

Bond Market Insight

Gradual increase in rates continues

Comment on government bond placement

The Ministry was not able to avoid having interest rates rise yesterday. There were two possible choices: cancel the auction, or increase rates and borrow a large amount of funds.

Demand for USD-denominated bills was low, just US\$52.7m, less than half what it was two weeks ago, and earlier this year. At the end of August, demand for FX-denominated bills was lower. However, demand was consistent with a 3.5% interest rate, therefore, the Ministry did not have to make a decision, just accept all 46 bids and borrow US\$52.7m or UAH1.5bn.

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 (UAHm)	Volume (UAHm)	YTM (%)	Outstanding (m) ⁴
UA4000212468	0.00	@Mty	27-Jan-21	4,000,000	980.78	3,923.12	4,000.00	7.30	5,603.87
UA4000204986	15.36	SA	29-Sep-21	1,648,505	1,053.76	1,737.12	1,648.51	10.51	9,613.05
Total UAH				5,648,505		5,660.24	5,648.51		15,216.92
UA4000211502	3.50	SA	21-Oct-21	52,674	1,000.00	1,492.72	1,492.72	3.54	5,452.66
Total USD				52,674		1,492.72	1,492.72		5,452.66

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

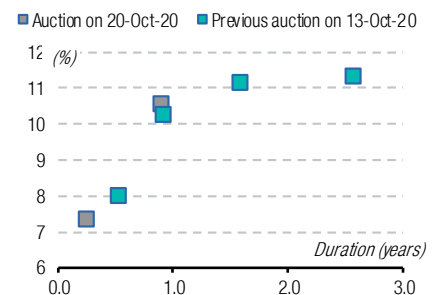
However, for UAH-denominated bills, demand increased in both amount and interest rates. Therefore, the MoF only rejected two bids with the highest rates, one for each bill issue. Rejected bids amounted to UAH200m (US\$7m), which were just a small part of total demand.

For three-month local-currency paper, the Ministry received just two bids, UAH4bn and UAH200m (US\$141m and US\$7m respectively). The larger one requested an increase in the cut-off rate by 10bp, the smaller one by 230bp. Of course, the larger one was accepted with proceeds of UAH3.9bn (US\$138m) at 7.3%, which was 10bp above the cut-off rate two weeks ago, and 11bp above the weighted-average rate at the previous auction.

The offering for 12-month bills was a bit more active, but with a lower amount of demand. In total, demand was UAH1.8bn (US\$65m) in 10bids, out of which nine at UAH1.6bn (US\$58m) at par value were accepted with proceeds of UAH1.7bn (US\$61m). The MoF decided to increase the cut-off rate by 30bp to 10.3%, while the

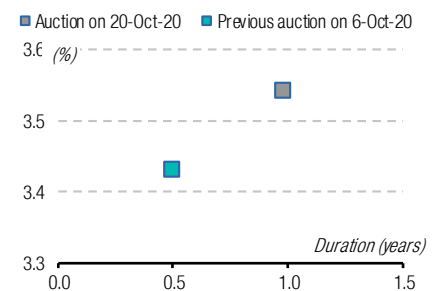
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UAH-denominated domestic gov't bonds: yield curve in past two auctions



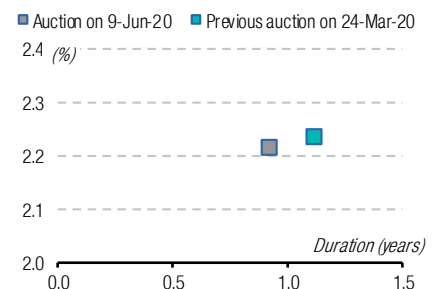
Source: Ministry of Finance of Ukraine, ICU.

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.

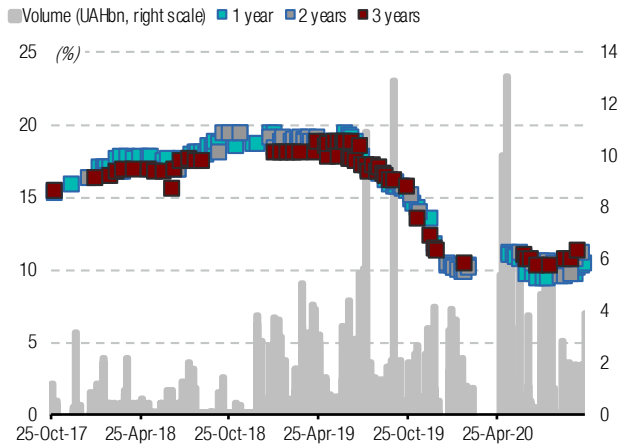
weighted-average rate was set at 10.22%, as part of demand was at 10%.

Interest rates for UAH-denominated bills continued to rise, which the Ministry accepted, likely when it is not a sharp rise, and not for all issues, as was seen last week. Therefore, it looks like the critical level of rates has not been reached, and with large demand, the Ministry can increase rates further, especially when demand is fully above the previous level of rates. The reality is the Ministry has to finance the budget deficit. When there is lack of demand from foreigners, then this demand has to be replaced with more expensive demand from locals.

Appendix: Yields-to-maturity, repayments

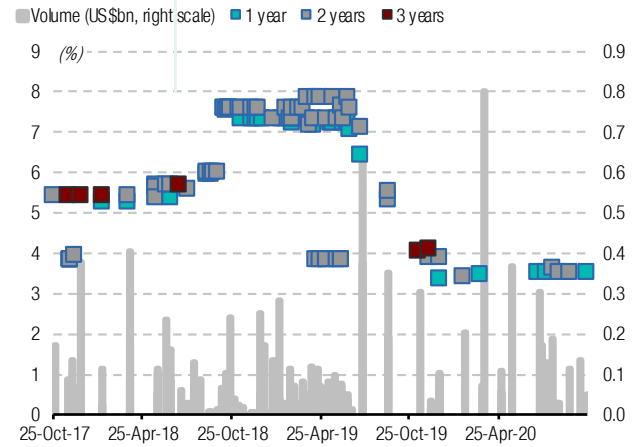
Chart 1. Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

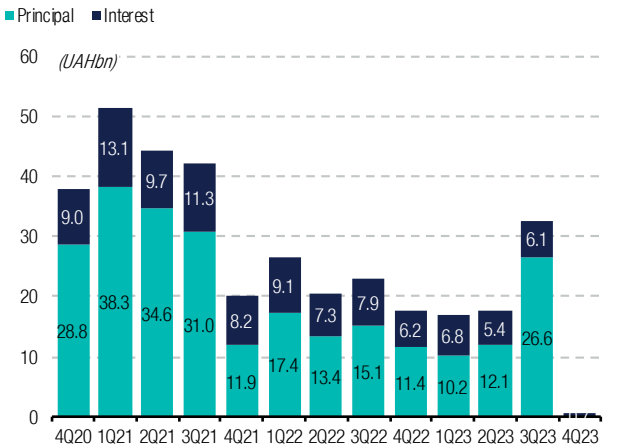
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

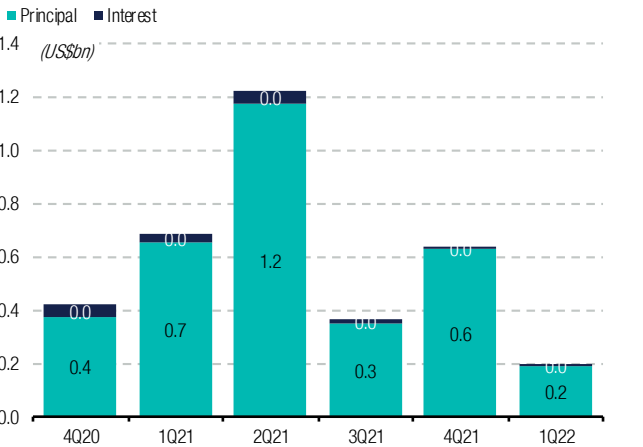
Chart 2. Future repayments on domestic government bonds (in billions of currency)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

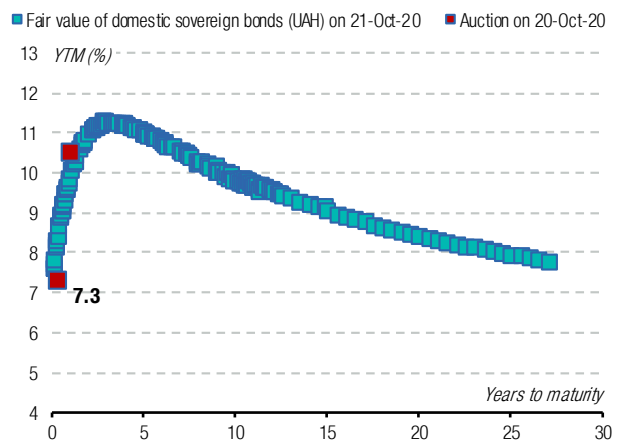
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

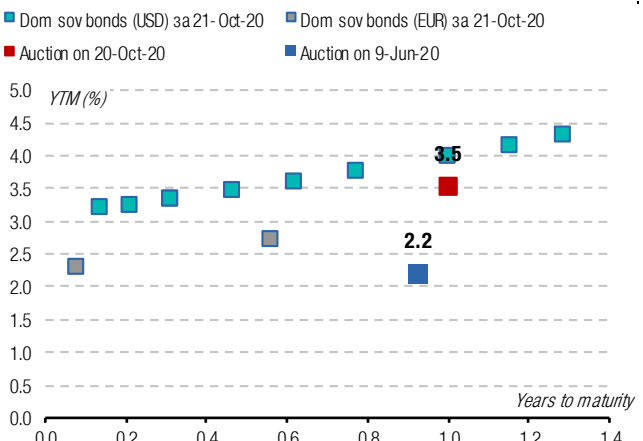
Chart 3. Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions

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 3777040

WEB www.icu.ua   

RESEARCH

Sergiy Nikolaychuk

Head of macro research
sergiy.nikolaychuk@icu.ua

Taras Kotovych

Senior financial analyst (Sovereign debt)
taras.kotovych@icu.ua

Dmitriy Dyachenko

Junior financial analyst
dmitriy.dyachenko@icu.ua

Alexander Martynenko

Head of corporate research
alexander.martynenko@icu.ua

Mykhaylo Demkiv

Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

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