



Fixed Income Weekly

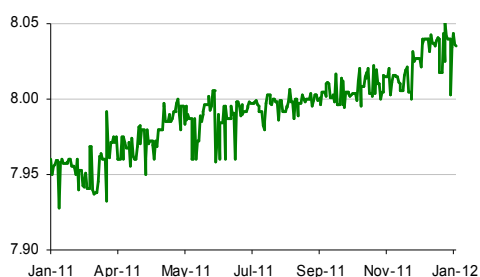
January 30, 2012

Ukraine Economics | Interest Rate Strategy | FX Strategy

	Today	Week ago*	Change
Global indicators			
UST 2Y, %**	0.22	0.22	0
UST 10Y, %**	1.95	2.03	-7
LIBOR 3M, %**	0.55	0.56	-1
EURIBOR 3M, %**	1.14	1.18	-4
Oil (Brent), USD	111.36	109.86	1.50
Baltic Dry (BDIY, pts)	753	862	-109
Sovereign risk			
CDS 1Y bp	766	820	-54
CDS 5Y bp	821	860	-39
Ukraine 13, YTM%**	10.0	10.1	-7
Ukraine 16, YTM%**	9.8	10.7	-87
Ukraine 20, YTM%**	9.8	10.0	-19
Currency			
USDUAH	8.0352	8.0397	-0.0045
EURUSD	1.3146	1.2931	0.0215
NDF 1M outright	8.15	8.1625	-0.02
NDF 6M outright	8.725	8.915	-0.19
NDF 12M outright	9.7	9.9025	-0.20
12M NDF Implied Yld%	20.8	23.8	-3.05
Local interest rates			
KievPrime, O/N %	3.78	1.21	2.57
KievPrime, 1M %	13.45	13.1	0.35
Wide interbank rate, % (UKIRAWIR)	16.1	16.1	0.00
1Y OVPD, YTM % (bid)	16.25%	16.50%	-0.25
VAT bonds, YTM % (bid)	18.5%	18.0%	-0.50
Liquidity, UAH bn	21.3	24.7	-3.4

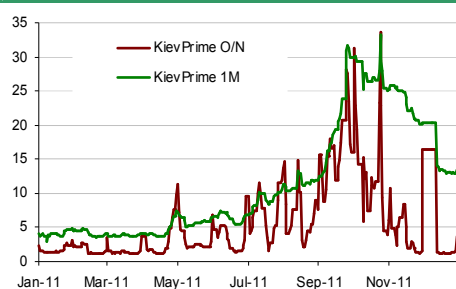
*Change over the last 7 calendar days; **change in bp

USD/UAH Spot



Source: Bloomberg

KievPrime O/N and 1M



Source: Bloomberg

- **US QE3 is unlikely to benefit Ukraine much**
- **No quick results from IMF talks last week**
- **Ukrainian Eurobonds appreciated, CDSs fell last week**
- **NDF rates fell sharply, spot UAH is stable**
- **Probably, the last weeks of low money market rates**
- **MinFin may sell short-term bonds this week**
- **Secondary market rates have inched down**

QE3 is unlikely to benefit Ukraine much

The Federal Reserve System of the USA is going to conduct ultrasoft monetary policy until the end of 2014, replacing the previous time span for it of until mid-2013. **QE3 is becoming more likely.** The market response to this announcement was moderate, although the markets experienced for a short time increase of investor interest towards risky assets.

We think that **frontier markets like Ukraine will not be the main beneficiaries of the QE3**: new money will be rather forwarded to less risky assets such as emerging markets or commodities, especially as near term prospects are shadowed by the European debt crisis. Nevertheless, Ukrainian assets should benefit from less risk aversion by investors.

No quick results from IMF talks last week

Quite expectedly, **the Ukrainian delegation returned from the IMF assuring that the negotiations would be continued.** Vice Prime Minister Serhiy Tigipko said that the main topic of discussion with the IMF was natural gas tariffs for households. He said the Ukrainian authorities are not going to raise these tariffs. The delegation submitted proposals for subsidising the tariff shortfalls from the state budget. Evidently, these proposals will not be accepted by the IMF.

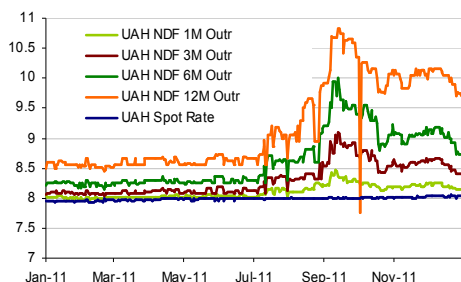
There are rumours in the press and among investment community that the main purpose of the Ukrainian officials' visit to the IMF headquarters was an attempt to reschedule the interest or principal payments. The IMF did not publish any specific comments on the recent meetings with Ukrainian officials.

Ukrainian Eurobonds appreciated, CDSs fell last week

YTM's of Ukraine's Eurobonds fell last week, especially in the mid-term notes, yields of which fell 50-100 b.p. **Credit default swaps were falling together with CDSs of other countries, but with a higher magnitude (credit default swaps for Ukrainian sovereign debt have a visibly high "beta").**



NDF outright rates



Source: Bloomberg

NDF rates fell sharply, spot UAH is stable

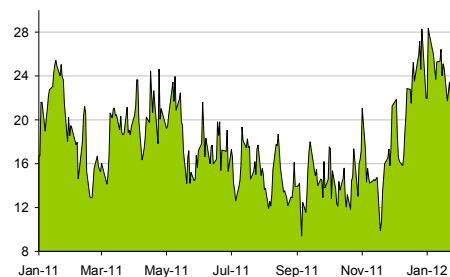
The interbank exchange rate had not changed much since the week before: on Friday the market closed at 8.034-8.038. The trade volume did not change much: USD3.1bn vs USD3.7bn the week before.

UAH NDF rates fell sharply across all maturities last week. In our view, this is caused by a number of factors, including:

- appointment of Mr Khoroshkovskyi as Minister of Finance
- leaks from the gas negotiations indicating that an agreement leading to lower gas prices will be ultimately signed somewhere in spring or June
- growing risk appetite among investors

We expect that the rally in NDFs will continue, especially for shorter contracts.

Banking System Liquidity, UAH bn



Source: NBU

Probably, the last weeks of low money market rates

The banking liquidity was slowly declining last week from UAH24.7bn on Friday, January 20, to UAH 21.3bn on last Friday. Actually, these figures are not particularly high, given that there is practically no NBU certificates of deposit now vs. UAH9-11bn a year ago.

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

Last Friday O/N rates moved up to the 2%-4% territory that is primarily explained by:

- end-of-month effects, and
- increased tax payments

1M rates were staying in the range of 9-13% last week.

On January 25 the NBU lent to 4 banks UAH100mn at 9% for 87 days at a special tender. We expect a similar tender this week.

The NBU lowered its O/N refinancing rates:

- from 9.25% to 9.00% for loans with OVDPs as collateral
- from 11.25% to 11.00% for loans without collateral

We think the decrease in the NBU rates will not have much impact on the market as current interbank O/N rates are much lower than 9-11%. The latest O/N refinancing by the NBU was on December 19, 2011.

The NBU and the MinFin has discussed their cooperation last week: the NBU is going to allow the Treasury to conduct operations with its resources, i.e. lend money to banks. In addition, new instruments on the local market, including bonds for individuals, may be created.



Primary auctions schedule

	UAH	USD-linked	USD
24.01.2012	3M, 6M, 12M and 2Y	1.5Y and 3Y	3Y
26.01.2012	12M, 2Y and 3Y	1.5Y and 3Y	-
31.01.2012	3M, 6M, 12M, 2Y	1.5Y and 3Y	3Y

Source: MinFin

Primary auctions results, January 24

# of Auction	18	19	20	21
ISIN (short)	133789	-	-	-
Currency	UAH	UAH	UAH	UAH
Maturity (days, M, Y)	3M	6M	12M	2Y
Cut-off yield	13,50%	-	-	-
Weighted average yield	13,35%	-	-	-
Highest bid	13,25%	14%	14%	20%
Lowest bid	15,00%	16%	17,50%	20%
Bids submitted, UAH mn	230	125	41,35	50
Number of bids	5	5	5	1
Number of bids accepted	3	0	0	0
Bids accepted, UAH mn	170,0	0	0	0
Amount raised, UAH mn	164,9	0	0	0

Source: MinFin

Primary auctions results, January 24

# of Auction	22	23	24
ISIN (short)	-	-	-
Currency	USD-I.	USD-I.	USD
Maturity (days, M, Y)	1.5Y	3Y	3Y
Cut-off yield	-	-	-
Weighted average yield	-	-	-
Highest bid	10,50%	-	10%
Lowest bid	10,50%	-	10%
Bids submitted, UAH mn	100	0	5
Number of bids	1	0	1
Number of bids accepted	0	0	0
Bids accepted, UAH mn	0	0	0
Amount raised, UAH mn	0	0	0

Source: MinFin

Primary auctions results, January 26

# of Auction	25	26	27	28	29
ISIN (short)	133763	-	-	-	-
Currency	UAH	UAH	UAH	USD-I.	USD-I.
Maturity (days, M, Y)	12M	2Y	3Y	1.5	3Y
Cut-off yield	-	-	-	-	-
Weighted average yield	-	-	-	-	-
Highest bid	16,00%	-	-	10,25%	-
Lowest bid	16,00%	-	-	10,25%	-
Bids submitted, UAH mn	20	0	0	10	0
Number of bids	1	0	0	1	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

MinFin may sell short-term bonds this week

Like in previous weeks, we expect that demand at primary auctions will be concentrated in 3M securities. In addition, there might be a few bids for 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 UAH165mn through sale of 3M UAH bonds. All other bonds (longer term UAH bonds, USD-linked bonds and USD bonds) went unsold. The MinFin accepted 13.50% for 3M and decided not to accept:

- 14% for 1Y UAH bonds
- 20% for 2Y UAH bonds
- 10.25% for 1.5Y USD-linked bonds, and
- 10.00% for 3Y USD bonds

The cut-off rate for 3M bonds, 13.50%, had not changed since the week before. **As 3M UAH bonds have secondary market bids around 13.5%, we could expect a significant demand for this maturity at Tuesday's auction.** The MinFin has yet to publish the primary auctions schedule for February.

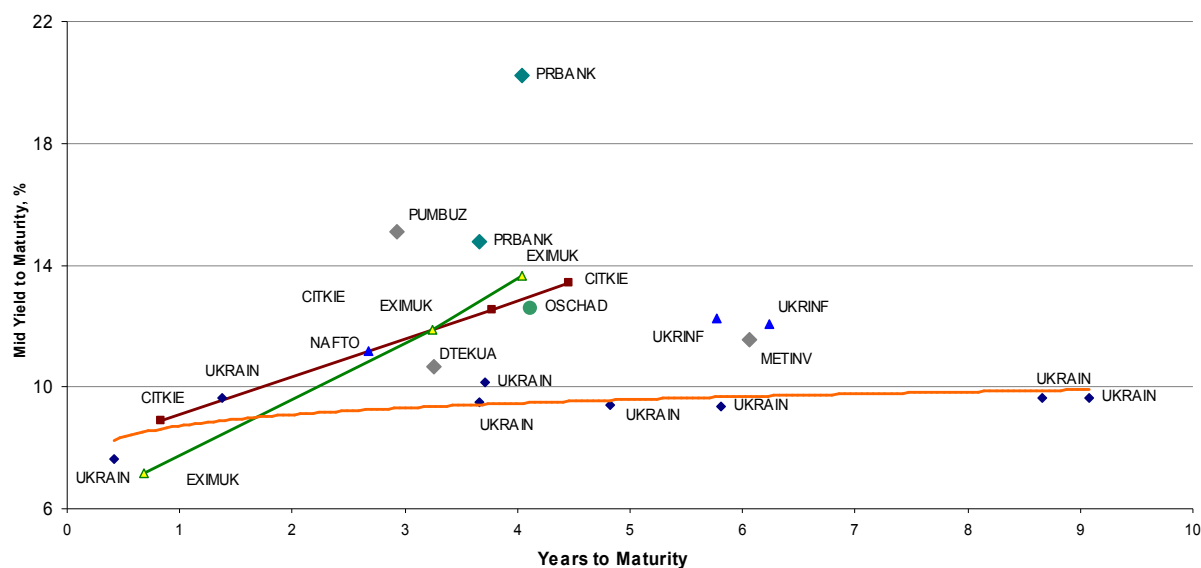
Secondary market rates have inched down

The secondary market appreciated slightly during the last week across all maturities. This is most likely caused by a stable level of the banking liquidity (still over UAH 20bn) and devaluation expectations shifting further in time. Another factor for a better secondary market is the joint initiative of the NBU and the MinFin to introduce new instruments, including placements of the State Treasury's money on bank deposits. OVDPs are likely to be used as collateral in some of the new financial instruments.

We expect that the banking liquidity will continue to decline this week, bringing to the end the current mini-rally on the secondary market.

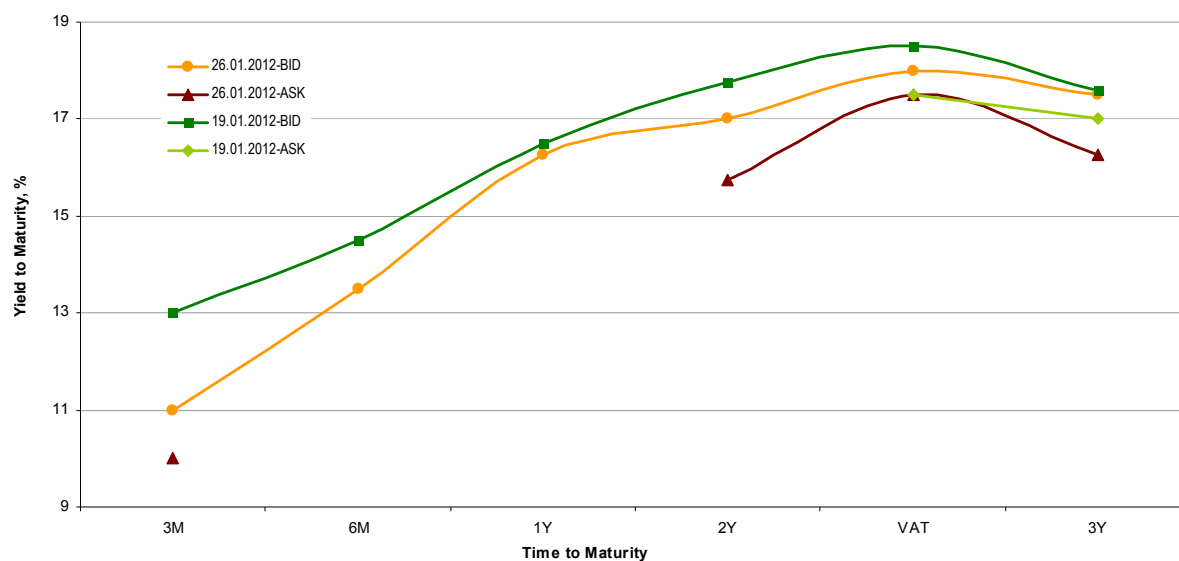


Ukrainian Eurobonds – yield map



Source: Bloomberg

Secondary market for UAH OVDPs



Source: traders' quotes

Selected Ukrainian local bonds, sovereign and corporate

ISIN	Maturity	Bid Yield	Ask Yield	YTM
UA4000048219	22.02.2012	11.00%	10.00%	YTM
UA4000101018	13.06.2012	-	12.00%	YTM
UA4000063564	12.09.2012	16.25%	-	YTM
UA4000061451	31.10.2012	16.50%	-	YTM
UA4000107510	12.12.2012	17.00%	-	YTM
UA4000115117	26.03.2014	18.00%	16.25%	YTM
VAT II-IV	Aug-2015	18.00%	17.50%	YTM
UA4000132260	12.06.2013	-	9.00%	YTM
Boryspil G	13.11.2012	-	16.50%	YTM
Sberbank of Russia (Ukraine)	18.01.2013	-	-	YTM
Prominvestbank B series	25.02.2013	22%	18%	YTM
Russian Standard (Ukraine)	28.02.2012	-	19%	YTM

Source: traders' quotes

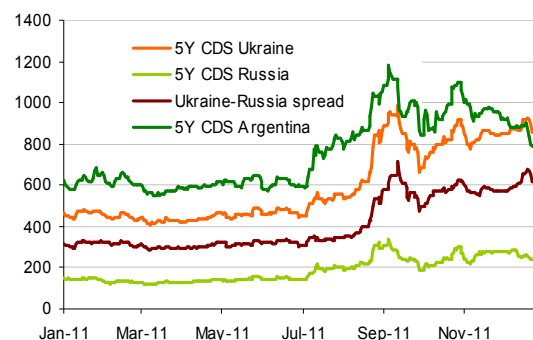


Ukrainian sovereign Eurobonds, YTM (%)



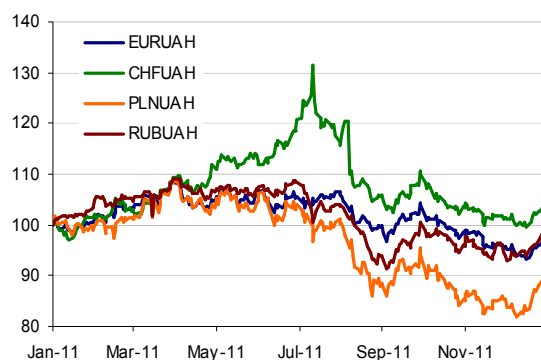
Source: Bloomberg

Credit default swaps



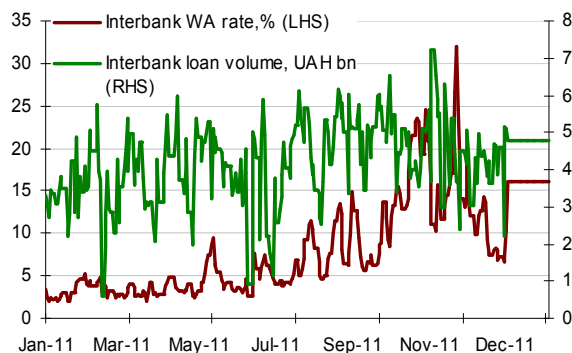
Source: Bloomberg

UAH vs other currencies, spot



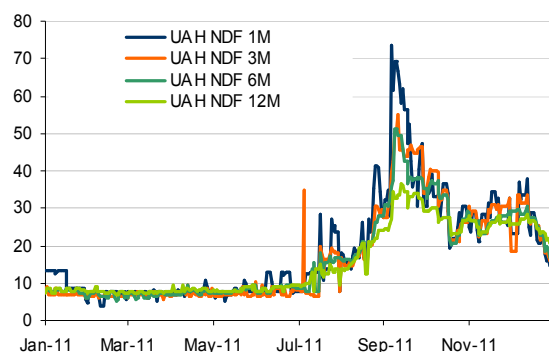
Source: Bloomberg

Interbank volume and rates



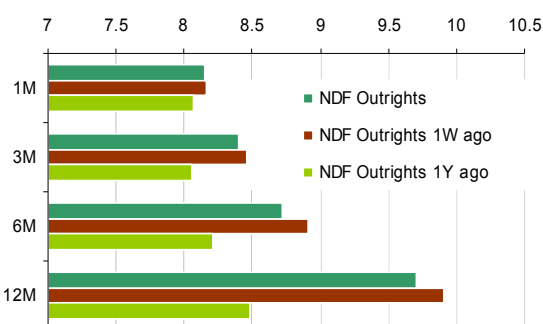
Source: Bloomberg

UAH NDF implied yields



Source: Bloomberg

UAH NDF changes – outright rates



Source: Bloomberg

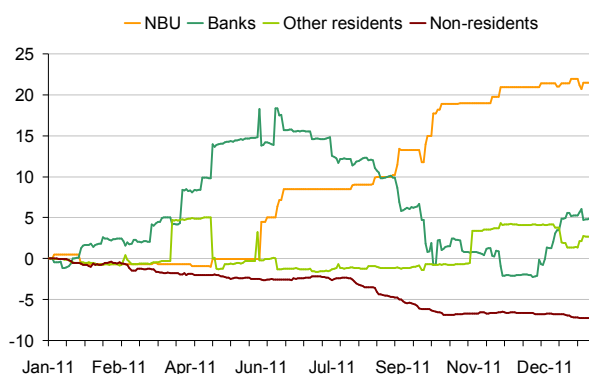


OVDP redemptions in 2Q 2012 (principal + interest), UAH mn

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	1528		4-Apr	1020		2-May	306		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	15-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													

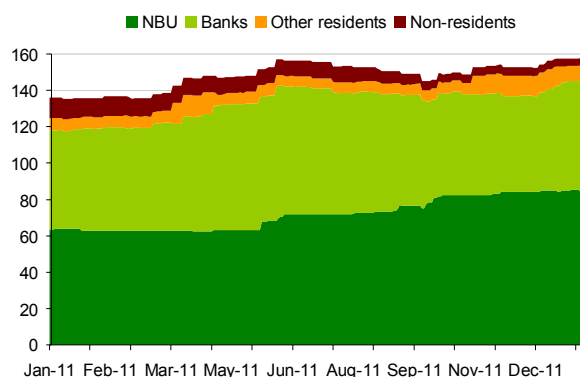
Source: MinFin, UkrSibbank

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



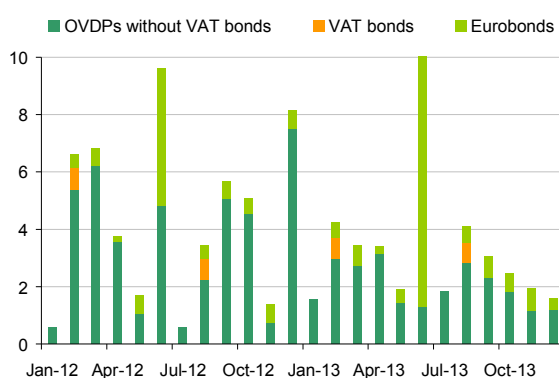
Source: NBU, UkrSibbank's calculations

OVDP in circulation structure, UAH bn



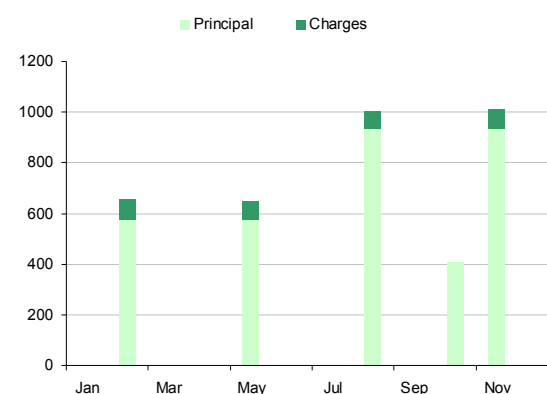
Source: NBU

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%	5,0%	3,8%	4,0%
Nominal GDP (UAH bn)	913	1095	1288	1484	1697
Nominal GDP (\$bn)	117	138	161	183	179
GDP per Capita (at F/X rate; \$)	2538	2998	3519	4017	3944
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	322	345	372
Expenditures	242	304	341	370	400
Budget balance (% of GDP)	-4%	-6%	-1,5%	-1,7%	-1,6%
Budget deficit (UAH bn, "-" is deficit)	-33	-64,3	-19,0	-24,7	-27,8
Total Public Debt (USD bn)	40	54	61	63	66
Total Public Debt (% of GDP)	34%	39%	38%	34%	37%
Gross External Debt (USD bn), e-o-p	103	117	127	132	140
Gross External Debt (% of GDP)	88%	85%	79%	72%	78%
External Balances					
Exports (USD bn)	40,4	52,2	72,2	73,6	77,2
Imports (USD bn)	44,7	60,6	86,9	87	82,5
Merchandise trade balance	-4,3	-8,4	-14,7	-13,5	-5,3
Services Trade Balance (USD bn)	2,4	4,4	3,9	3,7	3,7
Current Account Balance (USD bn)	-1,7	-2,9	-9,4	-8,2	-0,8
Current Account Balance (% of GDP)	-1,5%	-2,1%	-5,8%	-4,5%	-0,4%
Capital and Financial Accounts Balance (USD bn)	9,9	7,9	4,1	5,1	8,0
Net FDI Inflow (USD bn)	4,7	5,8	5,9	6,0	9,0
Net FDI Inflow per Capita (\$)	101	125	129	132	199
Gross F/X Reserves (USD bn)	26,5	34,6	30,1	21,7	22,4
FX					
UAH:USD (rate; eop)	7,99	7,97	8,02	8,40	9,80
UAH:USD (avg.)	7,79	7,94	7,99	8,10	9,50

Source: UkrSibbank



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