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# Ukraine Raises Key Rate to World's Highest Amid Hryvnia Rout

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(Bloomberg) -- Ukraine's central bank raised its benchmark interest rate to the world's highest, the fifth emergency move since the beginning of last week to arrest a plunge in the hryvnia as the nation moves closer to obtaining a bailout.

The National Bank of Ukraine raised its refinancing rate to 30 percent from 19.5 percent, effective Wednesday, to "stabilize the situation on the money and lending markets," Governor Valeriya Gontareva told reporters in Kiev. That's the highest benchmark among all countries tracked by Bloomberg.

Higher borrowing costs will squeeze local companies and households that are already struggling with a recession. The decline in the hryvnia, the world's worst performer in the past year, has spurred panic buying among shoppers and destabilized banks. Before opting to push the key rate to the highest since 2000, the central bank in Kiev used tighter capital controls and a one-day freeze on currency trading to steady the hryvnia.

"The picture is being blurred: every day a different measure is taken,'" Simon Quijano-Evans, head of emerging-market research at Commerzbank AG in London, said by e-mail. "What the local population in particular needs is a clear policy picture from the central bank."

The Ukrainian Equities Index slipped 1.9 percent in Kiev, while the nation's benchmark international bonds, the $2.6 billion of 9.25 percent notes due in July 2017, gained 0.82 cent to 44 cents on the dollar, extending their advance during the past four days to 2.5 cents. The hryvnia strengthened 9.3 percent.

**IMF Bailout**

The hryvnia, which has lost 60 percent against the dollar in the past year, strengthened or weakened more than 15 percent on a single day on five occasions in 2015, data compiled by Bloomberg show.

Policy makers are tightening policy as Ukraine is working to access an International Monetary fund loan to stay afloat after fighting with pro-Russian separatists in the country's east helped wipe 15.2 percent off the economy last quarter compared with a year earlier. The regulator, which is also trying to prevent capital flight, retained a requirement for exporters to convert 75 percent of their foreign-currency revenue.

"Higher interest rates only add to the myriad reasons to expect the Ukrainian economy to remain in recession for the second consecutive year," William Jackson and Liza Ermolenko, analysts at Capital Economics Ltd. in London, said in a report.

**Currency Tailspin**

As the economy deteriorated, the hryvnia went into a tailspin, sending inflation to 28.5 percent in January, the world's second-highest rate behind Venezuela. Annual price growth may be as quick as 272 percent, with a monthly rate of 64.5 percent that would qualify as hyperinflation, according to estimates based on the hryvnia's black-market price by Steve Hanke, a professor of applied economics at Johns Hopkins University and director of the Troubled Currencies Project at the Cato Institute.

In a sign of contagion affecting the financial industry, the Ukrainian regulator declared Delta Bank, the country's fourth-biggest lender, insolvent Tuesday. The bank's asset quality was too poor to allow for a state takeover, according to Gontareva.

Separatist Insurgency

A drop in the fighting in Ukraine's easternmost regions has stoked optimism that the cease-fire sealed last month in Minsk, Belarus, will hold. Even so, the Defense Ministry in Kiev said on Tuesday that Russian troops are massing within the conflict zone and Ukrainian government troops continue to come under shelling from pro-Russian rebels.

Ukraine and its allies accuse Russian President Vladimir Putin of stoking the strife by supplying the separatists with weapons, cash, intelligence and troops from across the border in Russia. The Kremlin rejects the accusations. More than 6,000 people have been killed in the fighting, the United Nations estimates.

President Barack Obama, on Tuesday in Washington, convened a videoconference with European leaders to discuss Ukraine, agreeing that they will remain unified if they impose more sanctions or get involved in other ways in the conflict.

The group, which also included leaders of the U.K., France, Germany, Italy and the European Council "affirmed their determination to act quickly and in unison to impose significant additional costs, if serious violations of the Minsk agreements occur or if Russian-backed separatists seek to gain new territory," the White House said in an e-mailed statement.

In a separate phone conversation, U.S. Treasury Scretary Jacob Lew told Ukrainian Prime Minister Arseniy Yatsenyuk that the U.S. and other countries will provide "robust financial support" as the country works toward stability, according to a Treasury Department statement.

On another front, the risk of Russia cutting off natural gas supplies to Ukraine diminished after the countries agreed on prepayment conditions in talks brokered by the European Union.

Russian Energy Minister Alexander Novak and his Ukrainian counterpart Volodymyr Demchyshyn met Monday in Brussels after a dispute over deliveries to rebel-held regions in the east of Ukraine threatened to disrupt gas flows.

**Hryvnia Appeal**

"The rate hike will increase the appeal of holding hryvnia, so it will be a positive factor, but I'm not sure that it alone will be enough to fix a rather acute deficit of dollar supply," Fyodor Bagnenko, a Kiev-based trader at Dragon Capital, said by e-mail. "What's really needed in this situation is a combination of administrative and monetary measures -- and it seems like this is exactly what the central bank is doing."

Importers returning to the market on Wednesday may help create a more representative hryvnia price, according to Dragon Capital's Bagnenko.

The hryvnia's plunge prompted the central bank to tighten capital controls last week as reserves declined to the lowest in more than a decade in January. Ukraine's First Deputy Finance Minister Ihor Umanskyi said Feb. 27 that IMF funds will go into reserves, because "it will be very difficult to douse the fire and panic without additional resources poured in."

**IMF Demands**

All measures sought by the IMF in exchange for a four-year $17.5 billion loan program have been adopted in legislation by lawmakers, Gontareva said. Ukraine on Tuesday approved a tripling of utility tariffs for households to comply with one of the IMF's demands.

The central bank is "eager" to strengthen the hryvnia toward the 21.7 per dollar average rate in the 2015 budget, which is important to ensure approval of the IMF deal by the lender's board next week, Timothy Ash, the chief emerging-market economist at Standard Bank Plc, said by e-mail.

The rate increase "is a desperate attempt by the National Bank to regain control of the currency, having botched its attempt to tighten capital controls over the past few weeks," Jackson and Ermolenko of Capital Economics in London, said. "The hryvnia has rebounded on the news, but we're not convinced that today's move will stem pressures on the currency."