

Eastern Europe Fixed Income: Weekly Overview

January 16 – 22, 2012

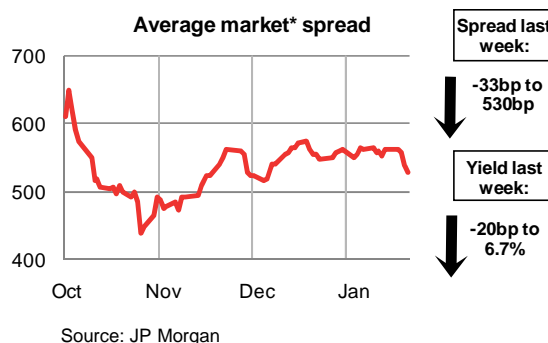
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- The region's Eurobond market* returned 1.3% during the week. Russia's and Kazakhstan's Eurobond markets advanced by 0.8% and 0.9%, respectively, while Ukraine jumped by 2.8% (Trust indices)
- Fitch changed Russia's credit rating outlook to stable
- Mixed industrial production results in CEE
- Division of posts in Kazakhstan – no surprises
- NBU released solid banking sector results
- Corporate news: Alliance Oil Company, Alfa Bank



General news

At the beginning of last week, rating agency Fitch changed the outlook on Russia's BBB credit rating to stable from positive. Hence, it effectively reduced the likelihood of Russia's sovereign rating to be upgraded in the near term. Decision by Fitch was based on elevated political uncertainty in the country and the possible contagion effects from Europe. The action was followed by a similar move towards rating outlooks on Gazprom, Russian Railways and others. Currently, Russia is rated BBB/stable from Fitch and Standard&Poor's, while Moody's has assigned a one notch higher rating – Baa1/stable. In our view the decision by Fitch brings little news and is by and large neutral to Russia's sovereign Eurobonds. Our view of Russian Eurobonds, however, has become neutral, but more on valuation rather than fundamental grounds.

Ukraine and Kazakhstan released mixed industrial production results for December 2011. Ukraine's industrial production grew mere 0.4% m/m in December, mainly driven by relatively strong performance of coal and iron ore mining segments in spite of the cooling in steel production. In aggregate, industrial production advanced 7.3% y/y in 2011. Conversely Kazakhstan's Agency of Statistics published a drop in industrial production of 2.2% m/m due to the plunge of mining sector by 5.1% m/m, while manufacturing segment advanced by 5.7% m/m. Crude oil production amount in 2011 slightly decreased, although oil price above \$100 per barrel should support the industry going forward, in our view.

Kazakhstan's second most influential post of prime minister was assigned to Karim Masimov by the newly elected parliament. The reappointment of several ruling party's members at various posts among state's committees as well as prime minister's second five year term in office cultivates ground for further comfortable control over government institutions by the Nur Otan party. Masimov's previous background in finance as well as strong connections with increasingly important state's trading partner – China, creates a good image of a capable official in the environment of deteriorating financial markets. Some also see him as a possible successor to the post of Kazakhstan's president after Nursultan Nazarbayev. However, the news bears no element of surprise, so we do not expect any immediate impact on the region's Eurobond market.

National Bank of Ukraine posted preliminary results of banking sector activities for December 2011. Total equity capital surged by 2% m/m, while liabilities advanced by 1.0% m/m due to the injection of deposits of UAH 16.3bn from legal entities, representing a 9.6% m/m growth. Loan portfolio in December remained flat, while total deposits grew by 4.4% m/m mainly driven by the New-Year deposit-attracting campaigns, boosting the share of term deposits. The results, in our view, are positive for Ukraine's banking sector and diminish liquidity concerns in the near term.

Corporate news

The management of Russia's Alliance Oil Company release solid company's operational data, which should translate into a healthy financial performance in FY2011. In particular, upstream volume advanced by 12% y/y and downstream was +13% y/y. At the same time, the management's guidance for 2012 was disappointing. It acknowledged that previous upstream target of 90k barrels per day at the end of 2012 will not be achieved, while the average downstream production will drop by approximately 4% y/y. Moreover, the annual CAPEX is estimated to reach up to \$1bn, almost equally divided between upstream and downstream, hence delaying the company's announced deleveraging already for this year. As a consequence, the company's Eurobond with maturity in 2015 does not seem particularly attractive, in our view.

* 50% EMBI Global Diversified Europe region and 50% CEMBI Diversified Europe region

During previous week, Alfa Bank decided not to exercise a call option on its \$300m subordinated bond with maturity in 2017. In general, the decision seems rational from economical point of view, as the new coupon will be set at 5Y UST+546bp or roughly 6.3%, which is ~200bp cheaper compared to Alfa Bank's senior Eurobond. Moreover, given the current market environment, it is not rational to reduce the bank's capitalization, while the reputational damage of skipping the call option is secondary, according to Alfa Bank's CFO. The bond was recently trading at a price of 90, implying that investors were not generally expecting the call option to be exercised. All in all, Alfa Bank's senior Eurobonds are attractive in Russia's privately-owned bank universe, in our view, while among subordinated Eurobonds only RSHB'21 seems to have appealing risk/return characteristics.

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