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Rating

Credit rating of the region
Outlook

BB
Stable

Main Economic Indicators of Chuvash Republic

Macro indicators	2014	2015	2016
Total reg. debt, RUB bn	14,1	16,3	16,4
Nominal GRP, RUB bn	237,4	250,4	259,6*
Real GRP growth, %	0,2	-2,7	0,2*
Total reg. debt/own cons. rev., %	49,0	55,7	49,5
Deficit (surplus)/own cons. rev., %	-11,7	-9,9	5,0
Total reg. debt/GRP, %	5,9	6,5	6,3*
Deficit (surplus)/GRP, %	-1,4	-1,2	0,6
External debt, USD bn	0,0	0,0	0,0
Development indicators	2015		
GRP per capita, RUB th	202,4		
Default indicator	21.06.2017		
5Y Gov Bond Yield, %	8,1		

Source: RAEX (Europe) calculations based on data from the Government of Chuvash Republic, Ministry of Finance of the Russian Federation, Rosstat, Cbonds. *Forecast for 2016 by the government of Chuvash Republic.

Summary

The 'BB' rating of Chuvash Republic is positively supported by the Region's positive fiscal performance in 2016, adequate structure of government liabilities with a high share of budget loans, as well as by the low share of debt servicing expenditures and high level of tax revenues diversification. However, the rating was restricted by the elevated debt load and moderately high share of transfers in budget revenues. In addition, most of the macroeconomic factors, such as the level of economic development, personal income and investments negatively affected the creditworthiness of the region.

Moderately low level of economic development combined with high volatility of the economy have an adverse effect on the regional tax base. Chuvash Republic has a medium-sized economy as compared to other Russian regions. In 2015, the gross regional product (GRP) was equal to 0,4% of the total sum of Russia's GRPs. In addition, the region is characterized by a moderately low level of economic development as shown by GRP per capita at RUB 202 th in 2015, which equaled 45,5% of the average national level.

The structure of the regional economy is concentrated in manufacturing and agriculture which together account for more than 40% of Chuvash GRP (see graph 1). Most of the manufacturing sector is dominated by the chemical industry and the production of agricultural machinery (tractors and related equipment). Both industries are oriented on the domestic market and are heavily exposed to the country's macroeconomic conditions, as shown by the industrial production index dynamic over the last years. In addition, the local industrial and agricultural sectors are mostly pro-cyclical and characterized by a lack of export-oriented enterprises. Thus, the Region's economy, as compared to the country's average dynamic, is substantially more volatile during periods of economic growth as well as in periods of economic deceleration (see graph 2), which ultimately affects the tax base stability negatively.

Demographics and personal income restrict the rating assessment.

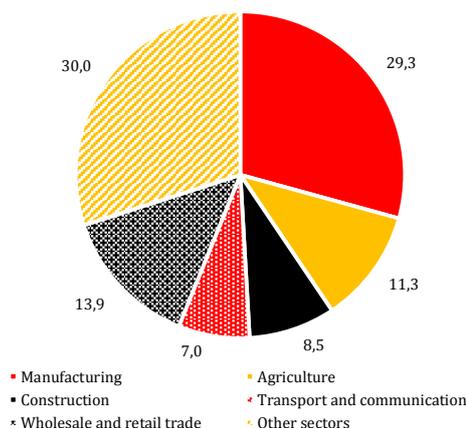
The current age structure of the region's population is close to the country's average with the share of people older than 65 standing around

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Graph 1: Structure GRP in 2015, %



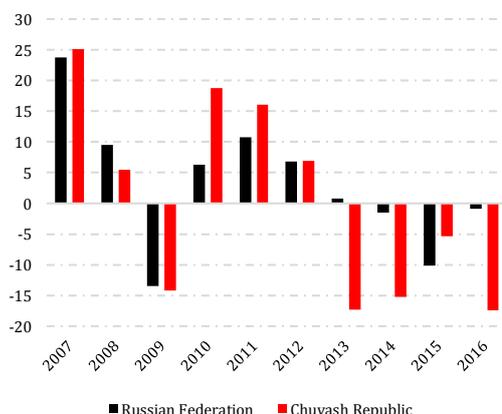
Source: RAEX (Europe) calculations based on data from the Rosstat

Graph 2: Real GRP dynamics, y-o-y, %



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

Graph 3: Dynamics of investment in fixed capital in real terms, y-o-y, %



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

24% of total population as of 2015. In addition, the dependency ratio¹ was equal to 74,1% in 2015, close to the country's average during the same period. However, this ratio has been growing at a pace higher than the national average over the last years, and we expect it to exceed Russia's average level within the following years. As a result, this is likely to introduce pressure on the regional budget through the need of additional expenditures on the social and health care infrastructure.

Chuvash Republic is also characterized by a moderately low level of nominal wages and personal income as compared to its national peers. In 2016, the average monthly nominal salary per employee in the region was equal to RUB 22,7 th or 61% of the country's average, while net personal income amounted to RUB 17,7 th, which represented 57,7% of the country's average. In real terms, the average salary grew by 1,2% in 2016, while the net personal income dropped by 8,3% in the same period. In addition, the region is characterized by an elevated share of social payments in the structure of personal income (24,6% as compared to 18,3% country average). All this has an adverse effect on the personal income tax base, and therefore restricts the creditworthiness assessment.

Low current and historical levels of investments negatively affected the region's creditworthiness. In 2016, Chuvash Republic received only 0,3% of Russia's total investments in fixed capital, occupying the 62nd position out of 85 regions. Furthermore, per capita volumes of investments are significantly below the average level which was 40,2% in 2016. The real volume of fixed capital investments declined in 2016 for the fourth year in a row (see graph 3). This restrains the potential economic growth and increases the risk of need of additional public spending on infrastructure in the future. Therefore, this factor has a strong adverse effect on the assessment of the region's creditworthiness.

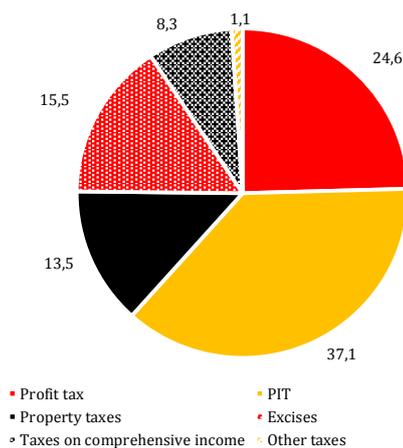
Dynamics of tax revenues and its structure are positive, but dependence on another budget tier is still high. Chuvash Republic showed a substantial increase in the consolidated budget revenues in 2016 with a y-o-y nominal growth rate of 10% as compared to a 6,6% increase of all Russian regions' revenues. Such a positive dynamic was mostly driven by tax revenues, which grew by 15,7% in nominal terms. The key drivers of this dynamic were corporate profit tax and excises, which increased by 36% and 37% y-o-y respectively due to better performance of the financial and chemical industries of the region, as well as due to implementation of the new methods to control the volumes of

¹ Dependency ratio is a measure which shows the number of dependents (aged 0-14 and over the age of 65) to the total population aged from 15 to 64.

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Graph 4: Structure of tax revenues, % of total



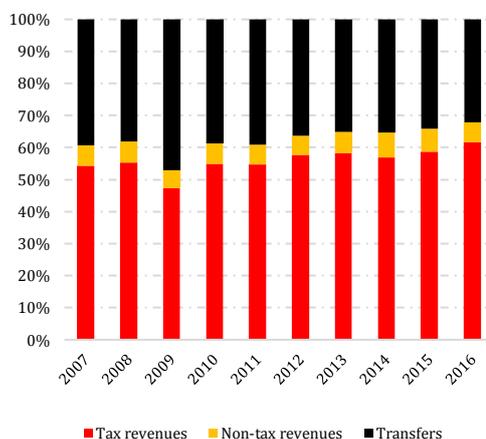
Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Russian Federation

alcohol production². In addition, the volume of personal income tax transferred to the regional budget increased by 5,1%. The three aforementioned taxes formed accounted for 77% of tax revenues in 2016 (see graph 4).

The overall structure of tax revenues of Chuvash Republic is assessed positively by the Agency due to the fact that none of the taxes represented more than 50% of total tax revenues, and the key tax payers are attributed to different industries with different market risks exposure. In addition, the ten largest tax payers accounted for around 25% of taxes collected on the territory of the region at all budget tiers.

Chuvash Republic is still characterized by an elevated share of transfers from the higher budget tier and, therefore, the region has high self-financing risks. These funds amounted to 32,1% of consolidated budget revenues as compared with 16,5% for aggregated regional budgets. However, these shares have shown a long-term declining trend over the last years, which is considered as a positive factor by the Agency (see graph 5).

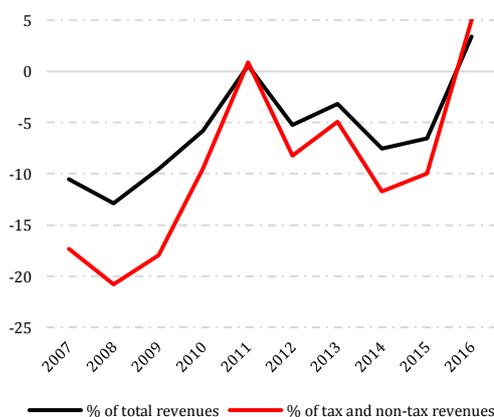
Graph 5: Consolidated budget revenues structure



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

Significant fiscal surplus with favorable expenditures structure and good quality of budget management. In 2016 the government of Chuvash Republic continued to consolidate its budget as evidenced by the decrease of total expenditures by 0,3% y-o-y in nominal terms. In combination with the revenues dynamic, it resulted in a fiscal surplus of 3,4% and 5,0% relative to total and own revenues respectively. This is considered as a significant improvement, taking into account a 2015 deficit of 6,6% and 10% respectively (see graph 6).

Graph 6: Consolidated budget deficit dynamics



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

The Region has a favorable budget expenditures structure, with the share of CAPEX at 13% of total expenditures of the consolidated budget in 2016 as compared to 12,6% for accumulated budgets of all Russian regions. The share of salaries and other related payments was as low as 6,2% for the same period as compared to average of 10%. This creates 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.

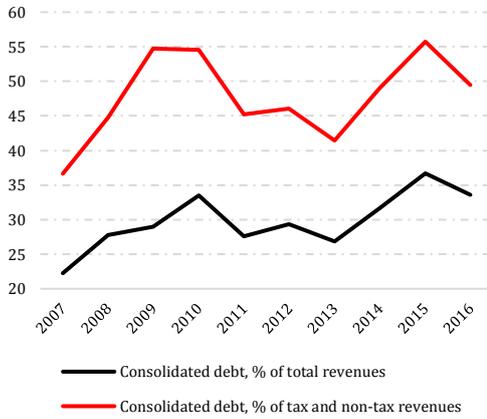
In addition, the quality of the regional budget management also positively influenced the rating assessment as Chuvash Republic was considered a region with an “acceptable quality of budget management” by the Ministry of Finance of the Russian Federation in its 2015 results assessment.

² One of the largest taxpayers in Chuvash Republic are beer-producers. The federal government of Russia obliged all producers of alcoholic products to implement new system of controlling the volume of production, in order to avoid underestimation of it and therefore underestimation of excises payable to the regional budgets.

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Graph 7: Debt metrics



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

Elevated levels of regional debt mitigated by its favorable structure and low debt servicing expenses. The current debt load of Chuvash Republic is elevated as evidenced by the ratio of consolidated region's debt to total revenues and own revenues at 33,6% and 49,5% respectively, as compared to average country levels of 27,4% and 32,8% (see graph 7). However, the fact that debt load growth rate declined as the regional government lowered its level of new debt issue supported the rating assessment. In that year the consolidated region's debt grew only by 0,6% y-o-y in nominal terms, while a year ago and in 2014 it increased by 15,7% and 21,5% respectively.

At the same time, the elevated debt metrics are 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 0,8% in 2016, as compared with 1,5% country average figures. In addition, more than 60% of the debt is formed by the loans issued by the Ministry of Finance of the Russian Federation, which are mostly long term and can be rolled over or restructured with high probability. In addition, all liabilities of the region are nominated in RUB, eliminating any currency risks. Furthermore, the region is characterized by a strict payment discipline, with no overdue payments recorded in the last five years, and a long history of bonds' issuance on the open market.

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_23.06.2017.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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