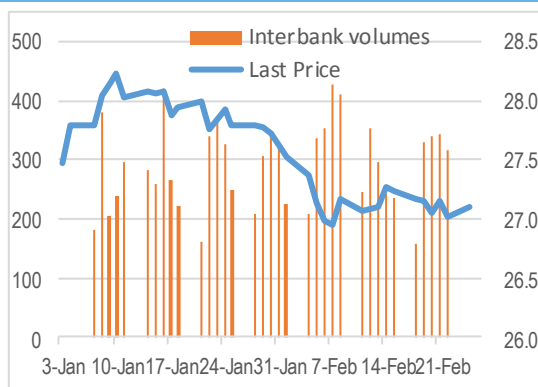


Retail sales to grow faster than GDP

	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

Retail sales in January 2019 posted +6.3% growth, according to UKRSTAT figures published last week. The figure comes in line with expectations, highlighting gradual decline in growth rates, on one hand, and overall situation, in which domestic trade growth exceeds that of GDP. We retain our full year expectation of 5.0% growth in retail sales.

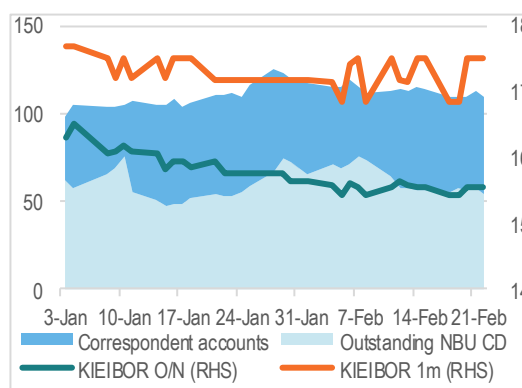
Figure 1. UAH exchange rate (UAH per USD)
FX&IR: Local currency remains strong, mandatory sale decrease this week


USD/UAH was at 27.01 as of the week ended February 22nd, as hryvnia appreciated by 0.85% during the week. The last week was a short one, due to US holiday (President's day) on Monday. On Wednesday, we saw a "double" mandatory sale, which pushed UAH even higher. Keep in mind that mandatory sale rate will be decreased from 50% to 30% this week.

MinFin's auction last week had virtually no impact on the market (unlike before) due to very limited number of international accounts (if any!) participating in the primary auction. Hence, no big tickets to sell hard currency have been detected. We have the same expectations for ongoing auctions—seems that appetite towards Ukraine's local debt is muted at the moment.

Figure 2. Banking liquidity (UAH bn)

The appreciation trend is being continued in the start of this week, **with UAH testing new highs breaking through 27.00 threshold.**



NBU continued to purchase foreign currency from the market for the sixth consecutive week, having bought USD 52 mn on a net basis (no sales of foreign currency from the reserves). USD 45 mn were bought via matching and USD 7 mn—via single rate interventions.

YTD reading of net NBU interventions amounted to USD 402.6mn of bought FX currency in 2019, as of February 22nd

Banking liquidity landed at UAH 109.4bn as of the end of week ended February 22nd, declining only marginally (UAH 0.2 bn), despite tax payment period being in full swing. About half of total liquidity is being allocated to certificates of deposit—UAH54.1 bn. UAH 8.6 bn out of which are overnight CDs. Our near term liquidity outlook is positive as we anticipate VAT repayments. This inflow of fresh UAH liquidity should also limit potential for further UAH appreciation.

Refinancing volumes of Ukrainian banks stood unchanged at UAH 54 bn.

Figure 3. Local UAH bonds market

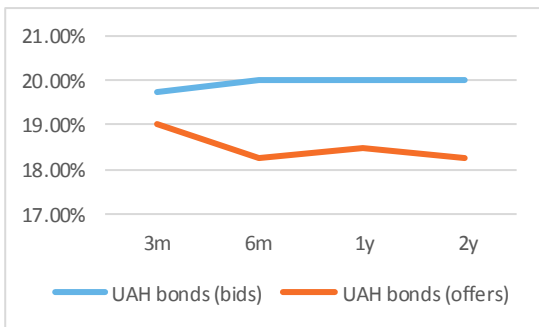
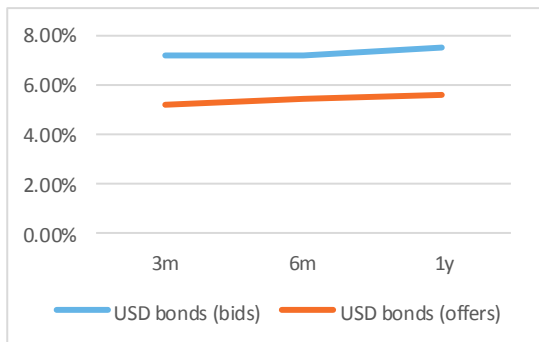


Figure 4. Local USD bonds market

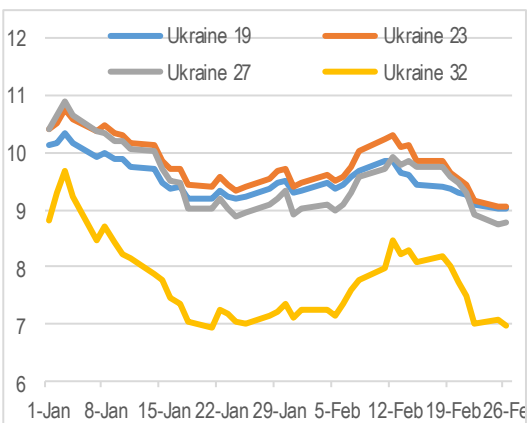


Government bond market

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%	16	16	675.87	675.87
UAH	6m	19.00%	19.00%	19.00%	19.00%	8	8	179.37	179.37
UAH	1y	18.50%	18.50%	18.50%	18.50%	4	4	2.71	2.71
UAH	2y	18.00%	18.00%	18.00%	18.00%	4	4	254.29	254.29
USD	3m	6.50%	6.50%	6.50%	6.50%	4	4	73.63	73.63
USD	5m	6.70%	6.70%	6.70%	6.70%	7	7	18.96	18.96
USD	9m	7.25%	7.25%	7.25%	7.25%	8	8	37.03	37.03
USD	1y	7.25%	7.25%	7.25%	7.25%	15	15	2.63	2.63
USD	1.5y	7.25%	7.25%	7.25%	7.25%	9	9	3.75	3.75
USD	2y	7.50%	7.50%	7.50%	7.50%	17	17	4.23	4.23

MinFin delivered no surprises on the primary auction held Feb 26th. Cut-off rates for UAH bonds stood at 18.00%-19.50% depending on maturity. USD bonds were offered in 6.50%-7.50% range (see table above). We note demand either for shortest (3m), or longest (2y) UAH bonds, with a limited participation of international accounts. Total auctions proceeds stand at UAH 1 057 mn and USD 136 mn. 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%. Offers are 0.25%-0.50% below yields offered on the primary market. Trading activity on the secondary market is low.

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



Ending the reduction of bonds on the Fed's balance sheet

Fed delivers dovish outlook, sees end of balance sheet reduction. Federal Reserve officials discussed at their meeting three weeks ago ending the reduction of the central bank's balance sheet before the end of 2019, according to minutes released Wednesday. The Fed began reducing the portfolio of financial instruments such as government bonds, MBS, etc in October 2017 by allowing a capped level of proceeds to roll off each month, and officials have tried to assure the markets that the process should go on seamlessly.

EURUSD has strengthening by 0.26 cents during last week amid positive expectations for a delay in Brexit deadline.

Benchmark UST stood at 2.49% (2Y) and 2.65% (10Y).

Media reports continue to suggest the U.S. and China are making progress towards a long-term trade deal, with **China offering to purchase an additional \$30bn. of U.S. agricultural products.** Trade representatives from both the U.S. and China are also reportedly working on memorandums for a trade deal. President Trump said he would delay an increase in tariffs on Chinese goods set to take effect at the end of this week, citing "substantial progress" on issues including intellectual property and technology transfer after a weekend of talks.

Ukraine Eurobonds continue to strengthen due to emerging markets rally related to Fed's signals of pause in rate hikes. Ukraine 19 grew by 46 basis points, while Ukraine 23 strengthened by 185 bps. The yield curve went closer to 8.0% as investor sought high yield opportunities, even though upcoming elections make difficult for the demand to unfold in full.

Figure 6. EUR USD spot (mid)

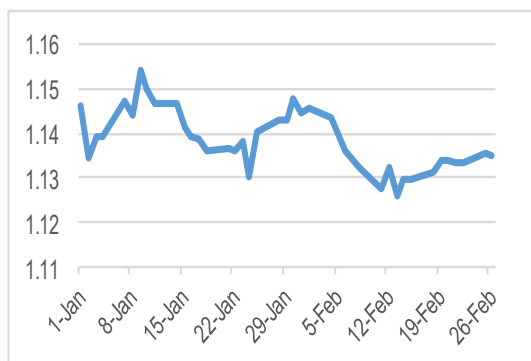
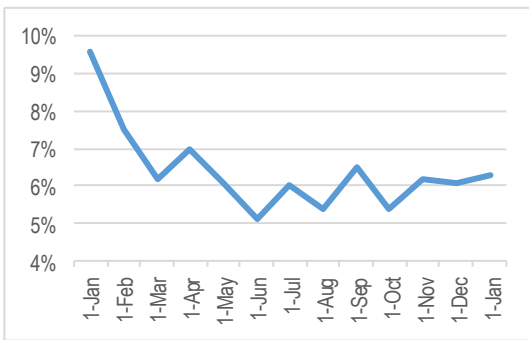


Figure 9. Retail Sales, 2018-2019

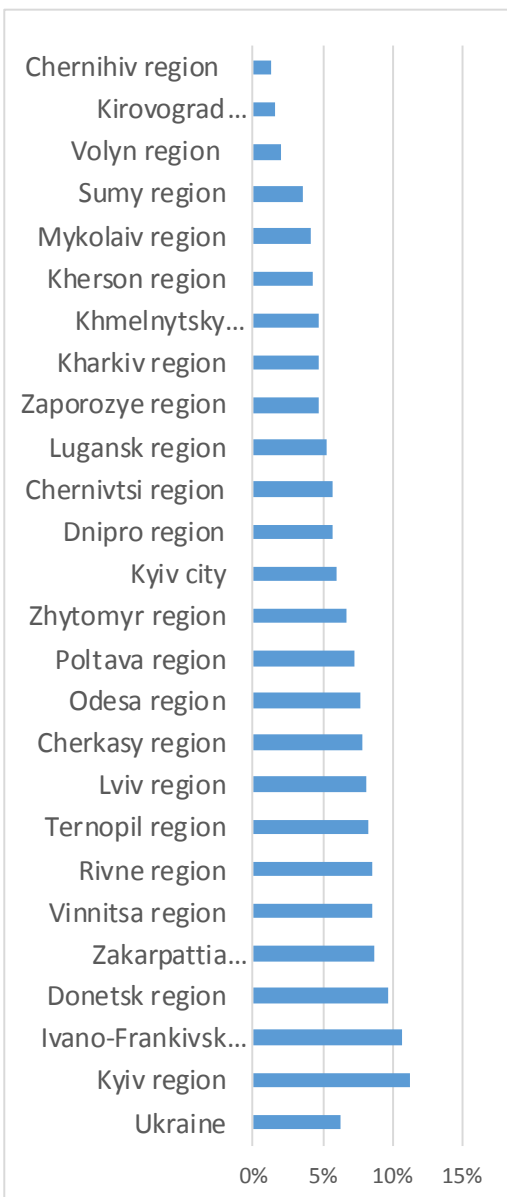
Retail sales to grow faster than GDP



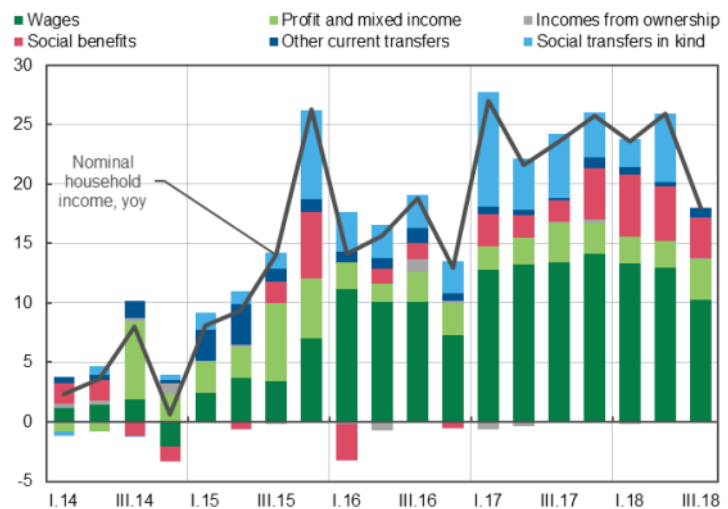
Retail sales in January 2019 posted +6.3% growth, according to UKRSTAT figures published last week. The figure comes in line with expectations, highlighting gradual decline in growth rates, on one hand, and overall situation, in which domestic trade growth exceeds that of GDP.

January reading can be rendered a healthy one as comparison basis last year was rather challenging (Jan18 displayed +9.6% growth). Also, we must note that in y/y terms retail sales growth rates saw a deceleration in Dec18—to just +4.9% y/y.

Figure 10. Retail sales, by regions



Income components growth, %



Continuously growing incomes of private individuals are pushing consumption up, with nominal wages taking the front seat in this situation. While we observe growth in all segments of income, it is wages component which remains most important as driver for retail sales.

Region-wise there were some fluctuations, with Kyivsky region (excl Kyiv) topping the league (+11.3%). The neighboring Chernihiv region was the slowest growing (+1.3% y/y).

Our end-year estimation of retail sales growth in 2019 stands at 5.0%, with risks being skewed to downside. We believe that the situation, in which retail sales could grow faster than GDP (expectation for 2019 is 2.7%) is possible in limited number of situations, all of them generating excessive imports. This needs to be cured either via depreciation of local currency or via dramatic improvement in production efficiency. The situation is similar to rally in local wages, which erodes competitiveness of local companies.

Migration continues to be a huge drag on retail sales, with number of people left in Ukraine being a much debated issue. According to Dec18 figures, available on UKRSTAT, current population of Ukraine stands at 42 mn, while some estimation of research institute show a different figure of 36 mn vs some statements in local press which display figure of 32 mn! According to EUROSTAT figures, which are available for 2017, the number of newly issued first resident permits issued to Ukraine nationals grew to 662 thds per year. At the same time, there is a larger number of Ukrainians already established to the West of EU border., especially since Ukraine was granted a visa-free regime with the EU.

UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2013	2014	2015	2016	2017	2018	2019F	2020F
Real sector								
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	6.10	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
Prices								
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
Fiscal balance (% of GDP)								
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
External balance								
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
Interest and exchange rates								
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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