



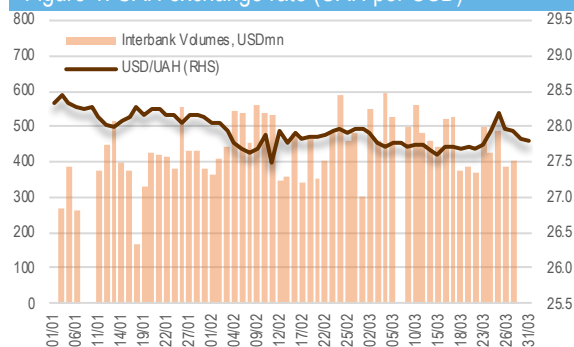
**ECONOMICS | INTEREST RATES STRATEGY | FX**

31 March 2021

**UKRAINIAN  
CAPITAL MARKETS  
WEEKLY**

|         | Rating | Outlook | Last update | This week in focus: Muddling through lockdowns   |
|---------|--------|---------|-------------|--|
| Fitch   | B      | STABLE  | 26.02.2021  | Ukraine's GDP declined 4.0% in 2020. Gains in consumer spending was the key factor behind the better-than-expected stats, while cutbacks in private investment held back the economy. Re-imposed social restrictions could delay expected this year service-led economic bounce back. But last year showed restrictions easing tend to provoke a larger-than-expected economic reaction. |
| S&P     | B      | STABLE  | 12.03.2021  |  |
| S&P (N) | uaA    | -       | 12.03.2021  |  |
| Moody's | B3     | STABLE  | 12.06.2020  |  |

Figure 1. UAH exchange rate (UAH per USD)

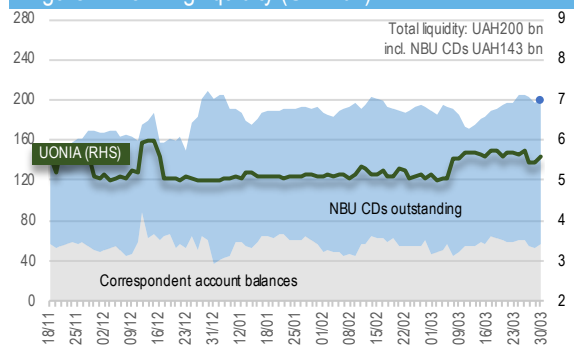


FX and interest rates: UAH regains footing as seasonal demand in sight

**The USD/UAH pair is entering into a strong time of year where it tends to see seasonal gains.** The beginning of the planting season typically pushes up demand for hryvnia. Market participants stick to expectations, that this year will be no exception.

**Last week the USD/UAH approached the key barrier of 28.0.** VAT redemptions, helping exporters reinforce their local currency liquidity balances, as well unsettling developments in Turkey, with Turkish lira losing at one point over 17% of its value following the surprising replacement of the central bank's governor, were the major factors behind the USD/UAH pair braking out of a two-week long narrow trading range around the 27.7 mark.

Figure 2. Banking liquidity (UAH bn)

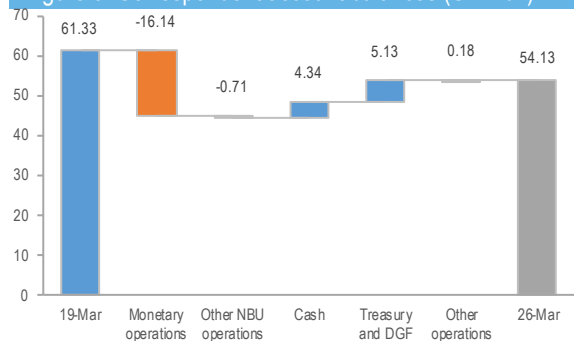


**But supply of FX liquidity remained strong.** Exporters made no attempts to hold onto foreign currency, fearing the USD/UAH pair to follow again a typical in 2Q appreciation pattern.

The springtime triggered fresh demand for foreign currency from importers. It proved to be unsustainable, however, amid another tightening of lockdown restrictions in a number of regions across the country, including Kyiv.

**We expect the USD/UAH pair to go below the 27.5 figure during the appreciation season.** The further movement toward the 27.0 mark hinges on foreign investment sentiment. Despite the finance ministry of Turkey vowed to keep a free market mechanism and continue implementing a liberal FX regime, concerns over the country's unorthodox measures of monetary policy and BoP position remain valid.

Figure 3. Correspondent account balances (UAH bn)



**Hryvnia liquidity in the banking system reached UAH203bn** by the end of last Friday (March 26). In spite of reallocation of UAH16.1bn into NBU CDs and redemption of refinancing facilities worth UAH1.42bn in total, the inflow drove the UONIA 3bp below the lower bound of the NBU standing facility corridor.

The increase largely resulted from State treasury operations, with VAT redemptions being the major source of inflow. The total injection by the State treasury amounted to UAH5.7bn.

Despite January's national lockdown and reintroduction of quarantine measures in a number of regions in March, paper money flow seems to get back on its normal path. Total cash outstanding showed a meager change since the beginning of the year.



Figure 4. Local UAH bonds market

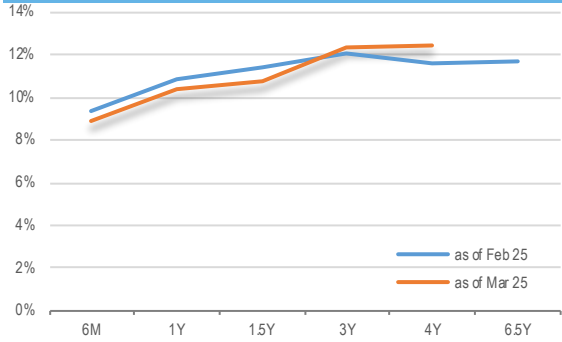
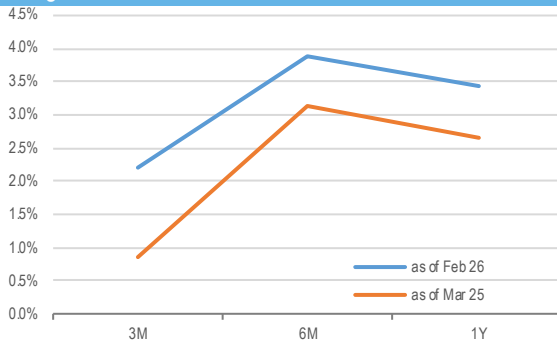


Figure 5. Local USD bonds market



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       | 7.98%        | 7.98%   | 8.29%        | 7.98%        | 18             | 11            | 1 348.96     | 500.00             |
| UAH | 1Y       | 10.75%       | 10.74%  | 10.95%       | 10.70%       | 30             | 29            | 2 726.90     | 2 576.90           |
| UAH | 1.5Y     | 11.10%       | 11.10%  | 11.10%       | 11.10%       | 13             | 13            | 373.51       | 373.51             |
| UAH | 2Y       | 11.80%       | 11.80%  | 12.05%       | 11.70%       | 22             | 21            | 856.83       | 845.42             |
| USD | 1Y       | 3.70%        | 3.70%   | 3.70%        | 3.70%        | 34             | 34            | 48.60        | 48.60              |
| USD | 2Y       | 3.90%        | 3.90%   | 3.90%        | 3.90%        | 23             | 23            | 106.77       | 106.77             |

**Ukraine experienced another decline in demand for its local currency bonds.** In the latest auction, the FinMin sold UAH4.3bn worth of UAH-denominated bonds, down from UAH6.4bn at the preceding auction.

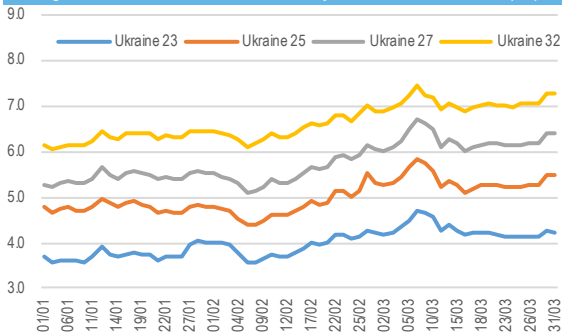
The bestselling 1y securities drew 30 bids for UAH2.7bn, or UAH2bn less than a week earlier. The cut-off rate remained unchanged at 10.75%. With no volume cap set the third auction in a row, the FinMin raised some UAH2.5bn in the sale.

Some decent demand – over UAH1bn – was also seen for 3m bonds. But, because of the volume limit set at UAH500mn, 7 bids for UAH849mn were slashed.

The rest of the local currency bonds in offer drew demand less than UAH1bn each.

Along with UAH bonds, the FinMin offered USD-denominated bonds, which helped the issuer to attract some USD155mn.

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



EUR/USD slips to low 1.1700

**EUR/USD is heading lower, having dropped from the 1.2000s at the month start to fresh lows for 2021 in the low 1.1700s.**

The downtrend has come amidst new yearly highs in U.S. yields climbing to levels last recorded in January 2020 beyond the 1.75%. **The U.S. Treasury yields continue to head skywards, in anticipation of a likely USD3tn infrastructure spending stimulus** due to be unveiled by President Joe Biden later this year. Along with economic recovery the next leg of the fiscal spending is expected to result in higher inflation expectations.

On the other side of the Atlantic, **the continuous rise in the Covid cases and slower vaccination campaigns on supplies delays are likely to weigh on the Euro area's economic prospects.** Therefore, the macroeconomic divergence between the U.S. and the old continent continues to undermine the sentiment around the euro.

Meanwhile, investors ignore the upbeat mood, driven by encouraging Chinese Manufacturing and Services PMI reports, as the spot remains at the mercy of the dynamics in the greenback and returns on the market.

Figure 7. EUR USD spot (mid)

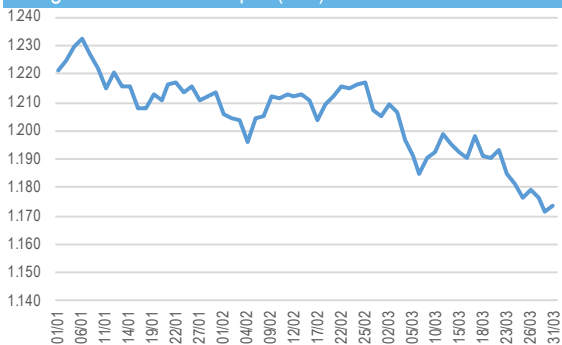
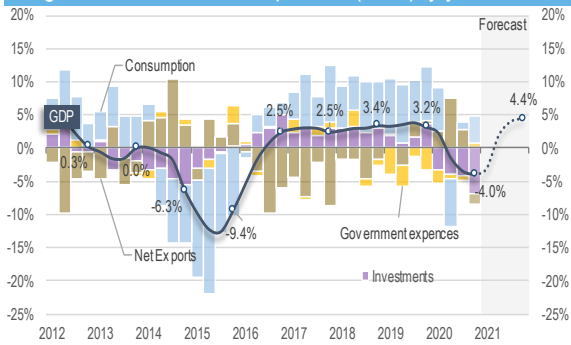


Figure 8. Gross domestic product (GDP), y/y

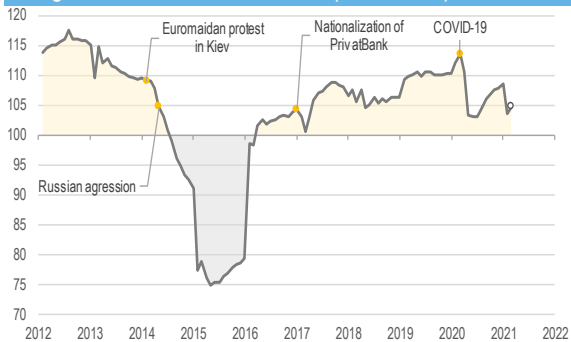


## Muddling through lockdowns

Ukraine's GDP declined 4.0% in 2020, in line with our calculations. Gains in consumer spending was the key factor behind the better-than-expected stats, while cutbacks in private investment held back the economy. Re-imposed social restrictions across many regions in Ukraine threaten with delays to expected this year service-led economic bounce back, but last year showed restrictions easing tend to provoke a larger-than-expected economic reaction.

**Investment expenses plummeted 24.4% y/y in 2020**, outpacing falling during Russian aggression in 2014. High uncertainty regarding future development of the pandemic, revenue shortfalls, and weak fiscal stimulus resulted in the double-digit drop in investments in 3Q20 (the latest available data) across all the segments of economic activity, but some minor ones. This could dent economic recovery in 2021-22, as well as have some price implications in the current year.

Figure 9. Retail turnover index (cumulative)

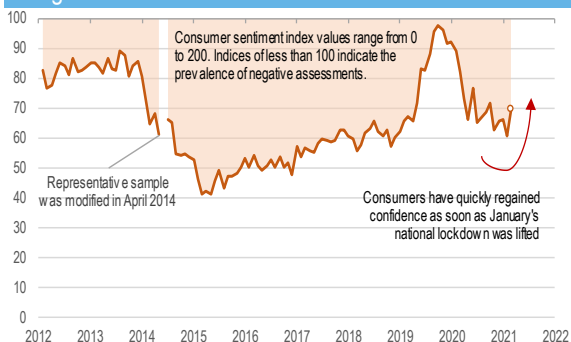


Considering the Covid outbreak likely remaining out of control in 1H21 and typically lengthy approvals of capital investments, pent-up business spending appears poised to deliver modest recovery in the current year. Government-led investments, largely related to the Great Construction project, might account for most of this year's capital spending.

**Consumption flexibility smoothed the way.** As we highlighted in our report of February 17, a quick recovery in consumption after a short but sharp slowdown helped soften the economic effect of the pandemic-induced decline.

People have quickly adapted to the new environment, switching from services to goods spending, so the weakness in consumption, which is the biggest contributor to the country's GDP, was limited. With increasing purchases of imported durables, however, the external trade balance again turned negative by the end of the year. Imports, which subtract from the total GDP, amounted to UAH1.5tn (circa USD57.4bn), while exports, which add to GDP, amounted to UAH1.77tn (some USD65.6bn).

Figure 10. Consumer sentiment index



**Covid-19 remains the major drain on growth in 2021.** New quarantine restrictions have been reintroduced in a number of regions, including Kyiv. This will weigh on 2Q retail trade figures and potentially delay the expected in 3Q economic bounce back led by services consumption. Reacceleration of Covid spread in Ukraine could leave untapped precautionary savings. Unlike in 2020, this year momentum in spending on goods fed by money saved by not spending on services is prone to weakening due to limited room for consumption of durables. The extremely slow vaccination campaign in Ukraine raises concerns over the prospects for consumption this year.

Along with this, we note, that restrictions **easing tend to provoke a larger-than-expected economic reaction.** In spite of building up downside risk for recovery, we still see the potential for the Covid-related economic damage being repaired just in one year. Massive fiscal and monetary stimuli introduced by developed economies could also power the recovery of the local economy, boosting exports of bulk commodities. **We hold our forecast of 4.4% GDP growth in 2021 followed by a 3.8% expansion in 2022.**

# UKRAINIAN CAPITAL MARKETS WEEKLY

| Key Macroeconomic Indicators                     |       |       |       |       |       |       |       |       |
|--|-------|-------|-------|-------|-------|-------|-------|-------|
|  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021E | 2022F |
| <b>Real sector</b>                               |       |       |       |       |       |       |       |       |
| Real GDP (%YoY)                                  | -9.8  | 2.4   | 2.5   | 3.4   | 3.2   | -4.0  | 4.4   | 3.8   |
| Industrial production (%YoY)                     | -12.3 | 4.0   | 1.1   | 3.0   | -0.5  | -4.5  | 1.5   | 1.0   |
| Retail sales (%YoY)                              | -19.8 | 4.3   | 6.5   | 6.2   | 10.3  | 8.4   | 9.2   | 10.0  |
| Unemployment rate end of year (ILO, working age) | 9.1   | 9.3   | 9.5   | 8.8   | 8.2   | 10.1* | 9.3   | 8.5   |
| Nominal GDP (UAH bn)                             | 1 989 | 2 385 | 2 984 | 3 561 | 3 975 | 4 194 | 4 370 | 4 537 |
| Nominal GDP (USD bn)                             | 90    | 93    | 112   | 131   | 155   | 156   | 156   | 151   |
| <b>Prices</b>                                    |       |       |       |       |       |       |       |       |
| CPI (average %YoY)                               | 48.5  | 14.9  | 14.4  | 11.0  | 7.9   | 2.7   | 7.5   | 5.7   |
| CPI (end of year %YoY)                           | 43.3  | 12.4  | 13.7  | 9.8   | 4.1   | 5.0   | 6.4   | 5.0   |
| Real average wage growth (%YoY)                  | -20.2 | 9.0   | 19.1  | 12.5  | 9.8   | 7.4   | 3.5   | 3.0   |
| <b>Fiscal balance (% of GDP)</b>                 |       |       |       |       |       |       |       |       |
| State budget deficit (without Naftogaz)          | 2.3   | 2.9   | 1.6   | 2.4   | 1.8   | 5.5*  | 3.0   | 2.5   |
| Total public debt (% of GDP)                     | 79.4  | 81.0  | 71.8  | 61.0  | 51.6  | 64.4* | 64.6  | 61.5  |
| <b>External balance</b>                          |       |       |       |       |       |       |       |       |
| Exports of goods and services (USD bn)           | 47.9  | 46.0  | 53.9  | 59.2  | 63.6  | 60.6  | 62.6  | 65.0  |
| Imports of goods and services (USD bn)           | 50.2  | 52.5  | 62.7  | 70.6  | 76.1  | 62.3  | 72.5  | 78.0  |
| Current account balance (USD bn)                 | 5.0   | -1.9  | -3.5  | -6.4  | -4.1  | 6.6   | -0.6  | -3.2  |
| Current account balance (% of GDP)               | 5.6   | -2.0  | -3.1  | -4.9  | -2.7  | 4.2   | -0.4  | -2.1  |
| Net FDI (USD bn)                                 | -0.5  | 3.8   | 3.7   | 4.5   | 5.9   | -0.4  | 2.0   | 3.0   |
| Foreign exchange reserves (end of year)          | 13.3  | 15.5  | 18.8  | 20.8  | 25.3  | 29.1  | 31.0  | 32.5  |
| Imports coverage (months of imports of goods)    | 3.4   | 3.7   | 3.6   | 3.5   | 3.9   | 4.8   | 5.1   | 5.0   |
| <b>Interest and exchange rates</b>               |       |       |       |       |       |       |       |       |
| NBU discount rate (% end of year)                | 22.0  | 14.0  | 14.5  | 18.0  | 13.5  | 6.0   | 7.0   | 6.0   |
| Exchange rate (USD/UAH) end of year              | 24.0  | 27.2  | 28.1  | 27.7  | 23.7  | 28.3  | 29.8  | 31.0  |
| Exchange rate (EUR/UAH) end of year              | 26.2  | 28.4  | 33.5  | 31.7  | 26.4  | 34.7  | 37.3  | 40.3  |

\*estimates, no official data yet available



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# UKRAINIAN CAPITAL MARKETS WEEKLY

## FOUR WEEKS AHEAD

| Mon   | Tue                   | Wed   | Thu  | Fri  | Sat        | Sun        |
|---|-----------------------|---|--|--|------------|------------|
| 29.03.2021                                      | 30.03.2021            | 31.03.2021  | 01.04.2021   | 02.04.2021   | 03.04.2021 | 04.04.2021 |
| FGB % USD 7.4mn<br>Ukrstat: Nominal & Real Wage |                       | LGB* % UAH 512.5mn<br>LGB % UAH 767.1mn<br>LGB P USD 325.2mn<br>NBU: BoP        |  |  |            |            |
| 05.04.2021                                      | 06.04.2021            | 07.04.2021  | 08.04.2021   | 09.04.2021   | 10.04.2021 | 11.04.2021 |
| Ukrstat: Business confidence                    |                       | LGB* % UAH 305.7mn<br>LGB % UAH 77.5mn<br>NBU: FX Reserves (deadline - 7th day) | LGB % USD 6.2mn<br>LGB P USD 365.9mn                           | Ukrstat: Price indices<br>NBU: Monetary Statistics |            |            |
| 12.04.2021                                      | 13.04.2021            | 14.04.2021  | 15.04.2021   | 16.04.2021   | 17.04.2021 | 18.04.2021 |
|   |                       | LGB* % UAH 1,228.2mn<br>LGB P UAH 11,684.7mn                                    | LGB % USD 4.0mn<br>NBU: MPC                                    |  |            |            |
| 19.04.2021                                      | 20.04.2021            | 21.04.2021  | 22.04.2021   | 23.04.2021   | 24.04.2021 | 25.04.2021 |
|   | Ukrstat: Retail trade | LGB* % UAH 473.6mn<br>LGB % UAH 490.3mn<br>LGB* P UAH 1,100.0mn                 | LGB % USD 11.6mn<br>Ukrstat: Industrial Production<br>ECB: MPC | LGB* % UAH 62.5mn                                  |            |            |

## 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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