

Research Update:

Ukraine Foreign Currency Ratings Lowered To 'CCC+/C' On Larger Fallout From Russia's Military Attack; Outlook Negative

May 27, 2022

Overview

- We expect the Russia-Ukraine military conflict to be protracted.
- The Ukraine government's capacity to meet its foreign-currency commercial debt payments is contingent on the flow of donor support, in our view.
- As a result, we lowered our foreign currency ratings on Ukraine to 'CCC+/C' from 'B-/B'.
- At the same time, we affirmed our 'B-/B' local currency and 'uaBBB-' national currency ratings because we consider Ukraine's hryvnia-denominated government debt to be less vulnerable to nonpayment.
- We removed all ratings from CreditWatch with negative implications, and assigned a negative outlook.

Rating Action

On May 27, 2022, S&P Global Ratings lowered its foreign currency long- and short-term sovereign credit ratings on Ukraine to 'CCC+/C' from 'B-/B'. At the same time, we affirmed the 'B-/B' local currency long- and short-term sovereign credit ratings on Ukraine. The outlook is negative. We also affirmed the national scale rating at 'uaBBB-'.

We removed all the ratings from CreditWatch negative where we placed them on Feb. 25, 2022.

We also revised downward our transfer and convertibility assessment to 'CCC+' from 'B-'.

As "sovereign ratings" (as defined in EU CRA Regulation 1060/2009 "EU CRA Regulation"), the ratings on Ukraine are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar Of 2022 EMEA Sovereign, Regional, And Local Government Rating Publication Dates," published on Dec. 16, 2021, on RatingsDirect). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed

explanation of the reasons for the deviation. In this case, the reason for the deviation is our resolution of the CreditWatch placement of our ratings on Ukraine following Russia's military intervention in late February 2022. The next scheduled publication on the Ukraine sovereign rating is Sept. 9, 2022.

Outlook

The negative outlook reflects risks to Ukraine's economy, external balances, public finances, and financial stability stemming from the military conflict, which might undermine the government's ability to meet its debt obligations.

Downside scenario

We could lower the ratings in the next 12 months if the government's liquidity position were to deteriorate or there were indications that the government might de-prioritize debt service against meeting general budget, defense, and reconstruction spending needs. We could also lower the ratings should we expect Russian military actions to significantly weaken the government's administrative capacity.

Upside scenario

We could revise the outlook to stable in case of an improvement in Ukraine's security environment and better visibility on its medium-term macroeconomic outlook.

Rationale

The rating actions reflect our expectation of a prolonged period of macroeconomic instability in the country, due to Russia's military intervention. We believe that substantial damage to Ukraine's economy and tax-generation capacity has made government debt payment more dependent on the steady flow of international financial support.

The first three months of Russia's military aggression have taken a severe toll on Ukraine's economy and society. About one-quarter of the country's productive capacity and most of its seaports are now located in areas occupied or blockaded by the Russian military. There is a large degree of uncertainty regarding how the conflict might develop, but at present the prospects for resolution are uncertain.

Assuming the conflict persists into the second half of 2022, we project Ukraine's real GDP will contract by 40% on the back of collapsing exports, consumption, and investment. Given substantial damage to physical and human capital, Ukraine's medium-term growth prospects are uncertain and hinge upon the extent to which the government regains a level of territorial integrity, alongside sizable reconstruction efforts.

The severe shocks to economic growth and tax revenue, coupled with increasing emergency and defense spending, have significantly undermined the government's fiscal position. The authorities currently estimate the resulting fiscal gap at \$5 billion (or 2.5% of pre-war GDP) a month. Our latest projections put the annual fiscal deficit in 2022 at 25% of GDP compared with 3.5% before the conflict.

Short-term government financing risks seem to be contained, in light of concessional funding committed by the international community, which we estimate exceeds \$35 billion as of late May.

We understand that G-7 nations have committed to provide \$20 billion in total of direct financial support, with a small portion already disbursed. In the next few months, the U.S. and German governments in particular will provide grants of around \$7.5 billion and \$1 billion, respectively. In a parallel effort, the European Commission has disbursed €1.2 billion (\$1.3 billion) of emergency assistance and has offered an additional €9 billion (\$9.6 billion) in the form of long-term concessional loans.

These resources come on top of other financing lines provided by international financial institutions, in particular the World Bank and the IMF. The latter allocated \$1.4 billion of emergency financial assistance in March and opened an administered account in April that would help accumulate resources from donors in reserve currencies or SDRs (Special Drawing Rights).

Concessional support could cover as much as 70% of Ukraine's financing needs in the coming months (with the rest coming from domestic issuance). The high share of grants in these funds will help contain the buildup of government debt in nominal terms.

However, the fiscal and funding outlooks beyond September are less certain. We expect government deficits to remain sizable in the next few years, due to substantial post-war reconstruction costs and significant disruptions to the government's tax mobilization capacity. There is also broader uncertainty over Ukraine's debt-to-GDP trajectory in light of unclear economic recovery prospects and the high sensitivity of the debt burden to exchange rate fluctuations, given that over 60% of government debt is denominated in foreign currencies.

Taken together, these factors could over time alter Ukraine's policy priorities and prompt the government to seek debt relief. That said, the government is current on its commercial debt obligations, both external and domestic, and has expressed strong commitment to timely debt service in the future.

We believe that the ability and medium-term incentives for the government to meet its financial commitments in local currency are somewhat higher than for those in foreign currency. Hryvnia-denominated debt is primarily held by the domestic banks, half of which are state owned. A default on these obligations would amplify banking sector distress, increasing the likelihood that the government would be required to provide the banks with financial support, limiting the potential benefits of government local-currency debt payment relief.

S&P Global Ratings acknowledges a high degree of uncertainty about the extent, outcome, and consequences of the military conflict between Russia and Ukraine. Irrespective of the duration of military hostilities, related risks are likely to remain in place for some time. Potential effects could include dislocated commodities markets, supply chain disruptions, inflationary pressures, weaker growth, and capital market volatility. As the situation evolves, we will update our assumptions and estimates accordingly. See our macroeconomic and credit updates here: [Russia-Ukraine Macro, Market, & Credit Risks](#).

Key Statistics

Table 1

Ukraine--Selected Indicators

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Economic indicators (%)										
Nominal GDP (bil. UAH)	2,385.4	2,983.9	3,560.6	3,978.4	4,222.0	5,459.6	4,127.4	5,312.0	6,388.7	7,043.5

Table 1

Ukraine--Selected Indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Nominal GDP (bil. \$)	93.4	112.2	130.8	154.2	156.5	200.2	111.6	123.5	138.9	142.3
GDP per capita (000s \$)	2.2	2.6	3.1	3.7	3.7	4.8	3.0	3.1	3.5	3.5
Real GDP growth	2.4	2.4	3.5	3.2	(3.8)	3.4	(40.0)	10.0	7.0	5.0
Real GDP per capita growth	2.8	2.8	4.0	3.8	(3.2)	4.1	(33.3)	3.8	5.9	4.5
Real investment growth	20.4	16.1	16.6	11.7	(21.3)	7.5	(50.0)	20.0	20.0	19.0
Investment/GDP	21.7	19.9	18.6	14.9	8.9	13.8	6.9	7.4	8.3	9.7
Savings/GDP	19.7	16.9	13.7	12.2	12.3	12.5	(0.9)	1.0	2.7	2.4
Exports/GDP	49.3	48.0	45.2	41.2	38.8	40.7	34.2	36.8	37.9	41.9
Real exports growth	(1.8)	3.9	(1.4)	7.3	(5.8)	(10.4)	(60.0)	19.0	18.0	16.0
Unemployment rate	9.7	9.9	9.1	8.6	9.9	9.5	40.0	25.0	20.0	15.0
External indicators (%)										
Current account balance/GDP	(2.0)	(3.1)	(4.9)	(2.7)	3.4	(1.3)	(7.8)	(6.5)	(5.6)	(7.3)
Current account balance/CARs	(3.2)	(5.1)	(8.5)	(4.9)	6.7	(2.6)	(17.4)	(12.1)	(10.4)	(12.6)
CARs/GDP	61.6	60.7	58.1	54.9	50.2	51.3	44.8	53.6	54.1	58.3
Trade balance/GDP	(7.4)	(8.6)	(9.7)	(9.2)	(4.3)	(3.3)	(9.2)	(9.2)	(9.4)	(10.8)
Net FDI/GDP	4.2	3.1	3.7	3.4	0	3.4	(4.5)	1.9	1.9	1.9
Net portfolio equity inflow/GDP	0.2	0.1	0	0	0.1	(0.1)	(0.2)	0	0	0
Gross external financing needs/CARs plus usable reserves	118.8	115.3	114.8	106.6	94.6	100.4	107.8	105.6	105.5	107.5
Narrow net external debt/CARs	131.8	109.7	94.5	83.2	86.3	61.2	138.6	109.4	99.6	96.1
Narrow net external debt/CAPs	127.6	104.4	87.2	79.3	92.5	59.6	118.1	97.6	90.2	85.4
Net external liabilities/CARs	57.6	44.6	32.4	30.6	21.6	15.1	32.8	33.1	35.8	41.6
Net external liabilities/CAPs	55.8	42.5	29.9	29.2	23.2	14.7	27.9	29.5	32.5	36.9
Short-term external debt by remaining maturity/CARs	42.1	35.7	33.9	27.3	31.0	25.5	55.4	39.3	35.5	32.9
Usable reserves/CAPs (months)	2.6	2.5	2.7	2.7	4.0	3.2	6.2	4.6	4.2	3.8
Usable reserves (mil. \$)	15,062	18,252	20,331	24,677	28,368	30,137	28,658	28,671	29,246	28,726
Fiscal indicators (general government; %)										
Balance/GDP	(2.2)	(1.4)	(2.1)	(2.1)	(5.6)	(4.0)	(25.0)	(10.0)	(6.0)	(5.0)

Table 1

Ukraine--Selected Indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Change in net debt/GDP	15.3	6.1	1.0	(4.0)	12.5	3.8	44.0	13.6	12.2	9.1
Primary balance/GDP	1.9	2.4	1.2	0.9	(2.7)	(1.4)	(21.0)	(4.8)	(1.0)	0.2
Revenue/GDP	38.5	40.3	39.8	39.4	39.7	38.5	30.0	32.0	35.0	38.0
Expenditures/GDP	40.7	41.7	41.9	41.6	45.3	42.5	55.0	42.0	41.0	43.0
Interest/revenues	10.6	9.3	8.2	7.7	7.3	6.7	13.3	16.1	14.2	13.6
Debt/GDP	81.1	71.8	60.9	50.2	60.4	50.3	110.5	99.5	94.9	95.2
Debt/revenues	210.3	178.1	153.0	127.4	152.2	130.6	368.5	310.9	271.2	250.4
Net debt/GDP	78.7	69.0	58.8	48.6	58.3	48.9	108.8	98.1	93.8	94.1
Liquid assets/GDP	2.3	2.7	2.1	1.6	2.1	1.4	1.8	1.4	1.2	1.1
Monetary indicators (%)										
CPI growth	13.9	14.4	11.0	7.9	2.7	9.6	30.0	12.0	9.0	7.0
GDP deflator growth	17.1	22.2	15.3	8.3	10.3	25.1	26.0	17.0	12.4	5.0
Exchange rate, year-end (UAH/\$)	27.30	28.10	27.72	23.81	28.34	27.29	42.00	44.00	48.00	51.00
Banks' claims on resident non-gov't sector growth	(1.6)	1.2	5.4	(9.7)	(3.0)	7.9	(15.0)	10.0	5.0	5.0
Banks' claims on resident non-gov't sector/GDP	42.8	34.6	30.5	24.7	22.6	18.8	21.2	18.1	15.8	15.0
Foreign currency share of claims by banks on residents	38.9	32.2	30.5	26.3	22.0	18.0	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	46.3	46.0	42.0	40.0	37.7	32.4	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(0.5)	5.2	6.4	15.2	(0.6)	5.0	N/A	N/A	N/A	N/A

Sources: State Statistics service of Ukraine (economic indicators), National Bank of Ukraine, State Statistics service of Ukraine (external indicators), Ministry of Finance of Ukraine, State Statistics service of Ukraine (fiscal indicators), and National Bank of Ukraine, IMF (monetary indicators).

Adjustments: Usable reserves calculated by subtracting required reserves for resident foreign-currency deposits from reported international reserves. General government expenditures calculated as reported expenditure plus expenditure related to Naftogaz. Government debt calculated as reported state debt plus state guarantees.

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. UAH--Ukrainian hryvnia. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	5	Reduced predictability of future policy responses because of moderate risk of challenges to political institutions. Relatively weak transparency and uncertain checks and balances between institutions.
Economic assessment	5	Based on GDP per capita (\$) as per Selected Indicators in Table 1.
External assessment	6	Based on narrow net external debt and gross external financing needs as per Selected Indicators in Table 1.
		There is a risk of marked deterioration in the cost of or access to external financing.
Fiscal assessment: flexibility and performance	6	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1.
		The ability of the government to raise taxes has weakened due to economic disruptions caused by the military conflict.
Fiscal assessment: debt burden	6	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenue) as per Selected Indicators in Table 1.
		About 60% of government debt is denominated in foreign currency.
		The banking sector's exposure to the government is around 30% of its assets.
Monetary assessment	5	Since late Feb. 2022, the National Bank of Ukraine has fixed the exchange rate.
		The transmission mechanism is weak due to a significant stress in the domestic financial system.
		The central bank has imposed capital and exchange controls to mitigate the financial market fallout from the conflict.
Indicative rating	b-	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Sovereign credit rating		
Foreign currency	CCC+	The final rating is based on "General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings."
Notches of uplift	1	Default risks apply differently to foreign- and local-currency debt. Government incentives to service local-currency debt are somewhat higher since it is held primarily by state-owned banks.
Local currency	B-	

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Russia-Ukraine Military Conflict: Key Takeaways From Our Articles, May 24, 2022
- Global Credit Conditions Special Update: Inflation, War, And COVID Drag On, May 17, 2022
- Global Macro Update: Growth Forecasts Lowered On Longer Russia-Ukraine Conflict And Rising Inflation, May 17, 2022
- Sovereign Ratings Score Snapshot, May 9, 2022
- Sovereign Ratings List, May 6, 2022
- Sovereign Ratings History, May 6, 2022
- Default, Transition, and Recovery: 2021 Annual Global Sovereign Default And Rating Transition Study, May 4, 2022
- Sovereign Risk Indicators, April 11, 2022; a free interactive version is available at <http://www.spratings.com/sri>

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion.

The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Ukraine		
Sovereign Credit Rating		
Foreign Currency	CCC+/Negative/C	B-/Watch Neg/B
Senior Unsecured	CCC+	B-/Watch Neg
Transfer & Convertibility Assessment	CCC+	B-

State Road Agency of Ukraine (Ukravtodor)

Senior Unsecured	CCC+	B-/Watch Neg
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Ratings Affirmed; CreditWatch/Outlook Action	To	From
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Ukraine		
Sovereign Credit Rating		
Local Currency	B-/Negative/B	B-/Watch Neg/B
Ukraine National Scale	uaBBB-/--	uaBBB-/Watch Neg/--
Senior Unsecured	D	D

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; or Stockholm (46) 8-440-5914

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