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Ukraine: Next in line for bankruptcy?

While the world was anxiously waiting for the outcome of Greece's debt restructuring, Ukraine continued to struggle with its own debt refinancing challenges. Ukraine's public debt rose from 10 per cent in 2007 to around 40 per cent today. Country borrowed USD3bn (3 per cent of GDP) from the International Monetary Fund (IMF) at the peak of the crisis in 2008 with the first part of the loan due this year. The country's Deputy Minister of Economy Vadym Kopylov acknowledged yesterday that the government will seek to postpone the debt repayment to the IMF for up to ten years. The IMF reported that it had not received any formal request for debt restructuring yet.

Deputy Minister's statement reveals chronic fundamental problems of the Ukrainian economy. Neither the level of the national debt (40 per cent of GDP), nor the budget deficit (-3 per cent of GDP) are critical. However, the country barely attracts foreign currency due to the weakening exports and increasing prices of energy imports. This led to the currency reserves depletion from USD40bn in 2009 to USD30bn today. Western banks have also contributed to the reduction of foreign reserves by continuing to withdraw funds from their subsidiaries in the country. Therefore, the refinancing of foreign currency denominated liabilities has become Ukraine's biggest challenge. In addition, international bond market is virtually shut for the country as the yield of 3-year USD denominated bonds currently stands at 8.5 per cent. Ukraine's foreign currency earnings may be even lower this year due to expected lower grain yields and a higher oil price.

Ukraine could reduce its borrowing needs by at least 1.1 per cent of GDP annually. It needs to abolish the gas price subsidies for domestic consumers. Not surprisingly this is the main condition required by the IMF before it continues any further discussions on loan extension.

Ukraine found itself on the brink of insolvency at the end of 2011 when it had to return the USD1.5bn debt to a Russian bank. However, the loan was rolled-over and increased to USD2bn with the maturity at early July, 2012. Ukraine will most probably be able to use existing resources to live through 2012 but the state finances are definitely on the wrong track.

Influence on Lithuania: Exports to Ukraine in Lithuania's export structure was at 3.6 per cent in 2010, albeit declined to 3.3 per cent in 2011. Should Ukraine make a radical decision to use its foreign reserves to repay its debts, the country's central bank might be forced to devalue its local currency hryvnia from 8 to about 9 to 10 hryvnia per U.S. dollar. In this case, the competitiveness of Lithuanian goods in Ukraine's market would decrease. However, the impact of Ukraine's financial problems on Lithuania remains modest.

Best regards,

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