21/02/2019

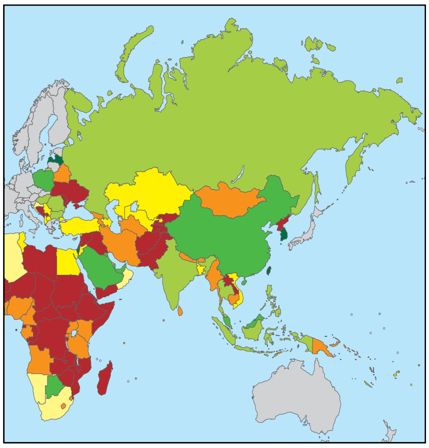
3/7 COUNTRY RISK CATEGORY

COUNTRY RISK ANALYSIS

Russia

0 1 2 3 4 5 6 7

The country risk categories are arranged on a scale from 0 to 7.
The lower the figure, the better the country's creditworthiness.



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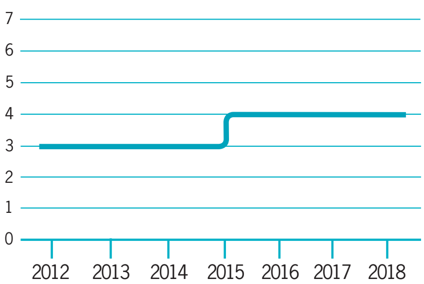
BASIC FACTS (2018)

Population	144 million
Nominal GDP	USD 1 576 billion
GDP/capita	USD 10 950

COUNTRY CLASSIFICATION HISTORY



Source: EKN

Weak growth, macroeconomic stability and increased geopolitical risk

The Russian economy continues to grow by just under two per cent per year thanks to the recovery of oil prices. In recent years, Russia's macroeconomy has improved and its central government finances are anticipated to remain strong with large currency reserves, low levels of debt and a budget that is largely in balance. Global oil prices have fallen during recent weeks, but continue to be significantly above the limit of USD 40 per barrel (Ural blend) where Russia starts to use its oil fund to support the state budget. The greatest future risks are within the commercial and banking sectors, where the business climate continues to be difficult. Worsening foreign policy relations mean that the geopolitical risk has increased and is expected to remain raised, which above all is reflected in higher currency volatility.

In terms of domestic policy, few changes are anticipated during the current presidential period (2018-2024), which will be Putin's last owing to constitutional restrictions. Putin has begun his mandate with a number of important but unpopular reforms, which have caused his popularity figures to decline. Taken together with changes that are imminent, the main part of the reforms planned up until 2024 have probably already been completed.

THE COUNTRY'S STRENGHTS AND WEAKNESSES

STRENGTHS

+ Low debt and budget balance.
+ Stable trade surplus and large currency reserves.
+ The exploitation of enormous natural resources provides important export revenues and attracts investments.

WEAKNESSES

- The economy is sensitive to changes in the price of oil.
- Sanctions and strained relations with the West.
- Difficult business environment, especially due to the weak legal system, widespread corruption and state domination of the economy, leading to weak growth and low foreign invest ments.

SWEDISH EXPORT TO RUSSIA, MSEK

	MSEK
2017	18 737
2016	14 648
2015	14 688
2014	22 078
2013	23 614

Source: SCB

EKN:S EXPOSURE

	MSEK
Guarantees	8 678
Offers	1 455

EKN:S POLICY

EKN places Russia in country risk category 3 for both short and long-term guarantees. 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 EXPOSURE AND EXPERIENCE

EKN's outstanding exposure amounts to SEK 10.1 billion, making Russia one of the major countries in EKN's portfolio. The greater part of current exposure is in the power industry, followed by telecommunications and transport. During the past five years, EKN has guaranteed 344 transactions with a large number of different small, medium and large exporters. A great majority of the transactions were in environmental risk category C, i.e. the lowest of the EKN's environmental risk categories.

In general, EKN's extensive experience of payment risks in Russia has been good. In the wake of the rouble's fall and the economic downturn of 2014 - 2016, payment arrears increased somewhat but remain at a low level in relation to the great exposure. Today, outstanding arrears amount to SEK 4 million, while outstanding receivables total SEK 71 million (pertains to several different industries). EKN has positive experience of the withdrawal of the lease objects - lease instruments are established and the lessor's ownership is recognised in local law. Thus far no claims disbursements have been made in 2018.

WHAT MIGHT CAUSE A CHANGE IN COUNTRY POLICY

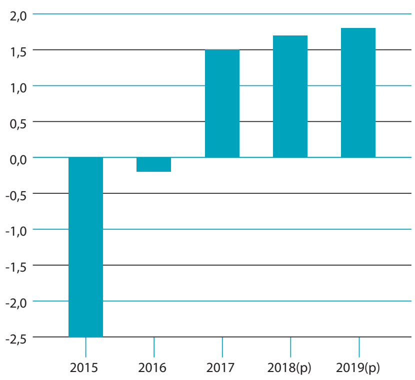
LESS RESTRICTIVE

- Continued high oil prices and stable macroeconomy. Fundamental economic reforms are necessary for a significantly better country risk category.
- A solution to the conflict in the Ukraine followed by easing sanctions.

MORE RESTRICTIVE

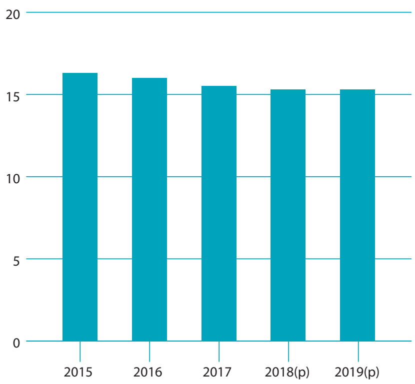
- A major, sustained drop in oil prices that threatens the country's payment abilities.
- Significantly increased long-term sanctions.

GDP-GROWTH (% PER ANNUM)



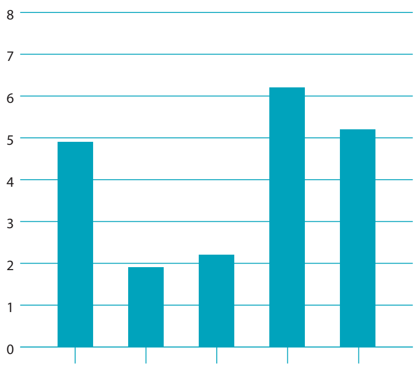
Weak but stable growth.
Source: IMF WEO 2018

PUBLIC DEBT (% OF GDP)



Public debt is low thanks to extraction and exports of large natural ressources.
Source: IMF WEO 2018

CURRENT ACCOUNT (% OF GDP)



The current account surplus has widened thanks to higher than expected oil prices.
Source: IMF WEO 2018

COUNTRY ANALYSIS

BACKGROUND

The Russian economy is fuelled by the oil and gas industry, which accounts for more than half of the country's exports and more than half of the state's revenues. With oil production topping 11 million barrels a day, Russia is one of the world's biggest oil and gas producers. Oil price trends, which are largely controlled by foreign factors, are thus by far the most important factor for central government finances and the economy in general.

Structural factors impede the economy, whose long-term growth has fallen. Average growth over the past decade was less than 1 per cent per year, compared to the period 2000-2008 when the Russian economy was growing at an average of 7 per cent per year. Structural factors include a weak rule of law, widespread corruption, an inefficient labour market, deficient infrastructure and a low rate of innovation, which together create a challenging business and investment climate. Economic policy continues to be characterised by a focus on public investments and incentive measures while the banking sector is almost entirely dominated by a few, extremely large state banks. The low retirement age means high pension expenditures while a low birth rate and low life expectancy mean that the proportion of the population of working age is decreasing.

In politics, Vladimir Putin continues to exercise great power at the cost of political openness and local influence. In formal terms, Russia is a democracy with clear demarcations between the executive, legislative and judicial powers, but is in practice authoritarian. Having possessed de facto power in Russia for 18 years, Putin has begun a new mandate period (2018-2024), which will be Putin's last under Russia's constitution.

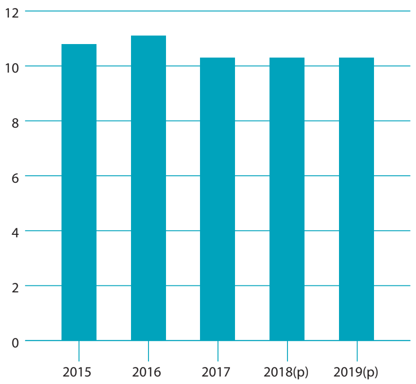
The EU and USA have imposed sanctions on Russia since 2014 due to Russia's annexation of the Crimea and the situation in eastern Ukraine. The sanctions, which mainly concern the oil, gas and arms industries, also include many prominent private persons, state enterprises and banks. Russia has introduced counter sanctions which mainly involve a prohibition on the import of dairy products from the EU.

RECENT DEVELOPMENTS

As expected, Vladimir Putin was reelected in 2018 by a good margin as President of the Russian Federation. At a reported 76.7 per cent, voter support exceeded expectations, but voter turnout was somewhat lower than expected. There is currently no political party or person able to challenge Putin on power.

Continued relatively high oil prices, increased capital investments and rising household consumption mean that the Russian economy continues to grow in the wake of the 2014-15 crisis. Most institutions are counting on growth of 1.2 to 2.0 per cent in 2018 and 2019, i.e. significantly lower than the global average. There are certain signs of

CURRENCY RESERVE (MONTHS OF IMPORT)



The foreign exchange reserve is stable at a high level.
Source: IMF Article IV 2018

a weakening in the economy; among other things growth in the retail trade and new-car sales flatlined during 2018. The sanctions bite unevenly in Russia where certain sectors and companies have suffered, but in the short term, they do not prevent the economy from growing.

The Russian central government finances continue to be strong. Thanks to the exploitation and export of major natural resources, government debt is only 15 percent of GDP, and government interest expenditure is low in relation to its revenues. Higher-than-expected oil prices mean the central government budget is likely to show a surplus of about two per cent for 2018 – the first surplus since 2011. Government debt is mostly medium to long-term and in Russian roubles, further reducing the risk of payment problems.

The external balance continues to be good. A stable balance of payments surplus of 2-3 per cent of GDP per year over the past decade means that external debt is low – equivalent to around 30 per cent of GDP. Major amortisations result in a high debt service ratio, but also mean that foreign debt is in practice back at the 2014 level expressed as a percentage of GDP. This despite the fact that the rouble has lost more than half of its value against the US dollar since 2014. International reserves fell by close to USD 170 billion during the 2014-15 crisis, but has slowly recovered to around 80 per cent of its value five years ago. However, reserves maintained a satisfactory level in relation to the country's external payment obligations even during the crisis years – today they correspond to just over 10 months' import requirements or more than 400 per cent of the country's current liabilities. Foreign direct and portfolio investments continue to be at a low level, which is largely the result of the difficult business and investment climate.

President Putin has begun his new mandate period with a number of important and unpopular reforms. During the autumn, the retirement age was raised to 65 for men and 60 for women following the president's retreat from a previous, more far-reaching proposal. The government also plans to raise VAT in the country from 18 to 20 per cent, and this together with the pension reform has caused the president's popularity figures to decline during the autumn. With the aim of raising tax revenues, Russia will also gradually begin taxing oil extraction instead of oil exports as of 2019.

LONG-TERM TREND

Oil and gas prices will continue to be the most important determining factors for developments in the Russian economy. According to most forecasts, an oil price above USD 50 per barrel is anticipated during the coming year, which speaks for weak but stable growth in Russia also in the long term. Continued stabilisation of the macro economy and central government finances can be expected, mostly thanks to the floating rouble and the new finance policy rules for saving in the oil fund, which aims to dampen the effects on the Russian economy from oil price fluctuations. The finance policy rule, whereby government revenues from oil prices higher than USD 40 per barrel (Ural blend) are saved in the oil fund, prioritises macro economic stability over growth. Exports and central government finances will continue to benefit from the weaker rouble.

The greatest risks are within the commercial and banking sectors, where a lack of predictability and transparency will continue to present major challenges. There is a significant risk of further turbulence within the banking sector, which comprises almost 500 banks and which is in great need of consolidation. However, through its massive support to Otkritie Bank and Bin Bank during the previous year, the central bank has shown that it is both capable of action and willing to act to maintain stability in the financial sector. A further risk reduction factor is the major state domination of the banking sector, which is negative in terms of competition, but which contributes to stability as long as the state's targeted lending is kept to a reasonable level.

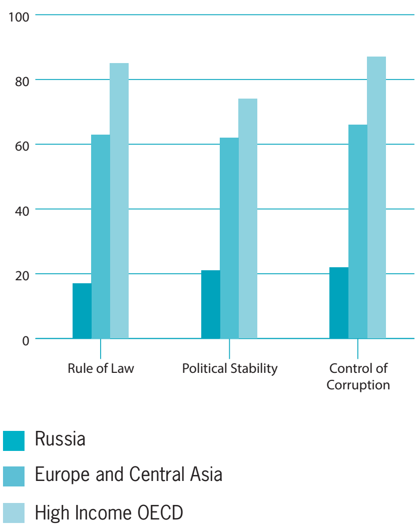
There will also be significant risks arising from Russia's worsened foreign policy relations, especially in the form of increased currency volatility. Confidence in the rouble suffered heavily when the USA hardened its sanctions in April 2018, in contrast to previous hardening of sanctions when the currency was not affected appreciably. Russia's relations with the USA and the EU continue to be frosty, not least because of Russia's actions in the Sea of Azov, and there are currently no signs of a de-escalation of sanctions. Western technology in particular is needed to maintain oil and gas production, which means the sanctions will continue to present difficulties for Russia. However, unless there is a very sharp escalation of the sanctions, e.g. the exclusion of Russia from the Swift system, the negative effects on the economy will probably be manageable.

Few domestic reforms are anticipated in addition to those already implemented. The principal scenario sees Putin remaining in power for the mandate period and that changes in terms of policies and the business climate will be limited. The longer the current mandate period wears on, the more domestic policy will be about how to allocate power after 2024. Thus the political risk will gradually increase.

BUSINESS ENVIRONMENT

The business climate is one of Russia's absolute weaknesses and is expected to continue being a challenge in the long term. Admittedly, Russia has quickly climbed to 31st place out of 190 in the World Bank's Doing Business Index , but the measurements only capture certain aspects of the business climate and there is great variation within the index. Extensive bureaucratic obstacles, an unpredictable regulatory environment, insufficient institutional capacity, corruption, a weak infrastructure and a lack of transparency in the commercial financial situation and ownership structures are the main challenges. With regard to corruption, the country is in 131st place out of 176 according to Transparency International's Corruption Index, which is far behind comparable growth countries such as Brazil, India, China and South Africa. Corporation tax is low, but social charges are significant and the cost of running cross-border trade is high according to World

BUSINESS ENVIRONMENT



Ranking from 0 (worst) to 100 (best)

Source: The World Bank

conditions for investment by choking access to financing and creating uncertainty.

Because of the weak institutions, local knowledge and nimble action are important in the event of payment problems in investments and transactions. Litigation and bankruptcy proceedings can be time-consuming and outcomes are uncertain. According to World Bank studies, the recovery rate is just over 40 per cent, which is slightly above the average for the region. The long-term trend shows that during the past decade, Russia is catching up with the world's leading nations in terms of governance effectiveness, while the regulatory environment has deteriorated. In the case of corruption and the rule of law, Russia has barely moved.