

It's time to get creative on Ukraine's debt

By Timothy Ash and Alex Garrard | 13 July 2023



Public and private sector lenders must work together

In June, government representatives from around the world came together to create the right conditions for [Ukraine's recovery and reconstruction effort](#), which should be led by the private sector. The [Ukraine Recovery Conference](#) included welcome commitments of support in the fields of commercial risk insurance, co-investment and guaranteed lending as well as technical assistance in supporting Ukraine's candidacy for European Union membership.

While such official support is a prerequisite for the [country's successful recovery and reconstruction](#), commercial external debt remains in limbo following the debt service suspension agreed in August 2022. Consequently, market access for both the sovereign and, critically, the private sector remains closed off and the budget is overwhelmingly reliant upon official sector financing.

Prudent fiscal and debt management over the 2015–22 period has meant that, 16 months into the conflict, Ukraine’s debt-to-gross domestic product is still below 80%, which is well below 2015 levels. While this ratio may rise a bit over the coming year, a dynamic, construction-driven recovery will create ample space to absorb new debt while lowering key debt ratios towards sustainable levels.

However, the damage done by Russia’s illegal invasion has created large multi-year financing gaps – \$25–30bn annually under the International Monetary Fund’s baseline and downside scenarios – which will need to be filled by assumptions about debt relief, market access and reparations payable by Russia.

The IMF’s current financing arithmetic assumes that Ukraine will be able to re-establish access to international capital markets relatively soon after the end of the programme in 2027 (it took just two years after the 2015 debt restructuring). But the amounts assumed don’t even touch the sides of what is required when set against Ukraine’s reconstruction needs.

Who should pay?

There is broad recognition that official sector funding commitments alone will not be enough to plug the gaps. Attention at the URC was therefore rightly focused on the inevitable need for a major financial contribution from frozen Russian assets. Assumptions about this will clearly need to be incorporated into the financing arithmetic before the parameters of a debt treatment can be negotiated.

Conventional debt relief can play a relevant but ultimately limited role in closing Ukraine’s financing gaps. War-time bilateral lending, multilateral lending and domestic debt are likely to be excluded from any restructuring perimeter. All payments on legacy commercial and bilateral debt are already subject to debt service suspension. The stock of restructurable public debt – Eurobonds, mainly – accounts for less than a quarter of the total public sector debt stock, and its share is rapidly shrinking. The savings that can realistically be generated from a conventional debt treatment are therefore very limited.

The appetite of investment funds which hold the Eurobonds to commit new funding, on behalf of the predominantly western pensioners and individuals whose assets they manage, will be closely correlated to the treatment of the existing debt. Restructured bonds will also need to carry coupons to compensate holders for the cost and risk of holding them, which is likely to be a source of

How can the private sector provide the official sector with the reassurance that much more private funding will be available to Ukraine once a debt restructuring is complete?

One solution is to combine a conventional debt relief exercise with a new money component. Proceeds from new lending would ensure strong positive cashflows from the private sector over the IMF Extended Fund Facility programme period, provide liquidity for government liability management and make available a large pool of capital for financing the budget and reconstruction.

Creditors would provide debt relief via a combination of maturity extensions beyond the end of the programme and lowering debt claims to create space in the debt arithmetic for committed new lending. Collective action clauses would be invoked on the base terms, but creditors participating in such an exchange on a voluntary basis would receive future financing rights eligible for use in post-restructuring sovereign issuance.

FFRs would work like discount vouchers, allowing the investor to recoup the upfront haircut over time by purchasing new bonds at a fixed discount to the par issue price, but only in return for committing considerable new money alongside.

By the time Ukraine restructures its debt in mid-2024, the stock of sovereign Eurobonds will stand at roughly \$24bn. Let's assume that investors, in addition to extending maturities past the horizon of the programme, agree to exchange a \$6bn upfront haircut for an equivalent notional amount of FFRs. Those FFRs would allow the ministry of finance to issue new bonds with a market-determined coupon. Investors would settle newly issued bonds at a pre-agreed percentage of 80% of their par value, with the remaining 20% settled in FFRs.

The stock of \$6bn FFRs would be exhausted once Ukraine had issued \$30bn of new debt, and this would raise \$24bn of new money, or \$6bn annually over a four-year period, of which perhaps a quarter would be required to service the restructured Eurobond stock. A secondary market in the vouchers would develop to allow creditors with lesser or greater appetite or capacity to lend to sell or accumulate rights. Secondary market pricing would also allow both creditors and the issuer to glean important signals about appetite for new issuance. The government might see an opportunity to lock in the principal reduction by repurchasing rights itself.

Combining upfront debt relief with credible new money commitments from the private sector would provide significantly higher certainty about financing assurances, reopen market access immedi- ly

with new money commitments – is critical to restoring Ukraine’s credit rating standing and complementing future private investment initiatives in the real economy. Having that discussion sooner rather than later will only serve to reduce the scope for delays once a debt operation becomes practicable and strengthen the laudable objectives of the URC.

Timothy Ash is Senior Sovereign Strategist at RBC-Bluebay Asset Management, and Associate Fellow on the Russia and Eurasia Programme at Chatham House. Alex Garrard is a Founding Partner and Portfolio Manager at Amia Capital.

Latest

COMMENTARY



Oscar Lewisohn: in best traditions of Anglo-Continental finance

ON DEMAND



March FOMC meeting outcomes

MEETING



Financial Stability Conference 2024: Turbulent Times

REPORT

Building inclusive
financial systems
in the Middle
East and Africa



Policy Center for
the Digital Economy



OMFIF

Connect with our membership team

 CONTACT



Subscribe

Select topics and stay current with our latest insights

Send

Who we are

Become a member

Media enquiries

Careers

Contact us

Privacy policy

Cookie policy