



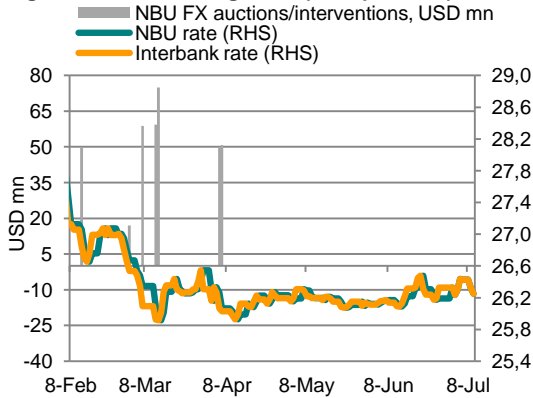
**This week in focus: Record budget performance in May: one off**

In May, budget collections landed at UAH 96.9bn, growing by 46.8% y/y. Improvements in state budget collections in May were due to a large extent to NBU transfer (UAH 17bn), which was 38% of annual plan. This came with a seasonal spike in collections of corporate profit tax (nevertheless underlying growth was also strong) and growing VAT in the country amid the backdrop of accelerating economy. On the expenses side, the largest part of acceleration was caused by debt servicing due to effect of reprofiling.

*Please see page 3 for more details*

**FX and interest rates: Ukraine's reserves fell 1.1% m/m in June**

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



Source: NBU, Reuters

**USD/UAH closed at 26.32 as of Friday the 6<sup>th</sup>, remaining flat comparing to a week ago.** Hryvnia enjoys a period of low volatility.

**Average daily FX volumes on the market amounted to the equivalent of USD 232.7mn, down by USD 28.mn week-on-week.**

**NBU avoided intervening on the currency market through currency auction in prior week.**

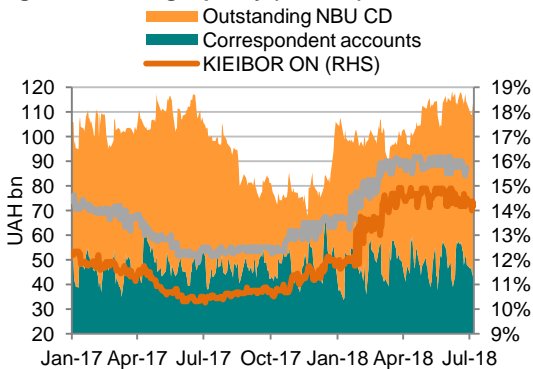
**Aggregate banking liquidity amounted to UAH 114.3bn as of Friday the 6<sup>th</sup>, down by less than UAH1bn during the week.**

**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.

**On July 3<sup>rd</sup>, MoF proceeds from the auction yielded UAH206mn.** While initially MoF had planned to place a line up bonds with maturity of 6m, 1y, 1.5y, 2y and 3y, the auction turned out to be less popular, resulting in placements of bonds with only longest maturity. The brightest spot of the auction was 3y issue, attracting the largest amount of demand and being at the same time the only issue to be placed at all. MoF placed it a cut off rate of 16.15%, bringing to the budget UAH 206mn. While primary dealers applied for roughly UAH 82mn in demand for 1.5y bonds in three bids, at the same time none of the bids were satisfied by the Ministry of Finance. Moreover, the demand for longer bonds was even lower by primary dealer, with only 1 bid applied for. On July 10<sup>th</sup>, MoF will offer one FX-denominated bond, with UAH bonds maturities ranging from 3m to 2y.

**Currently, yields (bids) of local OVDP in UAH at 17.90% (for 6m), 17.70% (for 2Y).** 1Y USD bids were at 5.55%, while bids for VAT bonds were at 17.95%.

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

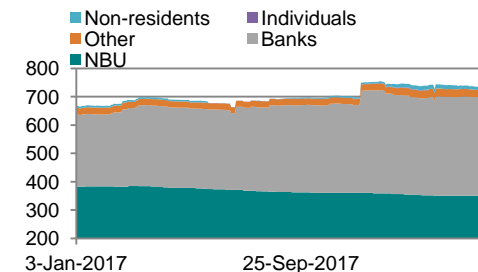


Source: Reuters, NBU, UkrSibbank, Minfin

**Figure 5. OVDP auction combined results, 3<sup>rd</sup> of July 2018**

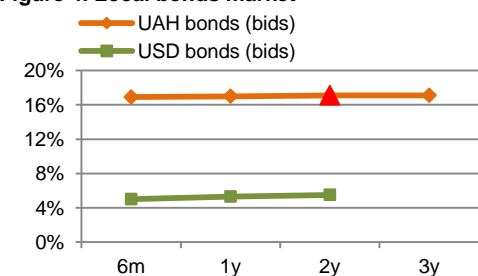
CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size	Placement size
UAH	3y	16.15%	16.15%	16.40%	16.15%	3	2	250.8mn	206.0mn
UAH	1.5y	-	-	16.45%	16.45%	3	0	81.7mn	-
UAH	2y	-	-	16.45%	16.45%	1	0	50.0mn	-

**Figure 3. OVDP holders, UAH bn**



Source: NBU

**Figure 4. Local bonds market**



Source: UkrSibbank

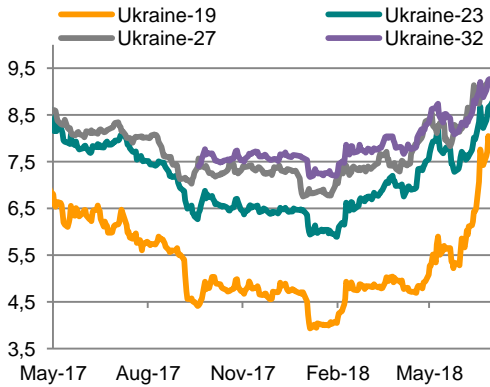
**Having declined by 1.1% m/m, Ukraine's international reserves amounted to USD 18.0bn effective June 1<sup>st</sup>.** Debt servicing by far was the most prominent reserves driver in June. Namely, Ukraine paid USD 562.4mn to service its debt obligations, out of which USD 552.5mn was paid in local OVDP denominated in foreign currency. Meantime, USD 162mn was paid to IMF in June on top of USD 0.9bn that already had been paid by Ukraine since 2018, bringing YTD reading to USD 1.1bn so far this year. As opposed to that, proceeds from local OVDP placements denominated in hard currency was the main factor, which supported reserves performance offsetting partly outflows. In particular, MoF managed to issue local FX-denominated bonds for a total USD 539.4mn in June. In regard to purchased FX currency on the market there was weaker performance comparing to latest months. NBU bought USD 90.0mn, while, at the same time, it was forced to sell USD 66mn to smooth primarily market fluctuations. As a consequence, NBU bought on a net basis only USD 24mn. International reserves covered 3.2 months of future imports, as of July 1<sup>st</sup>.



**Global markets:**

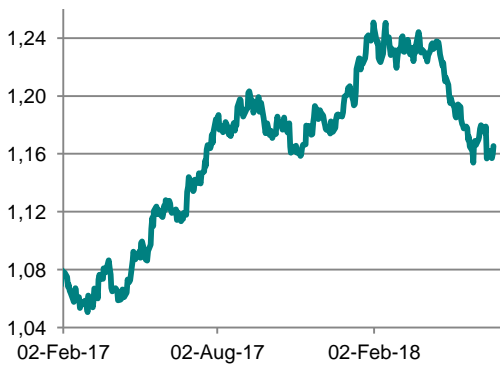
**U.S. jobs report encouraged markets**

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



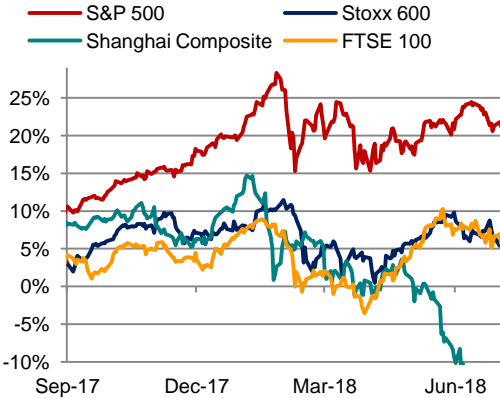
Source: Reuters

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



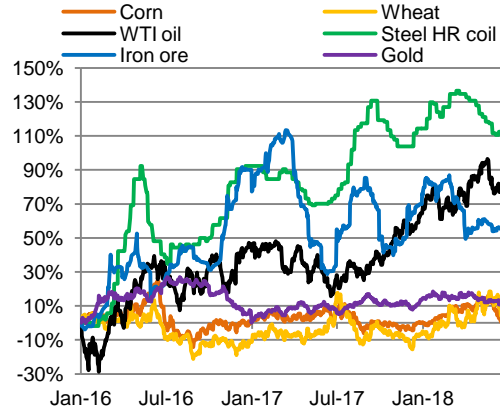
Source: Reuters

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



Source: Reuters

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



Source: Reuters

June's job report released on Friday displayed signs of health economy, as job gains exceeded initial projections for June. In the meantime, China was trying to persuade the European Union to act together against U.S. trade policies. At the same time, China's top officials said that China aims to continue open further its economy.

**Bond benchmarks increased**, with U.S. 10y Treasuries' yield lower by 2bp week-on-week landing at 2.83%, while German 10y Bunds' yields fell by 2bp, landing at 0.30%, Japanese 10y bonds yield's ended the week at 0.031 or remaining flat during the week.

**Major US stock indices were in a green territory during the week**, as S&P increased by 1.5%, while Nasdaq Composite gained by 2.4% week-on-week. On Friday 6<sup>th</sup>, trade war between U.S and China officially started which was accompanied with a strong jobs print in the U.S., at the same day. As a result, all major indexes increased strongly, albeit partly due to the fact that the escalation of trade war was already priced in equities earlier. Current week is an important one, as the official start of the earnings season should move investors focus from trade war issue to the earnings. Three big U.S. banks will report its performance on Friday, including Citigroup, JPMorgan and Wells Fargo.

**June's job report released on Friday displayed signs of health economy.** Job gains exceeded initial projections in June. Nonfarm payrolls rose by 213 000 jobs last month. Report showed health in the U.S. economy before a trade war started between China and United States. The unemployment rate gained to 4.0% in June from 3.8% in May, which was the first increase in the jobless rate in 10 months. In the meantime, the labor participation rate rose to 62.9% from 62.7% in May, falling for three consecutive months. Meantime, average hourly wages gained five cents, or 0.2% in June after increasing 0.3% in May. This puts the year-on-year gain for an employee wages increase at 2.7%.

**EUR/USD rate landed at 1.1745 as of Friday the 6<sup>th</sup>**, slightly up compared to last week closing level of 1.1683.

**Stoxx 600, a broader gauge of European equity performance rose by 0.6% during the week ending July 6<sup>th</sup>**, much weaker compared to overseas peers in the United States, while main index of Germany posted gains of 2.4 week-on-week, despite an official start of the trade war between U.S. and China. Positive jobs data reassured investors on Friday, allowing indexes to increase amid the backdrop of optimism abroad.

**China was trying to persuade the European Union to act together against U.S.** President trade policies. Namely, China aims to issue a strong joint statement with top European officials at a summit later this month. In the meantime, proposal is facing a lack of support from the EU side. At the meeting in Brussels Chinese top officials proposed an alliance, offering to open even more of the Chinese market. But the EU decided to reject that idea to act together against the world's largest economy.

**China is going to continue open further up its economy, according to the statements of China's Premier Li Keqiang** amid escalated trade tensions with the U.S. On top of that, he emphasized that China would focus keeping economy stable and improving despite external shocks. In the meantime, China's Premier noticed that he supports multilateralism and free-trade rules and China would never embark on any sort of trade dispute alone, not to mention a trade war.

**Crude oil prices gained**, as WTI futures climb down by 0.5% week-on-week and closed at USD 73.8 per barrel, while Brent futures fell much stronger by 2.9%

**Gold prices were effectively flat**, as NYMEX 1m futures increased by a mere 0.2% week-on-week and finished the week at USD 1254.3 per troy ounce.

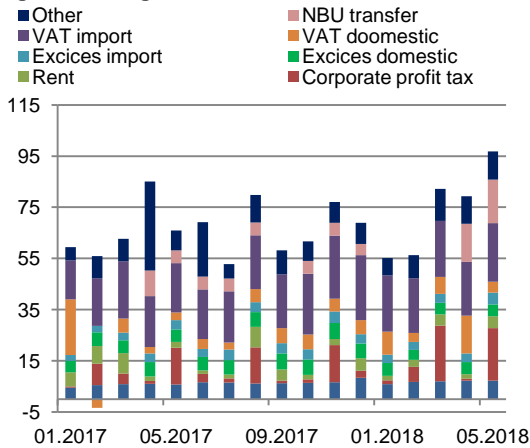
**Grains advanced**, as CBOT Corn 1m futures increased by 0.4% week-on-week and closed at USD 351.8 per bushel, while CBOT Wheat 1m futures landed at USD 512.8 per bushel, increasing by 3.1%.

**Iron ore was heading lower**, as NYMEX Iron ore 62% Fe 1m futures fell by 2.8%, week-on-week and closed at USD 63.0 per ton.



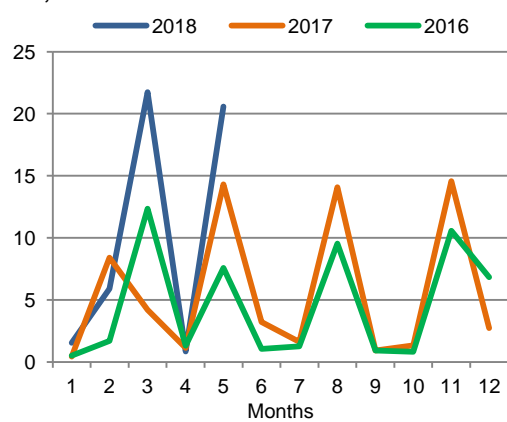
**This week in focus: Record budget performance in May: one off**

**Figure 9. Budget incomes in 2017-2018, UAHbn**



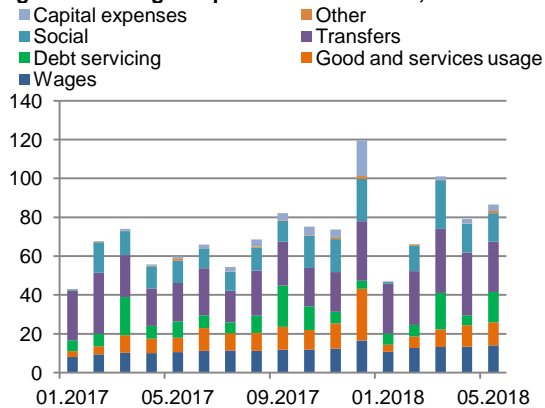
Source: State treasury

**Figure 10. Corporate profit tax collections in 2016-2018, UAHbn**



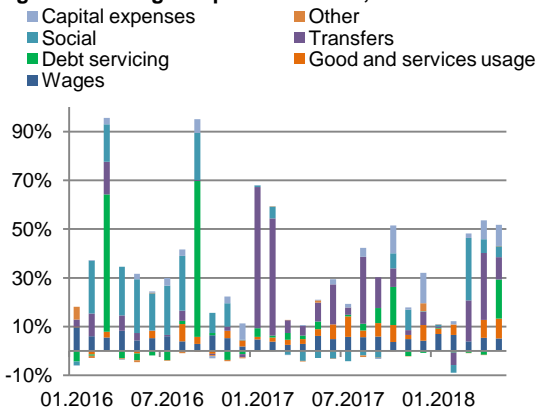
Source: State treasury

**Figure 11. Budget expenses in 2017-2018, UAHbn**



Source: State treasury

**Figure 11. Budget expenses drivers, %**



Source: State treasury

In May, budget collections landed at UAH 96.9bn, growing by 46.8% y/y. Improvements in state budget collections in May were due to a large extent to NBU transfer (UAH 17bn), which was 38% of annual plan. This came with a seasonal spike in collections of corporate profit tax (nevertheless underlying growth was also strong) and growing VAT in the country amid the backdrop of accelerating economy. On the expenses side, the largest part of acceleration was caused by debt servicing due to technical effect of reprofiling.

In May, state budget performance improved. While In April, budget deficit amounted to UAH 20bn in 4M18 vs 4M17, the same reading fell to UAH 9bn cumulatively in 5M18 vs 5M17. Moreover, the surplus of state budget reached UAH 11bn, which was the highest level for the last 5 years.

In May income growth was much stronger than growth in expenses. In particular, incomes landed at UAH 96.9bn, growing by 46.8% y/y, while expenses comprised UAH 86.5bn, increasing by 44.7%, or slightly lower.

First and foremost, in May NBU transferred to budget UAH 17bn, which amounted to UAH 32bn in 5M18 (it remains to reimburse only UAH 12.6bn by the end of the year). It's noteworthy, it was the biggest transfer on monthly basis for the many previous years. In contrast to 2016 year, when the biggest amount of transfers was concentrated in the end of the year (the board of the NBU was not functioning by the end of the year) and 2017, when all transfers were evenly distributed through the year to avoid the peak concentration happened in previous year. In 2018, NBU accelerated itself on that path drastically, making the largest amount of transfers in the first half of the year.

Regarding to the second important part of incomes related to non-tax category, namely dividends from state companies, there was also some acceleration in this category of budget collections. It's interesting that, previously was reported some lag in collections comparing to a previous year. But starting from May, some acceleration took place by 12.8% y/y during the month. At the same time, on a cumulative basis decline in collections landed at 23.6% (in 5M 2018) vs 35.1% y/y logged a month ago (in 4M 2018)

In general, budget revenue coming from non-tax sources accelerated its path, which amounted roughly 70% y/y in 5M 2018, which in turn comprises the strong gain compared to 46% increase reported a month ago for 4M 2018.

At the same time, budget incomes from taxes, which was the more important driver of its performance, increased by 18.3% in May cumulatively in 5M 2018, which indicated acceleration from 14.8% y/y growth reached in April, but meantime was much lower comparing to budget revenues growth coming from non-taxes. It was in part due to quarterly corporate profit payments made by business, as historically in this month the largest part of taxes for 1Q 2018 was paid in May (which is one of the peaks in such payments during the year).

While budget collections of taxes from private individuals in 4M 2018 increased by 21.9%, at the same time in 5M 2018 the same reading showed even further improvement growing by 22.5% y/y. At the same time, growth on non-cumulative basis showed even stronger performance with growth amounting to 25% y/y in May vs 19% y/y growth in April. Growing wages should underpin growth in this category further through the year end.

At the same time, the corporate profit tax was one of the most important drivers of budget improved performance in May (among aggregate taxes subcategory). In May, it's paid historically the largest part of quarterly tax on corporate profit for 1Q 2018, which amounted roughly UAH 20bn in May close to the March level. At the same time, quarterly payments reflected in May statistics exceeded the analogous payments a year ago by 44% in May, which contributed to cumulative growth by around 80% from the start of the year, which we attribute to growing profits in the business amid the backdrop of growing economy.

Moreover, rental payments were on the rise in May. In May, revenue from this tax comprised UAH 4bn, which was 2x times more compared to May a year ago. Due to that cumulative decline for 5M2018 improved to 41.7% in 5M2018 vs 5M2017. Changes in the taxation in this sector should bring bright prospects on the collections of rental taxes in the near future.

In regard to excises (goods produced in Ukraine) there was also some improvement in collections in May. While in April collections dropped by 17% y/y, in May the decline improved to 4% y/y. As a result, cumulatively from the beginning of the year the decline slowed to 11% y/y in 5M 2018 vs 5M 2017. It was partly related to the desire of authority to increase excises on alcohol and tobacco to



European level. It's planned to increase excises by around 20% each year till 2022. At the same time, the market is being supplied by illegal products, producers of which do not pay taxes.

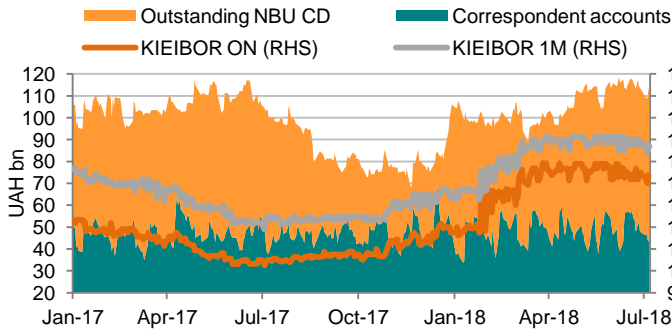
At the same time, the most important tax by weight, namely **VAT showed some acceleration too**. Collections of tax from goods produced in Ukraine increased by 29.7% y/y in 5M18 vs 5M17, which was acceleration after 28.4% y/y increase reported cumulatively in 4M18 vs 4M17. Meantime, VAT from goods imported to Ukraine increased also and accelerated to 14.4% y/y in 5M 18 vs 5M17.

**State budget expenses increased by 45% in May**, accelerating from 42% y/y reported gains a month ago. As a consequence, in 5M18 budget expenses were also accelerating to 26.6% y/y from 22.1% y/y in 4M18. In May, the most accelerated budget expenses were classified by functions as whole state functions in the functional classification of the budget. In particular, they increased by 88% in May. In contrast to that, in April growth amounted to only 3%. It was by far related to increase in the debt servicing, which increased even slightly stronger by 88% y/y. At the same time, cumulatively in 5M18 this led to 10% increase vs 7% decline a month ago in 4M18. Albeit it was partly due to reprofiling. After reprofiling coupons of part of obligations linked to inflation are to be paid in May and November (around UAH 150bn of bonds divided in 24 issues with roughly UAH 6bn in value each, with coupon redemption equally divided between May and November)



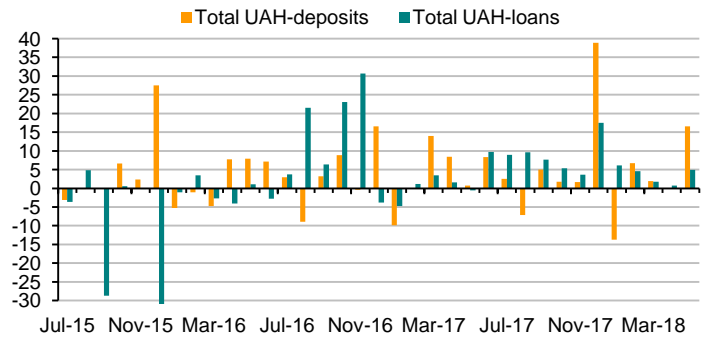
### Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

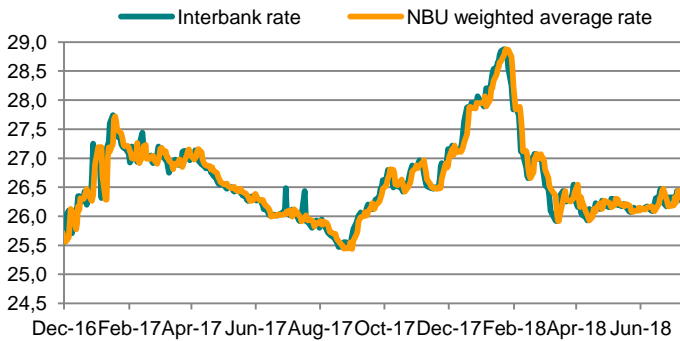
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

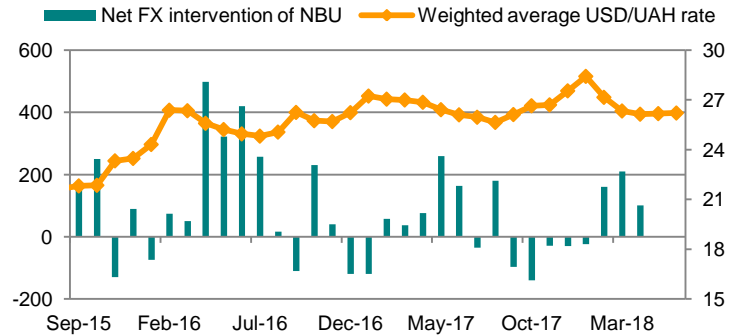
### Currency market

UAH exchange rate, UAH/USD



Source: Reuters

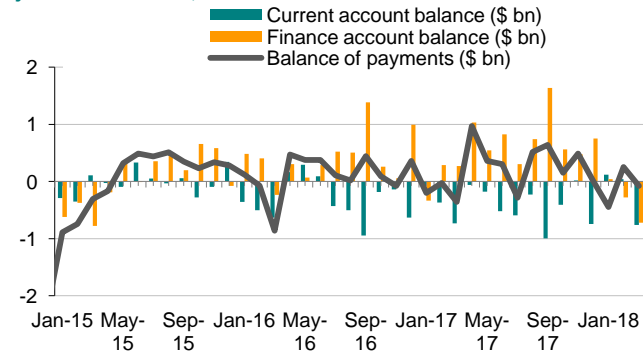
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

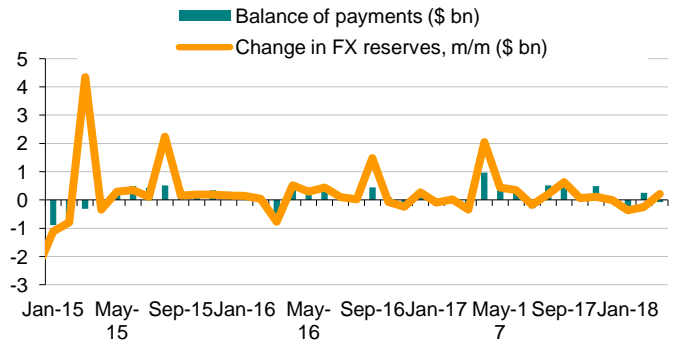
### Balance of payments

Major BoP accounts, USDbn



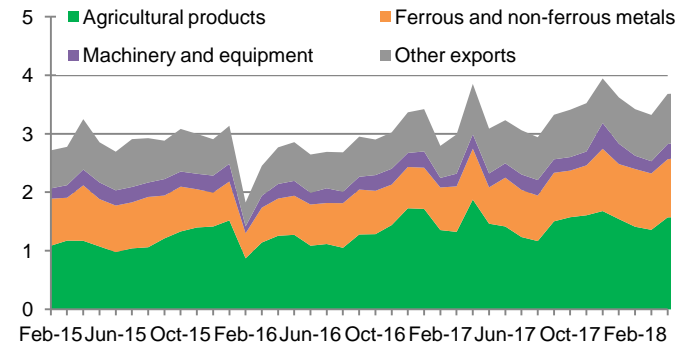
Source: NBU

BoP vs change in foreign reserves, USDbn



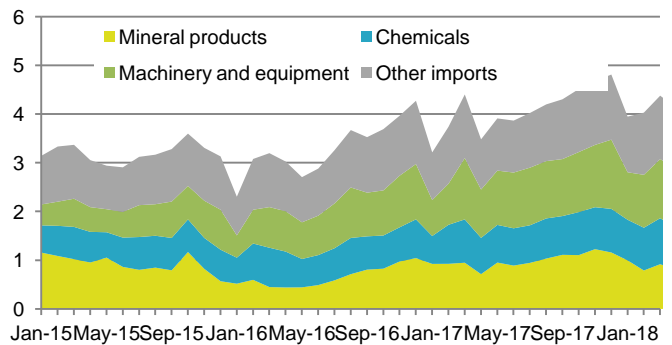
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU

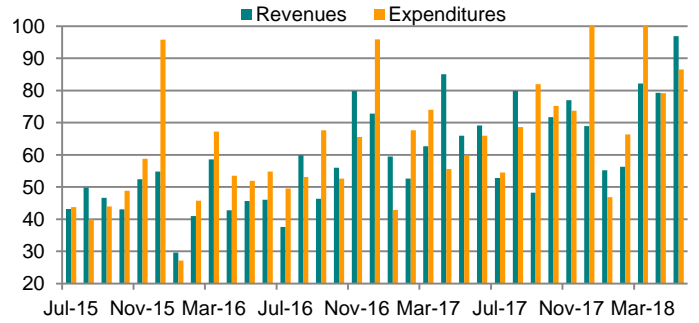


**Budget performance**

**Budget performance, UAHbn**

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

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

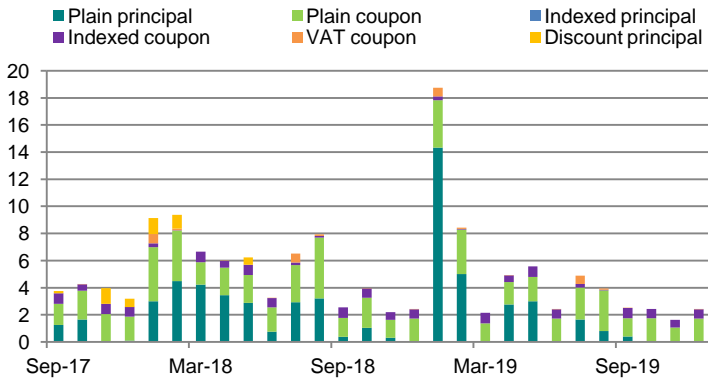


Source: NBU

Source: NBU, State Treasury

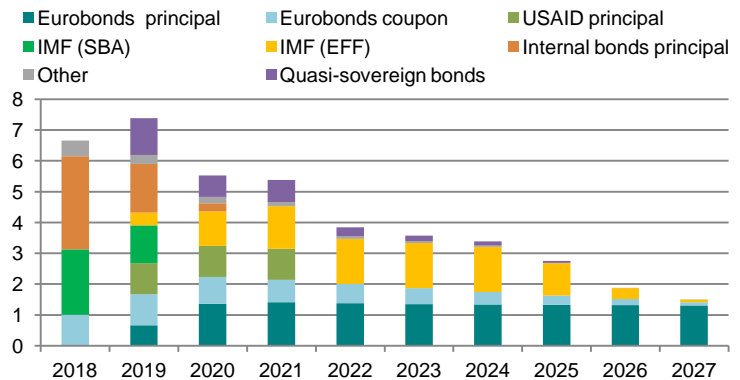
**Sovereign debt**

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



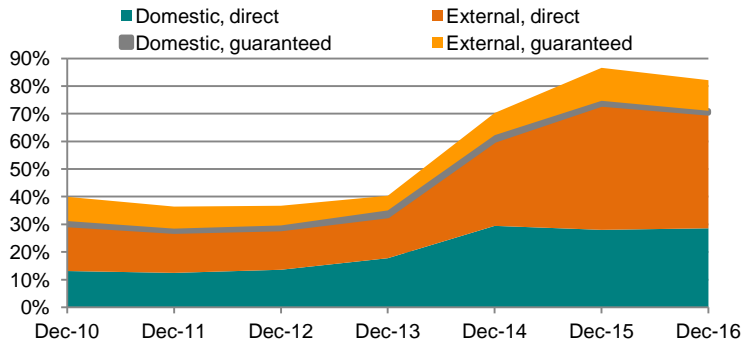
Source: NBU, UkrSibbank estimates

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



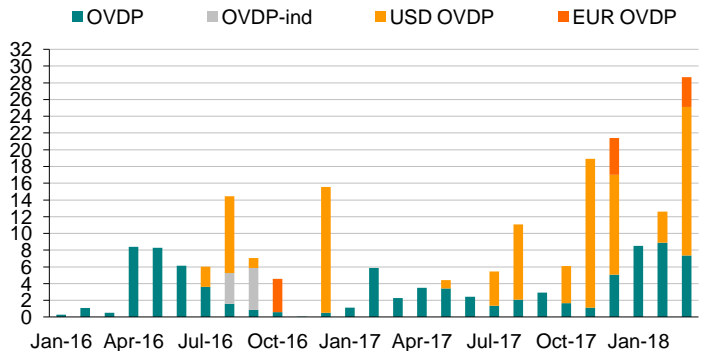
Source: Reuters, IMF, UkrSibbank estimates

**Total government debt, % GDP**



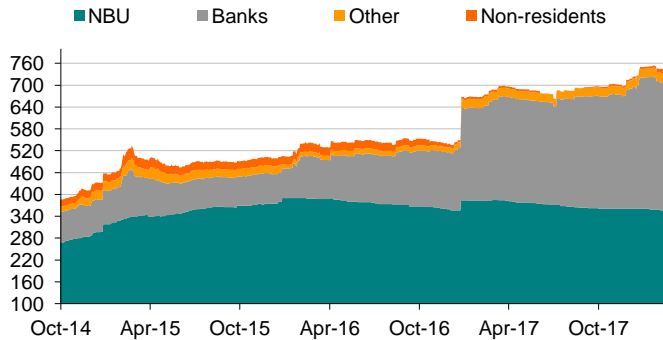
Source: MinFin

**Local borrowings, UAHbn equivalent**



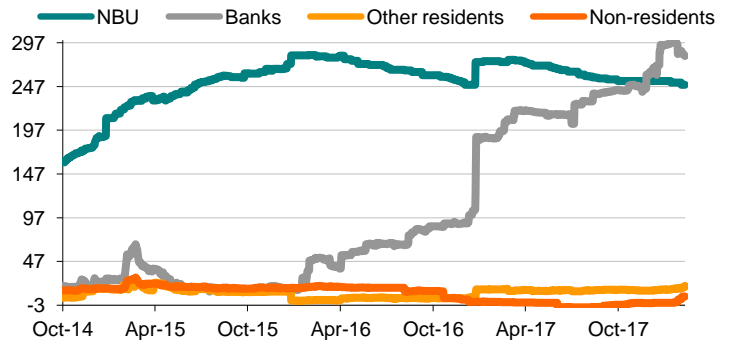
Source: NBU

**Outstanding OVDP owners structure, UAHbn**



Source: NBU

**Outstanding OVDP changes in holding, UAHbn**

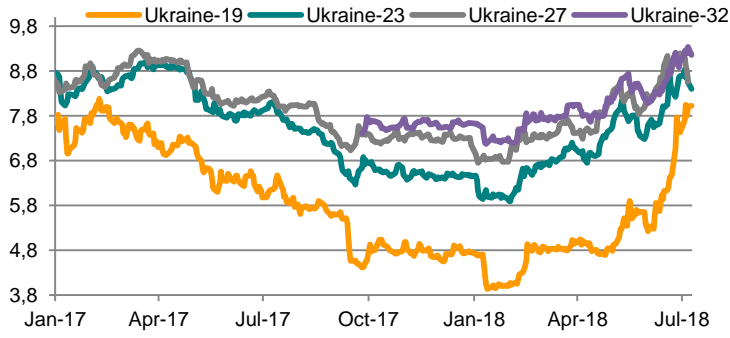


Source: NBU



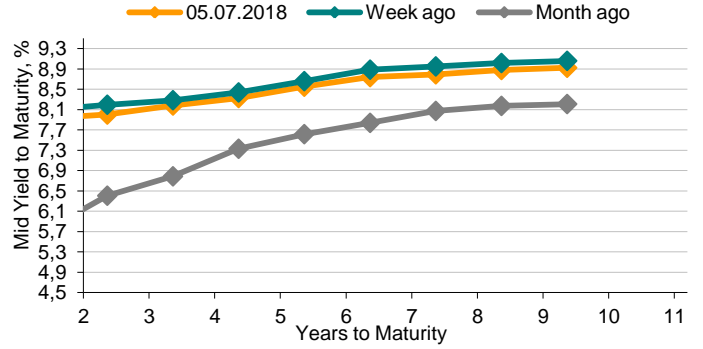
### Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

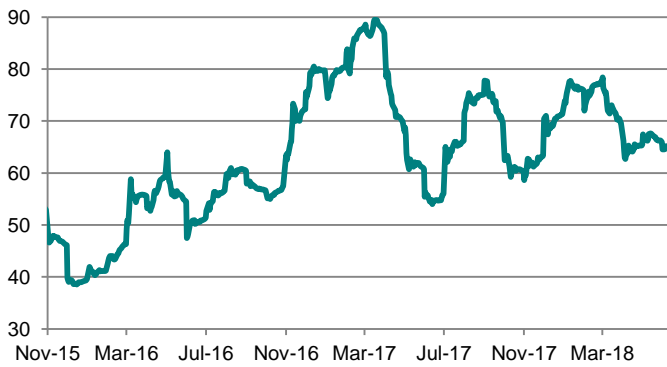
Ukraine's sovereign Eurobond yield curve



Source: Reuters

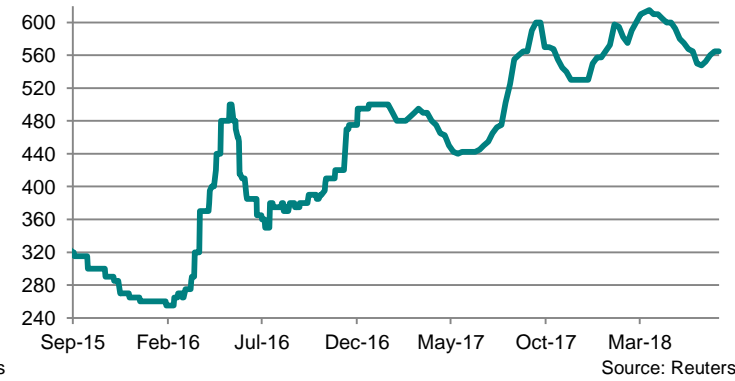
### Commodity markets

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



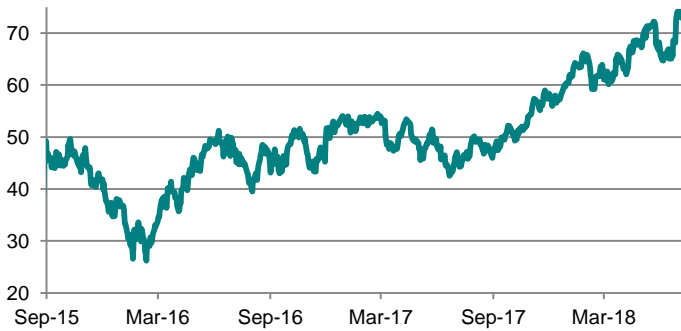
Source: Reuters

Steel CIS export HR coil, USD per ton



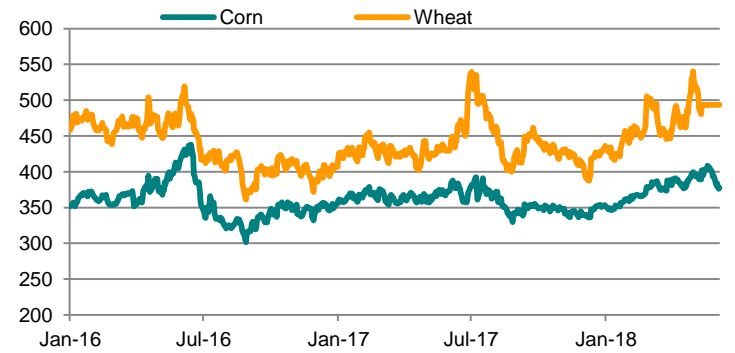
Source: Reuters

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





## Contacts

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### **Dmytro Tsapenko**

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

### **Serhiy Yahnych**

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

### **Oleksandr Duda**

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

### **Maksym Burynskyi**

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



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