



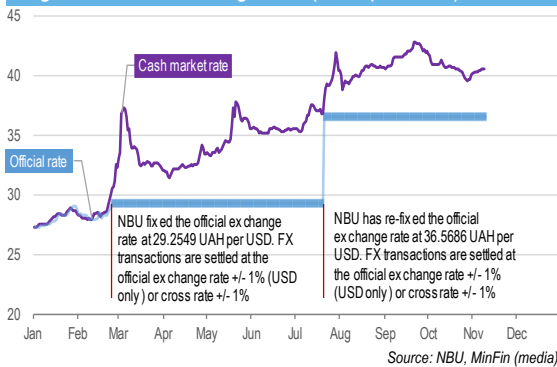
**ECONOMICS | INTEREST RATES | FX MARKETS**

15 November 2022

**UKRAINIAN  
CAPITAL MARKETS  
REVIEW**

	Rating	Outlook	Last update	This week in focus: Budget 2023: Don't get your hopes up
Fitch	CC	-	17.08.2022	The Ukrainian parliament approved the 2023 draft budget with a record deficit of USD38bn. In terms of revenue, the state budget looks achievable under normal conditions, but not robust enough when considering the war consequences. While no monetary funding is projected, other middle-ground solutions might be required, including tax amendments and UAH depreciation.
S&P	CCC+	STABLE	19.08.2022	
Moody's	Caa3	NEGATIVE	20.05.2022	
R&I	CCC	NEGATIVE	27.07.2022	

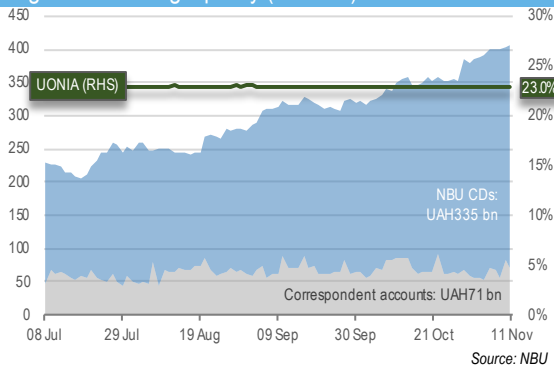
Figure 1. UAH exchange rate (UAH per USD)



FX and interest rates: USD/UAH remains below 41.0 as NBU steps in

The USD/UAH pair hovers around the 40.5 figure on the cash market, little changed since early October. **The apparent stabilization may be attributed to the latest actions by the NBU**, stepping up its efforts to get a grip on this market segment. Since early September, the central bank has been effectively providing the banking system with cash FX liquidity (USD493.6bn and EUR113mn were converted from cashless to cash). The NBU has also tightened control over non-banking currency exchanges and made a few amendments to its provision, allowing banks to sell cashless FX to individuals for the purpose of making term deposits.

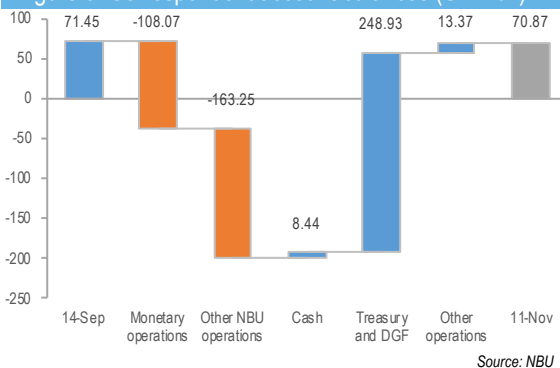
Figure 2. Banking liquidity (UAH bn)



The central bank's efforts quite succeeded. More than UAH20bn (roughly USD500mn at the cash market rate) of paper hryvnia returned into the banking system over September-October. The amount is unprecedentedly high, not to mention the short period in which that happened. While there might have also been some seasonal patterns behind the inflow, as well as some economic effects of the war – because of massive job loss, cash savings are increasingly spent – we assume it has mostly to do with the increasing involvement of banks in FX cash exchange transactions.

**The non-cash FX market is also highly dependent on the NBU's support.** Despite the grain deal, not much of the correspondent FX revenue has returned to the county yet. FX sales by the central bank rose to USD0.87bn per week in September but then returned below USD0.5bn per week over October-November.

Figure 3. Correspondent account balances (UAH bn)



**Banking liquidity in local currency is at a new historical high.** As of the end of 10 November, the correspondent account balance was UAH70.9bn, down by UAH1bn over the two months, while the position in CDs was UAH335bn, rising by a staggering UAH89bn in the same period.

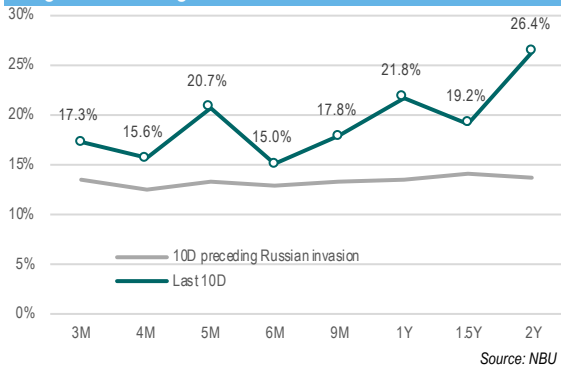
The swallowing hryvnia liquidity balance results from the continuous inflow of external financial aid. Because the war has heavily disrupted the government's revenue, most of the state budget expenditures are currently met from funds provided by foreign governments, IFIs, and other donors.

Net state treasury operations, representing public expenditures, have added some UAH240bn to total liquidity since early September. Another UAH12bn of the increase represents the contraction of cash outstanding. More than UAH160bn of hryvnia was absorbed via NBU's FX interventions.



# UKRAINIAN CAPITAL MARKETS REVIEW

Figure 4. Local government bonds in UAH

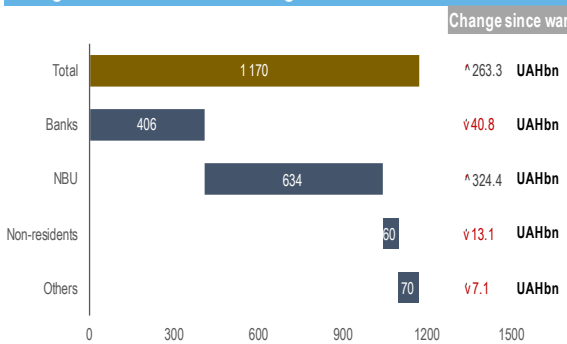


## Government bond market

**Primary public debt market has again lost demand.** After the FinMin raised UAH20bn over the three preceding to the last auctions, thanks to 1.5pp and 2.5pp concession in yield for 4m and 1.5y bonds correspondingly, demand for hryvnia-denominated public debt fell to the fresh year low last Tuesday (8 November).

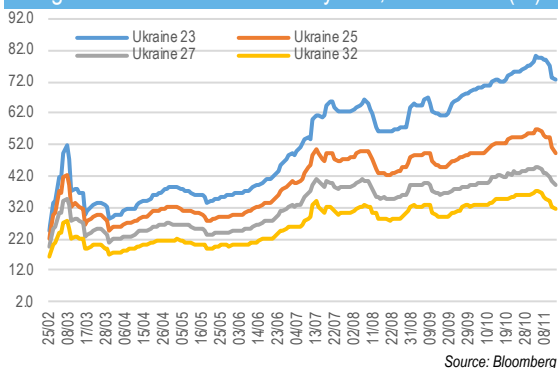
The drop might have resulted from the latest NBU's promises to revive trades in the local debt market. The new head of the central bank seems to have put off the idea of selling government bonds from its portfolio. He hinted instead of resuming endeavors to find in discussion with the FinMin a way to align primary public debt market yields with those on the secondary one. The one and half year bonds for instance are quoted on the secondary market with a yield above 19% per year versus 18.5% offered by the FinMin. And a similar spread could be observed along the curve.

Figure 5. Position in local government bonds in UAH



The next year's state budget, however, does not rely much on this source of financing. That could imply limited room for future price concessions. Foreign financial help, tax revenue, and NBU's income are supposed to be the major sources of funds. If tax proceeds remain insufficient because of continuing military operations, public debt is unlikely to find enough demand to offset the gap.

Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



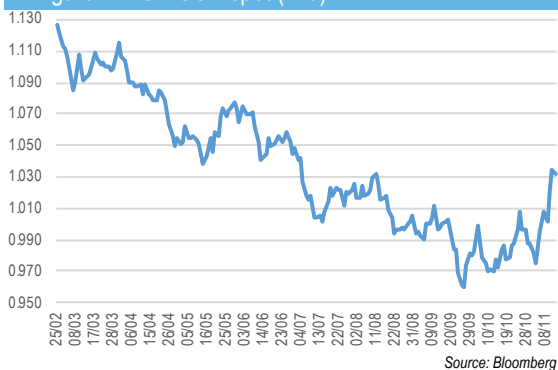
## EUR/USD: weak vs. weaker

**The EUR/USD advances for the third session in a row and flirts with the 1.03 region, an area last traded back in early July.** It is not about the strength of the euro, however, what drives the pair up, but because of a negative news background weighing on the U.S. dollar.

It started with a better-than-expected jobs statistic in the U.S., put out in early November. The surprising improvement gave rise to speculations about a potential easing in the labor market of the largest economy and subsequently to slower rate hikes in December.

The correspondent forecast gained wider acceptance across the markets following the release of U.S. inflation data, confirming the slowdown in consumer price growth beyond expectations. With the market extremely sensitive to all news that might determine December's monetary policy decision, another statistic that might provide some leeway for the Federal Reserve to moderate its rate-hiking path over the next months has sent the U.S. dollar and U.S. Treasury bond yields lower. The yield on the policy-sensitive 2-year Treasury was at 4.385% on Monday (November 14), down by 24.3bp since October's CPI release. The benchmark 10-year Treasury yield was at 3.887%, remaining below the key 4% level since then.

Figure 7. EUR USD spot (mid)



**But not all believe the euro has already fully priced in the headwinds facing the Eurozone economy.** The continuation of the hiking cycle vs. increasing recession risks dilemma concerns single currency too. Besides, market participants remain worried about the possible impact of the war in Ukraine and the persistent energy crunch on the region's growth prospects and inflation outlook.

Figure 8. State budget key assumptions

Budget 2023: Don't get your hopes up

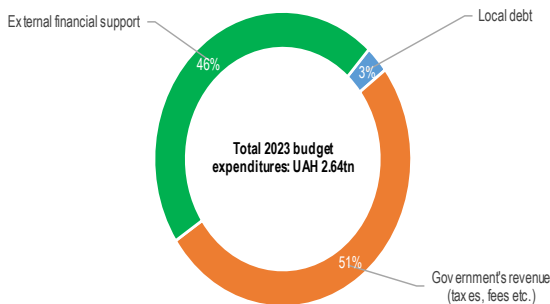
Item	2022	2023
GDP, UAHtn	4.73	6.28
GDP growth, y/y	-32.0%	3.2%
Inflation, y/y	29.3%	28.0%
Average salary, UAHth	14.0	18.3
USD/UAH (year average)	32.3	42.2

Source: FinMin

The Ukrainian parliament approved the 2023 draft budget with a record deficit of USD38bn. Government's revenues for 2023 are set to reach about UAH1.3tn, while state expenditures would amount to UAH2.6tn. Ukraine hopes to cover its budget deficit mainly by using the support from its international partners, namely the EU, the US, and the IMF.

**In terms of budget proceeds, the adopted state budget seems to be a modest one.** Taxes and fees, which typically generate up to 90% of the revenue, are projected at UAH1.15tn. That implies a 4% rise compared to the pre-war tax revenue, while inflation is expected to exceed 30% this year and remain in a double-digit zone through the end of next year. A few factors are worth mentioning, however.

Figure 9. Sources of state budget financing



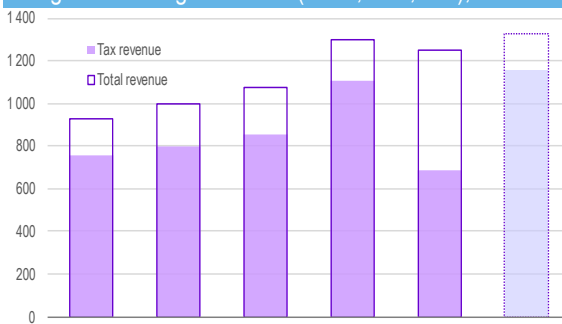
Source: FinMin

- **Many businesses incurred essential losses owing to the war**, both in terms of financial position and assets. That may result in huge tax loss carryforwards next year and revenue drops among those who remained profitable. This year's income tax flow falls behind last year's by about UAH10-20bn at times of the tax season.

- **Massive migration may also greatly affect the tax revenue.**

- **Imports remain constrained by disrupted logistics.** But for fuels, which are subject to preferential taxation, and for informal trade, imports have experienced a double-digit drop across the board this year. So contracted the correspondent tax revenue. Most of the competitive advantage from the 25% drop in the UAH value has been eroded by the disrupted supply chains and limited access to seaports. The import tax collection improved by about UAH20bn per month following the official rate adjustment in late July, but still needs another UAH20bn rise to meet the projected figure. Assuming Ukraine sets on the sustainable recovery path, the flow of imported goods might pick-up notably. Yet, many of them may still be exempt from tax.

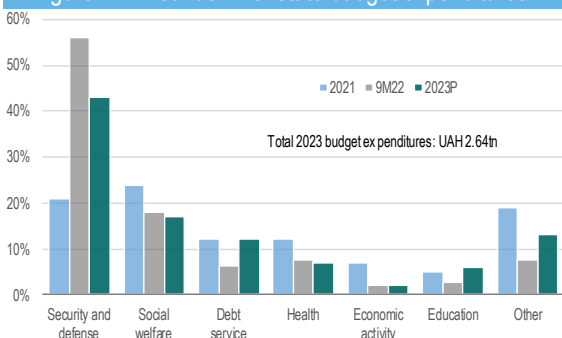
Figure 10. Budget revenue (taxes, fees, etc.), UAHbn



Source: FinMin

Another 10-15% of the government's revenue comprises profits received from state or state-owned entities. The NBU and the state-owned banks, enjoying the high key rate, might be the major source of funds. Privatization is supposed to generate a meager UAH6bn.

Figure 11. Breakdown of state budget expenditures



Source: FinMin

**But the expected government's proceeds cover only half of the projected expenditures** (UAH2.64tn in total). Some 46% of spending is expected to be covered by foreign financial help (about UAH100bn per month or USD2.8bn at the official rate) and remaining 3% (UAH90bn in total or about UAH2bn per auction) is to be raised on the local debt market.

While the foreign help is still under discussion, the correspondent funding looks achievable. There was news, however, that the EU help might be conditioned. The same is true regarding the IMF support. Considering Ukraine's weak track record of meeting such requirements, we see risks to the timely disbursement of funds. And that might give rise to various offsetting solutions, including fresh money emission or another FX rate adjustment.

In the end, **the 2023 state budget looks achievable under normal conditions, but not robust enough when considering the war consequences.** While no monetary funding is projected, other middle-ground solutions might be required. In this regard, phasing out of some tax exemptions introduced with the war is seen as likely. Hryvnia depreciation is also on the cards. And to soften negative effects of the adjustment, the NBU might consider transition to the crawling band regime or the managed float regime, when the FX rate is tied to some targets, i.e. trade balance, FX flows, etc.

# UKRAINIAN CAPITAL MARKETS REVIEW

Key Macroeconomic Indicators								
	2015	2016	2017	2018	2019	2020	2021	2022E
<b>Real sector</b>								
Real GDP (%YoY)	-9.8	2.4	2.5	3.4	3.2	-3.8	3.4	-40.0
Industrial production (%YoY)	-12.3	4.0	1.1	3.0	-0.5	-4.5	1.1	NA
Retail sales (%YoY)	-19.8	4.3	6.5	6.2	10.3	8.4	10.7	NA
Unemployment rate end of year (ILO, working age)	9.1	9.3	9.5	8.8	8.2	9.5	9.3*	NA
Nominal GDP (UAH bn)	1 989	2 385	2 984	3 561	3 975	4 222	5 460	NA
Nominal GDP (USD bn)	90	93	112	131	155	157	201	NA
<b>Prices</b>								
CPI (average %YoY)	48.5	14.9	14.4	11.0	7.9	2.7	9.4	19.9
CPI (end of year %YoY)	43.3	12.4	13.7	9.8	4.1	5.0	10.5	32.9
Real average wage growth (%YoY)	-20.2	9.0	19.1	12.5	9.8	7.4	11.9	NA
<b>Fiscal balance (% of GDP)</b>								
State budget deficit (without Naftogaz)	2.3	2.9	1.6	2.4	1.8	5.2	3.6	NA
Total public debt (% of GDP)	79.4	81.0	71.8	61.0	51.6	60.8	48.9	NA
<b>External balance</b>								
Exports of goods and services (USD bn)	47.9	46.0	53.9	59.2	63.6	60.7	81.5	NA
Imports of goods and services (USD bn)	50.2	52.5	62.7	70.6	76.1	63.1	84.5	NA
Current account balance (USD bn)	5.0	-1.9	-3.5	-6.4	-4.1	5.3	-2.1	NA
Current account balance (% of GDP)	5.6	-2.0	-3.1	-4.9	-2.7	3.4	-1.0	NA
Net FDI (USD bn)	-0.4	3.8	3.7	4.5	5.2	-0.1	6.0	NA
Foreign exchange reserves (end of year)	13.3	15.5	18.8	20.8	25.3	29.1	30.9	20.0
Imports coverage (months of imports of goods)	3.4	3.7	3.6	3.5	3.9	4.8	4.1	2.0
<b>Interest and exchange rates</b>								
NBU discount rate (% end of year)	22.0	14.0	14.5	18.0	13.5	6.0	9.0	25.0
Exchange rate (USD/UAH) end of year	24.0	27.2	28.1	27.7	23.7	28.3	27.3	42.0
Exchange rate (EUR/UAH) end of year	26.2	28.4	33.5	31.7	26.4	34.7	30.9	NA

\*estimates, no official data yet available

# UKRAINIAN CAPITAL MARKETS REVIEW

## FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
14.11.2022	15.11.2022	16.11.2022	17.11.2022	18.11.2022	19.11.2022	20.11.2022
LGB* % UAH 431.8mn		LGB* % UAH 557.6mn LGB % UAH 692.9mn	LGB* % UAH 195.6mn		LGB* % UAH 238.0mn	
21.11.2022	22.11.2022	23.11.2022	24.11.2022	25.11.2022	26.11.2022	27.11.2022
LGB* % UAH 313.6mn	LGB* % UAH 261.0mn Ukrstat: Retail trade	LGB* % UAH 922.1mn LGB % UAH 3 951.4mn LGB P UAH 15 031.9mn	LGB* % UAH 506.3mn LGB % USD 1.9mn	LGB* % UAH 251.3mn	LGB* % UAH 245.6mn	
28.11.2022	29.11.2022	30.11.2022	01.12.2022	02.12.2022	03.12.2022	04.12.2022
Ukrstat: Nominal & Real Wage		LGB* % UAH 497.2mn LGB % UAH 748.0mn Ukrstat: Industrial Production NBU: BoP	LGB % EUR 6.2mn LGB P EUR 494.6mn			
05.12.2022	06.12.2022	07.12.2022	08.12.2022	09.12.2022	10.12.2022	11.12.2022
		LGB* % UAH 1 065.5mn NBU: FX Reserves (deadline - 7th day)	NBU: MPC	Ukrstat: GDP Ukrstat: Price indices		

## MOST COMMON TERMS AND ABBREVIATIONS

GDP	Gross domestic product	DGF	Deposit Guarantee Fund
CPI	Consumer price index	Ukrstat	State Statistics Service of Ukraine
FDI	Foreign direct investment	NBU	National Bank of Ukraine
BoP	Balance of Payments	ECB	European Central Bank
CA	Current account	Fed	Federal Reserve System
FA	Financial account	FOMC	The Federal Open Market Committee
IIP	International investment position	MPC	Monetary policy committee meeting
VAT	Value-added tax	Minutes	Summary of MPC meeting
CD	Certificate of deposit	IMF	International Monetary Fund
FX	Foreign exchange, foreign currency	IFI	International financial institutions
UAH	Ukrainian hryvnia	LGB	Local government bonds
USD	U.S. dollar	FGB	Foreign government bonds (Eurobonds)
EUR	Euro	P	Principal due
SDR	Special drawing rights	%	Interests due
UONIA	Ukrainian OverNight Index Average	*	government bonds held by NBU or issued for recapitalization of state-owned banks
WA	Weighted average		
bp	basis point	m/m	in monthly terms; month-on-month change
pp	percentage point	TTM	trailing twelve months
y/y	in annual terms; year-on-year change	RHS	right-hand scale



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