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Victory for Putin in fight to force Ukraine to repay \$3bn bond

Shawn Donnan in Washington

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Franklin has been overexposed to emerging markets, such as Ukraine

The International Monetary Fund has handed a victory to Russia's Vladimir Putin in his fight to force Ukraine to repay a \$3bn bond that matures on Sunday, the fate of which has been threatening to force a halt to western efforts to rescue the war-hit Ukrainian economy.

Kiev has been trying unsuccessfully to force Moscow to participate in a restructuring it agreed with commercial creditors including US fund giant

Franklin Templeton earlier this year. But the IMF's executive board ruled on Wednesday that the Russian debt was official, or sovereign, throwing those efforts into disarray.

The decision means that under new IMF rules Ukraine will now have to demonstrate "good faith" in at least attempting to negotiate a restructuring of its debt with Russia if it wants to secure the next instalment of a \$17bn IMF-led rescue programme.

But the "good faith" bar is one that senior IMF officials do not believe Ukraine has yet met. To do so Ukraine's government will probably have to sit down for face-to-face negotiations with Russian representatives, as Moscow ramps up economic pressure on Kiev.

In his latest move, Mr Putin on Wednesday announced that he was suspending a free-trade agreement with Ukraine because of lack of progress in talks over Kiev's signing of a separate trade deal with the EU.

The IMF board last week voted to change longstanding rules that prohibited it from continuing to make emergency loans to any country that defaults on debts to another IMF member economy, drawing a furious reaction from Mr Putin.

Although a change to those rules has been in the works since at least 2013, the US and European IMF shareholders had sought the amendment to make sure that Moscow could not sabotage the rescue of Ukraine's economy. It is expected to contract by 9 per cent this year amid conflict with Russian-backed rebels.

However, with Wednesday's move the IMF board has handed new leverage to Mr Putin over Kiev, and created a new hurdle for Ukraine for its IMF rescue to continue.

"This is a figleaf for the Russians. It makes no sense," said Anders Aslund, a Ukraine expert at the Washington-based Atlantic Council.

The bond was issued by one of Russia's sovereign wealth funds, the National Wealth Fund, in December 2013, as part of an effort by Moscow to prop up the previous government in Kiev.

The Ukrainian government has argued that the sovereign wealth fund is a commercial entity. But the IMF said that both its staff and board had decided that the bond was held by the sovereign wealth fund on behalf of the government.

"Based on the foregoing considerations, staff is of the view that the Eurobond is an official claim," IMF staff wrote in a report.

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