



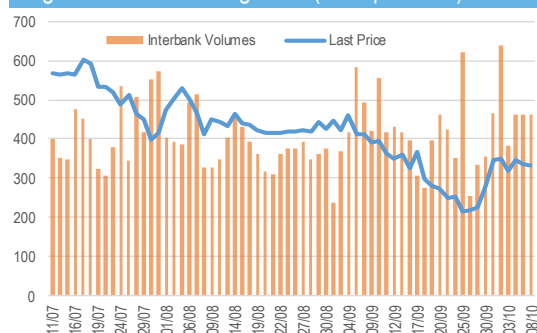
**ECONOMICS | INTEREST RATES STRATEGY | FX**

10 October 2019

# UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: CA remains stable, financial inflows to support FX reserves
Fitch	B	POSITIVE	06.09.2019	Current account (CA) saw some downside movement in August: the 12M rolling deficit increased by 3.9% m/m to USD4.13bn. We expect, however, the year-end reading will be in line with our forecast at USD4.4bn. Despite notable growth in machinery imports, strong agricultural exports and stable remittances inflow will soften the landing.
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)



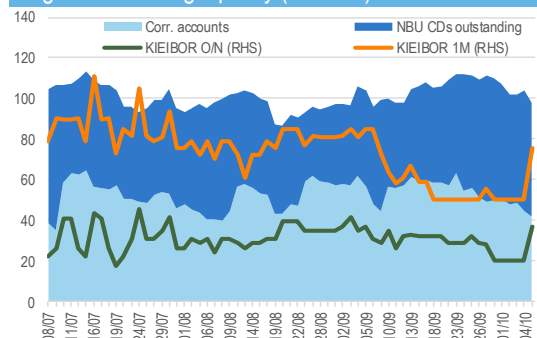
FX and interest rates: UAH/USD hovers near 24.8 mark

**Ukrainian hryvnia rebounded to 24.8 levels as no fresh foreign investments into local government debt followed the last wave of inflow on September 24.**

The local currency currently derives support from active sales of export revenues, mainly by agricultural producers, and seasonal remittances inflow.

**There was seen a local surge in demand for foreign currency in the cash market last week.** Though some media tagged it as a panic-buying, we have found little evidences to prove this conclusion. A surge in demand was seen only in central regions of Ukraine and lasted for only one or two days, which is not the case for panic actions.

Figure 2. Banking liquidity (UAH bn)



**The NBU sold USD200mn to fire back, which was the biggest foreign currency intervention since beginning of the year.** At the same time worth mentioning, that in other days of the week the central bank purchased USD42.5mn.

Though no clear reasons for this case have appeared so far, we find it would be difficult for similar ones to develop into large scale panic-buying, taking into account currently high price for UAH liquidity in the money market.

While expecting some depreciation in the last months of the year, we see no acute immediate risks for local currency. Export revenues sales look robust, thanks to strong agricultural harvest, again non-residents likely to continue increasing their positions in local government debt, still offering attractive real yield.

Figure 3. Correspondent account balances (UAH bn)



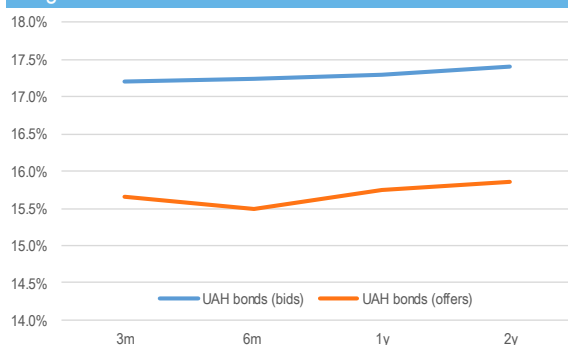
**Banking liquidity narrowed by UAH7.3bn to UAH104bn** in the week ending October 4. According to the NBU funds at correspondent accounts with NBU declined by UAH4.79bn to UAH44.8bn, while investments in central bank's certificates of deposits (CDs) decreased by UAH2.55bn to UAH59.3bn.

**Major impact on liquidity balance had NBU's FX sales,** draining about UAH4bn from the system. Another UAH3.5bn moved into State treasury and into cash due to usual in first dates of month cash withdrawals.

Monetary operations represent net change in funds invested in NBU's CDs: UAH10.5bn were withdrawn from ON CDs and UAH7.9bn invested into 2W CDs.



Figure 4. Local UAH bonds market

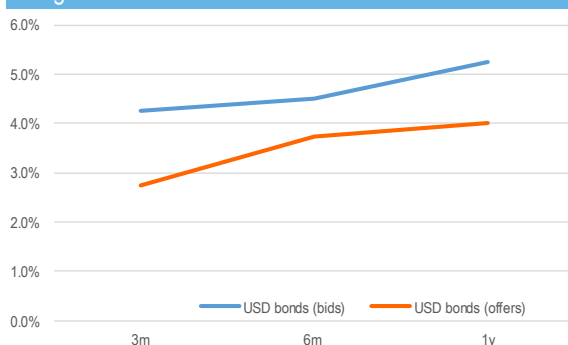


Government bond market

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	6m	15.65%	15.65%	15.95%	15.65%	8	7	167.41	27.41
UAH	1y	15.09%	15.09%	–	–	3	3	7.35	7.35
UAH	3y	15.50%	15.42%	15.70%	15.26%	20	16	2 915.53	2 000.00

**The Finance Ministry attracted UAH2.15bn at the primary auction on October 8. Allocation was heavily concentrated in 3y bonds, which made up 98% of the entire placement amount. Decreased though, bid-to-cover ratio at 1.45 was enough for the ministry to push cut-off rate for 3y bonds down by 20 basis points (bps) to 15.5%. This is well below the level of money market rates, which might imply that the major interest came from non-residents.**

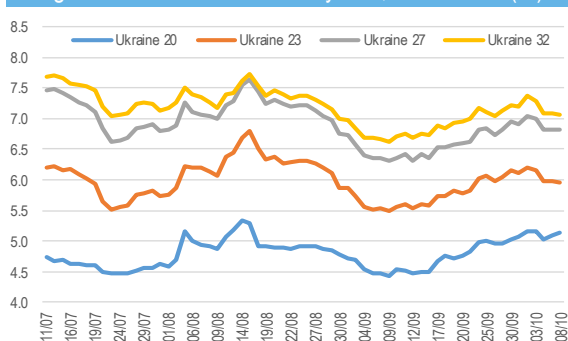
Figure 5. Local USD bonds market



Total demand for UAH500mn of 6m bonds and UAH500mn worth of 1-year bonds offered stood at UAH174mn. Nevertheless, the ministry rejected one UAH140mn worth bid for shorter ones and reduced their cut-off rate by 25bps to 15.65%.

**According to FinMin it is UAH30bn far from meeting its year borrowings plan and no more 5.5y bonds will be offered. Having fulfilled quantitative criteria for their listing in the JPM GBI, the ministry is going to substitute the issue with a longer one, likely 7y bonds. We expect new notes will be auctioned as soon as some progress around listing be reached.**

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



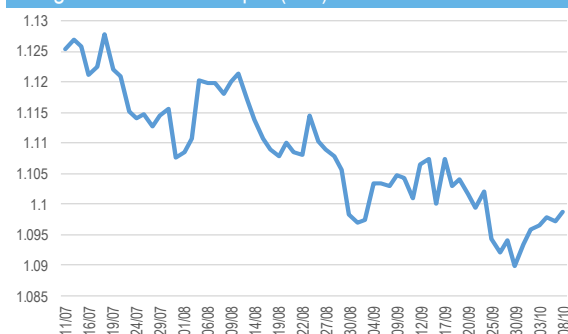
USD shows high volatility renewed trade-related worries

**The U.S. dollar slipped against the euro to 1.975 (October 9) on declining hopes for an amicable resolution to the U.S.-Chinese trade war.**

Headlines related to U.S.-China trade talks are moving markets' sentiment back and forth. The latest news indicate that China is open to making a deal with the U.S., at least a partial trade deal, while the Trump administration is moving ahead with discussions around possible restrictions on capital flows into China, with a focus on investments made by U.S. government pension funds.

**An unexpected drop in U.S. producer inflation supported the trend.** The smallest annual increase in nearly three years might give the Federal Reserve room to cut interest rates again later this month.

Figure 7. EUR USD spot (mid)



**The pair, however, is struggling to overcome the critical juncture at the 1.10.** Potential U.S. tariffs on imports of EU cars remain well on the table, while the Brexit limbo and UK politics also adds to the current negative view.

Rates on long-dated U.S. sovereign bonds rose on Wednesday (October 9) as investors awaited the release of a summary of the Federal Reserve's meeting last month. Investors, in particular, will look through the minutes for clues to whether the Fed will cut rates at its October meeting. It is largely expected to be another 25 basis-point rate cut.

**The 10-year Treasury yield rose to 1.562% by the end of Wednesday (October 9).**

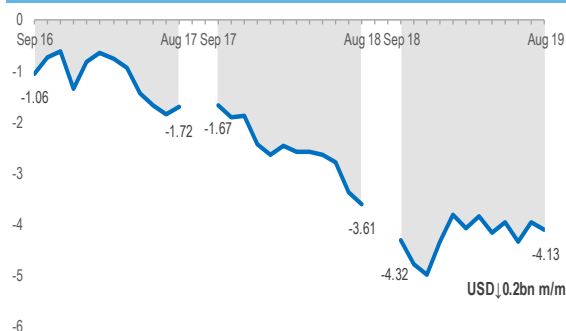


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Figure 8. Current account, USDbn



CA remains stable, financial inflows to support FX reserves

**Current account (CA) saw some downside movement in August: the 12M rolling deficit increased by 3.9% m/m to USD4.13bn.** We expect, however, the year-end reading will be in line with our forecast at USD4.4bn. Despite notable growth in machinery imports, strong agricultural exports and stable remittances inflow will soften the landing.

**Machinery imports delivers one more double-digit growth:** Another USD0.15mn increase in total CA deficit mainly came on the back of steadily expanding overseas purchases of machinery, with 25% y/y upsurge in August, stretching streak of growth to 14 straight months. A wave of used cars imports in 4Q18-1Q19 (there was a special law, dated November 8, 2018, setting a reduced excise tax rate on used cars until February 22, 2019) was followed by active purchases of other machinery, thanks to strong local currency and improved business expectations, likely bringing forward some mid-term business plans.

**External conditions have cooperated:** On the other hand, we see no less material improvement in Agri-Food sector, with 20% y/y exports increase amid strong grain harvest in 2019.

**Another positive comes from energy prices weakness** at the global markets. Though Fuels and Minerals imports – second after machinery FX consumer – increased in 12M horizon by 4% y/y to USD18.3bn, Ukraine had been actively replenishing natural gas reserves against favorable prices conjecture. As of October 2 state company Naftogaz Ukrainy accumulated more than 20.5 bcm in underground storage facilities – the nine-years maximum of reserves. In August Fuels and Minerals imports contracted by 1% to USD1.1bn and we expect the trend to continue going forward by the end of the year as natural gas purchases used to decline since September. Besides, our fears of energy prices spike due to risk of escalation tensions in the Middle East didn't come true.

We see positive developments in Agri-Food and Fuels and Minerals sectors, as well as robust inflow of work migrants' remittances, will help to mitigate risks of exacerbating the current-account shortfall.

**Financial inflow improved by USD300mn** in reported period. Separately worth noting gradual recovery of portfolio flows and increase in corporate flows. The later will be more clearly seen in September's and October's prints, taking into account recent corporate bonds' transactions.

Foreign exposure to local government debt didn't change much in August, though resultative government's primary auctions in late September herald about further improvement in stats and Ukraine's FX reserves.

With regard to the reserves itself, the NBU recently produced preliminary data, showing that as of October 1 Ukraine's international reserves stood at USD21.4bn, down by 2.6% as compare to the level on September 1.

While public debt pay offs in September drained reserves by USD1.97bn, sustained inflows of nonresident funds into hryvnia-denominated public debt and record-high grain yields led to an excess of foreign currency supply over demand and enabled the NBU to add USD0.93bn to international reserves in September.

**According to FinMin it is UAH30bn (USD1.2bn) far from meeting its annual borrowings plan, which corresponds to weekly allocations of UAH3bn.** We expect more than half of this sum might comprise fresh foreign investments into local government debt.

Figure 9. Exports and Imports breakdown, USDbn

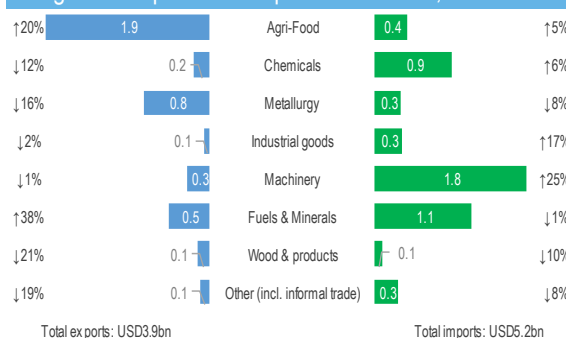


Figure 10. Balance of payments, USDbn

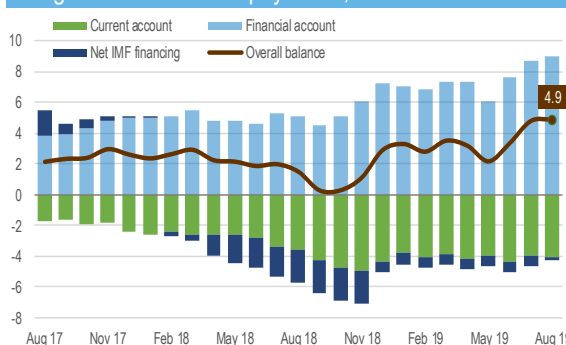
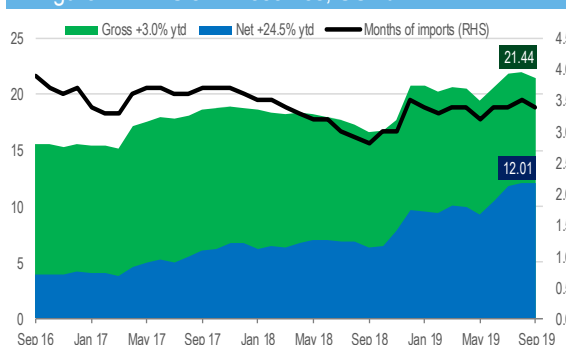


Figure 11. NBU's FX reserves, USDbn



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## 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
09-Oct (Wed)	Ukrstat: Consumer & Production Price Indexes	September
	NBU: Monetary & Financial Statistics	September
21-Oct (Mon)	Ukrstat: Retail trade turnover	September

## Upcoming pay offs related to local government bonds

Date	Payment	Amount
09-Oct (Wed)	Principal UAHmn	6 442.4
	Coupon UAHmn (capital notes)	305.7
	Coupon UAHmn	79.7
16-Oct (Wed)	Principal UAHmn	2 984.8
	Coupon UAHmn (capital notes)	524.1
	Coupon UAHmn	219.6
17-Oct (Thu)	Coupon USDmn	1.8

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



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