# Russian Federation
## Rating Report

SCOPE BB+ Under review

### Credit strengths

- Low public debt
- Sizable fiscal reserves
- Track record of effective fiscal, monetary and exchange-rate management

### Credit challenges

- Severe strengthening in sanctions, elevated geopolitical risks
- Weak governance
- Weak growth potential
- High commodity dependence

## Rating rationale:

The downgrade of Russia's sovereign ratings reflects the rapid escalation of Russia's military intervention into Ukraine, which has led to a severe strengthening of economic and financial sanctions from the US, EU, and UK and other international partners, including (i) banning transactions with Russia's central bank, preventing it from using a significant part of its international reserves, and (ii) cutting off some Russian banks from the SWIFT interbank messaging network, impairing Russia's ability to transact with financial institutions abroad. Such unprecedented measures carry significant negative implications for the Russian banking sector with associated severe disruption to the country's economy and to its ability to ensure timely debt service.

Scope believes that the economic, financial and political consequences of the ongoing crisis will severely undermine Russia's medium-run macroeconomic outlook, financial stability and already weak investment conditions, leading to a curtailed access to foreign capital and financial markets, higher capital outflows, capital controls, tighter financial conditions and reduced financial buffers.

**Russia's sovereign rating drivers**

| Risk pillars | | Quantitative scorecard | | Reserve currency adjustment (notches) | Qualitative scorecard* | Final rating |
|---|---|---|---|---|---|---|
| | | Weight | Indicative rating | | Notches | |
| Domestic Economic Risk | | 35% | a+ | | -2/3 | |
| Public Finance Risk | | 25% | aaa | | 0 | |
| External Economic Risk | | 10% | aaa | | -1/3 | |
| Financial Stability Risk | | 10% | b | | -3/3 | BB+ |
| ESG Risk | Environmental Risk | 5% | a+ | | -1/3 | |
| | Social Risk | 5% | a- | | -1/3 | |
| | Governance Risk | 10% | c | | -1/3 | |
| **Overall outcome** | | **a+** | | **0** | **-3** | |

* An additional three-notch negative adjustment has been applied to capture the severe strengthening in international sanctions and curtailed access to foreign capital and financial markets and elevated geopolitical and sanction-related risks and higher transition risks.

Note: The sum of the qualitative adjustments, capped at 1 notch per rating pillar, is weighted equally and rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket.
For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings GmbH

## Outlook and rating triggers

Scope will use the review period to further assess: i) the degree of risk related to a further escalation of the geopolitical crisis; ii) the resulting impact for Russia's macro-economic outlook, financial stability and external position as well as its policy framework.

### Positive rating-change drivers

- Stabilization in the current crisis curtails risks of additional sanctions
- The risks to fiscal and external finances are reduced

### Negative rating-change drivers

- Consequences of the ongoing crisis worsen Russia's medium-run challenges beyond current expectations
- Macroeconomic policy framework, including policy credibility, weakens
- Deterioration in Russia's external position and/or rouble undermine the sovereign's shock-absorption capacity

### Ratings and Outlook

**Foreign and local currency**

| | |
|---|---|
| Long-term issuer rating | BB+/Under review |
| Senior unsecured debt | BB+/Under review |
| Short-term issuer rating | S-3/Under review |


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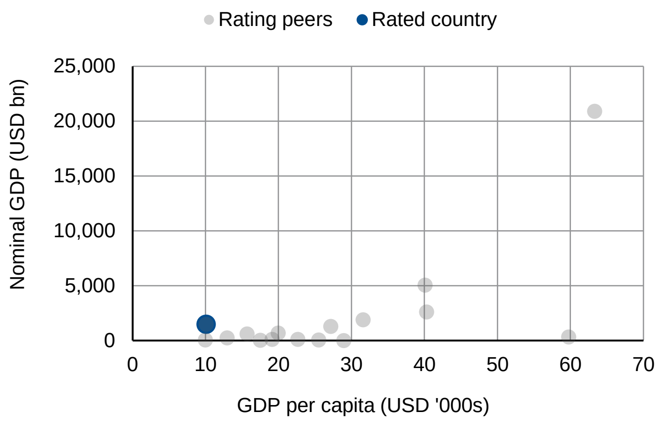
## Domestic Economic Risks

- **Growth outlook:** Weak growth prospects remain a key credit rating constraint. In Scope's view, sanctions and increased economic uncertainty tied to the ongoing conflict will have a significant negative impact on Russia's GDP. Weak growth prospects are furthermore driven by adverse demographics, an absence of far-reaching reform to materially lower the Russian economy's reliance on the oil and gas industry and curtail the state's significant role in the economy, which has brought a lack of domestic competition and economic inefficiencies, affecting long-run productivity growth, and structural challenges presented by weak physical infrastructure, high income inequality and inefficient social safety nets, affecting private investment.
- **Inflation and monetary policy:** The Bank of Russia increased the key rate to 20% per annum from 28 February 2022.
- **Labour market:** Scope projects Russia's unemployment rate to remain flat in the medium-run, at close to 5%.

**Overview of Scope's qualitative assessments for Russia's *Domestic Economic Risks***

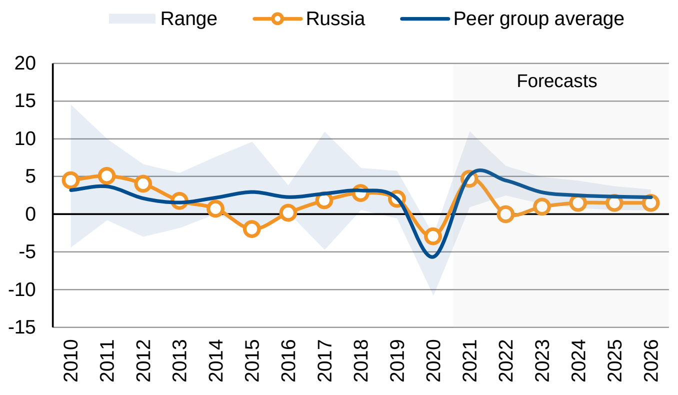
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| a+ | Growth potential of the economy | Weak | -1/3 | Low growth potential due to a weak investment environment and low levels of competition and innovation |
| | Monetary policy framework | Neutral | 0 | Credible central bank, commitment to inflation targeting, but weak domestic financial system limits effectiveness of monetary policy |
| | Macro-economic stability and sustainability | Weak | -1/3 | Over-reliance on the oil and gas sector |

**Nominal GDP and GDP per capita**




Source: IMF, Scope Ratings GmbH

**Real GDP growth**, %




Source: IMF, Scope Ratings GmbH

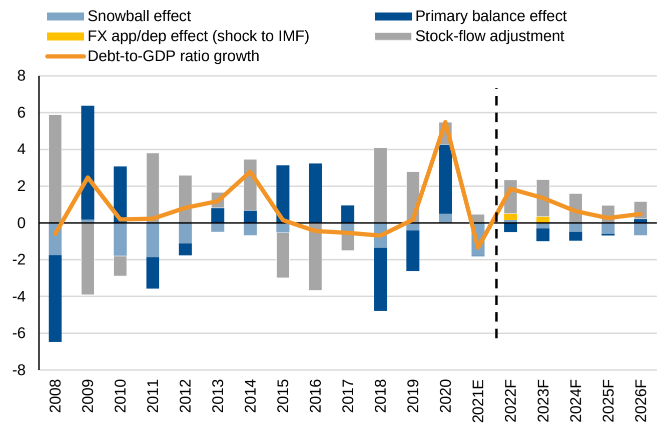
## Public Finance Risks

- **Fiscal outlook:** Russia's rules-based fiscal policies have centred on rebuilding fiscal buffers during the past several years. The 2022-24 medium-term budget is built around a conservative assumption of a decline in the Urals oil price to USD 62.2 per barrel in 2022, followed by further decline to USD 58.4 and USD 55.7 per barrel in 2023 and 2024, respectively. The average price of Urals oil was USD 85.6/barrel in January 2022. Such fiscal policies led to sizeable government savings in form of cash deposits. As of February 1, 2022, total assets of the National Wealth Fund (NWF) amounted to USD 174.9bn, or 10.2% of GDP projected for 2022, with liquid assets at USD 112.7bn (or 6.6% of 2022 GDP). However, Scope expects material fiscal deficit in 2022.
- **Debt trajectory:** Scope notes the continued credit strength in the low levels of public debt. Scope estimates general government debt at under 20% of GDP as of end-2021, which is low compared with that of sovereign peers. Scope expects material increase in public debt in 2022.
- **Market access:** The escalation in the Russia-Ukraine conflict has driven severe strengthening in international sanctions, including via curtailing the access of the Russian public sector to international capital markets. Among others, these measures restrain the ability of the Russian public sector to access the US's and EU's capital and financial markets, including such as extending by the US of existing debt prohibitions to cover participation in the secondary market for sovereign bonds issued after March 1, 2022. In Scope's view, this will further undermine Russia's fiscal flexibility.

**Overview of Scope's qualitative assessments for Russia's *Public Finance Risks***

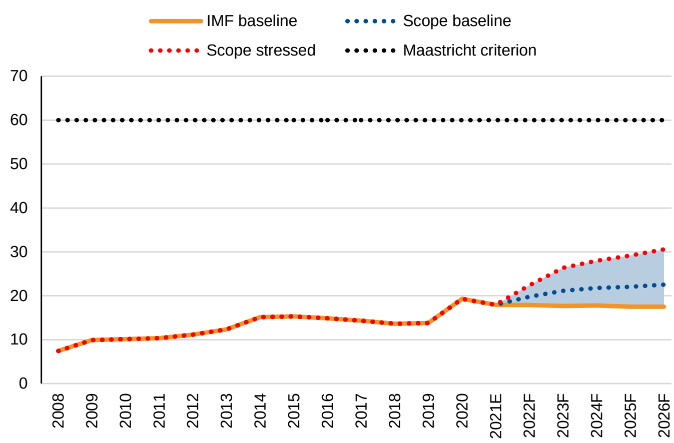
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| aaa | Fiscal policy framework | Neutral | 0 | Prudent fiscal policy framework following the introduction of the fiscal rule |
| | Debt sustainability | Strong | +1/3 | Benign debt trajectory supported by low debt levels |
| | Debt profile and market access | Weak | -1/3 | Curtailed access to international capital markets, less developed domestic capital markets |

**Contributions to changes in debt levels**, pps of GDP




Source: Scope Ratings GmbH

**Debt-to-GDP forecasts**, % of GDP




Source: Scope Ratings GmbH

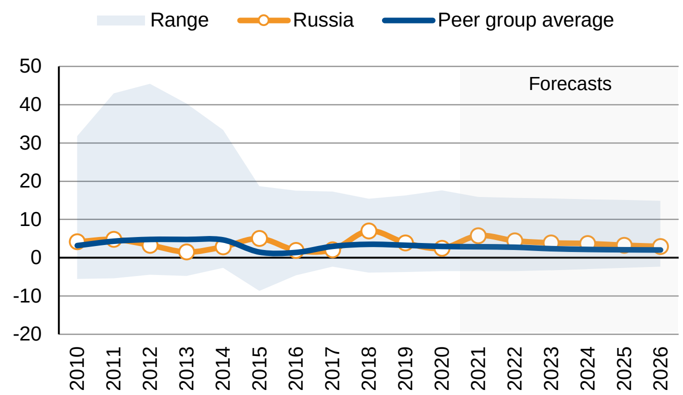
## External Economic Risks

- **Current account:** Russia's current account was in a significant surplus in 2021, at 6.7% of GDP. This was helped by higher near-term energy prices. Scope expects the current account to remain in a surplus in 2022. However, reliance on commodity exports remains a key credit weakness.
- **External position:** As of February 18, 2022, Russia's international reserves amounted to USD 643.2bn. Latest reserves are equivalent to around five times short-term external debt (on remaining maturity basis). However, restrictions on the access of the Bank of Russia to a significant part of international reserves materially undermine Russia's external buffers, putting pressure on the currency, hindering the country's financial flexibility and monetary policy framework.
- **Resilience to shocks:** The escalation in the Russia-Ukraine conflict has driven severe strengthening in international sanctions, and further penalties on Russia are probable. Scope believes that sanctions imposed to date and potentially tougher fresh sanctions will negatively affect Russia's medium-run macroeconomic outlook, financial flexibility and already weak investment conditions and productivity growth, lead to reduced capacity of the Russian banking system to act as a financial intermediary for the Russian foreign trade, curtailed foreign investments in the Russian economy, higher capital outflows, downward pressure on FX reserves, tighter financial conditions.

**Overview of Scope's qualitative assessments for Russia's *External Economic Risks***

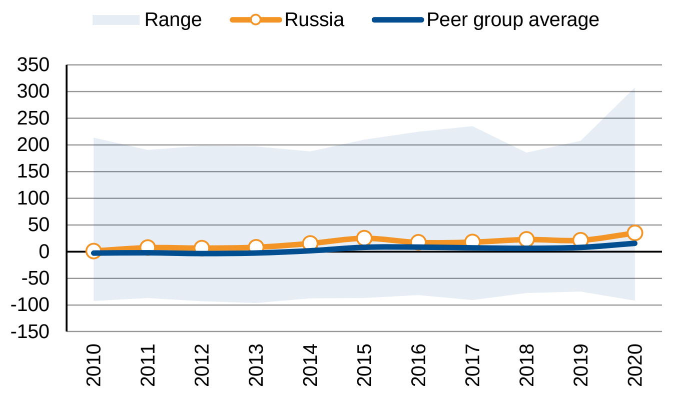
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| aaa | Current account resilience | Weak | -1/3 | Reliance on commodities exposes Russia to shocks |
| | External debt structure | Neutral | 0 | Low external debt but declining FDI |
| | Resilience to short-term shocks | Neutral | 0 | High foreign exchange reserves, but elevated sanctions |

**Current account balance,** % of GDP




Source: IMF, Scope Ratings GmbH

**NIIP**, % of GDP




Source: IMF, Scope Ratings GmbH

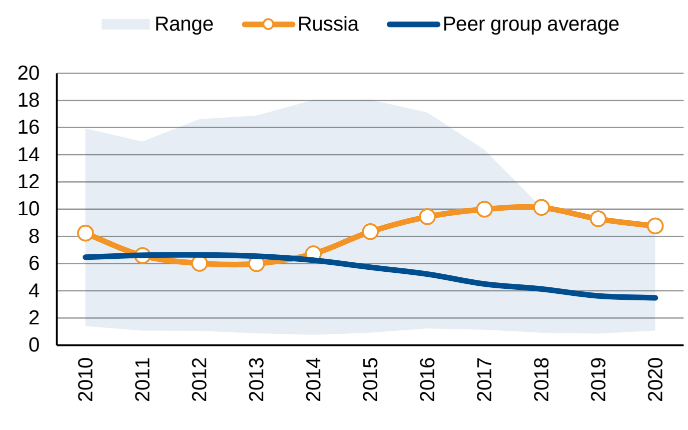
## Financial Stability Risks

- **Banking sector:** The sanctions to date restrain Russian systemically important financial institutions from processing payments through the U.S. financial system and undermine capacity of the Russian banking system to act as a financial intermediary for the Russian foreign trade because of the cut-off of some Russian lenders from the SWIFT interbank messaging network. In Scope's view, this will have a material negative impact on Russia's financial stability and banking system liquidly.
- **Private debt:** Domestic credit to private sector by banks amounted to around 60% of GDP in 2020, up from around 53% of GDP in 2019.
- **Financial imbalances:** The sanctions will have significant negative consequences for the Russian banking sector's capacity to settle cross-border payments.

**Overview of Scope's qualitative assessments for Russia's *Financial Stability Risks***

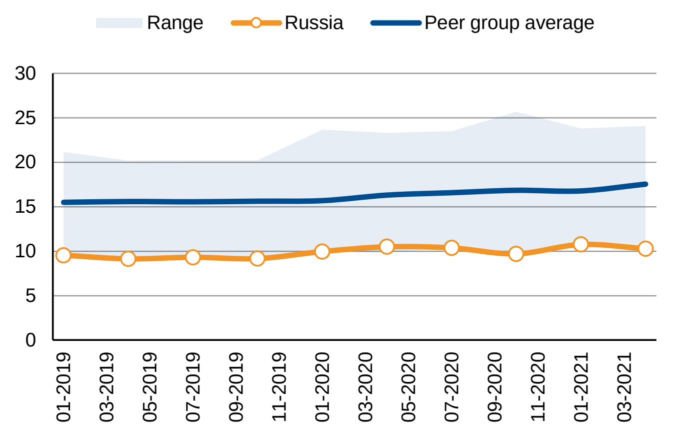
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| b | Banking sector performance | Weak | -1/3 | Banks' asset quality to weaken with the crisis |
| | Banking sector oversight | Weak | -1/3 | Systemic risks |
| | Financial imbalances | Weak | -1/3 | State's dominant role in the banking sector represents contingent liability risk for the sovereign |

**NPLs,** % of total loans




Source: IMF, Scope Ratings GmbH

**Tier 1 ratio**, % of risk-weighted assets




Source: IMF, Scope Ratings GmbH

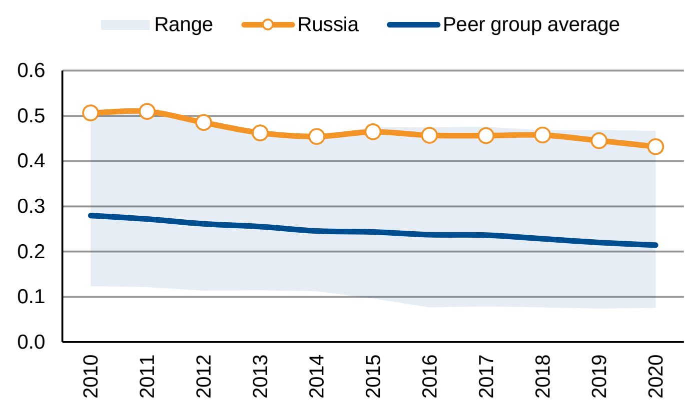
## ESG Risks

- **Environment:** Russia is the world's fourth largest carbon emitter, accounting for around 4.7% of the globe's CO2 emissions. The country still relies heavily on fossil fuels (60%) for energy production. The large scale of Russia's emissions makes its economy and budget vulnerable to Western environmental legislation. Importantly, Russia's exports to the EU could be materially affected by the EU's proposed new carbon border adjustment mechanism. Assessments of the potential costs for Russia are around EUR 5.5-6bn a year (less than 0.5% of 2021 GDP). This impact is still small as a share of the Russian economy but could increase should the EU expand the mechanism to include oil and gas.
- **Social:** Credit factors related to social criteria are designated via rising old-age dependency, high income inequality, low income levels.
- **Governance:** Weak governance affects business and investment conditions and drives chronic underinvestment. According to the World Bank's Worldwide Governance Indicators, Russia is ranked poorly in its application of the rule of law and control of corruption. This is reflected to some extent in lingering uncertainties with regard to the quality of contract enforcement and property rights enforcement. The presence of interconnected state-owned companies in mining, manufacturing and services sectors raises concerns over the extent to which public power is exercised for private gain and how this might affect the business climate. Levelling the playing field between state-owned enterprises and the private sector is key to enabling sustainable long-run growth. However, this has been politically challenging to implement, given relative competitiveness of these industries versus that of other tradeable sectors short term.

**Overview of Scope's qualitative assessments for Russia's *ESG Risks***

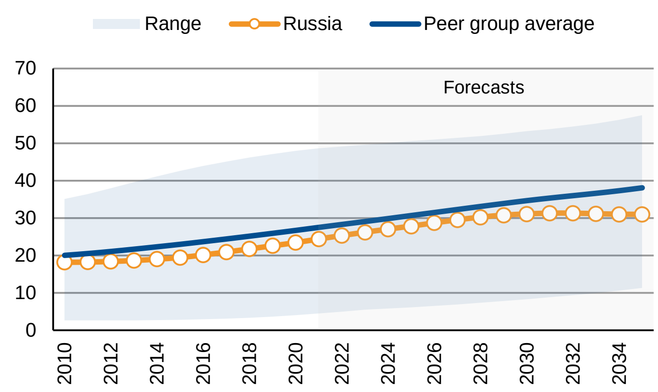
| CVS indicative rating | Analytical component | Assessment | Notch adjustment | Rationale |
|---|---|---|---|---|
| b- | Environmental risks | Weak | -1/3 | Elevated vulnerability to transition risks |
| | Social risks | Weak | -1/3 | Adverse demographics with a shrinking labour force, rising inequality |
| | Institutional and political risks | Weak | -1/3 | Elevated geopolitical and sanction-related risk, weak governance |

**CO2 emissions per GDP,** mtCO2e



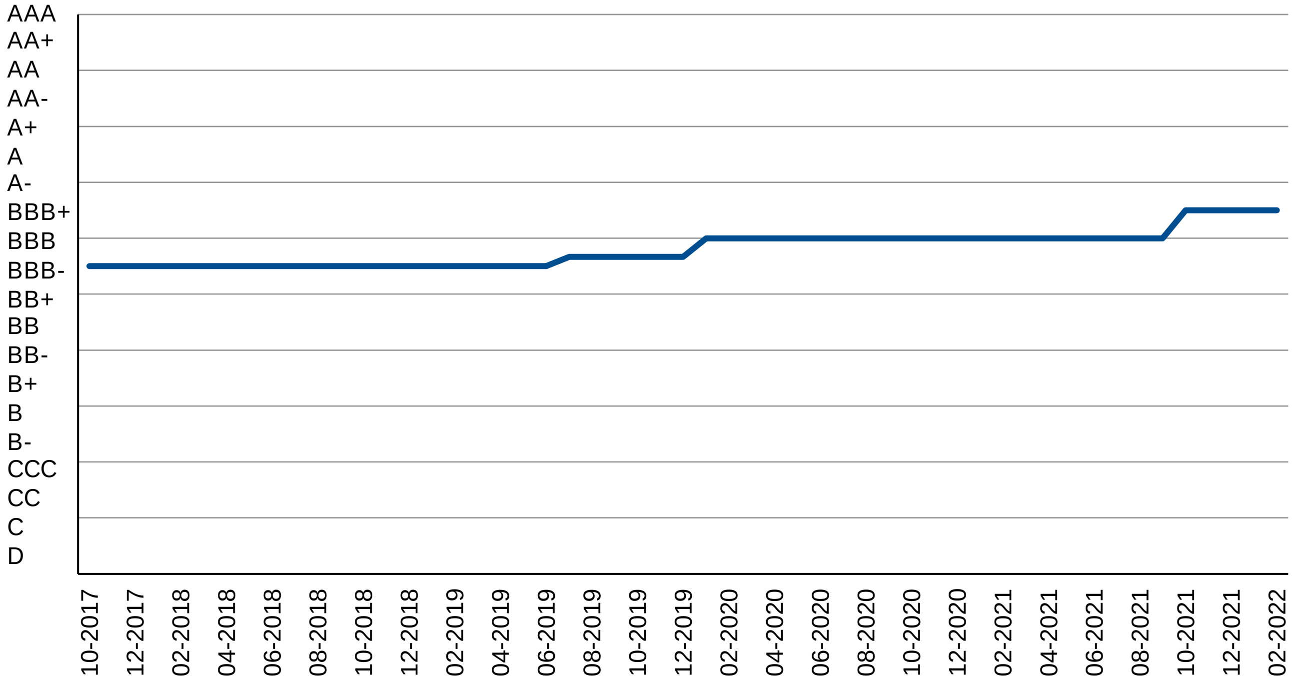

Source: European Commission, Scope Ratings GmbH

**Old age dependency ratio**, %




Source: United Nations, Scope Ratings GmbH

## Appendix I. Rating history




## Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard.

| Peer group |
|---|
| Bulgaria |
| France |
| Italy |
| Japan |
| Latvia |
| Malta |
| Poland |
| United States |
| Slovakia |
| Slovenia |
| Spain |

Publicly rated sovereigns only; the full sample may be larger.

## Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 29) used in Scope's quantitative model, the Core Variable Scorecard.

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021E | 2022F | 2023F |
|---|---|---|---|---|---|---|---|---|
| **Domestic Economic Risk** | | | | | | | | |
| **GDP per capita, USD 000s'** | 8.7 | 10.7 | 11.3 | 11.5 | 10.1 | 11.3 | 11.0 | 11.2 |
| **Nominal GDP, USD tn** | 1.3 | 1.6 | 1.7 | 1.7 | 1.5 | 1.6 | 1.6 | 1.6 |
| **Real growth, %[1]** | 0.2 | 1.8 | 2.8 | 2.2 | -2.7 | 4.8 | -5 | 1 |
| **CPI inflation, %** | 7.0 | 3.7 | 2.9 | 4.5 | 3.4 | 5.9 | 7.8 | 5.5 |
| **Unemployment rate, %[1]** | 5.5 | 5.2 | 4.8 | 4.6 | 5.8 | 4.9 | 5.5 | 5.5 |
| **Public Finance Risk** | | | | | | | | |
| **Public debt, % of GDP[1]** | 14.8 | 14.3 | 13.6 | 13.8 | 19.3 | 18 | 23 | 24 |
| **Interest payment, % of government revenue** | 1.3 | 1.5 | 1.4 | 0.8 | 0.7 | 1.6 | 2 | 2 |
| **Primary balance, % of GDP[1]** | -3.2 | -1.0 | 3.4 | 2.2 | -3.8 | 0.0 | -3 | -1 |
| **External Economic Risk** | | | | | | | | |
| **Current account balance, % of GDP** | 1.9 | 2.0 | 7.0 | 3.9 | 2.4 | 6.7 | 4 | 3 |
| **Total reserves, months of imports** | 13.2 | 12.5 | 12.9 | 14.5 | 18.7 | - | - | - |
| **NIIP, % of GDP** | 17.2 | 17.8 | 22.6 | 21.3 | 35.0 | - | - | - |
| **Financial Stability Risk** | | | | | | | | |
| **NPL ratio, % of total loans** | 9.2 | 9.7 | 9.7 | 8.8 | 8.3 | - | - | - |
| **Tier 1 ratio, % of risk weighted assets** | 9.2 | 8.5 | 8.9 | 9.2 | 9.7 | - | - | - |
| **Credit to private sector, % of GDP** | 53.1 | 52.1 | 51.2 | 52.7 | 60.0 | - | - | - |
| **ESG Risk** | | | | | | | | |
| **$CO^2$ per USD 1,000 of GDP, $mtCO^2e$** | 456.9 | 456.2 | 457.5 | 445.2 | 432.0 | - | - | - |
| **Income quintile share ratio (S80/S20), x** | 6.3 | 6.4 | 6.4 | - | - | - | - | - |
| **Labour force participation rate, %** | 74.2 | 74.2 | 74.4 | 74.0 | - | - | - | - |
| **Old age dependency ratio, %** | 20.2 | 20.9 | 21.8 | 22.6 | 23.5 | 24.4 | 25.3 | 26.2 |
| **Composite governance indicator[2]** | -0.7 | -0.7 | -0.6 | -0.6 | -0.6 | - | - | - |

[1] Forecasted values are produced by Scope and may differ from those presented in the charts of the previous sections
[2] Average of the six World Bank Governance Indicators
Source: IMF, World Bank, European Commission, Scope Ratings GmbH.

## Appendix IV. Economic development and default indicators

| | |
|---|---|
| IMF Development Classification | Emerging Market and Developing Economies |
| 5y USD CDS spread (bps) as of 25 February 2022 | 570 |

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