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## Introduction

After the 2014 economic turmoil, which followed a sharp drop in oil and gas prices, Russian authorities adjusted the fiscal budget at the beginning of 2015 according to the projected, lower but stable, oil market prices. This stable outlook vanished after the oil price dropped in the face of the newly arranged US-Iran agreement (which allows the latter country to increase world-oil exports) as well as the recent slow-down of the Chinese economy. The still heavy dependence of Russian fiscal revenues on oil price calls for keeping a close look on devaluation and price increase these days. Even though the Russian fiscal balance deteriorated significantly and foreign-currency-denominated debt increased as a result of a devaluation side-effect, the country's debt load remained bearable in 2014. Western sanctions and Russian countersanctions were additional drivers of the external position deterioration and poor economic performance of Russia during the year 2014.

## Main Economic Indicators of Russia

Macro indicators	2012	2013	2014
Gross pub. debt, bill Rub	7871	9286	10914
Nominal GDP, bill Rub	62147	66194	71406
Real GDP growth, %	3,4	1,3	0,6
Gross gov. debt/GDP,%	12,7	14,0	15,3
Deficit (surplus)/GDP,%	0,4	-1,3	-1,2
Inflation rate,%	6,6	6,5	11,4
Curr. Account balance/GDP,%	0,0	6,1	10,6

Development indicators	2014
Inequality adj. HDI	0,68
GDP per capita (Thou. of USD)	24,8

Default indicator	07.08.15
5-Year CDS spread (Bp)	345
10Y Gov Bond Yield, %	11,1

Sources: RAEX (Europe) calculations based on data from IMF, Ministry of Finance of Russia, Rosstat

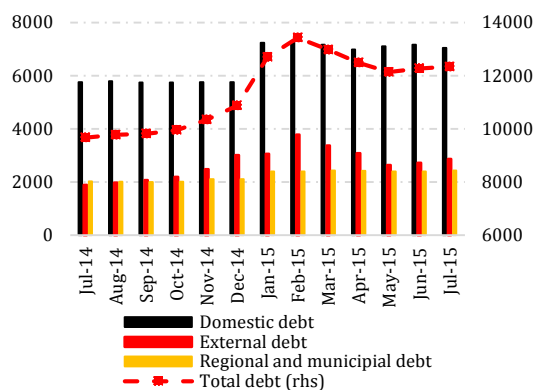
**Gross government debt of the Russian Federation remains at tolerable levels.** Despite total government debt having increased by 17,5% from 9 285 billions of Rubles in 2013 to 10 914 billions of Rubles in 2014, debt indicators remained at bearable levels as gross government debt represented 15,3% and 40,8% of GDP and fiscal revenues respectively by the end of 2014. The main driver of debt load increase in 2014 was external debt, which jumped from 1 885 billion RUB in 2013 to 3 057 billions of Rubles by the end of 2014 as a result of the harsh devaluation of the Russian currency over the second half of the year. The decline of external debt following the appreciation of the RUB against the USD during the first half of 2015, was compensated by a jump in the domestic debt, which contributed to an overall increase of the total government debt up to 12 338 billions of Rubles by July 2015 (see graph 1). Short-run risks remain negligible with short-term debt accounting for 2,5% of GDP and 6,7% of budget revenues in 2014. In contrast, the high long-term exposure is evidenced by the yield on 10-year government bonds (RUGE10Y), which amounted to 10,8% by the end of July 2015. Such a high yield resulted from the high uncertainties on the outlook of the Russian economy among international and local investors.

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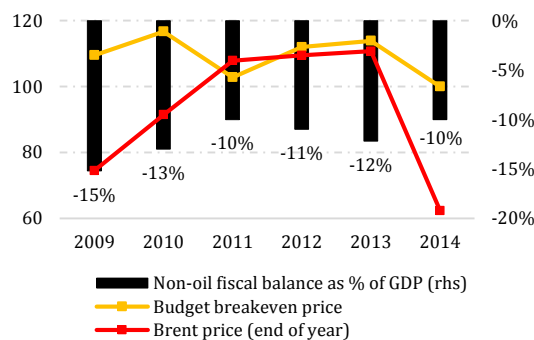
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**Graph 1: Break-down of Russian government debt (bill of RUB)**



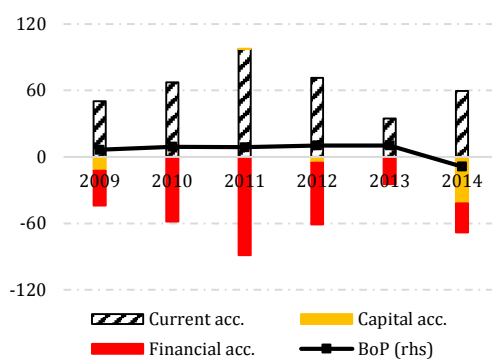
Source: RAEX (Europe) calculations based on data from the Ministry of Finance of Russia and CBR

**Graph 2: Non-oil fiscal balance performance**



Source: RAEX (Europe) calculations based on data from IMF and Deutsche Bank Research

**Graph 3: Russian balance of payments (Bill USD)**



Source: RAEX (Europe) calculations based on data from CBR

**Government's heavy reliance on oil revenues raises concern in the face of the recent drop in oil prices.** Diverting from the preliminary data provided in our previous research report<sup>1</sup>, the actual consolidated Russian deficit reached 846 billions of Rubles in 2014, representing 1,2% of GDP in that year and a slight decrease compared with 2013 figure (848 billions of Rubles). However, it is worth highlighting that consolidated deficit figures include taxation on oil and gas activities. In that sense, when the non-oil fiscal balance (excluding revenues from oil and gas taxation) is considered, the whole picture looks more disturbing (see graph 2). Non-oil fiscal balance showed a deficit of 10% of GDP in 2014 and is projected to keep such a trend in the years to come as Russia's dependence on oil and gas<sup>2</sup> is likely to remain in place and projected break-even price for oil stands around 100 USD/bbl. (more than twice the current price).

**Russia's external position has deteriorated in 2014, despite positive contributions from countersanctions on the trade balance.** The final impact of western sanctions and countersanctions on the Russian economy was clearly depicted by the 2014 balance of payments figures. As expected, Russian counter-sanctions on EU imported goods contributed to a rebound of the Russian current account, which totaled 59,5 billions of USD by the end of 2014 (see graph 3). However, the negative outcome recorded by the balance of payments (-8,7 billions of USD by the end of 2014) was mainly driven by the net loss in the capital account which suffered a sharp decline from -0,4 billions of USD in 2013 to -42 billions of USD by the end of 2014. Such a significant loss is explained by the large outflow of capital which took place in Russia after the strong devaluation of the Ruble in the second half of 2014. In an effort to prevent a speculative attack and further devaluation of the Ruble, the Central Bank of Russia (CBR) lost in 2014 over 112 billions of USD from its foreign exchange reserves (24% of the amount it had at the end of 2013).

**Recent decline in oil prices introduces risk of devaluation and further price increase.** Since October 2014 the consumer price index (CPI) has shown a positive trend as a consequence of lagged effects of Russian counter-sanctions on EU imported goods as well the sharp devaluation of the Ruble which followed the drop in world-oil prices (see

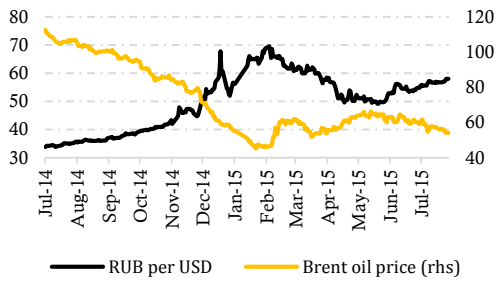
<sup>1</sup> Research report on Russia 13th of February, 2015 ([http://raexpert.eu/reports/Research\\_report\\_Russia\\_13.02.2015.pdf](http://raexpert.eu/reports/Research_report_Russia_13.02.2015.pdf)). Preliminary assessment based on the execution of consolidated budget as of 01.12.2014.

<sup>2</sup> Export sales of crude oil, petroleum products, and natural gas accounted for 68% of Russia's total export revenues in 2013, based on data from Russia's Federal Customs Service. Oil and natural gas activities make up a large portion of Russia's federal budget. According to the Ministry of Finance, 50% of Russia's federal budget revenue in 2013 came from mineral extraction taxes and export customs duties on oil and natural gas.

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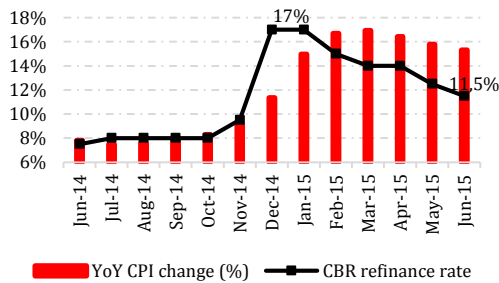
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**Graph 4: Exchange rate vs. Oil price**



Source: RAEX (Europe) calculations based on data from EIA and CBR

**Graph 5: Inflation rate vs. CBR refinancing rate**



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

graph 4). In order to face such a positive trend in prices, the CBR increased its refinancing rate, reaching a maximum of 17% by December 2014 (see graph 5). After oil prices stabilized and exchange rate trend became negative during the 1Q 2015, the CBR implemented a policy aimed at reducing the refinancing rate gradually (reaching 11,5% by June 2015). The recent US-Iran agreement, which among other factors will allow the latter country to increase oil supply globally, combined with negative prospects for the Chinese economy fueled a further drop in oil prices since May 2015. If this trend remains in place, a new devaluation and price increase could take place.

### Conclusion

The country's heavy dependence on oil revenues, devaluation and price increase risks still stand as the factors which determine the creditworthiness of Russia. While gross government debt and consolidated fiscal balance remain at tolerable levels, non-oil fiscal deficit represents the main matter of concern for the Russian government. If decline in the oil price persists during 2015, this could ultimately fuel a further devaluation of the Ruble and push Russia to another year of poor economic performance.

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