

Weekly Digest

- The NBU has left the discount rate unchanged at 17.5%
- Foreign currency reserves of the NBU in May decreased by \$1.1bln MoM to \$19.4bln
- The FinMin has announced intent to place a 7-year note denominated in euros
- Consumer inflation in May amounted to 0.7% MoM and 9.6% YoY
- The constitutional court will decide on the legality of snap elections, as Zelensky's party remains ahead in polls

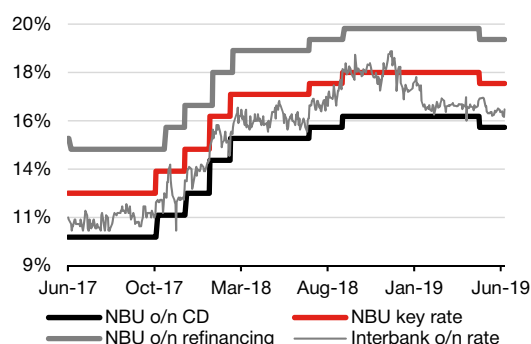
The NBU has left the discount rate unchanged at 17.5%. According to the official press release, the decision was driven by elevated inflation over the past 2 months, rising domestic demand, persistent external risks, and recent volatility of financial markets. The regulator believes the latter to have been caused by speculations in mass media concerning possibilities of default on sovereign external debt, delays in cooperation with the IMF, and court rulings that threaten the stability of the financial system.

Our view: The NBU's decision came in line with our expectations and is consistent with the evolution of price risks since April. That said, taking into account, that business and households estimate annual inflation at 9.0-10.9%, the perceived spread between the Finmin's real annual borrowing rate in dollars and hryvnia stand at c. 300-450bps, which suggests that room for monetary easing is present. Although the regulator may decide to continue erring on the side of caution (especially given that it is also trying to accumulate FX reserves), we believe that the discount rate is likely to come down sometime after parliamentary elections.

Foreign currency reserves of the NBU in May decreased by \$1.1bln MoM to \$19.4bln. Outflows came primarily on the back of debt servicing and amortizations totaling \$1.3bln, including a \$1.0bln eurobond redemption. An additional \$0.5bln were directed towards repayments to the IMF. Inflows were generated by \$0.4bln worth of local sovereign bond placements, the regulator's net currency purchases on the interbank market totaling \$0.2bln, and \$0.1bln of revaluations.

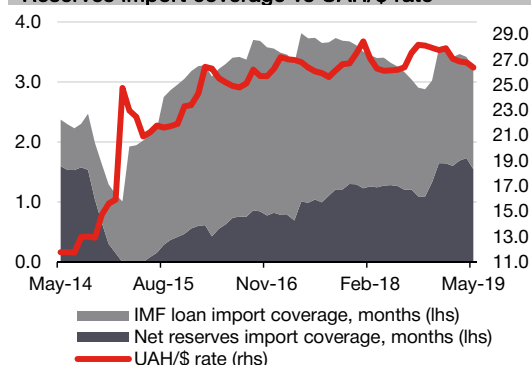
Our view: This month's figure came in generally in line with expectations, with the only deviation being somewhat higher actual local FX bond placements than anticipated (rollover rate at 172%). Our updated forecast for June stands at \$20.8bln and assumes a \$1.5bln net placement by the Finmin, which has recently announced its intention to issue a 7-year note denominated in euro (amount undisclosed). Taking into account that the foreign exchange market is not currently displaying signs of pre-election volatility (we expected it to occur over September and October before the snap vote was announced), we increase our net intervention projection for the year by \$0.5bln to \$1.2bln (vs \$1.4bln in 2018), triggering an upgrade of our annual reserves forecast to \$20.2bln. As mentioned previously, our base case macroeconomic scenario assumes that Ukraine will be able to secure one \$1.3bln SBA tranche from the IMF and EUR0.5bln from the EU in 4Q19.

Local interest rate dynamics



Source: NBU

Reserves import coverage vs UAH/\$ rate



Source: NBU, Adamant Capital estimates

The FinMin has announced intent to place a 7-year note denominated in euros. According to ministry head Markarova, 4 days of meetings with investors have already been scheduled.

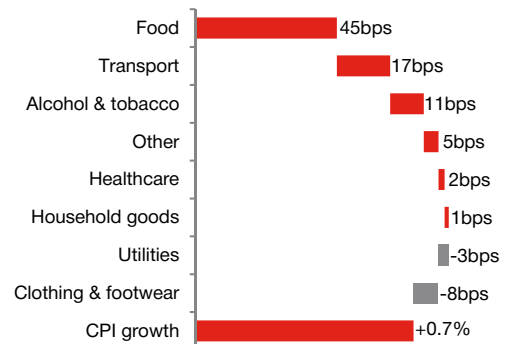
Our view: The decision to raise funds from the market falls both in line with the government's earlier announcements and our projections. That said, in our model we budget a \$1.5bln net borrowing (i.e. after refinancing of other obligations), which may not occur, given that interest from funds investing in assets denominated in euro may be limited. Taking into account that the bid yield on 2026 notes currently stands at 7.95% and that the EUR.USD forward rate is quoted at 1,932 (equivalent to a 2.2% p.a.), we estimate the coupon rate at c. 6.5% (assuming a 750bps premium).

Consumer inflation in May amounted to 0.7% MoM and 9.6% YoY.

Food remained the dominant contributor to growth versus April (+45bp) with fruit and meat categories having the most material impact. Other factors driving the index forward were fuel and alcohol, which were up by 4.1% and 1.3% MoM, respectively. A seasonal drop in the price of clothing reduced the CPI by 8bps. Core inflation landed at 0.2% MoM and 7.4% YoY.

Our view: MoM CPI growth came in slightly above our estimate of 0.6% mainly due to an unexpected bump in fruit prices, which may have stemmed from a local shortage of apples in stock. As wholesale food markets so far indicate that this trend is beginning to reverse, we consider it to be a one-off event. Taking also into account flat fuel prices to date (in contrast to an increase in May, which resulted from oil product supply disruptions from Belarus), we expect inflation to decelerate in June to 0.3% MoM. Our annual forecast, however, remains unchanged at 6.8% YoY, reflecting, in part, a moderate acceleration in the growth rate of average wages and remittances to Ukraine (to 21% and 17% YoY, respectively, in April).

CPI growth contributions by category in May

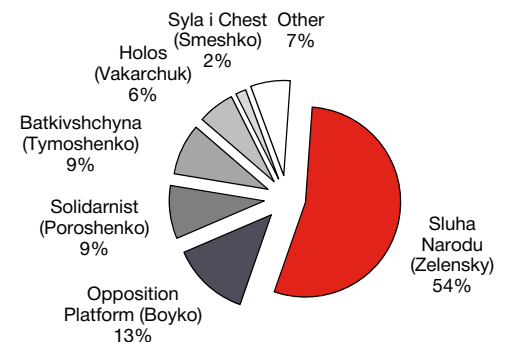


Source: SSSU, Adamant Capital estimates

The constitutional court will decide on the legality of snap elections, as Zelensky's party remains ahead in polls. The Constitutional Court of Ukraine held its first hearing on June 11 to determine whether the new president had legal authority to dissolve parliament, a claim that has been contested by 62 MPs. Taking into account that the case has been labeled as urgent, a ruling will have to be made by June 29. According to a new survey conducted by the Kyiv Institute of Sociology over May 26-June 6 totaling 2,021 respondents, five parties have sufficient backing to cross the 5% entry barrier into the new legislative body. These are Zelensky's Sluha Narodu, Boyko's Opposition Platform, Poroshenko's Solidarnist, Tymoshenko's Batkivshchyna, and Vakarchuk's Holos (supported by 48.5%, 11.8%, 8.1%, 7.8%, and 5.6% of voters that have already made up their mind).

Our view: As before, assuming that the results for local constituencies also align with the survey, Zelensky's Sluha Narodu can claim over 50% of all seats in the new parliament, which makes his party an undisputed leader of the process so far. Vakarchuk's Holos, which is a newcomer in the race, has been able to gain a substantial amount of traction, but only by chipping away at the support of its other competitors. The political landscape may end up experiencing a shift, however, if the constitutional court rules the snap vote illegal (of which there is at least a 50% probability, in our view), as this will not only delay voting by a full three months, but also place the new president in an awkward positions to deal with uncooperative MPs.

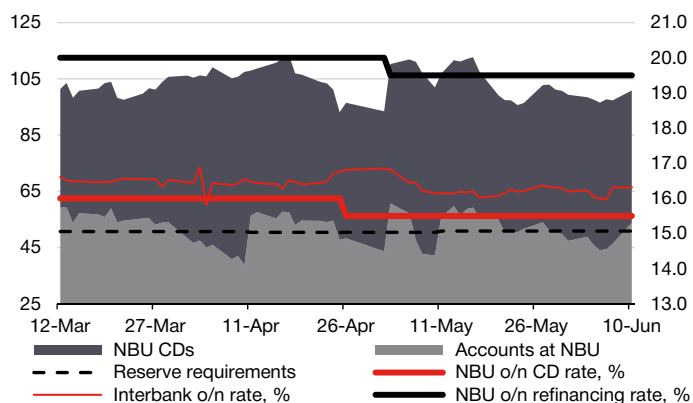
Poll-based breakdown of new parliament



Note: assuming that single-seat constituencies receive the same support shares as party lists
Source: Kyiv Institute of Sociology, Adamant Capital estimates

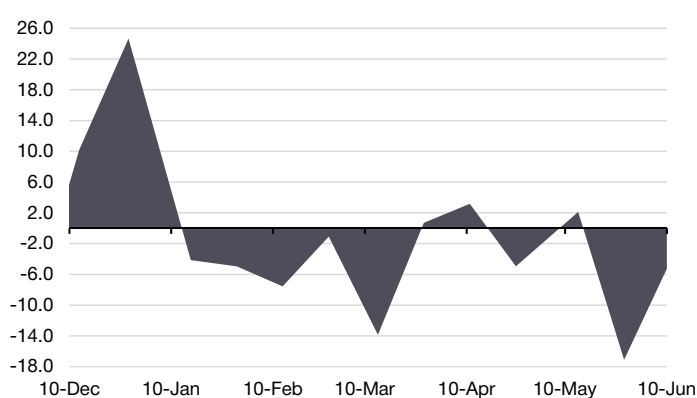
Appendix

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



Source: NBU, Adamant Capital estimates

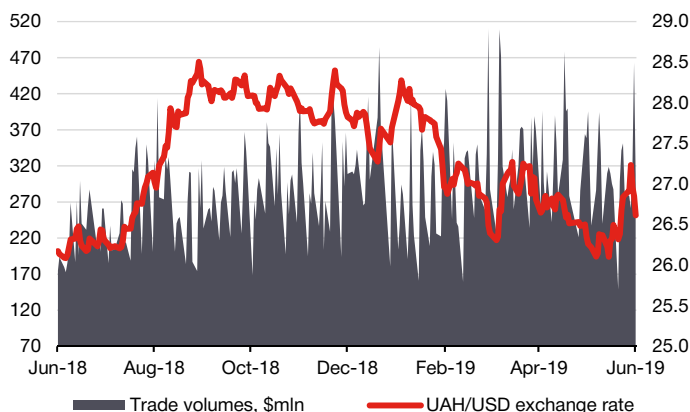
Banking system 6m inflows from the state treasury and the DGF



Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 2.4bln to UAH 100.8bln over the last week. On June 11 the Ministry of Finance conducted local hryvnia denominated placement maturing in September 2019, December 2019, May 2020, August 2021 and February 2025 with yields of 18.0%, 18.39%, 18.45%, 17.95% and 15.85%, respectively, and USD denominated placement maturing in April 2020 and October 2020 with yield of 7.25%. A total of UAH 6.5bln and \$4.4mln was raised as a result.

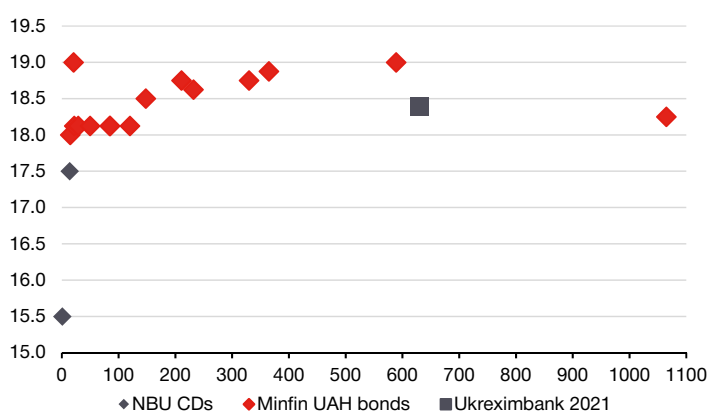
The UAH/USD interbank rate appreciated by 3.6% over the last week starting out with 27.23 and ending at 26.25.

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



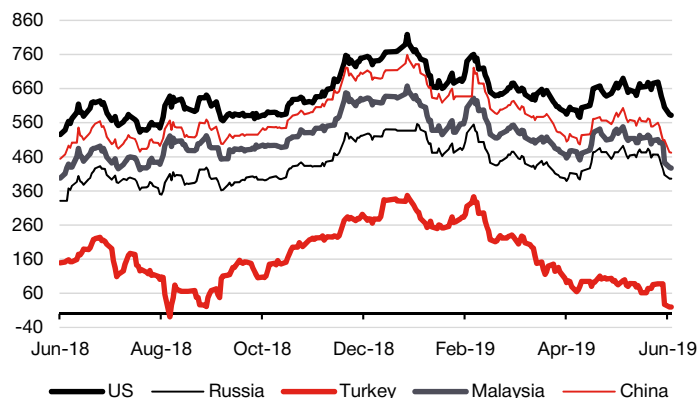
Note: Exchange rate figures are from official interbank data
Source: NBU

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



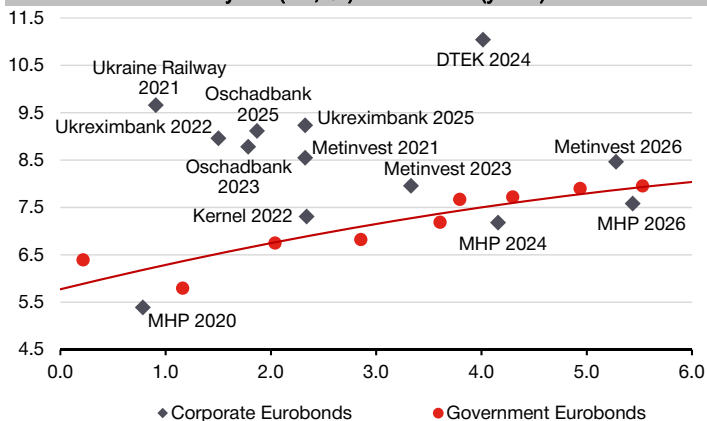
Source: NBU, Bloomberg, Adamant Capital estimates

Ukraine vs selected countries: 10y USD yield spread, bps



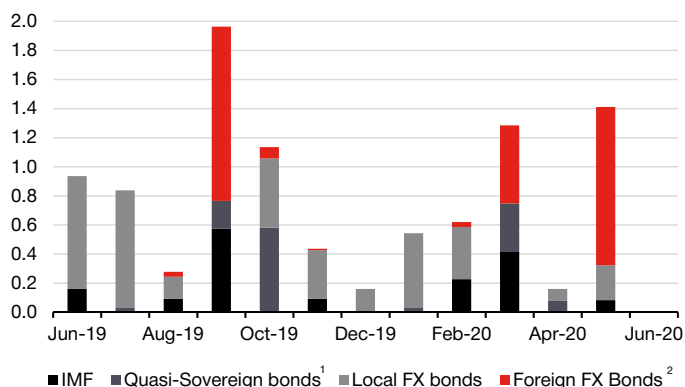
Source: Bloomberg, Adamant Capital estimates

Ukraine eurobonds: yield (lhs, %) vs duration (years)



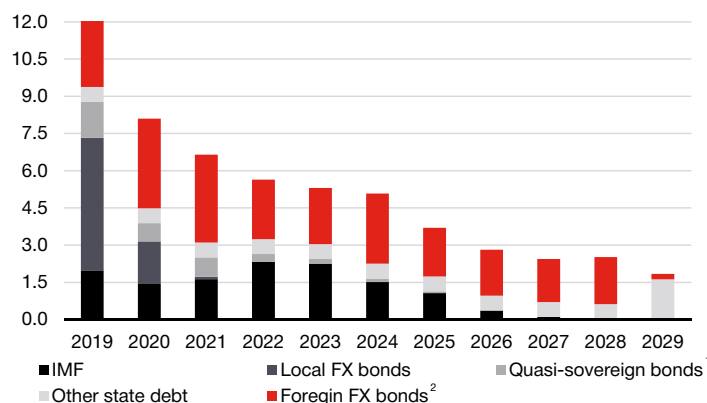
Source: Bloomberg, Adamant Capital estimates

State and NBU next 12m FX debt repayment schedule, \$bln



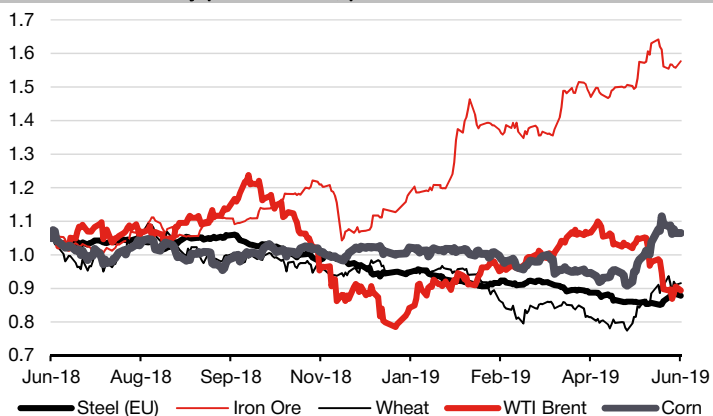
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

State and NBU FX debt repayment schedule 2019-29, \$bln



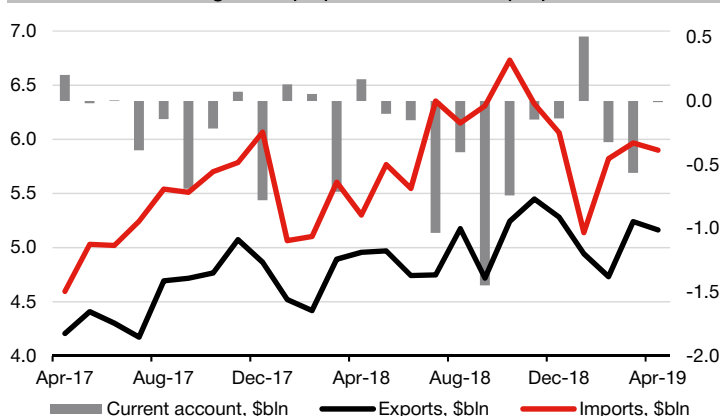
(1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

Global commodity price indices, past 12 months



Note: Rebased to 1. Indexes used: Platts TSI HRC N Europe; China Iron Ore 62% Fe; Wheat Futures (CBT); WTI Crude Oil Futures; Corn Futures (CBT)
 Source: Bloomberg, Adamant Capital estimates

Ukraine 24m trailing trade (lhs) and CA balance (rhs)



Source: NBU

Key macroeconomic indicators								
	2017	1Q18	2Q18	3Q18	4Q18	2018	1Q19E	2019E
Real GDP growth, YoY	2.5%	3.3%	3.8%	2.8%	3.5%	3.3%	2.2%	2.8%
Nominal GDP, UAHbln	2,984	705	811	995	1,048	3,559	795	4,024
Nominal GDP, \$bln	113	26	31	36	37	131	29	141
GDP deflator growth YoY, %	22.1%	15.1%	17.4%	16.0%	13.5%	15.0%	10.4%	10.0%
Period average CPI YoY, %	14.5%	13.8%	11.6%	8.9%	9.7%	11.0%	9.1%	8.8%
End of period CPI YoY, %	13.7%	13.2%	9.9%	8.9%	9.8%	9.8%	9.2%	6.8%
Consolidated budget deficit, % of GDP ¹	1.4%	0.4%	-1.7%	-0.4%	7.9%	1.9%	1.1%	2.3%
Broad public sector deficit, % of GDP ²	4.0%	0.4%	-1.2%	-0.4%	8.3%	2.2%	1.1%	2.3%
Public debt as % of LTM GDP, UAH	71.8%	66.3%	61.6%	62.1%	60.9%	60.9%	58.8%	56.2%
Public external debt as % of LTM GDP, \$ ³	43.5%	41.6%	38.6%	37.6%	38.6%	38.6%	37.6%	35.6%
Total external debt, \$bln	115	115	114	114	115	115	115	112
Export of goods and services, \$bln	53.9	13.8	14.7	14.6	16.0	59.1	14.9	60.8
Import of goods and services, \$bln	62.5	15.8	16.6	18.8	19.1	70.3	16.9	72.4
Trade balance, \$bln	-8.6	-1.9	-1.9	-4.2	-3.1	-11.2	-2.0	-11.6
Current account, \$bln	-2.4	-0.5	-0.1	-2.9	-1.0	-4.5	-0.4	-4.0
Financial account, \$bln ⁴	-5.0	-0.3	-0.7	-2.1	-4.3	-7.4	-0.7	-4.1
End of period NBU reserves, \$bln	18.8	18.2	18.0	16.6	20.8	20.8	20.6	20.2
Average interbank exchange rate, UAH/\$ ⁵	26.5	27.3	26.2	27.4	28.0	27.2	27.3	28.5
EOP interbank exchange rate, UAH/\$	28.1	26.3	26.3	28.3	27.7	27.7	27.2	30.0
EOP key policy rate NBU, %	14.5%	17.0%	17.0%	18.0%	18.0%	18.0%	17.5%	17.0%

(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	Hold	-	7.8	Sep-19	6.4	100.3	0.1	0.2	661
Ukraine 2023	Hold	-	7.8	Sep-23	7.2	102.0	3.9	3.6	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	7.7	105.1	3.9	3.8	750
Ukraine 2027	Hold	-	7.8	Sep-27	8.0	98.3	4.3	6.1	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	8.4	108.4	4.7	6.4	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	8.1	94.0	4.5	8.1	3,000
MHP 2024	Hold	23-Apr-19	7.8	May-24	7.2	102.3	1.1	4.2	500
MHP 2026	Hold	23-Apr-19	7.0	Apr-26	7.6	96.7	0.7	5.4	550
DTEK 2024	Hold	4-Jun-19	10.8	Dec-24	11.0	98.8	2.3	4.0	1,344
Metinvest 2023	Hold	28-May-19	7.8	Apr-23	8.0	99.3	1.0	3.3	945
Metinvest 2026	Hold	28-May-19	8.5	Apr-26	8.5	100.2	1.0	5.3	648
Ukrlandfarming in default	Sell	13-Jun-17	10.9	Mar-18	nm	14.5	0.2	nm	543
Avangard in default	Sell	9-Apr-19	10.0	Oct-18	nm	10.5	0.0	nm	214
Privatbank in default (10.250)	Not rated	-	10.3	Jan-18	nm	30.4	-0.4	nm	160
Privatbank in default (10.875)	Not rated	-	10.9	Feb-18	nm	30.8	0.5	nm	175
Oschadbank 2023	Buy	14-May-19	9.4	Mar-23	8.8	101.8	0.9	1.8	280
Oschadbank 2025	Buy	14-May-19	9.6	Mar-25	9.1	102.2	1.4	1.9	500
Ukreximbank 2021 (UAH)	Not rated	-	16.5	Mar-21	18.9	96.5	0.4	1.5	150
Ukreximbank 2022	Buy	14-May-19	9.6	Apr-22	9.0	101.6	0.8	1.5	375
Ukreximbank 2025	Buy	14-May-19	9.8	Jan-25	9.2	102.2	1.3	2.3	600
Ukrainian Railway 2021	Buy	7-May-19	9.9	Sep-21	9.7	100.4	0.1	0.9	350
Kernel 2022	Buy	28-May-19	8.8	Jan-22	7.3	103.4	0.8	2.3	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
MHP - Financial results for Q1 2019	Exact	12-Jun
SSSU - Agricultural production monthly data	Exact	14-Jun
SSSU - Q1 2019 GDP	Exact	19-Jun
SSSU - Wholesale and retail turnover monthly data	Exact	20-Jun
SSSU - Transportation monthly data	Exact	20-Jun
SSSU - Industrial production monthly data	Exact	24-Jun

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