Markit Recap – 10/5/2015

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Eastern Europe is generally viewed by credit investors as one of the safer segments of increasingly shaky emerging markets asset class. But the aggressive presence of Russia poses risks, as its neighbours know all too well. On September 23rd the Republic of Ukraine failed to pay principal on its $500m 6.875% coupon bond. A drawn out conflict with pro-Russian separatists in its eastern region and a plunge in price on its most lucrative exports have left the Eastern Bloc country struggling to meet its debt obligations.

Before the missed payment, the ISDA issued a statement citing a potential moratorium event (legal right to delay payment). The reason being that on August 27th, Ukraine decided to "technically" suspend bond payments as the country looked to restructure around $18bn of its debt to shore up its finances. It agreed with bondholders a deal which included a 20% write down in the face value of its bonds.

The restructuring agreement was well received by bond markets. Ukraine's $1.5bn Eurobond due 2020, which incidentally also missed an interest payment last month, saw its price spike 20pts on the back of the restructuring announcement. Its latest bid price is above 80 (cash basis to par), according to Markit's bond pricing service; double the level seen since the depths of March.

News of the missed payment and the subsequent failure to redeem by the end of the grace period wasn't taken lightly by those holding CDS contracts on Ukraine. CDS is used to hedge against potential bond losses.

Unsurprisingly, credit spreads have tightened significantly since the bond restructuring agreement. While still trading on an upfront basis, the cost to insure against $10m of Ukrainian debt over five years has dropped dramatically from $4.6m + 500k annually, to $1.9m + 500k annually.

On Monday morning the Determinations Committee of 15 ISDA members, who include banks and major asset managers, decided that both a Repudiation/Moratorium Credit Event and a Failure to Pay Credit Event with respect to the Republic of Ukraine occurred on or around October 3rd. The two part process, a unique case, led to an auction the following day administered by Markit/Creditex to determine the value of the defaulted bonds and subsequent CDS payouts. It was the first sovereign credit auction since Argentina in September last year.

The final price of the auction was 80.625, which was more or less in line with where Ukraine's Eurodollar debt was trading.

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