



NEWS RELEASE

Aug 09, 2019

R&I Upgrades to B, Stable: Ukraine

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

ISSUER: Ukraine
Foreign Currency Issuer Rating: B, Previously CCC+
Rating Outlook: Stable

RATIONALE:

Ukraine's economy will continue to recover. Its fiscal position has improved. Economic stability has increased thanks to disciplined fiscal policy, as well as monetary policy focused on inflation control. The current account balance remains in slight deficit. With foreign reserves expanding, its resilience to external shock is improving. In the parliamentary election held in July 2019, the new "Servant of the People" party led by President Volodymyr Zelensky won a single-party majority. Although there are difficult challenges to address, such as conflicts in the eastern part of the country and promotion of structural reforms, having a stable power base will allow the government to focus on its policy agendas, which can be highly evaluated. Based on these considerations, R&I has upgraded the Foreign Currency Issuer Rating to B.

Real gross domestic product (GDP) grew by 3.3% in 2018, driven by private consumption and investment. In 1Q 2019, the year-on-year growth rate slowed down to 2.5%, but private consumption and investment remain strong. The central bank revised upward its real GDP growth projections for 2019 and 2020 to 3% and 3.2%, respectively. In R&I's view, Ukraine's economy will basically continue to recover.

Inflation is on a downward path. The average inflation rate for 2018 was 11%, and that for the January-June 2019 period was 9.0%. With inflation pressure easing, the central bank has cut its policy rate in a phased manner since April 2019. Nevertheless, its austerity stance basically remains unchanged as the real interest rate is still high. R&I positively evaluates the central bank's policy actions prioritizing price stability, which it believes should contribute to stabilizing the economy.

The current account deficit widened to 3.3% of GDP in 2018. Given that the country is in the phase of rebuilding the economy, a temporary widening of the current account deficit to 3-4% will have no impact on its creditworthiness, in R&I's view. Ukraine's foreign reserves increased to US\$20.6 billion as of July 1, 2019, which covers 3.4 months of imports. Short-term external debt is high, more than double the foreign reserves, but on the decline. Its resilience to external shock is improving. To ensure foreign currency liquidity for large external debt repayments and maintain a sound financing environment, financial support by the International Monetary Fund will be important.

The banking sector has improved profitability and gained more stability on the liquidity front as well, as evidenced by growth in domestic currency-denominated deposits. The ratio of non-performing loans (NPL), though on the decline, is as high as about 52%, and such loans are concentrated in some banks including state-owned banks. While state-owned banks are dominant in the market in terms of asset size, they are facing the challenges of low profitability and high NPL ratios. R&I will follow the outcome of the government and the central bank's efforts to reform them. The lawsuit concerning the nationalization of Ukraine's largest lender PrivatBank in 2016 is still continuing. If the court overrules the government's decision to nationalize the bank, confidence in the financial system could be undermined. Attention should be paid to the developments on this matter.

Fiscal deficits have been narrowing since peaking in 2014. In 2018, the central government fiscal deficit was 1.7% of GDP, and the deficit of the consolidated government (the central and local governments) was 1.9% of GDP. The central government estimates its fiscal deficit to be 2.3% of GDP in the 2019 budget. Given that government spending is kept in check with domestic demand remaining strong, it is unlikely that the central government fiscal deficit will be far above the target. There are mounting demands for government spending, particularly for defense-related spending, support for the

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socially vulnerable people and expansion of infrastructure investments. The government introduced a medium-term fiscal plan to manage its expenditures and budget balance for the next three years. The framework is expected to facilitate the government to carry out fiscal policy with consideration to medium-term policy agendas while pursuing fiscal consolidation.

The ratio of outstanding government debt to GDP, which started to fall after reaching 69.2% at end-2016, stood at 52.3%, and 60.9% even with government-guaranteed debt included, as of end-2018. The Medium Term Strategy for the State Debt Management calls for lowering the government debt ratio to no more than 43% of GDP by the end of 2022. Following the establishment of the connection to the network of Clearstream, the international central securities depository, in May 2019, the country is witnessing an increase of non-resident holdings of domestic government bonds. The step is expected to boost liquidity in the domestic government bond market and diversify the investor base.

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:

ISSUER:	Ukraine
	Foreign Currency Issuer Rating
RATING:	B, Previously CCC+
RATING OUTLOOK:	Stable

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