International Finance and Accounting

Volume 2020 | Issue 6 Article 16

12-1-2020

EUROBONDS AS AN INVESTMENT TOOL IN UZBEKISTAN

S. Elmirzaev
Tashkent Institute of Finance

A. Abdurakhmonov
Tashkent Institute of Finance

Prof. S.E.Elmirzaev
Tashkent Institute of Finance
A.K.Abdurakhmonov
Banking and Finance Academy

EUROBONDS AS AN INVESTMENT TOOL IN UZBEKISTAN

Abstract. The article clarifies the essence of Eurobonds, defines the key characteristics and features of Eurobonds as an investment instrument. The work analyzes the role of Eurobonds in the current economic reform and the importance of issuing and placing Eurobonds, as well as the advantages and practice of attracting Euro bonds to our country. There is given a brief analysis of the first issue of Eurobonds by the Republic of Uzbekistan. Besides, conclusions, scientific proposals and practical recommendations on the effective use of Eurobonds have been developed.

Keywords: Eurobonds, benchmark, Eurobond market, liquidity, issuer, bond, interest rate

ЎЗБЕКИСТОНДА ЕВРООБЛИГАЦИЯЛАР ИНВЕСТИЦИЯ ВОСИТАСИ СИФАТИДА

Аннотация. Мақолада еврооблигацияларнинг моҳияти очиб берилган, инвестиция воситаси сифатида евробондларнинг асосий хусусиятлари аниқланган. Ҳозирги иқтисодий ислоҳотларда еврооблигацияларининг ўрни ва еврооблигацияларни чиқариш ва жойлаштиришнинг аҳамияти, шунингдек, мамлакатимизга еврооблигацияларини жалб қилишнинг афзалликлари ва амалиёти таҳлил қилинган. Ўзбекистон Республикаси томонидан еврооблигацияларининг биринчи чиқарилиши бўйича қисқача таҳлил берилган. Шунингдек, еврооблигациялардан самарали фойдаланиш бўйича хулосалар, илмий таклифлар ва амалий тавсиялар ишлаб чиқилган.

Таянч сўзлар: еврооблигациялар, кўрсаткичлар, еврооблигациялар бозори, ликвидлилик, эмитент, облигациялар, фоиз ставкаси

Introduction

During the period of the rapid development of world financial markets, investors view the securities market as an area for placing accumulated funds. In developed and developing countries, one of the most popular and large-scale segments of the securities market is the Eurobond market, which is represented by the primary and secondary markets, as well as the market for financial derivatives. This type of securities allows private investors to preserve and increase their funds during the period of instability in the global financial markets and low rates on bank deposits.

Eurobonds are usually understood as bonds placed by an issuer with the help of an international syndicate of underwriters among foreign investors in a currency, usually foreign for both the issuer and a foreign investor, mainly for a long term. Eurobonds belong to Eurobonds, along with Euro notes, Euro bills and global bonds. Now the share of Eurobonds accounts for more than 75% of all issues of Eurobonds.

Eurobonds are characterized by the following features:

- the syndicate of underwriters through which the Eurobonds are placed consists of several investment banks, of which at least two participants are registered in different states;

- can be initially purchased (including by subscription) only through a credit institution or other financial institution;

- have significant production volumes;

- are placed simultaneously in several countries, except for the country of registration of the issuer.

The economic essence of Eurobonds, like bonds in general, is that this type of securities expresses the relationship of the loan between the investor and the issuer. Under the loan agreement, the buyer of the Eurobonds acts as a lender of the issuer, receiving interest from him within a predetermined time frame, and upon the expiration of the agreement, its par value.

Eurobonds are characterized by features that largely determined the advantages of their market in comparison with national bond markets and other investment areas:

- are the most reliable financial instruments;

- are characterized by high liquidity;

- provide investors with access to a significantly larger number of potential issuers of various profiles than on national markets;

- Eurobonds are purely financial, that is, they do not bind the borrower with the targeted use of the funds received;

- a wide variety of types of Eurobonds allow the investor to choose the most acceptable investment instruments in terms of risk and profitability;

- provide an opportunity to apply various schemes for optimizing taxation.

However, Eurobonds, like any financial instrument, have inherent risks that an investor may face when purchasing them:

1. Interest rate risk - is the risk associated with changes in the interest rate. The price of a typical bond moves in the opposite direction to the movement of interest rates. A rise in interest rates causes a fall in the price of a bond; when interest rates fall, the price of a bond rises. If the owner is forced to sell the Eurobond before the date of its redemption, an increase in interest rates will lead to a loss fixation.

2. The risk of reinvestment. The investor runs the risk of reinvesting the intermediate cash flow at lower interest rates. The income generated by reinvestment depends on the prevailing level of interest rates in the market at the time of reinvestment. Interest rate risk and reinvestment risk are able to balance each other.

3. Credit risk - the risk of non-fulfilment by the issuer of the obligations assumed when issuing bonds on timely payment of interest and full repayment of the debt. This form of credit risk is called “default risk”.

4. Risk of inflation. This risk is significant for all Eurobonds, except for bonds with a floating rate linked to inflation.

5. Liquidity risk. This type of risk depends on how easy it is for the investor to sell the bond. The main measure of liquidity is the width of the spread quoted by the dealer. At the same time, this risk is minimal in Eurobonds of issuers with high credit quality and a significant volume of transactions.

6. Risk of volatility - the risk of the negative impact of changes in interest rates on the bond price. The risk can be realized during periods of major economic crises, especially when the most vulnerable part of the economy is the banking system.

There are the following main categories of participants in the Eurobond market: issuers, investors and organizations that make up its infrastructure - settlement and depository institutions and intermediaries.

The entire set of Eurobond issuers can be divided into two large groups depending on the type of borrower: sovereign borrowers and international organizations; banks, other credit organizations, national and transnational corporations.

The legislation of most countries does not require mandatory registration of the issue and the disclosure of information for Eurobond issues. Nevertheless, in many states, there is legislation on securities or taxation, certain norms of which may affect the issue and circulation of Eurobonds.

Among the other category of Eurobond market participants - investors - there are two groups - institutional and retail investors. The majority of investors in the Eurobond market are institutional investors. The role of retail investors in the world practice in the Eurobond market is, as a rule, individuals wishing to diversify their savings or increase interest income by purchasing securities denominated in different currencies.

Also, in the Eurobond market, as in any stock market, depositories, clearing organizations, information services, intermediaries that make up the infrastructure of the Eurobond market are of great importance. They ensure the reliability of the Eurobond market, its stability and the fulfilment of obligations of intermediaries and issuers to creditors.

The largest investment banks and investment companies that take part in the placement of securities act as intermediaries in the Eurobond market. Intermediaries also include rating organizations. The presence of a credit rating in world practice is currently a prerequisite for a commercial organization or even a nation-state to enter the debt market.

Literature review

This topic is relevant to the development of the international global capital market. The role of the stock market in the global movement of capital is increasing every day. This fact gives the stock market special economic importance.

So, according to the definition presented by O. Khmyz, “Eurobonds are bonds issued on the international stock market and denominated in Euro-currencies - currencies foreign to the issuing country” [1]. L. G. Chuvakhina gives a slightly different definition: “Eurobonds are debt securities denominated in foreign currency in relation to the issuing country and intended for placement simultaneously on several foreign stock markets” [2].

Foreign bonds are placed in a particular country based on the legislation of this state. Foreign bonds are also usually placed in major financial center cities around the world, such as New York, London, Tokyo and other cities. While the practice of using foreign bonds has existed for over 500 years, it has been around 30-40 years since the emergence of Euro-denominations. TODAY, foreign bonds are mainly issued by developed countries [3].

Eurobonds are one of the forms with high efficiency in the management of public debt [4].

Eurozone is a debt-related security issued in foreign currency for issuers and foreign investors, which are placed through international syndicate underwriters among foreign investors.

The euro is not registered in any other country of the world when placing bonds. Eurobonds are mainly emitted by banking consortia, syndicates and international organizations [5].

The circulation of euros is not organized by the economic legal norms of the regulation of the circulation of bonds of a particular state, but rather by the international legal norms in which Euros are mainly regulated, while the circulation of euros is placed on the stock markets of several countries or different countries at the same time [6].

Thus, a Eurobond is a debt security issued and traded on the international stock market, the face value of which denominates in foreign currency. Eurobonds can have a maturity of 1 to 30 years.

Research methodology

Analysis and synthesis, scientific abstraction deduction, classification, generalization, comparative, theoretical interpretation, and analytical methods were used in the methodology of this article, as a result of the bibliographic study, the problems of “Eurobonds”, the factors affecting them and the prospects for further development were identified.

The information used in the article is mainly obtained through two sources: the official web pages of the Ministry of Finance and the Bloomberg news agency.

Analysis and results

The volume of the world Eurobond market is increasing every year, and today, according to the Bloomberg news agency, it occupies two-thirds of the total debt market1. If in 2007 the secondary market traded Eurobonds worth $ 11,520 billion, then at the end of 2016, their volume almost doubled - up to $ 21,623 trillion.

Such a significant volume of the Eurobond debt market allows investors to perfectly diversify their risks when investing, and allows investment companies to form a large number of products, including derivatives, based on Eurobonds.

It is generally accepted that Eurobonds, due to their high level of reliability and slightly higher interest rates, are a good alternative to bank deposits for private investors.

Thus, Eurobonds cannot be considered an instrument, the yield of which is always higher than the yield of a bank deposit. First of all, the direct purchase of Eurobonds, i.e. without the use of derivative financial instruments, is interesting for investors who place dollar assets.

For the first time in its history, Uzbekistan has placed two tranches of Eurobonds with a total volume of $ 1 billion. The yield on 5-year securities in the volume of $ 500 million will be 4.75% per annum, on 10-year securities in the volume of $ 500 million - 5.375%.

We know that the proceeds from the placement of international bonds of the Republic of Uzbekistan will be directed to the purposes set by the President of the Republic of Uzbekistan and the Cabinet of Ministers. On April 2, 2019, the President of the Republic of Uzbekistan issued Resolution No. PP-4258 "On the effective use of funds from the placement of the first sovereign international bonds of the Republic of Uzbekistan" in order to effectively place the proceeds from the successful placement of sovereign international bonds (Eurobonds) of the Republic of Uzbekistan. .

According to the resolution, in order to effectively use the proceeds from the placement of international bonds of the Republic of Uzbekistan, including the financing of investment projects of strategic importance for further improving the welfare of the country and our people, the Ministry of Finance and the Central Bank approved (Figure 1):

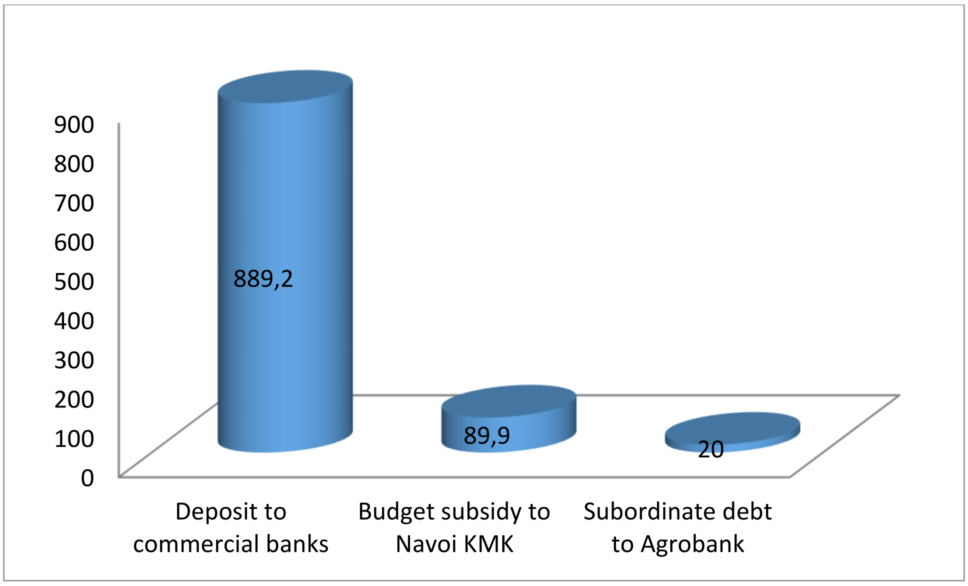

Figure 1. Directions for the effective use of funds from the placement of international bonds of the Republic of Uzbekistan, in mln.dollars [3]

As can be seen from the data above, the funds received from the Eurobonds and intended to be placed on deposit were distributed by auction among 9 state-owned commercial banks. At the same time, the National Bank for Foreign Economic Activity of the Republic of Uzbekistan, Asaka Bank had a share of more than 20%, while Uzpromstroybank and Agrobank attracted more than 10%. The share of commercial banks with other state participation is less than 10 percent.

According to the press service of the Ministry of Finance, citing a report from the London Stock Exchange, the maturity of the debt bonds is set for February 2024 and 2029.

Investor demand exceeded the volume of placement almost four times and amounted to 3.8 billion dollars on the eve of the book closing from about 150 institutional investors. This made it possible to reduce the yield benchmarks during the collection of applications from 5.625-5.75% and 6% per annum to 4.75% and 5.375% per annum, respectively.

From a geographical point of view, most of the 5-year and 10-year debt bonds were bought by investors from the UK - 39% and 32%, respectively, while American investors accounted for 23% and 31%, investors in continental Europe - 32% and 27%, countries in Asia, the Middle East and North Africa - 6% and 10%.

The main buyers of Eurobonds were fund managers - 75% and 78%, insurance companies and pension funds bought back 20% and 16% of bonds, while banks and private banks - 5% and 6%.

Why did the country's Eurobonds cause such a stir? Before finding an answer to this question, it is necessary to look at how the Eurobonds were placed with our neighbors (Table 1).

Table 1

Placement of Eurobonds in the CIS countries [15]

	Volume of government Eurobonds, billion USD	**Time of first placement**	**Current range of rates of return, %**	**Credit rating of the country at the date of the Eurobond placement**	**Placement of the first issue among investors**	**Excess of the volume of the order book over the issue, times**
Russia	54,052	October, 1996	3,11-4,95	Standart&Poor’s “BB-” Moody’s – “Ba2” Fitch – “BB+”	USA–41%, Korea–39%, Europe – 20%	2,1
Kazakhstan	6,5	December, 1996	3,85-5,175	Standart&Poor’s “BB” Moody’s – “Ba3”	Great Britain – 63%, USA–21%, Europe – 16%	4,4
Georgia	0,5	April, 2008	6,88	Standart&Poor’s “B+” Fitch – “B+”	Great Britain – 56%, USA–13%, Europe – 31%	3,4
Belarus	8,78	July, 2010	4,5-8,0	Moody’s – “B1”	USA–67%, Great Britain – 24%, Europe – 9%	1,8
Armenia	1,2	September, 2013	6,0-7,15	Moody’s – “Ba2”	USA–42%, Great Britain – 25%, Europe–17%, Russian Federation and Asia – 18%	4,3
Azerbaijan	3,5	March, 2014	3,5-4,75	Standart&Poor’s “BBB-/A-3”	USA–47%, Great Britain – 25%, Germany – 18%, Singapore and Israel – 10%	4
Tajikistan	0,5	September, 2017	7,125	Standart&Poor’s “B3”	USA–38%, Great Britain – 24%, Europe – 35%, Asia – 3%	9
Uzbekistan	1,0	February, 2019	4,75-5,375	Standart&Poor’s “BB-” Moody’s – “B1” Fitch – “BB-”	Great Britain– 39%, USA – 3%, Europe – 32%, Asia – 6%	8,5

On September 7, 2017, Tajikistan entered the open bond market by placing Eurobonds in the amount of $ 500 million on the London Stock Exchange. Repayment is expected in six equal installments from March 14, 2025 to September 14, 2027 (the weighted average maturity will be 8.75 years). The purpose of borrowing has been announced: the funds will be used to finance the construction of the “Rogun” hydroelectric power station - the largest hydroelectric power station in Central Asia and the highest dam in the world. Completion of this project will enable the country to achieve energy independence and generate income from electricity exports to neighboring Pakistan and Afghanistan. Before the auction, it was announced that the indicative coupon will be 8 percent. The total order book was $ 4.5 billion, which reduced the bond coupon to 7.125 percent.

So where did the $ 1 billion of borrowed funds go? By the presidential decree of April 2, 2019 No. PP-4258 “On the effective use of funds received from the placement of the first sovereign international bonds of the Republic of Uzbekistan”, the funds, subject to the receipt of the corresponding interest, will be directed to the following: “889.2 million US dollars will be placed through an auction for deposit accounts of commercial banks; USD 20 million will be issued as a debt of JSCB “Agrobank”; 89.9 million US dollars will be issued as a loan to the state enterprise “Navoi Mining and Metallurgical Combine”.

Only about 90 million dollars out of a billion will be directed to a specific project of the Navoi Mining and Metallurgical Combine. The rest of the funds are spread over the deposits of commercial banks. Is it true that there are no worthy investment projects in the republic and the issue of sovereign government bonds for $ 1 billion pursued only one goal - to determine a benchmark. Is the price too high for the price reference?

And why not invest borrowed funds - since we are borrowing - in the development of the republic's gold mining industry. Russia, for example, over the past decades has increased by an order of magnitude the annual gold production from 19 to 190 tons. There are 63 gold deposits in Uzbekistan, of which only nine are in industrial development. The total explored reserves of gold are more than 2,500 tons, and the probable reserves (in categories C1 and C2) are 5,990 tons. Besides, it should be borne in mind that the extraction of gold is also associated with the associated production of other minerals: platinum, silver, rare earth elements, ornamental and precious stones.

Conclusion

First of all, Eurobonds provide an opportunity to attract or place capital, the value of which does not depend on the regulation of the local (national) market of the issuer. Besides, Eurobonds allow attracting large amounts of funds from a wider circle of investors and for a long time. There are options for investors to place Eurobonds without collateral (collateral), which is also an important advantage of this method of raising funds.

The advantage of Eurobonds may be the existing vast market for their purchase and sale. Thus, the international central depository Clearstream has more than 2.5

thousand clients from 110 countries of the world. At the same time, the coverage area is about 50 markets and about 250 thousand transactions are made per day. Clearstream holds $ 10.9 trillion in securities, with annual income of approximately $ 760.7 million.

So why, when placing government bonds of Uzbekistan and Tajikistan, the potential demand of investors exceeded supply, respectively, 8.5 and 9 times.

First of all, because these were the debut placements of Eurobonds by the countries of Central Asia, which were previously distinguished by their closed economies. The appearance of new players on the market always arouses increased interest and the first placement of bonds is not always objective. Very often, investors put their expectations for a company or country into demand: in the case of Uzbekistan, this is the hope for successful reform of the economy and the financial sector, and with Tajikistan, the completion of the construction of the “Rogun” HPP.

As you can see, there is no investment product on the market with the following parameters:

- lack of a fixed tool life;
- availability of a guaranteed coupon;
- the ability of the investor to receive a yield higher than the guaranteed yield;
- low minimum amount for purchasing a product;
- denomination currency - US dollar.

This necessitates the development of a product with such parameters. The proposed product meets the investment needs of private investors, which means it can attract them to the stock market, which is of interest not only to the professional community, but also to the state.

References:

1. Resolution of the President of the Republic of Uzbekistan dated July 21, 2018 "On additional measures to diversify sources of external financing."
2. Resolution of the President of the Republic of Uzbekistan dated January 31, 2019 "On measures to organize the issuance of international bonds of the Republic of Uzbekistan and maintain a sovereign credit rating."
3. Resolution of the President of the Republic of Uzbekistan dated April 2, 2019 No PP-4258 "On the effective use of funds from the placement of the first sovereign international bonds of the Republic of Uzbekistan."
4. Khmyz, O.V. International securities – Eurobonds // Financial management. - 2003. - No. 2.
5. Chuvakhina L.G. Eurobonds and the Eurocommercial Paper Market. Voprosy sovremennoi nauki i praktiki - Problems of Contemporary Science and Practice, 2011, No. 2, pp. 322–326.
6. Ataniyazov J.X., Alimardonov E.D. Xalqaro moliyaviy munosabatlar.

7. Xavier Vanden Bosch & Stijn Verhelst, «A Briefing on Eurobond», Europian Policy Brief No. 2. 10, June 2012.
8. Aizenman, Hutchison and Jinjarak (2011), What is the risk of European sovereign debt defaults? Fiscal space, CDS spreads and market pricing of risk, NBER working paper nr. 17407, September 2011.
9. Bernoth, Von Hagen and Schuknecht (2012), Sovereign risk premiums in the Europan government bond market, Journal of International Money and Finance, 31, 975-995.
10. Elmirzayev S., Raxmedova M., Kholiqov H. Redistribution Of Funds From Sovereign Eurobonds And Their Efficiency, Journal of International Finance and accounting, Issue 3, 2020. Pages-5
11. Турсунова Н. Корпоратив молияни бошқаришда молиявий таъминотни самарали ташкил этиш йўллари. Монография. – Т.: “Iqtisodmoliya”, 2017. – 142 б.
12. Тошматов Ш.А. Ўзбекистон халқаро облигацияларининг жаҳон молиявий бозорларида жойлаштирилиши: риск ва прогнозлар.
13. https://repost.uz/bond-eurobond
14. https://review.uz/ru/post/uzbekistan-mojet-do-konca-goda-snova-razmestit-evrobond
15. https://aecsd.org/upload/iblock/fba/GM_24_343.pdf