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 fiscal stance improved significantly, from 1,5% consolidated budget deficit in 2017 to expected surplus of 2,2% in 2018 as a result of the government's fiscal consolidation and increased oil-related revenues. The fiscal surplus is expected to be on place in 2019 as a combined result of reduction of expenditures, increase of some tax (mostly VAT) and non-tax revenues, as well as increase of tax collection rate. In addition, the pension age increase approved in 2018 will reduce fiscal pressures;
- The country's macro profile is favorable with moderate real GDP growth rate forecast to be in a range from 1,7% to 1,8% in 2018 and it is set to remain at the same levels in 2019. We keep our opinion that growth is likely to remain at around 1,5% over the next years, if the macroeconomic environment and oil prices remain moderately stable. However, the materialization of additional sanctions risks as well as potential slowdown of the world's economic growth can have an adverse effect on the Russian economy growth metrics within the next years;
- Gross government debt is expected to increase slightly as compared to 2017 to around 16% of GDP and 45% of budget revenues by end-2018 driven mostly by the prudent fiscal and debt policy. We anticipate these metrics to remain low supported by moderately favorable economic developments and government debt policy;
- Despite short-term debt reaching 1,9% of GDP and 5,4% of budget revenues in 2018, the debt structure represents a low risk factor for the country's creditworthiness;
- International reserves improved further over the year and stood at USD 462 bn as of December 2018 as compared to USD 433 bn in December 2017. This amount covers almost 200% of gross government debt and 16 months of expected 2018 imports;
- Based on the FX volatility and rising inflation expectation, the CBR increased its key rate two times over the 2H 2018, setting this metric at 7,75% as of 17 December 2018, showing its strong commitment to the inflation targeting policy;
- Total banking sector assets stood at 89,5% of GDP in December 2018. The sector remained well capitalized with capital to assets ratio of 10,9% in 2018 and we anticipate this trend to continue in the upcoming years;
- The trade balance of goods and services is set to be positive at around 10% of GDP by end-2018 as compared to 7,3% in 2017.

Restricting factors:

- Private credit, which stood at 52,7% of GDP in 2017, is expected to stay at a range from 51% to 53% in 2018. This level of private credit is still well below Russia's BRICS peers (except India), whose average private credit stand well above 100% of GDP;
- The Russian stock market was quite volatile during 2018 with significant dropdowns (about 14% from its highest levels) because of U.S. sanctions imposed in April 2018, as well as new sanctions expectations and oil price volatility in 2H 2018. Also, its concentration levels remained high;
- Economic competitiveness of Russia remains around average world levels as shown by the Index of economic competitiveness from the World Economic Forum (43rd place out of 140 countries in 2018);
- Foreign direct investment inflows as percentage of GDP is forecast to drop to 1,2% in 2018 from 1,8% in 2017 according to the World Bank, mostly due to uncertainty caused by geopolitical tensions and oil price volatility;
- After reaching a historical minimum in December 2017 at 2,5%, the inflation rate hiked to 3,8% in November 2018 driven by the decision to increase the value-added tax (VAT) in 2019, volatility in the FX market and unanchored inflation expectations. According to our assessment, the final inflation metrics for 2018 will be close to CBR target of 4%, while we expect further increase of inflation in 1H 2019 due to FX volatility and delayed effects from VAT increase.

Negative factors:

- State-owned banks (SOB) dominate the Russian banking system, with around 67% of total banks' assets by end-2018, driven by the banking sector clean-up and the Central Bank of Russia's (CBR) last year's intervention to put large private banks under the state control. We expect the share of SOBs to increase during 2019 to more than 70% due to the continued private banks license revocation and M&A process led by large SOBs;
- The level of non-performing loans to total loans, according to our expectations, slightly increased to around 11% by end-2018 as compared to 10% in 2017. We expect a slight increase or stabilization of NPLs in 2019 if the macroeconomic environment remains stable; however, if the announced U.S. sanctions will be imposed in 1Q 2019 in the most strict way (including restrictions for any USD operations with large Russian SOBs), this can lead to turbulence in the banking system, and therefore increase the level of NPLs significantly.

Stress factors:

- Concentration of tax revenues on one single industry. Almost half of fiscal revenues proceed from oil and gas taxation, and this share is expected to increase by end 2018 (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. Moreover, uncertainty about the range of sanctions planned to be imposed in 1H 2019 creates a pressure on the Russian FX and stock market, as well as country's trade balance and growth prospects (moderately strong stress factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Imposition of new U.S. sanctions in 1H 2019 in a less adverse scenario or partial elimination of several existing sanctions.

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;

- Long-term and significant 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 Agency confirmed the credit ratings of Russia at ‘BBB-’ with a stable outlook. This reflects our view on the balance of negative and positive factors, which can be crystalized in the upcoming year. Imposing of new material sanctions by the U.S. government related to the Russian government debt, state-owned banks or energy companies in 1H 2019, can have a strong adverse effect on the country’s creditworthiness.

However, solid fiscal, debt and macroeconomic position can partly mitigate the risks. While the concrete range of sanctions to be imposed is hard to predict, we forecast that materialization of the worst-case scenario, such as restrictions on operations with state debt and SOBs, can trigger a negative rating action on credit rating or outlook. Even though we consider the probability of such scenario as low, we expect this to continue to weigh in the country’s financial and FX-metrics within the next 6 months. Therefore, we have increased the impact of the stress factor of the international sanctions from moderately weak to moderately strong, taking into account this uncertainty.” – Clarified Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA GmbH.

Responsible expert: Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA

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

Research report on Russia is available at:

https://raexpert.eu/reports/Research_report_Russia_21.12.2018.pdf

Next scheduled rating publication: 14 June 2019. The full sovereign rating calendar can be found at http://raexpert.eu/sovereign/#conf-tab-5

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
06.07.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
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 19 December 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: IMF, WB, 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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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.

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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.