

ECONOMICS | INTEREST RATES STRATEGY | FX

17 February 2021

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Ukraine closes out 4Q20 with better than expected GDP
Fitch	B	STABLE	04.09.2020	Ukraine's 4Q20 GDP predictably fell, but was better than market expectations. Favorable statistics came on the back of recovery in consumption and supportive global markets. We hold our expectation of a Nike-shape economy expansion in 2021. The NBU's monetary policy, however, should be closely watched, as aggressive rate hike can dent recovery.
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)

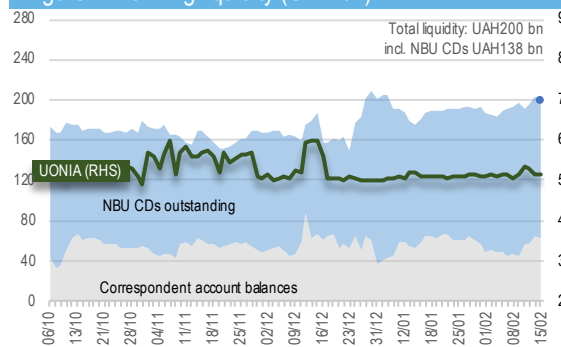


FX and interest rates: USD/UAH remains supported around 27.9 mark

In spite of the recent attempts of correction, the USD/UAH pair looks firmly supported around 27.9 level. The pair came under downside pressure last week, with the central bank's interventions and aggressive FX purchases by a state-owned bank being the major factors behind. While the NBU was predominantly present in the market in the first half of the week, mopping up excess liquidity coming from foreign accounts, the state-owned bank came out in the second half, producing unusual for its operations sweeping purchases.

There were also purchases by other market participants. But **the market seemed kept experiencing a lack of fundamental demand for FX liquidity** supplied by exporters, gaining from supportive external prices conjuncture. As a result, a double top pattern at 27.9 was broken with resumed on Monday speculative trades against the USD.

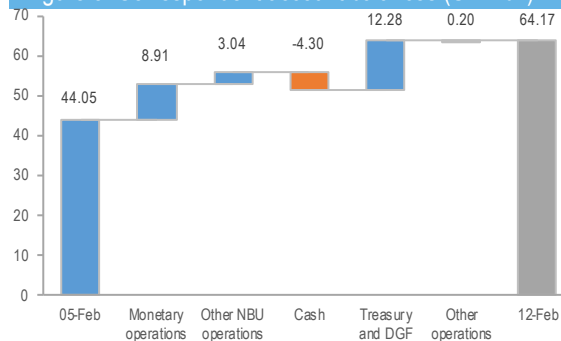
Figure 2. Banking liquidity (UAH bn)



Another attempt to drag the USD/UAH rate higher level followed on Tuesday. And the weekend's statement by the IMF of the no-deal conclusion of the remote review of USD5bn loan program (SBA) with Ukraine was the major catalyst. But inflow of fresh FX liquidity from non-resident investors, which seemed again participated in the public debt auction held on Tuesday, reversed the USD/UAH down. Since the beginning of the year, the foreign position in government bonds has risen by some USD520mn.

We assume the Fund's mission could resume review in April, if foreign investments dry out soon, or in early autumn, right before another spike in public debt payments.

Figure 3. Correspondent account balances (UAH bn)

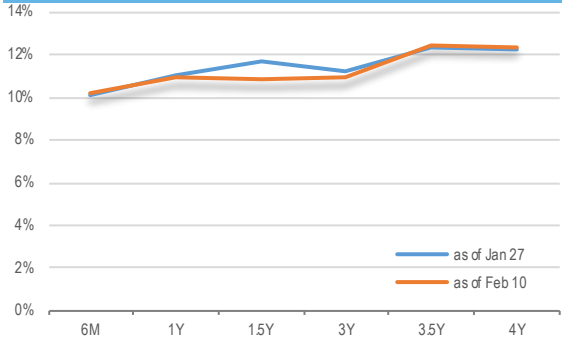


Total UAH liquidity in the banking system again exceeded the UAH200bn barrier last week.

The State treasury was the major liquidity supplier, injecting into the system up to UAH20bn. But some UAH7.4bn returned to FinMin following the primary debt auction. Another UAH3.3bn came via the central bank's FX interventions and OMOs.

Withdrawals of salaries resulted in a UAH4.3bn cash outflow from the banking system. But paper money typically returns into the system in the second half of the month.

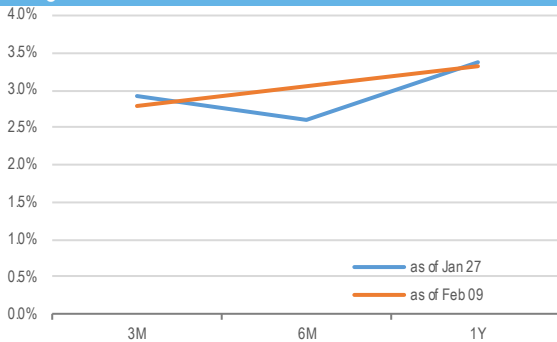
Figure 4. Local UAH bonds market



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	3M	9.15%	9.07%	9.50%	8.90%	30	21	937.90	500.00
UAH	1Y	11.05%	10.96%	11.35%	10.85%	44	26	2 846.47	1 000.00
UAH	1.5Y	11.45%	11.30%	11.75%	11.14%	41	21	5 285.73	1 500.00
UAH	2Y	11.90%	11.84%	11.90%	11.65%	21	21	1 534.52	1 534.52
UAH	3.5Y	12.15%	12.05%	12.15%	11.90%	22	22	1 308.09	1 308.09
EUR	1Y	2.50%	2.50%	2.50%	2.50%	29	29	70.49	70.49
USD	2Y	3.90%	3.89%	4.25%	3.80%	81	70	127.32	41.74

Figure 5. Local USD bonds market



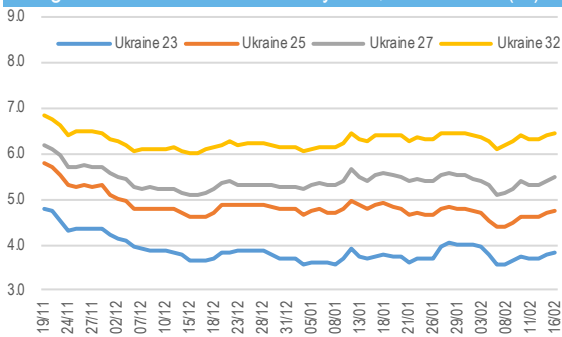
FinMin holds a "hardball" stance, despite dimmed prospects for receiving financial support from the IMF as soon as in 1H21.

This week the ministry offered a wide range of instruments, including 1y bonds in euro and 2y securities in U.S. dollars. And the highest demand was seen for 1.5y hryvnia-denominated bond, drawing 41 bids worth UAH5.3bn in total. With volume cap at UAH1.5bn circa half of applications worth UAH3.8bn was slashed. This allowed the ministry to push cut-off rate down 30bp to 11.45%.

There was also a 35bp cut in marginal rate for 3m bonds and 30bp reduction in cut-off rate for 1y securities, driving their yields to 9.15% and 11.05% respectively. Again, this was helped by a limits on offer set by the FinMin.

Going forward, we assume the no-deal ending of the IMF's virtual mission could have limited effect on attractiveness of Ukraine's local currency bonds as long as both parties hold their willingness to continue cooperation.

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



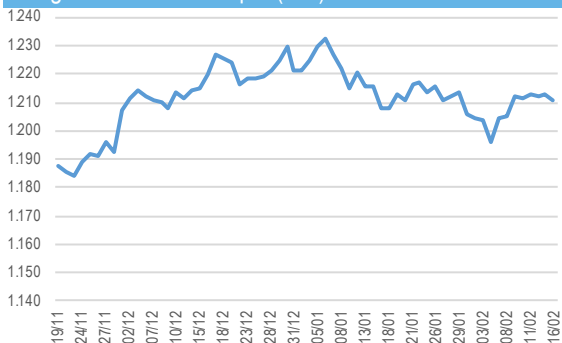
EUR/USD pulls back to 1.2000

The EUR/USD pair witnessed a modest pullback from two-week high set last Thursday (February 11).

The pullback lacked any obvious catalyst. President Joe Biden is working hard to promote his USD1.9tn stimulus package before federal unemployment benefits start expiring on March 14. There are hopes the rescue plan may be approved as early as next week, but Republicans keep staunchly opposing to the approval.

The markets in turn want more money. Elevated debt issuance by the U.S. has caused a sell-off in Treasuries, pushing yields on ten-year bonds to 1.30%, the highest post-pandemic level. This makes the greenback more attractive against the euro.

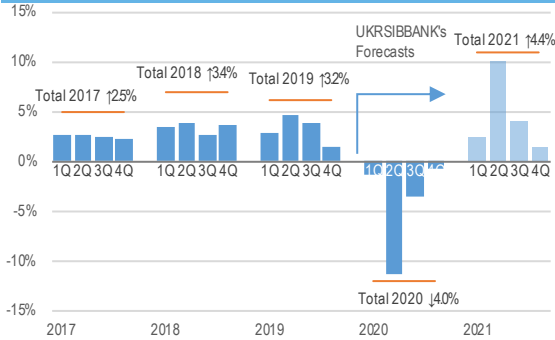
Figure 7. EUR USD spot (mid)



But the euro could find its footing in signs of a pick-up in inoculations and falling Covid cases, especially in Germany and Spain. So far the euro looked weaker compared to its peers, mostly due to the old continent's sluggish vaccination campaign.

The Federal Reserve is to produce meeting minutes on Wednesday (February 17). It is essential to note that these are not raw protocols from the late January meeting but rather a carefully revised document that takes market responses into consideration.

Figure 8. Gross Domestic Product

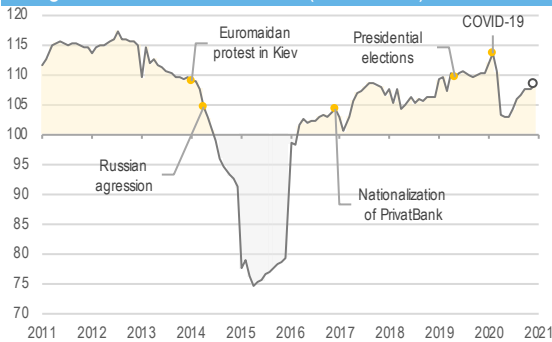


Ukraine closes out 4Q20 with better than expected GDP growth

Ukraine's 4Q20 GDP predictably fell, but was better than market expectations, with a drop standing at 0.7% y/y. Better than expected statistics came on the back of recovery in consumption and supportive global markets. We hold our expectation of a Nike-shape recovery in 2021 driven by gradual cuts in precautionary savings. The NBU's monetary policy, however, should be closely watched, as aggressive fighting inflation can dent recovery.

Ukraine's economy contracted by 0.7% y/y in 4Q20. This could yield a 4.0% GDP drop in 2020, according to our calculations. But the flash 4Q estimate came as a bare figure. A detailed picture will be presented on March 22.

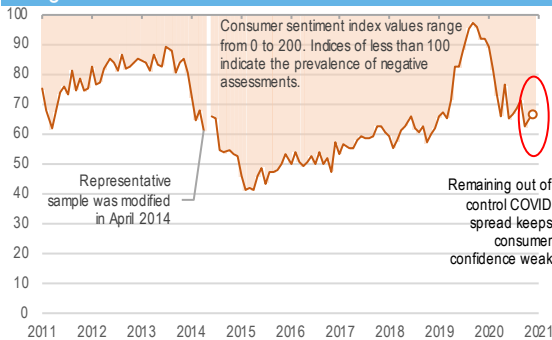
Figure 9. Retail Trade Index (cumulative)



Consumer spending, which accounts for more than two-thirds of Ukraine's economic output, likely saw accelerated growth in the 4Q after a 0.5% y/y rebound in the 3Q. More than doubled demand for electronic devices and in-house appliances spurred by attractive discounts amid tightening competition for customers got retail trade back to the level achieved before the introduction of a weekend quarantine in mid-November.

We hold our expectation of a swoosh-like (Nike-shaped) economic expansion in 2021 driven by recovery in consumption. Cold snap late in 2020 spells increases in utility bills, laying the ground for a strong economic rebound in 1Q. We improved our forecast for the annualized quarterly growth to 2.5% from 1.0%, expecting increased spending for utilities to dwarf the effect of another national lockdown that was in place in January.

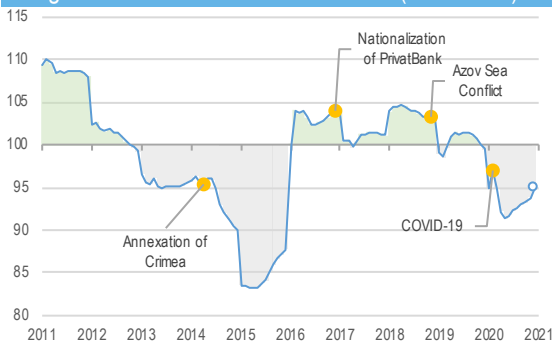
Figure 10. Consumer Sentiment Index



Going forward, the vaccine rollout schedule in Ukraine and the efficiency of vaccination in foreign countries will ultimately determine the pace of recovery. Expected summer pickup in spending on tourism and other hardest-hit services could be accompanied by narrowed purchases in other segments. On the other hand, **a gradual cut in precautionary savings once the pandemic is getting under control will result in a broad-based growth in consumption.**

Other factors at play include recovery in industrial output and construction. Extensive global fiscal and monetary stimuli could stimulate corporate capital expenses and hence support external demand for Ukraine's industrial production. In turn, local government spending on infrastructure and under The Great Construction program should help uphold investment strength in 1H21.

Figure 11. Industrial Production Index (cumulative)



But risks are still there. The major downside one is the virus worsening, with vaccines proved less effective than hoped for. We are continuing to monitor developments on this front, as they can raise the risk of stall speed. The recovery may take the form of a reverse square root sign, with a partial rebound in 1H21 being followed by a flat growth for a prolonged period of time.

One should also mind the risk of a W-shaped recovery. The NBU stands ready to push interest rates higher to battle inflation, which it considers as demand-driven. Although we do not rule out temporary pressure on the demand side, we stick to the view that inflation is rather a cost-push, with recent average wages rise, hryvnia depreciation, weak agricultural harvest, and a pickup in energy prices being the major drivers. As such, a premature policy tightening against edging up fixed costs could undermine earnings recovery, or result in plummeting of the economy even further before getting back on track again.

Tying all together, we see a lot of pent-up demand on the local consumer and global corporate level. But there still are many impediments for this demand to realize. We raised our forecast for 2021 to 4.4% from 3.8%. But the improvement majorly comes from increased energy consumption against cold winter. Going forward, a combination of energy prices growth and monetary policy tightening might result in the economic growth slowing to 3.5% in 2022.

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	-4.0*	4.4
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	3 918*	4 633
Nominal GDP (USD bn)	131	90	93	112	131	150	145*	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	31.0
Exchange rate (EUR/UAH) end of year	23.0	26.2	28.3	33.5	31.8	26.4	34.7	34.7

*estimates, no official data yet available



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UKRAINIAN CAPITAL MARKETS WEEKLY

FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
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 595.5mn				
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		
01/03/2021	02/03/2021	03/03/2021	04/03/2021	05/03/2021	06/03/2021	07/03/2021
FGB % USD 365.8mn Ukrstat: Nominal & Real Wage NBU: BoP		LGB* % UAH 125.8mn LGB % UAH 3,253.6mn LGB P UAH 11,743.3mn	NBU: MPC	LGB* % UAH 135.0mn Ukrstat: Business confidence		NBU: FX Reserves (deadline - 7th day)
08/03/2021	09/03/2021	10/03/2021	11/03/2021	12/03/2021	13/03/2021	14/03/2021
	Ukrstat: Price indices Risk committee meeting	LGB* % UAH 682.7mn LGB % UAH 369.2mn NBU: Monetary Statistics	ECB: MPC	IMF SDR 295.5mn		

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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