



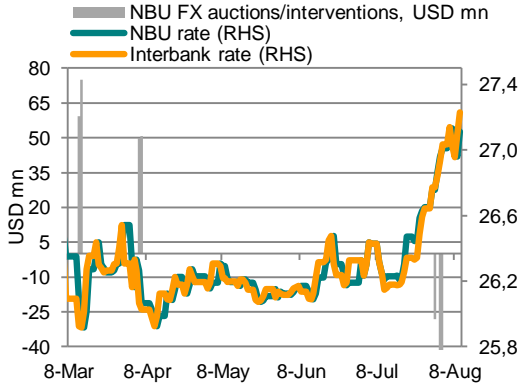
This week in focus: Food prices weigh on CPI in July

Food price deflation in July (the strongest in 3 years), pushed CPI lower, to 8.9% y/y, providing ground for NBU to keep interest rates on hold on the next monetary policy meeting on Sep 6th. We anticipate consumer inflation to take a U-shape, returning to double digits on the back of high domestic demand, adjustment of utility tariffs and worsened weather conditions.

Please see page 3 for more details

FX and interest rates: Taxes and interventions drained banking liquidity

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH closed at 27.11 as of Friday the 10th, as hryvnia fell by 0.4% on a week-on-week basis. Existing pressure on UAH is likely to be alleviated by news of IMF mission coming to Ukraine on September 6th.

Average daily FX volumes on the market amounted to the equivalent of USD 301.7mn, down by USD 19.6mn week-on-week.

Having conducted three currency auctions in the week ending August 3rd, NBU held no currency auction in prior week. At the same time, for a third week in a row NBU currency interventions concentrated on a selling currency from reserves, albeit the magnitude of that were lower in latest week. In particular, NBU sold USD 71mn on the market preferring this time to act only via matching. Moreover, YTD reading of central bank interventions dropped to USD 0.9bn of bought FX currency in 2018, as of August 10th.

Aggregate banking liquidity amounted to UAH 98.0bn as of Friday the 10th, down by UAH 9.1bn during the week, following UAH 4.2bn fall a week ago. There were two factors that affected the strong decline in liquidity. First, NBU interventions aimed to sell hard currency to smooth out market fluctuations. And the second was corporate income taxes paid to the budget. According to requirements, all taxes for 2Q should be paid by the end of this week, which can affect banking liquidity in the current week as well as in prior week. At the same time, we think that the major part of taxes has been already paid before.

Money market rates remained flat: cost of ON funds is around 16.00/16.50, 1 week is 16.25/16.75 while 1M is 17.00/18.00, according to our calculations.

MoF has conducted two primary auctions during the week ending August 10th instead of one. On the first auction, MoF offered seven bond issues including bonds denominated in USD and EUR, which both injected the largest amount of proceeds to the state coffers. At the same time, Ministry of Finance refrained from putting a limit on any issue that time not only on the Tuesday but also on Thursday as well. On the second auction, which was held on August 9th, MoF placed only two issues, namely 3m UAH bonds and 6m USD bonds. In August, 6 UAH issues are to be redeemed for a total UAH 5.9bn, with a largest part being concentrated in the second part of the month. On top of that, one USD denominated issue totalling USD 0.4bn will be redeemed in the middle of the month too. Combined all those maturing bonds amount UAH 16bn in August. During the prior week, MoF borrowed amount denominated in UAH close to that number.

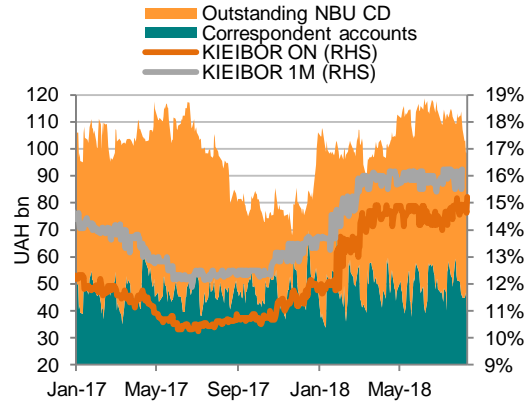
Currently, yields (bids) of local OVDP in UAH at 18.50% (for 6m), 18.50% (for 2Y). 1Y USD bids were at 5.65%, while bids for VAT bonds were at 18.50%.

Figure 5. OVDP auction combined results, 7th of August 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	18.00%	18.00%	18.00%	18.00%	7	7	1.8bn	1.7bn
UAH	6m	18.00%	18.00%	18.00%	18.00%	4	4	1.1bn	1.0bn
UAH	1y	17.90%	17.80%	17.99%	17.70%	8	7	16.3mn	11.8mn
UAH	2y	16.80%	16.80%	16.80%	16.80%	3	3	1.8mn	1.7mn
USD	3m	5.55%	5.52%	5.55%	5.20%	16	16	132.8mn	130.8mn
USD	6m	5.95%	5.89%	5.95%	5.40%	9	9	58.3mn	56.5mn
EUR	3m	4.50%	4.39%	4.50%	4.20%	10	10	68.3mn	69.0mn

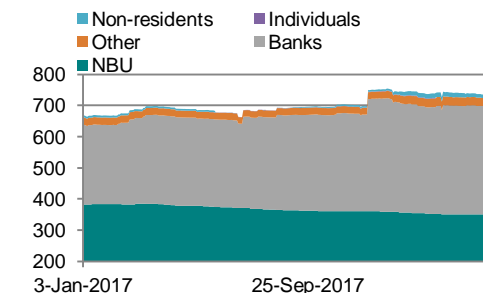
Ukraine's international reserves fell to USD 17.7bn or by 1.3% m/m in July. Ukraine paid USD 321.5mn during the month to service redemption of local bonds, out of which USD 231.6mn were bonds denominated in foreign currency. On the flip side, government managed to borrow USD 130.9 in denominated in hard currency, which indicated that government wasn't able to refinance all redemptions with a new debt issues, covering instead roughly half of that. On top of that, reserves were reduced by net currency interventions of NBU totalling USD 64.4mn during the month. As a result, reserves coverage ratio climb down to a 3.0 threshold.

Figure 2. Banking liquidity (UAH bn)



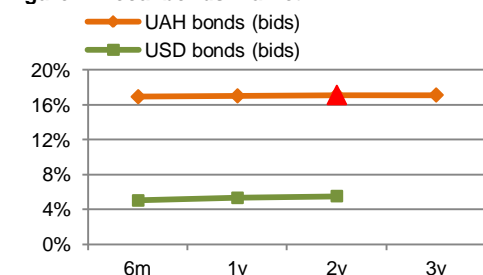
Source: Reuters, NBU, UkrSibbank, Minfin

Figure 3. OVDP holders, UAH bn



Source: NBU

Figure 4. Local bonds market

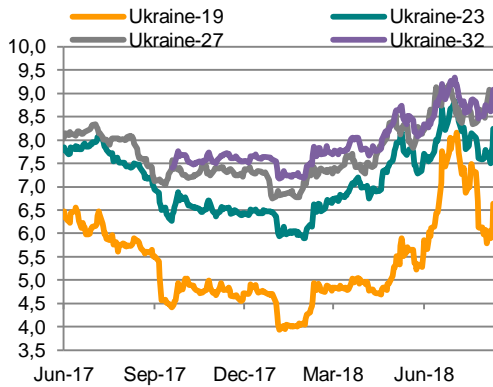


Source: UkrSibbank



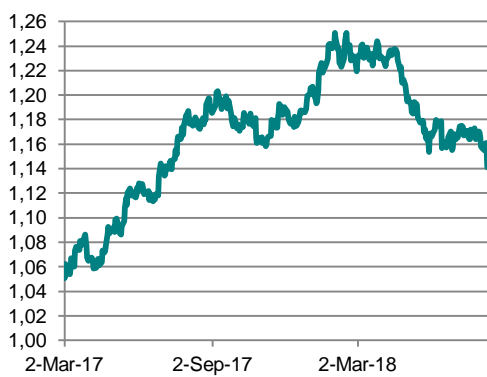
Global markets: Turkish lira is in a free fall

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



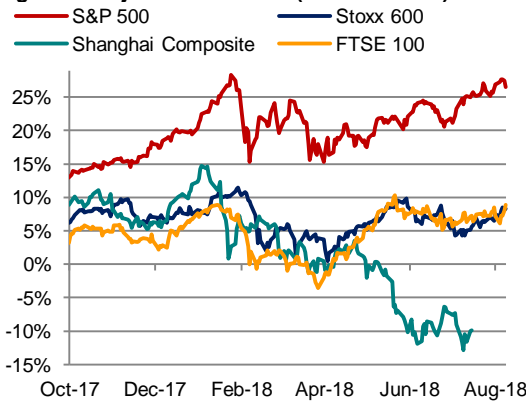
Source: Reuters

Figure 6. EUR USD spot (mid)



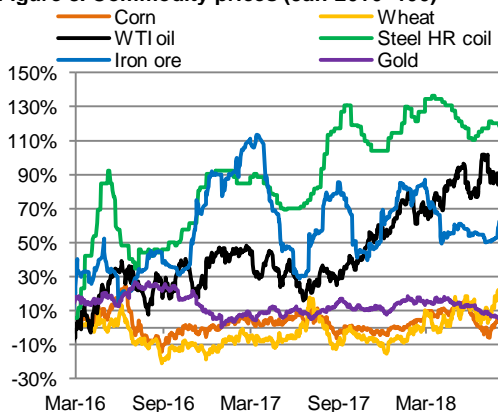
Source: Reuters

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



Source: Reuters

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



Source: Reuters

In July, U.S. inflation remained at high annual level, according to a report of Labor Department. Meantime, on Friday, Turkish lira tumbled by 20% against the U.S. dollar after U.S. President commented that he supported doubling of the metal tariffs for the country. At the same time, China's consumer price index advanced by 2.1 y/y in July, beating analysts' expectations of 1.9%.

Bond benchmarks advanced, with U.S. 10y Treasuries' yield fell by 9bp week-on-week landing at 2.86%, while German 10y Bunds' yields declined by 9bp, matching the decline in yields with their U.S. peers, landing at 0.41%, Japanese 10y bonds yield's ended the week at 0.10, slightly lower compared to the previous week.

Major US stock indices were mixed during the week, as S&P fell by 0.2%, while Nasdaq Composite gained by 0.3% week-on-week. In prior week, the stock markets were under pressure globally following historic plunge of the Turkish lira exacerbated by geopolitical concerns amid growing tensions between U.S and Turkey.

In July, U.S. inflation remained at high annual level, according to a report of Labor Department. U.S. CPI twelve month reading amounted 2.9% and was held steady since June reading was revealed. However, excluding volatile components, core CPI was higher by 2.4% y/y in July up from 2.3% y/y in June. From the prior month, both headline CPI and core CPI increased by 0.2%. Fed officials are widely projected to lift interest rates when they meet at the next meeting in September. The Federal reserve has already raised interest rates twice in 2018.

EUR/USD rate landed at 1.141 as of Friday the 10th, down compared to last week closing level of 1.1567.

Stoxx 600 fell by 0.8% during the week ending August 10th, while German DAX decreased by 1.5% week-on-weeks. The effect of Turkish lira dramatic decline had rippled though effecting European markets as well.

On Friday, Turkish lira tumbled by 20% against the U.S. dollar after U.S. President comments that he supported doubling of the metal tariffs for the country. While lira retraced some loses over the weekend following Turkish central bank moves to improve liquidity, is still devalued by more than 45% since the start of the year. The fall of the Turkish national currency was caused not only by large current account deficit and low reserves, but also difficult political environment. Turkey central bank officials said they ready to take all necessary measures to ensure financial stability after the strong plunge of the national currency.

China's consumer price index advanced by 2.1 y/y in July, beating analysts' expectations of 1.9%. On a month-on-month basis, the CPI delivered gains of 0.3%. At the same time, the core CPI rose by 1.9% in July, being unchanged from June's pace. While food prices increased by 0.5% y/y, non-food prices increased by 2.4% y/y comparing with 2.2% y/y posted a month ago. China's factory prices decreased in July. While prices gained by 4.6% y/y in July, they increased by 4.7% y/y in June. Meantime, raw material prices increased by 9.0% y/y in July, up from 8.8% gains a month ago.

Crude oil prices fell, as WTI futures decreased by a mere 1.3% week-on-week and closed at USD 67.6 per barrel, while Brent futures fell less by only 0.5%, landing at USD 72.8 per barrel.

Gold prices were flat, as NYMEX 1m futures fell by only 0.3% week-on-week and finished the week at USD 1211.1 per troy ounce.

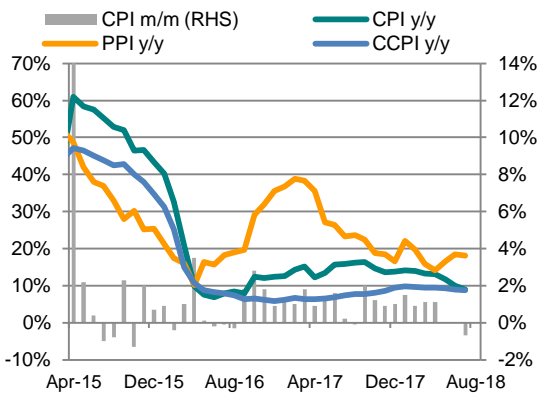
Grains were falling, as CBOT Corn 1m futures declined by 3.2% week-on-week and closed at USD 357.8 per bushel, while CBOT Wheat 1m futures landed at USD 546.8 per bushel, decreasing by 1.7%.

Iron ore was flat, as NYMEX Iron ore 62% Fe 1m futures advanced by a mere 0.5%, week-on-week and closed at USD 68.6 per ton.



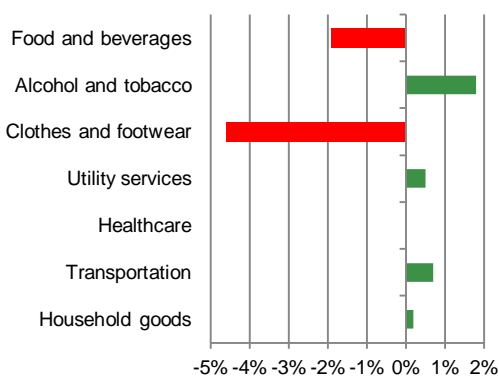
This week in focus: Food prices weigh on CPI in July

Figure 9. Inflation rates in 2015-2018



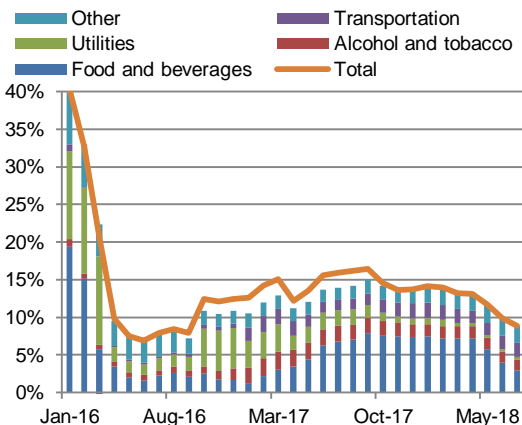
Source: Ukrstat

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



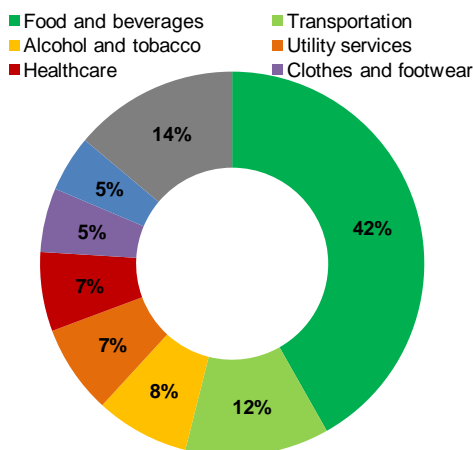
Source: Ukrstat

Figure 11. Inflation drivers in 2016-2018, %



Source: NBU

Figure 11. CPI basket



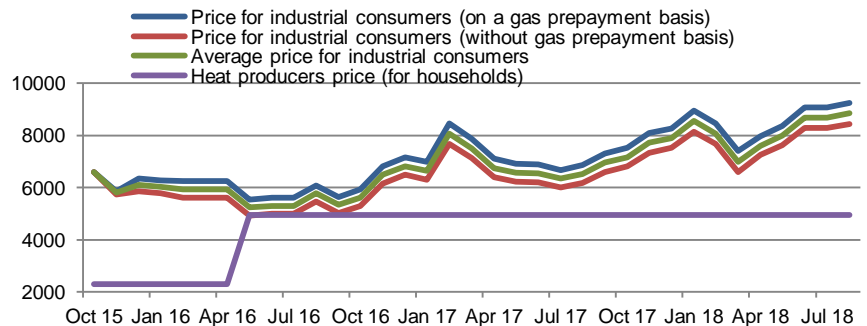
Source: Ukrstat

Food price deflation in July (the strongest in 3 years), pushed CPI lower, to 8.9% y/y, providing ground for NBU to keep interest rates on hold on the next monetary policy meeting on Sep 6th. We anticipate consumer inflation to take a U-shape, returning to double digits on the back of high domestic demand, adjustment of utility tariffs and worsened weather conditions.

According to our expectations, in July inflation continued to decelerate, falling to 8.9% y/y from 9.9% y/y in June. At the same time, inflation broke a two month string of zero inflation, bringing inflation on an m/m basis to deflation territory for the first time in the year.

Food basket posted deflation of 1.9% m/m, which is the healthiest deflation reading since July 2015. The strongest deflationary pressure came from the side of vegetables and fruits, while the former posted -12.4% m/m lower prices in July, the latter was quite close to that with the deflation print amounting to 11.1% m/m. Having fallen by 9.8% m/m in June, egg prices continued to weigh on CPI basket with a deflation reading of 7.6% m/m in July. As we wrote previously, egg prices are entirely in line with a seasonal pattern, when prices are usually bottoming out in the mid of the year. Milk prices also contributed negatively to inflation, posting 1.1% m/m decline in prices during the last month, at the same time, twelve month reading landed at +14.9% y/y. In the meantime, other major components increased mildly by 0.2 – 1% m/m in the second month of summer. Early results indicated that Ukraine farmers gathered 30.7mnt of grains, from area of 8.9mha with average yield of 3.43 t/ha as of August 8th. At the same time a year ago, similar numbers indicated stronger performance, namely farmers gathered 33.4mnt of grains from less area of 8.8mnha, with higher yield of 3.79 t/ha. At the same time, wheat, which is a king crop of early crops, bears the brunt of major decline, as yields of 3.74 t/ha were lower by around 8.6% from 4.09 t/ha reported a year ago, as of the same date of August 8th. We can conclude from that that early crops' harvest will be weaker compared to a year ago.

In regard to utilities, there was no strong upward or downward pressure on CPI basket, as opposed to the case with food basket. In this subcategory, prices advanced by a mere 0.5% m/m, resulting in y/y reading of 4.6% in July. The question of increasing gas tariffs for households was delayed as of now. Based on our calculations, prices of gas to households are to be increased by around 46% to bring them in line with market prices. At the same time, prices of gas to heat producers should be increased by roughly the same amount. At the same time, this should be translated in slightly less amount of increase in heating bill for end consumers. Based on our calculation this could add 1.2-1.3% to CPI as soon as heating season begins. The last time prices of regulated segment were brought in line with non-regulated in April-March of 2016, since then there was no increase at all.



Transportation prices advanced by 0.7% m/m in July slightly up from 0.6% m/m reported a month ago. While price of fuel were brought in the deflationary territory, falling by 0.3% m/m, prices of auto transportation for households increased by 3.6% m/m in July. **Prices of alcohol and tobacco delivered gains of 1.8% m/m** in July, following 1.6% m/m increase in June. From the beginning of the year prices has already increased by 11%, posting from January increase of around 1.5% on average in 2018 so far

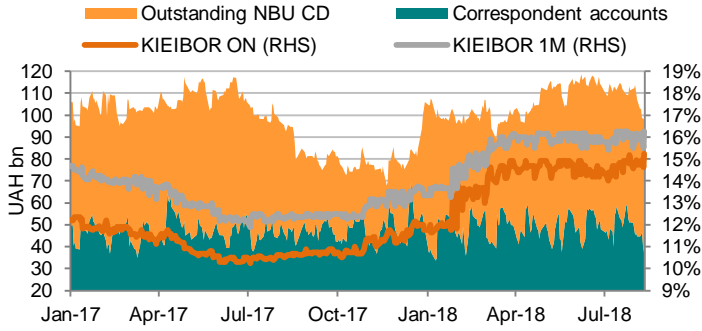
Core consumer prices moved in line with headline reading, namely falling into deflation territory during the month. In particular, price fell by 0.1% m/m. At the same time prices slightly decelerated on y/y basis to 8.8% y/y from 9.0% y/y. In contrast to that, **industrial prices showed some acceleration on a m/m basis to 1.6% in July** from 1.1% in June. Despite that, y/y reading posted lower prices growth in July at 18.1% from 18.4% in prior month. In the meantime, real wages increased by 13.0% in June, putting additional pressure on prices. While we believe both wages and social payments growth are likely to lose steam in the second half of the year due to budget constraints, a pressure stemming from vivid domestic demand growth remains a key inflation driver going forward.

We also expect oil prices to remain on elevated levels, creating upward pressure on CPI across the board. Also, we factor in gradual local currency depreciation (in a likely scenario of IMF deal being concluded beginning of Q4 2018). **All in all, we see reasons to maintain our CPI growth forecast of 10.9% for 2018 and 7.1% for 2019.**



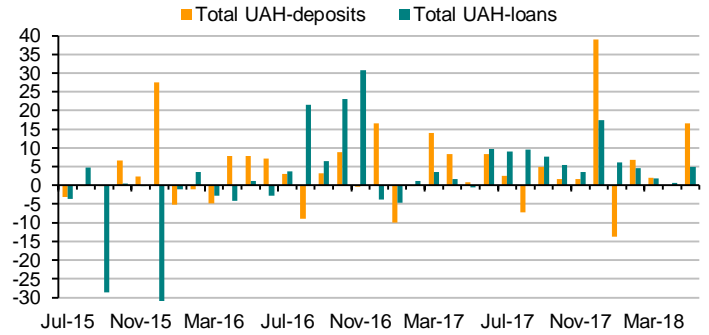
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

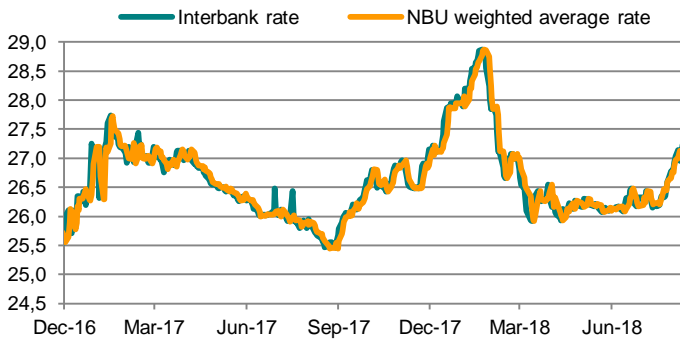
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

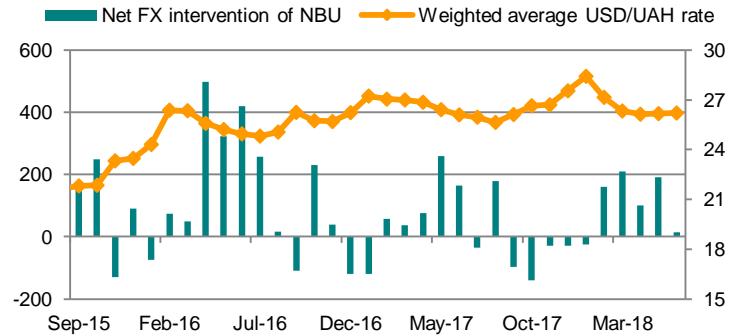
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

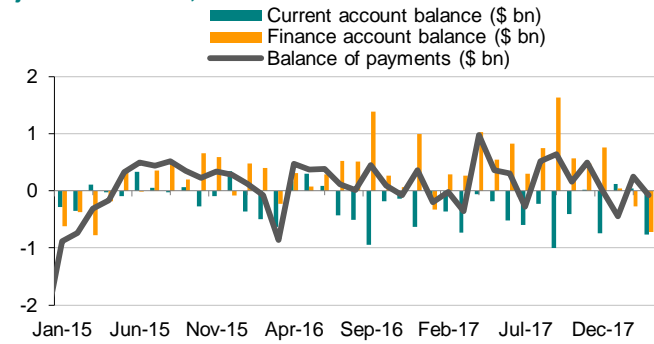
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

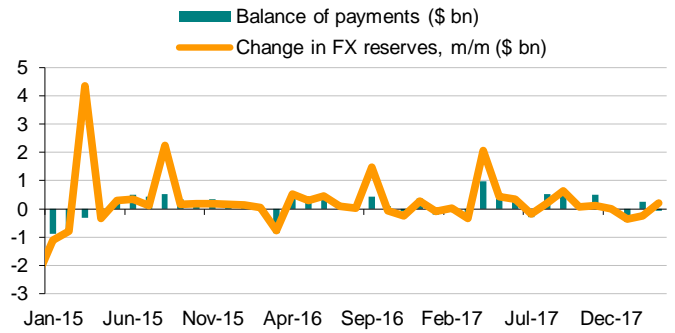
Balance of payments

Major BoP accounts, USDbn



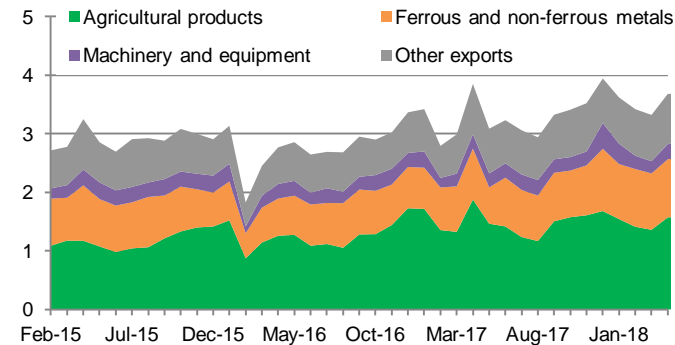
Source: NBU

BoP vs change in foreign reserves, USDbn



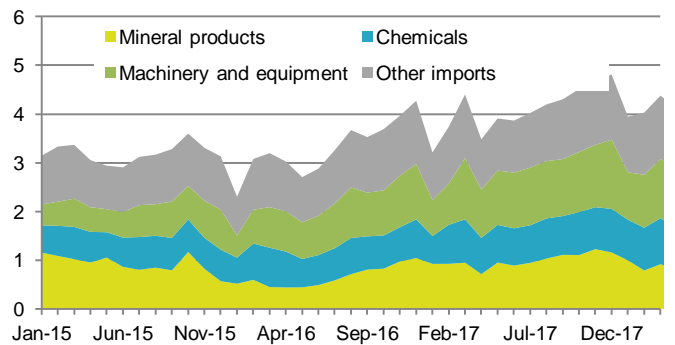
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU

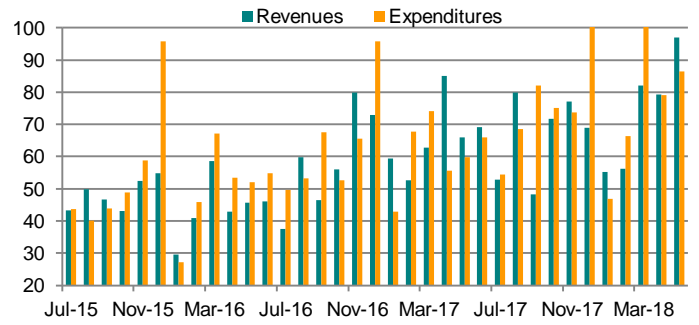


Budget performance

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

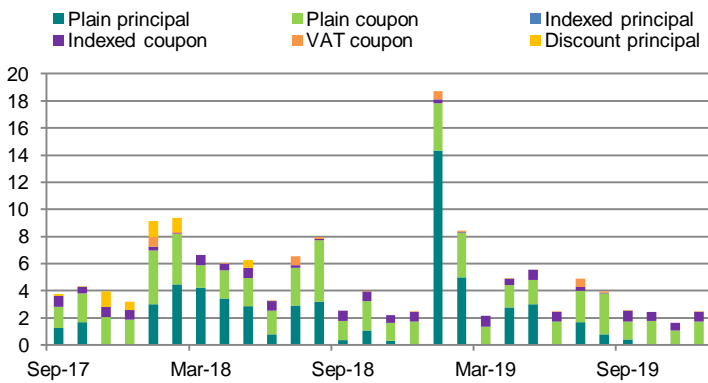


Source: NBU

Source: NBU, State Treasury

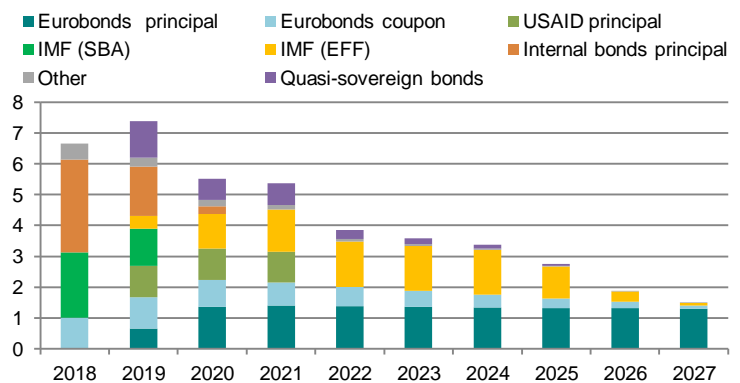
Sovereign debt

UAH- denominated debts' repayments schedule, UAHbn



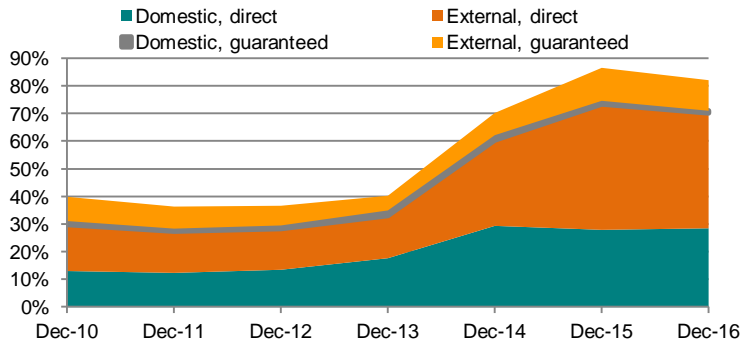
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



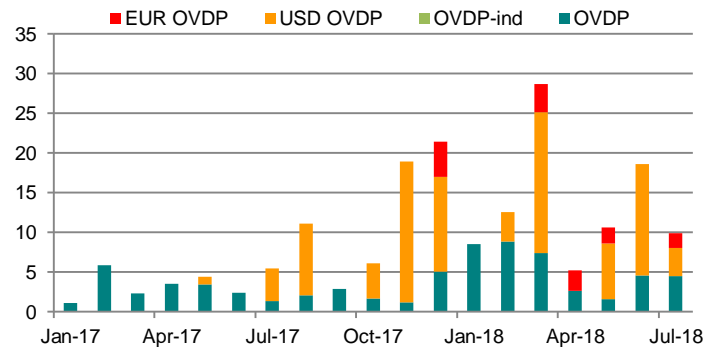
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



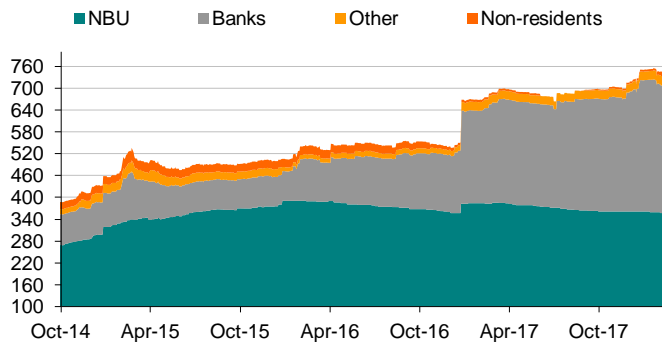
Source: MinFin

Local borrowings, UAHbn equivalent



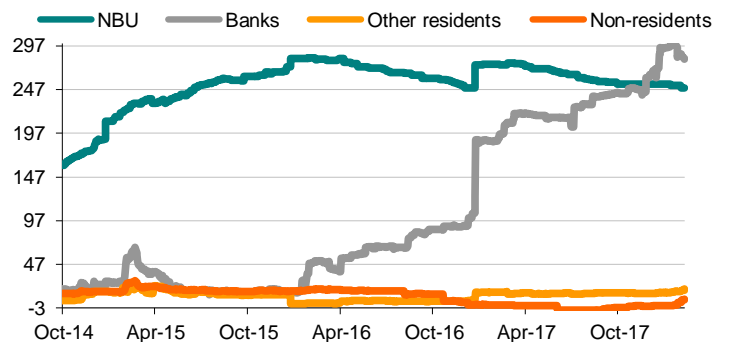
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

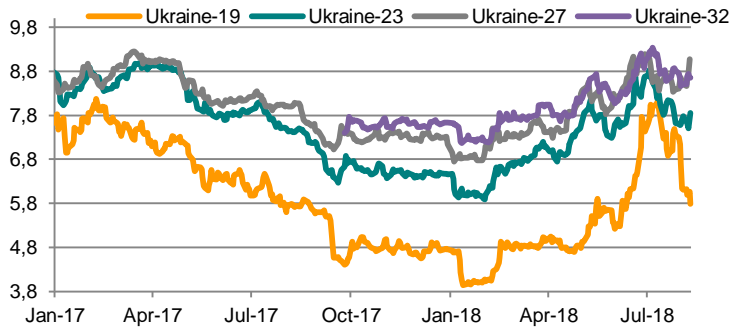


Source: NBU



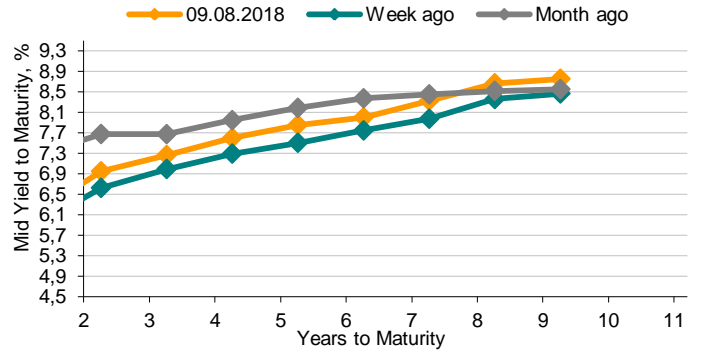
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

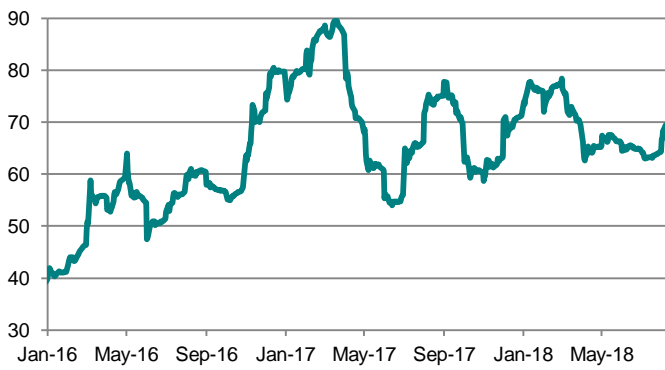
Ukraine's sovereign Eurobond yield curve



Source: Reuters

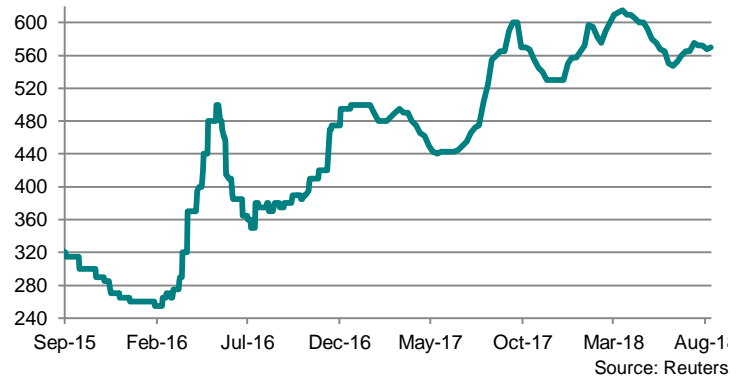
Commodity markets

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



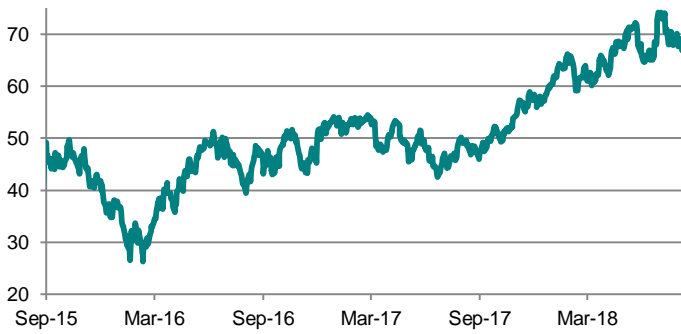
Source: Reuters

Steel CIS export HR coil, USD per ton



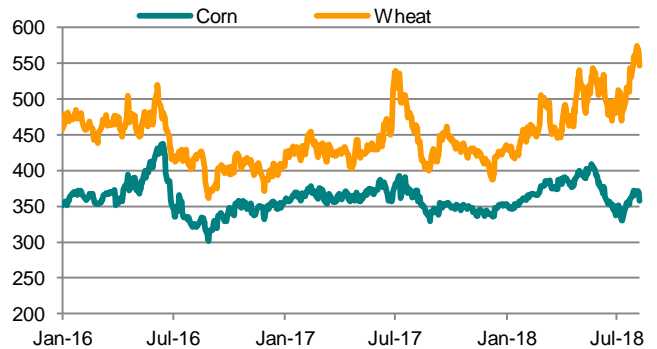
Source: Reuters

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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