MINISTRY OF EDUCATION AND SCIENCE OF UKRAINE
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THE YIELD OF DOMESTIC GOVERNMENT BONDS

ABSTRACT
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INTRODACTION

The relevance of the study. Over the last three years, the demand for Ukrainian domestic government bonds has increased significantly. From the beginning of 2019, foreign investors started to be actively involved in the government bonds market, whose bond portfolio increased by 193%. Since 2018, individuals have increased their interest in acquiring government bonds. Their demand has increased by 4.1 times during the year. One of the key elements of the analysis when taking decision whether to buy government bonds or other investment instruments is the level of their yield, which is why there is a need to analyze the profitability of government securities and identify the factors that affect it.

In Ukraine, government bonds were first issued in 1995, the yield of which was initially set at a high level (63-145% per annum). Along with the primary, the secondary market of government bonds emerged. The first trades were conducted on the stock section of the Ukrainian Interbank Currency Exchange.

Government securities are highly reliable financial instruments, so their rate of return is set at a relatively low level. Hovewer, in Ukraine the opposite process was observed - rapid inflation and transformational changes in the country's economy did not inspire confidence in government securities, which the government sought to offset by high interest rates. This approach increased the demand for government bonds, but did not solve the budget deficit problem as it provoked the formation of a debt spiral.

The study of the phenomenon of high real profitability "ex-post" was conducted by L. Lederman and G. Kaminsky. The phenomenon has been described in scientific papers for countries that have undergone a period of disinflation. The main purpose of the research was to identify significant determinants of rates of return and to analyze the processes that affect high yields on government bonds.

As the need for issuing state debt financial instruments is closely related to the public debt and budget deficits, many scientists have examined the significance of the impact of a budget deficit on the level of state yields. The budget deficit in the standard neoclassical model causes a reduction in domestic savings and an increase in

aggregate demand. There is an oversupply of state bonds that leads to an increase in the real interest rate. P. Orzag and V. Gayle were involved in determining the significance of the impact of the budget deficit on the yield rates and in their study they have summarized 60 works.

Nowadays, Ukrainian state bonds are the subject of increased interest of investors, especially the foreign ones. The reason is passing a law abolishing the personal income tax and corporate income tax received by non-residents in the form of interest on state securities in 2015 by the Verkhovna Rada of Ukraine. Now, the determining factor for investors is the level of yield on state bonds, which makes it important to identify the factors affecting bond yields and to determine the factors that influence the volume of demand.

The hypothesis of the study is that there is a statistically significant relationship between GDP growth rate, inflation rate, government budget deficit, FDI volume, IMF borrowing volume, international liquidity reserves, NBU interest rate, deposite interest rate, foreign exchange rate, control of corruption, quality of government regulation, efficiency of government and average weighted yield on state bonds, as well as demand for state bonds.

The aim of the master's study is to deepen the theoretical, methodological and practical aspects of the factors influencing the yield formation of Ukrainian bonds of the domestic state loan.

To achieve this goal, the following tasks were set:

– to summarize theoretical aspects considering issue, placment, circulation and usage of government debt securities as well as to systematize the results of current scientific researches on the formation of government bonds yields;

– to distinguish the factors influencing formation of the government bonds yield, including macroeconomic and macro-financial ones, to justify their influence as well as the application of parametric models defining the profitability level of government bonds;

– to determine trends of change in the yield factors of government bonds, including macroeconomic and macro-financial ones, on the basis of their empirical analysis and interpretation;

– to determine the nature of the impact of macroeconomic and macro-financial factors on the demand and profitability of government bonds using correlation-regression analysis;

– to provide recommendations on practical application of the results of the conducted research;

– to justify the directions of application of the research results on the government bonds profitability level and factors of its formation.

The object of the research is the process of Ukrainian bonds of domestic state loan yield formation.

The subject of the research is a set of factors of Ukrainian government bonds yield formation and the nature of their impact.

The research methods that formed the basis of the master's thesis required a combination of both general scientific, special economic and financial methods. Applied general scientific methods include: analogies, scientific abstractions and comparisons, economic analysis (for careful consideration of the constituent parts of the research subject), economic synthesis (for the study of constituent parts interaction in their integration), positive (for description, analysis and systematization of external facts), empirical, graphical (to illustrate the dynamics of certain factors). Used specific economic methods include the following: factor analysis (to determine the factors' degree of influence on the dependent variables of the regression equation); economic and mathematical, including statistical analysis (to study the directions of the dynamics of certain factors) and correlation-regression analysis (calculation of factors pairwise correlation matrix construction of a multifactor regression model).

The information base of the research is scientific and methodological works of national and foreign scientists, normative legal acts, official statistical and analytical, normative and methodological materials of the National Bank of Ukraine and the Ministry of Finance of Ukraine on the issue, placement, circulation, application and determination of government securities level of yield, including domestic government bonds; official statistical and analytical materials from the World Bank and Thomson Reuters.

The novelty of the research results is in deepening the theoretical, methodological and practical aspects of the factors influencing the formation of government bonds profitability and is reflected in the following statements:

improved:

– a theoretical and methodological approach to determining the factors influencing the government bonds yield, which in addition to macroeconomic and macro-financial factors included institutional (level of corruption, political stability of the country, government efficiency, quality of state regulation).

were further developed:

– approaches to determining and analyzing the weighted average yield of domestic government bonds;

– procedure for estimation the degree of impact of isolated macroeconomic, macro-financial and institutional factors on the demand and yield of government bonds and the ways of forecasting their future profitability level.

The practical value of the research results is to improve the approach to determining the factors of government bonds yield formation, to assess the degree of their impact based on the regression model, which can be applied to forecasting the profitability level by individual and institutional investors. Recommendations about the listed above aspects are provided in the paper.

The results of the master's study were tested at the 21st All-Ukrainian scientific and practical conference "Mohyla readings - 2019: Experience and trends of society development in Ukraine: global, national and regional aspects" (Mykolaiv, November 11-16, 2019) and published in the thesis of the report and articles in the students' scientific digest and the national professional edition.

Volume and structure of the master's study.The work consists of an introduction, four sections, conclusions and a list of sources used. The full volume of the work is 77 pages of text. The list of sources used includes 50 items, listed on 6 pages. The work contains 14 tables, 11 figures.

MAIN CONTENTS OF THE MASTER'S THESIS

The introduction justifies the relevance of the research topic, defines the aim, tasks, subject, and object of the study, defines the hypothesis of the study, methods of research, explains the scientific and personal motives for conducting the research, reveals the scientific novelty of the obtained results.

The first section "Review of literature on basic theories of state securities" analyzes the main reasons of issuing state bonds, regards the history of adopting such domestic state bonds in Ukraine, defines the reasons of high level of yield on state bonds and determines the factors, influencing the yield of state bonds, describes the process of emission of state securities and characterizes the features of domestic state bonds. The main conclusions of regarded scientific works are the following:

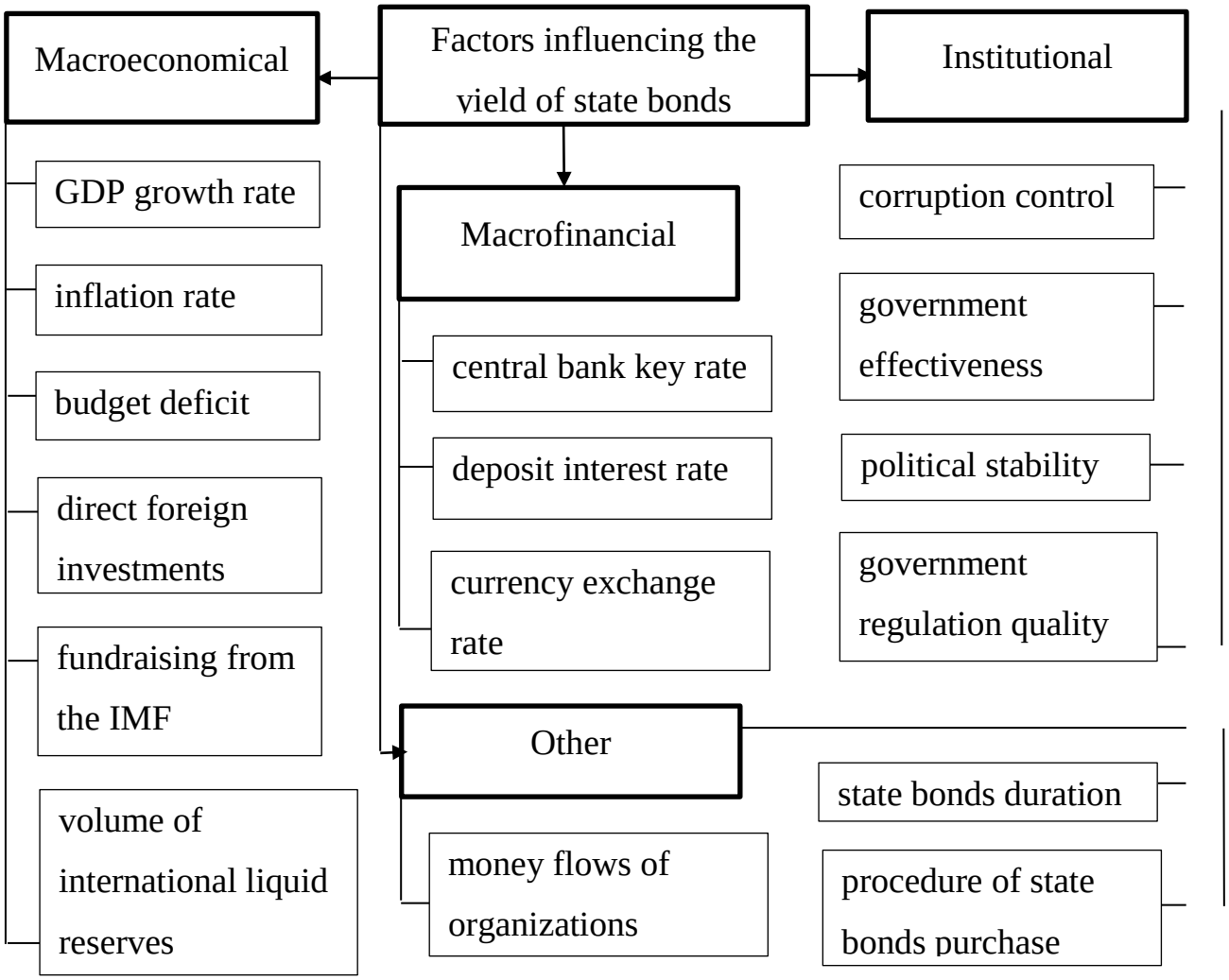
1. The main purpose of issuing government securities is financing the current budget deficit, regulating the circulation of money supply, stabilizing the financial market, cash execution of the state budget, providing low-risk equity instruments to portfolio investors.

2. Many empirical studies have shown that expectations of national currency devaluation and exchange rate volatility are important determinants of market interest rates. Exchange rate fluctuations result in risks to the return on domestic currency assets, and national and foreign investors will require a higher risk premium as compensation for currency risk.

3. Increasing demand for borrowed funds from the state, an indicator of which is an increase in the amount of public debt, an increase in the budget deficit, an increase in the amount of government bonds in circulation, are the driving force for the increase in the overall level of interest rates in our country.

4. The main advantages of state bonds are the following: 100% state guarantee, no income tax, opportunity to get additional profit in case of the decrease in interest, high liquidity level, the yield on state bonds is higher than the yield on deposits in European banks.

The second section “Methodology for investigating factors influencing the yield of state bonds” is devoted to determination of influencing factors together with determining the direction of influence. In the section there are also described the procedures used to solve the research goals of master’s thesis.



Pic.1. Factors influencing the yield of state bonds

After the main factors of influence were defined, they were divided into groups, which are represented in the picture 1.

It the process of research process it was defined that the National bank of Ukraine uses the following parametrical models for calculation of zero-yield curves:

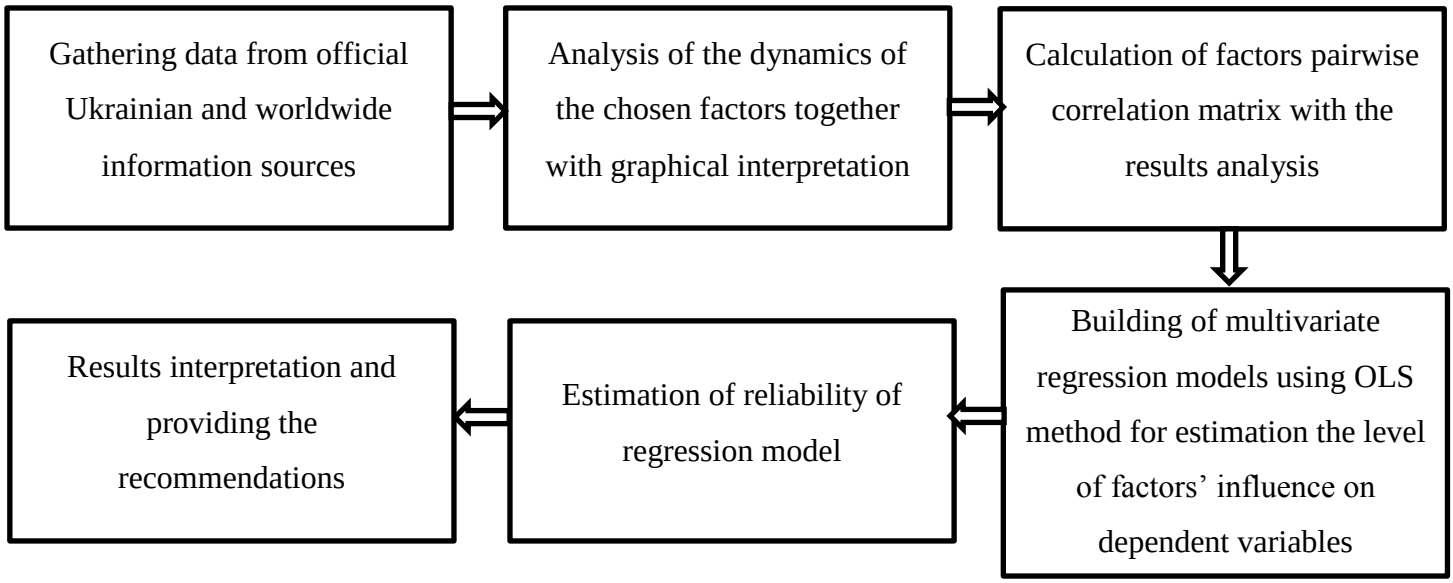
Nelson-Sigel model:

$$s_p = \beta_0 + \beta_1 \left(\frac{1-e^{-p/\tau}}{p/\tau}\right) + \beta_2 \left(\frac{1-e^{-p/\tau}}{p/\tau} - e^{-p/\tau}\right).$$

Svensson model:

$$s_p = \beta_0 + \beta_1 \left(\frac{1-e^{-p/\tau}}{p/\tau}\right) + \beta_2 \left(\frac{1-e^{-p/\tau}}{p/\tau} - e^{-p/\tau}\right) + \beta_3 \left(\frac{1-e^{-p/\tau_1}}{p/\tau_1} - e^{-p/\tau_1}\right).$$

The further guidance of the study is shown in the pic.2.



Pic.2. Further guidance of the study

Further guidance of the study consists of gathering and analysis of data, graphical interpretation of the factors' dynamics, determining correlation coefficients between factors, building of two multivariate regression models, where the dependent variables are average return on state bonds and the amount of sold bonds, determining the level of regression models reliability and interpretation of the results.

With the help of established methods in the third section "Empirical analysis of the demand and yield of state bonds" an empirical analysis of the factors which influence the amount of sold state bonds and the level of yield of state securities was done.

Both independent and dependent variables for the regression models were defined together with calculation of descriptive statistics. The results are shown in the table 1.

Table 1

Statistical indicators of the regression variables

Factors	Name of variable	Mean	Standard deviation
GPD growth rate (annual, %)	**gdp_growth**	2,393	6,850
Inflation rate (annual, %)	**inf**	16,190	8,674
Budget balance (% of GDP)	**saldo**	-2,291	1,795
FDI (% of GDP)	**fdi**	3,834	2,098
Log (IMF loan)	**log_imf**	8,860	0,687
Log (international liquid reserves)	**log_reserves**	9,667	0,713
Deposits interest rate (%)	**dep_int**	10,075	2,149
Central bank key rate (%)	**cb_int**	11,676	5,134
Currency exchange rate (UAH per 1 USD)	**usd_uah**	10,811	8,220
Control of corruption, percentile	**corruption**	17,617	4,318
Government effectiveness, percentile	**gov_effect**	31,239	5,298
Political stability, percentile	**pol_stab**	28,836	16,552
Government regulation quality, percentile	**reg_qual**	33,478	4,400
Average return on state bonds (%)	**avg_return**	12,410	3,909
Log (amount of sold state securities)	**log_n_sold**	9,265	1,603

Amount of IMF loan, international liquid reserves and amount of sold state securities were calculated in the form of natural logarithms in order to convert the values to one unit of measure. Such form of factors will show how the dependent variable changes when the independent variable changes by 1%.

In order to define the correlation between factors the correlation matrix was built. The results showed the highest correlation exists between inflation rate and central bank key rate (0,56), as well as between currency exchange rate and political stability (-0,84).

However, the results obtained from the correlation analysis cannot be 100% reliable since the pairwise correlation shows the interdependence of the two factors, in isolation from the influence of other factors. The more true results can be obtained

after determining the coefficients of regression model, as they take into account all other factors. The results of the first regression are interpreted in the table 2.

Table 2

Influence of macroeconomic, macrofinancial and institutional factors on the average return of state bonds

Dependent variable: avg_return				
Method: OLS				
Sample: 2001 - 2018 p.				
Included observations: 18				
Variable	**Coefficient**	**Standard deviation**	**t-statistics**	**p-value**
gdp_growth	-0,052	0,307	-0,168	0,877
inf	-0,148	0,166	-0,891	0,439
saldo	0,354	0,718	0,493	0,656
fdi	-0,876	0,813	-1,078	0,360
log_imf	1,267	3,047	0,416	0,705
log_reserves	-1,353	2,137	-0,633	0,572
dep_int	1,597	1,142	1,398	0,256
cb_int	0,346	0,414	0,836	0,464
usd_uah	-0,146	0,452	-0,323	0,768
corruption	0,546	0,330	1,656	0,196
gov_effect	-0,332	0,264	-1,261	0,296
pol_stab	0,038	0,175	0,218	0,841
reg_qual	0,367	0,287	1,278	0,291
Coefficient of determination	**0,950**	**Mean of dependent variable**		12,410
Adjusted coefficient of determination	0,731	**Standard deviation of dependent variable**		3,909
F-statistics	4,345	**Probability**		0,126

According to the obtained results, the coefficient of determination takes value of 95%. Such result means that the average return of state bonds can be considered as an indicator of the macroeconomic situation in the country, as the yield level is the result of influence of all examined factors.

The results of the second regression, where the dependent variable is the amount of sold state bonds, are demonstrated in the table 3.

Table 3

Influence of macroeconomic, macrofinancial and institutional factors on the amount of sold state bonds

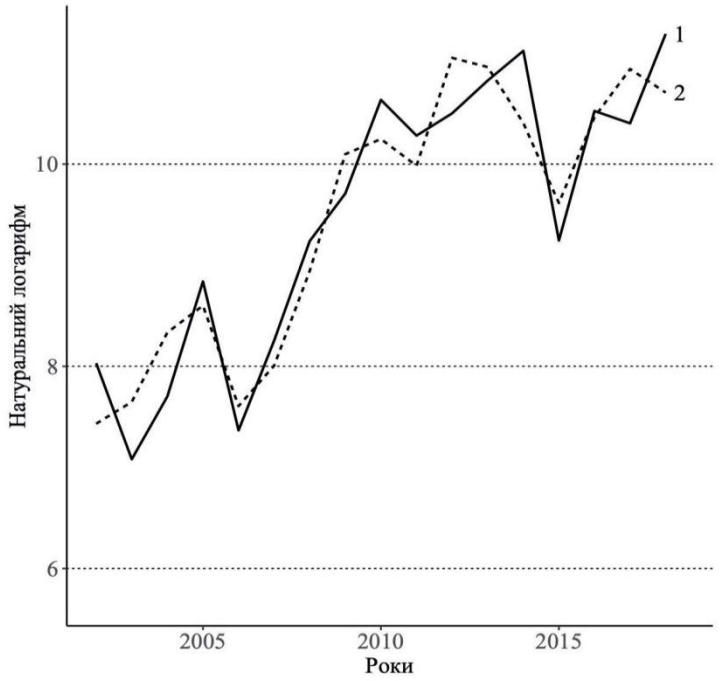
Dependent variable: log_n_sold				
Method: OLS				
Sample: 2001 - 2018 p.				
Included observations: 18				
Variable	**Coefficient**	**Standard deviation**	**t-statistics**	**p-value**
gdp_growth	0,022	0,155	0,144	0,895
inf	0,018	0,084	0,218	0,841
saldo	0,023	0,363	0,062	0,954
fdi	0,201	0,411	0,490	0,658
log_imf	1,210	1,540	0,785	0,490
log_reserves	0,630	1,080	0,583	0,601
dep_int	0,153	0,577	0,265	0,808
cb_int	-0,190	0,209	-0,909	0,430
usd_uah	0,011	0,229	0,049	0,964
corruption	-0,078	0,167	-0,471	0,670
gov_effect	0,038	0,133	0,289	0,792
pol_stab	-0,066	0,089	-0,743	0,512
reg_qual	-0,019	0,145	-0,133	0,903
Coefficient of determination	**0,890**	**Mean of dependent variable**		9,264
Adjusted coefficient of determination	0,414	**Standard deviation of dependent variable**		1,602
F-statistics	1,870	**Probability**		0,334

Looking at yield fluctuations and the coefficients of regression we can estimate all the macroeconomic processes in the country, which makes the model valuable for practical application.

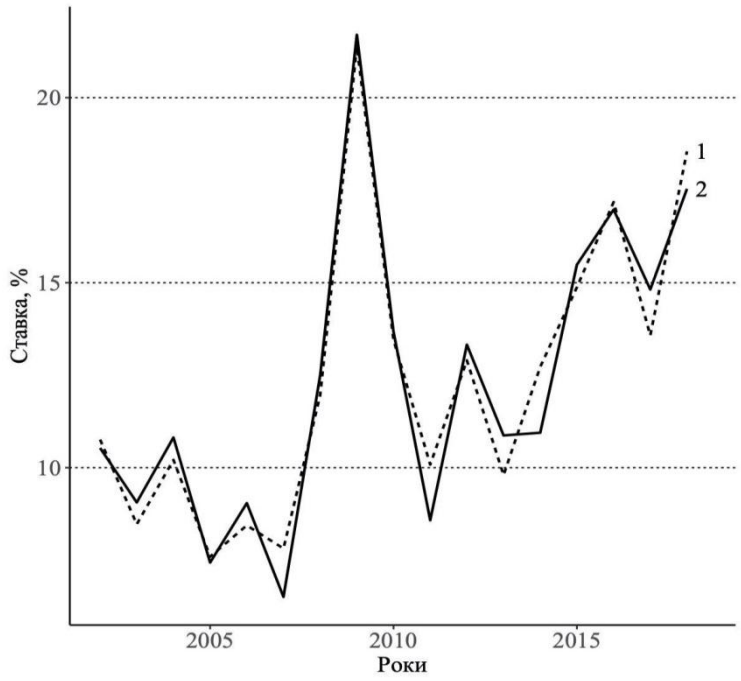
It is worth noting that the regression parameters show only the direction of the correlation of factors. Since all indicators are dependent it’s impossible to establish causation.

Pic. 3 and 4 reflect the actual and estimated values of average weighted yield and demand for government bonds, respectively. The high value of the coefficient of determination and the high percentage of coincidence of the estimated values to the

actual ones during the whole study period testify to the truth of the model and gives the possibility of using this model for forecasting the average yield on state bonds and amount of the demand.



Pic 3. Actual and estimated values of the amount of demand on state bonds
1 – actual values;
2 – estimated values.



Pic. 4. Actual and estimated values of the average return on state bonds
1 – estimated values;
2 – actual values.

The forth section “Results of regression analysis the factors of influence on the amount of sold state bonds and average return on state bonds” analyses the obtained results and provides recommendations for the further practical use of regression models. Table 4 provides the comparison of correlation coefficients and coefficients of the first regression, where the dependent variable is average return on state bonds.

Table 4

Correlation coefficients and coefficients of the regression

Factors	Correlation coefficients	Regression coefficients
gdp_growth	-0,60	-0,052
inf	0,07	-0,148
saldo	-0,31	0,354
fdi	-0,35	-0,876
log_imf	0,66	1,267
log_reserves	0,06	-1,353
dep_int	0,77	1,597
cb_int	0,51	0,346
usd_uah	0,58	-0,146
corruption	-0,18	0,546
gov_effect	-0,08	-0,332
pol_stab	-0,48	0,038
reg_qual	0,29	0,367

The correlation of the average weighted yield of the state bonds did not change with factors such as GDP growth rate, FDI volume, IMF loan, interest rate on deposits, NBU discount rate, government efficiency and quality of government regulation. The sign of correlation of average return with the level of inflation, deficits of the state budget, the volume of international liquidity reserves, the exchange rate, the level of corruption in the country and political stability have changed to the opposite. This is because the regression takes into account the impact of these factors on the yields of state bonds not in isolation, but in combination with other identified factors, which is a more reliable result.

Table 5 provides the comparison of correlation coefficients and coefficients of the second regression, where the dependent variable is an amount of sold state bonds.

Table 5

Correlation coefficients and coefficients of the regression

Factors	Correlation coefficients	Regression coefficients
gdp_growth	-0,52	0,022
Inf	0,07	0,018
Saldo	-0,67	0,023
Fdi	-0,11	0,201
log_imf	0,79	1,210
log_reserves	0,55	0,630
dep_int	0,51	0,153
cb_int	0,01	-0,190
usd_uah	0,54	0,011
Corruption	-0,25	-0,078
gov_effect	0,02	0,038
pol_stab	-0,47	-0,066
reg_qual	0,16	-0,019

The direction of correlation was changed by the following factors: GDP growth rate, state budget deficit, FDI volume, NBU discount rate and quality of government regulation.

The statistical significance of the regressions was verified using F-Fisher distribution statistics. The results of the calculations showed that the significance of F-statistics for both regressions is less than $\alpha = 0.05$, so it can be concluded that the models are adequate.

The results of this study can be used by investors, government and academics interested in further analyzing the topic.

With the help of the first regression model, where the dependent variable is the weighted average of bond yield, investors can predict the future level of yield. The second regression equation with the volume of demand for government securities as a dependent variable can be useful for the government, since the model allows

forecasting the volume of demand for state bonds depending with changes in certain factors. When analyzing both investors and the government should take to account that these models reflect only the direction of influence, but do not establish causation.

The absence of projected values for the year of identified factors creates an obstacle to the calculation of the exact forecast of yield on state bonds and the demand for them. To address this issue, it is recommended that the government publish the forecast data on official channels of information.

Also, to more accurately calculate the regression model and determine the exact significance level of the selected factors, it is necessary to expand the sample size. To achieve this, the government is recommended to publish not only annual data but also quarterly data on official sites. In this case, the sample size can be increased by 4 times.

For further analysis it is recommended to increase the number of study periods.

CONCLUSION

This study uncovers theoretical, methodological, and practical aspects of analyzing the impact of various factors on yields of domestic government bonds in Ukraine and concludes the following:

1. Domestic government bonds are widely used as an instrument of bond market, which yields an interest to investors, besides serving as a source of funding of government expenditures. Domestic government bonds as the least risky type of bonds have the following advantages: a comprehensive state guarantee, an absence of corporate and personal income taxes, a possibility to get income in case of interest rates reduction, high liquidity, higher yield as compared to bank deposits.

Changes in volumes of placement and yields of domestic government bonds are related to fluctuations of various basic indicators. Particularly, higher demand on debt securities from the government's side evidenced by an increase in volumes of issued government bonds can result in increase of an overall level of interest rates. Investors' expectation of a national currency depreciation and volatility of exchange rate are determinants of government bonds yields. A volatility of exchange rate leads to higher risk premium as a compensation for uncertainty.

2. Various factors that determine level and impact volatility of yields of domestic government bonds have been justified and classified into the following groups: macroeconomic, macrofinancial and institutional. Groups of factors include the following: GDP growth rate, inflation rate, state budget deficit, foreign direct investment, use of IMF credit, international liquidity reserves, National Bank interest rate, deposit interest rate, national currency exchange rate, control of corruption, regulatory quality, government effectiveness. Direction of impact of selected factors on such dependent variables as a demand and yields of domestic government bonds has been identified. In order to identify a direction and degree of impact allowing for linear interdependencies of covariates, a correlation and regression analysis based on a method of least squares with a sequential augmentation of a regression model has been chosen.

3. Empirical results are based on analysis of a sample of statistical data including selected indicators during 2001-2018. Interdependencies of factors have been studied based on a cross-correlation analysis. The results show that there is a moderate positive relationship between an inflation rate and a National Bank interest rate (0,56), and a strong negative relationship between an exchange rate and political stability (-0,84). The same factors have the largest impact on yields of domestic government bonds.

Inflation dynamics exhibited a large magnitude of fluctuations during the studied period: from 4,34% in 2013 to 38,88% in 2015 with a subsequent gradual decline to 7,9% in the end of 2019 thanks to implementation of inflation targeting starting from 2016. Correspondingly, a National Bank interest rate follows a similar trend.

Exchange rate dynamics up until 2013 exhibited a moderate upward trend with a subsequent abrupt increase in 2014-2015. The latter is explained by a transition from fixed to floating exchange rate regime as a reaction to financial crisis and high volatility caused by a drastic drop of political stability in Ukraine from 2014, due political conflict with Russia. Resurgence of a political stability is still going on, country's rating with respect to control of corruption is also still to be recovered.

4. Multiple regression analysis with a sequential augmentation of a regression model based on a method of least squares and a statistical sample constructed from log-linearized selected variables has shown that some covariates changed the direction of relationship with a dependent variable to the opposite one, in contrast to results of a cross-correlation analysis.

The first regression model incorporates a group of macroeconomic factors and explores their impact on a dependent variable. Estimation of this model has shown that signs of relationship between yields of domestic government bonds and such factors as inflation rate, state budget deficit, international liquidity reserves, national currency exchange rate, control of corruption and level of political stability have changed. Estimation of the second regression model, which includes macroeconomic

and macrofinancial factors, suggests for a change of signs of relationship between bond yields and the following factors: GDP growth rate, state budget deficit, National Bank interest rate and regulatory quality. Those changes are explained by the fact that estimation of a regression model does not show relationship of a dependent and each of covariates independently. Instead, it takes into account a complex structure of all interdependencies among covariates, which leads to more reliable results.

5. Small values of t-statistics obtained as a result of model estimations are explained by large standard errors of estimated coefficients, which depend on estimated variance of residuals obtained after a sample size correction. Thus, a small number of observations in a sample due to a limited availability of empirical data does not allow to obtain small enough standard errors and large enough values of t-statistics needed for significance analysis and statistical inference of each factor independently in a regression model. In order to assess significance of factors, each regression model is divided into parts and each group of covariates is included to the model one at a time. This approach allowed to inspect changes in coefficient of determination depending on the number of factors included to the model. Each subsequent specification of a regression model with a larger number of covariates exhibits a larger coefficient of determination which indicates a significant increase in a variation of dependent variable explained by the right hand side of the regression equation.

6. Suggested methodological approach of sequential multiple linear regressions relating yields of domestic government bonds to macroeconomic, macrofinancial and institutional factors shows that each group of factors improves predictive power of the model and, correspondingly, its ability to impute future dynamics of a dependent variable based on reliable institutional and macroeconomic forecasts. Additionally, average weighted yield of government bonds can serve an integral leading indicator which can predict fluctuations of market conditions.

7. Possible practical use of obtained results intended for investors, government and researchers has been justified. With a help of regression model which includes the average weighted yield of domestic government bonds as a

dependent variable, investors may forecast changes in yields of government bonds in future periods, in order to make an optimal decision regarding inclusion of Ukrainian domestic government bonds to investment portfolios. Government may anticipate changes in a demand for domestic government bonds with a help the second regression model. At the same time, the following obstacles to further analysis with a higher level of statistical significance may occur: an absence of predicted values of all factors and a limited size of sample.

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Даниленко А.В. Дохідність облігацій внутрішньої державної позики. – Рукопис.

Магістерська робота на здобуття освітнього ступеня магістра за спеціальністю 072 «Фінанси, банківська справа та страхування» – Чорноморський національний університет імені Петра Могили, Миколаїв, 2020.

У роботі узагальнено основні результати досліджень стосовно значущості облігацій внутрішньої державної позики як для держави, так і для інвесторів. Описано феномен високих ставок дохідності по державним цінними паперам та встановлено основні фактори впливу на дохідність по ОВДП. Обґрунтовано перелік потенційних факторів впливу на дохідність по державним цінним паперам та згруповано їх за категоріями. Здійснено емпіричний аналіз факторів впливу на обсяг попиту та дохідність по ОВДП. Пояснено вплив встановлених факторів на залежні змінні регресійних моделей. Надано рекомендації щодо практичного застосування результатів дослідження.

Ключові слова: ОВДП, дохідність по ОВДП, попит на державні облігації, параметричні моделі для розрахунку кривої безкупонної дохідності

ANNOTATION

Danylenko A.V. The Yield of Domestic Government Bonds. – Manuscript.

Master's thesis for a Master's Degree in Specialty 072 "Finance, Banking and Insurance" - Petro Mohyla Black Sea National University, Mykolaiv, 2020.

The paper summarizes the main results of studies on the importance of domestic state bonds for both the government and investors. The phenomenon of high rates of return on state securities is described and the main factors influencing the yield on state bonds are established. The list of potential factors influencing the yield on state securities is substantiated and grouped by categories. An empirical analysis of the factors influencing the volume of demand and the yield on state bonds is carried out. The influence of established factors on the dependent variables of regression models is explained. Recommendations for the practical application of the study results are provided.

Keywords: domestic state bonds, yield on state bonds, demand for state bonds, parametric models for calculating of zero-coupon yield curve.