

Bond Market Insight

Banks continue to finance budget deficit

Comment on government bond placement

The Ministry of Finance attracted UAH16bn yesterday, with almost the entire volume due to "reserve" bonds.

The MoF offered three UAH ordinary (non-military) bills with maturity from one to three years, with the three-year note as "reserve" paper. This "reserve" instrument is one of three securities placed last week that the NBU has allowed banks to use from March 11 to cover part of required reserves. That is why banks directed all their demand to this instrument.

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 ² (UAHm)	Volume ² (UAHm)	YTM ³ (%)	Outstanding (m) ⁴
UA4000224380	12.94	SA	14-Feb-24	64,246	961.02	61.74	64.25	19.41	10,097.68
UA4000222152	12.70	SA	30-Oct-24	14,930	950.96	14.20	14.93	20.51	15,888.61
UA4000227201	19.75	SA	5-Nov-25	15,000,000	1,065.55	15,983.26	15,000.00	20.68	18,060.15
Total UAH				15,079,176	16,059.20	15,079.18		44,046.43	

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 36.83/USD, 39.48/EUR; [3] yields on coupon-bearing bonds are effective yields to maturity. Sources: Ministry of Finance of Ukraine, Bloomberg, ICU.

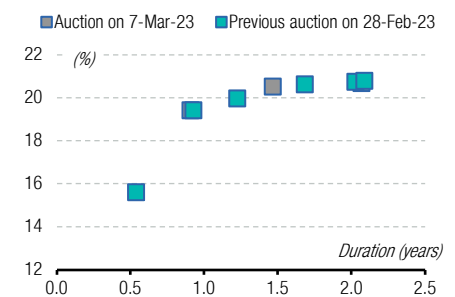
The three-year note was offered with a cap of UAH15bn. It received 42 bids for UAH 15.4 billion. Of this amount, UAH3.7bn was in non-competitive bids (satisfied at the actual weighted average rate), and the rest in competitive bids with rates from 19.25% to 19.75%. Demand with rates below the maximum interest rate was considerable because the MoF set the weighted average rate at 19.65%. As a result, the MoF fully satisfied all bids, non-competitive and competitive, with interest rates lower than 19.75%. Bidders who expected to buy bonds at the maximum rate received only a part of the desired volume within the remaining offer and in proportion to the size of their bids.

The other bills offered yesterday received little demand compared with "reserve" bonds: UAH164m for the one-year and UAH15m for the two-year securities. Seven participants were interested in the two-year bills at the usual rate, while the one-year instruments received a bid for UAH100m with a rate of 25%, which the MoF rejected.

The budget received 99.5% of the funds from yesterday's auction, most likely from banks that plan to use three-year government bonds to cover required reserves. The MoF sold UAH84.7bn of "reserve" bonds YTD, which provided the state budget with UAH89.4bn of proceeds or 76% of all funds raised YTD. Given that only banks buy "reserve" bonds, we can assume they are now the key provider of funds for financing the budget deficit from domestic sources.

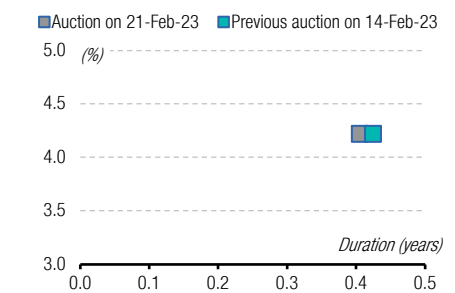
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UAH-denominated domestic gov't bonds: yield curve in past two auctions



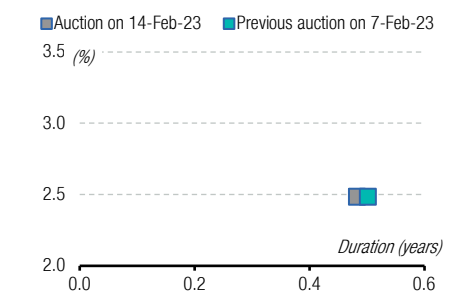
Source: Ministry of Finance of Ukraine, ICU.

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

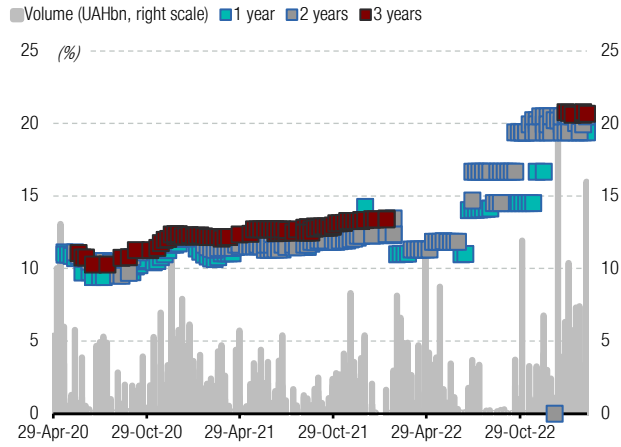


Source: Ministry of Finance of Ukraine, ICU.

Appendix: Yields-to-maturity, repayments

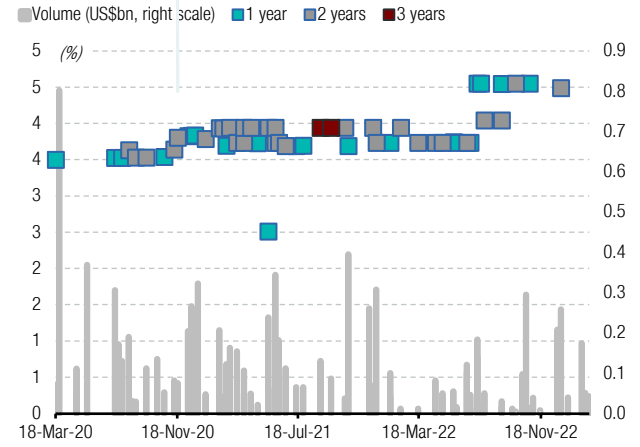
Chart 1. Three-year history of domestic government bond placements at primary market: proceeds (in billions) and yields-to-maturity (%)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

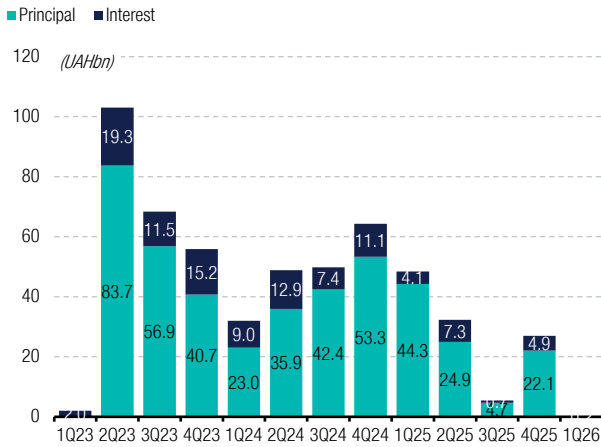
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

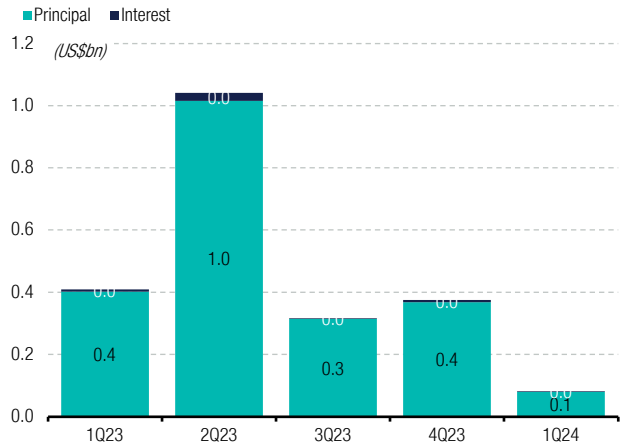
Chart 2. Future repayments on domestic government bonds (in billions of currency)

UAH-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

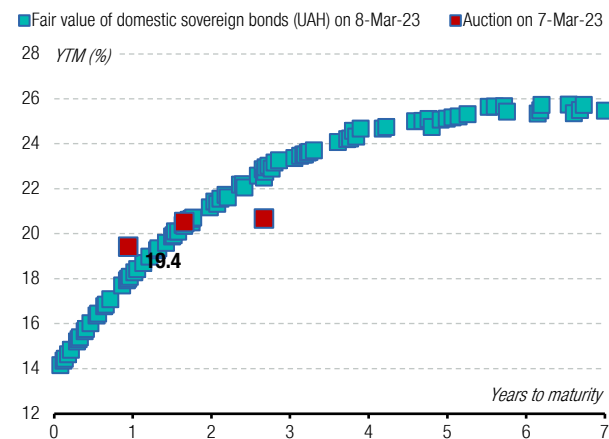
USD-denominated domestic government bonds



Source: Ministry of Finance of Ukraine, ICU.

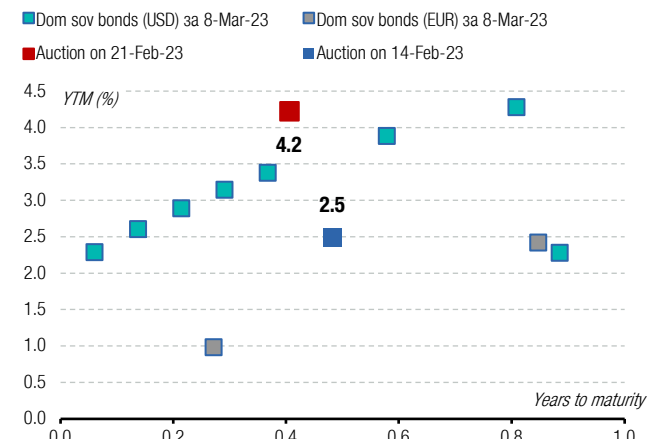
Chart 3. Fair value of domestic government bonds as calculated by NBU versus placements via primary market auctions

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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