S&P Global Ratings

RatingsDirect®

Ukraine

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This report does not constitute a rating action.

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Key Rating Factors

Institutional and economic profile

The economy is set to recover and reach its pre-pandemic level in 2022.

- Ukraine's economy will rebound with 3.3% growth in 2021 after contracting 4% in real terms in 2020.
- Epidemiological considerations amid rising infections and virus variants--remain a significant risk, even though the pace of vaccination picked up
- Negotiations on further IMF program disbursements continue, but financing pressures have eased

Flexibility and performance profile

Financing pressures have eased.

- We expect the current account will move back into deficit this year after a record surplus in 2020.
- External buffers against balance-of-payment risks have strengthened and we project that foreign currency (FX) reserves, net of required reserves, will cover four months of current account payments on average through 2024.
- The National Bank of Ukraine (NBU) has hiked interest rates on rising inflationary pressures after several cuts over the course of 2020.

Outlook

The stable outlook balances the risks to Ukraine's economy from continued delays in accessing concessional financing, the weak external environment, and the potential for a reversal of past reforms, against the country's external buffers.

Downside scenario

We could lower the ratings if disruptions to funding from concessional programs or capital markets over the next year call into question the government's ability to meet debt service obligations. Such disruptions could happen if the government backtracks on key reforms, such as ensuring the independence of the NBU, which acts as both the monetary authority and financial system regulator.

Upside scenario

We could raise the ratings over the next year if we anticipate that public finances would consolidate faster than we currently forecast. This could result from a stronger economic recovery and discretionary policies. The ratings could also benefit should Ukraine's external liquidity metrics outperform our projections.

Rationale

The ratings on Ukraine are constrained by the country's low per capita income and developing institutions.

Stronger macroeconomic management since 2015 and augmented FX reserves support our sovereign ratings on Ukraine. The ongoing implementation of reforms helps the government access commercial debt markets and receive concessional funding from international financial institutions.

Institutional and economic profile

Institutional bottlenecks continue to thwart reform progress

We project real GDP growth of 3.3% for Ukraine during 2021 following a contraction of 4% in 2020, reflecting a gradual stabilization of the public health situation, and a recovery in domestic demand. In 2021, remittance inflows and government support measures, including pension and wage hikes, have all supported a rebound in consumption that will only be partially offset by a recovery in imports.

Unlike many other European countries, Ukraine's GDP proved relatively resilient to the global pandemic last year, since services sectors at greatest risk from social distancing measures (arts, entertainment, recreation, retail, accommodation, and food services) make up only about 2% of gross value added (GVA). On the other hand, industrial and agricultural production, which together account for one-third of GVA, have continued to expand with little disruption. A noteworthy exception to the weakness in services last year was Ukraine's booming information technology sector, which, unconstrained by lockdowns, saw exports increase 20%.

The key risk to our forecast remains uncertainty about the distribution and take-up of vaccines. As in many emerging economies, Ukraine's rollout was initially slow, primarily on account of lagging deliveries. So far, only around 10% of the total population has been fully vaccinated.

Vested interests continue to confound Ukraine's relations with international creditors. A $5 billion program agreed with the IMF last year has stalled following rulings by Ukraine's constitutional court that rolled back previously implemented anti-corruption reforms. A push to tighten legislative loopholes is currently well underway. These efforts include reinstating criminal liability for falsified electronic declarations and amending the law on the National Anti-Corruption Bureau to prevent the premature dismissal of its head, alongside reforms to the judiciary.

In our base case we do not anticipate abrupt fiscal tightening. Despite delays to tranches, the government has retained market access and maintained liquidity buffers. Moreover, with an additional $2.7 billion received under the IMF's Special Drawing Rights (SDR) allocation, financing pressures have eased further.

Flexibility and performance profile

Financing pressures have eased.

The government budgeted a deficit of 5.3% of GDP in 2021, which factors in continued capital expenditure and another 20% minimum wage hike. However, the deficit for the full year is likely to be lower, at about 4% of GDP thanks to strong revenue performance. The general government deficit widened to an estimated 5.5% of GDP in 2020, lower than budgeted by two percentage points. Revenue intake outperformed our expectations owing to strong consumption dynamics and improvements in administration. Measures from the government to support the economy included higher unemployment benefits, pension top-ups, minimum wage hikes, and accelerated infrastructure spending.

Higher inflationary pressures will aid government debt dynamics. Despite the relatively wide headline deficit in 2021 and considering projected FX depreciation effects, net general government debt will slightly reduce to 58.5% of GDP from about 60% last year and stabilize thereafter. Inflation has stayed well above the NBU's 5% target for much of 2021, exceeding 10% in July thanks to increasing food and energy prices. This prompted the NBU to hike interest rates in 2021 by a cumulative 200 basis points. Nonresidents have increased their holdings to about 18% of total local currency government debt (excluding NBU holdings) in recent months after cutting their holdings of hryvnia-denominated government bonds through last year, though this figure is still down from a peak of nearly 33% in February 2020.

There is a residual risk for Ukraine's government balance sheet related to the 2013 $3 billion Eurobond, which was not restructured in 2015 and is held by Russia (see "Ukraine Foreign Currency Ratings Lowered To 'SD' (Selective Default) On Distressed Debt Restructuring," published Sept. 25, 2015, on RatingsDirect). In the event of a court ruling against Ukraine and its refusal to pay in full, legal or technical constraints on Ukraine's commercial debt service to other creditors could potentially apply.

Strengthening domestic demand and higher global prices for imported commodities, alongside dividend outflows, will push Ukraine’s current account back into deficit this year, after a record current account surplus in 2020. The surplus was due in part to a change in the accounting treatment of losses on foreign investment and imports compression. Moreover, the volume of Russian gas transiting through Ukraine will continue to decline over the forecast period.

Nonperforming loans (NPLs) in the Ukrainian banking system reduced to 37.2% as of mid-2021 from 49% in December 2019. This was due to the write-off of legacy NPLs, mainly by the four state-owned banks, with the largest declines at PrivatBank. We forecast NPLs in the system will reduce to about 25% by year-end 2022 as write-offs of legacy NPLs, fully provisioned, will outweigh asset-quality deterioration caused by COVID-19 and seasoning of loans in 2021.

We expect the rehabilitation of state-owned banks will continue in line with the government's aim of reducing its ownership in the sector to 25%. It intends to do this via the sale of PrivatBank and minority stakes in Oschadbank, Ukreximbank, and Ukrgazbank. We view the International Finance Corp.'s recent loan to Ukrgazbank, convertible into a stake in the bank's capital, as a step in this direction.

Republic of Ukraine--Selected Indicators

	2015	2016	2017	2018	2019	2020	2021bc	2022bc	2023bc	2024bc
Economic indicators (%)										
Nominal GDP (bil. UAH)	1,988.5	2,385.4	2,983.9	3,560.6	3,978.4	4,193.7	4,743.7	5,228.8	5,655.0	6,115.9
Nominal GDP (bil. $)	90.7	93.4	112.2	130.8	154.2	155.4	165.5	175.8	182.4	191.1
GDP per capita (000s $)	2.1	2.2	2.6	3.1	3.7	3.7	4.0	4.3	4.4	4.7
Real GDP growth	(9.8)	2.4	2.5	3.4	3.2	(4.0)	3.3	3.5	3.0	3.0
Real GDP per capita growth	(4.5)	2.9	2.9	3.9	3.8	(3.5)	4.1	4.1	3.6	3.6
Real investment growth	(9.2)	20.4	16.1	16.6	11.7	(24.4)	40.0	15.0	10.0	10.0
Investment/GDP	15.9	21.7	20.0	18.6	14.9	7.5	10.7	13.5	15.6	17.6
Savings/GDP	21.5	19.7	16.9	13.7	12.2	10.9	10.1	11.5	12.2	13.2
Exports/GDP	52.6	49.3	48.0	45.2	41.2	39.0	37.9	36.7	36.0	35.2
Real exports growth	(13.2)	(1.8)	3.8	(1.3)	7.3	(5.6)	4.5	3.3	3.5	3.5
Unemployment rate	9.5	9.7	9.9	9.1	8.6	9.9	9.5	8.9	8.9	8.5
External indicators (%)										
Current account balance/GDP	5.6	(2.0)	(3.1)	(4.9)	(2.7)	3.4	(0.6)	(2.0)	(3.4)	(4.3)
Current account balance/CARs	8.7	(3.2)	(5.1)	(8.5)	(4.9)	6.6	(1.2)	(4.0)	(7.0)	(9.1)
CARs/GDP	64.2	61.6	60.7	58.1	54.9	50.5	49.6	48.9	48.5	47.6
Trade balance/GDP	(3.8)	(7.4)	(8.6)	(9.7)	(9.3)	(4.4)	(6.3)	(7.8)	(9.0)	(9.6)
Net FDI/GDP	(0.5)	4.1	3.3	3.4	3.4	(0.1)	2.5	2.5	2.5	2.5
Net portfolio equity inflow/GDP	0.2	0.2	0.1	(0.0)	0.0	0.1	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	149.9	118.9	115.6	115.0	106.8	94.8	99.3	101.0	103.1	106.1
Narrow net external debt/CARs	152.3	143.1	119.2	103.5	90.8	94.5	89.2	84.7	84.0	85.1
Narrow net external debt/CAPs	166.7	138.6	113.4	95.5	86.6	101.2	88.1	81.5	78.4	78.0
Net external liabilities/CARs	65.4	60.7	47.4	34.8	32.7	24.2	27.3	31.1	37.2	45.3
Net external liabilities/CAPs	71.5	58.8	45.1	32.1	31.2	25.9	27.0	29.9	34.8	41.5
Short-term external debt by remaining maturity/CARs	75.7	42.2	36.0	34.2	27.5	31.2	32.4	32.1	32.4	33.0
Usable reserves/CAPs (months)	1.5	2.6	2.5	2.7	2.8	4.0	4.1	4.0	4.0	3.7
Usable reserves (Mil. $)	12,857.8	15,062.2	18,252.3	20,330.9	24,676.9	28,368.1	29,861.5	31,240.9	30,919.0	29,199.8
Fiscal indicators (general government %)										
Balance/GDP	(3.2)	(2.2)	(1.4)	(2.1)	(2.1)	(5.7)	(4.0)	(3.5)	(3.0)	(2.5)
Change in net debt/GDP	21.8	15.3	6.1	1.0	(4.0)	12.6	6.5	5.7	4.4	3.8
Primary balance/GDP	1.3	1.9	2.4	1.2	0.9	(2.7)	(1.0)	(0.5)	0.2	0.6
Revenue/GDP	42.4	38.6	40.3	39.8	39.4	40.0	38.5	39.5	40.0	40.0
Expenditures/GDP	45.5	40.7	41.7	41.9	41.6	45.6	42.5	43.0	43.0	42.5
Interest/revenues	10.5	10.6	9.3	8.3	7.7	7.3	7.8	7.6	8.0	7.8
Debt/GDP	79.1	81.1	71.8	60.9	50.2	60.9	60.3	60.3	60.2	59.4

Republic of Ukraine--Selected Indicators

Debt/revenues	186.6	210.3	178.1	153.0	127.4	152.2	156.6	152.8	150.4	148.6
Net debt/GDP	76.1	78.7	69.0	58.8	48.6	58.7	58.4	58.6	58.6	58.0
Liquid assets/GDP	3.0	2.3	2.7	2.1	1.6	2.1	1.9	1.7	1.6	1.5
Monetary indicators (%)										
CPI growth	48.7	13.9	14.4	11.0	7.9	2.7	9.5	6.5	5.0	5.0
GDP deflator growth	38.9	17.1	22.1	15.4	8.3	9.8	9.5	6.5	5.0	5.0
Exchange rate, year-end (UAH/$)	24.0	27.3	28.1	27.7	23.8	28.3	29.0	30.5	31.5	32.5
Banks' claims on resident non-gov't sector growth	(2.4)	(1.6)	1.2	5.4	(9.7)	(3.1)	5.0	7.5	7.5	7.5
Banks' claims on resident non-gov't sector/GDP	52.1	42.8	34.6	30.6	24.7	22.7	21.1	20.6	20.4	20.3
Foreign currency share of claims by banks on residents	48.4	38.9	32.2	30.5	26.3	22.0	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	45.3	46.3	46.0	42.1	40.0	37.7	N/A	N/A	N/A	N/A
Real effective exchange rate growth	(6.9)	(0.5)	5.2	6.4	15.2	(0.7)	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

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.
		Ukraine continues to face external security risks. Despite efforts to de-escalate tensions and the resumption of talks between Ukraine and Russia, ceasefire violations and fatalities in the Donbass continue.
Economic assessment	5	Based on GDP per capita ($) as per Selected Indicators in Table 1.
External assessment	5	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	3	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1
Fiscal assessment: debt burden	5	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 about 28% of its assets.
Monetary assessment	4	The hryvnia generally floats freely with intermittent interventions from the National Bank. of Ukraine.
		The transmission mechanism is weak, as demonstrated by still-weak real credit growth.
Indicative rating	b	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Sovereign credit rating		
Foreign currency	B	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt
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: 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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Banking Industry Country Risk Assessment Update: August 2021, Aug. 24, 2021
- Sovereign Ratings List, Aug. 17, 2021
- Sovereign Ratings History, Aug. 17, 2021
- Sovereign Ratings Score Snapshot, Aug. 3, 2021
- Sovereign Risk Indicators, July 12, 2021; a free interactive version is available at http://www.spratings.com/sri
- European Economic Snapshots: The Economy Is Responding Quickly To The Grand Reopening, July 9, 2021

- Default, Transition and Recovery: 2020 Annual Sovereign Default And Rating Transition Study, April 12, 2021
- Stress Scenario: The Sovereigns Most Vulnerable To A COVID-19-Related Slowdown In Tourism, March 17, 2020
- Sovereign Debt 2021: Global Borrowing Will Stay High To Spur Economic Recovery, March 1, 2021