

# Bond Market Insight

## Cost of borrowing increases

### Comment on government bond placement

After the NBU increased the key rate by 50bp to 17.5%, the Ministry of Finance had to increase cut-off rates at the primary auction yesterday, which, once again, increased the cost of budget financing. For three-month and six-month bills, rates were increased by 60bp, and for 12-month and three-year instruments by 45bp and 55bp, respectively.

Total demand amounted to UAH1.83bn, and was concentrated in the three-month and three-year bills, at UAH1.36bn and UAH0.41bn, respectively. From this demand, the MoF accepted all bids only for 12-month paper. For other instruments, the MoF rejected the most expensive bids. If the MoF had accepted all bids, the increase in rates could be more sufficient, with an additional 10bp for the six-month bills, 30bp for the three-year, and 50bp for three-month instruments, while the amount of proceeds would have been insufficiently different, only about UAH20m greater.

The primary market reacted to the NBU's decision on key rate in a more sufficient way than it did at the end of last year and earlier this year. For example, last October, after key rate was increased by 100bp, the cut-off rate for the 12-month bond rose just 35bp. After the key rate was increased this January by 150bp, the cut off rate added just 40bp.

**Table 1. Details of domestic government bonds placed at the auction (UAHbn)**

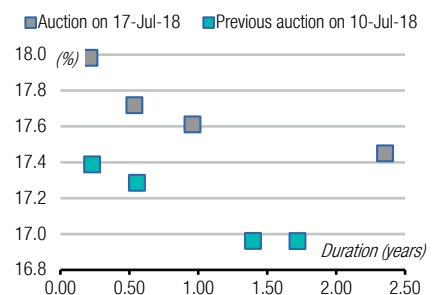
ISIN	Coupon rate (%)	Payment frequency	Maturity	Qty of bonds sold	Price (UAH)	Proceeds <sup>2</sup> (UAHm)	Volume <sup>2</sup> (UAHm)	YTM <sup>3</sup> (%)	Outstanding (m) <sup>4</sup>
UA4000200778	0.00	@Mty	3-Oct-18	1,354,981	963.45	1,305.46	1,354.98	17.98	3,718.11
UA4000201735	0.00	@Mty	30-Jan-19	25,791	913.12	23.55	25.79	17.72	525.79
UA4000201768	0.00	@Mty	3-Jul-19	13,100	855.53	11.21	13.10	17.61	13.10
UA4000194377	16.75	SA	2-Jun-21	408,246	1,019.84	416.35	408.25	17.45	3,561.92
<b>Total UAH</b>				<b>1,802,118</b>		<b>1,756.56</b>	<b>1,802.12</b>		<b>7,818.92</b>

Note: [1] payment frequency abbreviations: M - monthly, Qtly - quarterly, SA - semi-annually, @Mty - at maturity date; [2] proceeds and volumes for the USD-denominated bonds are calculated based on the previous day's exchange rate 26.21/USD, 30.47/EUR; [3] yields on coupon-bearing bonds are effective yields to maturity. Sources: Ministry of Finance of Ukraine, Bloomberg, ICU.

However, yesterday's increase by additional 45-60bp was more than the key-rate increase. The lowest rates that were bid could have allowed the MoF to set a less significant increase in rates, just 25-35bp, which would have been in line with its previous decisions. But such decision to reject more bids this time could provide the MoF with a significantly lower amount of funds, while proceeds are

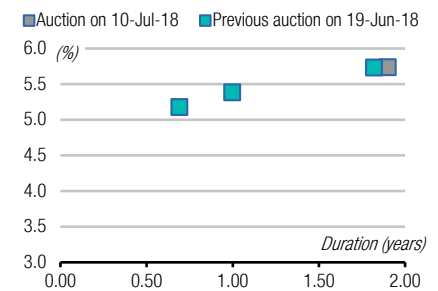
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### UAH-denominated domestic gov't bonds: yield curve in past two auctions



Source: Ministry of Finance of Ukraine, ICU.

### USD-denominated domestic gov't bonds: yield curve in past two auctions



Source: Ministry of Finance of Ukraine, ICU.

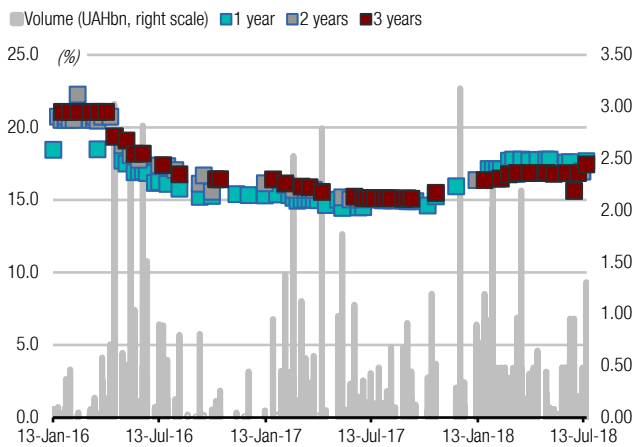
very important due to the low level of revenues collection, and high level of budget expenditures. Last week, the Treasury spent UAH7.3bn more than it collected in revenues.

For the coming weeks, the MoF will have to decrease budget financing to maintain the current level of interest rates. However, given that next week the Ministry has scheduled nearly UAH6bn of debt repayments, its requirements for new borrowings will be high, and they may be forced to be less conservative in setting rates.

# Appendix: Yields-to-maturity, repayments

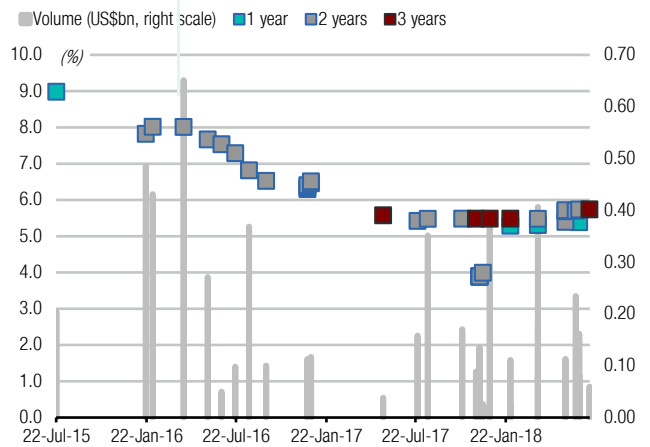
**Chart 1. Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)**

*UAH-denominated domestic government bonds*



Source: Ministry of Finance of Ukraine, ICU.

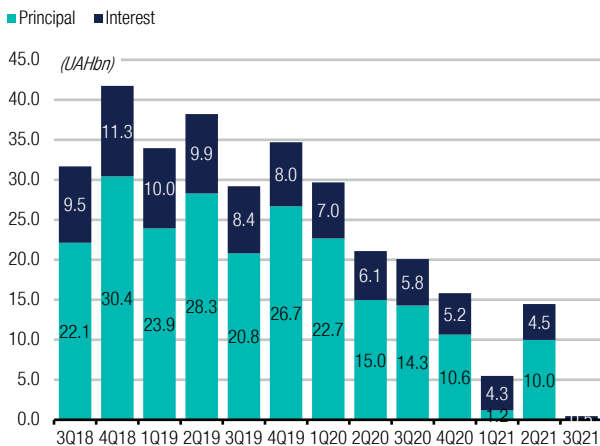
*USD-denominated domestic government bonds*



Source: Ministry of Finance of Ukraine, ICU.

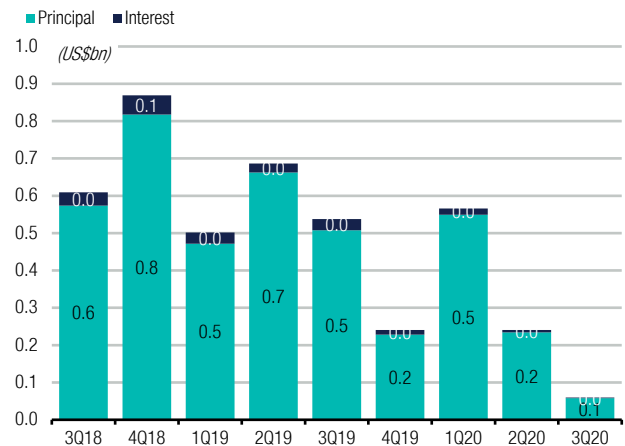
**Chart 2. Future repayments on domestic government bonds (in billions of currency)**

*UAH-denominated domestic government bonds*



Source: Ministry of Finance of Ukraine, ICU.

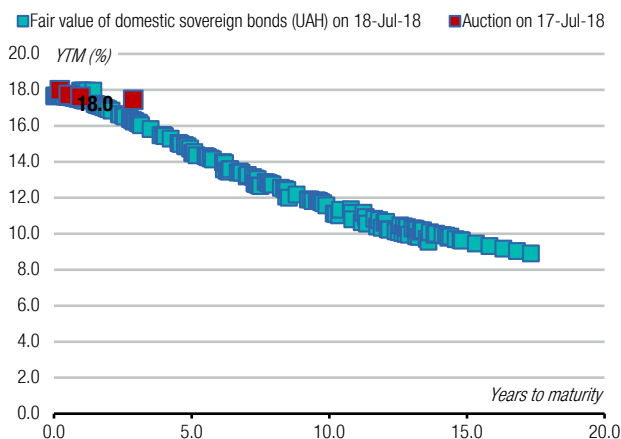
*USD-denominated domestic government bonds*



Source: Ministry of Finance of Ukraine, ICU.

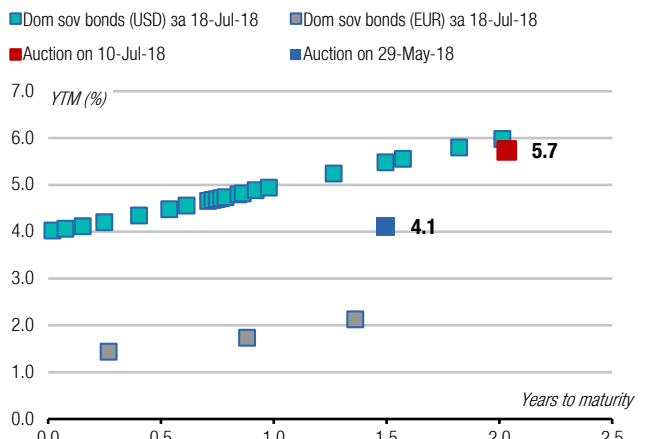
**Chart 3. Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions**

*UAH-denominated domestic government bonds*



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

*USD- and EUR-denominated domestic government bonds*



Source: National Bank of Ukraine, Ministry of Finance of Ukraine, ICU.

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

**WEB** [www.icu.ua](http://www.icu.ua)    [@ICU\\_UA](https://twitter.com/ICU_UA)

## CORPORATE FINANCE

**Makar Paseniuk, CFA**, Managing Partner  
[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)

## ASSET MANAGEMENT

**Grigoriy Ovcharenko**, Director  
Head of Local Asset Management  
[grigoriy.ovcharenko@icu.ua](mailto:grigoriy.ovcharenko@icu.ua)

**Liliya Kubytovych**   
Head of Marketing and Sales  
[liliya.kubytovych@icu.ua](mailto:liliya.kubytovych@icu.ua)


## TRADE OPERATIONS

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

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


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

**Yevgeniya Gryshchenko**  
Head of Brokerage Services Department  
[yevgeniya.gryshchenko@icu.ua](mailto:yevgeniya.gryshchenko@icu.ua)

**Vitaliy Sivach**   
Trader, Fixed-Income & Forex  
[vitaliy.sivach@icu.ua](mailto:vitaliy.sivach@icu.ua)


**Bogdan Vorotilin**   
[bogdan.vorotilin@icu.ua](mailto:bogdan.vorotilin@icu.ua)

## RESEARCH

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

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

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

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

**Dmitriy Dyachenko**  
Junior financial analyst  
[dmitriy.dyachenko@icu.ua](mailto:dmitriy.dyachenko@icu.ua)

**Artem Gladchenko**  
Junior financial analyst  
[artem.gladchenko@icu.ua](mailto:artem.gladchenko@icu.ua)

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