



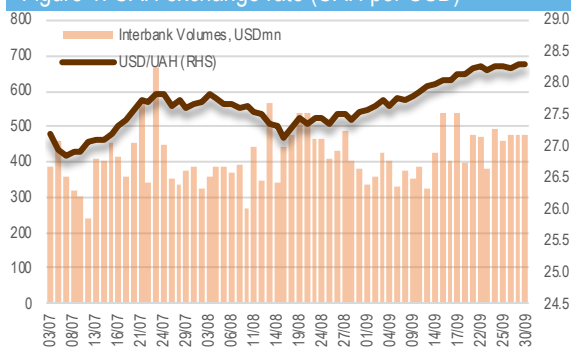
ECONOMICS | INTEREST RATES STRATEGY | FX

30 September 2020

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

	Rating	Outlook	Last update	This week in focus:
Fitch	B	STABLE	04.09.2020	Retail sales enjoy end-of-summer pickup in expenses
S&P	B	STABLE	11.09.2020	August saw a notable increase in consumption. Improved consumer sentiment amid faded fear of the virus and a transition from hot to wet season contributed the most. But a drastic change in COVID spread since September may set back recovery. While another lockdown is off the table, consumer confidence remains highly vulnerable to pandemic news.
S&P (N)	uaA	-	11.09.2020	
Moody's	B3	STABLE	12.06.2020	

Figure 1. UAH exchange rate (UAH per USD)



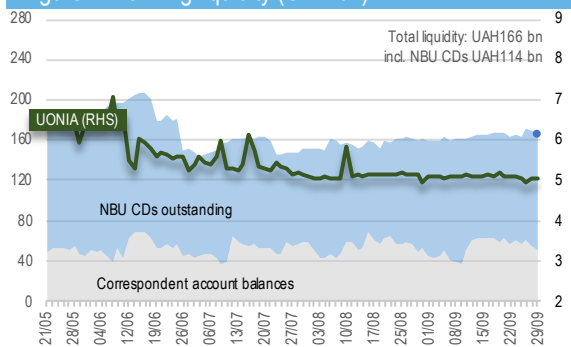
FX and interest rates: NBU steps in to relieve pressure on the hryvnia

The Ukrainian hryvnia (UAH) has slowed trending in a downward channel against the U.S. dollar (USD) after the National bank of Ukraine (NBU) appeared in the market with interventions.

The central bank stepped in with both verbal and actual support, selling some USD160mn from its reserves during the week ending on September 27. This followed a USD70mn FX sale in the last few days of the preceding week. The NBU sees the ongoing UAH depreciation against the USD as driven by gaining momentum import activity.

But the market keeps holding a bearish sentiment towards the hryvnia. Thanks to VAT refunding, exporters resort to foreign currency sales for covering some acute local currency needs only.

Figure 2. Banking liquidity (UAH bn)



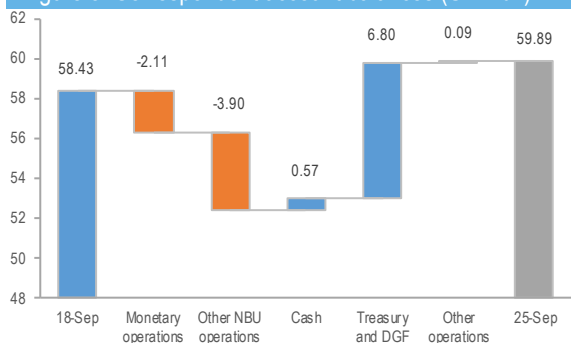
While imports indeed recover, there is also a notable contraction of foreign currency supply in the market.

Seasonal hryvnia depreciation usually lasts for one month. We expect, however, this year it may take longer, given upcoming local elections, where deputies of district councils and rural townships, as well as city mayors will be elected. Scheduled for November US election should also be closely watched.

Banking liquidity grew above UAH170bn by the end of last week, with correspondent account balance being just shy of UAH60bn.

The increase has mostly to do with the State treasury's operations. A lump-sum payment for UAH7.6bn on Friday may indicate of VAT refunding.

Figure 3. Correspondent account balances (UAH bn)



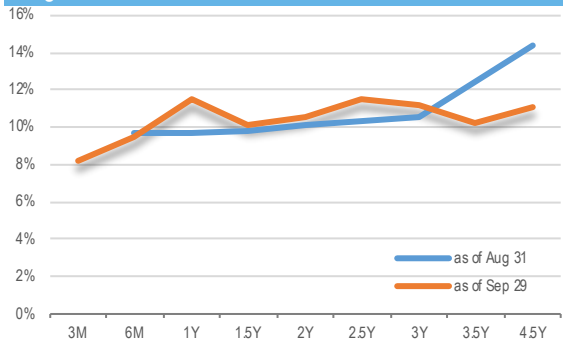
There was also a modest inflow via cash channel. But in general, physical money keeps leaving the banking system, and the total cash outstanding has already exceeded UAH516bn or 13% of last years' nominal GDP.

Other NBU operations for UAH3.9bn represent central bank's interventions in the FX market.

Some UAH2.1bn were reallocated from correspondent accounts to central bank's certificates of deposits (CDs), bringing the total banks' position to UAH111bn.



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	8.00%	8.00%	9.95%	8.00%	3	2	2 110.45	2 010.45
UAH	1Y	9.50%	9.50%	10.00%	9.50%	6	3	628.70	23.70
UAH	2Y	10.50%	10.50%	11.00%	10.50%	11	9	114.29	79.29

FinMin seems to give in to market pressure after a streak of meager primary auctions.

This Tuesday the ministry auctioned local currency bonds with tenure from 6m to 2y. As market interest was primarily concentrated in short term securities, drawing 3 application for UAH2.1bn in total, the FinMin agreed to draw cut-off rate up to the lower bound of the bid rate range at 8%, which is a 18 basis point increase against the cut-off rate for similar securities auctioned on September 15. This allowed the ministry to attract some UAH2bn, rejecting one application for UAH100mn with a bid rate of 9.95%.

Yet the secondary market continues pricing similar bonds with a yield around 9.5% per year. Taking into account that the vision to attract by the end of the year another tranche from IMF and contingent on it financial aid from EU remains blurred, a struggle for yield is likely to intensify going forward.

The rest of auctioned bonds 17 applications in total with rates ranging from 9.5% to 10.0% for 1y securities and from 10.5% to 11.0% for 2y ones. The total bid size amounted to UAH743mn. The FinMin decided to accept the best bids only, sacrificing some UAH640mn.

Figure 5. Local USD bonds market

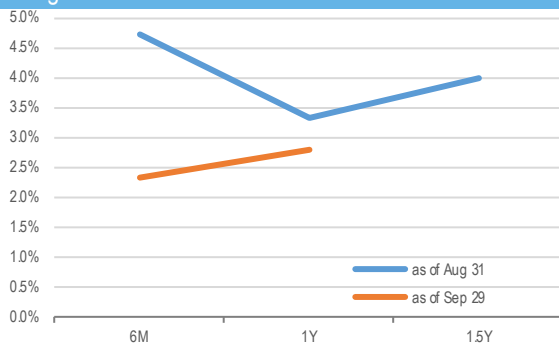
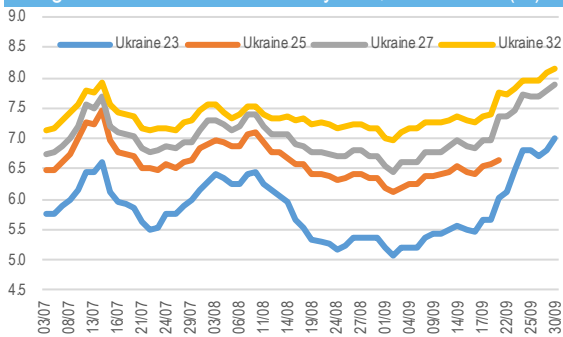


Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



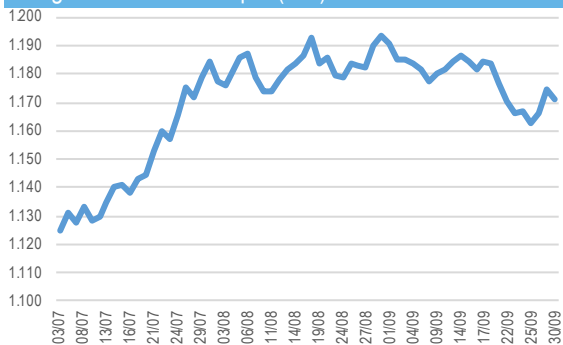
EUR/USD rebounds sharply after a dip below 1.17

The EUR/USD rate has been on a veritable roller coaster in a last decade of September.

The dollar gained ground at the beginning of the decade, ultimately touching an eight-week high, after a top Federal Reserve official struck a hawkish tone, saying the central bank could raise rates before the average 2% inflation is reached. The comments surprised many and provided a strong bid for the dollar across the board.

The commentaries by Christine Lagarde, President of the European Central Bank (ECB) about still uncertain economic recovery in the euro area have also contributed to the trend.

Figure 7. EUR USD spot (mid)

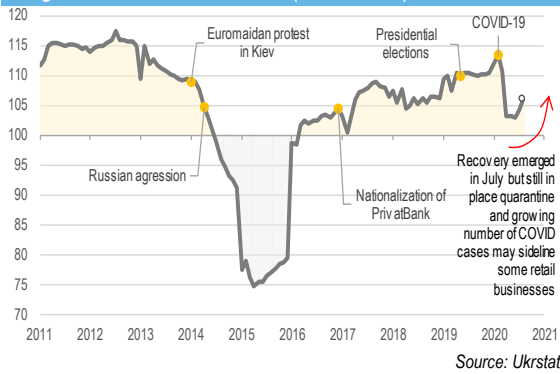


But the situation sharply changed in the middle of the decade, when investors started to capitalize the preceding gains in the greenback and cautiously looked ahead to the first debate between U.S. President Donald Trump and Democratic challenger Joe Biden.

The very debate boosted the safe-haven dollar, as it reinforced concerns that the outcome of the November 3 presidential election will not be accepted by the losing side.

The yield on the benchmark 10-year Treasury note keeps moving in a narrow range around 0.66%.

Figure 8. Retail trade index (cumulative)



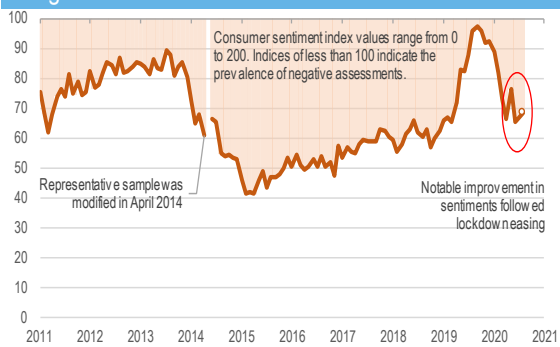
Source: Ukrstat

Retail sales enjoy end-of-summer pickup in expenses

The last month of summer saw a notable increase in consumption. Improved consumer sentiment amid faded fear of the virus and a transition from hot to wet season contributed the most to the uptick. But a drastic change in COVID spread since September – both a number of new cases and a share of positive tests keep growing – may set back recovery. While another lockdown is off the table, consumer confidence remains highly vulnerable to pandemic news.

Tired of being holed up. Cafe, restaurants, shops burst into the scene in August reaping pent-up consumption demand as a constant number of COVID cases back then contributed to the impression of hitting plateau. Retail sales volumes rose by 2.2% between July and August, and were 8.7% up on August 2019, according to Ukrstat. The cumulative index for January-August 2020 gained 6% compared with the corresponding period of 2019.

Figure 9. Consumer sentiment index

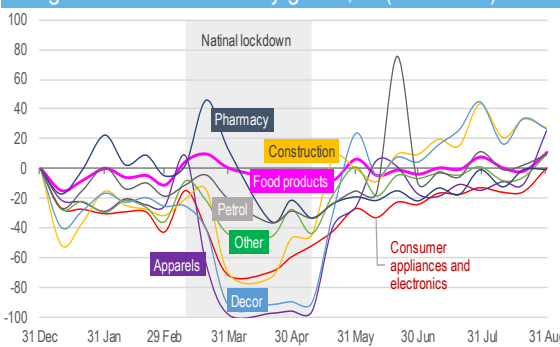


Sources: GfK, Info Sapiens

Spending on food remained the major contributor, approaching year high recorded in March before the introduction of temporary closures, according to State Fiscal Service of Ukraine (SFS) and q.rating.zone data.

Seasonal factors fueled the spending spree. Apparel, as well as consumer appliances and electronics, were also on demand. As for the former, a rainy final week of summer stimulated early preparation for autumn. Regarding the latter, it was driven by deep "back-to-school" discounts on items that could be of use not only for students, including computers, printers, and small appliances.

Figure 10. Retail trade by goods, % (2019=100)

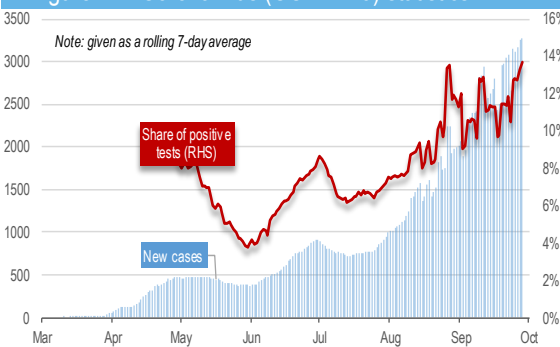


Sources: SFS, q.rating.zone

Yet consumer confidence remains at a relatively low level. Despite some improvement in August, consumer sentiment remains highly vulnerable to a rise in coronavirus cases, which can magnify consumer caution and limit future shopper footfall in the short term.

We consider a weak likelihood of tightening of social distancing measures on the eve of local elections, scheduled for October 25, 2020. At the same time, we express our concerns over a growing number of new cases and more importantly over a share of positive tests, which means that the former figure is not just a reflection of expended testing. The despairing statistics might preserve future spending and prompt authorities to respond somehow to the accelerated wave of the pandemic in late fall.

Figure 11. Coronavirus (COVID-19) statistics



Source: Ourworldindata.org

Moreover, retail operators expect a notable increase in the prices of goods purchased for sale, according to polling conducted by the NBU in August. This, coupled with recent hryvnia devaluation is likely to weaken appetite to purchases.

Worth also brief touching lagging a lot behind services activity, which is another important contributor to GDP within a personal consumption component. But for restaurants and cafes, which saw some inflow of visitors, who decided not to travel this year, in general services industry remain vulnerable to people avoiding crowds.

The correspondent evolution of factors confirms our forecast of negative GDP growth in 2020 at 5.8% followed by 3.8% recovery in 2021, but increase downside risks to CPI growth forecast at 4.9% y/y and 5.0% y/y respectively.



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 (USD/UAH) end of year	15.8	24.0	27.2	28.0	27.7	23.7	29.5	31.0
Exchange rate (EUR/UAH) 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
28.09.2020	29.09.2020	30.09.2020	01.10.2020	02.10.2020	03.10.2020	04.10.2020
Ukrstat: Nominal & Real Wage		NBU: Balance of Payments				
NBU: International Investment Position						
NBU: Direct Investments						
05.10.2020	06.10.2020	07.10.2020	08.10.2020	09.10.2020	10.10.2020	11.10.2020
		NBU: FX Reserves (deadline - 7th day)		Ukrstat: Price Indexes NBU: Monetary Statistics (Preliminary)		



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BNP PARIBAS GROUP

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Contacts

Investment Business Group

Serhiy Yahnych

Head of Investment Business

(+38044) 537-50-82 serhii.yahnych@ukrsibbank.com

Viktoriia Nebeska

Market Making Government Bonds

(+38044) 201-22-74 viktoriia.nebeska@ukrsibbank.com

Platon Yachmenov

Fixed Income Dealer

(+38044) 230-48-54 platon.yachmenov@ukrsibbank.com

Mykhailo Kharchuk

Market Analysis

(+38044) 537-49-75 mykhailo.kharchuk@ukrsibbank.com

Distribution of Capital Markets Weekly report:

macro@ukrsibbank.com



FX Business

Kostiantyn Rupchev

Head of FX Sales

(+38044) 537-50-04 kostiantyn.rupchev@ukrsibbank.com

Corporate Business

Ievgen Kulikov

Head of MNC team

(+38044) 201-22-43 ievgen.kulikov@ukrsibbank.com

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