



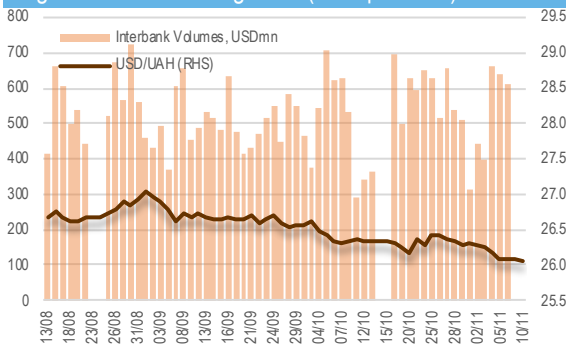
ECONOMICS | INTEREST RATES STRATEGY | FX

10 November 2021

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

	Rating	Outlook	Last update	This week in focus: USD/UAH: strong for now, weaker later
Fitch	B	POSITIVE	06.08.2021	Despite the picture of a deteriorating current account, Ukraine's external trade story seems to be going strong. Coupled with record-high remittances and buoyant foreign investments flow, this could extend the ongoing hryvnia appreciation against the dollar well into December. We think this appreciation is not sustainable in the mid-run and continue to expect a readjustment in 2022.
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 poised to challenge the 26.0 level

The USD/UAH witnessed a new way of selling pressure this week, with the downward momentum dragging the pair to the psychological barrier of 26.0 on Monday (November 8).

The state-run electricity grid operator Ukrenergo placed Eurobonds worth USD825mn last week. Expectations of an even more severe drop in the pair once the issuer starts converting raised funds to pay off a hryvnia-denominated debt to "green" energy producers pushed exporters to speed up FX sales before the upcoming tax season.

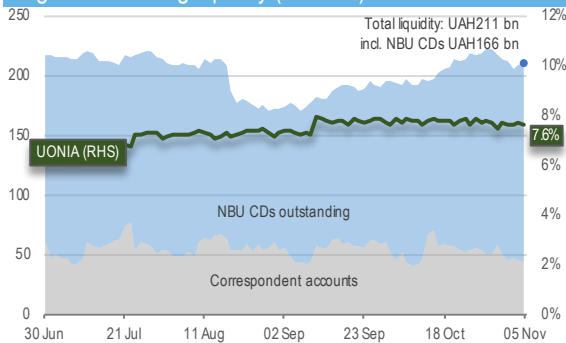
In the meantime, the pair by far lacks demand to cope with the bearish momentum. Reaccelerated spread of Covid-19 contribute to less travelling and consumption as uncertainty about future restrictions rises. Had the NBU not intervened in the market, the USD/UAH could have dropped to mid 25s. The central banks purchased in the market circa USD315mn over the last week.

The pair recovered a bit on Tuesday (November 9). Yet, **with remaining strong exports of steel and agricultural products, hryvnia may remain strong by the end of the month.**

Worth pointing out, however, that "green" electricity producers may seek to take advantage of the favourable currency rate as soon as they are repaid their debts.

Besides, Ukraine will likely to have less flexibility in timing of replenishment of its natural gas stocks in 2022. This could result in material FX liquidity drain in the middle of the year.

Figure 2. Banking liquidity (UAH bn)



Banking liquidity dropped to UAH211bn by the end of last week, in spite of continuing hryvnia injections by the NBU via FX interventions channel.

The balance of correspondent accounts with the central bank contracted by 25% to UAH44bn. And operations with State treasury account totalling approximately UAH15bn were the major cause of the liquidity drain.

Another UAH1.3bn left the system via cash channel. But the pressure on this side seems to have abated. Total liquidity outstanding has little changed since mid-July, amounting to UAH596bn as of November 5.

Figure 3. Correspondent account balances (UAH bn)

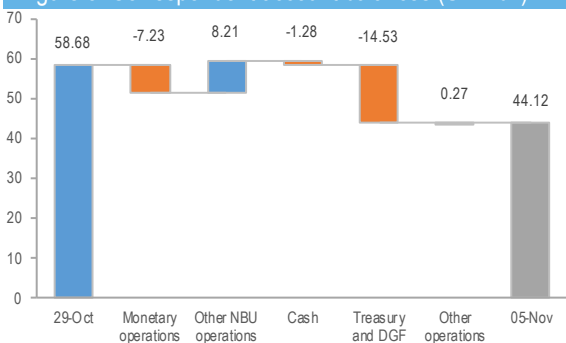
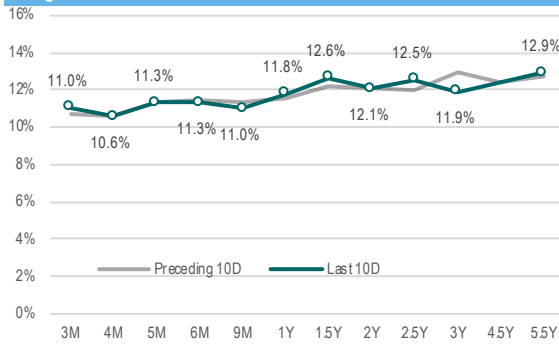


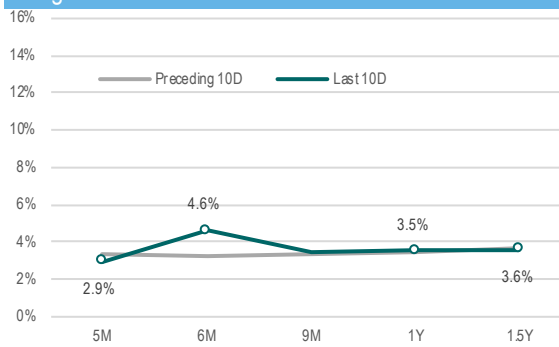
Figure 4. Local UAH bonds market



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	9.50%	9.50%	9.50%	9.50%	7	7	184.96	184.96
UAH	1Y	11.55%	11.54%	11.60%	11.50%	24	23	2 609.83	2 581.13
UAH	1.5Y	11.57%	11.57%	12.00%	11.57%	7	6	68.69	43.69
UAH	2Y	12.47%	12.47%	12.70%	12.47%	20	12	1 301.27	748.18
UAH	2.5Y	12.70%	12.70%	12.90%	12.70%	12	9	694.40	569.40
UAH	4Y	12.75%	12.75%	13.10%	12.75%	6	5	302.44	252.44
UAH	5Y	13.25%	13.23%	13.30%	13.05%	15	14	2 406.74	2 356.74
EUR	1Y	2.50%	2.50%	2.50%	2.50%	24	24	165.61	165.61

Figure 5. Local USD bonds market

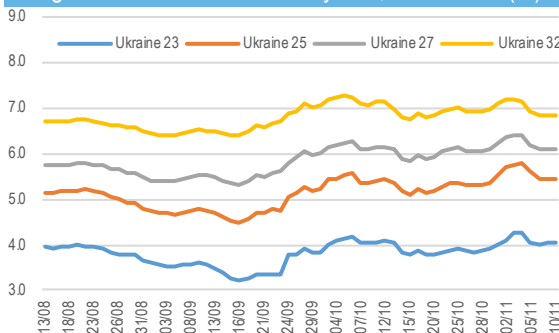


Another round of the primary debt auctions received a tepid reception from the market. This week the FinMin offered a range of securities, including UAH-denominated bonds with maturity from 3m to 5y, as well as 1y bonds in EUR.

While the highest demand was seen in 1y UAH securities, bids submitted fell short of UAH3bn of bonds offered. Having lifted cut-off rate by 5bp to 11.55%, the ministry accepted bids for UAH2.6bn in total.

Above average demand was also seen in 5y bonds and euro-denominated securities. The later drew 15 bids totaling EUR165.6mn, all of which were accepted at rate 2.5% per annum. Demand for the former amounted to UAH2.4bn, but one bid with required rate above the cut-off one of 13.25% was rejected.

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



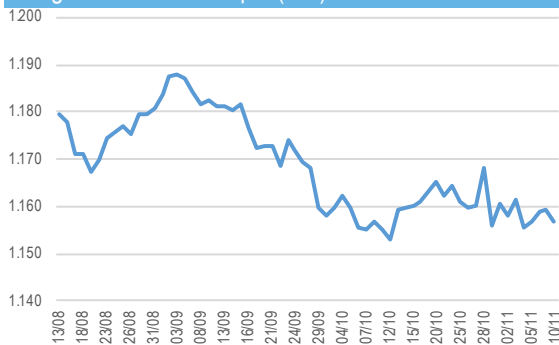
Euro remains on shaky ground

The euro continuously fails to regain the ground against the greenback, with each subsequent attempt to hold above 1.1600 gaining less support in the market. The pair was last seen slipping towards year low of 1.1527.

Risk-averse market environment and absence of fundamental drivers are helping the greenback to find demand.

Markets already know that the Fed expects price pressures to ease in the second half of 2022. More importantly, the Fed uses the Personal Consumption Expenditures (PCE) Price Index as its preferred gauge of inflation. So expected later on Wednesday October Consumer Price Index (CPI) data is likely to receive a muted market reaction, unless the index misses the market expectation by a wide margin.

Figure 7. EUR USD spot (mid)



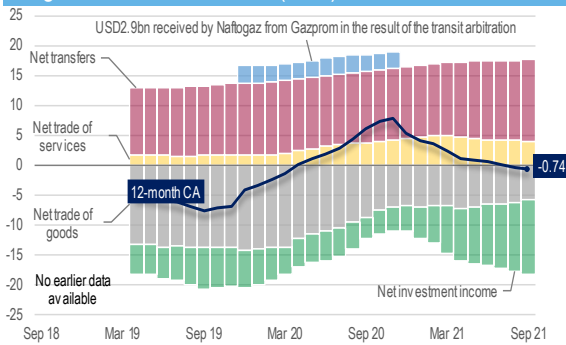
Meanwhile, European policymakers diverge on their vision about a rate hike. Klaas Knot said that conditions for a rate hike are very unlikely to be met in 2022, while top supervisor Andrea Enria said low ECB interest rates are now hurting bank margins more than they are boosting lending volumes.

Looking forward, market participants await President Biden's decision regarding Fed's Chair. According to the media, Fed Governor Lael Brainard (dovish) was interviewed for the top job at the U.S. central bank when she visited the White House last week. Jerome Powell's current term in that post expires in February and Biden said on November 2 that he'd make a decision "fairly quickly".

The yield on the benchmark 10-year Treasury note dropped to 1.44% by Wednesday from 1.67% two weeks ago as inflation fears and U.S. stimulus headlines weigh on investment sentiment.

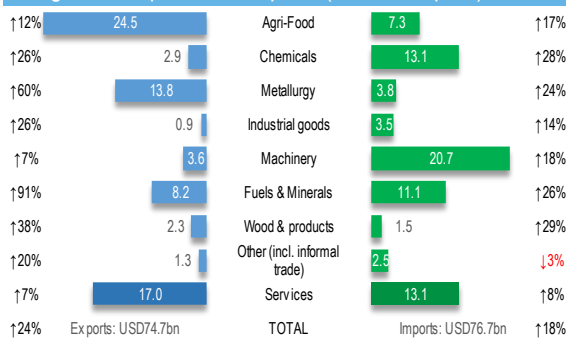
Figure 8. Current account (TTM), USDbn

USD/UAH: strong for now, weaker later



Despite the picture of a deteriorating current account, Ukraine's external trade story seems to be going strong. Coupled with record-high remittances and buoyant foreign investments flow, this could extend the ongoing hryvnia appreciation against the dollar well into December. We think this appreciation is not sustainable in the mid-run and continue to expect a readjustment in 2022.

Figure 9. Exports and imports (TTM to Sep 21), USDbn

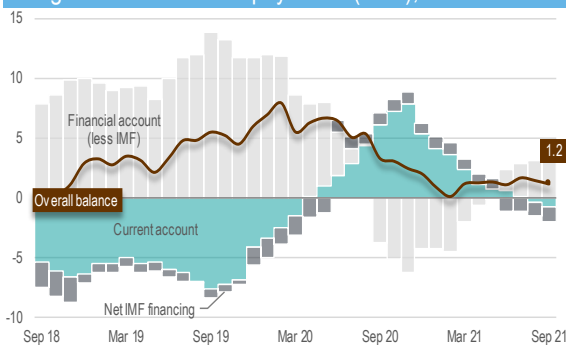


CA deficit nearly doubled to USD0.74bn in September, largely due to a continuous rise in the shortfall between the income on Ukraine's investments overseas and the income of foreign investments in Ukraine. The investment income outflow, which largely captures dividends and interest payments to non-residents, accelerated to USD12.4bn over 12m to September from USD4.3bn in 2020. But a simultaneous buoyant inflow of FDI, reaching USD5.1bn in September (TTM) versus USD0.1bn worth outflow in 2020, could signal about a partial return of repatriated incomes as round-tripping investments.

Export of agricultural products is in full swing. In the meantime, the trailing trade deficit narrowed to USD2bn in September from USD2.4bn a year prior. The factors driving the change have mostly to do with sound exports of steel and agricultural products. Strong crops and remaining elevated global prices boosted the agri revenues from abroad to USD24.5bn over 12m to September, up 12% from the corresponding period of 2020.

The collapse in iron ore prices had no dramatic impact so far. Total sales of steel products over the 12m to September rose by 60% y/y to USD13.8bn. And they may well exceed USD15bn in 2021, considering tight inventories amid continuous transportation bottlenecks. An expected rebound in auto production, which remains impeded by a lack of semiconductor chips, a global trend towards shortening of production chains, and China's decarbonization efforts, could keep demand for steel products and their prices high well into the 2022.

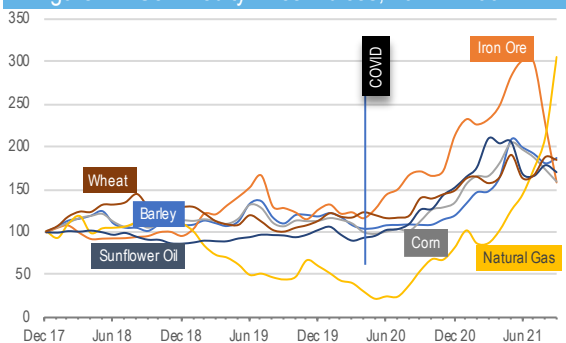
Figure 10. Balance of payments (TTM), USDbn



Another contributor to the improvement in the trade deficit was the slowed natural gas imports. Because gas prices have exceeded reasonable levels, businesses have pulled back on production instead of burning cash. This resulted in gas importers deterring from taking long positions, while local natural gas producers are increasingly seeking a way for conducting deliveries abroad.

Apart from the improvement in the trade balance, UAH continues benefiting from raising remittances from Ukrainians abroad. Transfers by working migrants reached USD13.7bn over TTM and may well exceed USD14bn in 2021.

Figure 11. Commodity Price Indices, 2017 = 100



A successful placement by Ukrenergo Eurobonds for USD825mn could add to FX supply pressure in the short-run, as the funds were raised to repay UAH-denominated debts for "green" electricity. We also do not rule out that the FinMin will follow the suit and taps into the global debt market by the year end.

But the UAH could face material headwinds going forward. First, the immediate gain from the placement of Eurobonds will likely reverse when receivers of green tariffs start to buy FX to pay on their FX denominated liabilities. Second, high prices for natural gas mean low imports for now, but as country/traders' reserves are gradually utilized, the energy imports will come back in greater volumes than before. Moreover, the energy crunch could cascade through the agriculture sector as the surge in energy prices has made fertilizers too expensive to produce. High inflation, coupled with strong UAH will continue hitting Ukrainian exporters of finished goods.

Considering the above, **we improve our USD/UAH end-year expectations to 27.0 but hold a bearish mood about hryvnia in 2022, with year-end forecasts kept unchanged at 29.8.**

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	178	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	27.0	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
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	
15.11.2021	16.11.2021	17.11.2021	18.11.2021	19.11.2021	20.11.2021	21.11.2021
LGB* % UAH 431.8mn Ukrstat: GDP flash estimate		LGB* % UAH 557.6mn LGB P UAH 6 599.1mn LGB % UAH 343.3mn	LGB* % UAH 195.6mn		LGB* % UAH 238.0mn	
22.11.2021	23.11.2021	24.11.2021	25.11.2021	26.11.2021	27.11.2021	28.11.2021
LGB* % UAH 313.6mn Ukrstat: Retail trade	LGB* % UAH 261.0mn Ukrstat: Industrial Production	LGB* % UAH 922.1mn LGB % UAH 3 904.9mn	LGB* % UAH 506.3mn	LGB* % UAH 251.3mn	LGB* % UAH 245.6mn	
29.11.2021	30.11.2021	01.12.2021	02.12.2021	03.12.2021	04.12.2021	05.12.2021
Ukrstat: Nominal & Real Wage	NBU: BoP NBU: Gross External Debt Future Payments	LGB* % UAH 568.5mn LGB % UAH 585.5mn LGB P UAH 12 690.5mn				

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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