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Research Report on Russia

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Ratings

Sovereign Government Credit (LC)	BB+
Sovereign Government Credit (FC)	BB+
Country Credit Environment (LC)	BB+
Country Credit Environment (FC)	BB+

* These ratings are unsolicited

Main Economic Indicators of Russia

Macro indicators	2013	2014	2015f
Gross gov. debt, RUB bn	9286	12723	13920
Nominal GDP, RUB bn	66190	71406	74045
Real GDP growth, %	1,3	0,6	-3,7
Gross gov. debt/GDP, %	14,0	17,8	18,8
Deficit (surplus)/GDP, %	-1,3	-1,2	-3,0
Inflation rate, %	6,5	11,4	12,9
Current Account Balance/GDP, %	-	-	5,0
External debt, USD bn	-	-	62,1

Development indicators	2014
Inequality adj. HDI	0,71
GDP per capita, USD th	24,4

Default indicator	29.01.2016
5-Year CDS spread, Bp	325
10Y Gov Bond Yield, %	10,2

Source: RAEX (Europe) calculations based on data from the IMF, Russian Ministry of Finance, Deutsche Bank, UN, CBR.

Summary

Russia's 'BB+' ratings are strongly influenced by external factors. The sharp decline of world oil prices has triggered a steep devaluation of the RUB and widened the fiscal deficit in recent years. Low debt metrics have been constantly increasing as a result of persistent fiscal deficits.

Monetary policy normalization is being delayed as further decline of oil prices could trigger additional internal imbalances. The banking sector showed mixed results over the past year and could deteriorate further on the wake of negative growth prospects.

Fiscal deficit widened, prospects are negative. Driven by a sharp decline of world oil prices during 2H 2015, the fiscal deficit of Russia increased up to 3% of GDP in 2015. The decline in oil prices resulted from a global excess-supply of oil and the unexpected slowdown of the Chinese economy.

In an attempt to cushion the adverse effect on government finances, around USD 44 bn were transferred from the Reserve and Wealth funds to the Russian treasury during 2015 at an ever higher pace (see graph 1). Funds could be depleted by end-2016 if the current status-quo persists and the amount transferred from the funds to the treasury remained at levels observed by end-2015.

The 2016 budget was revised based on oil price below USD 30 per barrel. The federal government recently announced a reduction of 30% in selected infrastructure projects and a 10% cut in several other government programs along 2016. However, fiscal expenditure could be resilient to decline before September-2016 legislative elections.

Government debt remains tolerable. Debt metrics increased steadily over the past six years as a result of persistent fiscal deficits. Government debt is projected at 19% of GDP and 54% of budget revenues for 2015 (see graph 2). External debt amounted to USD 62,1 bn or 6,1% of GDP by December-2015. Short-term debt around 1% of GDP and 3% of budget revenues presents no significant risk for the creditworthiness of the Russian economy.

The yield of the 10-year government bond around 11% in January 2016 reflects relatively high long-term risks in Russia. Furthermore, the Agency considers that the debt load of the Russian private sector, which stood at

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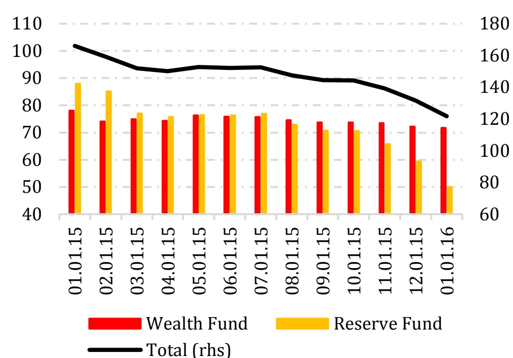
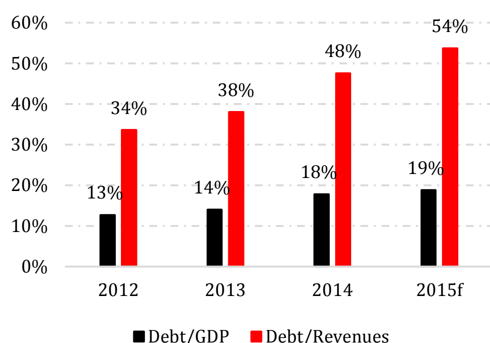
Graph 1: Wealth and Reserve funds, USD bn



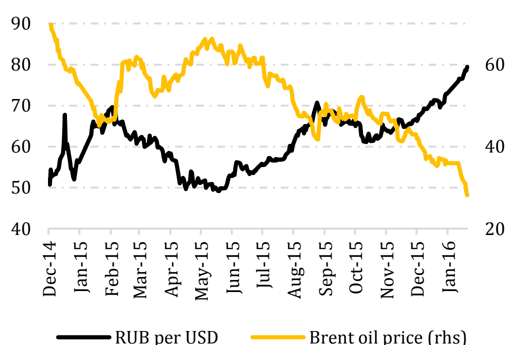
Source: RAEX (Europe) calculations based on data from the Russian Ministry of Finance

Graph 2: Government debt, %



Source: RAEX (Europe) calculations based on data from the Russian Ministry of Finance

Graph 3: Exchange Rate vs. Oil Price



Source: RAEX (Europe) calculations based on data from CBR, EIA

96% in 2014, presents a long-term underlying risk for the overall economy.

Monetary policy likely to remain on hold. The monetary policy of the Central Bank of Russia (CBR) in late2014 was a strong buffer to contain the economic imbalances triggered by lower oil prices. FX reserves resumed growth as RUB moved from a managed-flotation to a free-floating exchange rate regime by the end of 2014.

The RUB depreciated around 40% against the USD over December 2014-January 2016 (see graph 3), fuelling inflation through higher prices for imported goods. As a response, the CBR tightened its monetary policy by rising the key interest rate.

After oil prices stabilized in mid-2015, the CBR brought the key rate down to 11%, but the expectations on future oil prices will most likely delay the full normalization of the monetary policy.

External position remains sound. The external position of the country improved during 2014-2015 as consumption of imported goods declined faster than overall exports. As a consequence, the Agency expects the current account surplus to increase up to 5% of GDP in 2015 from 3,8% one year before.

Additionally, foreign reserves at 596% of FX denominated debt and equivalent to 9 months of 2014 imports, stand at a comfortable level.

Mixed results in the Banking sector. Solvency indicators of the banking sector remain strong, with banks' assets and volume of private credit around 105% and 60% of GDP respectively in 2015. Capital adequacy ratio at 9,3% in 2015 resumed growth after declining to 8,5% in 2014.

Non-performing loans accounted for 7,4% of total loans in 2015 and are expected to increase further on the wake of negative growth prospects for the Russian economy. Additionally, the banking sector reported after-tax losses during 1H 2015 and an end-of year ROA as low as 0,2%.

Important note for sovereign ratings

This Research Report shall be treated as a supplementary part of the published Press Release included in the following link:

http://www.raexpert.eu/reports/Press_release_Russia_29.01.2016.pdf

Both documents shall be treated as essential parts of each other.

For further information on the factors, their weights, methodologies, risks and limitations of these ratings, and other regulatory disclosures, please refer to the Press Release and the website of the agency.

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