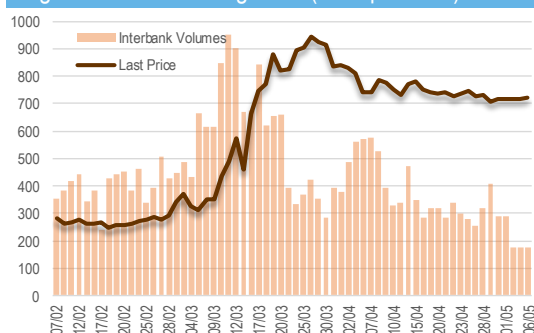


**ECONOMICS | INTEREST RATES STRATEGY | FX**

6 May 2020

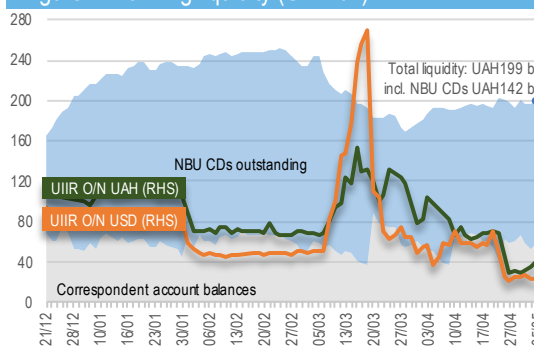
# UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: NBU cuts rate by 2pp, considers another move in June
Fitch	B	STABLE	22.04.2020	The NBU has cut its key lending rate to 8%, its lowest level since the introduction of inflation targeting regime. The NBU has also introduced a bundle of other liquidity supporting measures. The announced monetary stimulus is to help economy to recover after COVID, but its prolonged application needs implementation of more comprehensive measures.
S&P	B	STABLE	13.03.2020	
S&P (N)	uaA	-	13.03.2020	
Moody's	Caa1	POSITIVE	22.11.2019	

**Figure 1. UAH exchange rate (UAH per USD)**

**FX and interest rates: USD/UAH hovers around 27 amid ongoing lockdown**

**The USD/UAH pair movement has been confined to a narrow range around 27 level** since our last report (April 8) as lockdown in Ukraine keep on weighing on business activity. According to the National bank of Ukraine, monthly market turnover produced by banks' customers dropped by 33% m/m to circa USD9bn in April, with supply-demand surplus amounting to USD0.67bn against USD1.72bn gap in March.

**By the end of Wednesday (May 6), the pair traded as low as 26.9.** As a lockdown has been extended until 11th of May, gradual consumption of FX savings by both businesses and households is not ruled out. Such a development might contribute to further appreciation of the local currency.

**Figure 2. Banking liquidity (UAH bn)**


On the other hand, we see major exporters have notably decreased FX supply after the Finance Ministry refunded some VAT taxes in late April. Besides, some local entities of foreign holdings have announced hefty annual dividends and are about to increase FX purchases.

**Banking sector UAH liquidity has stabilized around UAH200bn since early April:** by the end of Tuesday (May 5) total funds in the system amounted to UAH199bn, with correspondent account balances equal to UAH58bn.

Despite a little change, there are two distinct trends behind the figures. The first is represented by increasing State treasury operations. Some corresponding injections has been seen in March, but they have notably accelerated in April (total inflow during the last month amounted to circa UAH33bn). The operations are likely related to medical procurements by the government and other fiscal measures aimed at supporting pensioners and quarantined people.

**Figure 3. Key autonomous liquidity factors (UAH bn)**


Another important trend is increasing demand for cash. The second wave of withdrawals appeared in late March. Since then the total outflow has amounted to circa UAH29.5bn and the total cash outstanding has hit a record high of UAH454bn, or 11.4% of the last year's GDP. Part of operations might be ascribed to Easter holidays, when increased demand for cash is common, but, in general, the outflow was seen all month long.

Worth also mentioning stabilization of interest rates at the money market, and their prompt adjustment to the recent monetary policy easing. The O/N rate for UAH liquidity has settled around the revised key rate – 8% per annum.

Figure 4. Local UAH bonds market

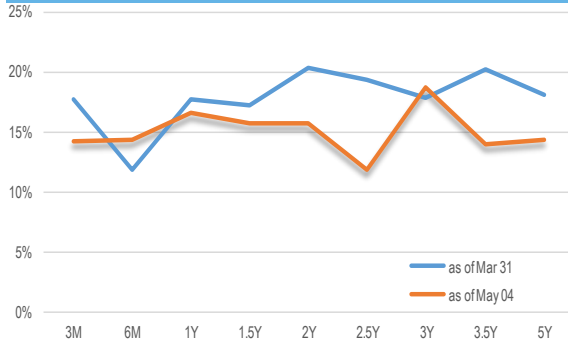
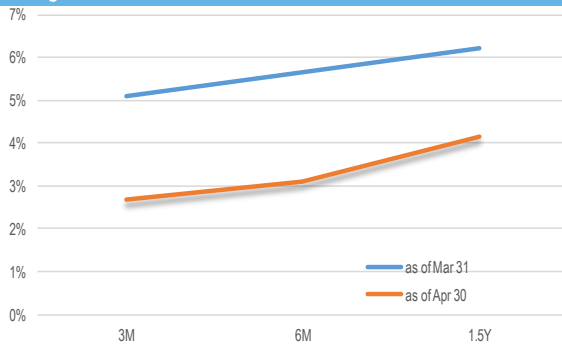


Figure 5. Local USD bonds market



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	3M	11.30%	11.26%	16.00%	11.00%	14	12	10 531.55	10 298.00

The Ministry of Finance (FinMin) conducted on Tuesday (May 5) second in a row primary debt auction after a month break, offering 3-month bonds in local currency with no volume caps.

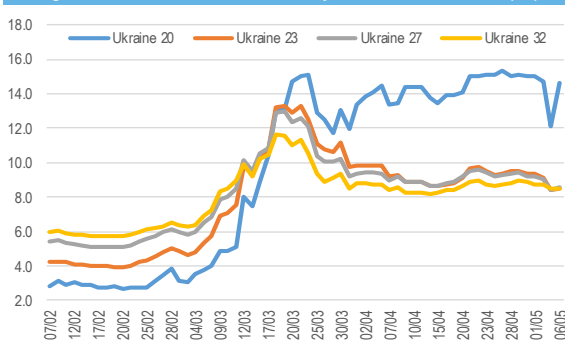
UAH10.3bn worth 3-month bonds were placed with an average yield of 11.26% per annum (cut-off rate remained unchanged at 11.3%, as compared to the action on April 28), with 12 of 14 bids accepted. Total demand amounted to UAH10.5mn, but the ministry decided not to increase the rate to 16% per annum.

Apparently, state-owned banks were the key participants of the auction, given that a day ago an average yield for government bonds with a similar tenure was around 14.3% per annum at the secondary market.

It is likely that another UAH bonds auction was conducted as a rollover of maturing debts.

Local currency government bonds' yield at the secondary market moved lower in April and settled around 14% percent along the curve. In early May, however, yields rebounded to the vicinity of 15%. Average daily turnover has fallen by half since early March to circa UAH1.2bn.

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



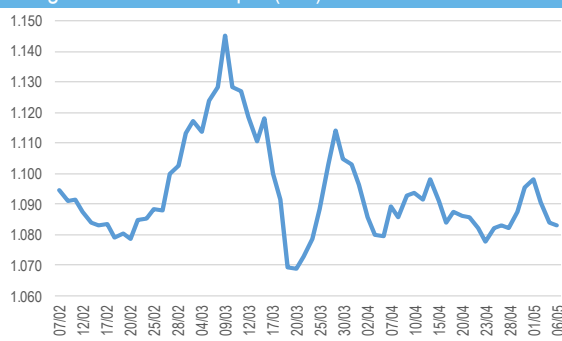
EUR/USD stays muted despite troubled stats

The EUR/USD rate keeps on drifting around 1.085 mark, despite initial estimate on USD GDP in the 1Q20 came in at minus 4.8%. This marked the first negative GDP reading since the 1.1% decline in the 1Q14 and the lowest level since the 8.4% plunge in 4Q of 2008 during the worst of the financial crisis.

The biggest drags on the economy were consumer spending, which comprise 67% of total GDP, nonresidential fixed investment, exports and inventories.

Consumer expenditures, despite being shuttered only at the end of March, plunged 7.6% in the quarter as all nonessential stores were closed and the cornerstone of the U.S. economy was taken almost completely out of stats.

Figure 7. EUR USD spot (mid)

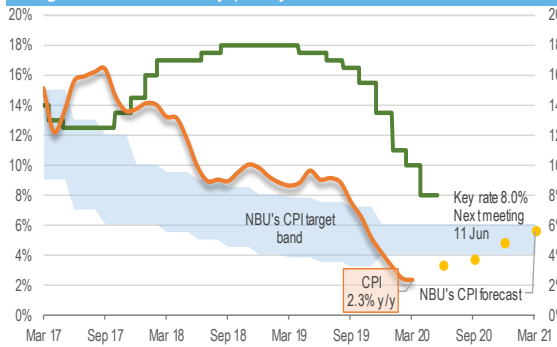


The euro, however, fails to gain momentum on the background. Across the pond, Germany has suffered a setback, with growing infection rates that may force the continent's largest economy to reimpose restrictions.

Besides, despite an agreement by EU leaders to fund a recovery from the coronavirus pandemic, delays to an agreement on divisive details of the European Union's stimulus package has kept investors from turning more bullish on the euro.

U.S. government debt prices dipped after a dismal GDP number. The yield on the benchmark 10-year Treasury note was about 2 basis points higher at 0.68% and the yield on the 30-year Treasury bond was also up at 1.35%. Yields move inversely to prices.

Figure 8. CPI vs Key policy rate



NBU cuts rate by 2pp, considers another move in June

Ukraine's central bank (NBU) has cut its key lending rate to 8% from 10%, its lowest level since the introduction of inflation targeting regime in January 2016. Deeper than expected reduction has not come alone, the NBU has also introduced a bundle of liquidity supporting measures and committed to further monetary policy easing. The announced monetary stimulus is to help economy to recover after COVID, but its prolonged application needs implementation of more comprehensive measures.

**Monetary Policy response to COVID-19 pandemic.** In addition to a reduced key rate decision, the central bank has increased the duration of new refinancing loans to banks to 90 days from 30 days. Besides, the NBU has expanded the list of eligible collaterals for liquidity operations to government-guaranteed corporate bonds and municipal bonds. The banks will also be able to use these securities in repo transactions with the NBU. The central bank has also announced an introduction in May of a long-term liquidity provision at flexible rates and duration up to 5 years.

**Underlying conditions smooth the way.** Consumer price index growth declined to 2.3% y/y March from 2.4% y/y a month before. The change has mostly to do with a high base effect (see our report of March 12). Unlike monthly deflation in February, a 0.8% m/m inflation in March didn't come as surprise and was primarily driven by a typical for early spring growth in prices of clothing and footwear as goods of the new season enter the market. Many other segments showed positive growth too. Declining costs for utilities, gradually adjusting to global tendencies in energy commodities prices, produced the major drag.

**It is not only about slowing inflation.** We consider a response to the COVID-19 outbreak was the primary motive for the NBU to deliver so aggressive monetary policy easing. The local economy heads for a deep downturn in 2Q20, with many businesses likely facing a crucial shortage of liquidity due to a lockdown.

The reduced price for money, together with foregoing extended liquidity provision, will help to ease cash flow strains and prevent from an uncontrolled mounting of financial imbalances.

**Joining the real negative rates club.** The central bank has also expressed readiness to reduce policy rate to 7% or lower though the end of the year, provided the Ukrainian authorities continue cooperation with the International Monetary Fund (IMF) and keep on delivering structural reforms.

We expect the NBU to cut key rate to 6% in 2020 and admit real interest rate (nominal rate less annual inflation) dipping to the negative zone after inflation prints adjust to the local currency devaluation. Such a development might help local businesses to withstand ongoing and upcoming COVID-related challenges, and highly likely review and adjustment of global value chains in particular.

**Dovish benefits need special care.** Worth stressing, however, that a bare monetary policy easing might lead to accumulation of financial imbalances. Comprehensive structural reforms aimed at improving country's risk profile are of a crucial importance for keeping key rate reduced.

Figure 9. GDP evolution

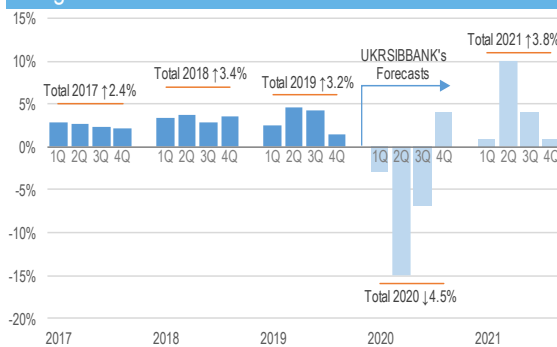


Figure 10. Monetary measures

- ▶ Frequency of liquidity tenders doubled
- ▶ Modified calculation of reserve requirements
- ▶ Deferred stress-testing for banks
- ▶ FX interventions to smooth out UAH moves
- ▶ Credit lines to banks extended to 90d from 30d
- ▶ Long-term liquidity provision at flexible rates
- ▶ Extension of eligible collaterals for liquidity operations

Figure 11. Schedule for the Monetary Policy Decisions

Statement	Minutes
11 Jun 2020	22 Jun 2020
23 Jul 2020	03 Aug 2020
03 Sep 2020	14 Sep 2020
22 Oct 2020	02 Nov 2020
10 Dec 2020	21 Dec 2020





# UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2014	2015	2016	2017	2018	2019	2020E	2021F
<b>Real sector</b>								
Real GDP (%YoY)	-6.6	-9.8	2.4	2.5	3.4	3.2	-4.5	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	4 117	4 633
Nominal GDP (USD bn)	131	90	93	112	131	154	144	154
<b>Prices</b>								
CPI (average %YoY)	12.1	48.7	16.5	14.4	10.5	7.9	6.0	5.5
CPI (end of year %YoY)	24.9	43.3	12.4	13.7	9.8	4.1	7.5	6.0
Real average wage growth (%YoY)	-6.5	-35.0	10.0	18.9	9.7	9.8	-5.5	3.5
<b>Fiscal balance (% of GDP)</b>								
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
<b>External balance</b>								
Exports of goods and services (USD bn)	65.4	47.9	46.0	54.0	59.0	63.4	50.5	55.6
Imports of goods and services (USD bn)	70.0	49.6	51.8	60.8	70.5	75.5	59.5	66.6
Current account balance (USD bn)	-4.6	1.6	-1.3	-2.4	-4.7	-1.1	-1.0	-2.1
Current account balance (% of GDP)	-3.4	1.8	-1.4	-2.1	-3.3	-0.7	-0.7	-1.3
Net FDI (USD bn)	-0.3	3.0	3.3	2.6	2.4	2.5	1.0	3.5
Foreign exchange reserves (end of year)	7.5	13.3	15.5	18.8	20.8	25.3	23.5	26.5
Imports coverage (months of imports of goods)	1.5	4.4	3.7	3.6	3.4	3.9	4.7	4.8
<b>Interest and exchange rates</b>								
NBU discount rate (% end of year)	14.0	22.0	14.0	14.5	18.0	13.5	6.0	5.0
Exchange rate (UAH/USD) end of year	15.8	24.0	27.2	28.0	27.7	23.7	29.5	31.0
Exchange rate (UAH/EUR) end of year	23.0	26.2	28.3	33.5	31.8	26.4	33.0	34.7

## Two Weeks Ahead

Date/Deadline	Event	Notes
07-May (Thu)	NBU: FX Reserves (deadline - 7th day of the month)	April
08-May (Fri)	Ukrstat: Consumer & Production Price Indexes	April
12-May (Tue)	NBU: Monetary & Financial Statistics (Preliminary)	April

## Upcoming pay offs related to local government bonds

Date	Type of debt	Payment	Amount
06-May (Wed)	Local bonds	Coupon UAHmn	65.4
		Coupon UAHmn (capital notes)	535.0
		Principal UAHmn	6 003.1
08-May (Fri)	Local bonds	Coupon UAHmn (capital notes)	203.1
13-May (Wed)	Local bonds	Coupon UAHmn	797.0
		Coupon UAHmn (capital notes)	116.7
		Coupon USDmn	8.9
		Principal USDmn	325.4

\*capital notes - government bonds, which were issued for recapitalization of state-owned banks



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