

FINANCIAL MARKETS IN RUSSIA AND CIS: VOLATILITY, RISK, POTENTIAL

Cbonds CIS and Baltics Bond Congress

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Sochi June 19, 2014

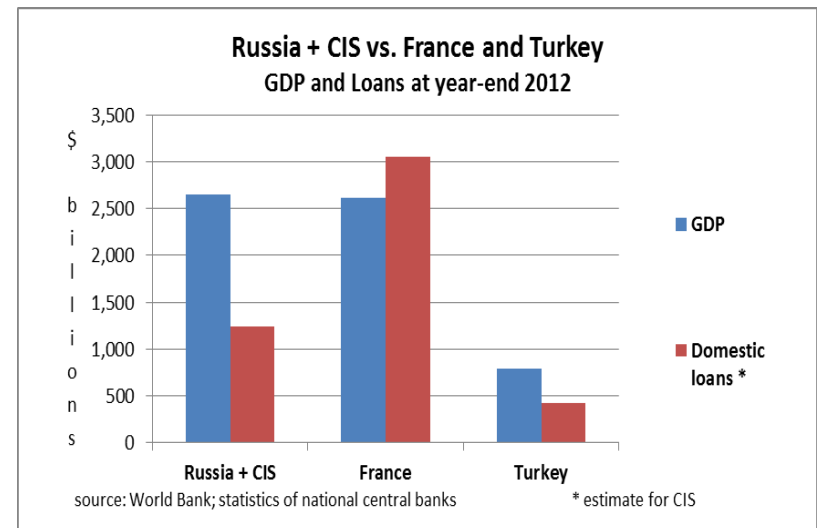
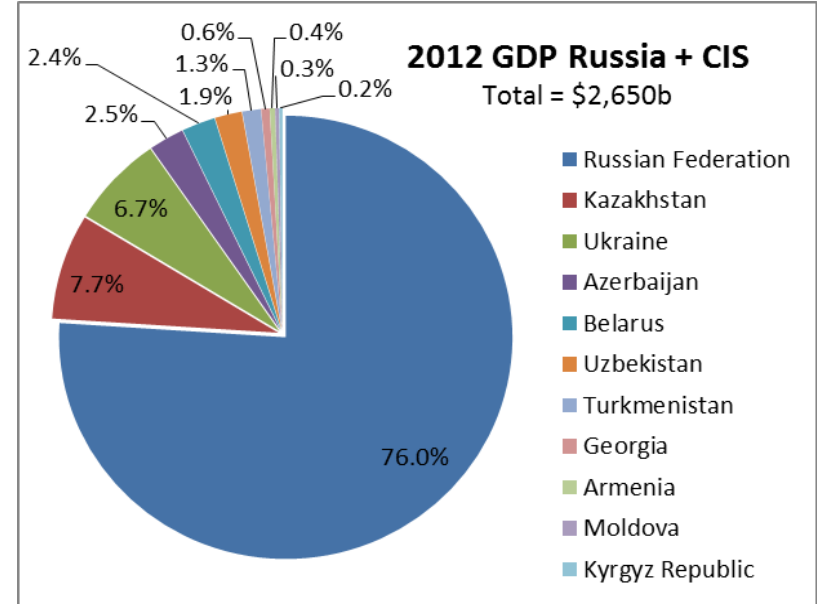
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GDP and Loans of Russia and CIS

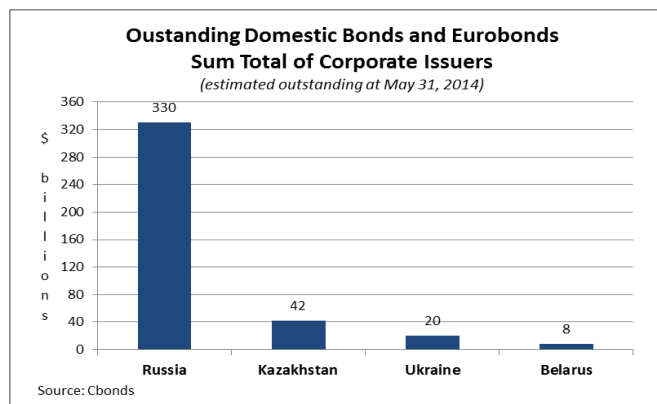
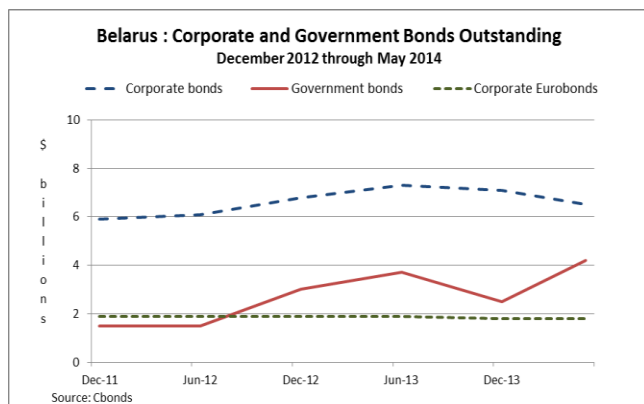
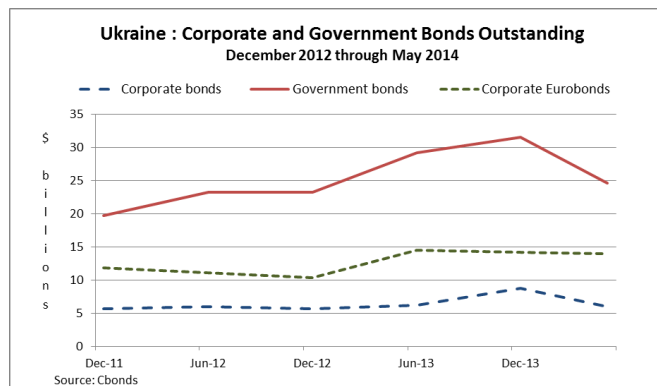
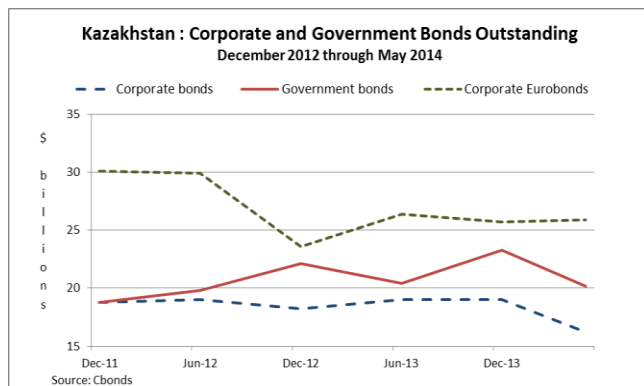
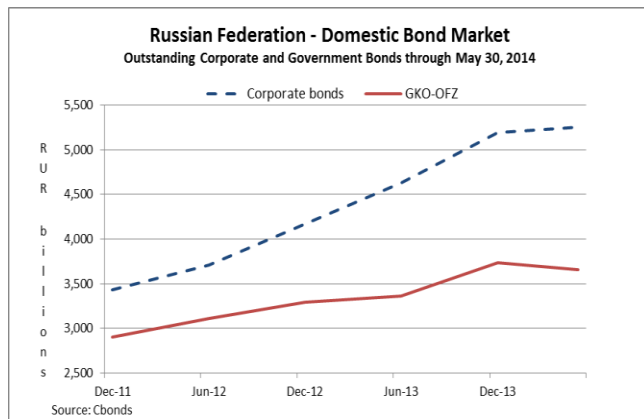
- Russia dominates region
- GDP of Russia + CIS about the same as France
- Loans to GDP for Russia + CIS approximately 47% in 2012 (versus 117% for France)
- Long-term growth prospects better for Russia + CIS

Key Question: What is debt capacity of region?

Gross Domestic Product in 2012 (US\$ billions)		as % of total CIS	Domestic loans at year-end 2012
Russian and CIS			
Russian Federation	2,015	76.0%	983
Kazakhstan	204	7.7%	81
Ukraine	176	6.7%	116
Azerbaijan	67	2.5%	16
Belarus	63	2.4%	17
Uzbekistan	51	1.9%	6
Turkmenistan	35	1.3%	
Georgia	16	0.6%	
Armenia	10	0.4%	
Moldova	7	0.3%	
Kyrgyz Republic	6	0.2%	
Total CIS	2,650	100.0%	1,240*
France	2,611		3,055
Turkey	789		430
World	72,682		
<i>Russia+CIS = 3.65% of World economy in 2012</i>			
Baltics			
Lithuania	42		
Latvia	28		
Estonia	22		
source: World Bank *estimate for CIS			



Trends in Domestic and Cross-Border Bonds: Russia and CIS



- Russia is by far the largest issuer
- Growth in domestic bonds and Eurobonds stopped by Ukrainian crisis
- Rapid growth in Russian domestic corporate bonds and Russian corporate Eurobonds in 2012-2013
- Bond markets of other major CIS countries were flat for the two years prior to the Ukrainian crisis, and down since

Creditworthiness of Russian Government Influences Credit Profile of all Public and Private Sector Entities in Russia (and some in CIS): Standard & Poor's

S&P: BBB-/Negative

- Outlook on S&P's rating of Russia to negative March 20, 2014. **Downgrade of sovereign rating to BBB- on April 25, 2014.** Sovereign *outlook remains negative*.
- **Rational for downgrade:** capital outflows and risk of deterioration in external financing. **Trends that could lead to further downgrade:** Weaker growth, reduced monetary policy flexibility, weakening of Russia's net external position
- S&P projects real growth in GDP to average 2.3% in 2014-2017, with significant downside risk of growth falling below 1% in 2014.
- Inflationary pressures, fiscal dependency on commodity receipts are negative factors. **S&P estimates that the average annual oil price needed to balance the 2014 budget is \$110.**
- Several **State-Controlled Enterprises (SCEs)** downgraded (e.g. Gazprom, VTB Bank) as a result of the sovereign downgrade and S&P's Government Related Entity methodology

- Outlook on **systemically-important private sector banks** (Alfa Bank and Promsvyazbank) revised to negative on April 28, following the sovereign downgrade.
- Seven **foreign-owned banks downgraded** on April 29, 2014, due to sovereign downgrade
- Trends on Industry Risk and Economic Risk of banking sector changed to negative on June 4, 2014. As a result, outlook revised to negative on majority of Russian private sector banks due to these trends.

S&P			
Bank	Rating action in 2014	Ratings before action	Current Ratings
Sberbank of Russia	-	NR	NR
VTB Bank	28 April 2014	BBB/Negative	BBB-/Negative
Gazprombank	26 March 2014	BBB-/Stable	BBB-/Negative
Gazprom OAO	26 March 2014	BBB/Stable	BBB/Negative
	28 April 2014	BBB/Negative	BBB-/Negative
OAO Lukoil	26 March 2014	BBB/Stable	BBB/Negative
	29 April 2014	BBB/Negative	BBB-/Negative

Creditworthiness of Russian Government Influences Credit Profile of all Public and Private Sector Entities in Russia (and some in CIS): Moody's

Moody's Baa1/Rating under Review

- **Placed Russia's sovereign Rating Under Review (RUR)** for downgrade on March 28, 2014
- The RUR action was triggered by **weakening of Russia's economic strength and upward revision in assessment of Russia's susceptibility to event risk**, owing to heightened geo-political risk implied by the potential for conflict in Ukraine to escalate further. Conflict with Ukraine and related uncertainty over future policy actions weigh on Russia's **already impaired investment climate and medium-term economic outlook**.
- To resolve the RUR, Moody's will assess financial, diplomatic and political consequences of the Ukrainian crisis and estimate the extent to which they will materially undermine Russia's medium term economic strength, whether by further discouraging foreign investor sentiment, undermining exports or further weakening domestic consumption and investment.
- **RUR likely will be resolved toward the end of July 2014**, when Moody's next committee review of the Russian Federation is scheduled.

- Moody's projects real GDP contraction of 1% in 2014.
- Moody's also placed state-controlled enterprises under review for possible downgrade (e.g. Gazprom, VTB Bank)
- **Credit Outlook for CIS Sovereigns Negatively Affected by Russia/Ukraine Crisis** due to the economic and political ties between Russia and CIS countries.

Moody's			
Bank	Rating action in 2014	Ratings before action	Current Ratings
Sberbank of Russia	1 April 2014	Baa1/Stable	Baa1/RUR*
VTB Bank	1 April 2014	Baa2/Stable	Baa2/RUR*
Gazprombank	1 April 2014	Baa3/Stable	Baa3/RUR*
OJSC Gazprom	1 April 2014	Baa1/Stable	Baa1/RUR*
OAOLukoil	-	Baa2/Stable	Baa2/Stable

Creditworthiness of Russian Government Influences Credit Profile of all Public and Private Sector Entities in Russia (and CIS): Fitch

Fitch: BBB/Negative

- Changed the rating Outlook of Russia to negative March 21, 2014. Long term IDR affirmed at 'BBB'. **Rational for Outlook change:** Potential impact of sanctions on Russia's economy and business environment
- Russia's sovereign rating would be sensitive to a weakening in the balance of payments that led to a substantial fall in reserves. Reserves fell 4.6% to USD486bn in the first quarter. Russia is also exposed to commodity price shocks. Oil and gas revenues account for half of federal government revenue and current external receipts
- High capital outflows in the first quarter of 2014 highlight a key risk to Russia's economy and sovereign credit profile. Fitch has negative outlook towards Russia's Market Access ability, Political Risk and Business Environment & competitiveness.
- Fitch cut its 2014 growth forecast to slightly below 1%**, with downside risks if investment continues to decline at the same rate as in the first quarter.
- Outlooks on supported state-owned and private sector banks and state-owned corporations changed to negative.**
- Banks' capital cushions are thinning, lending growth is slowing from high levels and non-performing loans have begun to rise, reversing post-crisis falls. Outlook on foreign-owned banks to negative due to negative outlook on country ceiling.
- Silver lining:** Current account surplus widened to USD27.6bn at end-1Q14 from USD24.3bn a year earlier as:
 - Imports dropped faster than exports following currency depreciation
 - Apparently resilient Consumer confidence, unlike business confidence

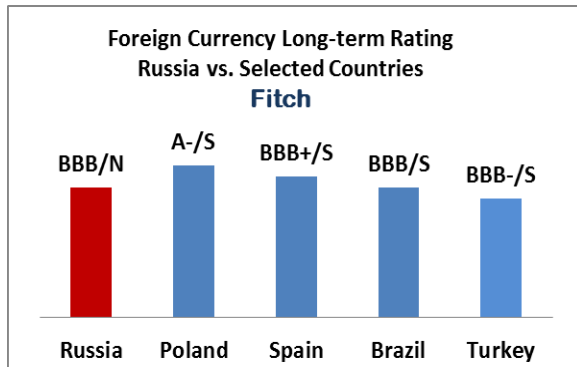
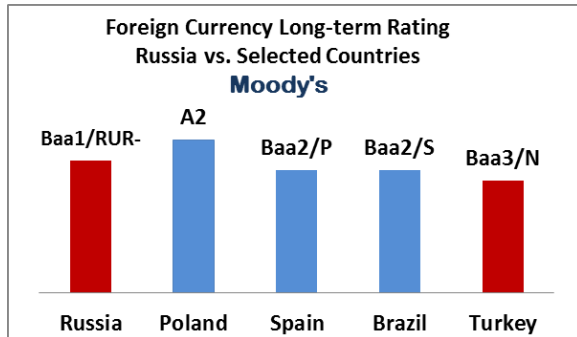
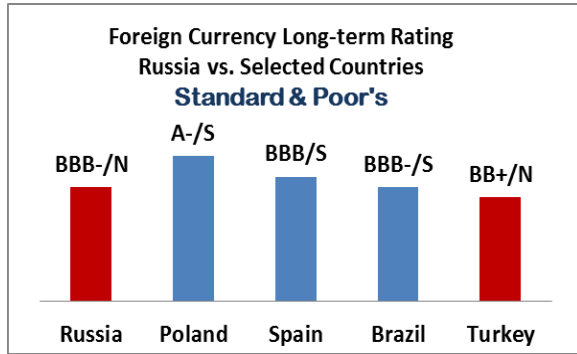
Fitch			
Bank	Rating action in 2014	Ratings before change	Ratings after Change
Sberbank of Russia	24 March 2014	BBB/Stable	BBB/Negative
Gazprombank	24 March 2014	BBB-/Stable	BBB-/Negative
Promsvyazbank	-	BB-/Stable	BB-/Stable
Gazprom OAO	24 March 2014	BBB/Stable	BBB/Negative
Lukoil	24 March 2014	BBB/Stable	BBB/Negative

Fitch's view of the impact of actual and potential sanctions (by US, EU and others):

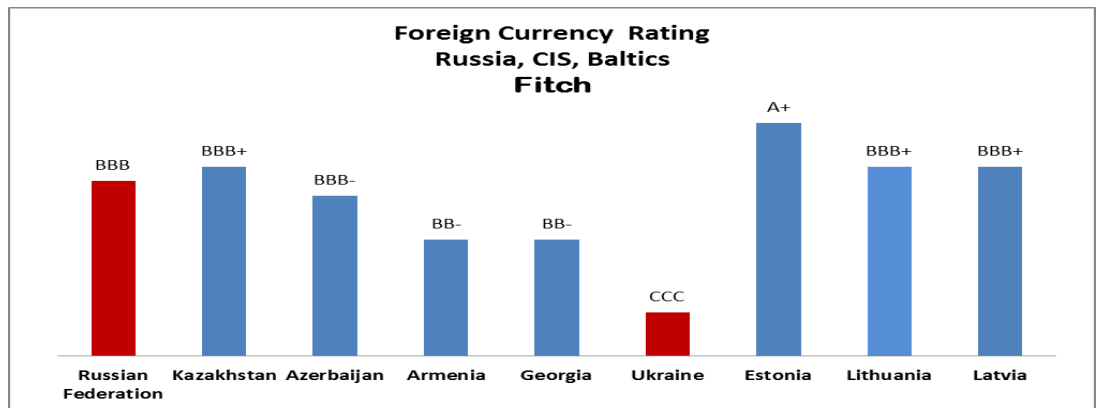
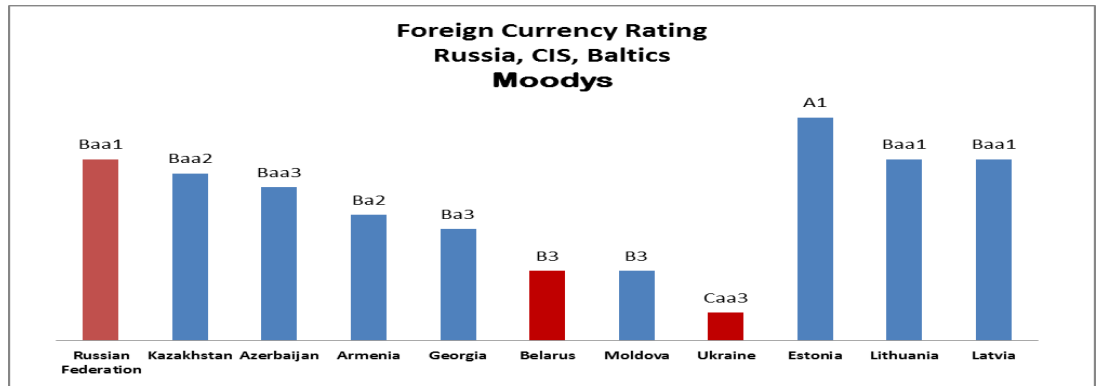
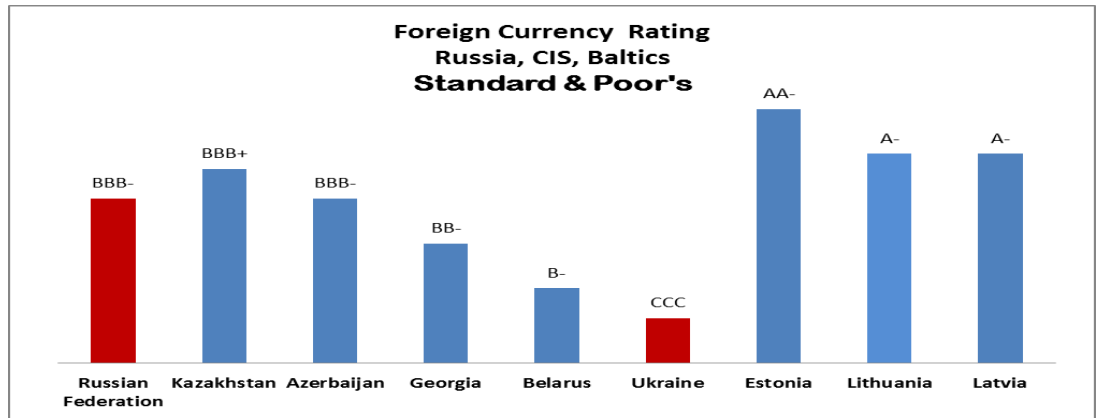
- International banks reducing Russian exposures
- New lending to Russian entities and other transactions is down, under greater scrutiny
- International capital markets are effectively closed to Russian entities
- Foreign equity holdings in some Russian entities are being sold
- Capital flight expected to reach as much as USD70bn in 1Q (though some capital is likely being repatriated as well)
- Reductions in FDI and domestic investment (already weak) may cause recession
- Economic reform agenda stalled

Sovereign Ratings: Russia vs. Peers

(as of June 13, 2014)



■ Negative Outlook
 ■ Stable Outlook

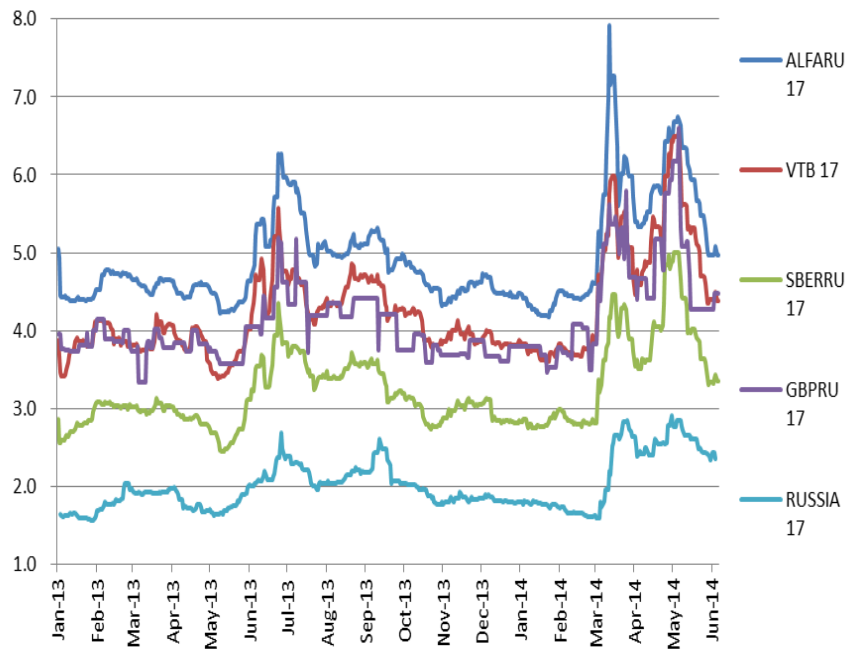


Comparative Yields and Spreads on Three-year Bonds

Alfa Bank, VTB Bank, Sberbank, Gazprombank, Russian Federation

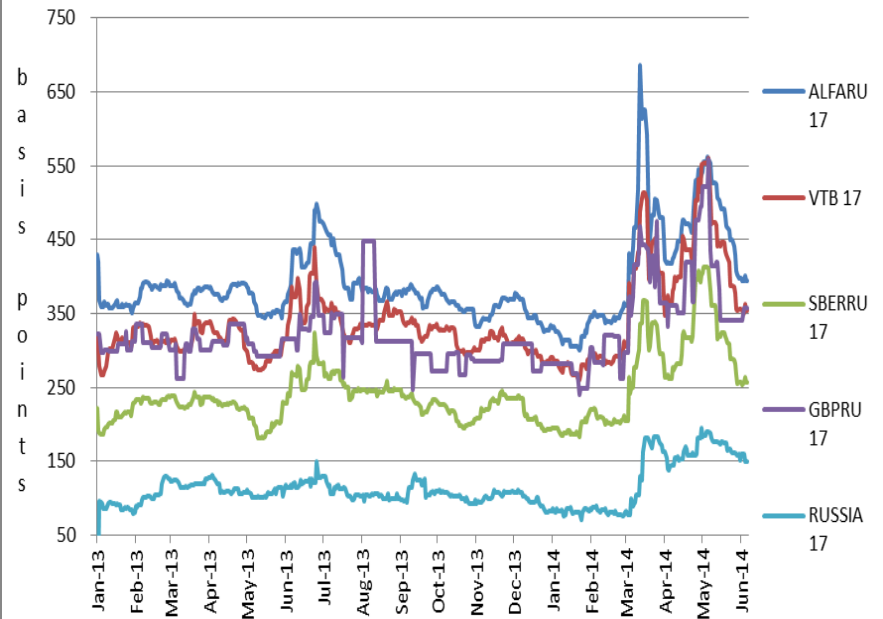
Yield to Maturity on US\$ bonds due Sept. 2017

Alfa Bank, VTB Bank, Sberbank, Gazprombank, Russian Federation



Spread over US treasuries on US\$ bonds due Sept. 2017

Alfa Bank, VTB Bank, Gazprombank, Sberbank, Russian Federation



What to Remember

- Despite current troubles, significant long-term growth prospects for financial intermediation in Russia and CIS.
- After 2 years of robust expansion, primary market issuance of Russian companies stopped cold in March 2014 (domestic and cross-border)
- All 3 major global rating agencies now have negative outlook on Russian Federation – under most base-case scenarios, this will stay in place at least through 2014.
- Strong presence of state enterprises in Russia means that negative credit outlook on Russia extends to a high proportion of Russian corporate bonds (e.g. Gazprom, Sberbank, VTB Bank, Russian Railways)
- As of mid-June 2014, sanctions themselves not important, but capital flight and foreign investor and foreign bank retreat from Russia is important.
- Outlook for many CIS issuers is also negative due to political and economic links between Russia and CIS.
- Spreads on Russian corporate bonds have come in since early May. *Will this rebound continue?*

Key longer-term questions:

Will Ukrainian crisis durably raise the Russian risk premium?

What is debt capacity of region?