R&I

NEWS RELEASE

Jul 27, 2022

R&I Downgrades to CCC, Retains on the Rating Monitor With View to Downgrading: Ukraine

Rating and Investment Information, Inc. (R&I) has announced the following:

ISSUER: **Ukraine**

Foreign Currency Issuer Rating:
(CCC), With View to Downgrading, Previously (B-)

RATIONALE:

Ukraine has been going through economic difficulties ever since Russia launched a massive military invasion in February. R&I expects that it would take quite a while to restore its growth potential due to the destruction of economic fundamentals. Amid a widening fiscal deficit, the government needs huge funds to wage war and to reconstruct the economy and society. The government of Ukraine has requested creditors to postpone debt service payments in order to preserve hard currency. This also suggests that the country's fiscal management is under severe pressure. Considering the above-mentioned factors, R&I has downgraded the Foreign Currency Issuer Rating to CCC and retained it on the Rating Monitor with a view to downgrading. R&I will update the rating after exploring the impacts of the military invasion from the economic, political and social perspectives and looking into the prospect of the debt management.

In the January to March quarter 2022, the Ukrainian economy saw a 15.1% contraction in terms of real gross domestic product (GDP) on a year-over-year basis, in sharp contrast to a 3.4% growth that it achieved for the full year of 2021 in spite of the lingering impact of the COVID-19 pandemic. As economic activities are depressed by the occupation of certain territories by Russian forces, destruction of infrastructure and industrial production base as well as restrictions on logistics, the country's full year real GDP in 2022 is expected to contract sharply. The future of Ukrainian economy depends on the development of the fight against Russia. The level of uncertainties about the future of Ukraine is extremely high and the scale of economy will likely remain at a level well below the pre-invasion level even on a medium-term basis.

In the wake of the invasion by Russia, the fiscal revenue decreased in marked contrast to the increased spending associated with defense and social welfare, resulting in a huge fiscal deficit in the January to May period, which has largely exceeded the full-year deficit recorded in 2021. On a full year basis, despite the government efforts to cut spending and mobilize taxes, the year of 2022 will likely see a massive fiscal deficit. Ukraine will likely run a certain extent of fiscal deficit for years to come, because of the funding needs for reconstruction and the weakened base of taxation.

The ratio of outstanding government debt including government-guaranteed bonds dropped to 48.9% of GDP in 2021, from the level of more than 60% recorded in 2020. However, the ratio will likely increase again due to a deterioration of fiscal balance in 2022. The future trend of government debt ratio will be determined by the movement of foreign exchange rate reflecting the high percentage of foreign currency denominated debt, in addition to the prospect of economic growth and fiscal balance. The central bank devalued the national currency in July, while it has fixed the exchange rate as a contingency measure since February 2022. The government debt ratio will likely remain at a high level for the time being.

As for fund procurement, the Ukrainian government depends mostly on the central bank, which is continuing to purchase the government bonds in order to meet the funding needs of the government, but this structure implies the risk of deteriorating the macroeconomic instability, if it persists. Although the Group of Seven (G7), the governments in Europe and other regions in the world and the international institutions are offering financial assistance continuously, the government is having difficulty in securing the reserve of foreign currency. On July 20, the government proposed to the creditors the plan to postpone debt payments for two years. The Group of Creditors of Ukraine including Japan, the United States, and European countries announced the intention to support the government's plan to delay debt

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payment until the end of 2023 and major institutional investors also supported the move. This is expected to ease the government financial burdens to a certain extent. On the other hand, as the war against Russia is prolonged, concerns about Ukraine's capability of servicing debts are growing. R&I will keep a close eye on how the government will handle its debt payments.

The primary rating methodology applied to this rating is provided at "R&I's Analytical Approach to Sovereigns". The methodology is available at the web site listed below, together with other rating methodologies that are taken into consideration when assigning the rating.
https://www.r-i.co.jp/en/rating/about/rating_method.html

R&I RATINGS:

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	Foreign Currency Issuer Rating
RATING:	**(CCC), With View to Downgrading, Previously (B-)**

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