



FINREP Focus

DOMESTIC GOVERNMENT DEBT MARKET

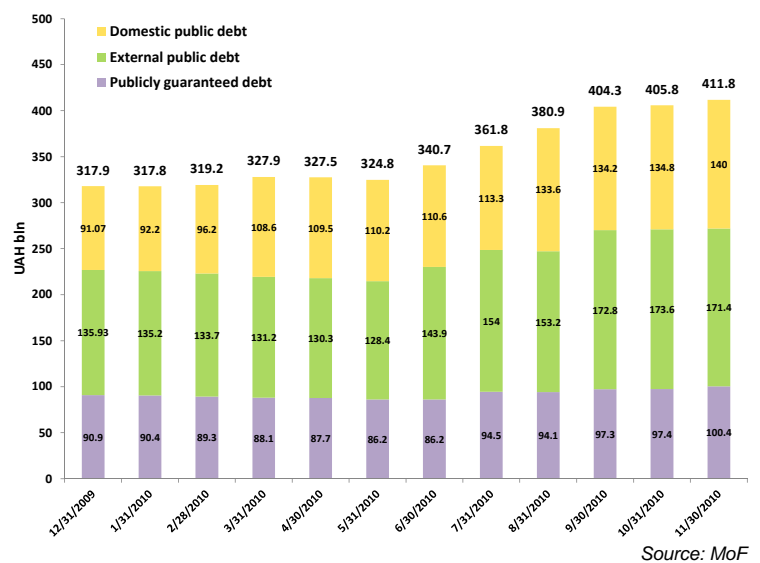
December 27-31, 2010

As 2010 draws to a close, it is a good time to look back and assess the important events and trends we have witnessed this year. Against the background of European sovereign debt crisis, the overall situation with Ukraine's public debt was quite stable. As of early December, public-debt-to-GDP ratio stood at healthy 28.7% and publicly guaranteed debt was 9.3% of GDP. In comparison: the average public-debt-to-GDP-ratio in the EU this year was over 70%, while the critical level is established at 60%. However, what does cause some concern is the pace with which Ukraine's debt is growing. In 2010, public and publicly guaranteed debt increased by nearly 30%. Although domestic debt demonstrated the highest growth rate of all categories (54%), its increased portion in total debt portfolio is a positive development. Ukraine is becoming less dependent on external financing and that is very important, especially given the current global financial situation.

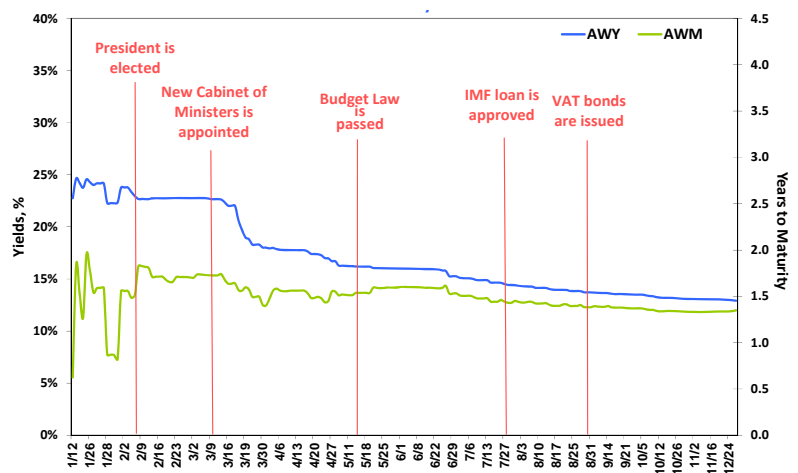
Ukraine's government securities market was developing very extensively this year, with the amount of marketable domestic public debt increasing by nearly 56%, as compared to the end of 2009, or 4.5% of GDP. Further development of domestic market together with decreasing external debt portion will help to maintain Ukraine's debt sustainability.

In the primary market, the MoF managed to decrease significantly the cost of borrowing from 23%-24% in early January to 10% in late December, thus bringing the average weighted yield to 13%. At the same time, the average weighted maturity also decreased from 1.8 years to 1.3 years. This shows the MoF reliance on short-term financing and highlights the need to extend public debt issuance in order to avoid refinancing risk.

Public and Publicly Guaranteed Debt in 2010

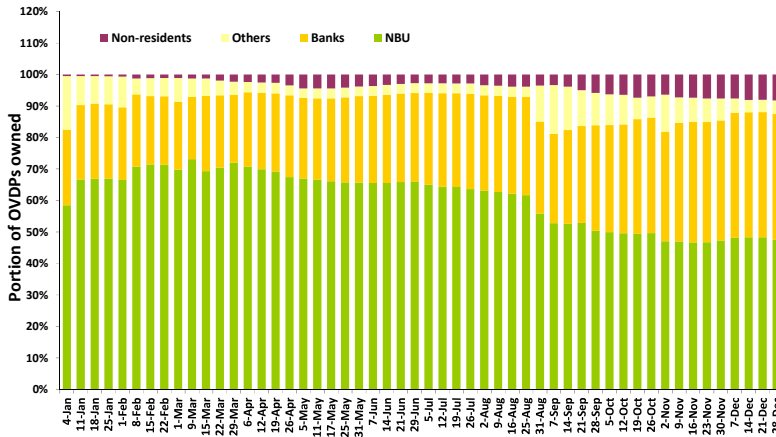


Average Weighted Yield and Average Weighted Maturity of Government Bond Primary Auctions in 2010



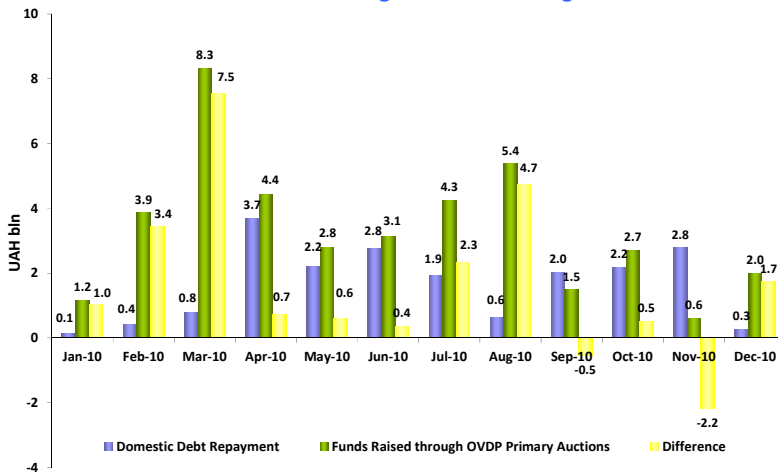


Dynamics of Domestic Government Bond (OVDP) Holders



This year was marked by a significant expansion of the government securities investor base, coming mostly as a result of the MoF adopting market placement of domestic debt in 2009. Under the credit crunch, banks took the most advantage of this policy change, increasing their government bond portfolios by 2.5 times – from UAH 20.6 bln in January to UAH 54.3 bln in December. Large part of this increase can be attributed to VAT bonds and Naftogaz recapitalization bonds. Non-residents became the category which demonstrated the most dramatic increase in market participation – from UAH 0.43 bln to UAH 11.2 bln, or by twenty-five times.

Domestic Debt Financing of the State Budget in 2010



Another positive trend occurring in 2010 was the NBU's decision to decrease the amount of government bonds in its portfolio, after almost two years of its continued growth. This resulted in a noticeable change in OVDP holdings structure: while in the beginning of 2010 nearly 60% of all government bonds was concentrated in the central bank's hands, at the end of December this amount stood at 47%. For the first time since March 2009 other market participants have outweighed the NBU.

The MoF raised over UAH 40 bln through primary auctions this year, as compared to UAH 18.8 bln in 2009. A shift to domestic financing of budget needs is highly necessary, especially given the risks inherent in external borrowing.

With the IMF approving the second disbursement of USD 1.5 bln under SBA last week, and with a sufficient amount of cash in treasury and currency accounts, the GoU can indeed start the new year with confidence. However, deliberate, consistent and transparent policy is needed to make sure that this reserve is not wasted.

FINREP Focus team wishes all our readers a very Happy New Year and Merry Christmas and may the year ahead be full of prosperity and joy.