

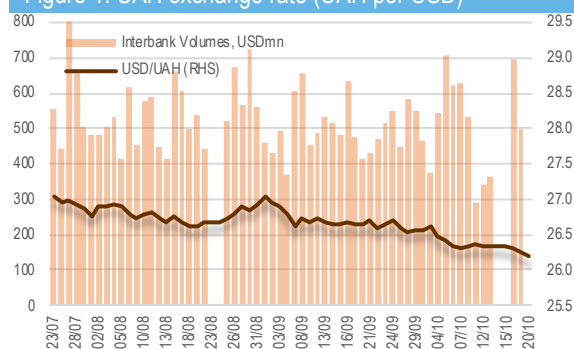
ECONOMICS | INTEREST RATES STRATEGY | FX

22 October 2021

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: NBU holds key rate unchanged
Fitch	B	POSITIVE	06.08.2021	The NBU has kept its key interest rate unchanged at 8.5%, expecting an inflation slowdown by the end of the year. Strong and appreciating UAH, as well as record-high grain crops, will help to contain future price growth, according to the NBU. That said, the central bank has stressed that it may deliver another rate hike in December if fundamental pressure persists.
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: Hryvnia holds its bullish momentum against USD

The USD/UAH pair extended its downward trend and was trading on Wednesday (October 20) at its strongest level since covid outbreak of 26.2, rising 0.83% over the last two weeks. Right after NBU's decision to hold the key rate unchanged the pair retreated to mid-26.3s, but quickly regained its support on the following day.

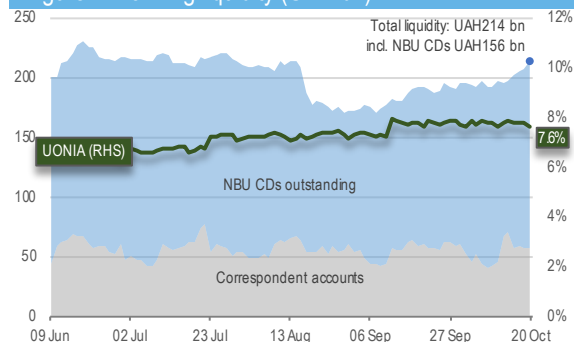
Incoming positive financial news, with the progress achieved in talks with the IMF and inclusion of government bonds in JP Morgan GBI EM Index reinforcing expectations of abundant FX liquidity supply, push exporters to put forward future foreign currency sales.

This comes along with favourable global prices for steel and agricultural products, supporting steady export revenues inflow. In turn, reaccelerating coronavirus spread, reminding of recent lockdowns and limited consumer spending, contribute to decline in demand for FX.

Another factor supporting hryvnia, is rising demand for local currency liquidity, stemming from rampant energy prices, which push running costs up. In the meantime, energy imports, which were assumed to drain FX, seem to be running into falling energy consumption, because many businesses cannot withstand such high prices.

Despite its public commitments not to step in when fundamental forces are in place, the NBU mopped up USD347.6mn over the last two weeks, and another USD173mn since this Monday (October 18).

Figure 2. Banking liquidity (UAH bn)



We see few opportunities for the ongoing hryvnia appreciation to be sustainable in the mid-term. Yet, with the continuous inflow of FX liquidity via financial account, the downtrend might hold for some more time.

Total hryvnia liquidity in the banking system recovered to UAH202.7bn, including funds held on correspondent accounts with the NBU to UAH57.5bn.

The increase majorly results from increased central bank's interventions, pouring into the system around UAH14bn.

There was also a return of cash money on deposit accounts after prolonged holidays, as well as state budget expenditures, behind the liquidity inflow.

Figure 3. Correspondent account balances (UAH bn)

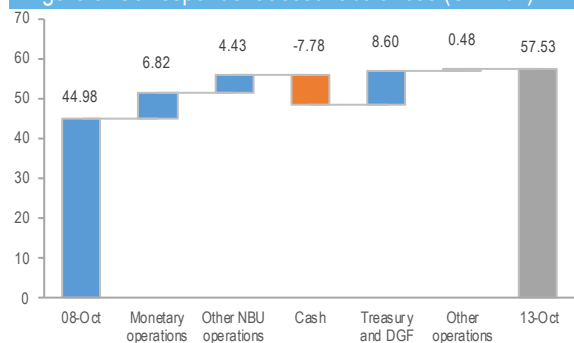


Figure 4. Local UAH bonds market

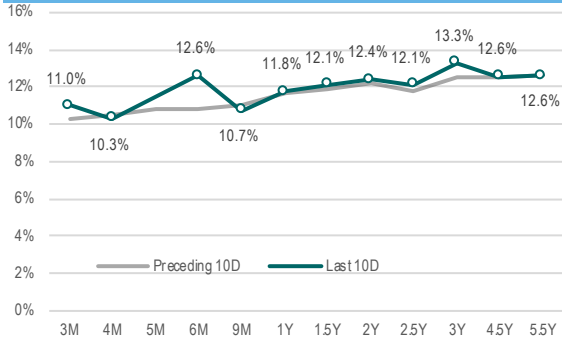
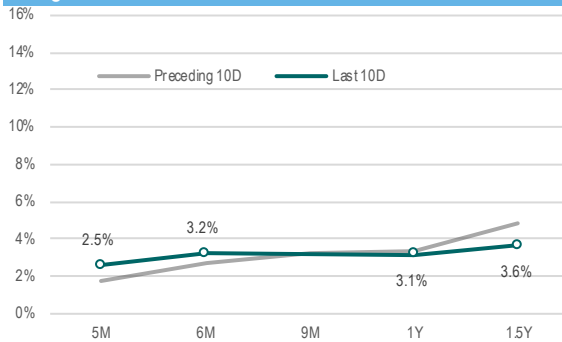


Figure 5. Local USD bonds market



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	6M	9.00%	9.00%	9.20%	8.75%	12	8	515.54	115.54
UAH	1Y	11.20%	11.20%	11.20%	11.20%	26	26	5,052.93	5,052.93
UAH	1.5Y	11.30%	11.30%	11.30%	11.30%	9	9	1,156.07	1,156.07

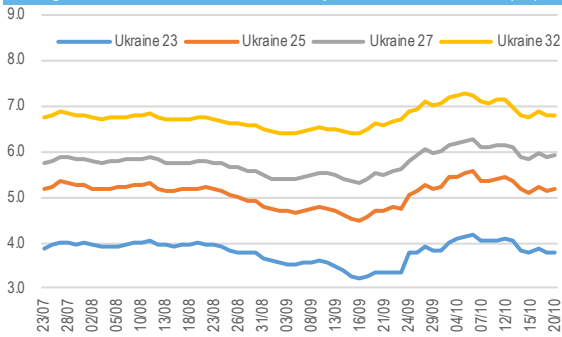
Another round of primary debt auctions brought no big news. This Tuesday FinMin's offer was limited to 9m and 2y bonds in UAH, and 1.5y bonds in USD.

In spite of numerous bids in 9m securities, the total interest fell short of the volume offered, with the bid-to-cover ratio standing as low as 0.35. All the applications were satisfied at unchanged since late September rate of 11.5%.

The 2y notes drew some UAH352mn in bids. Because the cut-off rate was held at 12.4%, three bids worth UAH250mn in total were rejected.

The government continues enjoying strong tax revenues. So far, the total state budget revenue surpassed the projected amount by some UAH40bn, according to the President's office. This suggests an easy borrowing schedule in 4Q21 with little changes in marginal rates. And the news report on the inclusion of UAH government bonds with maturity in February 2025 in the JP Morgan GBI EM Index could push FinMin to focus on the supply of this issue.

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



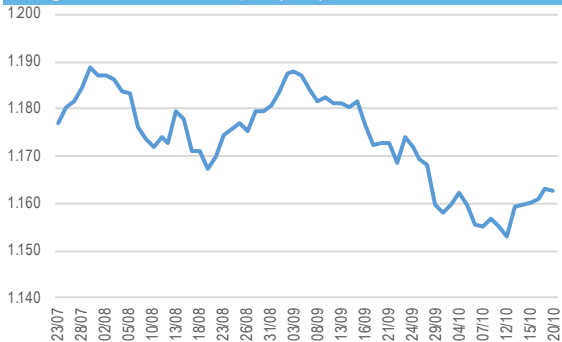
EUR/USD struggles for direction

The EUR/USD pair has been trading water around the 1.160 mark over the last two weeks on mixed signals.

For some time the greenback was trading lower against its main peers. The arrival of another U.S. inflation print, which confirmed the inflationary trend, strengthened doubts in the market on Fed Powell's theory of "temporary" high consumer prices pressures, adding pressure on the U.S. central bank to announce QE tapering in November.

No news from the recent publication of the FOMC Minutes also removed strength from the greenback. The Committee's general view continues to support the idea that the Federal Reserve could start trimming its bond-purchase program in November/December.

Figure 7. EUR USD spot (mid)

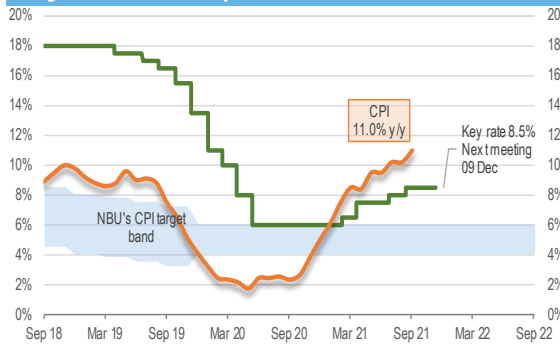


The save-have U.S. dollar regained support from rising speculations that the inflation across many countries could hold for longer than previously expected, putting the global growth outlook under pressure.

In addition to that, the U.S. President and the Democratic remained on track to agree upon a deal on the scope of their cornerstone economic revival package and hope to finalize a compromise in the week later, adding to positive sentiment around the greenback.

The 10-year U.S. Treasury yield reached 1.67% by Tuesday (October 19), its highest point since mid-May, as strong corporate earnings boosted economic sentiment. Strong earnings have strengthened hopes of a continued economic recovery in the U.S., alleviating some concerns that this could be thrown off course by Covid-19 cases and inflation.

Figure 8. CPI vs Key rate evolution



NBU holds key rate unchanged

The NBU has kept its key interest rate unchanged at 8.5%, expecting an inflation slowdown by the year-end. Strong and appreciating UAH, as well as record-high grain crops, will help to contain future price growth, according to the NBU. That said, the central bank has stressed that it may deliver another rate hike in December if fundamental pressure persists.

Inflation in Ukraine picked up again in September after a respite a month ago. The headline rate reached 11.0%, up 80bp from August, the core rate landed at 7.4%, adding 20bp for the month.

More than 70% of the categories in the CPI basket were up year-over-year, with a 1.1% y/y price growth in the food and non-alcoholic beverages segment being the major driver. The only two segments witnessing price cuts were transportation and recreation services. While the latter is heading towards another downturn amid the reacceleration of coronavirus spread, steady growth in energy costs and fuels, in particular, is not conducive to price stability in the former going forward.

Strong though, **September's inflation nevertheless fell short of the central bank's forecast of 11.2%**, providing arguments against another rate hike. The central bank maintains its expectations, that continuing strengthening of the local currency, record-high grain crops, and high statistical base of the previous year will contribute to consumer prices growth deceleration in the last two months of the year. This, along with an unchanged forecast that inflation will drop back toward the long-run goal of 5% by the end of the next year, seems to underline the central bank's view that the current price growth is transitory.

Figure 9. Monthly inflation

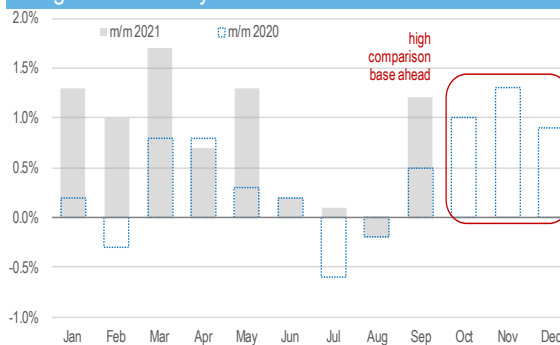
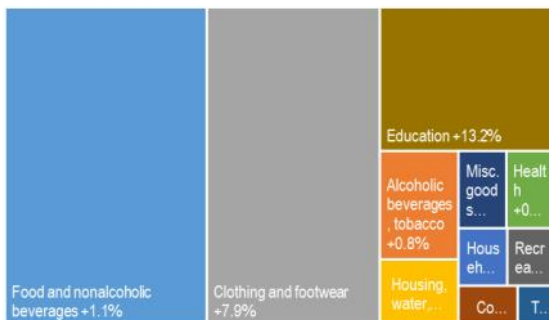


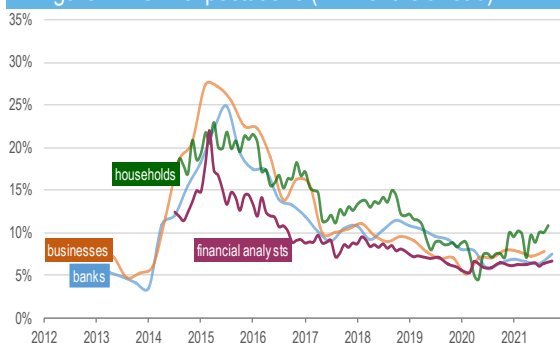
Figure 10. Contribution to monthly change in CPI



We are less positive on inflation growth in 2021, seeing it in a double-digit zone. The foregoing undershooting could result from deflation seen in August, while month-over-month inflation might keep running above NBU's projections. A high comparative base of 4Q20 largely built on the back of recovering energy prices indeed makes it harder for inflation to stay in the growing trend. But prices for energy commodities have skyrocketed since then. This, coupled with supply chain meltdowns across the world, might induce more protracted pressure than it was expected before, rippling across the board of products and services.

The NBU appears to admit such a scenario, stressing during the briefing the likelihood of another rate hike at this year's last policy meeting (scheduled on December 9) if fundamental pressure persists. And November's CPI print might be of critical importance in this regard, taking into account the central bank's bet on inflation slowing to a single digit by the end of the year.

Figure 11. CPI expectations (12 months ahead)



The NBU also admitted that inflation weakening in 2022 might come later than it was previously expected, with buoyant energy prices and strong consumer demand in the country continuing fuel prices growth. Accordingly, **the NBU put off projected policy easing to 3Q22 from 2Q22 and revised up year-end policy rate for 2022 by 1pp to 7.5%**.

Apart from this, **the central bank has revised down its economic growth forecast for 2021 and 2022 years. Both are now in line with our expectations of 3.1% and 3.8% respectively.**

As expectations across the globe shift towards lingering from transitory inflation and withdrawal of stimuli coming to the front of monetary agendas, another rate hike as a response to a general increase in rates is likely. But caveats to local economic growth, stemming from energy prices and the pandemic situation, will likely prevent the NBU from aggressive hiking action.

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	3.1	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	4 836	5 520
Nominal GDP (USD bn)	90	93	112	131	155	156	175	194
Prices								
CPI (average %YoY)	48.5	14.9	14.4	11.0	7.9	2.7	9.6	9.8
CPI (end of year %YoY)	43.3	12.4	13.7	9.8	4.1	5.0	11.5	8.9
Real average wage growth (%YoY)	-20.2	9.0	19.1	12.5	9.8	7.4	8.0	3.0
Fiscal balance (% of GDP)								
State budget deficit (without Naftogaz)	2.3	2.9	1.6	2.4	1.8	5.2	5.0	3.5
Total public debt (% of GDP)	79.4	81.0	71.8	61.0	51.6	60.9	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	-0.3	-1.7
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	8.0
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



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UKRAINIAN CAPITAL MARKETS WEEKLY

FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
18.10.2021	19.10.2021	20.10.2021	21.10.2021	22.10.2021	23.10.2021	24.10.2021
		LGB* % UAH 394.9mn LGB % UAH 951.7mn	LGB % USD 11.6mn LGB P USD 661.3mn NBU: MPC Ukrstat: Retail trade	LGB* % UAH 62.5mn Ukrstat: Industrial Production		
25.10.2021	26.10.2021	27.10.2021	28.10.2021	29.10.2021	30.10.2021	31.10.2021
		LGB* % UAH 895.1mn LGB P UAH 12 422.7mn	Ukrstat: Nominal & Real Wage ECB: MPC	NBU: BoP		
01.11.2021	02.11.2021	03.11.2021	04.11.2021	05.11.2021	06.11.2021	07.11.2021
IMF SDR 41.5mn FGB % USD 78.0mn NBU: Minutes NBU: Cost of Real Sector External Debt		LGB* % UAH 535.0mn LGB % UAH 379.1mn Fed: FOMC	LGB % EUR 2.6mn LGB P EUR 214.0mn	LGB* % UAH 203.1mn		NBU: FX Reserves (deadline - 7th day)
08.11.2021	09.11.2021	10.11.2021	11.11.2021	12.11.2021	13.11.2021	14.11.2021
Ukrstat: Busines confidence	Ukrstat: Price indices NBU: Monetary Statistics	LGB* % UAH 116.7mn LGB % UAH 1 527.5mn			LGB* % UAH 141.3mn	

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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