



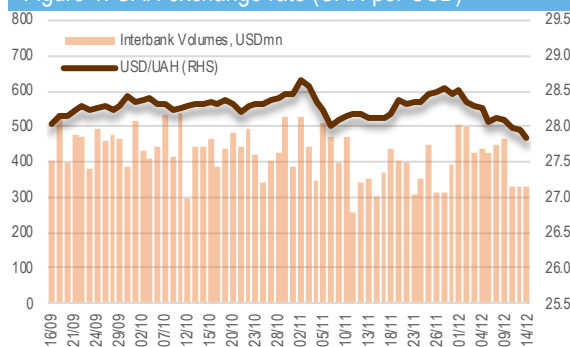
**ECONOMICS | INTEREST RATES STRATEGY | FX**

16 December 2020

**UKRAINIAN  
CAPITAL MARKETS  
WEEKLY**

	Rating	Outlook	Last update	This week in focus: Ukraine is likely to see a marginal key rate hike in 2021
Fitch	B	STABLE	04.09.2020	The NBU expectedly kept the policy rate on hold at 6%, as remaining out of control pandemic still weighs heavily on the economy, while gaining momentum inflation is likely to end the year just below the target of 5%. Though expecting inflation to enter its forecast range by the next MPC meeting, the NBU seems to have taken a balanced view on a key rate hike in the next year.
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: UAH recovers against USD amid resumed flows in LGB

**The USD/UAH rate returned below 28 reading** as foreign investors into local government bonds injected fresh FX in the market.

The FinMin's generosity at the last auctions met with a strong reception - investors snapped up circa UAH50bn in hryvnia denominated securities in two weeks. And foreign participation was noted during the auction.

Demand for FX, however, was weak, with the recent weekend lockdown being the main reason behind. Moreover, the government announced on December 9 reintroduction of tight quarantine measures in early January. Although it will last about 2 weeks (from January 8 to 24, almost 4 times as short as the first lockdown) it can push more long-struggling businesses to the wall. Another tough lockdown is likely to spell more troubles to the economy and hryvnia in 1H20.

We expect hryvnia to stay in an uptrend as long as the government is ready to pay lavish interests on its debt. But as soon as FinMin starts redirecting attracted funds for public spending the pressure on FX will gradually recover.

**Banking system liquidity grew by 3.5% to UAH175bn** by December 11.

Balance of correspondent accounts was UAH89bn, up by 60.7% to the preceding week. The major build-up represents pull out of funds from the central bank's CDs, the position in which narrowed by 24.3% to UAH86bn.

In addition to this, the NBU injected in the system some UAH10.9bn via refinancing loans and UAH2.2bn via interventions in the FX market.

Cash withdrawals produced the major outflow of liquidity, draining some UAH2.2bn. Demand for cash typically rise in December as Christmas and holiday season approaches. Total cash outstanding usually end up the month around UAH20bn above the starting position (UAH534bn as of the end of November). Then the money returns to the system through the whole January. But things may run differently in 2021, taking into account the upcoming lockdown. Cash withdrawals have notably increased since COVID strike.

Treasury operations drained another UAH1bn. But Treasury might boost liquidity in by the end of the month following the recent attraction of funds by the FinMin.

Figure 2. Banking liquidity (UAH bn)

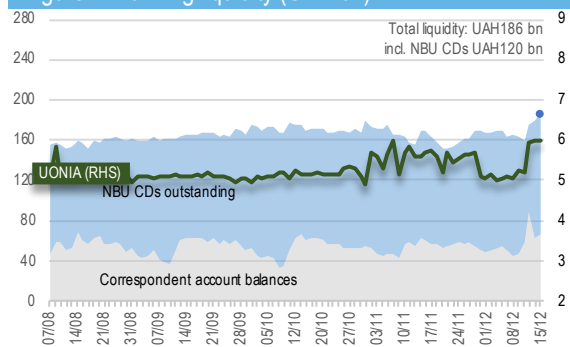


Figure 3. Correspondent account balances (UAH bn)

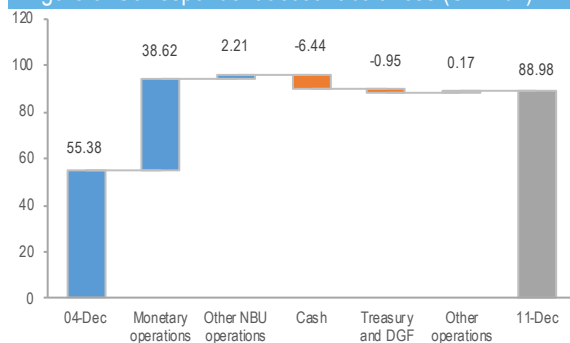


Figure 4. Local UAH bonds market

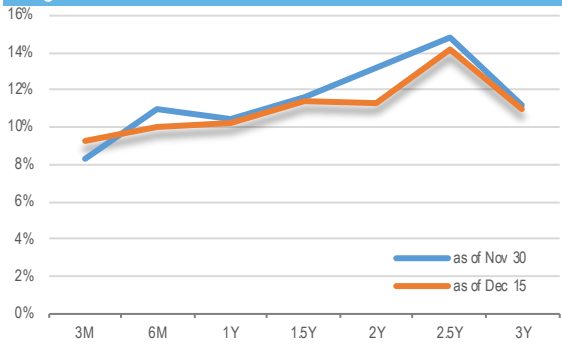
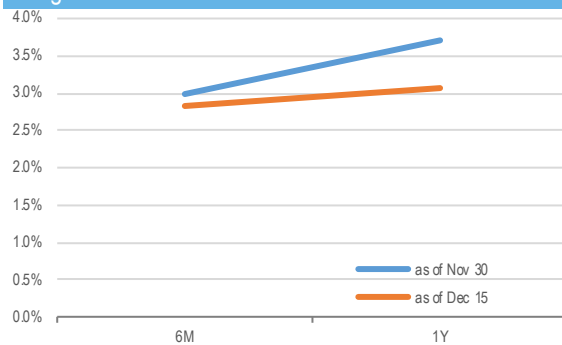


Figure 5. Local USD bonds market



Government bond market

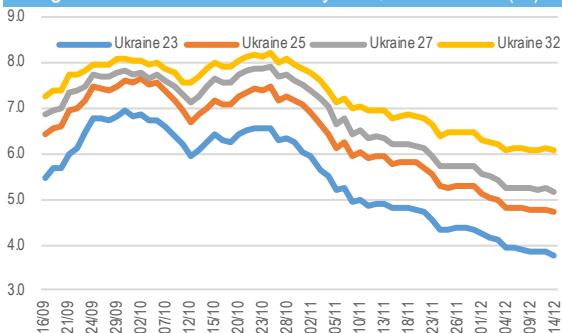
CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size, mn	Placement size, mn
UAH	3M	10.00%	10.00%	10.50%	10.00%	23	22	4 343.36	4 318.36
UAH	6M	10.50%	10.50%	11.50%	10.50%	12	11	9 852.32	9 842.32
UAH	6M	10.75%	10.75%	11.00%	10.75%	15	13	11 167.43	10 992.43
UAH	1Y	11.60%	11.56%	11.85%	11.35%	40	34	9 251.15	7 398.77
UAH	1.5Y	11.75%	11.70%	11.80%	11.50%	28	27	3 591.19	3 541.19
UAH	3Y	12.00%	11.98%	12.09%	11.70%	21	20	2 950.28	2 800.28
UAH	4Y	12.25%	12.18%	12.50%	12.08%	33	30	2 784.02	2 634.02
USD	1Y	3.80%	3.80%	4.00%	3.77%	67	63	266.67	265.32
EUR	1Y	2.50%	2.50%	2.50%	2.45%	10	10	56.53	56.53

**The market has taken the bait.** The last primary auctions were met with strong demand, showing the market is open to the government's plan to borrow heavily in December. And the recent uptick in yields helped to draw investors' appetite for the securities, with strong foreign participation in auctions.

The same as a week ago, this Tuesday the FinMin offered a wide range of instruments: 7 bond issues in UAH with tenure starting from 3 months to 4 years coupled with 1-year bonds in USD and in EUR.

The highest demand received the 7m bonds in UAH, followed by 6m and 1y securities. High demand was also seen for 1y USD bond, which received 67 bids worth USD266mn in total. In spite of zero change to cut-off yield of 3.8%, nearly the whole issue was sold.

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



EUR/USD hovers around two-year high

**The EUR/USD pair trades around the two-year high** amid an elevated appetite for risky assets.

**Hopes for a U.S. stimulus package worth USD1.4tn support investors' risk-on mood,** driving them away from safe-haven currencies.

**Further steps toward broader vaccine distribution also play against the greenback.** Moderna Inc's COVID-19 vaccine appeared set for regulatory authorization this week after U.S. Food and Drug Administration staff endorsed it as safe and effective.

Investors are also keeping an eye on the outcome of a two-day Federal Reserve policy meeting on Wednesday. Policymakers are expected to keep the key overnight interest rate pinned near zero and signal it will stay there for years to come, a decision that analysts say will further boost investors' risk sentiment.

The European Central Bank delivered its pledge to add stimulus via expanding its bond-buying scheme by EUR500bn and through March 2022. Moreover, the Frankfurt-based institution left its language on the exchange rate unchanged, only saying it is "monitoring" it.

U.S. Treasury yields inched higher ahead of the Federal Reserve's latest policy decision. The yield on the benchmark 10-year Treasury note rose slightly to 0.942%. Yields move inversely to prices.

Figure 7. EUR USD spot (mid)

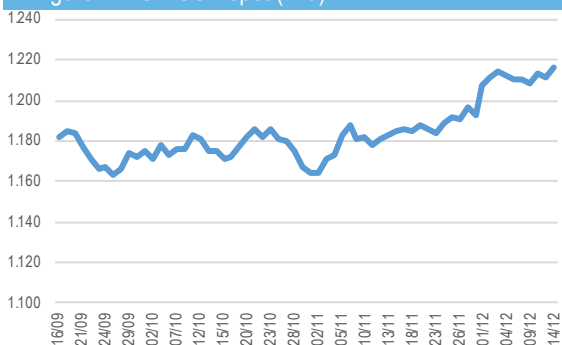
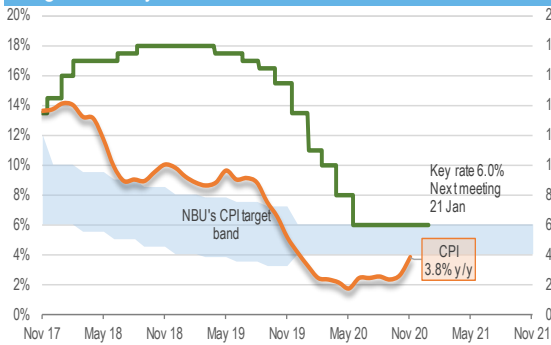


Figure 8. Key rate vs CPI evolution

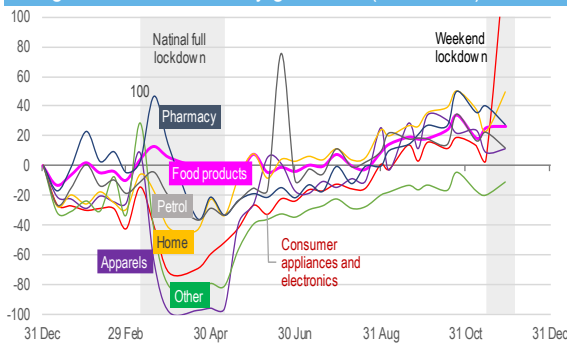


Ukraine is likely to see a marginal key rate hike in 2021

The NBU expectedly kept the policy rate on hold at 6%, as remaining out of control pandemic still weighs heavily on the economy, while gaining momentum inflation is likely to end the year just below the target of 5%. Though expecting inflation to enter its forecast range of 1pp around the target by the next MPC meeting, this time CB sounded not as bold as at the previous monetary briefing, admitting headwinds to consumer prices growth in 1H21. The NBU seems to have taken a balanced view on a key rate hike in the next year.

**Ukraine continues experiencing economic fallout from COVID.** The pandemic remains hardly controlled, with the 7-day moving average of newly-confirmed cases standing above 12th.

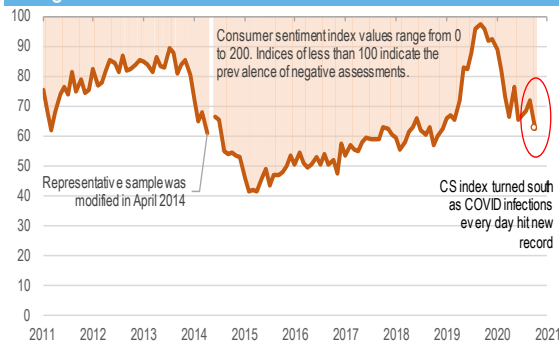
Figure 9. Retail trade by goods, % (2019=100)



Tightening of lockdown measures in November, with obligatory closure of all non-essential businesses on weekends, resulted in a double-digit drop in consumer spending – the major contributor to GDP growth recovery in 3Q20. Although this lockdown was not extended, the state officials have already announced the introduction of a tougher lockdown from January 8 to 24. All public events will be banned and non-essential consumer services shuttered.

Since the pandemic strike, firms more than ever have relied on monetary support, helping them meet liquidity needs. As long as the outbreak of COVID remains out of control and rolling out of vaccines program hardly expected before mid-spring 2021, the dovish monetary policy serves an important role as a backstop for still-strained and vulnerable economy.

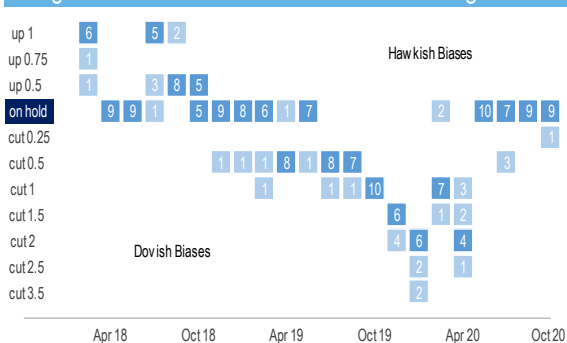
Figure 10. Consumer sentiment index



**Gaining momentum inflation might lose steam** following the reintroduction of another lockdown. As we warned (see our report of October 22) among important factors behind November's consumer prices growth were weaker hryvnia and some recovery in energy commodities prices. Weak harvest has also added pressure on food prices. Though will hold relevance in December, these factors seem to be an old story. The announced measures to help reduce the spread of COVID-19 will again negatively affect consumer expenses and therefore limit the scope for prices hike.

Hryvnia recovers against the U.S. dollar following the recent FinMin's success in attracting financing. This should help offset price growth for imports, and energy commodities in particular.

Figure 11. Voices distribution at MPC meeting



Worth also mentioning, that most of the bonds sold during the last primary auction mature in 12-month period. The forthcoming local debt repayments in 2021 should discourage the government from boosting state budget revenues via inflation tax, as such move might ricochet on future debt price.

We, however, do not rule out price shocks in 2021. Consumers may go on a spending spree following initial success in combating pandemic. This is likely to outpace the ability of firms to restore and expand their capacity, causing prices to rise. But such price growth is likely to be not sustainable.

**Monetary policy tightening in 2021 loses ground.** Charted following the previous MPC meeting key rate hike in 2021 was barely mentioned during the last meeting. The CB did say that it "stands ready to raise its key policy rate in response to accelerating price growth..." But the NBU sounded more moderate compared to the previous briefing, producing more factors, which to curb inflation. So the statement at this stage might serve rather as a warning to prevent an aggressive prices hike in the future.

Worth also noting a lack of hawkish biases among policymakers since 2018. Even the reshaped board appears to be inclined towards a loose policy, with 9 votes for putting rate on hold and one for 25bp rate cut at the last meeting.



# UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2014	2015	2016	2017	2018	2019	2020E	2021F
<b>Real sector</b>								
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
<b>Prices</b>								
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
<b>Fiscal balance (% of GDP)</b>								
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
<b>External balance</b>								
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
<b>Interest and exchange rates</b>								
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
14.12.2020	15.12.2020	16.12.2020	17.12.2020	18.12.2020	19.12.2020	20.12.2020
		LGB* % UAH 1,487.7mn LGB P UAH 10,265.3mn Fed: FOMC	LGB % USD 8.7mn	NBU: External Debt		
21.12.2020	22.12.2020	23.12.2020	24.12.2020	25.12.2020	26.12.2020	27.12.2020
NBU: Minutes Ukrstat: GDP Ukrstat: Retail trade		LGB* % UAH 656.1mn Ukrstat: Industrial Production				
28.12.2020	29.12.2020	30.12.2020	31.12.2020	01.01.2021	02.01.2021	03.01.2021
Ukrstat: Nominal & Real Wage	NBU: IIP NBU: FDI	LGB* % UAH 561.7mn NBU: BoP				
04.01.2021	05.01.2021	06.01.2021	07.01.2021	08.01.2021	09.01.2021	10.01.2021
		LGB* % UAH 413.2mn	NBU: FX Reserves (deadline - 7th day)			

## 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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