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## Research Update:

# Capital City of Moscow Outlook Now Negative After Same Action On The Russian Federation; 'BBB/ruAAA' Ratings Affirmed

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## Research Update:

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## Overview

- On March 20, 2014, we revised our outlook on the Russian Federation to negative from stable.
- Under our criteria, we do not currently rate Russian local and regional governments above the sovereign, and we consequently cap the long-term ratings and outlook on the City of Moscow at the level of our long-term ratings and outlook on Russia.
- We are therefore revising the outlook on Moscow to negative from stable and affirming our 'BBB/ruAAA' ratings on the city.
- The negative outlook on Moscow reflects that on Russia.

## Rating Action

On March 25, 2014, Standard & Poor's Ratings Services revised its outlook on Russia's capital city of Moscow to negative from stable. At the same time, we affirmed our 'BBB' long-term issuer credit rating and 'ruAAA' Russia national scale rating on the city.

As defined in EU CRA Regulation 1060/2009 (EU CRA Regulation), the ratings on Moscow are subject to certain publication restrictions set out in Art 8a of the EU CRA Regulation, including publication in accordance with a pre-established calendar (see "Calendar of 2014 Publication Dates for EMEA Sovereign, Regional, And Local Government Ratings," published Dec. 30, 2013, on RatingsDirect). Under the EU CRA Regulation, deviations from the announced calendar are allowed only in limited circumstances and must be accompanied by a detailed explanation of the reasons for the deviation. In this case, the deviation has been caused by the events described in the following Rationale.

## Rationale

The rating action on Moscow follows our recent revision of the outlook on the Russian Federation to negative from stable (see "Russian Federation Outlook Revised To Negative On Rising Geopolitical And Economic Risks; Ratings Affirmed," published March 20, 2014).

Under our methodology, a local and regional government (LRG) can be rated higher than its sovereign only if we consider that it exhibits certain characteristics as described in "Ratings Above The Sovereign--Corporate And

Government Ratings: Methodology And Assumptions," published Nov. 19, 2013. According to our assessment of the framework for intergovernmental relationships between the central government and LRGs in Russia, we believe that Russian LRGs, including the city of Moscow, cannot be rated above the sovereign. Therefore, we cap the long-term rating on Moscow based on our 'BBB' foreign currency sovereign long-term rating on Russia.

The long-term rating on Moscow reflects the city's position as Russia's economic, administrative, and financial center, with above average wealth in an international comparison. The city's low debt, "very positive" liquidity, and only limited contingent liabilities also support the rating. Its moderate budgetary flexibility and budgetary performance, which we expect to gradually deteriorate over the next few years, are neutral for the city's creditworthiness, in our view.

The rating is constrained by our views of Russia's "developing and unbalanced" institutional framework, under which distribution of revenues and expenditures largely depends on central government decisions, and Moscow's "negative" financial management, given the emerging nature of long-term planning and limited predictability of budget policy that we see.

At the same time, in accordance with our criteria, we assess Moscow's "indicative credit level" (ICL) at 'bbb+' (see "Methodology For Rating International Local And Regional Governments," published Sept. 20, 2010). The ICL is not a rating but a means of assessing an LRG's intrinsic creditworthiness under the assumption that there is no sovereign rating cap. The ICL results from the combination of our assessment of an LRG's individual credit profile and the effects we see of the institutional framework in which it operates.

Under our upside scenario, Moscow's ICL could improve if we revised our assessment of Russia's institutional framework upward, with all other things remaining equal under our base-case scenario.

Alternatively, we could revise our assessment of Moscow's ICL downward by one level if the city's budgetary performance weakened as a result of a significant reduction in tax revenues and insufficient use of the spending flexibility that we currently expect in our base case.

## **Outlook**

The negative outlook on Moscow reflects that on Russia.

We could revise the outlook on Moscow to stable if we revised our outlook on the sovereign to stable.

We would likely lower our rating on Moscow if we lowered the rating on Russia. We could also lower the rating on Moscow, even if the sovereign rating remained unchanged, in the unlikely case of a significant and recurring

reduction of the city's tax revenues. Combined with a lack of use of existing expenditure flexibility, such a decrease would lead to deteriorated performance, with average operating margins below 10% of operating revenues and deficits after capital accounts of more than 10% of total revenues in 2014-2016; debt accumulation exceeding 30% of consolidated operating revenues; and weaker liquidity. However, given the city's ICL of 'bbb+', we regard this scenario as highly unlikely.

## **Key Sovereign Statistics**

For the latest sovereign statistics, please click here:

- Sovereign Risk Indicators, March 24, 2014

## **Related Criteria And Research**

### **Related Criteria**

- Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010
- Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009

### **Related Research**

- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013
- Public Finance System Overview: Russian System For Regional Governments Is Developing And Unbalanced, Nov. 12, 2012

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook.

## Ratings List

Ratings Affirmed; Outlook Action

	To	From
Moscow (City of)		
Issuer Credit Rating	BBB/Negative/--	BBB/Stable/--
Russia National Scale	ruAAA/--/--	ruAAA/--/--
Senior Unsecured	BBB	BBB
Senior Unsecured	ruAAA	ruAAA

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