Medium-Term State Debt Management Strategy for 2021 - 2024

Introduction

The Medium-term state debt management strategy for 2021 - 2024 (hereafter referred to as the Strategy) is a tool designed by the Ministry of Finance of Ukraine (hereafter referred to as the MinFin) to assess the current status and dynamics of the state debt of Ukraine and define objectives, targets and tasks over the medium term to optimize state debt structure from a cost/risk perspective while preserving an acceptable level of debt burden for the country.

The Strategy is being implemented in the context of Ukraine's macroeconomic robust historic and forecasted growth which will resume after the 2020 Covid-19 economic contraction. The Ukrainian economy has turned to a sustainable growth phase. The country's economic recovery has been supported by a strong commitment from international financial organizations (hereafter referred to as the IFIs), which has materialized amongst other ways through provision of concessional loans.

Despite the economic crisis resulting from Covid-19 outbreak, **Ukraine's state debt management primary objective remains to secure the required financing at the lowest possible cost, while containing risks over the medium term**. In this respect, 4 main objectives for state debt management have been identified:

1. *Increase the share of state debt denominated in local currency.*
2. *Lengthen average debt maturity, and ensure a smooth state debt repayment profile.*
3. *Attract long-term concessional funding.*
4. *Continue developing strong investor relationships and further improve the state debt management policy framework.*

Debt sustainability analysis highlights a relatively low level of risks within Ukraine's current debt structure. According to rating agencies, Ukraine as a sovereign is successfully overcoming the pandemic crisis in terms of debt security. State debt to GDP ratio, standing at 53.9% (with ca. 69.6% as an average for countries with "B" rating) as of end-2020, is expected not to exceed the 47% target by the end of 2024. FX risk, refinancing risk and debt management risks have been identified as key threats to state debt sustainability for the upcoming years. One of the tasks of this Strategy stands in the constant monitoring and mitigation of mentioned risks.

Indicative roadmap over the current and the next three years foresees construction of EUR-denominated Eurobond yield curve and support of USD-denominated Eurobond yield curve, increase in issuance of UAH-denominated domestic government bonds, particularly by means of enhancing the participation of international investors in the Ukrainian domestic market. Also, pro-active liability management operations through buyback of government securities will be further performed subject to favorable market conditions. The purpose of the mentioned liability management exercises is to further smoothen Ukraine's state debt service profile and reduce peak pressure on the state budget. Other measures within this Strategy will be implemented in order to strengthen investor relations and improve Ukraine's credit ratings as a borrower.

Major regulations for state debt management:

Budget Code of Ukraine

Laws of Ukraine on the State Budget of Ukraine for the relevant year

Law of Ukraine "On Capital Markets and Organized Commodity Markets"

Resolution of the Cabinet of Ministers of Ukraine dated 01.08.2012 No 815 "On approval of the Procedure for monitoring risks associated with the state (local) debt management"

Resolution of the Cabinet of Ministers of Ukraine dated 31.05.2021 No 548 "On approval of the Budget Declaration for 2022 - 2024".

1. Ukraine's state debt snapshot

State debt split by holders as of end of period

	2018		2019		2020	
	UAHbn	% of total	UAHbn	% of total	UAHbn	% of total
External debt	**1,099**	**59%**	**932**	**53%**	**1,259**	**56%**
International financial institutions	418	22%	332	19%	493	22%
Bilateral loans	48	3%	39	2%	44	2%
Commercial banks	11	1%	33	2%	61	3%
Eurobonds holders	622	33%	528	30%	660	29%
Domestic debt	**761**	**41%**	**829**	**47%**	**1,001**	**44%**
NBU	2	0%	2	0%	2	0%
Domestic government bond holders	446	24%	520	30%	696	31%
State banks, SOEs and DGF (recapitalization)	312	17%	308	17%	302	13%
Owners of VAT refund bonds	1	0%	0	0%	0	0%
Total state debt	**1,860**	**100%**	**1,761**	**100%**	**2,259**	**100%**
as % of GDP	***52.2%***		***44.3%***		***53.9%***	

State debt split by instruments as of end of period

	2018		2019		2020	
	UAHm	% of total	UAHm	% of total	UAHm	% of total
Marketable securities and loans	**839**	**45%**	**818**	**46%**	**1,127**	**50%**
Domestic government bonds	217	12%	290	16%	467	21%
Eurobonds	622	33%	528	30%	660	29%
NBU and commercial bank loans	**13**	**1%**	**35**	**2%**	**63**	**3%**
Concessional loans	**466**	**25%**	**371**	**21%**	**537**	**24%**
International financial institutions	418	22%	332	19%	493	22%
Bilateral loans	48	3%	39	2%	44	2%
Other, incl. recapitalization	**542**	**29%**	**537**	**30%**	**532**	**24%**
Total state debt	**1,860**	**100%**	**1,761**	**100%**	**2,259**	**100%**
as % of GDP	***52.2%***		***44.3%***		***53.9%***	

State debt and state guaranteed debt as of end of period

	2018		2019		2020	
	UAHbn	% of total	UAHbn	% of total	UAHbn	% of total
Total state debt	**1,860**	**100%**	**1,761**	**100%**	**2,259**	**100%**
as % of GDP	***52.2%***		***44.3%***		***53.9%***	
State-guaranteed debt	**308**	**14%**	**237**	**12%**	**293**	**11%**
as % of GDP	***8.7%***		***6.0%***		***7.0%***	
Total public debt	**2,168**	**100%**	**1,998**	**100%**	**2,552**	**100%**
as % of GDP	***60.9%***		***50.2%***		***60.8%***	

State debt split by currency as of end of period

	2018	2019	2020
	% of total	% of total	% of total
UAH	33%	41%	38%
USD	48%	42%	39%
EUR	9%	11%	15%
XDR	8%	6%	8%
JPY	1%	1%	1%
CAD	0.4%	0.2%	0.0%
Total state debt	**100%**	**100%**	**100%**

State debt split by interest rate type as of end of period

	2018	2019	2020
	% of total	% of total	% of total
Fixed	75%	78%	78%
Variable	25%	22%	22%
Total state debt	**100%**	**100%**	**100%**

State domestic debt split by remaining maturity as of end of period

	2018	2019	2020
	% of total	% of total	% of total
< 3 years	32%	33%	46%
3-5 years	5%	9%	10%
5-7 years	8%	10%	5%
7-10 years	10%	9%	9%
> 10 years	46%	40%	30%
Total domestic debt	**100%**	**100%**	**100%**

State external debt split by remaining maturity as of end of period

	2018	2019	2020
	% of total	% of total	% of total
< 3 years	23%	18%	12%
3-5 years	8%	10%	19%
5-7 years	19%	18%	9%
7-10 years	13%	16%	18%
> 10 years	38%	39%	41%
Total external debt	**100%**	**100%**	**100%**

2. Ukraine's state debt benchmarking

As part of the analysis, a set of over 60 countries was selected based on the size of their economies, their macroeconomic performance in recent years, as well as their credit ratings. From this list of relevant peers only 18 countries, which published a comparable Strategy and up-to-date comparable data on their state debt, were finally selected.

This sample of peers was divided into three categories based on the following classification:

- regional peers: geographical proximity to Ukraine;
- rating peers: similar credit rating according to international rating agencies;
- peers – regional leaders: large EM countries, acting as economic drivers in their regions.

List of selected peers for Ukraine (S&P / Moody's / Fitch: B / B3 / B) by sample

Regional peers (9)	Rating peers (5)	Peers – regional leaders (4)
Albania (B+ / B1 / NR)	**Ghana** (B- / B3 / B)	**Nigeria** (B- / B2 / B)
Bosnia and Herzegovina (B / B3 / NR)	**Jamaica** (B+ / B2 / B+)	**Thailand** (BBB+ / Baa1 / BBB+)
Bulgaria (BBB / Baa1 / BBB)	**Macedonia** (BB- / NR / BB+)	**Turkey** (B+ / B2 / BB-)
Croatia (BBB- / Ba1 / BBB-)	**Montenegro** (B / B1 / NR)	**Uruguay** (BBB / Baa2 / BBB-)
Cyprus (BBB- / Ba2 / BBB-)	**Pakistan** (B- / B3 / B-)	-
Czech Republic (AA- / Aa3 / AA-)	-	-
Hungary (BBB / Baa3 / BBB)	-	-
Poland (A- / A2 / A-)	-	-
Serbia (BB+ / Ba2 / BB+)	-	-

Source Rating agencies

The average indicators for each of the sub-samples were used to benchmark Ukraine's state debt structure within the implemented analysis as well as Ukraine's state debt as of December 31, 2020.

A turning point for global economic development in 2020 was the outbreak of Covid-19 acute respiratory disease caused by the coronavirus SARS-CoV-2, which spread rapidly around the world during 1Q2020. To combat this disease, predominantly all developed countries have introduced strict quarantine restrictions, which have led to a sharp decline in economic activity throughout the world during 1Q2020. An unprecedented level of uncertainty has led to a sharp deterioration in business and consumer expectations creating significant risks for the global recession.

Ukraine, like most countries, has also been negatively affected by the spread of Covid-19. Strict quarantine measures introduced during March-May 2020 provided for a de facto ban on the activities of enterprises in various economic spheres (primarily transport and services), which negatively affected the economic dynamics. As a result of increasing uncertainty, business and consumer sentiment deteriorated, economic activity declined reducing consumption and investment and casting negative impact on actual state budget revenues. At the same time, there has been a growing need to provide resources for priority funding of adjusted public policy priorities, including the establishment of the COVID-19 Response Fund, additional expenditures on health care, education, social support, and economic stimulus measures.

The spread of the Covid-19 pandemic in 2020 has been a global challenge for countries around the world, whose governments have been forced to agree on financial assistance packages to support business and health care facilities, leading to growing budget deficits. Ukraine also did not avoid the need to increase the planned state budget deficit: in April 2020, the deficit propelled from 2.09% to 7.49% of projected GDP. Actual 2020 state budget was executed with a deficit of 5.47% of GDP. The increase in the marginal and actual budget deficits is the result of restrictive measures to prevent the disease spread and the necessary stimulus package to overcome the negative effects of the Covid-19 pandemic.

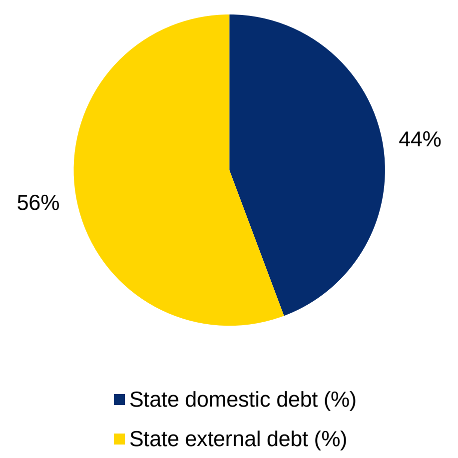
With loosening strict quarantine measures, the adaptation of economic entities to new conditions and the introduction of state support measures, Ukraine's economy have begun its rapid revival. The main drivers of economic recovery were domestic consumer demand backed by increasing wages and improved external demand for domestic exports on the back of recovering prices for basic commodities. Thus, the Ukrainian economy managed to pass 2020 with less losses than expected at the beginning of the pandemic. According to the results of 2020, real GDP decreased by 4.0% against the forecasted decrease of 4.8%, taken into account upon changes to the state budget. At the same time, state debt to GDP ration at 2020YE was 53.9% against 44.3% at 2019YE, while the average one for countries with "B" rating was approximately 69.6%.

2.1 State debt composition

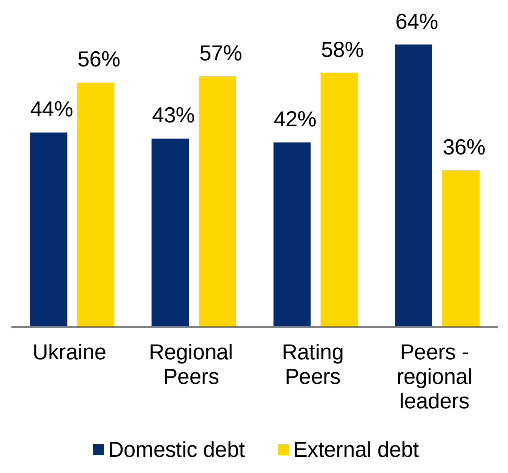
Domestic vs external debt

Ukraine's state debt is characterized by a relatively high share of external debt, accounting for 55.7% of total state debt. Ukraine's share of external debt stands above the average figure for peers – regional leaders. External debt represents, on average, only 36% of total debt for peers – regional leaders. This indicates a relatively higher vulnerability of Ukraine to external shocks. At the same time, the share of external debt for rating and regional peers comprises, on average, 58% and 57%, respectively, and is comparable to Ukraine's share of external debt.

Ukraine's state debt as of 31/12/2020



Ukraine compared to selected peers (% of total)



Increasing the share of state debt denominated in local currency will enable Ukraine to reduce its vulnerability to external factors and is, therefore, **one of the main objectives of state debt management. Ukraine has been succesfully moving towards this objective over** the last three years increasing the share of local currency denominated debt from 33% as of end-2018 to 38% as of end-2020. The task will also be facilitated by the further development of the domestic government bond market through the expansion of the range of available debt instruments, enhancing state debt management predictability and attracting foreign investors to the market.

State debt composition by instruments

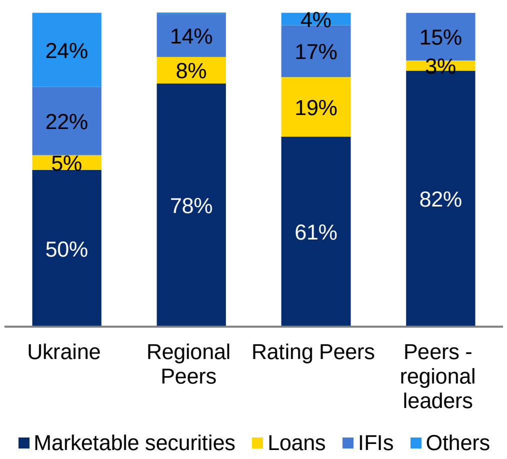
Marketable securities constitute 50% of Ukraine's state debt, including 29% of Eurobonds and 21% of domestic government bonds. The share of domestic marketable securities in total state debt has increased significantly from 12% as of end-2018 to 21% as of end-2020. "Other" category reflects non-market state debt and comprises, in particular, other domestic government bonds issued for the recapitalization of state banks and SOEs. The share of such recapitalization bonds is substantial compared to selected peers, representing approximately 24% of Ukraine's total state debt.

The amount due to international financial institutions and foreign countries represents 24% of the total state debt and illustrates their strong support of Ukraine received over the last few years, especially from the International Monetary Fund (hereafter referred to as the IMF) and the World Bank. This share is considerably lower for the selected peer groups.

Ukraine's state debt structure as of 31/12/2020

	UAHbn	% of total
Marketable securities and loans	**1,127**	**50%**
Domestic government bonds	467	21%
Eurobonds	660	29%
NBU and commercial bank loans	**63**	**3%**
Concessional loans	**537**	**24%**
International financial institutions	493	22%
Bilateral loans	44	2%
Other, incl. recapitalization	**532**	**24%**
Total state debt	**2,259**	**100%**
as % of GDP	***53.9%***	

Ukraine compared to selected peers (%)



State debt composition by currency

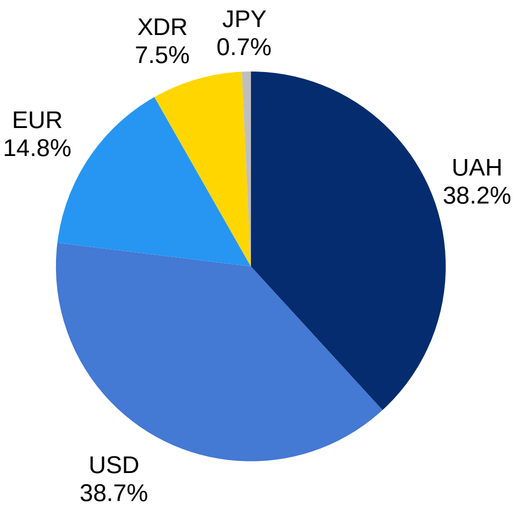
Ukraine's state debt is largely dominated by foreign currency denominated debt with respective share amounting to 62% as of end 2020. USD-denominated debt represents 39% of the total state debt and is predominantly composed of USD-denominated Eurobond series. The second largest category comprises EUR-denominated debt mainly raised as a part of the EU's Macro-Financial Assistance (hereafter referred to as the MFA) as well as EUR-denominated Eurobonds and commercial loans such as loans from Deutsche Bank loans under PBG from the World Bank as well as Cargill loans. SDR-denominated debt raised as part of financing within the IMF programs represents 8% of Ukraine's state debt as of the end of 2020. The existence of domestic debt denominated in foreign currency increases the share of total foreign currency denominated debt and, hence, its FX risk. However, this expands the range of debt instruments and, accordingly, increases the market capacity for government borrowings.

At the same time, USD-denominated debt share decreased during 2020 from 41.6% to 38.7% of the total state debt and from 70.6% to 62.7% of the state debt denominated in foreign currencies, which had a positive effect on the FX risk level.

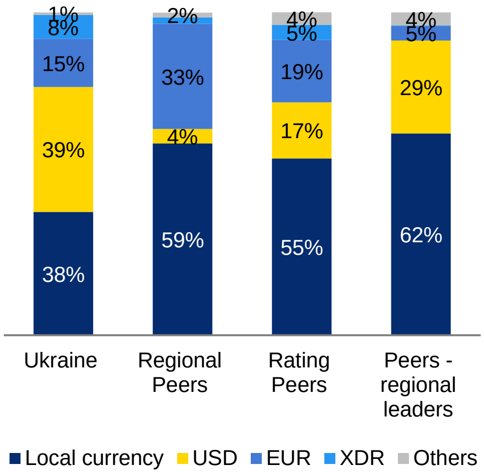
Ukraine's share of local currency denominated debt is lower compared to all groups of its peers (38% vs. 59% for regional peers, 55% for rating peers, and 62% for peers – regional leaders).

These figures underline a priority of Ukrainian government's actions in accordance with the first state debt management objective aimed at deepening the local currency bond market and mitigating FX risks, including by reducing the share of USD in Ukraine's state debt portfolio through the issuance of Eurobonds in other currencies.

Ukraine's state debt split by currency as of 31/12/2020



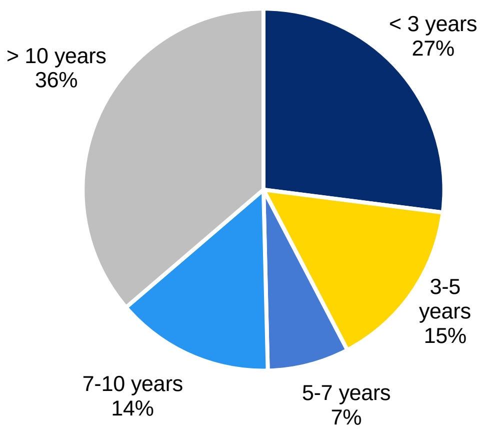
Ukraine compared to selected peers (%)



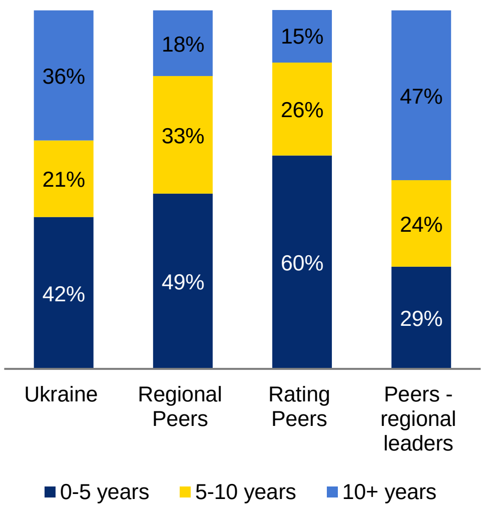
State debt structure composition by maturity

Ukraine's state debt structure by maturity is balanced, with a high portion of long-term debt that is greater as compared to regional and rating peers. The largest share is attributed to debt instruments maturing in more than 10 years. In contrast, the share of state debt maturing in less than 5 years is smaller as compared to regional and rating peers. At the same time, the current structure of Ukraine's state debt portfolio and external debt instruments indicates an opportunity to increase an average term to maturity, including through the issuance of long-term Eurobonds. As of the end of 2020, the weighted average term to maturity of Ukraine's domestic debt (including domestic government bonds in the NBU portfolio) amounts to 6.8 years, while state external debt matures on average in 6.3 years (this represents an improvement since the end of 2019 when the average maturity of the external debt was 5.8 years). As a consequence, the weighted average time to maturity of Ukraine's total state debt stands at 6.5 years.

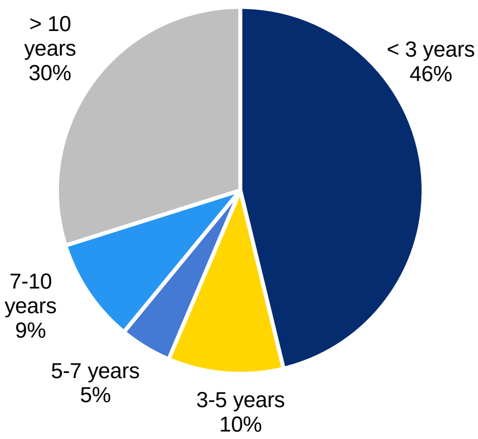
Ukraine's state debt composition by remaining maturity as of 31/12/2020



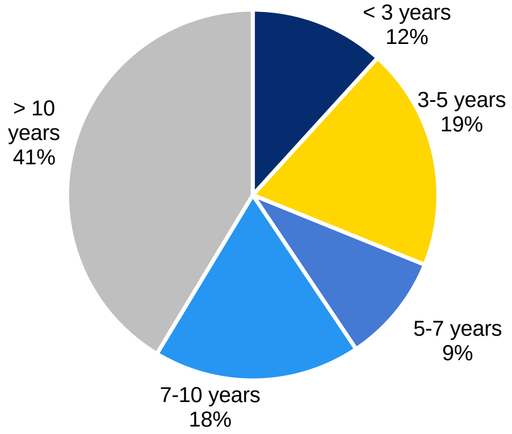
Ukraine compared to regional peers (%)



Ukraine's domestic debt composition by remaining maturity as of 31/12/2020



Ukraine's external debt composition by remaining maturity as of 31/12/2020

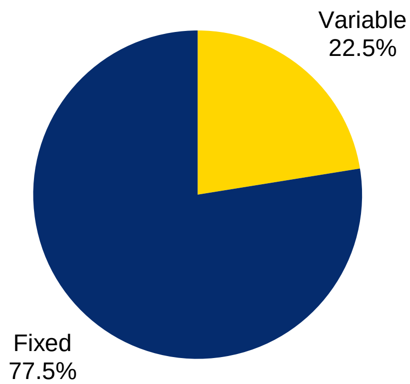


State debt composition by interest rate type

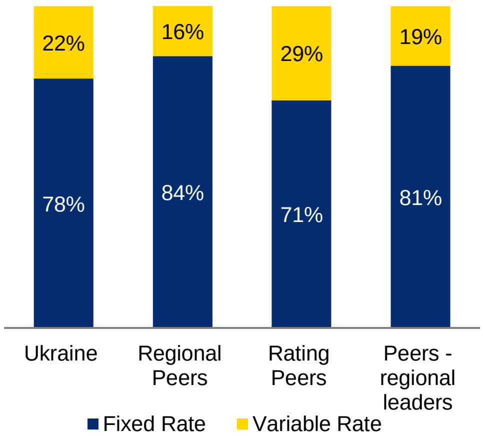
Ukraine's state debt includes a high portion of fixed-rate debt instruments (78%), which contains its interest rate risk. The share of Ukraine's fixed-rate state debt is slightly higher as compared to its rating peers (71%), although lower as compared to its regional peers and peers – regional leaders, which have 84% and 81% of fixed-rate debt, respectively.

Within Ukraine's state debt with variable interest rates, the majority of it is linked to EURIBOR (the Euro Interbank Offered Rate) **and LIBOR** (the London Interbank Offered Rate)**.** Therefore, such state debt interest payments are sensitive to the increase in interest rates in the Eurozone and the USA. On March 5, 2021, the Financial Conduct Authority (FCA) announced that all LIBOR settings for all currencies will either cease or no longer be representative strating from January 1, 2022 (except US Dollar overnight 1-month, 3-month, 6-month and 12-month settings which will cease on June 30, 2023) and have to be replaced.

Ukraine's state debt composition by interest rate as of 31/12/2020



Ukraine compared to selected peers (%)



State debt composition by financing terms

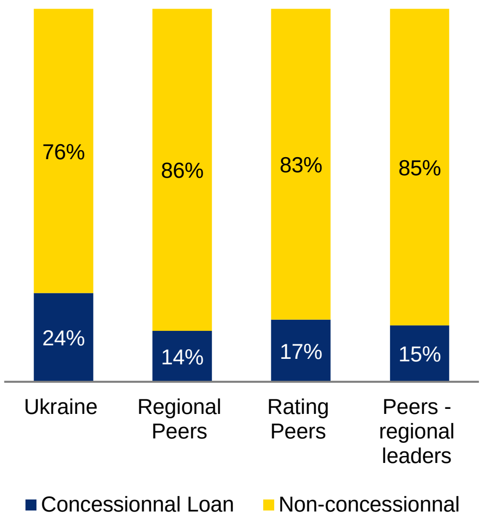
The share of concessional instruments in Ukraine's state debt structure accounts for 24% and is significantly higher compared to regional peers (14%), rating peers (17%), and peers – regional leaders (15%).

A significant share of concessional debt in Ukraine's state debt structure results from considerable support of economic development by international partners. Furthermore, one of the objectives of this Strategy is to increase the amount of financial support by deepening the cooperation with IFIs (EU, IMF, World Bank, European Investment Bank, EBRD), as well as through the development of new partnerships with foreign countries.

Ukraine's state concessional debt composition as of 31/12/2020

	UAHbn	% of total
Non-concessional funding	**1,722**	**76.2%**
Concessional funding	**537**	**23.8%**
of which IBRD	151	6.7%
of which EU (MFA)	132	5.9%
of which IMF	170	7.5%
of which EIB	27	1.2%
of which EBRD	14	0.6%
of which bilateral loans	44	1.9%
Total state debt	**2,259**	
as % of GDP	***53.9%***	

Ukraine compared to selected peers (%)

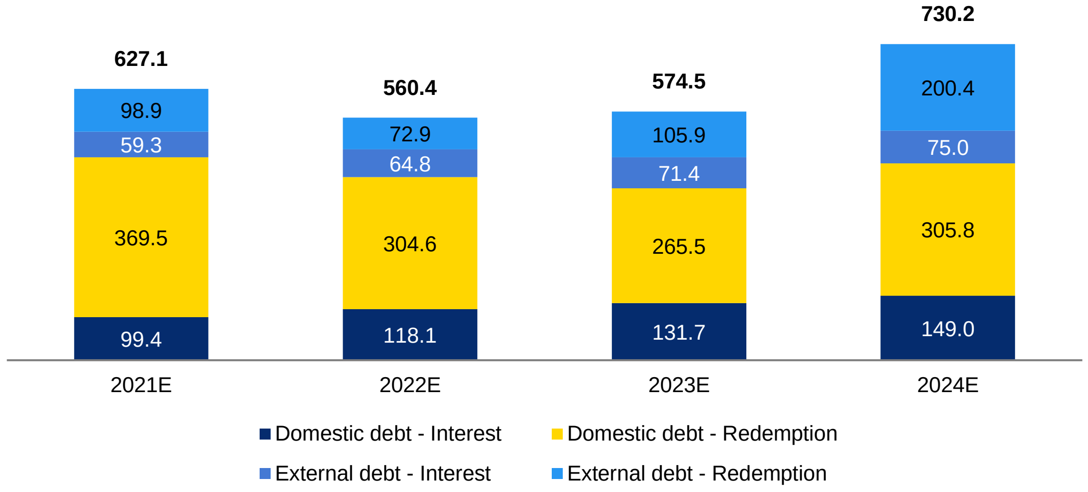


2.2 State debt service

Ukraine's state debt service profile

Ukraine's smooth debt service profile during 2021 - 2024 with a limited number of peaks is a result of **Ukraine's active state debt management policy after the restructuring of state and state-guaranteed external commercial debt in 2015**. The average state debt interest and redemption amount accounts for UAH 623.0bn during 2021 – 2024 with a standard deviation standing at UAH 66.7bn, based on outstanding and planned debt obligations.

Ukraine's state debt service profile (according to the Budget Declaration for 2022-2024), UAHbn



Periods of state debt refinancing peaks

State debt service payments in 2021 - 2024 (according to the Budget Declaration for 2022 - 2024)

UAH bn	2021	2022	2023	2024
Total	**627.1**	**560.4**	**574.5**	**730.2**
Average	**623.0**			
Standard deviation	**66.7**			
Debt payments / GDP	**13.9%**	**10.4%**	**9.6%**	**11.0%**
Debt payments / State budget revenues	**57.1%**	**45.9%**	**43.1%**	**50.3%**

The amount of expected state debt service payments in 2021 is in line with the state debt service in 2022 - 2024. Therefore, the difference between 2021 expected state debt interest and redemption amount and 2022 - 2024 average figure accounts for only UAH 5.4bn. Smoothing payment peaks will be accomplished by issuing new debt with longer maturities and by performing liability management exercises.

2.3. State debt cost

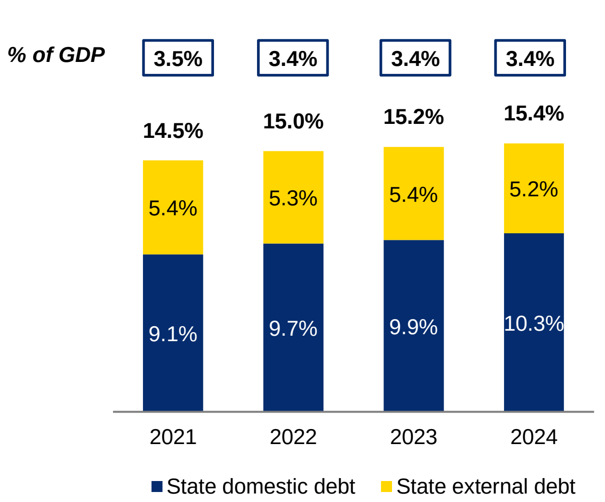
Evolution of Ukraine's state debt interest payments

	2017	2018	2019	2020
State domestic debt interest payments (in UAH bn equiv.)	**71.7**	**73.7**	**73.0**	**74.3**
USD bn equivalent	2.7	2.7	2.8	2.8
% of GDP	2.4%	2.1%	1.8%	1.8%
% of state budget revenues	9.0%	7.9%	7.3%	6.9%
State external debt interest payments (in UAH bn equiv.)	**38.8**	**41.4**	**45.9**	**44.9**
USD bn equivalent	1.5	1.5	1.8	1.7
% of GDP	1.3%	1.2%	1.2%	1.1%
% of state budget revenues	4.9%	4.5%	4.6%	4.2%
Total State budget interest payments (in UAHbn equiv.)	**110.5**	**115.1**	**118.9**	**119.3**
USD bn equivalent	4.2	4.2	4.6	4.4
% of GDP	3.7%	3.2%	3.0%	2.8%
% of state budget revenues	13.9%	12.4%	11.9%	11.1%

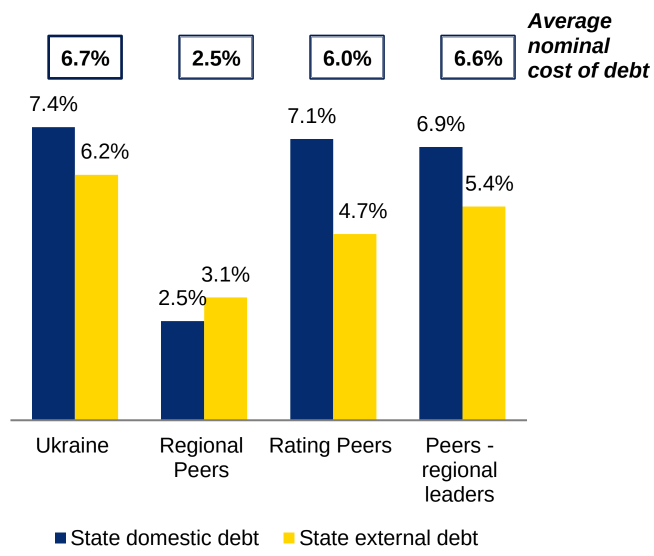
Average state debt cost

Ukraine's weighted average cost of state debt stands at 6.7% as of the end of 2020 and is comparable to rating peers (6.0%) and peers – regional leaders (6.6%). On the other hand, regional peers demonstrate significantly lower cost of debt – at 2.5% on average. Such cost of debt arises from average external debt nominal cost of 6.2% and a relatively higher average nominal cost of state domestic debt of 7.4%, which, in turn, results primarily from corresponding inflation levels and NBU's inflation targeting policy. Over the recent years, Ukraine made significant progress in decreasing the cost of its long-term debt. For instance, the weighted average yield on a domestic government bond due 2025 has decreased at the primary auctions from 15.84% in June 2019 to 12.25% in December 2020. With regard to external debt, the secondary market yields on Ukraine's Eurobonds have mainly recovered to its pre-crisis levels (for e.g., USD-denominated Eurobonds maturing in 2024 had a yield of approximately 5.13% at the beginning of March 2020 and 4.55% at the end of June 2021) after the sharp increase caused by Covid-19 outbreak.

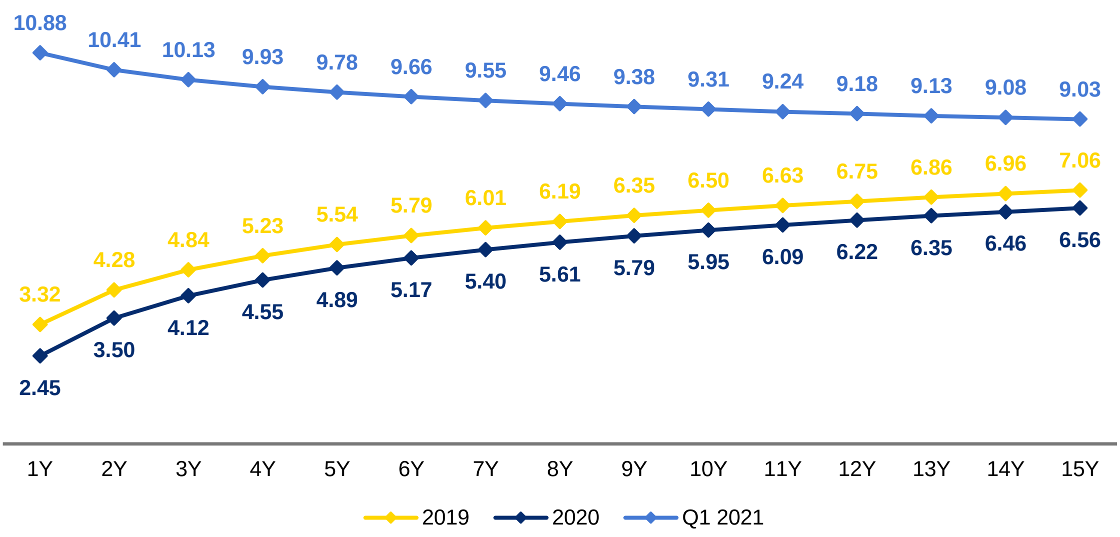
Interest payments on state debt (as % of state budget revenues)



Ukraine's weighted average cost of debt compared to selected peers (%)



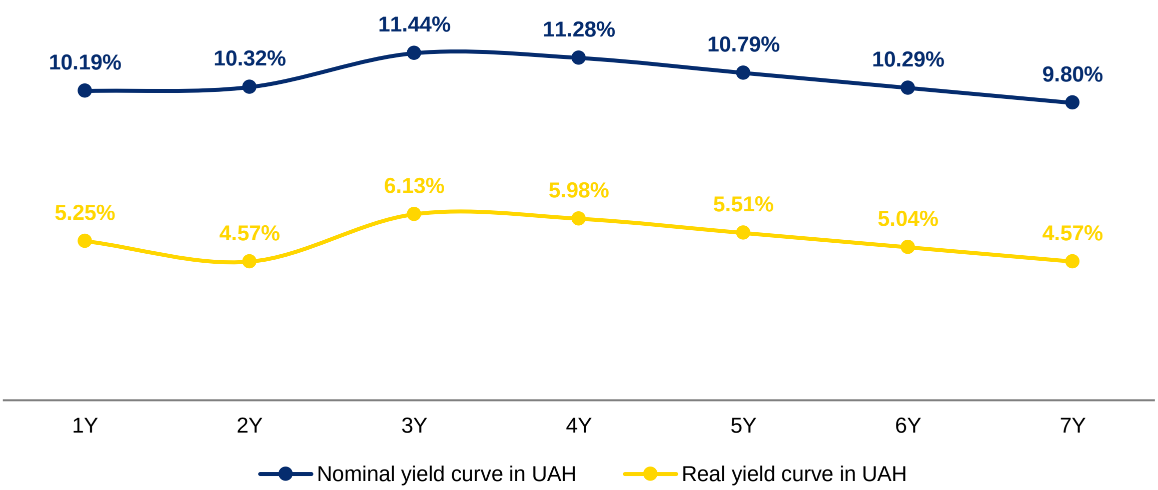
Ukraine's USD-denominated Eurobonds yield curve[1] as of end of period



Source Bloomberg

Eurobond yield curve reflects both trends in global economy and geopolitical tendencies, investors' risk appetite in particular moment, and the impact of Ukraine-related risks.

Ukraine's UAH-denominated domestic government bonds primary yield curve[2]



Source Ministry of Finance of Ukraine

Ukraine's UAH-denominated domestic government bonds real yield curve is U-shaped for the next 3 years and downward slopping thereafter, which is among others due to the corresponding inflation expectations.

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[1] Logarithmic interpolation

[2] UAH nominal yield curve is based on the results of primary auctions in 2020; real yield curve in UAH is calculated by using NBU CPI forecasts from July 2020 Inflation Report (direct forecasts for the first three years and assumed constant CPI at 5% of the NBU's medium-term target afterwards)

2.4 Positive developments over 2019-2021

Ukraine's credit ratings

Поточні кредитні рейтинги України				
	Standard & Poor's	**Fitch**	**Moody's**	**Rating and Investment Information (R&I)**
Current rating	**B / Stable**	**B / Stable**	**B3 / Stable**	**B+ / Stable**
Last rating action	Rating B Stable Affirmed (March 2021)	Rating B Stable Affirmed (February 2021)	Rating B3 Stable Affirmed (April 2021)	Upgrade from B to B+ Stable (September 2020)
Latest rating upgrade	From B- to B in September 2019	From B- to B in September 2019	From Caa1 to B3 in June 2020	From B to B+ in September 2020

Note As of 30/06/2021

(1) S&P Global Ratings

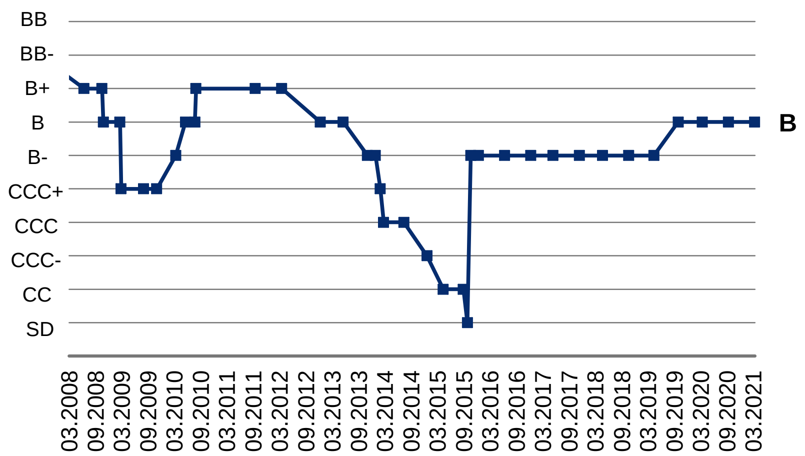
Ukraine's credit rating from S&P is based on the assessment of 5 composing factors, ranked from "1" (highest) to "6" (lowest):

- Institutional assessment with a "5" score;
- Economic assessment with a "5" score;
- External assessment with a "5" score;
- Fiscal assessment with a "4" score;
- Monetary assessment with a "4" score.

The combination of these factors leads to "B" indicative and final long-term foreign currency credit rating supported by the following S&P's conclusions:

- Ukraine's growth, balance of payments, and public finances all outperformed our expectations in 2020;
- Reserve adequacy has improved, providing a cushion against potential adverse external developments including further delays in the disbursement of concessional loans
- However, epidemiological considerations still pose an important risk

Ukraine's historical S&P rating



(2) Fitch

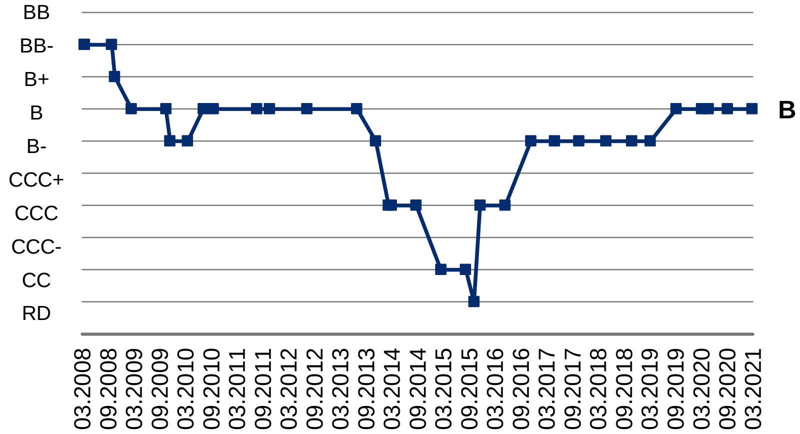
Fitch derives Ukraine’s credit rating based on the assesstment of 18 indicators within the Sovereign Rating Model (SRM). These indicators are grouped under four categories:

- Structural features
- Macroeconomic performance
- Public finances
- External finances

The SRM output leads to “B” indicative and final long-term foreign currency credit rating supported by the following Fitch’s conclusions:

- Track record of multilateral support and a credible macroeconomic policy framework that has underpinned a relatively high degree of resilience to the coronavirus shock
- Ukraine's human development indicators compare favourably with the peer group
- Net external creditor position of close to 13% of GDP
- General government debt is somewhat lower than the 'B' median
- Weak governance indicators (Worldwide Governance Indicators)
- High degree of legislative and judicial risk to policy implementation
- Low external liquidity relative to a large sovereign external debt service requirement

Ukraine’s historical Fitch rating



Cooperation with IFIs

IFIs major support programs as of 30.06.2021.

European Union Macro-Financial Assistance (MFA): On July 9, 2018, the legislative decision of the European Parliament and the Council of the EU on the provision of Ukraine with the Fourth programme of the EU macro-financial support totaling EUR 1bn became effective. This MFA program aims at supporting further economic stabilization in Ukraine as well as the reform agenda. Two tranches within this program were disbursed in December 2018 and June 2020.

On July 23, 2020, the European Commission has signed a Memorandum of Understanding (MoU) with Ukraine on macro-financial assistance (MFA) as a part of EUR 1,2bn package to help limit the economic fallout of the coronavirus pandemic. The MFA programme for Ukraine is worth up to EUR 1.2bn in two equal instalments. In December 2020, Ukraine received the first installment of EUR 600m to the state budget.

Overall, in 2014 - 2020 more than EUR 4.4bn was disbursed to Ukraine within five MFA programs.

IMF: On June 9, 2020, the Executive Board of the IMF approved a new 18-month Stand-By Arrangement (SBA) which is set to expire in December 2021 in the amount of USD 5.0bn representing c.179% of

Ukraine's quota in the IMF. Financing the balance of payment deficit and supporting structural reforms implementation are the key objectives of the program. Ukraine immediately received the first tranche of USD 2.1 bn distributed to the state budget.

The size of the previous SBA accounted for around SDR 2.8bn (about USD 3.9bn) corresponding to 139% of country's quota in the IMF, which, in turn, indicates significant support to economic stability and structural reform implementation by partners in Ukraine. After meeting all prior actions, Ukraine received the first tranche within the Stand-By program totaling USD 1.4bn on December 21, 2018.

World Bank Group: On June 26, 2020, the World Bank's Board of Executive Directors approved provision of USD 350m under the First Development Policy Loan (DPL) for Economic Recovery Project, the respective agreement for which was signed on June 25, 2021. The program aims to enable a recovery investments and economic activity as well as to bolster the social safety net with a focus on the elderly. The Second Development Policy Loan for Economic Recovery in the amount of USD 350m is being prepared.

Overall, since 2014 Ukraine received USD 6.2bn in financing from the World Bank Group (incl. among others 5 DPLs and 13 investment loans and one system project). Most World Bank's investment projects aimed at improving the quality of basic public services, social protection and healthcare policy as well as private sector and energy efficiency development.

Examples of major support from IFIs to Ukraine as of 30/06/2021

IFI	Amount	Selected major program terms
EU	EUR 4.4bn in MFAs (disbursed in 2013 - 2020)	● Macro-Financial Assistance program (MFA) (Covid-19): ○ The agreement signed in July 2020 ○ Total disbursed amount: EUR 600m (total program amount accounts for EUR 1 200m) ○ Interest rate: 1.25% p. a. ○ Maturity date: till 2035 ● MFA IV: ○ The agreement signed in September 2018 ○ Total disbursed amount: EUR 1 000m (two tranches loan) ○ Interest rate: 1.25% p. a. ○ Maturity date: till 2033 (1st tranche) and 2035 (2nd tranche) ● MFA III: ○ The agreement signed in May 2015 ○ Total disbursed amount: EUR 1 200m (two tranches loan) ○ Interest rate: 0.25% p. a. ○ Maturity date: till 2020 (1st tranche) and 2031 (2nd tranche) ● MFA II: ○ The agreement signed in May 2014 ○ Total disbursed amount: EUR 1 000m ○ Interest rate: 1.875% / 1.375% p. a. (two tranches loan) ○ Maturity date: till 2029 ● MFA I: ○ The agreement signed in April 2013 ○ Total disbursed amount: EUR 610m ○ Interest rate: 1.875% / 1.375% p. a. (two tranches loan) ○ Maturity date: till 2029 (1st tranche) and 2030 (2nd tranche)
IMF	USD 16.6bn (disbursed in 2014 - 2020)	Selected programs: ● 18-month SBA program: ○ The agreement signed in July 2020 ○ Total disbursed amount: SDR 1.5bn (total program amount accounts for SDR 3.6bn) ○ Maturity date: till 2025 ● 14- month SBA program: ○ The agreement signed in 2018 ○ Total disbursed amount: SDR 1.0bn (total program amount accounts for SDR 2.8bn) ○ Maturity date: till 2020 ● Extended Fund Facility: ○ The agreement signed in 2015 ○ Total disbursed amount: SDR 6.18bn ○ Maturity date: till 2025 ● 2-year Stand-By Arrangement: ○ The agreement signed in 2014 ○ Total disbursed amount: SDR 2.97bn ○ Maturity date: till 2019

World Bank	USD 6.2bn (committed in 2014 - 2021)	Selected projects and loan facilities: ● Second additional financing to overcome the consequences of the COVID-19 pandemic, within the framework of the Project «Modernization of the Social Support System of the Population of Ukraine»: ○ The agreement signed in December 2020 ○ Total amount: USD 300m ○ Interest rate: Libor 6m + variable spread ○ Maturity date: till August 2033 ● Eastern Ukraine: Reunification, Restoration and Revival (Project 3B): ○ The agreement signed in December 2020 ○ Total amount: USD 100m ○ Interest rate: Libor 6m + variable spread ○ Maturity date: till August 2047 ● Ukraine Emergency COVID-19 Response and Vaccination Project: ○ The agreement signed in May 2021 ○ Total amount: USD 90m ○ Interest rate: Libor 6m + varible spread ○ Maturity date: till October 2040 ● Development Policy Loan: First Economic Recovery DPL ○ The agreement signed in June 2021 ○ Total envisaged amount: USD 350m ○ Відсоткова ставка: Libor 6m + variable spread ○ Maturity date: till February 2050
USA	USD 3.7bn (in form of guarantees and military support)	● Three loan guarantees of USD 1bn each granted within cooperation with USAID in May 2014, May 2015 and September 2016 to support economic recovery and reform progress in Ukraine (Eurobonds under two loan guarantees have been already repaid in 2019-2020)
EIB	EUR 1.0bn in 2020 and EUR 7.8bn since the start of operations in 2007	● Tenor: from 20 to 24 years ● Interest rate: from EURIBOR 6m + 55 bps margin to EURIBOR 6m + 131 bps margin ● Selected projects: ○ Municipal infrastructure development programme ○ Road construction programme ○ Eastern Ukraine infrastructure development programme
EBRD	EUR 0.8bn in 2020 and EUR 4.8bn over 2015-2020	● Tenor: 15 years ● Interest rate: EURIBOR 6m + 100 bps margin ● Selected projects: ○ Improving the transport and operational conditions of highways/road approaches to Kyiv ○ Ukrposhta Logistics Network Development Projects (Ukrposhta Modernization and Digitization and Rural Branch)

Source IFIs, MinFin

3. Ukraine's guidelines for state debt management

3.1. Objective 1. Increase the share of state debt denominated in local currency

Reducing FX exposure of state debt

Since 2016, one of the objectives of the state debt management is to reduce FX risk related to a significant share of foreign currency denominated debt in Ukraine's state debt structure. An increase in the share of local currency denominated debt as well as the diversification of currencies in the state debt FX mix will enable Ukraine to reduce the potential impact of an FX shocks on its total debt service, thus improving Ukraine's state debt sustainability. The state debt currency structure should take into account the currency mix of Ukraine's balance of payments, as well as the level of correlation between UAH and other currencies.

Reducing the share of FX-denominated debt by gradually limiting non-UAH denominated domestic government bond issuances will have a positive impact on the value of international FX reserves in the long run. The build-up of international reserves, in turn, will support the creation of a well-balanced financial and economic environment by effectively supporting Ukraine's foreign trade expansion.

A substantial FX risk related to exchange rates volatility, especially UAH/USD, is a consequence of a relatively high degree of dollarization of the country's economy. The large part of payments for Ukrainian exports is still denominated in USD and EUR, with 67.6%[3] and 28.3%[3] of current account receipts in 2020 held in USD and EUR, respectively. The importance of containing FX risk is also corroborated by the fact that the Ukrainian banking sector is widely exposed to changes in exchange rates. The share of FX-denominated assets in the Ukrainian banking system amounted to 32.1%[3] as of the end of 2020.

Over 2020, Ukraine has managed to increase the amount of issued UAH-denominated government bonds (from UAH 231bn in 2019 to UAH 259bn in 2020).

Attraction of international investors into the local currency bond market

To achieve the goal of increasing the share of local currency denominated debt, continuation of local currency bonds issuance at domestic market and analysis of potential opportunities for issuing local currency bonds on the international capital markets are set as one of the tasks of Ukraine's state debt management. In order to extend the participation of international investors on the Ukrainian domestic government bond market, it is necessary both **to facilitate the access in general** and to issue instruments with a longer maturity as well as stimulate the interest of foreign investors through access to information. In addition, implementation of liquidity stimulating measures in secondary market is vital, including among others through the construction of a benchmark yield curve by means of liquid issues of benchmark bonds, performance of liability management operations, such as switches and buy-backs. The implementation of such measures will facilitate the arrival of anchor investors enabling larger issuances of domestic government bonds with longer maturities, as well as a decrease in the cost of borrowing.

The growing appetite of international investors for local currency bonds would enable to extend current investor base. The continued strengthened cooperation with the IFIs in order to secure their support of domestic government bond market development would contribute to realization of this objective. The further deepening of domestic local currency bonds market would also set a benchmark for the profitability of such debt instruments for domestic companies. The inclusion of Ukrainian bonds in the JP Morgan GBI-EM index will significantly expand the investment base and increase liquidity, which will reduce the borrowing cost. The Ministry of Finance will issue domestic government bonds in sufficient amounts to be included in JP Morgan's GBI-EM index with a maturity of more than four years.

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[3] Source NBU

3.2. Objective 2. Lengthen average debt maturity, and ensure a smooth state debt repayment profile

Containing refinancing risk

In order to ensure that Ukraine meets its existing debt obligations, the country will require sustainable access to the capital markets in the upcoming years and continuous control over its refinancing risk. Therefore, in order to mitigate refinancing risk by increasing the average time to maturity of Ukraine's state debt over the following years, preference will be given to issuing debt instruments with longer maturities. The possibility of issuing Eurobonds with a amortizing repayment schedule will also be considered. In turn, access to the international capital market in the medium term envisages the need for further cooperation between Ukraine and the IMF.

Over a broader time horizon, containing refinancing risk can be achieved by increasing the weighted average time to maturity of Ukraine's state debt portfolio primarily through proactive operations similar to Eurobonds redemption / swap operations in 2017 and 2020, as well as avoiding the accumulation of debt repayments in the coming years in order to smooth the state debt payments schedule.

This risk can be mitigated owing to the development of the domestic government bond market, as well as to the implementation of active domestic government bonds operations. The Institute of Primary Dealers has been established to ensure sufficient liquidity of government securities in 2009. According to the 2H2020 results, there were 11 primary dealers in the domestic market: Alfa-Bank, Pivdennyi Bank, Kredobank, OTP Bank, Oschadbank, First Ukrainian International Bank, PrivatBank, Raiffeisen Bank Aval, Ukrgasbank, Ukreximbank and Citi.

Development of domestic government bonds market is also envisaged by attracting international investors to Ukraine's domestic market. In order to achieve it:

- In May 2019, the Ukrainian market was connected to the network of the international central securities depository Clearstream through the securities account at the Depository of the National Bank of Ukraine. This facilitated access to the Ukrainian government securities for international investors, thus increasing demand for domestic government bonds and boosting their liquidity.
- On August 28, 2020, the NBU has also eliminated obstacles for foreign investors to enter the Ukrainian securities market through establishment of the direct access to the purchase and sale of government bonds with help of "a nominee holder". Therefore, Ukrainian banks having accounts with the NBU depository are able to open depot accounts for their foreign clients enabling the latter to buy and sell Ukrainian government bonds.

The increase in time to maturity of state domestic debt can be also achieved, in particular, by increasing the activity of primary dealers as market makers on the secondary domestic government bond market, improving the liquidity of Ukrainian banks and attracting of foreign investors to the domestic market.

Expansion of domestic government bond market can be also achieved by facilitating access to investments into domestic government bonds for households and conveying a broad information campaign to stimulate the conversion of households' savings into investments, which will contribute to the demand for long-term risk-free assets in the future.

The implementation of such measures should be transparent and foreseeable for all market participants.

Also during 2020, the maturities of new debt instruments were extended: EUR-denominated Eurobonds (10Y Eurobond issuance in 2020 vs 7Y Eurobond issuance in 2019) and USD-denominated Eurobonds (12Y Eurobond issuance in 2020 vs 10Y Eurobond issuance in 2019).

Liability management operations

During 2020, Ukraine continued performing liability management transactions to smoothen debt repayment profile (bayback of the portion of 2021 & 2022 Eurobond series from the funds raised under new 2033 Eurobond in July 2020).

Following the successful liability management operations in September 2017 and July 2020, the implementation of other similar transactions is considered, subject to favorable market conditions.

The amendments to the Budget Code of Ukraine introduced in September 2017 fully authorize the execution of the following liability management transactions:

- **A Tender Cash Offer** (a public offer provided by an issuer to buy back all, or a part, of its outstanding debt obligations from investors);
- **An Exchange Offer** for new obligations with other terms (an offer provided by an issuer to exchange all, or a part, of its debt obligations).

Such transactions also help (i) to decrease refinancing costs depending on the evolution of spreads, as Ukraine may benefit from improved economic and debt parameters, and **(ii) to expand maturity of state debt portfolio as a whole**.

Implementation of liability management operations with domestic government bonds in the future will also promote further development of the domestic government bond market, among others, by increasing its liquidity.

3.3. Objective 3. Attract long-term concessional funding

Ukraine's macroeconomic recovery, commencing after 2014-2015, was accompanied by strong reform momentum, contributing to a more stable and secure economic environment, created **additional conditions for minimizing state debt interest cost.** Reduction of the weighted average cost of state debt over the medium term will enable Ukraine to improve both fiscal performance and state debt sustainability.

Ukraine benefits from strong support from IFIs and aims **to further expand cooperation with such IFIs and establish bilateral partnerships,** similar to those with Japan, Canada, Germany, France and the USA. Much attention will be paid to raising funds from these institutions for the implementation of investment projects aimed at developing key sectors of the Ukrainian economy, which is especially crucial during global crises, including the current one, caused by the negative impact of the Covid-19 coronavirus pandemic.

Deepening the cooperation with the IMF, the IBRD, and the EU within structural reforms' implementation in most vulnerable areas of the Ukrainian economy is important both for attracting concessional funding as well as for strengthening the confidence of foreign investors and a further decrease in the cost of commercial loans.

In 2020, a range of concessional financing for Ukraine was approved, including USD 5bn IMF SBA program in May 2020, EUR 1.2bn MFA package signed with the EU in July 2020. Moreover, in December 2020, Federal Republic of Germany signed an Agreement on Financial Cooperation (appropriations 2012 - 2019) with Ukraine under which the Government of Ukraine was able to attract loans totaling up to EUR 214,55m to boost the energy, infrastructure sector and business support in Ukraine, as well as grants totaling EUR 38,9m, aimed in particular at financing projects in education and local government development.

3.4. Objective 4. Continue developing strong investor relationships and further improve the state debt management policy framework

Ensure strong support from investors

In order to ensure sustainable access to international capital markets, **it is necessary to continue developing systematic and long-term investor relationships**. One of Ukraine's tasks within this Strategy is to expand its investor base in terms of geography and type of investors. As such, the Strategy envisages providing investors with regular updates with regard to key macroeconomic and fiscal data.

Ukraine's efforts to develop communication with investors are supported **by regular update and publication of the investor presentation on the MinFin website**, dissemination of monthly outlooks on the essential developments and events in Ukraine, non-deal road shows, as well as by maintaining an official MinFin page on the Bloomberg and Refinitiv terminals.

Over 2020, Ukraine's effort in the development of investor relation (e.g. regular investor communication, over 70 meetings conducted with 400+ investors in total, up to date investor presentation and data release calendar, monthly investor outlook, etc.) **has brough results in both private and public transactions**, as proven by among others Cargill loan signed in September 2020, Deutsche Bank loan signed in December 2020, large orderbooks during Eurobond transactions (3.1x oversubscribed in both January and July 2020 transactions).

Reinforcing processes for Strategy implementation

The development and implementation of the Strategy is currently a part of the MinFin's responsibility. However, state debt management through an independent institution (i.e. Debt Management Office) can contribute to a more efficient implementation of the Strategy and reinforce state debt management processes in general. The establishment of such institution is already provided for by the amendments to the Budget Code of Ukraine and by the decision of the Government of Ukraine (Resolution of the Cabinet of Ministers of Ukraine dated **February 12, 2020 No 127**).

It should enable managing state debt and liquidity more flexibly, having a sufficient level of independence, being able to choose the best solutions and achieving long-term debt management goals through a limited subordination to political goals, whilst ensuring transparency and accountability.

Interactions with international rating agencies

As part of improving the investment attractiveness of sovereign debt instruments, active interaction with rating agencies will continue to further increase sovereign credit ratings.

4. Debt ratios evolution over 2021 - 2024

4.1. Key scenarios and macroeconomic assumptions

Macroeconomic and fiscal assumptions

The Strategy is based on the indicators of the Budget Declaration for 2022-2024, approved by the Resolution of the Cabinet of Ministers of Ukraine as of May 31, 2021 No 548, as well as on the MinFin's assumptions.

Macroeconomic assumptions

	2021	2022	2023	2024
Main macroeconomic assumptions				
Real GDP growth rate (%)	**4.6%**	**3.8%**	**4.7%**	**5.0%**
Nominal GDP (UAHbn)	**4,505.9**	**5,368.7**	**5,993.9**	**6,651.0**
Nominal GDP (USDbn)	156.5	187.1	207.4	226.2
GDP deflator (% change)	108.4%	107.6%	106.6%	105.7%
Fiscal assumptions				
State budget deficit (% of GDP)	**5.5%**	**3.5%**	**3.0%**	**2.7%**
Prevatization proceeds (UAHbn)	12.0	8.0	8.0	5.0
Exchange rates				
Period average:				
USD/UAH	**29.1**	**28.6**	**28.8**	**29.2**
End of period:				
USD/UAH	**28.8**	**28.7**	**28.9**	**29.4**
XDR/UAH	43.2	43.1	43.4	44.1
EUR/UAH	34.6	34.4	34.7	35.3
JPY/UAH	0.3	0.3	0.3	0.3

Sources MEDT, MinFin

4.2. Current projections and conclusions based on the results of the debt sustainability analysis

Debt stock to GDP ratios

According to the base case scenario, Ukraine's state debt level is considered sustainable. The state debt to GDP ratio is expected to progressively go down from 53.9% as of the end of 2020 to 47% as of the end of 2024. Such downward trend indicates a reduction of the debt obligations default risk over the medium term.

Evolution of Ukraine state debt stock

	2021	2022	2023	2024
State domestic debt				
in UAHbn equivalent	1,183.9	1,287.6	1,420.4	1,665.2
in USDbn equivalent	40.0	44.9	49.1	56.6
% of GDP	26.3%	24.0%	23.7%	25.0%
State external debt				
in UAHbn equivalent	1,381.0	1,441.6	1,487.9	1,458.4
in USDbn equivalent	47.4	50.2	51.5	49.6
% of GDP	30.6%	26.8%	24.8%	21.9%
Total state debt				
in UAHbn equivalent	2,564.9	2,729.3	2,908.3	3,123.6
in USDbn equivalent	87.4	95.1	100.6	106.2
% of GDP	**56.9%**	**50.8%**	**48.5%**	**47.0%**

Source MinFin

Evolution of Ukraine's state debt interest and redemption indicators

	2022	2023	2024
State domestic debt interest and redemption			
in UAHbn equivalent	422.6	397.2	454.8
in USDbn equivalent	14.7	13.7	15.5
% of GDP	7.9%	6.6%	6.8%
% of state budget revenues	34.7%	29.8%	31.3%
State external debt interest and redemption			
in UAHbn equivalent	137.7	177.3	275.5
in USDbn equivalent	4.8	6.1	9.4
% of GDP	2.6%	3.0%	4.1%
% of state budget revenues	11.3%	13.3%	19.0%
Total state budget interest and redemption			
UAHbn equivalent	**560.4**	**574.5**	**730.2**
in USDbn equivalent	19.5	19.9	24.8
% of GDP	10.4%	9.6%	11.0%
% of state budget revenues	45.9%	43.1%	50.3%

Source MinFin

5. Risk factors of Ukraine's state debt

The control over the state debt risks is performed in accordance with the Procedure for monitoring risks associated with the state (local) debt management, approved by the Resolution of the Cabinet of Ministers of Ukraine as of 01.08.2012 No 815, and is based on the analysis of refinancing risk, liquidity risk, as well as interest rate, currency, budget and state debt management (contingent liabilities) risks.

5.1. Refinancing risk

State debt maturing in 2021 - 2024

Considering Ukraine's current state debt portfolio, significant refinancing peaks are anticipated over the next 4 years. In particular, in 2021 debt interest and redemption payments total UAH 627bn, and the average amount of state debt payments in 2022 - 2024 is expected at UAH 622bn. The major part of these payments is composed of domestic debt repayment both in local and foreign currencies.

Since refinancing risk in the upcoming years stems also from a significant amount of Eurobonds due over the respective period, the reduction of the risk is also possible with the implementation of liability management operations. Such operations were already conducted in September 2017 and July 2020 and have proven to be successful showing the strong demand from the international investors.

Average time to maturity of Ukraine's state debt

Weighted average time to maturity of Ukraine's state debt as of 31/12/2020

	years
State debt	**6.8**
State domestic debt	7.5
State external debt	6.2

Ukraine's state debt structure has a balanced average time to maturity. In October 2017, Ukraine has successfully re-profiled its state domestic debt held by the NBU, thus extending the average time to maturity of the domestic debt.

Weighted average time to maturity of Ukraine's external debt has continuously lengthened by issuing long-term Eurobonds: 10-year EUR 1.25bn Eurobond in January 2020, 12.5-year USD 2.0bn Eurobond in July 2020, and 8-year USD 1.25bn Eurobond in April 2021 among the latest. In addition, the Ministry of Finance has conducted an active management of its liabilities with a portion of the proceeds from July 2020 issuance used for purchase of Eurobonds due in 2021 and 2022.

Moreover, the large share of concessional funding, which tends to have a longer time to maturity, as well as continuous liability management operations will enable further extension of the weighted average time to maturity of Ukraine's state external debt maturities in the medium term.

5.2. Liquidity risk

UAH bn	2018	2019	2020
International reserves, USDbn	**17.7**	**21.9**	**29.1**
State external debt service, USDbn	**4.0**	**5.0**	**7.1**
Exports, USDbn	**59.2**	**63.5**	**60.6**
Imports, USDbn	**70.6**	**76.0**	**62.4**
International reserves to external debt service	**4.4x**	**4.4x**	**4.1x**
International reserves in months of imports	**3.0x**	**3.5x**	**5.6x**
Exports to external debt service	**14.8x**	**12.6x**	**8.6x**

Sources: State Statistics Service of Ukraine, NBU

Following an economic downturn in 2014, Ukraine suffered from a sharp decrease in its international reserves. Owing to the financial support received from the international community as well as the NBU's decision to implement a floating exchange rate regime, the country was able to quickly restore its international reserves, from USD 7.5bn as of the end of 2014 to USD 15.5bn as of the end of 2016 and further boost them up to USD 29.1bn as of end of 2020.

As of the end of 2020, Ukraine's international reserves amounted to USD 29.1bn, representing 4.8 months of future imports, which indicates considerable progress in rebuilding international reserves from 1.8 months of imports as of end-2014. IMF future disbursements in the context of the ongoing program and/or establishment of the new cooperation program with the IMF will help further strengthen Ukraine's international reserves position.

The Cabinet of Ministers of Ukraine approved the Liquidity Management Concept for 2020-2023 by Resolution No 1375-r dated 04.11.2020 aiming to implement an effective liquidity management mechanism for the Treasury Single Account and Treasury foreign currency accounts for the timely fulfillment of obligations by the Treasury clients at minimal cost, including by improving the quality of cash-flow forecasting. Additionaly, by the Order of the Ministry of Finance as of February 22, 2021 No 114, the Methodology for cash-flow forecasting on the Treasury Single Account and foreign currency accounts of the State Treasury Service of Ukraine was approved.

5.3. Exchange rate risk

Despite noticeable decrease in recent years, the share of state debt denominated in foreign currency remains significant (62% as of the end of 2020). The impact of the pandemic on the structure of the borrowing plan made it impossible to reduce the share of state debt denominated in foreign currency in 2020, though the portion of USD-denominated state debt declined during 2020: from 41.6% to 38.7% in total state debt and from 70.6% to 62.7% in state debt denominated in foreign currencies positively effecting FX risk level.

Also, the rate of the national currency depreciation in 2020, being lower than one accounted for by budget calculations, delivers its positive impact on the FX risk level: average FX rate of ca. UAH 27.0 per USD 1, actual rate at 2020YE was about UAH 28.27 per USD 1 vs projected UAH 30.0 per USD 1.

UAH correlation with other currencies

The impact of UAH/USD exchange rate fluctuations on the state budget is accentuated by a high degree of correlation with other major currencies in which Ukraine's debt obligations are denominated, thus increasing exchange rate risk of Ukraine's state debt.

Historical correlation between exchange rates of UAH and main currencies of Ukraine's state debt since April 2019

	UAH/USD	UAH/EUR	UAH/SDR	UAH/JPY	UAH/CAD
UAH/USD		*95%*	*95%*	*97%*	*90%*
UAH/EUR	*95%*		*87%*	*96%*	*98%*
UAH/SDR	*95%*	*87%*		*74%*	*90%*
UAH/JPY	*97%*	*96%*	*74%*		*91%*
UAH/CAD	*90%*	*98%*	*90%*	*91%*	

Source: Bloomberg (30.06.2021).

Exchange rate dynamics forecast

The Forecast of Economic and Social Development of Ukraine anticipates a slowdown in depreciation of the Ukrainian hryvnia against the US Dollar in the coming years, in the context of further monetary policy strengthening. Such nominal exchange rate dynamics should expectedly lead the Real Effective Exchange Rate (REER) towards reaching its long-term equilibrium.

5.4. Interest rate risk

The average time to re-fix the interest rates for Ukraine's state debt portfolio accounted for 3.8 years. Such a figure indicates that a relatively low share of the state debt will be exposed to interest rate risk in the near future. Moreover, the value is higher for the external debt compared to the domestic one due to a larger share of long-term state external debt with fixed rates.

Interest rate risk indicators of the state debt

	Domestic debt	External debt	Total state debt
Average time to re-fix the interest rates (years)	3.5	4.1	3.8
Debt with interest rates to be refixed in 1 year (% of total)	45.9%	46.0%	46.0%
Service payments with fixed interest rates (% of total)	80.9%	60.2%	69.4%

Source: MinFin (31/12/2020).

Debt re-fixing in 1 year includes variable-rate debt and fixed-rate debt maturing in 2021

The proportion of Ukraine's state debt with interest rates to be re-fixed in 2021 constitutes 46%. In particular, the interest rates are expected to be re-fixed for 45.9% of state domestic debt and 46.0% of state external debt in 2021.

Debt with longer time to re-fix interest rates will bear more preference in order to limit the interest rate risk by enhancement of the interest rate structure. With regard to the domestic market, such figure is in line with the government's expectations on decreasing interest rates as well as with the forecast of decreasing inflation in the medium term.

5.5. Budget risk

Following the government's fiscal consolidation efforts in 2015-2019, Ukraine managed to reduce state budget deficit to GDP ratio from 4.9 % in 2014 to 2.0 % in 2019.

Against the backdrop of pandemic in 2020, the Ukraine's budget deficit widened to 5.2% of GDP, which is 2.3 p.p. lower than planned initially. It was supported by tax efficiency gains, lower than expected level of economic fallout and underspending within the support package Covid-19 Acute Respiratory Disease Response Fund.

To further mitigate the negative impact of coronavirus disease on Ukraine’s economic activity, the state budget deficit is envisaged at 5.5% of GDP with gradual resumption of its fiscal consolidation from 2022, which, alongside other factors, will contribute to reducing the debt burden.

5.6. Other risks

Macroeconomic risks and their implications for state debt management strategy

Following the 2014 crisis, two main macroeconomic risks were identified that could create uncertainty for Ukraine's state debt management:

- **Real GDP growth risk:** GDP growth rate can be lower than the expected level, as it happened in 2014 – 2015 or in 2020;
- **Inflation risk:** the NBU prudent monetary policy and shift towards inflation targeting framework, in particular, significantly reduced the pace of inflation in Ukraine. However, the risk of rising inflation should be considered among the potential scenarios.

However, the above-mentioned macroeconomic risks are beyond the control of the MinFin, thus not defining the analysis of Ukraine's state debt management.

State debt management (contingent liabilities) risk

The Ukrainian banking sector is characterized by a relatively large proportion of banks with state participation, representing 55.9% of the sector’s total assets as of end of 2020. Four banks, partially or wholly owned by the state, constitute contingent liabilities that could materialize in case of banks’ failure. PrivatBank, the largest commercial bank in Ukraine, was nationalized on December 19, 2016, following a major capital shortfall, which led to the need for capital injections by issuing domestic government bonds. In addition, contingent liabilities risk also stems from the additional recapitalization of the Deposit Guarantee Fund which may take place in case of commercial banks’ bankruptcy, as well as from the capitalization of SOEs.

To contain systemic risks of the banking sector associated with bank failures, bank recapitalization procedure and rules governing the termination of banking activities were simplified with the adoption of the Law On Simplifying Capitalization and Reorganization Procedures for Banks. In particular, the new Ukrainian legislation allows Ukrainian banks to:

- terminate their banking activity without the dissolution of the legal entity if they fail to meet the recapitalization requirements set by the NBU;
- shorten the duration of the bank reorganization procedures from 1.5 years to three-four months;
- merge with other banks to meet the recapitalization requirements set by the NBU, which was not possible under the previous legislation.

Additional risk is stemming from the indexed domestic government bonds linked to the US dollar FX rate and issued, inter alia, to capitalize state-owned banks, which represent approximately 5.4% of Ukraine's state debt.

Ukraine's state derivatives overview

In accordance with the Ukrainian legislation, state derivatives do not constitute a part of Ukraine's state debt. The IMF and credit rating agencies also do not include state derivatives into state debt, as payments on these instruments are conditional and the instruments themselves do not contribute to current expenses with regards to Ukraine's state debt interest payments.

Ukraine's state derivatives, issued in the context of 2015 debt restructuring, represent securities with contingent payments with a total nominal amount of USD 3.2bn and maturity in 2040. Such securities do not have the specific periodic payments (coupons) or the repayment amount. Payments on these instruments depend on the growth rate of Ukraine's GDP from 2019 to 2038 with payments being possible annually in two calendar years, namely from 2021 to 2040.

Coupon payments are estimated as follows:

- if real GDP growth is <3% or Ukraine's nominal GDP is less than USD 125.4bn: payment is not made;
- if real GDP growth ranges between 3% and 4%: 15% of the real GDP growth from 3% to 4%;
- if real GDP growth is > 4%: 40% of the real GDP growth exceeding 4%, in addition to the amount for GDP growth from 3 to 4%;
- from 2021 to 2025 payments are limited at 1% of GDP.

Given the volatility of potential payments on state derivatives in 2020, the Ministry of Finance (in accordance with Article 16, Para 35 of Section VI "Final and Transitional Provisions" of the Budget Code of Ukraine, Article 31 of the Law of Ukraine "On the State Budget of Ukraine for 2020", Resolution of the Cabinet of Ministers of Ukraine No 457-4 as of 09.06.2020, order of the Ministry of Finance of Ukraine dated 25.08.2020 No 523) carried out a transaction on state derivatives buy-back.

In 2019, all conditions for state derivatives payments (nominal GDP and its real growth) were met, and such payment was made in May 2021 accounting for approximately USD 40m.

Since 2015, the conversion of debt obligations into state derivatives has allowed Ukraine to save ca. USD 1.3bn in Eurobonds payments.

Dynamics of Ukraine's state derivatives pricing, %

Source: Bloomberg (21.07.2021).

6. Roadmap for 2021 – 2024

Based on the analysis of the sovereign debt risks and the benchmarking of Ukraine's state debt, the following options of state budget funding sources and state debt management activities within this Strategy are considered as the most expedient.

6.1. Available funding options for Ukraine's state budget

Domestic financing sources

	Доступні інструменти (не вичерпно)
Marketable securities	• UAH-denominated domestic government bonds • UAH-denominated inflation-linked domestic government bonds • USD/EUR-denominated domestic government bonds
Commercial loans	• Bank loans

External financing sources

	Доступні інструменти (не вичерпно)
World Bank	• Development Policy Loans ("DPL") • Project-based loans
EIB/ EBRD	• Project loans • Intermediated loans
European Union	• Macro-Financial Assistance (MFA)
Bilateral loans	• Bilateral financing from partner countries • Direct export financing
Commercial / semi-concessional loans	• Public Development Banks/agencies loans • Commercial bank loans • Bridge-loans
Eurobonds	• Eurobonds denominated in USD / EUR / UAH (public and private placement)

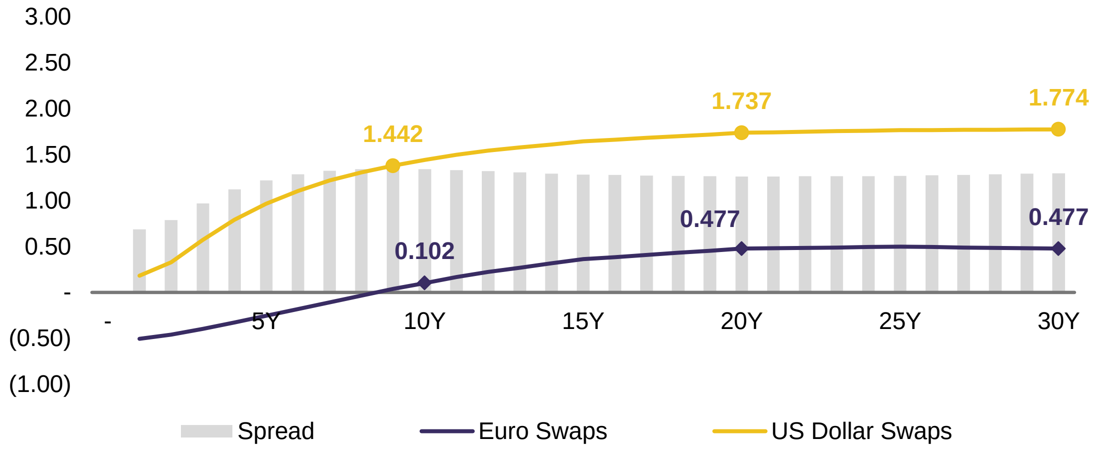
6.2. Plan for the medium term

Issuance of Eurobonds in currencies other than USD for international investors

Diversification of currencies within Ukraine's state debt portfolio is one of the measures to contain state debt FX risk. Issuance of Eurobonds denominated in other currencies (euro, yen, etc.) can among others contribute to lengthening the average term to maturity of Ukraine's state debt, as well as to reducing the average state debt interest cost.

Due to lower interest rates, current conditions on European bond markets are more favorable than the bond market in the US dollars. The interest rate swap curve in US dollars significantly exceeds a similar curve in Euro, whilst spreads on EUR-denominated instruments for Ukraine are much wider. Thus, favorable market conditions for transactions in Euro (see the graph below) upon spreads narrowing can be used to reduce the yield curve of Ukrainian government bonds and, accordingly, reduce the cost of state debt service.

Interest rate swap curves in USD and EUR as of 30/06/2021



Source: Bloomberg.

In addition, diversifying state debt currency structure would provide an opportunity to further widen the investor base for Ukraine's debt instruments and to expand Ukraine's funding sources which, in turn, would increase the flexibility of state budget financing and state debt management.

Local currency denominated Eurobond placement on international capital markets can be considered as an alternative source of financing and mitigation of state debt FX risk. The rationale for such placement will be determined based on the available demand and international market conditions.

USD-denominated Eurobond issuance

The issuance of USD-denominated Eurobonds is considered and could be done either through: tapping existing outstanding Eurobonds or issuing new debt instrument.

At the same time, new issuances should have a maturity which will enable Ukraine to smoothen its debt service profile.

Special debt instruments to finance Sustainable Development Goals

In line with its international commitments, Ukraine's government has defined an ambitious policy to achieve the Sustainable Development Goals and combat negative climate changes which is reflected in the National Report "Sustainable Development Goals: Ukraine". Special debt instruments, such as green, social bonds, etc., are used to finance measures aimed at consummating the Sustainable Development Goals. The Ministry of Finance of Ukraine will study international experience on financing state budget through such bonds issuance.

Liability management operations

Continuing series of liability management transactions launched in 2017 and successfully continued in July 2020 to smoothen Ukraine's debt maturity profile is under consideration.

The first option envisages the buyback/exchange of the specific Eurobond series through the announcement a buyback/exchange offer to reduce external debt refinancing peaks.

The second option implies a partial buyback/exchange of multiple Eurobond series in the form of the buyback/exchange offer aimed at optimizing state debt structure and reducing the cost of state debt service. For each of these series, the transaction can include a cap amount.

Concessional funding

As part of minimizing state debt interest expenditures by attracting and expanding concessional funding, potential partners for Ukraine are:

- **IFIs**
  - Development Policy Loans ("DPL"), granted by the World Bank and through EU MFA to support social and economic reforms;
  - Budget and project financing within the agreements signed with IFIs (IMF, EBRD, World Bank, EIB, etc.);
- **Bilateral loans from foreign countries**

Active interactions with investors and international rating agencies

In the annual ratings "Assessment of Investor Relations and Data Dissemination" of the Institute of International Finance, Ukraine is recognized as one of the most-improving countries for IR and data transparency practices since 2017, owing to the development of effective investor relations practices.

The main task for improving investor relations is an enhancement of transparency and publicity, including through further development of the official MinFin website. In this regard, MinFin is actively working towards improving relations with investors, which, among others, includes the following measures:

- dissemination of monthly reports on state budget performance, state debt, macroeconomic and business developments and events in Ukraine's economy;
- regular updates of the investor presentation with up-to-date detailed information on the economic situation and the structure of the state and state guaranteed debt;
- regular update of investor calendar including dates of important economic statistics publication;
- answers to investors' inquiries and global investor conference calls.

The MinFin also regularly updates a page at Bloomberg and Refinitiv terminals. The page contains information on sovereign financial instruments and aims at informing foreign investors, among others, regarding the schedule and the results of domestic government bond auctions, information on domestic government bonds and Eurobonds issued by Ukraine and the list of primary dealers with contact details. Also, switching to the Bloomberg auction platform in September 2019 has further facilitated the access to information for international investors.

7. Goal achievement metrics

Metric (measurement unit)	Base value (2020)	2021	2022	2023	2024
Share of local currency denominated state debt (percentage)	38.2	41	44	47	51
Weighted average time to maturity of Ukraine’s state debt, years	6.8	6.4	6	6.5	7
Share of long-term concessional financing from IFIs and foreign countries on the implementation of investment projects in the total state debt (percents)	5.9	6.3	6.5	6.7	7

8. Monitoring, evaluating and reporting on results of the Strategy implementation

Results monitoring and evaluation on the Strategy implementation are performed annually through the analysis of:

- accomplishment level of the Strategy tasks and measures;
- achievement of key metrics, their deviation from the planned values and investigation on reasons for such deviation.

Based on monitoring results, the Ministry of Finance prepares and submits to the Cabinet of Ministers of Ukraine, together with the report on the state budget implementation, the Report on the implementation of the Medium-Term State Debt Management Strategy.

9. Appendix

Overview of transactions conducted in 2020

Date	Deal overview	Key highlights
January 2020	Issuance of a EUR 1.25bn 10Y EUR-denominated Eurobond bearing at 4.375% interest rate	• New benchmark point on the EUR curve • Exceptional pricing with a negative NIP and unprecedented tightening
July 2020	Issuance of a USD 2bn 12Y Eurobond with a 7.25% reoffer yield Respectively USD 434m and USD 371m of Ukraine 2021 and 2022 notes have been bought back	• Implementation of a medium debt management strategy through Eurobond buy-back transaction on Ukraine 2021 and 2022 notes • The bond was c.3.6 times oversubscribed (above USD 7bn peak orderbook)
August 2020	Buy back of c.10% of state derivatives	• Limiting risks of Ukraine's contingent liabilities
September 2020	2nd EUR 250m dual tranche loan financing from Cargill	• Diversification of Ukraine's state debt currency mix and country's investor base
December 2020	USD 600m tap of the 2033 Eurobond	• Leveraging favorable market conditions to attract financing
December 2020	USD 344m 6m bridge loan from Deutsche Bank	• Investor base diversification