



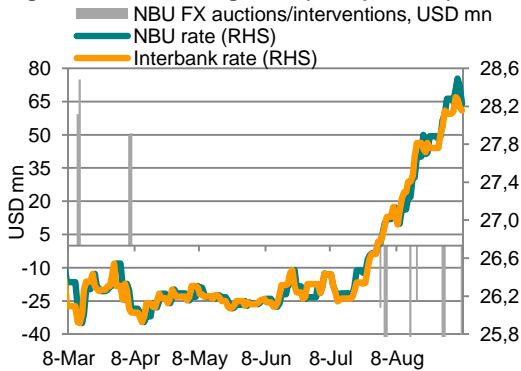
This week in focus: CPI gets boost in August on a y/y basis; NBU hiked main rate

Inflation slightly advanced in August and amounted to 9.0% y/y in the last month of the summer. While food basket posted a small deflation of 0.6% m/m in August, it was not enough to brought aggregate CPI basket to deflation territory too. As a result, consumer prices growth on a m/m basis comprised 0% in August, according to NBU data, following 0.7% m/m deflation in July. While headline inflation effectively overshoot NBU inflation target for the whole 2018 year in August, we keep our inflation forecast unchanged at 10.9% y/y in 2018.

Please see page 3 for more details

FX and interest rates: Ukraine reserves tumbled by 2.9% m/m in August

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH was at 28.22 as of Friday the 7th, as hryvnia was almost flat during the week, declining slightly by 0.2% on a week-on-week basis.

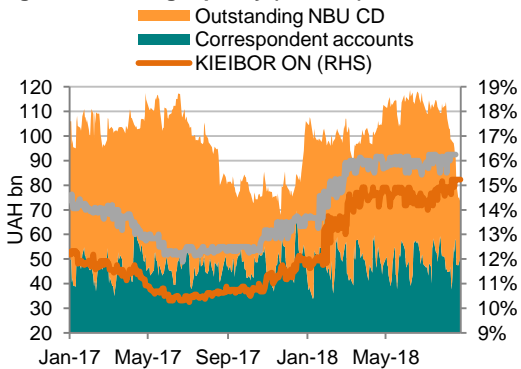
Average daily FX volumes on the market amounted to the equivalent of USD 262.6mn, up by USD 9.8mn week-on-week.

NBU has sold via currency interventions USD 40.1mn on September 4th. While banks initially applied for USD 53.5mn, auction resulted in only USD 40.1mn of sold currency on the market. During the week NBU managed even to buy some amount of FX from the market totaling USD 44.6mn through matching. Meantime, YTD reading of central bank interventions dropped to USD 530mn of bought FX currency in 2018, as of September 4th.

Aggregate banking liquidity amounted to UAH 74.7bn as of Friday the 7th, up by UAH 2.bn during the week, breaking a five weeks string of decline.

Money market rates remained flat: cost of ON funds is around 17.00/17.50, 1 week is 17.00/17.50 while 1M is 17.00/18.00, according to our calculations.

Figure 2. Banking liquidity (UAH bn)

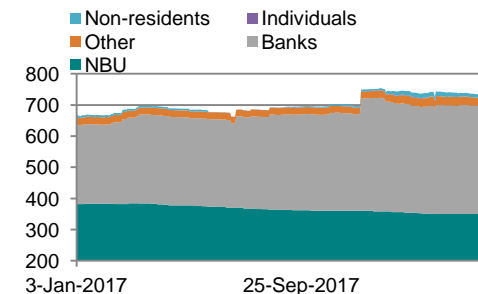


Source: Reuters, NBU, UkrSibbank, Minfin

The latest MoF primary auction brought mild proceeds to the budget, as everyone waited NBU decision on interest rates. MoF placed three UAH issues and two USD issues, resulting in UAH 373mn incomes to the budget. We expect the next auction will be more popular than latest. MoF issued the shortest 3m bonds with a cut off rate of 18.0%, which was in line with previous auctions. At the same time, all other UAH bonds were placed with the same cut off rate of 18.0%. USD denominated bonds brought the major part of proceeds to the budget following the auction. Both issues were placed with a cut off rate of 5.95%. On Wednesday, two bonds were redeemed for a total UAH 1.8bn. The next redemption in September is scheduled to be on September 12 totalling USD 100mn. On the next primary auction MoF is to place 10 bond issues, following NBU decision to raise interest rates, out of which 5 denominated in foreign currency.

Currently, yields (bids) of local OVPD 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 3. OVPD holders, UAH bn

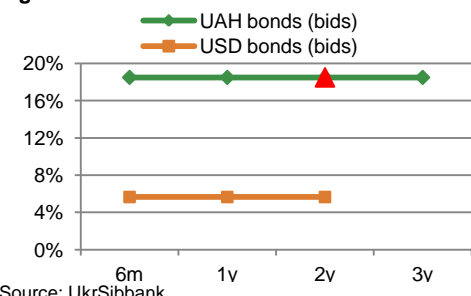


Source: NBU

Figure 5. OVPD auction combined results, 4th of September 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%	5	5	7.1mn	6.7mn
UAH	6m	18.00%	18.00%	18.00%	18.00%	2	2	2.1mn	2.0mn
UAH	1y	18.00%	18.00%	18.00%	18.00%	2	2	7.4mn	6.3mn
USD	9m	5.95%	5.95%	8.00%	5.95%	13	7	14.4mn	7.6mn
USD	1.5y	5.95%	5.95%	6.95%	5.95%	9	5	6.7mn	5.0mn

Figure 4. Local bonds market



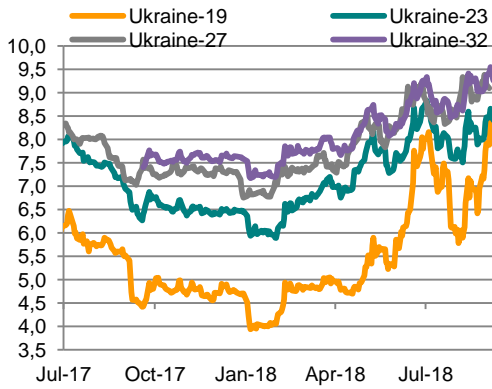
Source: UkrSibbank

Ukraine's international reserves tumbled to USD 17.2bn, as of September 1st, declining by 2.9% m/m. NBU had sold USD 668mn, out of which USD 356.1mn were sold via currency auctions. It was followed by Ukraine's payments to IMF for a total USD 607.4mn. At the same time, Ukraine alone spent USD 447.9mn to service its debt in foreign currency. In contrast to that Ukraine externally borrowed USD 0.7bn in August and USD0.4b internally during the month. All in all, Ukraine's reserves covered less than 3.0 months of future imports (2.9 months), as of September 1st, indicating troubled situation by international standards. The IMF tranche is the only option which can bring Ukraine's reserves back above threshold of 3.0. Decline in reserve coverage could jeopardize Ukraine rating of international credit rating agencies in the nearest perspective, making borrowing costs even higher on international markets.



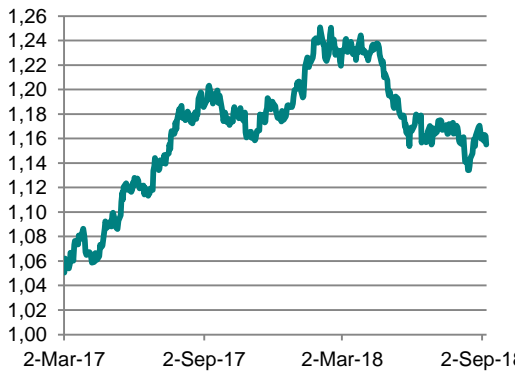
Global markets: Non-farm payrolls increased by 201 000 jobs

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



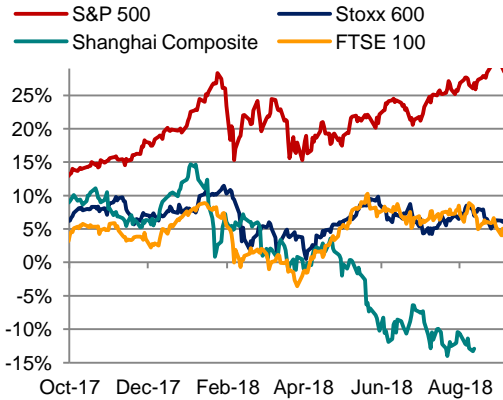
Source: Reuters

Figure 6. EUR USD spot (mid)



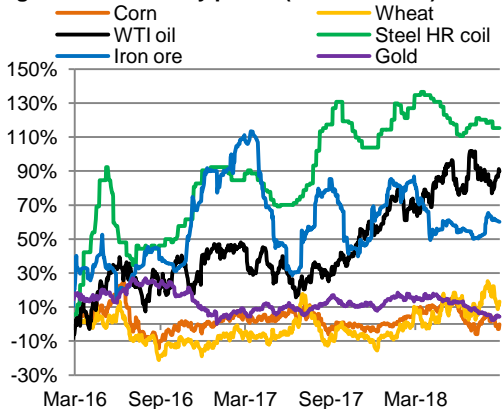
Source: Reuters

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



Source: Reuters

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



Source: Reuters

Non-farm payrolls surged by 201 000 jobs last month due to hiring at construction sites, wholesalers and professional business services, according to Labor Department. On Friday, Eurostat confirmed that euro zone economy expanded by 0.4% in the second quarter, matching earlier estimate.

Bond benchmarks declined, with U.S. 10y Treasuries' yield increased by 9bp week-on-week landing at 2.94%, while German 10y Bunds' yields rose by 6bp, landing at 0.39%, Japanese 10y bonds yield's ended the week at 0.11%, slightly higher compared to a previous week. The yield on the benchmark 10y treasury notes rose after the jobs results were revealed, increasing to the highs last observed in the beginning of August.

Major US stock were broadly in the declining mode during the week, as S&P fell by 1.0%, while Nasdaq Composite tumbled by 2.6% on the week-on-week basis, starting the first week of September with anxiety. Tech sector took the lead, as measured by magnitude of decline, as tariff talks and rising interest rates were the main topics of the week. Namely, strong jobs data in August resulted in higher yields of US treasuries.

Non-farm payrolls surged by 201 000 jobs last month due to hiring at construction sites, wholesalers and professional business services, according to Labor Department. Meantime, average hourly earnings increased by 0.4% or 10 cents during August, following 0.3% rise in July. At the same time, the annual increase in wages increased by 2.9% in August, up from 2.7% in July. On top of that, the unemployment rate was unchanged at 3.9% in August. Fed is widely expected to increase rates in September. The increase in rate in December is more unclear.

EUR/USD rate landed at 1.1551 as of Friday the 7th, down compared to last week closing level of 1.1599.

European main stock indexes fell, following suit of the major U.S. counterparts. Stoxx 600 fell by 2.2% during the week ended September 4th, while German DAX declined by 3.3% week-on-week.

On Friday, Eurostat confirmed that euro zone economy expanded by 0.4% in the second quarter, matching earlier estimate. Capital spending growth helped to offset net trade negative contribution. Namely, gross fixed capital formation rose by 1.2% during the second half quarter, contributing 0.3 percentage points to GDP (gross domestic product) growth. Net trade was also negative in the first quarter of 2018, but positive in the final two quarters of 2017. While exports rose by 0.6%, imports advanced by 1.1% during the quarter. On a monthly basis, prices gained by 0.7% during the month.

On Friday, Chinese consumer price index accelerated to 2.3% in August, up from 2.1% in July, according to the National Bureau of Statistic release. Among all other sectors, food prices were the main driver of higher prices. Having increased by 0.5% in July, food prices gained by 1.7% y/y in August. Due to disrupt supplies vegetable prices increased by 4.3% contributing to food basket prices increase during the month. At the same time, effect of rising oil price continued to exert upward pressure on consumer prices trajectory in August. In the meantime, inflation remains well below Chinese official target of 3% increase during the year.

Crude oil prices fell, as WTI futures dropped by 2.9% week-on-week and closed at USD 67.8 per barrel, while Brent futures declined by 0.8%, landing at USD 76.8 per barrel.

Gold prices declined as NYMEX 1m futures decreased by 0.6% week-on-week and finished the week at USD 1193.6 per troy ounce.

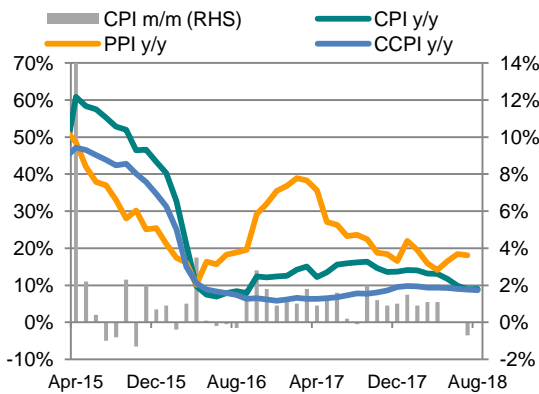
Grains prices moved in different directions, as CBOT Corn 1m futures rose by 0.9% week-on-week and closed at USD 354.3 per bushel, while CBOT Wheat 1m futures landed at USD 486.3 per bushel, falling by solid 6.2% during the week.

Iron ore declined, as NYMEX Iron ore 62% Fe 1m futures fell by a 1.4%, week-on-week and closed at USD 68.1 per ton.



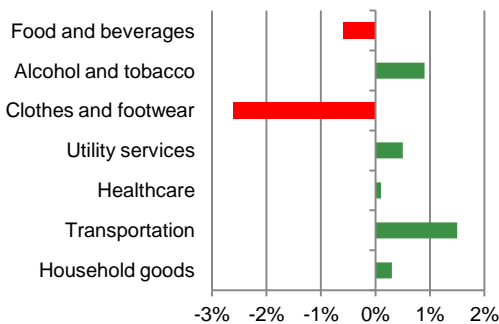
This week in focus: CPI gets boost in August on a y/y basis; NBU hiked main rate

Figure 9. Inflation rates in 2015-2018



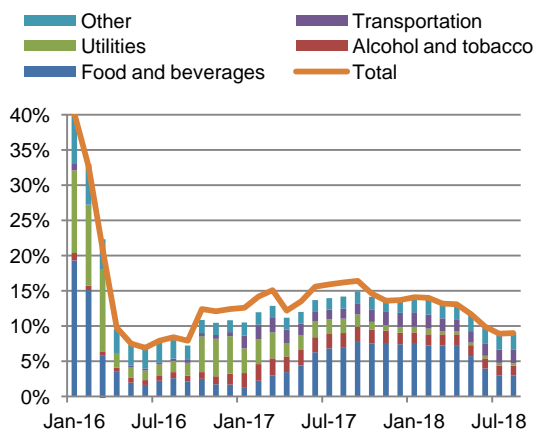
Source: Ukrstat

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



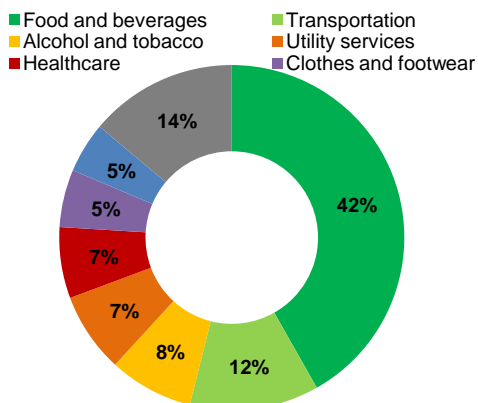
Source: Ukrstat

Figure 11. Inflation drivers in 2016-2018, %



Source: NBU

Figure 12. CPI basket



Source: NBU

Inflation slightly advanced in August and amounted to 9.0% y/y in the last month of the summer. While food basket posted a small deflation of 0.6% m/m in August, it was not enough to brought aggregate CPI basket to deflation territory too. As a result, consumer prices growth on a m/m basis comprised 0% in August, according to NBU data, following 0.7% m/m deflation in July. While headline inflation effectively overshoot NBU inflation target for the whole 2018 year in August, we keep our inflation forecast unchanged at 10.9% y/y in 2018.

Food basket delivered 0.6% m/m decline in prices during the latest month. Meantime, prices gained by 7.1% y/y in August. Vegetables and fruits continued to put downward pressure on prices, as prices in both categories fell by 10.5% m/m and 6.2% m/m in August. With the exception of some small items, all other major categories posted an increase in prices during the month on a m/m basis. The most outstanding increases were in egg prices (+6.0% m/m) and meat (1.0% m/m).

Utilities increased by 0.5% m/m in August, following the same increase in prior month. Cabinet of ministers extended the power of decree which freeze the households gas prices at current level up to October 1st. IMF mission started its work effectively on August 6th with agenda skewed toward addressing the issue of household's gas prices. The final day of the mission is scheduled to be on September 16th, which should clarify the extent to which household's gas prices are to be increased.

Transportation prices rose by 1.5% m/m in August, more than doubling their pace of growth during the month. At the same time growth in prices amounted to 16.2% y/y in prior month, up from 15.4% in July. Devaluation of hryvnia and raising global oil prices are the major culprits of growth. While the price of oil rose by only 1.1% m/m (19.7% y/y) in August, prices of auto services rose several time stronger, namely by 3.3% m/m (24.8% y/y).

As opposed to headline inflation, **core prices advanced by a mere 0.1% m/m in August.** Yet prices nonetheless fell to 8.7% y/y in August, down from 8.8% reported in July, extending a declining trend to four months in a row.

We do not rule out that y/y inflation could slightly decelerate in September (which is quite unusual for CPI), but starting from October consumer prices index will be heading toward two digit number by the end of the year. In prior year the strongest devaluation was observed in September (roughly 4%) and December (roughly 5%). As a result of that, inflation rose by 2.0% m/m in September 2017. As of now, hryvnia strengthened by 0.3% in September in contrast to decline by 4% a year ago. At the same time, in order to push inflation higher in September 2018 CPI should increase by at least 2.1% on m/m basis. Without devaluation in September or with even strengthening hryvnia during the month it will be quite difficult to rose by the same percentage.

Ukraine central bank raised its key interest rate on September 6th. The main reason of that was sharp and unexpected hryvnia devaluation, totaling more than 5% in August. Having increased key rate to 18.00% by 50bp, NBU cited more risk to inflation slowdown as the main culprit of tighter monetary stance.

In July, headline inflation declined to 8.9%, which according to NBU was in line with the latest NBU forecasts. At the same time, NBU has kept its inflation forecast unchanged at 8.9% in 2018. On top of that, regulator expects inflation to drop to 5% (mid term target) in 2020.

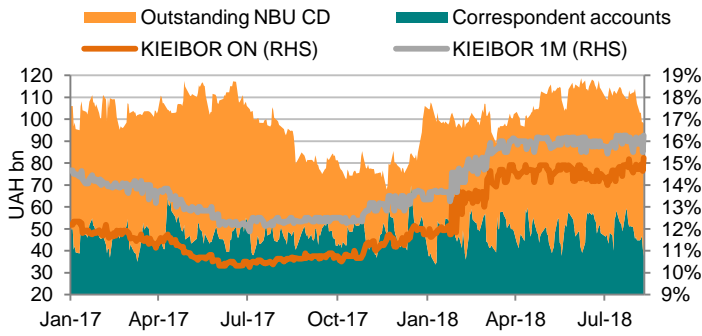
In regard to external risks, there was an increase in them, according to NBU. In particular, increased pressure on the exchange rates of the developing countries stemming from acceleration of capital outflows.

It is worth noting, that headline inflation overshoot NBU inflation target for a whole 2018 year in summer. Going forward devaluation of the hryvnia and increase in household's gas prices will be putting upward pressure on consumer prices in the nearest perspective. At the same time, tight monetary conditions are partly to counterbalance that contribution from them. All in all, we keep our inflation forecast unchanged at 10.9% y/y in 2018.



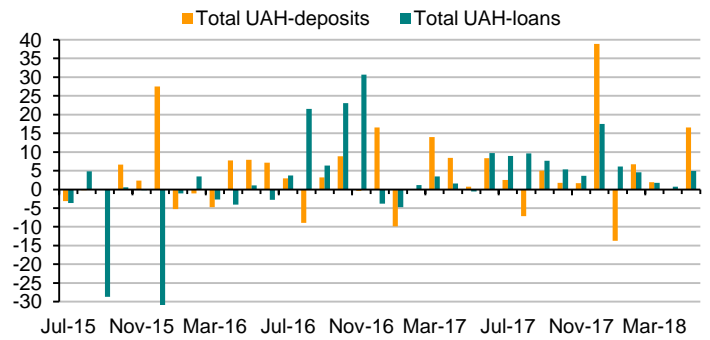
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

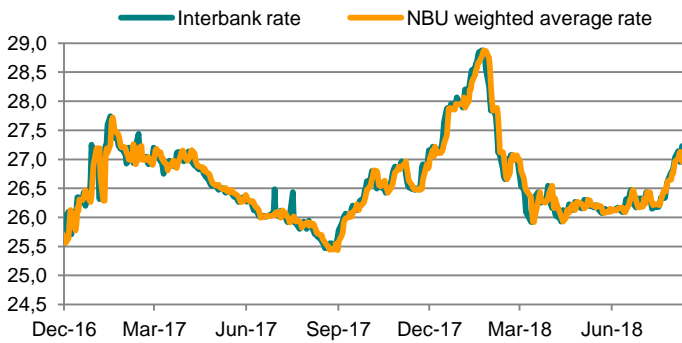
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

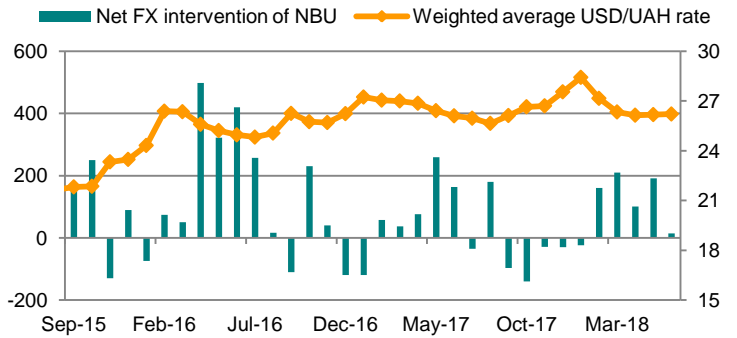
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

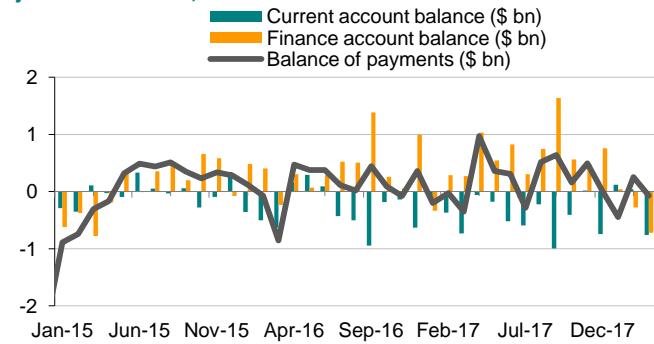
Net retail FX interventions of the NBU in 2015-2017, USDmn



Source: NBU

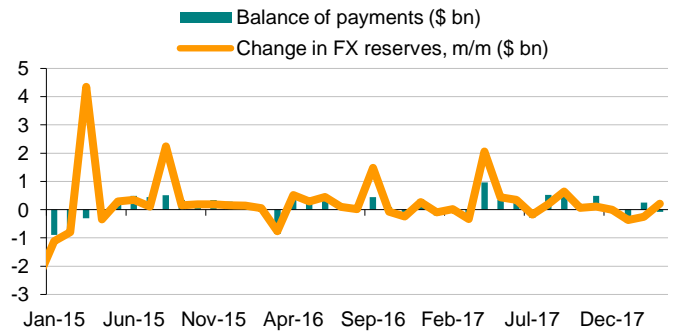
Balance of payments

Major BoP accounts, USDbn



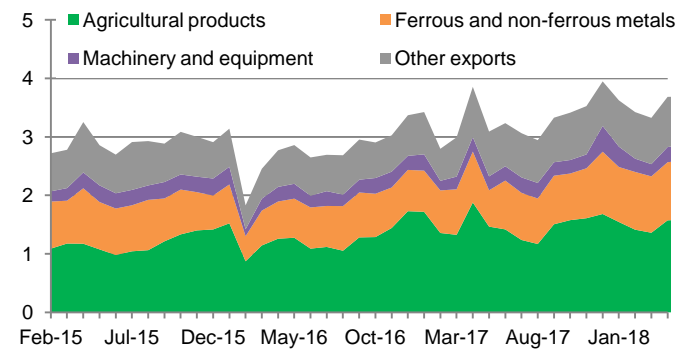
Source: NBU

BoP vs change in foreign reserves, USDbn



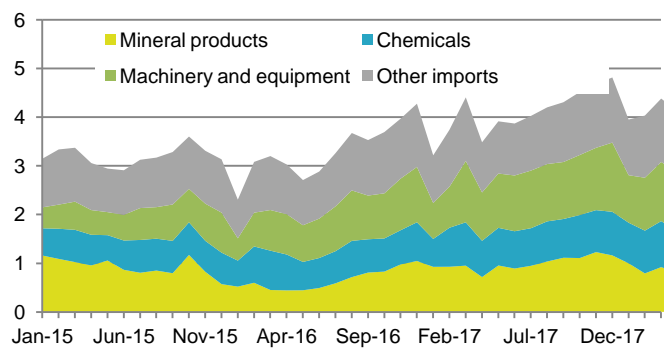
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU



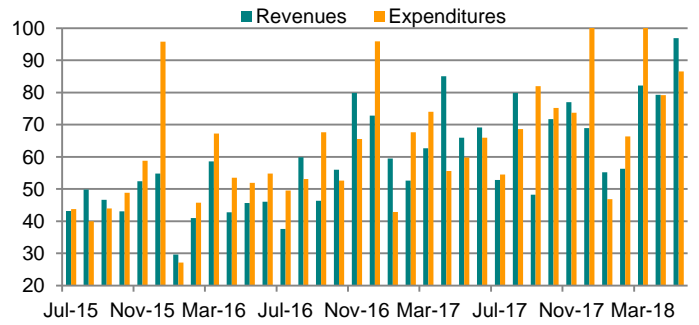
Budget performance

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

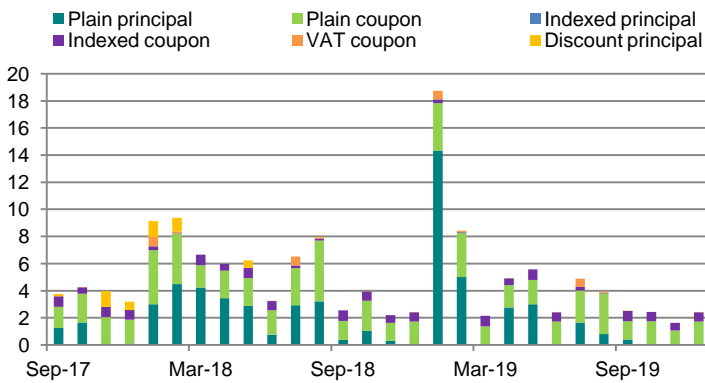
Monthly change in budget revenues and expenditures, UAHbn



Source: NBU, State Treasury

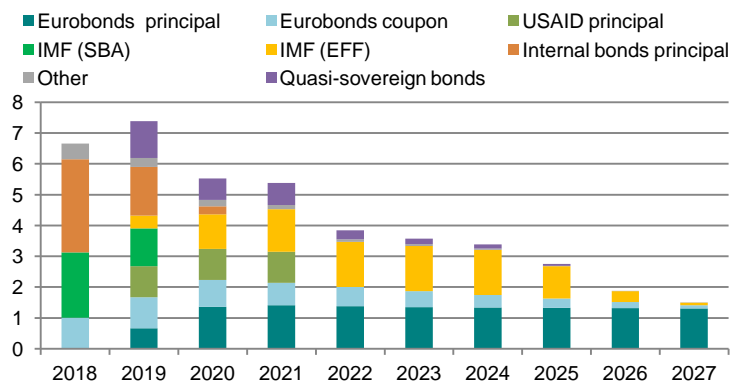
Sovereign debt

UAH-denominated debts' repayments schedule, UAHbn



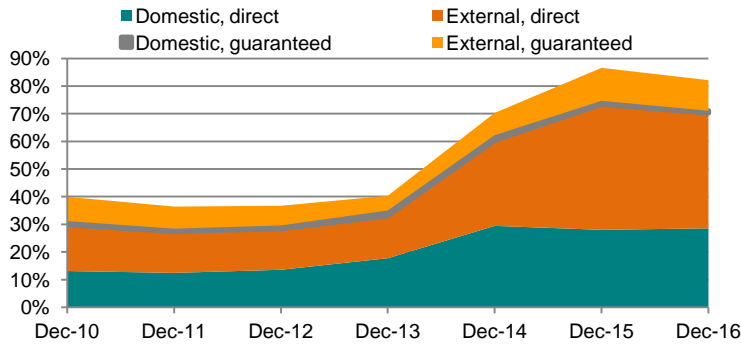
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



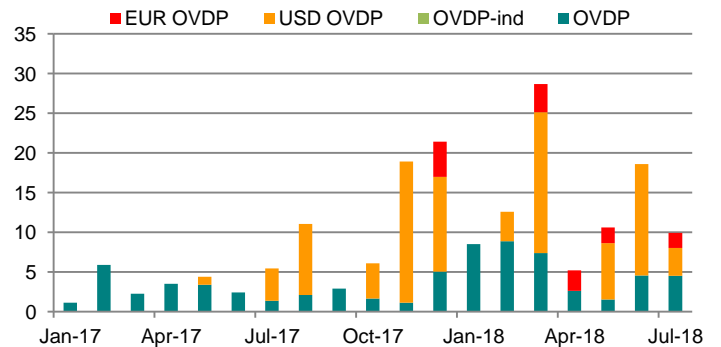
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



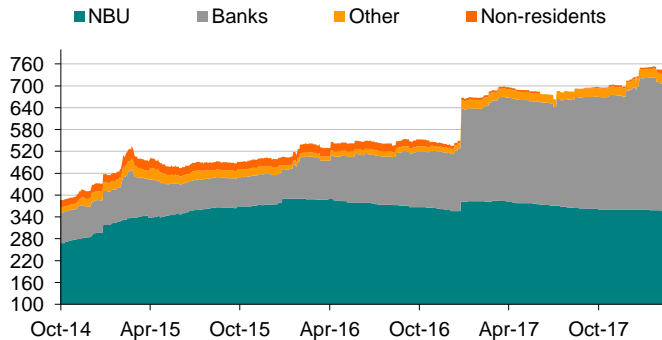
Source: MinFin

Local borrowings, UAHbn equivalent



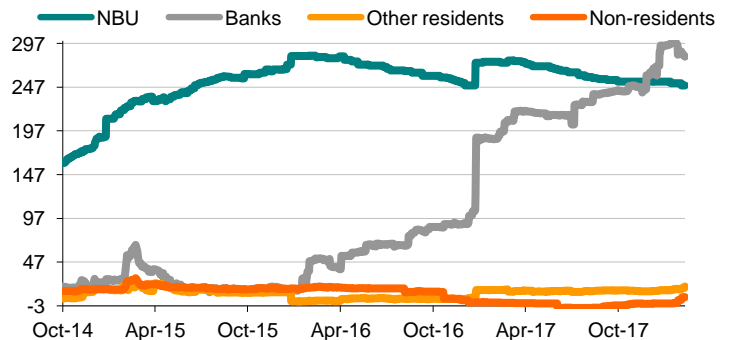
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

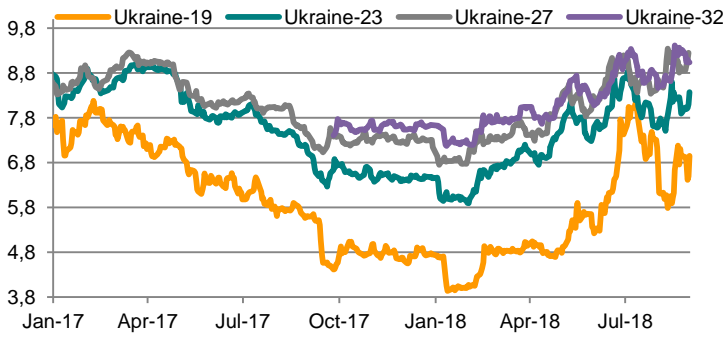


Source: NBU



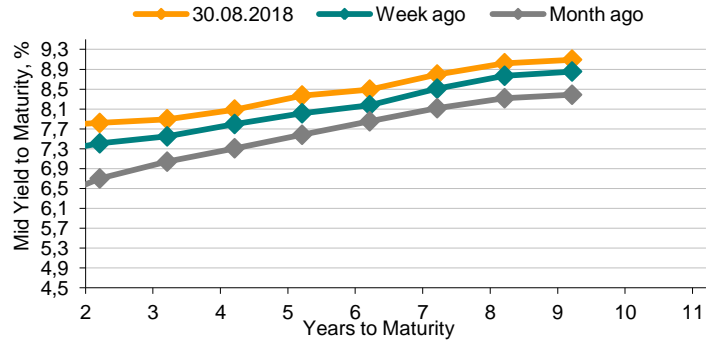
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

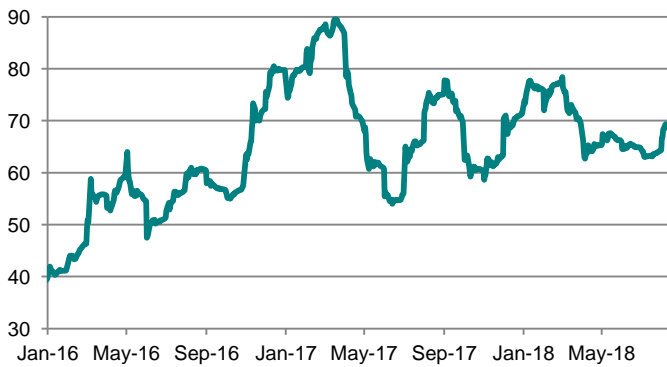
Ukraine's sovereign Eurobond yield curve



Source: Reuters

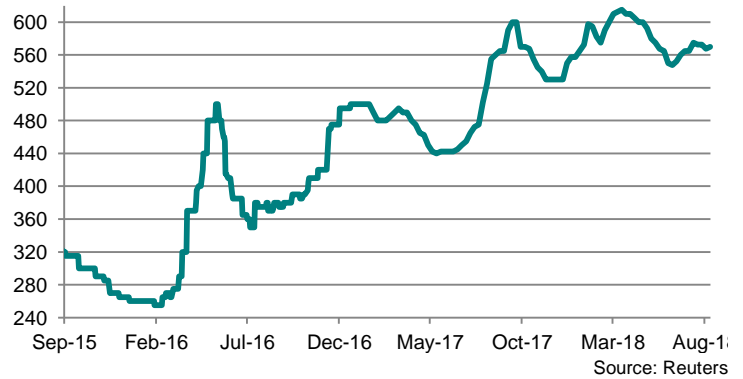
Commodity markets

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



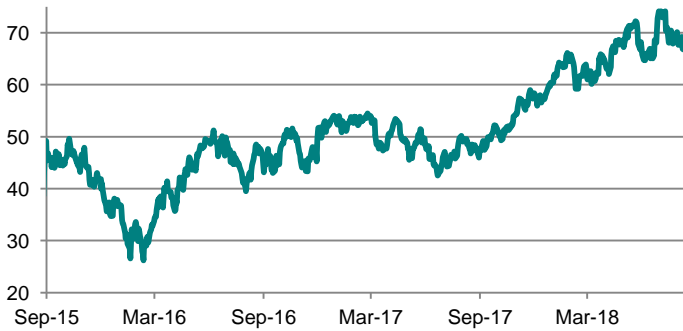
Source: Reuters

Steel CIS export HR coil, USD per ton



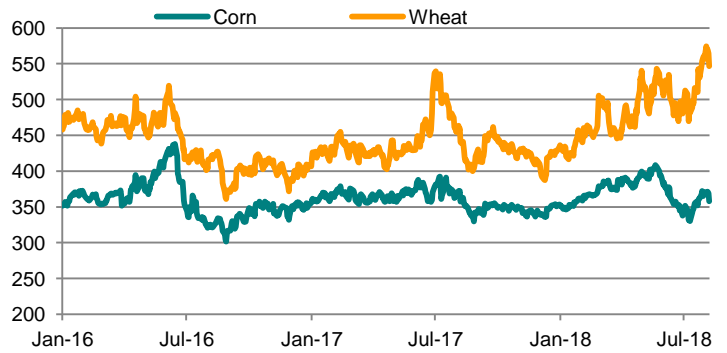
Source: Reuters

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	61.0
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	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
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	17.50*
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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