



## FINREP Focus

# DOMESTIC GOVERNMENT DEBT MARKET

August 9-13, 2010

This week the IMF published documents shedding light on the conditionalities of its USD 15 bln Stand-By Arrangement with Ukraine. Noting Ukraine's considerable financing needs, these documents, in particular, call for the development of domestic T-bills market stressing its key role in budget financing. At the same time, as part of fiscal consolidation measures to ensure public finance sustainability, it is provided that public and publicly guaranteed debt will gradually decrease reaching 35% of GDP by 2015 (as compared to 40% expected by the year end).

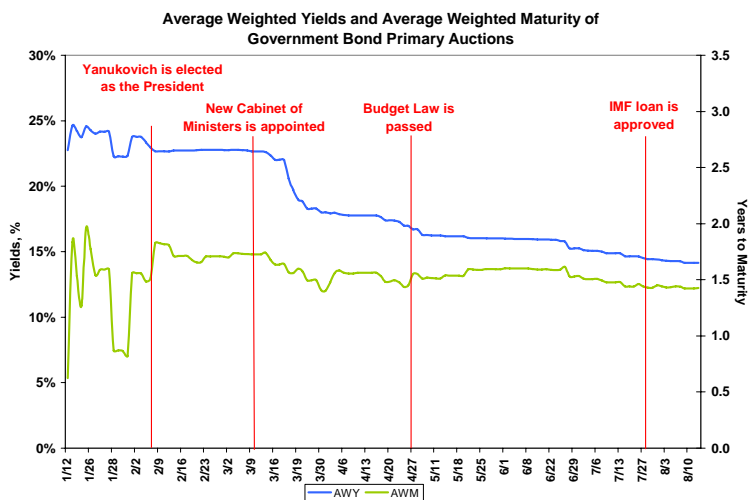
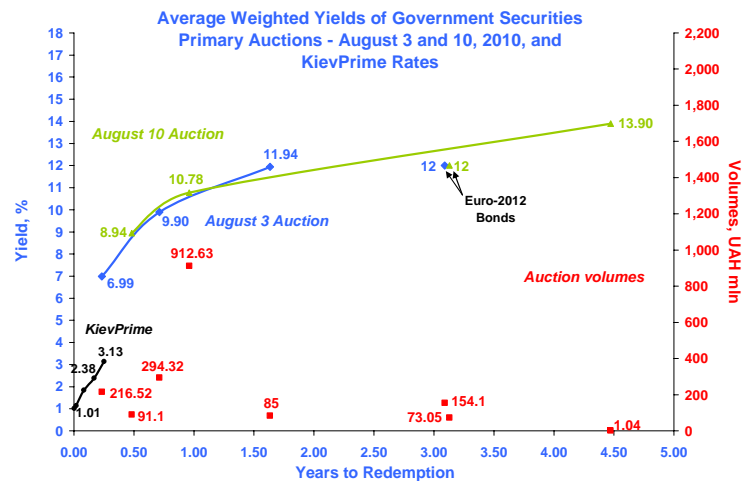
The GOU commitment to the IMF to settle the VAT refunds arrears this year resulted in the MoF announcing the issuance of the second tranche of VAT bonds by the end of this week. While the first tranche disappointed the market with its size, this one is bound to reduce that impression as its expected amount, according to the First Deputy Finance Minister Mr. Kopylov, will be over UAH 10 bln. It is also planned to have the remaining amount (nearly UAH 6 bln) issued by early September. According to market participants, such scheme may result in VAT bonds being sold in the secondary market at 15%-18% yield (which implies a discount of 20%-25%).

An important development took place in the government securities market infrastructure with OVDPs included in the listing of one more trading platform – the Ukrainian Exchange. Given the capacity of this Exchange, this may significantly expand the organized market for OVDPs, which is now 3 times less than OTC market (in July: UAH 4.7 bln vs. UAH 15.7 bln), thus ensuring better price discovery. Moreover, market participants, both large and small, will be able to effect repos in government bonds through a stock exchange which will boost the demand for such securities.

The MoF selected three more banks – Citibank, state-owned Ukreximbank and Sberbank of Russia Subsidiary Bank – to act as primary dealers, thus bringing their total number to 15 (the maximum number set by the GOU is 16). The first two newly selected primary dealers (Citibank and Ukreximbank) are often included in the list of top 10 banks by OVDP holdings which makes their assuming the primary dealer status quite logical. At the same time, Sberbank, unlike the other Russian bank VTB, has become active in the Ukrainian government securities market only recently.

Following the upgrade by S&P, another rating agency R&I (Japan) improved the outlook for Ukraine's "B+" rating from negative to stable on the positive news of the IMF loan approval. Meanwhile, the yields of Ukrainian sovereign Eurobonds hit new lows this week with issues due in 2016 and 2017 trading at 6.25%-6.44%. Therefore, the situation becomes more favorable for Ukraine's possible re-entering the Eurobond market this year.

This week's primary auction showed investors' willingness to fix their returns by turning to longer maturities against the backdrop of continued decrease in rates. As a result, the largest demand was for 12-month T-bills (UAH 1.05 bln) and, unexpectedly, for 5-year bonds (UAH 660 mln). Selling by the MoF of the large amount of 12-month OVDPs (UAH 1 bln) could be explained by the need to raise UAH 5 bln for the Agrarian Fund (the relevant CabMin resolution was published last week) on top of the annual domestic borrowing plan. Although the placement of 5-year bonds was not so successful with only a minimum of UAH 1 mln sold, it may be used as a benchmark for pricing of VAT bonds.



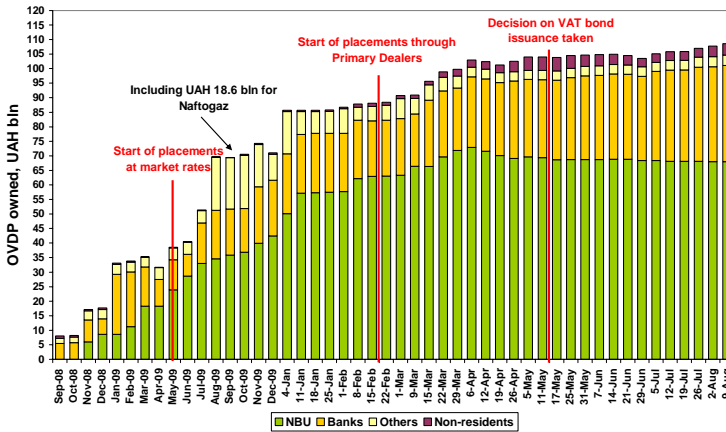


This week's auction marked a significant shift in investors' preferences with regard to maturities with nearly 50% of bids submitted for medium-term bonds. This could be explained by higher yields offered by such securities, as compared to 3- and 6-month bills, without any need to refinance in the near-term perspective which is especially relevant as the rates continue to go down.

**Amounts Submitted and Awarded and Yields of Primary Auctions**

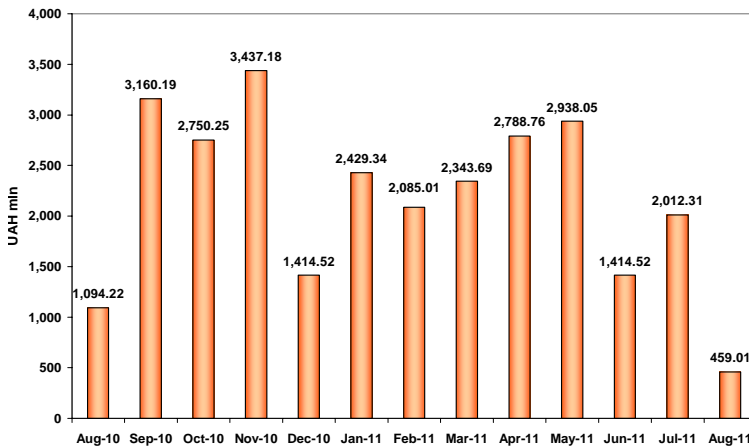
Auction Dates	Bids Submitted	Bids Accepted	Rates
4/13/2010	UAH 3.23 bln	UAH 3.5 mln	14.5%-15%
4/20/2010	UAH 5.28 bln	UAH 1.36 bln	12%-14%
4/27/2010	UAH 5.3 bln	UAH 2.86 bln	11.5%-13.92%
5/5/2010	UAH 2.58 bln	UAH 1.53 bln	11%-14%
5/11/2010	UAH 1.27 bln	UAH 450 mln	10.4%-13%
5/18/2010	UAH 2.37 bln	UAH 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%
7/27/2010	UAH 2.84 bln	UAH 1.62 bln	9.39%-12.5%
8/3/2010	UAH 2.29 bln	UAH 760 mln	6.99%-12%
8/10/2010	UAH 2.43 bln	UAH 1.17 bln	8.94%-13.9%

**Dynamics of Domestic Government Bonds (OVDP) Holders**



Despite the approaching of a large VAT bonds issue, OVDP holders continued to build up their portfolios: banks increased their holdings by UAH 0.5 bln, non-residents – by UAH 0.2 bln.

**Domestic Debt Servicing and Repayment in 2010-2011**



**UAH bln**

Date	Bonds Held by				Total
	NBU	Banks	Others	Non-residents	
8/2	68.06	32.61	3.43	3.66	107.76
8/9	68.06	33.08	3.54	3.87	108.54

By avoiding to sell large amounts of 6-month T-bills this week, the MoF achieved a rather smooth repayment profile for 1H2011. The recently demonstrated investor interest in medium-term bonds may assist the Ministry in further evening the repayment pressure by limiting the amount of short-term debt placed.