

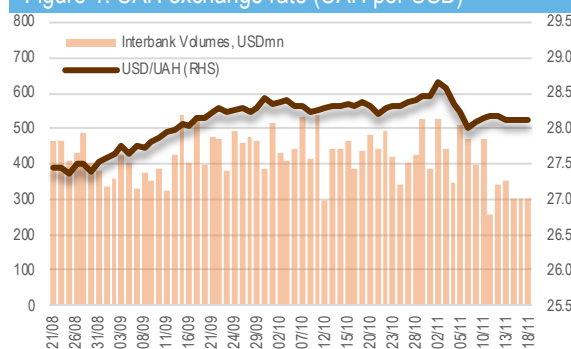
ECONOMICS | INTEREST RATES STRATEGY | FX

18 November 2020

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Better than expected 3Q GDP lends little support
Fitch	B	STABLE	04.09.2020	Coming off the spring lockdown Ukraine's economy managed to lessen contraction to 3.5% in 3Q20, thanks to pent-up consumer demand. Tentative recovery in industrial output supported the trend. Nevertheless, we hold our year-end GDP forecast at minus 5.8% as the economy has faced a new headwind with drastically reaccelerated COVID spread.
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 stabilizes around 28.15

The USD/UAH rate has recovered from the year-low at 28.65 with settling in the narrow range of 28.1-28.2 levels, as reaccelerated COVID spread dampened demand for foreign currency among importers.

Retailers and other public-oriented businesses brisk for another slump in sales cancelling some orders as the number of daily infections nearly tripled since the beginning of the fall, reaching a record high at 12,5th on Saturday (November 14). The government in response to the reaccelerated pandemic has lifted the quarantine status to general from adaptive and introduced a weekend lockdown. The former action replaces tiered regional restrictions with uniform national measures and the latter include the weekend closing of non-essential businesses such as shopping centres, restaurants, and bars. The action came into effect on 13 November and will hold until 30 November. But it can be extended further, depending on the pace of COVID-19 spread.

In turn, **tax season, which is ending this week, boosted FX sales** by exporters, switching into local currency in order to meet their fiscal expenditures.

But the NBU did not intervene in the market. Though foreign accounts reduced their pressure on UAH, persistent demand for FX still was in the market, preventing the rate from slipping to the 28.0 area. It is likely the central bank decided not to interrupt the pair's rebound from the year-lows.

We consider ongoing consolidation as a window to take/expend long positions in USD. We remain bearish on hryvnia and find the rate is currently driven by temporary factors, with tax season and improved investment sentiment following presidential elections in the U.S. being the major ones.

Figure 2. Banking liquidity (UAH bn)

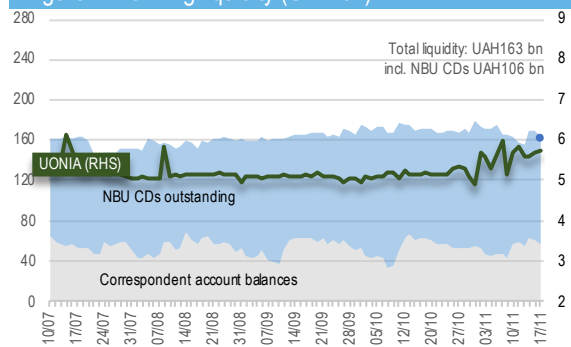
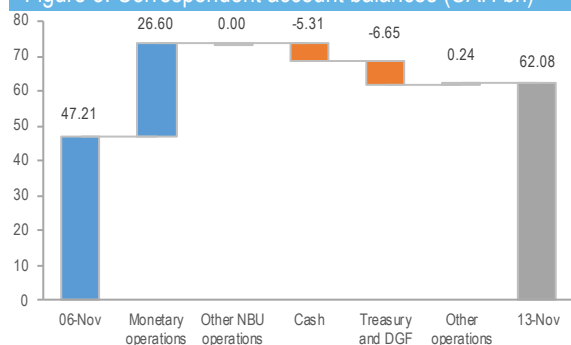


Figure 3. Correspondent account balances (UAH bn)



Banking liquidity balance returned to UAH170bn by the end of last Friday after contraction by UAH22bn in the preceding week.

Cash money demand and State treasury operations are the major sources of the liquidity drain, withdrawing from the system UAH5.3bn and UAH6.7bn correspondingly during the last week.

The outflow was covered by central bank's refinancing: the NBU disbursed to 16 banks UAH16.6bn in total, including UAH16.1bn in long-term loans.

With UAH11bn reallocated central bank's CDs, the balance of correspondent accounts by the end of last week improved by 31.5% to UAH62.1bn, while the total amount of CDs outstanding dropped by 9.3% to UAH107.8bn.

UKRAINIAN CAPITAL MARKETS WEEKLY

Figure 4. Local UAH bonds market

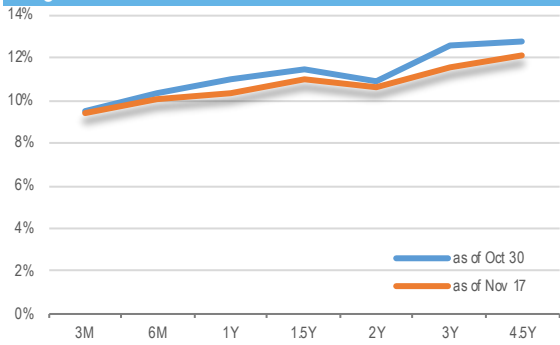
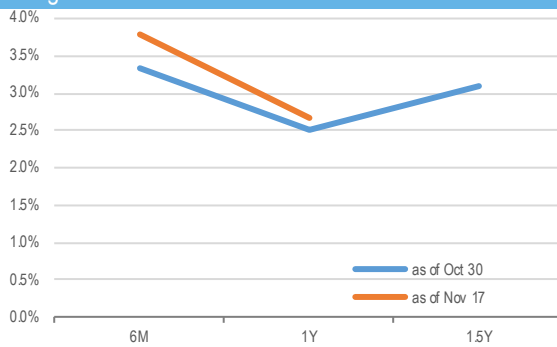


Figure 5. Local USD bonds market



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	1Y	10.50%	10.50%	11.00%	10.50%	18	11	600.55	328.05
USD	1Y	3.80%	3.77%	4.00%	3.70%	13	11	76.57	75.32
UAH	3Y	11.10%	11.10%	11.50%	11.10%	15	8	496.29	75.29

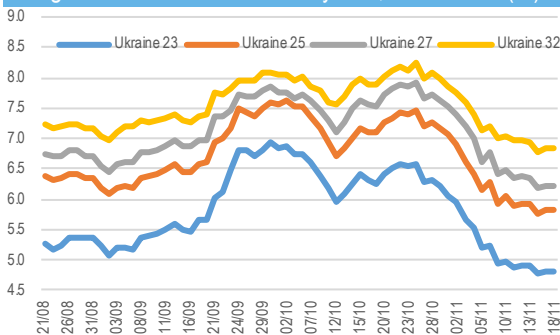
Tired of feeding the market with gradually rising yields at the latest auctions, FinMin tried to adopt zero tolerance to any further interest rate hikes. But expectedly faced cool reception from the market.

This Tuesday the ministry offered 1y and 3y bonds denominated in UAH and 1y securities in USD. The former drew bids for UAH1.1bn in total. But the placement size barely exceeded UAH400mn. As the ministry did not want to move up in rates (a 15bp cut-off rate hike to 11.1% in 3y bonds was razer an alignment with a yield curve), most of the applications remained unsatisfied.

Relatively more profitable was the offering of USD bonds, which received 13 applications for USD76.6mn with bid rate ranging from 3.7% to 4.0%. As the cut-off rate was lifted by 10bp to 3.8% most of the applications were accepted.

Despite improvement in outside conjuncture following U.S. elections, reducing pressure on UAH bonds from foreign accounts, the local market requires higher rates for government debt. A lack of progress toward securing another debt tranche with the IMF and upcoming next week sizable debt redemption play into the hands of local investors.

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

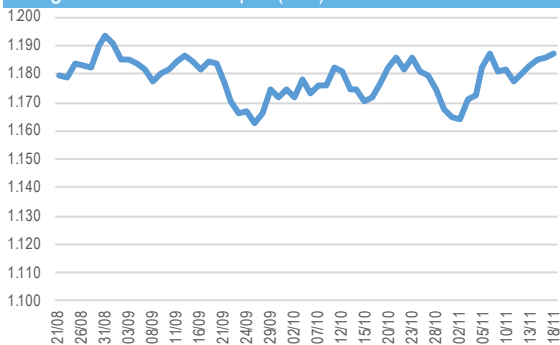


EUR/USD soars above 1.18 mark as progress in vaccine boosts risk appetite

The U.S. dollar again dipped below the key barrier at 1.18 mark against the euro as anticipated Joe Biden's victory in the U.S. presidential elections and a blow of positive news on COVID-19 vaccine boosted risk appetite among market participants.

Market participants believe a Biden win would weaken the greenback as the former vice president is expected to spend big on stimulus, boosting other currencies at the expense of U.S. one. Many, however, remain cautious in building up positions, pointing out that uncertainty remains very high about the election outcome.

Figure 7. EUR USD spot (mid)



After some rebound, **EUR/USD pare saw renewed pressure on USD as encouraging results for a coronavirus vaccine appeared**. Offset the surge in coronavirus cases and tighter economic restrictions across the world, the market showed a little more appetite for risk-taking after Pfizer and Moderna reported inventing COVID-19 vaccine with 94-95% effectiveness.

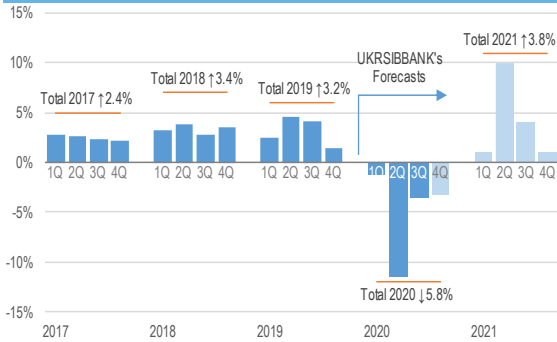
Across the pond the news flow was weak. The euro appears propped up by auspicious results from domestic fundamentals.

The yield on the benchmark 10-year Treasury note returned to 0.867% by Wednesday (November 18) after a rise above 0.9% during last week.

Treasury yields bounced down as coronavirus infections continue hitting new highs all around the world. on Thursday. Later disappointing U.S. retail sales dampened optimism on recent news of two effective coronavirus vaccines.

Figure 8. Ukraine's GDP evolution, y/y

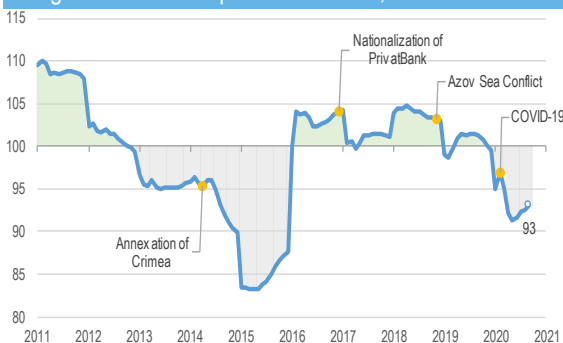
Better than expected 3Q GDP lends little support against resurging pandemic



Coming off the spring lockdown Ukraine's economy managed to lessen contraction to 3.5% y/y in 3Q20, thanks to pent-up consumer demand and emerged in quarantine demand for things helping make it bearable to be at home. Tentative recovery in industrial output driven by roaring back to life China's economy supported the trend. Nevertheless, we hold our year-end GDP forecast at minus 5.8% as the economy has faced a new headwind with drastically reaccelerated COVID spread and recently reintroduced social distancing measures.

Figure 9. Industrial production index, cumulative

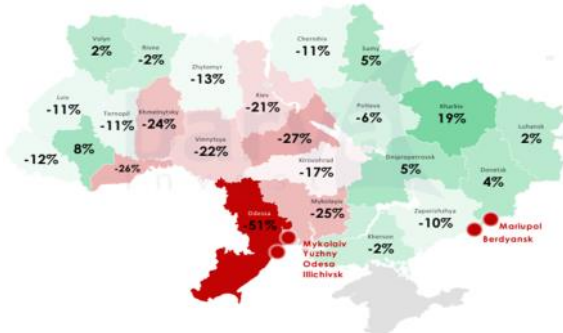
Low base support in 4Q is in question. While the flash estimate of GDP growth came without details, consumer spending, being the main engine of the economy, contributed the most to the recovery (see our report of October 30). Households boosted their spending in summer as the economy emerged from the first lockdown, with pent-up demand being the major driver of expenses. Later in September retail sales accelerated growth to 11.6% y/y, as consumers prepared for further months of working and studying from home.



But overall expenditures remain far below pre-pandemic levels, with in-person and travel services still experiencing the fallout of the COVID. Moreover, the momentum in consumption is likely to be limited, as the government again has tightened social restrictions (see details on the 1st page). On this background, a low base of the previous year, having mostly to do with costs saving warm weather, may offer a little support to GDP growth in 4Q20.

Figure 10. Wheat production in 2020, y/y

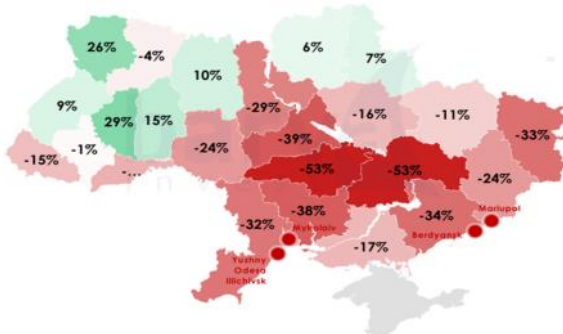
China lends a hand to industrial production. Being mainly focused on the production of raw materials and rough-processed products, local industrial production has benefited from the recovery in China, which has turned out to be Ukraine's largest trading partner in this year, according to the Ukrstat.



Manufacturing, the biggest component of industrial production, rose 11.4% m/m in September after a 6% m/m decline a month before. An August's hiccup, which interrupted a three-month growth streak, likely resulted from a late start of harvesting campaign, which affected the processing of food products. Production of food, beverages, and tobacco products dropped by 19.5% m/m in that month, and consumer non-durables output contracted by 16% m/m.

Figure 11. Corn production in 2020, y/y

But industrial production may give back some of its gains going forward. Mining fell 7.5% m/m in September, snapping four months of growth following a downward correction in iron ore prices.



Besides, **business expectations in the industrial sector remain weak.** The NBU October's survey found that while many businesses expect an increase in new export orders for their products, they also anticipate a rise of costs for raw materials and supplies prices, and some admit reduction of workplaces under resurgence of coronavirus infections and absence of additional fiscal relief.

Another impediment comes from a weak crop of grains, resulting from adverse weather conditions in 2020. Most of regions saw a double-digit drop in production, with the major impact concentrated in the central part of Ukraine. Although agricultural production makes up around 12% of Ukraine's GDP, the impact on the economy will be much more pronounced, taking into account sector's contribution to processing and other satellite services. In addition to that, there might be side effects to the economy via FX channel, as the agriculture industry is responsible for around 40% of the country's FX revenue.

Considering new headwinds, we **retained our year-end GDP growth forecast at minus 5.8%**, as well as hold expectations of 3.8% economic recovery in the next year.

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



UKRAINIAN CAPITAL MARKETS WEEKLY

FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
16/11/2020	17/11/2020	18/11/2020	19/11/2020	20/11/2020	21/11/2020	22/11/2020
LGB* % UAH 431.8mn		LGB* % UAH 1,256.6mn	LGB* % UAH 195.6mn	Ukrstat: Retail trade	LGB* % UAH 238.0mn	
23/11/2020	24/11/2020	25/11/2020	26/11/2020	27/11/2020	28/11/2020	29/11/2020
LGB* % UAH 313.6mn Ukrstat: Industrial Production	LGB* % UAH 261.0mn	LGB* % UAH 1,506.2mn LGB % UAH 642.6mn LGB* P UAH 1,400.0mn LGB P UAH 10,414.8mn	LGB* % UAH 506.3mn	LGB* % UAH 251.3mn Ukrstat: Nominal & Real Wage	LGB* % UAH 245.6mn	
30/11/2020	01/12/2020	02/12/2020	03/12/2020	04/12/2020	05/12/2020	06/12/2020
NBU: BoP		LGB* % UAH 1,094.3mn LGB % UAH 178.6mn	LGB* % USD 14.6mn			
07/12/2020	08/12/2020	09/12/2020	10/12/2020	11/12/2020	12/12/2020	13/12/2020
NBU: FX Reserves (deadline - 7th day)		LGB* % UAH 398.4mn LGB* P UAH 0.1mn Ukrstat: Price indices NBU: Monetary Statistics	NBU: MPC ECB: MPC			

MOST COMMON TERMS AND ABBREVIATIONS

GDP	Gross domestic product	DGF	Deposit Guarantee Fund
CPI	Consumer price index	Ukrstat	State Statistics Service of Ukraine
FDI	Foreign direct investment	NBU	National Bank of Ukraine
BoP	Balance of Payments	ECB	European Central Bank
CA	Current account	Fed	Federal Reserve System
FA	Financial account	FOMC	The Federal Open Market Committee
IIP	International investment position	MPC	Monetary policy committee meeting
VAT	Value-added tax	Minutes	Summary of MPC meeting
CD	Certificate of deposit	IMF	International Monetary Fund
FX	Foreign exchange, foreign currency	IFI	International financial institutions
UAH	Ukrainian hryvnia	LGB	Local government bonds
USD	U.S. dollar	FGB	Foreign government bonds (Eurobonds)
EUR	Euro	P	Principal due
SDR	Special drawing rights	%	Interests due
UONIA	Ukrainian OverNight Index Average	*	government bonds held by NBU or issued for recapitalization of state-owned banks
WA	Weighted average		
bp	basis point	m/m	in monthly terms; month-on-month change
pp	percentage point	TTM	trailing twelve months
y/y	in annual terms; year-on-year change	RHS	right-hand scale



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