



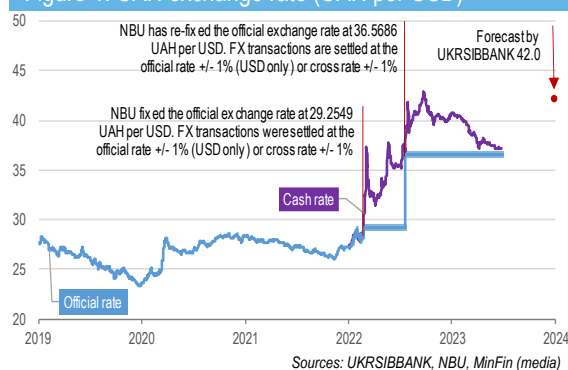
ECONOMICS | INTEREST RATES | FX MARKETS

30 June 2023

UKRAINIAN CAPITAL MARKETS REVIEW

	Rating	Outlook	Last update	This week in focus: Economy shows signs of rebound, but challenges persist
Fitch	CC	-	23.06.2023	Ukraine's economy is demonstrating promising indications of emerging from its downturn. We have improved our year-end forecast to -0.5% from -5.0%. It is important to note, however, that the recovery remains uneven. The situation on the battlefield continues to be a significant determining factor. Additionally, the substantial emigration of Ukrainians abroad may pose challenges ahead.
S&P	CCC	NEGATIVE	06.04.2023	
Moody's	Ca	STABLE	10.02.2023	
R&I	CCC	NEGATIVE	27.07.2022	

Figure 1. UAH exchange rate (UAH per USD)



FX and interest rates: USD/UAH cash rate gets closer to the interbank one

The gap between cash and interbank rates has contracted to less than 2% in June, down from around 3% at the start of May.

Although FX supply by banks' clients has been relatively stable in the last two months, there has been an 11% contraction in average weekly sales, compared to the preceding two months. Despite persistent challenges in the grain corridor, agriculture continues to be a major source of FX. However, with the conclusion of the sawing campaign, there may be a further decline in FX sales.

Meanwhile, the central bank continues to maintain a strong presence in the interbank market. Some reduction in FX interventions - to USD400 million per week from USD450 million per week - could be related to decline in offshore demand for FX, as more Ukrainians abroad are getting employed, as well as to retreat in global inflation and energy prices, helping to cut import costs. But import of non-consumer goods seems to gain momentum, with notable increase observed in wood, metal, chemical products, and machinery.

The NBU has recently announced the implementation of its initial FX policy easing measures, aimed at promoting new loans and investments. The central bank has allowed resident borrowers to service their foreign loan liabilities, subject to certain conditions. Considering that the relaxation relates to future cash flows, we consider its short-term effect as immaterial.

The whole conditions-based strategy on FX restrictions easing and transitioning to exchange rate flexibility will be presented by the NBU on 7 July. The correspondent document was approved on 29 June.

Figure 2. Banking liquidity (UAH bn)

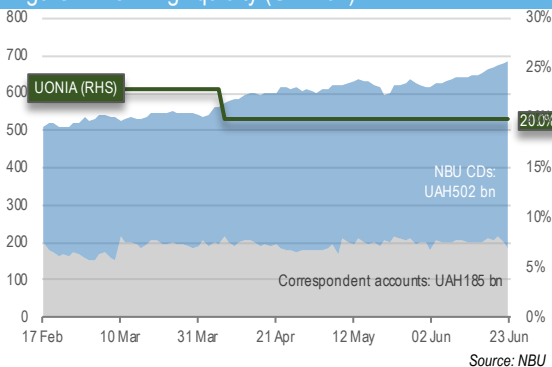
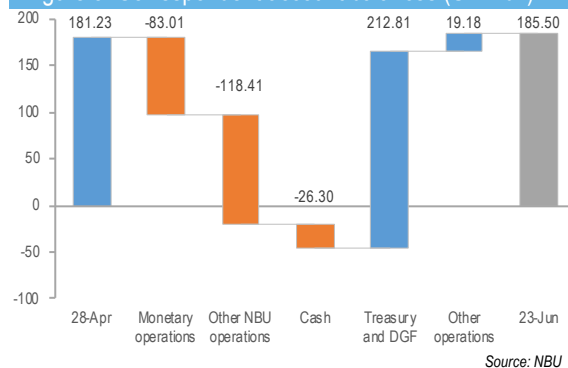


Figure 3. Correspondent account balances (UAH bn)



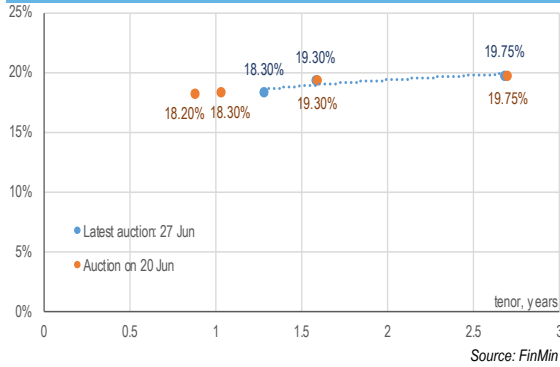
Banking system liquidity is poised to reach another significant milestone, approaching the barrier of UAH700bn. The driving force behind this increase is the continuous injection of funds into the system, primarily resulting from externally financed public spending. Since the beginning of May, net State treasury operations have exceeded UAH212bn. The NBU has absorbed approximately UAH200bn of that amount via monetary operations.

Alongside this liquidity increase, there has been a notable recovery in demand for cash since early May, with some UAH26.3bn being withdrawn. Earlier, the NBU has made efforts to tie hryvnia liquidity in term deposits, aiming to prevent abrupt withdrawals and their impact on the cash foreign exchange market. If high demand for cash persists, that could delay further FX policy easing.



UKRAINIAN CAPITAL MARKETS REVIEW

Figure 4. UAH government bonds primary market



Government bond market

The FinMin is forging ahead with its strategy to promote longer-term bonds amid a decline in inflation. As inflation receded to 15.3% y/y in May, the ministry adjusted yields for bonds with maturities shorter than 1.5 years, reducing them by 20-30bp. Yields for longer-term bonds, such as the 2-year and 2.5-year bonds, have remained unchanged at 19.70% and 19.75% respectively.

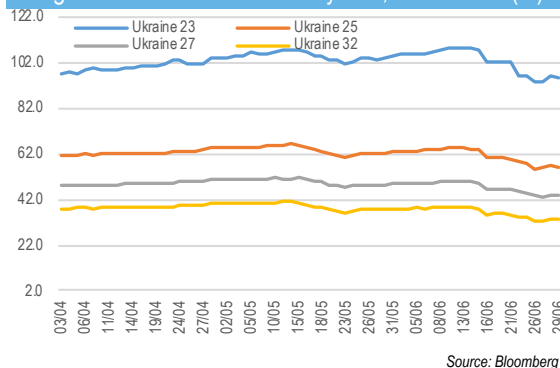
During June, the FinMin raised nearly UAH30bn through UAH bond placements, indicating minimal change compared to the previous month. However, the ministry managed to attract UAH4.1bn more than required for debt payments this month, a marked improvement from the UAH8.3bn shortage experienced in May.

Figure 5. UAH government bonds secondary market



In addition to continued demand for UAH-denominated bonds, the FinMin is observing renewed market interest in FX-denominated securities. In May, placements of EUR-denominated bonds attracted over EUR429mn, despite the absence of scheduled debt redemption or servicing. Similarly, the placement of USD-denominated bonds amounted to USD637 million, twice the amount of payments due. Although demand for FX bonds moderated in June, it remained sufficient to cover 75% of USD payments due and nearly all EUR debt payouts.

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



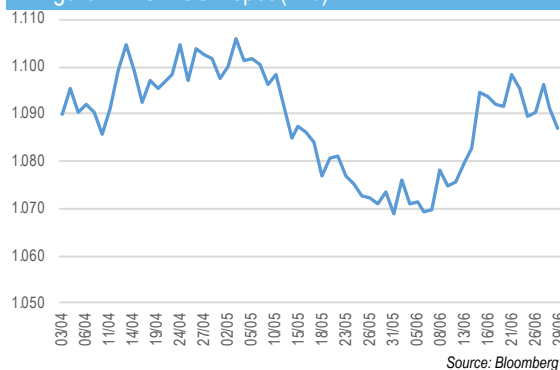
EUR rebounds above 1.09 against USD after dipping below 1.07

The EUR has regained support against the USD, reclaiming levels above 1.09 after briefly falling below 1.07 at the end of May. This recovery comes in the wake of the European Central Bank's (ECB) decision to raise rates by 25bp, while the US Federal Reserve (Fed) opted for a pause.

However, the EUR/USD pair has encountered hurdles in its upward trajectory as investors continue to digest the implications of central bank interest rate decisions on economic growth.

Despite the ECB's hawkish stance and plans for further rate increases, concerns arise from economic decline and credit data, tempering expectations regarding the extent and duration of the ECB's policy rate hikes.

Figure 7. EUR USD spot (mid)



On the other hand, the Fed's indication that more rate hikes are likely has provided reassurance to the markets, suggesting the potential for two additional interest rate increases.

The future actions of both the Fed and the ECB in normalizing their monetary policies remain subjects of ongoing debate.

By the end of 29 June, the EUR/USD rate retreated to the 1.0864 level, on hawkish comments from Fed Chair Jerome Powell, who Fed again indicated that rates would likely go higher.

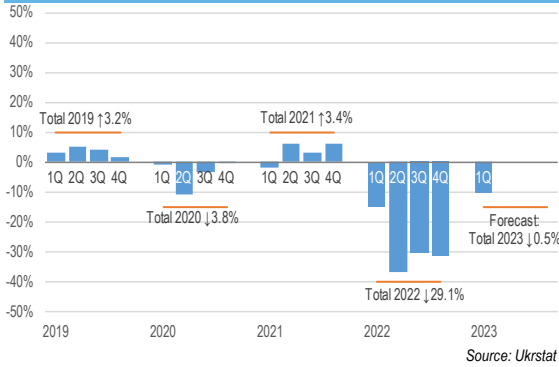


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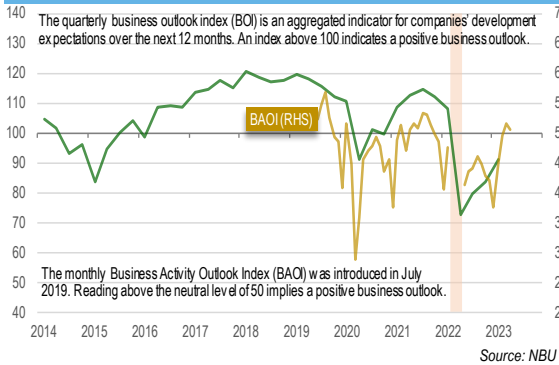
Figure 8. Ukraine's annual GDP evolution



Ukraine's economy shows signs of rebound, but challenges persist

Ukraine's economy is demonstrating promising indications of emerging from its downturn, thanks to improved power supply and enhanced air defence capabilities. We have revised our year-end forecast to a contraction of -0.5% from the previous estimate of -5.0%, anticipating minimal power outages through the end of the year and the implementation of monetary and FX policies' measures aimed at shoring up of the recovery trend. However, it is important to note that the recovery remains uneven, primarily driven by the agriculture and the retail trade. The situation on the battlefield continues to be a significant determining factor. Additionally, the substantial emigration of Ukrainians abroad may pose challenges to the post-war recovery efforts in the long term.

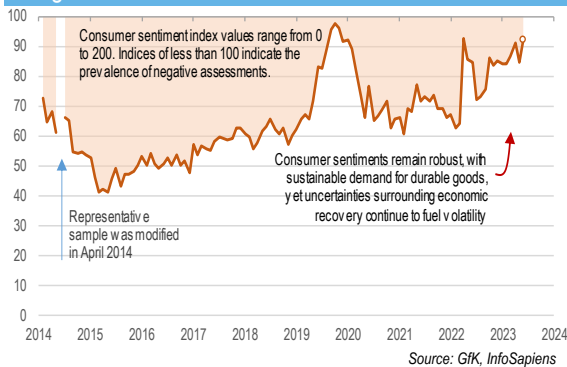
Figure 9. Business sentiment indices



Ukraine's GDP contracted by another 10.3% y/y in 1Q23. Another double-digit drop reflects the change compared to the pre-war state, while on a quarterly basis the GDP increased by 2.4%.

But recovery remains uneven, predominantly propelled by the agriculture industry and the retail trade. Moreover, only retail trade has shown sustainable improvement so far, with demand consistently outpacing supply. Exited downturn though, the agriculture is still on a weak footing. Those in the segment seeing prospects for increase in production and exports remain in minority (20-25% of businesses), according to a survey by Ukrstat. Many agricultural producers report limited opportunities for expansion due to ongoing hostilities, mine contamination in fields, and a shortage of human and financial resources.

Figure 10. Consumer sentiment index



The industrial production sector presents a negative picture, with capacity utilization increasing but new orders remaining scarce. This has led to an increase in inventories of finished goods, with approximately one-third of industries experiencing no new purchases and about half having stocks exceeding their current order lists. Moreover, the recent explosion at the Kakhovka Hydro Power Plant may further impact metallurgy and other heavy industries, which require significant water resources for their processes.

The construction also face challenges, with declining production despite positive sentiments limited to ongoing projects. Expectations for increased demand and new projects remain gloomy, as pessimism about raw material prices discourages new purchases.

Dormant competitiveness across markets indicates an early stage of recovery. But expectations for 2Q23 have improved compared to the previous survey, primarily due to improved power supply.

Increased efficiency of air defence is another factor helping to support business sentiment. That said, prevailing uncertainties regarding the situation on the battlefield keep weighing heavily on confidence. **Business remains cautious, recognizing the magnitude of the threats posed by Russia's actions.** The recent Kakhovka dam explosion, causing widespread flooding in the region, exemplifies the kind of disastrous scenario that, although not factored in before it actually comes true, continues occupying the minds.

Another potential long-term factor that may affect the recovery is a potential shortage of labour force due to significant migration of Ukrainians abroad and a rising number of Ukrainians employed overseas. Addressing this issue will require resolute reform efforts within the country to stimulate the reverse flow of skilled workers.

UKRAINIAN CAPITAL MARKETS REVIEW

Key Macroeconomic Indicators

	2017	2018	2019	2020	2021	2022	2023E	2024F
Real sector								
Real GDP (%YoY)	2.5	3.4	3.2	-3.8	3.4	-29.1	-0.5	5.0
Industrial production (%YoY)	1.1	3.0	-0.5	-4.5	1.9	-36.9	NA	NA
Retail sales (%YoY)	6.5	6.2	10.3	8.4	10.7	-21.4	NA	NA
Unemployment rate end of year (ILO, working age)	9.5	8.8	8.2	9.5	9.8	NA	NA	NA
Nominal GDP (UAH bn)	2 984	3 561	3 975	4 222	5 460	5 191	NA	NA
Nominal GDP (USD bn)	112	131	155	157	201	161	NA	NA
Prices								
CPI (average %YoY)	14.4	11.0	7.9	2.7	9.4	20.0	22.6	11.6
CPI (end of year %YoY)	13.7	9.8	4.1	5.0	10.5	26.6	18.4	7.0
Real average wage growth (%YoY)	19.1	12.5	9.8	7.4	11.9	NA	NA	NA
Fiscal balance (% of GDP)								
State budget deficit (without Naftogaz)	1.6	2.4	1.8	5.2	3.6	17.6	NA	NA
Total public debt (% of GDP)	71.8	61.0	51.6	60.8	48.9	78.4	NA	NA
External balance								
Exports of goods and services (USD bn)	53.9	59.2	63.6	60.7	81.5	57.1	NA	NA
Imports of goods and services (USD bn)	62.7	70.6	76.1	63.1	84.5	81.5	NA	NA
Current account balance (USD bn)	-3.5	-6.4	-4.1	5.3	-2.1	8.4	NA	NA
Current account balance (% of GDP)	-3.1	-4.9	-2.7	3.4	-1.0	5.2	NA	NA
Net FDI (USD bn)	3.7	4.5	5.2	-0.1	6.0	0.6	NA	NA
Foreign exchange reserves (end of year)	18.8	20.8	25.3	29.1	30.9	28.5	32.0	30.0
Imports coverage (months of imports of goods)	3.6	3.5	3.9	4.8	4.1	3.7	4.2	3.8
Interest and exchange rates								
NBU discount rate (% end of year)	14.5	18.0	13.5	6.0	9.0	25.0	20.0	14.0
Exchange rate (USD/UAH) end of year	28.1	27.7	23.7	28.3	27.3	36.6	42.0	50.7
Exchange rate (EUR/UAH) end of year	33.5	31.7	26.4	34.7	30.9	39.0	47.9	59.8

*estimates, no official data yet available

NA – data is not available because of continuing military operations



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FOUR WEEKS AHEAD

Mon	Tue	Wed	Thu	Fri	Sat	Sun
26/06/2023	27/06/2023	28/06/2023	29/06/2023	30/06/2023	01/07/2023	02/07/2023
NBU: Minutes		LGB % UAH 610.7mn		NBU: BoP		
03/07/2023	04/07/2023	05/07/2023	06/07/2023	07/07/2023	08/07/2023	09/07/2023
		LGB % UAH 394.1mn LGB P UAH 10 886.7mn		NBU: FX Reserves (deadline - 7th day)		
10/07/2023	11/07/2023	12/07/2023	13/07/2023	14/07/2023	15/07/2023	16/07/2023
Ukrstat: Price indices	NBU: Monetary Statistics		LGB % EUR 3.1mn			
17/07/2023	18/07/2023	19/07/2023	20/07/2023	21/07/2023	22/07/2023	23/07/2023
			LGB P USD 314.5mn			

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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