Focus
Ukraine

Markets
Domestic liquidity, government bonds, FX market, and macro

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Weekly Insight

GDP falls dramatically in 1Q22

Key messages of the today's comments

Ukrainian bond market

Bond market frozen waiting for new price signals

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Eurobond prices continue to decline

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Foreign exchange market

FX market stabilizing

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Economics

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MONDAY, 13 JUNE 2022

Banks' reserves market (10 June 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	25.00	+0bp	+1,750bp
ON rate (%)	9.76	+0bp	+259bp
Reserves (UAHm)[2]	80,656	-19.33	+86.02
CDs (UAHm)[3]	140,524	+19.27	-10.52

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) (10 June 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	498,606	+16.33	+57.15
Banks	539,261	-0.59	+6.91
Residents	73,859	-0.21	+65.53
Individuals	29,170	+0.39	+78.05
Foreigners[1]	72,422	+0.03	-32.05
Total	**1,213,521**	**+5.82**	**+22.65**

Source: NBU, ICU.

FX market indicators (10 June 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	29.5327	+0.97	+8.95
EUR/USD	1.0519	-1.87	-13.57
DXY	104.148	+1.97	+15.62
UAH TWI[1]	138.003	+0.28	+13.15

Notes: [1] UAH trade-weighted index.
Source: Bloomberg, ICU.

Market gov't bond quotes[1] (13 June 2022)

Maturity	Bid	Ask
6m	…	…
12m	…	…
2y	…	…
3y	…	…
12m ($)	…	…
2y ($)	…	…

Source: ICU.

READ FIRST THE DISCLOSURES SECTION (ON LAST PAGE) FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATION

Ukrainian bond market

Bond market frozen waiting for new price signals

MinFin hiked the rate on bonds sold to the NBU last week. This move fuelled investors' expectations that an increase in interest rates for bills in the primary market will follow.

Last week, demand at the primary auction fell to UAH856m (US$29m). The state budget received only UAH810m (US$27.4m), but interest rates have not changed since the beginning of martial law (for more details, see the auction review). It was the lowest amount of funds raised via a primary auction since the full-scale russian invasion.

Since rates on bonds remained unchanged despite the NBU’s hike in key policy rate, the activity in the secondary market shrank. The number of deals slid by about 10% compared with the previous week, but the volume declined more than fourfold, from UAH906m (US$31m) to UAH231m (US$8m) for bonds in local currency.

ICU view: The Ministry of Finance reiterated early last week that it considers military bills to be a tool that investors choose to support the country during the wartime rather than a tool that guarantees investors market yields. The gap in expectations of the MoF and investors prompted a decrease in purchases of paper whose yield remained unchanged from the week before.

Given the significant budget deficit and shrinking volume of new placements, the MoF had to raise more funds from the NBU. On Thursday, the NBU purchased military bonds worth UAH70bn (US$2.4bn), so the total amount of bonds purchased by the central bank since the beginning of the war increased to UAH190bn (US$6.5bn). New bonds sold to the NBU carry a floating annual coupon linked to the NBU key policy rate. Thus, it is likely that in June next year, the realized yield will exceed 20%. This level is now indicative for investors.

Demand from banks and private investors for new placements will likely remain low if yields do not rise. Banks will buy only symbolic volumes of securities simply to be present in the auction and meet the requirements they have as primary dealers rather than implement an investment strategy.

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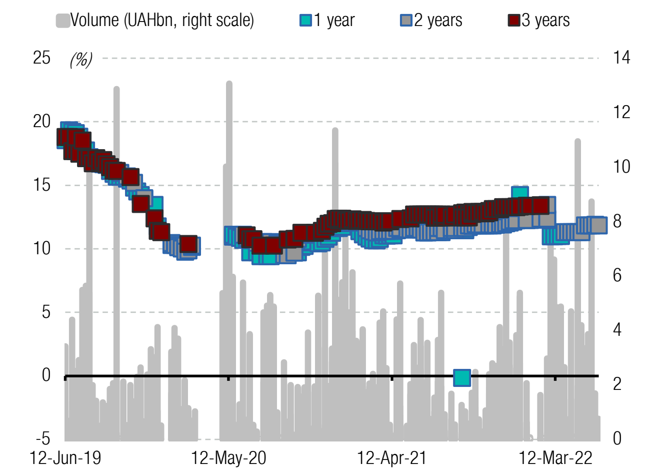
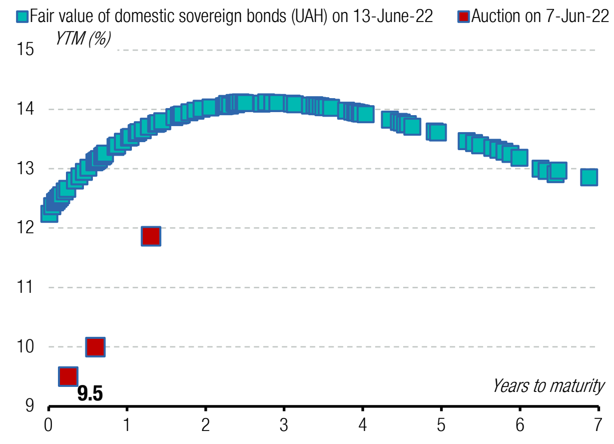
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

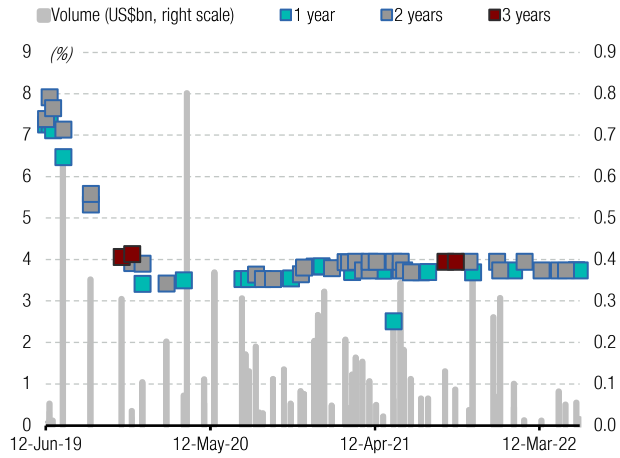
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

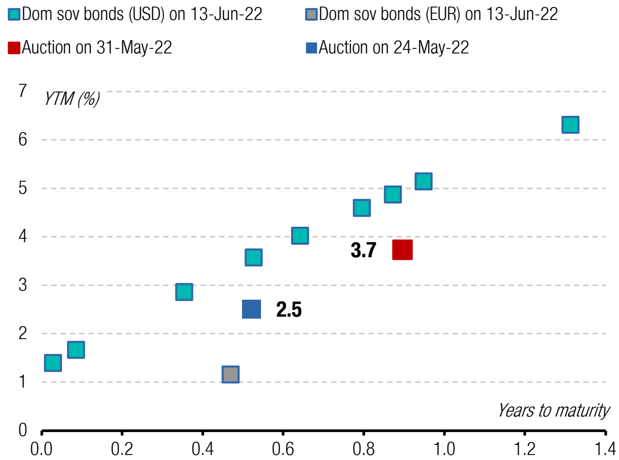
Chart 2. FX-denominated bonds

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



Source: MFU, ICU.

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



Source: NBU, MFU, ICU.

Eurobond prices continue to decline

The lack of news about the prospects of ending the war keeps pressure on Ukrainian Eurobond prices.

Over the past week, prices of all Eurobonds and VRIs slid again. Eurobonds maturing in 2025 fell by almost three cents, while instruments maturing in 2024 and 2028 declined by slightly less by two cents. The rest of Eurobond prices slid by less than two cents, and only Eurobonds due this September edged down half a cent and last Friday was priced at almost 70 cents. VRIs, which at the end of last week was priced at less than 37 cents, also lost less than a cent.

ICU view: In general, the situation in the Ukrainian Eurobond market remains unchanged. Investors are closely monitoring news from the front, and in the absence of positive news, prices continue to correct.

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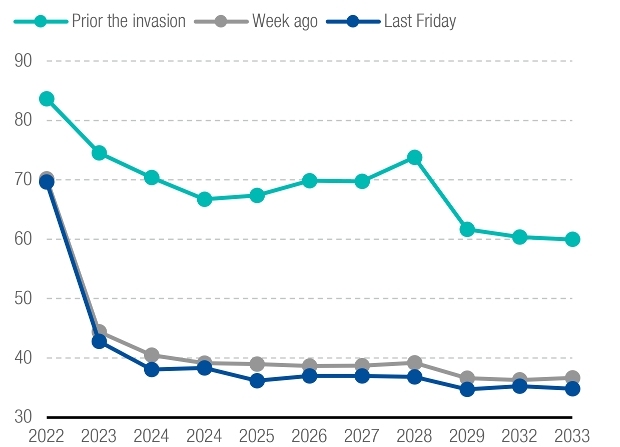
Chart 3. Ukrainian Eurobonds prices

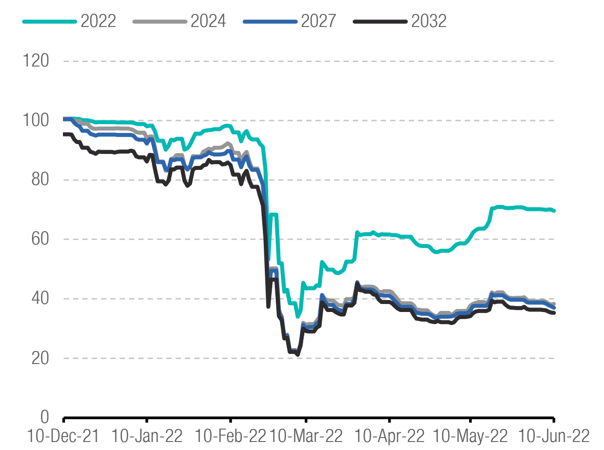
SPrices of USD-denominated Eurobonds as of last Friday, a week ago and prior the russian invasion



Source: Bloomberg, ICU.

Chart 4. Prices of selected Ukrainian Eurobonds

Last six-month historical data



Source: Bloomberg, ICU.

Foreign exchange market

FX market stabilizing

Last week, the FX market remained broadly stable both in the interbank and cash segments after the NBU eased some of its exchange regulations for the retail market.

In the interbank market, the volume of hard currency sales by banks and the NBU remained almost unchanged at close to US$200m per day. At the same time, NBU interventions slightly declined from US$827m to US$775m per week, which means that banks could increase the sale of hard currency.

The cash exchange rate set by banks did not change at all and remained in the range of UAH34.5–35.5/US$. The exchange rate for credit card transactions remained almost unchanged at UAH30–33/US$.

ICU view: Generally, the FX market remains relatively stable in all segments. The cash market already seems to have fully adjusted to current regulations. In the absence of important news, it should maintain equilibrium at current levels.

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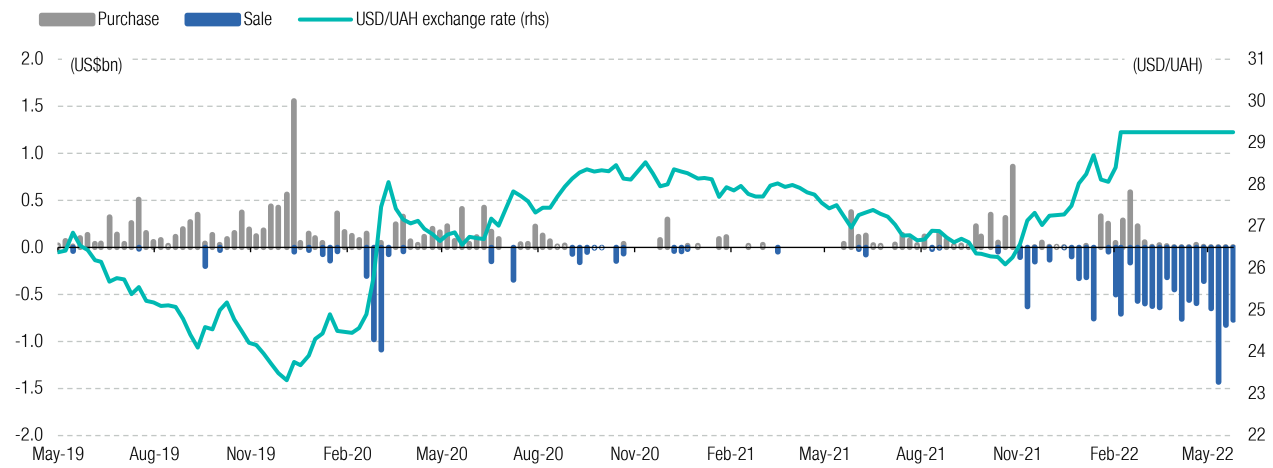
Chart 5. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Inflation reaches 18% in May

Annual inflation reached 18.0% YoY in May, up from 16.4% in April. Core CPI accelerated to 13.8% YoY from 13.0%.

The key drivers of a rapid consumer inflation remain unchanged: surging food prices and fuel prices. The two consumer basket components that restrain CPI growth are clothes and utilities. The prices for the latter continue to decelerate as government kept gas and electricity tariffs for households unchanged for the past 12 months.

ICU view: The May CPI reading indicates inflationary pressures remain strong, and we reconfirm our projection of CPI reaching the 25–30% range in autumn. The key inflation drivers remain on the supply side as delivery of many goods and services is complicated by impaired logistics. Surging fuel prices and a deficit of gas add cost

pressures across the board. We expect inflation in Ukraine to pick up further and remain elevated above 20% through end-2023 as the economy is adjusting to supply-side shocks and heightened exchange rate risks.

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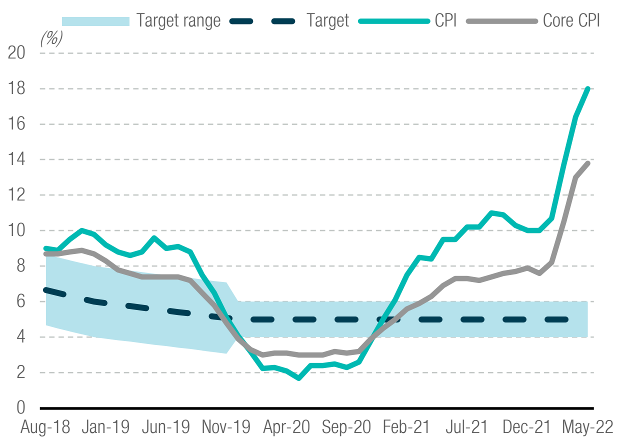
Chart 6. CPI, core CPI and target, YoY, %

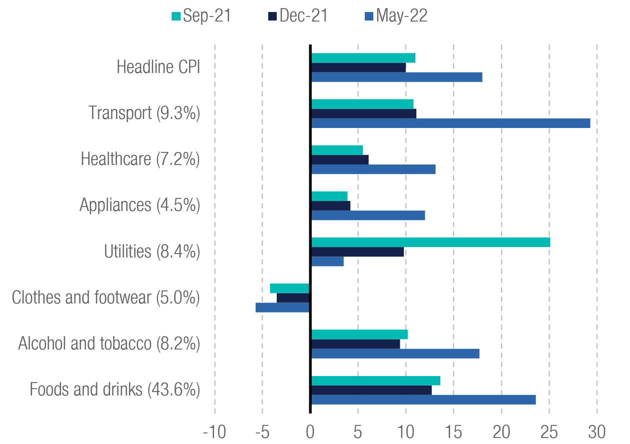
Inflation keeps accelerating



Source: Ukrstat, NBU, ICU.

Chart 7. CPI and its main components, YoY, %

Food prices, expectedly, remain the key inflation driver



Source: Ukrstat, ICU.

GDP falls dramatically in 1Q22

In 1Q22, Ukraine's GDP shrank 19.3% QoQ in seasonally-adjusted terms and 15.1% YoY.

ICU view: The numbers are fully in line with preliminary estimates released by the Ministry of the Economy in April. The 15.1% YoY decline for the full 1Q22 implies that GDP fell by 45–50% YoY in March, the first full month when economy suffered severe contraction due to russia's invasion of Ukraine. GDP recovered only moderately since March. We expect real GDP contraction of 35–45% YoY for the full 2022 depending on whether Ukraine will be able to improve its export capacities via railroads.

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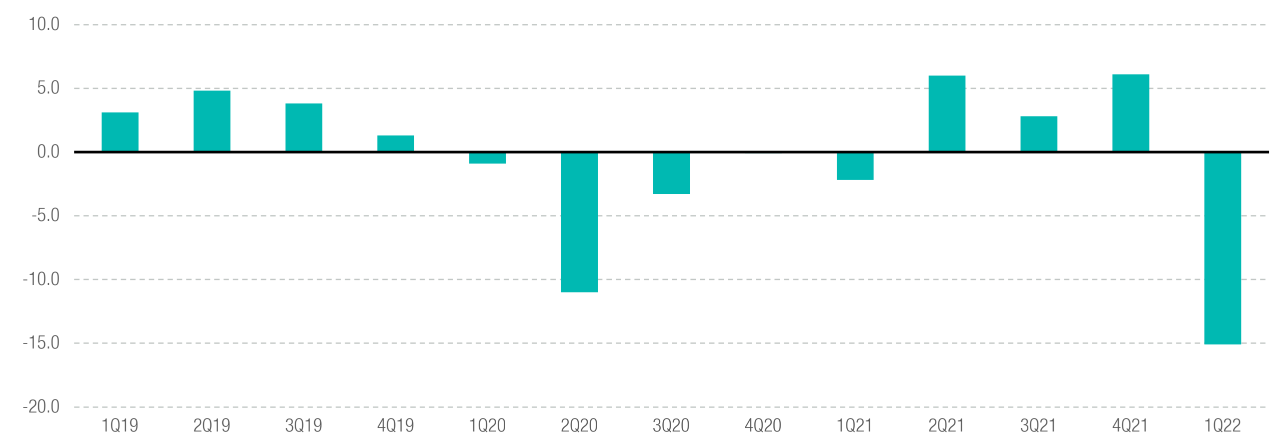
Chart 8. Change in quarterly real GDP, YoY, %

Economy contracted dramatically in 1Q22



Source: Ukrstat, ICU.

NBU reserves down 6.8% in May

The NBU gross international reserve declined 6.8% to US$25.1bn in May.

The central bank had to sell net US$3.4bn in the interbank market to meet excessive demand that was likely driven by widening trade in goods deficit and the continued strong demand for FX cash from households. The NBU indicated that withdrawal of FX cash abroad from hryvnia card accounts remained strong in May. Inflows of international aid was not impressive in May at just US$1.7bn, including EUR0.6bn from the WB and EUR0.6bn from the EU.

ICU view: We expect the significant deficit of hard currency will persist in the interbank market in the foreseeable future. Demand for FX is recovering faster than supply as export remains depressed due to logistical bottlenecks. The NBU will thus have to keep selling its reserves to keep the market balanced. We expect the central bank will seriously consider adding some flexibility to hryvnia exchange rate in autumn to let the hryvnia gradually depreciate and alleviate at least a part of the excessive demand. We also expect the NBU reserves will recover somewhat by the end of the year thanks to growing inflows of international financial aid.

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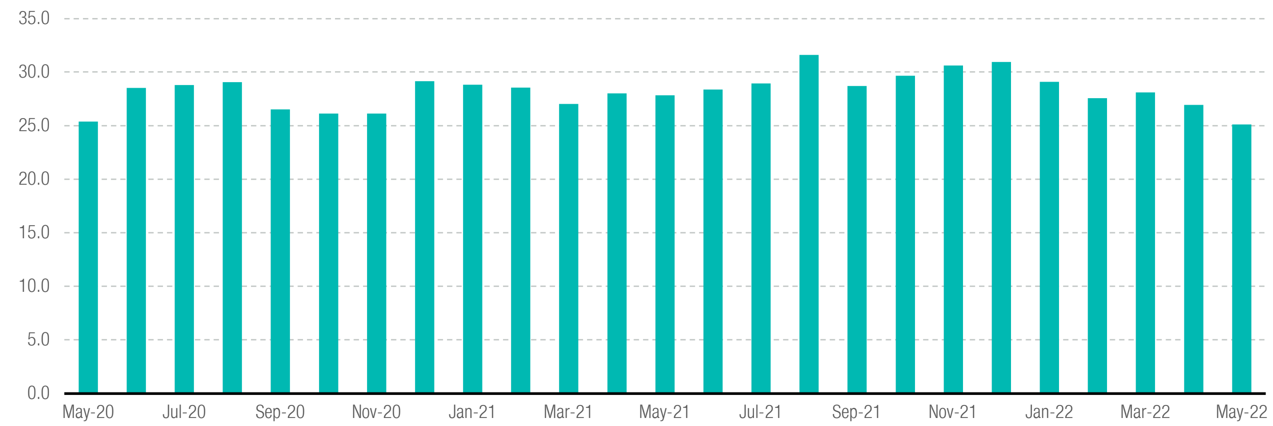
Chart 9. NBU gross international reserves, US$bn

NBU reserves fell significantly in May



Source: NBU, ICU.

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