

Bond Market Insight

Rates continue to decline

Comment on government bond placement

This week, the Ministry of Finance extended the list of bills with limited offerings, supporting a further decline in cut-off rates, and lowering the cost of borrowing. Due to these limits, cut-off rates for most of offered bills were reduced by 20-34bp. Total demand amounted to UAH9bn (US\$0.35bn), which was UAH1.6bn (US\$0.06bn) less than a week ago. The amount of proceeds this week slid UAH2bn (US\$0.08bn) to UAH6bn (US\$0.23bn).

Despite announced limits, demand for maturities from three months and up to one year significantly exceeded these limits. For three-month bills, demand was 30% larger than the limit, for seven months it was three time larger, and for the 12 month it was 2.8 times larger. This demand allowed a decrease rates since the MoF accepted only the cheapest part of demand. As the result, for three-month bills, the cut-off rate decreased by 20bp to 17.24%, for the seven month by 34bp to 17.60%, and for 12 month by 30bp to 18%.

Cut-off rates were reduced for longer maturities, too. For three-year notes, four bids were rejected, amounting to UAH100m (US\$3.9m), and the cut-off rate was reduced by 20bp to 16.75%. At the same time, for the six-year note, the cut-off rate remained unchanged, while the weighted-average rate decreased by 1bp to 15.84%, the same level as coupon rate.

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

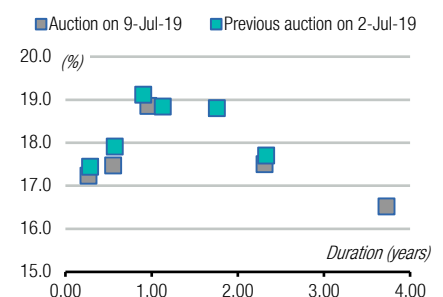
ISIN	Coupon rate (%)	Payment frequency ¹	Maturity	Qty of bonds sold	Price (UAH)	Proceeds ² (UAHm)	Volume ² (UAHm)	YTM ³ (%)	Outstanding (m) ⁴
UA4000204184	0.00	@Mty	16-Oct-19	500,000	955.77	477.88	500.00	17.24	1,920.47
UA4000203244	0.00	@Mty	29-Jan-20	500,000	911.43	455.72	500.00	17.47	1,887.97
UA4000171094	14.30	SA	8-Jul-20	1,000,000	967.53	967.53	1,000.00	18.86	4,099.77
UA4000204002	17.00	SA	11-May-22	1,159,307	1,030.91	1,195.14	1,159.31	17.50	3,968.33
UA4000204150	15.84	SA	26-Feb-25	2,762,122	1,054.09	2,911.52	2,762.12	16.52	10,237.73
Total UAH				5,921,429	6,007.79	5,921.43			22,114.27

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 26.17/USD, 29.6/EUR; [3] yields on coupon-bearing bonds are effective yields to maturity. Sources: Ministry of Finance of Ukraine, Bloomberg, ICU.

Although the largest demand was for 12-month bills, the largest amount of proceeds (UAH2.9bn or US\$0.11bn) came from six-year notes, as these notes had the most attractive rates in terms of the MoF's cost of borrowing. In our view, the main part of

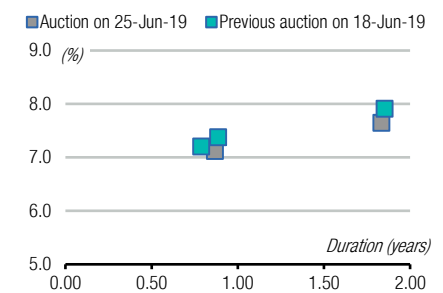
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UAH-denominated domestic gov't bonds: yield curve in past two auctions



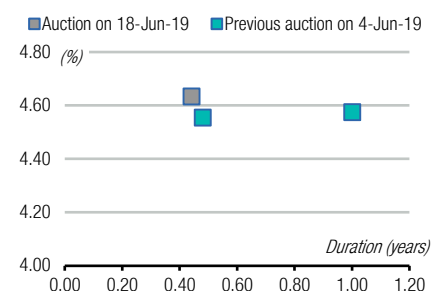
Source: Ministry of Finance of Ukraine, ICU.

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



Source: Ministry of Finance of Ukraine, ICU.

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



Source: Ministry of Finance of Ukraine, ICU.

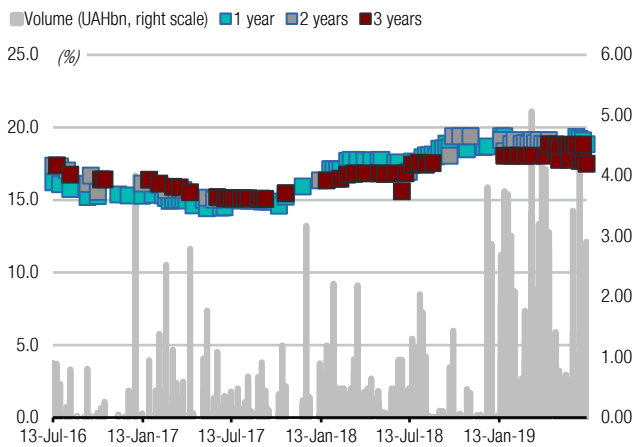
these notes was purchased by foreign investors.

The Ministry's position of limiting offerings for short-term bills and stimulating demand for longer maturities is having the intended result. Competition for short-term maturities supported the decline in interest rates, flattening the yield curve. There will be one primary auction next week before the NBU's monetary meeting. At this auction, we expect interest rates to continue to decline in anticipation of the NBU's key policy rate decreasing.

Appendix: Yields-to-maturity, repayments

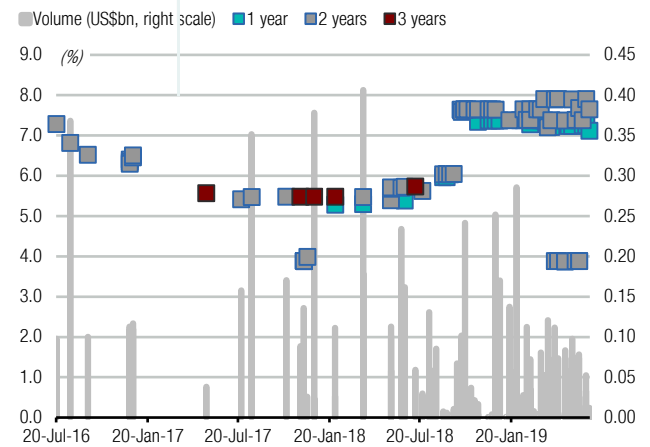
Chart 1. Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

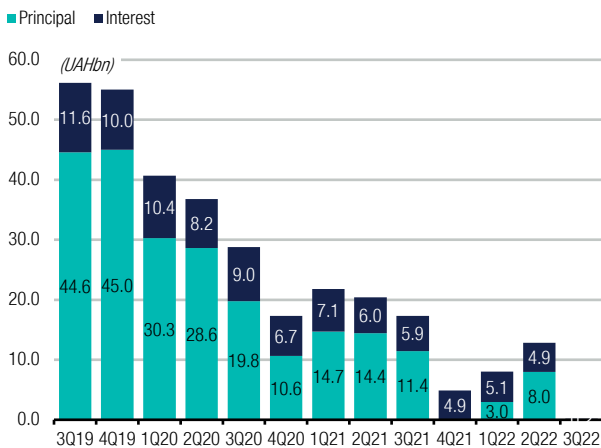
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

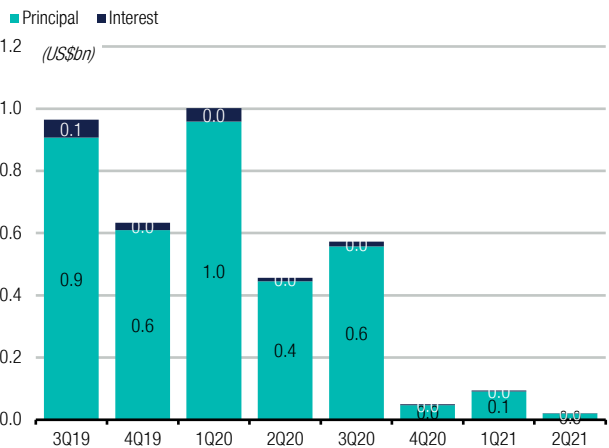
Chart 2. Future repayments on domestic government bonds (in billions of currency)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

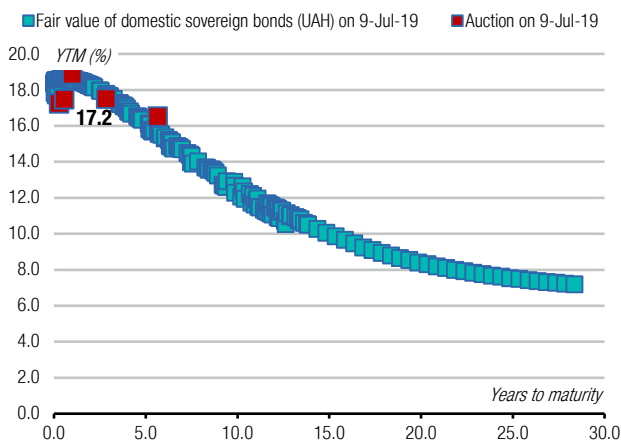
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

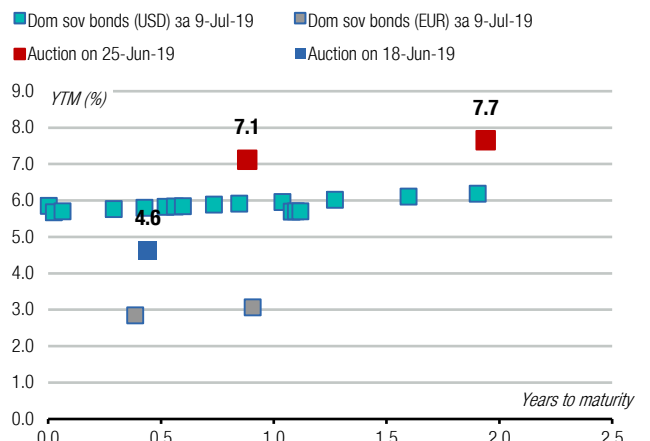
Chart 3. Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions

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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