Rating-Agentur Expert RA confirmed at 'BBB-' the ratings of Russia. The rating outlook is stable.

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Russia at 'BBB-' (Moderately high level of creditworthiness of the government) in national currency and at 'BBB-' (Moderately high level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- The country's macro profile is favorable with solid real GDP growth rate of 1,8% in 2017 and it is set to remain strong at 1,7% in 2018. We keep our opinion that growth is likely to remain at around 1,5% over the next years, driven by the stable macroeconomic environment, relaxed monetary policy, increase in oil prices and current positive global economic outlook;
- After reaching a historical minimum in December 2017 at 2,5%, the inflation rate remained at around 2,4% through 1H 2018, which makes it improbable that the CBR's target of 4% will be reached by end of 2018. However, the Russian government's proposal to increase the value-added tax (VAT) in 2019 to 20% from the current 18% percent could add 1,5 p.p. to inflation. This would ultimately bring inflation rate close to the target;
- Gross government debt remained low at around 17,4% of GDP and 52,4% of budget revenues by the end of 2017, driven mostly by the prudent fiscal policy. We anticipate these metrics to remain low supported by favorable economic developments;
- Despite short-term debt reaching 1,4% of GDP and 4% of budget revenues in 2017, the debt structure represents a low risk factor for the macroeconomic environment;
- International reserves improved further over 2017 and stood at USD 432 bn as of December (USD 376,3 bn in December 2016). This amount covers 1,5x of gross government debt and 13 months of 2017 imports;
- The fiscal stance improved, with the deficit shrinking from 3,7% in 2016 to 1,5% in 2017 as a result of the government's fiscal consolidation plan. Fiscal balance is expected to narrow further in 2018 as a combined result of better economic perspectives, reduction of expenditures and growing oil and gas revenues, mostly because of increases in energy prices. Going further, the potential approval of the pension reform is likely to reduce fiscal pressures;
- After the monetary policy easing resumed in March 2018 following the inflation outlook, the CBR further moved from a moderately tight to a more neutral monetary policy. Along 1H 2018, the CBR cut again the refinancing rate by 50 b.p. down to 7,25%;
- Total banking sector assets stood at 92,5% of GDP in December 2017. The sector remained well capitalized with capital to assets ratio of 10,5% in 2017 and we anticipate this trend to continue in the upcoming years, following the ongoing revocation of banking licenses (around 350 since 2014) and overall banking sector clean-up;

- The trade balance of goods and services remained positive at 5,4% of GDP in 2017 (4,7% in 2016) and it was driven by decreased domestic demand and increasing oil and gas prices.

Restricting factors:

- Private credit, which stood at 50,8% in 2016, slightly dropped to 49,9% of GDP in 2017. This level of private credit is well below Russia's BRICS peers (except India), whose average private credit stands well above 100% of GDP;
- The stock market remains concentrated with share trades on the 10 largest issuers at 78,5% in 2017. The market capitalization of Russia's MICEX increased steadily during 2H 2017 and remained stable during 1H 2018 following the rebound in oil prices;
- Economic competitiveness of Russia remains around average levels as shown by the Index of economic competitiveness from the World Economic Forum (38th place out of 137 countries in 2017-2018);
- Foreign direct investment inflows as % of GDP dropped to 1,7% in 2017 from 2,5% in 2016. This metric halved between 2013-2014 and reached 0,5% in 2015 following the sharp increase in inflation and the devaluation of the RUB. However, in 2017 the level of FDI in nominal terms increased compared to 2016, which could signal a potential resurge of foreign investors' interest.

Negative factors:

- State-owned banks still dominate the Russian banking system, with almost 70% of total banks' assets in 2017, driven by the banking sector clean-up and the Central Bank of Russia's (CBR) last year's intervention to put the three of the largest private banks under the state control;
- The level of non-performing loans (NPLs) stood at 7,5% as a share of total loans in 2017 after reaching a six-year record of 9,4% in 2016. We expect a further decline of this metric due to the aforementioned purge in the banking sector and the CBR's plan to consolidate it.

Stress factors:

- Concentration of tax revenues on one single industry. Almost half of fiscal revenues proceed from oil and gas taxation (moderately weak stress factor);
- Western sanctions on Russia, which had a negative impact on prices of imported goods and on international financing possibilities, remain in place (moderately weak stress factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Withdrawal of western sanctions on Russia which would boost trade and stronger economic growth;
- Further improvement in the GDP growth rates combined with the reduction of the fiscal deficit.

The following developments could lead to a downgrade:

- Introduction of a new set or strengthening of western sanctions on Russia, targeting Russian officials and companies as well as third countries' actors doing business with targeted Russian enterprises and individuals;
- Resumed long-term decline of oil prices which could lead to a deterioration of government debt and fiscal metrics as well as renewed devaluation of the RUB and higher inflation rates.

"The credit ratings of Russia are confirmed at 'BBB-' on the back of improving macroeconomic fundamentals, higher oil prices, low inflation rates, modest and stable government debt metrics and narrowing fiscal balance. Higher oil prices helped to reduce fiscal pressure and contributed significantly to the fiscal consolidation. With reduced financing needs, government debt metrics remained low and stable. As monetary policy becomes neutral, its pace of normalization is slowing-down. This was evidenced by the noticeable reduction of interest rates cuts done by the Central Bank of Russia (CBR) along 1H 2018 as compared to the same period in 2017.

The stable rating outlook is supported by our view that key macroeconomic variables are likely to remain unchanged in the mid-term perspective. Even through oil prices are likely to remain high and keep contributing to fiscal consolidation during 2H 2018, the country's significant dependence on this commodity and ongoing sanctions keep posing a risk for the continuation of the country's smooth recovery." – Clarified Gustavo Angel, Rating Associate of Rating-Agentur Expert RA GmbH.

Responsible expert: Gustavo Angel, Rating Associate of Rating-Agentur Expert RA GmbH

Reviewer: Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH

Research report on Russia is available at:

http://www.raexpert.eu/reports/Research_report_Russia_06.07.2018.pdf

Next scheduled rating publication: TBD in December 2018

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
12.01.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
14.07.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
20.01.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
22.07.2016	Scheduled revision of both types of ratings for the country	BB+	BB+	NA	NA
29.01.2016	First assignment of both types of ratings for the country	BB+	BB+	NA	NA

Minute's summary

The rating committee for Russia was held on 4 July 2018. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version (from May 2018) can be found under the following link: https://raexpert.eu/files/methodology/Methodology_Full_Sovereign_V3.pdf. Descriptions and definitions of all rating categories can be found under the following link: http://raexpert.eu/sovereign.php under the "Rating scale" section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: Central Bank of Russia, Ministry of Finance of the Russian Federation, World Federation of Exchanges, Russian Federal State Statistic Service, International Monetary Fund, World Bank, Trading Economics, World Economic Forum, Doing Business, United Nations, Moscow Stock Exchange (MOEX), Cbonds.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

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Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

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The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.