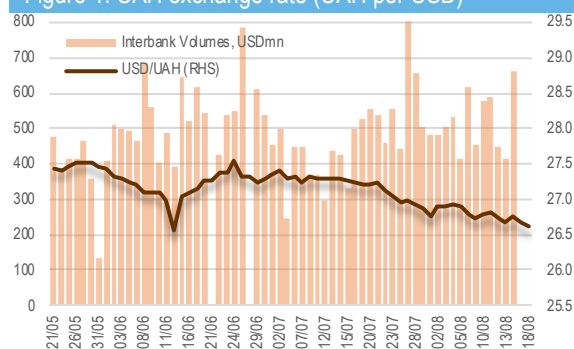


	Rating	Outlook	Last update	This week in focus: Inflation goes into double-digits
Fitch	B	POSITIVE	06.08.2021	Consumer prices in Ukraine increased by the most in nearly 3 years in July, in annual terms. The base effect factor could keep the CPI index going up through the end of 3Q, pushing the NBU to deliver another rate hike as soon as at September's MPC meeting. However, it is likely to reverse in 4Q21, when the effect of the global energy prices recovery starts waning.
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)



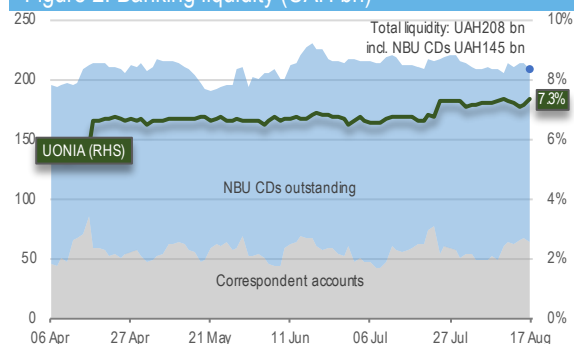
FX and interest rates: UAH on track to test 26.60 resistance against USD

**The buying tone surrounding the Ukrainian hryvnia keeps USD/UAH edgy.** After breaking below the key barrier of 27.00 in July, the pair continues making its way towards another resistance level of 26.60. On Wednesday the USD/UAH is trading at 26.64, down 0.15% on the day.

A continuous inflow of FX, covering not only market needs but also purchases by the NBU, could result from recent monetary policy tightening. With narrowed hryvnia liquidity supply and increased cost of short-term financing in local currency, exporters could turn to burning their FX revenues. This from time to time is supplemented by FX inflow from work migrants and the IT sector.

Expectations of hefty financial aid from the IMF, which is likely to be followed by one more tranche under the SBA program and FX financing from other sources, including commercial borrowings, added to the bearish bias.

Figure 2. Banking liquidity (UAH bn)

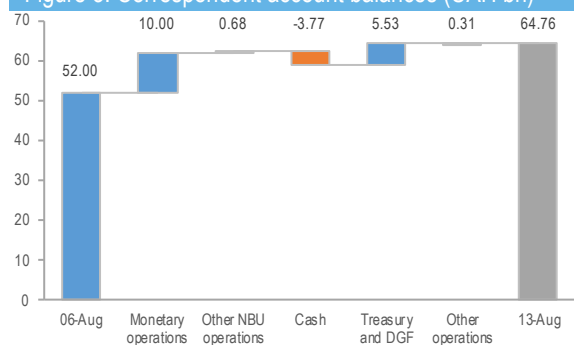


Last week the NBU absorbed some USD25mn and at least four times as much since Monday (August 16) according to early data. But interventions helped only slow the rate decline. The downtrend in the USD/UAH remains in place.

**We expect the pair could approach another resistance level of 26.60** in the coming days, remaining slightly above this mark through the end of August. Meantime we consider it highly doubtful for the rate to go deeply below mid-26.50s - the lowest since the pandemic onset.

**Banking liquidity increased by 2.2% to UAH213.6bn** in the week ending August 13. As of that date, the balance of correspondent accounts stood at UAH64.8bn, up UAH12.8bn from the week earlier, while banks' position in CDs contracted by UAH8.1bn to UAH148.8bn.

Figure 3. Correspondent account balances (UAH bn)



Several banks drew UAH1.86bn of refinancing from the NBU. Together with remaining above 7% interbank overnight interest rate (UONIA), this could point at a persistent demand for the UAH liquidity, presumably coming from agricultural companies, which are running a harvesting season.

Worth also pointing out the remaining high demand for the paper money. Though half the amount withdrawn during untypical 2020 year, when both the pandemic and the tightened money transfer rules prompted build up of cash balances, it is much above the demand seen all the preceding years since 2017, the earliest available record. Total cash outstanding has risen by UAH40bn since the beginning of 2021, reaching UAH598bn or 14.3% of GDP.

Figure 4. Local UAH bonds market

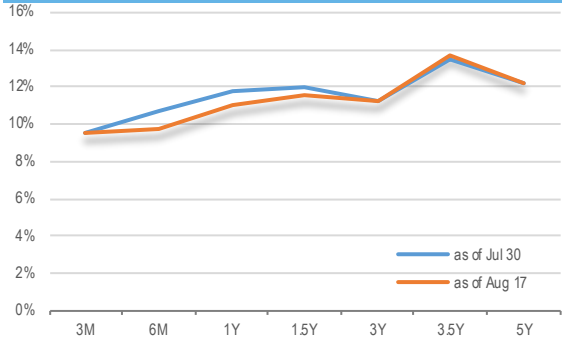
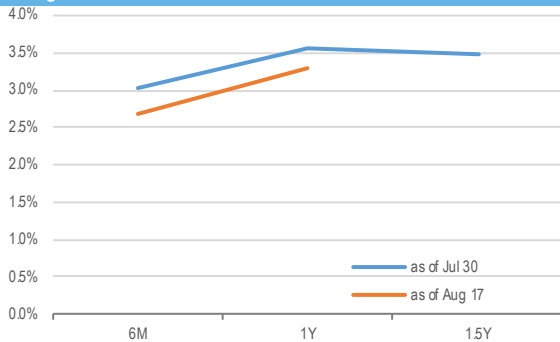


Figure 5. Local USD bonds market



Government bond market

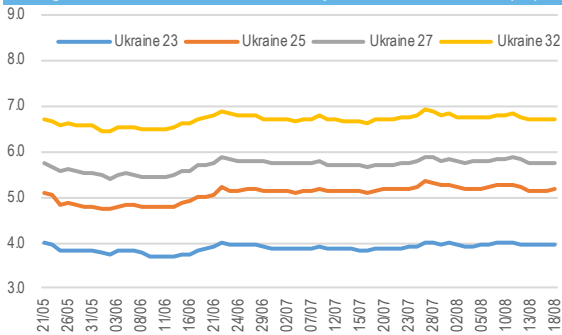
CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size, mn	Placement size, mn
UAH	1Y	11.15%	11.14%	11.20%	11.10%	30	29	574.74	524.74
UAH	1.5Y	11.30%	11.30%	11.30%	11.30%	6	6	48.12	48.12
UAH	3Y	12.30%	12.30%	12.30%	12.30%	14	14	184.10	184.10

**FinMin keeps experiencing penny-ante bond bets.** This Tuesday (August 17) the ministry raised just UAH0.7bn, the second lowest since the beginning of the year. Even assuming this week's modest demand results from low refinancing needs amid small redemptions due in dates around, a week ago the FinMin attracted four times as low as the amount was repaid.

Investors' appetite for buying Ukrainian state debt remains low since the last policy action by the NBU (July 22), with both banks and foreign investors cutting back their position. This could result from fears of runaway inflation, raising expectations for another rate lift in September.

The FinMin, in turn, sees little need to raise borrowing costs. September is going to be easy in terms of local bonds redemptions – some UAH23.4bn in total, while another financial tranche from the IMF under the stand-by agreement the government is seeking to secure, could unlock the ministry access to the foreign debt market.

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



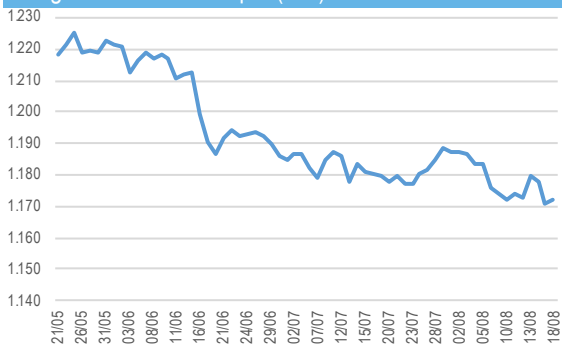
EUR/USD gathers momentum to tests 1.1700

**The euro remains under pressure against the U.S. dollar so far this month,** although sellers have not quite succeeded in dragging it further south of monthly lows near the 1.1700 mark.

Fresh coronavirus concerns, the solid pace of the economic recovery, high inflation, and speculations around an earlier-than-expected Q.E. tapering/rate hikes remain key factors supporting the dollar.

While Europe is now leading the U.S. in vaccinations – and has fewer cases when considering the population – the recent increase in Germany is of concern. Without an improvement in the old continent, the European Central Bank will likely maintain its bond-buying scheme for longer.

Figure 7. EUR USD spot (mid)



**But the mood around EUR/USD remains fragile. Further gains in the dollar appear somewhat limited after the latest FOMC meeting saw the committee talking down the probability of Q.E. tapering** in the near term. While the annual inflation is still troubling to some, the recent inflation readings were not alarming – and may prove the theory that price rises are transitory. Market participants are waiting for the publication of protocols from the bank's July gathering (to be released today, August 18), which could show whether calls for tapering down the bank's bond-buying scheme are gaining ground.

U.S. Treasury yields soared to a five-week high earlier this month after U.S. Senate passed of USD1.2tn backed by President Joe Biden. The gain was partly trimmed last week amid diminished expectations for an early Fed tapering. But on Wednesday (August 18) the yield on the benchmark 10-year Treasury note recovered to 1.275% ahead of the release of minutes from the Federal Reserve's latest policy meeting. Yields move inversely to prices.

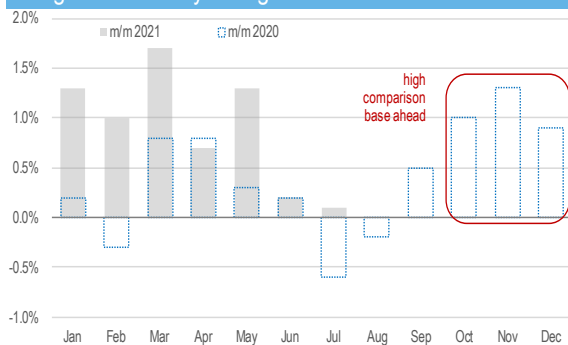
Figure 8. Consumer price indices evolution, y/y



Inflation goes into double digits, yet is expected to normalize soon

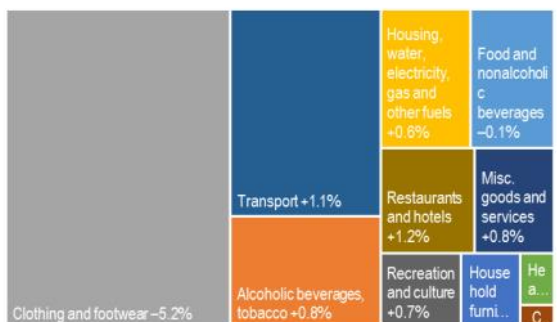
Consumer prices in Ukraine increased by the most in nearly 3 years in July, in annual terms. Led by rising energy cost and recovering demand, and magnified by the low base effect from last year's lockdown, annual inflation entered a double-digit zone, landing at 10.2% last month, double the target level of the central bank. The base effect factor could keep the CPI index going up through the end of 3Q, pushing the NBU to deliver another rate hike as soon as at September's MPC meeting. However, it is likely to reverse in 4Q21, when the effect of global energy prices recovery, which commenced in 3Q20, starts waning. This could arm the government with a strong argument against a further monetary policy tightening at announced discussions with the central bank.

Figure 9. Monthly change in CPI



**Hot, but a peak is ahead.** In July, annual inflation shot to 10.2% y/y from 9.5% y/y a month earlier. The prices jump was chiefly driven by the recovery of costs of services, which had been most severely hit by the pandemic. As consumption switched to tourism and other related services amid slowed coronavirus spread, restaurants and hotels, recreation and cultural services providers, as well as passenger carriers began to put higher price tags, not least in order to cover pandemic-induced losses. Nevertheless, as most of these services are exposed to competition, they are unlikely to produce a sustainable inflation pressure in the view of resurging covid spread.

Figure 10. Contribution to monthly change in CPI



Prices for most foods – the largest contributor to the inflation index – went down in July. The arrival of fresh harvest should curb prices recovery going forward. But there was also a notable increase in costs of utilities and administratively regulated prices of alcohol and tobacco. The former has mostly to do with remaining elevated global energy prices, which could fuel inflation growth over the next few months. Against a deflation observed back in August 2020, annual inflation could peak at around 11-12%.

**Between a rock and a hard place.** The NBU in July pressed on with policy tightening, pledging to another rate hike as soon as at September's MPC meeting. Although this will be held right a day before the arrival of another daunting inflation figure, guided by high-frequency indicators and considering a low base of the last year, the central bank is likely to have enough reasons not to backtrack on its commitment. And future cooperation with the IMF, which is currently under discussion, could keep the NBU focused on the inflation issue. Hence, we expect another rate hike at the next MPC meeting.

But such a commitment has raised the government's concerns, pointing to a non-monetary origin of inflation. Another theme of the government is a recovery of the economy after the past pandemic waves and before the country's heading into new lockdowns in the eyes of gaining momentum delta variant. First deputy prime minister, minister of economy Oleksiy Lyubchenko has announced recently that the government is to discuss with the NBU appropriateness of further policy tightening under such a context, sparing an opportunity for no more rate hikes. We assume a golden share in the talks is likely to be held by the IMF, whose mission is to visit Kyiv in September.

**Keep an eye on inflation expectations.** Looking forward, as long as financial experts' inflation expectations over the coming year remain anchored below 7%, running high inflation lays the ground for a sustainable disinflation in 2022. This could come into play as soon as in 4Q21, when the effect of global energy prices recovery, which commenced in 3Q20, starts waning. Provided no acute price shocks, we expect some 1-2pp of inflation could be buried under the high base of this year and another 3-4pp in the year to come. Therefore, we hold our forecast for CPI growth at 9% in 2021, followed by a 5% increase in 2022.

# 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	32.3	36.1

\*estimates, no official data yet available

# UKRAINIAN CAPITAL MARKETS WEEKLY

## FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
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		
30/08/2021	31/08/2021	01/09/2021	02/09/2021	03/09/2021	04/09/2021	05/09/2021
	NBU: BoP NBU: Gross External Debt Future Payments	LGB* % UAH 125.8mn LGB % UAH 3,253.6mn FGB % USD 334.6mn FGB P USD 974.1mn		LGB* % UAH 135.0mn		
06/09/2021	07/09/2021	08/09/2021	09/09/2021	10/09/2021	11/09/2021	12/09/2021
Ukrstat: Business confidence	NBU: FX Reserves (deadline - 7th day)	LGB* % UAH 682.7mn LGB % UAH 1,066.7mn	NBU: MPC Ukrstat: Price indices ECB: MPC 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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