ICU

Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

Current account worsens in 2Q24

Key messages of the today's comments

Ukrainian bond market

Government borrows three times more than redeems in July
During July, the Ministry of Finance raised 3.6x more funds from placements in the domestic bond market than it repaid.

Demand for bonds revives last week
Borrowing increased almost sevenfold WoW last week, partly due to the US$-denominated bills offered. Three main groups of investors increased their portfolios to new highs.

Ukraine in technical default, restructuring continues
The delay in the restructuring deal implies the government had to suspend payments for UKRAIN'26. Failure to make payments on Thursday means the country is in technical default.

Foreign exchange market

NBU weakens hryvnia after noticeable strengthening
The hryvnia exchange rate fluctuated slightly above UAH41/US$, while NBU interventions remained little changed.

Economics

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MONDAY, 5 AUGUST 2024

Banks' reserves market (2 August 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	13.00	+0bp	-900bp
ON rate (%)	13.00	+0bp	-700bp
Reserves (UAHm)[2]	232,835	-18.2	+8.4
CDs (UAHm)[3]	527,566	+5.9	+9.3

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) (2 August 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-2.1
Banks	726,745	+0.8	+30.0
Residents	169,943	+2.0	+42.2
Individuals	64,137	+1.5	+40.6
Foreigners	31,007	-3.6	-39.2
Total	**1,670,066**	**+0.5**	**+13.7**

Source: NBU, ICU.

FX market indicators (2 August 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	41.2801	+0.5	+11.8
EUR/USD	1.0911	+0.5	-0.2
DXY	103.208	-1.1	+0.6

Source: Bloomberg, ICU.

Market gov't bond quotes (5 August 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

Government borrows three times more than redeems in July

During July, the Ministry of Finance raised 3.6x more funds from placements in the domestic bond market than it repaid.

Borrowings in July fell by 30% MoM to UAH36.8bn, with almost a third—UAH11.4bn (US$280m)—in hard currency. At the same time, redemptions in July were relatively small, just UAH10.2bn, all in local currency.

As a result, debt rollover improved. For 7M24, the level of refinancing is 141%, up from 129% in 1H24. UAH debt refinancing increased from 153% in 1H24 to 161% in 7m24. In USD, refinancing was up to 132% in 7M24 from 106% in 1H24. Refinancing in euros remains at 81% for the third month.

ICU view: Thanks to small redemptions of UAH bonds, a decrease in borrowings did not hurt the level of debt refinancing. At the end of July, the Ministry of Finance saw weak demand below the supply cap for two weeks in a row. The low need to reinvest funds and market sluggishness in anticipation of the NBU's decision on rates decreased investors' activity in the market. NBU projects that it will only be prepared to restart monetary easing cycle next year, so it is unlikely that the market will see noticeable demand in the near future.

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Demand for bonds revives last week

Borrowing increased almost sevenfold WoW last week, partly due to the US$-denominated bills offered. Three main groups of investors increased their portfolios to new highs.

The Ministry of Finance raised UAH9.5bn last week, or a quarter of all budget proceeds in July. Almost 42% of the funds came from USD-denominated bills—US$97m (UAH4bn). However, nearly half of UAH funds (UAH2.3bn out of UAH5.5bn of all UAH proceeds last week), came in only because the MoF increased interest rates on two-year paper by 10bp to 15.5%. See details in the auction review.

Trading in the secondary bond market rose by 11% to UAH4.4bn. The most traded were UAH "reserve" notes maturing in February 2026, 16% of all bond trades.

Last week, the portfolios of most groups of investors grew to new highs. Banks' portfolios grew to UAH727bn, non-bank investors (legal entities) increased their portfolios to UAH170bn, and individuals' portfolios rose to UAH64.4 bn. Only foreign investors decreased portfolios to UAH31bn, the lowest amount since April 2019.

ICU view: The budget's liquidity pressures prompted the MoF to accept bids for approximately UAH2bn at rates that were higher than in the previous auctions. With no redemptions over the four-week period, most investors increased their portfolios to new highs. It took more than a month for individuals to rebuild their portfolios after significant redemptions at the end of June. However, the market is still in a summer lull, which may be interrupted for a short time should investors seek to redeploy tomorrow's repayments.

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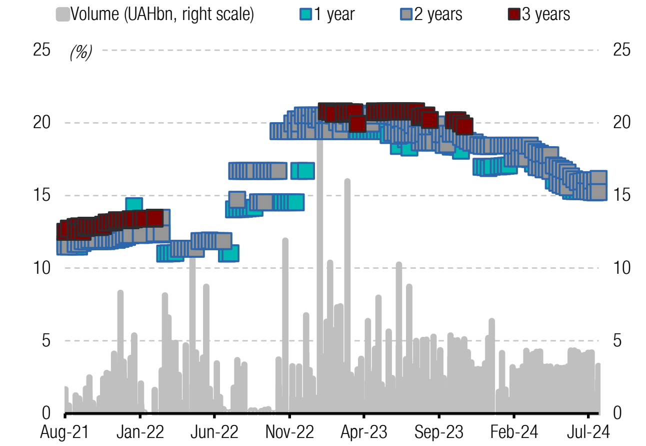
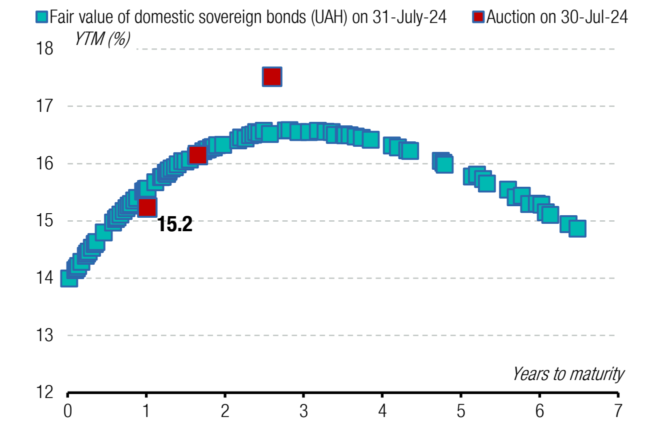
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

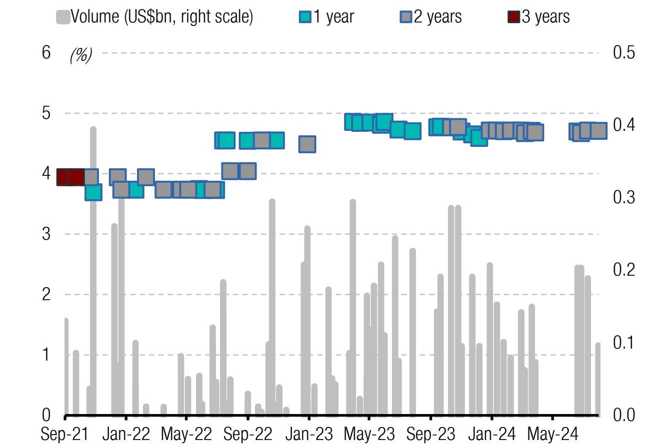
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

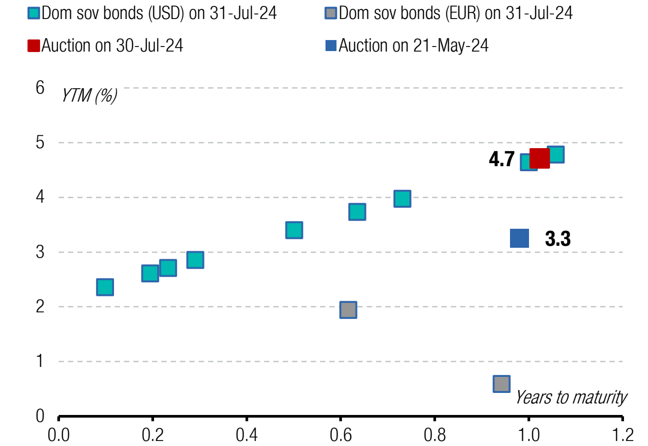
Chart 2. FX-denominated bonds

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.

Ukraine in technical default, restructuring continues

The delay in the restructuring deal implies the government had to suspend payments for UKRAIN'26. Failure to make payments on Thursday means the country is in technical default.

Last week, the government decided to suspend payments on UKRAIN'26. Ukraine had to pay a coupon deferred in 2022 and accrued interest on it last Thursday. The Ukrainian government also approved the terms of restructuring agreed in principle with the Creditors Committee in July. Such a resolution is a necessary prerequisite for further steps with an official restructuring proposal.

S&P Rating agency downgraded Ukraine’s rating to "selective default," which was inevitable at this stage.

Last week, Eurobond prices declined by an average 1.4% to 30.8–36.7. The price range for instruments with different maturities expanded to 8.8%. VRI's price sharply rose by 2.9% to 62 cents per dollar of notional value on anticipation of payment on 1 August (consent fee and interest thereon of USD 130.1m and a deferred payment amount and interest thereon of USD

70.5m for 2021). However, until the end of the week price declined to 61.1 cents per dollar of notional value. The EMBI index rose by 0.7% last week.

ICU view: Preparations for the final stage of the debt restructuring are ongoing, but the process is expected to take more time than initially thought. Currently, the Cabinet of Ministers has approved the general parameters of the restructuring, which allows the Ministry of Finance to release the official proposal for the exchange of bonds. The Parliament gave the Cabinet of Ministers the right to suspend debt payments, which the Cabinet can use until October 1 of this year. Therefore, if the MoF does not complete the restructuring in August, the government may also suspend payments for other instruments. As the government has suspended payments for only one Eurobond issue, this may imply that the Ministry of Finance is willing to complete all procedures this month.

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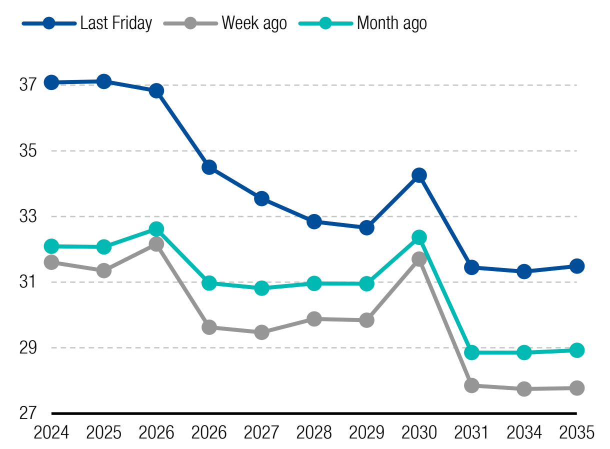
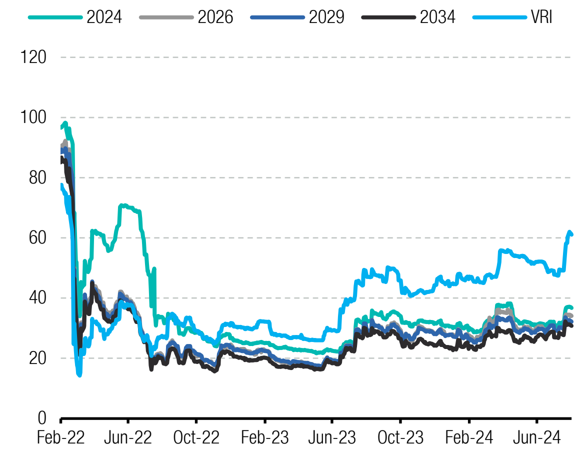
Chart 3. Ukrainian Eurobonds and VRI prices

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

NBU weakens hryvnia after noticeable strengthening

The hryvnia exchange rate fluctuated slightly above UAH41/US$, while NBU interventions remained little changed.

The trading in the interbank FX market rose significantly. The net purchase of hard currency increased by 55% to US$358m. Bank clients (legal entities) sold US$852m of foreign currency in four business days last week (1.4% less than the previous week) and bought 13% more, or US$1.2bn.

In the retail segment of the FX market, net purchases of hard currency increased again. Households bought US$221m of hard currency more than they sold, a 6% increase from the previous week.

As a result, the total deficit increased by 32% to US$579m in four business days. Despite the larger deficit, the NBU reduced interventions by 2% to US$767m, allowing the hryvnia to weaken slightly. The official hryvnia exchange rate lost 0.3% and moved to UAH41.2 UAH/US$, while the cash exchange rate in systemically important banks did not change and remained at 41.0–41.5 UAH/$.

ICU view: The NBU had been strengthening the hryvnia for more than a week until it reached UAH41/US$, but it recently allowed the exchange rate trend to reverse. Such dynamics indicate that the NBU is unlikely to allow the hryvnia to strengthen below UAH41/US$. At the same time, we also do not expect a significant hryvnia weakening soon. The rapid hryvnia devaluation in the middle of July upset the market noticeably, so the NBU will most likely avoid considerable volatility for some time. In general, we maintain our expectations of a gradual weakening of the hryvnia exchange rate to UAH42–43/US$ by the end of this year.

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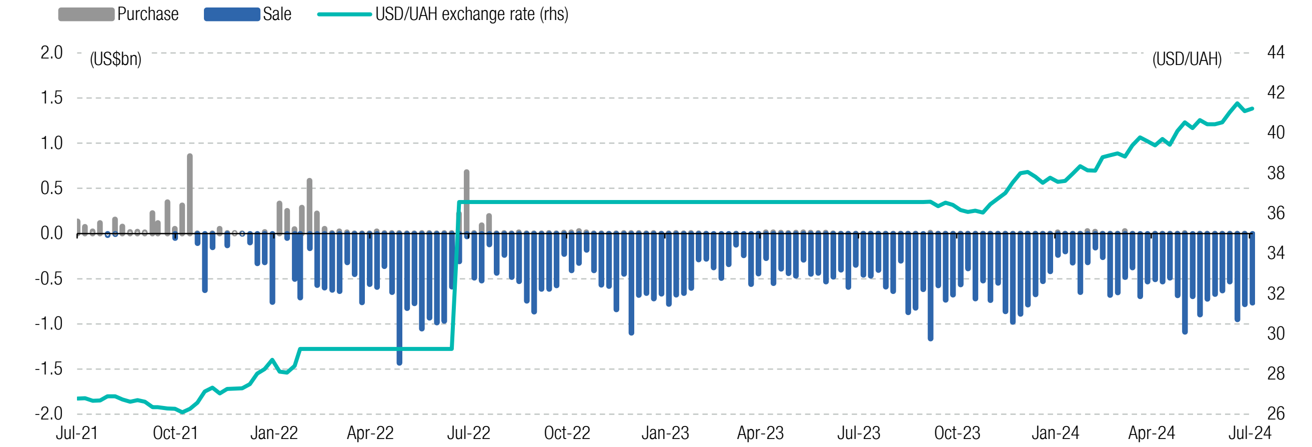
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Current account worsens significantly in 2Q24

The current account deficit widened substantially in June, and the largest quarterly C/A gap since the start of full-fledged invasion was registered in 2Q24.

The culprit was the widening trade-in-goods deficit that reached US$2.7bn in June and US$7.2bn in 2Q24. Even though Ukraine managed to increase export of goods by 8% YoY in 2Q24, the growth in import was more impressive at 14% over the same period. The balance of trade in services remained negative, but improved somewhat on lower import of tourism (largely represented by the expenses of refuges abroad). In terms of primary income, Ukraine also saw a decline in migrant income abroad by about a quarter in 2Q, but also a substantial decline in investment income transfers to non-residents, primarily FDI. The surplus of secondary income was at just 1/3 of the 2Q23 number as Ukraine received no significant budgetary grants from its allies over the period. Overall, Ukraine's C/A deficit reached US$5.4bn, a substantial deterioration from US$0.1bn a year ago.

The financial account was marginally negative in 2Q, as the inflow of official foreign loans to Ukrainian government was relatively insignificant and fell short of private capital outflows over the period. Since both current account and financial accounts were negative in 2Q24, the NBU had to use its reserves extensively to alleviate imbalance in the FX market. They fell 13% to US$37.9bn.

ICU view: Ukraine is seeing a significant deficit of foreign trade in goods during the summer as imports of electricity generating equipment surged in a wake of blackouts.

Also demand for consumer import remains strong despite weakening hryvnia. The trade deficit is set to narrow marginally in the coming months after import of equipment weakens and Ukraine increases exports of fresh agricultural exports. A major positive contributor to the current account will be US aid package of nearly US$8.0bn, which will come in 2H24 and will be registered as a grant. If this grant is accounted for, we expect the C/A deficit will widen to about 7% of GDP in 2024 from 5.2% in 2023. We also expect foreign governments and IFIs will significantly step up their lending to Ukraine in 2H, and the financial account surplus will be more than sufficient to offset the C/A deficit. This also implies the NBU will have sufficient resources to tackle substantial imbalances in the FX market.

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Chart 5. Key balance of payment components, $m

Current account deficit significantly widens 2Q24

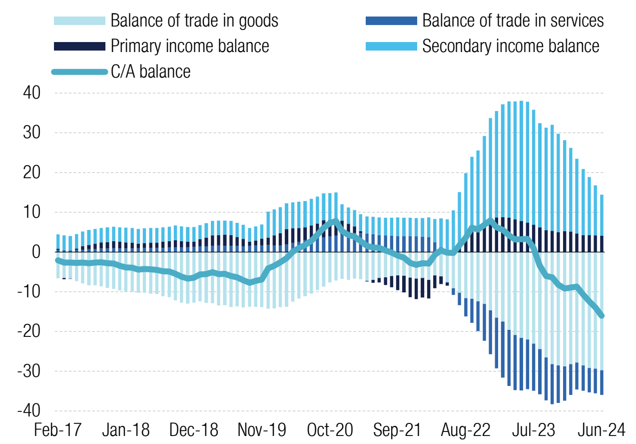
	2Q24	1Q24	2Q23
Current account	**-5,445**	**-3,234**	**-76**
Trade in goods	-7,211	-5,604	-5,935
Trade in services	-1,450	-1,359	-1,809
Primary income	1,025	371	1,202
incl. migrant income	2,099	2,431	2,837
Secondary income	2,191	3,358	6,466
incl. transfers to gov't	332	1,381	4,368
Financial account*	**297**	**-6,352**	**-3,936**
Change in trade credits	-690	-1,037	135
Change in cash out of banks	3,801	4,112	2,877
Net loans to government	-2,788	-8,257	-5,167
Other	-26	-1,170	-1,781

* 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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