

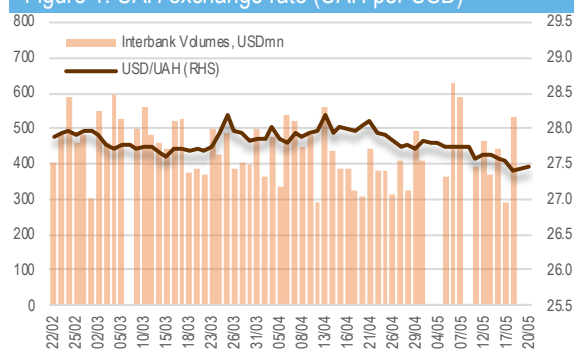
ECONOMICS | INTEREST RATES STRATEGY | FX

20 May 2021

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Steel and iron ore exports roar back
Fitch	B	STABLE	26.02.2021	Ukraine's metallurgical industry has emerged from the Covid-induced crisis stronger than before, thanks to booming demand for commodities. While the agri-food exports continues suffering from poor last year's crops, recovery in steel and iron ore exports could help cope with rising energy costs. It may also support UAH and restore foreign appetite to the country's debt.
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)



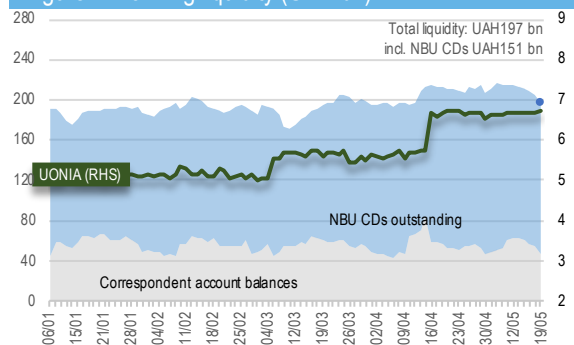
FX and interest rates: Ukrainian hryvnia keeps holding upside potential

The Ukrainian hryvnia maintains its latest breakout below 27.5 mark against the U.S. dollar, as we expected, while holding potential for further appreciation.

Strong inflow of FX revenues from steel and iron ore exports lacks sufficient demand to compete with. Tentative recovery in offshore interest to local government bonds, along with rising FX sales by population (mostly remittances) amid abating Covid concerns add to FX supply.

The central bank, in turn, shows no intention to step in with purchases of excess FX liquidity, which basically in line with its commitment not to intervene in the market when fundamental factors are in place. Besides, such inactivity should also reinforce the NBU efforts in taming inflation.

Figure 2. Banking liquidity (UAH bn)



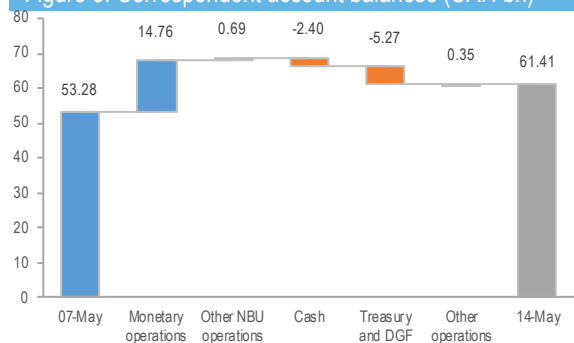
Ukraine and the IMF are on the way toward reaching staff-level agreement, according to the NBU deputy governor Yuriy Heletiy. He expressed expectations that conditions for another tranche under stand-by arrangement could be agreed in the next few weeks.

Confirmation by the IMF of sending a mission team to Kyiv could drive the USD/UAH rate further down towards 27.00 mark.

Banking liquidity, though dropped below UAH200bn level by Tuesday (May 18), remained abundant, so that no interbank rate fluctuations followed the decline.

Balance of banks' correspondent accounts with the NBU fell to UAH46bn by that date, position in NBU CDs contracted to UAH151bn.

Figure 3. Correspondent account balances (UAH bn)



The outflow largely resulted from State treasury operations, which drained around UAH17bn since the beginning of the previous week (May 11). And the transfer of dividends by state-owned banks and enterprises to the state budget, as well as the last primary debt auction may stand behind them.

The total amount of cash in hands is again expanding, with some UAH3.4bn withdrawn since May 11. This, however, can result from a long holiday season in early May, which could boost demand for paper money.

Figure 4. Local UAH bonds market

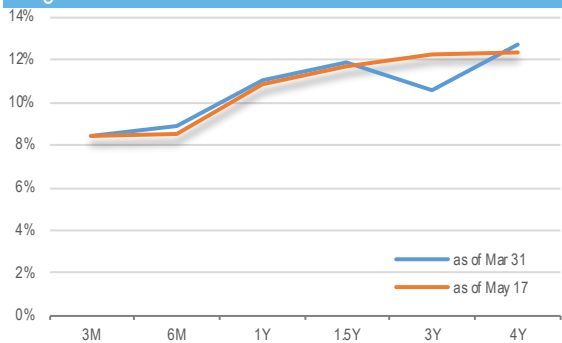
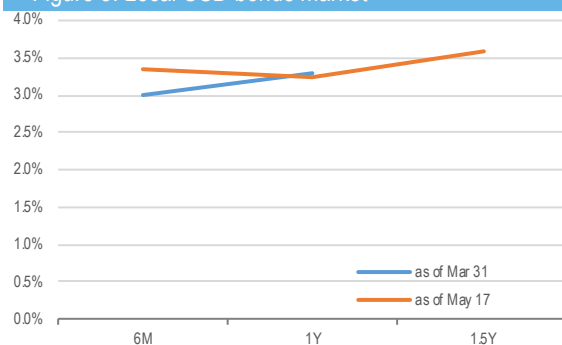


Figure 5. Local USD bonds market



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	8.48%	8.48%	8.50%	8.48%	11	6	1 295.35	500.00
UAH	1Y	11.20%	11.19%	11.20%	11.10%	32	32	1 846.18	1 846.18
UAH	1.5Y	11.30%	11.30%	11.30%	11.30%	9	9	236.28	236.28
UAH	2Y	12.05%	12.02%	12.05%	11.95%	23	23	1 432.29	1 432.29
USD	1.5Y	3.90%	3.90%	3.90%	3.90%	42	42	62.24	62.24
EUR	1Y	2.50%	2.50%	2.50%	2.50%	30	30	236.95	236.95

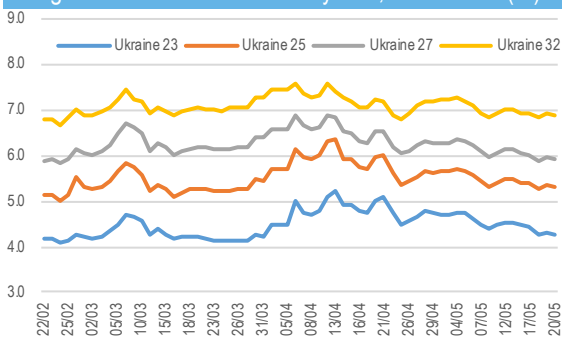
Another primary debt auction on May 18 ended with cut-off rates across the curve remaining mostly unchanged from the previous auction. FinMin seems to have reached its rate ceiling under adjustment of marginal yields for the local public debt to the recent key rate hike.

Among local-currency bonds, the highest demand was seen for 1- and 2-year securities, drawing bids for UAH1.8bn and UAH1.4bn respectively. All the applications were fully satisfied. But the latter cost the ministry an extra 5bp increase in cut-off rate to 12.05% to fully meet demand, which mostly stood above 12.00%.

High acceptance was also seen in Euro-denominated bonds. But it is typically a pent-up demand because these securities are offered not so often as others.

A signal from the IMF on resumed consultations with Ukrainian authorities under SBA could push demand into the long-end of the local currency curve.

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



EUR/USD revisits 1.2200 level

The U.S. dollar remains well under pressure against the euro as investors continue to favour the positioning in the risk-associated universe. The pair advanced to new highs above 1.2200 barrier.

Despite the rebound in yields of the U.S. 10-year Treasury to the 1.65% region and the re-emergence of the high inflation narrative in the next months, the greenback struggles to find demand.

The recent release of the latest FOMC Meeting's Minutes, which put chances of a tighter monetary policy back on the table, did not have lasting effect. The report showed the central bank would reconsider its easy monetary policy if the economy continues to rapidly improve. But some Fed officials stick to the view of the transitory nature of high inflation.

On the other side of the pond, the debate about the European Central Bank's next steps is raging as well. Some members want to continue printing euros and complete the Pandemic Emergency Purchase Program, while others want to cut it back already in June.

Europe's vaccination campaign is accelerating but still lags America's. Virus statistics in Germany have extended their decline, showing the efforts are bearing fruit.

Figure 7. EUR USD spot (mid)

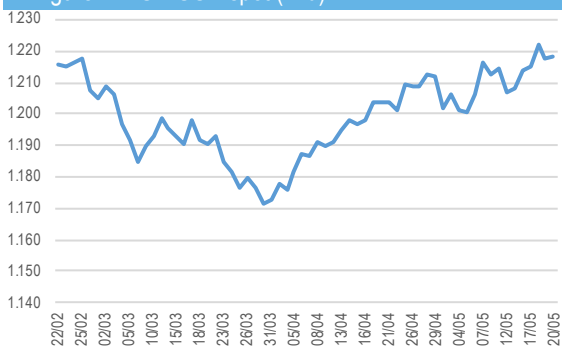
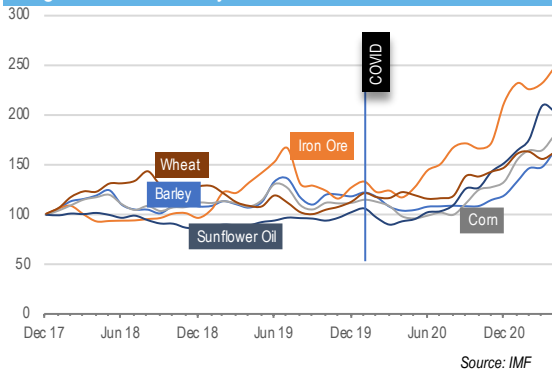


Figure 8. Commodity Price Indices

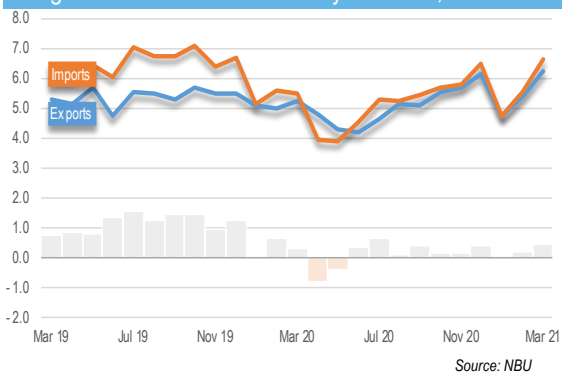


Steel and iron ore exports roar back

Ukraine's metallurgical industry has emerged from the Covid-induced crisis stronger than before. Booming global demand for commodities driven by buoyant economic growth in leading economies shows little sign of slowing at the moment. While the country's agri-food segment continues suffering from poor last year's crops, recovery in exports of steel and iron ore could help cope with rising energy costs. It may also improve expectations towards the hryvnia and hence restore foreign appetite to the country's public debt.

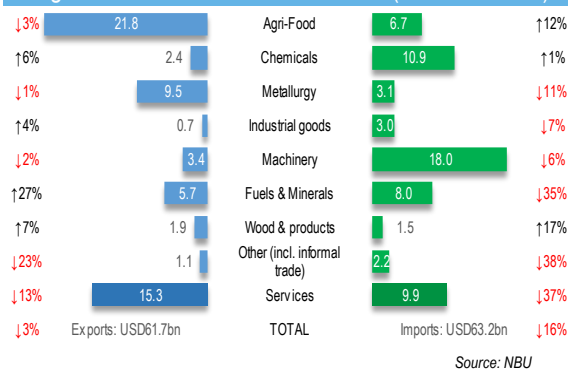
With global prices standing at multi-year highs, **export sales of metals and mineral products (largely iron ore) soared by 31.0% and 66.7% respectively in 1Q21 compared to 1Q20.** On the monthly basis, foreign sales of iron ore hit a record high in March, while export of metals gained the most since July 2014.

Figure 9. External trade monthly evolution, USDbn



An emerged demand-supply gap is likely to hold prices for industrial metals elevated through the end of 2021, providing much of a tailwind to steel and iron ore exports. While industrial production in developed countries is coming roaring back, a supply side, which is largely represented by emerging markets, fails to satisfy the soaring demand for it continues coming out of the Covid-induced economic shock. A transportation bottleneck, which appeared amid commodities boom, is another contributor to strong prices. Although foregoing constraints are likely to ease by the end of the year, prices for bulk commodities are unlikely to lose their gains fast.

Figure 10. External trade breakdown (TTM to Mar 21)



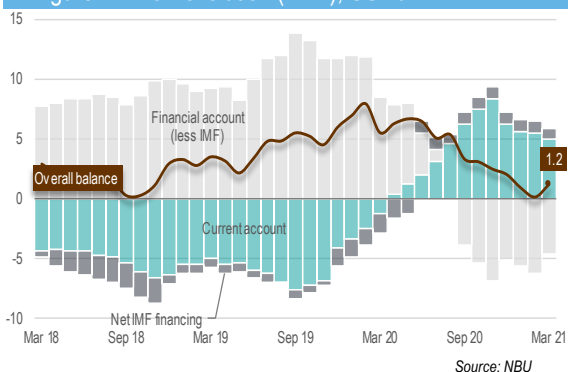
Total agro-based product exports were down 7.6% to USD5.22bn in 1Q21 on an annual basis. Because of poor grain crops in 2020, remaining high global prices for soft commodities have an adverse ripple effect, adding to costs of local producers and driving up expenses for agri-food imports. The latter jumped to USD1.87bn in 1Q21, up 11.2% year over year.

Imports of energy commodities approach a pre-pandemic level. Before prices crash in 2020, Ukraine consumed energy commodities for USD12-13bn annually, up by 39.3% on the energy imports in 2020.

There is a notable improvement in the services trade, but it looks not sustainable, for it largely came on the back of narrowed expenses for traveling.

Assuming net investment income (primary and secondary income less remittances and some other one-off items) hold unchanged and the trade deficit expands to before 2020 level – around USD13bn – **Ukraine may head into 2022 with a zero current account balance.**

Figure 11. BoP evolution (TTM), USDbn



The lessening CA surplus, however, is likely to be offset with recovery in capital flows. As commodity prices are bouncing, currencies with strong ties to export revenues have begun to gain appeal. This, coupled with NBU's signal of no more rate hikes in 2021, could trigger fresh offshore purchases of government bonds. But slow talks with the IMF remain the major impediment for Ukraine to participate fully in a recent switch to risk-on mood in the global capital markets.

Improvement could also be expected in FDI position, as recovery in foreign trade should boost round-trip investments.

With another public debt spike approaching (around USD3bn of external debt is due to repayment in September), we do not expect the FA to flip positive by the end of the year. But we see potential for BoP to improve by some USD2bn.

It is important, however, for the authorities to reach a staff-level agreement before the IMF's executive board breaks up for the summer recess, which typically happens in early August. If postponed for a later time, the resumed talks will be encumbered by an extra requirement of 2022 state budget law approval.

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
17.05.2021	18.05.2021	19.05.2021	20.05.2021	21.05.2021	22.05.2021	23.05.2021
LGB* % UAH 431.8mn		LGB* % UAH 714.9mn LGB % UAH 1 083.6mn LGB* P UAH 2 200.0mn LGB P UAH 10 771.0mn	LGB* % UAH 195.6mn	Ukrstat: Retail trade	LGB* % UAH 238.0mn	
24.05.2021	25.05.2021	26.05.2021	27.05.2021	28.05.2021	29.05.2021	30.05.2021
LGB* % UAH 313.6mn Ukrstat: Industrial Production	LGB* % UAH 261.0mn	LGB* % UAH 922.1mn LGB % UAH 1 930.6mn	LGB* % UAH 506.3mn	LGB* % UAH 251.3mn Ukrstat: Nominal & Real Wage	LGB* % UAH 245.6mn	
31.05.2021	01.06.2021	02.06.2021	03.06.2021	04.06.2021	05.06.2021	06.06.2021
NBU: BoP NBU: Gross External Debt Future Payments		LGB* % UAH 568.5mn LGB % UAH 1 272.1mn LGB P UAH 11 302.4mn	LGB % USD 14.6mn LGB P USD 387.7mn	Ukrstat: Busines confidence		
07.06.2021	08.06.2021	09.06.2021	10.06.2021	11.06.2021	12.06.2021	13.06.2021
NBU: FX Reserves (deadline - 7th day)		LGB* % UAH 398.4mn LGB* P UAH 1 500.0mn Ukrstat: Price indices NBU: Monetary Statistics	ECB: MPC			

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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Contacts

Investment Business Group

Serhiy Yahnych

Head of Investment Business

(+38044) 537-50-82 serhii.yahnych@ukrsibbank.com

Viktoriia Nebeska

Market Making Government Bonds

(+38044) 201-22-74 viktoriia.nebeska@ukrsibbank.com

Platon Yachmenov

Fixed Income Dealer

(+38044) 230-48-54 platon.yachmenov@ukrsibbank.com

Mykhailo Kharchuk

Market Analysis

(+38044) 537-49-75 mykhailo.kharchuk@ukrsibbank.com

Distribution of Capital Markets Weekly report:

macro@ukrsibbank.com



FX Business

Kostiantyn Rupchev

Head of FX Sales

(+38044) 537-50-04 kostiantyn.rupchev@ukrsibbank.com

Corporate Business

Ievgen Kulikov

Head of MNC team

(+38044) 201-22-43 ievgen.kulikov@ukrsibbank.com

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