

5 October 2011

USD-indexed Sovereign Bonds

First auction: Low yields, artificial demand

Finance Ministry sold UAH 860 mln (USD 107 mln) in USD-indexed sovereign bonds yesterday, the first time it offered these instruments for sale. There were three series of bonds offered with 3Y, 5Y and 10Y maturities. Market demand totaled UAH 940 mln (3Y papers – UAH 740 mln, 5Y – UAH 200 mln, 10Y - none). The yield range bidded for 3Y bonds was 8-16% and the 5Y bond yield bid was 8.75%. The government accepted 91% of bids, with an average yield of 8.22% for 3Y bonds and 8.75% for 5Y papers.

Our view: Yesterday's auction was a 'trial' for both the Finance Ministry and market and, in our opinion, does not reflect real market demand for the new instrument. Firstly, the Finance Ministry's announcement for the auction was made late in the afternoon on Monday, just one day beforehand and left too little time for investors to react. Secondly, we think real market players were waiting to see yield levels before assessing the attractiveness of the new instrument.

The attracted yields were even below comparable Sovereign Eurobonds, which currently trade at 9-10% YTM. We believe the bids were at an artificial level and think the bonds should trade at least 100-200 bps over the Sovereign Eurobond curve due to a liquidity premium and because the bonds are not fully hedged against FX risk. In our view, this stance will make the new USD-indexed bonds unattractive for non-residents.

Given low UAH liquidity, volatile interbank UAH and low yields, potential consumers are limited, perhaps only to local banks, making new bonds a 'niche' instrument. USD-indexed bonds could be used by banks to reduce their open long currency position in line with NBU requirements to decrease the position from 20% to 5%. Given that USD-indexed bonds are UAH-denominated, they would not influence the banks' FX position while alleviating some FX risk due to the USD peg.

The situation could slightly improve if the Finance Ministry offers shorter 1-1.5Y USD-linked papers. This might stimulate local banks to refinance maturing papers with new USD-indexed bonds of similar yields but better hedged against currency risk.

USD-indexed bonds auction result, October 4, 2011

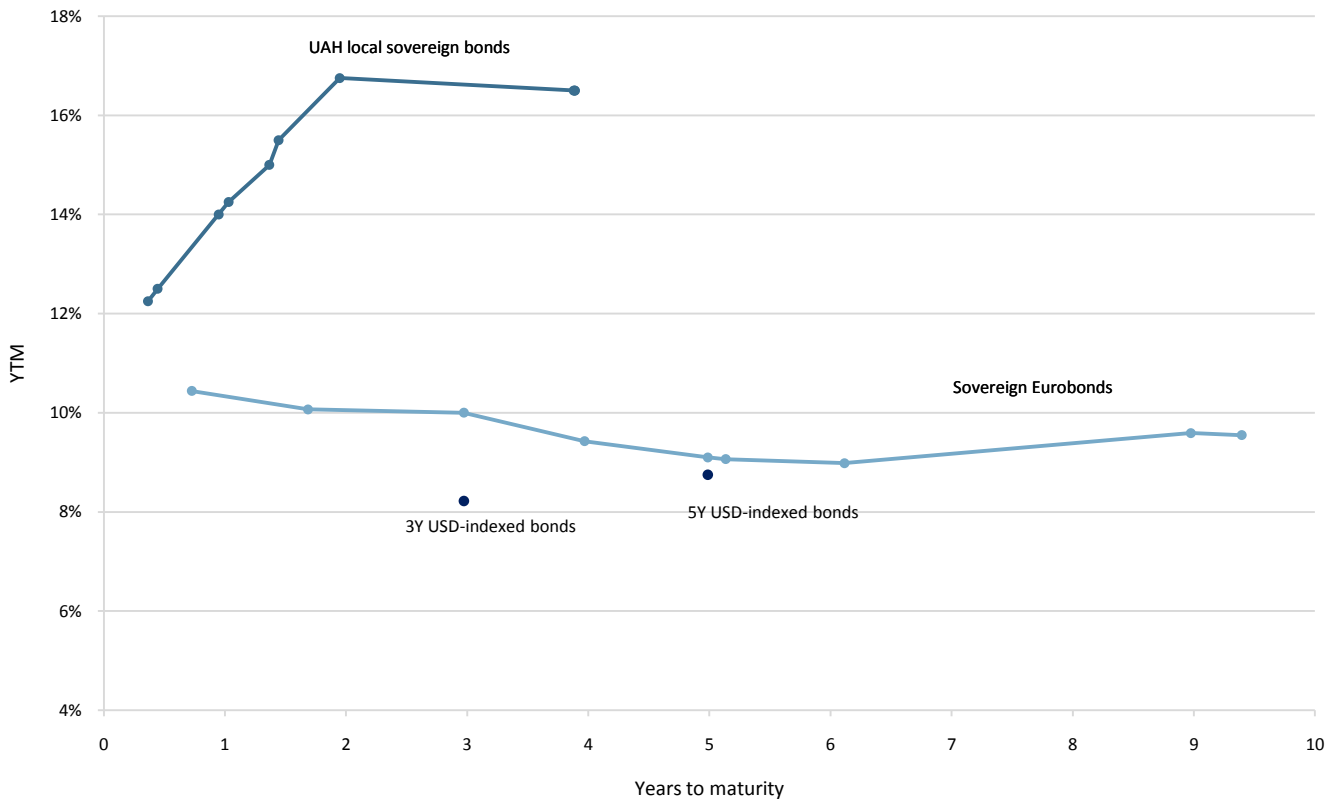
	3Y series	5Y series	10Y series
ISIN	UA40000129100	UA40000129118	none
Maturity date	29.04.14	28.09.16	15.09.21
Bidded volume (UAH mln)	740.0	200.0	none
Accepted volume (UAH mln)	660.0	200.0	none
Maximum bidded yield, %	16.00	8.75	-
Minimum bidded yield, %	8.00	8.75	-
Average accepted yield, %	8.22	8.75	-
Total to state budget (UAH mln)	661.1	200.0	-

Source: Finance Ministry

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Yield map of Ukrainian Sovereign debt



Source: Bloomberg, Finance Ministry, Concorde Capital estimates

Appendices

Analyst certification

I, Svetlana Rekrut, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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