Ukraine
Economy / Fixed Income

January 29, 2015

Sovereign restructuring?

We aren't believers

Alexander Paraschiy
ap@concorde.com.ua

The restructuring of Ukraine's sovereign debt, which has been actively discussed and speculated during the last few weeks, does not look like a realistic scenario for this year, we believe. Of course, nothing should be completely ruled out given the chaotic events of the last year. Yet the Ukrainian government proved during the last year its utter impotence in making bold decisions and we believe it simply doesn't have the guts to pursue a restructuring. The "soft" restructuring of sovereign Eurobonds (asking for a maturity extension of existing paper or exchanging them for longer paper) is not helpful for Ukraine's budget and not much helpful for state external accounts in 2015. A heavier restructuring (e.g. a radical cut in interest rates for state bonds, "haircut"), could be helpful for the state budget, but we are confident the government is far too timid for such a sharp maneuver that will be not very popular among the public.

The attitude towards restructuring abroad is much different than within Ukraine's borders. A restructuring (in essence, a technical default) is broadly expected internationally and it's priced in (to some extent) by the Eurobond market. Moreover, Ukraine can easily use the excuse of Russia's invasion and the need to mobilize funds in the country's defense (instead of repaying debt) to pursue restructuring. However, Ukraine does not critically need a restructuring, at least in 2015. And if there is no crucial need, then the government won't do it on its own initiative. Clearly, we base this outlook on the assumption that Ukraine will get financial aid from the IMF (to be buttressed by aid from other donors, like the EU and the U.S.) by early March.

No guts to do the restructuring

The government proved its impotence for strong moves
Our key argument in why we do not believe in restructuring is that our power brokers are incapable of making any bold decisions or sharp moves, which they have gone to great lengths to avoid. Examples include officially deeming the "conflict in Donbas" a war, imposing EU/U.S.-scale sanctions against Russia or Crimea, introducing a state of emergency or martial law in any part of Ukraine, executing painful and widely announced reforms, and refusing to pay any debt to the aggressor state.

Need to weigh political, macroeconomic consequences
Importantly, words like "restructuring" or "default" are loaded language in Ukrainian society, widely associated with loss of earnings, bank bankruptcies and other economic wreckage. In light of this, the authorities have very strong political motives to avoid "defaulting". Any news on a "default" might trigger more problems like a new wave of currency panic and stronger deposit outflows. The latter outcome is especially important: bank runs will potentially lead to a drop in the amount of dollars working for the Ukrainian economy, and such drop could exceed the potential dollar savings to be gained from the government's restructuring efforts in 2015.

On top of that, "default" will automatically prompt a plunge in political support for the government, at minimum. At worst, it would serve as a good pretext for a new wave of public unrest, potentially to be sponsored by the Kremlin, which is seemingly ready to exploit any domestic tension to split the country from inside.

Restructuring is possible only at the IMF's initiative
A healthy restructuring of Ukraine's entire external sovereign debt can only be initiated by Ukraine's core creditor, the IMF, we believe. In this case, the Ukrainian government can shift responsibility for such an initiative. It's pretty much the same with the state budget – the government dared not butcher the budget's sacred cows when drafting the document, with the hope that the IMF will do its dirty work in cutting social payments.

At this moment however, we do not see any signal from the IMF that it will require Ukraine to restructure its debt.

What for? The advantages aren't very appealing

Restructuring Ukrainian Eurobonds (ex. Russian bond), in its most extreme case, would bring USD 2.3 bln in savings to Ukraine in 2015. We believe that won't be enough to compensate for the potential reputation-related and political losses, as well as potential exiting of dollars from Ukraine's banking system from such a move. We also cite the following reason, strictly from a fiscal perspective:

Restructuring is not very helpful for easing the 2015 debt repayment schedule
External sovereign redemptions scheduled for 2015 amount to USD 5.6 bln, out of which:

- Only USD 1.2 bln (in Eurobonds) can be potentially restructured under the "soft scenario" (by getting consent from debt holders).
- The USD 1.5 bln repayment to the IMF due in 2015 cannot be avoided, though it will be most likely refinanced by the Fund.
- The core portion of the 2015 debt (USD 3.0 bln) must be paid to Russia's state welfare fund, and it's apparent that Ukraine won't receive any flexibility from Russia. The core question here is when. Based on Russia's expressed intention to demand its acceleration (as Ukraine has de facto breached the 0.6x debt/GDP covenant), we expect that Ukraine will have to repay it as soon as it officially publishes its annual 2014 GDP statistics (scheduled for March 11).

Distressed restructuring might be helpful to reduce budget expenditures
The total interest payments on external publicly listed state and guaranteed debt will amount to USD 1.3 bln, we estimate. For sure, this amount will be painful for the government since it would represent 4.7% of all Ukrainian budget revenue planned for 2015 and 1.3% of Ukraine's planned GDP (at the budget's estimated exchange rate of UAH 17/USD).

Theoretically, cutting or avoiding such costs (via a request for a haircut or lower coupon rates for Eurobonds) would be helpful for the 2015 budget. However, we reiterate in this case as well that the fiscal gains won't be enough to compensate for the reputation-related and political and possible economic damage of a sharp restructuring.

Meanwhile, the most straightforward way to save on interest payments in 2015, even slightly, is to pay the Russian USD 3 bln debt in advance. By repaying it by the end of March (instead of late December), Ukraine would save USD 0.11 bln, or 9% of total 2015 coupon payments on Eurobonds.

Contacts

CONCORDE CAPITAL
2 Mechnikova Street, 16th Floor
Parus Business Centre
Kyiv 01601, Ukraine
Tel.: +380 44 391 5577
Fax: +380 44 391 5571
www.concorde.ua
Bloomberg: TYPE CONR <GO>

CEO
Igor Mazepa im@concorde.com.ua

SALES

Alexandra Kushnir ak@concorde-group.eu
Yuri Tovstenko ytovstenko@concorde.com.ua
Alisa Tykhomirova at@concorde.com.ua
Marina Martirosyan mm@concorde.com.ua

RESEARCH

Head of Research
Alexander Paraschiy ap@concorde.com.ua

Macroeconomics
Alexander Paraschiy ap@concorde.com.ua

Metals & Mining, Consumer
Roman Topolyuk rt@concorde.com.ua

Utilities, Energy, Financials, Consumer
Alexander Paraschiy ap@concorde.com.ua

Politics
Zenon Zawada zzawada@concorde.com.ua

Editor
Zenon Zawada zzawada@concorde.com.ua

Disclaimer