

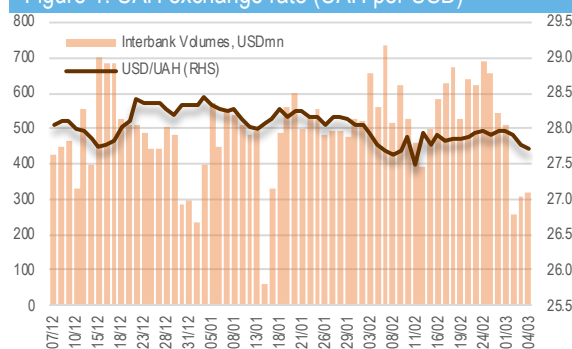
ECONOMICS | INTEREST RATES STRATEGY | FX

5 March 2021

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: NBU pivots from backing growth to fighting inflation
Fitch	B	STABLE	26.02.2021	The NBU raised the key rate to 6.5%, accompanying the move with a hawkish tone. The central bank signalled readiness to guard against inflation and admitted phasing out of relief programmes. We bring forward our forecast for expected this year rate hikes. We still admit no change in the policy rate in April if infection spread in the country regains strength.
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)

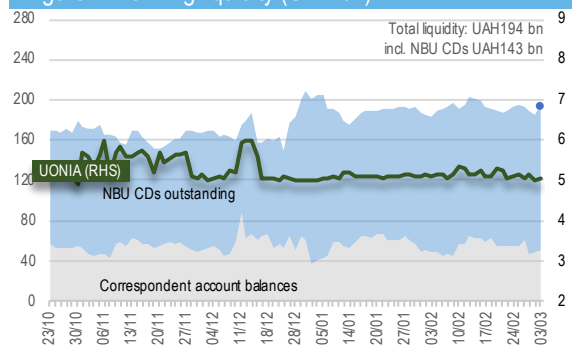


FX and interest rates: UAH extends appreciation against USD

The **USD/UAH pair has advanced to another resistance level at 27.7** on Thursday (March 4). By the end of the trading session, the hryvnia showed a tepid corrective decline against the U.S. dollar on the back of slim speculative trades, which typically dominate the FX market throughout the first and the last trading hours but fade against the fundamental supply/demand.

Fundamentally, **the USD/UAH pair has been long rangebound between the 27.8-28.0, but is being supported by a limited demand and continuous FX inflow** both from exporters and from foreign investors. And for this reason, a recent VAT refunding, which should have narrowed FX supply in the market, had little impact on the pair movement. As demand for FX remained constrained by the pandemic-related restrictions, the USD/UAH quickly regained ground after peaking at 27.9 last week.

Figure 2. Banking liquidity (UAH bn)



Today's **decision by NBU to raise the key rate by 50bp**, supplemented by aggressive commentaries about the future policy response to likely inflation acceleration, **could help hryvnia to appreciate below the foregoing bound.**

On the other hand, future FX supply could be dented by the recent rally in U.S. Treasuries. A bounce in the U.S. Treasury yields and declining interest in global stock markets could provide further support to the greenback, reducing investment FX inflow into Ukraine.

Banking liquidity continues fluctuating around UAH195bn figure.

Typical for the second half of the month return of paper money into the banking system is currently the major source of liquidity. Some UAH3.8bn of cash was placed in bank accounts during the last week.

Despite the recent VAT refunding, the State treasury conducted balanced operations, producing little pressure on interbank interest rate movement. This helped the UONIA index return closer to the lower bound of NBU's OMOs.

The central bank did not conduct FX market interventions in the last two weeks ending February 26.

By the end of the week (February 26), the balance of bank accounts with the NBU rose by 8.8% to UAH60.5bn, while the amount of NBU CDs outstanding contracted by 0.8% - to UAH133bn. And most of the funds remain allocated in 1-week CDs.

Figure 3. Correspondent account balances (UAH bn)

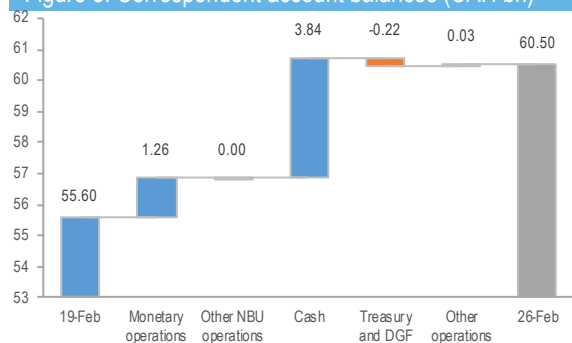


Figure 4. Local UAH bonds market

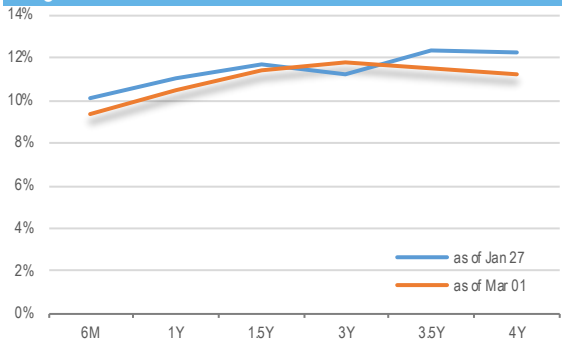
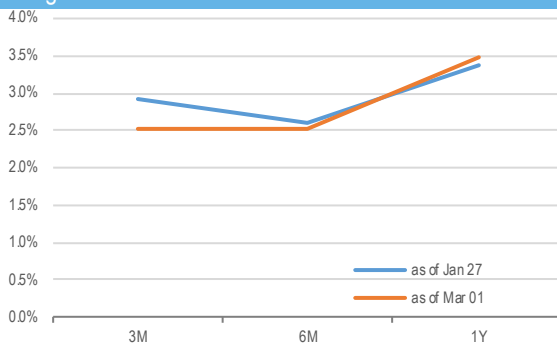


Figure 5. Local USD bonds market



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	8.50%	8.47%	9.00%	8.40%	22	12	1 672.92	500.00
UAH	1Y	10.75%	10.67%	10.99%	10.30%	33	25	4 707.81	2 000.00
UAH	1.5Y	11.05%	11.04%	11.15%	10.80%	25	17	2 055.25	1 500.00
UAH	2Y	11.80%	11.80%	11.90%	11.80%	27	24	2 251.01	2 126.01
UAH	3Y	12.05%	12.05%	12.15%	12.00%	20	18	804.99	629.99
USD	2Y	3.90%	3.90%	3.90%	3.90%	14	14	163.00	163.00

The primary bond market keeps standing on a strong footing. The FinMin continues offering a wide range of instruments while pushing investors into long maturities with volume caps set for 3m-1.5y bonds.

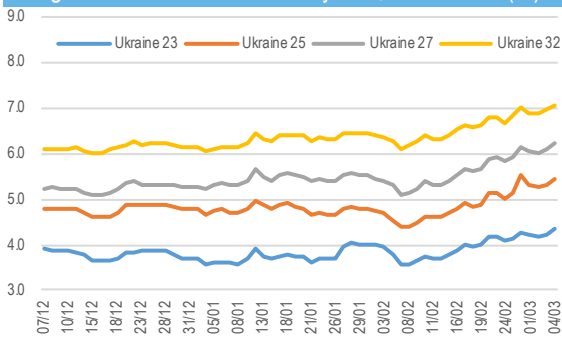
The highest demand was received for 1y UAH bonds. In spite of volume limit set at UAH2bn, the issue attracted a total bid of UAH4.7bn. This helped the ministry to cut marginal rate by 10bp to 10.75%.

Total demand for 3m bonds was lower. Yet, with volume cap set at UAH0.5bn, the issue had the bid-to-cover ratio, which measures the amount of bids versus the amount of bonds actually auctioned, of 3.35. The FinMin reduced the issue's cut-off rate by 65bp to 8.5%. After the NBU's 50bp rate hike, the yield spread to 1-week NBU CDs narrowed to 1 percentage point.

The ministry raised UAH11.5bn (in UAH equivalent) from the auction this week.

Going forward, the NBU's monetary policy tightening could notably cut demand for short-term maturities, as well as have price implications for long-term ones.

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



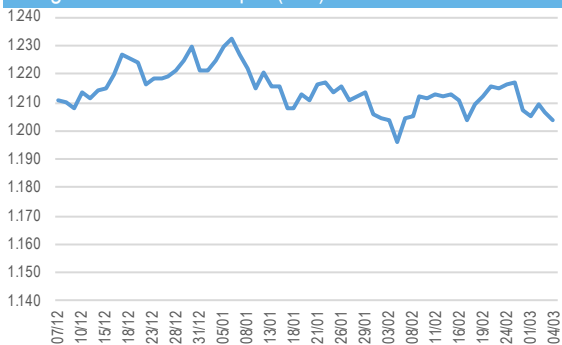
EUR/USD continuously returns into 1.20-1.21 area

The EUR/USD continues trading within an untypical for the pair wide range. The pair returned below 1.2050 mark by this Thursday (March 4) after an attempt to reach 1.2200 level a week ago.

The main upside driver of the U.S. dollar has been the rise in U.S. Treasury yields, with returns on 10Y Treasuries – the global benchmark - remaining too close to the 1.50% level. Cheaper government bonds and higher yields gathered investor appetite for USD.

Elevated U.S. yields come as President Joe Biden accepted a compromise on stimulus checks – potentially paving the way for approving his covid relief package in the Senate. Higher certainty of government spending is adverse for bonds and positive for the greenback.

Figure 7. EUR USD spot (mid)

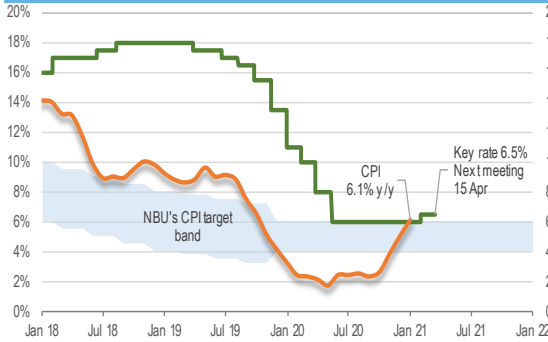


Fed Chair Jeremy Powell is set to make a speech on Thursday (March 4) about the U.S. economy at the Wall Street Journal Jobs summit. Investors are waiting to hear Powell's opinion on yields and whether the latest rally may affect the current monetary policy

Across the pond, **the slow pace in the vaccine rollout in Europe threatens to cool down expectations of a strong economic recovery in the region.**

The 10-year U.S. Treasury yield was mostly flat on Thursday after weekly jobless claims report that new claims remain elevated roughly a year into the pandemic. The yield on the benchmark 10-year Treasury note, which surged by around 30pb to 1.518% in the last two weeks, slipped to 1.467% on Thursday (March 4).

Figure 8. Key rate vs CPI evolution

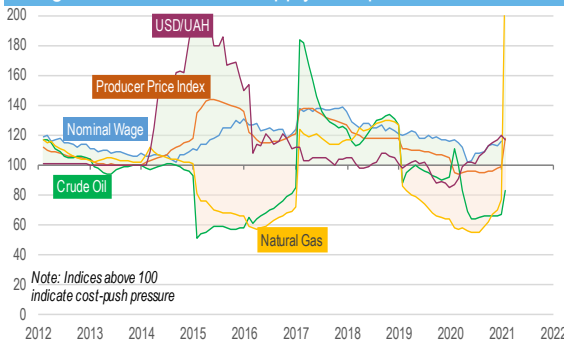


NBU pivots from backing growth to fighting inflation

The NBU board decided to raise the interest rate by 50bp to 6.5% per year, accompanying the move with a hawkish tone. The central bank signalled readiness to guard against inflation and admitted phasing out of relief programmes. We bring forward our forecast for expected this year rate hikes (so that the hike materialized sooner than expectations), now expecting another 50bp rise and a terminal rate of 7% for 2021, provided no change in global financial markets conditions. We still admit no change in the policy rate in April if infection spread in the country regains strength.

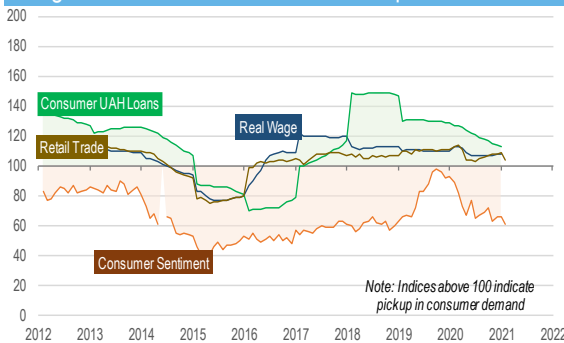
Ukraine's central bank says the key rate hike from 6% to 6.5% is an effort to ease inflation pressure which recently left the NBU target range. While such a move, followed by another rate hike on April 15, was embedded into the central bank's forecast, the market has been divided on whether the NBU would hold support to businesses or raise rates. With infection spread in the country regaining strength, possibly implying another lockdown, the decision to increase the policy rate was a debatable one, even though some emerging markets central banks already started hiking interest rates. The move also signalled about readiness to raise the key policy rate more resolutely, despite the negative effects on economic recovery.

Figure 9. Indicators of supply-side pressure



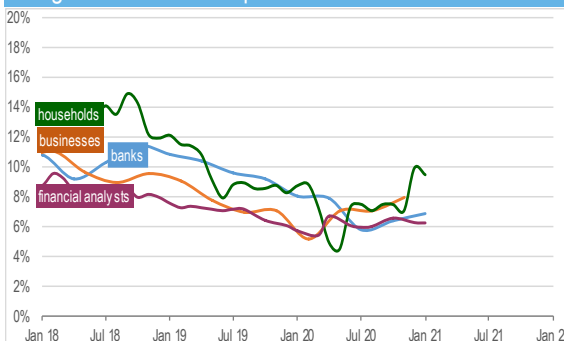
Our base case - another 50bp increase at the next MPC and then flat until year-end. NBU monetary policy committee sticks to the view that the main factors accelerating inflation are mostly temporary and largely beyond the effective influence of monetary policy, such as an upsurge in commodity prices. NBU will most likely try to anchor to the future deceleration path of inflation. Under this assumption, a tightening move could follow in the second quarter.

Figure 10. Indicators of demand-side pressure



Since the end of 2020, the inflation numbers have been largely boosted by cost increase, with minimum wage, energy prices and FX rate being the major factors behind. These just pushed up costs, which will have some lingering impact through the end of March. It is also important to understand that much of the inflation is caused by prices normalization - gradual return to pre-pandemic levels. This is especially true for energy-related commodities. Other items of CPI, e.g. sunflower oil, skyrocket due to increasing global prices. Last but not least is the poor harvest of 2020 which has implication for domestic foodstuff prices.

Figure 11. Inflation expectations 12m ahead



On the other hand, the NBU said that it might reschedule future rate increases, depending on the future evolution of the pandemic. The Ukrainian Prime Minister Denys Shmyhal has announced yesterday (March 4) the beginning of a third wave of COVID-19 in Ukraine and does not rule out that new lockdown restrictions could be introduced. Considering that the reaccelerated spread of infection started before the MPC meeting, only a new lockdown is likely to be factored in another policy rate decision.

Along with this, the NBU said that it has begun work on the development of a plan for gradual phasing out of anti-crisis measures introduced last year. These could affect long-term refinancing loans. Again, implementation of the plan will depend on the future evolution of the pandemic.

Considering the change in NBU' policy stance, we frontloaded our key rate forecast, expecting no rate hikes in 2H21. We see this year's marginal rate at 7%. How quickly it will be reached (either on April 15 or June 17) will depend on the government response to the pandemic reacceleration.

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)	-10.1	-12.3	4.0	1.1	3.0	-0.5	-4.5	0.0
Retail sales (%YoY)	-8.9	-19.8	4.3	6.5	6.2	10.3	8.4	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	2 984	3 561	3 975	3 918*	4 370
Nominal GDP (USD bn)	131	90	93	112	131	155	145*	156
Prices								
CPI (average %YoY)	12.1	48.5	14.9	14.4	11.0	7.9	2.7	7.5
CPI (end of year %YoY)	24.9	43.3	12.4	13.7	9.8	4.1	5.0	6.4
Real average wage growth (%YoY)	-6.5	-20.2	9.0	19.1	12.5	9.8	7.4	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	53.9	59.2	63.6	60.6	62.6
Imports of goods and services (USD bn)	70.0	50.2	52.5	62.7	70.6	76.1	62.3	72.5
Current account balance (USD bn)	-4.6	5.0	-1.9	-3.5	-6.4	-4.1	6.6	-0.6
Current account balance (% of GDP)	-3.5	5.6	-2.0	-3.1	-4.9	-2.7	4.5	-0.4
Net FDI (USD bn)	0.4	-0.5	3.8	3.7	4.5	5.9	-0.4	2.0
Foreign exchange reserves (end of year)	7.5	13.3	15.5	18.8	20.8	25.3	29.1	31.0
Imports coverage (months of imports of goods)	1.3	3.4	3.7	3.6	3.5	3.9	4.8	5.1
Interest and exchange rates								
NBU discount rate (% end of year)	14.0	22.0	14.0	14.5	18.0	13.5	6.0	7.0
Exchange rate (USD/UAH) end of year	15.8	24.0	27.2	28.1	27.7	23.7	28.3	29.8
Exchange rate (EUR/UAH) end of year	19.2	26.2	28.4	33.5	31.7	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
01.03.2021	02.03.2021	03.03.2021	04.03.2021	05.03.2021	06.03.2021	07.03.2021
FGB % USD 334.6mn 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	LGB* % UAH 682.7mn LGB % UAH 369.2mn NBU: Monetary Statistics	ECB: MPC	IMF SDR 295.5mn		
15.03.2021	16.03.2021	17.03.2021	18.03.2021	19.03.2021	20.03.2021	21.03.2021
FGB % USD 94.3mn NBU: Minutes	IMF SDR 59.7mn	LGB % UAH 118.3mn LGB* % UAH 199.6mn LGB P UAH 14,952.5mn Fed: FOMC		NBU: External Debt		
22.03.2021	23.03.2021	24.03.2021	25.03.2021	26.03.2021	27.03.2021	28.03.2021
Ukrstat: GDP Ukrstat: Retail trade	Ukrstat: Industrial Production	LGB % UAH 162.5mn LGB* % UAH 1,715.9mn LGB P UAH 9,983.5mn	FGB % USD 110.6mn			

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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