

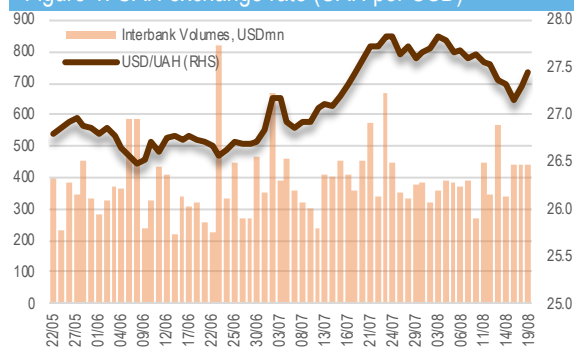
ECONOMICS | INTEREST RATES STRATEGY | FX

19 August 2020

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Lengthy recovery with new impediments along the road
Fitch	B	STABLE	22.04.2020	Ukraine's GDP plunged by 11.4% in the Q2, the lowest reading since economic meltdown in 2014-15. While impact of the COVID-19 outbreak is likely to be less devastating, we expect recovery to be uneven and anemic, especially taking into account growing number of COVID-19 cases in Ukraine and increasing chances of another lockdown.
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)



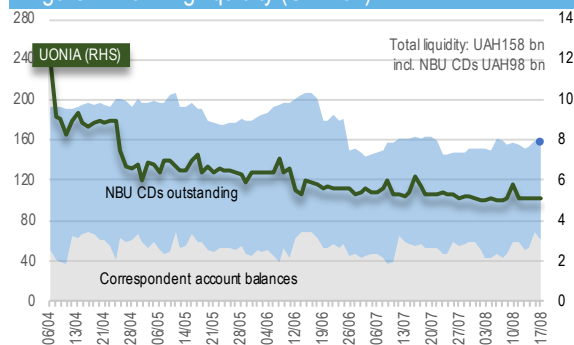
FX and interest rates: Hryvnia feels a breeze of seasonal decline

The USD/UAH pair has reversed North after an unexpected reshuffling of market forces on Tuesday, reminding to market participants of seasonal patterns of the past years.

Preceding two-week downtrend supported by stable supply of foreign currency seems to have faced a real test for sustainability after state-run Naftogaz reduced its sales of foreign currency.

We assume **hryvnia might keep appreciation momentum for some more time**. Ongoing harvest season, recovering prices for iron ore, and increasing FX sales by households amid growing remittances will produce the major support.

Figure 2. Banking liquidity (UAH bn)



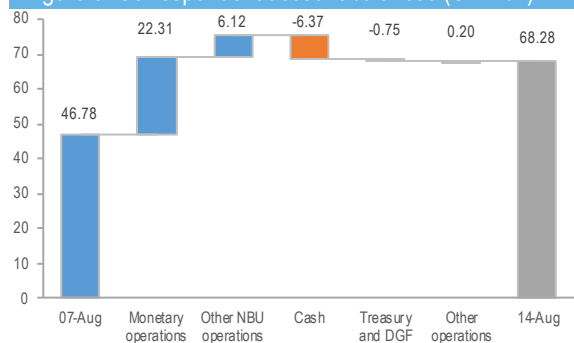
At the same time, we see near-term downside risks to the local currency stemming from recovering imports and abundant local currency liquidity in hands, which could be converted into hard foreign currency in the event of rising inflation expectations. Fortunately, a zero consumer price index growth in July keep this risk subdued.

In addition to that, foreign accounts keep gradually shortening their position in public debt, mopping up excess foreign currency.

Banking liquidity increased by another 2.4% - to UAH160bn during last week.

Central bank's FX interventions totaling USD223mn, were the only source of fresh liquidity, binging into system some UAH6.1bn.

Figure 3. Correspondent account balances (UAH bn)



In turn, resumed cash withdrawals were the only negative factor, draining last week some UAH6.4bn. As a result, total amount of cash outstanding has reached UAH510bn or 12.8% of last year's nominal GDP.

NBU's monetary operations for UAH22bn largely represent pulling out of funds from central bank's certificates of deposits. As a result, bank's position in NBU's CDs contracted to UAH91bn. Reallocation of liquidity on correspondent accounts might relate to ongoing season of tax payments.

Figure 4. Local UAH bonds market

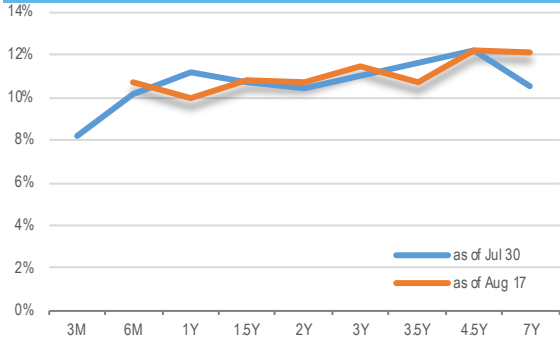
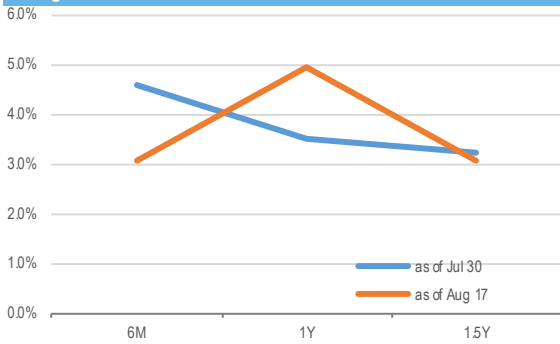


Figure 5. Local USD bonds market



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	7.82%	7.82%	10.00%	7.82%	2	1	1 140.00	1 040.00
USD	6M	3.39%	3.39%	4.00%	3.39%	26	23	31.86	30.53
UAH	2Y	10.25%	10.14%	13.00%	10.00%	12	10	704.31	598.50

State-owned banks keep expending their position in government bonds following the next primary debt auction on August 18. This week the Finance Ministry offered 6m and 2y bonds in hryvnia and 6m securities in U.S. dollars.

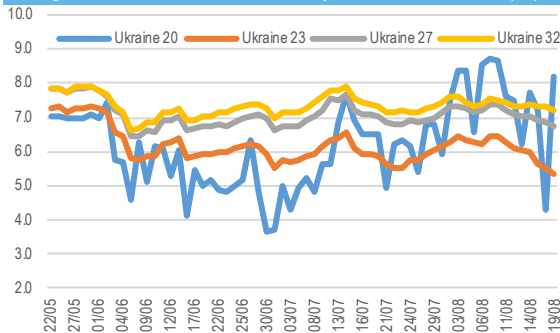
A sizable bid for the shortest bonds amounting UAH1bn highly likely indicates of belonging to one of state-owned banks. The application was satisfied at rate 7.82% per annum.

Real market interest seemed was concentrated in USD-denominated bonds. Total demand for bonds exceeded USD32mn, with 23 of 26 applications being accepted at cut-off rate of 3.39%.

Worth noting, that last week a similar high interest to USD bonds brought in a six times higher demand. Volume of bids might recover next week when the ministry again offers >1y securities. With banks having limited opportunities for reinvesting foreign currency deposits, FX-denominated bonds can help the ministry to plug financing needs this year.

2y print has also seen seemed market demand, drawing bids worth UAH700mn. Set by ministry cut-off rate at 10.25%, however, remains about 50 basis points below the secondary market pricing for similar maturity.

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



EUR/USD tests key barrier at 1.19

The EUR/USD retreated slightly after breaching a key barrier at 1.19. At the moment, the pair is slipping to 1.185 level. However, the impasse over the next round of the U.S. fiscal stimulus can easily bring back fresh selling around the greenback.

The pair finds extra sustain in auspicious results from U.S. statistics, as U.S. existing home sales turned out worse than analysts expected.

Later in the day, the Federal Open Market Committee (FOMC) will release its July meeting minutes. Market participants are chiefly concerned about the governors' forward view on employment and economic growth.

The euro keep enjoying prevailing risk-on sentiment supported by Federal Reserve's intervention into financial markets to maintain liquidity in the midst of the Covid-19 pandemic.

Besides, recently clinched deal on the European Recovery Fund still holds positive effect on the euro as Europe's political and economic situation in terms of dealing with the pandemic appears far more stable than that of the United States.

Treasury yields edge lower before release of the latest Federal Reserve minutes. The yield on the benchmark 10-year Treasury note dipped one basis point to 0.6485%

Figure 7. EUR USD spot (mid)

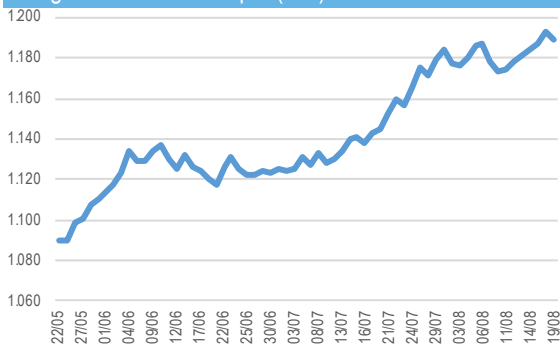
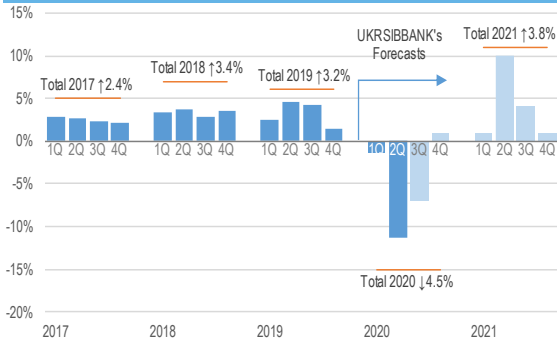


Figure 8. GDP evolution



Lengthy recovery ahead with new impediments along the road

Ukraine's GDP plunged by 11.4% in the Q2, the lowest reading since economic meltdown in 2014-15, when the country lost control over some of its territories. While impact of the COVID-19 outbreak is likely to be less devastating, we expect recovery to be uneven and anemic, especially taking into account growing number of COVID-19 cases in Ukraine and increasing chances of another lockdown.

Ukraine's economy contracted by 11.4% in the second quarter of 2020, compared to the corresponding quarter of 2019, according to preliminary data from the Ukrstat. A detailed picture will come out on September 18th.

Meantime, the latest data on NBU's Index of Key Sector Output (IKSO) suggests a sizable drop in passenger transportation – six-month cumulative index fell by 55.9% amid lockdowns - and agricultural production (down by 56.8%), especially in crop farming due to the late start of the harvesting campaign and lower yields of early grain crops. Adverse weather conditions this might put a serious dent in agricultural production this year and economy as a whole.

IKSO gauge, which substituted monthly GDP estimates in 2009, shows that sectors such as coal mining, cargo transportation, and construction have also been hit hard in Q2 2020.

As businesses started to reopen in late May after quarantine easing, **retail sales have reversed a two-month downtrend, gaining 1.4% m/m in June**. Rising of the minimum wages, which to be considered by the parliament in late August, might give a boost to private consumption in Q3, albeit at the cost of inflation acceleration.

While a deep drop creates a strong base effect for economic rebound in 2021, we expect an anemic recovery in a year horizon. A recent surge in infections and hospitalizations will keep businesses on their toes, weighing on reopening plans. **Fears of tightened virus quarantine measures increased this month as Ukraine saw steep rise in new cases since late July**. Though annual flu season is still far ahead, daily infections have almost doubled in the last three weeks, with the upper number approaching two thousand cases per day.

Recent changes in the NBU board have no impact on economic activity so far. We notice, however, increasing frequency of official statements about importance of state support to economic recovery and some initiatives toward elaborating correspondent ideas/plans. We hold our expectations, that future monetary policy will be skewed toward some extended lending support, with funding distribution in accordance with such ideas/plans. This might help to accelerate growth.

We hold, however, our ear-end GDP growth forecast at minus 4.5%, expecting that such initiatives will get momentum not earlier than in 2021. Worth also mentioning, that quick wins might carry additional risks, which need thorough inspection as soon as such initiatives are transformed into a documented plan.

We also keep closely watching situation in neighboring Belarus. Negative developments might have knock-off effect firstly on USD/UAH rate and later on inflation and macro stability in general, let alone local political situation. Besides, we one more time stress downside risks to our forecast stemming from adverse weather conditions and growing number of virus infections.

Figure 9. Grains production, mn tonnes

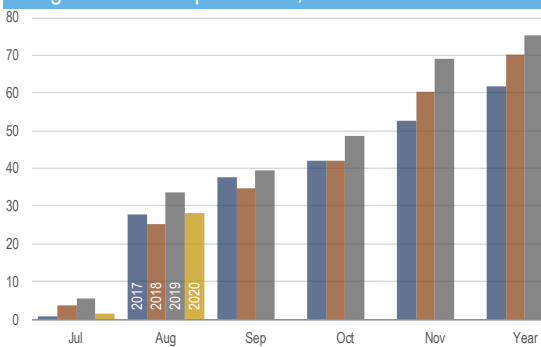


Figure 10. COVID-19 cases in Ukraine, thousands

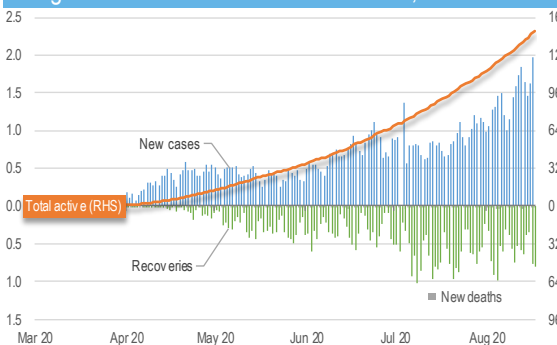
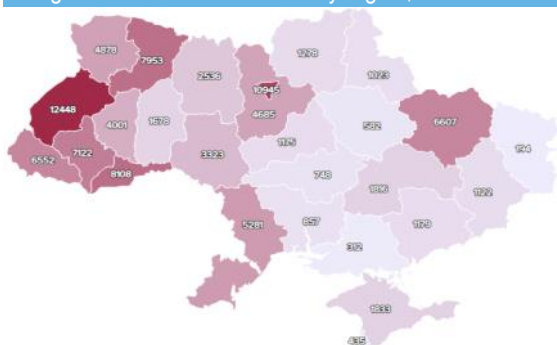


Figure 11. COVID infections by region, cases



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
17.08.2020	18.08.2020	19.08.2020	20.08.2020	21.08.2020	22.08.2020	23.08.2020
			Ukrstat: Retail trade			
24.08.2020	25.08.2020	26.08.2020	27.08.2020	28.08.2020	29.08.2020	30.08.2020
	Ukrstat: Industrial Production			Ukrstat: Nominal & Real Wage		



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