Rating-Agentur Expert RA confirmed at 'BBB-' the ratings of Russia

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.

Rating-Agentur Expert RA confirmed the country credit environment rating (CCE) of Russia at 'BBB-' (Moderately high quality of credit environment of the country) in national currency and at 'BBB-' (Moderately high quality of credit environment of the country) in foreign currency.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Driven by the stabilization of oil prices and the appreciation of RUB against major world currencies, the inflation rate recorded a historical minimum in December of 2017 at 2,5%. We maintain our expectations from the previous rating revision that inflation is likely to reach the CBR's target of 4% in 2018 and remain around this figure if there are no major external shocks which would potentially impact prices;
- Driven by a prudent fiscal policy since the end of 2014, gross government debt is low and is forecast at around 17,4% of GDP and 53% of budget revenues by the end of 2017. Following better economic conditions and reduced financing needs of the government, we anticipate these figures to remain low during 2018;
- Short-term debt increased slightly in 2017 from a year before, reaching 1,4% of GDP and 4% of budget revenues as of October 2017. However, this factor represents no significant risk for the Russian economy;
- International reserves at the Central Bank of Russia (CBR) increased significantly from USD 376,3 bn in December 2016 to USD 432 bn as of December 2017. This amount covers 1,6x of gross government debt and 13 months of imports;
- The fiscal deficit is forecast to narrow significantly from 3,7% in 2016 to 1,9% in 2017, as the new fiscal rule, combined with measures to exhaust the Reserve fund contributed to the country's fiscal consolidation. We keep our expectation that the fiscal balance will narrow in 2018 as a combined result of better economic perspectives and reduction of expenditures;
- The fiscal and monetary policies accommodated to macroeconomic conditions since 2015. The pace of the deficit reduction in the budget is consistent with the reality of permanently lower oil prices. Monetary policy easing resumed in March 2017 considering the inflation outlook. As a consequence, in December 2017, the CBR cut again the refinancing rate by 50b.p. to 7,75%;
- The Russian banking sector remains well positioned in terms of assets despite dropping by 4p.p. to 89,2% of GDP through September 2017. Furthermore, average capital to assets ratio improved in 2016 by almost 1p.p. to reach 9,4% by the end of 2016 and we expect to see similar improvements in the next years, following the ongoing revocation of licenses of banks (around 350 since 2014);
- Driven by decreased domestic demand and increasing oil and gas prices, the balance of goods and services to GDP remained positive at 4,7% in 2016 and is forecast at around 6,8% in 2017.

Restricting factors:

- Moderate level of private credit, which dropped to 48,5% of GDP by August 2017 from 50,8% in 2016. In these terms, Russia diverts significantly from its BRIC peers, whose average private credit stands well above 100% of GDP;
- The Russian stock market shows high concentration of share trades on the 10 largest issuers at 81% as of June 2017. Even though the capitalization of the stock market reached 44,5% of GDP in 2016, this was the result of two main factors, the "Trump effect" and the increase in the world oil price which followed the OPEC agreement. Even though the MICEX market cap showed a downward trend during 1H 2017, it increased steadily during 2H 2017 following the rebound of oil prices. We expect this trend to remain in place during 2018;
- Average economic competitiveness as evidenced by Russia's position in the Index of economic competitiveness from the World Economic Forum (38th place out of 137 countries in 2017-2018);
- Reduced amount of foreign direct investment inflows at around 1,6% to GDP in 2016. This metric halved between 2013-2014 and reached 0,5% in 2015 following the sharp increase in inflation and the devaluation of the RUB. Going forward, we expect this metric to reach similar figures as those before 2013, above 2% of GDP.

Negative factors:

- Driven by encouraging macroeconomic conditions, we revised our expectation of real GDP growth below 1,8% in 2017 (1,4% in our previous revision). Going forward, we expect growth prospects over the next years to remain around 1,5% as private investment in sectors other than oil and gas remain limited and sanctions on Russia are unlikely to be lifted in the near future;
- The banking sector remains highly concentrated on state-owned banks. The top-6 Russian banks are directly or indirectly owned by the government and represent more than 60% of total banks' assets taking into account the fact that 3 of the largest private banks were taken under CBR control during 2H 2017;
- The share of non-performing loans (NPLs) on total loans reached a six-year record of 9,4% in 2016. However, this metric declined steadily along 2017 following the Central Bank of Russia's (CBR) efforts to reduce the amount of "zombie" banks through license revocation.

Stress factors:

- Concentration of tax revenues on one single industry. Almost half of fiscal revenues proceed from oil and gas taxation (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 (moderately weak stress factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Positive factors:

- The real interest rate rebounded in 2015 and remained stable around 7% through 2016 as a result of a lower inflation rate and the accommodative monetary policy of the CBR. Volatility is expected to remain low as inflation rate is likely to remain close to the CBR's 4% target in 2018;
- Strong performance of the country's stock exchange index (MICEX) over the past six years;
- Private sector debt remained bearable as we forecast it to have dropped to around 86% of GDP by end 2016 (from 93% in 2015) driven by lower internal credit;
- Moderately high quality of investors' protection in the country (Russia occupied the 51st

place in the ranking of Protecting Investors (part of Doing Business) out of 180 countries in 2017).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Withdrawal of western sanctions on Russia which would boost trade and stronger economic growth;
- Further improvement in the GDP growth rates combined with the reduction of the fiscal deficit.

The following developments could lead to a downgrade:

- Introduction of a new set of US sanctions on Russia, targeting Russian officials and companies as well as third countries actors doing business with targeted Russian enterprises and individuals;
- Resumed long-term 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 ratings of Russia at 'BBB-' remain underpinned by improving macroeconomic fundamentals, as evidenced by a low inflation rate, acceptable and stable government debt metrics and narrowing fiscal deficit. The ongoing fiscal consolidation plan, coupled with a low and stable amount of government debt, drove the narrowing of the fiscal deficit in 2017 and is expected to keep this trend along 2018.

Monetary policy normalization continued with the CBR key interest being cut five times during 2017. The financial sector metrics improved in 2017 as profitability, assets of banks and market capitalization of listed companies increased, while NPLs declined. Sanctions on Russia remain affecting the rating negatively and are still one of the major drawbacks for the country". – Clarified Gustavo Angel, Rating Associate of Rating-Agentur Expert RA GmbH.

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

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

Research report on Russia is available at:

http://www.raexpert.eu/reports/Research_report_Russia_12.01.2018.pdf

Next scheduled rating publication: 6 July 2018. 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		CCE	
		National currency	Foreign currency	National currency	Foreign currency
14.07.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	BBB-	BBB-
20.01.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	BBB-	BBB-
22.07.2016	Scheduled revision of both types of ratings for the country	BB+	BB+	BB+	BB+
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 11 January 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 and Country Credit Environment Ratings – Short Public Version (from April 2017) can be found under the following link: http://raexpert.eu/files/methodology/Methodology_Short_Sovereign_v2.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), 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

Only SGC ratings can be used for regulatory purposes according to the ESMA definition. CCE ratings are not considered as credit ratings within the framework of Regulation (EC) No 1060/2009.

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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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.