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Research Report on Russia

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Introduction

Since the outbreak of the conflict in eastern Ukraine in early 2014, Western countries have imposed a number sanctions on Russia which ranged from travel restrictions for Russian officials to commercial and financial bounds on Russian state-owned companies. In response, the Russian Government enforced a one-year ban on import of products (mostly agricultural) from the countries which imposed the aforementioned sanctions. Even though the final effect on the overall Russian economy is still unknown, this set of bans and sanctions is expected to have upward pressure on internal prices. Also, recent increase in money circulation calls for keeping inflationary pressure on watch. In contrast, current levels of debt and deficit of the Russian Government pose no significant risk to the creditworthiness of the country. Furthermore, private sector can find it difficult to secure funding even though banking system remains strong.

Debt load of Russian federal government stands at reasonable levels. Gross public debt/GDP has been increasing slightly in recent years (from 7,9% in 2008 to 13,4% in 2013) but this figure remains at tolerable levels. Given that it only represents less than 1% of the federal budget income, short-term debt doesn't show a potential risk to the creditworthiness of the country.

Federal budget showed a slight deficit in 2013 and oil balance still contributes to most of total revenues. The deficit figure registered in 2013 in the consolidated Russian federal budget (-1,3% of GDP) was fuelled by lower GDP growth rate (1,3% in 2013 compared to an average of 4% per annum during the period 2010-2012) as well as by flat oil and gas prices. In contrast, non-oil budget showed a stronger deficit during 2013 (-11,1% of GDP), which shows high dependence of the Russian fiscal revenues on oil and gas taxation (see Table 1).

The number of Russian bank licenses has been recently reduced but the banking system remains healthy. During 2013, the Central Bank of Russia revoked a total of 28 banking licenses. Despite this situation, the banking system still showed a solvent position (Bank's assets/GDP = 84% in 2013 and has been increasing over previous years). What is more, the share of distressed loans remained stable over the past 3 years (share of

Main Economic Indicators of Russia

Macro indicators	2011	2012	2013
Gross pub. debt, bill RUB	6515	7875	9018
Nominal GDP, bill RUB	55644	61811	67260
Real GDP growth, %	4,3	3,4	1,3
Gross gov. debt/GDP,%	11,7	12,7	13,4
Deficit (surplus)/GDP,%	1,5	0,4	-1,3
Inflation rate,%	6,1	6,6	6,5
Curr. Account balance/GDP,%	5,1	3,6	1,6

Development indicators	2013
Inequality adj. HDI	0,78
GDP per capita (Thou. of USD)	17,9

Sources: RAEX (Europe) calculations based on data from World Bank, IMF, Bloomberg distressed loans was 6,6% and 6% in 2011 and 2013 respectively).

Private sector may suffer more than Government when it comes to financing. In terms of returns on investments, securities issued by the Russian Government seem to be more attractive for investors than those issued by the private sector. High interest rate on long term Government bonds (9,65%) is likely to divert capital from private investments to Government securities. This may have a negative impact on businesses funding, especially for small and medium enterprises. Additionally, a number of factors is also expected to have a negative impact on the overall investor's confidence. On the one hand, Russia has a low level of investors' protection (the country occupies place 115th out of 180 in the Protecting Investors ranking from Doing Business). On the other hand, real interest rate on loans to the corporate sector has fluctuated significantly over the last 6 years (Minimum value in 2011 = -6,4%, maximum value in 2009 = 13,1%). If a new set of EU and US sanctions on Russia aimed at the financial sector is finally approved, Russia can run into future difficulties accessing international financing as well as on encouraging domestic and foreign investments.

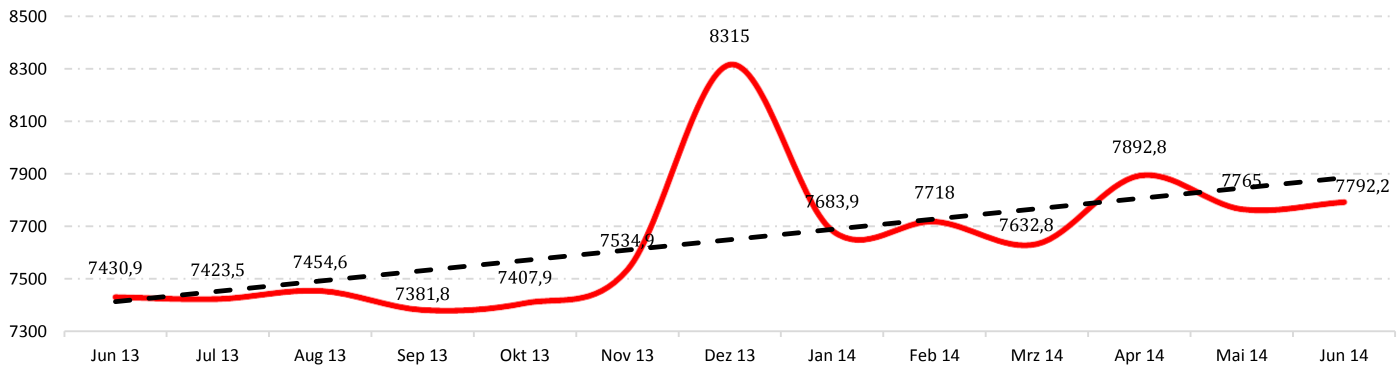
Table 1: Federal budget 2012-2013 (% of GDP):

	2012	2013
Expenditure	37,9	35,8
Revenues	37,5	37,1
Balance	0,4	-1,3
Oil-Balance	10,3	9,8
Non-oil Balance	-9,9	-11,1
Urals oil price, USD/barrel	110,4	107,9

Source: RAEX (Europe) calculations based on data from World Bank and IMF

Monetary policy carried out by the Russian Federation has worked well so far, but inflation should be monitored. Strong foreign exchange reserves of the country (509 Billion USD) and relatively low levels of debt denominated in foreign currency (3,35 Billions of USD) suggest that there is no risk for the current foreign exchange regime[1]. Even though current inflation rate (6%) is around half of the 2008 figure (13,3%), recent bans on import goods imposed by the Russian Government combined with the positive trend of Rubles in circulation (see graph 1) call for keeping future developments of domestic prices on watch.

Graph 1: Currency in circulation (billions of RUB)



Source: RAEX (Europe) calculations based on data from Central Bank of Russia

[1] The Central Bank of Russia conducts FX policy under managed floating exchange rate

Conclusion

Based on a number of factors, the Russian Federation benefits from sound levels of creditworthiness. On the one hand, the Russian Government shows low levels of debt and consolidated deficit. What is more, Russian banking system remains healthy despite the fact that a number of bank licenses have been revoked in recent months. On the other hand, Russia's low level of investors' protection alongside with highly fluctuating real interest rates are the main drawbacks of the country's credit climate. Even though sanctions on Russia have not had significant effects on the country's economy, this situation must be kept on watch since a new set of sanctions on financial operations may be expected in the near future.