



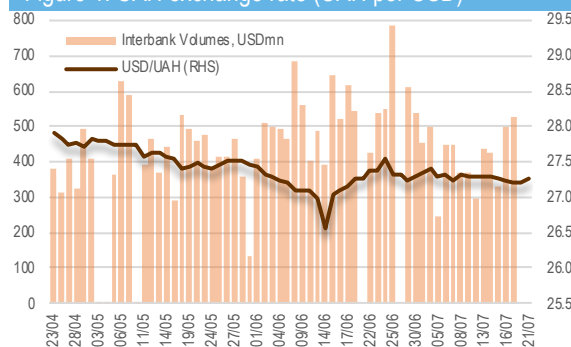
**ECONOMICS | INTEREST RATES STRATEGY | FX**

22 July 2021

**UKRAINIAN  
CAPITAL MARKETS  
WEEKLY**

	Rating	Outlook	Last update	This week in focus: Running hot inflation triggers another rate hike
Fitch	B	STABLE	26.02.2021	The NBU has increased its key rate to 8.0%. While medium-term inflation expectations have anchored around 6%, short-term price pressure could push CPI into double digits area. At the same time, the NBU is likely to concentrate on delivering on its 5% ± 1pp target in 2022. Unless volatility on global financial markets rises, this might be the last policy action this year.
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 trends water around 27.30

**USD/UAH remains sidelined around 27.30 for a third consecutive week.** While trades are brisk, which is untypical for the summer season - sustainable FX supply effectively meets market demand.

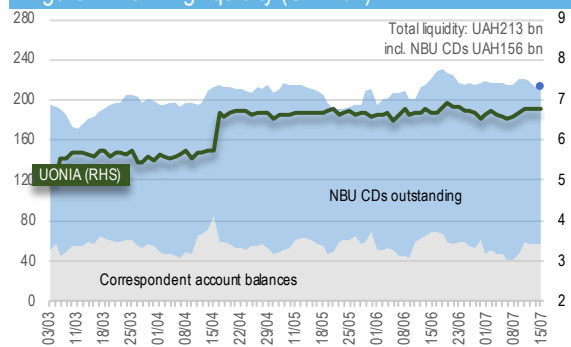
With iron ore and steel trading at record high price levels on the global markets, steel producers and iron ore exporters serve as the major source of fresh FX. Other market players adjust to the trend, adding to the total supply.

**Another easing of FX regulation, which become effective on July 20, has had little effect on trades so far.** According to the NBU decision, Ukrainian companies are now allowed to purchase up to EUR100th per day without documentary support of reasons or underlying commitments. Moreover, a 10-days rule, requiring to utilize funds within the period, is no more applicable under such a purchase.

There is, however, a number of blind spots in procedures the new rules have to be implemented. Therefore, the real effect of the action may appear a few weeks later.

**The NBU has also announced today cutting daily FX purchases on the interbank market to USD5mn from USD20mn.** This, coupled with lifting upper rate bound for quantitative tenders to key rate + 1pp from 0.5pp, could improve supply/demand balance on the market.

Figure 2. Banking liquidity (UAH bn)



**Banking liquidity remains above a UAH200bn level.** Amount of funds on banks' correspondent accounts with the NBU increased by UAH9.6bn to UAH57.2bn over the last week, position in central bank's CDs declined by UAH16.4bn – to UAH155.8bn.

Demand for paper money recovers. Total cash outstanding increased by UAH3bn in the last week and by UAH11.2bn since beginning of July. The intensified withdrawals could be related to summer vacations.

Another key rate hike could speed up return of cash back into system in 3Q21.

State treasury operations drained another UAH4.4bn during the last week. Because the major outflow occurred on Wednesday (July 14), primary debt auctions, which took place a day before, apparently were the cause of liquidity drain.

Figure 3. Correspondent account balances (UAH bn)

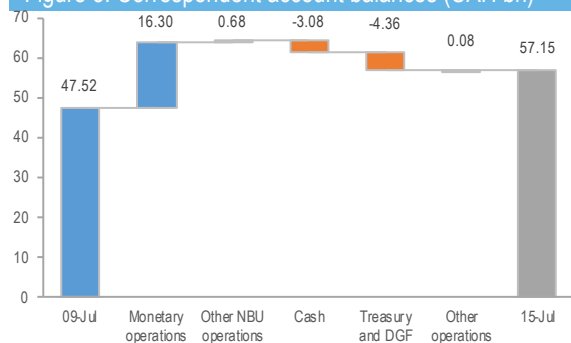


Figure 4. Local UAH bonds market

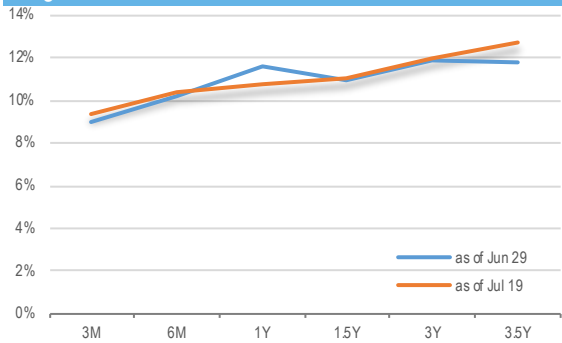
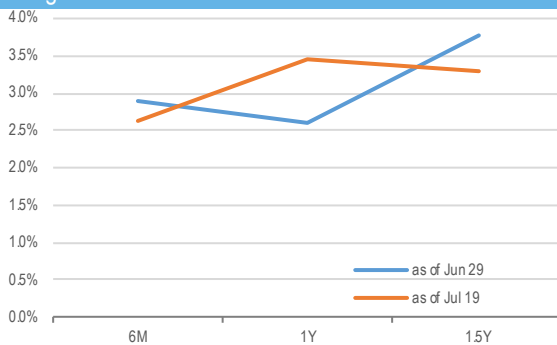


Figure 5. Local USD bonds market



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%	10.99%	10.99%	10.95%	28	28	1 926.74	1 926.74
UAH	1.5Y	11.30%	11.30%	11.30%	11.30%	9	9	142.41	142.41
UAH	2Y	12.09%	12.09%	12.09%	12.09%	11	11	5 369.85	5 369.85
UAH	3Y	12.30%	12.30%	12.30%	12.30%	9	9	18.03	18.03
UAH	5Y	12.59%	12.59%	12.59%	12.59%	5	5	16.38	16.38
EUR	1Y	2.50%	2.50%	2.70%	2.50%	18	17	8.29	8.14

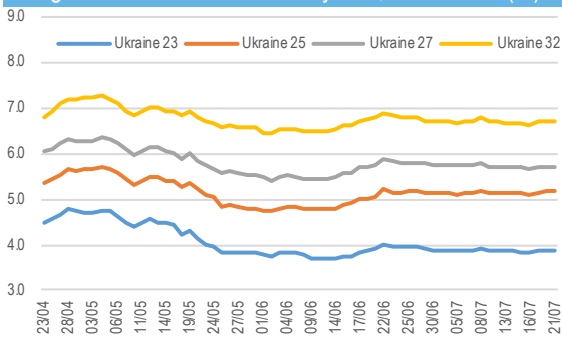
**FinMin again experiences weak demand for its debt.** The ministry attracted UAH7.75bn at primary debt auctions this Tuesday (July 20). It is more than twice as low as amount coming due this week.

Out of the range of instruments being in offer, the highest demand was seen for 2-year UAH bonds followed by 1.5-year securities in UAH. The rest of bonds in offer barely drew attention.

Worth also pointing out, that despite a number of applications, many issues were priced at a single level, with weighted accepted rate being equal to maximum and minimum bid rate. This also could indicate of market weakness.

A reason for the low activity might be a reluctance among market participants to increase the take-up of government bonds before the today's key rate decision. But a slow progress in talks with the IMF could weighing on market's mood too.

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



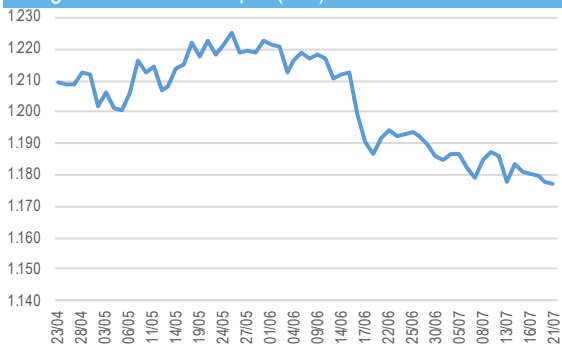
EUR/USD extends decline below 1.1800

**The EUR/USD has broken below another key barrier of 1.1800** and threatens with extra losses in the short-term horizon. The pair was last seen around 1.1780 mark as the U.S. dollar takes a breather from recent gains.

**The greenback appreciation below the 1.1800 followed the latest FOMC gathering**, when the Committee opened the door to tapering the quantitative easing (QE) program sooner than anticipated.

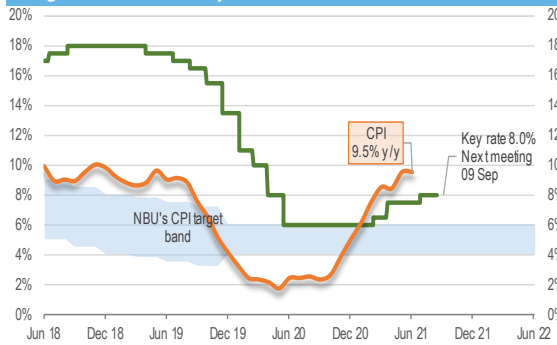
Besides, concerns about the economic fallout from the spread of the highly contagious Delta variant of the coronavirus continued weighing on investors' sentiment. This benefitted both the U.S. dollar's and U.S. Treasuries' relative safe-haven status. The yield on the benchmark 10-year Treasury fell to 1.27% by July 21 from 1.48% early this month.

Figure 7. EUR USD spot (mid)



**Unlike USD, concerns about future developments surrounding the coronavirus spread weigh on the euro.** The ECB is set to respond to rising coronavirus cases and their impact on Europe's recovery, which could push the euro further down.

Figure 8. CPI vs Key rate evolution

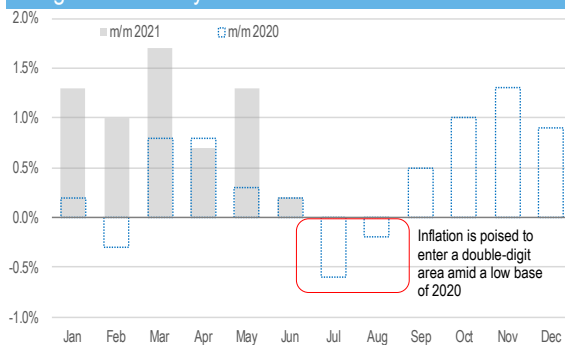


Running hot inflation triggers another rate hike

**Ukraine's central bank has increased its key interest rate to 8.0%** on Thursday, displaying the third hike this year in response to growing inflation pressures. While medium-term inflation expectations have anchored around 6%, short-term price pressure is likely to push CPI into double digits area and thus require a policy response. At the same time, the NBU is likely to concentrate on delivering on its 5% ± 1pp target in 2022, so unless the volatility in global financial markets increases, this might be the last policy action this year.

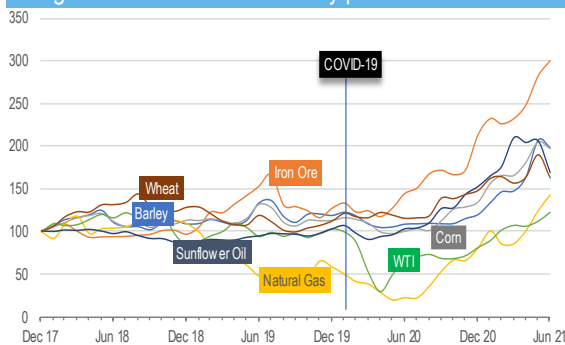
While remained unchanged at 9.5% on a year-over-year basis in June, the **CPI growth has come in above consensus expectations over the last few months**. The nature of inflation remains cost-driven, fuelled by surging food, commodity, and energy prices. Global commodity market keep experiencing demand boom, unfolding global inflation. The price movements were also significant in finished goods, with China experiencing a shortage of production capacities, inputs, but also significant logistics difficulties amid global demand for consumer goods exceeded all expectations. While price growth in soft commodities seems to be nearing the end of its rally, rise in energy prices has some further room to go, even though recent data on spread of Delta variant of COVID cast doubts on recovery of tourism.

Figure 9. Monthly inflation



**Demand-side pressures in Ukraine will also likely to be elevated provided some unwinding of precautionary savings and considering exceptionally strong growth in salaries and entrepreneurial incomes.** In nominal terms, average salary demonstrated 28.1% y/y growth in May, while in real terms it increased by 16.8% y/y. Having said this, we expect Ukraine's CPI to go into double-digit area in 3Q, before consolidating near 9% y/y by the end of 2021.

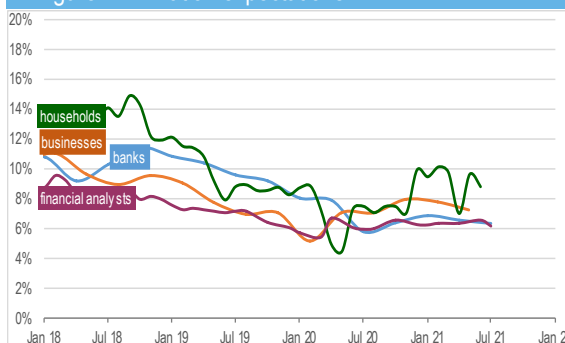
Figure 10. Selective commodity price indices



**Local currency struggles to slow inflation in 3Q.** We expect UAH exchange rate appreciation to reverse in the coming months, following seasonal patterns rather than price action in financial instruments (e.g. international accounts aggressively buying Ukraine government bonds in 2019).

Overall we expect that FX rate will have a muted impact on 2021 inflation (at least until 4Q). With Ukraine continuing enjoying high export prices and minimum outlays for tourism services amid still worrisome epidemic situation worldwide, the FX market is likely to remain roughly balanced.

Figure 11. Inflation expectations



However, in case of IMF deal later this year and simultaneously favourable capital markets, one could expect UAH strengthening in 4Q driven by fresh non-resident flows and improvement in country's financial account.

**We assume expectations of IMF deal accelerated the policy action.** Ukrainian authorities have recently step up activity towards securing one more tranche under the IMF supported program, and therefore it could be logical to react more proactively to accelerated inflation to deliver on the Fund's usual policy agenda. The most notable action was the recent approval of laws strengthening the country's judicial system. Although the Fund has said aftermath that it is not enough to get a staff level agreement (SLA), the movement still could signal about the authorities' strong desire to receive one more tranche before the program expires in December this year. With recent news of President Volodymyr Zelensky meeting with US President Joe Biden on August 30th, the probability of SLA being concluded in September-October (in course of current program or even within the new program) sharply increases.

Following the today's MPC meeting, the NBU sees this year's terminal rate at 8.5%, in line with our forecast (see report of July 17). Yet, provided deal with the IMF get a green light, which should also unlock access to other official financing, the central bank could restrain from further policy tightening.

# 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	4 492	4 664
Nominal GDP (USD bn)	90	93	112	131	155	156	161	164
<b>Prices</b>								
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
<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	-2.0
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
<b>Interest and exchange rates</b>								
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
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 1 337.7mn LGB P UAH 15 610.9mn	NBU: MPC Ukrstat: Industrial Production ECB: MPC			
26.07.2021	27.07.2021	28.07.2021	29.07.2021	30.07.2021	31.07.2021	01.08.2021
		LGB % UAH 87.8mn LGB* % UAH 637.7mn LGB* P UAH 1 170.9mn Ukrstat: Nominal & Real Wage Fed: FOMC	LGB % USD 9.6mn LGB P USD 349.7mn NBU: Cost of Real Sector External Debt	NBU: BoP		IMF SDR 45.1mn FGB % USD 33.7mn
02.08.2021	03.08.2021	04.08.2021	05.08.2021	06.08.2021	07.08.2021	08.08.2021
NBU: Minutes		IMF SDR 98.5mn LGB* % UAH 700.3mn LGB % UAH 1 279.2mn	LGB % USD 13.0mn	Ukrstat: Business confidence	NBU: FX Reserves (deadline - 7th day)	
09.08.2021	10.08.2021	11.08.2021	12.08.2021	13.08.2021	14.08.2021	15.08.2021
Ukrstat: Price indices	NBU: Monetary Statistics	LGB* % UAH 448.0mn LGB % UAH 892.2mn LGB P UAH 11 153.0mn				

## 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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