



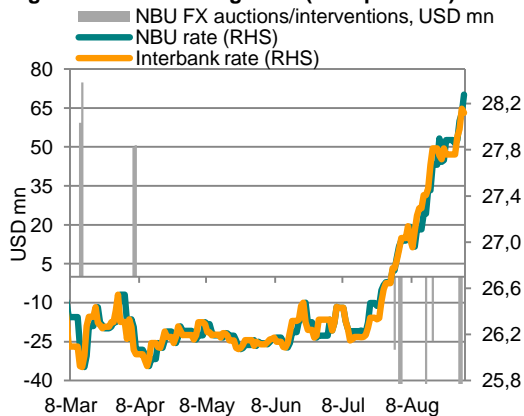
**This week in focus: Ukraine's C/A deficit: hitting a milestone in July**

In July, Ukraine's C/A delivered the highest monthly deficit in almost 5 years, being driven for the most part by skyrocketing goods trade deficit to USD 1.7bn, which was the highest reading since December 2013. We upgrade our forecast of C/A, expecting the deficit to land at USD 4.0bn in 2018, up from USD 2.4bn reported in 2017.

*Please see page 3 for more details*

**FX and interest rates: NBU currency auctions were in the driving seat**

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



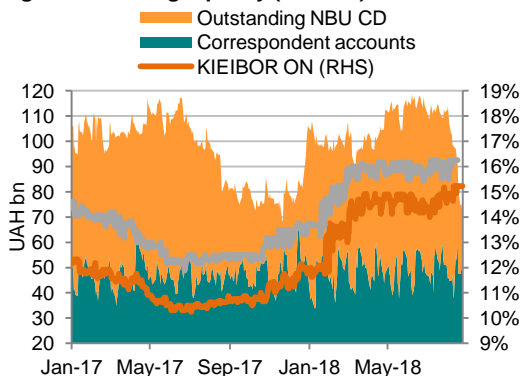
Source: NBU, Reuters

**USD/UAH was at 28.28 as of Friday the 31<sup>st</sup>**, as hryvnia fell by 1.4% on a week-on-week basis. In August, national currency declined by roughly 5%.

**Average daily FX volumes on the market amounted to the equivalent of USD 251.9mn**, up by USD 17.8mn week-on-week.

**NBU currency interventions via currency auctions were in the driving seat in prior week**, reflecting the existence of imbalance on the market especially from the side of demand. While NBU for the first time in while had bought FX on the market on a net basis as of week ended August 23<sup>rd</sup>, suggesting that excess demand were exhausted, there was not the case, as central bank turned to a net seller once again as of week ended August 31<sup>st</sup>. NBU conducted two currency auctions during the week. On Wednesday, central bank sold USD 65.3mn on the market. On Thursday, NBU followed suit and sold USD 49.4mn on the market to support national currency. At the same time, central bank also sold USD 45mn via other instrument besides currency auctions. Moreover, YTD reading of central bank interventions dropped to USD 550mn of bought FX currency in 2018, as of August 31<sup>st</sup>.

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



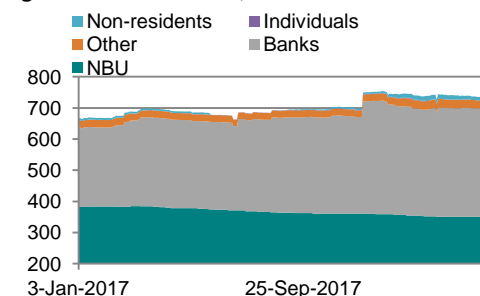
Source: Reuters, NBU, UkrSibbank, Minfin

**Aggregate banking liquidity amounted to UAH 72.3bn as of Friday the 31<sup>th</sup>**, down by UAH 4.3bn during the week. At the same time this result extended the decline in liquidity, which is effectively being running today for five weeks in a row dropping combined by around UAH 39bn. It was driven mainly by NBU currency interventions and taxes.

**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.

**The most recent MoF primary auction hasn't attracted as much demand as the previous auction.** Total proceeds yielded only UAH 21.2mn, down from UAH 2.4bn, as of August 21<sup>st</sup>. The yields on 3m bonds remained intact as well as on 6m. 5 year bonds contributed almost half to proceeds of the budget. At the same time, bonds with 5y maturity were placed with a cut off rate of 16.0%. In contrast to prior months, redemptions of OVDP are much smaller in September. In particular, two UAH issues totalling combined UAH 1.8bn and only one USD issue for a total USD 100mn. Both UAH bonds are to be redeemed on Wednesday September 5<sup>th</sup>. The USD issue is scheduled to mature on the next week.

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



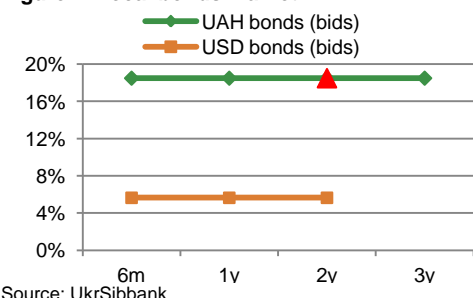
Source: NBU

**Currently, yields (bids) of local OVDP in UAH at 19.50% (for 6m), 19.50% (for 2Y).** 1Y USD bids were at 5.75%, while bids for VAT bonds were at 19.50%.

**Figure 5. OVDP auction combined results, 28<sup>th</sup> 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%	3	3	4.2mn	3.9mn
UAH	12m	17.90%	17.90%	17.90%	17.90%	4	4	8.0mn	6.9mn
UAH	3y	16.80%	16.80%	16.80%	16.80%	1	1	0.15mn	0.16mn
UAH	5y	16.00%	16.00%	16.50%	16.00%	4	0	12.9mn	10.3mn

**Figure 4. Local bonds market**



Source: UkrSibbank

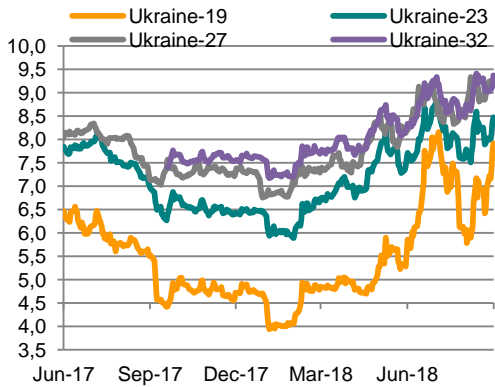
**In prior week, Ukrstat revealed data about wages growth in the country.** According to agency, Ukraine's nominal wages increased by 24.9 y/y in July. In the meantime, wages rose by 24.2% y/y in preceding months, indicating slight acceleration in July, especially amid the backdrop of falling inflation. On top of that, average real wages increased by 114.7% y/y in July, up from 13.0% y/y in prior month. Sectoral breakdown indicated that largest positive contributions steamed from industrial sector (+26.7% y/y), construction (26.3% y/y) and agriculture (+24.9% y/y) from the private sector. While wages in defence were higher on average by 41.6% y/y in July, contributing the most among all sectors controlled by the government.



**Global markets:**

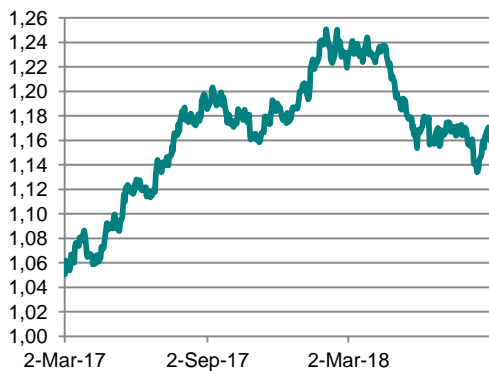
**Core PCI in the U.S. advanced to 2% in July**

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



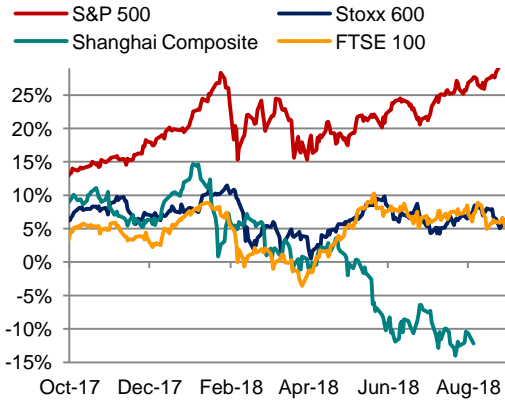
Source: Reuters

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



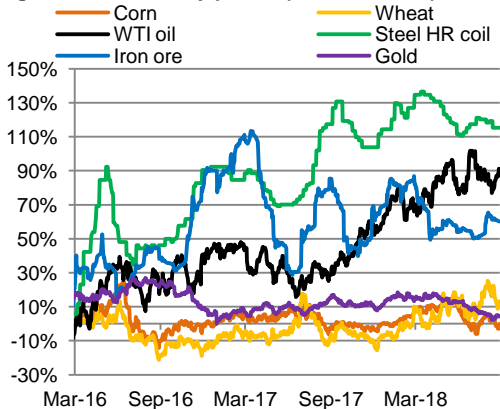
Source: Reuters

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



Source: Reuters

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



Source: Reuters

Consumer prices in the U.S. continued gradually increase in July, according to latest data from Labor Department. Meantime, Eurostat's latest report showed that EU's unemployment rate was at 8.2% in July. In a separate report, Chinese PMI showed weaker performance in 10 months.

Bond benchmarks were mixed, with U.S. 10y Treasuries' yield increased by 3bp week-on-week landing at 2.85%, while German 10y Bunds' yields declined by 1bp, landing at 0.33%, Japanese 10y bonds yield's ended the week at 0.10, slightly effectively being unchanged.

Major US stock indices gained during the week, as S&P rose by 0.9%, while Nasdaq Composite gained by 2.0% in the week-on-week finishing the last week of the month on an upbeat note. It was a remarkable month for stocks, with S&P added 3.0%, while Nasdaq Composite gained even stronger by 5.7%. At the same time, August performance was the strongest in 4 years, driven for the most part by strong corporate earnings season.

Consumer prices continued to gradually increase in July, according to U.S. Labor Department. Namely, personal consumption expenditure excluding food and energy costs rose by 0.2%, following 0.1% increase in June. As a result, the index rose by 2.0% on y/y basis in July. On Thursday, Labor Department has released data about initial claims for state unemployment benefits, which increased by 3000 to a seasonally adjusted 213 000, as of week ended August 25<sup>th</sup>. The latest results showed that claims have been declining for a three weeks in a row. As of now, labor market remains healthy even amid the backdrop of protectionist trade policy.

EUR/USD rate landed at 1.1599 as of Friday the 31<sup>th</sup>, down compared to last week closing level of 1.11621.

Stoxx 600 fell by 0.3% during the week ended August 31<sup>th</sup>, while German DAX declined by 0.2% week-on-weeks. On Friday, Europe shares ended lower, erasing weekly gains, as uncertainty around U.S. trade policy dragged down sentiment on the market.

According to Eurostat's report on Friday, EU's unemployment rate was 8.2% in July. In previous month, unemployment landed at 8.2%. The July's reading indicated that unemployment in the block remained on the lowest level since November 2008. On top of that, unemployment fell by 0.1% on a monthly basis. At the same time, wide disparities remained among different regions. The highest unemployment was registered in Greece (19.5%), Spain (15.1%) and Italy (10.4%). In contrast to that, the lowest unemployment was reported in Czech Republic (2.3%), Germany (3.4%) and Poland (3.5%).

Chinese PMI showed the weakest performance in 10 months. In particular, index dropped to 50.6 (Cauxin manufacturing PMI) to the lowest since June 2017. In prior month reading landed at 50.8. At the same time, official manufacturing PMI fell to 51.3 from 51.2 in July, also indicating weaker performance. Recent data suggested that economy has been affected by U.S. tariffs imposed earlier. At the same time, the manufacturing sector continued to weaken on the back of softened demand.

Crude oil prices gained, as WTI futures increased by 1.6% week-on-week and closed at USD 69.8 per barrel, while Brent futures gained by 2.1%, landing at USD 77.4 per barrel.

Gold prices fell as NYMEX 1m futures decreased by 0.5% week-on-week and finished the week at USD 1200.3 per troy ounce.

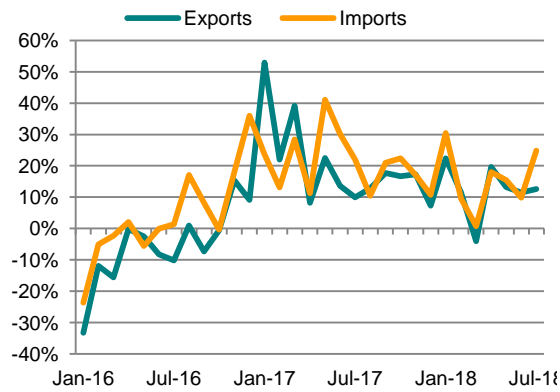
Grains increased, as CBOT Corn 1m futures rose by 0.7% week-on-week and closed at USD 351.0 per bushel, while CBOT Wheat 1m futures landed at USD 518.5 per bushel, gaining by the same 0.7% during the week.

Iron ore declined, as NYMEX Iron ore 62% Fe 1m futures fell by a 0.5%, week-on-week and closed at USD 67.16 per ton.



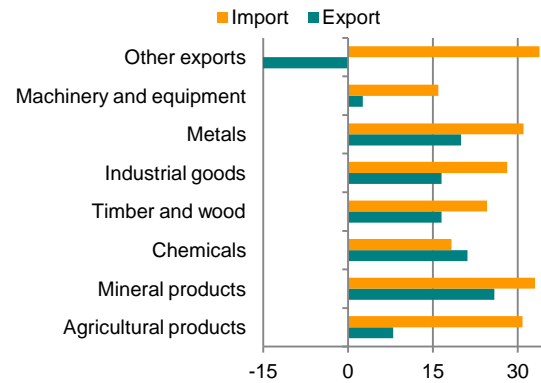
**This week in focus: Ukraine's C/A deficit: hitting a milestone in July**

**Figure 9. Exports and imports change, %**



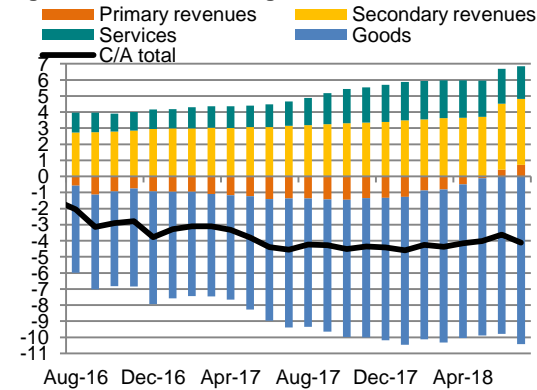
Source: NBU

**Figure 10. Exports and imports main components change, %**



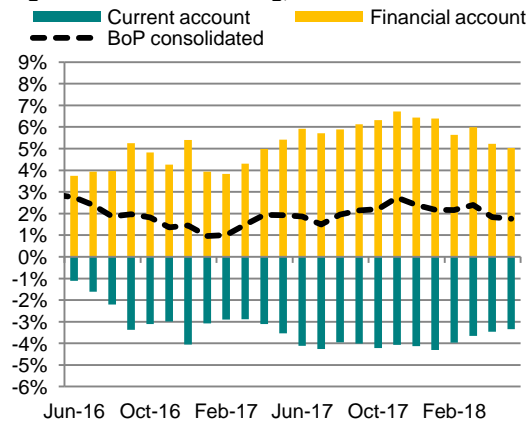
Source: NBU

**Figure 11. C/A 12m rolling, USDbn**



Source: NBU

**Figure 12. BoP 12m rolling, % from GDP**



Source: NBU

In July, Ukraine's C/A delivered the highest monthly deficit in almost 5 years, being driven for the most part by skyrocketing goods trade deficit to USD 1.7bn, which was the highest reading since December 2013. We upgrade our forecast of C/A, expecting the deficit to land at USD 4.0bn in 2018, up from USD 2.4bn reported in 2017.

Ukraine current account deficit skyrocketed to USD 1.1bn in July, which indicated the highest reading since December 2013 year. It was a sharp worsening from USD 125mn and USD 401mn for prior month and a year ago, respectively. Meantime, trade deficit accounted for USD 1.7bn and was the major part of worsened performance, being at same time at the highest level since 2013 year. The trade deficit was twice larger than before in July, provided that average trade deficit was USD 0.8bn for the last 12 months.

Exports landed at USD 3.3bn in July, growing by 12.6% y/y, up from 11.5% y/y in prior month. Exports of metals accounted for USD 0.9bn with growth being decelerated to 19.9% y/y in July from 35.2% y/y in June. Ukraine exported 4.0mnt, 2.4mnt and 0.5mnt of semi-finished products, hot-rolled and cold rolled steel in 7M18, which was 15.9%, 5.2% and 0.6% higher respectively compared to 7M17. Exports revenue in USD for these three types of metal exports was higher by 46.7%, 24.7% and 11% in 7M17, provided that prices were higher by 26.6%, 18.7% and 10.3%, respectively.

Having increased by 8.0% y/y in July, food and agriculture export comprised USD 1.3bn, up from USD 1.2bn. While export of wheat was almost flat in physical volumes, export of corn fell by 12.2% in 7M18, as spring crops were more devastated by weather in 2017/2018 marketing year in contrast to winter crops. At the same time Ukraine's farmers received by 10.2% more in USD equivalent exporting wheat, as prices were higher by 10.6% during this period. At the same time, farmers export proceeds from corn harvest in USD were lower by 6.2% in 7M18, as prices were higher by 6.9% higher helping partly to offset 12% fall in physical volume. Export of sunflower oil was 10% lower in 7M18 vs 7M17. At the same time, higher price by 1.2% resulted in falling proceeds in USD by 9.3% in 7M18.

Import landed at USD 5.0bn in July, gaining by 24.9% y/y several times higher compared to 9.9% y/y growth reported a month ago. Ukraine ramped up imports of coal in 2018. While Ukraine has already exported almost 13.0mnt of coal in 7M18 vs 7M17 (which is by 36.3% higher), falling prices by 10% resulted in growing imports bill in USD by only 22% in 7M18. Ukraine also managed to reduce gas consumption in 2018, as physical volume of imported gas fell by 28% in 7M18 vs 7M17. At the same time, in USD terms decline accounted for only 13.8%, as prices rose by roughly 20% in 7M18 vs 7M17 partly mitigating this shift. Moreover import of machinery indicated growth of 16% y/y in July, as consumer demand continued to support. In prior year, import of machinery rose by 37.4 in 7M17 vs 7M16.

Balance of services amounted to USD 30mn of surplus in July, higher compared to a month ago but lower compared to a year ago. At the same time, positive surplus of primary incomes were lower in July compared to June, as negative surplus of income from investments were growing faster (for the last 5 month in a row) than positive surplus of incomes from wages of migrants. The surplus of primary incomes landed at USD 0.3bn, down from USD 0.4bn a year ago. In our opinion, the growth of incomes from investments mostly due to liberalized repatriation of dividends since March 2018, as NBU allowed foreign companies in higher volume move dividends abroad.

The Financial account posted surplus of USD 0.9bn in July, several times higher compared to a month and year ago. In contrast to prior month when large amount of FDI stemmed from banking system conversion of debt to equity, major part of investments came from real sector in July. At the same time, investments amounted to USD 142mn in July, being at USD 1.3bn in 7M18.

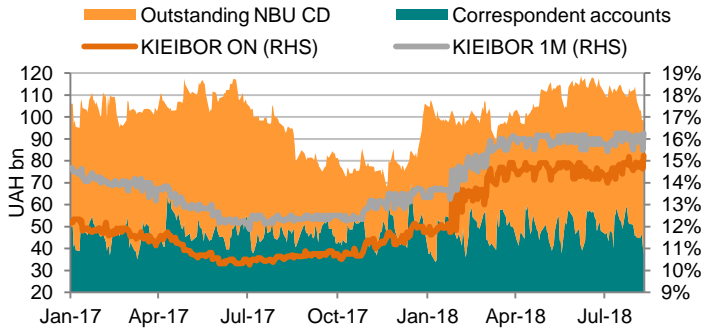
At the same time, real sector GDP increased its external loans by USD 0.6 during the month, supporting financial account proceeds in July. As a result, combined BoP posted USD 170mn of deficit in July. In 7m18, BoP surplus was USD 137mn, down from USD 764mn reported a year ago. International reserves stood at USD 17.7bn, as of end of July 2018.

Interesting to note, that NBU forecasted C/A deficit to be lower in 2018 comparing to 2017, namely falling to USD 2.0bn. It implies that average C/A deficit should tumble to about USD 60mn and effectively been running for a five months in a row by the end of 2018, which is quite unrealistic from our perspective, provided that in Ukraine average C/A monthly deficit tend to expand in the second half of the year. While we expected earlier the deficit to be more than USD 1bn higher in 2018 compared to NBU forecasts, accounting for the worsening of trade performance in this year. But our forecast needs to be upgraded even higher, as the magnitude of worsening was not fully reflected in prior forecast. We expect C/A deficit to increase to USD 4.0bn in 2018 from USD 2.4bn reported in 2017. Higher C/A deficit translates into larger pressure on the hryvnia by the end of the year, potentially creating more volatility for the national currency. Having kept this in mind, we expect UAH USD exchange rate by the end of the year at 29.5, leaving it unchanged at this juncture.



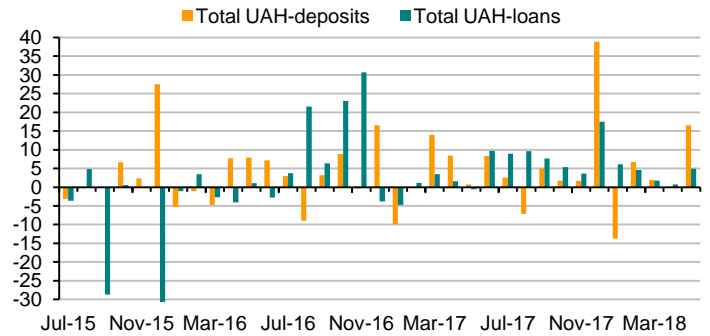
**Money market**

**Banking liquidity vs. money market rates, %**



Source: Reuters, NBU, UkrSibbank estimates

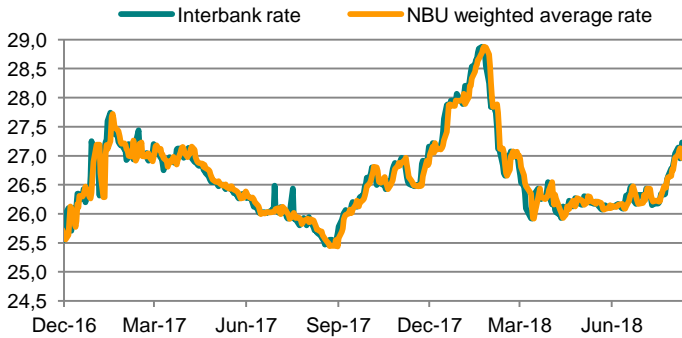
**Monthly change in local currency loans and deposits, UAHbn**



Source: the NBU

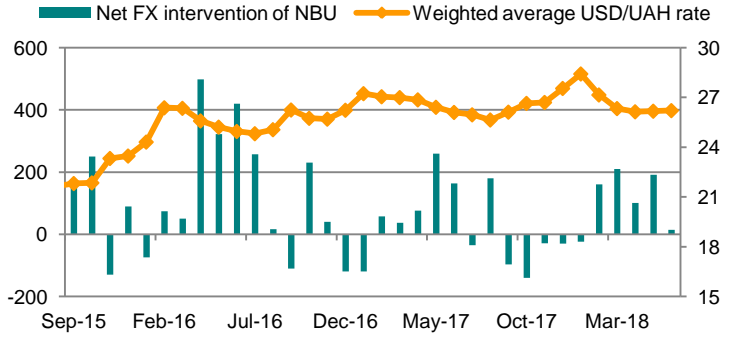
**Currency market**

**UAH exchange rate, UAH/USD**



Source: Reuters

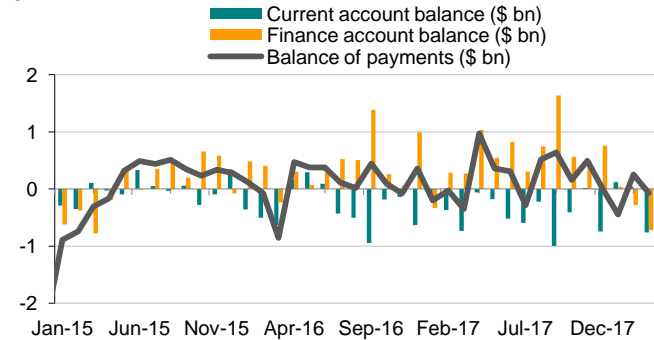
**Net retail FX interventions of the NBU in 2015-2017, USDmn**



Source: NBU

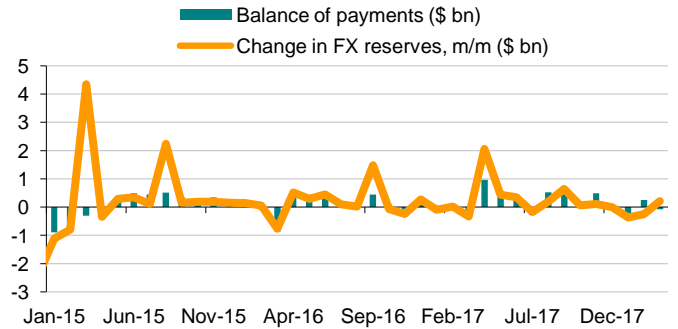
**Balance of payments**

**Major BoP accounts, USDbn**



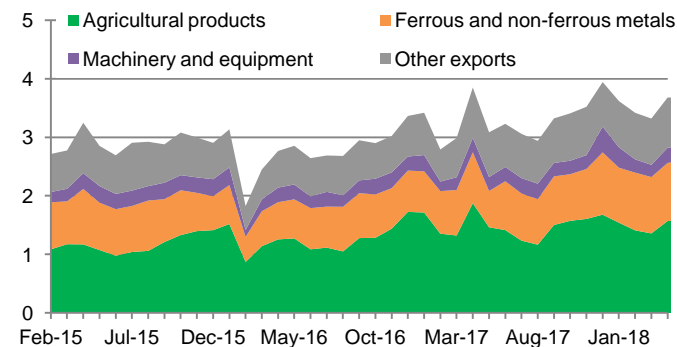
Source: NBU

**BoP vs change in foreign reserves, USDbn**



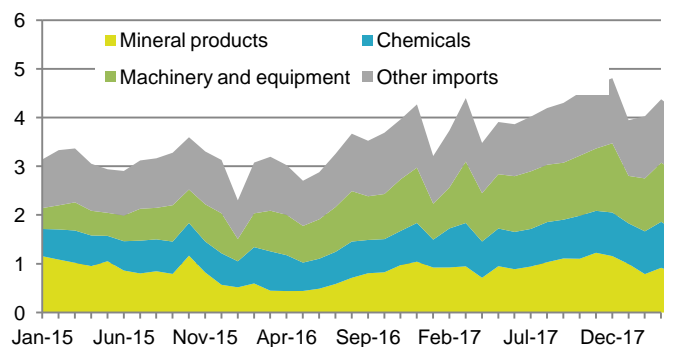
Source: NBU

**Exports components dynamic, USDbn**



Source: NBU

**Imports components dynamic, USDbn**



Source: NBU



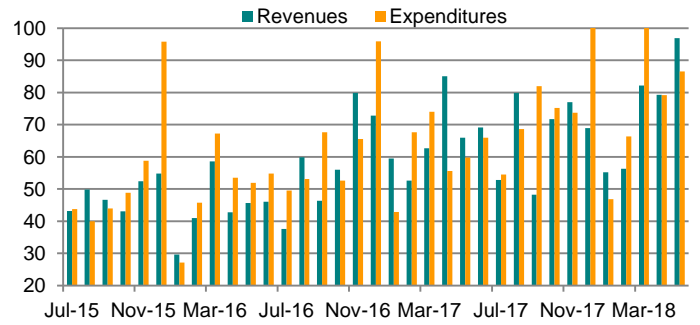


**Budget performance**

**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**

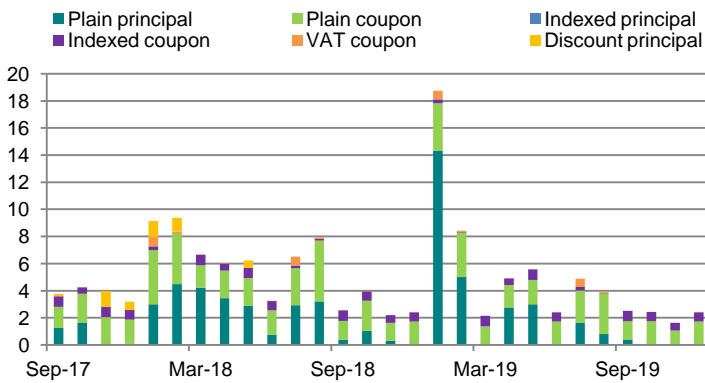


Source: NBU

Source: NBU, State Treasury

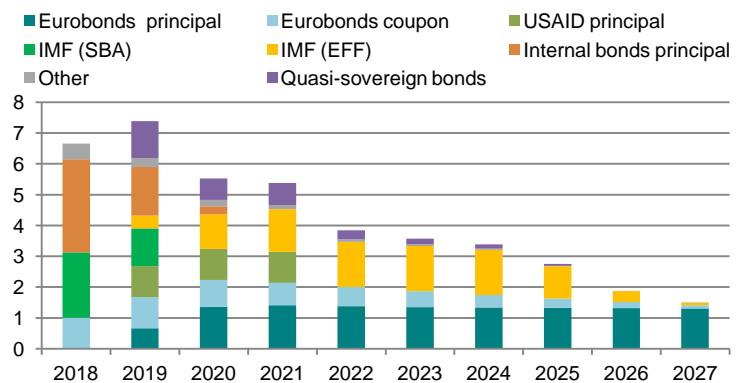
**Sovereign debt**

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



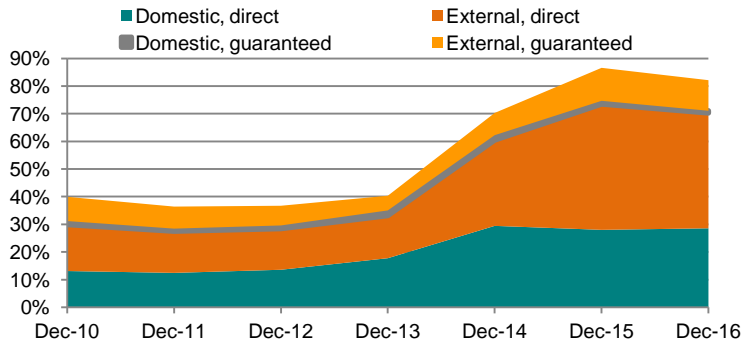
Source: NBU, UkrSibbank estimates

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



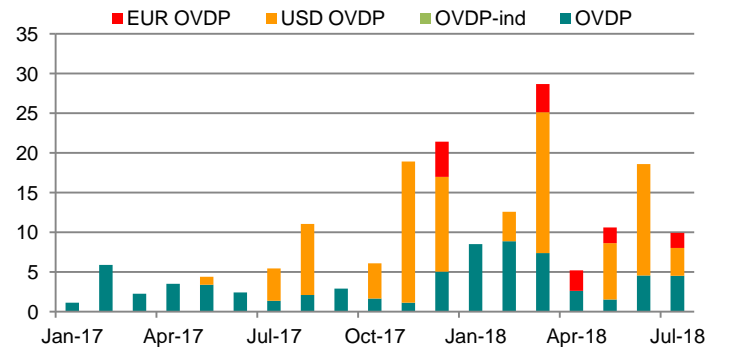
Source: Reuters, IMF, UkrSibbank estimates

**Total government debt, % GDP**



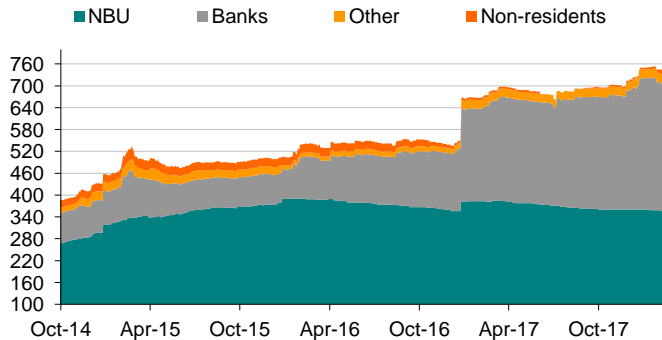
Source: MinFin

**Local borrowings, UAHbn equivalent**



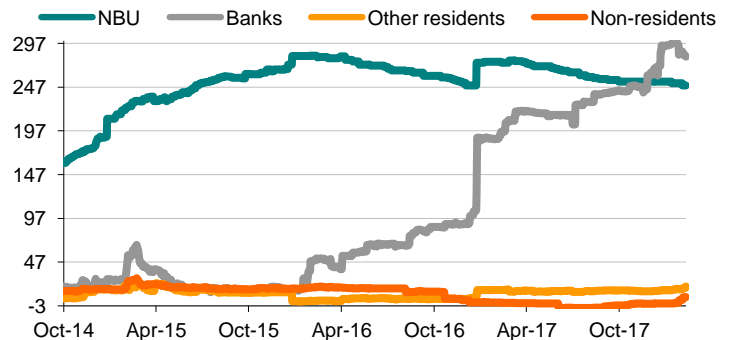
Source: NBU

**Outstanding OVDP owners structure, UAHbn**



Source: NBU

**Outstanding OVDP changes in holding, UAHbn**

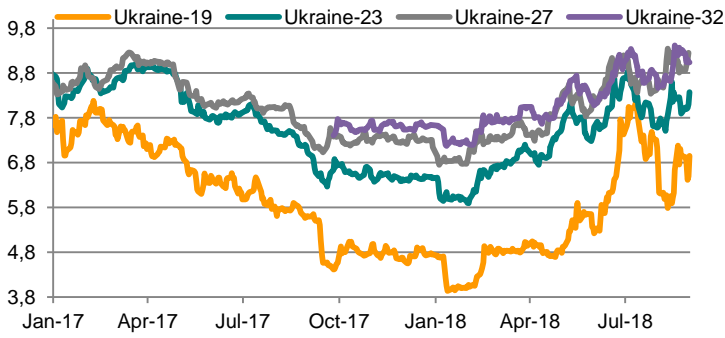


Source: NBU



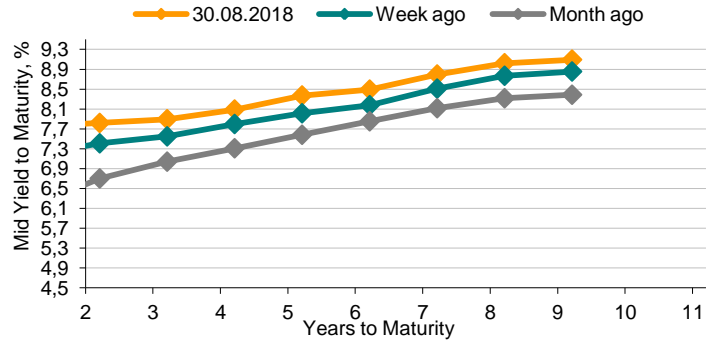
### Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

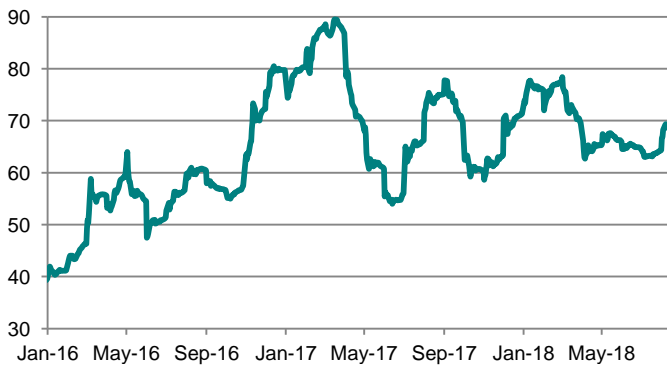
Ukraine's sovereign Eurobond yield curve



Source: Reuters

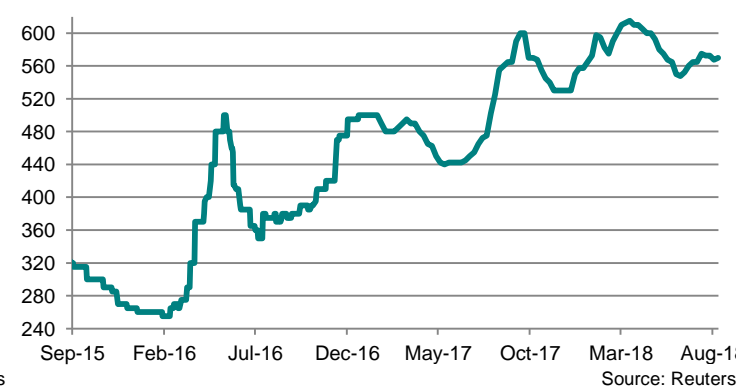
### Commodity markets

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



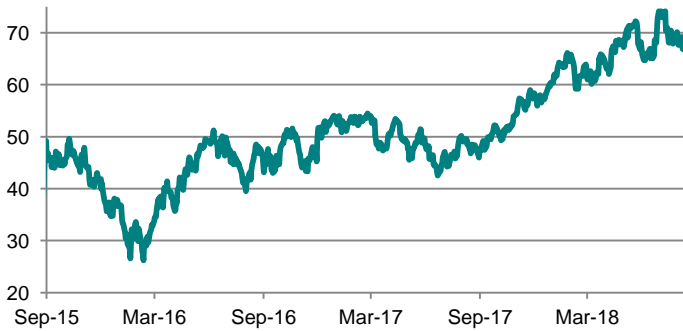
Source: Reuters

Steel CIS export HR coil, USD per ton



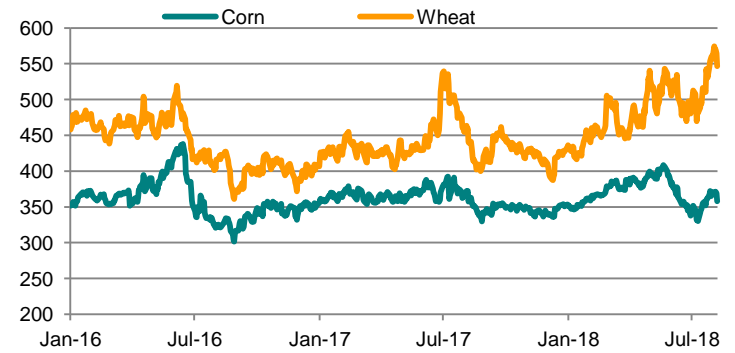
Source: Reuters

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	61.0
<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	1.6	-1.3	-2.4	-4.0
Current account balance (% of GDP)	-7.1	-1.5	-2.2	-6.3	-8.1	-9.0	-3.4	1.8	-1.4	-2.1	-3.3
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	19.5
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	3.2
<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	17.50*
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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