

Darii Daryna  
*2nd year student, NaUKMA*  
Holly Slaber  
*1st year student, University of Glasgow*

## **UKRAINIAN BOND MARKET DEVELOPMENT AS A METHOD OF INTERNATIONAL INVESTMENT ATTRACTION**

Bond trading is a significant part of Ukraine's securities market, and serves as an effective form of attracting both domestic and non-residential investments. This presentation aims to provide an overview of the current situation in Ukraine's bond market, highlighting the various instruments available for enhancing the financial system. Additionally, the impact of the ongoing war on the bond market will be examined, including how it currently operates and the next steps for development. In the end, it's discussed the role of bond trading in Ukraine and the strategies being employed to maintain stability amidst uncertainty.

The most popular reasons why investors buy bonds are because bond provides a predictable income stream, bond is a way to preserve capital while investing, bond can help offset exposure to more volatile stock holdings, and other reasons depending on the particular trade.

Companies, governments and municipalities issue bonds to get money for various purposes, which may include providing operating cash flow, financing debt, funding capital investments in governmental projects or country needs. Therefore, the advance of the Ukrainian bond market may nowadays be classified as one of the priorities for the further development of the financial system of Ukraine.

In 2021, the Ministry of Finance of Ukraine published an article where highlighted and generalized some main triggers for non-residents to sell Ukrainian bonds and buy dollar instead:

1. The reduction of effective income: Even though the annual interest rates were considerably high and might seem attractive for investors, inflation depreciated this interest rate.
2. Devaluation cycle: Non-residents invested the currency in Ukraine when the dollar increased in price, and withdrew the currency when the dollar price decreased. It's a reasonable way of fixing an income and, normally, it was a cyclic process for the Ukrainian bond market.
3. Expectations related to the monetary policy tightening of the Federal Reserve System, which reflects in the dollar price and world markets generally: Due to the decline of the dollar emission, the trend to reduce investment in emerging markets

occurred. The cost of loans increased, and the profitability of the carry trade decreased respectively. Risk is something that investors seek to avoid and thus choose a safer investment option, that is, buy bonds of the US and the European Union.

4. Uncertainty regarding Ukraine lending by the International Monetary Fund and additional political and economic risks: Simply, the reaction of bond owners to the risk depends on their strategies and forecasts in respect of Ukraine.

2022 has started for Ukraine with the full-scale war and a freeze of the equity market operations as a consequent reaction in order to appease the panic of the traders. This period is represented with such tendencies as loss of Eurobond market access, a net outflow of non-residents from the domestic bond market, and a generalized drop in investment inflows, which has opened large external financing gaps. Uncertainties were dramatically high around the potential market conditional in the absence of a further guarantee. The DSA assumed that the capital controls that were imposed early in the war ruled out any further non-resident portfolio outflows as in Q12022, and conservatively it did not anticipate further inflows for the nearest future.

As soon as the possible control under the financial situation was established, Ukrainian governmental organizations started gradually canceling all restrictions on capital markets to attract investors back to Ukrainian bond trading. Notably, on March 1 Ukraine successfully auctioned domestic war bonds and a strong demand from non-residents was reported.

With such a start, the Ministry of Finance of Ukraine continued making steps toward increasing investments. Firstly, it reflected an issue of non-war domestic bonds which are potentially expected to engage not only citizens, but also non-residents. Secondly, the higher rates on part of instruments of the national currency were set.

The war bond is a way to increase the amount of money in the national treasury, which supports the economy of the country and partially slows down the inflation. As it was already mentioned, Ukraine has successfully issued war bonds with the beginning of the Russian invasion.

Anyone can purchase military government bonds through authorized banks on the secondary market: individuals and legal entities, residents and non-residents. The regulator made the conditions for purchasing the asset as easy as possible even for foreign investors. They can buy military government bonds through the international depository Clearstream. They also have a simplified verification procedure, and all the benefits of securities are relevant. Buying Ukrainian bonds is another way for foreigners to support Ukraine.

However, even though governmental bonds are attractive from an ethical and national support perspective, this instrument as the only one is not going to make a huge impact on capital attraction.

The latest report dated 17<sup>th</sup> February 2023 of the greatest demand of the non-war governmental bonds this week is as following:

#### Repayment in Feb 2025

- Under 22%

#### Repayment in Nov 2023

- Under 18%

#### Repayment in Feb 2023

- Under 15%

The last two issues were preferred by market participants in more than 60% of cases, both in terms of volume and number of transactions. The nearest repayment terms seem to investors to be the most predictable, because planning the need for their funds for a long period is now considered not as reliable as before the full-scale invasion.

Foreign currency government bonds are in less demand because the minimum amount for securities available for purchase is much higher than for government bonds denominated in hryvnia.

As for the sale of securities, on average, customers sell military bonds twice as often as non-military bonds. The patriotic mood persists, investors in military government bonds are ready to keep them at lower rates until the end. Investors also expect that if the NBU's forecast for inflation slowing down to 18.7% this year is realized, they will earn more when the securities are redeemed than if they were sold earlier.

As of 31st of Jan 2023, the NBU and Clearstream have agreed to expand the existing link to the Ukrainian capital market with additional asset classes. Clearstream is one of the world's largest firms for domestic and international securities. Foreign investors will be able to make transactions not only with Ukraine's government securities, but also with other post-war reconstruction-related financial instruments. To achieve this, Clearstream will open a nominal holder's securities account at the NBU with the support of the Ministry of Finance of Ukraine.

This step will facilitate growth in cross-border investments, improve the Ukrainian capital market's liquidity, and enhance the market's capacity to provide instruments for the recovery of Ukraine's infrastructure and economy. To summarize,

thanks to the NBU & Clearstream cooperation, post-war reconstruction-related financial instruments are expected to be successfully implemented and issued.

As the prime minister, Denys Shmyhal, emphasized the readiness of market players to the financial sector development. After the victory of Ukraine, the development of the bond market (with the intersection with the other integrated financial instruments simultaneously) can become one of the drivers of the recovery of the national economy.

### *References*

1. NBU and Clearstream to Expand Link That Connects Ukrainian Capital Market to Global Financial Markets. URL: <https://bank.gov.ua/en/news/all/natsionalniy-bank-ta-clearstream-rozshiryuyut-link-scho-poyednuye-ukrayinski-rinki-kapitalu-z-mijnarodnimi-finansovimi-rinkami>
2. Why are foreigners exiting OVDP and how will it affect the hryvnia. URL: <https://minfin.com.ua/ua/currency/articles/pochemu-inostrancy-vyhodyat-iz-ovgz-i-kak-eto-povliyaet-na-grivnu/>
3. Approaching the victory of Ukraine by buying military bonds. URL: <https://business.dia.gov.ua/en/cases/finansii/nablizaemo-peremogu-ukraini-kupuuci-vijskovi-obligacii>
4. The three OVDP issues that were in the most demand this week. URL: <https://minfin.com.ua/ua/invest/articles/tri-vipuski-ovdp-yaki-koristuvalisya-naybilshim-popitom-cogo-tizhnya/>
5. Прімерова О. К. Особливості розвитку фондового ринку України // Ефективна економіка. - 2016. - №5. Режим доступу: <http://www.economy.nayka.com.ua/?op=1&z=4948>.