



This week in focus: Inflation: down and up!

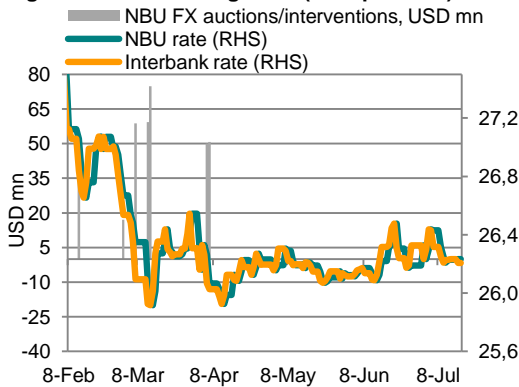
For the second month in a streak, in June inflation delivered zero growth on a monthly basis, and went into single digit territory in annual terms (9.9% y/y). Meantime, NBU returned to tightening mode, hiking key interest rate by 50bp (to 17.5%). Central bank cited higher risks to inflation forecasted trajectory, stemming mainly from strong domestic demand, delayed IMF tranche and inflation expectations. CPI inflation development came fully in line with our expectation: while positive weather positively impacted food markets, drought in June, combined with acceleration in domestic demand and coming hike in energy (gas) prices likely to re-accelerate inflation towards year end. We retain our end 2018 CPI expectation at 10.9%.

Please see page 3 for more details

FX and interest rates:

Verkhovna Rada voted for amendments to the Anticorruption law

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH closed at 26.23 as of Friday the 13th, remaining almost 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 206.7mn, down by USD 25.9mn week-on-week.

NBU interventions increased international reserves by USD 14.5mn via interventions on the market, as of week ending 6th July. In particular, **NBU bought USD 27mn and sold USD 12.5mn both through matching during the week.** In 2018, the YTD reading of interventions resulted in net NBU buying of USD 1.3bn.

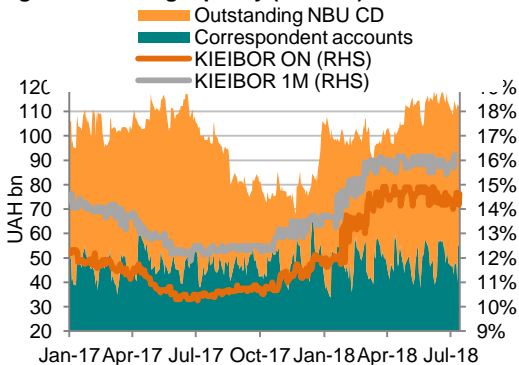
Aggregate banking liquidity amounted to UAH 111.5bn as of Friday the 13th, down by UAH2.9bn during the week.

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.

The latest auction was accompanied with placement of USD bonds. Among hryvnia bonds, the shortest issues, namely 3m, 6m, brought the largest amount of proceeds to the budget. At the same time, MoF set a cap on them, which amounted to UAH 0.5bn per issue. While on the 3m bonds demand effectively exceeded the cap by two fold, on the 6m bonds demand was almost in line with a restriction set by MoF. On top of that, the cut off rate of the shortest bonds were increased by 5bp comparing to the latest placements. In July, among USD-denominated OVDP issues are to be redeemed only two issues for a total USD 203mn. While one of them was redeemed on July 11th, totalling USD 98mn, the other is scheduled to be redeemed on July 25th for a total USD 105mn. The largest redemption of UAH OVDP remains on the horizon and scheduled to be on 25th July. On the next primary auction, MoF is to offer bonds with maturities 6m, 1y and 3y.

Currently, yields (bids) of local OVDP in UAH at 17.95% (for 6m), 17.80% (for 2Y). 1Y USD bids were at 5.55%, while bids for VAT bonds were at 17.95%.

Figure 2. Banking liquidity (UAH bn)

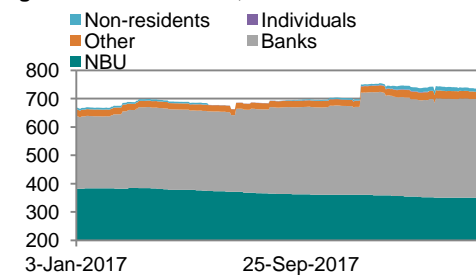


Source: Reuters, NBU, UkrSibbank, Minfin

Figure 5. OVDP auction combined results, 3rd of July 2018

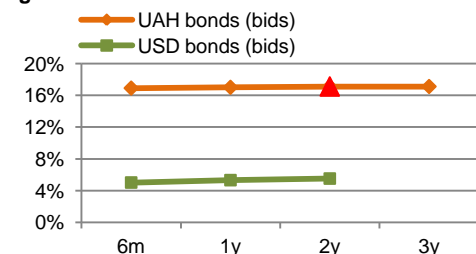
CCY	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size	Placement size
UAH	3m	17.40%	17.39%	17.40%	17.25%	25	25	1.0bn	480.8mn
UAH	6m	17.30%	17.29	17.30%	17.20%	13	13	505.4mn	456.1mn
UAH	1.5y	16.25%	16.25%	17.50%	16.25%	4	3	202.1mn	108.5mn
UAH	2y	16.25%	16.25%	17.50%	16.20%	4	3	400.7mn	296.2mn
USD	2y	5.65%	5.65%	5.70%	5.60%	20	19	62.9mn	59.4mn

Figure 3. OVDP holders, UAH bn



Source: NBU

Figure 4. Local bonds market



Source: UkrSibbank

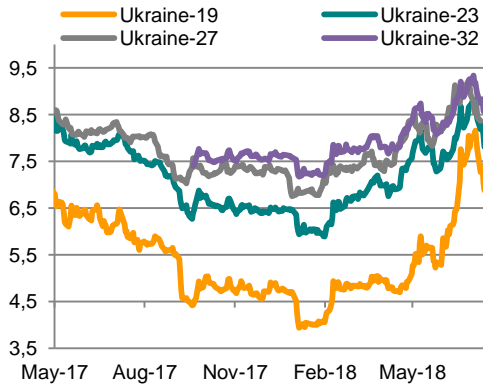
On July 12th, the Ukrainian parliament - the Verkhovna Rada - voted to support amendments to the anticorruption law required by IMF. Initially the Ukrainian parliament adopted a version of a law, which allowed some politicians to avoid being prosecuted in the Anticorruption court. In particular, the appeals from the cases involving high politicians (that were created before the Anticorruption court was established) were directed to old courts with lower power. Previously, top officials from IMF mentioned that the adoption of amendment which gives the anticorruption court power to hear all cases, without exemption was critical for new tranche arrival. While Christine Lagarde was emboldened by initial adoption of Anticorruption court, it also was important to add even more power to the court, especially to hear cases with high politicians created before the anticorruption court was legalized in Ukraine. Having adopted legislation, which creates anticorruption court, it remains only to raise gas tariffs to households in order to receive next IMF tranche and other international support linked to IMF disbursement.



Global markets:

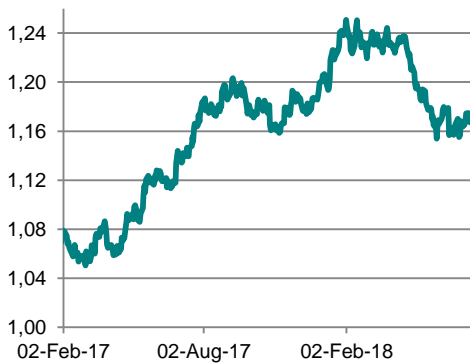
U.S. CPI showed prices increase to 2.9% in June

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



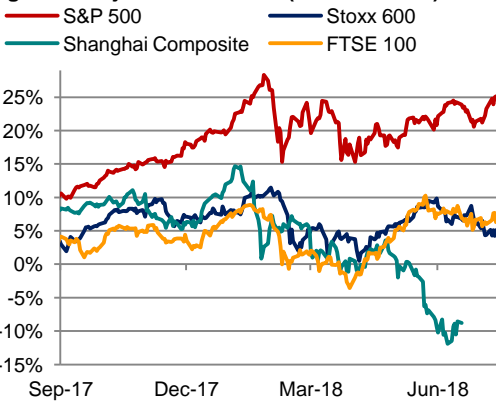
Source: Reuters

Figure 6. EUR USD spot (mid)



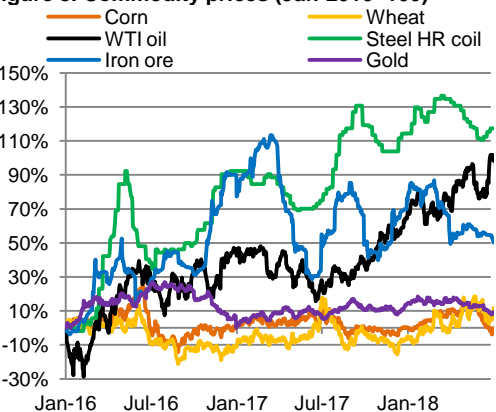
Source: Reuters

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



Source: Reuters

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



Source: Reuters

US consumer prices rose by 2.9% y/y in June in terms of CPI. Meanwhile, the European Commission released new forecasts of economic growth in Europe. Trade tensions with U.S. and rising oil prices were behind the euro zone economic growth downward revision. At the same time, China's economy advanced by 6.7% in the second quarter of the year.

Bond benchmarks were mixed, with U.S. 10y Treasuries' yield was flat week-on-week landing at 2.83%, while German 10y Bunds' yields fell by 1bp, landing at 0.28%, Japanese 10y bonds yield's ended the week at 0.045 or slightly up compared to the previous week.

Major US stock indices advanced during the week, as S&P increased by 1.5%, matching prior week gains, while Nasdaq Composite gained by 1.8% week-on-week. The week ending 13th of July was an official start of the earnings season in the United States. Large banks were at the forefront during the week. This week moves earnings season into higher gear, as more companies are scheduled to report second quarter results.

U.S. consumer prices rose by 2.9% y/y in June, as measured by CPI. At the same time, prices rose by 0.1% on a monthly basis, following 0.2% gain in May. In the meantime, the same measure excluding volatile food and energy components rose by 0.2% m/m, matching May's increase and by 2.3% y/y from 2.2% in May. Fed policymakers pointed out that they would not be too much concerned if inflation overshoots its target in 2018 year. In a separate report, the Labor Department showed that initial claims for state unemployment benefits declined 18 000 to a seasonally adjusted 214 000 for the week ended July 7th.

EUR/USD rate landed at 1.1685 as of Friday the 13th, down compared to last week closing level of 1.1745.

Stoxx 600 advanced by 0.7% during the week ending July 13th, weaker comparing to major counterparts in the United States, while German DAX delivered even weaker gains of 0.4% week-on-week. Stocks in Europe tracked gains in the U.S. where investors shifted focus from trade war to earnings season.

On Thursday, the European Commission released new forecasts of economic growth for euro zone. Trade tensions with U.S. coupled with rising oil prices were cited as key drivers of euro zone economic growth downward revision. Moreover, the slowdown of the whole euro zone economy should also affect major economies in the block. Out of which, Italy is expected to be hit the most. Euro zone will grow by 2.1% in 2018, lower than 2.3% increase expected earlier. At the same time, economic growth for the euro region was 2.4% in prior year. In 2019, economic growth in expected to slow to 2%, remaining unchanged to previous forecast.

China's economy rose by 6.7% in the second quarter, which was slightly lower than the previous quarter 6.8% growth and lowest reading in almost two year. At the same time, this suggests that China remains on track to meet government target of 6.5%. Trade tensions between two major economies dragged down sentiment. Meanwhile, fixed asset investments growth was 6.0% in 1H 2018, which matched a record low. It was accompanied with an industrial production growth at 6.0%, which was also the level last seen more than two year ago.

Crude oil prices fell, as WTI futures decreased by 3.8% week-on-week and closed at USD 71.0 per barrel, while Brent futures fell less by 2.3%, landing at USD 75.3 per barrel.

Gold prices declined, as NYMEX 1m futures fell by 1.2% week-on-week and finished the week at USD 1239.6 per troy ounce.

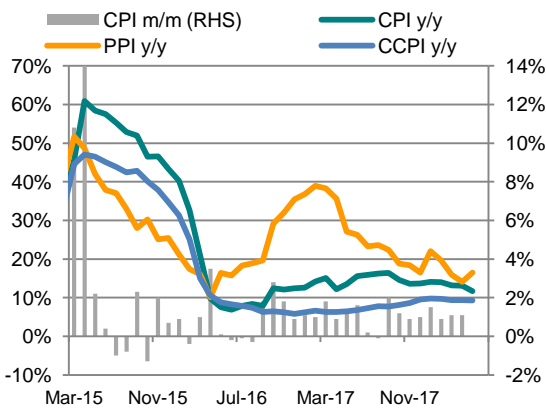
Grains slumped, as CBOT Corn 1m futures tumbled by 6.1% week-on-week and closed at USD 330.3 per bushel, while CBOT Wheat 1m futures landed at USD 481.5 per bushel, falling by the same 6.1%.

Iron ore rose, as NYMEX Iron ore 62% Fe 1m futures edged up by 0.4%, week-on-week and closed at USD 63.2 per ton.



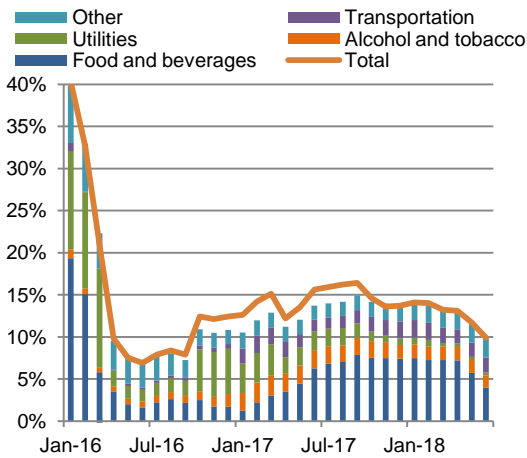
This week in focus: Inflation: down and up!

Figure 9. Inflation rates in 2015-2018, %



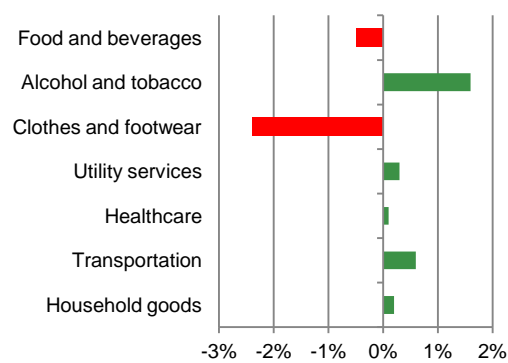
Source: Ukrstat

Figure 10. Inflation drivers in 2016-2018, %



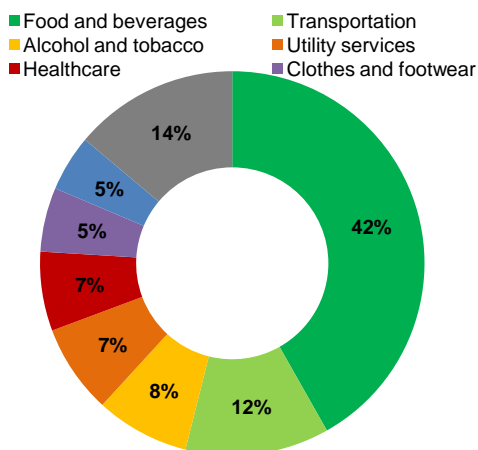
Source: Ukrstat

Figure 11. Price changes in selected categories, June 2018, %/m/m



Source: Ukrstat

Figure 11. CPI basket, %



Source: Ukrstat

For the second month in a streak, in June inflation delivered zero growth on a monthly basis, and went into single digit territory in annual terms (9.9% y/y). Meantime, NBU returned to tightening mode, hiking key interest rate by 50bp (to 17.5%). Central bank cited higher risks to inflation forecasted trajectory, stemming mainly from strong domestic demand, delayed IMF tranche and inflation expectations. CPI inflation development came fully in line with our expectation: while positive weather positively impacted food markets, drought in June, combined with acceleration in domestic demand and coming hike in energy (gas) prices likely to re-accelerate inflation towards year end. We retain our end 2018 CPI expectation at 10.9%.

Ukraine's inflation kept falling on y/y basis landing at 9.9% y/y in June, down from 11.7% y/y in May. Meantime, on m/m basis prices followed suit of prior month performance with growth amounting 0%. In line with May's performance, food basket weighted on aggregate CPI basket the most, as prices remained in deflation territory in the first month of the summer for a two month in a streak. In particular, aggregate food basket delivered -0.5% m/m decline in prices in June, albeit the decline was slightly weaker comparing to the same reading a month ago, with prices falling by 0.8% m/m. At the same time, on y/y basis prices moved lower even meaningfully, as inflation in the component landed at 9.5% y/y from 14.1% logged a year ago. Prices of fruits doubled down its prices decline to 2.1% m/m from 1.1% y/y in May. In the meantime, vegetables posted lower prices decline deceleration, as their prices decreased by 1.0% m/m, weaker comparing to 2.9% m/m reached in prior month. At the same time, meat price gained by 0% m/m in June, contributing to falling reading on a y/y basis too, as prices decreased to 17.5% y/y, down from 22.3% y/y in May. Egg prices slightly accelerated the pace of prices decline in June to 9.8% m/m, following 9.5% m/m decrease in May, as in summer egg prices usually bottoming out, reflecting seasonal consumption pattern on the product. Sugar prices also contributed to lower inflation reading in June, as prices kept falling on y/y, at the same time, remaining in the deflation territory on the m/m basis.

Utilities prices gained by only 0.3% m/m, slightly up from a gains in May. Meantime, prices increase comprised 4.7% y/y in June, slightly lower from 4.9% increase in May.

Transportation prices gained by the same print on m/m basis in June. Namely, prices rose by 0.6% m/m. But transportation prices showed acceleration on a y/y basis to 14.6%, up from 13.7% a month ago. Having delivered gains by 0.8% m/m, in May, fuel prices rose by only 0.3% m/m in June. On top of that, railway passenger transportation category displayed solid growth in prices too. Namely, prices increased by 10.4% m/m, bringing the same reading on a y/y basis to 15.6% y/y.

Core inflation fall to 9.0% y/y in June from 9.3% y/y in May. On a monthly basis core inflation was in line with headline posting 0% growth. As a result, core inflation climbed down to 9.4% y/y in 6M 2018, down from 9.5% y/y in 5M 2018. Despite solid deceleration in headline inflation, core inflation proved to be steadfast, remaining above 9% thus far.

Having moved in a declining mode in 2018, production prices turned to the upside starting from May, following suit in June. Namely, production prices growth comprised 18.4% y/y in June, following 16.5% y/y in May. While prices in the manufacturing subsector were at the prior month level or flat, namely at 13.6% y/y, prices in mining and utilities moved higher in June. Prices growth in former was led by increased prices in iron ore mining, while coal and oil mining prices advanced to a much lower extent in June.

On June 12, the Board of the National bank of Ukraine decided to hike its main interest rate by 50bp to 17.5%. In a press release following the decision, NBU emphasized that key risk remained delayed progress in next IMF disbursement. The decision came rather as surprise, as consensus unanimously expected no change (including us). We notice that with absolute level of 17%, 50 b.p. hike is not a dramatic one, but it is valuable signal for economic agents on central bank intentions to act in case IMF cooperation stalls.

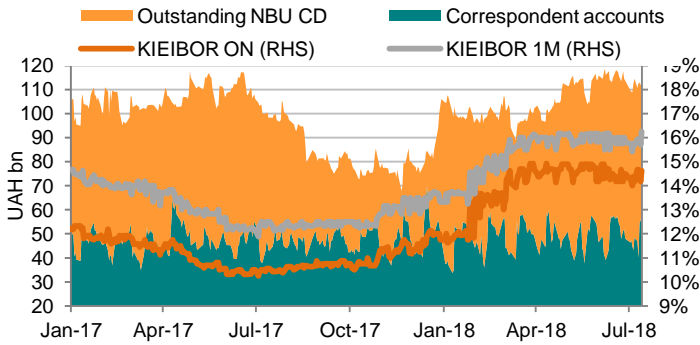
At the same time, **NBU left its previous inflation forecast with headline inflation landing at 8.9% y/y in 2018 unchanged.** Inflation slowdown was mainly due to increased supply of food products on the market, coupled with more favorable weather conditions. Moreover strengthening of the hryvnia in the first half of the year, also contributed to lower inflation in 1H 2018, as prices of imported goods were lower. We believe this trend to reverse, expecting softer US\$UAH (29.50 year end) and subsequently a hike in inflation expectations.

In the meantime, NBU revised down its GDP growth expectation to 2.5% in 2019 (from 2.9% y/y expected previously; vs UkrSib estimate 2.0%), as effects from increased wages will diminish. At the same time, tight monetary policy is to further dampen growth in economy.



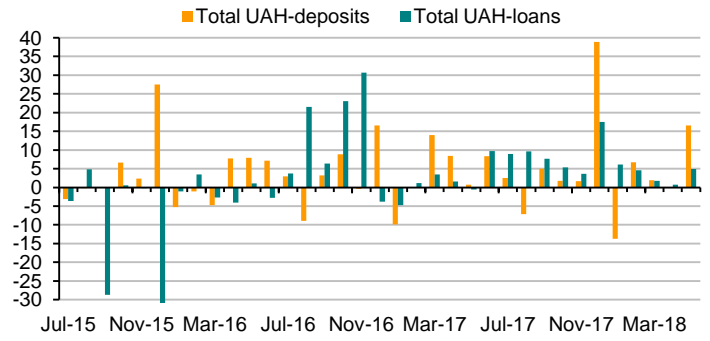
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

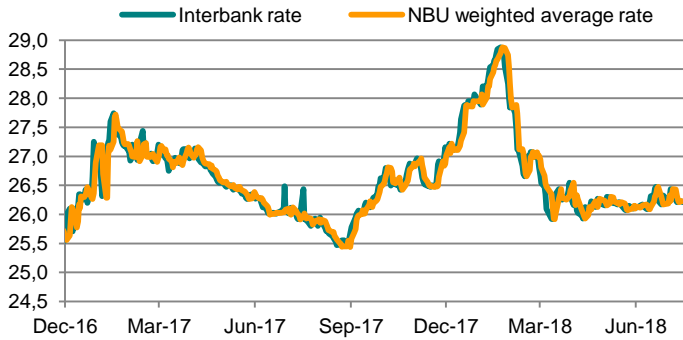
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

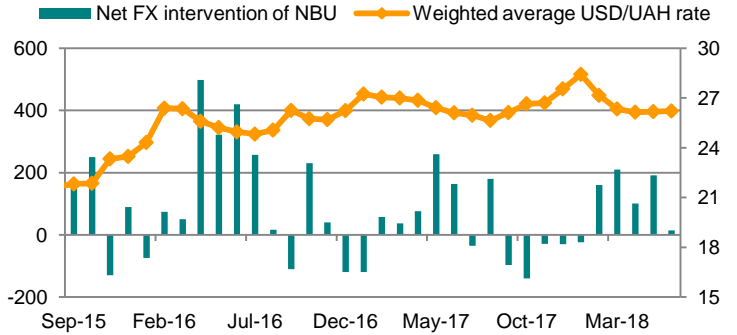
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

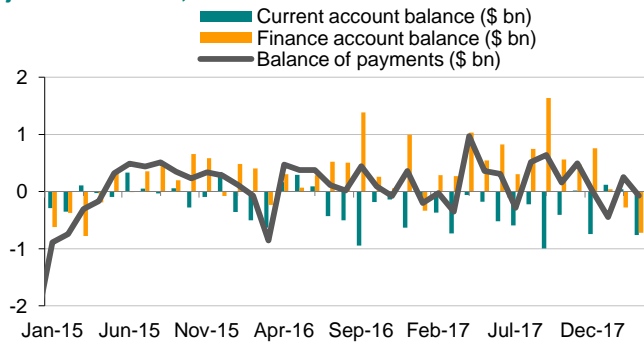
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

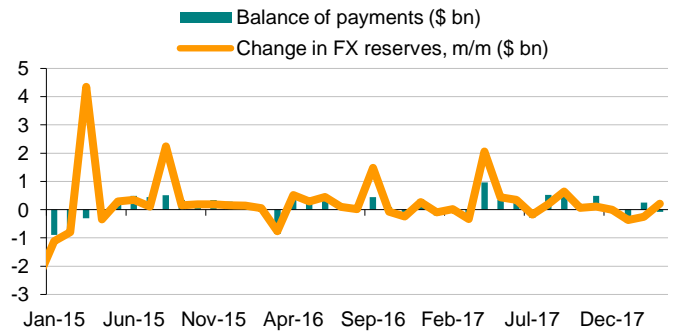
Balance of payments

Major BoP accounts, USDbn



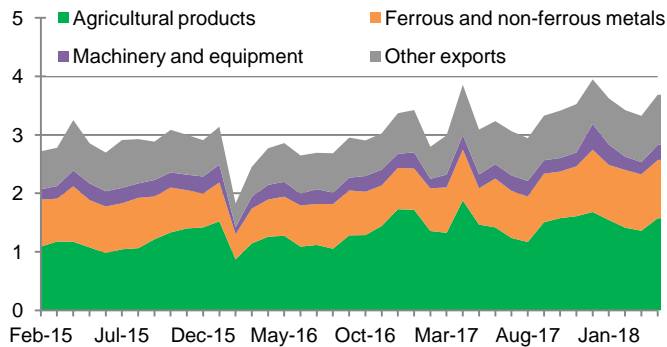
Source: NBU

BoP vs change in foreign reserves, USDbn



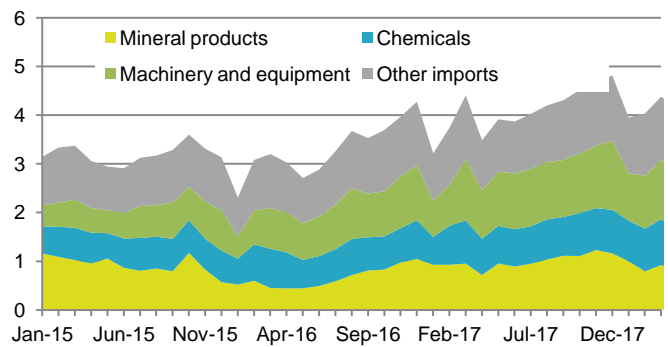
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU

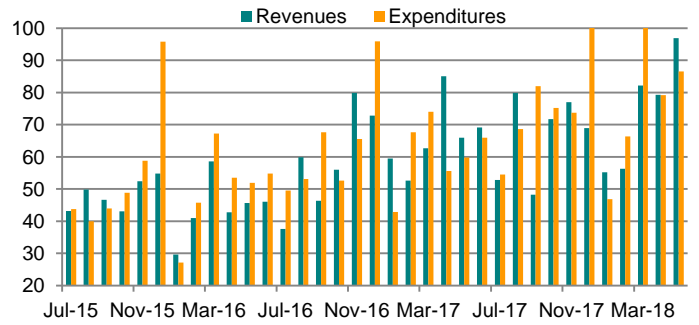


Budget performance

Budget performance, UAHbn

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

Monthly change in budget revenues and expenditures, UAHbn

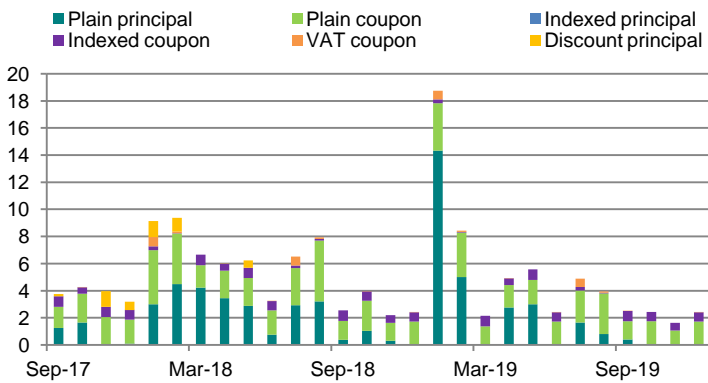


Source: NBU

Source: NBU, State Treasury

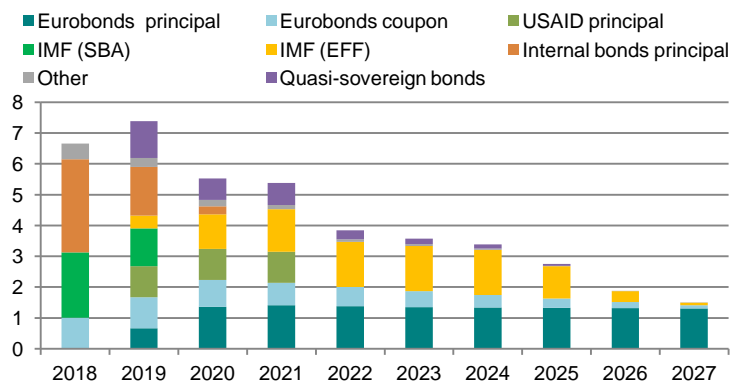
Sovereign debt

UAH-denominated debts' repayments schedule, UAHbn



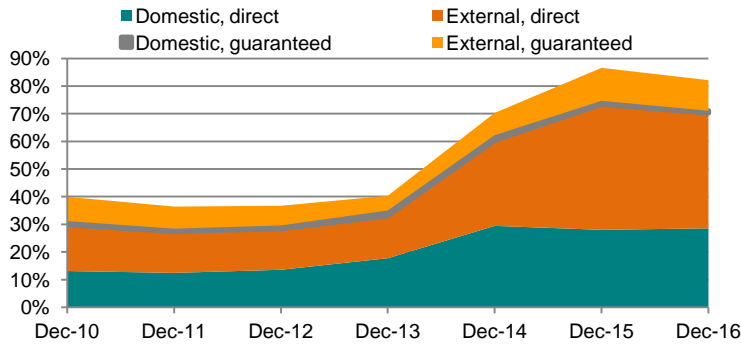
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



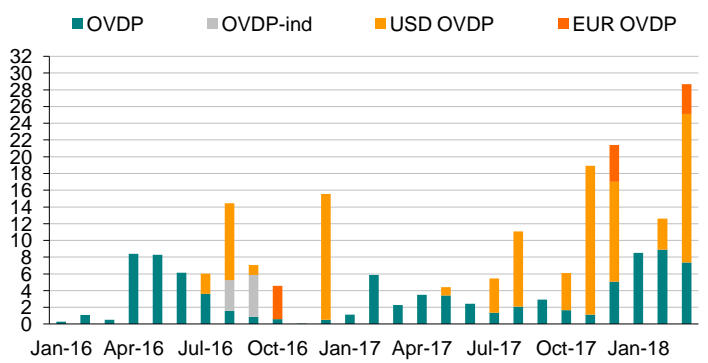
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



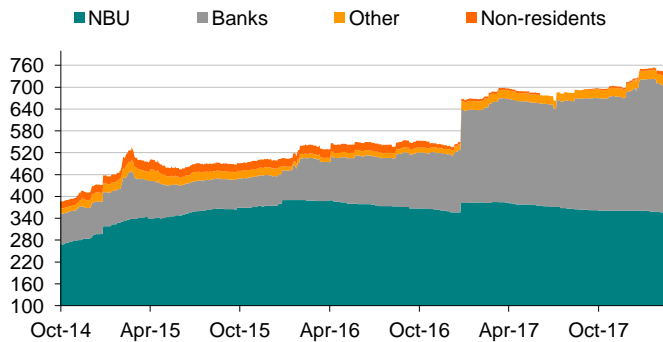
Source: MinFin

Local borrowings, UAHbn equivalent



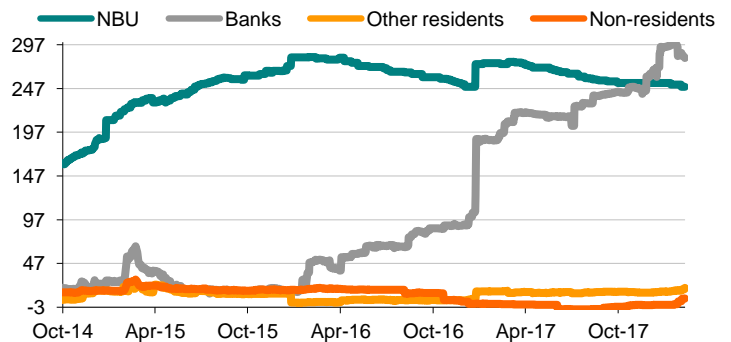
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

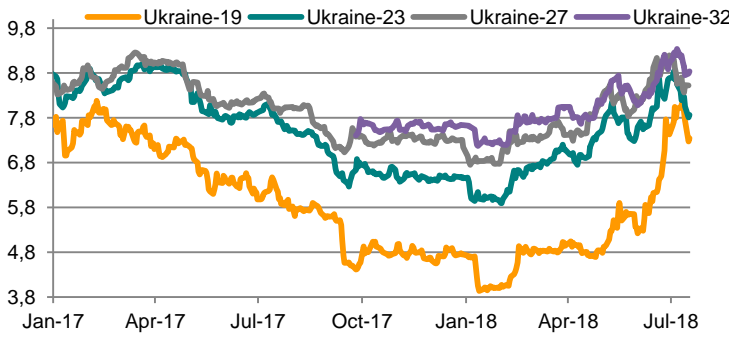


Source: NBU



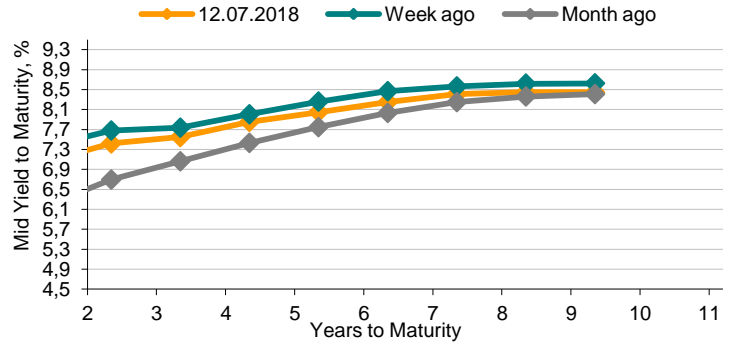
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

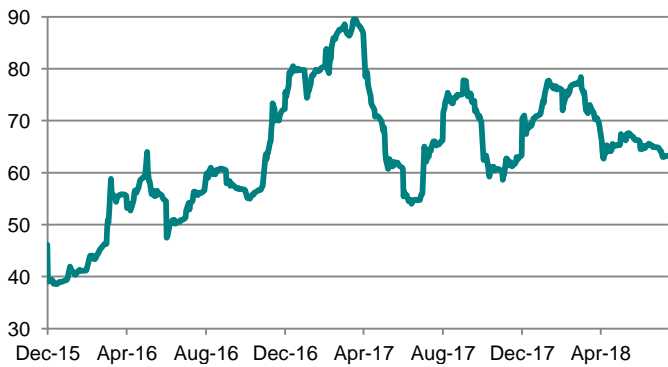
Ukraine's sovereign Eurobond yield curve



Source: Reuters

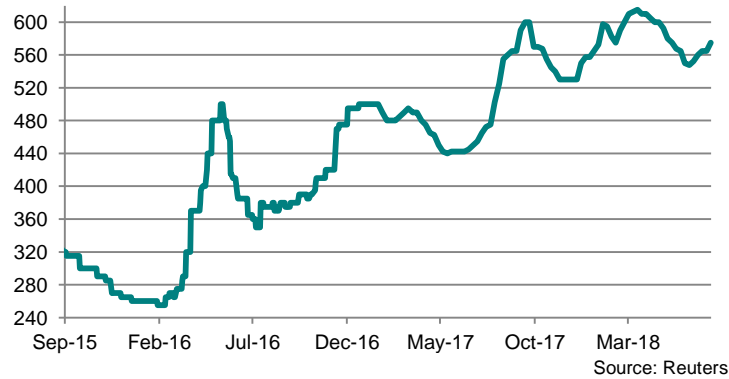
Commodity markets

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



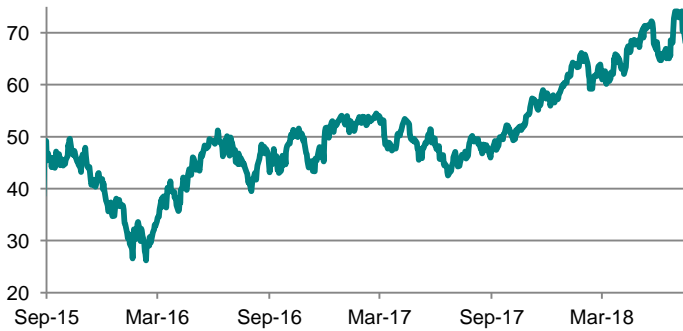
Source: Reuters

Steel CIS export HR coil, USD per ton



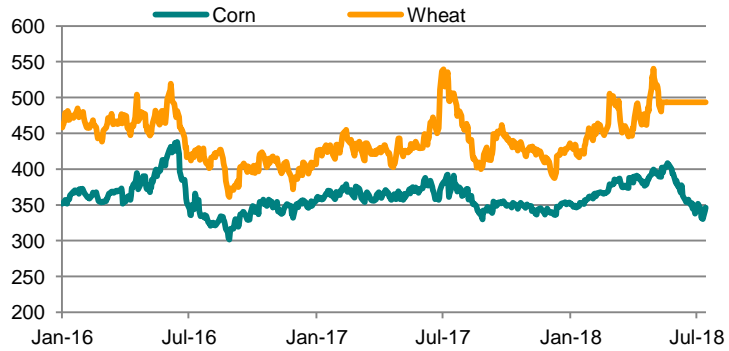
Source: Reuters

WTI oil (nearest active future at NYMEX), USD per barrel



Source: Reuters

Corn and wheat (nearest active future at CBT), USD per bushel



Source: Reuters



Key Macroeconomic Indicators											
Ratings (M/S&P/F) Caa2/B-/B-	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018F
Real sector											
Real GDP (%YoY)	2.3	-14.8	4.1	5.2	0.2	0.0	-6.6	-9.8	2.3	2.5	3.1
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



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