



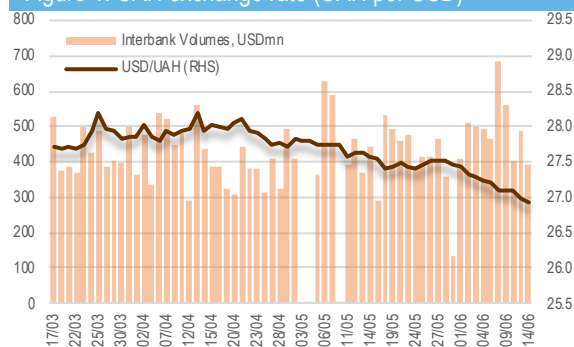
ECONOMICS | INTEREST RATES STRATEGY | FX

17 June 2021

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

	Rating	Outlook	Last update	This week in focus: NBU restrains from further policy tightening
Fitch	B	STABLE	26.02.2021	The NBU has decided to hold the key rate at 7.5%, expecting inflation to return into the target range in 1H22. Indeed, a high base being laid by the current price growth should contribute to inflation moderation over the next 12 months – the main objective of the central bank’s policy. And prudent NBU’s interventions in the FX market should reinforce the impact of the acting monetary policy.
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)



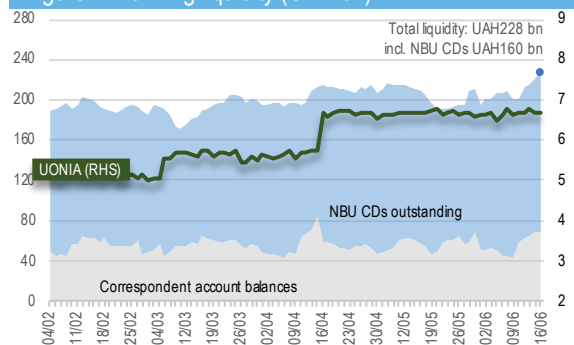
FX and interest rates: USD/UAH touches year low, further decline is likely

The USD/UAH pair witnessed some heavy selling during the last week and dived to year lows, below the 27.00 mark this Monday (June 14).

While the local currency continued benefiting from elevated global prices for steel and iron ore, the pair met with some fresh supply from foreign investors. On top of this, appreciating hryvnia feeds up an increase in FX sales by working migrants.

The inflow prompted the central bank to step in. During the last week, the NBU mopped up some USD315mn through interbank FX interventions. The purchases apparently targeted investment flows only.

Figure 2. Banking liquidity (UAH bn)

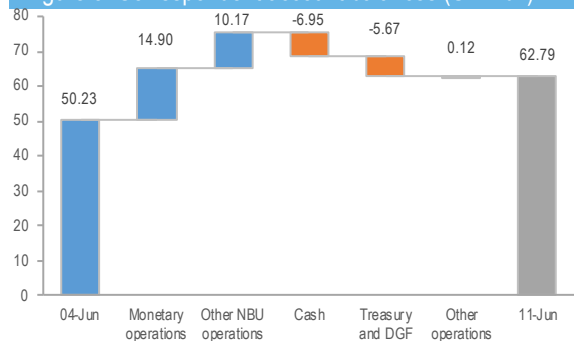


The USD/UAH seems poised to repeat the 2019 path when the pair extended decline through the end of the year. Considering an increasing contribution of steel and iron ore producers to total FX supply, and untypically strong commodity market in general, the hryvnia could break out of the seasonal pattern – strengthening in spring followed by depreciation in autumn – which is largely tied to work cycles in the agricultural industry.

This, however, will largely depend on progress in talks with the IMF. Though increased recently, foreign position in local government bonds remains some UAH20bn (circa USD760mn) below the maximum seen in 2020. Expectations for further hryvnia appreciation could attract some more offshore investments, but they are hardly capable of triggering any sizable inflow.

In this regard, foreign investment sentiment should also be closely watched amid continued speculation on sooner than anticipated monetary policy tightening by leading central banks.

Figure 3. Correspondent account balances (UAH bn)



Banking liquidity reached UAH213bn by the end of last Friday (June 11), up 3% from the preceding week.

The central bank’s operations were the major source of fresh local currency. FX interventions brought in some UAH10bn. In addition to this, the NBU injected some UAH8.6bn via refinancing loans.

Meantime State treasury operations and cash withdrawals absorbed about UAH12.6bn.



Figure 4. Local UAH bonds market

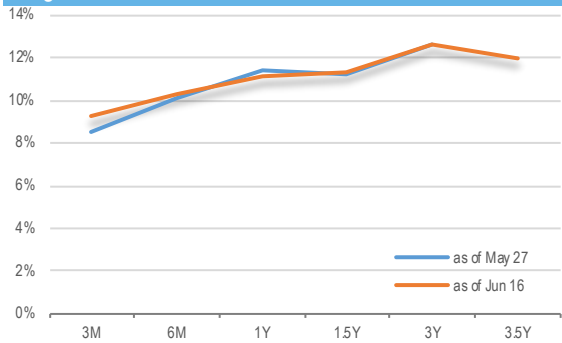
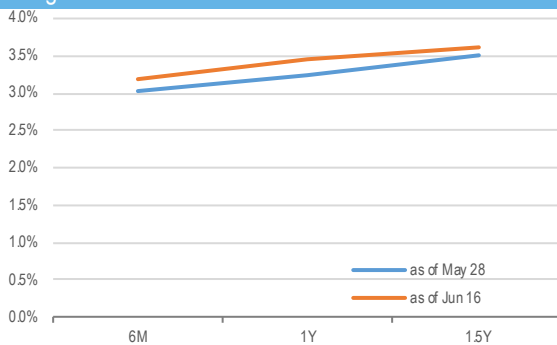


Figure 5. Local USD bonds market



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	1Y	10.99%	10.97%	11.20%	10.95%	19	16	2 516.57	2 000.00
UAH	1.5Y	11.30%	11.30%	11.30%	11.30%	6	6	61.11	61.11
UAH	2Y	12.00%	12.00%	12.05%	12.00%	23	22	1 410.42	1 405.42
UAH	3Y	12.30%	12.30%	12.30%	12.30%	13	13	738.69	738.69
UAH	5Y	12.59%	12.59%	12.80%	12.50%	34	30	1 765.56	1 604.36
EUR	1Y	2.50%	2.50%	2.50%	2.50%	23	23	60.73	60.73

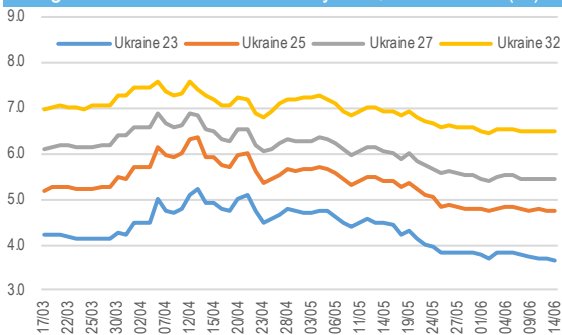
FinMin met tepid demand for government bonds this Tuesday (June 15), compared to a fruitful primary auction on June 8.

Out of a range of securities being on offer this week, the highest demand attracted 1-year UAH bonds. Total bids for the issue exceeded UAH2.5bn or UAH0.5bn above an auctioned volume. Thanks to a volume cap, the ministry has managed to reduce the cut-off rate by 21bp to 10.99%.

Demand for 5-year bonds fell to UAH1.7bn from UAH4.1bn a week ago. With cut-off rate held unchanged at 12.59% and half of last week's demand remaining unsatisfied due to the volume limit at UAH2bn, the sharp decline in total take-up may signal of a cooling appetite for government bonds among foreign investors.

But the offshore purchases could resume next week following the NBU's decision to hold the key rate unchanged.

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



EUR/USD dips below 1.2000

The EUR/USD dropped below 1.2000, the level the pair was trading around in April, as the U.S. dollar extends gains across the board. **The greenback rose sharply on the back of the Fed's decisions to hold interest rates and the quantitative easing (QE) program unchanged.**

The statement by the U.S. central bank was little changed compared with the previous one. There was no mention of tapering in asset purchases. Meantime the FOMC staff projections now show more rate hikes likely for 2023 compared to March.

However, the US central bank's upward revision to economics and rate forecast triggered the market's rush to the U.S. bonds and greenback the previous day. Amid these plays, US 10-year Treasury yields jumped to 1.57% from 1.49%.

Meantime, **the Euro is under selling pressure on mixed economic data** released on Wednesday. The Hourly Labor costs rose 1.5% in 1Q21, the Trade Surplus widened five times to EUR10.9bn in April, amid a sharp recovery in the global demand, and the Eurozone Industrial Production jumped 0.8% in April, much above the market expectations at 0.4%.

Earlier, ECB Chief Christine Lagarde said that the monetary and fiscal stimulus will be continued until clear signs of a solid and sustainable economic recovery are visible.

Figure 7. EUR USD spot (mid)

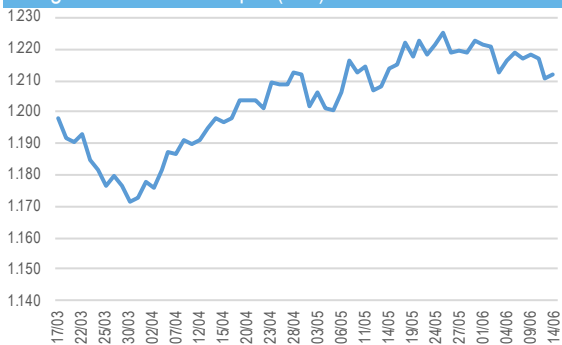
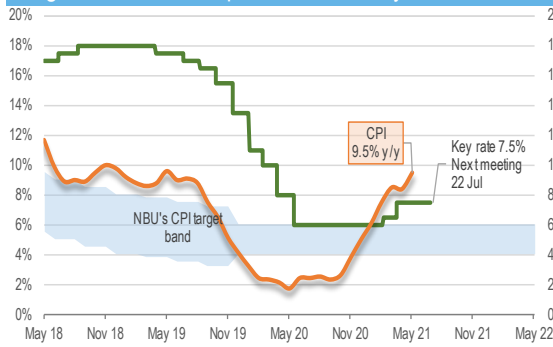


Figure 8. Consumer price index vs Key rate



NBU restrains from further policy tightening

The Ukrainian central bank has decided to hold the key rate at 7.5%, expecting inflation pressure to ease in the next 6 months and CPI growth to return into the target range in 1H22. Indeed, a high base being laid by the current price growth should contribute to inflation moderation over the next 12 months – the main objective of the central bank's policy. And prudent NBU's interventions in the FX market – mostly targeted at hot money inflow - should reinforce the impact of the acting monetary policy.

The consumer price index growth accelerated to 9.5% year-over-year in May, up from 8.4% for the year ended in April, according to the Ukrstat. Most of the increase in inflation came from a rise in food prices, which leapt 1.7% in May from April. Price increases were broad-based, but for eggs and vegetables. The food prices that jumped the most in May included fruits, up 14.5%, and sunflower oil, which climbed 6.8%.

Utility costs also picked up sharply. Prices for natural gas surged 14.6% in May compared with the prior month, resulting in a 3.6 price growth on an annual basis. Utilities accounted for about a quarter of the CPI increase.

We expect CPI inflation to peak out during the summer months driven by record harvest. As shoppers pull back on goods purchases and shift more of their spending to services following restrictions easing, food contribution – one of the major sources of current inflation - will decline. Several factors that have pushed up inflation are likely to fade in the coming months, including base effects and the impact of rising energy prices. Current UAH appreciation will also support price stability in the short run.

Figure 9. Monthly CPI growth

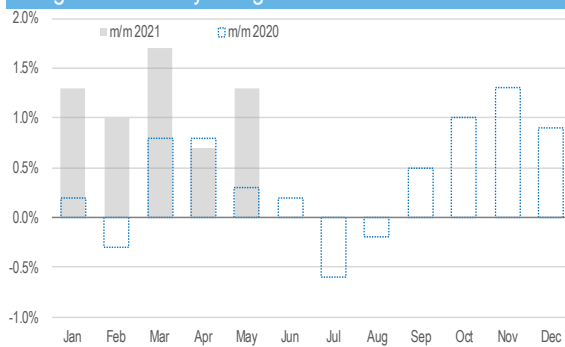
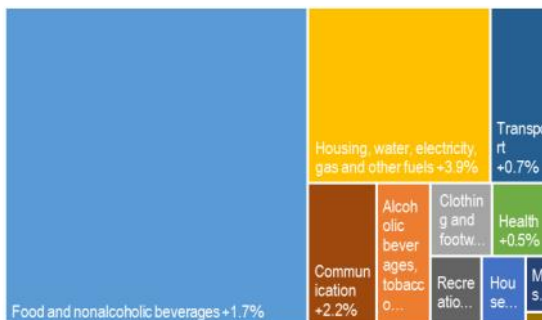


Figure 10. Contribution to monthly change in CPI

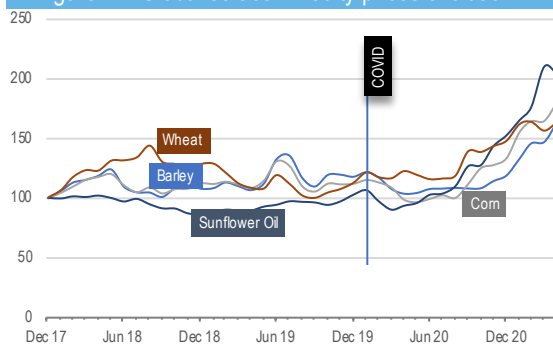


At the same time, inflation pressure will likely remain elevated. With Ukraine being an open economy, higher prices for soft commodities and energy will likely be translated into the CPI basket. Even if inflation pressure unwinds soon, fears that consumer prices could become more persistent may continue feeding up further price growth. Because of this, we upgrade our inflation forecast for 2021 and now expect a 9% price increase in 2021.

Meanwhile, we hold unchanged our forecast for the next year at 5%, keeping in mind that today's high inflation could become disinflation next year.

As higher prices flow through to more consumers, it will make it harder for the NBU to ignore them. In this environment, the NBU could be forced to keep rates higher than the initial forecast, even though it contradicts to the essential goals of the central bank, like launching mass mortgage loans, supporting growth etc.

Figure 11. Global soft commodity prices evolution



On the other hand, **the across-the-board rise in commodity prices, standing behind the acceleration, provides little room for monetary policy manoeuvres.** We expect this should curb the key rate hike above 8.5% by the end of the year.

The NBU has also decided to phase out anti-crisis monetary instruments, including long-term standing facility and interest rate swaps. This, coupled with prudent interventions in the FX market should reinforce the price impact of the acting monetary policy.

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	4 492	4 664
Nominal GDP (USD bn)	90	93	112	131	155	156	160	155
Prices								
CPI (average %YoY)	48.5	14.9	14.4	11.0	7.9	2.7	9.5	7.1
CPI (end of year %YoY)	43.3	12.4	13.7	9.8	4.1	5.0	9.0	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	8.5	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
14.06.2021	15.06.2021	16.06.2021	17.06.2021	18.06.2021	19.06.2021	20.06.2021
		LGB* % UAH 1 214.1mn LGB % UAH 2 057.8mn LGB P UAH 14 025.1mn Fed: FOMC	LGB % USD 11.5mn NBU: MPC	NBU: External Debt		FGB % EUR 67.5mn
21.06.2021	22.06.2021	23.06.2021	24.06.2021	25.06.2021	26.06.2021	27.06.2021
	Ukrstat: GDP Ukrstat: Retail trade	LGB* % UAH 655.1mn	Ukrstat: Industrial Production			
28.06.2021	29.06.2021	30.06.2021	01.07.2021	02.07.2021	03.07.2021	04.07.2021
	NBU: Minutes Ukrstat: Nominal & Real Wage	LGB* % UAH 553.0mn LGB % UAH 345.0mn LGB P UAH 4 143.7mn NBU: BoP				
05.07.2021	06.07.2021	07.07.2021	08.07.2021	09.07.2021	10.07.2021	11.07.2021
Ukrstat: Business confidence		LGB % UAH 939.1mn LGB P UAH 7 297.7mn NBU: FX Reserves (deadline - 7th day)		Ukrstat: Price indices NBU: Monetary Statistics		

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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