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Ukraine's agreement with private creditors

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On 27 August Ukraine reached an agreement with a group of private creditors, mostly American investment funds which hold Ukrainian Eurobonds totalling US$18 billion. The agreement allows for a haircut of 20% of the debt, that is US$3.6 billion (US$3.8 billion if the debt write-off also extends to the state-guaranteed debt of Kyiv and state-owned companies), which will help reduce the debt from US$19.3 billion to US$15.5 billion. The debt's maturity has been extended by four years (in 2019-2027) and the level of coupons has been raised from 7.2% to 7.75%. However, because part of the debt has been written off, this will not lead to an increase in the debt servicing costs. Ukraine has also committed to compensating for the cost of the debt haircut to creditors in case it reports a larger economic growth than that projected by the IMF (at the level of 3-4% after 2019), by issuing new securities tied to the growth of GDP.

Commentary

- The agreement comes as a success for Ukraine since it removes the threat of the country defaulting in the forthcoming months, and will allow Ukraine to continue benefiting from support from the IMF, which is currently its most important external source of funding. The implementation of the agreement should facilitate Ukraine's return onto international financial markets in 2017, which is crucial to securing the funding needed to stabilise the country's economic situation (the support pledged by the IMF and others, i.e. the EU, US, Canada, Japan, is not sufficient). The Ukrainian government estimates that the agreement will enable it to postpone principal payments of US$11.5 billion by four years, because of the extension of the debt's maturity and the debt haircut. Thanks to this, Kyiv will gain time until 2019, when the larger repayments are scheduled, and the funds it has saved may be used to introduce necessary reforms.
- Financial markets have responded positively to the agreement and the prices of Ukrainian bonds has increased. Despite this, the credit rating agencies have maintained Ukraine's low rating at the 'extremely speculative' level with a negative outlook. They claim that the change in the rating depends on the smooth implementation of the agreement and the introduction of economic reforms. The restructuring of part of the debt (Ukraine's public debt and guarantees as of the beginning of June this year totalled US$67.7 billion, including US$33.9 billion of foreign debt and US$9.7 billion in foreign debt state guarantees) does not mean that the threat of default has been removed. Ukraine remains in a very difficult economic situation, including a fall in its GDP

estimated at 10-15% this year. For this reason it will be quite challenging to achieve one of the IMF's targets, namely the reduction of the state debt below 71% of GDP (at the end of 2014 it accounted for 72%, although it kept growing due to the decreasing GDP).

- Ukraine's financial difficulties are further compounded by a US$3 billion loan granted by Russia (equivalent to around 30% of foreign exchange reserves) which reaches maturity in December this year. Moscow has consistently refused to hold any talks about restructuring it. The dispute concerning the nature of this agreement is unclear. Russia sees the loan as an official one, whereas Ukraine considers it a private loan. This is important because the IMF, according to its regulations, cannot pledge financial support to a state which has defaulted on debts it owes to another state. Should the IMF recognise this loan as private, it would present an opportunity for Ukraine since this would allow it to continue benefiting from the IMF aid programme, despite having defaulted on the Russian loan repayments.