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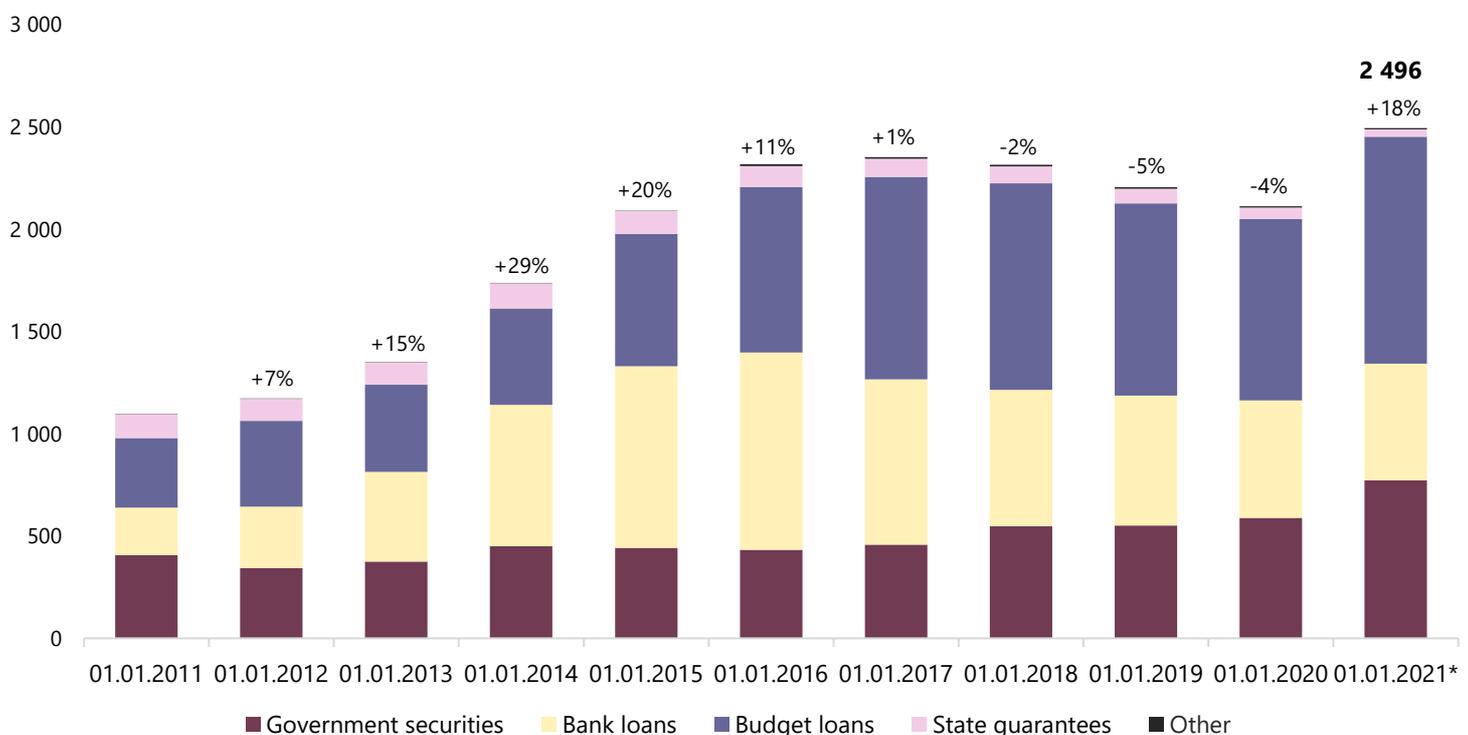
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Debt for the long term: what should be done about the outstanding growth of regions' debt load?

Overview of the dynamics of the debt load of Russia's regions

- **Regional budget expenses aimed at containing the COVID-19 pandemic have led to an increase in their total debt.** The deficits of 2020, which were due to a strong growth of budget spending on health care and social policy, had to be partially financed by attracting debt financing, which resulted in its increase (up 18%) for the first time since 2016. The relative debt load on regional budgets also grew because of a decline in their internal revenues.
- **Cheap six-month budget loans helped avoid a traditional growth of bank loans.** Their increase amounted to more than RUB 220 bln, i. e. more than half of the total debt growth. However, these loans were given as part of anti-crisis measures, and in six months they will need to be extended, or refinanced.
- **Some regions took advantage of historically low market rates and fixed an interest rate for several years, thereby eliminating the risks of refinancing.** However, only eighteen regions pursued this strategy, although the total bond debt amounted to a record RUB 773 bln as of the end of 2020.

Figure 1. Spending on minimizing the impact of the coronavirus pandemic led to an increase in the total debt of Russian regions



* ACRA calculations for the end of 2020 are based on operating data of the Ministry of Finance of the Russian Federation.

Source: Ministry of Finance of the Russian Federation, ACRA

In 2020, the total debt load of Russia's regions saw a record growth for the last few years

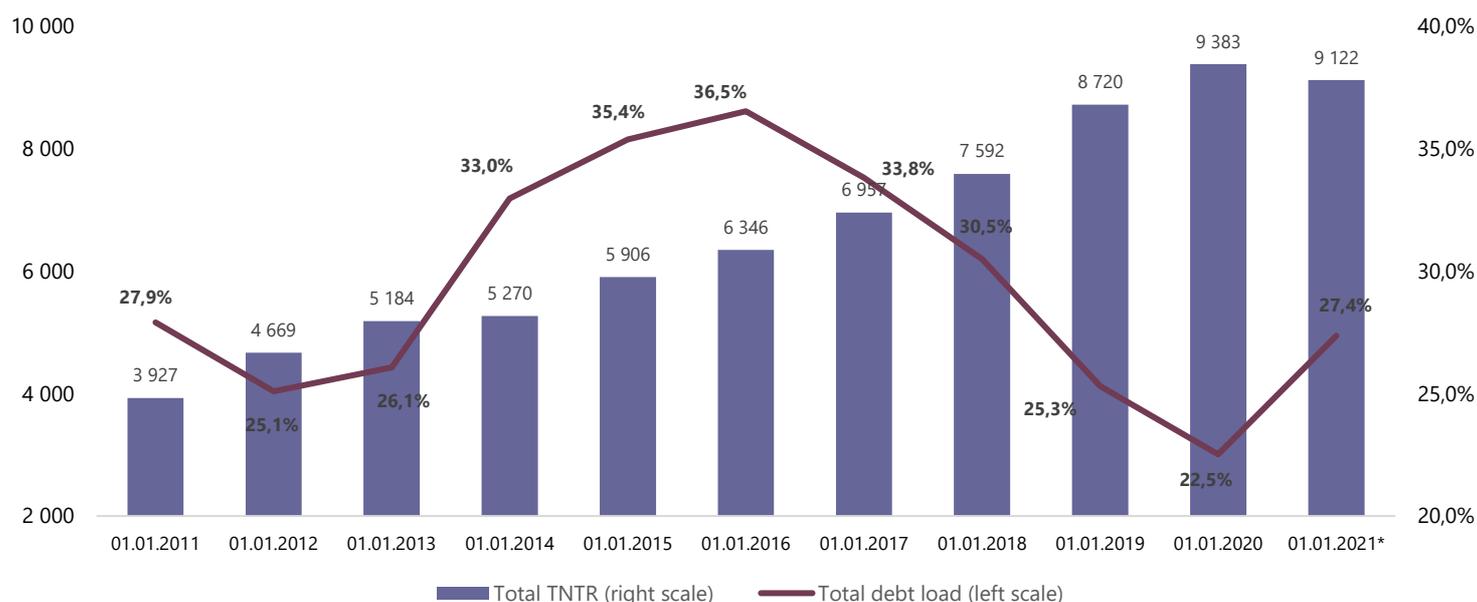
In 2020, the total debt of Russian regions grew for the first time since 2016, surging by 18% compared to 2019. It is noteworthy that comparable growth rates were observed in 2013 and in 2014, when the President's May decrees were actively implemented. However, during that period the regional budget deficit and the growth of debt were due to attempts aimed at improving the quality of life of certain categories of citizens. Meanwhile, the 2020 deficit is due to government efforts to contain the pandemic and, consequently, an increase in social spending aimed at supporting population and business. According to preliminary estimates of the Ministry of Finance of the Russian Federation, the total deficit of Russian regions amounted to nearly RUB 677 bln as of the end of 2020. In 2019 and 2018, by comparison, the regions' total budget resulted in a surplus of around RUB 16 bln and RUB 492 bln respectively. According to First Deputy Minister of Finance of the Russian Federation L. V. Gornin (official data has not been published yet), the regions financed nearly RUB 383 bln of their deficit via an increase in debt. The deficit of Moscow, which was covered with its internal funds, amounted to around 20% of the total deficit of Russian regions in 2020.

Under the circumstances, the total debt of Russian regions saw a record growth in absolute terms since 2013. According to the Ministry of Finance of the Russian Federation, it stood at RUB 2.496 tln as of January 1, 2021. Hence, the trend of the last three years towards reducing the total debt of Russian regions has been reversed.

In 2020, the relative debt load (the ratio of debt to tax and non-tax revenues, TNTR) of Russian regions also rose, which has not been seen in recent years either. The growth is not only due to an increase in the total debt, but also because of a 3% decline in TNTR year-on-year caused by the pandemic. The total debt load of Russia's regions as of the end of 2020 amounted to 27% against 23% a year earlier.

TNTR decreased in 2020 for the first time over the last ten years.

Figure 2. Decrease in revenues fueled the growth of debt load



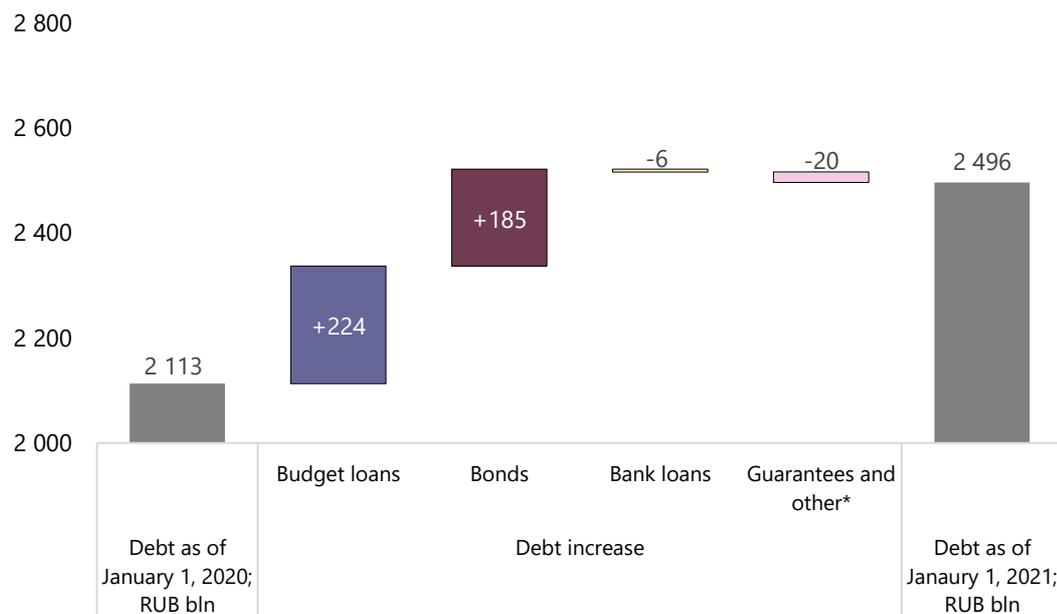
* According to operating data as of December 31, 2020.

Source: Ministry of Finance of the Russian Federation, Federal Treasury, ACRA

Temporary increase in the volume of budget loans

Last year, it was budget loans and bonds that accounted for the growth of debt. While an increase in the volume of borrowings is a common practice for bonds (from year to year, with some exceptions, the volume of debt financed with bonds has been growing), the share of budget loans in the total debt of Russian regions has been gradually decreasing since 2017: budget loans were not granted until the end of 2020. However, this year the above-mentioned trend has been temporarily reversed.

Figure 3. Budget loans accounted for more than half of the debt growth



* ACRA's forecast.

Source: Ministry of Finance of the Russian Federation, ACRA

At the end of 2020, we [wrote](#) about the mechanism of refinancing loans provided by the Federal Treasury Department (FTD) with budget loans by July 1, 2021.

According to the Federal Treasury Department, last December the regions were provided with 53 loans worth RUB 224 bln. It is logical to assume that all of them were refinanced.

As such, the volume of budget loans rose by around a quarter in 2020 compared to the previous year, and the regions will save nearly RUB 2 bln on interest expenses by attracting cheap financing, according to our estimates. However, these loans will have to be either extended, or refinanced with market instruments in mid-2021.

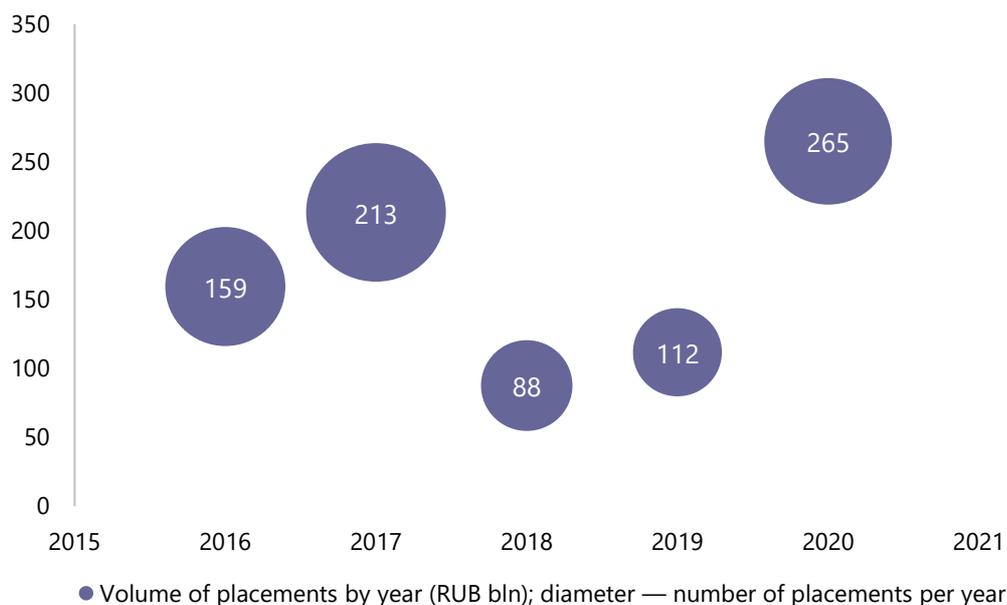
Several amendments were made to the Budget Code of the Russian Federation 1st December to ensure the provision of budget loans. For example, starting from December 8, 2020, the repayment date for loans granted by the Federal Treasury Department was changed from November 25 to December 15. According to data of the Ministry of Finance of the Russian Federation, all regions repaid their FTD loans by the beginning of last December (the balance of budget loans between the start of December, 2020, and early January, 2021, was not positive for any region). However, following the changes in legislation the regions were again provided with FTD loans.

It is worth noting that the region cannot raise loans from the Federal Treasury Department if it placed deposits. However, this does not apply to budget loans.

Bond boom

As we have mentioned before, bonds have become one of the key sources for financing regional budget deficits in 2020. The regions' bond debt reached RUB 773 bln as of January 1, 2021 (up RUB 185 bln compared with a year earlier). The total amount of all exchange-traded bond placements (including additional placements) amounted to RUB 265 bln.

Figure 4. Bond placements hit new record in 2020



Source: Cbonds, ACRA

Bonds were placed under unique conditions, allowing the issuers to fix a low coupon rate for several years. The volume of placements (including additional placements of previous years) in the first half of 2020 was unusually high — 22% of the total volume of placements, or RUB 57 bln.

At the same time, bank loans, which are characterized by a regulatory lower rate¹, were provided by banks reluctantly and for a short period in light of low interest rates. According to our estimates, over 40% of purchases of credit facilities did not take place. As per ACRA calculations, the maturity of almost half of the concluded loan agreements did not exceed one year in 2020, while in 2019, for example, the share of such short loans stood at around 25% of the total volume of concluded agreements.

According to our estimates, the growth of the total debt load of Russia's regions will slow down but not stop. The regions' ability to contain budget expenses that grew during the fight against the pandemic, primarily on health care and social policy, will be a determining factor. Of course, an increase in the absolute amount of debt given a constrained growth of budget revenues will negatively affect the regions' creditworthiness, especially those, whose debt load was high even before

¹ In most cases, an interest rate for the Russian region should not exceed the key rate +1%.

the coronavirus pandemic. ACRA believes that under the circumstances, it is important to avoid the risks of refinancing, i. e. a situation where a significant part of regional debt will be short, because a balanced repayment schedule will make it possible to avoid such a significant impact of the debt growth on the regions' credit quality.

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