



FINREP Focus

DOMESTIC GOVERNMENT DEBT MARKET

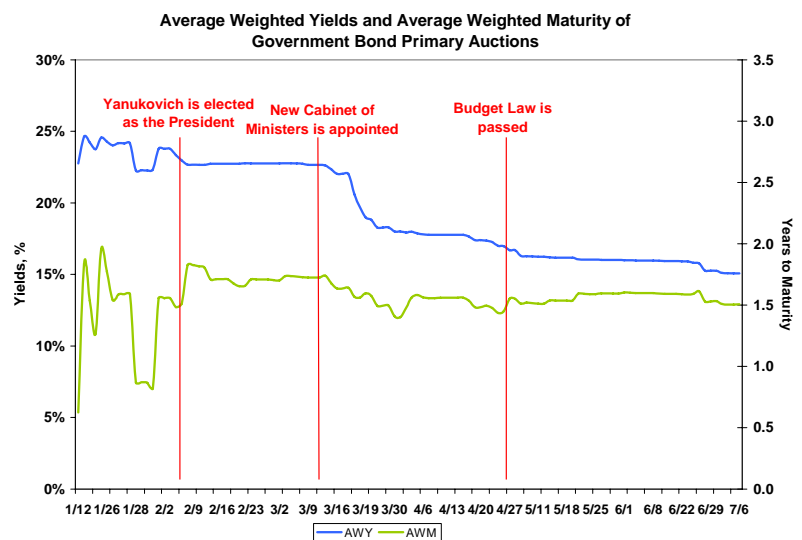
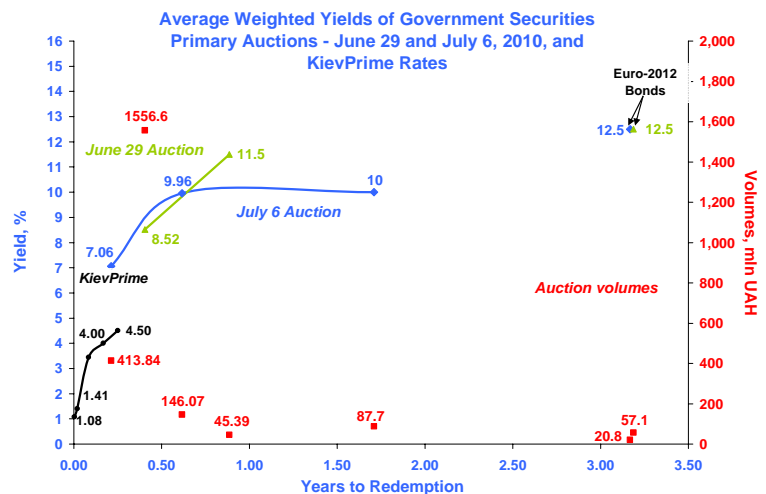
July 5-9, 2010

This week had plenty of positive news for Ukraine. First, the World Bank improved its forecast for Ukraine's GDP growth in 2010 from 2.5% to 3.5% (to UAH 1,071 bln), yet the inflation forecast was worsened from 10.6% to 11.9% still being more optimistic than the GOU estimate of 13.1%. This was followed by a long-desired staff-level agreement with the IMF on a new USD 14.9 bln Stand-By Arrangement for 2.5 years. However, in order for the IMF Board to approve this loan, Ukraine undertook to contain its budget deficit to 5.5% of GDP in 2010 and 3.5% of GDP in 2011. This may be quite problematic in particular due to the fact that current deficit figure does not take into account deficits of Naftogaz and Pension Fund. In addition, it does not address UAH 17.7 bln (1.6% of 2010 GDP est.) for the VAT bonds issue and UAH 5 bln (0.46% of 2010 GDP est.) for the State Agrarian Fund. The latter amount is stipulated by the budget law for interventions in the grain market. Price support appears necessary in light of a heavy crop anticipated this year.

Nevertheless, the positive message from the IMF was well received by the market. On Tuesday, Fitch upgraded Ukraine's long-term sovereign credit rating both in foreign and local currency from B- to B with a stable outlook. All this is likely to lead to a certain decrease in Ukrainian Eurobond yields creating a more favorable environment for a new issue planned for this year. During the MoF roadshow in Munich yesterday the investor interest for 10-year bonds was reportedly at 8.25%.

June became the third month of deflation with CPI dropping by 0.4%, and like in previous months this was caused by a seasonal drop in food prices. Whether this trend continues will depend a lot on the GOU decision regarding prices for gas and electricity for households. This question is likely to be raised again due to the recent agreement with the IMF providing for limiting of Naftogaz's deficit to 1% of GDP this year.

The Ukrainian banking system continues to enjoy high liquidity with correspondent bank balances hitting a new high of UAH 32.45 bln. That is why a further decrease of yields at Tuesday's auction came as no surprise for the market. The new lowest yield level of 7.06% was demonstrated by the reopening of 3-month bills which 2 weeks ago were placed at 9%. At the same time, under conditions of excess liquidity, placing by the MoF of such short-term instruments may cause competition between OVDPs and NBU's deposit certificates (89-day certificates were sold at 4.5%) thus interfering with central bank's monetary policy. Yields on 9-month and 2-year OVDPs this week also dropped from the results shown two weeks ago by 2% and 2.5% respectively. The trend for a decline in demand for Euro-2012 bonds continued with only one bid submitted and accepted at the unchanged 12.5%.



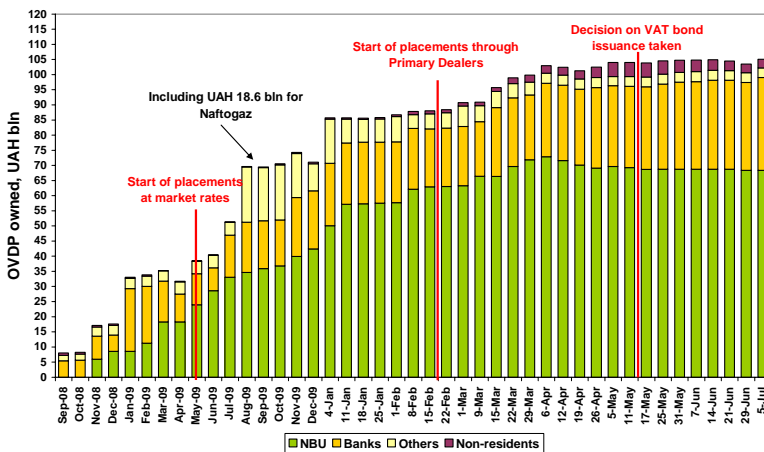


Total bids submitted and accepted were almost twice less than last week despite a further increase in bank's liquidity. Short-term bills turned out again to be the most popular accounting for 87% of all bids submitted. At the same time, the 10% rate for 2-year bonds may not reflect the market price since a UAH 80 mln bid accepted (out of total UAH 81 mln placed) was reported to be non-competitive.

Amounts Submitted and Awarded and Yields of Primary Auctions
(following the appointment of new CabMin)

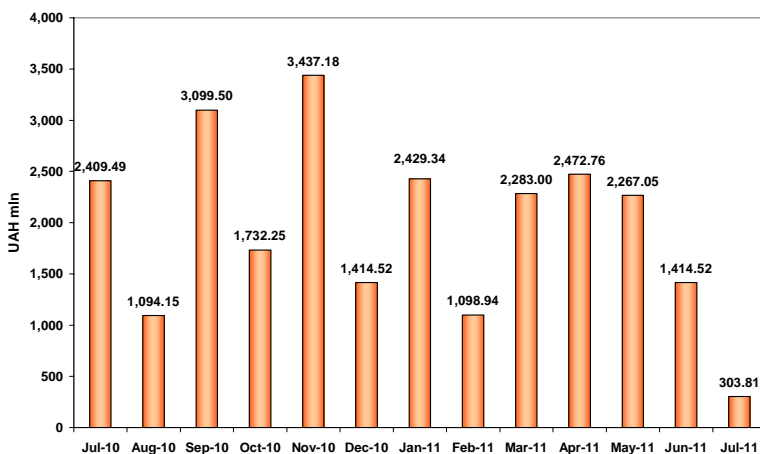
Auction Dates	Bids Submitted	Bids Accepted	Rates
3/16/2010	UAH 9.28 bln	UAH 686 mln	16%-17.3%
3/19/2010	UAH 3.4 bln	UAH 2.61 bln	11%
3/23/2010	UAH 5.43 bln	UAH 1.12 bln	11%-13%
3/30/2010	UAH 3.67 bln	UAH 2.34 bln	11.42%-14.58%
4/6/2010	UAH 1.23 bln	UAH 386.1 mln	14.27%-15%
4/13/2010	UAH 3.23 bln	UAH 3.5 mln	14.5%-15%
4/20/2010	UAH 5.28 bln	UAH 1.36 bln	12%-14%
4/27/2010	UAH 5.3 bln	UAH 2.86 bln	11.5%-13.92%
5/5/2010	UAH 2.58 bln	UAH 1.53 bln	11%-14%
5/11/2010	UAH 1.27 bln	UAH 450 mln	10.4%-13%
5/18/2010	UAH 2.37 bln	UAH 734 mln	11%-14%
5/25/2010	UAH 947 mln	UAH 187.2 mln	10%-14%
6/1/2010	UAH 670 mln	UAH 140 mln	11%-13%
6/8/2010	UAH 490 mln	UAH 71 mln	10.5%-13%
6/15/2010	UAH 706 mln	UAH 190 mln	11%-13%
6/22/2010	UAH 2.57 bln	UAH 1.05 bln	9%-12.5%
6/29/2010	UAH 3.02 bln	UAH 1.75 bln	8.52%-12.5%
7/6/2010	UAH 1.51 bln	UAH 676 mln	7.06%-12.5%

Dynamics of Domestic Government Bonds (OVDP) Holders



Non-resident holdings broke the 6-week downward trend and gained UAH 80 mln this week. Banks also increased their portfolio by UAH 1.6 bln which means that OVDPs are regaining their attractiveness, in particular as a liquidity management tool.

Domestic Debt Servicing and Repayment in 2010-2011



UAH bln

Date	Bonds Held by				Total
	NBU	Banks	Others	Non-residents	
6/29	68.38	29.01	3.23	2.86	103.48
7/5	68.37	30.65	3.17	2.94	105.13

This week's auction once again increased the repayment pressure on the second half of the year with amounts due in September crossing the UAH 3 bln line.