RUSSIA

Time of Rating	8 January 2019
Government bond rating (foreign currency)	A_g
Rating Outlook	Stable

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DATA

	2013	2014	2015	2016	2017	2018E	2019F
GDP per capita (PPP basis, US$)	26,497	27,156	26,736	26,960	27,893	--	--
Real GDP (%)	1.8	0.7	-2.5	-0.2	1.5	1.8	1.6
Inflation (CPI, % change Dec/Dec)	6.5	11.4	12.9	5.4	2.5	4.0	4.6
Gen. Gov. Financial Balance/GDP (%)	-1.2	-1.1	-3.4	-3.6	-1.5	1.7	1.6
Gen. Gov. Debt / GDP (%)	13.1	16.0	16.3	16.1	15.5	14.9	15.4
Gen. Gov. Int. Pymt / Gen. Gov. Revenue (%)	1.8	2.0	2.5	2.7	2.7	2.5	2.6
Current Account Balance/ GDP (%)	1.5	2.8	5.0	1.9	2.1	6.3	7.4

Data Source: CCXI Sovereign Database

BASIC VIEWS

CCXI assigns a credit rating of A_g to the Russian government's foreign currency bonds under local scale with stable outlook

CCXI believes that Russia, as the 12th largest economy in the world, has strong economic strength. Its strong financial strength, low debt level and relatively strong external solvency could provide sufficient support for sovereign credit. However, factors such as geopolitical risks, wide fluctuations in crude oil prices could bring challenges to Russia’s sovereign credit.

STRENGHTS

- Stabilized economic growth and effective anti-sanction measures;
- Sound fiscal position and low government debt levels;
- Relatively strong external solvency.

CHALLENGES

- Low economic structural diversity and high susceptibility to oil prices;
- Relatively high geopolitical risks.

Rating Perspective

CCXI assigns a credit rating of **A_g** to the Russian government's foreign currency bonds. Russia is the 12th largest economy in the world, and the huge economic scale offers support for its debt repayment. However, the Russian economy is still highly dependent on the oil and gas sector. About 60% of its exports are oil and natural gas, making the economy vulnerable to fluctuations in global oil prices. Since the second half of 2015, global oil price experienced a rise and then gradually stabilized, which offered support for the Russian economy. Driven by the overall rebound in oil prices, together with the boosting effect made by a series of counter-sanction measures, domestic inflation came under control, and the impact of consumption began to manifest. The growth of Russian economy, as indicated by real GDP (%), turned positive in the fourth quarter of 2016, and the growth rates in 2016 and 2017 were respectively -0.2% and 1.5%. According to Russian Federal State Statistics Service (RFSSS), the economy has a y-o-y growth rate of 1.6% in the first half of 2018, and 1.3% in the third quarter. Looking forward to 2019, subject to the tight monetary and fiscal policies, the growth of private consumption would be subdued, and the further increase in interest rates in deposits and credit markets could curb the growth of investment and financing of enterprises. Combined with the expectation of wide fluctuations in the global crude oil price, it is expected that the annual economic growth would maintain a relatively stable level. In the long run, the Russian economy still faces structural problems such as an aging population and a single-product dominated economic structure, limiting the space for economic growth.

Russia's financial situation continues to improve and its financial strength remains at a high level. Under the influence of global oil price shock in recent years, Russia's fiscal deficit had been enlarging, gradually rising from 1.2% in 2013 to 3.6% in 2016, while in 2017, driven by the rebound of global oil prices and the increase of tax revenue in non-oil and gas sectors, along with the reduction in fiscal expenditure brought by fiscal consolidation, the general government's fiscal deficit rate shrunk to 1.5%, and it's likely to achieve a surplus of 1.7% in 2018. Russia's level of government debt has been declining year by year and is much lower than that of sovereign peers sharing the same assessment. In 2017, the proportion of general government debt to GDP remained at a low level of 15.5%, and it is expected to further decline to 14.9% in 2018. The Russian government plans to raise the standard VAT tax rate from 18% to 20% as of January 1, 2019. The increase in tax revenue is expected to significantly improve government's fiscal revenue. Meanwhile, the Russian government plans to invest R3 trillion (about $40 billion) to upgrade infrastructure construction from the year of 2020.[1] According to the latest federal government budget for 2019-2021, revenue growth in the next few years will be somewhat lower than fiscal expenditure growth in the corresponding period. The budget surplus as a share of GDP is expected to be 1.8% in 2019 and 0.8% in 2021. In recent years, as Russia's financial circumstances improve, the demand for government financing has decreased, and government debt has remained at a low level. CCXI believes that Russia's fiscal situation will remain basically stable in the next two years, while the impact of oil price fluctuations on Russia's fiscal revenue deserves special attention.

Russia has a relative strong external solvency. Russia's current account balance has been in surplus for years. During the period from 2014 to 2016, although the decline in global oil prices led to certain decrease in export revenue, the sharp decline in import demand helped to keep the current account in surplus. In 2017, the proportion of current account balance to GDP increased by 0.2

[1] The Russian Federation's budget stipulates that R5.63 trillion will be allocated to the development of national projects and infrastructure in the next three years, specifically in the fields of health care, population, education, science, environment, housing construction, comfortable urban environment, modern transportation and energy infrastructure.

percentage point y-o-y to 2.1%. The ratio of current account surplus to GDP is expected to rise in 2018 as oil prices rebound and export volume expands. The volume of external debt has continued to decline since 2016, accounting for 32.8% of GDP in 2017. The short-term external debt accounts for 10.8% of total external debt, which indicates a reasonable structure. In 2018, the proportion of external debt to GDP is expected to further decline to 28.6%, presenting a continuously improved external solvency. Meanwhile, Russia is equipped with ample foreign exchange reserves, the volume of which amounted to $346.5 billion at end-2017, the highest level since 2014, and the proportion of foreign exchange reserves to external debt registered 66.89%, which is relatively high compared with peers of the same assessment. The central bank expects to see an increase in foreign exchange reserves[2] in 2018-19 due to the large scale of foreign exchange purchases made by the Ministry of Finance. In addition, Russia has maintained positive in net international investment position since 2008 and remains a net creditor.

Russia has a relatively stable political system and the institutional strength is assessed as moderate. Confronted with the global oil shock since June 2014, the government adopted appropriate policies and implemented them vigorously, enabling the economy to recover quickly from recession, demonstrating strong crisis management capacity. In November 2014, in the backdrop of sharp depreciation of the ruble, the Central Bank of Russia (CBR) announced a shift to a floating exchange rate regime, which conserved the CBR a large amount of foreign exchange reserves and stabilized the ruble exchange rate gradually. In order to ameliorate the short-term foreign exchange liquidity caused by international sanctions imposed on Russian entities, the central bank launched an FX repo plan to help enterprises with external debt repayment. To energize the production dynamics and counter the economic recession, the government successively introduced anti-crisis plans during 2015-16, which effectively alleviated the impact of falling oil prices and Western sanctions on the economy. Russia's domestic political environment has remained stable, and President Putin's support rate has been high. In March 2018, Mr. Putin won the presidential election. The focus of the new government will be on the adjustment of economic structure and financial system. [3]

The event risk faced by Russia is relatively high, reflecting geopolitical factors in particular. Economic sanctions imposed by Europe and the United States induced by the Crimean Crisis is to continue. In July 2017, the United States Senate and House of Representatives passed a bill to consolidate new sanctions on Russia, which plans to impose economic sanctions on more Russian enterprises and individuals. In December 2017, Council of the European Union renewed the extension of sanctions until 31 July, 2018. In March 2018, U.S. President Trump extended a series of existing sanctions against Russia for a further year concerning the latest moves of the Ukrainian crisis. So far, the Russian economy has manifested some flexibility in the face of multi-cycle sanctions imposed by the West. Geopolitical risks diverged in the second half of 2018. With the alleviation of tensions in Syria, the geopolitical risks previously induced by Russia’s intervention in the Syrian Civil War revealed some relief. At the same time, attention should be paid to the possibility of intensification of the Russian-Ukrainian conflict under the backdrop of superpower game and the likely ensuing

[2] Sources of official FX reserves comprise both central bank reserves and liquidity savings accumulated by the government in the Reserve Fund (RF) and National Wealth Fund (NWF). The RF is used to subsidize fiscal expenditure and repay the country's external debt, while NWF mainly used to subsidize pensions. These two funds are instilled by budgetary additional income allotment when the Urals oil prices are higher than $40/barrel and got combined after the RF was completely exhausted in recent years.

[3] In early 2019, at the 17th Congress of the United Russia party, Mr. Putin pointed out that the main tasks facing Russia in the next step are to ensure development, reduce poverty figure, promote economic growth and face the future. In October 2018, at the meeting of the Council for Strategic Development and National Projects, Mr. Putin claimed that in six years, Russia would raise R28 trillion ($428.7 billion) through various financing channels to implement national projects.

negative impact on the Russian economy. In addition, the Russian banking industry remain a weakness, and its capacity to energize the economy awaits enhancement. After the Global Financial Crisis of 2008, albeit the restructuring and reform carried out on the banking sector, which enabled total assets to sustain growth, the vicious cycle of capital outflows and domestic asset prices decline brought by sharp depreciation of the ruble still calls for effective containment.

Rating Outlook

CCXI assesses the outlook on Russia's sovereign rating as stable. Since being confronted with sanctions imposed by western countries and the sharp drawdown in global oil prices, Russia weathered the most severe period typified by financing constraints, currency devaluation, high inflation and high financing costs of enterprises. At present, a reasonable mechanism has been formed to cope with the Western sanctions, and Russia has abundant foreign exchange reserves in place, strong overall strength, stable domestic economic situation, relative strong financial strength and external solvency. In the next 12 to 18 months, factors such as geopolitical risks and uncertainties in oil prices need to be addressed.

Factors that could lead to an upgrade

Subsequent upgrades could occur if the Russian economy manages to develop more resilience to adverse factors from the global environment by way of structural reform, or, should the sanctions be mitigated, so that the Russian macro-economy has room for further progress. In the long run, measures such as adjusting population structure, reducing dependence on commodity trade, improving government efficiency and hence promoting the investment environment would improve Russia's economic growth prospects and enhance Russia's sovereign credit level.

Factors that could lead to a downgrade

If Russia's domestic macroeconomic prospects and credit environment deteriorate, its resiliency against external events damps, weakening the government's fiscal stability and external solvency, CCXI will consider downgrading Russia's sovereign credit rating.

Recent Developments

Concerned about an accelerating inflation, CBR raised the benchmark interest rate by 25 basis points consecutively in September and December 2018, which currently registers 7.75%. In terms of economic growth, the Central Bank stated that it expected GDP growth to be within the range of 1.2%-1.7% in 2019, and reiterated that GDP growth in 2018 would be within 1.5%-2%. Vladimir Putin won the presidential election in March 2018 and reorganized the government in May, and the new government set out to carry out economic restructuring.

The Government of the Russian Federation has deliberated and approved an act to raise the minimum wage to the same level as the basic cost of living allowances effective the beginning of 2019. According to the Act, the minimum wage is R9489 from January 1, 2018 and would be set equal to the basic cost of living allowances of the working population effective January 1, 2019.

The act covers about 4 million people, of whom 1.6 million are personnel of the budget allocation unit. The total expenditure on the minimum wage in the budget sector is R26.2 billion. In the aspect of tax rates, the Russian government finally approved amendments to a number of resolutions in October 2018, allowing two rounds of tariff increase on public utilities in 2019. In November 2018, the Russian government announced a hike in the value-added tax rate to 20% from 18% in January 2019.

As for the development plan, President Putin has instructed the government to formulate a national plan for the development of the Far East, setting out to do long-term planning for this region before 2035. The draft plan will be completed by September 1, 2019 and submitted to the President's Office for approval.

Appendix: Symbols and Definitions for Issuer Rating

Rating Symbol	Definition
AAAg	The rated entity has the highest capability of servicing its debt obligations, basically immune from any adverse economic environment change, subjected to minimum credit default risk.
AAg	The rated entity has excellent capability of servicing its debt obligations, relatively insensitive to adverse economic environment change, subjected to very low credit default risk.
Ag	The rated entity has sound capability of servicing its debt obligations, but sensitive to adverse economic environment change, subjected to low credit default risk.
BBBg	The rated entity has moderate capability of servicing its debt obligations, relatively sensitive to adverse economic environment change, subjected to moderate credit default risk.
BBg	The rated entity has relatively weak capability of servicing its debt obligations, very sensitive to adverse economic environment change, subjected to high credit default risk.
Bg	The rated entity's debt obligation service capability highly relies on the availability of positive economic environment, subjected to very high credit default risk.
CCCg	The rated entity's debt obligation service capability completely relies on the availability of positive economic environment, subjected to extremely high credit default risk.
CCg	The rated entity has little access to protection during bankruptcy or restructuring, highly likely to default.
Cg	The rated entity is in default.

Note: CCXI appends modifiers of "+" and "-" to each generic rating classification from AA to B. The modifier "+" indicates a ranking in the higher end of its generic rating category; the modifier "-" indicates a ranking in the lower end of that generic rating category.