



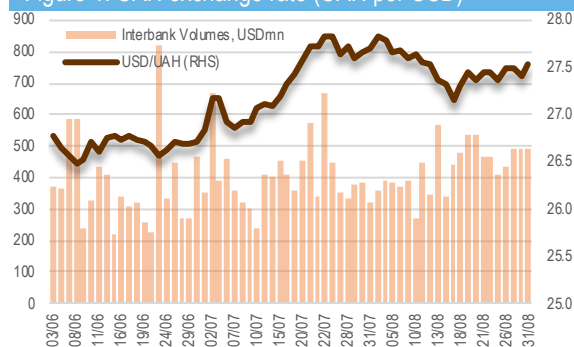
ECONOMICS | INTEREST RATES STRATEGY | FX

3 September 2020

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

	Rating	Outlook	Last update	This week in focus: NBU holds rate and hints of no plans to change policy
Fitch	B	STABLE	22.04.2020	The NBU has kept its key rate unchanged and continues to signal policy will stay on hold for the time being as economy is setting on recovery path. Raising the minimum wage, growth of energy prices, and seasonal FX weakening will push inflation toward NBU's target range. Notably narrowed consumption, however, will curb inflation reacceleration above NBU's long-term target at 5%.
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)

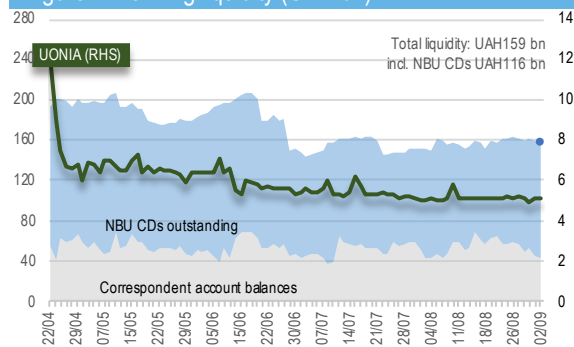


FX and interest rates: USD/UAH pair returns to the rise lane

Hryvnia retreating against the U.S. dollar as businesses enter new season. The USD/UAH pair has risen by circa 0.7% to the vicinity of 27.7 mark since Monday and is poised to challenge this level though the end of the week.

Usual in the end of summer – beginning of fall local currency depreciation is likely to be the major driver in the coming weeks, with speculations about magnitude of movement garnering the most market attention. Some signs of appropriate activity has already shown up in the market. While some agricultural producers have shortened FX supply due to late start of harvesting campaign, some players have been clearly performing unusual for this season activity in the last few days.

Figure 2. Banking liquidity (UAH bn)



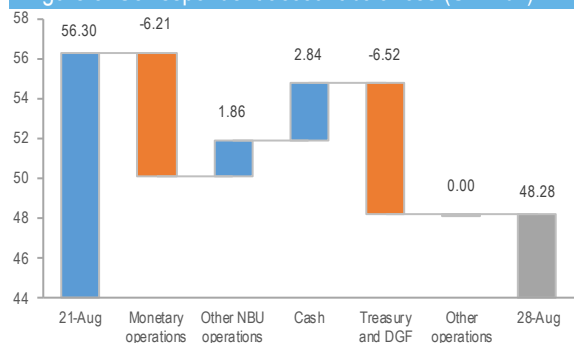
Besides, some businesses have been recently refunded with VAT tax, enabling them to cover some running costs without FX sales.

State-run Naftogaz at the moment is the major supplier of the foreign currency, partly filling up its reserves from Ukraine-Russia gas transit contract.

Looking ahead in the next few months, hryvnia might see increased pressure against sharply dropped remittances from work migrants in July and likely worsening of inflation expectations following growth of energy prices and increase of the minimum wages.

Banking liquidity remains around UAH160bn level. Though little changed, funds in the system have seen sizable mixed flows.

Figure 3. Correspondent account balances (UAH bn)



The major factor was State treasury operations, pulling out from the system some UAH6.5bn. While the FinMin doesn't specify the nature of its treasury operations, the outflow is likely related to tax payments as 31st of August was the deadline for rent payments.

This factor was nearly balanced by central bank's FX interventions for USD68mn, injecting circa UAH1.9bn, and physical cash inflow for some UAH2.8bn.

Monetary operations, but for UAH7.1bn reallocation of excess funds to certificates of deposit (CDs) from correspondent accounts, amounted to UAH0.9bn. All the funds were granted for 90 days.

In total, the balance of correspondent accounts dropped by UAH8bn to UAH48bn while position in CDs increased by UAH7.1bn to UAH111.7bn.



Figure 4. Local UAH bonds market

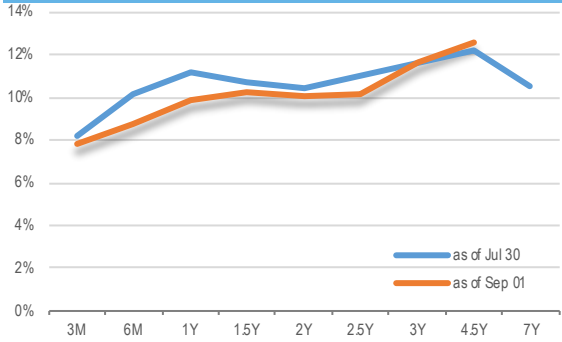
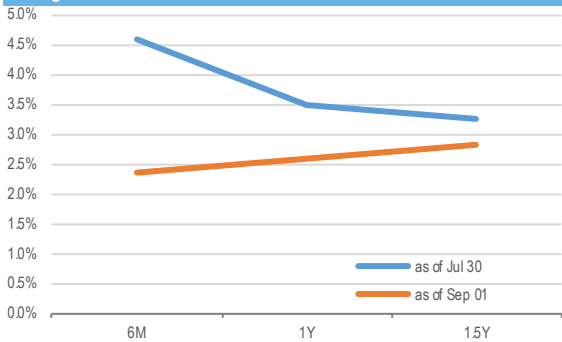


Figure 5. Local USD bonds market



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	0.00%	0.00%	10.00%	10.00%	1	0	53.26	0.00
UAH	1Y	9.29%	9.29%	11.50%	9.10%	11	6	2 773.64	2 513.44

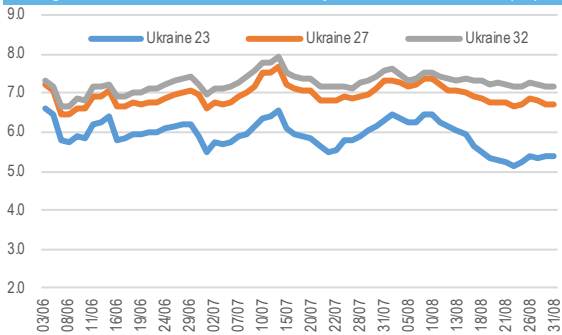
FinMin keeps experiencing soft demand for government bonds. The last primary debt auctions, which took place on the first day of the new season, again received a cool reception from market participants.

The ministry offered 6m and 1y securities denominated in local currency. All **the demand was concentrated in the 1y bonds**, which received 11 bids for UAH2.8bn. The ministry, however, rejected 5 bids with rate above 9.29%, and hence narrowed amount of funds risen to UAH2.5bn. Given that an equivalent coupon was due to repayment on the next day, the transaction just covered upcoming outlays, with no impact on FinMin's liquidity position.

The 6m bonds auction failed to attract any decent interest. There was just one application filed worth UAH53mn with bid rate at 10% per annum. Though closely reflected quotations in the secondary market, the bid was rejected by the ministry.

A constant gap between market's expectations and FinMin's cut-off yields might signal that the latter aims cover the majority of this year's liquidity needs via official financing. Some delays in drawing such funds might force FinMin to seek financing in the local market. But the ministry will likely continue squeezing liquidity from state-owned banks.

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



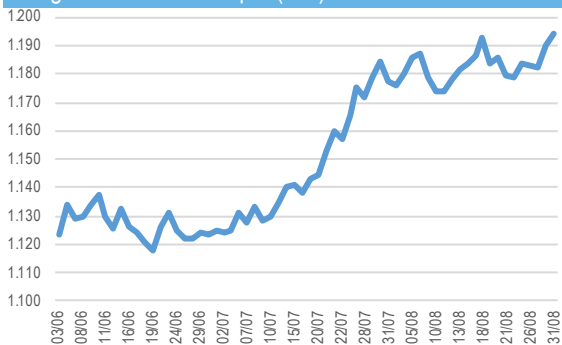
EUR/USD remains above 1.18 as wind blows against the dollar

The EUR/USD pair keeps trading above 1.18 barrier as investors increasingly pay more attention to other currencies whose economies are currently outperforming that of the United States in terms of managing the coronavirus pandemic.

Democrats and Republicans remain entrenched in their positions about the next fiscal stimulus. The impasse might force the Fed to step in with more measures.

The U.S. ISM Manufacturing Purchasing Managers' Index for August accelerated to a nearly two-year high amid a surge in new orders. Nevertheless, market participants keep eyeing break in EUR/USD rate above 1.2 level as employment in U.S. continued to lag, supporting views that the labour market recovery was losing momentum.

Figure 7. EUR USD spot (mid)

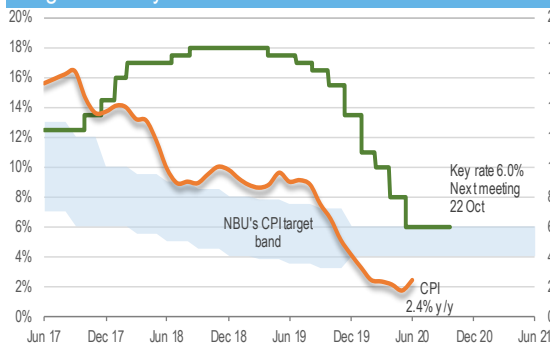


EUR/USD's rise is also driven by factors outside America. China's independent Caixin Manufacturing PMI beat estimates with 53.1 points in August, showing that the Asian giant continues recovering from the COVID-19 fallout.

In the meantime, Europe's locomotive Germany is powering forward, with economy ministry is set to publish an upgraded growth forecast.

U.S. government debt prices slide lower on the back of fresh employment data. The yield on the benchmark 10-year Treasury note was higher at 0.6559%. Yields move inversely to prices.

Figure 8. Key rate vs CPI evolution



NBU holds rate and hints of no plans to change policy

The National bank of Ukraine (NBU) has kept its key interest rate unchanged and continues to signal policy will stay on hold for the time being as economy is setting on recovery path. Raising the minimum wage, growth of energy prices, and seasonal FX weakening will push inflation toward NBU's target range in 2H20. Notably narrowed consumption amid ongoing social-distancing restrictions, however, will curb inflation reacceleration above central bank's long-term target at 5%.

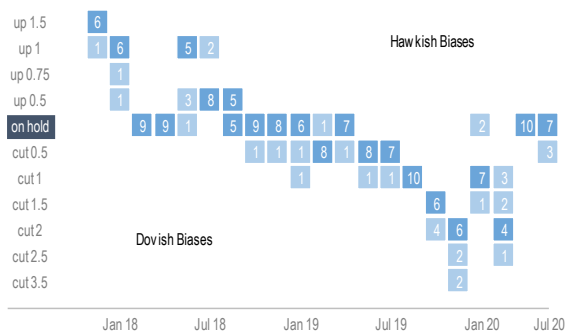
Lower-for-longer. The central bank left its key rate at 6% for a third consecutive meeting. While we see less dovish comments in the last two summary reports of the policy rate discussion, the central bank continue clearly signaling about importance to prop up economy with cheap funding.

"The fact that the key policy rate is being kept below its neutral level shows that monetary policy is expansionary. The policy also leaves enough room for further interest rate cuts in the economy", the NBU pointed out.

In addition to that, **the NBU keep on extending money supply by simplifying access to its lending facilities.** Since the previous MPC meeting, the central bank has loosened some collateral requirements for refinancing loans and during the today's briefing the governor mentioned that the NBU has also intensified its regulatory activities in order to promote lending .

NBU head once again pointed out that the local economy rebounded in 2H20 from the recession triggered by the Coronavirus outbreak.

Figure 9. History of distribution of votes at MPC



We see, however, that recovery still fragile, with headwinds from narrowed household spending and weaker agriculture production.

We expect the process of recovery to be quite gradual. Income losses and increased savings (both precautionary and involuntary) continue to weigh on consumption. Beyond that, as we mentioned in our previous report, adverse weather conditions might put a serious dent in agricultural production this year and economy as a whole.

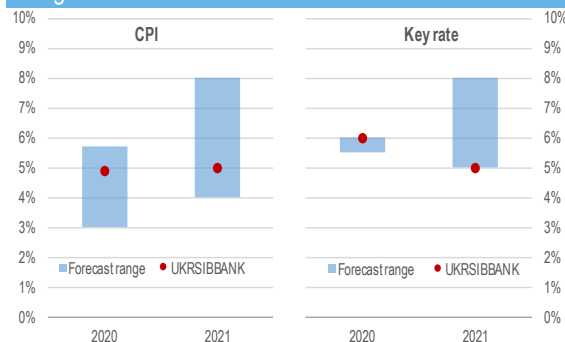
Business activity could be further dented by growing number of COVID-19 cases in Ukraine adding to fears about tightening of lockdown measures and further contraction of spending.

With regard to consumer prices, the NBU confirmed that inflation continues reaccelerating on the back of recovering consumption and growing energy prices, with government's fiscal stimulus fueling this trend going forward.

The CPI dynamics, however, was not mentioned among risk factors. The central bank pointed out, that future inflation will largely depend on how fast the economy recovers.

We improved your year-end CPI forecast to 4.9%. According to our expectations, recovery in consumption, increase of minimum wages, growth of energy prices, and FX factors will push inflation toward NBU's target range over the course of the year. Though current inflation remains 2.5pp far from our forecast, we hedge our outlook by warning of a high level of inflation vulnerability to FX fluctuations.

Figure 10. UKRSIBBANK's vs market forecasts*



* IMF (without key rate), NBU, NBU consensus (10 participants, inc. MS, JPM, Citi, IFF, Barclays)

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	4.5	5.0
CPI (end of year %YoY)	24.9	43.3	12.4	13.7	9.8	4.1	4.9	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
31.08.2020	01.09.2020	02.09.2020	03.09.2020	04.09.2020	05.09.2020	06.09.2020
NBU: Balance of Payments			NBU: Monetary Policy Meeting	Fitch Rating Action		
07.09.2020	08.09.2020	09.09.2020	10.09.2020	11.09.2020	12.09.2020	13.09.2020
NBU: FX Reserves (deadline - 7th day)		Ukrstat: Price Indexes NBU: Monetary Statistics (Preliminary)	ECB: Monetary Policy Meeting	S&P Rating Action		



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