



Fixed Income Weekly

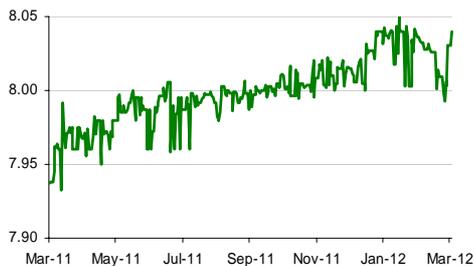
March 26, 2012

Ukraine Economy | Interest Rate Strategy | FX Strategy

	Today	Week ago*	Change
Global indicators			
UST 2Y, %**	0.28	0.29	-1
UST 10Y, %**	1.99	1.94	5
LIBOR 3M, %**	0.47	0.49	-1
EURIBOR 3M, %**	0.93	0.99	-6
Oil (Brent), USD	124.05	121.55	2.50
Baltic Dry (BDIY, pts)	771	738	33
Sovereign risk			
CDS 1Y bp	514	681	-167
CDS 5Y bp	755	776	-21
Ukraine 13, YTM%**	7.8	8.5	-63
Ukraine 16, YTM%**	8.8	8.7	8
Ukraine 20, YTM%**	9.6	9.4	13
Currency			
USDUAH	8.04	7.9923	0.0477
EURUSD	1.3225	1.3458	-0.0233
NDF 1M outright	8.09	8.09	0.00
NDF 6M outright	8.51	8.595	-0.09
NDF 12M outright	9.44	9.395	0.04
12M NDF Implied Yld%	18.4	18.4	-0.02
Local interest rates			
KievPrime, O/N %	1.1	5	-3.90
KievPrime, 1M %	12.9	13.5	-0.60
Wide interbank rate, % (UKIRAWIR)	3.4	8.4	-5.00
1Y OVDP, YTM % (bid)	14.75	14.75	-0.00
VAT bonds, YTM % (bid)	17.30	17.50	-0.20
Banking s. liquidity, UAH bn	20.15	20.87	-0.72

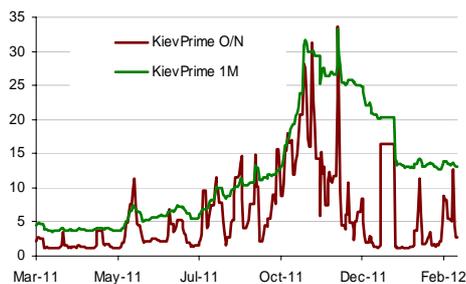
*Change over the last 7 calendar days; **change in bp

USD/UAH Spot



Source: NBU

KievPrime O/N and 1M



Source: Bloomberg

- **Ukraine's Eurobonds had a mixed week**
- **Central bank reported end-2011 Ukraine's external debt statistics**
- **NBU cut base refi rate by 0.25% to 7.50%, introduced some rebalancing concerning mandatory reserves**
- **MinFin mulls issuance of \$OVDPs with 3m-6m put options, EUR denominated bonds**
- **The government has placed bonds worth UAH1.9 bn last week**

Ukraine's Eurobonds had a mixed week

Yields of short-term bonds were contracting after some overreaction to possibility of "restructuring" of debt to IMF. Following reassurances of both government and IMF officials, the yield on short-term sovereign notes declined. Cost of 1Y insurance for Ukraine's sovereign debt was down 167 b.p. (to 514 b.p.). Also, news sources reported Mr. Kopylov, Deputy Economy Minister (who made Bloomberg headlines on "restructuring" earlier this month) made redundant today, officially switching to a new job as PM advisor.

Ukraine has postponed plans of Eurobond issue, "looking at various funding opportunities" such as issue of bilateral/syndicated loan, RUB denominated Eurobond. **In our understanding the government does not face immediate funding pressures in foreign currency and thus can use some time to work out a better yield for its new debt.**

Central bank reported end-2011 Ukraine's external debt statistics

The key messages are:

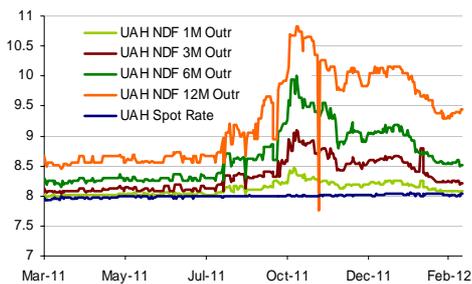
- the key currency of external debt of Ukraine remains USD (72%), SDR and EUR denominated debts are 13% and 10% respectively;
- short-term external debt (to be redeemed over the course of 2012) is \$56.8bn (+\$6.6 bn in 2011), share of short-term debt in funding mix is 45%;
- banks and government were deleveraging in Q42011
- Ukrainian companies managed to increase gross external debt by \$4.5 bn or by 8% q/q in Q4. Provided overall inability of international capital markets to provide loans at the time, this supports the idea of Ukrainian external debt being primarily driven by intra-group loans.

UAH spot rate marks time in a narrow range of 8.022-8.026.

Central bank is absent on the market, probably buying insignificant volumes of "alternative" currencies. This "steady state" on FX market supports the idea that NBU should not have any problems defending UAH at least until the October elections. Furthermore, some insignificant strengthening of local currency might be in the cards due to approaching EURO-2012 soccer championship.



NDF outright rates



Source: Bloomberg

NDF curve becomes even more steep. Rates on the short end are gradually declining due to low local rates in UAH while rates on the long end remain unchanged. 1Y USDUAH NDF was quoted 9.45/967 that corresponds to 18.9%/20.4% in terms of implied yields.

Banks are enjoying UAH20bn+ of banking system liquidity. While we expect that sowing season should take its toll, our liquidity outlook remains positive at least for the next few weeks. **KievPrime 1M rate is testing 10% level** which we expect to be taken within the next few weeks. Overnights are quoted around 1%.

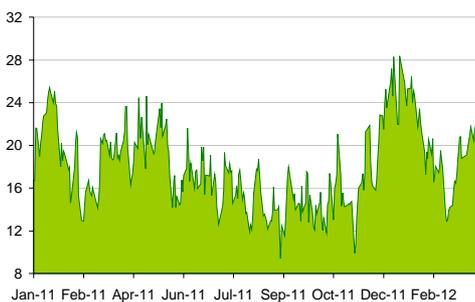
NBU placed UAH810 mn worth of deposit certificates last week. 94% of funds (UAH 760 mn) were placed for durations of up to 7 days. NBU paid 1% for 4 days CD and 2.50% for 7 days CD. The highest rate set for CDs (85 days) was 6.8% The combination of high placement volumes and very low interest rates tells us that banks are overliquid to a point where they don't find opportunities to place funds with the money market.

NBU cut base refi rate by 0.25% to 7.50%, introduced some rebalancing concerning mandatory reserves

Last week central bank issued Regulation #102, which stipulated a decline in base refi rate and altered conditions regarding mandatory reserves (effective April 1st):

- (a) reserve requirement for all types of short-term FX deposits was up by 0.5% - to 8.0% for deposits of up to 1 year and to 8.5% for deposits "on demand";
- (b) proportion of mandatory reserves that is required to be held on correspondent amount with NBU was decreased by 10% to 60%;
- (c) mandatory reserving norm for funding in RUB attracted from non-residents is set at the level 0% instead of 2% for other foreign currencies;
- (d) the minimal level set for standard NBU's nostro account controlled on the beginning of each day is increased from 25% to 30% of average mandatory reserves for previous month.

Banking System Liquidity, UAH bn



Source: NBU, UkrSibbank

Impact of Reg#102 on liquidity is neutral, higher mandatory requirements shall be offset via more flexibility in intraday liquidity management.

- immediate impact of changes in base rate is zero. We expect central bank to lower by 0.25% interest rates for covered and blank NBU loans (currently 8.75% and 10.75%) following changes in base rate.
- banks would have to freeze around UAH1 bn in additional mandatory reserves.
- Banks shall receive about UAH1.2bn more for their intraday operations.



Primary auctions schedule

	UAH	USD-linked	USD
01.03.2012	6M, 12M, 2Y,3Y	3Y	
06.03.2012	3M, 12M, 2Y		1.5Y,3Y
13.03.2012	12M, 2Y		1.5Y,3Y
15.03.2012	6M, 12M, 2Y, 3Y		
20.03.2012	3M, 12M, 2Y		1.5Y,3Y
22.03.2012	6M, 12M, 2Y, 3Y		
27.03.2012	6M, 12M, 2Y		1.5Y,3Y
29.03.2012	6M, 12M, 2Y,3Y	3Y	

Source: MinFin

Primary auctions results, Mar 20

# of Auction	101	102	103	104	105
ISIN (short)	137509	136824	137277	136832	133771
Currency	UAH	UAH	UAH	USD	USD
Maturity (days, M, Y)	3M	12M	2Y	1,5Y	3Y
Cut-off yield	12,00%	14,50%	15,00%	9,30%	-
Weighted average yield	11,98%	14,50%	15,00%	9,30%	-
Highest bid	11,50%	14,50%	15,00%	9,30%	-
Lowest bid	12,75%	14,50%	15,00%	9,30%	-
Bids submitted, mn	672,56	250	200	47,25	0
Number of bids	30	3	1	7	0
Number of bids accepted	10	3	1	7	0
Bids accepted, mn	360	250	200	47,25	0
Amount raised, mn	349,6	219,5	201	47	0

Source: MinFin

Primary auctions results, Mar 22

# of Auction	106	107	108	109
ISIN (short)	137608	136824	137277	-
Currency	UAH	UAH	UAH	UAH
Maturity (days, M, Y)	6M	12M	2Y	3Y
Cut-off yield	12,50%	14,50%	-	-
Weighted average yield	12,50%	14,50%	-	-
Highest bid	12,50%	14,50%	-	-
Lowest bid	13,00%	14,50%	-	-
Bids submitted, mn	725	300	0	0
Number of bids	19	1	0	0
Number of bids accepted	4	1	0	0
Bids accepted, mn	370	300	0	0
Amount raised, mn	348,5	263,6	0	0

Source: MinFin

MinFin mulls issuance of \$OVDPs with 3m-6m put options, EUR denominated bonds

According to the ministry, **government considers issuance of \$OVDP with put options**, allowing investors to put in the notes on quarterly/semiannual basis. If implemented, the instrument could attract a lot of attention from local banks, as those are currently overliquid in terms of USD liquidity. Also the instrument bears obvious refinancing risks for MinFin which could suddenly face long stream of redemptions.

Ukraine's government allowed MinFin to issue domestic debt, nominated in EUR. The respective decree was pasted today on Camin's website.

The government has placed bonds worth UAH1.9 bn last week. Investors are still buying durations up to 6m, yields on the short end of the curve are continuing to go down. Demand for 1Y and longer bonds is marginal, only a few bidders were recorded. Demand for \$OVDP is gradually losing steam as well.

Last week government held two auctions. On Tuesday MinFin took UAH360 mn worth of bids (at par) for 3m bill, satisfying 10 out of 30 bids and 54% of total volume. Cutoff was set at 12%, i.e. the government continued to lower cutoff rates despite significant redemption (UAH 2.5 bn) due Wed 21st. 1Y and 2Y bonds were sold in amount of UAH250 mn and UAH200 mn respectively with 3 and 1 bidders present.

On Thursday, the battle for 6m bill ended up with cutoff being reduced to 12.5%, with UAH370 mn out of UAH725 mn being accepted. 1Y note attracted a single bid of UAH 300mn which was satisfied at 14.5%.

All eyes on retail deposits in UAH. One should carefully watch changes UAH retail deposits, As we reported earlier, they are the key driver behind abundance of liquidity in the banking system. Any notable slowdown in retail deposits growth would mean that banks start to lose liquidity and that demand for government bonds evaporates. On the other hand, if current inflow is sustainable, Ukrainian banks shall start to buy 1Y and longer government bonds in May-June, thus providing relief during notable redemptions in March and June.

The inflow of retail deposits may be sustainable in two cases:

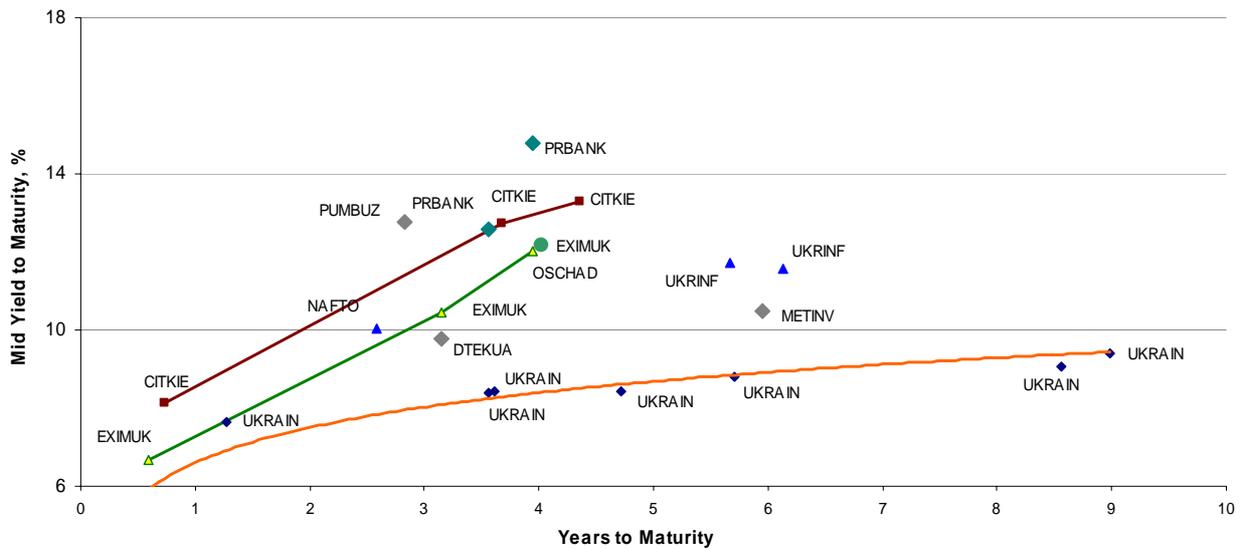
(a) long awaited gas price agreement is done, allowing to re-assess C/A prospects for 2013. This doesn't have to be a fundamental long-term solution. Retail deposits in Ukraine are short-term, so the outcome in form of one-year agreement could be enough to make UAH instruments attractive for population.

(b) current global wave of liquidity allows government and Ukrainian corporates to borrow from international markets, thus creating financial account surplus.

If neither condition holds, the population is **likely to reverse deposit flows**, escaping from local currency several months before parliamentary elections.

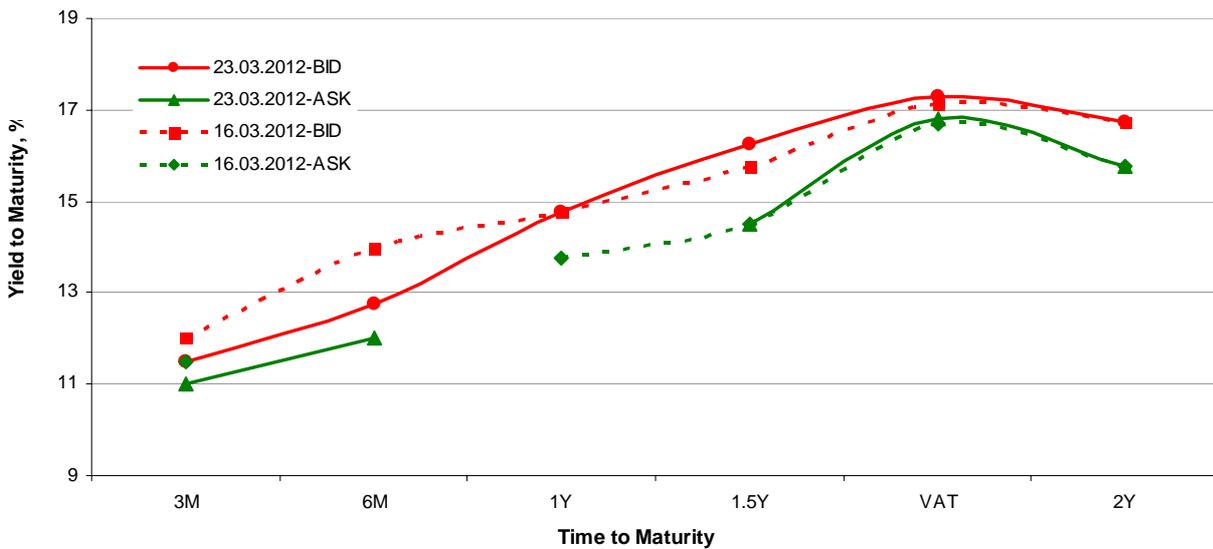


Ukrainian Eurobonds – yield map



Source: Bloomberg

Secondary market for UAH OVDPs



Source: traders' quotes

Selected Ukrainian local bonds, sovereign and corporate

ISIN	Maturity	Time to maturity	Bid Yield	Ask Yield	YTM
UA4000136295	30.05.2012	65	11.50%	11.00%	YTM
UA4000063564	12.09.2012	170	12.75%	12.00%	YTM
UA4000136824	06.03.2013	345	14.75%	-	YTM
UA4000118871	30.04.2013	400	16.75%	15.75%	YTM
VAT II-IV	Aug-2015	3Y5m	17.30%	16.70%	YTM
UA4000134431 (USD)	06.03.2013	345	9.00%	7.50%	YTM
Boryspil G series	13.11.2012	232	19.00%	15.75%	YTM
Sberbank of Russia (Ukraine)	18.01.2013	298	18.50%	17.60%	YTM
Prominvestbank B series	25.02.2013	336	18.50%	17.00%	YTM
Procreditbank G series	14.05.2013 (put)	414	21.00%	18.25%	YTM

Source: traders' quotes

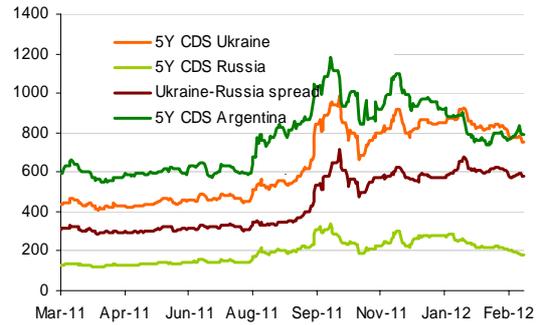


Ukrainian sovereign Eurobonds, YTM (%)



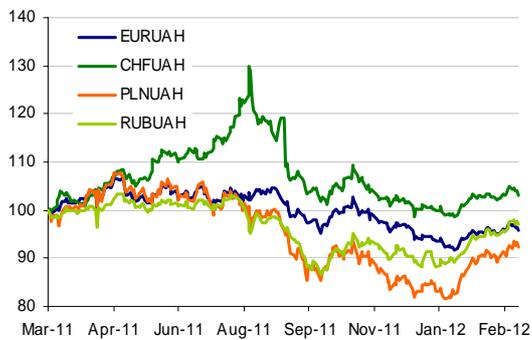
Source: Bloomberg

Credit default swaps



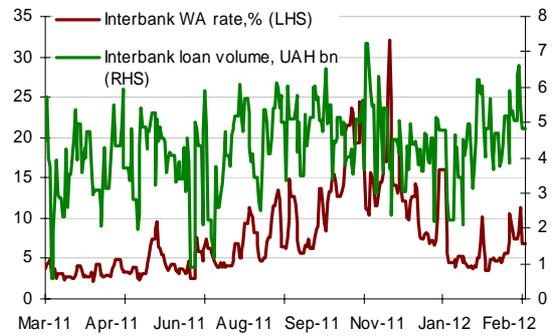
Source: Bloomberg

UAH vs other currencies, spot



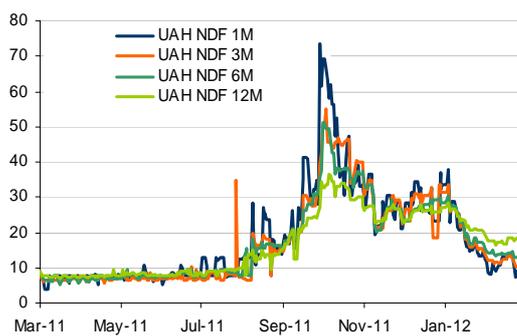
Source: Bloomberg

Interbank volume and rates



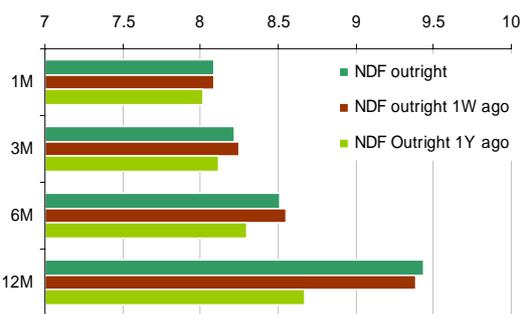
Source: Bloomberg

UAH NDF implied yields



Source: Bloomberg

UAH NDF changes – outright rates



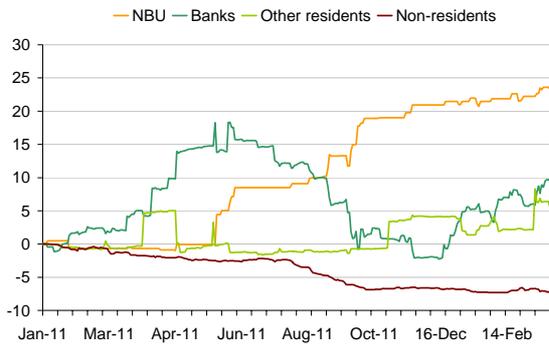
Source: Bloomberg



OVDP redemptions in 1H 2012 (principal + interest), UAH mn													
	7-Mar	14-Mar	21-Mar	23-Mar	28-Mar	4-Apr	11-Apr	18-Apr	20-Apr	25-Apr	2-May	9-May	
Local UAH mn	1638	1123	2489		1084	1020	1735	796		162	654	122	
Foreign USD mn				75					26			24	
	14-May	16-May	21-May	23-May	30-May	5-Jun	6-Jun	11-Jun	13-Jun	17-Jun	20-Jun	26-Jun	27-Jun
Local UAH mn		2673		171	196	12	452		2663		1831		231
Foreign USD mn	24		33					38		39		516	

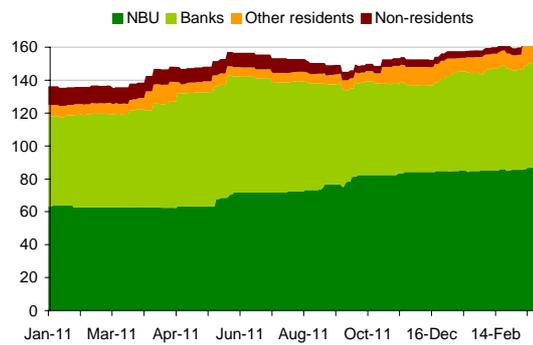
Source: MinFin, UkrSibbank

OVDPs change in holdings, UAH bn



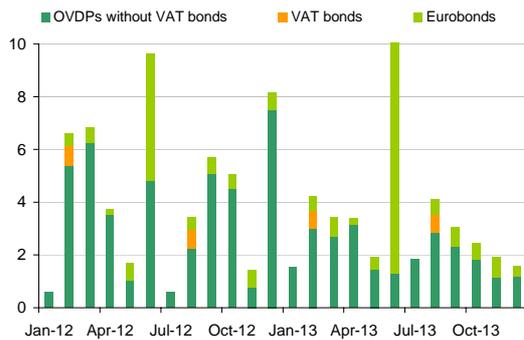
Source: NBU, UkrSibbank's calculations

OVDP in circulation structure, UAH bn



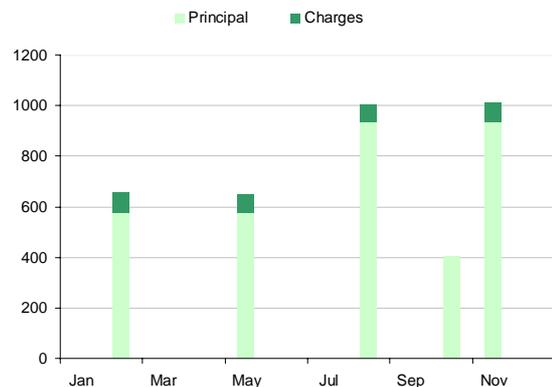
Source: NBU

Payments to bond holders, UAH bn



Source: MinFin, UkrSibbank's calculations

Payments to IMF, USD mn



Source: IMF



Key macroeconomic indicators

Base case scenario

	2009	2010	2011E	2012F	2013F
Business Cycle					
Real GDP growth (%)	-15.1%	4.2%	5.2%	3.8%	4.0%
Nominal GDP (UAH bn)	913	1095	1314	1514	1732
Nominal GDP (\$bn)	117	138	164	187	182
GDP per Capita (at F/X rate; \$)	2538	2998	3591	4099	4025
Real Industrial Output (% y/y)	-21.9%	11.2%	7.7%	3.5%	4.0%
Prices					
GDP Deflator	113.0%	115.0%	112.0%	111.0%	110.0%
CPI	112.3%	109.1%	104.6%	109.9%	115.0%
PPI	114.3%	118.7%	116.4%	111.5%	108.0%
Public Finance					
Revenues	210	241	315	337	364
Expenditures	242	304	333	370	410
Budget balance (% of GDP)	-4%	-6%	-1.8%	-2.2%	-2.7%
Budget deficit (UAH bn. "-" is deficit)	-33	-64	-24	-33	-46
Total Public Debt (USD bn)	40	54	59	63	66
Total Public Debt (% of GDP)	34%	39%	36%	34%	36%
Gross External Debt (USD bn). e-o-p	103	117	127	132	140
Gross External Debt (% of GDP)	88%	85%	77%	71%	77%
External Balances					
Exports (USD bn)	40	52	69	70	74
Imports (USD bn)	45	61	83	83	79
Merchandise trade balance	-4.3	-8.4	-13.8	-13.2	-5.3
Services Trade Balance (USD bn)	2.4	4.4	4.6	4.7	4.7
Current Account Balance (USD bn)	-1.7	-2.9	-9.3	-8.7	-1.1
Current Account Balance (% of GDP)	-1.5%	-2.1%	-5.7%	-4.6%	-0.6%
Capital and Financial Accounts Balance (USD bn)	9.9	7.9	6.8	5.8	8.0
Net FDI Inflow (USD bn)	4.7	5.8	6.6	4.0	7.0
Net FDI Inflow per Capita (\$)	101	125	144	88	155
Gross F/X Reserves (USD bn)	26.5	34.6	31.8	25.1	25.5
FX					
USD/UAH (rate; eop)	7.99	7.97	8.02	8.40	9.80
USD/UAH (avg.)	7.79	7.94	7.99	8.10	9.50

Source: UkrSibbank

	2010	2011	2012
Revenues, UAH bn	241	315	333
Expenses, UAH bn	304	333	358
Deficit, UAH bn	64	24	25
Recapitalisation borrowings, UAH bn	16	21	12
Privatisation, UAH bn	1	11	10
Debt redemptions, UAH bn	27	46	66
Borrowings, UAH bn	108	81	98
Net borrowings*, UAH bn	65	14	21

Source: Cabinet of Ministers of Ukraine. UkrSibbank

*Borrowings less recapitalization borrowings less debt redemptions



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