

**ECONOMICS | INTEREST RATES STRATEGY | FX**

March, 06, 2019

**UKRAINIAN  
CAPITAL MARKETS  
WEEKLY**

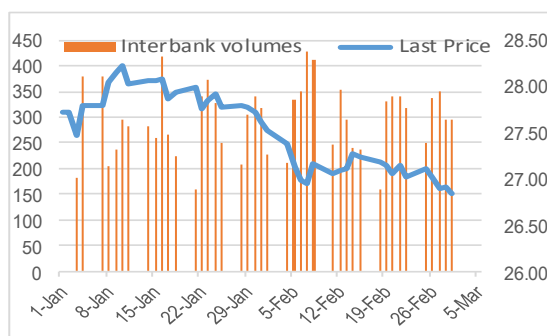
## Industrial production likely to be flat this year

	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

Industrial production (IP) in January decreased by 3.3% y/y, whereas in January 2018 growth by 4.3% y/y was recorded, according to UKRSTAT. Calendar adjusted IP in January fell by 2.9% y/y. The poor performance so far is mostly the result of logistics problems due to conflict in the Azov Sea, weighing on exports, mostly iron ore and metals. We retain our no growth (0.0%) forecast for Ukraine's industrial production this year.

Figure 1. UAH exchange rate (UAH per USD)

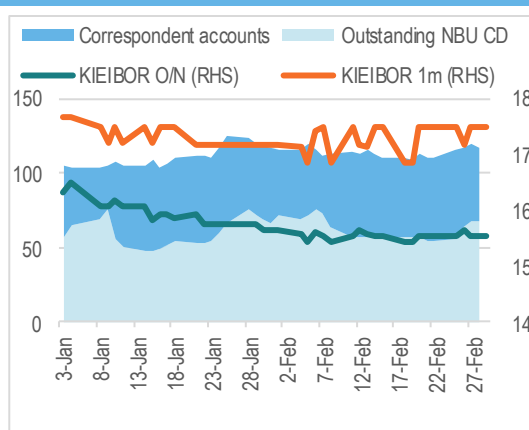
FX&amp;IR: Has UAH reached its strongest levels this year?



**USD/UAH was at 26.86 as of the week ended March 1st**, as hryvnia appreciated by 0.59% during the week. On Thursday, we saw traditional for end of month additional demand for UAH due to corporates salary payments for employees. On Friday was a first day of new mandatory sale rate which has been decreased from 50% to 30%. The proceeds from export remain strong, in particular in the agricultural sector. They could be linked to financing of sowing campaign. At the same time liquidity in the banking sector is increasing and that could finally weigh on USDUAH FX rate when these flows go down.

**As we predicted last week, MinFin's auction had no impact on the market.** There were no changes to international accounts during the week.

Figure 2. Banking liquidity (UAH bn)



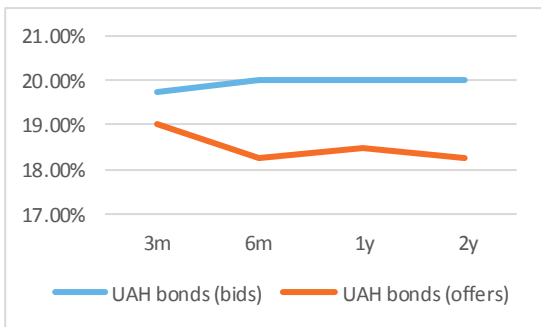
**UAH went below 26.80 levels in the start of the week testing new local highs.** In this light, NBU continued to purchase foreign currency from the market for the seven consecutive week, having bought USD 75 mn on a net basis during last week (no sales of foreign currency from the reserves). All amount were bought via matching. We believe that central bank will intensify purchases to replenish FX reserves and to prepare for eventual U-turn of FX market in Q2.

**YTD reading of net NBU interventions amounted to USD 477.58 mn** of bought FX currency in 2019, as of March 1st.

**Banking liquidity increased up to UAH 114.29 bn as of the end of week ended March 1st.** In total the liquidity has increased by 4.83 bn compare to previous Friday mainly due to VAT refund as usual flow for the end of the month. More than half of total liquidity is being allocated to certificates of deposit—UAH 70.10 bn. UAH 24.49 bn out of which are overnight CDs. This week, liquidity is likely will stay high with a possible slight decline.

Refinancing volumes of Ukrainian banks slightly decreased to UAH 52.22 bn—abundant liquidity is favorable for contraction of refinancing volumes, especially as refi rate is widely expected to have peaked.

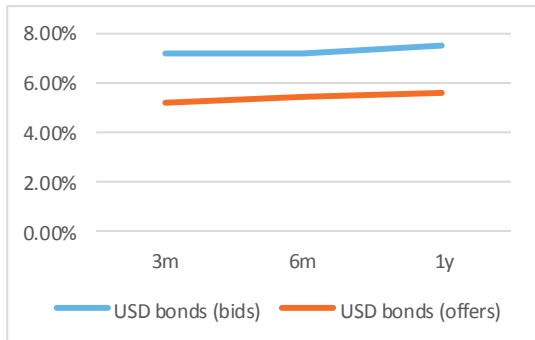
Figure 3. Local UAH bonds market



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%	15	15	1 737.33	1 737.33
UAH	6m	19.00%	19.00%	19.00%	19.00%	15	15	142.34	142.34
UAH	7m	19.00%	19.00%	19.00%	19.00%	4	4	949.31	949.31
UAH	9m	18.50%	18.50%	19.00%	18.50%	3	2	2 035.00	1 765.68
UAH	1.5y	18.25%	18.07%	18.25%	18.00%	5	5	204.85	204.85
UAH	2y	18.00%	18.00%	18.00%	18.00%	6	6	679.33	679.33
UAH	3y	17.25%	17.25%	18.00%	17.25%	4	2	552.56	2.52
USD	1y	7.25%	7.25%	7.75%	7.25%	23	22	8.07	7.88

Figure 4. Local USD bonds market



**Ukraine's MinFin attracted a loan from Deutsche Bank for EUR 529 mn under a guarantee of the World Bank.** First tranche amounted to EUR 240 mn for 4 years, and second tranche amounted to EUR 289 mn for 10 years. Actual rates for these loans have not been published yet, but should be not higher than 5.9%, according to government resolution.

**MinFin have attracted about 6 bn on the primary auction held March 5th.** Cut-off rates for UAH bonds stood at 17.25%-19.50% depending on maturity. USD bonds were offered in 7.25% 1y issue (see table above). We note demand for (3m, 9m, 2y) UAH bonds, with a limited participation of international accounts. Total auctions proceeds stand at UAH 5.48 bn and USD 7.8 mn. On the secondary market without any changes, 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. EUR USD spot (mid)

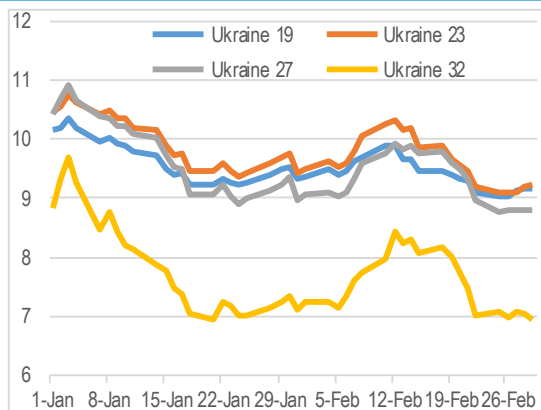


The lowest US manufacturing index numbers in almost three years

**US-China trade negotiations remains in center stage.** Further progress has been made in US-China trade talks. The US Administration has reportedly agreed to remove the tariffs it recently imposed on China. China also revealed a new foreign investment law that would strengthen IP protection, a key US demand.

**President Trump calling for a weaker dollar:** President Donald Trump gave a wide-ranging speech in Maryland over the weekend and bashed the Federal Reserve for raising interest rates and continuing with its monetary tightening policy.

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



**EURUSD was almost unchanged 1.1377 during last week amid mixed data from USA and Eurozone.** This week the pair started at 1.1337 levels.

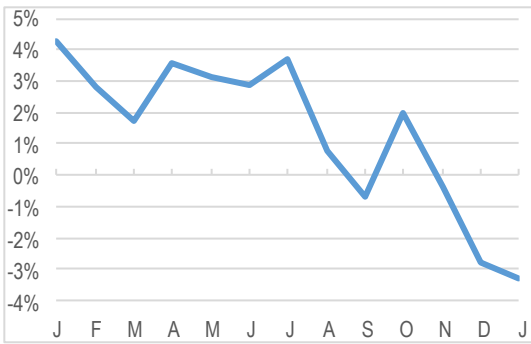
US GDP Q4 numbers showed gain 2.6% that is weaker compare to 3.4% print in Q3 but well above the estimate of 2.2%. **ISM Manufacturing PMI dropped to 54.2 points, well below expectations and is the lowest in almost three years.**

**German retail sales were unexpectedly strong, with a gain of 3.3%.** Eurozone CPI Flash Estimate came in 1.5%, as inflation levels remain well below the ECB target of 2.0%. The manufacturing sector is struggling, as Eurozone and German manufacturing PMIs came in below the 50-level, pointing to contraction.

**Benchmark UST stood at 2.55% (2Y) and 2.74% (10Y).** T-Bills yields have slightly increased during last week amid uncertainties with future FED's rates policy. Ukraine Eurobonds maintain previously reached levels mainly traded in flat. Loan from Deutsche has offset UST yields influence on sovereign yield.

Figure 7. Industrial Production Index 2018-2019 y/y

Industrial production likely to be flat this year

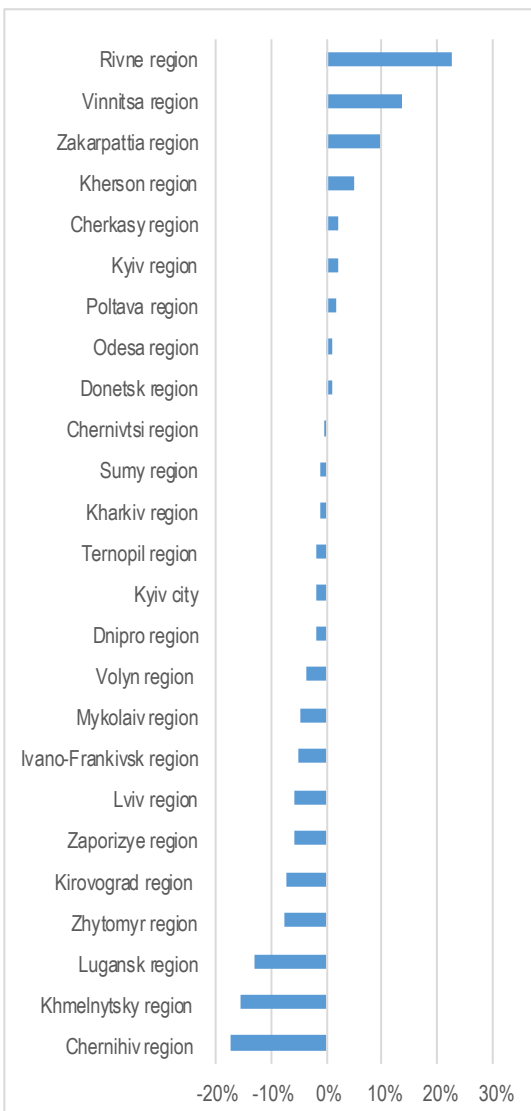


**Industrial production (IP) in January decreased by 3.3% y/y**, whereas in January 2018 growth by 4.3% y/y was recorded, according to UKRSTAT. Calendar adjusted IP in January fell by 2.9% y/y. We retain our no growth (0.0%) forecast for Ukraine's industrial production this year.

**The decline was broad based with mining industry down by 1.6% y/y and processing decreased by 5.5% y/y**, incl. chemicals - by 14.9% y/y, machinery - by 11.9% y/y, metallurgy - by 4.5% y/y and food production - by 1.9% y/y.

By region the outperformers were Rivne (IP increased by 22.8% y/y), Vinnytsia (by 13.8% y/y), Zakarpattia (by 9.6% y/y) and Kherson (by 5% y/y) regions.

Figure 8. January IPI, by regions y/y



Chernihiv (IP decreased by 17.4% y/y), Khmelnytsky (by 15.5% y/y) and Luhansk (by 13%) regions were falling behind.

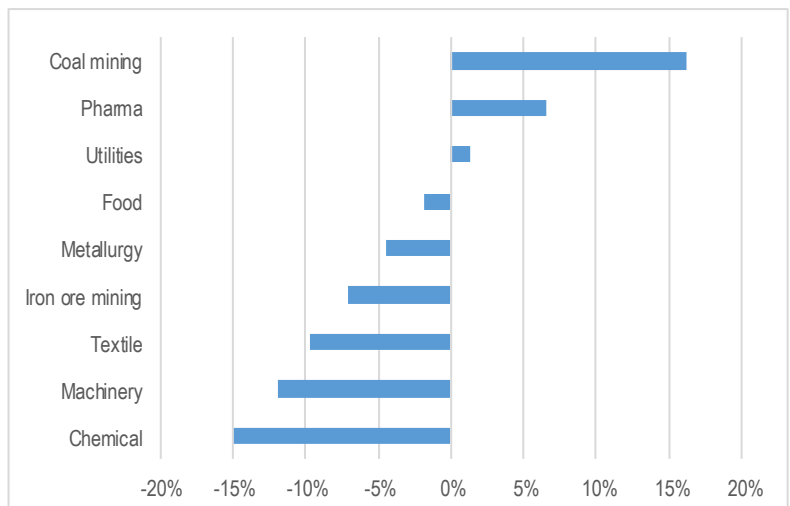
Industrial production continued on a downward path in January, contracting 13.8% mom (0.5% mom on a seasonally-adjusted basis).

**The poor performance so far is mostly the result of logistics problems due to conflict in the Azov Sea, weighing on exports, mostly iron ore and metals.** Besides January's IP downturn is attributable to lower iron ore and steel prices, as well as to strengthening of domestic currency (UAH).

**The improvement in IP will follow as iron ore and steel prices have started to recover at the end of the month.** The upside, however, may be pulled down by strength of UAH.

Among broad economic categories, a positive reading has energy production at 4.1% y/y (4.3% y/y on a seasonally-adjusted basis) and capital goods production at 0.8% (1.2%). The dynamic is consistent with positive business' expectations (according to NBU's Survey for the 4Q18) and high expectations for investment in machinery, equipment and tools.

Figure 9 January IPI, by sectors y/y



# UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators								
	2013	2014	2015	2016	2017	2018	2019F	2020F
<b>Real sector</b>								
Real GDP (%y/y)	0.00	-6.60	-9.80	2.30	2.50	3.30	2.70	3.00
Industrial production (%y/y)	-4.30	-10.70	-6.00	2.40	-0.10	1.60	0.00	1.20
Retail sales (%y/y)	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
<b>Prices</b>								
CPI (average %y/y)	-0.20	12.10	48.70	16.50	14.40	10.50	9.20	8.10
CPI (end of year %y/y)	0.50	24.90	43.30	12.40	13.70	9.80	8.50	7.20
Real average wage growth (%y/y)	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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