Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

NBU raises key rate, signals cautious approach

Key messages of the today's comments

Ukrainian bond market

Reserve bonds dominate in new placements

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Markets nervous about slow pace of ceasefire progress

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Foreign exchange market

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Economics

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MONDAY, 10 MARCH 2025

Banks' reserves market (7 March 2025)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	15.50	+100bp	+50bp
ON rate (%)	15.50	+100bp	+51bp
Reserves (UAHm)[2]	333,684	+42.7	+53.8
CDs (UAHm)[3]	436,502	-21.2	-20.7

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) (7 March 2025)

	Last	Weekly chg (%)	YoY chg (%)
NBU	676,622	+0.0	-0.9
Banks	855,869	-0.2	+27.8
Residents	207,522	+2.2	+41.3
Individuals	84,296	+3.8	+45.4
Foreigners	20,131	+1.0	-53.9
Total	**1,844,862**	**+0.4**	**+15.2**

Source: NBU, ICU.

FX market indicators (7 March 2025)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	41.2655	-0.8	+8.4
EUR/USD	1.0833	+4.4	-1.1
DXY	103.838	-3.5	+1.0

Source: Bloomberg, ICU.

Market gov't bond quotes (10 March 2025)

Maturity	Bid (%)	Ask(%)
6 months	15.50	14.25
12 months	16.50	15.25
2 years	18.00	16.50
3 years	18.50	17.00
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

Reserve bonds dominate in new placements

The MoF has borrowed funds mostly via UAH reserve bonds over the past two weeks. This week, we expect this pattern to continue.

Last week's primary auction amassed almost UAH28bn worth of demand, but generated less than UAH6.7bn for the budget with the bulk raised via new reserve bonds. Two UAH military bills provided the budget with just UAH1.6bn without changes in interest rates. At the same time, reserve bonds (the NBU added this paper to the list of designated reserve bonds last Wednesday) saw 5x oversubscription of UAH26bn vs a supply cap of UAH5bn. The placement resulted in UAH5.1bn of proceeds. Yields of reserve bond declined marginally. See details in the auction review.

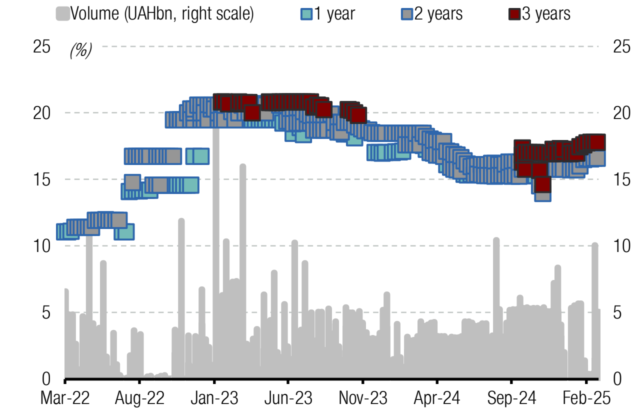
Activity in the secondary bond market decreased slightly. Total trading was down by 15% WoW to UAH14.3bn. The share of FX-denominated bills rose to 19%. New reserve bonds were the most traded paper with a 37% share. Bonds maturing this year accounted for 23% of the total turnover.

Non-bank investors significantly increased their portfolios last week: legal entities and individuals restored their portfolios to the level they had before the largest-ever one-time redemption in February. Foreign investors increased their portfolios by 1.3% WoW to just UAH20bn, which was significantly below the volume in February.

ICU view: The bond market remains segmented in two parts. Banks are mainly interested in reserve bonds while their clients prefer military bonds. Banks are gradually selling short-term bonds to clients, replacing them with new long-term reserve bonds. However, they were in no rush to buy new papers at last week's primary auction in anticipation of an increase of the NBU key rate. The prospective impact of last week's increase in the NBU key policy rate (see comment below) on bond yields is not apparent. During the winter, the NBU raised its key rate by 150bp, but the MoF raised rates on military bonds by only 75bp. Recent auctions have shown that higher yields have not resulted in more demand for military bills. We, thus, think the MoF may prefer to maintain bond yields at the current level and offer more reserve bonds to the market should there be liquidity pressure. However, we can't rule out completely that the MoF may increase interest rates somewhat if banks promise more demand in response.

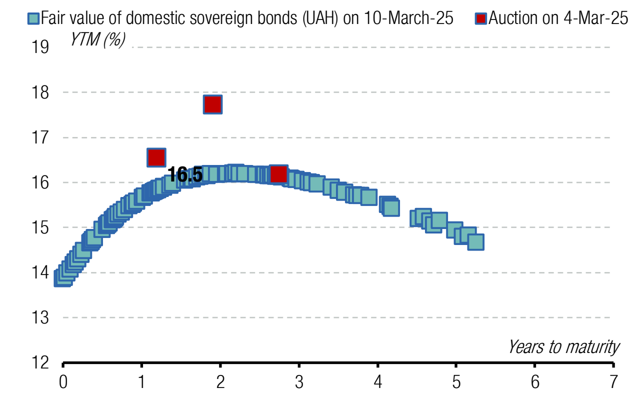
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

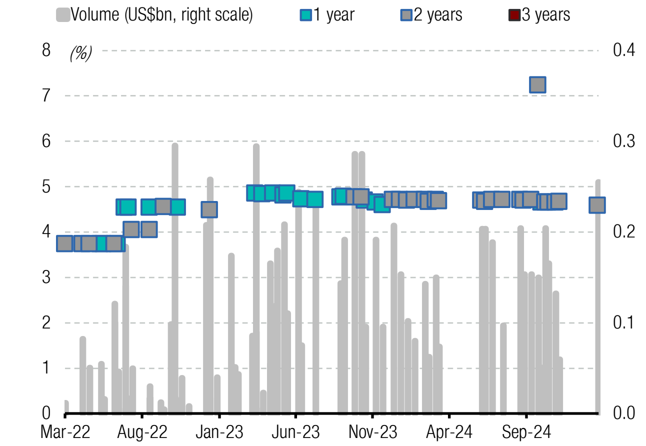
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

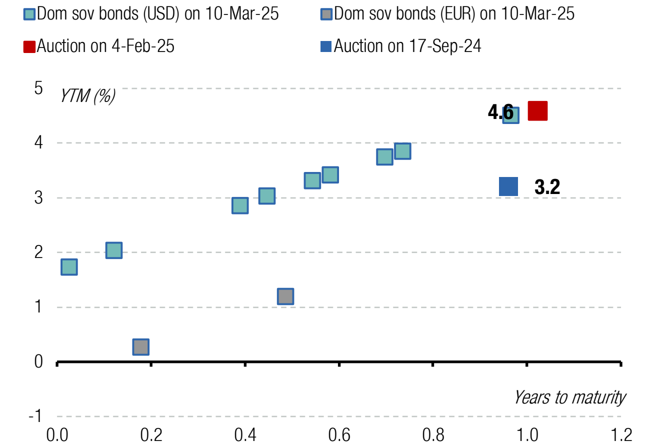
Chart 2. FX-denominated bonds

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.

Markets nervous about slow pace of ceasefire progress

Last week, markets continued to digest the backlash from the conflict between the presidents of Ukraine and the United States, as well as new statements from both sides and statements from the European leaders following the EU summit.

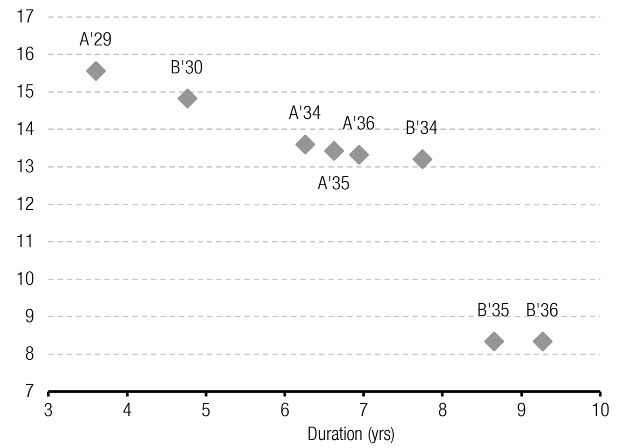
The week began with diverse statements from both the Ukrainian and US officials. On Tuesday, after the President of Ukraine made a public statement on his readiness and willingness to cooperate with the US President to reach a ceasefire deal swiftly, tension seemed to be on a downward trend. The statements of the President of France and the final statement of the EU summit also offered some hope that military support for Ukraine will be enhanced by the EU, even though the US remains reluctant to renew the supply of weapons. On Friday, President Trump said that he may impose additional sanctions against Russia if it does not move toward a ceasefire.

Against this backdrop, Eurobond prices remained highly volatile, with the average price declining by approximately 2.4% over the week. VRIs lost another 3% last week, falling below 81 cents per dollar of notional value. The EMBI index fell by 0.7% over the past week.

ICU view: Markets remain extremely sensitive to both positive and negative statements regarding the ceasefire negotiation process. However, the process has not moved beyond the statements and is apparently dragging on, worrying investors. This week's key news may be the disclosure of a peace plan by the US following talks in Saudi Arabia. It is unlikely to meet Ukraine's aspirations in full, but private investors may view any realistic plan positively. Therefore, we do expect sharp declines in Eurobonds prices, but we equally do not see any convincing reasons for another rally either. Volatility in the Eurobond market will persist in the coming weeks. VRI prices have decreased after the MoF approached warrant holders. Negotiations on the restructuring of VRIs may drag on, and clear outlines of a compromise may appear only in the last days before the deadline for starting a formal restructuring process.

Chart 3. Ukrainian Eurobond YTMs and prices

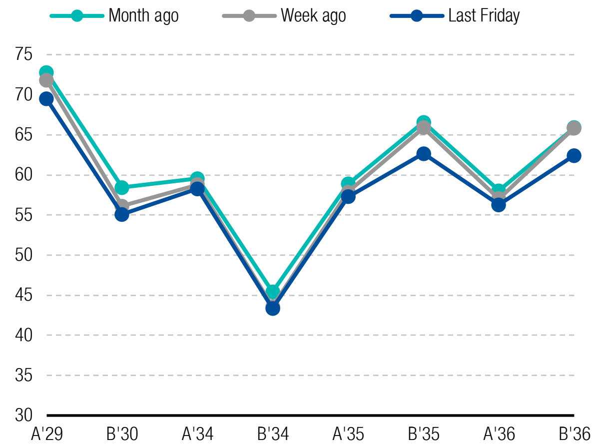
Eurobonds yield map



Note: The nominal value of Series B bonds due in 2035 and 2036 may increase in 2030

Source: Bloomberg, ICU.

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



Source: Bloomberg, ICU.

Foreign exchange market

NBU strengthens hryvnia further

Last week, the NBU strengthened the hryvnia to a new record this year and reduced its weekly interventions to US$514m.

The hard-currency deficit continued to decrease. Net foreign currency purchases decreased by 16% to US$417m. The decisive factor was the reduction of the shortage in the interbank FX market by 49% to US$183m. At the same time, in the retail segment, net foreign currency purchases increased by 71% to US$235m.

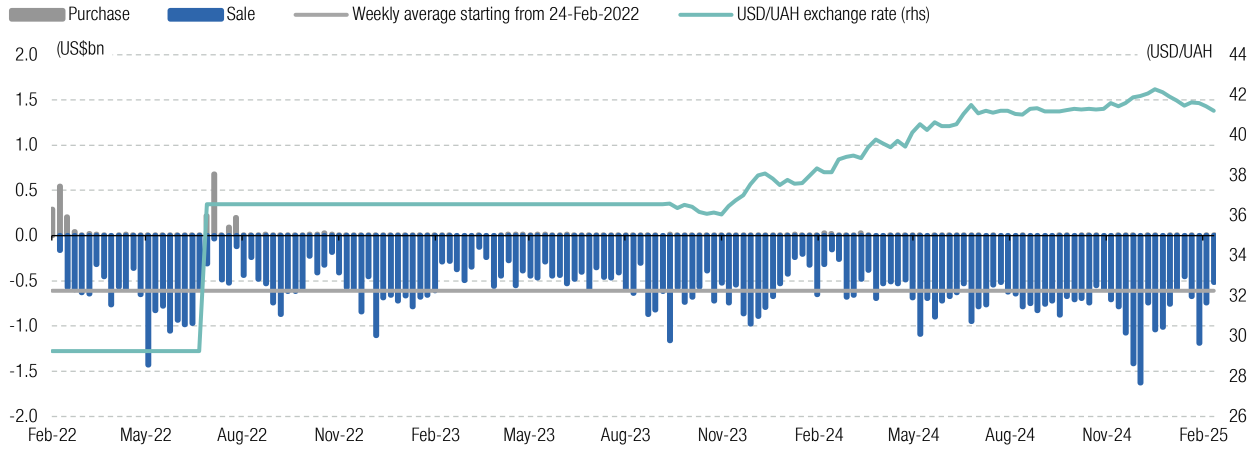
Given lower imbalances, the NBU sold US$514m from international reserves, 31% less than the previous week. This volume is significantly lower than the average weekly intervention during the full-scale war.

At the same time, the NBU again took a chance to strengthen the hryvnia even more - the official hryvnia exchange rate strengthened by 0.5% over the past week to UAH41.21/US$, the highest since October last year.

ICU view: The NBU keeps the hryvnia strong despite significant imbalances in the FX market. This may imply the NBU has high confidence that the inflows of external financial assistance will remain substantial going forward. However, this approach makes the economy extremely vulnerable to possible negative events, and the policy of a strong hryvnia is hardly justified. Therefore, we expect the NBU to eventually move to gradually weakening the exchange rate.

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 and weekly average starting from 24-Feb-2022



Source: NBU, Bloomberg, ICU.

Economics

NBU raises key rate, signals cautious approach

The key monetary policy rate was increased by 100 bps to 15.5%, marking the third consecutive hike.

The NBU continues to emphasize uncertainty in the inflation trajectory and external funding flows, signalling a cautious stance on future monetary policy adjustments.

In addition to this increase, the regulator has adjusted the operational framework parameters of its interest rate policy. The interest rate on three-month deposits was raised by 200 bps, while the maximum volume of such instruments available to banks is expected to expand. This measure is designed to incentivize banks to raise interest rates on retail term deposits in hryvnia and stimulate their growth.

ICU view: The NBU's latest decision underscores its commitment to anchoring inflation expectations. However, we believe the regulator is unlikely to implement further hikes in 2025, despite its statement about a possible tightening bias. The disinflationary trend should gain momentum in the second half of the year as supply-side pressures ease. Given this, we expect the NBU to begin its easing cycle later than previously anticipated, but rate cuts should still materialize in 2H25.

Current account turns deeply negative in January

In January, the current account balance turned negative to US$2.3bn as foreign budgetary grants dwindled.

The balance of trade in goods improved vs. Dec. 2024, but deteriorated sharply vs. January 2024, as imports increased 7% YoY while exports plummeted 13% due to lower exports of grains and vegetable oils (agro and food made up 63% of total export of goods in January). The deficit of trade in services also deteriorated vs. January 2024, partly due to suspension of transit of russian gas. The primary income balance was negative, as income of Ukrainian workers abroad declined 21% YoY while outflows of income on foreign capital surged by two thirds. The secondary income was close to that of January 2024, as budgetary grants were relatively small, implying the funds of US$3.0bn that came in under the ERA mechanism were classified as credits.

The net capital inflows under the financial account were positive at US$1.3bn thanks to the ERA loan to the government, but they were not enough to cover the current account gap. The NBU reserves were, thus, down 2% to US$43.0bn in January.

ICU view: The January BoP data fully display that the Ukrainian economy remains very vulnerable and macroeconomic stability is largely based on inflows of foreign financial aid. The classification of the ERA facility as a loan rather than as a grant (we, many other forecasters, and the NBU classified ERA as grants in the latest macro projections) implies the need to make a technical adjustment to the CA projections. This will redistribute capital inflows via BoP lines, but will not change the essence of the ERA facility as the money will be repaid with income from russian frozen assets. All in, we maintain our view that the deficit of Ukraine's external accounts will be fully covered with capital inflows from IFIs/partner countries, and the NBU will be fully equipped to keep the FX market under control in the near future. Yet, significant scheduled reduction of foreign financial aid is the main macro risk for the country beyond 2025.

Chart 5. Key balance of payment components, $m

Financial account turns negative in January

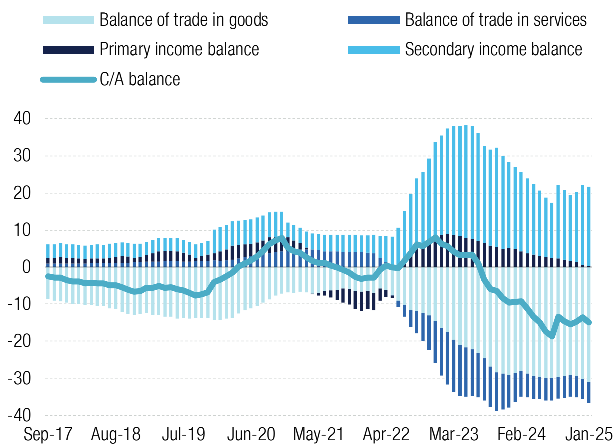
	Jan 2025	Dec 2024	Jan 2024
Current account	**-2,292**	**464**	**-871**
Trade in goods	-2,396	-3,896	-1,577
Trade in services	-594	-358	-438
Primary income	-135	133	287
incl. migrant income	544	617	691
Secondary income	833	4,585	857
incl. transfers to gov't	378	3,563	193
Financial account*	**-1,343**	**-2,637**	**1,021**
Change in trade credits	-558	544	44
Change in cash out of banks	1,674	1,530	1,576
Net loans to government	-3,037	-5,268	-321
Other	578	557	-278

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

Source: NBU, ICU.

Chart 6. Current account, 12-month trailing, $bn

12-month current account balance stabilized



Source: NBU, ICU.

NBU reserves down 6.7% in February

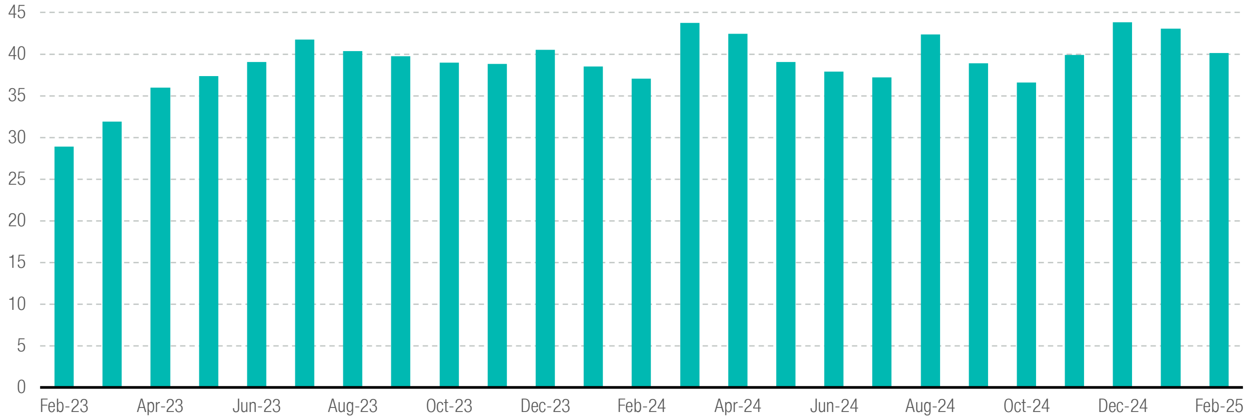
Gross international reserves of the NBU were down 6.7% in February to US$40.1bn, as inflows of foreign financial aid was not scheduled for the month.

The NBU had to sell net US$3.0bn to cover the shortage in the FX market and ensure the hryvnia exchange rate remains relatively stable. Also, the government and the NBU repaid about US$0.8bn to foreign official creditors, including the IMF. Ukraine did not receive any foreign financial aid in February, but a positive revaluation of reserves yielded US$0.7bn.

ICU view: A pause in inflows in foreign financial aid is not a concern as all major sources of inflows through end-2025 remain confirmed. Ukraine is expected to receive over US$35bn this year, primarily via the ERA mechanism and Ukraine Facility. This will help ensure that the NBU reserves remain in the range of US$40-45bn through the year, and the NBU is well equipped to keep the hryvnia exchange rate under full control. Yet, attention is now shifting to the potential size of foreign aid in 2026, and commitments at this point are substantially smaller beyond 2025.

Chart 7. NBU gross international reserves, US$bn

NBU gross reserves decline on lack of foreign aid



Source: NBU, ICU.

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