

# Ukraine. Monthly Market Overview

## October 2016



### Ukraine Sovereign Ratings

FCY rating	S&P	Moody's	Fitch
Long-term	B-	Caa3	CCC
Short-term	B	NP	C
Outlook	Stable	Stable	
LCY rating			
Long-term	B-	Caa3	CCC
Short-term	B	-	-
Outlook	Stable	Stable	
Latest assessment	20/10/15	19/11/15	22/07/16



Financial Markets team

# Ukraine. Monthly Market Overview. October 2016

## Major Macroeconomic Trends



### MACROECONOMIC INDICATORS - evolution

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016E	2017F	2018F
Nominal GDP (USDbn)	64.9	86.2	107.7	142.7	129.0	117.4	136.2	165	174	178	130	90	90	97	107
Real GDP growth (%)	12.1	2.7	7.3	7.9	2.1	-14.8	4.2	5.2	0.2	0.0	-6.8	-9.9	1.0	2.5	3.0
Inflation CPI, eop (%)	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	43.3	13.5	9.0	8.5
Industrial production (%)	12.5	3.1	6.2	10.2	-3.1	-21.9	11.0	7.6	-1.8	-4.7	-10.7	-13.4	1.5	3.2	3.5
Merchandise exports (USDbn)	41.3	44.4	50.2	64.0	78.7	39.7	51.4	68.4	68.8	63.3	55.3	35.4	32.2	34.9	38.5
Merchandise imports (USDbn)	36.3	43.7	53.3	72.1	92.2	45.4	60.7	82.6	84.6	77.0	61.3	38.7	36.8	39.0	41.9
Public debt (% of GDP)	24.8	18.0	14.8	12.0	13.7	32.2	39.7	36.2	36.6	41.0	70.5	79.5	87.1	85.4	82.9
Current account (% of GDP)	10.7	2.9	-1.5	-3.6	-7.1	-1.5	-2.2	-5.5	-8.4	-9.3	-3.5	-0.2	-2.2	-1.1	0.2
Net FDI inflow over year (USDbn) NBU methodology	1.7	7.5	5.7	9.2	9.9	4.7	5.8	7.0	7.2	4.1	0.2	3.0	3.8	4.3	5.4

### EXCHANGE RATES - evolution

USD/UAH eop	5.31	5.05	5.05	5.05	7.70	7.98	7.96	7.99	8.04	8.24	15.82	24.03	27.0-30.0	28.4-34.5	29.3-37.1
USD/UAH average	5.31	5.12	5.05	5.05	5.32	7.79	7.93	7.97	8.02	8.16	12.02	21.92	25.8-27.5	27.7-32.3	28.8-35.8
EUR/UAH eop	7.20	6.00	6.70	7.42	10.86	11.45	10.57	10.30	10.54	11.04	19.14	26.12	29.7-33.0	31.2-38.0	33.7-42.7
EUR/UAH average	6.61	6.38	6.26	6.92	7.78	10.88	10.52	11.09	10.31	10.81	15.87	24.29	28.4-30.3	30.4-35.5	33.2-41.2
UAH O/N average	5.3	3.5	4.0	3.5	11.3	8.4	1.5	5.7	11.9	2.7	8.1	19.3	16.5	8.0	7.5

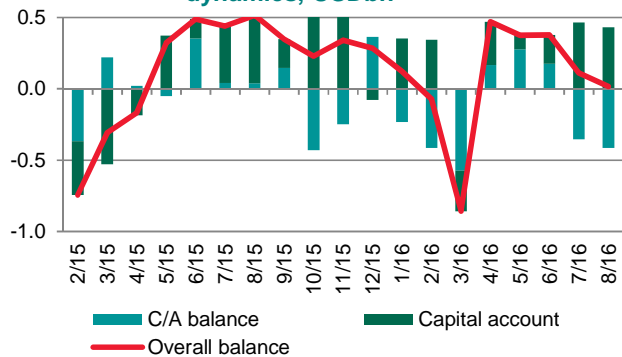
- **A new agreement on a cease-fire has reduced the number of casualties in the conflict**, while terrorists continue to break the agreement occasionally. In the event of an agreement on the withdrawal of troops from both sides (under tight control of OSCE) at three small points on the demarcation line being successful, we could see the same actions at other points and a sound reduction in fighting in the conflict zone. Preparation of the parties involved in Norman-style negotiations could also potentially improve the geopolitical situation by persuading the country-aggressor to follow the Minsk accord. In any case, we think **the risk of a solid escalation of the situation in the conflict zone** (strong enough to impact negatively financial markets' performance) **in the coming month is rather small**.
- After successful implementation of the major requirements and inclusion of the issue on the agenda, **a positive decision by the IMF Board on the resumption of EFF loan provision to Ukraine was just a technical issue. This decision unblocked the provision of a USD1.0bn guarantee from the US government** on the issuance of Eurobonds by Ukraine. Restoring cooperation with the IMF opens a potential chance to receive a second tranche from the IMF before the end of the year already. However, success here would depend on the ability of the government to move further in making reforms, including the implementation of some socially painful reforms like pension reform and the ability to sell agriculture land. **We currently consider the chances of implementing all these requirements quickly are low**.
- A positive decision by a dedicated committee of the European Parliament has **raised the likelihood of the approval of a visa-free regime between Ukraine and EU in the coming month or two**. Hence, if the issue is not politicised, the chance of a positive decision by the EU this year is moderately high.

# Ukraine. Monthly Market Overview. October 2016

## Major Macroeconomic Trends

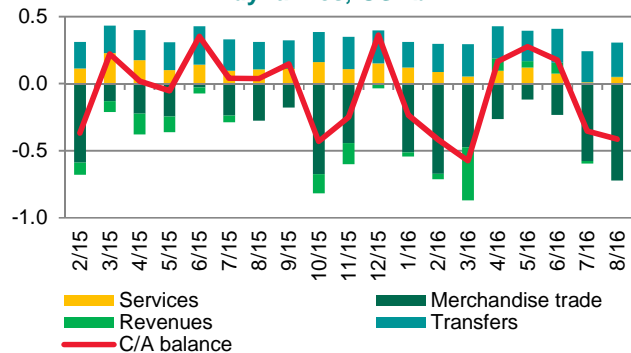


Major accounts of BOP, monthly dynamics, USDbn



Sources: NBU, Credit Agricole

Major accounts of CA, monthly dynamics, USDbn



Sources: NBU, Credit Agricole

Forecast	GDP, YoY
Q316	1.1%
Q416	0.9%
Q117	2.5%
Q217	2.7%

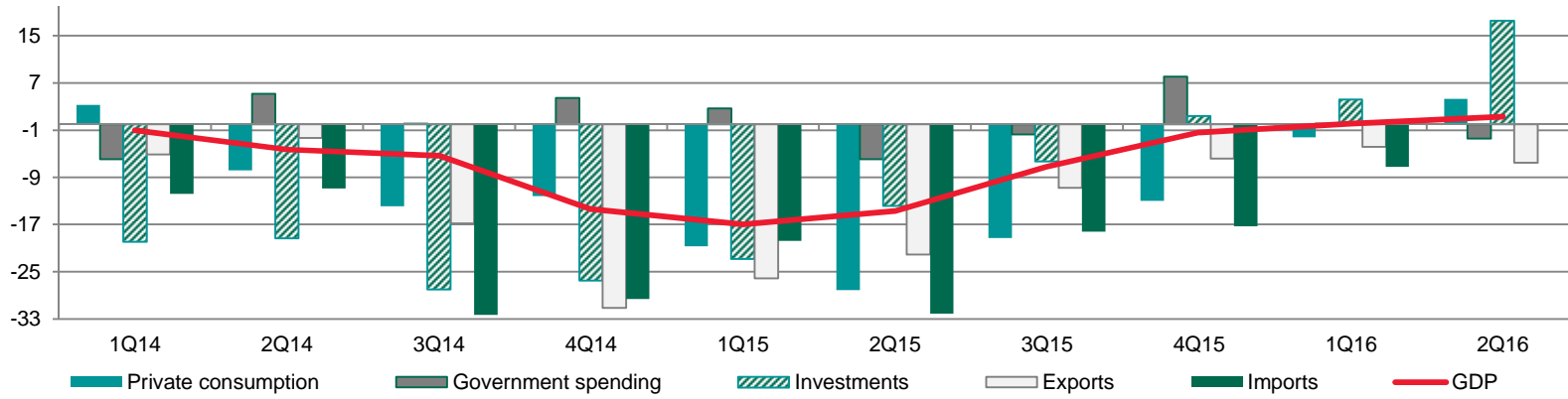
Source: Credit Agricole

- **The performance of domestic economic sectors YoY improved rather substantially in August (2.5%)** compared with the figure a month before (1.4%). We should say here that this improvement occurred even with a weakening comparison base effect vs last year, thus underlining **the growing importance of fundamental factors for economic growth recently.**
- **The most significant improvement was recorded in the industrial sector**, which was able to show a growing dynamic YoY in August (3.4%) compared with a drop for the two previous months. **The construction sector still demonstrates the highest YoY upturn in August (12.0%)** due to more active infrastructure rebuilding (including in the zone of military conflict) and higher capital investments from domestic businesses.
- In contrast to the improvement in performance of most sectors, **agriculture recorded a worsening in its YoY performance in August**, thus turning negative in August (-0.9%) versus growth the month before (1.2%). However, we do not see any risk here, because a worsening in performance might occur on the back of the shift in the harvesting season. In fact, **the volume of the grain harvest this year (as at 1 September) shows 2.3% growth in YoY terms. We expect a relatively good performance in the majority of economic sectors in September** on the back of the same effects.
- **The BOP worsened in August versus July's figure, while still remaining slightly positive (USD0.01bn).** This was achieved mostly thanks to contrasting balances for the current and capital accounts. In particular, the current account increased its deficit to USD0.41bn in August from USD0.35bn the month before. This worsening was mostly achieved by the merchandise trade balance, fully in line with our projections. In particular, falling steel and iron ore prices have reduced the value of corresponding exports while world prices for agriculture products have also faced a seasonal drop, thus undermining Ukraine's export potential in August. Consequently, **exports achieved just a marginal YoY upturn of 1.0%.**
- **In contrast to the export dynamic**, a rebound in consumer demand and the start of gas purchases **raised imports considerably (by 14.9% YoY).** As a result, the **merchandise trade deficit widened to USD0.72bn** in August versus USD0.57bn the month before, thus proving a major negative factor for the CA worsening. **We think the situation will not be drastically different in September.** In addition, more active FX purchases for dividend repatriation is likely to also put pressure on the CA.
- **The capital account balance in August (USD0.43bn) remained positive and rather close to the July figure (USD0.46bn).** It was again supported by positive FDI inflows (USD0.13bn) represented mostly by the corporate segment. The improvement in debt flows of the corporate and banking segments together with an outflow from the public sector have stabilised total net debt flows rather close to zero. However, **positive net FDI and an inflow of FC from the cash FX market remained the core contributors to the capital account surplus in August.**
- **We expect the capital account to remain positive in the coming few months** on the back of flows from FDI, cash FC and additional loans from international donors to Ukraine. In particular, the recent receipt of USD1.0bn from the placement of Eurobonds should improve net financial flows in September. At the same time, the **growing current account deficit (due to low commodity prices, a hike in imports and dividend repatriation) may worsen the BOP in the coming few months.**

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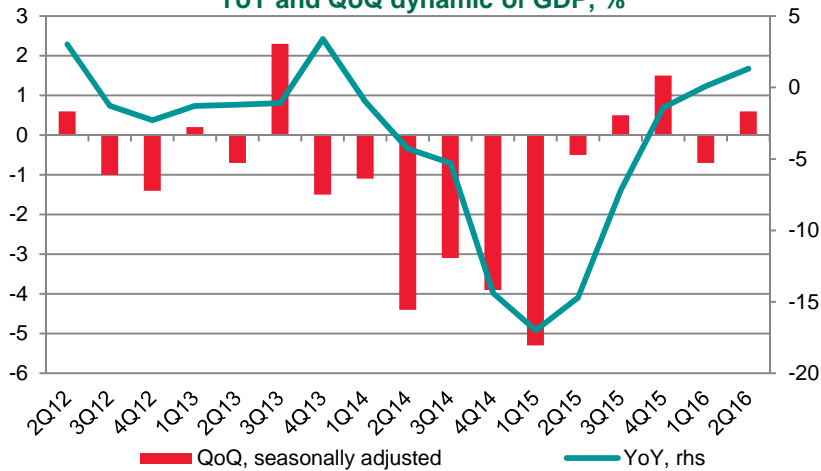
## Major Macroeconomic Trends

Quarterly GDP dynamics by expenditure components, %, YoY



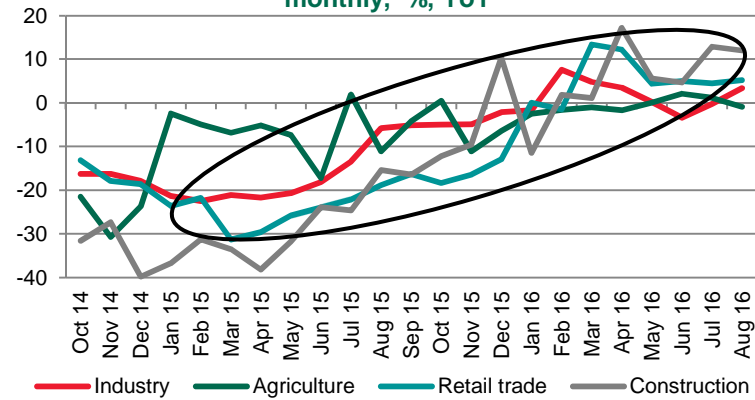
Sources: State Statistics Committee

YoY and QoQ dynamic of GDP, %



Sources: Statistic Committee, Credit Agricole

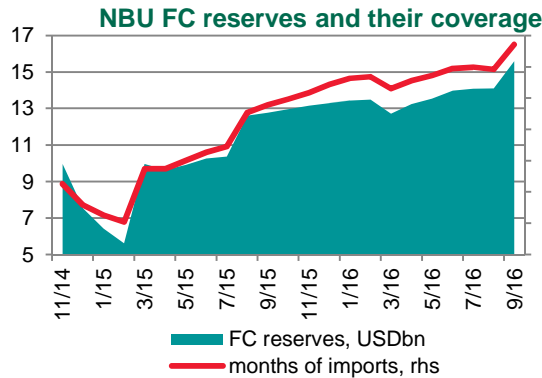
Performance of major economic sectors, monthly, %, YoY



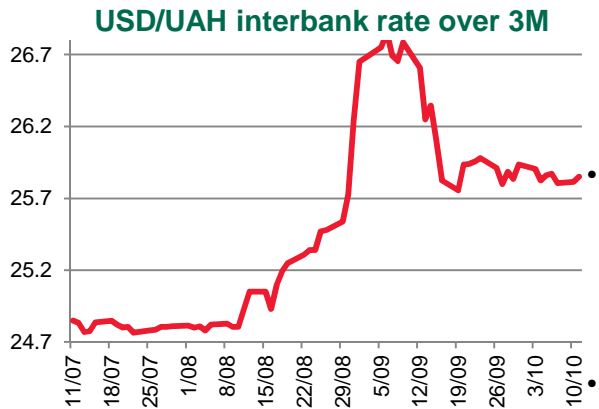
Source: State Statistics Committee

# Ukraine. Monthly Market Overview. October 2016

## FX Market



Sources: NBU, Credit Agricole



Source: Bloomberg, Credit Agricole

Forecast, eop	USD/UAH	EUR/UAH
Q4'16	27.0-30.0	29.7-33.0
Q1'17	26.8-30.0	29.2-32.7
Q2'17	26.0-30.0	28.3-32.7
Q3'17	27.5-33.0	30.3-36.3

Source: Credit Agricole

- **A spike in the USD/UAH in the first half of September has moved the exchange rate to a new support level close to 26.00.** As we expected, the hryvnia devaluation close to 27.00 was rather short-lived and grounded entirely on psychological factors. Therefore, **as soon as NBU showed support to the market through its interventions, the USD/UAH recovered slightly**, thus moving the market into relative balance in September-October. The fact that the FX market is not in a devaluation rush currently indicates that the NBU's FC auctions were recently changed by its FC purchase auctions. Even though net FC purchases by the NBU since September are still negative (-USD0.11bn), the market does not provide any strong factors for significant hryvnia devaluation in the near term.

- In contrast to the devaluation rush in September, when an unfortunate combination of several factors influenced the FX market's performance, **the dynamic of the USD/UAH in October has been impacted by a smaller number of negative factors. A resumption of the IMF loan** (with a provision for a new loan tranche following) coupled with the issuance of Eurobonds under US government guarantee have been **the most influential factors for improving FX market estimates recently.** Additionally, restoration of agriculture export proceeds (after a short break between grain exports and sunflower oil exports) and a hike in iron ore prices have created rather stable FC supply in the FX market.

- Even though devaluation fears are not substantial, **we still estimate a set of factors that might affect FC demand in the market in the coming few months, thus causing moderate imbalances.** In particular, because the world price of gas is rather low, the government is actively pumping it into its underground storage facilities, thus raising additional FC demand by USD350m per month. The monthly limit on dividend repatriation creates uneven distribution of FC demand throughout the month. In particular, **the volume of FC dividend demand is usually higher in the first two weeks of the month**, while in the second half of the month this demand is weaker.

- Contrary to the fears of some market participants that the NBU would tighten its capital controls again in mid-September (after hryvnia returned to a devaluation path), **the regulator even softened some of the requirements slightly** (mostly for the cash FX market) for the coming three months. **The near-term plans of NBU officials for capital controls include expanding the maximum term of returning export proceeds and lifting some limitations on FC purchases.** We consider the strategy announced as the right movement to liberalise the FX market, although the timing of these changes is not known yet. Since the FX market is not usually fully balanced in mid-December, **we expect no solid softening in capital controls by the NBU then.**

- The dynamic of the USD/UAH in October demonstrates that even additional FC demand for dividend repatriation does not necessarily cause big FC supply imbalances. **This supports our view that the USD/UAH (after a correction to a new temporary equilibrium of 26.00) should not face any solid upward movements in the coming month.** A moderate CA deficit on the BOP should be covered by positive net flows under the capital account. Therefore, **we expect a relatively balanced market in the coming month (with USD/UAH fluctuating in the range 26.00-26.50)**, although do not rule out some upward movements on the back of temporary imbalances. We think in these cases the upside potential of the USD/UAH would be limited by corresponding NBU interventions.

- **NBU FC reserves showed a visible upturn over September (by 10.5% or USD1.49bn) to a two-year high of USD15.6bn.** This was achieved thanks to the receipt of USD1.0bn from the IMF, USD1.0bn from Eurobond placement and USD0.1bn from the placement of local FC bonds. As a result, import coverage by NBU FC reserves has improved to 3.9 months – a high over the past four years. **We expect relatively unchanged reserves in October** due to a mostly balanced market and no strong FC flows in the public sector.

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## FX Market

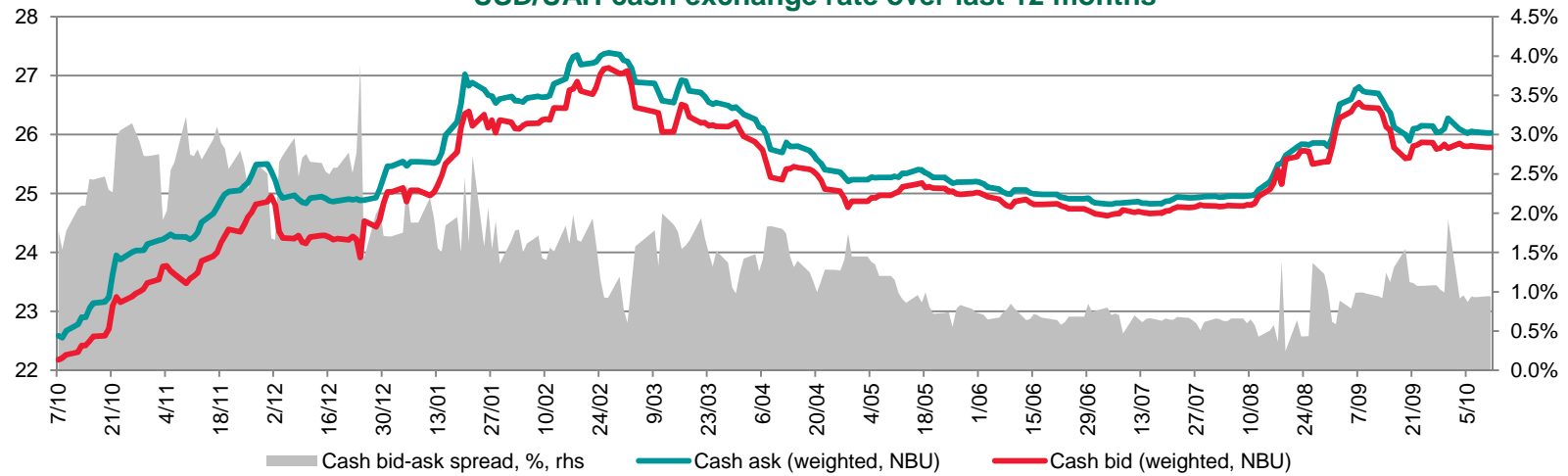


USD/UAH interbank exchange rate over last 12 months



Source: Bloomberg, Credit Agricole

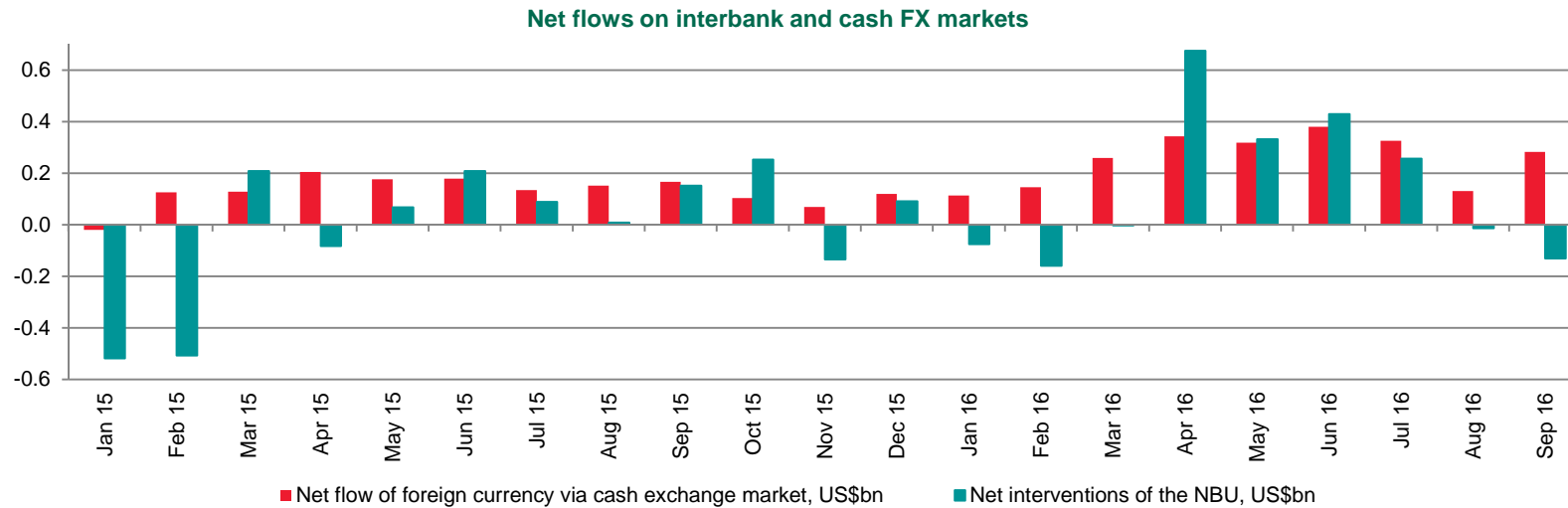
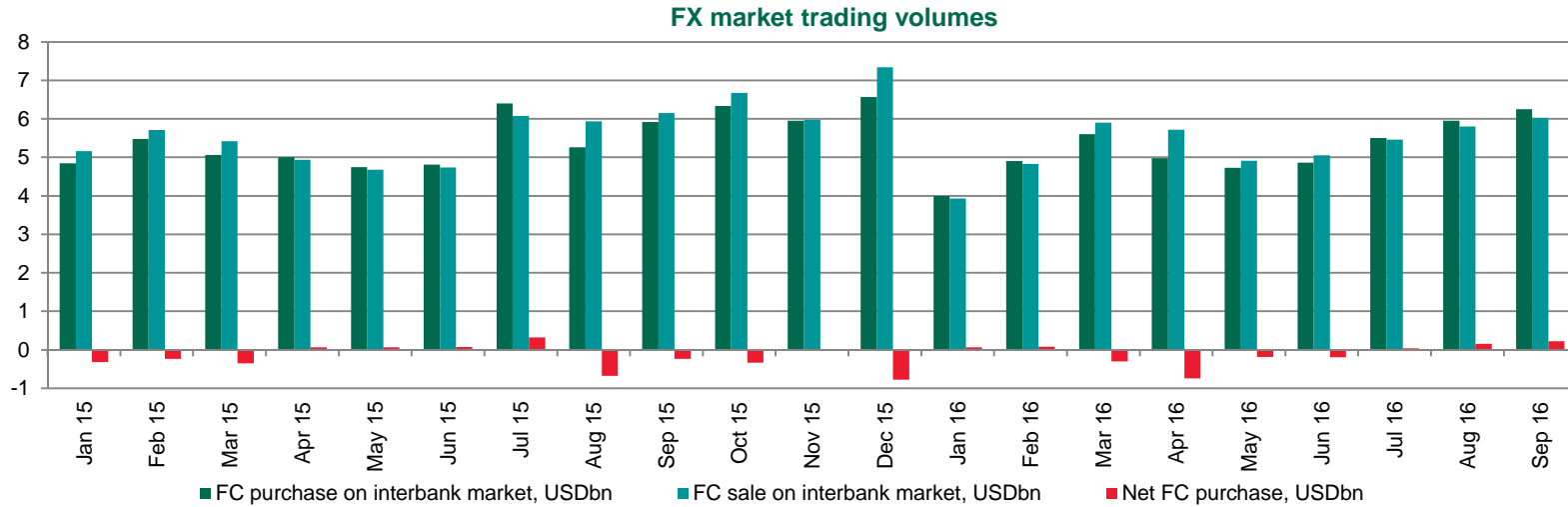
USD/UAH cash exchange rate over last 12 months



Source: NBU

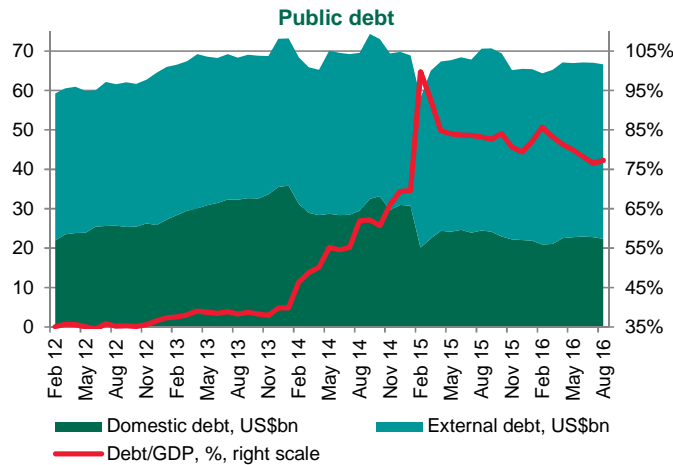
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## FX Market

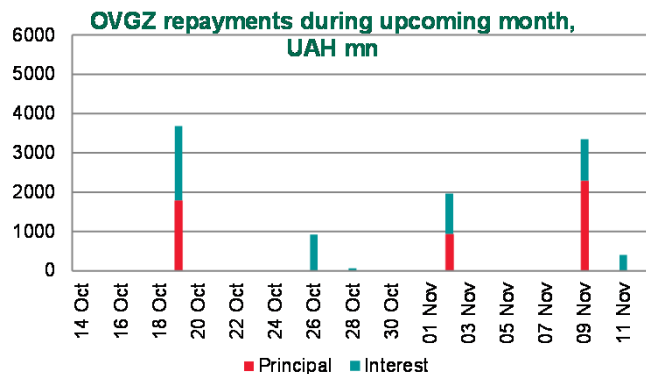


# Ukraine. Monthly Market Overview. October 2016

## Debt indicators



Sources: Finance Ministry, Credit Agricole



Sources: NBU, Finance Ministry

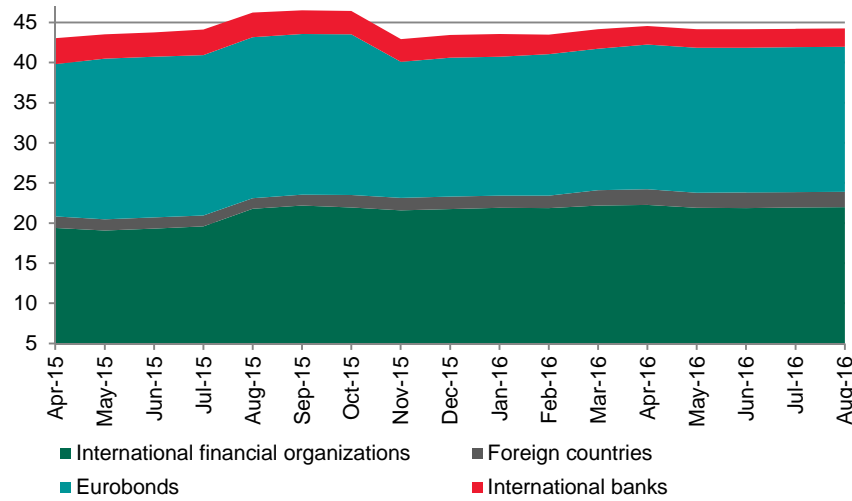
- **Public debt showed just a marginal drop in August in MoM terms (by 0.6%) to USD66.6bn.** At the same time the YoY drop was more significant in August (-5.6%) compared to July's figure (-1.5%). And a small decline in the USD value of debt over August occurred largely in the domestic segment of public debt (by 2.0%), mostly on the back of growth in the USD/UAH exchange rate at the end of the August.
- Even though public debt has dropped slightly in August, a hike in the USD/UAH month-end exchange rate has **worsened the debt-to-GDP ratio to 77.3%** compared to 76.6% the month before. The receipt of loans from the IMF and Eurobonds' placement **would increase public debt moderately in September, and debt-to-GDP, correspondingly.**
- **Last month was rather productive in terms of new borrowings.** And this is mostly regarding external debt. In particular, the resumption of the cooperation programme with the IMF has allowed USD1.0bn to be borrowed via a third tranche under the EFF loan programme, while issuance of Eurobonds under the US government guarantee brought an additional USD1.0bn. The government also issued local FC bonds in September. And despite total demand of USD0.15bn, the government limited the volume of issuance by USD0.10bn. But **servicing existing external obligations cost the government USD0.51bn last month** (including FC bonds worth USD0.05bn and a Eurobonds coupon worth USD0.46bn). In any case, **net inflow of FC under external borrowing was rather substantial and exceeded USD1.5bn.**
- Contrary to the external debt dynamic, **net flows under domestic debt remained negative in September.** In particular, the government spent UAH9.42 on principal and interest on earlier issued bonds. And the volume of new borrowing was just UAH5.86bn. At the same time, the bulk of funds received under local LC bonds' issuance (UAH5.0bn) came from the sale of index LC bonds to one buyer. We assume this might be a state-owned bank and the deal represents simply the refinancing of previous issues.
- We again **estimate a rather solid payment by the government under its external debt in October.** Indeed, USD0.31bn should be paid under local FC bonds. But we should not see any risks here. First of all, the government received a solid position of FC in September when issuing Eurobonds. Second, the government expects to issue local FC bonds on 25 October. And we think this would compensate (at least partially) for the volume of bond repayments this month.
- **Among potential inflows under external debt this month, we may expect a disbursement of EUR0.50bn from the World Bank** on the purchase of gas imports by Naftogaz into underground storage. This issue will be decided on by the WB Board on 18 October. Taking into consideration the successful implications of a similar loan previously, **we hope to see the disbursement of a new loan to Ukraine this month.** At the same time, according to state officials, the **provision of macro-financial assistance of EUR0.6bn by the EU has been postponed until next year.** However, we do not see any risks here, as FC outflows under external debt in the coming three months (ie, until the end of the year) are rather manageable (USD0.57bn), and are represented mostly by local FC bonds having high chances of being refinanced.
- **The volume of servicing the local LC bonds in October (UAH7.30bn) will likely be slightly lower than in September (UAH9.42bn).** And taking into consideration the rather inactive primary LC bonds market, we again expect net negative flows in October under this type of debt.



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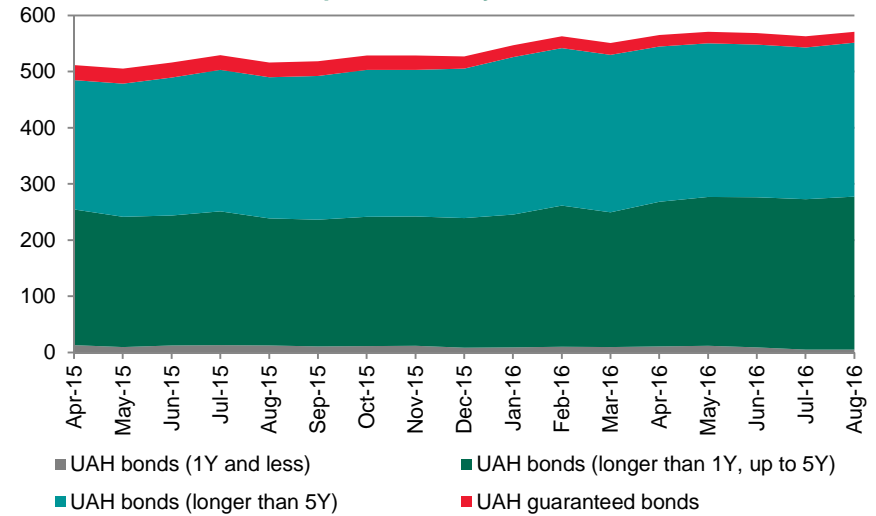
## Debt indicators

External public debt dynamics, USDbn



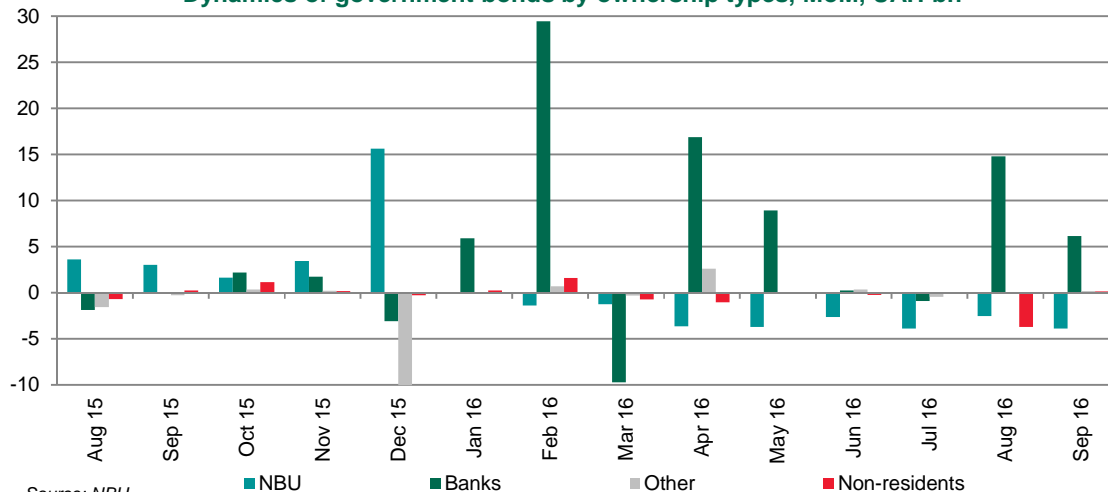
Source: Finance Ministry

Domestic public debt dynamics, UAHbn



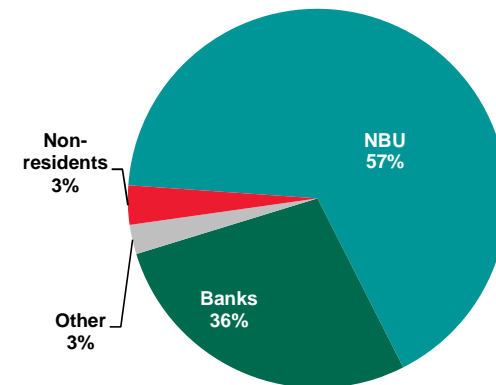
Source: Finance Ministry

Dynamics of government bonds by ownership types, MoM, UAH bn



Source: NBU

Breakdown of OVDP by owners (as of 11 Oct)  
Total volume - UAH552bn



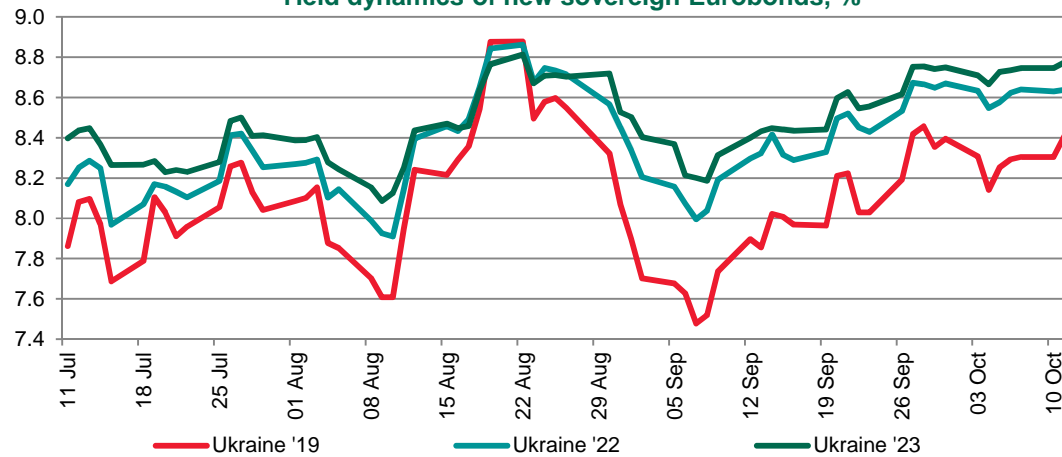
Source: NBU

# Ukraine. Monthly Market Overview. October 2016

## Debt indicators

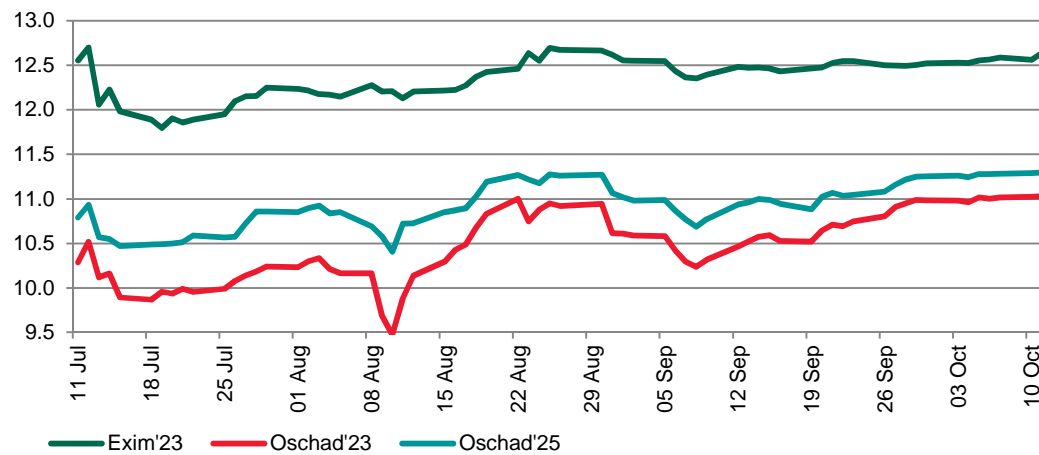


Yield dynamics of new sovereign Eurobonds, %



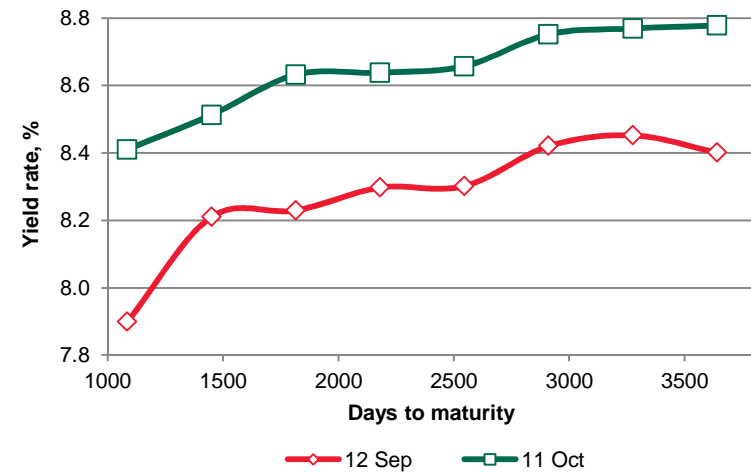
Source: Bloomberg

Yield dynamics of new quasi-sovereign Eurobonds, %



Source: Bloomberg

Ukraine's sovereign Eurobonds yield curve



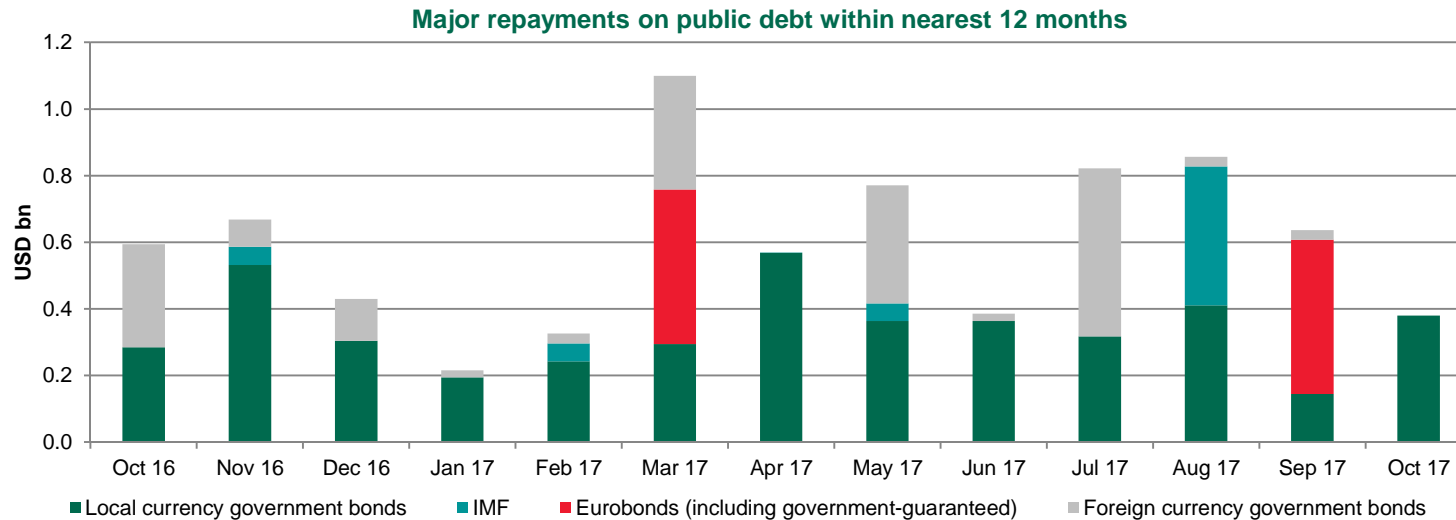
Source: Bloomberg

# Ukraine. Monthly Market Overview. October 2016

## Debt indicators



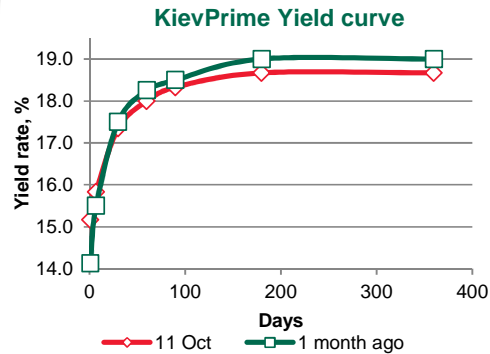
USDbn	Q416	Q117	Q217	Q317	2017
<b>Repayment of FC-denominated public debt</b>	<b>0.9</b>	<b>1.4</b>	<b>0.8</b>	<b>1.6</b>	<b>4.7</b>
Foreign currency local government bonds	0.5	0.4	0.4	0.6	2.2
IMF debt	0.1	0.1	0.1	0.4	1.1
Eurobonds (including state-guaranteed)	0.0	0.5	0.0	0.5	0.9
Other	0.3	0.4	0.3	0.2	0.5



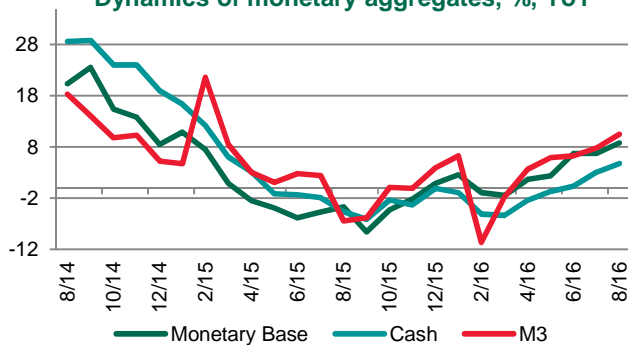
Source: Credit Agricole

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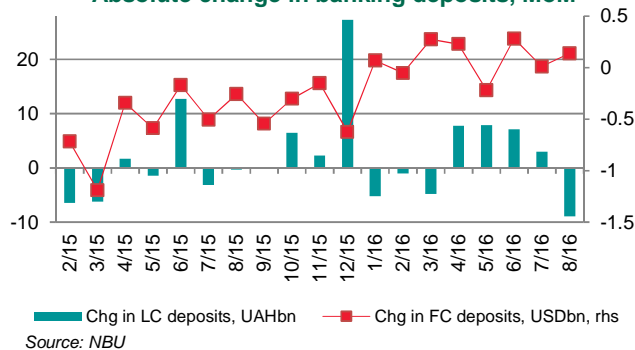
## Money Market



Dynamics of monetary aggregates, %, YoY



Absolute change in banking deposits, MoM

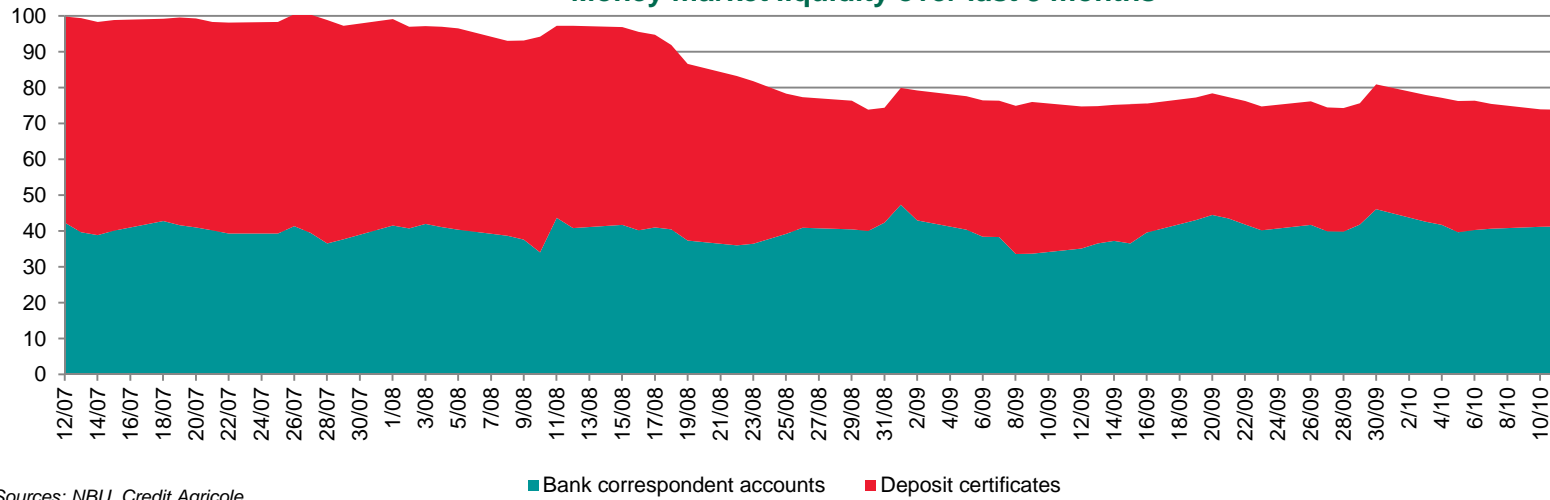


- **The NBU cut its key rate by 50bp to 15.0%** at September's monetary committee meeting. The movement in the rate was predicted by us. However, contrary to similar actions from the NBU during the summer, **a cut in the NBU key rate has not induced a corresponding decline in interest rates**. In particular, indicative KievPrime rates faced just a 25-30bp decline, while money market rates even faced a smaller drop. At the same time, the 1W KievPrime rate faced an opposite movement on the day before the NBU decision. Additionally, the O/N rate faced a decline for only a few days after the NBU decision, while approached a key rate already in a week after the announcement.
- Over the last three months we **noticed two different patterns for interest rates and their reaction to the decision by the NBU regarding the key rate**. In particular, in the summertime the O/N KievPrime rate was 100-150bp lower than the NBU key rate, while in September this spread narrowed to zero. We think rather high demand for hryvnia was a core reason of reluctant interest rates to recent decision of the NBU regarding its key rate. And we consider this reason as a core argument for the NBU's decision to not to cut its key rate at its next meeting on 27 October. And evident inflation acceleration would provide additional argument for this decision. Hence, **we predict the NBU key rate will remain unchanged at 15.0% until the end of the year** on the back of the aforementioned reasons. **We also expect relatively flat interest rates in the coming few weeks**, while not excluding its short-term hikes on the back of one-off factors.
- **Banking system liquidity was mostly volatile over the last month**, with a solid inflow of UAH5.2bn at the end of September raising its volume to a two-month maximum (UAH80.9bn). At the same time, rather active demand for hryvnia has allowed this inflow to evaporate quite quickly. And already in two weeks banking liquidity has dropped to its minimum (UAH80.9bn) from the last month and a half. We think **this volatility would be preserved in the coming month** on potential spikes in demand for hryvnia and temporary shortages of excessive hryvnia on money market. However, **we think such volatility in liquidity should not cause any sustainable shortage of resources**, thus not causing interest rates to skyrocket in the manner during previous years. And the role of the NBU in preventing these hikes is crucial here.
- **The dynamic of monetary aggregates indicates that the NBU is continuing with its monetary easing policy**. This has allowed YoY rates of all monetary aggregates to turn positive over recent months. And broad money aggregate M3 demonstrates the highest growth rate. Even though the NBU would not be able to cut its key rate substantially by the end of this year, **we still think that it would follow monetary easing policy**, thus trying to target inflation at 12% by year-end.
- **CPI acceleration in MoM terms (1.8% in September versus -0.3% the month before) was in line with our estimates**, taking into consideration seasonal increase in the price of food products (0.3%), a planned hike in public utility tariffs (3.7%) and a seasonal adjustment of prices for winter clothes and footwear (10.3%). At the same time, **YoY CPI demonstrated a small improvement (7.9% in September comparing to 8.4% in August)** due to more significant adjustment of prices a year before after a solid UAH devaluation in March 2015.
- **We still expect inflation acceleration in the coming few months** due to more solid seasonal effect in food prices and upward adjustment of heating tariffs. Hence, **our year-end forecast of CPI at 13.5% remains unchanged**.

# Ukraine. Monthly Market Overview. October 2016

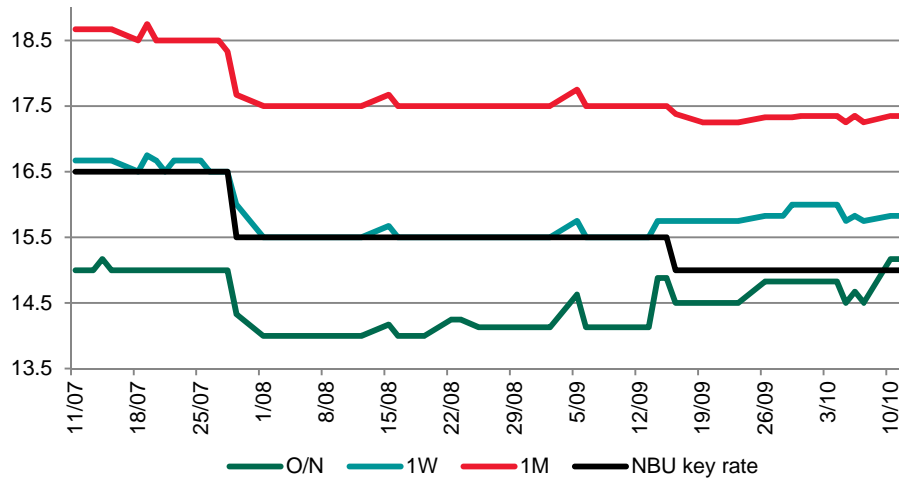
## Money Market

Money market liquidity over last 3 months



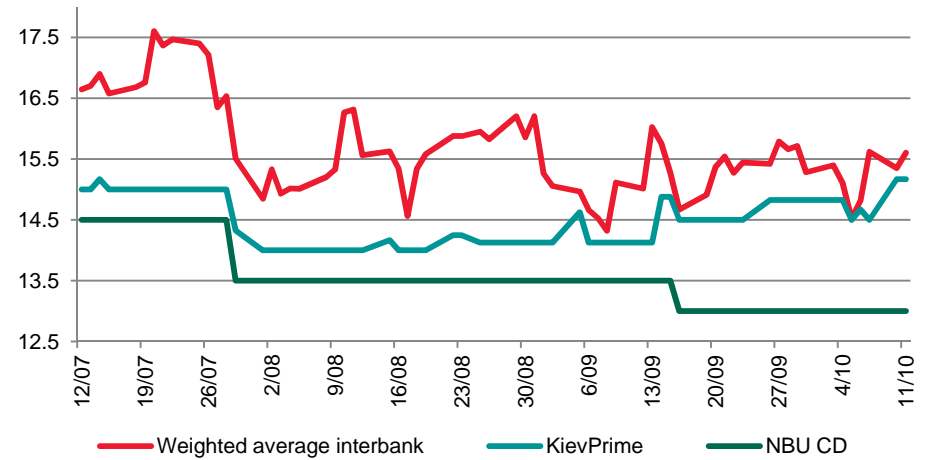
Sources: NBU, Credit Agricole

KievPrime rates over last 3 months



Source: Bloomberg

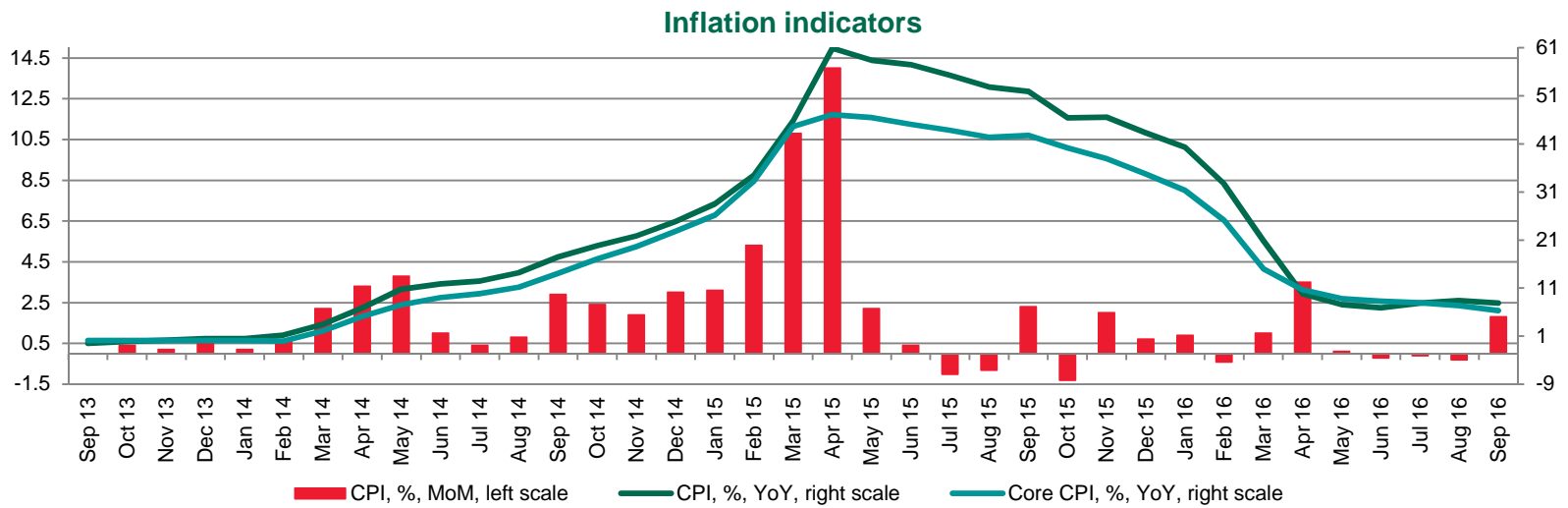
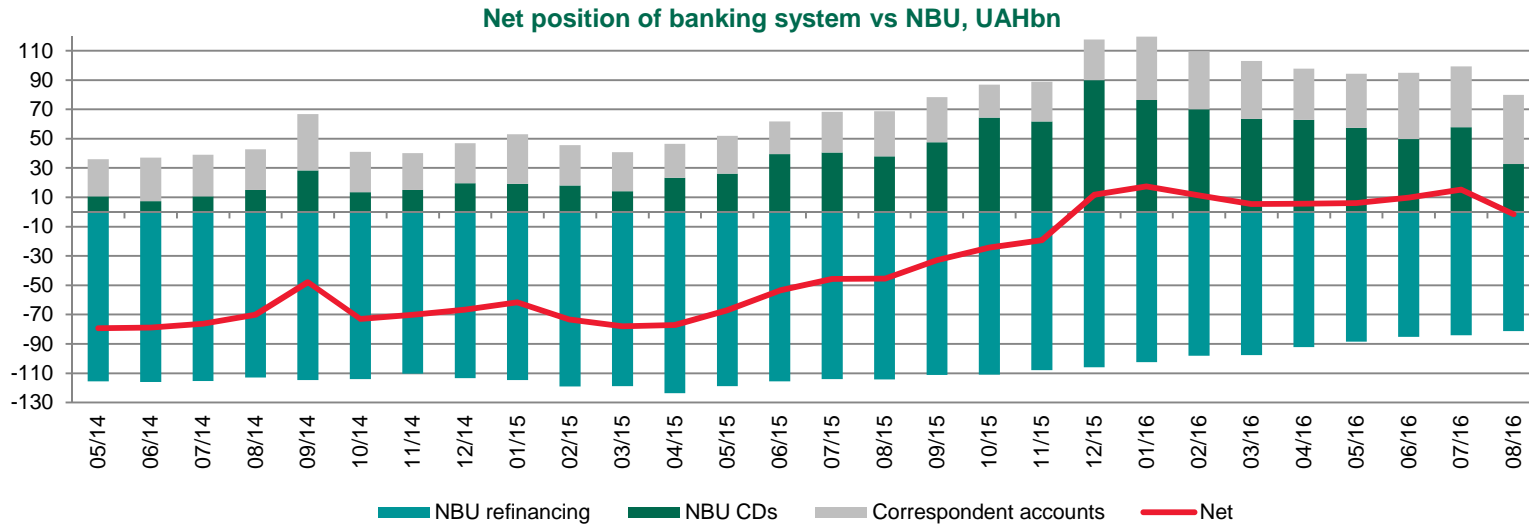
O/N benchmarks over 3 months



Source: Bloomberg, NBU

# Ukraine. Monthly Market Overview. October 2016

## Money Market



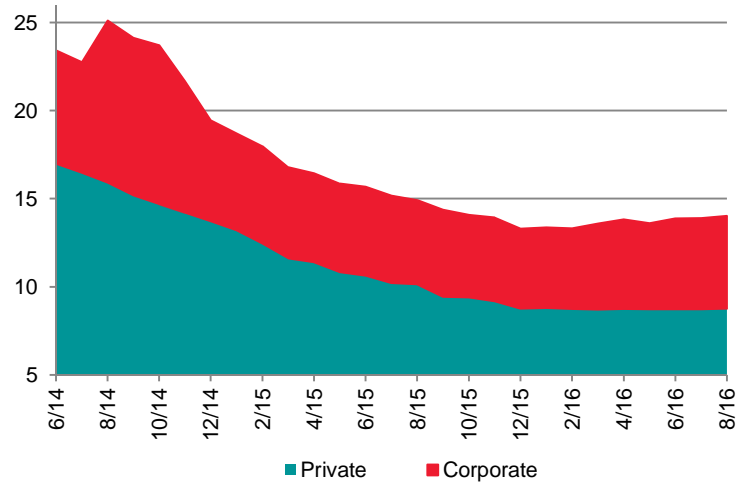
Source: State Statistics Committee

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## Banking sector

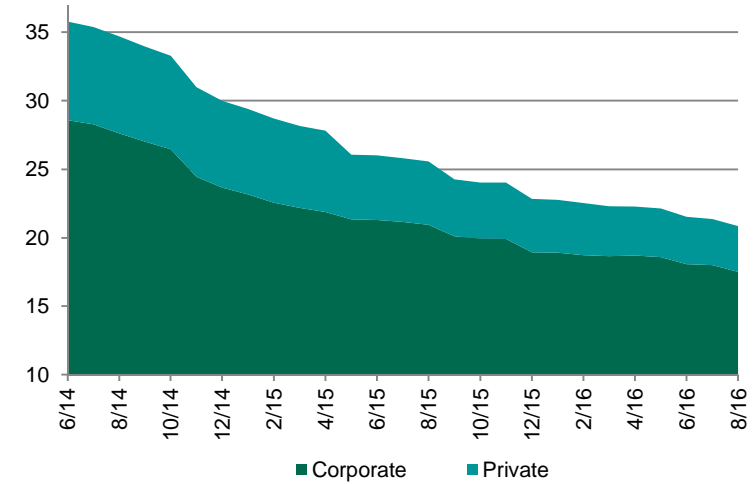


Banking FC deposits, USDbn



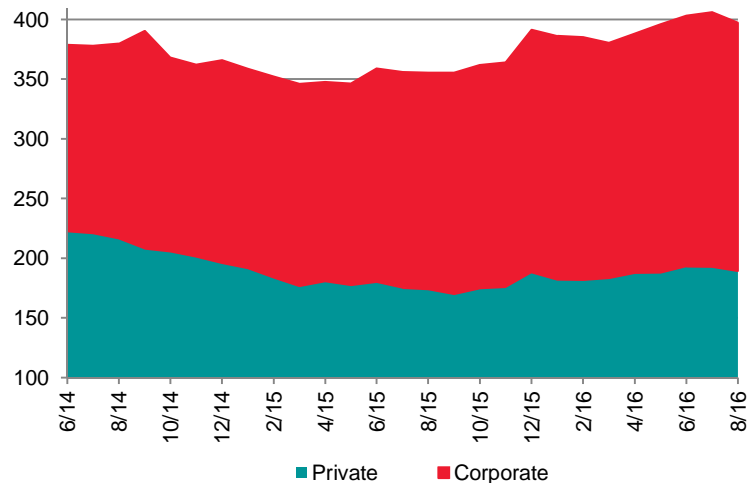
Sources: NBU, Credit Agricole

Banking FC loans, USDbn



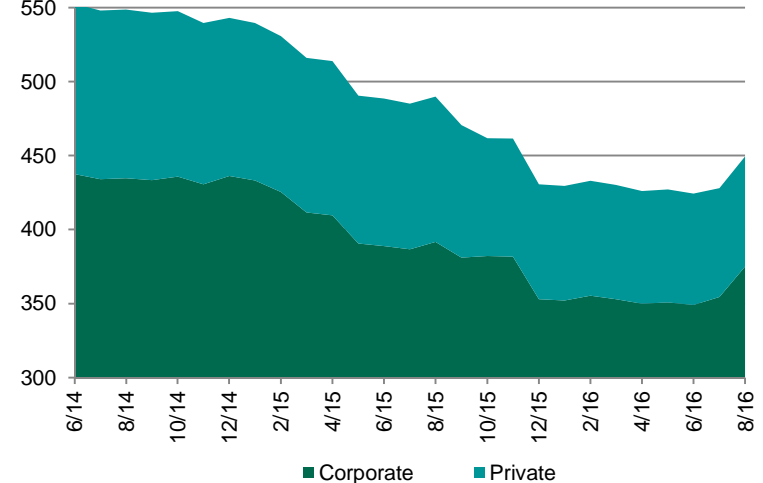
Sources: NBU, Credit Agricole

Banking LC deposits, UAHbn



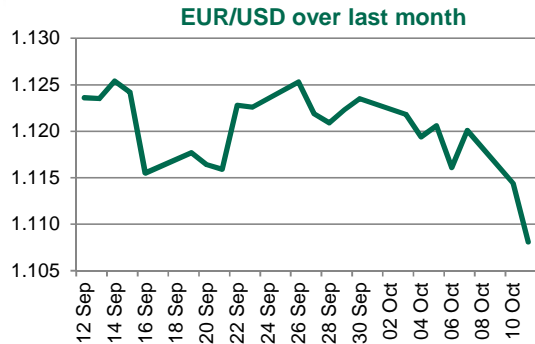
Sources: NBU, Credit Agricole

Banking LC loans, UAHbn

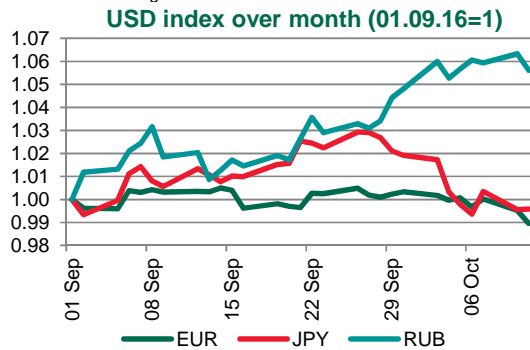


Sources: NBU, Credit Agricole

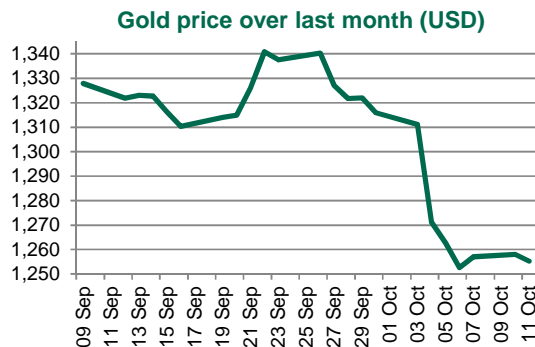
# Ukraine. Monthly Market Overview. October 2016



Source: Bloomberg



Sources: Bloomberg, Credit Agricole



Source: Bloomberg

- We expect real US GDP growth to average near 2.6% in the second half of the year. As more evidence accumulates that the economy continues to grow above its potential rate and labor markets strengthen further with a likely acceleration in wage growth, we believe that the cautious members of the FOMC will feel more confident on achieving their policy goals and are likely to raise rates by 25 bps in December. The November meeting should be off the table at this point because 1) the September payrolls report was solid but not exuberant, 2) a move would surprise markets just before the election and 3) there is no press conference scheduled for the November meeting.

The following are recent market forecasts:

**Crédit Agricole CIB EUR/USD forecast:**

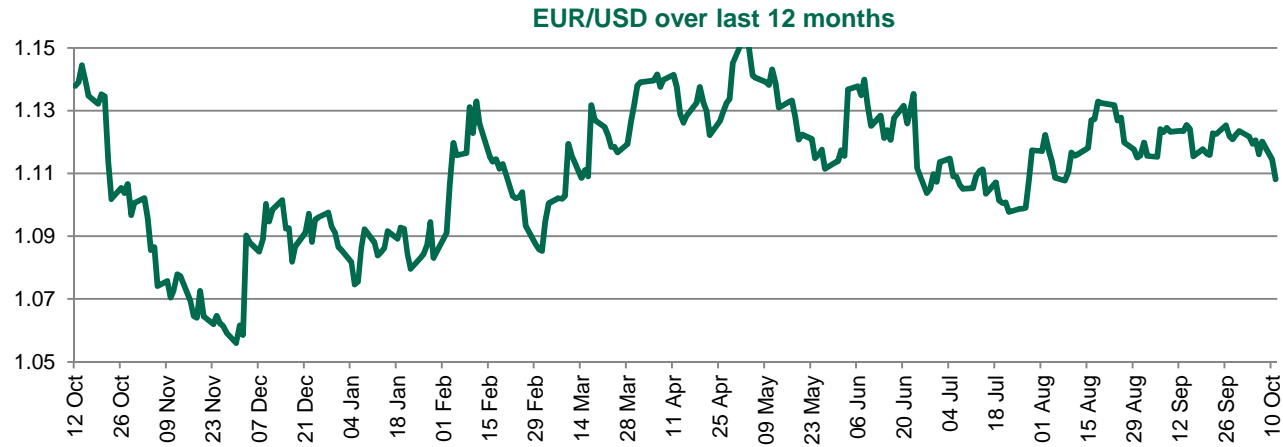
Q416	Q117	Q217	Q317
1.1000	1.1000	1.0900	1.0800

**Consensus forecast (Bloomberg FC Poll by 100 strategists average)**

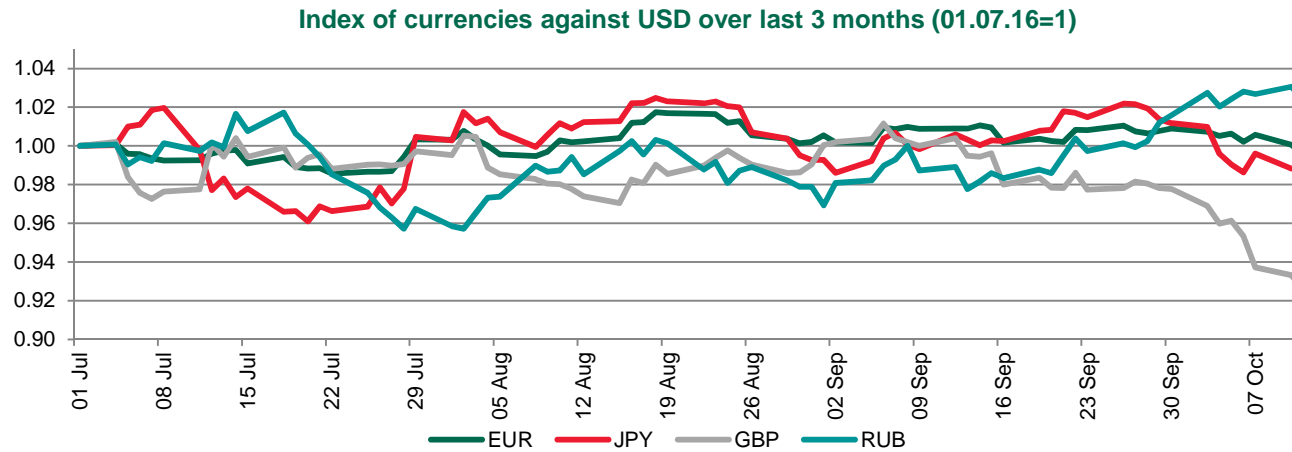
Q416	Q117	Q217	Q317
1.1000	1.0900	1.0900	1.1000



# Ukraine. Monthly Market Overview. October 2016



Source: Bloomberg



Sources: Bloomberg, Credit Agricole

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