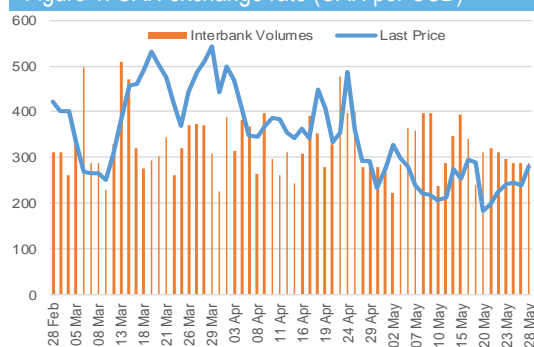


ECONOMICS | INTEREST RATES STRATEGY | FX

29 May 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

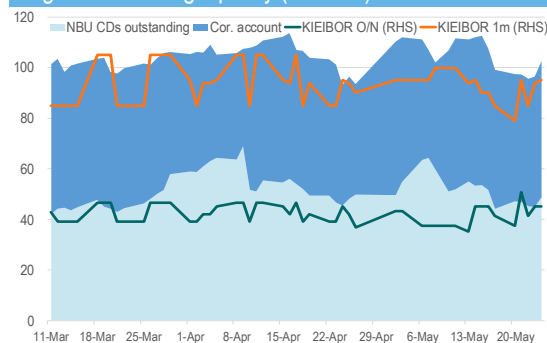
	Rating	Outlook	Last update	This week in focus: Industrial production records leave pleasant after-taste
Fitch	B-	STABLE	08.03.2019	Growth of industrial production index accelerated to 5.2% y/y in April from 2.1% in March on the back of manufacturing segment, that registered robust growth for second consecutive months. We point out continuous expansion of investment goods and We put on revise our no growth (0.0%) forecast for Ukraine's industrial production this year.
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: USD/UAH dips after lump VAT refunds

The week started in slow motion: bearing in mind that the US markets were closed due to the Memorial Day Holiday, key payers at the Ukrainian interbank FX market largely put off their operations till the next day. On Tuesday this pent up demand dragged UAH against US toward 26.5. **We assume a buying pressure was induced by large amount VAT refunds, we saw last Friday (May 24), and exaggerated by speculative trades at the end of the day.**

NBU FX purchases increased to USD70mn last week from USD22mn a week before. Banking liquidity has limited impact on FX quotations.

We expect VAT refunds will continue weighing on the FX market till the end of the week and will subdue FX supply at the beginning of June. On the other hand, there are stable FX injections from non-residents, which hold appetite to UAH local government bonds and might be willing to expend their portfolios on the back of linking Ukraine to Clearstream network. Since beginning of the current year foreign investors' holdings in Ukrainian domestic government bonds increased to UAH41.5bn (USD1.57bn as of May 27) from UAH6.3bn and continue growing.

Figure 2. Banking liquidity (UAH bn)


Banking liquidity restored to above UAH100bn from the month's lowest level recorded on May 22 (UAH95.6bn). Figures from the NBU on Friday May 24 showed the amount of cash deposited by banks at the central bank jumped to UAH54bn from UAH50.5bn a three days before, investments in CDs increased by UAH4.6bn to UAH48.8bn

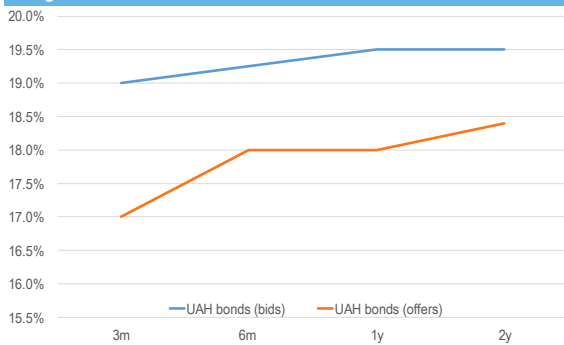
Figure 3. Correspondent account balances (UAH bn)


After a series of exhausting corporate tax repayments during last week, banking liquidity built up by the end of Friday, mainly due to extensive VAT refunds from the state budget on Friday (UAH3.3 were refunded on May 24).

There were also some liquidity injections from the NBU during last week, both trough FX interventions, which amounted to USD70mn, and refinancing tenders, which improved the balance of bank's liquidity by UAH1.1bn (during the auction five banks were provided with UAH4.2bn of fresh liquidity for the next 14 days while 3 banks returned UAH3.1bn of loans of similar tenure to the central bank).

We expect that banking liquidity to improve slightly by the end of the week on the back of further VAT refunds, which will help to offset upcoming repayments on the UAH local government bonds.

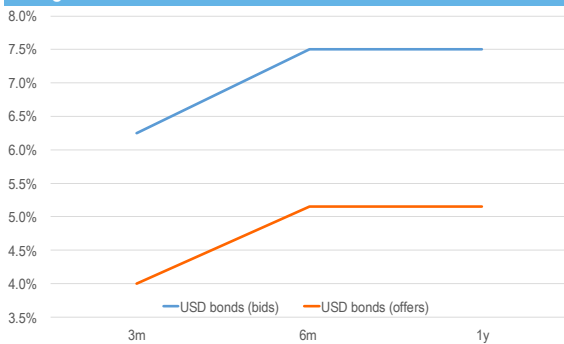
Figure 4. Local UAH bonds market



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	18.00%	18.00%	18.50%	18.00%	7	4	46.48	32.94
UAH	6m	18.50%	18.32%	18.50%	18.19%	10	10	500.14	500
UAH	1y	18.50%	18.50%	18.50%	18.50%	11	11	836.83	836.83
UAH	2y	17.95%	17.95%	17.95%	17.95%	6	6	29.05	29.05
USD	8m	7.25%	7.25%	7.25%	7.25%	9	9	12.88	12.88
USD	1.5y	7.25%	7.25%	7.50%	7.25%	10	9	4.06	3.86
USD	1.2y	3.85%	-	-	-	1	1	73	73

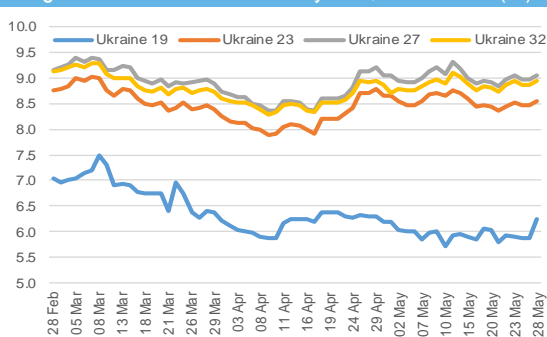
Figure 5. Local USD bonds market



FinMin attracted UAH3.6bn (equivalent) on the primary auction held on May 28. The key market demand was for 6m and 1y local currency bonds (UAH1.34bn in total), which were sold at rate 18.50%. The take-up of 3m and 2y bonds reduced to a slimmer UAH75mn in total from billions placements during previous auctions. Cut-off rate for short-term bonds went up to 18% from 17.89% a week before, for long-term ones stayed unchanged at 17.95%. Demand for USD bonds was also very modest, if exclude securities with put option for USD73mn, which traditionally were sold to one buyer at rate 3.85% per annum.

We see FinMin continue straggling with investors for yields, hoping for further softening of the Ukrainian central bank's monetary policy and for a fresh foreign accounts inflow after the Clearstream connected Ukrainian government bond's market to its network on May 27. These hopes, however, were partially dimmed this week by the ex-co-owner of PrivatBank Igor Kolomoysky, who recently suggested to declare default on Ukraine's debts.

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



USD rise further amid a renewed risk-aversion wave

The euro has been dipping starting from Monday as investors nervous about results of European parliamentary elections. While pro-Europe parties kept a majority of seats in the parliament, support grew for euroskeptic parties. The markets are still digesting the European election results and the focus moved to who gets top EU posts.

Regarding the USD, the markets continue watching every development in the US-Sino trade tension. Despite it has not increased in recent days -- the US has not imposed new tariffs -- a trade war persists. US President Donald Trump at the moment continues his visit to Japan and has repeated his stance that the US is not ready to make a deal with China just yet. As of May 29 the greenback edged up against the euro to 1.1152.

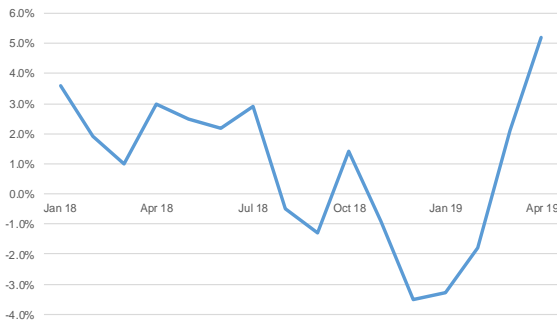
Figure 7. EUR USD spot (mid)



The US Treasury yields rise across the curve as a renewed risk-aversion wave gripped the markets amid escalating US-Sino trade tension. The yield on the benchmark 10-year Treasury note fell to a 19-month low on Wednesday (May 29) to 2.227% due to a growing number of believe that the trade war will last longer and afflict GDP growth more than first thought.

Besides, FI investors are focused on how the U.S. Federal Reserve will react to a worsening economic outlook end expects that the central bank to cut its overnight lending rate later in 2019 as the mounting trade disputes weigh on economic forecasts.

Figure 8. Industrial production index growth, % y/y



Industrial production records leave pleasant after-taste

Growth of industrial production (IPI) index accelerated to 5.2% y/y in April from 2.1% in March on the back of manufacturing segment, that registered robust growth for second consecutive months, according to UKRSTAT data.

The growth within the manufacturing sector was broad based with 11 of the 17 key industry groups showed a positive dynamic in March. The highest positive contributor was a metallurgical industry (up by 9.9% y/y) which continue restoring production after transportation challenges in the Sea of Azov in 2H18 and upon completion of planned repair works at several large metallurgical enterprises.

While on the month to month basis metallurgical industry contracted by 1.7% in March, we see a base effect took place there after high growth in previous month.

The same pattern followed mining industry, which grew by 2.7% y/y in April (0.7% m/m) after a rise of 1.8% y/y in March (12% m/m).

Food industry growth seasonally decelerated to 6.6% y/y (17.1% m/m) in April from 7.3% y/y in March (17.1% m/m), however, still holds positive impact to total IP dynamic.

In terms of goods categories, we point out continuous expansion of investment goods, driven respectively by items such as machinery, equipment, and tools.

Moreover, there are clear signs that the revival in investment activity will be sustained for some more time, taking improved businesses' expectations about economic growth in Ukraine and their own developments, as well as favorable at the moment situation on FX and energy markets.

We put on revise our no growth (0.0%) forecast for Ukraine's industrial production this year as a seasonal factor, we saw last year, played a less intensive role since beginning of the current year.

Figure 9. Industrial production index growth, % m/m

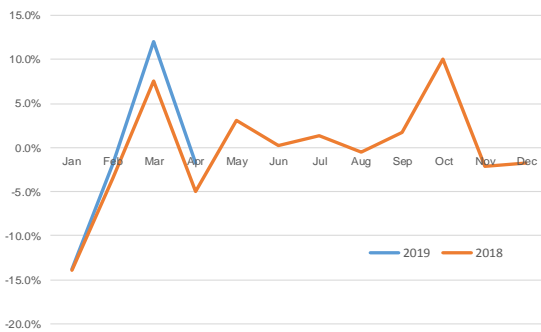


Figure 10. Contributors to IPI month growth

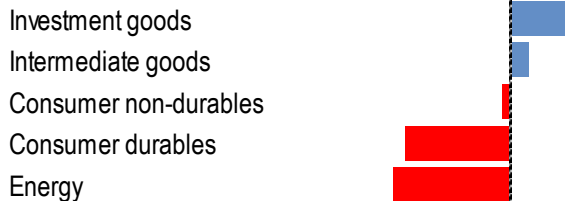
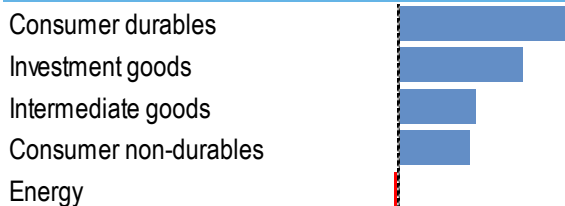


Figure 11. Contributors to IPI year growth



UKRAINIAN CAPITAL MARKETS WEEKLY

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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