

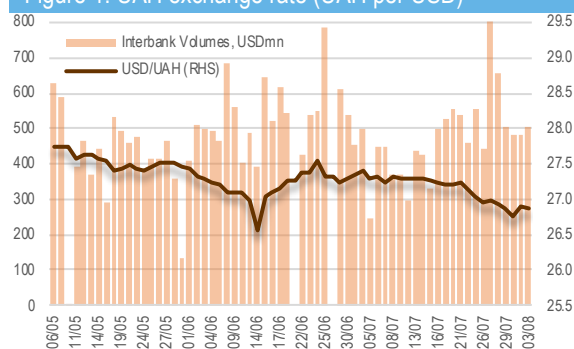
ECONOMICS | INTEREST RATES STRATEGY | FX

5 August 2021

# UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Better prospects for UAH despite growing imports
Fitch	B	STABLE	26.02.2021	Ukraine's 12M rolling CA remained in the positive territory in 1H21, reaching USD1.55bn. But with energy and machinery imports gaining momentum and tourism recovering, we believe CA will continue to deteriorate. However, one-off disbursement of SDR by the IMF, coupled with financing from official sources and from the global debt market, is likely to support the local currency.
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)



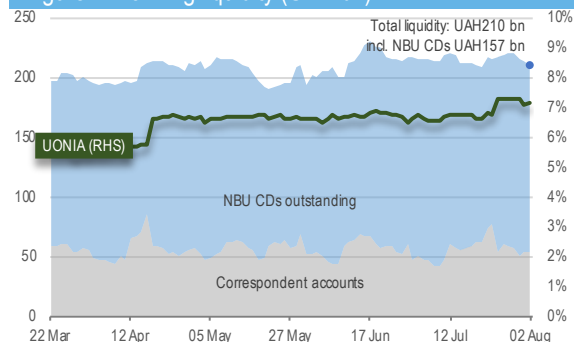
FX and interest rates: USD/UAH dips below 27:00 mark

**The Ukrainian hryvnia has witnessed supportive pressure against the U.S. dollar since the last policy rate hike on July 22**, driving the currency pair below another key barrier of 27:00. The USD/UAH rate was last seen trading in the mid-26.90s, with FX supply slightly exceeding sustainable demand.

In contrast to our expectations, the support came from state-owned enterprises, flooding the market with fresh FX during last week. The nature and sustainability of such flows remain unclear. The massive supply sparked FX sales by other market participants, giving the pair lingering inertial traction.

FX inflow from foreign accounts, despite our modest expectations, was barely notable and has even reversed in the last few days. This could result from a summer lullaby at foreign capital markets, as well as from limited government's need for new debts amid rising tax revenues.

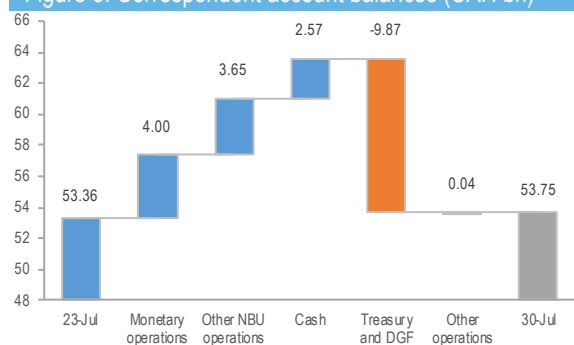
Figure 2. Banking liquidity (UAH bn)



**Supported by sustainable export revenues inflow, the USD/UAH pair holds the strength to remain below the 27:00 level through the end of August.** And increasing certainty among market participants in resumed cooperation with the IMF after the recent phone conversation between the head of the Fund and the president of Ukraine could boost FX supply and hence help smooth typical for the end of summer hryvnia depreciation.

**We improved our year-end forecast USD/UAH to 28.0** (see details below), but held 3Q forecast unchanged, hedging our expectations against a hard-to-foresee impact of the state-related entities on the market. With the resurging Covid spread across the world, we assume the government could produce occasional lump-sum FX purchases to finance the vaccination campaign. And because of a low understanding of how big such demand might be, the effect of such purchases could be magnified with speculative trades.

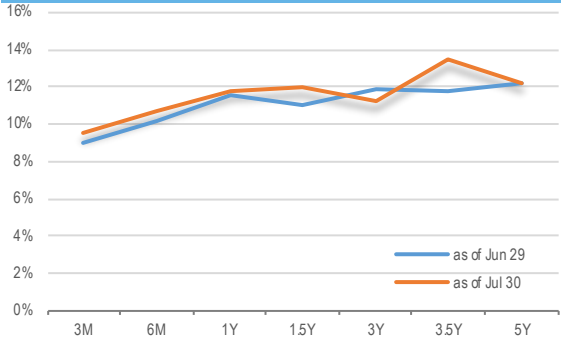
Figure 3. Correspondent account balances (UAH bn)



**Banking liquidity declined by 1.6% to UAH214.2bn** in the week ending 30 July. Though little changed, banks' correspondent accounts with the NBU saw a UAH9.9bn outflow to the State treasury account. And considering a weak primary debt auction in the reporting week, the foregoing FX sales by state-owned enterprises could precede funds reallocation.

NBU FX interventions, which absorbed some of the inflow, helped build up liquidity balance by UAH3.65bn. Another UAH2.6bn returned into the system via a cash channel.

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	1Y	11.15%	11.15%	11.15%	11.10%	27	27	1 479.19	1 479.19
UAH	1.5Y	11.30%	11.30%	-	-	11	11	42.12	42.12
UAH	2Y	12.09%	12.09%	12.09%	12.09%	12	12	125.23	125.23
UAH	3Y	12.30%	12.30%	12.30%	12.30%	9	9	150.08	150.08
UAH	5Y	12.59%	12.59%	12.59%	12.59%	4	4	16.80	16.80

**Another round of the government's debt auctions received a cool reception.** Nevertheless, FinMin keeps holding its head up proudly.

Out of bonds auctioned this week, the highest demand drew 1-year securities. But the issue attracted just UAH1.47bn of bids for a sale of UAH3bn. Normally, such auctions of government debt are oversubscribed.

The other issues barely drew attention.

There are, however, reasons not to treat such slim results as a failure. Firstly, the government has a sustainable revenue inflow. With all the efforts put to have the IMF program back on track and the benefits, it can bring, the ministry can afford not to yield in price to draw fresh money.

Secondly, in the last two weeks FinMin had an easy debt repayment schedule, implying low rollover demand. The next sizable payout comes next week – some UAH12bn to be repaid. In spite of the recent key rate hike, FinMin is likely to hold rates unchanged, trying to push rollover demand as much as possible towards the long end of the curve.

Figure 5. Local USD bonds market

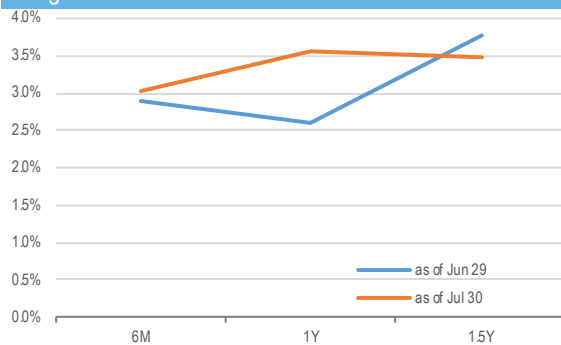
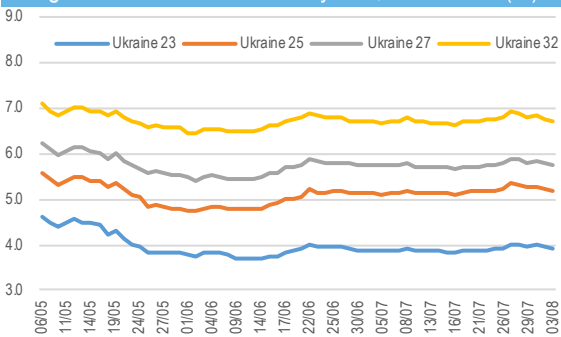


Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



EUR/USD swings around mid-1.1800s as Fed fights over hawks or doves

**The EUR/USD pair has been moving around mid-1.1800s since the beginning of August,** as speculation and concern have been mounting over talk of tapering and penciling in earlier than expected interest rate rises by The Federal Reserve.

Firstly, firming market expectations that the Fed will stick to its ultra-loose monetary policy stance for a longer period continued acting as a headwind for the greenback, pushing it towards the 1.1900 level against the euro.

Later on, Fed vice-chair Richard Clarida took a more hawkish turn and signalled a move to taper bond buying later this year or early 2022, adding that risks to his inflation outlook are to the upside. Moreover, he was joined by Mary Daly, president of the San Francisco Fed, who is usually a dove. That has been supporting the dollar, rebounding below 1.1850 against the euro on Thursday.

**But the euro appears staying firmly on the ground.** The latest macro statistics from the old continent proved to be better than early estimates, showing robust growth prospects.

Besides, Europe has an advantage when it comes to coronavirus – the EU vaccination rate has more than caught up with America. Falling cases in Spain already point to an earlier exit from the current Delta variant-induced wave.

The yield on the benchmark 10-year Treasury note slipped to 1.19% from 1.27% over the last two weeks.

Figure 7. EUR USD spot (mid)

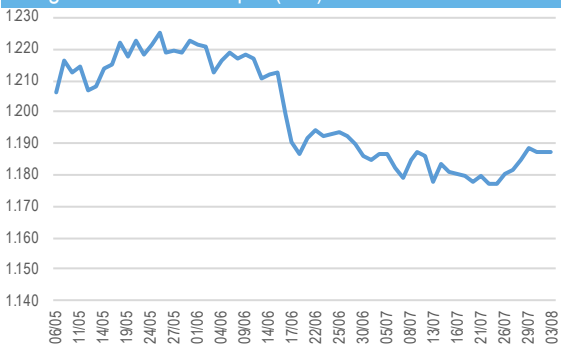
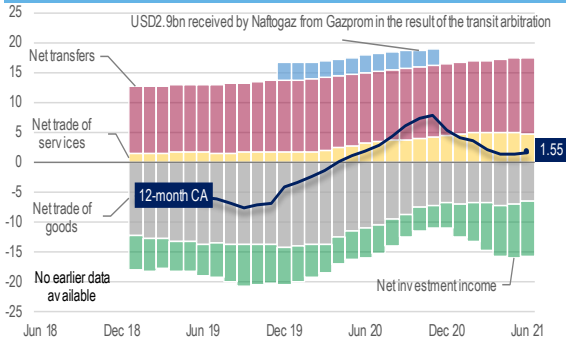


Figure 8. Current account evolution, USDbn

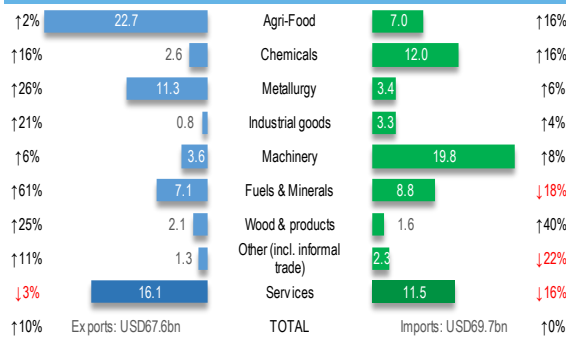
Better prospects for UAH despite growing imports



Ukraine's 12M rolling current account remained in the positive territory in 1H21, reaching USD1.55bn. This compares to the peak value of USD7.2bn seen in October 2020. With energy and machinery imports gaining momentum and tourism recovering (import of services), we believe the current account will continue to deteriorate. However, one-off disbursement of SDR by the IMF, coupled with financing from official sources and from the global debt market, is likely to support the local currency. There are growing expectations that NBU will deliver another 50bp key rate hike at September's MPC meeting and remove some of the temporary measures introduced last year to support liquidity. With this in mind, we upgrade our end-year FX rate expectations to 28.0 from 28.8, while remaining conservative on 2022.

Figure 9. Exports/Imports breakdown, USDbn

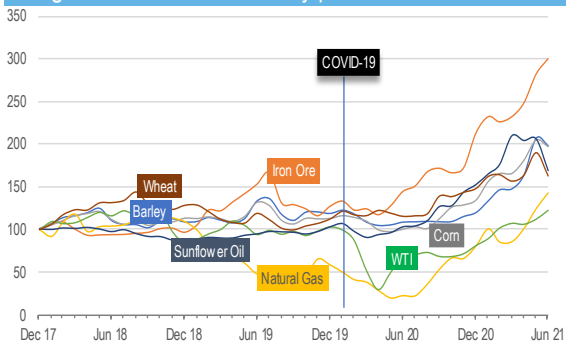
Ukraine continues enjoying hot demand for steel and iron ore on the global markets (see the report of May 20). Although iron ore prices have shed some of their gains since mid-July, we still see opportunities for iron ore foreign sales, combined with steel exports, to reach USD20bn in 2021, up 45% from the preceding year.



The recent plunge in iron ore prices followed the Chinese government's statement, expressing mounting concerns over soaring commodity prices. The resurging Covid spread across the world, which could impinge on the prospects of a global economic rebound, as well as speculations about China's likely cut in steel output to meet its carbon emissions goal, has added further fuel to prices.

Figure 10. Global commodity prices indices

But, demand for iron ore remains high as metals are vital to the global recovery from the pandemic, and supply constraints are still there. This should impede swift losing of the remaining 15% of the price gain since the beginning of the year. Besides, there will be some time lag related to contractual obligations before current prices start squeezing sales margin.

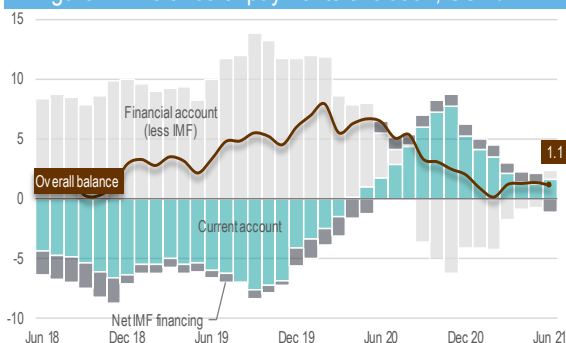


Strong agricultural output will also support exports and FX revenues in 2H21. Agri-food exports regained positive momentum in June, with 12-month rolling revenue increased by 2%.

Ministry of Agrarian Policy and Food expects favourable weather could help Ukraine to harvest at least 70mn tonnes of grain this year, versus 65mn tonnes in 2020. With global prices for grains remaining elevated amid slowing exports from Russia, agri-food exports could come close to USD24bn this year.

Figure 11. Balance of payments evolution, USDbn

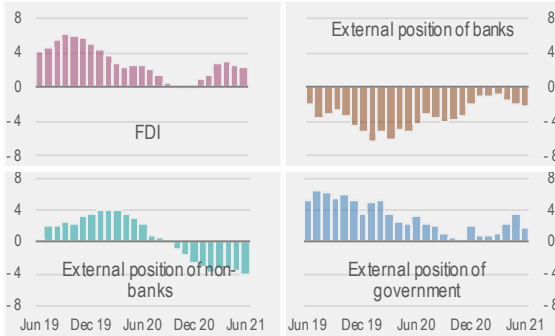
Import is gaining momentum. While remaining solid prices for steel are welcomed on the side of exports, they also affect costs of machinery - the largest item of imports. Machinery and equipment imports have reached 9.7bn in 1H21, up 32.8% on the corresponding period of 2020, and could exceed USD20bn through the end of the year. Yet, this may have positive long-run implications as the upswing mostly relates to increased purchases of production and capital equipment amid improved business confidence, according to the NBU. In particular, imports of commercial vehicles beats record due to demand from road construction sector.



The expected in 2H21 increase in the trade deficit will also come amid rising imports of fuels. Remaining elevated global oil prices have already pushed up the cost of importing fuel. The pressure is expected to ease in 4Q21 as the low base effect will come off. But with the beginning of the harvesting campaign, which will be followed by a heating season, energy imports are likely to remain high till the end of the year.

Figure 12. Financial account breakdown, USDbn

Better prospects for UAH despite growing imports

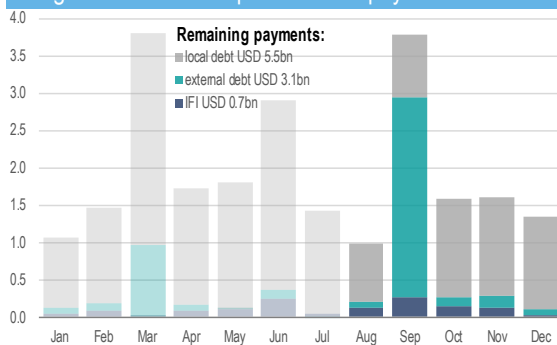


**Strong increase in remittances competes with rising income repatriations.** Money transfers by working migrants have reached USD12.6 in the 12 months to June. With a 12% pick up since the beginning of the year, work remittances flow could reach a record high of USD13bn in 2021.

This, however, will likely not preserve CA from slipping into deficit by the end of the year, along with recovering imports driven by deeply negative investment income. The deficit has swelled over the 12-months to end-June to its widest since detailed records began in Jan 2018. While some of the outflows could return to the country via fresh FDI – so-called round-trip investments - the figure also represents lavish dividend payments to foreign direct investors.

Figure 13. Ukraine's public debt repayment in 2021

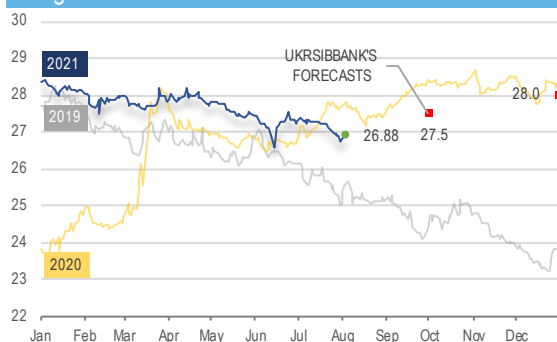
**"Greenlight" from the IMF.** Ukraine is about replenishing its FX reserves by USD2.7bn. The money to be received from the IMF under a recently approved general allocation of Special Drawing Rights (SDRs) equivalent to USD650bn for 190 member-nation countries will arrive on August 23, right before another significant foreign public debt payment.



Out of USD3.8bn of public debt payable in August-December, payouts coming due in September amount to USD3.0bn in total, including redemption of two issues of Eurobonds worth circa USD1bn each.

Besides the foregoing unconditional disbursement, Ukraine is seeking to receive some USD700mn of macro-financial assistance under the IMF-backed stand-by agreement (SBA). The authorities have by far stepped up their efforts to secure one more financial tranche before the program expires late in the year. IMF chief comments on "very constructive" phone call with Zelensky could herald a positive outcome in the aftermath of Fund's mission visit to Kyiv in September.

Figure 14. USD/UAH evolution



Although symbolic in amount, another financial tranche under SBA will unlock disbursement of EUR600mn from EU under macro-financial assistance program, which is conditional on the country's progress in cooperation with the IMF.

Moreover, this should clear the way for the government and later on to quasi-sovereign and corporate issuers to the global debt market. With improved sustainability of its FX position and relatively easy 2032 year, Ukraine could attempt to tap into the market with an 11-year issue. Otherwise, the county still has room to load 2030 year with roughly USD1bn worth issue.

**FX windfall increases downside risk to our USD/UAH forecast.** According to the NBU estimates, Ukrainian commercial entities are to pay USD1.8bn in 3Q and USD4.0bn in 4Q. The bulk of the debt comprises credits and internal loans. Assuming most of them are represented by trade financing, barely USD0.5bn will remain not refinanced or prolonged. If this is the case, Ukraine's financial account is prone to end the year firmly in surplus.

We also factor in the growing chance of another key rate hike at the next MPC meeting scheduled on September 9. The NBU is expected will also announce at the meeting termination of temporary measures introduced last year to support UAH liquidity shortages in time of the pandemic. Among such measures are long-term refinancing and interest rate swaps. With this in mind, **we upgrade our end-year FX rate expectations to 28.0 from 28.8.**

Yet, we keep closely watching the evolution of Covid spread in the country. Resurged daily infections will likely bring about new expenditures on vaccines, which could notably drain the country's FX stocks.

# 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	28.0	29.8
Exchange rate (EUR/UAH) end of year	26.2	28.4	33.5	31.7	26.4	34.7	33.3	36.1

\*estimates, no official data yet available



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# UKRAINIAN CAPITAL MARKETS WEEKLY

## FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
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				
16.08.2021	17.08.2021	18.08.2021	19.08.2021	20.08.2021	21.08.2021	22.08.2021
Ukrstat: GDP flash estimate		LGB* % UAH 377.0mn LGB* P UAH 2 500.0mn LGB % UAH 595.5mn	LGB % EUR 4.4mn	Ukrstat: Retail trade		
23.08.2021	24.08.2021	25.08.2021	26.08.2021	27.08.2021	28.08.2021	29.08.2021
		LGB* % UAH 590.4mn LGB % UAH 1 048.2mn LGB* P UAH 1 000.0mn Ukrstat: Industrial Production		LGB % UAH 48.9mn Ukrstat: Nominal & Real Wage		

## 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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