

Daily Insight

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TUESDAY, 20 DECEMBER 2016

Ukraine's hryvnia exchange rate per US dollar (three months through 19 December 2016)



Source: Bloomberg.

Selected indicators of the financial markets (three months through 19 December 2016)

	Last	Daily chg (%)	YTD chg (%)
DOMESTIC LIQUIDITY			
NBU key policy rate (%)	14.00	+0bp	-800bp
Overnight rate (interbank)	13.40	+20bp	-420bp
Banks reserves (UAHm)	51,951	-0.04	+35.07
Deposit certificates* (UAHm)	37,040	-25.90	-68.38
FOREIGN EXCHANGE MARKET			
UAH per US dollar	26.2700	+0.13	+9.33
Total trade volume (US\$m)	N/A		
UAH index PCI-based	100.584	+0.16	+2.34
UAH index PPI-based	132.816	+0.16	+0.78
UKRAINE SOVEREIGN EUROBOND MARKET			
CDS 5yr	720bp	+0bp	+0bp
GLOBAL FINANCIAL MARKET INDICATORS			
S&P 500	2,262.53	+0.20	+10.69
MSCI EM	851.13	-0.62	+7.18
US dollar index (DXY)	103.140	+0.18	+4.57
EUR / USD	1.0402	-0.47	-4.23
Crude oil WTI (US\$/bbl)	52.12	+0.42	+40.71
Crude oil BRENT (US\$/bbl)	54.92	-0.53	+53.62
CRB, commodities index	191.22	-0.11	+8.56
Gold (US\$/ounce)	1,137.90	+0.27	+7.21

Notes: * NBU's short-term bonds.

Source: Bloomberg, ICU.

Macroeconomics

Privatbank undergoing nationalization

NBU has declared that Privatbank is officially insolvent and that its recapitalization plan will not be executed. Insider lending comprises 97% of the total corporate exposure, most of which has very poor collateral.

Due to the systemic importance for the Ukrainian economy and retail cashless transactions, Privatbank is going to be nationalized, requiring a maximum of UAH148bn in capital. However, according to the law, all uncollateralized claims other than deposits will be effectively written down, saving the government up to UAH31.2bn. As both senior and junior Eurobonds will fall into this category, it is expected that the bondholder(s) might try to sue the Ministry of Finance.

The Ministry of Finance will purchase Privatbank for a symbolic 1 hryvnia and increase its capital by UAH43bn by the end of this week. It will issue UAH-denominated 10- to 15-year government bonds with a 10.5% interest rate. A further capital injection might also include indexed bonds linked to the USD exchange rate with a 6% coupon rate. The total amount of government bonds that can be issued for Privat's recapitalization is UAH116.8bn.

The authorities' top priority is to ensure that client servicing continues uninterrupted as a massive panic might threaten the effectiveness of the nationalization plan. Although Privatbank is experiencing a significant outflow of deposits, the NBU is ready to provide any liquidity needed. The bank's previous management has demonstrated their willingness to cooperate as the bank's IT systems are fully operating.

Former shareholders issued a declaration to provide collateral against the loans and restructure the existing loans to ensure cash inflows for Privatbank during the next half year. While that commitment is non-binding, the NBU expects shareholders to fulfill their duties to avoid criminal prosecution that is likely to follow.

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Domestic liquidity

Liquidity increases prior to outflows

This week began with banking sector liquidity up without inflows from the NBU. While the banks' account balance remains steady, banks increased investments in both ON and 14-day CDs.

Totally funds invested in CDs rose UAH1.26bn to UAH37.04bn, including a UAH0.90bn increase in ON CDs, while banks' correspondent accounts at the NBU slid a mere UAH0.02bn, causing banking sector liquidity to rise to UAH88.99bn.

Investment implications: *As only two weeks are left before the end of the year and month-end tax payments begin today, banks continued to collect liquidity in preparation for outflows. Liquidity could rise slightly today as a result of yesterday's cashflows, but today's tax payments should have a negative impact on tomorrow's liquidity indicators. If budget deposits are not withdrawn, liquidity should not fall significantly.*

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Primary auction announcement

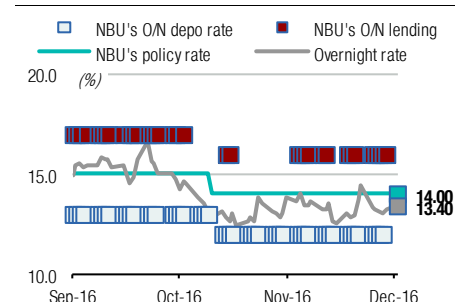
At today's auction, the MoF will follow the schedule and offer three local currency denominated zero-coupon bonds, the same as were offered last week, and also two USD-denominated bonds.

Having needs in FX to replace other funding sources, the MoF set no limits for these offerings and will probably accept all bids at its cut-off rate.

Investment implications: *We should anticipate no significant changes in bond interest rates. USD-denominated bonds could be sold at the 6.35-6.40% cut-off interest rates unless a larger volume bid warrants a higher rate. Local currency bonds could be sold at the 15.10-15.30% cut-off rates if any bids are submitted.*

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Interest rates in the banks' reserves market (three months through 19 December 2016)



Source: Bloomberg, ICU.

Key indicators (as of 19 December 2016)

	Last	Daily	Weekly	Monthly	YTD
	chg (%)	chg (%)	chg (%)	chg (%)	chg (%)
BANKS' RESERVES MARKET (%)					
NBU rate ¹	14.00	+0bp	+0bp	+0bp	-800bp
Overnight	13.40	+20bp	+10bp	-40bp	-420bp
KYIV PRIME RATES (%)					
Overnight	13.50	+0bp	+0bp	-17bp	-556bp
1 week	14.50	+0bp	+0bp	-17bp	-550bp
1 month	16.50	+17bp	+17bp	-17bp	-575bp
2 months	18.00	+0bp	+0bp	-17bp	-550bp
3 months	18.00	-17bp	-17bp	-33bp	-575bp
DOMESTIC LIQUIDITY (UAH MILLION)					
Reserves ²	51,951	-0.04	+16.12	+27.80	+35.07
DepCerts ³	37,040	-25.90	-24.68	-21.56	-68.38
Total	88,991	+0.15	+9.79	+17.83	-28.85
BREAKDOWN OF GOVT BOND HOLDERS (UAH MILLION)					
NBU	N/A	N/A	N/A	N/A	N/A
Banks	N/A	N/A	N/A	N/A	N/A
Residents	N/A	N/A	N/A	N/A	N/A
Non-res ⁴	N/A	N/A	N/A	N/A	N/A
Total	N/A	N/A	N/A	N/A	N/A
IMPLIED YIELDS OF THE UAH NDF MARKET (%)					
3 months	N/A	N/A	N/A	N/A	N/A
6 months	N/A	N/A	N/A	N/A	N/A
9 months	N/A	N/A	N/A	N/A	N/A
1 year	N/A	N/A	N/A	N/A	N/A
UKRAINE SOVEREIGN EUROBOND MARKET					
CDS 5yr	720	+0bp	+0bp	+87bp	+0bp

Notes: [1] NBU's key policy rate; [2] stock of banks' reserves held at NBU; [3] stock of NBU's short-term bonds; [4] non-residents.

Source: Bloomberg, ICU.

Foreign exchange markets

UK unemployment rate at 4.8%.

The number of unemployment benefit claims in Britain rose less than expected last month, while the unemployment rate held steady.

Official data published by the Office for National Statistics (ONS) on Wednesday showed claims for unemployment aid advanced 2,400 in November against an anticipated increase of 6,200. The October figure was revised up to 13,300, the highest since February 2015, from the originally reported 9,800. In the meantime, the unemployment rate remained unchanged at its 11-year low of 4.8% as fewer teenagers and homemakers entered the labor market. That was in line with analysts' expectations. Nevertheless, the number of employed people dropped 6,000 to 31.8 million after hitting its record high in October. That marked the first fall since the three months to June 2015. The ONS also reported the Average Earnings Index jumped 2.5% year-over-year in August-October. Excluding bonuses, earnings increased 2.6%, the largest gain since mid-2015.

Eurozone industrial production falls 0.1% MoM in October

Industrial production in the Eurozone dropped for the second straight month in October, against market expectations of a positive reading.

Also, production declines of non-durable consumer goods deepened the cause. The Eurozone's industrial production was down 0.1% from September, when it was down 0.0%, according to Eurostat. Economists forecasted 0.2% growth. The decrease during the month was attributed to the production of non-durable consumer goods falling 1.5% and intermediate goods down 0.5%. Meanwhile, energy production increased 0.8%, capital goods up 1%, and durable consumer goods up 1.5%. However, on the year, industrial production in the Eurozone was up 0.6%, below expectations of a 0.8% rise. In the EU-28 group of countries, industrial production was down 0.3% on the month but increased 0.5% in year-on-year terms.

The Fed raises key interest rate by a quarter-point to 0.5-0.75%.

After its two-day policy meeting, the Federal Open Market Committee unanimously voted to raise the range of the federal funds rate to 0.50% and 0.75%, citing progress in economic activity and labor market growth. The Fed's expectations for short-term GDP growth increased slightly to 2.1% in 2017, while forecasts for unemployment remained mostly the same, with officials expecting the rate to fall to 4.5% by 2019.

Retail sales rose 0.1% MoM last month, compared to 0.6% MoM growth in October, the Commerce Department said on Wednesday. Sales were up 3.8% from a year ago. The sharp rally in oil prices last month helped push producer prices 0.4% higher in November, the fastest pace since June. The market had forecast a rise of 0.1%. Industrial production fell 0.4% on the month due to a 4.4% drop in utilities' output as warmer-than-normal temperatures cut demand for heating. The drop in industrial production was the largest since March. Manufacturing production slipped 0.1%, mining production surged 1.1% amid rising oil and gas well drilling as the drag from last year's collapse in oil prices fades.

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Readers may follow the ICU trade-weighted indices of the local-currency, the hryvnia (UAH), on the ICU [website](#).

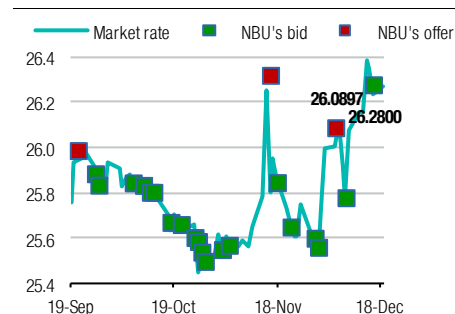
Key indicators (as of 19 грудня 2016)

	Last	Daily	Weekly	Monthly	YTD
	chg (%)	chg (%)	chg (%)	chg (%)	chg (%)
EXCHANGE RATES (PER US DOLLAR, EXCEPT EURO, POUND)					
UAH	26.2700	+0.13	+0.44	+1.57	+9.33
USD ¹	103.140	+0.18	+2.09	+1.91	+4.57
EUR	1.0402	-0.47	-2.19	-1.76	-4.23
JPY	117.0900	-0.71	+1.80	+5.57	-2.60
GBP ²	1.2395	-0.81	-2.24	+0.43	-15.89
CNY	6.9605	-0.01	+0.78	+1.07	+7.19
RUB	61.9057	-0.26	+1.46	-4.73	-14.64

Notes: [1] DXY, US dollar index; [2] British pound.

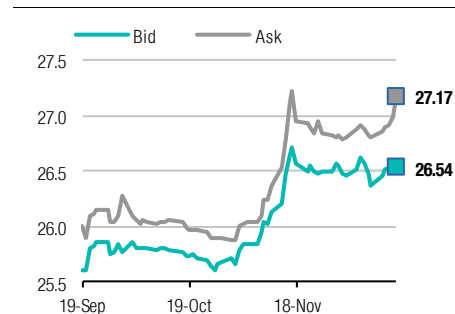
Source: Bloomberg, ICU.

Ukraine hryvnia UAH exchange rate per US dollar at the interbank market (three months through 19 December 2016)



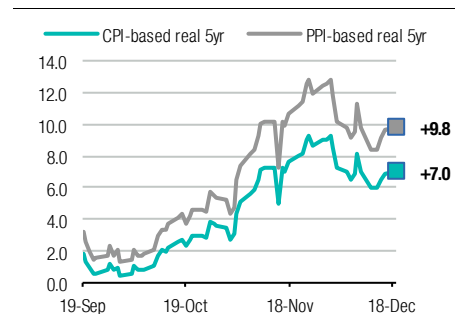
Notes: the chart provides labels for the average exchange rate at last two NBU auctions (one on buying FX from the market and one on selling it). Source: NBU, Bloomberg, ICU.

Ukraine hryvnia UAH exchange rate per US dollar at the cash market (three months through 19 December 2016)



Source: NBU.

UAH exchange rate misalignment¹ from fundamental level² (%) (three months through 19 December 2016)



Notes: [1] "+" overvalued, "-" undervalued; [2] based on the UAH's CPI- and PPI-based real TWIs. Source: ICU.

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