



Fixed Income Weekly

February 27, 2012

Ukraine Economy | Interest Rate Strategy | FX Strategy

	Today	Week ago*	Change
Global indicators			
UST 2Y, %**	0.3	0.29	1
UST 10Y, %**	1.98	2.00	-2
LIBOR 3M, %**	0.49	0.49	0
EURIBOR 3M, %**	1.01	1.04	-3
Oil (Brent), USD	123.86	119.58	4.28
Baltic Dry (BDIY, pts)	706	717	-11
Sovereign risk			
CDS 1Y bp	682	749	-66
CDS 5Y bp	772	822	-50
Ukraine 13, YTM%**	8.5	9.0	-51
Ukraine 16, YTM%**	8.2	9.5	-128
Ukraine 20, YTM%**	9.3	9.7	-34
Currency			
USDUAH	8.009	8.0263	-0.0173
EURUSD	1.3413	1.3140	0.0273
NDF 1M outright	8.10	8.08	0.02
NDF 6M outright	8.555	8.525	0.03
NDF 12M outright	9.385	9.3	0.08
12M NDF Implied Yld%	18.3	17.4	0.96
Local interest rates			
KievPrime, O/N %	5.4	2.19	3.21
KievPrime, 1M %	13.5	12.77	0.73
Wide interbank rate, % (UKIRAWIR)	8.7	5.6	3.10
1Y OVDP, YTM % (bid)	15.50	16.00	-0.50
VAT bonds, YTM % (bid)	18.00	17.85	0.15
Liquidity, UAH bn	14.2	18.0	-3.8

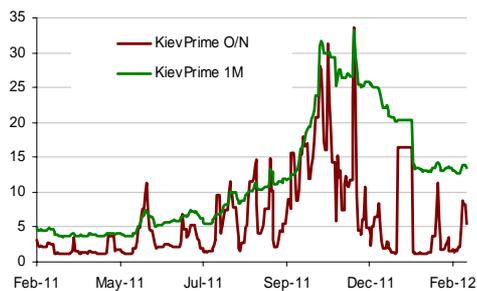
*Change over the last 7 calendar days; **change in bp

USD/UAH Spot



Source: NBU

KievPrime O/N and 1M



Source: Bloomberg

- **Russia elections and Eurobond placement plans in focus**
- **Ukrainian Eurobonds rally again, yields are down 50-100 b.p.**
- **Ukraine's current account in January is positive – NBU head**
- **UAH spot rate appreciates slightly, NDFs are a bit up after recent rally**
- **Banking system liquidity is on recovery track**
- **MoF passes major redemption date**
- **International accounts display healthy inflows in Ukrainian government debt**

Russia elections and Eurobond placement plans in focus

This week is abundant with global events. On Wednesday, ECB is to offer second part of Long Term Refinancing Operations program for EU banks, which should help to inject even more liquidity into European markets, lifting up global moods. The EU summit on Thursday is to focus on Greek issues, while Ben Bernanke is to address US Congress with regard to monetary policy. Finally, G20 meeting in Mexico over the weekend should discuss creation of a second global rescue package of 2\$tn.

The key market movers for Ukrainian debt over the next weeks are upcoming elections in Russia and Eurobonds placement plans.

Presidential elections in Russia (to be held on March 4th) – expected to provide Russian government with more degrees of freedom regarding more actions on Ukraine-Russia gas agreement. Furthermore, smooth elections should facilitate inflows into Russia/CIS focused funds, obviously providing more buyers for Ukrainian debt.

Upcoming placement of Ukrainian Eurobonds (if successful) should provide short-term relief for the government, allowing for **relaxed pricing on domestic market**. Provided overall extremely positive moods on the market, we think that placement in March is very probable.

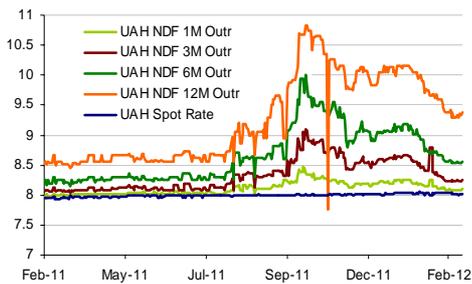
Ukrainian Eurobonds rally again, yields are down 50-100 b.p.

Pricing action in CIS bond universe was positive, with spreads tightening across the board.

Ukraine's sovereign benchmarks had a second consecutive excellent week, with Ukraine-13 yield down 50 b.p (now at 8.5%), and Ukraine-16 yield collapsing to 8.2% by remarkable 130 b.p. CDS levels for Ukraine compressed 50-60 b.p. on the week, 1Y CDS now stands near 680 b.p.



NDF outright rates



Source: Bloomberg

Ukraine's current account in January is positive – NBU head

Ukraine's current account in January is positive - \$395 mn, Governor of the National Bank of Ukraine (NBU) Serhiy Arbuzov has said in a video interview, placed on the NBU's website. In our view, the surplus in this year Jan's C/A should be attributed to (a) lower gas purchases in the very beginning of the year (b) contraction in imports following credit squeeze in Q4. This statistics should have muted impact on the market, especially in light of still negative NBU interventions (in Jan NBU sold \$0.9 bn on the market).

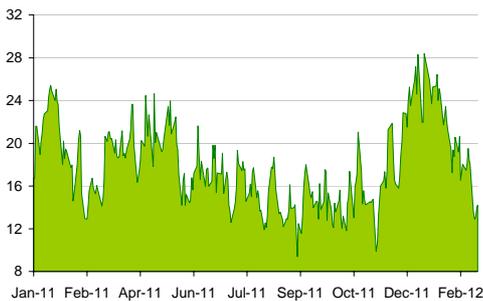
UAH spot rate appreciates slightly, NDFs are a bit up after recent rally

UAH spot rate appreciated some 0.2%, entering 8.00-8.01 range. This movement is in line with generally positive attitude towards local currency. We expect pressure on UAH to remain subdued over the weeks to come.

UAH NDF rates remained broadly stable (up a bit) last week. 3M NDF was traded at 8.20/8.26, which translates into simple yield of 9.5%/12.5%. **These levels should strengthen interest of international investors towards short-term UAH debt** (see next page).

Oil prices continued to appreciate this week (up to \$124 pbbl, +\$4.3), this should be very closely monitored with regard of UAH prospects in 2013 (see our last report) after NBU is expected to switch policy towards floating FX rate. **Quite expectedly, 1Y NDF was weaker, yielding 18.3% vs 17.4% one week ago.**

Banking System Liquidity, UAH bn



Source: NBU, UkrSibbank

Liquidity is on recovery track

According to our expectations, banking system liquidity was on recovery path last week after the nosedive caused by profit tax payment date. Liquidity plunged to its low UAH 12.9 bn on Tuesday and increased to UAH 14.2 bn by the end of the week. At this level we have not observed any UAH shortages in the market, implying that **existing liquidity was evenly distributed across the banking system.**

This has to support downward movement of interest rates, even though UAH 14 bn is a modest level (by historical standards). **We expect liquidity to continue recovering from its lows over the next two-three weeks.**

KievPrime o/n rates are declining from almost 9% to the area of 3-4%. 1M rates are somewhat up (from 12.8% to 13.55)



Primary auctions schedule

	UAH	USD-linked	USD
28.02.2012	3M, 6M, 12M, 2Y	3Y	1Y,3Y
01.03.2012	6M, 12M, 2Y,3Y	3Y	
06.03.2012	3M, 12M, 2Y		1Y,3Y
13.03.2012	3M, 12M, 2Y		1Y,3Y
15.03.2012	6M, 12M, 2Y, 3Y		
20.03.2012	3M, 12M, 2Y		1Y,3Y
22.03.2012	6M, 12M, 2Y, 3Y		
27.03.2012	3M, 12M, 2Y		1Y,3Y
29.03.2012	6M, 12M, 2Y,3Y	3Y	

Source: MinFin

Primary auctions results, Feb 21

# of Auction	65	66	67
ISIN (short)	135289	133763	134936
Currency	UAH	UAH	UAH
Maturity (days, M, Y)	3M	12M	2Y
Cut-off yield	13,50%	-	-
Weighted average yield	13,50%	-	-
Highest bid	13,50%	14,50%	-
Lowest bid	14,00%	14,50%	-
Bids submitted, UAH mn	1337,75	40	0
Number of bids	10	1	0
Number of bids accepted	8	0	0
Bids accepted, UAH mn	1 323	0	0
Amount raised, UAH mn	1283,00	0	0

Source: MinFin

Primary auctions results, Feb 21

# of Auction	68	69	70
ISIN (short)	-	134431	133771
Currency	USD-I	USD	USD
Maturity (days, M, Y)	3Y	1Y	3Y
Cut-off yield	-	9,30%	-
Weighted average yield	-	9,30%	-
Highest bid	-	9,30%	9,45%
Lowest bid	-	9,30%	9,45%
Bids submitted, UAH mn	0	40,52	0,75
Number of bids	0	13	1
Number of bids accepted	0	13	0
Bids accepted, UAH mn	0	40,52	0
Amount raised, UAH mn	0	42,23	0

Source: MinFin

Primary auctions results, Feb 23

# of Auction	71	72	73	74	75
ISIN (short)	135420	133763	134936	-	-
Currency	UAH	UAH	UAH	UAH	USD-I
Maturity (days, M, Y)	6M	12M	2Y	3Y	3Y
Cut-off yield	-	-	-	-	-
Weighted average yield	-	-	-	-	-
Highest bid	13,90%	-	-	-	-
Lowest bid	14,00%	-	-	-	-
Bids submitted, UAH mn	50	0	0	0	0
Number of bids	2	0	0	0	0
Number of bids accepted	0	0	0	0	0
Bids accepted, UAH mn	0	0	0	0	0
Amount raised, UAH mn	0	0	0	0	0

Source: MinFin

MoF passes major redemption date

Government has conducted another successful auction on Tuesday, attracting UAH 1.338 bn worth of bids (at par) on the short-end of the curve. 99% of bids (8 out of 10) were satisfied at 13.5%, 2 small bids above the cutoff rate were left open. Minfin rejected a single UAH 40 mn bid at 14.5% for 1Y note. In \$OVDP universe, ministry of finance satisfied 13 bids for 1Y note (totaling \$40.5 mn at par) at 9.3%. Provided this large number of bids one could suggest active participation of small banks and even private individuals, who could prefer \$OVDP to local deposits. Three year indexed note saw no bids.

Provided good auction results, Minfin faced no difficulties, redeeming significant amount on Wednesday. Regular auction on Thursday was a dull one, seeing UAH 50 mn in two bids (13.9% and 14.0%) for 6M note which were left open.

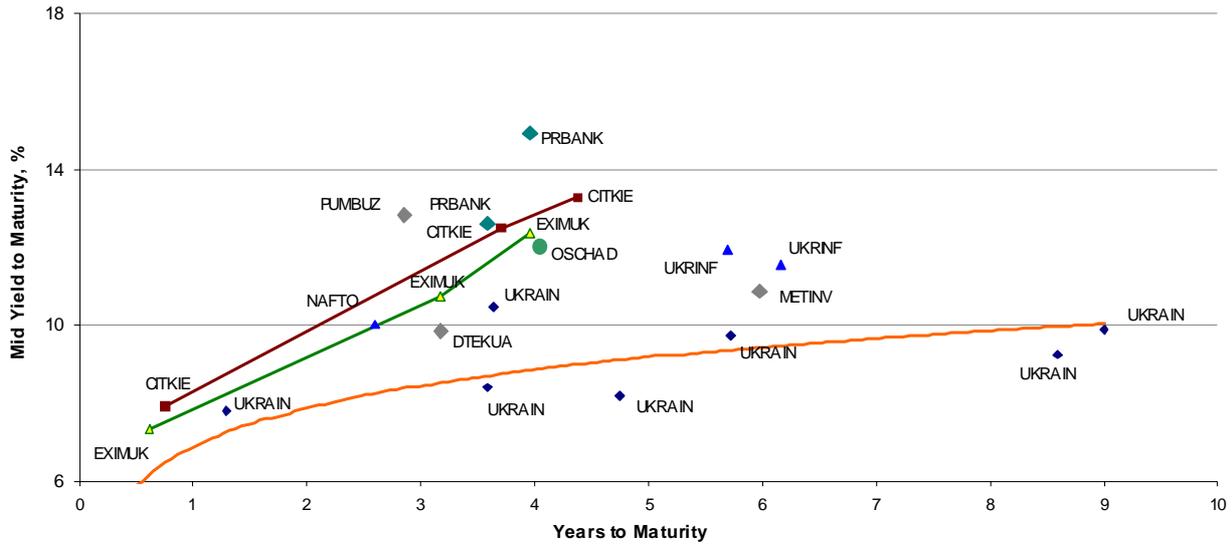
International accounts display healthy inflows in Ukrainian government debt

International accounts returned to local government bond market. In a week ending Feb 24th, international holders added UAH 360 mn (+8% w/w) which the second consecutive week of growth. In previous week, international buyers reported healthy +7% w/w increase in OVDP holdings.

The key strategy for foreign investors is **to long short-term UAH paper**, betting on UAH stability up to parliamentary elections in October, then switching back into hard currency. With global risk-on attitude driving the markets, one could well expect more bids for 3M Ukrainian notes, driving yields down in case MinFin decides to stop offering 3M note at 13.5% (which is quite likely).

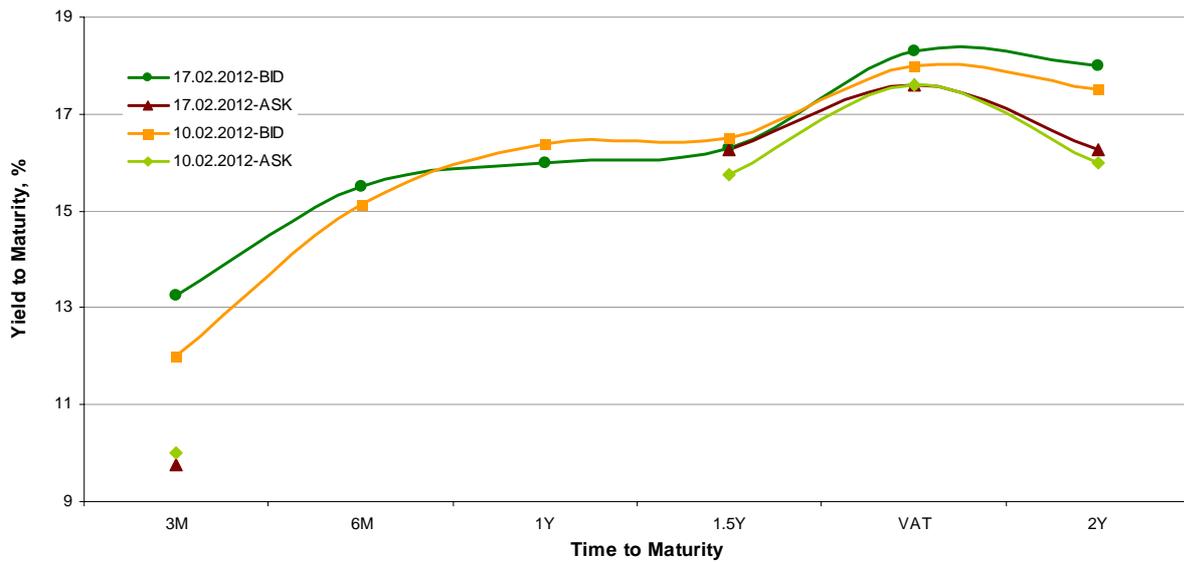


Ukrainian Eurobonds – yield map



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
UA4000101018	13.06.2012	107	14.50%	11.00%	YTM
UA4000061451	31.10.2012	247	15.00%	-	YTM
UA4000118871	30.04.2013	428	17.25%	16.50%	YTM
VAT II-IV	Aug-2015	3y6m	18.0%	17.60%	YTM
UA4000134431 (USD)	06.03.2013	373	9.50%	9.30%	YTM
Boryspil G series	13.11.2012	260	19.00%	15.75%	YTM
Sberbank of Russia (Ukraine)	18.01.2013	326	19.25%	18.00%	YTM
Prominvestbank B series	25.02.2013	364	19.00%	18.00%	YTM
Procreditbank G series	14.05.2013 (put)	442	23.00%	18.25%	YTM

Source: traders' quotes

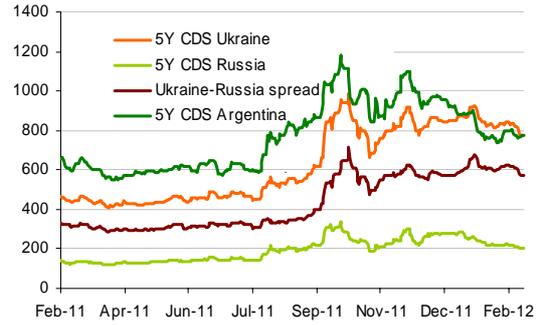


Ukrainian sovereign Eurobonds, YTM (%)



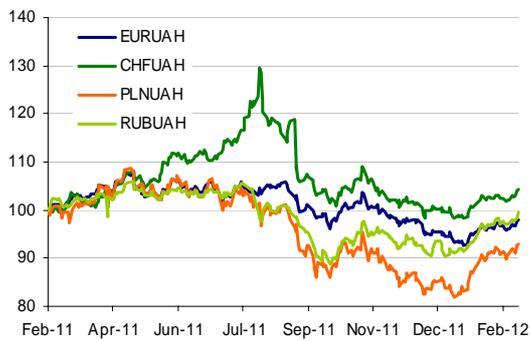
Source: Bloomberg

Credit default swaps



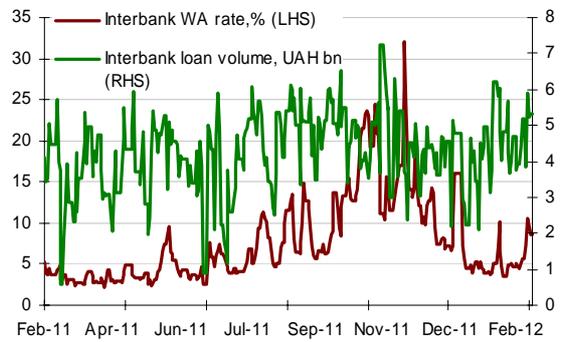
Source: Bloomberg

UAH vs other currencies, spot



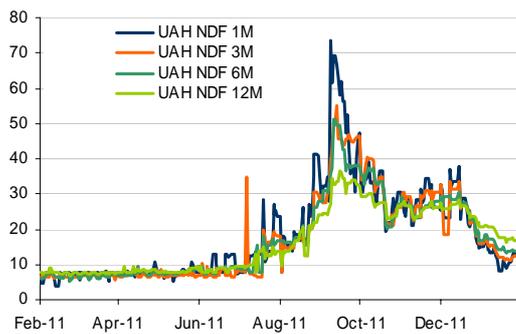
Source: Bloomberg

Interbank volume and rates



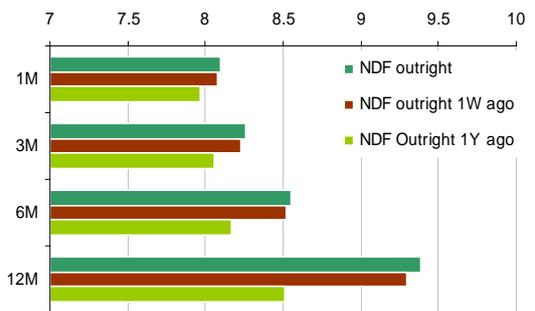
Source: Bloomberg

UAH NDF implied yields



Source: Bloomberg

UAH NDF changes – outright rates



Source: Bloomberg

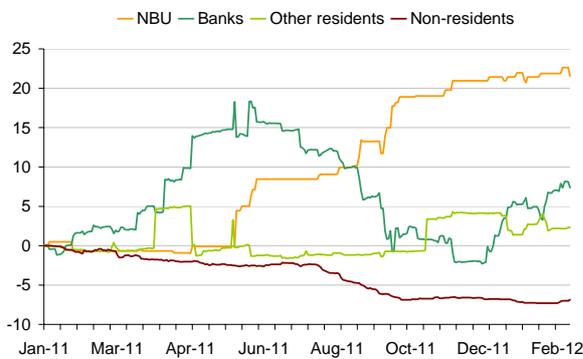


OVDP redemptions in 1H 2012 (principal + interest), UAH mn

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	1638		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	2673		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													

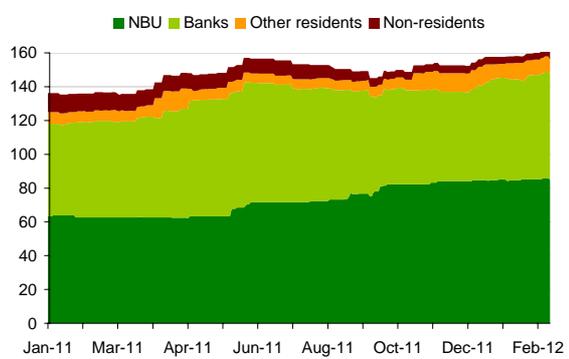
Source: MinFin, UkrSibbank

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



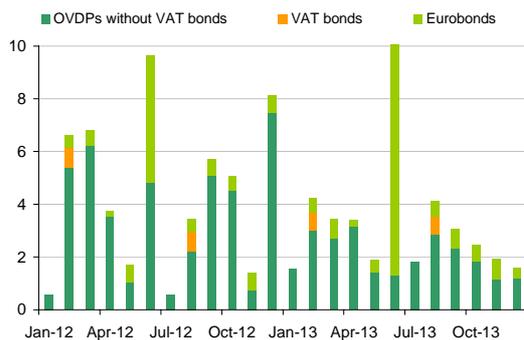
Source: NBU, UkrSibbank's calculations

OVDP in circulation structure, UAH bn



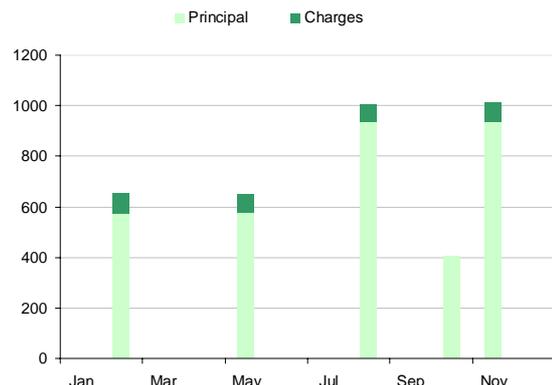
Source: NBU

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



Contacts

François Girod

Head of Capital Markets

(+38044) 537 5013. francois.girod@ukrsibbank.com

Oksana Shveda

Head of Investment Banking

(+38044) 201 2254. o_shveda@ukrsibbank.com

Serhiy Yahnych

Corporate Finance

(+38044) 585 0175. serhii.yahnych@ukrsibbank.com

Mykola Selekman, CFA

Trading and Brokerage

(+38044) 585 0120. mykola.selekman@ukrsibbank.com

Alexey Litvinov

Trading

(+38044) 201 2274. oleksii.litvinov@ukrsibbank.com

Pavel Mishustin

IB Services

(+38044) 585 0132. p_mishustin@ukrsibbank.com

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