StreetInsider.com
if you're not inside...you're outside

Log-In | Home | E-mail Alerts | My Headlines | Portfolio

Upgrade to StreetInsider Premium - FREE TRIAL!

GUGGENHEIM INVESTMENTS
Join Free | SI Premium | Ratings Insider | M&A Insider | EPS Insider | Dividend Insider | IPO Insider | Hedge Fund Insider | Premium Newsletters

QUICK LINKS : Upcoming Dividends | EPS Movers | Top Upgrades | Buffett's Stocks | Newsletters | Like 993

Trade with TradeStation commission free for 90 days.

# UPDATE: S&P Cuts Foreign Currency Ratings on Ukraine to CCC+/C

Article | Comments (0)

January 28, 2014 12:20 PM EST
(Updated - January 28, 2014 12:26 PM EST)

Send to a Friend

On Jan. 28, 2014, Standard & Poor's Ratings Services lowered its long- and short-term foreign currency sovereign credit ratings on Ukraine to 'CCC+/C'.

At the same time, we affirmed the long- and short-term local currency sovereign credit ratings at 'B-/B'.

The outlook is negative.

We also lowered the long-term Ukraine national scale rating to 'uaBB+' from 'uaBBB-'.

As a "sovereign rating" (as defined in EU CRA Regulation 1060/2009 [EU CRA Regulation]), the ratings on Ukraine are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar of 2014 Publication Dates for EMEA Sovereign, Regional, And Local Government Ratings," Dec. 30, 2013). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case, the deviation has been caused by the events described in the following Rationale.

FREE Breaking News Alerts from StreetInsider.com!
E-mail Address

Top News | Most Read | Highlighted

- Top 10 News for 03/10 - 03/14: Amazon's Premium Prime Price; Fuel Cell Stocks Sapped; A Bananas Merger
- Leading Chinese Social Media Platform We bo Files $500M IPO
- The Week Ahead: Another Round of Fed Tapering, Economic Data
- Tesla (TSLA) CEO Musk Issues Letter Following NJ MVC Decision
- General Mills (GIS) Guides Q3 EPS Below Consensus on Lower Volume, Currency Impact

RATIONALE

The downgrade reflects our view that the significant escalation of the political turmoil in Ukraine makes the expected financial support package from Russia less certain should the government of President Yanukovych fall.

Hundreds of thousands of protesters took to the streets in Kiev and other major Ukrainian cities after Mr. Yanukovych suspended the signing of an Association Agreement with the EU--which included a Deep and Comprehensive Free Trade Area Agreement--on Nov. 23, 2013. Since then, calls for Mr. Yanukovych to step down from power have increased. Protests, and the security forces' reaction to them, have turned violent and have resulted in loss of life. Political tensions significantly increased after Mr. Yanukovych signed a set of new laws on Jan. 17, 2014, which criminalized the protesters'
activities. We note that the Ukrainian parliament today voted to scrap these laws, while Prime Minister Azarov and his cabinet have also resigned.

It is currently unclear how the political situation will be resolved. In our view, the leading opposition candidates do not have control or the full support of the protesters. As a result, Mr. Yanukovych could hold onto power if wealthy individuals from Ukraine's business community continue to support him politically, while the Russian government supports him financially.� However, if he loses power--either by being forced from office or by early presidential elections being called--and if diplomatic relations with Russia deteriorated, we believe the $15 billion (about 8% of Ukraine's 2014 GDP) in direct financing to the Ukrainian government from Russia could be put at risk.

The Russian government disbursed an initial $3 billion (about 2% of GDP) to Ukraine last month by allowing its National Wealth Fund to be the sole subscriber to a Ukrainian government bond issue. The bonds mature in two years with a 5% coupon, well below the 12% secondary market

yield on an outstanding two-year Ukrainian dollar bond. If political turbulence leads to a new government that is negatively inclined toward the current government's alliance with Moscow, we believe the bonds could be subject to delayed or non-payment.

We view Ukraine's external liquidity as "weak," under our criteria. We project its gross external financing needs at 155% of current account receipts and usable reserves. We expect that, to cover those financing needs, rollovers of trade financing and other private sector debt will need to complement direct financial support from Russia. Further support should come from an additional agreement with Russia's Gazprom to reduce the price of Naftogaz gas imports by about 30%.

As a result of the political turmoil, the Ukrainian hryvnia has depreciated by about 2.5% so far in 2014. We assume that it will stabilize and be maintained against the U.S. dollar at a rate of around UAH8.5:USD1. We project foreign currency reserves held at the National Bank of Ukraine (NBU; the central bank) of about two months of current account payments and 35% of external short-term debt (by remaining maturity) in 2014.

We estimate the change in general government debt in 2014 at about 6% of GDP, and general government net debt at about 38% of GDP. We expect the Russian loans to meet existing foreign currency government debt service in 2014-2015, rather than significantly increasing government debt. About 52% of gross government debt is currently denominated in foreign currency, although mostly
on concessional terms.

We expect local currency financing of the general government deficit to continue to come largely from the NBU and state-controlled banks. The NBU held 58% of local currency debt as of December 2013, while banks held a further 32%, which is about 11% of commercial bank assets. We therefore see a lower likelihood of default on local currency government debt than on foreign currency debt, reflected in a one-notch distinction between the long-term foreign and local currency ratings.

Under our Banking Industry Country Risk Assessment methodology, we classify Ukraine's banking sector in group '10', our weakest category. We view the banking system as an impediment to monetary policy flexibility and the functioning of the transmission mechanism. Problem loans, including nonperforming and restructured loans in the banking system, are very high at about 40% of total loans and could rise further if there were a sharp hryvnia devaluation, as 34% of bank loans were denominated in foreign currency as of November 2013 (latest available data).

We estimate Ukraine's GDP per capita at $4,300 in 2014. We project the population will continue to decline by about 0.5% per year (leading to unaddressed medium-term pressure on age-related expenditures). Due to weak external demand for Ukraine's metals and machinery exports, and a continued decline in industrial production, we forecast trend growth at 1.8%.

OUTLOOK

The negative outlook reflects our view that there is at least a one-in-three chance that we could lower our long-term sovereign credit ratings on Ukraine over the next 12 months. We could lower the ratings if political turmoil resulted in a further reduction in the government's administrative capacity to meet debt service, or if the expected financial support from Russia is not realized and no alternative funding sources can be found.

The ratings could stabilize and eventually improve if political tensions were to abate and the external funding of Ukraine's high gross external financing requirement were secured.
KEY STATISTICS (TABLE 1)

**Ukraine - Selected Indicators**

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Nominal GDP (US$ bil) | 108 | 143 | 180 | 117 | 138 | 163 | 176 | 178 | 193 | 218 | 252 |
| GDP per capita (US$) | 2,296 | 3,060 | 3,881 | 2,540 | 3,001 | 3,570 | 3,864 | 3,899 | 4,260 | 4,833 | 5,618 |
| Real GDP growth (%) | 7.4 | 7.6 | 2.3 | (14.8) | 4.2 | 5.1 | 0.2 | (1.0) | 1.0 | 2.5 | 3.5 |
| Real GDP per capita growth (%) | 8.2 | 8.2 | 2.9 | (14.3) | 4.6 | 5.5 | 0.5 | (0.8) | 1.5 | 3.0 | 4.0 |
| Change in general government debt/GDP (%) | 0.5 | 0.7 | 6.3 | 10.5 | 8.8 | 2.6 | 3.0 | 9.6 | 5.6 | 4.6 | 4.0 |
| General government balance/GDP (%) | (1.4) | (2.0) | (3.2) | (8.7) | (7.0) | (4.0) | (5.4) | (7.5) | (5.6) | (4.6) | (4.0) |
| General government debt/GDP (%) | 12.1 | 9.9 | 13.8 | 24.9 | 29.6 | 27.4 | 28.3 | 36.9 | 38.5 | 38.6 | 37.4 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Net general government debt/GDP (%) | 8.7 | 7.7 | 12.4 | 23.8 | 27.2 | 26.2 | 27.8 | 36.5 | 38.1 | 38.3 | 37.1 |
| General government interest expenditure/revenues (%) | 1.5 | 1.2 | 1.2 | 2.7 | 3.4 | 4.4 | 5.0 | 5.6 | 7.4 | 8.0 | 8.4 |
| Oth dc claims on resident non-govt. sector/GDP (%) | 46.0 | 60.0 | 77.8 | 78.3 | 66.3 | 61.2 | 58.2 | 58.8 | 55.1 | 51.2 | 46.5 |
| CPI growth (%) | 9.1 | 12.8 | 25.2 | 15.9 | 9.4 | 8.0 | 0.6 | (0.5) | 5.0 | 8.0 | 8.0 |
| Gross external financing needs/CARs +use. res (%) | 107.4 | 116.6 | 121.1 | 130.4 | 132.9 | 131.0 | 136.5 | 147.4 | 155.1 | 152.5 | 152.1 |
| Current account balance/GDP (%) | (1.5) | (3.7) | (7.1) | (1.5) | (2.2) | (6.3) | (8.1) | (7.8) | (7.2) | (7.0) | (6.8) |
| Current account balance/CARs (%) | (2.9) | (7.3) | (13.4) | (2.8) | (3.9) | (10.3) | (14.1) | (15.3) | (14.1) | (13.9) | (14.2) |
| Narrow net external debt/CARs (%) | 47.4 | 52.4 | 60.5 | 100.5 | 84.6 | 77.3 | 87.9 | 110.7 | 107.7 | 103.6 | 99.9 |
| Net external liabilities/CARs (%) | 36.0 | 37.2 | 43.1 | 64.5 | 49.7 | 48.4 | 59.1 | 79.3 | 85.4 | 88.7 | 92.0 |

Other depository corporations (dc) are financial 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 assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. CARs--Current account receipts.

The data and ratios above result from S&P's own calculations, drawing on national as well as international sources, reflecting S&P's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

RELATED CRITERIA AND RESEAR


## You May Also Be Interested In

- UPDATE: Puerto Rico's GO debt affirmed by S&P, outlook Negative
- Russia's Putin Preparing to Invade Eastern Ukraine
- Goldman Sachs Upgrades NuStar GP Holdings (NSH) to Buy

## Related Categories

Create E-mail Alert

Credit Ratings, Forex

## Related Entities

Standard & Poor's, Industrial Production



### Add Your Comment

Login with Facebook  Sign in with Twitter

**Name**

**Subject**

**Body**

## Sign up for StreetInsider Free!

Receive full access to all new and archived articles, unlimited portfolio tracking, e-mail alerts, custom newswires and RSS feeds - and more!

Signup for StreetInsider Premium Today! Free Trial!

Sponsored Links

Charter Business Internet
The fastest business Internet for the price - over 15x faster than DSL
CharterBusiness.com

CNNMoney's Free Portfo...
One View of Your Stocks, Fu...
cnnmoney.com

Extended Stay America
Official Site. Free WIFI, Kitche...
www.extendedstayamerica.com

Buy a link here



© Copyright 2014 StreetInsider.com