



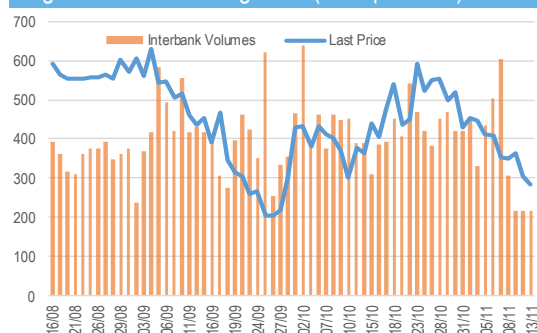
**ECONOMICS | INTEREST RATES STRATEGY | FX**

13 November 2019

# UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: External trade shows slight improvement
Fitch	B	POSITIVE	06.09.2019	CA deficit narrowed by 7.2% to USD3.7bn in 12M to September after marginal change in August. Improvement was mostly attributable to developments in external trade: primarily led by agri-food sales total exports rose by 11.9% y/y while total imports posted an annual increase of only 2%. We expect the year-end CA to land around our forecast at USD4bn.
S&P	B	STABLE	27.09.2019	
S&P (N)	uaBBB	-	12.04.2019	
Moody's	Caa1	STABLE	21.12.2018	

Figure 1. UAH exchange rate (UAH per USD)

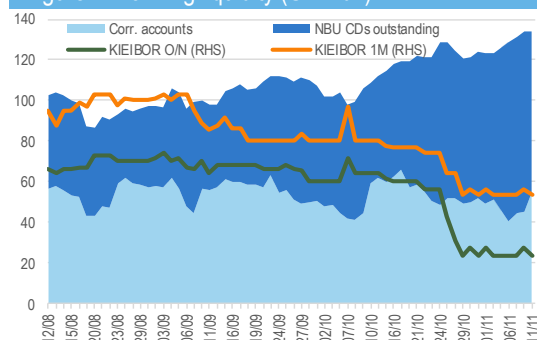


FX and interest rates: USD/UAH gathers momentum

**Ukrainian hryvnia rose against the U.S. dollar to a 5-week high near 24.3 figure.** Fresh foreign investments into local government's bonds, brining non-residents' participation in the public debt to more than UAH102bn (circa USD4bn) or 12% of total government local bonds outstanding, is the major driver of the pair change.

**The main impediment to more rapid strengthening of the local currency places the central bank,** mopping up excess FX liquidity via market interventions. During the last week the National bank of Ukraine (NBU) bought USD372mn, a 2.4-fold increase compared with the amount purchased a week ago.

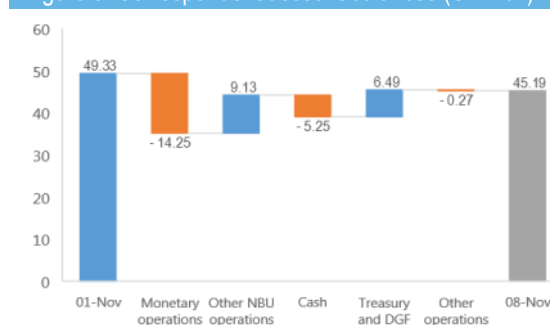
Figure 2. Banking liquidity (UAH bn)



Importers, in particular retailers, though increased demand for FX in order to finance seasonal purchases of goods before end-year's holidays, still find their needs far below the ample foreign currency supply.

**While continuing high non-residents activity in the local public debt market places some risk to our year-end forecast, we prefer to stay cautions** as we see hryvnia lacking internal strength due to wide current account deficit. If largely dependent on external investment sentiment foreign inflow into government's debt stop for a while, it would be difficult for the local currency to resist to the markets pressure from both importers and exporters, reluctant to sell cheap their FX revenues.

Figure 3. Correspondent account balances (UAH bn)



**Amount of liquidity in the banking system hit record high by the end of last week, exceeding UAH133bn.** The further expansion mainly resulted from wide central bank's interventions in the foreign currency market and State treasury operations, which amounted in total to some UAH15.9bn. With regard to Treasury operations, contributing the most since October, no details available about last week's transactions; scheduled for that period payouts related to local government bonds didn't correspond to actual funds flows. The only thing we can point out in this regard is that the government used to make active budget allocations in last months of previous years in order to fulfill its spending plans. If this is the case, we might see further expansion of the liquidity in the system, which in turn will lead to more strong decline of interbank interest rates.

The NBU's monetary operations represent reallocation of banks' free reserves into the central bank's 2-week CDs. As a result, total banks' position in CD's increased to UAH88.5bn.



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Figure 4. Local UAH bonds market

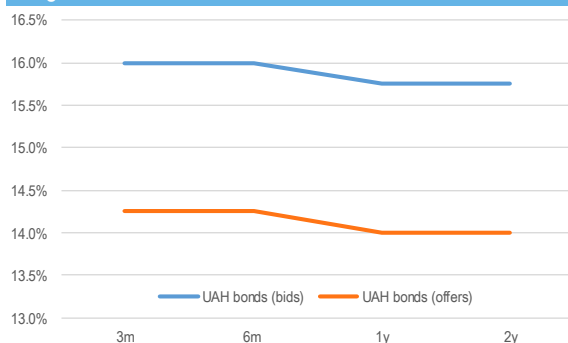
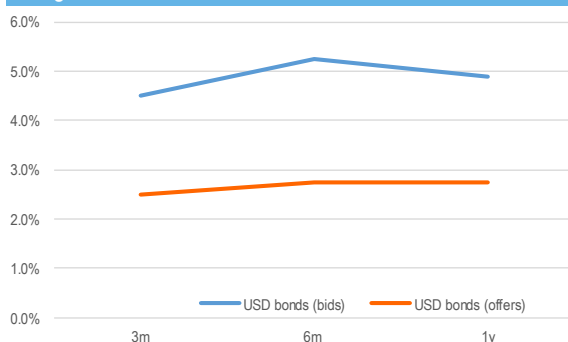


Figure 5. Local USD bonds market



Government bond market

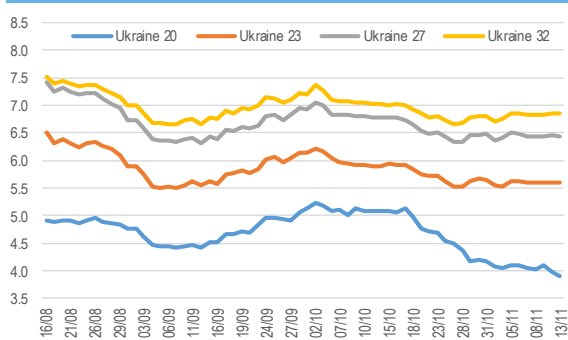
CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size, mn	Placement size, mn
UAH	6m	14.10%	14.10%	14.60%	14.00%	5	3	276.06	263.06
UAH	1y	13.75%	13.74%	14.00%	13.50%	7	6	680.98	500.00
UAH	3y	13.12%	13.07%	14.45%	13.02%	54	23	9 658.82	2 500.00
USD	2y	4.25%	4.02%	6.00%	3.50%	102	76	664.02	300.00

FinMin on Tuesday after a two-month break auctioned 2y USD government domestic loan bonds. All the USD300mn bonds offered were sold out and the bid-to-cover ratio - a measure of demand that indicates the amount of bids for each dollar worth of securities being sold - stood at 2.21. The cut-off rate was reduced to 4.25% from 5.5% per annum.

Apart of USD-denominated bonds the ministry offered UAH securities with a tenure of 6m, 1y and 3y. The highest demand attracted 3y bonds with total bids 3.8 times exceeding the threshold. As a result, the cut-off rate was reduced by 203 basis points (bps) to 13.12%, and 31 of 54 applications with rates up to 14.45% were dismissed.

The demand for 1y bonds was slightly more than the offer – UAH680mn compared with UAH500mn, while for 6m securities it amounted to UAH276mn and did not reach the offered amount – UAH300mn. Nevertheless, their cut-off rates for these bonds were reduced by 25bps to 13.75% and by 130bps to 14.1% respectively.

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



US dollar steady against euro on mixed trade war headlines

The U.S. dollar was lifted last week when comments from the Chinese trade ministry were interpreted as a sign of progress on rolling back China-U.S. tariffs, causing traders to dump safe-haven currencies. However, uncertainty hit again on Friday when Trump said that he had not agreed to reduce tariffs.

Since Monday the U.S. dollar was little changed against the euro. Widely awaited by traders President Trump's speech on Tuesday brought no further details on the US-China 'Phase One' deal, tariffs and a Trump-Xi meeting. As a result, markets' attention has shifted to the risk-off trade echoing in higher US yields and renewed demand for the safe haven space. The dollar was last trading at 1.1003 against the euro.

Figure 7. EUR USD spot (mid)



Regarding the euro currency, the outlook in Euroland remains fragile, the possibility that the German economy could slip into recession in Q3 remains a palpable risk for the outlook and is expected to weigh further on EUR in the short/medium term horizon.

U.S. Treasury prices are rising as mixed trade war headlines have left investors frustrated and confused. The yield on the benchmark 10-year Treasury note, which moves inversely to price, fell to 1.873%.



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Figure 8. 12M current account, USD bn



External trade shows slight improvement

**Current account (CA) deficit narrowed by 7.2% to USD3.7bn in 12 months to September** after marginal change in August. Improvement was mostly attributable to developments in external trade: primarily led by agri-food (+29% y/y) export sales in September rose by 11.9% y/y while total imports posted an annual increase of only 2%. We expect the year-end CA to land around our forecast at USD4bn while increasing inflows through the financial account will contribute to further increase of balance of payment's surplus.

**Strong grain harvest is supportive of exports growth.** The Ministry of Economic Development and Trade on November 12 improved its forecast for harvest of grain and leguminous crops in 2019 to about 74 million tonnes, which is 4 million tonnes above the 2018's factual level. Promising numbers combined with supportive prices at global markets should keep export sales expanding.

**On a monthly basis agri-food exports fell by 4% in September.** Though one change doesn't make a trend, the negative reading came as a surprise, taking into account high season, when short of storage facilities agricultural producers are prone to sell surplus crops. Although it is still too early to make conclusions, the slowing might be related to strong hryvnia, diminishing the value of income of Ukrainian firms from abroad when converted into the national currency. Realized expectations of softer monetary policy could complicate the situation, as exporters might find it better off to cover ongoing financial needs by local borrowings than by selling revenues in foreign currency.

**Recovery in machinery (+31% y/y) and chemicals (+3% y/y) exports also contributed to decrease in CA deficit.** The former, however stays relatively slim and highly sensitive to every single transaction.

Metallurgy, the second major contributor to the total exports, posted another decline both on an annual and monthly basis. The segment stays depressed amid unsupportive price conditions at the global markets.

**Total imports (+2%) increased more slowly on a year-over-year basis in September,** after posting a 7.6% increase in August. This was largely a result of lower fuels and mineral expenditures (-19% y/y) due to favorable energy prices.

Machinery imports (+16%), however, remains the major foreign currency drain. The high growth momentum is being supported by increasing investments in green energy and still high used cars imports from EU. Moreover, taking into account the latest government's initiative towards renewable energy, stimulating those who consider such projects to complete approvals through the end of the year in order to have better feed-in tariff since then, machinery imports is likely to maintain double-digit growth going forward.

Moving lower to financial account, **worth mentioning gradual improvement in foreign direct investment (FDI),** which has mostly to do with mentioned above wide investments into green energy. FDI inflow in 12-month to September rose by 6.1% to USD2.6bn.

With regard to other financial items, the daily central bank's data on the public debt holdings shows continued robust foreign investments inflow into local government's bonds, exceeding UAH102bn (above UAH4bn) as of November 12. In turn, recent successful Eurobonds placements (inc. Naftogaz, DTEK Renewables, Metinvest and others) amid declining yields for the Ukrainian debt to contribute to further improvement in real sector's external position.

Figure 9. External trade breakdown, USD bn

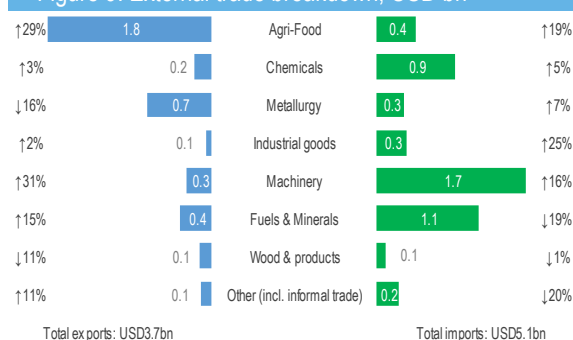


Figure 10. 12M Financial account breakdown

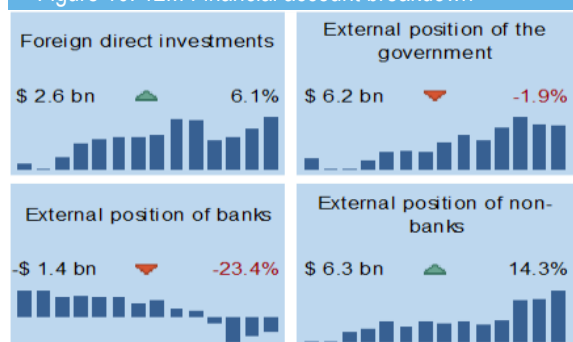
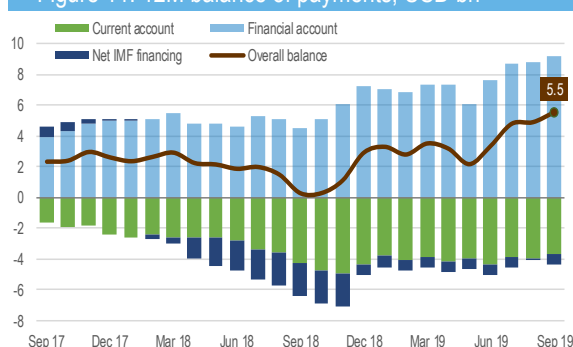


Figure 11. 12M balance of payments, USD bn



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# UKRAINIAN CAPITAL MARKETS WEEKLY

## Key Macroeconomic Indicators

	2013	2014	2015	2016	2017	2018	2019E	2020F
<b>Real sector</b>								
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
<b>Prices</b>								
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
<b>Fiscal balance (% of GDP)</b>								
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
<b>External balance</b>								
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
<b>Interest and exchange rates</b>								
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
13-Nov (Wed)	ECB: Non-Monetary Policy Meeting	
14-Nov (Thu)	Ukrstat: Gross Domestic Product (Operative)	Q3 2019
20-Nov (Wed)	Ukrstat: Retail trade turnover	October
22-Nov (Fri)	Moody's Rating Action	
	Ukrstat: Industrial Production Index	October

## Upcoming pay offs related to local government bonds

Date	Payment	Amount
13-Nov (Wed)	Coupon USDmn	8.9
	Coupon UAHmn (capital notes)	116.7
	Coupon UAHmn	797.0
20-Nov (Wed)	Principal UAHmn	1 584.8
	Coupon UAHmn (capital notes)	430.0
	Coupon UAHmn	541.8

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



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