



# Fixed Income Weekly

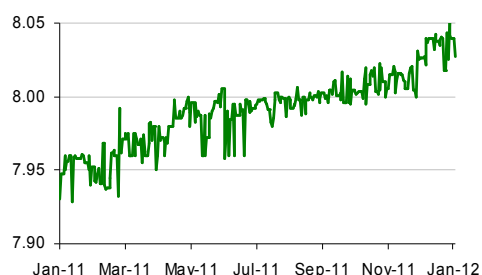
January 24, 2012

Ukraine Economics | Interest Rate Strategy | FX Strategy

	Today	Week ago*	Change
<b>Global indicators</b>			
UST 2Y, %	0.23	0.22	1
UST 10Y, %	2.01	1.86	16
LIBOR 3M, %	0.56	0.56	0
EURIBOR 3M, %	1.18	1.21	-3
Oil (Brent), USD	110.28	111.53	-1.25
Baltic Dry (BDIY, pts)	862	974	-112
<b>Sovereign risk</b>			
CDS 1Y bp	820	880	-61
CDS 5Y bp	860	928	-69
Ukraine 13, YTM%	10.4	11.6	-120
Ukraine 16, YTM%	10.3	11.5	-120
Ukraine 20, YTM%	10.1	11.0	-90
<b>Currency</b>			
USDUAH	8.0272	8.0253	0.0019
EURUSD	1.2929	1.2736	0.0193
NDF 1M outright	8.16	8.175	-0.02
NDF 6M outright	8.78	8.98	-0.20
NDF 12M outright	9.845	9.93	-0.08
12M NDF Implied Yld%	23.7	24.7	-0.97
<b>Local interest rates</b>			
KievPrime, O/N %	1.21	1.27	-0.06
KievPrime, 1M %	13.1	13.28	-0.18
Wide interbank rate, % (UKIRAWIR)	16.1	16.1	0.00
1Y OVDP, YTM % (bid)	21.7	25.3	-3.60
VAT bonds, YTM % (bid)	16.5	16.75	-0.25
Liquidity, UAH bn	18.5	18.5	0.00

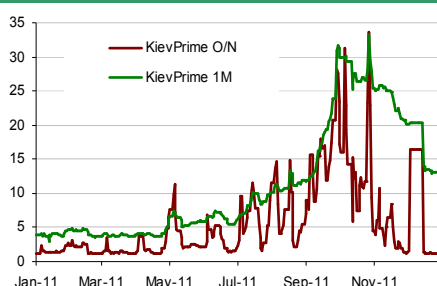
\*Change over the last 7 calendar days

## USD/UAH Spot



Source: Bloomberg

## KievPrime O/N and 1M



Source: Bloomberg

- **Ukraine is unlikely to receive substantial loans in 2012**
- **Ukraine got no “New Year” gift from Gazprom**
- **Investors concerns over Ukrainian risks decrease**
- **Spot UAH is stable, NDFs appreciate**
- **High banking liquidity brought about decrease in rates**
- **MinFin to sell short-term bonds this week**
- **Secondary market yields stopped declining**

## Ukraine is unlikely to receive substantial loans in 2012...

**Negative effects of a recent massive S&P downgrade proved to be muted:** the market had already largely priced in the announcement beforehand. We expect, however, that global uncertainty will remain and investors will increasingly avoid frontier markets like Ukraine. **Our base case scenario is that Ukraine will not be able to raise debt on international capital markets in 2012, at least, at a reasonable rate.**

The IMF estimates that in the two coming years troubled economies will require about USD1 trillion while the IMF's currently available resources total USD387bn. Cash shortage at the IMF coupled with Ukraine's inconsistent execution of the IMF programs do not promise any lavish disbursements of the IMF money to Ukraine. **We expect that in 2012 Ukraine will receive from zero to SDR2bn (in the very best case).**

## Ukraine got no “New Year” gift from Gazprom...

**The main internal factor for Ukraine's risks is again negotiations with Russia on lowering natural gas price and obtaining money to modernise the natural gas transportation system.** Harsh rhetoric and controversial proposals from the Ukrainian side (e.g., request for lowering the purchase amount to 27 bn m3) decrease Ukraine's chances to reach an agreement with Gazprom. **Without a new agreement the Ukrainian authorities will have it harder to support the hryvnia without spending much of the NBU's reserves.** The reserves will be needed to redeem foreign currency debts coming due in 2012, among them: USD500mn Eurobond, USD2bn to VTB Capital and ca. USD3.7bn to the IMF.

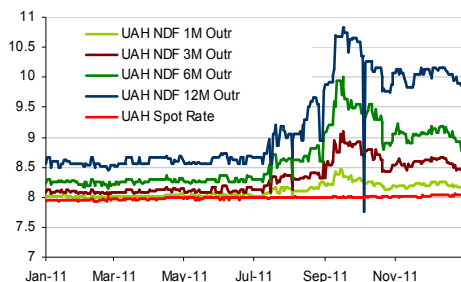
## Investors concerns over Ukrainian risks decrease...

**Ukrainian CDSs have decreased over the last week to 863** (from its high of 930 on January 17). The most likely cause is the appointment of Valeriy Khoroshkovskiy as Minister of Finance.

**YTM's of Ukrainian Eurobonds have declined** (most likely due to the same reason). Yields are around 10% across all maturities, and the curve is inverted. YTM's of Ukraine's Eurobonds may move in either direction in coming weeks.



### NDF outright rates



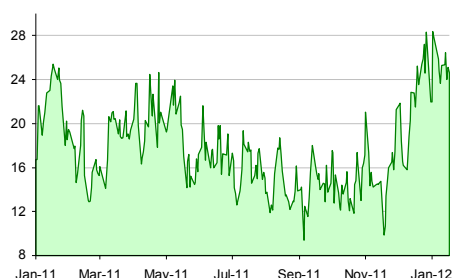
Source: Bloomberg

### Spot UAH is stable, NDFs appreciate...

The interbank exchange rate has moved to the 8.02-8.05 range. The NBU made USD interventions during last week. **We expect that the NBU will be quite frugal with FX interventions in coming weeks:** in February the country starts redeeming the IMF loans. Ukraine has to pay SDR428mn (ca. USD657mn) to the IMF next month.

NDF implied rates were inching down counterintuitively last week, probably indicating increased interest towards these instruments based on the expectations that UAH devaluation will be more distant in time.

### Banking System Liquidity, UAH bn



Source: NBU

### High banking liquidity brought about decrease in rates...

Money market rates stay at a relatively low level of 13% for 1M and 1.2% for O/N. **Low rates are explained by an unusually high level of the banking liquidity:** the banks' correspondent accounts with the NBU were in the range of UAH24.0-26.4 last week. On Monday morning they decreased to UAH21.7bn.

Relatively high level of the banking liquidity is explained by several factors:

- increased end-of year budgetary spending
- positive FX interventions (net purchase of foreign currencies) by the NBU in December
- monetary emission by the NBU in December (monetary base grew by a hefty UAH8.8bn, or 3.8% in December alone)

The NBU did not provide money to banks last week through O/N loans or liquidity support tenders and raised UAH61mn through its certificates of deposit.

On January 25 the NBU will lend UAH100mn to Ukrainian banks at 9% for 87 days. Bids will be accepted on a pro-rata basis.

**We expect that the decrease in money market rates will not be long-lived** as banking liquidity usually starts declining by mid-February and may get low (down to UAH15bn or less) again because of a seasonal increase in tax payments.



### Primary auctions schedule

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

Source: MinFin

### Primary auctions results, January 17

# of Auction	5	6	7	8	9
ISIN (short)	-	-	-	-	133771
Currency	UAH	UAH	USD-I.	USD-I.	USD
Maturity (days, M, Y)	1Y	2Y	1.5Y	3Y	3Y
Cut-off yield	-	-	-	-	9,60%
Weighted average yield	-	-	-	-	9,55%
Highest bid	-	-	-	-	9,50%
Lowest bid	-	-	-	-	10,00%
Bids submitted, USD mn	-	-	-	-	11,86
Number of bids	-	-	-	-	4
Number of bids accepted	-	-	-	-	2
Bids accepted, USD mn	0	0	0	0	1,86
Amount raised, USD mn	0	0	0	0	1,86

Source: MinFin

### Primary auctions results, January 17

# of Auction	10	11	12	4
ISIN (short)	133789	-	-	133763
Currency	UAH	UAH	UAH	UAH
Maturity (days, M, Y)	3M	6M	9M	12M
Cut-off yield	13,50%	-	-	14,75%
Weighted average yield	12,39%	-	-	14,75%
Highest bid	9,50%	15,50%	16,50%	14,75%
Lowest bid	16,00%	15,50%	16,50%	14,75%
Bids submitted, UAH mn	275	50	50	20
Number of bids	11	1	1	1
Number of bids accepted	5	0	0	1
Bids accepted, UAH mn	190,0	0	0	20
Amount raised, UAH mn	184,3	0	0	17,5

Source: MinFin

### Primary auctions results, January 19

# of Auction	13	14	15	16	17
ISIN (short)	133763	-	-	-	-
Currency	UAH	UAH	UAH	USD-I.	USD-I.
Maturity (days, M, Y)	1Y	2Y	3Y	1.5Y	3Y
Cut-off yield	13,50%	-	-	-	-
Weighted average yield	13,50%	-	-	-	-
Highest bid	13,50%	-	-	-	-
Lowest bid	13,50%	-	-	-	-
Bids submitted, UAH mn	22,4	0	0	0	0
Number of bids	2	0	0	0	0
Number of bids accepted	2	0	0	0	0
Bids accepted, UAH mn	22,4	0	0	0	0
Amount raised, UAH mn	19,8	0	0	0	0

Source: MinFin

### MinFin to sell short-term bonds this week...

This week the MinFin is likely to sell 3M, 6M and 12M UAH bonds (at market and non-market rates) and 3Y USD bonds. **We expect high demand for 3M (at 13-13.5%) and, probably, for 6M OVDPs and a few small bids for USD bonds.**

Abundance of banking liquidity coupled with uncertainty over future market conditions caused relatively high demand for 3M OVDPs at the auction on Tuesday, January 17.

Last week the NBU raised UAH237mn (including USD bonds) vs. zero in the first week of auctions in 2012. It is worth noting that 3M OVDPs were sold at market rates (WA of 12.39%, cut off of 13.50%). USD-linked bonds are de facto being phased out by USD bonds, although the primary sale volume for USD bonds is still low: just USD1.9mn last week.

**Valeriy Khoroshkovskiy was appointed Minister of Finance last week.** We expect that some changes to the MinFin's policy on the domestic bond market will be made within coming weeks. We singled out some of the possible moves:

- selling OVDPs at market rates
- selling OVDPs at very low rates only, compensating any shortfalls through higher budgetary revenues (this is a very likely scenario: Mr Khoroshkovskiy said that the budgetary revenues may be increased by UAH20bn through better tax and customs duty administration only)
- changing primary auction procedures
- introducing new instruments

### Secondary market yields stopped declining...

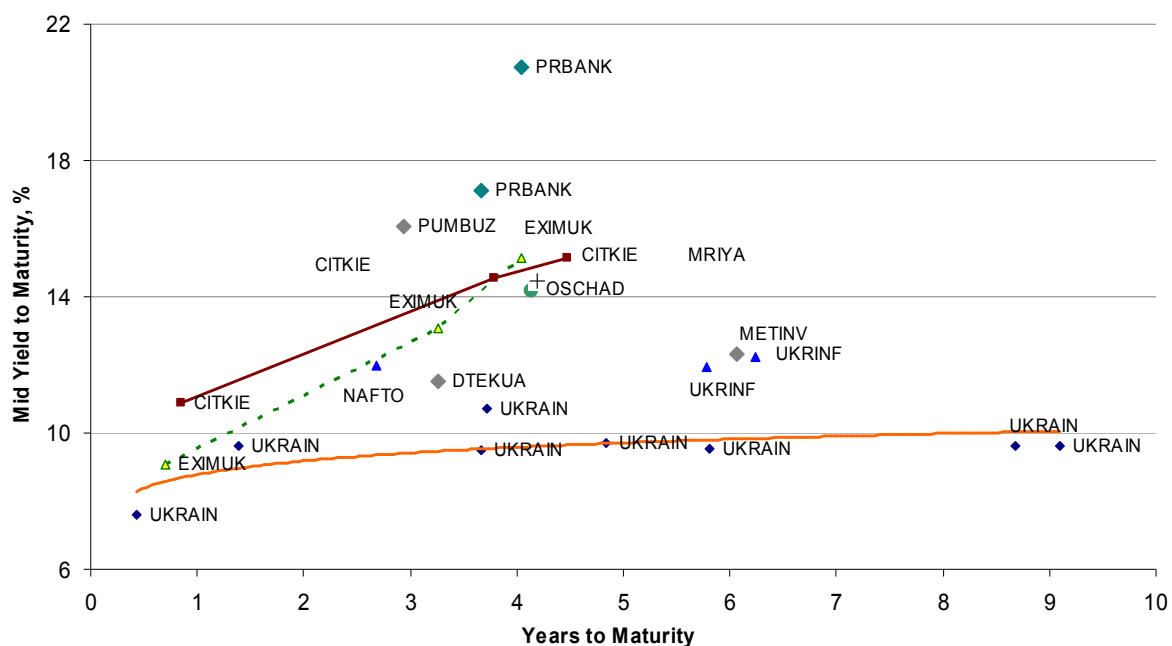
The secondary market was not very lively last week. OVDP yields have not changed much since last week. The NBU increased its sale of OVDPs through the "double quotes" mechanism: it sold UAH1250mn of OVDPs last week.

**We do not expect any significant changes on the secondary market this week:** the upside will be limited by the expectations of worsened liquidity conditions, and the downside will be limited by the "hold to maturity" strategy of many OVDP holders.

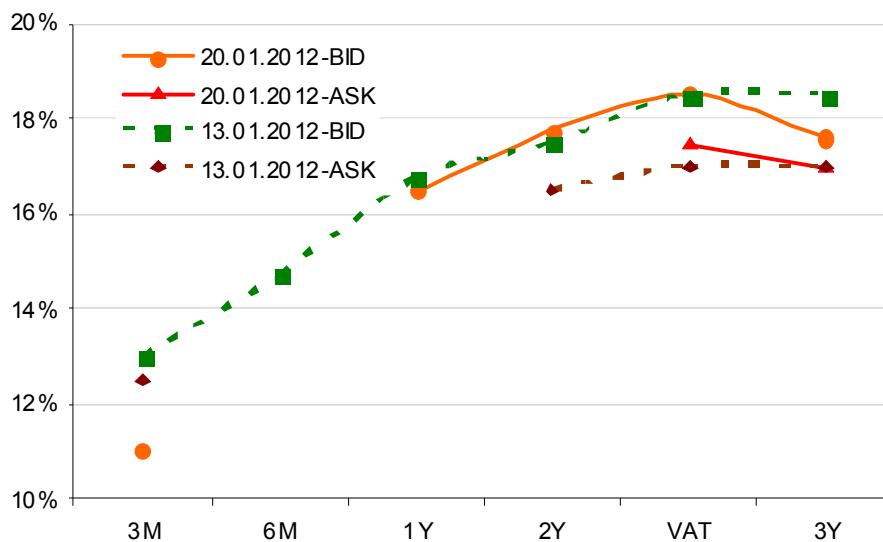
**We expect that OVDP yields will start growing in coming weeks,** as banking liquidity will decline because of FX interventions and the end of a seasonal January liquidity spike. Large OVDP redemptions (starting on February 15) are likely to mitigate expected liquidity squeeze effects: the MinFin pays UAH3.4bn on February 15 and UAH2.1bn in the last three days of February (mostly to VAT bond holders).



### Ukrainian Eurobonds – yield map



### Secondary market for UAH OVDs



### Selected Ukrainian local bonds, sovereign and corporate

ISIN	Maturity	Bid Yield	Ask Yield
UA4000048219	22.02.2012	12.00%	10.50%
UA4000101018	13.06.2012	-	12.00%
UA4000063564	12.09.2012	16.25%	-
UA4000061451	31.10.2012	16.50%	-
UA4000107510	12.12.2012	17.00%	-
UA4000115117	26.03.2014	18.50%	16.25%
VAT II-IV	Aug-15	19.00%	18.00%
UA4000132260	12.06.2013	-	9.00%
Boryspil G	13.11.2012	-	16.50%

Source: traders' quotes

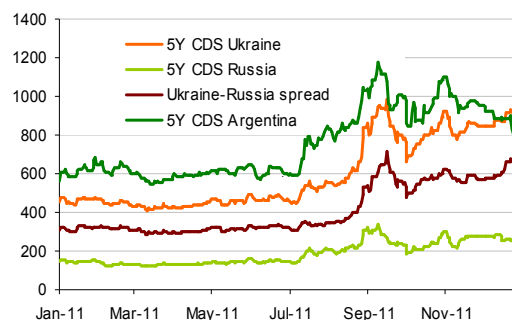


### Ukrainian sovereign Eurobonds, YTM (%)



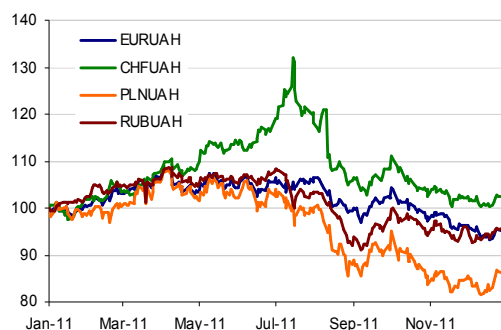
Source: Bloomberg

### Credit default swaps



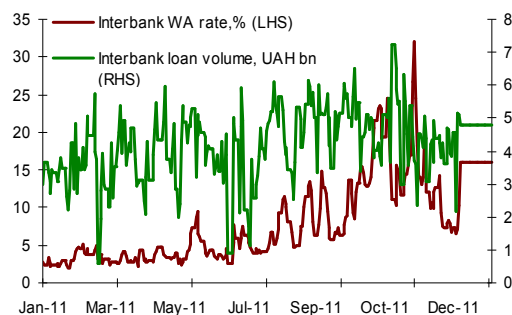
Source: Bloomberg

### UAH vs other currencies, spot



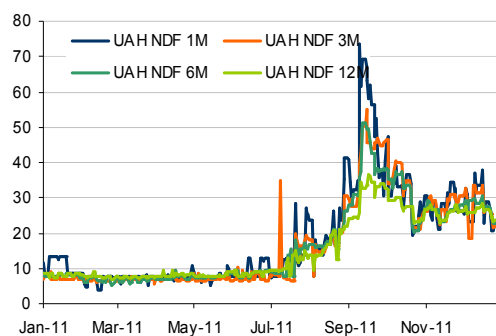
Source: Bloomberg

### Interbank volume and rates



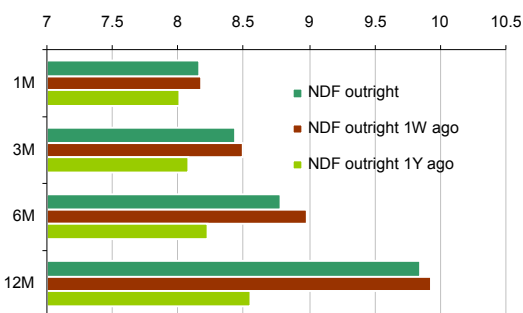
Source: Bloomberg

### UAH NDF implied yields



Source: Bloomberg

### UAH NDF changes – outright rates



Source: Bloomberg

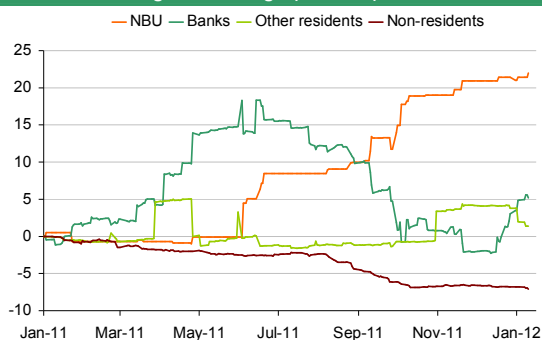


### OVPD redemptions in 2Q 2012 (principal + interest), UAH mn

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	626		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													

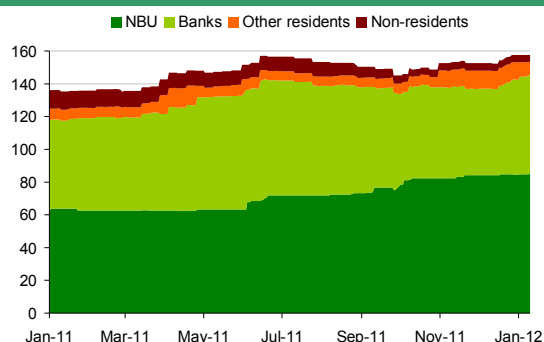
Source: MinFin, UkrSibbank

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



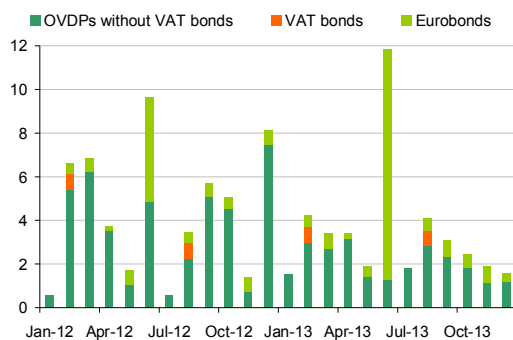
Source: NBU, UkrSibbank's calculations

### OVPD in circulation structure, UAH bn



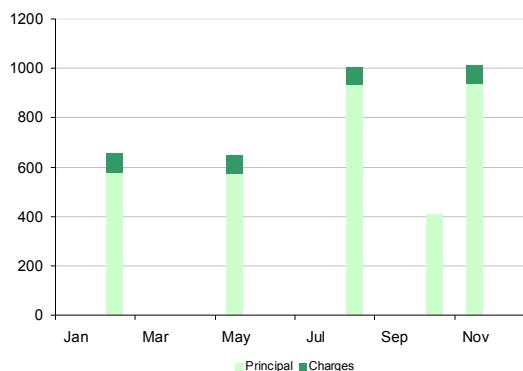
Source: NBU

### 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%	5,0%	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%
<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	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%
<b>External Balances</b>					
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
<b>FX</b>					
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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