

ECONOMICS | INTEREST RATES STRATEGY | FX

April, 17, 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

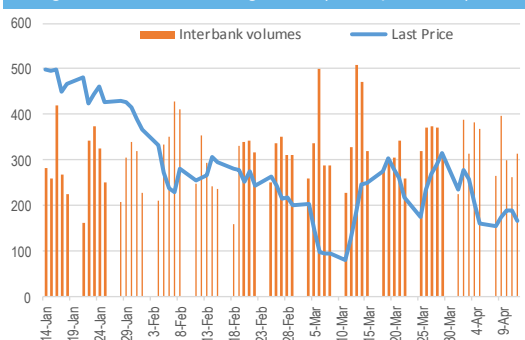
This week in focus: Inflation stay on downward track

	Rating	Outlook	Last update
Fitch	B-	STABLE	03/08/2019
S&P	B-	STABLE	04/12/2019
Moody's	Caa1	STABLE	12/21/2018
S&P (N)	uaBBB-	-	04/12/2019

Consumer price index (CPI) increased by 0.9% m/m in March 2019. In annual terms inflation decelerated to 8.6% from 8.8% in February, according to data released by the Urkstat. Generally, inflation follows downward pace in accordance with the NBU's forecast.

We expect the headline inflation is likely to stay at the level 8.5% by the end of the year (above the NBU's forecast at 6.3%) as external headwinds pose risk to inflation outlook.

Figure 1. UAH exchange rate (UAH per USD)



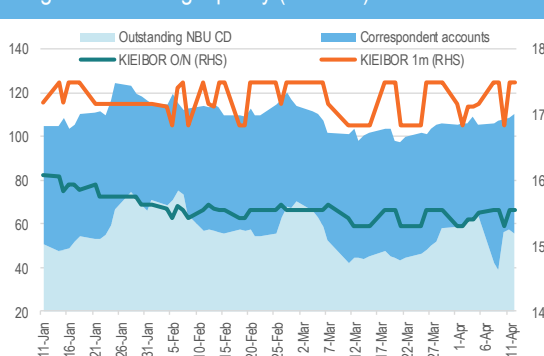
UAH benefiting from foreign investors' FX injections

USD/UAH performed sideward movement within the range 26.62-26.95 during the last week. Despite high activity, the market kept holding equilibrium, strictly meeting demand and supply. Even the last foreign investors' FX injection on the back of buying local government bonds for about UAH2.9bn didn't affect the market as the funds were immediately absorbed by some market participant.

The NBU last week decreased net FX purchase in the interbank market to USD56.5mn from USD118.4 a week before.

We expect nonresidents will hold interest to local bonds before the Apr 25 NBU's monetary committee meeting, providing further support to UAH. However, the upcoming run-off presidential election on Apr 21 will limit their activity.

Figure 2. Banking liquidity (UAH bn)



Ukrainian banking liquidity increased by UAH5.5bn to above UAH100bn by the end of last week. Banks increased amounts on correspondent accounts by UAH14.5bn to UAH55.33bn, incl. UAH9bn came from O/N CDs. Looking at outside injections, Treasury operations and NBU FX interventions are responsible for the rest of liquidity build up. At the same time, UAH5.8bn on correspondent accounts were converted into cash. **We expect no material changes in banking liquidity level by the end of this week.**

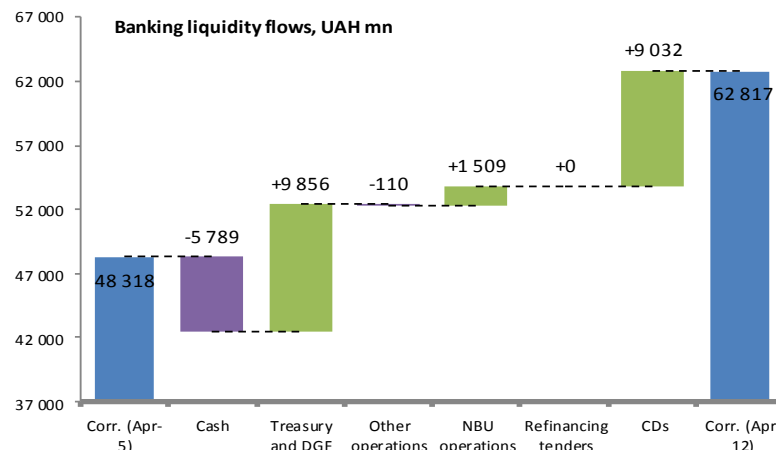
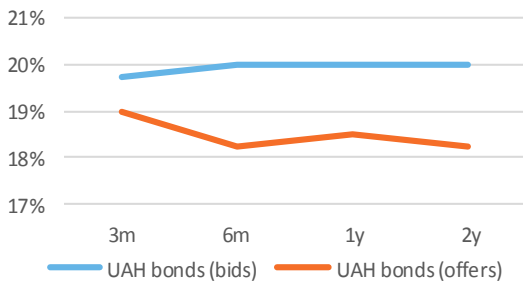


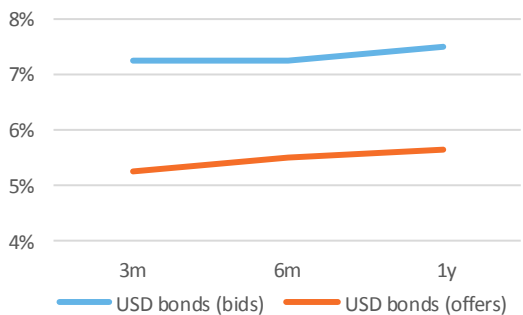
Figure 3. Local UAH bonds market



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%	19.50%	18	18	4 389	4 389
UAH	6m	19.00%	19.00%	19.00%	19.00%	12	12	136.387	136.387
UAH	1y	18.50%	18.50%	18.50%	18.50%	12	12	679.187	679.187
UAH	2y	18.00%	18.00%	18.00%	18.00%	12	12	2 979.65	2 979.65
UAH	3y	17.25%	17.25%	17.25%	17.25%	3	3	310.167	310.167
USD	1y	7.25%	7.25%	7.25%	7.25%	12	12	117.15	117.15
USD	1.5y	3.85%				1	1	73	73
USD	2y	7.75%	7.74%	7.75%	7.50%	23	23	13.491	13.491

Figure 4. Local USD bonds market



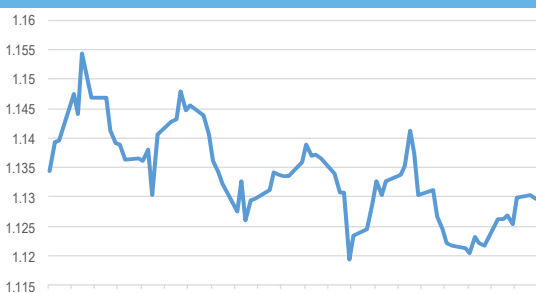
MinFin managed to rise circa UAH13.5bn (equivalent) on the primary auction held April 16th. Majority of funds were attracted through placement of USD bonds, incl. securities for USD73mn with fixed interest rate at 3.85% and embedded acceleration clause. However, this transaction was a rollover of the same bond issue due 10 April. The rest of USD bonds were offered in 7.25%..7.75% with key market demand for 1.5y securities.

Cut-off rates for UAH bonds stood at 17.25%..19.50%. The highest demand was recorded for 3m securities, totaling UAH4.4bn, however robust demand was also for 2y bonds, amounting UAH3bn, presumably from foreign accounts.

S&P affirmed Ukraine's 'B-/B-' long- and short-term foreign and local currency credit ratings. The rating action met expectations, hence didn't affect the market.

On the secondary market without any changes, yields (bids) of local UAH bonds 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.

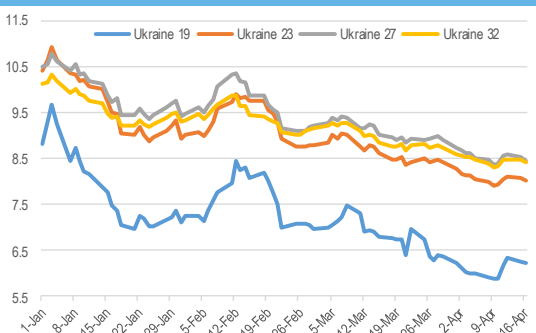
Figure 5. EUR/USD spot (mid)



EUR found situational support

EUR last week continued sluggish growth against the dollar and went up to 1.1269 by the end of Apr 16. In spite of weak incoming data on Euro zone, the euro's strength came from anticipated currency demand arising from a Japanese bank's plans to purchase a German multibillion-dollar aviation finance business. Meantime the greenback stayed firm and was bolstered by the latest reading of the U.S. consumer and producer price index. Furthermore, jobless-claims data, released on Apr 11, pointed to sustained labor market strength that could counter fears of a sharp slowdown in US economic growth.

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

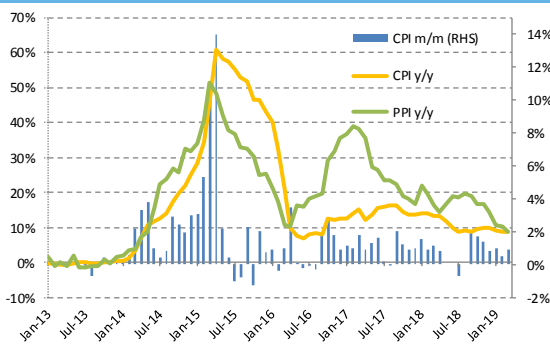


Taking into account situational character of the euro's strengthening, USD rebound might follow next week. Investors also keep on focused on U.S.-China trade talks as any deal is likely to remove headwinds to global growth.

10-year Treasury yield soared last week to about 2.56% after touching 2.477% on Apr 10 as US investors pivoted toward risky assets. The optimism about the last stemmed from strong Chinese economic data, that showed Chinese bank lending was on the rise in March and that the country's trade surplus increased beyond analyst expectations.

We expect 10-year benchmark is likely to stay subdued over the nearest future. Seeking higher yields investors are keeping a close eye in the stock market with a new earnings season start to have an effect.

Figure 7. CPI growth, %



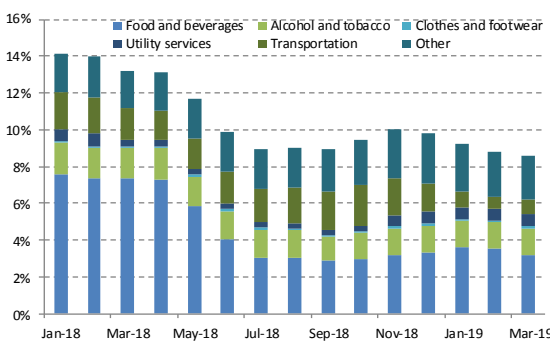
Inflation stay on downward track

Consumer price index (CPI) increased by 0.9% m/m in March 2019. In annual terms inflation decelerated to 8.6% from 8.8% in February, according to data released by the Urkstat.

Looking at details of inflation prints, **the main contributor to the year dynamic – food prices (incl. beverages), slightly weaken its' impact by the end of March**, with growth decelerated to 7% y/y from 7.8% y/y in February. While pace of growth in prices of highly processed foods slowed moderately, raw food prices growth decelerated to 3.6% y/y from 4.6% y/y in February on the back of decrease in price of imported fruits.

Segment of alcohol and tobacco prices also decreased own upward contribution, with year's growth down to 17.3% from 17.8% in February.

Figure 8. Main components of CPI, % y/y



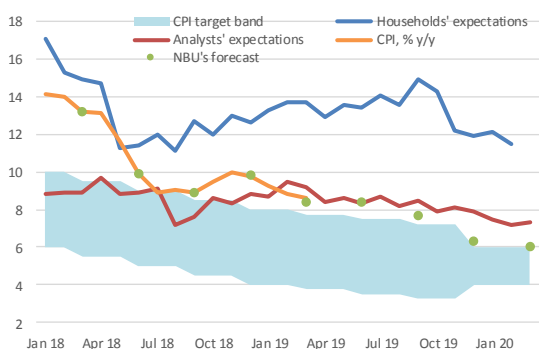
Acceleration of CPI growth in March largely came from risen clothing and footwear prices and transportation prices. For the first segment high inflation is traditional in March as buyers gear up for summer. As for transportation prices inflation, it was fueled by increase in passenger railway and public transport fares.

Other non-food products and fuel prices continued to decelerate, benefiting from the strengthening of the UAH.

Core inflation declined in annual terms to 7.6% from 7.8% in February.

Generally, inflation follows downward pace in accordance with the NBU's forecast (8.4% y/y in Q1). Though the growth stayed slightly above of the implied trajectory, we consider this exceedance was due to a bit ambitious expectations, but not as an inefficiency of the bank's tight monetary policy or influence of unexpected factors.

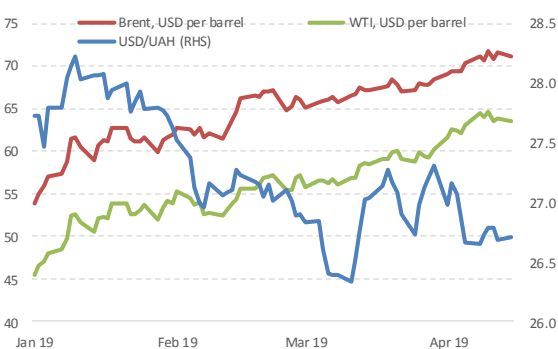
Figure 9. Inflation expectations, % y/y



There was huge monetization of subsidies for housing and utility services announced by the government, starting from March, as well as pension payments readjustment. So far, we see no material effect of increased social spending on inflation. However, we keep this factor in check. The NBU has warned earlier, that combination of these factors might substantially impact inflation expectations on the back of uncertainty arising from the presidential and parliamentary elections.

We expect the headline inflation is likely to stay at the level 8.5% by the end of the year (above the NBU's forecast at 6.3%) as external headwinds, specifically the rise of oil prices on the world markets in recent months and deterioration of world economic expectations, pose risk to Ukraine's FX market and subsequently to inflation outlook.

Figure 10. Brent, WTI, USD/UAH spot



The next meeting of the NBU Board on monetary policy issues will be held on 25 April. **We have toned down our expectations about possible policy rate cut on account of the March inflation prints.** However, we still stay optimistic, as current changes in headline inflation and its components evidence that inflationary pressure continues to ease.

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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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