



This week in focus:

Ukraine's BoP outperforming expectations now, facing strong headwind later

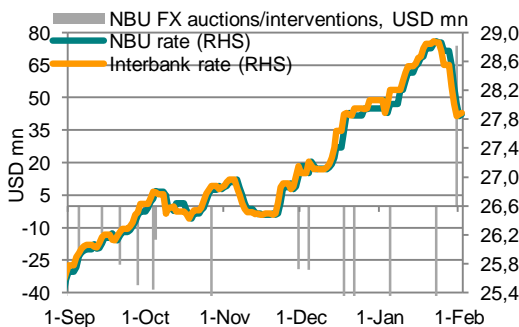
Last week NBU published balance of payments data for the full year 2017. Ukraine's current account deficit amounted to USD 3.8bn in 2017 (vs USD 3.5 bn in 2016) which corresponds to 3.5% of GDP and is better than our initial forecast of 4.2% GDP made one year ago (albeit partly – due to significant NBU statistic restatement). Going forward, we see more headwinds coming in 2018 and anticipate widening of current account deficit to expand to USD 5.3 bn (4.4% GDP), which poses downside risks for UAH stability if no further progress on IMF is made.

Please see page 3 for more details

FX and interest rates:

MoF proceeds from the auction yielded UAH 7.5bn

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH declined to 27.88 as of Friday the 2nd. Week-on-week local currency appreciated by 2.3% against the USD.

Average daily FX volumes on the market landed at the equivalent of USD 238.7mn, USD 22.2mn higher than in the previous week.

The NBU intervened on the market via currency auction twice, buying USD 73.9mn. On Friday, NBU announced the auction for a total USD 30mn. While initially banks applied for USD 105.9mn, auction resulted in a buy USD 30.0mn at average weighted rate of 27.83. A little while later, NBU announced the second auction for a total USD 100mn. And, while banks initially applied for USD 46.5, auction, they sold to NBU USD 43.9mn.

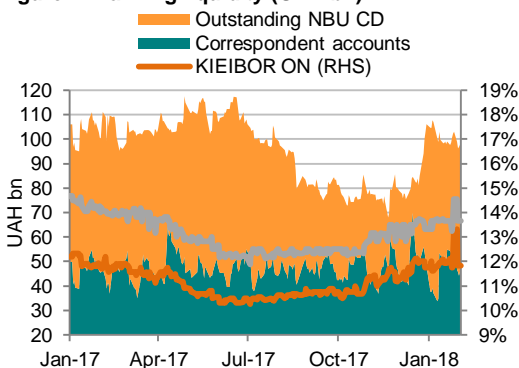
Aggregate banking liquidity amounted to UAH 98.0bn as of Friday the 2nd, declining by UAH 4.9bn during the week. In January, State Treasury reimbursed UAH 12.0bn of VAT, out of which the largest amount of UAH 0.9bn received Kernel, followed by Azovstal and Cargil of UAH 0.8bn and UAH 0.7bn, respectively. Moreover, State Treasury account residuals rose to UAH 20.1bn in January, up from UAH 5.1bn a month ago.

Money market rates remained flat: cost of ON funds is around 13.0/15.25, 1 week is 14.0/16.25 while 1M is 15.0/17.0, according to our calculations.

MoF proceeds from the auction yielded UAH 7.5bn. It sold 3m, 6m, 9m, 1y and 5y hryvnia denominated bonds and one, 2y USD-denominated bonds. 2y USD bond took the top spot by demand during the auction, followed by 9m, 3m and 6m UAH-denominated bonds. Three the shortest bonds were issued with a cut off rate set at 16.5%, up from 16.0% from prior auction.

Currently, yields (bids) of local OVDP in UAH at 16.80% (for 6m), 16.95 (for 2Y). 1Y USD bids were at 5.30%, while bids for VAT bonds were at 16.95%.

Figure 2. Banking liquidity (UAH bn)

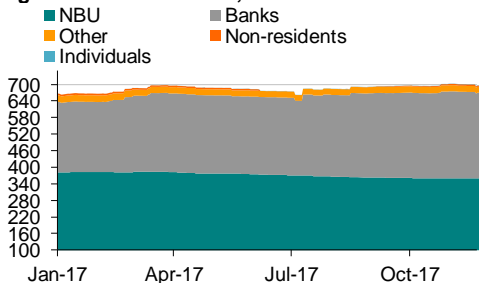


Source: Reuters, NBU, Uksribbank, Minfin

Figure 5. OVDP auction combined results, 30th 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-5y	-	-	-	-	57	20	8.0bn	3.6bn
USD	1-2y	-	-	-	-	19	17	148.6mn	137.5mn

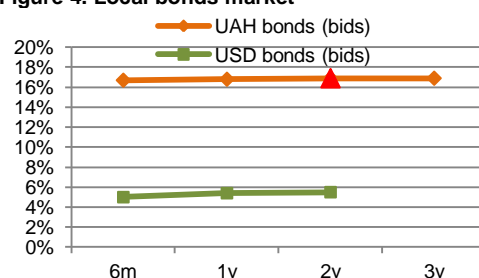
Figure 3. OVDP holders, UAH bn



Source: NBU

Ukraine's 2017 budget deficit reaches UAH 46bn in 2017 (roughly 1.6% GDP). According to reports on state budget performance, state budget incomes amounted to UAH 69bn in December, while the state budget expenditures reached UAH 119bn, far outpacing the level in prior month (around UAH 74bn) and similar expenses a year ago (UAH 96 bn). As a result, the budget deficit comprised UAH 50.5bn in December. Consolidated budget, which also includes performance of local budgets, recorded annual deficit of UAH 40bn. This implies that local budgets were recording a net surplus last year, probably due to technical inability to spend all funds, allocated to them end-December.

Figure 4. Local bonds market



Source: Uksribbank

NBU started publishing MNC minutes

NBU has placed two important indicators on its web site, aiming to increase transparency of MPC decisions. We can now see the minutes of the last monetary committee, coupled with inflation expectations statistics (banks, households, experts, firms). UkrSibbank is a long-time participant in two of these surveys. An important take away from the minutes is that overall tone of the discussion was very hawkish, with just one committee member supporting increase of 100 bp (vs 150 b.p. hike voted by the committee). Also, we noted expectations of «no loosening of monetary policy in 2018». We welcome decision of central bank to make monetary decision making more transparent.



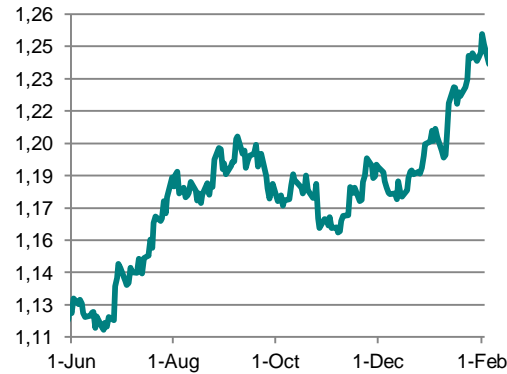
Global markets: Fed policymakers left interest rates unchanged

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



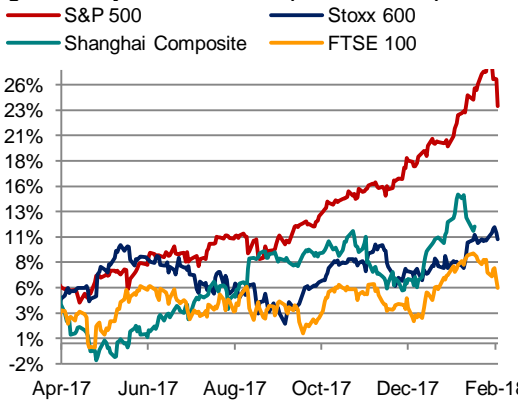
Source: Reuters

Figure 6. EUR USD spot (mid)



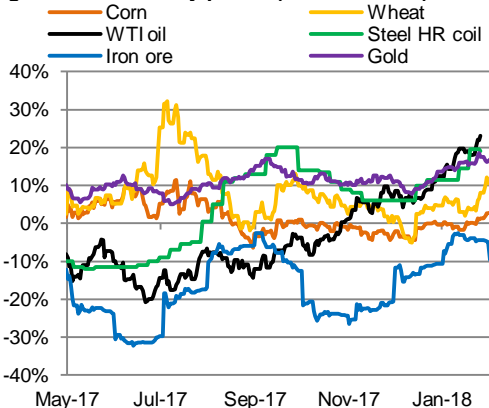
Source: Reuters

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



Source: Reuters

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



Source: Reuters

Janet Yellen, who served as a Fed chair the last time, along with other policymakers decided to keep interest rates unchanged in 1.25-1.5% target range. Fed highlighted brighter economic outlook for economy and higher confidence that inflation will reach 2% target this year. Policymakers expressed their views in a manner that warrants further rate hiking in excess of 3 expected previously for 2018. At the same time, Euro zone January's inflation print showed consumer price's deceleration, while the same gauge excluding volatile items printed higher growth in January.

Bond benchmarks dropped, with 10y Treasuries' yield higher by 18bp week-on-week increasing to 2.84%, while German 10y Bunds' yields increased 14bp, landing at 0.77%, Japanese 10y bonds closed the week at the same level at 0.085.

US equities mixed, with S&P fell 2.9%, while Nasdaq Composite declined even stronger by 3.5 % week-on-week.

Fed policymakers, with Janet Yellen in her latest FOMC meeting as a chair, voted unanimously to leave rates unchanged in 1.25-1.5% target range, setting the stage for an increase in March. Fed's preferred gauge of inflation, personal consumption expenditures, nudged slightly higher and expanded to 1.7% y/y in December, remaining short of the central bank target rate of 2%. The same inflation indicator, excluding volatile food and energy gained to 1.5% y/y, indicating strengthening underlying inflation pressure by the end of 2017. Central bank expressed brighter outlook on inflation path trajectory in 2018 acknowledging strong economic growth and higher confidence that inflation will reach 2% target in this year.

EUR/USD rate landed at 1.246 as of Friday the 2nd, higher than the last week closing level of 1.2419, as the USD major underperformed against its main counterparts. The strength of the dollar in the second half of the week was caused by the comments from Trump, who said that he expected the dollar to be strong due to the strength of the incoming data.

Stoxx 600, a broader gauge of European equity performance decreased by 3.1% during the week, while German DAX ended the week by 4.2% lower.

Consumer prices in Euro zone advanced 1.3% in January, according to European Union's statistics office. This reading below December's inflation of 1.4%. But at the same time, inflation excluding food and energy, accelerated to 1.2% from 1.1% in prior month, highlighting that underlying inflation pressure is still exists. ECB forecasts see inflation at 1.4% in 2018, rising gradually to 1.7% by 2020.

Japan's Prime Minister Shinzo Abe made some remarks in respect of monetary policy. He rebuffed the view that 2% inflation target is too ambitious, emphasizing the central bank effort to achieve this target as vital in improving situation in economy. Prime Minister remarks come ahead of leadership change in the BOJ, as terms of chairman Kuroda and his two deputies expiring in April and March respectively.

Crude oil moved downward, as WTI 1m futures fell by 1.0% week-on-week and closed at USD 65.5 per barrel, while Brent 1m futures declined by 2.8%, closing at USD 68.6 per barrel.

Gold prices fell, as NYMEX 1m futures increased by 1.3% week-on-week and finished the week at USD 1333.7 per troy ounce.

Grains finished the week on the rise, as CBOT Corn 1m futures rose 1.4% week-on-week and closed at USD 361.5 per bushel, while CBOT Wheat 1m futures laded at USD 446.8 per bushel, 1.3% higher week-on-week.

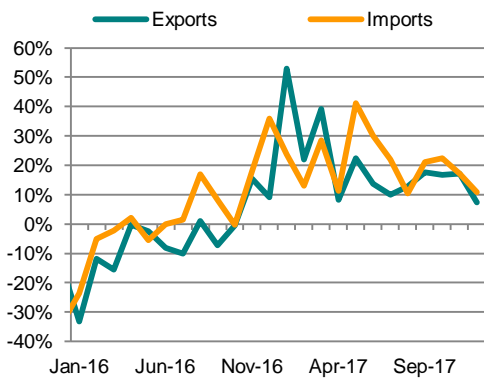
Iron ore declined as NYMEX Iron ore 62% Fe 1m futures fell 4.3% week-on-week and closed at USD 72.94 per ton.



This week in focus:

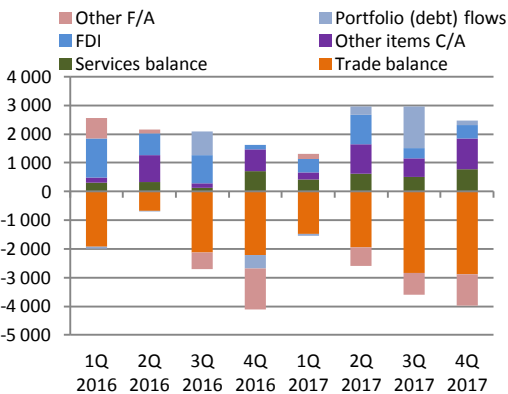
Ukraine's BoP outperforming expectation now, facing strong headwind later

Figure 9. Exports and imports change, %



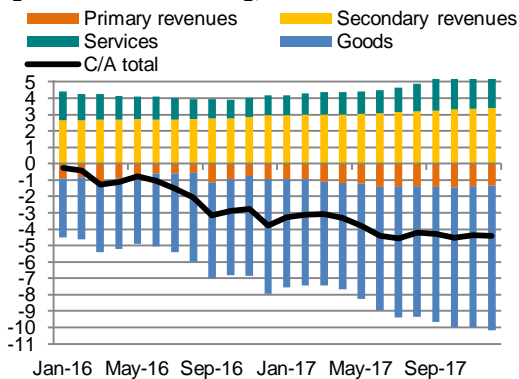
Source: NBU

Figure 10. Major components of C/A and financial account, USDmn



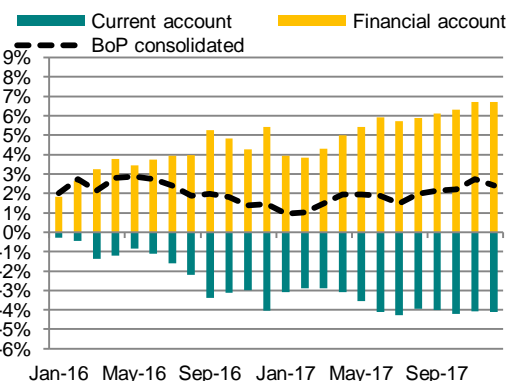
Source: NBU

Figure 11. C/A 12m rolling, USD bn



Source: NBU

Figure 11. BoP 12m rolling, USD bn



Source: NBU

Last week NBU published balance of payments data for the full year 2017. Ukraine's current account deficit amounted to USD 3.8bn in 2017 (vs USD 3.5 bn in 2016) which corresponds to 3.5% of GDP and is better than our initial forecast of 4.2% GDP made one year ago (albeit partly – due to significant NBU statistic restatement). Going forward, we see more headwinds coming in 2018 and anticipate widening of current account deficit to expand to USD 5.3 bn (4.4% GDP), which poses downside risks for UAH stability if no further progress on IMF is made.

Export of goods expanded by 18.8% in 2017 and reached USD 40bn, meanwhile import outpaced that, growing by 21.1%. Export's upswing occurred amid the back drop of increase in agriculture by 16.3% (up from +5.3% in 2016), metals by 22.1% (up from -11.6 in prior year), minerals by 47.1% (up from -10.5% in 2016), machinery by 9.8% (up from -17.8% in prior year) and chemicals by 12.0% (up from -24.8% a year ago).

Agriculture ended year on a minor note - in December, export of agricultural products fell by 10.0% y/y, reaching USD 18bn and still growing by 16% y/y on 12 month basis. Out of this, sunflower oil export amounted to USD 4.3bn (or 5mn t, with a share 24% from total), followed by corn export at USD 3.0bn (or 19.4mn t), wheat export at USD 2.8bn (or 17.4mn t), soybean at USD 1bn. According to provisional statistic, Ukraine's new harvest declined by 7.1% to 61.3mn t, as increased harvested area by about 0.7% was not offset by declining average yields by 8.2%. At the same time the harvest of wheat remained effectively flat y/y, while the largest decline was recorded in corn harvest at 3.9mn t and barley at 1.1mn t. In regard to animal breeding, which share in agricultural products export amounted to 7.2% (as opposed to nearly 93% share of farming) or around USD 1.3bn, there was a similar pattern of growth. Namely, poultry export rose to 271.3k t up from 240.1k t in 2016, accounting for USD 390mn (USD293mn in 2016) or nearly third from overall livestock breeding export of agriculture in 2017, accelerating by 33% y/y.

Steel prices are supportive so far. Iron ore export amounted to USD 2.6bn (or 37.4mn t) in 2017, while it was USD 1.83bn (39.2mn t) in 2016. This increase was caused by iron ore price increase (average benchmark with 62% iron content rose by 24% in 2017 and higher pellet premiums, as premiums in the last year recorded the high of USD 45, up from nearly USD 30 in prior year, due to flight to quality of Chinese steelmakers in an governmental effort to reduce pollution and idled operations of Samarco and other. In regard to metals, amid the falling physical volumes, the export proceeds in USD rose almost on all fronts. Export of semi-finished products for hot-rolling meals, such as slabs and billets, which accounts for the major part of export proceeds gained by nearly 15% y/y, reaching USD 2.5bn. Export of hot-rolled coils landed at USD 1.8bn, up by 18.6 y/y, amid falling physical volume by 11.3% y/y. While, export of cold-rolled coils gained by 45.4% y/y, comprising USD 441mn in 2017. Meanwhile, pig iron export amounted to USD 738mn, up 33.9% y/y.

Energy imports is a main downside driver. In 2017, Ukraine imported USD 4.2bn (up by 27.3% y/y) of oil and USD 3.8bn of gas (up by 65.7% y/y), accounting for the largest single items in energy import as well as in overall import of goods to the country with a share of 8.4% and 7.7%, respectively. It was followed by coal import. In 2017, Ukraine's coal import including anthracite amounted to USD 2.7bn (or 19.8mn t), while it was USD 1.5bn (or 15.6mn t) in prior year, highlighting its import acceleration growth by 87% y/y, mainly due to higher anthracite coal import.

Domestic demand is good for growth, but likely to accelerate consumer goods imports. Highlighting the strong consumer demand in the country, which is only gaining momentum in recent time, import of light vehicles cars skyrocketed by 44.1% y/y in 2017, reaching USD 2.1bn.

In 2017, primary incomes deficit shrank to USD 776mn and secondary incomes surplus reached USD 3.8bn, coupled with a balance of services surplus of USD 2.3bn helped to mitigate trade balance deficit of USD 9.2bn to more moderate current account deficit of USD 3.8bn.

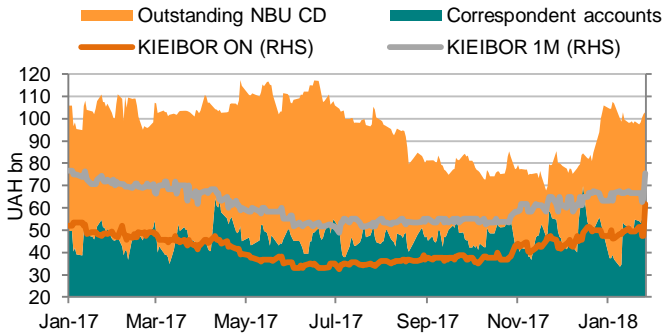
Having posted the highest inflow for last four years, financial account surplus comprised USD 6.4bn, growing by USD 1.7bn compared to a year ago. The surplus was due to FDI's inflows of USD 2.3bn (out of which USD 0.6bn reflects banks recapitalization), portfolio investments USD 1.8bn (out of which USD 1.3bn reflects Ukraine's Eurobond placement). Due to reduced FX cash outside banks financial account was underpinned by USD 1.7bn during the year.

Having increased by USD 3.3bn, NBU's international reserves amounted to USD 18.8bn, as of end 2017 and were partly boosted by International financing organizations, insofar as Ukraine received USD 1bn IMF's tranche in May and USD 0.6bn of macro financial aid from European Commission. Consolidated balance of payment surplus was reported at USD 2.6bn, as financial flows fully covered outflows related to current account.



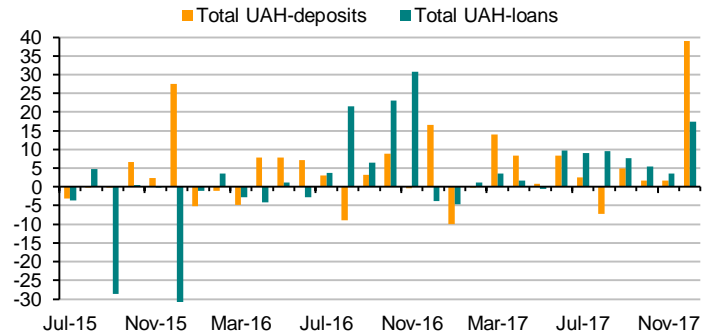
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

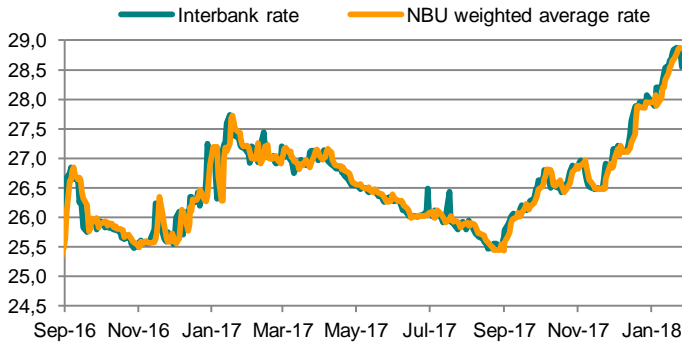
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

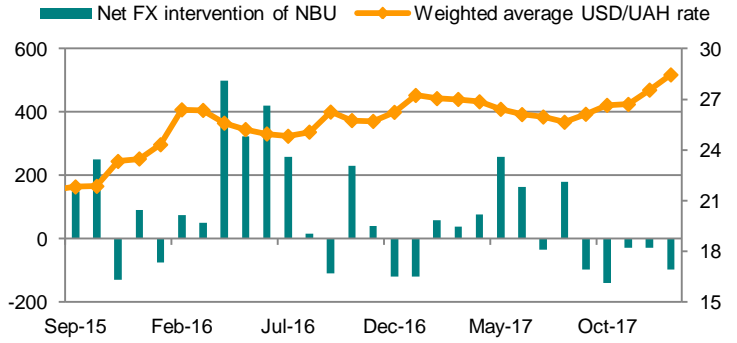
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

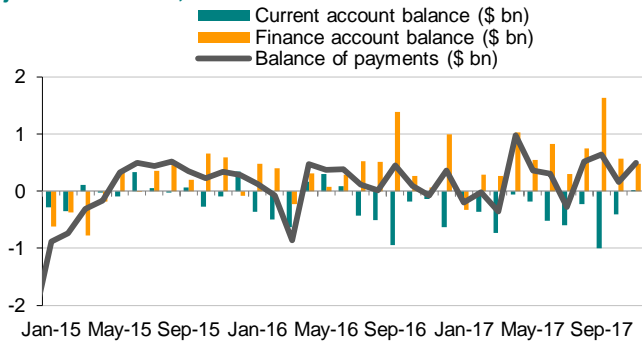
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

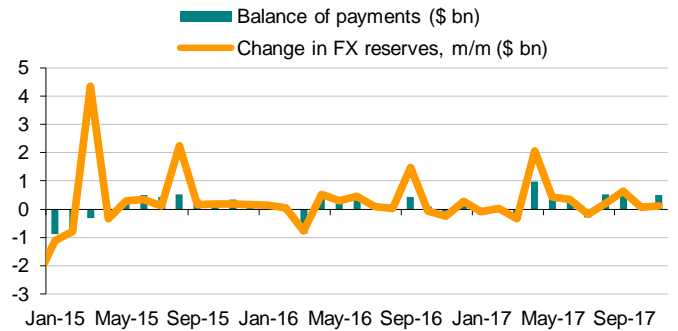
Balance of payments

Major BoP accounts, USDbn



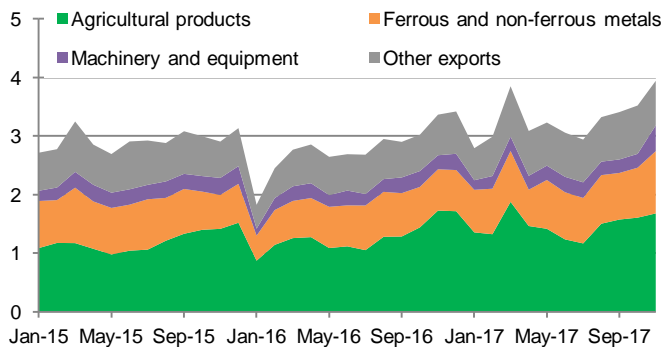
Source: NBU

BoP vs change in foreign reserves, USDbn



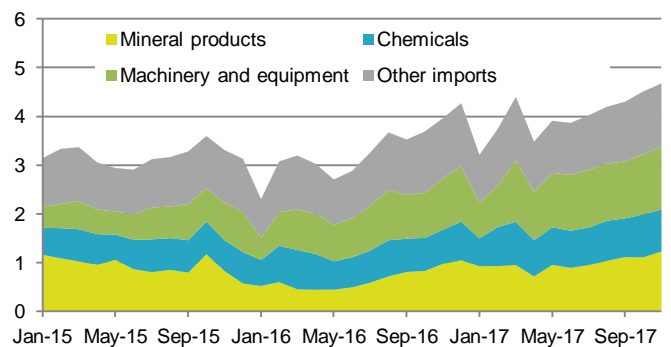
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU

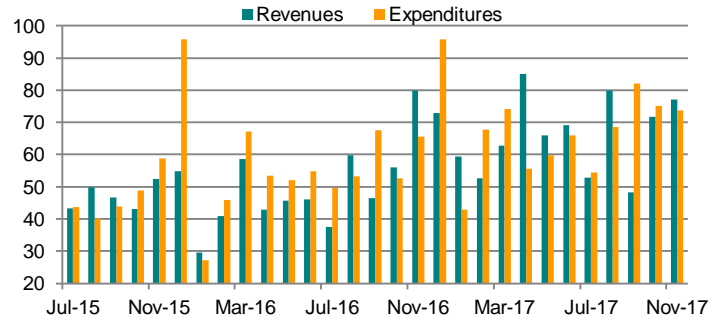


Budget performance

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

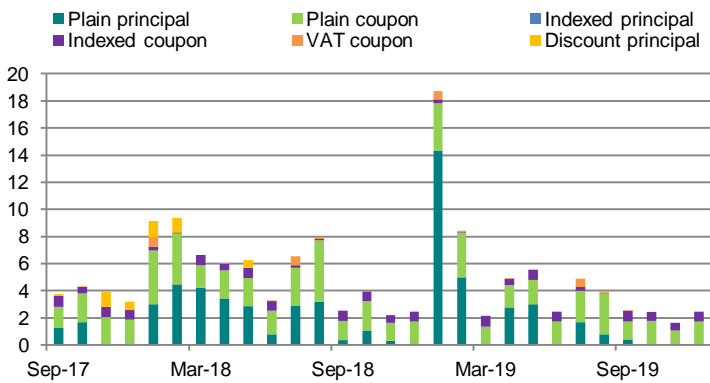


Source: NBU

Source: NBU, State Treasury

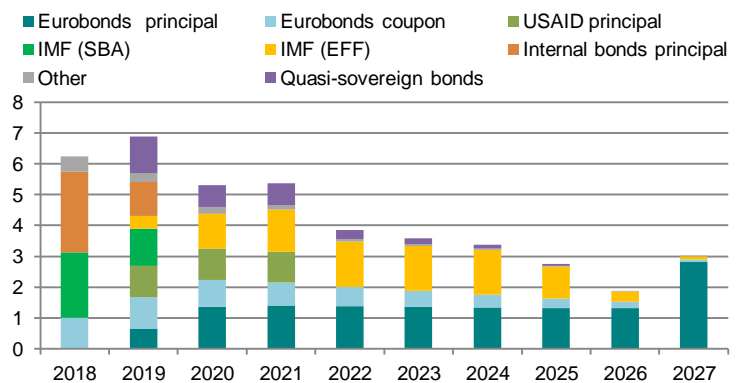
Sovereign debt

UAH-denominated debts' repayments schedule, UAHbn



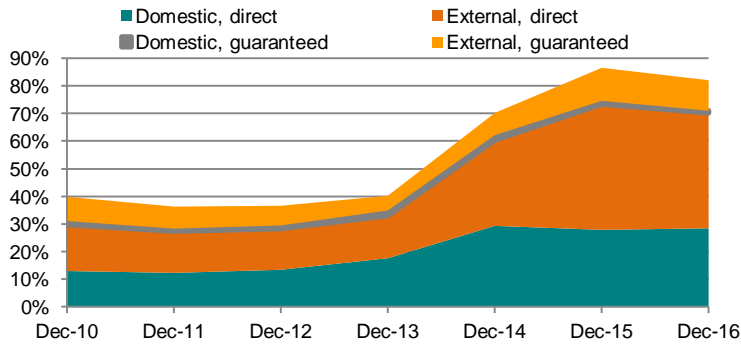
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



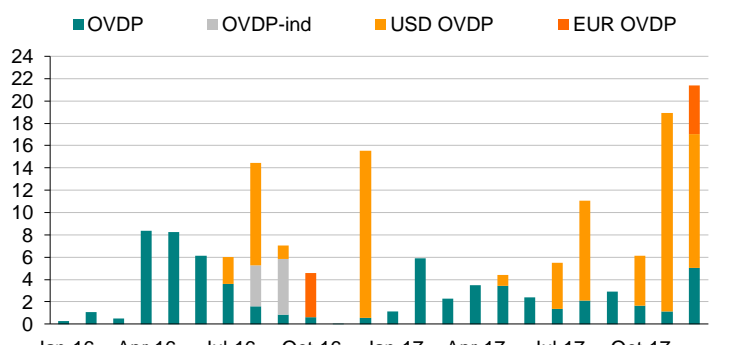
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



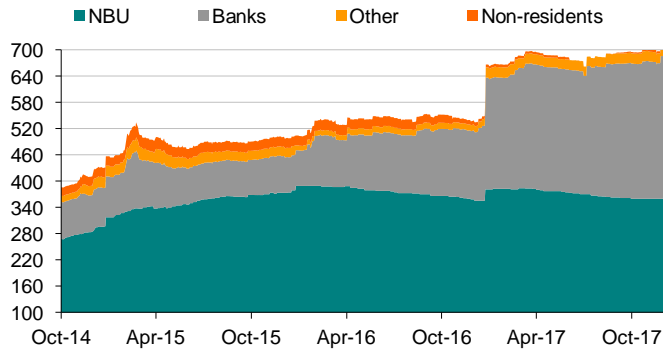
Source: MinFin

Local borrowings, UAHbn equivalent



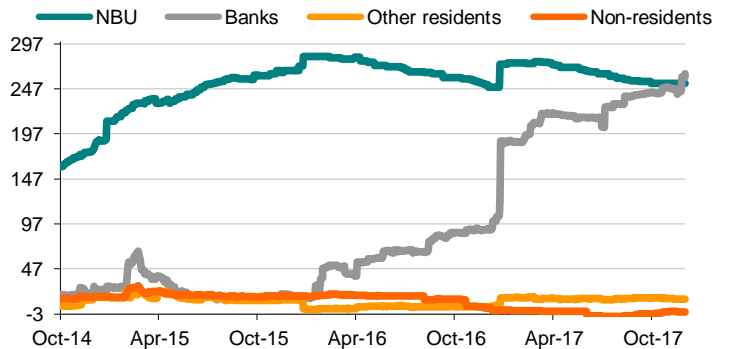
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

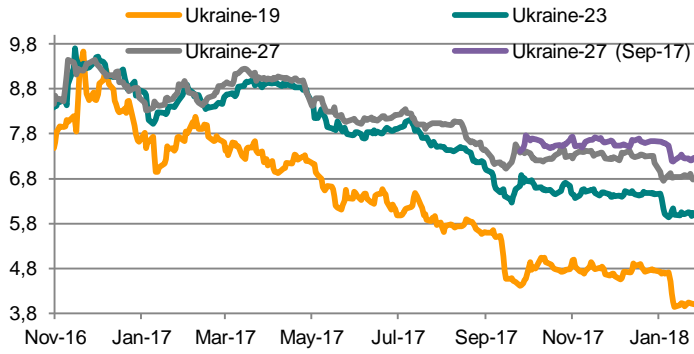


Source: NBU



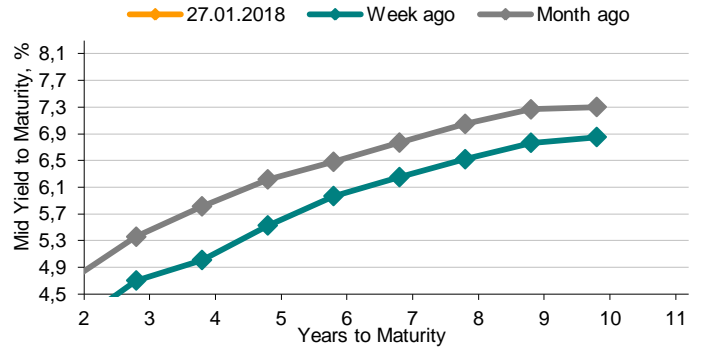
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

Ukraine's sovereign Eurobond yield curve



Source: Reuters

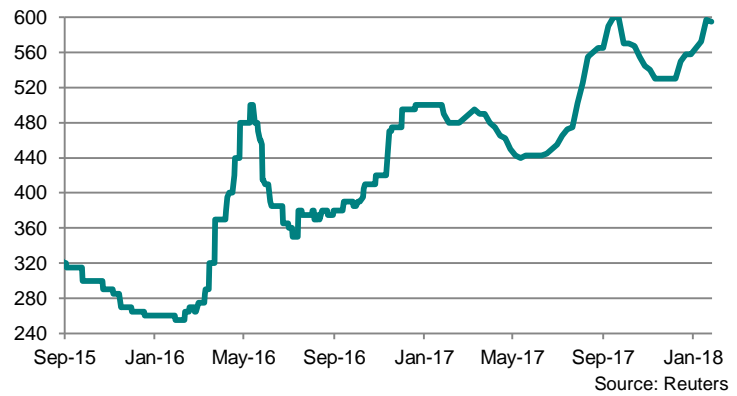
Commodity markets

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



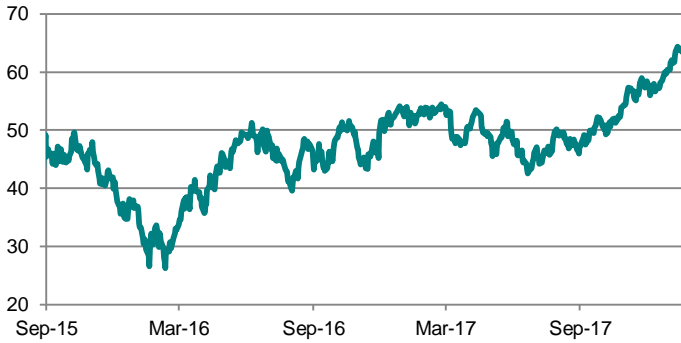
Source: Reuters

Steel CIS export HR coil, USD per ton



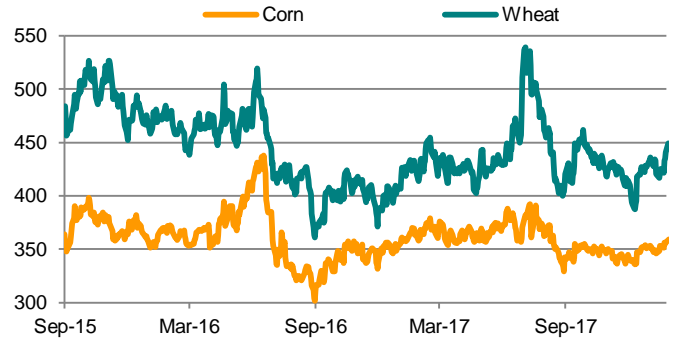
Source: Reuters

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	-5.3
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	-4.4
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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