

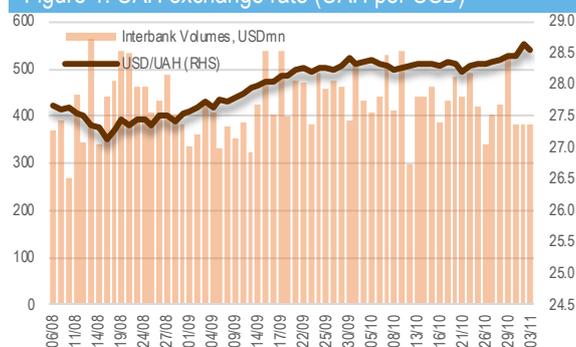
ECONOMICS | INTEREST RATES STRATEGY | FX

4 November 2020

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Record current account surplus to reduce FX risks
Fitch	B	STABLE	04.09.2020	Ukraine sees record current account surplus, with 12M trailing reading hitting a record high at USD5.7bn as of end-September 2020. Favorable commodities prices will likely continue helping local currency to escape a material devaluation following the recent controversial ruling by the constitutional court that puts at risk foreign financial support.
S&P	B	STABLE	11.09.2020	
S&P (N)	uaA	-	11.09.2020	
Moody's	B3	STABLE	12.06.2020	

Figure 1. UAH exchange rate (UAH per USD)



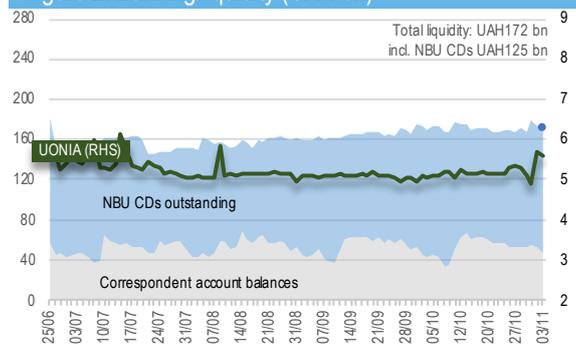
FX and interest rates: UAH faces extra pressure after court crisis

After spending a few sessions in a sluggish decline toward the year low, the Ukrainian hryvnia broke lower against the U.S. dollar on October 29 after the constitutional court struck down anti-corruption laws.

On Monday (November 2) the USD/UAH pair has set a fresh year-low at 28.65, but then bounced back to 28.4 area during the next sessions, as the market hopes for a prompt and effective reaction by the authorities to the situation.

The court's movement threatens with a full halt of foreign support, which is conditional on Ukraine's performance on reforms and tackling entrenched corruption. A programme agreed in June with the IMF and contingent on it financial aid from EU are of great importance against a backdrop of sharp economic downturn and limited opportunities to fund growing expenditures.

Figure 2. Banking liquidity (UAH bn)

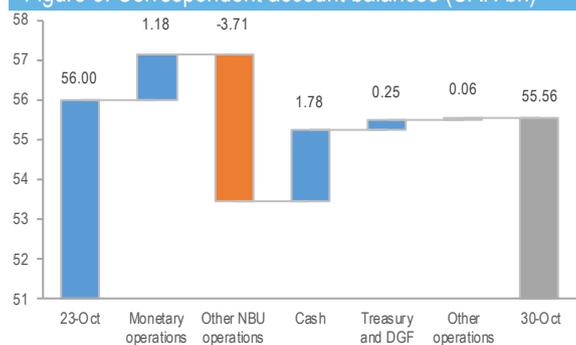


The downtrend was also fueled by recent VAT redemption, further shortening FX supply, and growing demand for FX from the population, reallocating accumulated in lockdown savings into liquid assets.

The widening demand-supply imbalance forced the NBU to step in with interventions, selling during the past week USD147.5bn.

While admitting local rebounds, especially if authorities find a widely accepted solution to the court impasse, we nevertheless expect hryvnia to remain in a bullish trend though the end of the year, driven by growing demand for safe-haven foreign currencies.

Figure 3. Correspondent account balances (UAH bn)



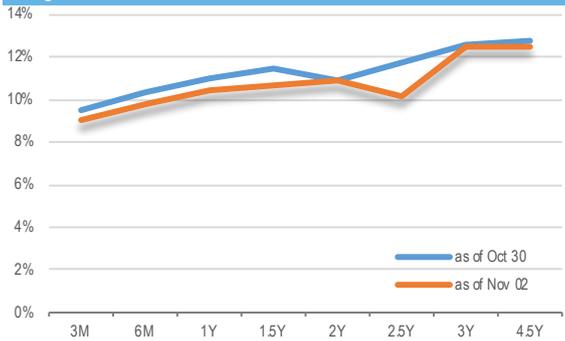
Banking liquidity exceeded UAH178bn in the week ended on October 30.

The major factor behind the change was a UAH10bn central bank's liquidity injection via refinancing facility. The NBU does not specify recipients in loans with maturity up to 30 days. The supportive transaction is not seen in the monetary operations bar in Figure 3, since a similar amount was reallocated to CDs, resulting in a 7.5% increase of total CDs outstanding to UAH123bn.

Worth also pointing out, that after the transaction costs of funds in the interbank money market jumped over 77pb to 5.69% from below 5% the last Friday.

Cash deposits and State treasury operations contributed UAH2bn in total. But due to the mentioned central bank's FX interventions, draining some UAH3.7bn, the balance of correspondent accounts declined by the end of the week by 0.8% to UAH55.6bn.

Figure 4. Local UAH bonds market



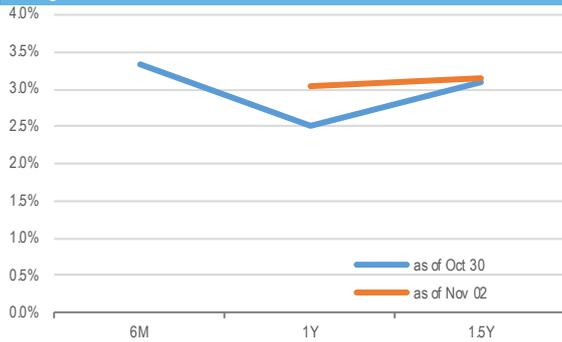
Government bond market

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	3M	7.50%	7.50%	7.50%	7.50%	1	1	2 000.00	2 000.00
UAH	1Y	-	-	11.50%	10.75%	9	0	290.30	0.00
UAH	3Y	10.95%	10.95%	12.50%	10.95%	7	4	177.74	2.79

Local currency government bonds keep losing appeal to investors, at least at rate levels offered by FinMin.

This Tuesday the ministry again limited proposal to hryvnia denominated bonds, with maturity ranging from 3 months to 3 years.

Figure 5. Local USD bonds market

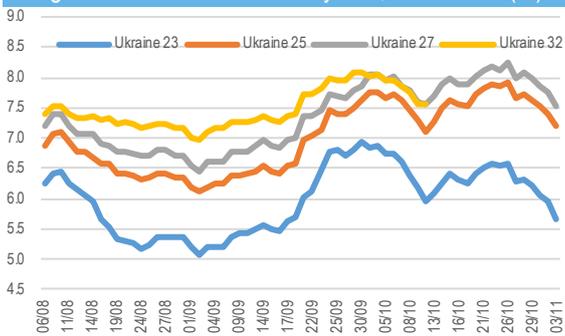


Without a single UAH2bn worth application for the shortest issue, with round amount pointing at the likelihood of being submitted by a state-owned bank, the auction was a failure. Worth also pointing out that cut-off rate was lifted by 20bp to 7.5% per year.

A year bonds received 9 bids for UAH290mn in total with rates ranging from 10.75% to 11.5%. But the auction was ultimately canceled.

With regard to the 3-year bonds, though received bids for some UAH178mn, the ministry only raised UAH2.8mn with a required rate below 10.95%. The max bid rate for long-term bonds was 12.5% per year, with no change compared to the max rate required by investors for 3.5y bonds at the previous auction. But this rate looks in line with the ones offered by foreign accounts in the secondary market. And as long as the local political situation remains tightened, FinMin will continue struggling to attract any meaningful demand.

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



EUR/USD bounces around 1.17 mark amid a tight election race

The U.S. dollar gained notably against the euro in the last week as escalating coronavirus cases in Europe stoked investor fears that fresh lockdowns would further hit the already fragile economic recovery.

Apart from that, the ECB sent the euro tumbling earlier in the past week after suggesting the introduction of further monetary stimulus measures in December. ECB President Christine Lagarde, in particular, assured that policymakers are prepared to "recalibrate" their tools at the final in this year's meeting.

On Tuesday the greenback has again set towards 1.17 mark against the euro as investors' attention migrated quickly to U.S. election process. Polls give Democrat Joe Biden a solid lead. But the contest is much tighter in battleground states that could decide the outcome. Besides, some still fear that the election results could be contested, leading to a protracted period of uncertainty.

But as the uncertainty in the economic outlook has not changed, the EUR/USD pair has limited bullish potential in the near-term.

Treasuries yield climbed to the highest level since early June. The yield on the benchmark 10-year Treasury note last traded at 0.892%, its highest level since June 8. Yields move inversely to prices.

Fixed-income investors are cautious of drawn out process – regardless of who ultimately occupies the White House in 2021.

Figure 7. EUR USD spot (mid)

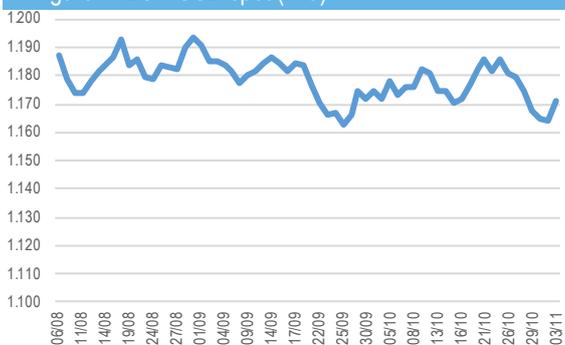


Figure 8. Current account (TTM), USDbn

Record current account surplus to reduce UAH devaluation risks



Ukraine sees record CA surplus, with 12M trailing reading hitting a record high at USD5.7bn as of end-September. Favorable commodities prices will likely continue helping hryvnia to escape a material devaluation following the recent controversial ruling by the constitutional court that puts at risk foreign support.

Ukraine's CA surplus reached a record high in the 3Q. The surplus in the 12 months to September was USD5.7bn, the equivalent of 3.9% of expected this year's GDP. Favorable prices for soft commodities in the global markets, with grains witnessing double-digit growth in recent months, help to keep agri exports lagging not too far from last year's levels. But expected this year weaker harvest for grains (mostly affecting the central part of Ukraine) will result in weaker agri production and export revenue levels.

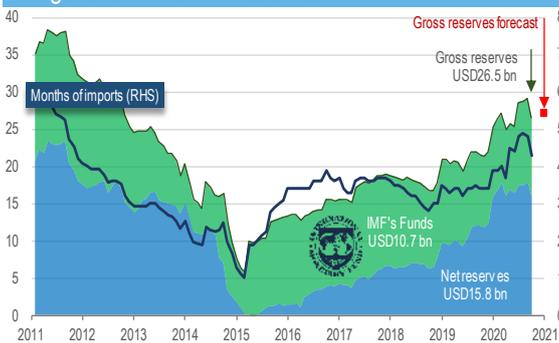
Figure 9. Foreign position in LGB, UAHbn



The rest of the contributors to exports of goods showed a mixed picture, including metallurgy which struggles to take advantage of supportive prices for iron ore. Going forward, the outlook for steel and mining products remains good, against the backdrop of global soft monetary conditions, stimulating demand for steel, particularly in China. Overall, we note that **Ukraine proved to be more resilient to the global drop of demand in 2020 than other economies**, in particular, due to a large share of raw commodities in the export mix.

Surprisingly, remittances by migrant workers in September reached USD1.1bn, exceeding the level in the same month of the previous year despite COVID-19 related slowdowns in EU services sector. Nevertheless, the improvement may be transitory as many countries are reintroducing lockdown measures.

Figure 10. NBU FX Reserves



Balance of services looks also supportive, with Naftogaz-Gazprom deal providing support to transportation services inflows, IT services dynamic remaining on a good track and tourism (the main negative drag on Ukraine's balance of services) remaining limited comparing to the previous years.

Financial account will represent a major problem for hryvnia going forward. While a USD2.4bn TTM balance drop in September has mostly to do with public debt redemption, FA has faced additional pressure after Ukraine's constitutional court issued a destructive ruling in an effort to dismantle an anti-corruption architecture. The last is an important precondition to foreign official financial support. And LGB, a bestseller among foreign accounts a year ago, are now actively offered for sale, draining the central bank's FX reserves. At this point of time sales of LGBs by international accounts do not represent any major issue, but the situation can change if country risks continue to rise or in case of any abrupt changes in sentiment in the global markets.

Figure 11. USD/UAH evolution in 2020



The room for maneuver is still there, and the authorities can turn the situation to their advantage if prompt reaction follows and it finds support among Ukraine's foreign partners. But still, it would be very difficult to ensure continuation of the current IMF program which is already off track. In this light, Ukraine's access to global capital markets will be limited, whether through official or private channels. And taking into account sharply widening budget deficits, with most of spending to be made in Nov-Dec, Ukraine will have to rely fully on domestic sources. Possible indirect involvement of NBU's balance sheet may subsequently increase UAH supply on the FX market.

Our USD/UAH forecast given in early April (see report of Apr 4) remains in line with the pair movement since then. **We reckon the USD/UAH rate to keep trending towards 29.5 through the end of the year, fueled by accumulated this year sizable amount of cash in hands and by likely to remain inconsistent local political situation, supporting demand for liquid assets.**

UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2014	2015	2016	2017	2018	2019	2020E	2021F
Real sector								
Real GDP (%YoY)	-6.6	-9.8	2.4	2.5	3.4	3.2	-5.8	3.8
Industrial production (%YoY)	-15.0	-5.1	6.6	-0.5	1.1	-6.7	-1.8	0.0
Retail sales (%YoY)	-11.0	-25.0	4.0	8.8	6.2	10.5	-10.9	9.2
Unemployment rate end of year (ILO, working age)	9.3	9.1	9.3	9.5	8.8	8.2	10.1	9.3
Nominal GDP (UAH bn)	1 587	1 989	2 385	2 983	3 559	3 975	3 926	4 633
Nominal GDP (USD bn)	131	90	93	112	131	150	144	154
Prices								
CPI (average %YoY)	12.1	48.7	16.5	14.4	10.5	7.9	4.5	5.0
CPI (end of year %YoY)	24.9	43.3	12.4	13.7	9.8	4.1	4.9	5.0
Real average wage growth (%YoY)	-6.5	-35.0	10.0	18.9	9.7	9.8	-5.5	3.5
Fiscal balance (% of GDP)								
State budget deficit (without Naftogaz)	4.9	2.3	2.9	1.6	2.4	1.8	7.5	3.0
Total public debt (% of GDP)	69.4	79.4	81.0	71.8	61.0	51.6	64.4	64.6
External balance								
Exports of goods and services (USD bn)	65.4	47.9	46.0	54.0	59.0	63.4	56.2	62.6
Imports of goods and services (USD bn)	70.0	49.6	51.8	60.8	70.5	75.5	64.3	72.5
Current account balance (USD bn)	-4.6	5.0	-1.9	-3.5	-6.5	-4.2	3.5	-0.6
Current account balance (% of GDP)	-3.5	5.6	-2.0	-3.2	-4.9	-2.8	2.4	-0.4
Net FDI (USD bn)	0.3	-0.4	3.8	3.7	4.5	5.2	1.0	2.0
Foreign exchange reserves (end of year)	7.5	13.3	15.5	18.8	20.8	25.3	27.0	27.5
Imports coverage (months of imports of goods)	1.5	4.4	3.7	3.6	3.4	3.9	5.0	4.5
Interest and exchange rates								
NBU discount rate (% end of year)	14.0	22.0	14.0	14.5	18.0	13.5	6.0	6.0
Exchange rate (USD/UAH) end of year	15.8	24.0	27.2	28.0	27.7	23.7	29.5	31.0
Exchange rate (EUR/UAH) end of year	23.0	26.2	28.3	33.5	31.8	26.4	33.0	34.7



UKRAINIAN CAPITAL MARKETS WEEKLY

FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
02/11/2020	03/11/2020	04/11/2020	05/11/2020	06/11/2020	07/11/2020	08/11/2020
NBU: Minutes		LGB* % UAH 535.0mn	Fed: FOMC	LGB* % UAH 203.1mn	NBU: FX Reserves (deadline - 7th day)	
09/11/2020	10/11/2020	11/11/2020	12/11/2020	13/11/2020	14/11/2020	15/11/2020
Ukrstat: Price indices	NBU: Monetary Statistics	LGB* % UAH 913.7mn	LGB % EUR 4.7mn		LGB* % UAH 141.3mn	
16/11/2020	17/11/2020	18/11/2020	19/11/2020	20/11/2020	21/11/2020	22/11/2020
LGB* % UAH 431.8mn		LGB* % UAH 1,256.6mn	LGB* % UAH 195.6mn	Ukrstat: Retail trade	LGB* % UAH 238.0mn	
23/11/2020	24/11/2020	25/11/2020	26/11/2020	27/11/2020	28/11/2020	29/11/2020
LGB* % UAH 313.6mn Ukrstat: Industrial Production	LGB* % UAH 261.0mn	LGB* % UAH 1,506.2mn LGB % UAH 642.6mn LGB* P UAH 1,400.0mn LGB P UAH 10,414.8mn	LGB* % UAH 506.3mn	LGB* % UAH 251.3mn Ukrstat: Nominal & Real Wage	LGB* % UAH 245.6mn	

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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