

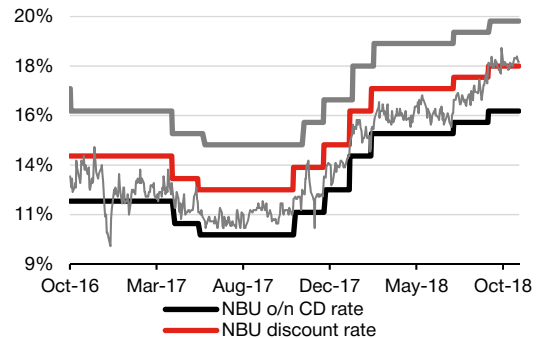
Weekly Digest

- The NBU has kept the discount rate unchanged at 18.0%
- Output of key economic sectors in September increased by 5.0% YoY
- The consolidated budget deficit in September landed at UAH20bln
- Ukraine has raised \$2bln via a eurobond placement

The NBU has kept the discount rate unchanged at 18.0%. According to the press release, the regulator deems monetary policy to be sufficiently tight for achieving its 5% inflation target by 2020. Ukraine's cooperation with the IMF on the recently agreed-upon SBA remains key for maintaining macroeconomic stability. Main inflation risks going forward include negative expectations on the back of the upcoming elections, a possible cooldown in the global economy, elevated energy prices, and further capital outflow from EM countries. The NBU has also increased its CPI growth forecast for 2018 and 2019 to 10.1% and 6.3%, respectively (from 8.9% and 5.8% previously).

Our view: We find the regulator's decision to be unsurprising, given that the country has finally reached an agreement with the IMF and the relative stability on the interbank FX market over October. With the current monetary policy in place, the spread between 24-month hryvnia and local USD interest rates stands at roughly 11% p.a., which seems sufficiently high if annual inflation is indeed to average some 6% over the period (realistic, if donor support continues, in our view).

Local interest rate dynamics

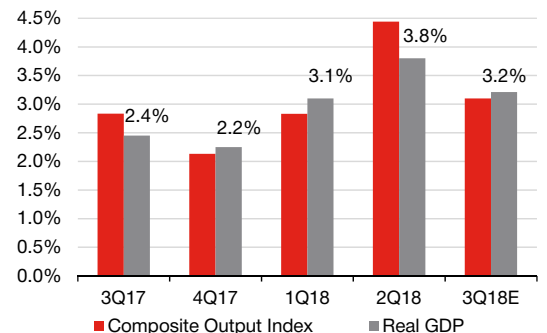


Source: NBU

Output of key economic sectors in September increased by 5.0% YoY, as measured by our COI indicator. Industrial production declined by 1.3% YoY (0.7% in seasonally adjusted terms) versus last month's 0.5% (also with SA) reduction. Agriculture grew by 11.4% YoY following a 9.0% surge in July. Passenger and cargo transportation fell by an estimated 1.1%. Retail sales growth decelerated from August by 0.6ppts but still remained high at 6.9%. Passenger and cargo transportation were up by 3.3% and down by 4.1%, respectively. Construction output slipped by 0.2% YoY, though infrastructure works increased by 11.7%.

Our view: Though still strong, the consolidated figure landed somewhat below expectations, mostly on the back of weak industrial output, smaller than anticipated crop production, and another month of declines in the transportation sector. Industry was most affected by the calendar effect, a 16% YoY drop in thermal power generation (crowded out by nuclear, where more capacities came online), and a 1.3% contraction in metal sales (possibly, once again, resulting from tensions with Russia in the Sea of Azov). Shipments of goods were reduced largely due to lower gas transfer volumes through Ukraine's pipelines. Though headline construction volumes also slipped YoY, a strong infrastructure development dynamic should lead to a bump in real value added for this sector, in our view (just like in 2Q18). All in all, our COI index was up by 2.6% YoY over 3Q18, which suggests that our previous real GDP growth forecast of 3.2% looks somewhat too optimistic. With this in mind, we reduce it to 2.9%. On a more positive note, however, we increase our guidance for 4Q18 to 4.0% from 3.5% previously, taking into consideration the latest projections for agricultural output (corn volumes are expected by WASDE to be up by 29% YoY). The net result is a 0.1ppt bump to our annual outlook, which now stands at 3.5%.

Real GDP growth vs the COI indicator growth



Note: The Composite Output Index represents the weighted average performance of industrial production, retail sales, wholesale sales, transportation, and agricultural output
 Source: SSSU, Adamant Capital estimates

The consolidated budget deficit in September landed at UAH20bln, bringing the 9M19 figure to -UAH15bln or -0.6% of nominal GDP. Revenue growth for the month amounted to 19% YoY, largely on the back of higher VAT, PIT, and excise tax contributions. Expenditures increased by just 6%, exhibiting a sharp slowdown comparable to that of August.

Our view: The figures came in lower than expected both with regard to revenues and outlays. On the income side the state delayed the remaining UAH7bln worth of transfers from the NBU, had a 6% MoM decline in net VAT collections despite a 3% devaluation of the hryvnia, but did see a surge in excise tax. Expenditures were characterized by a dramatic YoY decrease in subsidies (from UAH5.6 to just UAH1.5bln – possibly as a result of previously reviewing eligibility criteria) and a general slowdown in spending over most categories. The latter, we think, roughly demonstrates how quickly outlays can be permitted to grow until the end of the year in order to reach the IMF required 2.6% of GDP deficit target, which, going by current data, looks achievable.

9m18 state budget performance, UAHbln					
	September	YoY 9M18	YoY	AP	YoY
Revenues	88	19%	857	16%	14%
VAT	31	15%	268	20%	22%
Net local VAT	5	-22%	60	27%	33%
Import VAT	27	26%	209	18%	20%
CIT ¹	2	116%	82	54%	22%
Excise tax	13	30%	89	10%	17%
PIT ²	19	20%	164	24%	21%
Royalties	4	-9%	34	-17%	-1%
Import duties	2	14%	19	10%	17%
Local taxes	4	5%	44	14%	7%
Non-tax revenues	11	24%	145	28%	4%
NBU transfers	0	nm	45	49%	14%
Other	1	7%	12	-71%	-46%
Expenditures	107	6%	842	20%	20%
Debt servicing	19	-8%	87	-2%	18%
General government	5	3%	51	41%	35%
Defence	7	6%	58	29%	19%
Civil order and courts	10	24%	77	35%	26%
Economic activity	13	29%	78	41%	57%
Communal services	3	41%	18	32%	10%
Healthcare	10	4%	76	15%	11%
Education	17	13%	145	20%	18%
Social protection	21	-6%	229	16%	7%
Pension fund rev	17	20%	145	29%	34%
Pension fund costs	30	31%	265	37%	19%
Other	3	30%	22	13%	23%
Net loans	0	nm	1	nm	240%
Deficit³	20	-27%	-15	nm	178%
as % of GDP	nm	nm	-0.6%	1.4pp	1.9pp
Central budget revenues	67	16%	669	15%	16%
Central budget expenses	65	9%	455	22%	20%
Net transfers	20	-7%	220	14%	13%
Local budget revenues	21	-7%	188	17%	18%
Local budget expenses	1	13%	386	18%	19%
Nominal GDP used	na	nm	2480	19%	18%

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

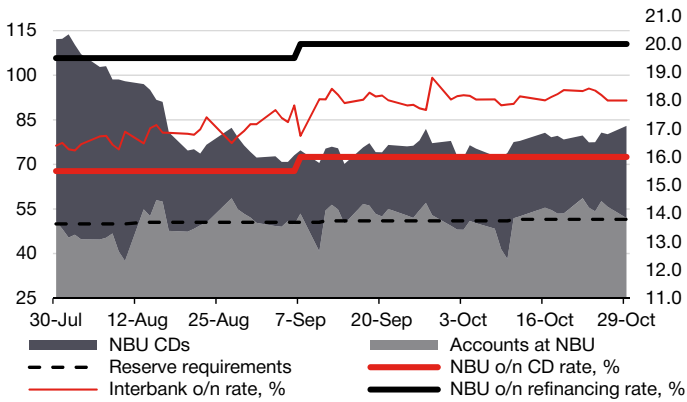
Source: SSSU, State Treasury, Adamant Capital estimates

Ukraine has raised \$2bln via a eurobond placement. According to a press release by the Ministry of Finance, a 5-year \$0.75bln and a 10-year \$1.25bln issue were sold with yields of 8.994% and 9.750%, respectively. The funds will be directed towards central budget expenditures and amortizing the \$725mln bullet note due in February.

Our view: Both the raised amount and the pricing are broadly in line with our expectations (though we did guide for \$1.5bln as the more likely figure). As noted previously, roughly \$6bln of external debt, including coupons, is due by the state and the NBU until the end of 2019, which means that the secured funding should be more than sufficient to deal with these liabilities without dipping into reserves, if donor financing is fully unlocked (\$3.9bln from the IMF, \$0.8bln from the world bank and EUR1.0bln from the EU). That said, since the government's operations will be disrupted over March-October on the back of elections (first Presidential and then Parliamentary), we do not rule out a second round of placements in 1Q19.

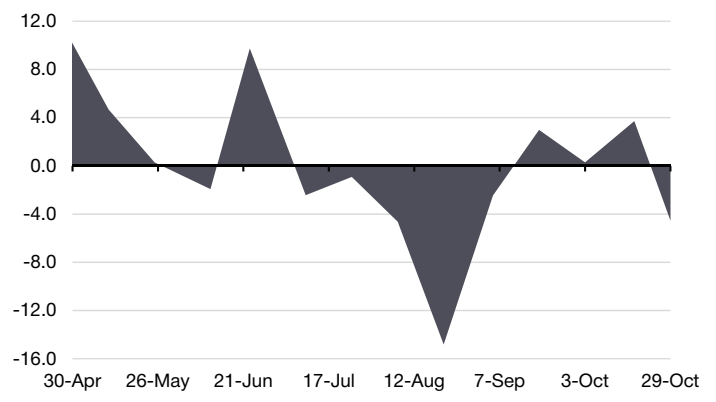
Appendix

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



Source: NBU, Adamant Capital estimates

Banking system 6m inflows from the state treasury and the DGF

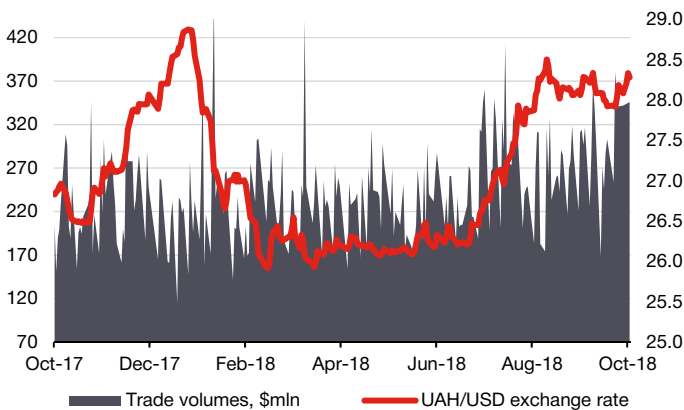


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 3.2bln to UAH 82.9bln over the last week. On October 30 the Ministry of Finance conducted local hryvnia denominated placement maturing in February 2019 with yield of 19.0% and USD denominated placement maturing in June 2019 yield of 7.0%. Moreover, euro denominated notes maturing in November 2019 with yield of 4.6% were also sold. A total of UAH 14.8mln, \$37.0mln and EUR 3.1mln was raised as a result.

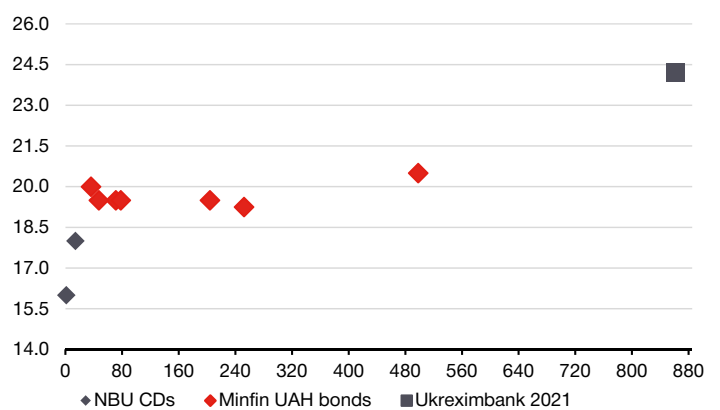
The UAH/USD interbank rate depreciated by 0.1% over the week starting out with 28.15 and ending at 28.18.

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

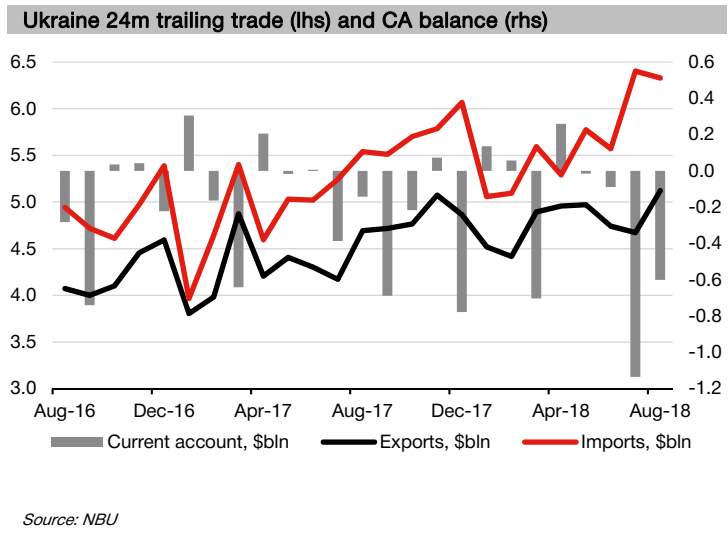
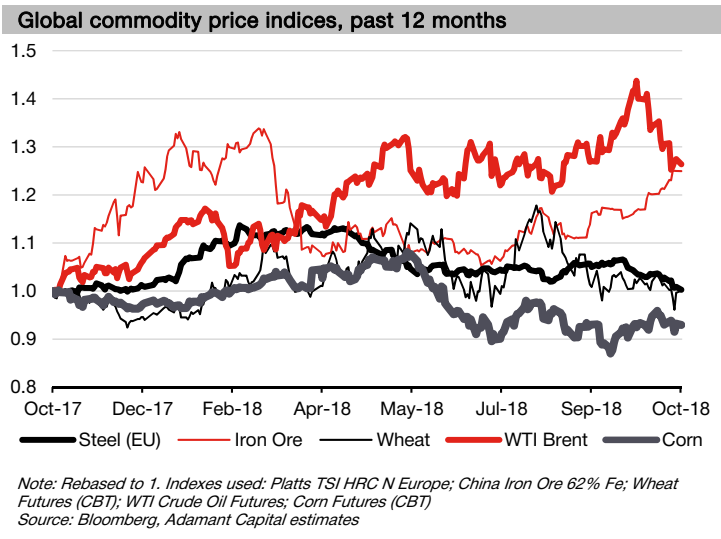
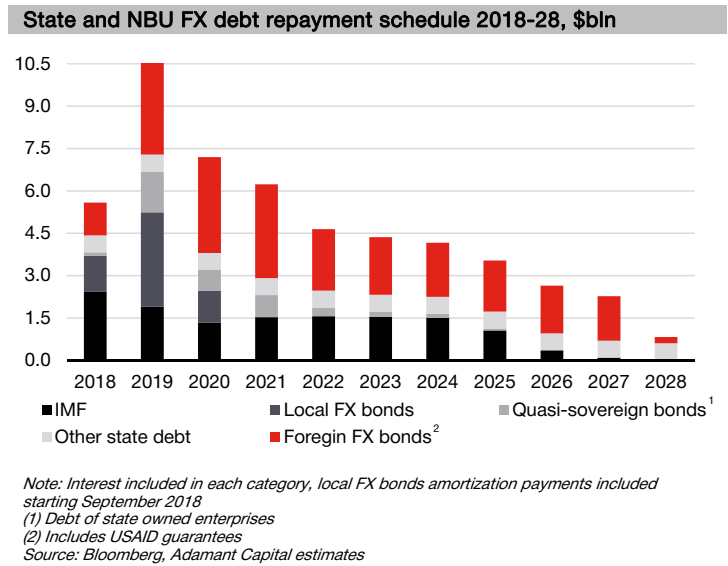
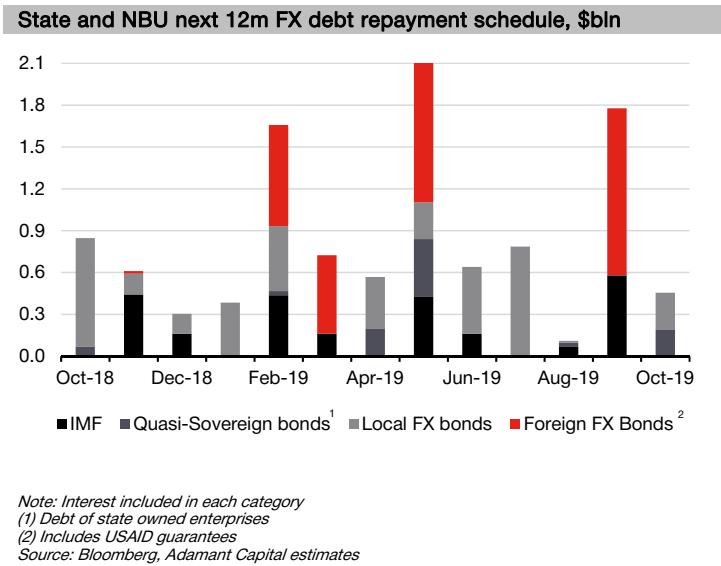
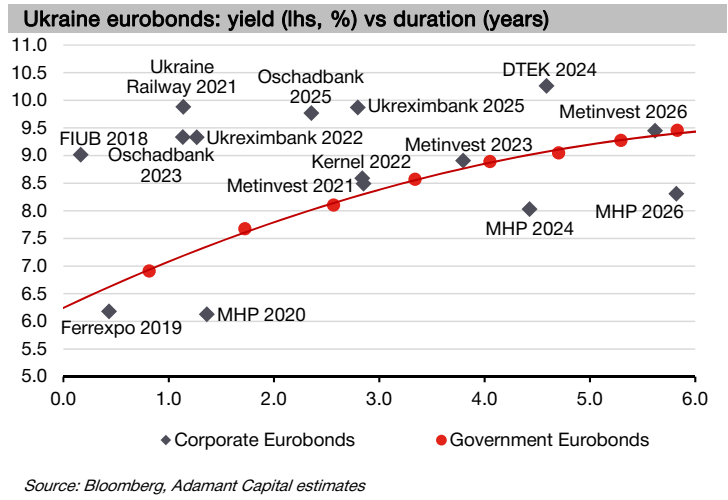
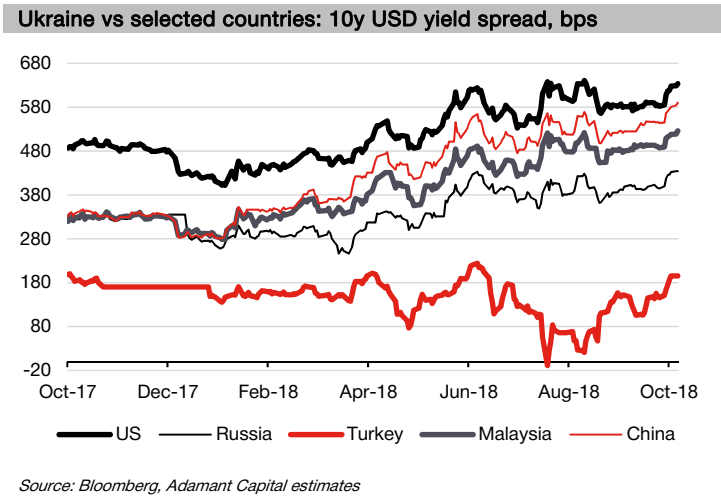


Note: Exchange rate figures are from official interbank data
Source: NBU

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



Note: as of 23.10.18
Source: NBU, Bloomberg, Adamant Capital estimates



Key macroeconomic indicators								
	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18	2018E
Real GDP growth, YoY	2.8%	2.6%	2.4%	2.2%	2.5%	3.1%	3.8%	3.5%
Nominal GDP, UAHbln	591	665	833	894	2,983	700	807	3,536
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%	14.6%
Period average CPI YoY, %	14.0%	13.8%	16.1%	14.0%	14.5%	13.8%	11.6%	11.0%
End of period CPI YoY, %	15.1%	15.6%	16.4%	13.7%	13.7%	13.2%	9.9%	10.0%
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%	63.3%
Public external debt as % of LTM GDP, \$ ³	46.9%	47.4%	46.5%	43.7%	43.7%	41.7%	38.7%	39.0%
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	-3.5
End of period NBU reserves, \$bln	15.1	18.0	18.6	18.8	18.8	18.2	18.0	17.4
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	11.3	96.5	0.1	0.3	725
Ukraine 2019	Hold	1-Dec-16	7.8	Sep-19	6.9	100.7	0.0	0.8	661
Ukraine 2023	Hold	1-Dec-16	7.8	Sep-23	8.9	95.6	-0.8	4.1	1,355
Ukraine 2027	Hold	1-Dec-16	7.8	Sep-27	9.5	89.8	-1.0	6.3	1,307
Ukraine 2032	Hold	1-Dec-16	7.4	Sep-32	9.5	83.5	-0.5	8.1	3,000
MHP 2024	Hold	23-Oct-18	7.8	May-24	8.0	98.8	-0.5	4.4	500
MHP 2026	Hold	23-Oct-18	7.0	Apr-26	8.3	92.6	-0.4	5.8	550
DTEK 2024	Buy	25-Sep-18	10.8	Dec-24	10.3	102.2	-0.8	4.6	1,344
Ferrexpo 2019	Hold	9-Oct-18	10.4	Apr-19	6.2	101.8	-0.1	0.4	346
Metinvest 2023	Hold	9-Oct-18	7.8	Apr-23	8.9	95.8	-0.1	3.8	945
Metinvest 2026	Hold	9-Oct-18	8.5	Apr-26	9.4	95.0	-0.2	5.6	648
Ukrlandfarming in default	Sell	13-Jun-17	10.9	Mar-18	nm	20.6	-0.1	nm	543
Avangard in default	Sell	5-Jun-18	10.0	Oct-18	nm	20.5	0.0	nm	214
FUIB 2018	Buy	7-Aug-18	11.0	Dec-18	9.0	100.3	0.0	0.2	59
Privatbank in default (10.250)	Not rated	7-Aug-18	10.3	Jan-18	nm	22.0	-0.2	nm	160
Privatbank in default (10.875)	Not rated	7-Aug-18	10.9	Feb-18	nm	22.5	0.6	nm	175
Oschadbank 2023	Buy	7-Aug-18	9.4	Mar-23	9.3	100.1	-0.4	1.1	700
Oschadbank 2025	Buy	7-Aug-18	9.6	Mar-25	9.8	99.3	-0.4	2.4	500
Ukreximbank 2021 (UAH)	Buy	7-Aug-18	16.5	Mar-21	25.7	84.4	-0.3	1.9	150
Ukreximbank 2022	Buy	7-Aug-18	9.6	Apr-22	9.3	100.9	-0.5	1.3	750
Ukreximbank 2025	Buy	7-Aug-18	9.8	Jan-25	9.9	99.4	-0.6	2.8	600
Ukrainian Railway 2021	Buy	9-Oct-18	9.9	Sep-21	9.9	100.0	-0.3	1.1	500
Kernel 2022	Buy	23-Oct-18	8.8	Jan-22	8.6	100.4	-0.7	2.8	500

Source: Bloomberg, Adamant Capital estimates

Fixed Income 2 week event calendar		
Event	Type	Date
NBU - Balance of payments monthly data	Exact	31-Oct
Privatbank - Financial results for Q3 2018 IFRS	Indicative	31-Oct
FUIB - Financial results for Q3 2018 IFRS	Indicative	31-Oct
Metinvest - Monthly report for August	Indicative	2-Nov
Metinvest - Operational results for Q3 and 9m18	Indicative	2-Nov
NBU - International reserves monthly data	Exact	7-Nov
SSSU - Monthly inflation	Exact	9-Nov

Contacts

Adamant Capital

5-B Volodymyrska Street, 2nd floor
01001 Kyiv, Ukraine
+380 44 585 52 36

Portfolio Management

Yuriy Sozinov | urs@adamant-capital.com

Research

Konstantin Fastovets | fks@adamant-capital.com

Liudmila Dunaieva | ldu@adamant-capital.com

PR

Inna Zvyagintseva | zin@adamant-capital.com

Disclaimer

This report has been prepared solely for information purposes and is not intended to be an offer, or a solicitation of an offer, to buy or sell any securities. Descriptions of any company or companies or/and their securities, or markets, or developments mentioned herein are not represented to be complete. There is no responsibility on our part to revise or update any information or correct any inaccuracies contained in this report on an on-going basis. Although the information in this material has been obtained from sources that Adamant Capital believes to be reliable, we do not guarantee its completeness or accuracy. In making their investment decisions investors are expected to rely on their own analysis of all risks associated with investing in securities. Adamant Capital, its top executives, representatives and employees accept no liability whatsoever for any direct or consequential loss arising from the use of the material or its contents. Adamant Capital, third parties related to it, its directors and/or employees, and/or any persons connected with them, may have interests in the companies or provide services to one or more companies discussed herein and/or intend to acquire such interests and/or to provide any such services in the future. All estimates and opinions expressed in this report reflect the judgment of each research analyst, who is fully or partially responsible for the contents of the document, and may differ from the opinions of Adamant Capital. This document, or any part hereof, may not be reproduced or copies circulated without the prior express consent of Adamant Capital.