27 October 2017

Public Finance

Russian Federation
Rating Report

Credit strengths

- Improving macroeconomic stability
- Strong external position
- Sound public finances

Credit weaknesses

- Low growth potential
- Vulnerabilities to geopolitical risks
- Weak governance

Rating rationale and outlook: Russia's upgrade to investment grade (to 'BBB-') under the revised sovereign rating methodology is underpinned by Russia's strengthened resilience, which has shielded its economy from major external shocks like lower oil prices, geopolitical tensions and subsequent international sanctions. The upgrade is mainly driven by strong improvements in the rating areas of 'domestic economic risk' and 'public finance risk' and reflects: i) strengthened macroeconomic stability due to a more robust policy framework with reform to an inflation targeting regime following the adoption of a flexible exchange rate; ii) Russia's strengthening external balance sheet and liquidity position; iii) sound public finances, underpinned by a conservative medium-term fiscal consolidation strategy and adherence to a prudent and strengthened fiscal framework; and iv) declining financial stability risks, following extensive bank restructuring and adoption of an improved bank resolution framework. Positive developments are counterbalanced by structural constraints undermining Russia's low growth potential, a high vulnerability to geopolitical risk, which has brought ramifications like restricted international market access for the private sector, and weak governance. The rating outlook is Stable and reflects Scope's view that rating risks are now balanced.

Figure 1: Sovereign rating categories summary:

Scope's sovereign risk categories	Russia	Peer comparison	
		Average	Turkey
Domestic economic risk			
Public finance risk			
External economic risk			
Financial risk			
Political and institutional risk			
Qualitative adjustment (notches)	2		1
Final rating	BBB-		BB+

AAA AA A BBB BB B CCC CC C

Positive rating-change drivers

- Ongoing reform progress resulting in higher growth potential
- Accelerating investment on the back of an improved business climate
- Reopening of international market access for the private sector

Negative rating-change drivers

- Depletion of FX reserves notably weakening resilience to shocks
- Oil price shock leading to growth stagnation or a downturn
- Escalation of geopolitical risks diminishing effective policymaking

Ratings and outlook

Foreign currency

Long-term issuer rating	BBB-/Stable
Senior unsecured debt	BBB-/Stable
Short-term issuer rating	S-2/Stable

Local currency

Long-term issuer rating	BBB-/Stable
Senior unsecured debt	BBB-/Stable
Short-term issuer rating	S-2/Stable

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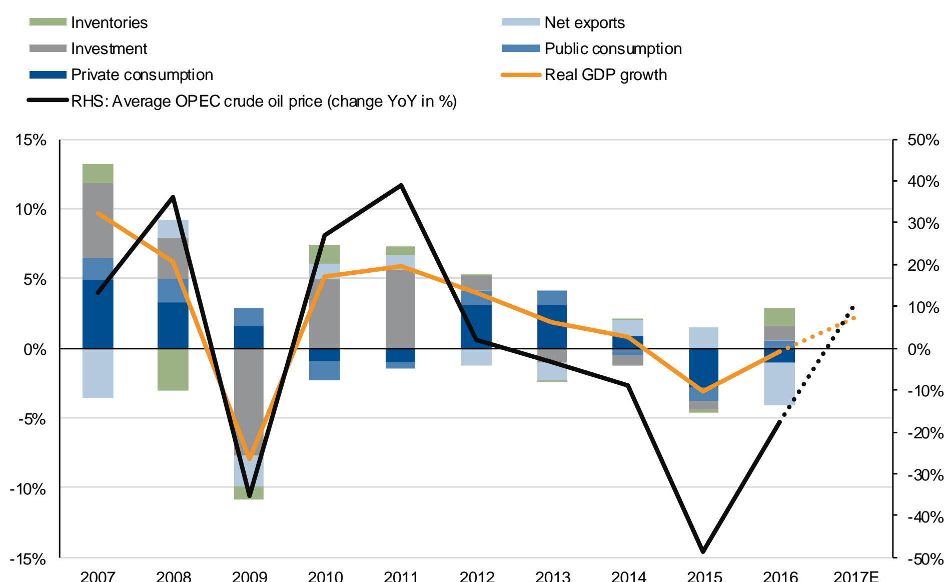
Domestic economic risk

Russia's economy has proved to be resilient to the major external shocks of low oil prices, elevated geopolitical tensions and subsequent international sanctions. After contracting by 2.8% in 2015, the economy stabilised in 2016. Despite the magnitude of shocks, the size of the downturn in 2014-16 was modest compared with the downturn in 2009. Half-year data points to higher real GDP growth of around 2% in 2017 and, going forward, in 2018 as well, supported by recovering oil prices, increasing investment and consumer demand.

Figure 2: Percentage-point contribution to real GDP growth



Source: National accounts, calculations by Scope Ratings AG

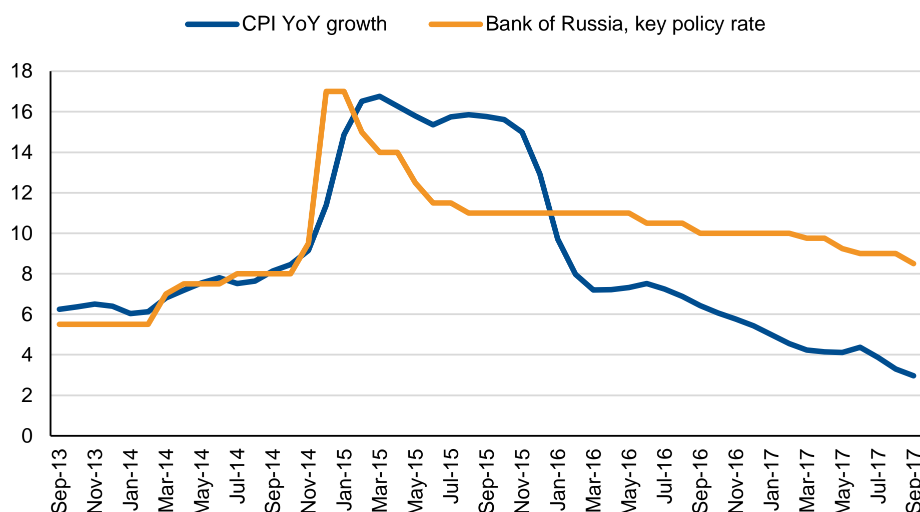
It is Scope's view that Russia's robust external buffers enabled an effective policy response that has cushioned the domestic economy from externally-sourced shocks. The impact of international sanctions on Russia mainly acted as a new catalyst to push ahead Russia's 'import substitution policy' and related industrial development programmes, which subsidised most of Russia's industrial sectors prior to the onset of sanctions. Russia's economic adaptation to lower oil prices has strengthened its degree of economic self-sufficiency, as reflected in a low import volume, non-reliance on trading partners for import of goods critical to national security, and significant energy and construction resources. The initiated economic adaptation to lower oil prices enabled Russia to react to international sanctions with a food-import embargo, benefitting Russia's domestic agricultural production. Here, for the first time on record, Russia will likely become a net agricultural goods exporting country in 2017.

Since the beginning of 2017, investment has risen, particularly in industry, laying the foundations for a sustained, domestically-driven recovery. Rising investment, albeit from low levels, has resulted in employment gains and stabilised unemployment at 5.5% in 2016. Corporate profits have continued to improve in 2017 on the back of recovering oil prices and protections for domestic industries against foreign competition, and household consumption has picked up.

The tight monetary policy pursued by the Central Bank of Russia (CBR) over recent years alongside decreasing food prices and the stabilisation in the rouble brought inflation down to 5.4% by late 2016.

After floating the rouble in late 2014, and underpinned by a more diversified banking sector funding structure and higher institutional share of investors compared to in 2009, the central bank relied mainly on higher interest rates to bring down inflation, demonstrating a strengthened institutional capacity and technocratic adherence to a new inflation-targeting floating exchange rate regime. Consumer inflation reached a record low in September 2017 with the 12-month CPI dropping further to 3%, which is below the target of 4% and down significantly from 15.5% in 2015, facilitating a more accommodative monetary policy going forward.

Figure 3: Key policy rate and inflation, %



Source: National statistics of Russia

It is Scope's view that high interest rates are a less constraining factor on investment when compared with Russia's governance weaknesses, the latter which is a major constraint on Russia's credit rating. According to the World Bank's Worldwide Governance Indicators, Russia is ranked low in terms of its application of the rule of law and control of corruption, reflecting in part ongoing uncertainties in relation to the quality of contract enforcement and respect for property rights. These weigh on business confidence and help explain Russia's chronic under-investment. In addition, a complex web of interconnected state-owned companies in mining, manufacturing and services sectors (including real estate and banking) weighs on investor confidence, due to inquiries on the extent to which public power is exercised for private gain, including in manners of corruption.

Russia has become the world's biggest wheat exporter, and its domestic food-processing industry has also developed to reach cumulative growth of roughly 7% in the three years that sanctions have been in place. Russia's import-substitution policy is also benefitting the automotive industry, as reflected by an increasing share of localised content in production. Car imports to Russia fell by 24% in 2016 and by a further 15% in the first half of 2017, while domestic production grew by 20% during the same time in 2017. It is Scope's view that foreign carmakers have adapted to the tariff barrier by setting up car-assembly lines in Russia. Domestic car production mainly uses imported components but is obliged to gradually increase the share of locally produced components, driving value-added in the domestic car industry.

Military-strategic factors have accelerated domestic substitution of the technologies that fell under the sanctions regime. The development and launch of production in marine gas turbines in 2017 reflects the separation of the Russian defence industry from previous suppliers in the Ukraine.

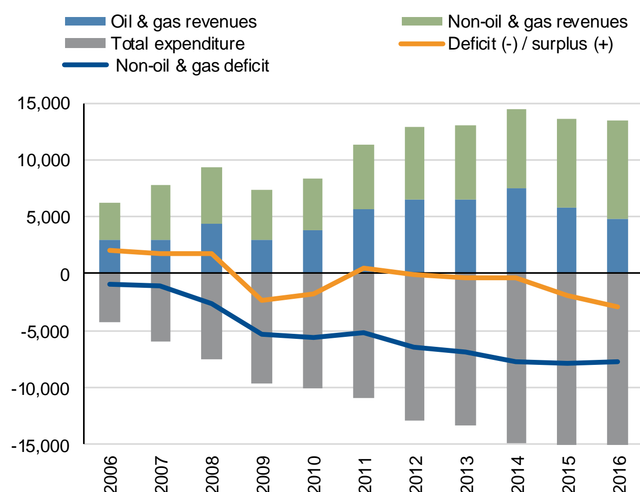
International sanctions specifically banning the transfer of technologies for Arctic offshore-drilling projects to Russian energy companies have resulted in the development of Russia's own state-of-the-art drilling technology for the Arctic region.

While short-term risks from low oil prices have diminished as a result of an effective economic-policy response and initiated economic adaptation, Russia's growth prospects remain structurally constrained and subdued with a potential growth rate of around 1.5%. Weak infrastructure, regional economic disparities, high regulated tariffs on natural monopolies and governance issues undermine competitiveness, hindering higher yields on human capital and deterring investment. These remain major constraints on long-term growth prospects. Challenging demographic trends in the form of a shrinking working-age population and a growing elderly population are further factors that weigh on productivity. The sanctions also weigh on Russia's economic potential by restricting capital-market access for the private sector and therefore raising the cost of capital. Sanctions also undermine growth by creating uncertainties for investors and businesses, who respond by refraining from investments.

Public finance risk

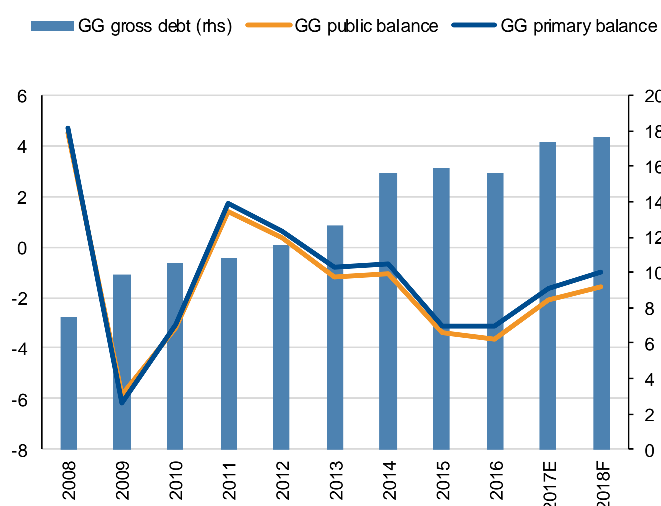
Russia's pre-crisis conservative budget and financing policy, including a 'borrow-and-save' strategy, has enabled the government to cut federal expenditures and accumulate considerable fiscal reserves (which are part of official foreign-exchange reserves). Oil-related cash flow shortages in the budget in recent years were covered by reserves, keeping deficits under control at 3.4% of GDP in 2015 and 3.7% of GDP in 2016, while public debt remained at a low level of 13.2% of GDP in 2016.

Figure 4: Fiscal developments (in RUB bn)



Source: Ministry of Finance

Figure 5: Debt burden (% of GDP)



Source: IMF

Half-year fiscal data for 2017 confirmed that the deficit is on a reduction trend, driven by recovering energy-related revenues as well as non-oil revenue collections, the latter which are well above budget projections with higher VAT collections from improved tax administration. In June, the government revised the 2017 budget-deficit target to 2.1% of GDP from the originally budgeted 3.2%, signalling that the government remains committed to fiscal consolidation despite higher oil prices than budgeted.

In July 2017, the so-called Reserve Fund balance equalled USD 17bn (compared to USD 50bn in January 2016) while the National Wealth Fund increased to USD 75bn from USD 72bn in January 2016. Transitional budgetary rules effective from February 2016 allowed the use of assets from both funds to finance government expenditure.

Essentially effective since this year, the government designed a new fiscal rule to facilitate rapid adjustments to sharp drops in oil prices. This rule will likely be formally introduced in 2018. It is Scope's view that the new mechanism, which is based on an oil-price benchmark replacing a backward-looking price formula, will likely underpin the economy's resilience against volatility in oil prices, replenish fiscal buffers in the near term, improve the predictability of fiscal policy, and partially mitigate structural dependence on oil-related revenues.

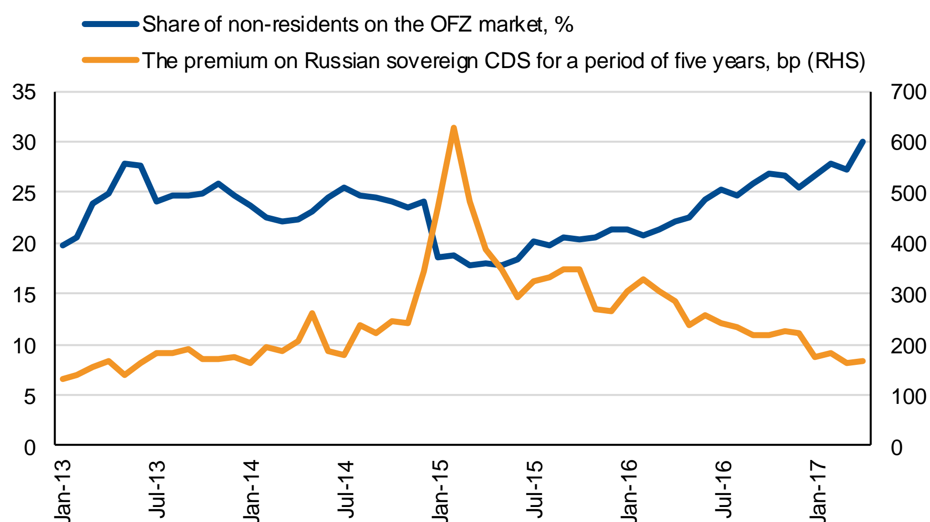
In principle, a fixed oil-price benchmark of USD 40 per barrel will replace the previous (suspended in 2015) backward-looking price formula, and a zero primary-balance target at the benchmark oil price will replace a targeted 1% overall deficit under the old rule. The benchmark price of USD 40 per barrel was derived from the 50-year average of oil prices. Fiscal savings in form of funds may be used to cover a budget deficit up to the amount of a defined shortfall in oil and gas revenues, i.e. the difference between actual revenues for the budget year and the oil and gas revenues calculated using the benchmark price. Furthermore, if the fund's liquid assets at the central bank are less than 5% of GDP, annual use of the fund is restricted to a maximum of 1% of GDP. Under the new rules, investment of fund assets in infrastructure projects is allowed, provided that fiscal savings at the central bank equal at least 7% of GDP.

Positively, Scope notes that the Russian public-debt framework stipulates compliance with conservative public-debt sustainability thresholds as set out by the Public Finance Management and Financial Market Regulation programme. According to estimations from the public-debt management policy for 2017-2019, public debt is to increase to 15.7% of GDP by 2019, remaining well below the threshold of 20% of GDP. The annual amount of the repayment and servicing of public debt is expected to increase from 9.2% of total federal revenues in 2016 to 11.6% in 2019 (with a threshold of 15%).

Russia's public debt sustainability is preserved by low debt and moderate financing needs. Risk of fiscal slippage is low given accumulated fiscal savings, recovering oil prices and the incorporation of conservative spending and revenue assumptions in the three-year budgeting framework (2017-2019). A key risk to Russia's public-debt sustainability is a protracted period of low growth. However, based on conservative assumptions in the form of weaker GDP growth than IMF baselines (over the forecast period until 2022), Russia's public debt would still remain below the threshold of 20% of GDP. The favourable debt structure mitigates refinancing risks, as around 75% of public debt consists of securities that are mainly denominated in roubles. 50% of the rouble-denominated government securities portfolio consists of standard federal loan bonds with fixed coupons and bullet repayments (OFZ-PD). Another major category of public domestic debt is represented by bonds with a floating coupon rate linked to the RUONIA overnight swap rate (OFZ-PK, 28% of public debt).

According to the public-debt management policy, government borrowing as a financing source for the federal budget deficit is to increase from 20% in 2016 to 91% in 2019. During the period from 2017-2019, net domestic borrowing is expected to exceed RUB 1.5tn per annum, i.e. these borrowing targets will be more than three times the average annual net-domestic borrowing over the past six years, leading to a modest volume of government securities worth around 10% of GDP. The market environment has improved since 2016 and resulted in strong demand for OFZs (including from non-residents). OFZ bonds issued in 2016 had an average yield of 8.7% (i.e. down to pre-crisis levels) vs 10% in 2015. The average duration of new bonds rose from 5.1 to 5.5 years. Consequently, the total duration of the OFZ portfolio was extended to 3.9 years, while its yield decreased to 8.5% per annum. The public-debt management policy foresees an increase in the average duration of debt to five years.

Figure 6: Sovereign CDSs of Russia and share of non-resident investments



Source: Central Bank of Russia

The share of non-resident investments in OFZs has remained high in recent years (representing one quarter of outstanding government securities), increasing again from 27.0% as of 1 October 2016 to 30.1% as of 1 April 2017, while yields on Russian bonds declined. Foreign investors are more actively involved in auctions and secondary trading of OFZs, contributing to the implementation of a programme of market borrowing by the Ministry of Finance, which increased recently in comparison to in 2016. Nevertheless, demand from Russian credit institutions, primarily systemically important ones, remains a crucial pricing factor in the OFZ market.

In 2016, Russia re-entered international bond markets, tapping USD 1.75bn and subsequently USD 1.25bn of 10-year eurobonds maturing in 2026, yielding 4.7% and 3.9% respectively. The new debt was priced considerably below the levels seen in 2013, when sanctions against Russia were first imposed (in September 2013, Russia priced its USD-denominated eurobonds at 5.1%). The books for the two transactions were well oversubscribed (2x and 6x respectively), reflecting strong foreign demand for Russian exposure. For the first time ever, Russia sold eurobonds in a deal with no involvement of foreign banks in managing the offering, but rather solely relying on domestic debt-market infrastructure. Borrowing on international capital markets in 2017-2019 is scheduled to be limited in volume but necessary to maintain Russia's market presence as a sovereign borrower and support a benchmark yield curve for foreign currency debt, thus laying the foundation for better borrowing terms for Russian corporates.

External economic risk

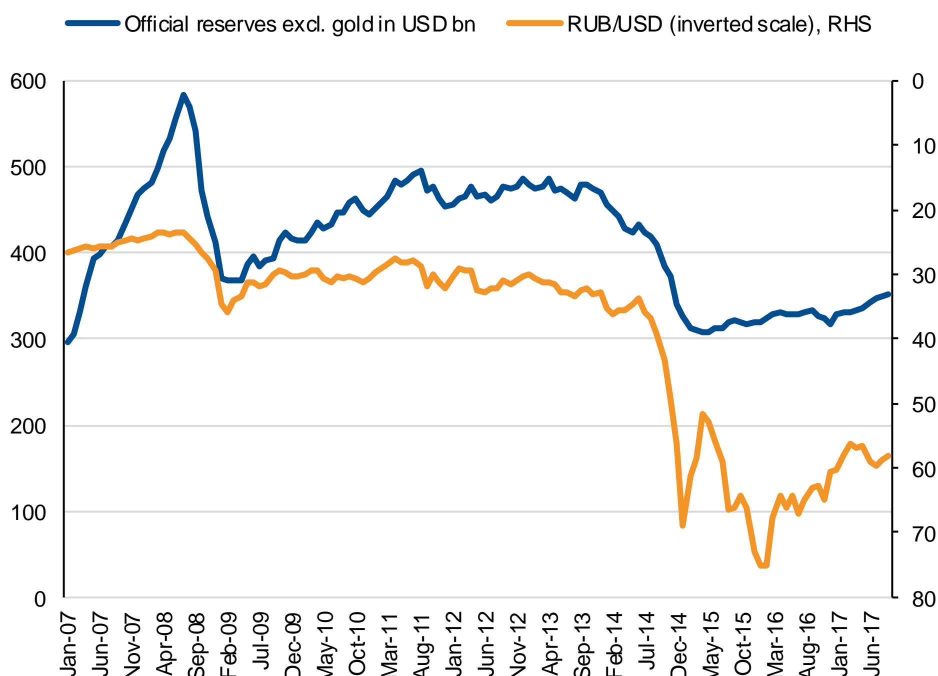
Russia's high foreign-exchange-reserve adequacy, robust current account surpluses, and its net external-creditor position underpin the ability of Russia's economy to maintain stability in environments of severe external shocks.

Russia's monetary transition in 2014 from a dual peg system to a more market-driven floating exchange regime allowed the rouble to depreciate in line with oil prices. Contrary to the oil price shock in 2008-09, the shock-absorbing capacity of the freely floating rouble after the collapse in oil prices in 2014 helped avoid costly interventions in the FX markets at the cost of reserves, which have instead been channelled to the sanction-hit banking sector and strategic corporates.

Alongside supporting growth, this has resulted in external repayments of the banking sector, keeping gross external debt low at 40.1% of GDP in 2016 (from 29.1% of GDP in 2014) while Russia's net external-creditor position consequently nearly doubled from 13.9% of GDP in 2014 to 23.9% of GDP in 2016.

In 2009, the Central Bank of Russia lost USD 200bn in a matter of months to defend the peg. In response to the downturn in 2014-2016, the shock-absorbing feature of floating the rouble resulted in a re-channelling of FX reserves to provide USD financing at favourable rates and cover cash shortfalls in the public budget, while interventions in the foreign-exchange market have instead been modest. In addition, private-sector capital flight was smaller in the post-2014 episode than in 2008-2009, reflecting increased diversification of funding and a higher share of institutional investors. In 2017, the rouble appreciated by around 20% year-on-year, reflecting greater confidence in the monetary framework, increasing oil prices and returning portfolio-investment inflows. According to budgetary rules in place, the government has been acquiring foreign-exchange reserves via the central bank to bolster its fiscal savings, which is also driving appreciation in the rouble. Consequently, foreign reserves ex-gold have been increasing again, from USD 318bn at the end of 2016 to USD 351bn in September 2017.

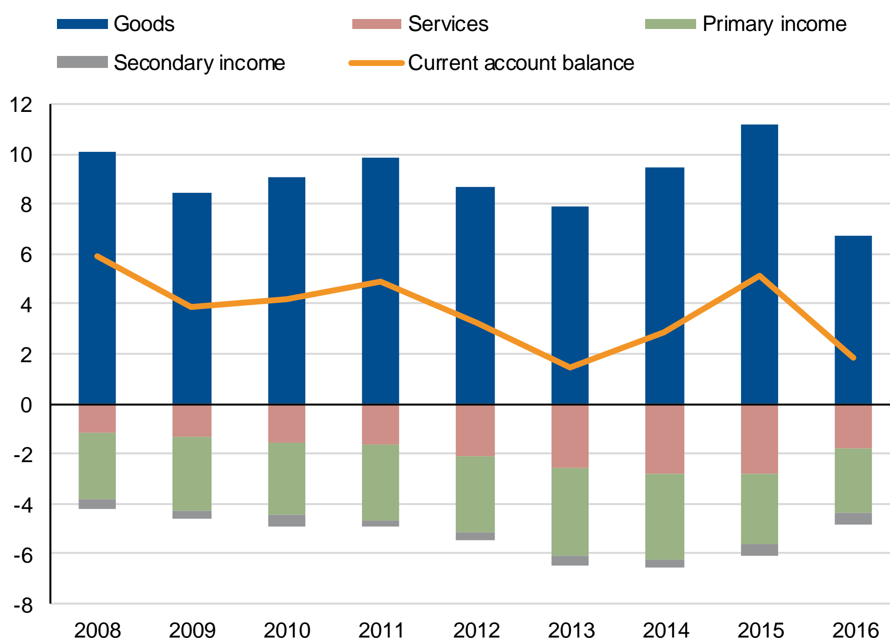
Figure 7: Exchange rate and reserves



Source: Central Bank of Russia

Russia has run current account surpluses since 1999 despite volatile commodity prices, with surpluses peaking at over USD 100bn in 2008 and averaging 7% of GDP since 2000 until the oil price crash in 2015. Lower oil prices shrank the current account surplus to USD 25bn (2% of GDP) in 2016 despite depreciation of 50% in the rouble and a 30% reduction in imports. The agricultural counter-sanctions imposed by Russia on the European Union (EU) reduced the share of imports in private food consumption from around 35% in 2014 to roughly 20% by the end of 2016. In 2017, total imports have been rising again (by 30% from January to June), particularly in machinery imports, which indicates recovering investment activity. Rising oil-related exports this year will likely be partially offset by the stronger rouble and recovering imports, resulting in a modest improvement in the current account balance to around 3% of GDP.

Figure 8: Current account balance (% of GDP)



Source: IMF, calculations by Scope Ratings AG

Financial stability risk

Despite the ample liquidity of the Russian banking sector as reflected by recent repayments of around USD 100bn in Russian banks' external debt since 2014, remaining vulnerabilities are reflected by the ongoing bank restructuring process. However, Scope positively observes structural steps taken to increase the resilience of the financial system, including an improved bank resolution mechanism. In 2016, the central bank closed 110 credit institutions (compared with 101 in 2015), continuing to target mostly small banks, bringing the number of total credit institutions to 616 in 2016. Effective from 2017, the bank resolution framework operated by the Deposit Insurance Agency (DIA) has been replaced with one operated by the CBR, allowing it to provide equity capital injections after the removal of shareholders' equity capital, rather than extending a loan below market rates via the DIA. Furthermore, a new Bank Consolidation Fund was created (financed and managed by the CBR) to provide resolution funding, whose size will be determined on a case-by-case basis. It is Scope's view that the use of CBR funds instead of federal funds in resolution proceedings for now provides an adequate mechanism to intervene (due to speed), while moral hazard in the form of opportunities for 'purchase and assumptions' transactions, i.e. acquiring banks to pool their own bad assets with those of the institution being resolved, are more limited within the new framework.

Overall, macro-financial risks have been declining as the economy has adjusted to lower oil prices. The banking sector's capital adequacy ratio remained stable overall at 13% in 2016, versus a regulatory minimum of 8%, with a common equity tier 1 ratio of 9.2% compared to a phased-in Basel III capital requirement of 4.5%.

The banking sector's liquidity has been improving over the past year, with increases in banks' deposit funding. In 2017, the banking system's liquidity situation has improved from a structural liquidity deficit (with chronic shortages of money in the economy and need for the central bank to lend to commercial banks) to a structural surplus (with no outstanding debt to the lender of last resort). Lending activity stopped contracting in Q4 2016, with loan volume growth averaging 2% annually since the beginning of 2016.

Consequently, net interest income in the banking sector is growing and reached RUB 677bn in the first quarter of 2017, exceeding the average level of the past three years.

The accumulated level of NPLs (around 10% of total loans, and as its maximum for the last ten years) will likely continue to put pressure on the sector's profitability. The relatively low coverage of bad loans by provisions remains a key short-term risk particularly for the privately-owned banks. Corporate and bank FX risks remain low as short-term liabilities are sufficiently covered by liquid external assets and in view of improved balance sheets after corporate deleveraging in the past two years. Global monetary tightening will likely not constitute a major risk factor on the interest margins of Russian banks as a significant share of FX loans is provided by them at floating rates, and long-term FX assets and liabilities are fairly balanced on maturity. Furthermore, the central bank also tightened macroprudential requirements to reduce dollarization by setting higher capital risk weights for FX lending by banks to unhedged borrowers.

Institutional and political risk

Russia's political system is based on a federal semi-presidential republic. According to the Russian constitution, the president is head of state and head of a multi-party system with executive power exercised by the government, headed by the prime minister, to be appointed by the president with parliamentary approval. Overall, the president has broad authority and under certain conditions, the president may dissolve the State Duma (the lower house of parliament), reflecting a centralised set-up of powers. President Vladimir Putin, now in his third term, received 64% of votes in the last presidential election in 2012 and is eligible to seek re-election in the next presidential election, which is scheduled for April 2018, although he has not yet officially confirmed that he will do this. Nevertheless, policy continuity after the presidential election in April 2018 is likely, underpinning the predictability of political priorities.

Geopolitical risks related to the ongoing conflict in Ukraine and the threat of additional sanctions remain significant potential event risks, inhibiting systemically important Russian companies from access to global debt-capital markets. The threat of escalation of these tensions has an adverse impact on business and consumer activity. However, despite geopolitical tensions, economic ties between Russia and the EU remain close as the EU is by far Russia's largest trading partner while Russia is the leading energy supplier to the EU. Scope believes that Russia's transformation to an economy producing more high-value-added goods will depend on improving the business climate and addressing Russia's chronic under-investment.

Methodology

The methodology applicable for this rating and/or rating outlook, 'Public Finance Sovereign Ratings', is available on www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

A comprehensive clarification of Scope's definition of default, definitions of rating notations can be found in Scope's public credit rating methodologies at www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months. A rating change is, however, not automatically ensured.

I. Appendix: CVS and QS Results

Sovereign rating scorecards

Scope's Core Variable Scorecard (CVS), which is based on relative rankings of key sovereign credit fundamentals, signals an indicative "BB" ("bb") rating range for the Russian Federation. This indicative rating range can be adjusted by the Qualitative Scorecard (QS) by up to three notches depending on the size of relative credit strengths or weaknesses versus peers based on analysts' qualitative findings.

For the Russian Federation, the following relative credit strengths have been identified: i) a strong economic policy framework; ii) high macroeconomic stability; iii) strong fiscal flexibility; iv) strong public debt sustainability; v) very good market access and internal funding sources; vi) a resilient current account; vii) good external debt sustainability; viii) strong resilience to short-term external shocks. Relative credit weaknesses are signalled for: i) weak growth potential of the economy; ii) high geo-political risk; iii) weak financial sector performance. The combined relative credit strengths and weaknesses generate an upward adjustment and signal a sovereign rating at BBB- for Russia. A rating committee has discussed and confirmed these results.

Rating overview	
CVS category rating range	BB
QS adjustment	BBB-
Final rating	BBB-

To calculate the rating score within the CVS, Scope uses a minimum-maximum algorithm to determine a rating score for each of the 22 indicators. Scope calculates the minimum and maximum of each rating indicator and places each sovereign within this range. Sovereigns with the strongest results for each rating indicator receive the highest rating score; sovereigns with the weakest results receive the lowest rating score. The score result translates to an indicative rating range that is always presented in lower case.

Within the QS assessment, the analyst conducts a comprehensive review of the qualitative factors. This includes but is not limited to economic scenario analysis, a review of debt sustainability, fiscal and financial performance assessments and policy implementation assessments.

There are three assessments per category for a total of fifteen. For each assessment, the analyst examines the relative position of a given sovereign within its peer group. For this purpose, additional comparative analysis beyond the variables included in the CVS is conducted. These assessments are then aggregated using the same weighting system as in the CVS.

The result is the implied QS notch adjustment which is the basis for the analyst recommendation to the rating committee.

Foreign- Versus Local-Currency Ratings

Scope sees no evidence that Russia would differentiate among any of its contractual debt obligations based on currency denomination. Russia's debt is predominantly denominated in domestic currency. Borrowing on international capital markets in 2017-2019 is scheduled to remain limited. It is, however, necessary to some extent to maintain Russia's market presence as a sovereign borrower and support a benchmark yield curve for foreign-currency debt, laying the foundation for better borrowing terms for Russian corporates. Furthermore, Russia benefits from substantial foreign-exchange reserves; therefore, its ability to pay in either local- or foreign-currency is considered by Scope to be equal. This is further corroborated by the recent history of sovereign defaults, which does not provide a strong justification for a rating bias in favour of either local- or foreign-currency debt.

II. Appendix: CVS and QS Results

CVS

Rating indicator	Category weight
Domestic economic risk	**35%**
Economic growth	
Real GDP growth	
Real GDP volatility	
GDP per capita	
Inflation rate	
Labour & population	
Unemployment rate	
Population growth	
Public finance risk	**30%**
Fiscal balance	
GG public balance	
GG primary balance	
GG gross financing needs	
Public debt	
GG net debt	
Interest payments	
External economic risk	**15%**
International position	
International investment position	
Importance of currency	
Current-account financing	
Current-account balance	
T-W effective exchange rate	
Total external debt	
Institutional and political risk	**10%**
Control of corruption	
Voice & accountability	
Rule of law	
Financial risk	**10%**
Non-performing loans	
Liquid assets	
Credit-to-GDP gap	
Indicative rating range	**bb**
QS adjustment	**BBB-**
Final rating	**BBB-**

QS

Maximum adjustment = 3 notches

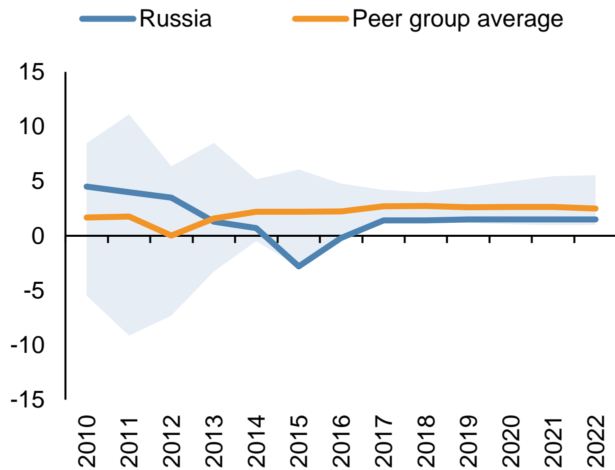
	+2 notch	+1 notch	0 notch	-1 notch	-2 notch
Growth potential of the economy	○ Excellent outlook, strong growth potential	○ Strong outlook, good growth potential	○ Neutral	◉ Weak outlook, growth potential under trend	○ Very weak outlook, growth potential well under trend or negative
Economic policy framework	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Macroeconomic stability and imbalances	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Fiscal performance	○ Exceptionally strong performance	◉ Strong performance	○ Neutral	○ Weak performance	○ Problematic performance
Debt sustainability	○ Exceptionally strong sustainability	◉ Strong sustainability	○ Neutral	○ Weak sustainability	○ Not sustainable
Market access and funding sources	○ Excellent access	◉ Very good access	○ Neutral	○ Poor access	○ Very weak access
Current-account vulnerabilities	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
External debt sustainability	○ Excellent	◉ Good	○ Neutral	○ Poor	○ Inadequate
Vulnerability to short-term shocks	○ Excellent resilience	◉ Good resilience	○ Neutral	○ Vulnerable to shock	○ Strongly vulnerable to shocks
Perceived willingness to pay	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Recent events and policy decisions	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Geo-political risk	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate
Financial sector performance	○ Excellent	○ Good	○ Neutral	◉ Poor	○ Inadequate
Financial sector oversight and governance	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate
Macro-financial vulnerabilities and fragility	○ Excellent	○ Good	◉ Neutral	○ Poor	○ Inadequate

*** Implied QS notch adjustment = (QS notch adjustment for domestic economic risk)*0.35 + (QS notch adjustment for public finance risk)*0.30 + (QS notch adjustment for external economic risk)*0.15 + (QS notch adjustment for institutional and political risk)*0.10 + (QS notch adjustment for financial stability risk)*0.10**

Source: Scope Ratings AG

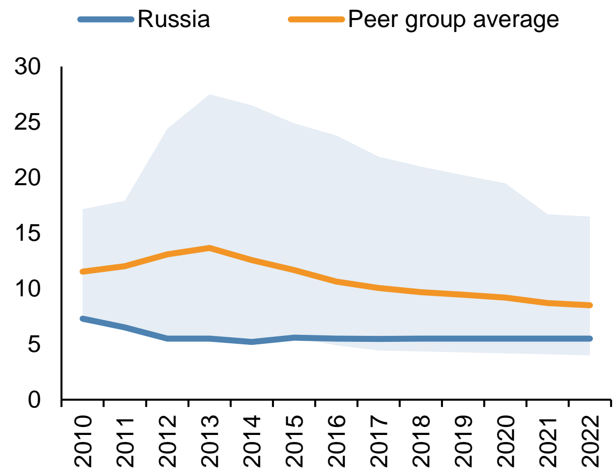
III. Appendix: Peer Comparison

Figure 9: Real GDP growth



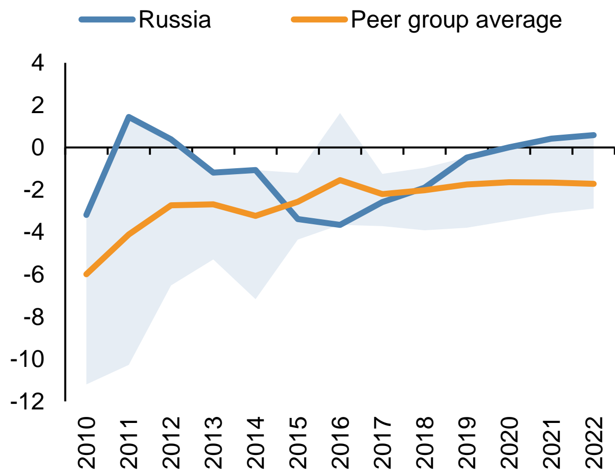
Source: IMF, Calculations Scope Ratings AG

Figure 10: Unemployment rate, % of total labour force



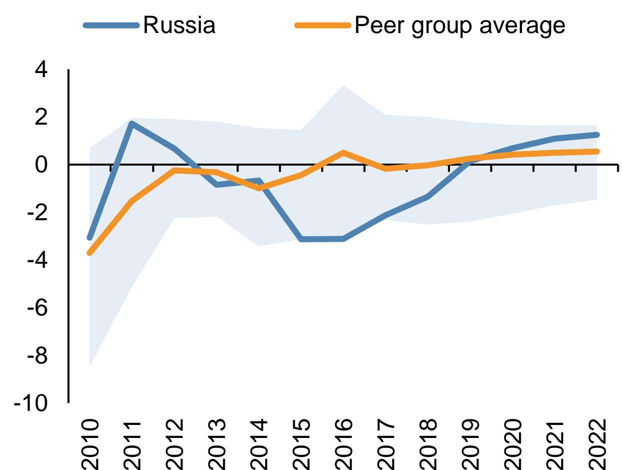
Source: IMF, Calculations Scope Ratings AG

Figure 11: General government balance, % of GDP



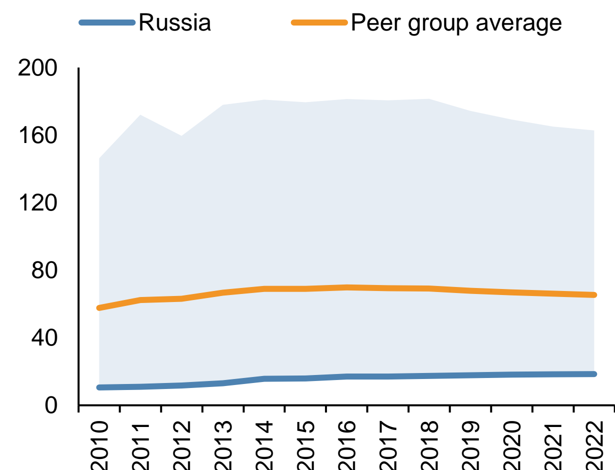
Source: IMF, Calculations Scope Ratings AG

Figure 12: General government primary balance, % of GDP



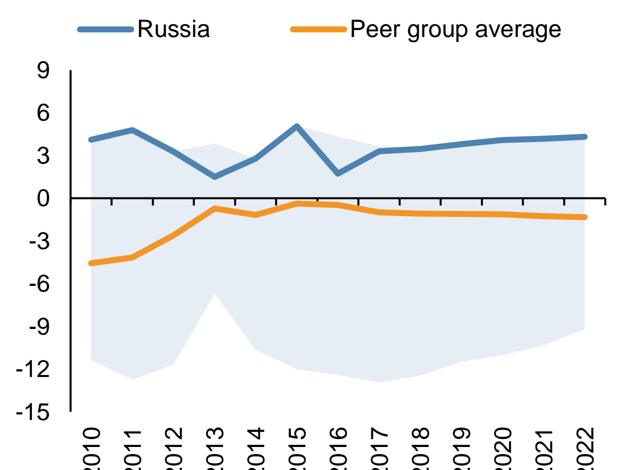
Source: IMF, Calculations Scope Ratings AG

Figure 13: General government gross debt, % of GDP



Source: IMF, Calculations Scope Ratings AG

Figure 14: Current account balance, % of GDP



Source: IMF, Calculations Scope Ratings AG

IV. Appendix: Statistical Tables

	2012	2013	2014	2015	2016	2017E	2018F
Economic performance							
Nominal GDP (Bil.RUB)	68,164	73,134	79,200	83,233	86,044	92,537	97,942
Population ('000s)	143,288	143,367	143,429	143,457	143,440	143,375	143,261
GDP-per-capita PPP (Int'l USD)	25,317	25,481	25,477	23,703	23,163	-	-
GDP per capita (RUB)	475,714	510,116	552,186	580,192	599,859	645,418	683,656
Real GDP growth, % change	3.7	1.8	0.7	-2.8	-0.2	1.8	1.6
GDP growth volatility (10-year rolling SD)	4.7	4.7	4.7	5.0	4.7	4.1	3.8
CPI, % change	5.1	6.8	7.8	15.5	7.0	4.2	3.9
Unemployment rate (%)	5.5	5.5	5.2	5.6	5.5	5.5	5.5
Investment (% of GDP)	24.8	23.7	22.2	22.1	25.3	23.8	24.4
Gross national savings (% of GDP)	28.0	25.1	25.0	27.2	27.3	26.6	27.5
Public finances							
Net lending/borrowing (% of GDP)	0.4	-1.2	-1.1	-3.4	-3.7	-2.1	-1.5
Primary net lending/borrowing (% of GDP)	0.7	-0.8	-0.7	-3.1	-3.1	-1.6	-1.0
Revenue (% of GDP)	34.4	33.4	33.8	31.8	32.8	32.8	32.0
Expenditure (% of GDP)	34.0	34.6	34.9	35.2	36.4	34.9	33.5
Net interest payments (% of GDP)	0.3	0.3	0.4	0.3	0.5	0.5	0.6
Net interest payments (% of revenue)	0.8	1.0	1.2	0.8	1.6	1.5	1.8
Gross debt (% of GDP)	11.5	12.7	15.6	15.9	15.6	17.4	17.7
Net debt (% of GDP)	-	-	-	-	-	-	-
Gross debt (% of revenue)	33.6	38.0	46.3	50.1	47.8	53.0	55.3
External vulnerability							
Gross external debt (% of GDP)	29.0	31.7	29.1	38.0	40.1	-	-
Net external debt (% of GDP)	-16.1	-14.9	-13.9	-20.7	-23.9	-	-
Current-account balance (% of GDP)	3.2	1.5	2.8	5.0	2.0	2.8	3.2
Trade balance [FOB] (% of GDP)	6.6	5.3	6.4	8.1	5.1	-	-
Net direct investment (% of GDP)	-0.1	0.8	1.7	1.1	-0.8	-	-
Official forex reserves (EOP, Mil. USD)	486,578.0	469,605.0	339,371.0	319,836.0	317,548.0	-	-
REER, % change	1.5	1.5	-9.9	-17.9	-1.5	-	-
Nominal exchange rate (EOP, RUB/USD)	30.4	32.7	56.3	72.9	60.7	-	-
Financial stability							
Non-performing loans (% of total loans)	6.0	6.0	6.7	8.3	9.4	-	-
Tier 1 ratio (%)	10.6	10.9	9.0	8.5	9.2	-	-
Private debt (% of GDP)	49.5	54.1	61.4	63.9	61.4	-	-
Domestic Credit-to-GDP gap (%)	-3.0	1.0	9.8	6.7	-1.1	-	-

Sources: IMF,Russian Central Bank, World Bank, Scope Ratings AG

Regulatory disclosures

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Rating prepared by Jakob Suwalski, Lead Analyst

Person responsible for approval of the rating: Dr Stefan Bund, Chief Analytical Officer

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The senior unsecured debt ratings as well as the short-term issuer ratings were assigned by Scope for the first time.

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Rating Committee: The main points discussed during the rating committee were: (1) Russia's economic outlook, (2) fiscal performance and debt sustainability, (3) Russia's macroeconomic and fiscal framework, (4) external position and resilience, (5) the financial sector's performance, (6) recent political developments, (7) impact of sanctions against Russia, (8) peer considerations.

Solicitation, key sources and quality of information

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The following material sources of information were used to prepare the credit rating: the public domain and third parties. Key sources of information for the rating include: ROSSTAT (the Russian Federation Federal State Statistics Service), the Ministry of Finance of the Russian Federation, the Central Bank of Russia, the European Commission, the IMF, the OECD, and Haver Analytics.

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