Focus	Markets	Research team
Ukraine	**Government bonds, FX market, and macro**	**Vitaliy Vavryshchuk** **Alexander Martynenko** **Taras Kotovych**

Weekly Insight

Ukraine's real GDP recovers 5.3% in

Key messages of the today's comments

MONDAY, 1 APRIL 2024

Ukrainian bond market

Bond yields continue to trend down

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Borrowings continue to exceed redemptions

During March, the MoF's borrowings exceeded redemptions by 31%.

Eurobond prices edge down after rally

The prices of Ukrainian Eurobonds edged down by the end of the last week after a rally that lasted a couple of days. At the same time, the price of VRIs increased sharply.

Foreign exchange market

UAH under pressure as market imbalances increase

The deficit in the FX market remained significant last week, prompting sizeable NBU interventions to restrain hryvnia weakening.

Economics

Ukraine's real GDP recovers 5.3% in 2023

Ukraine's real GDP grew by 5.3% YoY in 2023 following a 28.8% slump in 2022. The growth was supported by heavy government spending and recovery of domestic private consumption.

Banks' reserves market (28 March 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	14.50	+0bp	-1,050bp
ON rate (%)	14.50	+0bp	-850bp
Reserves (UAHm)[2]	217,968	-6.2	+12.5
CDs (UAHm)[3]	543,904	+1.6	+54.3

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) (28 March 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	680,490	-0.3	-2.4
Banks	680,032	+0.7	+26.4
Residents	153,343	+2.2	+36.4
Individuals	58,193	+5.2	+62.4
Foreigners	42,388	+5.0	-21.4
Total	**1,616,209**	**+0.7**	**+12.2**

Source: NBU, ICU.

FX market indicators (28 March 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	39.1103	+0.1	+5.8
EUR/USD	1.0790	-0.2	-0.5
DXY	104.487	+0.1	+1.8

Source: Bloomberg, ICU.

Market gov't bond quotes (1 April 2024)

Maturity	Bid (%)	Ask(%)
6 months	17.00	15.00
12 months	17.50	16.50
2 years	19.00	17.50
3 years	19.75	18.50
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

Bond yields continue to trend down

The MoF continued to decrease interest rates in the primary bond market, but at a slower pace vs a week before. Yields in the secondary market followed the trend.

The Ministry borrowed UAH12bn (US$319m), including US$74m via USD-denominated bills. The MoF sold all offered 13-month and two-year bills, while demand for three-year notes fell short of the supply. In the second consecutive auction, the MoF decreased interest rates for UAH bonds thanks to competition between bidders. See details in the auction review.

Competition was the highest for a new 13-month paper. Bidders reacted to a cut in interest rates for the NBU CDs and submitted bids for the shortest paper in the range of 16.12%–16.45% (down 15–58bp vs previous week). Due to a cap, only bids with lower rates were satisfied.

Since the NBU decision to cut its key policy rate and interest rates for CDs two week ago, the MoF managed to decrease interest rates for one-year bills by 45bp to 16.35%, and by 40bp to 17.2% for two-year paper, and by 20bp to 18.3% for three-year notes.

In the secondary bond market, trading in UAH bonds rose and was concentrated in longer maturities. Yields there followed the primary market. Individuals and foreigners increased their portfolios most actively.

ICU view: The NBU's rhetoric in the published minutes of the Monetary Policy Committee meeting sent a signal that the National Bank may cut rates further in April and June. Therefore, banks are increasing their investments in the shortest bills to lock in the current yields and gradually reduce their investments in three-month CDs. The plans to lock current yields is also noticeable among other investors, who are mainly investing in the secondary market.

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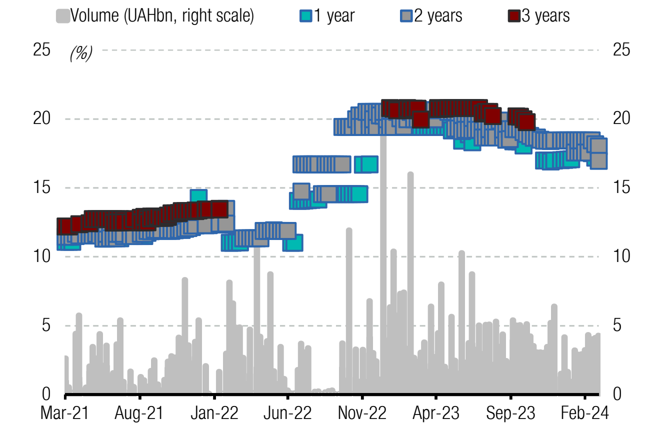
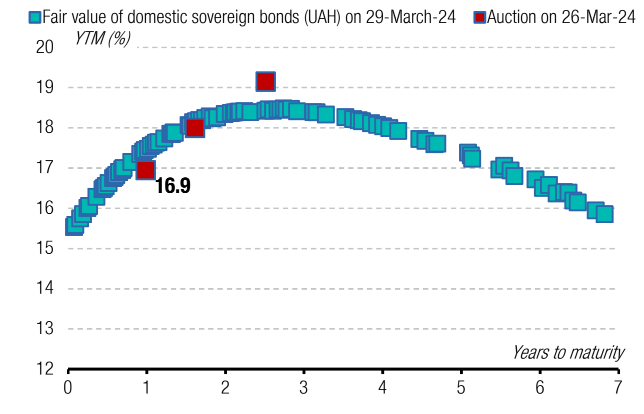
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

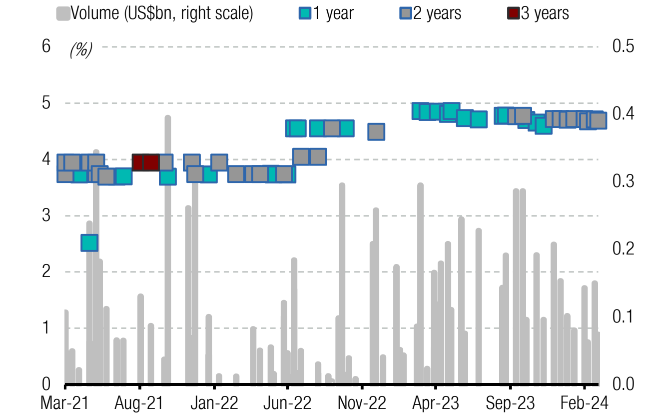
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

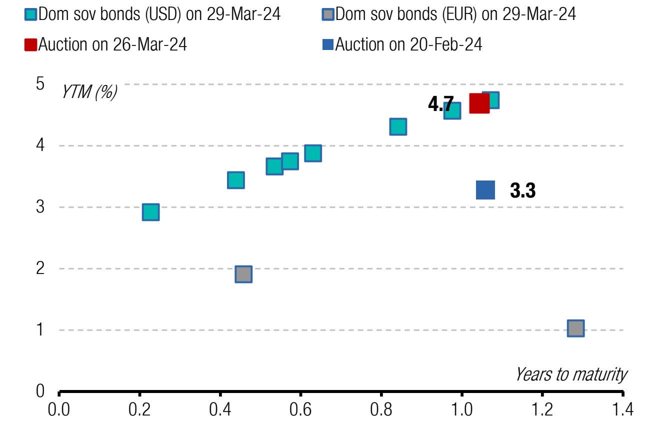
Chart 2. FX-denominated bonds

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.

Borrowings continue to exceed redemptions

During March, the MoF's borrowings exceeded redemptions by 31%.

Last month, the MoF redeemed UAH17.9bn (US$459m) and US$251.9m. At the same time, new borrowings totalled UAH33bn (US$$846m) and US$281m. The rollover rate for UAH instruments was 184%, and it stood at 112% for FX instruments.

In 1Q24, borrowings amounted to UAH116bn (almost US$3bn) in all currencies, implying a 131% refinancing rate, including 187% for hryvnia-denominated debt, 95.5% for USD, and 93% for euros.

In April, the scheduled repayments of state debt are relatively small at only UAH4.5bn (US$115m), while in May, they will increase to UAH19bn (US$487m) and EUR277m. In 2Q24, the MoF will continue offering one-, two- and three-year UAH bonds and FX-denominated bills in USD and euros.

ICU view: March was a success for MinFin in terms of domestic borrowings. The debt refinancing rate in 1Q24 rose to 131% from 119% in two months (total in all currencies). Most likely, the MoF will manage to increase the debt refinancing rate even further in April.

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Eurobond prices edge down after rally

The prices of Ukrainian Eurobonds edged down by the end of the last week after a rally that lasted a couple of days. At the same time, the price of VRIs increased sharply.

Last week, Eurobond prices slightly declined by an average of 1.6% to 29–38, with the price range unchanged around 12.2%. However, the price of VRIs rose by 16% to almost 56 cents per dollar of notional value. The EMBI remained almost unchanged from the previous week.

ICU view: Investor enthusiasm dried up after a short rally that followed a successful review of the IMF program for Ukraine. At the same time, the warrant price continued to increase, and it now exceeds the level before russia's full-scale invasion. The VRI rally came on the back of the fact that the IMF included warrant-related payments into its debt sustainability analysis for the first time and was also supported by [GDP figures](#) published last Thursday. In the coming week, Eurobond prices are likely to remain

volatile as investors anticipate news about the progress with the US aid package and, later, the announcement of Eurobond restructuring terms by the government.

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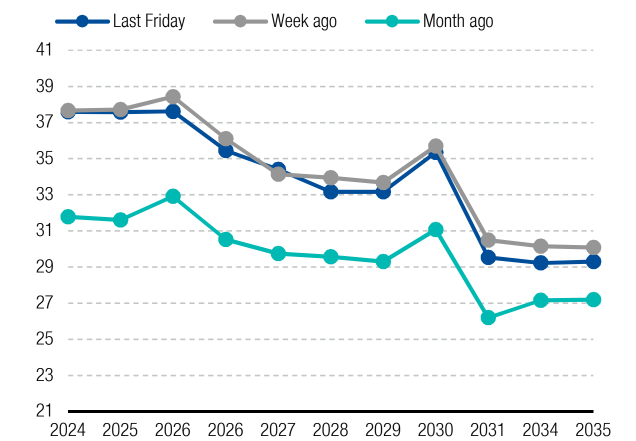
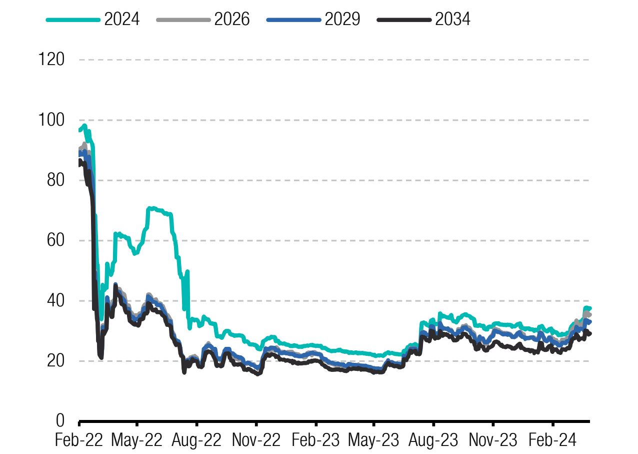
Chart 3. Ukrainian Eurobonds prices

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

UAH under pressure as market imbalances increase

The deficit in the FX market remained significant last week, prompting sizeable NBU interventions to restrain hryvnia weakening.

Trading in the FX interbank market remained almost unchanged from the previous week, with the hard-currency deficit increase by 7% (in four business days compared with the same period of the previous week). Therefore, the official exchange rate remains volatile within UAH39.22–39.34/US$ for most of last week, appreciating only last Friday to UAH39/US$.

In the retail segment, net foreign currency purchases rose by 10% to US$77m (in four business days). The cash exchange rate in systemically important banks weakened by 0.4% to UAH38.9–39.4/US$.

The huge hard-currency deficit forced the NBU to sell US$655m in interventions, just 4% less than the previous week.

ICU view: The FX market remained under pressure from large purchases in the interbank segment, probably by state enterprises for import contracts. Also, there can be an increase in imports for agricultural sector. The retail segment had an insignificant reaction to the interbank market movements last week.

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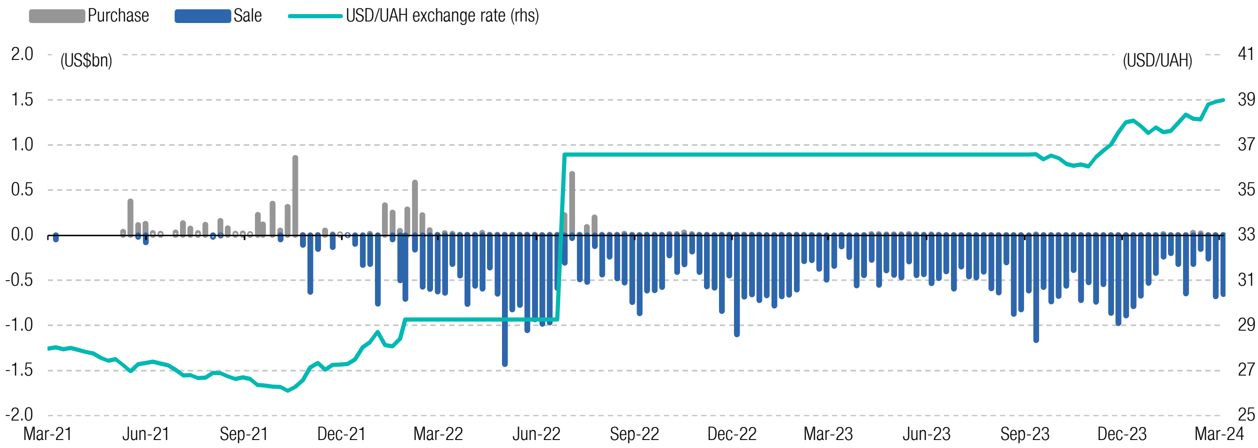
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Ukraine's real GDP recovers 5.3% in 2023

Ukraine's real GDP grew by 5.3% YoY in 2023 following a 28.8% slump in 2022. The growth was supported by heavy government spending and recovery of domestic private consumption.

Nominal GDP is estimated at UAH6,538bn (+25% YoY). In FX terms, GDP amounted US$179bn (+10% YoY) based on the 2023 official average exchange rate.

Last year's recovery came on continued expansion of government role in the economy due to hefty outlays on the defense and security sectors. Government consumption reached nearly 42% of nominal GDP in 2023, up from 18% in 2021. A 53% increase in investments (gross fixed capital formation) is also a reflection of increased government spending on military equipment. Recovery of private household consumption also had a substantial positive contribution to GDP growth. Meanwhile, the key drag on economic growth was international trade. Real exports fell 5.4% YoY in 2023 due to impaired logistics. Import increased 8.5% in real terms, thus satisfying a significant share of domestic demand.

ICU view: Gradual economic recovery is set to continue in 2024, but at a slower pace compared to 2023. We forecast it may reach 5.0% if no new material safety risks materialize during the year. This year, economic growth will be supported by further recovery in household demand thanks to an increase in real wages against the backdrop of very low inflation. Export may also become a major driver of GDP growth thanks to successful functioning of Black Sea shipping corridor that allows deliveries of a wide range of commodities abroad. On the downside, risks of blackouts have increased substantially recently following russia's massive attack on Ukraine's energy infrastructure. This may potentially become a material drag on economic growth.

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Table 1. Ukraine's GDP (production method components)

The structure of Ukraine's GDP changed considerably due to the war

Sector	Real change YoY		Share in nominal GDP		
	2022	**2023**	**2021**	**2022**	**2023**
Agriculture	-28.4%	7.6%	10.9%	8.6%	7.4%
Extraction industry	-32.2%	-1.9%	6.4%	4.4%	4.0%
Manufacturing	-43.1%	13.8%	10.3%	7.6%	8.2%
Power supply	-32.5%	-1.8%	3.3%	4.4%	4.7%
Construction	-67.6%	24.6%	2.8%	1.3%	1.6%
Trade	-30.9%	6.6%	13.6%	12.3%	12.6%
Transportation	-44.3%	5.6%	5.4%	4.3%	4.3%
Telecommunications	-15.4%	12.9%	4.7%	3.9%	4.0%
Financial services	-15.8%	-8.3%	3.0%	3.0%	2.4%
Real estate	-34.5%	10.6%	5.8%	4.5%	4.9%
Professional activities and science	-46.2%	-1.0%	2.9%	1.9%	2.0%
State governance (incl defense)	35.4%	5.8%	6.2%	21.7%	22.1%
Education	-11.4%	-3.6%	4.3%	4.3%	3.5%
Health care	-17.5%	4.1%	2.5%	2.9%	2.6%
Other	na	na	3.9%	3.2%	3.1%
Taxes net of subsidies	na	na	14.1%	11.7%	12.4%

Source: Ukrstat, ICU.

Table 2. Ukraine's GDP (consumption method components)

Household consumption and government spending supported economic recovery

GDP component	Real change YoY		Share in nominal GDP*		
	2022	**2023**	**2021**	**2022**	**2023**
Household consumption	-26.7%	6.3%	68.2%	64.4%	62.4%
Government consumption	18.0%	9.0%	17.7%	38.2%	41.7%
Gross fixed capital formation	-34.3%	52.9%	13.2%	11.6%	16.9%
Exports	-42.4%	-5.4%	40.7%	35.5%	28.6%
Imports	-18.5%	8.5%	-42.0%	-52.3%	-49.5%

* shares do not add up to 100% due to omitted other minor components

Source: Ukrstat, ICU.

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