

Bond Market Insight

Interest shifts to shorter instruments

Comment on government bond placement

WEDNESDAY, 18 JANUARY 2023

After banks actively purchased 1.5-year bills that were allowed to be included in obligatory reserves, yesterday, demand was focused on six-month paper, which brought 71% of all budget proceeds from yesterday's auction.

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 (%)	Outstanding (m) ⁴
UA4000226195	0.00	@Mty	5-Jul-23	4,164,008	941.78	3,921.59	4,164.01	13.43	10,386.74
UA4000224380	12.94	SA	14-Feb-24	135,972	1,002.23	136.28	135.97	19.41	7,427.47
UA4000226450	16.00	SA	13-Mar-24	1,443,320	1,024.79	1,479.11	1,443.32	19.96	3,419.01
UA4000222152	12.70	SA	30-Oct-24	6,495	927.43	6.02	6.50	20.51	15,858.73
Total UAH				5,749,795		5,543.00	5,749.80		37,091.95

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 36.75/USD, 39.53/EUR; [3] yields on coupon-bearing bonds are effective yields to maturity. Sources: Ministry of Finance of Ukraine, Bloomberg, ICU.

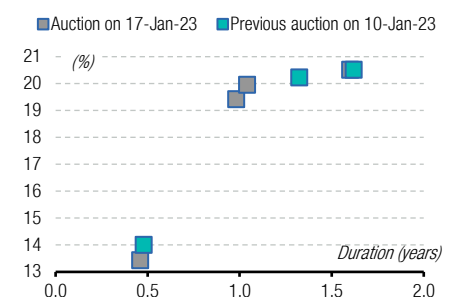
Obviously, for the Ministry, UAH20bn was optimal for the total amount of the first "reserve" issue. Therefore, after successfully reaching this volume, these bonds were not offered yesterday and are unlikely to be offered to the market in the future. Despite last week's great demand and the possibility of attracting a large amount of funds to the budget, the MoF is not likely to change its position.

Instead, the MoF offered the usual government bonds: two issues of military bills and two issues of ordinary (non-military) government securities. Military bills received the greatest demand. There were 29 bids to purchase the issue with maturity in July this year for UAH4.2bn, and for paper due in March next year, there were 13 bids for UAH1.4bn. The demand for ordinary instruments was insignificant.

Probably, because the Ministry of Finance satisfied most of last week's bids for the "reserve" paper only partially, some of the participants decided to play it safe. They submitted large bids with a rate of 75bp lower than last week. But yesterday, there was no cap, so the Ministry of Finance fully met all demand. As a result, the weighted average rate decreased by 57bp to 13.43%, which could be an unpleasant surprise for participants with non-competitive bids (satisfied at the level of the weighted average rate), as non-competitive demand was almost 20%.

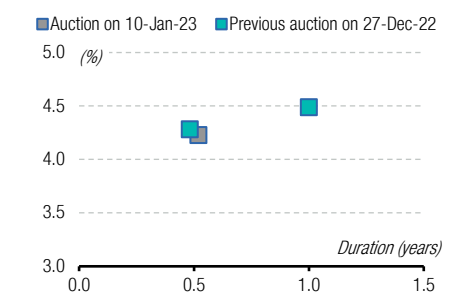
The rate for 14-month military paper continued to fluctuate. At the end of 2022, it was reduced to 18.5%, but yesterday, the Ministry of Finance agreed to return it to 19%, probably because the competitive demand was mainly with rates of 19%.

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



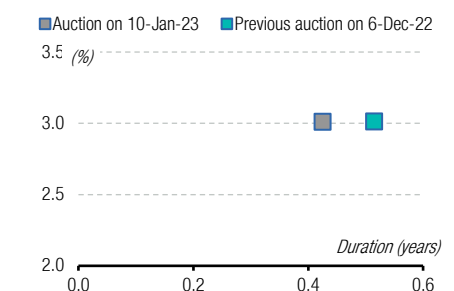
Source: Ministry of Finance of Ukraine, ICU.

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.

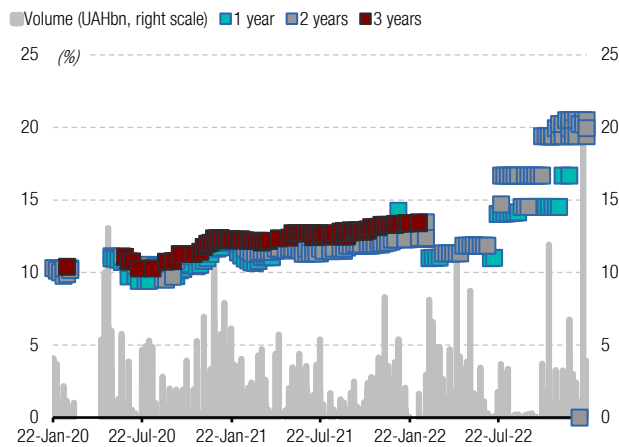
The terms of ordinary bonds did not change, although a bid for UAH100m for 12-month government paper was rejected because it required an immediate rate increase by 650bp up to 25%.

In general, the Ministry of Finance raised enough funds for the rollover of January repayments last week, so there was no special need to raise funds for this purpose yesterday. However, the budget always needs liquidity, and thanks to high demand, new borrowings will allow the MoF to meet the financing needs of current expenses, albeit using short-term government securities. That is why we see some flexibility on the issuer side along with a strategy, such as not raising rates significantly for a small volume of funds because they will not solve the needs of the budget.

Appendix: Yields-to-maturity, repayments

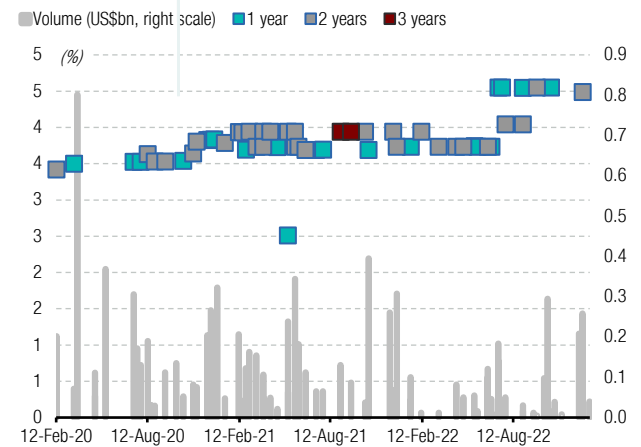
Chart 1. Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

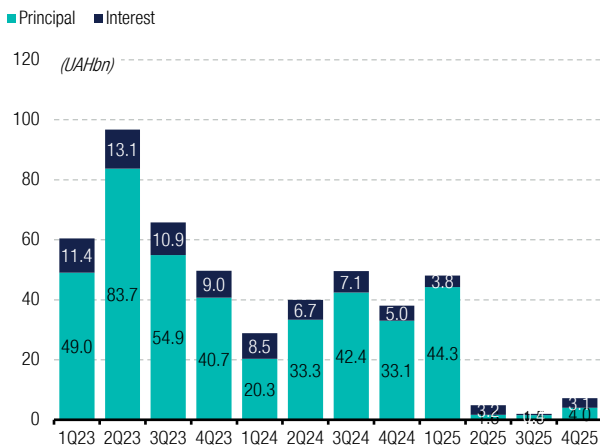
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

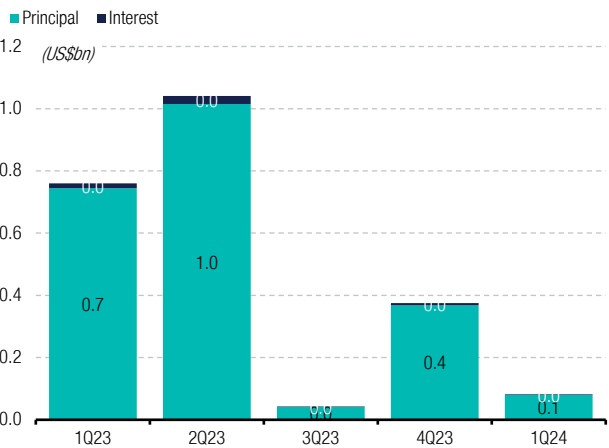
Chart 2. Future repayments on domestic government bonds (in billions of currency)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

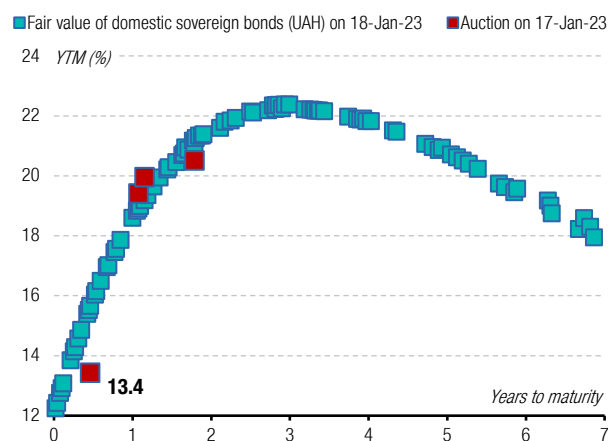
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

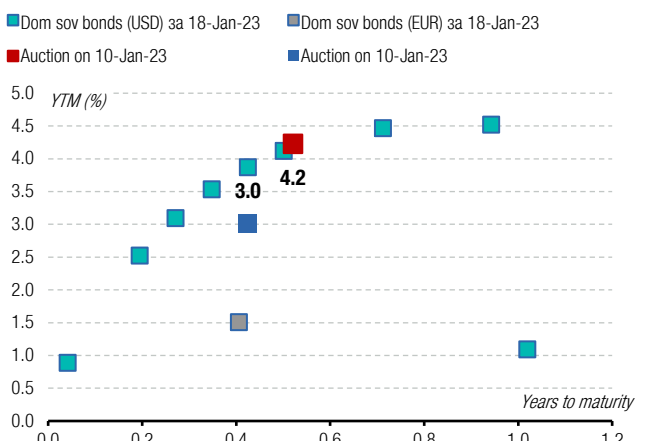
Chart 3. Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions

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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