

## Weathering the US storm: Economic Forecast for Russia for 2019 by Euler Hermes

- **The ‘new normal’ of modest growth predicted**
- **Russia GDP growth forecast to be 1.6% in 2018 and 1.5% in 2019**
- **New government measures to stimulate ruble payments anticipated**
- **Business insolvencies remain at a high level and set to increase in 2019**
- **Development of Russia credit insurance sector set to continue**

**Moscow – 12 October 2018** - The Russian economy is forecast to expand at the modest but steady rate of 1.6% in 2018 and 1.5% 2019, despite the external pressures of sanctions and weak oil prices, according to Euler Hermes, the world’s largest credit insurance company and a member of Allianz Group.

This is due mainly to smart monetary policy by the central bank of Russia, commercial import and export diversification, and the current strength of the manufacturing sector. At the same time, analysts at Euler Hermes highlight the risks to Russian and international business of the increasing risks of insolvency amongst enterprises in 2019 and the problems of collecting bad debts in Russia.

The macroeconomic forecast of Euler Hermes was prepared in Q3 2018 and is based on the results of the activities of major multinational enterprises from more than 50 countries of the world, constituting 92% of world GDP, and analytics from the Euler Hermes Economic Research Department. They present three scenarios of the ‘new normal’ of modest growth (75%), deteriorating environment (20%) and improving environment (5%).

### **Sanctions vs Dedollarization**

The Russian economy’s recovery remains on a positive but moderate growth path. Euler Hermes predicts Russia’s GDP growth at 1.6% in 2018 and 1.5% in 2019. However, according to Euler Hermes chief economist, Ludovic Subran; the sanctions of 2018 have influenced the ruble exchange rate for the first time, which has lost 15% against the dollar since the beginning of the year. In addition, the sanctions had a negative impact on the inflow of foreign investment, which can exacerbate capital outflows if the United States imposes sanctions on Russian government debt.

Set against these factors, Russia is fiscally prudent, with moderate expenditure level compared to other countries. The reduced pace of debt issuance (RUB310bn compared with RUB450bn previously planned) combined with shorter maturities will absorb the shock of uncertainty related to sanctions. Also, after the implementation of Western sanctions in 2014, falling exports to the EU were substituted by rising exports to China and the Middle East, and the story is similar for imports. The independence of the Central Bank of Russia and smart monetary policy in Russia have also helped manage the challenging macro environment.

Euler Hermes also considers further possible consequences of the containment of trade relations between the United States and Russia as a whole, the restriction of bank loans to Russian residents, and the ban on transactions with property and related interests of Russian state-owned banks.

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“De-dollarization could be a measure to counter this development: An increase of gold in foreign exchange reserves could be part of such a de-dollarization plan. Encouraging and facilitating the usage of alternative currencies in international trade could be another measure - for example, transactions with the EU and China, Russia’s main trading partners accounting for nearly 60% of its foreign trade, could be shifted into the Euro and Yuan while trade with CIS countries could be done in Ruble. The delisting of companies from international stock exchanges could become another tool,” said Ludovic Subran, chief economist at Euler Hermes.

Euler Hermes experts noted a downtrend in Days Sales Outstanding (DSO) in Russia as companies become more cautious about offering generous credit terms and longer repayment dates. In 2017, it decreased by 2 days and amounted to 56 days (in 2016, the average for Russia was 58 days). For comparison, the lowest rate of receivables turnover in our country was observed in the pre-crisis years 2007-2008 when it was 47 days and, conversely, it reached 60 days in 2014.

In line with that, insolvency risk decreased in Russia in the first 8 months of 2018 (-8% in the 12 months ending August 2018). Nevertheless, Euler Hermes expects a trend reversal and predicts an increase in insolvencies by +6% in 2019, because the 2018 figure is biased by the fact that the period of comparison (2017) was a high since 2010 and quarterly figures have been stable since Q4 2017. Moreover, three key sectors (construction, production, and transportation) remained out of the national trend and saw already rising failures in 2018 so far.

Debt collection procedure in Russia is very complicated: in the ranking of countries by the complexity of debt repayment submitted by Euler Hermes at the beginning of 2018, Russia ranks 5th after Saudi Arabia, the United Arab Emirates, Malaysia, and China. This position is due to the domestic legislation and low payment discipline. For comparison, the collection process is most well-adjusted in countries such as Sweden, Germany, and Finland.

The current Russian legislation regarding bankruptcies can delay the recovery process and reducing the likelihood of its positive outcome. The most common examples of manipulation by debtors include the launch of “managed” bankruptcies with the prior creation of imaginary payables, the initiation of counterclaims, the declaration of interim measures by “friendly” creditors, the provision of incorrect expert data to court, etc. According to Euler Hermes, Russian creditors can expect to receive no more than 3% of the stated requirements in the bankruptcy procedures.

“It is important to note that the national indicator masks a very uneven situation in various economic sectors,” comments Daria Yakovleva. “In particular, the construction sector and the retail trade in non-grocery goods continue to remain in the risk zone in the near future, due to changes in the structure of demand and incomes of final consumers. Growing competition, limited consumer demand, a general downward trend in profitability and liquidity, as well as limited access to credit resources are observed everywhere. The influence of these factors leads to a deterioration of the situation with payment discipline.”

For example, the retail trade turnover for the first 8 months of 2018 increased by 2.7%, and non-grocery sales are growing faster than food products. At the same time, real disposable incomes of Russians are still recovering very slowly: they increased by only 1.6% in the first half of 2018. In June, they rose by 0.2% in annual terms and in May by 0.1%. The growth in retail sales is mainly due to the availability of consumer loans and shopping on credit. Thus, there are no grounds for conclusions about the onset of the consumer recovery. “In addition, the adopted law on VAT increase from January 1, 2019, and the acceleration of inflation may adversely affect consumer demand. In general, there has been a deterioration in consumer expectations of customers in recent months, which will contribute to the slowdown in the economy next year,” said Daria Yakovleva.

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### Non-payment risk for Russian companies

It is equally important to pay attention to the risks of non-payment for Russian companies doing business in foreign markets. According to Euler Hermes, debt collection risk among the 20 countries that account for the largest share in Russian exports is the highest in China (share in Russian exports is 10%), India (share in Russian exports is 2%), Turkey (share in Russian exports - 5%), Kazakh (share in Russian exports - 3%), as well as in the US (share in Russian exports - 3%). The main reason for non-payment is the financial insolvency (bankruptcy) of companies in the listed countries (*see the chart “Debt collection complexity in leading markets for Russian exports”*).

“In 2019, the Global Insolvency Index is expected to grow for a third consecutive year, by +5% (following +8% in 2018 and +6% in 2017) although it varies greatly depending on different countries and sectors of the economy,” stresses Daria Yakovleva, CEO of Euler Hermes in Russia. “Insolvencies in China, a key trading partner of Russia, are set to rise by +50% in 2018.”

### Credit Insurance market

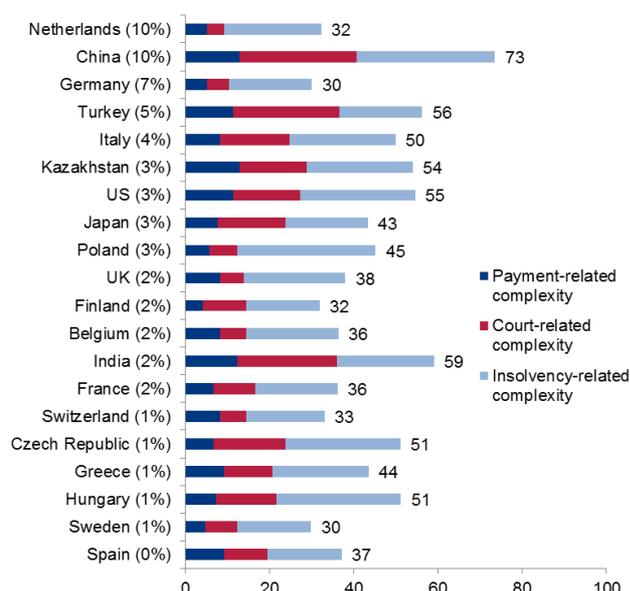
However, since the largest share of company assets is concentrated in accounts receivable, the demand for credit insurance in Russia is growing. “Over the past 2 years, the credit insurance market grew by more than 140%. At the end of 2017, the volume of premiums collected by insurers on the Russian market amounted to 4.35 billion rubles,” Daria Yakovleva shares.

The peculiarity of the Russian credit insurance market is its low penetration and the presence of potential for growth. Thus, the share of credit insurance fees in relation to GDP in the world is 0.018%, it reaches 0.034% in Western Europe, and this figure is only 0.002% in Russia. A positive factor is the planned changes by the Government of the Russian Federation to the Law on Currency Regulation and Currency Control, which will soften the requirements for returning foreign exchange earnings on foreign trade contracts in the event that foreign partners do not fulfill their obligations.

“Exporters will be able to avoid a penalty for not returning foreign exchange earnings if the insurance company transferred money to their bank account, including private insurers such as Euler Hermes,” Daria Yakovleva notes. “This will allow entrepreneurs to more effectively manage export credit risks. The export risks insurance policy will allow you to fulfill the requirements for the repatriation of foreign exchange earnings and avoid regulator’s sanctions.”

## REFERENCE

### Chart 1. Debt collection complexity in leading markets for Russian exports



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### Euler Hermes Receivables Recovery Statistics

Debt collection services are part of a comprehensive receivables management service that Euler Hermes offers to its customers. In 2017, Euler Hermes provided a refund of more than 303 thousand applications in 160 countries for a total of more than 1.75 billion euros.

The largest amount of receivables returned by Euler Hermes at the request of one of the clients was 3.7 million euros. The smallest collected amount was 47.6 euros.

### About Euler Hermes

Euler Hermes is the global leader in trade credit insurance and a recognised specialist in the areas of surety, collections, structured trade credit and political risk. Our proprietary intelligence network analyses daily changes in corporate solvency representing 92% of global GDP. We give companies the confidence to trade, and be paid. We compensate your company in the event of a bad debt, but more importantly, we help you avoid bad debt in the first place. Whenever we provide trade credit insurance or other finance solutions, our priority is predictive protection. But, when the unexpected arrives, our AA credit rating means we have the resources, backed by Allianz to provide compensation to maintain your business. Headquartered in Paris, Euler Hermes is present in 52 countries with 6,050 employees. In 2017, our consolidated turnover was €2.6 billion and insured global business transactions represented €894 billion in exposure.

For more information, please visit: [eulerhermes.com](http://eulerhermes.com).

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