Mini ceasefire to evacuate civilians. Default looms over Russia

The invasion in Ukraine

Temporary ceasefire to open humanitarian corridors agreed

EU grants refugees visa-free travel for one year. Lukoil calls for an end to the invasion. Moody's and Fitch downgrade Russian debt. Gas still at record prices

A glimmer of hope in the Russia-Ukraine war: temporary ceasefire to create humanitarian corridors. The EU grants refugees visa-free entry for one year. But Putin doubles down: "We will continue until we reach our objectives," Putin tells Macron and the Russian Security Council. Commodities skyrocket: gas at €200 per megawatt hour. Stock markets down; Milan -2.3%. Moody's and Fitch downgrade Russia: risk of default. Businesses flee the country: Ikea and Volkswagen among those leaving.

Russian debt is "junk"; the market fears default

Sovereign risk. Moody's and Fitch slash Moscow's securities, which only makes coupon payouts to Russian bondholders

$30 billion in foreign investments at risk

Maximilian Cellino

The threat of default looms over Russian debt, a collateral effect that is naturally of secondary importance compared to the tragic events taking place in Ukraine each day, but one with potentially serious impacts for markets and investors. Yesterday, the ratings agencies Fitch and Moody's downgraded Moscow's stocks to "junk", respectively reassigning ratings of B and B3 and following the similar move made by S&P, which last week downgraded its rating from BBB- to BB+.

However, it is possible that the ratings slashes made by the agencies may only be an intermediary step and may herald Russia's failure to repay coupons or debts to subscribers as Russian markets are currently experiencing an unprecedented situation of sanctions and blocked payment systems. "Russian financial assets are currently difficult to exchange," admits

"The maturity test: $107 million in coupons are due in mid-March, with over $400 million due by the end of the month

Francesco Castelli, Head of Fixed Income at Banor Capital, "because investment banks are prohibited from processing some of them and, in many cases, are preferring to keep their distance, contributing to the market's illiquidity".

Besides the obvious difficulties associated with the economic and financial impacts of the war, there are also obstacles linked to the material operation of the stock markets themselves. "There are some technical market challenges that need to be confronted," adds Nachu Chockalingam, Senior Credit Portfolio Manager of the International Division of Federated Hermes. In particular, these challenges regard cash transfers for coupons and repayments to foreign investors. "If these payments aren't made by the deadlines," warned Chockalingam, "we may see technical defaults".

The 1998 precedent

Meanwhile, the Federation's strength of will should not be underestimated. Russia may refuse to honour its commitments in retaliation, even if it is able to do so. When it comes to insolvency Moscow's record is far from clean, and, if nothing else, the previous Russian financial crisis in 1998 bears certain similarities to the current situation: the collapse of the rouble and the Russian stock market, for example, albeit not set against the backdrop of a military conflict and the trigger instead represented by the Asian financial crisis.

This time, significant sums are at stake for foreign investors who, according to data from the Russian central bank, in early February, held Russian government bonds in local currency worth almost $30 billion and sovereign Eurobonds of around $20 billion. Indeed, the Russian Settlement Depository has already announced coupon payouts of $96 million exclusively to Russian bondholders, shutting out foreign investors. Meanwhile, the fate of bonds in "strong" currencies is likely to be decided soon, given that coupon payments of $107 million are due in mid-March and over $ 400 million are up for payment by the end of the month — to say nothing of the $2 billion in bonds due for repayment in early April.

The situation in Ukraine is, understandably, even more complicated. The Ukrainian government, which defaulted in 2014 during the crisis brought on by the conflict in Crimea, is attempting to sell a new "war bond" after the initial €244 million bond announced two days ago. "Compared to then, the country's accounts were going through a different phase, with the value of foreign exchange reserves more than tripled, a current account surplus, a debt/GDP ratio of less than 15% and a stable exchange rate with the dollar", notes Luc D'hooge, Head of Emerging Market Bonds at Vontobel, going on to clarify that, "these were the values at the start of the year. Now, a technical default is more than likely".

The business situation

The situation in the corporate world is similarly complicated, where in certain sectors the combined weight of Russian and Ukrainian issuers is far from negligible. According to the calculations of Federated Hermes, in the energy sector, the bonds of the two countries are worth over 3% of European investment grade indices and over 6% when it comes to high yield bonds, but shareholdings in the heavy industry, utility and transport sectors are also significant.

"Certain companies are trying to remain solvent," notes Castelli, "for example, Gazprom is doing everything it can to pay a bond close to maturity". However, the picture depends on how events unfold. "If the crisis resolves quickly," Castelli adds, "we think that at least high-quality credit issuers could honour their commitments, but if the situation continues, we can't rule out that the long-term effect of sanctions could result in a general blockage in coupon payouts and bond repayments". In effect, the war risks changing the very nature of the markets.

KEYWORDS

#Junk bonds

The term "junk bonds" refers to bonds assigned the lowest rating by the three leading ratings agencies (Fitch, Moody's, S&P). A junk rating is well below investment grade, the rating given to bonds that, due to the underlying assets, are most likely to yield returns.