



# Fixed Income Weekly

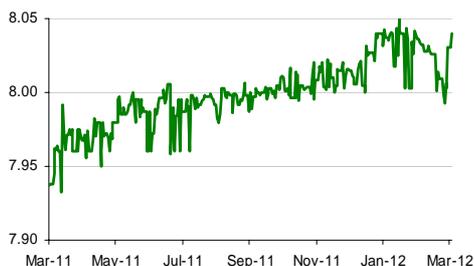
March 5, 2012

Ukraine Economy | Interest Rate Strategy | FX Strategy

	Today	Week ago*	Change
<b>Global indicators</b>			
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
<b>Sovereign risk</b>			
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
<b>Currency</b>			
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
<b>Local interest rates</b>			
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)	15.00	15.50	-0.50
VAT bonds, YTM % (bid)	17.50	18.00	-0.50
Liquidity, UAH bn	20.7	14.2	6.5

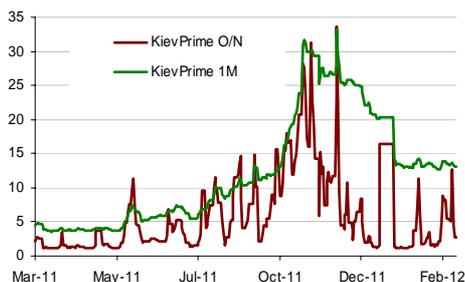
\*Change over the last 7 calendar days; \*\*change in bp

## USD/UAH Spot



Source: NBU

## KievPrime O/N and 1M



Source: Bloomberg

- **Global markets are enthusiastic following liquidity injection**
- **Accomplishment of presidential elections in Russia to support interest towards Ukrainian debt...**
- **... while rally on the short end of Eurobond curve has been remarkable**
- **UAH spot rate is down 0.3% in highly volatile week**
- **MinFin reduced offer of short-term debt, introduced changes to auction schedule**
- **The winner takes it all – one happy bidder walks away with UAH 550 mn of 6M bills, we expect yield on 3M bill to go below 13.00% during tomorrow's auction**

## Global markets are enthusiastic following liquidity injection

**Global markets are very enthusiastic, pricing in resolution of two year Greek saga.** Last week Euro-area finance ministers authorized European Financial Stability Facility to issue bonds for the swap. As of today, private bondholders represented by Institute of international finance have endorsed conditions of debt swap, which yet have to meet 75% participation rate set by Greek government. **To support the solution with Greek debt, ECB has injected EUR 320 bn of three year liquidity last week. This is far more powerful inflow of liquidity than that recorded in December 2011, when EUR 190 bn was injected.**

## Accomplishment of presidential elections in Russia to support interest towards Ukrainian debt

**Preliminary results of Presidential elections on Sunday indicate victory of Mr. Putin in the first round, providing further ground to Russian assets. This has to (a) support positive moods in Ukrainian debt universe, (b) unlock another prerequisite for long-awaited Russia-Ukraine gas deal. However, there is not much progress in this debate.**

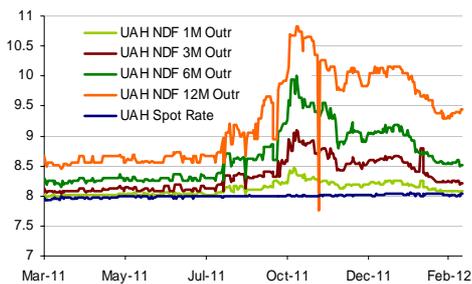
**Gazprom has submitted a draft agreement to the government of Ukraine, in which Russian gas supplier agreed to lower natural gas price by 10%, Ukrainian Prime-Minister Nikolay Azarov said. Earlier, Gazprom was reported to cut natural gas prices by 10% for some of its European clients. Ukraine would continue to look for a higher discount, in exchange stake in gas transportation system.**

## ... while rally on the short end of Eurobond curve has been remarkable

**Ukraine's benchmark Eurobonds had another excellent week, with Ukraine-13 breaking 8% mark and probably testing 7% this week should global markets continue to operate in Risk-On mode. Ukraine-12 already slid to roughly 5% this morning, albeit bid/ask spreads are as high as 100 b.p. on this short note maturing in June 2012. Ukraine-16 and**



**NDF outright rates**



Source: Bloomberg

Ukraine-20 were traded at yields around 8.6 and 9.1% on Friday, strengthening a bit today. Against the backdrop of rally in Ukrainian Eurobonds, 1.5Y \$OVDP domestic note offer from MinFin now provides up to 1% premium over Eurobond market.

**1Y CDS has shown remarkable contraction of 170 b.p.**, declining to just over 500 b.p. This corresponds to positive price action on the short end of Ukrainian Eurobond curve. It is interesting that 5Y CDS showed virtually no improvement over the last week marking time around 750 b.p.

**Ukrainian President Viktor Yanukovych appointed the deputy chairman of the central bank, Yury Kolobov, as finance minister**, according to Presidential decree #156 published on MinFin's site. Kolobov (actively rumoured as the most probable candidate) served as deputy head of Ukraine's central bank after a career in state and commercial banks. The previous finance minister, Valery Khoroshkovsky, held the post for just over one month before he was promoted to first deputy prime minister.

**The key implications for Ukrainian debt:**

- (a) *new Eurobonds are becoming very likely now as key obstacle has been removed;*
- (b) *expect further downward movement on the short end of UAH curve, less generous offer from MinFin on domestic primary market.*

According to our information, **Ukraine is ready to issue a Eurobond** (most likely 3 or 5 year), waiting out for current rally to finish before making offer to investors.

**UAH spot rate is down 0.3% in highly volatile week**

**Ukrainian currency was down 0.3% this week in several highly volatile sessions.** On Feb 27th USDUAH was strengthening to 7.98, shooting back to 8.03-8.04 range several days later. We have heard various reasons for these movements, with market discussing (a) Naftogaz purchases of foreign currency to pay \$1.3 bn gas bill by 7th of March and (b) speculative actions by unknown group of players. **UAH NDF rates remained broadly stable last week**, amid dull trading action.

**NB! Ukrainian markets will be closed on Mar 8-Mar 11<sup>th</sup> due to public holidays.**

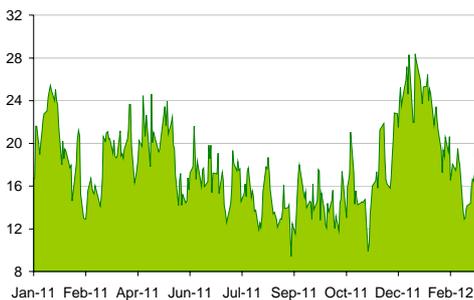
**Liquidity has fully recovered, Naftogaz payment ahead**

According to our expectations, **banking system liquidity has recovered**, displaying robust UAH 20.7 bn on Monday morning.

**This has to be reflected in KievPrime rates** and we expect 1M rates to slide towards single-digit zone, comparing to 12-13% recorded today.

There is not much to happen over the two weeks to come, with key anticipated events to be usual liquidity drop after long holidays and possible decline following Naftogaz payment for Russian gas. All in all **we expect liquidity to go down** next week to UAH 16-18 bn.

**Banking System Liquidity, UAH bn**



Source: NBU, UkrSibbank



**Primary auctions schedule**

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

Source: MinFin

**Primary auctions results, Feb 28**

# of Auction	76	77	78	79
ISIN (short)	136295	135420	133763	134936
Currency	UAH	UAH	UAH	UAH
Maturity (days, M, Y)	3M	16M	12M	2Y
Cut-off yield	13,00%	13,75%	-	-
Weighted average yield	12,89%	13,74%	-	-
Highest bid	12,49%	13,70%	-	-
Lowest bid	13,55%	14,00%	-	-
Bids submitted, mn	831	80	0	0
Number of bids	16	4	0	0
Number of bids accepted	3	3	0	0
Bids accepted, mn	53,3	75	0	0
Amount raised, mn	51,68	70,55	0	0

Source: MinFin

**Primary auctions results, Feb 28**

# of Auction	80	81	82
ISIN (short)	-	-	133771
Currency	USD-I.	USD	USD
Maturity (days, M, Y)	3Y	1,5Y	3Y
Cut-off yield	-	-	-
Weighted average yield	-	-	-
Highest bid	-	9,40%	9,50%
Lowest bid	-	9,50%	9,50%
Bids submitted, mn	0	63,1	0,1
Number of bids	0	3	1
Number of bids accepted	0	0	0
Bids accepted, mn	0	0	0
Amount raised, mn	0	0	0

Source: MinFin

**Primary auctions results, Mar 1**

# of Auction	83	84	85	86	87
ISIN (short)	135420	133763	134936	-	-
Currency	UAH	UAH	UAH	USD-I.	UAH
Maturity (days, M, Y)	6M	12M	2Y	3Y	3Y
Cut-off yield	13,50%	-	-	-	-
Weighted average yield	13,50%	-	-	-	-
Highest bid	13,50%	-	-	-	-
Lowest bid	13,75%	-	-	-	-
Bids submitted, UAH mn	838,25	0	0	0	0
Number of bids	11	0	0	0	0
Number of bids accepted	1	0	0	0	0
Bids accepted, UAH mn	550	0	0	0	0
Amount raised, UAH mn	518,3	0	0	0	0

Source: MinFin

**MinFin reduced offer of short-term debt, introduced changes to auction schedule**

**Government has kept its promise to limit placements of 3M notes on Feb 28<sup>th</sup>.** Following its statements earlier last week, government has **substantially limited volume of placement** of 3m and 6m notes. In particular, Minfin satisfied only miserable 6.4% of bids for 3m note (UAH 53.3 mn out of UAH 831 mn worth of bids @13.00%).

Government also took UAH 75 mn out of UAH 80 mn bid for 6m note at 13.75%. Longer term UAH and indexed notes went unbid. Government also left unsatisfied three bids for 1.5Y \$OVDP note totaling \$63.1 mn (in range of 9.4-9.5%).

**MinFin also introduced changes into auction schedule**, cancelling placements of 3M notes on 13<sup>th</sup> and 27<sup>th</sup> of March. Also, 1Y \$OVDP was substituted with 1.5Y \$OVDP.

**The winner takes it all – one happy bidder walks away with UAH 550 mn of 6M bills**

Following debacle of domestic investors on Feb 28<sup>th</sup> auction, one bidder went on with aggressive bid of 13.50% for 6M bill, walking away with UAH 550 mn (at par). The sole buyer is likely to be regular market participant, willing to get more short-term UAH bills rather than state owned bank.

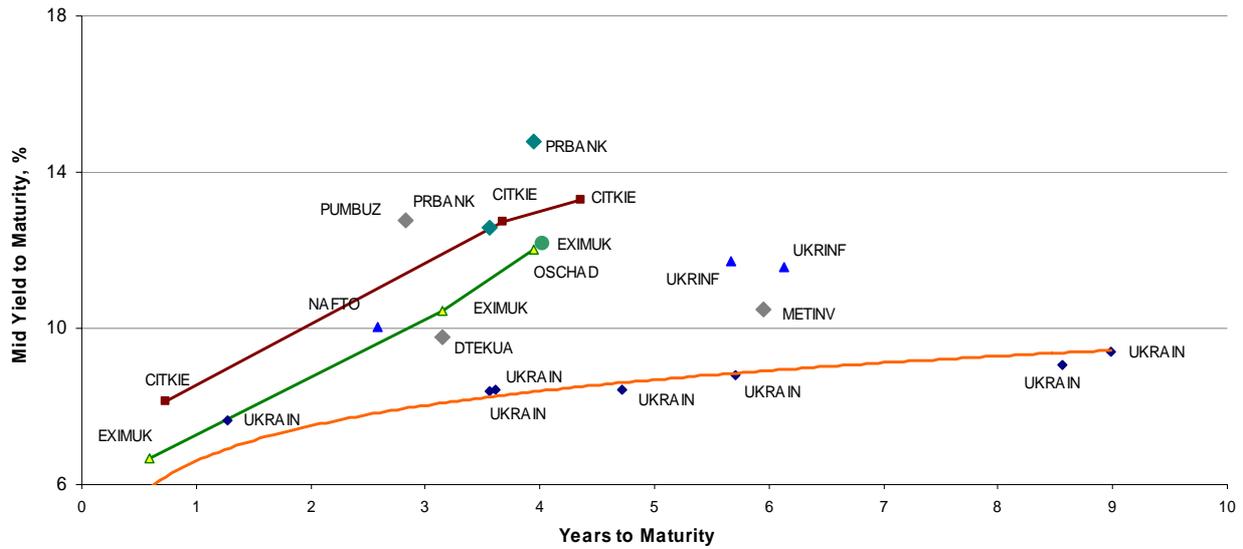
**...and we expect yield on 3M bill to go below 13.00% during tomorrow's auction**

Following drastic shortage of supply in 3M bills, we expect tough battle for it, with bids for 3M notes breaking through 13.00%.

**In the secondary market, the yields are moving lower across the board**, with shortest (1M) securities touching 11%. One year bond is traded at 15%, while VAT-OVDP remain virtually unchanged at 17.5%.

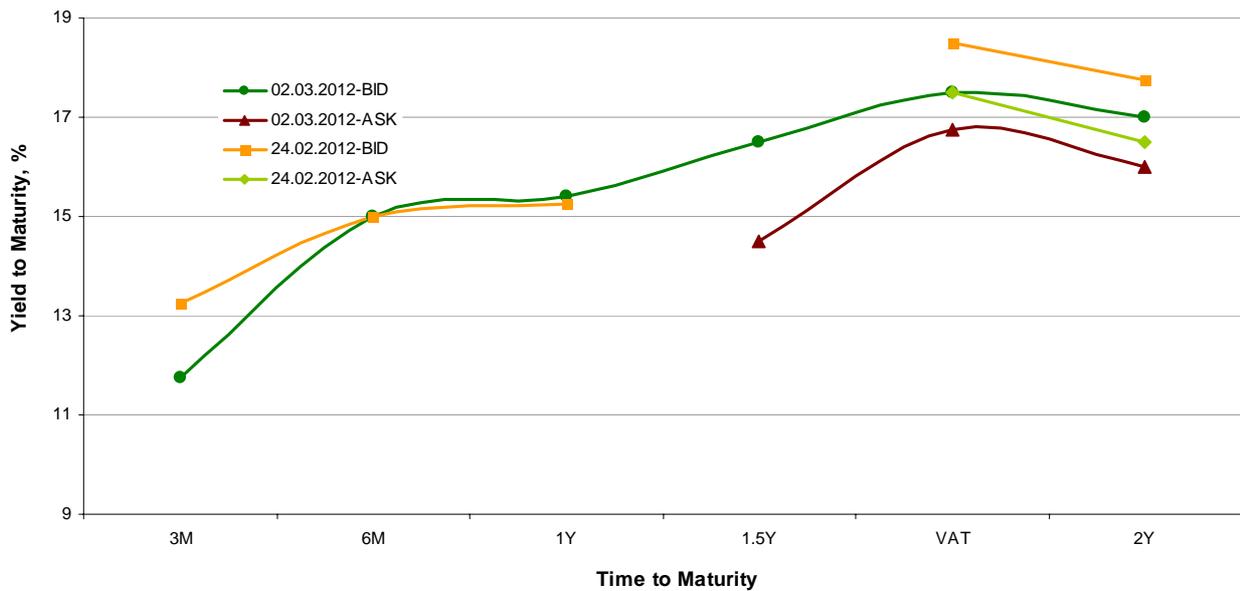


**Ukrainian Eurobonds – yield map**



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	102	14.50%	11.00%	YTM
UA4000061451	31.10.2012	242	15.00%	-	YTM
UA4000118871	30.04.2013	423	17.00%	16.00%	YTM
VAT II-IV	Aug-2015	3y6m	17.50%	16.75%	YTM
UA4000134431 (USD)	06.03.2013	368	9.20%	-	YTM
Boryspil G series	13.11.2012	255	19.00%	15.75%	YTM
Sberbank of Russia (Ukraine)	18.01.2013	321	19.25%	18.00%	YTM
Prominvestbank B series	25.02.2013	359	19.00%	18.00%	YTM
Procreditbank G series	14.05.2013 (put)	437	23.00%	18.25%	YTM

Source: traders' quotes

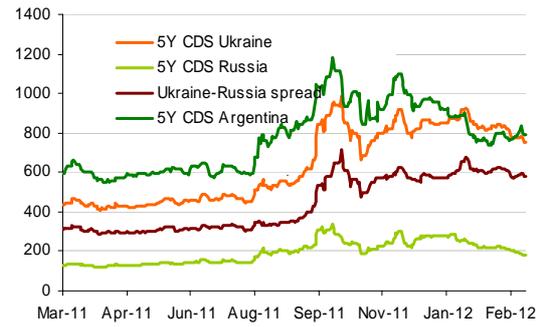


**Ukrainian sovereign Eurobonds, YTM (%)**



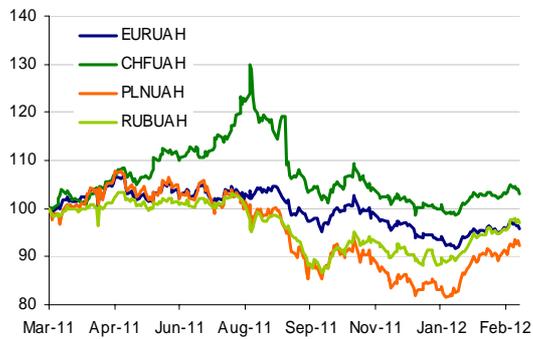
Source: Bloomberg

**Credit default swaps**



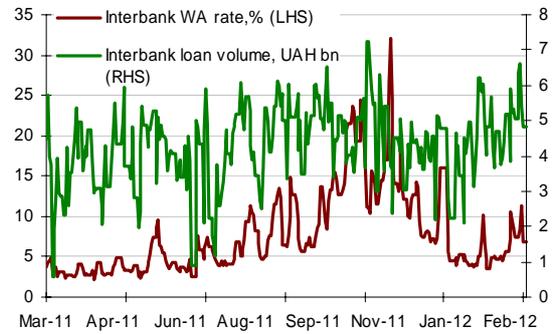
Source: Bloomberg

**UAH vs other currencies, spot**



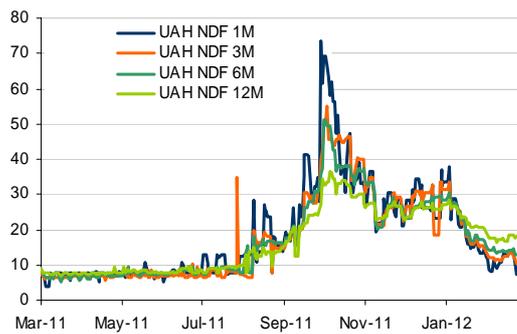
Source: Bloomberg

**Interbank volume and rates**



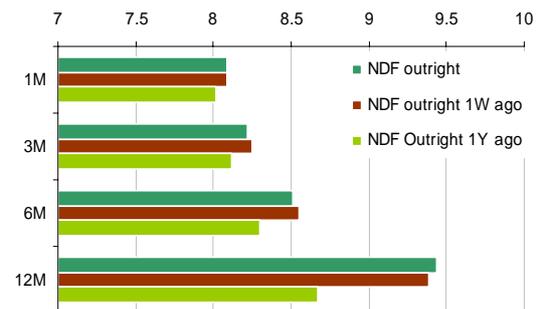
Source: Bloomberg

**UAH NDF implied yields**



Source: Bloomberg

**UAH NDF changes – outright rates**



Source: Bloomberg



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

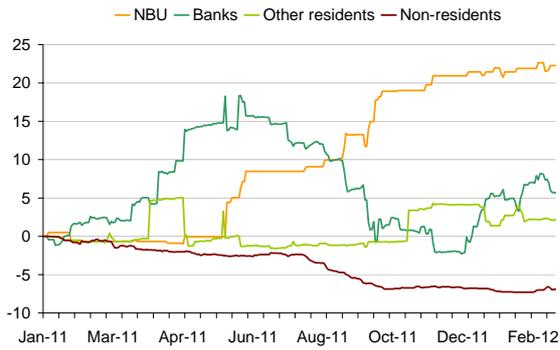
	7-Mar	14-Mar	21-Mar	23-Mar	28-Mar	4-Apr	11-Apr	18-Apr	20-Apr	25-Apr	2-May	3-May	9-May
Local UAH mn	1638	1123	2489		1084	1020	1735	796		162	654		122
Foreign USD mn				75					26			24	

	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		1471		231
Foreign USD mn	24		33					38		39		516	

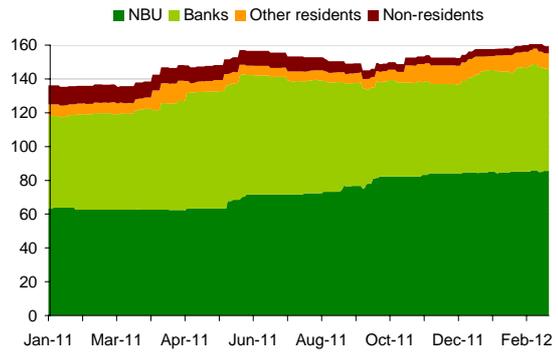
Source: MinFin, UkrSibbank

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



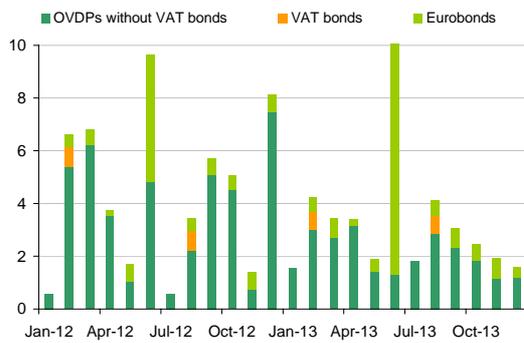
Source: NBU, UkrSibbank's calculations

**OVDP in circulation structure, UAH bn**



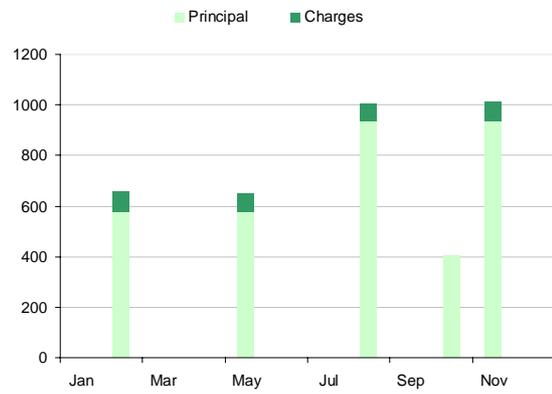
Source: NBU

**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
<b>Business Cycle</b>					
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%
<b>Prices</b>					
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%
<b>Public Finance</b>					
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%
<b>External Balances</b>					
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
<b>FX</b>					
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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