Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

Inflation accelerates in October

Key messages of the today's comments

Ukrainian bond market

Banks rush to buy reserve bonds

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Eurobond prices up on positive expectations

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Foreign exchange market

NBU keeps hryvnia below UAH41.5/US$

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Economics

Inflation print in October well above expectations

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The gross international reserves of the NBU were down 6% in October and 10% in 10m24 on surging FX market interventions and lack of new financial aid.

MONDAY, 11 NOVEMBER 2024

Banks' reserves market (8 November 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	13.00	+0bp	-300bp
ON rate (%)	13.00	+0bp	-300bp
Reserves (UAHm)[2]	227,261	-13.0	+17.2
CDs (UAHm)[3]	458,211	+0.4	-9.8

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) (8 November 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-1.9
Banks	836,578	+1.7	+39.8
Residents	148,695	+1.1	+17.3
Individuals	72,488	+2.8	+52.0
Foreigners	23,599	+0.6	-48.8
Total	**1,779,708**	**+1.0**	**+17.8**

Source: NBU, ICU.

FX market indicators (8 November 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	41.2592	-0.2	+14.3
EUR/USD	1.0718	-1.1	+0.1
DXY	104.997	+0.7	-0.6

Source: Bloomberg, ICU.

Market gov't bond quotes (11 November 2024)

Maturity	Bid (%)	Ask(%)
6 months	15.25	14.25
12 months	15.75	14.75
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

Banks rush to buy reserve bonds

The MoF reintroduced reserve bonds at the primary auction last week and received ample bids for these instruments. Demand for military bonds exceeded supply, too.

The MoF offered two and three-year reserve bonds last week, which banks can use to cover part of their mandatory reserve requirements. After a three-week break, postponed demand was huge, and banks submitted all their bids in one day, driving oversubscription to 9x. Such significant demand drove competition high and the range of interest rates in bids was wide. Therefore, the cut-off and weighted average rates fell sharply by about 100bp. At the same time, demand for military bills declined but still exceeded the cap. Nonetheless, there was no chance for the MoF to decrease interest rates for military bills. See details in the auction review.

Total turnover in the secondary bond market rose by 14% to UAH9.5bn. The most traded were military bills with a 58% share.

ICU view: It has been one month since the NBU increased reserve requirements for banks and the limit to which reserve bonds can be included into mandatory reserves. Yet, the MoF did not want to use this source for budget financing while demand for such bonds was building. Last week, due to high competition, banks could submit multiple bids with different rates to increase their chance of buying reserve bonds, and this caused a sharp decline in interest rates. At the same time, banks did not trade them actively in the secondary bond market. Therefore, this week, in the reserve bond segment we will likely see high activity in the primary auction and low activity in the secondary market. Banks will compete for bonds, which can cause a further decline in interest rates for reserve bonds.

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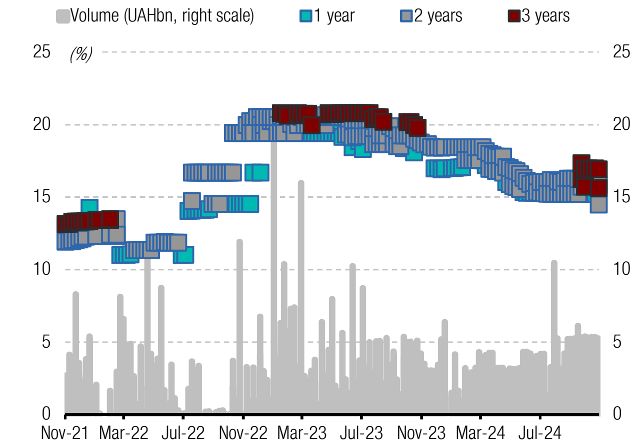
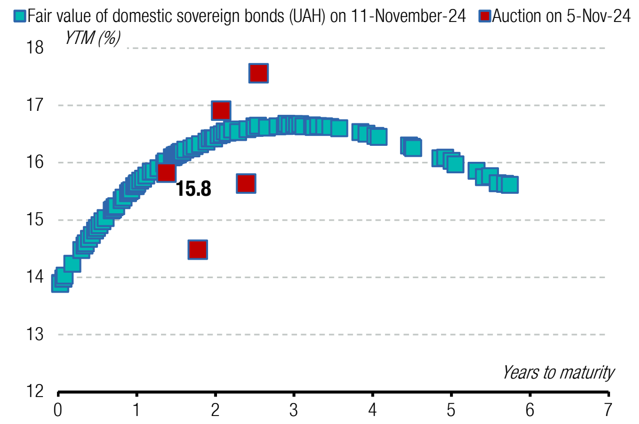
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

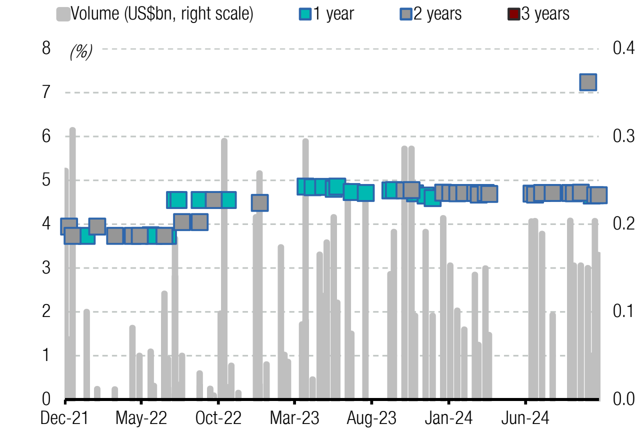
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

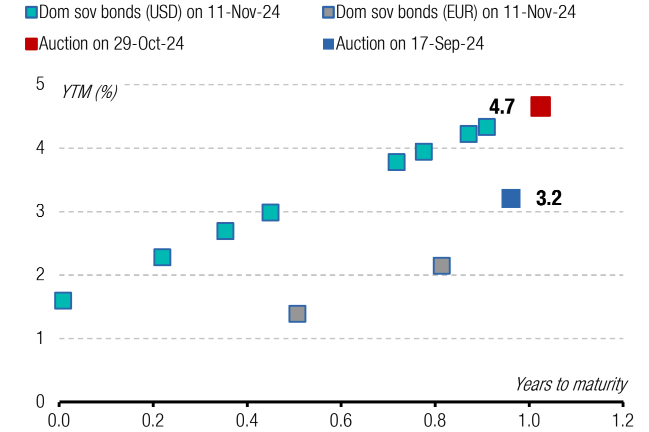
Chart 2. FX-denominated bonds

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.

Eurobond prices up on positive expectations

Last week, prices of Ukrainian Eurobonds rose significantly as investors positively assessed the results of the elections in the US and the chances of a near term start of negotiations to end the war in Ukraine.

During the week, prices rose by an average of 6%, and half of Eurobonds traded above 50 cents. The lowest price is still for Series B, due in 2034, and the highest for Series A, due in 2029. VRIs' price rose to its record high during the war – almost 77 cents per dollar of notional value. The EMBI index was up by 1% last week.

ICU view: The end of the presidential race in the US laid the foundation for optimism for investors and led to higher prices of Ukrainian Eurobonds. Trump's win enhanced positive sentiment that there may now be realistic ways to end the war in Ukraine in the foreseeable future. A peace deal may mark the start of the cycle of the country's recovery and increase the chance that the 1/3 write-off of old bonds will be reversed in 2030. The price of Series B bonds due in 2035-36 went up by 8%. Meanwhile, VRI investors were encouraged by the anticipated start of restructuring negotiations.

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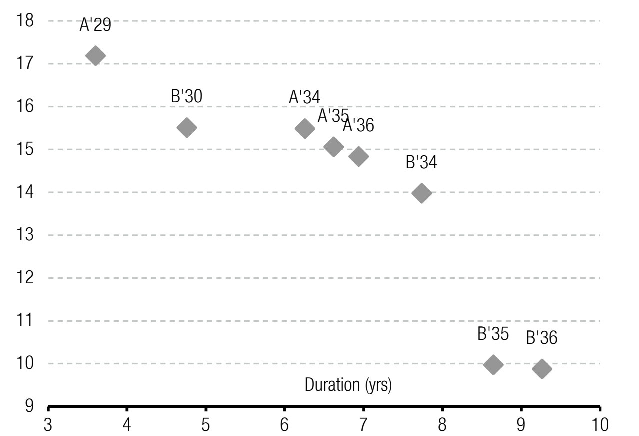
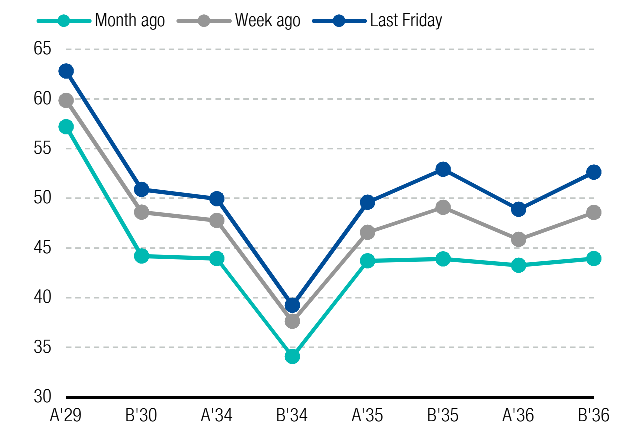
Chart 3. Ukrainian Eurobond YTMs and prices

Eurobonds yield map



Source: Bloomberg, ICU.

Prices of Eurobonds as of last Friday, a week and a month ago



Source: Bloomberg, ICU.

Foreign exchange market

NBU keeps hryvnia below UAH41.5/US$

The NBU again did not allow the hryvnia to weaken above UAH41.5/US$ and again sold more than US$700m from international reserves.

The total hard currency deficit rose last week, and net hard currency purchases rose by 36% WoW to US$473m, including US$234m in the interbank segment (up by 47%) and US$239m in the retail segment (up by 27%). Therefore, NBU's interventions rose by 6% to US$739m. Thanks to larger interventions, the hryvnia exchange rate remained almost unchanged WoW.

ICU view: The NBU kept hryvnia fluctuations within the range of UAH41.30-41.46/US$, selling hard currency from international reserves that led to their substantial decline in October (see comment below). Now, the NBU is still monitoring the reaction of the FX market to wider fluctuations, but is not allowing the hryvnia to weaken further. However, we still assume a moderate devaluation of the hryvnia to UAH42-43/US$ by the end of the year.

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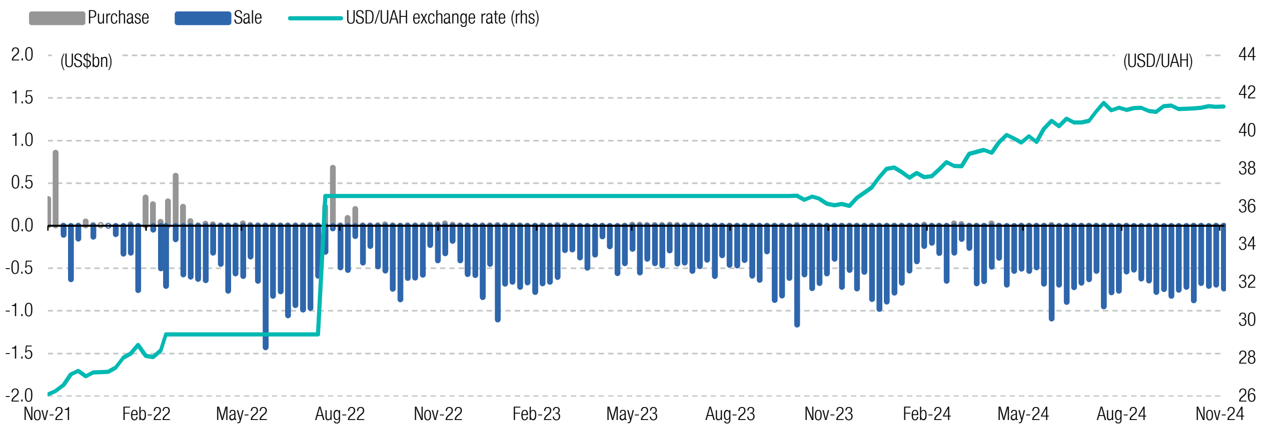
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Inflation print in October well above expectations

Consumer prices were up 1.8% MoM in October, taking the 12-month tally to 9.7%. This is well above the most pessimistic estimates and food prices are to blame.

The pickup in inflation in October was primarily driven by an upsurge in food prices that were up 3.3% MoM (+10.9% YoY) and contributed about three fourths to the monthly inflation print. Apart from prices for food and utilities that accelerated significantly since June, price growth for all other components remains fairly robust, and there are no indications of prices going out of control. Prices for transportation services remain a bright spot as they decelerated to 5.7% YoY from 6.7% in September thanks to favourable trends for global oil prices and high saturation of the domestic market with motor fuel. Prices for clothes and footwear are down 4.6% YoY indicating sluggish consumer demand for this consumer basket component.

ICU view: We remain of the view that that this year's poor harvest due to unfavourable weather conditions is the key factor behind the recent acceleration in consumer inflation. While hryvnia deprecation and labour shortages are also contributing factors, their role is much less significant. We expect that food inflation will cool noticeably in the coming months, and we are nearly certain to see a sharp deceleration in prices from 2Q25. We are updating our CPI projections to account for recent price statistics.

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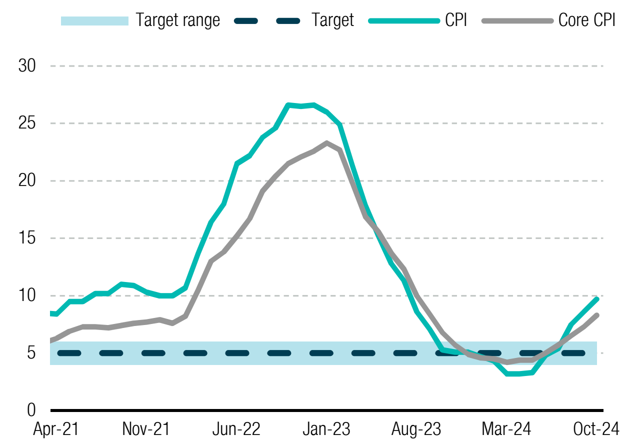
Chart 5. CPI, core CPI and target, YoY, %

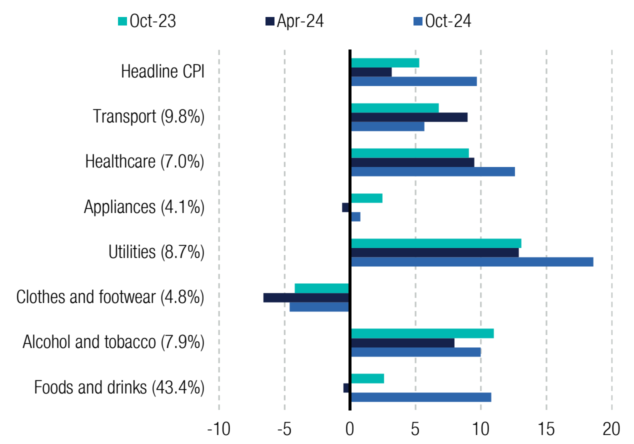
Annual inflation keeps accelerating



Source: Ukrstat, NBU, ICU.

Chart 6. CPI and its main components, YoY, %

Food prices up YoY are the key inflation driver



* numbers in brackets indicate the share of the component in consumer basket

Source: Ukrstat, ICU.

NBU reserves fall 6% in October

The gross international reserves of the NBU were down 6% in October and 10% in 10m24 on surging FX market interventions and lack of new financial aid.

The NBU had to maintain significant FX sale interventions at about US$3.4bn in October to alleviate market imbalances. The country also repaid US$0.3bn in external debt. Meanwhile, key inflows were US$1.1bn from the IMF and US$0.3bn from Canada.

ICU view: The decline in NBU reserves came on the back of lower inflow of foreign financial aid. This was fully anticipated. We expect that reserves will recover swiftly to above US$43bn by the end of 2024 as the largest donors, the US and the EU, provide final significant tranches of loans and grants to close the year.

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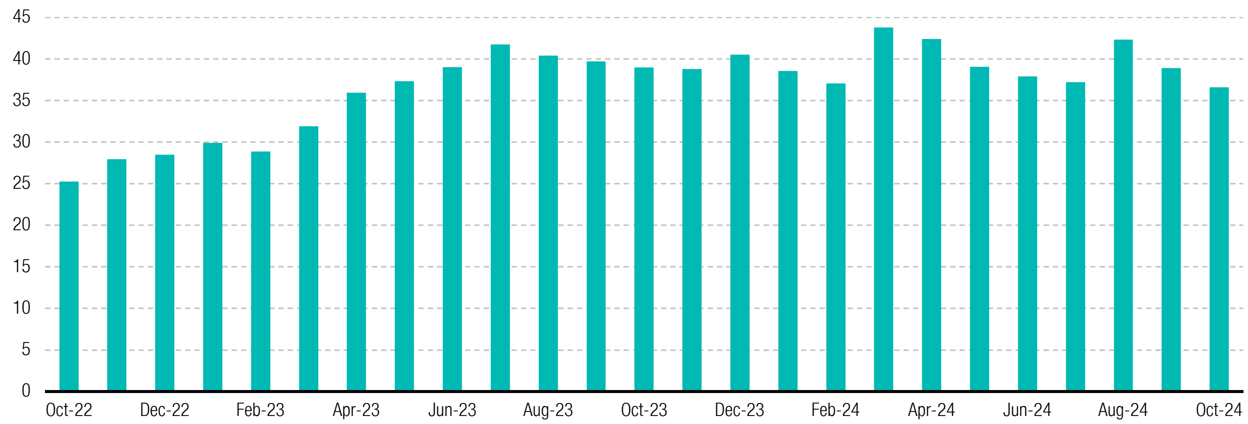
Chart 7. NBU gross international reserves, US$bn

NBU gross reserves down due to interrupted foreign financial aid



Source: NBU, ICU.

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