On 5 December 2014 Fitch Affirmed City of Moscow at 'BBB'; Outlook Negative

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Fitch Ratings-Moscow/London-05 December 2014: Fitch Ratings has affirmed the Russian City of Moscow's Long-term foreign and local currency Issuer Default Ratings (IDRs) at 'BBB' with Negative Outlooks, Short-term foreign currency IDR at 'F3' and National Long-term rating at 'AAA(rus)' with a Stable Outlook. Moscow's outstanding senior unsecured debt has also been affirmed at 'BBB' and 'AAA(rus)'.

KEY RATING DRIVERS

The affirmation reflects Moscow's capital status, its robust wealth and economic indicators, sound budgetary performance, capex flexibility and strong debt ratios. The ratings also factor in the slowdown of tax revenue due to the national economy's deceleration and corresponding pressure on its operating balance. Moscow's ratings are constrained by Russia's ratings (BBB/Negative). The Negative Outlook reflects that on the sovereign's ratings.

Fitch forecasts that the city will continue to record a stable operating performance and strong operating balance at about 17%-18% of operating revenue in 2014-2016. Despite the deterioration in the city's operating margin to 16%-20% in 2009-2013, compared with the high pre-crisis levels of 35%-40%, Moscow has a sound financial position, reflecting its capacity to absorb shocks.

Moscow receives significant tax proceeds from major national businesses headquartered in the city. However, due to the large proportion of direct taxes in its budget, it is vulnerable to economic shocks. In addition, new national tax regulation regarding corporate income tax paid by large consolidated taxpayers negatively affected the city's budget. Together with the decline of current transfers from the federal budget, this led to a deceleration of operating revenue growth to an average 4% yoy in 2012-2014, below the average growth of 16% yoy during 2011-2012.

Fitch expects operating expenditure growth will follow accelerating inflation and average 8% in 2014-2016. The city has managed to limit its operating expenses in line with a slowdown of tax revenues. Fitch expects that the city's recent territorial expansion will not lead to considerable investments in the medium term but there will be additional spending for new infrastructure development in the next 10-15 years.

Moscow's debt burden is low by both national and international standards. Based on the budget execution during January-September 2014 and the city's forecast, Fitch expects Moscow's direct risk will account to RUB134bn at end-2014 or a low 9% of current revenue. The increasing budget deficit due to sluggish revenue growth means direct risk will increase during 2015-2016 but stays below 15% of current revenue. Another reason for the debt increase is a decline in asset sales proceeds in 2014-2016 after an exceptional RUB105bn earned from asset sales in 2013. As a result, Moscow will likely use market borrowing to finance its investment programme.

Given the sound operating balance and low debt, the city has strong debt coverage (direct risk to current balance) below one year and a long direct risk maturity profile up to 2022. Combined with strong liquidity (RUB442bn at 1 October 2014), these factors underpin its strong financial position.

The city directly and indirectly controls an extensive public sector. This involves additional contingent risk and puts pressure on budget expenditure via administrative expenses and subsidies. Due to the large size of the city's budget, Fitch does not consider risk from the sector to be significant. The administration is making a significant and successful effort to reduce the number of public companies and has privatised several large shareholdings in 2013-2014.

Moscow benefits from its status as the Russian capital and the country's economic and financial centre. It has a strong, service-oriented economy and contributed about 17% of Russia's GDP in 2013. Per capita gross city product was almost 2.5x the national average in 2012, making the city one of the wealthiest regions in the country.

RATING SENSITIVITIES

A downgrade is unlikely due to the city's intrinsic strength, unless the sovereign is downgraded. However, a consistent material downward deviation from the baseline scenario would be negative for the city's ratings.

The ratings would be positively affected by a revision of the sovereign Outlook to Stable from Negative accompanied by healthy debt and debt coverage ratios.

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Applicable criteria, 'Tax-Supported Rating Criteria', dated 14 August 2012, and 'International Local and Regional Governments Rating Criteria outside United States', dated 23 April 2014, are available on www.fitchratings.com.

Additional Disclosure
Solicitation Status