



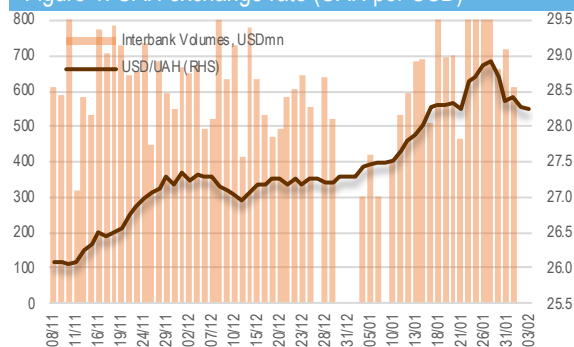
ECONOMICS | INTEREST RATES STRATEGY | FX

3 February 2022

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

	Rating	Outlook	Last update	This week in focus: CA figures support our conservative UAH expectations
Fitch	B	POSITIVE	06.08.2021	Ukraine reported a USD2.1bn CA deficit in 2021 versus a USD4.2bn surplus a year prior. The astonishing drop largely resulted from hefty dividend repatriations. This case is unlikely to repeat in 2022. But a likely retreat in prices for steel products, pent-up demand for energy imports and likely decline in harvests could push CA deeper into deficit.
S&P	B	STABLE	12.03.2021	
S&P (N)	uaA	-	12.03.2021	
Moody's	B3	STABLE	12.06.2020	

Figure 1. UAH exchange rate (UAH per USD)



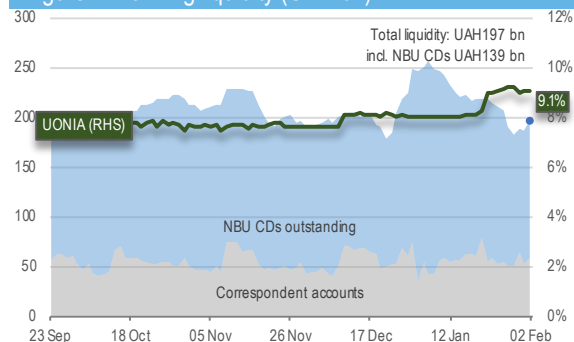
FX and interest rates: Hryvnia regains ground as escalation story lose steam

The USD/UAH pair has bounced off 4-year low as market concerns over likely Russian invasion in Ukraine seem to be losing steam.

Rising global support for Ukraine and the Russian statement that some 6000 troops deployed to the West of the country have been moved back to their permanent bases appear to have taken off some pressure.

Assuming further de-escalation, **the USD/UAH is prone to retreating below the 28.00 barrier**. Rising running costs and cost of funds are likely to drive businesses to sell back to the market excess FX reserves accumulated over the last month. Announced by EU a EUR1.2bn emergency macro-financial assistance package for Ukraine could also add to market confidence.

Figure 2. Banking liquidity (UAH bn)



But the pair so far remains well above the 28.00 level, as most Russian troops massed near the Ukrainian border for so-called "military exercises" remain there. Market participants keep closely watching the evolution of the story.

Because Russia has a history of using the guise of the Olympics to its advantage, there are fears in the market that the conflict could be rescheduled until after the Olympics. Russia's invasion of Crimea occurred in 2014 amid the Winter Olympics in Sochi, and in 2008, Russia invaded Georgia during the Summer Olympics in Beijing.

Banking liquidity dropped by UAH36bn to UAH183.4bn over the last week.

Central bank's FX fire sale in response to invasion fears was the major channel of the liquidity drain. The NBU interventions amounted to USD759.5mn, which is equivalent to UAH21.8bn outflow.

Figure 3. Correspondent account balances (UAH bn)



Another UAH14.2bn was transferred to the State treasury account.

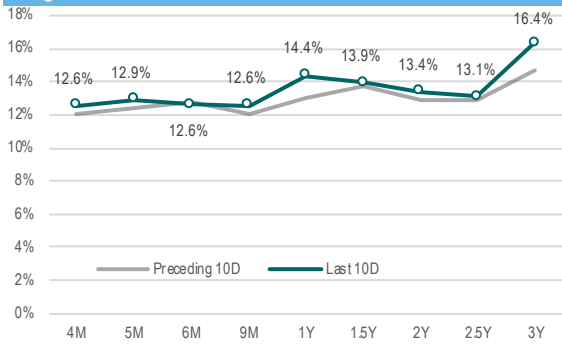
Notably, demand for paper money remained low. Total cash outstanding barely changed since the beginning of the year. Moreover, but for the last week, demand for cash FX was also quite moderate.

The sharp drop in hryvnia liquidity pushed the UONIA rate to 9.2%, 2pp above the lower bound of the central bank's standing facility.

As of Friday (January 28) the balance of banks' correspondent accounts was UAH51.2bn, their position in NBU CDs was UAH132.2bn.



Figure 4. Local UAH bonds market



Government bond market

CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size, mn	Placement size, mn
UAH	4M	11.50%	11.50%	11.50%	11.50%	18	18	70.62	70.62
UAH	1Y	0.00%	0.00%	12.40%	12.40%	5	0	16.35	0.00
UAH	1.5Y	0.00%	0.00%	12.40%	12.40%	3	0	2.39	0.00
UAH	2Y	13.00%	13.00%	13.45%	13.00%	14	13	19.10	15.21
USD	1Y	3.70%	3.70%	3.70%	3.70%	14	14	4.58	4.58

Rising tension between Russia and Ukraine, coupled with a sharp hryvnia liquidity drop, knocked Ukrainian public debt out of wish lists. Demand for government bonds fell to a 17-month low at the last primary auctions. Although FinMin had experienced even lower demand back then, it was the time, when the government had enough liquidity to turn down all the bids with a yield above the desired level.

Cool reception was seen even for USD-denominated bonds. FinMin received bids for a meager USD4.58mn versus USD600mn of FX debt obligations due this week. The ministry has roughly USD1.3bn on its FX accounts to meet these payments, according to the head of FinMin.

As long as the tensions over a possible Russian invasion of Ukraine remain alive, FinMin will have very limited access to debt markets. Official financing, either from the EU or the IMF will likely be the major source of funds for the government in February.

Figure 5. Local USD bonds market

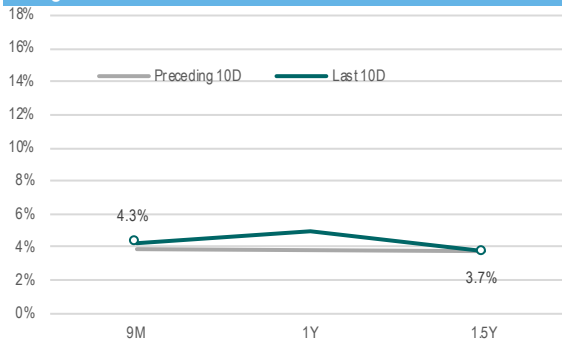
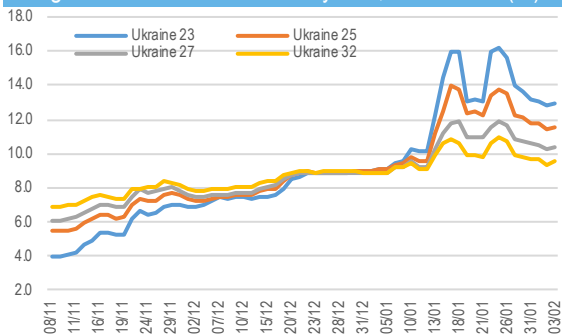


Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



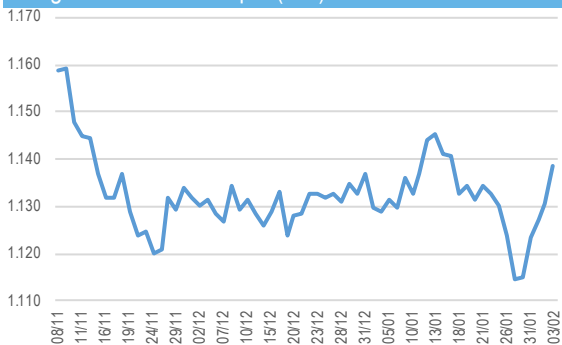
EUR/USD recovered above 1.1300 barrier

The EUR/USD pair advances for the fourth session in a row and gradually approaches the key 1.1400 neighbourhood. Rebound after revisiting a 1.1100 region late in January developed into a strong upswing, bolstered by the re-emergence of a quite firm appetite for riskier assets and the continuation of downside pressure on the greenback.

Rising the perception that the Fed might not be as aggressive as expected when it comes to hiking rates at the March event boosts the generalized risk-on sentiment and plays against a safe-haven U.S. dollar and U.S. Treasuries.

The yield on the benchmark 10-year Treasury note climbed to 1.834%, up 35.6 basis points over the last two weeks. Yields move inversely to prices.

Figure 7. EUR USD spot (mid)

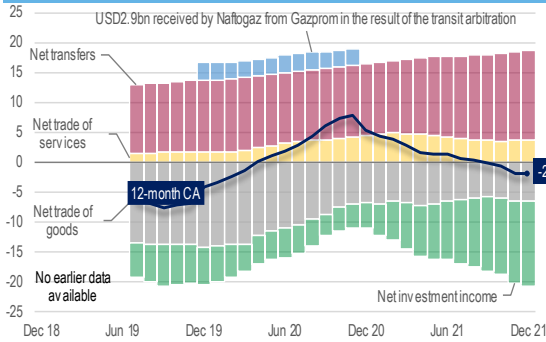


The euro, in contrast, remains vigilant and has gained fresh buying pressure following the European Central Bank meeting on Thursday (February 3). Although the ECB opted to hold interest rates steady, defying growing pressure to curb stimulus plans, there is rising speculation of a sooner-than-anticipated ECB interest rate hike.

Moving forward, the outlook for the pair remains far from rosy despite the rebound, particularly in light of the Fed's imminent start of the tightening cycle vs. the accommodative-for-longer stance in the ECB.

Figure 8. Current account evolution, USDbn

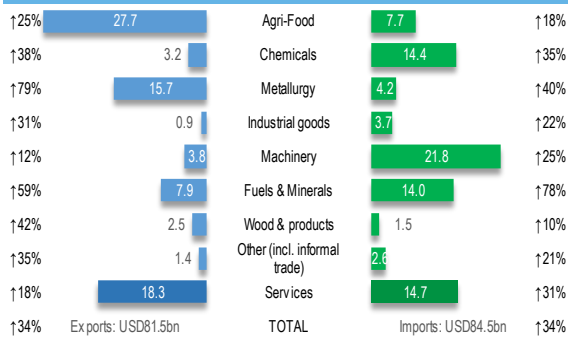
Current account figures support our conservative UAH expectations



Ukraine reported a USD2.1bn CA deficit in 2021 versus a USD4.2bn surplus a year prior. The balance of trade barely changed and remittances set another all-time high. The astonishing drop largely resulted from unusually favourable price conjuncture for Ukraine's key exports, allowing for hefty dividend repatriations. This case is unlikely to repeat in 2022. But a likely retreat in prices for steel products in response to a hawkish shift across the globe, pent-up demand for energy imports and likely decline in harvests could push CA deeper into deficit.

A surge in global consumption fuelled by ultra-cheap money gave a strong boost to Ukraine's external trade balance. Both exports and imports rose by 34% last year, with a double-digit growth being recorded across the board.

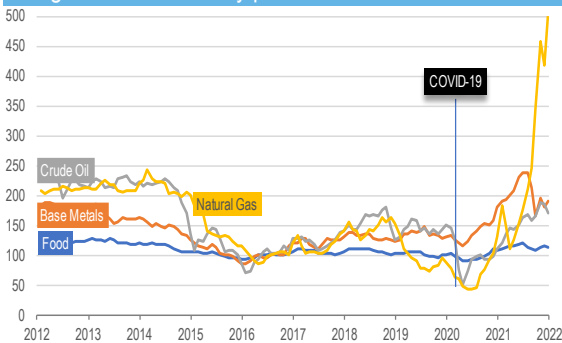
Figure 9. Exports and imports breakdown, USDbn



Iron ore and steel products sales were the best performers on the exports side (see Figure 9 for details). The former hit the record high and the latter approached the level seen before the country has lost control over certain areas of Donetsk and Luhansk regions. The major source of FX revenue remained agri-food exports, benefiting from the strong harvest and favourable prices.

But price implications induced by the global spending spree could have a reverse effect in 2022. As leading central banks increasingly embark on policy tightening to tame rampant inflation, some investment projects are likely to be postponed. This will weigh on demand for steel products. We expect price correction there will not be as steep as it was in iron ore in August 2021. That said, the downward tendency might extend well into 2023.

Figure 10. Commodity price indices

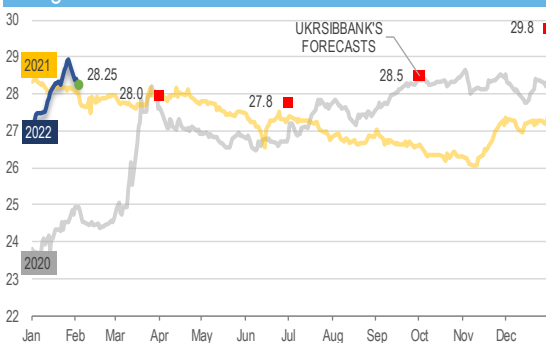


Performance in the agrifood segment is likely to be mixed. On the one hand, global fertilizer prices soared to multi-year highs last year following a surge in prices of key feedstocks natural gas, and coal. On the other hand, this could lead to another spike in food prices.

After surging for much of 2021, **natural gas prices are likely to cool down slowly**, as failed expectations of seasonal price correction in 2021 resulted in energy stocks being greatly depleted. And so will move prices for fertilizers.

As for machinery imports, some contraction is likely over the year. Apart from soft external credit conditions, the growth in the segment was fuelled by a temporary tax break for importers of used cars to Ukraine.

Figure 11. USD/UAH forecasts



Migrant remittances to Ukraine hit USD15bn in 2021, a rise of 25.4% from the year earlier. As many countries increasingly lift most of their Covid restrictions the uptrend is likely to sustain in 2022.

Investment profit distribution, which was the major drag to the CA in 2021, amounted to USD14.1bn. Ukrainian companies repatriated dividends for USD10bn last year and most of such companies are operating in iron ore and steel production, according to the NBU.

Worth noting, however, that most of the profit repatriations made by Ukrainian companies with an offshore holding entity typically return to the country via so-called "round-trip" investments. In turn, expected price correction for steel products, high inflation, pushing higher running costs, and the global policy tightening agenda is likely to slow investment profit outflow in 2H22.

Besides, the investment income outflow captures not only dividends and interest payments to non-residents, but also retained earnings accruing to non-residents. Because the latter are deemed to be reinvested, they contribute to FDI inflow, which reached USD6bn last year.

We confirm our conservative outlook for the USD/UAH, expecting gradual hryvnia depreciation against the U.S. dollar towards 29.8 by the year end.

UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2015	2016	2017	2018	2019	2020	2021	2022E
Real sector								
Real GDP (%YoY)	-9.8	2.4	2.5	3.4	3.2	-4.0	3.1*	3.8
Industrial production (%YoY)	-12.3	4.0	1.1	3.0	-0.5	-4.5	1.1	1.0
Retail sales (%YoY)	-19.8	4.3	6.5	6.2	10.3	8.4	10.7	10.0
Unemployment rate end of year (ILO, working age)	9.1	9.3	9.5	8.8	8.2	9.5	9.3*	8.5
Nominal GDP (UAH bn)	1 989	2 385	2 984	3 561	3 975	4 194	5 007*	5 820
Nominal GDP (USD bn)	90	93	112	131	155	156	184*	204
Prices								
CPI (average %YoY)	48.5	14.9	14.4	11.0	7.9	2.7	9.4	9.0
CPI (end of year %YoY)	43.3	12.4	13.7	9.8	4.1	5.0	10.5	8.9
Real average wage growth (%YoY)	-20.2	9.0	19.1	12.5	9.8	7.4	11.9	3.0
Fiscal balance (% of GDP)								
State budget deficit (without Naftogaz)	2.3	2.9	1.6	2.4	1.8	5.2	5.0*	3.5
Total public debt (% of GDP)	79.4	81.0	71.8	61.0	51.6	60.9	64.6*	61.5
External balance								
Exports of goods and services (USD bn)	47.9	46.0	53.9	59.2	63.6	60.7	81.5	65.0
Imports of goods and services (USD bn)	50.2	52.5	62.7	70.6	76.1	63.1	84.5	78.0
Current account balance (USD bn)	5.0	-1.9	-3.5	-6.4	-4.1	5.3	-2.1	-3.2
Current account balance (% of GDP)	5.6	-2.0	-3.1	-4.9	-2.7	3.4	-1.1	-1.6
Net FDI (USD bn)	-0.4	3.8	3.7	4.5	5.2	-0.1	6.0	3.0
Foreign exchange reserves (end of year)	13.3	15.5	18.8	20.8	25.3	29.1	30.9	32.5
Imports coverage (months of imports of goods)	3.4	3.7	3.6	3.5	3.9	4.8	4.1	5.0
Interest and exchange rates								
NBU discount rate (% end of year)	22.0	14.0	14.5	18.0	13.5	6.0	9.0	10.0
Exchange rate (USD/UAH) end of year	24.0	27.2	28.1	27.7	23.7	28.3	27.3	29.8
Exchange rate (EUR/UAH) end of year	26.2	28.4	33.5	31.7	26.4	34.7	30.9	32.5

*estimates, no official data yet available



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UKRAINIAN CAPITAL MARKETS WEEKLY

FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
31.01.2022	01.02.2022	02.02.2022	03.02.2022	04.02.2022	05.02.2022	06.02.2022
Ukrstat: Industrial Production NBU: Minutes NBU: BoP	IMF SDR 43.6mn FGB % USD 33.7mn NBU: Cost of Real Sector External Debt	LGB* % UAH 700.3mn LGB % UAH 1 279.2mn LGB P UAH 11 504.3mn	LGB % USD 13.0mn LGB P USD 367.9mn ECB: MPC	IMF SDR 98.5mn Ukrstat: GDP flash estimate		
07.02.2022	08.02.2022	09.02.2022	10.02.2022	11.02.2022	12.02.2022	13.02.2022
NBU: FX Reserves (deadline - 7th day)		LGB* % UAH 448.0mn Ukrstat: Price indices				
14.02.2022	15.02.2022	16.02.2022	17.02.2022	18.02.2022	19.02.2022	20.02.2022
		LGB* % UAH 198.2mn LGB % UAH 595.5mn	LGB % EUR 4.4mn LGB P EUR 349.2mn			
21.02.2022	22.02.2022	23.02.2022	24.02.2022	25.02.2022	26.02.2022	27.02.2022
	Ukrstat: Retail trade	LGB* % UAH 518.9mn LGB % UAH 1 998.4mn LGB P UAH 17 980.5mn		LGB % UAH 876.5mn		

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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