



**ECONOMICS | INTEREST RATES | FX MARKETS**

14 July 2022

**UKRAINIAN  
CAPITAL MARKETS  
REVIEW**

	Rating	Outlook	Last update	This week in focus: Inflation could extend well into 1H23
Fitch	CCC	-	25.02.2022	Ukraine has faced the new bout of inflation. So far, the major inflation drivers have been war-related panic buying, destruction of assets, and disruption of supply chains. Going forward, persistent problems with logistics, recovery in wages growth owing to a dramatic out-migration, as well as reaccelerated global inflation could keep pushing prices higher over the next 12 months.
S&P	CCC+	NEGATIVE	27.05.2022	
Moody's	Caa3	NEGATIVE	20.05.2022	
R&I	B-	-	28.02.2022	

Figure 1. UAH exchange rate (UAH per USD)

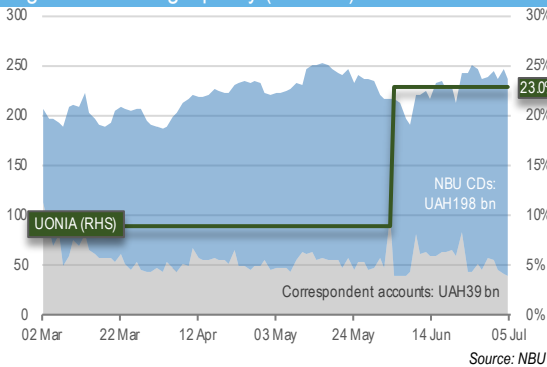


FX and interest rates: Ukrainian FX market operates in restricted mode

**Ukraine de-facto switched to a fixed FX rate regime** following the Russian invasion. The NBU suspended a number of FX market operations and most of cross-border FX payments to cope with war-related demand-supply imbalance.

The interbank market now operates with all transactions tied to the official rate, which has been fixed at 29.2549 UAH per USD since February 24. The daily turnover has dropped to around USD200mn from USD500-700mn before the war. At first offshore transactions by Ukrainians fleeing the country accounted for most of the turnover, followed by businesses involved in importing goods of critical importance. But the latter have increased their demand for FX over the last months following numerous amendments to the notion of critical, which now covers more than 90% of goods imported before the war.

Figure 2. Banking liquidity (UAH bn)

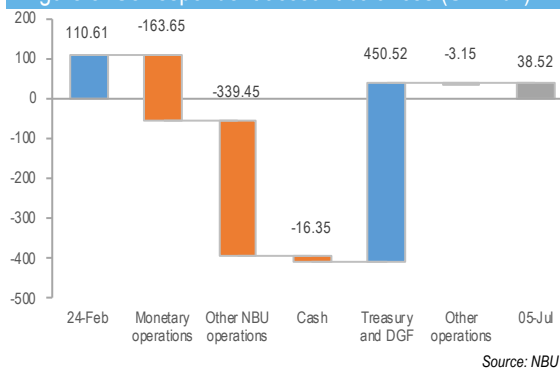


**Most of the FX demand at the interbank market is met by the NBU**, which has doubled its interventions since mid-May to around USD1bn per week. Because of logistics problems and lost access to seaports, FX sales by exporters, but for IT, have dwindled to insignificant levels.

Cash market, being disconnected from the interbank one, is largely driven by situational factors. While at first it was a war-related shock, in April demand for FX cash started to rise again after the government allowed tax-free imports of cars from the EU, as well as because of some speculations.

**We assume resetting of the official rate to the cash one** when the NBU starts phasing out the fixed FX rate regime. June's key rate hike by the NBU, followed by reintroduction of import taxes and removal of restrictions related to critical import appears to be important steps in that direction. But the NBU also requires fair prices for government bonds for setting on the deregulation path.

Figure 3. Correspondent account balances (UAH bn)



**Banking system remains full of liquidity.** As of July 1, banks held UAH46bn on correspondent accounts, up 5.9% from February 24, and UAH191bn in NBU CDs, down 7.5%.

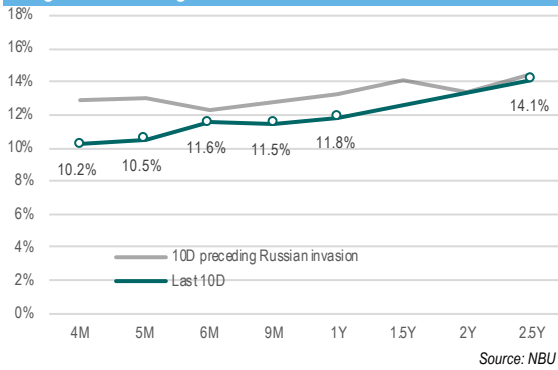
Typical in wartime cash outflow exceeded UAH60bn by mid-March. Because paper money has started returning into the system since then, and because most withdrawals occurred before the invasion, the drain narrowed to UAH16.4bn by the end of June.

At the moment two major factors defining the amount of liquidity in the system are government expenditures, which are majorly financed by international donors, and FX sales by the NBU.



# UKRAINIAN CAPITAL MARKETS REVIEW

Figure 4. Local government bonds in UAH

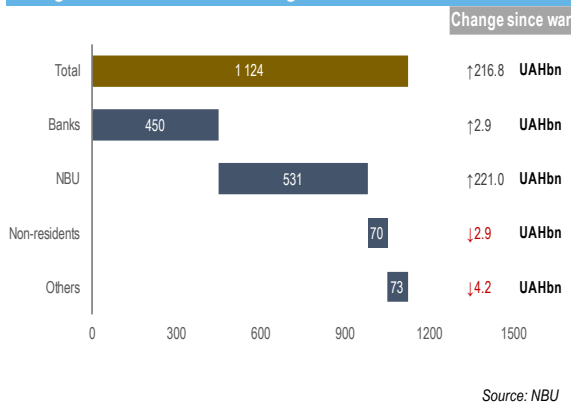


## Government bond market

Having lost access to commercial funds with the Russian invasion, **Ukraine has implemented a war finance policy** to meet its funding needs. The ministry of finance has offered citizens, businesses, and foreign investors to support the state budget by investing in so-called "war bonds", which are issued in the local market only. And to avoid establishing "unmanageable" postwar debt securities, these bonds pay much lower interests than traditional ones. The cut-off yield for 3m UAH bonds has been fixed at 9.5%, for 6-9m - at 10%, for 1y bonds - at 11%, and 1.5y ones - at 11.5% per year.

With annual inflation running almost twice as high as the yield for 1y UAH bonds, FinMin can barely find demand to cover its current debt servicing needs. FX-denominated bonds, though typically receive better reception, do not help much.

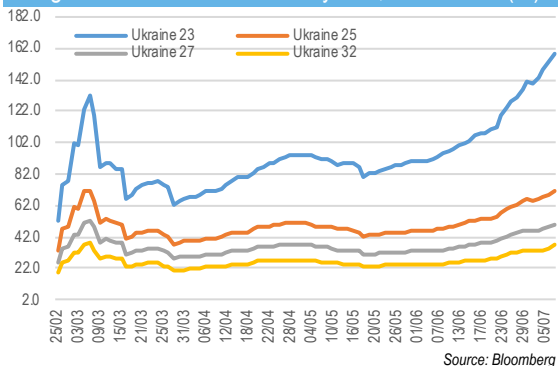
Figure 5. Position in local government bonds in UAH



**Foreign financial aid and the NBU are currently the two major sources of financing for Ukraine.** As of July 5 (starting from February 24), the government received circa USD11bn (in USD equivalent) from external donors and USD7.7bn (in USD equivalent) from the NBU. In comparison, FinMin raised some USD3.7bn (in USD equivalent) via sale of war bonds.

Despite the fact that the central bank continues publicly piling pressure on FinMin to raise interest rates for war bonds to a market level, we do not expect any changes in the yield curve until the economy is back to normal.

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



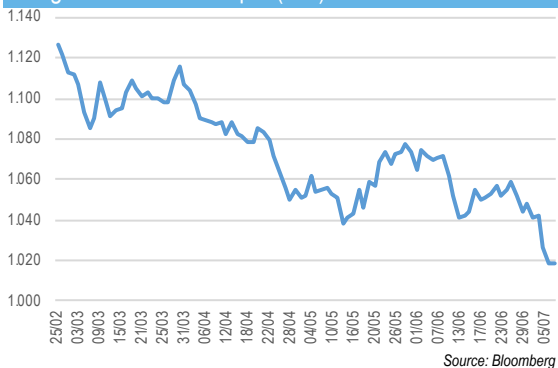
## Euro reaches US dollar parity as recession fears build

**The EUR/USD has fallen to its lowest level in two decades** as fears of a recession in the Eurozone have ramped up. The pair was trading at 1.0029 on Thursday (July 14), losing more than 10% over the last four months.

**Eurozone inflation hit a record 8.6% in June**, prompting the ECB to give markets advance notice of its intention to hike interest rates for the first time in 11 years at its July meeting. A rate hike looks likely as the ECB has already done with the Asset Purchase Program (APP) and is left with interest rate policy measures only.

The US consumer price index soared 9.1% from a year ago in June, up 0.5% on May. But **the US Fed has come way ahead of ECB in taming inflation**, raising its key short-term interest rates by 75 basis points in June – its largest hike since 1994 – to a range of 1.5% to 1.75%. And the market expects at least two more hikes ahead this year.

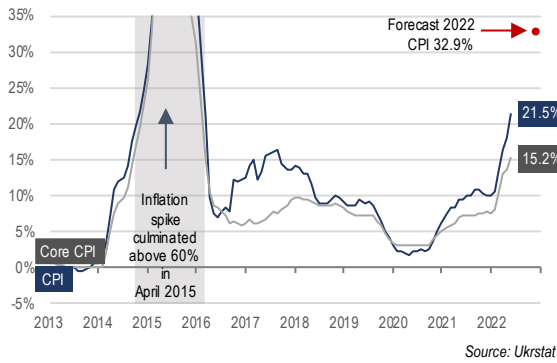
Figure 7. EUR USD spot (mid)



Fears of a recession in the eurozone have also intensified on the back of rising uncertainty about energy supply to the bloc, with Russia threatening to further reduce gas supplies to Germany and the broader continent. This, along with the prospect of an economic slowdown casts a specter of doubt over whether the ECB will be able to tighten monetary policy sufficiently to rein in record-high inflation.

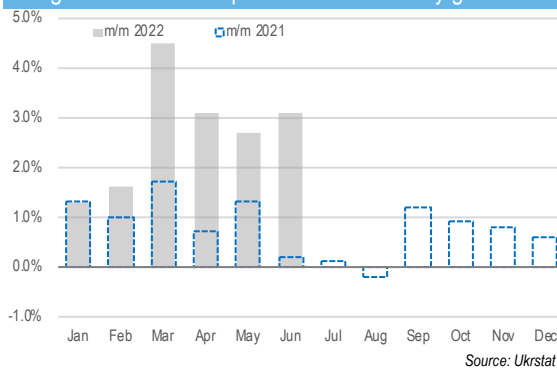
Figure 8. Consumer prices indices' annual growth rate

Inflation could extend well into 1H23



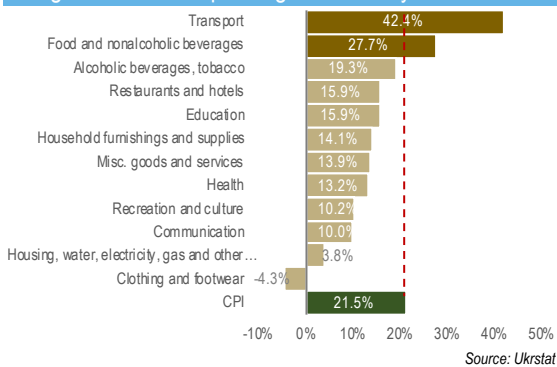
Ukraine has faced a new bout of inflation. Prices climbed 21.5% in the year through June, and a steeper rise looms ahead. So far, the major inflation drivers have been war-related panic buying, destruction of assets, and disruption of supply chains. Going forward, persistent problems with logistics, expected later recovery in wages growth owing to a dramatic out-migration, as well as reaccelerated global inflation could keep pushing prices higher over the next 12 months.

Figure 9. Consumer prices index's monthly growth rate



**Inflation is likely to exceed 30% in 2022...** The Consumer Price Index climbed 3.1% from May, with the escalating cost of food and transport contributing the most to the rising cost of living. While price growth at the beginning of the war had mostly to do with panic buying, now it is the continuous destruction of assets along with disruption of supply chains that drives inflation. Destruction of the country's major refinery and oil storage facilities coupled with the global steep rise in energy and fuel costs could pile further pressure on businesses by adding to the costs of final products.

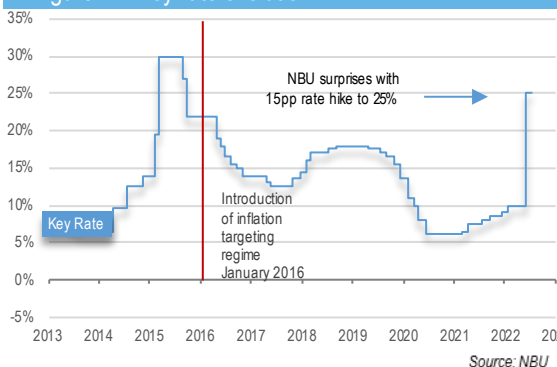
Figure 10. Annual prices growth in May



**...and keep rising in 1H23.** Assuming active hostilities end in 2H22, the next stage in the inflationary process will happen when the economy is set on the path of recovery. Reaccelerating around the world inflation has had a limited effect on local prices so far, thanks to import restrictions introduced by the government following the Russian assault. The situation will change, however, as soon as the government starts taking steps towards import liberalization.

Another source of inflation could result from dramatic out-migration. Currently, the local labour market is experiencing a glut resulting from the destruction of many businesses. But recovery would require much more labour than it is available now, giving rise to competition for skilled workers.

Figure 11. Key rate evolution



Finally, yet importantly, the government remains highly reliant on money emission. The state budget monthly funding needs amount to USD5bn, according to FinMin. Foreign donors cover about half of the amount and the rest comes from local sources, and chiefly from the NBU. Reintroduction of import duties in July is likely to cut down on the NBU's contribution, yet they apparently will not fully eliminate further expansion of money supply. Because of war shocks, the effects of money emission have been dim so far, but they may become more perceptible later in the year as the offensive campaign starts abating and consumer confidence improves.

**The headline figure may underestimate the real inflation.** Because of uneven price pressure across products (consumption is skewed towards essentials) and regions (prices in rural areas adjust to those in big cities amid urban-rural migration in the first month of the war) we see the risk of official inflation running below what consumers are suffering in their pockets.

**NBU lifted the key rate to 25% from 10% on June 2.** The action came as a surprise, considering preceding assurances of unchanged rate until monetary transmission channels are effective again and the fact that the current inflation has mostly to do with rising cost rather than demand.

The NBU signalled its expectations that "a significant rise" in the key policy rate "will be sufficient to ease pressures on the FX market and stabilize inflation expectations". The action, however, has not been followed by the correspondent rise in rates for public debt, which NBU's expectations rest on. Due to that, **the risks of another hike should not be ruled out.**

# UKRAINIAN CAPITAL MARKETS REVIEW

Key Macroeconomic Indicators								
	2015	2016	2017	2018	2019	2020	2021	2022E
<b>Real sector</b>								
Real GDP (%YoY)	-9.8	2.4	2.5	3.4	3.2	-3.8	3.4	-40.0
Industrial production (%YoY)	-12.3	4.0	1.1	3.0	-0.5	-4.5	1.1	NA
Retail sales (%YoY)	-19.8	4.3	6.5	6.2	10.3	8.4	10.7	NA
Unemployment rate end of year (ILO, working age)	9.1	9.3	9.5	8.8	8.2	9.5	9.3*	NA
Nominal GDP (UAH bn)	1 989	2 385	2 984	3 561	3 975	4 222	5 460	NA
Nominal GDP (USD bn)	90	93	112	131	155	157	201	NA
<b>Prices</b>								
CPI (average %YoY)	48.5	14.9	14.4	11.0	7.9	2.7	9.4	19.9
CPI (end of year %YoY)	43.3	12.4	13.7	9.8	4.1	5.0	10.5	32.9
Real average wage growth (%YoY)	-20.2	9.0	19.1	12.5	9.8	7.4	11.9	NA
<b>Fiscal balance (% of GDP)</b>								
State budget deficit (without Naftogaz)	2.3	2.9	1.6	2.4	1.8	5.2	3.6	NA
Total public debt (% of GDP)	79.4	81.0	71.8	61.0	51.6	60.8	48.9	NA
<b>External balance</b>								
Exports of goods and services (USD bn)	47.9	46.0	53.9	59.2	63.6	60.7	81.5	NA
Imports of goods and services (USD bn)	50.2	52.5	62.7	70.6	76.1	63.1	84.5	NA
Current account balance (USD bn)	5.0	-1.9	-3.5	-6.4	-4.1	5.3	-2.1	NA
Current account balance (% of GDP)	5.6	-2.0	-3.1	-4.9	-2.7	3.4	-1.0	NA
Net FDI (USD bn)	-0.4	3.8	3.7	4.5	5.2	-0.1	6.0	NA
Foreign exchange reserves (end of year)	13.3	15.5	18.8	20.8	25.3	29.1	30.9	NA
Imports coverage (months of imports of goods)	3.4	3.7	3.6	3.5	3.9	4.8	4.1	NA
<b>Interest and exchange rates</b>								
NBU discount rate (% end of year)	22.0	14.0	14.5	18.0	13.5	6.0	9.0	25.0
Exchange rate (USD/UAH) end of year	24.0	27.2	28.1	27.7	23.7	28.3	27.3	42.0
Exchange rate (EUR/UAH) end of year	26.2	28.4	33.5	31.7	26.4	34.7	30.9	NA

\*estimates, no official data yet available



# UKRAINIAN CAPITAL MARKETS REVIEW

## FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
11.07.2022	12.07.2022	13.07.2022	14.07.2022	15.07.2022	16.07.2022	17.07.2022
		LGB* % UAH 223.7mn LGB* P UAH 2 500.0mn LGB P UAH 139.8mn	LGB % USD 11.4mn LGB P USD 618.6mn			
18.07.2022	19.07.2022	20.07.2022	21.07.2022	22.07.2022	23.07.2022	24.07.2022
		LGB* % UAH 285.9mn LGB % UAH 995.6mn LGB P UAH 15 342.2mn	NBU: MPC ECB: MPC	Ukrstat: Retail trade		
25.07.2022	26.07.2022	27.07.2022	28.07.2022	29.07.2022	30.07.2022	31.07.2022
		LGB % UAH 87.8mn LGB* % UAH 554.0mn LGB* P UAH 2 500.0mn LGB P UAH 6 403.2mn Fed: FOMC	Ukrstat: Nominal & Real Wage	NBU: BoP		
01.08.2022	02.08.2022	03.08.2022	04.08.2022	05.08.2022	06.08.2022	07.08.2022
IMF SDR 38.2mn FGB % USD 33.7mn Ukrstat: Industrial Production NBU: Minutes		LGB* % UAH 700.3mn LGB % UAH 1 279.2mn LGB P UAH 15 526.1mn	IMF SDR 98.5mn LGB % USD 6.5mn Ukrstat: GDP flash estimate			NBU: FX Reserves (deadline - 7th day)

## 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



**UKRSIBBANK**  
BNP PARIBAS GROUP

The bank  
for a changing  
world

## Contacts

### Investment Business Group

#### Viktoriiia Nebeska

Market Making Government Bonds  
(+38044) 201-22-74  
[viktoriiia.nebeska@ukrsibbank.com](mailto:viktoriiia.nebeska@ukrsibbank.com)

#### Oleksandr Kredentser

Fixed Income Dealer  
(+38044) 298-83-35  
[oleksandr.kredentser@ukrsibbank.com](mailto:oleksandr.kredentser@ukrsibbank.com)



#### Mykhailo Kharchuk

Market Analysis  
(+38044) 537-49-75  
[mykhailo.kharchuk@ukrsibbank.com](mailto:mykhailo.kharchuk@ukrsibbank.com)

### FX Business

Kostiantyn Rupchev  
Head of FX Sales  
(+38044) 537-50-04  
[kostiantyn.rupchev@ukrsibbank.com](mailto:kostiantyn.rupchev@ukrsibbank.com)

### Corporate Business

Ievgen Kulikov  
Head of MNC team  
(+38044) 201-22-43  
[ievgen.kulikov@ukrsibbank.com](mailto:ievgen.kulikov@ukrsibbank.com)

### Distribution:

[macro@ukrsibbank.com](mailto:macro@ukrsibbank.com)

## Important Disclaimer

Legal Notice: This document is CONFIDENTIAL AND FOR DISCUSSION PURPOSES ONLY; it constitutes a marketing communication and has been prepared by a Sales and Marketing function within PUBLIC JOINT STOCK COMPANY "UKRSIBBANK" that is the part of BNP Paribas Group (hereafter – JSC "UKRSIBBANK") and/or its subsidiaries or affiliates (collectively "we" or "BNP Paribas"). As a confidential document it is submitted to selected recipients only and it may not be made available (in whole or in part) to any other person without BNP Paribas' written consent. This document is not a recommendation to engage in any action, does not constitute or form any part of any offer to sell or issue and is not a solicitation of any offer to purchase any financial instrument, nor shall it or any part of it nor the fact of its distribution form the basis of, or be relied on in connection with, any contract or investment decision. To the extent that any transaction is subsequently entered into between the recipient and BNP Paribas, such transaction will be entered into upon such terms as may be agreed by the parties in the relevant documentation.

The information contained in this document has been obtained from sources believed to be reliable, but there is no guarantee of the accuracy, completeness or suitability for any particular purpose of such information or that such information has been independently verified by JSC "UKRSIBBANK" or by any person. None of BNP Paribas, its members, directors, officers, agents or employees accepts any responsibility or liability whatsoever or makes any representation or warranty, express or implied, as to the accuracy or completeness of the information, or any opinions based thereon, contained in this document and it should not be used in place of professional advice. Additional information may be provided on request, at our discretion. Any scenarios, assumptions, historical or simulated performances, indicative prices or examples of potential transactions or returns are included for illustrative purposes only. Past performance is not indicative of future results. Investors may get back less than they invested. JSC "UKRSIBBANK" gives no assurance that any favourable scenarios described are likely to happen, that it is possible to trade on the terms described herein or that any potential returns illustrated can be achieved. This document is current as at the date of its production and JSC "UKRSIBBANK" is under no obligation to update or keep current the information herein. In providing this document, JSC "UKRSIBBANK" offers no investment, financial, legal, tax or any other type of advice to, and has no fiduciary duty towards, recipients. Certain strategies and/or potential transactions discussed in this document may involve the use of derivatives which may be complex in nature and may give rise to substantial risks, including the risk of total or partial loss of any investment or losses without limitation and which should only be undertaken by those with the requisite knowledge and experience. JSC "UKRSIBBANK" makes no representation and gives no warranty as to the results to be obtained from any investment, strategy or transaction, or as to whether any strategy, security or transaction described herein may be suitable for recipients' financial needs, circumstances or requirements. Recipients must make their own assessment of strategies, securities and/or potential transactions detailed herein, using such professional advisors as they deem appropriate. JSC "UKRSIBBANK" accepts no liability for any direct or consequential losses arising from any action taken in connection with or reliance on the information contained in this document even where advised of the possibility of such losses.

As a bank with a wide range of activities JSC "UKRSIBBANK" may face conflicts of interest and you should be aware that JSC "UKRSIBBANK" and/or any of its affiliates may be long or short, for their own account or as agent, in investments, transactions or strategies referred to in this document or related products before the material is published to clients and that it may engage in transactions in a manner inconsistent with the views expressed in this document, either for their own account or for the account of their clients. Additionally, JSC "UKRSIBBANK" may have acted as an investment banker or may have provided significant advice or investment services to companies or in relation to investments mentioned in this document. The information in this document is not intended for distribution to, or use by, any person or entity in any jurisdiction where (a) the distribution or use of such information would be contrary to law or regulations, or (b) JSC "UKRSIBBANK" or a JSC "UKRSIBBANK" affiliate would become subject to new or additional legal or regulatory requirements. Persons in possession of this document should inform themselves about possible legal restrictions and observe them accordingly.

This document is being communicated by JSC "UKRSIBBANK", 2/12 Andriivska street, Kyiv, 04070, Ukraine; tel: +380 44 590 06 90 ([www.my.ukrsibbank.com](http://www.my.ukrsibbank.com)). © JSC "UKRSIBBANK" 2021. All rights reserved .