



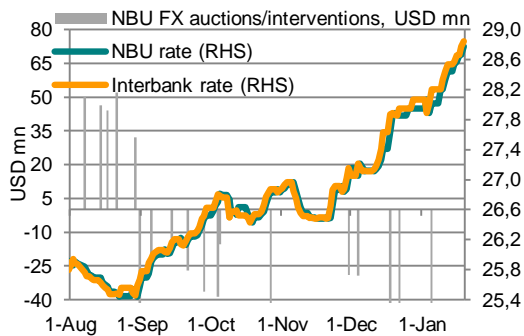
This week in focus: UAH to appreciate on a 6-month horizon

According to our expectations, Ukraine's currency is likely to be close to its trough vs USD and also likely to regain roughly UAH 1 per quarter between today and mid-2018.

Please see page 3 for more details

FX and interest rates: Rada adopted privatization law required by IMF

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH increased to 28.84 as of Friday the 19th. Week-on-week local currency declined by 1.1 % against the USD.

Average daily FX volumes on the market landed at the equivalent of USD 205.2mn, USD 13.5mn higher than in the previous week.

The NBU refrained from interventions on the market via currency auction this week. In 2018, NBU held only one currency auction, selling USD 50.5mn YTD.

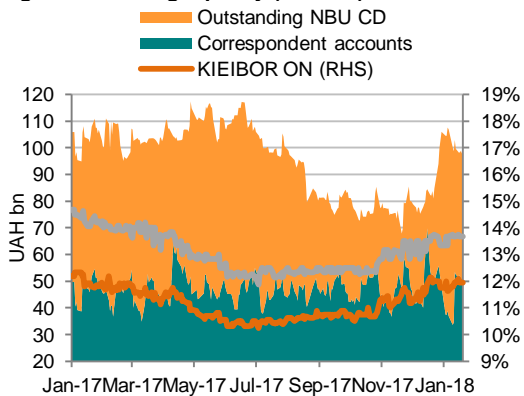
Aggregate banking liquidity amounted to UAH 98.9bn as of Friday the 19th, remaining effectively flat, declining by UAH 0.7bn.

Money market rates remained flat: cost of ON funds is around 12.25/13.5%, 1 week is 12.5/14.0% while 1M is 13.5/16.00%, according to our data.

On its latest auction, MoF managed to attract UAH 1.6bn of proceeds. At this time, market participants were offered only bonds issues denominated in local currency. Demand on the bonds with the shortest maturity exceeded other securities' demand with higher maturity.

Currently, yields (bids) of local OVDP in UAH at 16.50% (for 6m), 16.70 (for 2Y). 1Y USD bids were at 5.30%, while bids for VAT bonds were at 16.75%.

Figure 2. Banking liquidity (UAH bn)



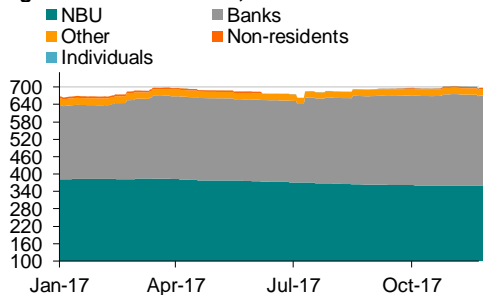
Source: Reuters, NBU, Uksribbank, Minfin

Figure 5. OVDP auction results, 16th of January 2018

CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size	Placement size
UAH	3m	16.00%	16.00%	16.00%	16.00%	7	7	695.0m	718.5mn
UAH	6m	16.00%	16.00%	16.00%	16.00%	3	3	570.9m	569.6mn
UAH	9m	15.75%	15.75%	16.00%	15.75%	6	3	382.6m	308.3mn
UAH	3 y	-	-	16.00%	15.70%	4	-	31.3mn	-

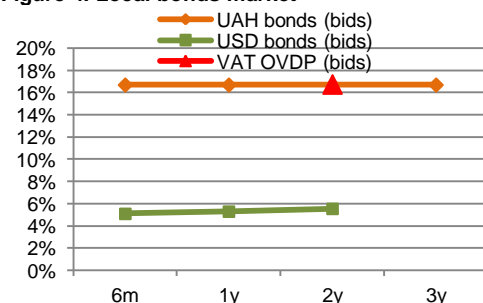
In December, Ukrainians bought from banks USD 801.7mn (in equivalent), while amount of hard currency sold to banks amounted to USD 736.5mn (in equivalent), resulting in net purchase of USD 65.2mn, up from USD 39.7mn in November. In 2017, foreign currency, which was sold to the banks by households were in excess of bought currency by USD 2.1bn. Overall balance on the cash market supported hryvnia in 2017, as households sold around USD 2.1bn to the banks on a net basis. While in 2018, this positive effect on the national currency most likely will be more moderate or even close to zero.

Figure 3. OVDP holders, UAH bn



Source: NBU

Figure 4. Local bonds market



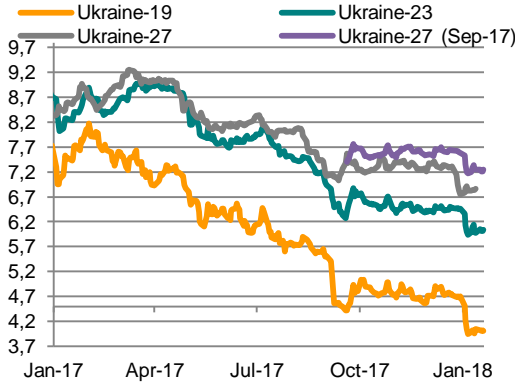
Source: Uksribbank

On Thursday, Verkhovna Rada passed the bill on privatization in the second reading and in full. Adopted privatization amendments include the following: 1) All privatization objects are split up into two categories, namely large and small (instead of 6 categories, according to previous legislation); 2) Large privatization objects shall be approved by Cabinet of Ministers and only after that by State Property Fund, while small objects shall be approved by State Property Fund only; 3) The time of the conducted procedure is reduced, as some stages are effectively canceled in the new law; 4) Small objects are required to be sold only on electronic auctions, with starting price set at a level of book value; 5) Large objects are to be sold at the auctions, with all terms set by Cabinet of Ministers and the starting price is reconciled with Cabinet of Ministers. In contrast, small objects will be sold via electronic auction system Prozoro. Not all investors can take part in the auction. Those who are recognized as related to a country aggressor are prohibited from participation.



Global markets: China's economy expanded by 6.9% in 2017

Figure 5. Ukraine's sovereign Eurobond yields, bid/ask mid (%)



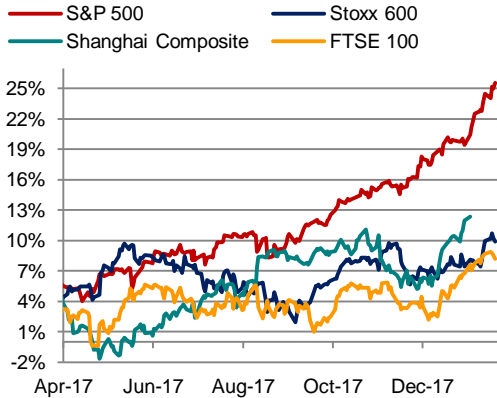
Source: Reuters

Figure 6. EUR USD spot (mid)



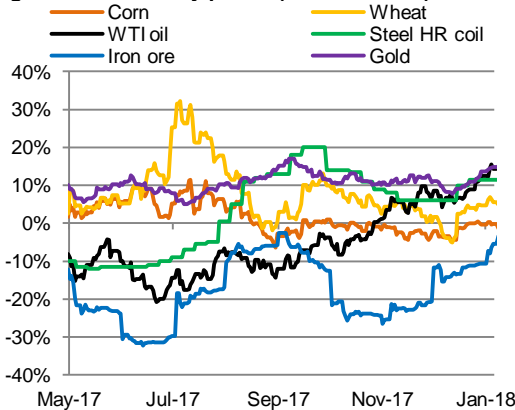
Source: Reuters

Figure 7. Major stock indices (Jan-2017=100)



Source: Reuters

Figure 8. Commodity prices (Jan-2017=100)



Source: Reuters

Having declined by 41 000 to 220 000, US jobless claims reading posted the lowest tally since 1973, remaining below 300 000 threshold for a 150th week in a row and reversing four straight prior week increases. While Euro zone trade surplus strengthened in November in line with German. China's economy surprised on the upside, growing 6.9% y/y in 2017.

Bond benchmarks fell, with 10y Treasuries' yields rose 11 bp week-on-week to the level of 2.66%, while German 10y Bunds' yields increased 5bp, landing at 0.57%, Japanese 10y bonds closed the week at 0.078.

US equities mixed, with S&P added 0.9%, while Nasdaq Composite gained by 0.0 % week-on-week.

On Thursday, the Labor Department revealed its latest reading on the health of the job market. Initial claims for state unemployment benefits dropped by 41 000 to a seasonally adjusted 220 000 for the week ended January 13. The latest data marked the 150th straight week that claims remaining below the 300 000 threshold. Supporting the health of the job market, the latest reading reversed prior trend, when claims rose four weeks in a row. At the same time, the jobless rate remains at a 17-year low of 4.1%, indicating near full employment in the country.

EUR/USD rate landed at 1.222 as of Friday the 19th, higher than the last week closing level of 1.2185, as the USD mainly underperformed against its main counterparts.

Stoxx 600, a broader gauge of European equity performance increased by 0.6% week-on-week, while German DAX ended the week by 1.4% higher.

The euro area current account surplus rose in November, reversing two months decline. It reached EUR 32.5bn, up from EUR 30.3bn in October. Euro area export of goods increased by 7.7% in November, while imports rose by 7.3%, resulting in trade surplus of EUR 26.3bn, up from EUR 23.8bn. Meanwhile, trade surplus in Germany increased to EUR 22.3bn in November, up from EUR 19.9bn in prior month. As export rebounded by 4.1% m/m, reversing -0.3% m/m decline in October. The pace of import gained by 2.3% m/m, accelerating from 1.8% m/m in previous month.

China's economy grew by 6.9% y/y in 2017 and 6.8% y/y in the fourth quarter, accelerating for the first time since 2010. According to the statistic bureau, it beat government target of around 6.5%. In 2017, economy expanded by 6.7% y/y, which was the lowest point in 26 years. As China ramped up efforts in recent time to reduce debt and increase air quality, this may impact 2018 GDP growth. Anti-pollution measures included shutting down or cutting back production at factories in industries like cement and steel.

Crude oil fell, as WTI 1m futures dropped by 0.6% week-on-week and closed at USD 63.4 per barrel, while Brent 1m futures declined by 1.8%, closing at USD 68.6 per barrel.

Gold prices slightly fell, as NYMEX 1m futures drop by 0.3% week-on-week and finished the week at USD 1331.9 per troy ounce.

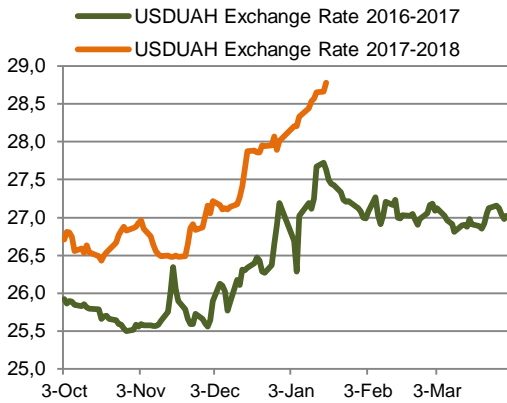
Grains finished the week in black, as CBOT Corn 1m futures rose 1.2% week-on-week and closed at USD 352.5 per bushel, while CBOT Wheat 1m futures laded at USD 422.75 per bushel, 1.5% higher week-on-week.

Iron ore were flat, as NYMEX Iron ore 62% Fe 1m futures rose 0.2% week-on-week and closed at USD 76.68 per ton.



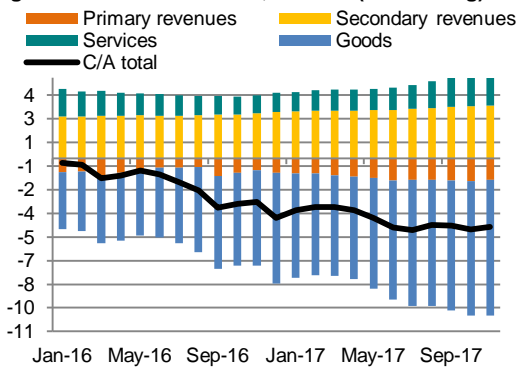
This week in focus: UAH to appreciate on 6-month horizon

Figure 9. USDUAH exchange rates



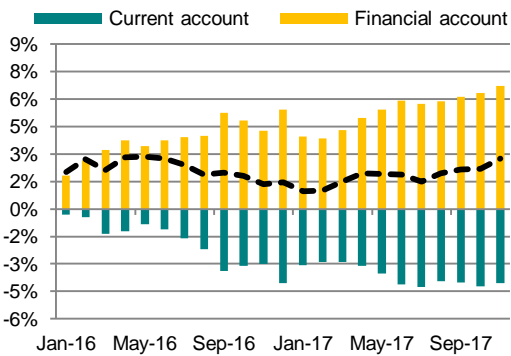
Source: NBU

Figure 10. Current account, USD bn (12m rolling)



Source: NBU

Figure 11. BoP 12m rolling, as a % of GDP



Source: NBU

Global markets have had remarkably bullish start in the year, the animal spirits are strong as never, and the equity markets have reached new historic highs. All of this has consequences for USD, which embarked on a soft patch. In particular, EUR has reached 1.2275 as of 11:00 Kyiv time on Friday, which implies 3% week-on-week appreciation. While there are worries that more expensive European currency might cause ECB concern, our Group research believes that it is only the speed of EUR appreciation which is worrisome for ECB, not the level itself (please, see “Eurozone: Hard currency” report distributed today). In fact, the model-implied fair value in EURUSD is close to 1.30 area.

At the same time, UAH continued to remain on depreciation trend, having lost more than 8% between beginning of Q4 2017 (where seasonal weakness started to weigh on the exchange rate), and today, now standing at 28.84 vs USD.

According to our expectations, Ukraine’s currency is likely to be close to its trough vs USD and also likely to regain roughly UAH 1 per quarter between today and mid-2018. We would like to provide the following USDUAH quarterly guidance:

- End Q1 **28.25**
- End Q2 **27.00**
- End Q3 **27.00**
- End Q4 **29.50**

As we were continuously pointing out in our research (see our Weekly reports), **the main driver of UAH depreciation in Q4 and Q1 is uneven supply of liquidity** from Ukraine treasury account which reaches its peak in December (this year we saw peak in Jan 4th with +UAH 28 bn), and drives devaluation expectations. This creates very clear seasonal pattern for local currency (see Graph below).

Another point to the favor of stronger UAH is **some stabilization in balance of payment** which we observe in the last months. I.e. in November Ukraine saw a surplus in current account, which helps to stabilize its annual external trade deficit in range of 4.3% of GDP, which is very reasonable comparing to other EM countries (which are not oil exporters, of course).

2018 is likely to be a good year for Ukraine’s economy. In line with other participants of NBU Survey of professional forecasters we expect 3.1% GDP growth this year, driven by consumption and investment growth.

Having spelled our arguments for a stronger UAH in the short run, **we also underline structural weaknesses of Ukraine’s economy and Ukraine’s policymaking which are both likely to deliver another round of local currency devaluation closer to year-end 2018 and create heavy tail risks for outlined FX scenario.**

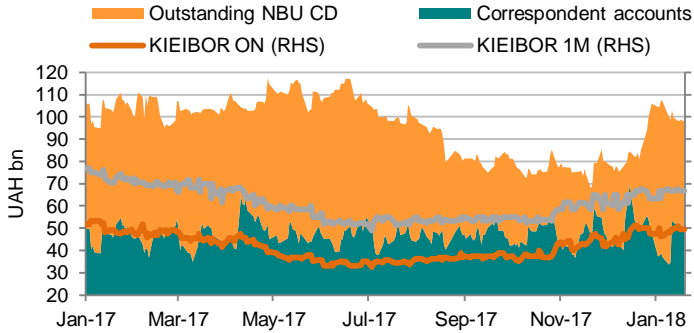
Ukraine clearly delivers very selective on reform agenda and this induced several long delays in ongoing EFF program. As of today it is clear, that reform progress has been fragmented and the country’s economy **remains extremely vulnerable to external shocks. In this light, we see the probability of a very material stress in case external environment becomes less favorable (not the case for now).**

Finally, we would like to comment on a “budget” FX rate of 29.30, stipulated in Ukraine’s budget law 2018. Indeed, some part of budget expenses will likely be made with stronger UAH around. However, recalling that peak in budget expenses is exactly December, where we expect UAH to weaken to 29.50, we must render the “budget” rate reasonable and fully compliant with our FX scenario.



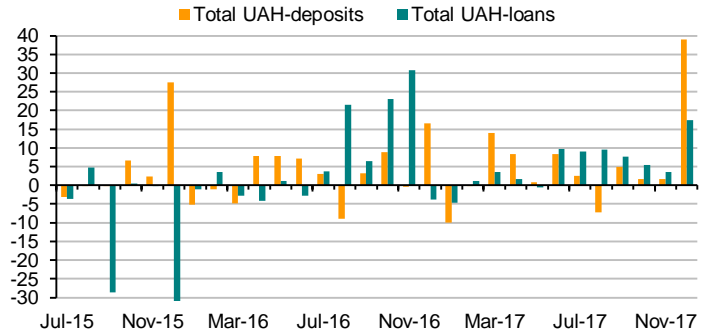
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

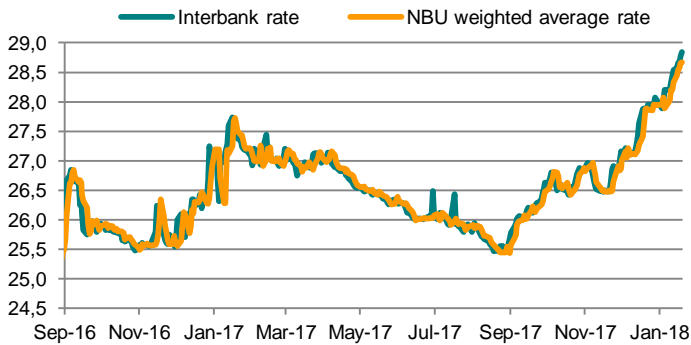
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

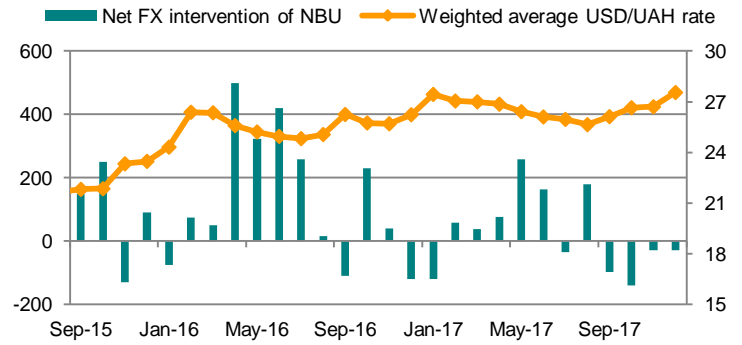
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

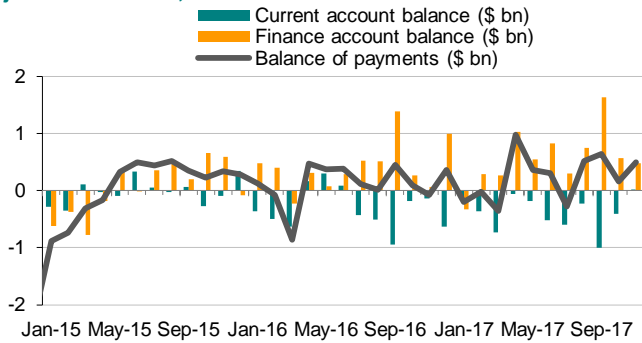
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

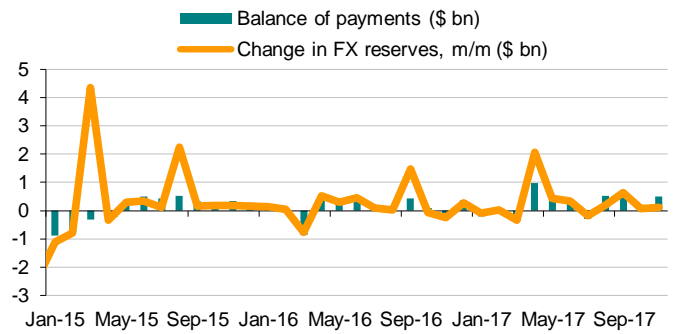
Balance of payments

Major BoP accounts, USDbn



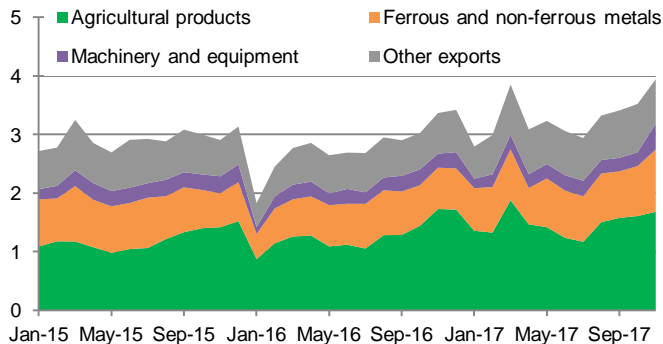
Source: NBU

BoP vs change in foreign reserves, USDbn



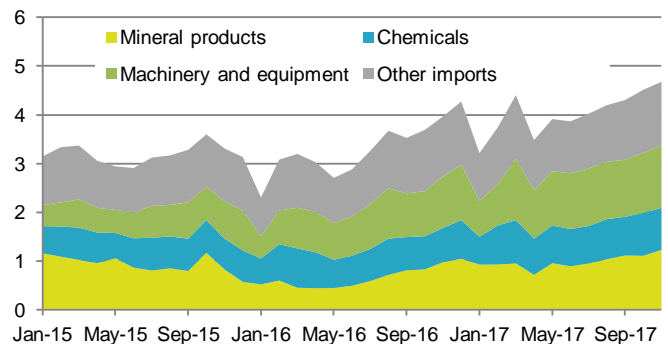
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU

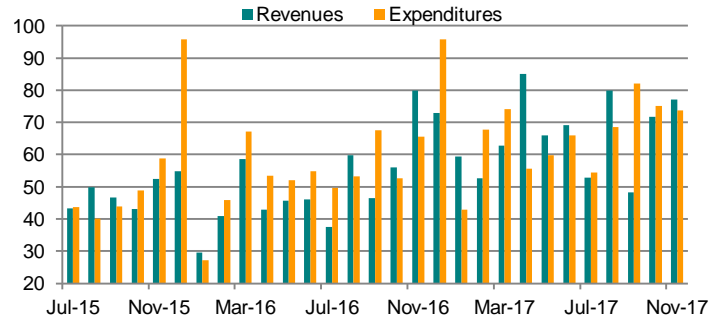


Budget performance

Budget performance, UAHbn

	Jan – Nov 2016	Jan - Nov 2017
Budget revenues	543,4	724,5
VAT proceeds	294,2	166,6
Corporate income tax	47,5	64,2
Budget expenditures	588,9	719,9
Deficit / Surplus	-45,5	4,5

Monthly change in budget revenues and expenditures, UAHbn

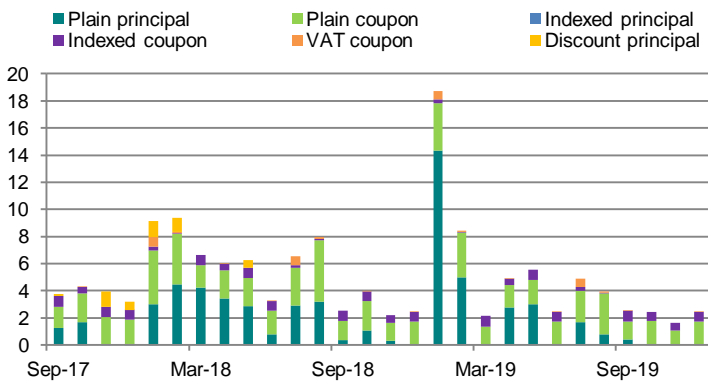


Source: NBU

Source: NBU, State Treasury

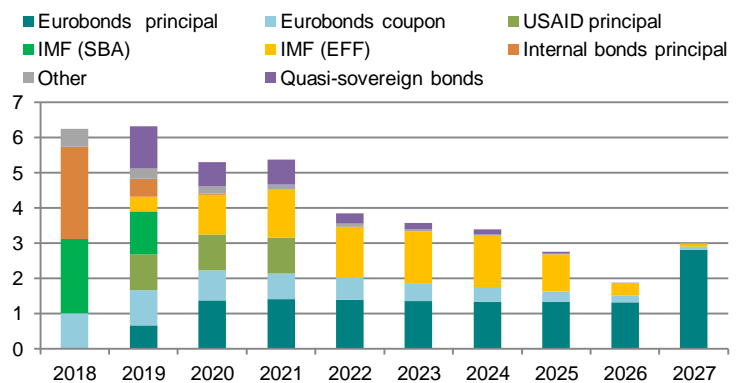
Sovereign debt

UAH-denominated debts' repayments schedule, UAHbn



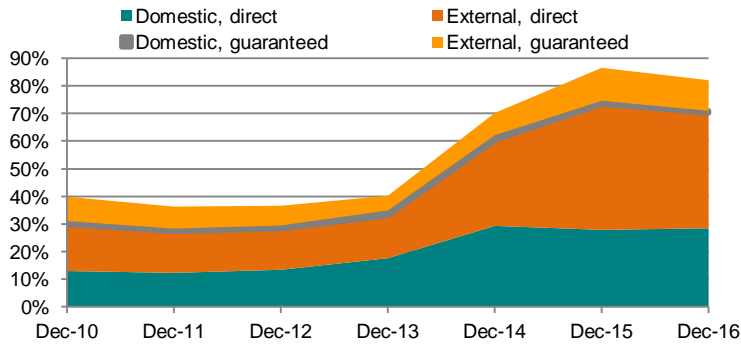
Source: NBU, UkrSibbank estimates

FX-denominated external debts' repayments schedule, USDbn



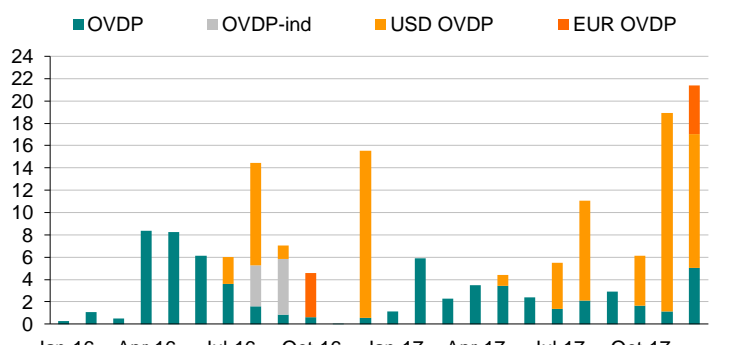
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



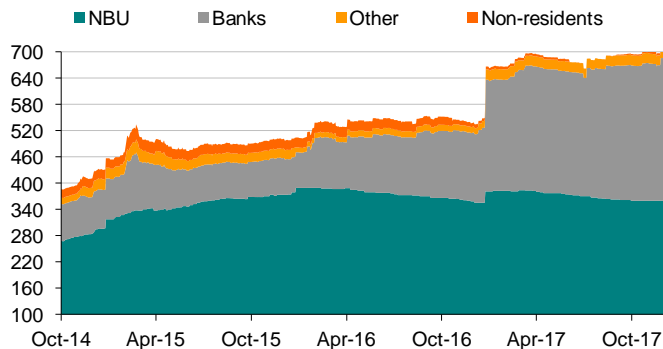
Source: MinFin

Local borrowings, UAHbn equivalent



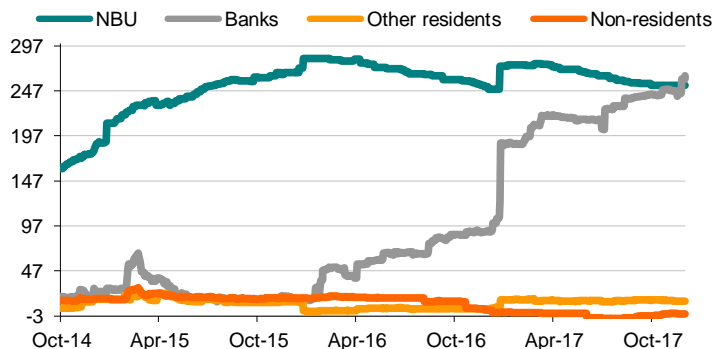
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

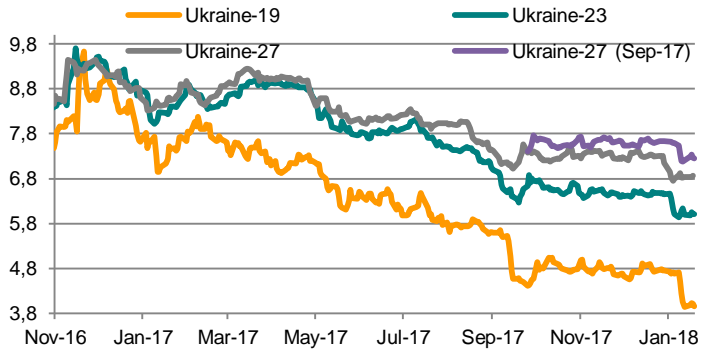


Source: NBU



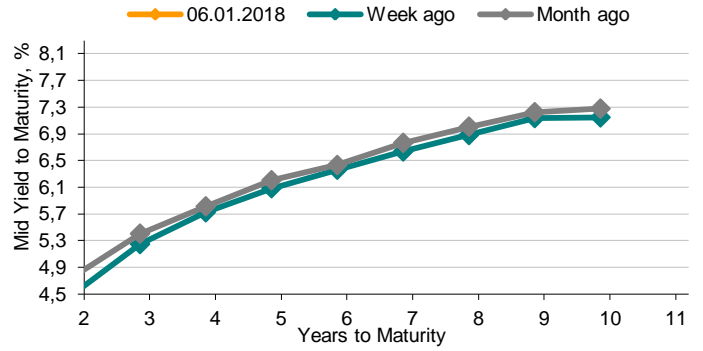
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

Ukraine's sovereign Eurobond yield curve



Source: Reuters

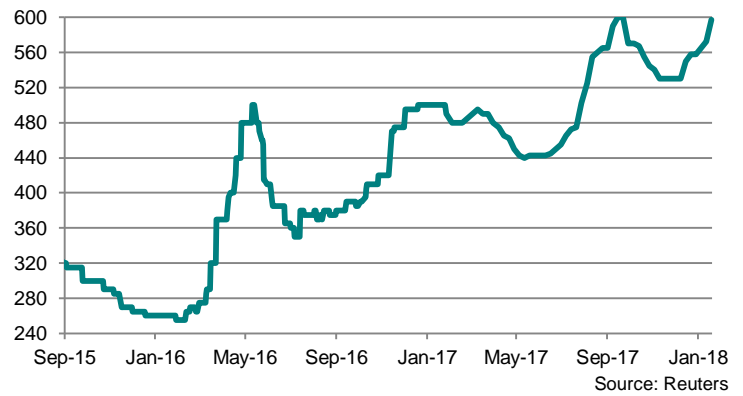
Commodity markets

Iron ore 62% Fe (nearest active future at NYMEX), USD per ton



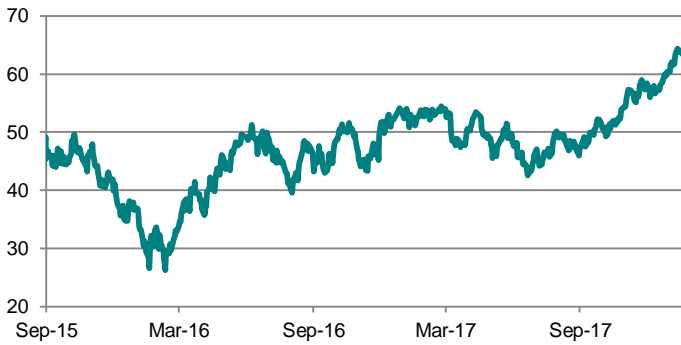
Source: Reuters

Steel CIS export HR coil, USD per ton



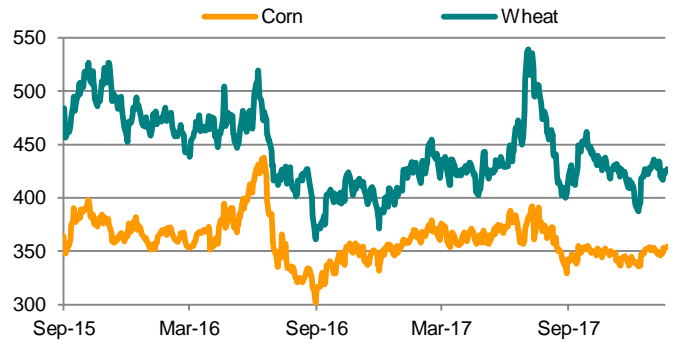
Source: Reuters

WTI oil (nearest active future at NYMEX), USD per barrel



Source: Reuters

Corn and wheat (nearest active future at CBT), USD per bushel



Source: Reuters



Key Macroeconomic Indicators											
Ratings (M/S&P/F) Caa2/B-/B-	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017E	2018F
Real sector											
Real GDP (%YoY)	2.3	-14.8	4.1	5.2	0.2	0.0	-6.6	-9.8	2.3	2.0	3.1
Industrial production (%YoY)	-5.2	-21.9	11.2	8.0	-0.7	-4.3	-10.7	-6.0	2.4	0.9	3.0
Retail sales (%YoY)	17.3	-20.9	10.1	13.2	12.3	6.1	-11.0	-25.0	4.0	8.0	7.0
Unemployment rate end of year (ILO, working age)	6.9	9.6	8.8	8.6	8.1	7.7	9.7	11.5	9.3	8.7	8.5
Nominal GDP (UAH bn)	948.1	913.3	1079.4	1299.9	1404.7	1465.8	1586.9	1979.5	2383.2	2855.5	3239.8
Nominal GDP (USD bn)	178.9	112.8	136.1	163.1	175.8	183.5	133.7	91.2	93.1	106.9	120.0
Prices											
CPI (average %YoY)	25.2	15.9	9.4	8.0	0.6	-0.2	12.1	48.7	16.5	12.5	9.0
CPI (end of year %YoY)	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	43.3	12.4	13.0	9.0
Real average wage growth (%YoY)	6.3	-9.2	10.2	8.7	14.4	8.2	-6.5	-35.0	10.0	12.0	7.0
Fiscal balance (% of GDP)											
State budget deficit (without Naftogaz)	1.3	3.9	5.9	1.8	3.7	4.2	4.9	2.3	2.9	2.9	2.5
Total public debt	20.0	34.8	39.9	36.3	36.7	39.9	69.4	79.4	81.0	77.0	76.0
External balance											
Exports of goods and services (USD bn)	67.7	40.4	65.6	83.7	86.5	81.7	65.4	47.9	46.0	53.0	53.5
Imports of goods and services (USD bn)	83.8	44.7	69.6	93.8	100.9	97.4	70.0	49.6	51.8	59.3	62.3
Current account balance (USD bn)	-12.8	-1.7	-3.0	-10.2	-14.3	-16.5	-4.6	-0.2	-3.8	-4.5	-5.1
Current account balance (% of GDP)	-7.1	-1.5	-2.2	-6.3	-8.1	-9.0	-3.4	-0.2	-4.1	-4.2	-4.3
Net FDI (USD bn)	9.9	4.7	5.8	7.0	7.2	4.1	0.3	3.0	3.4	2.2	2.5
Foreign exchange reserves (end of year)	31.5	26.5	34.6	31.8	24.5	20.4	7.5	13.3	15.5	18.8	22.0
Imports coverage (months of imports of goods)	4.5	7.1	6.8	4.5	3.3	2.9	1.5	4.4	3.7	4.4	4.7
Interest and exchange rates											
NBU discount rate (% end of year)	12.00	10.25	7.75	7.75	7.50	6.50	14.00	22.00	14.00	14.50*	14.00*
Exchange rate (UAH/USD) end of year	8.1	8.0	7.9	8.0	8.1	8.2	15.8	24.0	27.2	27.5*	29.5*
Exchange rate (UAH/EUR) end of year	10.9	11.5	10.5	10.4	10.6	11.3	23.0	26.2	28.3	31.5*	32.5*

Source: UkrStat, NBU, MinFin, UkrSibbank

* Broad estimate



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