



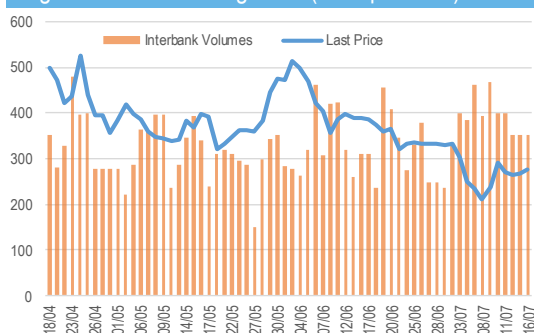
**ECONOMICS | INTEREST RATES STRATEGY | FX**

17 July 2019

**UKRAINIAN  
CAPITAL MARKETS  
WEEKLY**

	Rating	Outlook	Last update	This week in focus:
Fitch	B-	STABLE	08.03.2019	Inflation slowdown in June may prove short-lived
S&P	B-	STABLE	12.04.2019	Annual inflation slowed down to 9% in June from 9.6% in May, thanks to food deflation after the new harvest got to market. Inflation print stays in line with our year-end conservative forecast at 8.5%, yet above the NBU's expectations at 8.6% y/y by the end June. The latter might weigh on the central bank's monetary policy later this week.
S&P (N)	uaBBB	-	12.04.2019	
Moody's	Caa1	STABLE	21.12.2018	

Figure 1. UAH exchange rate (UAH per USD)

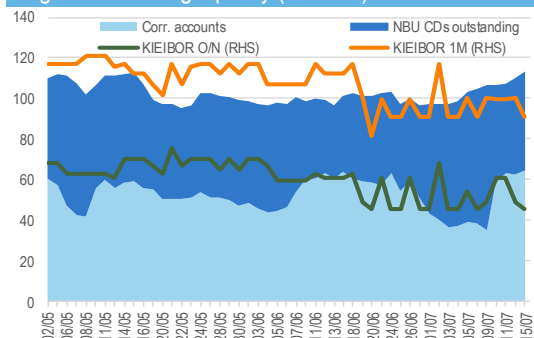


FX and interest rates: NBU might lower key rate

**The Ukrainian hryvnia has changed little since last Monday** (July 1) against U.S. dollar with quotations moving during this period in a tight range of 25.8-25.85. The Ukrainian interbank foreign currency (FX) market show high activity with demand and supply forces prevailing over news flow impact. Even one-off speculations find no support to develop into noticeable movement.

Going into details of demand and supply, the former was generated largely by major importers of energy products and retailers, hoarding FX cash for future imports amid favorable price for USD. The National bank of Ukraine (NBU) though went on intervening into the market did not substantially increase demand for USD. The central bank's weekly FX purchases contracted to USD138.5mn from USD321mn.

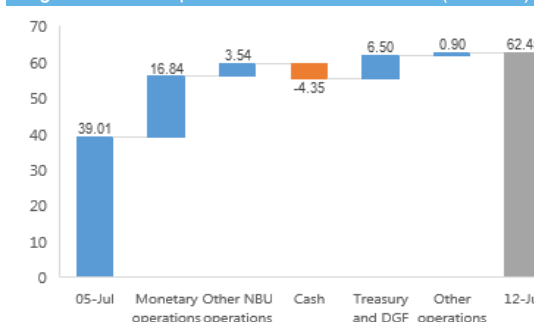
Figure 2. Banking liquidity (UAH bn)



**Last week the NBU has lifted all limits for repatriation of dividends abroad** or to nonresident accounts in Ukraine. This action, however, did not have material effect on the market as supply of FX stood strong, thanks to growing sales of export revenues by metal and agro producers, as well as to increasing foreign investments into local government bonds.

**Looking forward, Ukraine is approaching to the next election cycle, which might increase volatility in the market.** On the positive side is successful placement of Eurobonds by the state company Naftogaz. Having replenished its FX reserves, the company, which is currently stoking natural gas, might decrease demand pressure on the FX market.

Figure 3. Correspondent account balances (UAH bn)



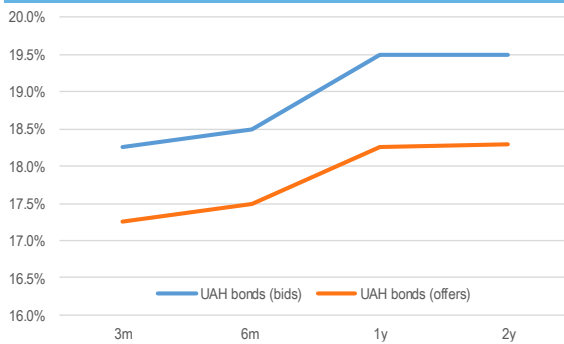
**Banking sector liquidity increased by 6.6% to UAH110bn** with amounts of cash deposited by banks on accounts with the central bank increased by 60% to UAH62.4bn as of July 12. Recovery was due to State treasury operations and central bank's interventions in the interbank currency market, producing total increase of liquidity in the system by UAH10bn. Among liquidity-absorbing factors cash withdrawals drained liquidity by UAH4.4bn.

The central bank's monetary operations, which contributed the most to growth of amounts at banks' accounts with the NBU represents release of UAH23.7bn from investments in O/N certificates of deposits (CDs), while investments in CDs placed through tenders increased by 22.9% to UAH37.1bn.

**Policymakers from the central bank are scheduled to meet on July 18.** Last time 7 of 8 votes approved keeping the key policy rate at 17.5%, pointing to steadily growing retail turnover.



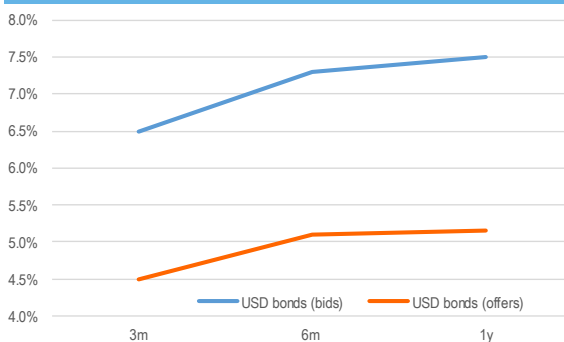
Figure 4. Local UAH bonds market



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	17.00%	16.96%	17.20%	16.94%	18	14	1 272.55	500.00
UAH	6m	17.40%	17.21%	17.60%	17.00%	22	18	1 023.24	500.00
UAH	1y	17.74%	17.68%	18.00%	17.50%	52	41	2 324.65	1 000.00
UAH	2y	17.75%	17.70%	17.85%	17.50%	36	31	5 915.97	<b>5 290.97</b>
USD	1y	6.50%	6.50%	7.00%	6.50%	67	62	756.87	<b>671.62</b>
USD	2y	7.00%	7.00%	7.50%	6.50%	59	53	368.45	<b>367.53</b>

Figure 5. Local USD bonds market

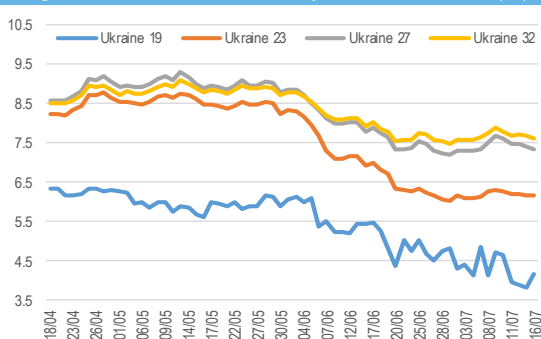


**FinMin attracted striking UAH33.3bn** on the primary bond auction held on Jul 9. Majority of funds came through placement USD-denominated bonds, strong demand for which likely stems from large payments on foreign currency securities last week and this week - about USD0.8bn. As a result, the debt sale tailed by 50 basis points (bps) for both 1y and 2y bonds. The tail is the gap between the highest yield of sale and the highest yield expected.

FinMin has also managed to lower the cut-off rate for UAH-denominated bonds for the fourth week in a row. Total tenders for short-term bonds reached UAH4.6bn, more than 2.1 times higher than the UAH2bn offer threshold. This helped the ministry to push yield for 3m securities to 17% from 17.24%, for 6m to 17.4% from 17.6%, and for 1y to 17.74% from 18%.

Only 2y debt was offered without limit with UAH5.3bn bonds sold. Though excess demand for them was less substantial than for the short-term ones, on the eve of likely reduction of the refinancing rate by the NBU the Ministry has pushed yield down by 20 bps to 17.75% per annum.

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



USD resumed growth on upbeat stats

Having ended last week with slight drop, **the USD is back on upward trend since Monday (July 15)** after stronger-than-expected June U.S. retail sales data dampened expectations that the Fed may embark on a deep interest rate cut later this month. The USD was at 1.1206 by the end of Tuesday, touching a July's peak.

**The struggling euro also provided additional impetus to the U.S. currency.** The euro currency weakens against other hard currencies due to data that pointed to a deterioration in confidence among German investors prompted by the trade conflict between China and the U.S. and political tensions with Iran.

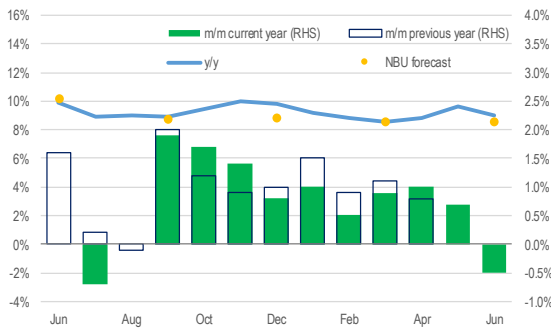
Figure 7. EUR USD spot (mid)



**An improved U.S. economic stats should provide some fuel for further dollar gains.** Traders also expect the European Central Bank (ECB) to move policy rates deeper into negative later this year, resume the QE programme and change forward guidance, as the euro zone economy has been struggling. The dovish stance from the ECB appears reinforced by the recent appointment of ex-IMF's C.Lagarde to succeed M.Draghi. If proved, this could provide additional boost for further USD growth.

**The benchmark 10-year Treasury yield trade around 2.117%, slowly sliding since Monday** on the back of better-than-expected retail data after growth to three-week high at the end of last week on stronger-than-expected inflation figures.

Figure 8. Consumer price index



Inflation slowdown in June may prove short-lived

**Annual inflation slowed down to 9% in June from 9.6% in May**, according to the UkrStat. Inflation print stays in line with our year-end conservative forecast at 8.5%, yet above the NBU's expectations at 8.6% y/y by the end June. The latter might weigh on the central bank's monetary policy.

**Month-to-month negative growth in June largely came on the back of food deflation** as the new harvest gets to market. In particular, seasonal drop in prices of vegetables and continuing rapid decline in prices of eggs contributed the most.

The government's resolution on cutting natural gas prices for households' needs and seasonal appreciation of hryvnia against the U.S. dollar and the basket of currencies of Ukraine's main trading partners have also contributed to the trend. The latter accelerated decline in prices for clothing, footwear, furniture and home appliances, which are mostly imported to the country.

The good news likely ends here as **we expect annual inflation will resume ticking up next month.**

First of all, a solid decline in food prices in July-18 has set high base, which would be difficult to beat.

Then, mentioned in our report of June 12th looming impact of an adverse weather conditions though didn't become apparent in the last stats, did affected negatively general supply of vegetables. We expect this factor to show up more aggressively in July's inflation print.

Figure 9. Expected year-end change in CPI

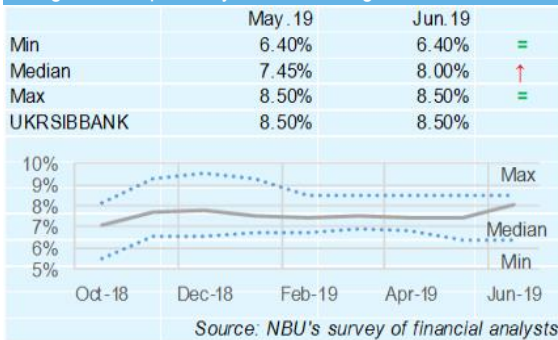
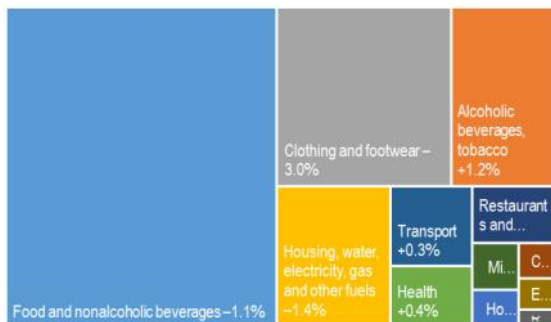


Figure 10. Contribution to monthly change in CPI



**Worth also mentioning a continuously growing prices of alcoholic beverages and tobacco.** This segment is the second larger contributor to the annual inflation and its impact is likely to increase next month after some articles of the state bill No. 9260 regarding increase of the excise duty on tobacco products come into force in July 1st.

Though the government's resolution will hold effect in July, with the price for natural gas for households is to decreased next month by 11.7%, we believe this factor would not be enough to counterbalance expected prices growth in other sectors.

In the June's report we also warned of a risk of acceleration of fuel and lubricants prices after Russia has embargoed oil products imports to Ukraine, and of likely deterioration in inflationary expectations after a new electricity market has been launched in Ukraine. While the former risk didn't realize, thanks to rapid market response, the latter is still difficult to evaluate. We see mutually exclusive statements from officials and other stakeholders about real price change on electricity since July 1. That is why prefer to wait for publication of July's industrial producer price index to see the actual effect.

In the bottom, despite slowed in June, we see a little possibility for annual inflation to continue abating in the next months. On the other hand, **we believe the odds of change in the NBU's monetary policy stance this month are even** as inflationary risks largely stem from non-core factors.

The NBU's quarterly forecast assume a decrease in annual inflation by the end of the second quarter to 8.6% with a further decrease to 7.3% in the third quarter and 6.3% in 2019. But the central during the last monetary policy committee meeting on Jun 6 pointed out risks of inflation forecast deterioration.

# 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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