Research Report on Russia

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Responsible Expert:

Hector Alvarez
Associate Director

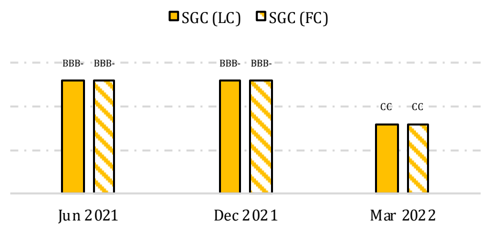
For further information contact:
Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00, 1213
E-mail: alvarez@raexpert.eu
www.raexpert.eu

Ratings

Sovereign Government Credit (LC)	CC
Sovereign Government Credit (FC)	CC
Outlook (LC)	Negative
Outlook (FC)	Negative

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Russia

Macro indicators	2019	2020	2021e
Gross gov. debt, RUB bn	15068	20623	21813
Nominal GDP, RUB bn	109242	106967	121620
Real GDP growth, %	2,0	-3,0	4,3
Gross gov. debt/GDP, %	13,8	19,3	17,9
Deficit (surplus)/GDP, %	1,9	-4,0	-0,6
Inflation rate, %	3,0	4,9	5,8
Current Account Balance/GDP, %	-	-	5,7
External debt, USD bn	-	-	478

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

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.
e Estimated

RAEX-Europe downgraded the credit ratings of Russia from ‘BBB-’ to ‘CC’. The rating outlook is negative. The ratings remain on watch.

RAEX-Europe downgraded the sovereign government credit ratings (SGCs) of Russia from ‘BBB-’ (Moderately high level of creditworthiness of the government) to ‘CC’ (Very low level of creditworthiness – possible delay in execution of some commitments) in national currency and from ‘BBB-’ (Moderately high level of creditworthiness of the government) to ‘CC’ (Very low level of creditworthiness – possible delay in execution of some commitments) in foreign currency. The rating outlook is negative which means that in the mid-term perspective there is a high probability of downgrading the rating score. The ratings remain on watch.

Summary

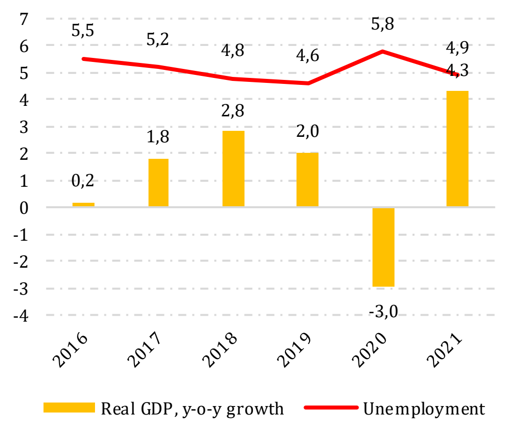
Russia’s sovereign credit ratings were downgraded from ‘BBB-’ to ‘CC’ with a negative outlook, as a result of the severe and wide sanctions imposed by the West in the midst of the Russian invasion of Ukraine. This, in turn, has extremely heightened risk of non-repayment of public FX- and LC-denominated debt. In addition, the isolation of Russia’s financial sector and the Central Bank of Russia (CBR) have already caused internal shocks in the economy, which are expected to become larger as the conflict continues.

Debt repayment at serious risk of not being executed. The Russian invasion of Ukraine has triggered a massive wave of coordinated sanctions by the US and Europe. The exclusion of certain banks from SWIFT alongside the sanctions imposed on the Central Bank have impaired the possibility of Russia to access reserves and, thus, foreign currency, in order to abide by their financial obligations. Almost 50% of the CBR reserves are directly affected by these sanctions.

Mounting to the fear of default is the fact that the government has already blocked coupon payments of LC-denominated bonds to foreign bondholders.

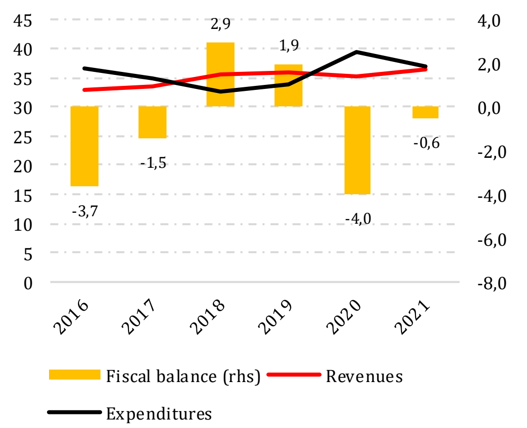
On March 16, the Russian government must pay out USD 107 m worth of coupons from 2 Eurobonds and the government has a 30-day grace period to execute the payments. Russia has already mentioned that the

Graph 1: Macroeconomic indicators, %



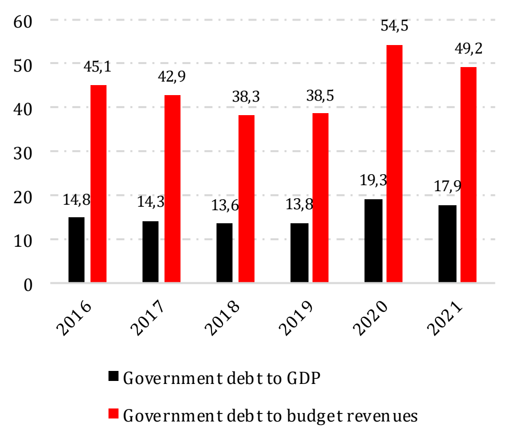
Source: RAEX-Europe calculations based on data from the IMF

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

repayment of debt will depend on the sanctions imposed by western nations, meaning that as long as the reserves from the CBR remain frozen, the probability of the government falling into a technical default is very high. Moreover, the capital controls introduced by the government, also prevent the transfer of funds to bondholders residing outside of Russia.

Economy set to take a hard hit. As we have already observed, western sanctions have caused the RUB to depreciate sharply by around 20% against the EUR. We expect this to cause an increase in inflation and overall economic trouble for Russian citizens. Moreover, the lack of access to Russia's financial assets has limited its ability to soften the blow. As we mentioned in our previous review, Russia's external position is quite strong, but without the possibility to use those buffers and/or convert commodities into fiat, the potential to keep up with sanctions appears dim.

Our initial estimates indicate that inflation could be above 10% by the middle of the year while the economic contraction could be substantial by year-end.

The banking sector is deteriorating rapidly. The sanctions imposed on Russia have mainly targeted the banking sector. As previously mentioned, 7 Russian banks have been banned from SWIFT, while there are convertibility and funds exchange constraints. Moreover, the indicator of the spread between the CBR reference rate and the interbank lending rate has widened, signaling concerns of asset price declines and, thus, loss in the values of collateral. Even though the gap is not yet at alarming levels, we have seen it widen, which could translate in a blowout financial crisis in the country.

Moreover, Russian banks have faced deposit withdrawals and will also be confronting a rise in NPLs in the form of consumer as well as corporate lending. This will be mainly exacerbated by FX-denominated loans to entities with RUB-denominated incomes. In addition, the high level of outstanding consumer loans and only acceptable levels of regulatory capital adequacy (12,6% as of 3Q 2021) will be another deterrent on the health of the financial sector.

The Central Bank of Russia (CBR) increased the reference rate substantially. As a response to western sanctions the CBR hiked the reference rate from 9,50% to 20,00% on 28 February 2022. This proved to be an important stabilizing factor as the spread between the reference rate and interbank rate widened, but not as much as expected. The CBR has also mentioned it would help banks with capitalization. However, as further sanctions mount and banks start liquidating assets, there may not be enough tools for the CBR to continue cushioning the shocks.

Stress factors:

- High concentration of tax revenues in the oil and gas industry due to the industry's dominance in exports. in light of the current situation, we have increased the impact of this stress factor (strong stress-factor);
- Additionally imposed severe sanctions, which have increased the threat of non-repayment of debt (very strong stress-factor);
- Armed conflict with Ukraine (very strong stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- A prolonged cease fire combined with a relief of sanctions and workaround that would cause the government to avoid default. However, we currently do not foresee many medium-term scenarios that would lead to an upgrade.

The following developments could lead to a downgrade:

- Failure to repay coupons and / or principal;
- Additional sanctions that would further squeeze the Russian government into non repayment of debt.

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.

Drivers of change

- Despite governance and institutional risks being inherent factors, we are also listing them as drivers of change factors given their extremely high material impact towards the downgrade of the ratings.

Next scheduled rating publication: 10 June 2022. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2022

SOVEREIGN RATING CALENDAR DEVIATION DISCLOSURE

Under EU credit rating agency (CRA) regulation, the publication of sovereign credit ratings must take place according to a published schedule, except where it is necessary for CRAs to deviate from this in order to comply with their legal obligations. RAEX-Europe interprets this provision as allowing us to publish a rating review outside the published schedule in situations where there is a material change in the creditworthiness of the issuer.

The publication of this rating action deviates from the previously scheduled release date in the sovereign calendar published at https://raexpert.eu/sovereign/#conf-tab-5. RAEX-Europe believes that developments in the country warrant such a deviation from the calendar and our rationale for this is set out in this Research report.

For further information contact:

Responsible expert:
Hector Alvarez, Associate Director of RAEX-Europe
+49 (69) 3085-45-00, ext. 1213
alvarez@raexpert.eu

Reviewer:
Pavel Mezian, Rating Analyst of RAEX-Europe
+49 (69) 3085-45-00, ext. 1215
p.mezian@raexpert.eu

Rating-Agentur Expert RA GmbH (RAEX-Europe)
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		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
10.12.2021	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
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	BB+	BB+	NA	NA

	ratings for the country				

Minute's summary

The rating committee for Russia was held on 7 March 2022. 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.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

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.