



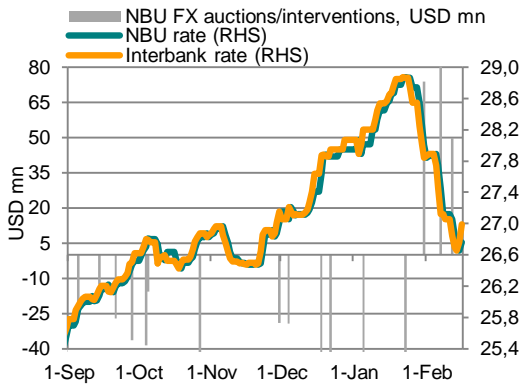
This week in focus: UAH appreciation is done for now

We view both rapid devaluation of Ukrainian currency and subsequent strengthening in the first months of 2018 as excessive and transitory. The first was entirely driven by uneven budget payments, and the second is the result of a short-term carry trade speculative flows (non-resident investors buying in high UAH rates). As of today UAH has reached reasonable levels for 1H2018 in our view, and we continue to expect depreciation in Q4 2018 to levels 29.50.

Please see page 3 for more details

FX and interest rates: MoF managed to attract UAH 1.5bn

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH declined to 26.99 as of Friday the 16th. Week-on-week local currency gained by 0.3 % against the USD. Out of 5 days, in 3 hryvnia continued to strengthen, while it bounce to some extent back on Thursday and then on Friday, reversing prior upswing.

Average daily FX volumes on the market amounted to the equivalent of USD 242.7mn, USD 45.8mn lower compared to previous week.

NBU held only one currency auction this time, during the week, as opposed to three in preceding week. Out of USD 78.3mn applied initially by the banks, NBU bought USD 49.9mn. Similar to the preceding week, non-residents increased their holding once again but to a lesser extent. Non-residents holding increased by UAH 0.6bn, compared to UAH 2.7bn in prior week. Indicating that international investors had kept their appetite toward Ukraine's credit risk.

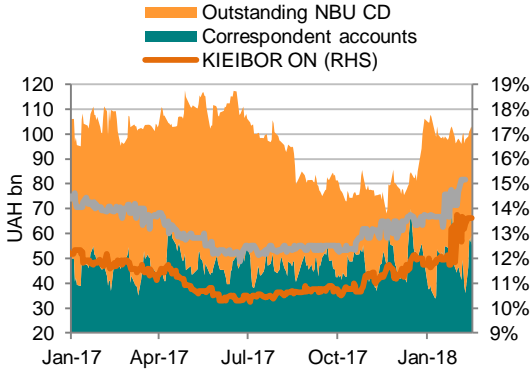
Aggregate banking liquidity amounted to UAH 102.0bn as of Friday the 16th, turning around to the upswing during the week and increasing by more than UAH 4bn.

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 managed to attract only UAH 1.5bn on its latest auction, as opposed to UAH 5.2bn in prior week, as ministry of finance introduced some novelty. MoF managed to reduce rates on the shortest issues as the largest part of bonds were submitted at a rates up to 16.0%. While banks submitted 15 bids totalling UAH 875.1mn, MoF accepted only 6, resulting in UAH 480.8mn (or around half from demand) proceeds to the budget. At the same time on its latest auction MoF introduced limits UAH 500mn per issue for 3m and 6m bonds.

Currently, yields (bids) of local OVDP in UAH at 16.50% (for 6m), 17.10% (for 2Y). 1Y USD bids were at 5.30%, while bids for VAT bonds were at 16.95%.

Figure 2. Banking liquidity (UAH bn)

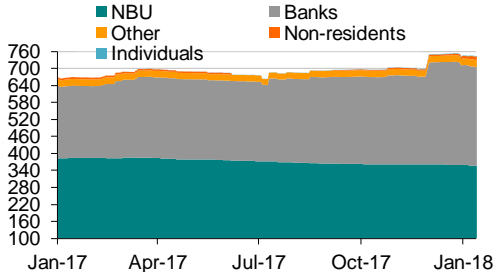


Source: Reuters, NBU, UkrSibbank, Minfin

Figure 5. OVDP auction combined results, 6th of February 2018

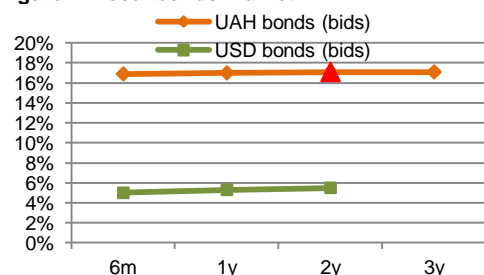
CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size	Placement size
UAH	3m	16.00%	16.00%	17.00%	15.89%	15	6	875.1mn	480.8mn
UAH	6m	16.24%	16.50%	17.00%	15.89%	21	20	604.2mn	462.5mn
UAH	9m	16.50%	16.50%	16.90%	16.50%	7	6	171.1mn	135.9mn
UAH	1y	16.40%	16.40%	16.40%	16.40%	7	6	130.2mn	129.7mn
UAH	2y	15.79%	15.80%	15.74%	16.50%	12	7	379.3mn	264.9mn

Figure 3. OVDP holders, UAH bn



Source: NBU

Figure 4. Local bonds market



Source: UkrSibbank

Ukraine's economy expanded by 1.8% y/y in 4Q 2017, according to Ukrstat preliminary reading. On a quarterly basis real GDP increased by 0.5%. It implies that overall economic growth was around 2.2% in 2017, which is slightly lower than 2.3% y/y growth in 2016, capping for a second year of positive readings. Detailed breakdown of GDP components it scheduled to be released in March.

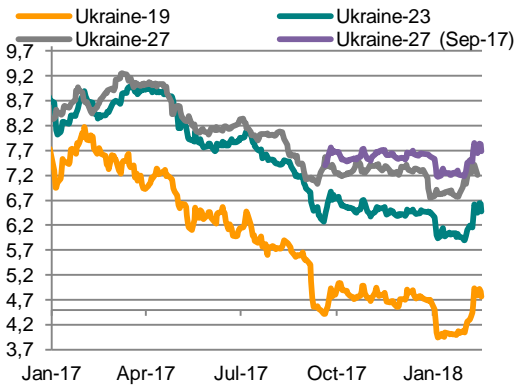
NBU is powering ahead to unwind its previously tightened regulations. **The central bank liberalized some its previously introduced requirements** allowing commercial banks to attract loans from non-residents (i.e.so called synthetic loans) in national currency. Previously, such type loans were attracted if creditors were international financial institutions.

One of the state banks, namely Ukreximbank most likely tap financing markets with Eurobonds issue denominated in hryvnia. The term of the bonds will be 5 year. Previously bank restructured all its Eurobonds issuance in line with sovereign issuer in 2015.



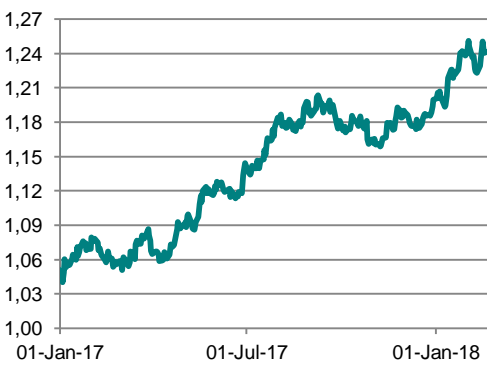
Global markets: U.S. consumer prices are on the rise

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



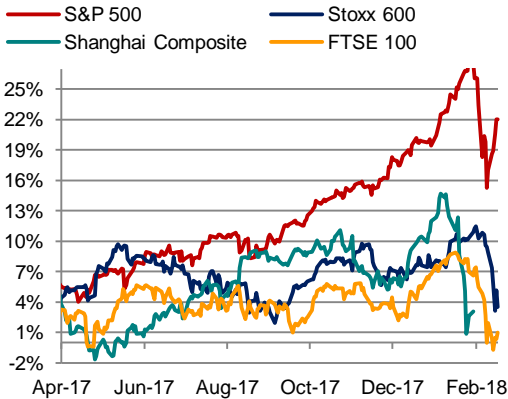
Source: Reuters

Figure 6. EUR USD spot (mid)



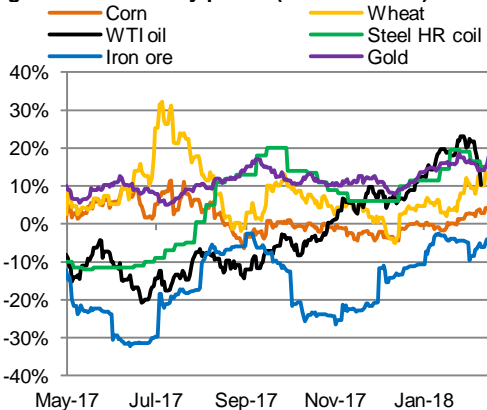
Source: Reuters

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



Source: Reuters

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



Source: Reuters

U.S. consumer prices gained more than expected in January, adding by 0.5% m/m in January, followed by 0.2% m/m in prior month. At the same time, core consumer prices advanced by 0.3% m/m. In Europe, German economy expanded by 0.6% q/q in 4Q 2017, slightly lower than in prior quarter. Moreover, Japan economy grew by 0.5% q/q in 4Q 2017, being positive for a 8 quarter running.

Bond benchmarks were mixed, with 10y Treasuries' yield higher by 2bp week-on-week increasing to 2.87%, while German 10y Bunds' yields fell 4bp, landing at 0.71%, Japanese 10y bonds closed the week slightly lower at 0.061%.

US equities were on the rise, with S&P gaining by 4.3% week-on-week, while Nasdaq Composite experienced stronger increase by 5.3% week-on-week.

U.S. consumer prices rose more than expected in January. According to data of Labor Department, CPI index increased by 0.5% in January, compared to 0.2% gain in December. Moreover prices increased by 2.1% y/y. At the same time, core CPI advanced by 0.3% m/m, followed by 0.2% m/m gain in December. While broad CPI measure was higher than 2% on a yearly basis, the preferred Federal Reserve's consumer prices gauge, namely core PCE, constantly fell short of 2% target since 2012.

EUR/USD rate landed at 1.2404 as of Friday the 16th, higher than the last week closing level of 1.2233, as the USD major underperformed against its main counterparts.

Stoxx 600, a broader gauge of European equity performance rose by 3.3% during the week, while German DAX ended the week by 2.8% higher.

German economy rose by 0.6% q/q in 4Q 2017, amid the backdrop of strong export growth. While it was in line with consensus, the latest GDP print was lower than 3Q 2017 reading, indicating small slowdown in economy. Economical growth bases on a yearly basis amounted to 2.2% in 2017, which translated into a calendar-adjusted rate of 2.5%. Overall, German economy was powering ahead on a consumer led growth, partly due to record high employment, raising real wages an low borrowing costs.

Japan economy grew by 0.5% annualized rate in 4Q 2017, which translated into longest continuous expansion since 1980s. According to the GDP fourth quarter reading, growth was boosted by increased consumer spending. The latest economic growth figure followed a 2.2% expansion in 3Q 2017. In 2017, overall economic growth accounted for 1.6% y/y, which is the fastest upswing in recent years. While the extended string of gains, running for a 8 quarter, could spark speculation that Japan's central bank can reduce its monetary stimulus, it remains unlikely as long as the year is strengthening and consumer price growth remains weak.

Crude oil moved higher, as WTI hm futures increase by 4.2% week-on-week and closed at USD 61.9 per barrel, while Brent 1m futures rose by 3.3%, closing at USD 64.8 per barrel.

Gold prices rose, as NYMEX 1m futures gained by 3.1% week-on-week and finished the week at USD 1353.2 per troy ounce.

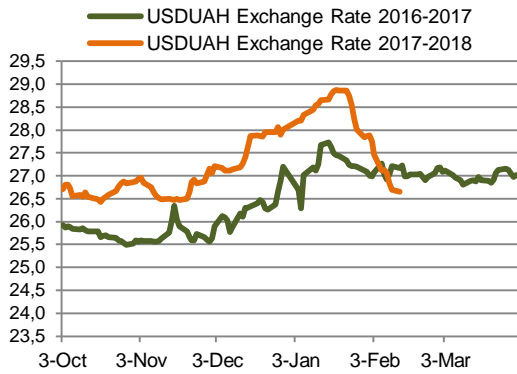
Grains finished were in the black, as CBOT Corn 1m futures rose 1.5% week-on-week and closed at USD 367.5 per bushel, while CBOT Wheat 1m futures laded at USD 457.8 per bushel, 1.9% higher week-on-week.

Iron ore increased as NYMEX Iron ore 62% Fe 1m futures rose 2.7% week-on-week and closed at USD 76.89 per ton.



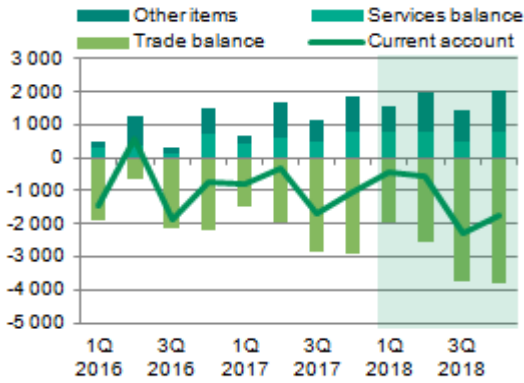
This week in focus: UAH appreciation is done for now

Figure 9. Hryvnia seasonality



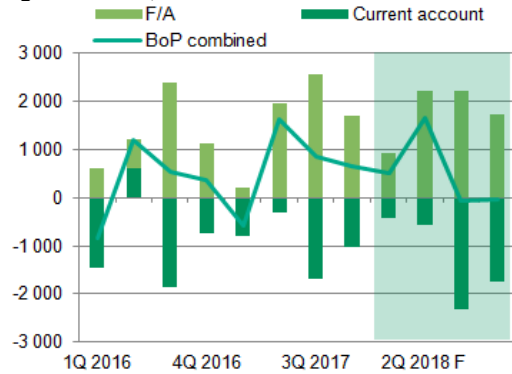
Source: NBU

Figure 10. C/A breakdown, USD mn



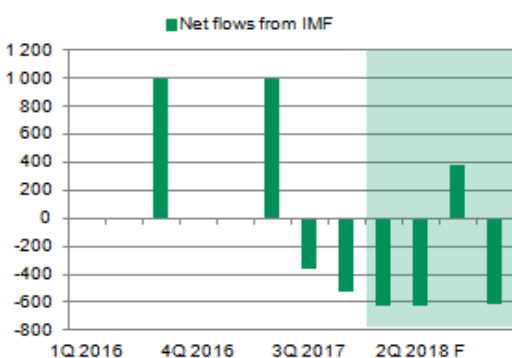
Source: NBU, Ukrsibbank

Figure 11. BoP, USD mn



Source: NBU, Ukrsibbank

Figure 12. Net flow from IMF, USD mn

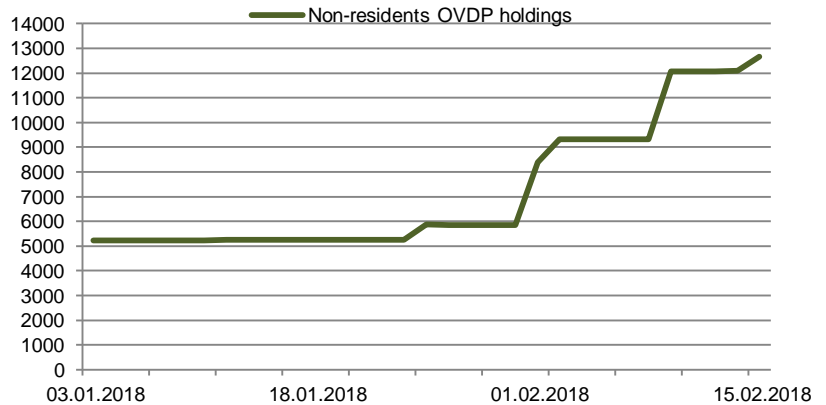


Source: NBU, Ukrsibbank

We view both rapid devaluation of Ukrainian currency and subsequent strengthening in the first months of 2018 as excessive and transitory. The first was entirely driven by uneven budget payments, and the second is the result of a short-term carry trade speculative flows (non-resident investors buying in high UAH rates). As of today UAH has reached reasonable levels for 1H2018 in our view, and we continue to expect depreciation in Q4 2018 to levels 29.50.

Further appreciation pressure driven by hot money is possible, but clouded by volatility in financial markets. Following 350 b.p. hikes delivered by NBU, non-residents bought around UAH 6.9bn of local OVDP, effectively more than doubling their holding in a very short period of time (which now reached UAH 12.8bn). This has created strong appreciation pressure on hryvnia, provided low depth of FX market. And this might be far from over, from our perspective, as non-resident holdings of Ukraine local bonds are very low by international standards. At the same time we note that recent volatility in financial markets and subsequent decline in EM risk appetite might have decreased interest towards local markets for now. Apart from high UAH rates, another potential driver for UAH local debt inflows is opening possibility to trade UAH bonds via Clearstream (for now, cumbersome procedures of opening local account are required).

Non-residents OVDP holdings, UAH mn

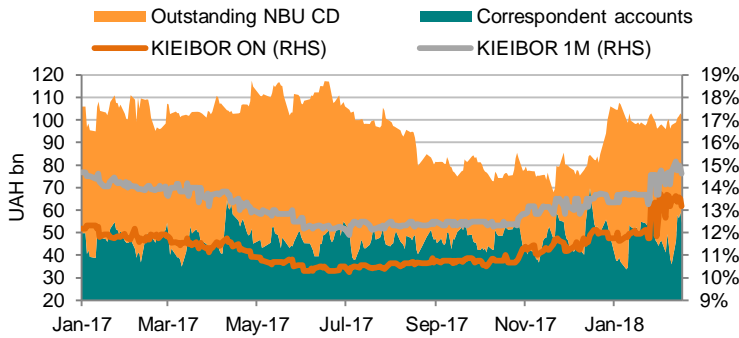


Current account deficit will expand significantly in 2H 2018, creating case of some devaluation towards year end. The main driver is acceleration of imports, driven by weak USD, rapidly rocketing imports of consumption goods, and energy price growth. This would require more aggressive inflows on financial account. While we price in two taps of international markets by Ministry of Finance and eventual bond placement of one quasi-sovereign, the stable inflows on financial account are subject to Ukraine-IMF deal. We are constructive, expecting one USD1.0-1.5 bn disbursement which would help to facilitate inflows on financial account. Also, this disbursement is needed to cover redemptions to IMF, which reach about USD 600mn per quarter.



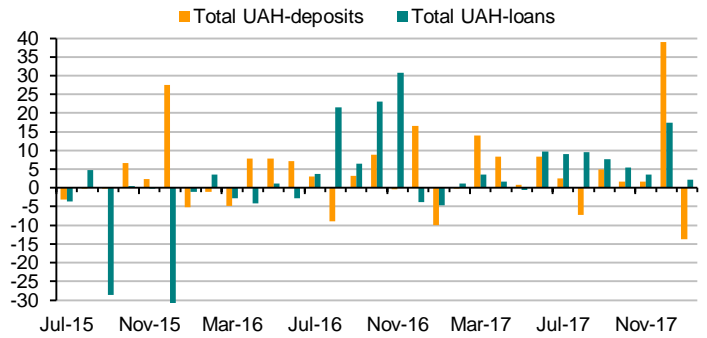
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

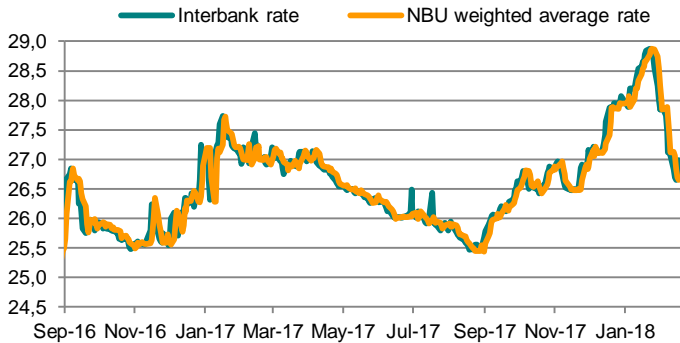
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

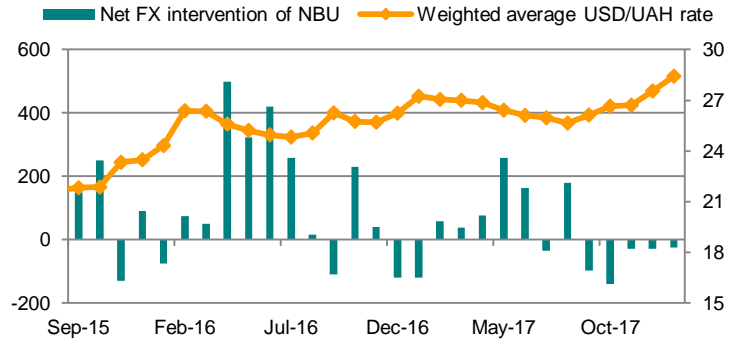
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

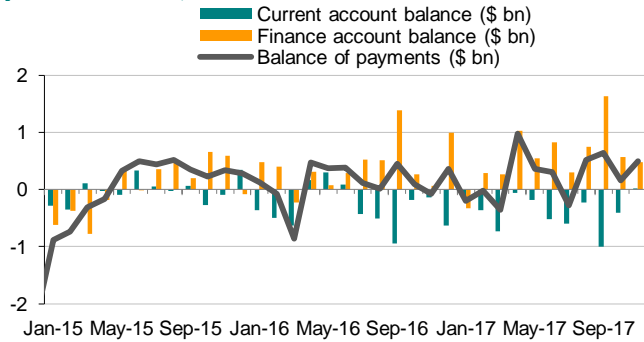
Net retail FX interventions of the NBU in 2015-2017, USDmnn



Source: NBU

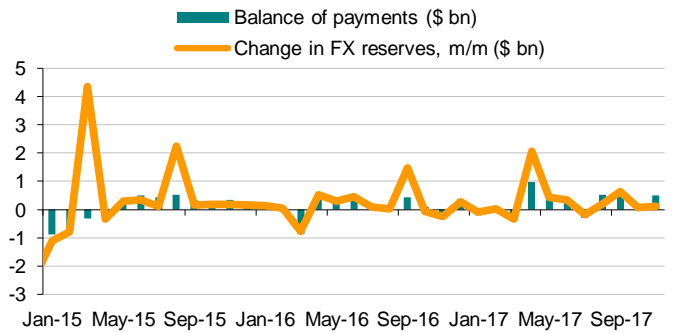
Balance of payments

Major BoP accounts, USDbn



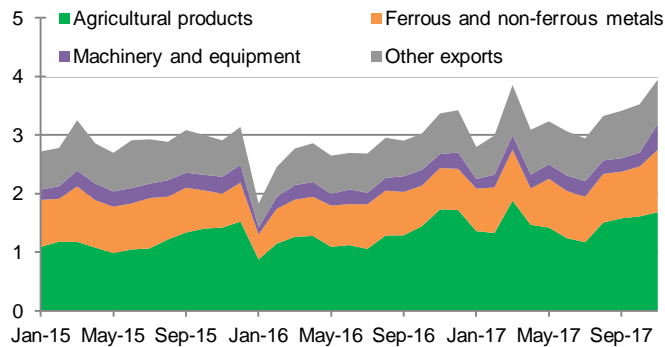
Source: NBU

BoP vs change in foreign reserves, USDbn



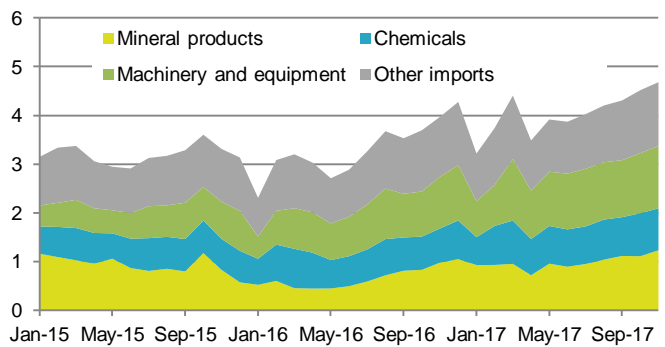
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU



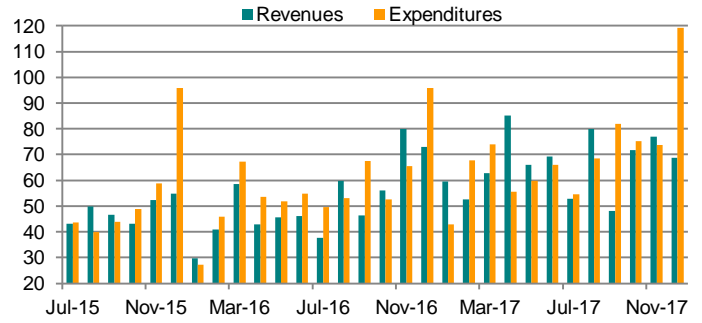
Budget performance

Budget performance, UAHbn

	Jan – Dec 2016	Jan - Dec 2017
Budget revenues	616,3	793,3
VAT proceeds	329,9	183,5
Corporate income tax	54,3	66,9
Budget expenditures	684,7	839,2
Deficit / Surplus	-68,5	-46,0

Source: NBU

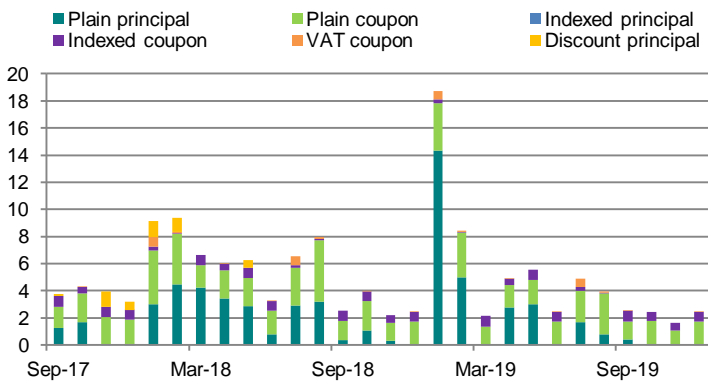
Monthly change in budget revenues and expenditures, UAHbn



Source: NBU, State Treasury

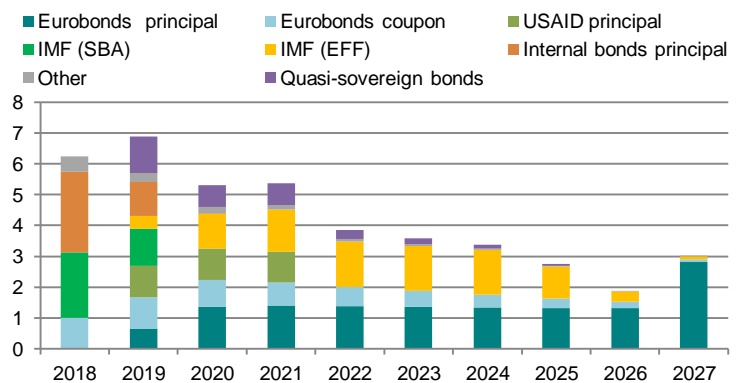
Sovereign debt

UAH- denominated debts' repayments schedule, UAHbn



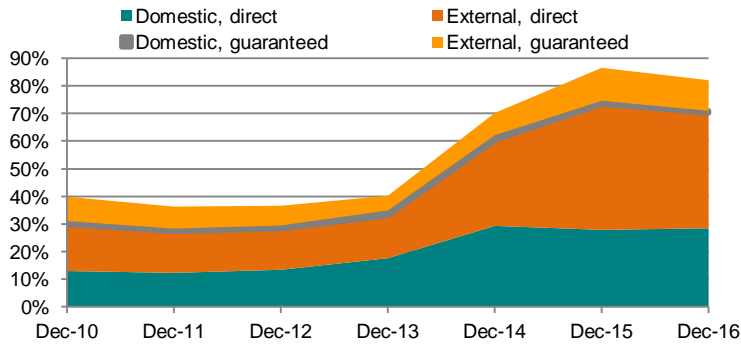
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



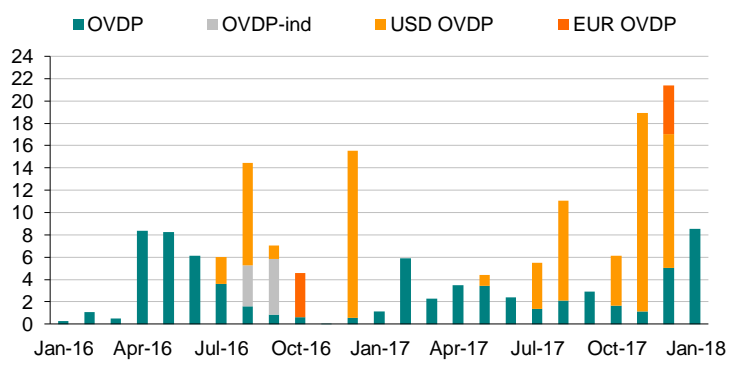
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



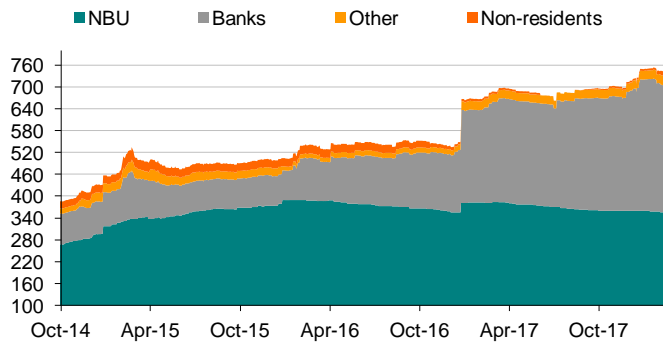
Source: MinFin

Local borrowings, UAHbn equivalent



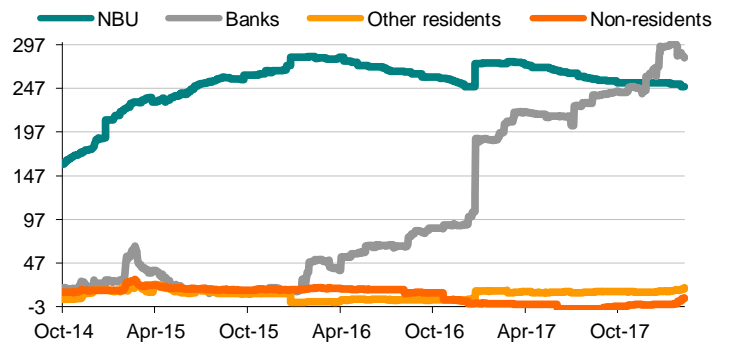
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

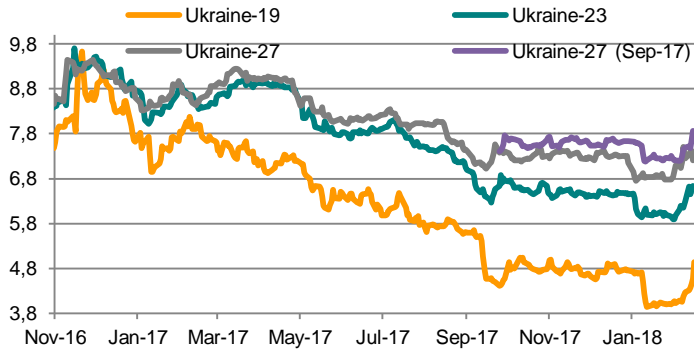


Source: NBU



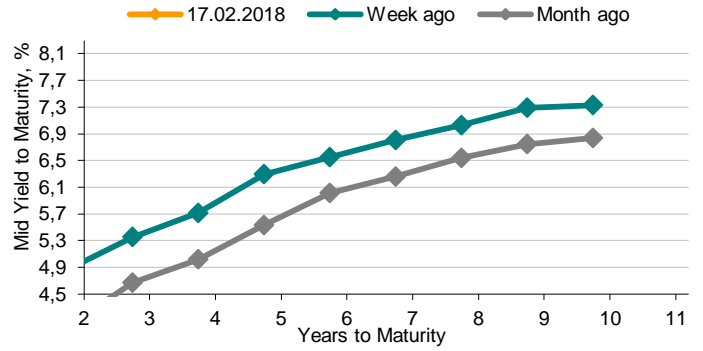
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

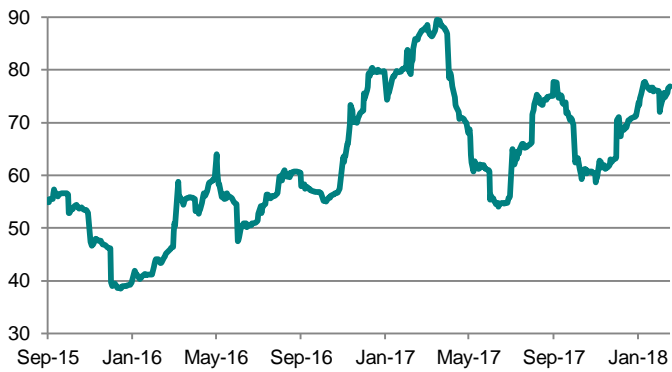
Ukraine's sovereign Eurobond yield curve



Source: Reuters

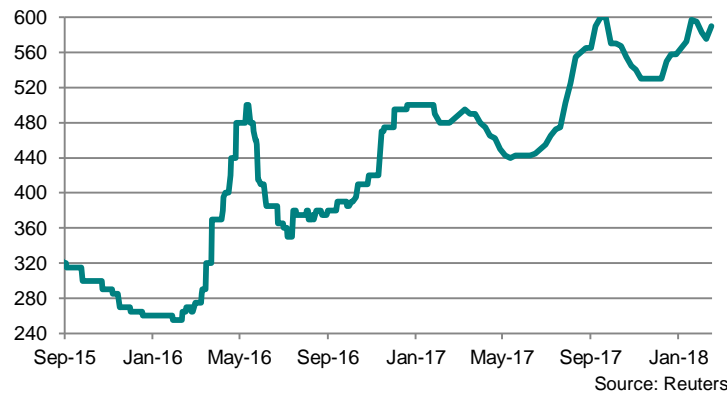
Commodity markets

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



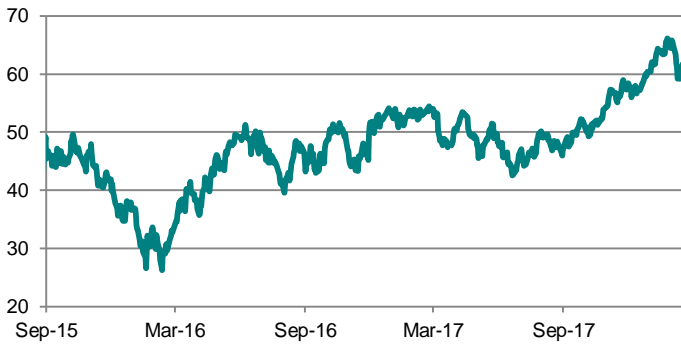
Source: Reuters

Steel CIS export HR coil, USD per ton



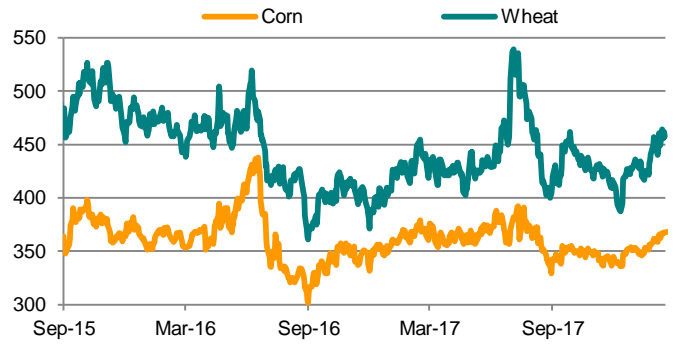
Source: Reuters

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	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
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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