

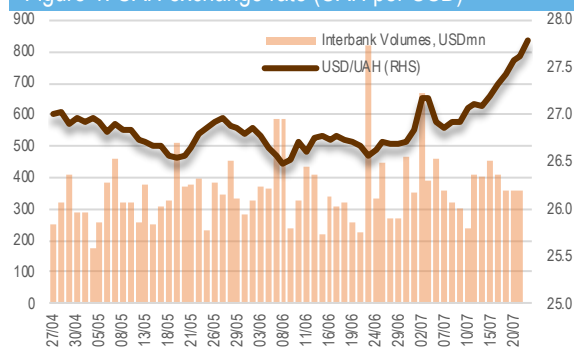
ECONOMICS | INTEREST RATES STRATEGY | FX

23 July 2020

# UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: NBU expectedly keeps interest rates on hold
Fitch	B	STABLE	22.04.2020	The National Bank of Ukraine (NBU) has expectedly kept the key policy rate on hold at 6%. The central bank sees a low rate through the end of the year as the economy is setting on a recovery path after the coronavirus crisis, and expects that further decline of funding costs should contribute to GDP growth in 2021-2022.
S&P	B	STABLE	13.03.2020	
S&P (N)	uaA	-	13.03.2020	
Moody's	B3	STABLE	12.06.2020	

Figure 1. UAH exchange rate (UAH per USD)

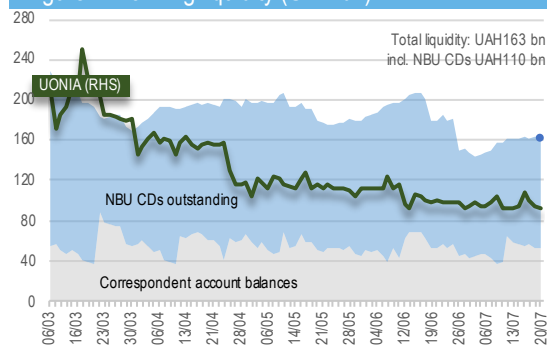


FX and interest rates: UAH loses support amid doubts about NBU's policy

**Hryvnia tanked versus dollar amid spreading concerns about sustainability of the central bank's support** to the local currency following the nomination of the new governor. The rate dropped below 27.7 figure against the U.S. dollar, a new low since beginning of April.

The market paid attention to the statements of the newly appointed governor of the National Bank of Ukraine (NBU) at the initial briefing about importance to preserve flexible exchange rate, and in particular to the second part of his speech, where he said about possible concessions to support economic growth. This, together with preceding official statements about importance to somehow devalue the local currency in order to support exporters and boost state budget revenues, pushed up demand for FX liquidity.

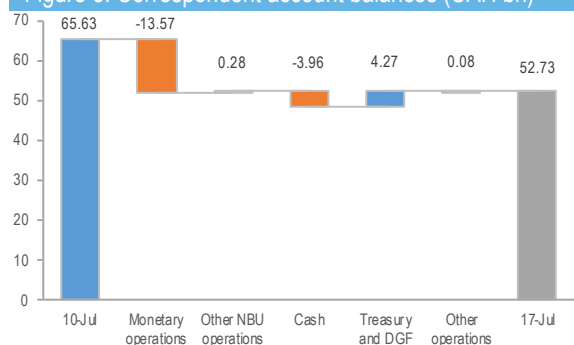
Figure 2. Banking liquidity (UAH bn)



The fact that the NBU last week for the first time since September 2018 did not intervene in the interbank FX market, added to the market concerns. This week the NBU did showed up with FX sales worth some USD350mn, but these interventions had limited effect on the market sentiment.

**We expect the hryvnia will remain under pressure through the end of this week.** Apart from foregoing factors, demand for FX is likely to keep increasing amid recovering imports. In addition to that, sizable public debt redemptions in the end of this month and beginning of the next one might increase volatility in the market in the surrounding periods.

Figure 3. Correspondent account balances (UAH bn)



**Banking liquidity stabilized around UAH160bn.** In spite of contraction of funds on bank correspondent accounts with the NBU to UAH53bn from UAH66bn, the change was due to reallocation of funds into the central bank's certificates deposits. The transactions, which accounted for majority of weekly monetary operations, resulted in a 14% increase in banks' position in CDs.

Autonomous factors have nearly balanced each other. Worth pointing out, however, that **cash withdrawals resumed in early July and total cash outstanding has breached UAH500bn**, which correspond to 12.6% of last year's GDP.

As mentioned above, the central bank did not perform FX interventions in the market during last week.

Figure 4. Local UAH bonds market

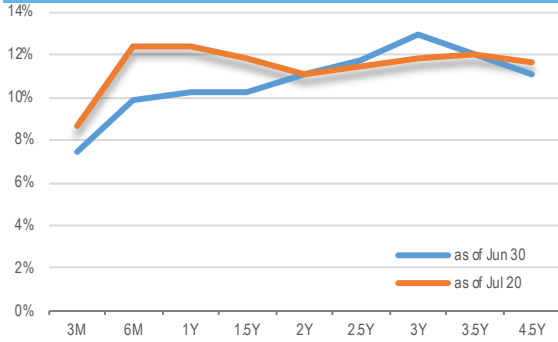
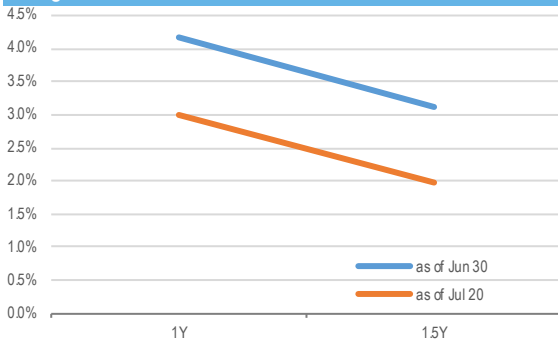


Figure 5. Local USD bonds market



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	6M	7.74%	7.74%	7.74%	7.74%	1	1	4 500.00	4 500.00
USD	6M	3.39%	3.39%	3.85%	3.20%	23	20	167.01	165.88
UAH	1.5Y	10.25%	10.25%	10.25%	10.25%	2	2	2 003.30	2 003.30

**FinMin keeps experiencing a streak of tepid demand for its debt securities.**

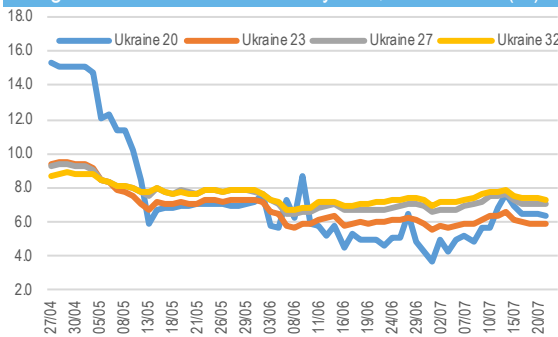
This Tuesday the ministry auctioned a limited range of instruments, including 6m and 1.5y bonds in the local currency and 6m bonds in the U.S. dollars.

The latter seems to have been the only offering that managed to draw market interest, with total demand exceeding USD167mn and bid yields ranging from 3.2% to 3.85%. The cut-off rate was set at 3.39% per annum, which resulted in rejecting 3 out of 23 applications submitted worth some USD1mn.

**Hryvnia-denominated bonds, despite showing decent results, apparently were bought by some state-owned banks.** Firstly, there was a limited number of applications and all of them were in line with FinMin's expectations. And secondly, the head of the ministry said in interview a few days ago that this topic was under discussion with state banks in the recent past.

Secondary market keep showing low liquidity, doubting in FinMin's capacity to hold such low rates for long. Situation however might change in favor of the ministry if it succeeds in placing Eurobonds, which it has failed to complete due to the NBU head resignation. According to the media, the FinMin resumed discussions with investors on this matter yesterday (July 22).

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



EUR approaches 1.16 vs USD after EU virus deal

**The euro is picking up momentum after European Union countries struck an agreement on a recovery fund** for economies in the region hit by the COVID-19 pandemic. The pair EUR/USD ended Wednesday's trading session just under 1.16, near its 21-month highs, and remains in an uptrend.

Inflows into the euro have accelerated after the EU massive stimulus plan worth EUR750bn was hailed as an important signal of unity by Europe's leaders and a foundation for economic recovery.

**Encouraging results from several COVID-19 vaccine trials also boosted market sentiment and drove a rally in global stock markets.**

Meantime the greenback suffers from disagreement between the Republicans and Democrats on the next round of economic stimulus measures, increasing concerns in currency markets about a possible delay to U.S. fiscal stimulus.

At the same time **market participants keep closely watching at mounting tensions between the U.S. and China**, threatening different actions against each other after China imposed a new security law in Hong Kong and the US removed privileges to the region. This factor from time to time flip risk appetite in currency markets, hence boosting safe-haven dollar and U.S. Treasury yields.

The yield on the benchmark 10-year Treasury note fell on Wednesday to 0.6036% amid rising tensions between the U.S. and China. Yields move inversely to prices.

Figure 7. EUR USD spot (mid)

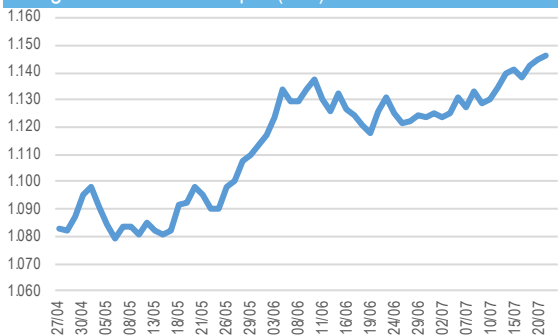
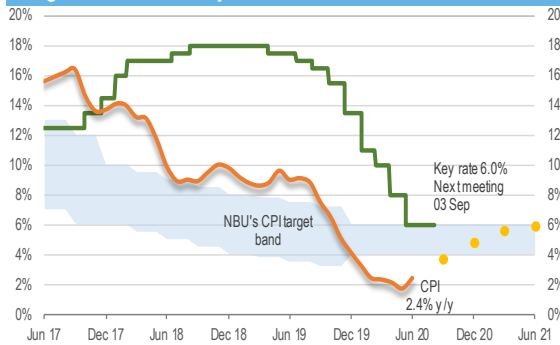


Figure 8. CPI vs Key rate



## NBU expectedly keeps interest rates on hold

The National Bank of Ukraine (NBU) has expectedly kept the key policy rate on hold at 6%. The central bank sees a low rate through the end of the year as the economy is setting on a recovery path after the coronavirus crisis, and expects that further decline of funding costs should contribute to GDP growth in 2021-2022.

**Another monetary decision came as no surprise (see our reports of June 11 and July 15) amid rebounding inflation.** As we mentioned in our reports, inflation acceleration commenced in May is likely to hold through the end of summer. Recovery in consumption and imports, growths of prices for energy resources, seasonal FX factors, and increase in UAH liquidity are the major factors behind the growth.

Figure 9. USD/UAH evolution

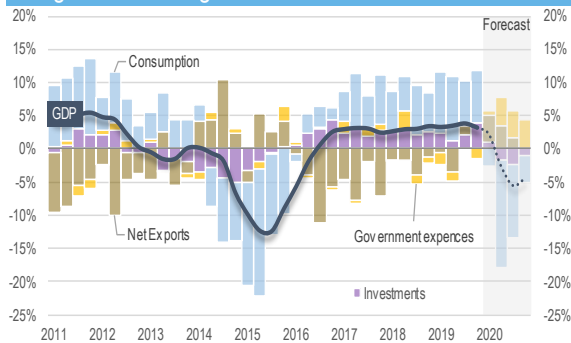


The central bank points out that the current policy rate will help to curb the future growth of prices and has improved year-end forecast to 4.7% from 4.8%.

**While the current CPI growth rate does not allow for another monetary easing round, we see room for some 50 basis points cut after a smooth onboarding of the new governor.** We do not rule out, that the NBU will bring forward expected in 2021 rate cuts after inflation growth subsides, with gradual reductions likely limited to 25-50 basis points.

While the central bank has revised its forecast for GDP drop in 2020 from 5% to 6%, the governor highlighted, that the low-point of the fall has already been passed in Q2, and the growth is likely to pick-up to 4% in 2021-22, thanks to monetary and fiscal stimuli and higher foreign demand.

Figure 10. GDP growth evolution



**According to the NBU head, the 6% rate allows enough room for further reduction of funding costs to one-digit levels.** Together with announced during inauguration briefing stimuli to lending expansion, this should give the impetus for consumer and investment demand recovery.

No details on such stimuli have been revealed, so far. We assume, that some extended liquidity support, changes to lending rules and bank supervision is likely to be under consideration, with some government-guaranteed bank lending being the major driver. Such tendency corresponds with the one in European countries, many of which have introduced unprecedented programs of loan guarantees and other forms of credit support for their businesses in response to the COVID-19 shock. At this moment, however, the announced measures lack details for a thorough analysis of their weaknesses and opportunities.

# 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	150	144	154
<b>Prices</b>								
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
<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	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
<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
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			
27.07.2020	28.07.2020	29.07.2020	30.07.2020	31.07.2020	01.08.2020	02.08.2020
	Ukrstat Nominal & Real Wage	FOMC: Monetary Policy Meeting NBU: Cost of Real Sector External Borrowing		NBU: Balance of Payments		



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