11/06/2020

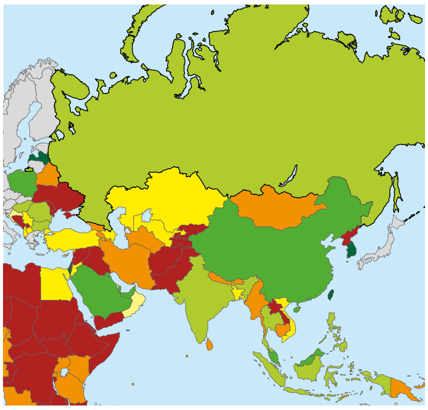
3/7 COUNTRY RISK CATEGORY

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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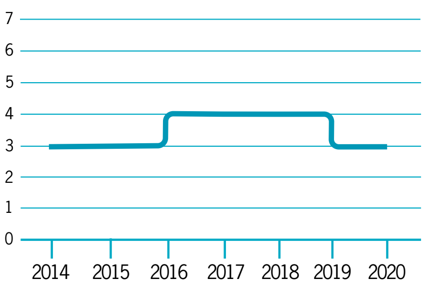
BASIC FACTS

Population: 147 million (2019)
GDP, nominally: USD 1,638 billion (2019)
GDP/capita: USD 11,163 (2019)

Source of basic facts: IMF WEO

COUNTRY CLASSIFICATION HISTORY



Source: EKN

The main impact of the crisis will be on growth and businesses

Russia's placement in country risk class 3 is based on strong state finances and a stable external position, which is balanced by a weak business climate, state dominance in the economy and weak growth prospects. Despite dramatic oil price drops and the corona crisis, transfer risk remains low thanks to low public indebtedness, limited external financing needs, large international reserves and the fiscal rule for saving in the wealth fund. Just as before the crisis, the largest risks can be found in the business and banking sector, where the business climate is deteriorating due to lock-down caused by the pandemic. A deep recession of five to six per cent is expected in 2020, and the shift towards a more growth-oriented economy, that was planned before the crisis, now risks becoming delayed. The threats to the economy still lie in structural factors which are only partially addressed through the state infrastructure investment programmes which have been launched, thus also making the growth prospects weak in the long term. The business climate is hampered by sanctions against the country, which has led to a significant currency volatility when new sanctions are announced. Regarding the domestic policy situation, the main scenario is that Putin will rule the country at least until the end of the current term (2018-2024), which means continued political stability but also high levels of corruption, deficiencies in the exercise of public authority and an unpredictable regulatory environment.

THE COUNTRY'S STRENGHTS AND WEAKNESSES

STRENGTHS

+ Low indebtedness and a balanced budget.
+ Stable current account surplus and large international reserve.
+ The country's enormous natural resources provide important export revenue and attract investors.

WEAKNESSES

- The economy is sensitive to changes in oil prices.
- Sanctions and tense relations with the West.
- Difficult business environment, primarily due to a weak legal system, widespread corruption and state dominance in the economy, which leads to weak growth and low foreign investments.

SWEDISH GOODS EXPORTS TO RUSSIA, MSEK

	MSEK
2019	21 904
2018	19 988
2017	18 737
2016	14 648
2015	14 688

Source: SCB

EKN:S EXPOSURE

	MSEK
Guarantees	5,697
Pledges	1,804

EKN:S POLICY

EKN places Russia in country risk class 3 for both short-term and long-term guarantees, i.e. one country risk class better than the consensus within OECD. Due to the sanctions, anyone applying for export guarantees to Russia has to provide information about the goods, the end user and any permits. Normal risk assessment applies to state risks, other public risks and banks, which means that there are no limitations to the guarantees given provided in advance. For businesses, premiums are elevated due to the corona crisis.

EKN:S EXPOSURE AND EXPERIENCE

EKN's outstanding commitments amount to just under SEK 8 million, which makes Russia one of the main countries in EKN's portfolio. The majority of the current commitment is within the power industry, followed by the transport and machine industry. Over the last 5 years, EKN has guaranteed approximately 450 transactions with small as well as medium-sized and large exporters. Most of these transactions have been in environmental risk class C, i.e. the lowest EKN environmental risk category.

EKN's long experience of payment risks in Russia is generally good. In the wake of the fall of the rouble and the financial downturn in 2014–2016, the number of payment delays rose slightly, but remains at a low level in relation to the large commitment. Today, the outstanding delays amount to approximately SEK 10 million, which is roughly in line with Q1-Q2 2019. Outstanding debts amount to around SEK 85 million (refers to multiple industries). EKN has positive experiences of recapturing leasing objects – the leasing instrument is established and the lessor's ownership is recognised according to local legislation. No indemnifications were made in 2019.

WHAT MIGHT CAUSE A CHANGE IN THE COUTRY POLICY

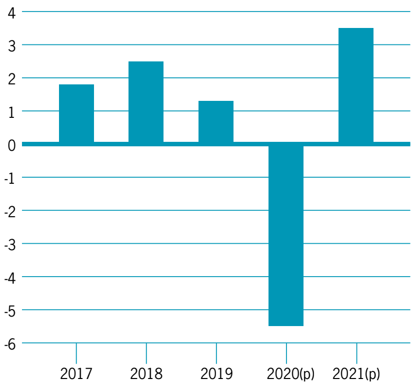
THE EASING OF RESTRICTIONS, IN THE EVENT OF:

- High oil prices and continued macroeconomic stability. Sweeping economic reforms would be needed for a considerable improvement in the country risk class.
- A solution to the conflict with Ukraine followed by eased sanctions.

THE TIGHTENING OF RESTRICTIONS, IN THE EVENT OF:

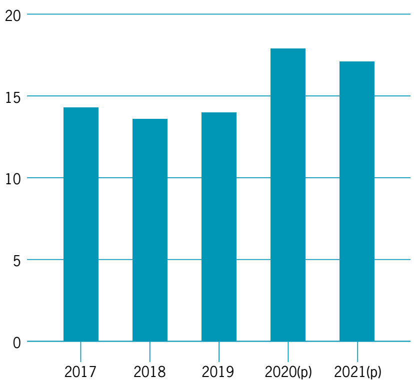
- A substantial and permanent drop in oil prices which threatens the country's payment capacity.
- Long-term and significantly expanded sanctions.

GDP-GROWTH (% PER ANNUM)



Severe recession in 2020 followed by significant recovery.
Source: IMF WEO

PUBLIC DEBT (% OF GDP)



The crisis will not materially increase the level of public debt
Source: IMF WEO

COUNTRY ANALYSIS

BACKGROUND

The Russian economy is powered by the oil and gas industry, which make up more than half of the country's exports, and more than half of state revenue. With an oil production of more than eleven million barrels per day, Russia is one of the world's largest producers of gas and oil. Oil price trends, which are mainly dictated by factors outside the country, are thus clearly the most important factor for state finances and the rest of the economy.

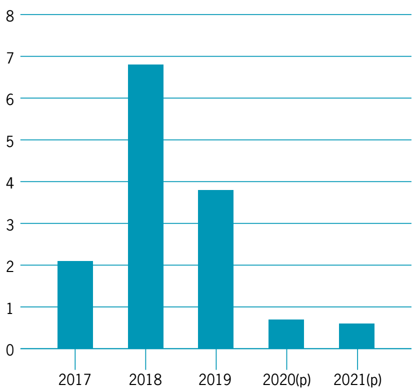
Structural factors slow down the long-term growth rate. The average growth for the last decade has barely reached 1 per cent per year, compared to the 2000–2008 period when the Russian economy was growing by an average of seven per cent per year. The structural factors include a weak rule of law, high levels of corruption, an inefficient job market, deficient infrastructure along with a low level of innovation, which creates a challenging business and investment climate. The retirement age was raised in 2018, but has yet to have an effect on the high pension expenditures, while low birth-rates and a low average life expectancy means that the proportion of the population able to work is shrinking. The economic policies remain characterised by a focus on state investments and stimulus measures.

In the political arena, Vladimir Putin wields a great deal of power at the expense of political openness and local influence. Russia is formally a democracy with a clear separation of the executive, legislative and judiciary branches of government, but is in practice subject to authoritarian rule. Having held the de facto power in Russia for 19 years, Putin has entered a new term of office (2018–2024), which is limited to be the presidents last according to the current constitution. The US and EU has imposed sanctions on Russia since 2014 due to the annexation of Crimea and the situation in eastern Ukraine. The sanctions, which mainly concern the oil, gas and weapons industry, includes a number of prominent private individuals, state businesses and banks. Russia has imposed counter sanctions which mainly means an import ban on dairy products from the EU.

MOST RECENT DEVELOPMENTS

In terms of domestic politics, the start of 2020 has been eventful with a government reshuffle, proposals to change the constitution and the outbreak of COVID-19. In January, prime minister Dmitri Medvedjev was replaced by Mikhail Mishustin – a more or less politically untested technocrat, and at the same time, a proposal to change the constitution was put forward. This change would lead to power being shifted from the president to the parliament, the prime minister and a presidential advisory unit (the State Council). However, the proposal was retracted and has now been replaced by a proposal, due to be voted on in July, which enables Putin to be re-elected for two additional terms of office (2024–2036). The main scenario is that Putin remains president for at least the duration of the current term of office. Regarding COVID-19, the spread of the infection gained real momentum in May 2020 and by the end of the

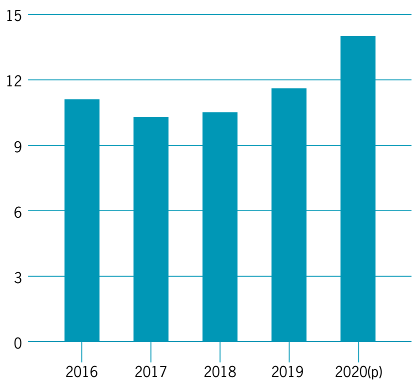
CURRENT ACCOUNT (% OF GDP)



The drop in oil prices means a practically erased current account surplus in 2020

Source: IMF WEO

INTERNATIONAL RESERVE (NUMBER OF MONTH'S IMPORT COVERAGE)



The high international reserve provides stability throughout the crisis

Source: IIF

month, the country had the third largest amount of infected in the world. However, according to the official figures, the amount of people who have died due to the pandemic is very low. The government has carefully begun lifting social restrictions, but there are currently no end in sight regarding the spread of the infection, and the risk for setbacks is high. Most signs point toward Russia still being weeks away from the peak in terms of infections.

The growth of the Russian economy has been below the global average for many years, and the economy will enter a deep recession in 2020. Similar to many other countries, small business in industries sensitive to changes in the economic cycle such as retail, hotels, restaurants and tourism are impacted the hardest by the shutdowns caused by the pandemic. The inflation is expected to fall somewhat below the Central Bank target of 4 per cent, which enabled an additional lowering of interest rates to 5.5% at the end of April. Cumulatively, interest has been lowered by almost 4 percentage points over the last three-year period, which will benefit the economic recovery. The sanctions continue to impact Russia unevenly, where some sectors and businesses have been affected, but in the long term, they do not prevent the economy from growing.

State finances and external positions remain strong, despite the crisis. Lost income from oil and stimulus measures equivalent to approximately six percent of GDP will result in a substantial budget deficit of around 5 per cent in 2020, but in spite of this, the public debt is not expected to exceed 18 per cent of GDP, and interest expenses on public debt remain low in relation to public revenues. The risk of default is therefore expected to remain low, especially considering that the public debt is primarily medium and long-term and in Russian roubles. Russia's current account surplus will essentially be wiped out in 2020 due to the drop in oil prices, but the net outflow of capital has thus far been limited. This shows that, compared to other emerging economies, Russia is viewed as a stable economy by investors during the corona crisis. During previous domestic crises, the country's capital balance has always been severely negative. One explanation is the low external debt, equivalent to 27 per cent of GDP in 2019, which is lower than five years ago despite the value of the rouble being halved compared to the USD since then. Another explanation is Russia's large international reserve, which constitutes almost a full year of imports, and its National Wealth Fund, NWF, which amounted to USD 168 billion in April 2020, i.e. around 9 per cent of GDP. During the crisis, the international reserve is used to support the currency and NWF to fund the deficit in the budget, which means that both will drop significantly in 2020.

LONG-TERM DEVELOPMENTS

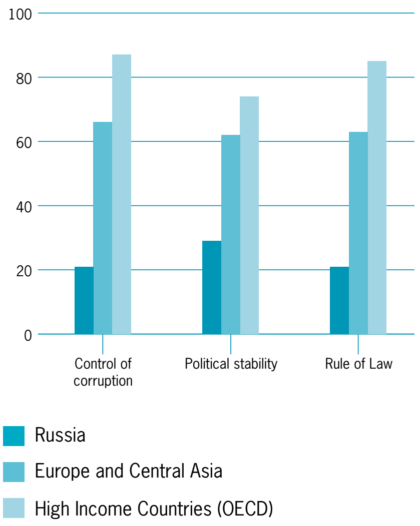
EKNs long-term outlook for Russia remains stable in country risk class 3, even if the corona crisis means another blow to the already weak growth. The prices of oil and gas are the most important deciding factors for the development of the Russian economy, which means that recent turbulence in the oil market, where Brent oil at times was being traded for USD 20/barrel, will have negative long-term consequences. Most forecasts point to an oil price of USD 40-50 per barrel in the coming years, which is significantly lower than previous forecasts, and means that even a growth rate 1 to 2 per cent may be difficult to attain. The gradual shift to a more growth oriented Russian economic policy, where the government plans to invest SEK 4,000 billion in thirteen so-called national infrastructure projects until 2024, also risks being put on hold. Therefore, Putin's goal of having an annual growth rate of 3 to 4 per cent currently seems very far off.

Starting in 2021, a recovery in terms of public finances is expected, and current account is expected to remain stable in the long term. At the current rouble exchange rate, the budget and current account are balanced at an oil price of approximately USD 40 per barrel, i.e. somewhat lower than the oil price forecasts for 2021 and going forward. Russian exports and public finances will continue to benefit from the weakened rouble that is allowed to float. Furthermore, Russia benefits from the fiscal rule which states that public revenue from an oil price exceeding USD 40 per barrel Ural Blend is saved in the NWF. Russia has a history of deviating from fiscal rules, but thus far, the financial policy framework is credible and creates stability.

The largest risks can be found in the business and banking sector, where the lack of predictability and transparency will continue to create major challenges (see business climate). The banking sector is dominated by a small number of very large state-owned banks, but at the same time, there is a need for consolidation. Next to the state-owned giants, there are close to 500 smaller actors and many of these will most likely fail in the coming years. The Central Bank has however proven itself both capable and willing to act to maintain stability in the financial sector, especially during the current crisis, while the dominance of state-owned enterprises contributes to the stability as long as government targeted lending is kept at a reasonable level.

Significant risks will continue to exist in Russia's foreign relations, especially in the form of increased currency volatility. Russia's relations with the US and EU remain frosty, due in no small part to Russians actions in the Sea of Azov, and there are currently no indications that the sanctions will be eased. Western technology is particularly needed to maintain oil and gas production, meaning that the sanctions will continue to spell trouble for Russia. However, barring a powerful escalation of the sanctions such as Russia being excluded from the Swift system, the negative effects on the economy will most likely be manageable. Few reforms are expected domestically, save for those already being implemented. The main scenario is that Putin will remain in power until the end of the current term of office and changes to policies and the business climate will be limited. This means a relatively high level of stability and predictability in terms of the overarching political system, but with significant capriciousness and unpredictability within the same system. Despite a certain degree of nervousness in the Kremlin, there are currently no political alternatives to seriously challenge Putin's power. The further we get into the current term of office, the more the domestic policy discussions will shift to the distribution of power after 2024, including Putin's potential role. As such, the level of political uncertainty will gradually increase.

BUSINESS ENVIRONMENT



Ranking from 0 (worst) to 100 (best)

Source: The World Bank

BUSINESS ENVIRONMENT

The business climate is one of Russia's key weaknesses and is expected to remain so even in the long term. While Russia has rapidly climbed to position 28 out of 190 in the World Bank's Doing Business Index, these measurements only captures certain aspects of the business climate, and there is a high level of variation within the index. Substantial bureaucratic obstacles, an unpredictable regulatory environment, weak institutional capacity, corruption, weak infrastructure and lack of transparency regarding the financial situation and ownership of businesses constitute the main challenges. Regarding corruption, the country is ranked 138 out of 180 according Transparency International's corruption index, which is far behind other comparable emerging economies such as Brazil, India, China and South Africa. Corporate taxation is low, but social security contributions are high and the cost of conducting cross-border trade is also high, according to the survey by the World Bank. Sanctions and counter-sanctions worsen the conditions for investments further by tightening up access to funding, which creates uncertainty.

Due to the weak institutions, local knowledge and swift actions are important when payment issues occur. Legal action and bankruptcy proceedings are time consuming and the outcome is unpredictable. According to surveys by the World Bank, the debt recovery rate is approximately 40 per cent in Russia, which is somewhat above the regional average. The long-term trend is that over the past decade, Russia has closed in on world-leading nations in terms of state governing efficiency, while the regulatory environment has worsened. Regarding corruption and rule of law, Russia has essentially remained stationary.