Ukraine

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This report does not constitute a rating action.

Credit Highlights

Overview

Institutional and economic profile	Flexibility and performance profile
The war has materially affected Ukraine's economy.	Foreign financial support will remain key to Ukraine meeting its external and fiscal funding needs
--S&P Global Ratings expects the Ukrainian economy to shrink by 2% in 2023 following an output contraction of 30% last year.	--Committed donor support of $39 billion will likely cover most of Ukraine's government funding requirements this year.
--Ukraine's medium-term growth prospects remain uncertain and depend on the evolution of military hostilities.	--Although Ukraine's government debt repayments have reduced following the debt restructuring in 2022, the ability of the government to resume debt service on foreign commercial debt in September 2024 hinges on the steady flow of foreign financial support.
--We expect the government's administrative capacity to remain uninterrupted despite the war.	--The National Bank of Ukraine (NBU) will likely maintain the fixed exchange rate regime in the foreseeable future.

In our view, Ukraine's debt-servicing capacity remains vulnerable and depends on favorable external conditions to meet its financial commitments. As a result of the external debt reprofiling in 2022, Ukraine's debt service profile this year primarily consists of domestic debt repayments. Assuming the rollover rate for domestic bonds will be high due to the steady demand from the highly liquid banking sector and donor support continues uninterrupted, the government's liquidity risks over the next 12 months are contained, absent a further significant escalation of the conflict with Russia. Still, the government's ability to resume debt service on foreign commercial debt beyond this timeframe is contingent on foreign financial support, including in the form of grants.

Our key assumption is that $39 billion of donor support so far committed for Ukraine in 2023 will be fully disbursed this year. In addition to meeting budget funding needs, these inflows should help support Ukraine's international reserve position. We also note the government's recent progress toward reaching an agreement on a new funded medium-term arrangement with the IMF, potentially resulting in additional concessional funding.

Ukraine's medium-term macroeconomic outlook depends heavily on the duration and evolution of the war. Economic prospects also depend on domestic and international reconstruction efforts once the war ends. Our base-case assumption is that there will not be a near-term resolution to hostilities. Given substantial damage to physical and human capital, Ukraine's post-war economic growth, balance of payments, and fiscal outlook hinge on regaining a level of territorial integrity and access to the Black Sea, the persistence of the war-driven dislocations on the labor market, continued international financial support, as well as restoration of tax mobilization capacity and reconstruction efforts.

Outlook

The stable outlook balances our view of the reduction in Ukraine's government debt-service requirements and our expectation of steady international financial support against risks to Ukraine's economy, external balances, public finances, and financial stability stemming from the ongoing war.

Downside scenario

We could lower the ratings in the next 12 months should the security outlook deteriorate, putting further pressure on Ukraine's foreign exchange reserve position or the government's administrative capacity, or resulting in much higher government gross financing needs than we currently anticipate. Absent an escalation of the conflict, material delays in foreign donor support could also lead to a downgrade.

Upside scenario

We could raise the ratings if Ukraine's security environment and medium-term economic outlook significantly improve.

Rationale

Institutional and economic profile: The evolution of the war continues to shape Ukraine's macroeconomic outlook

Russia began its military offensive in Ukraine on Feb. 24,2022, and the war has taken a severe toll on Ukraine's economy and society. Economic activity picked up in the second half 2022, and Ukraine's military regained control of some regions initially occupied by Russia's forces. Still, Ukraine's real GDP contracted by a substantial 30% in 2022.

There is a large degree of uncertainty regarding how the war might develop. Military developments over the past few months increasingly point to a prolonged war of attrition. As a result, we assume the active phase of the war will continue through 2023. By our estimate, some 10% of Ukraine's productive capacity is located in areas occupied by Russia. That said, we expect Ukraine's government and the NBU to maintain their administrative capacity, as was the case last year even in the face of outright military activities in the east, north, and south of the country.

We also assume that, in 2023, the Black Sea Grain Initiative remains functional, enabling agricultural exports from three Ukrainian sea ports; the power supply normalizes; outward migration from Ukraine eases; and committed international budget support is not delayed. Given the damage from Russia's continued missile attacks on critical infrastructure, including in the energy sector, we project Ukraine's GDP in 2023 to contract by 2%, keeping the nominal GDP in U.S. dollar terms one-third below of its pre-war level.

Given the substantial damage to physical and human capital, Ukraine's medium-term economic outlook is uncertain. The key determinant of the country's recovery prospects is the restoration of its export capacity, primarily via its sea ports. Although the UN's grain deal in August 2022 unblocked the shipping of agricultural exports from three out of four Ukraine's major seaports and allowed grain exports to approach the pre-war level, the export of other products (including non-agricultural commodities) still suffers from limited access to the Black Sea, Ukraine's key export route. The other factors affecting Ukraine's ability to rebuild its economy are demographic challenges, the post-war labor market profile, and the effectiveness of recovery efforts domestically and internationally.

S&P Global Ratings notes a high degree of uncertainty about the extent, outcome, and consequences of the Russia-Ukraine war. 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.

Flexibility and performance profile: External support will cover most of the government's foreign funding needs this year

The war-induced shock to the economy and the tax base, coupled with increasing defense and security spending, have significantly undermined the government's fiscal position. Despite the government's efforts to contain spending beyond defense, social transfers, and debt service, the war-time net financing needs averaged a sizable $4 billion a month last year. The resulting full-year general government deficit reached 27% of GDP (net of grants), or 17% of GDP including grants. This, in tandem with the exchange rate devaluation, has pushed gross government debt to over 86.5% of GDP from 50.0% in 2021.

Even though the government has made efforts to gradually normalized the taxation regime, the war will continue to weigh on public finances in 2023;over half of central government spending goes toward defense-related costs. We project the fiscal deficits this year will remain broadly flat.

At the same time, the gross budget financing requirement will likely decline to about $4.0 billion a month (net of grants) from some $4.8 billion a month last year. This is primarily because of the deferral of debt-service payments on government foreign debt agreed last year (see "Ukraine Foreign Currency Ratings Raised To 'CCC+' From 'SD' On Completed Debt Restructuring; Outlook Stable," published Aug. 19, 2022, on RatingsDirect). The foreign currency debt repayment schedule this year will mostly comprise payments on official debt--largely owed to the IMF and the International Bank for Reconstruction and Development--and domestic government bonds (which the government plans to rollover).

We expect most foreign currency budget financing needs in 2023 to be covered by international financial support. Commitments made so far by the key donors, primarily the U.S. and EU, amount to $39.0 billion versus $32.3 billion in 2022. We also understand that after the completion of the four-month non-funded IMF's Program Monitoring with Board Involvement (PMB) in March, the government aims for an agreement with the fund on the new financing arrangement. Although the size and conditionalities have yet to be decided, disbursements under this new program will come on top of existing donor commitments. Importantly, reflecting authorities' plans, we assume the direct financing of the government by NBU will be contained or even discontinued. In 2022, NBU covered more than 40% of budget financing requirements.

That said, given the ongoing conflict with Russia, Ukraine's ability to stay current on its debt after the debt deferral expires in August 2024 depends greatly on factors largely outside of government control, including the flow of foreign support.

We project that Ukraine's current account balance will slide from a surplus into a deficit this year. Last year's headwinds included the wide foreign trade deficit triggered by export disruptions, only mild contraction of imports as demand for essential goods remained strong, and high spending by refugees abroad (reported as services imports). Nevertheless, Ukraine's current account balance posted a headline surplus of some 5.9% of GDP in 2022. This was thanks to uninterrupted inflows of remittances from Ukrainian workers employed abroad, as well as foreign grants, which are recorded as secondary income inflows of the current account. However, we expect the current account balance to remain in a deficit in the medium term. This assumes only a partial recovery of exports and high energy and reconstruction-related imports.

One of our main assumptions is that steady international financial support should mitigate persistent balance of payments pressure and prevent accelerated depletion of Ukraine's international reserves. At the beginning of the war, the NBU fixed the hryvnia exchange rate versus the U.S. dollar at 29.25. to provide a nominal anchor to the economy and introduced extensive exchange restrictions to preserve financial stability. Last July, given exchange rate pressures partly driven by monetization of fiscal deficits, the NBU devalued the currency by 25% to 36.6 against the U.S. dollar. Despite a dip during 2022, official reserves recovered to their pre-war levels of $28-$29 billion in the fourth quarter of 2022. Still, pressure on the exchange rate and reserves could heighten should restrictions on agricultural exports be reinstated, donor disbursements face delays, and non-residents decide to repatriate proceeds from domestic government bonds (once they are allowed to do so from April 2023 as per the NBU's current plan).

The NBU has kept the policy rate unchanged since June 2022, when it hiked it by 15 percentage points to 25%. Meanwhile the institution has focused on improving the monetary transmission channel hampered by excessive banking sector liquidity. To that end, they have increased banks' mandatory reserve requirements for local and foreign-currency deposits. Additionally, the NBU has allowed banks to fulfill up to 50% of mandatory reserves with benchmark government bonds. The latter measure has already increased demand for government bonds and should help contain monetary financing. As a result, NBU has not been purchasing government bonds so far this year.

In January 2023, consumer price inflation declined to 26.0% year-on-year from 26.6% in December--its first year-on-year decline since the beginning of the war--on easing food and energy price pressures. We expect inflation to further decelerate in the coming months. In annual average terms, we project inflation to go down to 17% in 2023 from 20.2% in 2022.

Ukraine's banking system entered the war with adequate liquidity and capital buffers. This, teamed with the NBU's regulatory easing, has helped the banking sector maintain its operational capacity and absorb the immediate war-induced shocks. That said, the substantial fallout of the war on the private sector has jeopardized the outlook for asset quality. Banks' reported nonperforming loans increased to high 38% of total loans at end-2022 from approximately 30% in 2021. We expect the nonperforming loan ratio to further increase this year (for more detail see "Banking Industry Country Risk Assessment: Ukraine," published Nov. 28, 2022).

Ukraine--Selected Indicators

	2017	2018	2019	2020	2021	2022	2023bc	2024bc	2025bc	2026bc
Economic indicators (%)										
Nominal GDP (bil. UAH)	2,981.2	3,560.3	3,977.2	4,222.0	5,459.6	4,825.8	5,580.6	6,384.2	7,373.7	8,284.4
Nominal GDP (bil. $)	112.1	130.8	154.2	156.5	200.2	146.2	143.1	143.2	150.4	153.6
GDP per capita (000s $)	2.6	3.1	3.7	3.7	4.8	3.6	3.9	3.7	3.9	4.0
Real GDP growth	2.4	3.5	3.2	(3.8)	3.4	(30.4)	(2.0)	4.0	5.0	5.0
Real GDP per capita growth	2.8	4.0	3.8	(3.2)	4.1	(29.7)	8.9	0.0	4.5	4.5
Real investment growth	16.1	16.6	11.7	(21.4)	7.6	(40.0)	2.0	20.0	20.0	20.0
Investment/GDP	20.0	18.6	14.9	8.9	13.8	7.4	8.1	10.1	11.1	12.4
Savings/GDP	16.9	13.7	12.2	12.3	11.9	13.3	3.6	(0.6)	(0.4)	0.8
Exports/GDP	48.1	45.2	41.2	38.8	40.8	30.4	37.5	41.8	44.8	49.4
Real exports growth	3.9	(1.4)	7.3	(5.8)	(10.5)	(60.0)	14.0	18.0	18.0	18.0
Unemployment rate	9.9	9.1	8.6	9.9	10.3	29.0	25.0	18.0	15.0	15.0
External indicators (%)										
Current account balance/GDP	(3.1)	(4.9)	(2.7)	3.4	(1.9)	5.9	(4.5)	(10.7)	(11.5)	(11.5)
Current account balance/CARs	(5.1)	(8.5)	(4.9)	6.7	(3.8)	8.9	(6.7)	(14.5)	(15.2)	(14.2)
CARs/GDP	60.7	58.1	55.0	50.2	51.1	66.2	67.8	73.3	75.2	81.0
Trade balance/GDP	(8.6)	(9.7)	(9.3)	(4.3)	(3.3)	(10.0)	(12.5)	(15.9)	(12.3)	(12.0)
Net FDI/GDP	3.1	3.7	3.4	(0.0)	3.8	0.4	0.0	0.5	1.8	1.8
Net portfolio equity inflow/GDP	0.1	(0.0)	0.0	0.1	(0.1)	(0.0)	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	115.3	114.8	106.6	94.6	100.5	91.7	101.2	113.5	117.5	117.8
Narrow net external debt/CARs	109.7	94.5	83.2	86.3	61.4	81.3	93.9	102.6	105.2	105.7
Narrow net external debt/CAPs	104.4	87.2	79.3	92.5	59.1	89.2	88.0	89.6	91.3	92.6
Net external liabilities/CARs	44.7	32.4	30.6	21.6	18.7	11.8	19.1	32.8	46.3	56.9
Net external liabilities/CAPs	42.5	29.9	29.2	23.2	18.0	12.9	17.9	28.6	40.1	49.8
Short-term external debt by remaining maturity/CARs	35.7	33.9	27.3	31.0	24.6	29.1	23.2	25.7	24.9	24.1
Usable reserves/CAPs (months)	2.5	2.7	2.8	4.0	3.2	4.1	3.2	2.5	2.0	1.8
Usable reserves (Mil. $)	18,252.3	20,330.9	24,676.9	28,368.1	30,137.1	27,514.8	24,794.4	21,842.3	21,632.3	20,534.4
Fiscal indicators (general government %)										
Balance/GDP	(1.4)	(2.1)	(2.1)	(5.6)	(1.6)	(17.0)	(16.5)	(7.0)	(6.0)	(6.0)
Change in net debt/GDP	6.1	1.0	(4.0)	12.5	3.8	28.6	25.4	13.9	12.9	12.9
Primary balance/GDP	2.4	1.2	0.9	(2.7)	1.2	(13.7)	(13.9)	(3.4)	(0.7)	(0.6)
Revenue/GDP	40.3	39.8	39.5	39.7	36.9	37.0	38.0	38.0	38.0	38.0

Ukraine--Selected Indicators

Expenditures/GDP	41.7	41.9	41.6	45.3	38.5	54.0	54.5	45.0	44.0	44.0
Interest/revenues	9.3	8.3	7.7	7.3	7.7	8.9	6.9	9.5	13.9	14.2
Debt/GDP	71.8	60.9	50.2	60.4	50.3	86.5	100.2	101.4	100.7	102.5
Debt/revenues	178.1	153.0	127.4	152.2	136.3	233.7	263.6	266.9	265.1	269.8
Net debt/GDP	69.1	58.8	48.7	58.3	48.9	84.0	98.0	99.6	99.1	101.1
Liquid assets/GDP	2.7	2.1	1.6	2.1	1.4	2.5	2.1	1.9	1.6	1.4
Monetary indicators (%)										
CPI growth	14.4	11.0	7.9	2.7	9.4	20.2	17.0	9.0	7.0	7.0
GDP deflator growth	22.1	15.4	8.3	10.3	25.1	27.0	18.0	10.0	10.0	7.0
Exchange rate, year-end (UAH/$)	28.1	27.7	23.8	28.3	27.3	36.9	42.5	46.7	51.4	56.5
Banks' claims on resident non-gov't sector growth	1.2	5.4	(9.7)	(3.1)	7.9	(3.2)	(10.0)	15.0	20.0	15.0
Banks' claims on resident non-gov't sector/GDP	34.6	30.6	24.7	22.6	18.8	20.6	16.0	16.1	16.8	17.2
Foreign currency share of claims by banks on residents	32.2	30.5	26.3	22.0	18.0	17.9	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	46.0	42.1	40.0	37.7	32.4	36.1	N/A	N/A	N/A	N/A
Real effective exchange rate growth	6.0	5.6	15.7	(1.4)	2.3	0.1	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.
Economic assessment	5	Based on GDP per capita ($) as per Selected Indicators in Table 1.

External assessment	6	Based on narrow net external debt and gross external financing needs as per Selected Indicators in Table 1.
		Access to commercial external borrowing has been disrupted by the war. Ukraine is now dependent on foreign donor support.
Fiscal assessment: flexibility and performance	6	Based on the change in net general government debt (% of GDP) as per Selected Indicators in Table 1.
		Tax mobilization capacity is constrained by the ongoing war.
Fiscal assessment: debt burden	6	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 above 20% of its assets.
Monetary assessment	6	Since the start of the war, the central bank has switched to a pegged exchange rate arrangement. The central bank has been relatively independent in recent years. Since the start of the war its ability to influence domestic monetary conditions has been constrained.
		The transmission mechanism is weak, due to the war-induced disruptions to the financial system.
		The central bank maintains wide-ranging exchange restrictions.
Indicative rating	b-	As per Table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Sovereign credit rating		
Foreign currency	CCC+	The final rating is based on "General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings."
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.
Local currency	CCC+	

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: 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

- Sovereign Ratings List, Feb. 16, 2023
- Sovereign Ratings History, Feb. 16, 2023
- Sovereign Ratings Score Snapshot, Feb. 2, 2023
- EMEA Emerging Markets Sovereign Rating Trends 2023: Through A Glass Darkly, Jan. 26, 2023
- Sovereign Risk Indicators, Dec. 12, 2022, An interactive version is available at www.spratings.com/SRI
- 2021 Annual Global Sovereign Default And Rating Transition Study, May 4, 2022
- S&P Global Ratings Definitions, Nov. 10, 2021

Ratings Detail (as of March 09, 2023)*

Ukraine		
Sovereign Credit Rating		CCC+/Stable/C
Ukraine National Scale		uaBB/--/--
Transfer & Convertibility Assessment		CCC+
Senior Unsecured		D
Sovereign Credit Ratings History		
19-Aug-2022	*Foreign Currency*	CCC+/Stable/C
12-Aug-2022		SD/--/SD
29-Jul-2022		CC/Negative/C
27-May-2022		CCC+/Negative/C
25-Feb-2022		B-/Watch Neg/B
27-Sep-2019		B/Stable/B
19-Aug-2022	*Local Currency*	CCC+/Stable/C
12-Aug-2022		CCC+/Negative/C
27-May-2022		B-/Negative/B
25-Feb-2022		B-/Watch Neg/B
27-Sep-2019		B/Stable/B
19-Aug-2022	*Ukraine National Scale*	uaBB/--/--
12-Aug-2022		uaBB-/--/--
27-May-2022		uaBBB-/--/--
25-Feb-2022		uaBBB-/Watch Neg/--
27-Sep-2019		uaA/--/--
27-Jun-2018		uaBBB/--/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.