

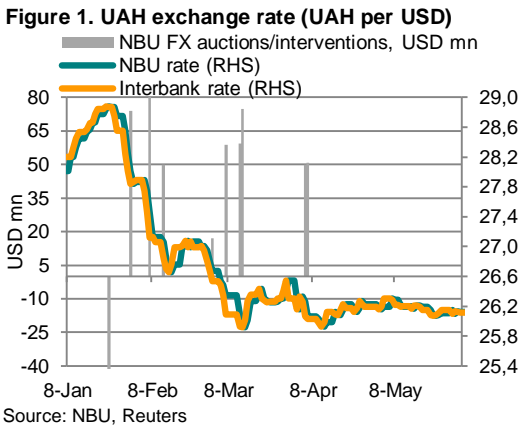


**This week in focus: Ukraine's CPI: lower for now, but upside risks remain**

In May, prices in Ukraine displayed zero growth on a monthly basis and this allowed CPI to go south to 11.7% y/y (from 13.1% y/y a month ago), in line with our expectations. The key disinflation driver is good weather, sending down CPI food components. And this trend is likely to continue during summer months. Still, we believe a lot of upside risks are still there, including risk of further increase in domestic government spending and adjustment of gas prices to satisfy IMF requirements. We retain our conservative end year CPI forecast at 10.9% and expect no change on upcoming MPC meeting July 12th.

*Please see page 3 for more details*

**FX and interest rates: Verchovna Rada adopted anticorruption law**



**USD/UAH closed at 26.14 as of Friday the 8<sup>th</sup>, slightly higher compared to a previous week, as hryvnia slightly weakened during the week.**

**Average daily FX volumes on the market amounted to the equivalent of USD 210.7mn, down by USD 13.8mn week-on-week.**

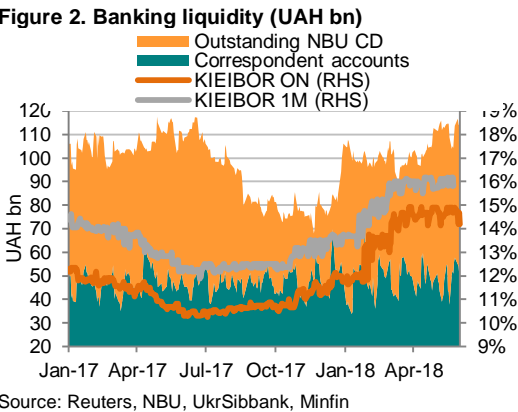
**NBU interventions resulted in net buying of foreign currency, amounting to USD 20mn during the week through matching.** At the same time, YTD reading were kept at USD 1.3bn in line with prior week.

**Aggregate banking liquidity amounted to UAH 115.9bn as of Friday the 8<sup>th</sup>, remaining flat week-on-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.

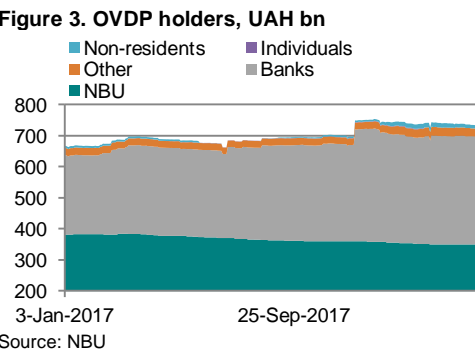
**On the latest primary auction the shortest bonds took the driving seat.** Namely, MoF managed to issue two placements of hryvnia denominated bonds with 3m and 6m maturity. At the same time both issues brought to the budget almost the same amounts of proceeds or roughly UAH 0.4bn. Demand on the shortest bonds amounted to almost UAH 1bn or roughly twofold the cap of UAH 0.5bn set on the placements. In regard to 6m bonds out of 8 only 7 bids were accepted by the MoF. At the same time the amount of demand and amount of proceeds to the budget were very close by volume. 3 USD denominated issues are to be redeemed in June totalling USD 541mn. Out of which, USD 103mn had been redeemed on June 6<sup>th</sup>. Meantime, the largest USD bond redemption remains on the horizon. On June 13<sup>th</sup> are to be redeemed bonds for a total USD 387mn. Moreover, on June 20<sup>th</sup> are to be redeemed USD bonds totalling USD 50mn.

**Currently, yields (bids) of local OVDP in UAH at 17.75% (for 6m), 17.70% (for 2Y).** 1Y USD bids were at 5.35%, while bids for VAT bonds were at 17.95%.



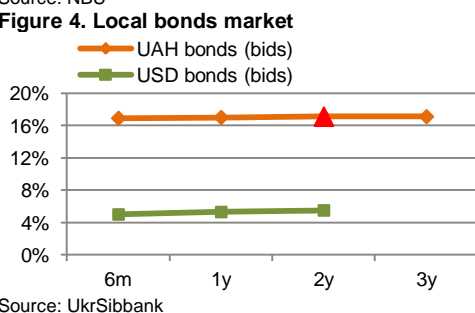
**Figure 5. OVDP auction combined results, 22<sup>th</sup> of May 2018**

CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size	Placement size
UAH	3m	17.44%	17.44%	17.44%	17.40%	17	17	911.6mn	438.8mn
UAH	6m	17.50%	17.41%	17.75%	17.20%	8	7	463.2mn	417.6mn
UAH	1y	-	-	17.50%	17.15%	3	0	68.6mn	-



**Ukraine took step toward establishing independent anti corruption court.** Namely, Ukraine's parliament adopted legislation that aims to establish an anti-corruption court on Thursday. It was previously one of the key requirements of the IMF to Ukraine for unlocking USD 2bn disbursement within EFF program.

**At the same time, Ukraine's Parliament also voted to dismiss the country's finance minister Oleksandr Danylyuk.** Danylyuk was fired on the recommendation of Prime minister Volodymyr Groysman, who had accused Danylyuk of spreading distorted information among international partners. The first deputy of the finance minister Oksana Markarova was approved as temporary Minister of Finance after Danylyuk dismissal.

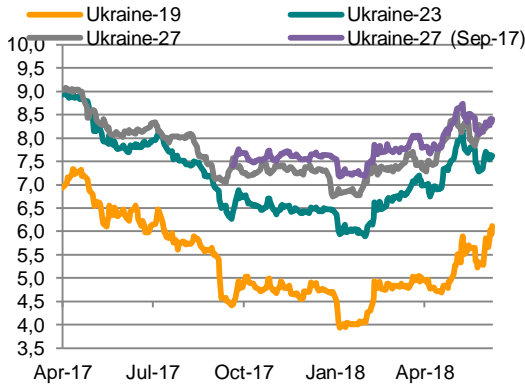




**Global markets:**

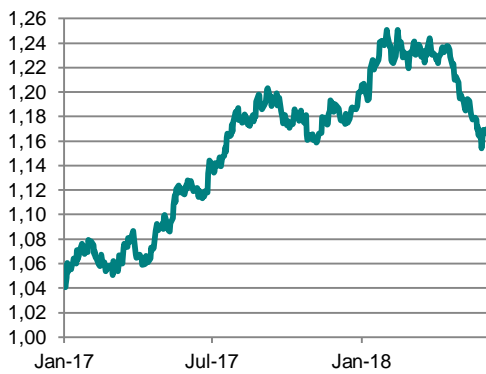
**Euro zone economy rose by 0.4% in 1Q 2018**

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



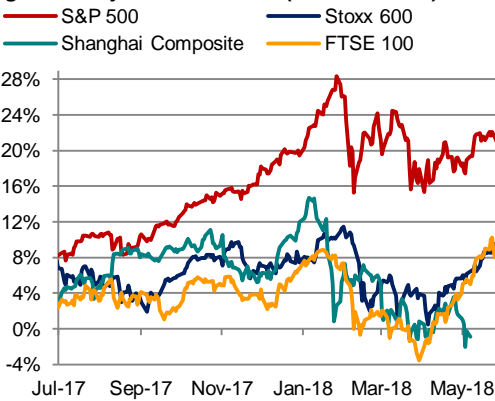
Source: Reuters

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



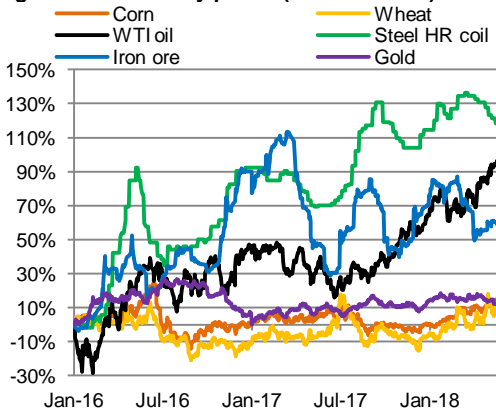
Source: Reuters

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



Source: Reuters

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



Source: Reuters

In the United States initial claims for state unemployment benefits fell by 1000 to a seasonally adjusted 222 000. Declined number of U.S. citizens filling for unemployment benefits indicated a further tightening in labor market. In Europe, the euro zone economy rose by 0.4% in the first three months of the year on a sequential basis. While Chinese trade surplus with a world narrowed in May, at the same time, it rose to USD 24.6bn with the United States from USD 22.2bn in April.

**Bond benchmarks fell**, with U.S. 10y Treasuries' yield higher by 4bp week-on-week gaining to 2.935%, while German 10y Bunds' yields increased by 7bp, landing at 0.45%, Japanese 10y bonds yield's ended the week at 0.042.

**The U.S. stock markets were on the rise during the week**, as S&P 500 increased week-on-week by 1.6%, while Nasdaq Composite gained slightly less by 1.4%.

**In the United States initial claims for state unemployment benefits fell by 1000 to a seasonally adjusted 222 000** for the week ended June 2, according to the Labor Department statement on Thursday. Declined number of U.S. citizens filing for unemployment benefits indicated a further tightening in labor market. Strong labor market and higher inflation supported expectations the Fed will hike interest rates on the next meeting scheduled on June-12-13<sup>th</sup> to prevent the United States economy from overheating. Moreover, market participants are widely priced in probability of the next hike on the next meeting, with a probability of 100%.

**EUR/USD rate landed at 1.1766 as of Friday the 8<sup>th</sup>**, higher compared to last week closing level of 1.166.

**Stoxx 600, a broader gauge of European equity performance fell by 0.5%**, while German Dax gained by 0.3% during the week.

**The euro zone economy rose by 0.4% in the first quarter on a sequential basis**, according to Eurostat reading revealed on Thursday. In prior quarter real GDP gained by 0.7% sequentially. This rate was in line with previous estimate released on May 15<sup>th</sup>. In the meantime, real GDP growth slowed to 2.5% on a year-over-year basis, following 2.8% reported a quarter ago. According to expenditure-side breakdown of GDP, household consumption gained by 0.5%. At the same time, government expenses were flat during the quarter. Meantime, gross fixed capital accumulation rose by 0.5%. It was lower than 1.3% increase reported in a quarter ago.

**While Chinese trade surplus with a world narrowed in May, at the same time, it rose to USD 24.6bn with the United States** from USD 22.2bn in April, based on the customs data, amid the backdrop on trade negotiations between two countries. Moreover, exports rose by 12.6% y/y in May, while imports advanced by 26% y/y on the bedrock of higher oil and other commodity prices. At the same time, the strong export reading in May was also partly due to ongoing trade tensions with companies made orders while they still can.

**Crude oil prices declined**, as WTI futures declined by 0.1% week-on-week and closed at USD 65.7 per barrel, while Brent 1m futures declined even stronger by 0.4% closing at USD 76.5 per barrel.

**Gold prices increased**, as NYMEX 1m futures slightly gained by 0.3% week-on-week and finished the week at USD 1298.1 per troy ounce.

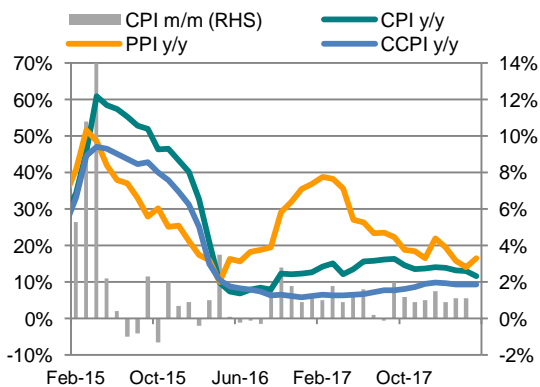
**Grains were falling**, as CBOT Corn 1m futures fell 3.5% week-on-week and closed at USD 377.8 per bushel, while CBOT Wheat 1m futures landed at USD 520.0 per bushel, decreasing by 0.6%.

**Iron ore rose** as NYMEX Iron ore 62% Fe 1m futures rose slightly by 0.3% week-on-week and closed at USD 64.8 per ton.



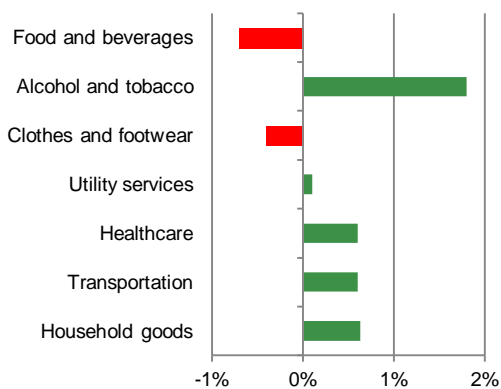
**This week in focus: Ukraine CPI: lower for now, but upside risk remain**

**Figure 9. Inflation rates in 2015-2018**



Source: Ukrstat

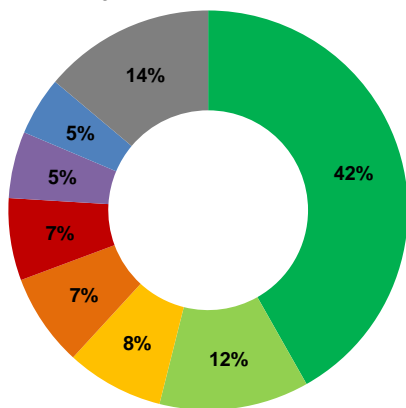
**Figure 10. Price changes in selected categories, May 2018, % m/m**



Source: Ukrstat

**Figure 11. CPI basket**

- Food and beverages
- Alcohol and tobacco
- Healthcare
- Household goods
- Transportation
- Utility services
- Clothes and footwear
- Other



Source: Ukrstat

In May, prices in Ukraine displayed zero growth on a monthly basis and this allowed CPI to go south to 11.7% y/y (from 13.1% y/y a month ago), in line with our expectations. The key disinflation driver is good weather, sending down CPI food components. And this trend is likely to continue during summer months. Still, we believe a lot of upside risks are still there, including risk of further increase in domestic government spending and adjustment of gas prices to satisfy IMF requirements. We retain our conservative end year CPI forecast at 10.9% and expect no change on upcoming MPC meeting July 12th.

**Food prices posted -0.7 m/m decline in May, following 1.1% m/m gains in April.** Meantime, on a year-on-year basis prices comprised 13.7% y/y, down from 17.2% y/y a month ago. During the month food basket was dragged down by vegetables (-2.9% m/m), fruits (-1.1% m/m), meat (-0.2% m/m), milk (-2.5% m/m) and sugar (-2.2% m/m). **Usually deflation coming primarily from such raw foods components as vegetables and fruits was more common in the months of summer, but in 2018 this happened earlier.** We also expect that deflation from food CPI component to continue being in the driving seat with effect lasting for several months.

**No change in utilities (+0.1% m/m), with 12 month reading slightly falling to 4.9% y/y,** following 5.6% y/y gain in April. Adoption of anticorruption court recently, paves the way to unlocking IMF disbursements. The only existing impediment remains household gas prices. In our opinion, this question will be resolved very soon, which most likely could accelerate to some extent inflation in the country by the end of the year (as heating season starts), **we expect impact on inflation of ca. +1% in annual terms.**

**Transportation prices rose by 0.6% m/m, bringing 12 month reading to 13.7% y/y.** Fuel price increase by about 0.8% m/m, coupled with railway and auto transportation passenger services increases in prices by 0.5% m/m and 0.7% m/m, respectively were behind slight advance in transportation subcategory prices (with slight acceleration to 13.7% (from 13.6% y/y) on a year-over-year basis). **Potential impact stemming from rising oil prices represents one of serious upside risks, also in the second round effects.**

**Core inflation delivered 0.2% m/m gains in May,** following 0.6% m/m reported in April. Having proved resilience for remaining intact at 9.4% y/y for 2 months in April and March, core inflation slightly climbed down in May. In particular, on a year-on-year basis core inflation broke 9.4%, landing at 9.3% y/y during the month.

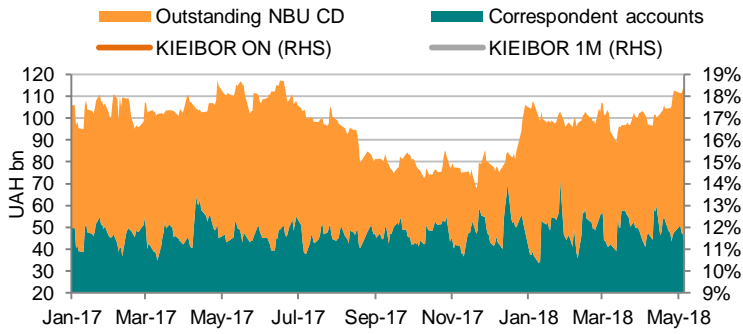
Having grown by 0% on a monthly basis in April, **production prices slightly turned to a growing mode in May, as prices increased by 0.6% m/m.** Factory gate prices increased to 16.5% y/y, following reading of 14.1% y/y reported a month ago. Despite high volatility in the mining segment performance, prices in manufacturing (which is bound to be less volatile) were supported by increased prices of sugar by 2.2% m/m and in utilities sector with prices growing by 3.1% m/m.

**Meantime, we see headwinds in the 2nd half of the year (increase in budget spending through primarily higher wages before elections in the next year), provided the resignation of Finance Minister who was not highly vocal supporter of wages excess growth (especially amid higher budget deficit in 4M 2018 vs 4M 2017) .**



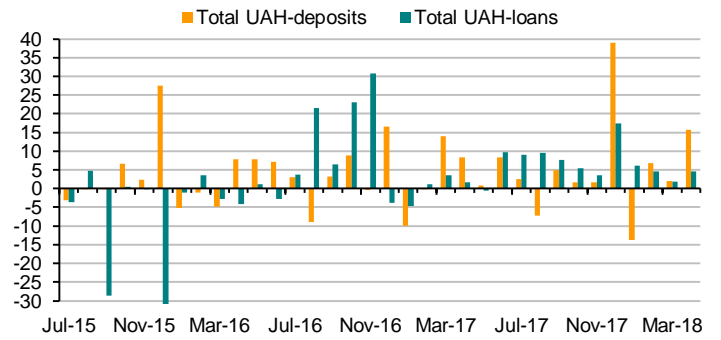
### Money market

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



Source: Reuters, NBU, UkrSibbank estimates

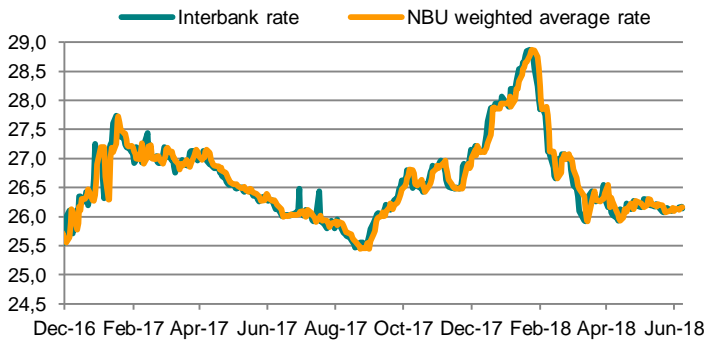
#### Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

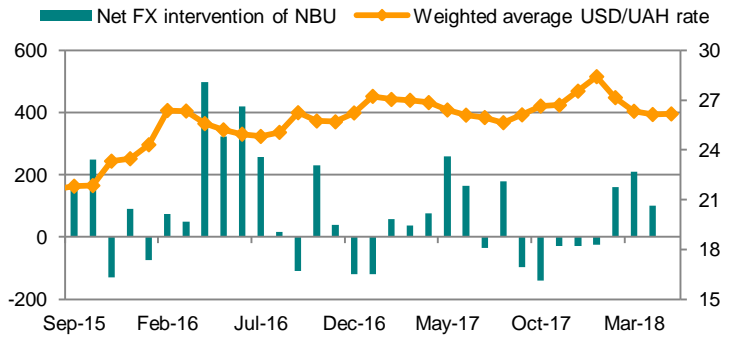
### Currency market

#### UAH exchange rate, UAH/USD



Source: Reuters

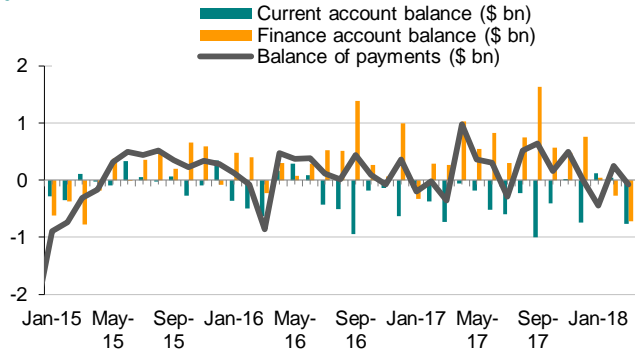
#### Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

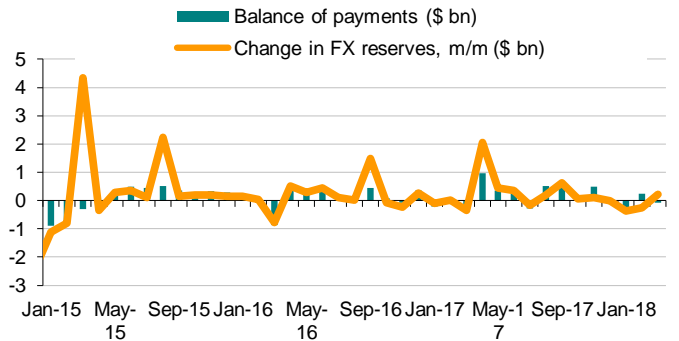
### Balance of payments

#### Major BoP accounts, USDbn



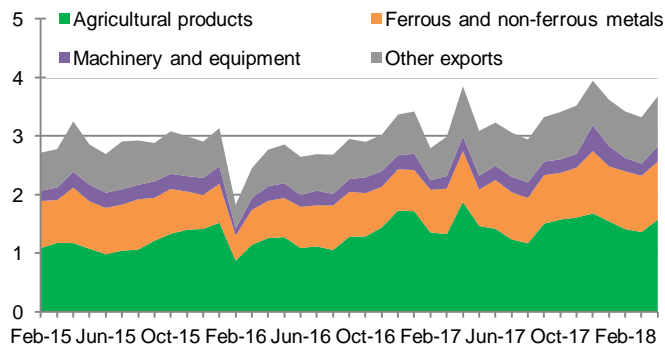
Source: NBU

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



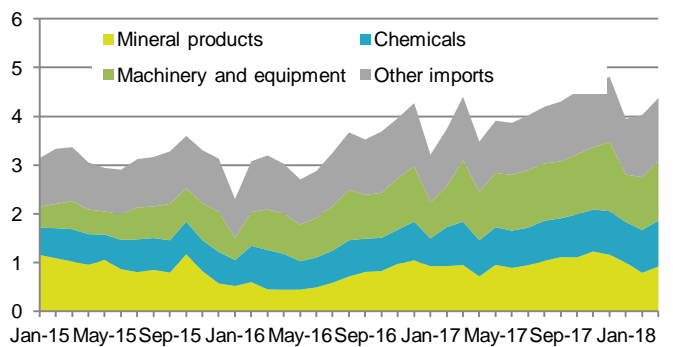
Source: NBU

#### Exports components dynamic, USDbn



Source: NBU

#### Imports components dynamic, USDbn



Source: NBU

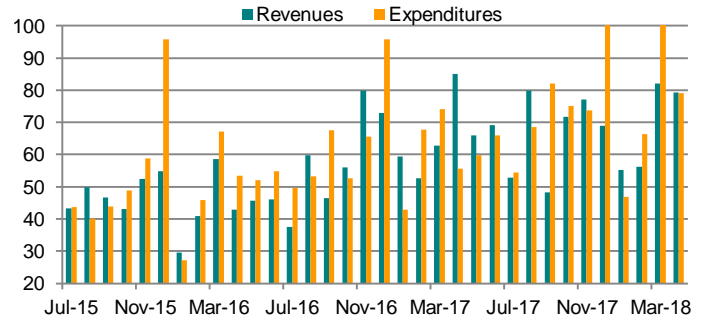


**Budget performance**

**Budget performance, UAHbn**

	Jan – Apr 2017	Jan - Apr 2018
<b>Budget revenues</b>	<b>259,8</b>	<b>272,8</b>
VAT proceeds	140,6	77,5
Corporate income tax	14,1	30,0
<b>Budget expenditures</b>	<b>240,2</b>	<b>293,4</b>
Deficit / Surplus	19,5	-20,6

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

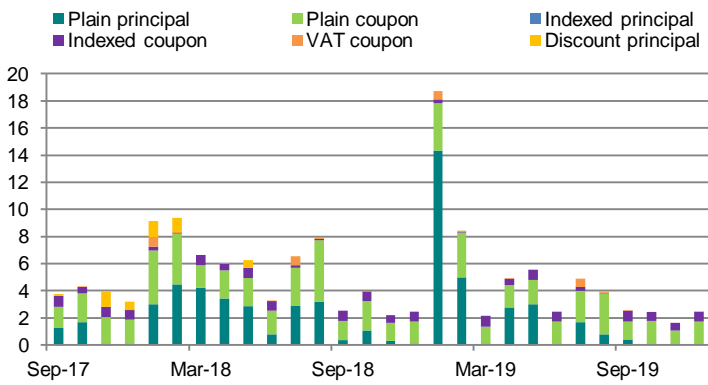


Source: NBU

Source: NBU, State Treasury

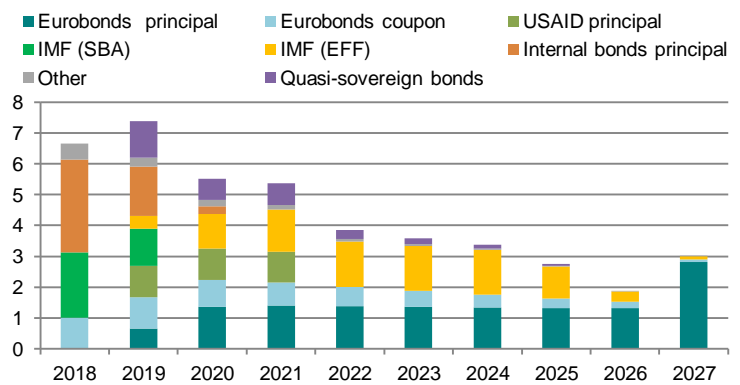
**Sovereign debt**

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



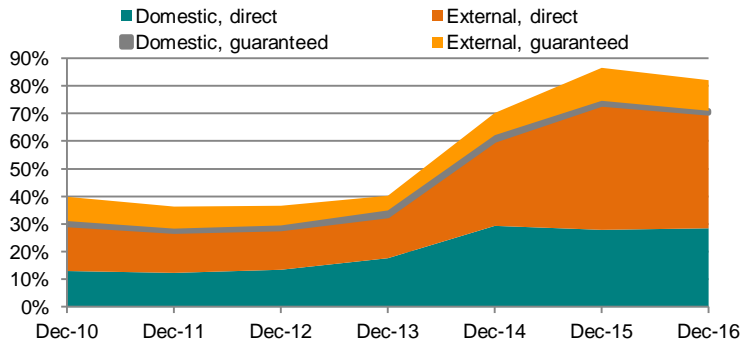
Source: NBU, UkrSibbank estimates

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



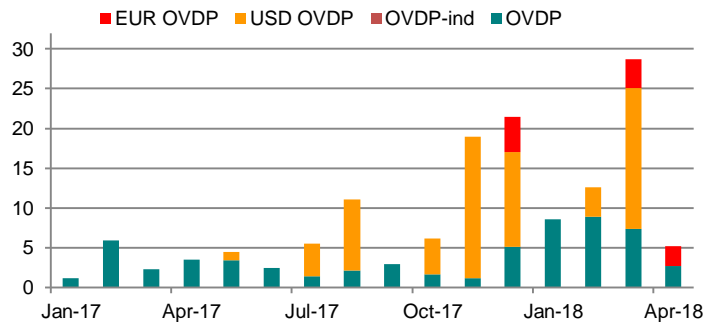
Source: Reuters, IMF, UkrSibbank estimates

**Total government debt, % GDP**



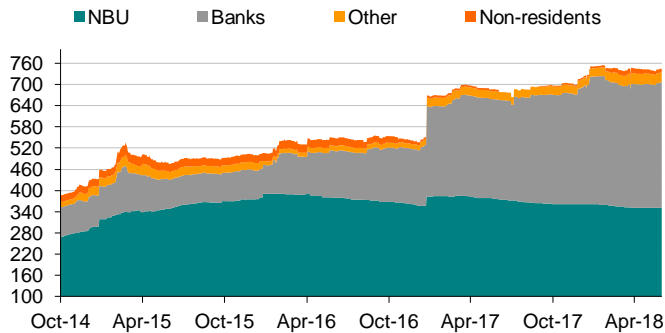
Source: MinFin

**Local borrowings, UAHbn equivalent**



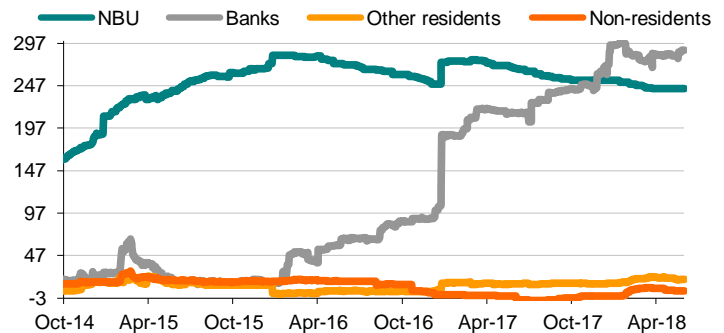
Source: NBU

**Outstanding OVDP owners structure, UAHbn**



Source: NBU

**Outstanding OVDP changes in holding, UAHbn**

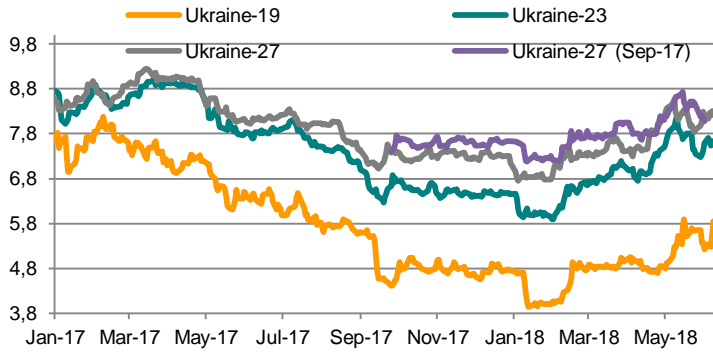


Source: NBU



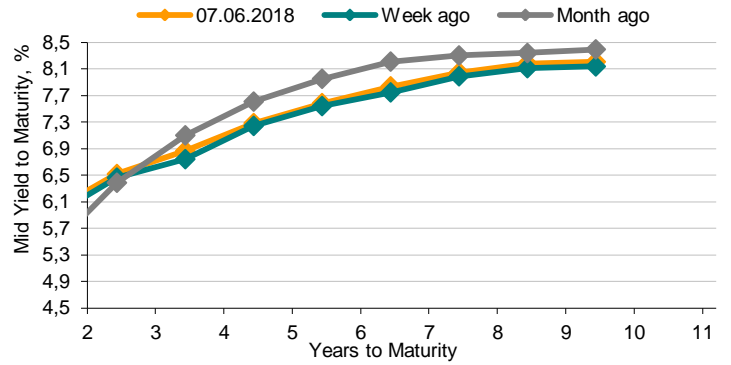
### Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

Ukraine's sovereign Eurobond yield curve



Source: Reuters

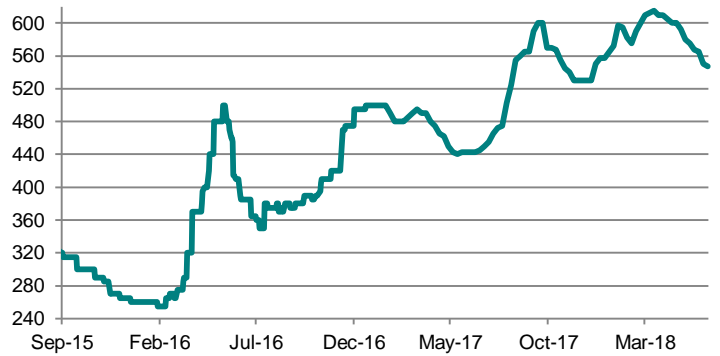
### Commodity markets

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



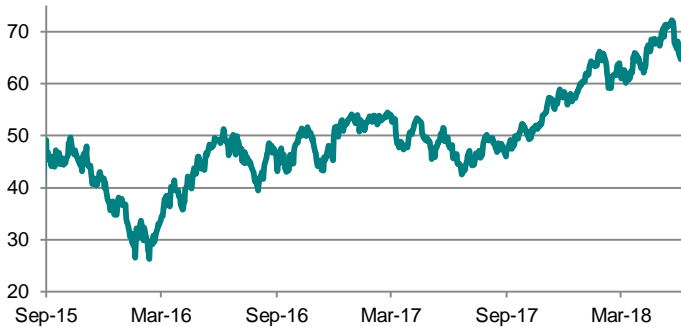
Source: Reuters

Steel CIS export HR coil, USD per ton



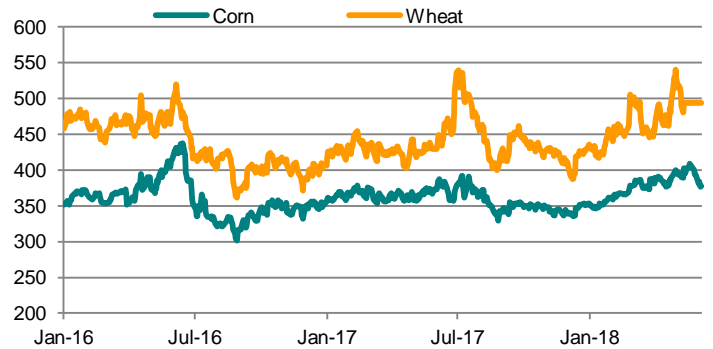
Source: Reuters

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	3.1
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	2982.9	3239.8
Nominal GDP (USD bn)	178.9	112.8	136.1	163.1	175.8	183.5	133.7	91.2	93.1	112.1	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	71.8	70.0
<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	-3.3
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	-2.8
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	17.00*
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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