



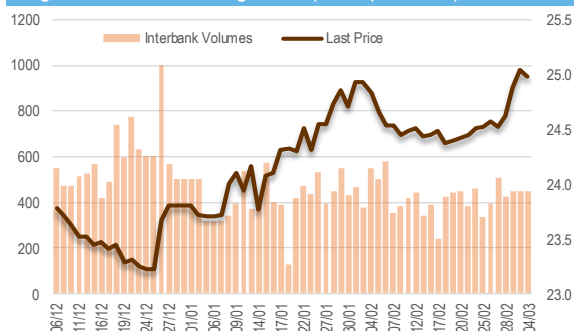
**ECONOMICS | INTEREST RATES STRATEGY | FX**

4 March 2020

**UKRAINIAN  
CAPITAL MARKETS  
WEEKLY**

	Rating	Outlook	Last update	This week in focus: Agro holds momentum, land reform to benefit in 2021
Fitch	B	POSITIVE	06.09.2019	Agriculture saw another record high crop harvest in 2019. This, coupled with buoyant commodity prices, helped the industry to build its contribution to 13% of GDP from 10% in 2018, according to our estimates. Being actively considered, land market reform carries low risks to the industry, but some short-term production gaps, and likely to benefit in 2021.
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)

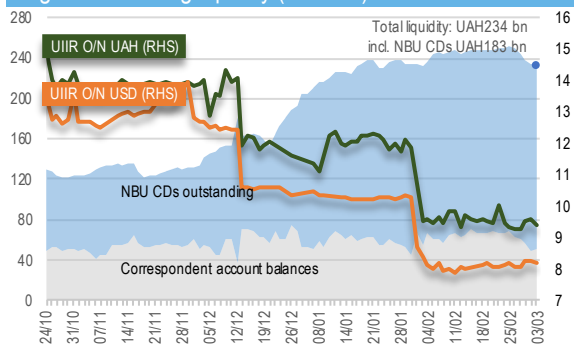


FX and interest rates: Looming risks drive UAH lower against USD

**The Ukrainian currency has declined by 2% against the U.S. dollar** since our previous report (Feb 19) and approached a support level at 25 figure. The currency pair remains under pressure since last week, reflecting spreading concerns over a possible impact of the coronavirus outbreak on the global economic growth and uncertainty surrounding dismissal of the local government.

As far as former is concerned, it is widely expected that the virus will lead to a pullback in global demand for commodities, undermining prospects for Ukrainian external sales. The situation is also complicated with a high uncertainty how large and persistent the economic impact of coronavirus will be. Foreign financial inflows are also at stake as risk-tolerance among investors declined notably. Last primary debt auctions with low foreigners' participation confirm the case.

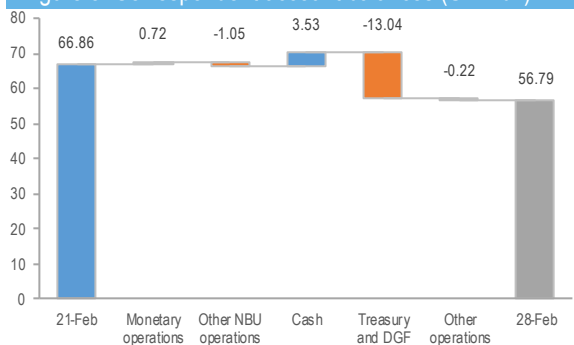
Figure 2. Banking liquidity (UAH bn)



With regard to local situation, the Ukrainian parliament on Mar 4 voted for the dismissal of the government. Leaving aside a new cabinet of ministers, which is still to be nominated, we reckon such a change might delay negotiations with the IMF, whose role in maintaining macroeconomic stability in the county increases amid foregoing external risks.

**Total liquidity in the banking system declined by UAH10.8bn to UAH239bn** over the last week. Balance of correspondent accounts with the NBU eased by UAH10bn and banks' holdings of central banks' certificates of deposits contracted by UAH0.7bn to UAH182.2bn.

Figure 3. Correspondent account balances (UAH bn)



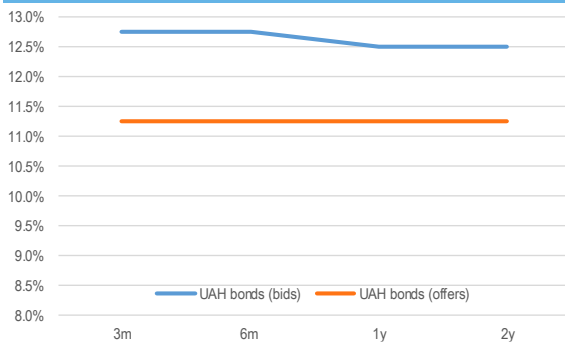
Large-sum transactions by State treasury, seen for the second week in a row, were the main reason of the change. In general, the State treasury in two week drained about UAH19bn, which is quite unusual amount for this period of time, especially against modest primary debt auctions.

NBU interventions withdraw from the system circa UAH2bn, but due to other central bank's operations, correspondent accounts balance declined by only UAH1bn. The NBU doesn't specify the nature of these other operations.

**Next week (on Mar 12) the central bank's policymakers are going to negotiate on the key rate. Having inflation trending down we expect to see further monetary policy easing.** Rising concerns over coronavirus impact, however, make it difficult to project the specific rate cut.



Figure 4. Local UAH bonds market

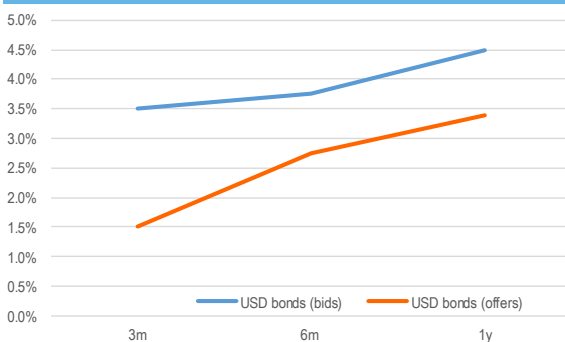


Government bond market

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	10.00%	9.90%	12.00%	9.80%	8	5	1 518.47	1 000.00
EUR	6M	2.25%	2.22%	4.00%	2.20%	25	17	238.78	200.00

**FinMin shifted focus towards bonds in foreign currency in the last primary debt auction on Mar 3.** The ministry called off its plan to place mid-term debt in local currency and offered short-term EUR-denominated bonds instead. The auction of EUR200mn worth of six-month bonds attracted a tepid demand with a bid-to-cover ratio at 1.19. Despite banks' frequent complaints about narrow opportunities for reinvesting FX deposits, they showed little interest to the debt with cut-off rate at 2.25% per year.

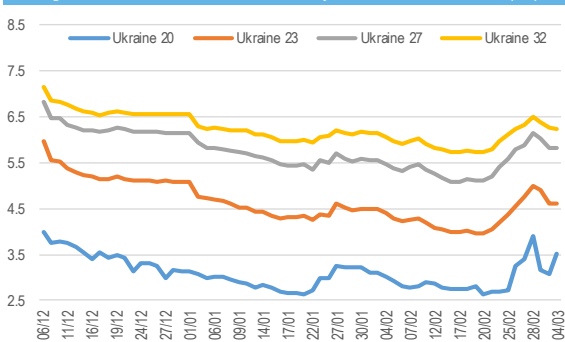
Figure 5. Local USD bonds market



Besides EUR-denominated bonds, the ministry offered six-month debt in local currency. Though not sizable, total demand was above amount of bonds placed, and this came as a surprise against a recent rise in interest rates in the secondary market. Bonds worth UAH1bn were placed with cut-off rate at 10%, which didn't change compared to the previous auction.

**A notable decline in foreign accounts participation take its toll on the government's capabilities to finance its operations.** This, coupled with likely changes in the government can make a dent in the government's borrowing costs going forward.

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



Virus panic sends dollar to year's low against euro

The dollar rebound to a two-month low against the euro amid persistent concerns regarding a deadly virus spreading outside China. The pair traded at roughly 1.115 on Wed (Mar 4). As the new coronavirus continues swiftly infecting hundreds of people, economic and financial impact has been felt globally, creating uncertainty and damaging near-term prospects. The Fed announced a surprise rate cut of 50 basis points on Tuesday morning (Mar 3) to help contain the economic impact of the coronavirus.

The ECB also remains vigilant and ready to act next week in case the outlook deteriorates further on the back of the coronavirus. On the other hand, the ECB is expected to finish its "strategic review" (announced at its January meeting) by year-end, leaving speculations of any change in the monetary policy before that time pretty flat. Further out, recent better-than-expected results in both Germany and the broader Euroland appear to have spurred some optimism among investors regarding the possibility of some recovery in the region and the currency.

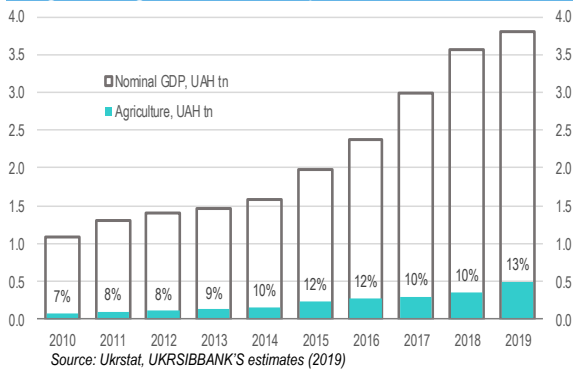
Figure 7. EUR USD spot (mid)



The Fed's move drove yields on U.S. Treasuries to historic lows. The yield on the benchmark 10-year Treasury note, which moves inversely to price, sank more than 11 basis points to an all-time low of 0.906% on Tue in the wake of an emergency rate cut by the Fed to combat the economic effects of the COVID-19 outbreak.

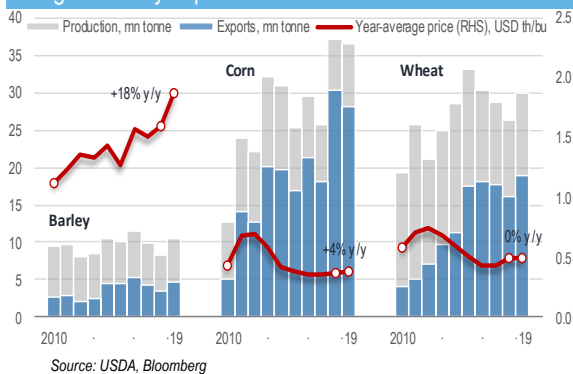
Figure 8. Agro-industrial complex contribution to GDP

Agro holds momentum, land reform to benefit in 2021



Agriculture saw another record high crop harvest in 2019. This, coupled with buoyant commodity prices, helped the industry to build its contribution to 13% of GDP from 10% in 2018, according to our estimates. Being actively considered, land market reform carries low risks to the industry, but some short-term production gaps, and likely to benefit in 2021.

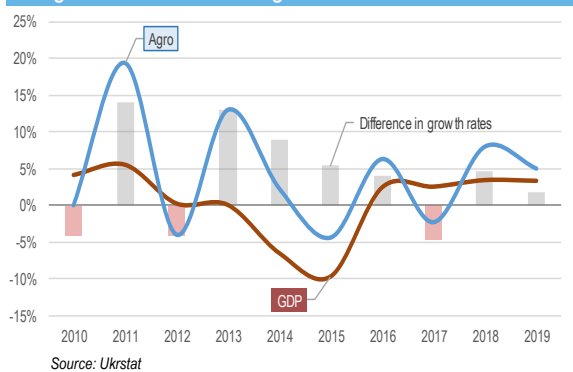
Figure 9. Key export commodities



**Another strong harvest supported increase in exports.** Ukraine's production of grain legume crops amounted to around 75 mn tonnes in 2019, compared with 70 million tonnes in 2018. Another record-high crop harvest coupled with favorable commodity prices (while year-average price for wheat and corn didn't change much in 2019 compared to 2018, price for barley saw another leap up by 18%) resulted in a 24% increase in export sales, reaching 40.9 mn tonnes (in 2019MY, Jun-July) as of beginning of March. In money terms, exports grew by 19% to USD22.1bn in 2019, out of which grain and leguminous account for 43.5% of overseas sales.

**Warm weather might prevent from enjoying another record harvest.** The last unusually warm winter might be followed by a limited rainfall during this spring, according to different experts in the field. They diverge, however, in their estimates about a possible impact on the winter crops, and water-craving wheat in particular. Some are of the opinion that there was a sufficient soil moisture for crops, but sunflower, ensuring good and satisfactory condition of plantings. Others warn of a possible drought in the months to come, which might require an extensive melioration works.

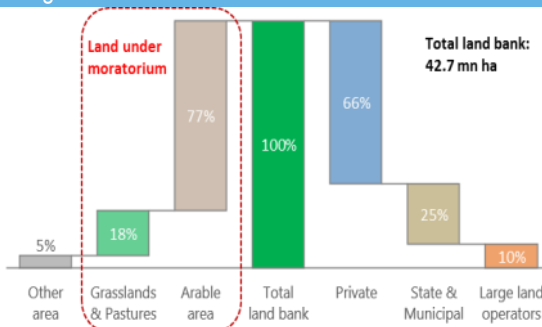
Figure 10. Evolution of agriculture vs GDP



While new technologies allow to preserve most of the crops, we admit a slightly weaker production this year, which can come up as a negative growth against the last year's record high yield.

**Agro stays prominent in long-term.** Considering agriculture in a long-run, the industry has proved to be more resilient to various shocks than the general economy of Ukraine, thanks to a continuously expanding external demand for food, and usually outperform economy in time of a positive growth. Considering market participants eagerly implementing modern technologies in the industry and opportunities offered by the land market reform, we expect the segment will remain robust going forward.

Figure 11. Breakdown of Ukraine's land resources



**Land reform gets through the mess of interests.** While staying on track, land market reform has undergone numerous amendments since initially presented. About 95% of agricultural lands, which is the primary object of the reform, is owed/processed by various groups with very different interest. In addition to that, some politics, regardless of their relation to the land market, also try to reap some dividends from the process. Searches for compromises among all these interests have resulted in multiple changes to the initial law (more than 4 thousand of amendments were offered to the 2nd reading), which consequently will impact a new market's effectiveness. This way, for instance, foreigners, which are largely represented by Ukrainian companies with a non-resident holding entity, were deprived of a right to purchase lands (in some cases to convert long-term lease contracts into land owning rights).

Another impediment is seen in high expectations in the market about price for land owned and no set benchmarks for real price.

All these factors will put off forming of the market itself and its positive contribution to the economy to 2021.

# 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	-7.7	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
<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	9.8	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	51.6	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	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
<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
06-Mar (Fri)	Fitch Rating Action	
07-Mar (Sat)	NBU: FX Reserves (deadline - 7th day of the month)	February
10-Mar (Tue)	Ukrstat: Consumer & Production Price Indexes	February
11-Mar (Wed)	NBU: Monetary & Financial Statistics (Preliminary)	February
12-Mar (Thu)	ECB: Monetary Policy Meeting NBU: Monetary Policy Meeting	
13-Mar (Fri)	S&P Rating Action	

## Upcoming pay offs related to local government bonds

Date	Type of debt	Payment	Amount
04-Mar (Wed)	Local bonds	Coupon UAHmn	3 001.4
		Coupon UAHmn (capital notes)	125.8
		Principal UAHmn	4 178.9
06-Mar (Fri)	Local bonds	Coupon UAHmn (capital notes)	135.0
11-Mar (Wed)	Local bonds	Coupon UAHmn	24.0
		Coupon UAHmn (capital notes)	727.8
		Principal UAHmn (capital notes)	950.0

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



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