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

Rating-Agentur Expert RA GmbH confirmed the sovereign government credit rating (SGC) of Russia at 'BB+' (Sufficient level of creditworthiness of the government) in national currency and at 'BB+' (Sufficient level of creditworthiness of the government) in foreign currency.

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

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Gross government debt was as low as 17,7% of GDP and 53,8% of budget revenues by the end of 2015. Despite Russia's government debt/GDP having risen along the past six years, it is still well below the Agency's internal risk thresholds and it stands significantly below that of its peers[1] at 16% as of June 2016;
- Negligible levels of short-term debt around 1% of GDP and 3% of budget revenues in 2015;
- Foreign exchange reserves at the Central Bank of Russia (CBR) at RUB 387 bn as of May 2016 were sufficiently high to cover 1,7x gross government debt. FX reserves also covered short-term debt and external debt by 33x and 12x as of 4Q 2015;
- Fiscal deficit, despite widening, remained manageable around 3,5% of GDP in 2015. We expect the deficit to expand further in 2016, but to recover from 2017 onwards as a result of better economic perspectives and higher oil prices;
- Adequate management of the fiscal and monetary policy. Measures were put in place to stabilize the budget following the oil price decline. Additionally, the change of the FX policy to a free-floating regime combined with key interest rate increase, refurbished FX reserves and cushioned the pass-through effect of devaluation on inflation rate;
- The Russian banking sector remains strong and profitable with assets standing around 103% of GDP and capital to assets ratio (CAR) at 9,3% in 2015. Also average ROE was 3% during 1Q 2016;
- As a result of western sanctions and lower consumption of imported goods in Russia, the balance of goods and services/GDP amounted to 12,6% and 8,9% in 2014 and 2015 respectively.

Restricting factors:

- The share non-performing loans (NPLs) in total loans increased to 7,4% in 2015 from 6,7% in 2014 driven by the economic slowdown in the country. However, the substantial amount of rolled-over debt held by banks could be a proxy for hidden NPLs. This might eventually increase the share of NPLs if the economic activity remains weak or declining;
- Moderate level of private credit around 57% of GDP in 2015, which stands well below Russia's peers;

[1] Brazil, India and China were considered as Russia's economic peers.

- The Russian stock market, with 702 listed companies, shows high concentration of share trades on the 10 largest issuers (74,2% in 2015) and 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 159 countries in 2015-2016).

Negative factors:

- Real GDP declined by 3% over the last three years (from RUB 46,3 tn in 2013 to RUB 44,9 tn in 2015). During 2014-15, real GDP declined by around 4%, the second worst performer among its peers;
- As a result of Western sanctions and Russian countersanctions as well as a sharp RUB devaluation, the inflation rate increased in 2014 and 2015 (CPI increased to 11,4% in 2014 and 12,9% in 2015). However, we expect inflation to end 2016 at around 8% as a result of declining real GDP, lower inflation expectations and the appreciation of RUB vs. USD;
- Relatively high yield on the 10-year government bonds (around 8,6% as of June 2016) and one of the highest among the major world economies. This is showing investors perception on Russia's long-term risks;
- 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:

Negative factors:

- Significant fluctuation of real interest rate over the last six years.

Restricting factors:

- Average performance of the country's stock exchange index (MICEX) over the last six years;

Positive factors:

- Bearable private sector debt around 93% of GDP in 2015;
- Moderately high quality of investors' protection in the country (Russia occupied the 66th place in the ranking of Protecting Investors (part of Doing Business) out of 180 countries in 2015);
- Low level of real interest rate, which was 3,4% in 2015.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Withdrawal of western sanctions on Russia, which would boost trade and economic growth;
- Stronger 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 in view of current levels of NPLs;
- Sharp deterioration of government debt and fiscal metrics.

"Russia's ratings at BB+ reflect the government's low debt and strong fiscal position, as well as our expectation that the oil price will continue to increase and EU sanctions could be gradually lifted after January 2017. From mid-2014, Russian authorities have implemented policies which helped the country to preserve a strong external position and prevented a collapse of the Russian financial system. The banking sector remains solid and profitable with comfortable amount of assets and sufficient capital coverage. However, the raising share of non-performing loans in the total loan portfolio could deepen the risks for the sector if the country's economic performance remains weak.

Negative real GDP growth rates, combined with high levels of inflation contributed negatively to the rating assessment. These risks have been reflected on Russia's 10Y government bond yield, one of the highest among the country's peers. In our view Russia will benefit from higher oil prices in the mid- and long run, ultimately improving the country's terms of trade, propelling the economy and relieving pressure on prices." – Clarified Gustavo Angel, Rating Analyst of Rating-Agentur Expert RA GmbH.

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

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

Research report on Russia is available at:

http://www.raexpert.eu/reports/Research_report_Russia_22.07.2016.pdf

Next scheduled rating publication: 13 or 20 January 2017, TBD in December 2016

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
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 19 July 2016. 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.

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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.