



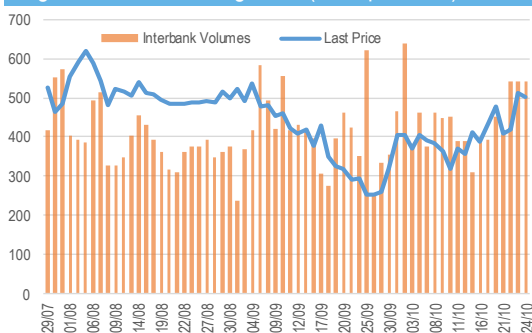
**ECONOMICS | INTEREST RATES STRATEGY | FX**

24 October 2019

# UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: NBU expectedly delivers aggressive key rate cut
Fitch	B	POSITIVE	06.09.2019	The Thursday's NBU meeting on the monetary policy resulted in aggressive 100 basis points (bps) key rate cut – to 15.5%. The verdict came as no surprise (see reports of Sep 18 and Oct 17) after annual inflation slowdown in September exceeded the NBU's expectations, and the dovish pivot of major global central banks. We expect the NBU will press on with monetary easing going forward.
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)



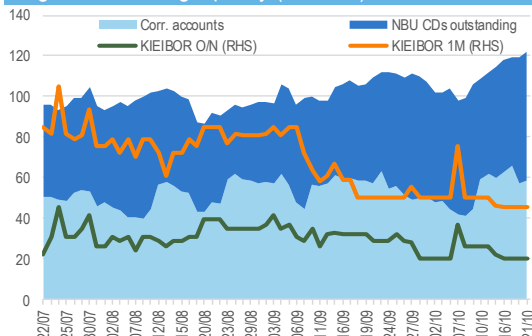
FX and interest rates: UAH retreated to the key level at 25 against the USD

**The Ukrainian currency dipped to the key resistance level at 25 against the U.S. dollar** as some market participant performed surprisingly high activity in the end of the last week.

The reason behind the active FX purchases stays unclear so far, with no significant changes in the foreign exposure to local government debt followed the operations. Worth mentioning, however, that most of transactions have been made in the second half of the trade sessions, when activity at the market decline and there is a lack of FX supply to have a good price. This may serve as an indicative of some foreign demand for FX liquidity.

To keep up with the increased demand the NBU sold in the last days of the week USD31mn which had been bought in the market a few day before. Hence there were zero net interventions last week.

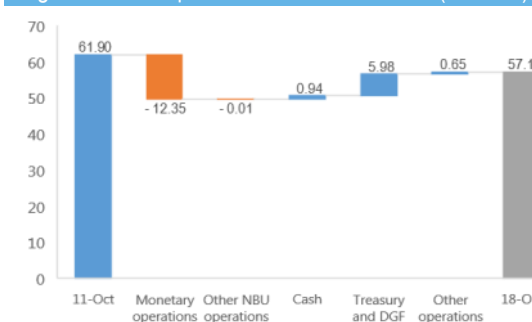
Figure 2. Banking liquidity (UAH bn)



**Another important statement came from the Arcelor Mittal steel company, which has revealed some details on its UAH11bn worth (circa USD440mn) payment of dividends.** The company is going to conduct the dividend distribution in five installments, each per month through April 2020. Such an approach will reduce the pressure on the FX market.

**Banking liquidity increased by another UAH7.57bn to UAH119.6bn** in the week ended on October 18. While amount of funds at banks' correspondent accounts with the NBU narrowed by UAH4.8bn to UAH57.1bn, investments in NBU's CDs went up by UAH12.35bn to UAH62.5bn.

Figure 3. Correspondent account balances (UAH bn)



**Liquidity change has mostly to do with Treasury and Depository guarantee fund operations, which drained from the system circa UAH6bn.**

The central bank's monetary operations, which lowered correspondent accounts' balances by UAH12.35bn represent reallocation of the free reserves into NBU's CDs, with most of funds invested in 2W CD before upcoming key rate decision.



Figure 4. Local UAH bonds market

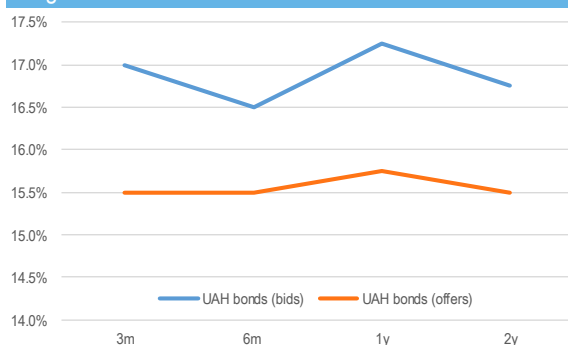
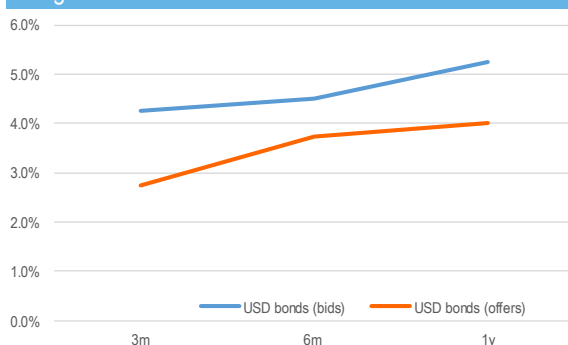


Figure 5. Local USD bonds market



Government bond market

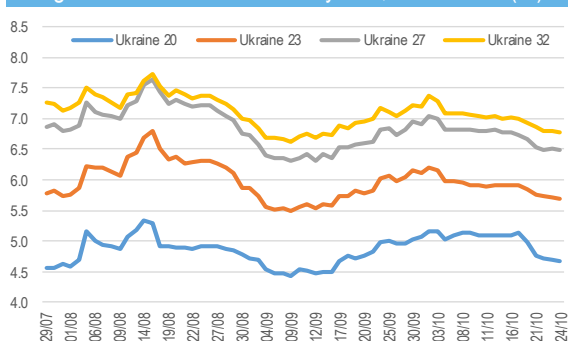
CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size, mn	Placement size, mn
UAH	6m	15.40%	15.40%	15.40%	15.25%	8	8	507.37	500.00
UAH	1y	14.80%	14.80%	15.00%	14.80%	9	7	513.09	497.69
UAH	3y	15.15%	15.06%	15.50%	14.94%	51	51	4 144.01	2 000.00

The last primary auction before the NBU's monetary policy decision was met with above average demand on Tuesday (October 22), suggesting that investors expected another key rate cut. The ministry offered 6m, 1y and 3y of local currency bonds and the strongest demand was seen for the last ones. Investors submitted bids for 2.07 times the UAH3bn of 3-year notes offered. The cut-off rate for the notes was reduced by 35 basis points (bps) to 15.15%. Given that resulting weighted average rate was even lower than that level – at 15.06%, the ministry is likely to press ahead with rate cuts at the next primary auctions.

Demand for the short bonds was slightly above the UAH500mn threshold. The FinMin, however, rejected two bids for 1y notes at 15% and therefore lowered the cut-off rate by 20bps to 14.80%. The cut-off yield of 6m bond has also been lowered by 25bps – to 15.40%.

The ministry of finance has reported this week that the deficit of the general fund of the national budget of Ukraine in January-September 2019 amounted to UAH25.8bn and was financed by borrowings. In order to be secured with financing its spending plans amid continuously widening state budget's deficit the ministry might increase borrowings in 2019 by about UAH8bn.

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



Euro hits 2-month high on Brexit deal

The euro rallied against the US dollar to its highest levels in nearly two months after the European Union and Britain struck a Brexit deal. The deal remains to be ratified by British lawmakers. Besides, European Union leaders still consider Britain's request for a Brexit delay. Nevertheless, risen hopes of the three-year Brexit drama end this week has dragged the euro out of a downtrend and pushed it above 1.1136 mark by the end of Wednesday (October 23).

The USD had limited opportunities for resistance due to a scarce macroeconomic calendar.

The European Central Bank is having a monetary policy meeting, the last one presided by Mario Draghi. It is unlikely that policymakers would make relevant announcements this time. Rather, investors will be waiting for the upcoming President, Christine Lagarde, and her stance toward monetary policy.

Figure 7. EUR USD spot (mid)



U.S. government debt yields tick lower Wednesday as investors digest the latest trade developments between the U.S. and China. The countries secured a limited trade deal last week, in an attempt to end a protracted dispute that has battered financial markets and hammered global growth. China's vice foreign minister confirmed on Tuesday that the world's two largest economies had achieved some progress in trade talks, before adding the dispute could be resolved as long as both sides respected each other.

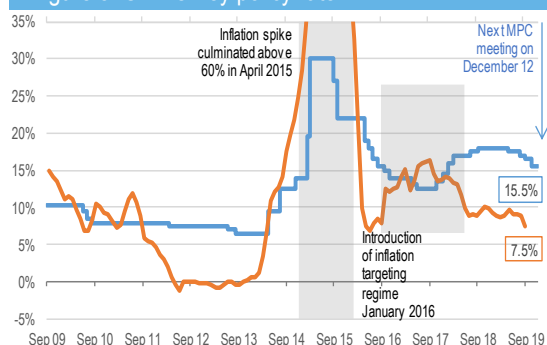
On this background the benchmark 10-year Treasury note was lower at around 1.75%. Yields move inversely to price.



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Figure 8. CPI vs Key policy rate



NBU expectedly delivers aggressive key rate cut

The Thursday's NBU meeting on the monetary policy resulted in aggressive 100 basis points (bps) key rate cut – to 15.5%. The verdict came as no surprise (see reports of Sep 18 and Oct 17) after annual inflation slowdown in September exceeded the NBU's expectations, and the dovish pivot of major global central banks.

Having most of internal inflationary factors moved in a favorable direction, we expect the NBU will press on with monetary policy softening going forward.

**Inflationary risks calm down.** At the summary of the key policy rate discussion on September 4 the NBU pointed out continuing growth in real wages and consumer demand with no clear signs of decelerating as one of the major inflationary risks. Indeed, year-over-year retail sales growth holds positive track for fifth consecutive month, and year-high consumer sentiment index in September may feed into further increase in consumer demand. At the same time, we see annual inflation stay subdued, thanks to strong local currency, while high base of the previous year should drag inflation gauge further down in October and November.

Another point of the NBU's concerns – court litigations between the state PrivatBank and its former owners and related to them hiccups in the negotiations between Ukraine and the IMF has been sidelined and apparently will not become actual in the 12-month horizon. At the moment the key issues under discussion with the IMF are the adoption of some bills, the budget for 2020 and the opening of the land market, which looks manageable as both sides seems are on the same page.

Figure 9. CPI vs central bank's expectations

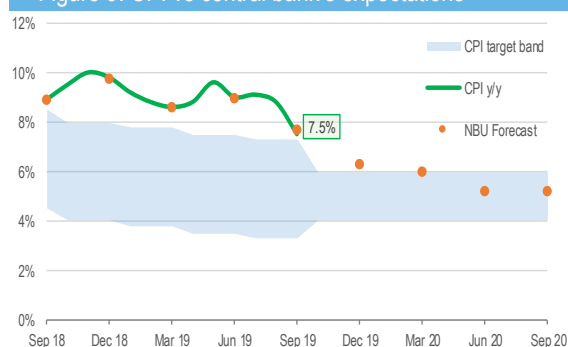


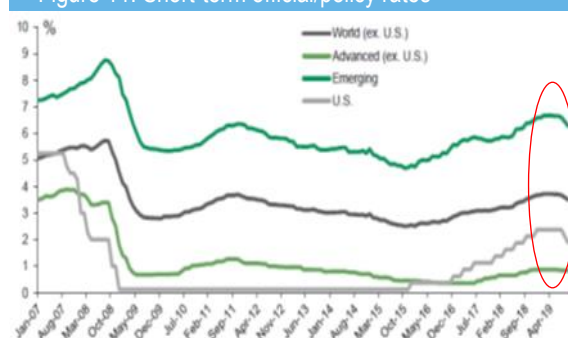
Figure 10. Financial analysts' year-end expectations



**The second reason for more rate cuts is improvement in inflation expectations.** According to the central bank's surveys financial analysts anticipate further decline in consumer prices in 12-month horizon, as strong foreign appetite for hryvnia-denominated domestic government bonds, boosted by FinMin's active promotion of the instrument, is supportive of sufficient foreign currency supply in the interbank FX market, which in turn will strengthen disinflation trend.

**Last but not least is a global trend of monetary policy softening.** Most central banks respond to the Federal Reserve (Fed) and adjust their policies accordingly to avoid a strong local currency, with neighboring central bank of Turkey, which held the monetary policy committee meeting on the same day, cut its key rate by 100 bps from 16.5% to 15.5%. Increasing complains from Ukrainian exporters about a financial inflows driven strong hryvnia, making them uncompetitive at the global markets, support the case.

Figure 11. Short-term official/policy rates



The next and the last in the current year monetary policy meeting will be held on December 12.



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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
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
31-Oct (Thu)	NBU: Balance of Payments	September
04-Nov (Mon)	NBU: Minutes	

## Upcoming pay offs related to local government bonds

Date	Payment	Amount
25-Oct (Fri)	Coupon UAHmn (capital notes)	62.5
30-Oct (Wed)	Coupon UAHmn (capital notes)	895.1
06-Nov (Wed)	Principal UAHmn	4 583.6
	Coupon UAHmn (capital notes)	535.0
	Coupon UAHmn	10.8

\*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](mailto:serhii.yahnych@ukrsibbank.com)

**Viktoriia Nebeska**

Market Making Government Bonds

(+38044) 201-22-74 [viktoriia.nebeska@ukrsibbank.com](mailto:viktoriia.nebeska@ukrsibbank.com)

**Platon Yachmenov**

Fixed Income Dealer

(+38044) 230-48-54 [platon.yachmenov@ukrsibbank.com](mailto:platon.yachmenov@ukrsibbank.com)

**Mykhailo Kharchuk**

Market Analysis

(+38044) 537-49-75 [mykhailo.kharchuk@ukrsibbank.com](mailto:mykhailo.kharchuk@ukrsibbank.com)

Distribution of Capital Markets Weekly report:

[macro@ukrsibbank.com](mailto:macro@ukrsibbank.com)



### FX Business

**Oleksandr Duda**

Head of FX Sales

(+38044) 537-50-02 [oleksandr.duda@ukrsibbank.com](mailto:oleksandr.duda@ukrsibbank.com)

### Corporate Business

**Ievgen Kulikov**

Head of MNC team

(+38044) 201-22-43 [ievgen.kulikov@ukrsibbank.com](mailto:ievgen.kulikov@ukrsibbank.com)

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