



**FINREP Focus**

**DOMESTIC GOVERNMENT DEBT MARKET**

November 1-5, 2010

Last week the Cabinet of Ministers approved the Procedure for Designing Medium-Term Public Debt Management Strategy and Controlling Its Implementation. The Procedure was a continuation of the efforts taken by the Ministry of Finance this spring together with other institutions including “FINREP” to regulate the process of the public debt management in the country. Under the procedure the strategy for a 3-year period shall be developed by the Ministry of Finance in coordination with the Ministry of Economy and approved by the Cabinet of Ministers every year within one month after the state budget law for the relevant year is passed.

On Friday the Financing of Infrastructural Projects state-run company placed government-secured seven-year eurobonds worth \$568 million (UAH4.5 b). According to the MOF the state guaranteed debt increased by UAH6.4 b for 9 month of 2010. The Cabinet of Ministers committed the IMF not to exceed the amount of UAH15 b of state guarantees worth.

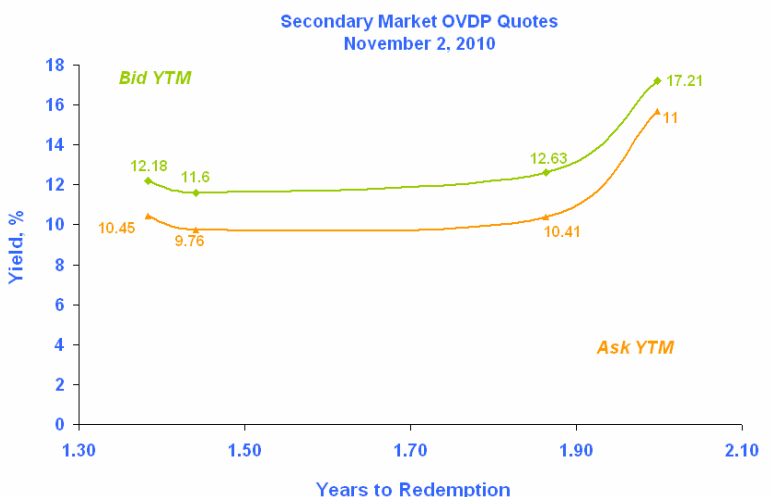
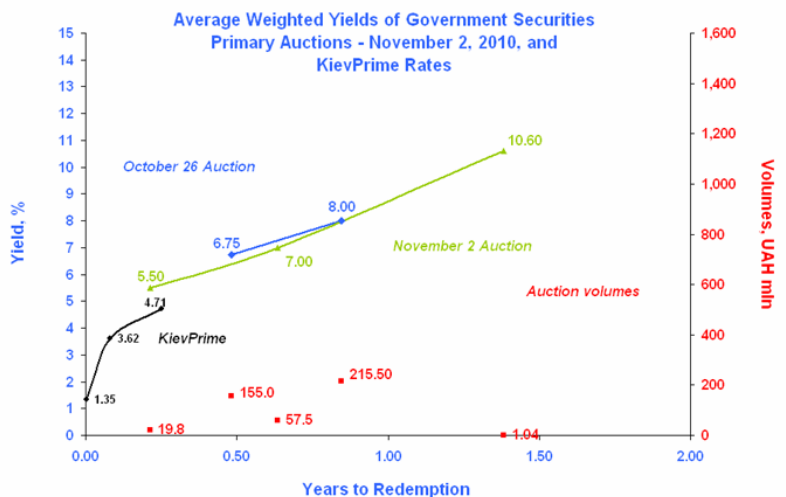
This week’s auction was, as predicted, basically a carbon copy of the auction held 10-19. The amount of bids accepted amounted to UAH78,270,270 which resulted in a pay down. The reopened t/bill maturing 77 days had one bid out of nine awarded for a total of UAH20 mil with average weighted yield (AWY) of 5.50%. The re-opened nine month t-bill received four bids of which one was accepted for UAH60 mil at AWY of 7% and finally reopened three year had two bids out of nine accepted at AWY of 10.60%

The marked increase in the holdings of “others”, seven bil UAH, occurring on 11/2 was the direct result of the placement of securities used in the recapitalization of NaftoGaz and subsequent reduction of two bil UAH, on the following day, was a sale of those previously mentioned securities to a commercial bank with the increase recorded in that category and corresponding reduction in Others.

The assumption is that the buyer was a state owned bank but as that information, although available, is not made public, despite several requests by FINREP for creation of separate category for state owned/controlled banking intuitions. Readers should follow the path of these amounts to determine if eventually any or all of the UAH seven bil of securities issued appear under the heading of the NBU.

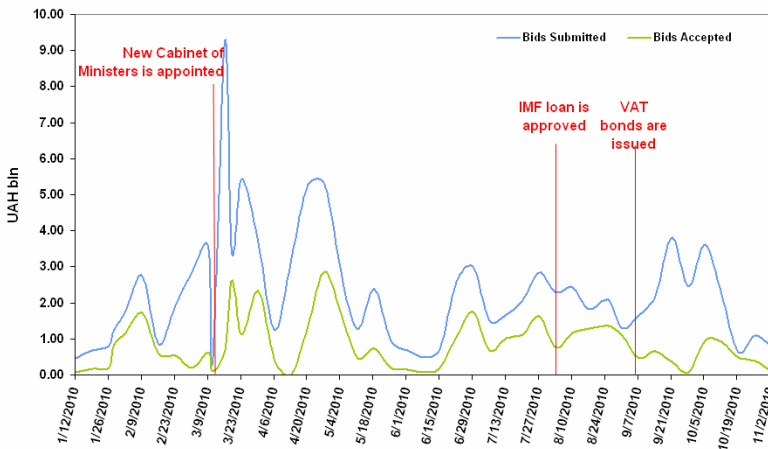
*UAH bln*

Date	Bonds Held by				Total
	NBU	Banks	Others	Non-residents	
10/26	64.21	47.51	8.74	8.96	129.42
11/03	64.21	49.47	13.86	8.97	136.5

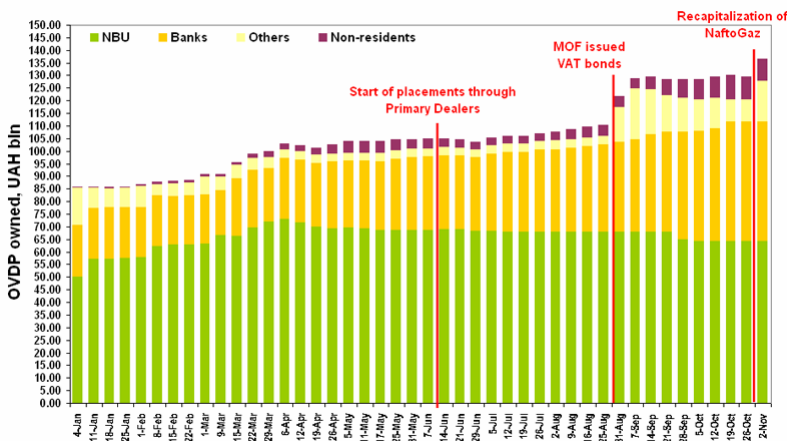




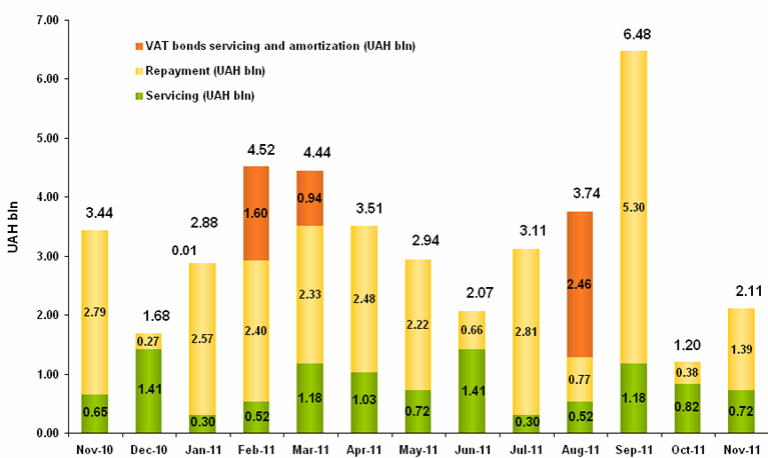
Amounts Submitted and Awarded at Primary Auctions in 2010



Dynamics of Domestic Government Bond (OVDP) Holders



Domestic Debt Servicing and Repayment in 2010-2011



Flow of funds into emerging market investments slowed in the last week of October down approximately 50%, \$2.68bil into equity funds and \$710mil into bond funds. The recipient of the remainder were money market funds which grew by \$20.2bil which was a fourteen week high and registered as the third highest infusion this year.

The reasons are apparent as all financial markets faced, to borrow a term from the options market, a triple witching hour quite apropos for this time of year.

The midterm elections in the US, decision by the Federal Reserve System to enact another round of quantitative easing (QE2) and to what extent, rate decisions by Bank of England(BOE) and the European Central Bank(ECB), and release of the employment figures or as they are titled non-farm-payrolls(NFP) in the US this Friday.

The decision to remove some chips from the table and seek the haven of money markets is entirely rational. The other market opinion that might have had some additional influence, of the before mentioned portfolio adjustments, is some concern regarding inflation in the emerging markets with continued flow of hot money, recent strains in commodity markets and constraints in both labor market and industrial capacity. There has also been as of late a noticeable widening of spreads between German interest rates and those of the European countries currently experiencing financing deficit problems.

Last Friday afternoon sources had reported the placement by SOE of 568 million USD of a seven year Euro Bond through a special purpose vehicle. The price looked extremely generous as compared to the secondary market and recent placement by NAFTGAZ to the extent of approximately half of one percent or fifty basis points. The proceeds of this issue are earmarked for development of facilities in Lviv for the European Football Championships in 2012. One would hope that the increased interest earned on the bond will go toward purchasing tickets for the matches.