Russia

SEB MERCHANT BANKING – COUNTRY RISK ANALYSIS Feb 3, 2015

Analyst: Rolf Danielsen. Tel : +46 8 763 83 92. E-mail : rolf.danielsen@seb.se

The continued steep drop in the oil price to $50/barrel has exacerbated the economic situation for Russia with repercussions hitting the financial sector and the exchange rate while macroeconomic variables appear more insulated from the shock. An inconsistent policy stand of the central bank since late 2014 could threaten the banking sector with collapse thru further weakening of the ruble.

Country Risk Analysis

As had been expected, last year the economy decelerated further to only 0,6% growth as consumer demand continued to trail. For the current year the slowdown is set to continue. Estimates of GDP vary widely among observers but the latest – of the IMF –projects 3% contraction as net exports – due to severe import compression –offset a further cut in domestic demand in response to the erosion of household purchasing power as price pressure accelerates. That is due to the sharp drop of the ruble as well as self-imposed sanctions on food imports.

The recent flare-up of hostilities in Eastern parts of the Ukraine has hardened the resolve of most Western countries for upholding the financial sector sanctions against Russia's for her annexation of the Crimea in March 2014 and subsequent support to the separatists. That is provided unity can be maintained within the EU despite protest from Greece and apparent misgivings by Italy. Sanctions agreed so far do not appear to have made much of an impression on Russia's leaders who are betting on the economy's ability to weather the head-winds as key macro-balances – internal and external deficits -- seem resilient and reserves are still ample. As such, Russia's stand-off with the West could be in for the long haul as long as Pres. Putin's approval ratings are high enough to make him unassailable to contenders.

Low global oil prices, by contrast, is a curse Russia's lopsided economy cannot easily withstand. The exchange rate depreciation they have prompted has fired up under a new bout of inflation into double digit levels. Against a backdrop of a partly dysfunctional banking system, this can present the monetary authorities with a challenge above the capacity of the political system to handle because conventional means of solving it might prove a medicine too bitter for 600-700 small and essentially redundant Russian banks. Having lost some $60-70bn in a futile pursuit of exchange rate management, last November the central bank let the ruble float freely. However, so far the new policy has failed to convince markets. As the central bank does not seem to have stopped sterilized interventions the ruble has weakened further. Last week the bank even cut its policy rate. With low unemployment and little output gap, that could trigger endemic inflation with lasting negative effects on the economy.

In the course of a few months the rating agencies have downgraded the sovereign twice, one of them even placing it in junk status. That is despite still strong fiscal metrics including very low government debt. Country risk, in contrast, has the potential to worsen rapidly on short notice especially in the case of a banking crisis combined with continued low oil prices.

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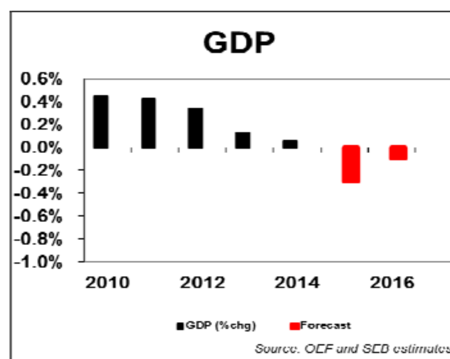
Recent developments:

Full blown recession looms: While the final growth numbers 2014 are likely to come in somewhat better than expected due to stronger net exports and private consumption towards the end of the year, the picture for 2015 has not improved much. While the central bank's recent "zero growth"-estimate appears like wish-full thinking we find the IMF's estimate of 3% contraction as the most reliable and at least the most updated at this point in time.[1]



Private consumption plunges: As had been on the cards since late 2013, private consumption had grown out of proportions. Being much based on borrowing it was ripe for a correction. As inflation has already reached double digit levels at the end of 2014 and the government has indicated that it will compensate less than half of that in coming wage settlements households are looking forward to a real wage cut of some 5%. That combines with apparent intentions to deleverage prompting observers to adjust estimates of private consumption growth to a negative 10% in 2015.

Net exports and agriculture to the rescue: When also investment growth trailed, net exports become the only driving demand component in 2014. That will be the situation also in 2015. Somewhat reduced oil and gas exports in real terms due to interrupted deliveries to the Ukraine during a part of 2014, was strongly offset by plummeting imports responding to Russia's self-imposed ban on certain food imports and growing domestic prices of other consumption imports. It remains to be seen if domestic producers can fill the gap when imports are taken off the Russian dinner table. So far last year's bumper harvest in agriculture has come to the rescue.

Inflation soars: In December 2014, year on year (yoy) inflation ended at 11,4% exceeding expectations of the central bank and most observers. Recent released January 2015 numbers ticked in even higher above expectations at 13,4% and our own at 15,6 % as the whole year average may already look too optimistic. Clearly, wage hikes limited to about 5% and reduction of domestic demand should help ease price pressure for the rest of the year. That much depends on the exchange rate which has continued to weaken into the current year.

The trade balance suffers but still remains strong: The roughly halving of export prices of oil and gas during the last few months of 2014, will affect Russian export revenues will full force from the beginning of the current year. The energy component dominates about two thirds of Russian export revenues which are set to drop 38% to $308bn. in 2015. However, the import bill is poised to drop sharper still by almost a half to $306bn. That leaves Russia with a smaller but still strong trade surplus which translates into a current account surplus of $32bn, equivalent to 2,5% of GDP, down from 3,1%/GDP in 2014.

A new bout of capital flight. As under the 2008-2009 global financial crisis (GFC), the Russian capital account has been hit by instability in part dominated by short term transactions. These have been characterized as "capital flight" in media but could as well be named "domestic hedging". Signs are that relatively little capital has left the country. While headline numbers of net foreign exchange reserves of the central bank indicate a drop of some $40bn in the first 7 months of the current year to $469bn. at the end of July that was matched by a rise in commercial bank reserves of RUB1,2 trillion or about $25 bn. at the contemporary exchange rate. That may

[1] SEB's Nordic Outlook of January 2015 estimates the contraction at 5,5% based on earlier IMF calculations.

suggest banks were hoarding foreign reserves to meet customer needs at a later time.[2]

Accelerated drop of foreign reserves: Since July, central bank reserves have shrunk rapidly by another $84bn. to $386bn at year end, raising alarms among observers and investors. However these numbers have to be interpreted with caution. Contrary to the practice of many other countries which hold reserves mainly in US dollar denominated securities and deposits, Russia is known to hold only 55% of its reserves in US dollars and the rest of it in euros. The steep fall in the euro against the dollar during the last five months of the year, however, would on its own have reduced reserves by almost $30bn. when those are presented in US dollars. Therefore, the decline of reserves through this period due to actual sales is unlikely to have been more than 60bn. That is still a significant loss but dominated by scheduled repayments of private sector foreign debt falling due in the period as many companies were unable to refinance as a result of Western sanctions. Capital flight in terms of speculative activities or reversal of earlier portfolio investments, have probably been of more limited nature.

Net FDI deficit: In 2013, the net foreign direct investment balance (FDI) turned negative as Russian investors were more interested in putting their money to work abroad, than foreigners were interested in the same in Russia. That trend continued through the first half of the year and as a working assumption we expect the same pattern for the whole of 2014 and in subsequent years although cognizant that at the present exchange rate regained competitiveness may eventually entice investors back.

At about $800bn. Russia's external gross debt is not trivial but at clearly less than 50% of GDP still manageable under normal circumstances. About three quarters of it belongs to the private sector of which a third represents banks. They are in a relatively strong foreign exchange position with assets exceeding liabilities. Less is known about the foreign exchange position of corporates but their capacity of recent quarters in meeting foreign obligations without refinancing suggests that at least a part of their foreign assets are relatively liquid.

Policies

While the fiscal balance appears relatively resilient to the ongoing shocks, monetary policies have actually taken a turn for unknown territories in a way that could have serious consequences for Russia's myriad of small and frail banks.

Budget balance turn out better than in 2013: Last year's fiscal austerity helped the government budget improve its balance by a about 0,6% of GDP ending the year with a deficit of less than an estimated 1%/GDP. For the current year, by contrast, reduced taxes and export fees from the oil and gas companies will hit budget revenues and raise the deficit to 2,4% of GDP. Such an increase is still modest against a possible drop of the global oil price taking into account that such revenues make up half of total government annual income. The explanation is that the halving of revenues in dollars is compensated by the doubling of the exchange rate of US dollar against the ruble. That helps the government meeting domestic obligations while the service of external obligations becomes more onerous. However the government's external debt is only a fraction of its total debt, which in itself is only 9% of GDP marking Russia as one of the stronger sovereigns in the global rating universe. It is hard to see Russia defaulting on this debt unless it deliberately chooses to do so.

Monetary and exchange rate policies: For many years after the global financial crisis in 2008-09 the Central Bank of Russia (CBR) followed a managed peg to the dollar-euro basket. Eventually this turned into a crawling peg but with the "crawl" too slow to count for the loss of external competitiveness as the rate of inflation, including wage inflation, remained significantly above that of competitors. In early

[2] corrected for central bank swap-transactions with domestic banks for liquidity management.

2014 a correction was long overdue as the ruble was hovering around 35 to the dollar whereas the fundamental equilibrium was estimated to around 50 -- that means weaker. This explains about half of the subsequent depreciation of the exchange rate in the last five months of the year with the rest representing overshooting. That should give rise to expectations of a coming boost to the international value of the ruble, but much of that depends now on market confidence with monetary policies.

Monetary policies in a quandary: With the central bank selling about $80bn out of reserves in 2014 in an attempt to slow the rapid fall of the exchange rate, it drained the market for domestic liquidity thereby quelling banks' ability to extend new credits to the public. As a result, the central bank began to sterilize its interventions in the local foreign exchange market mainly through so-called repos in order to keep a lid on interbank rates and helping banks continue normal business. However, with expectations running high of continued ruble weakness, many banks and/or their customers were probably more interested in buying even more dollars from the central bank with this new supply of local liquidity than investing in economic activities. That triggered a vicious circle which eventually forced the central bank to stop supporting the ruble.

The ruble let to float freely: In last November the central bank announced a new exchange rate policy of a floating ruble exchange rate determined entirely by market forces. Since then, however, the central bank does not appear to have abandoned sterilized interventions completely. Last week it even cut interest rates by 2 pp. after they had been raised two months earlier to 17% in an unsuccessful effort to stabilize the exchange rate and the banking sector itself. While it is too early to gauge the reaction to that measure, it is noted that the ruble has recovered less than half of recent days rising oil price. Since last July, the ruble has followed the oil price quite closely. Many local observers have monitored these developments in the central bank's reaction function and surmised that the bank is becoming concerned about the stability of domestic banks.

The legacy problem of the banking system: The present turmoil in Russia's financial markets is the kind of situation that could bring old problems to the surface. Higher interest rates and a weaker currency can challenge the financial stability of many bank clients even though the banks themselves may be able to manage the problems. Reports are of bad loans rising markedly to more than 6% and even that believed to present an understatement due to rising regulatory forbearance.

Disorderly banking resolution could be in the offing. As we have pointed out in the past on these pages, the Russian banking system is dominated by four large state owned banks and a handful of smaller but solid private banks. The former are under Western sanctions regime and shut out from Western capital markets, but still regarded as reasonably strong. The private banks are at the outset considered weaker but are, in return, not under sanctions. The problem of solvency and liquidity is related to some 800 smaller banks. Attempts of the central bank over the last decade at forcing them to close or merge with others have often failed against vested interests and organized mafias. Things could go on as markets were calm and high oil revenues greased the system. In the present climate, demands on regulatory and monetary authorities may grow beyond their capacity -- a situation known from many other countries in the past.

Politics

The conflict with Ukraine. The overthrow of the Ukrainian president Yanukovich in late February apparently took the Kremlin by surprise. Since the collapse of the USSR in 1991, the Kremlin seems to have been reasonably confident with the shifting political regimes in Kiev, including the Orange revolution leader, Tymoshenko, in 2004. However, the sudden coup against Yanukovich, widely perceived as a Kremlin stooge, may have marked a tipping point for Moscow which was forced to realize over-night it had lost control over events in a close neighbor.

Russia takes Crimea: The subsequent annexation of Crimea in last March looked more like off-cuff retaliation but also took Kiev and its western supporters unprepared. They responded with slashing gradually tighter sanctions on Russia after it also began to support an armed uprising against Kiev in Donbas. The latter has now led to a de facto partition of Ukraine, with the Kiev government apparently rendering attempts at controlling the situation of the contested territories. In September, a truce was agreed between Kiev, Moscow and the rebels but that has now fallen apart. Fighting over the Donetsk airport after the New Year as the Ukrainian army tried to retake it but was repelled by the rebels has now spread south as the rebels attempted to take the cost-line city of Mariupol. So far the conflict has caused some 5000 fatalities, including many civilians.

Why is Ukraine important to Moscow? What has surprised many observers in this conflict is the surging wave of Russian nationalism. According to the Moscow based Levada institute the Ukrainian crisis has raised Putin's approval rating above the 80% level in particular following the Crimea annexation and the subsequent support to the rebels. Besides that, Russia's own arms industry is apparently intertwined with the same of Ukraine -- some of it apparently located in areas taken by the rebels.

Any way out? Given the potential for grim alternatives, there are good reasons to believe that this crisis eventually will be contained although not before further intensification of the conflict. New western sanctions against Russia could be followed by Russian against the West although in both cases they may inflict more harm to the instigators than to the targeted victim. Possible sanctions against Russia's energy exports, by contrast, would hit the country's underbelly hard, but also drive up global energy prices and strike Europe's fledgling recovery. Freezing foreign assets of Russian banks would have a sharp effect on Russia, likely prompting default, without causing an immediate effect on the West. It could, however, have serious long term ramification for international finance by undermining general confidence of many international investors. All in all, it may therefore look like sanctions have not too much longer to go and that the only viable option is for all parties to step back and accept compromises.

Is such a Panglossian end-game realistic? A wild card in this conflict at least in Western eyes, is the highly unexpected moves by the Kremlin and Pres. Putin himself. Very high popular approval ratings would seem to make any hopes for his toppling a dream-pipe. Unless his popularity comes down significantly, the world will likely have to live with him for a long period. As such, it will be imperative to understand his reaction pattern. The first event, the annexation of the Crimea, may be explained as the temptation to pick a low hanging fruit. The peninsula was overwhelmingly populated by ethnic Russians and would present little popular resistance to the change of national status. In addition, Russia already had troops in situ at a local naval basis rented from Ukraine. The population of Russia itself had always regarded the peninsula as a part of its heritage and the transfer to the Ukrainian Soviet republic in 1954 was by many viewed as the fallout from a power struggle within the Kremlin after Stalin's death.[3]

Other contested areas of eastern Ukraine apparently came under Ukrainian control as a part of the Soviet government's redrawing in 1924 of the administrative map of the old Russian Empire. This happened under responsibility of Stalin and was not obviously based on a deep understanding of the cultural and ethnical background. Today these areas have a mixed population of Ukrainians, Galicians and Russians and could in no way be regarded as an easy gambit for the Kremlin if it were aiming for more land-grabs. Kremlin's strong support to the rebels, allegedly including ground troops, could look like painting itself into a corner. The situation may be difficult to explain to the Russian population as it comes to present them with

[3] Cold War International History Project of the Woodrow Wilson International Center for Scholars, Washington DC

material hardship perhaps suggesting tougher opposition in presidential elections scheduled for 2016.

Outlook

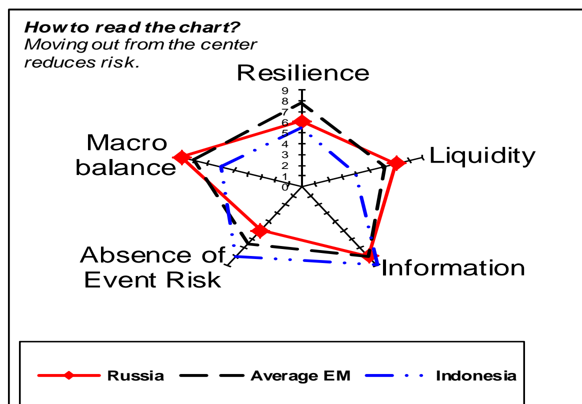
For the current year Russia should be able to keep head over water, despite the decline in activity that will leave the country in recession to the rune of some 3% contraction according to latest numbers from the IMF. Growth itself should recover somewhat in 2016 and following years but struggle to reach even a third of its performance in the heydays of the 2000s. That is also due to structural factors including a rapidly falling labor force set to shrink by around 0,6% a year to the end of the decade. Some annual deficits will occur in external and internal balances, but not likely at a scale to provoke immediate concerns.

After next year, oil price is king.[4] In a downside scenario of soft energy prices around the present level of $50/barrel in terms of Brent toward the end of the decade, external and internal balances will deteriorate to an extent where good access to global capital markets becomes paramount. Continuation of present sanctions against Russia will then raise the specter of debt service distress for banks and companies as the official reserves may have dwindled to a level where the government can no longer afford to be generous. Maturities, by contrast, will grow to an average of some $80bn to $100bn a year in the second part of the present decade. Much of that may still be covered by liquidation of private sector assets held abroad barring any future sanctions to include asset freezing combined with the on-going current account surplus. The sovereign itself, though, face only minor debt repayments for the rest of the decade.

Willingness to service foreign debt, by contrast, is another matter and will ultimately depend on political circumstances. There is virtually no example in modern financial history of countries or sovereigns defaulting when they actually are in a position to pay. The threat is rather one of indecisiveness or chaos in the wake of financial and perhaps political upheavals. All three major rating agencies have now lowered their ratings of the sovereign by two notches with warnings of more to come. That means two of the agencies could follow the lead of S&P into junk status to trigger immediate redemption clauses in some loan contracts. That would present an immediate pain, but likely be within the country’s repayment capacity provided government support.

Nevertheless, in our view the main risk in the near future is of the authorities’ own making, namely for monetary policies to continue being perceived as too soft and inconsistent in a climate of continued exchange rate weakness and financial stress.

Key ratios	2015
Population (mill)	142.1
GDP growth	-3.0%
GDP/capita (US$)	9243
Inflation	12.9%
Curr.Acc.Balance/GDP	2.5%
Reserves/imports (months)	32
Investments/GDP	18.1%
Government debt/GDP	12.3%



External ratings:
Moody's: Baa2/neg
Fitch: BBB/neg.
S&P: BBB-/neg

Peers:
Brazil
India
Indonesia

Graph: Compared with the average EM, Russia's risk profile is stronger on *liquidity* and *macro balance*, but weaker on long term factors: *resilience*. Ongoing hostilities in the war between Ukraine and Russian backed rebels has raised our event risk score and is further augmented by new downside risk to the oil-

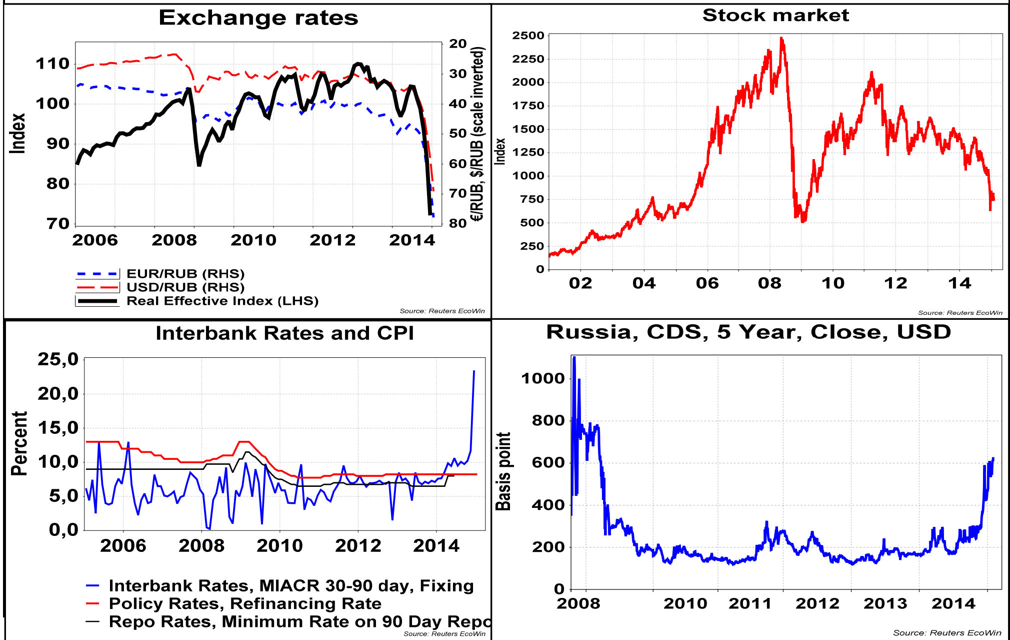
[4] Conf. Appendix ”The oil price of 2015 and beyond”

Key data:	2010	2011	2012	2013	2014	2015	2016
GDP (bill.US$)	1525	1905	2002	2097	1891	1313	1652
GDP/capita (US$)	10623	13287	13988	14687	13280	9243	11660
GDP (%chg)	4.5%	4.3%	3.4%	1.3%	0.6%	-3.0%	-1.0%
Investments/GDP	21%	22%	23%	22%	21%	18%	18%
Budget balance/GDP	-3.4%	1.5%	0.4%	-1.3%	-0.9%	-2.4%	-2.8%
Govt debt/GDP	7%	8%	9%	9%	9%	12%	14%
CPI inflation (% chg)	7%	8%	5%	7%	8%	13%	6%
Money demand (%chg)	34%	23%	16%	15%	6%	-4%	3%
Stock prices Avg.	143592	143367	143085	142762	142413		
Interest rates	6%	6%	7%	8%	10%	18%	14%
Exch. Rate ($)	30	29	31	32	38	61	50
Trade/GDP (%)	42%	44%	43%	41%	42%	35%	41%
Oil price (Brent)	$80	$111	$112	$109	$99	$55	$67
Millions US $							
Export of goods	392 673	515 408	527 434	523 276	494 362	309 141	388 531
Imports of goods	245 679	318 555	335 772	341 337	306 470	155 946	288 672
Other:	-79 542	-99 579	-120 379	-147 798	-128 998	-120 933	-23 358
Current account ($ mill)	**67 452**	**97 274**	**71 283**	**34 141**	**58 894**	**32 262**	**76 501**
(% of GDP)	4.4%	5.1%	3.6%	1.6%	3.1%	2.5%	4.6%
FDI	-9 449	-11 768	1 765	-15 948	-13 680	-13 680	-11 400
Loan repayments	-42 526	-52 396	-65 321	-71 047	-74 816	-77 655	-81 286
Net other capital flows	30 295	-3 690	-2 547	54 087	-32 832	-56 954	-37 808
Balance of payments	**45 772**	**29 420**	**5 180**	**1 233**	**-62 434**	**-116 028**	**-53 993**
Reserves	439 552	468 972	474 152	475 385	412 951	296 923	242 930
Total debt	471 550	528 800	590 850	711 150	705 217	583 986	518 071
o/w short term debt	58 075	67 775	77 775	86 025	92 650	107 378	121 615

Source: OEF (Oxford Economic Forecasting) and SEB estimates.

Rating history	2010	2011	2012	2013	2014
Fitch (eoy)	BB+	BBB-	BBB	BBB	BBB-
Moody's	Baa1	Baa1	Baa1	Baa1	Baa3-

Type of government: Presidential democracy
Next elections Presidential elections 2017
Other:
Latest PC deal 1999/active
Latest IMF arrangement 1998/SBA



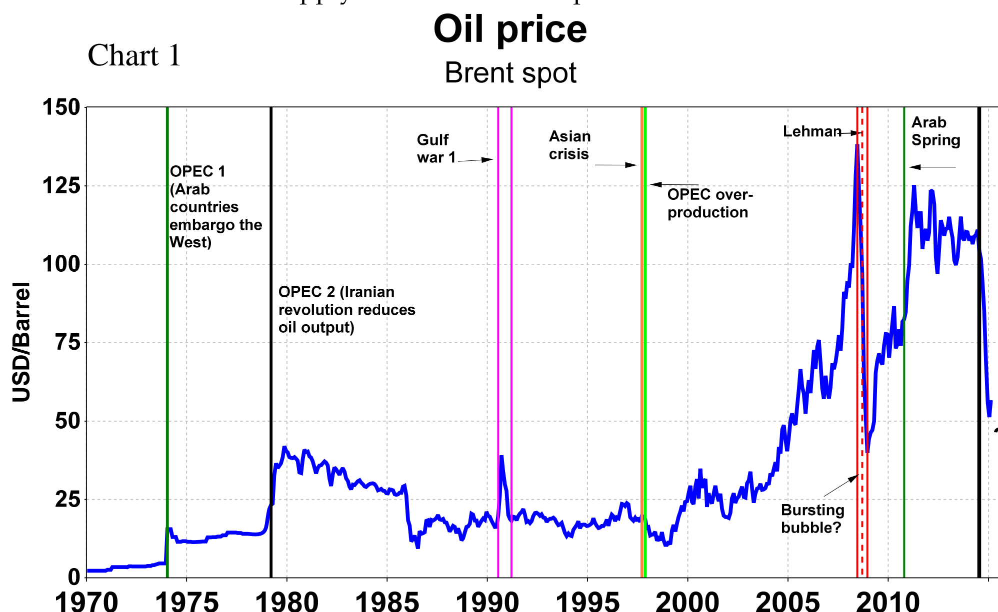
The oil price of 2015 and beyond

APPENDIX

As normal following a sharp and unexpected drop in the global oil price as the present fall of 50% since last July, market participants and observers begin asking if the price will soon bounce back, as happened on various occasions in the past, or whether we are heading for a new market paradigm of sustainable low prices as also has happened in the past. That question is paramount for how oil dependent countries like Russia and Saudi Arabia will face the future. Many observers remain sanguine as long as these countries maintain ample reserves. However, reserves as a stock are good as solving other stock problems, for instance external debt, but not necessarily as good as solving flow problems such as government deficits.

Since the first OPEC sanctioning of Western countries in 1973, the oil market has experienced periods of turbulent instability mostly for political reasons, but also reflecting fundamental supply-demand imbalances. In the 1970s, 1980s and the early 1990s political events dominated. They resulted in price spikes and periods of elevated prices reflecting instabilities in the Middle East. Since then political events have interchanged with fundamental market imbalances to determine increasingly more violent price variations. The recent unexpected slump is result of the fundamental demand-supply imbalances while politics are less involved

Chart 1



Source: Reuters EcoWin

Will the price soon bounce back?

- Futures prices for crude signal markets expectations of a tighter market and higher prices in the second half of the current year, improving further in 2016.
- Euphoria/panic: Emotions rise when the oil price drops fast and unexpectedly. Media and markets have recently filled with speculations about the further developments of the oil price but last time the global oil price dropped precipitously (in 2008) it was soon back at previous levels.
- Recent oil price recovery: Over the recent week the oil price has recovered some 20% from a trough of $46/barrel to $58/barrel, More of that going forward and panic/euphoria could be over as fast as it occurred.

Are low prices here to stay? <u>*Appendix 1*</u>

<u>The Arab spring</u> was an adverse event for the global oil market and took eventually up to 3,5mbpd away from it. The oil price shot up from what had proved as a temporary equilibrium price in 2010. However, something curious happened as the market went into backwardation for more than three years with the consequence that futures prices remained consistently lower than the spot price suggesting market suspicion about high spot prices. The price seemed ripe for a correction.

- <u>Shale oil</u>: at the turn of the decade shale oil and gas began to flow from wells in Texas and other on-shore US installations. The flow grew rapidly to around 4mbpd in 2014 and rising drilling activity suggested more to come.
- <u>Rising inventories</u>: Since early 2014 oversupply in the market rose to 0,5mbpd accumulating an additional 180mn. barrels by year-end on top of already high inventory levels.
- <u>Sluggish growth</u>: In November, the IMF reduced its projection for global growth in 2015 by 0,5 percentage points due to lower expectations for growth in most countries with the exception of the US. Markets quickly estimated that would mean lower than so far expected demand for oil.
- <u>Energy saving inventions</u>: High oil prices for almost a decade has triggered inventiveness in consumer countries. More efficient electrical cars and solar panels are soon to compete with combustion engines and traditional sources of energy to reduce the growth rate for oil demand.

The upshot

Sheik Yamani, the famous Saudi oil minister in the 1980s, once quipped that "the stone age did not end for lack of stones" meaning that his country should be wary of becoming too dependent on the black gold. He might well have added that new technology -- basis for the shale business – could render conventional resources less competitive and cost Saudi Arabia its market hegemony.

Economists often find it safest to project the present into the future. Many have recently chosen to disregard futures markets and made it their working assumption that the oil price will remain at the present weak level or weaker for years going forward. (BP, Marubeni, Goldman Sachs et al.)[5]

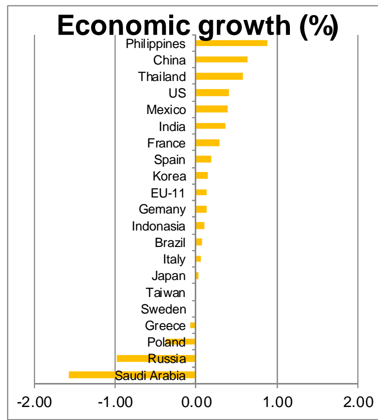
In such a situation the two traditional oil giants and low cost producers, Saudi Arabia and Russia, would suffer. Saudi Arabia is not immune to lower prices. It needs at least $80/barrel to keep its government budget on an even keel. As explained in Chart 2, at $50/barrel the budget deficit could run as high as 15%/GDP. Financing this only from reserves could destabilize the financial sector and threaten to increase inflation, unpopular in a country where faith bans interest on money. By contrast, Russia's problem would be endemic double digit inflation due to the fall in the ruble-rate. Out of necessity, the two countries may eventually find it worthwhile to cooperate to limit supply. That might give them a reprieve for some years until new technology once again catches up.

In that scenario one can foresee prices remaining below $60/barrel before rising to $80 in 2016. This may prevail to the end of the decade until Texas calls the bluff and yank up production. That may eventually pull the carpet under oil cartels like OPEC or other forms of cooperation on supply.

[5] http://www.bloomberg.com/news/articles/2015-02-06/these-experts-know-exactly-where-oil-prices-are-headed

Chart 1: Difference from base scenerio with the oil price at $50/barrel.

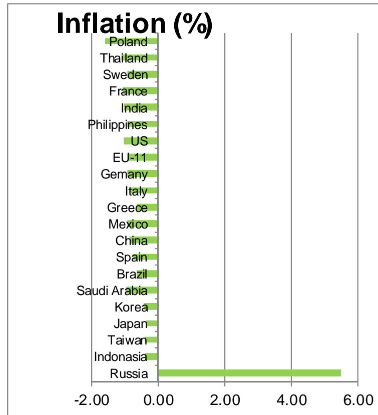
Economic growth (%)



Not surprisingly, the two largest oil producers in our sample fare worst in a low-oil price scenario. In Saudi Arabia, growth in 2015-17 falls by about 1,5 pp per year. In Russia, GDP growth falls by an average of 1 pp. per year leaving the economy in a steep fall of almost 5% in 2015 versus a 3-4% downfall in the main scenario. Starting from a better position, Saudi Arabia will still manage positive growth of around 2%, clearly weaker, though, than in the main scenario. This is mainly in response to our assumption of partial fiscal contraction to contain the the budget deficit. Without that the country would continue normal growth.

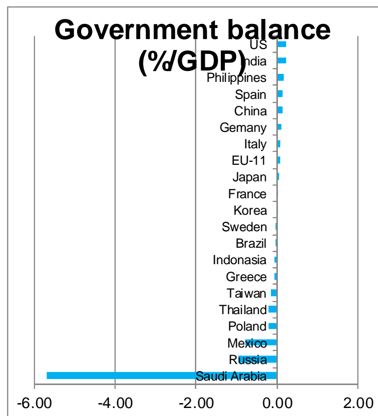
On the upside, most countries will benefit in a low price scenario, with the Phillipines and China as top winners as lower oil prices raise households' real

Inflation (%)



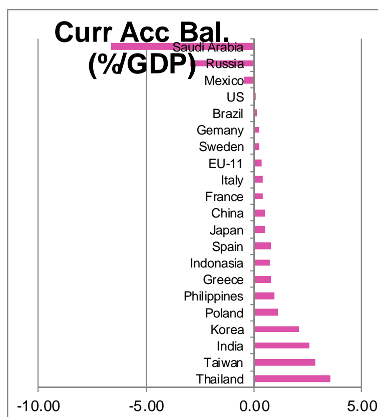
All countries, with Russia as the lone and extreme exception, will see domestic price pressure ease. For a few countries, including Indonesia, the Philippines and Brazil, that will be a clear blessing, while others, like China and the euro-11 countries -- already flirting with deflation, might see further downward price pressure as complicating monetary policies. In the euro-zone that could prompt more aggressive monetary easing even though its opponents will argue that the price fall should be of a temnporary nature. In China, the central bank may be more reluctant to follow suit lest it reopens the gates for undesired new lending binge of the country's various financial institutions to house builders and other investors.

Government balance (%/GDP)



The government balance will once again become the achilles heel of Saudi Arabia in a low oil price scenario. That is despite our assumption that the governmenbt will rein in expenses for new investment projects by a half to the level reached before the global financial crisis in 2008-9

Curr Acc Bal. (%/GDP)



Not surprisingly, the two largest oil producers in our sample fare worst in a low oil price scenario. In Saudi Arabia, growth in 2015-17 falls by about 1,5 pp per year. In russia, GDP growth falls by an average of 1 pp. per year leaving the economy in a steep fall of more than 5% in 2015 versus a 4% downfall in the main scenario. Saudi Arabia, starting from a better position, will still manage positive growth of around 2% but weaker than in the main scenario. This is mainly in response to our assumption of partial fiscal contraction to contain the the budget deficit.

On the upside, most countries will benefit in the low price scenario, with the Phillipines and China as top winners mainly because lower oil prices raise households' real disposible incomes.

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