



Focus  
Ukraine

Scope  
Bonds

Analyst  
Alexander Valchysheh

# Bond Market Insight

## MoF pushes domestic yield curve down

### Government bond auction results

We consider last domestic government bond placement (held on 16 August 2016) as a success for the government.

First, the yield curve shifted downward on this government bond placement versus the previous one on August 9. Two short-term domestic government bonds with 9 and 11 month maturities were placed at 15.5% and 15.7% yields respectively. At the last auction, the 6-month domestic government bond sold at a 15.7% yield. While the short-term section of the yield curve on local government bonds fell by 20 basis points, the medium-term yield curve shifted even more significantly for maturities of one to three years. At the previous auction held on August 9th, a 21-month sold at a 17.04% yield, while a lower yield of 16.76% was achieved for a 30-month maturity bond at the last auction on August 16th.

Secondly, a greater volume of domestic government bond placements in local currency signals a greater appetite by local investors for medium-term instruments providing interest payments every six months at 16% and higher. A 16.07% coupon domestic government bond sold by the Ministry of Finance raised nearly UAH800m at last auction versus only UAH180m at the previous one. If the Ministry of Finance would not have announced a placement of USD-indexed domestic government bonds at an unscheduled auction for next day (August 17th), the total volume of domestic government bond placements in local currency could have been higher yesterday, as investors most likely postponed purchases of bonds.

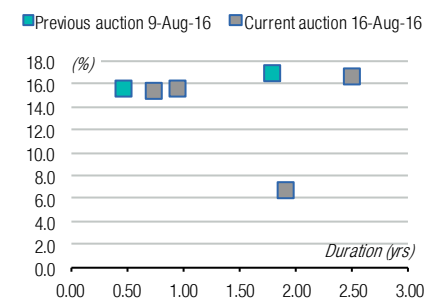
**Table 1. Details of last government bond auction**

| ISIN         | Coupon rate (%) | Payment freq <sup>1</sup> | Maturity  | Qty of bonds sold | Price (UAH) | Proceeds <sup>2</sup> (UAHm) | Volume <sup>2</sup> (UAHm) | YTM <sup>3</sup> (%) | Outstanding (m)  |
|--------------|-----------------|---------------------------|-----------|-------------------|-------------|------------------------------|----------------------------|----------------------|------------------|
| UA4000195010 | 0.00            |                           | 10-May-17 | 5,000             | 898.51      | 4.49                         | 5.00                       | 15.50                | 5.00             |
| UA4000194856 | 0.00            |                           | 26-Jul-17 | 5,000             | 871.43      | 4.36                         | 5.00                       | 15.70                | 68.50            |
| UA4000195036 | 6.69            | SA                        | 15-Aug-18 | 368,247           | 1,000.11    | 9,181.45                     | 9,180.40                   | 6.81                 | 9,180.40         |
| UA4000195028 | 16.07           | SA                        | 14-Aug-19 | 797,900           | 1,000.09    | 797.97                       | 797.90                     | 16.76                | 797.90           |
| <b>Total</b> |                 |                           |           | <b>1,176,147</b>  |             | <b>9,988.27</b>              | <b>9,988.30</b>            |                      | <b>10,051.80</b> |

Note: Note: [1] payment frequency abbreviations: Q - quarterly, SA - semi-annually; [2] proceeds and volumes for the USD-denominated bonds are calculated based on the previous day last price of USD/UAH exchange rate 1; [3] yields on coupon-bearing bonds are effective yields to maturity. Sources: Ministry of Finance of Ukraine, Bloomberg, Investment Capital Ukraine LLC.

THURSDAY, 18 AUGUST 2016

### Term structure of yields



Sources: Ministry of Finance of Ukraine, ICU.

### Auction results

| Auction | Last<br>16-Aug-16 | Previous<br>9-Aug-16 | Change |
|---------|-------------------|----------------------|--------|
|---------|-------------------|----------------------|--------|

#### Breakdown by yields (%)

|         |       |       |          |
|---------|-------|-------|----------|
| 3-month |       |       |          |
| 6-month |       | 15.70 |          |
| 9-month | 15.50 |       |          |
| 1-year  | 15.70 |       |          |
| 2-year  | 6.81  | 17.04 | -1,023bp |
| 3-year  | 16.76 |       |          |
| 5-year  |       |       |          |

#### Breakdown by proceeds (UAHm)

|              |                 |               |               |
|--------------|-----------------|---------------|---------------|
| 3-month      |                 |               |               |
| 6-month      |                 | 2.40          |               |
| 9-month      | 4.49            |               |               |
| 1-year       | 4.36            |               |               |
| 2-year       | 9,181.45        | 179.16        | 51.25x        |
| 3-year       | 797.97          |               |               |
| 5-year       |                 |               |               |
| <b>Total</b> | <b>9,988.27</b> | <b>181.56</b> | <b>55.01x</b> |

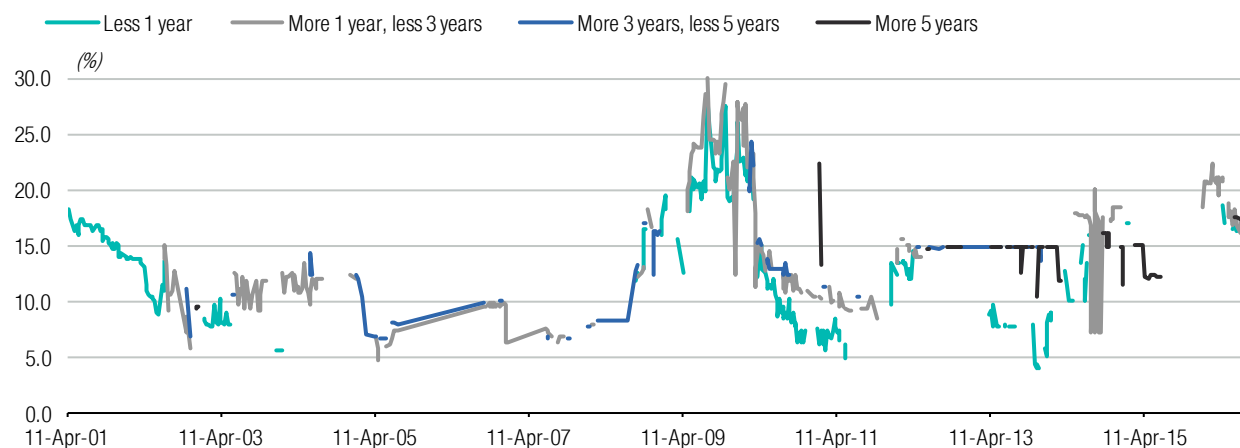
Notes: yields on coupon bearing bonds are effective yields to maturity; [1] only bonds that were placed via the auctions; [2] WA life – weighted average life or years to maturity.

Sources: Ministry of Finance of Ukraine, ICU.

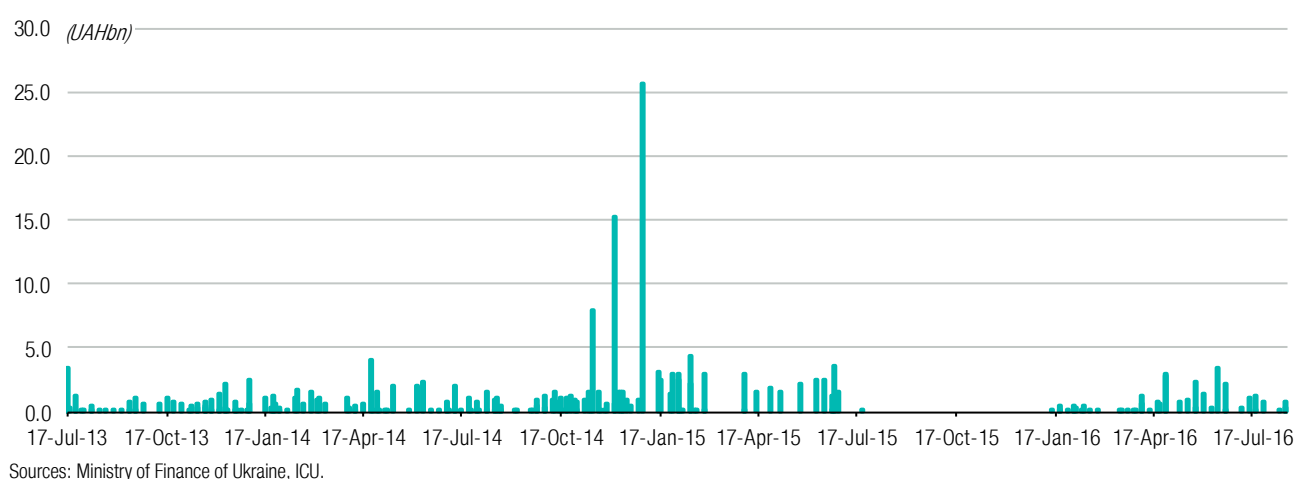
Thirdly, last auction as well as the one scheduled for next day (August 17<sup>th</sup>) indicate more substantial demand from local buyers for government bonds with an FX hedge of any kind (either for bonds that are denominated in foreign currency or that are in hryvnia but their par value is indexed by a hryvnia's exchange rate on the due date) than for ordinary government bonds that are denominated in national currency. At last auction, total placement of USD-denominated government bonds was US\$370m, slightly more than UAH9bn in a local currency equivalent. Moreover, buyers of government FX bonds are accepting a declining yield on this financial instrument – yesterday's effective yield to maturity was 6.8%, below the 7.3% yield, which was recorded last time when the government was placing domestic foreign currency bonds a few weeks ago. As a consequence, the Ministry of Finance dictates a more comfortable rate on foreign currency bonds for itself. The evidence of successful foreign currency bond placements says more about another factor – the Ministry of Finance has been able to replenish its foreign exchange account with the NBU, where according to the latest available data on July 1, the balance was US\$1.7bn. The net flow of funds in this account for the July-August should maintain that balance (as outflows were nearly matched by inflows). More importantly, this allows the government to fulfil its financial obligations in foreign currency without new borrowings, including from the IMF, until the mid of first quarter of 2017. Therefore, it can be assumed that the relatively calm macro environment allows the government not to aggravate the internal politics during this fall by the IMF factor, for example, when the state budget law for 2017 is discussed in parliament. This means that the resumption of the IMF program could be postponed again. However, despite this assumption, our baseline macro scenario still relies on the developments when Ukrainian authorities resume cooperation with the IMF this year rather than next year.

## Appendix: Auctions history and schedule for 2014

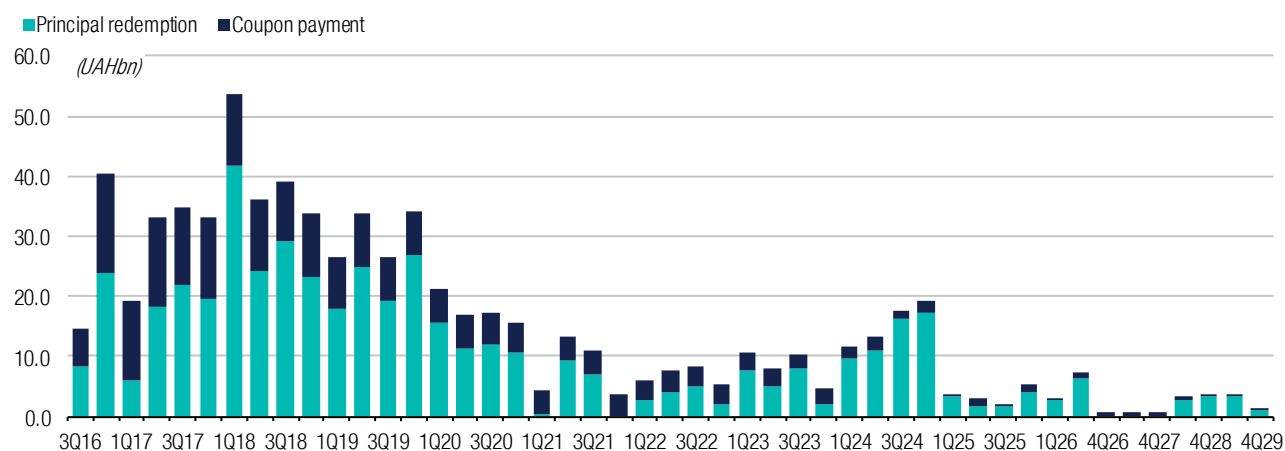
**Chart 1. History of yields at government bond auctions: breakdown by tenor of bonds sold (last 3-year period)**



**Chart 2. History of proceeds at government bond auctions: breakdown by tenor of bonds sold (last 3-year period)**



**Chart 3. Schedule of redemptions of the local-currency government bonds\***



**Table 2. Schedule of government bond auctions in 2016**

Action dates, tenors of bonds to be offered and volume (in hryvnia) of government's refinancing needs for the next 7-day period as of auction date

| Month            | Auction details               | 1st Tuesday             | 2nd Tuesday             | 3rd Tuesday             | 4th Tuesday             | 5th Tuesday             |
|------------------|-------------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| <b>January</b>   | Auction date                  | 5 January 2016          | 12 January 2016         | 19 January 2016         | 26 January 2016         |                         |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Next 7 days refinancing needs | 0.00                    | 0.00                    | 0.00                    | 0.00                    |                         |
| <b>February</b>  | Auction date                  | 2 February 2016         | 9 February 2016         | 16 February 2016        | 23 February 2016        |                         |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Next 7 days refinancing needs | 0.00                    | 0.00                    | 0.00                    | 0.00                    |                         |
| <b>March</b>     | Auction date                  | 1 March 2016            | 8 March 2016            | 15 March 2016           | 22 March 2016           | 29 March 2016           |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Next 7 days refinancing needs | 0.00                    | 0.00                    | 0.00                    | 0.00                    | 0.00                    |
| <b>April</b>     | Auction date                  | 5 April 2016            | 12 April 2016           | 19 April 2016           | 26 April 2016           |                         |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Next 7 days refinancing needs | 0.00                    | 0.00                    | 0.00                    | 0.00                    |                         |
| <b>May</b>       | Auction date                  | 3 May 2016              | 10 May 2016             | 17 May 2016             | 24 May 2016             | 31 May 2016             |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Next 7 days refinancing needs | 0.00                    | 0.00                    | 0.00                    | 0.00                    | 0.00                    |
| <b>June</b>      | Auction date                  | 7 June 2016             | 14 June 2016            | 21 June 2016            | 28 June 2016            |                         |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Next 7 days refinancing needs | 0.00                    | 0.00                    | 0.00                    | 0.00                    |                         |
| <b>July</b>      | Auction date                  | 5 July 2016             | 12 July 2016            | 19 July 2016            | 26 July 2016            |                         |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Next 7 days refinancing needs | 0.00                    | 0.00                    | 0.00                    | 0.00                    |                         |
| <b>August</b>    | Auction date                  | 2 August 2016           | 9 August 2016           | 16 August 2016          | 23 August 2016          | 30 August 2016          |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Next 7 days refinancing needs | 0.00                    | 0.00                    | <b>1,169,987,129.25</b> | <b>2,579,181,572.50</b> | <b>1,083,750,000.00</b> |
| <b>September</b> | Auction date                  | 6 September 2016        | 13 September 2016       | 20 September 2016       | 27 September 2016       |                         |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Next 7 days refinancing needs | 466,462,159.50          | <b>4,984,637,452.50</b> | <b>981,104,479.00</b>   | <b>3,289,949,627.99</b> |                         |
| <b>October</b>   | Auction date                  | 4 October 2016          | 11 October 2016         | 18 October 2016         | 25 October 2016         |                         |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Next 7 days refinancing needs | <b>1,234,578,150.00</b> | <b>1,239,031,858.50</b> | <b>3,681,932,317.00</b> | <b>8,710,641,869.25</b> |                         |
| <b>November</b>  | Auction date                  | 1 November 2016         | 8 November 2016         | 15 November 2016        | 22 November 2016        | 29 November 2016        |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     | N/A                     |
|                  | Next 7 days refinancing needs | <b>1,969,036,389.15</b> | <b>3,470,520,636.00</b> | <b>3,257,617,998.50</b> | <b>2,456,702,730.22</b> | <b>4,043,105,750.72</b> |
| <b>December</b>  | Auction date                  | 6 December 2016         | 13 December 2016        | 20 December 2016        | 27 December 2016        |                         |
|                  | Short-term bonds              | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Medium-term bonds             | N/A                     | N/A                     | N/A                     | N/A                     |                         |
|                  | Next 7 days refinancing needs | <b>4,421,367,312.50</b> | <b>3,513,958,919.20</b> | <b>1,642,283,652.25</b> | <b>660,717,890.00</b>   |                         |

Notes: 1) highlighted data in the rows of "Next 7 days refinancing needs" indicates critical volume of refinancing needs (i.e. above UAH0.5bn) for the government in the next 7-day period; 2) the volume of refinancing needs include principal redemptions and coupon payments.

Sources: Ministry of Finance of Ukraine, Investment Capital Ukraine LLC.

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**Buy:** Forecasted 12-month total return greater than 20%

**Hold:** Forecasted 12-month total return 0% to 20%

**Sell:** Forecasted 12-month total return less than 0%

Note: total return is share price appreciation to a target price in relative terms plus forecasted dividend yield.

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11th floor, LEONARDO Business Centre  
19-21 Bogdan Khmelnytsky Street  
Kiev, 01030 Ukraine  
Phone/Fax +38 044 2200120

**WEB** [www.icu.ua](http://www.icu.ua)



@ICU\_UA

## CORPORATE FINANCE

**Makar Paseniuk, CFA**, Managing Director  
[makar.paseniuk@icu.ua](mailto:makar.paseniuk@icu.ua)

**Ivan Shvydanenko**, Director  
[ivan.shvydanenko@icu.ua](mailto:ivan.shvydanenko@icu.ua)

**Roman Nikitov, ACCA** Director  
[roman.nikitov@icu.ua](mailto:roman.nikitov@icu.ua)

**Yuriy Kamarytskyi**, Vice President  
[yuriy.kamarytskyi@icu.ua](mailto:yuriy.kamarytskyi@icu.ua)

**Ruslan Kilmukhametov**, Director  
[ruslan.kilmukhametov@icu.ua](mailto:ruslan.kilmukhametov@icu.ua)

**Ruslan Patlavsky**, Director  
[ruslan.patlavsky@icu.ua](mailto:ruslan.patlavsky@icu.ua)

## STRATEGY AND CORPORATE DEVELOPMENT

**Vlad Sinani**, Director  
[vlad.sinani@icu.ua](mailto:vlad.sinani@icu.ua)

## SALES AND TRADING

**Konstantin Stetsenko**   
Managing Director  
[konstantin.stetsenko@icu.ua](mailto:konstantin.stetsenko@icu.ua)

**Liliya Kubytovykh**   
Asset Management Product Sales  
[liliya.kubytovykh@icu.ua](mailto:liliya.kubytovykh@icu.ua)

**Sergiy Byelyayev**  
Fixed-Income Trading  
[sergiy.byelyayev@icu.ua](mailto:sergiy.byelyayev@icu.ua)

**Yevgeniya Gryshchenko**  
Fixed-Income Sales  
[yevgeniya.gryshchenko@icu.ua](mailto:yevgeniya.gryshchenko@icu.ua)

**Vitaliy Sivach**   
Fixed-Income & FX Trading  
[vitaliy.sivach@icu.ua](mailto:vitaliy.sivach@icu.ua)

## RESEARCH DEPARTMENT

**Alexander Valchyshen**   
Head of Research  
[alexander.valchyshen@icu.ua](mailto:alexander.valchyshen@icu.ua)

**Alexander Martynenko**   
Head of corporate research  
[alexander.martynenko@icu.ua](mailto:alexander.martynenko@icu.ua)

**Bogdan Vorotilin**   
Financial analyst (Food & Agribusiness)  
[bogdan.vorotilin@icu.ua](mailto:bogdan.vorotilin@icu.ua)

**Taras Kotovych**   
Senior financial analyst (Sovereign debt)  
[taras.kotovych@icu.ua](mailto:taras.kotovych@icu.ua)

**Mykhaylo Demkiv**   
Financial analyst (Banks)  
[mykhaylo.demkiv@icu.ua](mailto:mykhaylo.demkiv@icu.ua)

**Lee Daniels, Rolfe Haas**  
Editors

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