

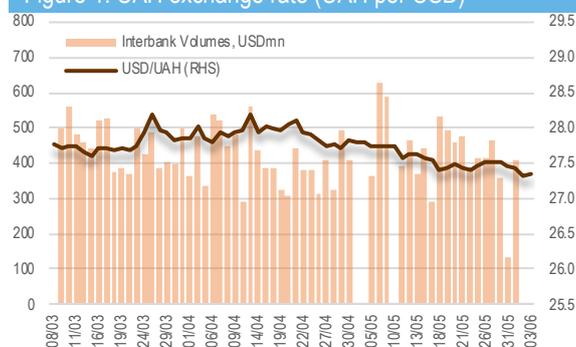
ECONOMICS | INTEREST RATES STRATEGY | FX

3 June 2021

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Renewable energy in Ukraine: slower and smarter
Fitch	B	STABLE	26.02.2021	Ukraine's renewable-energy capacity grew 6.5 times over the last five years. Large investments in renewable generation capacity were fuelled by high feed-in tariffs, which have promised a rapid return on investment. Going forward, the fiscal space to support green energy likely to be limited and this is to have a dramatic impact on number of new installations.
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)



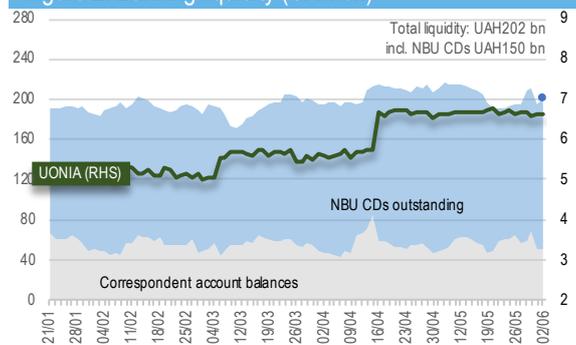
FX and interest rates: USD/UAH edges lower supported by firm FX flows

Ukraine's hryvnia extends recovery against the U.S. dollar driven by favourable macro settings and strong FX supply in particular. The pair traded between 27.33 and 27.35 yesterday, down 0.8% on a week ago.

Export revenue sales by steel and iron ore producing companies, benefiting from record-high prices at the global commodity markets, are the major source of the foreign currency. And rising running costs, largely related to recovering energy prices, keep foreign currency sales high.

Stagnating demand for tourism services, which typically drain cash liquidity, and strong FX inflow from work migrants and IT sector, also contributed to the USD/UAH rate downtrend.

Figure 2. Banking liquidity (UAH bn)

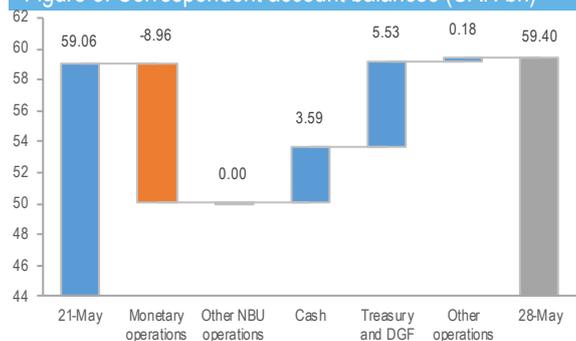


The NBU has not been producing FX interventions since the beginning of April.

Last week FinMin reported about increasing government bonds purchases by foreign investors. Before resumed cooperation with the IMF, however, we see limited support to the hryvnia on this side. The deals are likely to have been triggered by appreciating hryvnia. But the secondary market for government debt remains too slim to digest some meaningful amount of such short-term investments.

Total hryvnia liquidity in the banking system is again above UAH200bn. As of the end of last week, the balance of correspondent accounts with the NBU was UAH59bn and position in the central bank's CDs - UAH150bn.

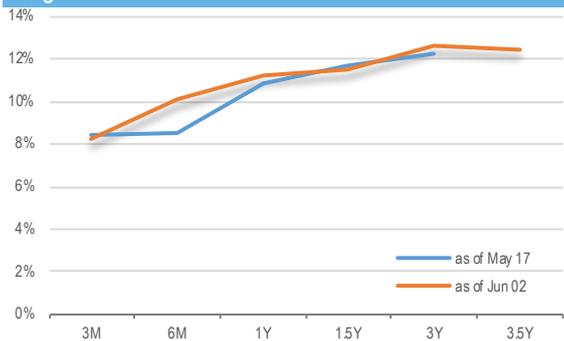
Figure 3. Correspondent account balances (UAH bn)



Monetary support by the NBU of UAH8.9bn provided via refinancing loans was the major source of liquidity. While the system, in general, holds excess liquidity, the recent tax payment season may have strained resources of some banks.

State treasury operations, mostly represented by VAT refunding, have brought in some UAH5.5bn, and another UAH3.6bn came via cash channel. The cash money inflow, however, may reverse by the end of this week as soon as monthly salaries are paid out.

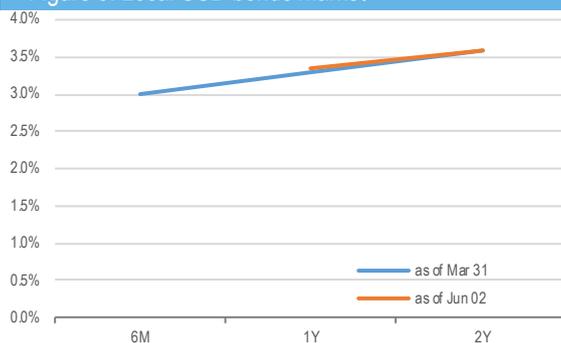
Figure 4. Local UAH bonds market



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	8.50%	8.42%	9.00%	8.40%	11	10	806.00	500.00
UAH	1Y	11.20%	11.20%	11.25%	11.20%	30	29	2 524.93	2 523.93
UAH	1.5Y	11.30%	11.30%	11.30%	11.30%	10	10	988.63	988.63
UAH	2Y	12.05%	12.04%	12.05%	11.99%	16	16	716.82	716.82
UAH	3Y	12.30%	12.30%	12.30%	12.30%	15	15	1 169.30	1 169.30
USD	1Y	3.70%	3.70%	3.75%	3.70%	45	44	339.36	339.06
USD	1.5Y	3.90%	3.90%	3.90%	3.90%	31	31	14.56	14.56

Figure 5. Local USD bonds market



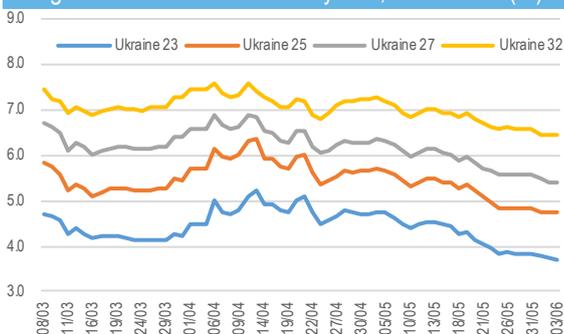
FinMin attracted UAH5.8bn and USD354mn at the primary debt auctions this Tuesday. Nearly all bids were accepted, with the highest demand seen for 1- and 3-year bonds. Worth pointing out, however, that most of the applications were satisfied at the maximum bid rate. In addition, although looks strong, the total demand falls below the amount due to repayment this week – some UAH12.5bn on local currency bonds and USD400mn on FX securities.

Despite the NBU signalling of no more key rate hikes through the end of the year, investors may remain concerned about possible policy tightening by the leading central banks. This could trigger policy adjustment in Ukraine.

Little information on progress in talks with the IMF is another impediment.

But FinMin has recently received dividends from state-owned companies. This, along with rising tax revenues from steel and iron ore producers, could provide some liquidity buffer to the ministry.

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



EUR/USD trends water around 1.2200 mark

The EUR/USD pair continues struggling for direction around the 1.2200 area since mid-May.

Last week FX markets rotated around inflation expectations and their possible effects on the current monetary policies.

The USD holds to multi-month lows amid growing market conviction that the Fed will retain its ultra-loose monetary policy for a longer period, as Federal Reserve officials stick firmly to the same message – the rise in inflation is transitory, and the economy has a long way to go.

At the same time, the main U.S. dollar supporter remains speculation about the Federal Reserve's next moves – will the world's most powerful central bank taper down its bond-buying scheme. According to Jerome Powell, the Fed will reduce its monthly bond purchases before it commits to an interest rate increase. Therefore, the market thinks this could happen sooner if inflation rises too fast.

Across the pond, the European Central Bank is on a different channel. Policymakers have repeated multiple times that the monetary policy will remain “very accommodative” amid persistent low inflation.

The yield on the benchmark 10-year Treasury note ticked down to 1.601% as investors digested last week's inflation data.

Figure 7. EUR USD spot (mid)



Figure 8. Renewable energy capacity, MW

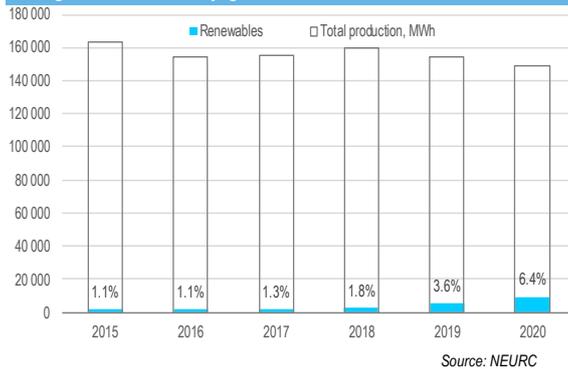
Renewable energy in Ukraine: slower and smarter



Ukraine's renewable-energy capacity grew 6.5 times over the last five years, adding an extra 5.5GW to the total supply—more than the 10% of the country's energy-generation capacity. The surge was largely fuelled by a lucrative compensation mechanism - the green tariff (feed-in tariff, FiT) – offering one of the most attractive feed-in rates thus providing an excellent incentive for development of renewable energy.

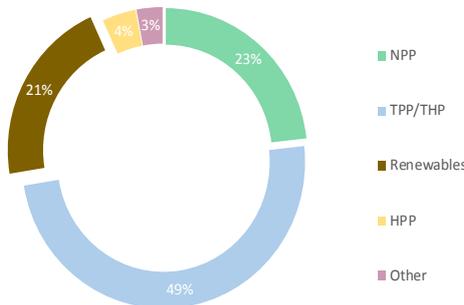
Most of these gains went to new solar installations (SPP, account for 79.9% of the total installed renewables capacity), followed by wind power plants (WPP, 17.2%) and biofuel plants (2.9%). And because initial government subsidies to SPP expired in 2020, twice as much solar renewable-energy capacity was added in the 2019. **With introduction of a new compensation mechanism, a shift towards WPPs and biofuel installations is likely.**

Figure 9. Electricity generation, MWh



The Energy Strategy of Ukraine until 2035 (ESU 2035) implies increase in a share of renewables in Ukraine's Total Primary Energy Supply to 25% by 2035. The State Agency for Energy Efficiency (SAEE) has estimated that approximately EUR30bn will need to be raised for the construction of renewable energy facilities. Looking forward, considering Ukraine's low share of renewables in total primary energy supply (7.7% in 2021 according to Ministry of energy and environmental protection projections) compared with European Union (30% in 2018), **it has significant technical potential for further renewable energy sources development.** Heinrich Boell Foundation study finds that a 63% share of renewable electricity generation by 2035 is technically feasible and economically viable. The economic feasibility of developing this potential, however, depends on factors such as fossil fuel prices, technology availability and public support.

Figure 10. Total energy supply cost breakdown in 2020



Large investments in renewable generation capacity were fuelled by high feed-in tariffs, which have promised a rapid return on investment. However, in spring 2020, a crisis hit the renewable energy market; the green energy producers started to experience difficulties with receiving payments for generated electricity. By the end of 2020, the debt has reached tenth of billions of UAH. **Going forward, the fiscal space to support green energy likely to be limited and this is to have a dramatic impact on number of new installations.**

Figure 11. Key changes following restructuring of FiT

Favourable

Stabilization clause for RES producers / investors Reduction of FiT rates without extension of the FiT validity period

"Green" auctions to be launched in 2021 and the model of holding auctions is being improved

Curtailment compensation mechanism

Certain measures are envisaged to improve settlements with RES producers going forward

GoU is instructed to develop law on mechanisms for settlement of the Guaranteed buyer's historical debt (approx. UAH 16 billion as of July 2020)

Unfavourable

Reduction of FiT rates without extension of the FiT validity period

Strengthening liability for imbalances

Source: KPMG



UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2015	2016	2017	2018	2019	2020	2021E	2022F
Real sector								
Real GDP (%YoY)	-9.8	2.4	2.5	3.4	3.2	-4.0	4.4	3.8
Industrial production (%YoY)	-12.3	4.0	1.1	3.0	-0.5	-4.5	1.5	1.0
Retail sales (%YoY)	-19.8	4.3	6.5	6.2	10.3	8.4	9.2	10.0
Unemployment rate end of year (ILO, working age)	9.1	9.3	9.5	8.8	8.2	10.1*	9.3	8.5
Nominal GDP (UAH bn)	1 989	2 385	2 984	3 561	3 975	4 194	4 370	4 537
Nominal GDP (USD bn)	90	93	112	131	155	156	156	151
Prices								
CPI (average %YoY)	48.5	14.9	14.4	11.0	7.9	2.7	7.5	5.7
CPI (end of year %YoY)	43.3	12.4	13.7	9.8	4.1	5.0	6.4	5.0
Real average wage growth (%YoY)	-20.2	9.0	19.1	12.5	9.8	7.4	3.5	3.0
Fiscal balance (% of GDP)								
State budget deficit (without Naftogaz)	2.3	2.9	1.6	2.4	1.8	5.5*	3.0	2.5
Total public debt (% of GDP)	79.4	81.0	71.8	61.0	51.6	64.4*	64.6	61.5
External balance								
Exports of goods and services (USD bn)	47.9	46.0	53.9	59.2	63.6	60.6	62.6	65.0
Imports of goods and services (USD bn)	50.2	52.5	62.7	70.6	76.1	62.3	72.5	78.0
Current account balance (USD bn)	5.0	-1.9	-3.5	-6.4	-4.1	6.6	-0.6	-3.2
Current account balance (% of GDP)	5.6	-2.0	-3.1	-4.9	-2.7	4.2	-0.4	-2.1
Net FDI (USD bn)	-0.5	3.8	3.7	4.5	5.9	-0.4	2.0	3.0
Foreign exchange reserves (end of year)	13.3	15.5	18.8	20.8	25.3	29.1	31.0	32.5
Imports coverage (months of imports of goods)	3.4	3.7	3.6	3.5	3.9	4.8	5.1	5.0
Interest and exchange rates								
NBU discount rate (% end of year)	22.0	14.0	14.5	18.0	13.5	6.0	8.0	6.0
Exchange rate (USD/UAH) end of year	24.0	27.2	28.1	27.7	23.7	28.3	29.8	31.0
Exchange rate (EUR/UAH) end of year	26.2	28.4	33.5	31.7	26.4	34.7	37.3	40.3

*estimates, no official data yet available



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UKRAINIAN CAPITAL MARKETS WEEKLY

FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
31/05/2021	01/06/2021	02/06/2021	03/06/2021	04/06/2021	05/06/2021	06/06/2021
NBU: BoP NBU: Gross External Debt Future Payments		LGB* % UAH 568.5mn LGB % UAH 1 272.1mn LGB P UAH 11 302.4mn	LGB % USD 14.6mn LGB P USD 387.7mn	Ukrstat: Business confidence		
07/06/2021	08/06/2021	09/06/2021	10/06/2021	11/06/2021	12/06/2021	13/06/2021
NBU: FX Reserves (deadline - 7th day)		LGB* % UAH 398.4mn LGB* P UAH 1 500.0mn Ukrstat: Price indices NBU: Monetary Statistics	ECB: MPC			
14/06/2021	15/06/2021	16/06/2021	17/06/2021	18/06/2021	19/06/2021	20/06/2021
		LGB* % UAH 1 214.1mn LGB % UAH 2 057.8mn LGB P UAH 14 025.1mn Fed: FOMC	LGB % USD 11.5mn NBU: MPC	NBU: External Debt		FGB % EUR 67.5mn
21/06/2021	22/06/2021	23/06/2021	24/06/2021	25/06/2021	26/06/2021	27/06/2021
	Ukrstat: GDP Ukrstat: Retail trade	LGB* % UAH 655.1mn	Ukrstat: Industrial Production			

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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