



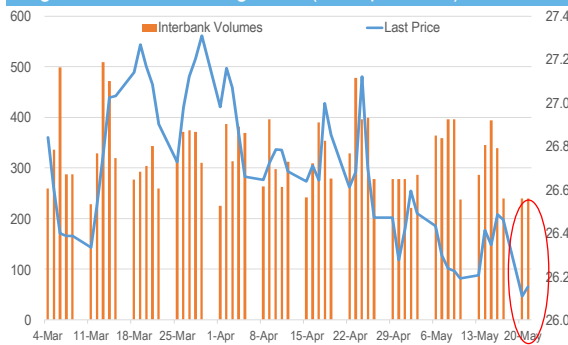
ECONOMICS | INTEREST RATES STRATEGY | FX

22 May 2019

**UKRAINIAN
CAPITAL MARKETS
WEEKLY**

	Rating	Outlook	Last update	This week in focus: Newly-inaugurated president went to the country
Fitch	B-	STABLE	08.03.2019	Volodymyr Zelensky took the office as Ukrainian president on Monday, May 20, and immediately exercised his constitutional right to dissolve the parliament. The current Rada will continue to work until the members of the next parliament are sworn in. Hence, formal termination of the Rada's powers doesn't materially increase current political uncertainty.
S&P	B-	STABLE	12.04.2019	
S&P (N)	uaBBB	-	12.04.2019	
Moody's	Caa1	STABLE	21.12.2018	

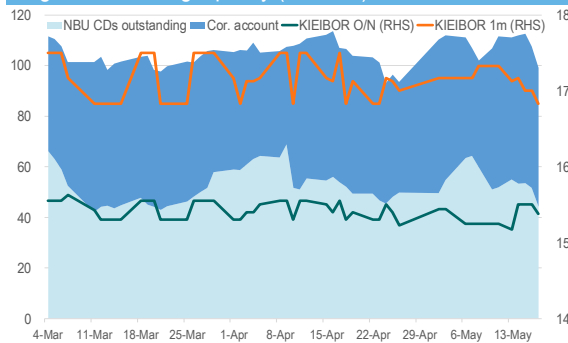
Figure 1. UAH exchange rate (UAH per USD)



FX and interest rates: UAH looks shaky after tax deadline

UAH made a comeback at the beginning of this week, rising against USD to 26.1 by the end of Monday (May 20). The hryvnia exchange rate largely benefited from FX sales, that increased before the tax payment deadline on May 20. The dissolution of the Verkhovna Rada, announced by the new president on May 20, and the possible resignation of the government didn't have significant effect on the hryvnia exchange rate. Along with that, further political developments and delivery on key reforms will have a decisive impact on UAH trade course. The course of negotiations with the IMF mission, which is currently in Kyiv for assessment of the implementation of the current Stand-By Arrangement, will be a benchmark in this regard.

Figure 2. Banking liquidity (UAH bn)



On Wednesday (May 22) UAH bounced off versus USD after poor government's bonds auction and stalled slightly below 26.3.

Banking liquidity fell below USD100bn by the end of the last week. The balance of deposits on correspondent accounts with the NBU dipped by 7.9% to UAH55bn, investments in CDs decreased by 14.8% to UAH44.2bn.

The decrease of liquidity in the system during the past week was attributed to the quarter tax payments, which were due by May 20. Some demand on the liquidity came from the cash market and was induced by combination of cash withdrawals after mid-month salary repayments and temporary demand on cash FX.

Figure 3. Correspondent account balances (UAH bn)



Despite large redemptions of local government bonds, these repayments, together with modest NBU injections through the interbank FX market, didn't offset liquidity outflow, that was seen during the last week.

We expect banking liquidity will continue narrowing by the end of the current week.



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Figure 4. Local UAH bonds market

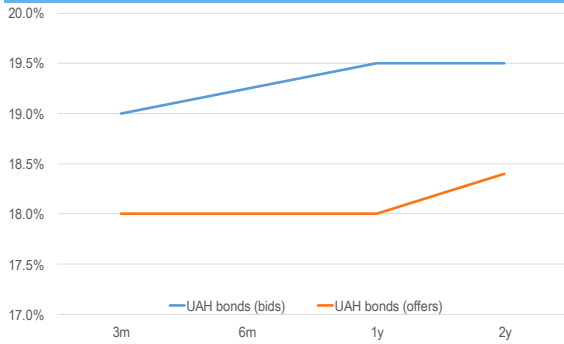
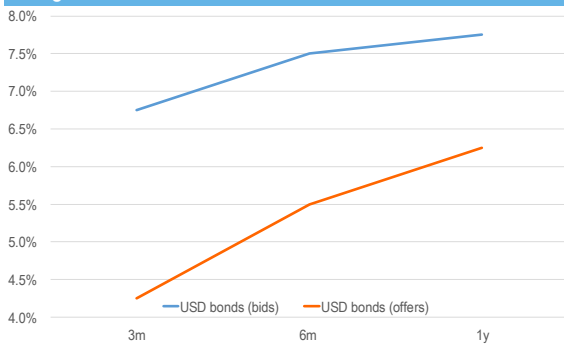


Figure 5. Local USD bonds market



Government bond market

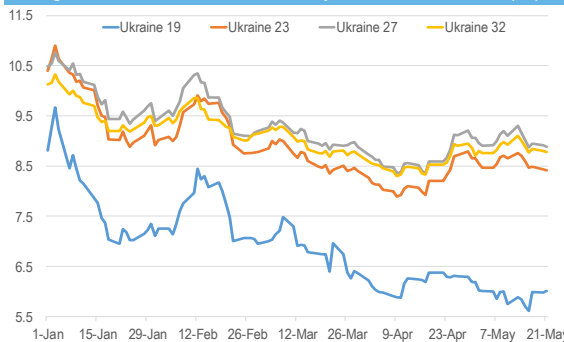
CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size, mn	Placement size, mn
UAH	3m	17.89%	17.89%	18.50%	17.89%	18	8	674.614	500
UAH	6m	18.50%	18.37%	18.50%	18.25%	16	16	319.48	319.48
UAH	1y	18.50%	18.50%	18.50%	18.50%	15	15	498.17	498.17
UAH	1.5y	18.00%	17.95%	18.50%	17.95%	13	9	528.46	345.46
UAH	3y	16.00%	16.00%	16.10%	16.00%	8	7	668.20	667.20
USD	6m	6.70%	6.70%	6.70%	6.70%	16	16	97.23	97.23
USD	1y	7.25%	7.25%	7.25%	7.25%	11	11	8.62	8.62
USD	1.5y	7.75%	7.74%	7.75%	7.50%	26	26	6.39	6.39

FinMin has attracted UAH5bn (equivalent) on the primary auction held May 21st. The key demand was on 3m UAH bonds, totaling to UAH674.6mn. The Ministry, however, continued to limit the bonds offer and satisfied only 10 of 18 applications, for UAH500mn, pushing the cut-off rate on 3m UAH down to 17.89% from 18.5% a week before. Cut-off rates for the rest of UAH bonds generally stayed unchanged within a range 16.00%..18.50%.

Sales of USD-denominated bonds doubled to USD112mn comparing to the previous auction. The key demand was on 1y bond at the rate of 6.7%.

According to the NBU the international accounts decreased participation in the FinMin auctions in May comparing to April. We attribute this cooling of interest to the current political uncertainty. We expect, however, that attractiveness of UAH government bonds will restore after connection of the Ukrainian market to Clearstream system in late May.

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



USD gain on safe haven flows

The USD rises since beginning of the week amid heightened trade tensions between the United States and China, which revived risk aversion amid investors. The greenback reached 1.1157 against euro by the end of Wednesday (May 22), however, has not quite succeeded in going further ahead of the release of Federal Reserve meeting minutes. The Fed is expected to provide insight into its May 1 meeting, when policymakers left interest rates unchanged and signaled little appetite to adjust them any time soon.

As for EUR, the recent data releases in Euroland and Germany have poured cold water over the idea that some healing process could be under way in the region. The broad-based risk-appetite trends and USD-dynamics should dictate the sentiment surrounding the European currency for the time being.

Figure 7. EUR USD spot (mid)



U.S. government debt yields copy the USD dynamic, benefiting from sell-offs on the stock markets amid increasing trade war fears. Bonds are largely seen as a safer investment relative to stocks. Hence, money usually flows into bonds when investors see downside economic or political risks on the horizon.

By the end of Wednesday the benchmark 10-year Treasury yield lowered to 2.4% and stalled on this level as investors await the minutes of the Federal Reserve's latest meeting.

Election Timeline

Newly-inaugurated president went to the country

Date	Event
May 21	Dissolution of the Parliament
tbc	Start of the election campaign
Jul 21	Parliamentary elections, voting
till Aug 11	Parliamentary elections, results
till Sep 4	New parliament convenes its first meeting
till Oct 4	A coalition of parliamentary factions shall be formed

Following landslide victory, Volodymyr Zelensky took the office as Ukrainian president on Monday, May 20. The power transfer process was fair, transparent and leaved no doubts about the new incumbent legitimacy.

Right after taking the oath the new president decided to exercise his constitutional right and dissolved the parliament. According to the president order, the snap elections will take place on Jul 21.

Moreover, the president suggested that the government resign. With regard to this suggestion, the prime minister Volodymyr Groyzman announced his resignation following a meeting of the government on May 22.

Despite some legal ambiguity relating to the president's authority to dissolve the Rada, most of parliamentary factions publically expressed their intention to take part in snap elections, therefore indirectly supporting the process. Hence, **we do not expect possible legal proceedings will succeed in putting in question legitimacy of the Rada dissolution.**

As for the government's state, pursuant to the Constitution it is the parliament's right to dismiss the prime minister, and the resignation of the last results in the resignation of the entire cabinet of ministers. At the same time, there was a clear will of Groyzman's to step down expressed by him in public statements. Hence, **we expect the Rada will support prime minister resignation.**

The current Rada will continue to work until the members of the next parliament are sworn in. However, the Rada's strength to deliver on further reforms is in question, given debate over existence of coalition in the parliament. Even adoption of the bill on criminal liability for illegal enrichment, important for further cooperation with the EU and the IMF, remains unclear. Hence, formal termination of the Rada's powers doesn't materially increase current political uncertainty.

Unlike the case with the Rada, there is more uncertainty who will run the Cabinet of Ministers. There should be a decree naming the person who will fulfil the premier's duties. Approval of this person rests with the Rada, which might postpone or impede appointing any of candidates. Though we expect Ukraine will be able to maintain macro financial stability in short-term, in the mid-term the country needs to continue cooperation with the IMF, which has to be signed by the prime minister.

In conclusion, the new president's ability to govern effectively and to comply with IMF demands widely depend on successful cooperation with the parliament. **We think the new president has chosen a right political momentum for radical decisions, continuing benefiting from his landslide victory.** The blitzkrieg approach bolster chances of his Servant of the People party, which clearly enjoys strong president's support and leaves its adversaries unprepared to contest elections.

At this moment, however, it is too early to make assumptions what parties will be presented in the new Rada. Despite many political parties declared their intentions to take part in snap elections, there is no clear view about their future structures, and hence reliable polls about their chances. As for the Servant of the People party, its support will be highly dependent on the president's first initiatives.

As for the further cooperation with the IMF, the mission of the Fund has arrived in Kyiv on May 20 and will work in Ukraine for two weeks. Despite the mission plans to assess the implementation of the current stand-by arrangement, we do not expect IMF disbursements following this visit. Nevertheless, **the high importance will have the course of negotiations between the president's team with the Fund.**



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Key Macroeconomic Indicators								
	2013	2014	2015	2016	2017	2018	2019F	2020F
Real sector								
Real GDP (%YoY)	0.00	-6.60	-9.80	2.30	2.50	3.30	2.70	3.00
Industrial production (%YoY)	-4.30	-10.70	-6.00	2.40	-0.10	1.60	0.00	1.20
Retail sales (%YoY)	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 %YoY)	-0.20	12.10	48.70	16.50	14.40	10.50	9.20	8.10
CPI (end of year %YoY)	0.50	24.90	43.30	12.40	13.70	9.80	8.50	7.20
Real average wage growth (%YoY)	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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