FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Ukraine to 'CCC'

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Related Fitch Ratings Content:
Ukraine - Rating Action Report

Fitch Ratings - London - 25 Feb 2022: Fitch Ratings has downgraded Ukraine's Long-Term Foreign-Currency Issuer Default Rating (IDR) to 'CCC' from 'B'. Fitch typically does not assign Outlooks or apply modifiers to sovereigns with a rating of 'CCC' or below.

A full list of rating actions is at the end of this rating action commentary.

EU CALENDAR DEVIATION DISCLOSURE

Under EU credit rating agency (CRA) regulation, the publication of sovereign reviews is subject to restrictions and must take place according to a published schedule, except where it is necessary for CRAs to deviate from this in order to comply with their legal obligations. Fitch interprets this provision as allowing us to publish a rating review in situations where there is a material change in the creditworthiness of the issuer that we believe makes it inappropriate for us to wait until the next scheduled review date to update the rating or Outlook/Watch status. The next scheduled review date for Fitch's sovereign rating on Ukraine is 22 July 2022 but Fitch believes that developments in the country warrant such a deviation from the calendar and our rationale for this is set out in the first part (High weight factors) of the Key Rating Drivers section below.

KEY RATING DRIVERS

The downgrade reflects the following key rating drivers and their relative weights:

HIGH

The military invasion by Russia has resulted in heightened risks to Ukraine's external and public finances, macro-financial stability and political stability. Russia has launched missile and ground operations across multiple fronts, including Kyiv. There is high uncertainty over the extent of Russia's ultimate objectives, the length, breadth and intensity of the conflict, and its aftermath.

MEDIUM

The invasion represents a severe negative shock to a broad-range of key credit metrics. Ukraine has fairly low external liquidity relative to sovereign external debt service of USD4.3 billion in 2022, and expected capital outflows will further weaken its external financing position.

The shock to domestic confidence is expected to have a severe impact on economic activity and the currency, fuelling inflationary pressure and macro-economic volatility. Public finances would additionally be impacted by greater military expenditure, and the ability to roll over domestic debt will be severely constrained.

Developments markedly increase the risk of bank deposit outflows and an increase in the dollarisation ratio. There is a high likelihood of an extended period of political instability, with regime change a likely objective of President Putin, creating heightened policy uncertainty and potentially also undermining the willingness of Ukraine to repay debt.

Ukraine's 'CCC' rating also reflects the following rating drivers:

Until now, Ukraine has had a credible macroeconomic policy framework (underpinned by exchange rate flexibility, commitment to inflation-targeting, and prudent fiscal policy), record of multilateral support, favourable human development indicators, a net external creditor position of 9% of GDP, and low public debt. Set against these factors are geopolitical risk, weak governance indicators, low external liquidity, and risks to policy implementation.

ESG - Governance: Ukraine has an ESG Relevance Score (RS) of '5' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. These scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model (SRM). Ukraine has a low WBGI ranking at the 32nd percentile, reflecting the Russian-

Ukrainian conflict, weak institutional capacity, uneven application of the rule of law and a high level of corruption.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Increased signs of a probable default event, for instance from severe external liquidity stress and reduced capacity of the government to access external financing.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Structural: De-escalation of conflict with Russia reducing vulnerabilities to Ukraine's external finances, fiscal position and macro-financial stability.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

In accordance with its rating criteria, Fitch's sovereign rating committee has not utilised the SRM and QO to explain the ratings in this instance. Ratings of 'CCC' and below are instead guided by the rating definitions.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Ukraine has an ESG Relevance Score of '5' for Political Stability and Rights as WBGI have the highest weight in Fitch's SRM and are highly relevant to the rating and a key rating driver with a high weight. The invasion by Russia has undermined political stability. As Ukraine has a percentile below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Ukraine has an ESG Relevance Score of '5' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as WBGI have the highest weight in Fitch's SRM and in the case of Ukraine weaken the business environment, investment and reform prospects; this is highly relevant to the rating and a key rating driver with high weight. As Ukraine has a percentile rank below 50 for the respective Governance Indicators, this has a negative impact on the credit profile.

Ukraine has an ESG Relevance Score of '4[+]' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the WBGI is relevant to the rating and a rating driver. As Ukraine has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Ukraine has an ESG Relevance Score of '4' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Ukraine, as for all sovereigns. As Ukraine has a fairly recent restructuring of public debt in 2015, this has a negative impact on the credit profile.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Ukraine	LT IDR	CCC	Downgrade	B Rating Outlook Stable

	ST IDR	C	Downgrade	B
	LC LT IDR	CCC	Downgrade	B Rating Outlook Stable
	LC ST IDR	C	Downgrade	B
	Country Ceiling	B-	Downgrade	B
senior unsecured	LT	CCC	Downgrade	B

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sovereign Rating Criteria (pub. 26 Apr 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v1.7.2 (1)

Debt Dynamics Model, v1.3.1 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.12.2 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Ukraine	UK Issued, EU Endorsed

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Sovereigns Europe Ukraine
