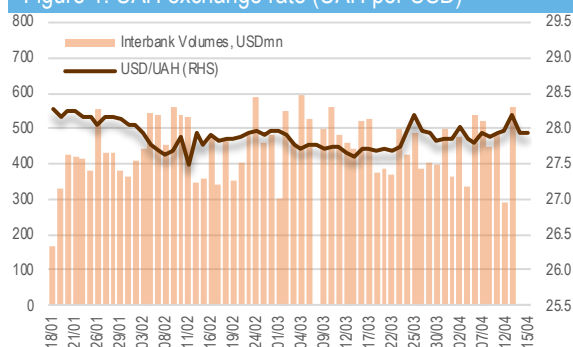


ECONOMICS | INTEREST RATES STRATEGY | FX

15 April 2021

UKRAINIAN CAPITAL MARKETS WEEKLY

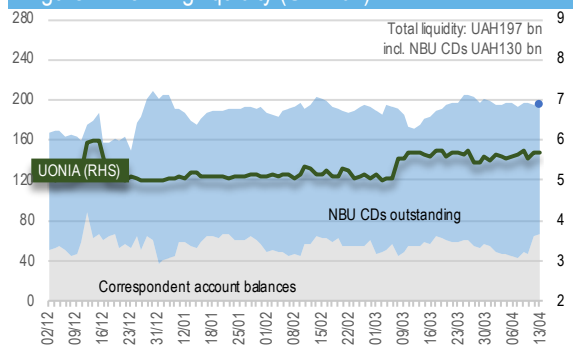
	Rating	Outlook	Last update	This week in focus: NBU delivers 100bp hike, signals unchanged rate in 2021
Fitch	B	STABLE	26.02.2021	NBU has delivered a larger-than-expected rate hike by 100bp in response to soaring inflation. A full-point key rate increase to 7.5% followed the acceleration of annual inflation to 8.5% in March. At the same time, the central bank stressed its expectations of stabilizing inflation around mid-year, and projects the key rate to remain at the current level until year-end.
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: Border tension weighs on hryvnia

The USD/UAH pair seems to have lost seasonal support as a rising tension at the country's eastern border makes market participants hold onto hard currency. The USD/UAH rate is currently trading at 27.95, losing 0.04% on a daily basis.

Russia has been actively building-up military forces on Ukraine's borders and in Crimea since the beginning of April. The movements have also been accompanied with hostile statements by Russia's officials.

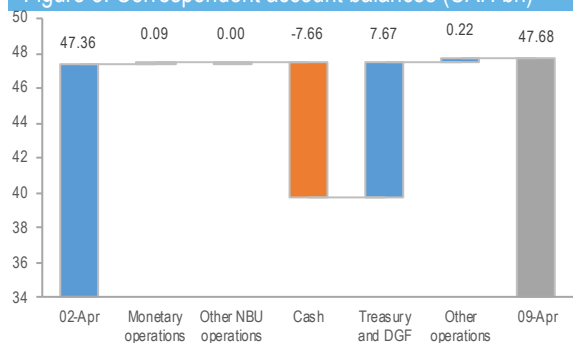
While there is no rush to cash in the FX market yet, increased uncertainty weighs on FX supply, hence allowing bearish traders to continue pressure the hryvnia rate lower against the U.S. dollar.

Figure 2. Banking liquidity (UAH bn)


The downtrend may be expected to continue over the next week or so, with developments in the eastern border remaining the primary driver.

The fundamental picture is dimmed. The prospects for economic recovery remain constrained by quarantine measures imposed across Ukraine. Moreover, market observers are becoming increasingly concerned about soaring consumer prices and the price of taming inflation. The pace of ongoing consumer price growth could result in more buying of FX.

We do not rule out, however, a healthy FX bounce back in late April, provided tensions on the country's eastern border abate. Today's sharp rate hike may accelerate hryvnia's recovery.

Figure 3. Correspondent account balances (UAH bn)


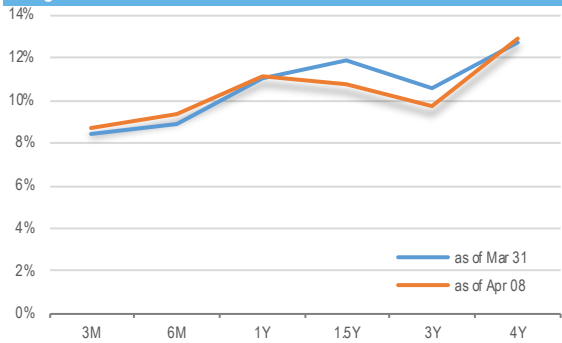
Hryvnia liquidity in the banking system little changed over the past two weeks. As of April 9, the balance of correspondent accounts with the NBU was UAH47.7bn, up 0.66% on a previous week, and position in NBU CDs increased by 2.03% to UAH149.9bn.

The State treasury remains the major supplier of liquidity. Last week State treasury operations resulted in a UAH7.67bn inflow.

Considering an easy tax schedule for the ongoing week and weak last primary debt auction, redemption of government bonds for UAH11.7bn on April 14 could push total liquidity again above UAH200bn level by the end of the week.

The only factor helping to counterbalance liquidity increase is a typical for the first half of month cash withdrawals.

Figure 4. Local UAH bonds market

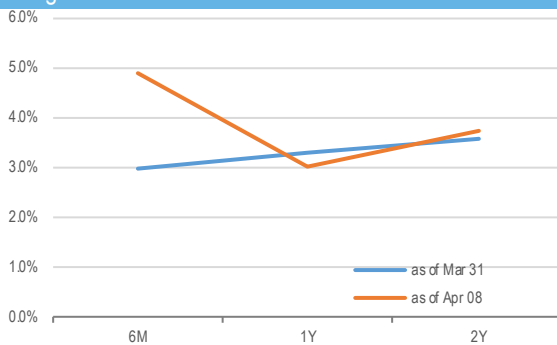


Government bond market

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	6M	8.50%	8.07%	8.50%	8.00%	6	6	133.50	133.50
UAH	1Y	10.75%	10.75%	10.75%	10.75%	3	3	70.23	70.23
UAH	1.5Y	11.10%	11.10%	11.10%	11.10%	4	4	5.69	5.69
USD	2Y	3.90%	3.90%	4.20%	3.90%	50	48	49.02	48.82

FinMin keeps experiencing tepid interest for government bonds. The range of instruments auctioned this week was not much different from the preceding offerings. But the ministry managed to sell only UAH200mn of local currency bonds and USD49mn of USD-denominated securities.

Figure 5. Local USD bonds market

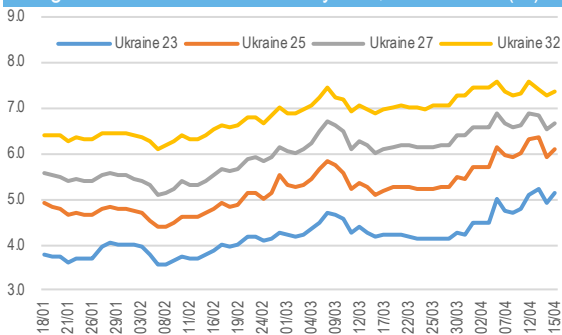


The outcome of the auctions of UAH bonds was particularly surprising amid the scheduled for April 14 redemption of bonds for UAH11.7bn. These securities were initially placed in late November 2020, before offshore investors started actively increasing their position in local government bonds.

The reluctance of the local market participants to rollover the debt suggests a wide gap between offered and required yield, especially before another monetary policy meeting.

But the ministry may currently benefit from volatile FX and rising inflation, implying an improvement in tax revenues. This could allow the issuer to remain firm at current cut-off levels for some more time.

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



EUR/USD heads back up toward 1.2000

The EUR/USD pair has been firmly on the front foot over the last few weeks, rallying from the low 1.1700s seen two weeks ago to current levels around the 1.2000 level.

The safe-haven dollar has come under pressure as recent statistics proved to be very strong, supporting the narrative that the U.S. economy continues to recover and at a seemingly accelerating pace.

Another sell-off in the dollar followed the release of U.S. inflation figures on Tuesday (April 13). As the Core Consumer Price Index (CPI) growth only met expectations, the central bank may continue holding low rates for longer.

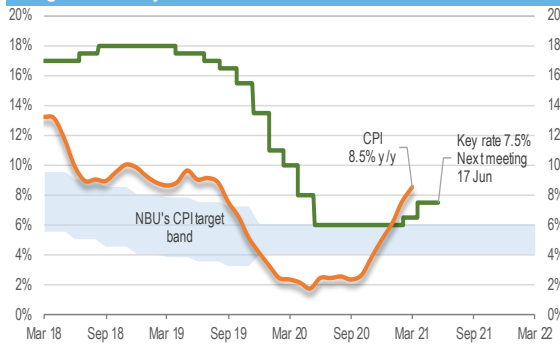
Failing to surprise inflation has also sent the U.S. government 10-year bond yield back to 1.64% from above 1.74 at the end of March.

Figure 7. EUR USD spot (mid)



The weakness in the dollar, however, might prove to be unsustainable. The U.S. economic strength, as well as a rising tide of Covid-19 infections in Europe causing fresh lockdowns, may well limit the associated with a safe-haven assets USD downside.

Figure 8. Key rate vs CPI evolution



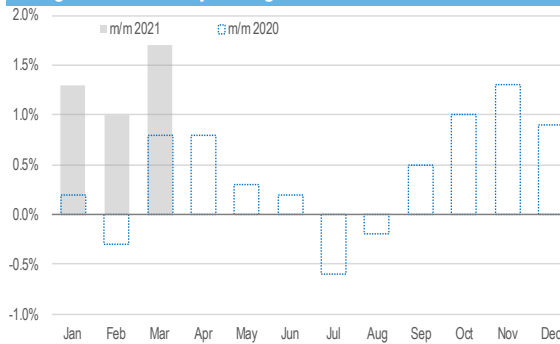
NBU delivers 100bp hike, signals unchanged key rate until year-end

NBU has delivered a larger-than-expected rate hike by 100bp in response to soaring inflation. **A full-point key rate hike to 7.5% followed the acceleration of annual inflation to 8.5% in March.**

The consumer price index rose 1.7% in March on the previous month, the highest monthly gain since October 2018. Year-to-date inflation reached 4.1%. In annual terms inflation accelerated to 8.5% last month, exceeding both NBU and market expectations.

Food prices were the biggest contributor to the monthly gain, surging 2.1% in March and responsible for more than half of the overall CPI growth.

Figure 9. Monthly change in CPI



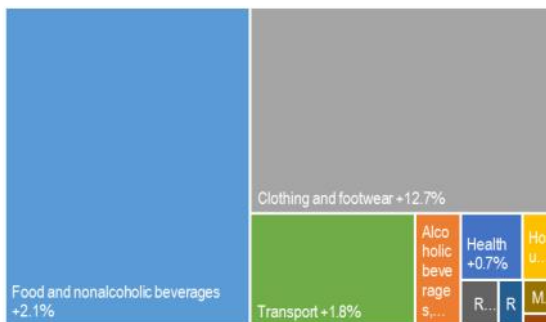
The food prices increase mostly resulted from a strong growth of global prices for soft commodities, pulling up production costs in the categories of meats (incl. poultry), bakery products, and sunflower oil.

Transport prices nudged higher as well, up 1.8% for the month, reflecting recovery in global energy prices.

A big gain was also seen in prices for clothing and footwear, which, however, followed their usual seasonal pattern, with a typical price spike in early spring and autumn.

The inflation report clearly indicates cost-push drivers behind the mounting inflation. The minimum wage rise, higher grains, and energy costs get passed on to the consumer prices. The impact of these factors is likely to be transitory and should ease in 2Q.

Figure 10. Contribution to monthly change in CPI



Another driver of the more aggressive hike is increased volatility in financial markets following growing geopolitical risks with Russia amassing a large number of troops alongside the border of Ukraine before the upcoming May 9th dates (Victory Day). This already caused a sell-off on the short end of the government bond curve by international investors and caused an unusually high demand for local currency. A due increase in the key rate is a good signal to international markets and also to the IMF.

We also note increased iterations between Ukrainian authorities and the Fund over the last weeks, which could imply good news in terms of getting back on track with the SBA program.

It is important that the NBU stressed its expectations of stabilizing inflation around mid-year following the arrival of a new harvest and expiry of the normalization period for energy prices. This goes in line with our expectations. We project the key rate to remain at 7.5% until year-end, agreeing with the guidance provided by the central bank.

UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2015	2016	2017	2018	2019	2020	2021E	2022F
Real sector								
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
Prices								
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
Fiscal balance (% of GDP)								
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
External balance								
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
Interest and exchange rates								
NBU discount rate (% end of year)	22.0	14.0	14.5	18.0	13.5	6.0	7.5	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
12.04.2021	13.04.2021	14.04.2021	15.04.2021	16.04.2021	17.04.2021	18.04.2021
		LGB* % UAH 524.1mn LGB % UAH 1,117.8mn LGB P UAH 11,684.7mn	LGB % USD 7.9mn 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 LGB % UAH 951.7mn LGB* P UAH 1,100.0mn	LGB % USD 11.6mn Ukrstat: Industrial Production ECB: MPC	LGB* % UAH 62.5mn		
26.04.2021	27.04.2021	28.04.2021	29.04.2021	30.04.2021	01.05.2021	02.05.2021
NBU: Minutes		LGB* % UAH 895.1mn LGB P UAH 11,606.0mn Ukrstat: Nominal & Real Wage Fed: FOMC		IMF SDR 0.0mn NBU: BoP NBU: Cost of Real Sector External Debt	IMF SDR 45.3mn FGB % USD 78.0mn	
03.05.2021	04.05.2021	05.05.2021	06.05.2021	07.05.2021	08.05.2021	09.05.2021
		LGB* % UAH 535.0mn LGB % UAH 222.8mn	LGB % EUR 2.6mn	LGB* % UAH 203.1mn Ukrstat: Price indices Ukrstat: Business confidence 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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