Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

Real GDP growth impresses in 1Q24

Key messages of the today's comments

MONDAY, 1 JULY 2024

Ukrainian bond market

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Domestic debt rollover sufficiently high

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Investors hopeful of positive restructuring news

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Foreign exchange market

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Banks' reserves market (28 June 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	13.00	+0bp	-1,200bp
ON rate (%)	13.00	-1bp	-698bp
Reserves (UAHm)[2]	238,428	+0.9	+17.3
CDs (UAHm)[3]	507,350	-2.8	+5.8

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 June 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-2.4
Banks	713,541	+1.0	+31.1
Residents	158,649	-1.9	+37.2
Individuals	58,038	+2.1	+47.0
Foreigners	32,654	-10.2	-35.8
Total	**1,641,028**	**+0.1**	**+13.3**

Source: NBU, ICU.

FX market indicators (28 June 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	40.5441	+0.2	+9.8
EUR/USD	1.0713	+0.2	-1.8
DXY	105.866	+0.1	+2.9

Source: Bloomberg, ICU.

Market gov't bond quotes (1 July 2024)

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

Source: ICU.

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Ukrainian bond market

Bond rates on hold

Interest in UAH bonds weakened even more last week, pausing the progress made on interest-rate reduction at the primary auction.

Total demand for UAH-denominated bonds decreased last week by more than a third to UAH7bn. Among UAH bonds, demand was the greatest for 12-month UAH bills, slightly above the cap. Demand for USD-denominated paper exceeded the cap, too. The MoF sold all bonds (three UAH-denominated and one USD-denominated) with terms almost unchanged from the previous auction. See details in the auction review.

At the same time, the secondary market became significantly more active. Trading increased by 46% to almost UAH11bn. The most traded bills were those due in October 2024 (19%), February and July 2025 (10% and 13%, respectively).

Redemption of UAH bonds last Wednesday led to a sharp reduction in investors' portfolios. Foreigners' portfolios fell the most, by 9%, as they were in no hurry to reinvest funds. At the same time, individuals restored the amount of invested funds to UAH58.4bn. This week, the only July's redemption of bonds is scheduled, so investors will be able to replenish their portfolios over the next few weeks.

ICU view: Despite large repayments, investors are no longer in a hurry to compete in primary auctions and are gradually choosing from a diversity of instruments in the secondary market. During July, the MoF will sell fewer bonds than in May and June. Demand will likely remain moderate as investors will be waiting for new information from the NBU on the path of the key policy rate through end-2024. Such information will be released at the end of the month after the next meeting of the Monetary Policy Committee and an update of the NBU's macro forecast. Therefore, we do not expect significant changes in rates tomorrow and later this month. Rates may only edge down on certain instruments that may see high market demand.

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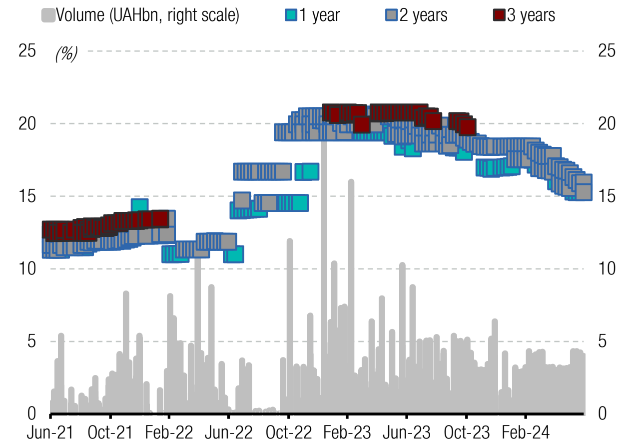
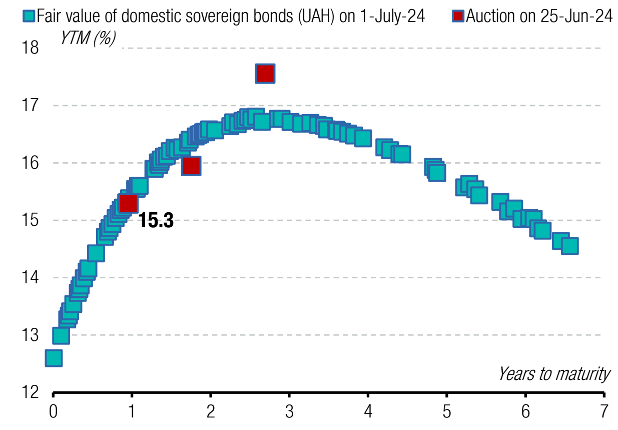
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

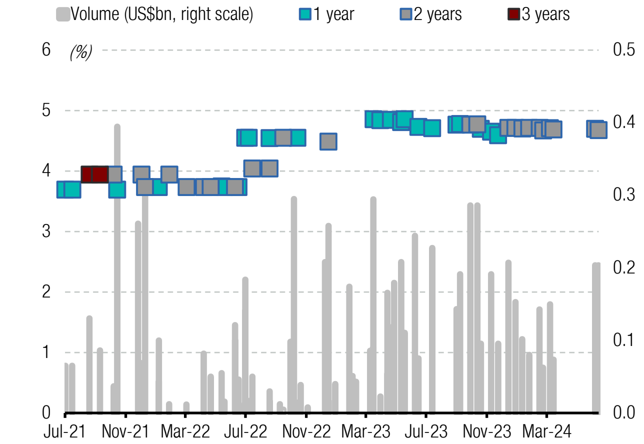
YTMs *of domestic government bonds as calculated by NBU versus placements via primary market auctions*



Source: NBU, MFU, ICU.

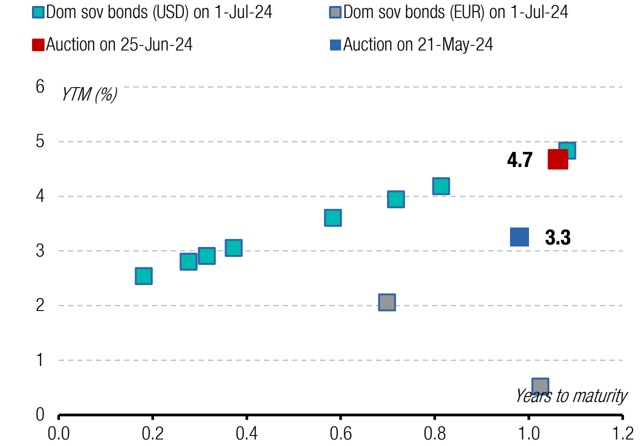
Chart 2. FX-denominated bonds

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.

Domestic debt rollover sufficiently high

The Ministry of Finance fully refinanced all scheduled redemptions in June.

In June, the Ministry of Finance borrowed UAH36.7bn and US$400m while repaying UAH32b and US$303m. Thus, the rollover rate for UAH debt stood at 153% in 1H24 and at 106% for USD-denominated debt. In 5M24, the rollover was higher for UAH debt at 169% but lower for USD-denominated debt at 96%.

The MoF did not issue or redeem EUR-denominated bonds in June, so refinancing in this currency for six months remained at 81%.

In general, the refinancing of domestic state debt inched down from 132% YTD at the end of May to 129% at the end of June. Net borrowings amounted to the equivalent of UAH54.5bn in 1H24.

ICU view: We expect the Ministry of Finance will be accumulate liquidity in July to make repayments in August (UAH20bn) and September (UAH4bn and US$335m) and also to further increase net borrowings from the local market. In 2H24, the Ministry is scheduled to repay US$1.8bn, EUR120m, and UAH117bn in bonds principal. The current pace of bond placements broadly guarantees that the full-year plan for net domestic borrowings will be fulfilled. However, the target for net domestic borrowings may be increased as the government has repeatedly signalled the state budget deficit for 2024 will exceed the current plan of UAH1.6tn. The MoF may need to finance a part of this additional gap with borrowing from the domestic market.

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Investors hopeful of positive restructuring news

Last week, prices of Ukrainian Eurobonds increased in anticipation of positive news about debt restructuring progress.

Consultations between the Ministry of Finance and the Creditors' Committee, and between their advisers continued, so certain rumours about the two parties making some concessions likely circulated among investors. Investors broadly expect that a compromise may be found in the coming weeks, which had a positive impact on the market sentiments.

Over the week, on average, the prices of Eurobonds were up by 3.2%, to 28.9–32.6, and the range of prices for instruments with different maturities narrowed to 6.1%. The price of VRIs rose by 0.9% to 49.1 cents per dollar of notional value. The EMBI index slid by 0.4% last week.

Last Friday, the IMF Board approved the fourth review of the EFF Program. The new Memorandum reiterated the targets for Ukraine's debt-to-GDP trajectory, namely the ratio should be down to 65% by end-2033 and financing needs should be below 8% of GDP in 2028–2033, i.e. after the end of the current IMF program. However, these parameters are not news, so release of the MEFP is unlikely to have a visible impact on the market.

ICU view: Eurobond prices last week indicate that investor sentiment improved after a sharp deterioration following the announcement of an unsuccessful first round of negotiations. The approval of the fourth review of the IMF program can speed up talks, and reiterated DSA targets can help find a compromise on the level of the haircut, coupon payments in the following three years, and the maturity of new Eurobonds.

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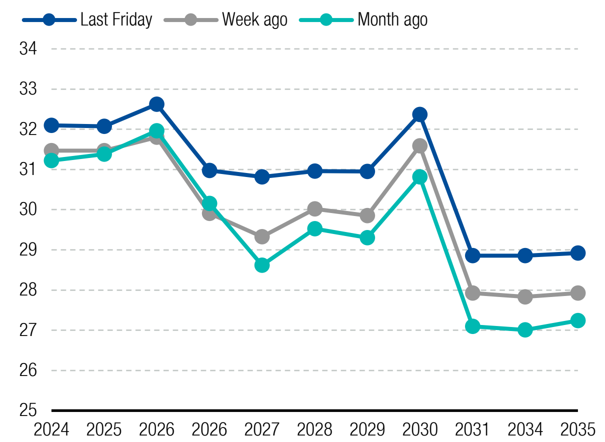
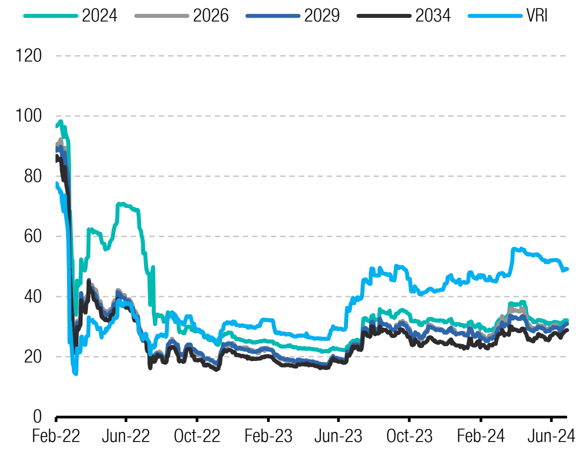
Chart 3. Ukrainian Eurobonds and VRI prices

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 fluctuations moderate

Last week, the FX market improved compared with the previous week, while the hryvnia exchange rate fluctuated close to UAH40.5/US$.

In the interbank FX market, trading increased, with the imbalance narrowing. Bank clients (legal entities) sold US$903m of foreign currency in four days (+13% compared with the same period of the previous week) and purchased US$1.1bn of hard currency (+8%). Therefore, the net purchase decreased slightly from US$247m to US$224m. In the retail segment of the FX market, trading remained approximately the same as the previous week.

The hard currency deficit amounted to US$389m in four days, only about 5% below the previous week. So, over the week, the NBU reduced interventions by another 7% to $671m.

The hryvnia exchange rate remained unchanged. The official rate remains UAH40.45/US$, and the cash rate in systemically important banks still UAH40.3–40.9/US$.

ICU view: Overall, the FX market remained relatively calm, without significant purchases of foreign currency by state agencies or businesses. Imbalances remain little changed from week to week, and the market has not needed emergency interventions by the NBU, which rarely exceed US$150m per day. Nevertheless, these volumes are significantly higher than the average weekly interventions in 1H24.

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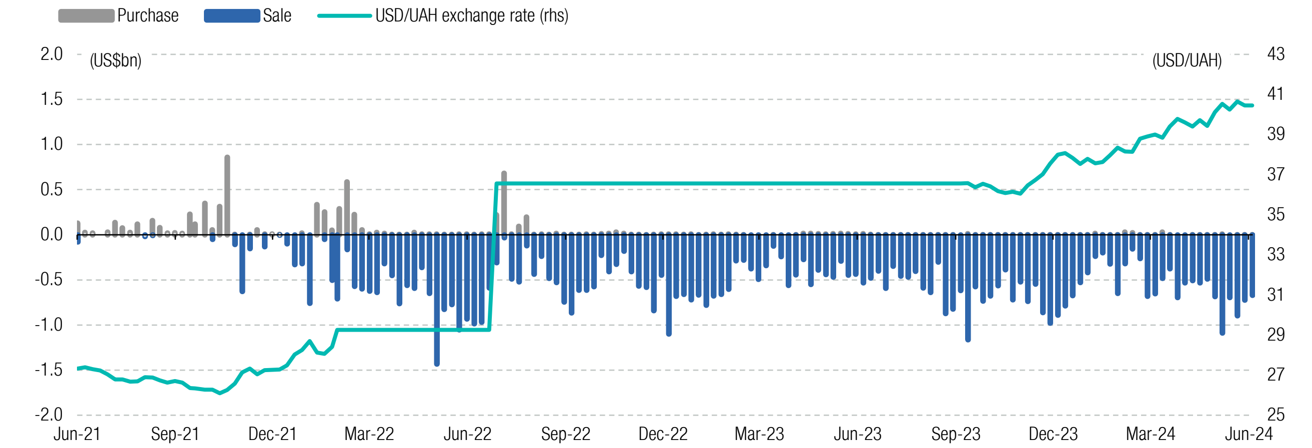
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Real GDP growth impresses in 1Q24

Real GDP surged 6.5% YoY in 1Q24, according to preliminary estimates of UkrStat, well above the preliminary estimate of the Ministry of Economy of 4.6%±1%. This implies real GDP was 81.6% of pre-war 1Q21.

UkrStat did not provide GDP breakdown by components. Yet, the recently published sectoral data for 1Q24 indicate strong growth across the board: industry output was up 11.2% YoY, construction surged 40%, and cargo and passenger transportation increased 20% and 24%, respectively.

ICU view: We believe that on the demand side the key growth drivers were strong domestic household demand and a recovery in exports thanks to uninterrupted operations of the Black sea maritime routes. Government consumption likely also played a positive role, but to a much lesser extent than in the previous two years. The economy apparently slowed in 2Q24 due to destruction of electricity-generating infrastructure, and it will take a much harder toll on the economy in 2H24. The economy is expected to slow further as some energy-intensive industries may face a deficit of electricity in autumn and winter. Yet, a strong start of the year makes us feel comfortable with our current 2024 GDP growth forecast at 4.1%.

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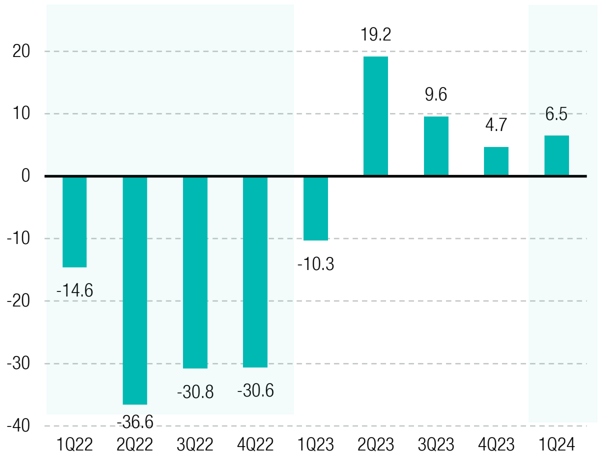
Chart 5. Real quarterly GDP, change YoY, %

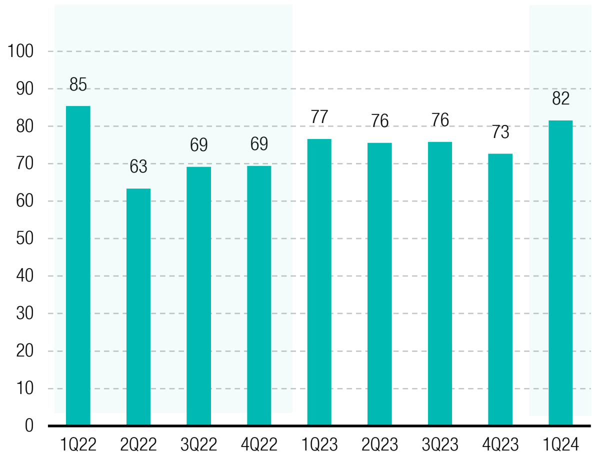
GDP surges 6.5% YoY in 1Q24



Source: Ukrstat, ICU.

Chart 6. Real GDP, 2021=100%*

Real GDP at 82% of the pre-war level in 1Q24



* Respective quarter of 2021 = 100%

Source: Ukrstat, ICU.

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