UKRAINE MACRO AND INDUSTRY OVERVIEW

A THIRD YEAR OF GROWTH

In 2018, the Ukrainian economy expanded for the third year in a row, as real GDP increased by 3.3% compared with 2017, its strongest growth in recent years. Buoyed by structural reforms, favourable export markets and various stronger macroeconomic indicators, the country appears to be on a path of continued economic growth.

ON THE GROWTH PATH

In 2018, Ukraine continued to recover, driven by several factors such as the ongoing and unprecedented structural reforms, a record agricultural harvest, favourable export markets, more solid macroeconomic fundamentals and relatively greater stability in the temporarily non-government controlled territory. Additional support came from improvements in consumer spending and higher real wages, which rose by 12.5% year-on-year in 2018, bringing the cumulative growth over the past three years to 46%.

Overall, real GDP growth accelerated to 3.3% year-on-year in 2018, building on the momentum that developed over 2016 (up 2.4%) and 2017 (up 2.5%).

In 2018, the National Bank of Ukraine (NBU) continued its monetary policy of inflation targeting, to which it had effectively switched in early 2016. The main policy instrument, and the operational target, in such a framework is the interest rate.

As part of its ongoing efforts to combat inflation, the NBU increased its key interest rate – the discount rate – on four separate occasions in 2018: by 350 basis points year-to-date to 18% as of 7 September 2018. As a result of these efforts, the consumer price index (CPI) decelerated to 9.8% in December 2018, down from 13.7% in December 2017, although this exceeded the NBU target range of 4-8%.

At the same time, the NBU maintained a floating exchange rate for the hryvnia. During the year, the exchange rate for the local currency against the US dollar seasonally strengthened from 28.43 in January to 26.14 in April, weakened to 28.19 in September and gained again to 27.69 at the year-end. This brought the average to 27.22 for 2018, compared with 26.60 for 2017, equalling depreciation of 2.3% year-on-year. Such exchange rate fluctuations were due to several factors, including remittances from migrant workers (which reached a new record of US$11 billion in 2018), the seasonality of the agricultural business and foreign participation in the local government bond market.

Since 2016, the NBU has made certain steps to ease the currency control restrictions introduced in 2014-15. In particular, it has gradually reduced the required share of foreign currency proceeds subject to mandatory sale on the interbank market: from 75% to 30% from 1 March 2019. Additionally, the settlement period for import-export transactions in foreign currency has steadily increased from 90 to 180 days on 26 May 2017. Also, on 3 March 2018, the NBU increased the amount of dividend payments allowed from Ukrainian companies to non-residents to US$7 million a month. This was eased further to EUR7 million on 7 February 2019.

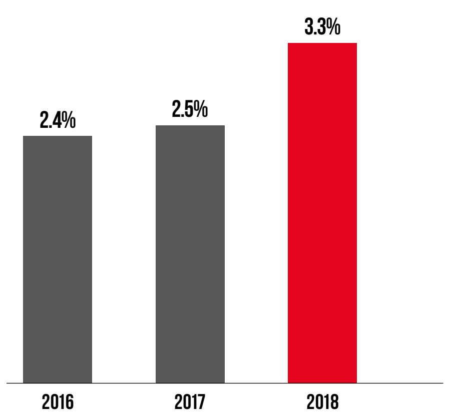
International financial support remained highly important for Ukraine, given the sizeable external debt repayments in 2018 and peak amortisations in 2019-20. Several measures, including those listed below, helped the NBU to increase its foreign exchange reserves to US$20.8 billion by the end of 2018, their highest since September 2013.

In December 2018, the International Monetary Fund (IMF) approved a new 14-month Stand-By Arrangement (SBA) of US$3.9 billion after certain milestones were reached. It replaced the previous Extended Fund Facility Programme, under which the country received four tranches totalling US$8.7 billion in 2015-17. The first tranche of US$1.4 billion under the SBA was received in December 2018. Ongoing cooperation with the IMF is viewed as a key driver of positive change in the country, while further disbursements depend on Ukraine's success in fulfilling the terms of the Memorandum on Economic and Financial Policies.

Ukraine also further strengthened its relationship with its largest trading partner, the European Union, with which its Association Agreement is now in full force. As part of the bloc's ongoing support, it approved a EUR1 billion macro-financial assistance to the country in late 2018.

To refinance its upcoming short-term maturities, Ukraine returned to the international debt markets in October 2018. The government raised US$2 billion in a dual-tranche Sovereign Eurobond offering, including a 5.25-year Eurobond at 8.994% per annum and a 10-year Eurobond at 9.750% per annum. Several Ukrainian corporates also placed Eurobonds to refinance their debt, including Metinvest, which in April 2018 conducted the largest corporate placement in Ukraine to date.

Real GDP growth



Source: State Statistics Service of Ukraine

Sovereign credit ratings encompass a wide range of risks associated with investing in a country, while a country ceiling reflects the risk of capital and exchange controls being imposed that would reduce the ability to service foreign-currency debt. As such they affect the cost of financing for not only the country, but also domestic corporate borrowers, and they are monitored closely by all parties concerned. In 2018, both Standard & Poor's and Fitch affirmed their ratings for Ukraine at 'B-', the outlook 'stable'. Meanwhile, Moody's upgraded its Sovereign rating to 'Caa1', the outlook 'stable', and its country ceiling to 'B3'. Among other factors, this was a result of the agreement of the new SBA with the IMF, gradual reform progress and greater resilience regarding the situation in the east of the country.

Additional confirmation of the recent progress was a further gain in the World Bank's Ease of Doing Business index, in which Ukraine rose to 71 among 190 economies, up from 76 in 2017.

INFRASTRUCTURE CYCLE TO DRIVE STEEL DEMAND

Buoyed by the resurgent economy, steel-consuming industries are driving demand for steel products in Ukraine.

In 2018, apparent steel consumption grew by another 4.0% year-on-year to 5.7 million tonnes, driven primarily by an 8.5% rise in construction. The sector is the largest steel user in Ukraine, accounting for around 70% of the total consumed in 2018. Its main drivers were non-residential (up 5.7% year-on-year) and infrastructure construction (up 13.6%). The latter stemmed from the urgent need to upgrade infrastructure, most of which dates from 30-40 years ago, including building and repairing roads. In addition, domestic steel consumption was supported by a 32.3% year-on-year surge in railcar manufacturing amid strong local demand.

Overall, Ukraine has vast potential in this regard. According to the WSA, apparent steel consumption per capita was 106 kilogrammes in Ukraine, compared with 391 kilogrammes in Poland and 288 kilogrammes in Hungary.

Ukraine produced 23.1 million tonnes of crude steel in 2018, up 3.6% year-on-year. The country's steel industry is export-oriented. Metal Expert has reported that overseas sales of rolled steel products, excluding pipes, accounted for 79% of overall output in the year, totalling 16.5 million tonnes.

Nevertheless, the country traditionally imports certain types of steel products that are either not made locally or produced in insufficient quantities or the price-quality ratio better meets customer needs, such as polymer-coated, galvanised and other goods. In 2018, according to Metal Expert, Ukraine imported 1.4 million tonnes of such products. This represents further potential for the Group to expand in the market.

Metinvest estimates that in 2018, Ukraine's merchant iron ore product consumption rose by 15.8% year-on-year to 36.9 million tonnes, driven by greater steel output. Amid this demand, the Group boosted its local sales of iron ore products by around 1.1 million tonnes year-on-year. At the same time, the country's merchant iron ore product output remained flat year-on-year at 68.7 million tonnes.

As for coking coal, production in Ukraine has been falling for the last decade, latterly due to the situation in Eastern Ukraine. In 2018, Metinvest estimates that the country's raw coking coal output dropped by another 18% year-on-year to 5.8 million tonnes, forcing local coke producers to increase imports, which are often costlier. As such, the share of coking coal imports in national consumption reached a record 82% in 2018, up 5 percentage points compared with 2017.

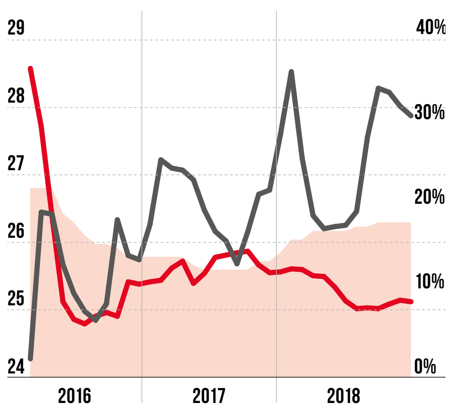
All told, the Group's overall sales in Ukraine surged by 35% year-on-year in 2018, bringing the country's share in its consolidated revenues to 28%.

OUTLOOK

In 2019, developments in Ukraine are likely to be influenced by the new presidency and the parliamentary elections in October. There is a common belief that whatever the political direction that the country takes, it will have to continue to implement important structural reforms to secure the international financial support, primarily from the IMF, needed to meet the peak external debt repayments of 2019-20.

While several other factors could also create fresh challenges to the Ukrainian economy, the nearer-term economic outlook remains positive: as of April 2019, the IMF forecasts GDP growth of 2.7% year-on-year in 2019 and 3.0% year-on-year in 2020. This and the need to renovate vital infrastructure are expected to fuel steel demand.

Monetary policy

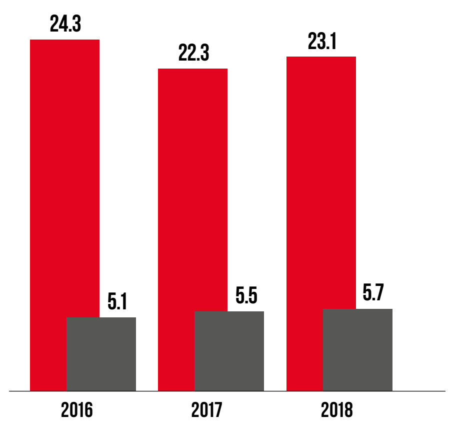


Key interest rate, % (RHS)
Average exchange rate, UAH/US$ (LHS)
Consumer price index, % (RHS)[1]

1 For CPI, the year-on-year change is for the relevant month.

Source: State Statistics Service of Ukraine, National Bank of Ukraine

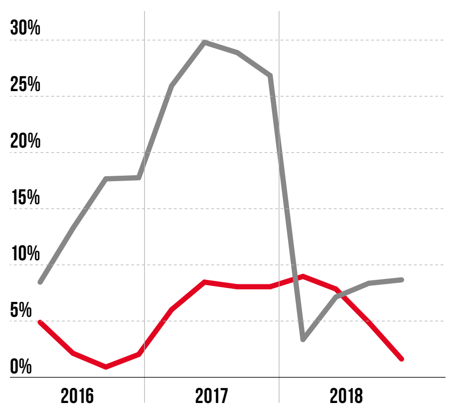
Steel industry in Ukraine



Crude steel production, MT
Rolled steel consumption, MT

Source: Metal Expert

Key steel consuming sectors in Ukraine[2]



Construction index
Machinery production index

2 All indexes represent the cumulative index from the beginning of the respective year, year-on-year change.

Source: State Statistics Service of Ukraine, Metal Expert