



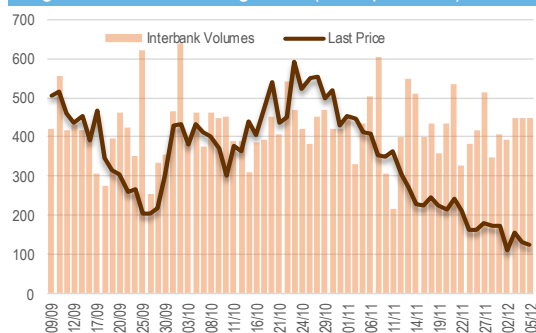
ECONOMICS | INTEREST RATES STRATEGY | FX

5 December 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Increasing Agri-Food exports narrows CA deficit
Fitch	B	POSITIVE	06.09.2019	CA saw another improvement in October: a 12-month cumulative deficit decreased by 1.6% m/m to USD3.7bn. The change seems to justify strengthening of the local currency, but the gap stays too wide. We keep our year-end forecasts both for UAH FX rate and CA unadjusted to the recent developments, though admit that final prints might prove better than we expect.
S&P	B	STABLE	27.09.2019	
S&P (N)	uaBBB	-	12.04.2019	
Moody's	Caa1	POSITIVE	22.11.2019	

Figure 1. UAH exchange rate (UAH per USD)



FX and interest rates: Hryvnia pushes higher against US dollar

The upbeat momentum in the Ukrainian local currency remains firm for yet another week and is now pushing the USD/UAH rate to fresh lows below the 24 key mark.

The pair is up for the third consecutive session on Thursday, extending the upside on the back of persistent FX liquidity inflow related to both fresh foreign investments into local government debt and recurring single large scale FX transactions. The latter is said to be related to the state company Naftogaz and the bulk of funds sold were absorbed by the central bank.

Regarding non-residents' transactions, being not material in volumes they currently produce a kind of psychological pressure, making the market to believe that further hryvnia strengthening, at least for upcoming months, is inevitable.

The recent National bank's (NBU) statements, confirming a natural course of the foreign currency market, only reinforce such expectations.

We noticed, however, that non-residents' position in the public debt showed negative change on certain days since the last decade of November. This may indicate of a profit-taking before the New Year. If this is the case, the currency pair may reverse the upward trend for a while in case of intensification of such debt sales.

Total liquidity in the banking system increased by 4.2% - to UAH131bn in the week ended on November 29. The central bank's interventions in the foreign currency market and changes in the volume of cash money were the main contributors to the increase. In particular, the NBU bought USD120mn during the last week (a 37.4% decrease compared with a week earlier), injecting into the system UAH4.4bn. In turn, an inflow via a cash channel amounted to UAH3.5bn.

Monetary operations represent increase of investments into central bank's certificates of deposits (CDs) by 9.6% to 77.2%. Most of funds are allocated in 2-week CDs (UAH62.8bn).

Figure 2. Banking liquidity (UAH bn)

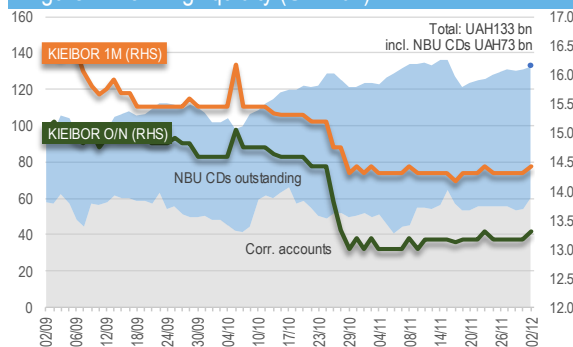


Figure 3. Correspondent account balances (UAH bn)



Figure 4. Local UAH bonds market

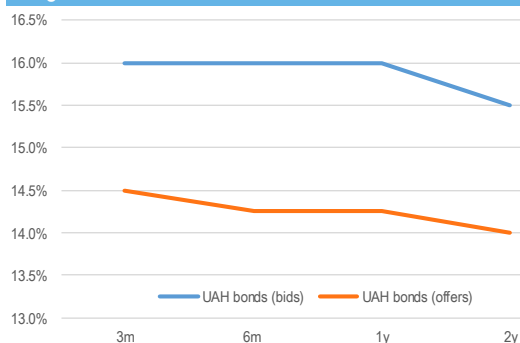
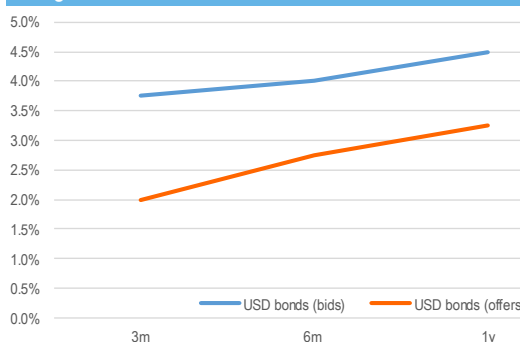


Figure 5. Local USD bonds market



Government bond market

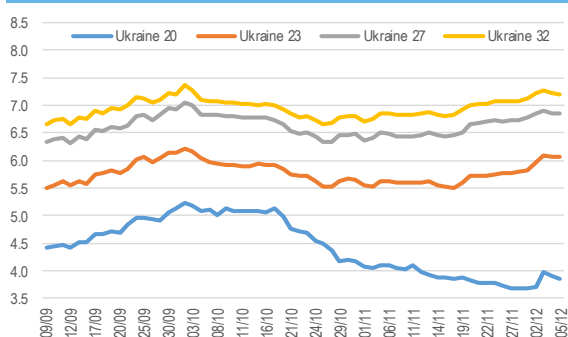
CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size, mn	Placement size, mn
UAH	3m	13.80%	13.06%	15.00%	13.00%	7	5	372.58	52.58
UAH	4.5y	12.50%	12.38%	12.90%	12.25%	19	14	4 087.43	3 000.00
USD	1y	4.00%	3.88%	4.50%	3.45%	30	24	27.80	18.25
USD	2y	4.25%	4.08%	5.00%	3.49%	23	19	45.31	34.46

The Finance Ministry attracted UAH3.4bn and USD53.9mn at the primary auction on December 3. Among UAH-denominated bonds there were offered 3m bonds worth UAH3bn and 4.5y securities with a ceiling lifted to UAH3bn from UAH2.5bn. The rising in the threshold is likely due to increase in FinMin's borrowing plan for 2019 by UAH16.4bn, as we mentioned in our previous report.

While the auction of the short-term bonds went poorly – there were sever applications for UAH373mn but the ministry accepted only five of them for UAH53mn with a rate below 13.8% - the 4.5y securities draw a bid-to-cover ratio - a gauge of demand – of 1.36. The bonds were sold at an average yield of 12.38%, and the cut-off rate was set at 12.5%, a 40 basis points below the maximum bid rate.

In addition to debt in local currency the ministry offered USD100mn worth of 1y bonds and USD250mn worth of 2y securities in foreign currency. The auctions drew a cool reception with a total amount of bids at USD73mn. The shorter-dated bonds were sold at an average yield of 3.88% with a cut-off rate at 4% and the 2y securities were sold at an average yield of 4.08% (a cut-off rate was set at 4.25%).

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



USD weakens against EUR on trade tensions

The greenback fell 1% in the last seven days, taking it to a one-month low versus the single currency on renewed trade tensions. In early trading on Thursday, the U.S. dollar edged up to 1.1082 against the euro.

U.S. President Donald Trump's statement that he had "no deadline" for an agreement with China hurt sentiment as lengthy trade negotiations have already weakened world growth, with many economies struggling to find their footing.

Poor prints in the U.S. docket as of late have resurrected doubts regarding the 'good shape' of the U.S. economy, while news on the U.S.-China trade front have been also weighing on yields and morphed into extra weakness for the buck.

Figure 7. EUR USD spot (mid)



Data wise in Euroland, retail sales disappointed expectations in October, while final 3Q19 GDP prints matched consensus. In general, the slowdown in the region appears far from abated despite some positive results from key fundamentals in Germany and the euro bloc as of late.

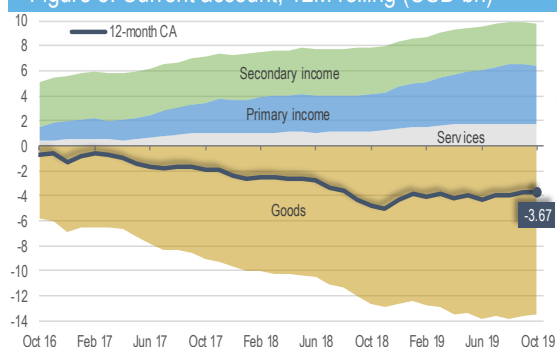
Fixed income market focus is also largely attuned to global trade developments, following a media report suggesting the world's two largest economies were on the cusp of signing a so-called "phase one" trade deal. The yield on the benchmark 10-year Treasury note, which moves inversely to price, was seen on Thursday at around 1.807% compared to 1.767% a week earlier.



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Figure 8. Current account, 12M rolling (USD bn)

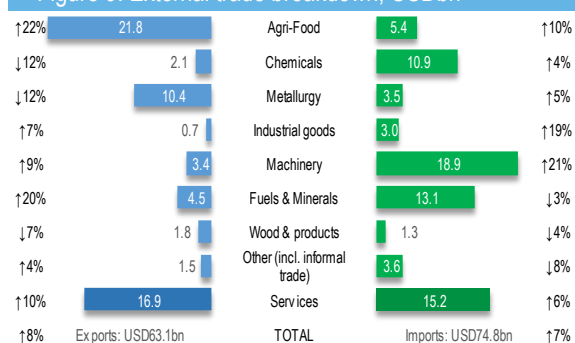


Increasing Agri-Food exports narrows CA deficit

Current account (CA) saw another improvement in October. According to the central bank's updated stats 12-month cumulative CA deficit decreased by 1.6% m/m to USD3.7bn. The change seems to justify strengthening of the local currency, but the gap stays too wide. We keep our year-end forecasts both for UAH FX rate and CA unadjusted to the recent developments, though admit that final prints might prove better than we expect.

Not much changed in terms of major contributors to the trade balance as compared with the previous month (see report of Nov 13). Worth noting however, that record-breaking grain crops in 2019 – 74.3 mn tonnes according to Ministry of Economic Development, Trade and Agriculture – contributed to a record high export revenue inflow per month – USD2.3bn. Total agrifood export sales in the first ten months of the year increased by 22% - to USD17.9bn.

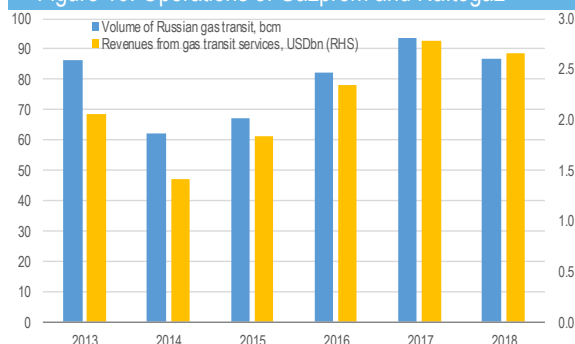
Figure 9. External trade breakdown, USDbn



A year-end CA deficit reading might prove better than we expect (below our forecast at USD4bn). Agricultural export revenue inflow is likely to stay buoyant through the end of the year against strong crops and existing storage capacities gap. Yet some decline in monthly sales might take place, taking into account that harvesting campaign has been completed within a shorter period compared with a year earlier, so some agropducers could have pushed forward with their export sales amid strengthening hryvnia.

Increasing machinery imports, however, will not allow the final print to show a surprising change. In addition to extensive investments into green energy projects, draining incoming foreign currency, used cars imports from EU seems to regain momentum amid favorable local currency conditions.

Figure 10. Operations of Gazprom and Naftogaz



Focus on the services segment, and looming gas transit cut-off through Ukraine in particular. On January 1, 2020 expires the current ten-year contract between Naftogaz and Russia's Gazprom regarding the transportation of Russian natural gas through Ukraine. Having its Nord Stream-2 project in the final stage Russia is clearly reluctant to negotiate with Ukraine over a new long-term agreement on transporting natural gas to Europe. Some concessions from the Russian side might be needed though, as the new gas pipeline is clearly lacking capacity for complete substitution of the Ukrainian transportation gas channel. Ukraine-EU-Russia are continuing trilateral gas talks on the matter in December.

Services net contribution to the external trade balance has tripled since 2016 and this year might reach USD2bn. Gas transportation services, in turn, generate about USD2.5bn annually during the last three years. While a total halt in Russian gas transit through Ukraine in 2020 is hardly likely, we expect a notable reduction in volumes of gas transported, reducing current surplus in external trade of services.



UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators

	2013	2014	2015	2016	2017	2018	2019E	2020F
Real sector								
Real GDP (%YoY)	0.0	-6.6	-9.8	2.3	2.5	3.3	3.5	3.5
Industrial production (%YoY)	-4.3	-10.7	-6.0	2.4	-0.1	1.6	0.0	1.2
Retail sales (%YoY)	6.1	-11.0	-25.0	4.0	8.8	6.1	5.0	4.0
Unemployment rate end of year (ILO, working age)	7.7	9.7	11.5	9.3	8.7	8.5	8.5	8.4
Nominal GDP (UAH bn)	1 466	1 587	1 980	2 383	2 983	3 393	3 830	4 321
Nominal GDP (USD bn)	184	134	91	93	112	125	145	152
Prices								
CPI (average %YoY)	-0.2	12.1	48.7	16.5	14.4	10.5	9.2	8.1
CPI (end of year %YoY)	0.5	24.9	43.3	12.4	13.7	9.8	7.9	7.2
Real average wage growth (%YoY)	8.2	-6.5	-35.0	10.0	18.9	9.7	8.0	6.0
Fiscal balance (% of GDP)								
State budget deficit (without Naftogaz)	4.2	4.9	2.3	2.9	1.6	2.4	2.4	2.3
Total public debt (% of GDP)	39.9	69.4	79.4	81.0	71.8	61.0	60.0	61.0
External balance								
Exports of goods and services (USD bn)	81.7	65.4	47.9	46.0	54.0	59.0	57.2	59.5
Imports of goods and services (USD bn)	97.4	70.0	49.6	51.8	60.8	70.5	69.1	71.8
Current account balance (USD bn)	-16.5	-4.6	1.6	-1.3	-2.4	-4.7	-4.0	-4.5
Current account balance (% of GDP)	-9.0	-3.4	1.8	-1.4	-2.1	-3.3	-3.3	-3.2
Net FDI (USD bn)	4.1	0.3	3.0	3.4	2.3	2.5	2.3	2.4
Foreign exchange reserves (end of year)	20.4	7.5	13.3	15.5	18.8	20.8	22.5	23.5
Imports coverage (months of imports of goods)	2.9	1.5	4.4	3.7	3.6	3.4	3.5	3.5
Interest and exchange rates								
NBU discount rate (% end of year)	6.5	14.0	22.0	14.0	14.5	18.0	15.5	13.0
Exchange rate (UAH/USD) end of year	8.2	15.8	24.0	27.2	28.0	27.7	26.5	28.5
Exchange rate (UAH/EUR) end of year	11.3	23.0	26.2	28.3	33.5	31.8	29.2	31.4

Two Weeks Ahead

Date/Deadline	Event	Notes
07-Dec (Sat)	NBU: FX Reserves	by 7th day
09-Dec (Mon)	Ukrstat: Consumer & Production Price Indexes	November
10-Dec (Tue)	FOMC: Monetary Policy Meeting	10-11 of Dec
	NBU: Monetary & Financial Statistics	November
12-Dec (Thu)	ECB: Monetary Policy Meeting	
	NBU: Monetary Policy Meeting	
18-Dec (Wed)	ECB: Non-Monetary Policy Meeting	

Upcoming pay offs related to local government bonds

Date	Payment	Amount
05-Dec (Thu)	Coupon USDmn	14.6
11-Dec (Wed)	Coupon UAHmn (capital notes)	398.4
	Coupon UAHmn	527.9
12-Dec (Thu)	Principal USDmn	160.0
18-Dec (Wed)	Coupon UAHmn (capital notes)	1 214.1
	Coupon UAHmn	273.6

*capital notes - government bonds, which were issued for recapitalization of state-owned banks



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Contacts

Investment Business Group

Serhiy Yahnych

Head of Investment Business

(+38044) 537-50-82 serhii.yahnych@ukrsibbank.com

Viktoriia Nebeska

Market Making Government Bonds

(+38044) 201-22-74 viktoriia.nebeska@ukrsibbank.com

Platon Yachmenov

Fixed Income Dealer

(+38044) 230-48-54 platon.yachmenov@ukrsibbank.com

Mykhailo Kharchuk

Market Analysis

(+38044) 537-49-75 mykhailo.kharchuk@ukrsibbank.com

Distribution of Capital Markets Weekly report:

macro@ukrsibbank.com



FX Business

Oleksandr Duda

Head of FX Sales

(+38044) 537-50-02 oleksandr.duda@ukrsibbank.com

Corporate Business

Ievgen Kulikov

Head of MNC team

(+38044) 201-22-43 ievgen.kulikov@ukrsibbank.com

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