Research Update:

Ukraine Foreign Currency Ratings Raised To 'CCC+' From 'SD' On Completed Debt Restructuring; Outlook Stable

August 19, 2022

Overview

- Ukraine has completed a distressed debt restructuring.
- We raised our long- and short-term foreign currency sovereign credit ratings to 'CCC+/C' from 'SD/SD' (selective default) and our issue rating on the restructured bonds to 'CCC+' from 'D'.
- At the same time, we affirmed our local currency sovereign credit ratings at 'CCC+/C' and raised the national scale rating to 'uaBB' from 'uaBB-'.
- The stable outlook balances our view of the reduction in Ukraine's government debt service requirements and our expectation of steady international financial support against risks stemming from the ongoing war.

Rating Action

On Aug. 19, 2022, S&P Global Ratings raised its foreign currency long- and short-term sovereign credit ratings on Ukraine to 'CCC+/C' from 'SD/SD' and the long-term issue rating on the restructured foreign currency bonds to 'CCC+' from 'D'. At the same time, we affirmed our local currency sovereign ratings at 'CCC+/C' and raised the national scale rating to 'uaBB' from 'uaBB-'. In addition, we kept our transfer and convertibility assessment at 'CCC+'. The outlook on the long-term ratings is stable.

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: Midyear Update," published June 23, 2022, 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 the completion of the government of Ukraine's debt restructuring. The next scheduled publication on the Ukraine sovereign rating is Sept. 9, 2022.

Outlook

The stable outlook balances our view of the reduction in Ukraine's government debt service requirements and our expectation of steady international financial support against risks to Ukraine's economy, external balances, public finances, and financial stability stemming from the ongoing war.

Downside scenario

We could lower the ratings in the next 12 months should the security outlook deteriorate, putting further pressure on Ukraine's foreign exchange reserve position or the government's administrative capacity, or resulting in much higher government gross financing needs than we currently anticipate. Absent an escalation of the conflict, material delays in foreign donor support could also lead to a downgrade.

Upside scenario

We could raise the ratings if Ukraine's security environment and medium-term economic outlook significantly improve.

Rationale

The rating action follows the completion of Ukraine's Eurobond restructuring (see "Ukraine FC Rating Lowered To 'SD' On Approved Debt Restructuring; LC Rating Lowered To 'CCC+' With Negative Outlook," published Aug. 12, 2022, on RatingsDirect). The government restructured the equivalent of $22.6 billion in sovereign Eurobonds and about $1.5 billion of state-guaranteed Eurobonds after receiving consent from the required majority of bondholders to postpone interest and principal payments on the debt for 24 months. The government has amended the respective bond terms and conditions and they have become legally effective.

The 'CCC+' ratings on Ukraine reflect our forward-looking opinion on Ukraine's creditworthiness, following the recent debt restructuring. In our view, Ukraine's debt servicing capacity remains vulnerable and dependent upon favorable financial and economic conditions to meet its financial commitments.

Our rating action reflects strong committed international financial support to Ukraine, coupled with eroding, albeit still relatively high, foreign exchange reserves. At the same time, the completed debt reprofiling has significantly eased Ukraine's government debt service needs until September 2024, when the payments on the amended Eurobonds will resume. As a result, Ukraine's foreign-currency debt repayments have declined by roughly 40% over 2022-2024 to about $10 billion from $16 billion before the restructuring. Repayments now primarily comprise payments on official debt--mostly owed to the IMF and the International Bank for Reconstruction and Development--and foreign-currency domestic-law bonds, held primarily domestically, including by state-owned banks. As a result, the near-term risks to the government's liquidity position and, more broadly, its capacity to honor commercial debt, including in foreign currency, appear manageable. Our sovereign ratings reflect our view of an issuer's ability and willingness to meet its commercial, nonofficial financial obligations in full and on time.

That said, given the ongoing conflict with Russia, Ukraine's ability to stay current on its debt is highly dependent on factors largely outside of government control. The first six months of the war have taken a severe toll on the economy and society. About one-fifth of Ukraine'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 we see limited prospects for resolution.

We estimate Ukraine's real GDP will contract by 40% in 2022 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 on regaining a level of territorial integrity and access to the Black Sea, alongside sizable reconstruction efforts.

The severe war-related shock to the economy and the tax base, coupled with increasing emergency and defense spending, have significantly undermined the government's fiscal position. The authorities estimate the resulting gross financing needs at close to $5 billion (or 2.5% of pre-war GDP) a month. In our latest projections, the 2022 fiscal deficit will be at least 20% of GDP, compared with 3.5% before the conflict.

Given limited access to the capital markets, the government has focused on attracting donor financial support. Of the $30 billion of financial aid pledged by the international community since the beginning of the war, about 45% has been disbursed. Almost half of government funding needs have been covered by domestic issuance, largely purchased by Ukraine's central bank (NBU), amplifying already high inflationary and exchange rate pressures.

One of the key assumptions behind our rating is that donor fund disbursements, primarily from the U.S. and EU, will continue in the coming months. Apart from meeting budget funding needs, these inflows should also help stabilize Ukraine's international reserves. These decreased by one-fifth from February to July 2022, to $22.4 billion. We also understand the government is considering a new IMF financing and policy program arrangement. Although the timing and details of the new program remain to be seen, if approved it could further ease government financing pressures, and support confidence and macroeconomic stability.

At the beginning of the war, the NBU fixed the hryvnia exchange rate and introduced extensive exchange restrictions in an effort to contain risks to financial stability. In June-July, given exchange rate pressures, the NBU hiked its key policy rate by 15 percentage points to 25% and devalued the currency against the U.S. dollar by 25%. Still, we expect the currency to weaken further, adding to inflationary pressures. Ukraine's banking system entered the war with adequate liquidity and capital buffers, which together with the NBU's regulatory easing has helped it absorb the immediate war-induced shocks. That said, given the substantial fallout of the war on the private sector, the outlook for asset quality is challenging.

S&P Global Ratings notes a high degree of uncertainty about the extent, outcome, and consequences of the Russia-Ukraine war. Irrespective of the duration of military hostilities, related risks are likely to remain in place for some time. 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.

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

- Sovereign Ratings History, Aug. 4, 2022
- Sovereign Ratings List, Aug. 4, 2022
- Russia-Ukraine Military Conflict: Key Takeaways From Our Articles, July 28, 2022
- EMEA Emerging Markets Sovereign Rating Trends Midyear 2022: Hard Times, July 18, 2022
- Sovereign Risk Indicators, July 11, 2022, An interactive version is available at www.spratings.com/SRI
- Global Credit Conditions Q3 2022: Resurfacing Credit Headwinds, June 30, 2022
- 2021 Annual Global Sovereign Default And Rating Transition Study, May 4, 2022
- S&P Global Ratings Definitions, Nov. 10, 2021

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

Upgraded

	To	From
Ukraine		
Sovereign Credit Rating		
Foreign Currency	CCC+/Stable/C	SD/--/SD
Ukraine National Scale	uaBB/--/--	uaBB-/--/--
Senior Unsecured	CCC+	D
State Road Agency of Ukraine (Ukravtodor)		
Senior Unsecured	CCC+	D

Ratings Affirmed; Outlook Action

	To	From
Ukraine		
Sovereign Credit Rating		
Local Currency	CCC+/Stable/C	CCC+/Negative/C

Ratings Affirmed

Ukraine	
Transfer & Convertibility Assessment	CCC+
Senior Unsecured	D