



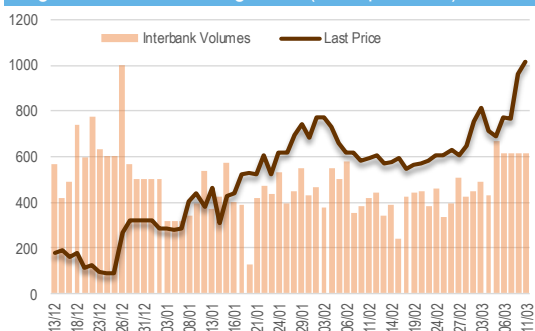
ECONOMICS | INTEREST RATES STRATEGY | FX

12 March 2020

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

| | Rating | Outlook | Last update | This week in focus: NBU remains dovish and for a good reason |
|---------|--------|----------|-------------|--|
| Fitch | B | POSITIVE | 06.03.2020 | Ukraine's central bank's policymakers have reduced key rate to 10% from 11%, treating coronavirus-related developments as having opposing effects on the local economy. In turn consumer inflation deceleration below the forecasted range (5% +/- 1 pp) which is likely to be followed by contraction in consumers' expenses allows for further gradual monetary policy easing. |
| 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)

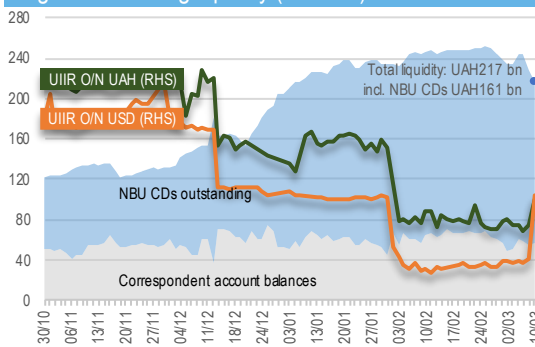


FX and interest rates: Hryvnia whipsaws on speculations about global crisis

The USD/UAH pair has produced a sharp drop since last week to the 26 area as persistent coronavirus fears have fed speculations in the local foreign currency market about inevitability of a new global crisis. Another "black swan event" attributed to COVID-19 outbreak apparently is the most cited wording in the local media so far, with gloomy forecast of different sort overflowing headlines.

While global emergency does takes toll on world economies, **situation seems to be overheated locally**. Global markets prefer to keep to a milder wording in this regard, with trade and travel disruptions more commonly used instead of the tag "crisis". Moreover, foreign investors keep hopes that global monetary policymakers will offer further stimulus to offset economic impact of coronavirus.

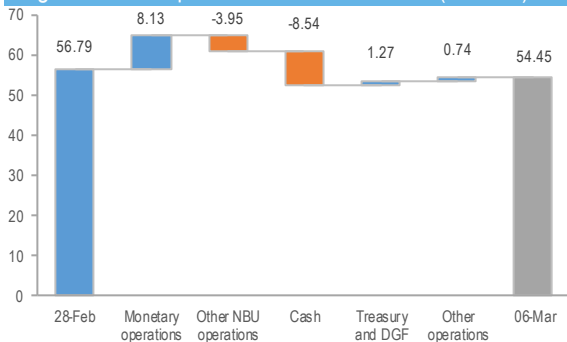
Figure 2. Banking liquidity (UAH bn)



The National bank of Ukraine (NBU) says the current FX market turbulence doesn't resonate with actual figures on external trade transactions. According to the central bank (CB) Ukraine's exports keep on growing, with price decline compensated by increased volumes of sales. The central bank acknowledges notable decline in foreign demand for local government bonds, yet it doesn't see material risk there as long as related outflow stay low.

It is noteworthy that the **CB supports its position with sizable FX interventions**. The NBU flooded the market with about USD1bn since beginning of the month to fire back speculative demand.

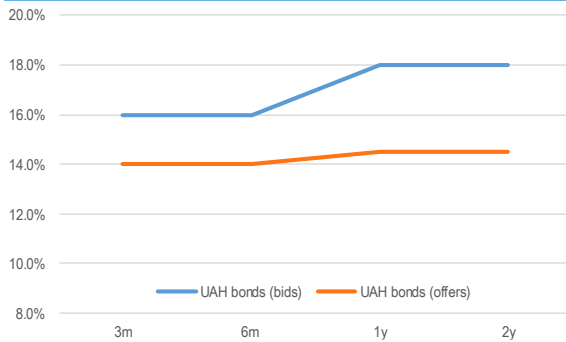
Figure 3. Correspondent account balances (UAH bn)



Total liquidity in the banking system contracted by another UAH10.5bn to UAH228.5bn, with balance of correspondent accounts declined by UAH2.3bn to UAH54.4bn. Major factors that determined liquidity drain were cash demand, related to usual for the first decade of month salaries withdrawals, and central bank's FX interventions, which absorbed about UAH4bn. A sizable redemption of government bonds in the middle of last week helped to offset other State treasury operations, which continue to have a negative impact. Monetary operations for UAH8bn represent contraction of bank's position in CB's certificates of deposits.



Figure 4. Local UAH bonds market

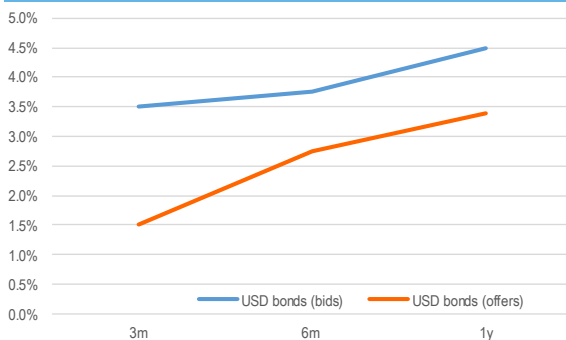


Government bond market

FinMin cancelled primary debt auctions scheduled to take place on Mar 10. According to the official statement, the decision resulted from a heightened price volatility in the capital markets, both local and global, brought about by spreading fears over coronavirus impact. All attention focuses now on safe assets, and Ukrainian debt, unfortunately, is out of this liege.

Market participants adjust prices, but trade activity stays low. Secondary market, which was behind the curve when ministry was aggressively pushing yields for government bonds down, has emerged as a price maker in current conditions. We have seen already single deals with yields above 15% and quotations in the range 14/18% (offer/bid). It is important to mention, however, that trade activity stays as usual, no panic sales have been seen so far but some transactions with non-residents.

Figure 5. Local USD bonds market

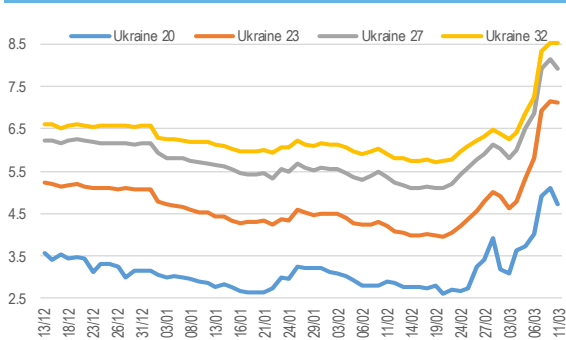


We expect FinMin freeze for some time local currency debt auctions so that not to damage debt yield curve. We assume the ministry is ready to some price concessions, but not to the extent the current volatile situation suggests.

Meantime the ministry can source financing via FX bonds auctions. On the one hand such debt carries foreign currency risk. On the other, the ministry might benefit from FX corrective rebound if global concerns around the COVID-19 and its economic impact assuage and investors' risk sentiment improve.

In addition to that, a debt deal between the ministry and Cargill Financial Services still holds relevant. No details are available on the deal. We assume, however, the amount available is not less than the previous credit for USD277.5mn, attracted in Oct 2019.

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



EUR/USD recovers after shot to the highest since Jan-19

The EUR/USD currency pair has set to recovery path after surging to its highest level since Jan 2019 on Mon (Mar 9). The initial downturn was brought about by a combination of both the crashing oil prices after failed Friday's (Mar 6) Organization of the Petroleum Exporting Countries meeting and the ongoing coronavirus scare, denting global economies.

Oil prices fell 30% after Saudi Arabia pledged to slash prices and boost production following the collapse of an OPEC supply agreement. In turn on the coronavirus front, the number of people infected with the virus topped 110,000 across the world as the outbreak reached more countries and caused more economic damage.

Figure 7. EUR USD spot (mid)

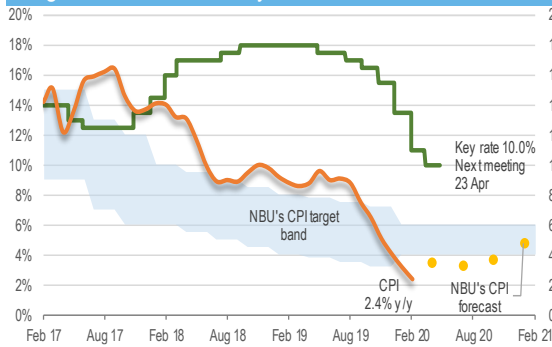


Market tensions has assuaged partly since Tue (Mar 10) after the World Health Organization's decided not to declare a global emergency. Extensive efforts coming from central banks and governments around the world to limit the economic damage of the coronavirus outbreak have also contributed positively. Yet, it is too early to say the market sentiment has turned positive.

Yields for safe-haven U.S. Treasury declined to record lows, with the benchmark 10-year yield falling below 40 basis points and the entire yield curve below 1% for the first time ever.

Along EUR/USD pair recovery the benchmark yield rebounded to 0.784% level.

Figure 8. Inflation vs Key rate evolution

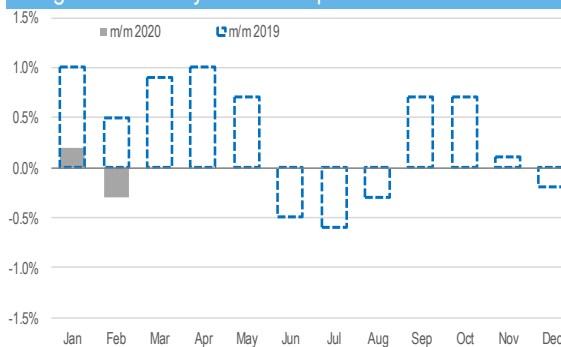


NBU remains dovish and for a good reason

Ukraine's central bank's policymakers have reduced key rate to 10% from 11%, treating coronavirus-related developments as having opposing effects on the local economy. In turn consumer inflation deceleration below the forecasted range (5% +/- 1 pp) which is likely to be followed by contraction in consumers' expenses allows for further gradual monetary policy easing.

Inflation keeps running below target. The Ukraine's consumer price index growth slowed to 2.4% y/y in Feb from 3.2% y/y in Jan, again undershooting the central bank's target (5% +/- 1 percent point). Monthly, underlying prices dropped by 0.3% versus 0.5% growth in Feb 2019. Apparels, food and utilities, being the major contributor to the change, keep inertial decline on the back of past local currency strength. The last also benefits from a prices decline for energy commodities in the global markets.

Figure 9. Monthly CPI development



FX risks lack feeding ground. With local currency skyrocketed to the 26 area, one should expect a broad adjustment in prices for consumer goods. At the same time, last year's high base for Mar-May should help to absorb appropriate acceleration of monthly inflation, which by the way has not become visible so far and is likely to emerge closer to the Easter holidays.

Worth also mentioning that induced by the coronavirus fears are likely to result in narrowed private consumption, which in turn will be curbing prices growth.

The deeper oil prices the better. Recent collapse of the oil prices, weighing on the whole energy commodities market, should help to keep inflation subdued too. This is of particular relevance considering that Ukrstat has updated expenditure weights recently. According to the state statistics office, food segment contribution to CPI has been reduced to 44.7% from 45.4% while dependent on global prices for energy commodities utilities and transport services will account for 5.4% (previously 4.9%) and 3.2% (2.35%) respectively.

Figure 10. USD/UAH spot rate



The new government make a step towards the IMF. Both President Volodymyr Zelensky and lately prime minister Denys Shmyhal confirmed their commitment to further cooperation with the Fund, slashing spreading speculations around abrupt change of the government. Further cooperation with the IMF is of great importance to the country facing difficulties with attracting financing amid tight situation at the global debt markets. We keep an eye on Ukraine's progress within taken commitments to fulfill in 2-3 weeks remaining Fund's conditions (implementation of land reform and passing legislation to protect the state's takeover of PrivatBank from its former owners).

Soft monetary policy might help withstand a capital flight. Fears over the economic fallout from the outbreak continue to drive investors towards safe-haven assets. Reduced key rate, which at the same time serves as an interest rate for the central bank's 2-week certificates of deposits, might induce local banks to reallocate some funds into government bonds through absorbing foreign supply.

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 | -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 |
| 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 |
|---------------|--------------------------------------|----------|
| 12-Mar (Thu) | ECB: Monetary Policy Meeting | |
| | NBU: Monetary Policy Meeting | |
| 13-Mar (Fri) | S&P Rating Action | |
| 18-Mar (Wed) | FOMC: Monetary Policy Meeting | |
| 20-Mar (Fri) | Ukrstat: Retail trade turnover | February |
| | Ukrstat: Gross Domestic Product | 2019 |
| | NBU: External Debt | 4Q19 |
| 23-Mar (Mon) | NBU: Minutes | |
| | Ukrstat: Industrial Production Index | February |

Upcoming pay offs related to government debt

| Date | Type of debt | Payment | Amount |
|--------------|--------------|------------------------------|---------|
| 13-Mar (Fri) | IMF | IMF SDRmn | 295.5 |
| 18-Mar (Wed) | Local bonds | Coupon UAHmn | 118.3 |
| | | Coupon UAHmn (capital notes) | 199.6 |
| 25-Mar (Wed) | Eurobonds | Coupon USDmn | 110.6 |
| | Local bonds | Coupon UAHmn | 1 061.0 |
| | | Coupon UAHmn (capital notes) | 817.4 |

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



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