



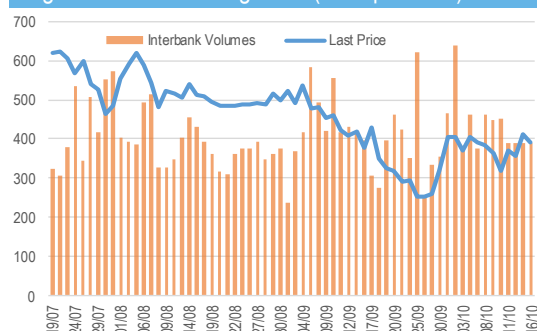
**ECONOMICS | INTEREST RATES STRATEGY | FX**

17 October 2019

# UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Slowing inflation rises odds of another dovish verdict
Fitch	B	POSITIVE	06.09.2019	CPI growth slowed down to 7.5% y/y in September from 8.8% y/y in August. In monthly terms, prices grew by 0.7% after three months of decline. Food and fuel prices – as major contributors - grew slower than expected, primarily thanks to the continued appreciation of the hryvnia. Being positively surprised, the NBU might resort to aggressive easing on October 24.
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)

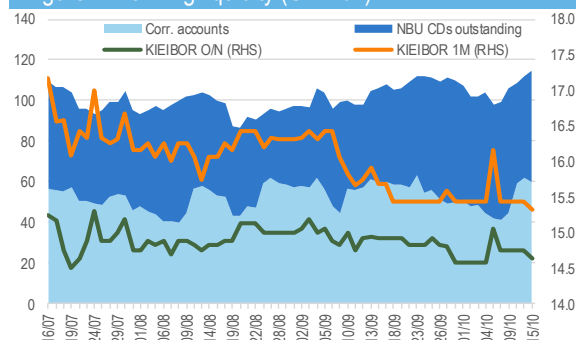


FX and interest rates: Hryvnia holds positions on strong local demand

**The hryvnia was down against the U.S. dollar by a slighter slimmer margin of 0.5% in the 7 days to Wednesday (October 16),** extending a sideways movement it took in the beginning of October. The pair was seen at 24.68 by the end of the last trade session.

**At the same time worth mentioning, that intraday volatility has notably increased in the foreign exchange market.** Modest-sized government's primary debt auction on Tuesday (October 15), implying low participation of non-residents, render little support to local currency. On this background some exporters made an attempt to hold FX until better rates. The others, however, were increasing supply due to recent salary advances payoffs.

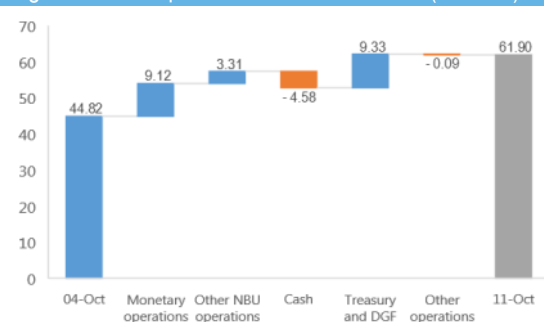
Figure 2. Banking liquidity (UAH bn)



**Started on Wednesday (October 16) season of fiscal payments should generated some additional supply of foreign currency by the end of the current week.** Resistance of local currency to sharp movements, however, looks fragile. Increasing volumes of imports and reluctance of exporters to sell their foreign revenues at low FX rates comprise a material pressure on the hryvnia. In addition, if the NBU's policymakers at the upcoming on October 24 meeting find convincing a recent inflation deceleration for more aggressive rate cut than we saw at the previous meeting, this move can release some UAH liquidity from the central bank's CDs and increase pressure on the local currency.

**Total liquidity in the banking system increased in the week ending on October 11 by about UAH8bn to UAH112.1bn.** Balance of correspondent accounts with the NBU saw much notable improvement - UAH17bn to UAH61.9bn as some funds came from investments in central bank's ON CDs, which in turn decreased by UAH9.1bn to UAH50.2bn.

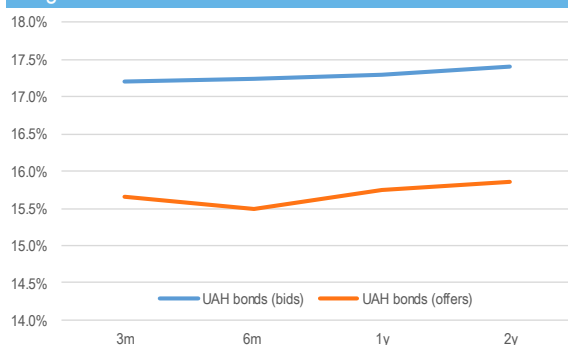
Figure 3. Correspondent account balances (UAH bn)



Other contributors to the correspondent accounts' growth were Treasury and Deposit guarantee fund's operations, some of which may be attributed to a sizable local government bonds' payouts in the reporting week, and NBU's interventions in the FX market at USD134.5mn.



Figure 4. Local UAH 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	15.35%	15.35%	15.50%	15.35%	11	9	518.22	500.00
UAH	1y	15.00%	14.93%	15.00%	14.85%	11	11	654.02	500.00
UAH	2y	15.10%	15.10%	15.10%	15.10%	5	5	114.98	114.98

**The Finance Ministry attracted UAH1.15bn at the primary auction on October 15.** There were 3m, 6m and 2y bonds offered at the auction and surprisingly the major demand was seen in short-term ones, with total bids slightly exceeded FinMin's thresholds at UAH500mn for each issue. This allowed the ministry to push cut-off rate for 3m bonds down by 40 basis points (bps) - to 15.35%, and for 1y bonds - by 9 bps, to 15%.

Two-year bonds drew a cool reception in the market: total demand for UAH2bn worth of securities auctioned was as low as UAH115mn. Their cut-off rate was reduced by 29 bps - to 15.1%.

Worth noting, that all bids in 3m and 2y bonds were satisfied at one price, pointing to a high share of non-competitive participation. Taking also into account a high concentration of the placement in short-term bonds, we assume that there was a low international participation at the auction.

We might see increase in foreign exposure to local government debt following the next primary auction (on October 22) as increasingly slowing inflation rise odds of aggressive key policy rate cut in the upcoming meeting on October 24. On the other hand, developments in the Middle East, namely Turkey's military offensive in Syria, may hold up new investments in Ukraine.

Figure 5. Local USD bonds market

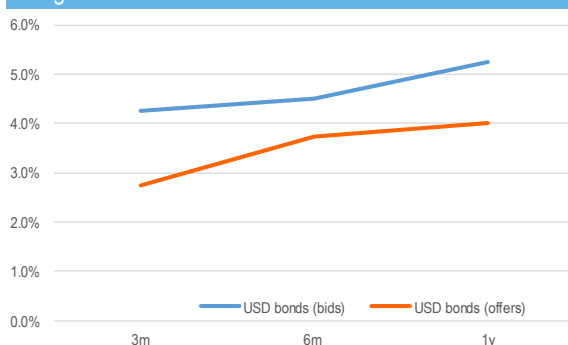
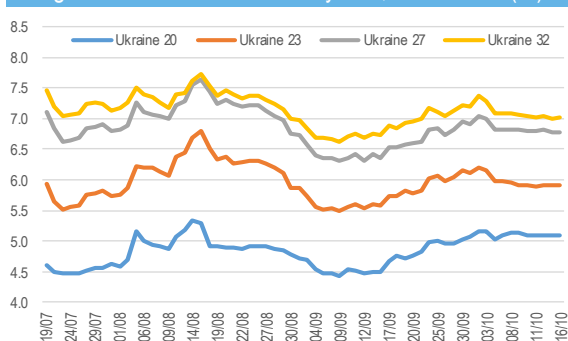


Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



USD drift lower against EUR amid rising doubts about US-China trade deal

**The U.S. dollar is falling against the euro to a low of 1.1116** as earlier optimism about an announced "phase 1" of a trade deal between U.S. and China ebbed in the absence of details.

U.S. and Chinese trade negotiators are working on nailing down text for the first phase of the trade deal for their presidents to sign next month.

The US Dollar got additional disappointment in the form of month retail sales data, painting a gloomy picture of the economy and supporting the case for further interest rate cuts by the Federal Reserve. U.S. retail sales fell for the first time in seven months in September, suggesting that manufacturing-led weakness could be spreading to the broader economy.

Figure 7. EUR USD spot (mid)

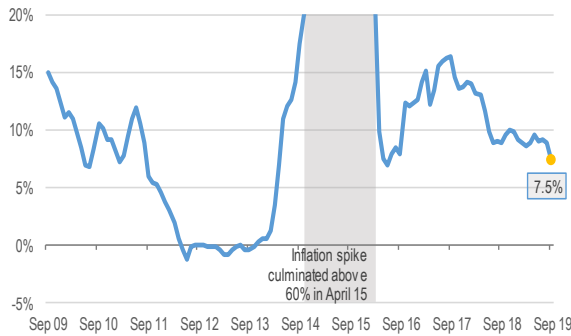


The euro, in turn, initially tried to make some headway on the hope of a Brexit deal. However, soon it became clear that it won't be easy for PM Johnson to find a majority in Parliament.

U.S. debt yields slipped as the lack of clarity into the timing and size of China's agricultural purchases persuaded some on Wall Street that the globe's two largest economies aren't much closer to resolving their protracted dispute. The rate on the benchmark 10-year Treasury note fell to 1.75%. Yields rise as prices fall. Also, recent risk rally is taking a breather. The picture on Brexit and on the trade talks remains muddy and soft US data are a source of caution, too.



Figure 8. Annual inflation

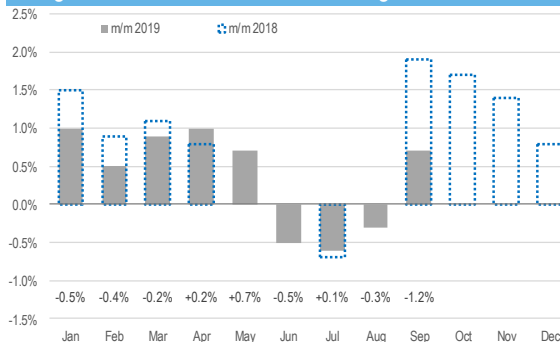


Slowing inflation rises odds of another dovish verdict

**The Consumer Price Index (CPI) growth slowed down to 7.5% y/y in September from 8.8% y/y in August**, according to Ukrstat. In monthly terms, prices grew by 0.7% after three months of decline. Food and fuel prices – major contributors to annual inflation decline - grew slower than expected, primarily thanks to the continued appreciation of the hryvnia. Being positively surprised, the NBU might resort to aggressive easing on October 24.

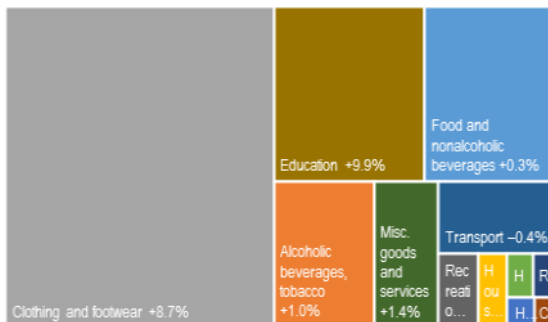
**Rise in the fall:** Three months of deflation (on a monthly basis) were followed by the 0.7% m/m CPI inflation in September as seasonal decline in food prices came to end, while approaching of a cold weather brought about an increase in prices for autumn-winter clothes.

Figure 9. Month-to-month CPI change



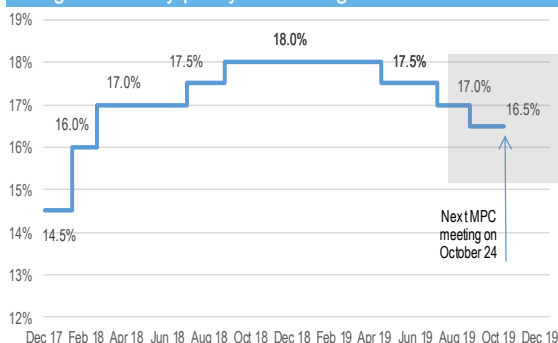
**Strong local currency keeps inflation subdued:** Although prices increased, inflation in September 2019 was much lower as compared with a change in prices in the same month a year earlier (1.9% m/m). Thanks to a strength of the local currency, a slower increase was seen in all but few segments, contributing to annual CPI growth slowdown to 7.5% from 8.8% y/y in August. The most notable prices drop was seen in food and transport segments. In spite of weak harvest, vegetables prices continued to move lower as strong hryvnia helped to cover shortages by imports. In turn, transport services benefited not only from FX rate but also from favorable prices for energy commodities, contributing to a fuel prices decrease in the local market by about 6% year over year in September.

Figure 10. Main contributors to month CPI growth



**External risks make us cautious:** The actual inflation figures show that inflation pressures are weakening and we see no immediate internal risks for reversal of the trend by the end of the year. Moreover, annual CPI inflation might even land below our year-end forecast if no material shocks occur in the local foreign currency market, as high base of the previous year should drag inflation gauge further down in October and November. High uncertainty over local currency, mainly deriving its support from aggressive foreign investments into local government debt, however, keeps us cautious. Though stabilized lately, external trade balance is on weak footing, with rapidly increasing machinery imports being barely covered by agri-food exports and remittances. In case of change in investor sentiment towards emerging markets, increasing upside pressure on hryvnia might push CPI inflation up in the last month of the year.

Figure 11. Key policy rate changes



**Market is positioned for a dovish NBU:** Decline of inflation in September below the central bank's forecast at 7.7% left no doubts about further monetary policy softening. While the NBU pointed out in the latest meeting minutes that rapid growth in real wages and the steady increase in consumption continue to exert significant inflationary pressures on the economy, the central bank should feel comfortable with meeting its year-end target at 6.3% as a high base of the previous year should ensure further slowdown in annual inflation. Upcoming local court rulings on Privatbank (to be released on October 17) and closely associated with it little progress with the IMF seems to be the only factors, that might convince policymakers to hold from aggressive decisions.



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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	-6.6	-9.8	2.3	2.5	3.3	3.5	3.5
Industrial production (%YoY)	-4.3	-10.7	-6	2.4	-0.1	1.6	0	1.2
Retail sales (%YoY)	6.1	-11	-25	4	8.8	6.1	5	4
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)	1466	1587	1980	2383	2983	3393	3830	4321
Nominal GDP (USD bn)	183.5	133.7	91.2	93.1	112.1	125	144.5	151.6
<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	10	18.9	9.7	8	6
<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	71.8	61	60	61
<b>External balance</b>								
Exports of goods and services (USD bn)	81.7	65.4	47.9	46	54	59	57.2	59.5
Imports of goods and services (USD bn)	97.4	70	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	-3.4	1.8	-1.4	-2.1	-3.3	-3.3	-3.2
Net FDI (USD bn)	4.1	0.3	3	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	22	14	14.5	18	15.5	13
Exchange rate (UAH/USD) end of year	8.2	15.8	24	27.2	27.95	27.7	26.5	28.5
Exchange rate (UAH/EUR) end of year	11.3	23	26.2	28.3	33.5	31.8	29.15	31.35

## Two Weeks Ahead

Date/Deadline	Event	Notes
21-Oct (Mon)	Ukrstat: Retail trade turnover	September
24-Oct (Thu)	ECB: monetary policy meeting	
	NBU: monetary policy meeting	
	Ukrstat: Industrial Production Index	September
28-Oct (Mon)	Ukrstat: Real wage	September
29-Oct (Tue)	FOMC: monetary policy meeting	29-30 of Oct

## Upcoming pay offs related to local government bonds

Date	Payment	Amount
17-Oct (Thu)	Coupon USDmn	1.8
23-Oct (Wed)	Principal USDmn	461.3
	Coupon USDmn	12.5
	Coupon UAHmn (capital notes)	473.6
	Coupon UAHmn	51.6
25-Oct (Fri)	Coupon UAHmn (capital notes)	62.5
30-Oct (Wed)	Coupon UAHmn (capital notes)	895.1

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



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