



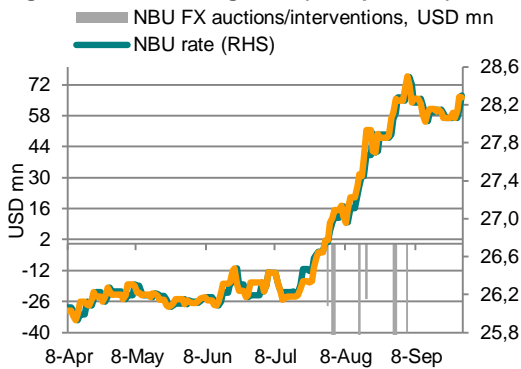
This week in focus: Ukraine economy shifted to a higher gear in 2Q18

Ukraine's economy shifted to a higher gear in the second quarter of the year, growing by 3.8% y/y. At the same time, contribution from investments was not enough to keep this component on the second place, as measured by contribution to real GDP growth. We upgrade our real GDP forecast to 3.4% y/y from 3.1% y/y, expecting stronger performance in the second half of the year, especially against the backdrop of higher harvest of spring crops, whose contribution to GDP larger than contribution of winter crops.

Please see page 3 for more details

FX and interest rates: Actual C/A deficit in 8M18 has overshoot NBU forecast for 2018

Figure 1. UAH exchange rate (UAH per USD)



Source: NBU, Reuters

USD/UAH was at 28.30 as of Friday the 28th, as hryvnia was almost flat during the week, gaining by less than 1.0% on a week-on-week basis.

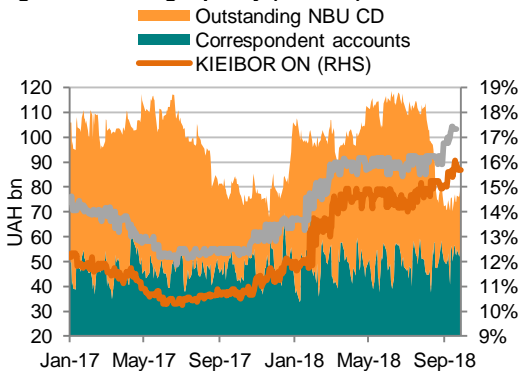
Average daily FX volumes on the market amounted to the equivalent of USD 291.8mn, up by USD 18.2mn week-on-week.

NBU held no currency auction during the prior week. The period of high volatility ended for the hryvnia effectively being running from the end of July to first week of September. As of now, NBU has bought from the market USD 72mn cumulatively for the last three weeks. Meantime, YTD reading of central bank interventions increased to USD 602mn of bought FX currency in 2018, as of September 28th.

Aggregate banking liquidity amounted to UAH 77.1bn as of Friday the 28th, up by UAH 0.6bn during the week, keeping a two week string of gains on track.

Money market rates remained flat: cost of ON funds is around 17.00/18.00, 1 week is 18.00/19.00 while 1M is 19.00/19.50, according to our calculations.

Figure 2. Banking liquidity (UAH bn)

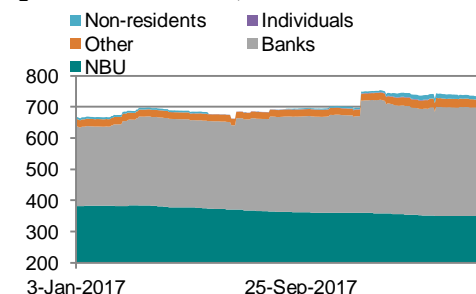


Source: Reuters, NBU, UkrSibbank, Minfin

The latest MoF primary auction resulted in low proceeds to the budget. While initially primary dealers applied for UAH 128.8mn of demand for the shortest 3m bonds, the auction resulted in UAH 8.5mn of proceeds to the state coffers, as MoF rejected a large amount of demand at a rate higher 18.5%, satisfying only 4 out of 6 bids. The demand on 6m issue was much weaker compared to 3m bonds totalling UAH 3mn, which was also similar for 9m UAH bonds. Having satisfied all bids for 1y UAH issue, which was in line with issues 6 and 9 months, MoF placed UAH 13.8mn of bonds with one year maturity, slightly larger amount than the most popular 3m bonds. Going forward in October are to be redeemed 3 UAH bonds for a total UAH 8.4bn, with more than half from that concentrated on October 3rd. In regard dollar denominated bonds, there are also quite large redemptions during the month. Namely, USD 0.5bn will be redeemed on October 17th, followed by EUR bond totalling EUR 0.2bn with redemption scheduled to be on October 24th.

Currently, yields (bids) of local OVDP in UAH at 19.50% (for 6m), 19.50% (for 2Y). 1Y USD bids were at 5.95%, while bids for VAT bonds were at 19.50%.

Figure 3. OVDP holders, UAH bn

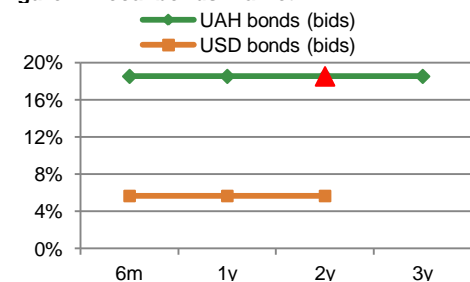


Source: NBU

Figure 5. OVDP auction combined results, 25th 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	18.50%	18.50%	19.50%	18.50%	6	4	128.8mn	8.5mn
UAH	6m	18.50%	18.50%	-	-	2	2	3.4mn	3.1mn
UAH	9m	18.50%	18.50%	18.50%	18.50%	2	2	3.9mn	3.4mn
UAH	1y	18.50%	18.50%	18.50%	18.50%	2	2	11.7mn	13.8mn
USD	9m	5.95%	5.95%	6.00%	5.95%	9	8	10.8mn	16.3mn
USD	2y	5.95%	5.95%	5.95%	5.95%	6	6	9.3mn	9.2mn

Figure 4. Local bonds market



Source: UkrSibbank

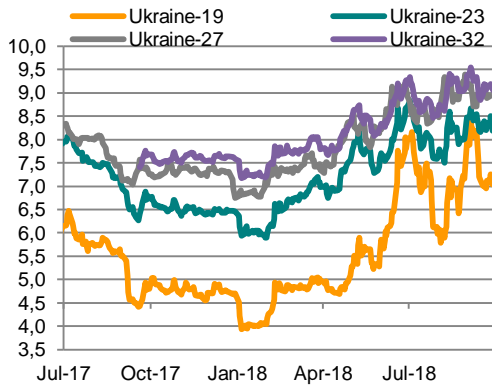
NBU has unleashed latest data regarding performance of balance of payment in August. Having posted USD 1.2bn deficit in July, current account deficit amounted to USD 0.6bn in the last month of summer alone. It is worth noting, that the deficit from the start of the year skyrocketed to USD 2.1bn. We expected the worsened performance earlier and keep our forecast unchanged at USD 4.0bn in 2018 (more details will be published in our next Weekly report on October 9th). NBU current account deficit forecast (USD 2.0bn) for the whole 2018 year was overshoot in the months of summer. Moreover, central bank even decided to reduce its current account deficit to USD 2.0bn in summer from USD 2.4bn deficit forecasted before. NBU previously mentioned that any kind of such overshoots in main economic indicators (GDP, inflation, BoP) creates bias for the central bank to raise interest rates (and we inclined to think that this factor wasn't priced in the latest NBU hike of the main rate). Not to mention the overshoot of such magnitude, when actual C/A deficit is on track to be as much as twice higher NBU current forecast.



Global markets:

Fed hiked its rate; Italy's budget deficit surged to 2.4% of GDP

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



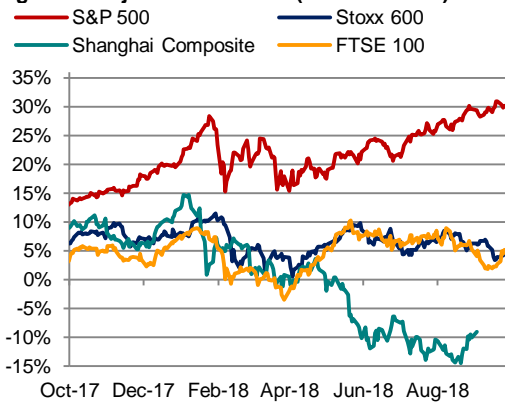
Source: Reuters

Figure 6. EUR USD spot (mid)



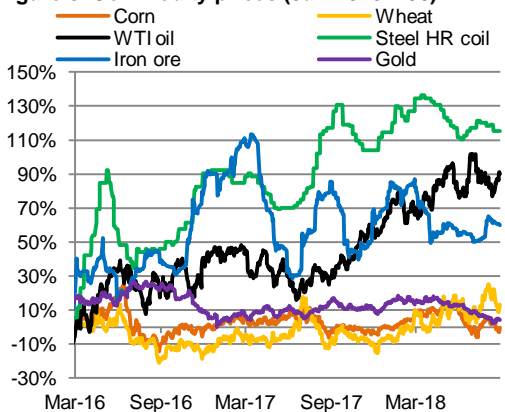
Source: Reuters

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



Source: Reuters

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



Source: Reuters

Prior week was marked by The Fed hiking its benchmark interest rate by 25 basis points and improving economic growth expectations for 2018 and 2019. At the same time, Italy was in the spotlight on prior week, as newly elected government dramatically increased state budget deficit to 2.4% of GDP restraining Italy's public finances.

Bond benchmarks were mixed, with U.S. 10y Treasuries' yield dropped by 1bp week-on-week landing at 3.06%, while German 10y Bunds' yields rose by 1bp, landing at 0.47%, Japanese 10y bonds yield's ended the week at 0.13%, slightly lower compared to a previous week.

As was broadly expected by the market participants, the Federal Reserve increased its benchmark interest rate by a 25 basis points on Wednesday. Along with that move, the FOMC improved its anticipation of economic growth in this year and next and showing for the first time its expectations about 2021 year. As a result federal funds rate were in the range of 2 - 2.25% for the first time since April 2008. It is noteworthy, that Fed in its latest statement dropped the language that the monetary policy remained accommodative. On top of that, FOMC estimate of GDP growth in 2018 was increased to 3.1% from 2.8% in 2018. In regard to 2019 projections, there was also similar increase in expectations by 0.1% to 2.5%, while expectation of growth in 2020 remained steady at 2.0%. For the first time, Fed released its expectation of economic growth in 2021, which indicated slowing economy to 1.8%.

Equity indexes in U.S. ended mixed, as S&P fell by 0.5% and Nasdaq Composite increased by 0.7% week-on-week. Markets were nervous especially on Friday as populist introduced the budget deficit of 2.4% of GDP in 2019. The end of the prior week was also the end of the third quarter. Third quarter of the year was quite brought quite strong results with S&P gaining by 7.2% and Nasdaq Composite - 7.1% in 3Q18.

EUR/USD rate landed at 1.1608 as of Friday the 28th, down compared to last week closing level of 1.1749.

Main stock indexes in Europe declined. Namely Stoxx 600 fell by 0.3% during the week ended September 28th, while German DAX declined slightly more by 0.5% week-on-week.

Italian newly elected top officials dramatically increased budget deficit to 2.4% of GDP in 2019. Initially plans suggested that the deficit could be about 0.8% of GDP in 2019. But the new government, formed as a coalition of the League and the Five Star Movement, decided to pursue a radical agenda including increased pensions and introducing basic income. The recent bridge collapse tragedy in Italy added only fuel to the fire. It was effectively brought attention to aging infrastructure in the country. According to that, spending in the new budget will be concentrated on infrastructure coupled higher social spending

The data released on Sunday suggest that the tariffs had already affected Chinese economy. Namely, Caixin Chinese manufacturing purchasing manager index (heavily weighted toward small private firms) fell to 50.0 from 51.0 in August. Meantime, another gauge or the official manufacturing purchasing manager index, which encompasses large state firms declined to a seven month low to 50.8 from 51.3 in August. As opposed to that the only bright spot in data released on Sunday was construction activity. Namely, Chinese official non-manufacturing PMI climbed to 54.9 in September from 54.2 in August, backed by the infrastructure projects to build bridges and roads and other.

Crude oil prices were broadly on the rise, as WTI futures increased by 3.5% week-on-week and closed at USD 73.3 per barrel, while Brent futures gained by 5.0%, landing at USD 82.7 per barrel.

Gold prices declined as NYMEX 1m futures fell by 0.4% week-on-week and finished the week at USD 1191.5 per troy ounce.

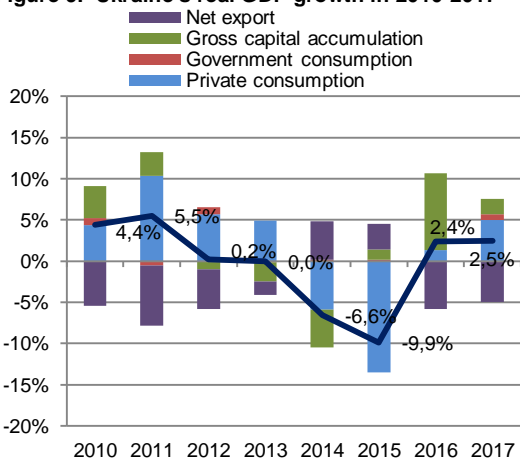
Grains prices were broadly falling, as CBOT Corn 1m futures fell by 0.3% week-on-week and closed at USD 356.3 per bushel, while CBOT Wheat 1m futures landed at USD 509.0 per bushel, falling by solid 2.4% during the week.

Iron ore declined, as NYMEX Iron ore 62% Fe 1m futures were effectively flat on a week-on-week basis and closed at USD 68.73 per ton.



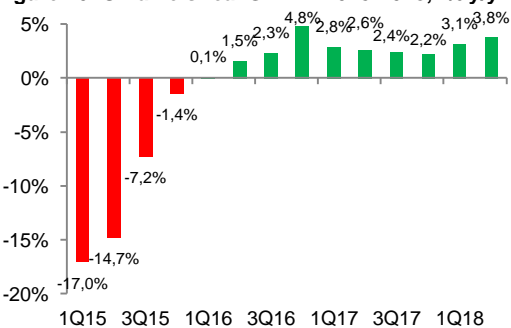
This week in focus: Ukraine economy shifted to a higher gear in 2Q18

Figure 9. Ukraine's real GDP growth in 2010-2017



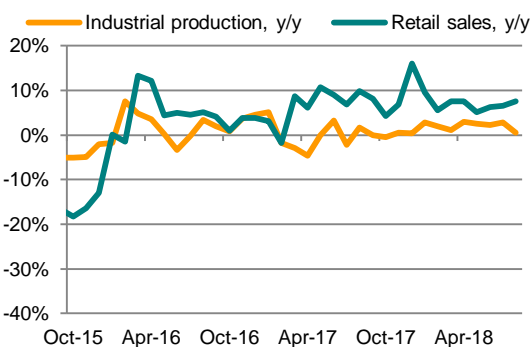
Source: Ukrstat

Figure 10. Ukraine's real GDP in 2015-2018, % y/y



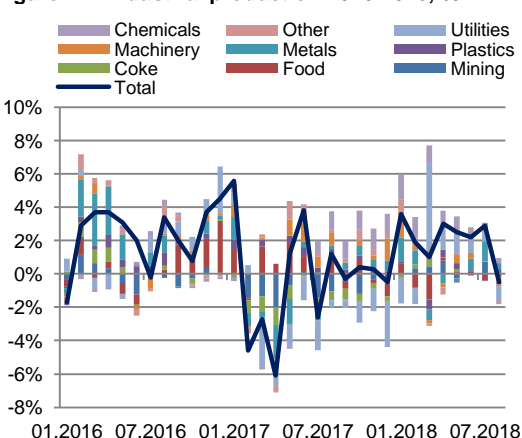
Source: Ukrstat

Figure 11. Industrial production and retail sales in 2015-2018, % y/y



Source: Ukrstat

Figure 12. Industrial production 2016-2018, %



Source: Ukrstat

Ukraine's economy shifted to a higher gear in the second quarter of the year, growing by 3.8% y/y. At the same time, contribution from investments was not enough to keep this component on the second place, as measured by contribution to real GDP growth. We upgrade our real GDP forecast to 3.4% y/y from 3.1% y/y, expecting stronger performance in the second half of the year, especially against the backdrop of higher harvest of spring crops, whose contribution to GDP larger than contribution of winter crops.

Ukrstat revealed data about components of GDP growth in second quarter of the year recently. Previously State Statistic Agency estimated economic growth in the second quarter at 3.6% y/y. At the same time, on September 16th, Ukrstat slightly upgraded this figure to 3.8% y/y. The latest GDP reading was quite unusual by the fact that it was not driven by private consumption followed by investments. Actually, the largest contribution to real GDP growth came from private consumption, followed by government consumption (with contribution in percentages almost the same as contribution of private consumption).

In 2Q 2018, private consumption rose by 4.2% y/y, down from 5.6% y/y in prior quarter. In the meantime, growth of government consumption skyrocketed landing at 11.0% y/y (it was falling by 1.4% in 1Q 2018).

Gross capital accumulation growth slightly decelerated to 4.0% y/y, down from 5.8% y/y in prior quarter. Its major component growth slowed to 14.2% y/y from 17.0% y/y in 1Q 2018. Gross capital investments in fixed capital had been moving in downward trend, peaking in 4Q 2016 with 27.1% y/y growth, with slight rebound in 4Q 2017 and 1Q 2018, followed by 14.2% y/y in 2Q 2018 (the lowest reading since 1Q 2016).

As opposed to weaker performance of gross capital accumulation and private consumption, which added lower percentage points to GDP in 2Q 2018, **external component, which in the most recent time acted as a drug on growth, sliced lower percentages of economic growth**, laying ground for improved GDP print in 2Q 2018. In regard to exports, we observed some increase in growth by a mere 0.1% y/y in 2Q 2018. It was followed by stronger growth in imports components by 3.0% y/y in 2Q 2018. In contrast to that, exports fell by all but 10% y/y (namely 9.9% y/y) in 1Q 2018, while imports declined by 5.4% y/y in 1Q 2018.

In August, **retail sales in Ukraine showed some acceleration, gaining by 7.5% y/y**, following by 6.6% y/y in July. Having decelerated to 5.2% of growth y/y in May, retail sales gained for a three consecutive months in a string, ending August 31st. Moreover, the reading on YTD basis fell to 5.4% in August, down from 6.0% y/y in July. At the same time, average real wage in the country increased by 15.7% y/y in August. Meanwhile, the average nominal wage in the country increased by 26.2% y/y in August. Top Ukraine officials mentioned that minimum wage will be increased by about 12% starting from January 1st, 2019 to UAH 4173 from UAH 3723.

Having risen by 2.9% y/y in July, **industrial production in Ukraine showed weaker performance in August**. In particular, industrial production reading fell by 0.5% y/y during the month (the reading adjusted on a calendar day effect was also in line with unadjusted reading). In 8M 2018, industrial output growth decelerated to 2.2% from 2.6% in 7M 2018. Among all major industries only metallurgy, chemical and mining managed to deliver some growth on y/y basis in August.

Growth in mining subsector was reported weaker in August, as iron ore mining dropped by 0.4% y/y in August, following 8.1% y/y gain in prior month. Meantime, mining of oil increased by 7.3% y/y, accelerating from 5.7% y/y increase in July. In contrast to that, mining of coal showed stronger performance, increasing by 7.2% y/y from 1.8% y/y decline in July.

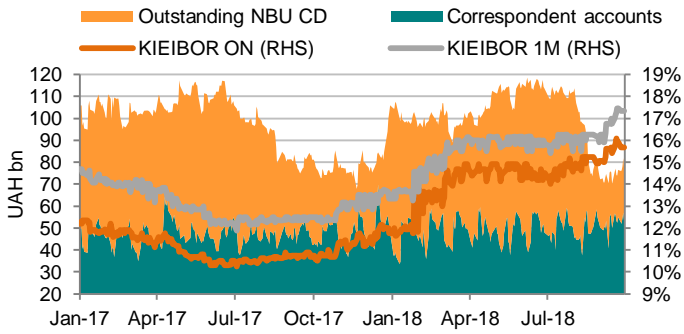
In line with performance of mining subsector, **manufacturing component of the industrial production statistic displayed less upbeat performance in August**, namely falling by 0.5%, reversing from 2.3% y/y gains registered in July. **Food production improved its decline to only 1.0% y/y drop in August**, following 1.9% y/y decline in prior month. It was weighted on mainly by sunflower oil production decline, which continues to reflect a weak prior year harvest, namely lower yields of spring crops. In contrast to that, harvest of 2018/2019 MY is expected to be higher, driven by strong performance of spring crops (sunflower, and corn) vs weak performance of winter crops (wheat primarily). As of September 26th, more than half of sunflower harvest had been gathered by Ukrainian farmers. According to that, we expect starting from September industrial production reading to post improved performance of food production component of industrial production reading, which is the component with one of the highest weight at the same time. On top of that, cold weather in the end of September and yearly October could result in more early start of the heating season in the country. In this case, industrial production is poised to get boost from utilities subsector contribution, and as result to grow more solidly.

While the industrial production slightly lose steam in August, we keep our forecast unchanged at 3.0% y/y growth in 2018.



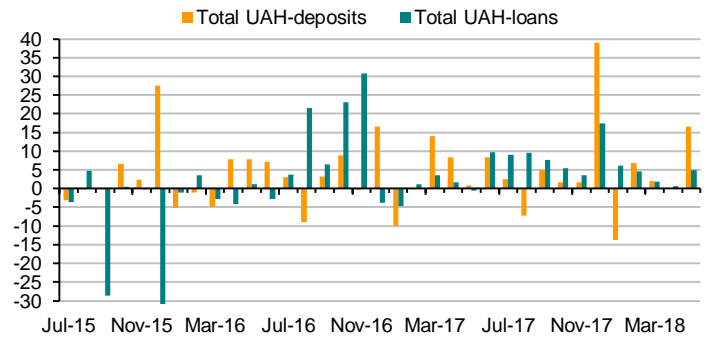
Money market

Banking liquidity vs. money market rates, %



Source: Reuters, NBU, UkrSibbank estimates

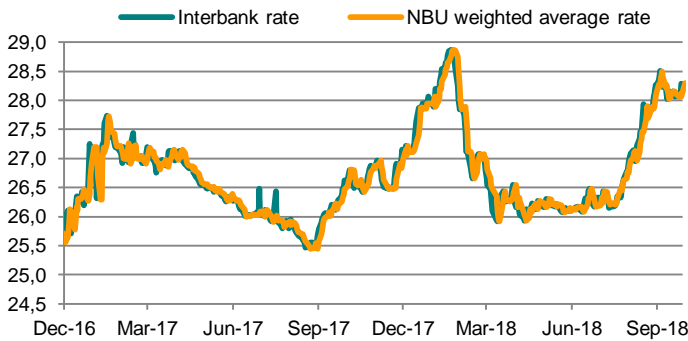
Monthly change in local currency loans and deposits, UAHbn



Source: the NBU

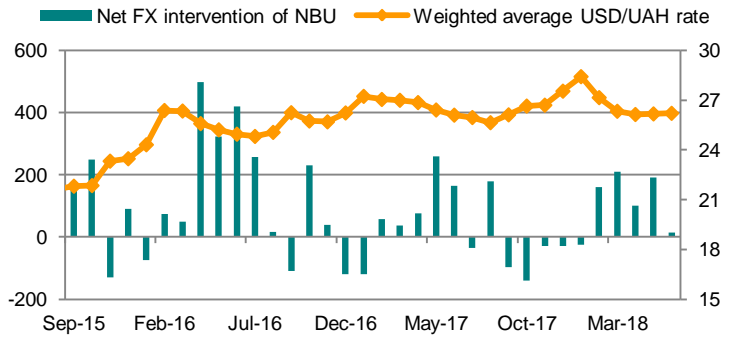
Currency market

UAH exchange rate, UAH/USD



Source: Reuters

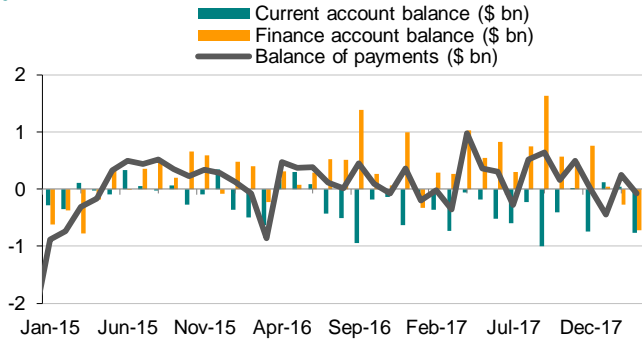
Net retail FX interventions of the NBU in 2015-2017, USDmnn



Source: NBU

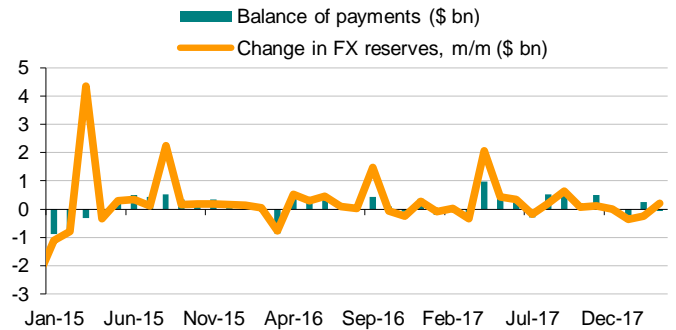
Balance of payments

Major BoP accounts, USDbn



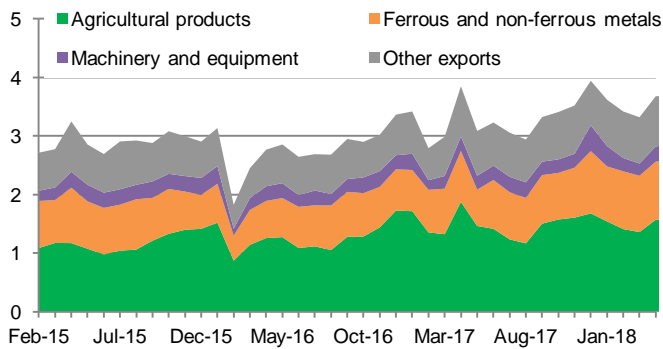
Source: NBU

BoP vs change in foreign reserves, USDbn



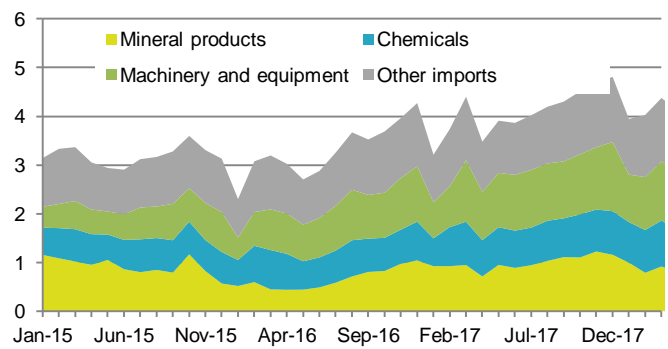
Source: NBU

Exports components dynamic, USDbn



Source: NBU

Imports components dynamic, USDbn



Source: NBU



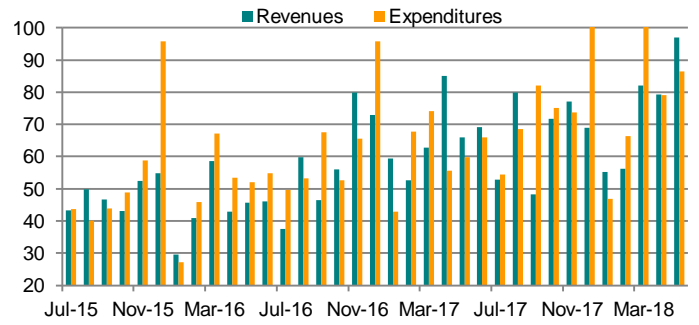
Budget performance

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

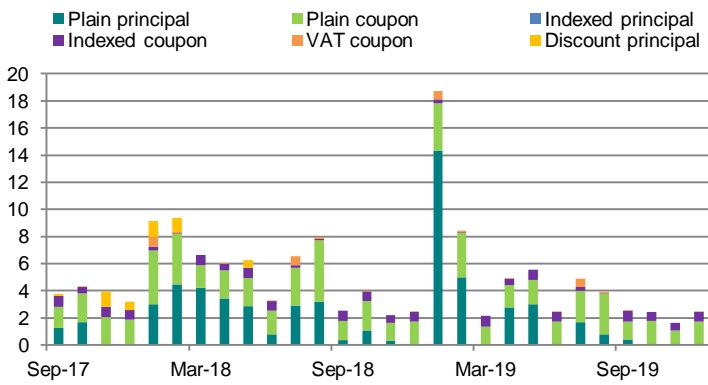
Monthly change in budget revenues and expenditures, UAHbn



Source: NBU, State Treasury

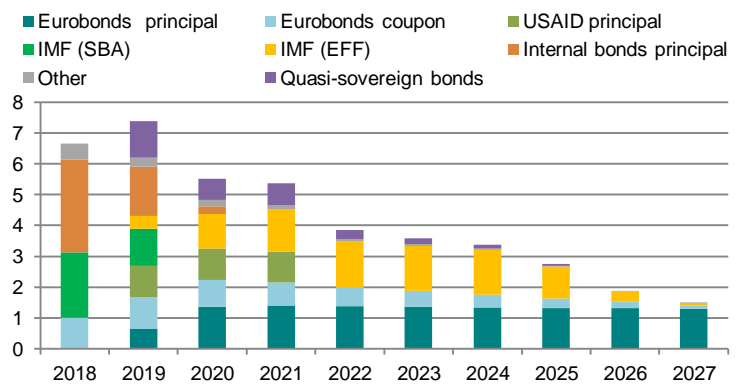
Sovereign debt

UAH- denominated debts' repayments schedule, UAHbn



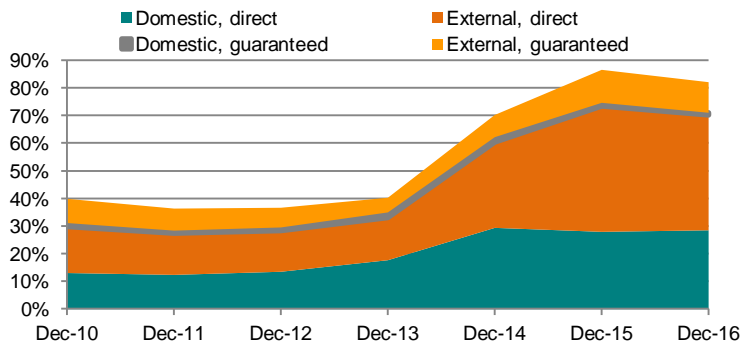
Source: NBU, UkrSibbank estimates

FX-denominated debt repayments schedule, USDbn



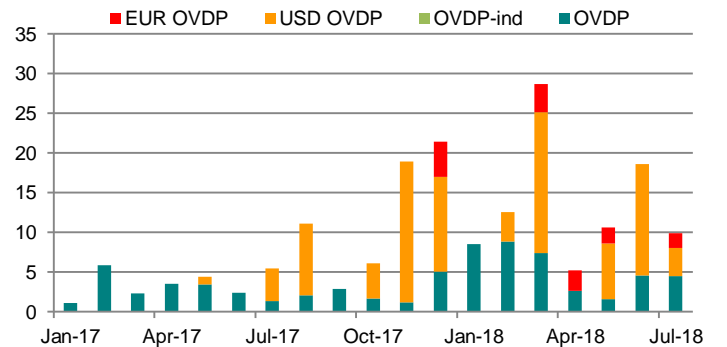
Source: Reuters, IMF, UkrSibbank estimates

Total government debt, % GDP



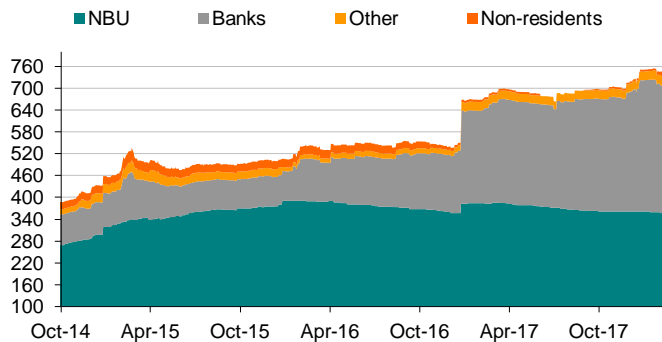
Source: MinFin

Local borrowings, UAHbn equivalent



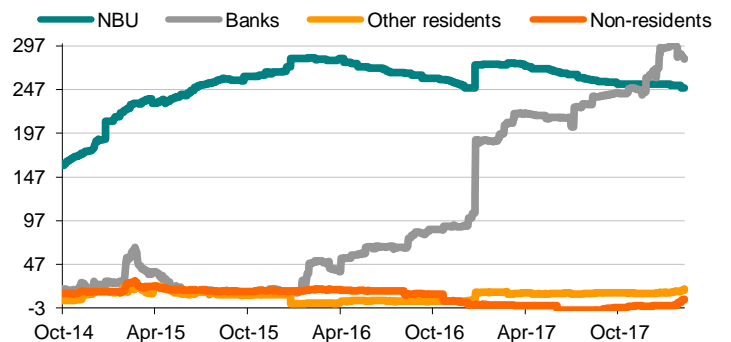
Source: NBU

Outstanding OVDP owners structure, UAHbn



Source: NBU

Outstanding OVDP changes in holding, UAHbn

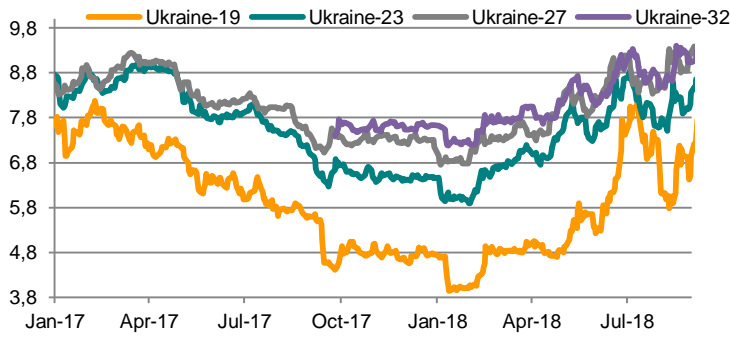


Source: NBU



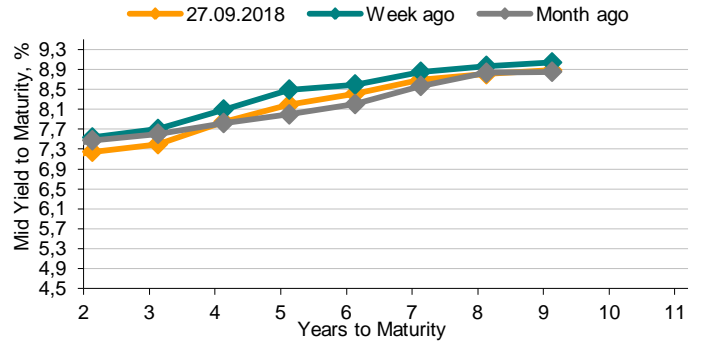
Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Reuters

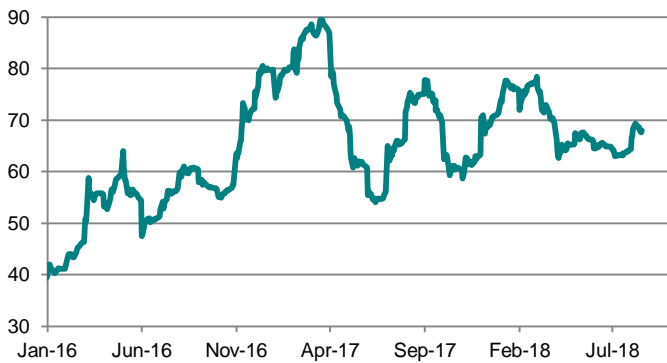
Ukraine's sovereign Eurobond yield curve



Source: Reuters

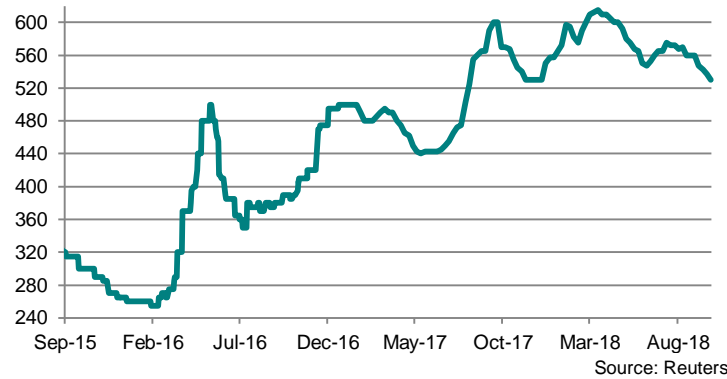
Commodity markets

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



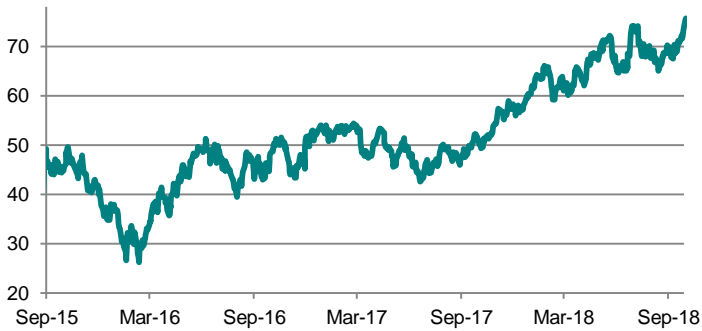
Source: Reuters

Steel CIS export HR coil, USD per ton



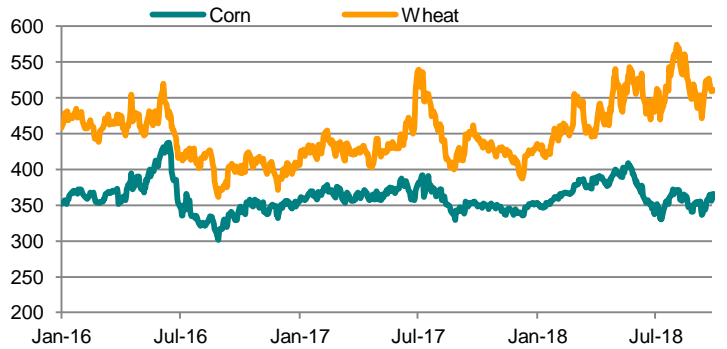
Source: Reuters

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	3.4
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	3393.0
Nominal GDP (USD bn)	178.9	112.8	136.1	163.1	175.8	183.5	133.7	91.2	93.1	112.1	125.0
Prices											
CPI (average %YoY)	25.2	15.9	9.4	8.0	0.6	-0.2	12.1	48.7	16.5	14.4	11.5
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	10.3
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	18.00*
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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