Focus
Ukraine

Markets
Government bonds, FX market, and macro

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Weekly Insight

NBU reserves down 4% in February

Key messages of the today's comments

MONDAY, 11 MARCH 2024

Ukrainian bond market

MoF in no rush to rollover FX debt

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Investors remain in optimistic mood

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Foreign exchange market

FX market balance improving further

Due to further improvements in the FX market, NBU's weekly interventions fell to the lowest amount for 11 months.

Economics

NBU reserves down 4% in February

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Banks' reserves market (8 March 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%)[1]	15.00	+0bp	-1,000bp
ON rate (%)	15.00	+0bp	-800bp
Reserves (UAHm)[2]	218,092	-2.0	+23.6
CDs (UAHm)[3]	533,399	-4.5	+45.8

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) (8 March 2024)

	Last	Weekly chg (%)	YoY chg (%)
NBU	682,490	+0.0	-2.1
Banks	667,796	-0.1	+29.2
Residents	149,597	+4.4	+35.9
Individuals	58,329	+3.0	+75.5
Foreigners	43,520	+0.6	-22.0
Total	**1,603,849**	**+0.5**	**+13.2**

Source: NBU, ICU.

FX market indicators (8 March 2024)

	Last	Weekly chg (%)	YoY chg (%)
USD/UAH	38.2500	+0.4	+3.5
EUR/USD	1.0939	+0.9	+3.7
DXY	102.712	-1.1	-2.8

Source: Bloomberg, ICU.

Market gov't bond quotes (11 March 2024)

Maturity	Bid (%)	Ask(%)
6 months	17.00	15.00
12 months	18.00	17.00
2 years	19.25	18.25
3 years	20.00	19.00
12 months ($)	5.00	4.50
2 years ($)	N/A	N/A

Source: ICU.

Ukrainian bond market

MoF in no rush to rollover FX debt

Last week, the Ministry of Finance raised only US$62.7m, keeping the FX debt refinancing level YTD almost unchanged vs previous weeks.

At last Tuesday's primary auction, the MoF raised above UAH5bn in UAH bonds for the fifth consecutive week. At the same time, the demand for USD-denominated bills was only US$64.2m. The Ministry rejected a small fraction of it due to high rates and attracted US$62.7m. See details in the auction review. With these proceeds, the Ministry refinanced only 45% of the USD-denominated paper redeemed at the end of February.

At the same time, trading in FX-denominated bills intensified in the secondary market. The total volume of FX-denominated securities trades increased fourfold to an equivalent of UAH3.8bn last week, and the share of FX-denominated bond trading in the secondary market increased to 51% from 12% a week before. The most traded securities were USD-denominated bills maturing this September (64%) and euro bonds maturing in May 2024 (15% of all FX-denominated bills transactions). Bills maturing this year made up almost 96% in FX-denominated trading.

The MoF will redeem UAH16bn of UAH bonds this week, and will offer only UAH instruments tomorrow with maturities of one, two, and three years. The cap is set at UAH4bn for each paper.

ICU view: YTD, the MoF has raised UAH38.2bn in hryvnia bonds, which exceeds repayments by UAH20.6bn. However, investors and the Ministry are in no hurry to fully refinance FX-denominated debt. The Ministry does not wish to sell short-term bills due this year and keeps offering instruments maturing not earlier than in spring of 2025. The government likely expects to reach 100% rollover rate for FX instruments later this year. Investors currently prefer short-term instruments in the secondary market and are in no rush to buy one-year instruments in the primary market.

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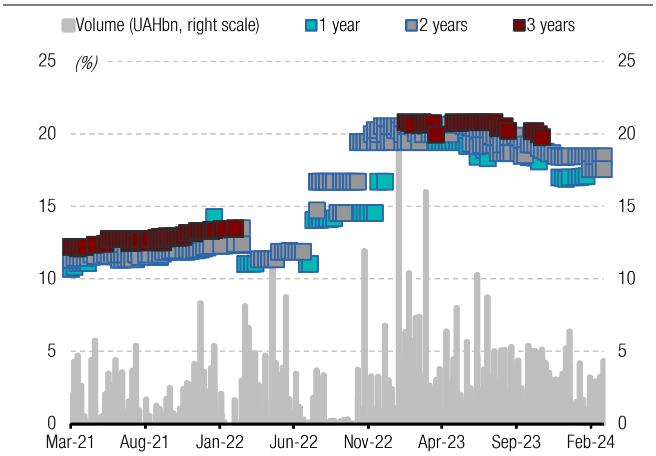
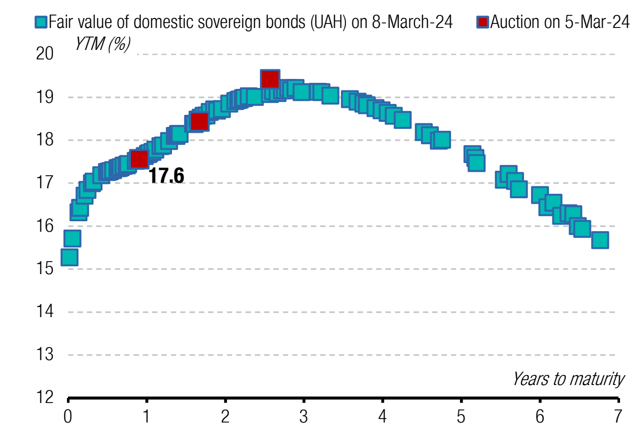
Chart 1. Local-currency bonds

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



Source: MFU, ICU.

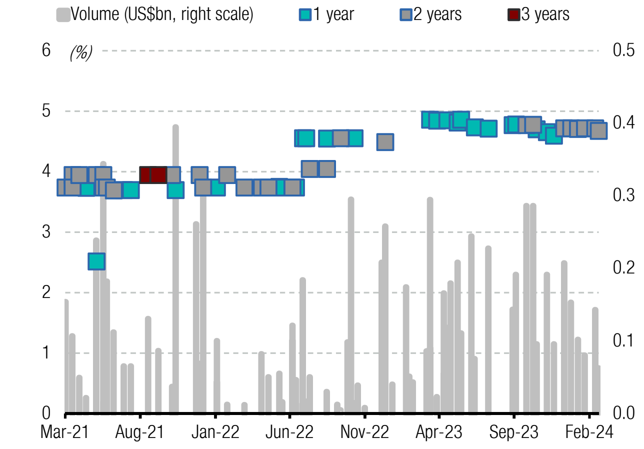
YTMs of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: NBU, MFU, ICU.

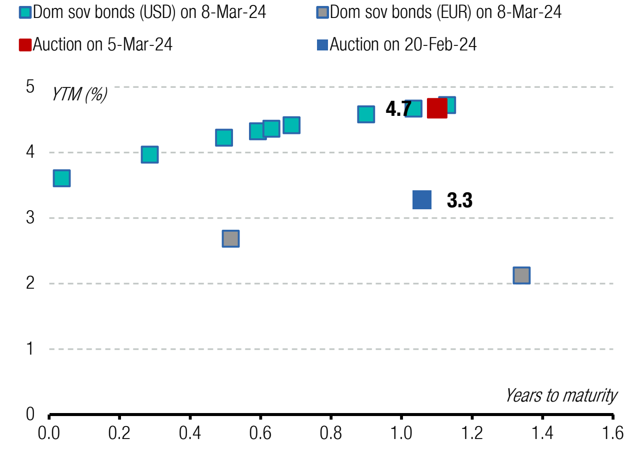
Chart 2. FX-denominated bonds

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 remain in optimistic mood

The rally in the Ukrainian Eurobond market continued last week. Eurobond prices rose, while the range of prices for different maturities narrowed.

Ukrainian Eurobond rose by an average of 7.3%. The price range shifted during the week to 29–35 cents, and it narrowed to 9.1%. The price of VRIs increased by 1.8% to almost 48 cents per dollar of notional value. The EMBI index increased by 1.1% last week.

ICU view: Last week, investors' anticipation of the launch of debt restructuring negotiations continued to have an impact on sentiment for Eurobond holders. Although there is no new information on potential restructuring terms, investors have reacted positively to signals that the government will likely carry out a full-fledged restructuring and not extend the deferral of debt payments. The lack of news about US aid is not causing negative pressure currently, as investors expect the government to get loan tranches from the EU and the IMF in March.

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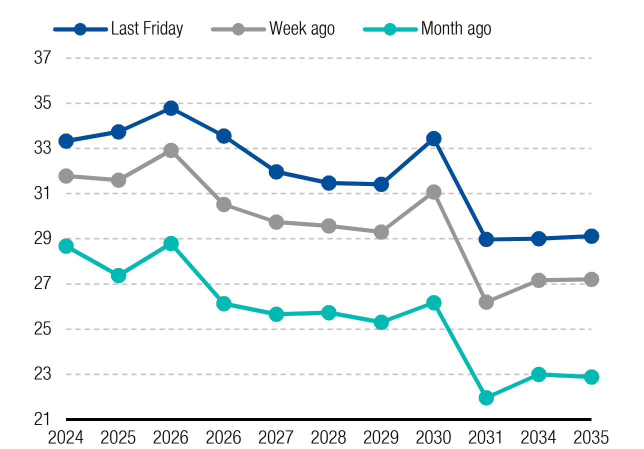
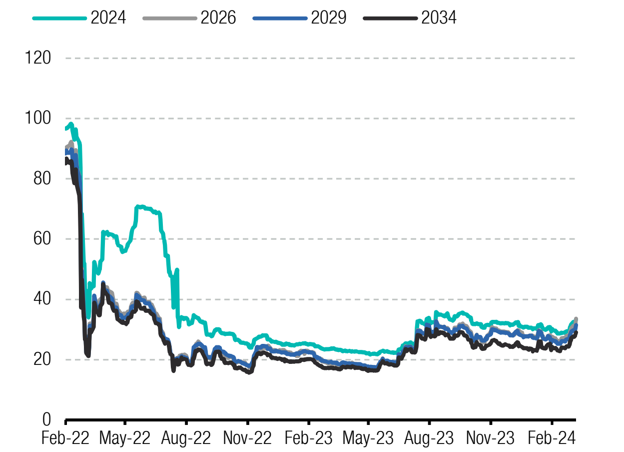
Chart 3. Ukrainian Eurobonds prices

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

FX market balance improving further

Due to further improvements in the FX market, NBU's weekly interventions fell to the lowest amount for 11 months.

In the interbank FX market last week, supply exceeded demand. Bank clients (legal entities) sold US$1bn of hard currency and purchased only US$896m (for four business days), or 7% more and 1% less than in the same period of the previous week. As supply exceeded demand for the second week, the NBU again reduced its interventions and sold only US$157m, the smallest volume in 11 months. However, despite much lower interventions, the official exchange rate remained almost unchanged.

At the beginning of the month, net purchases of foreign currency in the retail market increased 10% to US$145m. However, the cash exchange rate in systemically important banks remained at UAH38.0–38.6/US$.

ICU view: Stable net FX sales by bank clients' allowed the NBU to significantly reduce interventions in the interbank FX market. The NBU allows the hryvnia exchange rate to fluctuate within one per cent range. Despite improvements in the FX market the NBU did not allow the exchange rate to strengthen to below UAH38/US$.

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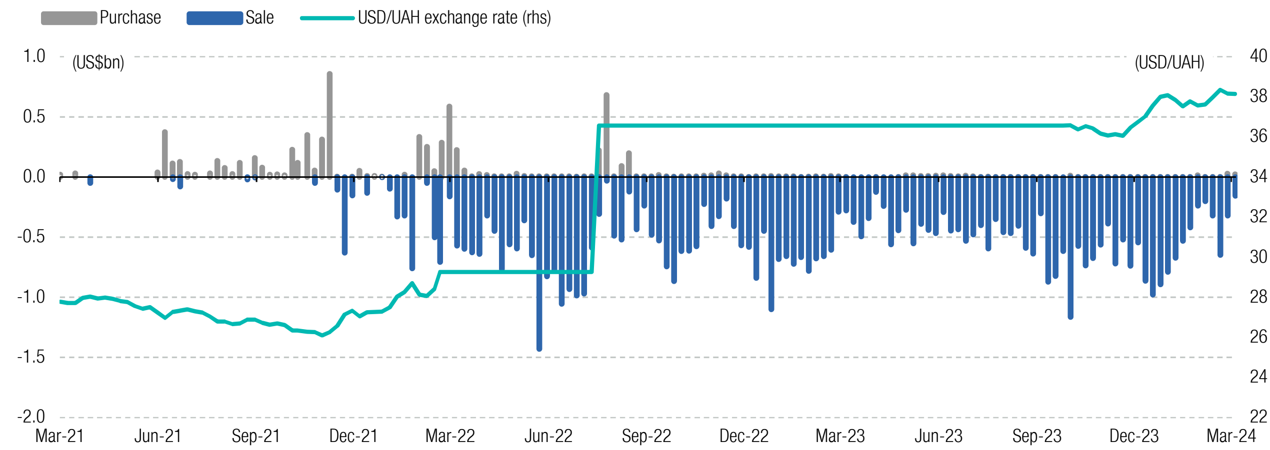
Chart 4. FX market indicators, 3-year history

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



Source: NBU, Bloomberg, ICU.

Economics

NBU reserves down 4% in February

NBU gross international reserves decreased 3.8% in February and 8.5% YTD to US$37.1bn as inflow of foreign financial aid remains insignificant.

The decline in reserves was driven by NBU sale interventions in the FX market that totalled net US$1.5bn in February. Also, Ukraine repaid nearly US$0.7bn of principal and interest to IFIs. Meanwhile, the government received US$0.8bn in grants from Japan and Norway, which replenished NBU reserves. Net FX borrowings in the domestic market were negative at US$0.3bn.

ICU view: The decline in NBU reserves in February was well expected since lending to Ukraine from its allies was put on hold as the EU continued to finalize its formal approval procedure for Ukraine Facility and the US Congress remained in discussions over the Ukraine aid package. Yet, the declining reserves trend will be reversed in March as Ukraine is set to receive a EUR4.5bn loan tranche from the EU and a US$0.9bn loan tranche from the IMF following successful completion of the third program review in February. Overall, we remain of the view that inflows of foreign aid to Ukraine will exceed gaps in external accounts in 2024. This means the NBU reserves will remain close to US$40bn through end-2024, and the NBU will have the needed resources to keep the FX market under control while allowing for a gradual depreciation of hryvnia.

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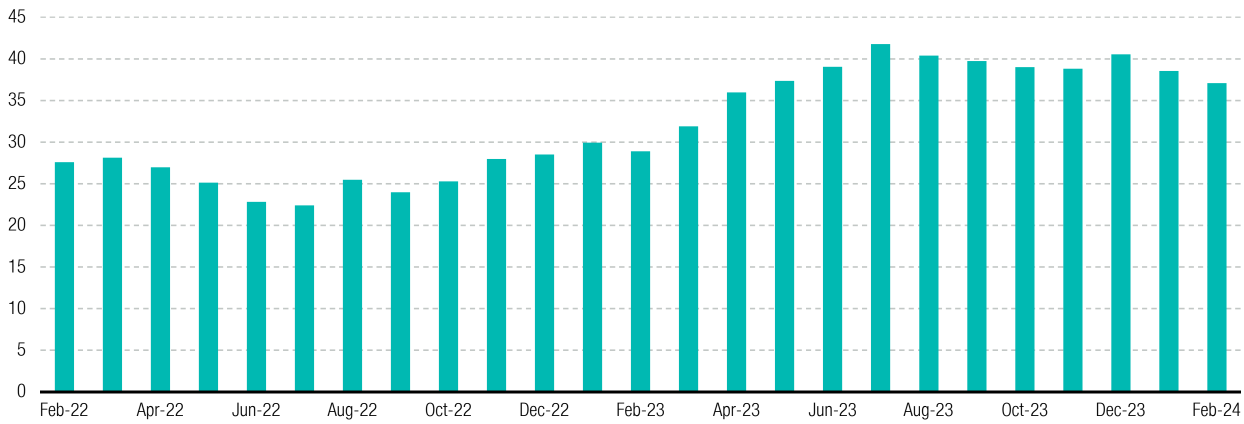
Chart 5. NBU gross international reserves, US$bn

NBU reserves down 8.5% in January-February



Source: NBU, ICU.

Inflation edges down further in February

Ukraine's annual inflation slowed further to 4.3% YoY in February from 4.7% in January.

Prices continued to decelerate practically across the board with the slowdown in prices for food being especially notable. The only exceptions were prices for transportation, which accelerated in February driven by high cost of motor fuels, and prices for hotels and restaurants.

ICU view: The continued deceleration in consumer prices is an outcome of several favorable factors. Firstly, last year's bumper harvest keeps domestic agricultural market more than saturate. Secondly, relatively stable exchange rate prevents increase in prices for imported goods. Also, administratively regulated utility tariffs have remained little changed over the past 12 months. We expect CPI will accelerate close to 10% in 2H24 due to normalization of agricultural harvest and a gradual depreciation of hryvnia. Nevertheless, it's safe to say that inflationary risks will remain relatively low in the foreseeable future. Given the above and also a stable FX market, we see some room for a further reduction in the NBU key policy rate by 2pp to 13% by end-2024.

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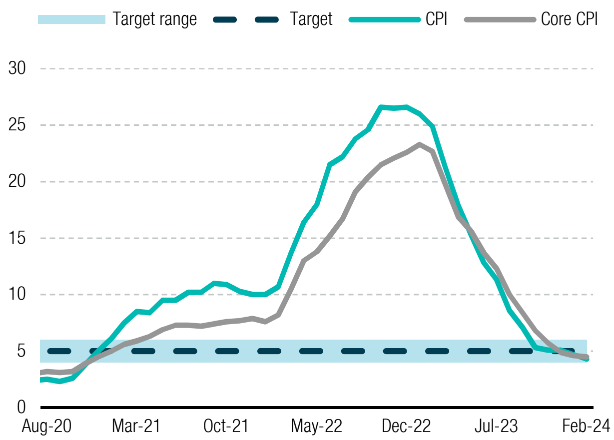
Chart 6. CPI, core CPI and target, YoY, %

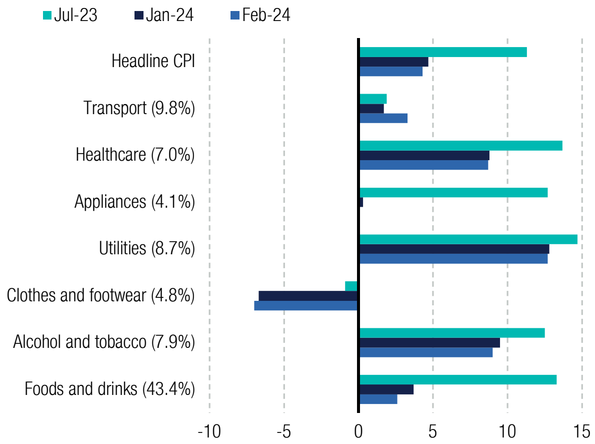
Inflation slows to 4.3% in February



Source: Ukrstat, NBU, ICU.

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

Consumer prices continue to slow down across the board



* numbers in brackets indicate the share of the component in consumer basket

Source: Ukrstat, ICU.

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