



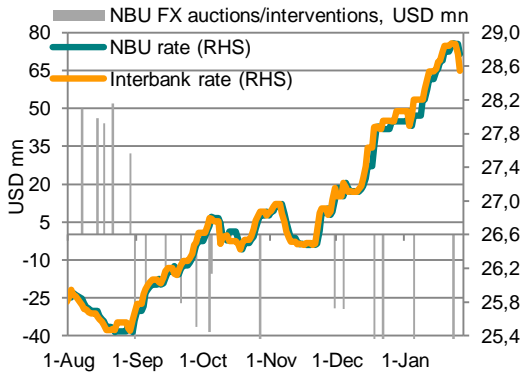
This week in focus: NBU hikes main rate 3-d time in a row, sticking to a tight stance

Ukraine's central bank hikes interest rate by 150 bp, we believe that this hike creates opportunities for carry trade in Ukrainian hryvnia, as attractive strategy to long UAH and collect ~16% interest on a reasonable short investment

Please see page 3 for more details

FX and interest rates: Hryvnia strengthened during the week

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH declined to 28.55 as of Friday the 26th. Week-on-week local currency gained by 1.0 % against the USD.

Average daily FX volumes on the market landed at the equivalent of USD 216.5mn, USD 11.3mn higher than in the previous week.

The NBU intervened on the market via currency auction only once, selling USD 47.3mn. On Tuesday, NBU announced the auction for a total USD 100mn. While initially banks applied for USD 48.9mn, auction resulted in a sell USD 47.3mn at average weighted rate of 28.85. In 2018, NBU held only two currency auctions, selling USD 97.8mn YTD.

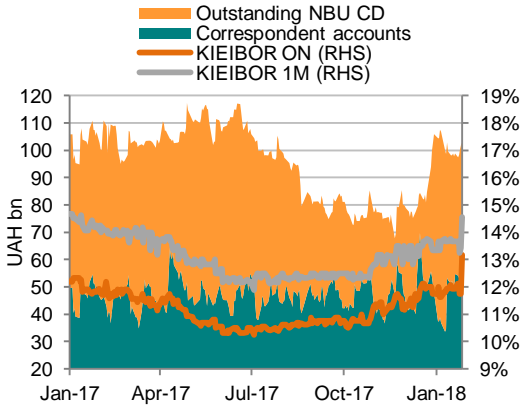
Aggregate banking liquidity amounted to UAH 102.9bn as of Friday the 26th, growing by UAH 4bn during the week. On Wednesday State treasury reimbursed in bulk around UAH 5bn of VAT refund, while on Tuesday it reimbursed around UAH 4.2bn, driving the level of bank's liquidity before NBU board members meeting.

Money market rates remained flat: cost of ON funds is around 13.0/15.25 up from 12.25/13.5% a week ago, 1 week is 14.0/16.25 up from 12.5/14.0%, as of the end of prior week while 1M is 15.0/17.0 up from 13.5/16.00% a week ago, according to our data. NBU rate hike by 150bp caused the rates to increase on Friday.

MoF proceeds from the auction yielded UAH 2.3bn. It sold primarily 3m and 6m bonds with a cut off rate set at 16.0%. 3m bonds were the top spot during the auction, attracting to the budget around half from UAH 2.3bn. Out of 8 bids, MoF accepted all. Meanwhile, 6m issues attracted 6 bids, which were entirely accepted by the Ministry of Finance. In regard to 3y bonds, out of 6 bids only 5 were accepted at a cut off rate of 15.7%.

Currently, yields (bids) of local OVDP in UAH at 16.70% (for 6m), 16.90 (for 2Y). 1Y USD bids were at 5.30%, while bids for VAT bonds were at 16.90%.

Figure 2. Banking liquidity (UAH bn)

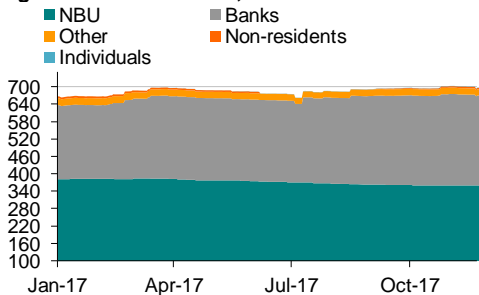


Source: Reuters, NBU, UkrSibbank, Minfin

Figure 5. OVDP auction results, 23rd 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%	15.89%	16.00%	15.60%	8	8	1.2bn	1.2bn
UAH	6m	16.00%	16.00%	16.00%	16.00%	6	6	998.3mn	924.5mn
UAH	3y	15.70%	15.70%	16.00%	15.70%	6	5	196.3mn	196.3mn

Figure 3. OVDP holders, UAH bn

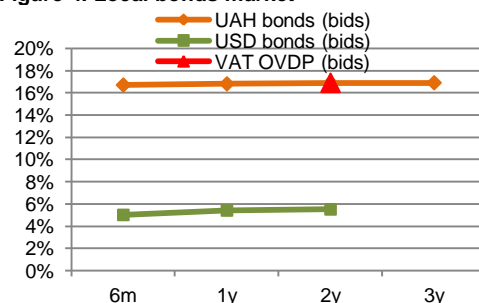


Source: NBU

On Thursday Oleksandr Danylyuk said, that he expects Ukraine to receive the next IMF wire under a USD 17.5bn fund programme in May. The requirements to Ukraine include the following: creation of anticorruption court and appointment of the constant head of National Bank of Ukraine. Adoption of privatization law was also a requirement, but it was approved in the second reading and in full recently. **According to Petro Poroshenko recent statements, Ukraine has fulfilled 80% of commitments to IMF to receive next disbursement.**

National Bank of Ukraine revised down its expectations about disbursements from International Monetary Fund. It expected previously two tranches totalling USD 3.5bn. During its latest board members gathering on Monetary Policy Committee, to revise the path of interest rates in the country it was announced that only one tranche is expected to arrive in this year for a total USD 2bn.

Figure 4. Local bonds market



Source: UkrSibbank

According to Agrarian Ministry, Ukrainian agrarian export amounted to USD 18bn in 2017, accelerating by 16.3% from a previous year. In prior year, Ukraine exported 5 mn t of sunflower oil for a total USD 4.3bn, accounting for the largest component with a share 24% from total. It was followed by corn export, which amounted to 19.4 mn t or USD 3.0bn and wheat export, which was around 17.3 mn t or USD 2.8bn. Export of soybean was USD 1bn. Out of USD 18bn, USD 16.7bn (or 93.3%) came from farming and USD 1.3bn (or 7.2%) from livestock breeding. From the perspective of regional breakdown, 42.6% was exported to Asia, followed by EU – 32.4%, Africa – 14.2% and CIS – 7.6%.



Global markets: ECB kept its monetary policy unchanged

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



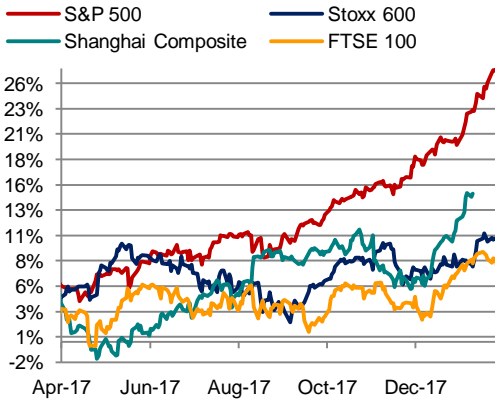
Source: Reuters

Figure 6. EUR USD spot (mid)



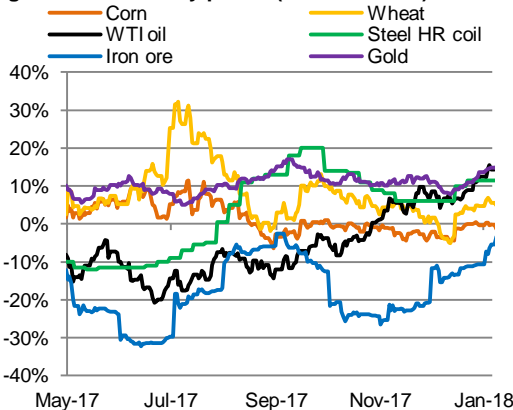
Source: Reuters

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



Source: Reuters

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



Source: Reuters

Market observers were watching closely this week commodity prices upswing on a broad front amid the backdrop of lower U.S. dollar. The decision of ECB to keep its monetary stance unchanged, with EUR 30bn per months of asset purchases, coupled with quit low interest rates environment, was not enough to counterbalance the U.S. State Treasury Steven Munich comments, which welcomed weaker dollar. Hitting the 1.25 level, the euro slightly reversed its upheaval only after additional Mario Draghi comments taming surging euro zone currency. At the same time, news from the U.S., heralded unexpected deceleration in U.S. economy in the fourth quarter to 2.6%, breaking a two quarters string of gains above 3%, followed by 3.2% in previous quarter.

Bond benchmarks fell, with 10y Treasuries' yield were effectively flat week-on-week to remaining at 2.66%, while German 10y Bunds' yields increased 6bp, landing at 0.63%, Japanese 10y bonds closed the week at 0.085.

US equities mixed, with S&P added 2.2%, while Nasdaq Composite gained by 2.3 % week-on-week.

On Friday, the Commerce Department said, gross domestic product in the United States rose at 2.6% annual rate in the fourth quarter, following 3.2% growth in previous quarter. Consumer spending increased at a 3.8% in the fourth quarter and followed a 2.2% growth in third quarter. Imports surged by 13.9% in the quarter, which was the fastest pace since 2010. It growth rose at a double the pace of exports, dragging down the economy. Meanwhile, business investments expanded by 11.4%, accelerating from 10.8% reported in Q3. The economy grew by 2.3% in 2017, acceleration from 1.5% recorded in 2016.

EUR/USD rate landed at 1.2419 as of Friday the 26th, higher than the last week closing level of 1.222, as the USD mainly underperformed against its main counterparts. The euro hit USD 1.25 on a press conference held by Draghi after the ECB policy makers decided to left monetary policy unchanged. The euro declined below that threshold after Draghi's comments aimed to calm down the surging currency during the conference. Draghi's conference followed comments of U.S. Treasury secretary Steven Munich, which welcomed the week dollar, citing that it was good for U.S. trade.

Stoxx 600, a broader gauge of European equity performance were effectively flat during the week, while German DAX ended the week by 0.7% lower.

ECB left its monetary stance unchanged during its meeting. The volume of assets that ECB intends to buy remained at the level of EUR 30bn per month until at least the end of September. Moreover, policy makers left interest rates unchanged, reiterating that borrowing costs will stay at present level far longer the end of the bond purchases. Draghi mentioned in his pres conference that he does not expect the bank to raise interest rate in this year.

Consumer prices in Japan measured by core consumer price index rose by 0.9% in December, remaining at the same level as in November. While the headline inflation tally expanded by 1.0% in December. With inflation still far below central bank target, the week consumer price dynamic, supports the likelihood that Bank of Japan will leave its stimulus unchanged at a high level. As a result of Munich comments and Trump's statements, favoring a weaker dollar, the yen had strengthened in recent time, bringing inflation pressure down, undermining BoJ efforts through lower import prices to lift it up.

Crude oil increased, as WTI 1m futures rose by 4.4% week-on-week and closed at USD 66.1 per barrel, while Brent 1m futures gained by 2.8%, closing at USD 70.5 per barrel.

Gold prices rose, as NYMEX 1m futures increased by 1.5% week-on-week and finished the week at USD 1351.6 per troy ounce.

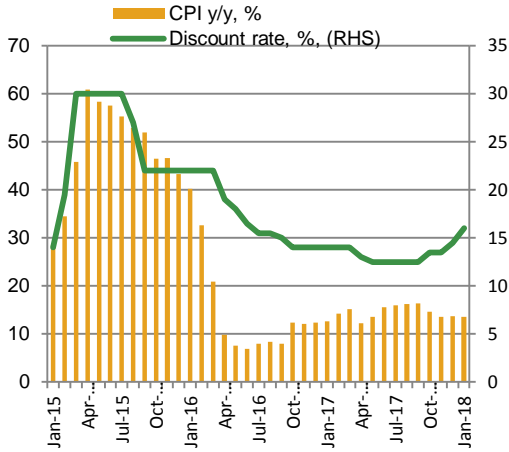
Grains finished the week in black, as CBOT Corn 1m futures rose 1.1% week-on-week and closed at USD 356.5 per bushel, while CBOT Wheat 1m futures laded at USD 441.0 per bushel, 4.3% higher week-on-week.

Iron ore declined as NYMEX Iron ore 62% Fe 1m futures fell 0.6% week-on-week and closed at USD 76.21 per ton.



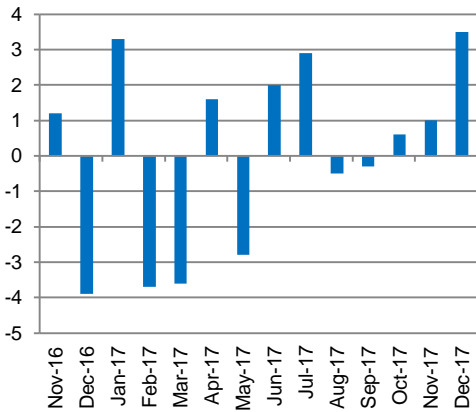
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Figure 9. Consumer prices vs discount rate, %



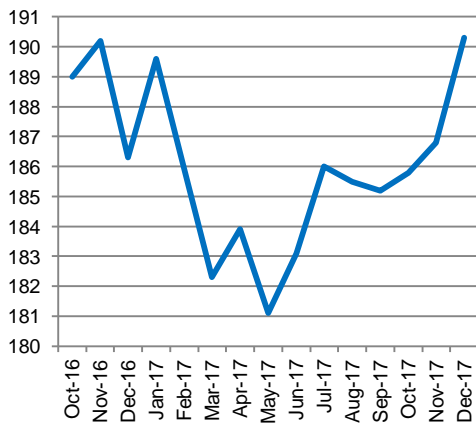
Source: NBU

Figure 10. Households inflation expectation change, points



Source:

Figure 11. Household's inflation expectation, points



Ukraine's central bank hikes interest rate by 150 bp, opening carry trade opportunities

Following MPC meeting held on Jan 25th, **Ukraine's central bank increased its key rate by 150 b.p.**, to 16%. As we reported before, the visibility to anticipate interest rate decision became more obscured, with most of market participants having expected no change. During one of the last meetings in NBU on Jan 15th, polls suggested 62% expectation of no change in Jan 25th meeting.

In a broad regional context, inflation in Ukraine is highly elevated and can be matched only with Turkey. However, in Turkey, headline inflation actually decelerated in December 2017, plunging by 1.1 p.p. to +11.9% y/y. Also, inflation in Turkey is happening against backdrop of authorities' aggressive pro-growth bias. In the rest of the region, inflation levels 2017 ranged from +2.1% (Poland, Hungary) to +4.6% (Belarus).

150 b.p. hike is fully justified from the inflation expectations point of view. Inflation expectations were drastically up in December (see Graphs) also mimicking path of baseline inflation. Also, with 13.7% CPI inflation print it became clear that NBU has both missed 2017 target of 8%, and likely to miss 6% target for 2018.

On another hand, we stick to a point that higher UAH interest rates can be counter-productive in terms of taming inflation and the key impact on prices can only come from stronger UAH (which is not the case for now). From that perspective, NBU should stop hiking rates as soon as possible.

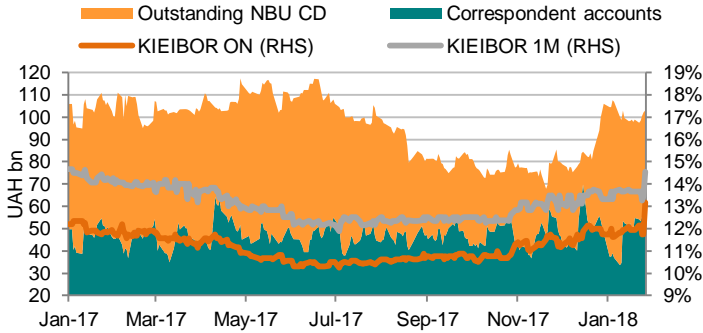
We believe that this hike creates opportunities for carry trade in Ukrainian hryvnia. With Ukrainian currency being traded at multi-year low, and depreciation pressure likely losing its steam, it seems to be attractive strategy to long UAH and collect ~16% interest on a reasonable short investment on 6m horizon.

Please also see our recent report "UAH to appreciate on 6m horizon" issued on Jan 19th 2018.



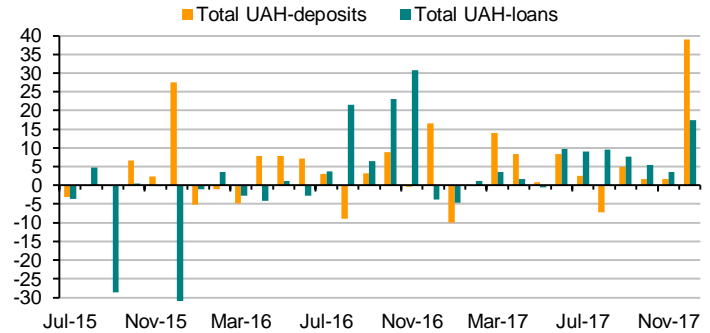
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

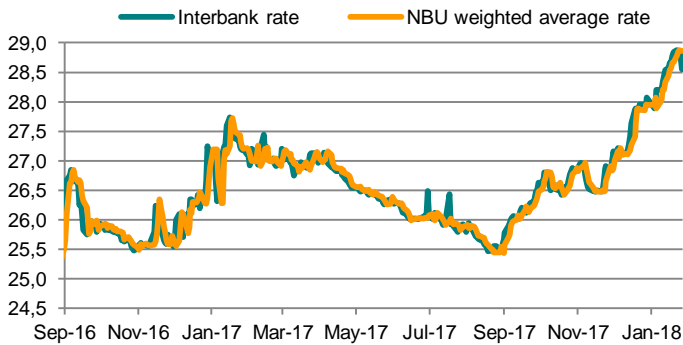
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

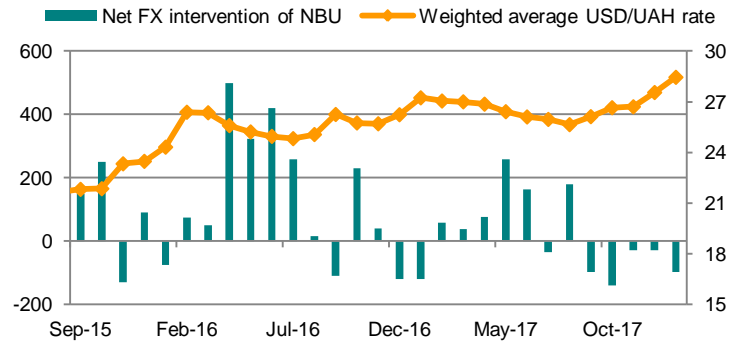
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

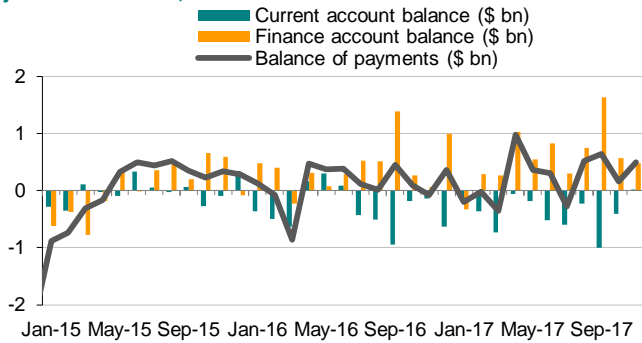
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

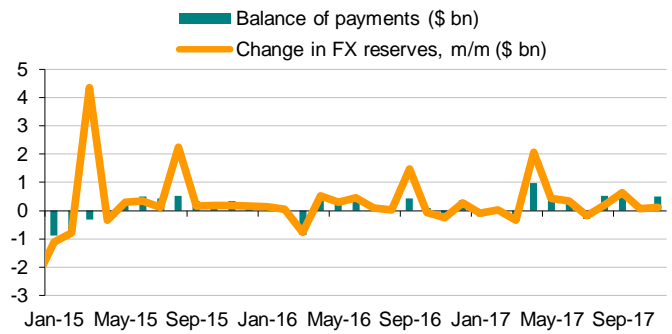
Balance of payments

Major BoP accounts, USDbn



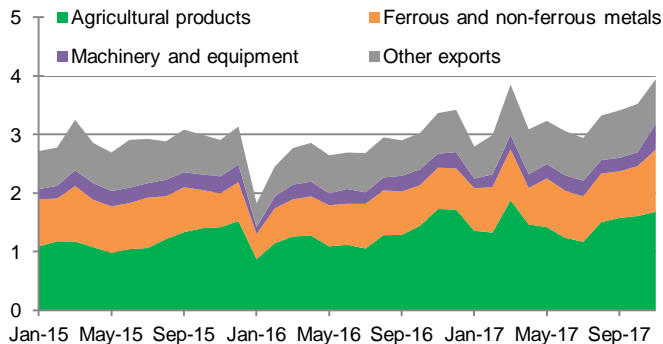
Source: NBU

BoP vs change in foreign reserves, USDbn



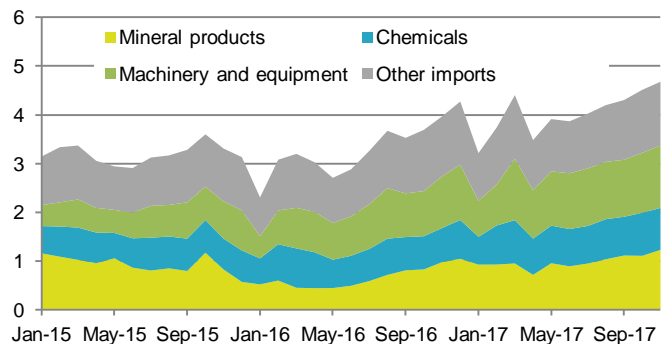
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU

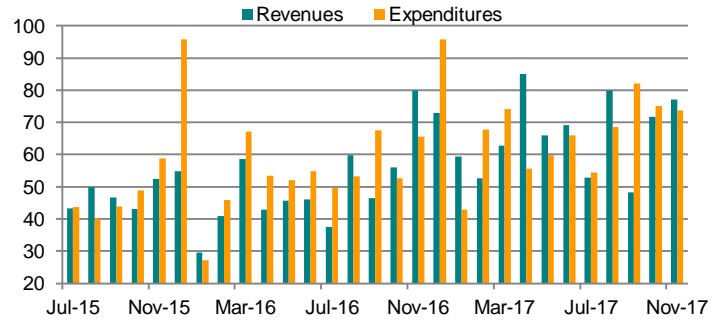


Budget performance

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

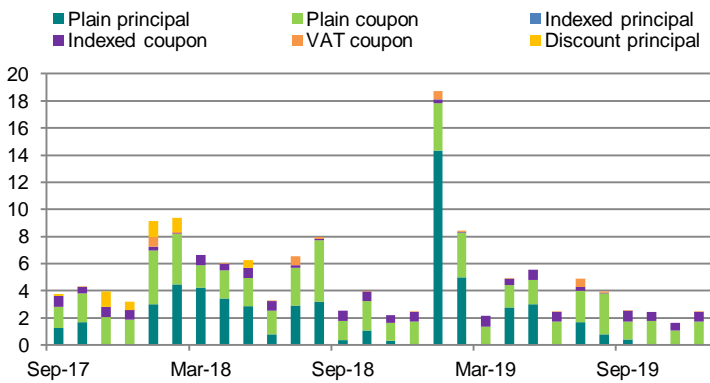


Source: NBU

Source: NBU, State Treasury

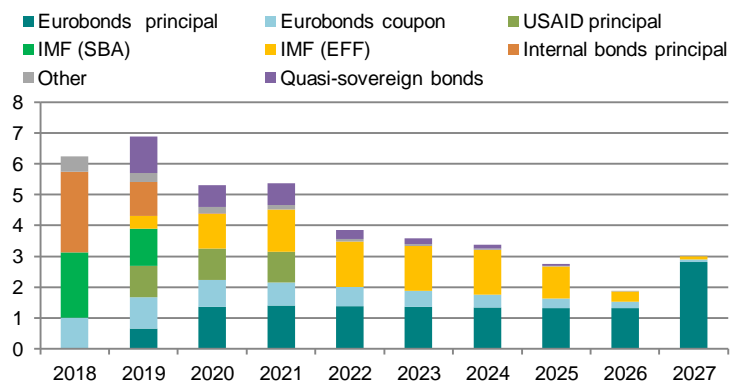
Sovereign debt

UAH-denominated debts' repayments schedule, UAHbn



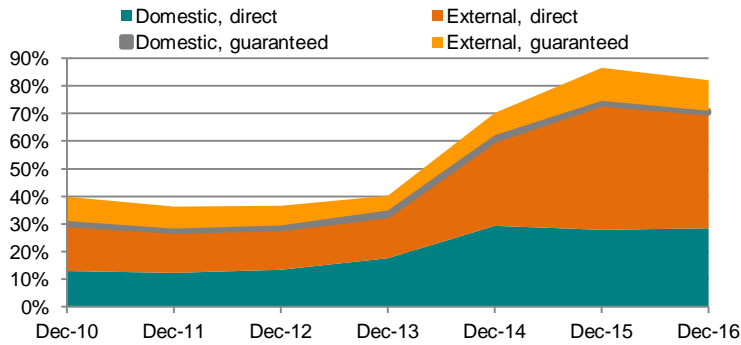
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



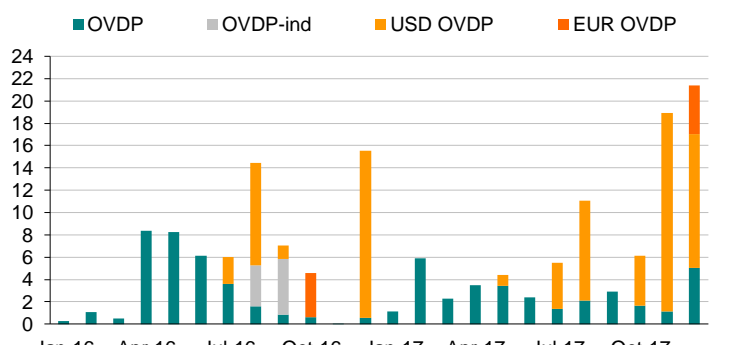
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



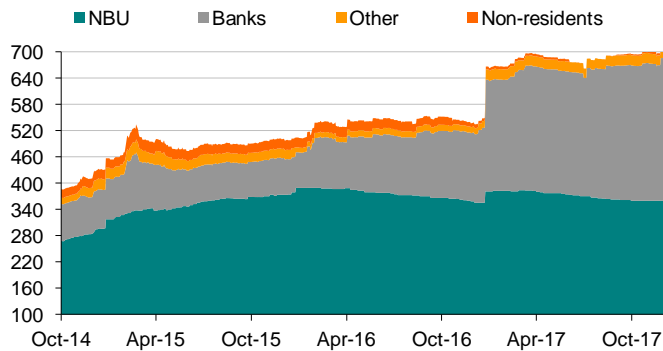
Source: MinFin

Local borrowings, UAHbn equivalent



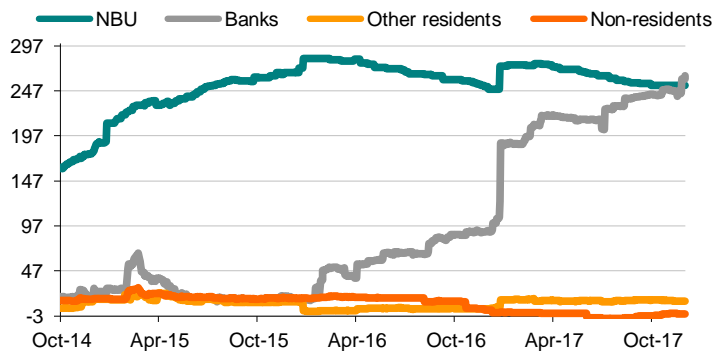
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

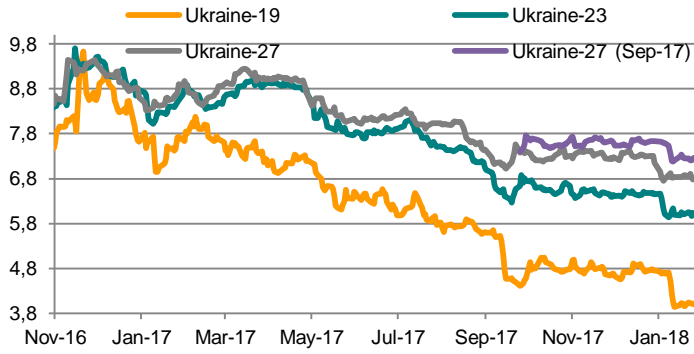


Source: NBU



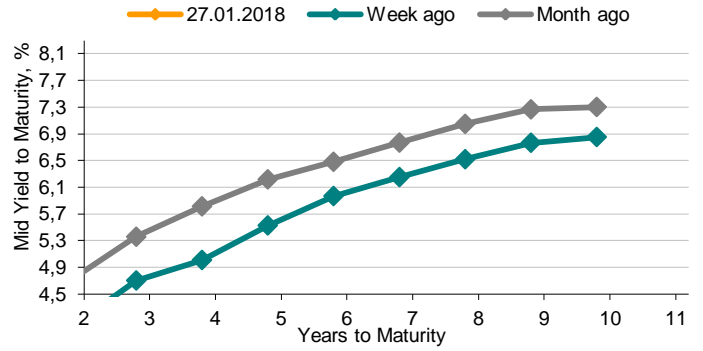
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

Ukraine's sovereign Eurobond yield curve



Source: Reuters

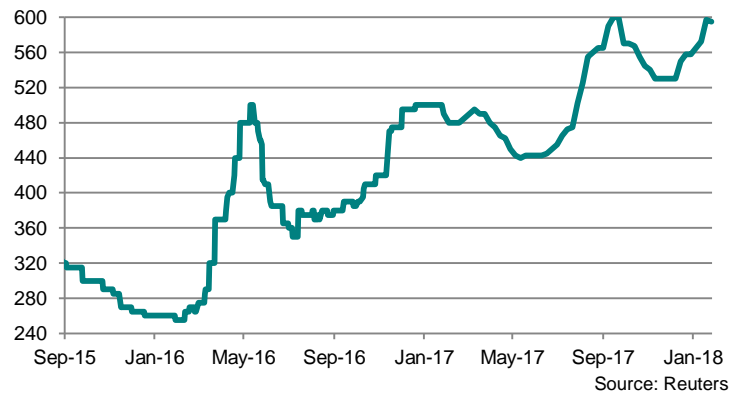
Commodity markets

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



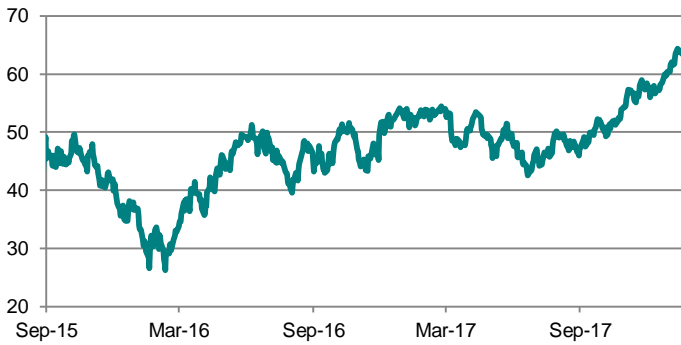
Source: Reuters

Steel CIS export HR coil, USD per ton



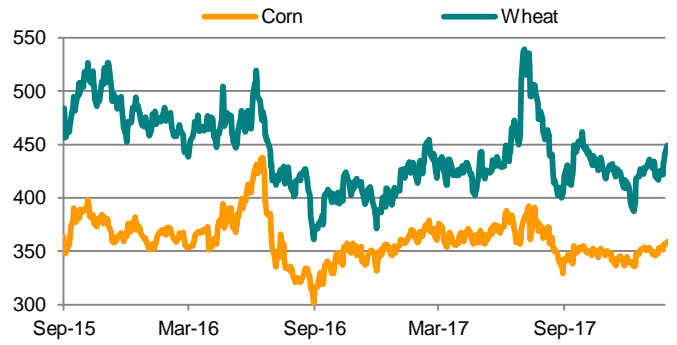
Source: Reuters

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	-0.1	3.0
Retail sales (%YoY)	17.3	-20.9	10.1	13.2	12.3	6.1	-11.0	-25.0	4.0	8.8	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	14.4	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	13.7	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	3.6	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	27.95	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	33.50	32.5*

Source: UkrStat, NBU, MinFin, UkrSibbank

* Broad estimate



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