Research Report on Russia

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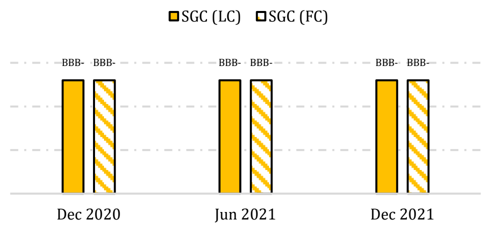
Ratings

Sovereign Government Credit (LC)	BBB-
Sovereign Government Credit (FC)	BBB-
Outlook (LC)	Stable
Outlook (FC)	Stable

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Russia

Macro indicators	2018	2019	2020
Gross gov. debt, RUB bn	14146	15068	20623
Nominal GDP, RUB bn	103862	109242	106967
Real GDP growth, %	2,8	2,0	-3,0
Gross gov. debt/GDP, %	13,6	13,8	19,3
Deficit (surplus)/GDP, %	2,9	1,9	-4,0
Inflation rate, %	4,3	3,0	4,9
Current Account Balance/GDP, %	-	-	2,4
External debt, USD bn	-	-	472,3*

Development indicators	2020
Inequality adj. HDI	0,74
GDP per capita, USD th	28,1

Default indicator	10.12.2021
5-Year CDS spread, Bp	111,8
10Y Gov Bond Yield, %	1,92**

Source: RAEX-Europe calculations based on data from the IMF, WB, Rosstat, CBR, Ministry of finance of the Russian Federation, Ministry of the economic development of the Russian Federation, Cbonds.
* 2Q 2021 ** USD-denominated with maturity in 2030.

RAEX-Europe confirmed at 'BBB-' the credit ratings of Russia. The rating outlook is stable.

RAEX-Europe confirmed the sovereign government credit ratings (SGCs) 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.

Summary

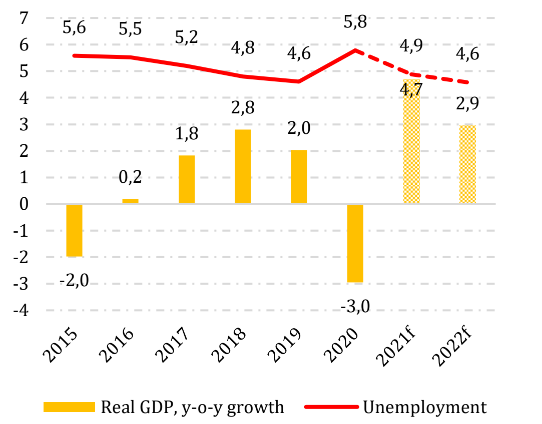
Russia's sovereign credit ratings were confirmed at 'BBB-' with a stable outlook, which is mainly a reflection of the still solid external position, a strong economic recovery supported by higher oil prices and a solid fiscal stance. In addition, the banking system remained resilient and financial soundness indicators reflect an improved situation for the sector. Finally, the effectiveness of the monetary policy remains in place and the CBR has intervened in a favorable manner.

On the negative side, the lingering state of western sanctions and their potential tightening remain the main threat to Russia's creditworthiness.

Economy recovered in 2021. After the Russian economy contracted in 2020 due to the adverse effects from the pandemic, we have already observed a strong recovery in 1H 2021 as consumer demand increased, reflected by strong retail sales, while the industrial sector was also strong. On the retail side, non-food consumption drove growth, while better output in the manufacturing and mining sectors propelled industrial output growth. Moreover, increased oil production and higher oil prices have also contributed to stable growth. In addition, exports grew as a result of better conditions in the global commodity markets, also propelling growth in real output. However, we expect 4Q 2021 to be sluggish amid the increase in coronavirus cases combined with low vaccination rates and recent lockdown in Moscow. Therefore, we anticipate the real GDP growth rate to be at around 4,7% y-o-y at the end of 2021. In regard to unemployment, the rate stood at 4,3% as of September 2021, showing a continuous decline throughout 2021.

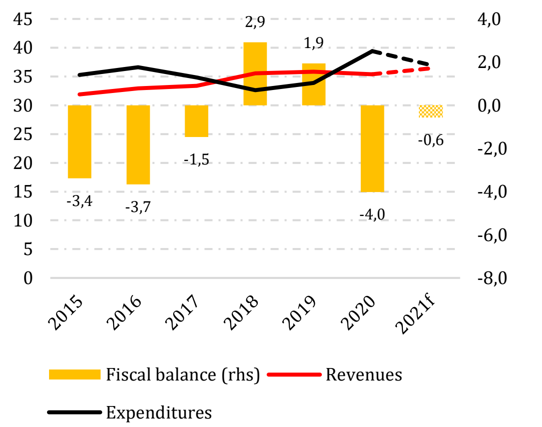
The economic competitiveness of Russia remains average according to the Global Competitiveness Index from the World Economic Forum (Russia

Graph 1: Macroeconomic indicators, %



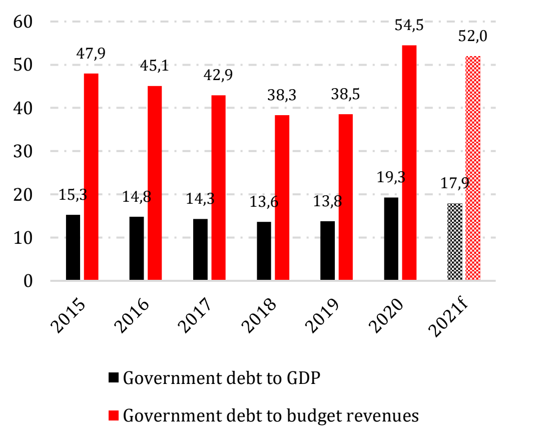
Source: RAEX-Europe calculations based on data from the IMF

Graph 2: Fiscal budget dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the IMF and Ministry of finance of the Russian Federation

Graph 3: Government debt dynamics, %



Source: RAEX-Europe calculations based on data from the IMF, CB and Ministry of finance of the Russian Federation

ranked at 43rd place out of 141 countries in 2019). In addition, international sanctions against Russia remain in place and have even been increased by countries like the U.S. and there is a high risk of additional sanctions in the future. This issue continues to constrain the creditworthiness of the country. Some of the risks arising from sanctions have already materialized as investment has been limited and financial costs for the government have been high.

Budget deficit to prevail in 2021. Despite the substantial recovery of the economy in 2021, we anticipate the budget balance to remain slightly negative. The improvement in the government accounts has been mainly a result of higher oil prices, a reduction on COVID-related expenditures and the overall recovery of the economy, which translated in larger budget revenues. Thus, we anticipate the fiscal deficit to narrow down to -0,6% of GDP in 2021.

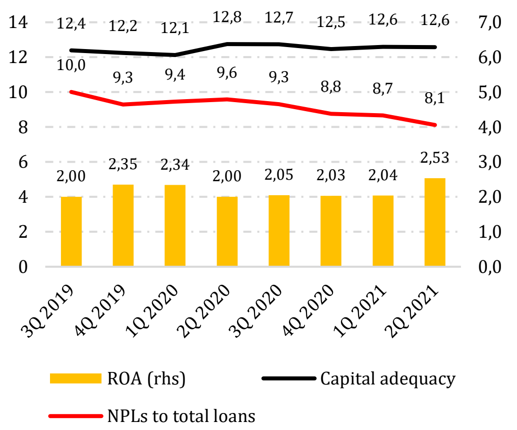
In 2022, we anticipate the government to go back to the fiscal rule after being lifted during the peak of the pandemic. In addition, we still consider the government to have very strong fiscal buffers as the National Wealth Fund (NWF) stood at around 12% of GDP as of November 2021.

Government debt expected to decline. Government debt to GDP is expected to decline down to 17,9% in 2021 as a consequence of mainly an increase in nominal GDP as the economy recovers from the pandemic's adverse effects. This level of debt remains quite low and manageable relative to other emerging market peers.

In terms of debt structure, the share of FX liabilities remains low at 20,4% as of September 2021, which poses low exposure to currency risk. Furthermore, the share of short-term liabilities is also low at 3,1% of total debt as of the same date. The main sources of new borrowings remain loans from domestic banks and issuance of local government bonds, as U.S. sanctions continue to constrain the ability to issue USD-denominated debt.

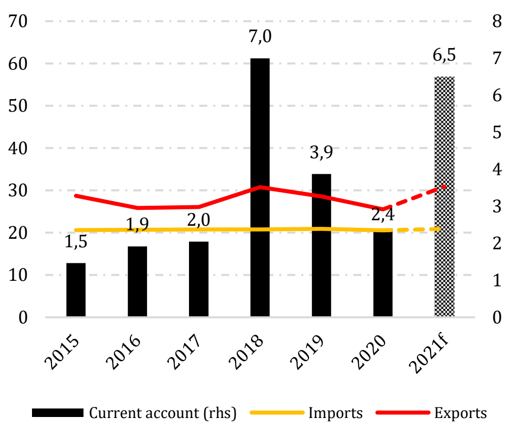
The Central Bank of Russia (CBR) continued to tighten monetary policy. Since inflation continues to develop upward above the level desired by the regulator, the CBR Board of Directors made the decision to hike the key rate by 75b.p. up to 7,50% back in October 2021. Fast growth in the demand resulting from the economic recovery in the country and slow output in production, has exerted pressure on prices and driven inflation higher than anticipated by the CBR. In addition, inflation expectations of the population have also increased and remain at high levels. Therefore, we expect the CPI index to grow by around 7% y-o-y by the end of 2021, but to start declining in 2022 as the base effect vanishes and the changes in the key rate are transmitted to the economy. We expect the CBR to continue

Graph 4: Financial soundness indicators, %



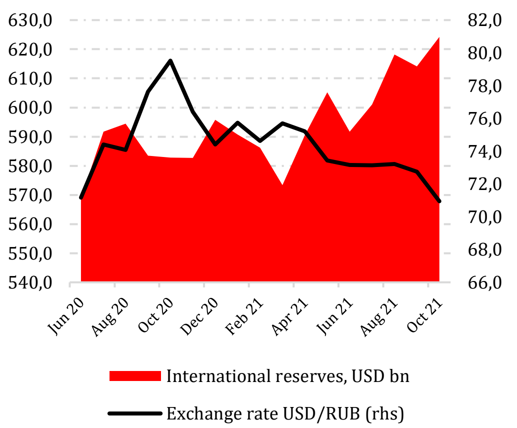
Source: RAEX-Europe calculations based on data from the CBR.

Graph 5: External sector indicators, % of GDP



Source: RAEX-Europe calculations based on data from IMF and WB

Graph 6: International reserves and FX-rate



Source: RAEX-Europe calculations based on data from CBR

with monetary flexibility to adapt to any changes in inflationary expectations going forward.

Banking system still resilient. Bank assets and private credit continued to grow steadily in absolute terms in 2021; however, we anticipate the figure relative to GDP to decline as the economy recovered substantially in 2021. Thus, we project bank assets to GDP and private credit to GDP to be around 93% and 79% respectively by the end of 2021. The growth in loans was mostly propelled by individual loans as a result of government subsidized mortgages. In addition, financial soundness indicators remained favorable, profitability in the banking sector persists, with ROA and ROE at 2,5% and 22,8% as of 2Q 2021. Capitalization was also at an acceptable level as the regulatory capital adequacy was 12,6% and NPLs to total loans ratio remained stable at 8,1% as of the same date. Nonetheless, we consider that the deterioration of the quality of the loans is still a potential risk to the banking system in the medium term, as well as a risk of materialization of contingent liabilities for the government, as SOBs concentrate almost 68% of banking sector assets.

Russia's external position still strong. After posting a current account surplus of 2,4% of GDP in 2020, we expect the metric to remain in positive territory in 2021. As a consequence of higher oil prices and overall export increase, we anticipate the current account surplus of around 6,5% while the trade surplus to stand at around 10% by the end of 2021. The level of international reserves increased further mainly resulting from foreign currency transactions carried out in the domestic foreign exchange market under the fiscal rule; the reading was USD 624,2 bn as of October 2021 covering 205% of gross government debt.

Stress factors:

- High concentration of tax revenues in the oil and gas industry due to the industry's dominance in exports with a 57% share; oil and gas revenues accounted for 18,2% of total consolidated budget revenues as of August 2021 (moderately weak stress-factor);
- The threat of sanctions risks remains high, with additional sanctions imposed by the U.S. and the EU (moderately strong stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Increase in the oil prices higher than our base scenario to support GDP growth and the external trade position;
- Faster and stronger than initially anticipated recovery from the current economic crisis with higher non-oil GDP growth and improvement of non-oil fiscal balance;
- Relaxation of sanctions regime could be an incentive for the revival of the investment climate and reverse the outflow of the foreign capital.

The following developments could lead to a downgrade:

- Significant deviation from current monetary and fiscal policies, which may lead to macroeconomic instability;
- Weakening of the banking system, which would materialize contingent liabilities of the government;
- Increasing pressure from international sanctions against large state-owned banks and the oil and gas sector, which may lead to materialization of implicit contingent liabilities.

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Next scheduled rating publication: TBD December 2021. The full sovereign rating calendar can be found at
Sovereign Rating Calendar 2021

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
11.06.2021	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
11.12.2020	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
12.06.2020	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
13.12.2019	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Positive	Positive
14.06.2019	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
21.12.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
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 10 December 2021. 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 August 2020). Descriptions and definitions of all rating categories can be found 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.

The definition of default can be found on the Agency's website in the section for Internal policies.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of informationIMF, 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.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: ESG factors in RAEX-Europe's Credit Ratings

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.

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.