Economics | Interest Rates Strategy | FX
December 4, 2018

Ukrainian Capital Markets Weekly

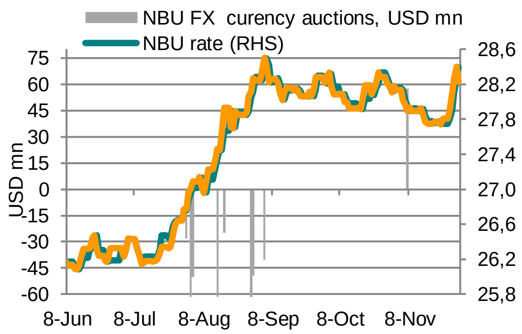
This week in focus: Ukraine's trade balance kept running high deficit in October

Despite strong trade balance deficit in October, our forecast of C/A deficit of 4.9bn in 2018 has proved to be intact, as of end of October 2018. Going forward we expect exports growth stemming from agriculture and food item to pick up steam in the last months of the year. On top of that, we do not expect decline in imports in November and December. All in all, we keep our C/A forecast unchanged at USD 4.9bn for 2018 year.

Please see page 3 for more details

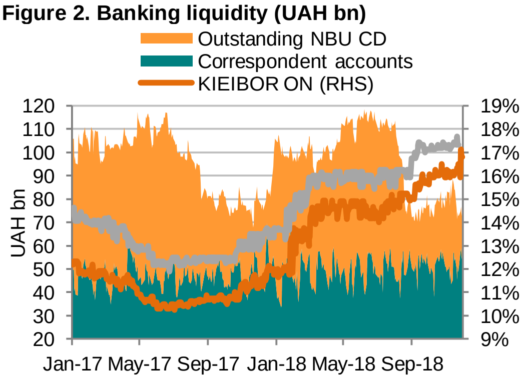
FX and interest rates: IMF made remarks about tranche prospects

Figure 1. UAH exchange rate (UAH per USD)



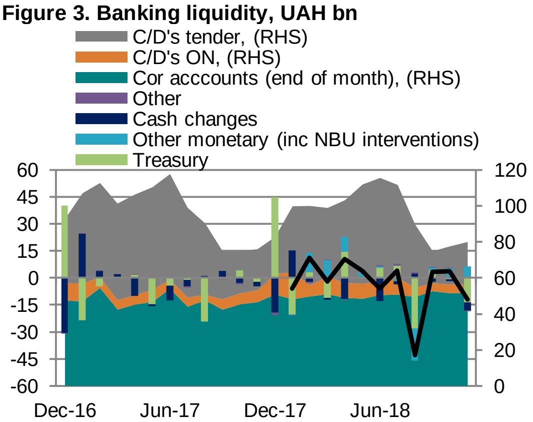
Source: NBU, Reuters

Figure 2. Banking liquidity (UAH bn)



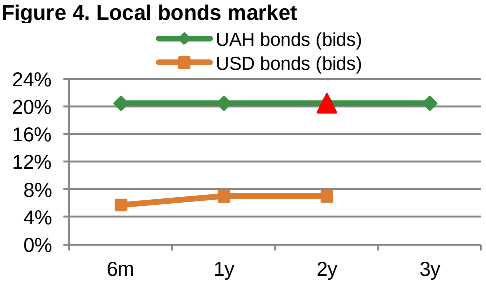
Source: Reuters, NBU, UkrSibbank, Minfin

Figure 3. Banking liquidity, UAH bn



Source: NBU

Figure 4. Local bonds market



Source: UkrSibbank

USD/UAH was at 28.39 as of Friday the 30th, as hryvnia devalued during the week, dropping by 2.3% week-on-week.

In contrast to prior weeks, central bank interventions turned to selling FX from reserves. NBU bought USD 40mn during the week, at the same time central bank sold USD 125mn, as of week ended November 30th. As a consequence, NBU sold on a net basis USD 85mn, which was the largest negative intervention since the last week of August. Using matching, NBU bought USD 10mn and sold USD 50mn during the week. YTD reading of central bank interventions dropped to USD 1.0bn of bought FX currency in 2018, as of November 30th.

In November, Treasury reimbursed UAH 13.6bn, up from UAH 10.3bn reimbursed a month ago. At the same time, treasury account accumulated UAH 17.2bn, as of December 1st, 2018. In November, refinancing loans added approximately UAH 2.9bn to banking liquidity, partly mitigating drop created from income tax payments and other budget payments. At the same time, the latter, reduced liquidity by UAH 13bn. It was followed by increase in cash slicing liquidity by UAH 5.3bn. As opposed to that, NBU bought roughly USD 0.3bn from the start of the month, partly resulting in lower drop in liquidity in November.

Money market rates remained flat: cost of ON funds is around 18.00/19.00, 1 week is 18.00/19.00 while 1M is 18.50/19.50, according to our calculations.

MoF total proceeds from the primary auction yielded only UAH 48.1mn. There were only two issues that were placed during the auction effective November 27th. In particular, 3m and 6m bonds issues were in the forefront on the auction. And 6m bonds took the top spot by demand in excess of UAH 40mn resulting in almost the same amount of placement proceeds to the government coffers. In regard to yields, they were completely intact comparing to the levels set before by issues with respective maturities. While on the previous auction there were participants accepting bids at a rate above cut off rate established previously this time all bids were in line with 19.0% and 18.5% cut off rates established by the Ministry of Finance before. On November 28th the last chunk of hryvnia bonds had been redeemed, which were scheduled to be redeemed in November. Going forward, two bonds will be redeemed in December. Firstly, USD-denominated bond totalling USD 132.5mn. Secondly, UAH-denominated bond for a total UAH3.8bn.

Currently, yields (bids) of local OVDP in UAH at 20.25% (for 6m), 20.50% (for 2Y). 1Y USD bids were at 7.00%, while bids for VAT bonds were at 20.50%.

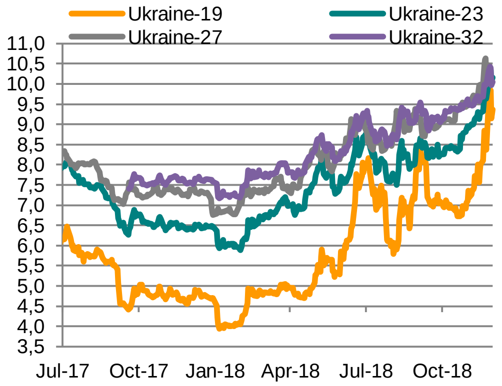
Figure 5. OVDP auction results, 27th of November 2018

CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size	Placement size
UAH	3m	19.00%	19.00%	19.00%	19.00%	4	4	5.6mn	5.4mn
UAH	6m	18.50%	18.50%	18.50%	18.50%	2	2	42.5mn	42.7mn
UAH	12m	-	-	-	-	-	-	-	-
USD	2y	-	-	-	-	-	-	-	-

IMF Managing Director held telephone call with the President of Ukraine. Following the call, Christine Lagarde said it was a constructive discussion with Poroshenko. During the call Ukraine's' president mentioned the key parameters of the 2019 budget, which is currently under review by IMF staff. The process of preliminary assessment state budget was satisfactory and expected to be short, according to IMF press release. Ukraine authorities' convened IMF that all prior actions will be completed by December 10th. Following that date the meeting of the Executive Board would be held promptly after that. All in all, Ukraine will likely to receive the IMF funding by the end of the year.

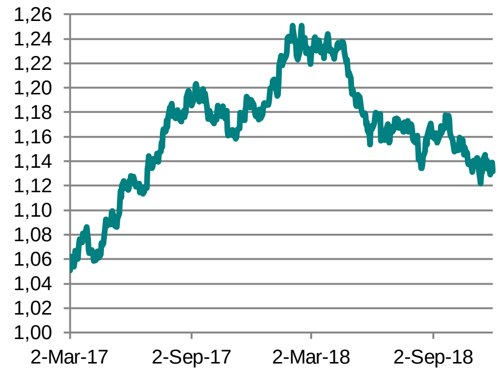
Global markets: Chinese PMI dropped to 50

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



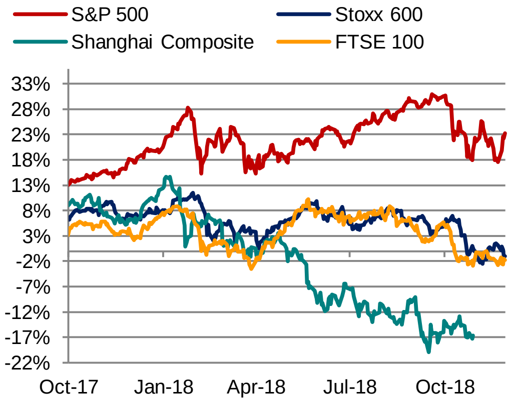
Source: Reuters

Figure 6. EUR USD spot (mid)



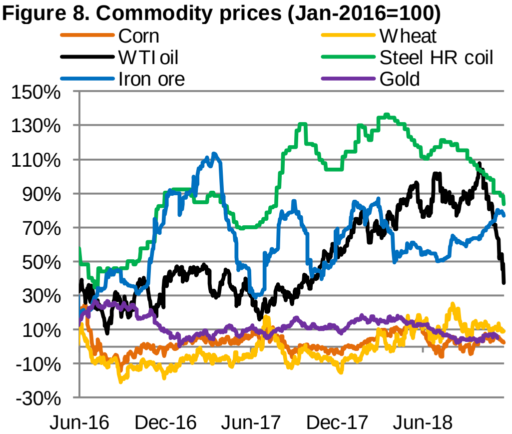
Source: Reuters

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



Source: Reuters

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



Source: Reuters

During the prior week, the Commerce Department released data about the state of U.S. economy. In line with previous estimates economic growth comprised 3.5%. Government delegates of the European Union backed a disciplinary move against Italy over its debt. In regard of China, November's manufacturing Purchasing Managers Index showed performance on the brink of recession.

Bond benchmarks increased, with U.S, 10y Treasuries' yield fell by 4bp week-on-week landing at 3.01%, while German 10y Bunds' yields fell by 3bp, landing at 0.31%, Japanese 10y bonds yields ended the week at 0.08%.

The Commerce Department released data about the performance of U.S. economy in the third quarter. Economic growth amounted to 3.5% annualized rate in line with estimate which was given in October. It marked slowdown from 4.2% annualized rate reported in second quarter. On top that, gross domestic income increased by 4.0% in the third quarter, indicating acceleration from 0.9% posted a quarter ago. Strong third-quarter growth is expected to keep the FED on its path to increase interest rates in December. Estimates of the growth for the fourth quarter are standing currently at 2.5%, as effect of fiscal stimulus is expected to fade, while trade disputes with China are expected to weigh on the growth in the nearest future.

Equity indexes jumped, as S&P advanced by 4.8%, while Nasdaq Composite plummeted by 5.6 % week-on-weeks. As a result of strong results, S&P increased by 3.2% from the start of the year effective November 30th.

EUR/USD rate landed at 1.1315 as of Friday the 30th, down compared to last week closing level of 1.1340.

Main stock indexes in Europe increased. Namely Stoxx 600 decreased by 1.0% during the week, while German DAX increased by 0.6% week-on-week.

Italy's not complying with EU regulations that require the country to reduce its excessive debt. As a result delegates of governments of the European Union backed a disciplinary move against Italy over its debt at the Economic and Financial Committee. While EU ceiling of amount of debt to gross domestic product amounts to 60%, the Italy's debt to GDP ratio exceeded 130%, according to latest data. At the same time, EU rules require a reduction of the debt for the countries with metric above official limit. Delegates at the Economic and Financial Committee expressed concerns over Italy's planned increase in pension spending by allowing citizens to retire earlier than before. According to report, this measure coupled with negative demographic trends could weaken fiscal sustainability in the mid and long term.

Chinese November's manufacturing Purchasing Managers' Index (PMI) displayed performance on the brink of contraction. On top of that, new export orders declined for a sixth month in a row, while expansion on non-manufacturing gauge decelerated. In particular, Chinese official PMF dropped to 50, down from 50.2 reported previously. At the same time, contraction deeper below 50 indicates that economy is shrinking. Amid slowing economy, Chinese officials tried tax cuts, investment incentives and efforts to increase lending in private sector and on infrastructure. As a result, of lower growth in Chinese economy, we can expect more vigorous stimulus going further.

Crude oil prices were mixed, as WTI futures increased by 1.0% week-on-week and closed at USD 50.9 per barrel, while Brent futures declined by a mere 0.2%, landing at USD 58.7 per barrel.

Gold prices were flat as NYMEX 1m futures increased merely by only 0.1% week-on-weeks and finished the week at USD 1220.2 per troy ounce.

Grains prices gained, as CBOT Corn 1m futures increased by 2.1 % week-on-week and closed at USD 366.5 per bushel, while CBOT Wheat 1m futures landed at USD 515.8 per bushel, expanding by 3.2% during the week.

Iron ore dropped, as NYMEX Iron ore 62% Fe 1m futures decreased by a 2.6% on a week-on-week basis and closed at USD 72.3 per ton.

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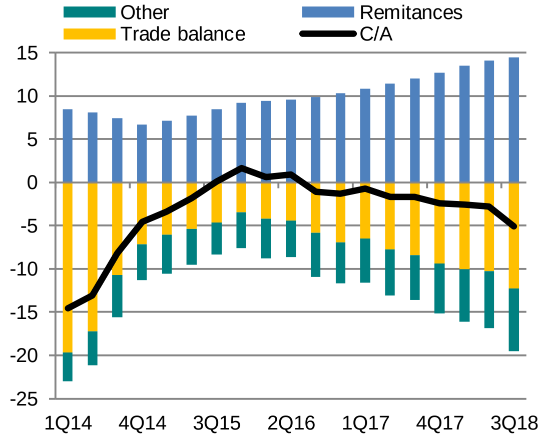
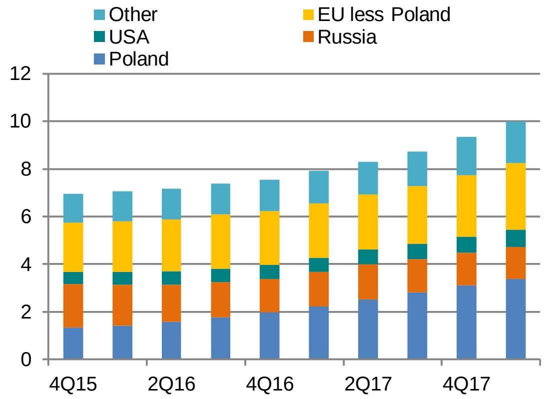
Figure 9. C/A breakdown (for 12m), USDbn



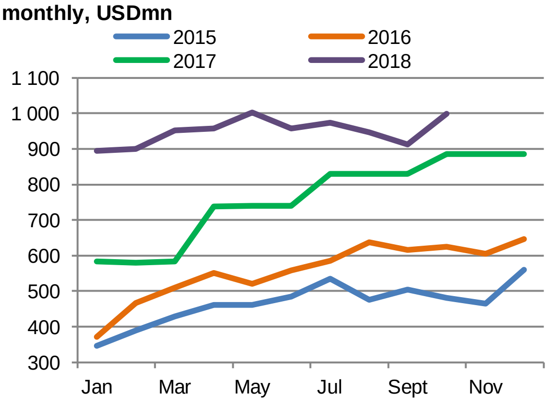
Source: NBU

Figure 10. Private transfers (net) by country of origin (for 12m), USDbn



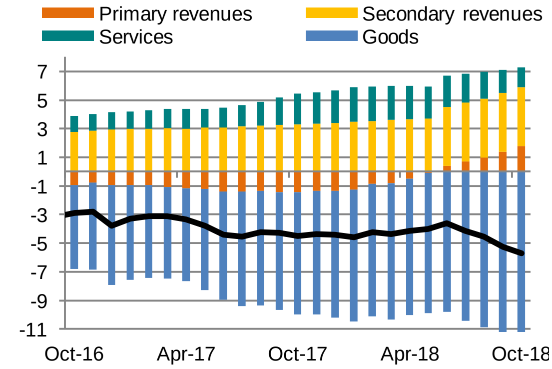
Source: NBU

Figure 11. Migrants wages (in primary incomes) monthly, USDmn



Source: NBU

Figure 11. C/A 12m rolling, USDbn



Source: NBU

Despite strong trade balance deficit in October, our forecast of C/A deficit of 4.9bn in 2018 has proved to be intact, as of end of October 2018. Going forward we expect exports growth stemming from agriculture and food item to pick up steam in the last months of the year. On top of that, we do not expect decline in imports in November and December. All in all, we keep our C/A forecast unchanged at USD 4.9bn for 2018 year.

Exports amounted to USD 3.9bn and increased by 11% y/y. At the same time it reversed from a drop posted in prior month. Exports upbeat performance during the month was driven primarily by improved exports of agricultural and food products, increasing by solid 15.8%, following 9.8% y/y drop in September. From the start of the year this category has been under pressure, as prior year weak harvest of spring crops kept exerting downward pressure on the exports proceeds. At the same time, it strongly reversed in October, as early harvest of spring crops, namely corn and sunflower of 2018/2018MY started to be reflected in statistics. According to our calculations, improved agri and food exports explained two thirds from 11% combined growth in exports in October. At the same strong performance of agri is expected in the end of 2018, despite that imports kept expanding much higher.

Chemicals exports were on the second place by contribution to total aggregate exports growth. Growth gained by a double digit figure, namely by 22.5% y/y, while in prior month exports had increased by just 4.8% y/y. At the same time, **minerals exports advanced by 11.4 y/y**, contributing positively to aggregate exports gains in October.

Metals exports increased by 3.2% y/y in October. In prior month, the exports growth amounted to 8.3% y/y. At the same time, it increased by 23.3% y/y in 10M 2018.

Imports comprised USD 5.6bn and advanced by 22.2% y/y, accelerating from 16.1% y/y increase in September. Machinery imports had delivered the strongest gains during the month, as measured by imports growth. While it posted 22.6% y/y gains in prior month, in October it gained even more solid footing with rate of increase amounting to 34% y/y.

It was followed by mineral imports, increasing by 22.2% y/y. October's data at the same time indicated some deceleration in that reading from 24.6% y/y increase reported in September.

In regard to balance of services, there was considerable improvement in the reading in October. While the BoP posted USD 21mn of loss in September, it turned into surplus of USD 112mn, indicating one of the strongest readings from the start of the month.

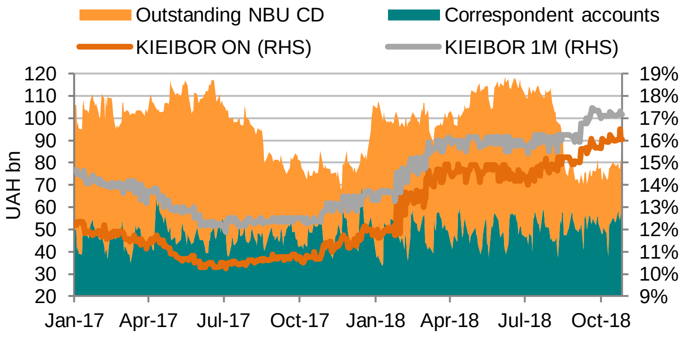
While we previously expressed concern about migrant's wages deceleration in September, the concern was alleviated in October, as growth was restored once again.

Financial account was reported with a strong surplus, reaching USD 1bn, which remained intact compared to September's proceeds. Its' s worth noting that FDI has doubled during the month. Having amounted to USD 102mn, FDI reached USD 203mn in October. Out of which, 64% was directed to the real sector, followed by 36% (USD 73mn) to the banking sector. During the month, major part of financial account inflow came from increase in trade loans, amounting to USD 0.6bn in October.

Trade balance deficit amounted to USD 1.7bn, slightly accelerating but remaining at USD 1.7bn in September. Having posted the strongest deficit from the start of the year, combined BoP was reported in surplus of USD 164mn, as inflows from financial account exceeded outflows of current account caused for the most part by trade balance. All in all, we keep our C/A forecast unchanged at USD 4.9bn for 2018 year.

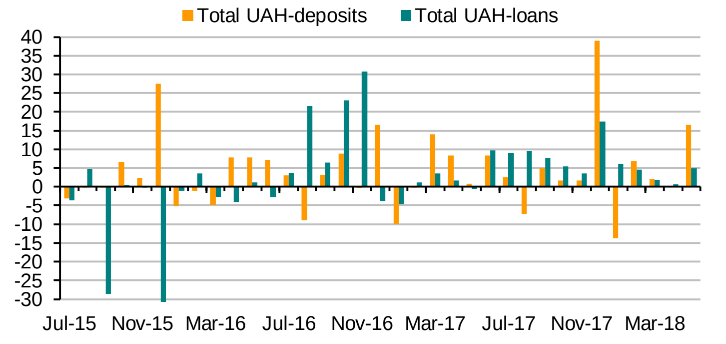
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

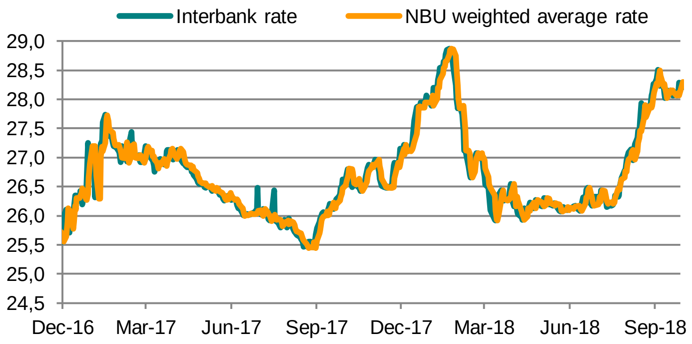
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

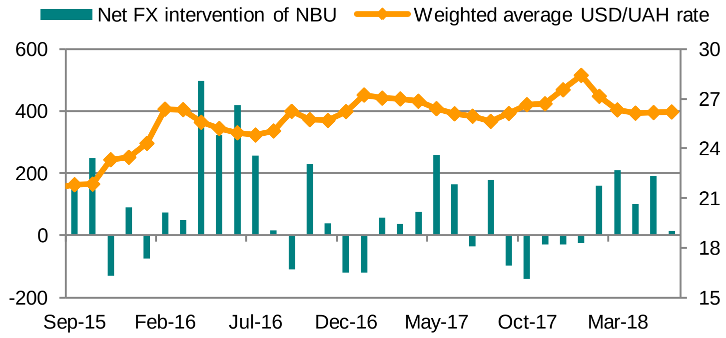
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

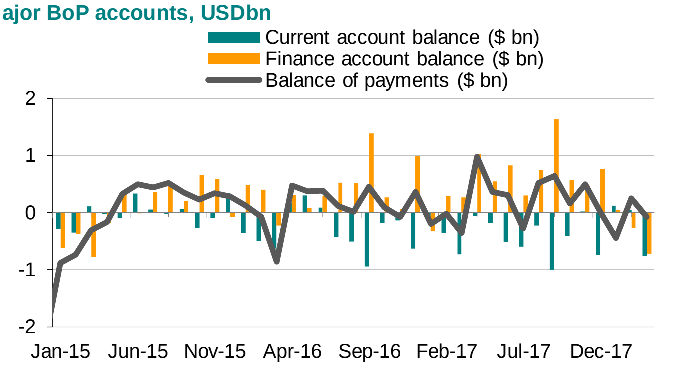
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

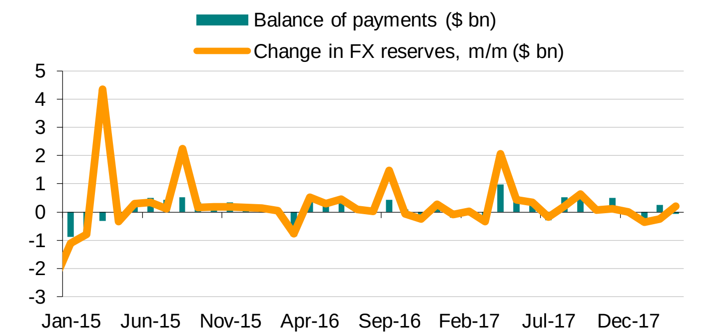
Balance of payments

Major BoP accounts, USDbn



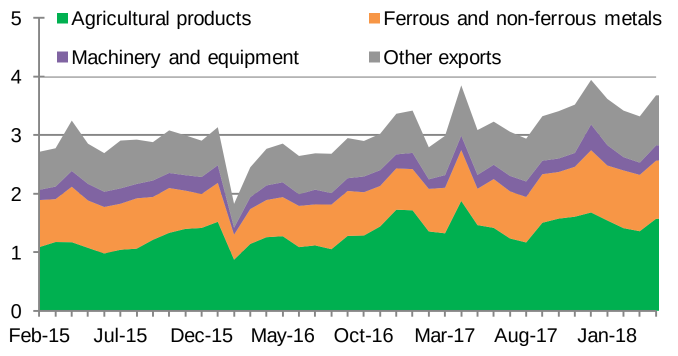
Source: NBU

BoP vs change in foreign reserves, USDbn



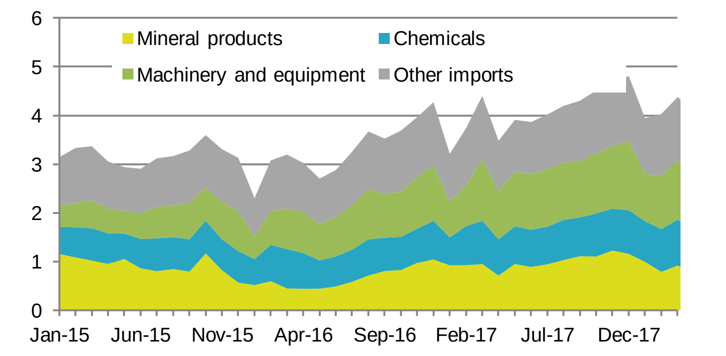
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU

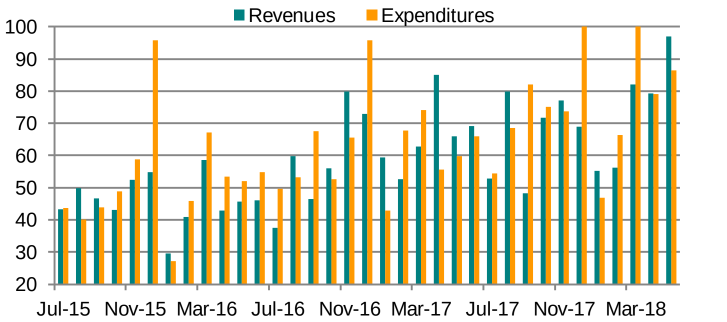
Budget performance

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

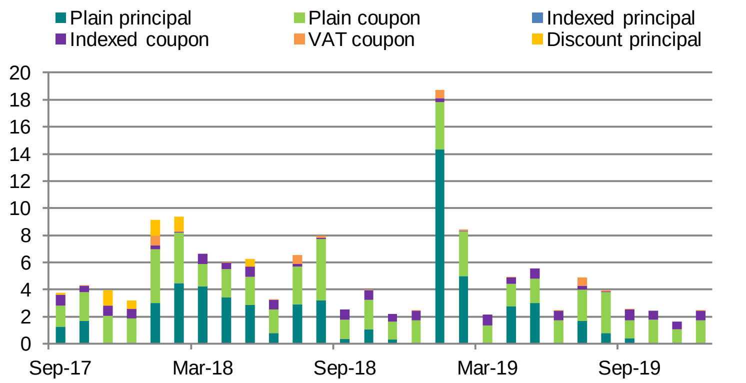
Monthly change in budget revenues and expenditures, UAHbn



Source: NBU, State Treasury

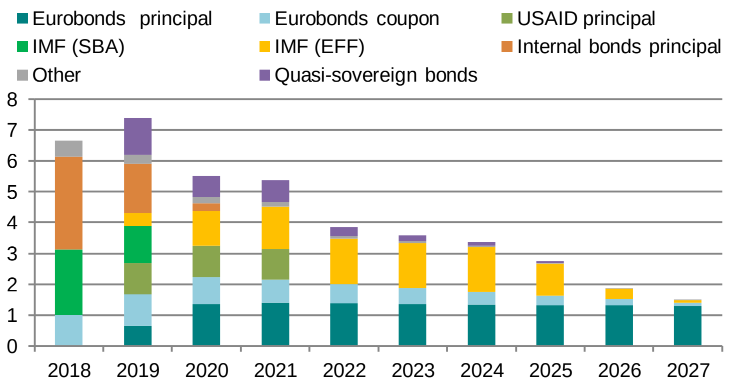
Sovereign debt

UAH- denominated debts' repayments schedule, UAHbn



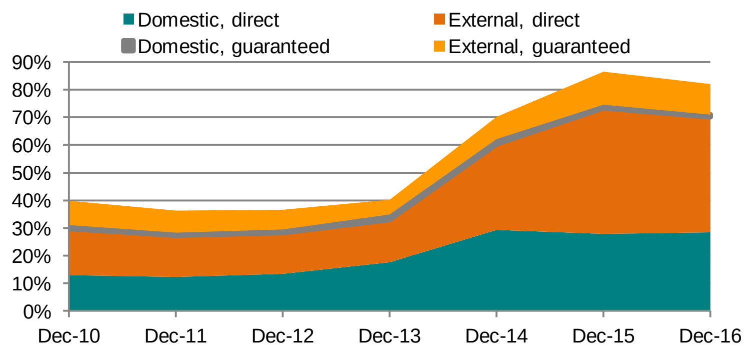
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



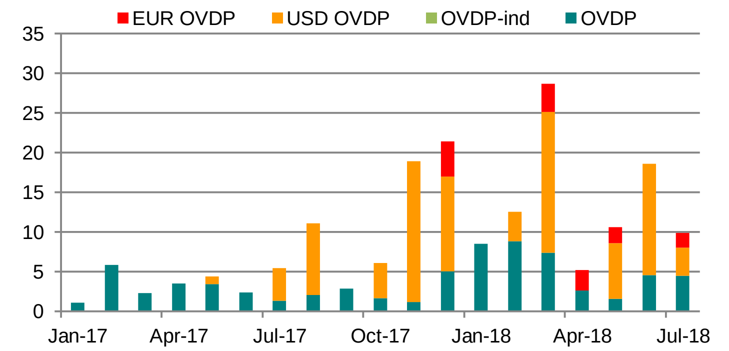
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



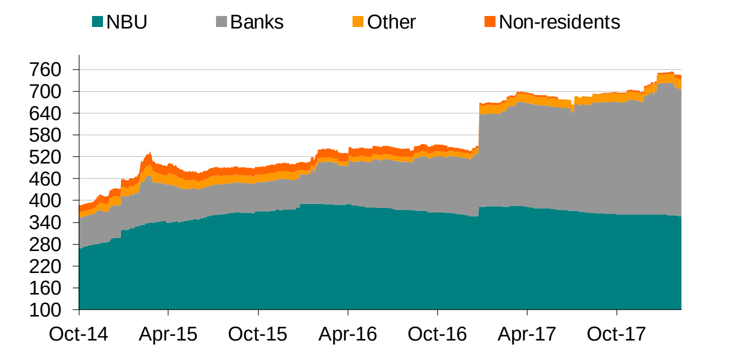
Source: MinFin

Local borrowings, UAHbn equivalent



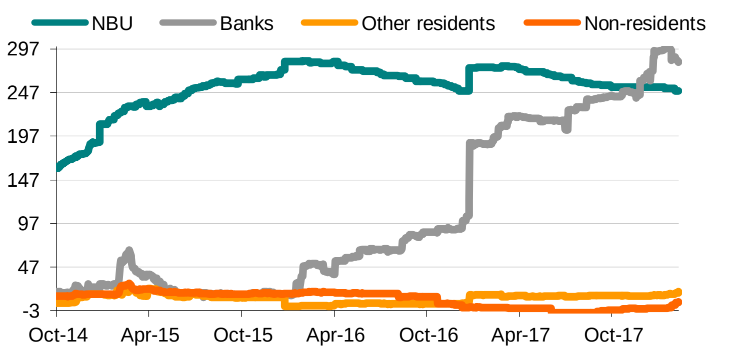
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

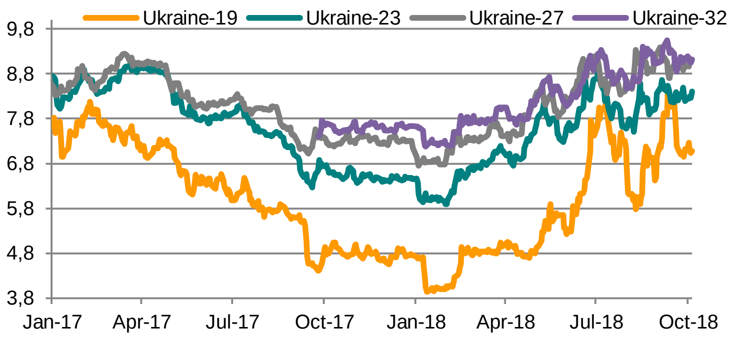
Outstanding OVDP changes in holding, UAHbn



Source: NBU

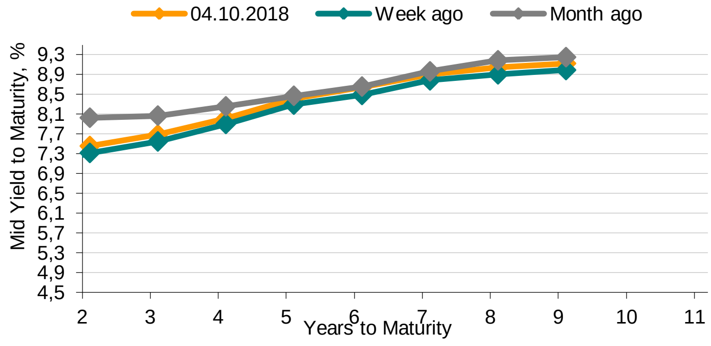
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

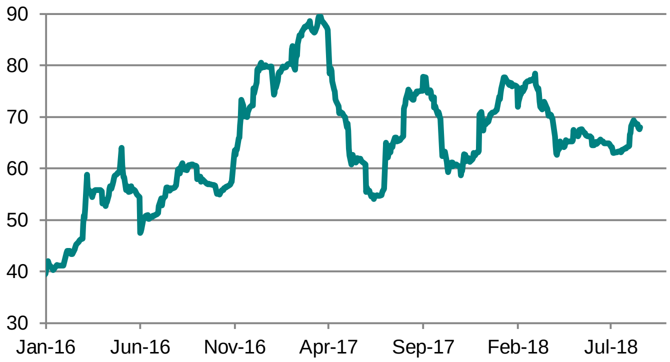
Ukraine's sovereign Eurobond yield curve



Source: Reuters

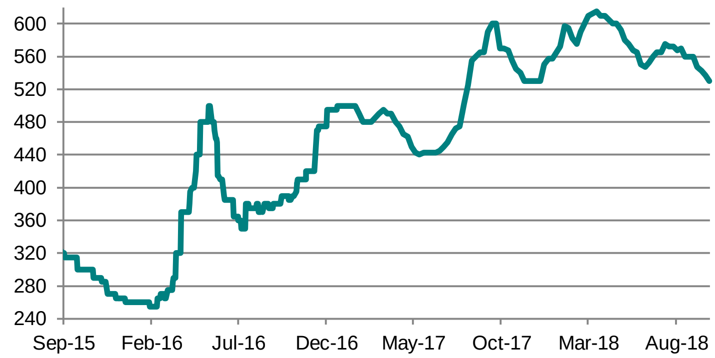
Commodity markets

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



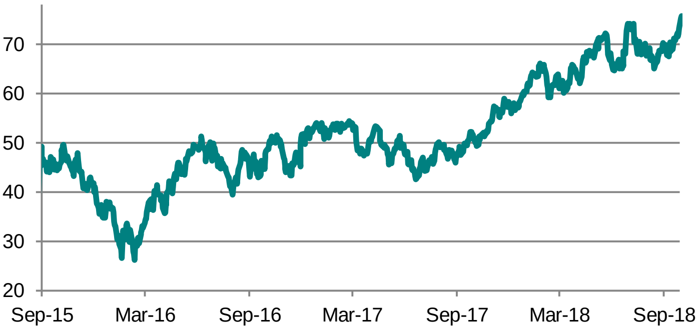
Source: Reuters

Steel CIS export HR coil, USD per ton



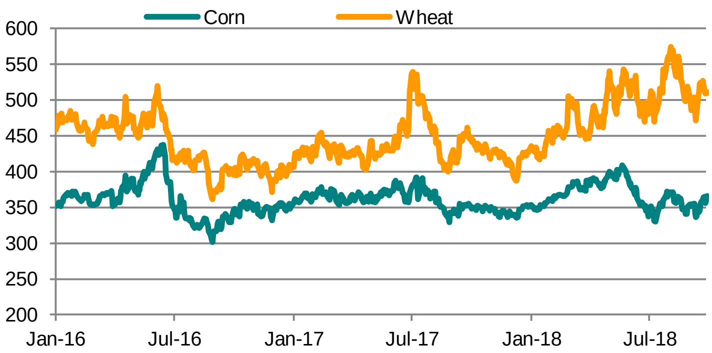
Source: Reuters

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	3.4
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	3393.0
Nominal GDP (USD bn)	178.9	112.8	136.1	163.1	175.8	183.5	133.7	91.2	93.1	112.1	125.0
Prices											
CPI (average %YoY)	25.2	15.9	9.4	8.0	0.6	-0.2	12.1	48.7	16.5	14.4	11.5
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	10.3
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	61.0
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	1.6	-1.3	-2.4	-4.0
Current account balance (% of GDP)	-7.1	-1.5	-2.2	-6.3	-8.1	-9.0	-3.4	1.8	-1.4	-2.1	-3.3
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	19.5
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	3.2
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	18.00*
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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