



Fixed Income Weekly

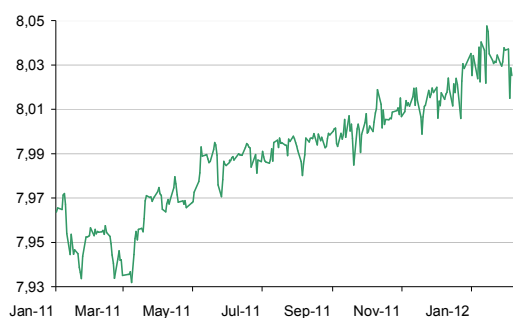
February 13, 2012

Ukraine Economy | Interest Rate Strategy | FX Strategy

	Today	Week ago*	Change
Global indicators			
UST 2Y, %**	0.26	0.23	2
UST 10Y, %**	1.98	1.90	8
LIBOR 3M, %**	0.51	0.53	-2
EURIBOR 3M, %**	1.06	1.10	-4
Oil (Brent), USD	117.17	114.58	2.59
Baltic Dry (BDIY, pts)	695	647	48
Sovereign risk			
CDS 1Y bp	767	754	13
CDS 5Y bp	830	819	11
Ukraine 13, YTM%**	10.1	10.5	-38
Ukraine 16, YTM%**	10.0	9.7	29
Ukraine 20, YTM%**	10.2	9.8	36
Currency			
USDUAH	8.032	8.0365	-0.0045
EURUSD	1.3241	1.3158	0.0083
NDF 1M outright	8.09	8.11	-0.02
NDF 6M outright	8.55	8.675	-0.13
NDF 12M outright	9.375	9.6	-0.23
12M NDF Implied Yld%	17.5	20.7	-3.18
Local interest rates			
KievPrime, O/N %	1.65	1.85	-0.20
KievPrime, 1M %	13.42	13.15	0.27
Wide interbank rate, % (UKIRAWIR)	16.1	16.1	0.00
1Y OVDP, YTM % (bid)	16.4	17	-0.60
VAT bonds, YTM % (bid)	18.0	18.25	-0.25
Liquidity, UAH bn	18.0	20.6	-2.5

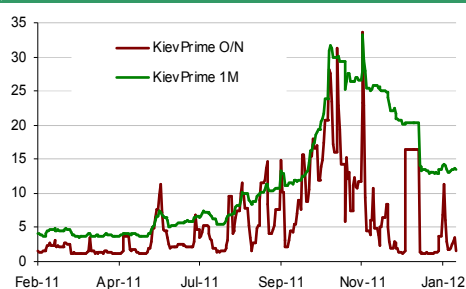
*Change over the last 7 calendar days; **change in bp

USD/UAH Spot



Source: NBU

KievPrime O/N and 1M



Source: Bloomberg

- **“Double B” sovereigns are starting to tap markets; prospects for the single “B” Ukraine are brightening**
- **Sovereign risks are decreasing: state debt to GDP ratio is down, imports are slowing**
- **Ukrainian Eurobonds trade sideways, CDS rates inch upwards**
- **NDF rates decrease across all maturities, spot UAH is stable**
- **Money market rates did not move last week**
- **3M UAH and 1Y USD bonds continue to be an interesting opportunity for local investors**
- **Secondary market rates did not move**

Double “B” sovereigns are starting to tap markets; prospects for the single “B” Ukraine are brightening

The week before the last had the historically highest weekly volume of EM debt issuance: 20 deals totalling USD18bn. This is primarily caused by reassessment of EM risks by investors and by abundance of funds that may be invested in EM debt. Countries with “double-triple B” and “double B” ratings, such as Romania, Latvia and Turkey, have executed or are planning primary debt issuance. **We expect that international investors will be more interested in Ukraine’s new debt as the primary market for “double B” issuers gains depth and momentum** (Ukraine has “single B” ratings). Meanwhile, we may see effects of attitude change reflected in lower Eurobond yields and CDS rates for Ukrainian issuers.

Contagion effects from the expected slow-down in Europe are getting less probable. Mario Draghi, President of European Central Bank, talked optimistically last week about the prospects for Greek debt crisis resolution and the European economy as a whole: “Looking ahead, we expect the euro area economy to recover very gradually in the course of 2012”.

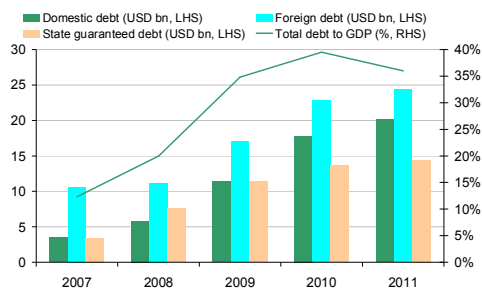
Sovereign risks are decreasing: state debt to GDP ratio is down, imports are slowing down

Ukraine’s debt to GDP ratio decreased from 39.5% at the end of 2010 to 36.0% at the end of 2011 (this figures comprise both direct state debt and debt guaranteed by the state; the latter includes the NBU’s debts to the IMF). Several factors were at play for this change:

- nominal GDP growth of 19% in 2011 expressed in US dollars (for reference: nominal GDP growth is 20% expressed in national currency, real GDP growth is 5.2%)
- higher than expected budgetary revenues (UAH315bn vs. UAH304bn budgeted) and lower than expected budgetary expenses (UAH333bn vs. UAH343bn budgeted)



State debts



Source: Cabinet of Ministers, UkrSibbank

- the de facto stalled Stand-By Arrangement with the IMF (that could have brought an additional SDR7.75bn (ca. USD12bn) in case of Ukraine's full compliance with the IMF's requirements
- bad conditions on international capital markets during most of 2011
- lack of demand for local sovereign debt, mainly due to the banking liquidity squeeze that started in May 2011

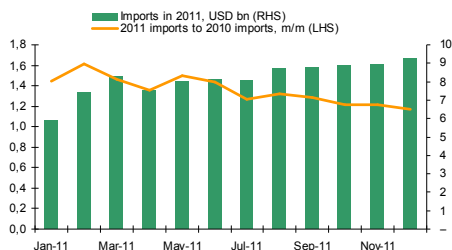
The Ukrainian authorities may have to resort to heterodox measures when raising debt in 2012. Last week the Ministry of Finance published its 2012 and 1Q 2012 plans for managing the state debt. **The government plans to borrow USD3.5bn on the foreign markets in 2012**, including USD1.5bn in 1Q 2012. **It also plans to raise UAH61bn on the domestic market** (including recapitalisation bonds). We do not exclude that foreign issues may look like closely held placements and domestic issuance may be done with assistance from the NBU.

Ukraine's chances to maintain the UAH exchange rate without losing much of the NBU's reserves are improving. This could be implied from the latest data published by the NBU:

- the NBU's reserves shrank by just USD430mn in January 2012 (from USD31.8bn to USD31.4bn)
- imports growth was slowing down in the last months of 2011 (although base case effects are also present)

We expect that the slow-down in imports will continue, supported by more rigorous customs administration and limited availability of loans for Ukrainian importers.

Imports in 2011



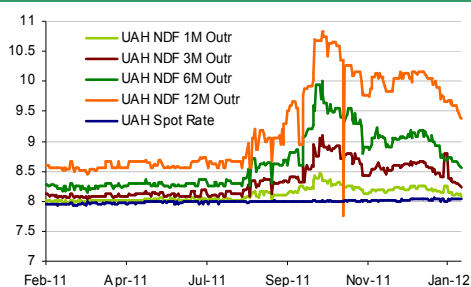
Source: NBU, UkrSibbank

Ukrainian Eurobonds trade sideways, CDSs inch upwards

Ukraine's Eurobonds trade around 10% across all maturities, except for June12 notes that trade at 8.0%/6.0%. 5Y CDSs increased from 819 to 830 while Markit index for CEEMEA CDSs inched up marginally, from 289 to 290. **One of the explanations for higher Ukraine's CDS rate is the rumours and, later, news, of the Ukrainian government's plans to tap international debt capital markets in coming months.** Four investment bankers were appointed to lead prospective sovereign issues in 2012.

NDF rates decrease across all maturities, spot UAH is stable

NDF outright rates



Source: Bloomberg

Expectations of a short-term UAH stability continued gaining strength last week. We expect that NDF rates will be declining in coming weeks (unless some negative news arrive) and the interbank exchange rate will remain stable around 8.03.

UAH NDF outright rates declined considerably last week across all liquid maturities:

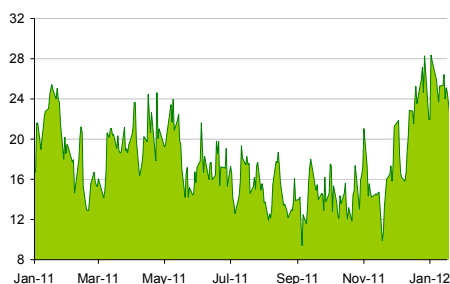
- 1M decreased from 8.11 to 8.085 (13.2% to 8.2% in terms of implied yield)
- 3M (May) decreased from 8.315 to 8.24 (15.4% to 11.9% in terms of implied yield)
- 6M (August) decreased from 8.675 to 8.55 (17.3% to 14.1% in terms of implied yields)



- 1Y decreased from 9.6 to 9.375 (20.7% to 17.5% in terms of implied yields)

The interbank exchange rate had not changed much since the week before: on Friday the market closed at 8.024-8.028. The NBU did not make any USD interventions last week.

Banking System Liquidity, UAH bn



Source: NBU, UkrSibbank

Money market rates did not move last week

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

Last Friday O/N rates were at a relatively low level of 0.5-1.5% after jumping to 2.50%/4.50% on Thursday. 1M rates remained unchanged at 11%/14% as drop in liquidity was quite modest: the average banking liquidity was UAH18.3bn last week vs. UAH19.1bn the week before.

They are likely to be highly volatile this month because of a seasonal increase in tax payments.

3M UAH and 1Y USD bonds continue to be an interesting opportunity for local investors

Like in previous weeks, we expect that demand at primary auctions will be concentrated in 3M UAH and 1Y USD bonds. 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 UAH150.1mn (UAH337mn the week before) through sale of 2Y UAH bonds **and USD50mn** from sale of 1Y and 3Y USD bonds (USD142mn the week before realised from the sale of USD bonds). 2Y bonds were sold at 15% meaning that this was not likely a market deal. All other bonds (6M, 12M and 3Y UAH bonds as well as USD-linked bonds) went unsold as they have not got much demand at rates acceptable for the MinFin: bids at 14% for 6M UAH bonds, at 14.50% for 6M UAH bonds and at 15% for 1Y UAH bonds were rejected. USD bonds did not get bids: it looks like USD-linked bonds have been fully supplanted by "regular" USD bonds.

1Y USD remains a good investment opportunity for local holders of USD cash, including foreign owned banks. The government will auction them on Tuesdays in February.

In coming weeks we may see introduction of floating rate OVDPs, e.g. inflation-linked notes.

Secondary market rates did not move

The secondary OVDP market has been stable so far. 6M to 18M maturities had their yields declined by 50-100 bp. We expect, however, that the banking liquidity may continue to decline this week leading to higher rates on the secondary market.

Primary auctions schedule

	UAH	USD-linked	USD
02.02.2012	3M, 12M, 2Y, 3Y	3Y	
07.02.2012	6M, 12M, 2Y	3Y	1Y, 3Y
09.02.2012	6M, 12M, 2Y, 3Y	3Y	
14.02.2012	3M, 12M, 2Y	3Y	1Y, 3Y
16.02.2012	6M, 12M, 2Y, 3Y	3Y	
21.02.2012	3M, 12M, 2Y	3Y	1Y, 3Y
23.02.2012	6M, 12M, 2Y, 3Y	3Y	
28.02.2012	3M, 6M, 12M, 2Y	3Y	1Y, 3Y

Source: MinFin

Primary auctions results

# of auction	45	49	50	52
ISIN (short)		-	-	-
Currency	UAH	UAH	UAH	UAH
Maturity (days, M, Y)	2Y	6M	1Y	3Y
Cut-off yield	15%	-	-	-
Weighted average yield	15%	-	-	-
Highest bid	15%	14%	14.5%	16%
Lowest bid	16%	15%	14.5%	16%
Bids submitted, UAH mn	250.1	460	100	100
Number of bids	3	8	1	1
Number of bids accepted	2	0	0	0
Bids accepted, UAH mn	150.1	0	0	0
Amount raised, UAH mn	150.1	0	0	0

Source: MinFin

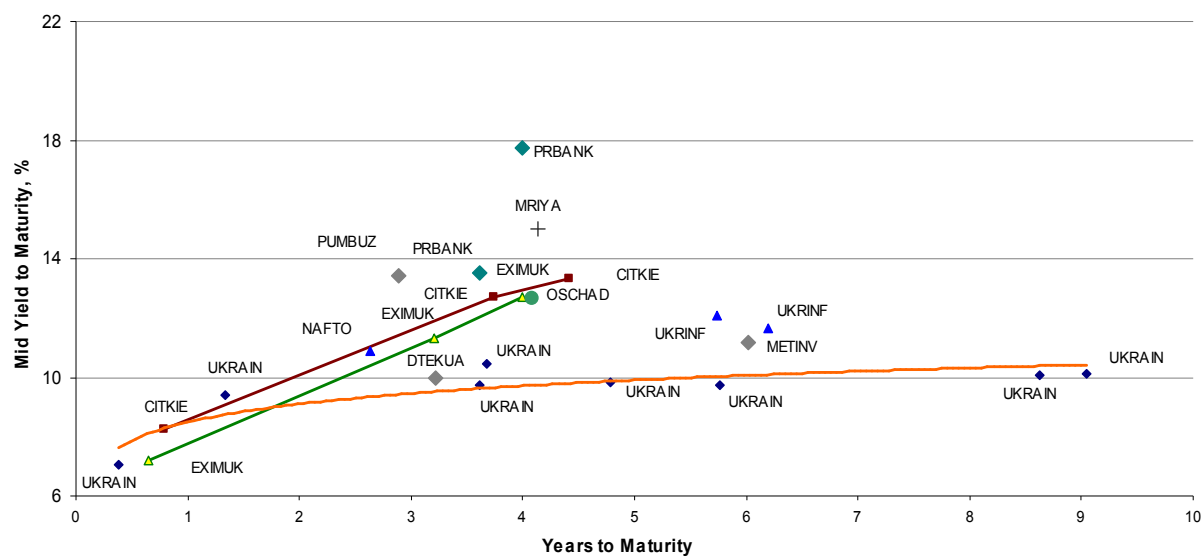
Primary auctions results

# of auction	47	48
ISIN (short)	134431	133771
Currency	USD	USD
Maturity (days, M, Y)	1Y	3Y
Cut-off yield	9.30%	9.45%
Weighted average yield	9.30%	9.45%
Highest bid	9.20%	9.45%
Lowest bid	9.50%	9.45%
Bids submitted, USD mn	51.4	4.45
Number of bids	13	1
Number of bids accepted	12	1
Bids accepted, USD mn	45.9	4.45
Amount raised, USD mn	47.6	4.49

Source: MinFin

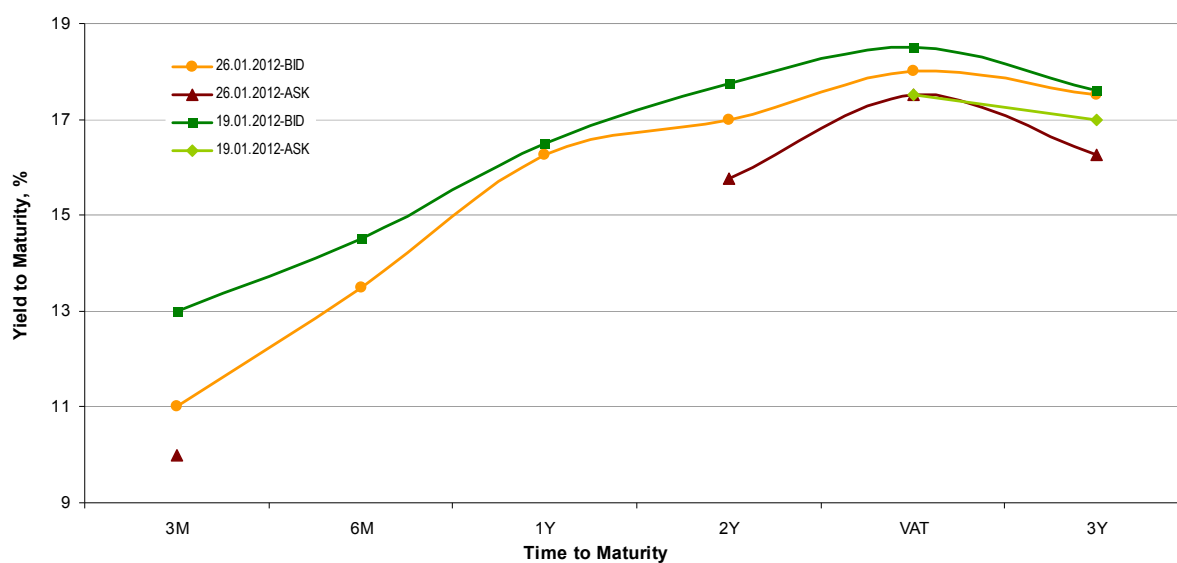


Ukrainian Eurobonds – yield map



Source: Bloomberg

Secondary market for UAH OVDs



Source: traders' quotes

Selected Ukrainian local bonds, sovereign and corporate

ISIN	Maturity	Time to maturity	Bid Yield	Ask Yield	YTM
UA4000048219	22.02.2012	12	9%	8%	YTM
UA4000101018	13.06.2012	124	14.50%	12%	YTM
UA4000061451	31.10.2012	264	15.90%	-	YTM
UA4000118871	30.04.2013	445	17.00%	16.00%	YTM
VAT II-IV	Aug-2015	6m	18%	17.60%	YTM
UA4000132260	12.06.2013	488	10.50%	9%	YTM
Boryspil G series	13.11.2012	277	18.00%	16.00%	YTM
Sberbank of Russia (Ukraine)	18.01.2013	343	26.00%	18.00%	YTM
Prominvestbank B series	25.02.2013	381	26.00%	18.00%	YTM
Procreditbank G series	14.05.2013 (put)	459	26.50%	18.25%	YTM

Source: traders' quotes

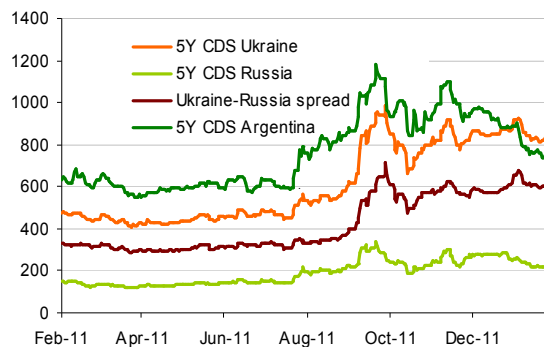


Ukrainian sovereign Eurobonds, YTM (%)



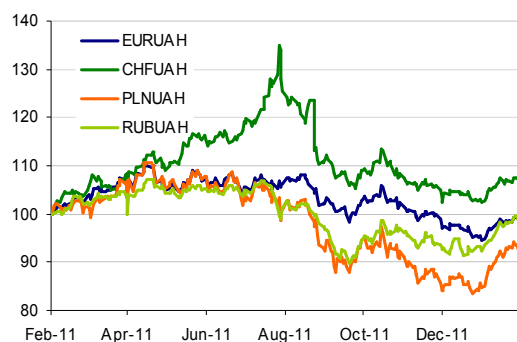
Source: Bloomberg

Credit default swaps



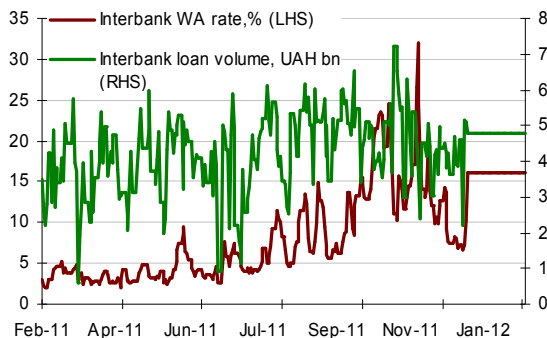
Source: Bloomberg

UAH vs other currencies, spot



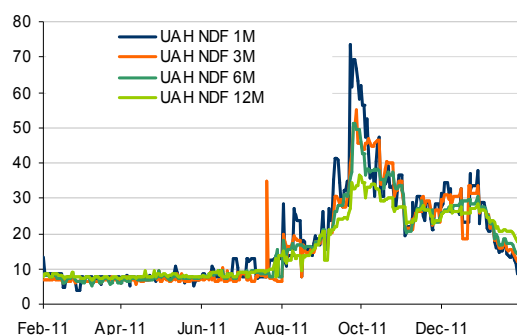
Source: Bloomberg

Interbank volume and rates



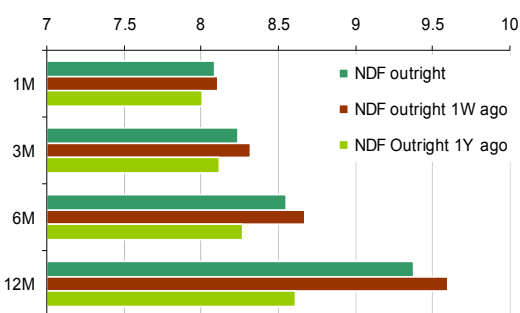
Source: Bloomberg

UAH NDF implied yields



Source: Bloomberg

UAH NDF changes – outright rates



Source: Bloomberg

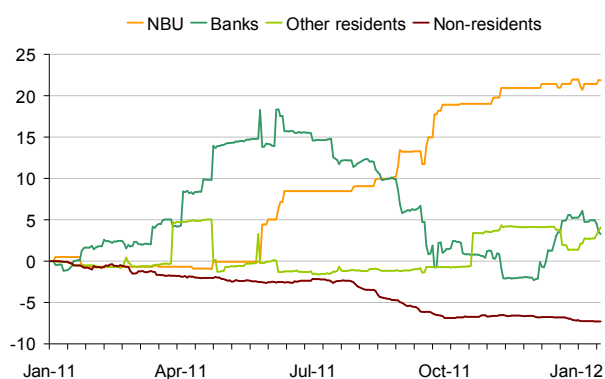


OVDP redemptions in 1H 2012 (principal + interest), UAH mn

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	1596		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													

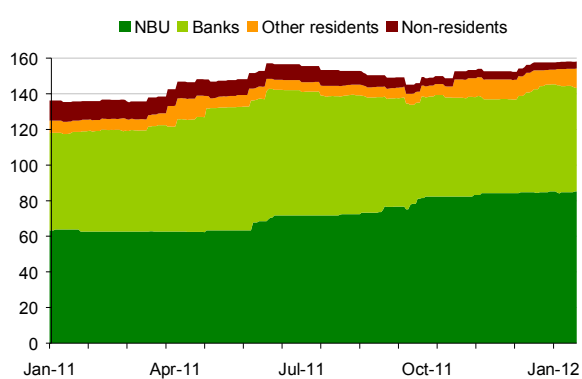
Source: MinFin, UkrSibbank

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



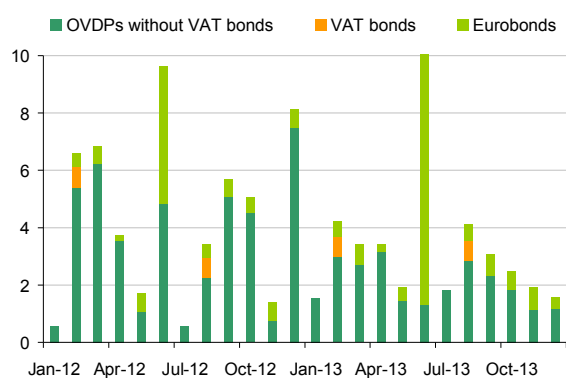
Source: NBU, UkrSibbank's calculations

OVDP in circulation structure, UAH bn



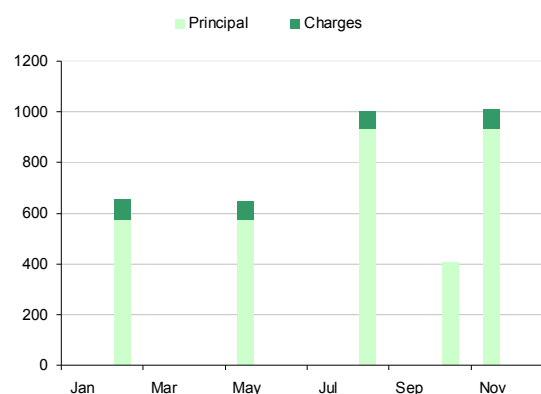
Source: NBU

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%	-1.8%	-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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