Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

NBU increases key rate, signals two more hikes

Key messages of the today's comments

MONDAY, 27 JANUARY 2025

Ukrainian bond market

MoF pushes down yields on reserves bonds further

Last week, the MoF again refused to increase interest rates on military bonds, but the key rate hike may force the MoF to revise the decision.

Eurobond prices at new highs

Hopes of Ukrainian Eurobond holders for a quick end of the russia war in Ukraine strengthened again last week.

Foreign exchange market

NBU strengthened the hryvnia significantly

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Economics

NBU increases key rate, signals two more hikes

The regulator has raised the key monetary policy rate by 100 bps, to 14.5%. This decision aligns with the upper bound of market expectations—forecasts ranged between a 50bps and a 100bp hike.

Banks' reserves market (24 January 2025)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	14.50	+100bp	-50bp
ON rate (%)	14.50	+100bp	-50bp
Reserves (UAHm)[2]	498,063	+77.6	+143.5
CDs (UAHm)[3]	218,837	-51.9	-62.8

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) (24 January 2025)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,606	+0.0	-1.4
Banks	883,852	+0.4	+33.8
Residents	200,982	+0.7	+39.0
Individuals	79,830	+3.4	+42.0
Foreigners	20,763	-2.1	-52.9
Total	**1,863,447**	**+0.4**	**+16.8**

Source: NBU, ICU.

FX market indicators (24 January 2025)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	41.8922	-0.5	+11.6
EUR/USD	1.0497	+2.2	-3.6
DXY	107.443	-1.7	+4.1

Source: Bloomberg, ICU.

Market gov't bond quotes (27 January 2025)

Maturity	Bid (%)	Ask(%)
6 months	15.25	14.25
12 months	16.00	15.00
2 years	17.00	16.00
3 years	17.75	16.75
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

MoF pushes down yields on reserves bonds further

Last week, the MoF again refused to increase interest rates on military bonds, but the key rate hike may force the MoF to revise the decision.

The primary bond market is becoming deeply segmented. Banks maintained their strong preference for four-year notes, which the NBU allowed banks to use to partly cover mandatory reserves. Competition for such bonds remained strong. However, small investors prefer military bills, and primary dealers attempted to get higher yields on such papers. The MoF pushed interest rates on four-year bonds below 14%, while the yields for military 1.5 and 2.5-year bills remained unchanged at 15.1% and 16.2%. See details in the auction review.

The secondary bond market remains heavily skewed towards regular and military securities. Trading in reserve bonds (including paper due in 2029) was just 22% of the total.

Investors gradually rebuild their portfolios after recent redemptions. Individuals increased their portfolio by 2.2% to UAH80bn last week. Only foreigners continue to reduce their portfolios. This week, the MoF will redeem US$353m worth of FX bonds and will offer new USD-denominated bills next week.

ICU view: In recent weeks, the MoF has managed to keep interest rates for military bills unchanged even though the bond market expected an increase in the NBU key rate. We expect that the MoF will prefer not to increase rates by the same 100bp. In the following weeks, the MoF will offer mostly longer-maturity instruments, to accumulate funds to redeem UAH41bn of bonds at the end of February. As far as military bonds are concerned, the MoF offers paper with maturities of at least 1.5-years. Since the NBU signals it will start decreasing the key rate in 2H25 (see comment below), the MoF's decision on interest rates will depend on government financing needs and an increase in yields will likely be lower than a hike in the key rate by the NBU.

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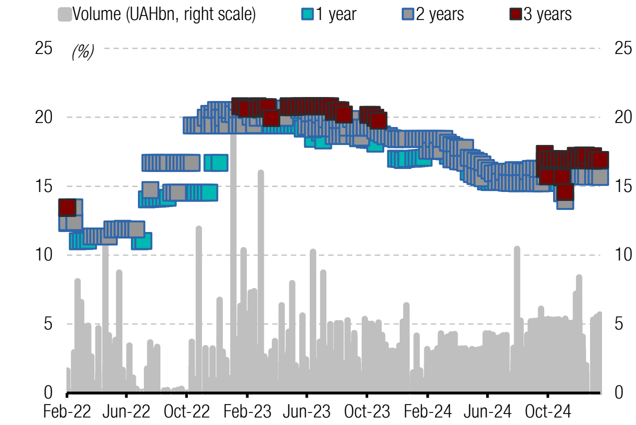
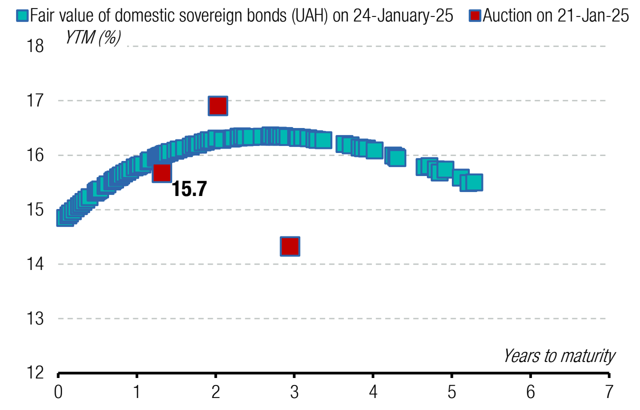
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

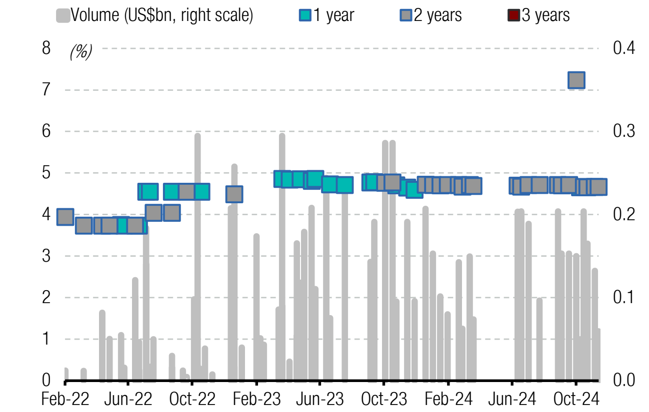
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

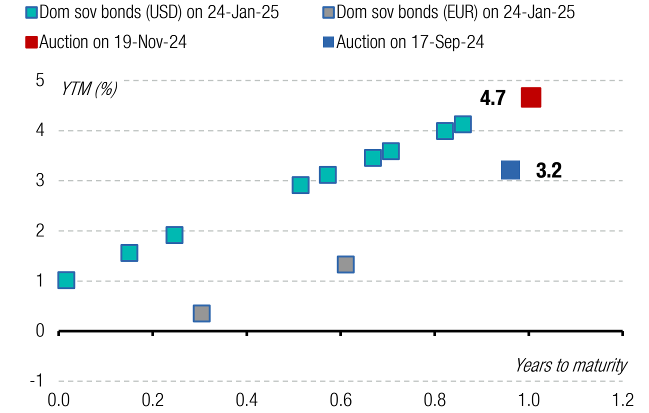
Chart 2. FX-denominated bonds

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 at new highs

Hopes of Ukrainian Eurobond holders for a quick end of the russia war in Ukraine strengthened again last week.

The Eurobond market, thus, saw a new rally. The prices of StepUp series A bonds maturing in 2034-36 increased significantly and approached the maximums recorded in early January. At the same time, the price of UKRAIN'A'29 and of all series B Eurobonds rose to new highs. The price of all Eurobonds rose by an average of almost 4% over the week. Accordingly, yields fell below 15% and spreads to the benchmark (US Treasuries) narrowed by 30-90bp. The EMBI index rose by 0.5%. VRI's grew by another 4% to 84 cents per dollar of notional value, which is a new three-year high.

ICU view: Last week, investors got new support for their optimism from official statements from the new US President and his team about their intentions to end the war. Bondholders broadly anticipate that negotiations will start soon. Statements by European leaders about their continued support for Ukraine also supported investor sentiment. Signals about the progress or lack of it in preparation for negotiations will have a decisive impact on the Eurobond prices in the coming months.

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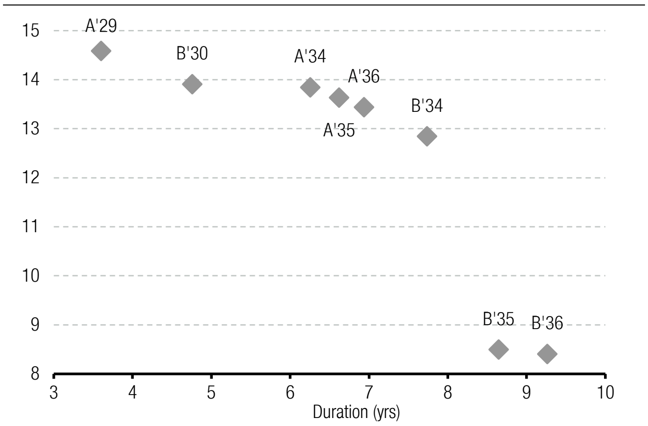
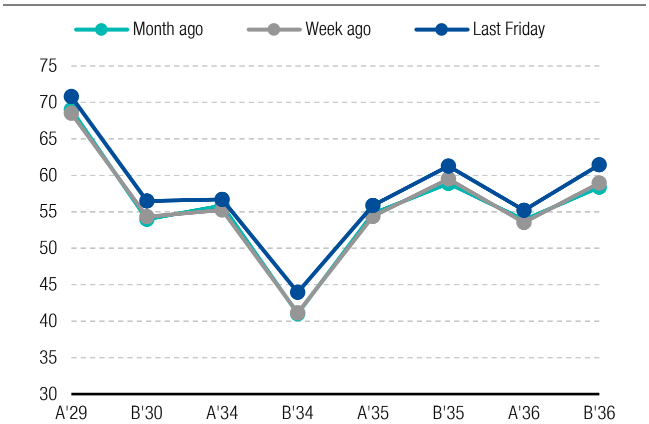
Chart 3. Ukrainian Eurobond YTMs and prices

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 strengthened the hryvnia significantly

Last week, the NBU reduced interventions to this year's minimum, which did not prevent the strengthening of the hryvnia exchange rate to this year's maximum.

The total FX deficit decreased by a third last week. Over the four business days of last week, net foreign currency purchases amounted to about US$472m, staying significantly above the last year's average weekly deficit. In the interbank FX market, net hard currency purchases decreased to US$267m (-38% WoW), and in the retail segment, net foreign currency purchases decreased to US$205m (-24% WoW).

The NBU reduced interventions by 25% last week to US$756m, the smallest volume since the beginning of December 2024. The official hryvnia exchange rate strengthened by 0.5% to UAH41.93/US$, the strongest since late December.

ICU view: The NBU has significantly reduced its interventions, but they still remain relatively large and considerably higher than last year's weekly average (US$665m). This week, the market may receive additional support from exporters who will need more UAH liquidity to pay taxes. The NBU may thus continue to reduce interventions while keeping exchange rate fluctuations limited. The pattern of the hryvnia exchange rate shows that the NBU will likely keep it close to UAH42/US$ this week.

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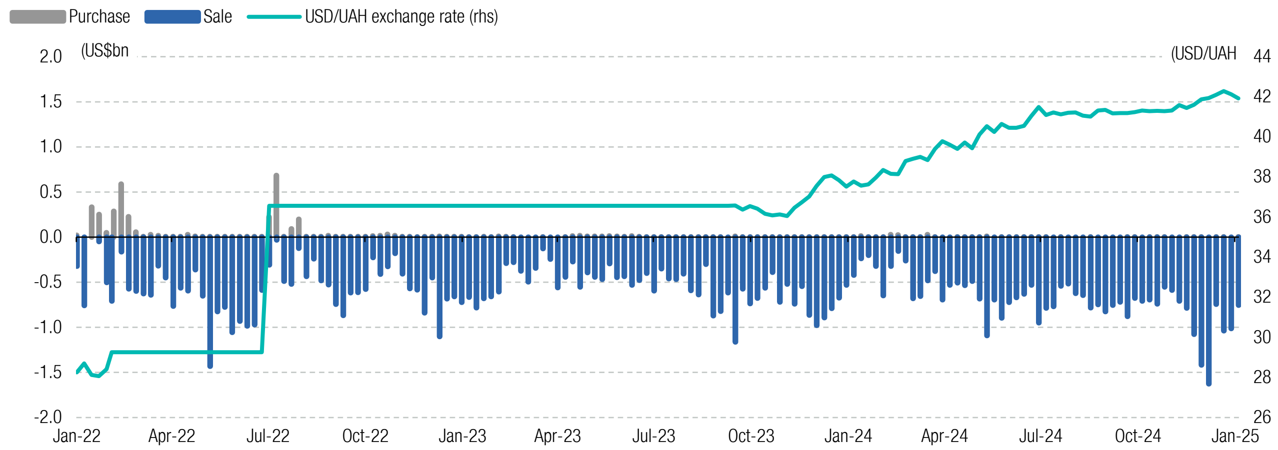
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

NBU increases key rate, signals two more hikes

The regulator has raised the key monetary policy rate by 100 bps, to 14.5%. This decision aligns with the upper bound of market expectations—forecasts ranged between a 50bps and a 100bp hike.

The move follows a 50bps increase in December. Additionally, the NBU has updated its macroeconomic forecast, revising its end-2025 CPI expectations to 8.4% YoY, up from a previous forecast of 6.9%, and signalled its preparedness for two further hikes of 50 bps each in March and June.

ICU view: The NBU's decision was driven by inflation exceeding expectations, reaching 12% YoY in December, a high likelihood of it accelerating further in the coming months. We remain of the view that inflation will start to decelerate significantly in 2H25 as adverse conditions in the agricultural sector, which contributed significantly to elevated inflation, are unlikely to repeat this year. This should enable the NBU to begin cutting rates as projected in its macroeconomic forecast. The regulator currently anticipates a sharp 300bps rate reduction during the period from July to December 2025.

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