



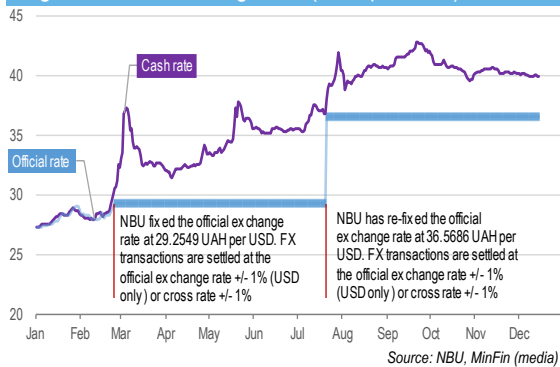
ECONOMICS | INTEREST RATES | FX MARKETS

19 December 2022

**UKRAINIAN
CAPITAL MARKETS
REVIEW**

	Rating	Outlook	Last update	This week in focus: Economy gets used to war context
Fitch	CC	-	17.08.2022	The economy has adjusted to the war context. New challenges still lie ahead, with continuous missile strikes creating a critical situation in the country's energy system. That said, the rehabilitation pace seems to weigh more for both business and consumers' confidence now than the new challenges themselves. And it seems to be high time for drawing up a recovery plan.
S&P	CCC+	STABLE	19.08.2022	
Moody's	Caa3	NEGATIVE	20.05.2022	
R&I	CCC	NEGATIVE	27.07.2022	

Figure 1. UAH exchange rate (UAH per USD)

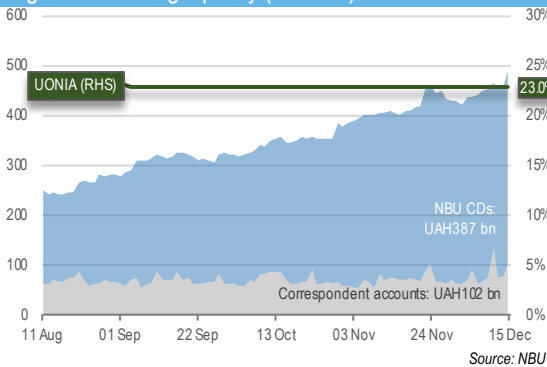


FX and interest rates: USD/UAH cash rate remains sideways around 40.0 mark

The USD/UAH pair keeps displaying a lacklustre performance since our last report as the NBU effectively holds a grip on the market sentiment. The rate is hovering around the 40.0 psychological level on the cash market.

As we mentioned in our previous report, the central bank has managed to tighten control over the cash currency exchange. That likely entails extra costs for the country's FX reserves. Yet they are hardly a burden against the continuous inflow of external financial support. Moreover, dealing with speculative attacks could prove to be more taxing for the country's coffers, particularly now that the country is on the brink of a blackout. The NBU has sold more than USD1.5bn since Russian missile strikes in late November, resulting in half of the country's power capacity being knocked out. Hryvnia withdrawals over that period, driven by fears of having no access to own savings, exceeded UAH17bn (circa USD477mn at the official rate) over that period.

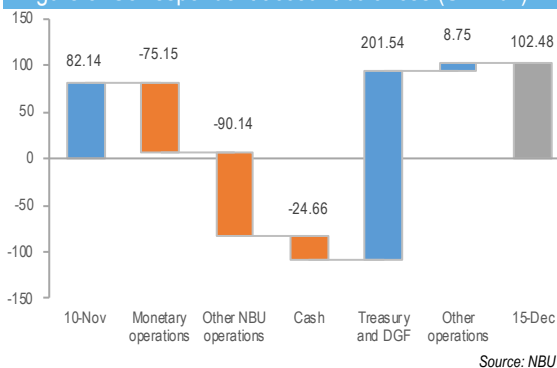
Figure 2. Banking liquidity (UAH bn)



Now with both cash and non-cash markets being virtually fully dependent on the NBU interventions and with the central bank having enough power and reserves to shape and meet market demand, **another official rate adjustment is out of agenda**. And because of that, we improved our year-end forecast, aligning it with the current official rate of 36.6 hryvnias per US dollar.

The rate is likely to remain sideways through the end of the winter. But the constantly rising trade balance deficit is likely to push the NBU to consider making some adjustments to the official rate later on (see our assumptions in this respect in the report of 15 November).

Figure 3. Correspondent account balances (UAH bn)



Banking liquidity keeps pushing the record high further up, reaching UAH490bn as of the end of 15 December. And that without the foregoing cash withdrawals.

State expenditures, being mostly financed through the foreign aid, remain the major cause of continually swallowing liquidity.

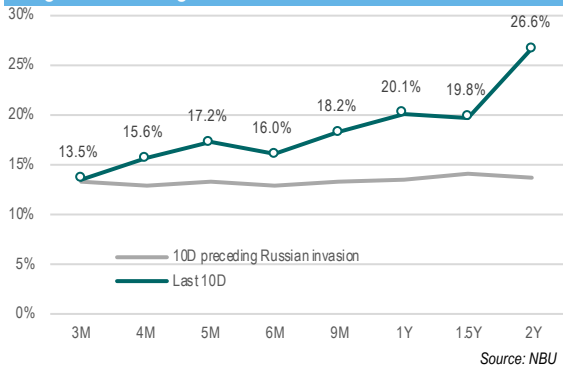
To deal with excess liquidity the NBU lifted the mandatory reserves ratio for hryvnia and FX current accounts by 5pp. Moreover, the regulator hinted at another hike later on, as well as admitted taking extra measures to improve monetary transmission.

As half of the total mandatory reserves are allowed to be allocated in benchmark public debt securities, at least UAH50bn of liquidity could spill over to the State treasury account, according to NBU's estimates.



UKRAINIAN CAPITAL MARKETS REVIEW

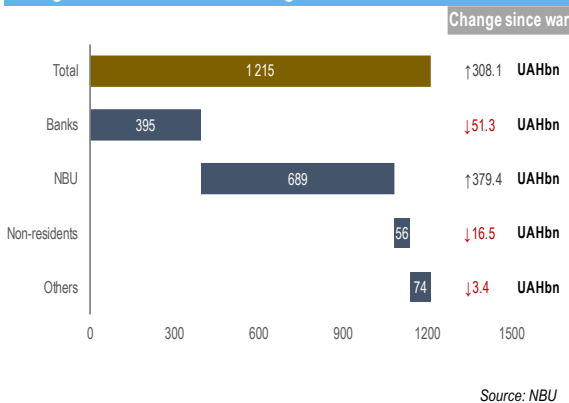
Figure 4. Local government bonds in UAH



Government bond market

FinMin wins back demand for public debt, thanks to an improved dialogue with the NBU. As we mentioned in our previous report, the central bank revived endeavours to find an amicable solution with FinMin on non-monetary ways of financing public expenditures following the appointment of the new head. The gradual rise in government bond yields in the aftermath suggests the discussions are being carried on constructively. The central bank for its part signalled during the recent monetary briefing (took place on 8 December) of no intention to extend its ban on income repatriation attributable to investments in government bonds. Besides, the regulator allowed banks to allocate half of the mandatory reserves in benchmark bonds (to be specified later on) starting from 11 January. According to the NBU, that will contribute to an increase in banks' position in public debt by at least UAH50bn.

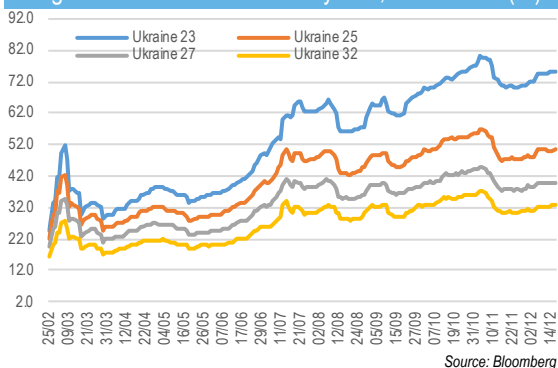
Figure 5. Position in local government bonds in UAH



The market seems to enjoy the news. FinMin saw at the last primary auction the highest demand for hryvnia bonds starting from the Russian invasion. And the highest take-up was in 2y securities – the ministry sold bonds worth upwards of UAH7.4bn at a marginal rate of 19.5%. Another UAH7.4bn was attracted via the sale of 4-months and 1-year bonds. The cut-off rate for securities was set at 14.0% and 16.0% correspondingly.

Though it remains above the primary market, the secondary market yield curve has sagged slightly over the last month.

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



US dollar still on the back foot

The EUR/USD rate continues to push higher toward the 1.07 level, as the underlying bearish sentiment surrounding the USD seems to act as a tailwind for the pair.

The greenback languishes near its lowest level since late June and seems to be attracting justifications for its weakness. Before Wednesday's announcement (14 December) of the monetary policy decision by the US Federal Reserve (Fed), for nearly a month the incoming data fuelled speculations that the central bank will pivot from an ultra-hawkish stance to something more neutral.

As the Fed came out with disappointing hawkish comments, stressing that it needs to hold rates at their peak until really confident inflation comes down in a sustained way, the market armed itself with the fresh US economic data, which came to be weaker than expected, as a reason to push USD further down.

The 10-year US Treasury note yield has been copying the USD dynamic, slipping to 3.48% from 3.81% over the last month.

The euro in turn keeps on inching higher, benefiting from hawkish European Central Bank (ECB) decisions. As was priced in the markets, the ECB delivered a 50bp rate hike at the policy meeting this Thursday (15 December), taking its key rate from 1.5% to 2.0%. It also said that from the beginning of March 2023 it would begin to reduce its balance sheet by EUR15bn (USD16bn) per month on average until the end of the second quarter of 2023.

Figure 7. EUR USD spot (mid)

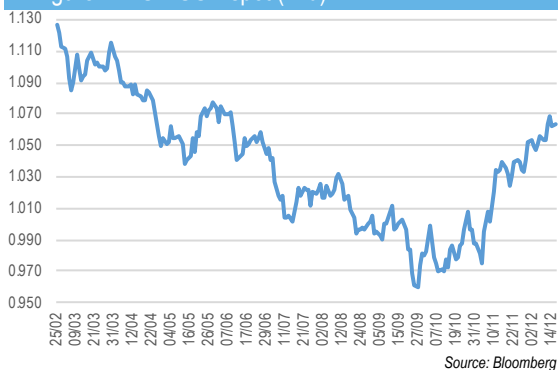
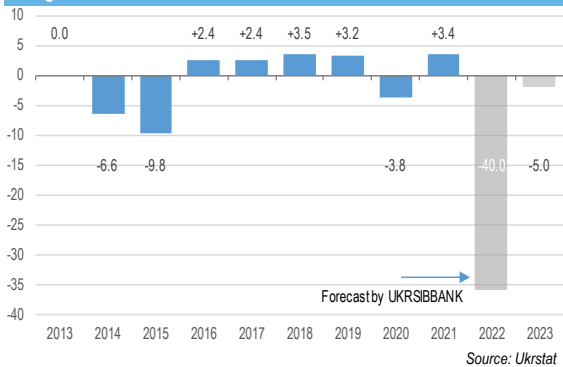


Figure 8. Ukraine's GDP evolution, %

Economy gets used to war context, time to think on post-war recovery

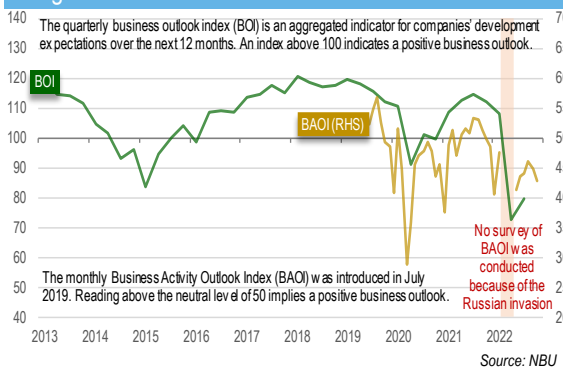


The economy apparently has adjusted to the war context. New challenges still lie ahead, with continuous missile strikes creating a critical situation in the country's energy system. That said, the rehabilitation pace seems to weigh more for both business and consumers' confidence now than the new challenges themselves. And it seems to be high time for drawing up a recovery plan and shaping business views about the way the economy will develop in the post-war period.

The evolution of the situation on the battlefield remains the key determinant of the economic outlook. Ukraine's economy slowed down its fall to 30.8% y/y in 3Q22 after the 37.2% drop a quarter earlier. Both positive news from the battlefield and various internal processes in the economy contributed to that. As Ukrainian armed forces press ahead liberating new territories, the more perceptible to the economy becomes the grain deal, the businesses relocation, and the flawless work of the local payment system, boosting both business and consumers' confidence. Neither GDP breakdown nor other economic activity statistics is available since February because of continuing hostilities.

But resumed in October extensive missile attacks and now drone strikes on the country's critical infrastructure pose new challenges to the economy. Because of that, we hold our year-end GDP forecast at minus 40% instead of a 30-33% contraction we would have expected otherwise. The forecast for 2023 remains unchanged at minus 5% too. The outlook, however, is subject to upside risk if Ukraine manages to make it through the year without a countrywide blackout.

Figure 9. Business sentiment indices



Being on the brink of blackout. Having failed to deliver a quick win and being pushed out of territories it conquered in the first months of the war, Russia has resorted to terroristic attacks, aiming at the destruction of Ukrainian civil critical and vital infrastructure. Around 50% of the Ukrainian energy system is out of operation now. A shortage of manoeuvrable capacities (TPP and CHP), which can adjust to volatility in energy consumption, hampers power output by nuclear power plants (NPP), requiring a stable demand. The issue gets worse with more than 40% of the power network being destroyed or heavily damaged, impeding the effective distribution of available capacities across all regions.

If they continue with the same intensity, new missile and drone strikes may disable the whole country's energy system. And considering a shortage of some repairing components on the global market, there is a risk of the whole of Ukraine being paralyzed in a blackout for at least a week.

Figure 10. Consumer sentiment index

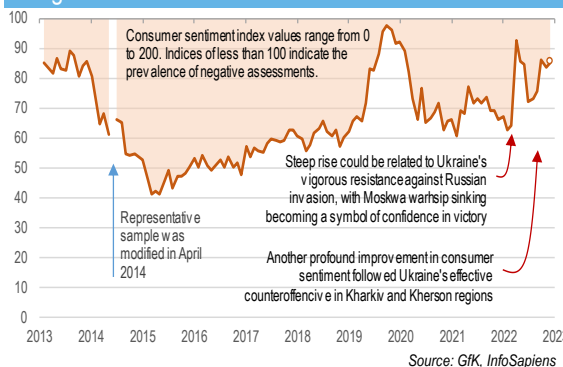
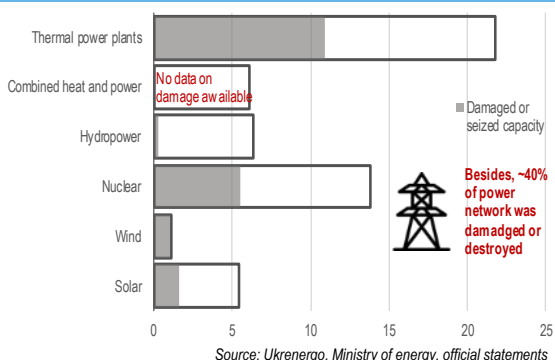


Figure 11. Ukrainian installed capacity, GW



Missile strikes on Ukraine's critical infrastructure, which began in October, have broken several months of growth in business and consumers' sentiment indices. Worth pointing out, however, that **infrastructure rehabilitation speed appears to have a greater weight for both business and consumers' confidence than strikes themselves.** A sober assessment of the war-caused crisis and a realisation that some of the most catastrophic scenarios now seem unlikely to materialise appears to have already taken place.

The pro-recovery mindset offers a great opportunity for drawing up a post-war economic transformation plan. Ukraine will find itself with a new set of economic inputs following the war, requiring a new set of rules to gain the most effective allocation of capital. A continuous inflow of external financial support or rebuilding infrastructure to the pre-war state is not sufficient for a country to prosper in the long run. **Adapting various institutions and economic agents to the post-war ways of doing will be crucial to generate sustained economic growth.**

UKRAINIAN CAPITAL MARKETS REVIEW

Key Macroeconomic Indicators								
	2016	2017	2018	2019	2020	2021	2022E	2023F
Real sector								
Real GDP (%YoY)	2.4	2.5	3.4	3.2	-3.8	3.4	-40.0	-5.0
Industrial production (%YoY)	4.0	1.1	3.0	-0.5	-4.5	1.1	NA	NA
Retail sales (%YoY)	4.3	6.5	6.2	10.3	8.4	10.7	NA	NA
Unemployment rate end of year (ILO, working age)	9.3	9.5	8.8	8.2	9.5	9.3*	NA	NA
Nominal GDP (UAH bn)	2 385	2 984	3 561	3 975	4 222	5 460	NA	NA
Nominal GDP (USD bn)	93	112	131	155	157	201	NA	NA
Prices								
CPI (average %YoY)	14.9	14.4	11.0	7.9	2.7	9.4	19.9	29.7
CPI (end of year %YoY)	12.4	13.7	9.8	4.1	5.0	10.5	32.9	22.1
Real average wage growth (%YoY)	9.0	19.1	12.5	9.8	7.4	11.9	NA	NA
Fiscal balance (% of GDP)								
State budget deficit (without Naftogaz)	2.9	1.6	2.4	1.8	5.2	3.6	NA	NA
Total public debt (% of GDP)	81.0	71.8	61.0	51.6	60.8	48.9	NA	NA
External balance								
Exports of goods and services (USD bn)	46.0	53.9	59.2	63.6	60.7	81.5	NA	NA
Imports of goods and services (USD bn)	52.5	62.7	70.6	76.1	63.1	84.5	NA	NA
Current account balance (USD bn)	-1.9	-3.5	-6.4	-4.1	5.3	-2.1	NA	NA
Current account balance (% of GDP)	-2.0	-3.1	-4.9	-2.7	3.4	-1.0	NA	NA
Net FDI (USD bn)	3.8	3.7	4.5	5.2	-0.1	6.0	NA	NA
Foreign exchange reserves (end of year)	15.5	18.8	20.8	25.3	29.1	30.9	27.0	22.0
Imports coverage (months of imports of goods)	3.7	3.6	3.5	3.9	4.8	4.1	3.0	2.0
Interest and exchange rates								
NBU discount rate (% end of year)	14.0	14.5	18.0	13.5	6.0	9.0	25.0	15.0
Exchange rate (USD/UAH) end of year	27.2	28.1	27.7	23.7	28.3	27.3	36.6	48.0
Exchange rate (EUR/UAH) end of year	28.4	33.5	31.7	26.4	34.7	30.9	39.0	50.4

*estimates, no official data yet available



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UKRAINIAN CAPITAL MARKETS REVIEW

FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
12.12.2022	13.12.2022	14.12.2022	15.12.2022	16.12.2022	17.12.2022	18.12.2022
		LGB* % UAH 1 214.1mn LGB % UAH 827.0mn LGB P UAH 14 382.6mn Fed: FOMC	LGB % EUR 0.7mn ECB: MPC			
19.12.2022	20.12.2022	21.12.2022	22.12.2022	23.12.2022	24.12.2022	25.12.2022
NBU: Minutes NBU: External Debt	IMF SDR 125.0mn	LGB* % UAH 655.1mn LGB % UAH 1 209.1mn	LGB % USD 9.4mn LGB P USD 350.6mn Ukrstat: Retail trade			
26.12.2022	27.12.2022	28.12.2022	29.12.2022	30.12.2022	31.12.2022	01.01.2023
		LGB* % UAH 376.8mn LGB % UAH 0.3mn Ukrstat: Nominal & Real Wage	LGB P USD 352.5mn	Ukrstat: Industrial Production NBU: BoP		
02.01.2023	03.01.2023	04.01.2023	05.01.2023	06.01.2023	07.01.2023	08.01.2023
		LGB % UAH 314.0mn				

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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