

ECONOMICS | INTEREST RATES STRATEGY | FX

March, 20, 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

Key rate: hold for now, a cut in April is likely

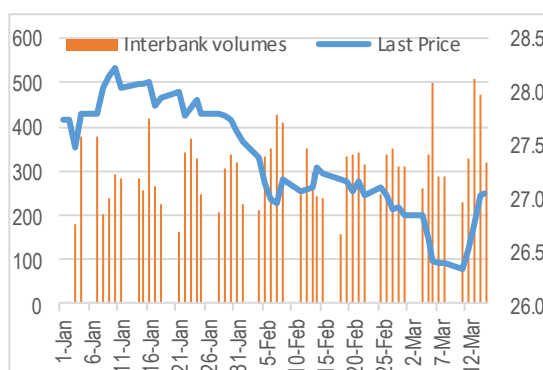
	Rating	Outlook	Last update
Fitch	B-	STABLE	03/08/2019
S&P	B-	STABLE	10/19/2015
Moody's	Caa1	STABLE	12/21/2018
S&P (N)	uaBBB	-	06/27/2018

The central bank of Ukraine kept the key policy rate unchanged at 18%, despite the downtrend in annual inflation in January and in February. The NBU communicated that the tight monetary conditions are needed to reduce inflation to the 5% target in 2020.

The next meeting of the NBU board on monetary policy will be held on 25 April 2019. We see a potential rate cut in range 50..100 bps if Q1 inflation (to be published on 11 April) meets the NBU's expectations (8.4%) and there will be no surprise outcomes after the first round of elections.

Figure 1. UAH exchange rate (UAH per USD)

UAH slightly weaker against external debt redemption

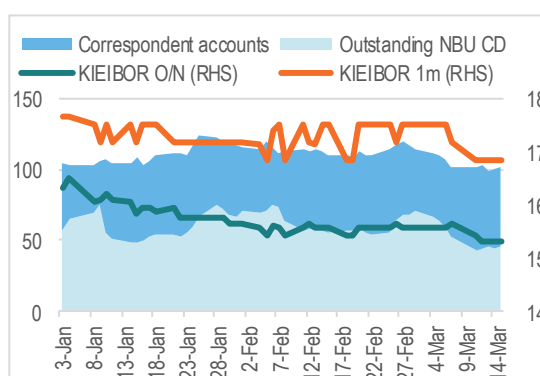


The level of banking liquidity stayed almost unchanged by the end of the last week with UAH101.45bn at the beginning and UAH101.54bn at the end of period. Outflows to NBU via the FX market have been offset by budget expenditures.

The lion's share of liquidity is concentrated on correspondent accounts, whereas amounts on CDs (certificates of deposit) has shrunk with overnight CDs significantly reduced to UAH7.89bn from UAH15.45bn as of the end of last Friday (Mar 15).

Refinancing volumes of Ukrainian banks dropped to UAH48.99bn from UAH51.45bn after some three banks repaid loans for a total amount of UAH2.53bn and some three banks attracted new ones for a total amount of UAH71.5mn. (the NBU does not specify names of borrowers if operation is shorter than 30 days. Provided very low volumes, we do not rule out these were "test" operations to check if central bank liquidity is available from a technical viewpoint.

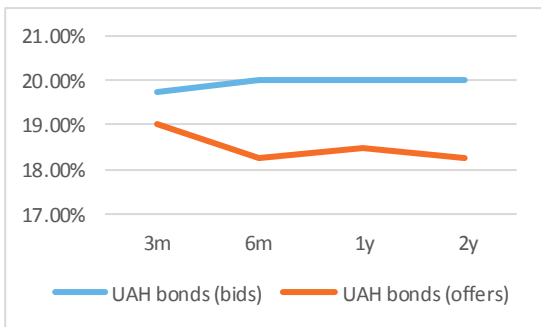
Figure 2. Banking liquidity (UAH bn)



The national currency experienced short turbulence climbing to 27.15-27.30 area as the market moved to the demand side. A meaningful influence on the market very likely had partial redemption of Eurobonds issued by Ukrainian Railway due to 2021 with USD175mn repaid on notes. At the same time traditional placement of government bonds on Tuesday had no positive effect on UAH so far.

Last week the NBU came out on the market with sale of reserves to fill up temporary demand on USD. During that period the central bank sold USD109.5mn and bought USD15mn. At the end of the Tuesday situation on the

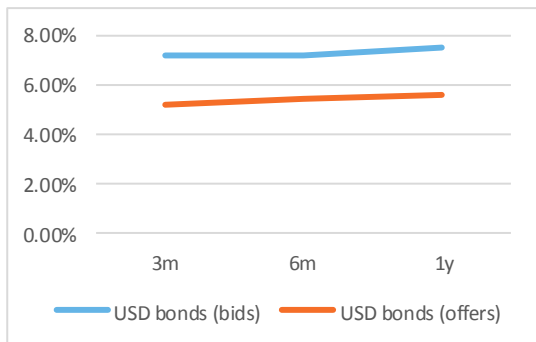
Figure 3. Local UAH bonds market



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%	18	18	5 330.08	5 330.08
UAH	6m	19.00%	18.99%	19.00%	18.95%	10	10	669.13	669.13
UAH	9m	18.50%	18.49%	19.00%	18.45%	7	6	672.65	662.65
UAH	1y	18.50%	18.50%	18.50%	18.50%	7	7	40.46	40.46
UAH	1.5y	18.25%	18.25%	18.25%	18.25%	2	2	508.28	508.28
UAH	2y	18.00%	17.98%	18.00%	17.95%	4	4	3 430.70	3 430.70
UAH	3y	17.25%	17.25%	19.00%	17.25%	3	1	31.05	30.00
USD	3m	6.50%	6.50%	6.50%	6.50%	13	13	82.02	82.02
USD	1y	7.25%	7.25%	7.25%	7.25%	10	10	1.99	1.99
USD	2y	7.50%	7.50%	7.50%	7.50%	13	13	2.49	2.49

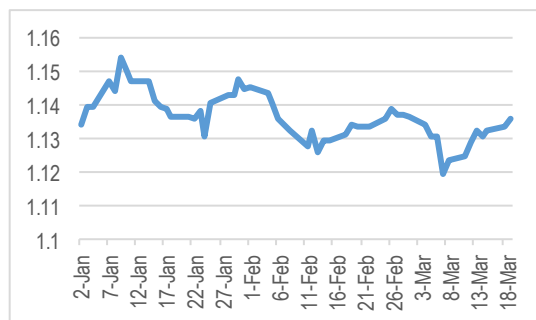
Figure 4. Local USD bonds market



MinFin has attracted about UAH12bn (equivalent) on the primary auction held March 19th. As before, cut-off rates for UAH bonds stood at 17.25%..19.50% depending on maturity. USD bonds were offered in 6.50%..7.25% (see table above). We note demand for 3m and 2y UAH bonds, while extent of participation of international accounts will play a role on FX market. For USD bonds, the key demand was in 3m short-term securities in size of USD80mn. We also note that current placement of UAH denominated bonds is to large extent a refinancing of upcoming redemptions.

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)

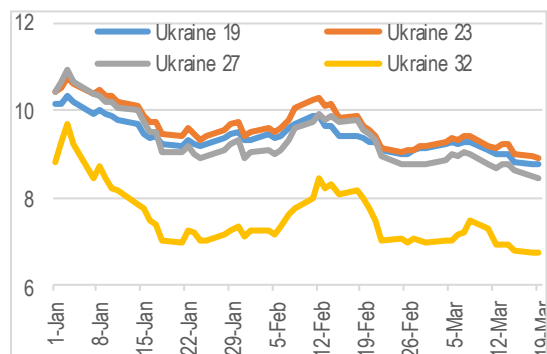


Investors widely expect the FOMC to keep rates unchanged

EUR/USD pair was on rise during the past week in response to structural USD weakness. There was a series of disappointing US data, undermining strengths of USD against the low-yielders. Moreover right before this weekly report was published the USD was suppressed by the expectations of FRS to keep soft monetary policy after the meeting of the FOMC on Mar 20.

Ukraine increased outstanding 2028 Eurobonds by US\$350mn to US\$1.6bn. JP Morgan acted as sole bookrunner and purchaser, according to media reports. The settlement was scheduled for Mar 21. MinFin this way is trying to secure itself before peak debt repayments, scheduled for this year. Receipt of these funds should provide the government with enough foreign exchange to cover debt repayments through most of the summer.

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

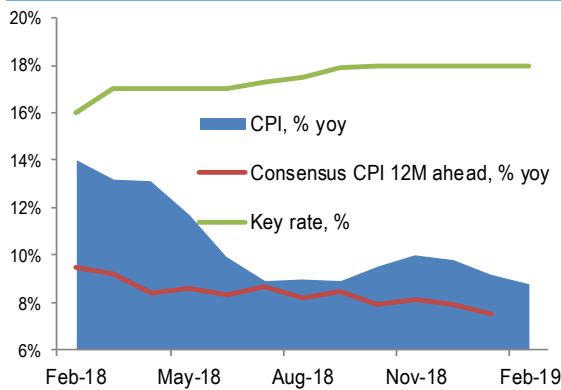


US Treasury market volatility is at a record low. At the current moment, investors took a waiting stance in the run-up to the FOMC-meeting (scheduled for today). Investors widely expect the FOMC to keep rates unchanged and reaffirm its patient to keep wait-and-see policy stance.

At a longer period US-China trade talks will be in focus. So far, US officials sent mixed signals on the issue, with some expressing concerns that China is pushing back against US demands.

Figure 7. CPI vs Key rate

Key rate: hold for now, a cut in April is likely



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A summary (minutes) of the monetary policy committee discussion is to be published on Mar 25 2019. The minutes are likely to provide more clarity about the ongoing discussion and the distribution of votes within MPC (monetary policy committee).

This was the fourth time in a row that the central bank kept the refinancing rate unchanged — in previous meetings held on Jan 31 2019, Dec 25, and 25 Oct 2018. The last time the NBU delivered a cut in the key policy rate - to 12.5% from 13% per annum – was on 26 May 2017.

Although leaving the key policy rate unchanged, the National Bank has been continuously expressing dovish sentiments since the end of 2018. The head of the central bank has talked about "reason to revise and weaken our monetary policy" in the mid-January and the NBU has stated that the annual inflation in Jan and in Feb was in line with its' monthly forecast (not disclosed).

The Bank's tight stance may be treated as a reasonable prudence against weak credit activity in the last two months, stemming from uncertainty over upcoming presidential elections. That is, potential negative impact of high real rates on lending could be viewed by central bank as muted.

Vice versa, potential impact on UAH strength / stability and ability of central bank to increased much needed FX reserves cannot be overestimated. It would be highly logical to start a gradual decrease of interest rates following run-off in the Presidential elections.

Focus on UAH stability is very important in light of ongoing fiscal loosening which took form of "subsidy monetization" - transformation of pay-in-kind social transfers into monetary form. In Mar 2019, Ukraine distributed around UAH3.4bn of such payments to subsidy receiving pensioners (70% of the amount, paid together with pensions) and other households (payments done via Oschadbank).

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UKRAINIAN CAPITAL MARKETS WEEKLY

Key Macroeconomic Indicators

	2013	2014	2015	2016	2017	2018	2019F	2020F
Real sector								
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
Prices								
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
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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