

# Ukraine Rating Report



## Credit strengths

- Significant international financial support
- Adept central-bank response to crisis
- Improved economic resilience since 2014-15 geopolitical crisis
- Enhanced banking-system governance

## Credit challenges

- Severe economic recession
- Increase in risk to debt sustainability
- Risk of debt restructuring
- Weakening external-sector resilience
- Increasing banking-system risks

## Rating rationale:

**Significant international financing support:** Loan and grant financing from a range of international multilateral and bilateral official benefactors. However, a further acceleration of international financial assistance and a much more substantive share of grant financing may be required moving ahead to preserve debt sustainability and support Ukraine's ratings at current levels.

**Government preparedness for this crisis:** The National Bank of Ukraine (NBU) adopted speedy administrative and capital controls after the war escalated to preserve foreign-exchange reserves, stem deposit flight, inject liquidity and adopt regulatory forbearance.

**Enhanced macroeconomic stability entering the crisis:** Ukraine benefits from enhancements of macroeconomic policy frameworks and strengthened economic stability since a 2014-15 crisis.

**Ratings challenges include:** i) Severe economic recession due to the war; ii) long-run debt-sustainability risk and possibility of debt restructuring; iii) restricted market access; iv) weakening external-sector resilience and renewed dollarisation; and v) banking-system vulnerabilities.

## Ukraine's sovereign rating drivers

Risk pillars	Quantitative scorecard		Reserve currency adjustment (notches)	Qualitative scorecard		Final rating	
	Weight	Indicative rating		Notches			
Domestic Economic Risk	35%	ccc	0	0	Extraordinary adjustment* (notches)	CCC	
Public Finance Risk	25%	bbb		-2/3			
External Economic Risk	10%	bb+		-1/3			
Financial Stability Risk	10%	bb		-1/3			
ESG Risk	Environmental Risk	5%		aa-			0
	Social Risk	5%		a-			-1/3
	Governance Risk	10%	c	-1/3			
<b>Overall outcome</b>	<b>b+</b>		<b>0</b>	<b>-2</b>	<b>-1</b>		

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, an extraordinary adjustment to a CCC issuer rating reflects consequences of war with Russia. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

## Outlook and rating triggers

The Negative Outlook reflects Scope's view that risks to the ratings are skewed to the downside over the forthcoming 12-18 months.

### Positive rating-change drivers

- Momentary armistice or fighting eases
- Debt sustainability outlook meaningfully improves and/or debt ratio stabilises
- Private-sector involvement in debt relief seems unlikely
- External-sector dynamics re-anchored
- Banking-system risks eased

### Negative rating-change drivers

- Elevated likelihood of debt restructuring
- Suspension of debt service to commercial creditors
- External-sector risk profile impaired
- Banking-system risks escalate
- Institutional and governance dangers increase

## Ratings and Outlook

### Foreign currency

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

### Local currency

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

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Bloomberg: RESP SCOP

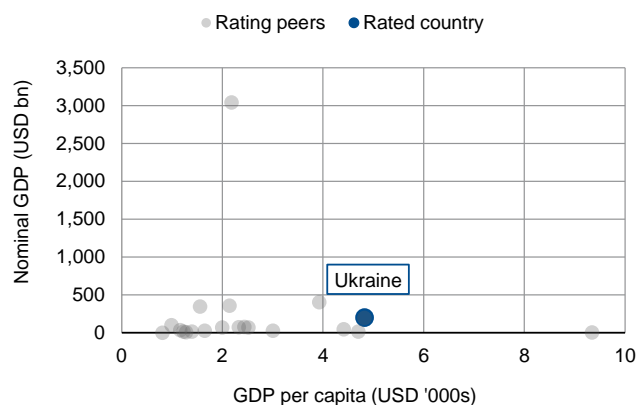
### Domestic Economic Risks

- **Growth outlook:** Real GDP contracted 4% in 2020 during Covid-19 crisis peaks, but thereafter recovered during 2021 with 3.4% economic growth, due to gradual easing of pandemic restrictions anchoring private-demand recovery as well as a better-than-anticipated harvest. The full-scale invasion of Ukraine since end-February has triggered an unprecedented shock for economic activity: despite areas of the country where the conflict has eased starting to recover and businesses adapting gradually to wartime conditions, disruption of labour markets as well as of supply and production chains persist across the nation. However, according to latest NBU figures, the number of companies that completely ceased activities declined, to 14% in May from 32% shortly after hostilities escalated, but capacity utilisation remains 40% under pre-crisis levels. We expect Ukraine's economy to contract 37.5% this year before rebounding 17.5% in 2023, with output remaining next year 27% below 2021 levels.
- **Inflation and monetary policy:** CPI inflation reached 18% YoY in May, rising from 10% in January due to large-scale supply-chain disruption as well as destruction of production capacity and infrastructure. Some disinflationary forces, however, are emerging from logistical restrictions of exports, excess supplies of agricultural products and moratoria on the raising of heat tariffs and gas distribution during martial law. With the war's escalation, the NBU decided to postpone decisions as regards the key policy rate and concentrate on maintaining price and financial stability via capital controls, a fixed exchange rate, FX-market interventions and monetary financing of the state budget. However, due to acceleration of inflationary pressure and inadequate yields on hryvnia assets, the central bank hiked the policy rate earlier this month 15pps to 25% to protect household incomes and savings in hryvnia, boost attractiveness of hryvnia assets in countering dollarisation and ease pressures in the FX market. We see this key rate being raised to 30% by year-end, before cut(s) to 20% by end-2023.
- **Labour markets:** The economy displayed an average rate of unemployment (10.9% as of Q4 2021 for those of working age) under international comparison before the further invasion. After a sharp decline in March, labour market activity is gradually recovering, despite the number of vacancies remaining subdued compared with numbers of jobseekers.

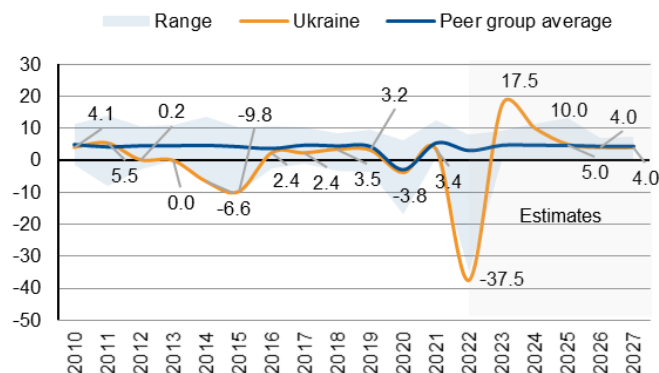
#### Overview of Scope's qualitative assessments for Ukraine's Domestic Economic Risks

CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
CCC	Growth potential of the economy	Neutral	0	Robust growth potential but uneven pattern of growth due to vulnerability to crisis
	Monetary policy framework	Strong	+1/3	Significant pre-crisis improvement of monetary governance centring around inflation targeting; central-bank measures since the Russia-Ukraine crisis have been crucial in anchoring macroeconomic and financial stability
	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 '000s



Real GDP growth, %



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

Source: IMF WEO, Scope Ratings forecasts

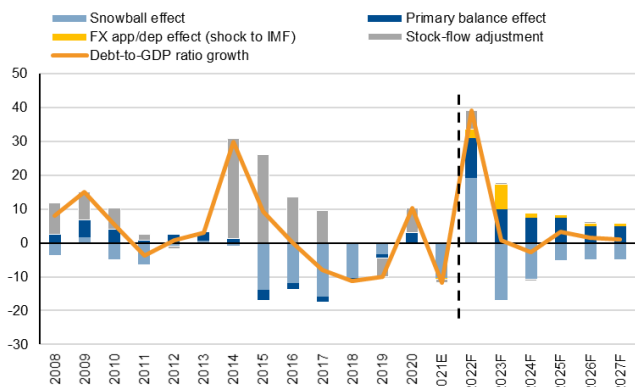
### Public Finance Risks

- **Fiscal outlook:** To mitigate the economic shock from the war, the government has introduced a series of administrative controls and tax deferrals, contributing to a substantive reduction of tax revenue during March-April 2022. Revenue, however, was cushioned by early transfers of dividends from state-owned enterprises, advanced tax payments and disbursements of grant funds from international institutions. Expenditure also rose significantly and shifted in direction of security and social needs. This resulted in a wider budgetary gap of circa USD 5-7bn a month (3-5% of GDP per month), mostly financed via international, central-bank and local-government-bond financing. We expect the budget deficit to reach 17.6% of GDP this year, after 4% in 2021, before averaging a still-elevated 14.7% over 2023-27. According to the Ministry of Finance and Kyiv School of Economics, up to USD 600bn (277% of average 2023-27 GDP) is necessary to repair destroyed infrastructure and physical capital due to the war.
- **Debt trajectory:** The severe 2022 decline of economic output will place significant pressure on debt sustainability: we see the debt-to-GDP ratio increasing to roughly 88% of GDP in 2022, from 48.9% at the end of 2021 and to edge nearly sideways thereafter, concluding a forecast horizon to 2027 at 92.1%. Under an adverse scenario of more severe economic loss or more timid economic recovery, wider deficits, more extensive exchange-rate losses and/or further crystallisation of contingent liabilities, Ukraine's public debt can rise to above 100% of GDP.
- **Debt profile and market access:** Access to international debt capital markets remains restricted, but the government introduced a new debt instrument, war bonds, to open up funding via domestic capital markets. The government has borrowed USD 3.4bn via local government bonds since 24 February from domestic and foreign banks, but with a further USD 6.9bn of war bonds covered by purchases of the NBU under momentary extraordinary monetary financing operations. Reduced market access, higher local borrowing rates after the NBU's recent rate hike and monetary financing reflect an unsustainable funding backdrop – highlighting growing fiscal and balance-of-payment risks absent acceleration of international assistance and/or an earlier end of the conflict. Average term-to-maturity of government debt is around 7.4 years (near an emerging-market average).

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

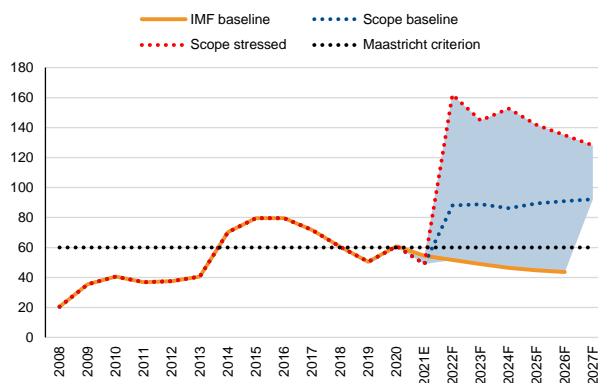
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bbb	Fiscal policy framework	Neutral	0	Record of fiscal discipline with oversight from the IMF and multilateral creditors; revenue-raising flexibility reduced due to wartime conditions
	Debt sustainability	Weak	-1/3	Significant weakening of debt sustainability amid this crisis; debt sustainability vulnerable under adverse scenarios
	Debt profile and market access	Weak	-1/3	Reduced international and domestic market access, high foreign-currency risk in government debt, but access to significant multilateral & bilateral funding options

#### Contributions to changes in debt levels, pps of GDP



Source: IMF WEO, Scope Ratings forecasts

#### Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

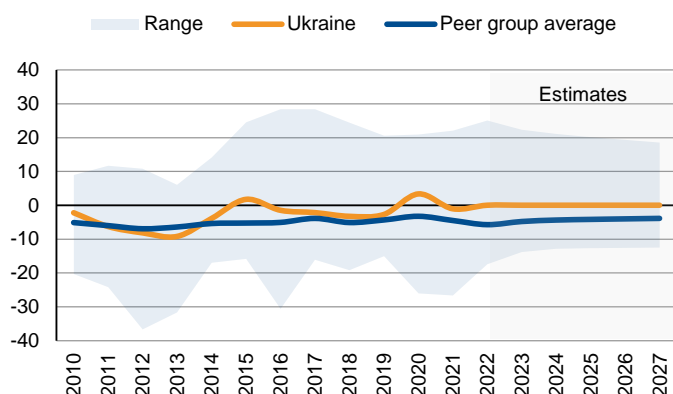
### External Economic Risks

- **Current account:** After hikes of commodity prices and a decline of imports resulted in a current-account surplus of 3.4% of GDP in 2020, Ukraine returned to a current-account deficit in 2021 as domestic demand recovered and terms of trade reversed, with a deficit of -1.3% of GDP last year. The full-scale invasion has meaningfully compromised Ukraine's export capacity and brought imposition of goods-import restrictions. However, narrower goods-trade deficits due to import contraction, remittances inflows, alongside barred dividend payment align with a modest current-account surplus expected in this year. Net foreign direct investment (FDI) aggregated to 3.6% of GDP in the year to Q4 2021, with such inflows having accelerated during 2021. However, FDI is likely to be impaired during 2022.
- **External position:** Due to external-debt deleveraging, gross external debt had been curtailed over the years, from 131.5% as of Q4 2015 to 65.3% by Q4 2021. Consequently, Ukraine's net international investment position (NIIP) was strengthened, standing at -11.4% in Q4 2021, correcting from a peak of -50.2% of GDP in Q3 2015. The IMF expects an increase of external debt in 2022, however, to circa 71% of GDP.
- **Resilience to short-term external shocks:** While Ukraine has rebuilt foreign-exchange reserves over recent years, existing external-sector cushions are, at this stage, inadequate under extended crisis conditions. This is in consideration of modest forex reserve coverage of 45% of short-term external debt (on a remaining maturity basis) as of May 2022, declining from 62% at end-2021. Foreign-currency reserves declined USD 7.1bn since December 2021 to USD 22.3bn in May. Acceleration of capital outflows is one of the factors explaining reserves drain, together with central-bank sales of foreign exchange. Such sales have defended a temporary fixed exchange rate against the US dollar, with hryvnia resultingly depreciating only 4% against euro since November 2021 (although an unofficial cash-market rate is off 18% against the official rate).

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

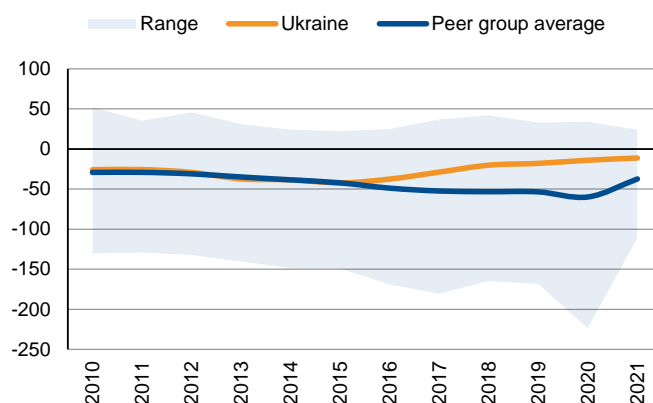
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb+	Current account resilience	Neutral	0	Risk from capital outflows, reliance upon remittances inflows, temporary rebound expected in the current account, impairment of FDI
	External debt structure	Neutral	0	Decline of external debt ratio, high share of external debt that is short-term, composition embeds significant share of Eurobonds
	Resilience to short-term shocks	Weak	-1/3	Inadequate levels of reserves, representing modest coverage of short-term external debt

Current-account balance, % of GDP



Source: IMF WEO, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

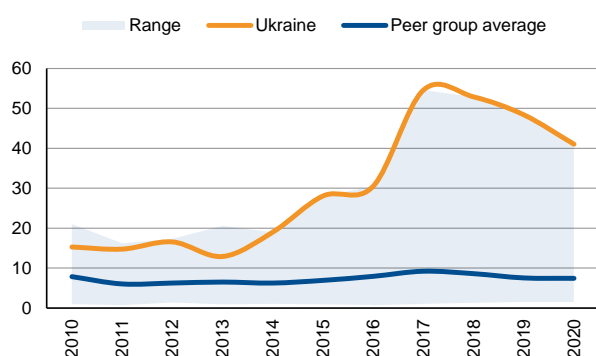
### Financial Stability Risks

- **Banking sector:** The system-wide tier 1 capital ratio dropped to 11.7% of risk-weighted assets by January 2022, before the full-scale invasion, with an average return-on-equity ratio of 33% the same month. The banking sector recorded a UAH 0.16bn loss in Q1 as higher provisions of UAH 21.6bn were needed for expected losses due to the war. Around 75% of such provisions had been made in March, resulting in return on equity dropping to -0.2% in the month. The non-performing loan (NPL) ratio remains elevated, easing to a still high 26.6% of gross loans in February from 29.5% in January, due to liquidation of two Russian state-owned banks, but rising again slightly by April to 27.4% as financial institutions started gradual recognition of deterioration of loan quality. Sectoral concentration risk is high. System-wide dollarisation has recently increased, with savings migrating to foreign- from domestic-currency. Before re-dollarisation, the share of bank deposits in foreign currency had earlier dropped 3.5pps since January to 31.3% as of April 2022, with loans in foreign currency likewise having declined 3.6pps over a same period to 26.1%.
- **Private debt:** Private debt of Ukraine remains limited as households and non-financial corporations (NFCs) demonstrate only trifling amounts of loans outstanding as a share of GDP borrowed in national currency, amounting to 4.3% and 8.9% as of December 2021. Shares are even smaller for loans in foreign currency (0.4% of GDP for households, 4.9% for NFCs). Deposit funding in domestic currency has remained strong: between the full invasion and end-May, retail deposits rose around 19%, with corporate deposits in hryvnia rising 4%. The outflow of deposits in foreign currencies halted. Term deposit outflows slowed in May and are smaller than those observed during the crisis of 2014.
- **Financial imbalances:** Ukraine's banking system faces significant credit-risk and profitability challenges, given the effect of the current severe economic downturn on loan quality and bank incomes. Supportive policy measures such as repayment holidays, reduced commissions and loan restructurings could help ease the impact of the crisis on asset quality, and their eventual phase-out is expected to be gradual even after martial law is lifted. A delayed recognition of financial losses, however, could result in sharp deterioration of financial positions when losses are recognised in the future.

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

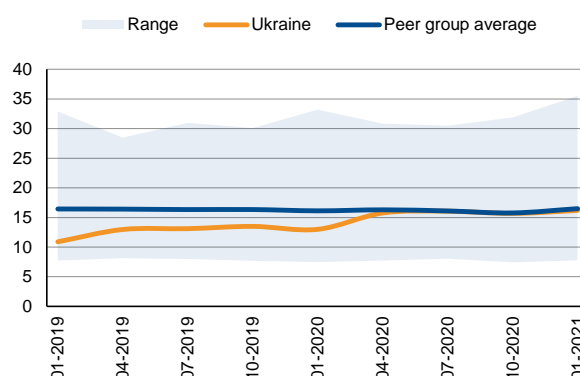
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
bb	Banking sector performance	Weak	-1/3	Declining banking-system capitalisation and profitability. NPL ratio still elevated, concentration risk, high foreign-currency risk on bank balance sheets amid re-dollarisation trends.
	Banking sector oversight	Neutral	0	Multiple initiatives over the years to enhance banking-sector governance; regulatory processes still challenged by vested interests
	Financial imbalances	Neutral	0	Low level of private-sector debt amid developing domestic capital market

Non-performing loans, % of total loans



Source: World Bank, Scope Ratings GmbH

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings GmbH

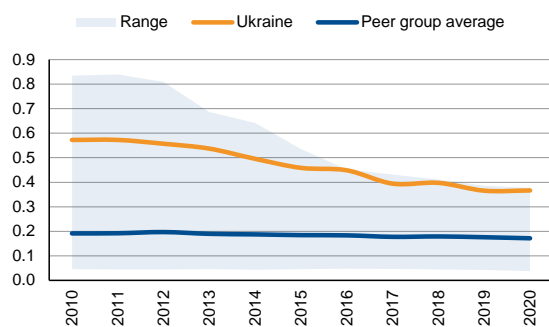
### ESG Risks

- **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% under 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 in renewables. There is exposure to natural as well as man-made disasters such as flooding, harsh winters, storms, mine disasters as well as the legacy of the 1986 Chernobyl disaster. The ongoing war is causing huge, long-lasting environmental and climate damage as far as to waterways, air and soil pollution, forest destruction and increase of carbon footprint due to the use of weapons, which contributes to greenhouse gas emissions.
- **Social:** Ukraine's labour-market performance is mixed, as 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 educational performance and lower marks as regards healthy life expectancy. According to World Bank simulations, due to the war, the share of the population with income under the national poverty line may reach 70% this year, compared with 18% in 2021. Demographic trends represent a significant challenge to longer-run economic growth. Ukraine's old-age dependency ratio is expected to rise in parallel with declines of the working-age population of -0.8% per year over 2022-27 according to United Nations estimates (estimated before February).
- **Governance:** The 2019 presidential and parliamentary elections in Ukraine delivered prospect for the government under President Volodymyr Zelenskyy to address longer-standing structural weaknesses. 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 military conflict, as an armistice does not seem a viable option presently. After Ukraine applied for EU membership at the end of February, the European Commission has formally recommended candidate status for Ukraine – starting a longer-term process for the nation's EU accession ambitions, but subject to conditions for enhancement of rule of law and anti-corruption legislation.

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

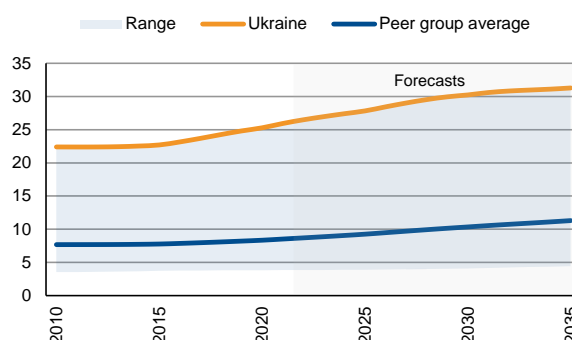
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b	Environmental risks	Neutral	0	Transition risks outstanding for a higher carbon-intensity developing economy; ambitious climate objectives
	Social risks	Weak	-1/3	Poverty, emigration and internal displacement of persons due to the war, demographic decline and rising old-age costs, moderate income inequality, moderate performance on education, weaker health metrics
	Institutional and political risks	Weak	-1/3	War on the sovereign's territory and associated exceptional adverse credit rating implications; political instability risk; institutional weaknesses in areas of corruption, rule of law, judicial independence

CO<sub>2</sub> emissions per GDP, mtCO<sub>2</sub>e



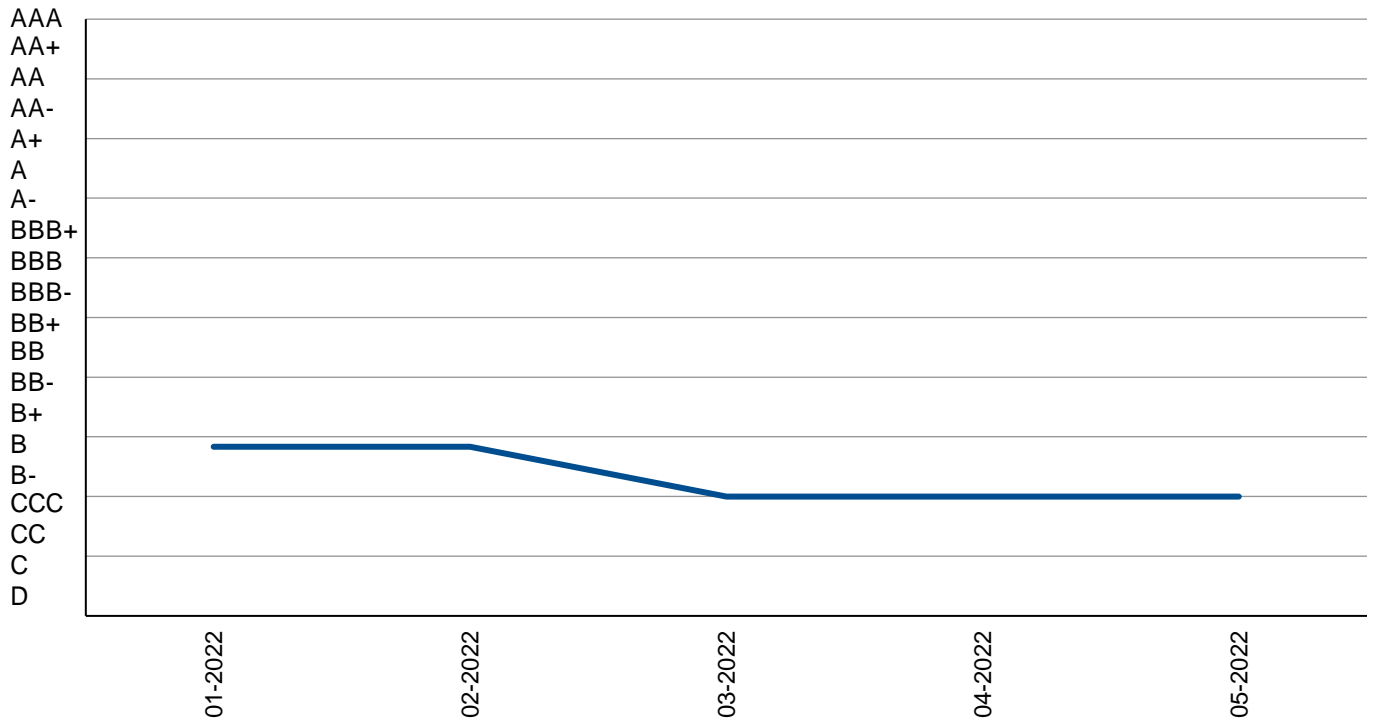
Source: European Commission, Scope Ratings GmbH

Old age dependency ratio, %



Source: United Nations, Scope Ratings GmbH

### Appendix I. Rating history



### 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 embedding a methodological reserve-currency adjustment.

Peer group
Egypt
Nigeria
Uganda

### Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard.

	2016	2017	2018	2019	2020	2021E	2022F	2023F
<b>Domestic Economic Risk</b>								
GDP per capita, USD '000s	2.2	2.7	3.1	3.7	3.8	4.8	-	-
Nominal GDP, USD bn	93.3	112.1	130.9	154.0	155.3	198.3	-	-
Real growth, % <sup>1</sup>	2.4	2.4	3.5	3.2	-3.8	3.2	-37.5	17.5
CPI inflation, %	13.9	14.4	10.9	7.9	2.7	9.4	-	-
Unemployment rate, % <sup>1</sup>	9.5	9.7	9.0	8.5	9.2	10.6	-	-
<b>Public Finance Risk</b>								
Public debt, % of GDP <sup>1</sup>	79.5	71.6	60.4	50.5	61.0	48.9	88.0	88.9
Interest payment, % of government revenue	10.7	9.5	8.3	7.7	7.3	7.8	-	-
Primary balance, % of GDP <sup>1</sup>	1.9	1.5	1.1	1.1	-3.0	-4.0	-17.6	-18.1
<b>External Economic Risk</b>								
Current-account balance, % of GDP	-1.5	-2.2	-3.3	-2.7	3.3	-1.1	-	-
Total reserves, months of imports	3.2	3.2	3.1	3.5	4.9	3.6	-	-
NIIP, % of GDP	-37.4	-28.8	-20.2	-18.0	-14.1	-11.4	-	-
<b>Financial Stability Risk</b>								
NPL ratio, % of total loans	39.0	54.8	54.4	50.5	43.5	31.7	-	-
Tier 1 ratio, % of risk-weighted assets	9.0	12.1	10.5	13.5	15.7	12.0	-	-
Credit to private sector, % of GDP	47.3	38.3	34.5	30.0	28.4	-	-	-
<b>ESG Risk</b>								
CO <sub>2</sub> per EUR 1,000 of GDP, mtCO <sub>2</sub> e	448.4	394.2	397.4	365.6	366.4	-	-	-
Income quintile share ratio (S80/S20), x	3.5	3.7	3.6	3.8	3.6	-	-	-
Labour-force participation rate, %	66.3	66.5	66.6	66.6	-	-	-	-
Old-age dependency ratio, %	23.1	23.7	24.3	24.8	25.3	25.9	26.5	27.0
Composite governance indicator <sup>2</sup>	-0.7	-0.7	-0.7	-0.6	-0.5	-	-	-

<sup>1</sup> Forecasted values are produced by Scope

<sup>2</sup> Average of the six World Bank Worldwide Governance Indicators

Source: European Commission, IMF WEO, World Bank, Scope Ratings GmbH

### Appendix IV. Economic development and default indicators

IMF Development Classification

Emerging Market and Developing Economies

5y USD CDS spread (bps) as of 17 June 2022

8,842.3





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