Focus

Ukraine

Markets

Government bonds, FX market, and macro

Research team

Vitaliy Vavryshchuk
Alexander Martynenko
Taras Kotovych

Weekly Insight

Staff level agreement reached with IMF

Key messages of the today's comments

Ukrainian bond market

MoF maintains steady pace of bond placement

During May, the Ministry of Finance offered the same amount of UAH bonds every week, while gradually reducing rates in the primary bond market.

Launch of debt restructuring negotiations linger

The last week of May ended without important restructuring news.

Foreign exchange market

NBU continues to restrain hryvnia weakening

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Economics

Staff level agreement reached with IMF

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MONDAY, 3 JUNE 2024

Banks' reserves market (31 May 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	13.50	+0bp	-1,150bp
ON rate (%)	13.50	+0bp	-650bp
Reserves (UAHm)[2]	241,093	+3.8	+15.2
CDs (UAHm)[3]	549,316	-2.5	+29.0

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) (31 May 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-2.4
Banks	692,258	+1.0	+26.7
Residents	163,182	+0.7	+45.5
Individuals	63,405	+2.7	+62.5
Foreigners	36,833	+3.8	-16.8
Total	**1,634,781**	**+0.7**	**+13.6**

Source: NBU, ICU.

FX market indicators (31 May 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	40.5981	+1.2	+9.9
EUR/USD	1.0832	-0.1	+0.9
DXY	104.716	+0.0	+0.5

Source: Bloomberg, ICU.

Market gov't bond quotes (3 June 2024)

Maturity	Bid (%)	Ask(%)
6 months	15.50	13.00
12 months	16.50	15.00
2 years	17.50	16.00
3 years	18.00	16.50
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

MoF maintains steady pace of bond placement

During May, the Ministry of Finance offered the same amount of UAH bonds every week, while gradually reducing rates in the primary bond market.

In May, the MoF borrowed the equivalent of UAH46.3bn, including UAH40.6bn and EUR113.6mn (the equivalent of UAH5.7bn), achieving a 102% ratio of debt refinancing in local currency and 41% in EUR-denominated papers. YTD, the Ministry borrowed UAH189bn in all currencies, with a total rollover rate at 132%, including 169% in local currency, 96% in US dollars, and 81% in Euros.

The Ministry placed EUR-denominated bills twice in May, but saw low demand for them at EUR54-60m vs the EUR200m weekly cap. At the same time, the demand for UAH instruments increased significantly in May, enabling the MoF to increase borrowings and/or lower interest rates. The Ministry offered three UAH bonds every week, maturing in one, two, and three years, with a cap of UAH3bn for each. The MoF did not increase the offer in response to high demand.

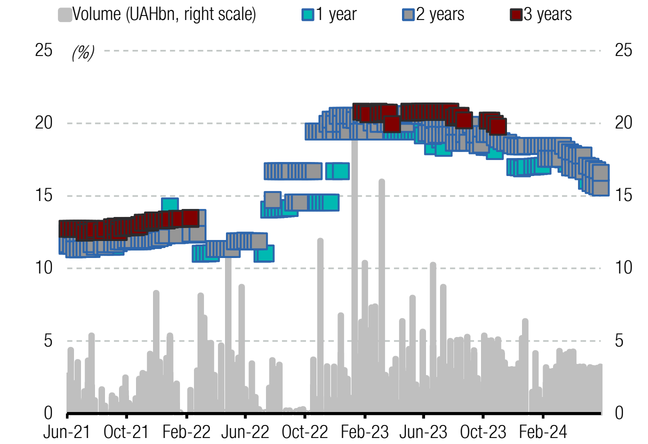
Every week in May, demand significantly exceeded supply, and the difference was especially large for three-year notes. Last week, the three-year paper got a six-fold oversubscription, but the MoF sold only the planned amount of UAH3bn. This allowed the Ministry to lower the cut-off rate by 31bp to 16.62% (see details in the auction review). Therefore, since the beginning of the spring cycle of monetary policy easing, interest rates on this instrument have already decreased by 188bp, the most among the instruments the Ministry offered at the primary auctions. For one-year bills, the rate reduction during this time is 182bp and for two-year paper 170bp.

ICU view: The Ministry of Finance is not in a rush to attract large, one-off amounts of funds, preferring smaller borrowings every week. Such an approach reinforces competition at primary auctions and allows the MoF to reduce the cost of borrowings every week. So, in more than two months after the start of the spring cycle of monetary policy easing, the cumulative rate cut for UAH bonds already exceeds the rate cut by the NBU. Investors' drive to lock in higher rates for a longer time will continue to exercise pressure on yields.

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

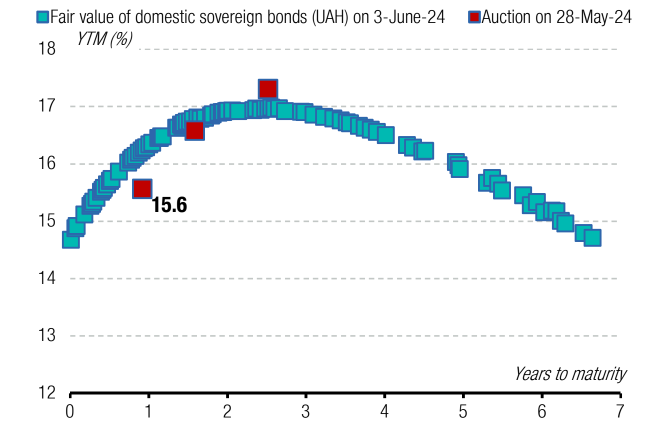
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

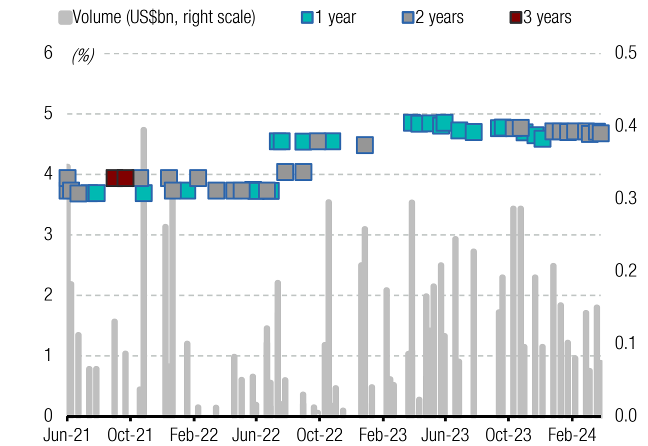
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

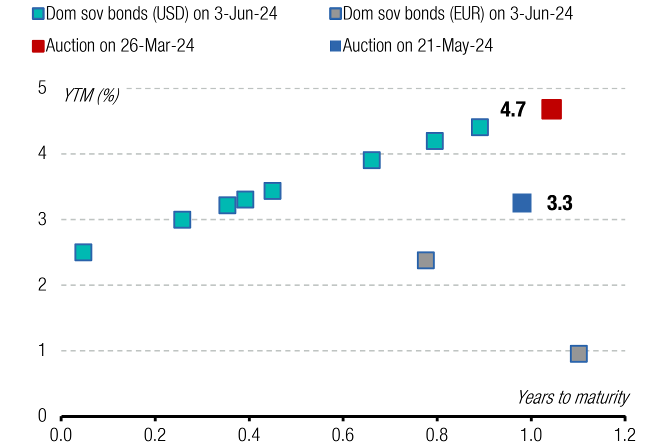
Chart 2. FX-denominated bonds

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.

Launch of debt restructuring negotiations linger

The last week of May ended without important restructuring news.

Price fluctuations for Eurobonds were minor last week. They increased by an average of 1.9% to 27–32, narrowing the price range for instruments with different maturities to 8.4%. The price of VRIs rose by 0.3% last week to 52 cents per dollar of notional value. The EMBI index was unchanged last week.

ICU view: Prices of Ukrainian Eurobonds fluctuated insignificantly on rumours and discussions of possible restructuring scenarios. Consultations with the creditors' committee are still ongoing, and new guesses, assumptions, and possible scenarios are emerging. Last week, one of the bondholders came up with a proposal to discuss new scenarios (could be done by using US treasuries as collateral) to incentivise bondholders to provide new money to Ukraine as part of the debt restructuring. However, at the moment, no official information is out about possible restructuring scenarios.

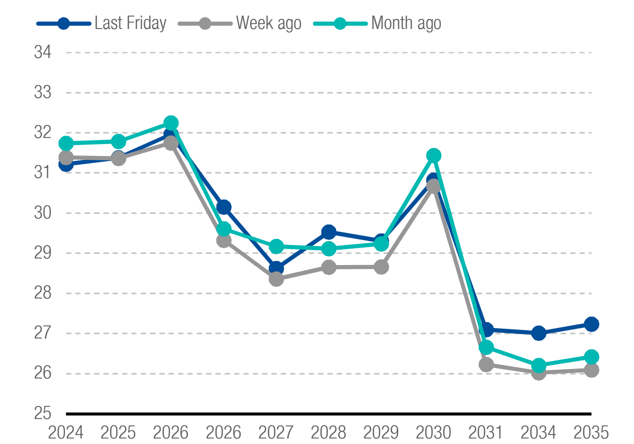
On Friday, Ukraine and the IMF reached a staff-level agreement on the fourth review of the EFF program (see comment below). As expected, the Ministry of Finance and the

IMF did not provide any important details on the restructuring process in their press releases. The IMF only noted the progress toward a commercial external debt restructuring on terms that is consistent with the program objectives, i.e. to create space for high priority expenditures and to help bring debt back to sustainable levels. Approval of the program review and a revised DSA by the IMF Board should accelerate the start of restructuring negotiations.

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

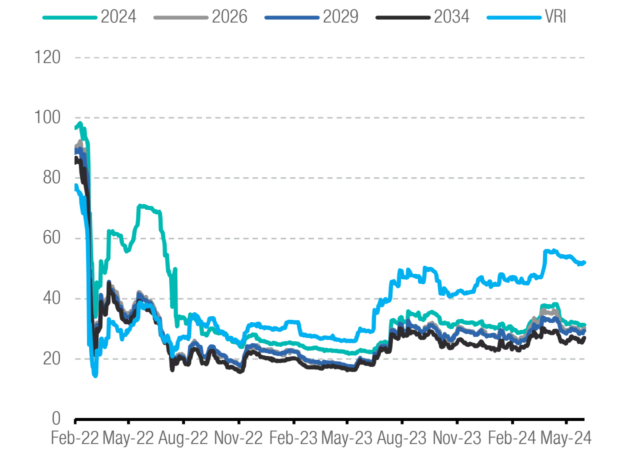
Chart 3. Ukrainian Eurobonds prices

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 continues to restrain hryvnia weakening

Last week, the hryvnia weakened to its historic low, but the NBU did its best to contain depreciation.

FX trading in the interbank market (for four business days) and imbalances increased significantly last week. Hard currency purchases by bank clients (legal entities) amounted to US$1.4bn (54% more than in the same period of the previous week), and sales decreased by 4% to US$0.8bn. Net purchases increased sevenfold to US$618m.

In the retail market last week (also over four business days), households' hard currency purchases increased by 24%, while hard currency sales increased by only 8%. The net purchase of foreign currency increased by 52% to US$234m.

For four days, the FX deficit amounted to US$851m, or four times more than during the same period of the previous week. The NBU's weekly interventions increased by 59% to US$1.1bn, which is just below the intervention size in the first week after the NBU switched to a managed flexible exchange rate regime in October last year.

The hryvnia exchange rate weakened significantly both in the interbank market and in the retail segment. The official exchange rate weakened by 1.1% to UAH40.54/US$ last week, and the cash rate in systemically important banks weakened by 1.5% to UAH40.4–41.1/US$.

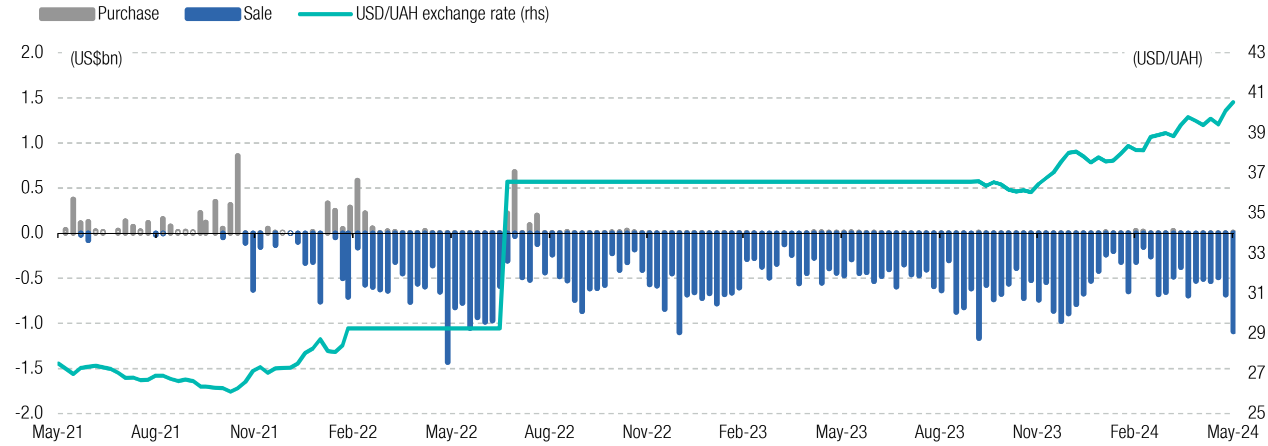
ICU view: Last week started with high activity of buyers in the interbank market. Businesses could purchase foreign currency to pay interest on loans and dividends after the NBU eased FX restrictions at the beginning of May (see our comment). Also,

government agencies likely bought hard currency to pay for large import contracts. However, by Wednesday and Thursday, imbalances decreased to an acceptable US$50–60m per day, and the NBU also reduced interventions. Last week, the NBU made considerable efforts to restrain the further weakening of the hryvnia, and it seems very likely that it wants to return the official exchange rate below UAH40.5/US$ to maintain the UAH40–40.5/US$ corridor for exchange rate fluctuations in the following weeks.

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

Staff level agreement reached with IMF

The IMF announced it reached a staff level agreement with Ukraine on the fourth review of the EFF cooperation program launched in March 2023.

In a press-release, the IMF mission to Ukraine said all quantitative performance criteria were met and all benchmarks were either met on time or implemented with short delays. The mission noted that downside risks to the economy are high and raising due to the war, and economic activity is expected to slow in 2H24 due to attacks on the energy sector and weaker confidence. Inflation is expected to raise somewhat going forward, but since real interest rates are still high, there is more room for monetary policy easing. The exchange rate will remain a shock absorber and FX liberalization should proceed according to the NBU's strategy. The press release's heaviest focus is on fiscal sustainability. The IMF mission noted that Ukraine is expected to proceed with the implementation of tax and revenue administration reforms. The 2025 budget will require measures to advance domestic revenue mobilization given still high spending needs. Once the review is approved by the IMF board, Ukraine is set to receive a loan tranche of US$2.2bn.

ICU view: The market did not expect any negative surprises and a successful fourth review of the EFF program for Ukraine was a baseline scenario. The program conditionalities were and remain relatively light, and we expect smooth progress with the program going forward.

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

Current account remains strongly negative in April

In April, the current account deficit remained little changed from March at US$1.6bn taking the 4M24 tally to US$3.7bn.

The current account deficit was primarily shaped by a hefty trade-in-goods deficit of US$2.4bn, significantly above the US$1.7bn recorded in April last year. The growth in the trade deficit YoY came on the back of a significant increase of imports (+23% in April) while growth in exports significantly lagged behind (+14%). In 4M24, growth was comparable for imports and exports at 4%. The monthly trade-in-services deficit has remained volatile, but predominantly in the range of US$0.4–0.6bn over the past year. The balance of primary income was also little changed, but May numbers may be significantly worse due to the recent wave of FX liberalization launched by the NBU. Budgetary transfers (grants) to the government remain insignificant and a decline in secondary income balance after the US stopped providing regular grants for Ukraine is going to be a major drag on the current account balance going forward.

The financial account saw only moderate net inflows of capital in April as foreign financial aid to Ukraine from other governments and IFIs was insignificant that month. Thus, Ukraine's BoP saw a net outflow of US$1.3bn in April, which led to a reduction in NBU reserves by 3% to US$42.4bn. Yet, in 4M24, the net capital inflows to Ukraine remained strong thanks to loans from Ukraine's official partners.

ICU view: We expect the C/A balance to remain strongly negative through end-2024, and the deficit will be shaped by two main factors. Firstly, the trade-in-goods deficit will remain significant as exports will continue to lag imports. Secondly, the recent wave of FX market liberalization will start to exercise additional pressure as companies are now free to make all current interest payments on external debt as well as limited dividend repatriation. Also important is that US financial aid will now come in the form of loans rather than grants, which implies it will no longer lend support to the current account. We thus see the C/A deficit widening to nearly 8% of GDP in 2024 from 5.2% in 2023. Yet, this deficit is expected to be more than fully covered with capital inflows via the financial account. This implies the NBU will have sufficient resources to control the FX market and be present with FX sale interventions to the extent required by circumstances.

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

Chart 5. Key balance of payment components, $m

Current account deficit significantly widens YoY in 4M24

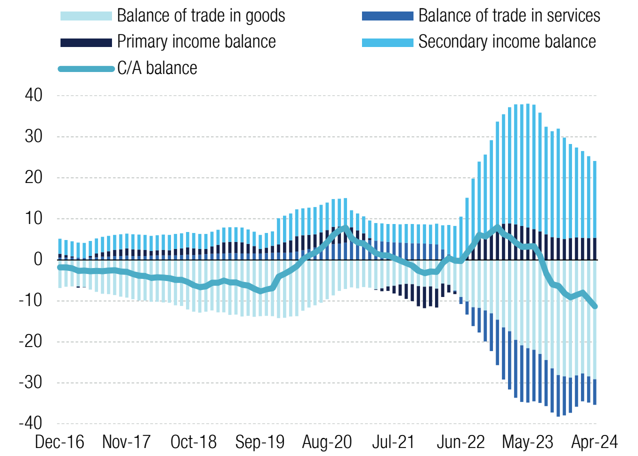
	4M24	4M23
Current account	-3,681	-1,568
Trade in goods	-7,927	-7,599
Trade in services	-1,820	-4,163
Primary income	1,877	1,768
incl. migrant income	3,233	4,021
Secondary income	4,189	8,426
incl. transfers to gov't	1,582	5,594
Financial account*	-5,468	-6,783
Change in trade credits	-1,840	-1,911
Change in cash out of banks	5,277	4,301
Net loans to government	-8,941	-8,644
Other	36	-529

* 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.

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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
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