

ALEXEY MUKHIN

Managing Director

+7 (495) 139 04 80, ext. 101
alexey.mukhin@acra-ratings.ru

Media contact:

SVETLANA PANICHEVA

+7 (495) 139 04 80, ext. 169
svetlana.panicheva@acra-ratings.ru

DEBT MARKET | RUSSIA

DEBT MARKET BULLETIN

Issue I: Q1 2023

ACRA presents its *Debt Market Bulletin*, which describes the current situation and trends in Russia's fixed income and public debt market.

- In Q1 2023, the Russian debt market demonstrated results that were high for the start of the year, despite the reduction in the size of new placements compared to the record fourth quarter of 2022.
- The risk premium for bonds continued to decline vs. 2021 after a period of high volatility and record highs reached last year. This trend will encourage second-tier and third-tier issuers to enter the debt market.
- Given the expectations of growth of the key rate and a slight rise of the OFZ curve compared to the end of 2022, first-tier issuers will focus on issuing bonds with maturities of up to five years in order to make placements at the lowest possible rates.
- The high-yield bond sector may grow in the upcoming months amid a decline in average yields to below 15% and the need to refinance previously issued obligations.
- ACRA assumes that in the absence of new geopolitical black swans, new placements of corporate bonds in Q2 2023 may exceed RUB 1 tln. Among other things, this will be driven by issuers' need to refinance bonds that are being redeemed and issue replacement bonds¹, the potential placement of which the Agency's estimates at USD 25–30 bln (in dollar equivalent).

Current state of the debt market

From early 2023 until mid-March, the corporate bond market grew by 2.6% to RUB 19.5 tln. The main growth driver was non-financial companies that placed bonds worth more than RUB 500 bln. Upon placement, the rates for debt obligations of first-tier issuers remained at the level of Q4 2022, and in the second tier growth was about 80 bps.

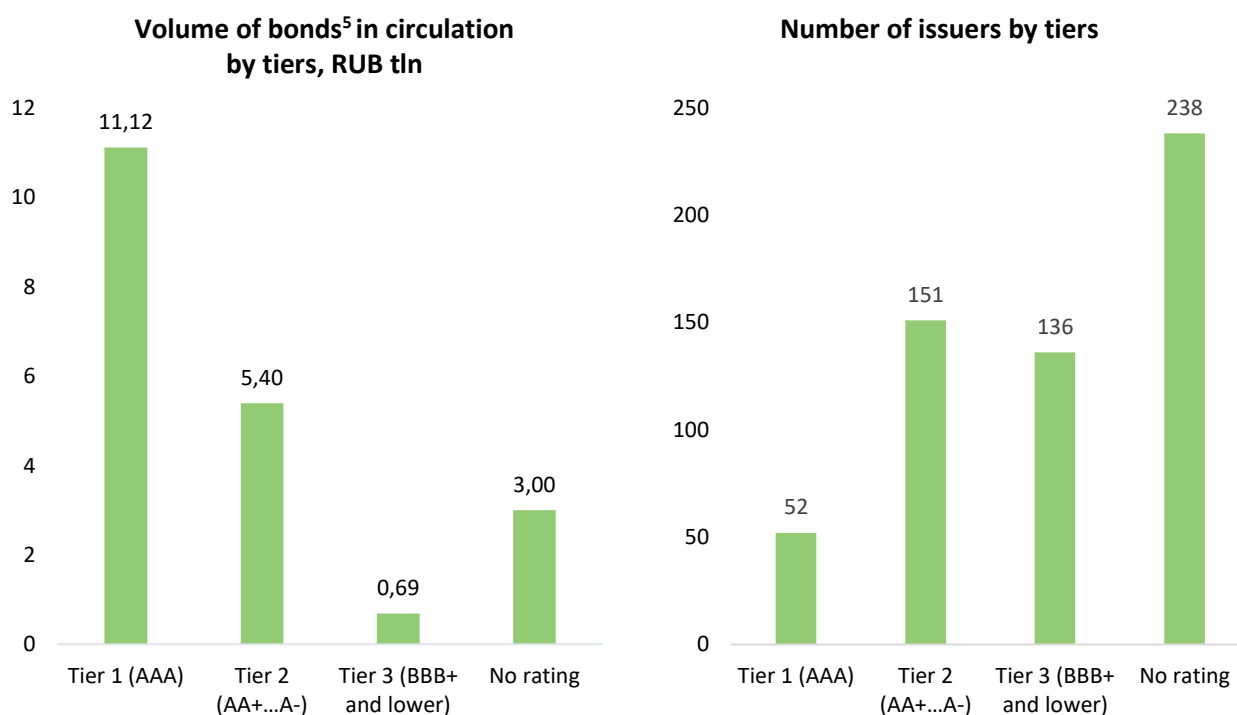
Despite the actions of the Russian Ministry of Finance in the debt market since the start of 2023, growth in the volume of the corporate bond market by 0.5% exceeded the growth in the debt burden for public debt (for details on the structure of consolidated public debt, see *Appendix 1*).

¹ Bonds issued to replace Eurobonds of Russian companies that were partially blocked due to sanctions and external restrictions.

Table 1. Bond market structure (by outstanding nominal value), RUB bln

Borrower type	01.01.2023	15.03.2023	Trend
Public debt			
Federal government ²	18,079	18,486	▲ 2.3%
Regions and municipalities	665	666	▲ 0.2%
Corporate bonds market			
Financial institutions ³	3,453	3,477	▲ 0.7%
Supranational development banks	191	170	▼ 11%
Other financial organizations ⁴	3,316	3,307	▼ 0.3%
Non-financial companies	12,067	12,578	▲ 4.2%
Total, excluding public debt	19,027	19,532	▲ 2.7%
Total	37,771	38,684	▲ 2.4%

Sources: Russian Ministry of Finance, Cbonds, ACRA

Figure 1. Volume of bonds in circulation by tiers

Sources: Cbonds, ACRA

Sources: Cbonds, ACRA

The main volume of bonds in circulation falls on the debt obligations of first-tier issuers (companies with AAA credit ratings under the national scale for the Russian Federation) — more than 50% of the bond market at outstanding nominal value. The share of bonds issued by second-tier issuers is 25%.

² Including OFZ-PK, OFZ-PD, OFZ-IN, OFZ-AD, OFZ-n, GSO-PPS, GSO-FPS, excluding Eurobonds

³ Including VEB.RF

⁴ Including DOM.RF, leasing companies, micro-finance companies, PUR RTB, SFO, SOPF, and IA.

⁵ Credit ratings assigned by one of the four credit rating agencies included in the Bank of Russia's register were taken into account. If the debt obligation had a credit rating (regardless of whether the issuer had a credit rating and its level), the credit rating of this issue was used. The indicator is calculated for the corporate bond market, as well as for issues of regions and municipalities.

New placements at the start of the year

From January 1, 2023 until March 17, 2023, the volume of placements of new bond issues amounted to around RUB 900 bln, with 99% of these being made by first-tier and second-tier issuers.

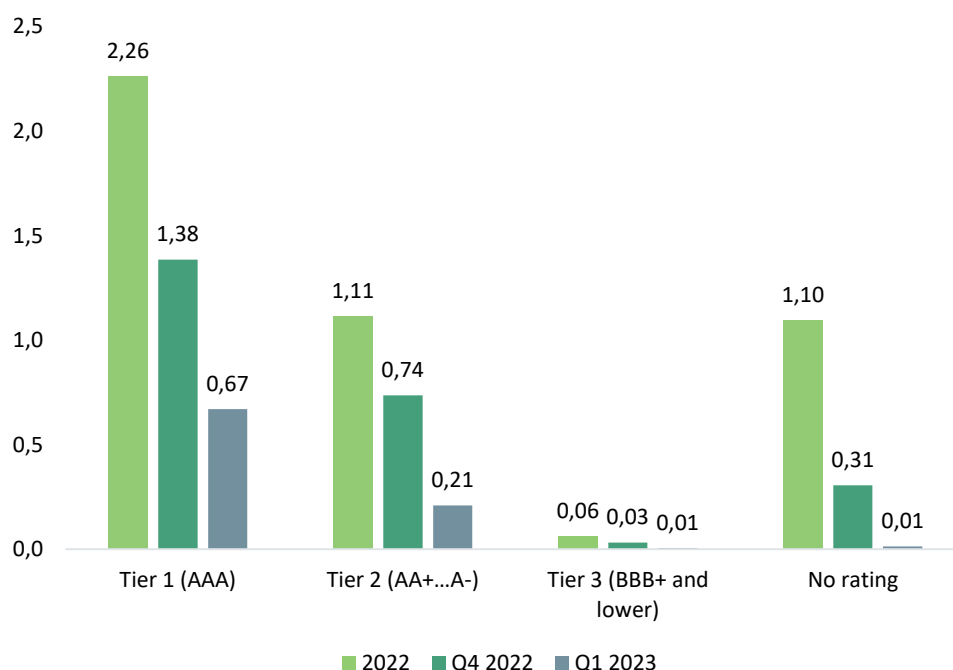
Compared to the highs achieved in Q4 2022, new placements in the opening months of 2023 look more modest (36% of the volume of bonds placed from October to December 2022), but are considerably higher than the figures for Q1 2022. This indicates that issuers maintained considerable interest in making placements during the window that opened in Q4 2022, despite the minor growth in yield for the first and second tiers.

Table 2. Placements in Q1 2023, RUB bln

	Total	Tier 1	Tier 2	Tier 3	No rating
Financial institutions	160.412	83.066	77.346	-	
Supranational development banks	8.0	8.0	-	-	
Other financial organizations	36.528	25.873	5.500	2.118	3,037
Non-financial companies	694.087	553.936	125.885	3.266	11.0
Total	899.027	670.875	208.731	5.384	14.037

Sources: Cbonds, ACRA

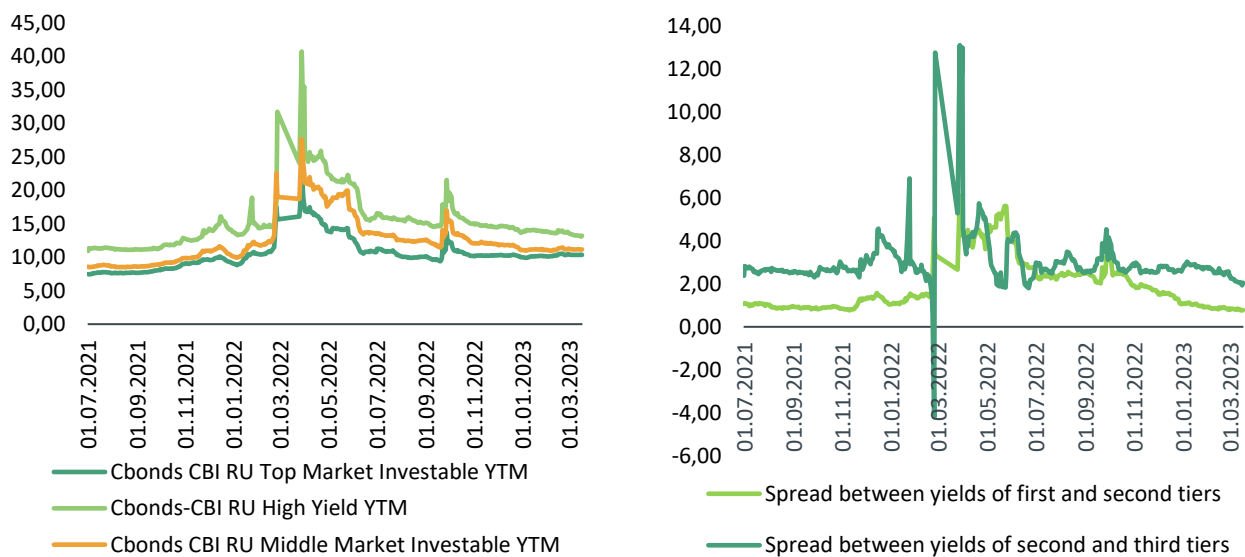
Figure 2. Volumes of new placements in 2022; Q4 2022 and Q1 of 2023 by tiers, RUB tln



Sources: Cbonds, ACRA

In the first quarter of this year, the volatility of yields for debt obligations in the secondary market continued to decrease compared to the fourth quarter of 2022, while the dynamics were multidirectional. Thus, the yields of third-tier bonds declined, while the first tier had a slight upward correction due to the growth in OFZ yields. However, after a strong jump in the period from September to October 2022, the spreads between yields of bonds in the secondary market returned to the state observed in mid-2021: about 80 bps between the first and second tiers and about 200 bps between the second and third tiers.

Figure 3. Difference in yields of issuers of different tiers



Source: Cbonds

Source: Cbonds, ACRA

Replacement bonds

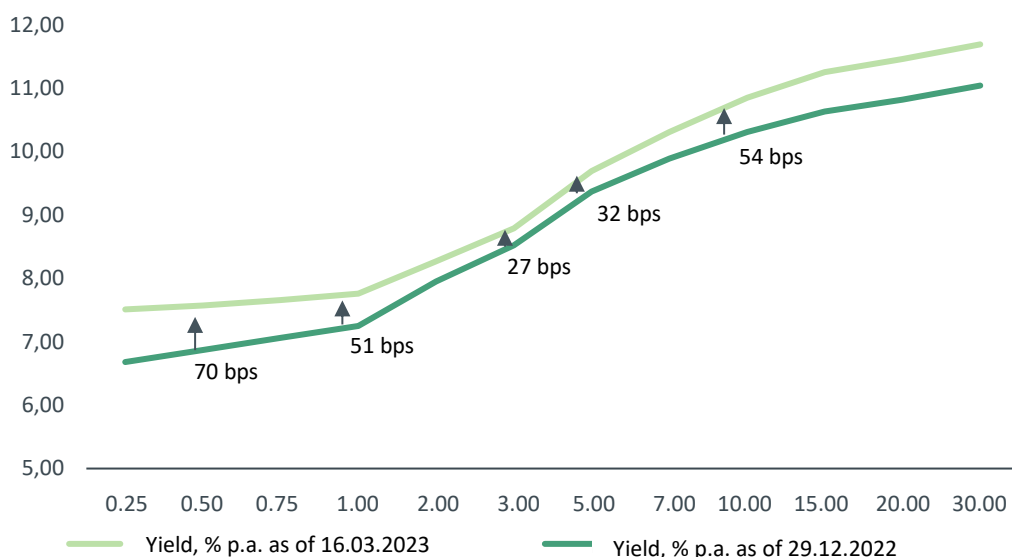
One of the key drivers of the growth of the debt market in Q1 this year was the placement of nine new replacement bonds issued by oil and gas sector companies, which exceeded USD 6 bln. ACRA estimates the potential of replacement bonds in the Russian market at USD 25–30 bln (in dollar equivalent), given the existing volume of bonds to the equivalent of USD 14.4 bln.

Against the backdrop of the popularity of this instrument among investors, replacement bonds may take over part of the free liquidity of the secondary market. In December 2022, the volume of trading in them exceeded RUB 30 bln, amounting to 6.5% of the total volume of the secondary bond market.

Key rate and OFZ yields

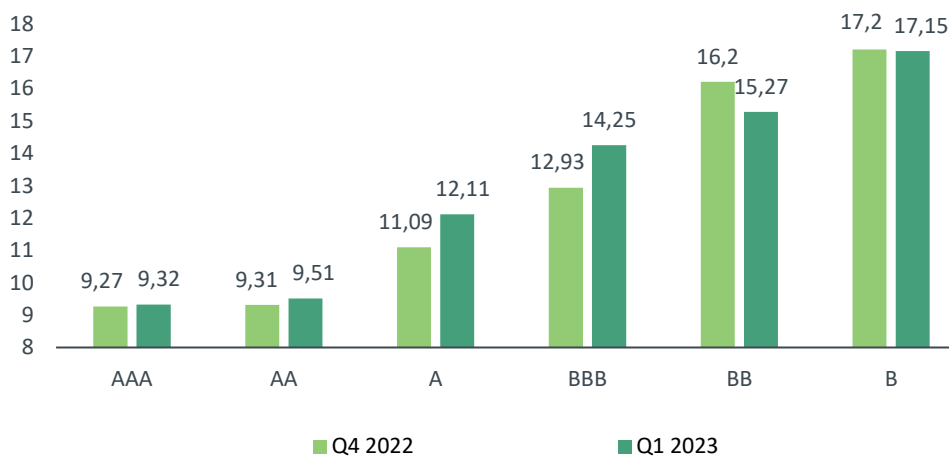
Last week, the Bank of Russia kept its key rate unchanged at 7.5% per annum and confirmed the forecast of its average key rate at 7–9% per annum for 2023. The likelihood of a rate hike against the backdrop of a predominance of pro-inflationary risks in the future remains. In the base case scenario of its [macroeconomic forecast](#), ACRA predicts that the key rate will be close to the current 7.5% as of the end of 2023, while in the longer term (over a two to three-year horizon) it is expected to be 6.75–7% in the event of a normalization of external risks.

Since the end of 2022, against the backdrop of persisting pro-inflationary risks and the regulator's reaction to them, as well as the significant activity of the Russian Ministry of Finance in the debt market, OFZ yields have been growing. The volume of funds raised by the Russian Ministry of Finance at OFZ auctions since the beginning of 2023 amounts to about RUB 624 bln, which is equivalent to 78% of the plan for the first quarter. In February 2023, there was a slowdown in the dynamics of budget expenditures relative to January, with a simultaneous slight increase in oil and gas revenues. However, the budget deficit for the first two months of this year was 88% of the target for the year, which may lead to an increase in the OFZ borrowing plan and, as a result, to an increase in their cost and additional pressure on the OFZ curve. In addition, the possible review by the Bank of Russia of the neutral value of its key rate, which is expected in 2023, may result in higher borrowing costs amid the structural deficit of the budget and higher country risks.

Figure 4. OFZ curve dynamics

Sources: Bank of Russia, ACRA

Growth in OFZ yields put slight pressure on coupon rates of new first-tier and second-tier bonds (*Fig. 5*)

Figure 5. Comparison of coupon rates on recently issued bonds broken down by issuer creditworthiness*

* Coupon rate on 3-year corporate bonds issued in Q4 2022 and Q1 2023. The sample includes only market exchange-traded issues, including non-financial companies, banks, and financial institutions.

Source: Cbonds, ACRA

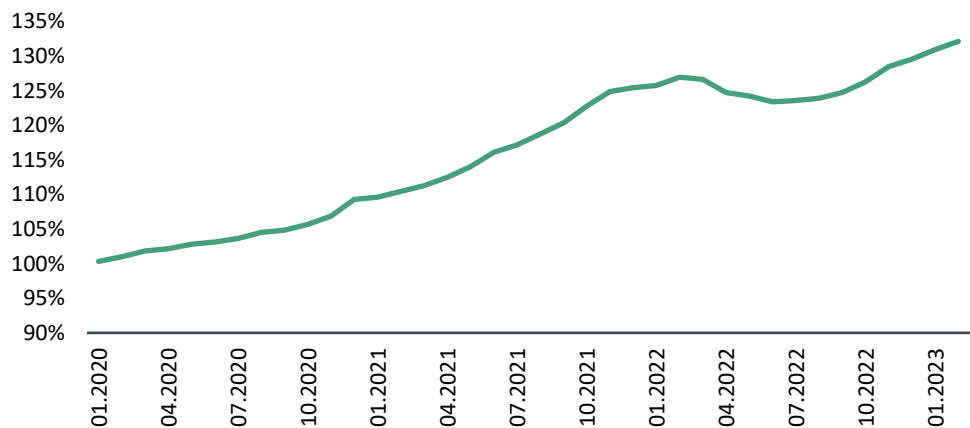
At the same time, ACRA notes a decrease in the coupon rates on third-tier bonds, which, among other things, is confirmed by the convergence of yield curves. This, in turn, may lead to an increase in the number of third-tier companies entering the bond market in the near future.

Issuer credit risks

There have been no defaults of new issuers in the Russian bond market since the beginning of 2023. However, the risks of refinancing previously issued obligations may persist for high-yield companies with weak liquidity and debt coverage metrics (in the conditions of further rate increases during 2023). At the same time, ACRA does not expect mass defaults in the coming months in the absence of new black swans in the market.

ACRA calculates, on a monthly basis, the Rating Action Index for the two largest Russian credit rating agencies, which reflects the dynamics of the agencies' assessments of their customers' creditworthiness (Fig. 6). The index has been calculated since the beginning of 2020. Index values show that the trend observed until February 2022 has actually recovered since the beginning of autumn 2022. In general, this may indicate a stabilization of rating downgrades for companies included in the rating agencies' portfolios. Currently, approximately 85% of public debt is covered by credit ratings, while 81% of the total volume of outstanding bonds have ratings of A- or higher under the national scale for the Russian Federation, which indicates an expected default probability of less than 0.5%.

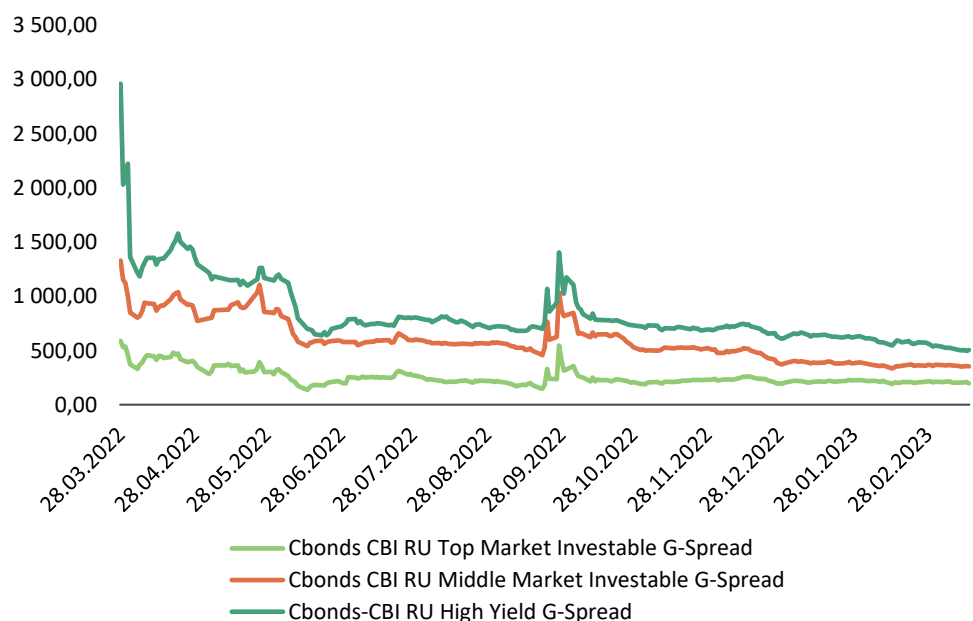
Figure 6. Rating Action Index



Sources: data from ACRA and Expert RA, ACRA's calculations

The decline in G-Spreads of corporate bonds that began in Q4 2022 is worth noting as well. According to the Cbonds CBI G-Spread index for the top-tier and middle-tier companies and high-yield companies, the decrease in spreads compared to OFZs was 15 bps for companies of the top tier, about 165 bps for companies of middle credit quality, and about 140 bps for high-yield companies.

Figure 7. G-Spreads by issuer type



Source: Cbonds

In Q2 2023, corporate bonds worth about RUB 520 bln are to be repaid, which is 13% higher than in Q1 2023. In the conditions of narrowing spreads and in the absence of geopolitical shocks, this will support the issuance dynamics at the level of the first months of 2023. Current rates and interim market stabilization may also be of potential interest to new issuers, regardless the potential further increase in the value of risk-free assets.

Appendix 1

Table 3. Structure of Russia's public debt, RUB bln

	2018	2019	2020	2021	2022
Debt of the general government of the Russian Federation					
TOTAL	14,113.8	15,082.5	20,546.6	22,114.2	23,638.9
% of GDP	13.5%	13.8%	19.1%	16.3%	15.6%
USD bln	204.9	243.6	278.1	297.7	336.1
guarantees	2,305.9	1,723.9	2,036.6	2,159.0	2,108.2
securities	10,839.9	12,458.5	17,677.0	19,477.4	21,294.2
other	968.1	900.1	833.0	477.7	236.6
guarantees	16.3%	11.4%	9.9%	9.8%	8.9%
securities	76.8%	82.6%	86.0%	88.1%	90.1%
other	6.9%	6.0%	4.1%	2.2%	1.0%
internal debt ⁶	n/a*	11,670.0	16,421.8	17,816.6	19,707.7
external debt	n/a	3,412.5	4,189.2	4,435.7	4,038.7
internal debt	n/a	77.4%	79.9%	80.6%	83.4%
external debt	n/a	22.6%	20.4%	20.1%	17.1%
Debt of the federal government					
TOTAL	12,562.1	13,567.4	18,875.9	20,783.7	22,712.1
% of GDP	12.0%	12.4%	17.5%	15.4%	15.0%
USD bln	182.4	219.2	255.5	279.8	322.9
guarantees	2,223.6	1,661.0	1,993.4	2,126.0	2,083.6
securities	10,270.4	11,848.7	16,882.5	18,657.7	20,628.5
other	68.1	57.7	-	-	-
guarantees	17.7%	12.2%	10.6%	10.2%	9.2%
securities	81.8%	87.3%	89.4%	89.8%	90.8%
internal debt	9,176.4	10,171.9	14,751.4	16,486.4	18,781.0
external debt	3,385.7	3,395.4	4,189.0	4,435.4	4,038.6
internal debt	73.0%	75.0%	78.1%	79.3%	82.7%
external debt	27.0%	25.0%	22.2%	21.3%	17.8%
Internal debt	9,176.4	10,171.9	14,751.4	16,486.4	18,781.0
% of GDP	8.8%	9.3%	13.7%	12.2%	12.4%
USD bln	133.2	164.3	199.7	221.9	267.0
guarantees	1,426.9	840.5	695.3	726.6	701.7
securities	7,749.5	9,331.4	14,056.2	15,759.9	18,079.3
External debt	3,385.7	3,395.4	4,189.0	4,435.4	4,038.6
% of GDP	3.2%	3.1%	3.9%	3.3%	2.7%
USD bln	49.2	54.8	56.7	59.7	57.4
guarantees	796.7	820.4	1,298.2	1,399.4	1,381.9
securities	2,520.9	2,517.3	2,826.3	2,897.9	2,549.2
other	68.1	57.7	64.5	138.1	107.5
Debt of administrative subjects					
% of GDP	2.1%	1.9%	2.3%	1.8%	1.8%
USD bln	32.0	34.1	33.4	33.0	39.4
guarantees	71.5	55.4	36.4	28.5	21.0
securities	551.4	588.5	769.9	799.9	651.8
bank loans	636.0	575.8	568.1	257.6	123.2
budget loans	940.0	886.2	1,094.2	1,363.3	1,972.3
other	7.5	7.1	0.2	0.1	0.1

⁶ External and internal debt categories are indicated in accordance with the Budget Code of the Russian Federation.

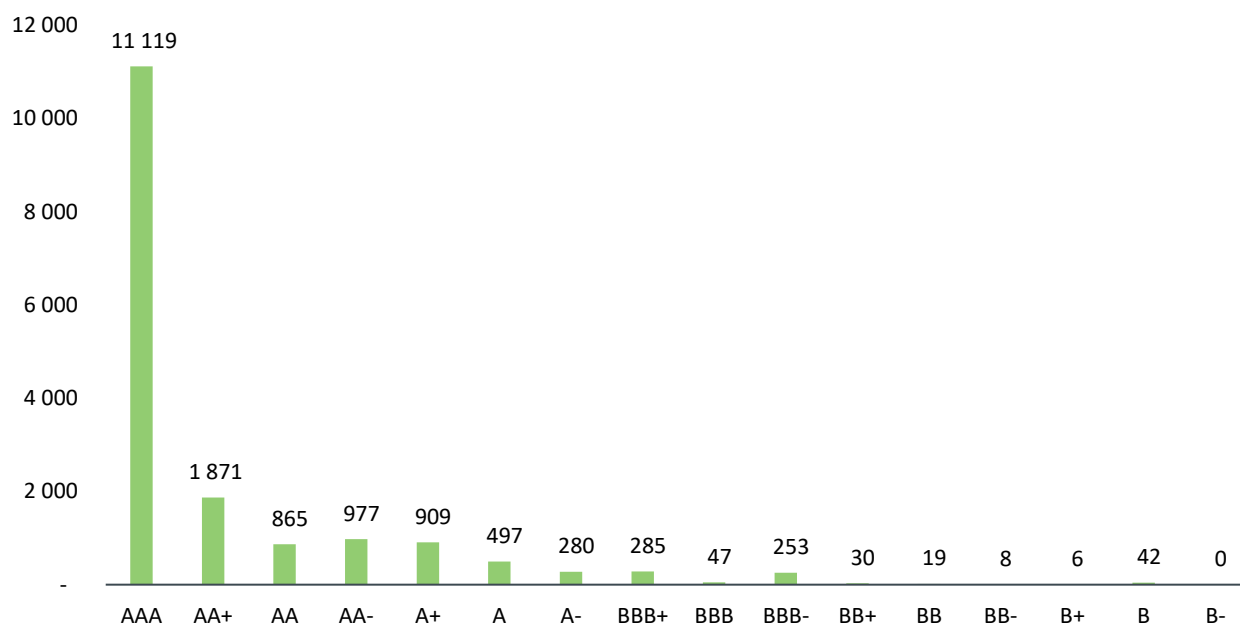
Internal debt	2,206.3	2,086.9	2,468.4	2,449.0	2,768.0
guarantees	71.5	45.7	36.3	28.4	20.9
securities	551.4	588.5	769.9	799.9	651.8
bank loans	636.0	575.8	568.1	257.6	123.2
budget loans	940.0	876.8	1,094.1	1,363.2	1,972.1
other	7.5	0.1	0.1	0.0	0.0
External debt	-	26.1	0.4	0.3	0.3
guarantees	-	9.7	0.16	0.15	0.07
securities	-	-	-	-	-
bank loans	-	-	-	-	-
budget loans	-	9.4	0.12	0.11	0.11
other	-	7.0	0.1	0.1	0.1
Debt of municipalities	371.9	380.5	387.2	376.8	374.5
% of GDP	0.4%	0.3%	0.4%	0.3%	0.2%
USD bln	5.4	6.1	5.2	5.1	5.3
guarantees	10.7	7.6	6.7	4.5	3.7
securities	18.1	21.3	24.7	19.9	13.9
bank loans	256.5	259.5	264.7	220.0	113.3
budget loans	86.5	92.1	91.2	132.4	243.6
other	0.0	0.0	0.0	0.0	0.0
Internal debt	n/a	380.1	387.2	376.8	374.5
guarantees	n/a	7.3	6.7	4.5	3.7
securities	n/a	21.3	24.7	19.9	13.9
bank loans	n/a	259.5	264.7	220.0	113.3
budget loans	n/a	92.1	91.2	132.4	243.6
other	n/a	0.0	0.0	0.0	0.0
External debt	n/a	0.3	0.0	0.0	0.0
guarantees	n/a	0.3	0.005	0.003	0.002
securities	n/a	-	-	-	-
bank loans	n/a	-	-	-	-
budget loans	n/a	-	-	-	-
other	n/a	-	-	-	-
Federal government's debt in securities					
TOTAL	10,270.4	11,848.7	16,882.5	18,657.7	20,628.5
in national currency	7,749.5	9,331.4	14,056.2	15,759.9	18,079.3
in foreign currency	2,520.9	2,517.3	2,826.3	2,897.9	2,549.2
in national currency	75.5%	78.8%	83.3%	84.5%	87.6%
in foreign currency	24.5%	21.2%	16.7%	15.5%	12.4%
Federal government's internal debt in securities					
Breakdown by type of security	7,749.5	9,331.4	14,056.2	15,759.9	18,079.3
OFZ	7,387.2	8,969.1	13,708.9	15,533.5	17,904.9
OFZ-PD	4,929.4	6,474.7	8,102.2	9,812.7	9,794.8
OFZ-AD	416.9	345.0	282.6	209.3	166.0
OFZ-PK	1,731.8	1,713.9	4,709.3	4,709.3	6,896.9
OFZ-IN	253.5	371.2	574.8	763.1	1,025.1
OFZn	55.6	64.2	39.9	39.2	22.2
GSO	362.3	362.3	347.3	226.4	174.4
RUB/USD exchange rate, end of period	68.88	61.91	73.88	74.29	70.34
GDP, RUB bln	104,630	109,608	107,658	135,295	151,456

*n/a — data is not published

Source: website of the Russian Ministry of Finance

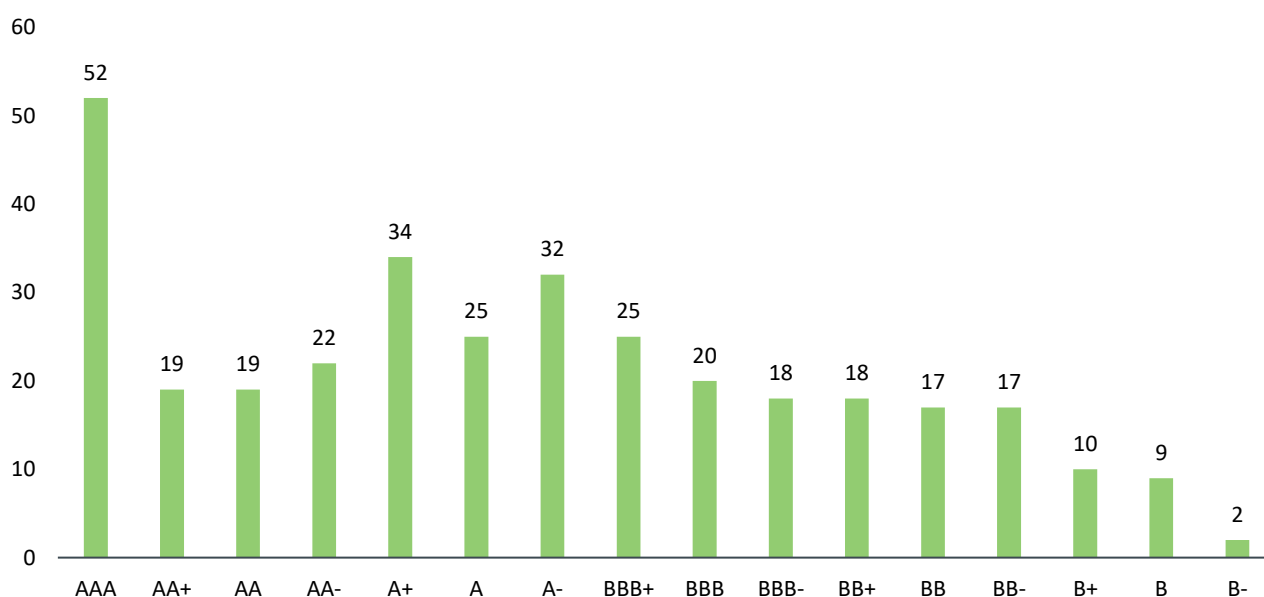
Appendix 2

Figure 8. Volume of outstanding bonds⁷ (non-repaid par value) by rating, RUB bln



Source: Cbonds, ACRA

Figure 9. Number of issuers by rating



Sources: Cbonds, ACRA

⁷ Credit ratings assigned by one of the four credit rating agencies included in the Bank of Russia's register were taken into account. If the debt obligation had a credit rating (regardless of whether the issuer had a credit rating and its level), the credit rating of this issue was used. The indicator is calculated for the corporate bond market, as well as for issues of regions and municipalities.

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Analytical Credit Rating Agency (Joint-Stock Company), ACRA (JSC)
75, Sadovnicheskaya embankment, Moscow, Russia
www.acra-ratings.com

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