

	Rating	Outlook	Last update	This week in focus: Ukraine's current account data are supportive for hryvnia
Fitch	B	STABLE	04.09.2020	Ukraine's current account has posted muscular growth this year, primarily benefiting from non-energy commodities, low energy prices, and recovery in workers' remittances. Some gains, however, are likely to be given back in 2021 against recovery of tourism and normalization of energy prices, therefore we expect appreciation trend to reverse in the second half of the 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: USD/UAH drops below 28.0 level

The Ukrainian hryvnia has regained ground against the U.S. dollar on the inflow of fresh foreign liquidity into local government debt. The pair spent Thursday's (February 4) trading session below the 28.0 figure, down from 28.2 a week earlier.

Liquidity support provided to both businesses and individuals as well as facilitating financial institutions by leading central banks and governments has a positive spillover into Ukraine's public debt. The country has managed to tap into liquidity reallocation flows, thanks to appealing yields for its government bonds.

Although FinMin has recently resumed the practice of limiting the volume of bonds on offer at primary debt auctions, pushing yield-seeking investors' into long-term maturities, **we expect the hryvnia to continue experiencing support of foreign portfolio investments through the end of spring.**

Recent refunding of VAT taxes to exporters, which typically narrows FX proposal in the market, had little impact on the total supply. The renewed FX sales to meet monthly running costs followed soon after.

The upside in the currency pair could have been even more pronounced but for the NBU, which has resumed FX purchases in the market on Thursday after more than a two week break.

Banking liquidity little changed in the week ending January 29. While the balance of correspondent accounts with the NBU declined by UAH3bn to UAH57.3bn, banks' position in central bank's CDs increased by UAH3.8bn to UAH135bn.

Despite redemption of refinancing loans for UAH1.1bn and slim outflow via State treasury's operations, liquidity levels remained robust. A continuous inflow of cash produced the major support. It is typical for paper money, which was withdrawn during the holiday season, to return into the banking system in the second half of January.

The overnight money market rate hovers around 5.1%. But FinMin's decision to cut supply of short-term bonds at the primary auctions may drive the money market rate closer to the lower bound of NBU's OMOs rate range of 5% +/- 1pp.

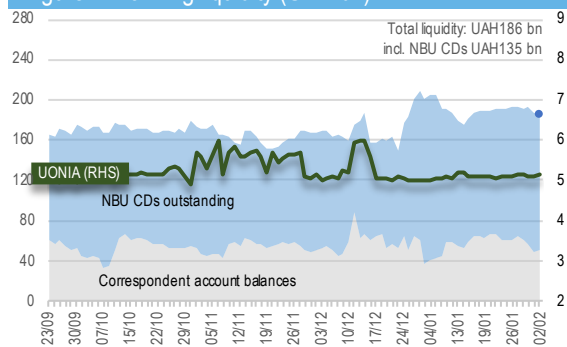
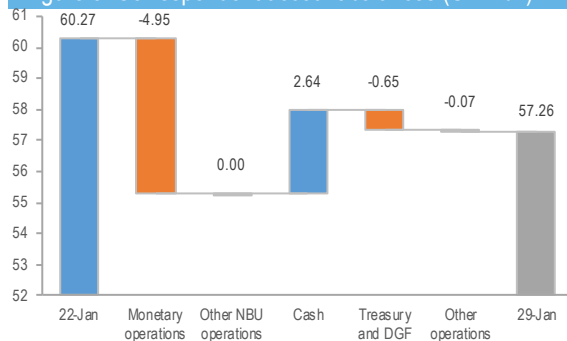
Figure 2. Banking liquidity (UAH bn)

Figure 3. Correspondent account balances (UAH bn)


Figure 4. Local UAH bonds market

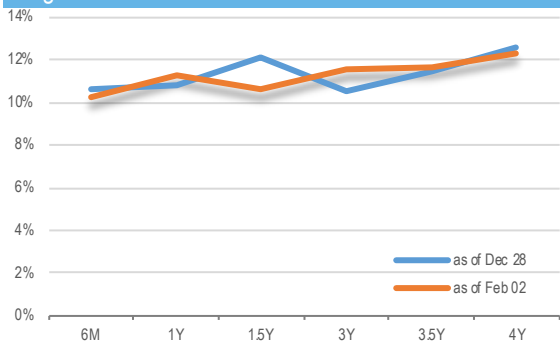
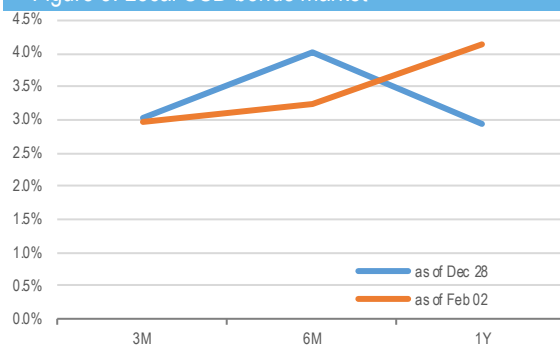


Figure 5. Local USD bonds market



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	9.50%	9.29%	10.39%	8.75%	25	17	338.42	257.07
UAH	1Y	11.49%	11.40%	11.75%	11.20%	60	31	3 268.52	1 000.00
UAH	2Y	11.90%	11.88%	12.00%	11.80%	33	31	1 964.40	1 904.40
UAH	3.5Y	12.15%	12.15%	12.15%	12.10%	14	14	2 078.58	2 078.58

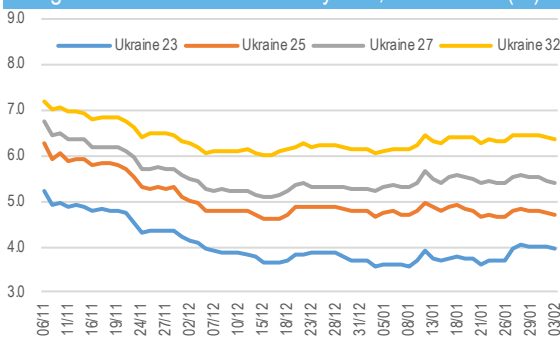
FinMin tightens supply of short-term maturities. This Tuesday the ministry offered hryvnia denominated bonds with maturity ranging from 3m to 3.5y. The issuer, however, placed a volume cap on short-term maturities of UAH500mn for 3m bonds and UAH1bn for 1y securities.

In spite of numerous bids, demand for the 3m bonds fell short of the threshold, drawing a bid-to-cover ratio of 0.68. Having raised the marginal rate by 5bp to 9.5% the ministry accepted bids for UAH257mn.

A different story was with brand new 1y bonds, for which reintroduction of volume limit resulted in 25bp marginal rate cut. The issue attracted 60 bids for UAH3.3bn in total. But half of applications were slashed for their bid rate was standing above 11.49%. That said, the resulting weighted average yield of 11.4% suggests that many banks saw their bids rates even lower. This, coupled with the fact that government bonds with similar maturity are traded at the secondary market with a yield around 11.3% could encourage the ministry to press on with marginal rate cuts. A light redemption schedule in the next two weeks could also help the ministry in lowering costs of public debt.

Demand for the rest of offered bonds was nearly fully met.

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

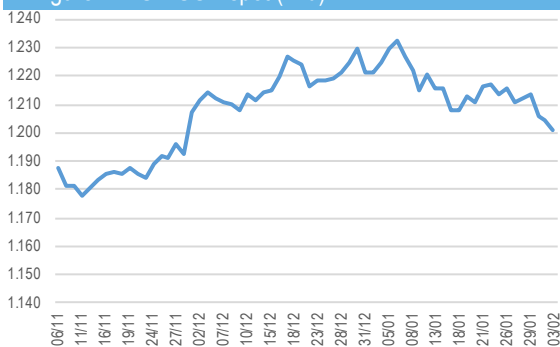


EUR/USD slips back to 1.2000

The U.S. dollar has seen a gradual grind to the upside against the euro since our last report on January 21, with the gains accelerating on the renewed hopes of U.S. government will manage to pass a new, large stimulus program.

Democrats took their first votes in Congress this week, taking the first step in potentially approving President Joe Biden's proposed USD1.9tn stimulus package without Republican support. And the U.S. dollar has been gaining ground as investors sell Treasuries in response to higher prospects of a generous relief package.

Figure 7. EUR USD spot (mid)



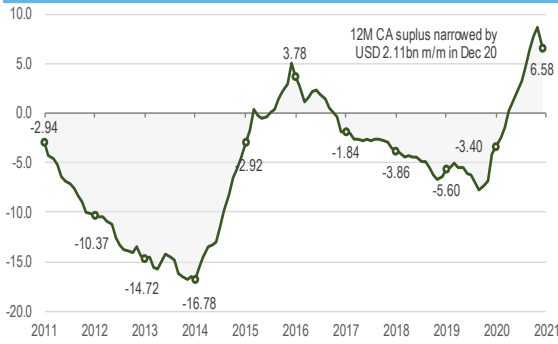
Coronavirus vaccines are also generating optimism. But vaccines distribution is delayed globally, fueling the dismal mood, as shortfalls are directly linked to a delay in a possible economic comeback.

U.S. government bond yields keep advancing as Democrats pushed forward with trying to pass President Joe Biden's \$1.9 trillion stimulus plan without Republican support.

The 10-year U.S. Treasury yield rose above 1.12% by Wednesday (February 3), up from 1.04 a week ago.

Figure 8. Current account (TTM)

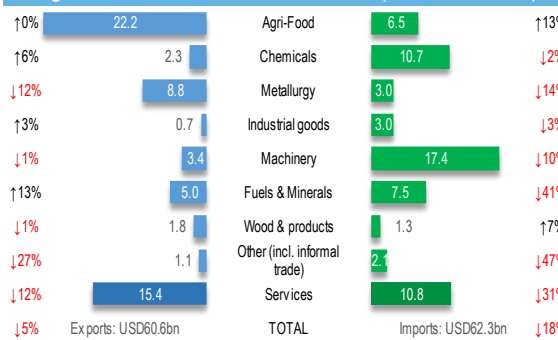
Ukraine's current account data are supportive for hryvnia



Ukraine's current account has posted muscular growth this year, primarily benefiting from non-energy commodities, low energy prices, and recovery in workers' remittances. Some gains, however, are likely to be given back in 2021 against recovery of tourism and normalization of energy prices, therefore we expect appreciation trend to reverse in the second half of the year.

Ukraine enjoyed a notable improvement in its current account position in challenging 2020. The country's current-account surplus, a measure of the nation's trade and financial flows with other countries, climbed to a record high of USD6.6bn in 2020 after USD3.4bn shortfall a year earlier, according to the NBU's first estimate.

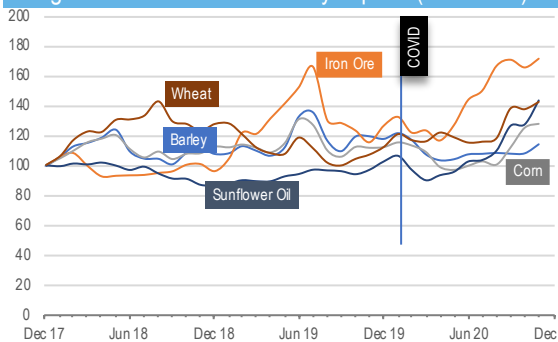
Figure 9. External trade breakdown (TTM to Dec 20)



Strong agriculture helps to withstand Covid-induced demand shock. In spite of last year's weak grains harvest, the segment's export revenue rose by 0.25% y/y to USD22.2bn. Sustainable demand for soft commodities (grains, cereals, sunflower oil, etc.), which is related to their persistent use in essential food items, helped the segment to quickly recoup price losses from the COVID-19 pandemic. The country's limited involvement in global production chains, which have been drastically affected by the lockdowns and mobility restrictions, also helped to play down the pandemic impact.

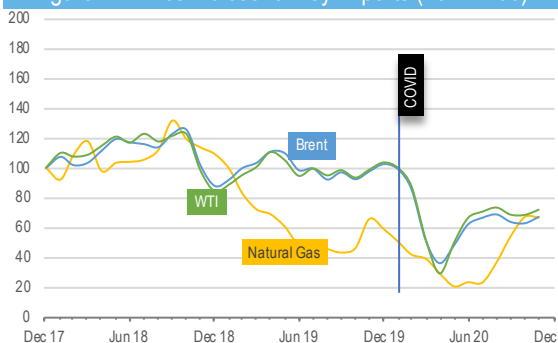
Two-track recovery. Another contributor to the record high CA surplus was the price crush for energy commodities in 1Q20. The country's energy imports contracted by 47% y/y to USD7.5bn as a slowdown of global economic activity during the pandemic notably reduced prices of energy since the Covid-19 outbreak. Global oil and gas prices have managed to recover much of their losses in 2Q20 and 3Q20 respectively amid robust involvement of governments in response to the crisis. Unprecedented fiscal and policy measures aimed at boosting aggregate demand and revitalizing key industries have been adopted at national and sectoral levels, driving prices for hard commodities up.

Figure 10. Price indices for key exports (2017=100)



Although we expect prices for energy to stabilize below pre-pandemic levels, Ukraine's energy imports bill may experience a double-digit expansion in 2021. Ukraine's metallurgy has also benefited from a pick-up in iron ore prices. Considering that global supply chains have been seriously affected by the pandemic, a global shift to localization or to narrowing of production to some specific area could help revive the country's metallurgical industry.

Figure 11. Price indices for key imports (2017=100)



We also expect a recovery in tourism and travel expenses in summer, reckoning that the rollout of vaccination could help achieve some form of widespread immunity by that time. But increase in imports of services could be offset with lower expenses for goods, hence producing a limited effect on the CA balance.

Hryvnia may appreciate and test the 27.0 mark in 1H21. With monetary easing by global central banks increasing the challenge for investors seeking yield, local public debt with its appealing returns may harbour some foreign liquidity in the first half of the year. It is very important that we expect financial markets to remain favourable for Ukraine, allowing for placement both local and foreign debt to international investors, even though there are few chances for a quick continuation with the IMF program. We reckon the local currency could appreciate against the U.S. dollar as low as 27.0 level, or even slightly below.

For the second half of the year, we sketch gradual UAH weakening against soaring domestic monetary aggregates, deterioration in terms of trade, limited progress with the IMF (development of larger IMF program likely to take some time if external conditions worsen) and lack of visibility concerning future appetite for emerging markets debt. We expect USD/UAH to approach range of 30.0 by the end of the year.

UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2014	2015	2016	2017	2018	2019	2020	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	4.8	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	5.0	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	60.6	62.6
Imports of goods and services (USD bn)	70.0	49.6	51.8	60.8	70.5	75.5	62.3	72.5
Current account balance (USD bn)	-4.6	5.0	-1.9	-3.5	-6.5	-4.2	6.6	-0.6
Current account balance (% of GDP)	-3.5	5.6	-2.0	-3.2	-4.9	-2.8	4.6*	-0.4
Net FDI (USD bn)	0.3	-0.4	3.8	3.7	4.5	5.2	-0.4	2.0
Foreign exchange reserves (end of year)	7.5	13.3	15.5	18.8	20.8	25.3	29.1	27.5
Imports coverage (months of imports of goods)	1.5	4.4	3.7	3.6	3.4	3.9	4.8	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	28.3	29.8
Exchange rate (EUR/UAH) end of year	23.0	26.2	28.3	33.5	31.8	26.4	34.7	37.3

*estimates, no official data yet available



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UKRAINIAN CAPITAL MARKETS WEEKLY

FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
01/02/2021	02/02/2021	03/02/2021	04/02/2021	05/02/2021	06/02/2021	07/02/2021
IMF SDR 49.7mn FGB % USD 33.7mn NBU: Minutes	NBU: Cost of Real Sector External Debt	LGB* % UAH 1,510.0mn LGB % UAH 32.5mn	IMF SDR 98.5mn LGB % USD 6.2mn			NBU: FX Reserves (deadline - 7th day)
08/02/2021	09/02/2021	10/02/2021	11/02/2021	12/02/2021	13/02/2021	14/02/2021
Ukrstat: Busines confidence	Ukrstat: Price indices NBU: Monetary Statistics	LGB* % UAH 626.8mn LGB % UAH 772.2mn LGB* P UAH 2,500.0mn	LGB % USD 13.4mn LGB P USD 378.3mn			
15/02/2021	16/02/2021	17/02/2021	18/02/2021	19/02/2021	20/02/2021	21/02/2021
Ukrstat: GDP flash estimate		LGB* % UAH 377.0mn LGB % UAH 235.6mn				
22/02/2021	23/02/2021	24/02/2021	25/02/2021	26/02/2021	27/02/2021	28/02/2021
Ukrstat: Retail trade		LGB* % UAH 590.4mn LGB % UAH 520.1mn LGB P UAH 10,561.6mn	Ukrstat: Industrial Production	NBU: Gross External Debt Future Payments		

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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