

Weekly Digest

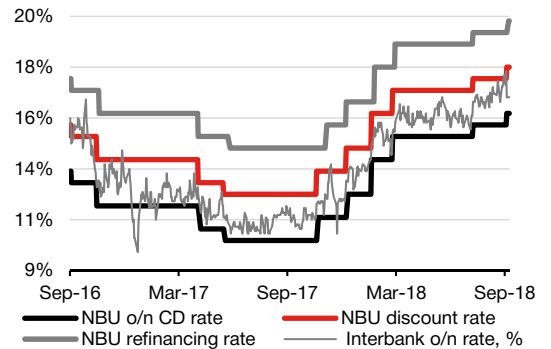
- The NBU has increased the discount rate by 50bps to 18.0%
- Foreign currency reserves of the NBU in August decreased by \$0.5bln MoM to \$17.2bln
- Consumer inflation in August was absent in MoM terms, but increased to 9.0% YoY

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According to the press release, monetary policy has been tightened primarily in response to a hike in external risks that stem from deteriorating terms of trade with other EM economies (a result of relative currency devaluation abroad), and potential for commodity price weakness in the wake of an escalating US-China trade war. Internal pressures generated by growing disposable income (on the back of labor migration) and elevated inflation expectations were also noted to be a concern.

Our view: Taking into account that the NBU has spent over \$650mln of reserves over August to stabilize the interbank FX market, the rate increase did not come to us as a surprise. Moreover, we do not exclude that the regulator will tighten monetary policy even further if pressures on the hryvnia continue to build just like they did in 4Q17. Since the latter is a part of our base-case macroeconomic scenario (a devaluation driven by negative expectations), we bump our discount rate forecast for the end of December to 19.0%. In our view, potential for a more relaxed policy will be greatly increased by a positive outcome of negotiations with the IMF (a mission has already arrived in Kyiv).

Local interest rate dynamics, past 2 years

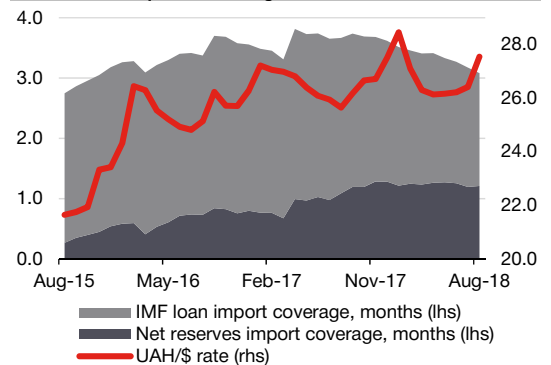


Source: NBU

Foreign currency reserves of the NBU in August decreased by \$0.5bln MoM to \$17.2bln. Outflows were caused primarily by \$1.1bln of state debt interest and amortization payments (including \$607mln to the IMF) and the regulator's net interventions worth of \$650mln. Inflows came on the back of local FX notes and eurobond placements by the government that raised \$460mln and \$725mln, respectively.

Our view: The decline in reserves substantially exceeded our expectations due to the sizeable amount of interventions conducted by the NBU. In fact, our previous base-case scenario envisioned that the regulator would be able to purchase FX currency from the market until September, when a seasonal shift in sentiment usually occurs. Adjusting our model for the new reality, we decrease the private sector's funding contribution to the BoP to just \$0.1bln from \$2.0bln previously. Taking into the account the surprise \$725mln private placement, we downgrade our end-of-year reserves estimate by a smaller amount: to \$19.4bln from \$20.8bln previously. We note that we continue to expect that Ukraine will receive the upcoming \$2.0bln tranche from the IMF, EUR0.5bln from the EU, and \$0.5bln from the World Bank. Additionally, we model that the state will place an additional \$1.0bln net via a eurobond operation.

Reserves import coverage vs UAH/\$ rate

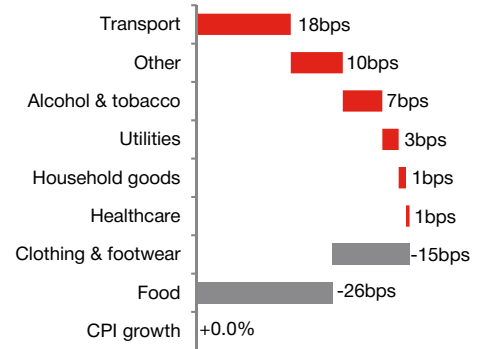


Source: NBU, Adamant Capital estimates

Consumer inflation in August was absent in MoM terms, but increased to 9.0% YoY from 8.9% previously. Following a 0.7% MoM deflation in July, prices remained flat, owing to even cheaper food (mostly a result of seasonality of fruit and vegetable markets) and clothing (sales on old collections). Categories that pushed the CPI forward were transportation services (partially due to more expensive bus and metro tickets), as well as alcohol and tobacco. Core inflation landed at 0.1% MoM.

Our view: The reported data came generally in line with our estimates, which allows us to retain our EOP inflation outlook for the year at 9.5%. Over the next three months we continue to expect the CPI to be driven by three principal factors: an increase in natural gas prices and heating tariffs (as per the upcoming agreement with the IMF), a seasonal devaluation of the hryvnia (at c. 4% since the beginning of August), and growing disposable income. With regard to the latter we note that average salaries in July were up by 25% YoY, which is a slight acceleration from June. In its published commentary, the NBU has remarked that inflation landed above expectations, which may mean that its 8.9% target will experience an upward revision.

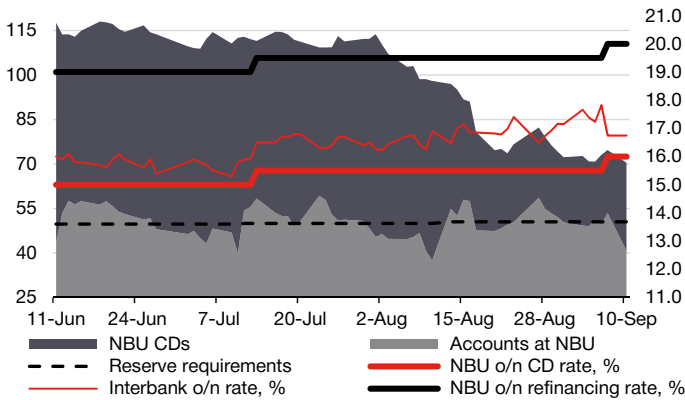
MoM CPI growth breakdown in August



Source: SSSU, Adamant Capital estimates

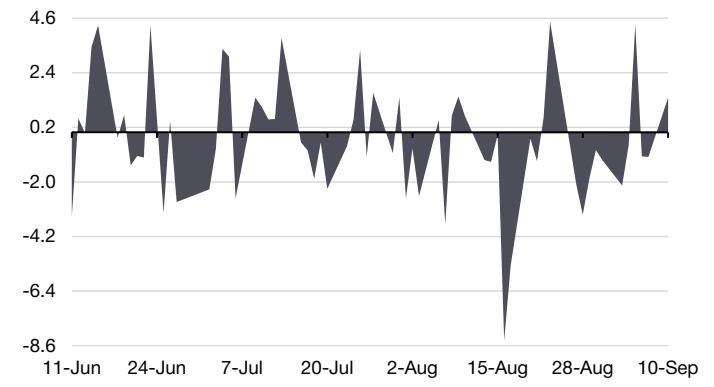
Appendix

Banking system 3m liquidity (lhs, UAHbln) vs NBU CD rates (%)



Source: NBU, Adamant Capital estimates

Banking system inflows from the state treasury and the DGF

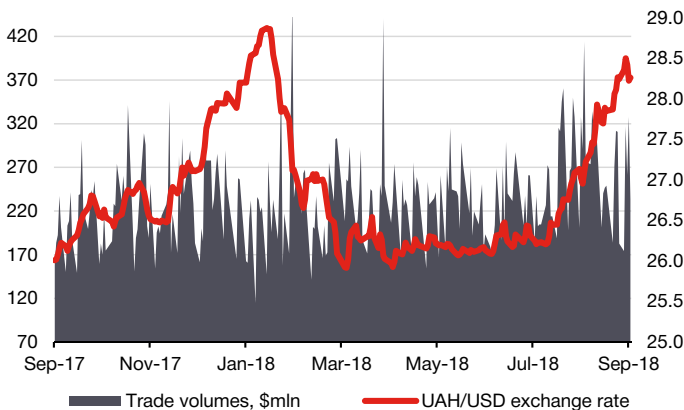


Note: in UAHbln
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 2.2bln to UAH 70.4bln over the last week. On September 11 the Ministry of Finance conducted local hryvnia denominated placement maturing in December 2018, March 2019 and September 2019 with yield of 18.5% and USD denominated placement maturing in June 2019 and July 2020 with yield of 5.95%. A total of UAH 134.6mln and \$10.3mln was raised as a result.

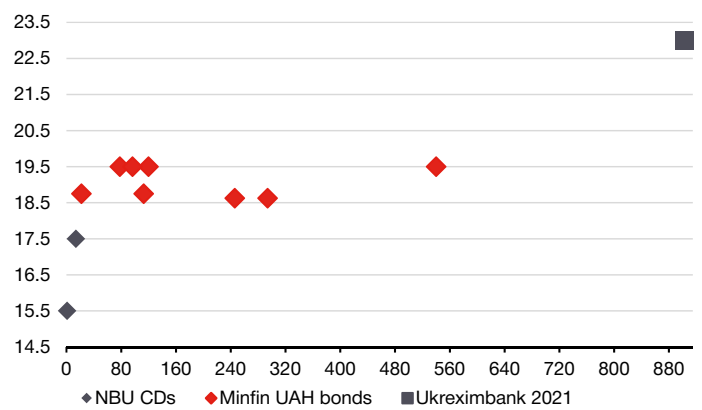
The UAH/USD interbank rate appreciated by 1.4% over the week starting out with 28.50 and ending at 28.10.

FX interbank trade volume (lhs) and FX rate (rhs), past 12 months

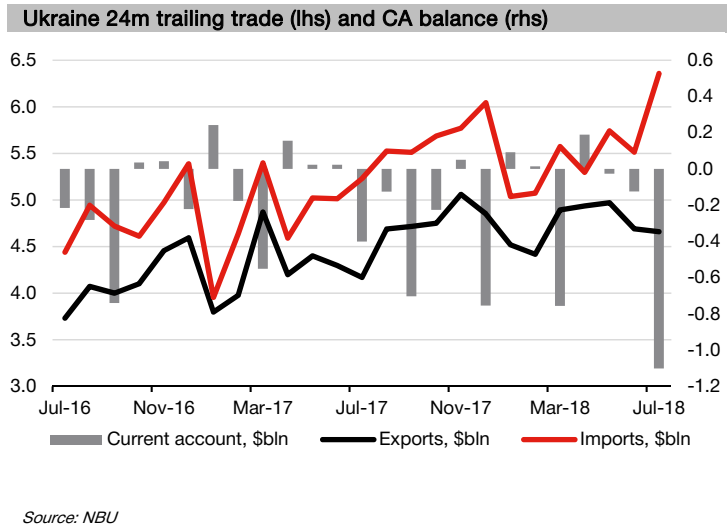
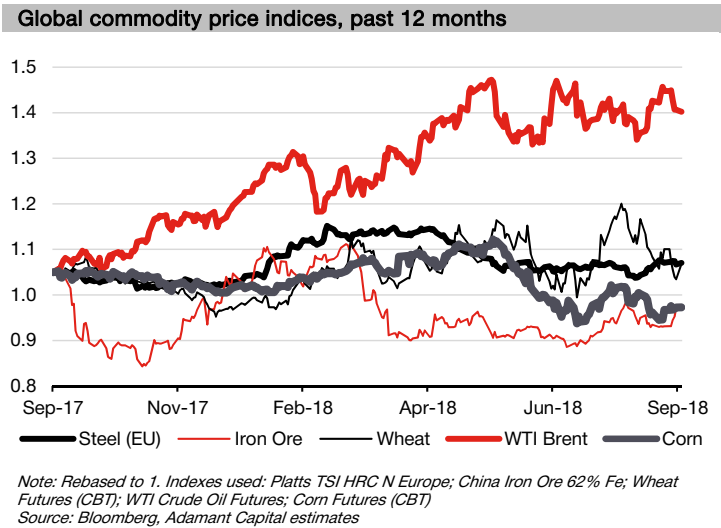
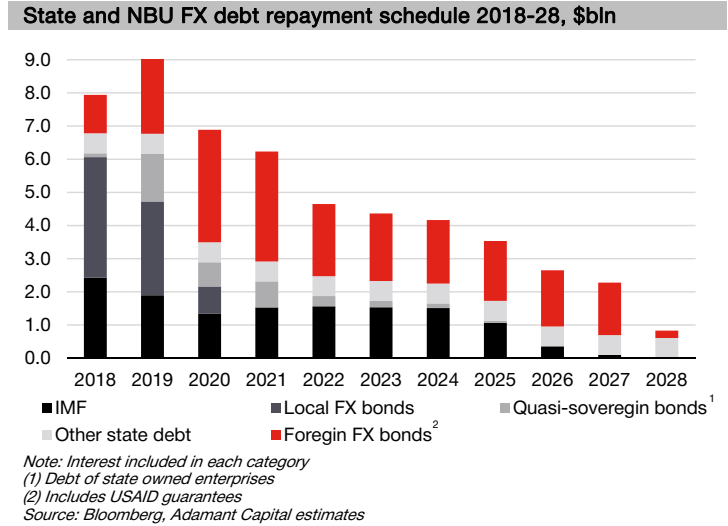
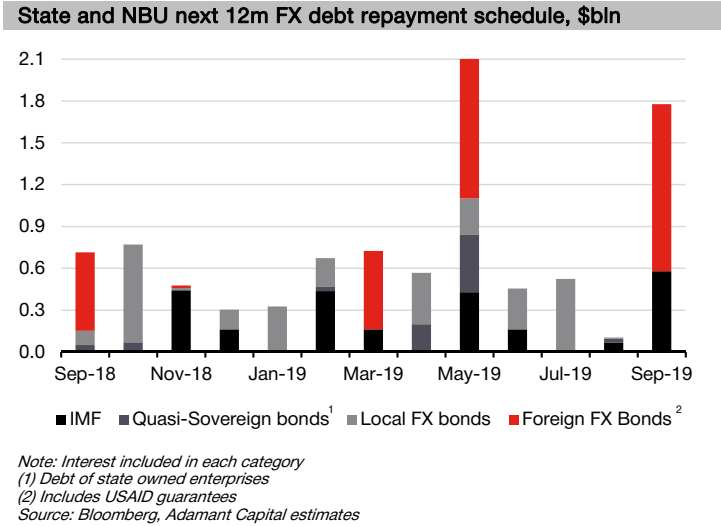
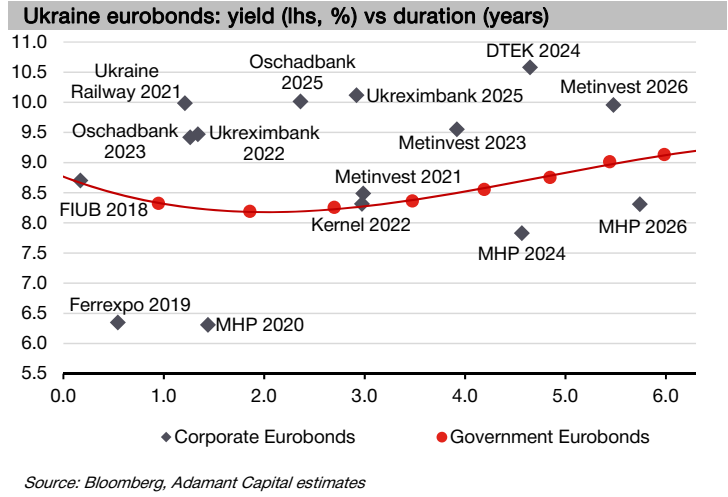
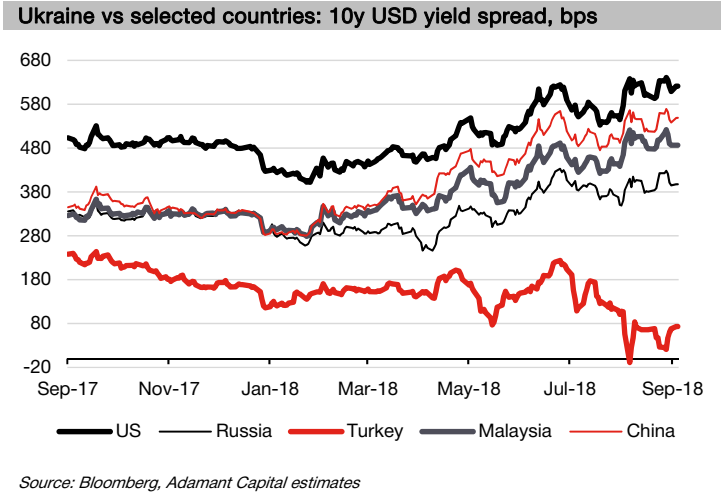


Note: Exchange rate figures are from official interbank data
Source: NBU

Local market yield curve: yield (lhs, %) and maturity (rhs, days)



Source: NBU, Bloomberg, Adamant Capital estimates



Key macroeconomic indicators								
	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18E	2018E
Real GDP growth, YoY	2.8%	2.6%	2.4%	2.2%	2.5%	3.1%	3.6%	3.3%
Nominal GDP, UAHbln	591	665	833	894	2,983	700	775	3,449
Nominal GDP, \$bln	22	26	32	33	112	26	30	125
GDP deflator growth YoY, %	26.2%	20.9%	21.1%	20.9%	22.0%	14.9%	12.5%	11.9%
Period average CPI YoY, %	14.0%	13.8%	16.1%	14.0%	14.5%	13.8%	11.6%	11.5%
End of period CPI YoY, %	15.1%	15.6%	16.4%	13.7%	13.7%	13.2%	9.9%	9.5%
Consolidated budget deficit, % of GDP ¹	-0.7%	-7.2%	1.3%	9.4%	1.4%	0.4%	-1.7%	2.5%
Broad public sector deficit, % of GDP ²	3.8%	-7.2%	4.0%	12.7%	4.1%	0.4%	-1.2%	2.6%
Public debt as % of LTM GDP, UAH	77.4%	73.9%	72.7%	71.8%	71.8%	66.4%	62.4%	64.8%
Public external debt as % of LTM GDP, \$ ³	46.9%	47.4%	46.5%	43.7%	43.7%	41.7%	39.1%	40.0%
Total external debt, \$bln	114	115	117	117	117	116	116	117
Export of goods and services, \$bln	12.6	12.9	13.6	14.9	60.8	13.8	14.6	54.8
Import of goods and services, \$bln	13.7	14.2	15.9	17.0	54.0	15.7	16.6	65.1
Trade balance, \$bln	-1.1	-1.3	-2.3	-2.1	6.8	-1.9	-2.0	-10.3
Current account, \$bln	-0.8	-0.3	-1.7	-1.0	-3.8	-0.7	0.0	-3.5
Financial account, \$bln ⁴	-0.2	-1.9	-2.5	-1.7	-6.4	-0.4	-0.5	-4.5
End of period NBU reserves, \$bln	15.1	18.0	18.6	18.8	18.8	18.2	18.0	19.4
Average interbank exchange rate, UAH/\$ ⁵	27.1	26.0	25.9	26.9	26.6	27.3	26.2	27.5
EOP interbank exchange rate, UAH/\$	27.0	26.0	26.6	28.1	28.1	26.3	26.3	28.0
EOP key policy rate NBU, %	14.0%	12.5%	12.5%	14.5%	14.5%	17.0%	17.0%	19.0%

(1) Includes net loans given out to state enterprises from the central budget

(2) Includes quasi-fiscal expenditures such as the recapitalization of Naftogaz, state banks, and the DGF. Also accounts for state guarantees.

(3) GDP calculated in \$ according to the average UAH/\$ exchange rate for the year

(4) As per the 6th edition of the IMF's Balance of payments and international investment position manual

(5) Based on official NBU data of average daily interbank rates. Not weighted by volume traded

Source: NBU, SSSU, State treasury, Ministry of Finance, IMF, Adamant Capital estimates

Indicative Eurobond prices, yields, and recommendations									
Bond name	Recommendation	Rec date	Coupon	Maturity	Bid Yield	Bid Price	1 week Δ	Dur, yrs	Out, \$mln
Ukraine 2019	Not rated	-	0.0	Feb-19	8.3	99.5	0.1	0.9	725
Ukraine 2019	Hold	1-Dec-16	7.8	Sep-19	8.3	99.5	0.1	0.9	661
Ukraine 2023	Hold	1-Dec-16	7.8	Sep-23	8.6	96.8	0.4	4.2	1,355
Ukraine 2027	Hold	1-Dec-16	7.8	Sep-27	9.2	91.2	0.8	6.5	1,307
Ukraine 2032	Hold	1-Dec-16	7.4	Sep-32	9.3	84.9	1.1	7.9	3,000
MHP 2024	Hold	24-Jul-18	7.8	May-24	7.8	99.6	-0.4	4.6	500
MHP 2026	Hold	24-Jul-18	7.0	Apr-26	8.3	92.5	-0.2	5.7	550
DTEK 2024	Buy	4-Sep-18	10.8	Dec-24	10.6	100.8	-1.4	4.6	1,344
Ferrexpo 2019	Buy	7-Aug-18	10.4	Apr-19	6.3	102.2	0.2	0.5	346
Metinvest 2023	Hold	4-Sep-18	7.8	Apr-23	9.6	93.4	-1.3	3.9	945
Metinvest 2026	Hold	4-Sep-18	8.5	Apr-26	10.0	92.4	-0.7	5.5	648
Ukrlandfarming 2018	Sell	13-Jun-17	10.9	Mar-18	nm	20.4	-0.6	2.4	543
Avangard 2018	Sell	5-Jun-18	10.0	Oct-18	nm	20.4	0.2	0.1	214
FUIB 2018	Buy	7-Aug-18	11.0	Dec-18	8.7	100.7	-1.0	0.2	59
Privatbank in default (10.250)	Not rated	7-Aug-18	10.3	Jan-18	nm	23.0	-0.3	2.7	160
Privatbank in default (10.875)	Not rated	7-Aug-18	10.9	Feb-18	nm	23.3	-1.7	2.6	175
Oschadbank 2023	Buy	7-Aug-18	9.4	Mar-23	9.4	99.8	-0.3	1.3	700
Oschadbank 2025	Buy	7-Aug-18	9.6	Mar-25	10.0	98.2	-0.8	2.4	500
Ukreximbank 2021 (UAH)	Buy	7-Aug-18	16.5	Mar-21	24.2	86.3	-0.6	2.1	150
Ukreximbank 2022	Buy	7-Aug-18	9.6	Apr-22	9.5	100.5	-0.2	1.3	750
Ukreximbank 2025	Buy	7-Aug-18	9.8	Jan-25	10.1	98.3	-0.6	2.9	600
Ukrainian Railway 2021	Buy	17-Apr-18	9.9	Sep-21	10.0	99.7	-0.3	1.2	500
Mriya 2018	Hold	19-Jun-18	9.5	Apr-18	nm	7.6	0.0	1.3	400
Kernel 2022	Buy	17-Jul-18	8.8	Jan-22	8.3	101.2	-0.3	3.0	500

Source: Bloomberg, Adamant Capital estimates

Fixed Income 2 week event calendar		
Event	Type	Date
SSSU - Agricultural production monthly data	Exact	17-Sep
SSSU - Q2 2018 GDP	Exact	18-Sep
SSSU - Wholesale and retail turnover monthly data	Exact	20-Sep
SSSU - Transportation monthly data	Exact	20-Sep
SSSU - Industrial production monthly data	Exact	21-Sep

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