



This week in focus: Ukraine's external trade faces headwinds, downside risk for UAH

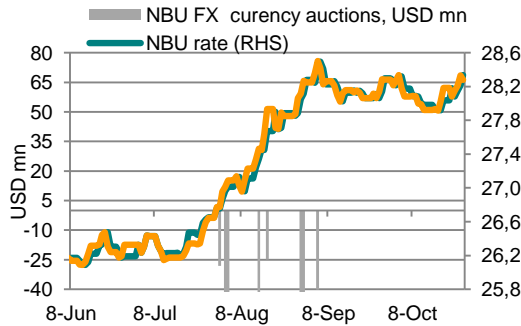
National bank of Ukraine reported that in September 2018 balance of payment saw deficit of USD 0.6bn, driven by skyrocketing current account deficit. While cumulatively for 8M 2018 C/A deficit reached USD 2.2bn, in September alone the monthly deficit expanded by USD 1.7bn. We downgrade our C/A forecast to USD 4.9bn of deficit in 2018 from USD 4.0bn expected previously.

Please see page 3 for more details

FX and interest rates:

Naftogaz aims to issue Eurobonds

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

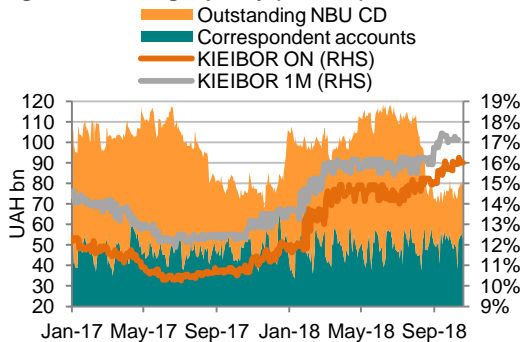
USD/UAH was at 28.15 as of Friday the 2nd, as hryvnia slightly gained some ground during the week, increasing by a 0.6% on a week-on-week basis.

Central bank held no currency auctions during the week once again. NBU has bought USD 85.2mn on the market during the week ended November 2nd. Out of which USD 36.7mn were bought via matching. Meantime, YTD reading of central bank interventions amounted to USD 0.8bn of bought FX currency in 2018, as of November 2nd

Aggregate banking liquidity reached UAH 82bn as of Friday 2nd, up from roughly UAH 80bn from prior week level. The main driver of increase in liquidity during the month were central bank interventions, as NBU bought slightly more than USD 0.2bn. As opposed to that, change in cash and treasury operations dragged liquidity down by UAH 1.1bn and UAH 0.7bn, respectively during the month. Going forward we expect large injections of liquidity in December driven by accelerated fiscal spending.

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.

Figure 2. Banking liquidity (UAH bn)

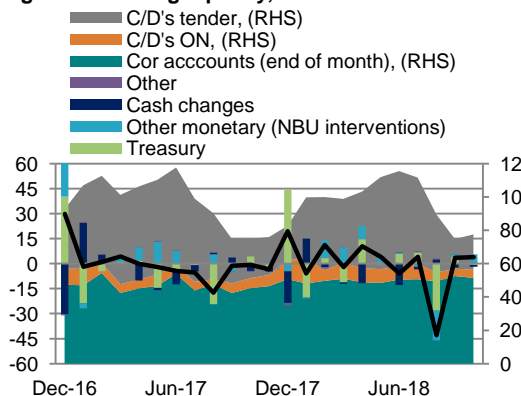


Source: Reuters, NBU, UkrSibbank, Minfin

On the latest auction bonds denominated in hard currencies were in the forefront. The interests of Ministry of Finance were at loggerheads with interests of primary dealers, as of October 30th. While the former tried to keep rate at previous level of 19.0%, the latter tried to force MoF to push it even higher applying with bids at a rate of 19.4%. In particular, total demand on hryvnia bonds amounted to as much as UAH 0.5bn, at the same time MoF satisfied only 3% of that, keeping cut off rate effectively on hold. In the meantime, the largest amount of proceeds came from USD denominated issue. While primary dealers initially applied for USD 38mn, which were divided at 13 bids), MoF satisfied all of 13 bids. At the same time, there are a plenty of redemptions scheduled in November. The largest redemptions are concentrated on November 7th (UAH 5.6bn), followed by November 28th (UAH 5.3bn). At the same time hryvnia bonds with capitalization will be redeemed on November 28th. Last but not least, USD denominated bond totalling USD 133mn will be redeemed as of November 28th.

Currently, yields (bids) of local OVDP in UAH at 20.50% (for 6m), 20.50% (for 2Y). 1Y USD bids were at 7.00%, while bids for VAT bonds were at 20.50%.

Figure 3. Banking liquidity, UAH bn



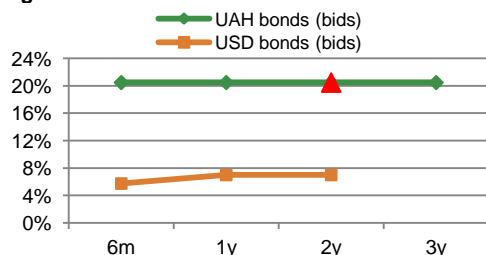
Source: NBU

Figure 5. OVDP auction results, 30th 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%	19.00%	19.40%	19.00%	9	8	515.6mn	14.8mn
USD	9m	7.00%	7.00%	7.00%	7.00%	13	13	38.6mn	37.0mn
EUR	2y	7.50%	7.50%	7.50%	7.50%	10	10	3.0mn	3.1mn

Ukraine's largest producer and importer of gas, Naftogaz aims to issue Eurobonds. According to local news sites, Natogaz are to hold a serious of meetings with investors in U.S. and London, following which it plans to place 5 year USD denominated Eurobonds. Previously, the Cabinet of Ministers has approved the placement up to USD 1bn of Eurobonds, as of October 24th. Use of proceeds among main priorities includes the following: redemption of borrowings, purchase on new gas for heating season and increasing production of gas.

Figure 4. Local bonds market



Source: UkrSibbank

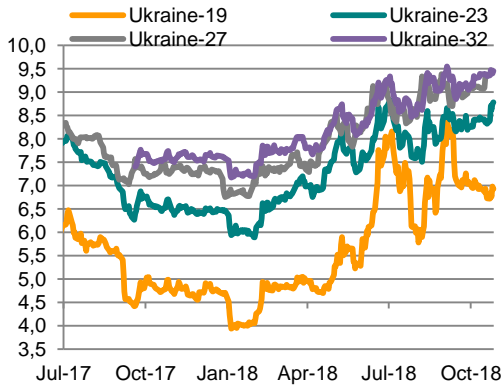
Representatives of IMF said that the visit of constant IMF mission is scheduled in the nearest future. The main topic of discussions will be the consultations about Ukraine's state budget for the next year, the main left condition required by IMF to disburse next tranche to Ukraine. In particular, the mission is going to visit Ukraine from November 4 up to November 9th. Previously, Ukraine's parliament Verchovna Rada successfully passed the state budget bill on the next year in the first reading.



Global markets:

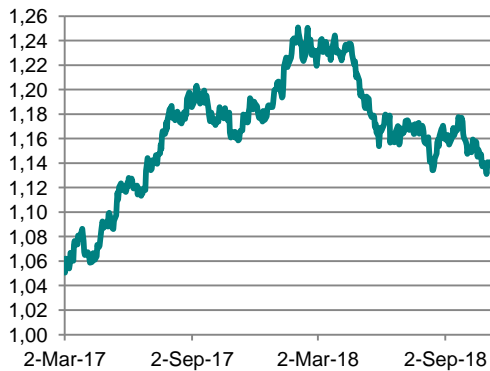
U.S. economy added 250 000 jobs

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



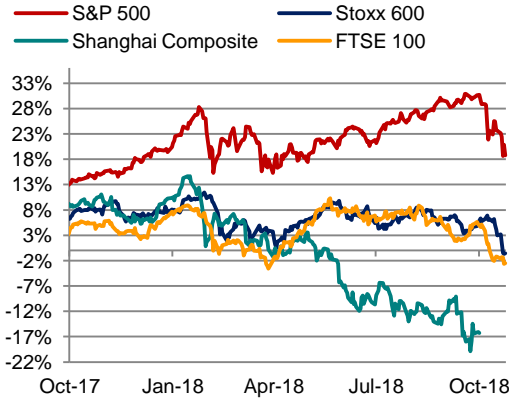
Source: Reuters

Figure 6. EUR USD spot (mid)



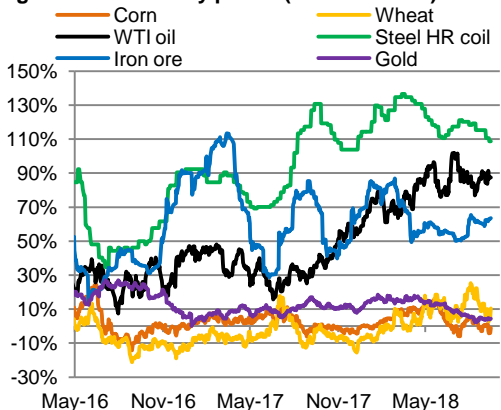
Source: Reuters

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



Source: Reuters

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



Source: Reuters

On Friday, the Labor Department said that employers added 250 000 jobs in October, or more than expected. Meantime, European Union economy grew only half as expected in the 3Q 2018.

Bond benchmarks were mixed, with U.S. 10y Treasuries' yield increased by 14bp week-on-week landing at 3.21%, while German 10y Bunds' yields increased by 19bp, landing at 0.44%, Japanese 10y bonds yields ended the week at 0.13%.

On Friday, the Labor Department said that employers added 250 000 jobs in October, or more than expected. The report showed that pace of wage growth picked up last month, as average earnings climbed to USD 27.3 an hour or 3.1% above a year earlier. On top of that, unemployment rate remained at 3.7% or the lowest in several decades. The Fed is most likely to remain on track to increase main rate on the next FOMC meeting scheduled on December. On Tuesday November 6th, midterm elections in USA are to be held, which is the main political event in US in the end of 2018, in which Republicans are expected to retain its control in Senate but House of Representatives is under threat.

Equity indexes advanced, as S&P fell by 2.4%, while Nasdaq Composite gained by 2.6 % week-on-week.

EUR/USD rate landed at 1.1385 as of Friday the 2nd, down compared to last week closing level of 1.1401.

Main stock indexes increased in Europe. Namely Stoxx 600 decreased by 3.3% during the week, while German DAX climbed even more by 2.8% week-on-week.

European Union economy grew only half as expected in the 3Q 2018. At the same time, the preliminary estimate of 0.2% (or the lowest since 2Q 2014) was also much lower compared to 0.4% growth in second quarter. The European Commission economic sentiment index for the euro zone tumbled in October for a tenth month in a row. At the same time, weak Purchasing Managers' Index survey pointed to little increase in growth in the final month of current year. Moreover, Italy's weak economic growth of around 0.0% adds to the concern of overall economic growth in Europe too.

Chinese President Xi Jinping made some remarks about economy at the opening ceremony of the first China International Import Expo in Shanghai. According to him, China's economy remains at most stable and on its path to make progress. On top of that, he highlighted that fundamentals for sound and stable economic growth remain unchanged, the necessary production factors for high-quality development remain unchanged and the overall momentum on long-term economic stability also remains unchanged.

Crude oil prices tumbled, as WTI futures dropped by 6.6% week-on-week and closed at USD 63.1 per barrel, while Brent futures fell by 6.2%, landing at USD 72.8 per barrel.

Gold prices were flat as NYMEX 1m futures decreased by a mere 0.1% week-on-weeks and finished the week at USD 1230.9 per troy ounce.

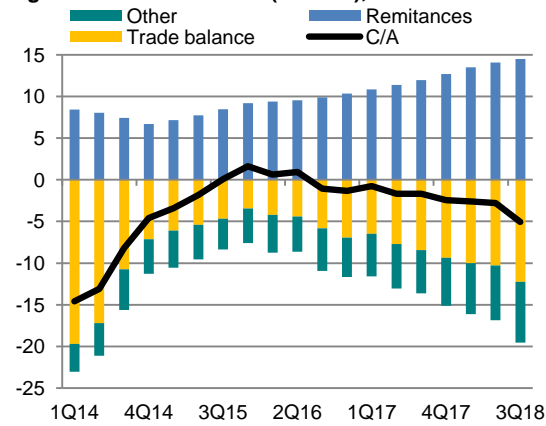
Grains prices advanced, as CBOT Corn 1m futures increased by 1.0% week-on-week and closed at USD 371.3 per bushel, while CBOT Wheat 1m futures landed at USD 508.8 per bushel, climbing by 0.7% during the week.

Iron ore increased, as NYMEX Iron ore 62% Fe 1m futures increased by 0.7% on a week-on-week basis and closed at USD 72.9 per ton.



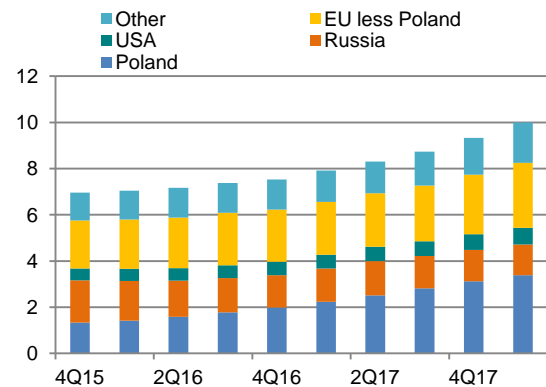
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Figure 9. C/A breakdown (for 12m), USDbn



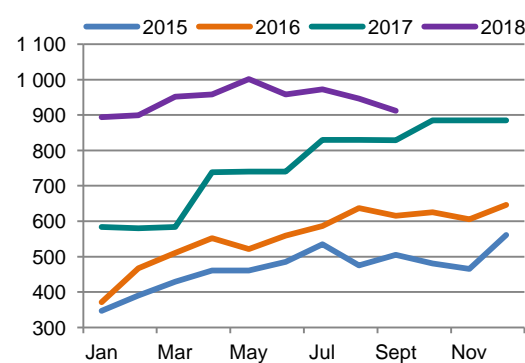
Source: NBU

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



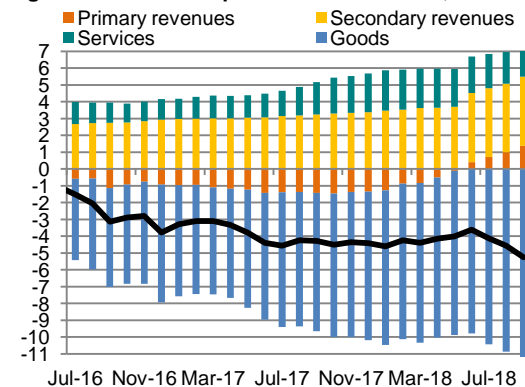
Source: NBU

Figure 11. Migrants wages (in primary incomes), USDmn



Source: NBU

Figure 12. Industrial production in Ukraine, %



Source: NBU

National bank of Ukraine reported that in September 2018 balance of payment saw deficit of USD 0.6bn, driven by skyrocketing current account deficit. While cumulatively for 8M 2018 C/A deficit reached USD 2.2bn, in September alone the monthly deficit expanded by USD 1.7bn. We downgrade our C/A forecast to USD 4.9bn of deficit in 2018 from USD 4.0bn expected previously.

While we initially expected the deficit to land at USD 3.3bn (and the NBU initially forecasted the deficit at USD 2.4bn), we downgraded our forecast based on July statistic to USD 4. While we were more conservative in accessing C/A performance compared with central bank by more than a USD 1bn from the start of the year and by USD 2.0bn (or twice higher) from the summer, the magnitude of worsening was even somewhat higher than we expected initially.

Exports amounted to USD 3.3bn and had declined by 3.6% y/y in September, reflecting the weakest performance since March 2018. Concurrently, the cumulative 9M 2018 reading fell to 20.9%. The strongest decline stemmed from agri and food component of the exports, falling by 9.8% y/y in September. Having increased by 11.1% y/y in August, metals exports pared its growth to just high single digit, namely to 8.3% y/y, bringing 9M 2018 reading to 25.8%. In the meantime, machinery exports turned to the red in September, as exports declined by 1.8% y/y, following 17.8% growth in August. And on top of that, chemical production positive growth decelerated to only 4.8% y/y in September from 7.2% growth in prior month, which also corresponds to decelerating digits of growth in industrial production of chemical goods. In regard to solid spring crops performance we expect the largest effect from this will be reflected in the next year export performance, namely in 1H 2019, as farmers harvested only roughly 70% of corn, according to the latest data, at the same time we can see some improvement in growth numbers of agri export in coming month or in November and December statistics.

Having risen by 17.2% in August, imports amounted to USD 5.1bn in September, indicating slight acceleration of its growth to 17.3% y/y in last month, according to NBU data. Mineral imports gained by 24.9% y/y in September, strongly beating prior month reading of only 16.7% growth, as prices of oil on international markets advanced strongly during the month. In regard to machinery imports performance it was solidly advancing for the last several consecutive month. Having grown by 20.4% in August, machinery component advanced even stronger or by 22.6% in September, supported by strong consumer demand in the country, especially from households. Regarding other components, there were also higher digits of growth as well. In particular, chemical imports, which amounted to USD 0.8bn in recent month, showed growth of 5.4% y/y in September vs 4.8% y/y growth in August. According to Ukrtransgaz data, Ukraine has reduced its imports of natural gas from Europe by 23% in 10M 2018 in physical volume. Imports of oil (less raw) in physical terms increased by a mere 1.5% in 9M 2018 vs 9M 2017, at the same time prices increased by more than 30%. Meantime, imports of oil (raw), declined by quarter of percent, with price increasing by 30% as well in 9M 2018 vs 9M 2017.

Having acted as a support for C/A recently, the balance of services turned to the negative balance for the first time since September 2016, as imports of services outpaced exports slightly during the month.

Having picked at slightly more than USD 1bn in May, wages of Ukrainian migrants reflected in the primary incomes started to subsidy, amounting only to USD 0.9bn in September and lower comparing to several preceding months. It's quite worrisome, as in previous three years they were constantly heading toward higher digits supporting strongly C/A performance.

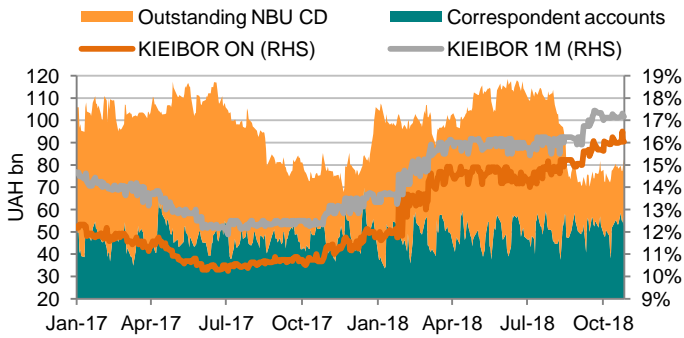
The surplus of financial account amounted to USD 1.1bn in September or the strongest since September 2017 when Ukraine placed Eurobonds. Foreign direct investments amounted to USD 102mn, down based on y/y as well as on m/m basis. While to a large extent prior month financial account surplus stemmed from Ukraine's placement of Eurobonds totaling USD 0.7bn, in September the largest financial proceeds were accounted for as trade loans for a total USD 0.6bn. On top of that, FDI comprised USD 0.1bn, which was the lowest reading from the start of the year with more than half directed to the banking system. Going forward in November are concentrated Ukraine's redemptions of IMF amounting to SDR 0.3bn (or USD 0.4bn).

We downgrade our C/A forecast to USD 4.9bn of deficit in 2018 from USD 4.0bn expected previously. Widening of trade balance driven by strong consumer demand and weakening momentum in private transfers (especially coming from the part of wages reflected in primary incomes) will be the main factors of higher C/A going forward. At the same time we keep our USD UAH exchange rate forecast unchanged at 29.5 as of end of the year.



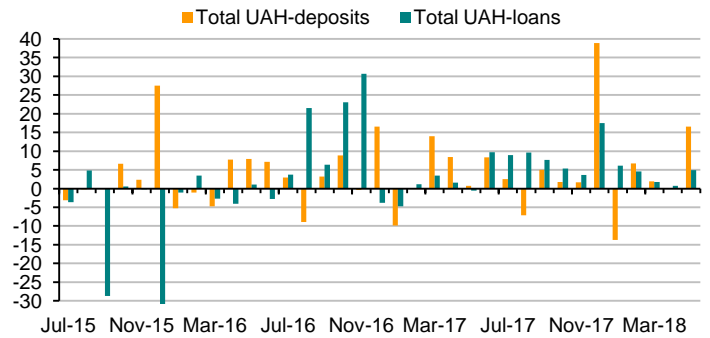
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

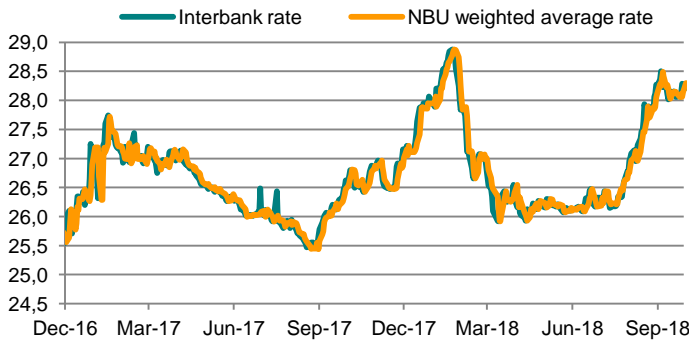
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

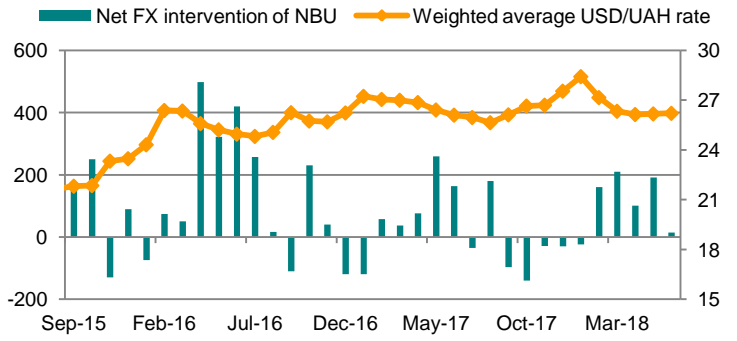
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

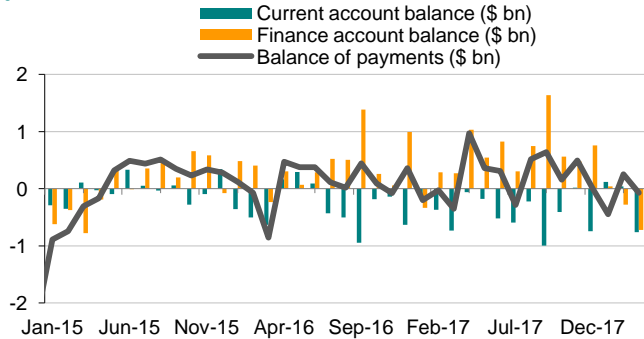
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

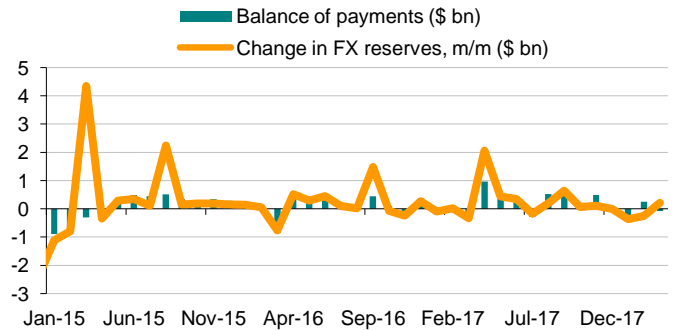
Balance of payments

Major BoP accounts, USDbn



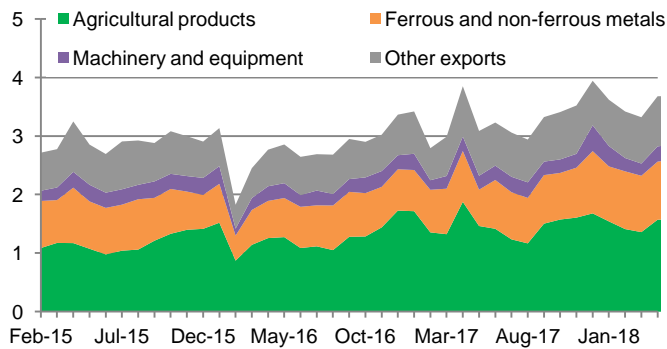
Source: NBU

BoP vs change in foreign reserves, USDbn



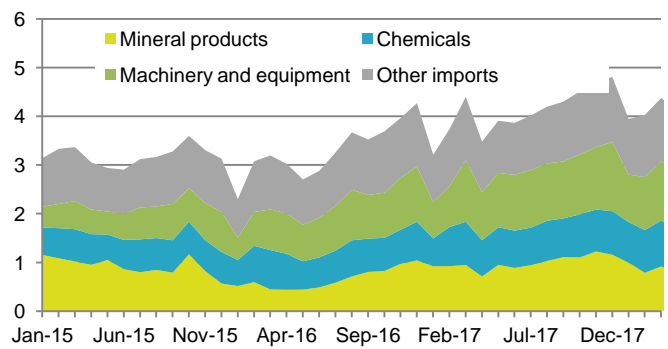
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU

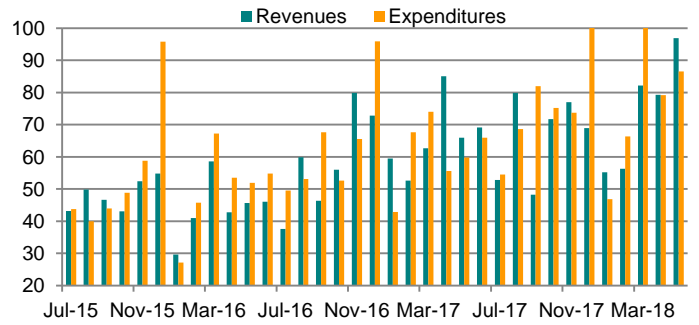


Budget performance

Budget performance, UAHbn

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

Monthly change in budget revenues and expenditures, UAHbn

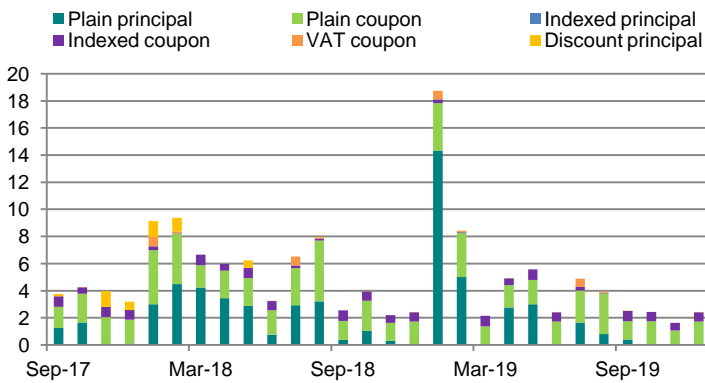


Source: NBU

Source: NBU, State Treasury

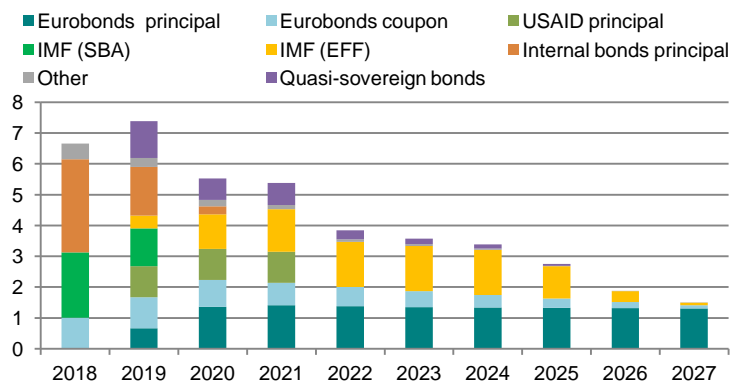
Sovereign debt

UAH-denominated debts' repayments schedule, UAHbn



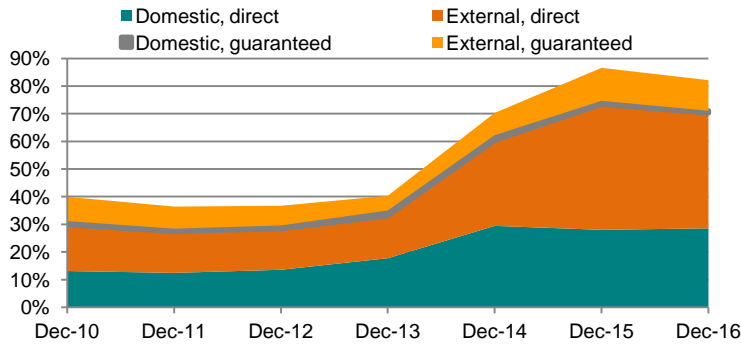
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



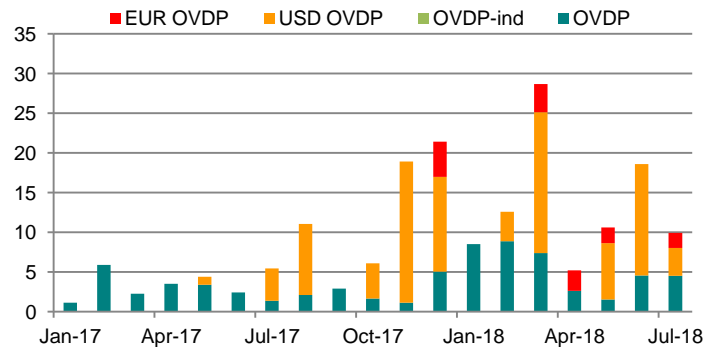
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



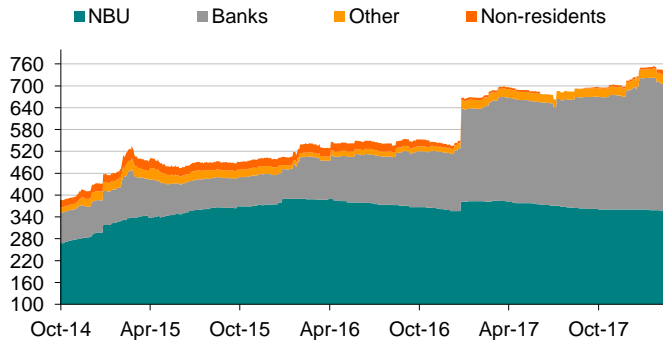
Source: MinFin

Local borrowings, UAHbn equivalent



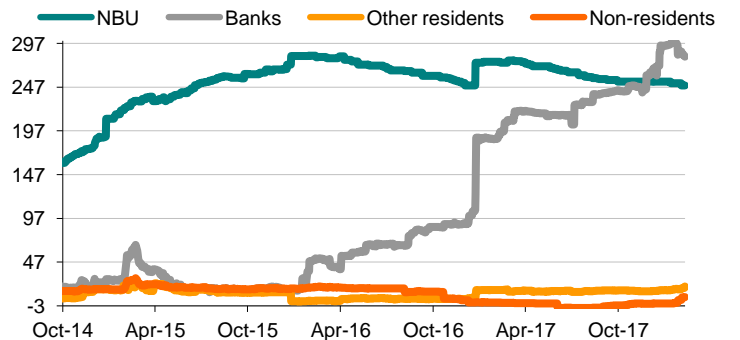
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

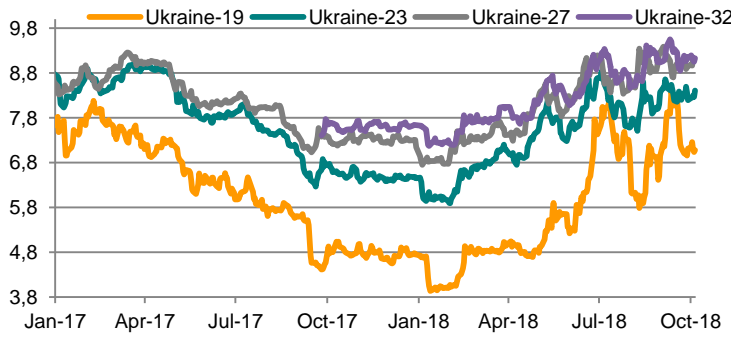


Source: NBU



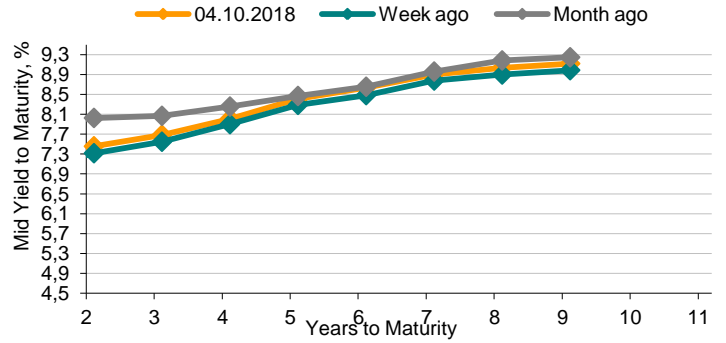
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

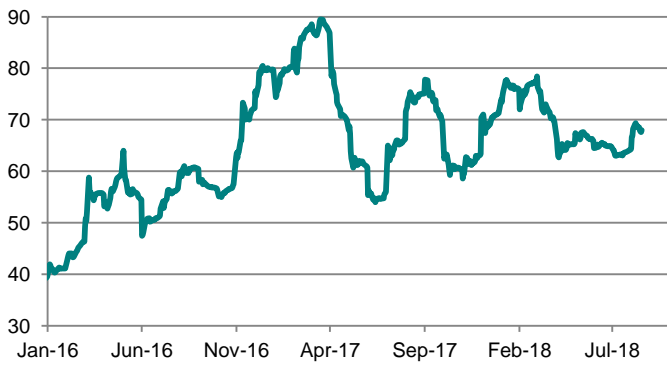
Ukraine's sovereign Eurobond yield curve



Source: Reuters

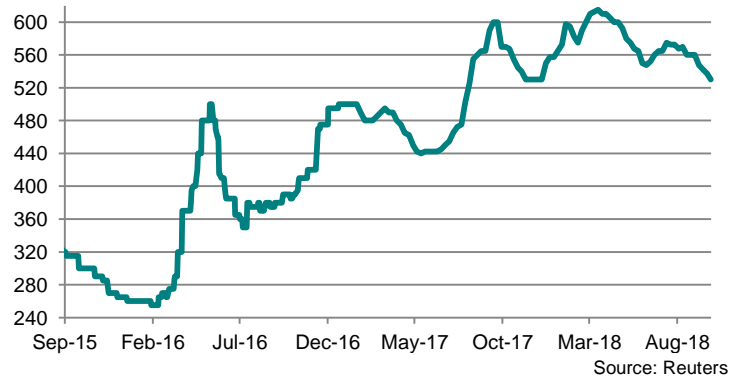
Commodity markets

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



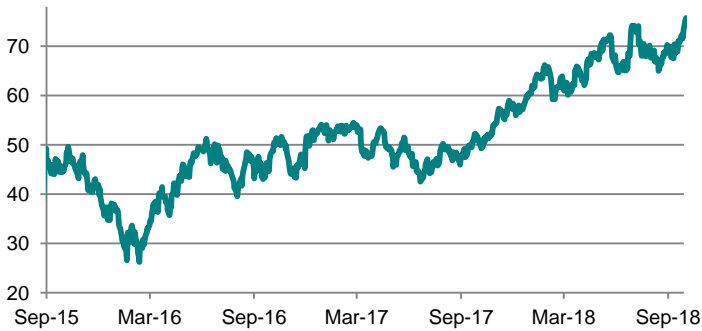
Source: Reuters

Steel CIS export HR coil, USD per ton



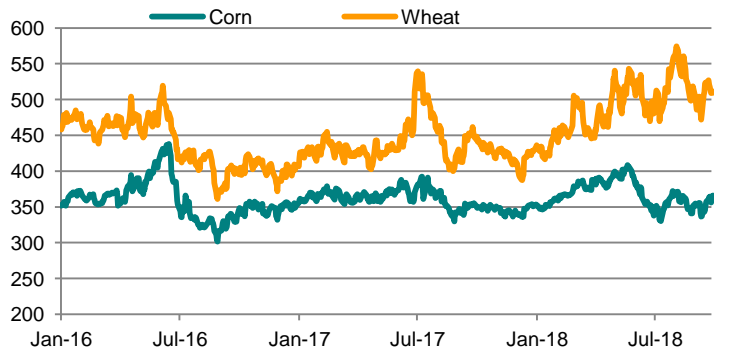
Source: Reuters

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	2017	2018F
Real sector											
Real GDP (%YoY)	2.3	-14.8	4.1	5.2	0.2	0.0	-6.6	-9.8	2.3	2.5	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
Prices											
CPI (average %YoY)	25.2	15.9	9.4	8.0	0.6	-0.2	12.1	48.7	16.5	14.4	11.5
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
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	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
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	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
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	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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