

Ukraine's Debt Default, Kiev's Desperate Financial Maneuvers, and the IMF's Backroom Deals

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Ukraine is headed straight toward a full-scale default on its public debt, which currently totals \$70 billion, of which \$40 billion is owed to foreign creditors, about half of whom are private lenders, while the others are official state or public entities (such as foreign governments and international financial institutions).

Strictly speaking, Ukraine has already defaulted, because on September 23 Kiev did not make its scheduled payment on a \$500-million Eurobond. In this case, responsibilities to the private (not state or public) Eurobond holders were not met. According to some sources, these private bondholders are the [Aurelius Capital](#) and [Elliott Management](#) hedge funds, which are notorious financial vultures. A ten-day grace period ended in early October without any moves from Kiev to pay its debts. The International Swaps and Derivatives Association (ISDA) issued [a verdict](#) of «technical default» on October 5, but soon the word «technical» will have to be removed.

After precisely 90 days from this declaration of Ukraine's technical default (the period during which Ukraine can still begin to make payments on its debt), Aurelius and Elliott will start to devour the country's assets. Ukraine will not be subject to any sanctions or lawsuits during those 90 days, but once that period ends – in early January 2016 – all of Ukraine's debt holders will be legally entitled to employ any acceptable means of recovering those debts from Kiev.

Although the \$3-billion loan from the Russian Federation will come due in December, Kiev doesn't have that kind of money. This missed payment would qualify as a full-fledged default, so Kiev is spending these two remaining months frantically searching for a way out of this problem.

The IMF and World Bank recently held their annual summit in Lima, which included a meeting between the finance ministers of Russia and Ukraine, where Natalia Jaresko asked Anton Siluanov to take part in Ukraine's debt restructuring, an agreement on which had allegedly been reached at the end of August. In other words, she asked him to agree to the idea of Ukraine not paying that \$3 billion. The answer was «no,» which should come as no surprise.

It goes without saying that this so-called restructuring of Ukraine's debt is highly problematic. Holders of Ukraine's securities, only about half of which are considered commercial debt, took part in the negotiations on this issue. But half is not much. That ratio should be at least 90%, or even better – 100%.

On October 15, Arseniy Yatsenyuk astounded everyone with the following statement: «The majority of Ukraine's creditors – more than 75% of the votes cast at the meeting of the committee of creditors – agreed to write off a total of \$3 billion of Ukraine's debt and to restructure debt worth another \$8.5 billion.» This was the prime minister's take on the results of the scheduled round of negotiations with Kiev's creditors that took place October 14. But at the same time Yatsenyuk announced that a new round of talks would be held on Oct. 29 in London, and he urged Russia to attend that meeting and to agree to the general terms of the «restructuring» of Ukraine's debt.

That immediately raises several questions. First of all, if the negotiations over the restructuring concluded successfully in late August, why did the Finance Ministry hold further talks on October 14? Second, if the negotiations on October 14 ended successfully, why schedule yet another meeting in two weeks? Third, [the information](#) about the October 14 negotiations that is posted on the website of the Ukrainian Ministry of Finance is very confusing. It indicates that Yatsenyuk has once again been less than truthful. And that's not just my opinion. In an interview with RIA Novosti-Ukraine, the president of the Ukrainian Analytical Center, Oleksandr Okhrimenko, stated, «There has not been any agreement. The meeting has still not taken place, because there has been no quorum. Seventy-five percent of the Eurobond holders had to attend, but they didn't have that many there. Now they all have to reconvene on October 29, and hopefully all of them will manage to make it. Then the exchange process will begin [of Eurobonds for new securities – V.K.]. The ministry's website expressly states that the meeting for the owners of bonds maturing in December 2015 will reconvene in London on October 29, because there had been no quorum at the sessions on October 14. I read this to mean that there has thus far been no vote. Therefore we will await a new vote on October 29.»

I do not think that there will be a quorum at the end of this month in London. And there would certainly be nothing for the Russian representatives to do there anyway.

Yatsenyuk must surely understand all of this, which is why he is frantically promoting «unconventional initiatives» that could preempt the nightmare of a full default in December 2015. One such initiative was the prime minister's statement that Kiev intends to go to the European Court of Human Rights (ECtHR) to demand <http://tass.ru/en/world/829232> that the Russian Federation pay over one trillion hryvnia for its reunification with Crimea. In addition, he is counting on getting compensation through that court from Moscow for the damages inflicted on Donetsk and Lugansk. Yatsenyuk also mentioned Ukraine's lawsuits against Gazprom: «As a separate matter, we also have two key court cases underway against Gazprom, in regard to a contract to buy and sell gas, as well as pertaining to the transit of gas.» Yatsenyuk finished his statement on a threatening note: Kiev is ready to launch a «legal war» against Moscow.

It is difficult to understand the idea behind such statements. The goal must either be to try to put psychological pressure on Moscow to allow the suspension of debt payments and the restructuring of the \$3-billion Eurobond debt, or perhaps to foist upon Moscow a scheme under which counter claims would be used to offset liabilities, freeing Kiev of the burden of all its debts to Russia (the total of which is many times higher than the Eurobond debt). Or perhaps the objective is simply to further inflame Russian-Ukrainian relations and then to take advantage of these rekindled tensions to wheedle the next allotment of money out of the West. It does not look like Kiev has a clear plan, but is operating on the principle of «anything that works.»

In regard to Yatsenyuk's statements about lawsuits, he is, as usual, bluffing. Experts do not believe that his legal claims fall anywhere within the mandate of the ECtHR. And even if the ECtHR agrees to review those claims (for political reasons), that process will take a very long time, during which Ukraine could not only fall into full-fledged default, but foreign creditors could strip the country of 100% of its assets. The Russian president's press secretary, Dmitry Peskov, immediately noted the farcical nature of Yatsenyuk's demands: «Crimea is the territory of Russia. Donbas is the territory of Ukraine. What is this \$1 trillion about? It is not clear. But when it comes to Ukraine's public debt, the Russian position on that remains unchanged.»

In my opinion, Moscow need not hold off until December 20, 2015 – the deadline for the final payment on the loan – with its demands that Ukraine settle its debt. Under the terms of the loan, Moscow was entitled to demand that Kiev repay the entire amount of the loan back in March of this year, when, after the collapse of hryvnia, Ukraine's debt-to-GDP ratio surpassed [the threshold of 60%](#). And they can't wait any longer, because by the first week in January 2016 the financial vultures will have descended upon the arena and Ukraine's debt history will enter a critical phase.

Recently, President Vladimir Putin [suggested](#) that the International Monetary Fund give Kiev a \$3-billion loan, so that money could be used to pay off Ukraine's debt to Russia in December. This would be a simple and effective solution that would forestall Ukraine's financial collapse. But several days have now passed without a response from the IMF.

Behind the scenes, the IMF is currently under fierce pressure from Washington to quickly rewrite the international rules in favor of Ukraine. That might mean that Russia's loan to Ukraine in the form of Eurobond purchases in December 2013 could be treated as commercial credit. Washington is trying to use the IMF to help Kiev force Moscow to accept a restructuring of that debt. The IMF has remained remarkably silent in recent months as Kiev has suggested that Moscow agree to restructure its Eurobond debt, although the fund should have explained to Kiev that Ukraine's debt to the Russian Federation came from an official, state-issued loan and is thus not subject to restructuring.

When it comes to Ukraine, the IMF behaves like Washington's obedient flunky. I would not be surprised if tomorrow the fund – which is today far and away Ukraine's biggest official creditor – announced at Washington's behest that that it was also willing to participate in the restructuring of Ukraine's debt, although nothing like that has ever occurred in the history of the IMF's 70 years of existence.

Ukraine's debt problems are a manifestation of the death throes of more than just that country's economy. It is significant that the day in late December 2015 on which Ukraine must repay its debt to Russia falls on the anniversary of the founding of the IMF in December 1945. So Ukraine's debt problems are also a reflection of the death throes of the International Monetary Fund, and I consider it quite possible that the fund itself might suddenly meet its demise, once its anniversary celebrations are over.

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