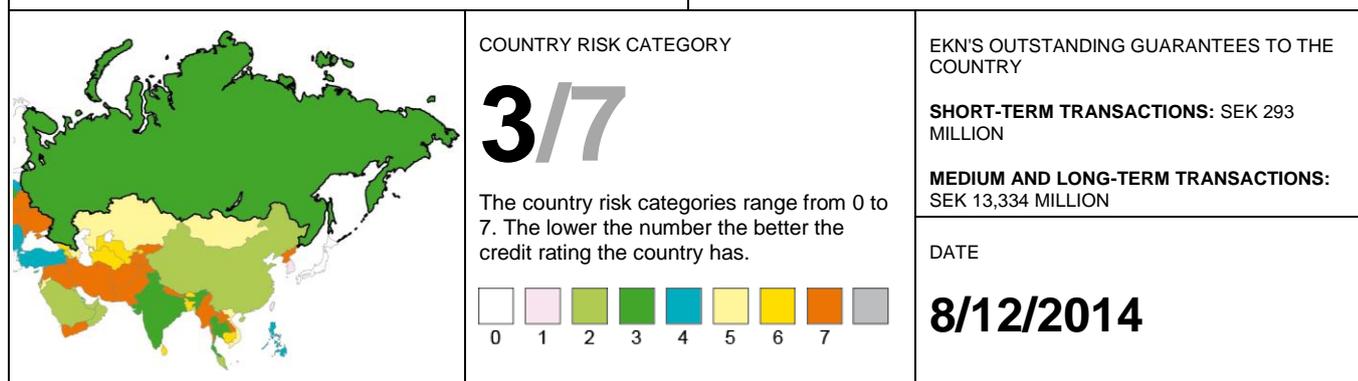


Russia



Ukraine conflict exposing structural weaknesses

The sanctions against Russia as a result of its annexation of Crimea and Russia's involvement in the unrest in eastern Ukraine have left their mark on the Russian economy. Greater uncertainty concerning future developments is reducing an already low willingness to invest. Even before the sanctions, Russia has been characterised by institutional and structural obstacles to investments as well as lacking economic diversification, which has led to a decline in GDP growth in the last years. The crisis in Ukraine has accelerated this negative trend and the country's GDP is expected to fluctuate between weak growth and recession in 2014 and 2015. The sanctions will likely remain in place for several years and exacerbate the already weakened Russian economy via continuing low growth, rising inflation and capital outflows. There is an impending risk of the sanctions being expanded.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Strategically important trade partner for the EU.
- Low public debt and large international reserves.
- Enormous natural resources in the form of oil, gas and minerals.

Weaknesses

- Insufficient investment impeding growth.
- A difficult business environment due to widespread corruption, as well as weak and politicised institutions.
- Tense relations with the West and most of the financial system under sanctions.
- Risk of expanded sanctions.

Increased restrictiveness

EKN provides guarantees for export transactions to Russia within the frameworks of the trade sanctions against Russia. Applicants for guarantees for exports to Russia must submit information about the product, end user and, where applicable, licences. Some form of restriction is in place for all buyer categories, in addition to purely sovereign risks. Due to the sanctions against Russia, EKN's restrictiveness has increased for other public buyers and banks. For companies, this policy means that EKN, in addition to assessing the risk on its own merits, has adopted a more restrictive approach from the outset. EKN prefers that any transaction is fully transparent and that there are buffers in place, particularly in foreign currency, at the company or bank.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- A solution to the Ukraine crisis that would lead to a reduction in sanctions.

The policy may be made more restrictive in the event of

- An exacerbated conflict with Ukraine or the conflict spreading in a way that leads to increased sanctions.
- Long-term sanctions that affect Russia's liquidity and business environment negatively.
- Heavily eroded international reserves that threaten the country's ability to pay.

EKN'S EXPOSURE AND EXPERIENCE

EKN's outstanding guarantees to Russia are equal to SEK 13.6 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 paper/pulp industry. The largest flow in terms of number of transactions is in the transport sector and the construction industry. EKN's experience guaranteeing transactions to Russia is generally good, but there are exceptions. Late payments are not uncommon, especially in SME export transactions with Russian customers. In the autumn of 2014, we have seen late payments which are most likely due to the Russian counter-sanctions against the EU sanctions. The Russian food import ban is creating profitability problems for Russian carriers.

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DISCLAIMER

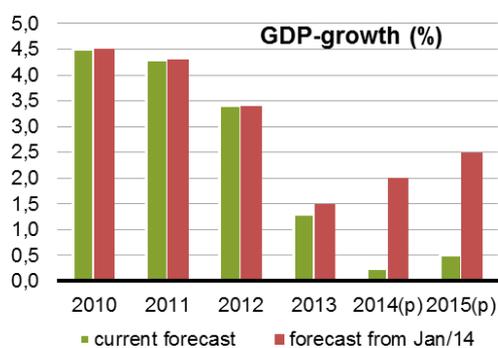
The country analysis is based on a range of sources and reflects information that is relevant to EKN at the time of publication. The responsibility for how the information is used or interpreted rests solely with the user, and EKN cannot be held responsible for any loss or damage.

Harder foreign-policy line

The annexation of Crimea and conflict in eastern Ukraine has led to increased tensions in Russia's relations with the West. The conflict was exacerbated over the summer in conjunction with the shooting down of a Malaysian passenger airliner and Russia's clearer support for the separatists in eastern Ukraine. Expanded sanctions in July and September have led to increased turbulence in the region and caused a further drop in confidence in Russian policies. Russia is developing in a more authoritarian direction and the increasing centralisation of power around Putin is occurring at the expense of political openness, local influence and much-needed institutional and structural reforms. Putin's nationalist attitude will probably give him stronger domestic policy standing and may be an attempt to shift attention from the weaker domestic economy to an external enemy. A harder line is also being shown in foreign policy, such as in actions against Ukraine, Russian counter-sanctions in the form of an import ban on certain goods from the West and a law to limit foreign ownership in media companies. These Russian actions probably aim to obstruct Ukraine from getting closer to the EU and simultaneously retain Russian influence in Ukraine by pushing for increased autonomy in the eastern parts of Ukraine. It is highly likely that the conflict will be a long one. The threat of expanded sanctions will remain. Without a political solution, easing of sanctions against Russia will not be possible.

Light shed on structural problems

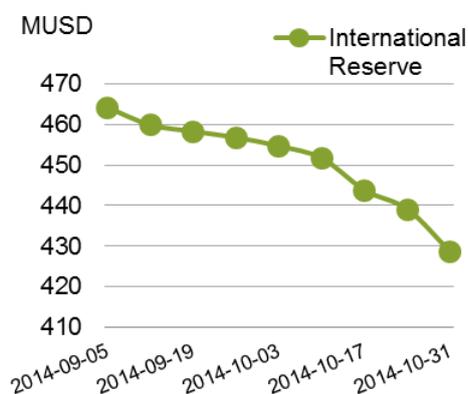
Russia's economy is suffering from structural problems. As a result of the weak business climate and the uncertain regulatory environment, investment levels are low in proportion to modernisation needs of Russia's capital-intensive industry. Attempts at economic diversification have often been misguided and have not reduced Russia's dependence on the oil and gas sector, which accounts for two-thirds of its exports and over half of government revenues. Stagnant oil production and lower oil prices are amplifying these shortcomings. The sanctions introduced by the EU, the US and other countries against Russian banks, the oil sector and other sectors have increased the uncertainty surrounding developments in Russia, impacted willingness to invest negatively and increased capital outflows. The five Russian banks subject to the sanctions account for approximately half of the Russian banking system. As a result of the sanctions, they no longer have access to the EU or the US for their financing. However, there is an exception that allows banks to finance import and export transactions, which means that EKN is permitted to guarantee transactions for lending to these banks. The sanctions have made the credit risk worse and increased uncertainty with respect to the consequences of any expanded sanctions against the financial system in the future.



Source: IMF

The rouble has depreciated considerably over the year and has forced the central bank to raise the interest rate, which, along with rising inflation, will further impede growth. GDP growth is fluctuating around zero for 2014. The prospects for 2015 are equally bleak and the IMF's forecast has been revised down sharply since the beginning of the year. The relatively low price of oil, currently around USD 85 per barrel, will probably remain low in 2015, given the low global growth rate.

Russia's budget is balanced at a price around USD 100 per barrel, which puts pressure on the government to cut spending.



Source: Russia Central Bank

Russia's debt is at a low level and will not pose a threat to the country's ability to pay, even if the sanctions persist. Russia's liquidity is more of a cause of concern a couple of years down the road. In October, Russia's international reserves fell by as much as USD 26 billion, which is equal to a 6% decrease. The central bank has decided to reduce its intervention buying of the rouble and switch in practice to a floating exchange rate, which will likely slow down the decrease of the international reserves. The central bank retains the ability to intervene to mitigate temporary exchange rate decreases in

individual cases. Both state-owned banks and companies have requested support from the government on account of the restrictions on hard currency financing stipulated by the sanctions. This will also put pressure on the international reserves, because the sanctions, by all indications, will be long term.

The current sanctions will likely remain in place for several years and worsen an already weakened investment trend, which will contribute to growth remaining low. There is an impending risk of expanded sanctions and the probability of selective payment defaults among the sanctioned state-owned banks and enterprises has increased.

BUSINESS ENVIRONMENT

Tougher business environment

Russia's business climate is being held back by extensive bureaucratic obstacles, an unpredictable regulatory environment, weak institutional capacity and corruption. Transparency with respect to the financial situation and ownership of companies is poor and investor protection is generally weak. Regulatory changes are commonplace and generate uncertainty for businesses. For example, a law was adopted in Russia in October 2014, after very short deliberation, which will restrict foreign ownership in Russian media companies. Pursuing court cases and bankruptcy proceedings can be time-consuming and the outcome is unpredictable. It is therefore important to have local knowledge and take action quickly in the face of payment problems.

There are no signs of deep, structural improvements, and the business climate is therefore expected to remain difficult. The situation is being aggravated by the restrictions on economic capabilities caused by the sanctions. Russia is ranked 127th out of 177 in Transparency International's corruption index, which is far behind other comparable emerging countries, such as Brazil, India, China and South Africa. The World Bank's Doing Business Index ranks Russia 62nd in its most recent rankings.