



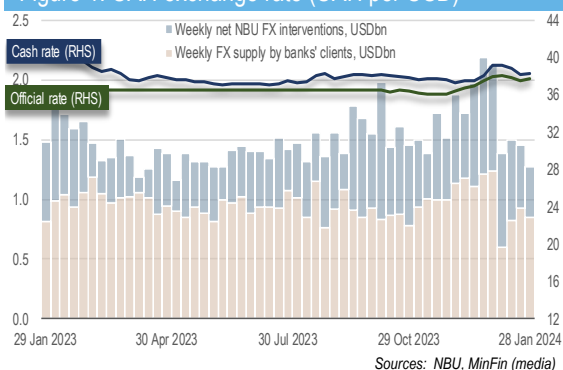
ECONOMICS | INTEREST RATES | FX MARKETS

2 February 2024

UKRAINIAN CAPITAL MARKETS REVIEW

	Rating	Outlook	Last update	This week in focus: To print, or not to print
Fitch	CC	-	08.12.2023	Ukraine entered 2024 being short of approximately USD29bn in confirmed external financing, or about USD2.5bn per month. While we expect most funds will ultimately be provided, with the recent decision by EU leaders to greenlight a EUR50bn aid package for Ukraine reinforcing our assumption, the risk of government falling back on monetary financing remains high.
S&P	CCC	NEGATIVE	08.09.2023	
Moody's	Ca	NEGATIVE	10.02.2023	
R&I	CCC	NEGATIVE	23.01.2024	

Figure 1. UAH exchange rate (UAH per USD)



FX and interest rates: NBU manages exchange rate flexibility cautiously

The official UAH/USD exchange rate ended last year 5.3% below our forecast.

The late 2023 trend, while aligning with our devaluation expectations, demonstrated a weaker trajectory than we anticipated. One contributing factor to this milder devaluation might be the tightening measures imposed on agri-commodity exporters. In addressing unofficial export transactions that diluted export revenue return, the government implemented restrictions last November, confining agri-commodity exports to entities meeting specific criteria. Concurrently, the NBU reduced to 90 days from 180 days the settlement period for agri-commodity exports conducted after 10 November.

Consequently, the spike in total FX demand witnessed in December, largely driven by a seasonal upswing in import purchases related to holiday activities, was partly offset by heightened FX supply from banks' clients, propelling FX sales at the interbank market beyond USD1bn since mid-November.

While FX demand has eased with the onset of the new year, facilitating a rebound for the local currency, **we anticipate the hryvnia to maintain a defensive stance in the first half of the year.**

The central bank's intention of extending the 90-day settlement period for export beyond agro commodities suggests that the market is evolving differently than it was anticipated by the NBU when shifting to the managed flexibility regime.

But the NBU is likely to continue employing extensive FX interventions to mitigate sharp losses in hryvnia rate.

Figure 2. Banking liquidity (UAH bn)

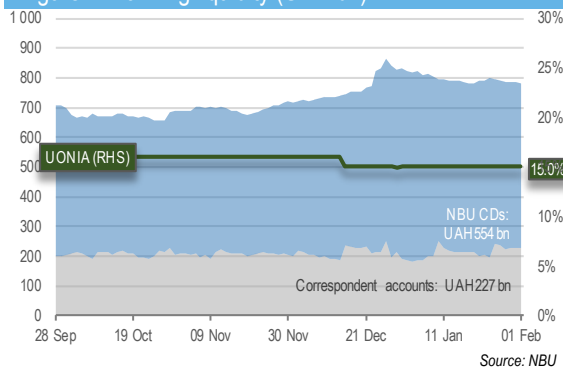
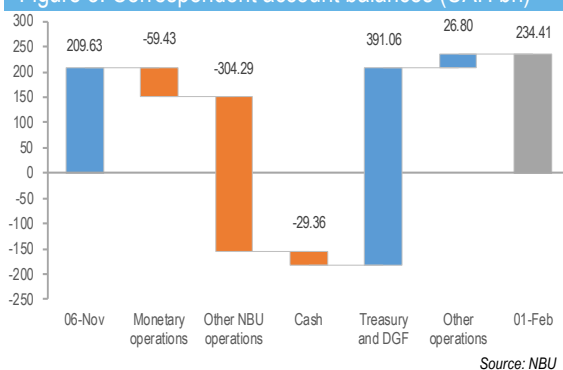


Figure 3. Correspondent account balances (UAH bn)



Banking liquidity surged above UAH800bn in December, marking an increase of approximately UAH100bn over the month. The rise is primarily attributed to heightened government expenditures amounting to UAH274.9bn, overshadowing extensive FX interventions by the central bank (UAH132.2bn) and seasonally accelerated cash hryvnia withdrawals (UAH44.5bn).

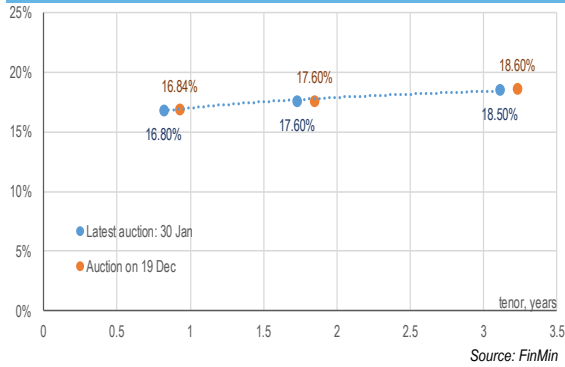
Notably, the amplified flows in December 2023 bear similarities to those observed in December 2022, with continued in January FX interventions mopping up most of the liquidity increase.

As of end of last month, total liquidity in the banking system amounted to UAH781bn, out of which UAH554bn were allocated in central bank's CDs.



UKRAINIAN CAPITAL MARKETS REVIEW

Figure 4. UAH government bonds primary market



Government bond market

In January, the FinMin raised UAH13bn through placement of UAH-denominated bonds. While this amount exceeds the ministry's needs for hryvnia debt servicing due last month, it represents the lowest take-up since 2022, when uncertainties of the Russian invasion of Ukraine paralyzed the market.

All 16 auctions of hryvnia bonds conducted in January fell short of the UAH4bn cap set by the FinMin. For this reason, the yield curve exhibited minimal movement, except for 3-year securities, experiencing a 10bp cut in yield to 18.5% per annum likely because of participation of state-owned banks in the auction.

To compensate for the shortfall, the ministry also offered FX-denominated bonds, helping to raise EUR235mn and USD250mn. The cut-off rate for 1.5-year securities in EUR with an early redemption option were set at 2.5% per year, and for plain 1.2-year ones at 3.25% per year, while cut-off rate for USD-denominated bonds was set at 4.66% per year, applicable to both 1-year and 1.2-year maturities.

Despite these efforts, the total funds raised lag behind the amounts implied by the state budget projections. This shortfall may reflect the dampened market interest in public debt amid unclear prospects for key rate cuts this year and uncertainties surrounding the war campaign.

Figure 5. UAH government bonds secondary market

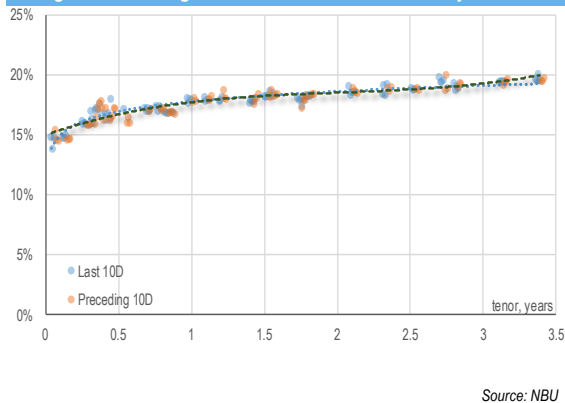
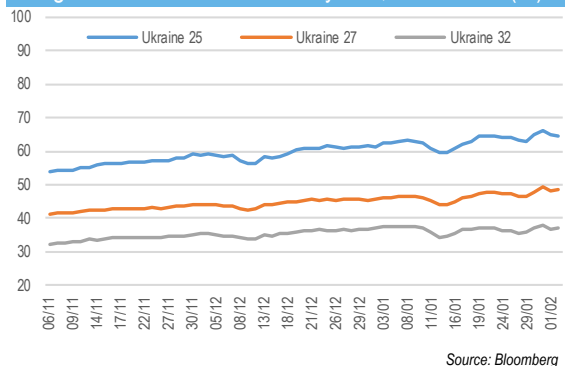


Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)

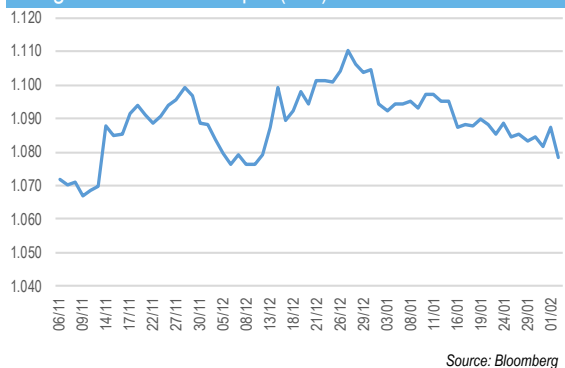


EUR/USD slides below 1.0800

The EUR/USD retreated below the 1.0800 level by the close of January, influenced by a cautious stance from the Fed.

In the FOMC Minutes released earlier in the year, the committee emphasized that rates are approaching their peak cycle. However, the committee refrained from providing any clues about future rate movements, leading to speculations that the policy rate might be maintained at its current level for an extended period. These sentiments were further reinforced after the monetary policy meeting in January, where the Fed indicated it would be inappropriate to cut rates until it has "greater confidence" that inflation is approaching its 2% target. The central bank also stated that it was unlikely that rates would be cut at the next Fed meeting in March.

Figure 7. EUR USD spot (mid)



The prevalent risk-off market sentiment has contributed to the USD's strength.

The 10-year U.S. Treasury topped 4% on Friday after a surprisingly strong jobs report that suggested continued economic strength, but raised questions on when the Fed can cut interest rates.

Across the pond, market participants lean towards the possibility of policy rate cuts by the ECB as a measure to prop up the economy. Despite the ECB's commitment to keep rates high for a "sufficiently long duration" to bring inflation to target, investors seem to have priced in six rate cuts for 2024.

Besides, the ECB head noted during the last press briefing that the uptick in December inflation was expected and driven by base effects, emphasizing that it "does not detract from the view we have that the disinflation process is at work."

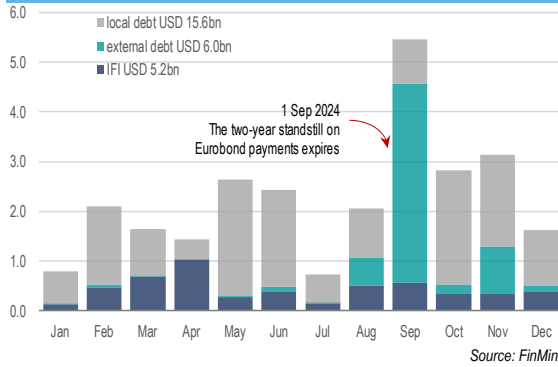


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Figure 8. Public debt repayment schedule in 2024



To print, or not to print: Assessing Ukraine's financial landscape in 2024

Ukraine entered 2024 being short of approximately USD29bn in confirmed external financing, or about USD2.5bn per month. While we expect most funds will ultimately be provided, with the recent decision by EU leaders to greenlight a EUR50bn aid package for Ukraine reinforcing our assumption, the risk of government falling back on monetary financing remains high.

On 1 February, EU leaders reached an agreement on an eagerly awaited four-year EUR50bn aid package for Ukraine. The first tranche of EUR4.5bn is expected to be disbursed in March.

Yet, uncertainties persist over the USD14bn financial support from the U.S. Being a part of the comprehensive USD60bn package for Ukraine, it is pending approval by the U.S. Congress, with the timeline for passage remaining uncertain.

Figure 9. Schedule of reviews of IMF-led program

Availability Date	USDmn	Conditions
29 Feb 2024	889.93	3rd review and end-December 2023 performance criteria
15 Jun 2024	2 238.32	4th review and end-March 2024 performance criteria
01 Sep 2024	1 119.12	5th review and end-June 2024 performance criteria
01 Dec 2024	1 119.12	6th review and end-September 2024 performance criteria
01 Mar 2025	915.04	7th review and end-December 2024 performance criteria
31 Aug 2025	915.04	8th review and end-June 2025 performance criteria
01 Mar 2026	1 288.12	9th review and end-December 2025 performance criteria
31 Aug 2026	1 288.12	10th review and end-June 2026 performance criteria
10 Mar 2027	1 282.58	11th review and end-December 2026 performance criteria

Source: IMF

Meantime, **the ongoing war continues to strain resources**, with certain expenditures outlined in the 2024 state budget appearing overly conservative against this backdrop. Notably, the USD28.6bn allocated to the defence ministry is equivalent to the amount spent in the initial seven months of the preceding year.

The upcoming third review of the IMF-led program, with performance criteria are due to be met by end-February, marks a crucial milestone, especially given the two-month delay in completing the preceding review. And this is just the beginning of the IMF story. **Ukraine has to pass four reviews by year-end, with total amount at stake exceeding USD5bn.**

Room for manoeuvre is limited. Single-digit inflation coupled with a stable local currency rate, desired by the central bank for macro stability though, pose challenges for the Finance Ministry by slowing the growth of tax proceeds. The latter half of 2024 may present a brighter picture for state budget replenishment, as we expect inflation to accelerate due to factors such as utility tariff hikes, wage increases, and gradual hryvnia devaluation. Yet, this scenario has its own drawbacks, as anticipated inflation reacceleration will hamper demand for public debt. And unlike last year, raising extra funds via government bonds that banks can use to meet reserve requirements is no more a silver bullet.

On the positive side, the tight schedule of IMF reviews provides some assurance of minimizing the need for printing more money, if such a need arises.

In 2022, the central bank's position in public debt surged by UAH394bn, more than doubling. While we consider the risk of another UAH400bn increase low, it's essential to note that money emission in 2024 could have more profound implications for inflation expectations and the local currency rate than in 2022, given the backdrop of recovered consumer expenditures and a more relaxed foreign currency regime.



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Key Macroeconomic Indicators

	2017	2018	2019	2020	2021	2022	2023E	2024F
Real sector								
Real GDP (%YoY)	2.5	3.4	3.2	-3.8	3.4	-29.1	4.5*	3.0
Industrial production (%YoY)	1.1	3.0	-0.5	-4.5	1.9	-36.9	NA	NA
Retail sales (%YoY)	6.5	6.2	10.3	8.4	10.7	-21.4	NA	NA
Unemployment rate end of year (ILO, working age)	9.5	8.8	8.2	9.5	9.8	NA	NA	NA
Nominal GDP (UAH bn)	2 984	3 561	3 975	4 222	5 460	5 191	NA	NA
Nominal GDP (USD bn)	112	131	155	157	201	161	NA	NA
Prices								
CPI (average %YoY)	14.4	11.0	7.9	2.7	9.4	20.0	12.9	8.9
CPI (end of year %YoY)	13.7	9.8	4.1	5.0	10.5	26.6	5.1	10.0
Real average wage growth (%YoY)	19.1	12.5	9.8	7.4	11.9	NA	NA	NA
Fiscal balance (% of GDP)								
State budget deficit (without Naftogaz)	1.6	2.4	1.8	5.2	3.6	17.6	NA	NA
Total public debt (% of GDP)	71.8	61.0	51.6	60.8	48.9	78.4	NA	NA
External balance								
Exports of goods and services (USD bn)	53.9	59.2	63.6	60.7	81.5	57.0	50.9	NA
Imports of goods and services (USD bn)	62.7	70.6	76.1	63.1	84.2	82.7	88.6	NA
Current account balance (USD bn)	-3.5	-6.4	-4.1	5.3	-3.9	7.9	-9.8	NA
Current account balance (% of GDP)	-3.1	-4.9	-2.7	3.4	-1.0	5.2	NA	NA
Net FDI (USD bn)	3.7	4.5	5.2	-0.1	7.5	0.3	4.2	NA
Foreign exchange reserves (end of year)	18.8	20.8	25.3	29.1	30.9	28.5	40.5	30.0
Imports coverage (months of imports of goods)	3.6	3.5	3.9	4.8	4.1	3.7	5.4	3.8
Interest and exchange rates								
NBU discount rate (% end of year)	14.5	18.0	13.5	6.0	9.0	25.0	15.0	15.0
Exchange rate (USD/UAH) end of year	28.1	27.7	23.7	28.3	27.3	36.6	38.0	44.0
Exchange rate (EUR/UAH) end of year	33.5	31.7	26.4	34.7	30.9	39.0	42.0	50.6

*estimates, no official data yet available

NA – data is not available because of continuing military operations



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FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
29.01.2024	30.01.2024	31.01.2024	01.02.2024	02.02.2024	03.02.2024	04.02.2024
			IMF SDR 180.7mn FGB P USD 750.0mn FGB % USD 33.7mn LGB % USD 4.7mn ECB: MPC			
05.02.2024	06.02.2024	07.02.2024	08.02.2024	09.02.2024	10.02.2024	11.02.2024
NBU: Minutes		LGB % UAH 1 925.0mn LGB % UAH 1 964.9mn NBU: FX Reserves (deadline - 7th day)				
12.02.2024	13.02.2024	14.02.2024	15.02.2024	16.02.2024	17.02.2024	18.02.2024
		LGB % UAH 659.3mn LGB P UAH 10 189.4mn				
19.02.2024	20.02.2024	21.02.2024	22.02.2024	23.02.2024	24.02.2024	25.02.2024
		LGB % UAH 1 970.0mn	LGB P EUR 304.0mn			

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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