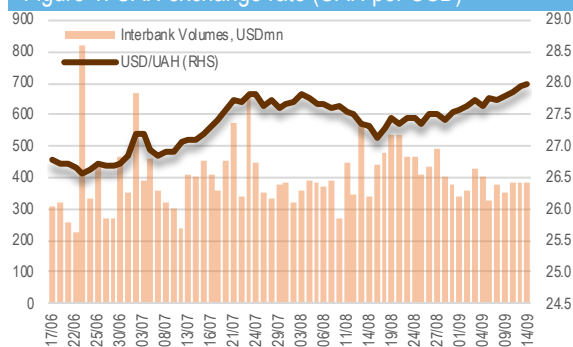


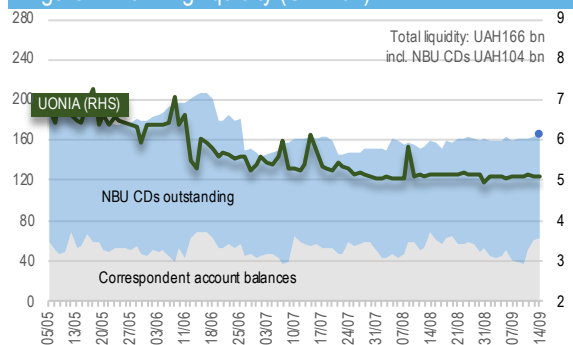
	Rating	Outlook	Last update	This week in focus: Inflation struggles to enter target range amid weak demand
Fitch	B	STABLE	04.09.2020	Ukraine's inflation increased marginally to 2.5% y/y in August against the backdrop of a very low base. Going forward, the statistical effect will favour a decline in inflation, but economic drivers such as increase in wages, rising fuel costs, and gradual UAH weakening will likely push prices up, despite the COVID19 impact, which is currently seen as a major disinflationary factor.
S&P	B	STABLE	11.09.2020	
S&P (N)	uaA	-	11.09.2020	
Moody's	B3	STABLE	12.06.2020	

Figure 1. UAH exchange rate (UAH per USD)

FX and interest rates: USD/UAH accelerates growth after breaking 28.0 barrier

The USD/UAH pair has pushed higher since breaking a key barrier at 28.0 on September 14.

There seemed to be a seasonal local currency depreciation in the market, driven by a demand spike for USD among farmers converting their harvest proceeds into foreign currency. In turn, those receiving export revenues try to hold FX sales for some time for the sake of benefiting from the trend.

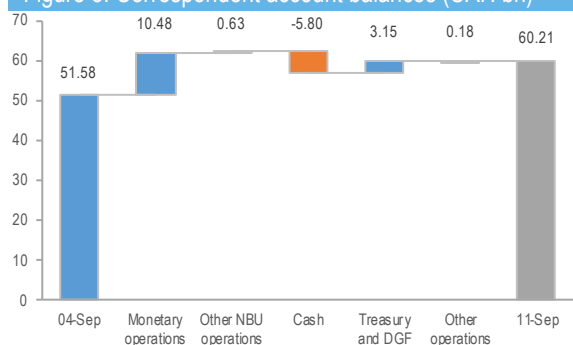
The central bank shows little attention to market volatility. Even verbal interventions have been scarce during this month. Some minor foreign currency sales were noticed after the pair approached 28.1 mark, gaining 0.4% during Tuesday's trading session. But the rebooted central bank apparently has a different view about currency fluctuations and FX intervention policy, in general, comparing to the previous composition.

Figure 2. Banking liquidity (UAH bn)


The FinMin's statement on gaining consent from the NBU to apply a year average rate of 29.1 when drawing up the state budget draft for 2021 added to market volatility.

The situation plays into hands of speculators, who observing as the tide turned in favour of sellers, try to draw the rate closer to FinMin's benchmark.

We expect hryvnia to remain under pressure through the end of the month. Some technical corrections, which are likely as soon as in the coming days, will slowdown further growth.

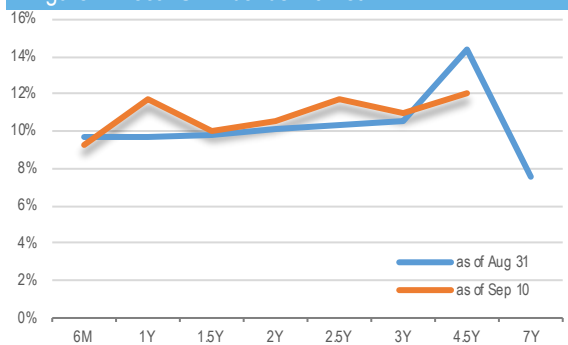
Figure 3. Correspondent account balances (UAH bn)


Banking liquidity keeps balancing around UAH160bn in the week ended on September 11. A detailed picture on weekly liquidity fluctuations shows remained in place high demand for physical cash. Cash withdrawals amounted to UAH5.8bn last week, increasing year to date cash outflow to UAH90bn.

Central bank's liquidity injections amounted to UAH1.7bn. Some UAH630mn came via FX market interventions as the NBU purchased USD22.5mn during last week. Another UAH1.1bn was disbursed to banks as refinancing loans. The rest of the monetary operations for some UAH9.4bn represent flow of funds from central bank's certificates of deposits (CDs) to correspondent accounts.

As a result, banks' balance of correspondent account with the NBU increased by 16.7% to UAH60.2bn, while position in CDs narrowed to UAH102.9bn.

Figure 4. Local UAH bonds market



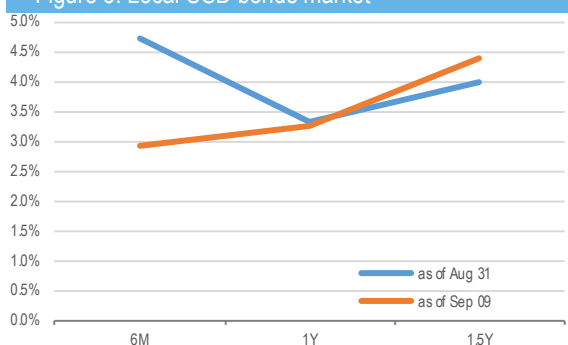
Government bond market

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	6M	7.82%	7.82%	9.50%	7.82%	4	2	2 505.47	2 095.47
USD	1Y	3.50%	3.50%	4.00%	3.50%	30	28	111.15	110.30
UAH	2Y	10.50%	10.43%	11.00%	10.25%	7	6	903.57	803.57

Another FinMin's primary auctions resulted in the mobilization of about UAH6bn (in hryvnia equivalent) of new cash.

A mix of bonds was up for auctions on September 15, including 6m and 2y instruments in UAH and 1y securities in USD.

Figure 5. Local USD bonds market

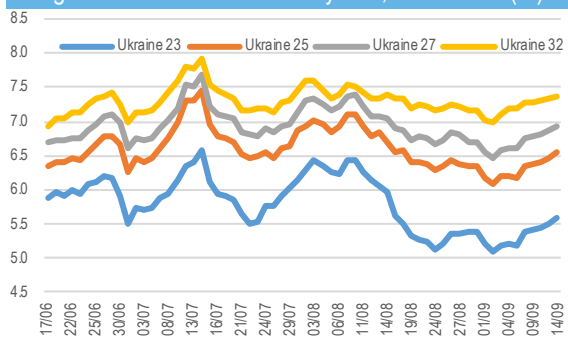


The former showed mixed results. There was some demand for 2y bonds, which attracted 7 bids worth in total UAH900mn with rates ranging from 10.25% to 11%. But one bid worth UAH100mn with a rate above cut off yield at 10.5% was rejected by the ministry.

Short-term bonds were sold for a total of UAH2bn with an annual interest rate of 7.82%. There were 4 applications submitted, but two of them worth in total UAH500mn with a rate exceeding foregoing yield were rejected.

The highest demand attracted USD bonds, which allowed the ministry to mobilize USD110mn with an annual interest rate of 3.5%, a zero change from the previous auction. There were 30 applications submitted, 28 of which were accepted.

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



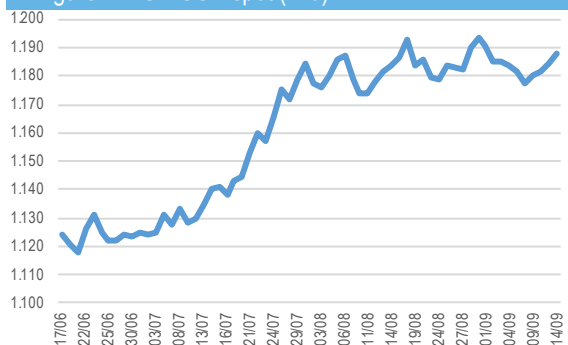
EUR/USD remains in a consolidation phase

The EUR/USD pair keeps trending between 1.175 and 1.19 marks, with little opportunities to move out of this range, which emerged in late July.

Later in the day, the Fed concludes its first meeting since adopting a more accommodative approach to inflation. The U.S. central bank is expected to keep interest rates unchanged at record lows and reiterate tolerance for high inflation. The markets have already factored the odds of rates remaining low for a prolonged period.

Besides policy, where any changes would likely be a shift in its bond-buying program to longer tenors, a major area of focus will be on the Fed's economic projections, especially where it figures inflation is headed.

Figure 7. EUR USD spot (mid)

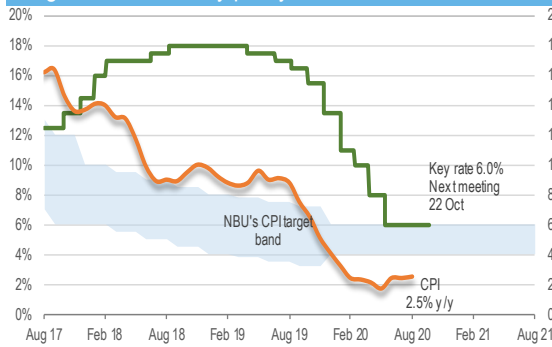


Looking at the broader picture, markets hold a bearish view on the U.S. dollar amid improved sentiment in the risk-associated universe, auspicious results from domestic fundamentals, as well as a calmer U.S.-China trade front.

Going forward, the pair may take cues from the Eurozone trade balance and the U.S. retail sales data.

U.S. Treasury yields edge lower as investors await Fed's verdict. The yield on the benchmark 10-year Treasury note was down at 0.6740%. Yields move inversely to prices

Figure 8. CPI vs Key policy rate

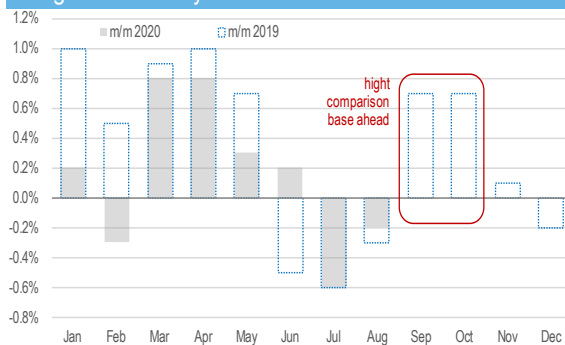


Inflation struggles to enter target range amid weak demand

Consumer prices in Ukraine increased marginally to 2.5% y/y in August against the backdrop of a very low statistical base. Going forward, the statistical effect will favour a decline in inflation, but economic drivers such as increase in wages, rising fuel costs, and gradual UAH weakening will likely push prices up, despite the COVID19 impact, which is currently seen as a major disinflationary factor. We keep a conservative inflation forecast of 4.9% for 2020 and 5.0% for 2021, expecting the central bank to retain the key rate at 6.0% during the next monetary policy meetings.

The consumer price index registered 0.1 percent point (pp) increase vs July. But a minor improvement came on the back of a low base of last year. It allowed 0.2% monthly deflation in August, despite being 0.1 pp weaker than in August 2019, to bring the annual reading a bit higher.

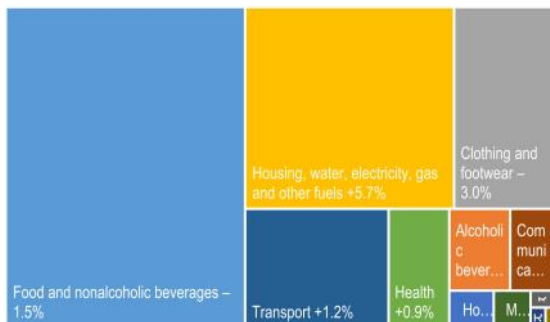
Figure 9. Monthly evolution of CPI



COVID19 is a serious disinflationary driver. Stagnating demand on the background of rising coronavirus infections and still in place in the country selective social distancing measures pushed prices for food and apparels further down in August by 1.5% m/m and 3.0% m/m respectively.

Some consumer-oriented services have notably improved performance following lockdown relief, and benefit from accumulated in lockdown involuntary savings. But in general, consumer confidence remains weak against widespread income losses in the time of strict quarantine. Aggressive price policy in segments contributing the most to consumer price index (CPI) can promptly hit back with a narrowed customer base.

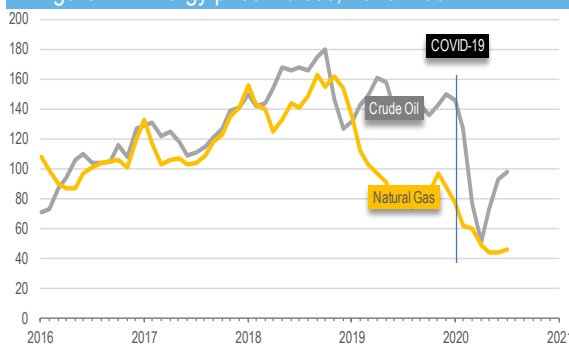
Figure 10. Contribution to monthly CPI change



A host of factors can fuel inflation growth. Firstly, energy prices tick higher, pushing up consumer expenses in such price inelastic segments as utilities, which saw a 5.7% m/m costs increase in August, and transport services, which experienced a 1.2% m/m costs increase. With global demand exceeding supply, which was severely affected by negative oil prices during lockdown measures, energy commodities prices are likely to remain buoyant ahead of the heating season.

Secondly, the ongoing seasonal weakening of the local currency is likely to hit final consumer prices across the board. Taking into account an equivocal statement from the NBU on this matter, the factor may bring about a sustained deterioration of inflation sentiments.

Figure 11. Energy price indices, 2016=100



Thirdly, Ukraine's parliament approved a bill on August 25 that increases the country's monthly minimum wage. The bill lifts the minimum wage to UAH5.0th (USD182) from circa UAH4.7th (USD172), starting from September 1. The action came as a governmental response to facilitate Covid-19 impact on society and was aimed at stimulating the growth of consumer demand. An increased spending power might be accompanied with so-called wage push inflation.

Two months of favourable statistical base ahead will likely put off inflation acceleration to 4Q. While all these factors may boost month-to-month inflation acceleration, the annual reading is likely to be little affected in the coming months as the high base of the last year will absorb the corresponding impacts.

We keep, however, a conservative outlook on inflation, expecting the foregoing factors to reveal itself in the last months of the year.

At the same time, we expect no change in policy rate 6.0% in the next MPC meetings - on October 22 and on December 10 - reckoning that the central bank will keep supporting consumption, which is the major driver of the economy growth.

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	-5.8	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	3 926	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	56.2	62.6
Imports of goods and services (USD bn)	70.0	49.6	51.8	60.8	70.5	75.5	64.3	72.5
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	27.0	27.5
Imports coverage (months of imports of goods)	1.5	4.4	3.7	3.6	3.4	3.9	5.0	4.5
Interest and exchange rates								
NBU discount rate (% end of year)	14.0	22.0	14.0	14.5	18.0	13.5	6.0	6.0
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
14.09.2020	15.09.2020	16.09.2020	17.09.2020	18.09.2020	19.09.2020	20.09.2020
NBU: Minutes		FOMC: Monetary Policy Meeting		Ukrstat: GDP (Preliminary) NBU: External Debt		
21.09.2020	22.09.2020	23.09.2020	24.09.2020	25.09.2020	26.09.2020	27.09.2020
Ukrstat: Retail trade		Ukrstat: Industrial Production				



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