Research Update:

Ukraine FC Rating Lowered To 'CC' On Proposed Debt Restructuring; 'B-/B' LC Ratings Affirmed; Outlook Negative

July 29, 2022

Overview

- Ukraine has proposed to its foreign creditors to defer payments on all external debt obligations by 24 months.
- As a result of this proposal, we believe a default on the sovereign's foreign currency debt is a virtual certainty.
- In turn, we lowered our long-term foreign currency rating on Ukraine to 'CC' from 'CCC+'.
- At the same time, we affirmed our 'C' short-term foreign currency, 'B-/B' local currency, and 'uaBBB-' national scale ratings on the sovereign. We consider Ukraine's hryvnia-denominated government debt to be less vulnerable to nonpayment.
- The negative outlook reflects our view that Ukraine is likely to implement its debt restructuring plans, which we consider tantamount to a default.

Rating Action

On July 29, 2022, S&P Global Ratings lowered its foreign currency (FC) long-term sovereign credit and issue ratings on Ukraine to 'CC' from 'CCC+'. The outlook on the long-term sovereign rating is negative. At the same time, we affirmed our 'C' short-term FC rating and our 'B-/B' local currency (LC) long- and short-term sovereign credit ratings on the sovereign. We also affirmed our national scale rating at 'uaBBB-' and our transfer and convertibility assessment remains 'CCC+'.

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 Ukraine's proposal to defer external debt service payments. The next scheduled publication on the Ukraine sovereign rating is Sept. 9, 2022.

Outlook

The negative outlook reflects high risks to Ukraine's commercial debt service payments, given the government's debt restructuring plans, which stem from economic, balance-of-payments, and fiscal pressure from the war with Russia.

Downside scenario

We could lower the FC rating to 'SD' (selective default) if Ukraine implements what we view as a distressed debt restructuring, or if the government fails to make payments on its FC obligations in accordance with the original terms and we do not expect such a payment to be made within the applicable grace period. We could lower the LC ratings if we see indications that Ukrainian-hryvnia-denominated obligations could suffer nonpayment or restructuring.

Upside scenario

Upward pressure on the ratings could arise if Ukraine's security environment and medium-term macroeconomic outlook improve.

Rationale

The rating action follows Ukraine's consent solicitation offer made to its creditors on July 20, 2022, to defer all its foreign debt (commercial and official) service payments over the next 24 months. We understand that the country's official creditors, including the G-7 nations, have already accepted the offer, while private bondholders have been asked to vote on it by Aug. 9. We believe it is virtually certain that the Ukrainian government will stop payments on at least some foreign debt as currently documented. The ratings reflect our view of an issuer's ability and willingness to meet its commercial, nonofficial financial obligations in full and on time.

According to our ratings definitions (see "S&P Global Ratings Definitions," published Nov. 10, 2021), under the proposed conditions, we would likely consider this debt restructuring as distressed and therefore lower our FC ratings on Ukraine to 'SD' and the affected issue ratings to 'D' (default) when implemented. Upon the debt restructuring taking effect, we would subsequently reflect the new terms and conditions of the debt in the rating. We tend to rate most sovereigns emerging from default in the 'CCC' or 'B' categories depending on post-default credit factors.

We understand that the proposal to defer debt service on external debt does not include any debt haircuts and offers some compensation to bondholders in the form of additional interest payments on regular Eurobonds and a consent fee on the GDP-linked securities.

The proposal comes amid significant macroeconomic, external, and fiscal pressures emanating from the war. Ukraine's fiscal and funding outlooks beyond the next few months are uncertain, in our view. We expect general government deficits to remain sizable due to substantial defense spending and disruptions to the government's tax mobilization capacity. Authorities estimate the resulting fiscal gap at a minimum of $5 billion (or 2.5% of prewar GDP) a month. Of the $30 billion of financial aid committed by the international community since the beginning of the war, only 45% has been disbursed, whereas almost half of government funding needs have been covered by

Ukraine's central bank and government domestic issuance. There is also broader uncertainty over the country's debt-to-GDP trajectory in light of unclear economic recovery prospects and the debt burden's high sensitivity to exchange rate fluctuations, given that over 60% of government debt is denominated in FC. In addition, the war and terms-of-trade shocks have weakened Ukraine's international reserves, with its headline level decreasing one-fifth to $22.8 billion from February to June 2022.

In our view, the government's ability and medium-term incentives to meet its financial commitments in LC are somewhat higher compared with those in FC. Hryvnia-denominated debt is primarily held by domestic banks, half of which are state-owned. A default on these LC obligations would amplify banking sector distress, increasing the likelihood that the government would have to provide the banks with financial support, which would limit the benefits of debt 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. 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

- Russia-Ukraine Military Conflict: Key Takeaways From Our Articles, July 21, 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
- Sovereign Ratings History, July, 7, 2022
- Sovereign Ratings List, July 7, 2022
- 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

Downgraded

	To	From
Ukraine		
Senior Unsecured	CC	CCC+
State Road Agency of Ukraine (Ukravtodor)		
Senior Unsecured	CC	CCC+

Downgraded; Ratings Affirmed

	To	From
Ukraine		
Sovereign Credit Rating		
Foreign Currency	CC/Negative/C	CCC+/Negative/C
Ratings Affirmed		
Ukraine		
Sovereign Credit Rating		
Local Currency	B-/Negative/B	
Ukraine National Scale	uaBBB-/--/--	
Transfer & Convertibility Assessment	CCC+	
Senior Unsecured	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