



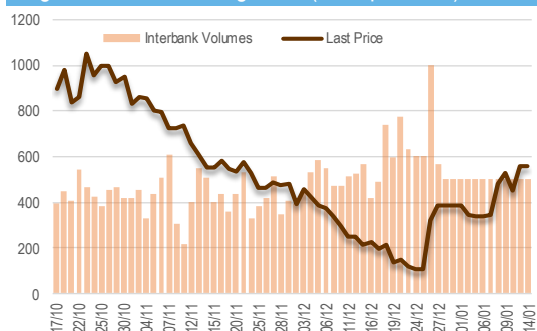
ECONOMICS | INTEREST RATES STRATEGY | FX

15 January 2020

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

	Rating	Outlook	Last update	This week in focus: 300 bps cuts are likely in 1Q
Fitch	B	POSITIVE	06.09.2019	Ukraine's CPI rate continued to fall in Dec 2019: annualized growth reduced to 4.1% from 5.1% in Nov. Continued strengthening of local currency in reporting period kept prices for imported products down, and we still think a little more hryvnia appreciation is to come in 1H20. Having annual inflation falling short of its target, the NBU might deliver another heavy policy rate cut on Jan 30th.
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)



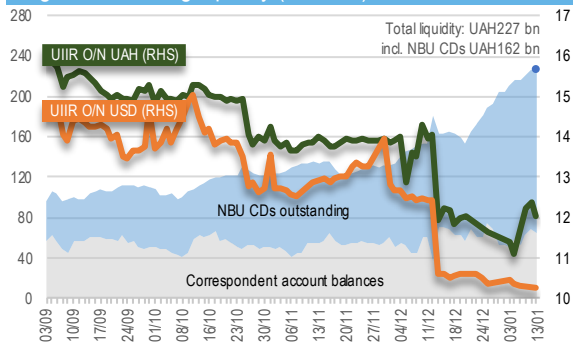
FX and interest rates: USD/UAH failed to rally after striking debt auction

The Hryvnia failed to set on a recovery course after some retreat before the holidays, despite striking demand for public debt, revealed during the last FinMin's primary debt auction.

A record-high appetite for government bonds seen on Tuesday for a while revived fears in the market of another wave of local currency appreciation. This resulted in the USD/UAH pair rising this morning to 23.96 figure. The trend, however, didn't last long due to central bank's active interventions, and the hryvnia ended trading day at around 24.04 level.

This year the impact of FX inflows from foreign accounts into public debt might be less perceptible than in 2019: on Dec 12th, 2019 the National bank of Ukraine (NBU) increased planned amount of daily interventions on the interbank FX market by USD20mn - to USD50mn.

Figure 2. Banking liquidity (UAH bn)

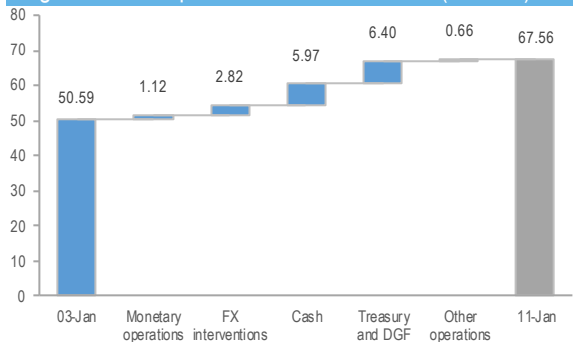


Besides, on Jan 10th, 2020 the NBU doubled the limits on banks' FX long and short positions to 10% of the regulatory capital (the decision is entering into effect on Jan 20th and will remain in force until the end of 1Q20). According to the central bank's estimations, this action will contribute to expansion of banks' transactions by roughly USD400mn.

For the record, this month the NBU has already purchased in the FX market USD198mn and sold USD30mn. Net purchase in 2019 was USD7.9bn.

Total liquidity of the banking system reached record high UAH225.7bn by the end of last week, with most of funds hoarded in central bank's certificates of deposit (CD).

Figure 3. Correspondent account balances (UAH bn)

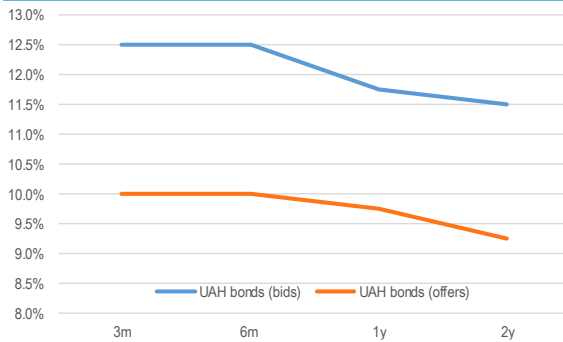


All the factors contributed to further increase of liquidity in the system. In particular, State treasury's operations added UAH6.4bn, cash money deposits on banks' accounts – circa UAH6bn, and central bank's FX interventions – UAH2.8bn.

While stepping up monetary easing will partly help to unload so high stockpiles of money, taking into account still inefficient legal framework it is difficult to expect a swift channeling of excess funds into the real economy.



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	10.85%	10.73%	12.00%	10.46%	23	9	3 474.87	500.00
UAH	1.5y	10.44%	10.18%	12.10%	9.95%	40	14	5 120.12	500.00
UAH	2y	10.21%	10.04%	11.75%	9.75%	38	18	6 957.41	1 500.00
UAH	3.5y	10.10%	9.88%	11.00%	9.73%	66	31	9 690.45	3 000.00

The Finance Ministry (FinMin) enjoyed another rush of bidding for government bonds at the primary debt auction on Tuesday (Jan 14).

The ministry offered only local currency debt for UAH5.5bn, which was split into a number of instruments, ranging from 3m to 3.5-year. The measures of the auction's success, the ratio of bids received to bids accepted, recorded its highest level in the last years. In particular, 1.5y bonds drew a bid-to-cover ratio of astonishing 10.2. The appropriate gauges of demand for the rest of securities offered were no less impressive: for 3m – 6.9, for 2y – 4.6, and for UAH3bn worth of 3y bonds - 3.2.

So high appetite helped to drive down yields for government debt to new lows, with weighted average yield for 3y securities slipped below a key level at 10%.

The secondary bond market is currently in wait-and-see mood. As many market participants had their bids unsatisfied during the auction, they prefer hold their positions in the public debt in order not to sell it too cheap, especially in view of record-high liquidity in the banking system and limited opportunities for its allocation.

Figure 5. Local USD bonds market

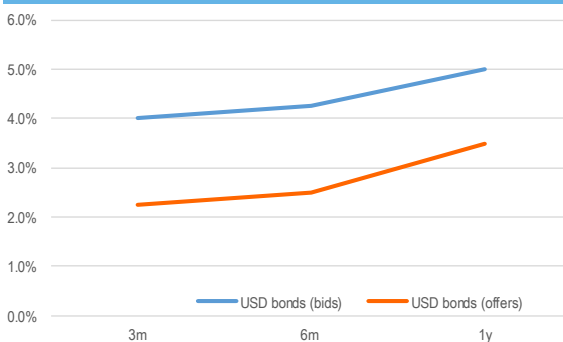
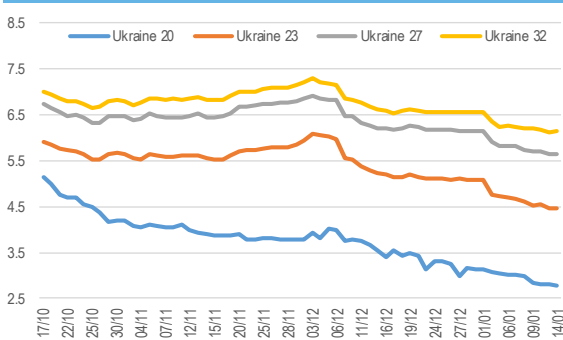


Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



EUR/USD pair hovers ahead of US-China trade deal

The EUR/USD pair is trading within a narrow channel as investors are waiting for the signing of a U.S.-China trade deal. The U.S. and China are set to sign Phase One of the trade agreement later on Wednesday. Ahead of the publication of the full details, Washington announced that it expects no further tariff reductions until November when the U.S. elections are due.

The greenback is currently holding above a one-week low against the single currency as markets are disappointed that barriers to global growth are set to persist.

In the old continent, the European Central Bank (ECB) has repeated its calls on Germany and others to invest more and stimulate the eurozone economies as growth has been meager in recent quarters.

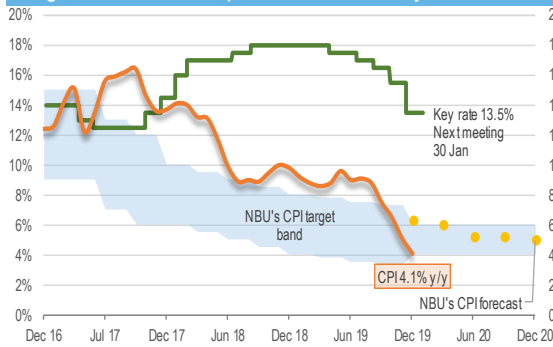
Figure 7. EUR USD spot (mid)



While the expansion is limited, one ECB member downplayed the chances of an outright downturn.

U.S. government debt prices move higher on Wednesday, as investors await the imminent signing of an interim trade deal between the world's two largest economies. The yield on the benchmark 10-year Treasury note, which moves inversely to price, slipped to around 1.8056%.

Figure 8. Consumer price index vs Policy rate

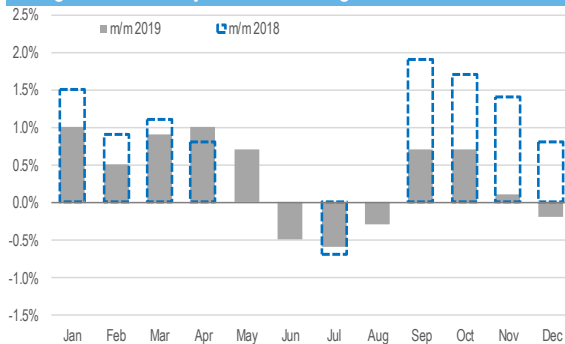


300 bps cuts are likely in 1Q

Ukraine's consumer price inflation (CPI) rate continued to fall in Dec 2019: annualized growth reduced to 4.1% from 5.1% in November. Contrasting with market expectations, continued strengthening of local currency in reporting period kept prices for imported products down, and we still think a little more hryvnia appreciation is to come in 1H20. Having annual inflation falling short of its target, the central bank might deliver another heavy policy rate cut on Jan 30th.

Inflation print down to the lowest level since Apr 2014: the statistics office (Ukrstat) said consumer prices rose 4.1% y/y in December, against 5.1% in November. It is 0.7 percent points (pps) below our latest estimation and about two figures lower than it was expected by economists polled by the NBU.

Figure 9. Monthly inflation change



What went right? As before, strong Ukrainian currency was the main disinflation factor in December, that in turn had been driven by continued high appetite to local government bonds from foreign investors and sizable FX sales by the state company Naftogaz. Being full of stocks, retailers allowed some price cuts for imported products after developments at the FX market ran counter their expectations. Drop in prices for apparels (-3.4% y/y), meats (-0.4% y/y) and fruits (-1.2% y/y) was the most notable in this regard.

Positive price developments in the global energy markets reinforced slowdown in inflation. Government-induced though, both natural gas and fuel prices in the local market were adjusted to downside trends in the global markets and USD/UAH pair change. This resulted in reduction in utilities and transport services costs by 3.4% y/y and 0.8% y/y respectively.

Figure 10. Contribution to monthly change in CPI



Disinflation factors will again play a role in 1H20. We expect situation in both local FX and global energy markets will be supportive to low inflation in the 6-month horizon. Double-digit yields for UAH-denominated public debt amid 6-year low inflation in Ukraine and disinflationary slump worldwide, preventing leading central banks from lifting their policy rates, is likely to hold non-residents' appetite to local government bonds. As for energy prices, there are two points worth mentioning. We expect further decline in natural gas prices, reckoning that record-high stockpiles in European gas storage facilities and reduced consumption due to a warm winter will be pushing prices down. In turn, recent gas transit deal between Ukraine and Russia will help to avoid rising local tariffs for natural gas and its distribution. With regard to oil prices, on the one side, recent Iran-U.S. tensions seems to intensify geopolitical uncertainty, promoting an oil price increase. On the other, some tone down in rhetoric of Iran and U.S. leaders in last days might be a sign of an inflection point in tensions between two countries.

On the brink of global disinflation trend. Inflation number in 2019 turned out to be much below both economists' expectations and the NBU's 6.3% target, allowing the central bank to speed up in the pace of monetary policy easing in 1H20, with 200 +/-50bps rate cut during upcoming MPC meeting on Jan 30th. Given an extensive role of USD/UAH pair in conquering runaway prices, it is too early to speculate on development in Ukraine sustainable disinflation trend, similar to those seen in advanced and most of emerging economies. Demand-side drivers, in particular continuously growing wages and social payments, still hold relevance. On the other hand, in case of no serious external shocks, we might experience inflation in the bottom half of the NBU's target range (4-6%).

UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators

	2013	2014	2015	2016	2017	2018	2019	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
17-Jan (Fri)	NBU: Liquidity Auction	
21-Jan (Tue)	Ukrstat: Retail trade turnover	2019
22-Jan (Wed)	Ukrstat: Industrial Production Index	2019
23-Jan (Thu)	ECB: Monetary Policy Meeting	
24-Jan (Fri)	NBU: CDs Auction	

Upcoming pay offs related to local government bonds

Date	Payment	Amount
15-Jan (Wed)	Coupon UAHmn	274.2
	Coupon UAHmn (capital notes)	223.7
	Coupon USDmn	8.8
	Principal USDmn	312.9
22-Jan (Wed)	Coupon UAHmn	584.7
	Coupon UAHmn (capital notes)	643.4
	Coupon USDmn	2.4
	Principal UAHmn (capital notes)	2 500.0

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



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