



**This week in focus: Ukraine's banking liquidity December spike to be lower**

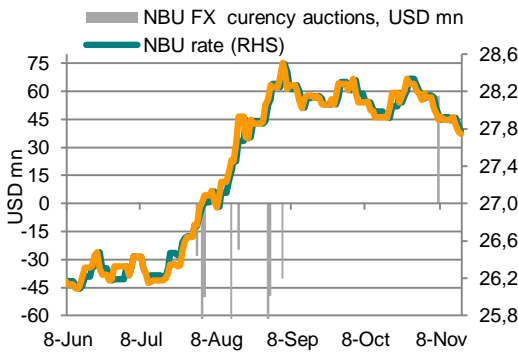
Historical data suggest that Ukraine's domestic liquidity is to increase by UAH 30-40 bn until the year end. It is driven by seasonality in budget spending, with heavy concentration in the last months of the year.

*Please see page 3 for more details*

**FX and interest rates:**

**Income tax payments pulled liquidity down**

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



Source: NBU, Reuters

**USD/UAH was at 27.77 as of Friday the 16<sup>th</sup>**, as hryvnia appreciated during the week, increasing by a 0.5% on a week-on-week basis for a third week in a row.

**Central bank continued to buy FX on the market.** In particular, NBU managed to buy USD 81mn during the week ended November 13<sup>th</sup>, extending accumulation of FX for the fourth week in a string. In the last four weeks central bank bought USD 354mn. In regard last week performance, NBU utilized two tools to buy currency namely, matching and interventions under single rate. As a result, YTD reading of central bank interventions amounted to USD 1.1bn of bought FX currency in 2018, as of November 13<sup>th</sup>.

**In prior week, the main driver of liquidity was tax payments by the business, especially income tax payments.** During prior week, treasury operations reduced liquidity by about UAH 13bn cumulatively. More importantly, the half of that happened during only one day, namely on Friday, when liquidity had been reduced by UAH 7.2bn during single day. It was followed by increase in cash outside of the banking system, reducing liquidity by UAH 1.5bn. The only strong counterbalance to that were interventions of the NBU to buy FX to reserves. Having bought USD 81mn during the week, central bank added slightly more than UAH 2bn to banking liquidity during the week ended November 16<sup>th</sup>. From the start of the month, liquidity decreased, as treasury operations decreased it by about UAH 7bn, which was offset by about UAH 7bn increase in liquidity coming from interventions. And on top of that changes in cash weighted on liquidity by about UAH 6bn from the start of the month. In regard to VAT reimbursement, it was reimbursed only UAH 2.2bn as of the start of November 19<sup>th</sup>, from the beginning of the month. And the major part of refund is yet to come on the market by the end of November.

**Money market rates remained flat:** cost of ON funds is around 17.50/18.50, 1 week is 17.50/18.75 while 1M is 18.50/19.50, according to our calculations.

**MoF has placed 4 bond issues denominated in hryvnia during the week ended November 13<sup>th</sup>, on top of that Ministry of Finance issued two USD denominated bonds.** While initially MoF was intended to place 5 UAH issues, at the end MoF refused to satisfy bids on 1y issue. The main reason behind such decision was clear, namely primary dealers applied with bids at 19.0%, above 18.5% which was used in previous auctions. In regard to other issues, all bonds were placed with the same cut off rate at 18.5%, in line with previous levels, except only 3m bonds (which were placed with a cut off rate at 19.0%). Total proceeds from USD bonds amounted to USD 20.8mn, with the largest part concentrated in shorter bonds. Redemption of bonds denominated in USD will be held on November 21<sup>st</sup>, amounting to USD 132mn. At the same time the largest UAH bond denominated redemption totalling UAH 5.3 is scheduled to be on November 28.

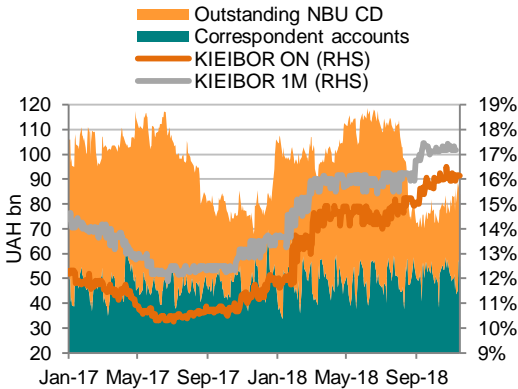
**Currently, yields (bids) of local OVDP in UAH at 20.50% (for 6m), 20.50% (for 2Y).** 1Y USD bids were at 7.50%, while bids for VAT bonds were at 20.50%.

**Figure 5. OVDP auction results, 13<sup>th</sup> of November 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%  | 19.20%       | 19.00%       | 17             | 15            | 527.3mn  | 409.4mn        |
| UAH | 6m       | 18.50%       | 18.50%  | 19.00%       | 18.50%       | 9              | 8             | 83.9mn   | 53.3mn         |
| UAH | 9m       | 18.50%       | 18.50%  | 18.50%       | 18.50%       | 1              | 1             | 1.0bn    | 1.0bn          |
| UAH | 1.5y     | 18.50%       | 18.50%  | 18.50%       | 18.50%       | 5              | 5             | 6.1mn    | 5.8mn          |
| USD | 1y       | 7.25%        | 7.22%   | 7.50%        | 7.00%        | 10             | 7             | 17.4mn   | 16.8mn         |
| USD | 2y       | 7.50%        | 7.50%   | 8.00%        | 7.50%        | 10             | 9             | 4.2mn    | 4.0mn          |

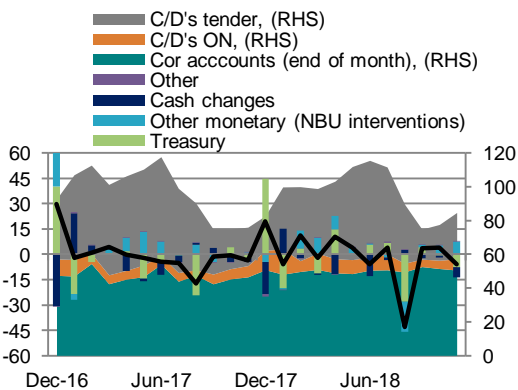
**On November 15<sup>th</sup>, Jerry Rise IMF press secretary said that a meeting of Board to approve staff level agreement reached with Ukraine will be held after Ukraine's parliament vote for next year budget.** He also mentioned that Ukraine visited IMF mission to conduct negotiations regarding next Stand-by program which scheduled to last only 14 months. According to Ukraine side, the vote is expected to be on November 22<sup>nd</sup>. We expect the Verhovna Rada to succeed in voting for the budget. If Ukraine parliament failed to vote in November, the next possibility would be in beginning of December.

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



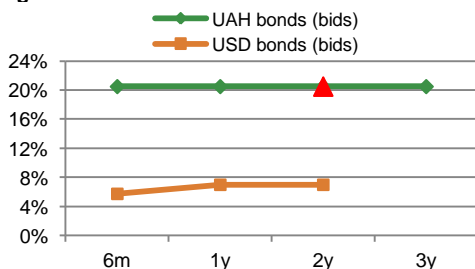
Source: Reuters, NBU, UkrSibbank, Minfin

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



Source: NBU

**Figure 4. Local bonds market**



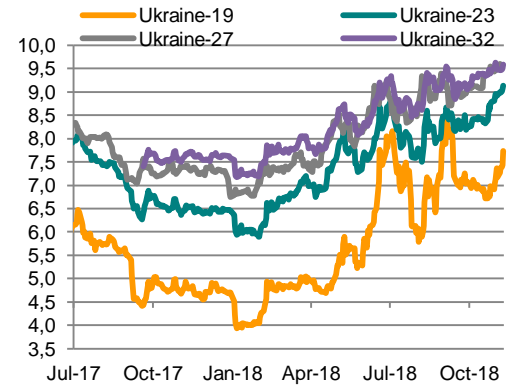
Source: UkrSibbank



Global markets:

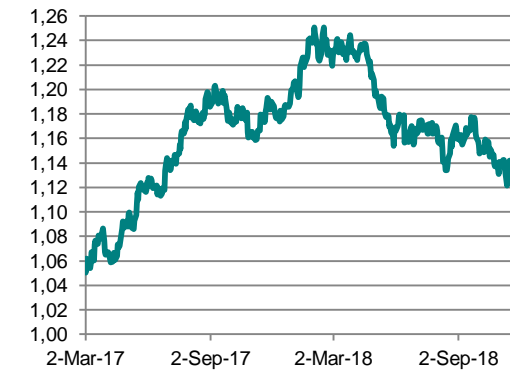
U.S. residential investments showed deceleration

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



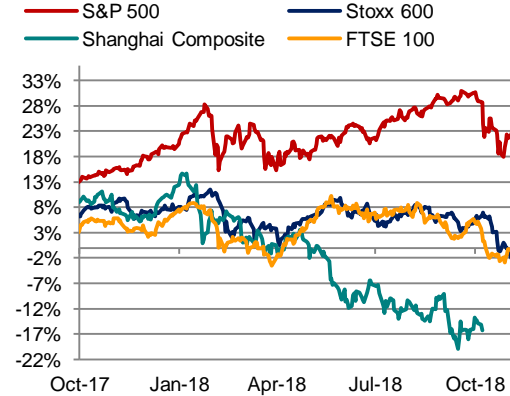
Source: Reuters

Figure 6. EUR USD spot (mid)



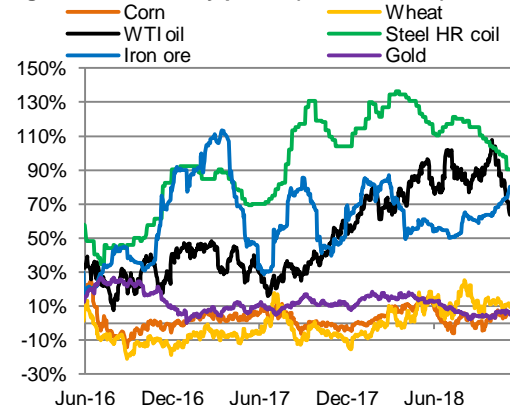
Source: Reuters

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



Source: Reuters

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



Source: Reuters

Residential investments of Americans showed slowdown in the first three quarters of the year, following 3.4% growth in prior year. At the same time, Euro area economy stumbled in the three months ended in September amid the economic growth falling to 0.2%. Chinese central bank advisor said that opening of the economy will help to deal with trade frictions.

Bond benchmarks advanced, with U.S. 10y Treasuries' yield fell by 11bp week-on-week landing at 3.05%, while German 10y Bunds' yields fell by 4bp, landing at 0.37%, Japanese 10y bonds yields ended the week at 0.10%.

American residential investments virtually stagnated at an annual rate of 0.6% in the first three quarters of 2018, following solid slowdown to a 3.4% growth in 2017. And that can be treated as a serious strike to private consumption, as a slowdown of housing demand always causes decline in sales of consumer durable goods, such as furniture, cars and other. At the same time, consumer durables account for nearly 40% of all goods bought in U.S. economy. Their annual growth rate in 9M2018 was a mere 1.4%. And the weaker growth is yet to come, provided interest rates on mortgages continue to increase. The costs of popular 30 year fixed mortgages increased by 100bp during a year, standing at about 5% now.

Equity indexes plummeted, as S&P declined by 1.6%, while Nasdaq Composite plummeted by 2.1 % week-on-week.

EUR/USD rate landed at 1.1418 as of Friday the 16<sup>th</sup>, down compared to last week closing level of 1.1334.

Main stock indexes in Europe followed suit their U.S. counterparts and were strongly in the red territory. Namely Stoxx 600 tumbled by 2.2% during the week, while German DAX declined less by only 1.6% week-on-week.

The Euro area economy stumbled in third quarter ended in September amid economic growth falling to just 0.2%. The weak growth looks as slowdown following 0.7% growth at the end of last year. Recent data from Germany added only fuel to the worries, as economy fell by 0.2% in the last quarter ended in September. Some part of slowdown can be attributed to weakening exports, raising questions about the impact of the U.S. trade war and uncertainties like Brexit could create for European largest exporters. At the same time, a key risk to the slowdown is Italy, which wants to spend more on social welfare, and the European Union executive Commission demanding Italian lower budget deficit for the next year.

China's central bank advisor mentioned that opening of Chinese economy will help deal with the trade frictions with the largest economy. On top of that, he added that China can't move backwards in conducting its market reforms. Previously, European Union urged China to take decisive steps in the process of further opening its market to foreign companies. At the same time, small business in China more worried that the top officials are more focused on providing support to large state-owned enterprises instead of providing support to small and medium sized companies.

Crude oil prices plummeted, as WTI futures decreased by 6.2% week-on-week and closed at USD 56.5 per barrel, while Brent futures dropped by 4.9%, landing at USD 66.8 per barrel. Oil prices continued to be in strongest downside trend starting in the beginning of October.

Gold prices advanced as NYMEX 1m futures increased by 1.2% week-on-weeks and finished the week at USD 1220.8 per troy ounce.

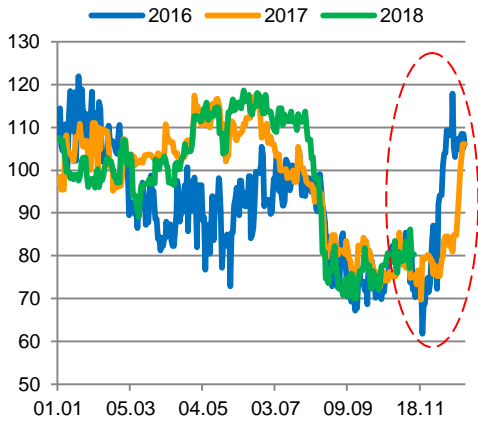
Grains prices were mixed, as CBOT Corn 1m futures decreased by 1.4% week-on-week and closed at USD 364.8 per bushel, while CBOT Wheat 1m futures landed at USD 506.8 per bushel, increasing by 0.9% during the week.

Iron ore increased, as NYMEX Iron ore 62% Fe 1m futures decreased by a 0.7% on a week-on-week basis and closed at USD 75.1 per ton.



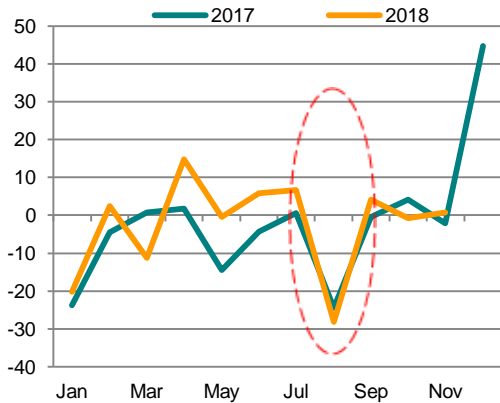
**This week in focus: Ukraine's banking liquidity December spike to be lower**

**Figure 9. Banking liquidity seasonality, UAHbn**



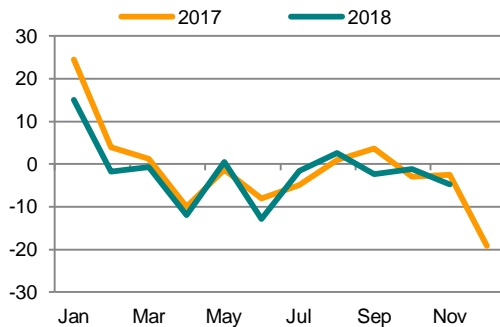
Source: NBU

**Figure 10. Contribution of treasury account to liquidity, UAHbn**



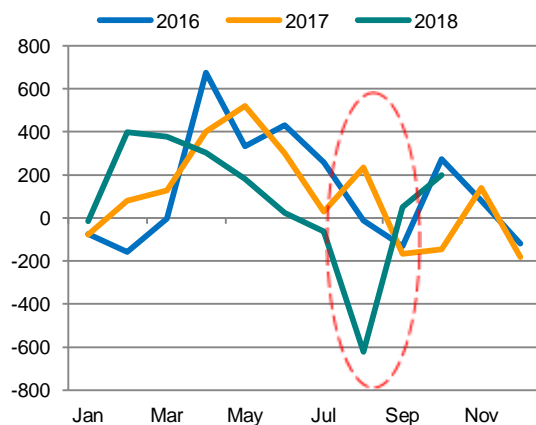
Source: NBU

**Figure 11. Contribution of cash to liquidity, UAHbn**



Source: NBU

**Figure 11. NBU interventions, USDmn**



Source: NBU

**Historical data suggest that Ukraine's domestic liquidity is to increase by UAH 30-40 bn until the year end.** It is driven by seasonality in budget spending, with heavy concentration in the last months of the year.

**The key liquidity drivers are fiscal payments, changes in cash and central bank interventions.**

- State budget payments (excluding local budgets) are particularly heavy in December. In particular, on average expenses on pensions reached UAH 11.1bn in 11M 2017 from the state budget. At the same time, in December expenses amounted to UAH 22.1bn, or increasing by 11.0bn or almost twofold comparing to average expenses. On top of that, expenses on defense in December were by 2.7x times higher comparing to the average level during the year. Additional meaningful impact was also observed in increased expenditures on education. For example, in December 2017 expenses comprised UAH 6.1bn during one single month. The average reading of that during 11M 2017 amounted to UAH 3.0bn, indicating that expenses doubled in December adding additional several billions of hryvnias to liquidity via fiscal system. Expenses on police, safety and judiciary also added as much as UAH 6.6bn additionally in December or growing by 77% m/m in the last month of the year.

| UAHbn     | Average 2017* | Dec 2017 | Change % | Change in UAH |
|-----------|---------------|----------|----------|---------------|
| Pensions  | 11 122        | 22 141   | 99%      | 11 020        |
| Defense   | 5 427         | 14 651   | 170%     | 9 224         |
| Police    | 6 608         | 15 165   | 130%     | 8 557         |
| Education | 3 201         | 6 082    | 90%      | 2 881         |
| Medicine  | 1 197         | 3 567    | 198%     | 2 370         |

\* average data for 11M 2017

In percentage terms the strongest increase displayed expenses grouped in the category Capital expenses. While the average reading of that was UAH 2.1bn in 11M 2017 and UAH 3.9bn alone in November, the outlays in December reached UAH 18.3bn, or adding additional UAH 15.0bn in December alone. We can't avoid to highlight the local budgets performance. As of end of September, the surplus of general budget decreased to UAH 15.6bn at the same time state budget was running a deficit of UAH 6.5bn, implying that local budgets remained in healthy surplus of UAH 22bn, as of the end of September. A year ago the surplus of local budgets was somewhat stronger, amounting to UAH 26.8bn. Local budgets are usually trying to spend funds available for them by the end of the year.

- Changes in cash. Above-mentioned increase in fiscal spending in December accompanied usually with increase in cash on hands of household's, acting as negative driver of liquidity growth. Data from NBU shows that, for example, increase in cash in December 2017 comprised UAH 19bn, according to our calculations, during one single month, without such offset banking system liquidity would gained much stronger in December 2017. Data from December 2016 showed that cash on hands increased by as much as UAH 30.6bn in one single month alone. The more pronounced increase in December 2016 was caused by psychological factor from Privatbank nationalization. We can continue to expect some cash impact on banking liquidity in December 2018 but with lower magnitude.

- NBU interventions amounted approximately USD 1.1 (of purchased FX currency to reserves), as of November 16<sup>th</sup>. At the same time, the average USD UAH rate was 27.13, adding approximately UAH 30bn to the banking system liquidity from the start of the year effective November 16<sup>th</sup>. There was some difference in magnitude of interventions during the year, as in July-August NBU was forced to sell strongly to support plunging currency. As a consequence, banking liquidity tumbled severely in summer, which wasn't usually the case in previous years. Low level of net and gross reserves forces NBU to buy currency on the market at every possible situation. Devaluation of the hryvnia, which we expect closer to the end of the year, might lead to NBU selling some modest amount of FX currency from reserves, acting as a drag on liquidity.

**We believe that domestic liquidity will largely follow historical pattern, but the upcoming increase in liquidity is going to be less pronounced vs previous years.**

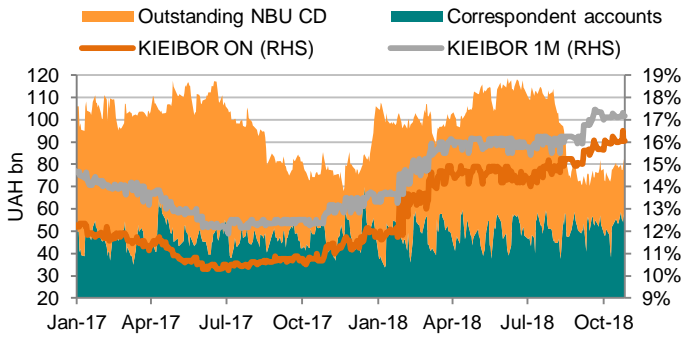
9M2018 budget performance is notably weaker comparing to the last years. On top of the above-mentioned, the performance of treasury account is also important factor in assessing banking liquidity going forward. It surplus fell to UAH 14.6bn, as of November 1<sup>st</sup>, or plummeting by 70% m/m. At the same time, the reading as of the same date a year ago showed much healthy surplus of UAH 48.6bn, indicating that this year treasury account fell short by UAH 33.9bn comparing to a year ago. In this light, we believe that ability of government to afford paying double pensions, for example, will be limited and this could happen only with respective decline in other spending.

We also note that, funding budget deficits became much more difficult in light of continuous delay in IMF cooperation, unfavorable capital markets and higher domestic interest rates (NBU tightened domestic key rate by 350 b.p. since January 2018).



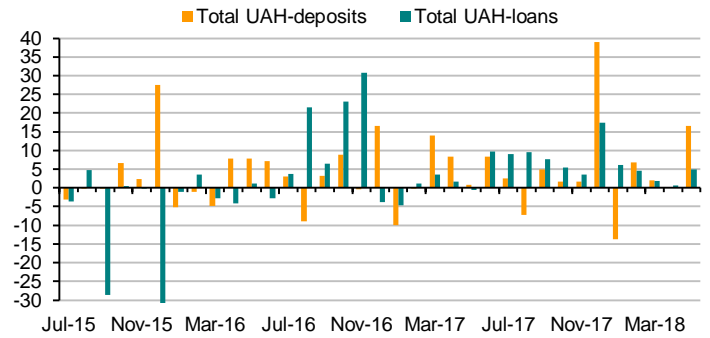
### Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

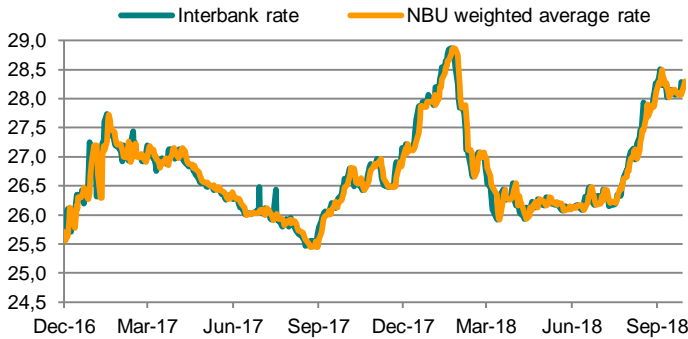
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

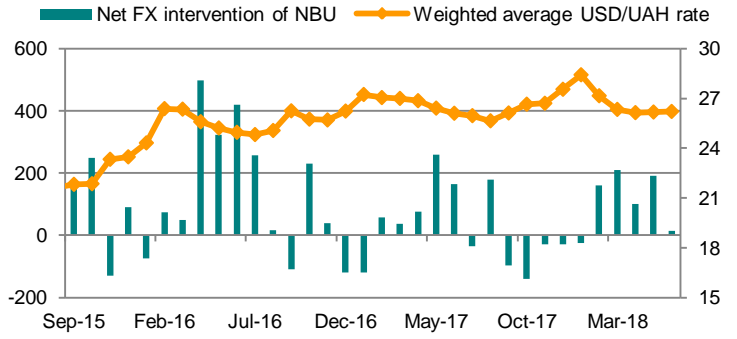
### Currency market

UAH exchange rate, UAH/USD



Source: Reuters

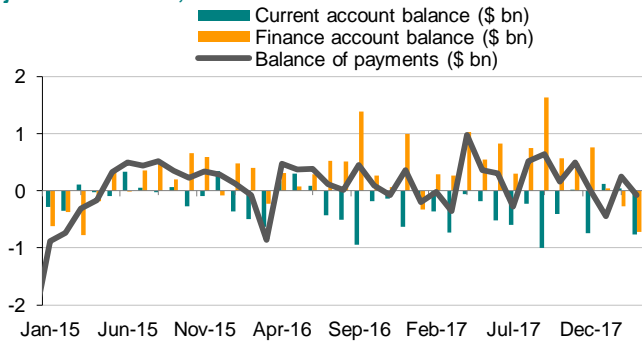
Net retail FX interventions of the NBU in 2015-2017, USDm



Source: NBU

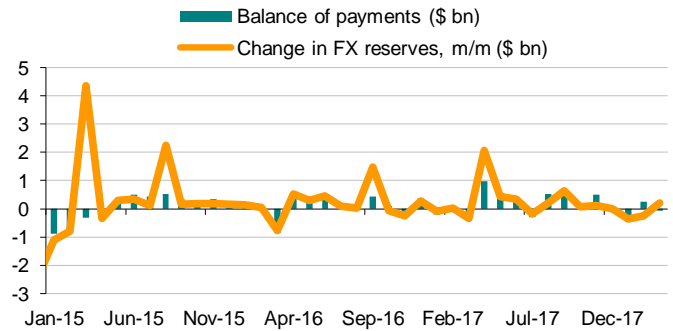
### Balance of payments

Major BoP accounts, USDbn



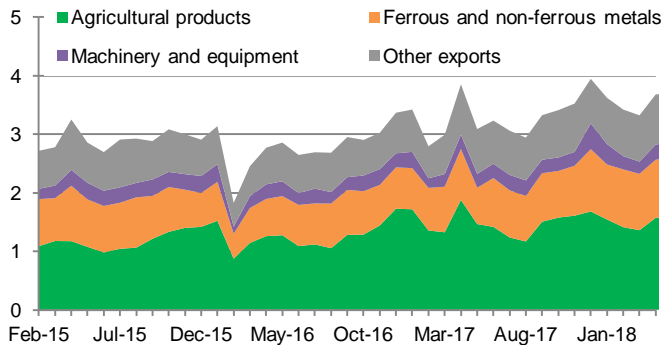
Source: NBU

BoP vs change in foreign reserves, USDbn



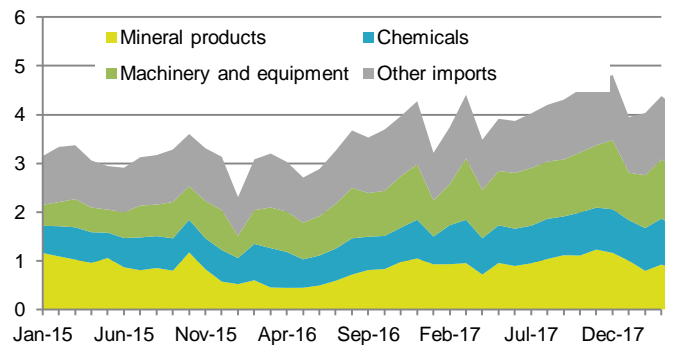
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU

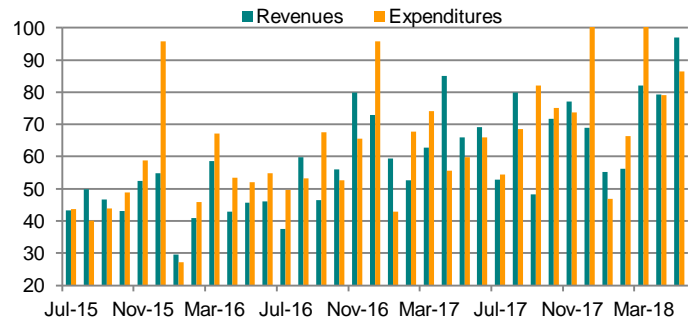


**Budget performance**

**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          |

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

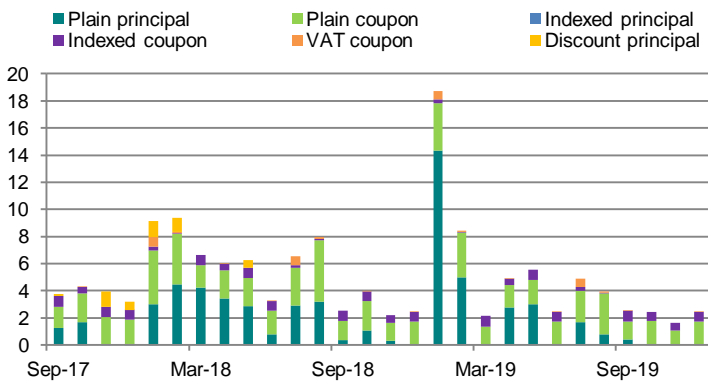


Source: NBU

Source: NBU, State Treasury

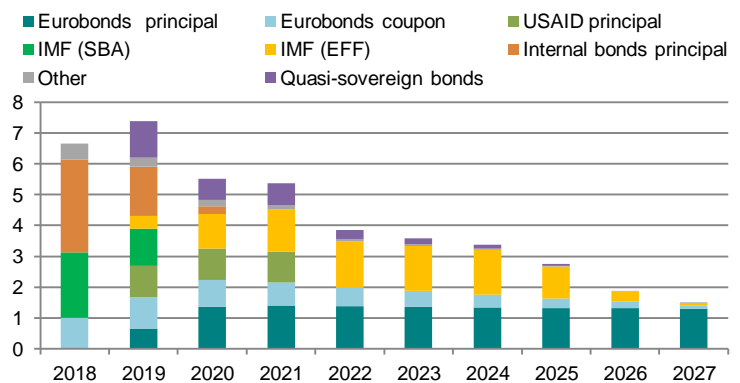
**Sovereign debt**

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



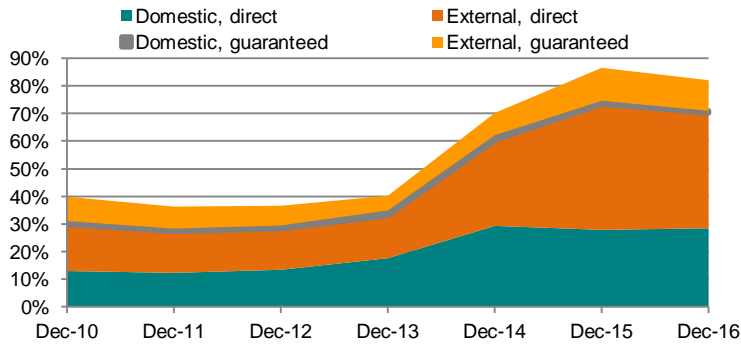
Source: NBU, UkrSibbank estimates

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



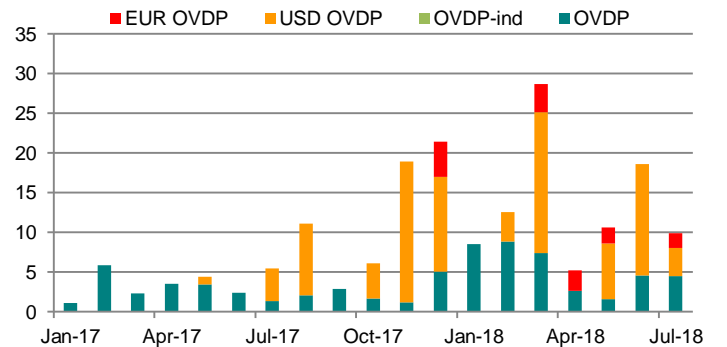
Source: Reuters, IMF, UkrSibbank estimates

**Total government debt, % GDP**



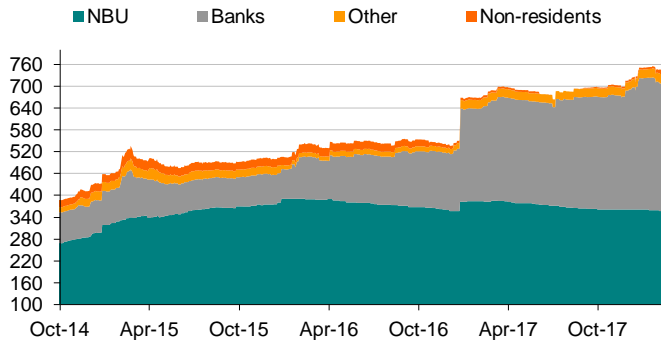
Source: MinFin

**Local borrowings, UAHbn equivalent**



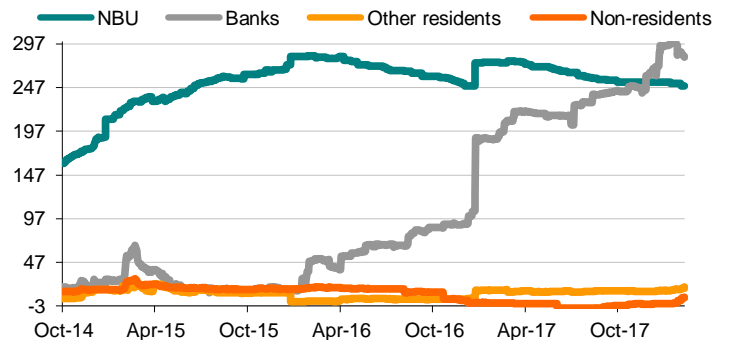
Source: NBU

**Outstanding OVDP owners structure, UAHbn**



Source: NBU

**Outstanding OVDP changes in holding, UAHbn**

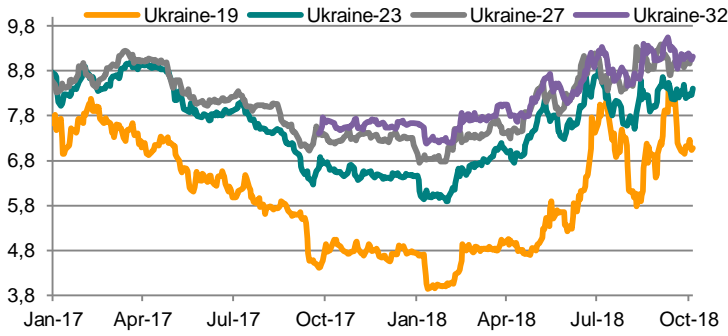


Source: NBU



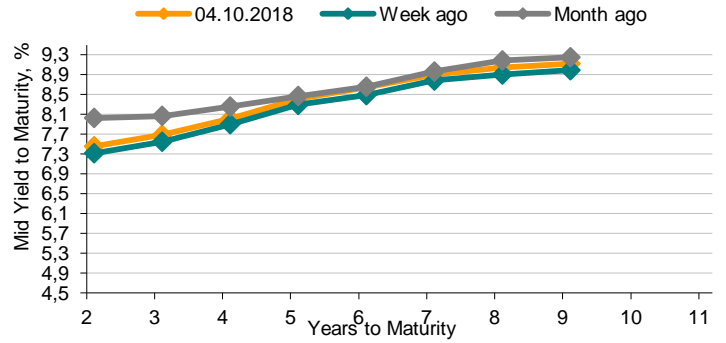
### Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

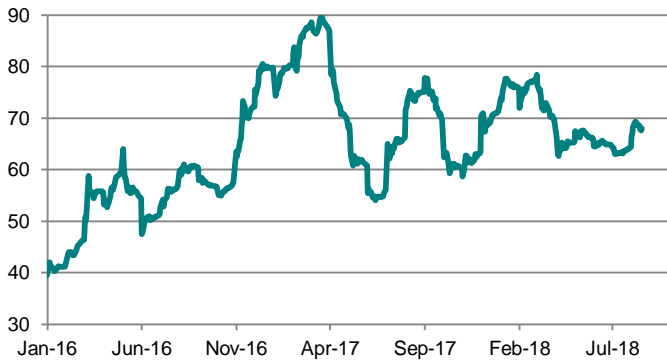
Ukraine's sovereign Eurobond yield curve



Source: Reuters

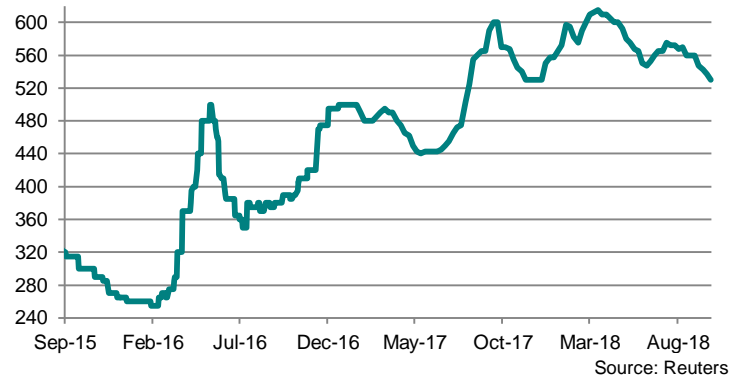
### Commodity markets

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



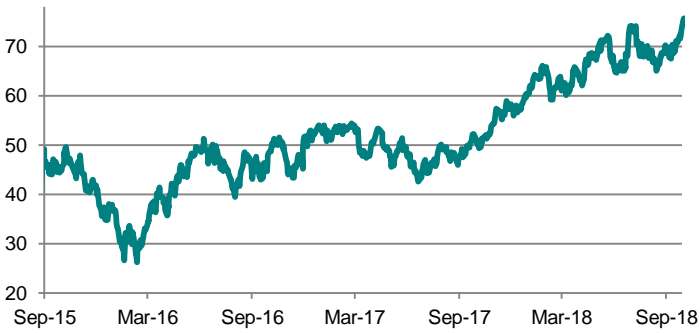
Source: Reuters

Steel CIS export HR coil, USD per ton



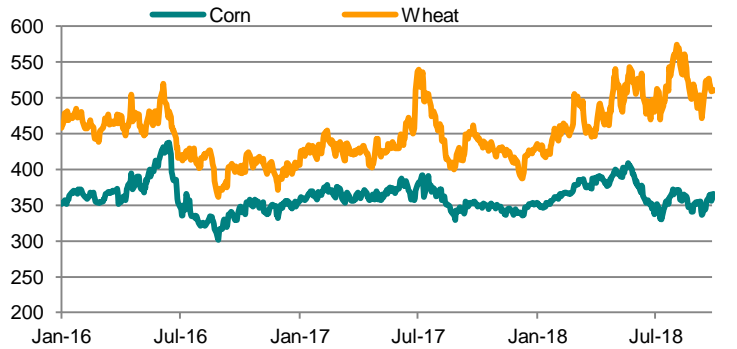
Source: Reuters

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  |
|--|-------|-------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| <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



## Contacts

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### Investment Business

**Serhiy Yahnych**

Head of Investment Business

(+38044) 537 5082 [serhii.yahnych@ukrsibbank.com](mailto:serhii.yahnych@ukrsibbank.com)

**Maksym Burynskyi**

Research Analyst

(+38044) 230 48 54 [maksym.burynskyi@ukrsibbank.com](mailto:maksym.burynskyi@ukrsibbank.com)

**Viktoriiia Nebeska**

Brokerage Local Securities & Custody Sales

(+38044) 201 22 74 [viktoriiia.nebeska@ukrsibbank.com](mailto:viktoriiia.nebeska@ukrsibbank.com)

**Platon Yachmenov**

Advisor Local Securities

(+38044) 230 48 54 [platon.yachmenov@ukrsibbank.com](mailto:platon.yachmenov@ukrsibbank.com)



### FX Business

**Oleksandr Duda**

Head of FX Sales

(+38044) 537 5002 [oleksandr.duda@ukrsibbank.com](mailto:oleksandr.duda@ukrsibbank.com)

### Corporate Business

**Ievgen Kulikov**

Head of MNC team

[ievgen.kulikov@ukrsibbank.com](mailto:ievgen.kulikov@ukrsibbank.com)

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