



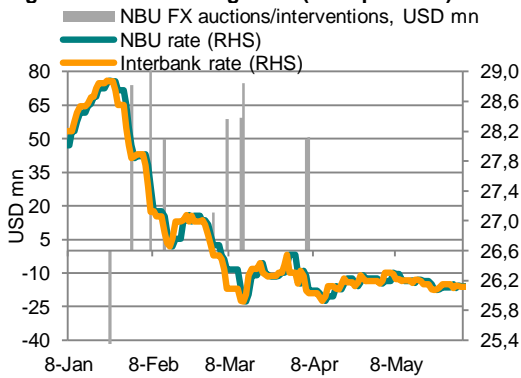
This week in focus: Growth in Q1 meets expectations

Ukrstat confirmed that Ukrainian economy advanced by 3.1% y/y in 1Q 2018. We expect that growing wages will offset current slowdown in retail sales and secure stronger reading by the end of the year. We keep our Ukraine's GDP forecast at 3.1% y/y in 2018.

Please see page 3 for more details

FX and interest rates: Verchovna Rada adopted currency law

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH closed at 26.24 as of Friday the 22nd, slightly lower compared to a previous week, as hryvnia slightly strengthened during the week.

Average daily FX volumes on the market amounted to the equivalent of USD 238.6mn, up by USD 36.5mn week-on-week.

NBU interventions resulted in net selling of foreign currency, amounting to USD 3.5mn during the week. NBU utilized two instruments conducting its interventions during the week. First, NBU sold USD 33.5mn via its the most popular tool matching, which market the second time when regulator sold FX via matching since the week ending April 13th. Second, central bank also managed to buy USD 30mn via single currency tool, which is the more often takes back seat comparing to matching. In the meantime, YTD reading landed at USD 1.3bn in line with a week ago.

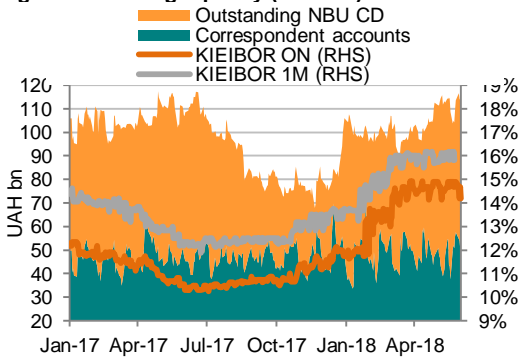
Aggregate banking liquidity amounted to UAH 113.2bn as of Friday the 22nd, remaining flat week-on-week. At the same time, refund of value added tax during the June landed only at UAH 3.1bn, as of the end of June 22th. Given the scale of refund in previous months, we should be ready to see VAT reimbursement acceleration in the last three working days of June, which could bring liquidity higher and slightly weaken hryvnia currency rate on short term basis.

Money market rates remained flat: cost of ON funds is around 14.0/16.00, 1 week is 14.5/16.50 while 1M is 15.00/17.50, according to our calculations.

Primary auction attracted UAH 9.5bn to the budget. Out of that, more than 80% were attracted through government fixed income instruments denominated in hard currency. In particular, MoF placed three USD bonds, with 9m, 1y and 2y maturity at a cut off rate 5.20-5.40% satisfying almost all demand as measured by volume. At the same time, MoF issued the same number of bonds denominated in hryvnia. While MoF restrained the maximum amount of hryvnia bonds with 3m maturity by UAH0.5bn, the demand by far fell short of this target, amounting only UAH 0.1bn instead. During previous week, USD bond totalling USD 50mn was redeemed, resulting in aggregate USD 541mn redemption of USD bonds during June.

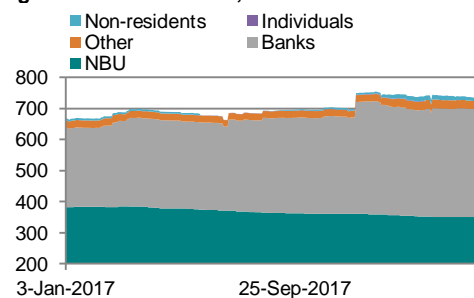
Currently, yields (bids) of local OVDP in UAH at 17.75% (for 6m), 17.70% (for 2Y). 1Y USD bids were at 5.35%, while bids for VAT bonds were at 17.95%.

Figure 2. Banking liquidity (UAH bn)



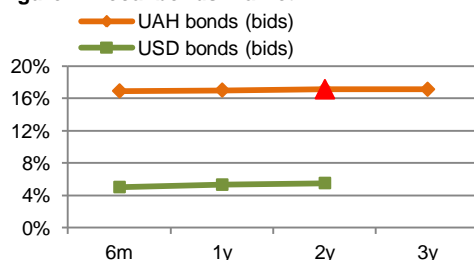
Source: Reuters, NBU, UkrSibbank, Minfin

Figure 3. OVDP holders, UAH bn



Source: NBU

Figure 4. Local bonds market



Source: UkrSibbank

Figure 5. OVDP auction combined results, 19th of June 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	17.43%	17.41%	17.43%	17.40%	5	5	135.0mn	130.2mn
UAH	6m	17.50%	17.41%	17.75%	17.20%	8	7	463.2mn	417.6mn
UAH	9m	17.29%	17.29%	17.30%	17.25%	4	3	421.6mn	370.7mn
USD	9m	5.20%	5.20%	5.30%	5.20%	10	7	167.5mn	161.7mn
USD	1y	5.40%	5.40%	5.50%	5.40%	9	7	73.6mn	60.3mn
USD	2y	5.40%	5.40%	5.65%	5.40%	13	13	83.0mn	83.2mn

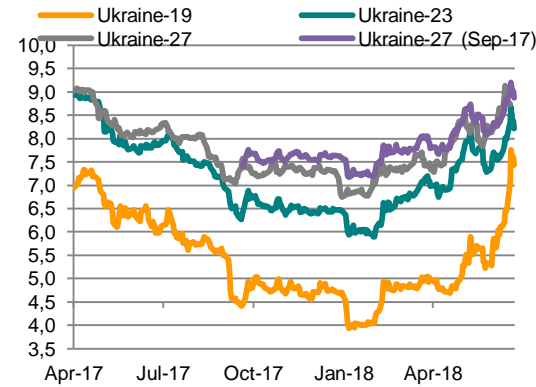
Ukraine's parliament adopted Currency law in prior week in the second vote and in full. The law aimed to replace a number of obsolete legislative documents adopted since Ukraine became independent. Yakiv Smolii said previously that law creates comfortable, transparent and safe conditions for doing business in Ukraine, opening doors to foreign investors. Adoption of the law acts a crucial milestone in the road map developed by the NBU on currency liberalization.



Global markets:

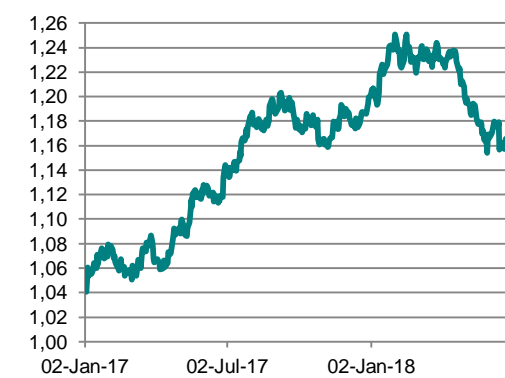
U.S. job market showed further sign of tightening

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



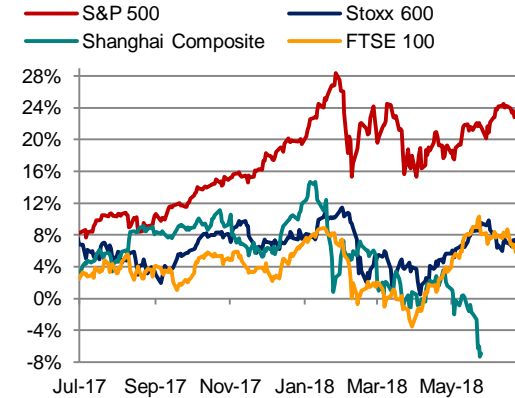
Source: Reuters

Figure 6. EUR USD spot (mid)



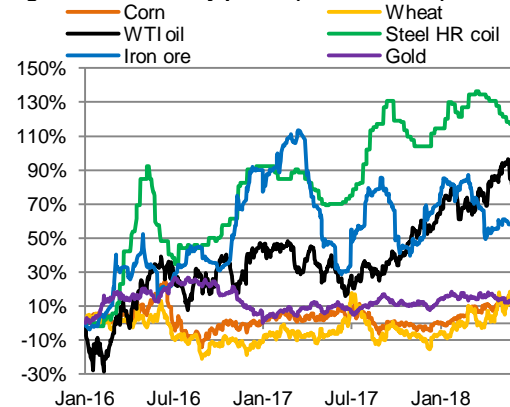
Source: Reuters

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



Source: Reuters

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



Source: Reuters

The number of Americans filing for unemployment benefits fell last week, showing a further tightening of labor market in the country. Meantime, International Monetary Fund is likely to revise down its growth forecasts of the euro zone, stemming mainly from the risk of trade war, according to Christine Lagarde recent statements. China's officials accused the United States of being capricious over bilateral trade issues.

Bond benchmarks advanced, with U.S. 10y Treasuries' yield lower by 2bp week-on-week lowering to 2.9%, while German 10y Bunds' yields fell by 7bp, landing at 0.33%, Japanese 10y bonds yield's ended the week at 0.032.

The U.S. stock markets fell during the week, as S&P 500 decreased by 0.9%, while Nasdaq Composite declined by 0.7% week-on-week. The S&P advanced on Friday, with energy stocks surging as OPEC's plans to boost output less than some investors had anticipated.

The number of Americans filing for unemployment benefits fell last week, showing a further tightening of labor market in the country. The strong labor market most likely will pave the way for the Federal Reserve to raise interest rates two times this year, out of 4 in 2018. According to the Labor Department, initial claims for state unemployment benefits decreased 3000 to a seasonally adjusted 218 000 for the week ended June 16th. In the meantime, claims fell for four consecutive week in a row. At the same time, the jobless rate remains at 18-year low of 3.8%.

EUR/USD rate landed at 1.1655 as of Friday the 22nd, higher compared to last week closing level of 1.1607.

Stoxx 600, a broader gauge of European equity performance fell by 1.1%, while German Dax tumbled by 3.3% during the week.

International Monetary Fund is likely to revise down its growth forecasts of the euro zone, amid higher risk from trade. Christine Lagarde said that the revision most likely to be modest, without sharp declines. She also emphasized that the main reasons for the likely revision were the risks of a global trade war exacerbated by Brexit talks and Italy's plans to increase public spending. Christine Lagarde especially noticed that the risk of trade tensions initiated by tariff increase on steel and aluminum by the United States were the first reason for concern. The lack of progress in regard of Brexit also was mentioned as the second biggest risk to the Euro zone growth.

China's commerce ministry on Thursday accused the United States of being capricious over bilateral trade issues, warning that the interests of U.S. workers and farmers will be hurt by Washington. Investors became more nervous this week about possibility of a full-blown trade war due to increasingly sharp rhetoric between the United States and China. Chinese state media said on Friday that U.S. protectionism was self-defeating and "symptom of paranoid delusions" that must not distract China.

Crude oil prices gained, as WTI futures rose by 5.4% week-on-week and closed at USD 68.6 per barrel, while Brent 1m futures increased slightly weaker by 2.9% closing at USD 75.6 per barrel.

Gold prices were lower, as NYMEX 1m futures slightly tumbled by 0.6% week-on-week and finished the week at USD 1267.4 per troy ounce.

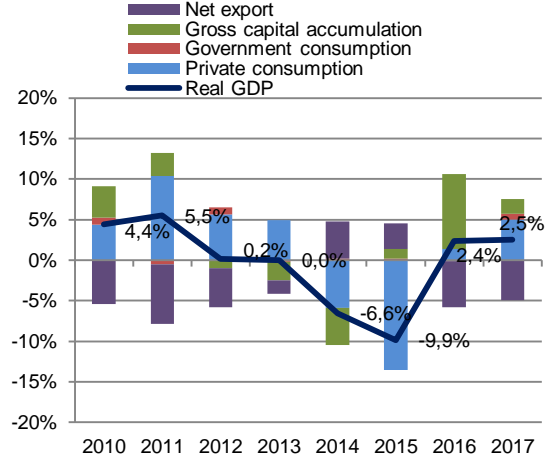
Grains were falling, as CBOT Corn 1m futures fell 1.1% week-on-week and closed at USD 357.3 per bushel, while CBOT Wheat 1m futures landed at USD 491.3 per bushel, decreasing meaningfully by 1.7%.

Iron ore decreased as NYMEX Iron ore 62% Fe 1m futures rose slightly by 0.8% week-on-week and closed at USD 64.9 per ton.



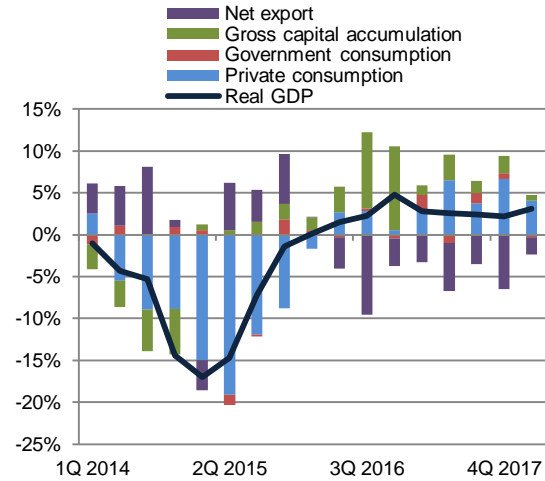
This week in focus: Growth in Q1 meets expectations

Figure 9. Ukraine's real GDP growth in 2010-2017



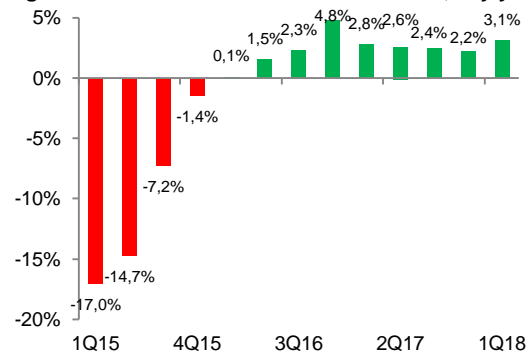
Source: Ukrstat

Figure 10. Ukraine's real GDP quarterly growth in 2014-2018



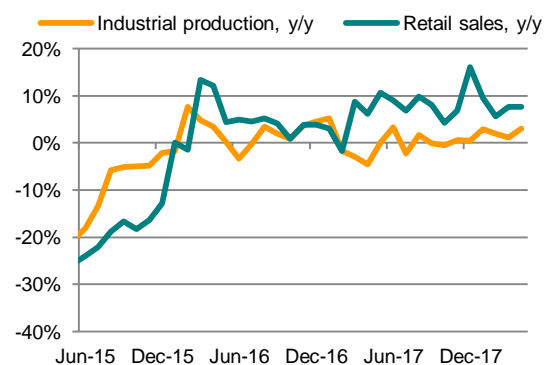
Source: Ukrstat

Figure 11. Ukraine's real GDP in 2015-2017, % y/y



Source: Ukrstat

Figure 11. Industrial production and retail sales in 2015-2018, % y/y



Source: Ukrstat

Ukrstat confirmed that Ukrainian economy advanced by 3.1% y/y in 1Q 2018. We expect that growing wages will offset current slowdown in retail sales and secure stronger reading by the end of the year. We keep our Ukraine's GDP forecast at 3.1% y/y in 2018.

Having grown by 10.7% y/y in 4Q 2017, private consumption posted less gains in 1Q 2018, increasing by only 5.6% y/y. While the pace of expansion of the main Ukrainian GDP driver almost halved on y/y basis in 1Q 2018 vs 4Q 2017, aggregate real GDP reading managed to post 3.1% y/y growth in 1Q 2018, beating 2.8% y/y growth reached in 4Q 2017. Meantime, **gross capital accumulation rose by only 5.8% in 1Q 2018**, down compared to both 1Q 2017 (9.7% y/y) and 4Q 2017 (9.2% y/y). More importantly gross capital accumulation of fixed assets increased by 17% y/y. One key takeaway stressed by the latest Ukrstat GDP reading was that investments were slightly hit in Q1. It's interesting that previously Ukrstat reported that in Ukraine capital investments showed strong signs of acceleration with growth reaching 37% y/y in 1Q 2018 (vs 21.4% y/y in 1Q 2017). In our opinion, that was mainly due to accelerated prices in the country. Accordingly, deflator increased by around 60% in 1Q 2018 vs 1Q 2017, which mislead initially surprising all on the upside (without data on hand available now). But in constant prices it's clearly visible that investments merely edged lower, landing at 17.0% y/y in latest quarter. Given high comparative base in previous year and the fact that the country is moving closer to political elections in next year (which kick off a period of uncertainty in the country without clear boundaries), the declining investments look absolutely logical in such environment. Moreover, we expect to see even lower growth in the second half of the year.

In regard to **aggregate gross capital formation component of GDP there was also another force which moved it much lower in 1Q 2018** vs especially 1Q 2017 and 4Q 2017. The scale of decline of gross capital accumulation was exacerbated by declining inventories in the country, especially gas and grain inventories. The winter in 2018 was much longer comparing to the same period a year ago. As a consequence, Ukraine burned a larger amount of gas during the heating season (especially part of the season lasting in 2018 year) and thus country spent more reserves compared to a year ago. At the same time, in 1Q 2018 inventories of grains were seasonally reduced, in sharp contrast to 3Q when a reverse process is gaining traction.

Government sector also showed weaker performance, as **government consumption tumbled by 1.4% y/y**, slicing some amount GDP growth in 1Q 2018 (while in prior quarter the contribution was positive at 3.2% y/y, with a 1Q 2017 being even higher at 7.9% y/y). According to the latest data, government reduced amount of subsidies meaningfully in the first months of 2018, comparing to the same period a year ago. The component of social welfare, which is one of the most important by weight in the government consumption, took the top spot in 1Q 2018, with weight accounting for one fourth of aggregate government consumption component of GDP, causing government consumption to decline.

Last but not least, **trade performance was meaningful driver of higher GDP growth in 1Q 2018, as deficit of goods and services was lower**, according to Ukrstat, slicing less GDP growth comparing to previous quarter. Having broken a two quarter string of gains with average growth around 8%, exports fell by 9.9% y/y in 1Q 2018. At the same time, the only major component which supported 3.1% GDP reading in the last quarter was decline in imports. While imports advanced by 20.2% y/y in 4Q 2017, it posted a moderate decline of 5.4% y/y in 1Q 2018, resulting in lower net exports negative contribution during the latest quarter and slicing less GDP growth than previously. While net exports kept the 8 quarter string of decline, with 1Q 2018 print improving moderately, at the same time it posted the smallest negative contribution to real GDP growth since 1Q 2016, according to our calculations.

Retail sales reading delivered 5.2% gains in May 2018, following 7.6% increase in April. At the same time, on y/y basis the reading nosedived to 6.1% YTD May, down from 7.0% YTD in April. The latest available data about wage growth showed that nominal wages increased by 27.3% (effective April 2018), accelerating from 24.1% y/y reached previously. Meantime, real wage growth followed suit and accelerated to 12.5% y/y in April, up from 9.5% y/y growth reached a month ago.

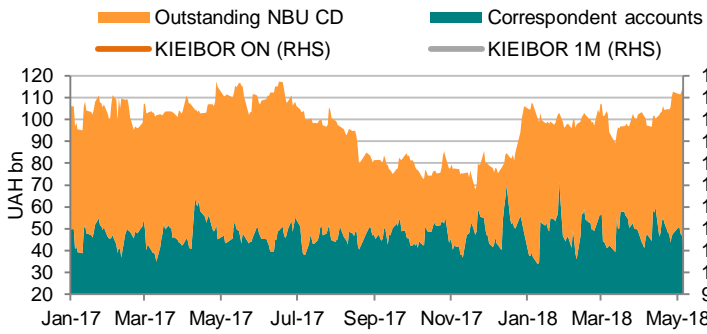
According to statements of Vice Prime Minister Pavlo Rozenko, around 1mn people are going to receive higher pensions since July 1st, 2018. In the meantime, the next increase is scheduled to be on December 2018. The July's increase will be more meaningful for those pensioners who obtain minimum pension. According to Vice Prime Minister statements, minimum pensions will be increased to UAH 1436 from UAH 1373 effective July 1st. He also said that UAH 4200 minimum wage is real for Ukraine in this year, in contrast to prior rhetoric from Ministry of Finance.

We expect that higher minimum wage will offset current slowdown and secure stronger retail sales reading by the end of the year, provided resignation of top Ministry of Finance officials and reversal of rhetoric about availability of minimum wage increase. Despite recent slowdown, our latest forecast of 7.0% y/y growth in retail sales in 2018 looks feasible, and we keep it unchanged.



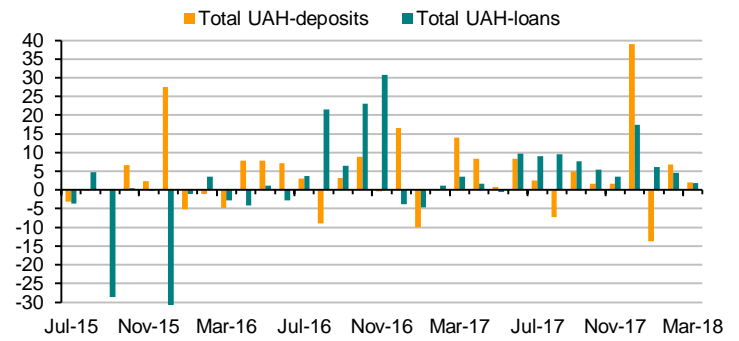
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

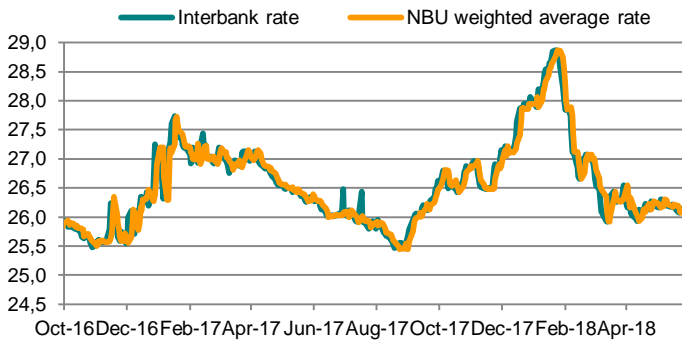
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

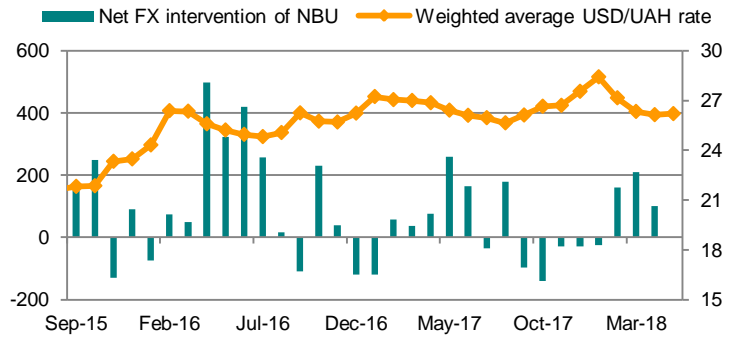
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

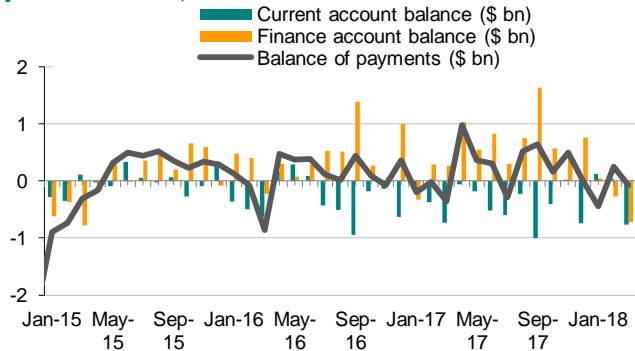
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

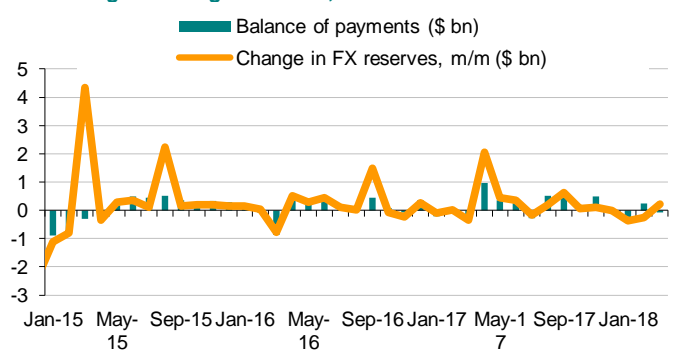
Balance of payments

Major BoP accounts, USDbn



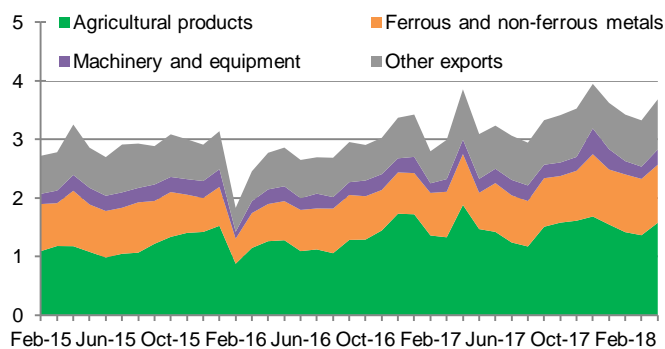
Source: NBU

BoP vs change in foreign reserves, USDbn



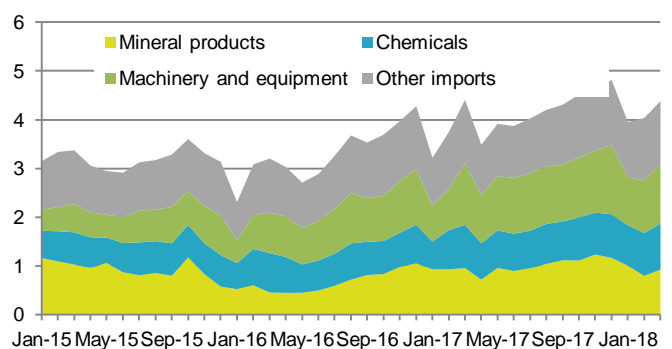
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU



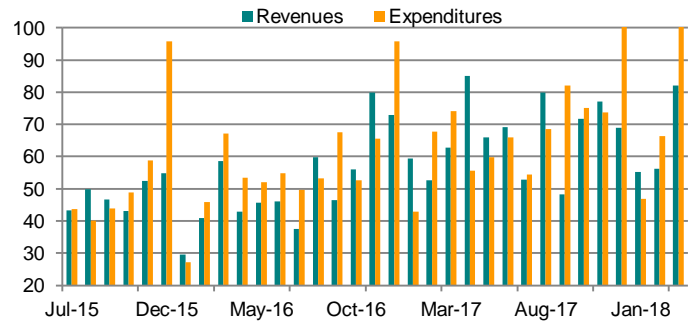
Budget performance

Budget performance, UAHbn

	Jan – Feb 2017	Jan - Feb 2018
Budget revenues	112,0	111,4
VAT proceeds	35,3	36,0
Corporate income tax	8,8	7,4
Budget expenditures	110,6	113,2
Deficit / Surplus	1,5	-1,8

Source: NBU

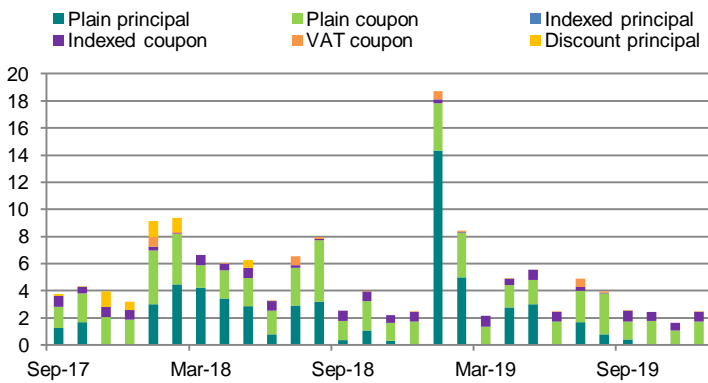
Monthly change in budget revenues and expenditures, UAHbn



Source: NBU, State Treasury

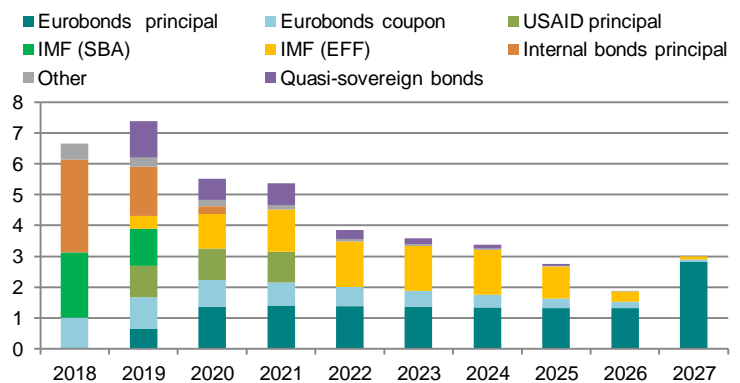
Sovereign debt

UAH- denominated debts' repayments schedule, UAHbn



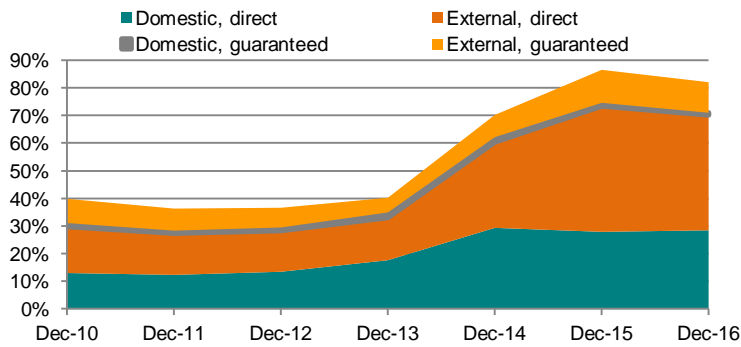
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



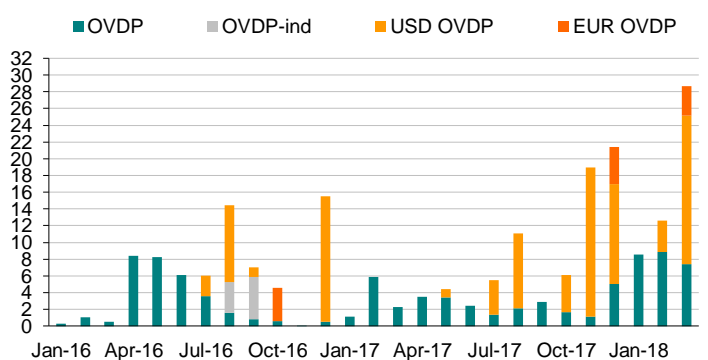
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



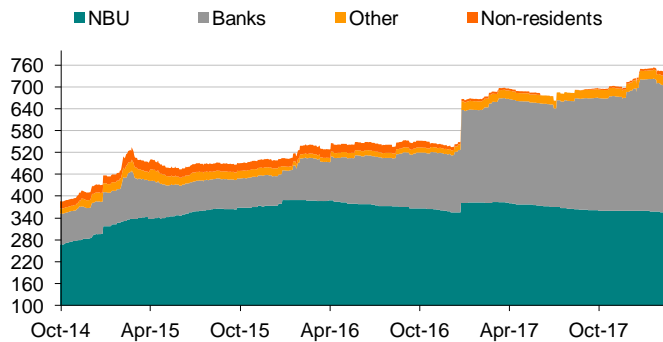
Source: MinFin

Local borrowings, UAHbn equivalent



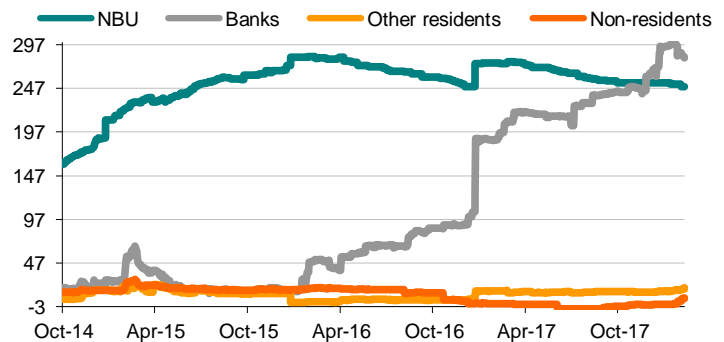
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

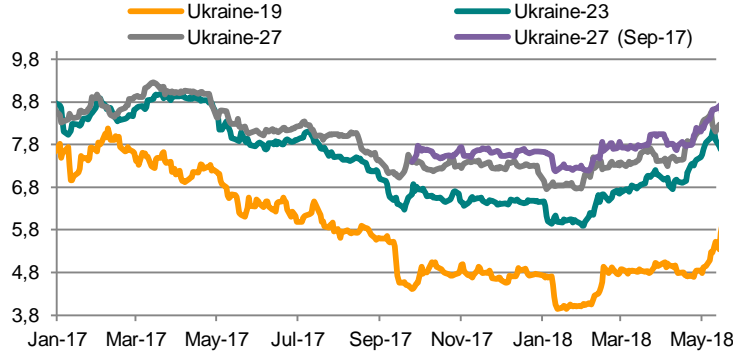


Source: NBU



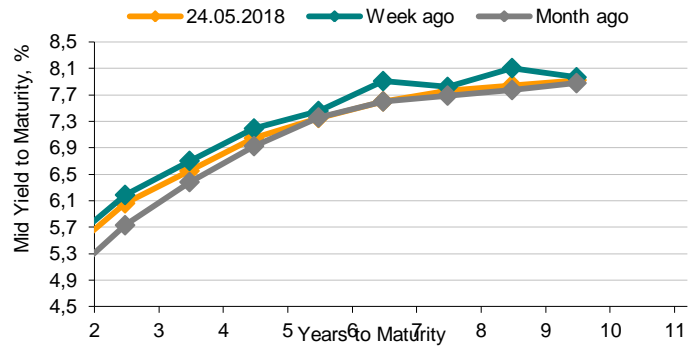
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

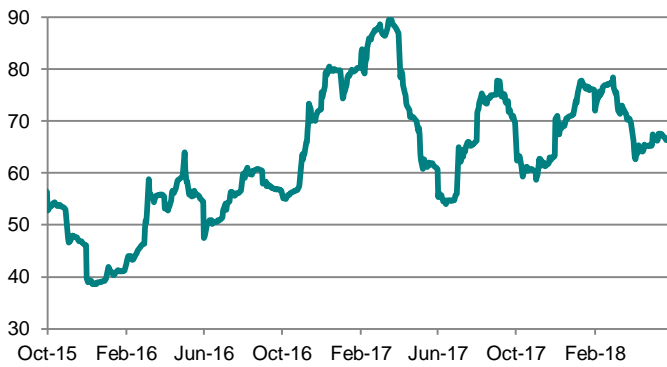
Ukraine's sovereign Eurobond yield curve



Source: Reuters

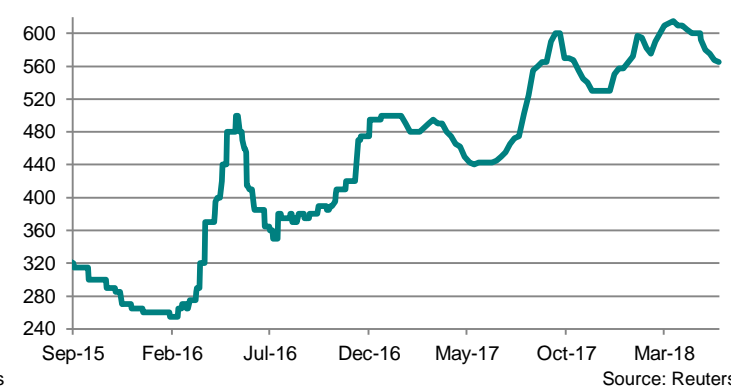
Commodity markets

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



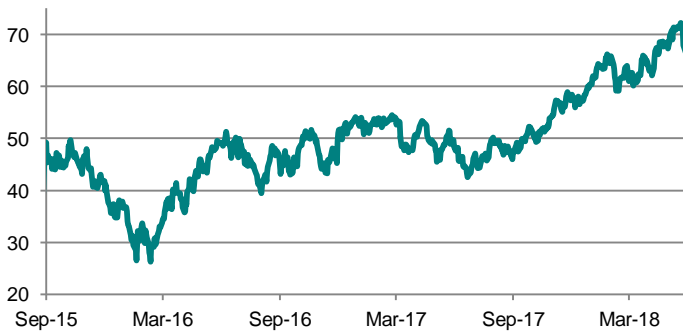
Source: Reuters

Steel CIS export HR coil, USD per ton



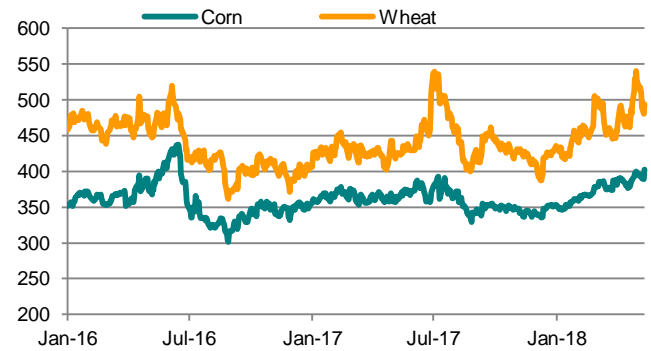
Source: Reuters

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
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	3.1
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
Prices											
CPI (average %YoY)	25.2	15.9	9.4	8.0	0.6	-0.2	12.1	48.7	16.5	14.4	11.9
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
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	70.0
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	-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
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	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



Contacts

Dmytro Tsapenko

Head of ALMT&Capital Markets
(+38044) 537 5015

Serhiy Yahnych

Head of Investment Business
(+38044) 537 5082 serhii.yahnych@ukrsibbank.com

Oleksandr Duda

Head of FX Sales
(+38044) 537 5002 oleksandr.duda@ukrsibbank.com

Maksym Burynskyi

Analyst
(+38044) 230 48 54 maksym.burynskyi@ukrsibbank.com



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