COUNTRY RISK ANALYSIS

Russia

CREATING CONFIDENCE IN YOUR EXPORTS

COUNTRY RISK CATEGORY

3/7

The country risk categories range from 0 to 7. The lower the number the better the credit rating the country has.

0 1 2 3 4 5 6 7

EKN'S OUTSTANDING GUARANTEES IN THE COUNTRY

Short-term transactions: SEK 0.3 billion

Medium and long-term transactions: SEK 15.9 billion

EKN'S POLICY

Sovereign risks: Normal risk assessment

Other public risks: Restrictive risk assessment

Bank risks: Restrictive risk assessment

Corporate risks: Restrictive risk assessment

See “EKN'S POLICY” section

DATE

20/03/2013

Reforms needed but delayed

Russia's future growth rate trend is slowing and the dependence on oil remains. However, the external balance is good and the government debt is low while international reserves are among the largest in the world. In other words, the country still has a substantial buffer, but needs to implement a programme of fiscal austerity and structural reforms. With Putin back as president, the country is continuing along an unchanged political and economic path. Despite protests, Putin's popularity is basically stable, and there is a lack of a strong opposition. Overall, political and economic continuity is expected in the future, even though reforms are being delayed. At the same time, there are signs of a slightly greater willingness to reform than before, which is expected to produce positive economic impacts in the long term.

STRENGTHS

- Low national debt
- Large reserves
- The central bank's monetary policy has been tightened

WEAKNESSES

- Weak investment climate and limited reforms are inhibiting foreign investment
- Oil dependent economy, diversification taking time
- Widespread corruption

POLITICS

Russia's centre of power is being challenged

Voters gave Putin's United Russia party a majority in the Parliament at the 2011 election. The election was followed by some unrest as demonstrators protested against electoral fraud. Expressions of dissatisfaction have continued, but on a smaller scale since the election. Putin remains the most popular politician in Russia. The social elite supports Putin and the opposition is divided between Communists and Nationalists which means that there is no dominant alternative to Putin and United Russia. Nevertheless, the expressions of dissatisfaction are forcing Putin to reconsider his previous strategy, with the result so far mainly being that the freedom of movement for minority groups, the civil society and the media has contracted. Overall, political developments have meant that Russia has dropped in indexes measuring openness.

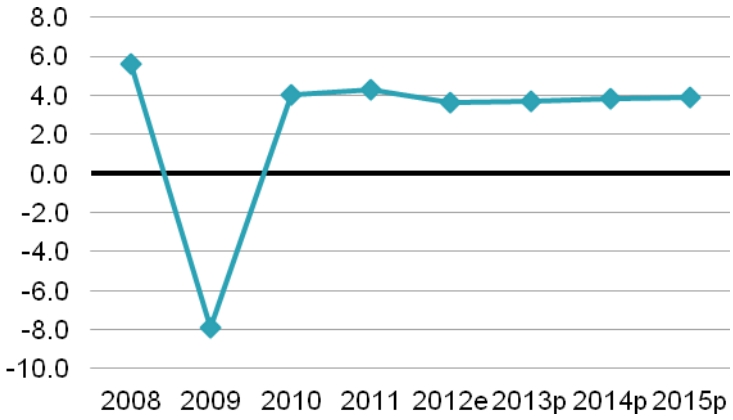
The power in Russia is centralised to Moscow, and Russian politics continues to be characterised by a lack of transparency in the decision-making processes. This means that the long-term domestic politics is shrouded in great uncertainty as many issues are handled by spheres of influence behind the scenes of the Russian Parliament. Institutional reforms are taking a long time, as they are unpopular to implement. Several of the regions, particularly in the North Caucasus, which is calling for an increased degree of autonomy have once again been given the opportunity to elect their own leaders. This has been one way of improving relations between Moscow and the regions, which at times has been problematic. Conflicts flare up periodically between these parties, something that is likely to continue to be the case in the future. To date, these conflicts have been dealt with by force. An escalation of conflicts, including armed ones, are likely to be fought resolutely.

ECONOMY

Growth rate stalling

The financial crisis of 2008 impacted Russia negatively and GDP fell by eight per cent as a result. The economy has since recovered and the growth rate is expected to be four per cent in the coming years. Although the average price of oil is over USD 100 per barrel, the future growth rate is not expected to exceed four per cent. Growth prospects in the medium term are deteriorating because of continued delays in reforms to improve the business climate, and diversify the economy. With the exception of some positive effects of WTO accession, it would appear the will and capacity to reform the economy by the political leadership, in reality, is small. This is reducing the ability to increase growth and diversify the economy away from oil and gas in the longer term.

GDP GROWTH (%)



The growth rate will level off following the years of crisis. Source: IMF.

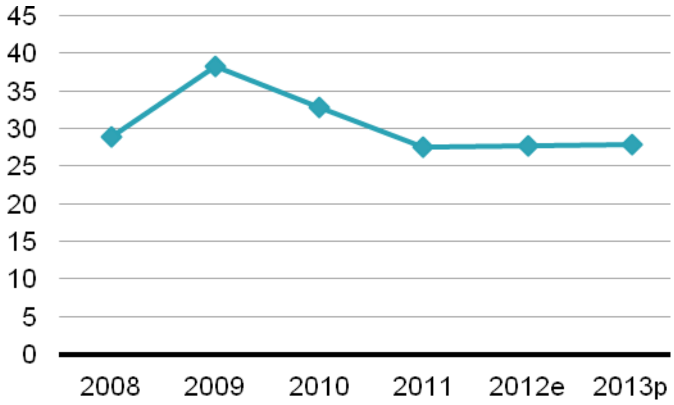
Ahead of the parliamentary and presidential elections, the government was less inclined to implement the necessary fiscal tightening policies. Since then, the administration has certainly tightened a little, which includes limiting spending in relation to the price of oil, but tax cuts and increased military spending will see an increase to the budget deficit in the coming years. Although Russia still has fiscal buffers in the form of oil funds, the underlying status of public finances has deteriorated. The rapid growth in government spending has seen the budget deficit rise. This means that the oil price needed to balance the budget has gone up. Consequently, this increases the vulnerability of the country to a possible decline in oil prices. In the event of a new global recession, the state will have less room for fiscal stimulus than it had in 2008. The conclusion is that the combination of the current policies and economic structure will not lead to a decreased dependence on oil. While oil prices remain at levels above USD 100 a barrel, the outlook is stable, but if there is an increased fluctuation in the price of oil, Russia will be more vulnerable.

BALANCE OF PAYMENTS AND DEBT ISSUES

External balance strong despite large capital outflows

Russia's external balance is good. External debt currently represents about 30 % of GDP. This is expected to rise slightly, but remain manageable. International reserves, which are one of the largest in the world, provide a liquidity buffer.

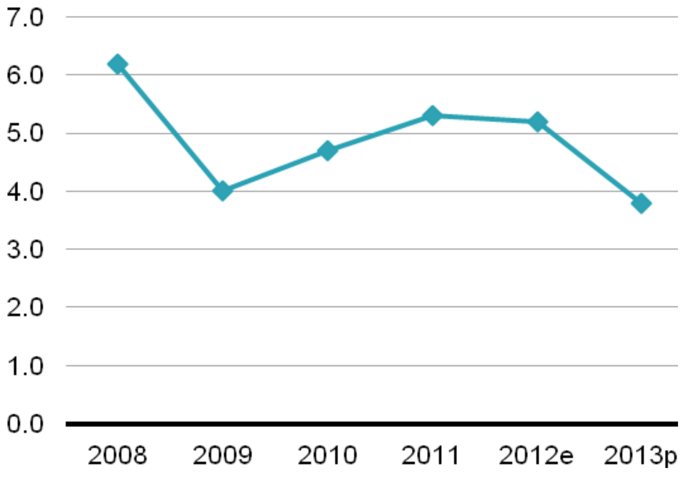
EXTERNAL DEBT (% OF GDP)



External debt is limited. Source: IMF.

Russia has had a current account surplus every year since 1997. In 2012, oil production reached its highest level since the fall of the Soviet Union, and oil and gas constitute 65 % of the country's exports. The country has the world's eighth largest oil and gas reserves, probably a lot more if the Arctic region is included, but there is a major need for investment in the sector. The current account surplus is now shrinking at an increasing rate. Most forecasts for the current account deficit in the coming years point to a reduced surplus as imports rise. This is mainly due to the import of services increasing, primarily in the form of an increased outflow since Russians travel more. The expectation is that travel will remain a significant factor in the future as the emerging middle class is happy to spend money on holidays abroad. For Russia to continue to enjoy a current account surplus, the oil price needs to remain above USD 110 a barrel, which is high compared to many other oil producing countries.

CURRENT ACCOUNT BALANCE (% OF GDP)



The current account surplus is contracting. Source: IMF.

Historically, capital outflows from Russia have been significant, especially in recent years. Capital outflows totalled about USD 80 billion in 2012, representing around four per cent of GDP which is about the size of the current account surplus. Capital outflows were **among** the largest ever. In 2013 some improvement is expected and the outflow is likely to fall. Financing conditions in international capital markets have improved somewhat for larger companies and banks, even if domestic political uncertainty is expected to persist. Capital outflows remain manageable thanks to the buffer in international reserves. Foreign direct investment gained momentum in the second half of 2012. The majority of investment comes from Cyprus, where many Russian companies are based for tax purposes and is probably made up of Russian reinvestments.

CURRENCY POLICY

New currency policy increasing stability

The central bank has switched its focus from inflation to exchange rate stability in recent years. The initiative, which involves a more flexible exchange rate, has helped reduce inflation and improve economic stability. The central bank is continuing to intervene in order to reduce sharp fluctuations in exchange rates, but there is no longer a target for the Russian ruble as the exchange rate is largely being driven by market forces. In 2011 and 2012, the currency has been allowed to both strengthen and weaken, which has increased the credibility of the new foreign exchange policy. More action is still required to create and maintain confidence in the ruble in the longer term. Most forecasts point to a largely unchanged exchange rate in the coming year. Major changes in oil prices, in particular, could have an impact on the exchange rate. In summary, relatively high confidence remains in the currency. The currency has a high degree of convertibility and can be assessed by EKN in local currency financing transactions.

FINANCIAL SECTOR

Banking sector dominated by state banks

The Russian banking assets are equivalent to 80 per cent of GDP and the rate of growth has been rapid. Lending to the private sector is still relatively limited, although it is on the rise. The banking system, which includes over 900 banks, is dominated by a few large state-owned banks and some prominent privately owned banks. The quality of the loan portfolios of the major banks has improved since the crisis albeit from a low level, and mainly because of an increase in lending. The share of bad loans in the banking sector is around six per cent. Meanwhile, official data shows that reserves just about cover the bad loans in full. The figures are probably not completely accurate as loans to households and companies who cannot pay are often renegotiated. Capital adequacy has also fallen along with profitability which is at a relatively low level since the crisis. Overall the financial sector is growing, as the larger private and state banks are well placed at the present time. For small and medium-sized banks, the situation has not yet fully recovered from the financial crisis, and a number of challenges remain.

Financial problems were revealed at the Bank of Moscow, the country's fifth largest bank, in 2011, necessitating a government bailout. This incident demonstrates the poor transparency in the banking system, the inadequate supervision and the risks involved in lending to related companies. The risk scenario is more favourable for state banks or banks with strong foreign parent banks, as they can usually count on support from the state or their respective owners.

BUSINESS ENVIRONMENT

Corruption and weak business climate

Russia is a problematic country for lenders and investors. Corruption is widespread. The country is ranked 133 (of 174) in the world regarding corruption by Transparency International. It is far behind comparable emerging countries such as Brazil, India and China which are ranked between 66 and 94. The business climate is also a weakness, as Russia is ranked 112 (of 185) by Doing Business. The transparency of the financial status and ownership of companies is poor and business groups are often complex. Pursuing court cases and bankruptcy proceedings can be unpredictable and time consuming, especially outside of Moscow. Regulatory changes are common and generate uncertainty for businesses. Local knowledge and quick action in the face of payment problems are therefore important.

Improved liquidity in the corporate sector

Small and medium-sized companies have not yet felt any noticeable relief in financial markets, which has led to an increased dependence on loans from large state-owned banks where they were not previously customers. However, incentives from the central bank have also facilitated lending by banks to larger companies. The short-term debt in foreign currency has generally declined in recent years, and the risk of liquidity problems in the corporate sector is lower now than before the financial crisis of 2008/2009.

Russia's accession to the WTO was completed in December 2011 following 18 years of negotiations. The effects have so far been limited. In the longer term, the commitment to open up the economy to foreign direct investment, for example, in the banking and telecom sectors, will have positive effects in terms of higher growth. The obligation to treat foreign and domestic companies on equal terms and abolish state aid for Russian exporters ought to strengthen competition in the Russian economy and help to increase the predictability and accountability of the state.

Weak public and political institutions are generating uncertainty in terms of the ability and willingness of public buyers to pay. Russia consists of a variety of regional and local entities and the allocation of accountability between them and the federation is often unclear. Some regional and local entities have credit ratings and should therefore be regarded as relatively transparent.

EKN'S EXPOSURE

Major exposure dominated by the telecom sector

Russia is the fourth largest export market outside the EU and exports to Russia account for around two per cent of total exports. The majority of exports consist of vehicles and telecom equipment. There is major potential for substantial exports to the commodities sector, infrastructure, agriculture and food production.

EKN OFFERS AND GUARANTEES TO RUSSIA (AT DECEMBER 31)

Guarantee and offer volume is greatly affected by large individual transactions. Source: EKN

COUNTRY RISK ANALYSIS	DATE	
Russia	20/03/2013	CREATING CONFIDENCE IN YOUR EXPORTS ekn

EKN's outstanding guarantees to Russia were about SEK 16 billion. This makes Russia one of the largest countries in EKN's portfolio. Most of the guarantees are in the telecom sector. There is also significant exposure in the power sector and the pulp and paper industry. The largest flow in terms of number of transactions is in the transport sector.

PAYMENT EXPERIENCE

EKN's experience of guaranteeing transactions to Russia is generally good but since the financial crisis, problems have occurred in some cyclical sectors, particularly transport. Over the period 2010-2012, EKN had indemnification payments amounting to SEK 127 million. The problems have led to delays, rescheduled payment plans and, in some cases indemnifications. Some withdrawals of equipment have also occurred. The experience of indemnifications and recovery processes in the country is unclear, but overall the impression is that it is still satisfactory.

EKN'S POLICY

EKN classifies Russia in country risk category three, an assessment undertaken in collaboration with the OECD. However, as a result of the crisis, Russia was classified in risk category four by the OECD over the past year 2009/2010. EKN opted at that time to differ from the OECD classification and let the country remain in category three. For all buyer categories except for sovereign risks, some form of restrictions is in place.

For private companies and banks, the policy means that EKN, in addition to assessing the risk on its own merit, has adopted a more restrictive approach from the beginning. EKN prefers that any transaction is fully transparent and there are buffers in place, particularly in foreign currency, at the company or bank.

OFFICIAL COUNTRY DATA AND CREDIT RATINGS

OFFICIAL COUNTRY DATA

Area: 17,075,400 km² (38 times Sweden)
Population: 141.9 million (2011)
Population growth: -0.1 % (2011)
GDP: USD 1,480 billion in 2010 (Sweden USD 458 billion in 2010)
GDP/capita: USD 13,543 in 2011 (Sweden USD 58,228 in 2011)

CREDIT RATING

	COUNTRY CEILING	SOVEREIGN RATING
Moody's:	A2	Baa1/Stable
S&P:	BBB	BBB/Stable
Fitch:	BBB+	BBB/Stable

Country analyst

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DISCLAIMER
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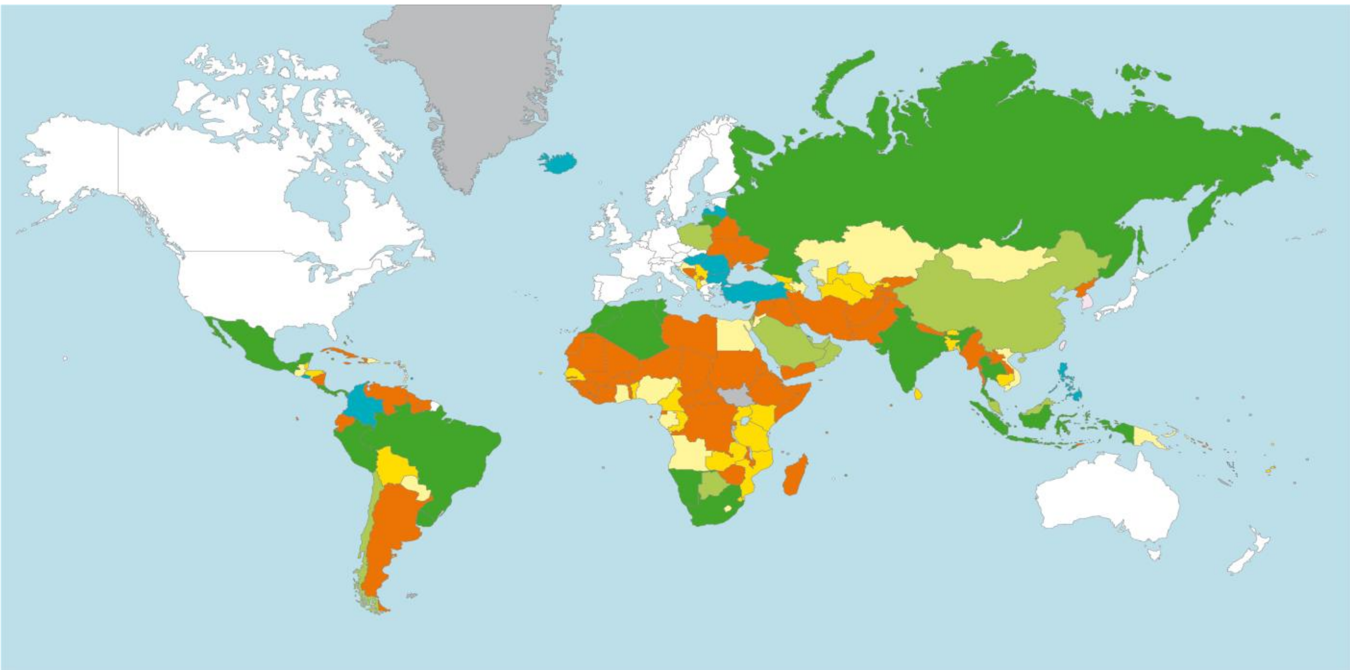
EKN's view of the world



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EKN – CREATING CONFIDENCE IN YOUR EXPORTS
EKN is a government agency that supports Swedish exports and the internationalisation of Swedish industry. This we do by offering exporting companies and banks guarantees for payment and financing, together with advice on business structure and risk management. Our services provide an extra level of confidence, increased competitiveness and more opportunities for successful export transactions.

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