



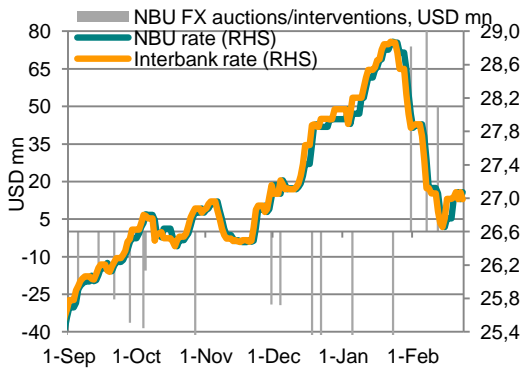
**This week in focus: Ukraine's central bank likely to stop tightening for now**

Inflation expectation of households, revealed last week, displayed the sharpest plunge in almost 1.5 years, according to GfK. We believe that the significant change in inflation expectation of households creates a signal for NBU to stop tightening for now, while heavy inflation prints coupled with ongoing uncertainties regarding IMF program are likely to make any easing prospects rather distant.

*Please see page 3 for more details*

**FX and interest rates: MoF managed to attract UAH 1.2bn**

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



Source: NBU, Reuters

**USD/UAH closed at 26.99 as of Friday the 23<sup>rd</sup>.** Week-on-week local currency remained unchanged against the USD. The volatility of exchange rate during the week was at the lowest level since the start of the year.

**Average daily FX volumes on the market amounted to the equivalent of USD 296.2mn,** USD 46.5mn lower compared to previous week.

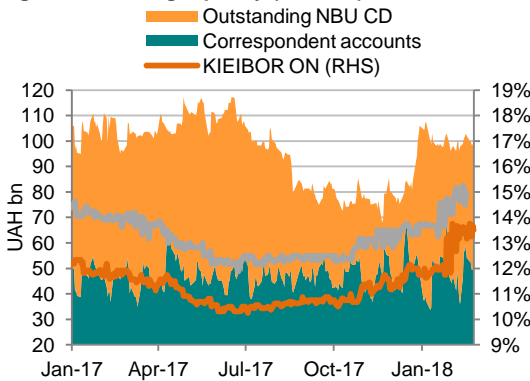
**NBU refrained from conducting currency auctions this time, during the week.** While it bought USD 49.9mn in previous week in the wake of currency appreciation.

**Aggregate banking liquidity amounted to UAH 97.1bn as of Friday the 23<sup>rd</sup>,** reversing to decline and falling by UAH 4.9bn during the week.

**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 effective February 20<sup>th</sup> resulted in UAH 1.2bn** in prior week, down from UAH 1.5bn a week earlier. As was the case in prior auction, the shortest bonds, namely 3m and 6m issues, were capped by UAH 0.5bn per issue, in an effort to enhance competition between banks. Non-residents also contributed to demand of the auction, as their holding rose by UAH 371, reaching UAH 13.1bn. demand from non-residents was also

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



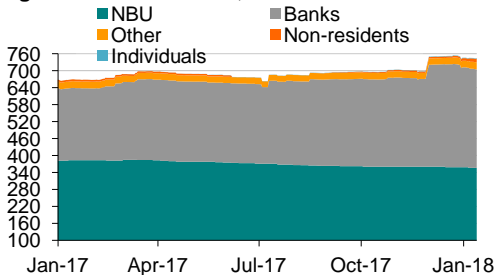
Source: Reuters, NBU, UkrSibbank, Minfin

**Currently, yields (bids) of local OVDP in UAH at 17.00% (for 6m), 17.50% (for 2Y).** 1Y USD bids were at 5.30%, while bids for VAT bonds were at 17.20%.

**Figure 5. OVDP auction combined results, 20<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	16.00%	16.00%	17.00%	16.00%	3	2	552.8mn	482.2mn
UAH	6m	16.50%	16.37%	16.50%	16.23%	12	12	410.3mn	380.5mn
UAH	9m	-	-	16.90%	16.75%	2	0	145.1mn	0.0mn
UAH	1y	16.39%	16.40%	16.40%	16.38%	5	5	233.4mn	233.1mn
UAH	3y	15.79%	15.79%	16.25%	15.79%	4	1	185.0mn	80.8mn

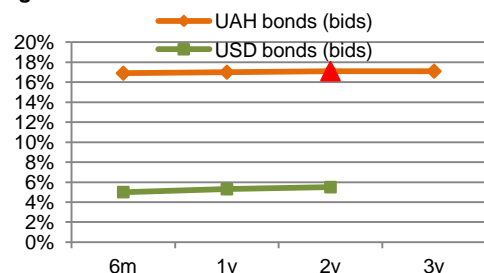
**Figure 3. OVDP holders, UAH bn**



Source: NBU

**Ukraine's finance minister, in his recent interview, mentioned that final agreements were not reached during the latest negotiations with representatives of IMF technical mission.** Danilyk said that it was preliminary agreed that anticorruption infrastructure should be vertical including an anticorruption bureau, anticorruption prosecutor office, and an anticorruption court. In regard to household's gas prices, the minister said that there was not find a formula how to increase the prices. At the same time, Aleksandr Danyluk keeps his optimism about arrival of next IMF tranche.

**Figure 4. Local bonds market**



Source: UkrSibbank

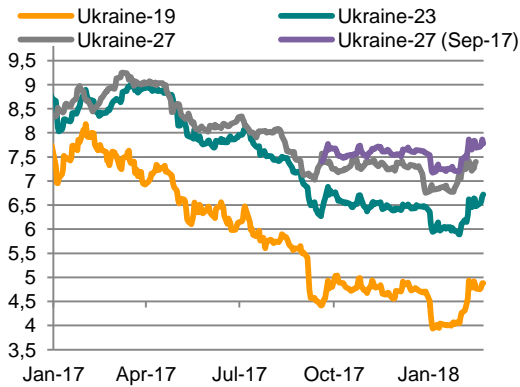
**The head of Verchovna Rada, Andriy Parubiy said, that he expects the parliament to vote for new NBU governor nomination and previous governor resignation, as of March 1.** The issue of acting NBU governor was discussed also with IMF technical mission As was reported earlier, Ukraine's President Petro Poroshenko, on January 18<sup>th</sup>, submitted a bill to parliament, in which Yakiv Smoliy was nominated as the new chairman of the central bank.



**Global markets:**

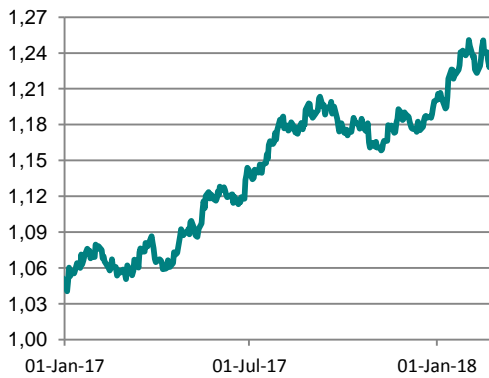
**Fed's minutes bolsters the chances of four rate hikes in 2018**

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



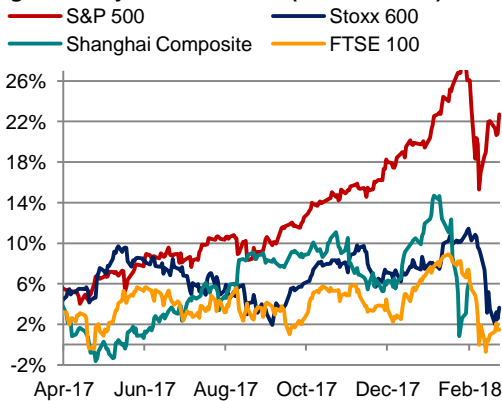
Source: Reuters

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



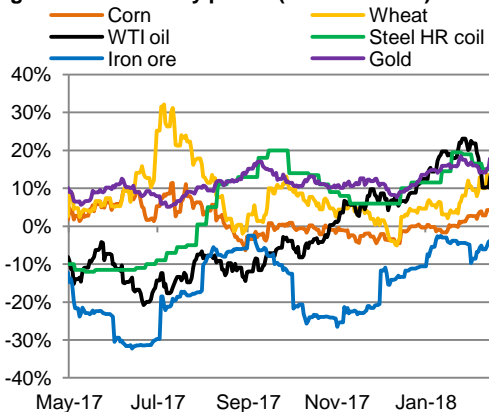
Source: Reuters

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



Source: Reuters

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



Source: Reuters

Minutes of the Fed's last meeting revealed that strengthening of the U.S. economy bolsters the chances of more than three rate hikes in 2018. At the same time, the minutes of the ECB released a little bit later rejected any changes to message, citing that it was premature. Japan core consumer prices reading was unchanged at 0.9%, followed by the same number in previous two months. From the side of equity markets in U.S., stocks witnessed to withstand a two week upswing, following a tremendous decline.

**Bond benchmarks rose**, with U.S. 10y Treasuries' yield lower by 1bp week-on-week falling to 2.86%, while German 10y Bunds' yields fell much stronger by 5bp, landing at 0.65%, Japanese 10y bonds declined and ended the week at 0.051%.

**US equities continued to appreciate**, with S&P gaining by 0.6% week-on-week, while Nasdaq Composite has delivered more upbeat number, gaining by 1.4% week-on-week. Having declined strongly during the week ended February 9<sup>th</sup>, equity markets in terms of S/P 500 index, bounced back by more than 4% in prior week, while this trend continued to lose its steam, with only 0.6% gain by the index registered during the week ended February 23<sup>rd</sup>. It also was remarkable that high level of volatility, which sparked a lot of concern on the market has been gradually normalizing in recent time. In line with that, VIX also was gradually returning to its more historic levels of volatility followed by tremendous upswing during February 5<sup>th</sup> and 6<sup>th</sup>.

**Minutes of the January FOMC meeting, headed the last time by Janet Yellen as the Fed chair, revealed that strengthening of the United States economy bolsters the chances of more than three rate hikes this year.** FOMC members concluded that upside risk to higher economic growth realized due to growing consumer spending and Trump's tax reform enacted since the start of the year. As a result policymakers revised upward their economic projections of higher economic growth, as opposed to projections being made on previous meeting held in December. In regard to inflation, Fed's policymakers expected that consumer prices would move in a manner that would warrant further rate hiking of interest rates.

**EUR/USD rate landed at 1.2293 as of Friday the 23<sup>rd</sup>**, higher than the last week closing level of 1.2404, as the USD over performed against its main peers. On Thursday, the euro briefly spiked after ECB minutes. But it reversed its gains after that and was flat on the day after the minutes were released by the European Central Bank.

**Stoxx 600, a broader gauge of European equity performance rose by tine 0.1% remaining effectively flat during the week, while German DAX gained a little bit stronger, ending the week by 0.3% higher.**

**On Thursday, European Central Bank released minutes of its January meeting.** ECB policymakers rejected changes to the policy message, arguing that it was too premature. ECB officials highlighted the concern over strong euro that rhetoric of the United States in regard of weak dollar could jeopardize a decade-long deal among major developed countries not to target exchange rate. ECB was always sensitive to large currency moves, as stronger euro could cut into inflation, making the task of increasing consumer prices much harder for ECB, simultaneously reversing the effect of massive stimulus on the economy.

**Japan core consumer prices stood at 0.9% in January, remaining well below the central bank target.** The rate had also stood at 0.9% in each of the previous two months. Electricity fees and gasoline prices were the main driver behind the increase in the core CPI, raising 6.4% and 8.8%, respectively. While, lower cost of mobile contracts weighted the index down. Excluding both fresh food and energy prices consumer prices rose by 0.4% y/y in January.

**Crude oil moved higher**, as WTI futures gained by 3.0% week-on-week and closed at USD 61.6 per barrel, while Brent 1m futures rose by 3.5%, closing at USD 67.3 per barrel.

**Gold prices declined**, as NYMEX 1m futures fell by 1.8% week-on-week and finished the week at USD 1328.2 per troy ounce.

**Grains were in the red**, as CBOT Corn 1m futures fell 0.3% week-on-week and closed at USD 366.3 per bushel, while CBOT Wheat 1m futures laded at USD 452.3 per bushel, 1.2% lower week-on-week.

**Iron ore was flat** as NYMEX Iron ore 62% Fe 1m futures rose by tiny 0.3% week-on-week and closed at USD 77.11 per ton. Iron ore, on Monday 27<sup>th</sup>, rallied to a highs last seen 10 month ago, which was sparked by the possibility of extending steel production curbs in China well beyond the winter season.



**This week in focus: Ukraine's central bank likely to stop tightening for now**

Figure 9. Household's inflation expectations, p.

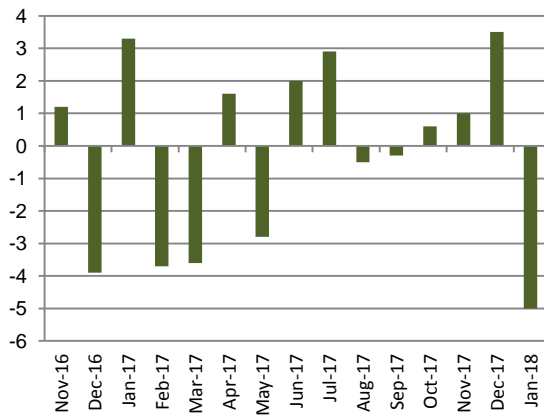
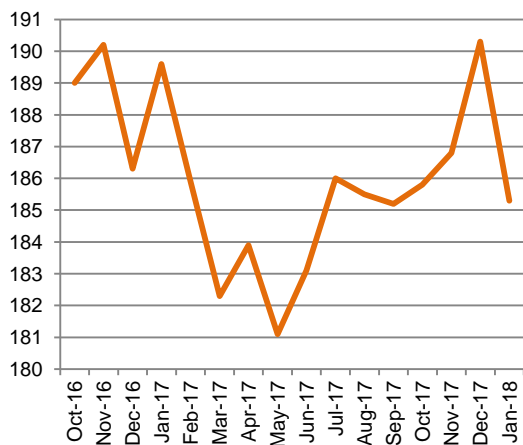


Figure 10. Household's inflation expectations, p.



**Inflation expectation of households, revealed last week, displayed the sharpest plunge in almost 1.5 years, according to GfK.** Ongoing appreciation of hryvnia (coupled with 350 b.p. tightening by central bank) might have resulted in significant decline in inflation expectations. Having delivered upbeat reading in January, GfK said that household's inflation expectations landed at 185.3 points vs 190.3 points in December.

**Inflation expectations of financial analysts increased, but remained at very low level,** which is not supportive for another rate hike. According to last update, financial analysts expected inflation to land at 9.5% y/y in 2018, up from, 8.9% y/y expected earlier. Divergence of expectations of professional forecasters (financial analysts) and households does not seem to be a strong red flag to the central bank, as they often have been moving in different directions.

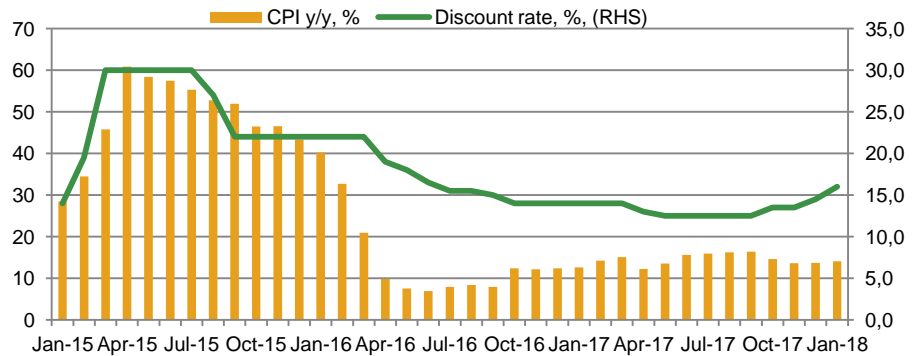
**Inflation print in January was quite heavy (see our Weekly dated February 13th).** Core inflation continued to decelerate on m/m basis, to +0.7m/m in January, but remained fairly elevated in y/y terms at +9.8% up from 9.5% y/y in December. In contrast, headline inflation was on the rise (in m/m terms as well as in y/y terms), reaching to 14.1%/y/y in January. It was driven by food (+2.0 m/m, +17.9% y/y), transportation (+3.0% m/m, +17.1% y/y), shoes/apparel (-3.9% m/m, +1.4 % y/y) and alcohol prices (+1.1% m/m, +20.6% y/y) in January.

**Recent strengthening of local currency will help to deliver on inflation objectives.** Recent slowdown of inflation expectations was also bolstered by strongly appreciated national currency amid a high demand of foreign investors on local debt securities. We believe UAH stabilization is a key driver to keep inflation expectations under control.

**We believe that the significant change in inflation expectation of households creates a signal for NBU to stop tightening for now, while heavy inflation prints coupled with ongoing uncertainties regarding IMF program are likely to make any easing prospects rather distant.**

**All in all we now expect no change on upcoming MPC meeting on March 1st, while some easing is on the cards until year end, provided our expectations of one IMF disbursement in 2H2018.**

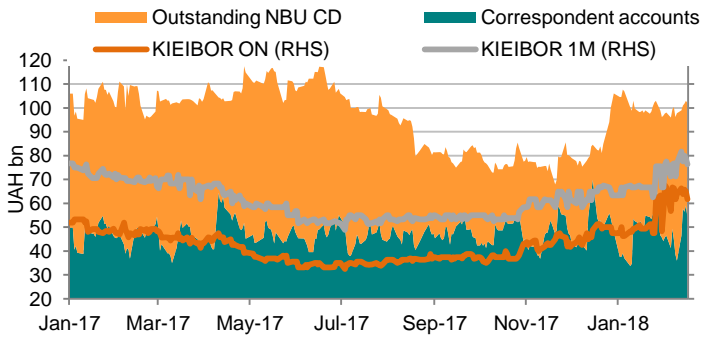
Consumer prices vs discount rate, %





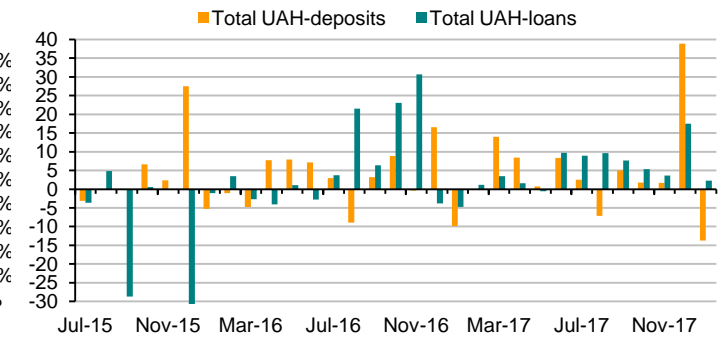
### Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

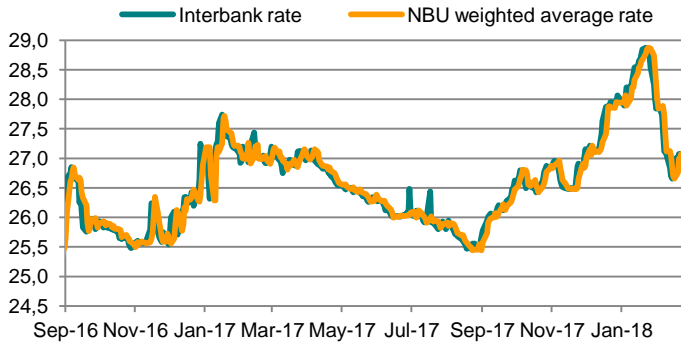
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

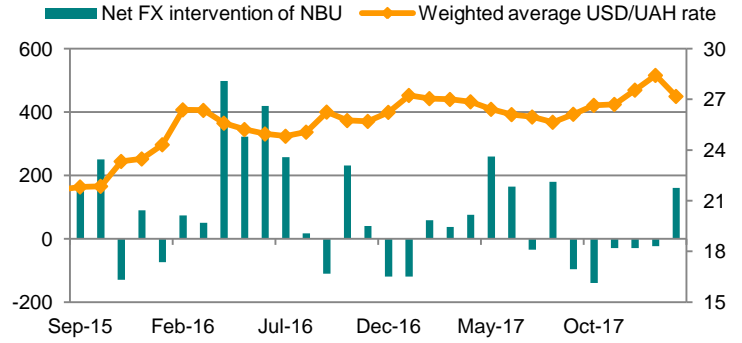
### Currency market

UAH exchange rate, UAH/USD



Source: Reuters

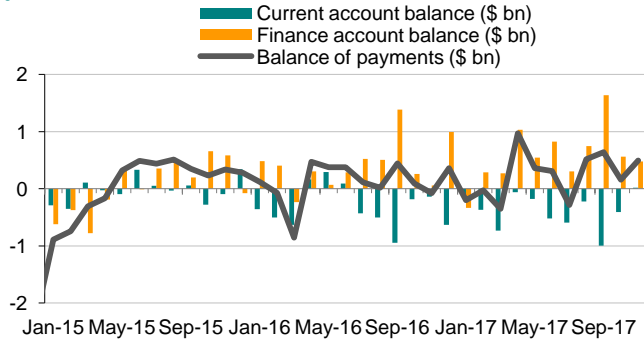
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

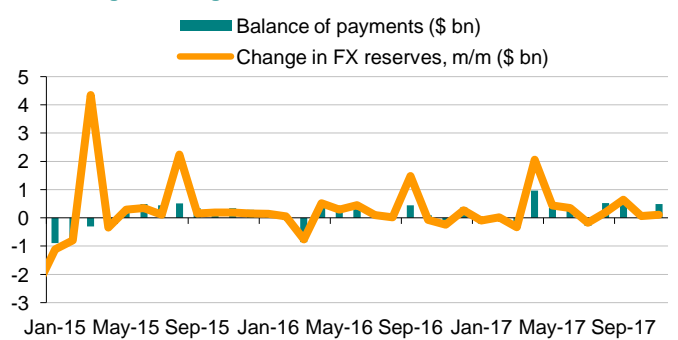
### Balance of payments

Major BoP accounts, USDbn



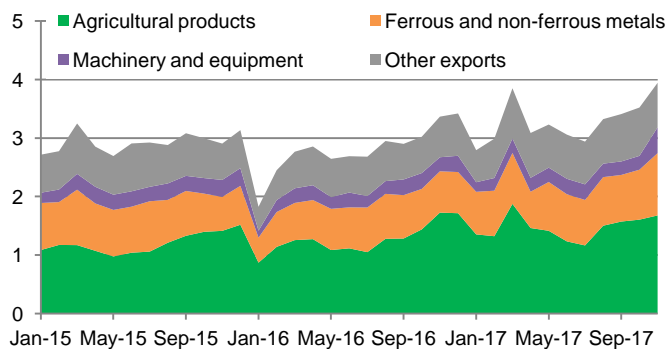
Source: NBU

BoP vs change in foreign reserves, USDbn



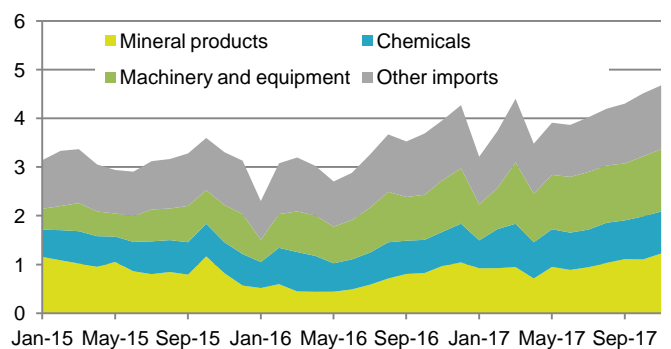
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU



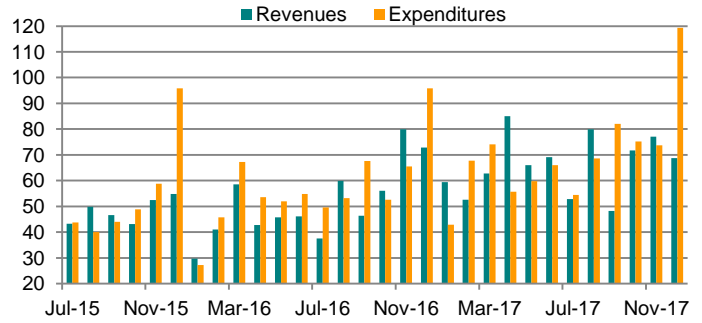
**Budget performance**

**Budget performance, UAHbn**

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

Source: NBU

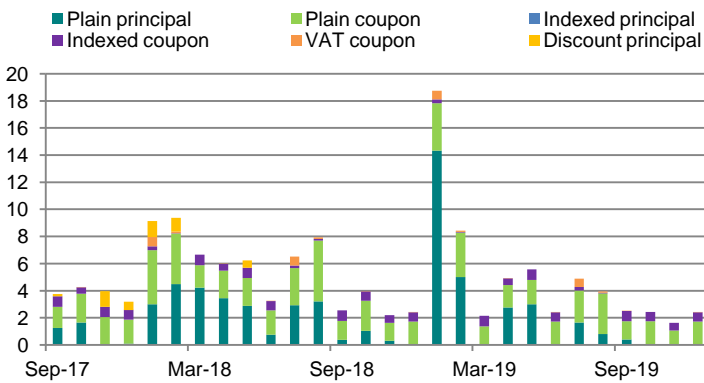
**Monthly change in budget revenues and expenditures, UAHbn**



Source: NBU, State Treasury

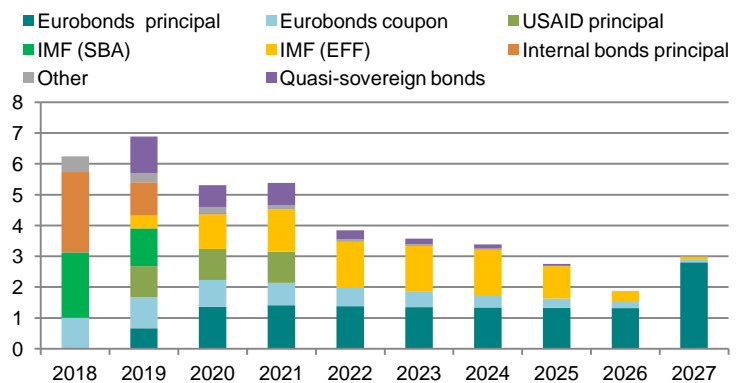
**Sovereign debt**

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



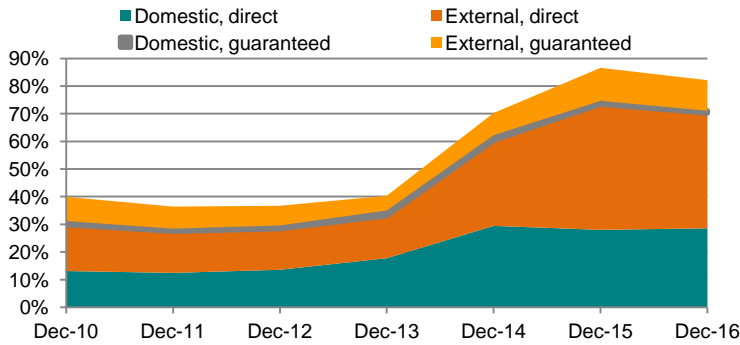
Source: NBU, UkrSibbank estimates

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



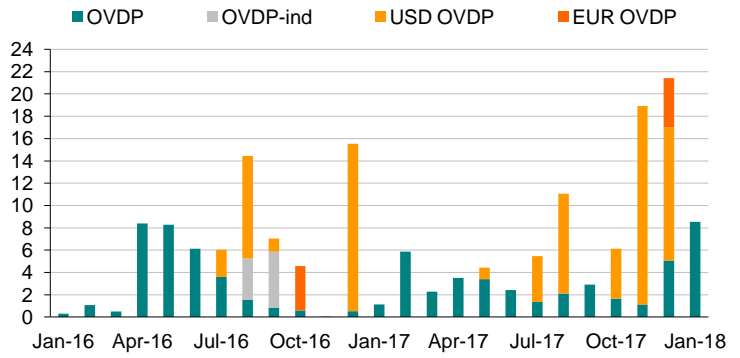
Source: Reuters, IMF, UkrSibbank estimates

**Total government debt, % GDP**



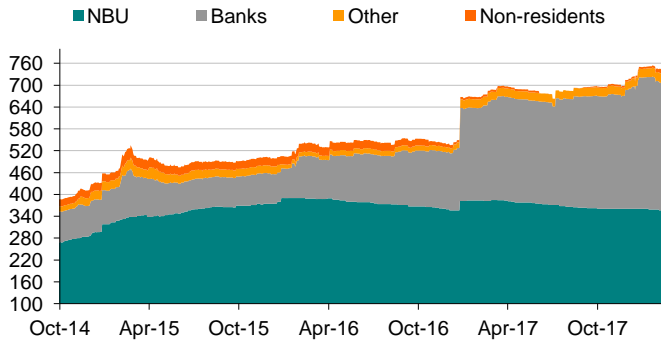
Source: MinFin

**Local borrowings, UAHbn equivalent**



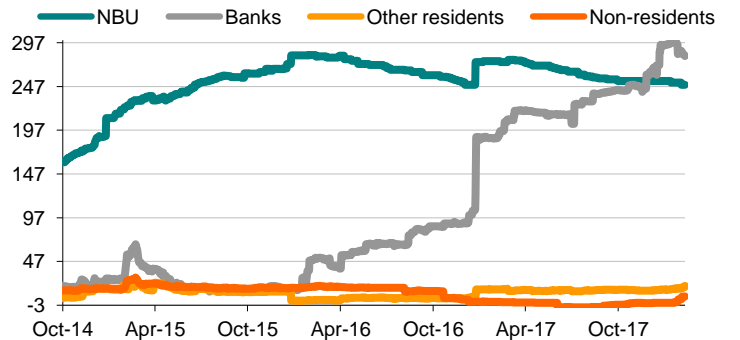
Source: NBU

**Outstanding OVDP owners structure, UAHbn**



Source: NBU

**Outstanding OVDP changes in holding, UAHbn**

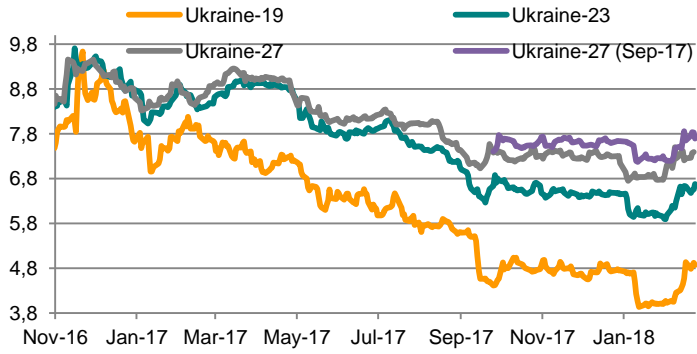


Source: NBU



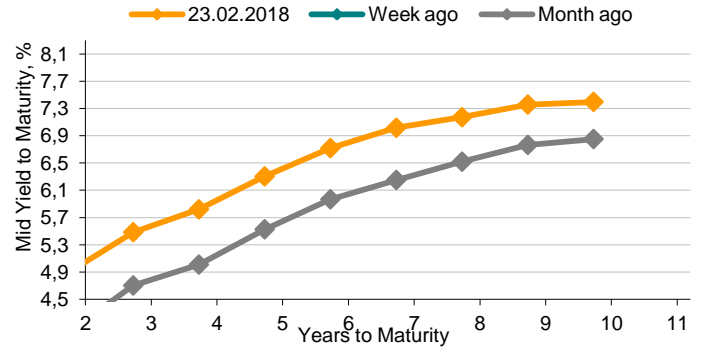
### Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

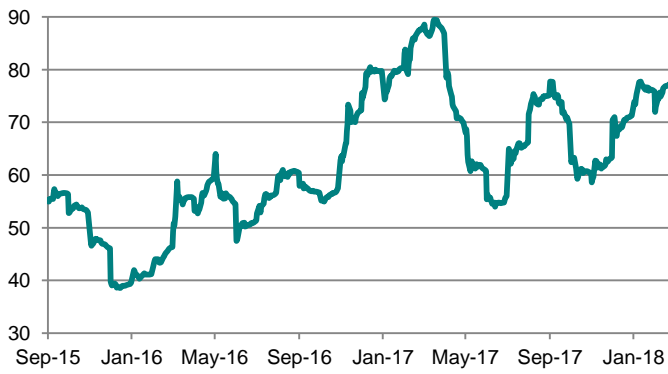
Ukraine's sovereign Eurobond yield curve



Source: Reuters

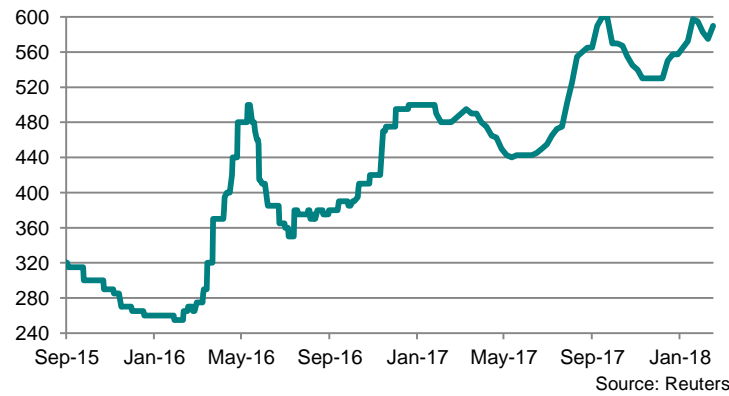
### Commodity markets

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



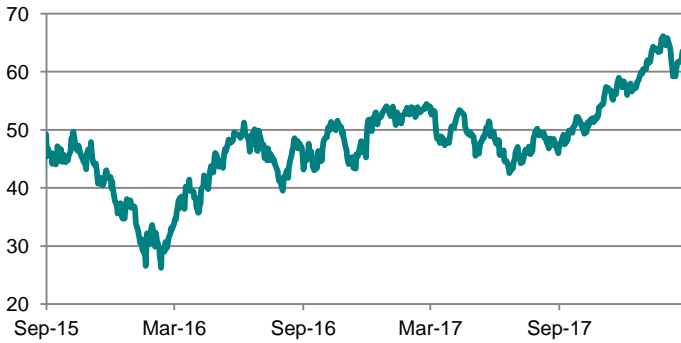
Source: Reuters

Steel CIS export HR coil, USD per ton



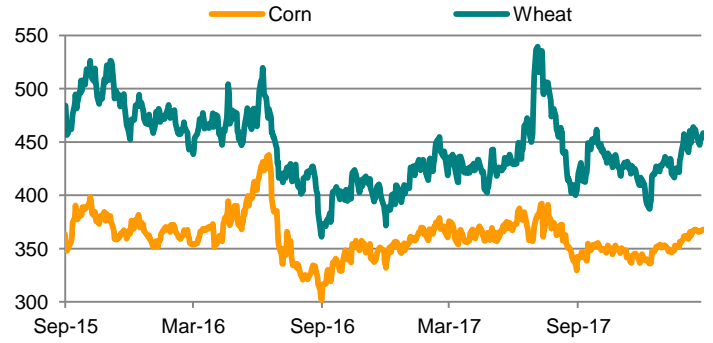
Source: Reuters

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
<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	18.9	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	1.6	2.4
Total public debt	20.0	34.8	39.9	36.3	36.7	39.9	69.4	79.4	81.0	72.0	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	54.0	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	60.8	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	-3.8	-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	-3.6	-4.4
Net FDI (USD bn)	9.9	4.7	5.8	7.0	7.2	4.1	0.3	3.0	3.4	2.3	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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