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ACRA assigns **BBB-(RU)** to **the Volgograd Region**, outlook **Stable**

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The credit rating of the Volgograd Region (hereinafter, the "Region") is determined by significant improvement in fiscal discipline and debt burden in 2017 due to lower fiscal spending on education and social policy as set forth in the Law on state budget and in respective government programs as well as relatively high unemployment and low per capita income, well-balanced commercial debt in terms of its repayment schedule and pricing, and moderately high level of infrastructure.

Key rating assessment factors

Diversified economy with relatively high unemployment and below-avergage per capita income. Manufacturing sector (petrochemicals, finished metal products, and food), wholesale and retail trade, and agricultural industry are the foundation of the Region's economy. Since 2012, investments in the Region exceed the average level in Russia by 13.6%. The Volgograd Region is a net contributor to the federal budget (approximately 30% of the Region's tax proceeds accumulated in the consolidated budget of Russia comprised excise duties on refined products and tobacco goods). The unemployment rate, as calculated using ILO methodology, is substantially (by 25% on average) higher than the average rate in Russia. The below-average level of per capita income is explained by relatively small wages in trade industry (both wholesale and retail), agricultural sector, and social services.

Improved fiscal discipline through regular revenue growth and maneuvers in social spending. The Region's budget is defined by a substantial share of domestic income (76%) and moderate level of mandatory expenditures in the budget structure. The Region balances its fiscal indicators by optimizing social spending (education and social sphere), while staying compliant with the current standards for public sector wages. Social spending is optimized well in advance (one-three years before the respective fiscal year starts). Maneuvers done early enable avoiding intra-year emergency cutting of social expenditures, and, thus, preventing from shock effects for the local economy. In the course of a fiscal year, as additional revenue flows in, the Region may increase financing of specific social programs.

Well-balanced commercial debt in terms of its repayment schedule and pricing. As of June 15, 2017, the Region's compliance rate with the annual commercial debt repayment schedule was 59%. More than 70% of the commercial debt is due after 2019 (inclusively). Following 2016 results, the Region breached the covenant with respect to providing public budget loans (due to higher actual deficit vs. the level set forth in the agreement) and was forced to repay a substantial part of public budget loans early in 2017 (totaling RUB 21.3 bln). Russian government intends to issue a long-term public budget loan to the Volgograd Region in 2017 (for approximately RUB 10-15 bln) in order to compensate for the public budget loan repaid early. This would allow to substantially save on interest expenses and to avoid any shock effects for the Region's debt portfolio.

Sufficient liquidity. Region's administration has no legal right to hold deposits with banks; it has, however, a sufficient level of liquidity to perform its expenditure obligations in a timely manner including interest payments. Current month expenses mainly exceed cash balances on budget accounts as at month-start. The Region covers its short-term liquidity needs in rare cases of planned cash gaps by federal budget funds available on the single account, short-term loans from Federal Treasury Department, and revolving credit lines.

Key assumptions

- Russian Ministry of Finance issues a long-term public budget loan over RUB 10 bln in 2017;
- Saving on debt servicing costs in 2017-2018 vs. approved annual figures;
- Spending on education and social sphere in 2017-2018 remains at levels as set forth in the current versions of respective government programs;
- Staying eligible for federal budget transfers in 2017.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Lower unemployment, per capita values of GRP indicators and cash wages of the Region's population advance to the average level for Russia;
- Improvements in budget discipline and operating balance.

A negative rating action may be prompted by:

- Increased Region's fiscal spending on education and social sphere exceeding figures as set forth in the current versions of government programs without respective increase in Region's fiscal revenues;
- Breach of eligibility to receive budget transfers;
- Failure to obtain a long-term public budget loan compensating for the early-repaid public budget loan.

Regulatory disclosure

The credit rating has been assigned under the national scale for the Russian Federation based on the Methodology for Credit Ratings Assignment to Regional and Municipal Authorities of the Russian Federation and the Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities.

A credit rating has been assigned to the Volgograd Region for the first time. The credit rating and its outlook are expected to be revised within 182 days following the rating action (June 22, 2017).

The assigned credit rating is based on the data provided by the Volgograd Region, information from publicly available sources (the Ministry of Finance, the Federal State Statistics Service, and the Federal Tax Service), as well as ACRA's own databases. The credit rating is solicited, and the Volgograd Region participated in its assignment.

No material discrepancies between the provided data and the data officially disclosed by the Volgograd Region in its financial report have been discovered.

ACRA provided no additional services to the Volgograd Region. No conflicts of interest were discovered in the course of credit rating assignment.