Rating-Agentur Expert RA GmbH confirmed at 'BBB-' the ratings of Russia

Rating-Agentur Expert RA GmbH 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.

Rating-Agentur Expert RA GmbH confirmed the country credit environment rating (CCE) of Russia at 'BBB-' (Moderately high quality of credit environment of the country) in national currency and at 'BBB-' (Moderately high quality of credit environment of the country) in foreign currency.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Driven by a prudent fiscal policy since the end of 2014, gross government debt is low and reached 17% of GDP and 52,7% of budget revenues by the end of 2016. Following better economic conditions and reduced financing needs of the government, we expect these figures to remain low in 2017;
- Short-term debt around 1% of GDP and 2,5% of budget revenues as of April 2017, represented no significant risk for the Russian economy. This metric also remained flat since 2015;
- International reserves at the Central Bank of Russia (CBR) increased up to around USD 400 bn as of June 2017. This amount covers 1,6x of gross government debt 17 months of 2016 imports, well above the world's 13 months average;
- Fiscal deficit, despite widening, remained manageable at 3,7% of GDP in 2016. However, we keep our expectation that the fiscal balance will narrow in 2017 as a combined result of better economic perspectives and expenditure consolidation reflecting the reality of permanently lower oil prices;
- The fiscal and monetary policy accommodated to macroeconomic conditions since 2015. The pace of deficit reduction in the budget is consistent with the reality of permanently lower oil prices. Monetary policy easing resumed in March considering the inflation outlook. As a consequence in June 2017, the Central Bank of Russia cut again the refinancing rate by 25p.p. to 9%;
- The Russian banking sector remains well positioned in terms of assets despite dropping by 7p.p. to 93% of GDP in 2016. Furthermore, average capital to assets ratio improved in 2016 by almost 1p.p. to reach 9,4% by the end of 2016;
- Driven by decreased domestic demand and increasing oil and gas prices, the balance of goods and services to GDP remained positive at 4,7% in 2016, despite halving from a year before.

Restricting factors:

- Driven by a stabilization of oil prices and the appreciation of RUB against major world currencies, the inflation rate recorded a historical minimum in 2016 at 5,4%. This downward trend continued during 2017, as annual inflation rate approached CBR's target (4%) by reaching 4,1% in May. If our expectations that price levels will remain stable and inflation close to its target materialize and persist in the long run, this factor could become positive;

- Moderate level of private credit, which we estimate to have dropped to around 50% of GDP by end 2016. In this terms, Russia diverts significantly from its BRIC peers, whose average private credit stands well above 100% of GDP;
- The Russian stock market shows high concentration of share trades on the 10 largest issuers at 80% in 2016. Even though the capitalization of the stock market reached 44% in 2016, this was the result of two main factors, the "trump effect" and the increase in the world oil price which followed the OPEC agreement. However, the MICEX market cap has shown a downward trend during 1H 2017, following decreasing oil prices, suggesting that the market cap trend could revert;
- Average economic competitiveness as evidenced by Russia's position in the Index of economic competitiveness from the World Economic Forum (45th place out of 140 countries in 2016-2017);
- Reduced amount of foreign direct investment inflows at around 1,6% to GDP 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. The slight improvement in 2016 is the result of better economic conditions and forecasts, which are likely to foster higher investment inflows in 2017.

Negative factors:

- The real GDP growth rate showed a negative trend in absolute and per capita terms in 2015 and 2016 driven by lower oil prices, which triggered a devaluation of the RUB, and ultimately higher consumer prices. However we forecast, in line with the IMF, that real GDP will expand by around 1,4% in 2017 driven by better economic conditions for the country;
- The banking sector remains highly concentrated on state-owned banks. The top-6 Russian banks are directly or indirectly owned by the government and represent around 60% of total banks' assets;
- The share of non-performing loans (NPLs) on total loans reached a six-year record of 9,4% in 2016. Such an increase in NPLs affected profitability of the banks and increased pressure on capital adequacy metrics.

Stress factors:

- Concentration of tax revenues on one single industry. Almost half of fiscal revenues proceeds 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).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Positive factors:

- The real interest rate rebounded in 2015 and remained stable around 7% through 2016 as a result of lower inflation rate and the accommodative monetary policy of the CBR. Volatility is expected to remain low as inflation rate is likely to remain close to the CBR's 4% target in 2017.
- Strong performance of the country's stock exchange index (MICEX) over the past six years. However, the index showed a negative trend during 1H 2017 following the drop of oil prices;
- Private sector debt remained bearable as we forecast it to have dropped around 86% of GDP by end 2016 (from 93% in 2015) driven by lower internal credit;

- Moderately high quality of investors' protection in the country (Russia occupied the 53rd place in the ranking of Protecting Investors (part of Doing Business) out of 180 countries in 2016).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Withdrawal of western sanctions on Russia which would boost trade and 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:

- Deterioration of the banking sector's solvency and profitability indicators on the back of further increase in the ratio of NPLs;
- 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 ratings of Russia at BBB- remain positively influenced by encouraging macro indicators which translate into low inflation rate levels, stable government debt metrics and a consolidating fiscal balance. However, the unpredictability of oil prices, combined with western sanctions on Russia and increasing non-performing loans (NPLs) in the banking system affect the ratings negatively.

The new fiscal rule introduced by Russian authorities combined with measures to replenish the Reserve Fund are likely to contribute to the fiscal consolidation and the creation of fiscal buffers. We expect inflation rate to approach the Central Bank's target this year. However, the stability of prices will ultimately depend on the long-term oil price trends". – 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_14.07.2017.pdf

Next scheduled rating publication: TBD in December 2017.

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RATING HISTORY:

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

Minute's summary

The rating committee for Russia was held on 12 July 2017. 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 and Country Credit Environment Ratings – Short Public Version (from April 2017) can be found under the following link: http://raexpert.eu/files/methodology/Methodology_Short_Sovereign_v2.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

Only SGC ratings can be used for regulatory purposes according to the ESMA definition. CCE ratings are not considered as credit ratings within the framework of Regulation (EC) No 1060/2009.

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.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

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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.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

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.