Ukraine
Rating Report

SCOPE CC NEGATIVE

Credit strengths

- Significant international financial support
- Adept central-bank response to crisis
- Resilient banking system under the exceptional circumstances
- Improvements within the external sector

Credit challenges

- Expectation of further debt restructuring
- Long-run debt sustainability risk amid protracted war
- External-sector risks
- Banking-system vulnerabilities

Rating rationale:

Significant international financing support: Loan and grant financing alongside prudent debt relief from a range of international multilateral, bilateral-official and private creditors and donors. Sustained international financial assistance coupled with increasing bank borrowing in the domestic market are crucial to eliminating monetary financing and reinforcing long-run debt sustainability.

Institutional preparedness for this crisis: The National Bank of Ukraine (NBU) adopted speedy administrative and capital controls following the full-scale invasion to preserve foreign-exchange reserves, stem deposit flight, inject liquidity and adopt regulatory forbearance. It has appropriately held its policy rate at 25% to control inflation and boost an attractiveness of hryvnia assets.

Resilient banking system under exceptional circumstances: The resilience of the domestic financial system since the war supports an ongoing elimination of monetary financing, boosts sovereign financing in domestic markets and anchors the domestic-debt ratings of the sovereign.

Rating challenges include: i) an expectation of a (second) external debt restructuring by 2024; ii) long-run debt sustainability risk amid a protracted conflict; iii) risks to external-sector resilience and elevated dollarisation; and iv) banking-system vulnerabilities.

Ukraine's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating (foreign currency issuer)
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	ccc	UAH [+0]	0	CC
Public Finance Risk		20%	b		0	
External Economic Risk		10%	bb-		0	
Financial Stability Risk		10%	bb		0	
ESG Risk	Environmental Factors	5%	a+		-1/3	Final rating (local currency issuer)
	Social Factors	7.5%	bbb		-1/3	
	Governance Factors	12.5%	c		-1/3	CCC
Indicative outcome			**b-**		**-1**	
Additional considerations (local currency)					**0**	
Additional considerations (foreign currency)**					**-1**	

Note: *The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve-currency adjustment applies to currencies in the IMF's SDR basket. **For Ukraine, a one-notch extraordinary downside adjustment to foreign-currency issuer ratings reflects an expectation of near-term external debt restructuring. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Negative Outlook for long-term foreign-currency issuer ratings reflects Scope's expectation of an external debt treatment next year. The Stable Outlook for local-currency issuer ratings reflects a view that risks relevant to the domestic debt are balanced over the next 12-18 months.

Foreign-currency long-term issuer rating:

Negative rating-change driver:

- Negotiations approach for the further extension of the debt-servicing freeze

Positive rating-change driver:

- Restructuring plans with the external private sector are cancelled

Domestic debt ratings:

Negative rating-change driver:

- Likelihood rises for debt restructuring of Ukrainian domestic debt

Positive rating-change driver:

- A ceasefire; improved government debt sustainability and/or easing banking risk

Ratings and Outlook

Foreign currency

Long-term issuer rating	CC/Negative
Senior unsecured debt	CC/Negative
Short-term issuer rating	S-4/Stable

Local currency

Long-term issuer rating	CCC/Stable
Senior unsecured debt	CCC/Stable
Short-term issuer rating	S-4/Stable

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Bloomberg: RESP SCOP

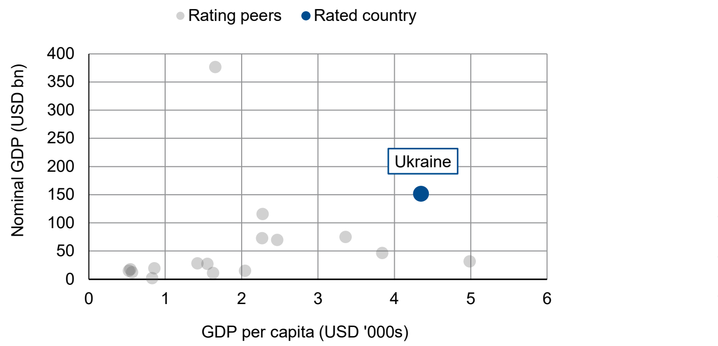
Domestic Economic Risks

- **Growth outlook:** After a 3.8% economic contraction amid the Covid-19 crisis in 2020, followed by a rebound to 3.4% in 2021, Ukraine's economy contracted severely by 29.1% in 2022 (about in line with our estimate of 31% since last July, but significantly more moderate than a World Bank estimate for a 45% contraction). Russia's full-scale invasion of Ukraine has caused unprecedented damages to economic activity, with significant disruptions of the labour market, critical energy infrastructure, as well as supply and production chains. In Q1 2023, the economy displayed further evidence of slow recovery, on the back of the liberation of select territories, households' and firms' adaptation to power outages, and stable energy sector conditions since mid-February. The "grain corridor" opening supported a recovery of trade, while improved business and consumer sentiment anchored activity across some industrial and service sectors. We project growth to recover to 4% this year – revised down from our 7% estimate previously, although staying meaningfully above an IMF estimate of -3 to +1% for this year – before 2.5% growth (IMF: 3.2%) estimated regarding 2024.
- **Inflation and monetary policy:** Headline inflation decreased since 2023, reaching 17.9% YoY by April, from the 26.6% peaks as of December 2022. Despite being partially due to more favourable base effects, this drop was also a result of sufficient food and fuel supplies, alongside rapid revival in the energy system. In addition, the termination of monetary financing, a stronger cash exchange rate of hryvnia and greater attractiveness of hryvnia assets helped cut inflation expectations. However, core inflation remains elevated at 16.9% and pressure on business production costs persist, given difficulties of running businesses under prevailing wartime conditions. Therefore, we expect inflation to average 17.4% in 2023 before 11.4% in 2024. The NBU held its key policy rate unchanged at 25% last month, seeking to guarantee exchange-rate stability amid significant economic uncertainty, as well as maintain an enhanced attractiveness of hryvnia-denominated assets. The NBU's objective is for a gradual liberalisation of FX market restrictions and return to a floating exchange rate.
- **Labour markets:** The unemployment rate was 10.6% (for those aged 15-70) as of last reporting from Q4 2021. According to NBU estimates, this rate rose significantly following the full-scale invasion, peaking at nearly 30% in Q2 2022. The labour market displayed signs of recovery in Q1 2023, with increased job openings. Nevertheless, employment remains low and the number of persons having a job before the war's escalation but today unemployed stayed stable around 36%. On the back of slow recovery in production capacity and only gradual reduction of supply-chain disruptions, the NBU estimates unemployment staying elevated around 18.3% on average in 2023, before declining to 16.5% in 2024 and 14.7% by 2025.

Overview of Scope's qualitative assessments for Ukraine's *Domestic Economic Risks*

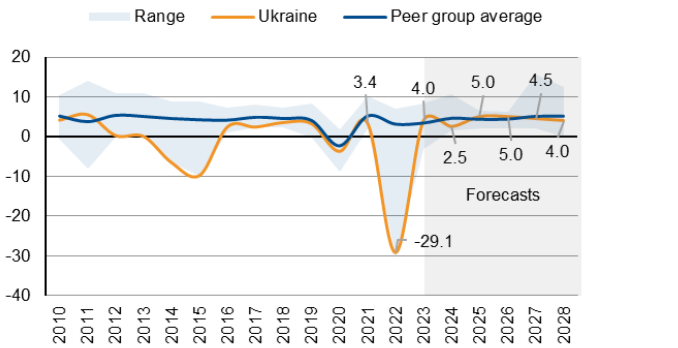
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
ccc	Growth potential of the economy	Neutral	0	Moderate long-run growth potential but significant uncertainty around recovery trajectory given the war; growth better than IMF expectations
	Monetary policy framework	Strong	+1/3	Significant pre-crisis improvement in monetary governance; central-bank measures since the full-scale war have been crucial in the anchoring of macroeconomic and financial stability; elimination of monetary financing
	Macro-economic stability and sustainability	Weak	-1/3	Average economic diversification and labour-market flexibility, conflict with Russia undermines longer-run macroeconomic stability

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

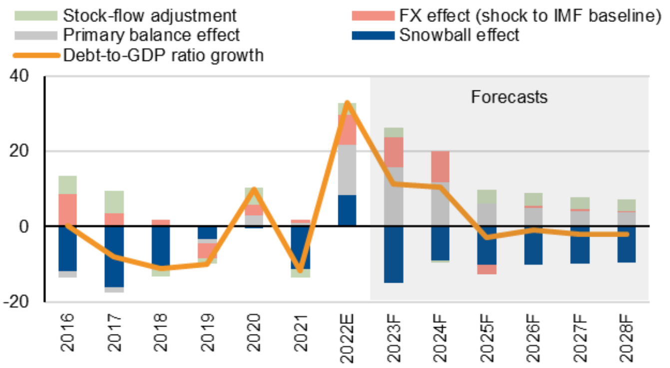
Public Finance Risks

- **Fiscal outlook:** Ukraine's general government deficit stood at 16.7% of GDP last year, curtailed to a degree by prudent policy commitments under a previous Program Monitoring with Board Involvement (PMB) with the IMF. There was material annual expenditure growth of 55% during 2022 – mostly driven by defence, security and social programmes. Tax revenues remained comparatively stable last year, on the back of higher wages in the defence and security sectors supporting personal income tax payments and social security contributions. International grants and loans are still a core source of budget deficit financing, coupled since 2023 by domestic bank financing. The latter accelerated since early 2023, after the NBU allowed banks to meet their reserve requirements using government securities. The 2023 Budget was amended this March to raise budget spending further by a record of >UAH 486bn, guaranteeing sufficient funding for crucial security and defence expenditure, which is expected alone to reach around 27% of GDP this year. We see the budget deficit standing around 20% of GDP in 2023, before 17.5% in 2024 and averaging 8.1% of GDP from 2025-28.
- **Debt trajectory:** The severe 2022 drop in economic output, sizeable deficits and one-off 25% exchange-rate devaluation last July have put substantive strain on debt sustainability, although debt sustainability is supported by continued extraordinary international financial assistance, including the Group of Creditors' extension of a debt-service suspension until 2027. Ukraine's debt-to-GDP ratio rose from 48.9% as of 2021 to 78.4% by 2022. We expect said ratio to peak around 100% by 2024, pushed up nevertheless by persistently elevated budget deficits amid expenditure on war and reconstruction. Under an adverse scenario of intensification of the war, Ukraine's general government debt could rise above 150% of GDP by 2025.
- **Debt profile and market access:** In view of restricted access to international debt capital markets, official-sector concessional loans and grants remain the primary source of funding. This has recently been strengthened further by the IMF's historic USD 15.6bn 48-month Extended Fund Facility for Ukraine, opening an estimated USD 115bn of aggregate financing over four years. Moreover, an increasing strategic reliance on domestic bank borrowing to sustain an elimination of monetary financing curtails the likelihood of domestic debt restructuring, enhances the sustainability of war financing and eases pressure on the hryvnia and forex reserves. The liability management exercise concluded during August 2022 resulted in a two-year deferral of USD 6bn (by end-2023) in foreign-currency debt service. An extended debt-service suspension could deliver USD 4.6bn (3% of GDP) of savings on payments due to foreign bondholders and bilateral creditors in 2024.

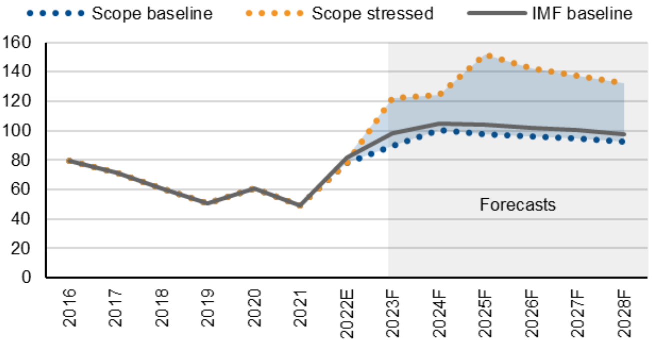
Overview of Scope's qualitative assessments for Ukraine's *Public Finance Risks*

CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a-	Fiscal policy framework	Neutral	0	Record of fiscal discipline with oversight of the IMF and multilateral & bilateral creditors; reduced spending flexibility due to the war
	Debt sustainability	Weak	-1/3	Significant weakening of debt sustainability amid Russian invasion; debt sustainability vulnerable under adverse economic scenarios
	Debt profile and market access	Strong	+1/3	Restricted international market access, high foreign-currency risk in government debt, but extraordinary access to global multilateral and bilateral lenders and donors

Contributions to changes in debt levels, pps of GDP*



Debt-to-GDP forecasts, % of GDP, by scenario*



*Scenarios are pre-debt restructuring seen near the end of the forecast horizon (2027). Source: IMF WEO, Scope Ratings forecasts.

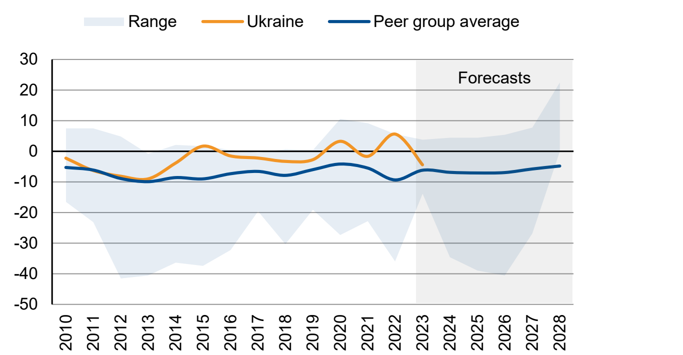
External Economic Risks

- **Current account:** After a current-account surplus of 3.4% of GDP in 2020 due to hikes of commodity prices, a decline in imports and reinvested income payments, Ukraine returned to a 1.9% of GDP current-account deficit in 2021 as domestic demand recovered, terms of trade reversed and as reinvested income and dividend payments reached records. Unprecedented international financial assistance including grants, resilient remittances inflows, decline in primary income payments, an opening of the grain corridor by Q3 2022 and record high supplies of electricity to the European Union anchored a rebound to a current-account surplus last year (of around 5% of GDP). However, persistent logistical bottlenecks, curtailed production capacity due to the destruction of supply-chain facilities and severe disruption in the supply of electricity constrain exports, which remain around 45% under pre-February 2022 levels. Despite significant forex inflows due to remittances from diaspora and international financial assistance, the current-account deficit is seen by the IMF reversing this year to a deficit (of 4.4% of GDP) on the back of higher imports alongside reduced exports. This deficit is seen thereafter averaging 6.5% of GDP over 2024-26.
- **External position:** Due to external-debt deleveraging, gross external debt has been curtailed over the years, from 131.2% as of Q4 2015 to 65.5% by end-2021. Ukraine's net international investment position (NIIP) was strengthened, standing at -2.1% of GDP in Q4 2022, correcting from an ebb at -50.2% of GDP as of Q3 2015. However, due to large-scale international loan financing, levels of external debt have reversed higher, reaching 83% of GDP by Q4 2022. A higher share of grant financing in international financial assistance remains required for enhancement of sovereign external debt sustainability.
- **Resilience to short-term external shocks:** Given a steady inflow of funding from international partners – for instance, USD 11bn was received in Q1 2023 alone – foreign-currency reserves reached USD 29.7bn in April, surpassing the USD 29.4bn level recorded at end-2021. Significant reductions in NBU interventions in the forex market on the basis of improved economic expectations, elimination of monetary financing and a stronger real policy rate have furthermore helped to consolidate levels of forex reserves. Foreign-currency reserves coverage of short-term external debt (the latter on a remaining maturity basis) has improved, reaching a moderate 62% by April, from the 44% at July 2022 lows, and nearly equal to levels from before the full-scale war beginning. The official hryvnia exchange rate was devalued 25% against the dollar in July 2022, resulting in convergence against the unofficial hryvnia rate. The unofficial hryvnia rate trades currently only 3% off the official hryvnia-dollar cross.

Overview of Scope's qualitative assessments for Ukraine's *External Economic Risks*

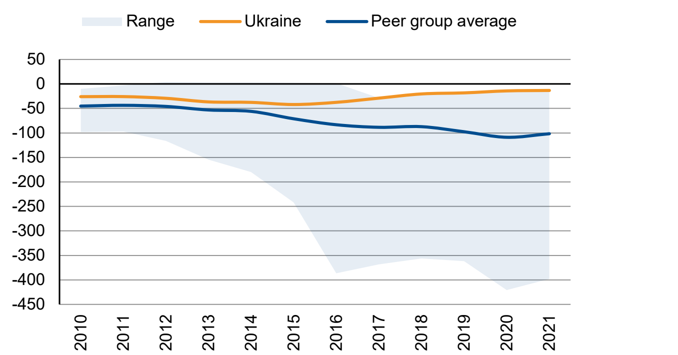
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb-	Current account resilience	Neutral	0	Risk from capital outflows, reliance on remittances inflows, significant international financial assistance, return to a current-account deficit
	External debt structure	Neutral	0	Reversal in the external debt ratio, a high share of external debt that is short-term, maturity of external debt extended after debt restructuring
	Resilience to short-term external shocks	Neutral	0	Moderate albeit increasing levels of reserves, representing moderate coverage of short-term external debt

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position, % of GDP



Source: IMF, Scope Ratings

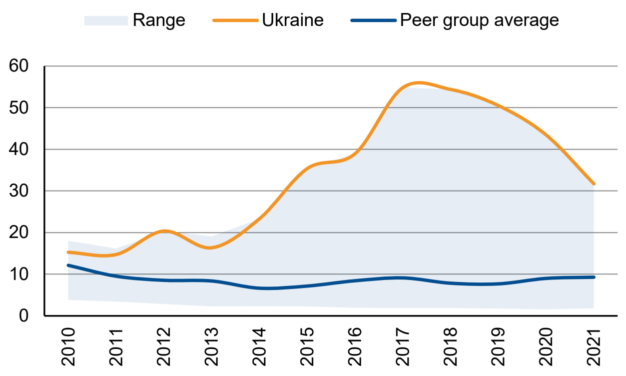
Financial Stability Risks

- **Banking sector:** Since the full-scale invasion of Ukraine, domestic banks have adapted and continued operating effectually although operational risks have started rising, due to measures needed to adapt bank branch activities to power outages. At the same time, heightened credit risks resulted in the crystallisation of credit losses. This deterioration of credit quality was reflected in Ukraine's non-performing loan ratio steadily gaining to 36.8% by November of last year, from 26.6% lows in February 2022, resulting in rises of loan-loss provisioning. This contributed to eroding bank capital, with the tier 1 capital ratio standing at 13.4% of risk-weighted assets as of February 2023, although stronger than the 11.7% level pre-invasion. Said capital adequacy is moderately higher since mid-2022, supported by robust operating profitability given buoyant return-on-equity of 56% in February 2023 – driven by higher interest, fee and commission income. System-wide dollarisation of deposits moderated to 36.8% in March 2023. In the same month, the share of foreign-currency loans dropped to 27.4%, from highs of 29% reached July 2022.
- **Private debt:** Private debt of Ukraine remains low as households and non-financial corporations (NFCs) display loans outstanding in domestic currency of around 4.4% and 10.7% of GDP respectively as of February 2023. Figures are even smaller as far as loans in foreign currency (0.3% of GDP for households; around 5.2% for the NFCs sector). Retail deposits rose during 2022 after substantive payments made to military personnel and social-benefit recipients drove an increase in nominal household income. FX deposits resumed growth as well, due to the possibility of purchasing FX cash for making term deposits. At the same time, corporate deposits have risen on the back of recovery in economic activity. In the short run, despite persistent attacks on crucial infrastructure and power outages, a steady inflow of corporate deposits has continued.
- **Financial imbalances:** Ukraine's banking system faces significant credit-risk challenges, in view of the effects of the war and challenging economic conditions on loan quality and banking-sector income. Supportive policy countermeasures such as repayment holidays, reduced commissions and loan restructurings could ease the effects of the crisis on asset quality, and their eventual phase-out is expected to prove gradual even after martial law is lifted. However, a delayed recognition of financial losses could bring about sharp deterioration in financial positions when losses are recognised in the future. Activity in the housing market is still subdued and the market is expected to stagnate over the medium run given the protracted conflict, high security risks for households and slow recovery in household income.

Overview of Scope's qualitative assessments for Ukraine's *Financial Stability Risks*

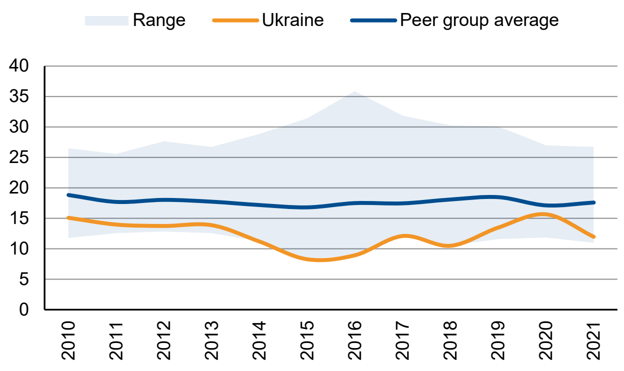
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb	Banking sector performance	Neutral	0	Resilience in the banking sector. Stable liquidity and rises in capital adequacy, although crystallisation of credit risks challenges bank balance sheets. Modest decline in dollarisation.
	Banking sector oversight	Neutral	0	Multiple initiatives over the years to enhance banking-sector governance; challenges still in financial supervision
	Financial imbalances	Neutral	0	Low-level of private-sector debt given developing domestic capital market

Non-performing loans, % of total loans



Source: IMF, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

ESG Risks

- **Environment:** Ukraine's economy faces high transition costs to a more sustainable economic model, as reflected in elevated carbon emissions per unit of GDP. The current government aims to bring emissions to 65% below 1990 levels by 2030 and achieve full climate neutrality by year 2060. Ukraine has committed to ending coal-fired power generation by 2035 while investing significantly into renewables. There is exposure to natural as well as man-made disasters such as frequent flooding, harsh winters, storms, mine disasters as well as the legacy of the 1986 Chernobyl disaster. The war is causing significant, long-lasting environmental and climate damage.

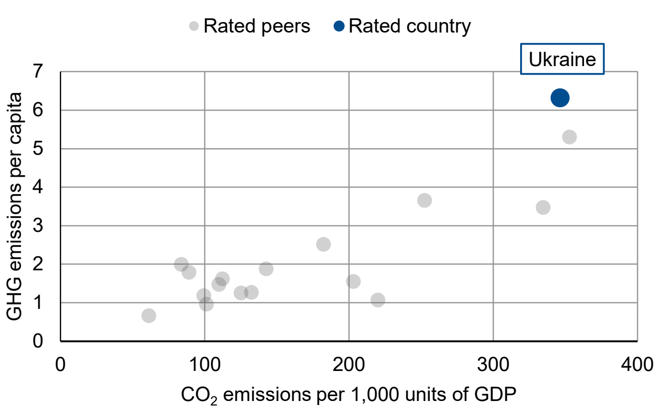
- **Social:** Ukraine's labour-market performance was reflected in average rates of unemployment and labour-market participation (under an international comparison) *before* the war escalated. Ukraine sees average international rankings with respect to its educational performance and lower marks as regards its healthy life expectancy. According to World Bank's preliminary estimates, due to the war, the population's poverty rate rose from 5.5% in 2021 to 24.2% in 2022, representing an added 7.1m people falling into poverty status, a setback of 15 years of progress. Demographic trends represent a significant challenge to longer-run economic growth. Ukraine's old-age dependency ratio is expected to rise, despite temporary recovery in the working-age population during 2024-26 (before resuming demographic decline by 2027), according to 2022 UN forecasts.

- **Governance:** The 2019 presidential and parliamentary elections in Ukraine delivered the prospect for a government under President Volodymyr Zelenskyy to address longer-standing structural impairments. Reforms aiming to quell political and endemic corruption were undertaken. Major challenges have hindered the reform process, however, such as Constitutional Court challenges and adverse court rulings. Governance and institutional risks relate to the war, as Russian aggression seeks annexation of additional regions of Ukraine. After Ukraine applied for EU membership at the end of February 2022, the European Union formally agreed by June of last year to candidate status for Ukraine – beginning a longer-run process for the nation's EU accession, but subject to conditions around the enhancement of rule of law and anti-corruption legislation.

Overview of Scope's qualitative assessments for Ukraine's *ESG Risks*

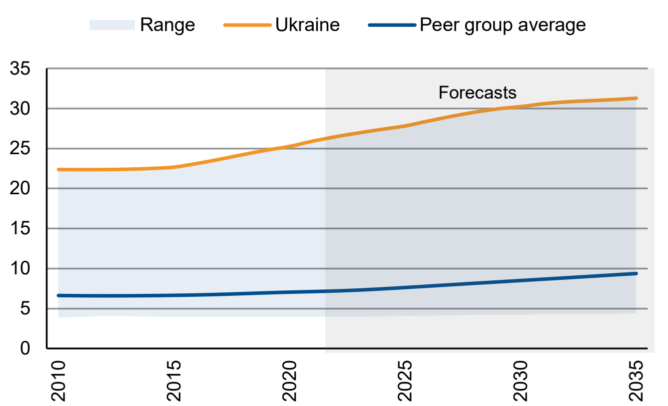
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b-	Environmental factors	Weak	-1/3	Transition risk outstanding for higher carbon-intensity developing economy; the war is causing long-lasting environmental damage
	Social factors	Weak	-1/3	Poverty, emigration and internal displacement of people due to the war, rising old-age costs, moderate income inequality, moderate performance on education, weaker health metrics
	Governance factors	Weak	-1/3	War on sovereign's territory and associated exceptional adverse credit implications

Greenhouse gas (GHG) emissions per GDP and per capita, $mtCO_2e$



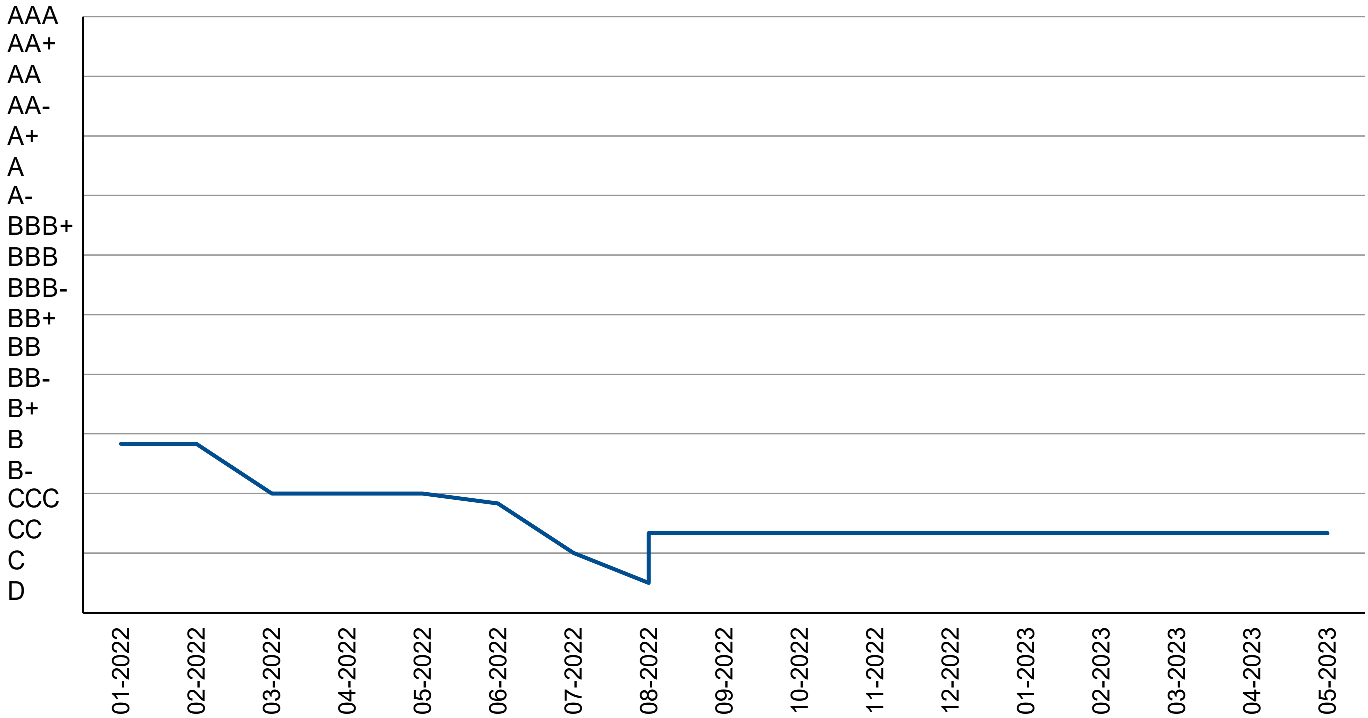
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history (foreign-currency long-term debt)



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
n/a

*Publicly rated sovereigns only; the full sample is larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022
Domestic Economic	**GDP per capita, USD '000s**	IMF	3.1	3.7	3.8	4.9	3.4
	Nominal GDP, USD bn	IMF	130.9	154.0	156.4	199.7	138.4
	Real growth, %	IMF	3.5	3.2	-3.8	3.4	-29.1
	CPI inflation, %	IMF	10.9	7.9	2.7	9.4	20.2
	Unemployment rate, %	WB	8.8	8.2	9.1	8.9	-
Public Finance	**Public and publicly-guaranteed debt, % of GDP**	IMF	60.9	50.2	60.4	48.9	78.4
	Interest payment, % of revenue	IMF	8.3	7.7	7.3	7.7	8.1
	Primary balance, % of GDP	IMF	1.4	1.1	-3.0	-1.1	-13.4
External Economic	**Current-account balance, % of GDP**	NBU	-4.9	-2.7	3.4	-1.9	5.0
	Total reserves, months of imports	NBU	3.3	4.8	4.2	4.5	3.7
	NIIP, % of GDP	NBU	-20.2	-17.9	-14.1	-13.1	-2.1
Financial Stability	**NPL ratio, % of total loans**	IMF	54.4	50.5	43.5	31.7	-
	Tier 1 ratio, % of risk-weighted assets	IMF	12.0	10.9	13.0	16.2	12.0
	Credit to private sector, % of GDP	WB	34.5	30.0	28.2	-	-
ESG	**CO_2 per EUR 1,000 of GDP, mtCO_2e**	EC	407.2	370.9	366.3	346.3	-
	Income share of bottom 50%, %	WID	22.7	22.6	22.6	22.6	-
	Labour-force participation rate, %	WB	66.6	66.6	-	-	-
	Old-age dependency ratio, %	UN	24.3	24.8	25.3	25.9	26.5
	Composite governance indicators*	WB	-0.7	-0.6	-0.5	-	-

* Average of the six World Bank Worldwide Governance Indicators.

Appendix IV. Economic development and default indicators

IMF Development Classification	Emerging Market and Developing Economies
5y USD CDS spread (bps)	n/a

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