



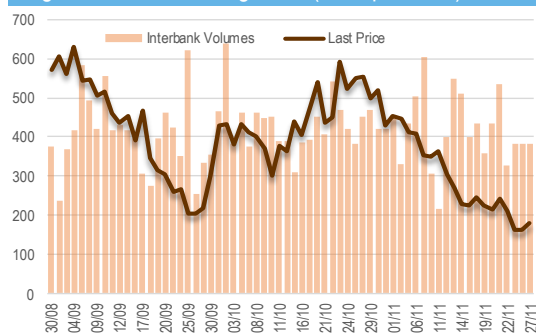
ECONOMICS | INTEREST RATES STRATEGY | FX

28 November 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Main trends in Ukrainian banking sector
Fitch	B	POSITIVE	06.09.2019	Mixed developments in banking sector clearly reflect situation in Ukraine's economy. While led by remarkable improvement in consumer confidence and fast-growing wages lending to households has grown by 12% this year through September, non-financial corporates lending shrank by 11% ytd. As the latter make up about 79% of total credits issued, the bottom number fell by 7.7% ytd.
S&P	B	STABLE	27.09.2019	
S&P (N)	uaBBB	-	12.04.2019	
Moody's	Caa1	POSITIVE	22.11.2019	

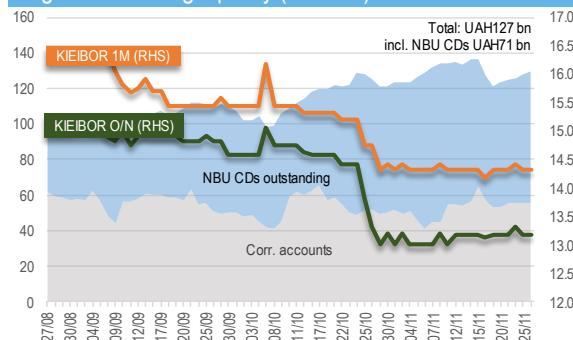
Figure 1. UAH exchange rate (UAH per USD)



FX and interest rates: Hryvnia dives below 24-mark against the US dollar

The USD/UAH pair crashed to 23.96 this week and is now just a tad higher. The previous record low rate of 24.08 was on September 25, shortly after the Finance Ministry attracted UAH12.3bn at its primary debt auction through placement of the most popular among foreigners 5.5y bonds. The reason for the last record-breaking appreciation was pretty much the same. Though the amount of long-term bonds offered during the last primary auction on November 26 was limited to UAH2.5bn, a three times higher demand for the securities confirmed a high appetite for Ukrainian debt among non-residents and forced interbank foreign currency market participants to change their minds about odds of year-end depreciation.

Figure 2. Banking liquidity (UAH bn)



Some expectations of late-year hryvnia adjustment against the U.S. dollar, however, are still there. Market participants point to upcoming VAT refunds and likely increase in social transfers in December. In turn, foreign investors, is expected, to reduce their activity with the approaching of New Year holidays. All told, this might result in tightening of FX liquidity in the market.

The central bank's interventions during the last two weeks amounted to USD312mn. The total FX purchase exceeds amount of government bonds placed in that time by more than USD100mn. In addition to foreign accounts, there were seen some single large scale FX transactions in the market during last two weeks. The related funds were largely absorbed by the central bank.

Figure 3. Correspondent account balances (UAH bn)



Amount of liquidity in the banking system declined during the last two weeks to UAH126bn. The outflow has mostly to do with increasing government's expenditures before the end of budget year. Such transactions have drained about USD14.4bn from the system.

Again, central bank's FX market interventions boosted total liquidity by about UAH7.6bn.

Investments in central bank's certificates of deposits remain above UAH70bn with most of funds allocated in 2-week securities.



Figure 4. Local UAH bonds market

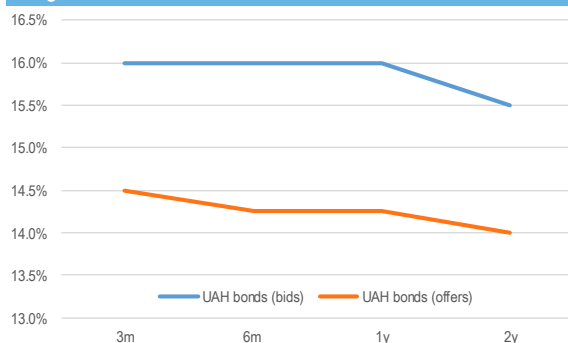
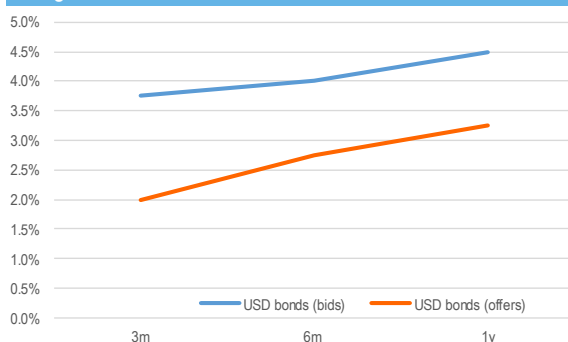


Figure 5. Local USD bonds market



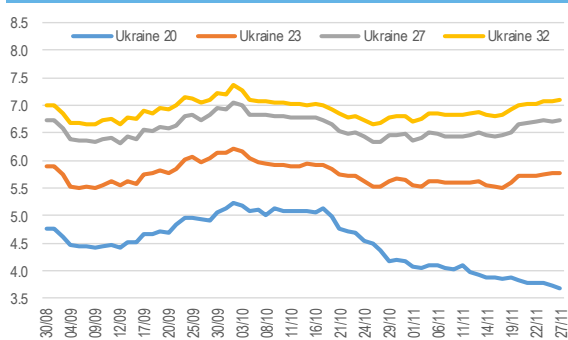
Government bond market

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	6m	14.10%	14.10%	14.10%	14.10%	1	1	2.38	2.38
UAH	1y	-	-	-	-	-	-	0.00	0.00
UAH	4y	12.64%	12.40%	13.25%	12.33%	44	24	7 669.47	2 500.00

The last Finance Ministry's primary debt auction has proved again high appetite among foreign accounts to local government debt. The ministry auctioned 6m, 1y (both capped at UAH500mn) and 4y bonds with a threshold at UAH2.5bn. While the offer of short-term ones was nearly ignored – there was only one application for UAH2.38mn to buy 6m bonds, which was accepted at the unchanged rate of 14.1% - the long-term debt attracted demand three times exceeding the offer. The cut-off rate for securities was reduced to 12.64% from 13.38% three weeks ago. Worth also mentioning that weighted-average yield stood at 12.4% with the best bid rate at 12.33%. This might signal about potential for further interest rate reductions.

This week the government has increased its borrowing plan for 2019 by UAH16.4bn, according to media reports. According to our estimations, this action raises the amount to be borrowed in the local market through the end of the year to about UAH21bn. If so, the ministry might need to lift threshold on long-term bonds in order to meet with the updated plan.

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



EUR/USD returns close to 1.10 barrier

The EUR/USD pair keeps the choppy performance this week against the backdrop of no relevant U.S.-China headlines and the steady activity in the USD-dynamics. The Chinese media has reported a "consensus" in talks after high-level officials from the world's largest economies spoke on the phone early on Tuesday. However, markets seem unconvinced. Moreover, Beijing remains dissatisfied with the American bill on human rights in Hong Kong. President Donald Trump has yet to sign it off.

While markets are suspicious of the trade-related headlines, the U.S. central bank is upbeat on the economy. Jerome Powell, Chairman of the Federal Reserve, has said that he sees a "glass more than full" and is content about the Fed's current monetary policy.

Figure 7. EUR USD spot (mid)



On the background of trade headlines, speculation about monetary policy, and US data the EUR/USD pair in Thursday tested daily lows in the 1.10 neighborhood, but lately managed to regain some traction amidst marginal gains.

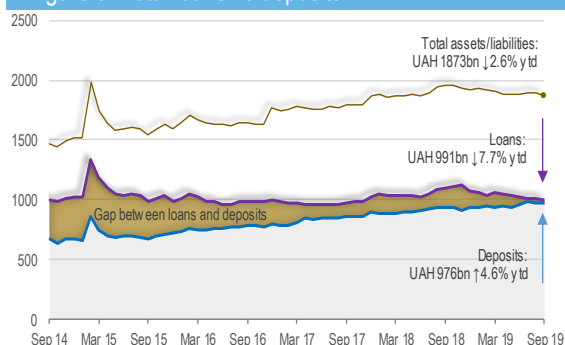
The yield on the benchmark 10-year Treasury note, which moves inversely to price, rose to around 1.7127% by the end of Thursday. Market focus is largely attuned to global trade developments after China's Ministry of Commerce said the leaders of U.S.-China trade talks held another phone call on Tuesday morning.



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Figure 8. Total loans vs deposits



Main trends in Ukrainian banking sector

Mixed developments in banking sector clearly reflect situation in Ukraine's economy. While led by remarkable improvement in consumer confidence and fast-growing wages lending to households has grown by 12% this year through September, non-financial corporates lending shrank by 11% ytd. As the latter make up about 79% of total credits issued, the bottom number fell by 7.7% ytd.

In turn, amount of total deposits has increased by 4.6% this year and has approached level of total loans issued, thanks to attractive interest rates and improved inflation expectations.

On the background of narrowing gap between deposits and loans issued, the share of government securities (domestic government bonds and NBU's certificates of deposit) has tripled to 30% of total banks' assets compared to pre-crisis levels.

Delving into lending data, the **only expanding segment - consumer loans in local currency (19.3% ytd)** - is supported by several factors. On the one hand, increasing wages, robust remittances and decreased expenses on energy products contribute to improvement of personal income. On the other hand, improved consumer sentiment, with correspondent index hitting a 12-year high, and strengthened local currency boost appetite to foreign-made goods, and vehicles in particular.

We expect further steady growth in consumer lending. The ratio of gross consumer loans to GDP at 5.7% means that related risks are minor, while moderate debt burden of households (about 8.7% of annual disposable income, according to the NBU) implies the room for further growth. With expected decline in interest rates amid intensifying competition among banks for borrowers, consumer lending is likely to maintain growth momentum. Moreover, should the interest rates decline and lending conditions improve, car loans and mortgage lending may serve as another important growth factor.

Lending to non-financial corporations remains weak. There is some modest growth in loans issued to not burdened enterprises: several big companies even borrowed from abroad in 3Q19. Besides, after central bank reduced key policy rate and hryvnia appreciated to 3-years high, export oriented companies have interested in financing ongoing expenses through borrowed funds rather than through selling foreign currency revenues. These movements, however, are far from sufficient to reverse the negative trend.

In spite of businesses' intention to increase borrowings to invest in fixed and working capital and banks' eagerness to ramp up corporate lending, excessively high interest rates and still high legal risks to banks when dealing with enforcement of charges are major impediments to recovery in the segment.

Another factors of sluggishness in lending to nonfinancial corporations are still significant debt leverage and sizable amount of non-performing loans. Worth mentioning, however, that banking debt burden vary across different sectors, while banks' efforts to resolve bad debts and increase in new retail lending contribute to decline in the NPL ratio.

Figure 9. Evolution of bank lending

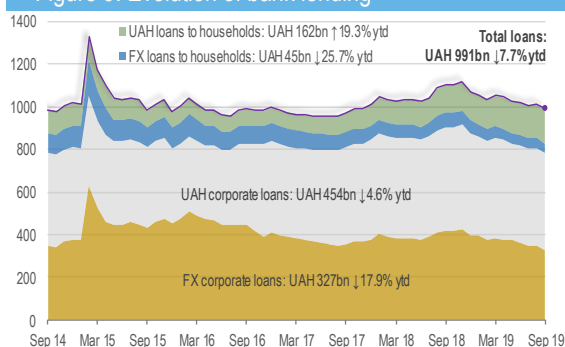


Figure 10. Banks' loans breakdown, UAHbn

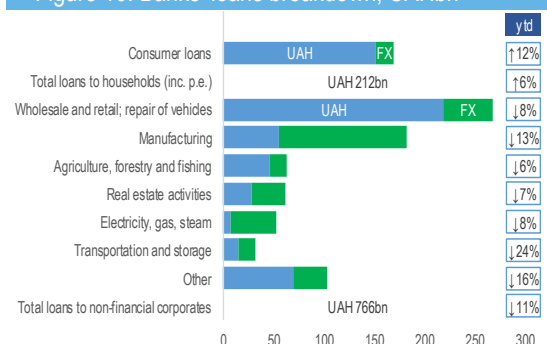
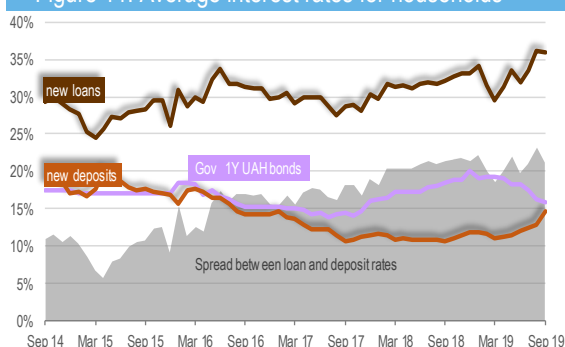


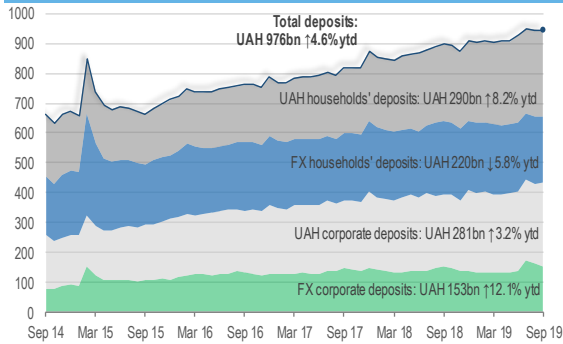
Figure 11. Average interest rates for households



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Figure 12. Bank deposit flows

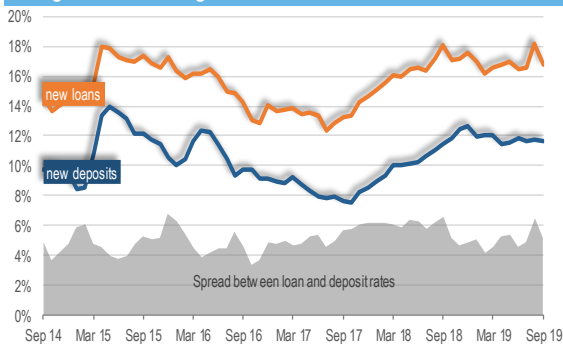


Main trends in Ukrainian banking sector

Situation in deposits positively contrast with the one in lending. Total deposits increased by 4.6%. Strong growth in nominal wages and in corporates' income, coupled with attractive interest rates against improved inflation expectations contributed to the inflow of deposits. Besides, some pick-up in FX corporate deposits in July-August reflects receipts from Eurobond placements by some companies.

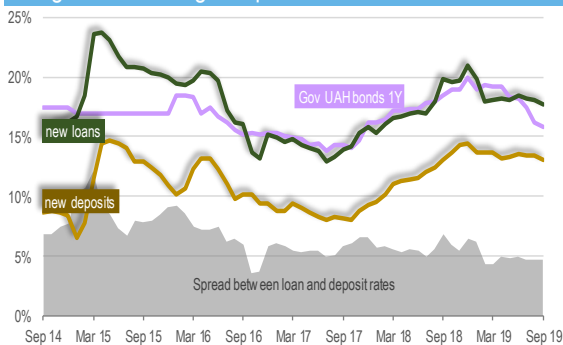
As financial standing of both households and businesses continue improving, we expect total deposits to maintain positive momentum. Growing confidence to banking system and little alternatives for reinvesting savings are supportive to the trend.

Figure 13. Average interest rates



The gap between deposit and loan average interest at the end of September was 5.18 percentage points (pps). This is 27 basis points (bps) wider than in the beginning of the year. The increase, however, has mostly to do with expanding share of retail lending, where borrowing spread exceeds 21 percentage points (minus 18 bps ytd), while spreads in corporate lending this year decreased by 1.7 pps to 4.7%.

Figure 14. Average corporate interest rates



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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	-4.4	-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
28-Nov (Thu)	Ukrstat: Real Wage	October
29-Nov (Fri)	NBU: Balance of Payments	October
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

Upcoming pay offs related to local government bonds

Date	Payment	Amount
04-Dec (Wed)	Principal UAHmn	4 387.4
	Coupon UAHmn (capital notes)	568.5
	Coupon UAHmn	525.8
05-Dec (Thu)	Coupon USDmn	14.6
11-Dec (Wed)	Coupon UAHmn (capital notes)	398.4
	Coupon UAHmn	527.9

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



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