Center of Public Finance and Governance at Kyiv School of Economics
KSE | Kyiv School of Economics
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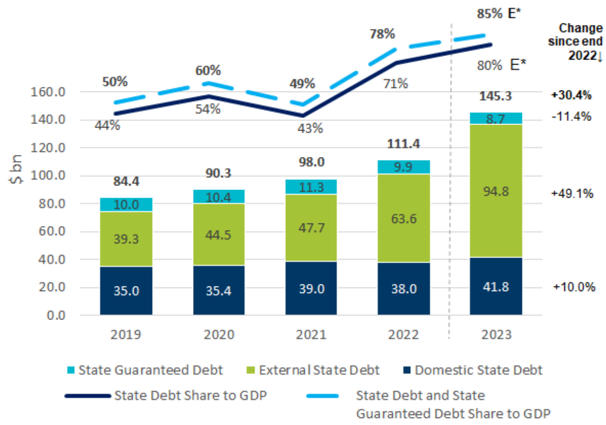
State Debt Review 2023

Summary

External finance on concessional terms has become the biggest source of financing for the Ukrainian budget[1] in 2023, although the role of domestic debt has also risen compared to 2022. Over the course of the year, the combined state debt and state-guaranteed debt surged by 30.4% (or $33.9 bn), reaching $145.3 bn (85% of estimated GDP). This is primarily attributed to a significant 49.1% (or $31.2 bn) increase in external debt (Figure 1). Domestic debt only experienced a modest increase of 10.0%, equivalent to $3.8 bn. The disproportionate growth of external debt has substantially skewed Ukraine's debt structure toward foreign exchange (FX) debt, which now accounts for 73% of total debt, up from 67% in 2022 (Figure 2). The current debt and guaranteed debt portfolio stands at an estimated 85% of the gross domestic product (GDP) – a noteworthy increase from the 49% it represented in 2021. About 67% of the debt carries fixed rates, which is close to the respective share at the end of 2022. Meanwhile, state-guaranteed debt stayed relatively stable, with a marginal reduction of 11.4% over the course of 2023.

Figure 1. State Debt and State Guaranteed Debt Dynamics, $ bn

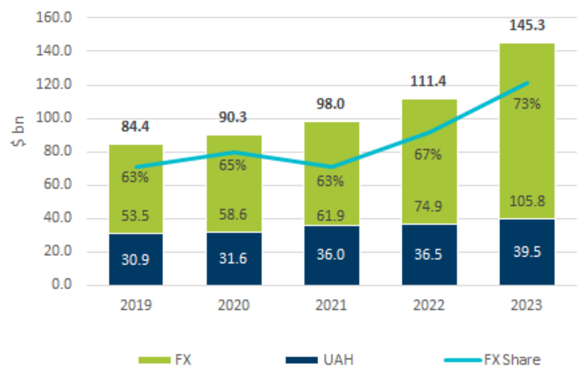


Note. E*, estimation based on Ministry of Finance projection of the 2023 GDP used for the State Budget Law 2024

External Debt

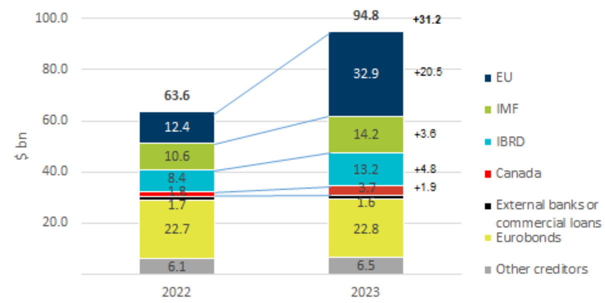
The largest portion of the increase in external debt (Figure 3) is attributed to the highly concessional loan from the EU's Macro-Financial Assistance (MFA) package of $19.5 bn (or EUR 18 bn originally), which was dispersed in equal monthly tranches over 2023. The repayment period is 35 years, which is unprecedented for Ukraine. The loan also has a grace period for principal payments until 2033 and an interest rate subsidy from EU member states and third countries, subject to compliance with political conditions, which will be checked annually. Going forward, the MFA is set to be replaced with the Ukraine Facility Program – a EUR 50 bn fund, out of which EUR 38 bn will be dispersed to the budget over 2024-2027.

Figure 2. State Debt and State Guaranteed Debt, Currency Structure and Share to GDP



The IMF has been another large creditor last year, contributing $3.6 bn for financing needs, net of redemptions. In March 2023, Ukrainian authorities and the IMF reached an agreement on a new 4-year Extended Fund Facility (EFF) arrangement. The EFF provides access to around $15.6 bn (SDR 11.6 bn). Over 2023, the IMF successfully completed two program reviews. With the initial payout and two reviews, a combined $4.5 bn were disbursed in 2023 (compared to $2.7 bn in 2022 under the Rapid Financing Instrument). Aside from the large financial contribution, the program's successful implementation and fulfillment of performance criteria are an important factor for other donors' and investors' activities.

Figure 3. External Debt Dynamics over the period, $ bn



Note. Values in the report are presented in US dollars for clarity and are converted using the NBU's official foreign exchange rate, either the average for the period or the rate at the end of the period.

The IBRD's exposure to Ukraine increased by $4.8 bn last year. However, this amount is distributed among a number of projects, backed by different official creditors or guarantors. Among them, two projects contributed the most: Public Expenditures for Administrative Capacity Endurance in Ukraine (PEACE) project, and the Social Protection for Inclusion, Resilience and Efficiency (INSPIRE) project. Both Projects have concessional terms, and a grant component.

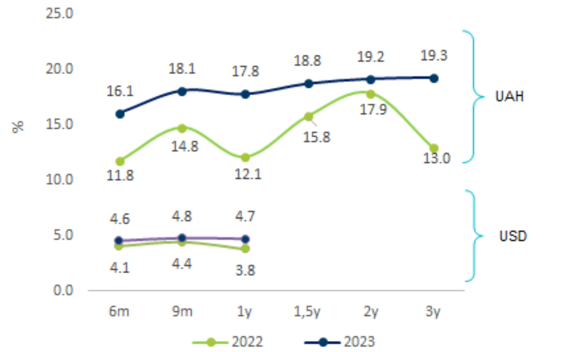
The Canadian government has allocated the equivalent of $1.9 bn in 2023, extending the loan agreement initiated in 2022. This financial support comes with concessional terms, including a 4.5-year grace period within the 10-year overall maturity of each tranche. Additionally, the interest rate for the tranches disbursed in 2023 is set at 1.5%.

[1] *Here and after term "budget" is used for the central (state) level budget*

Domestic Debt

Ukrainian domestic government bonds (OVDP) became a significant source of funding in 2023, in contrast to the previous year, resulting in a net inflow of $5.4 bn into the budget (vs. an outflow of $4.2 bn in 2022, Figure 6). Through 2023, the Ministry of Finance (MoF) raised a gross amount of $15.5 bn via OVDP and redeemed $10.1 bn, resulting in a system-wide rollover rate of 150% in all currencies (67% in 2022). This substantial change can largely be attributed to collaborative efforts by MoF and NBU aimed at a revival of the local market. Firstly, the MoF increased primary market yields to align with a higher interest rate environment for the local currency. Notably, the weighted-average yields for Hryvnia bonds with maturities of 6 months to 3 years were 1-6 percentage points higher than in 2022 (Figure 4).

Figure 4. Weighted-average Yields of Debt Raised via OVDP by Maturity and Currency



In addition, in 2023, the NBU permitted banks to cover up to 50% of the specified amount of required reserves with benchmark OVDP from the gradually expanding list of bond issues determined by the NBU. These initiatives led to heightened demand from banks and resulted in a cumulative increase of $4.7 bn in their bond portfolios over the year. Legal entities and individuals also played a role by increasing their portfolios by $0.9 bn and $0.6 bn, respectively. The NBU attempted to incentivize non-residents to reinvest the principal amount and accumulated hryvnia funds from OVDP into the primary market by allowing repatriation of OVDP interest received after 1 April 2023 (an option banned in 2022). However, this measure only partially stopped the outflow from OVDP by non-residents, resulting in a reduction of their bond portfolio by $0.4 bn (compared to a decrease of $1 bn in 2022). Larger demand and preserved financial stability allowed the MoF to transition to longer-term maturity issuance. While the average maturity of bonds issued in 2022 was 8.6 months due to high uncertainty, it extended to 18.7 months for 2023. However, the overall duration of domestic debt is lower in 2023 than in 2022 – 7.3 years vs 8.4 years. Assuming market yields on the primary market in 2024, we expect that the system-wide rollover rate for OVDP will remain above 100% in the coming year.

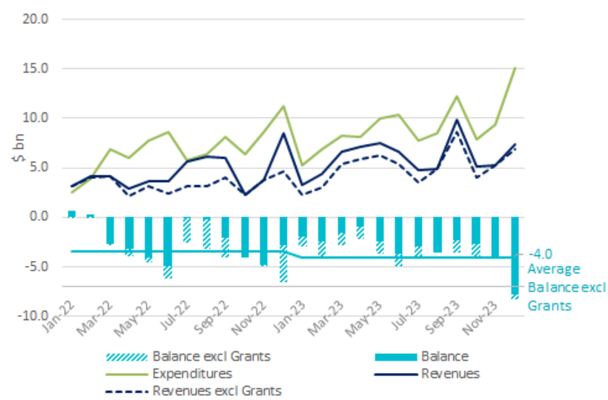
State Guaranteed Debt

The primary factor contributing to the slight decrease of the state-guaranteed debt (by $1 bn, Table 1) in 2023 is the redemption of IMF credit (by $1.6 bn) from the foreign exchange reserves of the NBU. Other components had minimal impact. Following a sharp increase in state portfolio guarantees in 2022 (from $0.1 bn), the guaranteed volume remained relatively stable in 2023, hovering around $0.8 bn. Portfolio guarantees provided coverage for the issuance of 13.7k in corporate loans with a total volume of $1.3 bn during the year. Another large component, commercial loans guaranteed by the state to banks, remained steady. Additionally, the payment of Ukravtodor and Ukrenergo Eurobonds amounting to $1.5 bn combined, are deferred until 2024 under terms similar to those of the sovereign Eurobonds.

Budget Financing

The central budget ran a deficit of $48.1 bn (not considering foreign grants as a part of the budget revenues), amid large defense expenses and a limited ability to increase tax collection on a similar scale. In 2023, 52% of budget expenditures went to the Ministry of Defense and an additional estimated 13% went to war-related security issues. The deficit was much higher than planned in the initially enacted Law on State Budget for 2023 ($35.4 bn), but foreign grants reduced it considerably – to $36.5 bn (20.6% of GDP). On average, expenditures exceeded budget revenues by $4.0 bn monthly – or $3.1 bn if foreign grants are considered as a part of budget revenues (Figure 5).

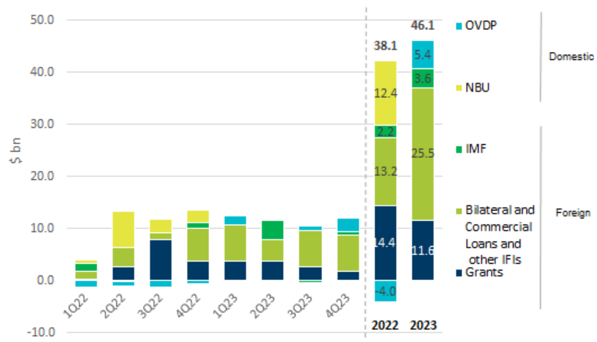
Figure 5. State Budget Balance, $ bn



In 2023, altogether, only 56% of budget expenditures (which reached $109.8 bn) were covered by budget revenues excluding foreign grants. Another 5% were financed internally through the issuance of domestic government bonds, 2% stemmed from a change of balances in the State Treasury accounts, while the remaining 37% relied on external loans and grants.

Foreign finance was fully sufficient to close the gap, and amounted to $40.7 bn (Figure 6), net of $1.8 bn directed mostly toward redemption of IFI loans, including the IMF. The financing was partly provided in non-repayment grant form. The United States contributed the largest share of the grants – $11 bn, while Japan ($233 m), Norway ($190 m), Spain ($53 m) and other countries provided the remaining $680 m. The remaining financing needs were covered with concessional loans ($25.5 bn), IMF EFF disbursements ($4.5 bn), and by the domestic market ($5.4 bn) at market rates. The NBU did not finance the budget by Hryvnia emission in 2023.

Figure 6. Net Financing of the State Budget, $ bn



Country Credit Rating

S&P and Moody's lowered Ukraine's long-term foreign currency ratings by one notch in 2023, to CCC and Ca, respectively. Fitch and R&I (R&I release in January 2024) have affirmed their previous ratings at CC and CCC levels. The latter ratings, along with Moody's, imply a near-default assessment of the debt. The prolonged war poses enduring challenges to Ukraine's economy and public finances, increasing risks of public debt sustainability. The anticipated 2024 restructuring will likely result in considerable losses for commercial creditors or further deferral of payments if an agreement cannot be reached. Both outcomes would imply a further downgrade to default status. Conversely, local currency ratings are generally higher, as hryvnia-denominated government debt is not expected to be a part of any restructuring deal and is easier to service.

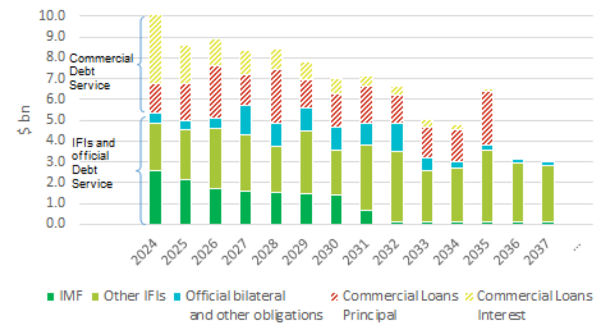
Debt Service and Projections

In December Ukraine was able to extend the memorandum on debt service suspension to official creditors from G7 and Paris Club, which was initially signed in September 2022. Then, the participating creditor countries expressed their support for a debt service suspension to Ukraine from 1 August 2022 until the end of the year 2023 to allow the government to increase social, health, and/or economic spending in response to the war. According to recent amendments, the extension of the memorandum lasts until the end of March 2027, when the current IMF EFF is also set to conclude. The total debt stock covered by the memorandum amounts to around $3.1 bn. This agreement lays the ground for a restructuring of Eurobonds, whose payments suspension is ending in 2024. Ukrainian authorities have expressed their commitment to seek a comparable treatment with commercial creditors. Thus, burden sharing is likely to be required by official creditors, given their continued financial backing of the critical expenditures during the ongoing war.

Ukraine spent 11% ($6.8 bn) of budget revenues (excluding grants) on interest payments for domestic and external state debt (Table 2). Most of this amount ($5.5 bn) went into servicing of domestic debt, and is close to the net fund inflow from OVDP placement on the local market in 2023. The cost of domestic debt was significantly higher in 2023 than that of external debt – 8.9% vs 2.2%. This is explained by the deferral of the commercial payments, highly concessional conditions of the newly attracted external funding, and high interest rate environment for the national currency.

About 10.6% of GDP or $18.7 bn was directed to the service (interest and principal payments) of the state debt in 2023. Most of it ($15.6 bn) was paid for domestic debt, while $3.2 bn went to foreign creditors.

Figure 7. External Debt Amortization and Interest Payments, $ bn



For the Outstanding Debt as of Jan 1, 2024

The cost of servicing the debt (interest and principal payments) in 2024 is estimated to be close to the 2023 level of 11.1% of GDP or $20.8 bn (Table 2), assuming the continuation of deferral of the payments on Eurobonds and commercial loans, or their restructuring with a grace period. Out of this, about $5.3 bn will be needed to cover debt service ($2 bn in interest payments and $3 bn in principal) of IFIs loans and other official creditors (Figure 7). The debt repayment suspension agreed with private creditors is expiring, and the government of Ukraine needs to undertake other debt operations for external liabilities in order to secure fiscal sustainability.

International financial aid will continue to play a key role in financing budgetary needs in 2024. According to the budget for 2024, financing needs in the form of credit will amount to around $38.6 bn, which is close to the amount in 2023 if grant support is considered. The Ukraine Facility Program (EUR 50 bn) has been voted on by the European Council, with transitional financing (enabling Ukraine to receive support before the full launch), and final approval by the EU expected in April. However, risks of untimely funds inflows are still high in 1Q2024, along with the risk of declining financial aid starting in 2025. A tangible part in the form of grants for 2024 has not yet been approved by the partners. Thus, the anticipated commercial debt treatment in 2024 should not only prioritize the imperative of restoring debt sustainability, but also keep in mind the liquidity needs and securing of private financing for post-war development.

Table 1. State Debt and State Guaranteed Debt of Ukraine for the last 5 years, $ bn

	2019	2020	2021	2022	2023	% of Total	Change over 2023	Change, %
Total amount of state debt and state guaranteed debt	***84.4***	***90.3***	***98.0***	***111.4***	***145.3***		***33.9***	***30.4%***
State Debt	**74.4**	**79.9**	**86.6**	**101.6**	**136.6**	***100.0%***	**35.0**	***34.4%***
Domestic Debt	**35.0**	**35.4**	**39.0**	**38.0**	**41.8**	**30.6%**	**3.8**	**10.0%**
Government securities issued at the domestic market	34.9	35.3	38.9	38.0	41.8	*30.6%*	3.8	*10.0%*
in UAH	30.4	30.4	34.5	34.9	38.3	*28.0%*	3.3	*9.6%*
in FX	4.5	4.9	4.3	3.0	3.5	*2.5%*	0.5	*15.4%*
Other liabilities	0.1	0.1	0.1	0.0	0.0	*0.0%*	(0.0)	*(11.1%)*
External Debt	**39.3**	**44.5**	**47.7**	**63.6**	**94.8**	**69.4%**	**31.2**	**49.1%**
IFO Loans and Bilateral loans	15.7	19.0	22.9	39.3	70.5	*51.6%*	31.2	*79.4%*
EU	3.7	4.7	5.0	12.4	32.9	*24.1%*	20.5	*166.1%*
IBRD	4.9	5.3	6.2	8.4	13.2	*9.6%*	4.8	*57.2%*
IMF	4.1	6.0	8.8	10.6	14.2	*10.4%*	3.6	*34.3%*
Canada	0.2			1.8	3.7	*2.7%*	1.9	*101.5%*
Other creditors	2.8	3.0	2.9	6.1	6.5	*4.7%*	0.4	*5.9%*
Eurobonds	22.3	23.4	22.9	22.7	22.8	*16.7%*	0.1	*0.5%*
External banks or commercial loans	1.4	2.2	1.9	1.7	1.6	*1.1%*	(0.1)	*(5.1%)*
State Guaranteed Debt	**10.0**	**10.4**	**11.3**	**9.9**	**8.7**	***100.0%***	**(1.1)**	***(11.4%)***
Domestic Guaranteed Debt	**0.4**	**1.1**	**1.8**	**2.0**	**1.8**	**20.8%**	**(0.2)**	**(8.3%)**
Domestic banks or commercial loans	0.2	0.3	1.2	1.7	1.6	*18.4%*	(0.0)	*(3.0%)*
Portfolio Guarantees			0.1	0.8	0.8	*9.5%*	0.1	*6.6%*
Securities issued at the domestic market	0.2	0.9	0.6	0.3	0.2	*2.4%*	(0.1)	*(35.2%)*
External Guaranteed Debt	**9.6**	**9.2**	**9.5**	**7.9**	**6.9**	**79.2%**	**(1.0)**	**(12.2%)**
IFO Loans	8.1	7.8	6.8	5.2	4.2	*48.5%*	(1.0)	*(19.1%)*
IMF in NBU's FX Reserves	7.1	6.7	5.6	3.7	2.1	*24.4%*	(1.6)	*(42.8%)*
EBRD	0.3	0.4	0.3	0.6	1.1	*12.8%*	0.5	*84.9%*
Securities issued at the external market			1.5	1.5	1.5	*17.5%*	0.0	-
External banks or commercial loans	1.4	1.3	1.1	1.0	1.0	*11.7%*	0.0	*0.3%*
Other liabilities	0.1	0.1	0.1	0.1	0.1	*1.3%*	0.0	*0.8%*

% of GDP

	2019	2020	2021	2022	2023
Total amount of state debt and state guaranteed debt	***50.2%***	***60.4%***	***49.0%***	***77.8%***	***85.4%***
State Debt	***44.3%***	***53.5%***	***43.3%***	***70.9%***	***80.3%***
State Guaranteed Debt	***6.0%***	***6.9%***	***5.7%***	***6.9%***	***5.1%***

Source: Based on MoF data.
Note. Due to relatively low Hryvnia volatility in 2023, FX rate changes played only a marginal role in the absolute value changes.
% of GDP, originally calculated in national currency.

Table 2. Government Debt Redemptions, Factual and Projection for 2024, $ bn

	2019	2020	2021	2022	2023	2024E*
Interest payments	4.7	4.6	5.3	4.9	6.8	8.4
Domestic	2.9	2.8	3.5	3.6	5.5	6.0
External	1.8	1.8	1.8	1.3	1.3	2.3
% of GDP	*3.0%*	*3.0%*	*2.8%*	*3.0%*	*3.8%*	*4.5%*
% of State Budget Revenues	*12.1%*	*11.6%*	*11.6%*	*8.8%*	*9.3%*	*14.9%*
% of State Budget Revenues w/o Grants	*12.1%*	*11.7%*	*11.6%*	*12.0%*	*11.1%*	*19.3%*
% of State Budget Revenues w/o Grants, Domestic	*7.4%*	*7.1%*	*7.7%*	*9.0%*	*8.9%*	*13.9%*
% of State Budget Revenues w/o Grants, External	*4.6%*	*4.5%*	*3.9%*	*3.0%*	*2.2%*	*5.4%*
Principal and Interest payments	17.9	19.0	21.0	19.0	18.7	20.8
Domestic	12.9	11.8	15.7	16.2	15.6	15.5
External	5.1	7.1	5.3	2.7	3.2	5.3
% of GDP	*11.7%*	*12.1%*	*10.9%*	*11.7%*	*10.6%*	*11.1%*
% of GDP, Domestic	*8.4%*	*7.5%*	*8.1%*	*10.0%*	*8.8%*	*8.2%*
% of GDP, External	*3.3%*	*4.6%*	*2.7%*	*1.7%*	*1.8%*	*2.8%*
% of Gross Export of Goods, Services and Workers' Remittances, External Principal and Interest payments	*6.6%*	*9.9%*	*5.5%*	*3.9%*	*5.1%*	*n/d*

Source: KSE calculations based on MoF and NBU data

Note.

1. *Expected values are calculated based on scheduled debt payments, the value of GDP, budget revenues and debt attraction set in the State Budget Law for 2024, using historical cost of domestic debt, and assuming further deferral of commercial debt payments, $ 13bn in the form of grants in 2024, highly concessional terms of new external loans.
2. Revenues (and expenditures) set in the State Budget Law 2024 consist only ~80% of 2023 factual values, which increases the ratios of interest payments to State Budget Revenues for 2024E. The amount of revenues to be received in 2024 is planned too conservative in the State Budget, and expected to be higher.
3. Ratios are initially calculated in UAH, except for Export of Goods, Services and Workers' Remittances

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