| Focus | Markets | Research team |
|---|---|---|
| **Ukraine** | **Government bonds, FX market, and macro** | |

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# Weekly Insight

# NBU pauses rate-cutting cycle

**Key messages of the today's comments**

## Ukrainian bond market

### Bond market in summer doldrums

Activity in the Ukrainian domestic bond market fell sharply last week, resulting in low budget proceeds and tiny trading in the secondary segment.

### Investors assess restructuring proposal

Last Monday, the MoF announced that it agreed in principle to the restructuring terms with the Creditors Committee. Markets were inspired by the news and the updated restructuring offer, and Eurobond prices rose sharply.

## Foreign exchange market

### NBU reversed hryvnia weakening trend

The hard currency deficit declined again, and the NBU brought the official hryvnia exchange rate back close to UAH41/US$.

## Economics

### NBU pauses rate-cutting cycle

The key rate remained unchanged at 13% following the Monetary Policy Committee meeting, even though the minutes of the previous MPC meeting hinted that the rate-cutting cycle could be continued.

**MONDAY, 29 JULY 2024**

**Banks' reserves market (26 July 2024)**

| | Last | Weekly chg (%) | YoY chg (%) |
|---|---|---|---|
| NBU rate (%)[1] | 13.00 | +0bp | -900bp |
| ON rate (%) | 13.00 | +0bp | -700bp |
| Reserves (UAHm)[2] | 284,733 | +31.4 | +66.6 |
| CDs (UAHm)[3] | 497,955 | -12.0 | -8.2 |

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) (26 July 2024)**

| | Last | Weekly chg (%) | YoY chg (%) |
|---|---|---|---|
| NBU | 677,606 | +0.0 | -2.1 |
| Banks | 720,997 | +0.1 | +29.6 |
| Residents | 166,632 | -0.1 | +43.8 |
| Individuals | 63,170 | +0.8 | +55.9 |
| Foreigners | 32,162 | -2.8 | -36.5 |
| **Total** | **1,661,194** | **+0.0** | **+14.0** |

Source: NBU, ICU.

**FX market indicators (26 July 2024)**

| | Last | Weekly chg (%) | YoY chg (%) |
|---|---|---|---|
| USD/UAH | 41.0580 | -1.0 | +11.2 |
| EUR/USD | 1.0856 | -0.2 | -2.1 |
| DXY | 104.316 | -0.1 | +3.4 |

Source: Bloomberg, ICU.

**Market gov't bond quotes (29 July 2024)**

| Maturity | Bid (%) | Ask(%) |
|---|---|---|
| 6 months | 14.50 | 12.50 |
| 12 months | 15.75 | 14.75 |
| 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.

# Ukrainian bond market

## Bond market in summer doldrums

Activity in the Ukrainian domestic bond market fell sharply last week, resulting in low budget proceeds and tiny trading in the secondary segment.

Last week, demand on the primary bond auction stood at just one-tenth of the MoF's offering. Investors were primarily interested in 14-month bills, which received UAH1.3bn of bids, while two- and three-year securities received just UAH92m of demand together. For the 14-month paper, the MoF decreased the cut-off rate by 5bp to 14.65%, which was the maximum bid rate. See details in the auction review.

In the secondary bond market, trading fell by 60% to UAH3.9bn, the smallest weekly amount since February. The most traded were bills due in February and March of next year, 17% and 12%, respectively.

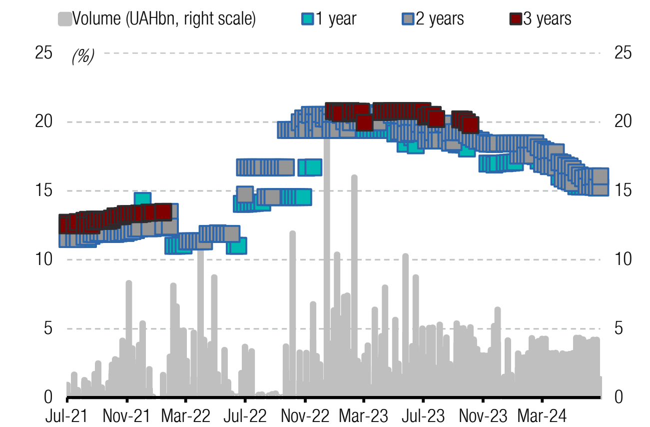
The next and only remaining summer redemption of domestic bonds is scheduled for August 7 totalling UAH20bn.

***ICU view: The sharp decline in activity was mainly due to the market taking a pause in anticipation of the NBU's rate decision and also due to no scheduled redemptions. Investors were in no hurry to buy huge amounts of new bonds, as they started to believe that the NBU could put the rate-cutting cycle on hold due to high MoM inflation in June and sharp hryvnia weakening in July. According to an updated forecast, the NBU will not cut rates this year and may re-start the monetary policy loosening cycle no earlier than January 2025. Such NBU plans provide no incentives for investors to increase their portfolios as they are unlikely to book a profit from the bond revaluation in the coming months if the NBU's forecast proves accurate. As the next redemption will be next week, we can see a spike in trading with a gradual decline later in the month.***

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

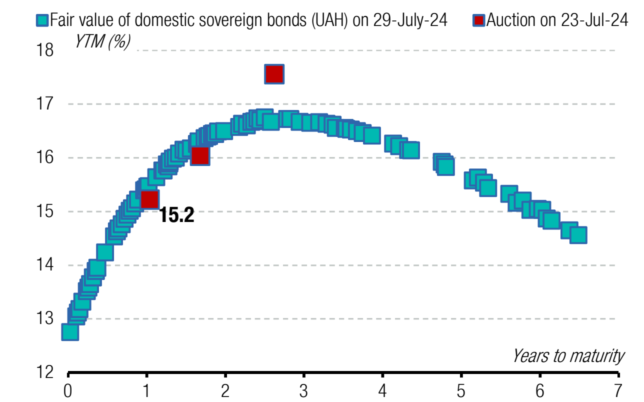
**Chart 1. Local-currency bonds**

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




Source: MFU, ICU.

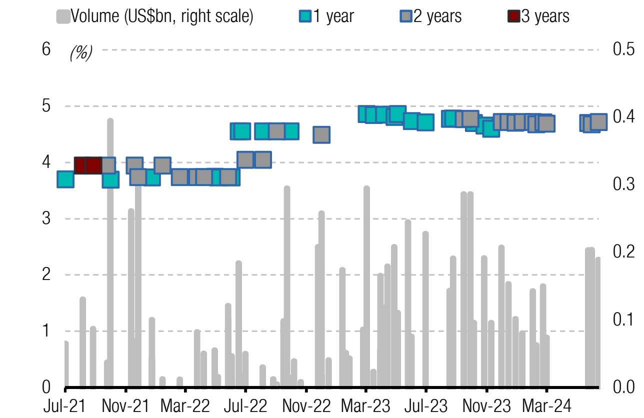
*YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions*




Source: NBU, MFU, ICU.

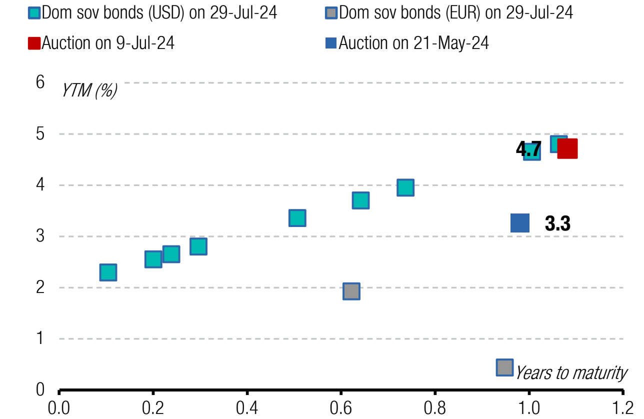
**Chart 2. FX-denominated bonds**

*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.

## Investors assess restructuring proposal

Last Monday, the MoF announced that it agreed in principle to the restructuring terms with the Creditors Committee. Markets were inspired by the news and the updated restructuring offer, and Eurobond prices rose sharply.

On the first day of the week, prices rose by 14% on average to 31.9–36.3, and the range of prices for instruments with different maturities narrowed to 6.5%. The price of VRIs rose by 14% to 56 cents per dollar of notional value.

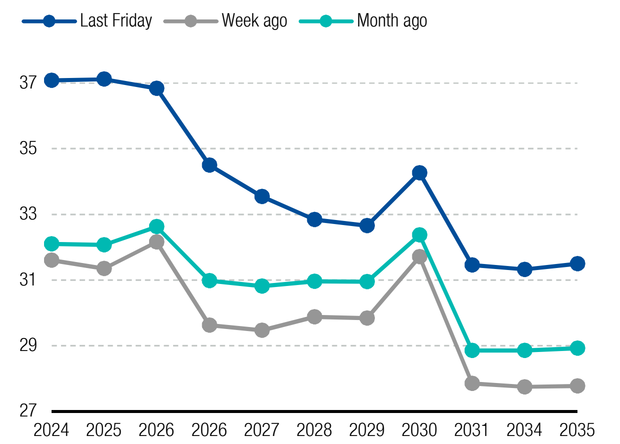
Since Tuesday, the market has seen a slight correction and only Eurobonds maturing no later than 2026 kept increasing in price. Prices of Eurobonds with maturity in 2027–2035 (according to the schedule agreed in 2022) declined by around 2% until the end of last week. Overall, during last week, Eurobonds prices rose by 13% on average to 36.3–37.1 and the range of prices for instruments with different maturities widened to 8.6%. The price of VRI rose last week by 22.5% to 60.3. The EMBI index rose by 0.2% last week.

***ICU view: Investors assessed the restructuring agreement positively. The Eurobond restructuring conditions also gave investors some hope that the VRI restructuring deal would also be relatively favourable. VRI holders reportedly started to form a committee to negotiate with the government. Over the week, the price of warrants has risen to the highest level since the start of the full-scale war.***

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

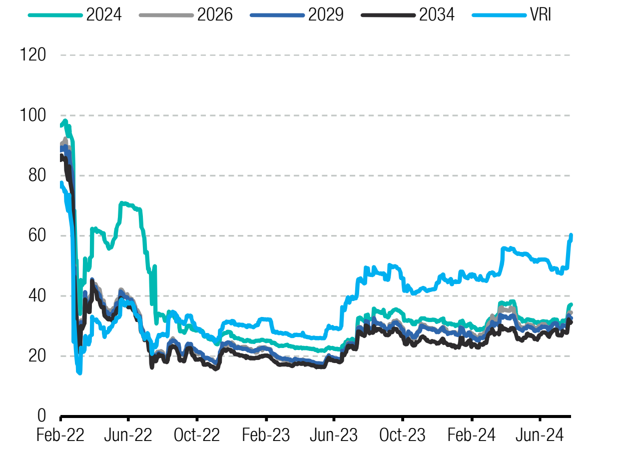
**Chart 3. Ukrainian Eurobonds and VRI prices**

*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

## NBU reversed hryvnia weakening trend

The hard currency deficit declined again, and the NBU brought the official hryvnia exchange rate back close to UAH41/US$.

In the interbank FX market, net hard currency purchases almost halved to US$231m, as bank clients (legal entities) sold US$840m (+14% to the previous week) and purchased almost US$1.1bn (-6%) of foreign currency (in four business days).

In the retail segment, net purchases by households rose by 6% to US$206m.

Finally, the hard currency deficit in the four business days of last week was US$437m, nearly a quarter less than a week before. The narrowing deficit allowed the NBU to decrease its interventions by 17% to US$785m and strengthen the hryvnia. At the end of the week, the official hryvnia exchange rate appreciated by 1% to UAH41.1/US$, and the cash exchange rate—by approximately 0.8% to UAH41.0–41.5/US$

***ICU view: Despite the lower deficit, the NBU actively intervened in the FX market and strengthened the hryvnia, almost compensating for its weakening in the previous week. NBU communications indicate that it became truly concerned about the sharp weakening of the hryvnia since it could undermine the attractiveness of UAH-denominated assets. Therefore, the NBU may try to keep the exchange rate close to the current level for some time before resuming its weakening to UAH42–43/US$ by the end of the year, according to our projections.***

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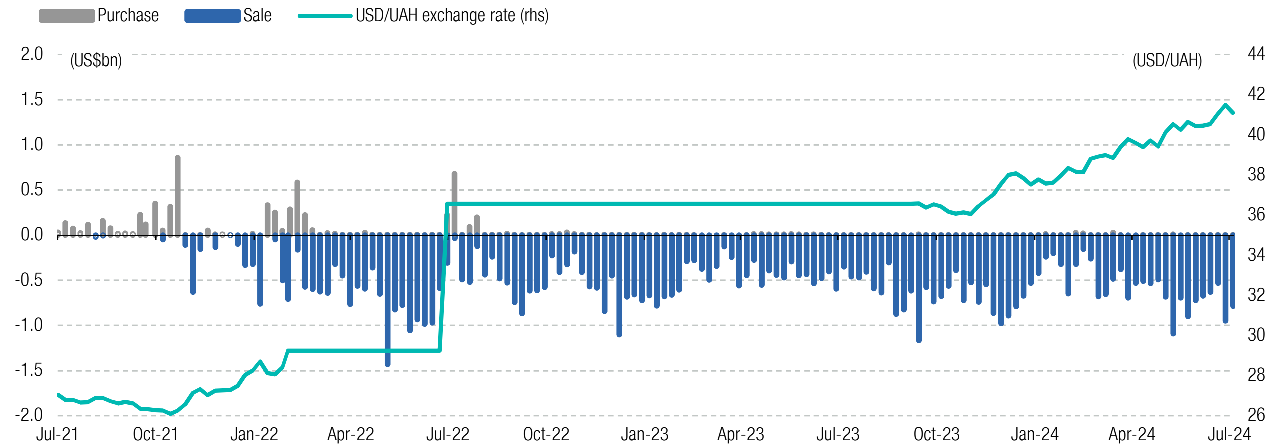
**Chart 4. FX market indicators, 3-year history**

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




Source: NBU, Bloomberg, ICU.

# Economics

## NBU pauses rate-cutting cycle

The key rate remained unchanged at 13% following the Monetary Policy Committee meeting, even though the minutes of the previous MPC meeting hinted that the rate-cutting cycle could be continued.

The NBU reported that inflationary risks increased since the last MPC. It also cited the necessity to ensure FX market stability and its aim to bring inflation to the target level within the forecast horizon as the reasons for not cutting the rate.

The new macro forecast implies the next rate cuts will be in January, June, September, and October of 2025. The new rate trajectory is less steep compared with the previous forecast.

***ICU view: The NBU decision was broadly expected by the market since June's CPI print came in much higher than expected and following turbulence in the FX market in the second half of July. The NBU clearly decided to take a more cautious stance and see how new pro-inflationary factors, including an expected increase in taxes, impacts the CPI trend. We continue to expect inflation to remain below the NBU projected path and chances still are that the central bank may cut the rate further before end-2024.***

***Mykhaylo Demkiv, Kyiv, (044) 377-7040 ext.723***

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