

Weekly Digest

- The 8m18 consolidated budget demonstrated a surplus equivalent to 1.0% of nominal GDP
- The government has extended its household gas price freeze until October 18
- Ukraine's CA deficit increased by \$460m YoY to \$600m in August

The 8m18 consolidated budget demonstrated a surplus equivalent to 1.0% of nominal GDP (UAH27bln). Revenue growth in August landed at 17% YoY, bringing the cumulative figure to 15%. Expenditures increased by 7% for the month and 23% for 8m18. Surplus of the central budget soared to UAH25bln vs a UAH3bln deficit in July.

Our view: On the consolidated level, August performance stood substantially stronger than in July primarily on the back of larger revenues, which benefitted from a seasonal inflow of the CIT and a UAH7bln injection from the NBU. Among more subtle trends we identified a slight pick up in VAT collections (a 7% increase MoM, which is just above the 4% depreciation of the hryvnia) and a two-year low in subsidy spending (possibly a result of an earlier review of eligibility criteria). All in all, however, we continue to stick to our previous view that in order to reach the IMF's 2.5% of GDP deficit target, expenditure growth versus last year will need to decelerate significantly (to c. 16% YoY from 23% YoY currently). This is especially true considering that the current plan (if the central and local budgets are pooled together and payment for 4G licenses is reallocated to financing) already exceeds the permitted amount by c. UAH25bln (mostly due to unrealistic imbalances of regional accounts). Spending on social protection (transfers to the Pension fund and subsidies for gas tariffs are key items) remains a key problem area and, though some savings can be generated via lower than expected debt servicing, other items such as economic activity, communal services, and education will need to see a noticeable reduction (will most likely be applied in December). Unless negotiations with the IMF fall through (which we currently see as very unlikely), authorities will continue to exercise the agree-upon fiscal discipline, in our view.

8m18 state budget performance, UAHbln					
	August	YoY 8M18	YoY AP	YoY	YoY
Revenues	117	17%	769	15%	13%
VAT	33	25%	237	21%	22%
Net local VAT	6	23%	55	34%	33%
Import VAT	26	25%	182	17%	20%
CIT ¹	20	31%	79	52%	22%
Excise tax	11	17%	76	7%	17%
PIT ²	19	24%	145	25%	20%
Royalties	6	-32%	30	-18%	-2%
Import duties	2	22%	16	10%	17%
Local taxes	6	12%	40	15%	6%
Non-tax revenues	17	10%	134	29%	4%
NBU transfers	7	nm	45	49%	14%
Other	3	36%	11	-73%	-46%
Expenditures	90	7%	734	23%	19%
Debt servicing	7	-21%	67	0%	18%
General government	6	30%	46	48%	35%
Defence	7	24%	51	33%	19%
Civil order and courts	9	29%	67	36%	26%
Economic activity	14	46%	65	44%	54%
Communal services	3	42%	15	31%	4%
Healthcare	9	-2%	66	17%	11%
Education	11	26%	128	21%	17%
Social protection	21	-19%	209	19%	7%
Pension fund rev	16	25%	129	30%	34%
Pension fund costs	30	31%	235	38%	19%
Other	3	18%	19	11%	23%
Net loans	0.03	nm	0.76	238%	239%
Deficit³	-27	nm	-34	nm	170%
as % of GDP	nm	nm	-1.0%	2.8pp	1.8pp
Central budget revenues	93	18%	603	15%	16%
Central budget expenses	51	14%	390	25%	20%
Net transfers	17	-26%	200	17%	13%
Local budget revenues	17	-25%	167	16%	5%
Local budget expenses	1	25%	344	21%	18%
Nominal GDP used	na	nm	3,543	96%	19%

Note: AP stands for this year's annual plan

(1) Corporate income tax

(2) Personal income tax

(3) Revenues less expenditures and net loans of the consolidated budget. Equivalent to the IMF's "general government overall balance" term

Source: SSSU, State Treasury, Adamant Capital estimates

The government has extended its household gas price freeze until October 18. An appropriate resolution has been passed by the Cabinet of Ministers on September 22.

Our view: The prolongation is mostly technical in nature, given that the authorities would have otherwise had to implement a hike on October 1 without having reached a definitive agreement with the IMF. Of note is that the extension this time stands at 18 days instead of a full month (which has been the case for 6 times in a row since April 1), suggesting that a final decision on tariffs may be made within the next two weeks (the deadline may be tied to the official start of the heating season).

Ukraine's CA deficit increased by \$460m YoY to \$600m in August. The LTM figure landed at \$3.7bn vs \$1.7bn a year ago. Monthly trade balance (of goods and services) deteriorated by \$360m YoY to -\$1.2bn. Net inflows of the FA remained flat YoY at \$0.6bn, leading to a practically balanced BoP result.

Our view: This month's CA figure landed broadly in line with expectations, recovering after a record-high deficit in July caused by the calendar effect and a drop in the export of metals. The revival occurred mostly on the back of a seasonal increase in shipments of agricultural goods. Steel sales remained subdued both in MoM and YoY terms, possibility being, once again, affected by a trade conflict with Russia in the Sea of Azov. Other notable trends include a deceleration in energy imports (potentially tied to efforts by domestic TPPs to decrease anthracite consumption and a one-off decline in oil products) and a rebound in purchases of machinery (most notably cars and fuel rods for nuclear power plants). Remittances remained flat both in MoM and YoY terms, suggesting that the previously expected leveling out effect is occurring. All in all, we reiterate our end-of-year CA deficit forecast at \$3.5bn (2.7% of nominal GDP). The FA was able to finance the CA gap this month mostly via NBU interventions of c. \$650m, which were refilled by the \$725m eurobond placement. The private sector received roughly \$600m of funding from abroad (trade credit, loan, and FDI split at 50/30/20), but the majority of these resources remained in deposit accounts held at domestic and foreign banks. Hoarding likely occurred due to a temporary spike in devaluation fears. Below the line IMF repayments this month constituted \$520m, reducing NBU reserves by the same amount.

BoP summary for August, \$m					
	Aug-18	Jul-18	Jun-18	LTM	LTM-1
Exports:	5,123	4,673	4,742	57,720	51,599
MoM	10%	-1%	-5%		
YoY	9%	12%	10%	12%	14%
Imports:	6,329	6,403	5,571	68,178	59,140
MoM	-1%	15%	-3%		
YoY	14%	22%	11%	15%	18%
TB:	-1,206	-1,730	-829	-10,458	-7,541
MoM	524	-901	-27		
YoY	-360	-659	-110	-2,917	-2,612
CA:	-601	-1,135	-89	-3,700	-1,718
MoM	534	-1,046	-74		
YoY	-459	-749	-95	-1,982	-1,718
FA:	-625	-935	-112	-5,131	-3,784
MoM	310	-823	169		
YoY	34	-841	187	-1,347	-2,136
BoP:	27	-170	23	1,448	2,095
MoM	197	-193	-243		
YoY	-491	115	-283	-647	364
Funding flow ¹ :	588	1,289	298	3,906	2,435

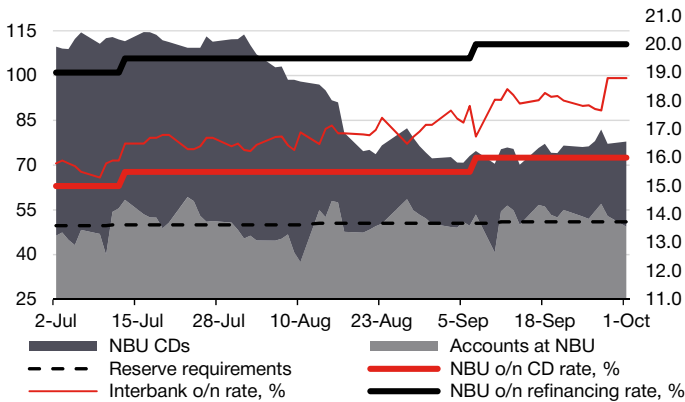
Note: LTM and LTM -1 stand for last twelve months and last twelve months a year ago, respectively

(1) Private sector financing: an estimated amount of capital flowing into the private sector (including banks) via lending and investment

Source: NBU, Adamant Capital estimates

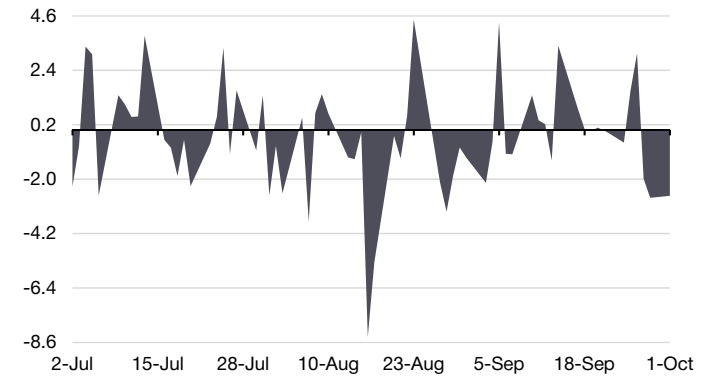
Appendix

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

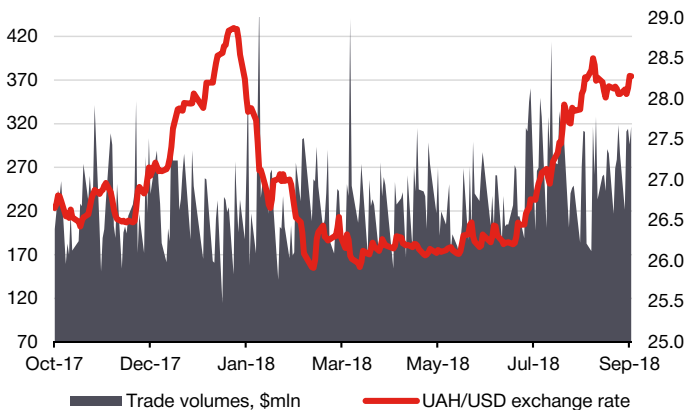


Note: in UAHbln
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 1.8bln to UAH 77.9bln over the last week. On October 2 the Ministry of Finance conducted local hryvnia denominated placement maturing in December 2018, April 2019, September 2019 and September 2020 with yields of 19.0%, 18.5%, 18.5% and 17.25%, respectively, and USD denominated placement maturing in June 2019 with yield of 7.0%. A total of UAH 881mln and \$67mln was raised as a result.

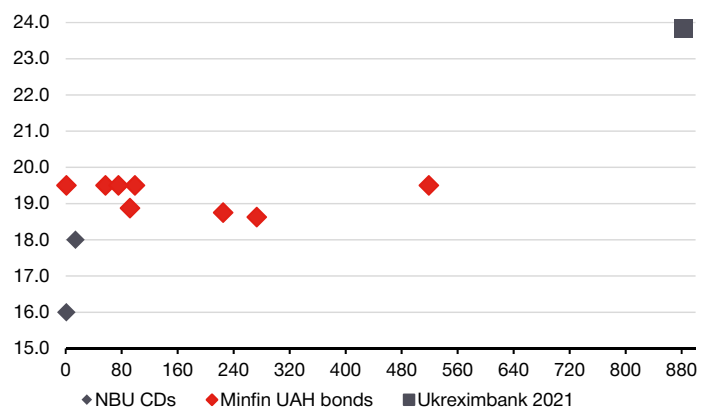
The **UAH/USD interbank rate** depreciated by 0.8% over the week starting out with 28.06 and ending at 28.27.

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

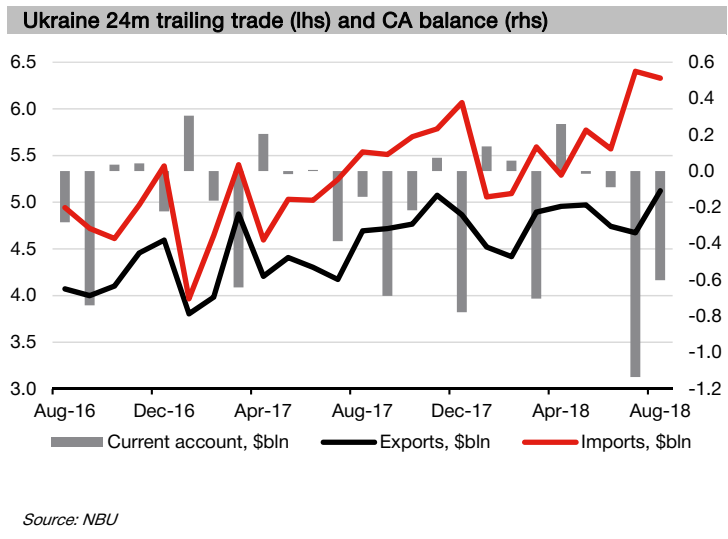
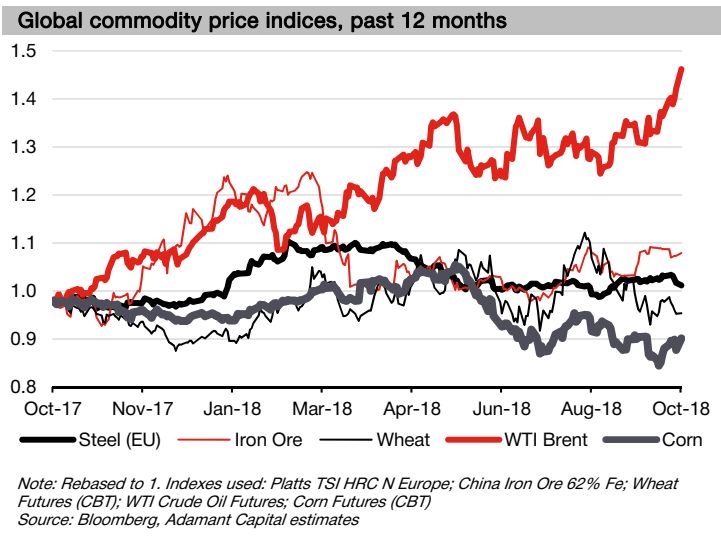
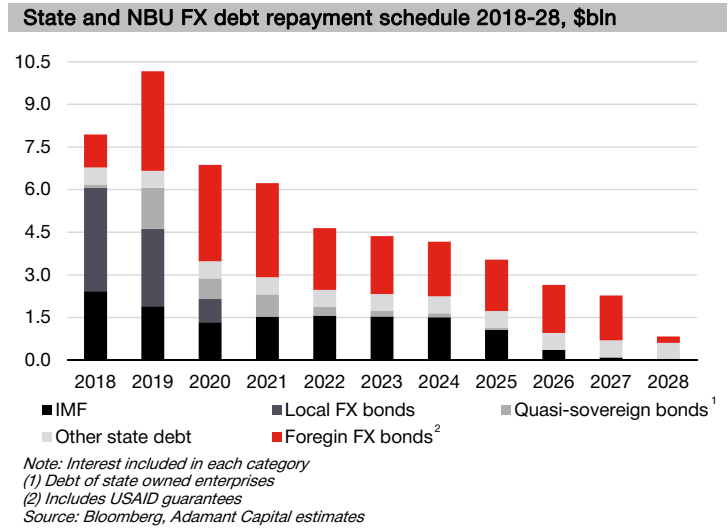
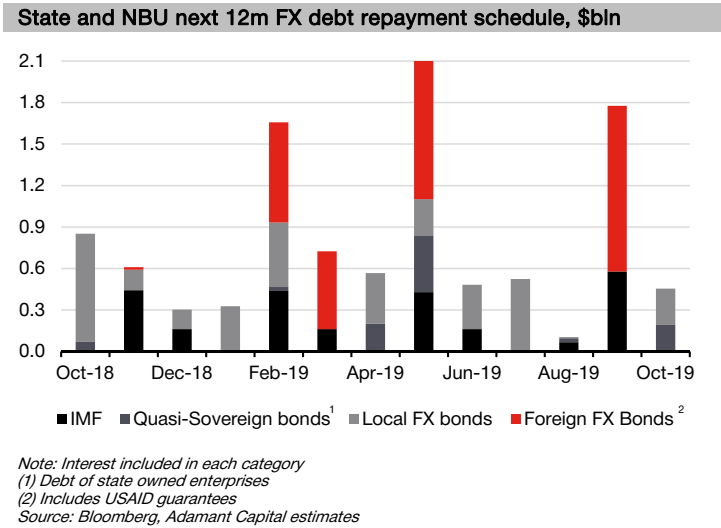
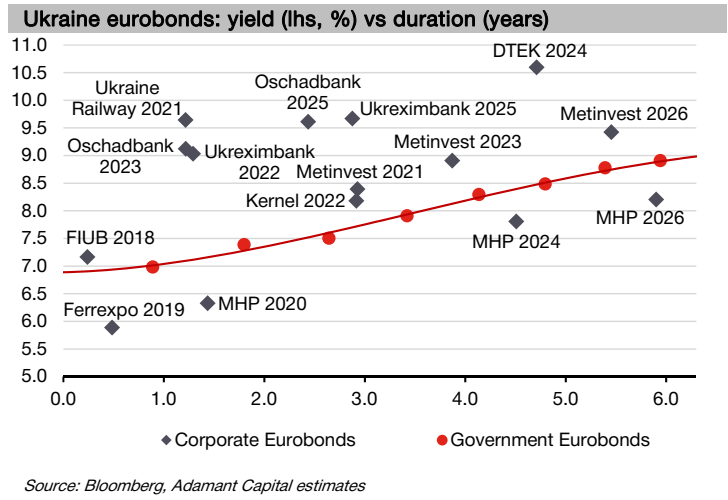
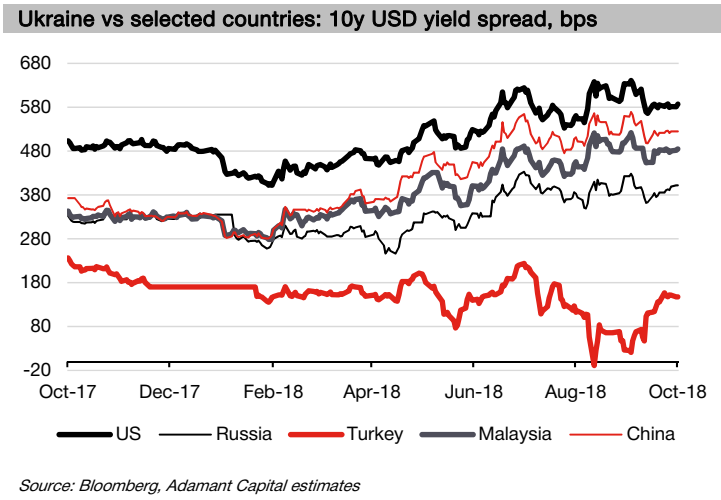


Note: Exchange rate figures are from official interbank data
Source: NBU

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%	3.8%	3.4%
Nominal GDP, UAHbln	591	665	833	894	2,983	700	807	3,543
Nominal GDP, \$bln	22	26	32	33	112	26	31	129
GDP deflator growth YoY, %	26.2%	20.9%	21.1%	20.9%	22.0%	14.9%	17.0%	14.9%
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%	-1.6%	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%	61.8%	63.1%
Public external debt as % of LTM GDP, \$ ³	46.9%	47.4%	46.5%	43.7%	43.7%	41.7%	38.7%	38.9%
Total external debt, \$bln	114	115	116	115	115	115	114	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	29.0
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 (bullet)	Not rated	-	0.0	Feb-19	9.8	96.2	0.2	0.4	725
Ukraine 2019	Hold	1-Dec-16	7.8	Sep-19	7.0	100.7	0.4	0.9	661
Ukraine 2023	Hold	1-Dec-16	7.8	Sep-23	8.3	97.8	0.5	4.1	1,355
Ukraine 2027	Hold	1-Dec-16	7.8	Sep-27	9.0	92.6	0.2	6.4	1,307
Ukraine 2032	Hold	1-Dec-16	7.4	Sep-32	9.1	86.3	0.2	8.3	3,000
MHP 2024	Hold	24-Jul-18	7.8	May-24	7.8	99.7	-0.2	4.5	500
MHP 2026	Hold	24-Jul-18	7.0	Apr-26	8.2	93.1	0.0	5.9	550
DTEK 2024	Buy	25-Sep-18	10.8	Dec-24	10.6	100.8	-0.5	4.7	1,344
Ferrexpo 2019	Buy	7-Aug-18	10.4	Apr-19	5.9	102.2	0.1	0.5	346
Metinvest 2023	Hold	4-Sep-18	7.8	Apr-23	8.9	95.7	1.0	3.9	945
Metinvest 2026	Hold	4-Sep-18	8.5	Apr-26	9.4	95.1	1.3	5.5	648
Ukrlandfarming 2018	Sell	13-Jun-17	10.9	Mar-18	nm	20.6	-0.4	2.4	543
Avangard 2018	Sell	5-Jun-18	10.0	Oct-18	nm	20.1	0.0	0.1	214
FUIB 2018	Buy	7-Aug-18	11.0	Dec-18	7.2	100.9	-0.7	0.2	59
Privatbank in default (10.250)	Not rated	7-Aug-18	10.3	Jan-18	nm	22.5	0.0	2.7	160
Privatbank in default (10.875)	Not rated	7-Aug-18	10.9	Feb-18	nm	22.4	-0.7	2.6	175
Oschadbank 2023	Buy	7-Aug-18	9.4	Mar-23	9.1	100.9	0.2	1.2	700
Oschadbank 2025	Buy	7-Aug-18	9.6	Mar-25	9.6	100.1	0.2	2.4	500
Ukreximbank 2021 (UAH)	Buy	7-Aug-18	16.5	Mar-21	24.8	85.5	0.0	2.0	150
Ukreximbank 2022	Buy	7-Aug-18	9.6	Apr-22	9.0	101.8	0.0	1.3	750
Ukreximbank 2025	Buy	7-Aug-18	9.8	Jan-25	9.7	100.4	0.1	2.9	600
Ukrainian Railway 2021	Buy	17-Apr-18	9.9	Sep-21	9.6	100.6	0.2	1.2	500
Mriya 2018	Hold	19-Jun-18	9.5	Apr-18	nm	7.7	0.1	1.3	400
Kernel 2022	Buy	17-Jul-18	8.8	Jan-22	8.2	101.6	0.2	2.9	500

Source: Bloomberg, Adamant Capital estimates

Fixed Income 2 week event calendar		
Event	Type	Date
NBU - International reserves monthly data	Exact	7-Oct
SSSU - Monthly inflation	Exact	9-Oct
Ferrexpo - Production report for 3Q 2018	Exact	9-Oct

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