Putin Pushes Untradeable Notes as Bond Sales Fail: Russia Credit

By Vladimir Kuznetsov Mar 27, 2014 9:00 PM GMT+0100

Russian President Vladimir Putin.

Russia is selling notes directly to pension funds and banks for the first time in 1 1/2 years, sidestepping the bond market after four failed auctions since President Vladimir Putin’s incursion into Crimea.

The Finance Ministry is offering 100 billion rubles ($2.8 billion) of non-tradeable securities today, with half due March 2015 at a 7.73 percent yield and the rest maturing in February 2016 at 8.25 percent, it said on its website on March 26. The yield on government ruble bonds due January 2016 rose 212 basis points since the start of the year to 8.25 percent the day before the sale was announced.

By offering almost three times the amount auctioned this year in one day, Russia may be signaling it doesn’t foresee investor sentiment being restored anytime soon, according to BCS Financial Group and GHP Group. Russian borrowing costs rose to a record after Putin’s annexation of Ukraine’s Crimea peninsula sparked the worst standoff with the U.S. since the Cold War.

“The Finance Ministry doesn’t want to scare off any demand that might still be out there,” Fedor Bizikov, a money manager at GHP Group in Moscow, said by phone from Moscow yesterday. “It’s saying: ‘I’m ready to borrow, but I’m not going to do it on the market.’ It can’t count on foreigners and locals won’t stump up the cash without a hefty premium.”

The Finance Ministry didn’t respond to requests for comment.

Axing Auctions

Russia has scrapped seven bond auctions this year, citing “unfavorable” market conditions. Investors fled emerging-market assets in January as the Federal Reserve reduced its bond-buying program. They continued their exodus from Russian markets as the crisis in Ukraine deepened, leading Standard & Poor’s and Fitch Ratings to cut the country’s credit outlook to negative this month.
Outflows were probably near $70 billion in the first three months, Deputy Economy Minister Andrey Klepach told reporters on March 24. That compares with $63 billion in all of 2013.

The government may refrain from selling $7 billion in Eurobonds and pare its 825 billion-ruble domestic-bond target, Finance Minister Anton Siluanov said March 21. The ministry has borrowed 37 billion rubles since the start of the year, data on its website show.

“They don’t want to pressure the market by increasing the cost of funding for the whole economy,” Dmitry Dudkin, head of fixed-income research at UralSib Capital in Moscow, said in e-mailed comments yesterday. The untradeable notes allow them “to cover all refinancing needs for the rest of the year,” he said.

‘Defensive’ Mode

Russia needs to redeem 324 billion rubles of debt this year, the Finance Ministry said in a statement March 18. With the cash from the auctions that did go ahead and about 174 billion rubles tentatively earmarked for the country’s sovereign wealth fund, the non-market placement will cover the balance, Dudkin said.

When the Finance Ministry placed GSO bonds in 2012 it was criticized for raising funds off-market, Alexander Kudrin, head of fixed-income research at Sberbank CIB, said in an e-mailed note.

The decision to suspend the sales allowed VEB, the development bank, which manages money for the State Pension Fund, to boost investments into corporate bonds, he said. That included infrastructure bonds issued by state-controlled companies for long-term projects, according to Kudrin.

The Finance Ministry conducted its last GSO sale in October 2012, placing 24 billion rubles in 13-year notes at an 8.18 percent yield, according to a statement on its website.

Budget Help

The return to the GSO market is a “defensive” move in volatile market conditions, Kudrin said. “The ministry is apparently unable to place OFZs at acceptable yields.”

The Micex stock index dropped 1.3 percent yesterday, snapping two days of gains and the ruble slid 0.2 percent against the dollar, taking its retreat this year to 7.7 percent, the worst performance among emerging markets tracked by Bloomberg after Argentina’s peso.

The currency’s weakness has helped Russia boost local-currency revenue from exports. The country ran a budget surplus of 30.5 billion rubles in January and February, Finance Ministry data show.

Oil and natural gas contribute about half of the country’s budget proceeds. Brent crude added 0.5 percent to $107.57 per barrel yesterday, the highest level in almost two weeks.

The yield on the Russian government’s April 2020 dollar bond fell 14 basis points, or 0.14 percentage point, to 4.30 percent as of 7:51 p.m. in Moscow yesterday. The extra yield on
Russia’s dollar debt over Treasuries narrowed one basis point to 303, according to JPMorgan Chase & Co. indexes.

“Essentially they decided to borrow through GSOs, despite claiming they don’t need to borrow,” Yulia Safarbakova, an analyst at BCS Financial Group in Moscow, said by e-mail. “So now they can continue canceling auctions and resort to relatively non-market deals.”

To contact the reporter on this story: Vladimir Kuznetsov in Moscow at vkuznetsov2@bloomberg.net

To contact the editors responsible for this story: Wojciech Moskwa at wmoskwa@bloomberg.net Alex Nicholson, Daliah Merzaban