



## This week in focus:

## Inflation likely to be in the low double digits going forward

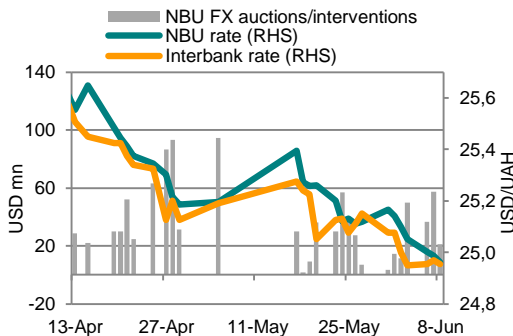
CPI decreased to 7.5% y/y in May 2016, further down from 9.8% y/y the month before. It is highly probable that from this point the inflation rate will begin to accelerate as new household utility tariffs will come into effect on July 1, whereas the NBU reconfirms its intentions to ease the monetary policy.

*Please see page 4 for more details.*

## Currency market:

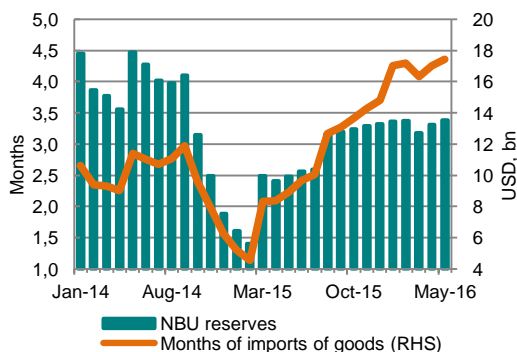
## USD/UAH flat around 25

Figure 1. UAH exchange rate (UAH per 1\$)



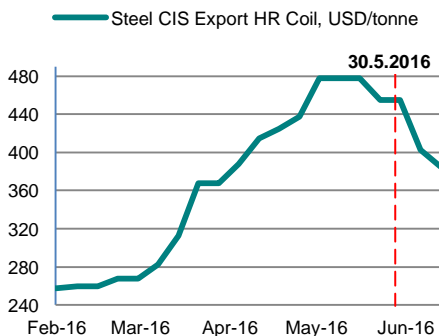
Source: NBU, Bloomberg

Figure 2. NBU FX reserves and months of covered imports



Source: NBU, UkrSibbank

Figure 3. Steel CIS Export HR coil price YTD



Source: Bloomberg

As anticipated, **USD/UAH breached the 25 threshold on June 3<sup>rd</sup>**, and has been hovering slightly below it since then, closing at 24.9950 on Friday the 10<sup>th</sup>.

Sale volumes of USD on the market decreased slightly comparing to the previous week, on average amounting to USD 158mn per day.

**NBU intervened in the market 3 times last week** with a total amount of **USD 115.1mn**. Cut-off rates have been on a decline just like the previous week, decreasing from 24.99 on June 6<sup>th</sup> down to 24.95 on June 8<sup>th</sup>.

**The NBU has been ramping up its FX reserves** that reached USD 13.53bn on June 1. The regulator is likely to continue increasing the reserves in an attempt to reach the required end-year level of USD 22.3bn that is stipulated in the IMF EFF program (according to July 2015 memo).

**Capital and currency controls are being gradually lifted**, to reflect FX liberalization commitment and to support weaker UAH on levels that would allow NBU to continue accumulating reserves.

**The NBU significantly liberalized the FX market in its rulings #341 and #342 from June 7**. The regulator **decreased the percentage of the foreign currency sale requirement to 65%** from 75% and **doubled the limit of foreign currency deposits withdrawal to UAH 100,000 (~USD 4,000)** from UAH 50,000 (~USD 2,000).

Furthermore, the NBU **increased the limit on foreign currency cash purchases to UAH 12,000 (~USD 480)** from UAH 6,000 (~USD 240) per person per day in one bank. Lastly, the central bank **allowed banks to alter their exchange rate during a business day**.

This opportunity for easing was made possible by the recent FX inflow into the country due to benign external conditions. Such positive **steps should give a confidence boost to the local currency and prop up the troubled banking system**.

**CIS export HR coil steel prices decreased precipitously by USD 17.5 per tonne to USD 385 per tonne since last week** and by USD 70 per tonne since May 30. Steel export is a sizeable part of overall exports, wherefore such a **decline will palpably relieve appreciation pressure on UAH**. As anticipated, **steel prices lagged iron ore prices**, which declined sizably in the previous months.

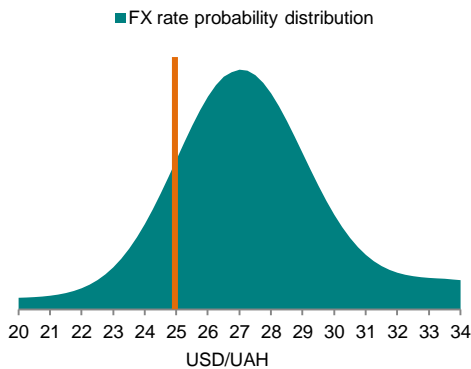
Lastly, an NBU ruling #342 from June 7 allowed for **repatriation of dividends by foreign investors or dividend payers for 2014-2015**, which was previously restricted. **The measure also applies till September 14**. **Monthly transfer limits per person are set at USD 1mn or 10% of the total dividend amount, whichever is greater**. If these 10% exceed USD 5mn, then the greatest amount permitted for repatriation cannot be higher than USD 5mn.

**The NBU expects that the repatriation of dividends for 2014-2015 could amount to USD 0.5-0.6bn**. It is not yet clear whether dividends for 2016 will be allowed for repatriation.

We are keeping our projection that **UAH will likely appreciate against USD to approximately 24.5** during the next 2-3 months, while the **outlook for the end of 2016 remains at bearish 27 level**.



**Figure 4. 12m forward USD/UAH rate probability distribution**



Source: UkrSibbank

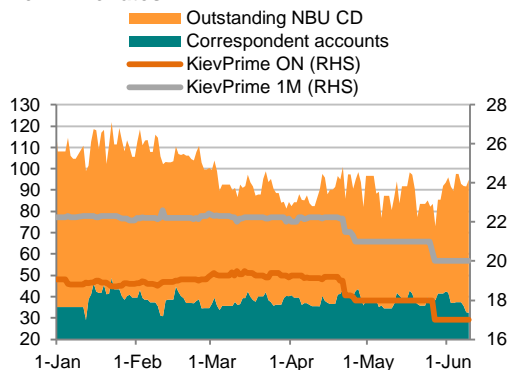
A probability distribution of the USD/UAH is skewed to the right, i.e. in the direction of a weaker UAH going forward. While current economic conditions exert appreciation pressure on the currency, the Ukrainian economy's structural weakness and the NBU's policy preferences are likely to weaken the UAH

**EUR/USD moved up and down last week closing at 1.1251 of June 10.** The movements of the rate were mostly attributed to swings of USD, whereas EUR remains to be flat, since the EU economy is flagging weighted down among other things by concerns regarding the looming BREXIT.

### Money market:

### Liquidity recovers, cut-off rates on the decline

**Figure 2. Banking liquidity (UAH bn) vs. KievPrime rates**



Source: Bloomberg, NBU, UkrSibbank, MinFin

**Banking liquidity increased above UAH 100bn and landed on Friday the 10th at UAH 101.8bn level,** increasing by UAH 9bn from June 6. Liquidity is recovering due to FX purchases by the NBU and is expected to continue increasing.

Money market rates stayed level: cost of ON funds is around 15.5/16.5%, indicative 1 week is 16/18% while indicative 1M is 18/20%, according to our data.

**The next meeting of the NBU Monetary Policy Committee (MPC) is scheduled for the 23<sup>th</sup> of June,** on which a decision to slightly **decrease the key rate (ca. 1%)** might be expected. Further policy steps are unlikely to be taken before the MPC meeting on the 28<sup>th</sup> of July, as an ostensibly leaked draft of a memorandum with the IMF, which is circulating in the media, suggests that there might be changes in the EFF program, increasing uncertainties over international funding in 2016.

The last OVDP auction was held on June 7. **Cut-off rates decreased from the previous auction by 0.5% (to 17.5%) for 2y bonds** and remained the same for 1y bonds. We expect the MinFin to keep driving the cut-off rates down the way it has been doing for the previous several weeks.

**Demand for bonds is expected to pick up** on the last two auctions before the MPC meeting as market participants are anticipating further rate cuts that will drive down the yields.

Total proceed from the June 7 auction amounted to UAH 309.03 mn

**Figure 3. OVDP auction schedule, 2Q 2016**

Date	Currency	Maturity
07.06.16	UAH	3M, 6M, 9M, 1Y, 2Y
14.06.16	UAH	3M, 6M, 9M, 1Y, 3Y
21.06.16	FCY	3M, 6M, 9M, 1Y, 2Y

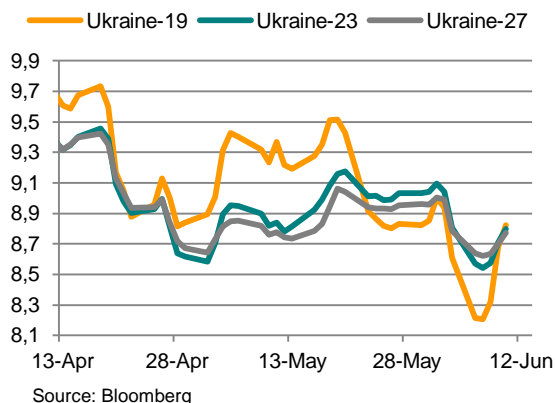
**Figure 5. OVDP auction results, 7 June 2016**

Currency	Maturity	Cut-off rate	WA rate	Max bid rate	Min bid rate	Number of bids	Bids accepted	Bid size	Placement size
UAH	1y	16.85%	16.85%	16.85%	16.85%	1	1	175mn	175mn
UAH	2y	17.00%	16.99%	17.20%	16.90%	6	5	183mn	157,95mn

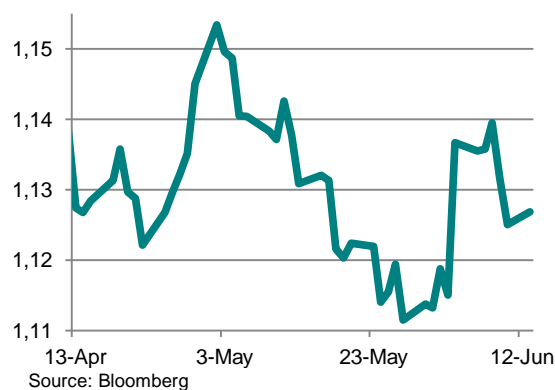


## Global markets: Global concerns persist

**Figure 4. Ukraine's sovereign Eurobond yields, bid/ask mids (%)**



**Figure 5. EUR/USD spot (mid)**



On the 7<sup>th</sup> of June the **World Bank** issued its bi-annual **Global Economic Prospects** report, in which it **lowered the expected growth of the world's economy to 2.4%** for 2016, down by 0.5% from its previous January 2016 projection of 2.9%.

Advanced countries are expected to grow by 1.7% while growth in Emerging and developing economies is projected at 3.5%. Among other things like concerns about monetary policy effectiveness, political uncertainties, and willingness and ability of policymakers to use fiscal policy if necessary, the institution cited **a divergence between commodity exporters and commodity importers in Emerging and developing economies**.

Woes of commodity exporters are attributed to further downward revision of commodity price forecasts, weak global trade, volatile capital markets and persistent domestic challenges. **Growth in commodity exporting Emerging and developing economies is expected at 0.4% for 2016.**

**Bonds rose last week**, namely safe havens like **Germany and Japan** seeing yields near all time low, as investors are flocking to safety in the light of **forthcoming key events**: FED meeting on June 15, the Bank of Japan policy meeting on June 16 followed by a BREXIT referendum the week after that on June 23. At the same time **EM countries continue the recent issuance streak** with long-term international placements by Indonesia and Oman both in amounts of USD 3bn.

The European statistics agency (**Eurostat**) revised the **Eurozone's growth in 1Q 2016 up to 0.6% q/q and 1.7% y/y**, strengthening hopes for the bloc's economic recovery. Despite the news, **Stoxx Euro 600 slipped 1.6%** on Friday.

Furthermore, **ECB began to buy investment grade corporate bonds on June 8**, in its latest attempt to spur inflation in the Euro area. **Yields on both investment and speculative grade bonds slid** in anticipation of the ECB's entry.

**Fears over the next week's FOMC meeting strengthened the USD** starting from Wednesday, ending the depreciation against peer currencies that began with a disappointing payroll figures on June 2.

**May 2016 Chinese economic readings are rather lackluster**: the **CPI at 2.0% y/y** below a forecast of 2.3%, whereas **PPI is in the red** for the 51<sup>st</sup> straight month. Moreover, **exports in USD-denominated terms contracted by 4.3% y/y** in May, double the April figure of 1.8%, while **imports decreased by 0.4% y/y**, narrower than expected 6.0%. On the other hand, **RMB-denominated figures showed improvements** due to **the local currency's continuous weakening against the USD**. These disappointing developments increase the probability of the Chinese government applying more **economic stimuli** in 2016.

**The Russian central bank cut the key interest rate to by 0.5% to 10.5%** on Friday, justifying the move by the stable rate of inflation, which came out in at 7.3% y/y for the third month in a row in May. Experts are divided over whether further cuts will follow since there are signs that inflation accelerates from this point on up to 7.8% y/y in Q3 2016.

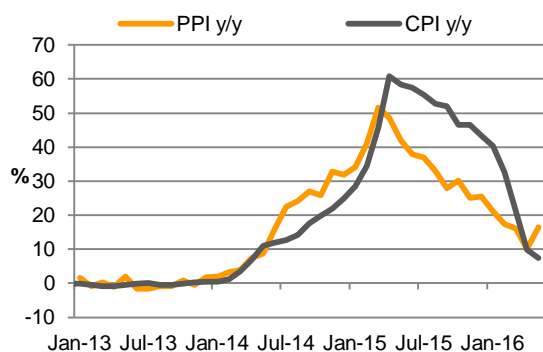
**Oil still couldn't manage to beat the USD 50 barrier** with WTI closing at USD 49.89 on Friday, trimming its recent advances. **The short-term outlook is likely moving to the downside**, since the Gulf countries are not curbing output, weekly US date showed a first uptick in production in three months, whereas China is moving closer to its maximum stock capacity of approximately 155mn barrels with its current estimated stock of 135mn barrels.



This week in focus:

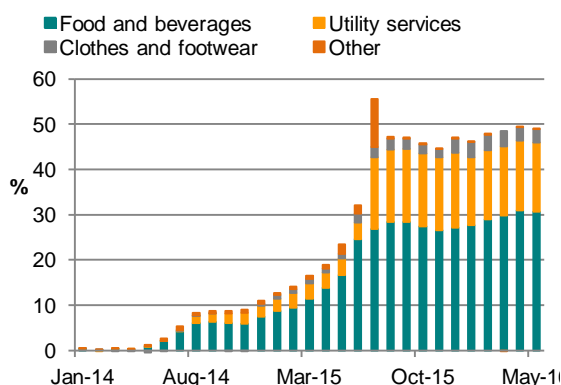
Inflation likely to be in the low double digits going forward

Figure 6. Inflation rate 2013-2016, y/y



Source: NBU, Uksribbank

Figure 7. Cumulative inflation since 2014



Source: State statistics service of Ukraine

In May 2016 CPI fell to 7.5% y/y and 0.1% q/q, according to data of the State statistics service of Ukraine. At the same time PPI reached 16.4% y/y, up from 10.1% in April. Core inflation slowed down to 8.8% y/y and 0.2% m/m, somewhat exceeding expectations. This movement of price levels is in line with previous projections by the both NBU and Uksribbank.

CPI deceleration is partially attributed to seasonal factors, for example rising supply of vegetables, both imported and grown locally drove the prices down by 5.8%. The same holds true dairy products. Core inflation decreased mainly due to UAH appreciation and subdued domestic consumer demand.

Major contributors to an increase in PPI are metal ores extraction costs, which increased by 33% y/y (6.9% y/y in April) and metallurgy costs, which increased by 20.4% y/y (comparing with April's figure of 4.6% y/y).

It is most likely that currently inflation is close to its lowest point in 2016 and will start accelerating from now on due to a set of factors.

Export revenues are expected to dwindle since commodity markets are gradually deteriorating, with steel prices finally beginning to decline, several weeks after the correction of iron ore prices. The inflow of USD that has been propping up the UAH will be markedly less pronounced.

Domestic demand is picking up along with a turnaround of the overall economy, pushing up core inflation. Retail sales demonstrated strong growth in March and April (13.4% and 12.2% y/y respectively). This trend is expected to persist, supported by real wage growth (7.6% y/y in April).

Furthermore the NBU is anticipated to cut the key rate on the meetings of its Monetary Policy committee in June and July, eliminating the appreciation pressure caused by the current 10.5% mismatch between the inflation rate and the key rate. A lower key rate is expected to give a boost the economy, driving prices further up.

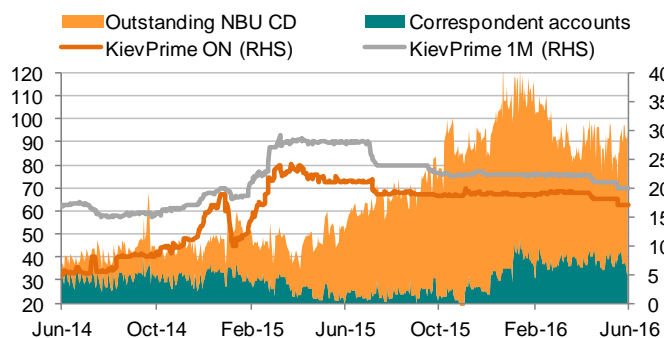
Additionally, inflation is expected to receive a push from administered prices. Utility services became a major contributor to the CPI increase from mid-2015 and are projected to exert even more upward pressure in 2016. New utility prices were finally set by the National commission on regulation of energy and utilities on June 9. New heating and hot water tariffs will be increased twofold and are effective July 1. It should be noted that larger part of the anticipated effect will kick in when the 2016 heating season begins.

We expect the inflation rate to start accelerating in the nearest future and eventually reach 14% y/y by the end of 2016.



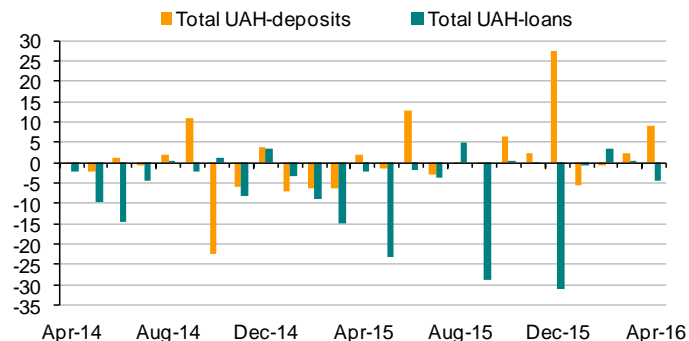
## Money market

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



Source: Bloomberg, NBU, UkrSibbank estimates

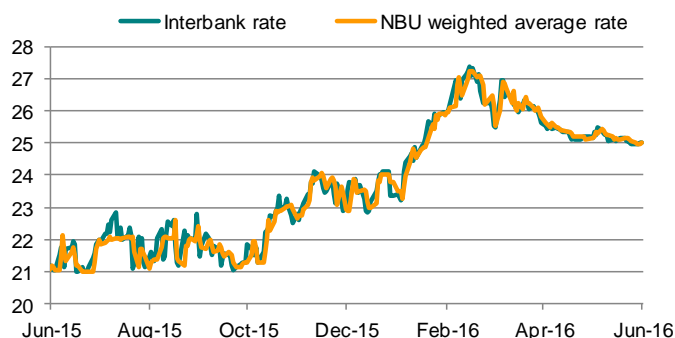
### Change in local currency loans and deposits, UAHbn



Source: the NBU

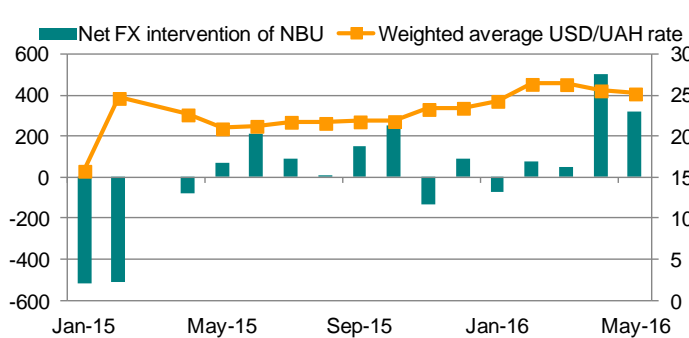
## Currency market

### UAH exchange rate, UAH/\$1



Source: Bloomberg

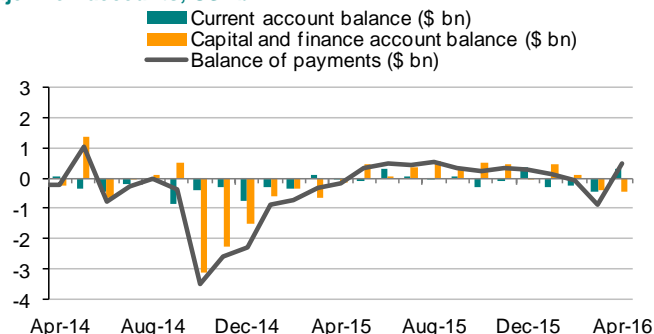
### Net retail FX interventions of the NBU in 2015-2016, USDmn



Source: NBU

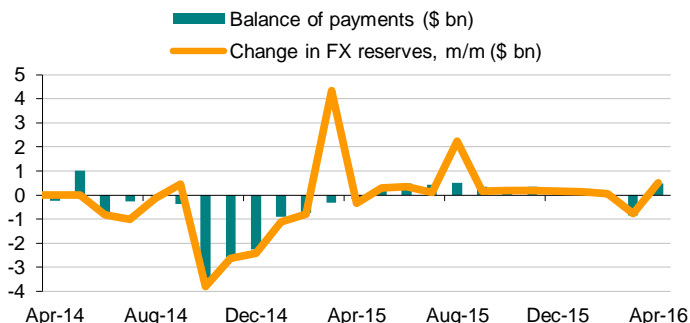
## Balance of payments

### Major BoP accounts, USDbn



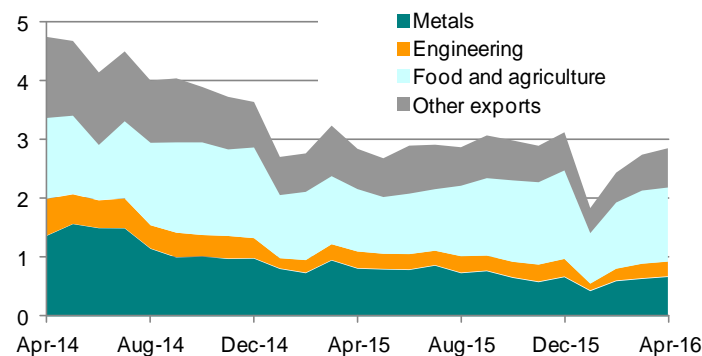
Source: NBU

### BoP vs change in foreign reserves, USDbn



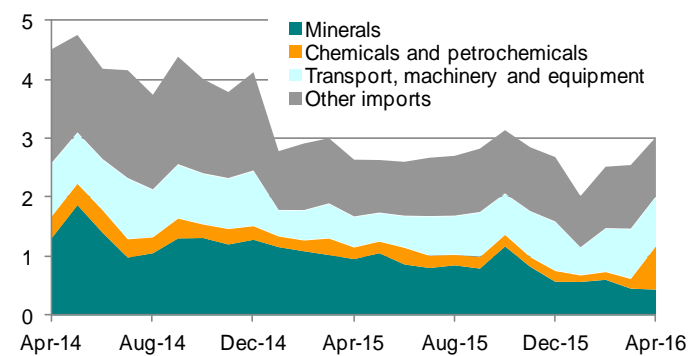
Source: NBU

### Exports components dynamic, USDbn



Source: NBU

### Imports components dynamic, USDbn



Source: NBU





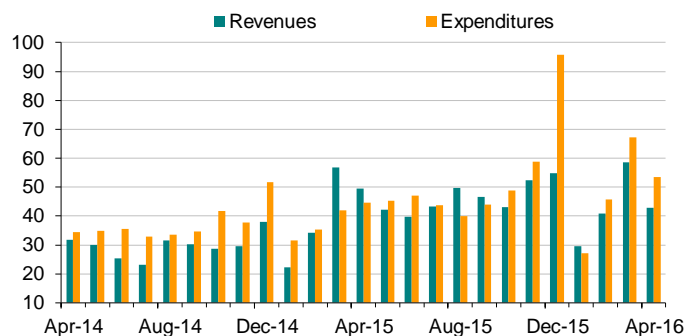
## Budget performance

### Budget performance, UAHbn

	Jan-Apr 2015	Jan-Apr 2016
<b>Budget revenues</b>	<b>162.64</b>	<b>171.94</b>
VAT proceeds	41.37	54.26
Corporate income tax	17.41	15.82
<b>Budget expenditures</b>	<b>153.30</b>	<b>193.67</b>
Deficit / Surplus	+9.34	-21.73

Source: NBU

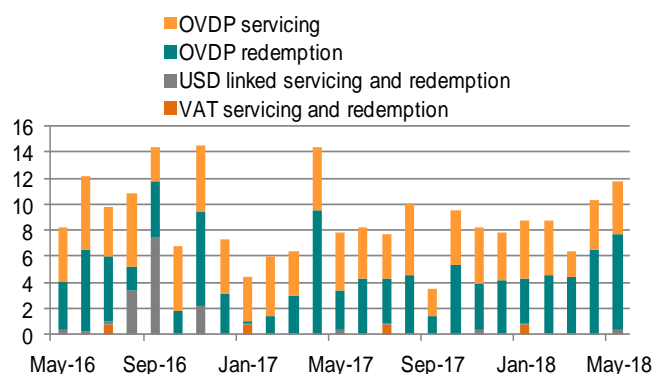
### General budget revenue and expenditures, UAHbn



Source: NBU, State Treasury

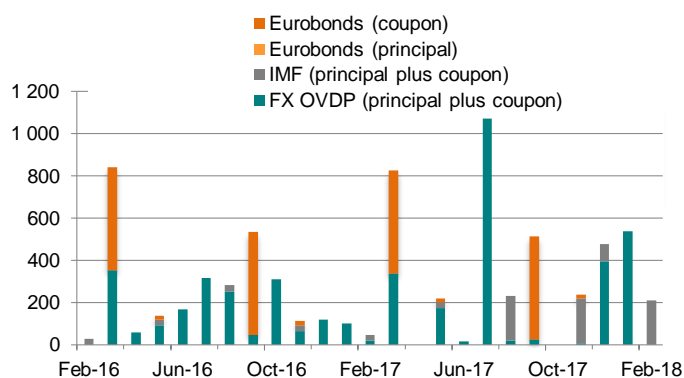
## Sovereign debt

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



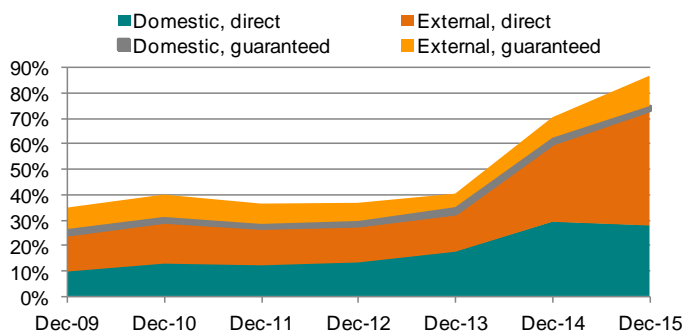
Source: NBU, UkrSibbank estimates

### FX-denominated debts' repayments schedule, USDmn



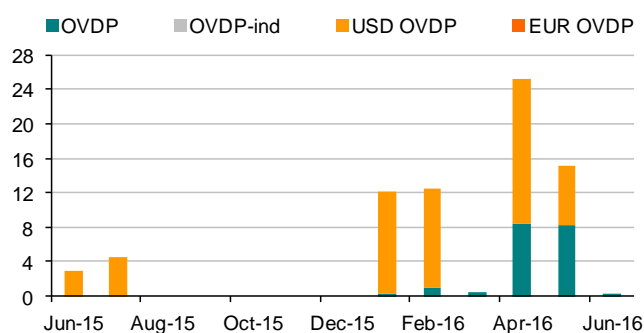
Source: NBU, UkrSibbank estimates

### Total government debt, % GDP



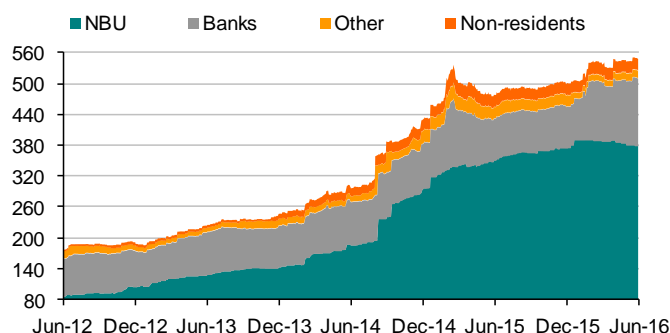
Source: MinFin

### Local borrowings, UAHbn



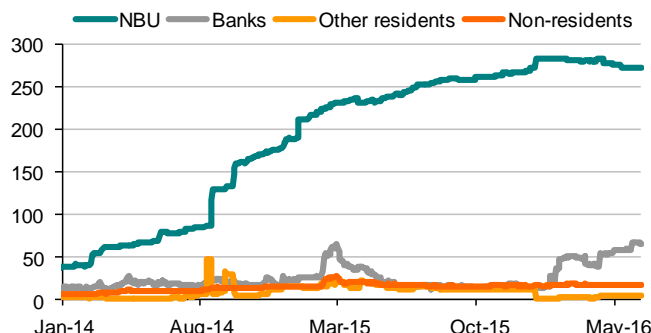
Source: NBU

### Outstanding OVDP owners structure, UAHbn



Source: NBU

### Outstanding OVDP changes in holding since start 2013, UAHbn

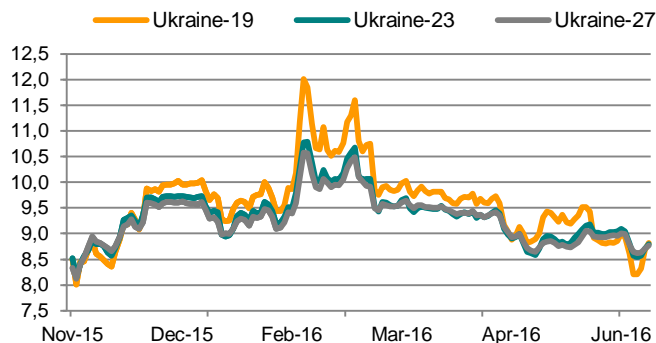


Source: NBU



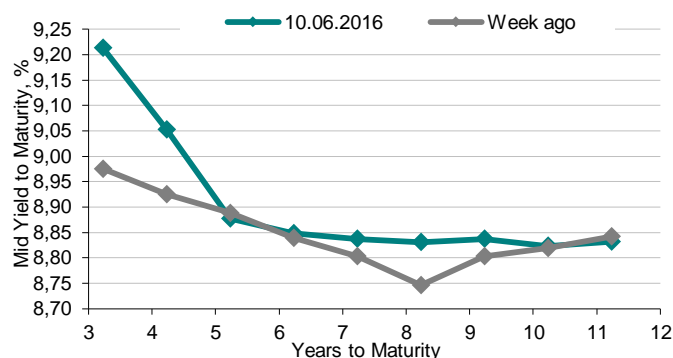
## Eurobond market

Ukraine's sovereign Eurobond yields, %



Source: Bloomberg

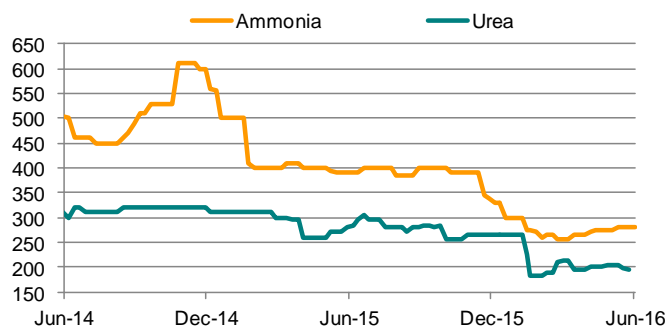
Ukraine's sovereign Eurobond yield curve



Source: Bloomberg

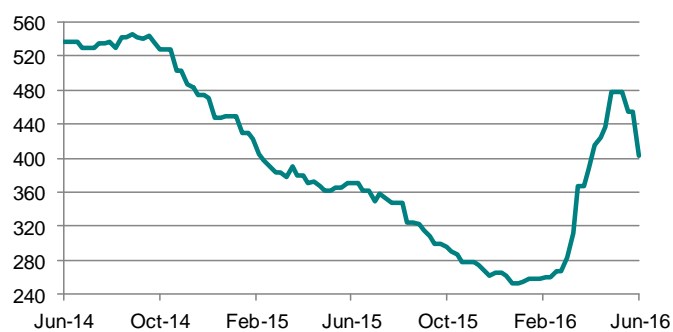
## Commodity markets

Fertilizers (Black Sea), USD per ton



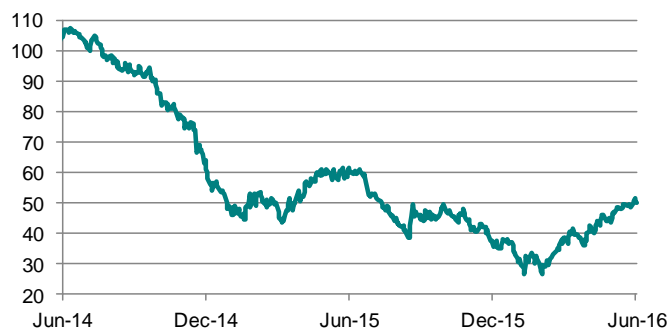
Source: Bloomberg

Steel CIS export HR coil (Black Sea/Baltic Sea), USD per ton



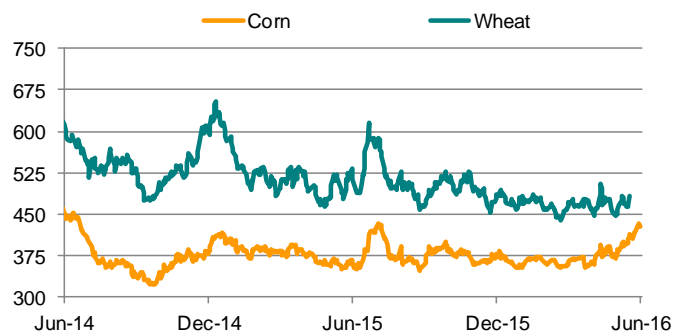
Source: Bloomberg

WTI oil (nearest active future at NYMEX), USD per barrel



Source: Bloomberg

Corn and wheat (nearest active future at CBT), USD per bushel



Source: Bloomberg



Key Macroeconomic Indicators									
Ratings (M/S&P/F) Caa3/B-/CCC	2008	2009	2010	2011	2012	2013	2014	2015	2016F
<b>Real sector</b>									
Real GDP (%YoY)	2.3	-14.8	4.1	5.2	0.3	0.0	-6.8	-10.0	1.2
Industrial production (%YoY)	-5.2	-21.9	11.2	8.0	-0.7	-4.3	-10.7	-6.0	1.0
Retail sales (%YoY)	17.3	-20.9	10.1	13.2	12.3	6.1	-11.0	-25.0	0.4
Unemployment rate end of year (ILO, working age)	6.9	9.6	8.8	8.6	8.1	7.7	9.7	11.5	10.3
Nominal GDP (UAHbn)	948.1	913.3	1082.6	1302.1	1411.2	1454.9	1566.7	2031.3	2322.1
Nominal GDP (\$bn)	178.9	112.8	135.3	162.8	174.2	177.4	131.3	88.7	86.0
<b>Prices</b>									
CPI (average %YoY)	25.2	15.9	9.4	8.0	0.6	-0.2	12.1	48.7	18.0
CPI (end of year %YoY)	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	43.3	14.0
Real average wage growth (%YoY)	6.3	-9.2	10.2	8.7	14.4	8.2	-6.5	-35.0	5.0
<b>Fiscal balance (% of GDP)</b>									
State budget deficit (without Naftogaz)	1.3	3.9	5.9	1.8	3.8	4.4	5.0	3.0	2.5
Total public debt	20.0	34.8	39.9	36.3	36.5	40.2	70.3	91.4	96.4
<b>External balance</b>									
Exports of goods (\$bn)	67.7	40.4	52.2	69.4	70.2	65.0	50.5	35.4	33.2
Imports of goods (\$bn)	-83.8	-44.7	-60.6	-85.7	-89.7	-84.6	-56.7	-38.7	-38.1
Current account balance (\$bn)	-12.8	-1.7	-3.0	-10.2	-14.3	-16.4	-5.2	-0.2	-2.1
Current account balance (% of GDP)	-7.1	-1.5	-2.2	-6.3	-8.2	-9.2	-4.0	-0.2	-2.5
Net FDI (\$bn)	9.9	4.7	5.8	7.0	7.2	4.1	0.3	2.3	3.9
Foreign exchange reserves (end of year)	31.5	26.5	34.6	31.8	24.5	20.4	7.5	13.3	16.4
Imports coverage (months of imports of goods)	4.5	7.1	6.8	4.5	3.3	2.9	1.5	4.4	5.3
<b>Interest and exchange rates</b>									
NBU discount rate (% end of year)	12.00	10.25	7.75	7.75	7.50	6.50	14.0	22.0	14.0 *
Exchange rate (UAH/\$) end of year	8.1	8.0	7.9	8.0	8.1	8.2	15.8	24.0	27.0 *
Exchange rate (UAH/EUR) end of year	10.9	11.5	10.5	10.4	10.6	11.3	23.0	26.2	30.7 *

Source: UkrStat, NBU, MinFin, UkrSibbank

\* Broad estimate

Economic calendar 2016												
Source:	UkrStat								NBU			State Treasury
	GDP growth	Fixed capital investments	Industrial production	Retail trade	Construction works	Agricultural output	Inflation rate	Jobless rate	Balance of payments	NBU reserves	Monetary / FX statistics	Balance of Treasury account
Date of release (actual / indicative)	act	act	act	act	act	act	act	act	ind	ind	ind	act
<b>June</b>												
June 3										V		
June 4										V		
June 5							V			V		
June 10											V	
June 11											V	
June 12											V	
June 16				V		V						
June 17					V							
June 18			V									
June 19	V							V				
June 23												
June 29									V			
June 30									V			V
<b>July</b>												
July 1										V		
July 2										V		
July 3										V		
July 6							V					
July 8											V	
July 9											V	
July 10											V	
July 15						V						
July 16				V								
July 17			V		V							
July 29									V			
July 30									V			
July 31									V			V





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