

ECONOMICS | INTEREST RATES STRATEGY | FX

April, 3, 2019

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

This week in focus: current account is back to deficit reading

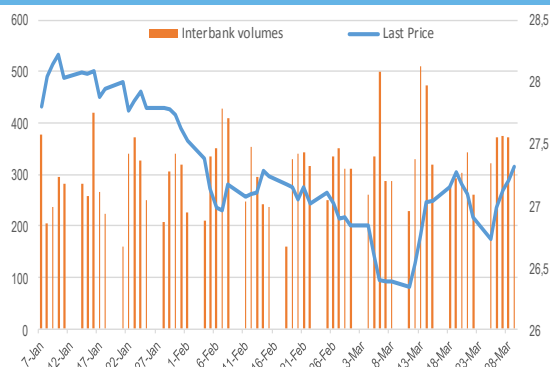
	Rating	Outlook	Last update
Fitch	B-	STABLE	03/08/2019
S&P	B-	STABLE	10/19/2015
Moody's	Caa1	STABLE	12/21/2018
S&P (N)	uaBBB	-	06/27/2018

Ukraine's current account turned into a deficit at USD381mn in Feb 2019 from surplus at USD56mn in Feb 2018, increasing the country's current account 12-month rolling deficit by 10.6% to USD4.55bn, according to NBU.

February records appear to be a bit disappointing and underline our base case of weaker UAH in 2H2019. Buffers against sudden BoP vulnerabilities looks sufficient, with official FX reserves at USD20.2bn as of end-Feb (3.3 months of imports).

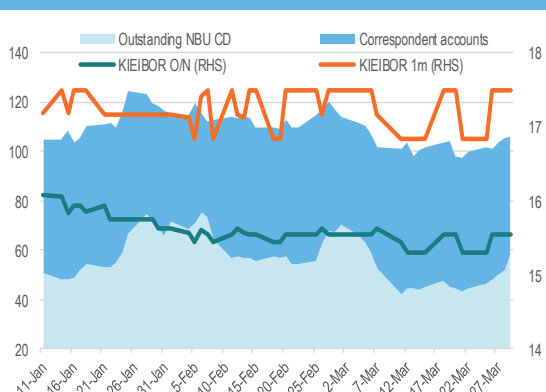
Figure 1. UAH exchange rate (UAH per USD)

Market unfriendly scenario avoided for now...

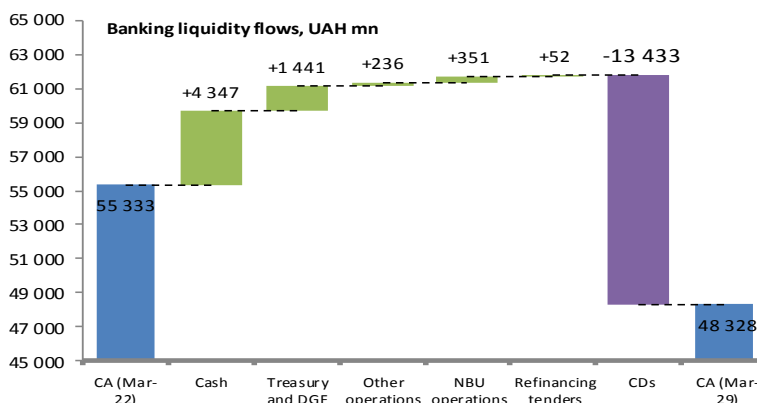


USD/UAH moved on a bumpy road during last week with presidential elections as a main driver along this way. Having started slightly below 27.0, UAH swiftly depreciated to 27.3 by Friday as most of sellers preferred to slow down sales of hard currency, just in case of any abnormal developments after 1st round vote on Mar 31. Then revaluation came on Monday as market-unfriendly scenario didn't realize and international observers confirmed that elections were conducted transparently. However, this movement didn't last long and on Tuesday situation reversed on a next round of speculations about the run-off of elections, scheduled for Apr 21. **We expect UAH/USD will continue experience high volatility in the short run.**

Figure 2. Banking liquidity (UAH bn)

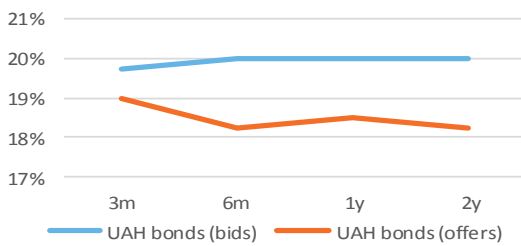


Banking liquidity recovered during the last week: despite amounts deposited on correspondent accounts decreased by 12.7% to UAH48.3bn, investments in CDs increased by UAH13.4bn. Notably all funds were placed in O/N CDs. This may signal about expectations of some liquidity outflow during current week.



Money primarily came into system from cash inflow, which used to increase in the last week of a month (inflow UAH4.35bn). Besides, amount of liquidity was boosted by MinFin operations associated with local bonds redemption. Other operations had less material effect, the NBU performed minor activity on the interbank FX market during last week.

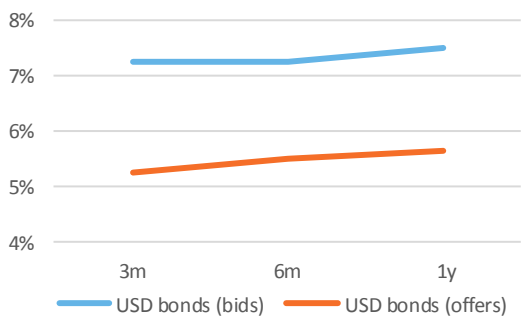
Figure 3. Local UAH bonds market



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%	19.00%	36	36	3 379.59	3 379.59
UAH	6m	19.00%	19.00%	19.00%	19.00%	16	16	1 255	1 255
UAH	1y	18.50%	18.50%	18.50%	18.25%	8	8	2 529.21	2 529.21
UAH	1.5y	18.25%	18.25%	18.25%	18.25%	8	8	296.41	296.41
USD	3m	6.50%	6.50%	6.50%	6.50%	11	11	123.54	123.54
USD	1y	7.25%	7.25%	7.50%	7.25%	11	10	1.24	1.09

Figure 4. Local USD bonds market



MinFin primarily offered short-term bonds on the primary auction on Apr 2.

The main demand came to the shortest 3m and to 1y UAH bonds. Cutoff rates for UAH bonds almost unchanged with a range 18.25%-19.50%. USD bonds were offered in 6.50%-7.25% range (see table above).

Total auctions proceeds stand at UAH6.77bn and USD122mn.

There was noted expansion of international accounts holdings, which reached the highest level since Aug 2016.

On the secondary market situation stayed even due to traditional low activity: 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.

Figure 5. EUR USD spot (mid)



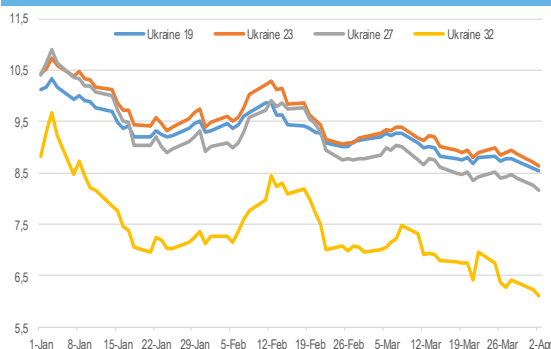
Risk appetite on

EUR/USD was moving sideward since last Wed (Mar 27) around 1.125 and on Tue (Apr 1) US currency appreciated sharply to 1.1199, reflecting some positive revisions to US consumer data and another round of bad news from Eurozone: German's manufacturing index fell further than initially estimated to the worst in almost seven years, Italy's industrial contraction deepened, and a euro-wide measure put confidence and demand at factories at a multi-year low.

U.S.-China trade talks set to continue. But signals about progress appeared – according to media China has made complex proposal on a range of issues. In fact, that factor may be supportive not only to USD but also to EUR as Eurozone exports suffered from trade tensions and the growth slowdown in China.

In the interminably tedious UK-EU divorce no changes...

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

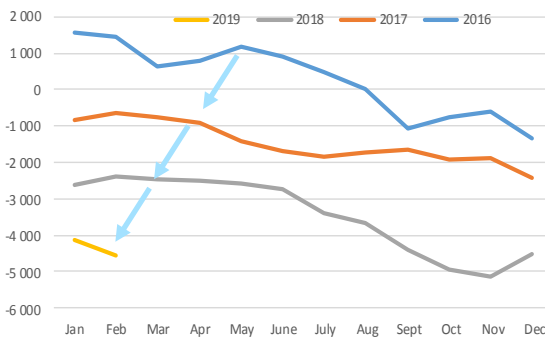


At the moment we see USD overvalued, peaking historical high, and the EUR undervalued. USD continue to benefit as a safe guard in the absence of convincing evidence of a turn in the global cycle. Besides, despite euro macro has deteriorated somewhat, a number of offsetting forces appears, including expectations for fresh ECB economic stimulus.

10-Yr US Treasury experienced rally amid speculations that US economy growth is faltering enough to trigger a Fed for easing its' monetary policy this year. Treasury yields soared to 2.47% (Apr 1) from 2.36% (Mar 28) as if a recession is nearly here. The bundle of important economic reports coming this week might reveal whether those fears got overblown.

Figure 7. Current account (USD bn, 12M rolling)

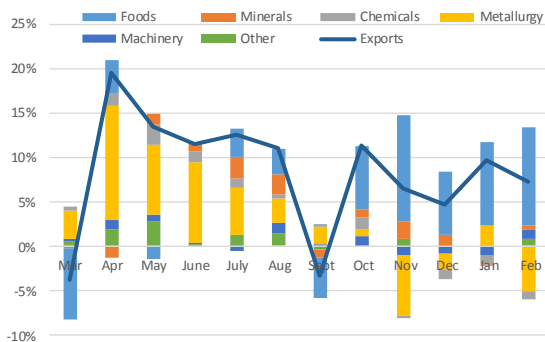
Current account is back to deficit reading



Ukraine's current account turned into a deficit at USD381mn in Feb 2019 from surplus at USD566mn in Feb 2018, increasing the country's current account 12-month rolling deficit by 10.6% to USD4.55bn, according to NBU.

Exports of goods in Feb improved by 7.3% y/y - to USD3.56bn due to strong exports of agricultural products. The trend is likely to persist over some time, taking into account historical high crop harvest in Ukraine for the previous year (grain harvest exceeded 70mn tonnes, oilseeds – 30mn tonnes, according to NBU) and stable agricultural commodities prices. At the same time, exports of ferrous and non-ferrous metals decreased by 17.9% and chemicals exports contracted by 15.4% as situation in the Azov Sea continue to weigh on logistics through The Kerch Strait, which is an important exports channel.

Figure 8. Exports of Goods, % y/y



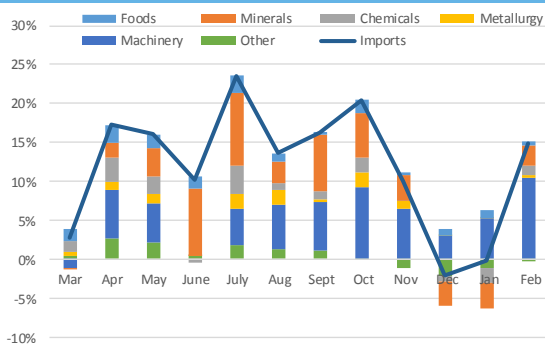
The trade balance deficit, incl. goods and services, however, widened by USD0.44bn y/y to USD1.12bn due to rampant imports growth by 14.9% y/y to USD4.64bn in February.

Expansion of imports was driven by all subcomponents, but the greatest contribution came from machinery and minerals (incl. energy). The growth of machinery imports accelerated to 38.9% y/y by situational demand on cars on the threshold of expiration of preferential terms for customs clearance. Imports of minerals, in turn, expanded by 13.8% y/y on the back of increased energy products purchases.

Services item recorded a slight net outflow of USD47mn in contrast to surplus at USD31mn in the same month of the last year.

Remittances from Ukrainians working abroad are estimated at \$0.97 million, which is 8.4% higher than in February 2018.

Figure 9. Imports of Goods, % y/y

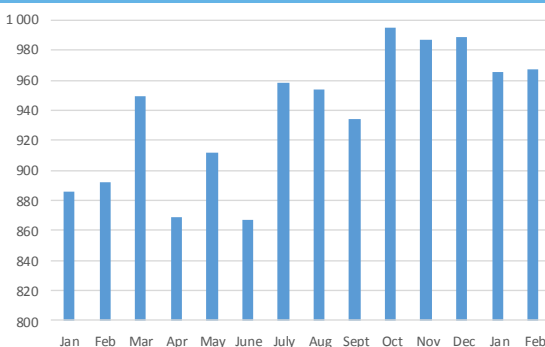


On the financing front, net inflow shrank by USD66mn to USD131mn y/y in Feb 2019, with 12-month inflow down by 0.9% - to USD7.27bn. However, FDI grew twofold to USD369mn y/y, out of which 33% consisted operations of conversion of banks' subordinated debt into statutory fund.

February records appear to be a bit disappointing and underline our base case of weaker UAH in 2H2019. Buffers against sudden BoP vulnerabilities looks sufficient, with official FX reserves at USD20.2bn as of end-Feb (3.3 months of imports).

We expect the trend seen in import of machinery to remain in place in 2019 on account of existing deficit of spare production capacities (according to the NBU's Q4 business survey). But the strength of this growth is conditional on elections processes. In other words, we expect business' confidence will materialize if completion of the second round of voting removes a large part of uncertainties in relation to the future outlook of economic policy in Ukraine.

Figure 10. Remittances, US mn



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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