Russia Rating Cut by Moody’s on Sluggish Economic Growth

By Ye Xie, Elena Popina and Daria Solovieva - Oct 20, 2014

Russia’s ruble dropped and sovereign bonds were little changed after the country’s credit rating was cut to the second-lowest investment grade by Moody’s Investors Service amid sanctions over Ukraine.

Moody’s downgraded the sovereign one level to Baa2 from Baa1 and kept a negative outlook on the rating on Oct. 17. It is in line with Fitch Ratings Ltd.’s credit grade and one step above Standard & Poor’s, which lowered Russia to BBB- in April. The yield on the nation’s March 2030 Eurobond fell one basis point to 4.81 percent. The ruble weakened 0.2 percent to 40.84 versus the dollar as of 11:45 a.m. in Moscow.

Russia has spent $13 billion from its foreign reserves this month to slow the ruble’s weakening as tumbling oil prices add to the woes of an economy that’s teetering toward recession amid the sanctions by the U.S. and European Union. President Vladimir Putin and European negotiators are struggling to hold together a six-week truce in eastern Ukraine, inching forward in talks to prevent the fighting from escalating.

“It’s negative news, but it’s not really critical because it’s still an investment grade,” Vladimir Osakovskiy, chief economist for Russia at Bank of America Corp. in Moscow, said by phone yesterday. “It was expected and therefore the negative reaction will probably be limited.”

The downgrade is driven by “Russia’s increasingly subdued medium-term growth prospect,” Kristin Lindow, an analyst at Moody’s Investors Service Inc., said in a phone interview on Oct. 17. “The gradual and ongoing erosion of the country’s international reserve buffer” contributed to a weakening of Russia’s creditworthiness, she said.

Extra Yield

The extra yield investors demand to own Russia’s dollar-denominated government bonds due in September 2023 instead of similar Treasuries was 2.86 percentage points today, compared with an average of 2.16 since the notes were sold 13 months ago, according to data compiled by Bloomberg. The spread has increased as the U.S. and its allies accused Russia of inciting the rebellion in eastern Ukraine, an allegation Putin denies.

The ruble has lost 14 percent against the dollar in the past three months, more than any other
currency tracked by Bloomberg, extending its drop this year to 19 percent. Foreign reserves (RUREFEG) have declined 11 percent this year to a four-year low of $452 billion as the central bank acted to shore up the ruble.

Brent crude’s 25 percent drop from its June peak further damped Russia’s growth outlook. The country derives more than half its budget revenue from energy.

**Reserves Sufficient**

Putin said on Oct. 17 that Russia won’t spend all of its $451.7 billion in reserves defending the ruble.

“Bank of Russia, on the one hand, will pursue balanced financial policies,” Putin told reporters on a trip to Milan. “That means that it will use elements of a floating exchange rate and won’t mindlessly burn up all its reserves. But there’s enough reserves to adjust the level of the national currency.”

Moody’s expects Russia to fall into a recession in 2015 for the second time since 2009, contracting 1 percent after growing 0.5 percent this year, Lindow said. The International Monetary Fund predicts a growth rate of 0.5 percent next year.

“The rating remains investor grade,” former Russian finance minister Aleksei Kudrin said on his Twitter account on Oct. 18. “Further downgrades may be extremely negative for the financial market.”

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