

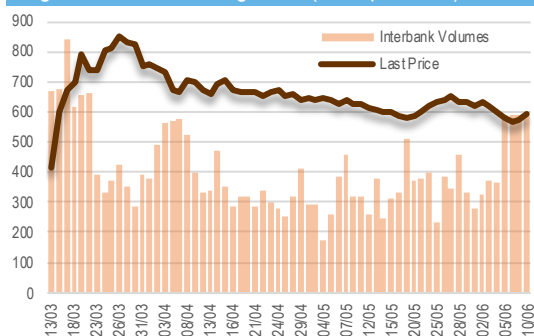
ECONOMICS | INTEREST RATES STRATEGY | FX

11 June 2020

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: The end of sharp rate cuts
Fitch	B	STABLE	22.04.2020	The NBU has expectedly cut its policy rate by 200 basis points to 6%. Though four more monetary meetings scheduled in 2020, this is likely the last sharp rate cut. Going forward, the NBU will have to re-evaluate inflation prospects and take into account potential threats to macro stability coming from lower UAH interest rates. We anticipate CPI to bottom-out in summer against a low base of 2019.
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 shows marginal gains after IMF decision

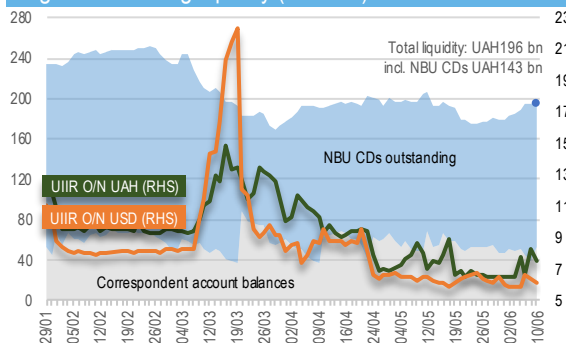
USD/UAH rate keep hovering near 26.5 level and is set to complete the week around this figure.

Despite this week has been rich in news, neither IMF's executive board approval of 18-month USD5bn stand-by arrangement for Ukraine nor the NBU's pessimism about the economy and another aggressive rate cut has found any noticeable response in the currency market.

Even NBU's purchase of USD411mn during last week - 6 times as much as a week ago - has not affected the rate.

The pair movements seems to be constrained by still high uncertainty regarding further evolution of Covid-19 and depending on it slow lockdown easing.

Figure 2. Banking liquidity (UAH bn)



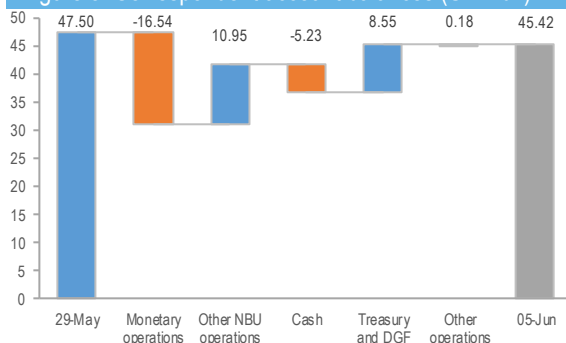
Banking liquidity recovered to UAH194bn in the week ended on June 5.

An increase was relative to extensive central bank's FX interventions and State treasury operations, injecting in the system some UAH19.5bn in total.

Some UAH5.1bn of this amount were drained by continuing cash withdrawals. The rest of funds came back to the central bank via certificates of deposits (CD).

As a results, balance of banks' correspondent accounts with the NBU declined by June 5 by UAH2bn, while amount of central bank's CDs outstanding increased by UAH16.5bn to UAH148.6bn, incl. O/N CDs – by UAH4.9bn to UAH21.6bn.

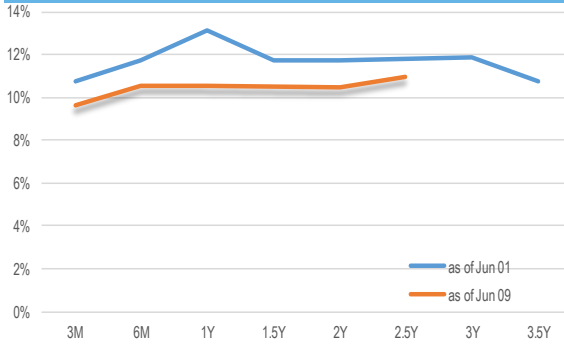
Figure 3. Correspondent account balances (UAH bn)



Looking forward, **we expect no material changes in liquidity balance following today's policy rate cut, but admit some little adjustment of interbank interest rates.**

In terms of USD/UAH movements, lower policy rate could potentially weaken the hryvnia but slow inflation is likely to offset this factor.

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	9.00%	9.00%	9.75%	9.00%	11	5	1 666.23	500.00
UAH	6M	9.50%	9.50%	10.50%	9.50%	11	4	1 140.48	500.00
UAH	6M	10.75%	10.70%	10.79%	10.50%	8	7	271.08	221.08
EUR	1Y	2.20%	2.20%	2.20%	2.20%	19	19	352.63	352.63
UAH	1Y	10.79%	10.70%	10.85%	10.60%	8	6	303.26	228.26
UAH	1.5Y	10.80%	10.80%	10.98%	10.80%	8	7	5 924.15	5 324.15

Finance Ministry attracted UAH17.8bn (in equivalent) in primary debt auction on June 9 amid rising expectations of another dovish movement by the central bank.

The ministry offered a broad range of local currency bonds and 1-year securities nominated in euro.

The major demand was concentrated in 1.5y UAH. Total bids for the securities amounted to UAH5.9bn, out of which only one application UAH0.6bn worth was rejected for its offer yield was 18 basis points (bpc) above cut-off rate at 10.8%. Worth also pointing out that 1y UAH bonds with cut-off rate only 1 bpc below the one for 1.5y securities merely drew interest. This might signal about a market intention to fix yields for a longer period.

As the expectations of another policy rate cut have been fulfilled, and market participants are currently guessing about an extent of likely appreciation of the government bonds' yield curve.

Figure 5. Local USD bonds market

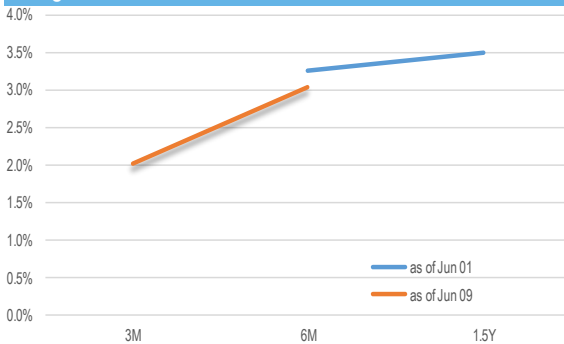
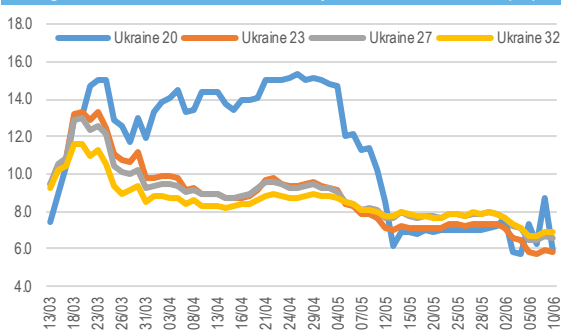


Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



USD slips to 3-month low against the EUR

U.S. dollar lose harbor benefits on optimism that the worst of the COVID-related economic downturn is over. **The greenback fell to 3-month low at 1.138 against the single currency** as investors turn their eyes on risky assets and demand for the former is gradually drying up.

The recently offered by the Fed a bleak outlook for the U.S. economy had limited negative impact on the market optimism. Market participants reckon that Fed's commitment to keep easy monetary policy should be supportive for risk assets too.

Across the pond, **the European Central Bank (ECB) has recently increased stimulus to shore up economies hurt by the coronavirus pandemic.** The single central bank, in particular increased the size of its Pandemic Emergency Purchase Program (PEPP) to EUR1.35tn from EUR750bn, more than most analysts had expected, and extended it until June 2021 at the earliest, with a pledge to reinvest proceeds until at least the end of 2022.

The movement was widely welcomed by market participants, which expect that extended package will help to accelerate recovery of the euro zone economy from COVID-19 recession.

The benchmark 10-year Treasury Note yield dropped to 0.7% after the Federal Reserve offered a dour forecast for the U.S. economy in the wake of the coronavirus crisis. Yields move inversely to prices.

Figure 7. EUR USD spot (mid)

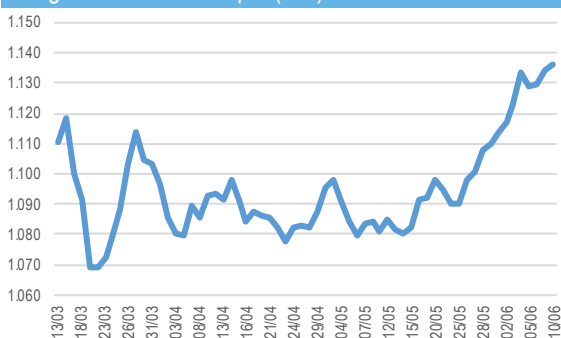
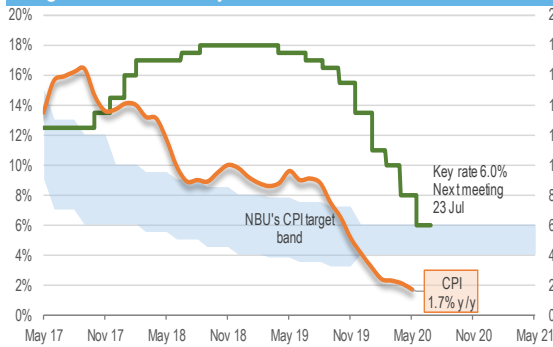


Figure 8. CPI vs Key rate evolution



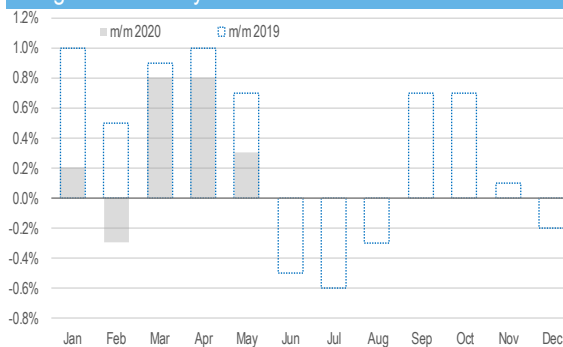
The end of sharp rate cuts

Ukraine's central bank (NBU) has expectedly cut its policy rate by 200 basis points to 6% on Thursday, easing policy for an eighth straight time. Though four more monetary meetings scheduled in 2020, this is likely the last sharp rate cut implemented by NBU this year. Going forward, the central bank will have to re-evaluate inflation prospects and also take into account potential threats to macro stability coming from lower UAH interest rates. **We anticipate inflation to bottom-out in summer months against a low base of last year and believe that the cut has good chances to be the last one for 2020.**

All efforts to fight COVID effects. The Ukrainian central bank has cut its benchmark interest rate to 6% from 8%, once again pointing out that the monetary policy loosening is aimed at reducing the negative effects of a pandemic. Though the lockdown has been gradually relaxed since late May, many businesses is likely to continue suffering from contracted consumer demand and COVID-caused disruption to the economy through the end of 3Q20. In this regard, reduced cost of funding will help to ease cash flow strains and prevent from mounting of more dangerous financial imbalances.

At the same time, the central bank has narrowed the corridor of market operations to +/- 1% from +/- 2%, implying even bigger impact on the refinancing rate. So that refinancing rate will go down from 10% to just 7%. This will trigger a re-pricing of sovereign curve which is being traded well below 10% at the short end (tenors up to one year).

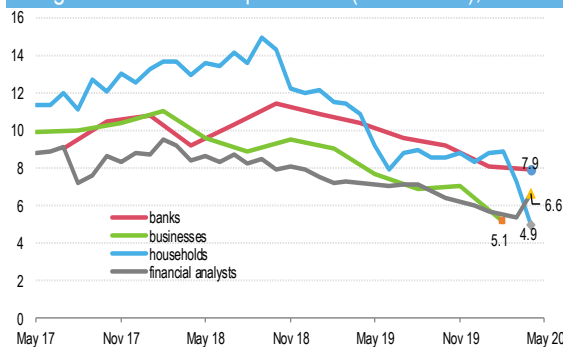
Figure 9. Monthly inflation



In figures, reported earlier this week, **Ukraine's consumer price inflation slowed to 1.7% in May from 2.1% in April**, the weakest number since the central bank's embarking on the inflation targeting regime in 2016. The smaller year-over-year increase was mostly attributable to lower energy prices, which reflected on utilities (minus 13.1% y/y) and transport (minus 6.6% y/y) costs. We see this factor holding relevance until fall.

In spite of notable depreciation of local currency in March, the parallel-predicted inflation acceleration had not materialized due to a weakness of consumer demand and relatively limited fiscal stimulus.

Figure 10. Inflation expectations (12M ahead), %



CPI inflection point looms in summer months. We see a low base of 2019 - both in summer and winter months - to be the major factor driving annual inflation up. A gradual lockdown easing since late May and record low household inflation expectations support our expectations.

One last cut? Though there are four more monetary meetings scheduled in 2020, in our central scenario we expect no more rate cuts though the end of the year. Another monetary policy easing is seen as having little impact on the real economy and CPI evolution (considering forced acceleration). In spite of reduced cost of funding, the power of monetary policy will be constrained by general business environment, COVID-related income loses and a weak fiscal policy stimulus. Having said that, **we believe that NBU will be shifting attention from the level of policy rate to issues such as monetary transmission to the economy and also gradually will be paying more attention to risks to macrostability coming from lower UAH interest rates and their potential impact on dollarization level in the economy.**

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	-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
Prices								
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
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	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
Interest and exchange rates								
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
08.06.2020	09.06.2020	10.06.2020	11.06.2020	12.06.2020	13.06.2020	14.06.2020
	Ukrstat Price Indexes NBU: Monetary Statistics (Preliminary)	FOMC: Monetary Policy Meeting	NBU: Monetary Policy Meeting			
15.06.2020	16.06.2020	17.06.2020	18.06.2020	19.06.2020	20.06.2020	21.06.2020
				Ukrstat: GDP (Preliminary) NBU: External Debt		



Contacts

Investment Business Group

Serhiy Yahnych

Head of Investment Business

(+38044) 537-50-82 serhii.yahnych@ukrsibbank.com

Viktoriia Nebeska

Market Making Government Bonds

(+38044) 201-22-74 viktoriia.nebeska@ukrsibbank.com

Platon Yachmenov

Fixed Income Dealer

(+38044) 230-48-54 platon.yachmenov@ukrsibbank.com

Mykhailo Kharchuk

Market Analysis

(+38044) 537-49-75 mykhailo.kharchuk@ukrsibbank.com

Distribution of Capital Markets Weekly report:

macro@ukrsibbank.com



FX Business

Oleksandr Duda

Head of FX Sales

(+38044) 537-50-02 oleksandr.duda@ukrsibbank.com

Corporate Business

Ievgen Kulikov

Head of MNC team

(+38044) 201-22-43 ievgen.kulikov@ukrsibbank.com

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