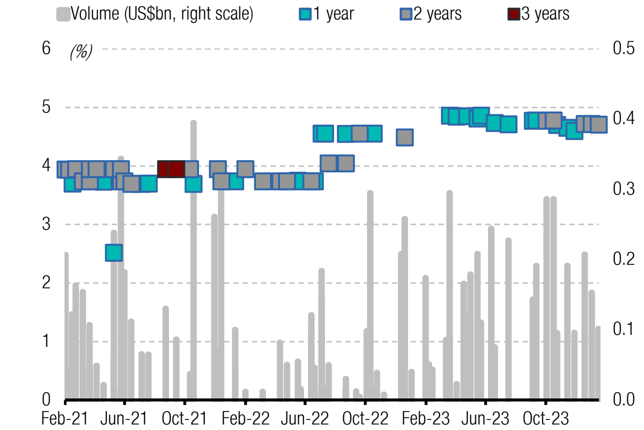
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

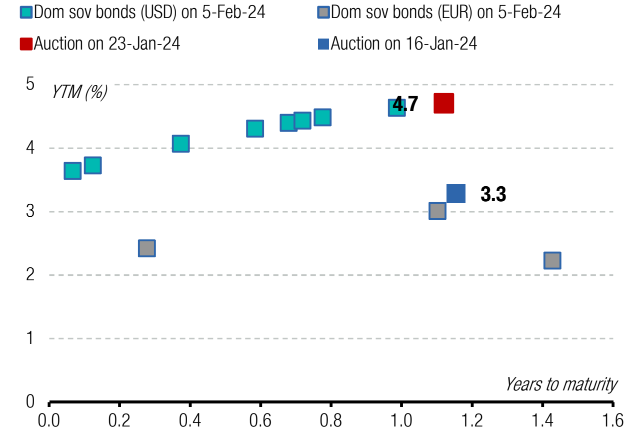
Chart 2. FX-denominated bonds

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.

Approval of EU aid provides only temporary support for Eurobonds

Ukrainian Eurobond prices slid last week despite the EU approval of EUR50bn financing support for Ukraine.

Last week, the prices of Ukrainian Eurobonds declined by 4% on average to 23–30 cents. The price range for Eurobonds with different maturities widened to 13.1%. The price of VRIs was up by 1% to 47 cents per dollar of notional value. The EMBI index rose by 0.3% last week.

ICU view: Last Thursday, the EU approved its EUR50bn financial aid package for Ukraine for 2024–27. The first tranche of EUR4.5bn is expected in March. This decision provided a quick boost for Ukrainian Eurobonds, but on Friday, prices rolled back and finished last week on a downward trend. Bondholder focus remains on the discussion of the US aid package in Congress, including financial and military support for Ukraine. The outcome of negotiations in Congress will be critical for Eurobond prices in the coming weeks.

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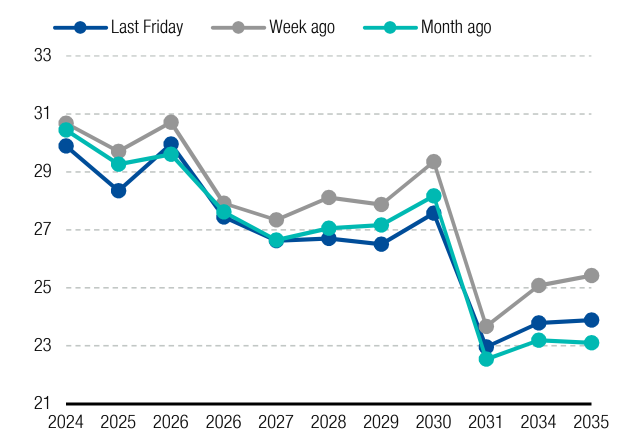
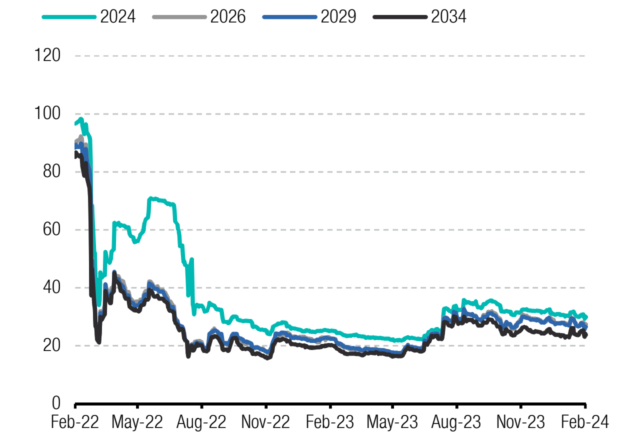
Chart 3. Ukrainian Eurobonds prices

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

NBU restrains hryvnia appreciation

The NBU decreased its weekly interventions to a 10-month low and restrained hryvnia appreciation last week.

In the interbank FX market, bank clients (legal entities) increased the sale of hard currency by 21% (in four business days), while FX purchases declined by 9%. Overall, their net sale of foreign currency amounted to US$135m. For a second consecutive week, this market segment saw a positive balance after it had been in deficit every week for nine months before the situation changed in late January. The official hryvnia exchange rate strengthened by 0.6% to UAH37.57/US$.

Meanwhile, in the retail FX market, volumes hardly changed. The average exchange rate in systemically important banks appreciated by 0.4% to UAH37.5–38.1/US$.

NBU decreased its FX sale interventions to the lowest amount in almost 10 months — US$239 — and it even purchased US$15m last week.

ICU view: Significantly better demand/supply balance from businesses indicates that exchange rate expectations improved and that the market now has better confidence in the NBU's ability to control the FX market. Noteworthy, the NBU decreased its presence in the market, preventing further hryvnia appreciation.

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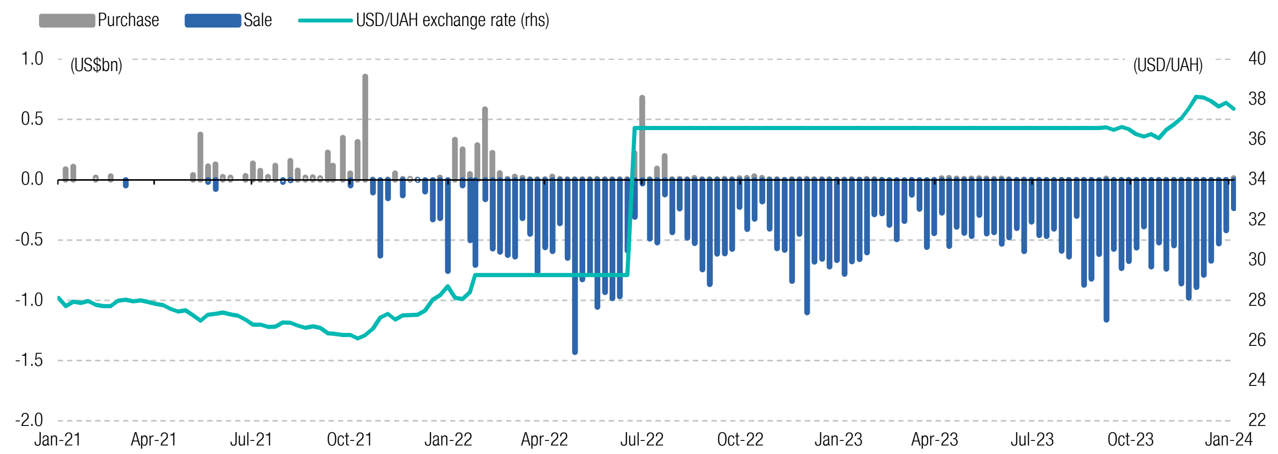
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Government borrowings fully cover current account gap in 2023

Ukraine's current account turned negative at US$9.8bn (5.4–5.6% of GDP) in 2023 on a widening deficit of trade in goods and disruption of grant financing from the US.

The trade-in-goods deficit nearly doubled last year to US$29bn. Export of goods declined 16% due to logistics bottlenecks and unfavorable prices for agro products. Meanwhile, import of goods increased 14% due to strengthening domestic demand. The balance of external trade in services improved thanks to lower expenditures of Ukrainian refugees abroad.

Migrant income remained robust last year and kept the primary income balance in healthy surplus. Transfers of grants to the government declined by a fifth as the US significantly reduced grant support vs 2022.

The shortfall of the current account was fully compensated with capital inflows via the financial account, of which concessional loans to the government played the key role. Strong support from Ukraine's allies kept the total balance of the current account and financial account in strong surplus, which enabled the NBU to increase its gross reserves by 42% to US$40.5bn.

ICU view: By our estimates, the deficit of external trade reached its peak last year at 21–22% of GDP and is likely to narrow marginally in 2024. A gradual recovery of commodity exports via Black Sea routes and lower expenditures of Ukrainian migrants abroad are the two supporting factors. Factoring them in and assuming Ukraine will receive grants from the US (a part of secondary income of C/A) we expect the C/A gap will remain relatively stable YoY at 5-6% of GDP. Like last year, we expect it to be fully covered with concessional loans, implying the NBU will not be forced to use its existing reserves to maintain stability in the FX market. The failure of the US Congress to approve an aid package for Ukraine will introduce more risks for Ukraine's balance of payments. Yet, we believe chances are high that loans from other partners will be almost sufficient to offset the expected C/A gap. We, thus, expect the situation in the FX market will remain relatively stable through end-2024.

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Chart 5. Key balance of payment components, $m

Financial account inflows compensate for C/A deficit

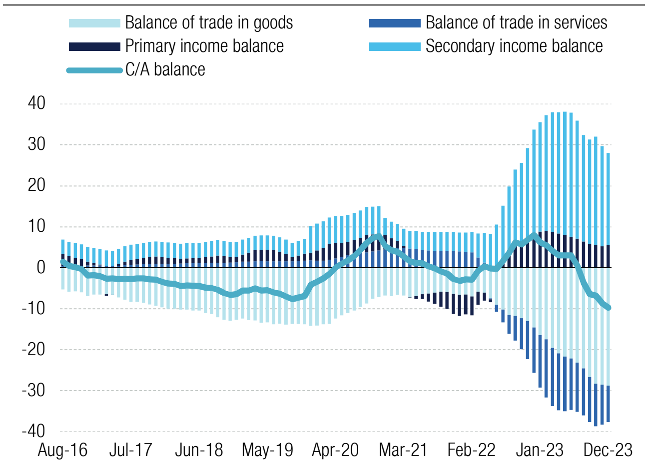
	2023	2022	Dec 2023	Dec 2022
Current account	**-9,750**	**7,972**	**-797**	**273**
Trade in goods	-28,810	-14,652	-2,116	-3,116
Trade in services	-8,936	-11,085	-562	-589
Primary income	5,513	8,481	350	1,041
incl. migrant income	11,504	12,826	879	943
Secondary income	22,483	25,228	820	1,867
incl. transfers to gov't	14,004	17,777	948	2,683
Financial account*	**-19,057**	**11,055**	**-1,143**	**-1,884**
Change in trade credits	-906	12,736	503	346
Change in cash out of banks	11,801	10,073	1,085	1,536
Net loans to government	-25,942	-14,749	-1,970	-3,831
Other	-4,010	2,995	-761	65

* 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 keeps deteriorating



Source: NBU, ICU.

Ukraine's public debt up 30% in 2023

Ukraine's public debt was up 3.2% in US$ terms in December and 30% in 2023 to US$145bn.

Since the start of russia's full-scale invasion, the public debt increased 56%. The increase in public debt over 2023 was primarily driven by concessional borrowings from the EU and, to a much lesser extent, from the World Bank, the IMF, and domestic borrowings. Financial aid from the US was provided in the form of grants, which prevented an even bigger increase in indebtedness. The share of hryvnia debt was down 5.6pp to 27.2%. Eurobonds made up 13.6% of end-2023 public debt stock (excluding Eurobonds purchased by russia).

ICU view: We estimate the end-2023 debt-to-GDP ratio at 83–84% depending on the size of nominal GDP, which is still an unknown metric. This is somewhat above our

forecast of 81% due to weakening of the hryvnia at the end of last year. We see the ratio deteriorating close to 90% by the end of 2024, again on the back of heavy concessional external borrowings and gradual hryvnia depreciation. While this debt ratio is far from a comfortable level, it does not pose any significant risks in the mid-term. All new external borrowings since the start of russia's full-fledged war represent long-term debt that will not start maturing at least in the next ten years, and it carries minimal (or zero) interest rates. Ukraine will have enough time to address its debt issues so that debt does not become a drag on liquidity of Ukraine's government during wartime. The key thing to watch in the coming months is the upcoming restructuring of Eurobonds that the government plans to complete in the first half of the year.

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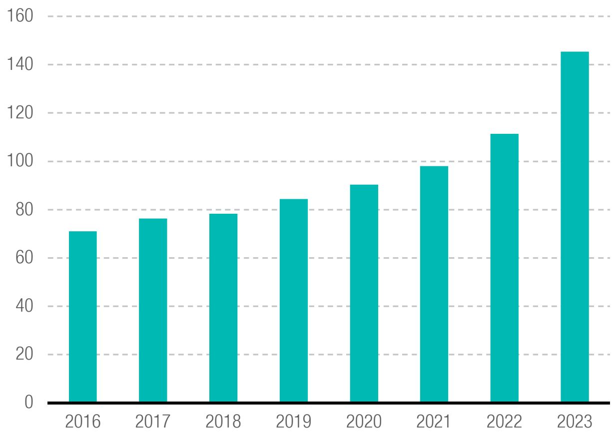
Chart 7. Ukraine's public debt, $bn

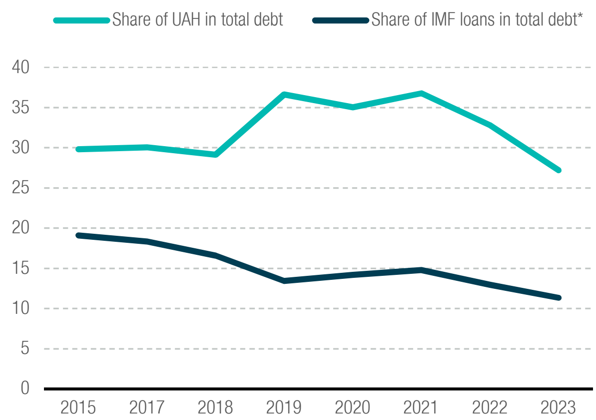
Public debt increases nearly one third in 2023



Source: MoF, ICU.

Chart 8. Share of UAH and IMF loans* in total public debt, %

Share of hryvnia debt continues to decline due to large external borrowings



* includes IMF SDR allocation

Source: MoF, ICU.

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