

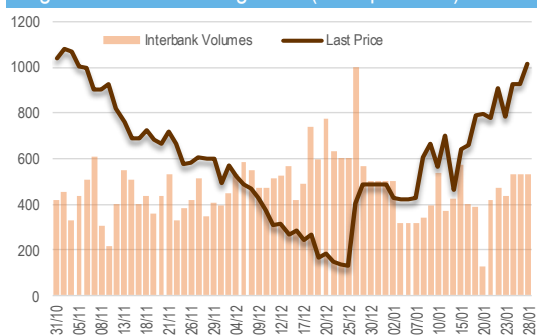
**ECONOMICS | INTEREST RATES STRATEGY | FX**

30 January 2020

# UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: Further easing stays on NBU's policy agenda
Fitch	B	POSITIVE	06.09.2019	The NBU has cut its key rate by 250 basis points to 11%, delivering its fifth policy easing in a row. The decision came as no surprise, another cut was widely expected after annualized consumer price inflation hit a 6-year low in 2019. Yet the market participants were embarrassed to admit such an aggressive easing amid deepening global fears over China's coronavirus.
S&P	B	STABLE	27.09.2019	
S&P (N)	uaBBB	-	12.04.2019	
Moody's	Caa1	POSITIVE	22.11.2019	

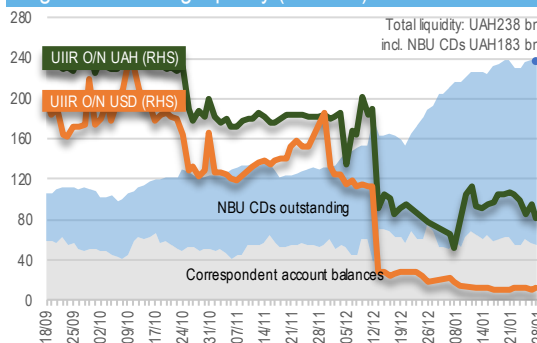
Figure 1. UAH exchange rate (UAH per USD)



FX and interest rates: Hryvnia remains under pressure

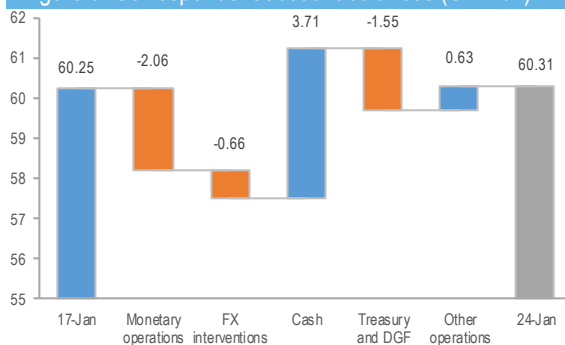
**The Hryvnia slipped against the US dollar to 24.88 by the end of Thursday.** It seems aggressive NBU's interventions in Dec and early Jan, resulting in a USD3.2bn FX drain (net purchase), have set in the market a bearish mood, which currently neglects any positive news, including FinMin's double debut on debt markets, both of which turned out to be successful, and stable foreign participation in primary debt auctions. The last week's NBU's FX injections, totaling USD26.5mn (net), apparently have only reinforced expectations of further USD/UAH pair correction. This has stimulated exporters to retain export revenue sales and cover their current business expenses by recently disbursed VAT refunding. Importers also increased FX purchases, both due to upcoming on the first of the month settlements on external transactions and as a reaction to the recent developments in the exchange market.

Figure 2. Banking liquidity (UAH bn)



**Another factor, fueling hryvnia's retreat are worldwide concerns over the spread of the new virus from China.** Expectations signal that China's 1Q GDP could drop significantly, with a strong impact anticipated on a global level. Besides, if the virus keeps on spreading extensively, it might strengthen risk aversion in the markets. All told, it seems both current and financial account of Ukraine's balance of international operations looks highly exposed to possible negative developments. The worries, however, might turn out short-lived, as it was seen following similar outbreaks of the viruses in the past. Hence, it is too early to make long-term conjectures on this matter.

Figure 3. Correspondent account balances (UAH bn)

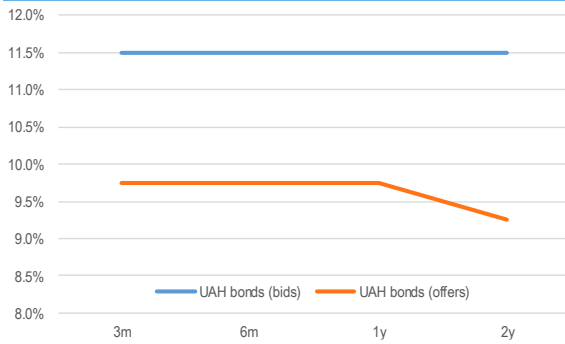


Apart from this, worth pointing out the NBU head's statement during today's monetary briefing that the Nafogaz has not yet sold a USD2.9bn, received from Gazprom in late 2019. This implies a substantial inflow of FX into the market in 1Q. At the same time, we expect all the funds will be absorbed by the central bank, and hence they will not affect the USD/UAH rate.

**The banking system keeps holding a record high liquidity:** total funds in the system stay around UAH238bn, with UAH183bn allocated in the central bank's CDs. In spite of an outflow related to FX interventions, which amounted to UAH0.7bn, and negative State treasury's operations, draining another UAH1.6bn, a cash money inflow resulted in a UAH3.7bn boost into the banking system.

Today's policy rate cut is likely to push rates in the money market further down. We expect, however, that bank loan rates might lag adjusting, and the shape of banking liquidity to stay unchanged.

Figure 4. Local UAH bonds market

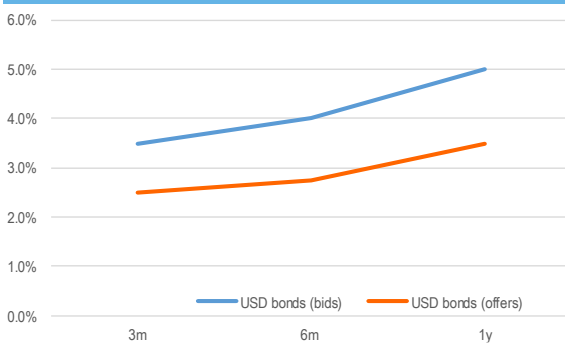


Government bond market

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	10.25%	10.15%	11.00%	9.90%	11	8	1 683.90	500.00
UAH	1y	10.10%	9.91%	10.50%	9.75%	13	12	1 259.71	1 000.00
UAH	2y	10.20%	9.86%	11.53%	9.75%	20	17	1 302.03	802.03
UAH	7y	9.95%	9.79%	12.10%	9.00%	73	44	9 007.13	3 649.57

A brand new FinMin's seven-year bonds received a warm reception from targeted foreign investors on the primary debt auction on Tuesday (Jan 21). The debut auction of UAH6bn worth of the long-term bonds drew a weighted average yield of 9.79 percent, with a cut-off rate set at 9.95%, and a bid-to-cover ratio of 1.5. The ministry, however, accepted bids amounting to UAH3.6bn. A lower than the borrowing target acceptance may be related to rising fears of economic fallout from the Chinese virus, which continues to send shockwaves through the financial markets and sent investors to safe-haven assets.

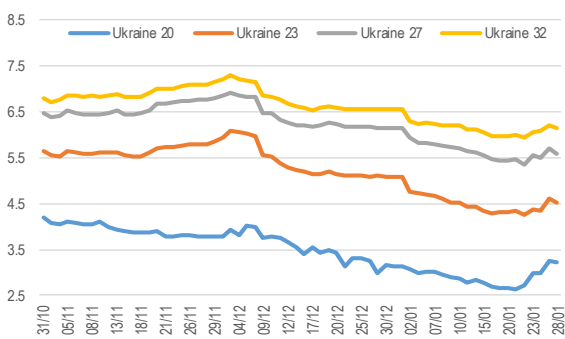
Figure 5. Local USD bonds market



The government attracted another UAH2.3 via offering 3m, 1y and 2y securities. For the former two, the ministry accepted UAH1.5bn as planned out of total bids worth circa UAH3bn. The average rate for the 3m bonds dropped by 58 basis points (bps) to 10.15%, and their cut-off rate was reduced by 60 bps to 10.25%. As for 1y tap, the average rate declined by 13 bps to 9.91%, with cut-off rate set at 10.1% (down by 5bps).

A UAH1.5bn 2-year bond auction drew a cool reception, with the bid-to-cover ratio of 0.87. Their cut-off rate was reduced by a modest 1 bps to 10.2% and an average yield declined to 9.86% from 10.04%.

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



Dollar gains vs euro as investors reach for safe havens on virus scare

**The U.S. dollar gained against the euro over the last few days to 1.1029** as the rising toll from a virus spreading in China sent investors scurrying to the shelter of perceived safe-haven currencies. As fears over economic impact of coronavirus deepen, the dollar emerged as an ultimate safe-haven destination, with its high interest rates relative to the rest of its developed market peers also boosting its appeal.

The relatively positive performance of the U.S. economy, has underlined its safe-haven credentials.

Across the Atlantic, the EU Economic Sentiment Indicator, which improved in January to 102.9 from 101.3, and Germany preliminary estimate of January inflation, which came pretty much in line with the market's expectations, failed to impress and hence had no effects on the pair action.

The U.S. Treasuries, as the greenback, continue benefiting from safe-haven flows related to the outbreak of the coronavirus. The drop in global stocks is boosting demand for the safety of US bonds.

**The yield on the benchmark 10-year Treasury note dipped to 1.546%**, falling below the three-month Treasury rate briefly.

The Federal Reserve left its interest rate unchanged as expected, and made only subtle changes to its statement. At the same time, during a press conference following the rates decision, Fed chairman Jerome Powell said the central bank is "very carefully monitoring" the situation with the fast-spreading coronavirus.

Figure 7. EUR USD spot (mid)

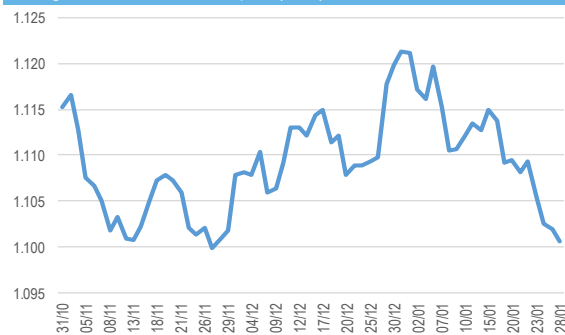
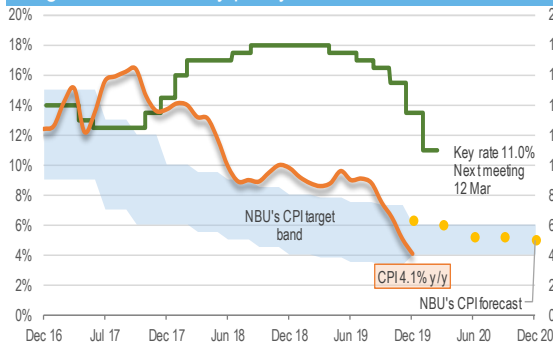


Figure 8. CPI vs Key policy rate



## Further easing stays on NBU's policy agenda

**The National bank of Ukraine has cut its key rate by 250 basis points to 11% on Jan 30**, delivering its fifth policy easing in a row. The decision came as no surprise, another cut was widely expected after annualized consumer price inflation hit a 6-year low in 2019. Yet the market participants were embarrassed to admit such an aggressive easing amid deepening global fears over China's coronavirus.

**Old wins set room for more rate cuts.** The risks list has not changed substantially since the last monetary policy committee (MPC) meeting, according to the NBU head Yakiv Smolii statement in the briefing on Thursday. The faster-than-expected tempering of inflation and sustainable economic growth - at 2.2% in 4Q19 and 3.3% for the year, according to NBU's estimates - allow for a saturated monetary policy easing, he added.

**A lucky seven:** The governor also admitted, that the key rate might be reduced to 7% (revised from 8% previously) through the year-end, provided the macroeconomic situation does not change dramatically.

Though cheering, we see this forecast as quite ambitious (we expect 8.5%). Indeed, the real interest rate (nominal rate minus inflation) allows the central bank to consider an aggressive monetary easing path in 1H20. We expect, however, that the policymakers will prefer to err on the side of caution in 2H20, as inflation rate remains largely dependent on the FX market, and its behavior might change considerably under a low-rate regime.

**Concerns over the Chinese virus are out of NBU's list of risks.** At the moment, the NBU policymakers consider that possible negative developments related to the outbreak of the virus don't pose uncertainty to the central bank's economic outlook. According to

A summary of the MPC discussion will be published on Feb 10. Earlier that month, on Feb 6, the NBU will publish a new detailed macroeconomic forecast in the Inflation Report. The next policymakers' meeting is scheduled for Mar 12.

Figure 9. USD/UAH exchange rate chart



# 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	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
<b>Prices</b>								
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
<b>Fiscal balance (% of GDP)</b>								
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
<b>External balance</b>								
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
<b>Interest and exchange rates</b>								
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
30-Jan (Thu)	NBU: Monetary Policy Meeting	
31-Jan (Fri)	NBU: Balance of Payments	2019
	NBU: Cost of Real Sector External Borrowing	4Q19
07-Feb (Fri)	NBU: FX Reserves (deadline - 7th day of the month)	January
10-Feb (Mon)	NBU: Minutes	
	Ukrstat: Consumer & Production Price Indexes	January

## Upcoming pay offs related to local government bonds

Date	Type of debt	Payment	Amount
30-Jan (Thu)	Local bonds	Coupon USDmn	19.3
		Principal USDmn	258.9
05-Feb (Wed)	Local bonds	Coupon UAHmn	642.1
		Coupon UAHmn (capital notes)	859.8
		Principal UAHmn (capital notes)	2 200.0
06-Feb (Thu)	Local bonds	Coupon USDmn	2.8
12-Feb (Wed)	Local bonds	Coupon UAHmn	925.3
		Coupon UAHmn (capital notes)	626.8
		Coupon USDmn	10.5
		Principal USDmn	388.6



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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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