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N. Krylova, PhD, Associate Professor,
Taras Shevchenko National University of Kyiv

GOVERNMENT DEBT MANAGEMENT IN UKRAINE: IMPACT OF EUROPEAN DEBT CRISIS

Остання глобальна економічна криза, дуже повільне відношення та поточна боргова криза в Європі підняли фундаментальні питання в сфері макроекономіки та економічної політики. Наслідки, з якими заткнулися всі країни, вимагають нових теоретичних підходів для їх подолання. Це означає, що традиційні теорії не можуть надати нам рецептів для розвитку ефективної макроекономічної та фінансової політики. Стаття присвячена ідентифікації ступеню впливу поточної боргової кризи в Європі на процес управління державним боргом в Україні. Необхідно визначити ступінь впливу фінансових проблем в ЕС на економіку України, що дозволить нам актуалізувати підходи управління держборгом.

Ключові слова: глобальна криза, Європейська криза заборгованості, економіка України, своп кредитних дефолтів, основні показники заборгованості, вплив боргової кризи на економіку, міжнародні інвестиції, міжнародна торгівля, дефіцит бюджету.

Последний глобальный экономический кризис, весьма медленное восстановление после него и текущий кризис задолженности в Европе подняли на поверхность фундаментальные вопросы в сфере макроэкономики и экономической политики. Последствия, с которыми пришлось столкнуться всем странам, требуют новых теоретических подходов для их преодоления. Это означает, что традиционные теории не могут предоставить нам рецептов для развития эффективной макроэкономической и финансовой политики. Статья посвящена идентификации степени влияния текущего финансового кризиса в Европе на процесс управления государственным долгом в Украине. Необходимо определить степень влияния финансовых проблем в ЕС на экономику Украины, что позволит нам актуализировать подходы управления госдолгом.

Ключевые слова: глобальный кризис, Европейский долговой кризис, экономика Украины, своп кредитных дефолтов, основные показатели задолженности, влияние долгового кризиса на экономику, международные инвестиции, международная торговля, дефицит бюджета.

The last global crisis and the weak recovery that has followed, the current debt crisis in Europe raise fundamental questions concerning macroeconomics and economic policy. The complications of the recent outcomes require new theoretical approaches to cope with them. It means that traditional theories will not give us the recipes and will not allow developing efficient macroeconomic and financial policies. The paper is devoted to identification of the depth of recent financial crisis in Europe onto the government debt management in Ukraine. It is necessary to identify the level of impact of the financial problems in European Union on to the Ukrainian economy, which will allow us to update the main patterns for the government debt management.

Keywords: Global crisis, European debt crisis, economy of Ukraine, credit default swaps main debt indicators, impact of debt crisis on economy, international investments, international trade, budget deficit.

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There are a huge number of theoretical and practical researches have studied spillovers from the financial system to the economy in general using models with financial imperfections. A subset of researches focuses on the "financial accelerator" and argues that the amplification and propagation of a credit shock operates through information asymmetries between lenders and borrowers and a balance sheet effect.

An increase in asset prices pushes up the net value of firms, wealth of households or countries, and improves the capacity to borrow. Through general equilibrium effects, this dynamic then leads to further increases in asset prices. In this way, strong balance sheets in boom periods may lead to lending against inflated values of collateral. In a recent contribution that does not include a financial accelerator. Mendoza (2010) studied how fluctuations in asset prices can affect the value of collateral required for international funding. Output falls when the economy becomes overleveraged and access to working capital financing is reduced.

Of course there are additional reasons why credit growth and quality are pro-cyclical aside from a financial accelerator.

The main impacts of the European debt crisis on the Ukrainian economy are the following:

Trade impact

- Reduction of the volumes of international trade. As far as EU is one of the main trade partners of Ukraine.
- Deterioration of the trade balance as the results of export reduction, which is the consequence of Euro depreciation, decrease of purchasing power in EU.

Investment impact

- Reduction of investments in Ukraine both foreign direct investments and portfolio investments. Investments in Ukraine were of high risk even before, and the risk aversion of European investors will be even higher. European Union accounted 78,9% of foreign investments in 2011. So, any reduction from the EU investors will have a negative impact on the further development of Ukrainian economy.

- Activity of European based banks in Ukraine became more conservative, which is caused by a number of reasons where one of them

Current forecast for the second wave of the global recession would have a significant affect on the Ukrainian economy. The main reasons were the dominating market trends, which similar to those ones, which had been observed I 2008. However, the source for the financial crisis in 2008-2009, were the excessive private loans in USA, but in the current situation the reason is the governmental debts in European countries [3].

IFM changed the assessments of world economy development indicators to reduce the numbers: from 4,4% in April to 3,8% by the end of the 2011. International rating agencies reduced the credit rating for many European

countries and in August 2011 Standard & Poor's reduced the credit rating of the USA from the top AAA to AA+ with negative prognoses [1].

Debt problems of developed countries, slow down of rates of world economy development and significant deterioration of future expectation, determined the instability on international financial markets and outgoing trends of capital flows from the developing countries into the developed countries.

Limitation of accessability to the financial resources on the international capital markets is combined with costs of borrowing for any type of borrowers. For example, Italy placed the 10-years bonds at 7%, and 3-years notes at 8%. However, in June 2011 the Ukraine (Ministry of Finance of Ukraine) managed to place 5-years bonds of 1.25 billion USD at 6,25% with the format "144A/Reg S" [4].

Table 1. Debt Indicators of EU Countries, %

Рік	Debt to GDP Ratio, in euro	Debts in other currencies (other than euro) to GDP	Residents debts, in the GDP	Non Residents debts, in GDP
2011	77,9	0,8	36,6	42,2
2010	68,6	0,7	32,5	36,8
2009	65,4	0,5	32,1	33,9
2008	67,7	0,6	33,8	34,4
2007	69,1	0,9	35,5	34,6
2006	68,6	0,8	37,5	31,9
2005	68,1	0,9	39,3	29,8
2004	66,7	1,3	39,9	28,0
2003	66,7	1,5	41,8	26,4
2002	67,4	1,8	44,0	25,2
2001	69,9	2,0	48,7	23,3

Source: Created based on ECB data [4]

In EU countries and other countries, similar to Ukraine who invest a lot of money to save their banking system the debt pressure on the government finance increased dramatically. Lack of ability to pay off the mandatory debts payments (interest plus loan) with the reduction of ability to re-structure the debts causes the increment of bonds' yields and costs of insurance via credit default swap contracts.

The highest ratio of Government debts to GDP were in Greece (145 %) and Italy (118,4 %). The biggest budget deficit to the GDP had Ireland (-31,3 %) and Greece (-10,6 %). Also, 14 out of 27 EU countries and 12 out of 17 countries of euro zone exceed the Maastricht's criteria of convergence.

Financing of budget deficit via the loans increase the debt pressure on the EU countries and, as a result forces investors to re-estimate their risk tolerance to the government bonds investments. For example, by the November 2011 the yield of 10-years bond in Greece increased by 2 times and reached 31%, Portugal - 12,1%, Ireland - 8,33%, Italy - 6,24%, Spain - 5,53% ("PIIGS" countries). Bonds issued by those countries have the highest yield but they have the biggest problem with their debts services.

Along with the government bonds yields the spreads for credit default swap (CDS) also increased and as a result the indicator of probability of default. In the case of 5-years CDS the difference of 10 ppt in the cost covering of 1 mln USD loan will cost 10 thousands USD.

The main indicators of health of world economy are the stock market indicators. Reduction of exchange indices is claimed to be the first attribute of the future second wave of crisis. And pre-default state of Italy, Spain, Greece, Portugal and others just support this thesis. USA is also in the difficult position in respect to the lowering of its rating,

which affect the all US businesses. China might be significantly affected due to lowering purchasing power in EU and US. This will cause a lot of problems for any country, which depend on their market, including Ukraine [1,4].

Traditionally Ukrainian stock market trends tend to emulate the US or EU trading flows, but the fact the size of Ukrainian market is quite insignificant means that any reduction in developed countries minimizes the volume of trade in our country. So, it will have a negative effect on Ukrainian companies, particularly on public ones.

European debt crisis causes the depreciation of euro. This fact will reduce the competitiveness of the countries, whose export is EU oriented, also, the value of euro transfers to Ukraine (for example, from migrants) is also decreasing.

The next negative effect will be caused by the fact the largest investor in Ukraine is EU. The volume of FDI from EU to Ukraine on the 01.01.2011 was 35,2 bln USD, which is accounted 78,8% of the total volume of FDI. Main investors (accounted 82% of EU investments) are Cyprus, Germany, Netherlands, Austria and France. The positive fact is that there are no countries with the greatest debts problems among main investors.

European banks are already reduce their activities in Ukraine, which they explain with the debt crisis in EU. However, this is not the only reason, among others they name the low level profits or even losses they had in Ukraine, unclear prospects of the economy, complex legislation and corruption in justice system, which speed up the migration out of Ukraine by European banks.

In the same time ECB prognosis the prime refinancing rate for 2012-2013 at 1%, which is relatively safe and its stability reduces risks and allows making other forecasts.

Table 2. Main economic indicator of EU countries

	1Q12	2Q12	3Q12	4Q12	2011	2012	2013
Real GDP growth, %	(0,7)	(1,1)	(0,5)	0,0	1,5	(0,6)	1,2
CPI	2,6	2,5	2,6	2,2	2,7	2,5	1,7
Budget Deficit (% GDP)					(4,4)	(2,5)	(2,2)
Unemployment level, %	10,7	10,9	11,1	11,3	10,2	11,0	11,5
Re-finance rate of ECB, %	1,00	1,00	1,00	1,00	1,00	1,00	1,00
Yield of German Government 10-years bond	1,75	1,65	1,50	1,75	1,83	1,75	2,50
\$/euro	1,25	1,20	1,23	1,25	1,31	1,25	1,30

Source: create based on Nomura Global Weekly Economic Monitor 23rd March, 2012 [5]

In the second quarter 2012 the rate for the GDP growth will be the lowest and will be 1,1%, and will be 1,2% in 2013.

Such prognosis directs us to the conclusion that 2013 will be the year of enhancement of the situation with debts of some countries in Europe.

The crisis in EU will affect both trade and investment areas and as a result will have a negative effect on the hryvna's exchange rate. However, EU remains the main strategic partner for Ukraine.

Negative implications of government debts on the economy can be grouped into the following blocks:

1) Dependency of national economy on countries – lenders, international organizations and non residents, who are buying governmental bonds. Such problem is important as far as it is hard to predict non residents' behaviour, financial system became dependant on the lenders requirements (cut down of social programs, level of budget deficit, etc.) and can cause the imbalance of financial system.

2) Existing of significant governmental debts. Such problem is related to the necessity of serving the foreign debts. Annual increment of outgoing payments, which are financed by the tax income, will cause either the reduction in other governmental programs financing, such as social and economic programs or increase of tax rate. Such situation can imbalance the budget system.

Positive impact of foreign debts will be caused by the ability to use them as a source of investments under effective budget mechanism, which implies considering of

exchange rate dynamic and purchasing parity assessments on the local and foreign markets.

Conclusions. Consequences of foreign debts impacts on the macroeconomic of Ukraine prove the necessity incorporate the ratio of government debts along with other indicator under development of balanced strategy of economic growth. There are 2 groups of indicators: indicators, which reflects flows and indicators, which reflects balances.

Crisis in EU does have a significant negative effect on the current and future development of Ukrainian economy. Investments in Ukraine were quite risky even before crisis in Europe and it became even less attractive for most of European investors, who do not want to take such risks. Cutting down of foreign investments will cause the deterioration of economic growth and this will cases the living standards in Ukraine. However, EU remains to be the main partner, but the role of each country must be defined by its possibilities for mutual beneficial cooperation.

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