

ECONOMICS | INTEREST RATES STRATEGY | FX

March, 27, 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

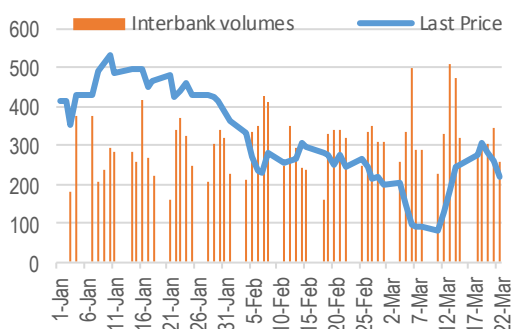
Ukraine's economy grew by 3.3% in 2018, likely to decelerate

	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

Ukraine's real GDP growth accelerated to 3.3% in 2018 from 2.5% in 2017, the Ukrstat has reported. The main growth driver remains private consumption (growth slowed down to 8.9% from 9.5%/y/y) underpinned by steep increase of real wages, pension payments and migration remittances. The economy also benefited from improvement in net exports. We retain our 2019 GDP growth forecast at 2.7%, expecting a marginal slowdown in growth rates due to ongoing political cycle, tight monetary policy and strong local currency.

Figure 1. UAH exchange rate (UAH per USD)

Liquidity absorbed by payments to state treasury



USD/UAH was at 26.92 as of the week ended March 22. Hryvnia started week at the downward pace and has depreciated by 1.33% to 27.38 during the first days. Situation reversed OVDP auction where government attracted USD150mn from nonresidents. Additional demand on UAH came from corporates, which converted export revenues in order to meet upcoming salary and tax payments. All these factors helped UAH to finish the week below 27 threshold. This week local currency is a bit weaker, as upcoming first round of presidential election seems to have impact on currency market. Also, there seems to be some elevated demand from private individuals on cash market.

Last week the NBU came out to the market with purchase of USD. During that period the central bank bought USD15mn without any sales from reserves.

Banking liquidity contracted below UAH100bn during the last week, incl. funds on correspondent accounts decreased by UAH1.4bn to UAH55.33bn and funds invested in CDs (certificates of deposit of NBU) down by UAH419mn. According to NBU data, the **key impact on amounts of money in the system had government's auction**, which took place on Mar 19. Liquidity outflow was partly offset by NBU, which renewed purchases of USD in interbank currency market. However, taking into account calendar factor, implying upcoming tax payments, we suggest that banking liquidity will stay at a current level or below it by the end this week.

Figure 2. Banking liquidity (UAH bn)

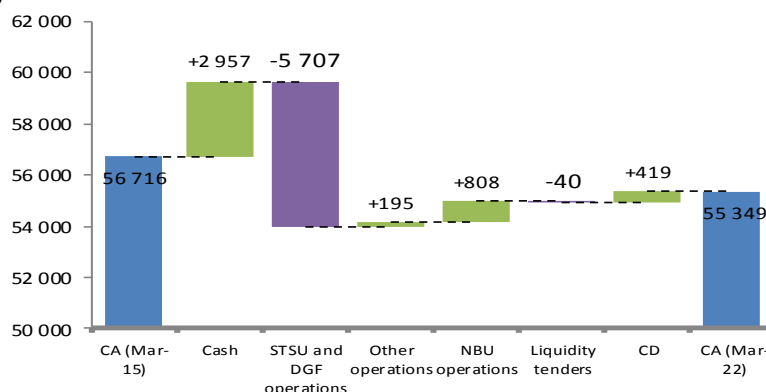
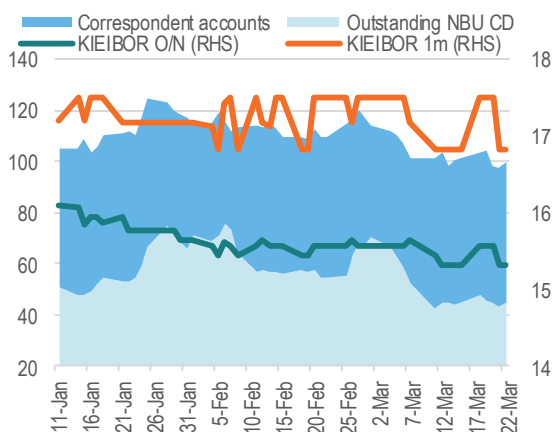
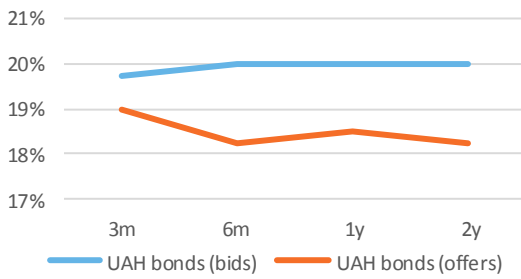


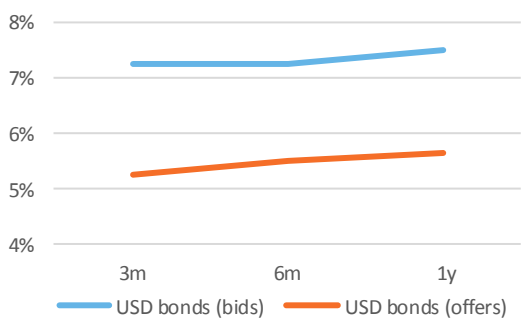
Figure 3. Local UAH bonds market



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%	32	32	1 258.23	1 258.23
UAH	6m	19.00%	19.00%	19.00%	19.00%	8	8	16.126	16.126
UAH	1y	18.50%	18.50%	18.50%	18.50%	4	4	4.031	4.031
UAH	1.5y	18.25%	18.25%	18.25%	18.25%	7	7	528.172	528.172
UAH	2y	18.00%	18.00%	18.00%	18.00%	4	4	2 076.25	2 076.25
UAH	3y	0.00%	0.00%	17.00%	17.00%	3	0	0	0
USD	3m	6.50%	6.50%	6.50%	6.50%	7	7	8.64	8.64
USD	1y	7.25%	7.25%	7.25%	7.25%	9	9	1.646	1.646
USD	2y	7.75%	7.75%	7.75%	7.50%	13	13	52.144	52.144

Figure 4. Local USD bonds market

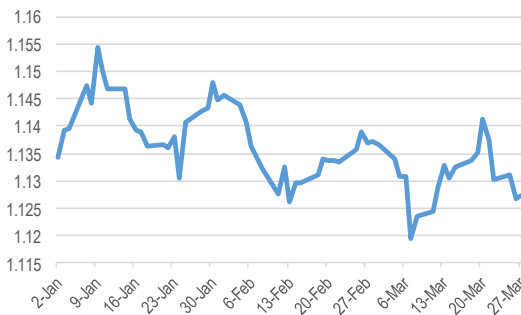


MinFin has attracted UAH5.48bn (equivalent) on the primary auction held March 26th. Cut-off rates for UAH bonds stood unchanged at 18.00%..19.50% depending on maturity. USD bonds were offered in 6.50%..7.75% (see table above). Main demand was concentrated in 2y UAH bonds. For USD bonds, the key demand was in 2y long-term securities in size of USD52mn.

We also note that current placement of 2y UAH denominated bonds is to large extent reflects improvement of expectations on the market about long-run of rates after two out of eight members of the MPC (monetary policy committee) voted to cut the key policy rate at a meeting on Mar 13.

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)



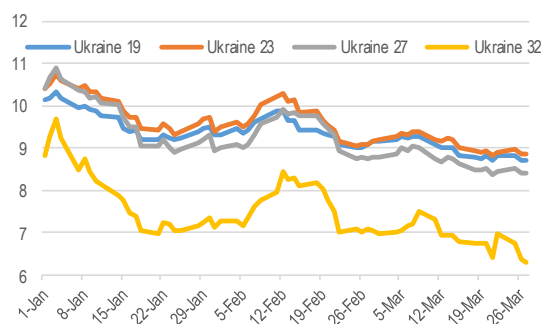
EURUSD: mixed performance

US currency has rebounded temporarily to EUR/USD1.1301 (Mar 25) from EUR/USD1.1424 (Mar 21) after Fed brought its tighten monetary policy to an abrupt end, abandoning projections for any interest rate hikes this year amid signs of an economic slowdown. Besides that, at the end of the last week the bullish trend was underpinned by positive statistics on US labor market conditions.

Similar reaction performed US Treasuries with 10-Y benchmark yield down to 2.4381% (Mar 25) form 2.5236% (Mar 21).

Another theme, that broadly attracted attention, was Brexit impasse. European Union leaders has postponed Brexit until April 12, on condition that she manage to persuade many opponents in parliament about her twice-defeated European divorce deal.

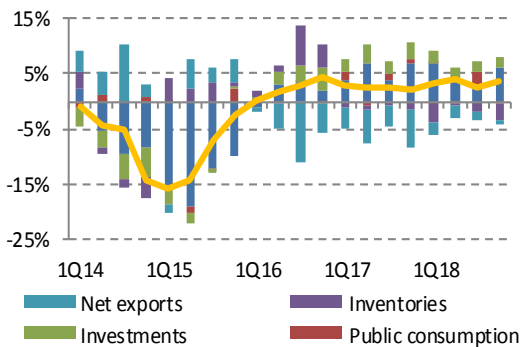
Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



Since the beginning of the year, European currency exhibits downward movement, against backdrop of downbeat outlook for the economy delivered by ECB, Brexit uncertainty and upcoming elections to EU Parliament, which are likely to deliver more negative surprises. Even though we are negative on USD in the long-medium run, short run momentum seems to be to the favor of US currency.

Figure 7. Components of GDP, q/q

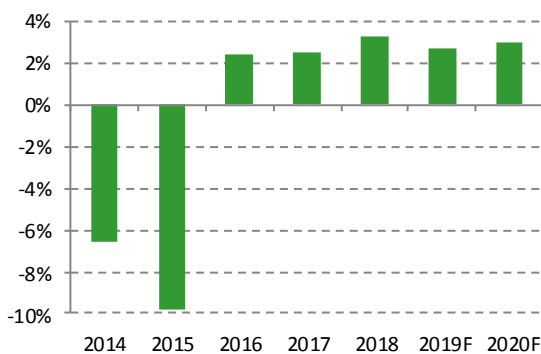
Ukraine's economy grew by 3.3% in 2018, likely to decelerate



Ukraine's real GDP growth accelerated to 3.3% in 2018 from 2.5% in 2017, the Ukrstat has reported. The main growth driver remains private consumption (growth slowed down to 8.9% from 9.5%/y/y) underpinned by steep increase of real wages, pension payments and migration remittances. The economy also benefited from improvement in net exports. **We retain our 2019 GDP growth forecast at 2.7%, expecting a marginal slowdown in growth rates due to ongoing political cycle, tight monetary policy and strong local currency.**

The main driver for the dynamic remains private consumption (growth slowed down to 8.9% from 9.5%/y/y) underpinned by strong growth of real wages, pension payments and stable migration remittances.

Figure 8. Real GDP growth, y/y



Material effect also had investments as the business undergo a deficit of free capacities and hold positive mid-term expectations (pursuant to Business Outlook Survey, performed by NBU in Q4 2018). Growth of investments, however, declined slightly – to 14.3% from 16.1% – after business confidence had receded ahead of challenging 2018 year.

The economy also benefited from **imports growth slow down – to 3.2% from 12.6%. In this regard worth to notice natural gas import contraction by 25%** followed by decline of oil and gas prices and decrease of energy consumption amid relative warm winter.

But the impact of imports was limited due to decline in exports by 1.6% after growth by 3.8% in 2017 against unstable external demand and logistics impediments, exaggerated by conflict in the Azov Sea.

In terms of sectoral contribution, the outperformers were agricultural production with record crops and retail, while share of processing and transportation services decreased. The last one was widely depressed in the end of the year after situation in the Azov Sea.

Generally, year's records suggest that **economy follows stable, but a slower than expected pace.** In special, seemingly positive statistics benefits from strong local demand while investment growth stay relatively weak, taking into account material contraction of the economy in 2014-15.

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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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