

ECONOMICS | INTEREST RATES STRATEGY | FX

May, 08, 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

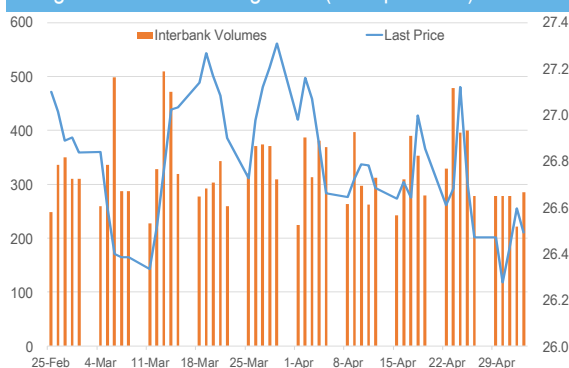
This week in focus: NBU increases FX purchases to build up reserves

	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

Ukraine's FX reserves contracted by slight 0.5% to USD20.525 as of May 1. The current amount covers 3.4 months of future imports and is sufficient for Ukraine to meet its obligations. We expect FX reserves to decrease next month due to large external debt repayments ahead. As for further perspective, we see the NBU has a potential to succeed in its plans to increase reserves by the end of 2019, however, further cooperation between Ukraine and the IMF holds a critical importance for realizing this potential.

Figure 1. UAH exchange rate (UAH per USD)

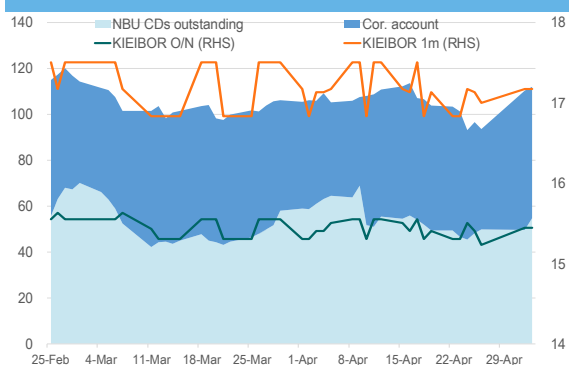
UAH continue benefit from steady supply



USD/UAH was stable during last short week as market participants preferred to carry most operations over prolonged holidays. This week UAH started from strengthening to below 26.4 (as of May 7) from 26.5 at the end of last week. UAH benefits from seasonal demand, as corporates convert export revenues in order to meet upcoming salary and tax payments.

The NBU has announced increase of the volume of FX purchases up to USD20mn a day in order to boost reserves. Besides, the central bank has increased limit for repatriation of dividends to EUR12mn a month. We expect these decisions will somehow curb UAH strengthening, but without significant effect on the trend of the hryvnia exchange rate, as UAH continue benefit from steady supply of USD and fundamental economic factors.

Figure 2. Banking liquidity (UAH bn)



Ukrainian banking liquidity restored to above UAH110bn by the end of last week after sharp decline to UAH93bn due to prolonged holidays. Since Apr 19 investments in CDs increased by UAH5.4bn to UAH54.8bn, amount of funds on correspondent accounts with the NBU up by UAH2.65bn to UAH57.1bn.

The NBU has increased planned volumes of intervention in the interbank FX market to USD20mn a day since beginning of May. Besides the MinFin has limited volumes of bonds placements during the last two auctions. We expect these factors will support further increase of liquidity.

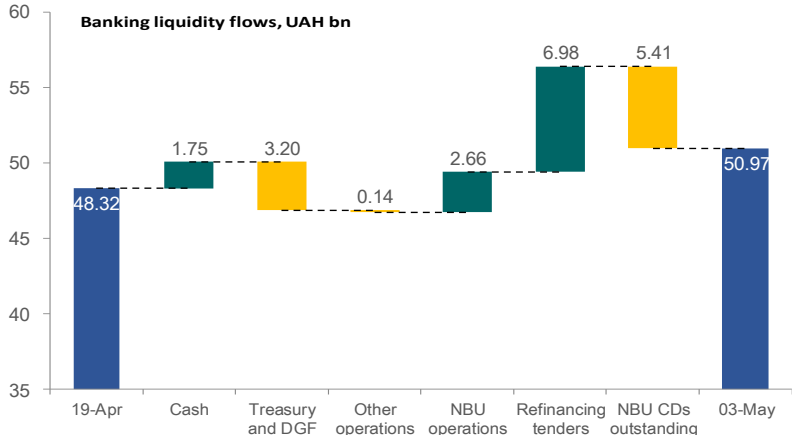
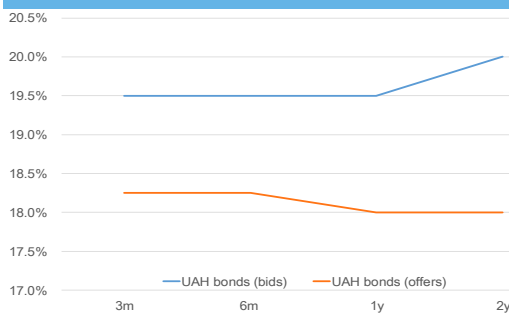


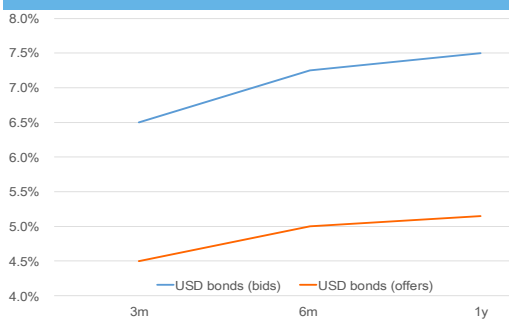
Figure 3. Local UAH bonds market



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	18.50%	18.33%	19.00%	18.25%	43	43	4 455.87	1 500
UAH	6m	18,50%	18.41%	19.00%	18.20%	22	22	2 319.56	1 500
UAH	1y	18.50%	18.33%	18.50%	17.75%	15	15	1 372.73	1 372.73
UAH	1.5y	18.00%	17.99%	18.25%	17.99%	5	3	406	255
UAH	2y	17.95%	17.75%	18.00%	17.50%	14	12	1 431.15	1 231.15
UAH	5y	16.00%	16.00%	16.00%	16.00%	3	3	1 201.87	1 201.87
USD	1.5y	7.25%	7.25%	7.25%	7.25%	16	16	8.2	8.2
USD	1.5y	3.85%				1	1	73	73
USD	1.5y	3.85%				2	2	83	83

Figure 4. Local USD bonds market



MinFin has attracted UAH10.9bn (equivalent) on the primary auction held May 7th. Cut-off rates for UAH bonds fell to 16.00%..18.50% depending on maturity, following the NBU decision to cut key policy rate to 17.50%. USD bonds were offered in 3.85%..7.75% (see table above). Main demand was concentrated in 3m UAH bonds, however the MinFin decided to limit sells of short-term bonds, counting on further lowering of rates due to high demand. For USD bonds, the market demand was in 1.5y securities in size of USD8.2mn.

On the secondary market yields (bids) of local OVDP in UAH declined to 18.25% (for 6m). 1Y USD bids were at 5.15%. Simultaneously with primary market, offers on secondary one promptly reacted on the NBU decision. However, trading activity on the secondary market stays low.

Figure 5. EUR/USD spot (mid)



Investors focused on US-China trade standoff

The euro rebounded from its weakest level against the U.S. dollar since May 2017. However, generally the euro currency stays weak due to weak statistics and excite not much market attention.

The main focus is on U.S., and U.S.-China trade talks, which seems to continue in a Brexit-like manner. The recent developments suggest growing of trade tensions between countries, though not long ago a deal was close.

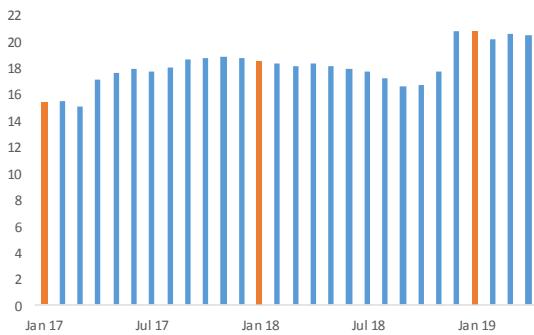
Nevertheless, the greenback stays in upward trend with quotations at 1.12 (as of May 8). The USD finds support from strong statistics, that signal the American economy is outperforming rivals.

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



U.S. government debt prices rise amid trade war threat. Traders are closely following trade relations between the U.S. and China. U.S. officials confirmed Tuesday that there will be higher tariffs on Chinese goods later this week. Such situation creates uncertainty and excite investors' interest to safe havens. As of May 8 the yield on the benchmark 10-year Treasury note, which moves inversely to price, fell to 2.44%.

Figure 7. FX Reserves (USD bn)



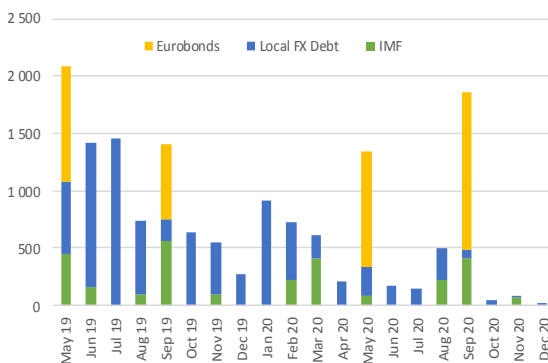
NBU increases FX purchases to build up reserves

Ukraine's FX reserves contracted by slight 0.5% to USD20.525 as of May 1. The current amount covers 3.4 months of future imports and is sufficient for Ukraine to meet its obligations, according to the NBU.

Despite huge pay offs on sovereign debt, totaling an equivalent of USD0.88bn, they were largely made up by revenues from the placement of FX local bonds, totaling USD0.42bn. Besides, the NBU has doubled net FX purchases in the interbank market in Apr to USD0.3bn on the back of favorable external price conditions for Ukrainian exports and record high nonresident investments in UAH local bonds (over USD0.57bn in Apr).

We expect FX reserves to decrease next month due to large external debt repayments ahead. Ukraine is to pay off over USD2.5bn on public and publicly guaranteed sovereign debt in May, incl. about USD0.45bn on liabilities to the IMF and USD1bn on the Eurobonds guaranteed by the U.S. In order to meet these expenses, the MinFin piled up by the end of Apr UAH36.85bn on the treasury account UAH53.8bn (in the UAH equivalent) on the FX accounts.

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



While there are some amounts to be repaid on FX local bonds, we saw last month the MinFin replaced maturing issues with another ones of the same kind. We expect the government will manage to follow this pattern with a rest of bonds coming due this month.

As for further perspective, **we see the NBU has a potential to succeed in its plans to increase reserves by the end of 2019** to over USD21bn. Since the beginning of the year the FX supply and the volume of trading in the interbank FX market continue to grow and the decision of the NBU to increase the planned volume of interventions on the interbank FX market by USD5mn to USD20mn will be supportive to restoring FX reserves.

Moreover, the inflow of foreign capital into government securities accelerated significantly and presumably stay high in spite of the recent NBU's decision to cut the key interest rate. We assume the dovish sentiments, prevailing among world's leading central banks, to keep interest to Ukrainian high yield bonds.

However, further cooperation between Ukraine and the IMF holds a critical importance for building up Ukraine's FX reserves and repayment of maturities due in late 2019. The mission of the Fund is to arrive in the mid-May. We do not expect IMF disbursements following this visit and stick to our previously announces supposition, that the further cooperation will be contingent on broad consultations between the Fund and the new president's team. Presumably, such consultations will take place during the May's visit. If this is a case, the next IMF tranche might arrive in the second half of this year.

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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	16.00	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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