Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

NBU significantly eases FX restrictions

Key messages of the today's comments

MONDAY, 6 MAY 2024

Ukrainian bond market

UAH bond rates fall sharply

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Investors expect more restructuring news

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Foreign exchange market

NBU significantly eases FX restrictions

Last Friday, the NBU eased some of its toughest FX restrictions.

FX trading increases

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Economics

Current account reasonably negative in 1Q24

In March, the current account deteriorated significantly vs 2M24 on a surge of trade-in-goods deficit and lower official grants to government.

Ukraine's public debt surges in March

Ukraine's public debt surged 5% in US$ terms in March to US$151bn.

Banks' reserves market (3 May 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	13.50	+0bp	-1,150bp
ON rate (%)	13.50	+0bp	-650bp
Reserves (UAHm)[2]	241,037	+49.4	+33.2
CDs (UAHm)[3]	539,085	-13.0	+26.3

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) (3 May 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	677,990	+0.0	-2.4
Banks	684,241	-2.2	+28.7
Residents	161,173	+1.3	+38.9
Individuals	60,283	-2.4	+65.0
Foreigners	41,395	-1.0	-21.5
Total	**1,626,540**	**-0.9**	**+13.4**

Source: NBU, ICU.

FX market indicators (3 May 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	39.4122	-0.6	+6.7
EUR/USD	1.0761	+0.2	-2.7
DXY	105.030	-0.5	+3.6

Source: Bloomberg, ICU.

Market gov't bond quotes (6 May 2024)

Maturity	Bid (%)	Ask(%)
6 months	17.00	14.50
12 months	17.50	16.00
2 years	19.00	17.00
3 years	19.75	18.00
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

UAH bond rates fall sharply

The NBU's decision to reduce its interest rates by 1pp resulted in an immediate and sharp decline in interest rates on UAH bonds.

Last week's primary auction followed the NBU's decision to cut the key policy rate and interest rates for CDs by 1pp. In addition, it was the last time the MoF offered bonds due in April 2025 and July 2027, as the total issuance limit of UAH20bn was about to be reached. Therefore, all offered bonds were oversubscribed, and demand exceeded the cap by two to three times. Due to high competition, interest rates declined by 55–70bp. See details in the auction review.

The secondary bond market also reacted to the NBU's decision and MoF's cutting rates in the primary bond market. YTMs declined by 50–70bp. The most traded (about 30% of total trades in UAH bonds) was a 12-month paper, which the MoF sold in recent weeks. Total turnover rose by 25% to UAH9.2bn.

ICU view: The bond market immediately reacted to the NBU's decision to cut its rates. Although the MoF will offer new 12-month and three-year instruments tomorrow, due in June 2025 and August 2027, we expect a significant demand as investors will be in a hurry to reinvest last week's redemption. However, we do not expect substantial changes in interest rates in the primary market. Most likely, the MoF will reduce interest rates gradually in the following weeks, and the next significant change in interest rates is only likely following NBU's rate decision in mid-June.

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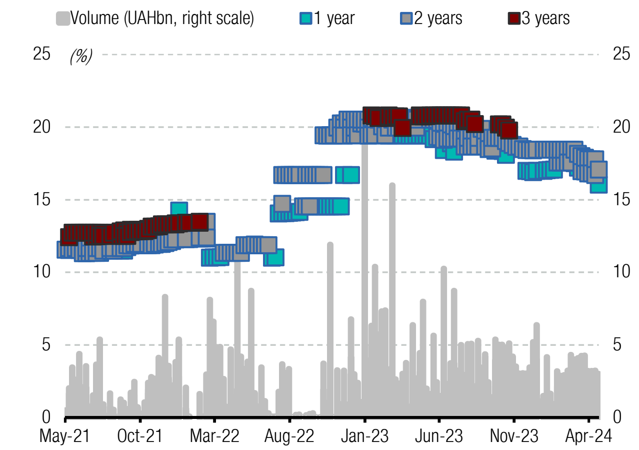
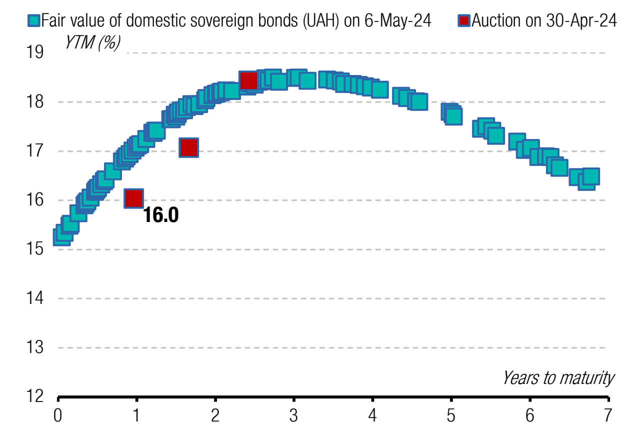
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

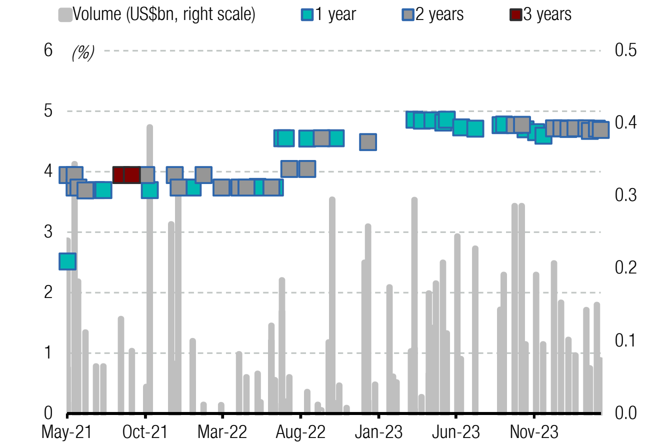
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

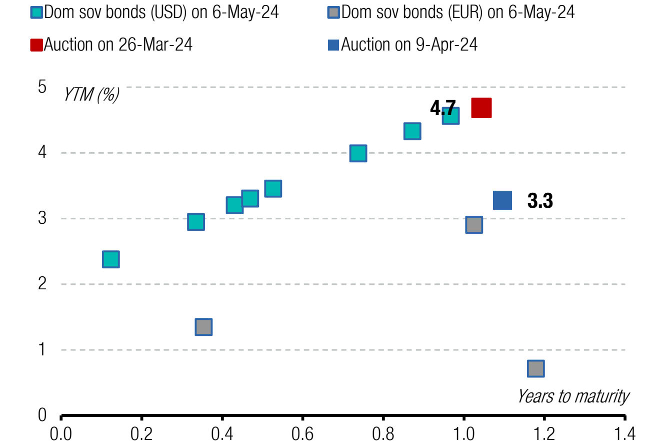
Chart 2. FX-denominated bonds

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.

Investors expect more restructuring news

Last week, there was no major news for bondholders. Therefore, Eurobond prices remain almost unchanged from the previous week.

Prices moved only slightly in different directions depending on maturity. Eurobonds due in 2024–2026 become cheaper, while prices for bonds due in 2027–2035 rose slightly. The range of prices for instruments with different maturities narrowed to 26.2–32.3 or 10.3%. The price of VRIs remains unchanged at 54 cents on a dollar of notional value. The EMBI index rose by 0.8% last week.

ICU view: Investors expect the MoF to launch negotiations and send its proposals for debt restructuring in the coming weeks. At this point, nothing is known about to what extent a downside DSA scenario from MEFP will shape the proposed restructuring terms. Over the weekend, mass media reported that a group of several of the largest creditors, which own about a fifth of Eurobonds outstanding, came up with their own expectations of the terms of the restructuring. They will agree to a haircut only in exchange for resumption of coupon payments. In the coming weeks, Eurobond prices will depend on rumours and assumptions about potential restructuring terms that the Ukrainian government may offer.

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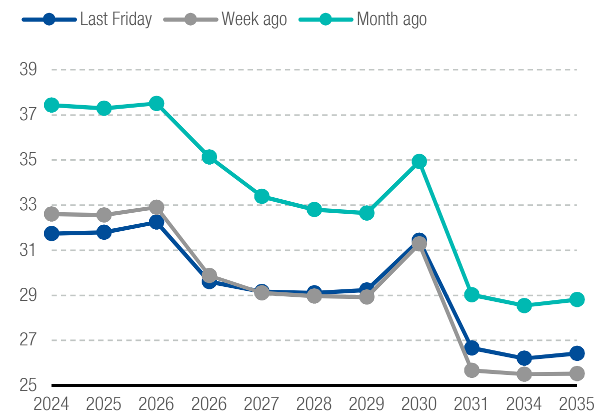
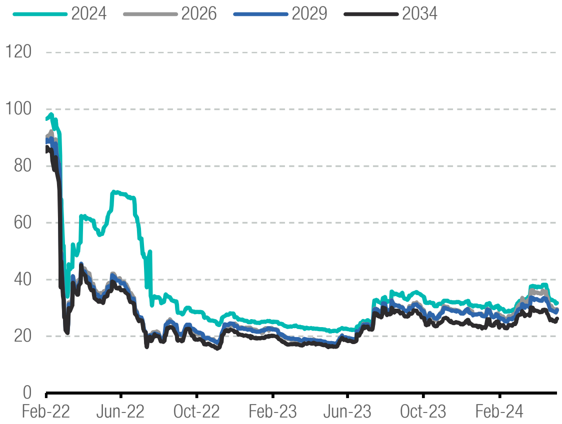
Chart 3. Ukrainian Eurobonds prices

Prices of USD-denominated Eurobonds as of last Friday, two weeks and a month ago



Source: Bloomberg, ICU.

Historical data since February, 2022



Source: Bloomberg, ICU.

Foreign exchange market

NBU significantly eases FX restrictions

Last Friday, the NBU eased some of its toughest FX restrictions.

NBU allowed businesses to buy hard currency for payments for import services, payments of penalties, and membership fees. It also allowed the repatriation of dividends based on the results of operations after January 1, 2024, but the amount is limited to EUR1m per month. Also, the NBU has completely removed restrictions on transferring funds to pay for leases or rent.

In addition, the NBU has simplified the terms of payments for "new" loans (where funds were received after June 20, 2023), allowing the purchase of foreign currency for the repayment of at least one-year loans, while previously such payments were allowed only for three-year loans. The NBU also allowed businesses to buy foreign currency to pay interest on "new" loans with any maturity. Finally, the NBU allowed residents to transfer funds abroad to pay interest payments on "old" external loans that were due after February 24, 2022. However, the volume of such payments is limited to EUR1m during one calendar quarter.

ICU view: This is the most significant relaxation of capital controls by the NBU since the beginning of russia's full-scale invasion. The regulator decided to take this step only after the largest aid packages from international partners, specifically from the EU and the USA, were finally confirmed. The NBU expects that its international reserves may grow this year even though the demand for hard currency may rise following relaxation of FX restrictions. Almost every step in the liberalization of the FX market has built-in prevention mechanisms as the NBU set monthly or quarterly limits on FX purchases and repatriation. At the same time, an increase in demand for foreign currency due to the easing of FX restrictions may lead to slightly higher volatility of the hryvnia exchange rate against world currencies.

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FX trading increases

Amounts of hard currency purchases and sales increased last week while the NBU decreased its interventions slightly.

In the interbank FX market, trading increased while imbalances hardly changed. Bank clients (legal entities) purchased US$1bn (3% more than in the same period of the previous week) in four business days, while sales rose by 7% to US$840m. Net purchase of hard currency slid by 11% to US$160m.

In the retail segment, the net purchase of hard currency rose by 34% to US$133m.

Despite a slight increase in the hard-currency deficit, the FX market required lower NBU interventions, which slid by 5% to US$508m.

The official appreciation of the exchange rate was 0.5% to UAH39.4/US$ last week, and the cash rate in systemically important banks strengthened by 0.3% to UAH39.3–39.9/US$.

ICU view: The interbank FX saw an increase in daily transactions at the end of April. However, the FX market remains in deficit and cannot function properly without the NBU interventions, which amounted, on average, to about US$100m per day last week.

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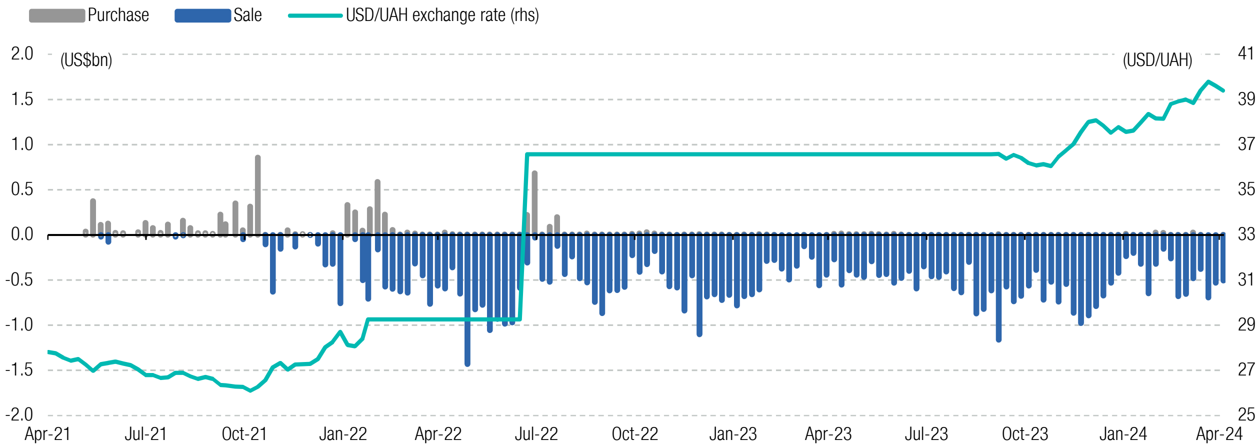
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

Current account reasonably negative in 1Q24

In March, the current account deteriorated significantly vs 2M24 on a surge of trade-in-goods deficit and lower official grants to government.

The current-account deficit widened to US$1.6bn in March taking the full 1Q24 shortfall to US$2.2bn. The deterioration was driven by a trade-in-goods deficit that widened to US$2.5bn in March from US$1.4bn in February. Overall, the trade-in-goods balance slightly improved in 1Q23 vs 1Q23 thanks to active cargo shipments through the Black Sea transit corridor. Another major hit to the C/A in March came due to a lack of grant financing to the Ukrainian government. In 1Q24, official transfers to the government declined US$1.6bn from US$4.2bn in 1Q23.

The financial-account balance saw significant net inflows of funds in March after two consecutive months of deficit. The change was driven by loans that government received following a two-month pause in Jan-Feb. This took the 1Q24 financial account balance to US$5.4bn, only slightly below US$5.6bn recorded in 1Q23. As inflows of funds via the financial account significantly exceeded the C/A deficit in 1Q24, NBU reserves increased 8% over the quarter to US$43.8bn.

ICU view: Recently, we marginally revised our projections of Ukraine's external accounts. We expect the full-year C/A deficit at 7.8% of GDP vs 5.2% in 2023. Nevertheless, we expect the C/A shortfall will remain fully covered with the inflow of funds via the financial account thanks to concessional loans to the government. That implies the NBU reserves will grow this year, and the NBU will have sufficient resources to keep the FX market under its total control.

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Chart 5. Key balance of payment components, $m

Financial account surplus twice exceeds C/A deficit in 1Q24

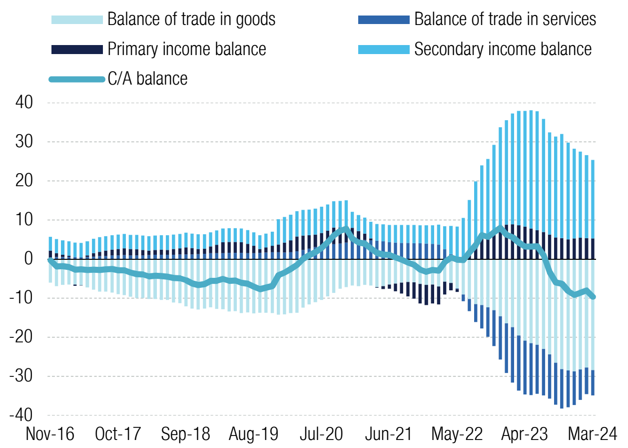
	1Q24	4Q23	1Q23
Current account	-2,198	-3,095	-1,758
Trade in goods	-5,584	-8,271	-5,907
Trade in services	-1,431	-1,599	-3,556
Primary income	1,348	1,967	1,332
incl. migrant income	2,427	2,667	3,084
Secondary income	3,469	4,808	6,373
incl. transfers to gov't	1,576	2,455	4,168
Financial account*	-5,316	-3,040	-5,598
Change in trade credits	-1,276	741	-1,985
Change in cash out of banks	4,116	3,685	3,256
Net loans to government	-8,066	-7,399	-7,066
Other	-90	-67	197

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

Source: MoF, ICU.

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

12-month current account balance keeps deteriorating



Source: NBU, ICU.

Ukraine's public debt surges in March

Ukraine's public debt surged 5% in US$ terms in March to US$151bn.

A rapid increase in public debt was due to heavy external borrowings as government received concessional funding from Ukraine's key allies after they managed to complete their internal domestic approval procedures. The largest contribution to the stock of public debt came on the back of an EU loan for EUR4.5bn, a loan from Japan for USD1.6bn, and a loan from Canada for US$1.5bn.

ICU view: An upsurge in the stock of public debt in March was expected as Ukraine received large loans that were being finalised by its allies over the course of Jan-Feb. Ukraine's public debt will continue to grow substantially as the economy remains reliant on international financial aid. We see the public debt-to-GDP ratio raising to 92% by the end of 2024 from 84% at the end of 2023. The potential write-down of sovereign Eurobonds will provide a partial relief for the economy in terms of its debt burden.

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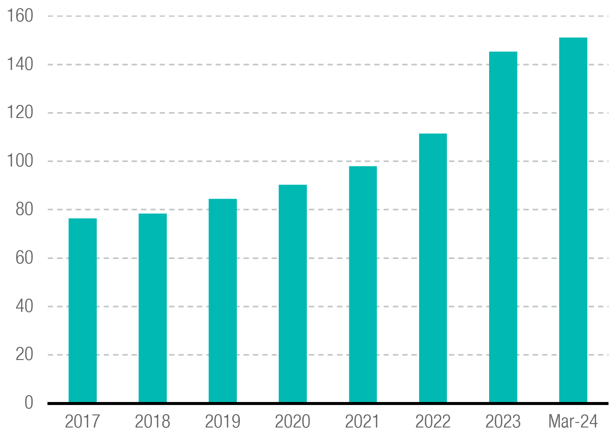
Chart 7. Ukraine's public debt, $bn

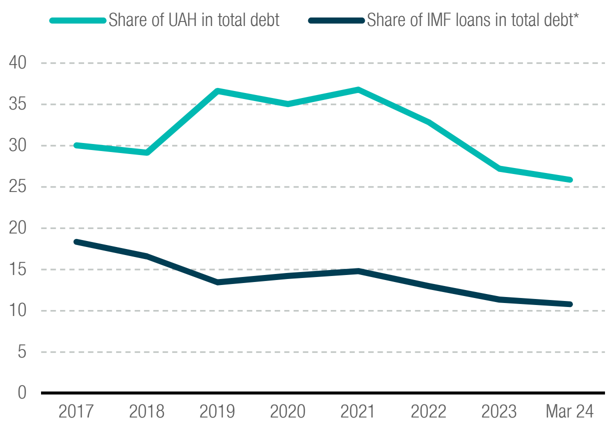
Public debt surges 5% in March



Source: MoF, ICU.

Chart 8. Share of UAH and IMF loans* in total public debt, %

Share of hryvnia debt continues to decline due to external borrowings



* includes IMF SDR allocation

Source: MoF, ICU.

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