Focus
Ukraine

Scope
Economics

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Economic Insight

USD super rally fades, its meaning for UAH

THURSDAY, 30 APRIL 2015

Yesterday's global financial markets' reaction to US statistics results once again underscored the trend that has evolved since late March and early April. As the US economy slowed in 1Q, the US Fed is likely to postpone a decision to increase interest rates until this fall, halting the extended nine-month rally of the US dollar. This should provide a welcome reprieve for Ukraine in the remainder of 2Q through the first half of 3Q, as long as the Kremlin adheres to the Minsk 2 agreement and does not escalate the war.

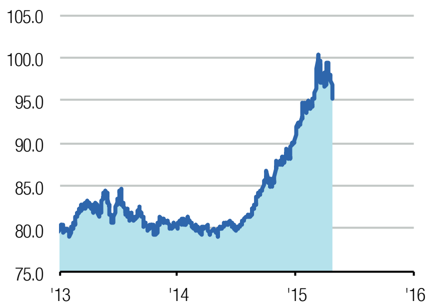
US economy increased just +0.2% in 1Q. Market consensus since March has been that the US real GDP in 1Q15 will be well below 2.5% and in the 0.0-1.0% range. Yesterday's disappointing data release was in the low side of that range, causing the dollar to decline 1.3% to the euro (closing at 1.1128) and 0.9% to the basket of major currencies as measured by the DXY index. This also signals the end of the prolonged US dollar rally (in DXY terms) that lasted from last June to this March. We expect a lull over the next three-four months at the very least.

The cautious Fed likely to postpone rate increase until fall. In the recent past, consensus opinion was that the Fed would start raising rates either this June or September. Following yesterday's data, the prevailing consensus is the move will occur in September, with ongoing data releases from May through the summer to determine the decision date. Although the 5.5% US unemployment rate has been near the target level recently and its improvement is likely to lose momentum, employment data is not widely anticipated to deteriorate. As financial markets adjust to the expected rate increase by the Fed in late summer or early September, the US dollar may rediscover its strength again as investors increase long positions. However, another US dollar super rally has a very low probability of repeating itself later this year.

Ukraine: UAH to stabilize, economic recovery to be visible. The devaluation pressure on the UAH is set to subside. Future returns of building low-yielding USD long positions are declining as these trades become less desirable for Ukrainian investors. The recent appreciation of the UAH toward 21/USD is in line with the above-mentioned macro developments despite Ukraine's real GDP in 1Q being expectedly super weak because of the war and the World Bank's announcement of worsening its full-year real GDP forecast to 7.5% YoY. ICU's forecast of a 7.6% YoY contraction forecast was published on March 12. The above-mentioned moderation of the domestic financial market should support a recovery of the real part of the economy and hear we expect recovery will be visible in the statistical data published for 3Q (not in 2Q, albeit some stabilization is expected particularly in the second quarter).

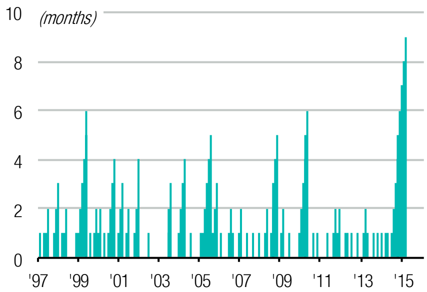
Kremlin is a risk. If Kremlin-run militants in the ungoverned enclave of Donbas renew their offensive and violate Minsk 2, the above-mentioned expectations will be derailed. The sanctions regime so far has not resulted in Kyiv retaking territory annexed by the Kremlin.

US dollar index (DXY)
Daily history since 1 Jan 2013 through now



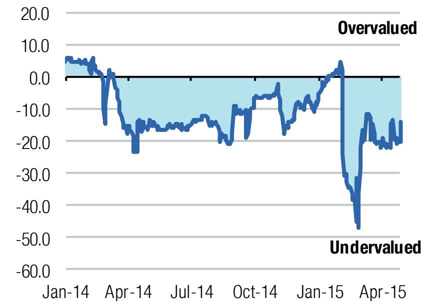
Source: Bloomberg.

Number of months in a row of DXY rise
Monthly history since Jan 1997 through now



Source: ICU.

UAH misalignment by CPI-based real TWI
Since 1 Jan 2014 through now



Note: * CPI-based real trade-weighted index.
Source: ICU.

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