Rating-Agentur Expert RA GmbH upgraded to 'BBB-' the ratings of Russia

Rating-Agentur Expert RA GmbH upgraded the sovereign government credit rating (SGC) of Russia from 'BB+' (Sufficient level of creditworthiness of the government) to 'BBB-' (Moderately high level of creditworthiness of the government) in national currency and from 'BB+ (Sufficient level of creditworthiness of the government) to 'BBB-' (Moderately high level of creditworthiness of the government) in foreign currency.

Rating-Agentur Expert RA GmbH upgraded the country credit environment rating (CCE) of Russia from 'BB+' (Sufficient quality of credit environment of the country) to 'BBB-' (Moderately high quality of credit environment of the country) in national currency and from 'BB+' (Sufficient quality of credit environment of the country) to 'BBB-' (Moderately high quality of creditworthiness of the government) 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 was as low as 17,7% of GDP and 53,8% of budget revenues by the end of 2015. In line with IMF forecasts, we expect these figures to reach 17,6% and 53,1% in 2016 respectively;
- Short-term debt around 1% of GDP and 3% of budget revenues in 2016, represented no significant risk for the Russian economy. This metric also remained flat since 2015;
- International reserves at the Central Bank of Russia (CBR) at USD 379 bn as of December 2016 were sufficiently high to cover 1,8x of our forecasted gross government debt for the year 2016. Additionally, FX reserves were enough to cover 12,4 months of imports in 2015 (almost the same amount as the world average);
- Fiscal deficit, despite widening, remained manageable at around 4% 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 higher and more stable oil prices;
- The fiscal and monetary policy accommodated to macroeconomic conditions in 2016. Measures were put in place to stabilize the budget following the oil price decline. Additionally, the key interest rate decrease followed the decline of the inflation rate and more encouraging macroeconomic forecasts;
- The stance of the Russian banking sector remains strong with assets standing at around 103% of GDP in 2015 and capital to assets ratio at 9,4% by the end of 2016. However, banks' assets declined slightly to 95% of GDP through October 2016 and ROA remained negligible as of end 2016;
- Driven by decreased domestic demand and increasing oil and gas prices, we forecast that the balance of goods and services to GDP will remain positive and strong at 8,4% in 2016. However, the ongoing appreciation of the RUB and stronger internal demand could trigger an increase of imports, ultimately narrowing the trade balance in 2017.

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 represents a decline of 7,5p.p. when compared with the 2015 figure (12,9%) which was fueled by a lagged one-time effect of Western sanctions on and countersanctions from

Russia as well as the sharp drop of world oil prices. We also expect a single-digit inflation for 2017 as oil prices and RUB exchange rate are likely to remain stable;

- Based on the latest figures published by the World Bank, the ratio of non-performing loans (NPLs) to total loans increased from 8,3% in 2015 to 9,2% in 2016. This was mainly driven by Russia's negative macro position and the sharp decline of the real GDP in 2015;
- Moderate level of private credit at 60% of GDP in October 2016, which stands well below Russia's peers. However, this metric has improved by 22,3p.p. since 2010;
- The Russian stock market, with 702 listed companies, shows high concentration of share trades on the 10 largest issuers (74,2% in 2015) and a relatively low market capitalization around 21,5% of GDP;
- 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).

Negative factors:

- Real GDP declined by 3,7% in 2015 from RUB 63 031 bn in 2014. We forecast, in line with the IMF, that real GDP will contract by 0,8% in 2016. However, this trend is likely to rebound in 2017 on the back of higher oil prices and a stronger macroeconomic outlook;
- Relatively high yield on the 10Y government bonds around 8,1% as of January 2017 and one of the highest among the major world economies. However, the yield has been declining since the beginning of 2015, showing investors' confidence on Russia's long-term prospects;
- High concentration of state-owned banks in the banking sector (the top-6 Russian banks are directly or indirectly owned by the government and represent around 60% of total banks' assets).

Stress factors:

- Concentration of tax revenues on one single industry. Almost half of fiscal revenues proceed from oil and gas taxation (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 (weak stress-factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Restricting factors:

- The real interest rate volatility reduced significantly since 2015 driven by declining inflation and an accommodative monetary policy. In October 2016 the real interest rate stood at around 6,1%, slightly below the 2015 figure.

Positive factors:

- Strong performance of the country's stock exchange index (MICEX) over the last three years;
- Private sector debt remained bearable at around 93% of GDP as of October 2016;
- 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 and the volatility of inflation.

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;
- Sharp deterioration of government debt and fiscal metrics.

"We are upgrading the ratings of Russia from 'BB+' to 'BBB-' mainly on the basis of higher and more stable oil prices, lower inflation rate expectations and a stronger macroeconomic outlook.

The recently signed OPEC agreement to cut oil production stabilized the oil price by the end of 2016. This drove an appreciation of the RUB, which we expect will contribute to lower inflation rates in the short run. Additionally, a higher and more stable oil price will likely reduce pressures on the fiscal budget and prevent the government debt metrics to increase during 2017.

Russian banks' assets remain strong despite having declined slightly and profitability is still negligible. Despite laying within bearable levels, the ratio of NPLs to total loans increased in 2016. However, this metric could decline in the back of more encouraging macro outlook for 2017. A lower and less volatile real interest rate and interest rates spread combined with an improving stock market contributed positively to the assessment of the credit climate environment." – 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_20.01.2017.pdf

Next scheduled rating publication: 14 July 2017. The full sovereign rating calendar can be found at http://raexpert.eu/sovereign/#conf-tab-5

For further information contact:

Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
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 17 January 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 2015) can be found under the following link: http://raexpert.eu/files/methodology/Methodology-Short-Sovereign.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).

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.

Despite similar methodologies, credit ratings of Russia from RAEX (Moscow) (both SGC and CCE) may be different from those assigned by Rating-Agentur Expert RA GmbH due to:

- Possible differences in expert assessments of individual factors;
- Some differences in methodologies (methodologies are similar but not identical);
- Differences in the date/period of assessment for individual factors.

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

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's Research Reports.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

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.