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An Excerpt from the Editorial of the Weekly Courier
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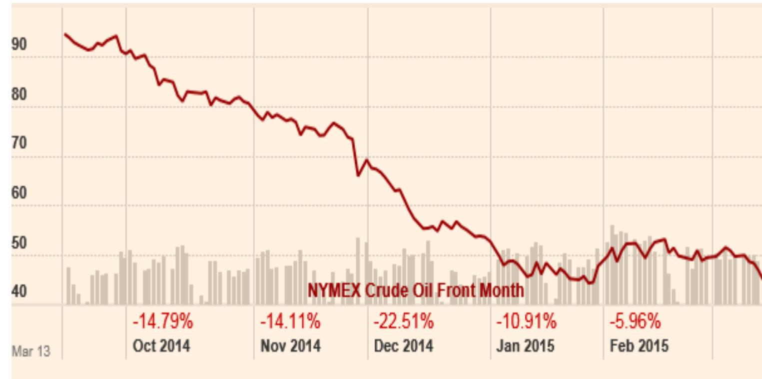
Ukraine

The economic situation in Ukraine is extremely challenging. Output is falling massively as economic activity in parts of the east has more or less ground to a halt. The economy contracted by 15.2% LFL in the final quarter of last year, bringing the drop for the year as a whole to 6.3%. The IMF thinks that the economy will contract by a further 5.5% this year. While the current account deficit has narrowed sharply as imports have collapsed, the central bank has continued to bleed foreign reserves as residents switch into dollars and foreign funding has fallen short of expectations. Foreign reserves stand at just USD 5.6bn as of the end of last month compared to USD 20.4bn in December 2013. Last month, the central bank therefore abandoned its foreign exchange auctions and hiked interest rates by 550bps to 19.5%. When this failed to stem the fall in the hryvnia, it hiked rates to 30% and tightened controls on demand for foreign exchange. This has stabilized the currency, although it has nevertheless still lost 62% of its value since the start of last year. Inflation has accelerated to 35%. It may yet increase further following the latest leg downward in the currency and as higher domestic gas prices start to bite. This is evidenced in the price of the 2020 government bonds which are yielding 55% at the moment. The market is pricing in a 46% government bond "haircut" on average for private investors. This week the IMF agreed a package worth €40 bn. This includes a €17.5 bn immediate disbursement. It will be fascinating to watch developments in the next few months in the Ukraine.

The Weekly Courier has had the opportunity to examine balance sheets of some Ukraine banks for the year just passed. Owing to high interest rates in Ukraine, a great deal of bank lending is already in dollars. The banks' balance sheets therefore don't look as horrible as one would expect as they contain a substantial "carry" profit. The problem of course, is that the balance sheets may appear strong with the dollar loans have appreciated, while the borrowers may be unable to pay. Those who live in Iceland know that a principal is one thing and a possible repayment another.

Contango

The low price of oil has been the source of great deal of speculation. In previous oil crashes future price of oil, i.e. oil to be delivered at a later date, has often become higher than current prices. This has often led to the so-called contango trade whereby traders buy oil now and store it in tanks and ships all around the world. In January this year, this looked like a golden opportunity as commodity arbitrageurs got ready to take advantage of this mispricing. This trade has now fizzled as oil prices have become more staple. Owing to tighter bank regulation there is less leverage available to take risk on commodities. Banks and traders alike are not allowed to take forward risks as before. Forward prices have moved to a reasonable level taking into interest rates and the cost of storage. Traders mourn the days of plentiful leverage and easy profits.



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