



# EASTERN EUROPE FIXED INCOME: WEEKLY OVERVIEW

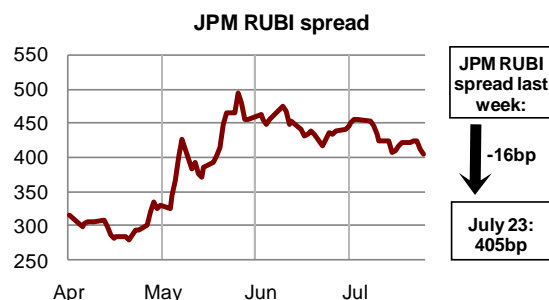
19 – 25 JULY 2010

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- Russia's fixed income market gained 0.71% during the week, while spreads shrank by 16bp (JPM RUBI)
- Telecoms and metals outperformed, while banks underperformed within the RUBI Index
- Ukraine jumped 1.1%, while Kazakhstan was flat during the week (TDI indices)
- Russia's GDP grew by 4.2% in 1H10, while monthly macro statistics sent mixed signals
- Asset quality of Kazakh banks improved in June
- Belarus issued debut 5-year eurobond at 9% YTM
- Corporate news: IIB, Metinvest, Interpipe
- We foresee generally favourable environment for emerging market debt for the nearest term, yet the "easy money" appears to be behind us. In Eastern European debt markets we continue to prefer Ukraine and Kazakhstan to Russia, yet in all markets security selection remains critical. As usual, in Central Europe's eurobond market bottom-up approach is the basis for investing



## General news

The Economy Ministry of Russia estimated that the country's GDP in June increased by 0.3% m-o-m, which results in half-year's growth of 4.2% y-o-y. Recently, President Medvedev announced that Russian economy could expand by nearly 5% in 2010. At the same time, various monthly macroeconomic indicators for June sent mixed signals. Positive performance was demonstrated by retail sales, fixed investments and unemployment. On the negative side, real disposable income and agricultural output disappointed.

Kazakhstan's banking regulator AFN released banking sector statistics for June. The system saw 1.6% m/m inflow of deposits in USD terms with the leader being ATF (+13.5% m/m) and BTA (+8.9% m/m), while Halyk demonstrated a deposit outflow of 3.7% m/m. On the asset quality front, systemic loans over 90 days overdue decreased by 1.6pp to 25.3% of systemic gross loans. Earliest asset quality indicator – loans overdue at least one day – decreased by 3.3pp to 32.2% of gross systemic loans. It is noteworthy that improvement of systemic asset quality was mostly due to KKB, where loans over 90 days overdue dropped 5.1pp and loans at least 1 day overdue dropped 7.6pp. Performance of other bank portfolios was mixed. Overall, the figures are positive for KKB and negative for Halyk (loans at least 1 day overdue +2.7pp to 26.8%, loans over 90 days overdue +0.3pp to 19.1%) and ATF (-0.1pp to 44.8% and +2.9pp to 33.7%). Due to poor performance of ATF loan portfolio Moody's downgraded the bank by one notch to Ba2.

Eurobond market welcomed Belarus as a new sovereign issuer last week, while Kazakhstan sovereign and Ukrainian iron ore miner Ferrexpo cancelled eurobond issuance citing unfortunate market conditions. We believe both Kazakhstan and Ferrexpo would still place eurobonds, Kazakhstan doing it as a benchmarking exercise, and Ferrexpo being in need for CAPEX funding. Debut Belarus 5-year bonds gained 1.5% after the placement. The bonds were issued at 9% YTM, now trading at 8.5% YTM. In our view, Belarus is a high risk play in the sovereign space, as country's economy and finances are currently unsustainable – they mostly depend on IMF's willingness to start a new lending programme and on relations with Russia.

## Credit rating news

S&P placed Ukraine under review for a possible upgrade. The agency believes important policy steps were made to fulfil IMF requirements. The agency plans to raise Ukrainian rating to B+ if the country succeeds in getting IMF financing. We believe the rating action is positive for Ukrainian eurobond market – the country currently is rated B by all three major rating agencies.

## Corporate news

International Industrial Bank (IIB) or Mezhprombank received approval from more than 90% of EUR 200m bondholders to extend maturity on the Eurobond by one year and on other terms, as proposed earlier. It was reported that following the completion of restructuring, IIB made a 9% annual coupon payment and 5% early consent fee to bondholders who voted in favor of the proposal by July 14. Nevertheless, situation with other bank's eurobond IIB'13 remains unclear. During the week, the trustee, BNY Corporate Trustee Services Limited, officially announced the default on this Eurobond, thus investors are eligible to ask for accelerated redemption of this issue.

Ukraine's leading steel and iron ore holding Metinvest attracted a \$700m 5-year syndicated loan at LIBOR+3%. In our view, the borrowing was expected, and would improve short-term liquidity of Metinvest, which is positive for eurobonds. However, risks for the bondholders lie in aggressive acquisition plans of Metinvest, which is currently acquiring Ukraine's largest steel factory MMKI and seem to look towards IUD factories. Although acquisitions by debt will strengthen Akhmetov's steel empire, Metinvest's leverage will surely increase and make the company more vulnerable in poor steel market environment.

According to Debtwire, Interpipe is to start consent solicitation with its bondholders this week due to the approaching maturity of the eurobonds on August 2. We believe the bond trading at 77% of par is priced fairly by the market, assuming a 5-year rollover and no haircut, however nominal haircut remains a possibility.

### **Our strategy**

We foresee generally favourable environment for emerging market debt for the nearest term, and we expect some further gains, yet the "easy money" appears to be behind us – the markets are not cheap. Our global inflation outlook foresees that liquidity will remain abundant for a prolonged period of time. On growth front we do expect negative surprises in H2'10, yet we do not subscribe to the "double-dip" thesis. Sovereign risks will continue to weigh on the market sentiment, but should also indirectly support emerging markets where fiscal fundamentals are indeed stronger. On relative terms, in Eastern European debt markets we continue to prefer Ukraine and Kazakhstan to Russia, yet in all markets security selection remains critical. As usual, in Central Europe's eurobond market bottom-up approach is the basis for investing.

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