



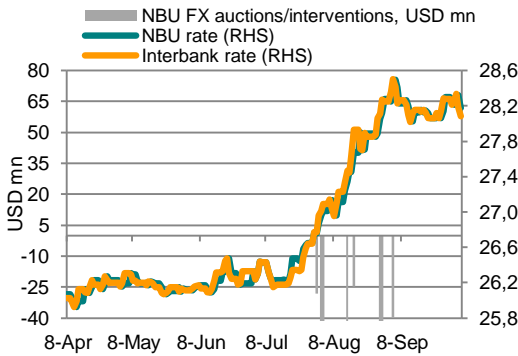
**This week in focus: C/A deficit in 8M18 overshoots NBU 2018 forecast**

National bank of Ukraine has revealed data about balance of payment performance in the last month of summer. Having posted USD 1.1bn deficit in July, C/A deficit amounted to USD 0.6bn in August. It is worth noting, that the deficit from the start of the year advanced to USD 2.1bn.

*Please see page 3 for more details*

**FX and interest rates: Yields on UAH 3m bonds hit 19.0%**

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



Source: NBU, Reuters

**USD/UAH was at 28.18 as of Friday the 5<sup>th</sup>**, as hryvnia was almost flat during the week, gaining by a mere 0.4% on a week-on-week basis.

**Average daily FX volumes on the market amounted to the equivalent of USD 303.7mn**, up by USD 11.9mn week-on-week.

**NBU refrained from conducting currency auction, as market balance was skewed toward higher supply.** For the last four weeks central bank managed to buy USD 136.4mn from the market. At the same time, NBU bought USD 64.5mn of hard currency in prior week. Meantime, YTD reading of central bank interventions increased to USD 666.7mn of bought FX currency in 2018, as of October 5<sup>th</sup>.

**Aggregate banking liquidity amounted to UAH 75.3bn as of Friday the 5<sup>th</sup>**, down by UAH 1.8bn during the week. For the most part, banking liquidity was balanced in September, as all major components hadn't exerted neither strong upward nor downward pressure, in sharp contrast to August. In particular, change in cash slightly decreased liquidity by UAH 2.3bn, at the same time it was counterbalanced by operations of the State Treasury (UAH+4.1bn), followed by NBU interventions, which added approximately UAH 1.4bn (which is UAH equivalent of USD 52.9mn bought by NBU during the month), resulting in slight increase in liquidity in September.

**Money market rates remained flat:** cost of ON funds is around 16.50/18.25, 1 week is 17.00/18.75 while 1M is 18.50/19.50, according to our calculations.

**Yields on UAH 3m bonds hit 19.0%.** It's quite remarkable that cut off rate of the shortest bonds advanced to 19.0% for the first time in quite a while. More importantly was the fact that out of UAH 1.0bn of demand Ministry of Finance satisfied a hefty part of that or more than 80%, suggesting the MoF was no longer tried to contain pressure from market participants to raise interest rates. Not so long ago, namely on the previous auction effective September 25<sup>th</sup>, MoF has satisfied only roughly 7% from demand on the shortest bonds to keep rates on hold, as opposed to latest auction. On top of that, cut off rates of bonds denominated in USD were on the rise in latest primary auction as well. Having placed USD bonds at 5.95% in the end of September, MoF issued USD bonds at 7.0% cut off rate in the beginning of October. While initial demand was USD 70.3mn (measured in 9 bids), MoF results indicated that proceeds amounted to USD 67.0mn, accepting 8 bids.

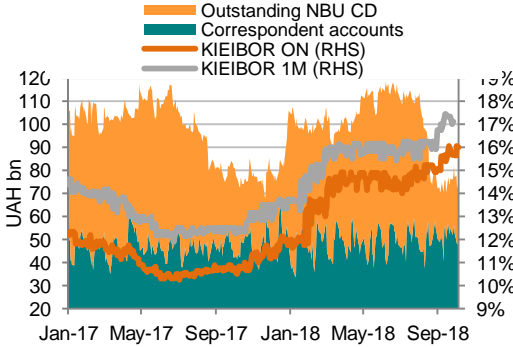
**Currently, yields (bids) of local OVDP in UAH at 19.50% (for 6m), 19.50% (for 2Y).** 1Y USD bids were at 5.95%, while bids for VAT bonds were at 19.50%.

**Figure 5. OVDP auction combined results, 25<sup>th</sup> of October 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	19.00%	18.91%	19.50%	18.50%	19	17	1.0bn	834.4mn
UAH	6m	18.50%	18.50%	18.50%	18.50%	6	6	13.5mn	12.3mn
UAH	1y	18.50%	18.50%	18.50%	18.50%	6	6	36.8mn	31.5mn
UAH	2y	17.25%	17.25%	22.00%	17.25%	2	2	17.6mn	3.0mn
USD	9m	7.00%	6.82%	7.00%	5.95%	9	8	70.3mn	67.0mn

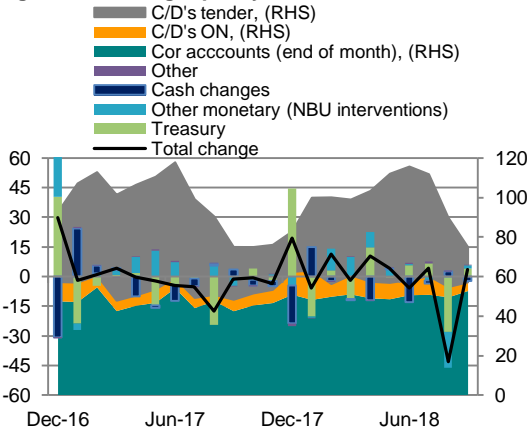
**NBU has reported that international reserves of the central bank dropped by 3.5% in September.** NBU has sold USD 74.2m of hard currency from reserves. Out of which USD 40.1mn it sold via currency auctions. In the meantime, central bank has bought USD 127.1mn from the market, as a result increasing reserves by USD 52.9mn during the month. In contrast to that, operations, which encompass the process of debt servicing, acted as a primary drag on level of reserves by the end of the month. In particular, servicing of coupon of Eurobonds issued in 2015 years reduced reserves by USD 562.3mn, followed by payment of USD 103.2mn aimed at servicing local government bonds denominated in hard currency. All in all, international reserves covered only 2.8 months of future imports, which indicated that coverage ratio dropped by 0.1 during in September.

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



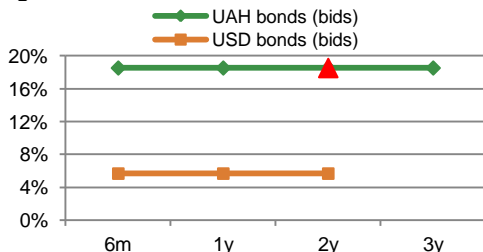
Source: Reuters, NBU, UkrSibbank, Minfin

**Figure 3. Banking liquidity, UAH bn**



Source: NBU

**Figure 4. Local bonds market**

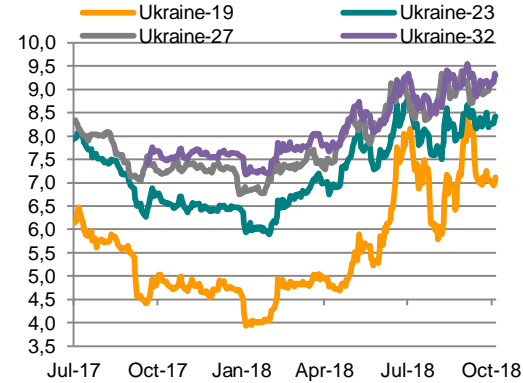


Source: UkrSibbank



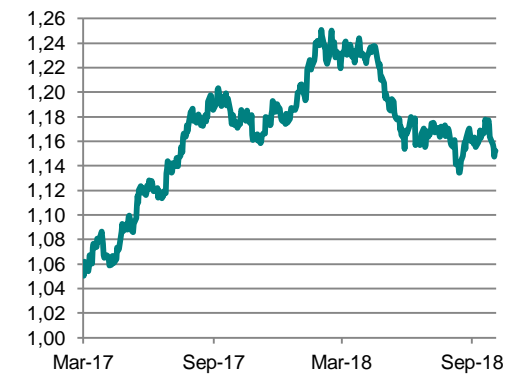
**Global markets: Yield on U.S. 10y treasuries hit 3.23%**

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



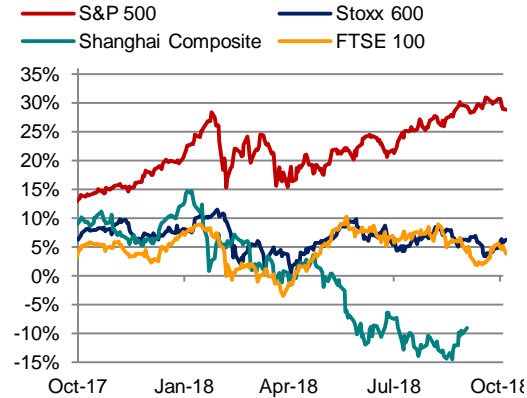
Source: Reuters

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



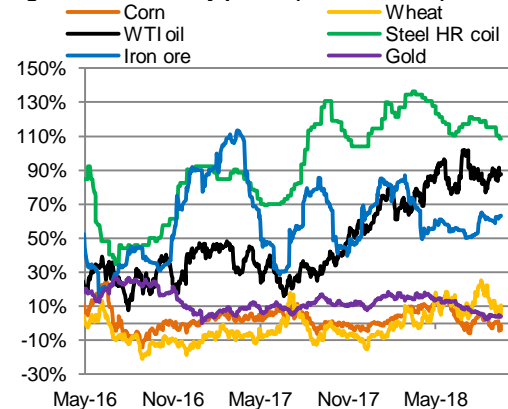
Source: Reuters

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



Source: Reuters

**Figure 8. Commodity prices (Jan-2016=100)**



Source: Reuters

The yield of 10y U.S. treasury bonds skyrocketed by 17bp during the week, landing at 3.23%, which was the highest level since 2011. It was also acted partly as a drug on the stock globally. At the same time, unemployment rate in the U.S. fell to 3.7%, according to the latest reading from Bureau of Labor Statistic.

**Bond benchmarks fell**, with U.S. 10y Treasuries' yield gained strongly by bp week-on-week landing at 3.23%, while German 10y Bunds' yields rose by 9bp, landing at 0.56%, Japanese 10y bonds yield's ended the week at 0.15%, slightly higher compared to a previous week.

**Unemployment rate in United States fell to 3.7%, implying the lowest level in 48 years.** According to data released by Bureau of Labor Statistic, the rate of unemployment fell to 3.7%. Meantime, non-farm payrolls gained by 134 000 slowing recently, which was partly driven by Hurricane Florence losses. Labor can begin to slice more from corporate profits, provided that job market was so strong for so long. At the same time, the pace in increase in corporate profits were on several years high in 2018, albeit partly driven by effect of the tax reform, which most likely keep the amount which slices from corporate profits in the percentage form closer at the previous level.

**Equity indexes in U.S. ended strongly in the red, as S&P fell by 1.0% and Nasdaq Composite increased by 3.2% week-on-week.** Tech shares acted as a main drag on the stock indexed during the week, as data that attack of Chinese spy hit the major tech company in U.S. In particular, China used small chips into equipment from Amazon and Apple, putting a strong pressure on the stocks of both companies. On top of that shares were brought into decline by the fact that yield on 10y bonds advanced to 3.23% by the end of the week, which was the highest level in many years or since 2011.

**EUR/USD rate landed at 1.1523 as of Friday the 5<sup>th</sup>**, down compared to last week closing level of 1.1608.

**Main stock indexes in Europe declined. Namely Stoxx 600 fell by 1.8%** during the week ended September 28th, while German DAX declined slightly more by 1.1% week-on-week, following suit of their counterparts in United States.

**According to Dutch central bank governor, ECB will have to start discussions of the timing of interest rate increase in January (for the first time since 2011).** He also mentioned that no one can expect the current accommodative financial conditions to stay for long. At the same he added that ECB would continue to cautiously normalize its monetary policy. In regard to Italy, governor highlighted that the outlook for monetary policy wasn't changed due to Italy dramatically increased state budget deficit.

**People bank of China announced measures aiming to cut the reserve requirement ratio.** Currently, the measure accounts for 15.5% for large institutions and 13.5% for smaller banks. The decision of Chinese central bank will result in an injection of 750bn yuan or equivalent of USD 109.2bn in cash into the banking system. At the same time, central bank mentioned that the monetary policy remained prudent and neutral without accommodation. It was the four time of reserve requirement ratio cut since the start of trade between U.S. and China.

**Crude oil prices increased**, as WTI futures increased by 1.5% week-on-week and closed at USD 74.3 per barrel, while Brent futures gained by 1.7%, landing at USD 84.2 per barrel.

**Gold prices declined** as NYMEX 1m futures increased by 0.8% week-on-week and finished the week at USD 1201.2 per troy ounce.

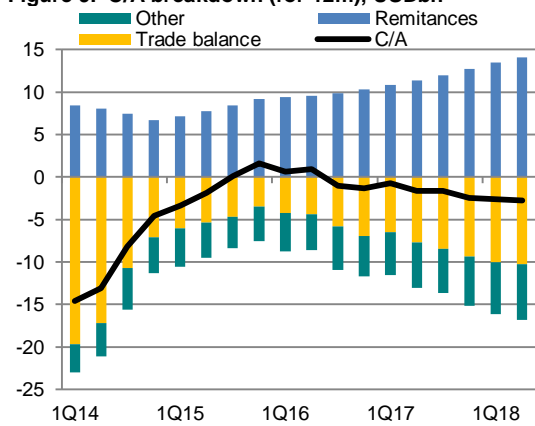
**Grains prices gained**, as CBOT Corn 1m futures increased by 3.4% week-on-week and closed at USD 368.3 per bushel, while CBOT Wheat 1m futures landed at USD 521.0 per bushel, climbing by 2.4% during the week.

**Iron ore declined**, as NYMEX Iron ore 62% Fe 1m futures slightly increased by 0.7% on a week-on-week basis and closed at USD 69.2 per ton.



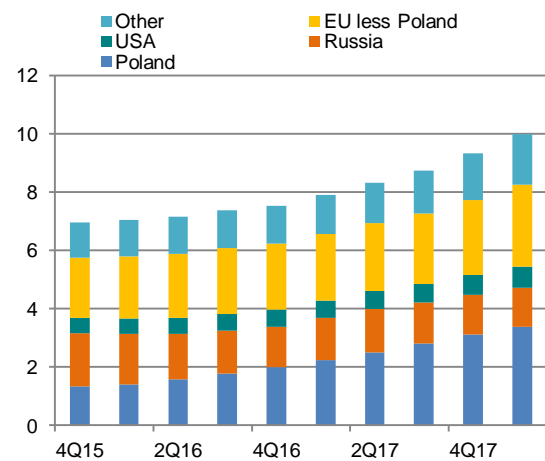
**This week in focus: C/A deficit in 8M18 overshoots NBU 2018 forecast**

**Figure 9. C/A breakdown (for 12m), USDbn**



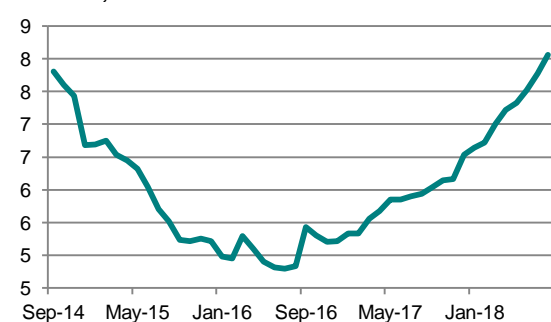
Source: NBU

**Figure 10. Private transfers (net) by country of origin (for 12m), USDbn**



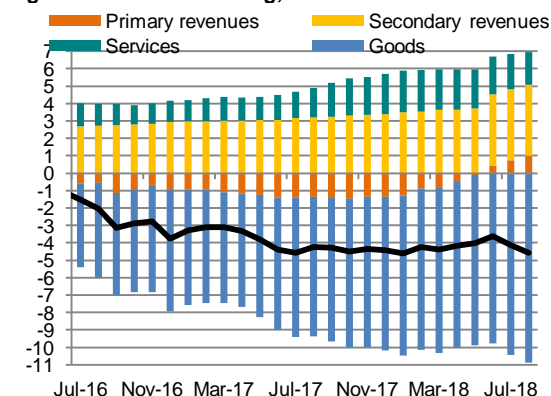
Source: NBU

**Figure 11. Interests and dividends paid to non-residents, USDbn**



Source: NBU

**Figure 12. C/A 12m rolling, USDbn**



Source: NBU

National bank of Ukraine has revealed data about balance of payment performance in the last month of summer. Having posted USD 1.1bn deficit in July, C/A deficit amounted to USD 0.6bn in August. It is worth noting, that the deficit from the start of the year advanced to USD 2.1bn.

Having jumped on y/y basis and growing by as much as 4x times, Ukraine C/A deficit reached USD 0.6bn in August. At the same time, on m/m basis it showed some deceleration, as in July C/A delivered record high deficit, which hasn't been seen for a while. At the same time, the major cause of worsened performance, namely trade deficit, amounted to USD 1.3bn, growing by quite solid 43% y/y in August.

Exports have delivered less growth on y/y basis in August comparing to July. In particular, it increased by 10.5% y/y, down from 12.7% y/y increase a month ago. At the same time, the reading landed at USD 3.7bn in August, up from USD 3.3bn in prior month. Exports growth deceleration came on the backdrop of decelerating in growth of both agri and metals exports. While in prior month agri exports increased by 8.0% y/y in July, it pared its gains to only 6.0% y/y increase in August. In regard to metals the magnitude of deceleration were even more pronounced. In particular, the growth numbers has tumbled to 11.2% y/y in August from 19.9% y/y in July, bringing YTD reading to 28.0% in 8M 2018 up from 18.6 % in 8M 2017.

Having posted 25.3% y/y growth acceleration in imports growth in prior month, imports posted gains of 17.4% y/y in August, amounting to USD 5.0bn in the last month of summer. The main reason of the deceleration was that mineral and chemical imports posted lower digits on y/y basis in August, which was albeit partly counterbalanced by gathering pace machinery imports. In particular, mineral imports posted gains of only 15.4% y/y in August vs more than 30% y/y increase in prior month. On top of that, import of chemical products showed signs of weakening in August, as imports growth pared its gains to only 5% y/y growth in August, following 18.2% y/y growth in July.

Balance of services added positively USD 68mn to the C/A deficit of USD 601mn in August, or by 55% more on y/y basis. The positive surplus amounted to USD 470mn in 8M 2018 or by 8% lower in 2018 vs 2017 thus far.

Private transfers were keeping their upward trend. In 8M 2018 they gained by 26% y/y (on a gross basis), with the major part of growth coming from primary incomes, followed by transfers. At the same time, Poland remained as key country, as measured by a number of Ukrainians who earned or send their money from there to Ukraine.

At the same time, interests and dividends paid to non-residents abroad kept increasing, exceeding roughly USD 8.0 threshold cumulatively for the last 12m for the first time since the mid of 2014. It is worth noting, that the pace of growth recently was as much as twice higher comparing to the growth of private transfers.

As opposed to solid C/A deficit, financial account surplus has gained also healthy ground in August. But to the large extent the financial flow which accounted a lion share of that was of non-recurring nature. While the financial account inflow to the country was USD 625mn, which at the same time was lower comparing to the same reading a year ago, it was enough to cover C/A deficit during the month, bringing combined balance of payment result to positive territory with a mild surplus totaling USD 27mn. If we look at investments, it's absolutely clear that FDI slightly fell on y/y basis, but gained from the perspective of m/m basis. But the more important was that a largest part of that came not from the banking system but rather than from real sector, whose good performance is a testament of improved investment climate in the country in contrast to the operation of converting debt to equity which was more common to the banking system in recent time. In particular, 67% of FDI were directed to real sector, followed by the rest directed to the banking system.

And last but not least operations of the government sector, namely placement of USD 725mn discount Eurobonds, were the main driver of improved performance of financial account in August.

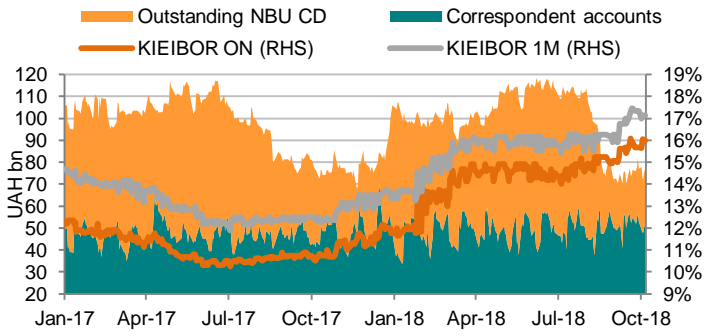
As a consequence of combined balance of payment surplus albeit quite mild during the month, international reserves remained at USD 17.2bn in August, suggesting imports coverage ratio of 2.9 by the end of the month.

NBU forecasted C/A deficit to be USD 2.0bn in 2018, revising down its forecast from USD 2.4bn fairly recently or in the summer. Our conclusion (please see our report published on September 4th) that the NBU current account forecast was somewhat optimistic posted a month ago, proved to be the true as of now. Moreover, central bank previously mentioned that overshoots of such nature in main economic indicators (GDP, inflation, BoP) creates bias for NBU to raise interest rates to address this issues (and we inclined to think that this factor wasn't priced in the latest NBU hike of the main rate effective September 6th).



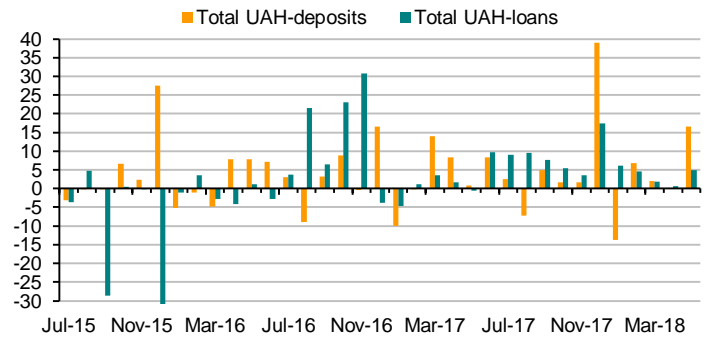
### Money market

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



Source: Reuters, NBU, UkrSibbank estimates

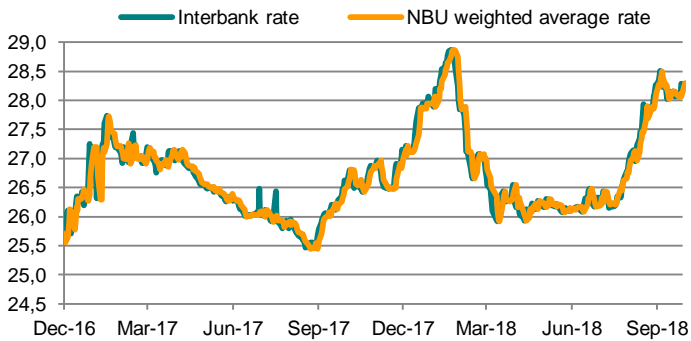
#### Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

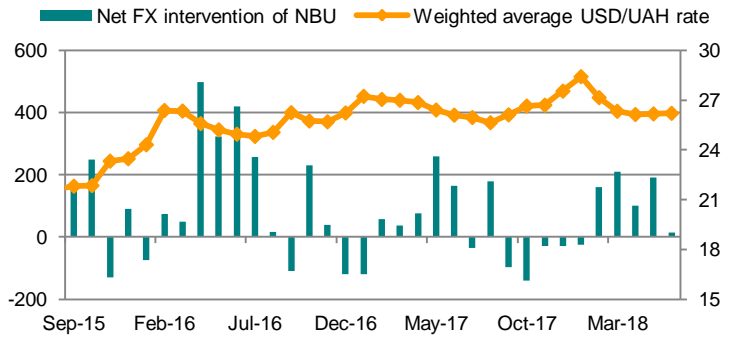
### Currency market

#### UAH exchange rate, UAH/USD



Source: Reuters

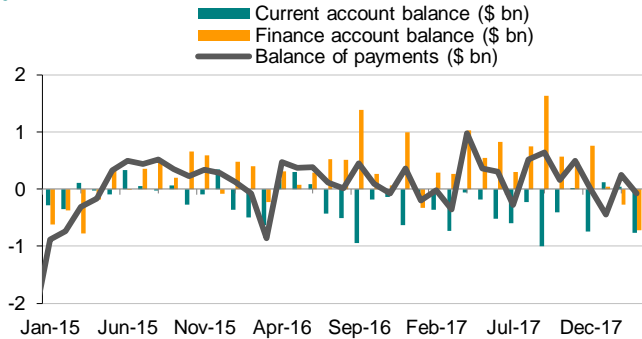
#### Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

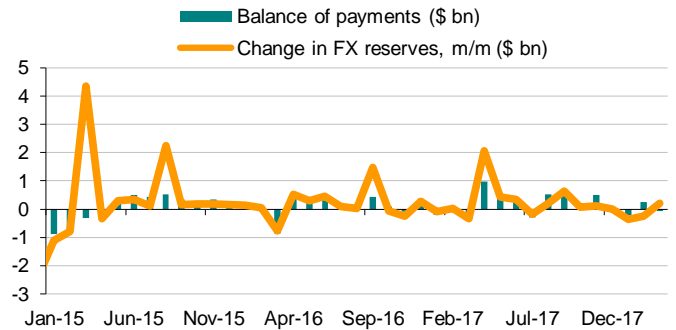
### Balance of payments

#### Major BoP accounts, USDbn



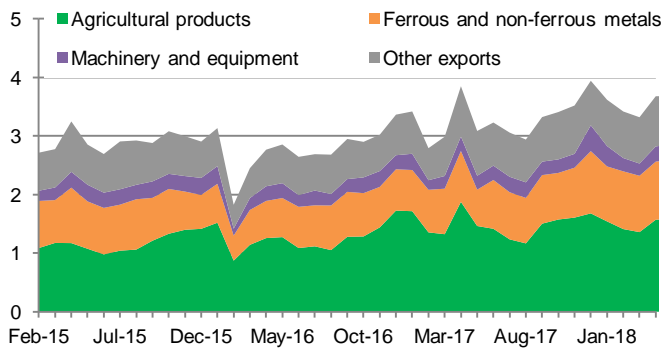
Source: NBU

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



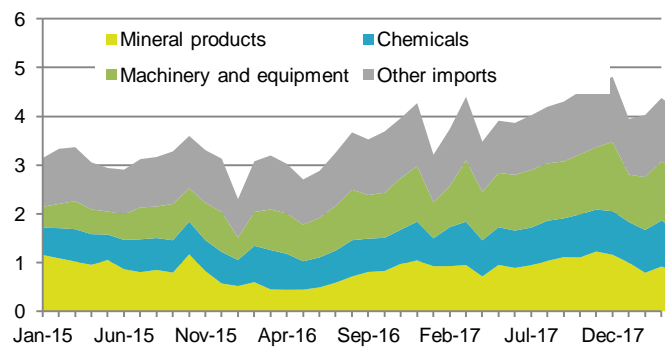
Source: NBU

#### Exports components dynamic, USDbn



Source: NBU

#### Imports components dynamic, USDbn



Source: NBU



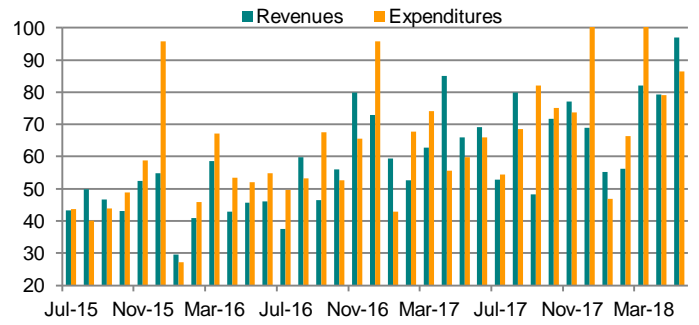
**Budget performance**

**Budget performance, UAHbn**

	Jan – May 2017	Jan - May 2018
<b>Budget revenues</b>	<b>325,8</b>	<b>369,7</b>
VAT proceeds	77,3	93,0
Corporate income tax	28,4	50,6
<b>Budget expenditures</b>	<b>300,0</b>	<b>379,9</b>
Revenues - Expenses	25,7	-10,2

Source: NBU

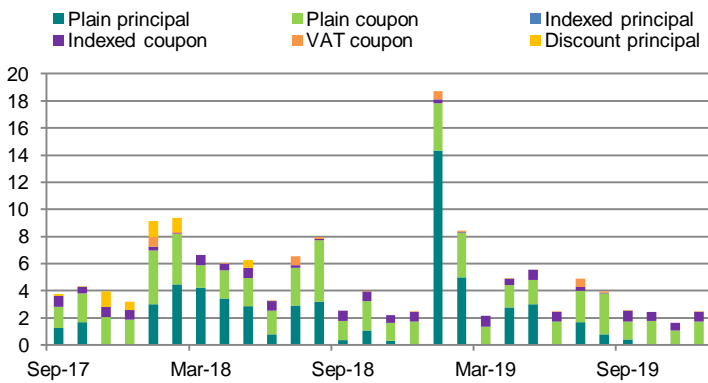
**Monthly change in budget revenues and expenditures, UAHbn**



Source: NBU, State Treasury

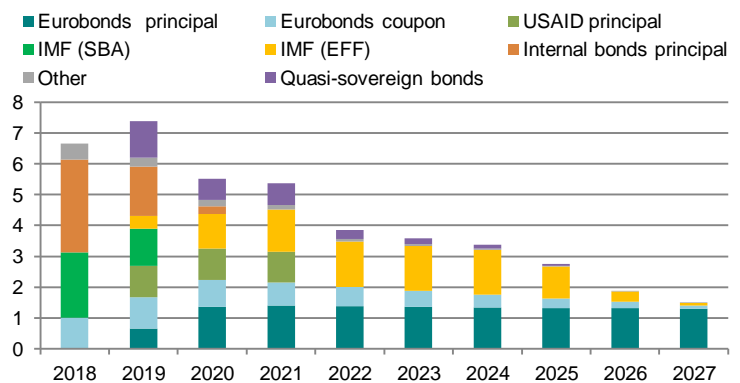
**Sovereign debt**

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



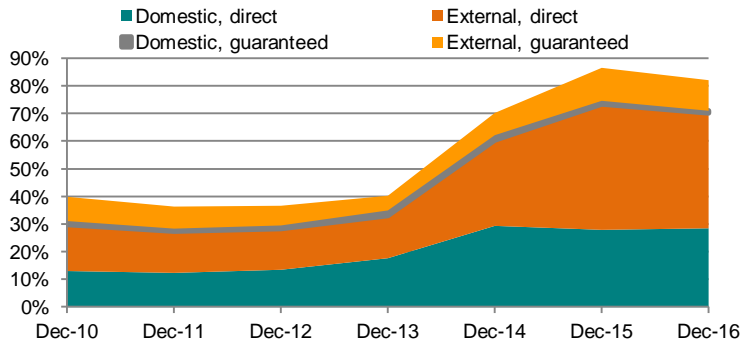
Source: NBU, UkrSibbank estimates

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



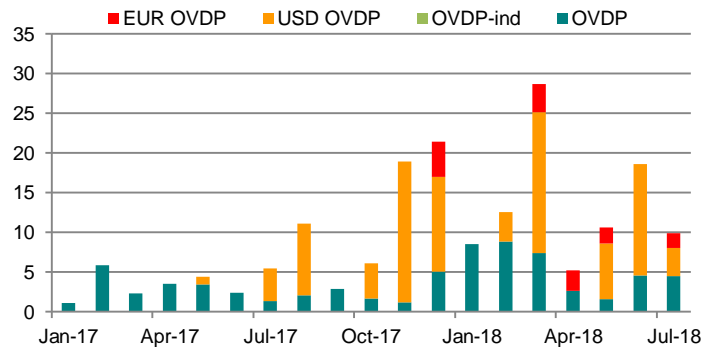
Source: Reuters, IMF, UkrSibbank estimates

**Total government debt, % GDP**



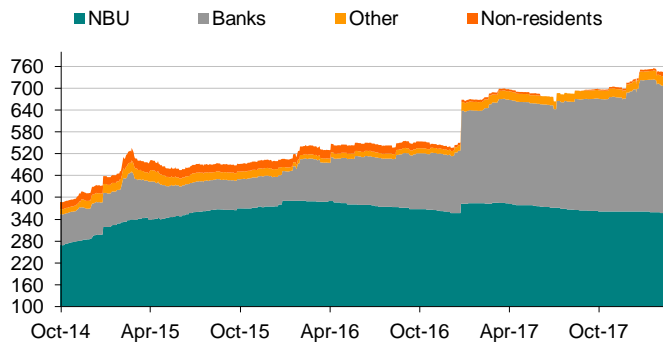
Source: MinFin

**Local borrowings, UAHbn equivalent**



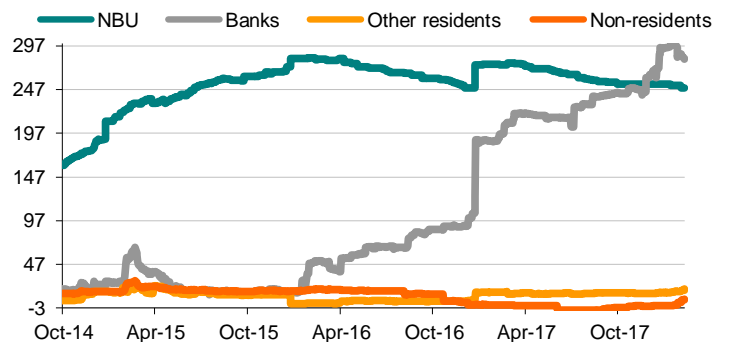
Source: NBU

**Outstanding OVDP owners structure, UAHbn**



Source: NBU

**Outstanding OVDP changes in holding, UAHbn**

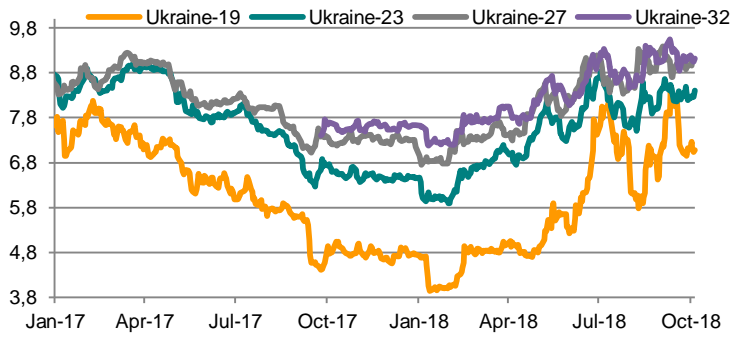


Source: NBU



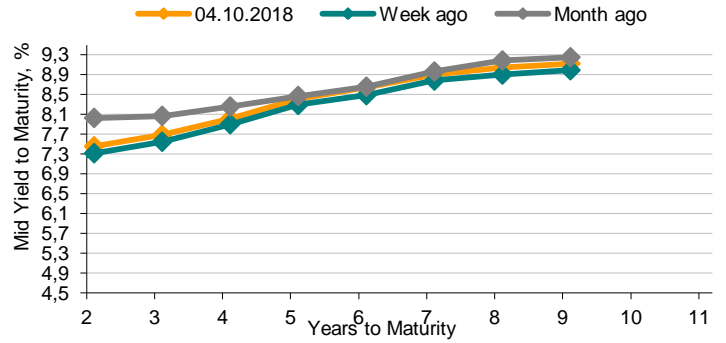
### Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

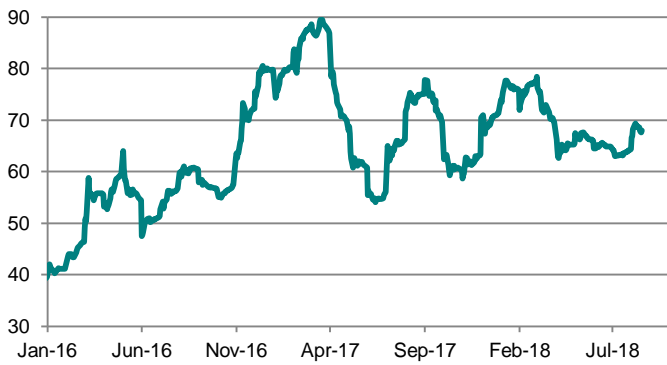
Ukraine's sovereign Eurobond yield curve



Source: Reuters

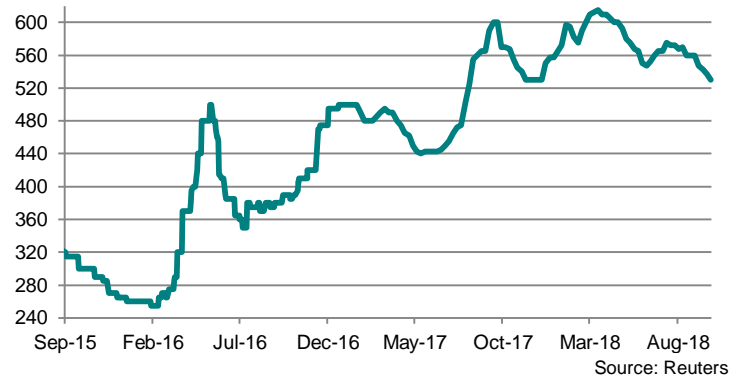
### Commodity markets

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



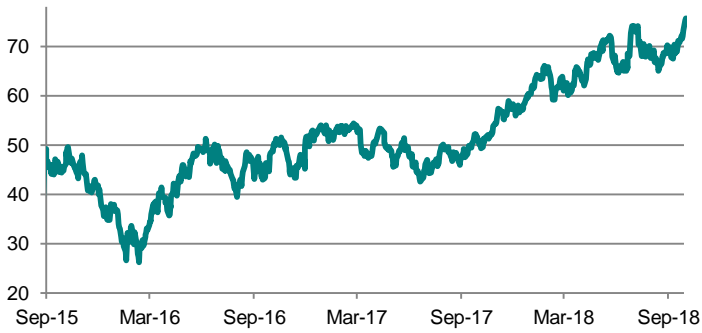
Source: Reuters

Steel CIS export HR coil, USD per ton



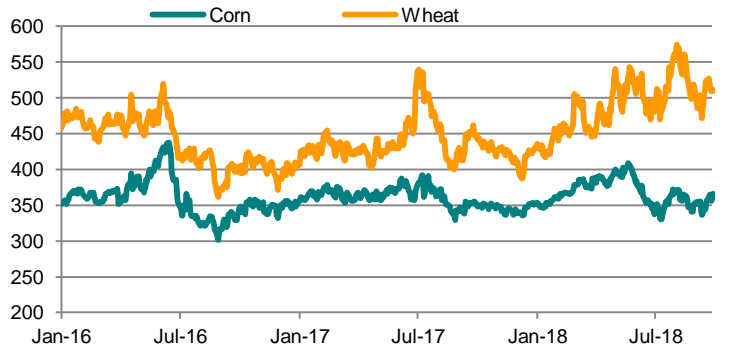
Source: Reuters

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	2017	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	2.5	3.4
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	2982.9	3393.0
Nominal GDP (USD bn)	178.9	112.8	136.1	163.1	175.8	183.5	133.7	91.2	93.1	112.1	125.0
<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	11.5
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	10.3
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	71.8	61.0
<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	1.6	-1.3	-2.4	-4.0
Current account balance (% of GDP)	-7.1	-1.5	-2.2	-6.3	-8.1	-9.0	-3.4	1.8	-1.4	-2.1	-3.3
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	19.5
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	3.2
<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	18.00*
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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