

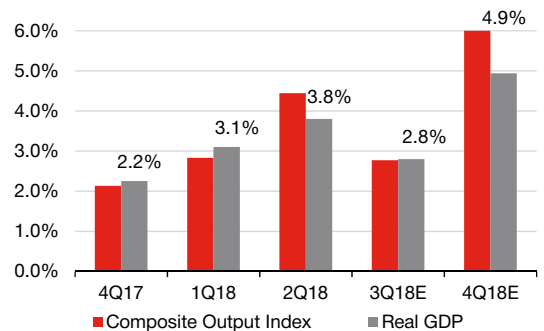
Weekly Digest

- Output of key economic sectors in October increased by 11.8% YoY
- Oschadbank has won a \$1.3bn lawsuit against Russia over losses in Crimea
- The consolidated budget broke even in October
- The Parliament has approved the 2019 state budget
- Ukraine has imposed a 30-day martial law for regions bordering Russia and the coast

Output of key economic sectors in October increased by 11.8% YoY, as measured by our COI indicator. Agriculture stood as the primary driver, having bumped production by 28.5% relative to last year (mostly on the back a record corn harvest, which was up by over 50% for the month). Industrial output grew by 1.4% YoY (0.3% in seasonally adjusted terms) versus last month's 1.3% reduction (0.7% with SA). Passenger and cargo transportation increased by an estimated 3.2%, mostly owing to excellent performance of passenger aviation. Retail sales volume dynamic slowed from September by 1.9ppts but still remained high at 5.0%, in line with our estimates for wholesale. Construction output was up by 5.8% YoY, with infrastructure works surging by 9.6%.

Our view: The consolidated figure landed significantly above our projections predominantly on the back of growth in the agricultural sector coming in earlier than expected (we anticipated higher corn volumes to appear mostly in December). Taking into account that the shift was largely caused by a two-week head start of the harvesting campaign versus last year, we feel that the data mostly demonstrates a difference in distribution vs our forecasts (though not entirely). With regard to other indicators, we note that industrial output is likely to remain broadly flat over the next two months, as the current rise vs September was predominantly due to the calendar effect. Trade should remain strong, given that volumes still stand some 10-15% below 2013 (pre-crisis) levels and wages continue rising. Transportation may post slightly positive figures going forward resulting from expanding demand for passenger flights (up by 51% in October). Finally, construction, which has so far benefitted from a pickup in infrastructure works versus 2017, should be able to continue its positive trend, in our view, given that the state budget has, as of September, only disbursed 53% of the total amount allocated for road maintenance. All in all, we feel that the data warrants a slight upward revision in our projections and thus increase our 4Q18 real GDP guidance by 90bps to 4.9% (results in a 20bps bump to the FY18 figure to 3.7%).

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

Oschadbank has won a \$1.3bn lawsuit against Russia over losses in Crimea. According to an official statement, the hearing took place at an international arbitration court in Paris.

Our view: Although undoubtedly good news, Russia's justice ministry has already stated that it does not recognize the ruling, which means that enforcement of the court's decision may be difficult. Moreover, it is currently unclear whether an appeal process is possible and, if so, what kind of timelines are realistic (the litigation in question took 4 years to complete).

The consolidated budget broke even in October. The 10M19 deficit landed at -UAH14bln or -0.5% of nominal GDP. Revenue growth for the month amounted to 15% YoY, largely on the back of higher VAT, PIT, and royalty contributions. Expenditures increased by just 3%, exhibiting a 3.1ppt slowdown from September.

Our view: The figures outperformed our expectations both with regard to revenues and outlays. On the income side the state saw a 23% MoM surge in net VAT collections, stemming from a simultaneous 15% increase in import VAT and an 18% decline in refunds (a combination of hryvnia weakness and one-off events). Local taxes also came in at an all-time high of UAH7.4bln. Expenditures were characterized by low debt servicing (just UAH5.8bln vs UAH12.2bln last year) and smaller-than-anticipated transfers to the pension fund, which saw a 6.0% MoM revenue boost. All in all, we think that the data now suggest that the IMF required (2.6% of GDP) deficit target is entirely achievable, as annual income may exceed the original plan by up to 0.3% of GDP and expenses can be kept in check, especially given that debt servicing seems to have been overestimated by c. 0.5% of GDP.

10m18 state budget performance, UAHbln					
	October	YoY	10M18	YoY	AP YoY
Revenues	96	15%	953	16%	14%
VAT	38	28%	306	21%	22%
Net local VAT	7	18%	67	26%	33%
Import VAT	31	31%	240	20%	20%
CIT ¹	2	1%	83	52%	22%
Excise tax	13	0%	102	9%	17%
PIT ²	20	24%	184	24%	22%
Royalties	4	126%	39	-11%	-1%
Import duties	3	21%	22	12%	17%
Local taxes	7	16%	51	14%	8%
Non-tax revenues	9	-28%	153	23%	5%
NBU transfers	0	nm	45	27%	14%
Other	1	4%	13	-69%	-46%
Expenditures	96	3%	938	18%	20%
Debt servicing	6	-52%	93	-8%	18%
General government	6	22%	57	39%	36%
Defence	8	34%	67	29%	19%
Civil order and courts	9	25%	86	34%	26%
Economic activity	13	35%	91	40%	59%
Communal services	3	59%	22	36%	12%
Healthcare	10	6%	85	14%	13%
Education	18	22%	163	20%	18%
Social protection	20	-20%	249	12%	7%
Pension fund rev	18	25%	163	28%	34%
Pension fund costs	30	3%	295	32%	19%
Other	3	21%	25	14%	23%
Net loans	0	nm	1	nm	240%
Deficit³	0	nm	-14	nm	183%
as % of GDP	nm	nm	-0.5%	0.8pp	1.9pp
Central budget revenues	72	18%	741	15%	16%
Central budget expenses	51	-7%	507	18%	20%
Net transfers	20	0%	240	13%	13%
Local budget revenues	21	1%	212	16%	19%
Local budget expenses	45	16%	431	18%	20%
Nominal GDP used	na	nm	2,837	19%	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 Parliament has approved the 2019 state budget. Although the absolute final version has not yet been made available to the public (some alterations to the second draft were introduced hours before the voting), the revised document envisions revenues and expenditures at UAH1,026bln and UAH1,112bln, respectively (up by UAH20bln and UAH18bln from the initial draft). Both the target deficit (UAH90bln or 2.3% of nominal GDP) and its sources of financing (UAH74bln via internal and external borrowing, and UAH17bln from privatization) have been left unchanged.

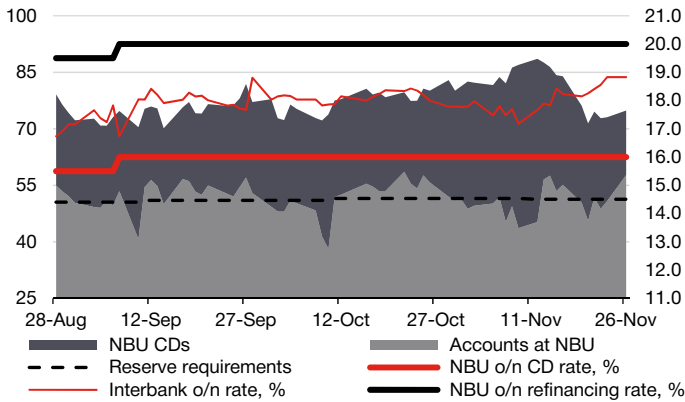
Our view: Despite the fact that revenues have been essentially inflated via various justifiable (such as via a bump to royalties and transfers from the NBU) as well as somewhat questionable (an increase in CIT collection and state revenue estimates) means from their initial version, we still find the overall document to be sound, and expect it to be approved by the IMF. According to our calculations, the state expects its total income to grow by 11.7%, which is consistent with the combination of the NBU's inflation target and possible real GDP growth for 2019 (we find 2.5-3.0% to be a reasonable projection). This is especially true, given that 2018 figures are currently well positioned to outperform their initial estimates. All in all, we expect the document together with the anticipated heating tariff hike to pave the way for Ukraine to receive the approval for its first SBA tranche in December.

Ukraine has imposed a 30-day martial law for regions bordering Russia and the coast. As per the relevant laws, the measure essentially allows authorities to restrict certain citizen rights and freedoms in case of an emergency. These include limiting mobility over strategically important territories, introducing a curfew, and even making use of personal belongings. According to President Poroshenko's press conference such actions will only be considered if Russia begins a full-on assault on the country's mainland. Prior to adopting the resolution in question, the Parliament has voted to formally schedule presidential elections for March 31. The local IMF office in Kyiv has commented that the Fund has no legal restrictions regarding continuation of cooperation with Ukraine in light of the events.

Our view: Taking into account that martial law is unlikely to have any impact on day-to-day life in absence of a further escalation of military tensions with Russia and that international donors are willing to continue their support programs for Ukraine, we view the impact of the adopted measure as very limited. Of note, however, is that both internal and external investors have reacted negatively to the news. Ukraine's 10 year yield spread with the US has gained 50bps and the hryvnia has devalued by 1% over 48 hours.

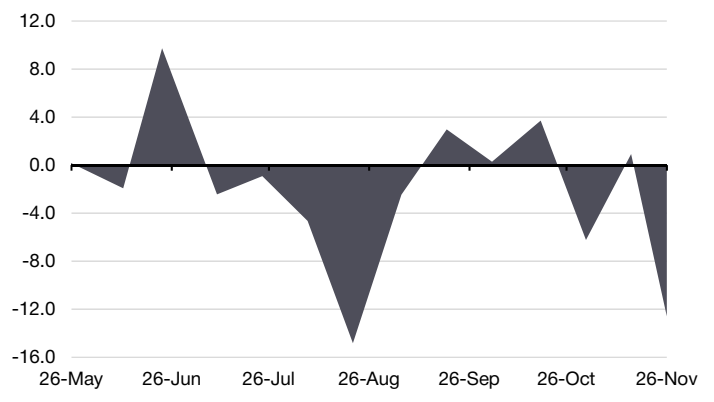
Appendix

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

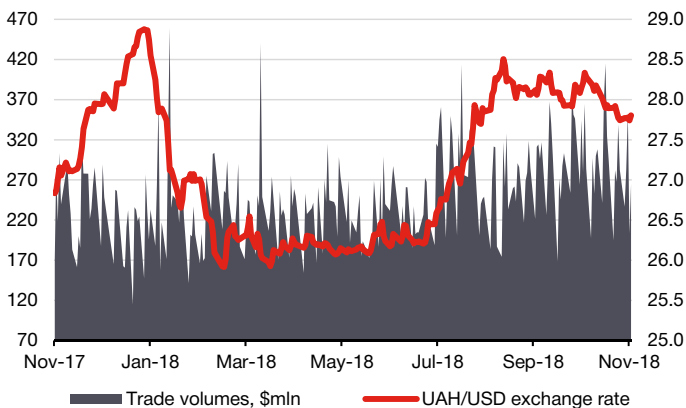


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 1.3bln to UAH 74.8bln over the last week. On November 27 the Ministry of Finance conducted local hryvnia denominated placement maturing in February and May 2019 with yields of 19.0% and 18.5%, respectively. A total of UAH 48.1mln was raised as a result.

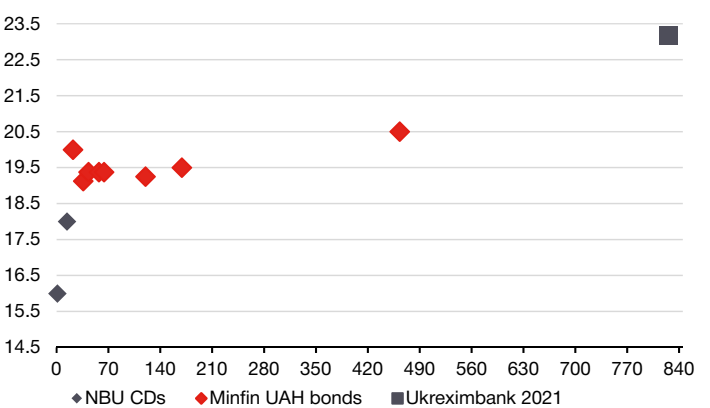
The UAH/USD interbank rate depreciated by 1.2% over the week starting out with 27.77 and ending at 28.10.

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

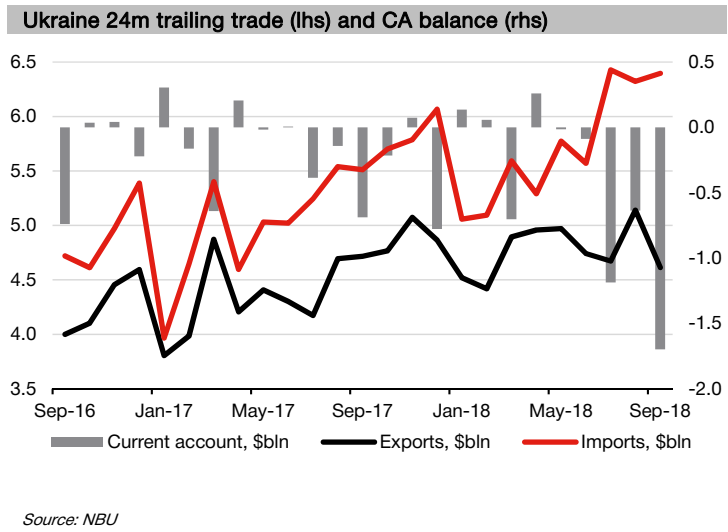
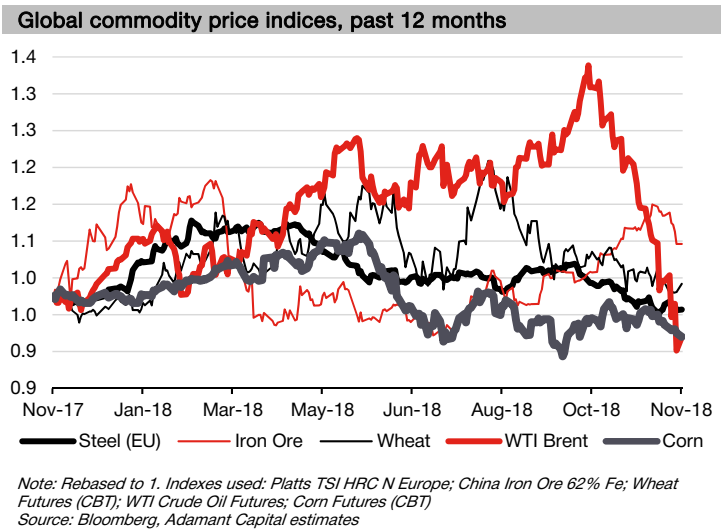
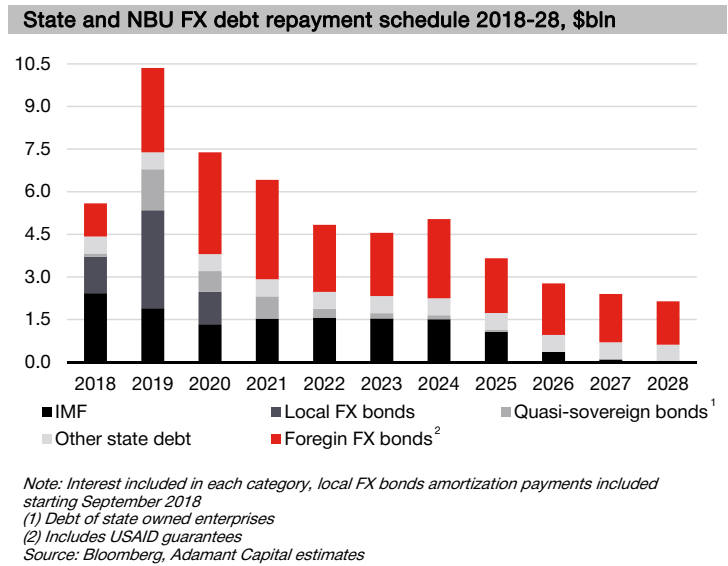
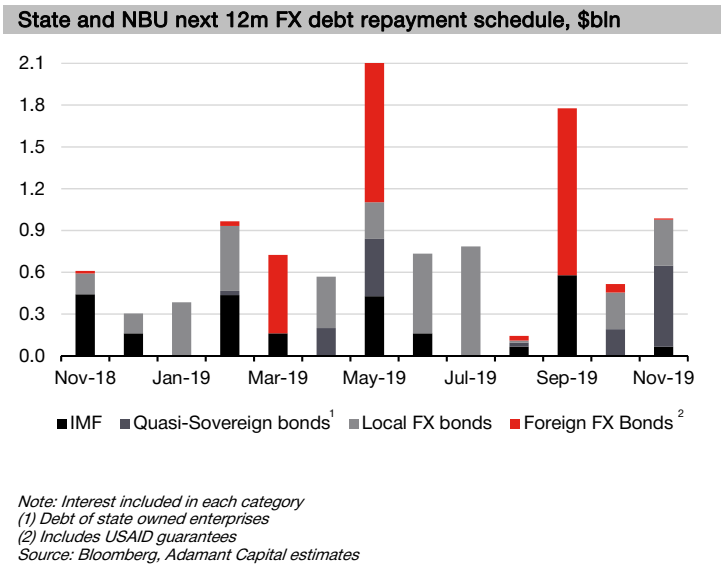
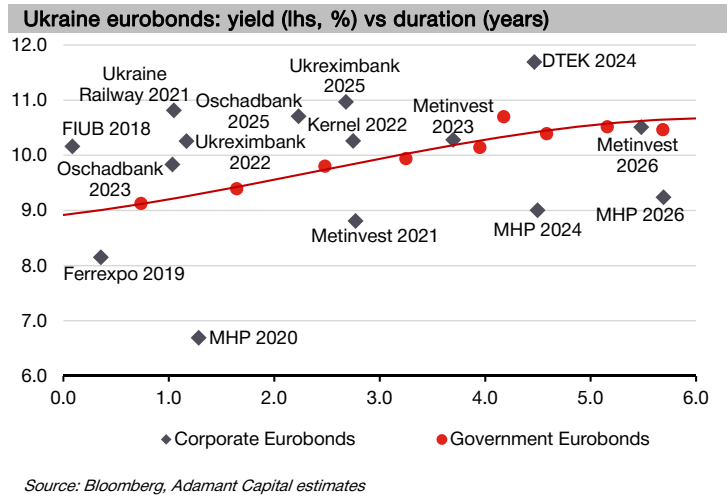
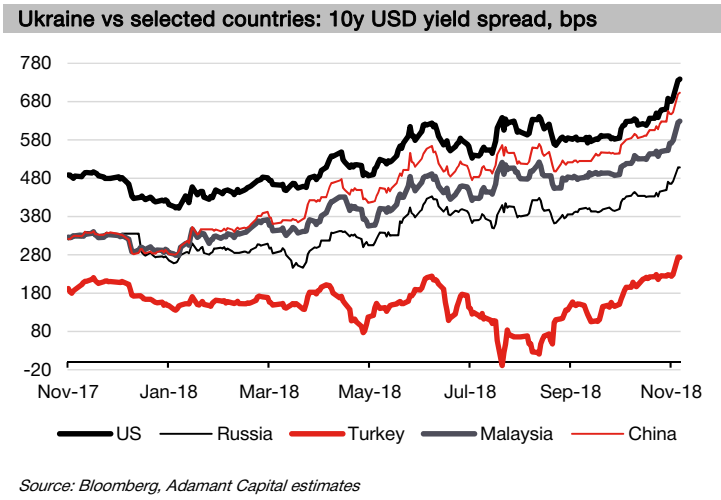


Note: Exchange rate figures are from official interbank data
Source: NBU

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



Source: NBU, Bloomberg, Adamant Capital estimates



Key macroeconomic indicators								
	3Q17	4Q17	2017	1Q18	2Q18	3Q18E	4Q18E	2018E
Real GDP growth, YoY	2.4%	2.2%	2.5%	3.1%	3.8%	2.8%	4.9%	3.7%
Nominal GDP, UAHbln	833	894	2,983	700	807	969	1,082	3,559
Nominal GDP, \$bln	32	33	113	26	31	35	38	130
GDP deflator growth YoY, %	21.1%	20.9%	22.0%	14.9%	17.0%	13.2%	15.3%	15.1%
Period average CPI YoY, %	16.1%	14.0%	14.5%	13.8%	11.6%	8.9%	10.4%	11.2%
End of period CPI YoY, %	16.4%	13.7%	13.7%	13.2%	9.9%	8.9%	11.0%	11.0%
Consolidated budget deficit, % of GDP ¹	1.3%	9.4%	1.4%	0.4%	-1.7%	-0.4%	9.2%	2.6%
Broad public sector deficit, % of GDP ²	4.0%	12.7%	4.1%	0.4%	-1.2%	-0.4%	9.2%	2.7%
Public debt as % of LTM GDP, UAH	72.7%	71.8%	71.8%	66.4%	61.8%	62.7%	62.8%	62.8%
Public external debt as % of LTM GDP, \$ ³	46.5%	43.5%	43.5%	41.7%	38.7%	38.0%	38.2%	38.2%
Total external debt, \$bln	116	115	115	115	114	114	117	117
Export of goods and services, \$bln	13.6	14.7	53.9	13.8	14.7	14.4	15.7	58.6
Import of goods and services, \$bln	16.3	17.6	62.5	15.7	16.6	19.1	18.2	69.7
Trade balance, \$bln	-2.7	-2.9	-8.6	-1.9	-2.0	-4.7	-2.5	-11.1
Current account, \$bln	-1.2	-0.9	-2.4	-0.5	0.2	-3.5	-0.6	-4.5
Financial account, \$bln ⁴	-2.1	-1.6	-5.0	-0.2	-0.4	-2.8	-2.1	-5.5
End of period NBU reserves, \$bln	18.6	18.8	18.8	18.2	18.0	16.6	18.9	18.9
Average interbank exchange rate, UAH/\$ ⁵	25.9	26.9	26.5	27.3	26.2	27.4	28.5	27.3
EOP interbank exchange rate, UAH/\$	26.6	28.1	28.1	26.3	26.3	28.3	29.0	29.0
EOP key policy rate NBU, %	12.5%	14.5%	14.5%	17.0%	17.0%	18.0%	18.5%	18.5%

(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	Hold	-	7.8	Sep-19	9.1	99.0	-0.4	0.7	661
Ukraine 2023	Hold	-	7.8	Sep-23	10.1	91.1	-1.9	3.9	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	10.7	93.4	-3.1	4.2	750
Ukraine 2027	Hold	-	7.8	Sep-27	10.5	84.4	-2.6	6.2	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	11.0	92.6	-2.8	6.4	1,250
Ukraine 2032	Hold	-	7.4	Sep-32	10.3	78.6	-2.0	7.8	3,000
MHP 2024	Hold	20-Nov-18	7.8	May-24	9.0	94.7	-2.4	4.5	500
MHP 2026	Hold	20-Nov-18	7.0	Apr-26	9.2	88.0	-2.4	5.7	550
DTEK 2024	Hold	13-Nov-18	10.8	Dec-24	11.7	95.9	-1.8	4.5	1,344
Ferrexpo 2019	Hold	9-Oct-18	10.4	Apr-19	8.1	100.7	-0.5	0.4	346
Metinvest 2023	Hold	6-Nov-18	7.8	Apr-23	10.3	91.2	-2.8	3.7	945
Metinvest 2026	Hold	6-Nov-18	8.5	Apr-26	10.5	89.8	-3.0	5.5	648
Ukrlandfarming in default	Sell	13-Jun-17	10.9	Mar-18	nm	13.3	-0.1	nm	543
Avangard in default	Sell	5-Jun-18	10.0	Oct-18	nm	20.4	0.0	nm	214
FUIB 2018	Buy	6-Nov-18	11.0	Dec-18	10.2	100.1	0.0	0.1	59
Privatbank in default (10.250)	Not rated	-	10.3	Jan-18	nm	21.1	0.0	nm	160
Privatbank in default (10.875)	Not rated	-	10.9	Feb-18	nm	22.5	0.0	nm	175
Oschadbank 2023	Buy	6-Nov-18	9.4	Mar-23	9.8	98.4	-1.2	1.0	700
Oschadbank 2025	Buy	6-Nov-18	9.6	Mar-25	10.7	95.1	-2.5	2.2	500
Ukreximbank 2021 (UAH)	Buy	6-Nov-18	16.5	Mar-21	24.2	87.0	0.0	1.9	150
Ukreximbank 2022	Buy	6-Nov-18	9.6	Apr-22	10.3	98.2	-1.3	1.2	750
Ukreximbank 2025	Buy	6-Nov-18	9.8	Jan-25	11.0	94.6	-2.1	2.7	600
Ukrainian Railway 2021	Buy	9-Oct-18	9.9	Sep-21	10.8	97.8	-1.8	1.0	500
Kernel 2022	Buy	23-Oct-18	8.8	Jan-22	10.3	96.0	-2.0	2.7	500

Note: all bonds are rated in relation to the sovereign, which is assumed to have a 'Hold' rating

Source: Bloomberg, Adamant Capital estimates

Fixed Income 2 week event calendar		
Event	Type	Date
Metinvest - Monthly report for September	Indicative	28-Nov
NBU - Balance of payments monthly data	Exact	30-Nov
NBU - International reserves monthly data	Exact	7-Dec
SSSU - Monthly inflation	Exact	10-Dec

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.