Contents

1. Stock Markets: Ukraine and the World

Leading stock markets of the world continued to grow during the 2nd quarter of 2019, albeit weaker than in the first one (Chart 1). This was facilitated by maintaining a moderate monetary policy with constant low interest rates by key central banks. At the same time, the IMF lowered its forecast for global economic growth in 2019 from 3.5% in January to 3.3% in April.

According to polls, back in April most global institutional investors did not expect an economic recession until the second half of 2020 or later. However, two-thirds had a bearish sentiment about the long-term dynamics of the world economy and inflation over the next 12 months. This was the highest predicted stagnation since October 2016. Emerging markets, while reducing the risk appetite of international investors, retained their greatest commitment, while developed European markets were virtually in a neutral position towards them. In this atmosphere of caution, bonds took precedence over stocks.

During May-June, investor sentiment became less optimistic due to the unresolved trade conflict between the US and China and the threat of its escalation, as well as against the backdrop of the slowdown in China's economy, which had began before the conflict began. However, investor confidence has increased somewhat and interest in EM Group assets, albeit somewhat weakened, has been maintained, given the expected decline in US Fed base rates, which should have left relatively cheap liquidity low and facilitated the search for more profitable markets and assets. For example, most investors in EM-based debt instruments were more likely to invest more in local high-yield bonds, including Egyptian and Ukrainian ones, which have been popular since April. At the end of Q2, demand for gold as a major asset increased overall in the world. Nonetheless, the US core indices in April-June 2019 showed a weak growth (+ 2.3-3.2%, after + 12.4-14.0% in the 1st quarter) and even accelerated annual dynamics (+ 8-10%).

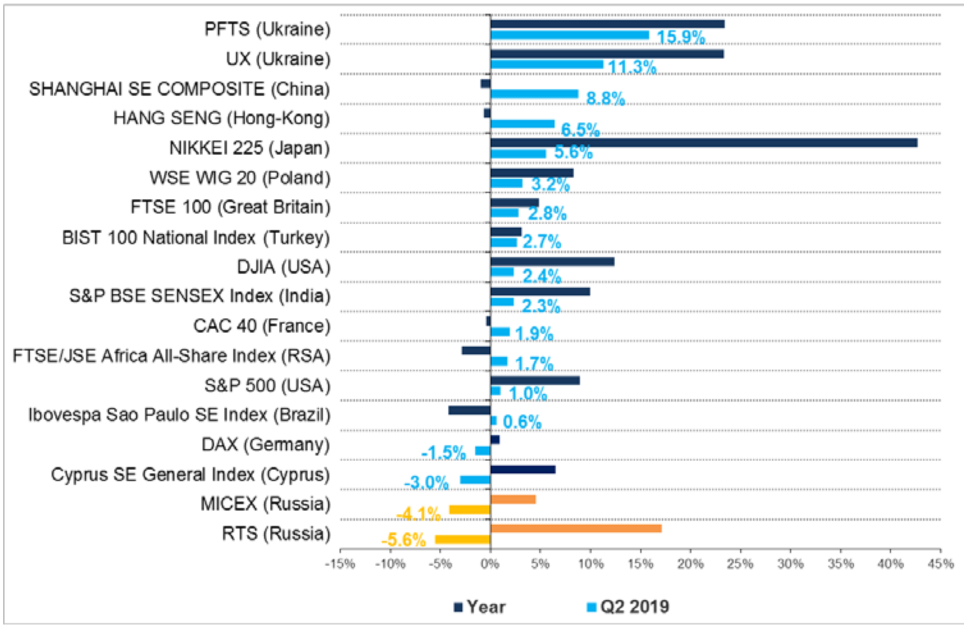

*Chart 1. Dynamics of the world stock indices in Q2 2019**

** Based on the data of exchanges and Bloomberg Agency. Ranking in the chart is based on annual indicator.*

Elections to the European Parliament took place in May, showing steady support for pro-European citizens, and the euro area and EU economies continued to (slowly) grow, with German GDP showing + 0.4% in Q1 2019 - the first increase since Q3 2018, which was a encouraging signal for international markets[1]. The key stock index of the main engine of the EU economy grew by 6.5% in the second quarter compared to the indicators of other leading countries of the bloc. This was weaker than in the first one (+ 9.2%), but brought down its previously negative annual figure from almost zero. Shares of key companies in the EU's second largest economy, France, added only 2.7% in

[1] *However, according to the German Bureau of Statistics published in August, in the 2nd quarter of 2019, the country's GDP decreased by 0.1% yoy, and according to Eurostat, for the EU this indicator decreased from + 0.4% in the 1st quarter to + 0.2% in 2nd.*

April-June in a tightened domestic situation (after + 14.4% in January-March). In June, their annual growth decreased slightly compared to March (to + 3.1%).

The UK, in the course of its EU negotiations, finally agreed to at least postpone the Brexit withdrawal date to 31 October, but remained without an agreed exit agreement and further relations with it. Prime Minister May's resignation thereafter did not add confidence to the problem. Britain's financial sector, in particular asset management, has suffered the most under these conditions due to the transfer of resources to other European jurisdictions and the decline in business profitability. Finally, during the 2nd quarter of 2019, the core British stock index rose 1.7% (after + 8.1% in Q1), but lost almost 3% in the year.

In Poland, the stock market slightly slowed its growth to 1.0% in Q2 2019 (from + 1.6% in Q1), accelerating year-over-year (from + 4.6% in March to + 9.0% in June).

Against the background of geopolitical and trade complications in the world, Japanese stocks showed volatile dynamics this quarter, and by the end of June they had only + 0.6% compared to March. By this time, they were also 4.2% below their level last year - one of the factors behind the deterioration of the annual current indicator was the appreciation of the yen against the US dollar.

Emerging markets in April-June 2019 had a very diverse dynamic and ended Q2 with a generally broader range of results than developed markets, although most of the former showed growth at the same levels as the second. The tense situation in China's relations with the US as well as in its domestic politics (protests in Hong Kong), weakening in the economy, as well as extraordinary growth in Q1, led to a fall in the key Chinese index in Q2 by 3.0% (along with a 1.5% drop in Hong Kong's blue chips). However, a rapid take-off in early 2019 allowed Chinese stocks to show an increase in the first half of the year, and the annual trend shifted to a positive zone at the end of June (+ 6.5%).

The Turkish index during this period outperformed some developed markets (+ 1.9%, after + 3.7%), although investors doubted the stability and effectiveness of the country's financial and credit policy, which was reflected in the lack of growth of the stock market over the last year (-0.4%). Brazilian stocks continued to slow down in the 2nd quarter (+ 5.6% after + 8.6% in Q1), but maintained the first annual yield (+ 42.7%). Russia's indexes led the quarterly increase (+ 11.3-15.9% in the 2nd quarter, after + 5.4% -12.4% in Q1). This happened despite the fact that at the end of May - in early June, oil fell sharply, which led to a fall in its prices for April-June by almost 3%. However, the ruble, along with Thai, Egyptian and Ukrainian currencies, was among the world leaders in growth (the Bank of Russia lowered its key rate for the first time since the beginning of 2019 in June), which in particular supported the more dynamic growth of the RTS dollar index compared to the MICEX.

The Ukrainian stock market underwent the second quarter of 2019 with a decline and had one of the worst results in April-June and the first half of the year (-4.1-5.6% and -3.1% respectively). Following the April failure of both major stock indices (UX and PFTS) against the backdrop of political turbulence between the two rounds of Ukraine's presidential election, domestic blue chips quickly recovered to March levels and rose in May; however, a correction was made in early June that determined the quarterly total. One of the main drivers of the downward trend is the decline in international speculative investors' demand for emerging markets, due to a reduction in their global risk appetite and the approaching end of the economic cycle, discussed above. This traditionally primarily affects the most risky (the most volatile, but also potentially the most profitable) markets to which Ukraine belongs. The very small market size and shallow liquidity still make it highly dependent on external players, while weak domestic demand and lack of progress in privatization hinder its vulnerability. Some additional pressure on the market was caused by the decision of the President-elect to suspend the powers of the Verkhovna Rada, which nevertheless added political uncertainty for the next few months and halted consideration of necessary changes to the legislation of Ukraine, including bills and related legislation development of capital markets and financial services, introduction of the 2nd tier (cumulative component) of the pension system.

Further, during April-June, a series of positive developments took place in Ukraine regarding the regulation of the financial sector, which could further stimulate the inflow of both portfolio and direct investments into the local economy. The successful conduct and emergency of the presidential election with the election of an out-of-state new politician have also been praised by the international community as a demonstration of democracy in action and perceived as unmet demand by Ukrainian citizens for deep reforms, above all for the implementation of the constitutional provision on Ukraine as a rule of law. Therefore, effective judicial reform remained the biggest demand of external stakeholders and potential investors in Ukraine, along with further modernization of the economy and opening it to foreign markets.

In this regard, for the gradual transition of Ukraine to free movement of capital, the National Bank in April granted new financial market entities in Ukraine - foreign companies, including foreign investment funds and asset management companies acting on behalf of such investment funds, - to open accounts in banks of Ukraine and carry out currency transactions through such accounts. This was made possible by the recently enacted Laws of Ukraine on Currency and Currency Transactions (February 2019) and on Amendments to Certain Laws of Ukraine on Promoting Foreign Investment (November 2018), as well as the Association Agreement between Ukraine and the European Union.

With regard to macro-financial stability, the Minister of Finance of Ukraine shared the experience of Ukraine in stabilizing the economy since 2014 and transitioning to sustainable growth at the G20 conference in May in Paris, entitled "A sustainable debt for sustainable growth: sound financing for development" war in the east. Thus, the government reduced the ratio of government debt and government guaranteed debt to GDP from 80.9% in 2016 to 60.9% in 2018, and in 2019 it fell even lower, giving reason to expect the Ministry of Finance's medium-term objective to reach 49% by the end 2020.

Also, according to a survey of participants in the international capital markets at the GlobalCapital Bond Awards 2019, which is the main reward in the bond market, Ukraine was recognized as the second best in the category "Most impressive CIS issuer or former CIS participant" (in the previous year Ukraine raised $ 2 billion. by placing Eurobonds).

At the end of May, the international securities depository Clearstream established direct correspondent communications with the NBU, in accordance with the agreement signed in March, which opened up opportunities for foreign investors to acquire and work with Ukrainian government bonds much faster, easier and more effectively. This was accompanied by an increase in the volume of purchases of domestic hryvnia bonds by non-residents, as it happened in the conditions of the almost highest real yield on such securities in the world (their coupon income was at the level of 16-19.5% per annum during the quarter, while the NBU discount rate was 17.5% and the NBU discount rate was 17.5% close to 9%). The demand for these government bonds strengthened further against the hryvnia against the US dollar and the euro during this period, as the hryvnia entered the leading currencies of growth since the beginning of the year and kept trend throughout the quarter (+ 2.8% in April-June and 6.7% in the 1st half of the year). 2019).

In general, during April-June 2019, the Ministry of Finance conducted 12 weekly auctions for the placement of government bonds, which attracted UAH 99.2 billion in the state budget. in equivalent, 98.7% of them are on hryvnia bonds. At the same time, the volume of government bonds held by non-residents increased almost 9 times from the beginning of 2019 to the end of June, and only a month since the launch of the link between NBU and Clearstream - by one third to UAH 56.2 billion. (including UAH 54.3 billion - nominated in UAH). Thus, foreign investors increased their share of the domestic debt market exponentially during the first half of the year: if they owned 0.8% of government bonds in early January (1.6% excluding NBU-owned government bonds), then by the end of June they were already 7.3% (12.9% respectively). At the same time, 97% of government bonds purchased by non-residents were denominated in UAH, and their share in placed government bonds, excluding NBU proper, rose from 2.3% to 16.5% in the six months to June[2]. This can be considered a healthy trend, given the potential for further growth when comparing international investors' participation in the domestic market with other developing countries (30-40%), and given the incentives actually provided for such external support for hryvnia exchange rates.

The large-scale inflow of foreign currency from the acquisition of the state bonds allowed the NBU, after some reduction in April-May, to replenish its international reserves by the results of Q2 by $ 1.2 billion and restore them to March level ($ 20.6 billion), which eventually allowed to cover enough comfortable 3.4 months of import.

Global sovereign debt investors during this period were also able to buy hryvnia eurobonds in foreign markets - thanks to issues made in particular by the International Finance Corporation (IFC), in addition to previously issued EBRD bonds.

The State Statistics Committee revised upward growth of real GDP of Ukraine in Q1 2019 (from + 2.2% to + 2.5%), and according to preliminary data for the 2nd quarter, estimated it at + 4.6% yoy, which significantly exceeded the expectations of various Ukrainian and

[2] As of 16.08.2019, the volume of government bonds owned by non-residents increased to UAH 87.7 billion, i.e. up to 11% of all government bonds in circulation (18.9% excluding government-owned government bonds in general and 23.9% for UAH-denominated government bonds in particular).

international institutions and forced them to start reviewing their forecasts for the whole of 2019. As of May, the World Bank has maintained its forecast for the Ukrainian economy at + 2.7%, which also corresponded to the IMF estimate in April and was higher than the forecast of the National Bank of Ukraine at that time[3]. The Ukrainian economy has been steadily growing for the fourth consecutive year (quarterly since Q1 2016). At the same time, the long-term downward trend in inflation (CPI) remains broad, although in the second quarter of 2019 it increased slightly: from 8.6% yoy in March to 9.0% in June. Given the increased inflation risks since the decision to reduce the interest rate in April by 0.25 in. to 17.5% per annum against the backdrop of favorable price dynamics in the previous few months, in June the NBU kept the discount rate unchanged, which should also serve the goal of 5% ± 1 pp. inflation next year.

In Q2 2019, the stock market moved downward not only in terms of stock indices dynamics but also in terms of market volume: the total number of securities issues admitted to trading on the stock exchanges, the number of listed securities and the volume of trading continued to decrease on the exchanges.

The consolidated stock list of all existing exchanges in April-June 2019 decreased by 11.0% (after -16.7% in January-March, Table 1), and thus, as of June 30, 2019, there were 28.6% fewer issues than the year ago (acceleration of the fall from -1% at the end of March). At the same time, the number of "listed" securities (those in the stock registers) decreased by 18.4% (after -3.2% in the 1st quarter) - at the expense of government bonds (-19.3%, after 2.8%). The number of other types of "listed" securities in the second quarter did not change: there were three such shares (taking into account MHP S.A.'s depository receipts) - one and a half times less than a year ago; of corporate bonds - 10 (-16.7% for the year). Thus, at the end of June 2019, the share of the state bonds in the listing of exchanges decreased slightly compared to March - from 95% to 94%[4].

The composition of the index basket of the UX index remained unchanged until the end of June (4 power companies, one - machine building and one bank) and again in the 2nd quarter only the weight of four shares in it was again. Similar was the situation with the PFTS index basket, which retained its 7 components since the beginning of the year (5 stocks that were in the UX index and also changed weight in the PFTS index, as well as one machine-building and one telecommunications company).

Table 1. Dynamics of the stock market of Ukraine in Q2 2019

Indicator / Date	30.06.2018 (Q2 2018)	31.12.2018 (Q4 2018)	31.03.2019 (Q1 2019)	30.06.2019 (Q2 2019)	*Q2 2019 change*	*YTD*	*Annual change in Q2 2019*
Number of Securities in the listing of stock exchanges, incl.:	**917**	**884**	**736**	**655**	***-11.0%***	***-25.9%***	***-28.6%***
Number of securities in the registers (listing) of stock exchanges, incl.:	**346**	**377**	**365**	**298**	***-18.4%***	***-21.0%***	***-13.9%***
State bonds (OVDP)	**322**	**357**	**347**	**280**	***-19.3%***	***-21.6%***	***-13.0%***
equities*	**6**	**5**	**3**	**3**	***0.0%***	***-40.0%***	***-50.0%***
corporate bonds	**12**	**10**	**10**	**10**	***0.0%***	***0.0%***	***-16.7%***
municipal bonds**	0	0	0	0	*x*	*x*	*x*
NBU deposit certificates	0	0	0	0	*x*	*x*	*x*
Trading volume on all stock exchanges in total, UAH M, incl.:	**56 932.3**	**61 608.8**	**76 342.5**	**72 141.4**	***-5.5%***	***17.1%***	***26.7%***
State bonds (OVDP+OZDP)	**54 725.4**	**56 663.2**	**73 155.4**	**70 347.1**	***-3.8%***	***24.1%***	***28.5%***
equities	**326.5**	**171.6**	**165.8**	**98.2**	***-40.8%***	***-42.8%***	***-69.9%***
corporate bonds	**1 262.1**	**4 160.0**	**2 790.1**	**1 478.3**	***-47.0%***	***-64.5%***	***17.1%***
municipal bonds	0.0	0.0	0.0	5.4	*x*	*x*	*x*
NBU deposit certificates	0.0	0.0	0.0	0.0	*x*	*x*	*x*
investment certificates	24.9	199.8	169.1	131.0	*-22.5%*	*-34.4%*	*425.7%*
derivatives (excl. state derivatives)	593.4	414.3	62.1	45.3	*-27.0%*	*-89.1%*	*-92.4%*

Sources: data on securities in lists of stock exchanges and trading volumes – NSSMC, stock exchanges; calculations – UAIB.

** Including depositary receipts of MHP S.A., excluding CIFs equities and investment certificates of UIFs (as at 30.06.2019 there were 5 of them: equities of 4 CIFs and IC of one UIF). ** As at June 30, 2019, there were five issues of municipal bonds on the SEs lists (two of Lviv City Council and three of Ivano-Frankivsk City Council), which were 'out of the listings'.*

[3] *Already in July, the NBU raised its economic growth forecast for 2019 (from 2.5% to 3%) and 2020 (from 2.9% to 3.2%): https://bank.gov.ua/control/uk/publish/article?art_id=99977772&cat_id=55838. Already in mid-August, after the release of preliminary data from the State Statistics Committee for the 2nd quarter of 2019, the international investment bank Morgan Stanley raised the forecast of real GDP growth of Ukraine in 2019 from 2.4% to 3.7% (see https://www.bloomberg.com/news/articles/2019-08-15/as-europe-struggles-ukraine-s-economy-heads-for-an-upswing).*

[4] *As of June 30, 2019, there were 186 issues of shares in the total number of listed securities, including 182 ordinary shares (after 201 and 197 respectively in March) and 82 corporate bonds (after 84 in March), and the share of the state bonds among all exchange-traded securities decreased for the 2nd quarter of 2019 from 47.1% to 42.7%.*

The aggregate quarterly trading volume on all exchanges in the 2nd quarter of 2019 decreased by 5.5% (after + 24% in Q1) and amounted to **UAH 72.1 billion**. The share of the state bonds transactions increased further - from 95.8% to 97.5%, as the volume of exchange trades decreased much less than other instruments (-3.8%, after + 29.1% in Q1).

Thus, the aggregate value of stock transactions in April-June 2019 fell 40.8% (after -3.4%) - against the backdrop of a decrease in the volume of trading in PFTS by 60%. The fall in the quarterly annual trading volume in June 2019 decelerated slightly to almost -70% (from -71% at the end of March) and was still attributable to a stop in full-fledged trading on the UX in Q3 2018.

The volume of corporate bond transactions in the 2nd quarter of 2019 fell by another 47.0% (after -32.9% in Q1), though it was 17.1% higher than a year ago.

In contrast to Q1, which once again changed the direction of trading in investment certificates and derivatives, their negative trend remained in Q2: the volume of exchange trades with the former decreased by 22.5% (after -15.3%), the latter - by 27.0% (after -85%). Although the volume of trades in investment certificates increased more than 5-fold in April-June, these instruments accounted for only 0.2% of the total value of traded deals.

2. Asset Management Industry

2.1. Number of AMC, CII, NPF and IC with assets under management

In Q2 2019, the Ukrainian asset management industry continued to grow quantitatively - in terms of number of funds (CII) - and in value. ***The number of active asset management companies*** decreased from 298 in March to 295 as of 30.06.2019 (Chart 2).

According to UAIB, no new AMCs were created during the quarter. AMCs with funds under management in June 2019 also decreased by three to 280, but they had from one to 36 funds under management (in March - a maximum of 34). More than 99% of all AMCs have managed at least one venture CII.

During April-June 2019, *30 new CIIs* (all venture capital) were registered. Taking into account those that closed during the 2nd quarter, as of 30.06.2019, ***the number of existing registered CII***, according to UAIB, increased to ***1822*** (+1.6% for the 2nd quarter, after +0.6% in Q1). Therefore, the dynamics of new fund creation remained positive for the 15th consecutive quarter and accelerated.

The number of formed CIIs that reached the minimum asset standard ("recognized" CII) also maintained an upward trend in the 2nd quarter of 2019 and reached **1259** by the end of June (+17 funds, or +1.4%, after +1.0% in Q1) [5].

The acceleration of the market for new funds during this period was accelerated mainly due to the demand for CIFs (22 of the 30 newly created CIIs and the 31st fund that reached the norms. Instead, 9 mutual funds were recognized during Q2.

The number of non-state pension funds (NPFs) in management as of 30.06.2019 has not changed - 58 (excluding NBU fund), including 45 open, 7 corporate and 6 professional ones. However, the number of AMCs managing the assets of the NPF decreased from 34 in March to 33 in June.

The number of insurance companies (ICs) that transferred their assets to AMC's management in the 2nd quarter of 2019 remained unchanged (two), as did AMCs that provided such services (one).

[5] *Growth figures for Q2 and Q1 2019 as well as the data on the general number of acting CII, which have reached compliance with the standard, for Q2 2018 through Q1 2019 in the Chart 2 have been corrected due to the new/correct respective data received (one fund has been added for Q2 and Q3 2018, two funds for Q4 2018 and 5 funds for Q1 2019).*

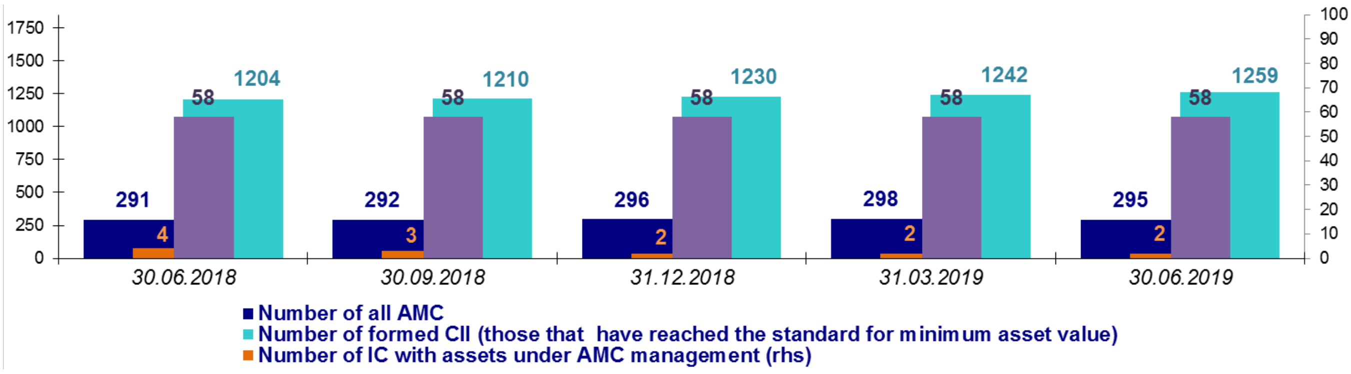

Chart 2. Dynamics of the number of AMC and CII, NPF and IC with assets under AMC management in Q2 2018-2019

2.2. Assets under management, CII NAV and Net Inflow of Capital in Open-Ended CII

The aggregate total assets of all institutional investors under AMC management increased by 6.9% in the first quarter of 2019 and as at 31.03.2019 amounted to ***UAH 336,435.1 M.*** On an annual basis, since March of 2018, they increased by ***21.5%.***

The total assets of CII under management, including those that have not yet reached the norms for minimum asset value, also increased by 6.9% in the first quarter, and for the year – by 21.6%, to ***UAH 334,882.4 M.***

The total assets of operating CII, which were managed by AMC and reached the standards ("recognized" CII), as at 31.03.2019 amounted to ***UAH 317,437.5 M.*** (Chart 3). In the 1st quarter of 2019, they added 7.0%, and for the last 12 months - 15.7%. At the same time, assets of *venture CII* increased by 7.3% in January-March and by the end of the 1st quarter amounted to *UAH 300,241.7 M.* (+13.0% for the year).

The assets of open-ended and interval funds fell slightly again in the first quarter of 2019 (of open-ended ones - very insignificantly), but *closed-end funds with public placement* recovered after subsidence as at the end of 2018, partly due to the dynamics of Ukrainian stock indices.

Assets of NPFs under the AMC management in the 2nd quarter of 2019 increased by 5.6% (after + 4.4% in Q1), in the 1st half - by 10.3%, again increasing the annual growth - to + 19.0% in June (from + 17.1% in March). As of 30.06.2019, they reached **UAH 1,505.1 million.**

Assets of IC under the AMC management for the 2nd quarter of 2019 increased by 3.5% (after + 12.0% for the 1st), slowing down year-on-year further from -15.9% in March to -13.8% in June. As of 30.06.2019 these assets amounted to ***UAH 92.7 million.***

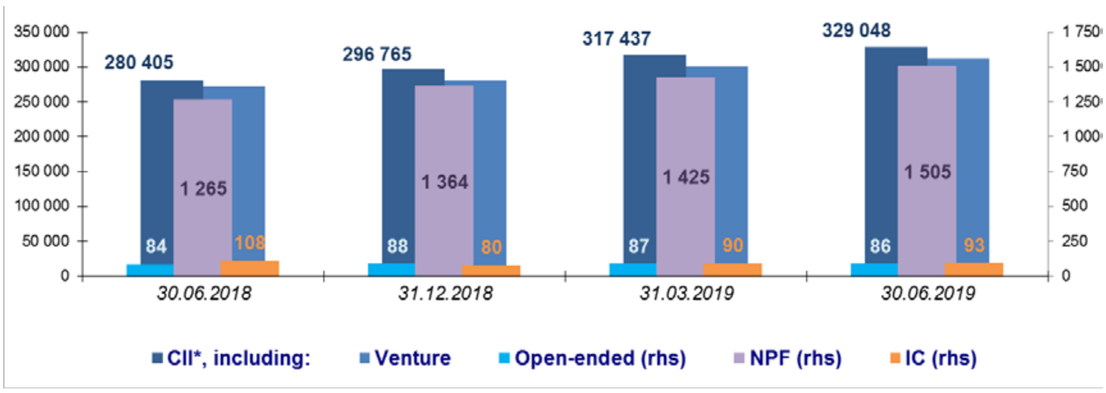

Chart 3. Dynamics of the value of assets under management in Q2 2018-2019, UAH M

The value of net assets (NAV) of the formed CII, which reached the norms, in the 2nd quarter of 2019 increased by 3.3% (after + 4.6% in Q1) and reached ***UAH 254 784.1 million*** as of 30.06.2019. From the beginning of the year NAVs of the industry grew by 8.0%, and for the year in June - 16.2% (from + 12.1% in March). The weaker growth in the net assets of the CII industry compared to its total assets was due, as before, to a partial (but much more limited compared to Q1) increase in assets of venture capital funds at the expense of leverage.

Venture CII in the 2nd quarter of 2019 increased their NAV by 3.7% (after + 4.8% in Q1) to UAH 239 679.7 million. Since the beginning of the year, this sector has increased by 3.7% on net assets, and in the year in June - by 13.2% (after + 9.1% in March). Thus, their share in the aggregate net assets of all operating CIIs continued to grow - from 93.7% at the end of March 2019 to 94.1% in June.

Open-end CII (the same existing 17 funds as in March and early 2019) experienced a rapid decline in the value of net assets in the 2nd quarter (-1.5%, after -0.1% in Q1), which was determined as net outflow of capital from these funds, and partially negative revaluation of portfolios in the conditions of decrease of domestic stock indices by 4-6%. Since the beginning of 2019 the NAV of these CIIs lost 1.6%, but in the year to the end of June it added 4.1%, which contributed to the growth of the stock market during this period and occurred despite a net outflow of these CII. As of 30.06.2019 the NAV of open-ended funds equaled UAH 86.0 million.

Total net capital outflow from open-end CII decelerated to UAH -1.5 million in Q2 2019 (from UAH -2.1 million in Q1, Chart 4), and 2/3 of it fell into two equity funds. At this time, international capital markets also experienced mainly capital outflows from such funds and similar investment strategies.

The annual capital flow in open-end CII in the 2nd quarter of 2019 accelerated the negative dynamics to UAH -5.4 million. (from UAH -1.2 million in Q1).

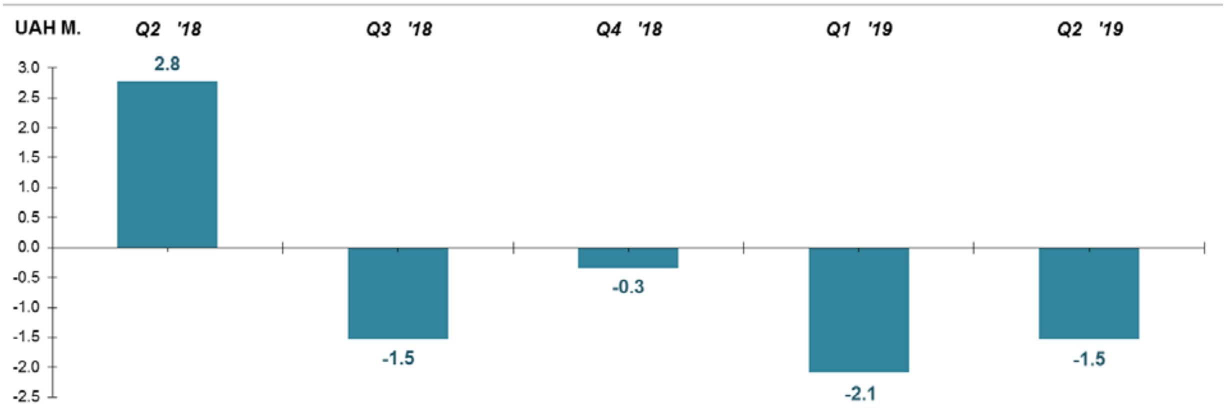

Chart 4. Net inflow/outflow of capital in open-ended CII in Q2 2018-2019

For more detailed information on the performance of CII, NPF and IC asset management markets, see special UAIB reviews, which will be published on the website: http://www.uaib.com.ua/analituaib/publ_ici_quart.html

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