

# Traders Concerned by Kiev Debt Burden

By [The Moscow Times](#)

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LONDON — Ukraine has muddled its way through several debt crises in the past, but investors and traders are concerned that default may finally be round the corner as the country's finances deteriorate and its relations with Russia worsen.

When it was downgraded to Caa1 from B3 by Moody's on September 20, it gained the dubious honor of joining the "Triple C" club alongside Cuba, Ecuador, Egypt and Pakistan.

Some observers, however, are playing down the risk of default, saying the country could still find a way to make its debt payments, which amount to more than \$10 billion in hard currency in the coming year.

"Fears of default and devaluation in Ukraine are almost seasonal in nature and usually peak at the end of Q3 or beginning of Q4 and get forgotten as the winter holidays approach," said Peter Attard Montalto and Dmitri Petrov, analysts at Nomura. The actual risk of default is still only moderate, they said.

Bond investors are not so sure. The sovereign bond was at 13.9 percent late last week — an extremely high level for one-year risk.

Ukraine's yield curve is hugely inverted, with the 2014 bond trading the end of last week at a Z-spread of plus 1,398bp, or basis points, compared with plus 775bp for its 7.5 percent 2023 note.

Last week, a Central Bank official said Ukraine would meet its debt repayment obligations on time, but the 2014 bond's cash price only rose by 0.8 of a point to 96.25.

"The difference this time around seems to be that there is a political element to the problem, particularly the issues with Russia," said a DCM banker who has worked on Ukrainian eurobond deals in the past.

"There is growing concern that this will all provoke a full-scale trade war with Russia with damaging consequences for the Ukrainian economy," said Timothy Ash, an emerging markets analyst at Standard Bank.

Ukraine's foreign reserves stood at \$21.65 billion on August 31 — insufficient to cover three months of imports.

Worryingly for investors, Moscow has been angered by Ukraine's apparent preference for a free trade agreement with the EU, due to be signed in November, over a customs union with Russia.

Russia recently restricted Ukrainian exports by increasing nontariff barriers for several weeks — a serious move as Russia accounts for about 25 percent of Ukraine's total exports, Moody's said.

Ukraine is also seeking a loan from the IMF, or International Monetary Fund, though it may find the conditions attached hard to swallow — particularly the requirement to cut gas subsidies just ahead of the 2014 general elections.

"Loss of confidence, locals fleeing the currency, a big current account deficit to cover, significant corporate balance sheet exposure to dollar debt — it would be more painful for households if the default occurs than if gas subsidies are reduced," said David Hauner, an analyst with Bank of America Merrill Lynch.

"But with an election coming up, I can't see this happening," he said.

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