Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

First rate hike since 2022

Key messages of the today's comments

MONDAY, 16 DECEMBER 2024

Ukrainian bond market

The MoF completes placement of 3.5-year reserve bond

Last week, the MoF sold three UAH military bonds and completed the placement of the longest reserve paper.

Positive expectations support Eurobond prices

Investors expect that security risks will decrease next year, so Eurobond prices continue to rise.

Foreign exchange market

NBU interventions up sharply

The hryvnia weakened last week to a recent low while the NBU had to increase FX interventions.

Economics

First rate hike since 2022

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Banks' reserves market (13 December 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	13.50	+50bp	-150bp
ON rate (%)	13.50	+50bp	-150bp
Reserves (UAHm)[2]	435,722	+82.8	+126.3
CDs (UAHm)[3]	251,121	-43.8	-53.8

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) (13 December 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-1.8
Banks	884,398	+1.9	+40.2
Residents	166,245	+2.6	+24.0
Individuals	75,647	+1.6	+45.4
Foreigners	21,813	-5.6	-51.1
Total	**1,826,396**	**+1.1**	**+17.6**

Source: NBU, ICU.

FX market indicators (13 December 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	41.6927	+0.6	+12.7
EUR/USD	1.0501	-0.6	-3.4
DXY	107.003	+0.9	+4.0

Source: Bloomberg, ICU.

Market gov't bond quotes (16 December 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

The MoF completes placement of 3.5-year reserve bond

Last week, the MoF sold three UAH military bonds and completed the placement of the longest reserve paper.

The primary auction saw significant oversubscription for all offered bonds. Military bonds received UAH9-11bn of demand each vs. the UAH5bn cap. However, price competition was weak and there was no room for the MoF to lower interest rates. At the same time, reserve bonds saw 5x oversubscription. Bids came in with a wide range of interest rates, allowing the MoF to decrease the cut-off rate by 48bp to 15% and the weighted average rate by 63bp to 14.59%. See details in the auction review.

Of all investors, the bond portfolios of banks rose the most last week, by UAH16.7bn, as they purchased the majority of military bonds. Individuals' portfolios rose by UAH1.1bn to a new record high, UAH75.7bn.

In the secondary bond market, military bonds were actively traded. The total number of deals was UAH18.4bn (up by 47%), of which nearly 46% was military bills.

ICU view: Banks are now primarily interested in reserve bonds, but also are keeping a large part of their funds in military securities. Higher YTMs of military bonds allow banks to partially compensate for the lower YTMs of reserve bonds. The MoF does not plan to offer new reserve paper tomorrow and will offer only three military bonds. Due to the NBU's revision of the key policy rate , banks will likely try to secure higher interest rates for the shortest instrument, but most likely, the MoF will not agree to revise interest rates.

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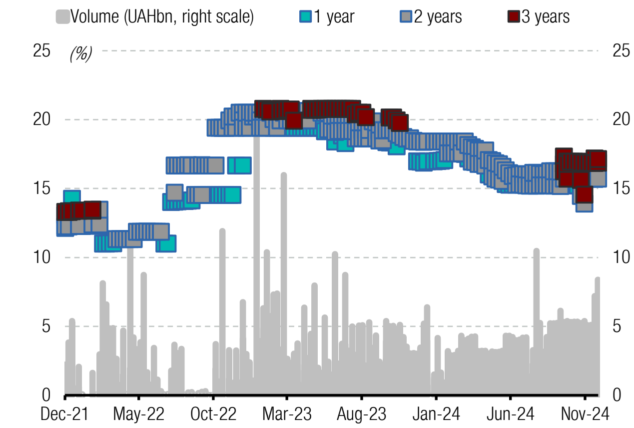
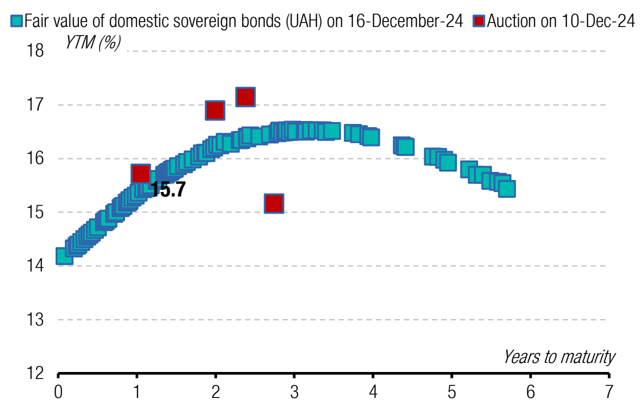
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

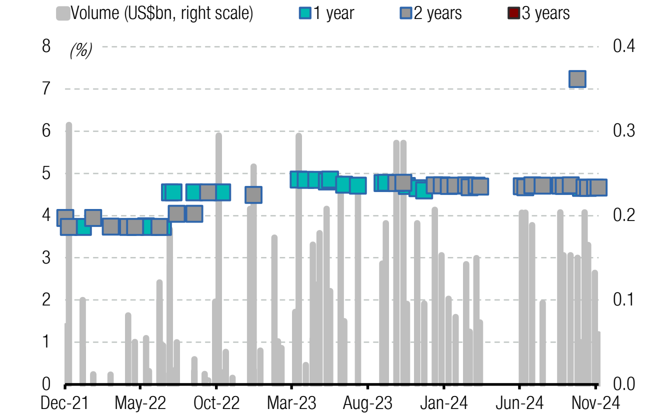
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

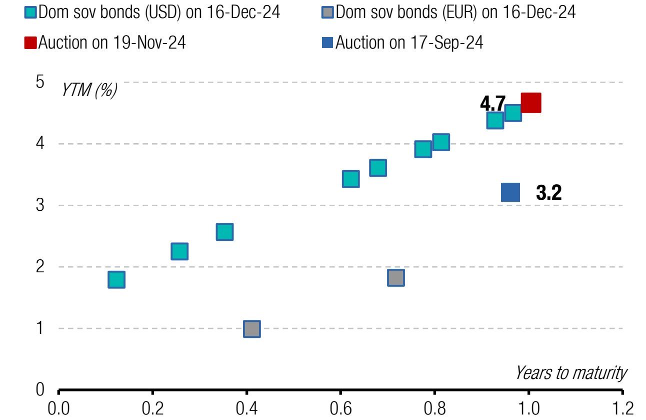
Chart 2. FX-denominated bonds

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.

Positive expectations support Eurobond prices

Investors expect that security risks will decrease next year, so Eurobond prices continue to rise.

On average, Ukrainian Eurobond prices rose last week by 2% and the spread to the benchmark tightened by 20-100bp for all bonds. Only the UKRAIN'B'35 price slid by 0.4%. The price of VRI remained slightly below 76 cents per dollar of notional value. The EMBI index slid by 0.8%.

ICU view: General investor sentiment toward Ukrainian Eurobonds remains cautiously optimistic. International investors' expectations regarding the actions of the new US presidential team remain positive amid the increase in military aid from the current administration. The approval of US$50bn of international aid funded with the proceeds generated by russian frozen assets and the expectation that Ukraine will receive at least some of this aid early next year also support optimism. Therefore, in the absence of negative news in the coming weeks, Eurobond prices may rise gradually.

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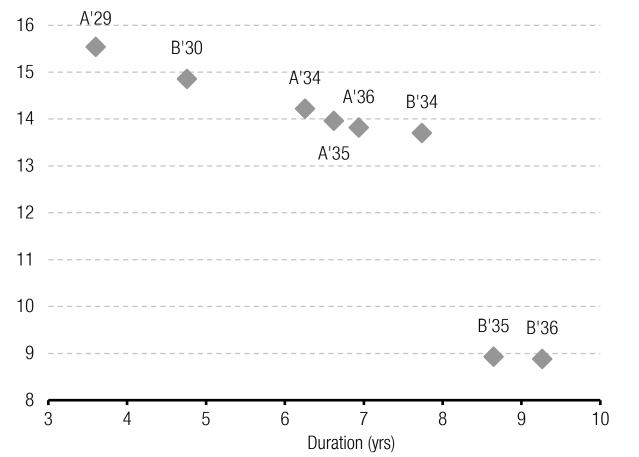
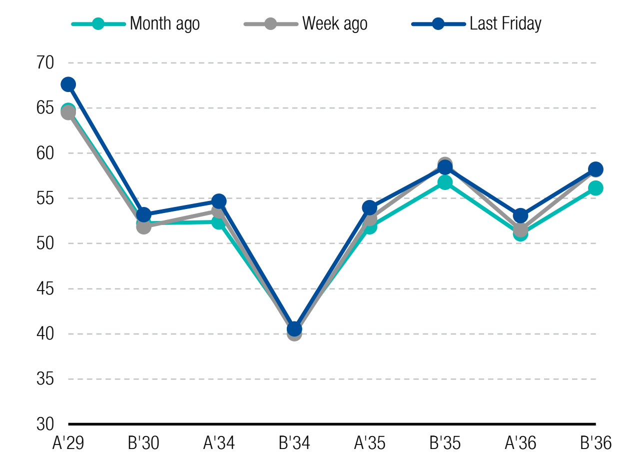
Chart 3. Ukrainian Eurobond YTMs and prices

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 interventions up sharply

The hryvnia weakened last week to a historical low while the NBU had to increase FX interventions.

A foreign-currency shortage rose last week, as demand in interbank FX market rose to this year's high, almost US$1.5bn. The hard-currency deficit in the interbank FX market grew 83% WoW (in four business days) to US$541m. In the retail segment, it declined by 8% WoW to US$219m. Net purchases rose 42% to US$760m.

The NBU increased interventions by 37% to US$1.08bn to cover the deficit and prevent the hryvnia from further weakening. The hryvnia weakened to its new low at UAH41.7/US$ last Wednesday, the week ended with the official exchange rate at UAH41.61/US$.

ICU view: Demand in the interbank FX market rose to its highest level since the end of May, causing NBU interventions to reach a new six-month high. The NBU demonstrated that it will not allow the hryvnia to weaken sharply and will increase interventions when necessary to avoid wide fluctuations of exchange rate. During the next two weeks, the NBU is unlikely to allow hryvnia to weaken above UAH42/US$.

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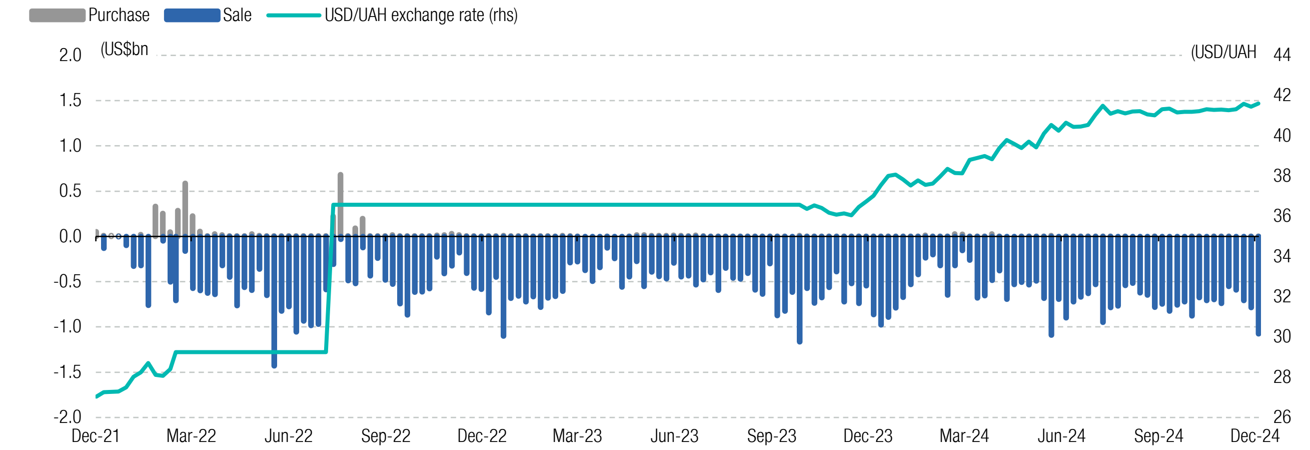
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

First rate hike since 2022

The NBU raised the key monetary policy rate by 50 bps to 13.5%, defying market expectations.

Rising inflation, which reached 11.2% YoY in November, compelled the NBU to act despite its recent macroeconomic forecast, which had anticipated no changes in the interest rate until the second half of next year when the first cut was expected. The regulator cited inflationary pressures from food prices as a key driver for the hike, aiming to preserve the attractiveness of UAH-denominated assets.

ICU view: We anticipate another 50 bps hike in January. The NBU will then likely signal a pause in rate increases and provide updated guidance. With the inflationary impact of 2024's adverse agricultural conditions dissipating, we expect inflation to decrease, paving the way for the first rate cut in 2H25.

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CPI hits 11.2% in November on surging food prices

Consumer prices were up 1.9% MoM in November on the surging cost of food, lifting the annual inflation rate to 11.2% from 9.7% in October.

Consumer inflation continued to be primarily fueled by prices for food, which surged by staggering 4% MoM and 14.4% YoY. The market continues to digest adverse effects of the summer drought that undercut production of oilseeds, grains, vegetables, and fruits. Prices for tobacco and alcoholic drinks also keep accelerating notably (+1.3% MoM and 11.1% YoY) driven by tough administrative measures to reduce the shadow segment of this market. Overall, an increase in prices for food, tobacco, and alcoholic drinks along with a hike in electricity tariffs for households explain about three quarters of the annual inflation tally in November. Growth in prices for other components of the consumer basket remain little changed from previous periods.

ICU view: We expect that after another several months of double-digit inflation, consumer prices will start to slow considerably in the spring. Should next year's weather be favorable for agriculture, a rapid disinflation is nearly guaranteed, and we see the CPI at 7.0% at the end of 2025. With this CPI projection, we believe that the NBU could have avoided a recent increase in the key policy rate by 50bp to 13.5%. As inflation will start to slow notably in 2H25, this will open the way for monetary policy loosening again.

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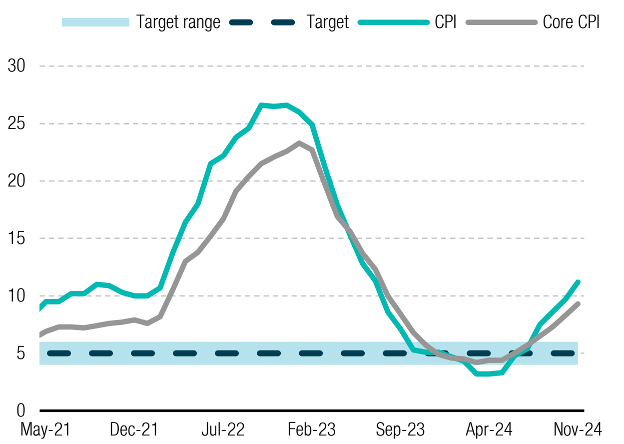
Chart 5. CPI, core CPI and target, YoY, %

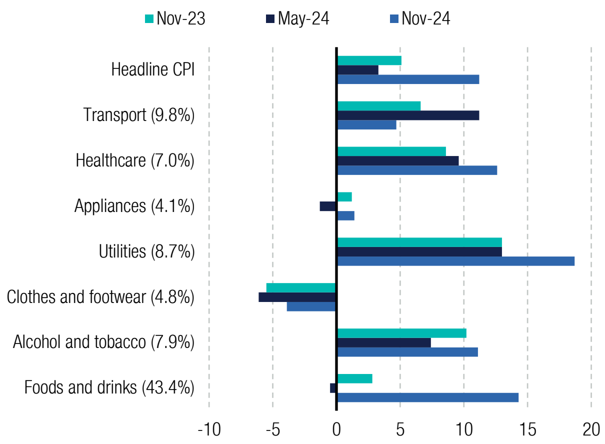
Annual inflation accelerates at a high rate



Source: Ukrstat, NBU, ICU.

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

Food prices are now the key inflation driver



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

Source: Ukrstat, ICU.

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