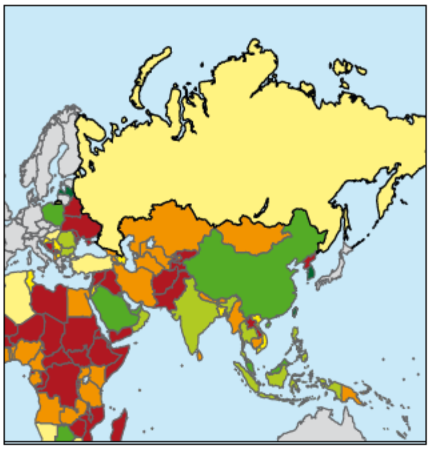
4/7 COUNTRY RISK CATEGORY

COUNTRY RISK ANALYSIS

Russia

0 1 2 3 4 5 6 7

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



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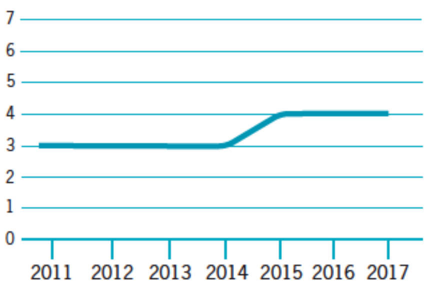
BASIC FACTS

Population	143 million (2016)
GDP, nominal	USD 1,281 billion (2016)
GDP/capita	USD 8,929 (2016)

COUNTRY CLASSIFICATION HISTORY



Source: EKN

Rising oil prices have turned the Russian economy around

Thanks to the price increase for crude oil, the Russian recession was relatively short-lived. In the autumn of 2016, the economic trend in Russia went back up and for 2017 the growth rate is expected to be just under two per cent. International reserves have recovered from the critical years 2014–2016, inflation is under control and Russia's debt remains at a low level. The default risk is therefore low. Oil and gas exports continue to drive the economy, though structural problems prevent the country from achieving a higher growth rate in the long term. The centralised and oil-dependent economy is dominated by government investments and incentives, which, combined with a weak rule of law and an unfavourable business climate, leads to low investment levels in relation to the needs of the capital-intensive industry. In August 2017, the USA increased its sanctions against Russia, and the EU sanctions have been extended until January 2018. There is a risk that these sanctions can be costly in the long term, but they have not stopped the economic recovery. Russia will continue to get by but will not soar.

EKN places Russia in country risk category 4 of 7. Normal risk assessment is applied for all purchase categories. EKN has long experience when it comes to payment risks in Russia and it has been generally good.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

STRENGTHS

+ Low level of debt
+ Enduring current account surplus and large international reserves
+ Extraction of enormous natural resources yields important export revenues and attracts foreign investment

WEAKNESSES

- The economy is excessively dependent on oil exports
- Sanctions and strained relations with the West
- Difficult business environment due to the weak rule of law, widespread corruption and government dominance of the economy

SWEDISH EXPORTS TO RUSSIA, MSEK

Russia	MSEK
2016	14,648
2015	14,688
2014	22,078
2013	23,614
2012	23,641

Source: Statistics Sweden

EKN'S EXPOSURE

	MSEK
Guarantees	9,000
Offers	4,900

EKN'S POLICY

EKN places Russia in country risk category 4 for both short-term and long-term guarantees – an assessment shared by the other OECD countries. Due to the sanctions, anyone applying for a guarantee for exports to Russia must provide information about the product, the end user and potential licences. Normal risk assessment applies to all types of purchasers, which means that there are no predetermined restrictions in the issuance of guarantees.

EKN'S COMMITMENT AND EXPERIENCE

EKN's outstanding guarantees amount to SEK 13.9 billion This makes Russia one of the largest countries in EKN's portfolio. The majority of the guarantees are in the telecom industry, followed by the energy and mechanical engineering industries. In the wake of the ruble's fall and the economic recession between 2014 and 2016, payment arrears have increased from SEK 17 million in 2016 to SEK 49 million in 2017. The arrears are thereby at their highest level since 2012, but only correspond to one fourth of the arrears that arose in guaranteed transactions in the country following the global financial crisis of 2007 to 2008 The arrears relate to transactions in several different industries. In 2017, EKN has paid a claim of SEK 5 million related to a transaction within the mining industry. This is the first claim paid in the country since 2013. In view of the high level of exposure to Russia, the arrears and claims remain small. EKN has long experience when it comes to payment risks in Russia and it has been generally good.

WHAT MIGHT CAUSE A CHANGE IN THE COVER POLICY?

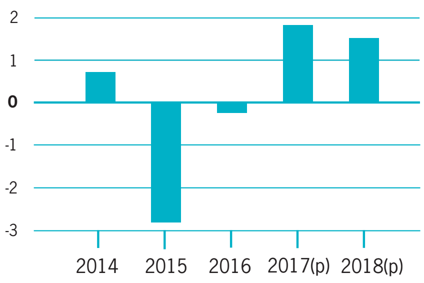
EASING OF RESTRICTIONS, IN THE EVENT OF:

- A continued stable oil price combined with comprehensive economic reforms
- A resolution of the conflict in Ukraine followed by the easing of sanctions

TIGHTENING OF RESTRICTIONS, IN THE EVENT OF:

- A drastic and prolonged drop in oil prices which threatens the country's ability to pay
- Long-term and significantly broader sanctions

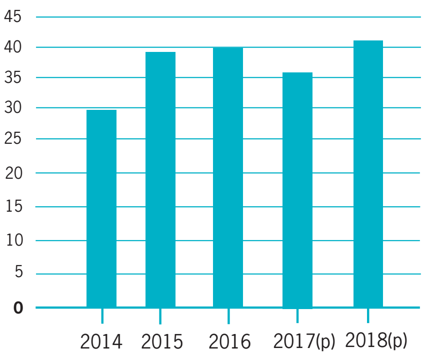
GDP GROWTH (% PER ANNUM)



Rising oil prices have turned the Russian economy around.

Source: IMF WEO 2017

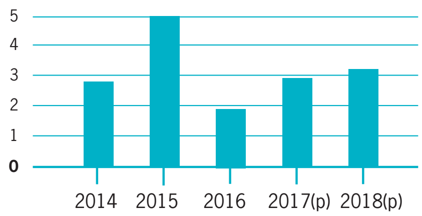
EXTERNAL DEBT (% OF GDP)



The external debt is relatively low.

Source: IMF 2017

CURRENT ACCOUNT (% OF GDP)



Surplus in the current account over a long period of time.

Source: IMF 2017

COUNTRY ANALYSIS

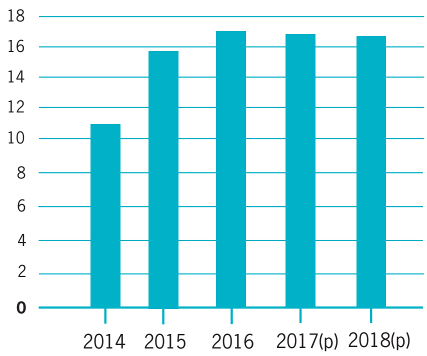
BACKGROUND

The development of the Russian economy is driven by the oil and gas exports, but is curbed by structural obstacles. Compared to the period 2000–2008, when the Russian economy grew at an average rate of seven per cent per year, the growth rate has slowed down. A drastic drop in global oil prices combined with the introduction of American and European sanctions shook the Russian economy in the autumn of 2014. The fall in the price of oil and the sanctions severely weakened the ruble, which caused inflation and interest rates to spiral upwards. The result was a two-year long economic recession, which clearly exposes the vulnerability of excessive oil-dependency. The sanctions against Russian banks and the oil sector, among others, aggravated the economic situation, for example by hampering financing and making foreign stakeholders less willing to invest. In 2014 there was a large outflow of capital from Russia, which consisted mainly of loan payments from Russian banks. The sanctions drastically reduce the banks' possibilities of renewing foreign loans, and many banks therefore chose to pay them off ahead of time. The economic recession was cushioned by the fact that the ruble was allowed to depreciate and domestic prices could adjust, while the increased interest rates reduced the capital outflow. Russia's political development is continuing to take an authoritarian direction and the increasing centralisation of power is happening at the expense of political transparency, local influence and much needed structural reforms. Foreign policy has taken a tougher and more nationalistic tone, as seen not least in Russia's involvement in Ukraine and its counter-sanctions in the form of import bans on certain products from the West. In the East, Russia continues to lose political and economic influence, above all in Central Asia, where China is gaining a lot of ground. Next year President Putin will have been in power for 18 years.

RECENT DEVELOPMENTS

Since 2016, the growth trend has turned around and the economy is expected to grow by 1.5–2 per cent in 2017. This recovery is due almost exclusively to higher oil prices. In September of 2017, inflation dropped to the historically low level of three per cent and interest rates are falling along with it. The return on Russian government bonds, which is a forward looking indicator of risk in the Russian economy, is steadily decreasing and is now nearing the 2013 level. International reserves have recovered while capital flows have returned to normal. One positive effect of the sanctions is an increased liquidity in the banking sector as Russian banks have brought home assets and paid off foreign debts. The macroeconomic policy has been strengthened over the last three years. In 2017, a new fiscal rule was decided for government expenditure and savings in the country's oil fund. The rule means that the federal government is tasked with balancing the primary budget based on a predetermined oil price of USD 40 per barrel (Urals blend). Any state revenues from an oil price above USD 40 per barrel will be saved in the oil fund and may only be spent if the oil price drops below USD 40 per barrel. This is a sound rule, as it means that state expenditure will be decoupled to a greater degree from fluctuating

INTERNATIONAL RESERVES (MONTHS OF IMPORT)



International reserves have been restored to a very reassuring level.

Source: IMF WEO 2017

BUSINESS ENVIRONMENT

Ranking from 0 (worst) to 100 (best)

Source: The World Bank

oil prices. In addition, the rule is based on a conservative oil price. However, this is not Russia's first fiscal policy rule for oil fund savings, and it remains to be seen to which extent it will be adhered to. The fiscal policy rule will come into force first in 2019.

The banking sector still consists of predominately state-owned companies and remains relatively underdeveloped, but stable. During the crisis years, the government supported the systematically important Russian banks, while the Central Bank took strict measures against many of the smaller banks that had not complied with statutory requirements. In the last few months, there has again been some turbulence in the banking sector. In August, the government seized control of the privately owned Otkritie Bank following suspicion that the bank had intentionally exaggerated the value of its eurobond assets, which triggered a bank run in which primarily companies emptied their accounts. Otkritie was Russia's fourth largest bank, and it was bailed out by the Central Bank's newly instated bank stabilisation fund. The bailout package is one of the largest in the country's history. The same fund was used to bail out the significantly smaller and previously privately owned Bin Bank in September, even though this bank is not on the Central Bank's list of systemically important banks. This recent turbulence in the banking sector is unpromising. At the same time, the Central Bank's intervention shows that the institution is both capable and willing to take measures to maintain stability in the banking sector. There may be trouble ahead for other financial institutions, which makes the choice of bank an important factor in export transactions with Russia.

In terms of foreign policy, the relationship with the USA has deteriorated over the last year and the thawing of relations that the Kremlin had hoped for appears not to be forthcoming. The situation in eastern Ukraine and Crimea remains unchanged, which means that the EU sanctions against Russia have been prolonged and also extended in scope due to four German turbines that have ended up in Crimea. The individuals and companies involved in the transaction have been added to the list, including Deputy Minister of Energy Andrey Vladimirovich. In August 2017, the USA decided to introduce sanctions against Russian pipeline projects and at the same time sharpened its financial sanctions against Russian banks and businesses. The new sanctions do not apply to American individuals/ entities only, and, unlike earlier sanctions, they are legally binding. Congressional approval is thus required to change or remove them, which means there is a risk they will remain in place for a long time. A ban on the purchasing of Russian government bonds is being investigated as part of the new sanction package, which could significantly reduce the Russian government's loan possibilities. The results of the investigation will be presented early in 2018.

Presidential elections will be held in March 2018. President Putin has yet to announce his candidacy, but most indications are that the president will run and thereby likely get another six years in power. There is currently no person or political party that could pose as a serious challenger to the sitting president.

THE LONG-TERM TREND

The prices of oil and gas will continue to be the most important decisive factors for the development of the Russian economy. According to the latest prognosis from the International Energy Agency (IEA), oil prices will stabilise at above USD 50 per barrel in the coming years, which would make for a continued growth of 1.5–2 per cent in the long term. The economy is slowed by an economic policy focusing on government investment and incentives. A weak rule of law and unfavourable business climate entails low investment levels in relation to the extensive modernisation needs of the capital-intensive industry. There are serious weaknesses in terms of ownership rights, labour market policies, innovation and infrastructure. Another structural problem is the antiquated pension system with its high retirement age and large pension costs. Low birth rates and a short average life span reduces the proportion of the population of full earning capacity, which has a negative impact on growth prospects. The sanctions against Russia makes long-term investment more difficult, especially in the oil industry, and further limits the growth prospects. However, other financiers have proven willing to fill the gap, not least China and Saudi Arabia, which reduces the long-term negative effects of the sanctions. At present there is nothing to indicate that they will be removed.

There is an ongoing debate, initiated by the Kremlin, regarding Russia's future economic policy. On one side is a small group of liberal reformists led by the former Minister of Finance Alexej Kudrin, now an independent researcher at the Saint Petersburg University and friend of the president. This group wants to see budget cuts and reduced government involvement in order to stimulate growth. On the other side is the so-called Stolypin Club, led by Presidential Commissioner for Entrepreneurs' Rights and leader of the Party of Growth, Boris Titov. The economists of the Stolypin Club want further government incentives in the form of cheap credits, increased government debt and external debt. If Putin runs for president, he will do so on a platform that is based on one of these proposals or, more likely, a combination of both. Kudrin's reforms would solve some of Russia's structural problems, but also entail a risk of challenging the current political system. This means that Putin is unlikely to align himself fully with Kudrin.

Thanks to the extraction and export of enormous natural resources, the country has a low level of government debt at approximately 16 per cent of GDP, and the government's interest expenses correspond to only 1.5 per cent of exports. The government debt consists primarily of medium to long-term debt and is owed in Russian rubles. A permanent current account surplus of 2–3 per cent of GDP per year in the last decade also means a relatively low external debt of 40 per cent of GDP and a high amount of international reserves. At present, these reserves are equivalent to 17 months' imports and more than 400 per cent of the country's short-term debts. According to IMF prognoses, only minor changes to debt levels and reserves are expected up until 2022. The debt service ratio is very high at 40 per cent, but it is manageable given the large international reserves. The macroeconomic policy is relatively strong, which indicates that it will be possible to keep inflation at a low and stable level also in the long term. All in all, the factors mentioned indicate that Russia will be able to handle potential financial crises in the future. A crisis involving the balance of payments or the introduction of currency regulations, which would entail transfer problems, is deemed unlikely. At the same time, the dependency on natural resources makes the Russian growth model vulnerable, as the country does not control oil and gas prices. Attempts at economic diversification that have been made have often been misdirected and have not reduced the dependency on the oil and gas sector, which represents two thirds of exports and more than half of government revenues.

BUSINESS ENVIRONMENT

Russia's business climate is still stifled by extensive bureaucratic obstacles, an unpredictable regulatory environment, a weak institutional capacity and corruption. Transparency in terms of the companies' financial situation and ownership remains weak. The corporate tax rate is low, but there are significant social contributions. Regulatory changes are common and create uncertainty for businesses. Political measures to reduce the dependency on imports have for example changed the playing field for many foreign businesses in a short period of time. Litigation and bankruptcy proceedings can be time-consuming and the outcome is uncertain. The protection for investors is generally weak. Local knowledge and quick action in the event of payment issues is therefore important when it comes to export transactions.

There are no indications of more in-depth structural improvements, and the business climate is therefore expected to remain difficult. Russia has quickly climbed up the World Bank's Doing Business Index and was ranked 35 out of 190 in the latest version. However, the World Bank's parameters only capture certain aspects of the business climate – the index does not reflect corruption levels, institutional quality and infrastructure for example, all of which are significant in Russia. Certain sub-indices place Russia far down in the ranking and others significantly higher, which is why the weighted ranking does not show all of the difficulties of the business environment. Especially troubling is the cost of cross-border trade, where Russia is ranked at no. 100 in the associated sub-index. When it comes to corruption, the country is ranked number 131 of 176 according to the Transparency International Corruption Perceptions Index. This is far behind comparable emerging markets such as Brazil, India, China and South Africa. The sanctions further deteriorate the conditions for investment by limiting the access to financing and creating uncertainty.