



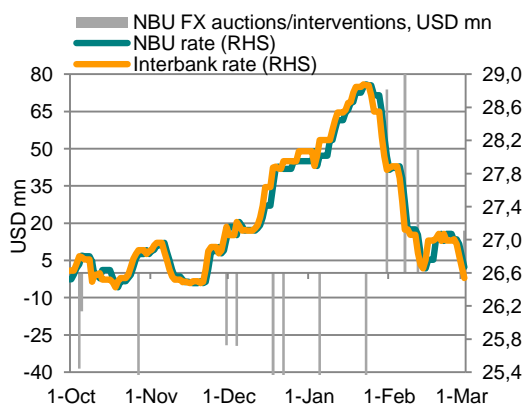
**This week in focus: Ukraine BoP: upbeat C/A, financial flows at a weak footing**

Ukraine's current account reading, delivered upbeat results in January driven by transfers from Ukrainians working abroad, while the financial side of the balance of payment started the year on a weak footing.

*Please see page 3 for more details*

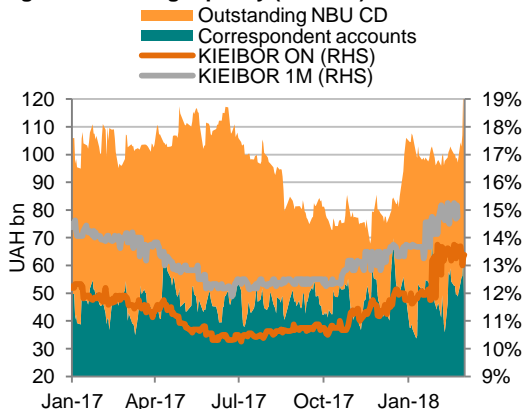
**FX and interest rates: Naftogaz won historical dispute with Gazprom**

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



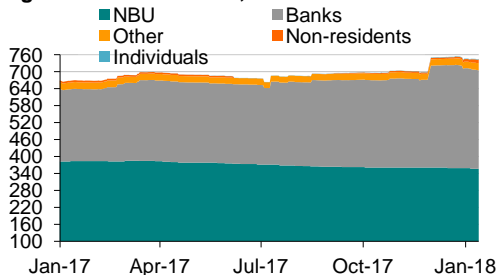
Source: NBU, Reuters

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



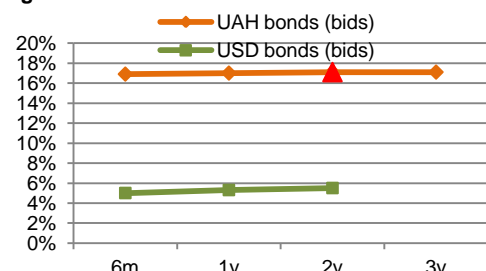
Source: Reuters, NBU, Ukrsibbank, Minfin

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



Source: NBU

**Figure 4. Local bonds market**



Source: Ukrsibbank

**USD/UAH closed at 26.54 as of Friday the 2<sup>d</sup>.** Week-on-week local currency strengthened by 1.7% against the USD.

**Average daily FX volumes on the market amounted to the equivalent of USD 164.3mn,** USD 31.9mn lower compared to previous week. We should expect even lower volume on this week, provided to days off due to March 8<sup>th</sup> celebration.

**In the first days of spring, NBU managed to conduct one currency auction, buying USD on a local market.** While Banks initially applied for USD 29.0mn the auction result transformed in buy of USD 17.0mn from local interbank market, supporting NBU international reserves.

**Aggregate banking liquidity amounted to UAH 101.5bn as of Friday the 2<sup>d</sup>,** growing by UAH 4.4bn 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 27<sup>th</sup> resulted in UAH 1.0bn** in prior week, down from UAH 1.2bn a week earlier. MoF kept the practice of capping the shortest issues by UAH 0.5bn per issue. Non-residents' interest in local bond market also supported demand at this juncture, as their holding grew by UAH 0.6bn after the auction, indicating that they bought more than half from bonds issued on Tuesday 27<sup>th</sup>.

**Currently, yields (bids) of local OVDP in UAH at 17.55% (for 6m), 17.70% (for 2Y).** 1Y USD bids were at 5.35%, while bids for VAT bonds were at 17.60%.

**Figure 5. OVDP auction combined results, 27<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%  | 18.00%       | 16.00%       | 5              | 4             | 753.9mn  | 483.7mn        |
| UAH | 6m       | 16.45%       | 16.40%  | 16.50%       | 16.40%       | 7              | 4             | 226.1mn  | 194.0mn        |
| UAH | 9m       | 16.50%       | 16.50%  | 16.90%       | 16.50%       | 4              | 2             | 172.7mn  | 24.6mn         |
| UAH | 5y       | 16.39%       | 16.40%  | 16.40%       | 16.38%       | 5              | 5             | 233.4mn  | 233.1mn        |

**NBU decided to loosen its requirements regarding dividend repatriation,** allowing non-residents repatriate dividends paid by Ukrainian companies in 2017. The monthly cap for such operations was set at USD 7mn, which implies to all dividends earned in earlier years. Previously companies were allowed to repatriate up to USD 5mn per month for dividends accrued in 2014-2016 year, and up to USD 2mn for dividends for 2013 and previous years.

**The NBU raised main interest rate by 100bp in its latest MPC board meeting,** citing worsening prospects of next IMF tranche arrival and increased domestic demand. Consumer prices growth in January 2018 was higher than projected initially by the central bank. NBU believes that current conditions are sufficiently tight to bring inflation by the end of the year to its targets. Current tightening cycle is overdone, in our view, provided decrease in inflation expectations (see our research alert dated March 1<sup>st</sup>).

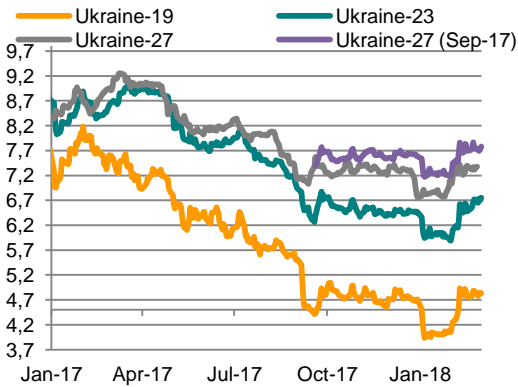
**Having won historical dispute with Russian counterpart, Naftogaz had brought welcome news for Ukrainians.** Stockholm arbitration court ruled in favor of Naftogaz in most recent court hearing between Naftogaz and Russian Gazprom to compensate USD 4.63bn for undersupplied gas for transit through Ukraine's territory, thereby, breaching earlier agreed conditions in regard to natural gas transit contract. In prior court ruling, Natogaz was obliged to pay USD 2.03bn to Gazprom for breaching another gas supply contract. Given that this time Naftogaz won 4.06bn, on a net basis Naftogaz should obtain USD 2.56bn from the Russian side. Initially, Ukraine's Naftogaz aimed to recover USD 16bn from the Russian side for breaching gas transit contract signed in 2009 year.



**Global markets:**

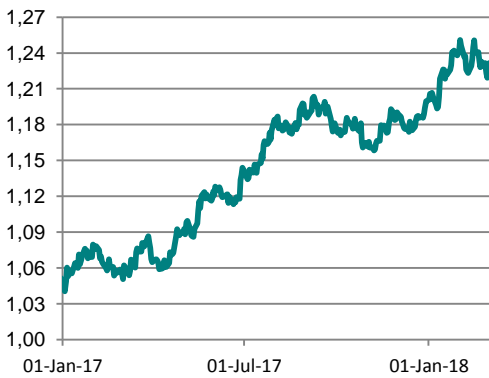
**Italy's voters punished mainstream parties on elections**

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



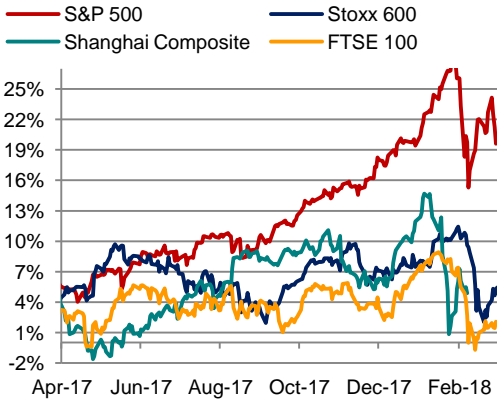
Source: Reuters

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



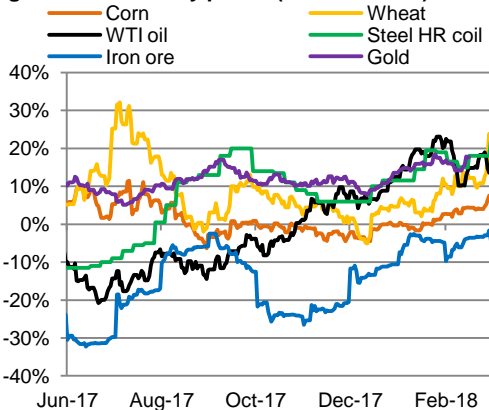
Source: Reuters

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



Source: Reuters

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



Source: Reuters

The Jerome Powell twin appearance during the week with public speeches in regard of monetary policy showed that his personal outlook for economy has strengthened since December, effectively warranting four rate hikes in 2018. At the same time, the biggest winner on Sunday Italian election was a 5-Star Movement, which was forecasted to win a third of all votes.

Bond benchmarks were mixed, with U.S, 10y Treasuries' yield lower by 1bp week-on-week falling to 2.857%, while German 10y Bunds' yields were effectively unchanged, landing at 0.655%, Japanese 10y bonds declined and ended the week at 0.071%.

US equities are on the downside, with S&P falling by 2.0% week-on-week, while Nasdaq Composite has outperformed, falling by 1.1% week-on-week. The recent market decline had ended a two week streak of gains after considerable decline in the beginning of February. This time decline was also supported by the commentary of Jerome Powel, arguing in favor of stronger economy and boosting the chances of four rate hikes in 2018 during his testimony in Congress.

On Tuesday, Jerome Powell was testified before Congress, which effectively marked his first public appearance as the new Fed chairman. He stated during the meeting that he's personal outlook for economy has strengthened since December of the last year and inflation could be gaining speed. On Thursday, Powell returned to Capitol Hill to conclude his semiannual testimony on monetary policy. Jerome Powell also acknowledged that the labor market may have room to improvement, strengthening even further

EUR/USD rate landed at 1.2317 as of Friday the 2<sup>d</sup>, higher than the last week closing level of 1.2293, as the USD performed mixed against its main peers.

Stoxx 600, a broader gauge of European equity performance declined by 3.7% during the week, while German DAX fell even stronger, ending the week by 4.6% lower.

Italy faces a period of high instability after the voters heavily supported far-right groups in record numbers. The biggest winner on Sunday election was 5-Star Movement, which was forecasted to have won a third of all votes, putting it in the driving seat in any further coalition talks. It was followed by League, which campaigned on a fiercely anti-migrant slogans was projected to win more than 17% of the vote, up from 4% at latest elections in 2013.

On Sunday, Germany's Social Democrats voted to join Chancellor Angela Merkel's next government, clearing the path to her fourth term and restoring political stability.

China's 30 year practice of limiting the government terms is officially coming to an end. The Chinese communist party is trying to amend China's constitution to allow President Xi Jinping to serve more than two five year terms. According to that Xi Jinping most likely will be serving in office and to be president for life, similar to Mao Zedong or Deng Xiaoping.

Crude oil prices were in the red, as WTI futures dropped by 3.6% week-on-week and closed at USD 61.3 per barrel, while Brent 1m futures fell by 4.4%, closing at USD 64.4 per barrel.

Gold prices declined, as NYMEX 1m futures fell by 0.5% week-on-week and finished the week at USD 1321.1 per troy ounce.

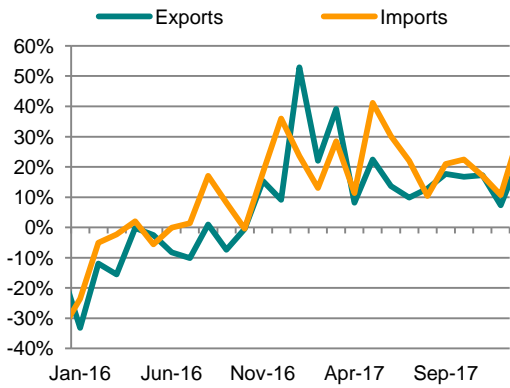
Grains were in the green, as CBOT Corn 1m futures rose 3.0% week-on-week and closed at USD 377.3 per bushel, while CBOT Wheat 1m futures laded at USD 492.0 per bushel, 8.8% higher week-on-week.

Iron ore fell as NYMEX Iron ore 62% Fe 1m futures fell by 1.0% week-on-week and closed at USD 76.4 per ton.



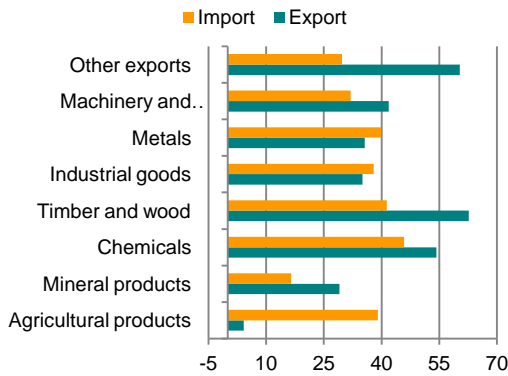
**This week in focus: Ukraine BoP: upbeat C/A, financial flows at a week footing**

**Figure 9. Exports and imports change, %**



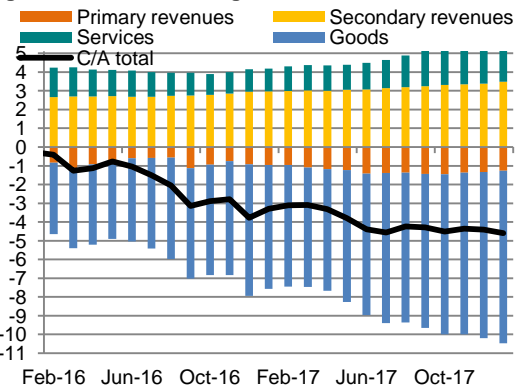
Source: NBU

**Figure 10. Export and imports main components change, %**



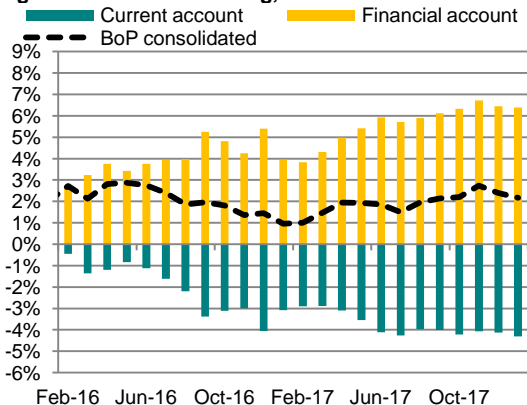
Source: NBU

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



Source: NBU

**Figure 12. BoP 12m rolling, % from GDP**



Source: NBU

**Ukraine's current account reading delivered upbeat results in January driven by transfers from Ukrainians working abroad, while the financial side of the balance of payment started the first month of the year on a weak footing.** As a consequence, consolidated balance of payment deficit expanded to USD 449mn in January, reducing NBU's international reserves to USD 18.6bn, as of end of February. Going forward, prospects of US introducing import tariffs for steel and decline in Russian gas transit represent the key headwinds for external trade.

**Having expanded by almost twofold on a y/y basis in January, trade balance deficit was reported in a red for a total USD 547mn, following USD 1.1bn deficit in prior month.**

**Export proceeds increased by 22.4% in January and amounted to USD 3.4bn. Metals export expanded by 35.6% y/y, reaching USD 986mn in a month.** International prices were supportive statistically at this juncture, as average HRC price were around 18% y/y higher, while prices for semi finished products which accounts for the major part of Ukraine steel export rose by around 30% on a year-over-year basis in January 2018. We should see a deceleration of this pace further during the year on a higher comparative base and also provided expectations of protective tariffs likely to be imposed by the US.

**Food export rose by more moderate 4.2% y/y in January (to USD 1.4 bn), slowing down its pace by more than double compared to a month ago.** While volumes of sunflower oil, wheat and corn declined in January on a year-over-year basis, the volumes of soybeans (+44% y/y) and ripe (+55% y/y) as well as sugar (+17% y/y) increased. Out of 3 latter, international prices in first two items were also supportive. While the volume of wheat exported declined in physical terms, increased export proceeds also contributed positively to overall food export growth, as prices on the international market were higher. The meat export acceleration, namely poultry, also supported overall food export subcategory, growing by 79% y/y in January in physical terms.

**Having grown by 30.5% y/y in January, import volume ballooned to USD 4bn, up by USD 0.9bn compared to a year ago. The highest pace of import acceleration was in chemicals sector, up by 45.8% y/y in January, partly boosted by pharmaceutical import acceleration.** It was followed by food import (+39.4% y/y) and machinery import (+32.0% y/y).

**Balance of services surplus was reported lower in January on a m/m as well as on a y/y basis, as transit of Russian gas through Ukraine declined by staggering 32.1% in January.** Provided recent developments in Gazprom-Naftogaz dispute we expect Gazprom to minimize transit volumes and put every effort in enacting alternative transit routes.

Primary incomes dwindled to a mere USD 4mn in January, while **secondary incomes demonstrated the most upbeat performance, growing by 20.4% (to USD 308 mn) y/y in January.** All growth came from transfers as more and more Ukrainians each year receive permits to work in EU (primarily, in Poland). Noteworthy, official numbers may well underestimate impact of transfers as Poland takes a minor part in official transfers (we believe that earned money is being brought back to Ukraine in cash).

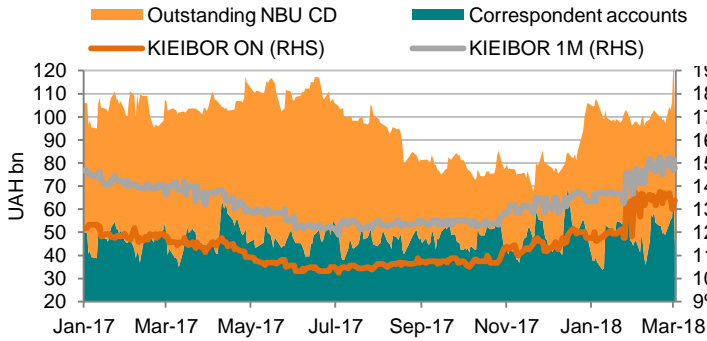
**Net financial account outflow comprised USD 388mn in January, reversing more accustomed surpluses of prior periods.** Remaining weaker compared to a year ago period, net FDI in Ukraine amounted to USD 80mn, as effectively all proceeds had been directed to real sector. Moreover, financial account this time was strengthened by portfolio investments more strongly than ever (beating even FDI contribution), as foreign investors appetite toward Ukraine's local bonds resulted in USD 116mn of proceeds in January to financial account. **FX cash outside banks turned around in January** and was reduced by USD 189mn, blowing a three months streak of increase reported in fourth quarter of 2018, as household's were tempted to sell more FX to banks than to buy compared to a month ago.

**Last but not least, real sector markedly reduced its debt in January, namely by USD 230 of long-term debt and USD 204mn of trade loans.** The state company Naftogaz reported on January 25th, that the company paid down its loan to European Bank of Reconstruction and Development for a total USD 300mn. This loan was attracted for the purpose of gas purchases during 2015-2018 winter seasons, maturing in three years.



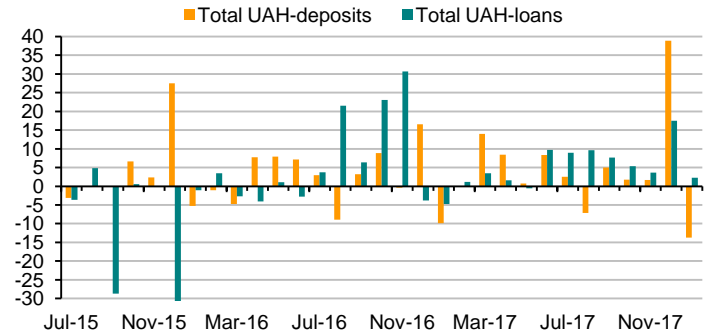
### Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

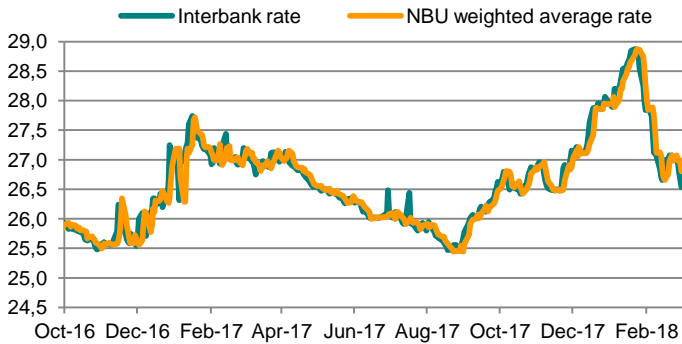
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

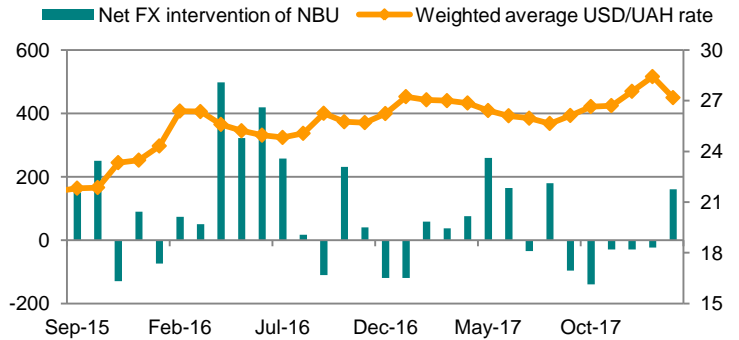
### Currency market

UAH exchange rate, UAH/USD



Source: Reuters

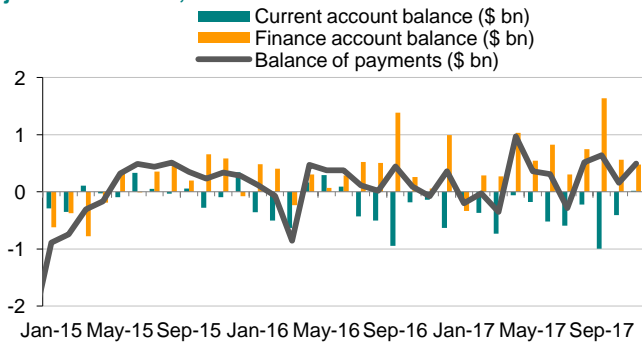
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

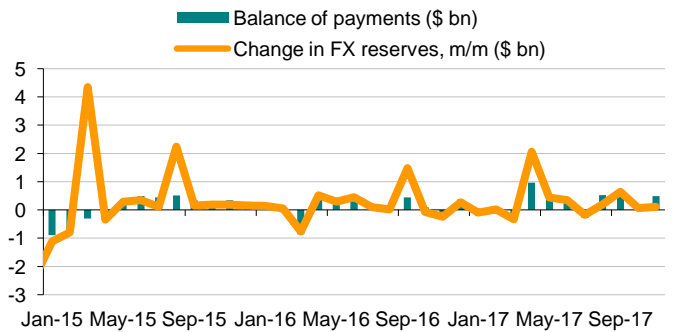
### Balance of payments

Major BoP accounts, USDbn



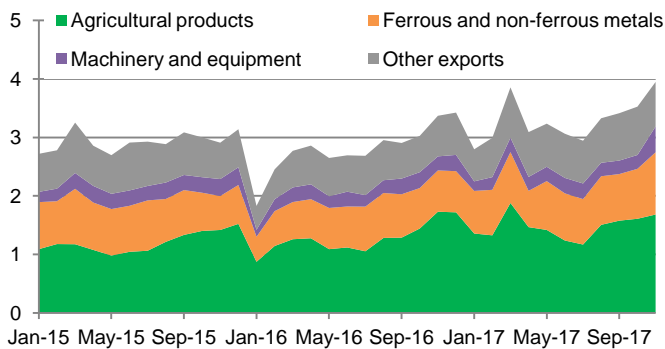
Source: NBU

BoP vs change in foreign reserves, USDbn



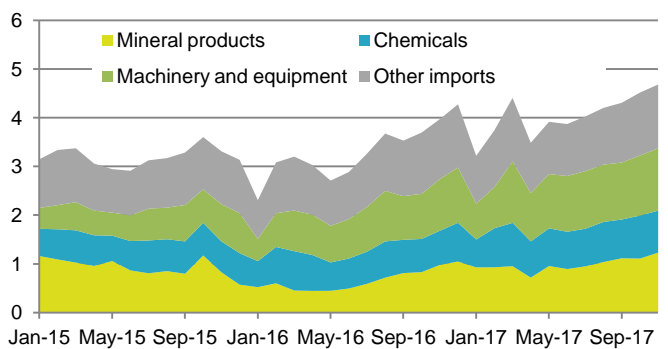
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU



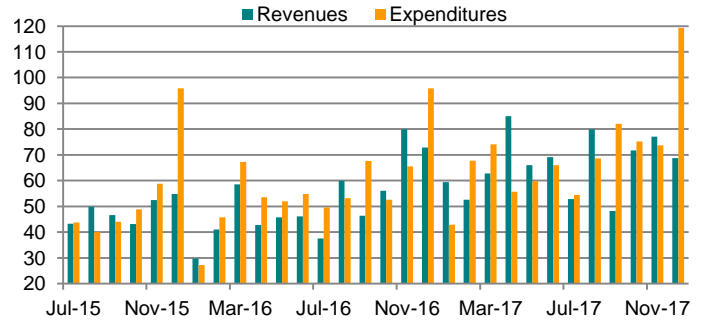
**Budget performance**

**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

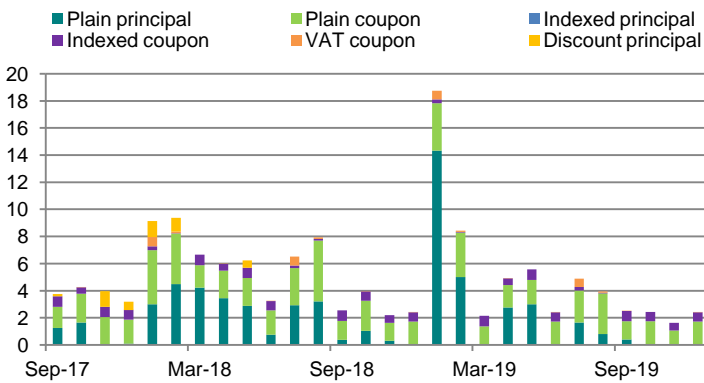
**Monthly change in budget revenues and expenditures, UAHbn**



Source: NBU, State Treasury

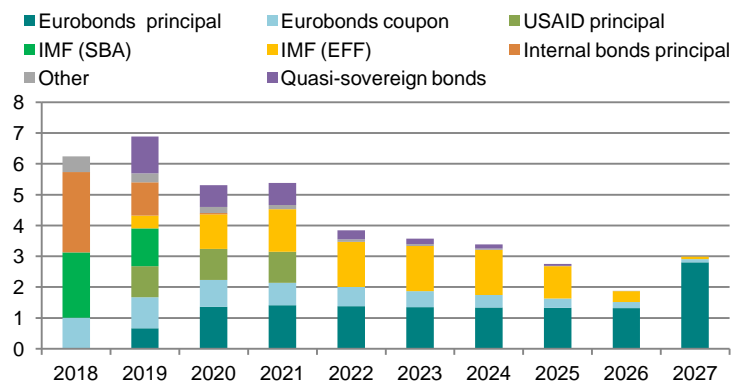
**Sovereign debt**

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



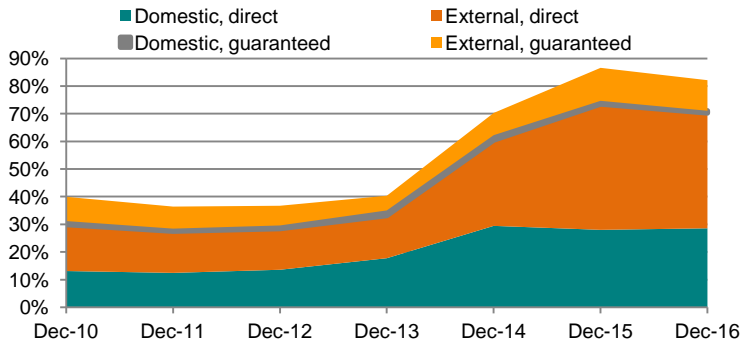
Source: NBU, UkrSibbank estimates

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



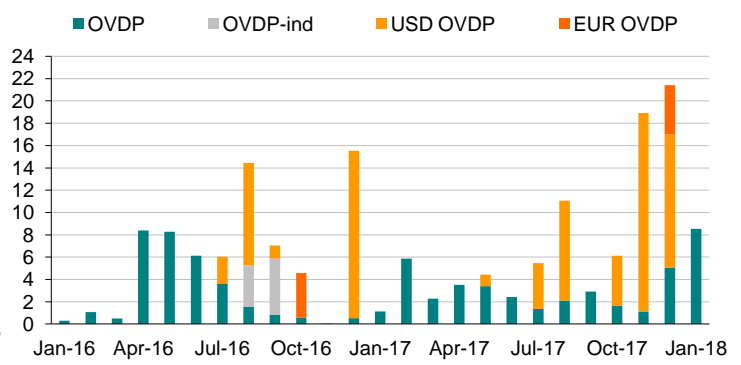
Source: Reuters, IMF, UkrSibbank estimates

**Total government debt, % GDP**



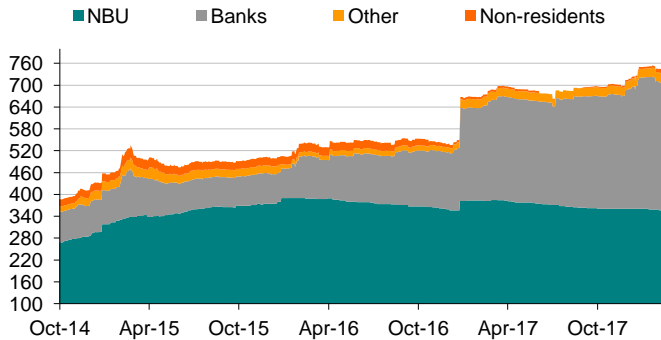
Source: MinFin

**Local borrowings, UAHbn equivalent**



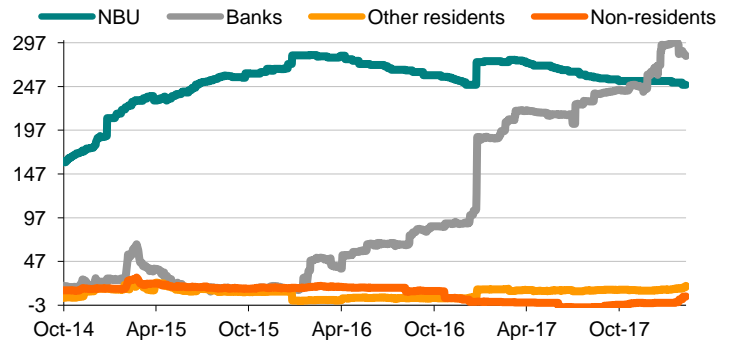
Source: NBU

**Outstanding OVDP owners structure, UAHbn**



Source: NBU

**Outstanding OVDP changes in holding, UAHbn**

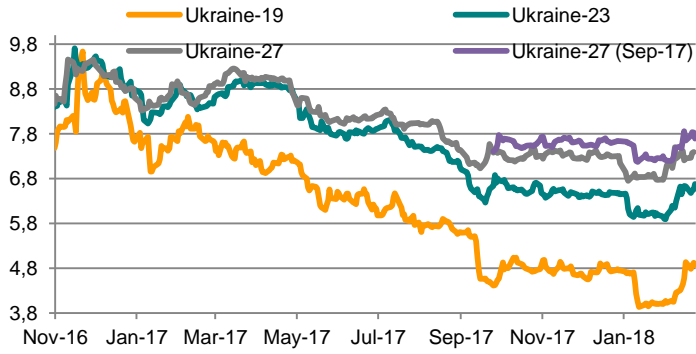


Source: NBU



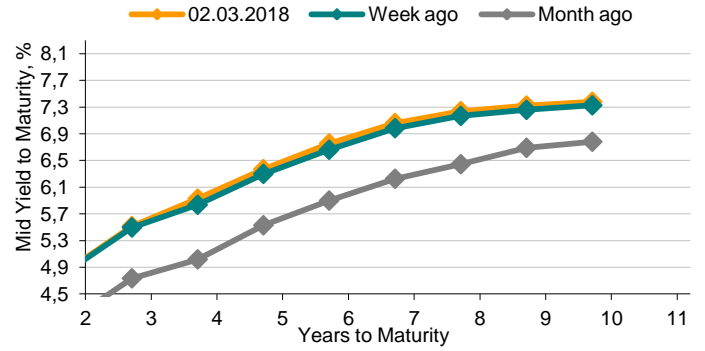
### Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

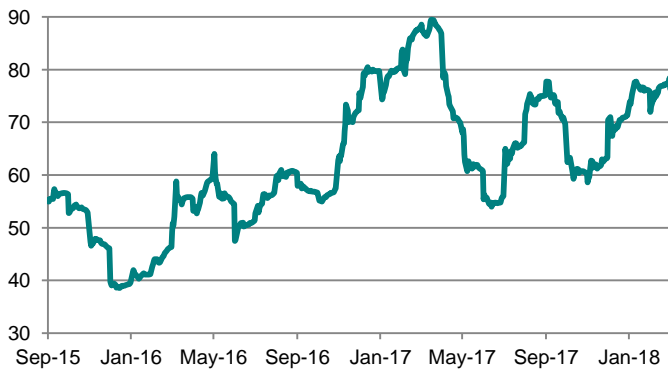
Ukraine's sovereign Eurobond yield curve



Source: Reuters

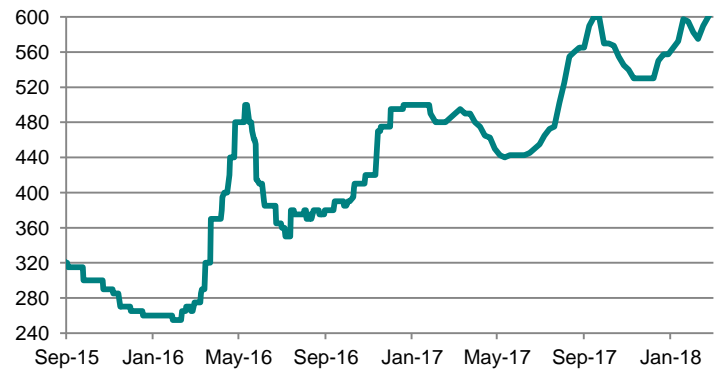
### Commodity markets

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



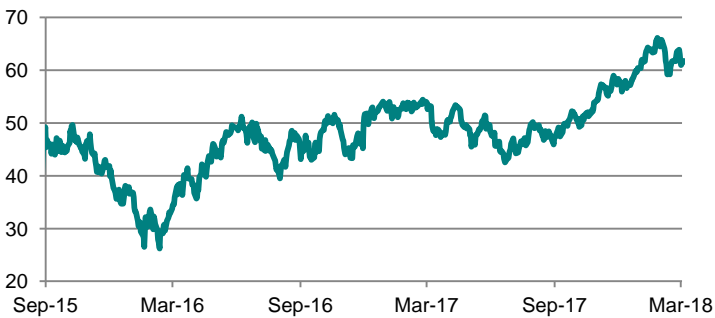
Source: Reuters

Steel CIS export HR coil, USD per ton



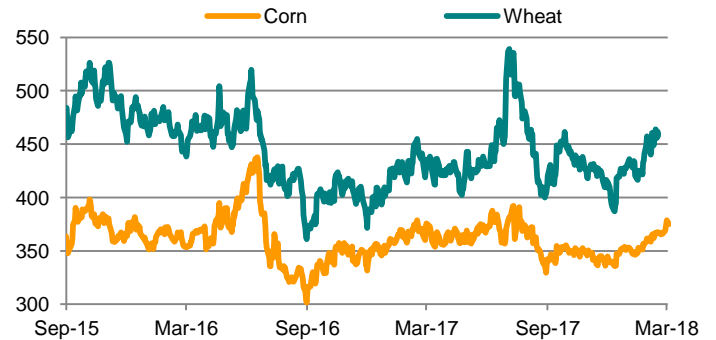
Source: Reuters

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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