

## **Impact of Russia's Invasion of Ukraine on Credit Ratings of Japanese Companies—Direct Impact Currently Limited, but JCR Will Watch for Spillover Risks Through Various Channels**

The following is Japan Credit Rating Agency, Ltd. (JCR)'s opinion on the impact of Russia's invasion of Ukraine on the credit ratings of Japanese companies.

- (1) The creditworthiness of Japanese companies was on the way to recovery from the risk of spread of COVID-19, but Russia's invasion of Ukraine from late February 2022 has again an uncertain impact on the outlook for creditworthiness. There are not many Japanese companies rated by JCR that are highly dependent on transactions with Ukraine and Russia. There are some companies that have production bases and sales networks, and a certain degree of impact is inevitable, but in general, the impact on creditworthiness can remain limited. However, JCR believes that there is a concern that economic sanctions against Russia by countries around the world could have a negative impact on the creditworthiness of Japanese companies in the medium term, either in a chain-reaction or through various channels.
- (2) The most important issue to watch is the impact of shortage of energy resource supply and price hike. If the supply of Russia's trade resources, such as oil, natural gas, and coal, is squeezed in retaliation for the economic sanctions, the supply-demand balance will become even tighter than it is now. While the global trend toward decarbonization has been progressing and the supply side's willingness to increase production has been on the wane, the oil market has been tightening, partly due to a rapid recovery in demand in reaction to the COVID-19 crisis. The invasion of Ukraine by Russia is likely to push prices even higher and at a higher level. Moreover, Russia and Ukraine are showing their presence as global exporters of rare metals such as palladium and foodstuffs such as wheat and corn. The deterioration in these non-energy markets will not be resolved quickly, and both manufacturing and non-manufacturing industries will be forced to raise costs. Furthermore, the suspension or reduction of trade with Russia could indirectly transform supply chains on a global basis. In general, economic sanctions against Russia are not expected to be lifted in the short term and are expected to have a negative impact on the creditworthiness of Japanese companies through various channels.
- (3) In the financial sector, JCR expects that in many cases, Russia-related exposures will be small, or if not small, possible losses will be limited to a range that can be fully absorbed by periodic revenues. Nevertheless, the outlook for some aircraft leasing is more uncertain, and leasing companies with relatively large exposures to Russia may be affected to a certain extent. As for the direct impact, uncertainty and seriousness of the situation will increase, if economic sanctions against Russia and Russia's countermeasures against them are strengthened, and the situation does not allow for optimism. Indirectly, it appears that turmoil in the financial market has already had the effect of depressing the market value of assets held in the securities investments. In addition to the risk that losses may be more likely to be recorded amidst increasing market volatility, if interest rates rise overseas, especially in the U.S., the increase in foreign currency financing costs could worsen profits. Furthermore, if corporate performance deteriorates due to higher costs and sluggish production, as mentioned above, there is a concern that this could lead to higher credit costs for financial institutions.
- (4) Many Japanese companies that were not directly affected by the COVID-19 have rapidly recovered their business performance since the summer of 2020, after bottoming out in the spring of the year, and their financial structures have been improving. Although JCR has taken positive action on the ratings and outlook of these companies, the above-mentioned chain-reaction and spillover risks may have a negative impact on their performance in FY2022 and beyond. However, the degree of impact will vary depending on the business model of individual companies, their degree of dependence on domestic and overseas operations, and the degree of financial soundness of their financial base, and will not be uniformly reflected in the ratings. Although the path to a resolution of the dispute is extremely uncertain, JCR will closely monitor changes in the intensity of economic sanctions against



Russia and the impact of their duration on market conditions, as well as the effects of any policy measures to support economic conditions, if any, and take appropriate action in a timely manner.

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