

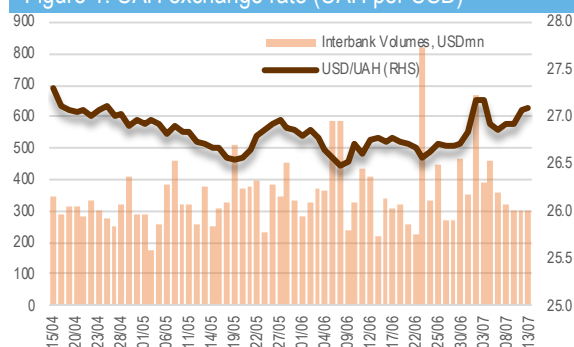
ECONOMICS | INTEREST RATES STRATEGY | FX

15 July 2020

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus:
Fitch	B	STABLE	22.04.2020	Inflation reaccelerating in line with our expectations
S&P	B	STABLE	13.03.2020	Ukraine's CPI accelerated to 2.4% y/y in June as demand bounced back following lockdown easing. Last year's low base, which will continue holding influence through the end of summer, has also contributed to positive change.
S&P (N)	uaA	-	13.03.2020	We expect CPI to enter NBU's target range through the end of 3Q against increasing energy prices and likely reversal in FX trend since late summer.
Moody's	B3	STABLE	12.06.2020	

Figure 1. UAH exchange rate (UAH per USD)

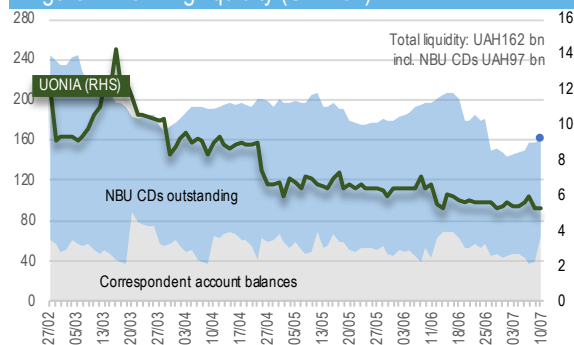


FX and interest rates: USD/UAH remains attuned to news on NBU head

The USD/UAH rate again have breached a key barrier at 27 as speculations on who will hold the office of the National bank of Ukraine (NBU) were revived in the market. Two weeks have passed since resignation of the central bank's governor and no reliable information has appeared since then. Authorities' communications do not shed any light in this regards. On the contrary, their rhetoric on a future independence of the central bank, as well as on desirable levels of inflation and FX rate, have only added to already high concerns about sustainability of the central bank's monetary policy.

This lack of information plays into the hands of speculators, who emerge in the market as soon as trading volumes go down.

Figure 2. Banking liquidity (UAH bn)



Continuous FX sales by agricultural and metallurgical companies is currently the major factor smoothing volatility in the market.

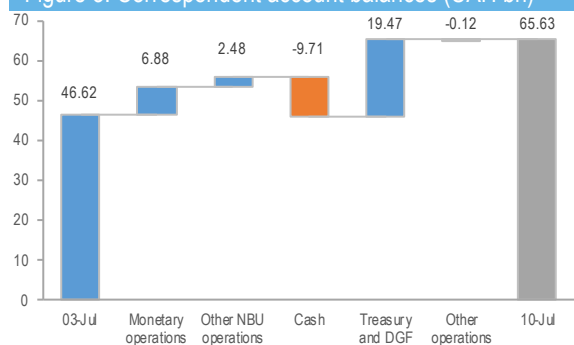
At the same time, we see sustainable demand for FX from foreign investors and local representatives of multinationals continuing remitting profits to their head offices. This segment remains attuned to developments around the NBU.

Last week the NBU increased FX purchases to USD92mn from USD18.9mn a week before.

Total liquidity in the banking system recovered to UAH162bn from USD146bn, with correspondent accounts' balance reaching UAH66bn.

State treasury operations, injecting into system some UAH19.5bn contributed the most.

Figure 3. Correspondent account balances (UAH bn)



On the other hand, we see resumed cash withdrawals, draining from the system some UAH9.8bn.

Regarding monetary operations, the NBU last week disbursed some UAH5bn in long-term facility at rate 6% per annum. Most of funding was attracted by to banks for purposes likely not related to liquidity issues, considering the latest prints on liquidity coverage ratios.

The rest of monetary operations represent reallocation of funds between banks' correspondent accounts and certificates of deposits (CD). Noteworthy, that banks still hold little interest to short-term government bonds yielding circa 7%, and rather prefer holding excess funds in 2w central bank's CDs at 5%.

Figure 4. Local UAH bonds market

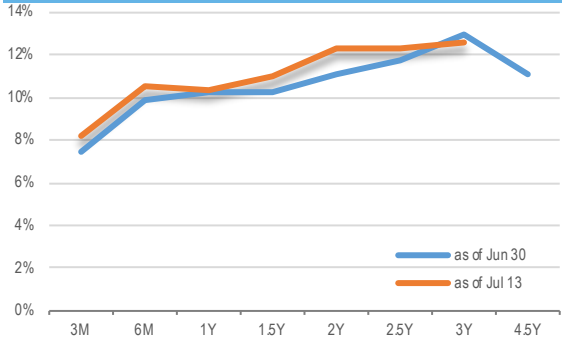
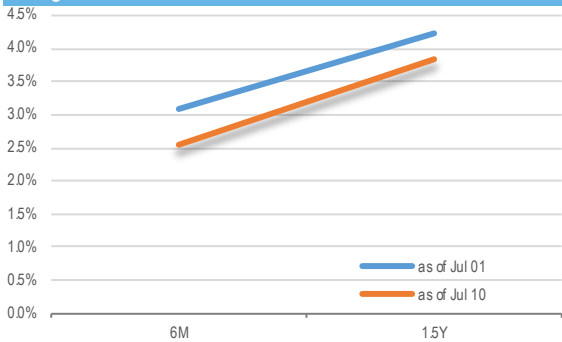


Figure 5. Local USD bonds market



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	7.00%	7.00%	7.00%	7.00%	3	3	2.96	2.96
USD	1Y	3.50%	3.50%	4.50%	3.40%	46	43	294.92	293.55
UAH	1Y	9.20%	9.20%	9.50%	9.20%	2	1	2.97	2.59
UAH	2.5Y	10.00%	10.00%	10.00%	10.00%	4	4	4.45	4.45

FinMin again received a cool reception for local currency bonds, as market price government debt much lower than current cut-off rates suggest.

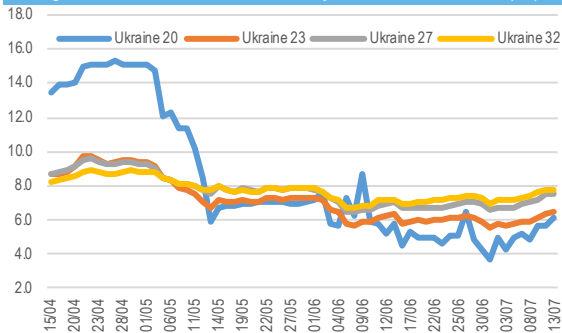
This Tuesday the ministry offered 3m, 1y and 1.5y UAH-denominated bonds, as well as 1y bonds in USD. None of the issues in local currency drew any material interest. For comparison, secondary market shows reluctance to increase positions in government bonds and requires circa 9% for shorter securities and above 11% for the longer ones.

The only success for the FinMin was placing USD-denominated bonds, which were sold at 3.5% per annum. Total demand for these securities reached USD295mn, out of which only 3 applications for USD1.4mn were rejected.

The ministry is likely to keep actively offering USD-denominated bonds during this month after cancelation of placement of the 12-year eurobonds worth USD1.75bn.

With regard to local currency bonds, situation clearly relates to uncertainty around nomination of the new central bank's governor, with lack of official information giving birth to speculations.

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



EUR/USD edging up despite worsening US-China tensions

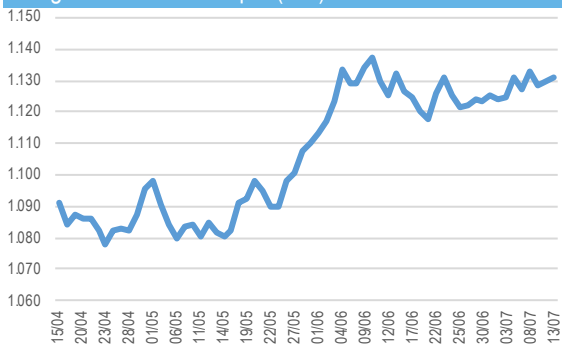
The U.S. dollar slips against the euro above 1.138 level. The market seems remain bullish after last week's rush into risky assets, ignoring renewed tensions between the U.S. and China and growing number of infections in the United States and around the world.

The current uptick seemed lacked any obvious fundamental catalyst.

The latest U.S. consumer inflation figures have not impressed market.

In turn, the euro saw muted reaction to the release of weaker-than-expected German/Eurozone ZEW economic survey and mostly inline German CPI print as investors seemed reluctant to place any aggressive bets ahead of the European Central Bank policy decision on Thursday (July 16).

Figure 7. EUR USD spot (mid)

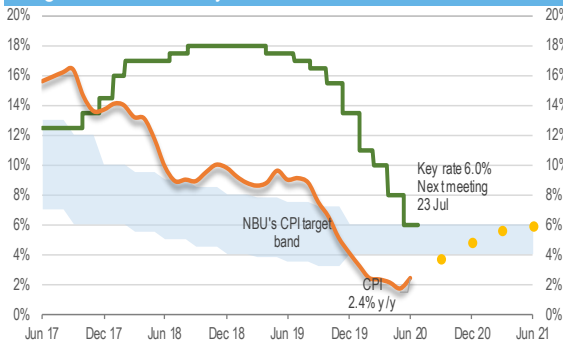


Diplomatic tensions between U.S. and China, however, still hold importance. Intensified verbal confrontations between Washington and Beijing over access to U.S. financial markets, civil liberties in Hong Kong and territorial claims in the South China Sea, it is feared, can potentially lead to new trade friction.

U.S. Treasuries' yields remain subdued as new coronavirus cases and hospitalizations continue to surge. The yield on the benchmark 10-year Treasury note edge down toward 0.625%. Yields move inversely to prices.



Figure 8. CPI vs Key rate



Ukraine's inflation reaccelerating in line with our expectations

Ukraine's consumer price index accelerated to 2.4% y/y in June as demand bounced back following lockdown easing. Last year's low base, which will continue holding influence through the end of summer, has also contributed to positive change. We expect inflation index to enter NBU's target range through the end of 3Q against increasing energy prices and likely reversal in FX trend since late summer.

The June's inflation acceleration was primarily driven by food and non-alcoholic beverages prices. Although they continue cooling off after 2.1% monthly leap in April, a 0.4% m/m gain in June against 1.1% decline in the correspondent month of the previous year led to acceleration of annual growth to 4.2% from 2.7% in May. Recovering in local traveling and recreation services might buoy food prices through the end of summer.

Transportation services have also notably contributed to the CPI growth. Increased demand for petrol following the end of business closures in much of the country in late May and stabilization of oil prices in the global markets allowed fuel retailers to push prices for fuels and fats higher (monthly growth amounted to 2.1% vs. 0.2% decline in June 2020).

In other segments, a low inflation environment caused by demand shock remained in place.

The latest polls, performed by the NBU and InfoSapiens showed some further improvement in inflationary expectations among households and financial analyst. Both categories of respondents, however, expect acceleration of inflation in the next 12 months. Besides, a strong dependence of inflation expectations on FX rate movements should also be kept in mind.

Looking at the low base of last year's summer months we see a strong case for inflation entering the NBU's target range (5% +/- 1 percent point) during this quarter.

In addition to that, gaining momentum imports is likely to reshape balance of forces in the FX market in the coming months, pushing local currency lower. Unlike last year's appreciation, expected devaluation of the hryvnia will be promptly retranslated in consumer prices.

Another factor, worth considering, is expected nomination of a new head of the central bank. The resignation of the former governor has casted serious doubts regarding future independence of the NBU's monetary policy. Further commentaries by authorities' representatives regarding a need to accelerate inflation and devalue local currency to boost state budget's revenues make economic agents consider the nomination process from the worst part.

We hold our year-end inflation forecast at 5.9% and expect terminal key rate to be at 5% in 2021. The figures, however, might be revised following nomination of the new NBU's governor and subsequent changes to monetary policy.

Figure 9. Monthly inflation

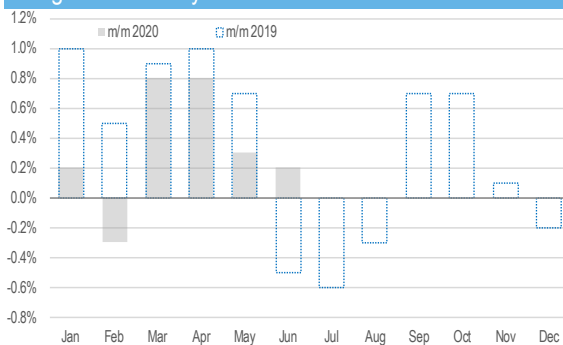


Figure 10. Key contributors to CPI, m/m

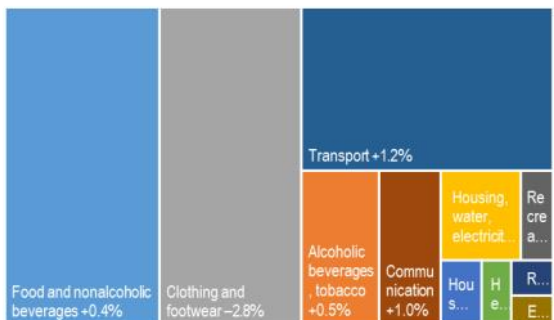
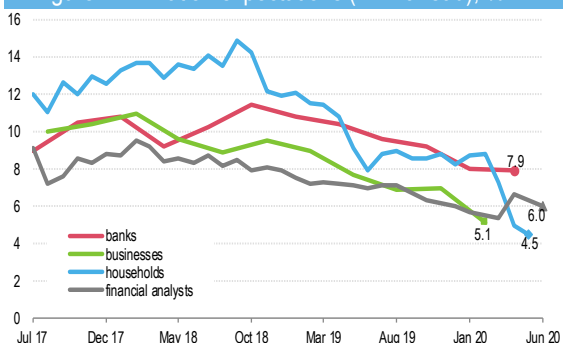


Figure 11. Inflation expectations (12m ahead), %



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	150	144	154
Prices								
CPI (average %YoY)	12.1	48.7	16.5	14.4	10.5	7.9	4.9	5.4
CPI (end of year %YoY)	24.9	43.3	12.4	13.7	9.8	4.1	5.9	5.0
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	5.0	-1.9	-3.5	-6.5	-4.2	1.0	-0.6
Current account balance (% of GDP)	-3.5	5.6	-2.0	-3.2	-4.9	-2.8	0.7	-0.4
Net FDI (USD bn)	0.3	-0.4	3.8	3.7	4.5	5.2	3.0	2.0
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
13.07.2020	14.07.2020	15.07.2020	16.07.2020	17.07.2020	18.07.2020	19.07.2020
			ECB: Monetary Policy Meeting			
20.07.2020	21.07.2020	22.07.2020	23.07.2020	24.07.2020	25.07.2020	26.07.2020
	Ukrstat Retail trade	Ukrstat Industrial Production	NBU: Monetary Policy Meeting			



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