Russian Federation
Rating Report

SCOPE CCC Under review for downgrade

Credit strengths

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

Credit challenges

- Undermined willingness to service debt to foreign investors
- 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: i) the imposition of major capital controls by the Russian authorities, raising significant questions surrounding the Russian sovereign's willingness to service its debt owed to foreign residents; ii) the severe and rapidly strengthening economic and financial sanctions from the US, EU, UK and other international partners, which is severely undermining Russia's credit fundamentals; iii) Scope's view, that the consequences of the ongoing crisis will severely undermine Russia's medium-run macro-financial stability, institutional credibility.

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		-1/3	
External Economic Risk		10%	aaa		-1/3	
Financial Stability Risk		10%	b		-3/3	CCC
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 nine-notch negative adjustment has been applied to capture: i) the imposition of major capital controls by the Russian authorities, which raise significant questions surrounding the Russian Federation's willingness to service its debt owed to foreign residents (-3 notches); ii) elevated geopolitical and sanction-related risks, the impact of severe and rapidly strengthening international sanctions on Russia's macro-financial stability (-2 notches); iii) curtailed access of the public and private sector to foreign capital and financial markets, and the impaired use of Russia's international reserves (-2 notches); and iv) weakened macroeconomic outlook, higher inflation, reduced fiscal flexibility and higher transition risks not captured by the scorecards (-2 notches).

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) Russian sovereign's willingness to service its debt in full and on time; ii) the degree of risk related to a further escalation of the geopolitical crisis and strengthening in sanctions; and iii) the resulting impact for Russia's macro-financial stability and external position.

Positive rating-change drivers

- Resumed willingness of the Russian sovereign to service its debt
- Stabilization in the current crisis curtails risks of additional sanctions
- The risks to fiscal and external finances are reduced

Negative rating-change drivers

- Further evidence of Russian sovereign's curtailed willingness to honour its debt obligations in full and on time
- Consequences of the ongoing crisis further worsen medium-run challenges
- Persistent deterioration in external liquidity and/or a significant weakening of the rouble were to further undermine the sovereign's ability to service its debt

Ratings and Outlook

Foreign and local currency

Long-term issuer rating	CCC/Under review
Senior unsecured debt	CCC/Under review
Short-term issuer rating	S-4/Under review

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Bloomberg: RESP SCOP

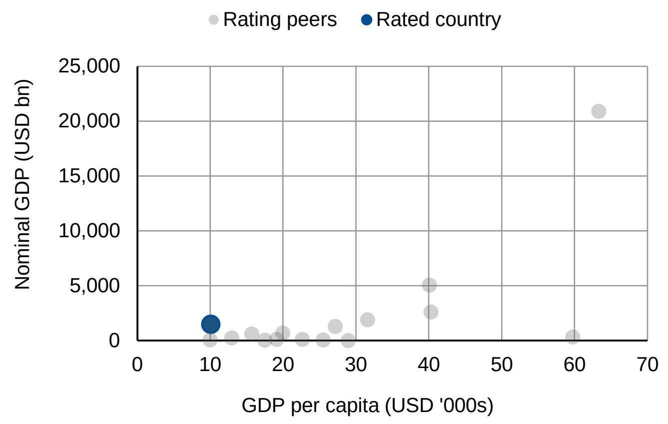
Domestic Economic Risks

- **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*

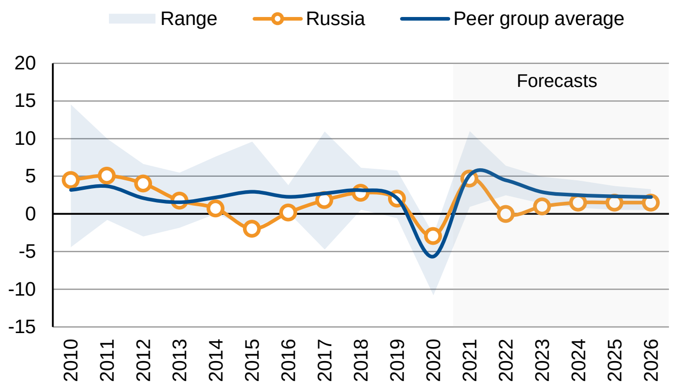
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Growth potential of the economy	Weak	-1/3	Low growth potential due to a weak investment environment and low levels of competition and innovation
	Monetary policy framework	Neutral	0	Credible central bank, commitment to 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

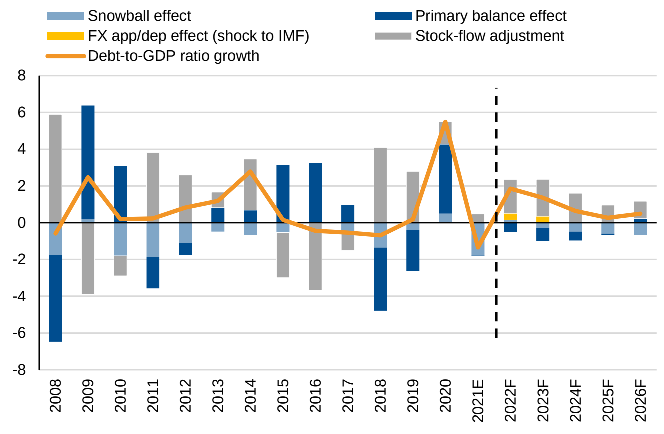
Public Finance Risks

- **Fiscal outlook:** Russia's rules-based fiscal policies to date 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*

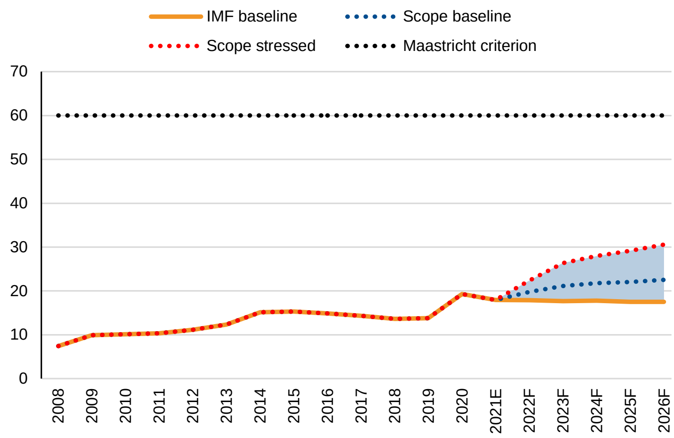
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Fiscal policy framework	Neutral	0	Prudent fiscal policy framework following the introduction of the fiscal rule
	Debt sustainability	Neutral	0	Benign debt trajectory supported by low debt levels, but constrained fiscal flexibility
	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

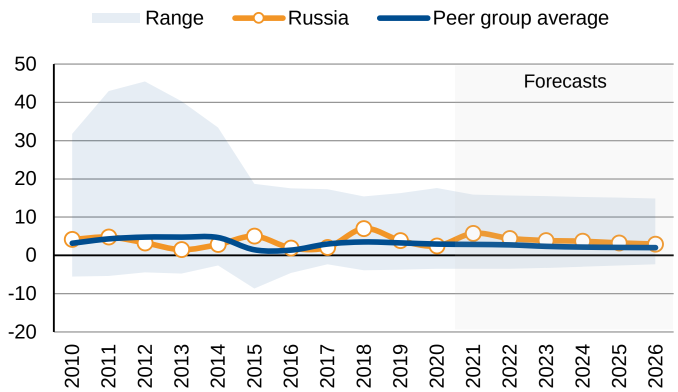
External Economic Risks

- **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. 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*

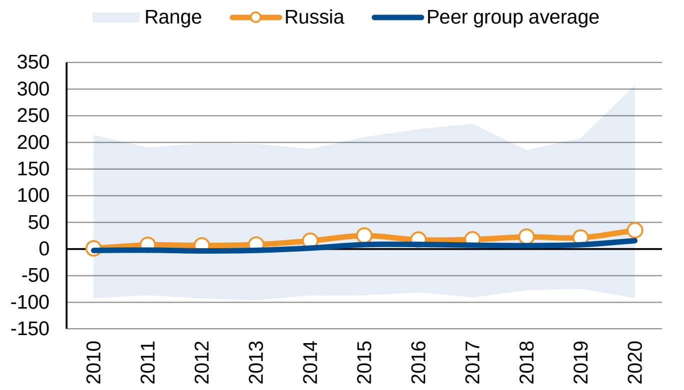
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Current account resilience	Weak	-1/3	Reliance on commodities exposes Russia to shocks
	External debt structure	Neutral	0	Low external debt but declining FDI
	Resilience to short-term shocks	Neutral	0	High foreign exchange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

Current account balance, % of GDP



Source: IMF, Scope Ratings GmbH

NIIP, % of GDP



Source: IMF, Scope Ratings GmbH

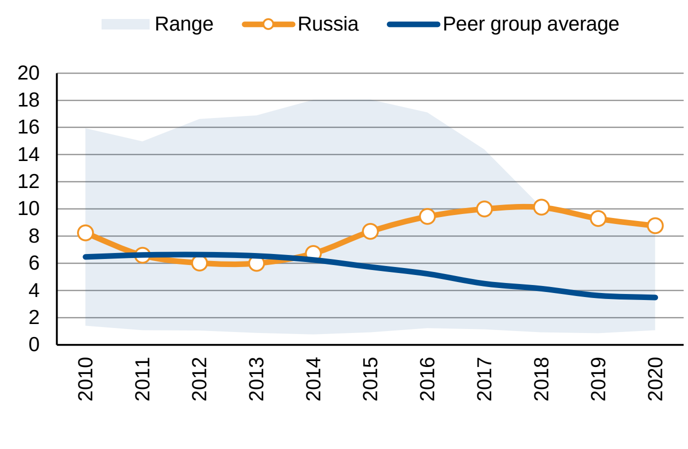
Financial Stability Risks

- **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*

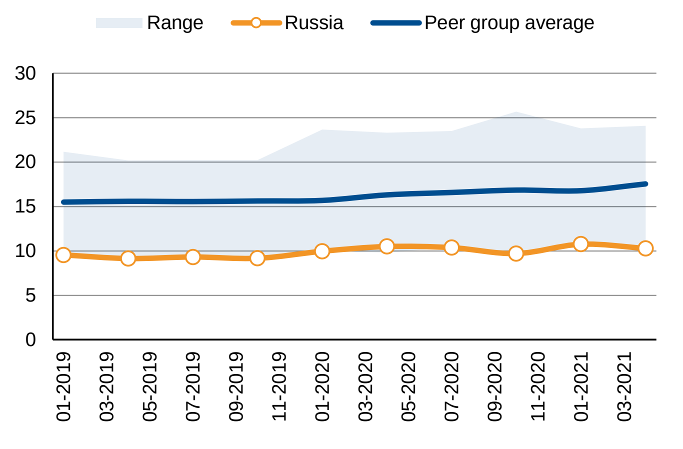
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b	Banking sector performance	Weak	-1/3	Banks' asset quality to weaken with the crisis
	Banking sector oversight	Weak	-1/3	Systemic risks
	Financial imbalances	Weak	-1/3	State's dominant role in the banking sector represents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

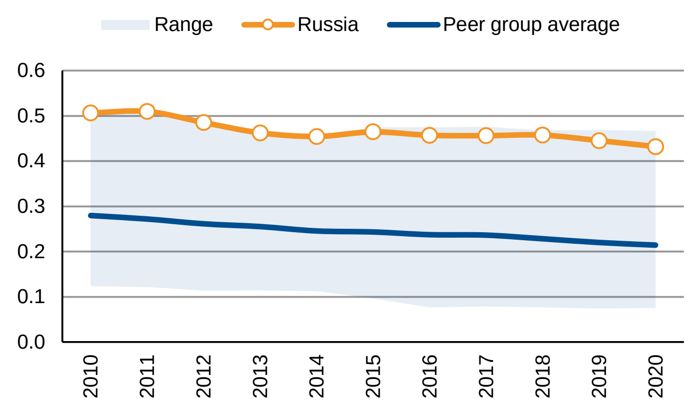
ESG Risks

- **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*

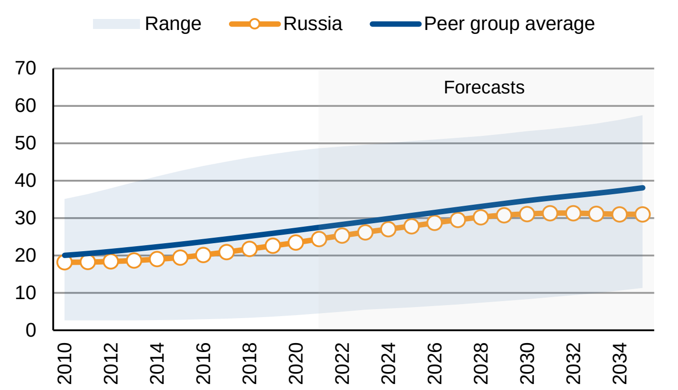
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
b-	Environmental risks	Weak	-1/3	Elevated vulnerability to transition risks
	Social risks	Weak	-1/3	Adverse demographics with a shrinking labour force, rising inequality
	Institutional and political risks	Weak	-1/3	Elevated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

CO2 emissions per GDP, mtCO2e



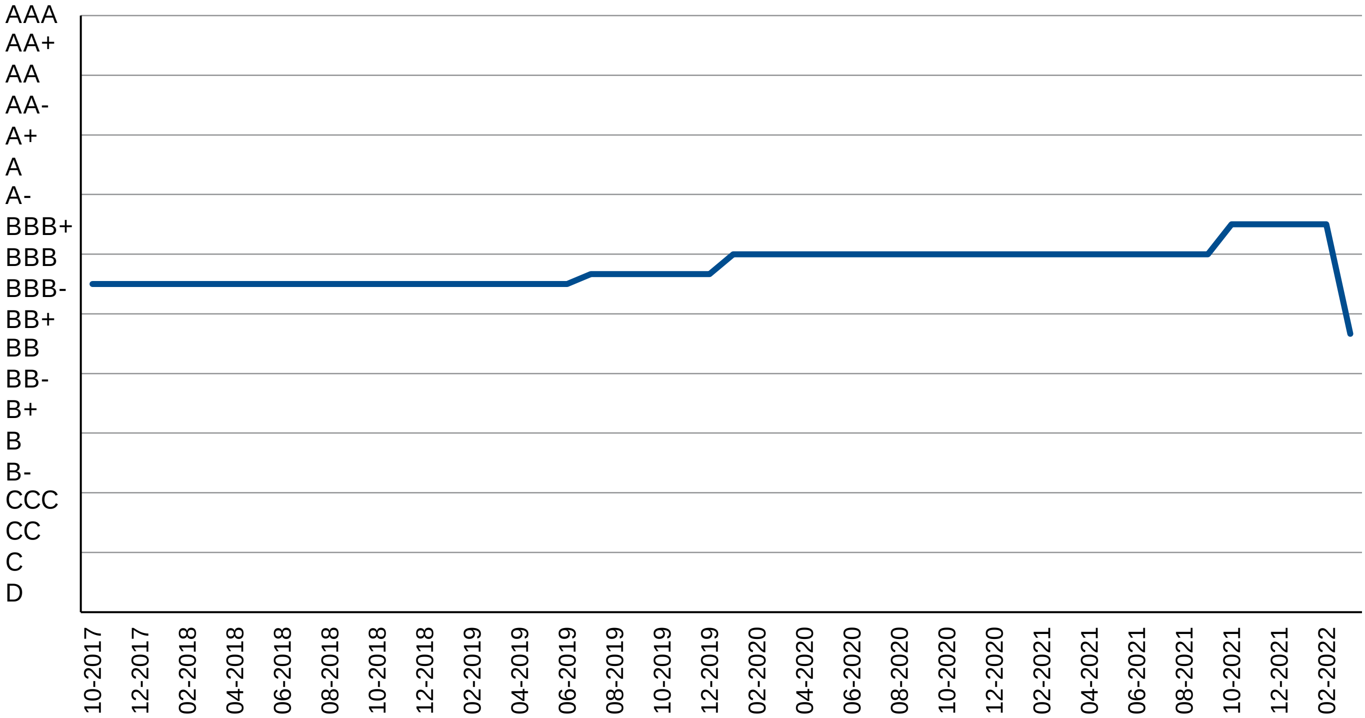
Source: European Commission, Scope Ratings GmbH

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

	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, national central bank and statistical office, 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 03 March 2022	1340

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