

# Latest developments in Ukraine

Oleksiy Blinov, Head of Research

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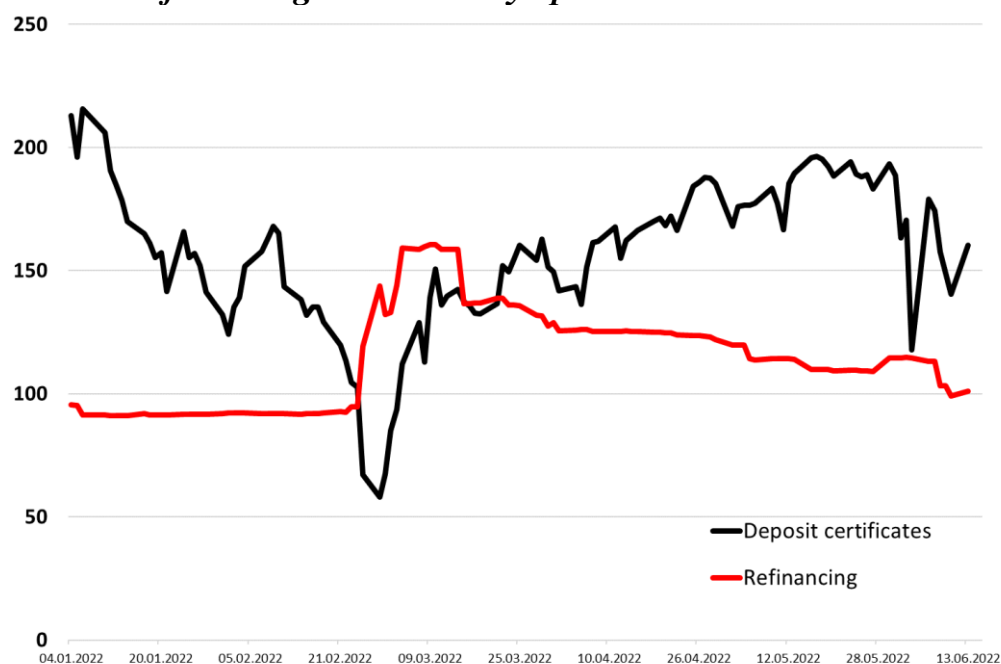
**NBU surprises with a harsh rate hike, likely to unfreeze the official FX rate soon.** The central bank surprised the market by raising its prime rate from 10% to 25%. While the NBU had sent some public messages about a strong shift in its policy prior to the review, hardly anyone felt the message was about imminent decisions. Indeed, no one among economists polled by the NBU had expected any rate hike in June.

This decision has little to do with inflation targeting. Sticking to this approach is not a priority now, and the central bank admits that. Ukraine has effectively found itself in the exchange rate targeting mode, with the latest NBU decision being primarily a major attempt to address FX market imbalances.

The official exchange rate has remained frozen at USD/UAH 29.25 since the start of the war. Before the NBU rate decision, that had been coming at an increasingly high price to FX reserves, as low-yielding hryvnia and devaluation expectations spurred imports and flight to foreign currency. In the week prior to the key policy rate change, net FX sales by the NBU surged to USD 1.4 bln. After the prime rate hike, this subsided back to USD 0.8 bln weekly over the past 2 weeks.

The immediate effect on the banking sector was that NBU refinancing has become overnight the most expensive funding source, priced at 27% per annum. So, banks have accelerated returning the funds to the NBU (*see chart below*). As free liquidity is still ample and now yields 23% per annum, the sector enjoys a moderate positive net effect from the policy decision (however, not evenly distributed among banks). And banks have much leeway in pace of adjusting their client rates to the new prime rate.

## ***Balance of banking sector money operations with the NBU in 2022, UAH bln***



Sources: NBU, Alfa-Bank Ukraine

The central bank signaled that the 25% rate is likely to remain the highest point in the foreseeable future and could be decreased when multiple pressures and inflationary expectations subside. We pencil end-year prime rate at 20-22%.

In our view, the next big decision by the NBU would be unfreezing the exchange rate. There is a broad consensus that the official rate of USD/UAH 29.25 does not keep up with the status quo. As a temporary stability support measure, it has been producing negative side-effects, increasingly favoring imports and discouraging sales of export revenue. Recent government decisions to expand the list of critical imports (which are allowed to buy FX at the official rate plus 1%) have made that list almost all-inclusive, with intangible (and thus uncontrollable services included). We think that the official rate is very likely to be unfrozen in July, even if the announced return of taxes on imports is delayed further (a respective draft law has been in the parliament over 2 weeks already without consideration).

**Inflation accelerates further to 18%, expected to surpass 20% this summer.** The Consumer Price Index (CPI) added 2.7% MoM in May, accelerating annual CPI growth further to 18% YoY. This came significantly below our expectations (18.7%) and greatly above the NBU's estimate (17%). We maintain our forecast for CPI growth surpassing 20% this summer.

### *Inflation in May 2022*

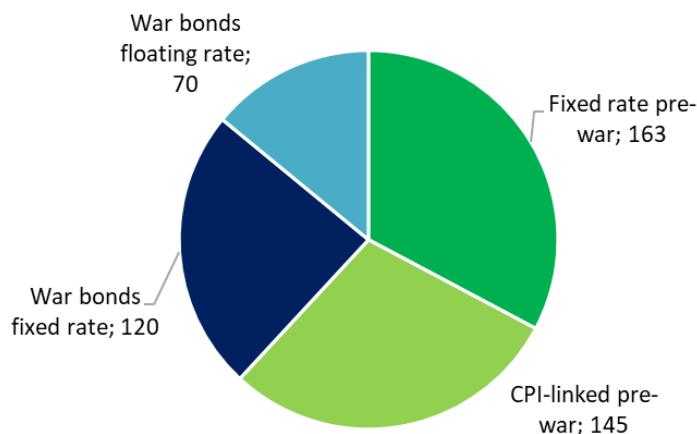
Goods and services	MoM price growth, %	MoM contrib. to CPI growth, p.p.	YoY price growth, %	YoY contrib. to CPI growth, p.p.	Recent trend*	Share in CPI basket, %
Foodstuffs, including:	2.7	1.2	23.6	10.3	↑↑	43.6
bread and grain products	3.7	<b>0.3</b>	29.8	<b>2.3</b>	↑↑	7.6
meat and products	0.4	0.0	13.8	<b>1.5</b>	→	10.7
fish and products	5.9	0.2	28.0	0.8	↑↑	2.8
eggs	-21.2	-0.2	-28.5	-0.2	↓↓	0.8
sunflower oil	0.5	0.0	8.0	0.1	↓↓	1.1
fruit	11.5	<b>0.4</b>	20.3	0.6	↑↑	3.1
vegetables	5.4	0.2	77.1	<b>2.7</b>	↑↑	3.5
sugar	-1.3	-0.0	14.1	0.1	↓	0.7
Tobacco and alcohol	3.9	<b>0.3</b>	17.8	<b>1.5</b>	↑↑	8.2
Clothes and footwear	-0.2	-0.0	-5.7	-0.3	→	5.0
Utilities, including:	0.4	0.0	3.5	0.3	↓	8.4
electricity	0.0	0.0	-7.4	-0.1	→	1.6
natural gas	-0.4	-0.0	10.1	0.2	↓	2.3
Healthcare	-0.9	-0.1	13.1	<b>0.9</b>	↑	7.2
Transportation, incl.:	10.2	0.9	29.3	2.7	↑↑	9.3
gasoline	22.8	<b>0.6</b>	57.5	<b>1.6</b>	↑↑	2.8
Other	—	0.4	—	2.6	—	18.3
<b>CPI</b>	<b>2.7</b>	<b>2.7</b>	<b>18.0</b>	<b>18.0</b>	↑↑	<b>100.0</b>
<b>Core CPI</b>	<b>1.4</b>	—	<b>13.8</b>	—	↑↑	—

\* arrow up means acceleration in YoY terms over the last 3 months,  
arrow down means deceleration

Sources: State Statistics Service, Alfa-Bank Ukraine

**MinFin now borrows from the NBU at a much higher price.** After the prime rate increase, the government updated the parameters of long-term bonds it sells to the NBU. If previously war bonds were cashed by the NBU at a comfortably fixed rate of 11% per annum, now it is floating rate linked to an average NBU prime rate over 12 months preceding to the coupon payment. After that, the NBU purchased another UAH 70 bln in such bonds to cover the fiscal gap, expanding its total war bond ownership to UAH 190 bln and total portfolio of T-bills to UAH 499 bln par value.

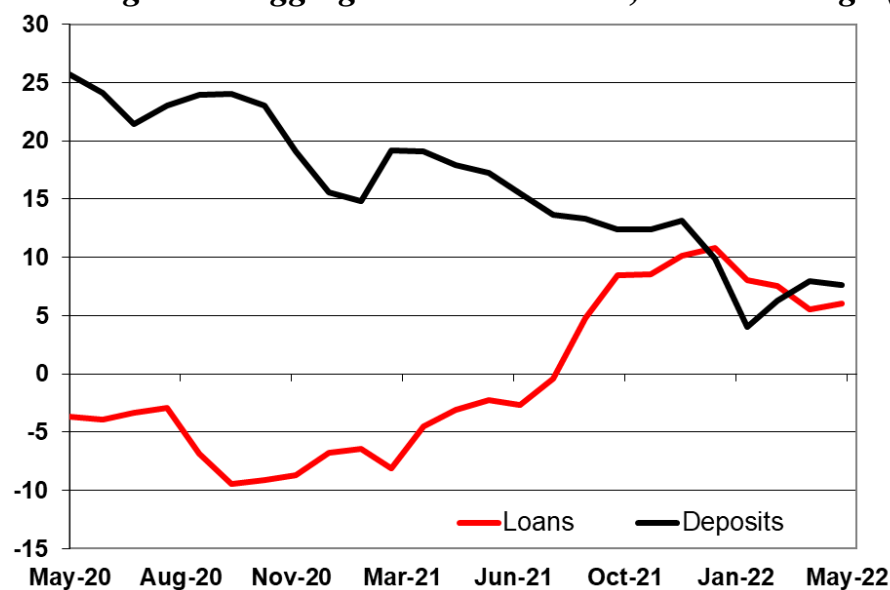
***T-bills owned by the NBU as of 13 June 2022, UAH bln***



*Sources: Ministry of Finance, NBU, Alfa-Bank Ukraine*

**Bank deposits stable.** In May, cash on client accounts in Ukrainian banks remained almost unchanged at UAH 1,507 bln, slipping just UAH 1 bln (-0.1% MoM). This is good performance, considering May is usually when household deposits deep for a while. They did actually this time too, decreasing UAH 2.05 bln (-0.4% MoM) and USD 74 mln (-0.9% MoM). But that was offset by increased FX stocks at corporate accounts, which grew USD 0.3 bln (+4.1% MoM). Overall, the banking sector managed to maintain its deposit base in the positive territory.

***Banking sector aggregates in 2020-2022, YoY % change (cleared of FX rate effects)***



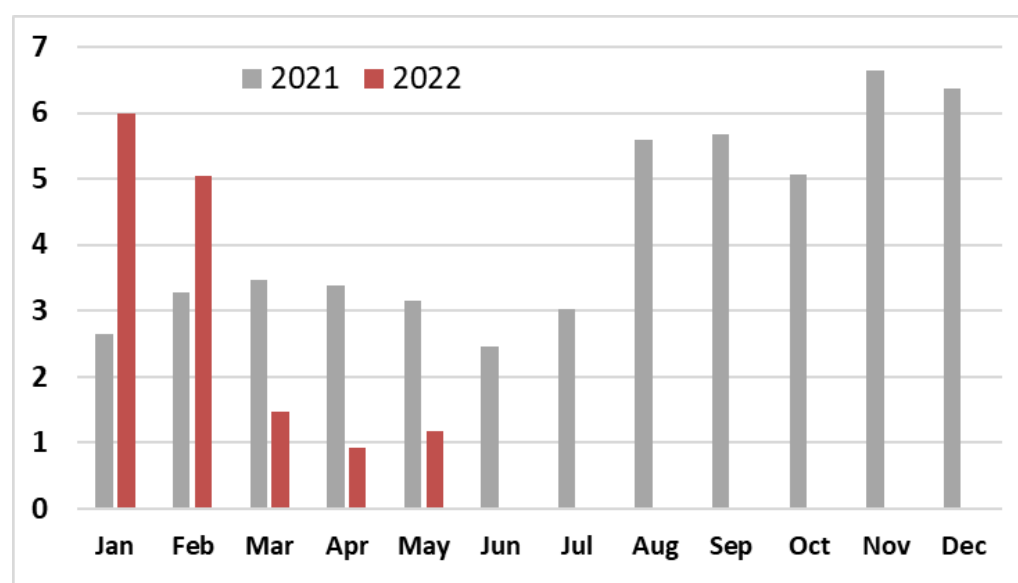
*Sources: NBU, Alfa-Bank Ukraine*

**NBU deemed Megabank as insolvent.** That is a medium-sized Kharkiv-based bank, ranked 24 by assets (market share of less than 0.5%). The NBU stressed that the bank encountered severe stability issues prior to the war.

**Ukraine managed to export 1.2 mln tonnes of grain in May.** This 28% MoM increase owes to intensified use of railways and Danube delta ports. However, that is still a very thin bottleneck for around 50 mln tonnes of grain from inventories and prospective harvest that Ukraine could send overseas.

*For more insight on the grain exports issue, please see the recent VoxEU column by Oleksiy Blinov and Simeon Djankov, [Restarting Ukraine's Agricultural Exports](#).*

### *Monthly grain exports from Ukraine, mln tonnes*



*Sources: State Customs Service, Alfa-Bank Ukraine*

**Steel output at a fifth of its pre-war level.** According to a flash estimate by UkrMetalurgProm, steel output dropped 53% YoY over 5M22. While this accumulated figure might look not very bad, it actually implies that the sector operated at around 20% of its pre-war output in March-May.

**Real GDP down 15% YoY in 1Q22...** After a long delay, the State Statistics Service has produced a flash estimate for real GDP falling 15.1% YoY in the first quarter of 2022. It is important to note that the war started at the end of February, thus the 1Q22 includes just a deep plunge in March, while more than half of the reported period still was about pre-war moderate expansion.

It is obvious that the second quarter should reveal a much deeper fall, which we estimate at 40-50% YoY. We maintain our full-year real GDP decline forecast for 2022 at 33%.

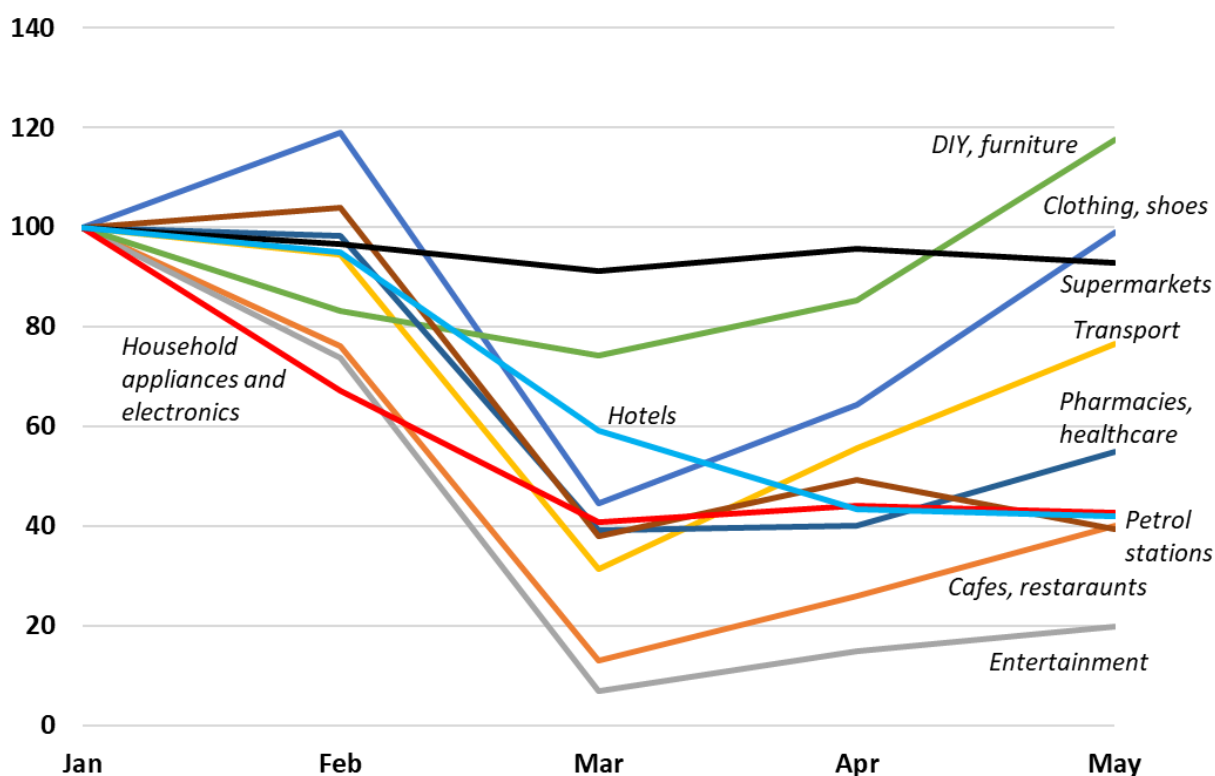
**...while retail data reveal domestic demand recovery in May.** Addressing general setbacks in national statistics, we have compiled data from the use of our nation-wide

network of payment terminals (POS) to follow changes in consumer spending in Ukraine.

Overall, Ukrainians increased their spending via POS terminals by 19% MoM in May. In particular, spending on construction materials, homeware and furniture surged 38% MoM and was already some 20% above their January level. Similar trend was seen for clothing and shoes: up 54% MoM and back to its pre-war level. POS sales in cafes and restaurants also jumped 54%, but were still at 40% of their January volume.

At the same time, deficit of oil products led to sales at petrol stations declining 20% MoM in May. These also ended at just 40% of their January volume, but, considering strong price increases for oil products, the plunge is even deeper.

**POS payments by vendor type in 2022, January 2022 = 100**



Source: Alfa-Bank Ukraine

**Economy-related legislation voted in Verkhovna Rada over last 2 weeks**

Draft Law No.	Content	Status
6070-1	On technical control over agricultural vehicles	Approved
7307	Fast-track rent for industrial-military complex companies	Approved
7347	Amendments to legislation on audit (ban for Russian-related auditors, ease of audit business)	Approved
7401	Support for bio-ethanol production	Approved
7413	Amendments to the State Budget for 2022 (expenditures expanded by debt-financed UAH 287 bln)	Approved

Sources: Verkhovna Rada, Alfa-Bank Ukraine

***Recent sovereign debt operations and upcoming payments schedule***

	New debt	Payments	
		<i>Amortization</i>	<i>Interest</i>
23 May	—	—	UAH 552 mln*
24 May	UAH 7,559 mln + USD 54.9 mln + EUR 131.2 mln + JPY 13 bln	—	UAH 261 mln*
25 May	—	UAH 14,363 mln	UAH 4,875 mln
26 May	—	—	UAH 506 mln* + USD 0.9 mln
27 May	—	—	UAH 251 mln*
30 May	—	—	UAH 246 mln*
31 May	UAH 2,752 mln + USD 15.8 mln	—	—
01 June	—	UAH 1,500 mln*	UAH 1,317 mln
02 June	—	—	EUR 6.2 mln
07 June	UAH 856 mln	—	—
08 June	—	—	UAH 1,065 mln
09 June	UAH 70,000 bln**	EUR 131.7 mln	EUR 1.6 mln
14 June	UAH 3,841 mln + EUR 54.6 mln	—	—
15 June		UAH 18,161 mln	UAH 3,108 mln
20 June		SDR 125 mln***	EUR 67.5 mln
21 June	<i>placement</i>	—	—
22 June		—	UAH 1,864 mln
23 June		USD 517 mln	USD 6.5 mln
28 June	<i>placement</i>	—	—
29 June		UAH 5,213 mln	UAH 553 mln

\* *paid fully to the NBU*

\*\* *NBU purchase of war bonds*

\*\*\* *debt to the IMF, paid fully by the NBU*

*Sources: Ministry of Finance, IMF, Alfa-Bank Ukraine*

### ***Ukraine: key macroeconomic indicators***

	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022f</b>
GDP, UAH bln	3,977	4,222	5,460	4,680
GDP, USD bln	155.0	155.8	200.9	152
GDP, % real change	3.2	-3.8	3.4	-33
Industrial output, % real change	-0.5	-4.5	1.1	-37
CPI, % average annual change	7.9	2.7	9.4	19
CPI, % change Dec/Dec	4.1	5.0	10.0	21
Average wage, USD	406	430	514	U/R
Average wage, % real change	9.8	7.4	10.5	U/R
Consolidated Budget balance, % of GDP	-2.1	-5.3	-3.4	U/R
Public debt (incl. guarantees), % of GDP	50.2	60.4	48.9	U/R
Net FDI inflow, USD bln	5.2	-0.1	6.7	U/R
Current account balance, % of GDP	-2.7	3.4	-1.3	0.0
FX reserves, USD bln at year-end	25.3	29.1	30.9	U/R
USD/UAH rate*, annual average	25.85	26.96	27.29	30.50
NBU key policy rate, % (annual average)	17.0	7.9	7.5	17.7

*\* NBU official rate, now fixed at USD/UAH 29.25 since 24 February 2022*

*Sources: State Statistics Service, National Bank of Ukraine, Ministry of Finance, forecast by Alfa-Bank Ukraine*

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