

# Weekly Insight

## Public debt up significantly in May

### Key messages of the today's comments

MONDAY, 4 JULY 2022

### Ukrainian bond market

#### Bond placements sluggish in June

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#### Eurobond prices close to minimums

Over the past week, Ukrainian Eurobonds lost another 6 to 13% in price and are almost at the lows recorded in the first 10 days after the full-scale russian invasion.

### Foreign exchange market

#### NBU interventions increased to US\$4bn

Without noteworthy news last week, the USD/UAH exchange rate remained steady.

### Economics

#### Ukraine's public debt up significantly in May

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#### External misbalances grow in May, the BoP data indicate

Ukraine's current account (C/A) stayed in surplus in May even though trade balance deteriorated significantly.

### Banks' reserves market (1 July 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) <sup>1</sup>	25.00	+0bp	+1,750bp
ON rate (%)	9.76	+0bp	+326bp
Reserves (UAHm) <sup>2</sup>	55,801	+29.75	-6.72
CDs (UAHm) <sup>3</sup>	189,245	-5.37	+20.56

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) (1 July 2022)

	Last	Weekly chg (%)	YoY chg (%)
NBU	531,106	-38.14	+4.04
Banks	526,633	+2.24	+6.58
Residents	66,847	+16.32	+66.19
Individuals	28,677	+4.02	+58.27
Foreigners <sup>1</sup>	71,241	+5.26	-32.29
<b>Total</b>	<b>1,224,911</b>	<b>-14.54</b>	<b>+5.02</b>

Source: NBU, ICU.

### FX market indicators (1 July 2022)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	29.5444	+0.46	+8.06
EUR/USD	1.0414	-1.32	-12.12
DXY	105.138	+0.91	+13.54
UAH TWI <sup>1</sup>	138.794	+0.10	+12.34

Notes: [1] UAH trade-weighted index.

Source: Bloomberg, ICU.

### Market gov't bond quotes<sup>1</sup> (4 July 2022)

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

Source: ICU.

# Ukrainian bond market

## Bond placements sluggish in June

During June, the Ministry of Finance borrowed significantly less than it redeemed on the domestic market. Financing needs were thus covered by borrowing from the NBU and by international aid.

MinFin repaid US\$503m in USD-denominated bills in June while borrowing only US\$297m, implying a 59% rollover rate last month. Since the beginning of the year, US\$792m of redemptions have not been refinanced.

The refinancing of June's redemptions in euros was even lower: while repaying EUR132m, the MinFin managed to attract only EUR54.5m for a rollover rate of 41%. Therefore, since the beginning of the year, the government failed to rollover EUR229 million in the domestic market.

Refinancing of redemptions in hryvnia deteriorated the most. In June, the MoF was able to borrow just UAH6.1bn (US\$200m) in local currency. So, even with UAH2.6bn received on 1 June after the last auction in May, the rollover rate stood at just 35%. In general, more than UAH38bn of the redeemed hryvnia debt has not been refinanced YTD.

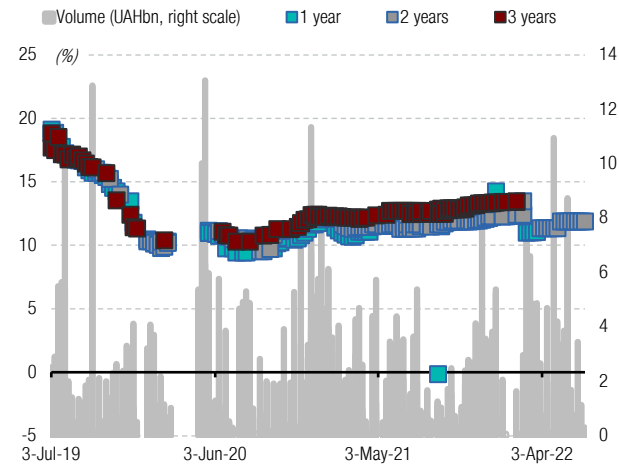
Investor activity in the secondary market also declined. After almost 90,000 deals worth over UAH 13 billion concluded in May, in June, the number of deals fell by nearly two-thirds to almost 35,000 deals, and the volume decreased almost fourfold to just UAH 3.4 billion.

***ICU view: After the NBU sharply increased the key policy rate, the Ministry of Finance decided to review the terms of government bonds issued to the NBU and tied their yield to the key policy rate. At the same time, the conditions for bills offered to other investors remained unchanged. This decreased demand for hryvnia bonds in the primary market as well as trading in the secondary market. Further, if yields on T-bills remain in the range of 9.5–11.5%, demand will be muted, implying the budget gap will be patched with loans from the NBU and assistance from international partners. The NBU providing a significant part of financing is an extremely undesirable scenario for the economy. At the same time, we maintain the opinion that an upward revision of yields on military bills will be only a matter of time.***

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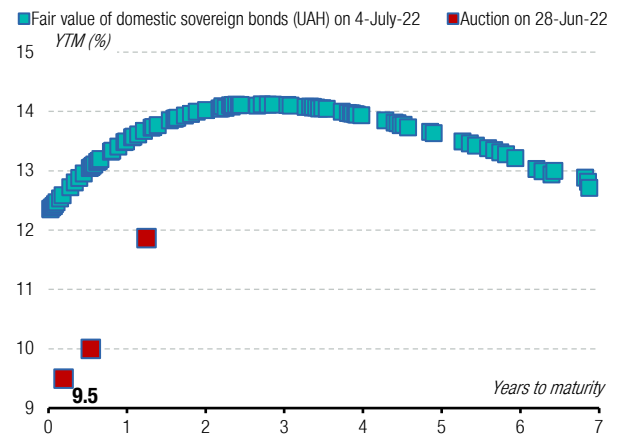
**Chart 1. Local-currency bonds**

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



Source: Ministry of Finance of Ukraine, ICU.

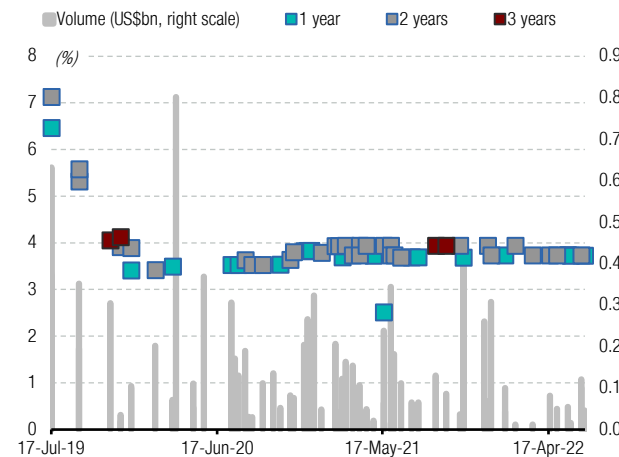
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

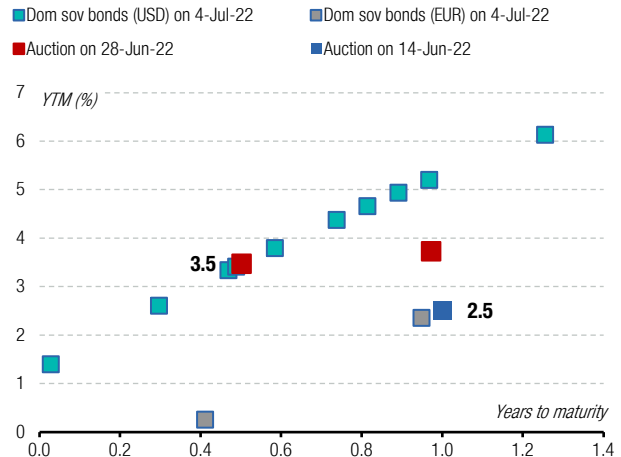
**Chart 2. FX-denominated bonds**

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



Source: Ministry of Finance of Ukraine, ICU.

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



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

**Eurobond prices close to minimums**

Over the past week, Ukrainian Eurobonds lost another 6 to 13% in price and are almost at the lows recorded in the first 10 days after the full-scale russian invasion.

During the week, prices gradually decreased by several cents, which, due to the low prices, resulted in a rather sharp relative decrease by 6–13%. Almost all Eurobonds lost 2–4 cents; only Eurobonds maturing in two months fell by more than 8 cents. So now, Eurobonds are mostly priced at 26–27 cents, which is slightly higher than prices recorded on 7 March. Only Eurobonds maturing in September of this year are priced significantly higher at 54 cents, or as much as 20 cents more than in March.

VRI prices fell the least, by one cent or 3%, and were trading at 27 cents per dollar of notional value last Friday.

**ICU view: Ukrainian Eurobonds remain under general market pressure as investor interest to high-yielding debt is very limited. By the end of the last week, the market was digesting a rumour that the government is in talks with the largest holders of**

**Ukraine's debt about potential restructuring. While no clear signals were given about the possible outcome of such talks and future government actions, it provided yet another warning that the balance of pros and cons of restructuring are not static and may shift quickly both ways under rapidly changing conditions.**

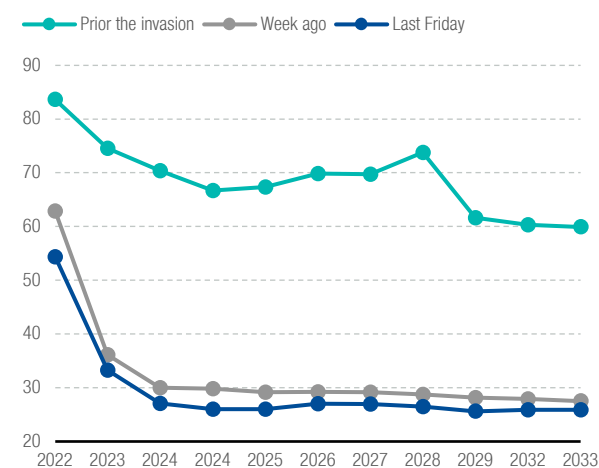
**Ukraine's Prime Minister noted in a recent [interview](#) that government will monitor financial situation until September, when significant redemption of Eurobonds is due but he did not provide any further details. At the same time, he said Ukrainian government would be grateful if Ukraine's partners proposed ways to solve Ukraine's debt issues.**

**Check our "[Eurobonds: Pros and Cons of Restructuring](#)" dated 20 June for more analysis.**

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**Chart 3. Ukrainian Eurobonds prices**

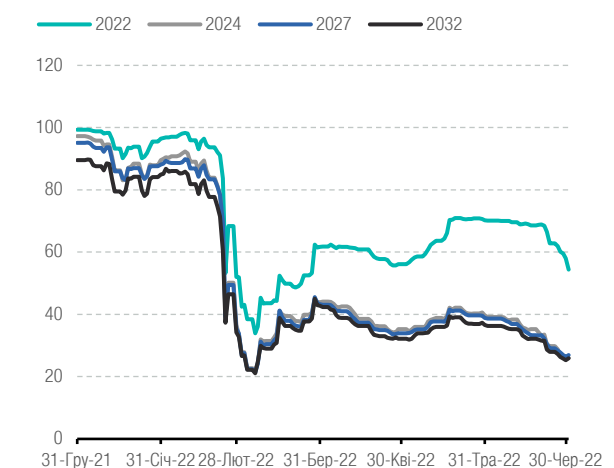
*Prices of USD-denominated Eurobonds as of last Friday, a week ago and prior the russian invasion*



Source: Bloomberg, ICU.

**Chart 4. Prices of selected Ukrainian Eurobonds**

*Last six-month historical data*



Source: Bloomberg, ICU.

## Foreign exchange market

### NBU interventions increased to US\$4bn

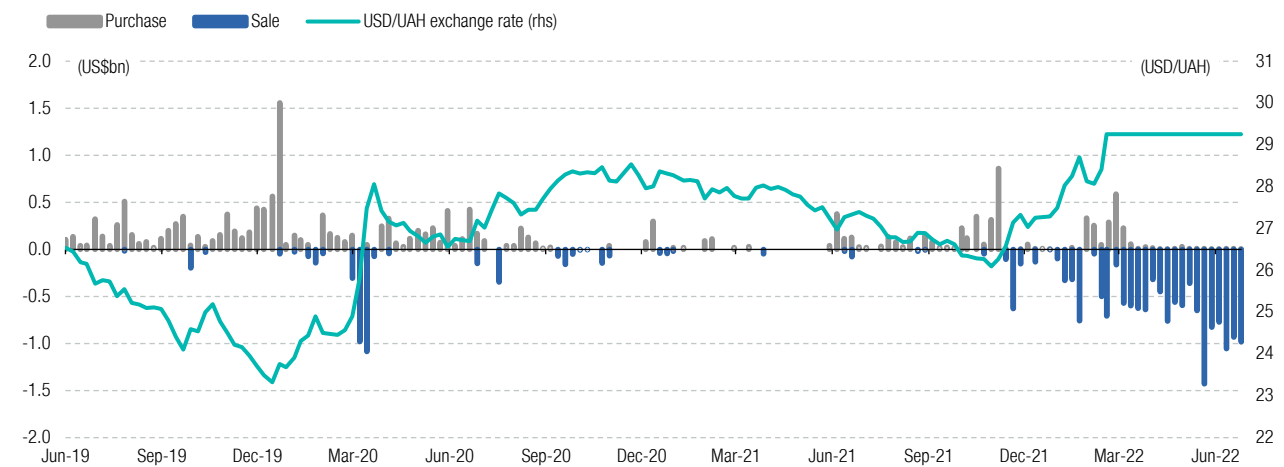
Without noteworthy news last week, the USD/UAH exchange rate remained steady.

The cash market exchange rate fluctuated at UAH34.7–35.5/US\$ for almost all of last week, but weakened a little closer to the weekend to UAH34.9–35.6/US\$. The exchange rate for card transactions even strengthened a little from UAH30.2–32.9/US\$ to UAH30.1–32.8/US\$.

With regard to the interbank market, the demand for hard currency remains high in the FX market. In June, the NBU sold almost US\$4 billion, or US\$600m more than US\$3.4bn sold in May. This compares even more unfavourably with net sales in April at US\$2.2bn and in March at US\$1.8bn

### 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.

**ICU view:** USD/UAH exchange rate in the cash FX market is rather steady with minor fluctuations, which indicate a temporary balance of demand and supply of cash among retail clients. At the same time demand for hard currency for import purchases was elevated in June since parliament reintroduced import taxation since 1 July. Importers bought FX to increased supplies to Ukraine before taxes were in place. Such increased demand was mostly covered with the NBU interventions.

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## Economics

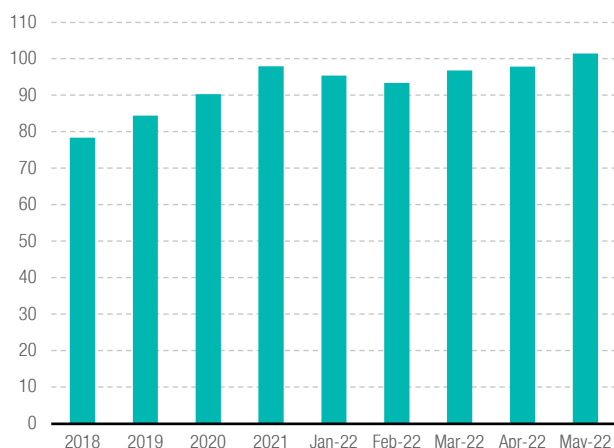
### Ukraine's public debt up significantly in May

Ukraine's public debt increased 3.7% in May to \$101.4bn.

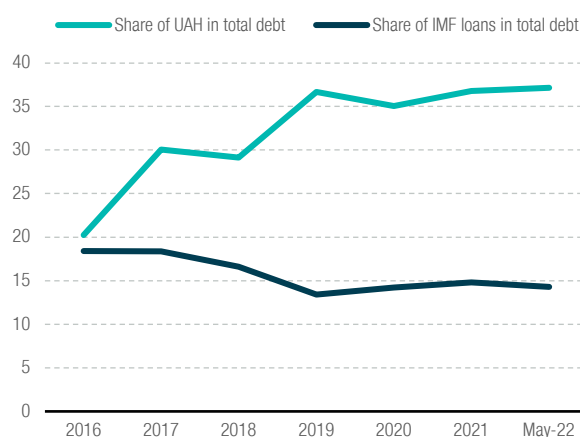
Almost two thirds of the increase were driven by domestic borrowings, largely due to the NBU's heavy purchases of government bonds in May. The rest came in as borrowings from the World Bank and the EU. Government faced minimal redemptions of external debt in May.

**ICU view:** Ukraine's public debt is poised to continue its rapid growth through end-2022 as Ukraine's allies stepped up their financial support to patch the country's fiscal gap of about \$5bn per month. We estimate about a third of total support will be in the form of grants while the rest will be provided in the form of concessional loans. In domestic market the borrowings will be dominated by direct sale of hryvnia bonds to the NBU. We thus expect Ukraine's public debt will exceed \$120bn by the end of 2022, with debt-to-GDP ratio exceeding 90%.

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**Chart 6. Ukraine's public debt, \$bn***Public debt increased 3.7% in May*

Source: MoF, ICU.

**Chart 7. Share of UAH and IMF loans\* in total debt, %***The share of hryvnia slightly up in May on NBU's purchases of debt*

\* includes IMF SDR allocation

Source: MoF, ICU.

## External misbalances grow in May, the BoP data indicate

Ukraine's current account (C/A) stayed in surplus in May even though trade balance deteriorated significantly.

Ukraine's trade-in-good deficit worsened substantially in May as the decline in exports remained broadly unchanged vs April while imports narrowed the YoY decline to just 25% in May from 47% in April. Balance of trade in services also remained deeply negative as Ukrainian refugees maintained high expenditures abroad that are recorded as imports of services according to BoP methodology. The widening trade balance was offset with robust migrant remittances as well as grants and humanitarian aid provided to Ukraine. The C/A balance ended at \$0.1bn in May and \$0.4bn in a 12-month period to May.

Financial account remained deeply negative at \$2.1bn with drivers largely unchanged since the start of Russia's invasion of Ukraine. The major driver is an increase in FX cash out of the banking sector – this is primarily driven by the withdrawal of FX cash from hryvnia cards by Ukrainian refugees abroad. The second most important driver is an increase in trade credits vs non-residents. Those were only partly offset with government borrowings from IFIs and foreign governments.

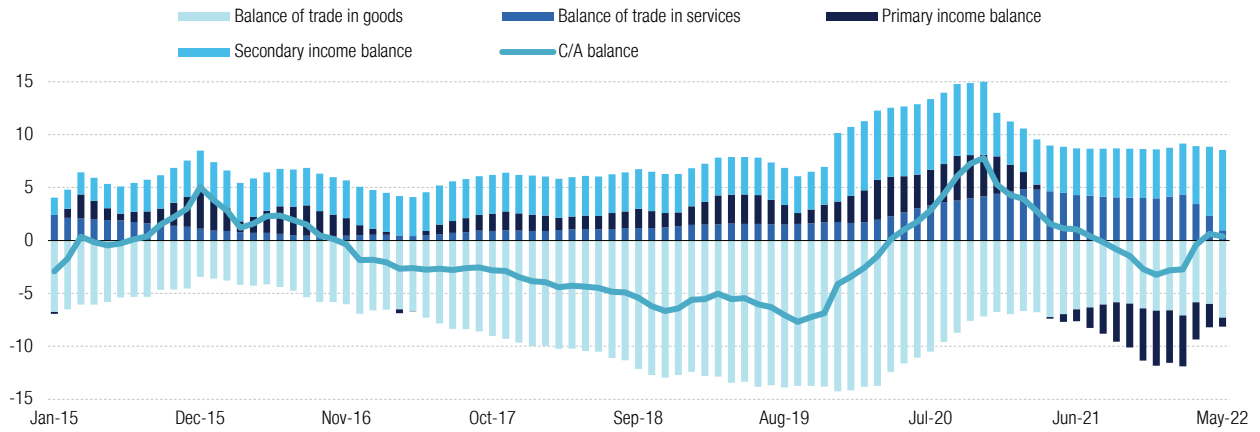
Overall, the combined balance of C/A and F/X was deeply negative at \$1.9bn in May and was offset with the sale of FX reserves by the NBU.

**ICU view: The BoP statistics remains deeply alarming as it indicates the external misbalances are accumulating at an unprecedented pace. Fortunately, they don't have immediate implications for the economy thanks to strong financing support provided by Ukraine's allies in the form of grant and loans. The committed financial assistance is sufficient enough to cover the misbalances over the next couple of months. However, given the size and persistence of misbalances, the NBU may decide to gradually add flexibility to the FX market in the coming months to let the hryvnia depreciate and partly alleviate the gap.**

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**Chart 8. Current account, 12-month trailing, \$bn**

*Current account remains in hefty surplus thanks to grants from foreign governments*



Source: MoF, ICU.

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