



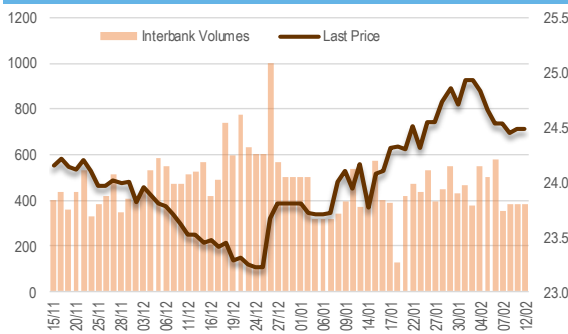
ECONOMICS | INTEREST RATES STRATEGY | FX

13 February 2020

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

	Rating	Outlook	Last update	This week in focus:
Fitch	B	POSITIVE	06.09.2019	Banking liquidity likely to stay elevated in 2020
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 holds steady around 24.5 mark

The USD/UAH pair managed to find some support near the 25 region and has recovered to 24.5 level. Again, the central bank's interventions in the currency market, it seems, were the major trendsetter, helping to stop a steady local currency devaluation, which began in late Dec.

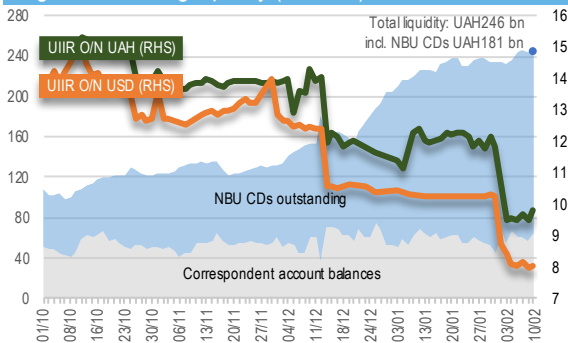
FX injections by the NBU in last days of Jan, amounting to USD143mn, apparently have slashed a speculative demand, which intensified amid revitalized threats of hryvnia weakening, and drove back market forces to natural stance. The latter currently looks quite balanced.

The NBU this week has produced a summary of the key policy rate discussion, where the central bank once again confirms its expectations of a short-lived effect on Ukraine after outbreak of the Chinese virus. The policymakers' current estimates suggest a possible limited depressing of exports, such as metals, and temporal restrictions in access to external financing.

As far as inflation and depending on it interest rates is concerned, the central bank pointed out a faster-than-expected abating of inflationary pressure, with energy prices still relatively low and the fruit and vegetable harvests projected to increase.

At the same time, the NBU admitted, that possible hryvnia's weakening could prevent prices index from moving within the central bank's inflation target band and could even reverse the trend.

Figure 2. Banking liquidity (UAH bn)



Banking liquidity increased by another UAH9.5bn to UAH244bn by the end of last week. The further expansion of liquidity in the system was mainly driven by central bank's FX interventions, accounting for UAH7.8bn and State treasury operation, a part of which represent continuous VAT refunding.

Monetary operations, amounting to UAH20bn, reflected reallocation of incoming to banks' correspondent account funds into central bank's deposit facilities (CDs). As a result, amount of funds in CDs increased to UAH188bn.

Figure 3. Correspondent account balances (UAH bn)

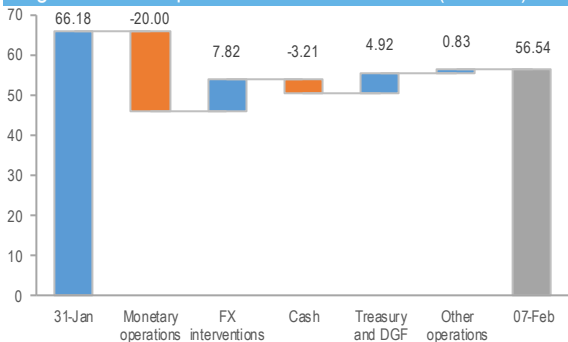
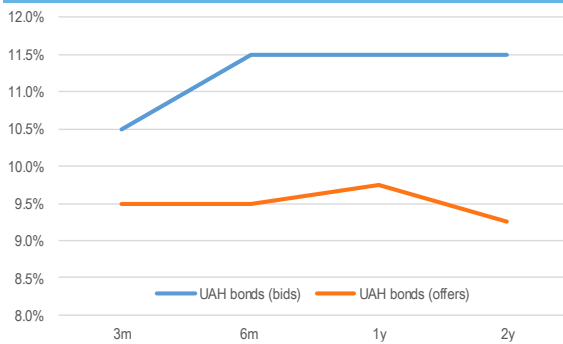


Figure 4. Local UAH bonds market

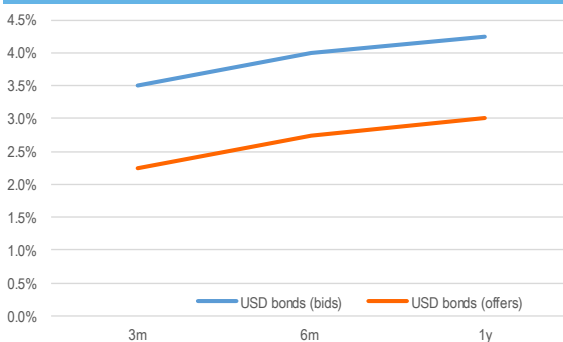


Government bond market

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	9.53%	9.46%	10.50%	9.10%	8	4	1 158.52	500.00
UAH	1.5y	9.53%	9.53%	11.00%	9.53%	8	2	1 627.19	1 000.00
UAH	2y	10.00%	10.00%	10.15%	10.00%	4	2	500.00	400.00
UAH	4.5y	10.09%	9.99%	10.20%	9.89%	17	12	2 175.30	2 130.30
USD	1y	3.50%	3.39%	4.90%	3.20%	69	48	279.20	200.00

A sharp UAH depreciation against the USD in Jan and adverse developments in the global capital markets caused by Chinese virus seems took a toll on foreign appetite to the government bonds. The last primary debt auction (on Feb 11) drew a cool reception, comparing to the previous ones.

Figure 5. Local USD bonds market

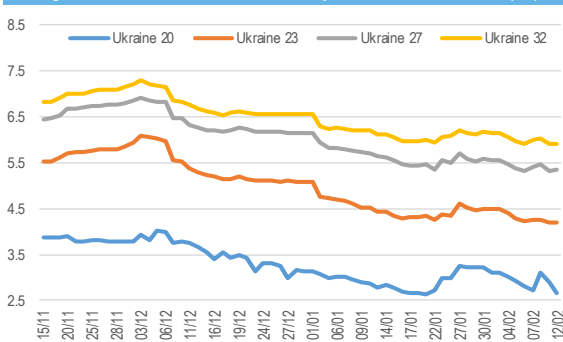


The FinMin offered a range of UAH-denominated instruments with a tenor from 3m to 4.5y, and USD200mn worth of 1-year FX bonds.

Though the highest, demand for the 4.5y bonds at UAH2.18bn didn't meet a threshold at UAH3bn, and the ministry accepted applications for UAH2.13bn with a bid rate below 10.09%. Short-term and FX bonds were of greater demand, drawing bid-to-cover ratio – a gauge of demand – above 1. The cut-off rate for 3m and 1.5y debt was set at 9.53%, and for USD bonds – at 3.5%.

The market's interest to short-term maturities, incl. FX-denominated bonds, might be another indicative of Ukraine's moving out of non-residents radars, pushing the ministry to search for local sources of finance. Yet we do not see fundamental change in non-residents' attitude toward Ukraine, and consider the current market stance as temporary.

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



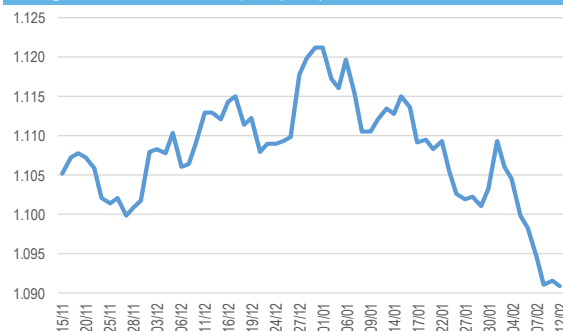
Recession fears in Europe drag EUR down

The economic divergence between the robust U.S. economy and the struggling eurozone one is the primary driving force in the global FX market, pushing the EUR/USD rate below another key level at 1.09 (by the end of Wed).

The U.S. dollar, which had soaked up safe-haven flows as worries about the virus coincided go on gaining on the back of strong economic data. In particular, figures on U.S. homebuilding surged to a 13-year high in December, with retail sales also on the rise and a gauge of manufacturing activity rebounding to its highest in eight months.

On the other side of the pond, European economic data points in the opposite direction and recession fears drag the single currency to a four-month low against the greenback.

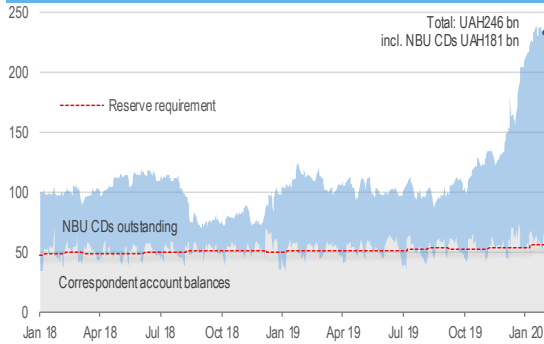
Figure 7. EUR USD spot (mid)



Returning to the coronavirus, Jerome Powell, Chairman of the Fed, said that the bank is closely monitoring the coronavirus outbreak, its damage to the Chinese economy and potential spillovers to the rest of the world. However, he expressed satisfaction with the upbeat domestic situation.

U.S. Treasury yields, however, continue climbing as investors prefer to stay clear of the potential economic impact of China's fast-spreading coronavirus. The yield on the benchmark 10-year Treasury note, which moves inversely to price, rose to around 1.634%.

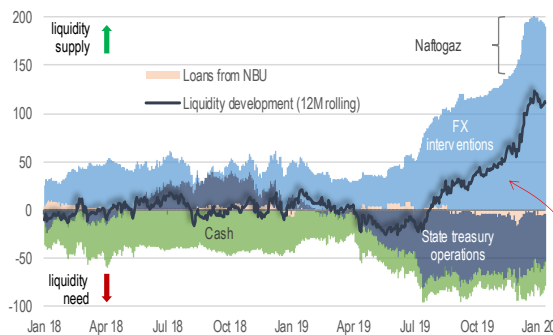
Figure 8. Banking liquidity evolution, UAH bn



Banking liquidity likely to stay elevated in 2020

The significant increase in liquidity in 2019 can be fully attributed to FX interventions channel, absorbing accelerated foreign investments into local government debt and a part of a settlement amount, which was received by Naftogaz from Gazprom and sold in the currency market. An impact of foreign inflows is likely to diminish this year, while fiscal related factors might gradually drain from the system up to UAH50bn.

Figure 9. Contributors to liquidity change, UAH bn

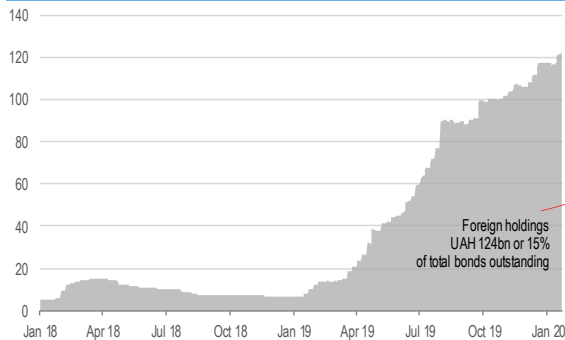


Foreign inflows are likely to moderate. An inflow of foreign investments into local currency government debt, amounting to circa UAH4.5bn in 2019, is likely to abate this year and bring no more than USD2bn. Expected aggressive monetary policy easing by the NBU will be pushing yields for government bonds to levels, not necessarily appealing to international investors.

As for one-off payment from Gazprom to Naftogaz as settlement of dispute (USD2.9bn), we expect the remaining USD2.4bn, which is supposed to be sold in 1Q20, will be fully transferred to the State treasury.

Banknotes might be impacted by land reform. Apart from strong annual seasonality, the growth rate of currency in circulation has not accelerated and demand for cash has even slowed when expressed as a share of GDP. The dominant reason is increasing share of cashless transaction, supported by the NBU's policy aimed at increasing share of non-cash payments. The government low, requiring the mandatory use of payment transactions recorders by the majority of entrepreneurs since Apr 2020, will only firm-up this trend.

Figure 10. Foreign participation in public debt, UAH bn



We expect, however, demand for cash may increase following launching of a land market in Ukraine. A package of relevant bills is likely to be passed in 1Q20, paving the way for the land market to open up in Oct 2020. We assume the first sales of land plots will mostly involve cash, which later on will be utilized in household consumption. This may also entail increase in tax payments, dragging on domestic liquidity.

Reserve-driven demand for liquidity to stay unchanged. Bank lending growth remains subdued, reflecting high interest rates, albeit we see some decline recently, high debt burden among the largest corporate borrowers, elevated legal risks and still slow progress in ease of doing business. The only expanding segment was consumer lending. Yet the NBU recently expressed its concerns about continuous double-digit growth in the segment, and hinted of possible credit standards tightening. With expected key rate decline, however, car loans and mortgage lending might appear as a growth factor.

Figure 11. Seasonal patterns in cash, UAH bn



Situation in deposits positively contrast with the one in lending, as financial standing of both households and businesses continue improving. Growing confidence to banking system and little alternatives for reinvesting savings are supportive to the trend.

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	6.2	10.5	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	9.8	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	51.6	61.0
External balance								
Exports of goods and services (USD bn)	81.7	65.4	47.9	46.0	54.0	59.0	63.4	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	-1.1	-4.5
Current account balance (% of GDP)	-9.0	-3.4	1.8	-1.4	-2.1	-3.3	-0.7*	-2.6
Net FDI (USD bn)	4.1	0.3	3.0	3.4	2.3	2.5	2.5	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
13-Feb (Thu)	NBU: Monetary & Financial Statistics (Preliminary)	January
20-Feb (Thu)	Ukrstat: Retail trade turnover	January

Upcoming pay offs related to government debt

Date	Type of debt	Payment	Amount
12-Feb (Wed)	Local bonds	Coupon UAHmn	925.3
		Coupon UAHmn (capital notes)	626.8
		Coupon USDmn	10.5
		Principal USDmn	388.6
13-Feb (Thu)	Local bonds	Coupon USDmn	12.3
19-Feb (Wed)	Local bonds	Coupon UAHmn	451.2
		Coupon UAHmn (capital notes)	587.2
		Principal UAHmn	1 599.7
20-Feb (Thu)	Local bonds	Coupon USDmn	3.0

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



UKRSIBBANK
BNP PARIBAS GROUP

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Contacts

Investment Business Group

Serhiy Yahnych

Head of Investment Business

(+38044) 537-50-82 serhii.yahnych@ukrsibbank.com

Viktoriia Nebeska

Market Making Government Bonds

(+38044) 201-22-74 viktoriia.nebeska@ukrsibbank.com

Platon Yachmenov

Fixed Income Dealer

(+38044) 230-48-54 platon.yachmenov@ukrsibbank.com

Mykhailo Kharchuk

Market Analysis

(+38044) 537-49-75 mykhailo.kharchuk@ukrsibbank.com

Distribution of Capital Markets Weekly report:

macro@ukrsibbank.com



FX Business

Oleksandr Duda

Head of FX Sales

(+38044) 537-50-02 oleksandr.duda@ukrsibbank.com

Corporate Business

Ievgen Kulikov

Head of MNC team

(+38044) 201-22-43 ievgen.kulikov@ukrsibbank.com

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