



Fixed Income Weekly

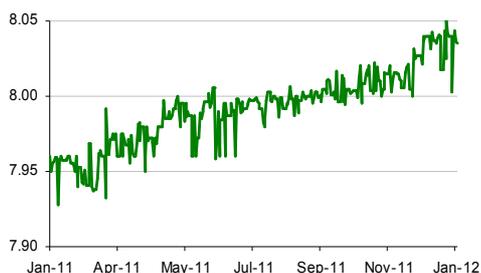
February 6, 2012

Ukraine Economy | Interest Rate Strategy | FX Strategy

	Today	Week ago*	Change
Global indicators			
UST 2Y, %**	0.23	0.22	2
UST 10Y, %**	1.90	1.89	1
LIBOR 3M, %**	0.53	0.55	-2
EURIBOR 3M, %**	1.10	1.14	-4
Oil (Brent), USD	113.25	111.46	1.79
Baltic Dry (BDIY, pts)	651	726	-75
Sovereign risk			
CDS 1Y bp	758	772	-14
CDS 5Y bp	815	827	-12
Ukraine 13, YTM%**	9.9	10.5	-58
Ukraine 16, YTM%**	9.8	10.2	-36
Ukraine 20, YTM%**	9.8	9.9	-17
Currency			
USDUAH	8.039	8.0028	0.0362
EURUSD	1.3118	1.3220	-0.0102
NDF 1M outright	8.12	8.25	-0.13
NDF 6M outright	8.685	8.685	0.00
NDF 12M outright	9.61	9.66	-0.05
12M NDF Implied Yld%	20.7	20.8	-0.03
Local interest rates			
KievPrime, O/N %	1.85	3.78	-1.93
KievPrime, 1M %	13.15	13.45	-0.30
Wide interbank rate, % (UKIRAWIR)	16.1	16.1	0.00
1Y OVDP, YTM % (bid)	17%	17%	0
VAT bonds, YTM % (bid)	18.25%	18.50%	-0.25
Liquidity, UAH bn	20.6	21.3	-0.7

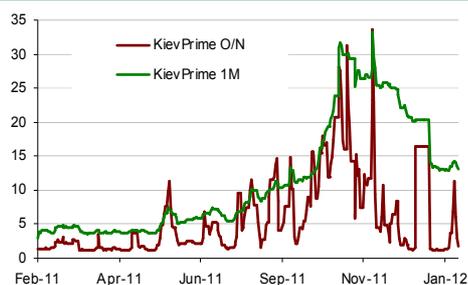
*Change over the last 7 calendar days; **change in bp

USD/UAH Spot



Source: Bloomberg

KievPrime O/N and 1M



Source: Bloomberg

- **Shift in risk attitude will benefit holders of Ukrainian bonds**
- **Sovereign risks are decreasing: Sberbank may give a loan**
- **Ukrainian Eurobonds appreciate, CDSs fell last week**
- **Total state budget deficit is 3.4% in 2011**
- **1M and 3M NDF rates decline, spot UAH is stable**
- **Money market are slowly increasing**
- **1Y USD bonds may be an interesting opportunity for local investors**
- **Secondary market rates inched down at longer end**

Shift in risk attitude will benefit holders of Ukrainian bonds

There was a sense of optimism on the world's markets last week on the expectations that the European debt crisis would be ultimately resolved. Markit iTraxx SovX CEEMEA CDS index decreased from 306.59 on January 27 to 296.75 on February 3. We think that there will be more investor interest towards emerging markets with investment grade ratings. **Ukraine with its single "B" level ratings is not likely to hit the primary market yet, but the secondary market will continue to benefit from the change in risk attitude.**

Sovereign risks are decreasing: Sberbank may give a loan

Ukraine may change its lender of last resort. Ukraine cannot receive further IMF tranches without raising natural gas tariffs. Doing so may be politically disastrous for the Ukrainian authorities. This week Ukraine starts redeeming the funds extended by the IMF under the previous Stand-By Arrangement signed in 2008. On February 7 Ukraine must pay back SDR375mn (ca. USD581mn). As expected, the IMF did not agree to any debt restructuring.

Herman Gref, Chairman of the Management Board & CEO of Sberbank, said last week that should the IMF refuse to extend further tranches under the 2010 Stand-By Arrangement, Sberbank may provide financing to Ukraine. He said that **Sberbank would examine a potential application for a loan from the Ukrainian government and "will try to help"**.

We think that Ukraine may borrow money from one or several Russian banks closer to the parliamentary elections in October 2012. Of course, such loans may imply certain political concessions from Ukraine. An important difference of potential loans from the IMF and Russian banks is that the IMF money would be directed to the NBU for regulation of the country's balance of payments while Russian loans would be received by the Cabinet of Ministers and used for state debt redemptions and financing of the state budget deficit.



Ukrainian Eurobonds appreciate, CDSs fell last week

YTM of Ukraine's Eurobonds decreased last week last week, '13 notes from 10.5% to 9.9%, '16 notes from 10.2% to 9.8% and '20 notes from 9.9 to 9.8% (all quotes are based on bids). Like the week before, **credit default swaps continued falling together with CDSs of other countries.**

State budget and financing			
	2010	2011	2012
Revenues, UAH bn	241	315	333
Expenses, UAH bn	304	333	358
Deficit, UAH bn	64	24	25
Recapitalisations, 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

Total state budget deficit is 3.4% in 2011

Ukraine's budget deficit in 2011 is not very large (when compared with the budget deficits of most countries in both Western and Eastern Europe): 3.4% of GDP. The MinFin published the 2011 budget execution figures. In line with our expectations, the state budget revenues and deficit totalled UAH315bn (24% of GDP) and UAH 24bn (1.8% of GDP), accordingly. For reference: last week the State Statistics Service published preliminary figures for Ukraine's GDP in 2011: UAH1314bn, y/y growth of 5.2%.

The "hidden" state budget deficit, i.e. recapitalisation bonds issued, totalled UAH21bn (1.6% of GDP). Thus, the total state budget deficit reached UAH45bn in 2011 that is a moderate 3.4% of GDP (particularly, if compared with troubled countries in Europe).

For 2012 the Cabinet of Ministers plans UAH25bn of the "regular" budget deficit and UAH12bn of recapitalisation bonds (for Naftogaz).

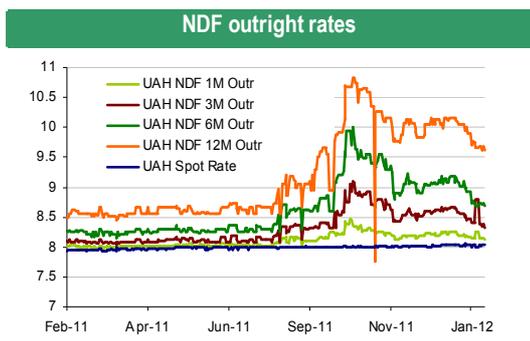
1M and 3M NDF rates decline, spot UAH is stable

Expectations of a short-term UAH stability gained strength last week. First, there were several leaks indicating increasing probability that a new agreement on natural gas would be signed. Second, the statistics on Ukraine's balance of payments in December 2011 published by the NBU proved to be better than expected (due largely to a windfall surplus of USD842mn on the foreign direct investment account). Third, global decrease of uncertainty may have played its role, too.

UAH NDF outright rates continued decreasing, especially at the shorter end while longer NDFs remained stable :

- 1M decreased from 8.145 to 8.12 (15.25% to 13.48% in terms of implied yield)
- 3M (May) decreased from 8.405 to 8.325 (15.94% to 15.47% in terms of implied yield)
- 6M (August) remained unchanged at 8.685 (implied yields of 16.86% and 17.39%, according to Bloomberg)
- 1Y inched down marginally from 9.66 to 9.61 (20.77% and 20.74%)

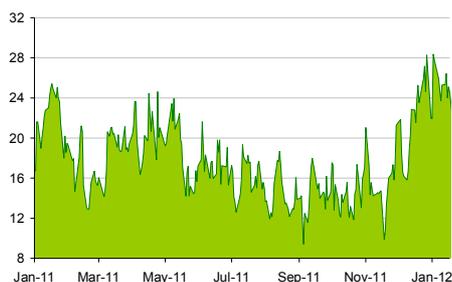
The interbank exchange rate had not changed much since the week before: on Friday the market closed at 8.036-8.038. The NBU did not make any USD interventions last week.



Source: Bloomberg



Banking System Liquidity, UAH bn



Source: NBU, UkrSibbank

Primary auctions schedule

	UAH	USD-linked	USD
07.02.2012	6M, 1Y, 2Y	3Y	1Y,3Y
09.02.2012	3M, 1Y, 2Y, 3Y	3Y	-
14.02.2012	6M, 1Y, 2Y	3Y	1Y,3Y
16.02.2012	3M, 1Y, 2Y, 3Y	3Y	-
21.02.2012	6M, 1Y, 2Y	3Y	1Y,3Y
23.02.2012	3M, 1Y, 2Y, 3Y	3Y	-
23.02.2012	6M, 1Y, 2Y	3Y	1Y,3Y

Source: MinFin

Primary auctions results

# of Auction	30	38	41	31
ISIN (short)	134423	-	-	133763
Currency	UAH	UAH	UAH	UAH
Maturity (days, M, Y)	3M	3M	3Y	6M
Cut-off yield	13,50%	13,50%	-	-
Weighted average yield	13,50%	13,50%	-	-
Highest bid	13,50%	13,50%	16,00%	-
Lowest bid	14,00%	14,00%	16,00%	-
Bids submitted, UAH mn	223	286	100	0
Number of bids	5	7	1	0
Number of bids accepted	2	6	0	0
Bids accepted, UAH mn	103	245	0	0
Amount raised, UAH mn	99	237	0	0

Source: MinFin

Primary auctions results

# of Auction	37	36
ISIN (short)	-	-
Currency	USD	USD
Maturity (days, M, Y)	1Y	3Y
Cut-off yield	9.30%	--
Weighted average yield	9.24%	-
Highest bid	9.10%	9.50%
Lowest bid	9.50%	9.80%
Bids submitted, UAH mn	171	1
Number of bids	11	5
Number of bids accepted	6	0
Bids accepted, USD mn	137	0
Amount raised, USD mn	142	0

Source: MinFin

Money market rates are slowly increasing

We expect that in February money market rates will be gradually growing as this is a peak month for tax payments.

The banking liquidity was at just UAH17-19bn rising to UAH20.6bn on Friday. Last Friday O/N rates returned to their normal level of 0.5-1.5% after jumping to 10/14% on January 31 due to the end-of-month effect. 1M rates increased to 11-14% last week from 9-13% the week before.

1Y USD bonds may be an interesting opportunity for local investors

Like in previous weeks, we expect that demand at primary auctions will be concentrated in 3M UAH securities. In addition, we will see demand for 1Y USD bonds re-introduced last week (they were not offered in January). Longer term UAH bonds as well as USD-linked bonds are not likely to gather bids that would be acceptable to the MinFin.

Last week the MinFin raised UAH 337mn (vs. UAH165mn the week before) through sale of 3M UAH bonds **and USD142mn** from sale of USD bonds that mature in March 2013. All other bonds (longer term UAH bonds, USD-linked bonds and USD bonds) went unsold as they have not got much demand at rates acceptable for the MinFin: bids at 16% for 3Y UAH bonds and at 9.50% for 3Y USD bonds were rejected.

We expect that demand for 3M UAH bonds will be gradually declining in February because of diminishing liquidity. The cut-off rate for 3M bonds, 13.50%, had not changed since the week before and is not likely to change in coming weeks.

1Y USD bonds may be a good investment opportunity for local holders of USD cash, including foreign owned banks. These bonds were re-introduced last week through an ad hoc auction on Tuesday and are now slated for sale each Tuesday in February. They gathered a hefty USD171mn of demand at the auction last Tuesday. Probably, market participants considered this auction as a one-time opportunity to buy local USD bonds with the yield of around 9.3% as at the announcement of the auction there was no auctions schedule for February published yet.

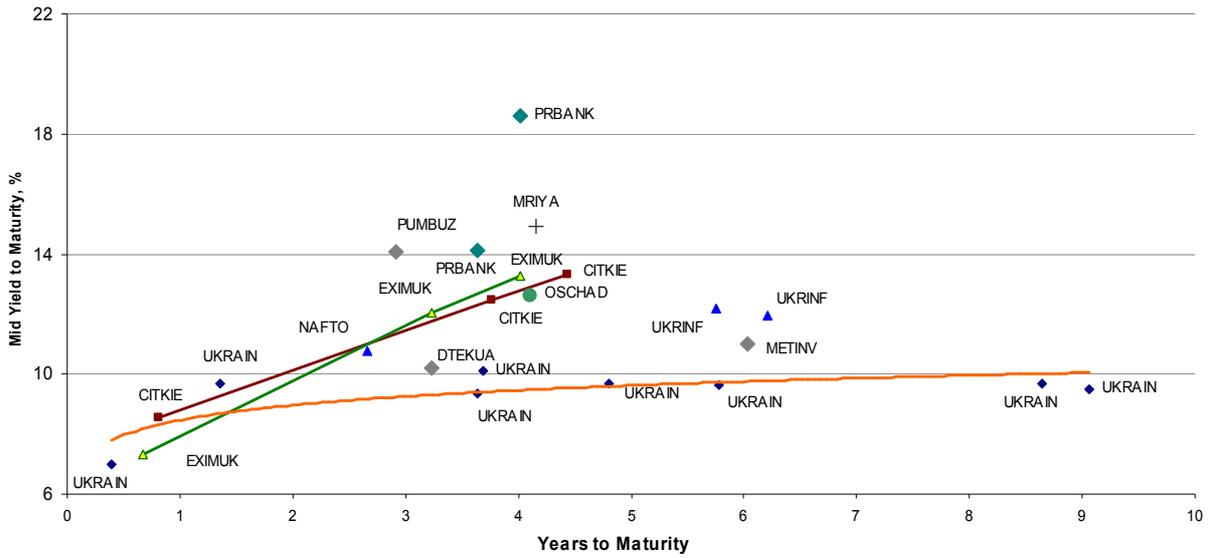
Secondary market rates inched down at longer end

The secondary market appreciated slightly during the last week at the longer end of the curve. This was to a large extent counterintuitive as the banking liquidity was lower last week than the week before (the average banking liquidity was UAH19.1bn and UAH22.2bn, accordingly)

We expect that the banking liquidity will continue to decline this week, finally bringing to the end the current mini-rally on the secondary market. On February 22 OVDP holders will receive UAH3.4bn that will to a certain extent alleviate an expected February liquidity squeeze. Next large payments are VAT bond amortisations (UAH1.6bn plus interest) at the end of February.

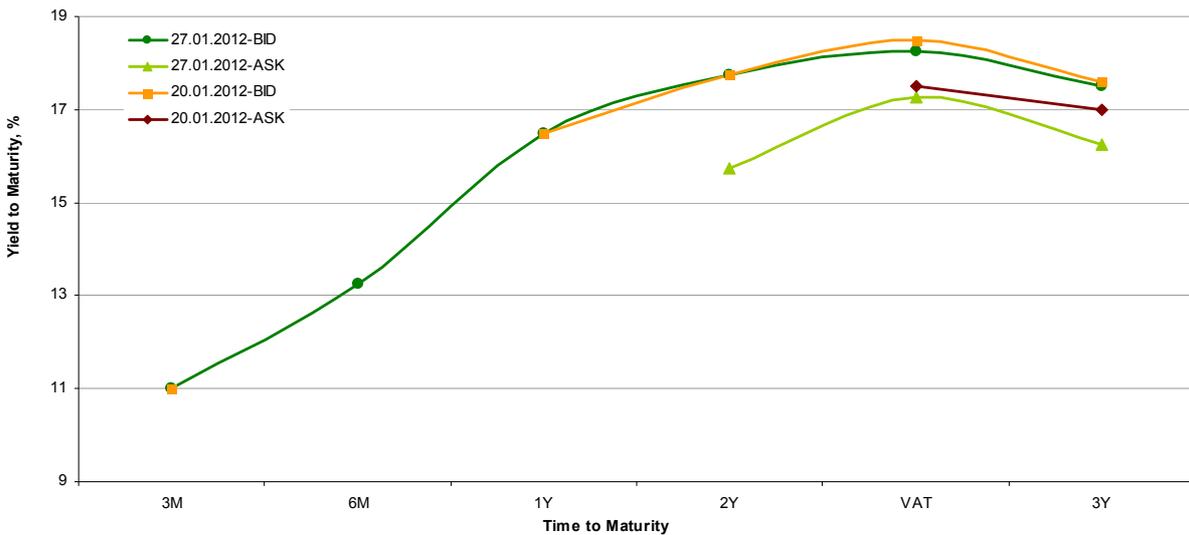


Ukrainian Eurobonds – yield map



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
UA4000048219	22.02.2012	19	11.00%	8%	YTM
UA4000101018	13.06.2012	131	14.00%	11.00%	YTM
UA4000061451	31.10.2012	271	17.00%	-	YTM
UA4000115117	26.03.2014	782	18.00%	16.00%	YTM
VAT II-IV	Aug-2015	6m	18.00%	17.70%	YTM
UA4000132260	12.06.2013	495	-	-	YTM
Boryspil G series	13.11.2012	284	18.00%	16.00%	YTM
Sberbank of Russia (Ukraine)	18.01.2013	350	26.00%	18.00%	YTM
Prominvestbank B series	25.02.2013	388	26.00%	18.00%	YTM
Procreditbank G series	14.05.2013 (put)	466	26.50%	18.25%	YTM

Source: traders' quotes

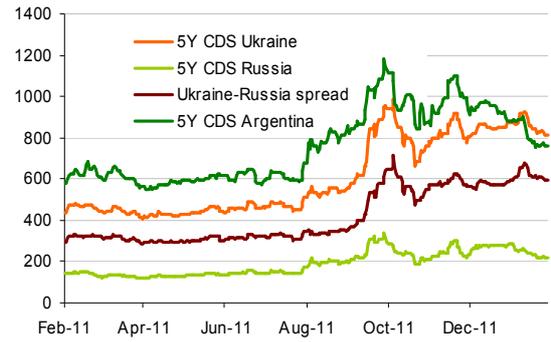


Ukrainian sovereign Eurobonds, YTM (%)



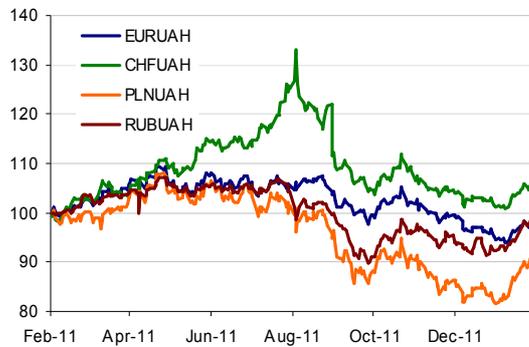
Source: Bloomberg

Credit default swaps



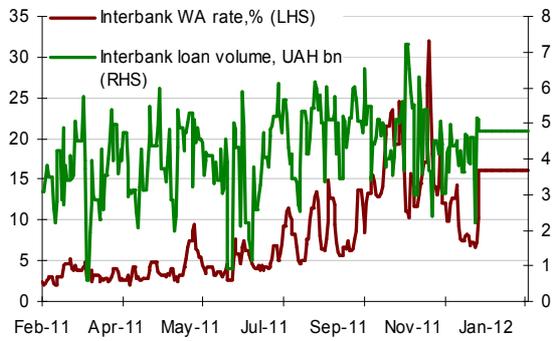
Source: Bloomberg

UAH vs other currencies, spot



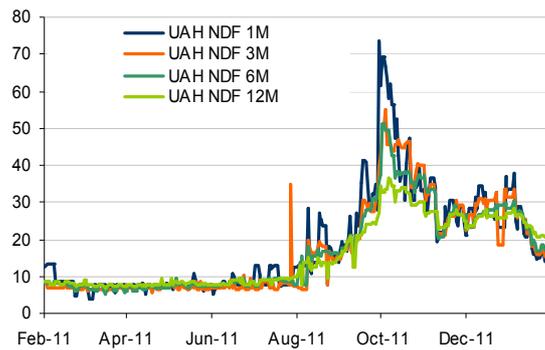
Source: Bloomberg

Interbank volume and rates



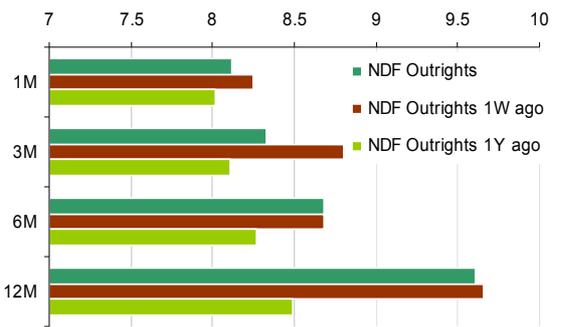
Source: Bloomberg

UAH NDF implied yields



Source: Bloomberg

UAH NDF changes – outright rates



Source: Bloomberg

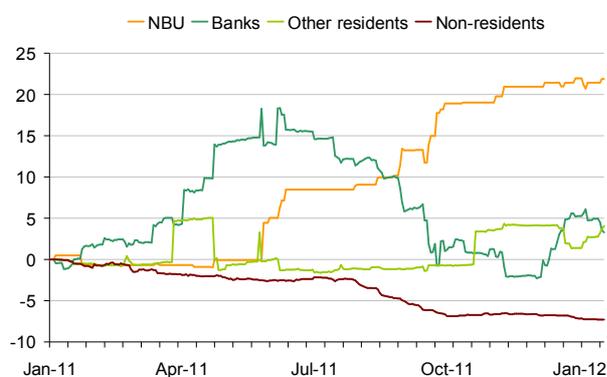


OVDP redemptions in 1H 2012 (principal + interest), UAH mn

Date	Local UAH mn	Date	Local UAH mn	Foreign USD mn	Date	Local UAH mn	Foreign USD mn	Date	Local UAH mn	Foreign USD mn	Date	Local UAH mn	Foreign USD mn	Date	Local UAH mn	Foreign USD mn
04-Jan	71	1-Feb	186		7-Mar	1579		4-Apr	1020		2-May	654		5-Jun	12	
11-Jan	38	8-Feb	57		14-Mar	1123		11-Apr	1735		3-May		24	6-Jun	452	
18-Jan	183	15-Feb	132		21-Mar	2489		18-Apr	796		9-May	122		11-Jun		38
25-Jan	286	22-Feb	3403		23-Mar		75	20-Apr		26	14-May		24	13-Jun	2663	
30-Jan	6	23-Feb		60	28-Mar	1084		25-Apr	162		16-May	317		17-Jun		39
		24-Feb	250								21-May		33	20-Jun	1471	
		27-Feb	1013								23-May	171		26-Jun		516
		28-Feb	737								30-May	143		27-Jun	231	
		29-Feb	354													

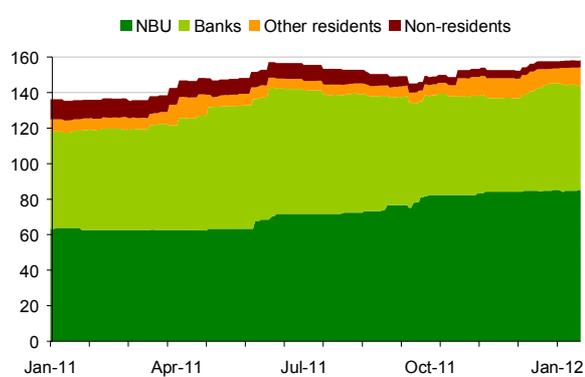
Source: MinFin, UkrSibbank

OVDPs change in holdings (to Jan-4), UAH bn



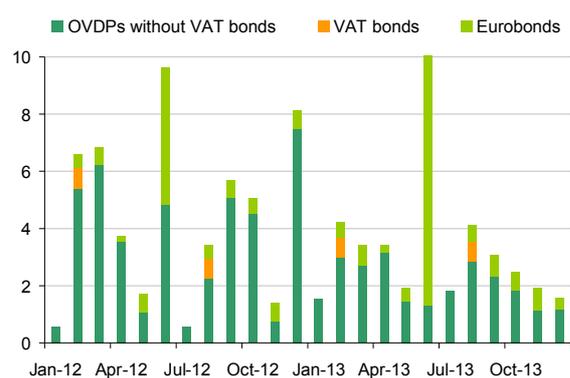
Source: NBU, UkrSibbank's calculations

OVDP in circulation structure, UAH bn



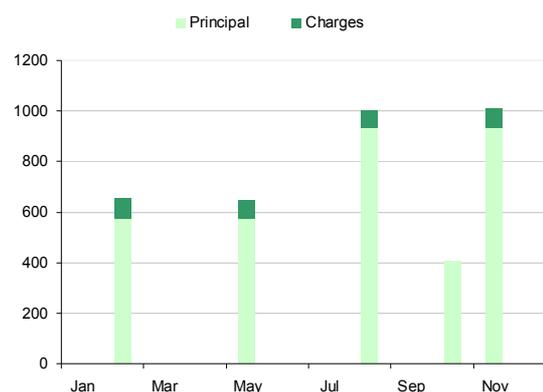
Source: NBU

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%	-1,4%	-2,1%	-2,7%
Budget deficit (UAH bn, "-" is deficit)	-33	-64,3	-18,0	-32,5	-46,2
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)	40,4	52,2	88,8	73,6	77,2
Imports (USD bn)	44,7	60,6	-98,0	87	82,5
Merchandise trade balance	-4,3	-8,4	-13,8	-13,5	-5,3
Services Trade Balance (USD bn)	2,4	4,4	4,6	3,7	3,7
Current Account Balance (USD bn)	-1,7	-2,9	-9,3	-8,2	-0,8
Current Account Balance (% of GDP)	-1,5%	-2,1%	-5,7%	-4,4%	-0,4%
Capital and Financial Accounts Balance (USD bn)	9,9	7,9	6,8	5,1	8,0
Net FDI Inflow (USD bn)	4,7	5,8	6,6	6,0	9,0
Net FDI Inflow per Capita (\$)	101	125	144	132	199
Gross F/X Reserves (USD bn)	26,5	34,6	31,8	21,7	22,4
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



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