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Economics | Interest Rates Strategy | FX
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Ukrainian Capital Markets Weekly

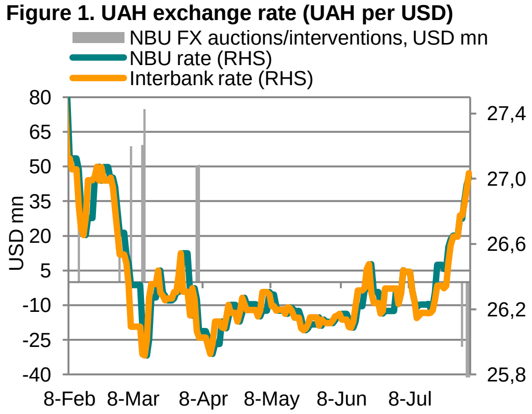
This week in focus: Current account is a mixed bag

On a 12M basis Ukraine's current account deficit amounted to USD 2.8bn, up from USD 2.4bn last year. While external trade continues to worsen, resilient export prices will help to offset (albeit partly!) negative impact coming from accelerated consumer imports and higher energy prices. The risks to FX rate stability are increasing and we expect another round of renewed pressure on UAH, retaining our end-year USDUAH expectations of 29.50.

Please see page 3 for more details

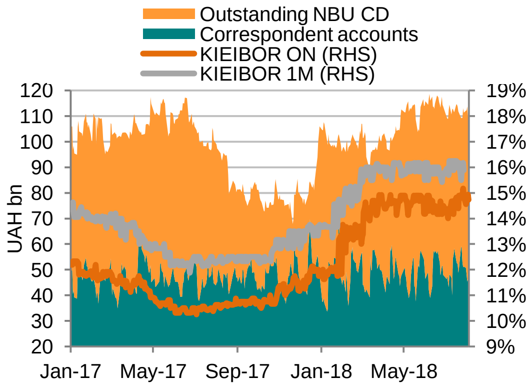
FX and interest rates: UAH weakness likely to slow for now, rates to go up

Figure 1. UAH exchange rate (UAH per USD)



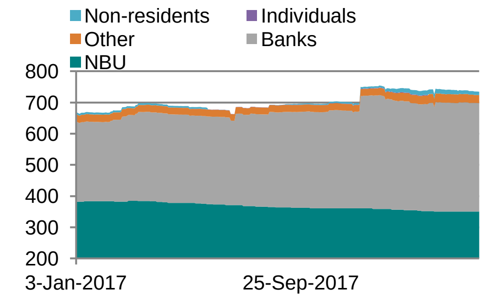
Source: NBU, Reuters

Figure 2. Banking liquidity (UAH bn)



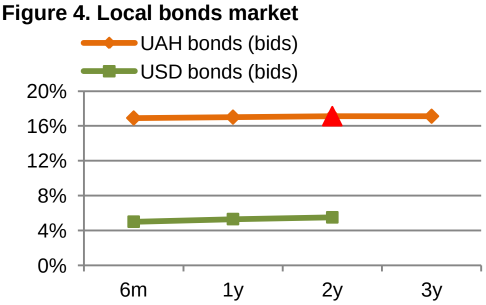
Source: Reuters, NBU, UkrSibbank, Minfin

Figure 3. OVDP holders, UAH bn



Source: NBU

Figure 4. Local bonds market



Source: UkrSibbank

USD/UAH closed at 27.01 as of Friday the 3rd, as hryvnia fell by 1.4% on a week-on-week basis. We expect hryvnia devaluation to lose steam in the nearest future, provided the withdrawal from the market large amounts of banking liquidity via accelerated selling of the FX currency on the market in the form of NBU interventions.

Average daily FX volumes on the market amounted to the equivalent of USD 231.8mn, down by USD 72.3mn week-on-week.

NBU resorted to three currency auctions during only just one week ending August 3rd, starting to use this tool for the first time since April. On the first auction, central bank aimed to sell initially USD 50mn, nevertheless auction resulted in only more modest USD 28.1mn of sold foreign exchange currency from international reserves. While on the second auction NBU initially was to sell USD 100mn, applied demand from the banks exceeded that volume, resulting in only USD 100mn of sold currency from NBU to commercial banks. On the third auction during the week, applied demand once again exceeded the amount NBU initially aimed to sell, namely USD 50mn, by more than USD 25mn, as an outcome only USD 50mn was sold from the side of NBU. As a consequence, roughly USD 0.2bn was sliced from the international reserves during only one week only through one tool. Moreover, YTD reading of central bank interventions dropped to USD 1.2bn of bought FX currency in 2018 so far.

Aggregate banking liquidity amounted to UAH 107.0bn as of Friday the 3rd, down by more than UAH 4bn during the week.

Money market rates remained flat: cost of ON funds is around 14.0/16.00, 1 week is 14.5/16.50 while 1M is 15.00/17.50, according to our calculations.

MoF managed to conduct 2 primary auctions in prior week instead of one. On the first auction, MoF offered three bond issues out of which 2 resulted in proceeds to the budget. 6 month issue attracted the major part of demand and brought to the budget roughly UAH 1bn. At the same time, 3y issue accounted only UAH 12.7mn proceeds to the state coffers. On the second auction, which was held on Thursday as opposed to Tuesday, demand was as much as twice higher compared to the auction held effective July 31st. As was the case in preceding auction, the shortest type of bonds drew almost all demand on the auction. While previously Ministry of Finance was inclined to set a restrain on the amount of placement of the short term bonds, namely 3m and 6m issues, this time MoF refrained from doing that, allowing all applied demand to be effectively satisfied.

Currently, yields (bids) of local OVDP in UAH at 18.50% (for 6m), 18.50% (for 2Y). 1Y USD bids were at 5.65%, while bids for VAT bonds were at 18.50%.

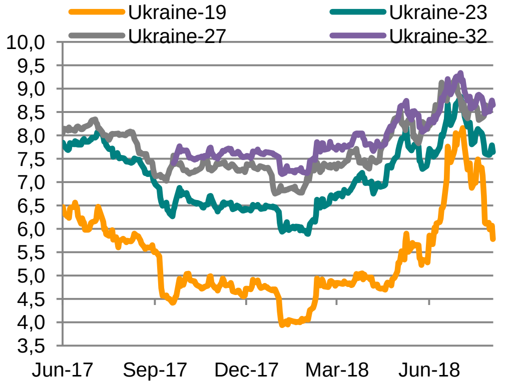
Figure 5. OVDP auction combined results, 2nd of August 2018

CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size	Placement size
UAH	6m	18.00%	18.00%	18.00%	17.80%	3	3	1.1bn	1.0bn
UAH	3y	16.85%	16.82%	18.00%	16.70%	3	2	37.4mn	12.7mn
Total								1.1bn	1.0bn
UAH	3m	18.00%	18.00%	18.50%	18.00%	11	5	2.2bn	2.0bn
UAH	6m	18.00%	18.00	18.10%	18.00%	4	2	101.0mn	74.1mn
Total								2.3bn	2.1bn

In June, **average nominal wage in Ukraine amounted to UAH 9141, which was up by 24.2% y/y**. In the meantime, real average wage has grown by 13.0% y/y in the same period, climbing down slightly from 14.1% y/y growth in prior month. Nominal wage increase was supported the most by transportation (+29.0% y/y), finance (+26.5% y/y), construction (25.8% y/y), agriculture (25.1% y/y) and industry (25.1% y/y) among private sector. Meanwhile, defence was the major contributor to growth among government controlled sectors. In particular, on y/y basis nominal wages rose by 38.8%, followed by education with a growth of 19.6% y/y.

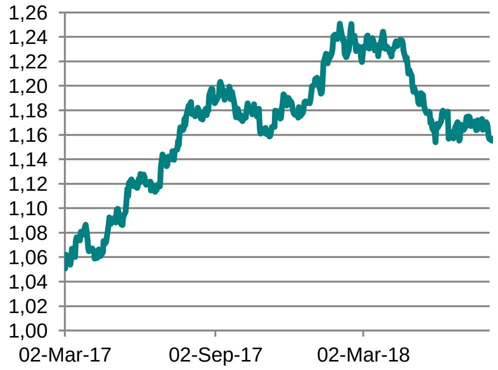
Global markets: July's payrolls in the forefront

Figure 5. Ukraine's sovereign Eurobond yields, bid/ask mid (%)



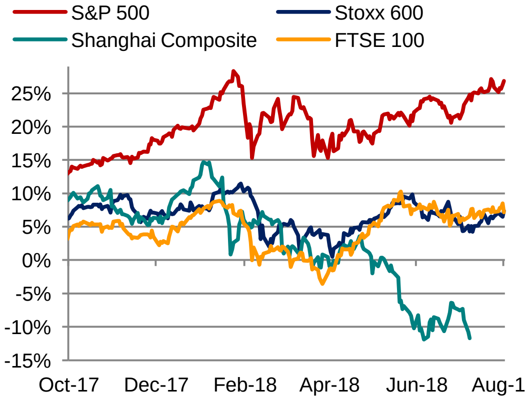
Source: Reuters

Figure 6. EUR USD spot (mid)



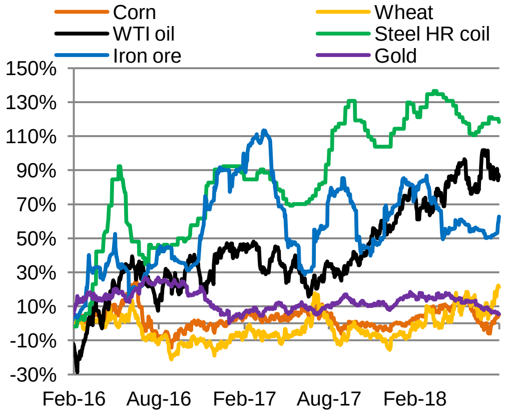
Source: Reuters

Figure 7. Major stock indices (Jan-2017=100)



Source: Reuters

Figure 8. Commodity prices (Jan-2016=100)



Source: Reuters

July's payrolls report displayed that employers added 157 000 people last month. In the meantime, in July, the CPI in EU rose at an annualized rate of 2.1%, which was higher than the 2.0% posted in prior month. At the same time, China signaled that it has no intention to retreat from a trade war with United States.

Bond benchmarks were mixed, with U.S, 10y Treasuries' yield was almost flat week-on-week landing at 2.95%, while German 10y Bunds' yields were flat too, landing at 0.41%, Japanese 10y bonds yield's ended the week at 0.11, up compared to the previous week.

Major US stock indices advanced during the week, as S&P increased by 0.8%, exceeding prior week gains, while Nasdaq Composite gained by 1.0% week-on-week. The most prominent event happened during the week was Apple quarterly report, which beat expectations by far. Following that company shares set new highs, resulting in reaching Apple USD 1tn market capitalization. Apple positive surprise ended negative mood flying in the tech industry after Facebook reported its results earlier, resulting in a drop of shares.

The July payrolls report displayed that employers added 157 000 people last month, compared with an average monthly gain 203 000 over period of 12 month. At the same time, the Bureau of Labor Statistics revised down the number of people hired in May and June. Having adjusted for revisions, job gains were 224 000 per month on average in the last three months. Meantime, jobless rate climbed down by 0.1% to 3.9%. In regard to average hourly earnings they increased too. In particular, over the year average hourly earnings have increased by 2.7%.

EUR/USD rate landed at 1.1567 as of Friday the 3rd, down compared to last week closing level of 1.1656.

Stoxx 600 fell by 0.7% during the week ending August 3rd, while German DAX declined even stronger by 1.9% week-on-week.

In July, the CPI in the Euro zone rose at an annualized rate of 2.1%, which was higher than the 2.0% posted in prior month. The main driver of inflation was energy prices that rose 9.4% y/y. Meantime, food, alcohol and tobacco contributed also to July's consumer prices growth gaining by 2.5% y/y. At the same time, the core CPI gained by 1.1%, which was higher than the expected 1.0%. The main point from last week ECB press conference indicated that there was no need to act on the monetary policy side.

On Friday, China signaled that it has no intention to retreat from a trade war with United States. In particular, government unleashed a list of USD 60bn worth of products ready to be imposed as soon as United States impose duties on an additional USD 200bn of Chinese imports. In particular, Chinese duties will range from 5 to 25% and will be levied on 5207 items of U.S. imports. This retaliation was similar to one observed in the previous round of tariff talks earlier, when both countries imposed tariffs on USD 34bn worth of imports.

Crude oil prices fell, as WTI futures decreased by a mere 0.3% week-on-week and closed at USD 68.5 per barrel, while Brent futures fell by 1.5%, landing at USD 73.2 per barrel.

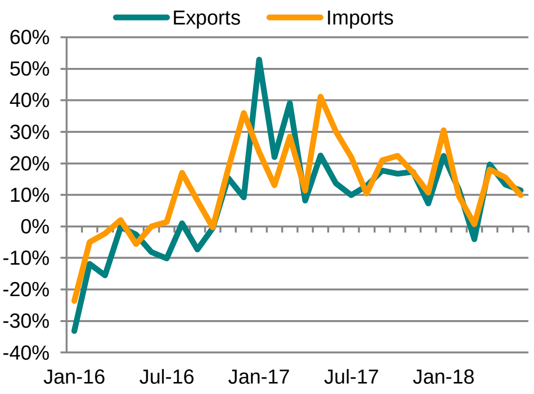
Gold prices declined, as NYMEX 1m futures fell by 0.7% week-on-week and finished the week at USD 1214.2 per troy ounce.

Grains were broadly on the rise, as CBOT Corn 1m futures rose by 2.1% week-on-week and closed at USD 369.8 per bushel, while CBOT Wheat 1m futures landed at USD 556.3 per bushel, gaining by 4.9%.

Iron ore rose, as NYMEX Iron ore 62% Fe 1m futures advanced by 6.5%, week-on-week and closed at USD 68.2 per ton.

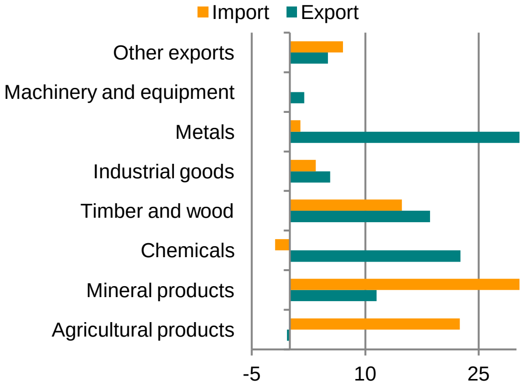
This week in focus: Current account is a mixed bag

Figure 9. Exports and imports change, %



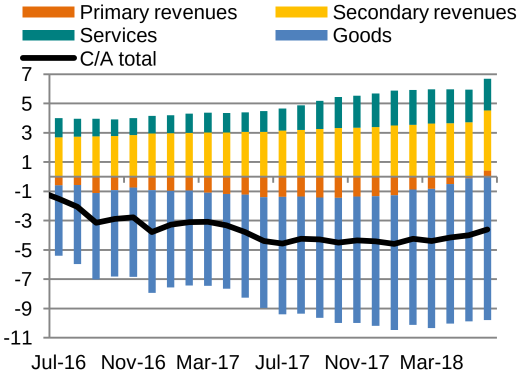
Source: NBU

Figure 10. Exports and imports main components change, %



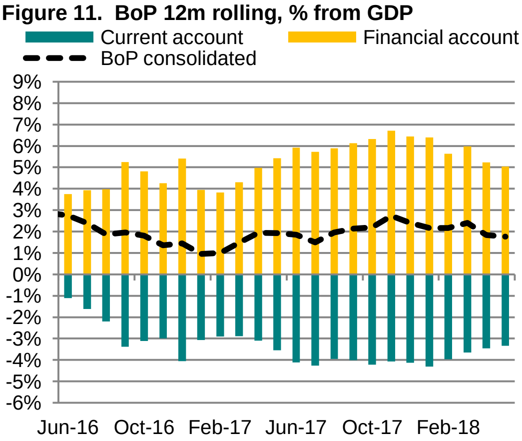
Source: NBU

Figure 11. C/A 12m rolling, USDbn



Source: NBU

Figure 11. BoP 12m rolling, % from GDP



Source: NBU

On a 12M basis the current account deficit amounted to USD 2.8bn, up from USD 2.4bn last year. While external trade continues to worsen, resilient export prices will help to offset (albeit partly!) negative impact coming from accelerated consumer imports and higher energy prices. The risks to FX rate stability are increasing and we expect another round of renewed pressure on UAH, retaining our end-year USDUAH expectations of 29.50.

Ukraine's current account was reported in deficit of USD 125mn in June. At the same time, it was a reversal from USD 23mn surplus posted a year ago. In line with previous month, growing trade deficit was the main culprit behind worsening current account performance. At the same time, trade deficit slightly improved comparing to numbers reported a month ago.

Exports landed at USD 3.4bn, gaining by 11.5% y/y. The most meaningful driver of export, namely **metal exports, posted gains of around 35% y/y in June**. While previously in May metal exports pared its pace of growth to around 30% y/y from almost 66% posted in April, in June metal exports picked up steam once again. It was led by both, increasing production of metals, as well as by higher prices.

In particular, the main steel exports component, namely, semi-finished products, brought as much as 45% more to the country in terms of export revenue in 1H 2018. It was led by both higher prices (+26% y/y) and increased production (14.9% y/y). It was followed by HRC, which increased exports revenue by 22.6% y/y. As opposed to semi-finished products, positive contribution from increased production was much lower (around 3.9% y/y), while higher prices (+18.0% y/y) accounted almost all the gains in export revenue. In the meantime, export revenue from cold rolled steel was higher by only 8.4% y/y in 1H 2018, as physical volume dropped by 0.6% y/y in 1H 2018, while prices gained by only 9.1% y/y in 1H 2018.

Having ramped up pig iron production meaningfully in recent time, Ukraine had almost doubled its sales so far this year. While, in physical terms Ukraine exported by roughly 89% y/y more, higher prices by around 13% resulted in more than doubling of export proceeds from pig iron for metallurgical companies in 1H 2018.

Agricultural and food export improved in June. While it fell by 3.3% y/y in May, Ukraine managed to report only 0.4% y/y decline in June. In 1H 2018, Ukrainian exports of wheat and corn was lower by 2.6% and by 11.8% less (in physical terms). Meantime, higher prices by 10-6% dampened this numbers as measured in USD terms. According to latest data from Agrarian Ministry, Ukraine had already exported 1.5mnt of 2018/2019 marketing year harvest, as of July 25th. In regard to sunflower oil export, there was also similar contraction in exported amount, stemming mainly from lower 2017/2018 marketing year harvest of sunflower seeds by around 1.4mnt. In particular, as measured by tonnage export fell by 8.8% y/y in 1H 2018. At the same time, prices remained effectively flat on a y/y basis.

In the meantime, balance of services posted a surplus by a mere USD 1mn, indicating worse performance in contrast to year ago reading. In the meantime,

Having reached around 19% y/y growth in March**, secondary incomes growth had declined by around 3% in June,** indicating that remittances from abroad reached some floor in their growth.

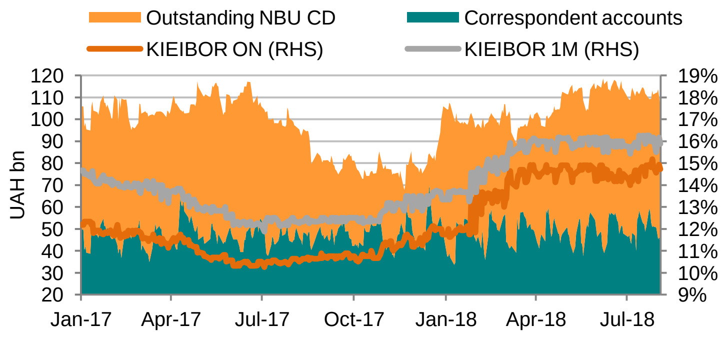
Imports amounted to USD 4.3bn in June, up by 9.9% y/y. Among different categories, mineral imports rose the most. It increased by 32.6% y/y, or more than doubling during the month. In contrast to that, machinery imports displayed solid signs of deceleration, growing by a mere 0.1% y/y, down from 17.7% y/y growth reported a month ago.

Financial account posted USD 148mn of surplus in June, down compared to a month and a year ago, USD 293 and USD 282, respectively. In June, FDI were in the forefront as measured by the inflows through financial account channels to the country. In contrast to the previous month, this time the major part of FDI was led by banking sector, namely by converting debt to equity. In 1H 2018, Ukraine's FDI amounted to USD 1.2bn, down from USD 1.7bn in 2017.

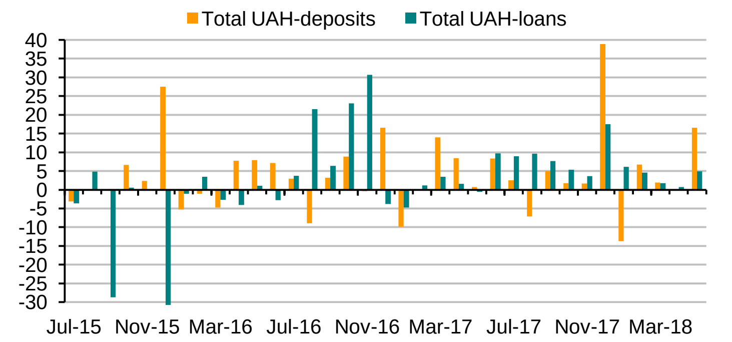
Meanwhile, combined BoP registered a modest surplus of USD 23mn. As a result, Ukraine's international reserves amounted to USD 18.0bn, as of July 1st. In the 2H of 2018 we expect renewed pressure on local currency, stemming from the fact that external financial flows halted in front of IMF disbursement. **We continue to expect IMF deal in Q4 2018 and in this scenario we expect a moderate UAH depreciation from current levels to 29.50 year end.**

Money market

Banking liquidity vs. money market rates, %



Monthly change in local currency loans and deposits, UAHbn

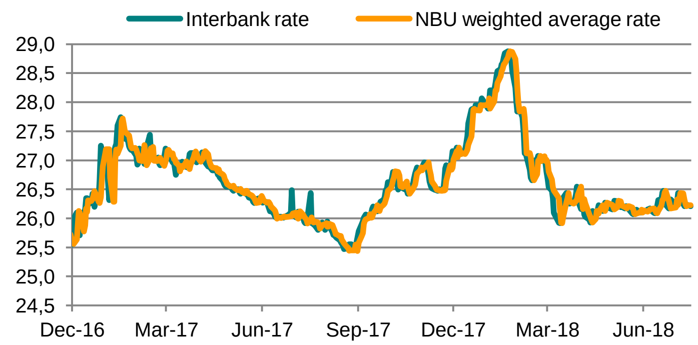


Source: Reuters, NBU, UkrSibbank estimates

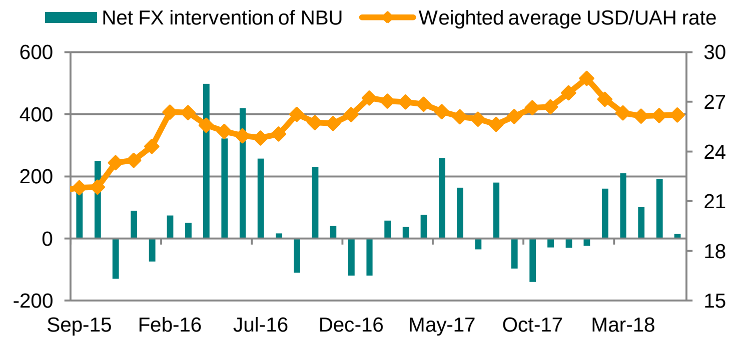
Source: the NBU

Currency market

UAH exchange rate, UAH/USD



Net retail FX interventions of the NBU in 2015-2017, USDmn

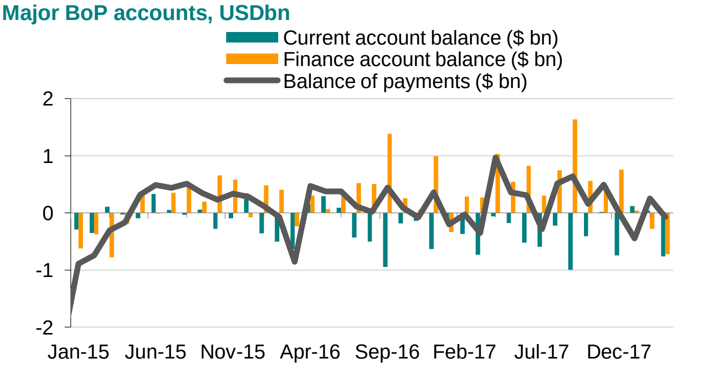


Source: Reuters

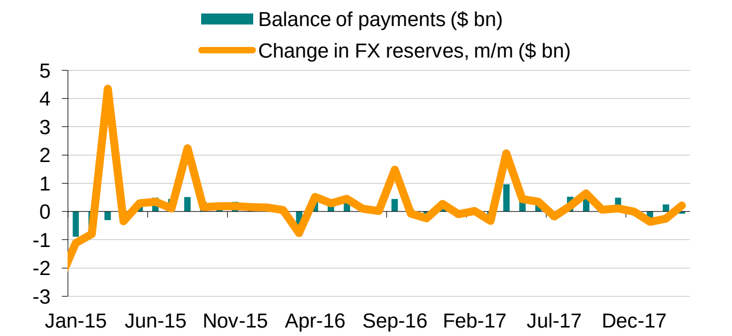
Source: NBU

Balance of payments

Major BoP accounts, USDbn



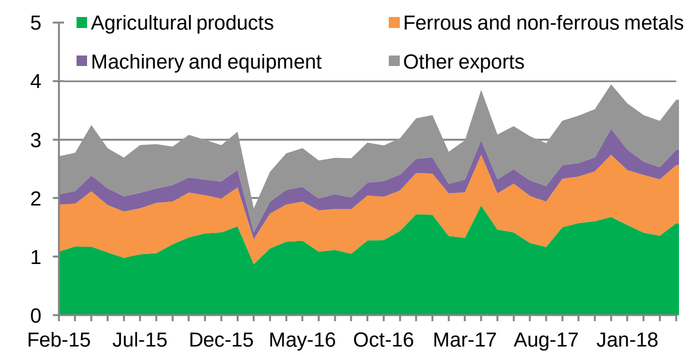
BoP vs change in foreign reserves, USDbn



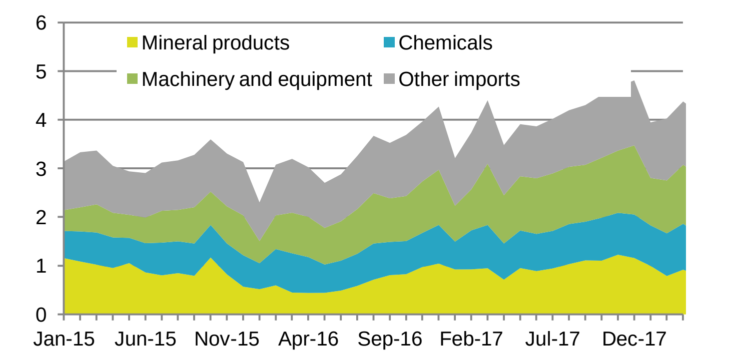
Source: NBU

Source: NBU

Exports components dynamic, USDbn



Imports components dynamic, USDbn



Source: NBU

Source: NBU

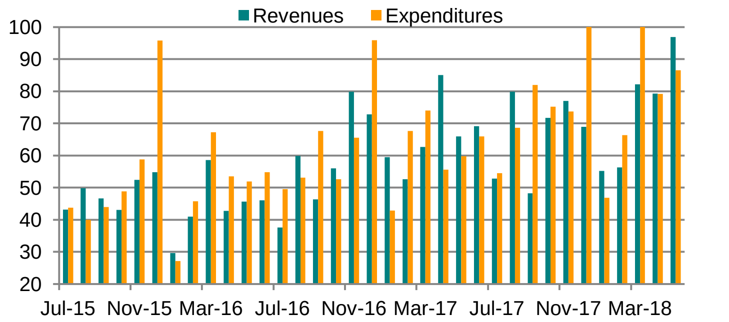
Budget performance

Budget performance, UAHbn

	Jan – May 2017	Jan - May 2018
Budget revenues	**325,8**	**369,7**
VAT proceeds	77,3	93,0
Corporate income tax	28,4	50,6
Budget expenditures	**300,0**	**379,9**
Revenues - Expenses	25,7	-10,2

Source: NBU

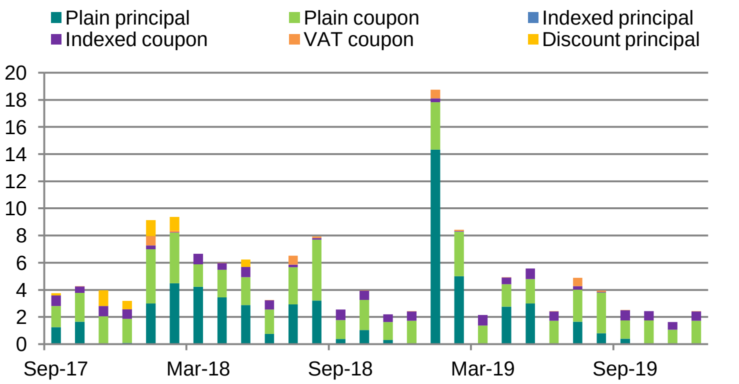
Monthly change in budget revenues and expenditures, UAHbn



Source: NBU, State Treasury

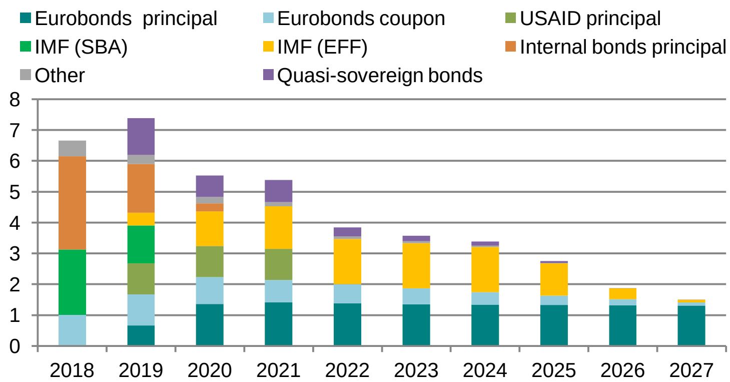
Sovereign debt

UAH- denominated debts' repayments schedule, UAHbn



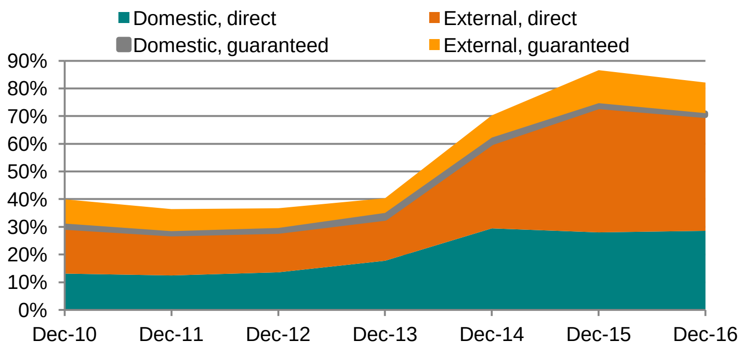
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



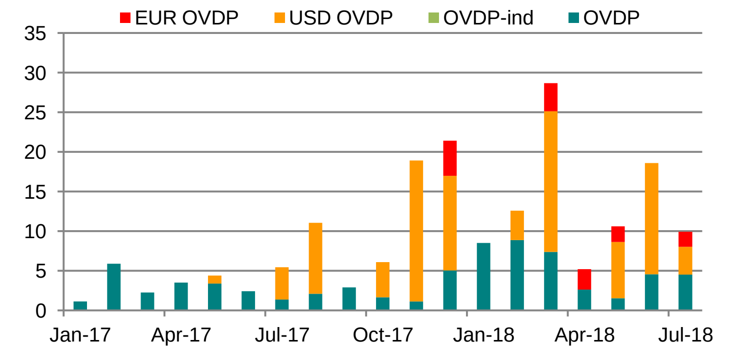
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



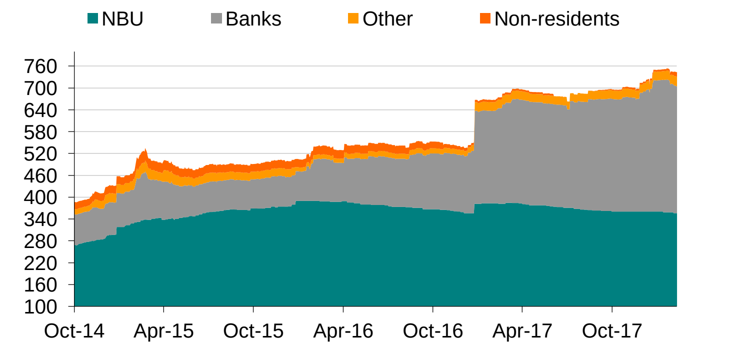
Source: MinFin

Local borrowings, UAHbn equivalent



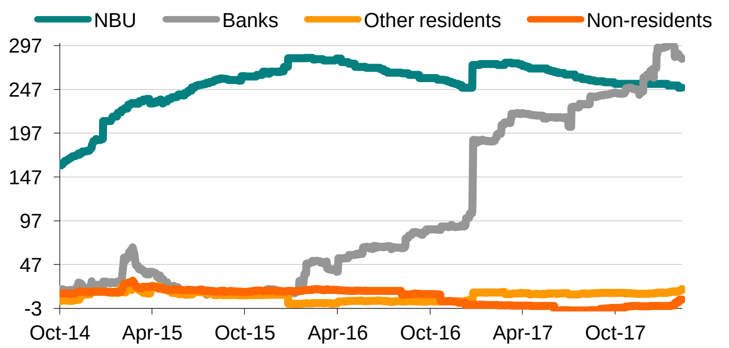
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

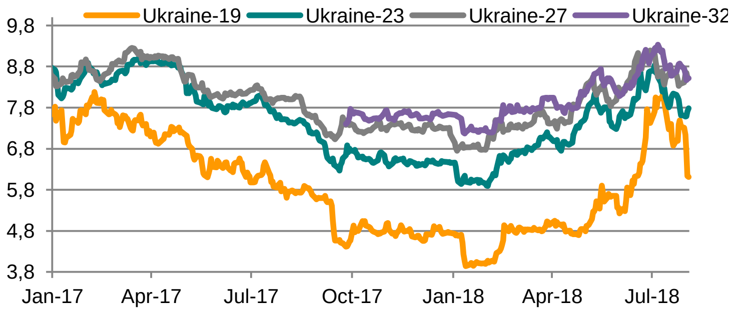
Outstanding OVDP changes in holding, UAHbn



Source: NBU

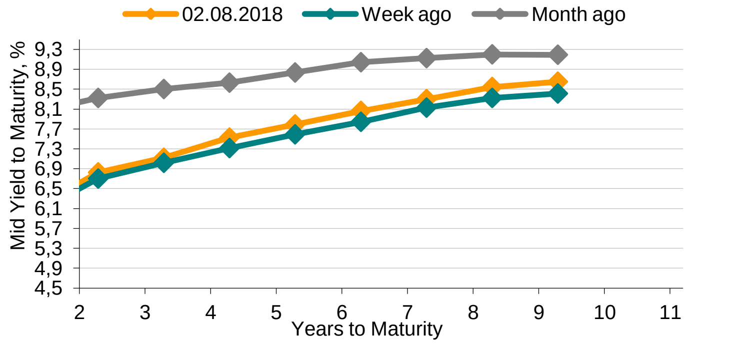
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

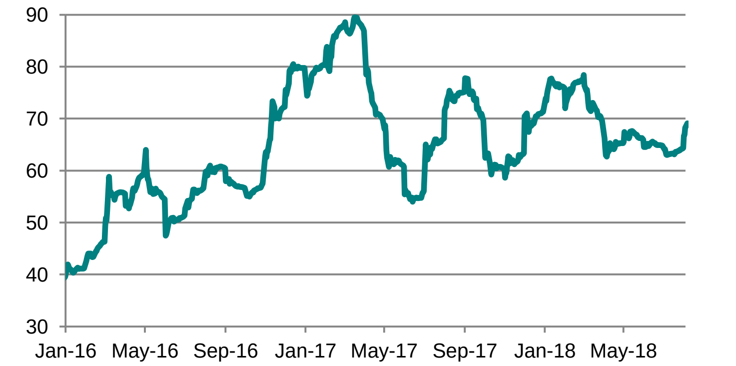
Ukraine's sovereign Eurobond yield curve



Source: Reuters

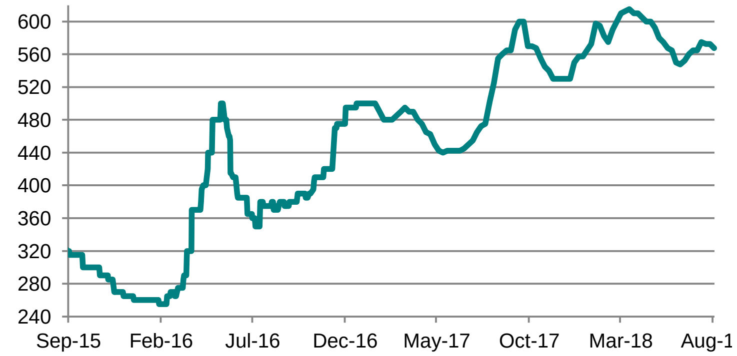
Commodity markets

Iron ore 62% Fe (nearest active future at NYMEX), USD per ton



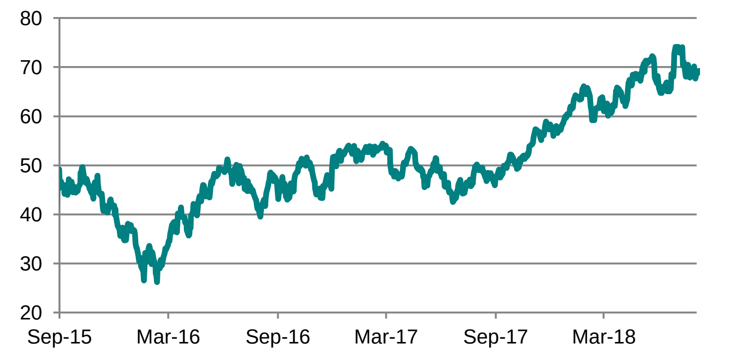
Source: Reuters

Steel CIS export HR coil, USD per ton



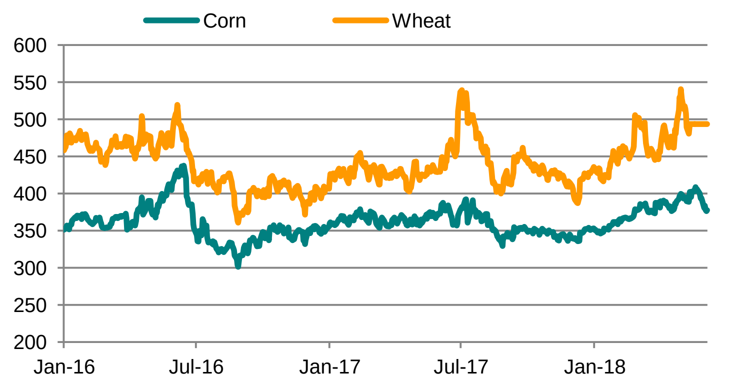
Source: Reuters

WTI oil (nearest active future at NYMEX), USD per barrel



Source: Reuters

Corn and wheat (nearest active future at CBT), USD per bushel



Source: Reuters

Key Macroeconomic Indicators											
Ratings (M/S&P/F) Caa2/B-/B-	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018F**
Real sector											
Real GDP (%YoY)	2.3	-14.8	4.1	5.2	0.2	0.0	-6.6	-9.8	2.3	2.5	3.1
Industrial production (%YoY)	-5.2	-21.9	11.2	8.0	-0.7	-4.3	-10.7	-6.0	2.4	-0.1	3.0
Retail sales (%YoY)	17.3	-20.9	10.1	13.2	12.3	6.1	-11.0	-25.0	4.0	8.8	7.0
Unemployment rate end of year (ILO, working age)	6.9	9.6	8.8	8.6	8.1	7.7	9.7	11.5	9.3	8.7	8.5
Nominal GDP (UAH bn)	948.1	913.3	1079.4	1299.9	1404.7	1465.8	1586.9	1979.5	2383.2	2982.9	3239.8
Nominal GDP (USD bn)	178.9	112.8	136.1	163.1	175.8	183.5	133.7	91.2	93.1	112.1	120.0
Prices											
CPI (average %YoY)	25.2	15.9	9.4	8.0	0.6	-0.2	12.1	48.7	16.5	14.4	11.9
CPI (end of year %YoY)	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	43.3	12.4	13.7	10.9
Real average wage growth (%YoY)	6.3	-9.2	10.2	8.7	14.4	8.2	-6.5	-35.0	10.0	18.9	7.0
Fiscal balance (% of GDP)											
State budget deficit (without Naftogaz)	1.3	3.9	5.9	1.8	3.7	4.2	4.9	2.3	2.9	1.6	2.4
Total public debt	20.0	34.8	39.9	36.3	36.7	39.9	69.4	79.4	81.0	71.8	70.0
External balance											
Exports of goods and services (USD bn)	67.7	40.4	65.6	83.7	86.5	81.7	65.4	47.9	46.0	54.0	53.5
Imports of goods and services (USD bn)	83.8	44.7	69.6	93.8	100.9	97.4	70.0	49.6	51.8	60.8	62.3
Current account balance (USD bn)	-12.8	-1.7	-3.0	-10.2	-14.3	-16.5	-4.6	-0.2	-3.8	-3.8	-3.3
Current account balance (% of GDP)	-7.1	-1.5	-2.2	-6.3	-8.1	-9.0	-3.4	-0.2	-4.1	-3.6	-2.8
Net FDI (USD bn)	9.9	4.7	5.8	7.0	7.2	4.1	0.3	3.0	3.4	2.3	2.5
Foreign exchange reserves (end of year)	31.5	26.5	34.6	31.8	24.5	20.4	7.5	13.3	15.5	18.8	22.0
Imports coverage (months of imports of goods)	4.5	7.1	6.8	4.5	3.3	2.9	1.5	4.4	3.7	3.6	4.7
Interest and exchange rates											
NBU discount rate (% end of year)	12.00	10.25	7.75	7.75	7.50	6.50	14.00	22.00	14.00	14.50	17.00*
Exchange rate (UAH/USD) end of year	8.1	8.0	7.9	8.0	8.1	8.2	15.8	24.0	27.2	27.95	29.5*
Exchange rate (UAH/EUR) end of year	10.9	11.5	10.5	10.4	10.6	11.3	23.0	26.2	28.3	33.50	32.5*

Source: UkrStat, NBU, MinFin, UkrSibbank

* Broad estimate

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