

Bond Market Insight

Yield curve flattens at 10%

Comment on government bond placement

The yield curve continued to flatten at yesterday's primary auction; it is now slightly above 10% between the six-month and three-year maturities. But this did not prevent the MoF from borrowing a bit more than UAH6.3bn (US\$260m).

Demand for the six-month bills exceeded the offered amount by more than six times, but MoF accepted only six out of 28 bids, which had interest rates not higher than 10.04%, setting weighted-average rate at 10.03% while the lowest rate in bids was at 10.0%. Compared with auctions at the end of last year, the decline was sufficient: the cut-off rate declined by 176bp and weighted-average rate by 172bp.

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
UA4000171094	14.30	SA	8-Jul-20	500,000	1,024.19	512.10	500.00	10.31	8,062.81
UA4000203723	18.00	SA	24-Mar-21	1,500,000	1,144.44	1,716.65	1,500.00	10.32	8,983.49
UA4000201255	16.00	SA	24-May-23	3,430,710	1,191.04	4,086.11	3,430.71	10.29	6,470.60
Total UAH				5,430,710	6,314.86	5,430.71			23,516.91

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.

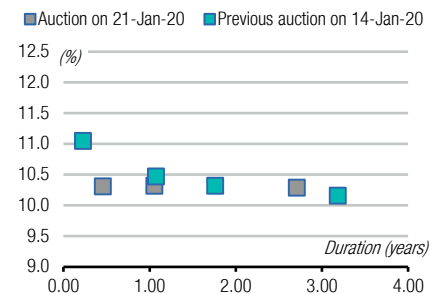
Fourteen-month bills with maturity next March also saw large demand, similar to last week's amount, but rates slightly declined. The lowest rate in bids for this instrument was 9.7% or 25bp lower than last week. The highest bid—at 10.75%—declined 135bp from last week's auction. Most of bids were rejected. Out of 29 bids, the MoF accepted only 13 with rates not higher than 10.15%. As the result, the cut-off rate declined by 29bp to 10.15% and weighted-average rate by 14bp to 10.04%.

Demand was lower for the three-year note than the offered amount, just UAH3.6bn vs UAH4bn. With this demand, the MoF decided to reject some bids due to high interest rates, although the highest rate was 10.75% or 100bp lower than the highest rate for two-year bills last week. Accepting 21 bids, the Ministry set the cut-off rate at 10.15%, the same as for the 14-month bills, and weighted-average rate at 10.01%. These rates were lower than for similar paper at the end of last year, by 85bp and 99bp, respectively.

In this auction, the MoF borrowed UAH6.3bn and was able to flatten the yield curve, especially for bills from six months and up to three years, which currently are

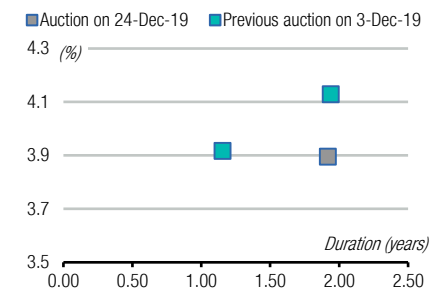
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UAH-denominated domestic gov't bonds: yield curve in past two auctions



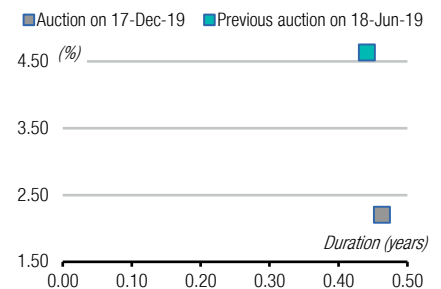
Source: Ministry of Finance of Ukraine, ICU.

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.

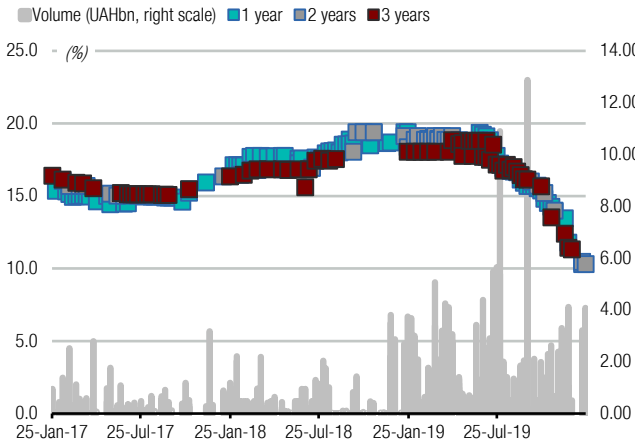
slightly above the psychological level of 10%. This level seems to be very close to the lowest level for such maturities, and probably notes with four and more years to maturity could see large demand with interest rates below 10% to set cut-off rates lower.

Generally, current conditions seems to have put rates very close to the bottom, and a further decline in the NBU key policy rate will not have significant impact, especially at the long end of yield curve, where demand is mostly seen from foreign investors.

Appendix: Yields-to-maturity, repayments

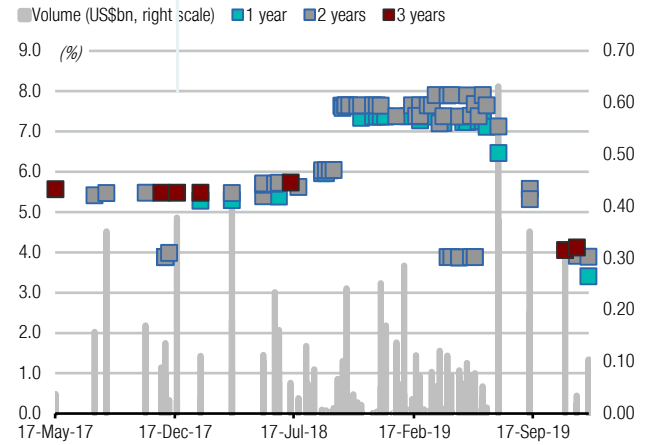
Chart 1. Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

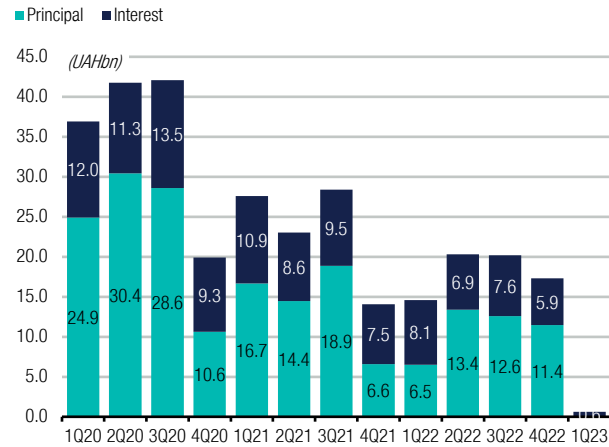
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

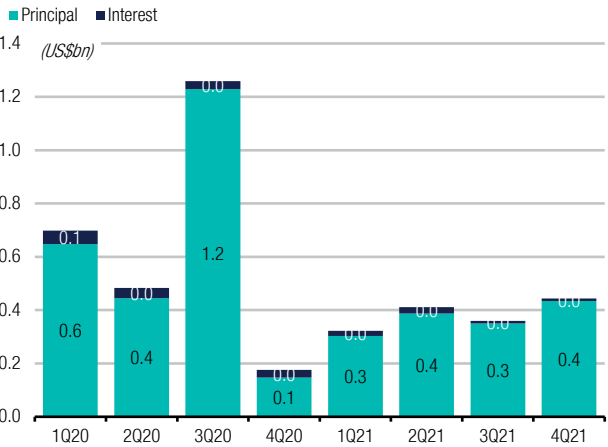
Chart 2. Future repayments on domestic government bonds (in billions of currency)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

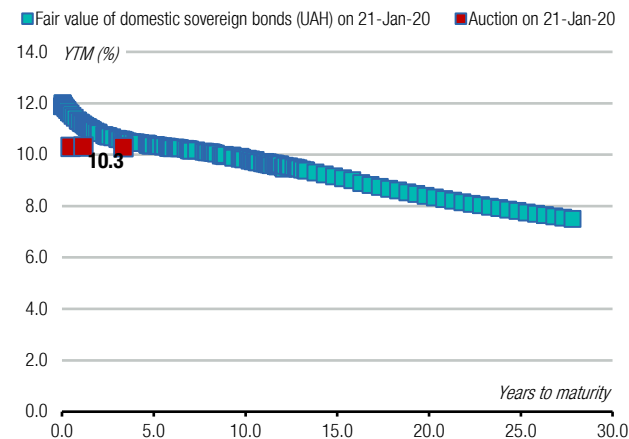
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

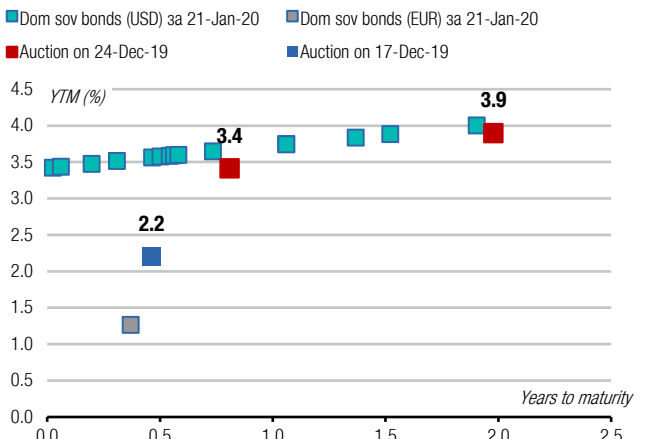
Chart 3. Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions

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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