

Bond Market Insight

Bonds anticipate NBU key rate decrease

Comment on government bond placement

The debut auction of 2020 attracted five times the demand over the amount of bonds offered. Large demand and a capped offering allowed the MoF to decrease cut-off rates below 11% for all paper.

We last saw this kind of demand for short-term bills during the spring of 2019. At that time, foreigner participation was restrained, and decreases in the NBU key policy rate had just started. In 2H19, demand for bills with maturities up to 12-month was low and sometimes did not cover the offered amount.

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

ISIN	Coupon rate (%)	Payment freq ¹	Maturity	Qty of bonds sold	Price (UAH)	Proceeds ² (UAHm)	Volume ² (UAHm)	YTM ³ (%)	Out-standing (m) ⁴
UA4000165773	14.30	SA	8-Apr-20	500,000	1,045.97	522.98	500.00	11.05	2,858.07
UA4000203723	18.00	SA	24-Mar-21	500,000	1,140.63	570.31	500.00	10.47	7,483.49
UA4000203236	17.25	SA	5-Jan-22	1,500,000	1,129.91	1,694.86	1,500.00	10.32	3,988.26
UA4000206460	11.67	SA	22-Nov-23	3,000,000	1,071.70	3,215.11	3,000.00	10.16	10,000.00
Total UAH				5,500,000		6,003.27	5,500.00		24,329.82

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 23.26/USD, 26.01/EUR; [3] yields on coupon-bearing bonds are effective yields to maturity. Sources: Ministry of Finance of Ukraine, Bloomberg, ICU.

But yesterday, demand for three-month bills was seven times larger than the cap. The MoF sold UAH500m of the offered amount of bills, and decreased the cut-off rate by 95bp to 10.85% and the weighted-average rate by 102bp to 10.73%.

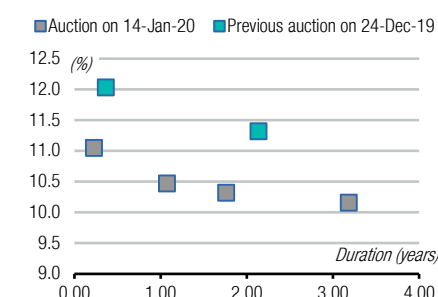
The bid-to-cover ratio for 1.2-year maturity was larger, exceeding 10 times, as demand was UAH5.1bn. This resulted in a decline in the cut-off rate of 101bp to 10.44%, and the weighted-average rate was decreased by 124bp to 10.18%.

Demand for longer maturities was similar with decline in rates. Demand for two-year bills exceeded the offered amount 4.6 times, but the decline in rates was less significant: the cut-off rate slid 79bp to 10.21% and weighted-average rate declined 96bp to 10.04%.

The most important decline in rates was seen for the four-year notes, as demand was at UAH9.7bn, with the bid-to-cover ratio at three times. As a result, the cut-off rate declined to 10.10% (the first time in the last few years) and the weighted-average rate fell to 9.88%, below the psychological level of 10%.

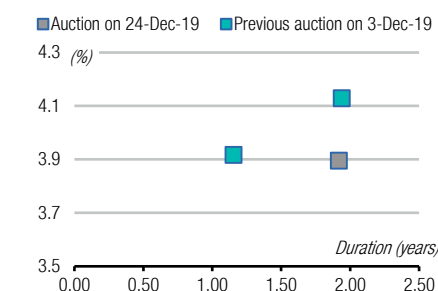
WEDNESDAY, 15 JANUARY 2020

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



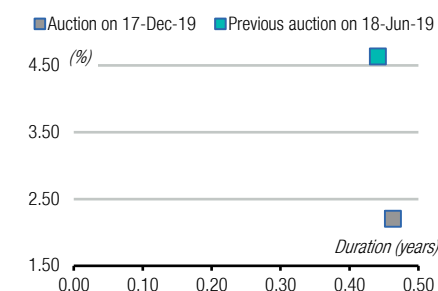
Source: Ministry of Finance of Ukraine, ICU.

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



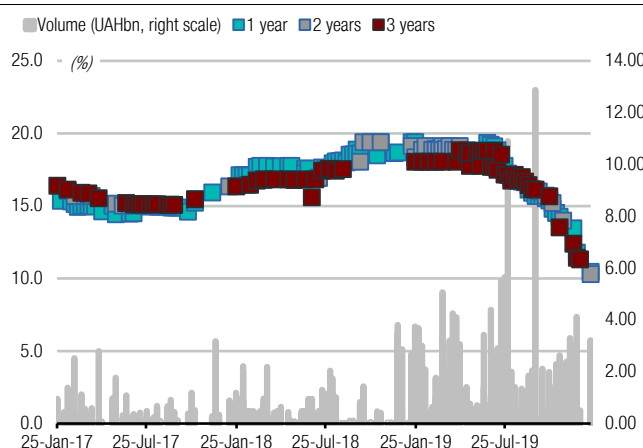
Source: Ministry of Finance of Ukraine, ICU.

Therefore, after a seasonal decline in foreigners' activity and a break in auctions due to the holidays, accumulated interest and demand resulted in a significant decline in interest rates for local-currency paper. Most likely, this was a reaction to low inflation (see [our weekly](#)), which increased expectations of a significant decrease in the NBU's key policy rate at the end of January. During the next two weeks, we could see a further decline in rates, close to 10%, even if they do not cross this level, which would be factored into bond prices in anticipation of a possible new level of the key policy rate, which will be announced on 30 January 2020.

Appendix: Yields-to-maturity, repayments

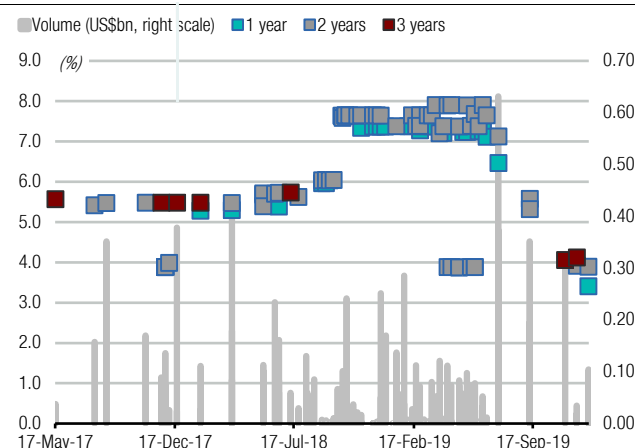
Chart 1. Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

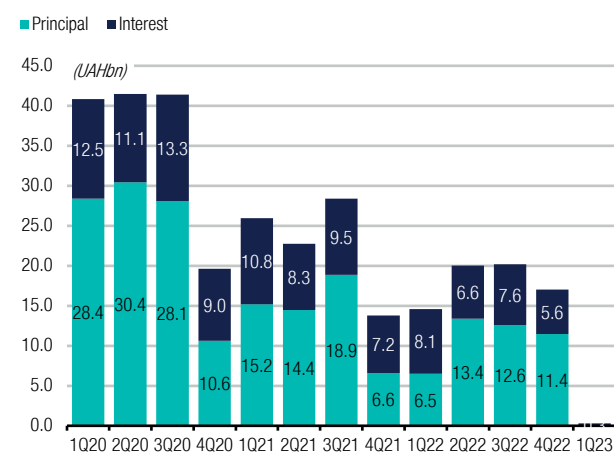
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

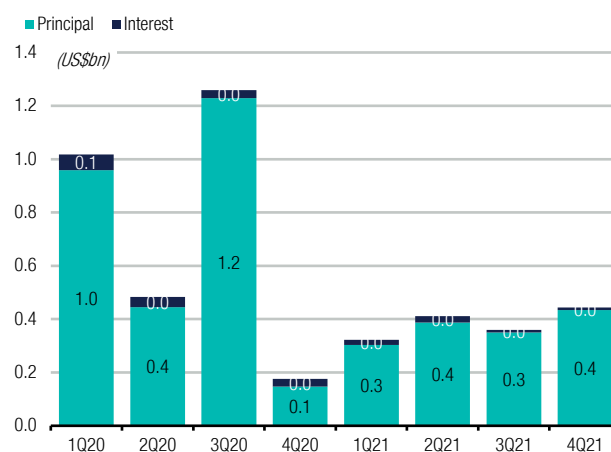
Chart 2. Future repayments on domestic government bonds (in billions of currency)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

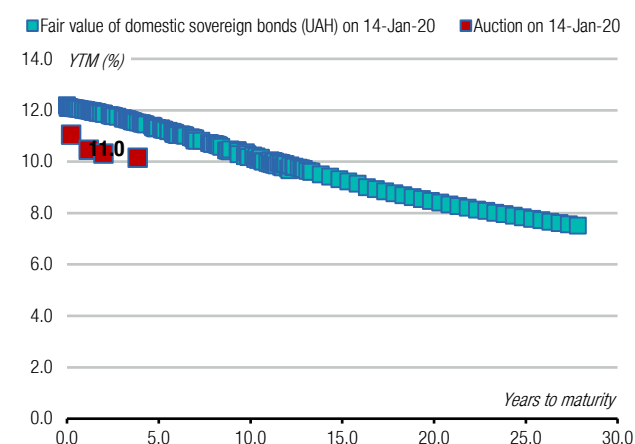
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

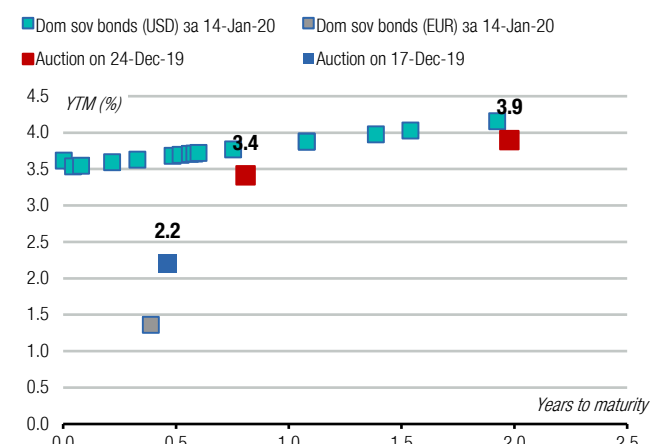
Chart 3. Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions

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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