

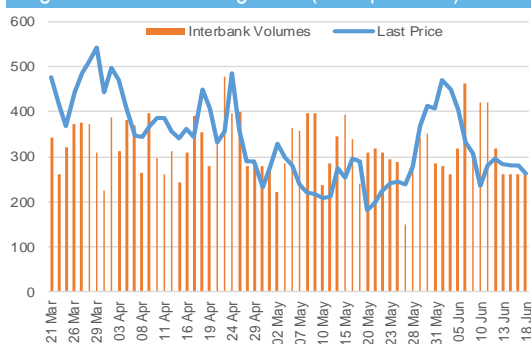
ECONOMICS | INTEREST RATES STRATEGY | FX

19 June 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

	Rating	Outlook	Last update	This week in focus: NBU puts rate cuts on hold
Fitch	B-	STABLE	08.03.2019	The NBU Board approved keeping the key policy rate at 17.5% per annum at the monetary policy meeting held on June 6. The decision was supported by seven out of eight MPC members. We expect new pro-inflation factors, that have arisen recently, will hinder the central bank from resuming monetary policy easing at the next MPC meeting on July 18.
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 consolidates gains on stable FX supply

The USD/UAH rate keeps following downward path on the back of stable inflow of foreign currency (FX) from exporters. Since the previous report, the hryvnia has appreciated against the greenback just below 24.4 by the end of June 18, and at the time of writing the UAH to USD exchange rate was seen at 24.35.

Despite the NBU has increased FX purchases by 31.5% last week, FX supply steadily stayed above the demand, thanks for exporters, which were actively selling FX in order to meet their monthly payments in local currency, incl. tax outlays.

Looking ahead, we would point out the NBU decision to lift surrender requirement to sell 30% of foreign currency proceeds starting from June 20, and growing demand for FX from importers.

Taking into account that business used to sell 90% of export revenues after the NBU lowered surrender requirement to 30% from 50% starting from March 1, we expect the last central bank's action will have limited impact on FX market.

Regarding growing demand for FX, we expect energy products' importers, as well as other importers, might increase foreign currency purchases through the final decade of the month, since the next week will be short again.

Ukrainian banking system liquidity increased by a modest UAH0.5bn to UAH101.3bn by the end of last week. As expected prior to a long weekend, demand on cash money increased to UAH8.23bn from UAH5.41bn a week before. This outflow, however, was more that counterbalanced by an inflow of UAH8.56bn, of which UAH3.56bn (USD135mn) represent the central bank's interventions in the domestic FX market, and UAH4.97bn represent the State treasury's operations.

There were also the NBU monetary operations, totaling UAH9.72bn. However, these operations reflect decrease of investments in certificates of deposits (CD). Specifically, banks' portfolio of O/N CD's contracted by UAH6.8bn to UAH8.8bn and of 14-day CD's – by UAH2.8bn to UAH2.5bn.

Figure 2. Banking liquidity (UAH bn)

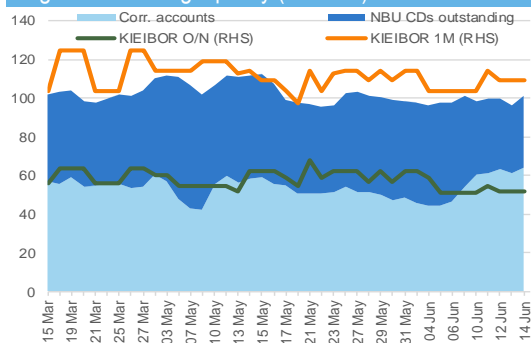


Figure 3. Correspondent account balances (UAH bn)

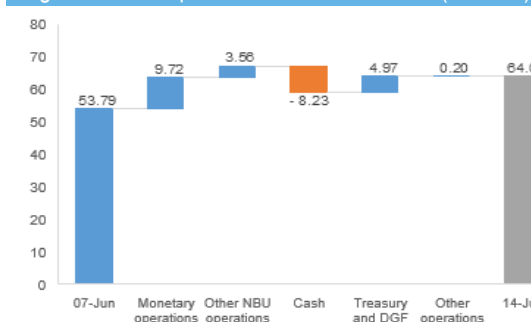
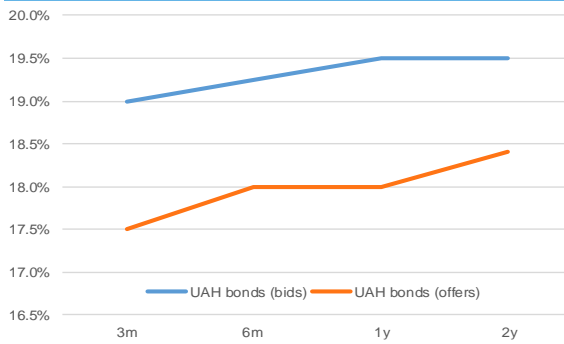


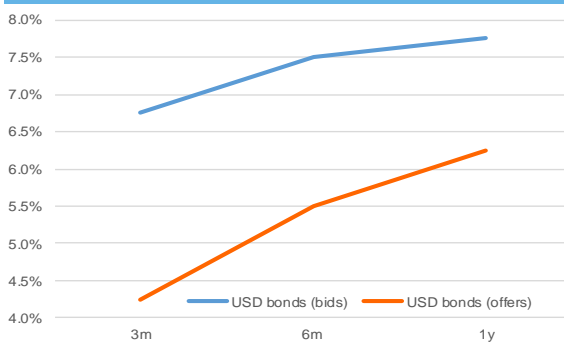
Figure 4. Local UAH bonds market



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	17.85%	17.85%	18.50%	17.85%	13	7	1 229.9	500
UAH	6m	18.35%	18.34%	18.50%	18.25%	18	15	795.8	500
UAH	1y	18.45%	18.45%	18.50%	18.43%	18	17	699.89	699.6
UAH	2y	17.95%	17.95%	17.95%	17.95%	8	8	290.2	290.2
USD	9m	7.25%	7.25%	7.25%	7.25%	12	12	34.6	34.6
USD	1y	7.25%	7.25%	7.25%	7.25%	11	11	53.2	53.2
USD	2y	7.75%	7.75%	7.75%	7.75%	16	16	14.8	14.8
EUR	6m	4.60%	4.60%	4.60%	4.50%	9	9	112.6	112.6

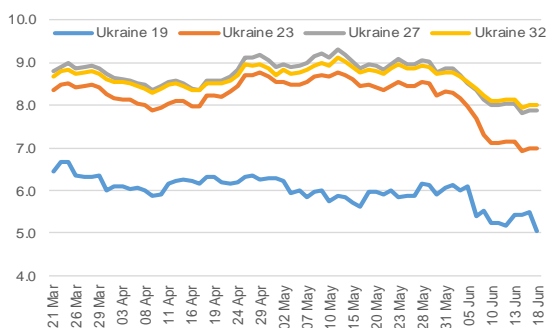
Figure 5. Local USD bonds market



FinMin attracted UAH7.9bn (equivalent) on the primary auction held on Jun 18, with the majority of funds attracted through placement of local bonds denominated in foreign currency. The highest demand was for 6m notes denominated in euros: securities for EUR112.6mn were placed at rate 4.6% per annum. Worth mentioning, that FinMin last week issued 7y eurobonds worth EUR1bn at 6.75% per annum.

Regarding government bonds in local currency, the ministry followed its already traditional approach of pushing rates down through limiting offer. In particular, FinMin has limited proposal of 3m and 6m notes with amount of UAH500mn each, and hence managed to cut interest rates to 17.85% and 18.35% respectively. Demand for 1y and 2y UAH bonds was UAH700mn and UAH290mn respectively. The rates for the securities stayed unchanged at 18.45% and 17.95% respectively.

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



USD bounced to two-week highs as rate-cut bets rise

The dollar rose to two-week highs of \$1.1181 (as of June 19) against the euro ahead of the Federal Reserve's (Fed) decision on whether to adjust interest rates.

While investors expect the Fed to leave interest rates unchanged, many expect hints at the central bank's ability to cut rates later in the year in light of global trade tensions. On the other hand, U.S. President Donald Trump said on Tuesday he would have an extended meeting with Chinese President Xi Jinping at the G20 summit later this month, raising hopes they can ease tensions in a trade dispute. The Fed is scheduled to release its monetary policy statement on June 19.

Figure 7. EUR USD spot (mid)

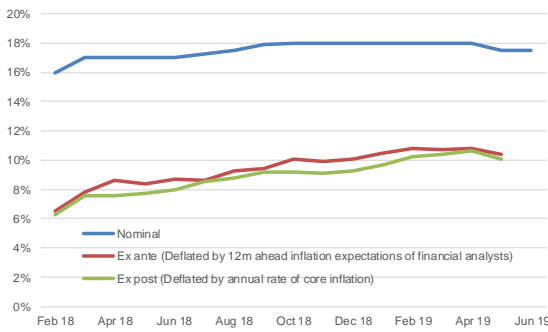


The dollar's rise was in part spurred by a weaker euro, which fell after ECB chief Mario Draghi said policymakers will provide more stimulus if inflation does not pick up.

The ECB statement has also sent global bond yields tumbling, with U.S. 10-year Treasury yield falling to 2.084%. At the moment the notes yield hovers near 2.09% per annum as market awaits Fed rate decision.



Figure 8. Key policy rate



NBU puts rate cuts on hold as consumer demand stays too strong

The NBU Board approved keeping the key policy rate at 17.5% per annum at the monetary policy meeting held on June 6. The decision was supported by seven out of eight monetary policy committee members (MPC), which pointed to growing pro-inflationary risks on the back of strong consumer demand.

Hawkish MPC members highlighted, that retail turnover might continue growing rapidly as for one thing, the NBU's assumption about abating wage growth had not materialized, and for another thing, consumer lending stays on steady growth path.

The only MPC member, that argued for lowering key policy rate by 50bp, said that monetary policy tools have a limited impact on these pro-inflationary factors, while the actual real rate is excessively high and might give a boost to increase of the current account deficit through support to local currency.

MPC members agreed on resuming monetary policy easing if food and global energy prices keep going down, inflation expectations continue improving, Ukraine receives the IMF financing this year, and the local currency stays strong. At the same time, some MPC members were cautiously optimistic about receiving financing from the IMF amid the present high political uncertainty, and warned of likely high volatility in the financial markets in autumn, when large repayments on the external sovereign debt come due.

Figure 9. Retail turnover, %

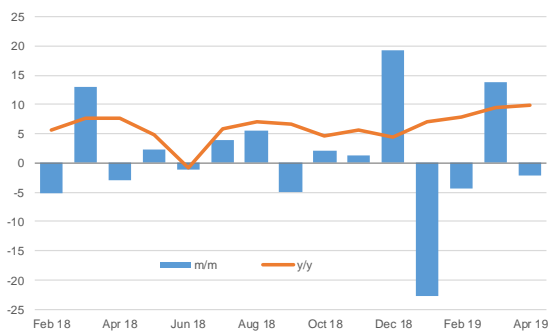
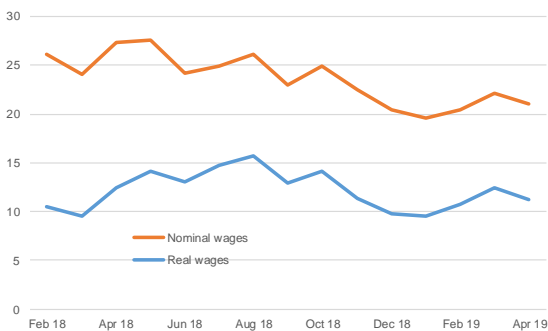


Figure 10. Nominal and real wages growth, % y/y



The next MPC meeting is scheduled for July 18. As we mentioned previously, fresh pro-inflation factors have arisen recently, namely Russia's embargo on exports of oil and petroleum products to Ukraine, and launching of a new electricity market in Ukraine. These factors might hinder the central bank from resuming monetary policy easing at the next MPC meeting. At the same time, we admit that these inflation factors have some political dimension. Taking this into account, we prefer to stick to our baseline scenario that envisages CPI slowdown to 8.5% y/y and the key policy rate cut by 200-250 bp by the end of the current year.



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



Contacts

Investment Business Group

Serhiy Yahnych

Head of Investment Business

(+38044) 537-50-82 serhii.yahnych@ukrsibbank.com

Viktoriia Nebeska

Market Making Government Bonds

(+38044) 201-22-74 viktoriia.nebeska@ukrsibbank.com

Platon Yachmenov

Sales Local Securities

(+38044) 230-48-54 platon.yachmenov@ukrsibbank.com

Mykhailo Kharchuk

Market Analysis

(+38044) 537-49-75 mykhailo.kharchuk@ukrsibbank.com

Distribution of Capital Markets Weekly report:

macro@ukrsibbank.com



FX Business

Oleksandr Duda

Head of FX Sales

(+38044) 537-50-02 oleksandr.duda@ukrsibbank.com

Corporate Business

Ievgen Kulikov

Head of MNC team

ievgen.kulikov@ukrsibbank.com

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