

ECONOMICS | INTEREST RATES STRATEGY | FX

April, 10, 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

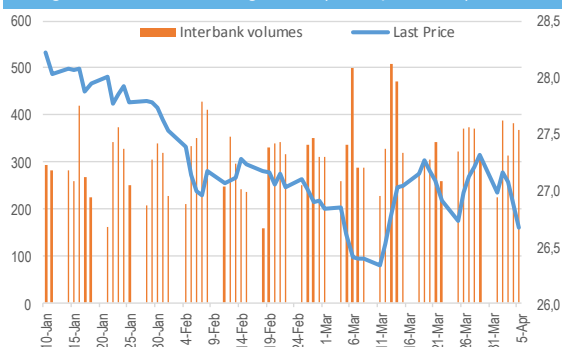
This week in focus: Reserves stay under pressure of FX debts

	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 FX reserves increased by 2.1% m/m to USD20.6bn in March; sufficient to cover 3.4 months of future imports, according to the NBU. International reserves are likely to stay under pressure of Ukraine's FX debts due in 2019. Strong UAH should provide an important support to MinFin's debt repayments and will help build up FX reserves. Further cooperation of Ukraine with the IMF is critical for maintaining stability in the coming months and repayment of maturities due in late 2019.

Figure 1. UAH exchange rate (UAH per USD)

USD/UAH entering turbulence zone

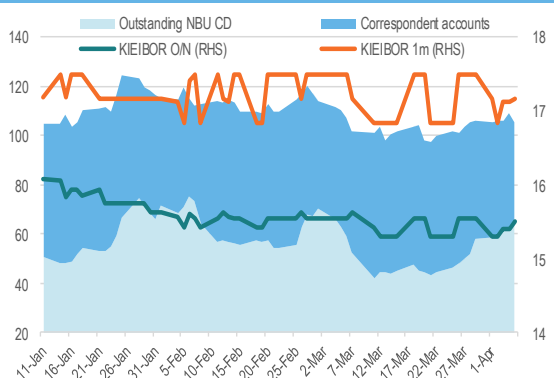


UAH climbed against USD to 26.74 by the end of Tuesday from above 27 last week. The wave of strengthening was primarily boosted by inflow of exports revenues and increased foreign investments in local currency government bonds. This movement was partially curbed by NBU's interventions to the FX market, but these operations were mainly limited to USD15mn per day.

We prefer cautious stance regarding the USD/UAH pair movement during upcoming weeks. We see both potential to further UAH strengthening and to downturn on the back of new speculations regarding candidates' debates and likely team nominations.

Ukrainian banking system ended last week with a minor change in liquidity level, with UAH105.2bn at the end of the period. Meanwhile, banks went on consolidating investments in CDs, increasing its portfolio by 11.3% to UAH64.37bn, where two-week CDs comprise a majority.

Figure 2. Banking liquidity (UAH bn)



Amounts deposited on correspondent accounts decreased by 15.5% to UAH40.83bn. Liquidity dipped due to MinFins operations and conversion of some sums on correspondent accounts into cash. These outflows, however, were offset by NBU's interventions on FX market.

We expect banking liquidity to stay above UAH100bn next week. Despite upcoming redemptions of government local bonds, we expect the central bank will go on taking advantage of current strengthening of UAH.

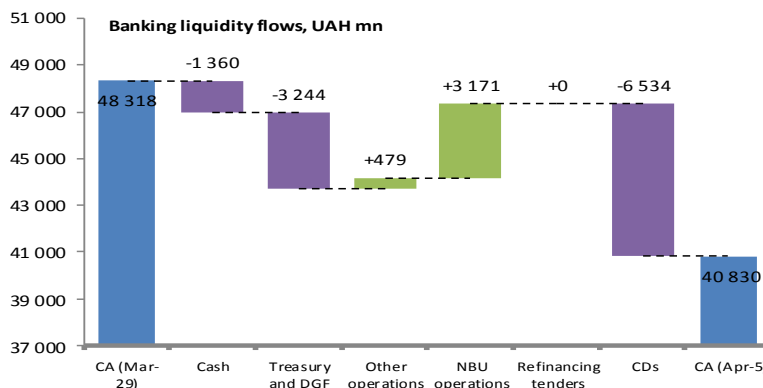
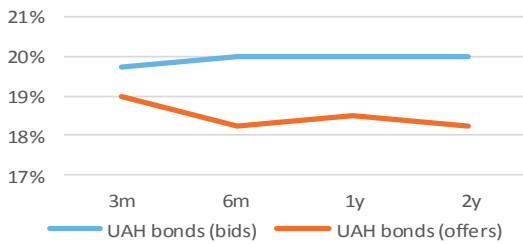


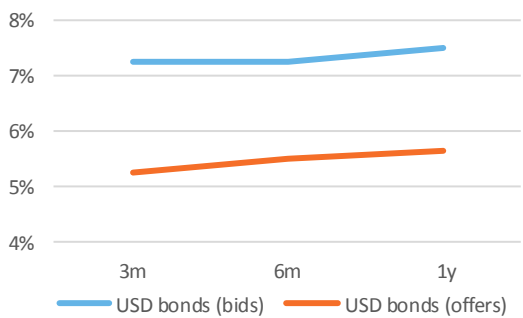
Figure 3. Local UAH bonds market



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%	20.00%	19.00%	38	37	4 536.79	4 526.79
UAH	6m	19.00%	19.00%	19.00%	18.50%	16	16	656.53	656.53
UAH	1y	18.50%	18.48%	18.50%	18.45%	9	9	1 098.90	1 098.90
UAH	2y	18.00%	18.00%	18.25%	18.00%	9	8	2 017.60	1 927.60
USD	1y	7.25%	7.25%	7.50%	7.25%	8	8	10.07	10.07
USD	1.5y	7.25%	7.25%	7.25%	7.25%	14	14	4.10	4.10
EUR	1.5y	4.60%	4.60%	4.60%	4.60%	10	10	2.54	2.54

Figure 4. Local USD bonds market



MinFin has attracted UAH8.16bn (equivalent) on the primary auction held April 9th. Cut-off rates for UAH bonds stood unchanged at 18.00%..19.50% depending on maturity. MinFin also offered USD bonds at yield 7.25% and EUR bonds at 4.6% (see table above).

While the key demand was concentrated in 3m UAH bonds, we treat this placement as a roll-over of upcoming redemption of UAH bonds with similar volume. For the same reason USD and EUR bonds were offered.

Hence, **real market interest was concentrated in 1y and 2y UAH bonds**, including from international accounts, which continued to increase exposure to government local securities on the back of lucrative yields.

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)

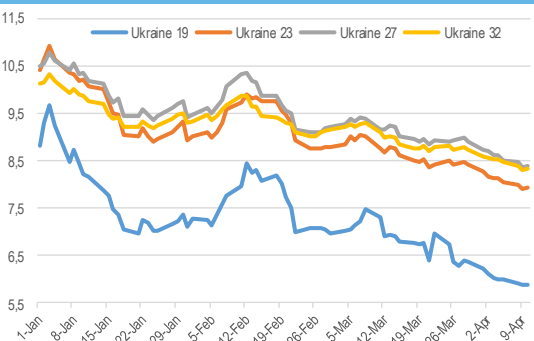


USD is standing firm against EUR

The EUR/USD pair maid a soft rebounded to 1.125 region and has entered into a phase of consolidation near this level. Investors viewed favorably signs of progress in U.S.-China trade talks, however a deal is not likely to be struck before May as U.S. officials are "not satisfied yet" about all the issues standing in the way of a deal. At the same time, markets turned cautious amid risen uncertainty about the Mexican border, that poses risks for NAFTA trade.

We expect EUR/USD to stay below the 1.13 for some time. A lack of clarity on the likely Brexit outcome remains a drag on EUR. Besides, U.S. administration has proposed to impose tariffs on selected imports from the European Union. The impact on European currency is yet to be estimated, but the threat will keep EUR in check.

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



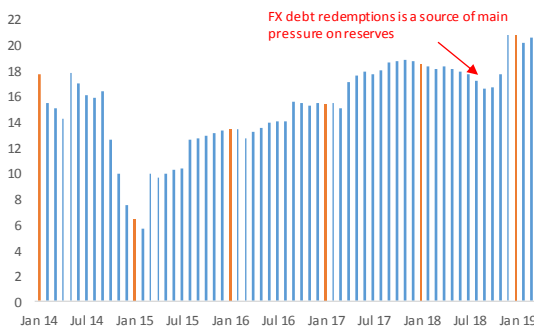
10-Yr US Treasury was drifting above a yield 2.5% ahead of upcoming Treasury auctions. Investors typically sell Treasuries ahead of an auction to push the yield higher so they can buy them at a lower price. Besides, some pressure on Treasuries put Saudi Aramco's inaugural bond placement. The deal was priced on Tuesday, the oil company attracted \$12 billion.

Investors this week are also looking for data on U.S. consumer and producer prices and the minutes from the last Fed policy meeting, that are due to be released on Wednesday.

Following the Fed's most recent meeting in March, the central bank decided to maintain interest rates and hold off on any further increases this year.

Figure 7. FX Reserves (USD bn)

Reserves stay under pressure of FX debts

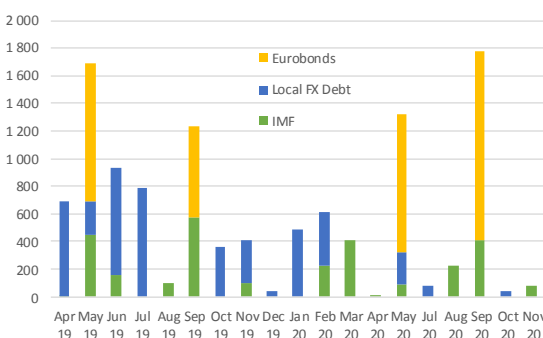


Ukraine's FX reserves increased by 2.1% m/m to USD20.6bn in March; sufficient to cover 3.4 months of future imports, according to the NBU.

The inflows were mainly generated by new FX borrowings. Specifically, the government received EUR512mn in loan funds guaranteed by the World Bank, USD357.1mn from the sale of tap issue of Eurobonds due in 2028, USD159.8mn and EUR5.4mn from the sale of FX local bonds. The NBU's net FX purchases added to reserves USD162.2mn.

On the other side, **FX debt repayments in March drained reserves by equivalent of USD866.5mn.** This amount (indirectly) includes an equivalent of USD706.7mn for servicing and partial redemption of Eurobonds issued by Oschadbank and Ukraine Railways, as well as servicing and repayment of domestic government bonds and other sovereign liabilities denominated in FX. On top of that, the government and the NBU paid an equivalent of USD159.8mn on liabilities to the IMF.

Figure 8. Debt repayments due in 2019-20 (USD mn)



Ukraine's FX reserves are likely stay under pressure of FX debts due in 2019, and recent surprising return of MinFin to bond markets in time of unfavorable conditions only confirms sizable 2019 FX financing requirements of the government. The nearest debt-repayment peak come in May with USD1bn (face value) to be repaid on Eurobonds guaranteed by the U.S. and about USD445mn to be repaid on stand-by arrangement to the IMF.

While there is also USD3bn to be repaid on local FX bonds in 2019, we believe that the government will manage to roll it over largely.

This heavy redemption schedule comes on top of weaker than expected budget revenues, which fell behind the pace of incomes plan for Q1 on the back of shrank taxation base and strengthened UAH.

At the same time, we see that MinFin holds stable position regarding servicing its FX obligations through the summer, and we assume that the **recent deal on the debt market was a prudent measure, in order to secure itself against current and upcoming elections uncertainty.**

Strong UAH should also provide an important support to MinFin's debt repayments and FX reserves during the upcoming months. We expect the local currency will continue benefit for some time from stable exports, underpinned by favorable external price conditions, and restored foreign investor's appetite for Ukraine's lucrative local currency bonds.

Further cooperation of Ukraine with the IMF is critical for maintaining stability in the coming quarters and repayment of maturities due in late 2019. At the moment both leading candidates speak in favor of such cooperation. If this is a case, we see no major drops in the NBU's reserves by the end of 2019.

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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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