



**ECONOMICS | INTEREST RATES STRATEGY | FX**

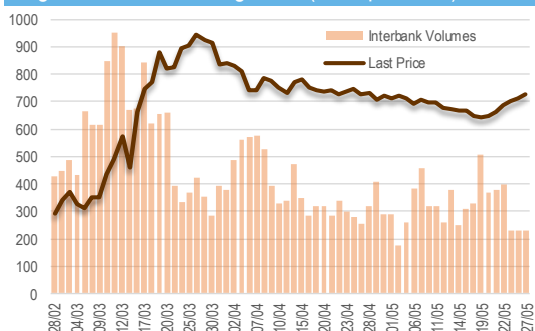
27 May 2020

**UKRAINIAN  
CAPITAL MARKETS  
WEEKLY**

	Rating	Outlook	Last update	This week in focus: Industry remains in the doldrums, retail erases past gains
Fitch	B	STABLE	22.04.2020	Economic activity indicators swooped down in April as the coronavirus damage reveals itself. IP has posted one of its steepest one-month falls on record since Russian aggression. Similarly, retail trade saw double-digit plunge. Despite an image of a black swan is seen across all the charts, risk of a deeper crisis have been mitigated after the authorities confirmed their commitment to reforms.
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: Hryvnia slips as lockdown restrictions ease



**The Ukrainian hryvnia retreated to the vicinity of 27 figure against the U.S. dollar as gradual lifting of lockdown measure brings back demand for FX.**

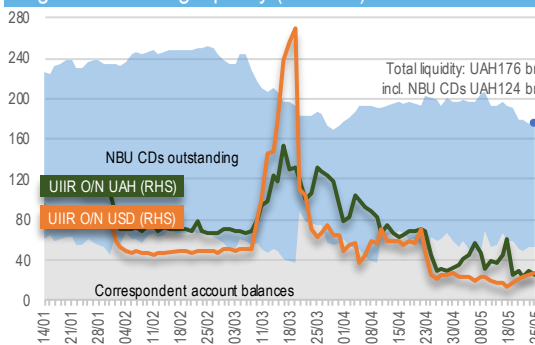
Importers of fuels were the first who responded to expected recovery in business activity, piling up FX stocks for the follow-up energy commodities purchases.

In turn, exporters have narrowed FX supply, waiting for upcoming VAT refunding.

Increased central bank's FX interventions reinforced the downward USD/UAH pair trend. **During last week the National bank of Ukraine (NBU) purchased on the market circa USD230mn.**

Figure 2. Banking liquidity (UAH bn)

Last week the International Monetary Fund (IMF) and Ukrainian authorities reached staff level agreement on a new 18-month stand-by arrangement of SDR3.6bn (equivalent to USD5bn). When approved by the IMF executive board, the deal might ramp up foreign appetite for local government bonds, bringing some support to local currency in a month horizon.



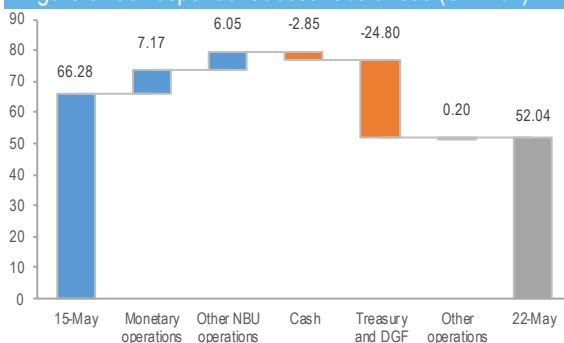
**Banking liquidity narrowed by UAH21.2bn - to UAH175bn** by the end of last week, incl. correspondent accounts balance declined by UAH14.2bn - to UAH52bn.

The major outflow produced State treasure operations, draining from the system UAH24.8bn, incl. UAH11.4bn via primary debt auctions.

Continuing cash withdrawals consumed another UAH2.8bn, bringing total cash outstanding above UAH470bn.

Figure 3. Correspondent account balances (UAH bn)

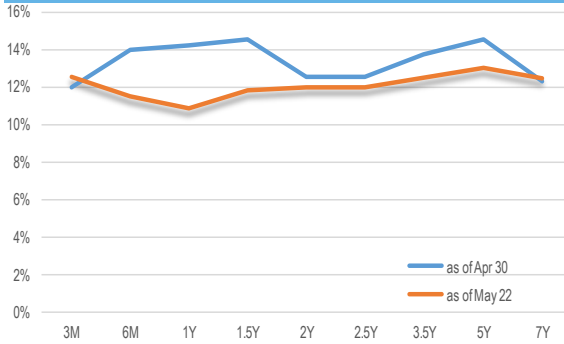
Central bank's FX interventions for UAH6bn were the major source of fresh liquidity.



Monetary operations for UAH7.2bn has mostly to do with reallocation of funds from certificates of deposits (CDs) to correspondent accounts. As a result, banks' investments into O/N CDs declined to UAH13.1bn and participation in 2W CDs contracted to UAH110bn. The extended liquidity provision package had limited impact on total liquidity balance so far.



Figure 4. Local UAH bonds market

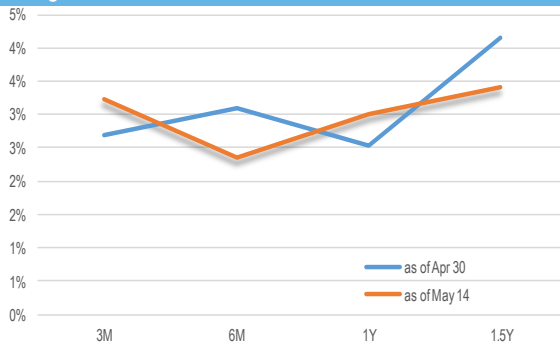


Government bond market

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	10.25%	10.19%	11.00%	9.99%	7	4	1 336.68	500.00
UAH	6M	10.95%	10.33%	11.00%	9.99%	5	4	228.99	208.99
UAH	9M	0.00%	0.00%	11.24%	11.24%	3	0	1 225.00	0.00
UAH	1Y	10.97%	10.97%	11.24%	10.95%	8	7	1 247.82	347.82

**Another primary debt auctions on May 26 produced meager results.** The FinMin offered a set of local currency bonds with a tenure ranging from 3m to 1y, limiting size of the allocation of 3m and 6m instruments to UAH500mn.

Figure 5. Local USD bonds market

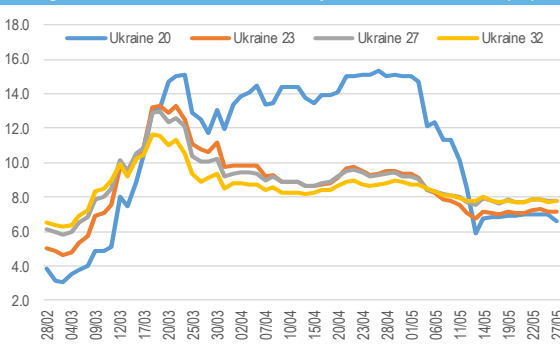


The total demand at four auctions declined to UAH4bn compared with UAH18.3bn a week earlier. Being confident about its debt sustainability amid continued cooperation with the IMF, the ministry sacrificed some UAH3bn of bids submitted for the sake of reducing cost of borrowings, including refused to accept bids for 12m securities worth UAH0.9bn and all of three submitted applications for 9m bonds worth UAH1.23bn.

As a results, the cut-off rate for 3m and 6m government bonds was reduced by 25 basis points (bps) to 10.25% and 5 bps to 10.95% per annum respectively. For 12m bonds cut-off rate remained unchanged at the level of 10.97%. For comparison, the average yield at the secondary market for 3m and 6m bonds has settled above 11.5%, and for 1y securities declined to 10.9%.

Indeed, resumed cooperation with the IMF and low inflation might induce some fresh foreign interest to local currency bonds. Such a development will contribute to further contraction of cost of local public debt likely below 10%.

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

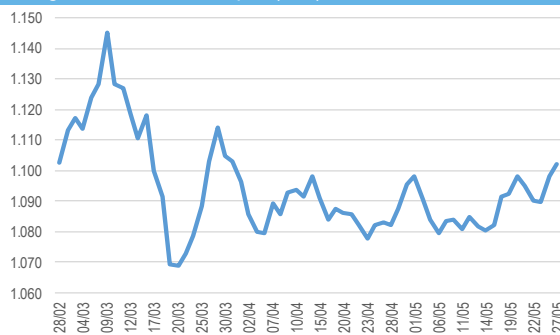


EUR/USD tops 1.10 amid growing optimism about coronavirus

**The EUR/USD currency pair continues enjoying upside momentum and edges up above 1.10 level.** Falling numbers of infected in both America and Europe, gradual steps to reopen economies, and additional vaccine efforts are keeping the mood upbeat and sap demand for safe-haven dollar.

**Simmering tensions between U.S. and China seems to fail attract any meaningful attention. Markets are focused on economic stimulus instead.** In particular, the head of Fed Jerome Powell has recently ruled out negative rates, although he stressed the readiness of the Fed to implement further measures to support the economy.

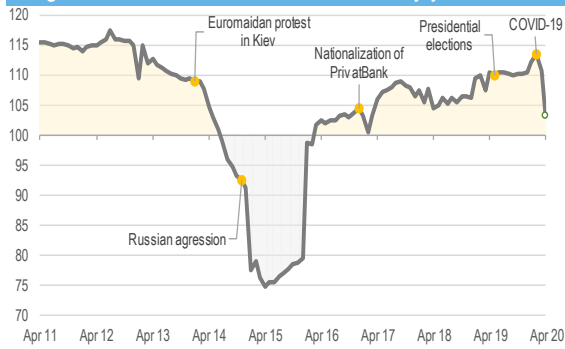
Figure 7. EUR USD spot (mid)



**Speculation is also mounting ahead of next week's European Central Bank (ECB) decision.** The ECB may opt to expand its special Pandemic Emergency Purchase Program (PEPP) to as much as EUR1tn from the current EUR750bn. In addition to that, the central bank might relax its capital key limits, enabling it to focus on countries in higher need such as Italy rather than buying debt according to member states' economic output.

**Fixed income market turned out to be more vulnerable to U.S.-Sino tensions than FX one.** News reports on U.S. concerns on new Hong Kong security laws have sent yield on the benchmark 10-year Treasury note down at 0.69%. Yields move inversely to prices.

Figure 8. Retail sales index, cumulative y/y

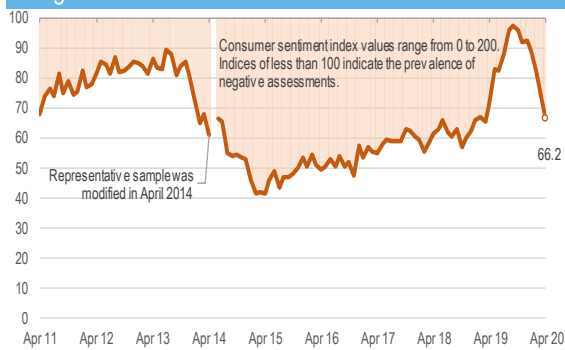


Industry remains in the doldrums, retail erases recovery gains

Ukraine's economic activity indicators swooped down in April as the coronavirus damage reveals itself. Industrial production (IP) has posted one of its steepest one-month falls on record since Russian aggression. Similarly, retail trade saw double-digit plunge after all nonessential stores were ordered closed. Despite an image of a black swan is seen across all the charts, risk of a deeper crisis have been mitigated after the authorities confirmed their commitment to further reforms (IMF deal).

**Lockdowns expectedly trigger rapid drop in retail sales.** April retail sales fell 14.9% y/y and 23% on a monthly basis. In spite of remaining in positive zone, cumulative indicator has nearly erased past recovery gains (see Figure 8).

Figure 9. Consumer sentiment index evolution

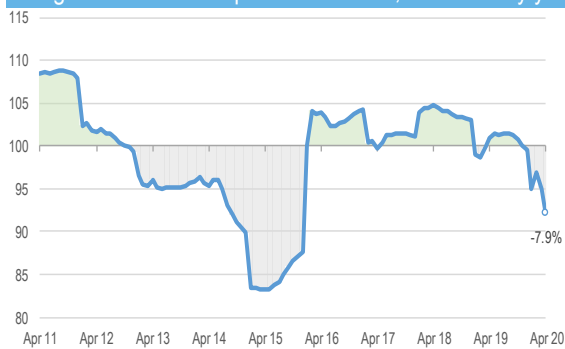


**Consumer sentiment is again far from balanced.** Severe containment measures, sapped savings and increasing unemployment took its toll on consumer confidence, bringing the corresponding index to the levels of last year (Figure 9).

**A sharp drop was not a surprise.** While some retailers, especially those with developed online representation, have seen spikes in purchases, most of casual shops were deemed nonessential and were ordered to stop.

We expect that decline in retail sales will not be prolonged, and will come to a halt in the nearest months. Worth mentioning, however, changes in consumers' daily activity brought about by the viral outbreak is likely to contribute to some changes in consumer expenditures.

Figure 10. Industrial production index, cumulative y/y



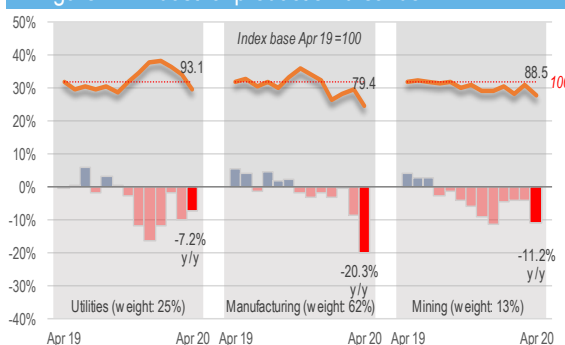
**Industrial output collapses in April.** Industrial production, a measure of factory, mining and utility output, decreased 12.8% in April from the prior month. Annual index fell by 16.2%, a cumulative one dived 7.9% y/y (see Figure 10).

Manufacturing output, the biggest component of industrial production, decreased 20.3% y/y in April. The decline reflects factory closures, with furniture and other manufacturing, textiles and wood products output being the most severely hit.

Mining saw 11.2% drop as its major component - the iron ore production - is suffering from contracting external demand.

Being chiefly dependent on performance of other segments, power consumption continued shrinking, resulting in 7.2% y/y drop in utilities output in April.

Figure 11. Industrial production breakdown



Across the main industrial grouping, intermediate and capital goods, as well as consumer durables production contracted the most.

**Prospects for industrial production remain bleak.** Recovery remains restrained by ongoing issues related to supply chain disruptions and global economy slowdown. Despite the government's efforts to boost output and spending through a state-guaranteed credit program, weak capacity of generating sustainable credit obligations will restrain immediate effects of this initiative. Fundamental reforms are of a greater demand for laying the ground for the sustainable growth. In this regard resumed cooperation with the IMF, securing further progress in reforms agenda, will contribute to improvement of consumer and business confidence and hence bring forward expected recovery.

Last week the Ukrstat reported that GDP in the 1Q contracted 1.5% y/y (preliminary reading). Though better than our estimates of a 3% drop, we hold our year-end forecast at minus 4.5% as we're looking at a much steeper decline in 2Q20.

# 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

Mon	Tue	Wed	Thu	Fri	Sat	Sun
25/05/2020	26/05/2020	27/05/2020	28/05/2020	29/05/2020	30/05/2020	31/05/2020
			Ukrstat: Nominal & Real Wage	NBU: Balance of Payments		
01/06/2020	02/06/2020	03/06/2020	04/06/2020	05/06/2020	06/06/2020	07/06/2020
			ECB: Monetary Policy Meeting			NBU: FX Reserves (deadline - 7th day)



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