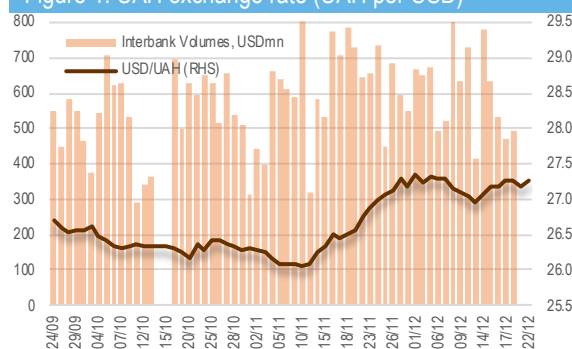


ECONOMICS | INTEREST RATES STRATEGY | FX

22 December 2021

UKRAINIAN CAPITAL MARKETS WEEKLY

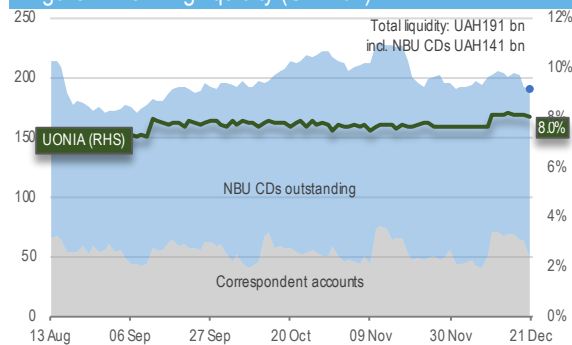
	Rating	Outlook	Last update	This week in focus: Another rate hike is likely in 2022
Fitch	B	POSITIVE	06.08.2021	Ukraine's central bank delivered another policy rate hike of 50bp on December 9. While the move came as no surprise, fresh arguments advanced by the NBU – the rising geopolitical tension and deteriorating global financial conditions - may shape the pretext for further policy tightening in 2022. We see at least one more key rate increase in 1Q22.
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 trades sideways

The USD/UAH has been moving in a relatively narrow trade band since our previous report. The pair ended Wednesday's trading session (December 22) at 27.29 figure, up 0.4% for the day.

For a while, the hryvnia attempted to regain the 27.00 level against the greenback after Russia's unusual military activity near the border with Ukraine turned into simmering tension. The rebound however proved to be short-lived, with hard-to-foresee FX purchases by state-run entities being the major cause behind the pair's retreat above the 27.20 mark.

As typical for the second half of December, the government ramps up spending to catch up with the state budget's projections. Because some funds may ultimately appear on the FX market, the USD/UAH pair is likely to perform high volatility in the final weeks of the year.

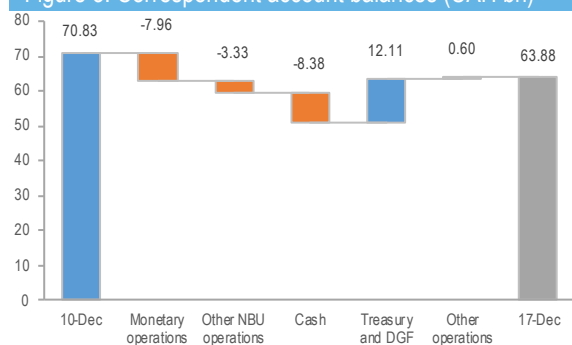
Figure 2. Banking liquidity (UAH bn)


The contrasting situation on the cash FX market caused by increased household spending before the upcoming holidays might help smooth the likely downtrend. But generally, the cash market tends to follow the interbank one.

Banking liquidity barely changed over the past week. As of December 17, the number of hryvnia funds in the system remained slightly above UAH200bn.

There were, however, notable changes in the structure of liquidity.

Some UAH8.4bn of liquidity went into cash money, as banks are getting prepared for the lengthy holiday season. By the end of the year, total cash outstanding may exceed UAH620bn, up 1.3% from the current level.

Figure 3. Correspondent account balances (UAH bn)


About UAH3.3bn were absorbed by the NBU via FX interventions. **Net FX sales by the central bank over the last week amounted to USD122.5mn.**

The outflow was offset by government expenditures for UAH12.1bn. And an extra UAH30bn might be injected into the system by the end of the month if FinMin follows its typical pattern of massive spending in the second half of December.

By the end of last week, the amount of funds on correspondent accounts with the NBU dropped by UAH7bn to UAH64bn, while banks' position in NBU's CDs increased by UAH7.8bn to UAH139bn.

Figure 4. Local UAH bonds market

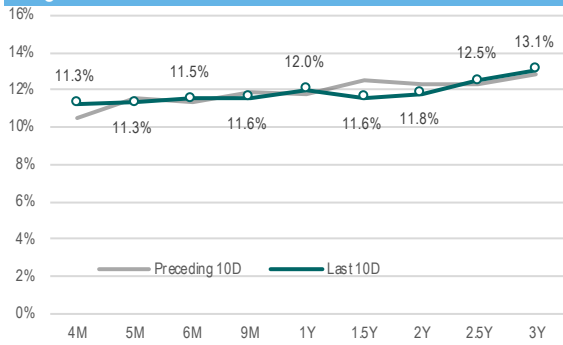
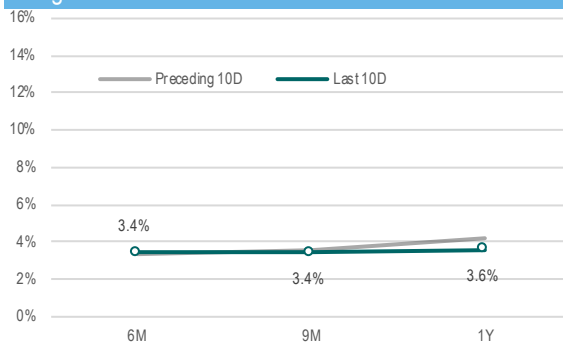


Figure 5. Local USD bonds market



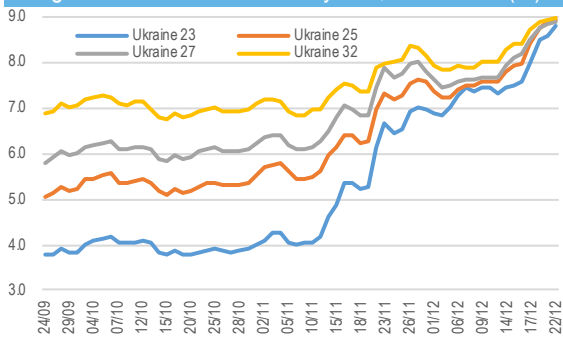
Government bond market

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	2M	10.50%	10.50%	10.70%	10.50%	16	15	1 736.68	1 636.68
UAH	4M	10.80%	10.80%	10.80%	10.80%	3	3	4 000.32	4 000.32
UAH	1Y	11.90%	11.88%	11.90%	11.85%	22	22	2 597.82	2 597.82
UAH	1.5Y	11.88%	11.88%	11.88%	11.88%	5	5	3.78	3.78
UAH	2Y	12.85%	12.78%	13.09%	12.65%	23	21	4 820.64	2 070.64
UAH	2.5Y	12.85%	12.85%	12.85%	12.85%	2	2	930.00	930.00
UAH	2.5Y	12.90%	12.90%	12.90%	12.80%	7	7	884.89	884.89
UAH	3Y	12.90%	12.88%	12.95%	12.85%	11	10	96.03	71.03
UAH	5.5Y	13.25%	13.25%	13.25%	13.25%	12	12	68.50	68.50
USD	1Y	3.70%	3.70%	3.75%	3.70%	40	39	307.96	307.46

FinMin resorted to new price concessions to keep with its projections on amounts attracted. As typical for periods when the ministry needs funding, a wide range of bonds with no volume caps was offered at the last primary debt auction.

Among local currency bonds, the market demand was principally concentrated in the short maturities. A small number of bids behind the UAH4bn demand for 4m securities, however, could point to the involvement of the state-owned banks in the transaction. Besides, a high number of bids worth UAH4.8bn in total received 2y bonds. But more than half of them were rejected as FinMin decided not to move the cut-off rate above 12.85%.

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



EUR/USD draws a sawtooth pattern around the 1.1300 mark

A combination of diverging forces failed to provide any specific impetus to the EUR/USD. **The pair spent the last two weeks moving around the 1.1300 mark.**

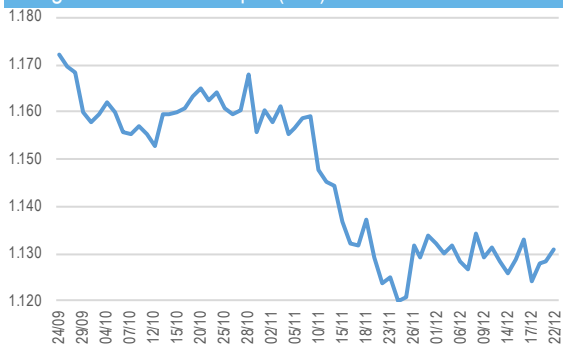
The Fed kept its interest rates unchanged at the 0 to 0.25% range but signaled an acceleration of the bond taper in 2022. Additionally, it released its Summary of Economic Projections. In this report, the **U.S. central bank policymakers expect three rate hikes by the end of 2022, projecting the Federal Fund Rates at 0.90%.**

The ECB also kept rates unchanged. Bond buying under its EUR1.85tn Pandemic Emergency Purchase Programme, which is due to end in March 2022, will be cut next quarter as the scheme winds down. However, bond buys under the Asset Purchase Programme will be ramped up, having continued at a monthly pace of EUR20bn euros in conjunction with PEPP.

Because both actions had already been priced by the market, no material change in the pair movement followed.

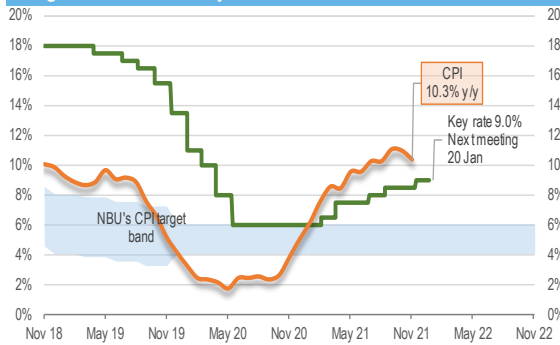
The final U.S. GDP report showed that the world's largest economy expanded by 2.3% annualized pace during the 3Q as against 2.1% estimated previously. This, however, also did little to lend any support to the USD, as a rise in optimism on the news that the Omicron is less severe than first thought plays against the safe-haven greenback.

Figure 7. EUR USD spot (mid)



Treasury yields hold steady ahead of holidays. The yield on the benchmark 10-year Treasury note was little changed at 1.478% compared to the level two weeks ago.

Figure 8. CPI vs Key rate evolution

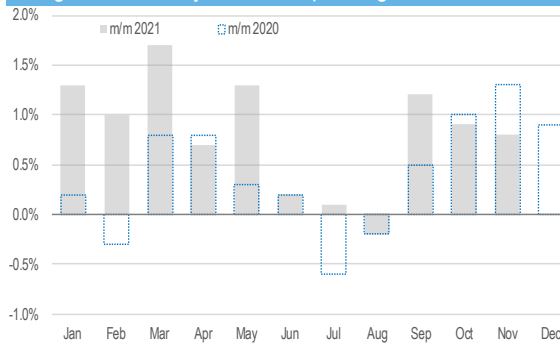


Slow disinflation and global tightening cycle may prompt new rate hikes

Ukraine's central bank delivered another policy rate hike of 50bp on December 9. While the move came as no surprise, fresh arguments advanced by the NBU – the rising geopolitical tension and deteriorating global financial conditions – may shape the pretext for further policy tightening in 2022. We see at least one more key rate increase in 1Q22. The next actions will largely depend on natural gas prices at the end of the heating season and the effectiveness of other measures taken by the NBU.

Inflation momentum remains in place. Annual CPI growth slowed to 10.3% in November from 10.9% a month prior. A seeming improvement, however, has mostly to do with a high base of 2020. Core inflation accelerated to 7.7% y/y from 7.6% in October. The downtrend in monthly inflation, with index growth slowing to 0.8% in November from 1.2% in September, does not lend much hope too. Running hot inflation across developed economies and return of the USD/UAH rate above 27.00 level amid the escalation of tensions between Ukraine and Russia means reemergence of imported inflation in local prints in the short run. Hence, despite some improvement, our forecast for consumer price index growth in 2021 remains in the double-digit zone.

Figure 9. Monthly consumer prices growth



... and will hold well into 2022. Looming pro-inflation risks and more importantly entrenched inflation expectations will likely impede price growth slowdown in 2022. We see year-end CPI growth decelerated to 8.9% at best.

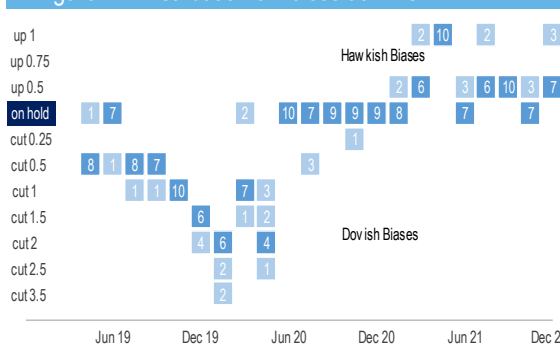
Figure 10. Contribution to monthly CPI growth



Regarding the former, it is worth noting the central bank's concerns over future harvest, "potentially having an adverse impact in 2H22", according to the minutes. Such pessimistic expectations expressed long before the appearance of any early results on the quality of crops could result from the global fertilizer market tightening on the back of the continuous growth in the cost of gas and persistent challenges with logistics.

In turn, the latter may give rise to broad-based wage inflation. Wage growth over 2020-2021 was largely limited to a few industries with the tightest labor supply. Most of the economy, however, saw wages lagging behind prices because the low annual prices growth in the correspondent years provided little room for adjusted increases. As wages try to catch up to the double-digit prices growth of 2021, inflation may get more persistent and hence feed up inflation expectations.

Figure 11. Distribution of voices at MPC



The question is not so much of whether but how many rate hikes to expect. The latest MPC minutes were full of hawkish sentiment, leaving no doubt about further policy tightening in the year to come. While no clues on the number and timing of future rate hikes were provided, it would be reasonable to expect expansion in confidence intervals in the next NBU's fun chart on future policy actions, considering the combination of both external and internal factors.

Worth also noting, that the importance to strengthen the transmission mechanism was repeatedly stressed in the minutes. Among such actions might be giving a "green light" to local banks to buy Eurobonds of Ukraine. Putting aside the long-term implication of such an action, which is still under consideration, in the perspective of the year a rise in competition for money in the country is likely. That may boost local rates for both FX and UAH money.

The global tightening cycle should also be taken into account in the context of the NBU's future policy actions. As inflation in many developed economies hit multi-year highs, more surprising monetary policy actions may follow next year, prompting the NBU to respond.

Considering the above, **we expect policy easing will be off the 2022 agenda.**

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	3.1	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	5 005	5 816
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	8.0	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	60.6	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	-0.3	-1.6
Net FDI (USD bn)	-0.5	3.8	3.7	4.5	5.9	-0.4	5.5	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	9.0	9.5
Exchange rate (USD/UAH) end of year	24.0	27.2	28.1	27.7	23.7	28.3	27.0	29.8
Exchange rate (EUR/UAH) end of year	26.2	28.4	33.5	31.7	26.4	34.7	30.5	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
20.12.2021	21.12.2021	22.12.2021	23.12.2021	24.12.2021	25.12.2021	26.12.2021
NBU: Minutes Ukrstat: GDP Ukrstat: Retail trade		LGB* % UAH 655.1mn Ukrstat: Industrial Production				
27.12.2021	28.12.2021	29.12.2021	30.12.2021	31.12.2021	01.01.2022	02.01.2022
	Ukrstat: Nominal & Real Wage	LGB* % UAH 553.0mn		NBU: BoP		
03.01.2022	04.01.2022	05.01.2022	06.01.2022	07.01.2022	08.01.2022	09.01.2022
		LGB % UAH 1 205.8mn LGB P UAH 10 970.4mn				
10.01.2022	11.01.2022	12.01.2022	13.01.2022	14.01.2022	15.01.2022	16.01.2022
		LGB* % UAH 223.7mn	LGB P USD 176.6mn LGB % USD 9.6mn NBU: Monetary Statistics			

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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