



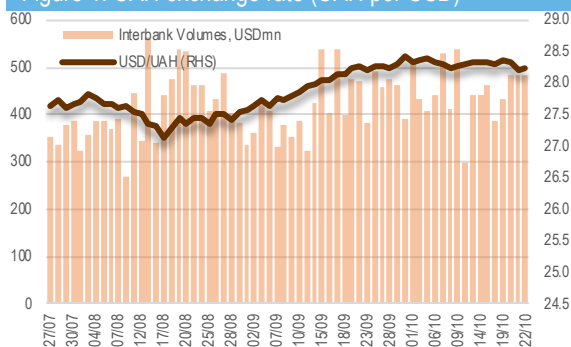
ECONOMICS | INTEREST RATES STRATEGY | FX

22 October 2020

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

	Rating	Outlook	Last update	This week in focus: NBU expectedly holds policy rate unchanged
Fitch	B	STABLE	04.09.2020	The NBU expectedly has left its key interest rate unchanged at 6%. Although we expect inflation to reaccelerate in 4Q20, we assume dovish policy to move into 1H21. But costs of funding is likely to remain unchanged to the downside against piling risks coming from gaining momentum infection spread, mounting state expenses, and slow progress in dealing with the IMF.
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)

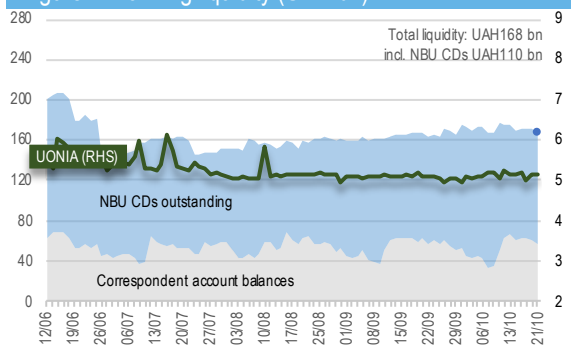


FX and interest rates: USD/UAH remains weak around 28.3

The USD/UAH pair had been trading with a mild negative bias in the last two weeks, approaching a year low at 28.4 mark, but was yesterday seen rebounding to the 28.3 region. **Although there seems to be a lack of support to breach the year low, the market keeps experiencing a tight supply.**

Usual for this season increase in FX sales by agricultural segment seems to be hampered by both growing prices for agri commodities, contributing to delays in export sales, and low incentives to shorten position in a hard currency in the context of upcoming elections (both in Ukraine and U.S.) and high uncertainty around future evolution of the pandemic. With regard to the former, worth pointing out that prices for corn soared about 30% in the last few months, putting at risk a large number of forward contracts, according to the media.

Figure 2. Banking liquidity (UAH bn)



But narrowed exports will eventually entail a slimmer VAT refunding. This should contribute to a stable FX supply in the market, limiting hryvnia devaluation through the end of the month.

The National bank of Ukraine (NBU) have been showing decreasing activity in the last weeks, producing meager purchases.

Banking liquidity contracted by 2.9% over the past week to UAH171.3bn. The decline solely results from still stable demand for physical cash, contributing to a UAH5bn outflow. Total cash outstanding so far has reached UAH527bn.

The rest of the factors showed little contribution.

Figure 3. Correspondent account balances (UAH bn)



Monetary operations for UAH17.2bn largely represent a shortening of banks' position in central bank's certificates of deposit (CDs) and overnight ones in particular. As a result, total NBU CDs outstanding dropped by UAH17bn to UAH109.2bn.

No effect on the interbank interest rate is expected following today's decision by the central bank to keep the key rate unchanged.



Figure 4. Local UAH bonds market

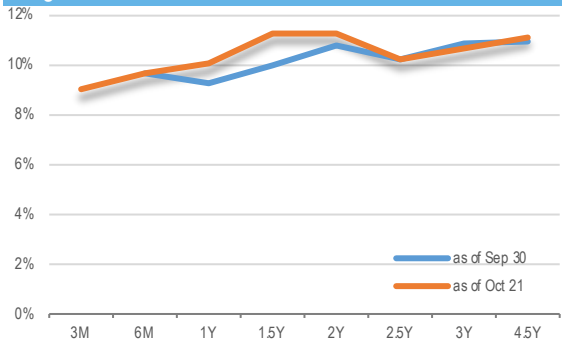
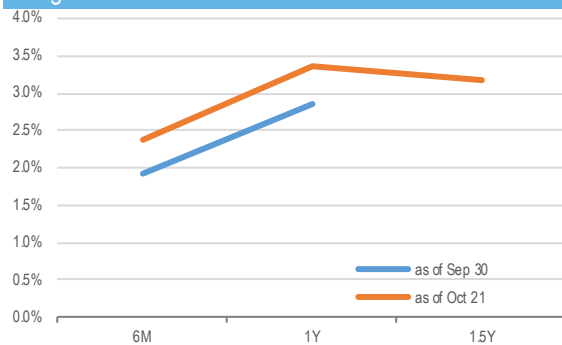


Figure 5. Local USD bonds market



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	3M	7.30%	7.30%	9.50%	7.30%	2	1	4 200.00	4 000.00
UAH	1Y	10.30%	10.22%	10.50%	10.00%	10	9	1 848.51	1 648.51
USD	1Y	3.50%	3.50%	3.50%	3.50%	46	46	52.67	52.67

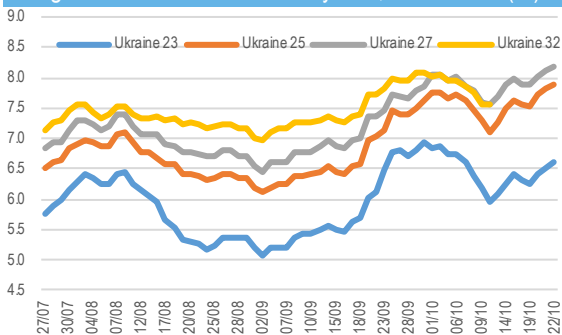
FinMin seems to have again applied to state-owned banks for financial support. It started from a renegotiated number of auctions: the ministry conducted this Tuesday only 3 instead of 5 initially scheduled auctions. Likely because of finding no enough demand, the issuer called off offering of 2.5y bonds in UAH and 9m bonds in USD.

Although the most rewarding was the placement of 3m bonds, the offer drew only 2 applications worth UAH4.2bn in total. And the only bid accepted for UAH4bn doesn't look like in line with a real market interest due to unusual volume. It was satisfied with cut-off rate at 7.3%, up by 10 basis points (bps) on the preceding auction.

A decent demand, compared with recent auctions, was seen for 1y bonds, attracting 10 bids with rate ranging from 10% to 10.5%. And the ministry surprisingly lifted cut-off rate by 30bps to 10.3%, which allowed it to accept all but one application and fetch some UAH1.65bn. The movement might point to getting more acute financing needs of the government.

USD local government bonds were the most appealing to investors, receiving 46 bids with a single rate at 3.5% and a total value of USD52.7mn. All the applications were satisfied.

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



EUR/USD again set to break 1.19 barrier

The world's most popular currency pair settled into an uptrend in the middle of the months and before yesterday was firmly heading toward a 1.19 key barrier.

The persistent dollar's weakness comes from speculations around a fiscal stimulus package, that might be pushed before the presidential elections.

Optimism about a U.S. stimulus is boosting markets and weighing on the safe-haven dollar. The recent progress in talks added to cautious optimism among the market participants, that an agreement in Washington could be reached.

A sign of diminished dollar's demand also comes from U.S. government bonds, as Treasuries' yields are sharply up and at fresh multi-week highs. The yield on the benchmark 10-year Treasury note hit a four-month high of 0.836% after closing above 0.8% for the first time since June in the previous session.

But pressure on the greenback eased after U.S. President Donald Trump on Wednesday (October 21) accused Democrats of being unwilling to craft an acceptable compromise.

At the same time, investors pay little attention to Eurozone, where fresh restrictions to combat COVID-19 have been introduced in many countries, and to the potential for more ECB stimulus.

Figure 7. EUR USD spot (mid)

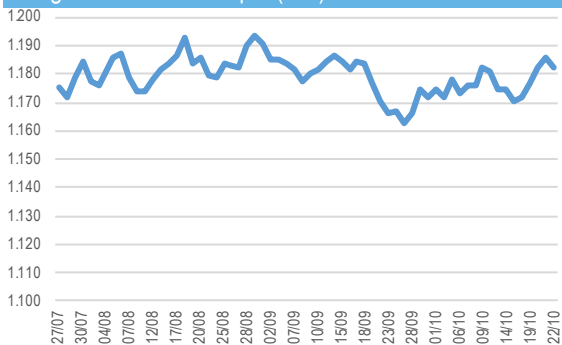
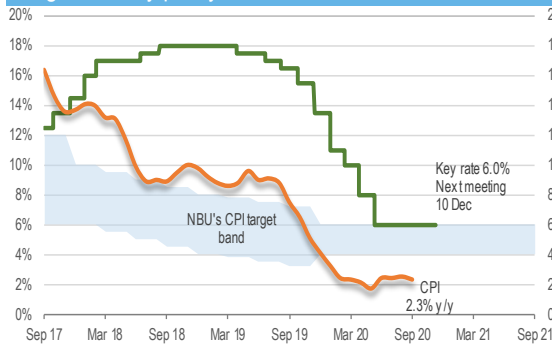


Figure 8. Key policy rate vs inflation

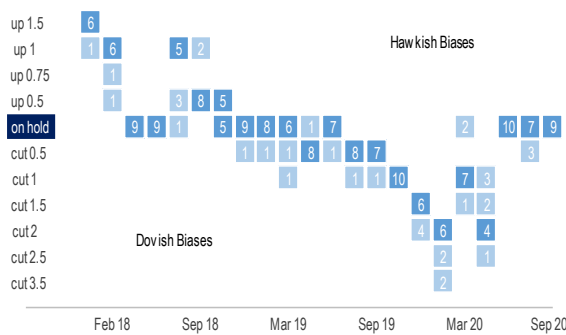


NBU expectedly holds policy rate unchanged

The NBU expectedly has left its key interest rate unchanged at 6% following today's meeting, confirming its commitment to support economy during the pandemic. Although we expect inflation to reaccelerate in 4Q20, we assume dovish policy to move into 1H21. But costs of funding is likely to remain unchanged to the downside against piling risks coming from gaining momentum infection spread, mounting state expenses amid limited opportunities to gain financing, and slow progress in dealing with the IMF.

Committed to dovish framework only. The central bank again signaled of no rate hikes in the coming future. That gives confidence, that the NBU is going to be leaning into economic recovery, allowing inflationary pressures to build without raising rates.

Figure 9. Voices distribution at past MPC

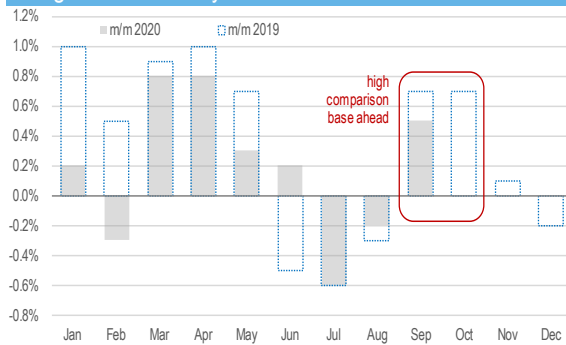


In particular, the central bank revised this year's inflation forecast, expecting CPI growth of 4.1%, an improvement from 4.7%, however upwardly revised next years' forecast to 6.5% growth from 5.5%.

The NBU also sees GDP decline at 6% by the end of the year (no change), followed by a 4.2% growth in the next year, an improvement from 4%.

While admitting inflation breaking out of the target range in 2021, **the NBU expects the reacceleration will be temporary, and hinted of no prompt turnaround in monetary policy for the sake of boosting economic recovery from the pandemic.**

Figure 10. Monthly inflation



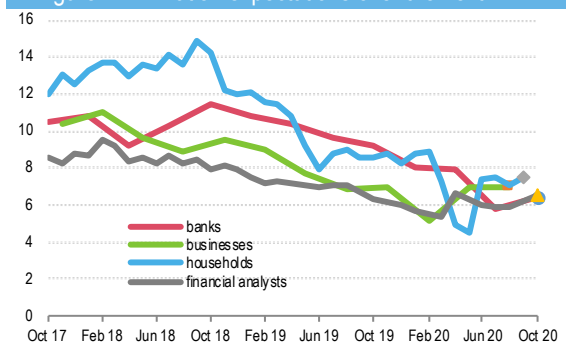
So far, consumer prices growth continues losing momentum, with annual inflation slowing to 2.5% from 2.7%, according to September's stats.

But the relief, which is likely to extend in October, is majorly driven by temporary factors, while inflationary pressures from weakening hryvnia, rising energy prices, and recovery in economic activity and consumer demand continue mounting.

This in line with deteriorating inflation expectations and improving consumer sentiments, highlighted by the NBU during the today's briefing.

On the other hand, monetary policy tightening in the context of Covid-induced widespread shortfalls in revenues could bring about an adverse effect. Instead of curbing excess prices growth, the action may backfire with an increased financial burden on businesses, narrowing number of survivals. That in turn could cause new disruptions to supply channels and likely a new cycle of price growth. Taking this into account, **we expect the dovish policy to move into 1H21.**

Figure 11. Inflation expectations over the next 12m



With this in mind, **we nevertheless expect costs of funding to remain unchanged to the downside.** With the pandemic being in an active phase worldwide and tightening conditions for the local government to finance expenses we see a limited room for landing rates to go down.

A limbo in dealing with the IMF adds to fears about the government's opportunities to source needed financing, affecting market's interest rate expectations.

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	3.5	-0.6
Current account balance (% of GDP)	-3.5	5.6	-2.0	-3.2	-4.9	-2.8	2.4	-0.4
Net FDI (USD bn)	0.3	-0.4	3.8	3.7	4.5	5.2	1.0	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
19.10.2020	20.10.2020	21.10.2020	22.10.2020	23.10.2020	24.10.2020	25.10.2020
		Ukrstat: Retail trade	NBU: Monetary Policy Meeting Ukrstat: Industrial Production			
26.10.2020	27.10.2020	28.10.2020	29.10.2020	30.10.2020	31.10.2020	01.11.2020
		Ukrstat: Nominal & Real Wage	ECB: Monetary Policy Meeting	NBU: Balance of Payments	NBU: Cost of Real Sector External Borrowing	



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