COUNTRY RISK ANALYSIS

Russia

CREATING CONFIDENCE IN YOUR EXPORTS

COUNTRY RISK CATEGORY

4/7

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 TO THE COUNTRY

SHORT-TERM TRANSACTIONS: SEK 175 MILLION

MEDIUM AND LONG-TERM TRANSACTIONS: SEK 13,989 MILLION

DATE

17/3/2015

Crisis management instead of structural reforms

The oil price decline and the sanctions against Russia as a result of its annexation of Crimea and Russia's involvement in the unrest in eastern Ukraine have left a deep mark on the Russian economy. Greater uncertainty concerning future developments is lowering an already low willingness to invest. Even before the sanctions, the Russian economy has been characterised by institutional and structural obstacles to investments as well as lacking diversification, which has led to lower GDP growth over the past years. The crisis in Ukraine and the oil price decline has accelerated this negative trend and Russia's GDP is expected to fall by 3% in 2015. The sanctions will likely remain in place in their current extent for several years and exacerbate the economic situation via continuing low growth, rising inflation and capital outflows.

THE COUNTRY'S STRENGHS AND WEAKNESSES

Strengths

- 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

- Far too heavy dependence on oil exports.
- A difficult business environment due to widespread corruption, as well as a weak and politicised legal system.
- Strained relations with the West.
- A large part of the financial system is under sanctions and there is a risk of expanded sanctions.

EKN'S POLICY

Deteriorated country risk category

Russia's negative economic performance led EKN to downgrade the country from country risk category 3 to 4. It is estimated that there is a greater risk of non-payment in general. Some form of restriction is in place for all buyer categories besides purely sovereign risks. 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. As a result of the sanctions, applicants for guarantees for exports to Russia must submit information about the product, end user and, where applicable, licences.

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- A resolution of the Ukraine crisis that would lead to easing of sanctions.
- Higher oil prices for a long period of time.

The policy may be made more restrictive in the event of

- Protracted or expanded sanctions which negatively affect Russia's access to capital and business environment.
- Persistently low oil prices that threaten the country's ability to pay.

EKN'S EXPOSURE AND EXPERIENCE

EKN's outstanding guarantees to Russia are equal to SEK 14 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 inflow in terms of the number of transactions is in the transport sector and the construction industry. In the autumn of 2014, EKN has seen an increase in payments in arrears, which is most likely due to the decline of the rouble and, to a certain extent, the Russian counter-sanctions against the EU sanctions. The sharp decline of the rouble has made it more expensive to pay for imported goods. The Russian food import ban has also created profitability problems for Russian carriers.

COUNTRY ANALYST

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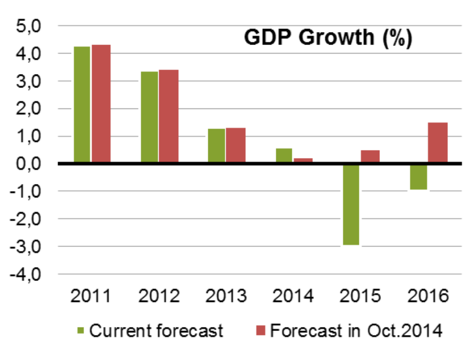
DISCLAIMER

Hard line policies

The annexation of Crimea and the conflict in eastern Ukraine have led to increased tensions in Russia's relations with the West. The conflict was exacerbated in the summer of 2014 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 2014 led to increased turbulence in the region and caused a further drop in confidence in the Russian regime. Russia is developing in a more authoritarian direction and the increasing centralisation of power is occurring at the expense of political openness, local influence and much-needed structural reforms. President Putin's nationalist attitude will probably give him stronger domestic policy standing in the short term and may be an attempt to shift attention from the weaker economy to an external enemy. A harder line has also been shown in foreign policy, such as in actions against Ukraine and Russian counter-sanctions in the form of an import ban on certain goods from the West. These Russian actions 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 the country. It is highly likely that the conflict will be a long one. The threat of expanded sanctions will remain. Without a political solution, sanctions against Russia will not be eased.

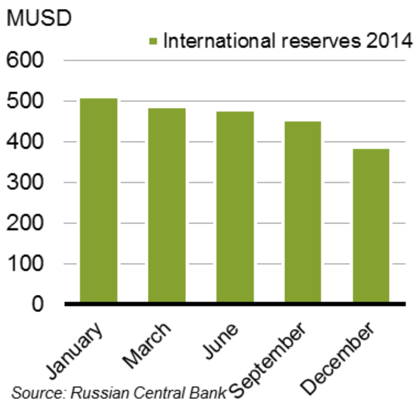
Crisis management, but no sustainable solution

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 the large-scale modernisation Russia's capital-intensive industry is in need of. 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. Stagnating oil production and the rapidly falling oil price in the latter part of 2014 are strengthening these deficiencies. 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, had a negative impact on willingness to invest and increased capital outflows. The five Russian banks on the sanctions lists account for approximately half of the Russian banking system. As a result of the sanctions, they no longer have access to the markets in 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 involving 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.



(Data:IMF)

The rouble depreciated considerably in 2014 as the oil price fell, forcing the central bank to raise the interest rate, which, along with rising inflation, will impede growth. 2014 was a year of zero growth for the Russian economy. The outlook for 2015 is even weaker and the IMF's forecast has been adjusted down sharply during the year. The most recent forecast for 2015 shows negative GDP growth of 3%, which will probably be adjusted down even more. The oil price will likely remain low in 2015, given the low global growth rate and continuing overproduction. Russia's past budget was balanced at a price around USD 100 per barrel, which has put pressure on the government to cut spending. The government has introduced a crisis package with major general budget cuts, but certain sectors have been exempted, including social services, defence and agriculture. The Russian government is presenting short-term solutions to cure the symptoms, hoping for a return to higher oil prices instead of implementing structural reforms and economic diversification.



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 continue. Russia's access to capital is more of a cause of concern a couple of years down the road. The oil price decline in the autumn of 2014 caused the rouble to fall dramatically, which led the central bank to use intervention buying to attempt to strengthen the exchange rate. The international reserves decreased by USD 25 billion in one week in December alone when the central bank drastically raised the interest rate. Only in the crisis year of 2008 were capital outflows higher than in 2014. The central bank has decided to reduce its intervention buying of the rouble and switch in practice to a floating exchange rate, which has slowed down the decrease of the international reserves. 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 will by all indications be long term.

The current sanctions will likely remain in place for several years, and combined with a low oil price, they will exacerbate an already low rate of investment in the economy. The risk of expanded sanctions affecting business opportunities or Russia's access to hard currency is not imminent, but the likelihood of companies and banks having payment problems due to the currency depreciation has increased. A balance of payments crisis or the implementation of strict currency controls in the coming years is considered less likely at this time.

BUSINESS ENVIRONMENT

Difficult 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 further aggravated by the economic decline and the fact that the sanctions restrict opportunities for investment. Russia is ranked number 136 out of 175 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 out of 189 countries in its most recent rankings. Certain sub-indexes rank Russia very low and others significantly better, which is why the cumulative ranking is not indicative of all difficulties in the business environment.