

# Standard & Poor's Bombards Russia With Downgrades

By [Peter Hobson](#)

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Gazprom CEO Alexei Miller standing in front of his company's logo at the annual shareholders' meeting in 2013.

After cutting Russia's credit rating to near-junk status last week, Standard & Poor's has turned its downgrade gun on the country's blue chips, major cities and regions, lowering ratings and slapping negative outlooks on companies including Gazprom, Rosneft and VTB bank.

Besides raising the cost of borrowing and damaging the Russian economy, S&P's offensive may end up undermining the position of Western ratings agencies in Russia, feeding a conviction among some that the system is rigged against Russia and energizing plans for a Russian credit rating agency.

Citing skyrocketing capital outflows, the hazards created by the crisis in Ukraine and Western sanctions and an oncoming recession, S&P on Friday cut Russia's foreign currency sovereign

debt rating from BBB to BBB-, one notch above junk status. Applying a negative outlook, the agency hinted at further downgrades to come.

The decision set off a chain reaction. State-controlled companies were first in S&P's firing line. Natural resource giants Gazprom and Rosneft, pipeline monopoly Transneft, rail companies Russian Railways and Federal Passenger Company, electrical infrastructure firm Federal Grid Company and VTB, the country's second-largest banking group, had their foreign currency ratings cut to BBB- from BBB. Technology investment firm Rusnano was downgraded to BB from BB+. All were given negative outlooks, S&P said in its news releases.

In the private sector, Alfa-Bank and Promsvyazbank — two of the country's top 10 banks — saw their outlooks knocked down to negative, though their ratings were left untouched. A weaker state with less financial firepower is likely to leave privately owned banks out to dry first, the agency explained.

Russia two biggest cities, St. Petersburg and Moscow, were downgraded to BBB- from BBB with a negative outlook. Two regions — Bashkortostan and oil-rich Khanty-Mansiysk, already on the edge of junk status with BBB- ratings, received negative outlooks.

After triggering international investment funds that orient their portfolios with reference to ratings to pull money from Russia, the flurry of downgrades will hit demand for Russian assets and raise the cost of borrowing, said Maxim Osadchy, head of analysis at Corporate Finance Bank. Rising loan expenses will "undercut companies' profitability, increase their inefficiency, depress investment and increase capital flight. None of these things are new, but they will likely accelerate," he said.

"We were already tumbling from the mountain that we spent so long climbing. Now we will tumble faster."

The Russian economy is in no shape to withstand such pressure. Capital outflow in the first quarter of this year was \$63 billion, matching the figure for the whole of last year. Economic growth slumped to 1.3 percent last year. Many analysts expect a recession in 2014.

The downgrades were predictable, said Natalya Orlova, chief economist at Alfa-Bank. Stock markets were certainly not spooked — Russian stocks rose 3 percent on Monday and Tuesday. However, the sting in the tail are S&P's ubiquitous negative outlooks, which exacerbate the sense of instability, Orlova said.

## **Western Bias**

For some officials and financial industry insiders, the squall of downgrades is another indication of anti-Russian bias in the international financial system. The big three credit rating agencies — Moody's, Standard and Poor's and Fitch — are all U.S.-based and undermine their Russian clients, abusing their position as gatekeepers to the international money markets, believers of this theory say.

Economic Development Minister Alexei Ulyukayev played to this gallery on Friday, when he branded the downgrade of Russia's sovereign debt "politically motivated."

Alexander Zaitsev, CEO of RusRating, a Moscow-based rating agency, slammed the downgrades as unjustified and "clearly orchestrated by U.S. and European politicians, who are trying to undermine the investment climate in Russia."

Such talk is "ridiculous," Osadchy said. "It is the search for a political backdrop that is politically motivated." But similar skepticism has not stopped the government from pursuing the idea of creating a local ratings agency to push back against the monopoly of U.S. firms.

Russia has credit ratings agencies, but many are untrustworthy and have been caught giving iron-cast ratings to no-hoper companies, according to Osadchy. Currently, the Finance Ministry accredits agencies on the basis of recommendations from the government.

Last week, Deputy Prime Minister Igor Shuvalov conducted a meeting on the creation of a Russian agency at which he attempted to get around that credibility gap. In an interview to television station Russia-24 on Saturday, Shuvalov said "there is an offer for an international partnership [to create a ratings agency] involving Chinese and U.S., as well as Russian, capital," stating the sum of investment at about \$300 million. "It is a proposal from business, not from government," he said, adding that while the agency would be a strictly private affair, "we will help it along."

At the meeting, the Central Bank was asked to draw up legislation to regulate rating agencies.

RusRating is one of the companies proposing the new agency. Zaitsev, who attended the meeting with Shuvalov, dismissed the notion that the state would create a ratings agency. A local agency cannot compete with the big three, he said. Rather a new international agency — Universal Credit Rating Group — would provide the market with non-Western competition.

Set up by RusRating, Chinese company Dagong and U.S. Egan-Jones 18 months ago, UCRG plans to gather up local member companies, mostly in Asia, Latin America and Africa, and unite them under one board, creating a platform independent of all governments and able to compete globally, Zaitsev said.

But it will take years for a new rating agency to gain the credibility to challenge S&P, Moody's and Fitch, Osadchy said — "If Russian companies want to enter the international financial system they will have to use the services of international ratings agencies. No-one will take them seriously if they don't."

Contact the author at [p.hobson@imedia.ru](mailto:p.hobson@imedia.ru)

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