

CIS

# CIS Fixed Income Daily

18 February 2009

## Today's news

Russian Transneft and Rosneft secure US\$25bn loan from China  
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Russia: Government revises its GDP growth forecast down to -2.2% for 2009

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Ukraine: Market comment: the NBU said it still has tools to defend the hryvnia

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Ukraine: NBU officially stuck to refinancing rate in its monetary policy  
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## Companies in this issue

Company	Currency	YTW (%)	Rec	Previously	Since
Transneft'12 (6.10%)	USD	12.5	Buy	Outperform	18/02/09
Transneft'13	USD	13.8	Buy	Outperform	18/02/09
Transneft'14	USD	13.4	Buy	Outperform	18/02/09
Transneft'18	USD	13.2	Buy	Outperform	18/02/09

Source: ING

## Benchmark yields

	Last	%ch (DoD)
UST 10Y (US\$)	2.654	-0.154
Russia 10Y (RUB)	9.440	0.000
Russia 10Y (US\$)	7.447	-0.001
Russia '30 (US\$)	9.654	0.244
Ukraine '16 (US\$)	26.198	0.417

## Currencies

	Last	%ch (DoD)
RUB/US\$	36.31	3.04
KZT/US\$	149.30	-0.08
UAH/US\$	8.20	1.22

## Money market rates

	Last	%ch (DoD)
3 months RUB	24.76	-0.25
3 months KZT	13.00	0.00
3 months UAH	23.60	0.93

## Russia

### Russian Transneft and Rosneft secure US\$25bn loan from China

According to newswires, China Development Bank will lend US\$10bn to Transneft<sup>[f]</sup> and US\$15bn to Rosneft<sup>[e]</sup> in exchange for future long-term oil supplies from Russia. No official information on the agreement have been released, although the media have reported terms of about 20 years for the loans and interest rates under 6%.

Although we do not know the full details of the agreement, the short- to mid-term implications of the deal look positive for the credits of the two Russian companies. The significant volume of the loan makes the deal also positive for Russian macroeconomic fundamentals. We see the following major consequences:

- The loans attracted should fully cover the financing needs of both Transneft and Rosneft for the next year or two. As a result, the companies may restrain themselves from potentially expensive and problematic borrowings during the current turbulence in the capital markets and banking sector.
- For Transneft in particular, the long-term loan of US\$10bn should cover its US\$5.5–7.3bn capex in 2009, as well as help to finance a significant part of its future mid-term investments, including around US\$10bn for the second stage of the ESPO pipeline and US\$3.6bn to be spent on the Baltic pipeline system. According to our estimates, the new long-term loan should fully cover Transneft's needs for new financing given that the company will retain access to a RBL145bn (US\$5.3bn) revolving credit facility from Sberbank<sup>[f]</sup> available up to 2014.
- The interest rate of presumably less than 6% for the 20-year loan is relatively cheap funding in the current environment. The 10-year sovereign CDS on Russia is currently at 700bp, while the yields on Transneft's 3–9 year Eurobonds are currently above 12%.
- The US\$25bn loan is also significant at Russia's macroeconomic level as it is equivalent to 6.6% of country's FX reserves and will cover more than 40% of corporate non-bank FX debt due in 2009.

We see short-term positive implications from the USD\$25bn loan deal not only for the credits of Rosneft and Transneft, but also to Russia's BoP. Taking into account that the new loan fully meets mid-term financing needs of Transneft we change our recommendation on its Eurobonds from Outperform to Buy.

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### Government revises its GDP growth forecast down to -2.2% for 2009

January data showed a sharp rise in wage arrears.

According to Deputy Minister Andrei Klepach (quoted by Reuters), the Ministry for Economic Development has cut its forecast for economic growth from -0.2% to -2.2% in 2009. The Ministry also now expects industrial production to drop by 7.4%, sharper than the previous 5.5%. The Ministry did not change its underlying oil price and currency forecasts – it still sees Urals at an average price of US\$41/bbl and an average RUB at 35/USD in 2009.

The State Statistics Office added to the doom and gloom by publishing depressing wage arrears data. According to its data, wage arrears amounted to RUB7bn or US\$194m on 1

February, a jump of RUB 4.7bn compared to the level of 1 January. However, they were still lower than the RUB7.8bn recorded as of 1 December. The development of wage arrears is likely affected by seasonal factors – during the 1990s when the arrears problem was acute, they would normally drop in December when companies closed their books for the year and tried to repay debts including to their employees, and then rise again in January.

Earlier this week, the Statistics Office also published very poor January output data (a 16% YoY drop in industrial production, and 24% YoY fall in manufacturing output in particular). The flood of negative news evidently affected the markets: Russia's two bourses, MICEX and RTS, had to suspend trading for an hour yesterday after their indices plunged by more than 5%. In the last two days, the rouble has lost nearly all its gains vs the bi-currency basket and ended the trading session at above 40.5 vs the bi-currency basket.

We are about to publish our *CIS Quarterly* with a set of updated forecasts for Russia. The recent economic data points at a high probability of a recession this year, with a sharply negative growth reading in 1Q. The stream of negative news will likely continue to affect the markets in the near term.

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## Ukraine

### **Market comment: the NBU said it still has tools to defend the hryvnia**

The FX market closed yesterday with a small decline of 1.2% DoD to 8.2/USD, which was even lower than the officially provided rates of the majority of market transactions (7.9-8.1/USD). As the NBU is highly concerned about maintaining the stability of the exchange rate in the market, the rate has remained quite stable since last week. The NBU sold US\$82m via interventions yesterday while traders noted that it did not satisfy all bids. We believe the main reason for the decline in the volume of interventions is the scarcity of reserves available for interventions due to the limitations on the volume of FX reserves until the end of March.

NBU Deputy Head Savchenko said on Monday that the NBU still has tools to strengthen the hryvnia to 7.0/USD. In particular he mentioned the necessity to create hryvnia reserves under foreign-currency loans and limitations on short and long currency positions. We believe these measures will be rather effective in the short term as they will force the banks to sell their currency positions and will replenish the demand for foreign currency on the FX market. At the same time, these measures would have a one-off effect and may theoretically send the hryvnia back to 7.0/USD. However, they would not reduce devaluation pressure significantly in the medium term as they will be unable to provide constant additional foreign currency demand. From the other side, these measures may stabilise the FX market until Ukraine receives another IMF tranche or until the end of March, when the NBU has to fulfill certain obligations to maintain its level of FX reserves.

Poroshenko, Head of the NBU Council, revealed the IMF's forecast for the minimum average UAH/USD exchange rate for this year is 8.6/USD. The rate is quite close to our forecast of 8.45/USD. In our forecasts we expect further hryvnia devaluation until the middle of the year with a slight recovery to 9.0/USD at the end of 2009.

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### **NBU officially stuck to refinancing rate in its monetary policy**

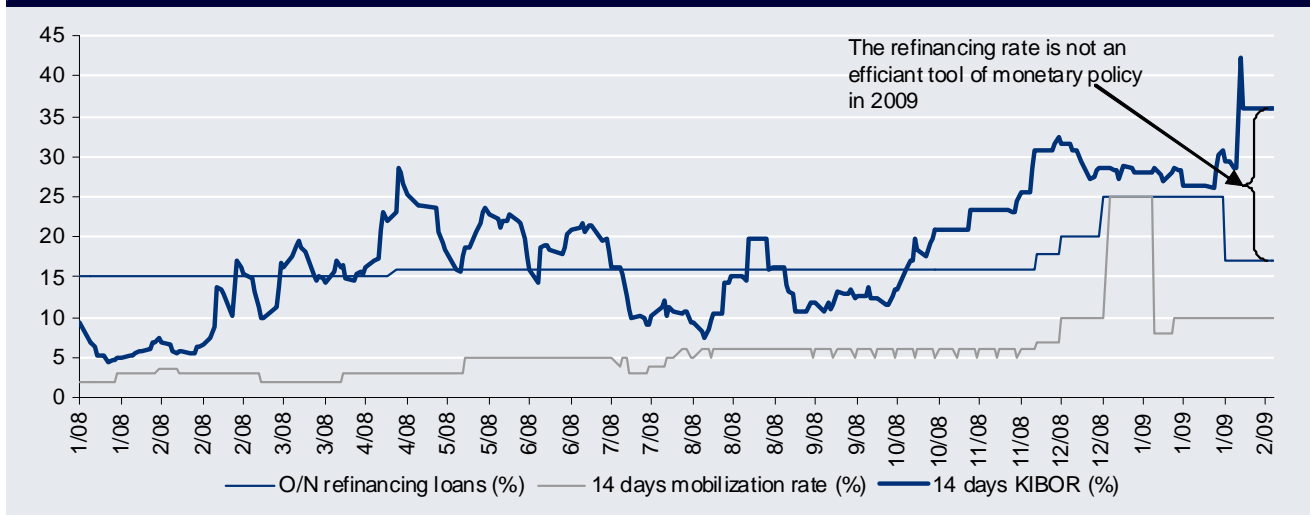
Refinancing rates and mobilisation rates for 14-day terms will guide the monetary policy of the National Bank. However, we believe these rates will have little influence.

In its recent letter to commercial banks the National Bank indirectly recognised that the discount rate is not an influential tool for guiding monetary policy in the country. Thus it stuck to refinancing and mobilisation rates for terms of 14 days. This decision corresponds to reality as the discount rate has been more an indicator than an influential tool of monetary policy already for several years as almost no deals on money market are tied to it. In contrast, the refinancing rate was a more influential tool at least until the middle of last year when banks could relatively easily obtain short-term financing from the NBU.

We believe the IMF might guide the NBU to change its approach to the key rate such that it should have a more significant impact on monetary policy. However interest rate policy may only be effective if market participants have equal and unrestricted access to financing. We believe current domestic monetary policy (as well as exchange rate policy) lack efficient market tools. Thus the NBU uses administrative tools rather than market instruments. In fact, a decline in refinancing rates in December 2008 might push the banks to apply for UAH funding from the NBU more actively. However, fearing that the excessive refinancing of banks will dry up the supply of foreign currency on FX market, the NBU imposed additional administrative restrictions on the

ability of banks to obtain refinancing loans. The decision of the government to approve any refinancing loans for terms of more than 14 days additionally restricts free access by banks to refinancing loans. The current level of refinancing rates (17.0% O/N) is behind the inflation level and might reflect loose monetary policy. However the broad gap between the refinancing rate and MM O/N rate (2300bp) reflects a tight monetary policy which none of the NBU rates reflect.

**Fig 1 The gap between market MM rate and refinancing rate widened sharply in early 2009**



Source: NBU, Reuters, ING

The decision to define the refinancing rate as a major tool of monetary policy will theoretically positively influence the predictability of monetary policy. However as a lot of administrative restrictions on refinancing loans are in force, we believe this decision will have a neutral effect on the money market and credit policy of banks in the short to medium term. In fact, the current level of refinancing rate indicates loose monetary policy while it is very tight now as indicated by the hryvnia liquidity deficit and high MM rates.

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## State Statistics Committee to publish quarterly data on GDP

According to Interfax, the State Statistics Committee will no longer publish GDP growth data on a monthly basis but will switch to quarterly data instead. The officials explain this as a move towards international standards. At the same time, the statistics office will continue to provide monthly data on the performance of major economic sectors.

We believe that a switch to quarterly GDP data this year will allow state officials to avoid having to explain the worsening economic performance on a monthly basis. Furthermore, as the 1Q GDP figure should be published somewhere in May-June, the government will have 4-5 months this year after the first official figures of GDP growth will be available. At the same time, based on the performance of the major economic sectors, we estimate that the GDP growth figure will be the worst in January due to interruptions in production for several sectors after shortages with gas supplies over the first half of January. We estimate January GDP declined 26.7% based on the performance of its major sectors. From the other side, alternative data on economic growth, ie, electricity production shows just a 15.2% YoY decline in January. However we should adjust this figure downward due to the relatively cold winter in 2009 compared with a year ago.

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## Industrial production bottomed in January due to the interruption in gas supplies

Industrial production declined by 34.1% YoY in January. Low demand domestically and externally as well as the interruption in gas supplies drove the trend. We expect a smaller decline in February.

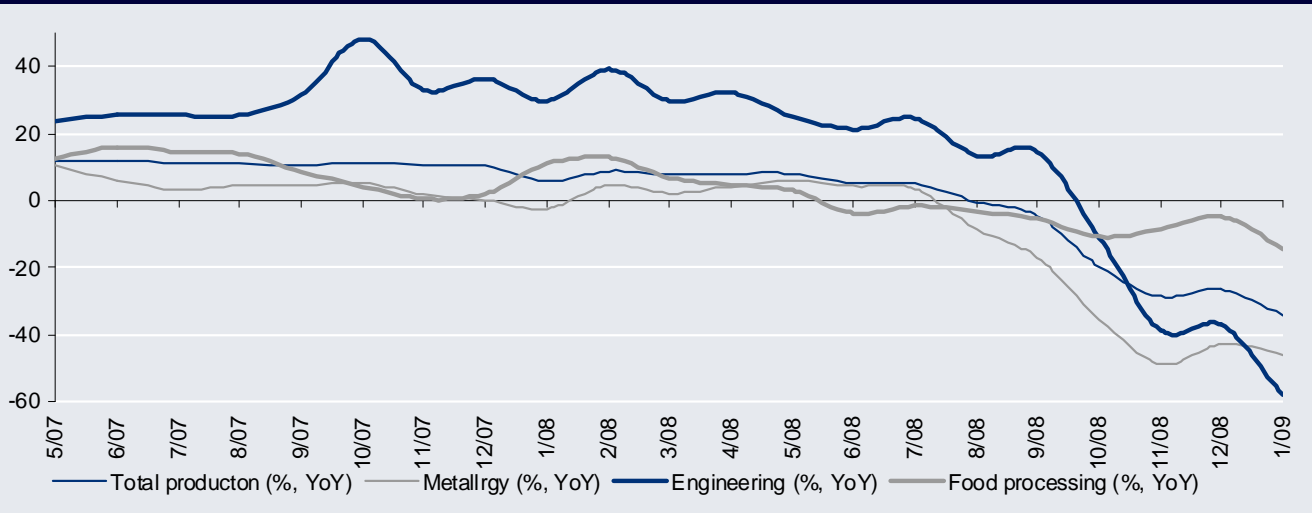
The State Statistics Committee reported a 34.1% YoY decline in industrial production in January. It was significantly worse than consensus forecasts (-27.3%) and below our estimates (-30.5%). However we need to mention that such a disappointing figure does not 100% reflect a continuation of the crisis and squeeze in demand both domestically and externally. It partially reflects a forced decline in production in the first half of the January after Russia cut-off Ukraine's gas supplies. This was reflected in the performance of the chemicals sector (-49.6% YoY) which uses natural gas extensively as a major input for the production of nitrogenous fertilisers while the reduction in gas supplies threatened to stop production.

Although the majority of industrial sectors saw dramatic drops in their performance, some benefited from the cuts in gas supplies. In particular, coke and oil refining showed its first YoY growth (2.4% in January) over the last eight months due to consumers being forced to switch to fuel oil and coke. Power utilities also showed a rather moderate rate of decline (-15.2%) due to growth in consumption because of the cold winter in January and interruptions with gas supplies.

Food processing was rather defensive and showed one of the smallest declines in January (-14.3% YoY) due to low elasticity of demand for a good portion of products. Although the steel sector recorded a 46.0% YoY drop, the MoM decline was rather small at 4.5% due to a small revival in global demand as foreign consumers replenished their stocks.

We believe industrial production in January will be the worst results of this crisis. Thus we expect lower rates of decline in February as gas supplies were restored in January. Furthermore, another rise in gas prices this year will maintain a declining trend in gas consumption while industries that supplied alternative energy sources (coke and oil refining, electricity) will benefit further. At the same time, we expect a recovery in industrial production no earlier than in 4Q09 after export-oriented sectors see a revival in global demand for their products. We reiterate our 2009 forecast for industrial production to decline 8.9%.

**Fig 2 All major sectors showed significant declines in January**

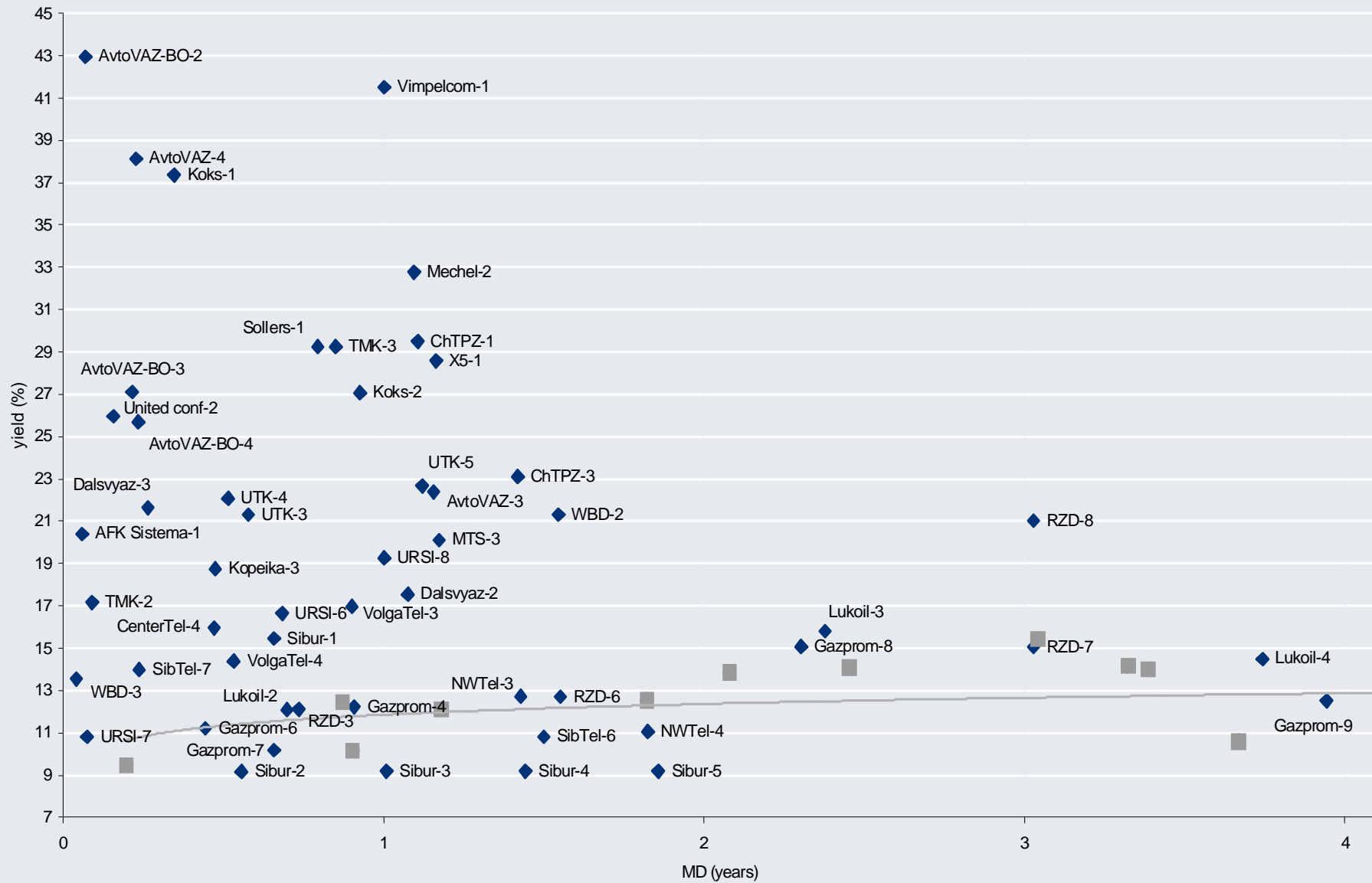


Source: NBU, Reuters, ING

The data on industrial production are quite disappointing although they were partially affected by an external shock, the cessation of gas supplies from Russia. The release will have an even more dramatic effect on forecasts after the State Statistics Committee stopped providing GDP figures on a monthly basis.

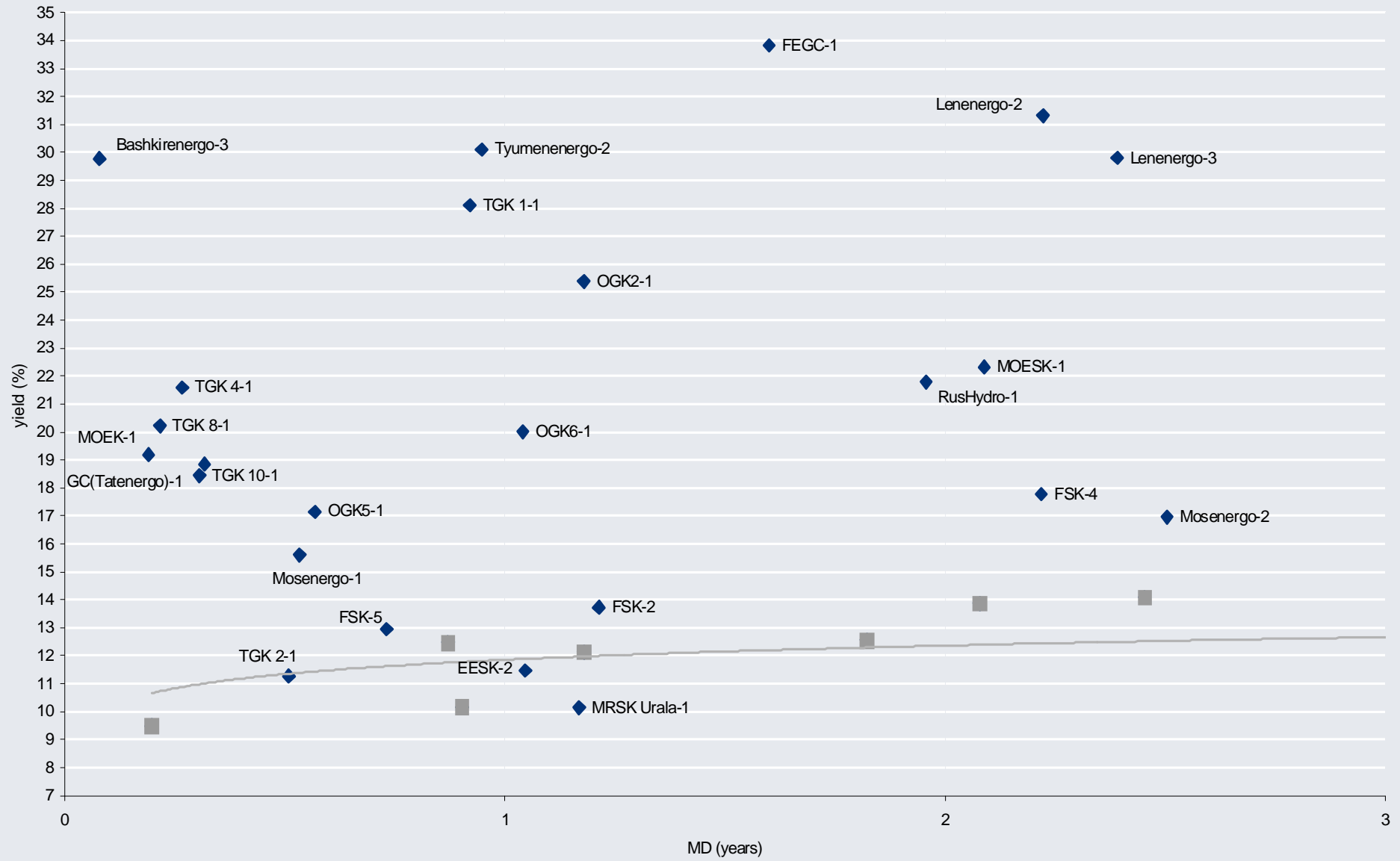
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# Russia's rouble corporate debt universe



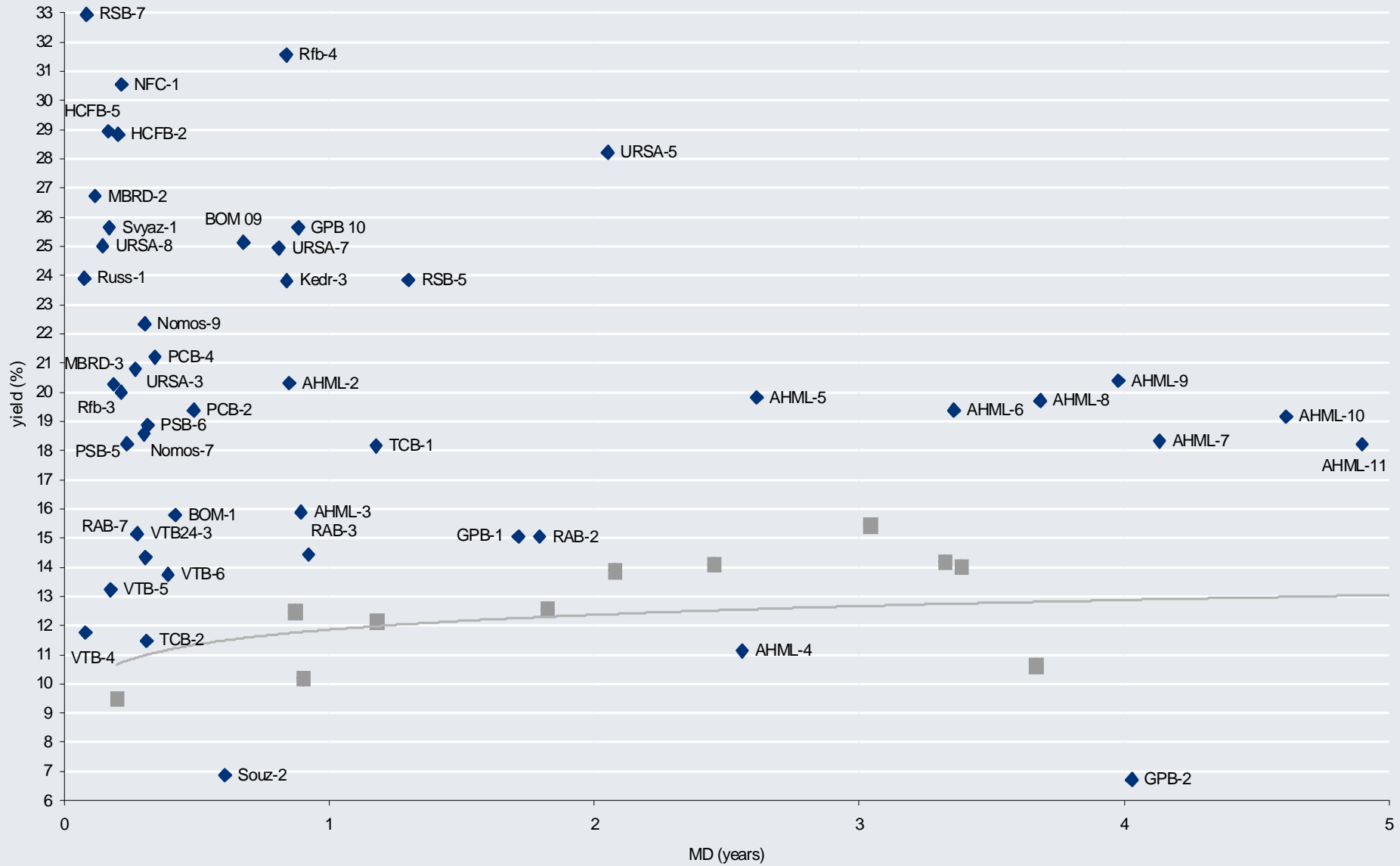
Source: Bloomberg, Micex, ING

## Russia's rouble utilities debt universe



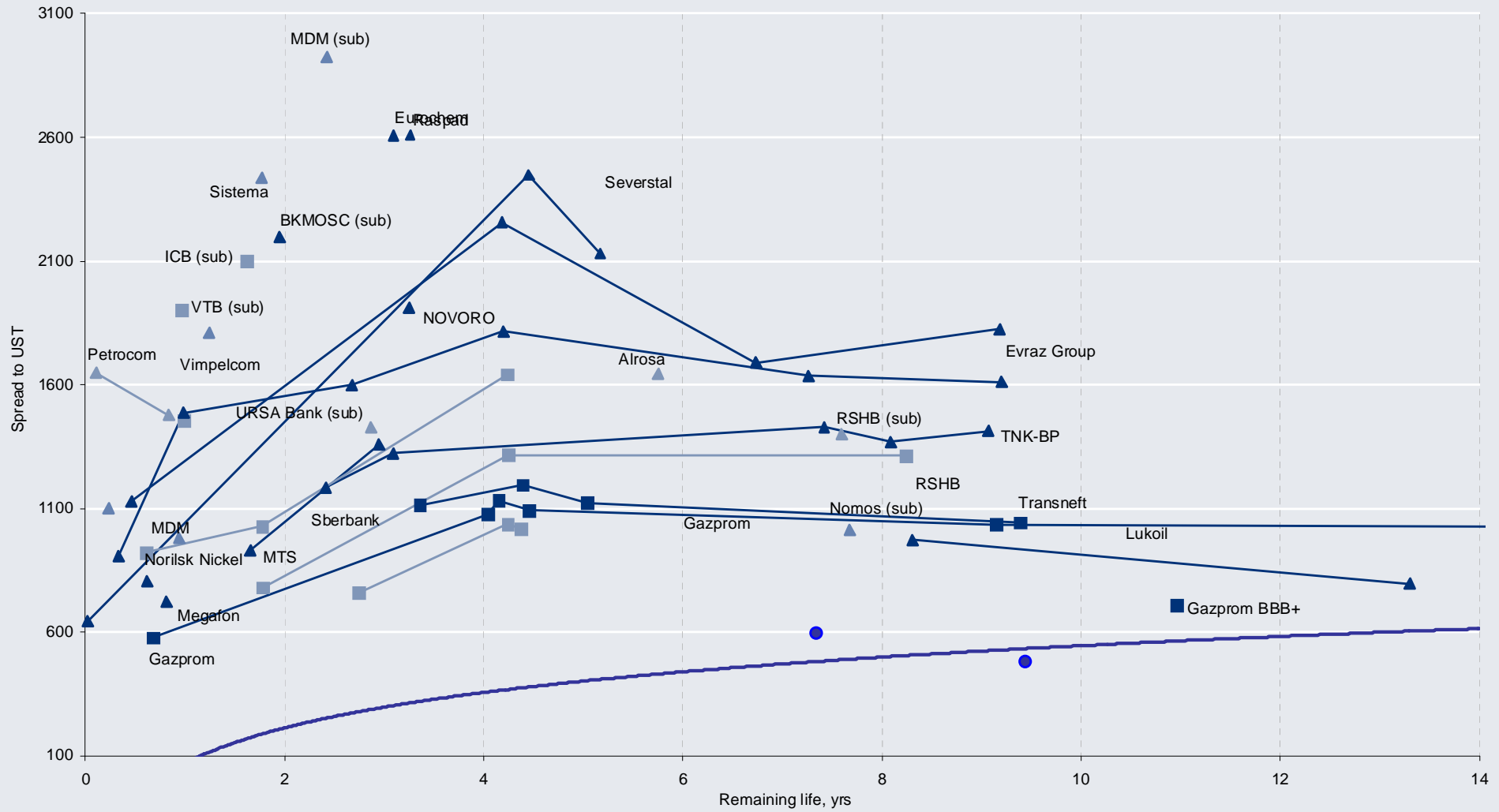
Source: Bloomberg, Micex, ING

# Russia's rouble financial debt universe



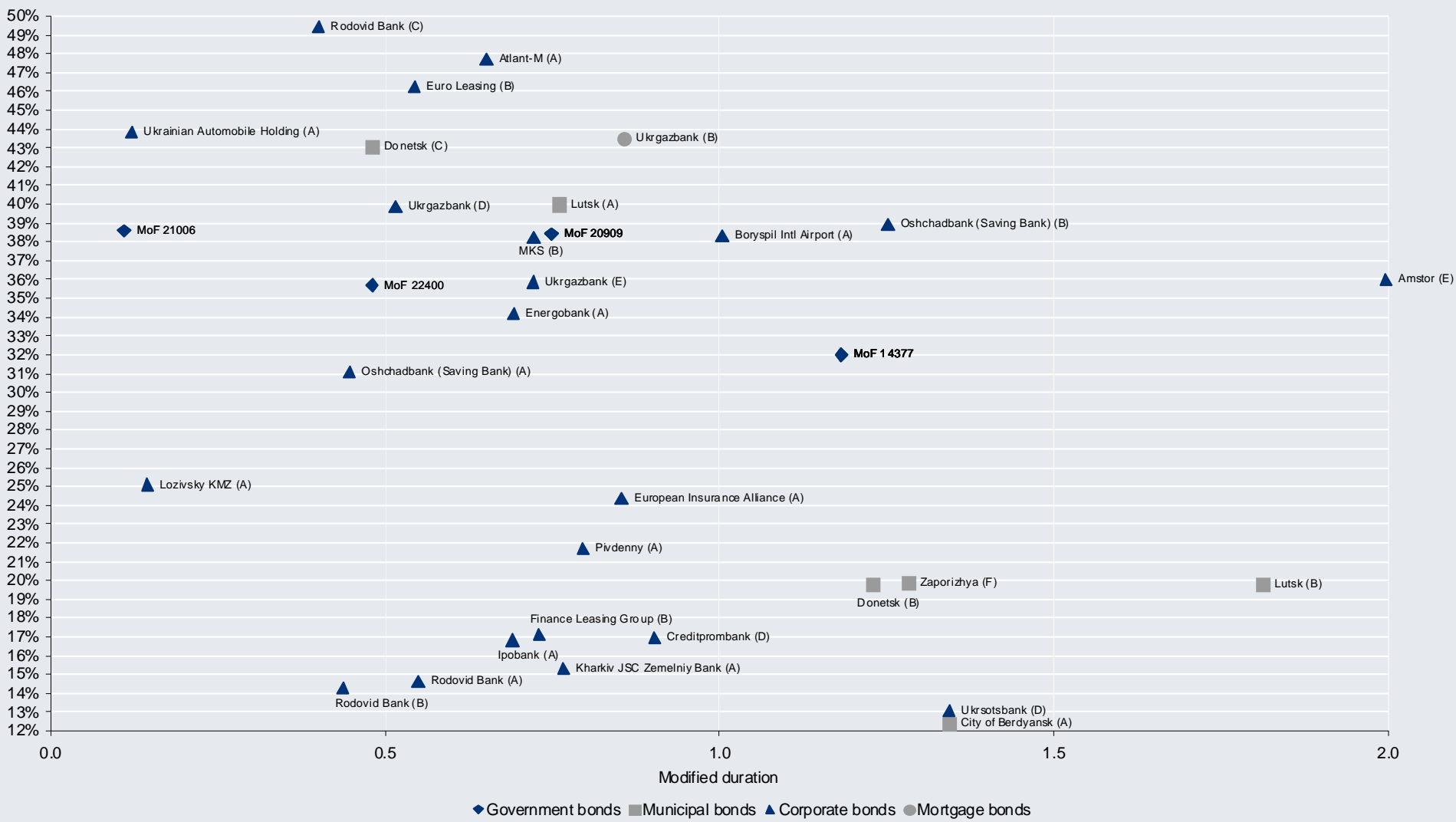
Source: Bloomberg, Micex, ING

# Russian corporates - USD Credit Curve



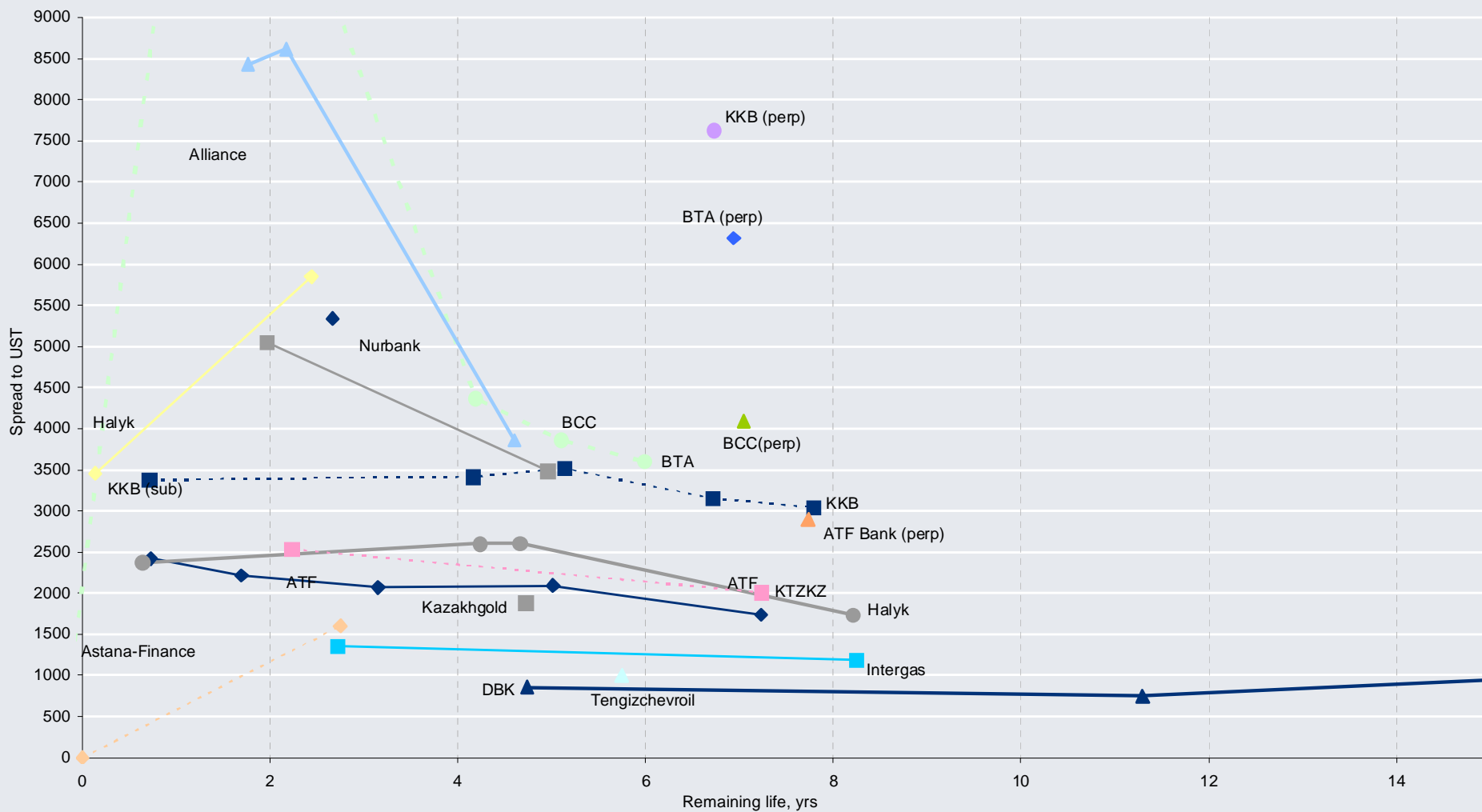
Source: Bloomberg, ING

### Ukraine's domestic tradable bond universe



Notes: corporate bond issues are with outstanding UAH50m and more. Source: PFTS, I

# Kazakhstani corporates - USD Credit Curve



Source: Bloomberg, ING

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