

**ECONOMICS | INTEREST RATES STRATEGY | FX**

February, 20, 2019

# UKRAINIAN CAPITAL MARKETS WEEKLY

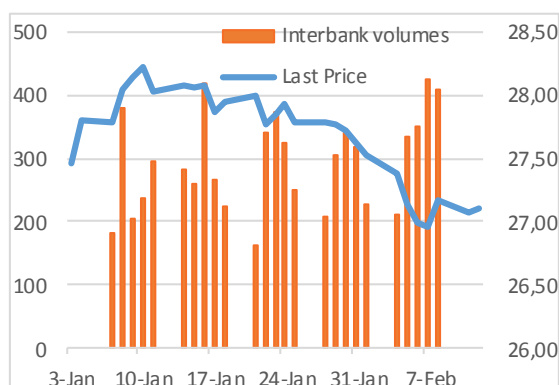
This week in focus: New consumer basket and lower inflation

	Rating	Outlook	Last update
Fitch	B-	STABLE	11/11/2016
S&P	B-	STABLE	10/19/2015
Moody's	Caa1	STABLE	12/21/2018
S&P (N)	uaBBB	-	06/27/2018

Ukraine's inflation decelerated to 9.2% y/y in January from 9.8% y/y in December. On a m/m basis prices advanced by 1.0%, following 0.8% m/m increase in December. A long awaited increase in heating tariffs amounted to 11.0% in January, bringing increase in prices from utilities subcategory to 13.1% y/y. We expect CPI inflation to decelerate to 8.50% by the end of the year, factoring in some UAH depreciation in the second half of 2019 and gradual decrease of NBU key policy rate.

Figure 1. UAH exchange rate (UAH per USD)

FX&amp;IR: Local currency remains strong, liquidity elevated



**USD/UAH was at 27.16 as of the week ended February 15th, as hryvnia weakened by a 0.7% during the week.** Local currency continued its appreciation this week, driven mostly by non-financial flows, as participation of international accounts in the primary bond auction seems to be limited.

**NBU has kept its buying streak for a fifth week in a row.** Having bought USD 172mn on a net basis, as of week ended February 8th, NBU purchases dropped to USD 25mn, as of week ended February 15th using exclusively matching. As a result, YTD reading of NBU interventions amounted to USD 350.6mn of bought FX currency in 2019, as of February 15th.

**Banking liquidity landed at UAH 112.6bn as of the end of week ended February 15th, falling by around UAH 0.5bn during the week.** The major contribution to decline in banking liquidity came from changes in cash, which reduced liquidity by UAH 1.0bn. As opposed to that, other monetary operations, including NBU interventions added to liquidity UAH 0.7bn, followed by operations with treasury account, increasing liquidity by around UAH 0.5bn. At the same time, from the start of the month, liquidity were reduced by changes in cash (-UAH 3.6bn) and by UAH 5.5bn via treasury operations. While other monetary operations (including NBU interventions) increased liquidity by UAH 5.8bn from the start of the month.

Figure 2. Banking liquidity (UAH bn)

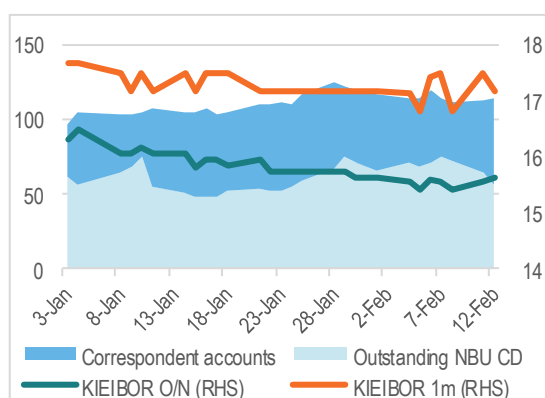
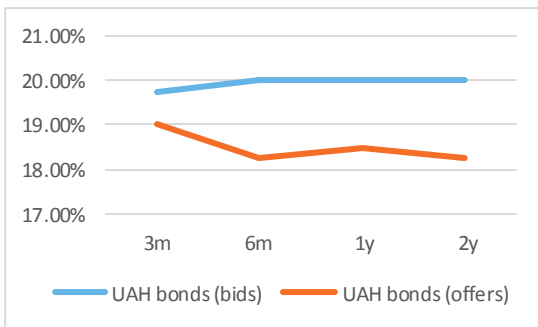


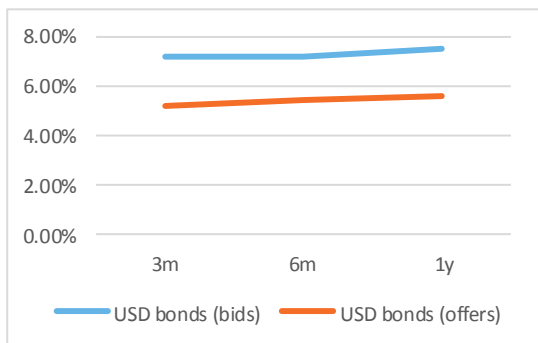
Figure 3. Local UAH bonds market



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	19.50%	19.50%	19.50%	19.50%	21	21	470.81	470.81
UAH	5m	19.00%	19.00%	19.00%	19.00%	7	7	80.09	80.09
UAH	1y	18.50%	18.50%	18.50%	18.50%	7	7	12.90	12.90
UAH	3y	17.25%	17.25%	17.25%	17.25%	3	3	7.14	7.14
USD	1m	6.25%	6.25%	6.25%	6.25%	7	7	112.95	112.95
USD	5m	6.50%	6.50%	6.50%	6.50%	4	4	1.74	1.74
USD	2y	7.25%	7.25%	7.50%	7.25%	14	9	5.10	2.27

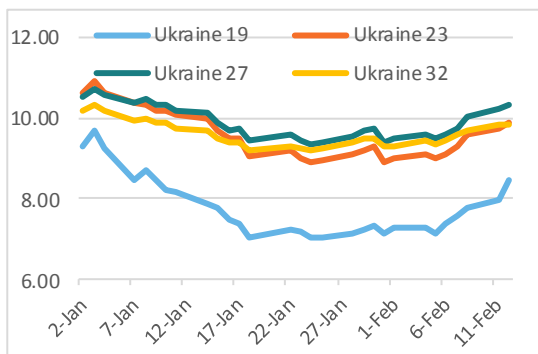
Figure 4. Local USD bonds market



**Ministry of finance printed 7 bond issues on the latest auction, the international accounts showed little activity.** UAH bond proceeds amounted to UAH 0.4bn with a cut off rate at 19.5%, which was in line with previous primary auctions. Meantime, bonds with 6m maturity were placed with a cut off rate at 19.0%. The shortest USD bonds with just 21 days attracted the major part of demand. Among all USD issues, the shortest bonds attracted USD 112.4mn at a cut off rate 6.25%, followed by USD 1.7mn and USD 2.2mn with 3m maturity and 1.5y maturity, respectively. Today is scheduled the redemption UAH bonds for a total UAH 1.5bn. Moreover, two bonds totaling USD 457.5mn and UAH 3.0bn will mature on February 27<sup>th</sup>.

On the secondary market, yields (bids) of local OVDP in UAH were at 19.75% (for 6m), 20.00% (for 2Y). 1Y USD bids were at 7.75%, while bids for VAT bonds were at 20.50%.

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

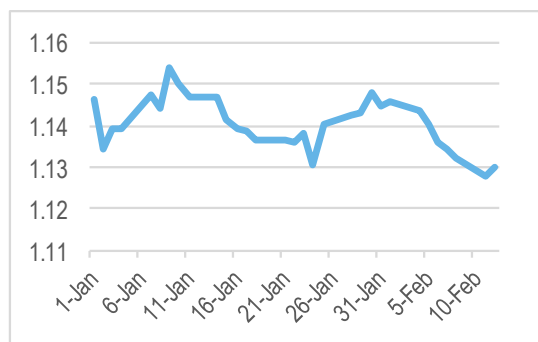


China auto sales are falling = risks for the steel market?

**The US Commerce Department said that retail sales sank 1.2% to USD 505.8bn, indicating the strongest drop since 2009.** At the same time, economist expected a little growth of about 0.1%. Excluding volatile categories including gasoline, cars and food, core retail sales fell by 1.7% in December. Moreover, industrial production fell by 0.6% in January on m/m basis, according to the Fed report released on Friday, which was also well below expectations of 0.1% increase. The breakdown showed that manufacturing output declined by 0.9% as a result of increasing protectionism and decelerating economic growth.

**The European Commission reduced its growth forecasts for Europe largest economies from Germany to Italy.** Having delivered a report, The European Commission sliced a whole percent from Italy's 2019 GDP forecast to just 0.2% from 1.2% expected earlier. The downward revisions follow the compromise of Rome and Brussels over Italy's deficit target reached two month ago. At the same time, the commission expects EU economy to grow by 1.3% in 2019, down from 1.9% expected in November last year. In 2020, the European Commission's projections of growth are at 1.6%, down from 1.7% expected previously.

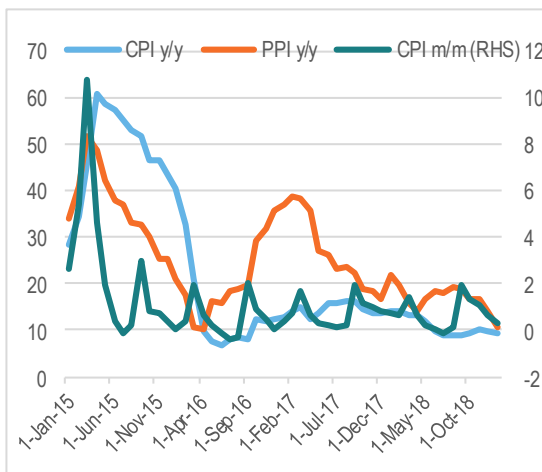
Figure 6. EUR USD spot (mid)



**China's top auto industry association said that the country's automobile car sales declined by 15.8% y/y in January landing to 2.37mn.** The latest data indicated a seventh straight month in a row of declining sales in the auto market. And many China market observers expect the top officials to announce some new measures to increase consumption, especially in the auto industry. These measures could be highly beneficial for the steel market, where demand was depressed recently.

Figure 7. Inflation rates in 2015-2018

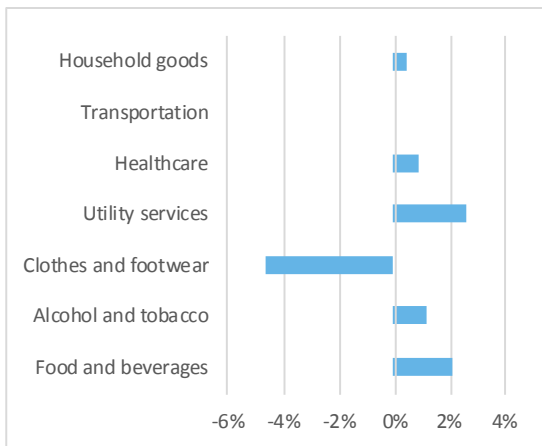
This week in focus: New consumer basket and lower inflation



Ukraine's inflation decelerated to 9.2% y/y in January from 9.8% y/y in December. On a m/m basis prices advanced by 1.0, following 0.8% m/m increase in December. A long awaited increase in heating amounted to 11.0% in January, bringing increase in prices from utilities subcategory to 13.1% y/y. We expect CPI inflation to decelerate to 8.50% by the end of the year, factoring in some UAH depreciation in the second half of 2019 and gradual decrease of NBU key policy rate.

Prices of food and beverages increased by 2.1% m/m in January, beating even the strong increase observed in December. At the same time, it was the largest increase on a m/m basis in more than a year, exceeding even 2.0% m/m rise in January 2018. Among food basket components all major categories displayed increase in prices with the exception only of egg, which fell by 0.5% m/m in January. The largest gains reported vegetables (+16.6% m/m), fruits (+4.7% m/m), milk (+1.6% m/m), cheese (+1.3% m/m), butter (+1.1% m/m), bread (+0.9% m/m), fish (+0.6% m/m). As a result, prices on y/y basis accelerated to 7.9% y/y from 7.8% y/y in December.

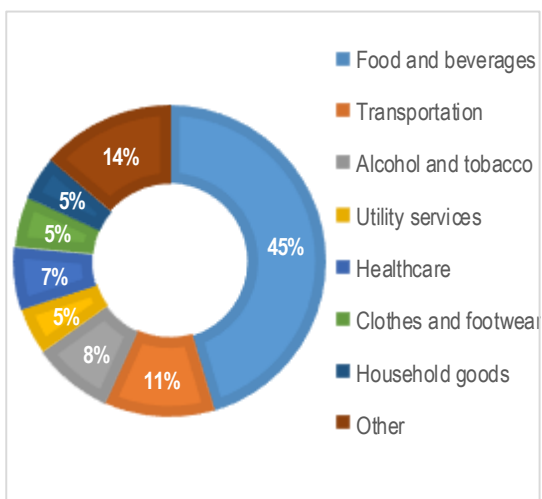
Figure 8. Price changes in selected categories, December % m/m.



Utilities showed the largest monthly gain among all CPI subcategories in January. In particular, aggregate utilities reading advanced by 2.6% m/m, following 0.7% m/m in December. It was a largest increase on a m/m basis in more than a year, with the exception of November 2018 result (+6.1% m/m). And it was driven for the most part by delayed increase in heating tariffs by 11.0%. Meantime, other components of utility subcategory showed less pronounced increase in the range of 0.4 – 2.8% m/m in January. As a result of skyrocketing heating prices, the utilities reading on y/y basis advanced to 13.1% from 10.6% in December.

Transportation prices were effectively in a free fall in January, as prices fell by 1.7% m/m. And in line with the performance of foods and utilities components the magnitude was the strongest in more than a last year. There were two major forces which defined the final result in January. Firstly, prices of oil fell by 6.1% m/m in January, on top of 6.0% m/m decline in December. Secondly, prices of railway passenger transportation increased by 5.5% on average in January, offsetting to some extent the sharp drop in oil prices. As a consequence, prices in transportation were higher by 7.7% y/y in January, down from 12.9% y/y in December.

Figure 9. New CPI basket



At the same time, the landing of inflation to 9.2% y/y in January wasn't the most important event in understanding consumer prices performance. **More importantly, Ukrstat has changed CPI basket's weights used in calculations of headline inflation.** Once again, we observed less weights attributed to the most volatile components. In particular, utilities weight fell by 1.3% to just 4.9% from 6.1% used previously. At it's quite remarkable that the lower natural gas component weight contributed almost half to that drop. At the same time, the weight of transportation was reduced by 0.4% to 11.4% from 11.8% used previously.

Food and beverage component of CPI reported some increase in its weight. While previously the weight amounted to 42.6%, it increased to 45.4%, increasing by several percentage points. And it's remarkable that the largest gains were reported in categories which are subject to less volatility (for example meat, fish and other), while the components with high volatility such as vegetables (zero increase) and fruits were reported with much smaller increase.

# UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2013	2014	2015	2016	2017	2018	2019F	2020F
<b>Real sector</b>								
Real GDP (%YoY)	0.00	-6.60	-9.80	2.30	2.50	3.30	2.70	3.00
Industrial production (%YoY)	-4.30	-10.70	-6.00	2.40	-0.10	1.60	0.00	1.20
Retail sales (%YoY)	6.10	-11.00	-25.00	4.00	8.80	6.00	5.00	4.00
Unemployment rate end of year (ILO, working age)	7.70	9.70	11.50	9.30	8.70	8.50	8.50	8.40
Nominal GDP (UAH bn)	1466	1587	1980	2383	2983	3393	3830	4321
Nominal GDP (USD bn)	183.50	133.70	91.20	93.10	112.10	125.00	129.50	135.90
<b>Prices</b>								
CPI (average %YoY)	-0.20	12.10	48.70	16.50	14.40	10.50	9.20	8.10
CPI (end of year %YoY)	0.50	24.90	43.30	12.40	13.70	9.80	8.50	7.20
Real average wage growth (%YoY)	8.20	-6.50	-35.00	10.00	18.90	9.70	8.00	6.00
<b>Fiscal balance (% of GDP)</b>								
State budget deficit (without Naftogaz)	4.20	4.90	2.30	2.90	1.60	2.40	2.40	2.30
Total public debt	39.90	69.40	79.40	81.00	71.80	61.00	60.00	61.00
<b>External balance</b>								
Exports of goods and services (USD bn)	81.70	65.40	47.90	46.00	54.00	59.00	61.50	63.70
Imports of goods and services (USD bn)	97.40	70.00	49.60	51.80	60.80	70.50	73.30	75.80
Current account balance (USD bn)	-16.50	-4.60	1.60	-1.30	-2.40	-4.70	-4.20	-4.80
Current account balance (% of GDP)	-9.00	-3.40	1.80	-1.40	-2.10	-3.30	-3.20	-3.50
Net FDI (USD bn)	4.10	0.30	3.00	3.40	2.30	2.50	2.30	2.40
Foreign exchange reserves (end of year)	20.40	7.50	13.30	15.50	18.80	20.80	19.50	20.50
Imports coverage (months of imports of goods)	2.90	1.50	4.40	3.70	3.60	3.40	3.30	3.30
<b>Interest and exchange rates</b>								
NBU discount rate (% end of year)	6.50	14.00	22.00	14.00	14.50	18.00	16.50	13.00
Exchange rate (UAH/USD) end of year	8.20	15.80	24.00	27.20	27.95	27.70	31.50	32.50
Exchange rate (UAH/EUR) end of year	11.30	23.00	26.20	28.30	33.50	31.80	37.80	39.00





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