

ECONOMICS | INTEREST RATES STRATEGY | FX

1 July 2021

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Economy is firm on the recovery track
Fitch	B	STABLE	26.02.2021	Ukraine's GDP declined 2.2% in 1Q21. This figure mainly reflects the statistical effect of FX movements last year and we expect GDP readings to improve during the year, bringing full-year GDP growth to 4.4%. Growth is supported by strong retail sales, record performance of agriculture, and favorable export prices.
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)



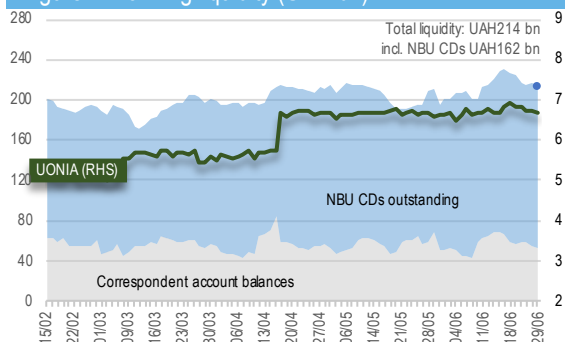
FX and interest rates:

The Ukrainian hryvnia has regained traction this week after a lumpy demand for FX left the market. The USD/UAH pair remains supported by a sustainable FX inflow and was last seen trading around the 27.28 mark.

While the nature of large-sum FX purchases seen during the preceding two weeks remains unclear, they were likely triggered by some local events, like dividends payouts, etc. Nevertheless, by the end of last week, some of those market players who performed the largest pressure on USD/UAH came out with FX sales.

So did the NBU. After seeing an upsurge in non-fundamental demand the central bank firstly stepped in with FX sales, but later on the NBU fully rebuilt its FX position by new purchases.

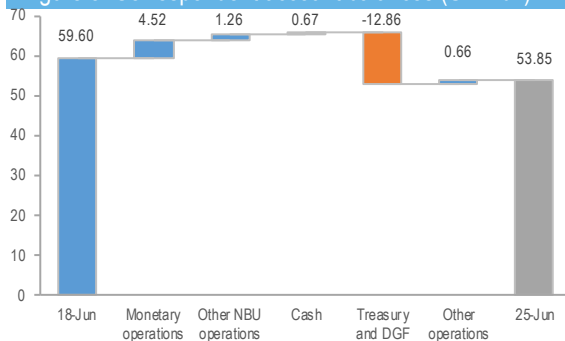
Figure 2. Banking liquidity (UAH bn)



As we previously mentioned, **a combination of factors continues pulling the USD/UAH rated down**. These are sustainable FX inflows from exporters and work migrants. And this could sustain through the end of the summer. On the other hand, recurring such untypical and sizable FX purchases as we saw before could impede the pair from diving below 27.00 level.

We revised our FX forecast for 2021-22, now expecting the USD/UAH pair to slip to 28.80 by the end of the year, with robust global demand for Ukrainian steel and iron ore exports helping smooth a typical for the local market seasonality. As for 2022, we forecast the USD/UAH rate to depreciate to 29.80.

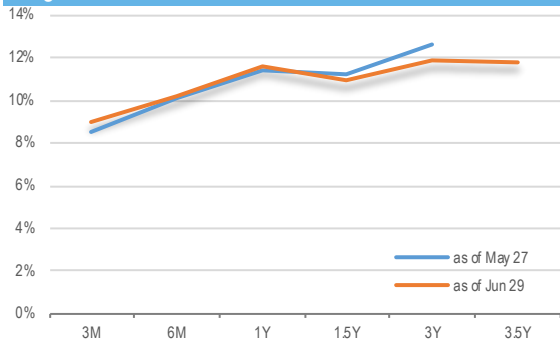
Figure 3. Correspondent account balances (UAH bn)



Banking liquidity dropped by UAH10bn in the week ending June 25, but remains well above a UAH200bn level. Balance of correspondent accounts with the NBU declined by UAH5.7bn to UAH53.9bn and position in CDs by another UAH4.3bn – to UAH162.0bn.

The decline has mostly to do with State treasury operations, draining from the system circa UAH12.9bn. Considering that the outflow peaked on Thursday (June 24), primary public debt auction is likely the major reason behind the change.

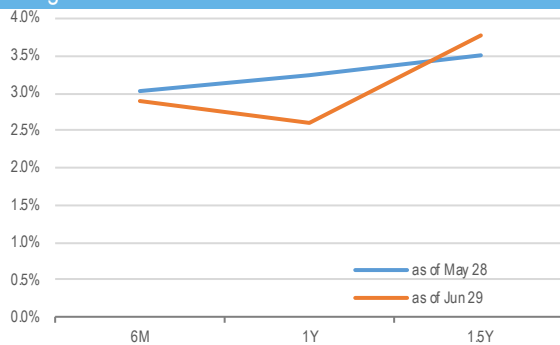
Figure 4. Local UAH bonds market



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	3M	8.50%	8.50%	8.50%	8.50%	5	5	111.34	111.34
UAH	1Y	10.99%	10.99%	10.99%	10.95%	7	7	707.14	707.14
UAH	1.5Y	11.30%	11.30%	11.30%	11.30%	9	9	201.60	201.60
UAH	2Y	12.00%	12.00%	12.00%	12.00%	15	15	472.12	472.12
UAH	3Y	12.30%	12.30%	12.30%	12.30%	7	7	80.02	80.02
UAH	5Y	12.59%	12.59%	12.59%	12.59%	5	5	548.05	548.05
UAH	6Y	12.75%	12.73%	12.75%	12.65%	11	11	368.49	368.49

Figure 5. Local USD bonds market

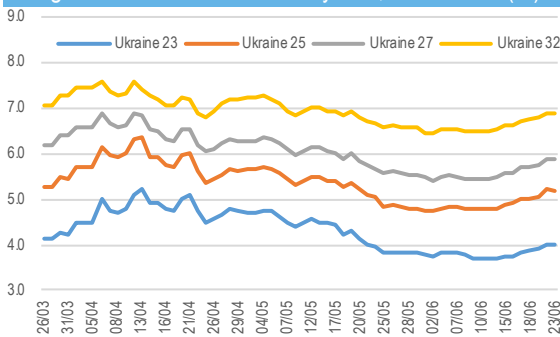


Another primary debt auction barely managed to draw market attention. While there was a wide range of UAH-denominated local bonds on offer, none of the issues received demand exceeding UAH1bn. And the total take-up was shy of UAH2.5bn.

The failing results, however, could be attributed to changes in operating procedures of the Settlement center. Though transitive, the changes cut a chunk of demand, for many market participants expressed their unwillingness to be the first to test the new system.

Luckily, an easy debt repayment schedule in the coming weeks allows time for both FinMin and market participants to make necessary adjustments.

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



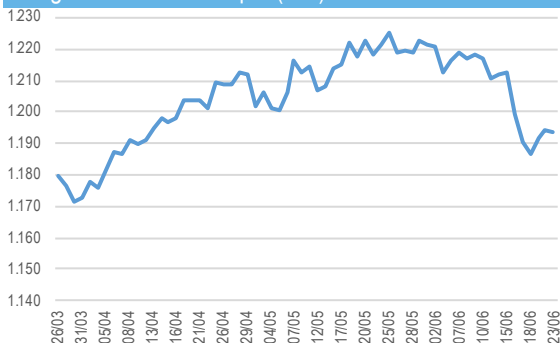
EUR/USD remains under downside pressure

The EUR/USD pair has slipped marginally below a 1.1900 barrier, with incoming news holding the euro from a rebound.

Clouds are darkening over Europe once again. Despite the Economic Sentiment Indicator improving to 117.9 in June from 114.5 in the previous month, investors remain pessimistic about the spread of the highly infectious Delta variant and its impact on the old continent's economy.

This, along with consumer prices growth remaining in line with estimates rather than falling short, could encourage the European Central Bank to maintain its dovish policy.

Figure 7. EUR USD spot (mid)

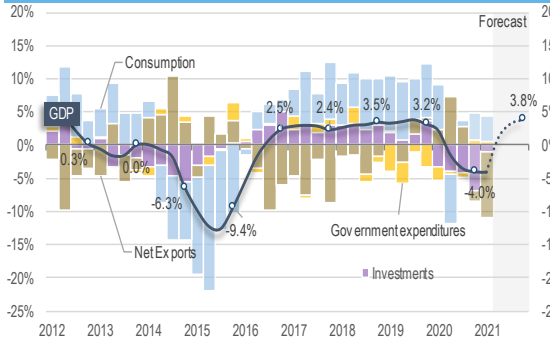


In turn, **the greenback gained substantial ground in June.** The dollar moved alongside U.S. government bond yields. The yield on the benchmark 10-year Treasury note peaked recently at 1.51% but trimmed some gains later on as investors shifted their focus on two key pieces of employment data due to be released this week.

Investors will be keeping a close eye on jobs data, to see if any significant changes prompt the Federal Reserve to consider tightening monetary policy sooner than expected.

That said, taking into account preceding upbeat U.S. figures, portfolio managers seem to be in no rush to unwind their positions in government bonds.

Figure 8. GDP growth by expenditure, y/y

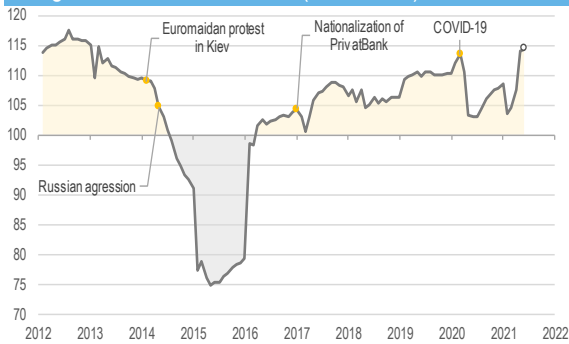


Economy is firm on the recovery track

Ukraine's GDP declined 2.2% in 1Q21. This figure mainly reflects the statistical effect of FX movements last year and we expect GDP readings to improve during the year, bringing full-year GDP growth to 4.4%. Growth is supported by strong retail sales, record performance of agriculture, and favorable export prices.

Ukraine's gross domestic product fell 2.2% in the first quarter, according to Ukrstat. **The biggest drag on the economy was the foreign balance of trade.** Most of the decline, however, reflects currency shock brought about by the coronavirus pandemic back in May 2020, when the Ukrainian hryvnia instantly lost 14% of its value against the U.S. dollar. This resulted in exports expressed in UAH tumbling 17.4% in 1Q21 compared with 1Q20 while imports were up 3.7% year-over-year.

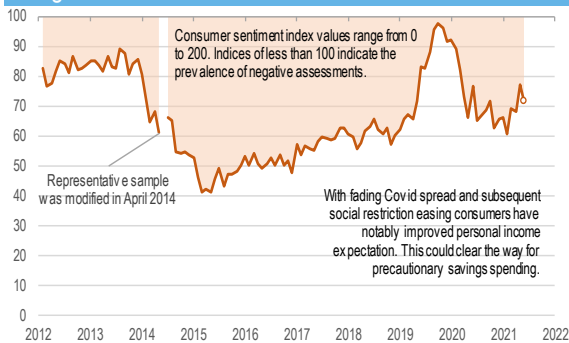
Figure 9. Retail trade index (cumulative)



Expressed in U.S. dollars **NBU statistics on BoP shows, however, that deficit in external trade of goods and services narrowed** by USD367mn, with export growth being driven by supportive prices for soft and bulk commodities strongly outpacing majorly energy-led pick-up in imports.

Even though the first quarter saw reimposed for several weeks lockdowns, **consumer expenditures, which comprise most of total GDP, increased by 4.4% in the quarter.** As we expressed in our weekly report of February 17, the recovery was backstopped by a sustainable demand for goods and food, as well as by rising energy bills amid an untypically cold winter.

Figure 10. Consumer sentiment index

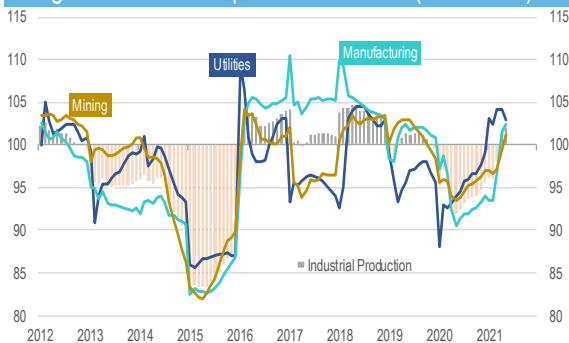


The only negative contributor to the GDP – but for the foregoing controversial picture in the foreign balance of trade – were fixed investments. Because businesses remained frightened by the Covid outbreak and were bracing for a prolonged pandemic crisis following another wave of daily infections, gross fixed capital formation declined by 7.8% year-over-year.

We expect retail sales to continue rising during the summer quarter, though at a slower pace than earlier in the Covid-19 outbreak. With daily cases declining to below 500 after topping 20000 in early April, consumer spending is likely to again focus on services and tourism in particular.

As shoppers trim expenditures on goods and food and switch their interest on services, this could also have a positive side effect on inflation, because services are less represented in the consumer price index.

Figure 11. Industrial production indices (cumulative)



Developments in industrial production also look promising. The cumulative IP index for January-May advanced 2.2% compared to the corresponding period of 2020. The slowdown in utilities resulted from a pullback in electricity and gas consumption amid global energy prices rebound from multi-year lows in 2020 to multi-year highs in 2021.

Meantime, the cumulative indices for manufacturing and mining rose 2.5% and 1.2% respectively. In spite of some price fluctuations recently in commodities representing Ukraine's key exports, sustainable global demand for these goods and former price gains heralds for industrial production coming out of 2021 much stronger than before the pandemic.

We confirm our expectations of 4.4% economic expansion in 2021 followed by 3.5% growth in 2022. The major risks to our forecasts are prolonged stagnation in construction against booming demand for commodities and industrial metals, in particular, remaining uncertainty about another wave of Covid outbreak in autumn, and fresh currency fluctuations amid a tense situation in the Ukraine-Russia borders.

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	161	164
Prices								
CPI (average %YoY)	48.5	14.9	14.4	11.0	7.9	2.7	9.2	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	-2.0
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	28.8	29.8
Exchange rate (EUR/UAH) end of year	26.2	28.4	33.5	31.7	26.4	34.7	35.1	37.0

*estimates, no official data yet available



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UKRAINIAN CAPITAL MARKETS WEEKLY

FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
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		
12.07.2021	13.07.2021	14.07.2021	15.07.2021	16.07.2021	17.07.2021	18.07.2021
		LGB* % UAH 223.7mn				
19.07.2021	20.07.2021	21.07.2021	22.07.2021	23.07.2021	24.07.2021	25.07.2021
	Ukrstat: Retail trade	LGB* % UAH 462.1mn LGB % UAH 751.7mn LGB P UAH 15 610.9mn	NBU: MPC Ukrstat: Industrial Production 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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