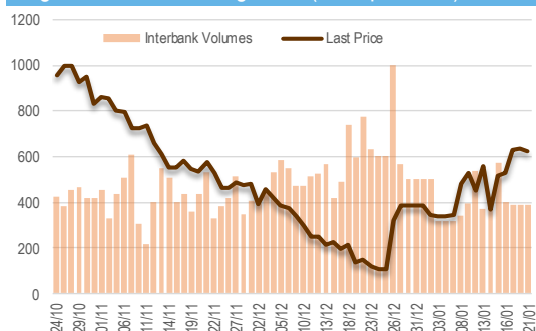


ECONOMICS | INTEREST RATES STRATEGY | FX

22 January 2020

UKRAINIAN CAPITAL MARKETS WEEKLY

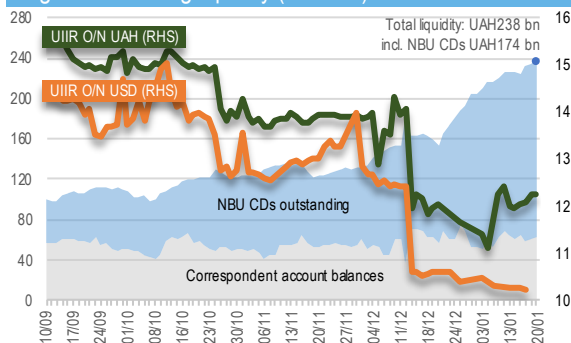
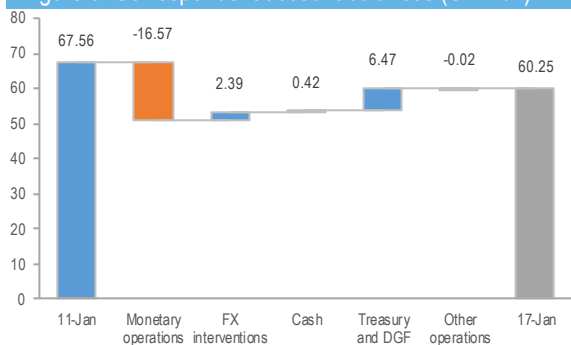
	Rating	Outlook	Last update	This week in focus: UAH: broadly stable as too many things went right
Fitch	B	POSITIVE	06.09.2019	The UAH finished last year 14.5% higher against the USD. Though the tendency for strengthening continued for a 2nd straight year, the double-digit appreciation came as a surprise. While fresh foreign investments into local government debt - the major contributing factor in 2019 – looks limited in 2020, potential structural shifts in the economy might provide further support to the local currency.
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: USD/UAH rate drifts North on NBU's FX interventions

The Ukrainian Hryvnia was whittled approximately 1% lower over the last seven days, closing today's trade session near 24.4 mark. Despite expanding non-residents' participation in the public debt and another FinMin's success in cutting yields for the UAH-denominated government bonds (see results of the debt auction on 21 Jan), the local currency continuously fails to capitalize these factors as the central bank presses ahead with its aggressive mopping-up of incoming correspondent FX liquidity. In total, the NBU's net interventions in the interbank exchange market during the last week accounted for USD100mn compared to USD118mn a week before.

Under such circumstances, the current USD/UAH pair dynamic has mostly to do with trade balance forces, and in this front, we see exporters have tempered FX revenues sales after replenishing their UAH liquidity stocks for business needs with VAT refunding, disbursed a week ago. This resulted in a modest downside trending of the pair, in spite of no material change in demand for foreign currency.

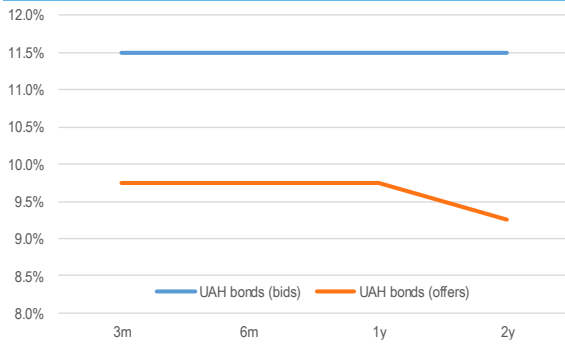
Looking ahead, it worth pointing out the latest news report about the government's intention to tap into the global debt market with a brand new 10-years eurobonds denominated in euro. According to the media, a book-building process is expected to start in the coming days. We assume the deal might stimulate exporters to expand FX sales lest not to lose more in case of hryvnia's entering in appreciation trend.

Figure 2. Banking liquidity (UAH bn)

Figure 3. Correspondent account balances (UAH bn)


The banking liquidity hit another record high level – UAH235bn by the end of last week. As during the previous reporting period, all the major factors contributed to further expansion of banks' correspondent account balances, with State treasury operations, largely related to VAT refunds, brought UAH6.5bn, and NBU's FX interventions - UAH2.4bn. A negative impact of monetary operations represents a reallocation of funds into central bank's CDs.

As a result, the total funds in correspondent accounts decreased to UAH60.2bn, while investments in CDs edged up to UAH174.7bn.

Figure 4. Local UAH bonds market

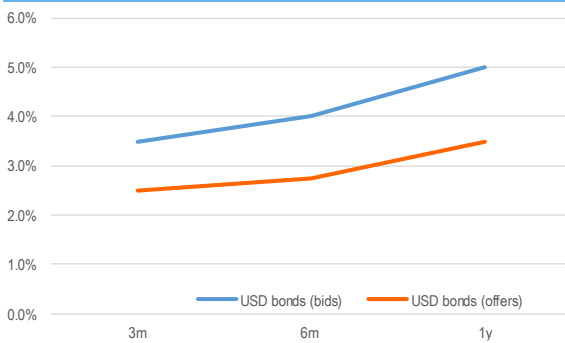


Government bond market

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	10.04%	10.03%	11.50%	10.00%	28	6	3 200.00	500.00
UAH	1y	10.15%	10.04%	10.75%	9.70%	29	13	5 196.83	1 500.00
UAH	3.5y	10.15%	10.01%	10.75%	9.74%	28	21	3 638.21	3 430.71

Another FinMin's primary debt auction (on 21 Jan) saw solid demand. The ministry offered UAH6bn in 6m, 1y, and 3.5y instruments. The highest demand was seen for the shortest debt, which attracted bid-to-cover ratio of 6.4. The last auction bonds with similar maturity were offered took place on 26 Nov. Since then the cut-off rate for this tenure fell by 406 basis points (bps) to 10.04%.

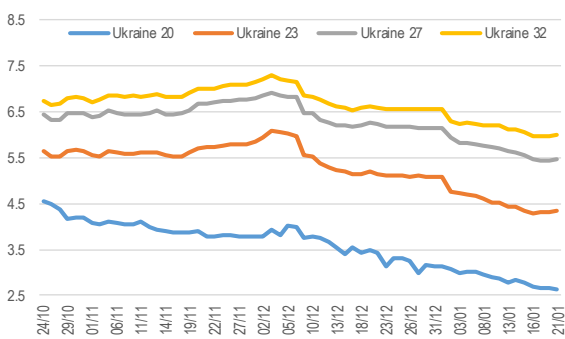
Figure 5. Local USD bonds market



As for the 1y debt, the ministry accepted only UAH1.5bn of UAH5.2bn in bids from participants and reduced its cut-off rate by 130 basis points (bps) to 10.15%. Total bids for 3.5y bonds surprisingly fell short of the UAH4bn offered. A moderate response to the offer might be indicative of an approximation of yields for government bonds to a resistance level, where competition for foreign investors' money increases. Nevertheless, in comparison with a prior auction, when these bonds were offered (on 3 Dec) their cut-off yield was reduced by 235bps to 10.15%.

Worth also mentioning, that the FinMin today announced the issue of new 10-year eurobonds pegged to euros. According to the media, the book-building process will start shortly, but the new issue has already been priced with a yield of 4.75%. The new bonds might stimulate for a while a fresh inflow of foreign investments into local government bonds.

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



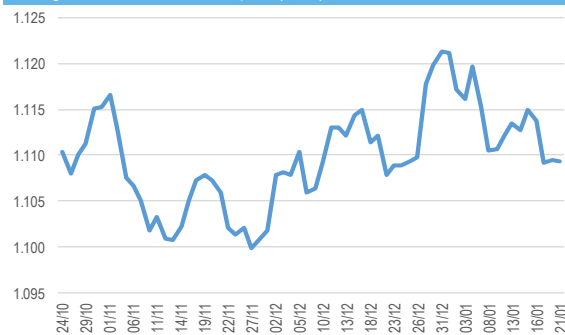
EUR/USD navigates near one-month high

The dollar holds near a one-month high against the euro at 1.1077, deriving its support from last week's run of data, confirming that the United States economy is holding up well.

Figures showed U.S. homebuilding surged to a 13-year high in Dec, with retail sales also on the rise and a gauge of manufacturing activity rebounding to its highest in eight months.

In turn, the euro remains weak as the slowdown in the region remains far from abated despite some positive results as of late in Germany and the euro area and the market participants expect European Central Bank policymakers will strike a cautious tone when they meet later on 23 Jan.

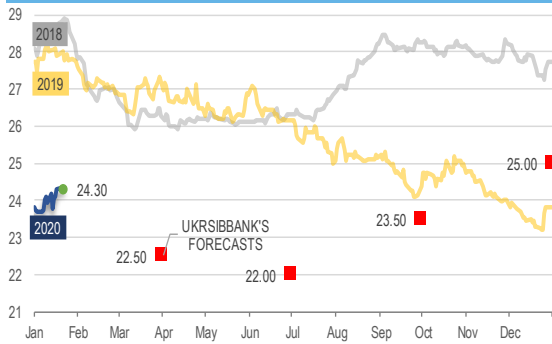
Figure 7. EUR USD spot (mid)



Another factor, weighing on the euro, is recent statements of Donald Trump. He said that the U.S. will have to impose a 25% tariff on European car imports if they were to fail to reach a trade deal with the European Union.

In the meantime, the 10-year U.S. Treasury bond yield fell to 1.759% level. The outbreak of a new strain of coronavirus in China's Wuhan region sent Treasury yields to a two-week low, as fears of a global pandemic sent investors running for safety.

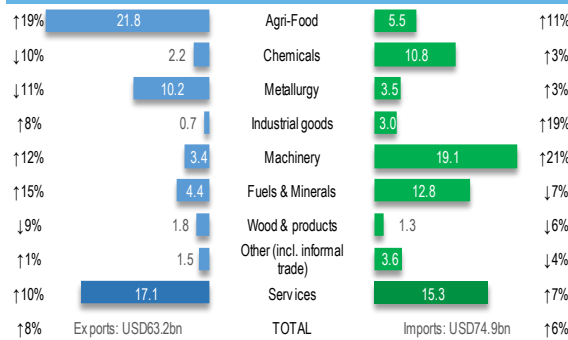
Figure 8. USD/UAH exchange rate chart



UAH: broadly stable as too many things went right

The Ukrainian hryvnia finished last year 14.5% higher against the U.S. dollar. Though the tendency for strengthening continued for a second straight year, the double-digit appreciation came as a surprise to all the FX market participants. While fresh foreign investments into local government debt - the major contributing factor in 2019 - looks limited for this year, potential structural shifts in the economy, if realized, might provide further support to the local currency.

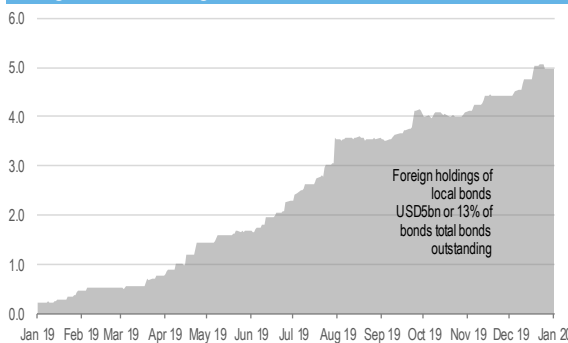
Figure 9. External trade breakdown (12M to Nov 19)



Exports' performance is mixed. Looking back on the local FX market in 2019, agri-food and metallurgy segments - Ukraine's two major export accounts - saw contrasting developments. Another record high harvest (a 7.1% increase to 75mn tonnes) and favorable price conditions in the global markets resulted in a 19% agri-food export sales growth (in the 12-month to Nov 2019). Unlike agricultural producers, steel and iron ore segment it seems to have concentrated all the bad luck. From the global perspective, prices for correspondent commodities were suffering from deteriorating demand, with protracted trade tensions between the U.S. and China, the U.S. and the E.U., and continuous uncertainty with the Brexit producing the main drag to the global economy. Internal conditions were hardly supportive too: rising production costs on the back of growing tariffs for electricity and transportation services, together with strengthening in UAH squeezed any possible margins.

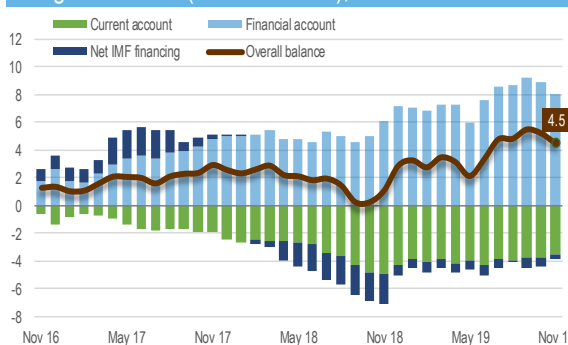
Agri-Food is likely to remain the major export driver. Our moderately optimistic harvest scenario envisages a further increase in total crops harvested and volumes of agri-food exports amid improving efficiency in the segment. In turn, the steel industry and iron ore production, as we expect, to stay depressed against overcapacity in the global steel industry, and soft global steel demand as industrial activity slows.

Figure 10. Local government debt bonds, USDbn



Investment-driven deficit. On the import side, despite a 6% increase in volume (to USD57.9bn in the 12-month to Nov 2019), a more nuanced picture provides us with some confidence. We saw machinery imports grew by 21% to USD19.1bn, but among major drivers behind were investments in green energy projects, exceeding USD4bn. In turn, developments in the global energy markets helped to have total expenses for fuels reduced by about 7%.

Figure 11. BoP (12M to Nov 19), USDbn



Much hinges on financial flows. While fundamentals imply some depreciation of the hryvnia, the real situation in the local FX market will be largely dependent on the financial flows too. As we saw last year, despite negative CA balance, the local currency appreciated by 14.5% as sizable investments into UAH-denominated local government bonds from foreign accounts, bringing into economy some USD5bn of fresh FX liquidity, helped to keep country's balance of international payments in surplus (USD4.5bn in the 12-month run to Nov 2019). We assume that this year the impact of foreign investments into public debt on the USD/UAH rate will not be as perceptible as before since yields for government bonds have already approximated singledigit zone and competition for investors' money in this area increase sharply. We recon, that some USD1-1.5bn still might come in 1Q20, but there is one more factor, cushioning an effect of fresh inflows. The NBU's since the end of 2019 has been actively mopping-up excess FX liquidity in the market (a special resolution will be effective till the end of 1Q20). These interventions have proved effective in keeping the USD/UAH rate stable in the vicinity of 24 figure.

On the other hand, gradual improvement in investors' sentiment toward Ukraine and active FX inflows allow an opportunity for both the government and corporates to tap into the global debt market, as well as might boost a growth of foreign direct investments. Progress in the IMF's agenda, and land reform, in particular, can give momentum in this regard.

UKRAINIAN CAPITAL MARKETS WEEKLY

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	8.0*	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	162*	173
Prices								
CPI (average %YoY)	-0.2	12.1	48.7	16.5	14.4	10.5	7.9	6.0
CPI (end of year %YoY)	0.5	24.9	43.3	12.4	13.7	9.8	4.1	5.5
Real average wage growth (%YoY)	8.2	-6.5	-35.0	10.0	18.9	9.7	8.5*	5.5
Fiscal balance (% of GDP)								
State budget deficit (without Naftogaz)	4.2	4.9	2.3	2.9	1.6	2.4	1.8	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	64.1*	67.5
Imports of goods and services (USD bn)	97.4	70.0	49.6	51.8	60.8	70.5	75.5*	79.3
Current account balance (USD bn)	-16.5	-4.6	1.6	-1.3	-2.4	-4.7	-4.0*	-4.5
Current account balance (% of GDP)	-9.0	-3.4	1.8	-1.4	-2.1	-3.3	-2.5*	-2.6
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	25.3	23.5
Imports coverage (months of imports of goods)	2.9	1.5	4.4	3.7	3.6	3.4	3.9	3.3
Interest and exchange rates								
NBU discount rate (% end of year)	6.5	14.0	22.0	14.0	14.5	18.0	13.5	8.5
Exchange rate (UAH/USD) end of year	8.2	15.8	24.0	27.2	28.0	27.7	23.7	25.0
Exchange rate (UAH/EUR) end of year	11.3	23.0	26.2	28.3	33.5	31.8	26.4	29.0

*estimates, no official data yet available

Two Weeks Ahead

Date/Deadline	Event	Notes
21-Jan (Tue)	Ukrstat: Retail trade turnover	2019
22-Jan (Wed)	Ukrstat: Industrial Production Index	2019
28-Jan (Tue)	Ukrstat: Nominal & Real Wage	December
30-Jan (Thu)	NBU: Monetary Policy Meeting	
31-Jan (Fri)	NBU: Balance of Payments	2019
	NBU: Cost of Real Sector External Borrowing	4Q19

Upcoming pay offs related to local government bonds

Date	Payment	Amount
22-Jan (Wed)	Coupon UAHmn	584.7
	Coupon UAHmn (capital notes)	643.4
	Coupon USDmn	2.4
	Principal UAHmn (capital notes)	2 500.0
29-Jan (Wed)	Coupon UAHmn	87.8
	Coupon UAHmn (capital notes)	797.2
	Principal UAHmn (capital notes)	2 200.0
30-Jan (Thu)	Coupon USDmn	19.3
	Principal USDmn	258.9

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



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