

Bond Market Insight

Demand doubles; borrowings increase

Comment on government bond placement

Investors and the Ministry of Finance were able to find common ground, which resulted in increased budget financing at a quite low cost. Interest rates for bills up to one year maturity fell below 10%. We expect to see single digits for longer bills very soon.

As expected, two of the shortest bills with limited offerings saw large demand, as last week, the Ministry accepted less than one-third of demand. Yesterday's demand was similar to what was rejected a week ago—UAH2bn—and the Ministry accepted only the bids with the lowest rates.

The cut-off and weighted-average rates for three-month bills decreased by 26bp to 7.24%. Likely, the MoF accepted one competitive and two non-competitive bids. However, for the six-month bills, the Ministry accepted at least two competitive bids, decreasing the cut-off rate by 26bp to 7.74%, while weighted-average rate was down 29bp to 7.71%.

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

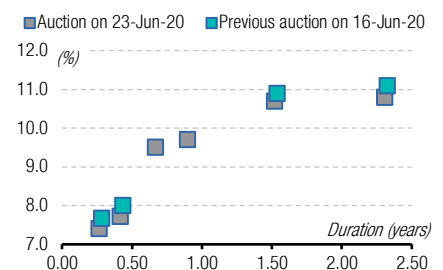
ISIN	Coupon rate (%)	Payment frequency ¹	Maturity	Qty of bonds sold	Price (UAH)	Proceeds ² (UAHm)	Volume ² (UAHm)	YTM ³ (%)	Outstanding (m) ⁴
UA4000202469	17.25	SA	30-Sep-20	500,000	1,065.65	532.83	500.00	7.39	7,440.99
UA4000209225	0.00	@Mty	25-Nov-20	500,000	968.49	484.24	500.00	7.71	9,914.82
UA4000209373	0.00	@Mty	24-Feb-21	120,000	940.06	112.81	120.00	9.50	7,521.56
UA4000209381	0.00	@Mty	19-May-21	4,198,812	919.60	3,861.24	4,198.81	9.70	10,013.91
UA4000209886	10.57	SA	23-Feb-22	1,063,025	1,036.93	1,102.28	1,063.03	10.69	1,769.39
UA4000207682	9.84	SA	15-Feb-23	123,598	1,019.44	126.00	123.60	10.78	1,272.16
Total UAH				6,505,435	6,219.40	6,505.44			37,932.84

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 26.73/USD, 30.23/EUR; [3] yields on coupon-bearing bonds are effective yields to maturity. Sources: Ministry of Finance of Ukraine, Bloomberg, ICU.

The largest decline was seen for nine-month and 11-month bills, as the last time these instruments were sold was prior to the NBU key policy rate revision. This caused a material decline in the rates seen in demand: the highest rates declined by 79-85bp while the lowest rates were down 93-100bp. Therefore, the Ministry decided to decrease rates significantly: for nine-month bills the cut-off rate was decreased by 125bp and weighted-average rate by 120bp, both to 9.5%. For 11-month paper, the Ministry decided to be less radical, and decreased the cut-off rate by 109bp and weighted-average rate by 100bp to 9.7%, likely to accept a larger part of demand,

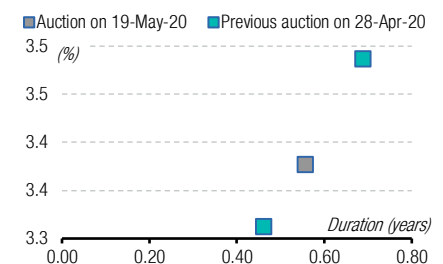
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UAH-denominated domestic gov't bonds: yield curve in past two auctions



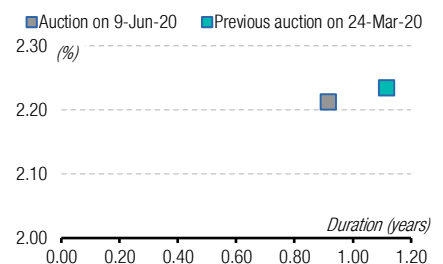
Source: Ministry of Finance of Ukraine, ICU.

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.

which was about half of total demand for the auction.

Longer bills received strong demand, too, especially the two-year paper. For the two-year instrument, the cut-off rate declined by 20bp and weighted-average by 18bp, while for three-year bills the cut-off rate declined by 20bp with the weighted-average cost of borrowing declining by 29bp.

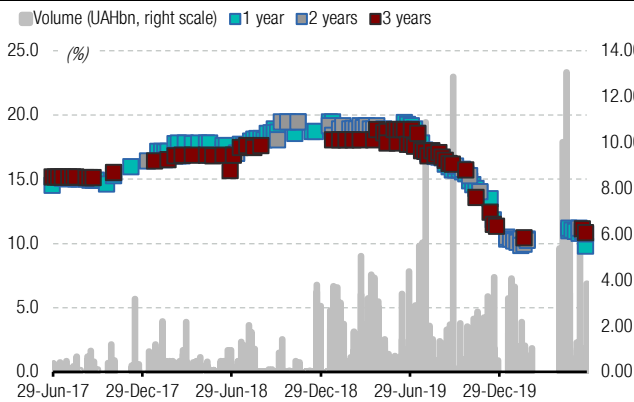
In total, more than UAH8bn of demand was received and the budget collected UAH6.2bn of proceeds, nearly 2/3 of which with 11-month tenor and more than UAH1bn with two and three-year maturities. Therefore, most of these borrowings will be accounted in budget financing and improve the government's ability to finance budget expenditures, or to create reserves for future debt repayments.

So, demand for new bills was huge without large debt repayments and despite a sharp decline in banking-sector liquidity last Friday. This demand allows the MoF to actively borrow new funds and finance the budget deficit. The cost of new borrowings follows the NBU key policy rate, and for longer bills, we could see a single-digit rate perhaps prior to the next revision of NBU key rate.

Appendix: Yields-to-maturity, repayments

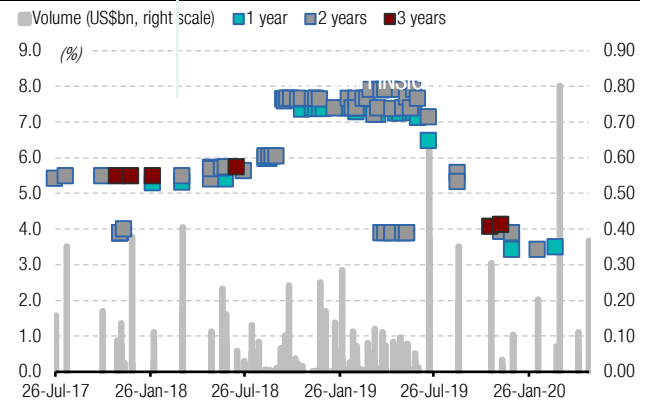
Chart 1. Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

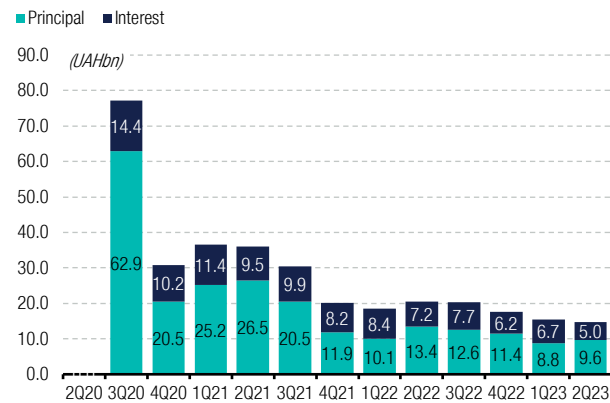
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

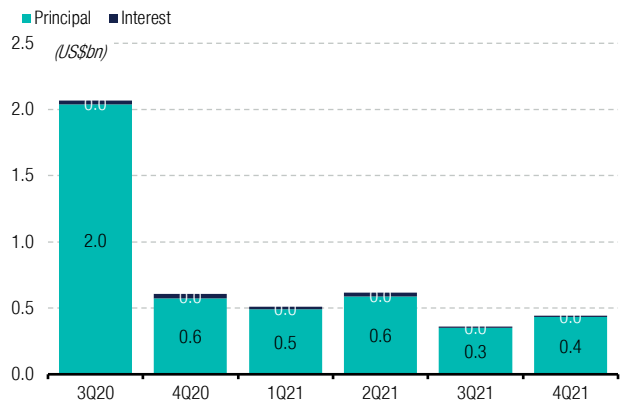
Chart 2. Future repayments on domestic government bonds (in billions of currency)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

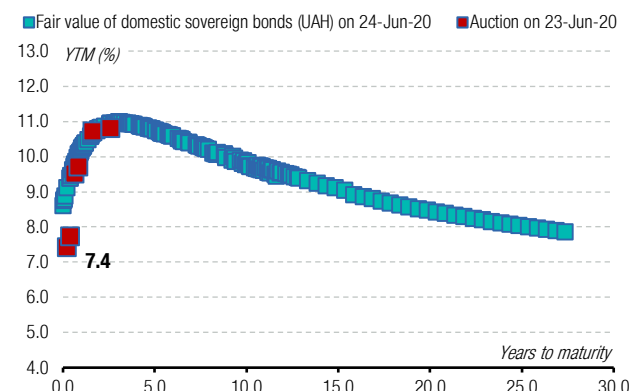
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

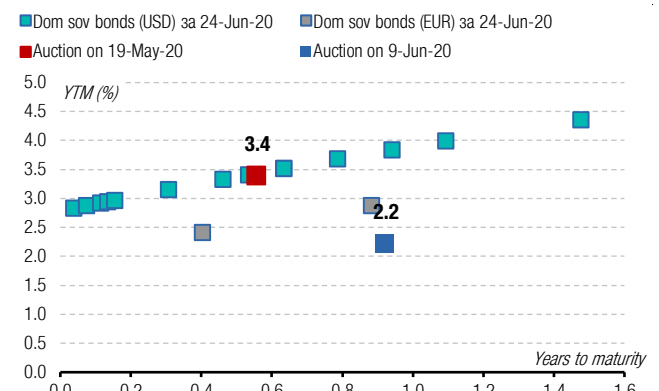
Chart 3. Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions

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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