



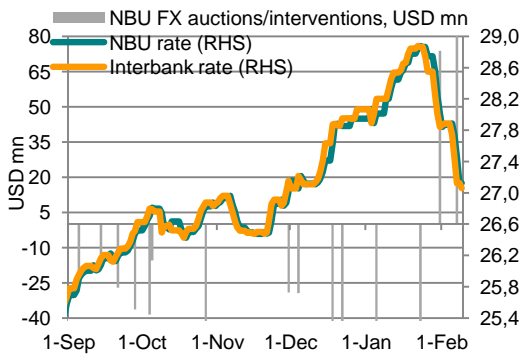
**This week in focus: Ukraine inflation continues to be high**

CPI inflation reading for January came out at +1.5% m/m and +14.1% y/y. We have expected fairly elevated reading in the start of the year due to fiscal expansion, seasonal devaluation of hryvnia, weaker USD and spill-off impact from energy prices. At the same time producers' prices surprised on the upside, jumping by +4.4% in one month (+22% y/y growth). We review our 2018 CPI expectation to 10.9% (year-end) and now see that risks are skewed towards further tightening during the next MPC meeting on March 1st.

*Please see page 3 for more details*

**FX and interest rates: Carry trade strengthened national currency**

**Figure 1. UAH exchange rate (UAH per USD)**



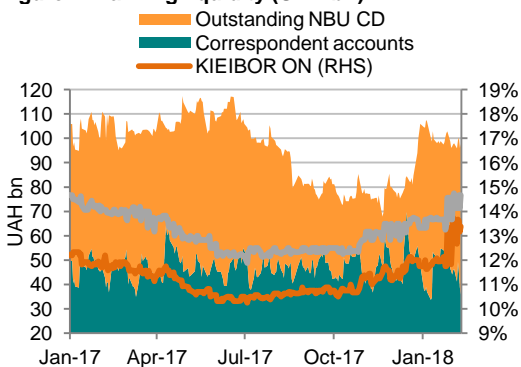
Source: NBU, Reuters

**USD/UAH declined to 27.05 as of Friday the 9<sup>nd</sup>.** Week-on-week local currency appreciated by 3.0 % against the USD.

**Average daily FX volumes on the market landed at the equivalent of USD 288.6mn,** USD 49.9mn higher than in the previous week.

**It's quite remarkable that NBU decided to conduct three currency auctions, buying out staggering USD 154.2 during the single week,** reversing strong selling. In our opinion, the main reason behind such upswing was a carry trade opportunity, which gained momentum after the latest increase of interest rates by NBU to 16.0%. By the end of January, non-residents held approximately UAH 5.86bn of OVDP (remaining at this level from the end of 2017), mainly denominated in UAH. While effective on February 8, their holding amounted to UAH 9.3bn, indicating that more than USD 100mn was sold on the interbank exchange market in order to buy such amount of bonds, allowing the central bank to buy approximately that volume via currency auctions. Had the NBU refrained to do that, hryvnia exchange rate would have strengthened even stronger.

**Figure 2. Banking liquidity (UAH bn)**



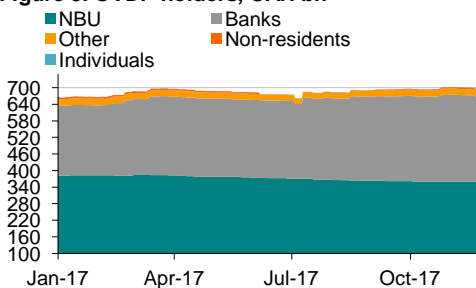
Source: Reuters, NBU, UkrSibbank, Minfin

**Aggregate banking liquidity amounted to UAH 97.7bn as of Friday the 9<sup>th</sup>,** remaining effectively flat during the week.

**Money market rates remained flat:** cost of ON funds is around 13.0/15.25, 1 week is 14.0/16.75 while 1M is 15.0/17.0, according to our calculations.

**While, having offered initially 6 bond issues, out of which 4 resulted in proceeds to the budget, MoF managed to attract UAH 5.2bn, as of February 6<sup>th</sup>.** MoF mainly refrained from issuance of bonds with the longest maturity during the auction, namely 2y and 3y debt securities. 6m bonds with a cut off rate set at 16.48% took the top spot this time, bringing total proceeds to the budget at UAH 2.2bn.

**Figure 3. OVDP holders, UAH bn**



Source: NBU

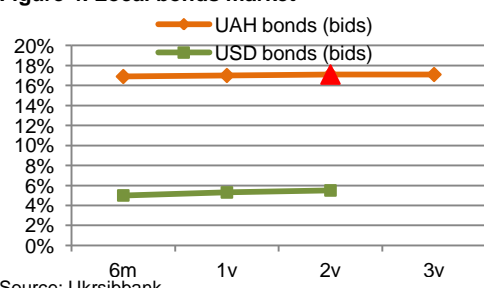
**Currently, yields (bids) of local OVDP in UAH at 16.90% (for 6m), 17.10% (for 2Y).** 1Y USD bids were at 5.30%, while bids for VAT bonds were at 17.10%.

**Figure 5. OVDP auction combined results, 6<sup>th</sup> of February 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	16.50%	16.50%	17.00%	16.50%	13	9	2.3bn	2.0bn
UAH	6m	16.50%	16.50%	17.00%	16.50%	16	12	2.6bn	2.2bn
UAH	9m	16.50%	16.48%	17.00%	16.47%	11	7	0.9bn	0.9bn
UAH	1y	16.40%	16.40%	17.00%	16.40%	5	4	191.0.mn	90,3mn

**Having dropped by 2% m/m, Ukraine's international reserves amounted to USD 18.4bn, as of February 1.** In January, government payments related to debt servicing accounted for USD 565.6mn, out of which USD 468.5mn was OVDP redemption. In prior month, NBU sold USD 266.8mn (USD 169mn via RFQ), while purchased USD 250.9mn (USD 177.0mn via RFQ) on the market. As a consequence, a net amount of sold currency comprised USD 15.9mn. Besides, NBU international reserves were affected by USD 205.9mn of revaluation of financial instruments. NBU' reserves covered 3.5 months of future import by the end of January 2018.

**Figure 4. Local bonds market**

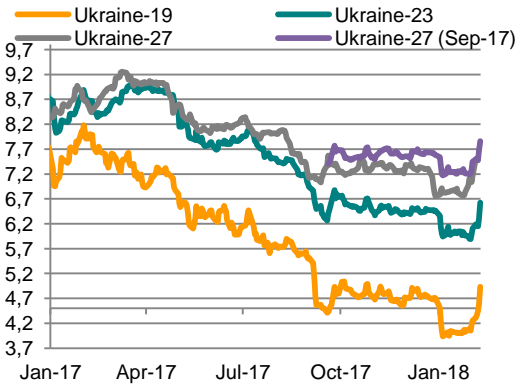


Source: UkrSibbank



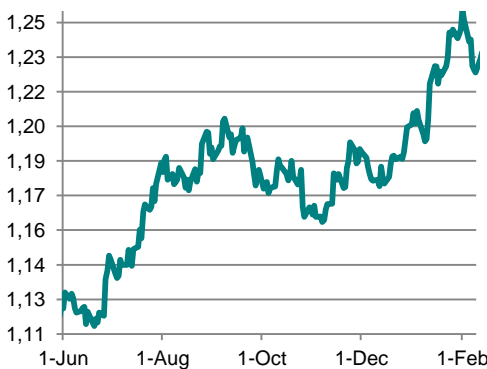
**Global markets: U.S. budget was signed into law by Donald Trump**

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



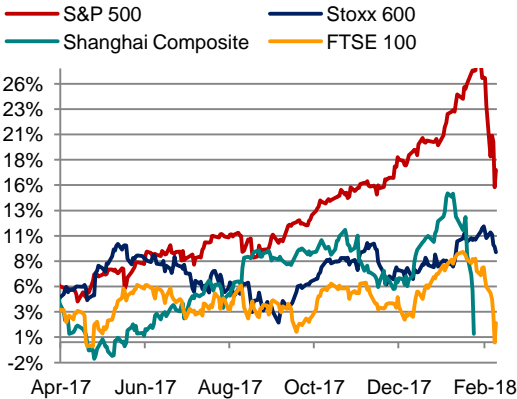
Source: Reuters

**Figure 6. EUR USD spot (mid)**



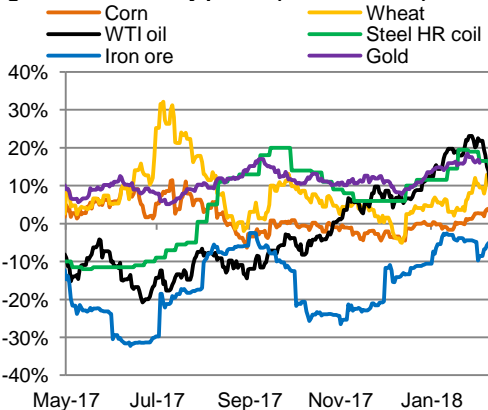
Source: Reuters

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



Source: Reuters

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



Source: Reuters

Donald Trump had signed into law a budget agreement that will boost federal spending by almost USD 300bn. While, Bank of England policymakers decided to leave interest rates on hold at 0.5%, as of February 8.

Bond benchmarks were mixed, with 10y Treasuries' yield higher by 2bp week-on-week increasing to 2.86%, while German 10y Bunds' yields fell 2bp, landing at 0.76%, Japanese 10y bonds closed the week at 0.071%.

US equities mixed, with S&P declining by 5.2%, while Nasdaq Composite declined a little bit lower by 5.1 % week-on-week.

Donald Trump had signed into law a budget agreement that will boost federal spending by almost USD 300bn, suspending debt ceiling for a year. The Congress passed that bill that ended government shutdown. Trump signature came quickly after the House gave final approval early Friday to the deal, hours after a one-man blockade by Senator Rand Paul delayed the votes and forced the government to briefly close.

EUR/USD rate landed at 1.2233 as of Friday the 9<sup>th</sup>, lower than the last week closing level of 1.246, as the USD major over performed against its main peers.

Stoxx 600, a broader gauge of European equity performance decreased by 5.0% during the week, while German DAX ended the week by 5.3% lower.

Bank of England policymakers decided to leave interest rates on hold at 0.5%, as of February 8. Bank of England said that inflation is projected to remain above 2% target in 2018, while economic growth forecast was lifted. The most prominent statement elaborated the outlook on interest rates that interest rates were likely to need to rise somewhat faster and to a somewhat greater extent than it had previously thought.

China's international reserves rose by USD 21.5bn, reaching USD 3.16tn in January. It was a 12<sup>th</sup> straight month of rise, supported by tougher capital controls and weakening dollar. In prior month, reserves increased less by USD 20.2bn. China had introduced a series of capital controls in the past several years. Among them the most important were a higher scrutiny of individual purchases of insurance plans abroad and foreign assets.

Crude oil moved downward, as WTI 1m futures declined by 9.5% week-on-week and closed at USD 59.2 per barrel, while Brent 1m futures declined by 5.8%, closing at USD 62.8 per barrel.

Gold prices fell, as NYMEX 1m futures dropped by 1.5% week-on-week and finished the week at USD 1313.1 per troy ounce.

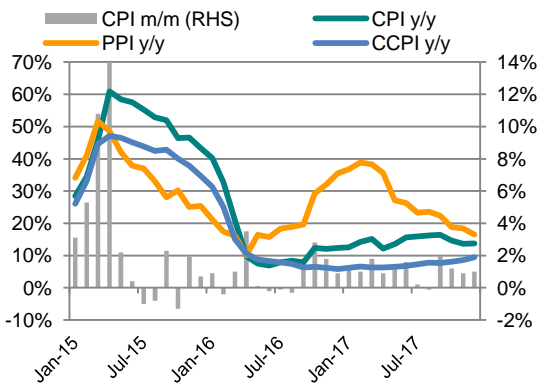
Grains finished the week flat, as CBOT Corn 1m futures rose 0.1% week-on-week and closed at USD 362.0 per bushel, while CBOT Wheat 1m futures laded at USD 449.0 per bushel, 0.5% higher week-on-week.

Iron ore increased as NYMEX Iron ore 62% Fe 1m futures fell 2.7% week-on-week and closed at USD 72.89 per ton.



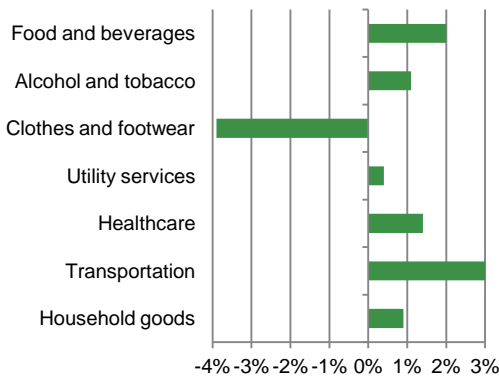
**This week in focus: Ukraine inflation continues to run high**

**Figure 9. Inflation rates in 2015-2018**



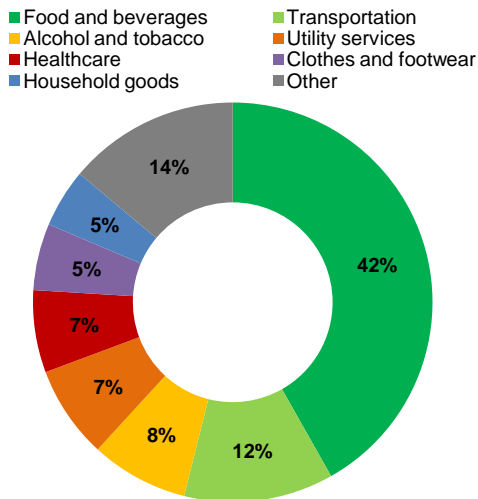
Source: Ukrstat

**Figure 10. Price changes in selected categories, January 2018, % m/m**



Source: Ukrstat

**Figure 11. CPI basket**



Source: Ukrstat

**CPI inflation reading for January came out at +1.5% m/m and +14.1% y/y.** We have expected fairly elevated reading in the start of the year due to fiscal expansion, seasonal devaluation of hryvnia, weaker USD and spill-off impact from energy prices. At the same time producers' prices surprised on the upside, jumping by +4.4% in one month (+22% y/y growth). **We review our 2018 CPI expectation to 10.9% (year-end) and now see that risks are skewed towards further tightening during the next MPC meeting on March 1st.**

**Food items displayed worse-than-average performance (+2.0 m/m, +17.9% y/y),** with broad and strong acceleration in prices of bread, meat, fruits and vegetables. The only stable items in the basket seem to be those which already showed aggressive growth last year. This leads us to conclusion that demand drivers are already fully in play against backdrop of loose and procyclical fiscal policy. In first month of the 2018, the most profound contribution came from raw food prices, namely vegetables and fruits. The former increased by 10.8% m/m, while the latter rose by 7.6% m/m. Sugar prices fell by 1.0% m/m, putting an annual tally to -8.8% y/y, following a -7.4% y/y drop in prior month. Moreover, egg prices, which are subject to seasonal patterns, added fuel further with a 3.0% m/m rise, resulting in a 27.8% on a year-on-year basis. It's noteworthy, that usually beginning and the end of the year accompanied with egg prices being on the rise, while declining by far in the middle of the year.

**In January, meat prices rose by 1.1% m/m, bringing year-on-year print to 29.4%.** Meat export acceleration poses a threat to inflation. In January, poultry export amounted to 19.692kt, up by 79% yoy in physical terms, coupled with stronger prices this resulted into USD 30.4mn of export proceeds from poultry, up by 133.5% y/y. In prior year, accelerate poultry export, especially in the first half of the year, resulted in higher domestic prices. As part of a strategy, some market leaders are striving to increase the size of their business.

**Over the course of next several years, MHP (Myronivskiyi Hliboproduct) is going to add 250-260 kt of poultry,** fully launching its Vinnitsa Phase 2 of the Vinnitsa Poultry complex. Management mentioned, that out of 250-260 kt, 200 kt to be exported, while the remaining 50 kt will contribute to enhanced supply of poultry on the local market, resulting in more balanced market.

**Out of all inflation subcategories, transportation prices rose the most on a monthly basis, accelerating by solid 3.0% (and +17.1% y/y) compared to December.** It's stronger than ever upheaval, stemming mainly from fuel prices increase by 4.4% m/m, translated into corresponding increase in all transportation services costs. The last time when transportation grew by more than in January was in March 2015, amid the backdrop of ravaging devaluation, with monthly inflation print at 7.4% m/m at that time. As a consequence, inflation subcategory related to transportation picked up to 17.3% y/y in January, a bit higher compared to 16.7% y/y in December.

**Having dropped by 3.9% m/m, shoes and apparel prices gauge, gained by 1.4% y/y,** following a 0.9% y/y increase in prior month.

**Alcohol and tobacco prices printed higher by 1.1% m/m,** up from 0.6% m/m in December and 20.6% y/y.

**Core inflation continued to decelerate on m/m basis, to +0.7% m/m,** but remains fairly elevated in y/y terms at +9.8%. We noted increased divergence between base inflation and wider CPI index in the last several months.

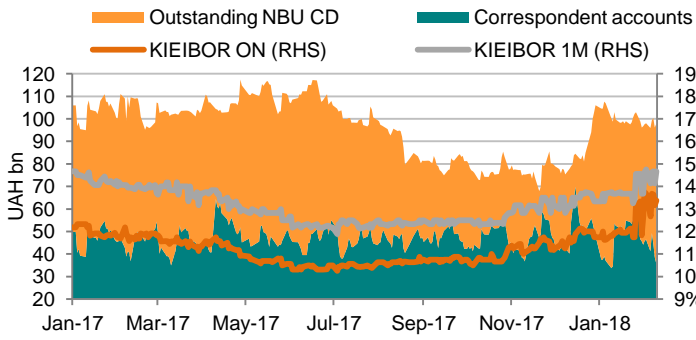
**The main message to read is producers prices and this message is worrisome.** PPI was on decelerating path since April 2017, before re-accelerating sharply in January 2018 (from +16.5% y/y to 22.0% y/y). This sharp acceleration was led by domestic prices (vs export prices) and may point to a quickly closing output gap in the economy, with the labor market being particularly tight for quite some time. We have long argued that ongoing NBU tightening (+350 b.p.) to some extent may contribute to increased financial costs that creates ground for higher PPI levels.

Following open publication of MPC minutes, which displayed very hawkish stance of MPC committee, we believe it is likely that the regulator continues to hike, unless we see a sudden favorable inflation expectations change. We welcome recent steps of NBU aimed at bringing more transparency to decision making in monetary policy.



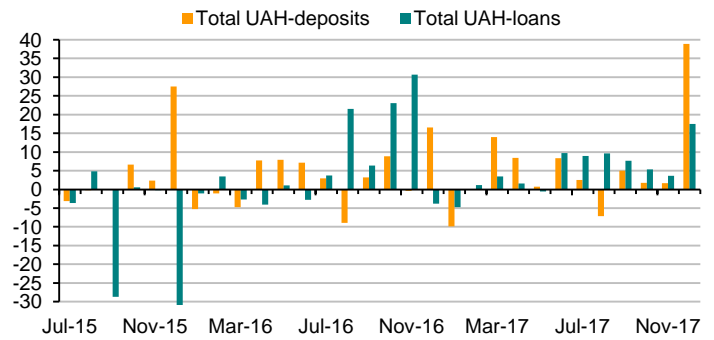
**Money market**

**Banking liquidity vs. money market rates, %**



Source: Reuters, NBU, UkrSibbank estimates

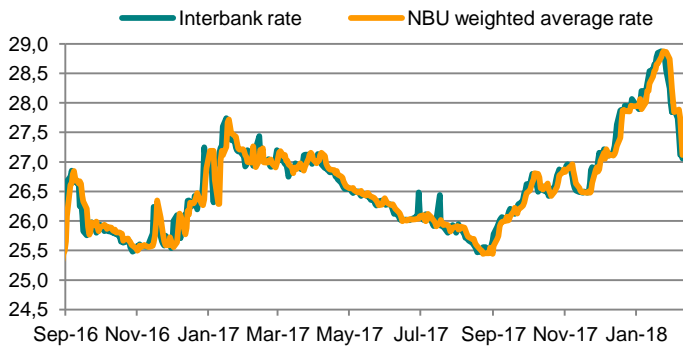
**Monthly change in local currency loans and deposits, UAHbn**



Source: the NBU

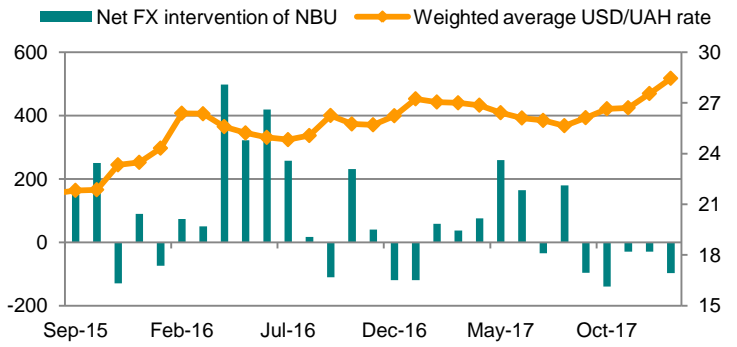
**Currency market**

**UAH exchange rate, UAH/USD**



Source: Reuters

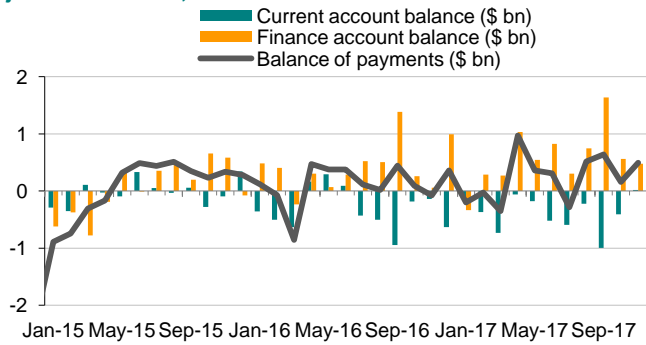
**Net retail FX interventions of the NBU in 2015-2017, USDmn**



Source: NBU

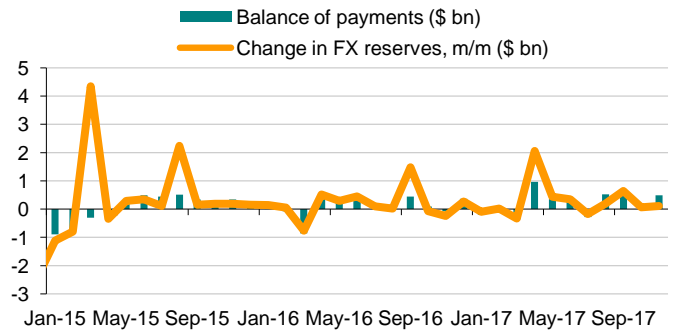
**Balance of payments**

**Major BoP accounts, USDbn**



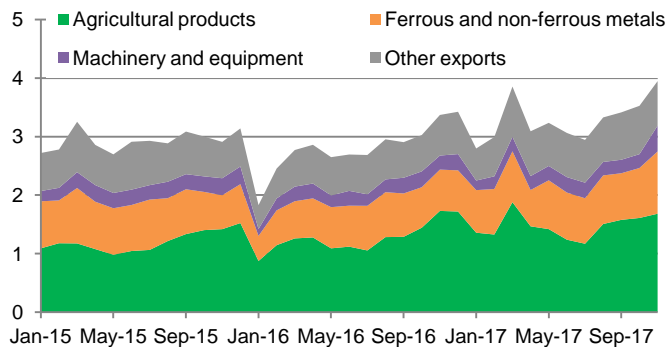
Source: NBU

**BoP vs change in foreign reserves, USDbn**



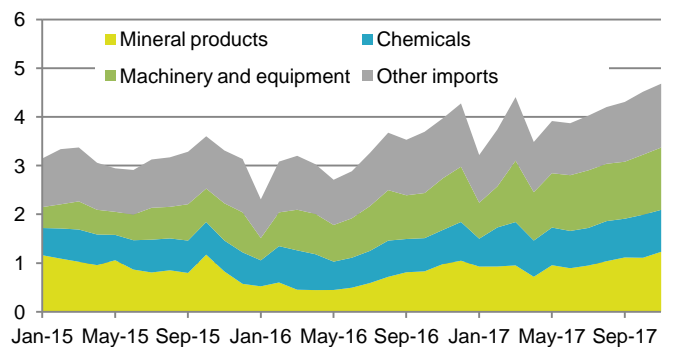
Source: NBU

**Exports components dynamic, USDbn**



Source: NBU

**Imports components dynamic, USDbn**



Source: NBU

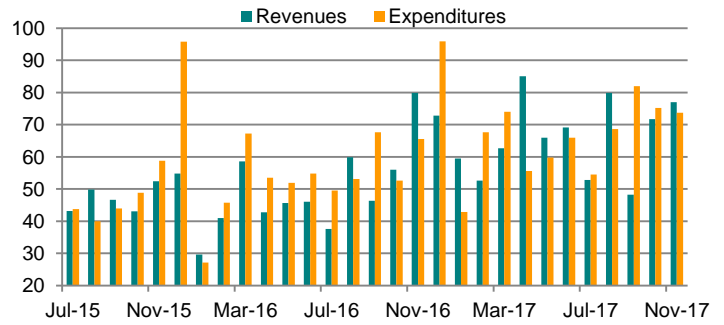


**Budget performance**

**Budget performance, UAHbn**

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

**Monthly change in budget revenues and expenditures, UAHbn**

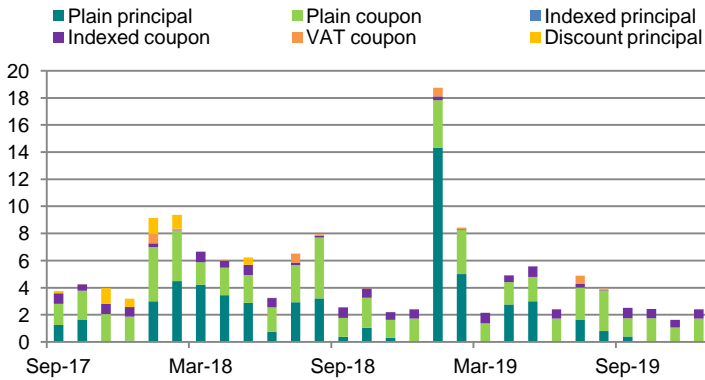


Source: NBU

Source: NBU, State Treasury

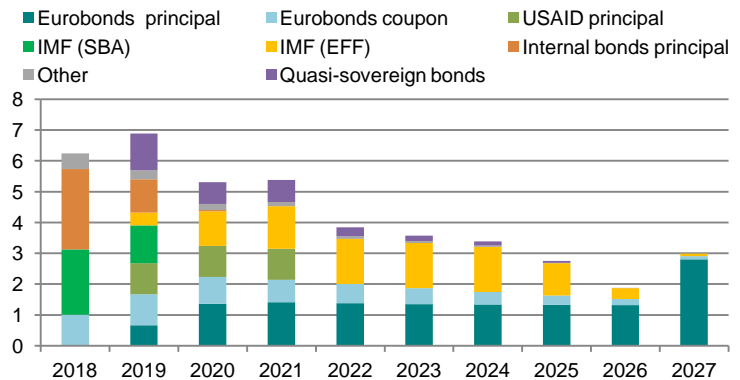
**Sovereign debt**

**UAH-denominated debts' repayments schedule, UAHbn**



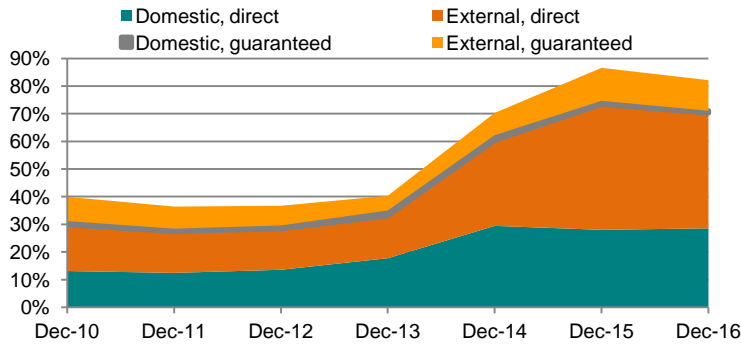
Source: NBU, UkrSibbank estimates

**FX-denominated debt repayments schedule, USDbn**



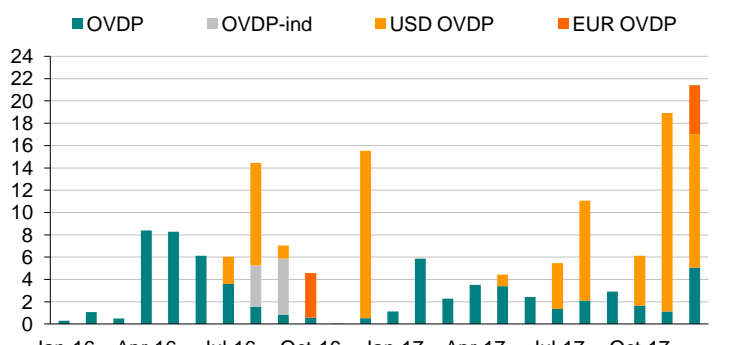
Source: Reuters, IMF, UkrSibbank estimates

**Total government debt, % GDP**



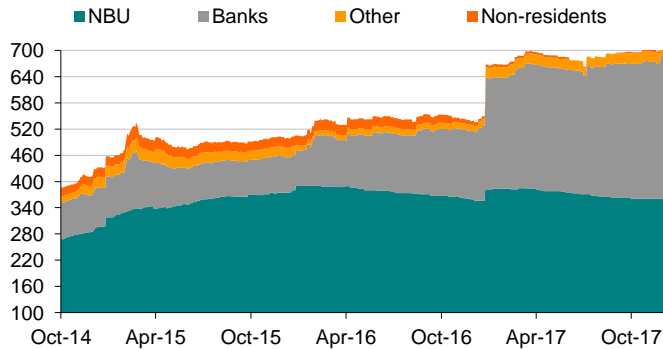
Source: MinFin

**Local borrowings, UAHbn equivalent**



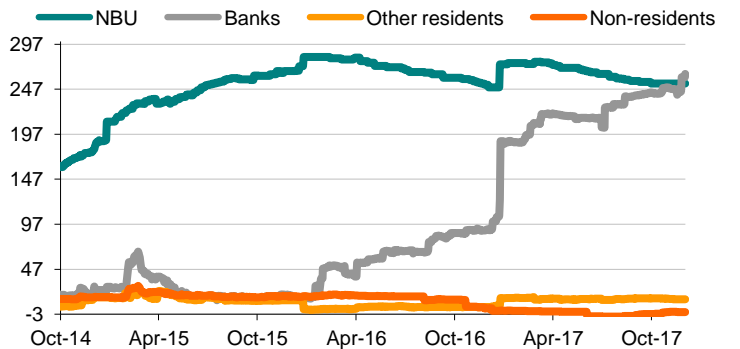
Source: NBU

**Outstanding OVDP owners structure, UAHbn**



Source: NBU

**Outstanding OVDP changes in holding, UAHbn**

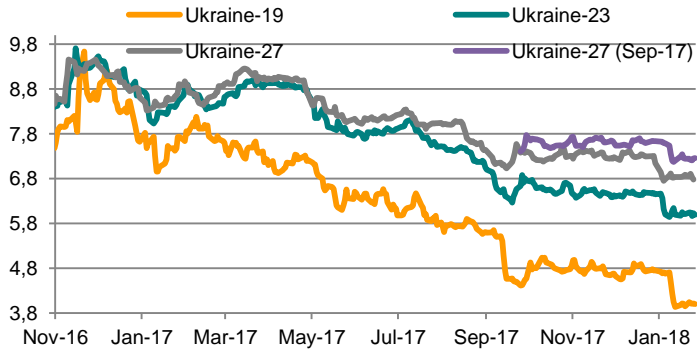


Source: NBU



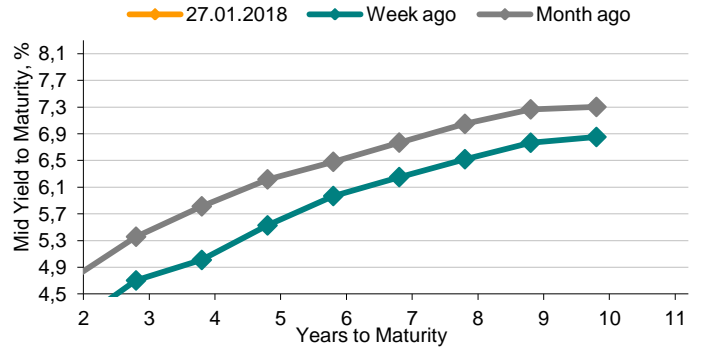
### Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

Ukraine's sovereign Eurobond yield curve



Source: Reuters

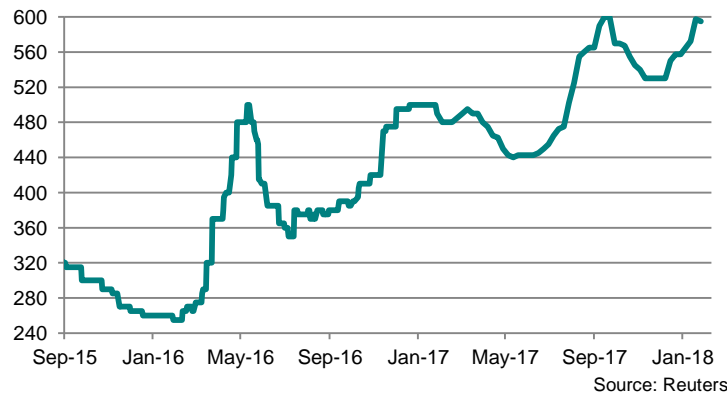
### Commodity markets

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



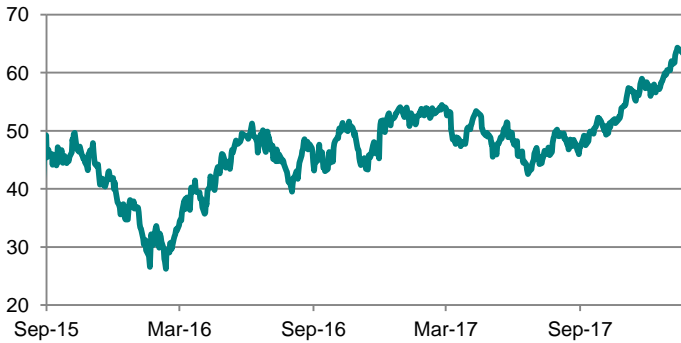
Source: Reuters

Steel CIS export HR coil, USD per ton



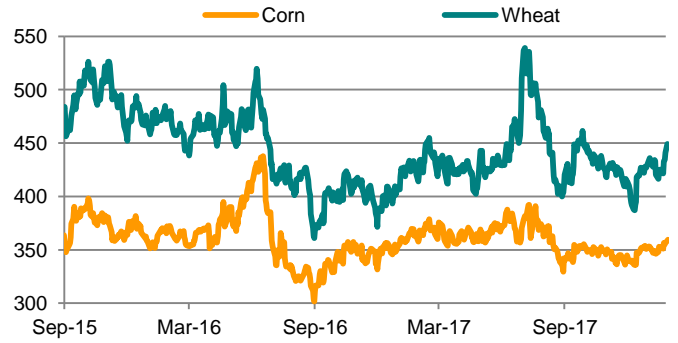
Source: Reuters

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
<b>Real sector</b>											
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
<b>Prices</b>											
CPI (average %YoY)	25.2	15.9	9.4	8.0	0.6	-0.2	12.1	48.7	16.5	14.4	11.9
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	10.9
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
<b>Fiscal balance (% of GDP)</b>											
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
<b>External balance</b>											
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
<b>Interest and exchange rates</b>											
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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