Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

NBU worsens inflation forecast for 2025

Key messages of the today's comments

Ukrainian bond market

MoF changes UAH bond offering set

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UAH bonds rollover up in October

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Foreign exchange market

NBU increases UAH rate fluctuations

Last Tuesday, the official hryvnia exchange rate weakened to UAH41.38/US$, but at the end of October, the NBU strengthened the hryvnia on the back of a better FX market balance.

Economics

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NBU worsens inflation and key rate forecast for 2025

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MONDAY, 4 NOVEMBER 2024

Banks' reserves market (1 November 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	13.00	+0bp	-300bp
ON rate (%)	13.00	+0bp	-300bp
Reserves (UAHm)[2]	261,276	+1.5	+29.0
CDs (UAHm)[3]	456,513	-1.2	-6.0

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) (1 November 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-1.9
Banks	822,264	+0.0	+37.2
Residents	147,096	+0.8	+16.4
Individuals	70,486	+2.7	+46.0
Foreigners	23,278	-5.0	-50.6
Total	**1,761,461**	**+0.1**	**+16.4**

Source: NBU, ICU.

FX market indicators (1 November 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	41.3253	+0.0	+13.4
EUR/USD	1.0834	+0.4	+2.5
DXY	104.282	+0.0	-2.4

Source: Bloomberg, ICU.

Market gov't bond quotes (4 November 2024)

Maturity	Bid (%)	Ask(%)
6 months	15.25	14.25
12 months	15.75	15.00
2 years	16.75	15.50
3 years	17.75	16.50
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

MoF changes UAH bond offering set

The MoF reintroduced reserve bonds at primary offerings, but excluded 12-month military bills from the auctions.

In the past three weeks, the MoF did not offer reserve bonds, which banks can use to cover the mandatory reserves. Such a decision led banks to focus on military bonds, and the MoF has seen up to 5x oversubscription and borrowed significant funds. However, considerable demand did not induce price competition, as bids were close to cut-off rates. See details in the auction review.

In November, the MoF has to repay about UAH30bn and US$287m in bond principal, while redemptions in October were UAH42.7bn and US$668m.

For November, the MoF excluded 12-month paper and replaced 1.5 and 2.5-year bills with new bond series. Also, the MoF will offer two and three-year reserve bonds.

ICU view: The MoF expects the demand for military bonds will significantly exceed the supply. So, by offering a combination of two types of bonds, the MoF may borrow enough funds to roll all redemptions and finance other budget needs. At the same time, small investors, who usually prefer maturities below one year, will likely move to the secondary bond market.

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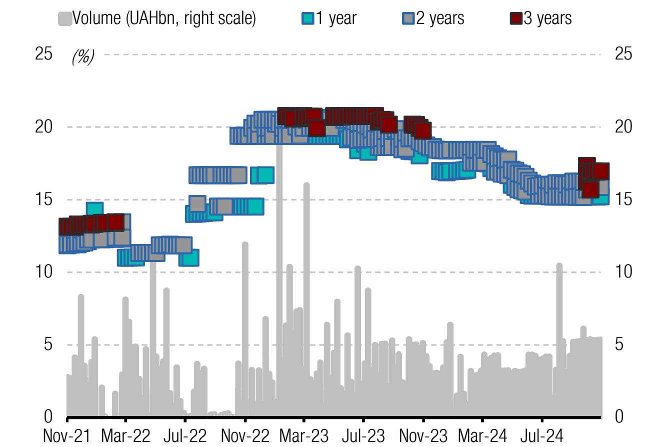
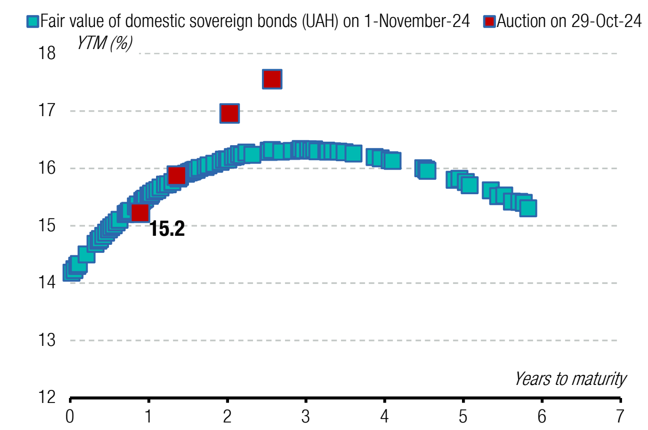
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

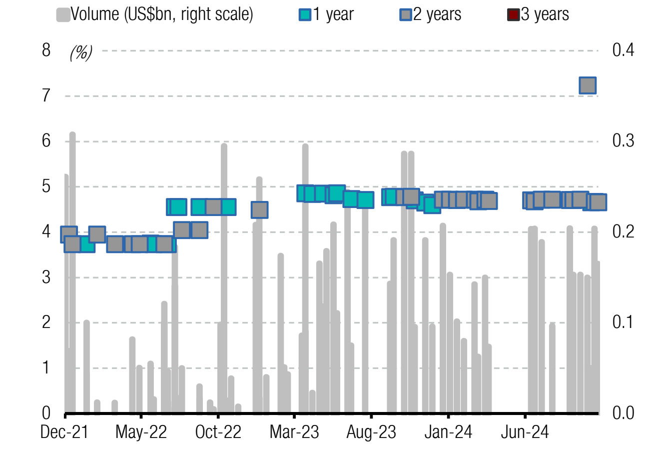
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

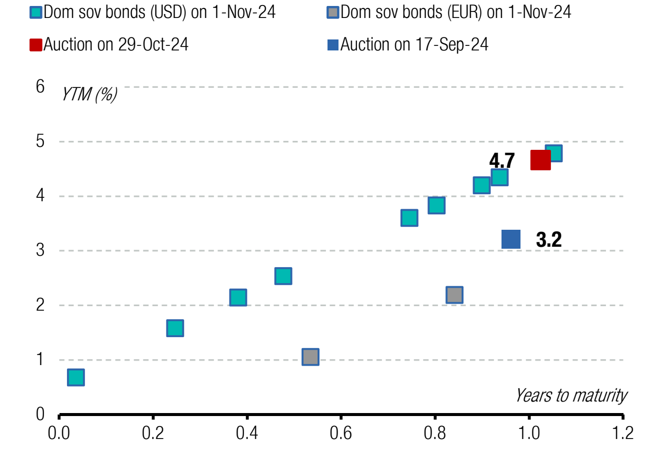
Chart 2. FX-denominated bonds

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.

UAH bonds rollover up in October

In October, the MoF borrowed the record volume of funds and improved the rollover rate for UAH papers significantly.

In October, the MoF borrowed UAH103bn, including UAH80bn and US$562m. At the same time, it repaid UAH42.7bn and US$668m. Therefore, the total rollover ratio for 10M24 was 152%. Rollover for UAH debt was 187% in October and 181% in 10M24, up by 2pp compared with 9M24. Rollover for USD-denominated debt was 84% in October, implying 119% in 10M24, down from 136% in 9M24. The ratio for EUR-denominated debt remained unchanged at 83% for the third month, as there were no repayments and borrowings in euros.

ICU view: The MoF borrows actively by placing UAH bonds, but is in no hurry to sell more FX-denominated bills. The Ministry can step up FX borrowings from the domestic market later if needed. The schedule for November debt redemptions is relatively light. However, the budget financing needs remain significant, so we expect net borrowings to increase compared with October.

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Foreign exchange market

NBU increases UAH rate fluctuations

Last Tuesday, the official hryvnia exchange rate weakened to UAH41.38/US$, but at the end of October, the NBU strengthened the hryvnia on the back of a better FX market balance.

The total FX-market deficit sharply declined last week. Net hard currency purchases fell by 26% to US$348m, including US$159m in the interbank FX market (37% down) and US$189m in the retail segment (down 13% compared with the same period of the previous week).

However, the NBU kept interventions broadly flat WoW at US$696m. The hryvnia official exchange rate remained almost unchanged at UAH41.3/US$.

ICU view: Last Monday, there was a sharp increase in demand for hard currency from bank clients (legal entities), so banks had to replenish their FX accounts on Tuesday,

causing an increase in interventions. In four days, bank clients increased foreign currency sales by 20% as they needed UAH liquidity for tax payments with a deadline set for last Wednesday.

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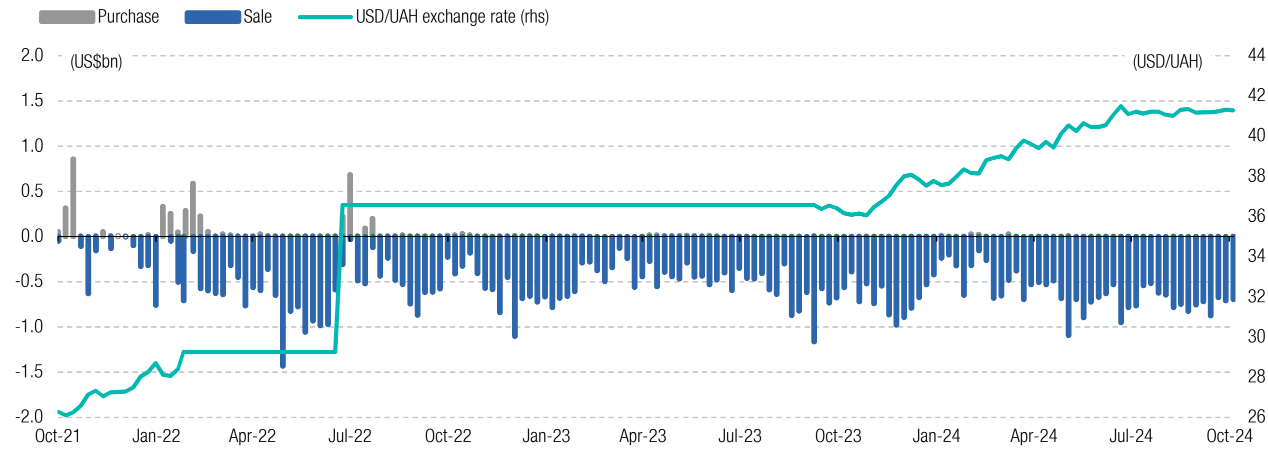
Chart 3. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Current account expectedly turns negative in September

The monthly current account (C/A) turned negative at US$2.4bn in September, a reversal from a surplus of US$3.1bn in August due to a pause in foreign budgetary grants inflows.

There were not major surprises with C/A components in September as the deficits of both foreign trade in goods and foreign trade in services were very close to August prints. The primary income balance also remained marginally negative for the second month in a row as investment income of nonresidents somewhat exceeded the labor income of Ukrainians abroad. Should this trend continue, it will mark a fundamental shift in primary income pattern for Ukraine. Secondary income fell significantly in September vs. August as Ukraine did not receive budgetary grants from foreign partners. This was the only explanation for a major fall in C/A in September.

On the financial account (F/A) side, net outflow of private capital of about US$0.4bn and marginal outflow of capital from the official sector were registered. Increase in cash out of banks remains the key channel for private capital outflows—it reached US$1.4bn in September, one of the largest monthly outflows of the recent past. Meanwhile, apart from the IMF loan that is recorded below the line in BoP data, government did not receive any significant concessional loans or grants from international allies.

With both the C/A and F/A being negative in September, the NBU had to spend a significant amount of its reserves to maintain stability in the FX market. Gross international reserves of the central bank were down 8% MoM to US$38.9bn.

ICU view: With no major surprises in BoP data, we maintain our projection for a 2024 current account deficit at about 6% of GDP. This projection assumes that the scheduled grants from the US and the EU will be provided in full by the end of the year. We also expect net positive inflows of capital via the financial account as Ukraine's

partners finalize some of the large credit facilities for Ukraine. All this should ensure a significant increase in NBU reserves that we forecast to reach about US$44bn at end-2024.

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Chart 4. Key balance of payment components, $m

Current account turns negative in September

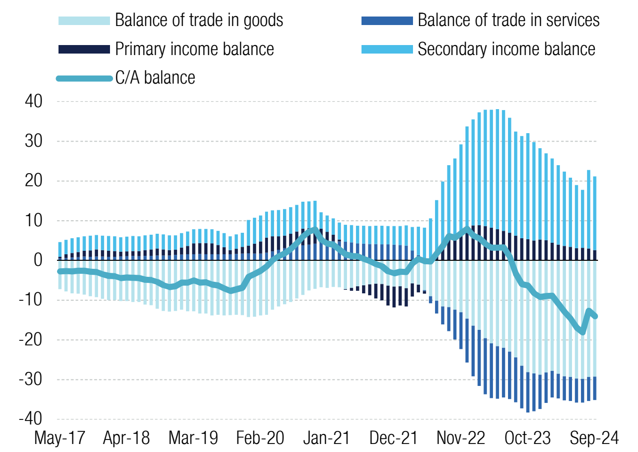
	Sep.24	Aug.24	Sep.23
Current account	**-2,396**	**3,145**	**-992**
Trade in goods	-2,664	-2,508	-2,804
Trade in services	-521	-573	-654
Primary income	-37	-44	331
incl. migrant income	656	682	891
Secondary income	826	6,270	2,135
incl. transfers to gov't	216	5,655	1,459
Financial account*	**433**	**-1,772**	**-1,259**
Change in trade credits	-598	-552	502
Change in cash out of banks	1,376	1,093	771
Net loans to government	48	-2,856	-1,687
Other	-393	543	-845

* negative numbers in financial account indicate increase in liabilities (cash inflow)

Source: NBU, ICU.

Chart 5. Current account, 12-month trailing, $bn

12-month current account balance volatile due to irregular inflow of grants



Source: NBU, ICU.

NBU worsens inflation and key rate forecast for 2025

The regulator has kept the key rate unchanged at 13%, which is in line with expectations.

NBU has cited inflation that accelerated beyond the forecast as the main reason for revising the key rate forecast more conservatively. Previously, the NBU expected four 50bps cuts in 2025, starting as early as January. Now, they see their first cut not until July, followed by another 50bps cut in October, shifting more cuts into 2026. The NBU now sees CPI at 9.7% at end-2024 (up from the previous forecast of 8.5%) with further deceleration to 6.9% at end-2025 (up from 6.6%). No changes to monetary policy were introduced at this time.

ICU view: NBU has shifted its stance not only by postponing the rate cuts in its forecast, but also by mentioning the possibility of a rate hike. We believe that the current pick-up in inflation is mostly transitory due to a poor harvest this year and the inflation should not exceed the revised NBU forecast. The chances for a rate increase in the coming months are still low, even though, apparently, they increased over the past couple of months. We also share the NBU view of inflation decelerating substantially in 2H25, opening the way for rate cuts.

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