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Rating

| | |
|----------------------------------|---------------|
| Credit rating of the region – LC | BB |
| Outlook | Stable |
| Credit rating of the region – FC | BB |
| Outlook | Stable |

Main Economic Indicators of the Chuvash Republic

| Macro indicators | 2015 | 2016 | 2017 |
|-------------------------------------|------------|-------|--------|
| Total reg. debt, RUB bn | 16,3 | 16,4 | 16,2 |
| Nominal GRP, RUB bn | 251,3 | 261,6 | 277,4* |
| Real GRP growth, % | -2,7 | 0,6 | 0,7* |
| Total reg. debt/own cons. rev., % | 55,7 | 49,5 | 46,9 |
| Deficit (surplus)/own cons. rev., % | -9,9 | 5,0 | -1,5 |
| Total reg. debt/GRP, % | 6,5 | 6,3 | 5,8* |
| Deficit (surplus)/GRP, % | -1,2 | 0,6 | -0,2* |
| External debt, USD bn | 0,0 | 0,0 | 0,0 |
| Development indicators | 2016 | | |
| GRP per capita, RUB th | 211,6 | | |
| Default indicator | 04.05.2018 | | |
| 5Y Gov Bond Yield, % | 5,4 | | |

Source: RAEX (Europe) calculations based on data from the Government of the Chuvash Republic, Ministry of Finance of the Russian Federation, Rosstat, Chonds. *Assessment for 2017 by the government of the Chuvash Republic.

Summary

The confirmation of the credit ratings of the Chuvash Republic at 'BB' in foreign and local currency was driven by the stable development of the key rating drivers. The ratings remain positively supported by the current structure of government liabilities (with a high share of budget loans), as well as by the low share of debt servicing expenditures and the high diversification of tax revenues. However, the ratings remain restricted by a moderately high share of transfers in the budget revenues as well as low levels of personal income, per capita investments and GDP. The deterioration of the government's fiscal position in 2017 also contributed negatively to the rating assessment.

Industrial and retail sectors improved, while levels of personal income and investments remain moderately low. As mentioned in our previous reports¹, the Chuvash Republic has a medium-sized economy with moderately low level of GRP per capita as compared to the country's average and main industries oriented to the domestic market.

The key economic metrics showed mixed results during 2017 as compared to the country's average. The industrial and retail sectors, which account for 37% of the regional economy, grew by 4,4% and 2,7% respectively, as compared to a national average of 1% and 1,2%. In addition, the agricultural sector grew only by 1%, well below the national average of 2,4% (see graph 1).

After several years of slowdown, the dynamics of investments in fixed assets returned to a positive ground, growing by 1,4% in 2017 as compared to the country's average of 4,4%. However, as we mentioned in our previous report, the poor investment growth was coupled by very negative performance of the construction industry in the region during the last year. The index of construction activity stood at -16% as compared to -1,4% for the country average. In addition, the per capita level of investments in fixed capital remains significantly below the country's average and we do not expect significant improvement of this ratio in the mid-term perspective.

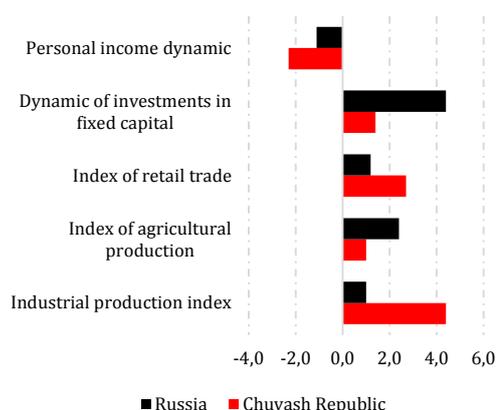
Personal income dropped for three years in a row by 2,3% in 2017 as compared to 2016. The Chuvash Republic remains within the group of the

¹ Research report on Chuvash Republic from 24 November 2017
https://raexpert.eu/reports/Research_report_Chuvash_Republic_24.11.2017.pdf

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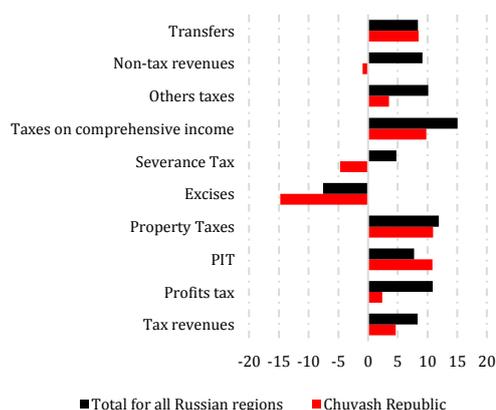
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Graph 1: Dynamic of the key economic metrics in real terms in 2017, %



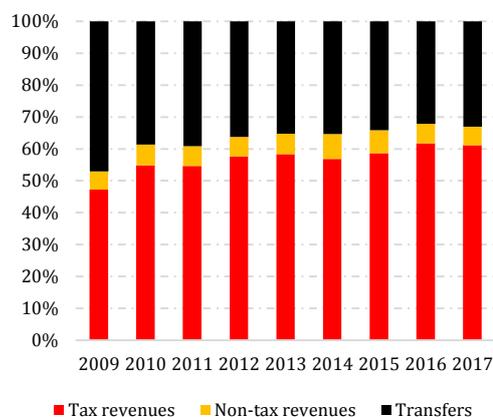
Source: RAEX (Europe) calculations based on data from the Rosstat

Graph 2: Dynamics of the key components of consolidated budget revenues in nominal terms in 2017, %



Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Russian Federation

Graph 3: The Chuvash Republic's consolidated budget revenues structure, %



Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Russian Federation

Russian regions having moderately low level of this metric as compared to the country's average. Together with the long-term demographic problems, this introduces strong risks to the sustainability of the personal income tax revenues and, therefore, on the creditworthiness assessment.

Budget revenues dynamics and structure remain favorable. The Chuvash Republic showed positive dynamics on key items of the consolidated budget revenues in 2017. Tax revenues increased by 4,6% y-o-y in nominal terms as compared to the 8,3% reported for all Russian regions (see graph 2) mostly due to the growth of corporate profit tax and personal income taxes, which together accounted for around 60% of the consolidated budget revenues. In addition, the growth of tax revenues was supported by property tax, which increased by 10,9% in 2017.

After two years of reduction, the Russian federal government provided more transfers to all Russian regions in 2017 as compared to the same period of the last year. Incoming transfers of the Chuvash Republic's consolidated budget increased by 8,5% in this period, which led to the increase of the transfers' share in total revenues of the region (see graph 3). The Agency expects the Chuvash Republic's dependence on funds from the higher budget tier to remain elevated in the mid-term despite the positive dynamics in the previous years.

In addition, the structure of tax revenues of the consolidated budget keeps positively affecting the regional creditworthiness with no tax type representing more than 50% of total tax revenues.

Expenditures structure and the quality of budget management support the region's creditworthiness, while the fiscal position deteriorated. After two years of reduction, the regional authorities substantially increased its public spending in 2017. Total spending of the consolidated budget of the Chuvash Republic raised by 10,3% in nominal terms as compared to 2016, while total spending of all Russian regions increased only by 8,8%. This affected the budget's balance, which returned to negative in 2017 and stood at -1% of total revenues of the consolidated budget or -1,5% of its own revenues in this year². The Agency considers that such a negative trend restrains the creditworthiness assessment of the region.

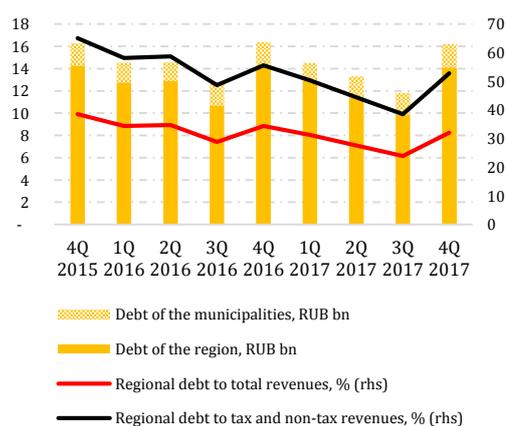
However, according to the Agency's assessment, the region kept a favorable budget expenditures structure with the share of CAPEX at 11,4% of total expenditures of the consolidated budget in 2017 as compared to 12,2% for accumulated budgets of all Russian regions and

² Total regional revenues consist of tax, non-tax revenues and transfers from other levels of budgetary system; regional own revenues include only tax and non-tax revenues.

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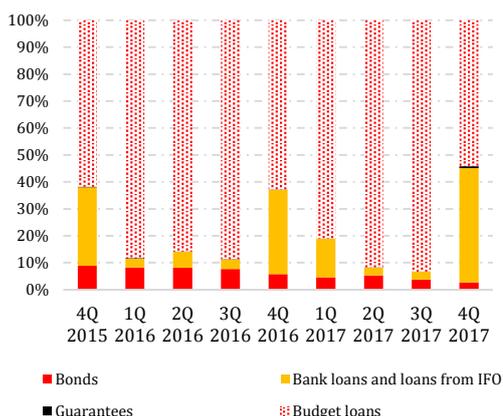
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Graph 4: The Chuvash Republic's debt metrics



Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Russian Federation

Graph 5: The Chuvash Republic's debt structure



Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Russian Federation

8% median for the same year. This creates an additional space for the regional government to cut expenditures in case of a drop in revenues and, therefore, partly offsets the risks of debt increase.

In addition, according to the recent results of the assessment by the Ministry of Finance of the Russian Federation regarding the quality of the regional budget management for 2016, the Chuvash Republic was described as a region with “high quality of budget management”. This assessment is an improvement as compared to 2015 when it was categorized as “proper quality”.

Debt load remains moderate despite the positive dynamics, while the structure of debt is favorable. The Chuvash authorities supported the declining trend of the debt level during 2017, which led to the total amount of consolidated debt of the region (the sum of debt of the regional and municipal authorities) to decrease by 1% as compared to the beginning of the year (see graph 4).

This favored the improvement of key debt metrics, as the ratio of the consolidated region's debt to total revenues dropped from 33,6% in 2016 to 31,5% in 2017 and the ratio of consolidated region's debt to own revenues declined from 49,5% to 46,9% for the correspondent periods. The Agency considers this as a positive trend. Both metrics are substantially above the aggregated figures for all Russian regions³ at 25% and 30%, however remained below the median levels for regions in 2017 – 38% and 51%. Therefore, the current debt load of Chuvash Republic is considered as moderate.

The debt load remains mitigated by the low share of debt servicing expenditures in total expenditures and the favorable creditors' structure. The share of debt servicing expenditures was as low as 0,6% in 2017, as compared to 1,2% country average figures. Around 55% of the debt as of 4Q 2017 was formed by the loans issued by the Ministry of Finance of the Russian Federation or Treasury, which are the objects of restructuring⁴ and have a non-market interest rate (see graph 5).

According to the Agency opinion, this share is likely to increase within the current year. The substantial hike of the share of bank loans by end of year has a seasonal effect, related to the specific of Russian local public debt regulation. The Russian regions cannot use short-term treasury loans in December, and therefore have to attract more commercial loans, which are usually payed during 1H of next year with funds obtained from soft

³ The sum of the consolidated debt of all Russian regions divided by the sum of total and own revenues respectively.

⁴ In accordance with the decision of the Ministry of finance of the Russian Federation (MFRF) done in 2017, the interbudget loans to the Russian regions will be restructured the following way. Regardless the maturity structure of the loans (excluding the targeted loans), only 5% of the accumulated debt to the MFRF shall be paid in 2018 and 2019, 10% in 2020, and 20% starting from 2021 on yearly basis.

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loans granted by the Treasury. Therefore, the regional government can substantially reduce its debt servicing expenses.

Finally, absence of FX-liabilities and strict payment discipline supported the creditworthiness assessment of the Chuvash Republic.

Important note for regional ratings

This research report shall be treated as a supplementary part of the published press-release included in the following link:

https://raexpert.eu/reports/Press_release_Chuvash_Republic_18.05.2018.pdf

Both documents shall be treated as essential parts of each other.

For further information on the factors, their weights, methodologies, risks and limitations of these ratings, and other regulatory disclosures, please refer to the press-release and the website of the Agency.

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