



FINREP Focus

DOMESTIC GOVERNMENT DEBT MARKET

July 19-23, 2010

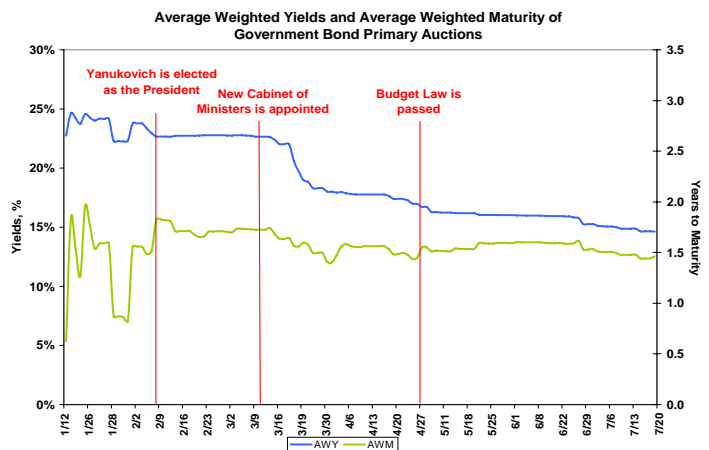
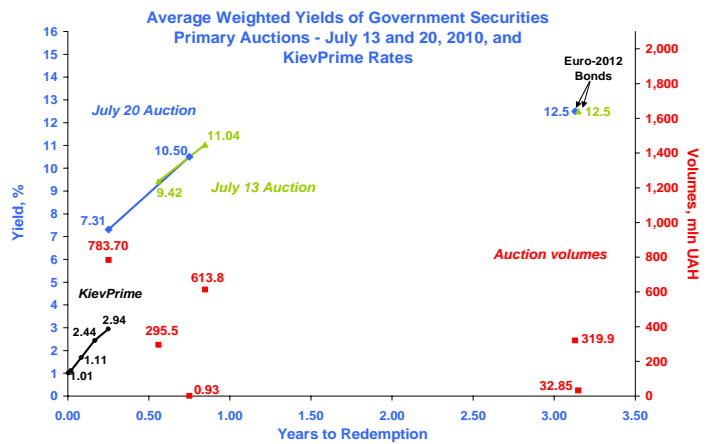
The most prominent recent news was certainly the MoF decision not to crown the Eurobond roadshow with the placement because of yields offered by investors being higher than the Ministry was willing to pay (8.2%-8.5% vs. 6%-7%). That was the third time when Ukraine cancelled Eurobond issuance: first one was in the summer of 2007 (yet later that year the placement did take place due to changes in global financial environment) and the second one – in 2008. However, in the first two cases the decision not to place Eurobonds was caused by external factors, such as considerable worsening of conditions in global markets, yet this time the situation, on the contrary, became more favorable for Ukraine right before the roadshow started and continued to improve. In particular, investors' appetite for risk in emerging markets was improving and progress in talks with the IMF reduced the cost of hedging currency risks for hryvnya. And although the decision not to proceed with the placement brought down the yields of Ukraine's outstanding Eurobond issues, it may have an adverse impact on Ukraine's image in the eyes of potential lead managers and complicate possible re-entering of Eurobond market.

According to Vice Prime Minister Sergiy Tigipko, the amount of VAT bonds to be issued this year is UAH 16.4 bln and that will cover the arrears for 2009 while the exporters' claims for 2010 debt are still being verified. The issuance is now scheduled for early August and will be done in several tranches. As reported, the exporters are now struggling for a place in the first tranche list as that will allow them to sell their bonds on better terms given less competition. The GOU is most likely to facilitate the VAT bond issuance as VAT arrears repayment was one of the conditions for Ukraine to be able to proceed with the IMF loan, which will be discussed at the IMF Executive Board meeting on July 28.

In line with our expectations, Agrarian Policy Ministry stated that UAH 5 bln of OVDPs would be issued in August for the GOU's financial interventions in the domestic grain market. The exact terms of the issue are still unknown. Yet, taking into account the intervention mechanism, those may be 12-month bonds repaid with proceeds from the sale of this year's harvest. This amount will add 0.46% of GDP to the budget deficit. At the same time, many market participants believe these bonds will not appear in the market at all and will be refinanced directly by the NBU or through the state-owned banks.

The excessive liquidity has started to become a problem for the banks. The need to pay interest on increasing deposits and inability to profit from lending will most certainly result in banks' losses. The NBU is now trying to get the situation under control with its deposit certificates (as of July 20, UAH 18.6 bln was "tied" to this instrument). The liquidity of the banking system is not expected to go down until the lending is resumed.

Absence of pressure in the form of approaching large maturities allowed the MoF to return to the previous low rates at this week's primary auction. Three-month T-bills, more actively used by the banks as a liquidity management tool under current circumstances, were placed at 7.31% bringing UAH 784 mln to the budget, while the respective money market rate was 2.9%. Opening of 9-month bills was not such a success with only the minimum amount of UAH 1 mln placed. The MoF satisfied no bids for 2-year OVDPs since rates offered ranged 13%-13.5% with banks probably expecting the Ministry to be more flexible given the cancellation of Eurobond issuance. This week's auction saw no changes in the yield of special Euro-2012 bonds, yet the amount placed exceeded last week's by ten times. This may be the result of the NBU deciding to exclude the special accounts, on which the required reserves are kept, when calculating the liquidity requirements.



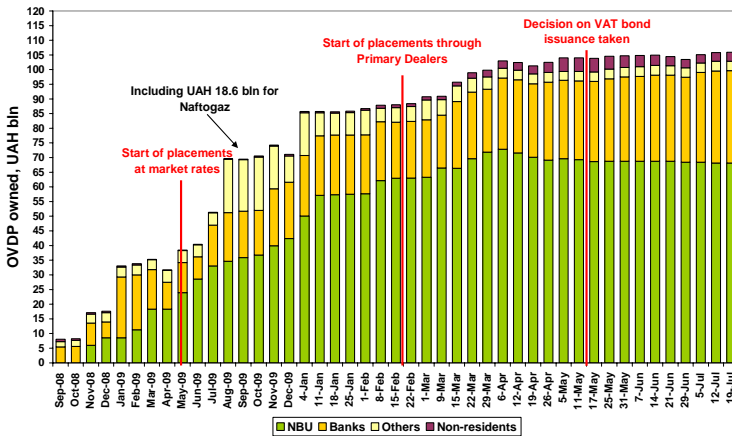


The total amount placed at this week's auction is 14.5% higher than last week mostly thanks to the extremely attractive 3-month T-bills which accounted for over 70% of attracted funds. The failed placement of 2-year OVDP proved that the results this bond showed two weeks ago (UAH 81 mln at 10%) were due to the non-competitive bid submitted and that the trend for investors' low demand for longer maturities continued.

Amounts Submitted and Awarded and Yields of Primary Auctions

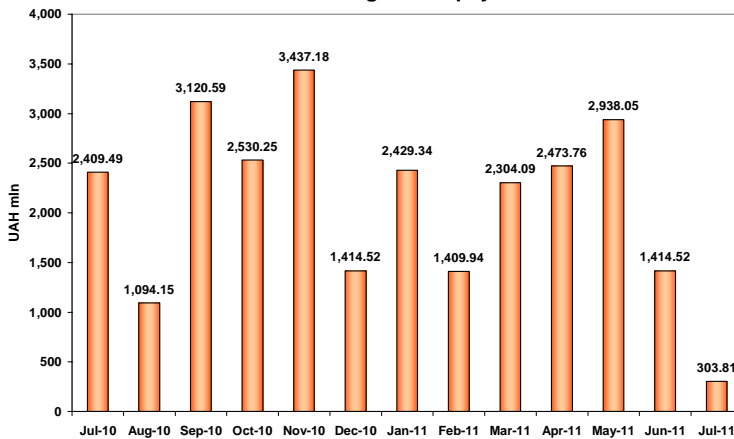
Auction Dates	Bids Submitted	Bids Accepted	Rates
4/13/2010	UAH 3.23 bln	UAH 3.5 mln	14.5%-15%
4/20/2010	UAH 5.28 bln	UAH 1.36 bln	12%-14%
4/27/2010	UAH 5.3 bln	UAH 2.86 bln	11.5%-13.92%
5/5/2010	UAH 2.58 bln	UAH 1.53 bln	11%-14%
5/11/2010	UAH 1.27 bln	UAH 450 mln	10.4%-13%
5/18/2010	UAH 2.37 bln	UAH 734 mln	11%-14%
5/25/2010	UAH 947 mln	UAH 187.2 mln	10%-14%
6/1/2010	UAH 670 mln	UAH 140 mln	11%-13%
6/8/2010	UAH 490 mln	UAH 71 mln	10.5%-13%
6/15/2010	UAH 706 mln	UAH 190 mln	11%-13%
6/22/2010	UAH 2.57 bln	UAH 1.05 bln	9%-12.5%
6/29/2010	UAH 3.02 bln	UAH 1.75 bln	8.52%-12.5%
7/6/2010	UAH 1.51 bln	UAH 676 mln	7.06%-12.5%
7/13/2010	UAH 1.67 bln	UAH 1.01 bln	9.42%-12.5%
7/20/2010	UAH 2.07 bln	UAH 1.11 bln	7.31%-12.5%

Dynamics of Domestic Government Bonds (OVDP) Holders



Only slight changes in OVDP holdings this week may result from July 14 large maturity of UAH 1.06 bln rather than from decreasing investor interest in government bonds. However, the anticipation of VAT bonds, low-rate auction policy of the MoF and the seasonal slowdown in market activity may prevent the OVDP holders from significantly increasing their portfolios.

Domestic Debt Servicing and Repayment in 2010-2011



UAH bln

Date	Bonds Held by				Total
	NBU	Banks	Others	Non-residents	
7/12	68.09	31.43	3.31	2.96	105.80
7/19	68.09	31.53	3.27	3.04	105.92

Placement of short-term 3-month bills this week further built up the already significant repayment pressure on the second half of the year increasing the amount due in October by nearly 50%. Thus, the total repayment amount for August-December is UAH 11.4 bln which is still quite manageable provided the MoF adherence to the smooth placement profile with amounts sold not varying greatly from auction to auction. This is especially important in light of scheduled issuance of special OVDPs – VAT bonds and “agri” bonds for the State Agrarian Fund – which may distract a significant part of banks' resources from the primary market.