

Weekly Insight

Anti-corruption court legislation on its way

Key messages of the today's comments

WEDNESDAY, 20 JUNE 2018

Domestic liquidity and bonds market

FX-denominated bonds issuances

Last week, total outstandings of domestic bonds declined due to a partial refinancing of debt repayments in FX. This reverse this week with new FX-denominated bond offerings.

Liquidity unstable at high level

Banking-sector liquidity remains above UAH110bn; last week saw high volatility with changes in components.

Foreign exchange market

Hryvnia depreciated 0.8%

The national currency's exchange rate could be volatile this week due to the beginning of budgetary tax payments and VAT refunding.

Economics

The European Parliament approves EUR1bn aid for Ukraine

Ukraine may obtain the first tranche of the EU macro-financial aid (MFA) in the end of 2018. However, the key preliminary condition is that Ukraine restore cooperation with the IMF.

Stockholm arbitration in favour of Naftogaz suspended

The lawsuit surrounding the Stockholm arbitration may drag on for a considerable amount of time and may become a part of the overall dispute between Naftogaz and Gazprom over Russian gas transit through Ukraine.

Anti-corruption court legislation on its way

Ukrainian parliament still needs to pass supplementary bills to secure establishment and proper functioning of the HACC, as well as provide full compliance of the HACC law with the requirements of the IMF. Still, these procedures may be finalized by parliament as soon as this week.

Banks' reserves market (19 June 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU rate (%) ¹	17.00	+0bp	+450bp
ON rate (%)	15.60	-50bp	+450bp
ON \$ swap (%)	15.12	-39bp	+387bp
Reserves (UAHm) ²	57,441	-0.25	+12.51
DepCerts (UAHm) ³	60,272	+7.47	-8.66

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's short-term bonds.
Source: NBU, Bloomberg, ICU.

Breakdown of govt bond holders (UAHm) (19 June 2018)

	Last	Weekly chg (%)	YoY chg (%)
NBU	350,325	+0.00	-6.08
Banks	349,742	-0.56	+24.28
Residents	23,791	-0.07	+7.42
Individuals	3,071	+2.95	+356.49
Non-res ⁴	10,409	+0.19	+17,231.39
Total	737,339	-0.25	+8.86

Notes: [1] non-residents
Source: NBU, ICU.

FX market indicators (19 June 2018)

	Last	Weekly chg (%)	YTD chg (%)
USD/UAH	26.4400	+1.22	+1.59
EUR/USD	1.1590	-1.70	+3.96
DX ²	95.013	+1.57	-2.60
UAH TWI ³	122.671	+0.36	+6.99

Notes: [1] UAH trade-weighted index.
Source: Bloomberg, ICU.

Gov't bond quotes¹ (20 June 2018)

Maturity	Bid	Ask
6m	17.50	16.75
12m	17.75	17.00
2y	17.50	16.50
3y	17.50	16.50
12m (\$)	5.50	4.85
2y (\$)	5.70	5.00

Notes: [1] Actual quotes you can see at www.icu.ua.
Source: ICU.

Domestic liquidity and bonds market

FX-denominated bonds issuances

Last week, total outstandings of domestic bonds declined due to a partial refinancing of debt repayments in FX. This reverse this week with new FX-denominated bond offerings.

At last week’s auction, the MoF offered and sold five issues of local-currency instruments, and one note denominated in US dollars. This allowed the MoF to borrow UAH7.4bn. They refinanced most of last week’s debt repayments, which amounted to UAH0.6bn in hryvnia and US\$391m in FX. So, local-currency repayments were fully refinanced. For repayments in FX, the government had to use funds from its FX accounts. For details of this auction please read [our review](#).

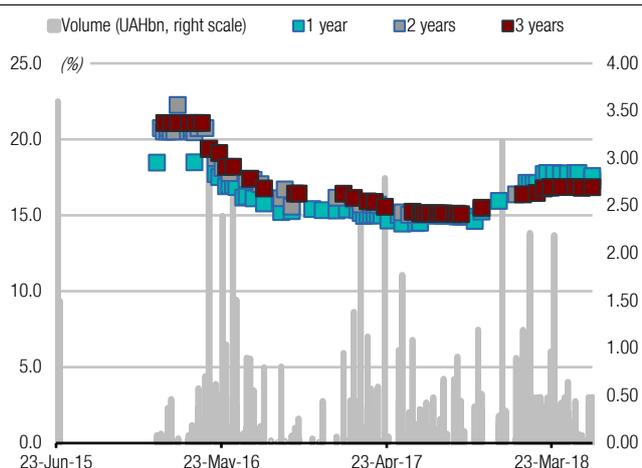
This week, the MoF will offer three issues of FX-denominated paper with nine-month, two-month, and two-year maturities. This could enable the MoF to increase budget financing, especially in FX.

ICU view: Extending the offering of FX-denominated bonds could be the result of a low amount of funds in the government’s FX-accounts. With the current offering, the MoF will attempt to reimburse those accounts for the FX spent last week for debt repayments. A positive result of yesterday’s auction should improve budget financing and increase the amount of FX available in the MoF’s accounts prior to large debt repayments in 3Q18, for UAH0.7bn of domestic, and more than US\$1bn of external debt repayments.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

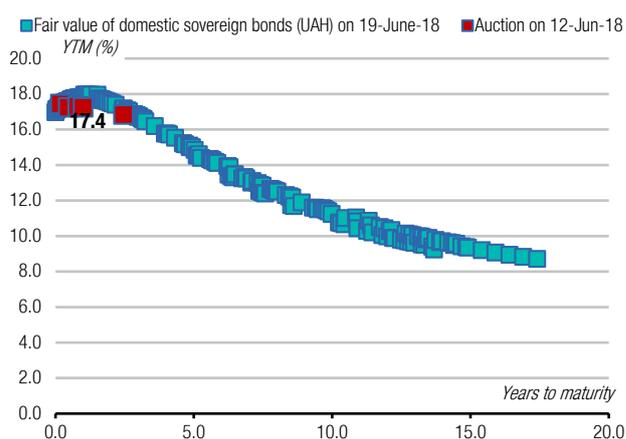
Chart 1. Local-currency bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: Ministry of Finance of Ukraine, ICU.

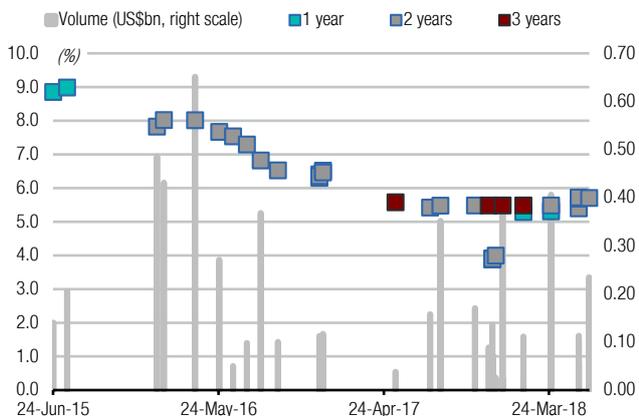
Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

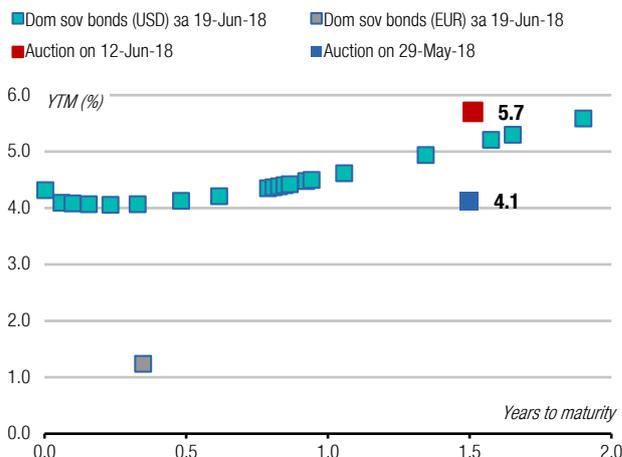
Chart 2. FX-denominated bonds

Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)



Source: Ministry of Finance of Ukraine, ICU.

Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

Liquidity unstable at high level

Banking-sector liquidity remains above UAH110bn; last week saw high volatility with changes in components.

Last week, liquidity rose UAH0.4bn with concentration in CDs maturing at the end of this month. Liquidity fell below UAH113 bn, but remained above UAH118bn until the end of the week.

Non-monetary operations had the greatest impact on liquidity last week, which was negative. However, these operations compensated outflows by the end of week with net inflows at UAH0.5bn. The Treasury’s operations had the greatest impact. Reserves exchange into cash amounted to UAH4.5bn during the week.

NBU’s FX operations had a low impact on liquidity. Last week, the NBU sold FX the first time since April. NBU sold net US\$4m, absorbing just UAH109m of liquidity.

ICU view: Non-monetary operations may put pressure on Treasury transactions this week also. Month-end tax payments will start at the end of the week, and we could also see a portion of VAT refunds. So, these cashflows on different days will greatly increase liquidity volatility.

Taras Kotovych, Kyiv, (044) 377-7040 ext.724

Chart 3. Banks reserves usages over last week(UAHm)

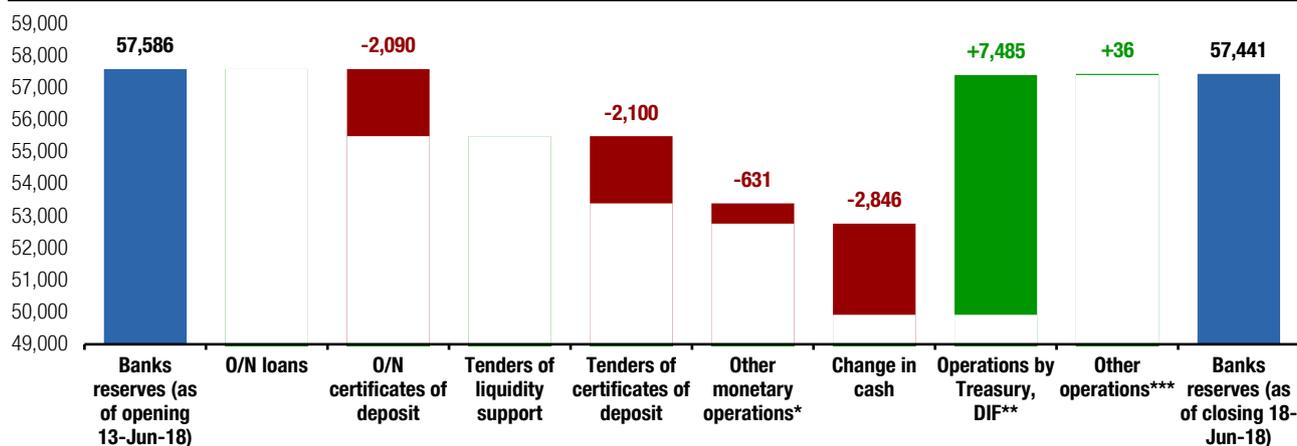
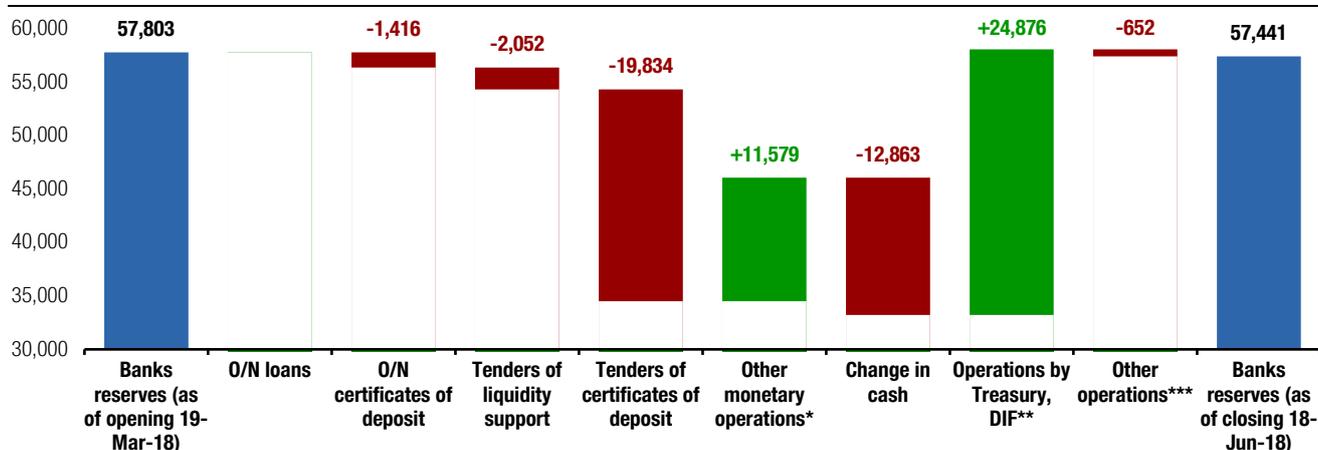


Chart 4. Banks reserves usages over last 90-day period (UAHm)



Notes: [1] data from the NBU's daily reporting https://bank.gov.ua/control/uk/publish/article?art_id=38643651&cat_id=40807142 ;

* operations repo, purchase and sale of government bonds, FX market interventions, stabilisation loans, FX swap agreements; ** DIF – deposit insurance fund;

*** interest payments on NBU's loans and on NBU's certificates of deposit, other operations. Source: NBU, ICU.

Foreign exchange market

Hryvnia depreciated 0.8%

The national currency's exchange rate could be volatile this week due to the beginning of budgetary tax payments and VAT refunding.

The first half of the previous week was relatively stable for the hryvnia; it was almost unchanged in a tight range. However, on Thursday and Friday, increased demand for foreign currency pushed the US dollar rate higher and the NBU was forced to sell USDs after its purchase in the beginning of the week. Net sales amounted to US\$4m, while total operations of the regulator reached US\$44m. The key rate hike by the Fed also favoured the dollar against emerging-markets currencies. Thus, the hryvnia depreciated by 0.8% to 26.36 USD/UAH last week.

The hryvnia's CPI-based real trade-weighted index (which includes currencies of 27 countries trade partners of Ukraine) increased 0.4% to 122.5 for the period. In year-on-year terms, real trade-weighted indices (CPI and PPI based) increased 7% and 13.7%, respectively, which implies faster prices growth in Ukraine compared with its main trade partners.

ICU view: We expect increased volatility of the UAH exchange rate this week on the back of the start of tax-payments and VAT refunding, which may cause imbalance

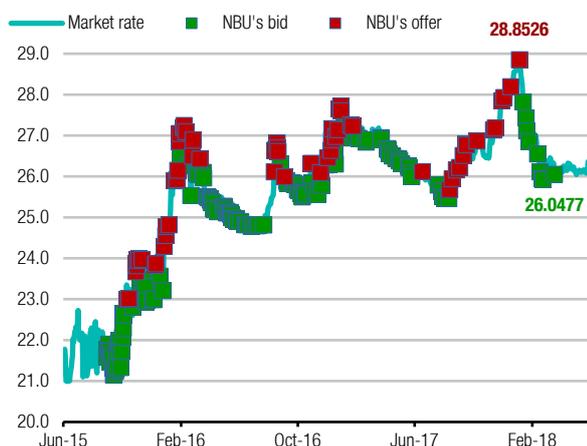
between supply and demand of foreign currency on the local market. The NBU will further sell foreign currency to restrain hryvnia's depreciation.

Alexander Martynenko, Kyiv, (044) 377-7040 ext.726

Artem Gladchenko, Kyiv, (044) 377-7040 ext.737

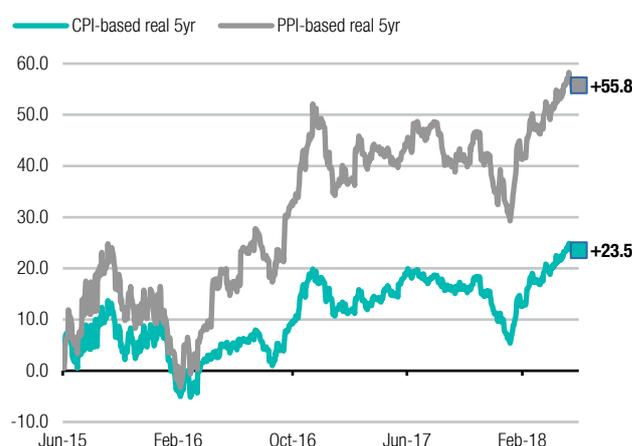
Chart 5. FX market indicators, 3-year history

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market



Notes: the chart provides labels for the average exchange rate at last two NBU auctions (one on buying FX from the market and one on selling it). Source: NBU, Bloomberg, ICU.

UAH exchange rate misalignment¹ from fundamental level² (%)



Notes: [1] "+" overvalued, "-" undervalued; [2] based on the UAH's CPI- and PPI-based real TWIs. Source: ICU.

Economics

The European Parliament approves EUR1bn aid for Ukraine

Ukraine may obtain the first tranche of the EU macro-financial aid (MFA) in the end of 2018. However, the key preliminary condition is that Ukraine restore cooperation with the IMF.

The European Parliament voted for the provision of a EUR1bn MFA to Ukraine. The funds will be provided as a loan at EURIBOR + 0.2% for a term of up to 15 years.

The credit arrangement with the IMF, and a satisfactory track-record of implementing IMF programme reforms are the key preconditions for granting the MFA. Also, the common statement of the European Parliament, the EU Council, and the European Commission mentions such conditions as the launch of the e-declaration verification system, verification of data on companies' ultimate beneficiaries, establishment of the anti-corruption court, and efforts to fight money laundering and tax evasion. MFA funds will be released in tranches strictly tied to the fulfilment of conditions aimed at strengthening macro-economic and financial stability.

ICU View: As Ukraine will need about \$6.1bn for payment of external debt in 2H2018 and in 2019, securing inexpensive financing such as EU's MFA programme is critical. In the case of a successful restoration of the programme with the IMF, Ukraine can expect the first tranche from the EU as soon as this year. But the success of cooperation with the IMF is still under question. Also, the additional terms and conditions of the MFA can cause difficulties in implementation by Ukrainian authorities, as was the case with the requirement of the EU to introduce automatic verification of e-declaration of assets.

Alexander Martynenko, Kyiv, (044) 377-7040 ext.726

Stockholm arbitration in favour of Naftogaz suspended

The lawsuit surrounding the Stockholm arbitration may drag on for a considerable amount of time and may become a part of the overall dispute between Naftogaz and Gazprom over Russian gas transit through Ukraine.

The Svea Court of Appeals upheld a petition from Gazprom and suspended the Stockholm Arbitration Court's decision to fine Gazprom a net amount of \$2.6bn in favour of Naftogaz in the gas-transit contract litigation. The Court ruled that there are reasonable grounds for the suspension of this decision, including suspension of attempts to arrest the assets of Gazprom in Europe.

At the same time, Naftogaz said in a press release that it considered such suspension temporary. They will appeal the Court's decision and present counterarguments. On Monday, Naftogaz's representative stated that the company has appealed the suspension to the Swedish Court of Appeals. Also, the commercial director of Naftogaz Ukraine, Yuriy Vitrenko, opined yesterday that litigation over the Stockholm Court's decision may last as long as three years.

ICU View: As we expected, the decision of the Stockholm Arbitration Court to levy a net penalty of \$2.6bn against Gazprom did not end the lawsuit, which can drag on for quite a long time. Also, it is possible that the penalty may be used by Naftogaz as leverage in future negotiations with Gazprom on the transit of Russian gas across Ukraine. So far, the two sides remain far from any compromise. In addition, the position of Ukraine's partners in the EU and the US on the construction of the gas pipeline Nord Stream-2 should play a critical role in the Naftogaz-Gazprom dispute.

Alexander Martynenko, Kyiv, (044) 377-7040 ext.726

Anti-corruption court legislation on its way

Ukrainian parliament still needs to pass supplementary bills to secure establishment and proper functioning of the HACC, as well as provide full compliance of the HACC law with the requirements of the IMF. Still, these procedures may be finalized by parliament as soon as this week.

The High Council of Justice supported the draft law on the formal establishment of the High Anti-corruption Court (HACC), which was prepared by the President Petro Poroshenko, according to UNIAN. As a result, the President was able to register this bill in the Ukrainian parliament yesterday.

Also, parliament registered the project on abolition of an amendment to the HACC law. This amendment would allow the appeal of graft cases sent by the National Anti-corruption Bureau of Ukraine to courts before the HACC to circumvent the HACC and be processed by ordinary courts. A number of watchers including Transparency International Ukraine and Anticorruption Center already said that the amendment violates the recommendations of the Venice Commission and the requirements of the IMF (sources: antac.org.ua, ti-ukraine.org).

Christine Lagarde, Managing Director of the IMF, in her statement yesterday applauded the adoption of the HACC law. However, she also noted that it is important for parliament to quickly approve the supplementary law submitted by the President, as well as the necessary amendments to restore the requirement that the HACC will adjudicate all cases under its jurisdiction (source: IMF).

ICU view: Adoption by parliament of the HACC law only partially meets the criteria of the IMF, which require full-scale establishment of the HACC, including its formation, functioning, and compliance with judicial legislation of Ukraine. To do this, parliament still must pass the President's law to create the HACC and pass appropriate changes

to the Law on the Judiciary and the Status of Judges. Parliament also needs to bring in the amendment allowing the HACC to deal with all corruption-related cases. Still, all the necessary supplementary laws may be passed by parliament as soon as this week. It remains to be seen whether the IMF approves the resulting anti-corruption court legislation.

Alexander Martynenko, Kyiv, (044) 377-7040 ext.726

This page is intentionally left blank



11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kyiv, 01030 Ukraine
Phone/Fax +38 044 3777040

WEB www.icu.ua



INVESTMENT ADVISORY

Makar Paseniuk, CFA, Managing Partner
makar.paseniuk@icu.ua

Ivan Shvydanenko, Director
ivan.shvydanenko@icu.ua

Roman Nikitov, ACCA Director
roman.nikitov@icu.ua

Yuriy Kamarytskyi, Vice President
yuriy.kamarytskyi@icu.ua

Ruslan Kilmukhametov, Director
ruslan.kilmukhametov@icu.ua

Ruslan Patlavsky, Director
ruslan.patlavsky@icu.ua

ASSET MANAGEMENT

Grigoriy Ovcharenko, Director
Head of Local Asset Management
grigoriy.ovcharenko@icu.ua

Liliya Kubytovych
Head of Marketing and Sales
liliya.kubytovych@icu.ua

TRADE OPERATIONS

Konstantin Stetsenko
Managing Partner
konstantin.stetsenko@icu.ua

Vlad Sinani, Director
Strategy and Business Development
vlad.sinani@icu.ua

Sergiy Byelyayev
Head of Fixed-Income Trading
sergiy.byelyayev@icu.ua

Yevgeniya Gryshchenko
Head of Brokerage Services Department
yevgeniya.gryshchenko@icu.ua

Vitaliy Sivach
Trader, Fixed-Income & Forex
vitaliy.sivach@icu.ua

Bogdan Vorotilin
bogdan.vorotilin@icu.ua

RESEARCH

Alexander Valchyshen
Head of Research
alexander.valchyshen@icu.ua

Taras Kotovych
Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Alexander Martynenko
Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv
Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Dmitriy Dyachenko
Junior financial analyst
dmitriy.dyachenko@icu.ua

Artem Gladchenko
Junior financial analyst
artem.gladchenko@icu.ua

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (license numbers: dealer activity AE 263019, broker activity AE 263018, underwriting activity AE 263020 dated 11 April 2013).

DISCLAIMER

This research publication has been prepared by Investment Capital Ukraine LLC solely for information purposes for its clients. It does not constitute an investment advice or an offer or solicitation for the purchase or sale of any financial instrument. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, Investment Capital Ukraine makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of Investment Capital Ukraine LLC. All rights are reserved. Any investments referred to herein may involve significant risk, are not necessarily available in all jurisdictions, may be illiquid and may not be suitable for all investors. The value of, or income from, any investments referred to herein may fluctuate and/or be affected by changes in exchange rates. Past performance is not indicative of future results. Investors should make their own investigations and investment decisions without relying on this report. Only investors with sufficient knowledge and experience in financial matters to evaluate the merits and risks should consider an investment in any issuer or market discussed herein and other persons should not take any action on the basis of this report.

Additional information is available upon request.

