Responsible Expert:

Vladimir Gorchakov
Rating Associate

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

Credit rating of the region – LC	**BB**
Outlook	**Stable**
Credit rating of the region – FC	**BB**
Outlook	**Stable**

Main Economic Indicators of Krasnodar Region

Macro indicators	2015	2016	2017
Total reg. debt, RUB bn	164,2	170,3	170,2
Nominal GRP, RUB bn	1933,5	2015,9	2352,0*
Real GRP growth, %	-1,6	0,1	2,3*
Total reg. debt/own cons. rev., %	82,1	74,2	67,4
Deficit (surplus)/ own cons. rev., %	-8,6	1,1	6,9
Total reg. debt/GRP, %	8,4	8,4	7,2*
Deficit (surplus)/GRP, %	-0,8	0,1	0,7*
External debt, USD bn	0,0	0,0	0,0

Development indicators	2016
GRP per capita, RUB th	363,7

Default indicator	10.04.2018
7Y Gov Bond Yield, %	7,4

Source: RAEX (Europe) calculations based on data from Krasnodar Region, Ministry of Finance of the Russian Federation, Rosstat.
*Preliminary assessment for 2017 by the government of Krasnodar Region.

Summary

The confirmation of the credit ratings of Krasnodar Region at 'BB' in foreign and local currency was driven by the stable performance of the key rating drivers. The rating remains positively supported by the positive fiscal developments in 2016 and 2017, the current structure of government liabilities – with a high share of budget loans, as well as by the favorable structure of budget revenues showing a reduced share of transfers from the central government and a high level of tax revenues diversification. In addition, the large and well diversified economy of the region contributed favorably to the creditworthiness assessment. However, the rating was restricted by high debt load and moderately low level of capital expenditures.

Large and highly diversified economy positively influencing the tax base. As mentioned in our previous report[1], Krasnodar has a large and well-diversified economy with a high share of "defensive" (non-cyclical) industries, such as transport, agriculture and food production, which accounts for more than 30% of total regional output (see graph 1).

In addition, the regional economy benefits from its geographical location with access to the Black Sea and high level of infrastructure development underpinned by elevated road density as compared to the country's average.

After several years of slowdown, the dynamics of investments in fixed assets returned to a positive trend showing a 6,1% growth in 2017 as compared to a country average of 4,4%. Also, due to the objective characteristics of the economy, Krasnodar Region remains one of the most attractive territories for private investors. According to the latest rating of Investment attractiveness from RAEX-Moscow, Krasnodar occupied the 4th position in terms of investment risks (the region with one of the lowest investment risks).

At the same time, personal income dynamics keeps showing a negative trend declining by 1,3% in 2017 as compared to the same period a year ago. In our view, such a negative trend is related not only to the macroeconomic conditions, but also to the increasing share of "shadow" revenues as was mentioned in our previous research reports. Together
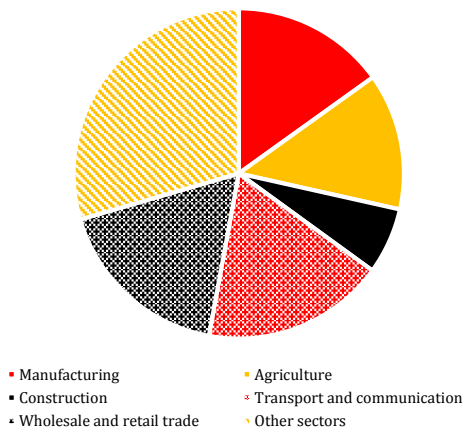
[1] Research report on Krasnodar Region from 13 October 2017
(https://raexpert.eu/reports/Research_report_Krasnodar_Region_13.10.2017.pdf)

Graph 1: Structure of Krasnodar Region's GRP in 2016, % of total

- Manufacturing
- Agriculture
- Construction
- Transport and communication
- Wholesale and retail trade
- Other sectors

Source: RAEX (Europe) calculations based on data from the Rosstat

Graph 2: Dynamic of the key components of consolidated budget revenues in nominal terms in 2017 (to 2016), %
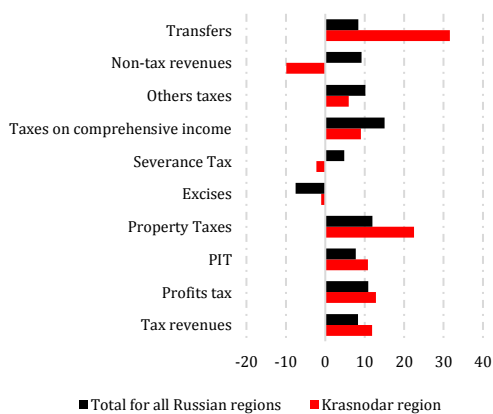
- Total for all Russian regions
- Krasnodar region

Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Russian Federation

Graph 3: Krasnodar Region's consolidated budget revenues structure, %
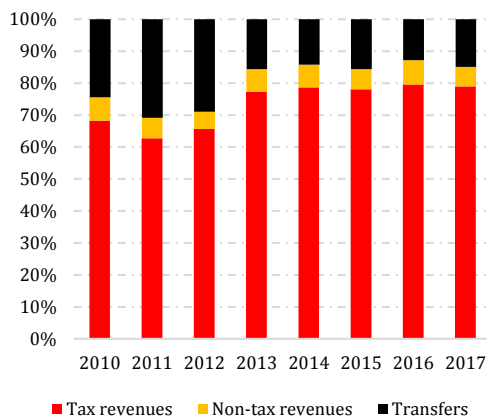
- Tax revenues
- Non-tax revenues
- Transfers

Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Russian Federation

with the long-term demographic risks, this creates a strong adverse effect on the personal income tax base and, therefore, the creditworthiness assessment.

Budget revenues' dynamics and structure are favorable. Krasnodar keeps showing better dynamics on key items of the consolidated budget revenues in 2017 as compared to the overall trend for Russian regions. Tax revenues increased by 12% y-o-y in nominal terms as compared to 8,3% for all Russian regions mostly due to the growth of corporate profit tax which formed around 17% of the consolidated budget revenues at that period, as well as growth of personal income and property taxes (see graph 2).

After two years of reduction, the federal government of the Russian Federation provided more transfers to all Russian regions in 2017 as compared to the previous year. Incoming transfers of the Krasnodar region's consolidated budget increased by 32% in this period, which led to a slight elevation of the transfers' share in total revenues of the region (see graph 3).

In addition, the structure of tax revenues of the consolidated budget keeps positively affecting the regional creditworthiness with no taxes representing more than 50% of total tax revenues. Personal income tax and corporate profit tax form 58% of total tax revenues, while other tax income is represented mainly by property tax (21%); excises (10%) and taxes on comprehensive income (9%).

Fiscal performance keeps improving, but expenditures' structure and quality of the budget management still restrain the region's creditworthiness. The regional authorities' consolidating fiscal policy continued to restrain expenses' growth in 2017 when it stood at 7,1% y-o-y in nominal terms, while the country's average growth was equal to 8,8%. Combined with a significant increase in revenues, this led to an outstanding fiscal surplus at 5,9% of total revenues or 6,9% of own budget revenues in 2017 as compared to 0,9% and 1,1% respectively in 2016.
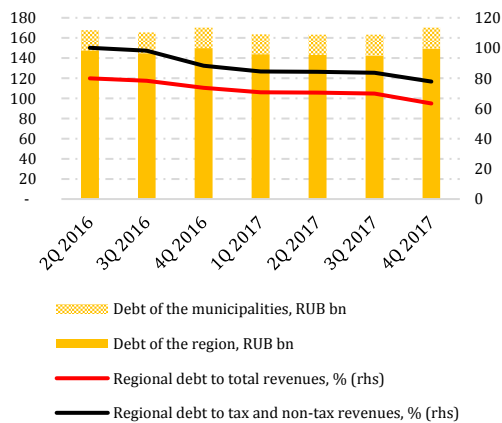
As mentioned in our previous report, the structure of expenditures has an adverse effect on the region's creditworthiness. The share of CAPEX in total expenditures of consolidated budget was as low as 4,9% in 2017 (compared to a country's average of 12,3%). This share indicates that there is a very narrow space to cut expenditures in case of a drop in revenues and, therefore, creates an additional risk of further growth in debt levels.

In addition, according to the recent results of the assessment by the Ministry of Finance of the Russian Federation regarding the quality of the
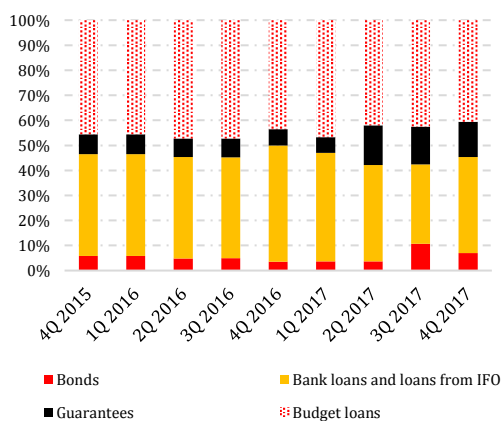
Graph 4: Krasnodar Region's debt metrics

Legend:
- Debt of the municipalities, RUB bn
- Debt of the region, RUB bn
- Regional debt to total revenues, % (rhs)
- Regional debt to tax and non-tax revenues, % (rhs)

Source: RAEX (Europe) calculations based on data from the Ministry of finance of the Russian Federation

Graph 5: Krasnodar Region's debt structure

Legend:
- Bonds
- Bank loans and loans from IFO
- Guarantees
- Budget loans

Source: RAEX (Europe) calculations based on data from the Ministry of finance of the Russian Federation

regional budget management for 2016, Krasnodar was described as a region with "proper quality of budget management". This assessment is an improvement as compared to a year ago when it was categorized as "low quality". However, Krasnodar region was included in the list of territories which violated the Russian budgetary regulation within the 2016 in regard to the new debt issuing: the total amount of raised debt during 2016 exceeded the amount of debt redemption within the same year.

Debt load remains elevated despite the positive dynamics, while the structure remains favorable. As of 1 January 2018, the total amount of consolidated debt of the region (the sum of debt of the regional and municipal authorities) stood at RUB 170,2 bn, which remains the highest level among all Russian regions. However, the Agency noticed a positive dynamic within 2017: after several years of the constant growth the total amount of consolidated debt decreased by 0,03% as compared to the beginning of the year (see graph 4).

Key indicators of indebtedness remained high as compared to the country's average despite the slight improvement during 2017. The ratio of the consolidated region's debt to total revenues and own revenues stood at 57% and 67% respectively, as compared to average country levels of 25% and 30% as of end 2017, while the share of debt servicing expenditures stood at 2,9% in 2017 (against 1,2% average for Russian regions).

These levels of indebtedness remain mitigated by the currency and creditors' structure with more than 40% of it formed by loans issued by the Ministry of Finance of the Russian Federation (see graph 5), and absence of FX-debt. In addition, the maturity structure of debt is very favorable with almost 40% of the debt to be paid in 2022 or later. Furthermore, the region is characterized by a strict payment discipline, with no overdue payments recorded in the last five years, and a long history of bonds' issuance on the open market, including the issuance of new bonds in August 2017.