

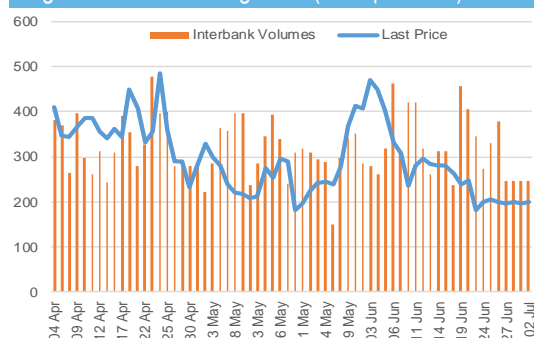
ECONOMICS | INTEREST RATES STRATEGY | FX

3 July 2019

UKRAINIAN CAPITAL MARKETS WEEKLY

| | Rating | Outlook | Last update | This week in focus: Sovereign debt weights on BoP, but looks manageable |
|---------|--------|---------|-------------|---|
| Fitch | B- | STABLE | 08.03.2019 | 12M rolling BoP surplus decreased in May by 32.3% to USD2.13bn compared with the April's readings, according to the NBU. The change was mainly driven by redemption of sovereign USD1bn Eurobonds, while 12M rolling CA deficit decreased by 8.4% to USD3.8bn, thanks to growing exports of agricultural products and stable migrants' remittances. |
| 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)



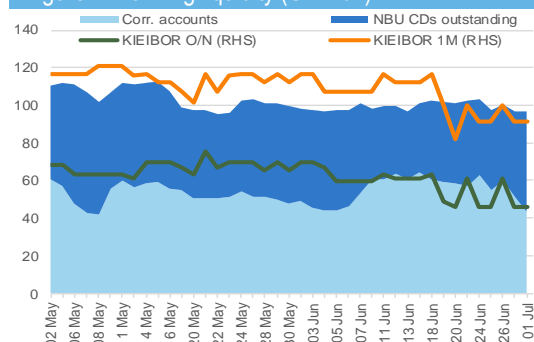
FX and interest rates: UAH is set to test year's highs near 26.13 vs USD

UAH continues strengthening, though at a snail's pace, toward year's highs near 26.14 against USD. While FX supply by exporters generally meets with importers demand, we see stable inflow of fresh USD liquidity from foreign accounts as non-residents continue expending purchases of government local currency bonds. During the last week their portfolio of the government securities increased by UAH6bn (circa USD230mn) to UAH57bn (USD2.18bn).

Another source of FX liquidity is a cash market, where UAH quotations vs. USD stay below the interbank level, thanks to stable migrants' remittances.

Excess FX liquidity, however, used to be effectively picked up by the NBU and several large buyers, likely energy products importers and non-resident subsidiaries, that repatriate dividends to head offices.

Figure 2. Banking liquidity (UAH bn)



The market looks too weak to reverse in a short-term the current trend of the UAH/USD pair. Though some sellers from time to time make attempts to enhance volatility, the market does not support their efforts. Furthermore, amount of liquidity in the banking system fell to 3m low level by the end of Tue (Jul 2). This fact will impede any sharp movements of the pair in short-term run.

On the other hand, we do not rule out local corrective rebound of hryvnia, which might be prompted by traditional for the first decade of month demand for FX coming from non-resident subsidiaries.

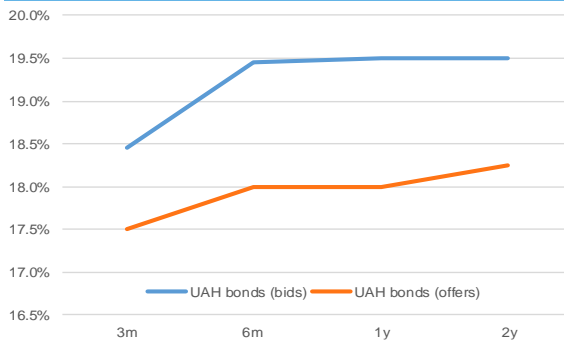
Figure 3. Correspondent account balances (UAH bn)



Banking system liquidity contracted by the end of last week below UAH100bn benchmark level. While banks' investments in CDs almost didn't change, amounts deposited on correspondent accounts with the NBU fell to UAH51.3bn due to redemption by some banks of refinancing loans before the central bank and allocation of some liquidity into the government bonds.

We see banking liquidity continue declining since beginning of the current week, and is currently below the NBU's mandatory reserve requirements at UAH51.5bn. The main draining factors in the first dates of the month used to be cash withdrawals after monthly salaries have been transferred. We expect, however, that banking liquidity will restore by the end of the week on the back of upcoming government bonds redemptions and expected liquidity injections by the NBU, both through interventions and monetary operations.

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 | 17.44% | 17.44% | 18.00% | 17.44% | 12 | 3 | 859.01 | 500.00 |
| UAH | 6m | 17.94% | 17.91% | 18.35% | 17.89% | 25 | 11 | 1 947.97 | 500.00 |
| UAH | 1y | 18.30% | 18.23% | 18.40% | 18.19% | 33 | 21 | 2 741.10 | 2 129.89 |
| UAH | 1.5y | 18.00% | 17.98% | 18.25% | 17.80% | 7 | 5 | 1 445.00 | 1 330.00 |
| UAH | 2y | 17.95% | 17.94% | 17.95% | 17.85% | 23 | 23 | 2 448.99 | 2 448.99 |
| UAH | 3y | 16.95% | 16.93% | 19.95% | 16.90% | 12 | 11 | 1 135.02 | 1 110.02 |

FinMin attracted UAH8bn on the primary auction held on Jul 2. The Ministry offered solely hryvnia-denominated bonds with maturity ranging from 3m to 3y. The highest demand was for 1y securities, totaling UAH2.7bn. FinMin, however, repelled 12 bids with rates exceeding cut-off rate at 18.3% and, hence, satisfied applications for only UAH2.1bn.

Demand for short-term bonds stay strong in spite of FinMin's further limitations of offer with amount of UAH500mn for the sake of pushing rates down. During the auction the Ministry managed to cut rates for 3m and 6m securities by 31bp to 17.44% and 17.94% per year respectively.

Foreign currency denominated local bonds were not offered this time. According to the FinMin's auctions calendar for 3Q19, such securities will be offered only once in Jul (on Jul 16) and at a few auctions in Aug.

Figure 5. Local USD bonds market

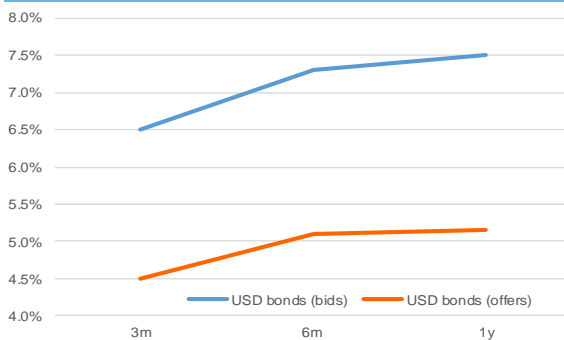
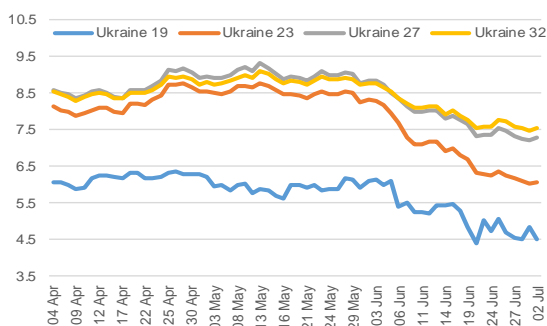


Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



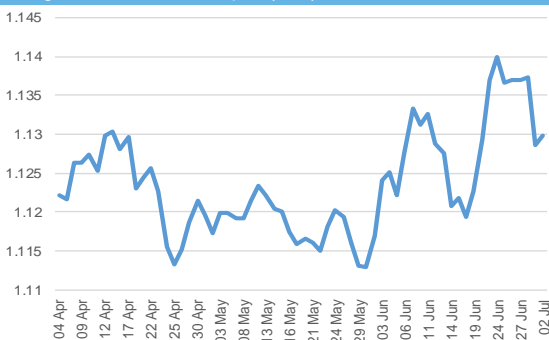
USD regain strength on revived Sino-U.S. trade deal hopes

The EUR/USD pair rebounded to 1.13 by the end on Tue (Jul 2) from the previous week's peak at 1.14 (on Jun 24) after the United States and China agreed to restart their troubled trade talks. Better than expected outcome of U.S. President Donald Trump and Chinese counterparty Xi Jinping's meeting on the sidelines of the G20 meeting has prompted investors selling safe-haven currencies.

In addition, EUR is deriving extra downside pressure after yields of the German benchmark 10-year bonds fell to all-time lows near the "minus" 0.40% level.

The renewed dovish stance from the ECB and USD-dynamics should dictate the price action around the pair in the near term, helped at the same time by the broad risk-appetite trends and expected positive developments from the U.S.-China trade front.

Figure 7. EUR USD spot (mid)



The yield on the 10-year Treasury note fell below the psychologically important 2% level to 1.953% as of Tue (Jul 2). This comes after concerns about global economic growth pushed investors toward safer assets, with some skeptical investors doubting further quick progress in trade negotiations between U.S. and China.



Figure 8. 12M rolling BoP, USDbn

Sovereign debt weights on BoP, but looks manageable

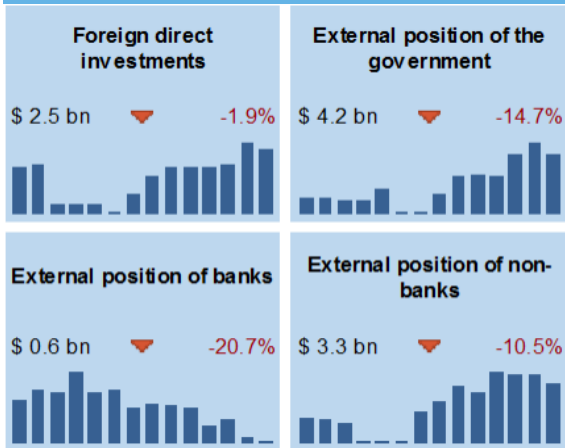


Consolidated balance of payments (BoP) deficit increased to USD750mn in May from USD45mn in April, according to the National bank of Ukraine (NBU). 12M rolling BoP surplus decreased in May by 32.3% to USD2.13bn compared with the April's readings.

One of two debt repayment peaks has been passed: contraction of the overall balance was mainly driven by redemption of sovereign USD1bn Eurobonds guaranteed by the U.S. government.

Worth mentioning, however, that financial account stays broadly weak, with 12m rolling FDIs decreased by 1.9% to USD2.5bn and real sector external position shrank by 10.5% to USD3.3bn. This might be attributed to high political uncertainty, stemming from this year's double elections, which weigh on investment plans and debt prices. The next repayment "spike" comes in September, totaling circa USD1.9bn.

Figure 9. Financial account main components

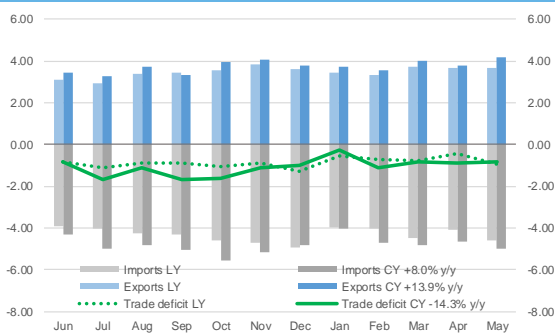


A supportive global backdrop: 12M rolling current account (CA) deficit decreased in May by 8.4% to USD3.8bn compared to April, thanks to exports of agricultural products, which jumped in May by 34.1% y/y to USD1.8bn. Another major exports contributor – metallurgy industry - however, contracted foreign sales by 7.1% y/y to USD1bn, likely due to repair works at some facilities.

In general, we see trade balance deficit roughly stays constant. Despite hryvnia follows appreciation trend since beginning of the current year, this factor has not affected volume of import operations so far.

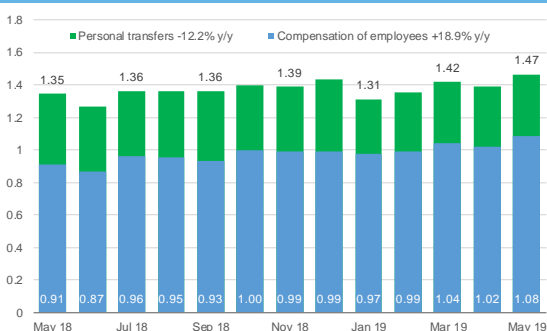
Migrants' remittances is another supportive factor, that might help counterbalance growth of imports and restore the NBU's foreign currency reserves. Going forward, we expect remittances to keep on growing amid Germany's authorities likely decision to facilitate access to the country's labor market for skilled migrants from non-EU countries. Such action is likely to boost both labor migration to Germany and growth of salaries of migrant workers at Eastern European countries.

Figure 10. Trade balance, USDbn



We expect CA pressure on Ukraine's external balance will abate during upcoming months on the back of the favorable external conditions. Nevertheless, with the continuing economic recovery driven by expenses, both private and investment, Ukraine's trade and current account balances will likely to stay under pressure.

Figure 11. Remittances, USDbn



UKRAINIAN CAPITAL MARKETS WEEKLY

| Key Macroeconomic Indicators | | | | | | | | |
|--|--------|--------|--------|-------|--------|--------|--------|--------|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019E | 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 | 134.40 | 141.50 |
| 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 | 74.30 | 76.80 |
| Current account balance (USD bn) | -16.50 | -4.60 | 1.60 | -1.30 | -2.40 | -4.70 | -4.70 | -4.80 |
| Current account balance (% of GDP) | -9.00 | -3.40 | 1.80 | -1.40 | -2.10 | -3.30 | -3.50 | -3.40 |
| 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 | 28.50 | 30.50 |
| Exchange rate (UAH/EUR) end of year | 11.30 | 23.00 | 26.20 | 28.30 | 33.50 | 31.80 | 33.60 | 36.30 |



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