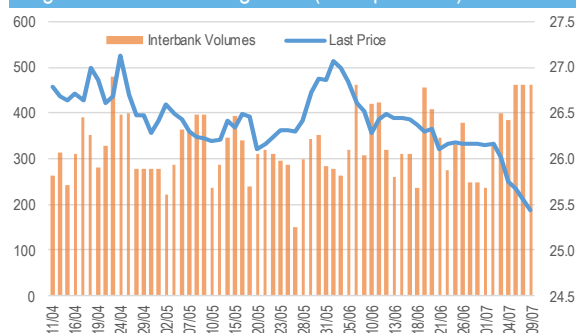


	Rating	Outlook	Last update	This week in focus: Record strong UAH and growing FX reserves
Fitch	B-	STABLE	08.03.2019	Following two month of decline, Ukraine's international reserves restored to USD20.6bn by the end of June from year's low USD19.4bn in the beginning of the month, with net FX reserves reached five-year high of USD10.5bn. The growth of reserves largely reflects a positive net change in government debt position after two months of debt expenditures exceeding new debt inflow.
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)

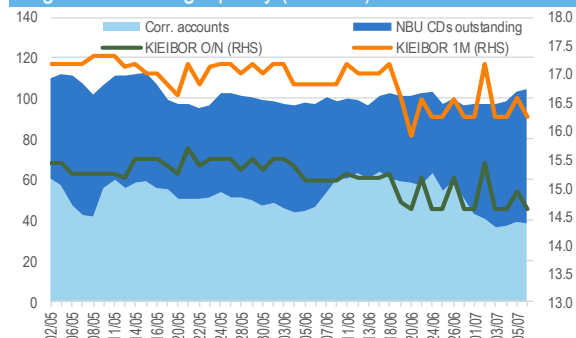


FX and interest rates: UAH is buoyed by ample FX liquidity

**Ukrainian hryvnia is prolonging five-week recovery and rose by Wednesday (July 10) to the 25.6 neighborhood.** The upsurge is backed by growing supply of foreign currency (FX), with foreign investments in UAH government bonds provided circa USD150mn of fresh liquidity during last week. Exporters also increased sales of FX revenues, seemingly responding to such an unexpected situation on the market, not seen in previous years.

**The National bank of Ukraine (NBU) during last week increased purchases of FX in the interbank market to USD321.2mn** from USD44mn a week before, but these interventions, together with demand from major importers, had limited impact on general trend. Banking liquidity stays at the lowest level since January and can lend little if not to say no support to total FX demand.

Figure 2. Banking liquidity (UAH bn)



**UAH is currently in the vicinity of two-year high and keeps on trending upward.** We see the NBU has turned to more aggressive interventions in the market this week, but the greenback remains heavily offered. Taking into account weak buyers' positions due to a low level of UAH liquidity in the banking system, and likely increase of foreign take-up of UAH bonds before upcoming NBU board meeting on monetary policy, we see potential for further strengthening of Ukrainian hryvnia.

At the same time, we do not rule out local corrective rebound of hryvnia.

While banking system liquidity restored above UAH100bn by the end of last week, **amounts deposited on correspondent accounts with the NBU continued to decrease and fell to UAH39bn** by the end of Friday (July 5).

Figure 3. Correspondent account balances (UAH bn)



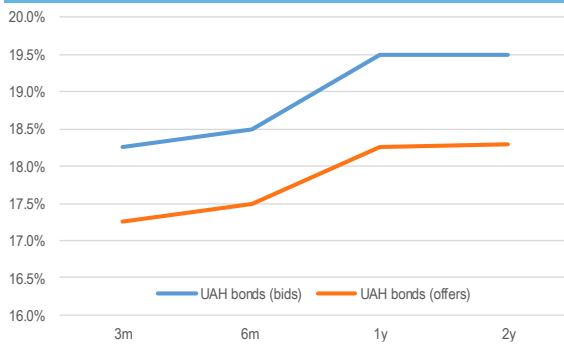
Monetary operations, which resulted in contraction of cash deposited by banks by UAH14bn, represent twofold growth of banks' investments in O/N CDs to UAH34bn and redemption by some banks of refinancing loans to the NBU.

Repayment by business of excise taxes to the State treasury has also contributed to banking liquidity withdrawal.

The national bank's interventions in the interbank currency market, though injected into system UAH8.3bn, were not enough to cover the drain.

**We expect banking system liquidity will continue suffering from the current appreciation of the local currency,** with FinMin bond auctions representing a main source of liquidity drain.

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	17.24%	17.24%	17.50%	17.00%	11	8	654.27	500.00
UAH	6m	17.60%	17.47%	17.99%	17.42%	22	10	1 530.89	500.00
UAH	1y	18.00%	17.99%	18.30%	17.99%	48	27	2 776.64	1 000.00
UAH	3y	16.75%	16.75%	16.95%	16.75%	17	13	1 259.02	1 159.31
UAH	6y	15.85%	15.84%	15.85%	15.63%	17	17	2 762.12	2 762.12

The yields on bonds fell further on the primary auction held on Jul 9 as FinMin continues pushing rates down through limiting securities proposal and dumping uncompetitive bids. As it was previously announced, only UAH bonds were offered with maturity ranging from 3m to 6y. Keeping proposal of short-term bonds at UAH500mn FinMin managed to cut rates for 3m securities by 20bp to 17.44% and for 6m bonds by 34bp to 17.60%. Worth mentioning that demand for half-year bonds was three times of the amount sold.

The Ministry also initiated UAH1bn threshold for 1y bonds. While demand for the securities reached UAH2.8bn, FinMin rejected about half of applications and managed to reduce bond's yield by 30bp to 18.00% through picking the best rates. There were only 6y UAH bonds completely sold out on the auction, with total demand of UAH2.76bn and rates ranging from 15.63% to 15.85%.

Having hoarded on its accounts about UAH100bn, including UAH81.2bn on FX accounts (as of July 8), the Ministry, as we expect, will continue playing hardball. Growing expectations for the NBU to resume monetary policy easing are also supportive of further decline of yields.

Figure 5. Local USD bonds market

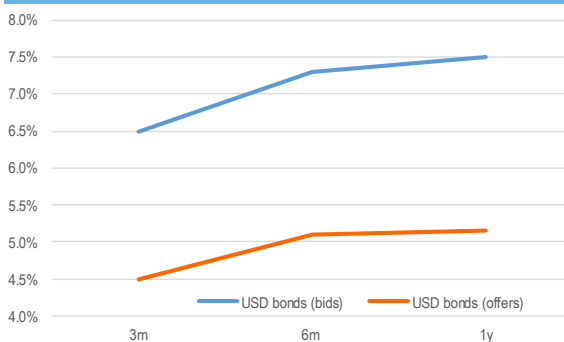
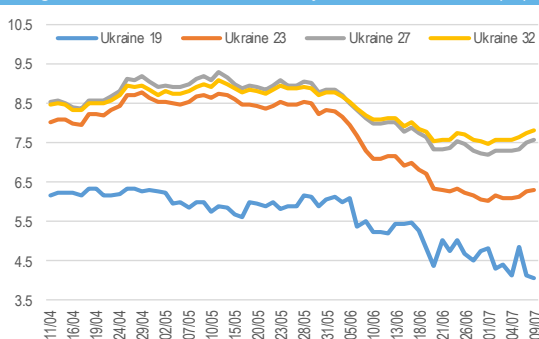


Figure 6. Ukraine's Eurobond yields, bid/ask mid (%)



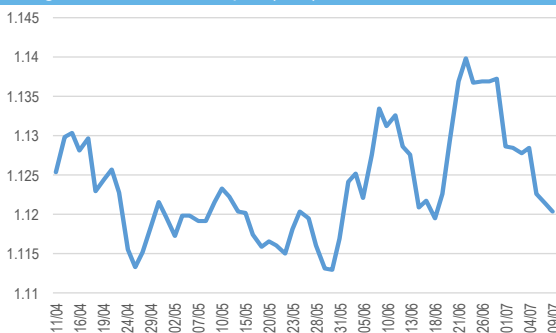
Declining bets on U.S. rate cuts pushed dollar to 3-weeks high

U.S. dollar rose to 3-weeks high against euro as investors re-assessed their expectations of how much the Federal Reserve (Fed) may cut interest rates by this month. After news of a stronger-than-expected increase in U.S. jobs in June traders scaled back their expectations of a sharp Fed rate cut at the end of July.

From the EUR's backyard, the currency remains under pressure among speculations that the European Central Bank (ECB) may resume its asset purchases program.

Moreover, the nomination of International Monetary Fund (IMF) Chairwoman Christine Lagarde as the new head of the ECB added to market participants' worries that the central bank would be inclined to ease monetary policy faster than its U.S. counterpart.

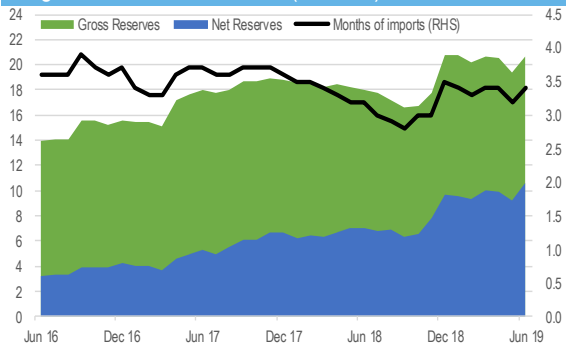
Figure 7. EUR USD spot (mid)



Against the backdrop of fading expectations of multiple decreases of U.S. interest rates by the Federal Reserve the yield on the benchmark 10-year U.S. Treasury note jumped to around 2.06% from a year's low level at 1.953% (on July 3).

Market participants currently await Fed Chairman Jerome Powell's two-day testimony before Congress, which starts on Tuesday, for further clues about a rate decrease.

Figure 8. NBU FX reserves (USD bn)



FX reserves are deriving benefits from foreign take-up of UAH bonds

**Following two month of decline, Ukraine's international reserves restored to USD20.6bn** by the end of June from year's low USD19.4bn in the beginning of the month, according to the NBU.

**Net FX reserves reached five-year high of USD10.5bn**, the rate of coverage of future imports increased to 3.4 months.

**The growth of reserves largely reflects a positive net change in government debt position** after two months of debt expenditures exceeding new debt inflow. Following improvement of investment sentiments, the FinMin tapped into the market with EUR1bn issue of Eurobonds. Besides, the Ministry attracted USD325.8mn and EUR148mn on the local debt market via placement of foreign currency denominated bonds. At the same time amounts spent on servicing and repaying of foreign currency public and publicly guaranteed debt stood at USD0.95bn.

Increased export revenue sales on the back of favorable market conditions and FX capital inflow from non-residents, continuously building up their investments in the government UAH bonds, also helped bolster reserves.

In June foreign investors' ownership of the UAH government bonds rose by 33% to UAH56.2bn (circa USD2bn) and exceeded UAH61.5bn by as of July 5. Therefore, **non-resident holdings approached 8% of the outstanding local government bonds.**

These factors boosted FX supply in the interbank market and, hence, allowed the NBU to replenish reserves via FX interventions by USD322.3bn.

**We note potential for further increase of foreign take-up of UAH bonds** with non-residents' portfolio approaching 10% of the outstanding local government bonds by the end of the year. We see attractiveness of Ukraine's government securities is supported by a complex of factors. In particular, growing expectations among investors about monetary easing by leading central banks have spurred interest to riskier assets, and Ukraine is benefiting from this trend on account of its stable economic track and waning political concerns.

On top of that, the FinMin just recently announced its intention to increase the issue of UAH 6y bonds to USD1-1.5bn from the current USD0.3bn for the sake of listing securities in one of globally recognized bonds' indexes. The intention of the ministry was produced in verbal form thus far and there are no details how soon this target might be reached. Nevertheless, we assume, that this verbal intervention is likely to enhance attractiveness of UAH bonds.

On the negative side we point out that situation at the global markets, and risk tolerance among investors in particular, very receptive to global news flow and can change sharply and swiftly.

**In such case further cooperation with the International monetary fund (IMF) is important for keeping macroeconomic stability in Ukraine.**

So far we see both sides expressed their willingness to continue such cooperation, and readiness to negotiate a new programme. At the same time the Fund specified that its mission would return to Kyiv only after the parliamentary elections and the formation of a new government. Taking into account continuing uncertainty about distribution of power in a new parliament, we still lack confidence that negotiations about a new arrangement to start by the end of the summer.

Figure 9. Foreign holdings of UAH bonds

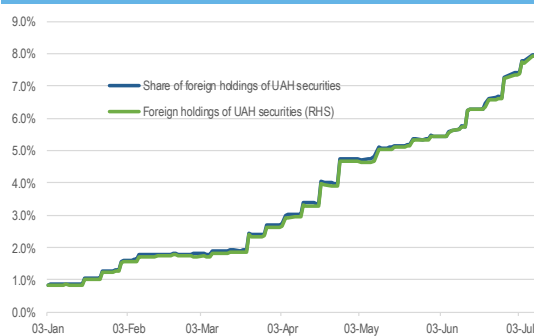


Figure 10. Seasonal appreciation of UAH



# UKRAINIAN CAPITAL MARKETS WEEKLY

## Key Macroeconomic Indicators

	2013	2014	2015	2016	2017	2018	2019E	2020F
<b>Real sector</b>								
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
<b>Prices</b>								
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
<b>Fiscal balance (% of GDP)</b>								
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
<b>External balance</b>								
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
<b>Interest and exchange rates</b>								
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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