



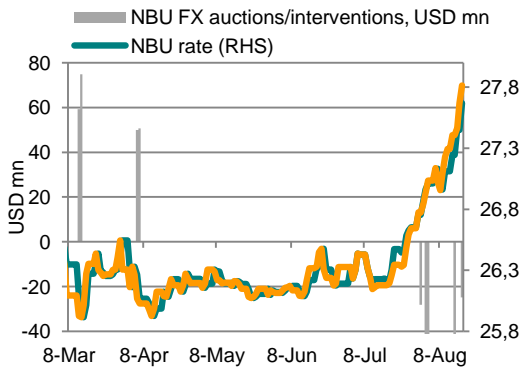
This week in focus: Banking system loss in 2Q18 is of a non-recurring nature

While banking system posted a loss in 2Q18 due to accelerating loan loss provisioning, we do not see this as a broader trend among all banks in the sector. More importantly, only one bank was responsible for the bulk of those losses, without which the other banks were profitable in 2Q18. We expect banking system to post a first net profit in 2018 for the first time in many years.

Please see page 3 for more details

FX and interest rates: Liquidity continues to bear the brunt of taxes and interventions

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH closed at 27.67 as of Friday the 17th, as hryvnia fell by 2.1% on a week-on-week basis. Drastic decline in liquidity should support hryvnia in the nearest time.

NBU conducted two currency auctions during the week ending August 17th, selling combined USD 91.4mn. On top of that, NBU resorted to interventions via matching totalling USD 70mn. At the same time, NBU sold USD 215mn during only a one single week. For the last three weeks, amount of sold FX on the market to support national currency accounted for USD 0.5bn. All in all, YTD reading of bought FX on the market stood at USD0.7bn by the end of the week.

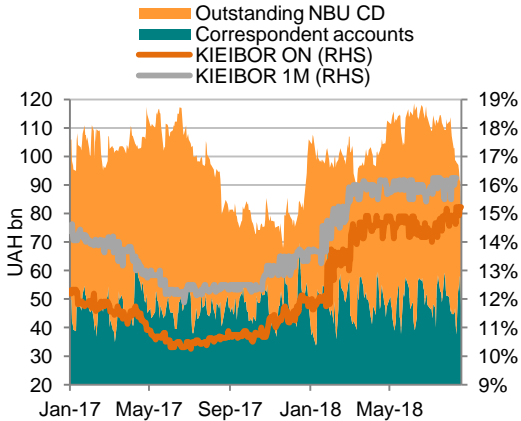
Aggregate banking liquidity amounted to UAH 80.0bn as of Friday the 1th, down by UAH 17.0bn during the week, following UAH 9.1bn fall a week ago. As we wrote in previous weekly two factors caused decline in banking liquidity in the week ending August 11th, the same two factors drastically reduced liquidity in the week ending August 17th. At the same time the magnitude in which they affected liquidity changed (accelerated). In prior week, the currency interventions of the central bank to support national currency decline accounted for roughly UAH 6n of drop in liquidity. And we attribute the major part of decline to the fact that the end of prior week was official deadline for corporate clients to pay quarterly income taxes to the budget. (Please see Weekly dated August 14th). Going forward, only UAH 2.2bn was reimbursed in August as of the end of prior week, leaving the major part to be reimbursed in the shorter week ending August 23rd and next. This factor is to drive liquidity higher in the nearest term. Given that the average monthly VAT refund in 2018 so far was UAH 10.8bn it could add by roughly UAH 9bn by the end of the month to banks liquidity.

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.

Having attracted from the budget UAH12.6bn in the week ending August 11th, **MoF proceeds from the placements tumbled meaningfully by about ten times on the latest primary auction.** USD denominated issues with 2 years maturity took the top spot this time, as measured by demand and placement size, followed by UAH issue with 3 months maturity. On prior week USD denominated issues was redeemed for a total of USD0.4bn. In regard to UAH denominated issues, there were two redemptions of them on the prior week totalling UAH3.4bn combined. On the next week will be redeemed UAH bonds, amounting to UAH 0.8bn.

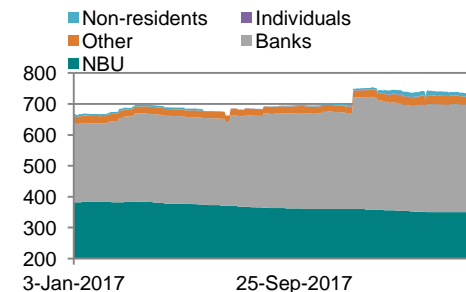
Currently, yields (bids) of local OVDP in UAH at 18.50% (for 6m), 18.50% (for 2Y). 1Y USD bids were at 5.65%, while bids for VAT bonds were at 18.50%.

Figure 2. Banking liquidity (UAH bn)



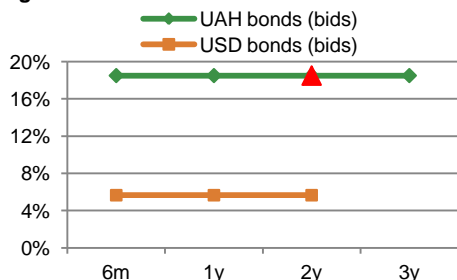
Source: Reuters, NBU, UkrSibbank, Minfin

Figure 3. OVDP holders, UAH bn



Source: NBU

Figure 4. Local bonds market



Source: UkrSibbank

Figure 5. OVDP auction combined results, 14th 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%	11	11	1.1bn	1.0bn
UAH	12m	17.90%	17.90%	17.90%	17.90%	3	3	3.2mn	2.8mn
UAH	3y	16.70%	16.70%	17.10%	16.70%	4	2	15.6mn	4.8mn
USD	2y	5.95%	5.95%	6.50%	5.95%	19	16	54.5mn	50.3mn

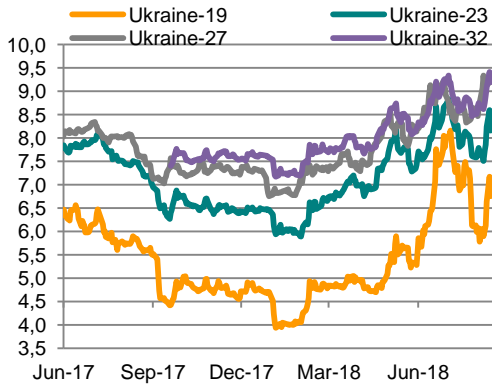
According to the latest data from Ministry of Agriculture, **Ukraine's harvest of yearly crops proved to be worse comparing to the prior year result.** While the acreage area was higher this year by around 2% to 9.6mnha, the declining average yield was lower by about 12% at 3.47 t/ha vs 3.94 t/ha a year ago. As a direct consequence, harvest of yearly crops amounted to 34mnt, down from 37.3mnt reported in prior year. If measured by physical volume early crops, namely wheat, accounts for slightly half than overall harvest of the country for example in prior year early crops harvest comprised roughly 60% from combined harvest. At the same time, if measured by value to the country harvest of late crops is more important, provided that main crops are corn and sunflower. Given that the wheat price is higher it seems that as measured by value the early harvest is more important too. But in reality one of the main types of crops which are harvested in late crops is sunflower, which is directly undergoes transformation to sunflower oil the price of each is several times higher compared to wheat and corn. It's not already clear how late crops will perform.



Global markets:

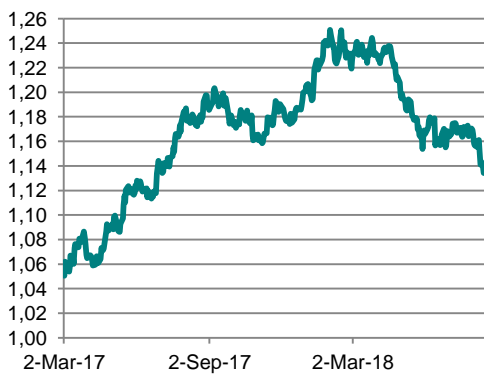
U.K. inflation accelerated recently

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



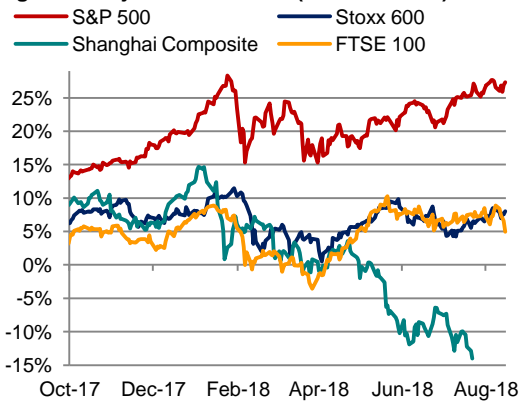
Source: Reuters

Figure 6. EUR USD spot (mid)



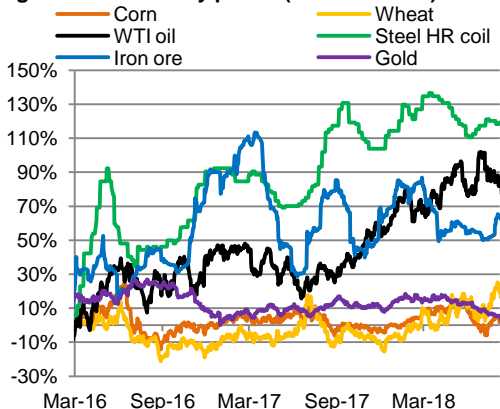
Source: Reuters

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



Source: Reuters

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



Source: Reuters

In an updated economic outlook Congressional Budget Office forecasted real GDP would grow by 3.1% in 2018. In the meantime, U.K. inflation slightly increased in July, according to the latest data from Office of National Statistic. In regard to China, there was a deceleration of economy in recent time, as key macroeconomic indicators showed weaker performance.

Bond benchmarks were mixed, with U.S. 10y Treasuries' yield increased by 1bp week-on-week landing at 2.87%, while German 10y Bunds' yields increased by 2bp, exceeding the increase in yields of their U.S. counterparts landing at 0.31%, Japanese 10y bonds yield's ended the week at 0.095, lower compared to the previous week.

Major US stock indices were mixed during the week, as S&P increased by 0.6%, while Nasdaq Composite closed slightly negatively by 0.3% week-on-week. The main event of prior week was earnings result of Wal-Mart. Having beaten forecasts by far, shares skyrocketed by around 9% on Thursday, giving a boost to S&P 500 in that day, which closed by 0.8% higher.

In an updated economic outlook Congressional Budget Office forecasted real GDP would grow 3.1% in 2018, exceeding prior year growth. At the same time, CBO said it expected economical growth to slow in the second half of 2018 and in 2019. In 2019, the pace of economic expansion will slow to 2.4%, stemming mainly from business investment and government consumption, according to the agency forecast. At the same time, CBO gave some remark that effect of a trade wars could cause a bigger negative effect on the U.S. economy. Moreover, from 2023 to 2028, the CBO forecast the GDP to grow by about 1.7% per year.

EUR/USD rate landed at 1.1437 as of Friday the 17th, remaining effectively flat compared to last week closing level of 1.141.

Stoxx 600 fell by 1.2% during the week ending August 17th, while German DAX decreased by 1.7% week-on-week. Looming Italian budget risk, German elections and spectre of higher tariffs acted as a headwind during the week.

U.K. inflation slightly increased in July, according to the latest data from Office for National Statistic. At the same time, CPI increased to 2.5% y/y from 2.4% in June, reversing prior trend of gradually declining inflation in 2018. While prices of transport tickets and fuel had increased, at the same time, prices of women's clothing and footwear declined coupled with financial services. In a separate report, Office of National Statistic showed that unemployment in the U.K. declined to 4.0%, which the lowest reading observed since early 1970.

Chinese key macroeconomic indicators showed signs of deceleration. The pace of growth of investment in fixed assets was the weakest since yearly 1996. It expanded by 5.5% in January-July period, being much lower than initially expected. At the same time, fixed assets investment grew by 3.0% y/y in July. Moreover, retail sales rose by 8.8% y/y in July, down from 9.0% y/y in June, indicating that consumers more reluctant to spend more money. Meantime, industrial production rose by 6.0% in July, matching increase reported a month ago.

Crude oil prices decreased, as WTI futures decreased by a 2.5% week-on-week and closed at USD 65.9 per barrel, while Brent futures fell 1.3%, landing at USD 71.8 per barrel.

Gold prices were declining, as NYMEX 1m futures fell by only 2.9% week-on-week and finished the week at USD 1176.5 per troy ounce.

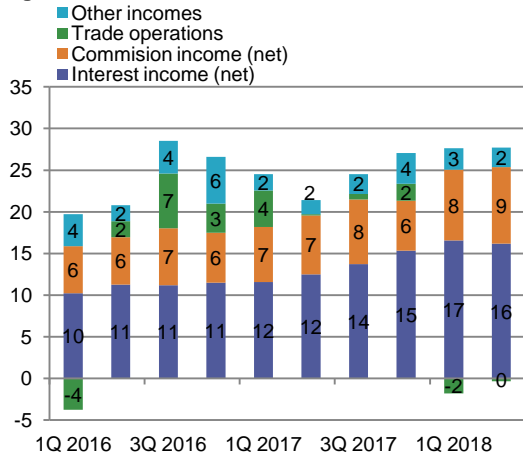
Grains were on the rise, as CBOT Corn 1m futures increased by 1.8% week-on-week and closed at USD 364.3 per bushel, while CBOT Wheat 1m futures landed at USD 560.5 per bushel, gaining by 2.5%.

Iron ore was flat, as NYMEX Iron ore 62% Fe 1m futures fell by a 0.9%, week-on-week and closed at USD 68.0 per ton.



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Figure 9. Bank income in 2016-2018, UAHbn



Source: NBU

Figure 10. NPL in the banking system, UAHbn

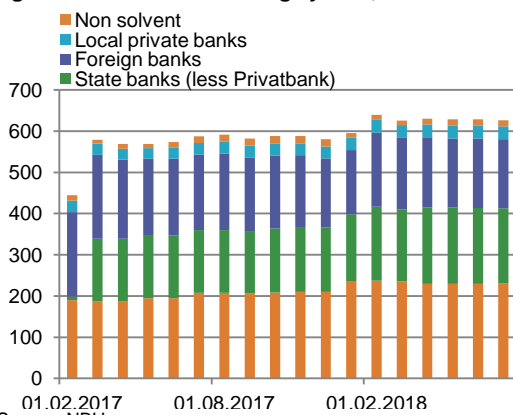
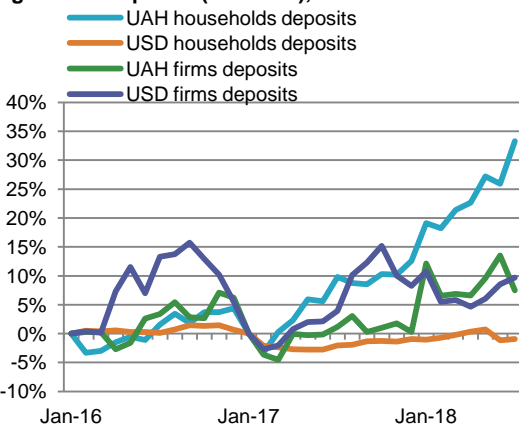
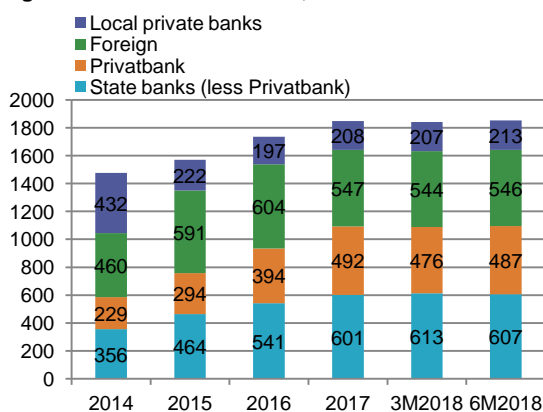


Figure 11. Deposits (2016=0%), %



Source: NBU

Figure 12. Banks total assets, UAHbn



Source: NBU

While banking system posted a loss in 2Q18 due to accelerating loan loss provisioning, we do not see this as a broader trend among all banks in the sector. More importantly, only one bank was responsible for the bulk of those losses, without which the other banks were profitable in 2Q18. We expect banking system to post a first net profit in 2018 for the first time in many years.

From the start of the year households UAH deposits increased by 11.9% by the end of 1H18. At the same time, they posted gains of only 3.0% by the end of 3M18, accelerating in the second quarter of the year. Household deposits denominated in USD also were higher by the end of 1H18 vs 2H17. In particular they gained by a mere 0.1% YTD. At the same time, in 1Q18, they increased by a 1.4% YTD, which indicates a slowdown of the growth in the second of the year and even some decline on a m/m basis during 2Q18. In contrast to that, deposits of corporate sector both USD and UAH denominated declined. While deposits in UAH fell by 4.2% YTD in 1H18, the deposits in USD decreased by only 1.0% YTD in 1H18. As a result of that, the share of household deposits to total banking liabilities increased to 42.5% in 2Q18, up from 41.8% in 1Q18.

While the amount of UAH denominated loans of corporate sector had been growing in 2018 for 5 consecutive months in a row resulting in 2.3% YTD growth in May, in June loans declined on a m/m basis, bringing 5 month string of gains to an end. As a result, UAH corporate loans increased by modestly by 0.1% YTD in 6M18. Meantime, while the amount of corporate FX loans fell by 0.2% YTD in 6M18, but the same numbers adjusted for FX gains resulted in 7.0% YTD gains in 1H18, almost in line with amount of gains reported in 1Q18 at 7.2%. As a result of decline of corporate loans in UAH in June, by the end of the month the share of corporate client loans to net assets slightly fell to 32.5% in 2Q18 from 33.8% 1Q18. At the same time, loans to households showed much brighter performance during the second half of the year, stemming mainly from good performance of UAH loans vs weak performance of USD loans. While UAH loans gained by 6.5% YTD in 1Q18, they accelerated its pace of expansion growing by 14.2% YTD in 6M18. At the same time, loans in USD fell by 2.5% YTD in 6M18, much higher compared to 0.2% YTD in 3M18. As a result, performance of the household loans (both combined UAH and USD denominated) was by far good, provided that the share of UAH loans as much as twice larger of the share of USD loans. As a consequence, the share of household's loans to net assets increased to 7.7% by the end of 2Q18, up from 7.3% by the end of 1Q18.

Banks total assets slightly increased during the second quarter and landed at UAH 1,9bn. While assets of Privatbank, Foreign banks and local private banks increased slightly during the month, assets of state banks (less Privatbank) slightly climbed down in 2Q18. In 2Q18, banks increased the amount of cash they held as a percentage of their net assets. In regard to loans there were two different trends. While the share of corporate loans slightly declined, the share of retail loans gained to 7,7% from banking system net assets, as of end of 2Q18 (among solvent banks).

In 2Q18, bank income remained at higher level comparing to a year ago. Interest income (net) growth pared its gains to 30% y/y growth, from 43% y/y reported in a prior quarter. The deceleration was caused partly by slowdown of growth of the interest income to around 0% y/y in June. Meanwhile, the growth of commission income (net) slightly accelerated to 30% y/y from 28% y/y reported in 1Q18. Health divergence in interest rates remains. But while rates on household's deposits were steady, rates on firms' deposits were increasing in recent time.

On the expenses side, **LLP accelerated in 2Q18 in contrast to 1Q18.** In particular, provisions for bad loans reached UAH8.3bn, up from UAH 1,1bn reported in 1Q18. As a result, banking system profits turned to losses in the 2Q18 of UAH 0,6bn vs UAH 8,8bn of profit in 1Q18. At the same time, in 1H18 banking system was profitable by UAH 8,3bn vs UAH 1,7bn losses for the same period a year ago.

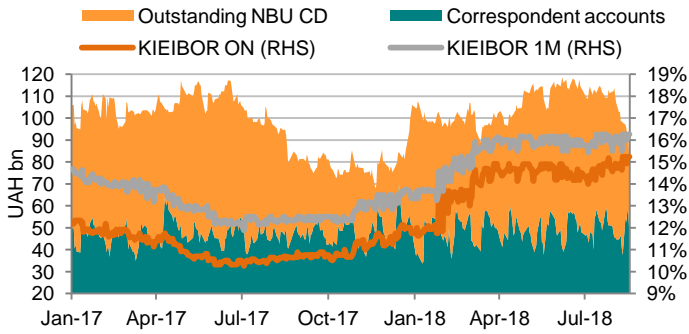
We do not see a drastic acceleration of the loan provisioning in the banking system as a major trend among all banks. More importantly is that losses in the second quarter of the year we treat as one off event, caused by only one bank. In particular, only one bank with Russian capital (Sberbank) loan loss provisions caused more than 80% of the overall provisions of the banking system in 1H18 and roughly 90% of them were made in 2Q18, namely in June. Without that loss of one big bank, banking system (with the exception of Sberbank of Russia Ukraine) would have reported moderate net profits by far. Given that, we expect to see also profits in the second half of the year. And banking system should report profits for the first time in many years.

The share of NPL to loans was almost the same at roughly 56% in 2Q18 vs 1Q18, according to NBU data. The total amount of NPL in the banking system comprised UAH 626.1bn, as of July 1st, down from UAH630bn posted as of end of 1Q18. Lower amount NPL in 2Q18 stemmed mainly from state banks (less Privatbank) and international banks. In particular, state banks (less Privatbank) have decreased NPL for a total of UAH 3.1bn (which was led by Ochadbank accounting for the major part of that). At the same time, international banks decreased their amount of NPL by UAH 2.4bn during the 2Q18. As a result, their shares of NPL to loans fell slightly to 71.06% in 2Q18 from 72.29% in 1Q18 and to 42.54% in 2Q18 from 43.27% in 1Q18 for state banks (less Privatbank) and international banks respectively.



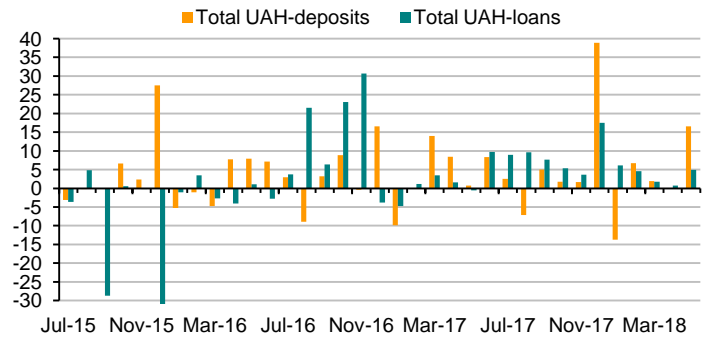
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

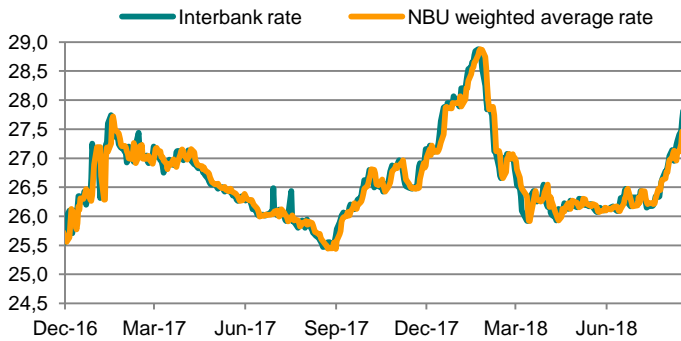
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

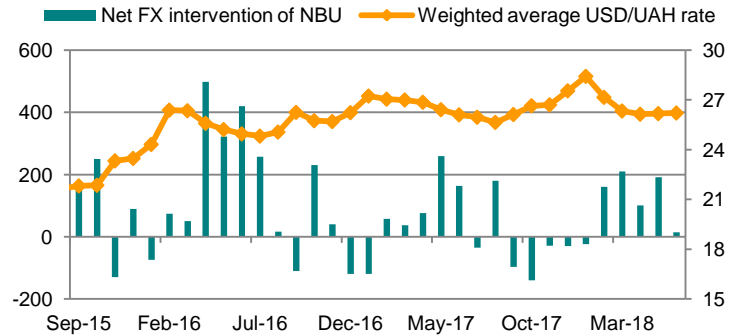
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

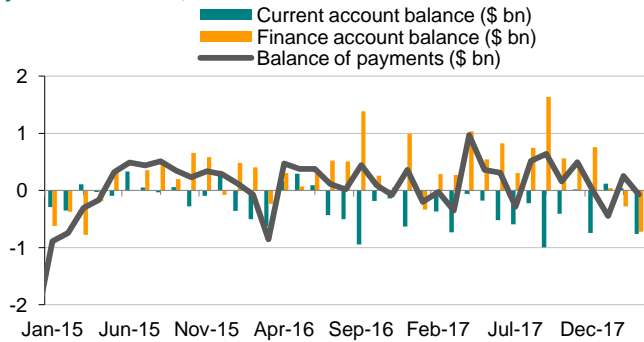
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

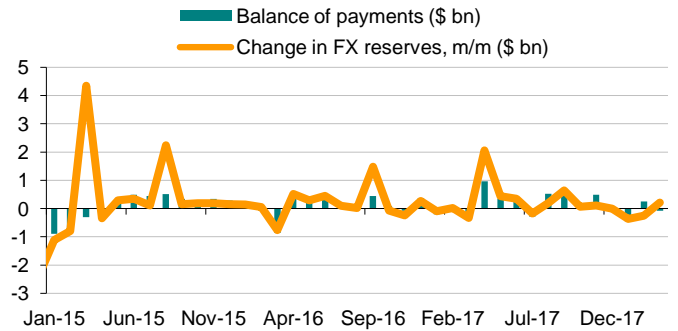
Balance of payments

Major BoP accounts, USDbn



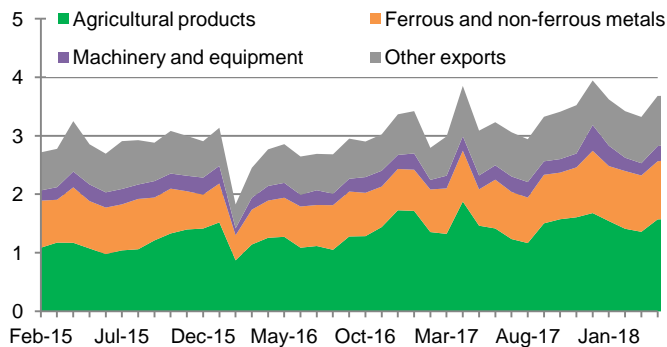
Source: NBU

BoP vs change in foreign reserves, USDbn



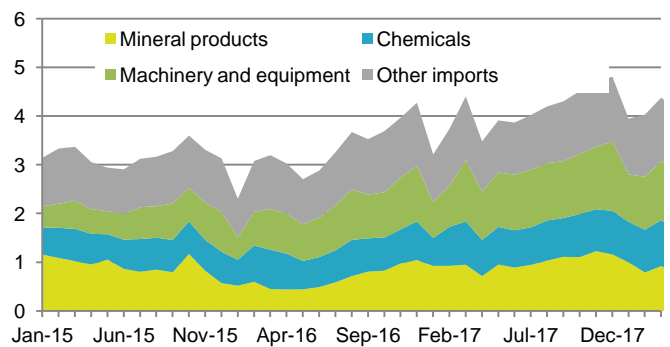
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU



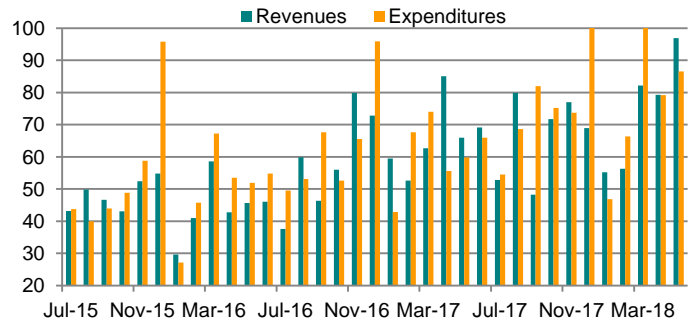
Budget performance

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

Source: NBU

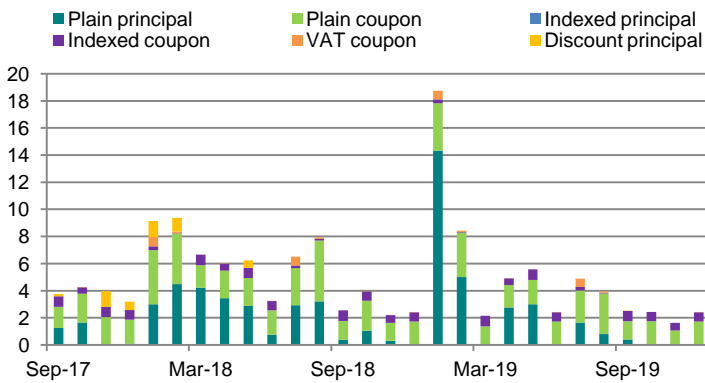
Monthly change in budget revenues and expenditures, UAHbn



Source: NBU, State Treasury

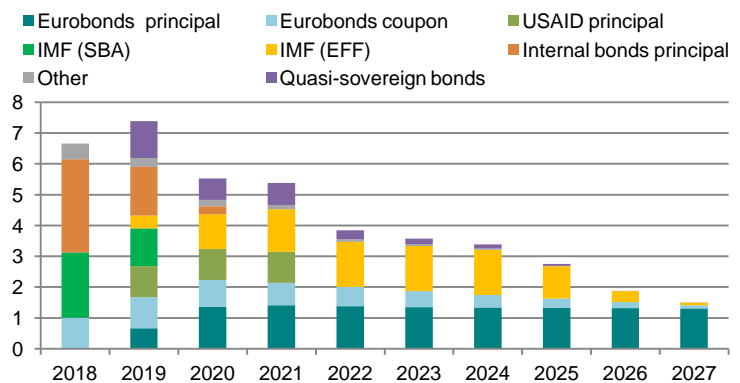
Sovereign debt

UAH-denominated debts' repayments schedule, UAHbn



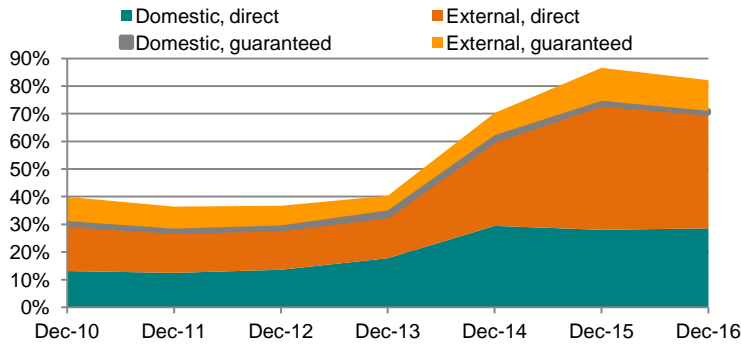
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



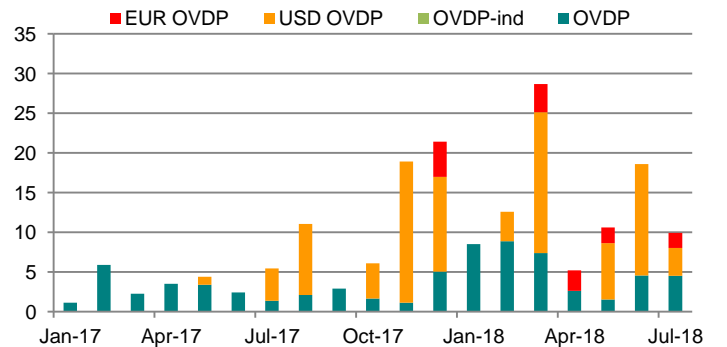
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



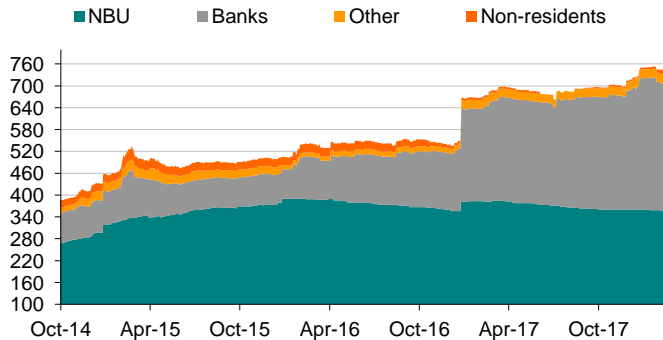
Source: MinFin

Local borrowings, UAHbn equivalent



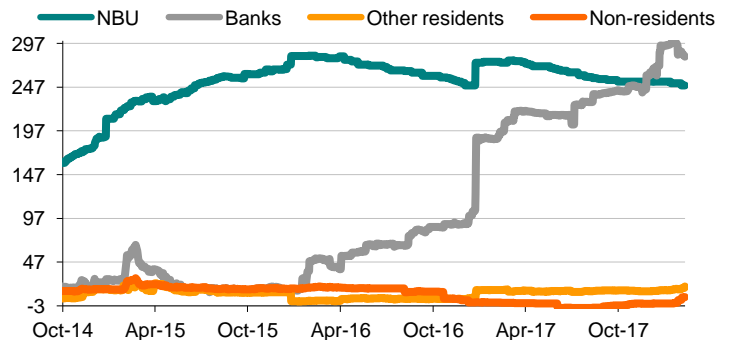
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

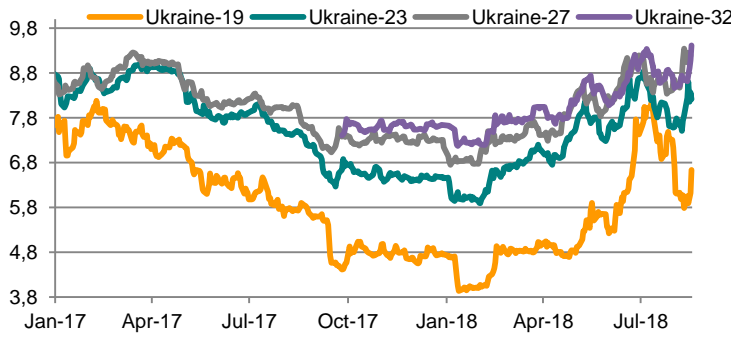


Source: NBU



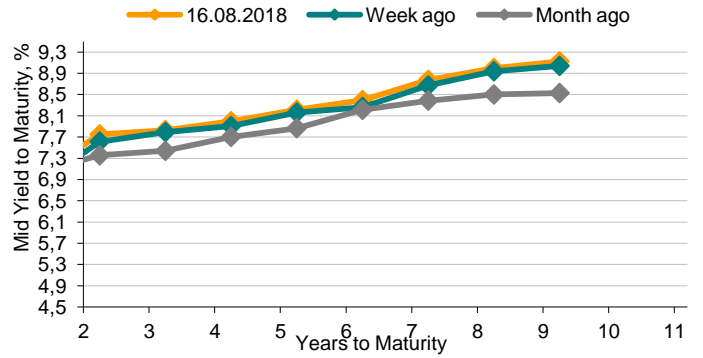
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

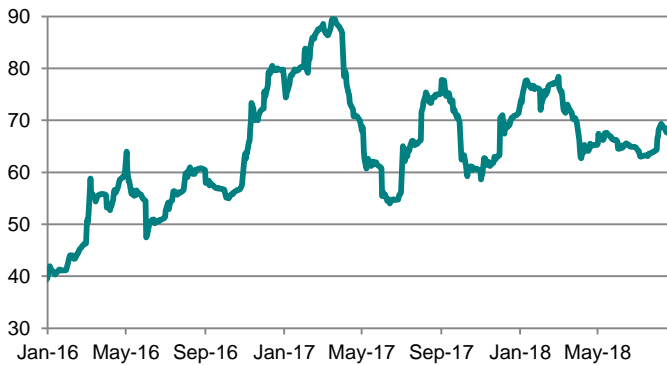
Ukraine's sovereign Eurobond yield curve



Source: Reuters

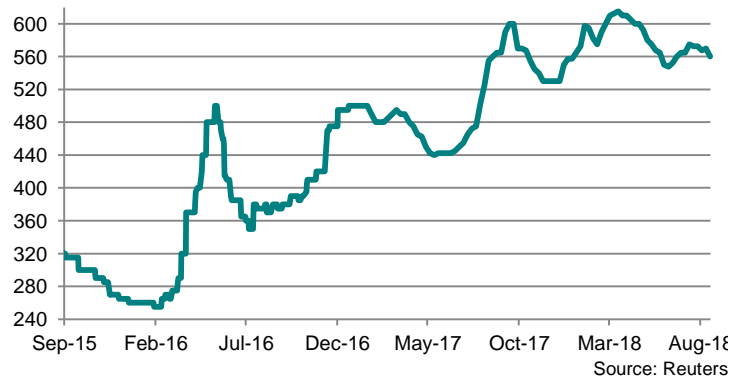
Commodity markets

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



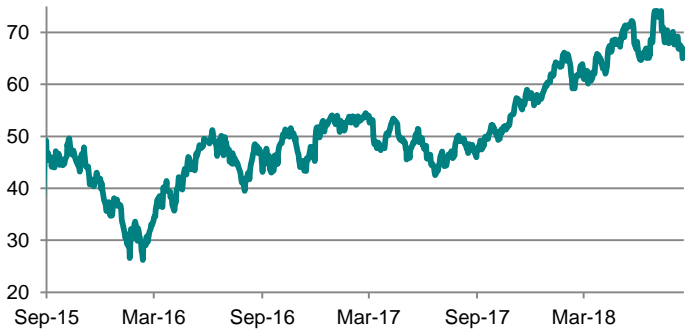
Source: Reuters

Steel CIS export HR coil, USD per ton



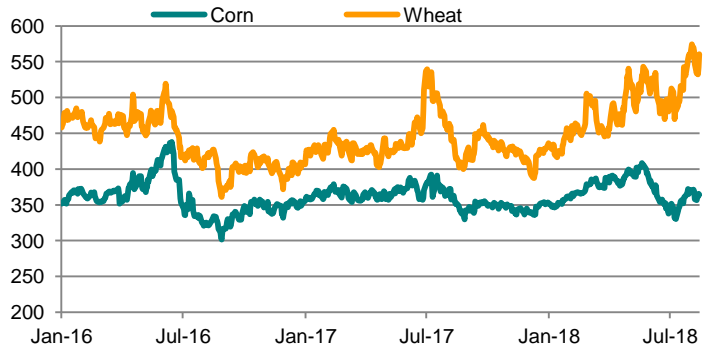
Source: Reuters

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	18.4
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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