

# Ukraine. Monthly Market Overview

## February 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	18/11/15



Financial Markets team

# Ukraine. Monthly Market Overview. February 2016

## Major Macroeconomic Trends



### MACROECONOMIC INDICATORS - evolution

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015E	2016F	2017F
Nominal GDP (USDbn)	49.5	64.9	86.2	107.7	142.7	129.0	117.4	136.2	165	174	178	130	94	95	104
Real GDP growth (%)	9.4	12.1	2.7	7.3	7.9	2.1	-14.8	4.2	5.2	0.2	0.0	-6.8	-10.4	1.0	3.0
Inflation CPI, eop (%)	8.2	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	43.3	13.0	8.7
Industrial production (%)	15.8	12.5	3.1	6.2	10.2	-3.1	-21.9	11.0	7.6	-1.8	-4.7	-10.7	-13.4	0.9	3.2
Merchandise exports (USDbn)	28.9	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	34.8
Merchandise imports (USDbn)	27.7	36.3	43.7	53.3	72.1	92.2	45.4	60.7	82.6	84.6	77.0	61.3	39.2	37.3	39.3
Public debt (% of GDP)	29.0	24.8	18.0	14.8	12.0	13.7	32.2	39.7	36.2	36.6	41.0	70.5	79.0	84.9	89.1
Current account (% of GDP)	5.8	10.7	2.9	-1.5	-3.6	-7.1	-1.5	-2.2	-5.5	-8.5	-9.1	-4.1	-0.7	-0.2	-2.3
Net FDI inflow over year (USDbn) NBU methodology	1.4	1.7	7.5	5.7	9.2	9.9	4.7	5.8	7.0	7.2	4.1	0.2	3.1	4.1	4.7

### EXCHANGE RATES - evolution

USD/UAH eop	5.33	5.31	5.05	5.05	5.05	7.70	7.98	7.96	7.99	8.04	8.24	15.82	24.03	26.0-29.0	27.3-33.3
USD/UAH average	5.33	5.31	5.12	5.05	5.05	5.32	7.79	7.93	7.97	8.02	8.16	12.02	21.92	25.2-27.5	26.7-31.2
EUR/UAH eop	6.70	7.20	6.00	6.70	7.42	10.86	11.45	10.57	10.30	10.54	11.04	19.14	26.12	28.6-31.9	32.8-40.0
EUR/UAH average	6.02	6.61	6.38	6.26	6.92	7.78	10.88	10.52	11.09	10.31	10.81	15.87	24.29	26.7-29.2	32.0-37.4
UAH O/N average	6.5	5.3	3.5	4.0	3.5	11.3	8.4	1.5	5.7	11.9	2.7	8.1	19.26	9.5	8.0

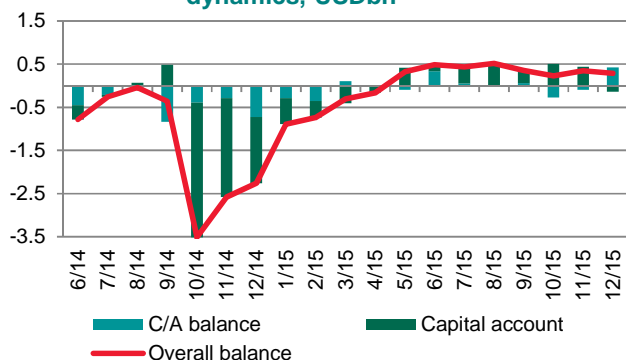
- **Political turmoil and growing risk of new parliamentary elections** were the most influential negative factors last month impacting both sentiment on domestic and external financial markets as well as perception of potential investors regarding medium-term opportunities in Ukraine. Potential political conflict also threatens to postpone the provision of financial assistance by international donors. Therefore, **ability of state officials to consolidate political forces. To keep government operating and to avoid early elections would be crucial** in restoring political stability and to continue reform path of the government.
- **Relatively unchanged situation in the zone of war conflict has impacted neither domestic economy nor financial markets** much last month, while non-readiness of the parliament to approve Constitutional changes regarding decentralisation (and, correspondingly, special status of Donbass) in final reading moved the problem and outcome of Minsk negotiations for few more months. **We think in base-case the situation would remain flat in the coming month.**
- Meetings with Ukrainian president and IMF managing director in Davos in January and corresponding comments on the issue raised probability that next IMF tranche to be disbursed in the coming month or two. And according to comments of finance minister **IMF is satisfied with new budget and amendments to Tax code, thus not requiring to change them immediately.** And we still consider recent comments of IMF director on concerns with slow progress in improving governance and fighting corruption rather as a warning signal to Ukrainian officials than a final verdict on inability to continue EFF program. Therefore, **we think coming few weeks may be important for president and the government to demonstrate political will in following IMF requirements.** And **as of now, we still consider possible a provision of new IMF tranche in March.**

# Ukraine. Monthly Market Overview. February 2016

## Major Macroeconomic Trends

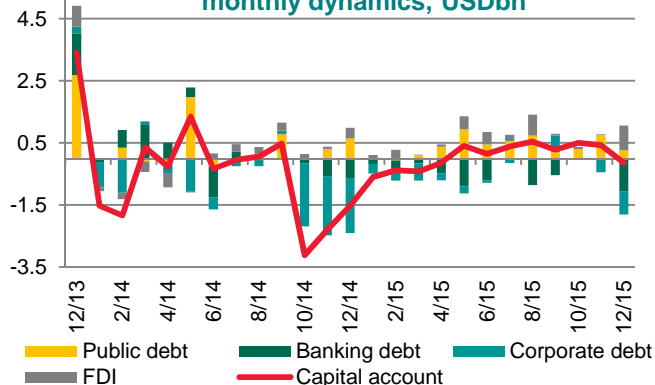


Major accounts of BOP, monthly dynamics, USDbn



Sources: NBU, Credit Agricole

Major accounts of capital account, monthly dynamics, USDbn



Sources: NBU, Credit Agricole

Forecast	GDP, YoY
Q415	-1.2%
Q116	1.7%
Q216	1.2%
Q316	0.5%

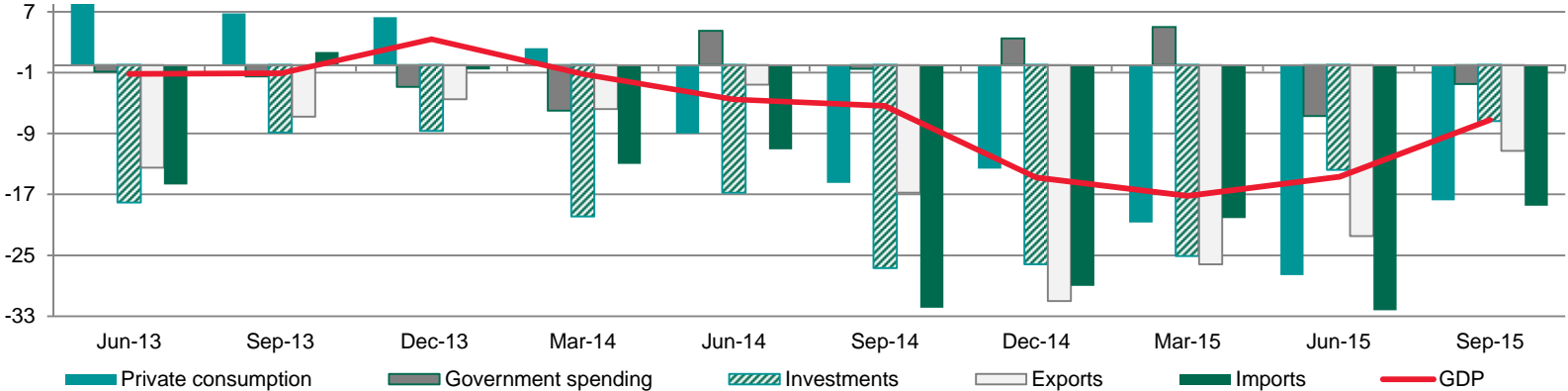
Source: Credit Agricole

- **Estimates of economic sector's dynamics over December showed a visible improvement**, while most of sectors still demonstrate a negative dynamics. **Most significant improvement was shown by construction** (YoY drop by 9.5% in November was changed with a first growth of 10.4% over recent three years). The improvement in negative dynamics was also recorded in all major sectors: industry from -4.9% YoY in November to -2.1% in December, agriculture – from -11.1% to -6.4% and trade – from -16.4% to -12.9%.
- **We still consider low comparison base of 2014 as a most likely reason for improvement in the performance of major economic sectors last December.** We think same reason would should have been contributing much to the performance of Ukrainian sectors last January. However, a recovery factor is not hefty enough yet to support positive YoY dynamics in the economy. Therefore, we think **economic performance would still look better in January than in December, albeit at slower pace.**
- **Preliminary estimate of Ukrainian GDP dynamics over 2015 by economic ministry shows a decline of 10.4% YoY.** The figure is quite close to our projections (-10.2%), thus reflecting a natural reaction of economy on war conflict in Donbass, annexation of Crimea and rapidly falling world commodity prices.
- **Even though Ukrainian GDP with a high probability should be positive for 2016, the growth may be weakened** by slow progress in reforming economy and its slow recovery from shocks it received during war conflict in Donbass and annexation of Crimea. Additionally, trade embargo together with a ban on transit imposed by neighboring country as well as still falling world commodity prices would negatively weigh on ability of economic sectors to show strong growing dynamics. Therefore, **we had to downgrade our 2016 GDP forecasts from previous 1.8% to current 1.0%.**
- **BOP turned positive over 2015 (USD0.8bn)**, which strictly contradicts to tremendous deficit of USD13.3bn in 2014. We consider the improvement in balance of payments occurred on the back of two influential factors. First of all, solid hryvna devaluation in Feb-Mar of last year, declining energy consumption as well as a ban on dividends' repatriation **have improved current account to a tiny deficit of USD0.2bn versus -USD4.6bn the year before.** Second, solid package of financial assistance from international donors into public sector (net inflow of USD4.6bn) compensated partially the outflows under accounts of banking (-USD5.3bn) and corporate (-USD2.4bn) sectors. And **negative balance of external debt flows was also minimized by inflows under FDIs** (USD3.1bn) and net purchase of foreign currency on cash FX market (USD2.1bn).
- **We expect that current account balance would be worsened again this year** (to -USD2.2bn) due to still falling world commodity prices and temporary disruptions in exports (backed by trade embargo and transit bans imposed by country-aggressor). However, **solid estimated net surplus of external debt's flows in public sector (USD1.5-2.0bn) as well as further inflow of FDIs (USD3.5bn) will keep BOP in positive area this year** (estimated at 1.0-1.5bn).
- **We predict BOP negative this January** due to worsening external trade balance (after a ban on imports and transit) and postponement of financial assistance flows). However, the FDI may still remain slightly positive on continuing support of existing investments by their owners.

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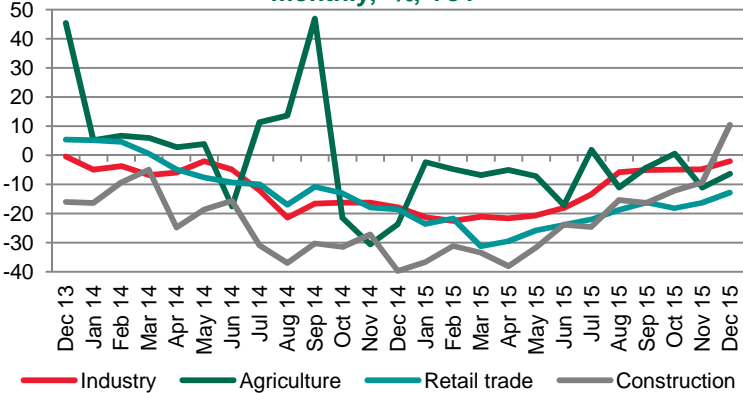
## Major Macroeconomic Trends

Quarterly GDP dynamics by expenditure components, %, YoY



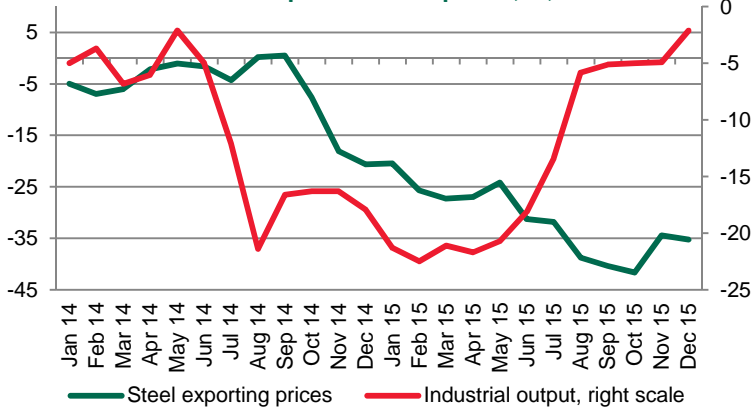
Sources: State Statistics Committee

Performance of major economic sectors, monthly, %, YoY



Source: State Statistics Committee

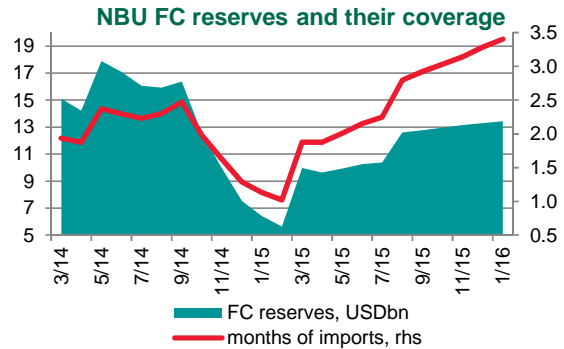
Industrial output and steel prices, %, YoY



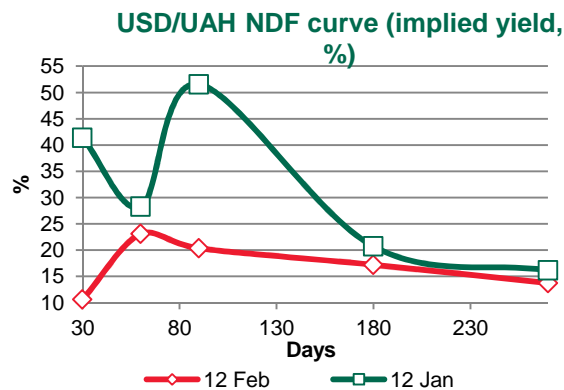
Sources: State Statistics Committee, Bloomberg, Credit Agricole

# Ukraine. Monthly Market Overview. February 2016

## FX Market



Sources: NBU, Credit Agricole



Source: Bloomberg

Forecast, eop	USD/UAH	EUR/UAH
Q1'16	25.0-27.0	27.0-29.2
Q2'16	24.5-26.5	25.7-27.8
Q3'16	25.5-27.5	26.8-28.9
Q4'16	26.0-29.0	28.6-31.9

Source: Credit Agricole

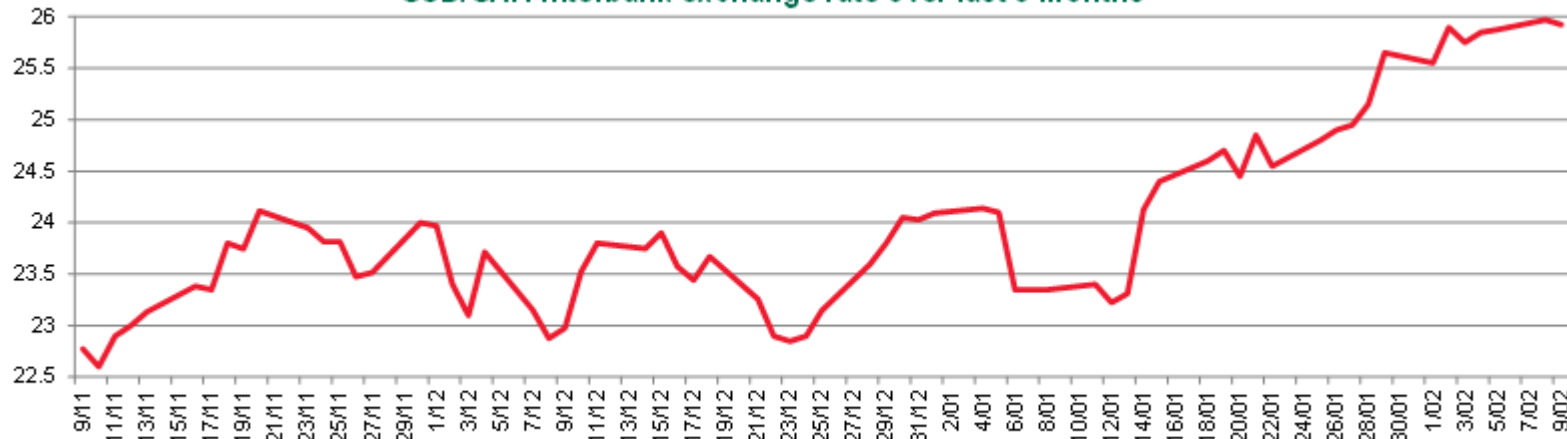
- FX market started the year with a traditional deficit of foreign currency** due to long Christmas holidays. This turned the USD/UAH upwards already in the middle of January above a previous benchmark of 24.00 that NBU followed over November-December of last year. However, the imbalance of foreign currency on the market was strengthened recently by introduction of food embargo by neighboring country because Ukraine joined association agreement with EU. But even this effect was not as dramatic for exports and, correspondingly, for FX market recently as introduction of ban on transit of Ukrainian exporting goods to Asian CIS countries and northern China through territory of Russia. Therefore, **recent FX market dynamics reflected temporary problems Ukrainian exporters have faced after imposition of export limitations by a country-aggressor**. However, **we do not consider this risk as a long-lasting**. First of all, the volume of food exports into Russia has already dropped in 2015 in 3.5 times versus last year to just USD0.25bn. Secondly, Ukrainian exports are adjusting their exports to alternative routes, thus trying to restore their deliveries.
- In addition to temporary shortages in exports, **negative perception of FX market participants was strengthened in the middle of February after IMF managing director stated on inability to continue Fund's program without progress in improving governance and fighting corruption**. And despite the fact that this was just a warning signal than a real threat, domestic FX market was frightened by this news, thus raising imbalances and sending the USD/UAH to new 12-month heights (ie above 26.00). However, **recent actions of the NBU provide evidence that it decided to defend 26.00 as new temporary benchmark**.
- As soon as the USD/UAH moves above 26.00, NBU acts correspondingly through FC sale auctions. However, **the auctions are not frequent yet and the volume of FC sale was not tremendous**. In particular, NBU sold just USD118m through five auctions in January and USD52m through three auctions over first half of February. This supports **our view on potential ability of the NBU to stabilise the market around 26.00 for near-term**. However, **the risk to this scenario may still come from political (or geopolitical) scope, thus forcing the NBU to move to new benchmark**.
- NBU FC reserves inched slightly up in January (by 1% MoM to 16-month maximum of USD13.4bn)**. This together with a further drop in imports **raised the coverage of imports by reserves to 3-year maximum of 3.4 months**, thus indicating on growing ability of the NBU to control FX market stability, at least in the short-term. We think reserves grew last month mostly due to issuance of FC local government bonds of USD0.49bn, while spending on servicing external debt was quite moderate (USD0.34bn). Additionally, NBU spent USD0.07bn from its reserves through net FC interventions.
- As spending for repayment of external debt would be rather small (USD0.07bn), **we expect relatively stable volume of FC reserves in February**. At the same time, it would also depend on the volume of foreign currency the NBU spends through its FC interventions.
- Because the behaviour of domestic FX market as well as the path of the USD/UAH is not often ties to fundamental factors, but is highly sensitive to political and geopolitical news, **we consider it inadequate currently to make FC projections for the coming few years based on point forecasts**. Hence, **we decided to move to the range of forecasts**, with lower value there reflecting our estimates based on fundamental factors and a higher value based on influence of non-fundamental (eg. political and geopolitical factors). As a result, **our year-end USD/UAH forecasted range is 26.00-29.00**.

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## FX Market

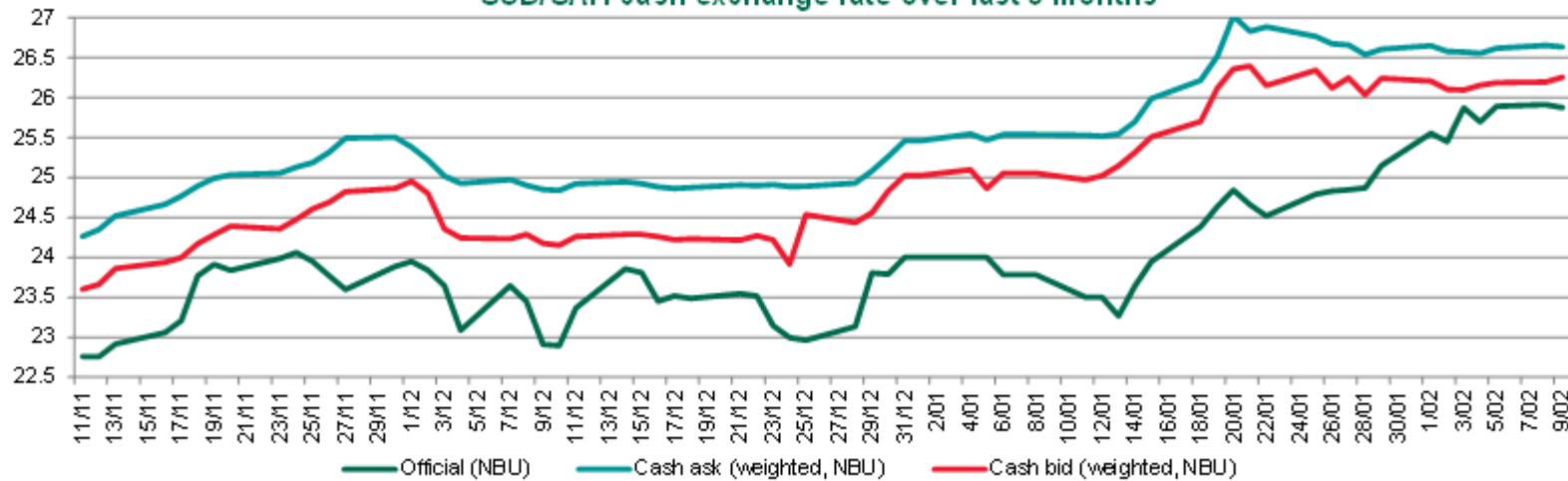


USD/UAH interbank exchange rate over last 3 months



Source: Bloomberg, Credit Agricole

USD/UAH cash exchange rate over last 3 months



Source: NBU

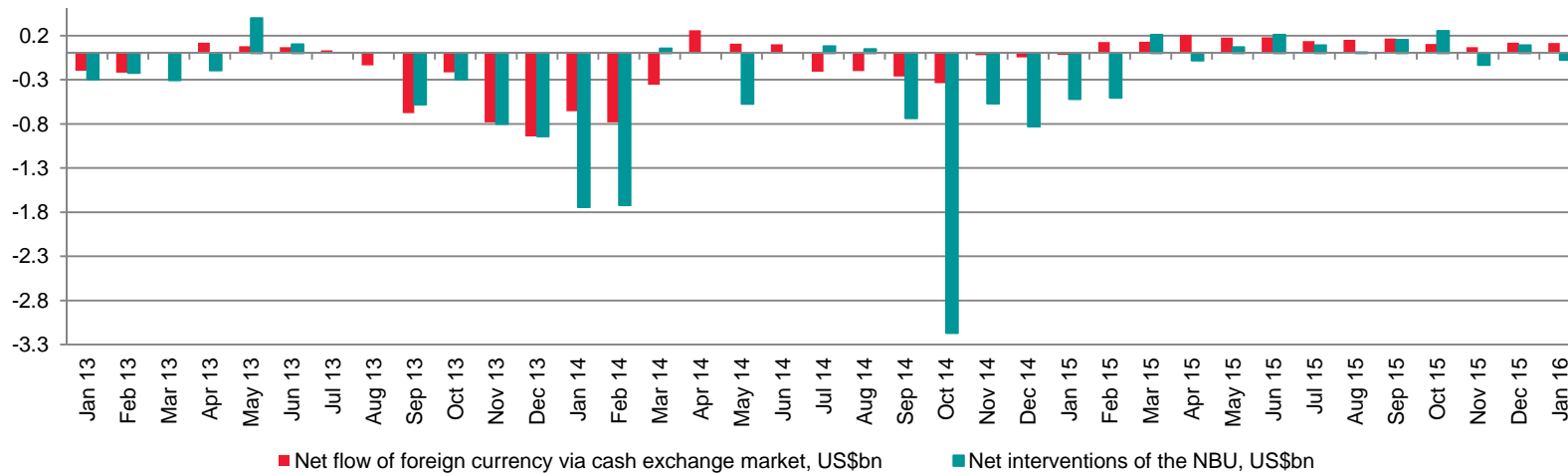


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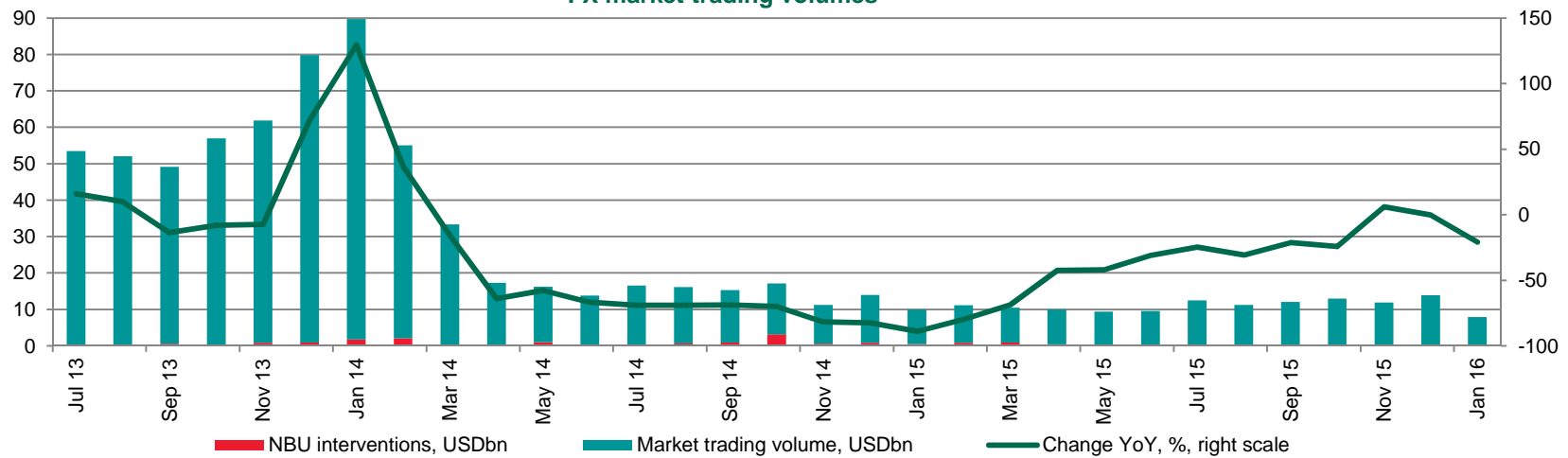
## FX Market



Net flows on interbank and cash FX markets

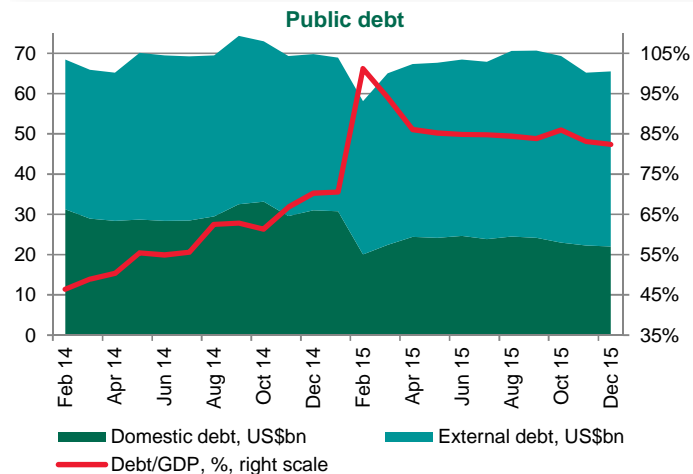


FX market trading volumes

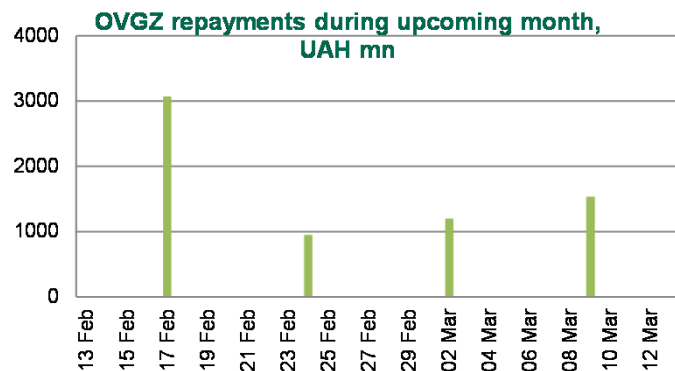


# Ukraine. Monthly Market Overview. February 2016

## Debt indicators



Sources: Finance Ministry, Credit Agricole



Sources: NBU, Finance Ministry,

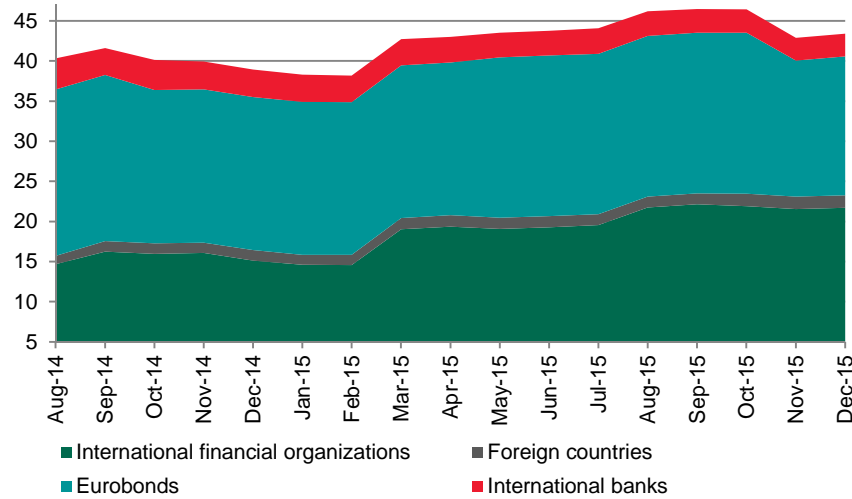
- **Public debt inched slightly up 0.5% MoM over December**, mostly due to increase in external debt (by 1.2%). In particular, the stock of Ukrainian Eurobonds grew by USD0.35bn due to inclusion of City of Kyiv Eurobonds into a package of restructured debt. External debt nominated in USD also corrected upwards on the back of EUR/USD rate fluctuations. Contrary to external debt, domestic one faced a small drop over December (-0.8% MoM) due to no new borrowings and continuing redemption of the debt by the government. **Debt-to-GDP ratio has improved slightly over December (82.4%) versus 83.1% the month before.**
- **We expect moderately flat public debt in January** on the back of relatively same volume of new borrowing and redemptions. In particular, the government borrowed USD0.43bn through issuance of local government FC bonds, while paying simultaneously USD0.34bn for holders of these bonds back. At the same time, **an upward correction in the USD/UAH may reduce the USD value of public debt slightly.**
- **The return of Finance ministry to the market of domestic borrowings occurred in both local currency and foreign currency segments.** Initially, FC government bonds were more attractive, where Finance ministry borrowed USD0.92bn through two auctions in January-February. We think attractiveness of these bonds is tied not only to their issuance in foreign currency and attractive yield. Instead, **these bonds are viewed by some exporters as an instrument to sell their foreign currency proceeds** at better USD/UAH rate than current FX market one. According to borrowing schedule, **Finance ministry is not planning to issue new FC bonds, at least until end of March.** Therefore, interest of domestic banks in the coming month or two may be more skewed towards UAH bonds.
- Similar to FC bonds, activity of investors in the segment of local LC bonds **was also quite strong.** In particular, **the government managed to borrow UAH1.30bn, while 90% of bonds sold represent the ones maturing in more than one year.** Taking into consideration auction yield of these bonds at 19.50-20.00% (ie rather close to secondary market rates), we think **the bulk of these auctions was market-oriented**, thus providing a hope for the restoration of UAH bonds secondary market in the near-term. And decision of the NBU not to offer UAH bonds from its portfolio as well as not to sell CDs maturing in one and three months **should move interest of domestic banks to short-term bonds of the government soon.**
- **Ukrainian finance minister expects around USD10bn of inflow from external creditors in 2016.** We think the bulk of external loans is expected from IMF (around USD6.8bn via EFF) and US government (USD1.0-1.0bn via guarantee on bond issuance). Taking into consideration the volume of external public debts' repayments this year at around USD4.0bn, **the government would remain in net FC surplus of around USD6.0bn.** This should positively affect the ability of the government to service its obligations as well as reduce devaluation fears regarding hryvnia in the medium-term, with simultaneous replenishing of NBU FC reserves.
- **The yields of Ukrainian restructured Eurobonds reached maximums in early Feb since their initiation in Nov'15 on political turmoil** tied to possible changes in the government, growing risk of pre-term parliamentary elections and fear that political turbulence may delay international bailout programs. And **in case this risk would grow we expect higher Eurobonds yield in the near-term backed entirely by non-fundamental factors.** However, any external default risk is still quite small currently.



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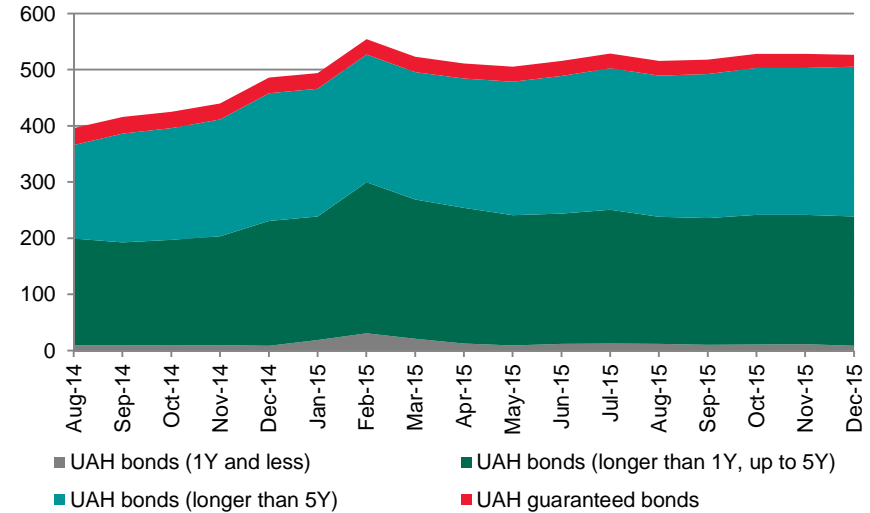
## Debt indicators

External public debt dynamics, USDbn



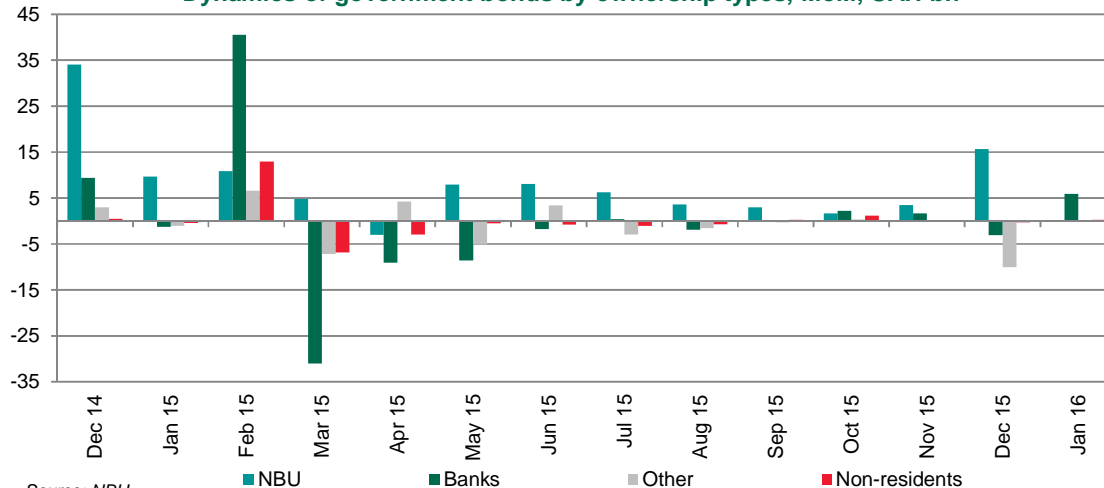
Source: Finance Ministry

Domestic public debt dynamics, UAHbn



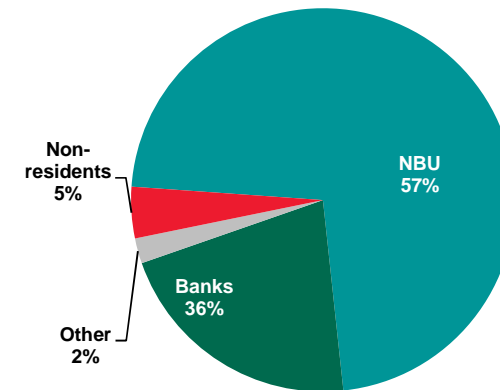
Source: Finance Ministry

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



Source: NBU

Breakdown of OVDP by owners (as of 12 Feb  
Total volume - UAH540bn)



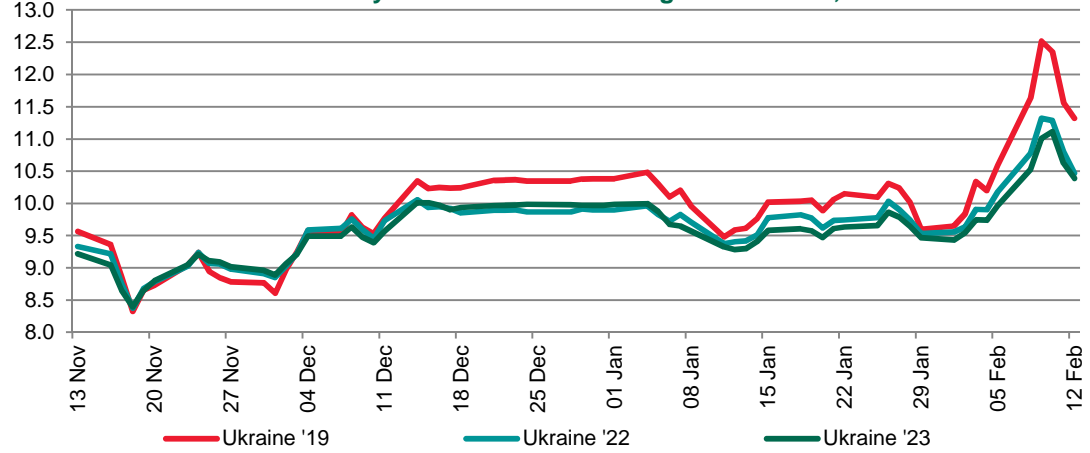
Source: NBU

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## Debt indicators

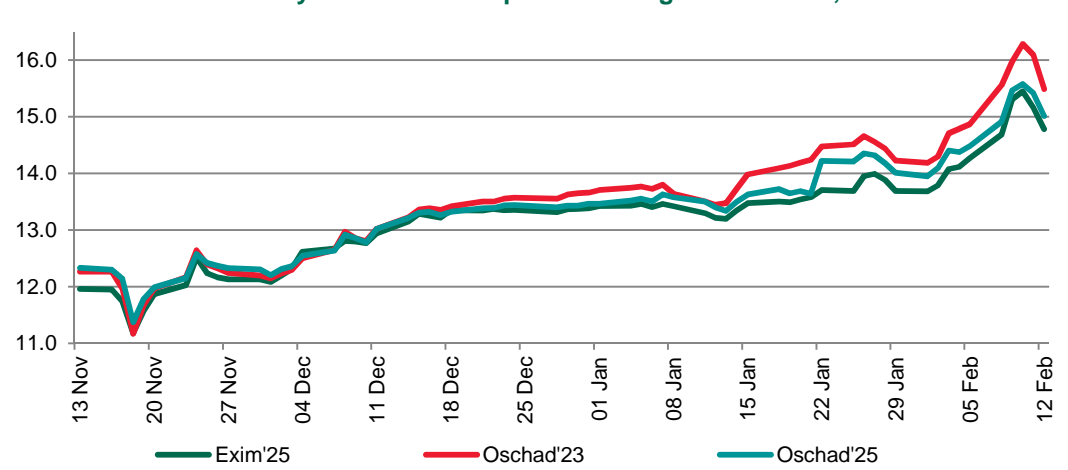


Yield dynamics of new sovereign Eurobonds, %



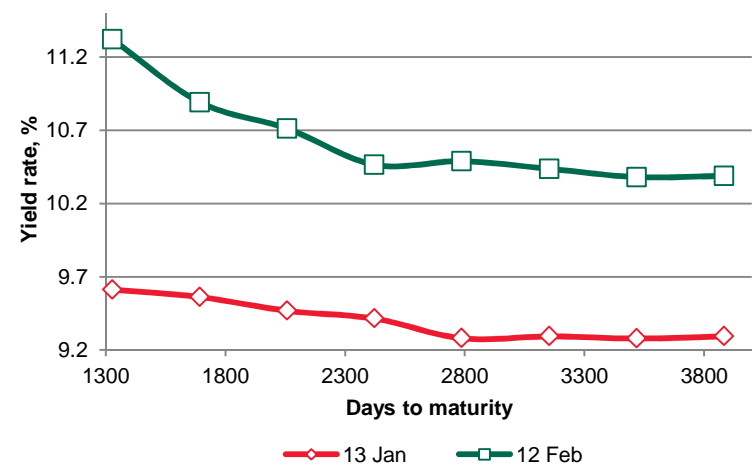
Source: Bloomberg

Yield dynamics of new quasi-sovereign Eurobonds, %



Source: Bloomberg

Ukraine's sovereign Eurobonds yield curve



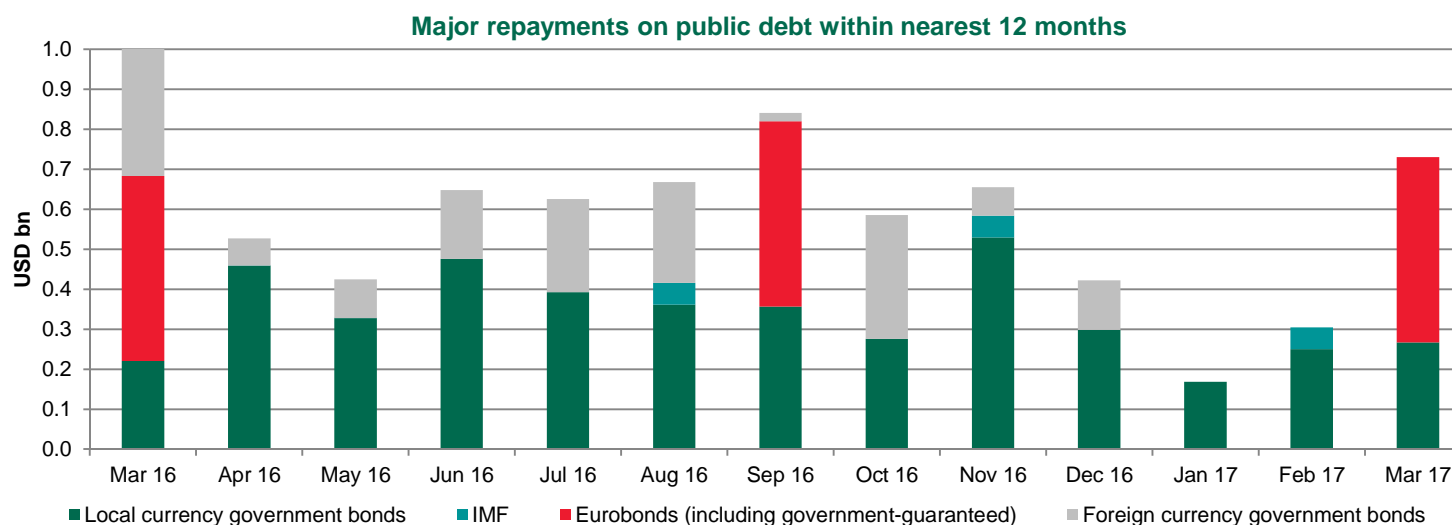
Source: Bloomberg

## Ukraine. Monthly Market Overview. February 2016

### Debt indicators



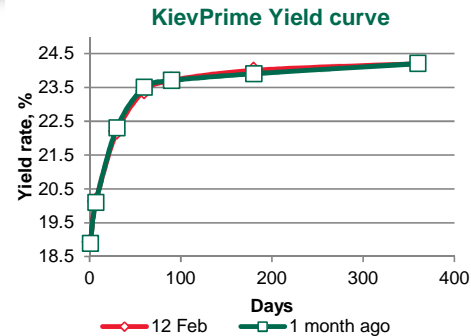
USDbn	Q116	Q216	Q316	Q416	2016
<b>Repayment of FC-denominated public debt</b>	<b>1.5</b>	<b>0.6</b>	<b>1.3</b>	<b>0.9</b>	<b>4.3</b>
Foreign currency local government bonds	0.7	0.4	0.5	0.5	2.0
IMF debt	0.0	0.0	0.0	0.1	0.2
Eurobonds (including state-guaranteed)	0.5	0.0	0.5	0.0	0.9
Other	0.3	0.2	0.3	0.3	1.1



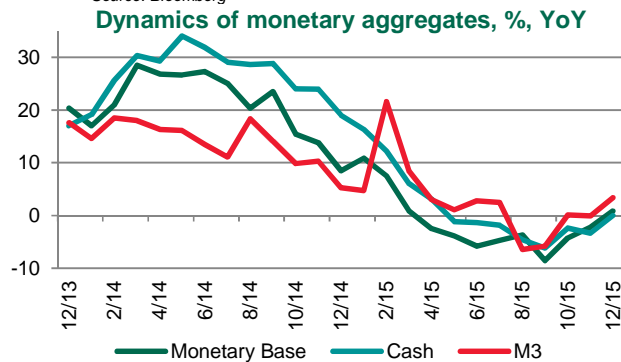
Source: Credit Agricole

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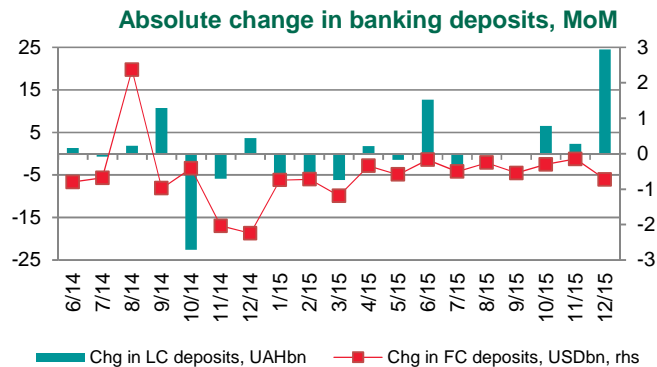
## Money Market



Source: Bloomberg



Source: NBU



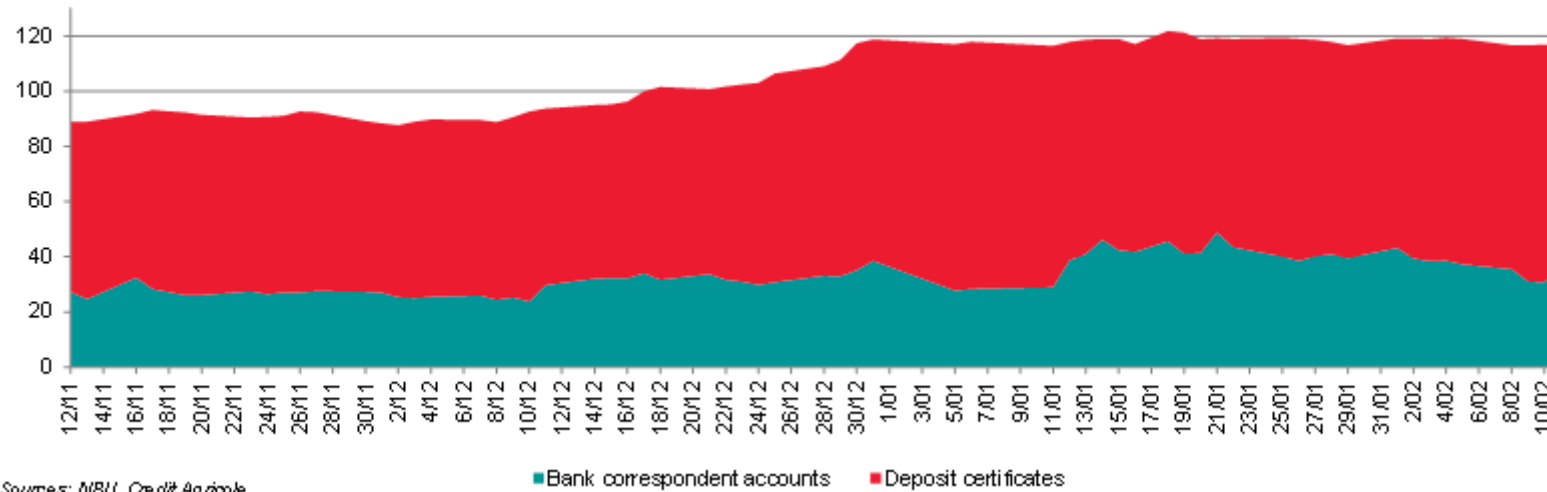
Source: NBU

- **Interest rates have been relatively stable over recent month.** We think sufficient money market liquidity and no changes in the rates of NBU CDs was a core factor behind such dynamics in interest rates. General banking liquidity (including NBU CDs) has remain mostly flat even though quick liquidity fluctuated. In fact, these fluctuations were almost fully absorbed by NBU deposit certificates. We think **the path of interest rates in the coming month would mostly depend on the NBU CDs rates.** And taking into consideration growing probability of lowering NBU key rate (and, possible CDs rates) at the end of February, **we can see a downward movement in interest rates in the coming month.**
- **NBU decided to keep its key rate unchanged at 22% for February.** The decision fully fits with consensus forecasts as inflation over January has not provided signs of its visible contraction. Therefore, NBU monetary policy remains mostly tight. And NBU decision on preserving key rate has impacted neither its CDs rates nor money market interest rates.
- Because CPI would show its visible slowdown in the coming two months and the bulk of last year's inflation was recorded in March-April, we think **NBU may soften its key rate already at the end of February.** As we expect CPI for February and March at 34.9% and 22.8%, respectively, **we think NBU may decide to lower its key rate towards 15-18%.**
- **NBU is not offering 3M CDs to banks since mid-Feb.** It also thinks on abolishing the auctions on offering one-month certificates. Hence, the scope of NBU instruments would be narrowed just to CDs with a maturity of one day to two weeks. NBU officials explain such decision to plans of Finance ministry to issue three-month government bonds and elimination of potential competition between the latter and NBU in placing short-term instruments. The stock of 1M and 3M CDs currently reaches UAH21.3bn or a quarter of all deposit certificates. And it is logical that a portion of banks' demand for 1M and 3M CDs should be switched towards government bonds, in case they will offer adequate yield. However, taking into consideration placement in 2016 of only one issue of government bonds maturing in less than a year (ie 9 months) at a yield of 18.50%, we think **current rates for short-term CDs at 18.00-20.00% would induce banks to reinvest into them instead of switching to government bonds.**
- **CPI in January (0.9% MoM) was slightly lower than a consensus forecasts of 1.1%. In YoY terms it shows a visible slowdown to 40.3% versus 43.3% last December.** We think seasonal factor for food products (2.2% MoM) was the only driving factor for positive inflation last month. And same factor would be a core for inflation dynamics in the coming few months. At the same time, moderate hryvnia devaluation should also contribute to prices' dynamics in February. Hence, **we expect its acceleration to 1.3% this month. However, in YoY terms CPI should still show a visible decline.**

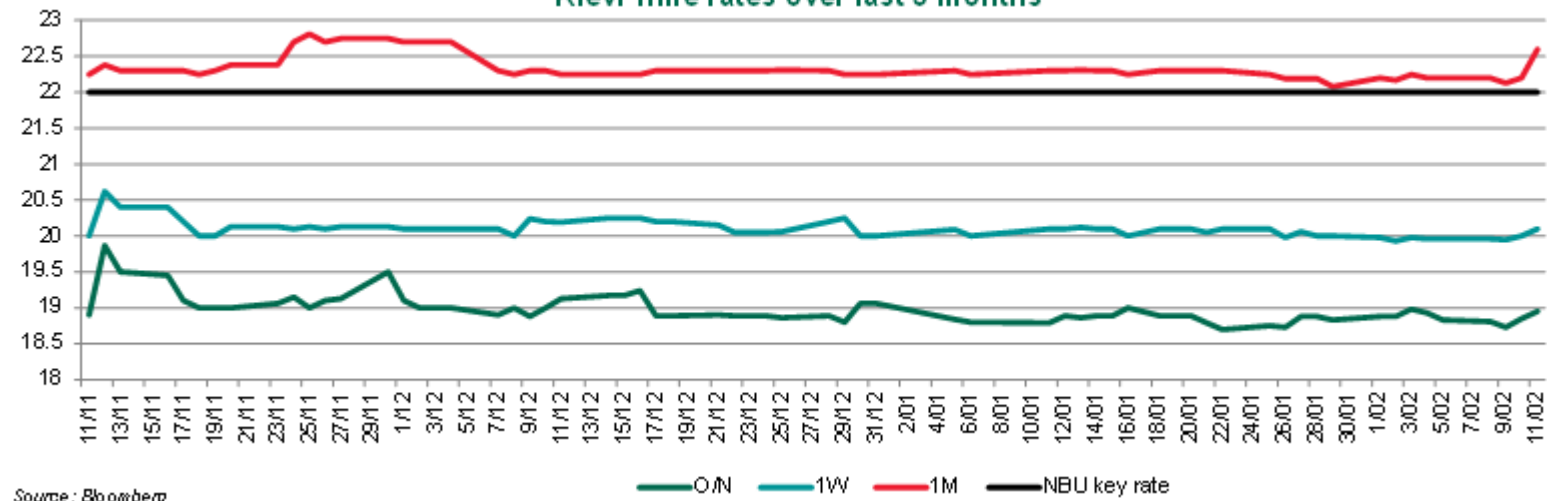
# Ukraine. Monthly Market Overview. February 2016

## Money Market

Money market liquidity over last 3 months



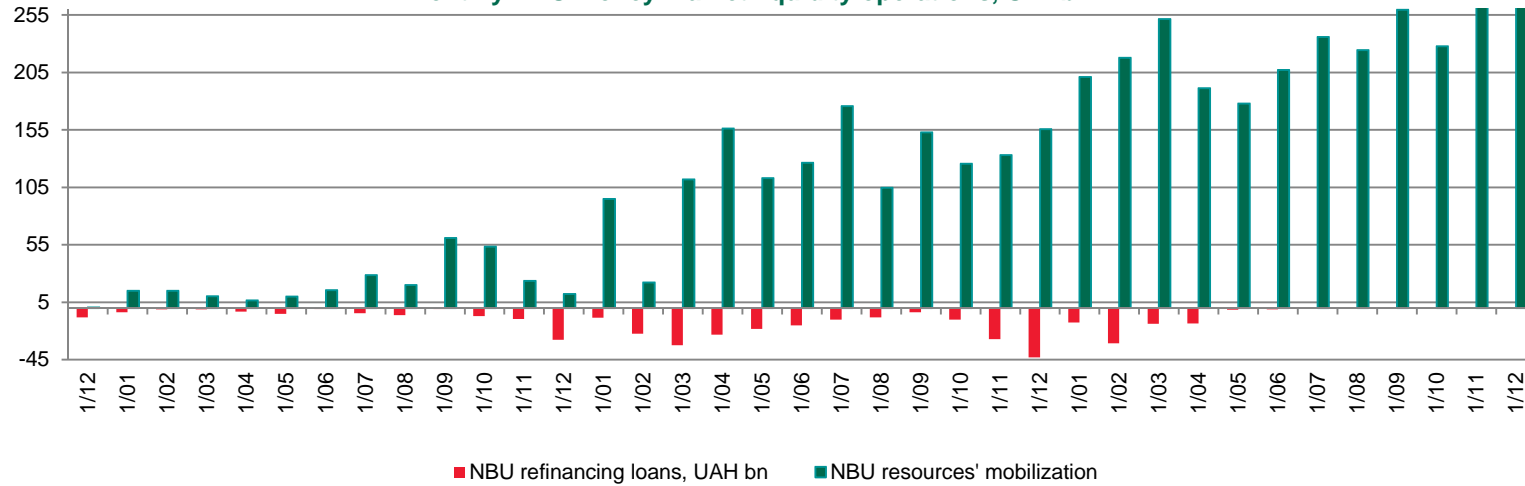
KievPrime rates over last 3 months



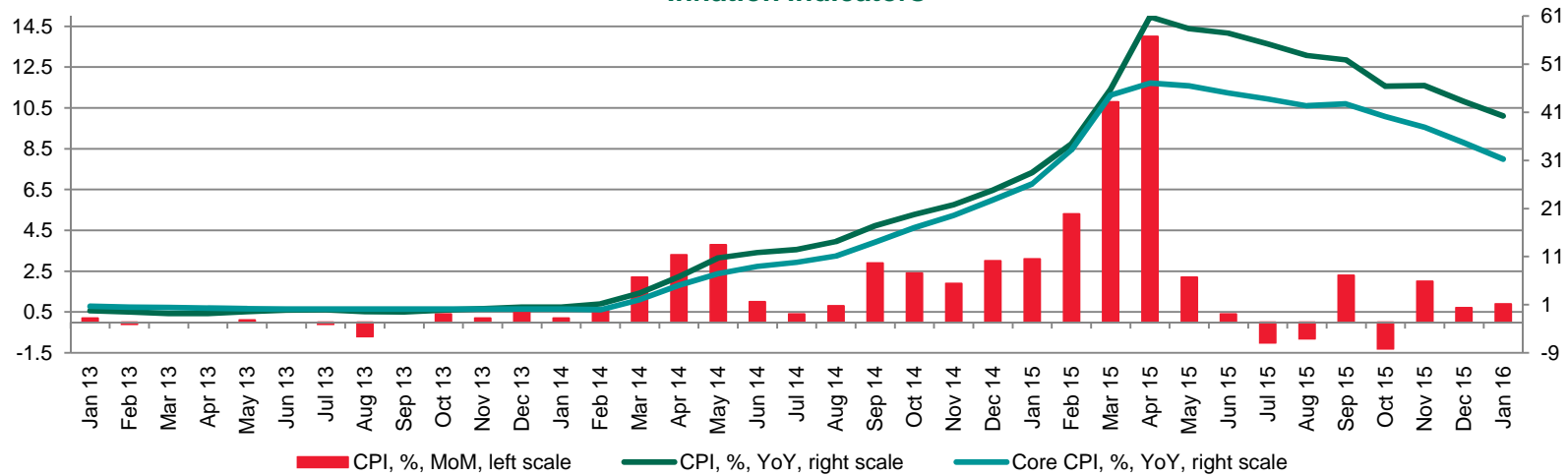
# Ukraine. Monthly Market Overview. February 2016

## Money Market

Monthly NBU money market liquidity operations, UAHbn



Inflation indicators



Source: State Statistics Committee

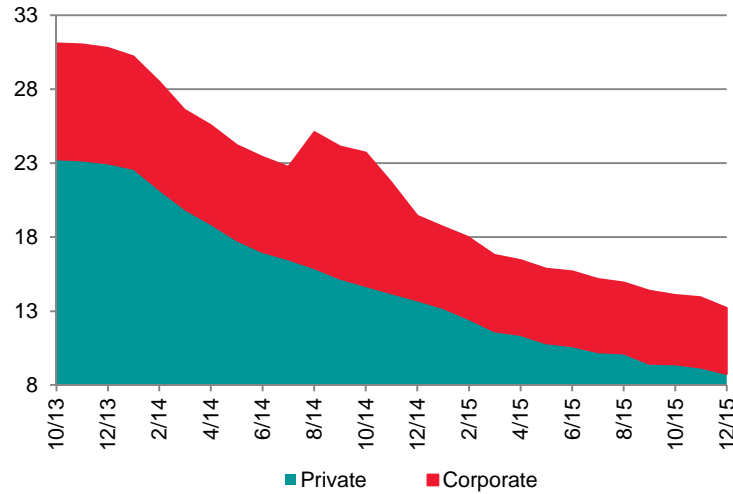


# Ukraine. Monthly Market Overview. February 2016

## Banking sector

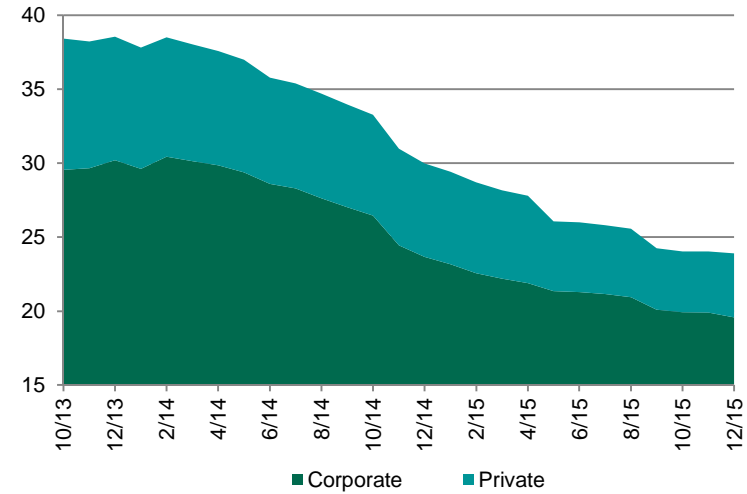


Banking FC deposits, USDbn



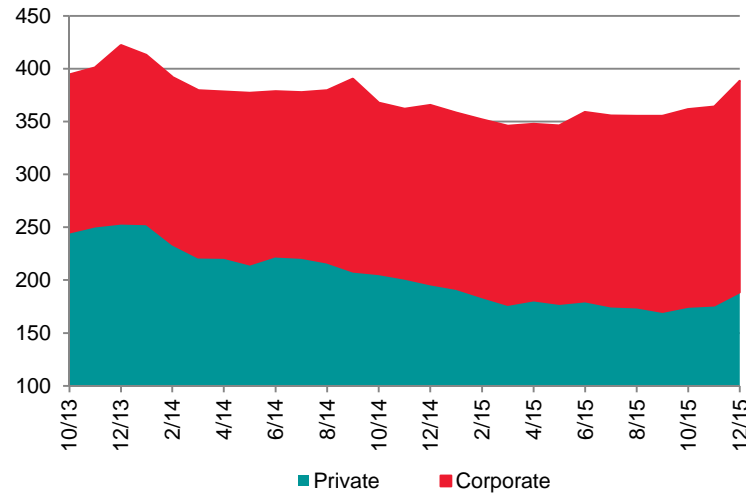
Sources: NBU, Credit Agricole

Banking FC loans, USDbn



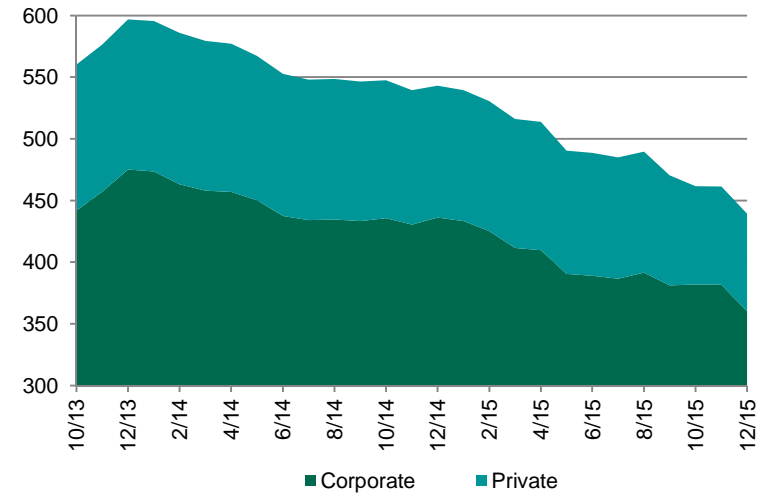
Sources: NBU, Credit Agricole

Banking LC deposits, UAHbn



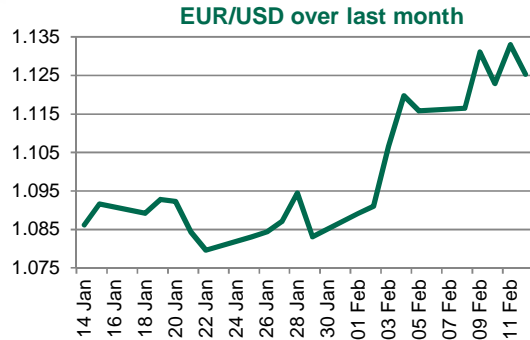
Sources: NBU, Credit Agricole

Banking LC loans, UAHbn



Sources: NBU, Credit Agricole

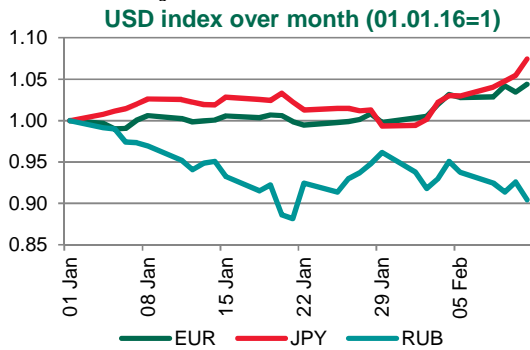
# Ukraine. Monthly Market Overview. February 2016



Source: Bloomberg

- The EUR/USD spent the month on a roller coaster ride with the Federal Reserve and the ECB being the main focus of the markets. The EUR closed at 1.0833 seeing a small decline for the month of 0.25%. Of notable concern was a drop-off in consumer spending growth to 2.2% in the fourth quarter, down from 3% in the prior quarter. There hopes that dramatic decline in oil prices in the latter half of 2015 would put more money in consumers' pockets, allowing them to spend more freely on consumer goods. Consumer spending, after all, represents nearly 70% of overall GDP

The following are adjusted market forecasts:



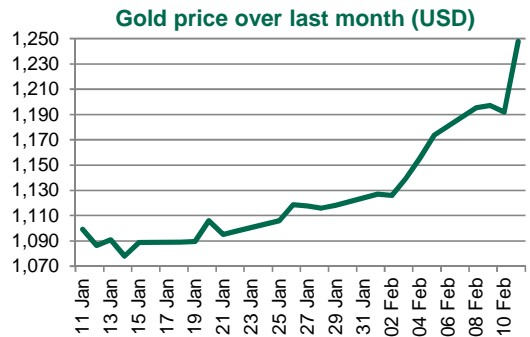
Sources: Bloomberg, Credit Agricole

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

Q116	Q216	Q316	Q416
1.0400	1.0300	1.0200	1.0300

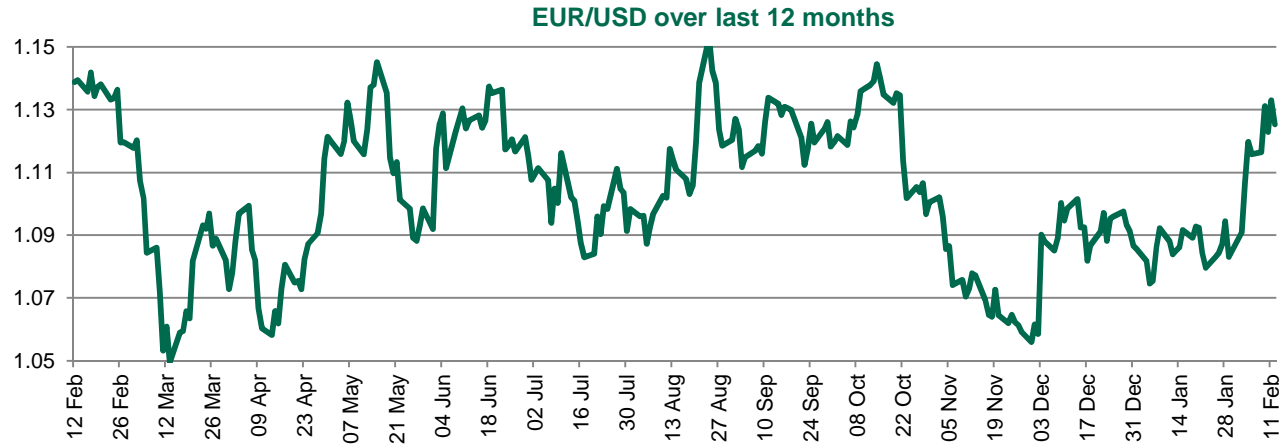
**Consensus forecast (Bloomberg FC Poll by 99 strategists average)**

Q116	Q216	Q316	Q416
1.0700	1.0600	1.0600	1.0600

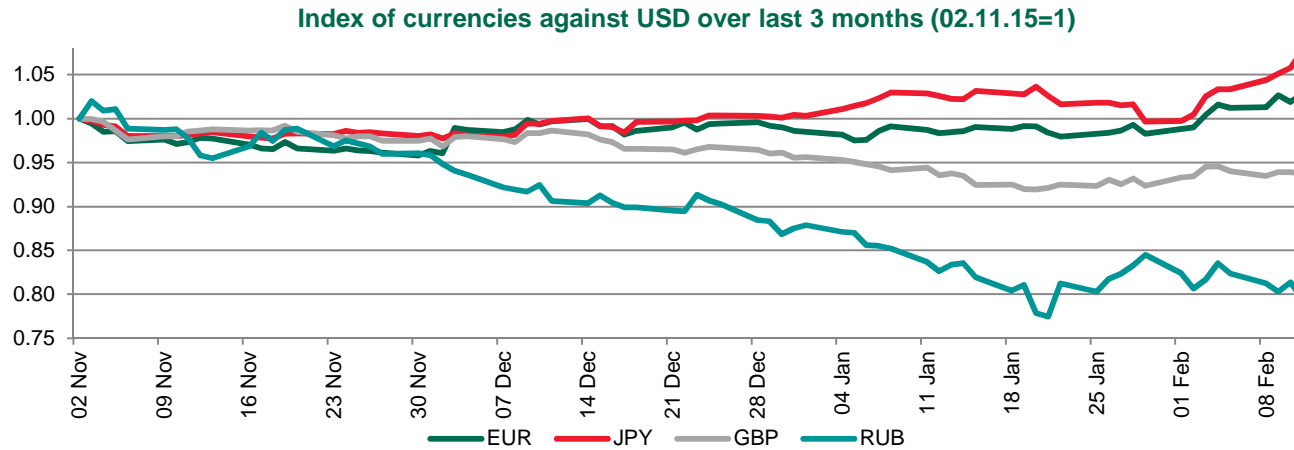


Source: Bloomberg

# Ukraine. Monthly Market Overview. February 2016



Source: Bloomberg



Sources: Bloomberg, Credit Agricole

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