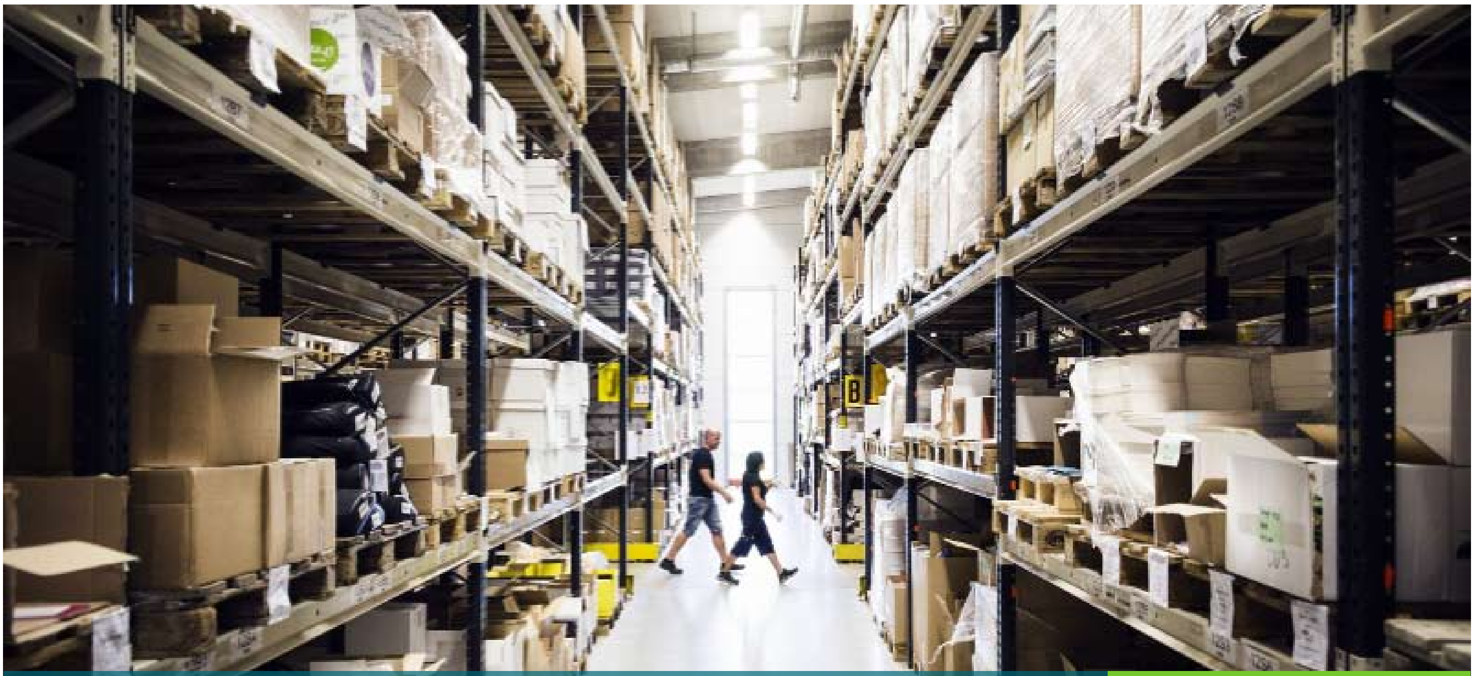


Baltic Business Outlook

January 2015

Foreword

For the third consecutive year, SEB Group conducted a large-scale SME advisory project among the companies in Estonia, Latvia and Lithuania. In thousands of face-to-face meetings with the entrepreneurs, the bank shared its financial expertise with SMEs, with the focus on the advisory of financial planning and management.

During the advisory project, SEB carried out a survey to map the SMEs' sentiment for the upcoming business year. Current Baltic Business Outlook sums up the project and provides insights from 6,125 Baltic SMEs participating in the survey.

Simultaneously SEB held in Estonia, Latvia and Lithuania a survey among 160 largest companies, with the annual turnover of more than 20 million euros, polling the company CFOs about the future prospects. Their views are also summarised in the report that charts to trends in the Baltic entrepreneurship in 2015.

Executive Summary

- Ailing external demand and consequences of geopolitical tensions have led the SMEs in Estonia, Latvia and Lithuania to more reserved expectations.
- In all countries, the share of optimists, i.e. companies expecting the turnover growth of more than 15%, has been in the decline. However, in Latvia 73% of the SMEs believe to see a moderate turnover growth in 2015 and the corresponding indicator exceeds the 50% threshold in Estonia and Lithuania.
- The views on export activity have not changed notably during the last 12 months: The focus is still on the domestic markets. The biggest share of companies eyeing either new or existing export markets is the largest in Lithuania — 33%, followed by Estonia (28%) and Latvia (18%).
- Most strongly, the Lithuanian SMEs would be hiring, as 29% indicate staff expansion in 2015. However, most of the respondents in all countries do not see any relevant changes in the staff composition.
- Especially in Estonia and Lithuania, the SMEs are planning to increase efficiency through innovation where product and service innovation is a preferred field. Of the polled companies, 73% in Estonia, 69% in Lithuania and 39% in Latvia are planning innovation or employees trainings in 2015.
- Due to uncertainties in the export markets, the companies are more cautious when planning new investments. While Estonian SMEs are the most active with 41% expecting to make investments in 2015, the share of companies planning to invest more than 30,000 euros has declined in all countries, to about 16–18% of the total.

SEB

Key indicators

	Estonia	Latvia	Lithuania
Population*	1.3 m	2.0 m	2.9 m
Currency (as of 1 January 2015)	Euro	Euro	Euro
GDP per capita (EU=100)*	73	64	73
Real GDP growth	1.6%	4.2%	3.1%
Inflation	2.8%	0.0%	1.2%
Unemployment rate*	8.6%	11.9%	11.8%

Source: SEB Nordic Outlook, November 2014
** Eurostat data as of end of 2013*

Economic forecast 2015

	GDP growth	Inflation
Estonia	1.8%	1.6%
Latvia	2.7%	2.1%
Lithuania	3.2%	1.0%

Source: SEB Nordic Outlook, November 2014

Methodology

Turnover growth
In the survey, the companies expecting at least a 15% turnover growth in 2015 are labelled as 'optimists" while the companies expecting growth figures below 15% are 'moderate optimists' and the rest, seeing a decline in turnover, are 'pessimists'.

Employment
The employment outlook is divided in three groups: The companies hiring new staff in 2015, the ones keeping the headcount unchanged and the companies intending to cut back on personnel.

Exports
All respondents are divided into three groups: Companies planning to enter new markets in 2015, those intending to grow on existing export markets and then companies focusing on the domestic market.

Innovation
The result refers to two groups of companies: Those planning innovation in 2015, either in products or services, business model, employees development and those not planning any of the above mentioned.

Investments
The threshold of considerable investments is set on 30,000 euros, the companies investing amounts above and below that constitute the first two groups and the third group is composed of companies not planning any investments in 2015.

Baltic views in brief

Less optimism about turnover growth

Optimists — Over 15% growth

Estonia	20%	↓
Latvia	10%	↓
Lithuania	16%	↓

Moderate optimists — Up to 15% growth

Estonia	60%	↓
Latvia	73%	→
Lithuania	53%	↓

Pessimists — Decrease

Estonia	20%	↑
Latvia	17%	↑
Lithuania	31%	↑

Instead of entering new markets, companies focus on the domestic market

New markets — Expand into new export markets

Estonia	16%	→
Latvia	8%	↓
Lithuania	17%	↑

Existing markets — Expand in current export markets

Estonia	12%	↓
Latvia	10%	↓
Lithuania	16%	→

Domestic — Focused on domestic market

Estonia	72%	↑
Latvia	82%	↑
Lithuania	67%	↓

No major changes planned in the staff

Hiring staff — Plan to recruit more people

Estonia	23%	↓
Latvia	13%	→
Lithuania	29%	↑

No changes — Keep the number of employees unchanged

Estonia	73%	↑
Latvia	84%	→
Lithuania	65%	↓

Reducing staff — Plan to decrease the number of employees

Estonia	4%	→
Latvia	3%	→
Lithuania	6%	↑

Companies express more interest in product innovation and staff training

Innovation in ...

Product/service — Product or service innovation

Estonia	36%	↑
Latvia	26%	→
Lithuania	46%	↑

Business model — Change of business model

Estonia	11%	↑
Latvia	3%	→
Lithuania	5%	↑

Employees — Investment in employees development

Estonia	24%	↑
Latvia	6%	↓
Lithuania	14%	↑

Companies' investment plans have been reduced considerably

Above 30th — Investment projects above 30 th EUR

Estonia	16%	↓
Latvia	18%	↓
Lithuania	17%	↓

Below 30th — Investments up to 30 th EUR

Estonia	25%	↑
Latvia	10%	→
Lithuania	12%	→

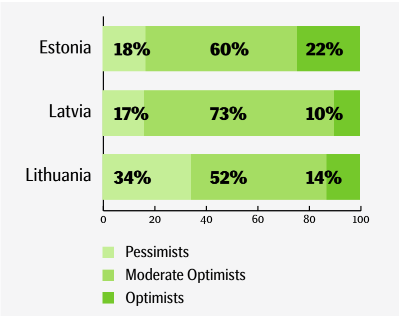
No — No investment plans

Estonia	19%	↑
Latvia	39%	↑
Lithuania	32%	↓

Baltic businesses by sectors

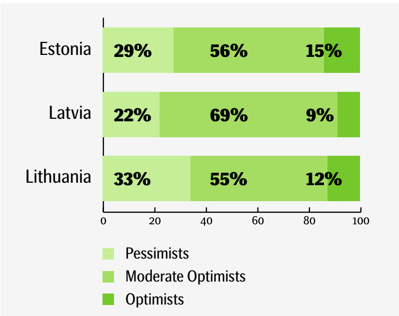
Of five indicators surveyed during the SME advisory project, the outlook of the turnover growth is the basis for assessing the business prospects for 2015. Defined as 'optimistic' are the SMEs expecting the sales to grow at least 15% this year.

Trade



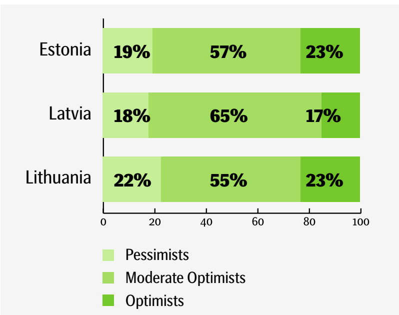
Estonian SMEs look most confident in the **trade** sector, with 22% of the companies expecting at least 15% sales growth in 2015 while in Lithuania 14% and in Latvia 10% are of the same opinion.

Transport and logistics



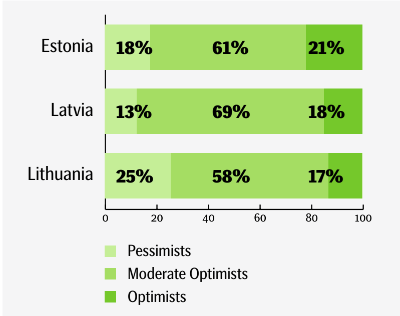
The companies in the Baltic **transport and logistics** sector look cautious when assessing the 2015 outlook. In all countries, the share of optimists does not exceed 15% of the polled sector companies. Still, about three-fourths expect the turnover to increase.

Construction



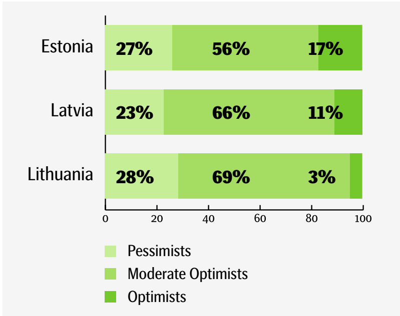
Of Lithuanian and Estonian **construction** companies, 23% of have an optimistic outlook for 2015 and in Latvia 17% believe the turnover growth to exceed 15%.

Manufacturing



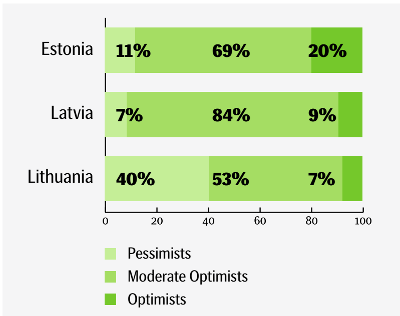
The **manufacturing** sector is most optimistic in Estonia with 21%, followed by 18% in Latvia and 17% in Lithuania.

Agriculture



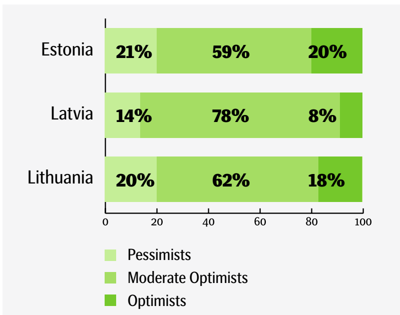
In **agriculture and fishery**, the expectations are rather modest and most optimistic is the sector in Estonia, where 17% of respondents expect the turnover to increase more than 15% in 2015, while in Latvia the indicator is at 11% and in Lithuania 3%.

Housing and catering



In **housing and catering** sector, the outlook is strongest in Estonia where the share of optimists amounts to 20%, followed by Latvia and Lithuania with 9% and 7% respectively.

Other



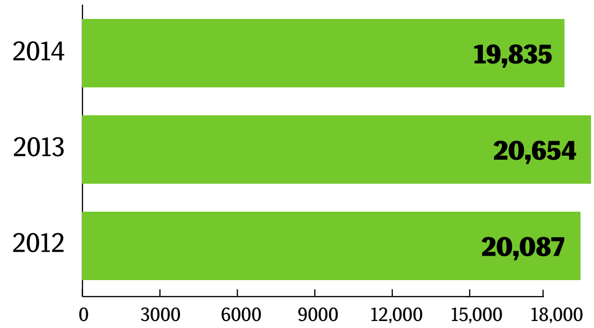
Among the companies in other sectors, the optimism in Estonia is the strongest with 27%, followed by Lithuania and Latvia with 18% and 15% respectively.

Business environment country-by-country

Estonia

- For 2015, Estonian SMEs forecast a moderate turnover growth, activity on export markets and recruitment of employees.
- A fifth of enterprises forecast turnover growth of more than 15%; most confident companies are in the sectors like trade, construction and housing and catering, with about 30% of optimists in each.
- The share of the enterprises planning to enter new markets or expand on the existing ones has changed to 28% from last year's 31%.
- The largest drop happened in the field of investments: Only 16% of the companies plan in 2015 investments of at least 30,000 euros, down from 42% the year before.
- Of the polled SMEs, 23% plan to hire people in 2015, which means that the companies concerned would create almost 1,500 new jobs.
- Innovation enjoys a positive trend as 73% of the polled SMEs are planning innovation, compared to 59% the year before.

New companies established:



Estonia: SME plans for 2015

73%	will keep the number of employees unchanged
72%	will remain focused on domestic market
16%	will make investments
46%	plan innovations in business model or products/ service

Up and down: Where are they?

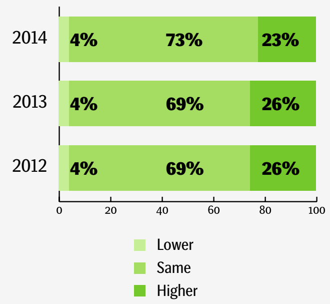
Optimists

- Trade, construction, housing and catering sectors
- Harju county
- Up to 9 employees
- Turnover up to 65,000 EUR

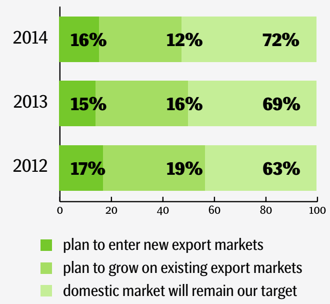
Pessimists

- Transport and logistics sector
- Hiiu county
- 10–99 employees
- Turnover 2–3 m EUR

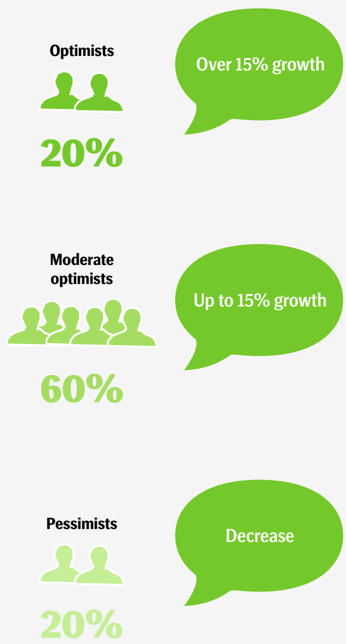
Number of employees next year...



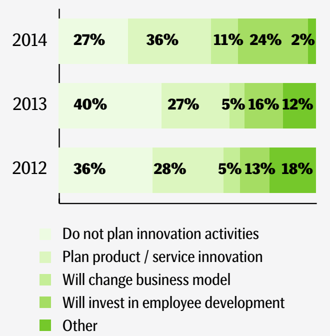
Export markets



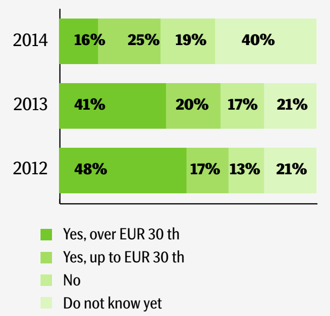
Turnover next year...



Innovations and changes

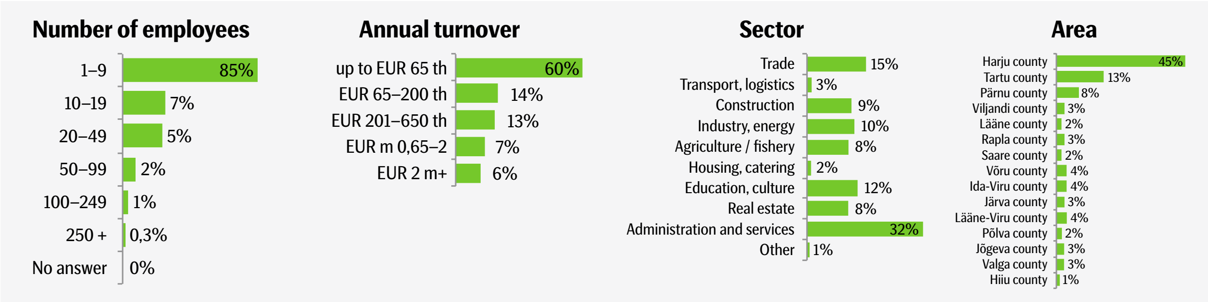


Investment projects

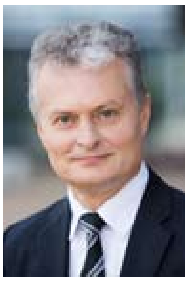


Profile of the Estonian survey

(2837 companies partcipated in total)



Economist's view



Gitanas Nausėda
Chief Economist
SEB Lithuania

Exports remain the weakest link in the economy — especially merchandise exports. Overall, foreign demand is expected to recover only slightly over the coming year due to weak demand in Finland and Russia. On the positive side, the growth in Sweden, the most important export partner (18% of total merchandise exports), is expected to pick up in 2015. Finland, the export country No. 2 (15%), should finally emerge from recession after 2 years of contraction. The demand in Latvia and Lithuania, which take up 11% and 5% of exports respectively, is not expected to stumble. Recession in Russia (10% of exports) and rouble depreciation will harm Estonian sales while Russia's restrictions on food imports are adding to Russia's weaker demand. Since these trade ties are relatively modest, the effects will not be broad. Russian food sanctions will only have minor direct negative effects on Estonia's exports, but will show up more in the transport sector.

The real effective exchange rate is expected to start falling, both via low inflation and the depreciating nominal euro, which will provide some help to exports. The search for new alternative markets will also provide new opportunities.

In the coming year the main driver of the economy will continue to be private consumption, which has increased at relatively steady rate. In an economy driven by domestic consumption, the most likely beneficiaries are retail sales and domestic demand-related services, while transport, agriculture and construction will face the biggest difficulties. Confidence indicators continue to reveal widening differences between sectors, including negative prospects for the construction and transport sectors, whereas the outlook for retail trade and manufacturing remain fairly stable.

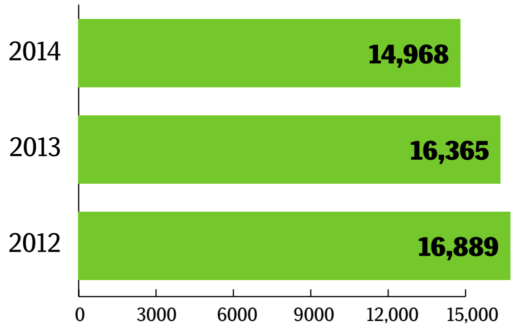
Private consumption has been supported by several factors. The labour market has been very favourable, with the unemployment rate dropping and real wages growing at a robust pace. Looking ahead, this trend will worsen slightly. As nominal wage growth starts to decelerate and when inflation starts to return, real wage growth will be squeezed somewhat. In addition, employment looks set to stabilise or decrease as companies facing the challenge of growing wages and weak economic growth try to boost their productivity. But wage growth will continue to be propped up by the fact that the labour force is shrinking and unemployment has declined below its equilibrium level, thereby implying increasing labour shortage pressures. Unemployment remains structural due to the mismatch of skills. The shrinking labour force is showing a rare combination of simultaneously decreasing unemployment and employment. In 2015, wages will be additionally pushed up due to increase in minimum wages and salaries and start of wage agreements in several sectors. Notably, Estonia's wages and salaries have been increasing to a largest extent among the Baltic States recently.

Both business and public investment development is expected to be sluggish in 2015 due to underused existing capacities and an expected time lag before absorption of new EU funds. Public investment is not forecasted to recover until 2016 while company investment will only gradually recover in 2015. Due to shrinking labour market and sluggish export growth, business investment will maintain its focus on productivity increase. Business investment is hampered by lingering uncertainty, rather fragile growth prospects and a decreasing foreign fund inflow, whereas loans to companies are slightly increasing again.

Latvia

- Like the year before, the Latvian SMEs are moderately optimistic about the turnover growth. More strongly, they remain focused on the domestic market while no significant changes are seen in the employee numbers.
- Of Latvian SMEs, 10% expect the turnover to grow of more than 15% while a clear majority, 73%, believes that the turnover growth will be up to 15%.
- The share of enterprises planning to enter new markets or expand on the existing ones has changed to 18% from last year's 26%.
- The companies envisage the investment activity slightly lower than the year before when 18% (compared to 27%) of the companies plan investments of at least 30,000 euros
- Eighty-four per cent expect that the staff number remains in 2015 unchanged and 13% intend to hire new people.
- Innovation activities are planned by 39% of the polled SMEs and the focus, preferred by 26%, lies in the product or service segment.

New companies established:



Latvia: SME plans for 2015

84%	will keep the number of employees unchanged
82%	will remain focused on domestic market
18%	will make investments
29%	plan innovations in business model or products/ service

Up and down: Where are they?

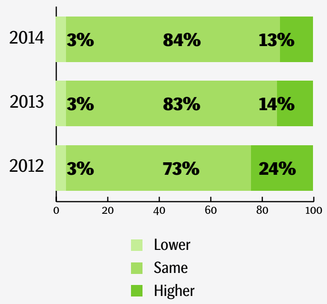
Optimists

- Trade, construction and manufacturing sectors
- Companies with 50–99 employees
- Turnover from 3 to 6 m EUR

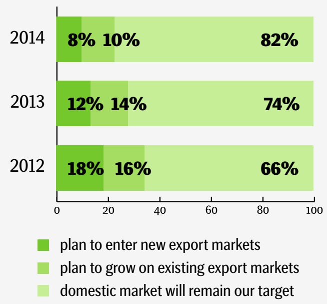
Pessimists

- Agriculture, transport and logistics sectors
- Smaller companies with up to 50 employees
- Turnover up to 65,000 EUR

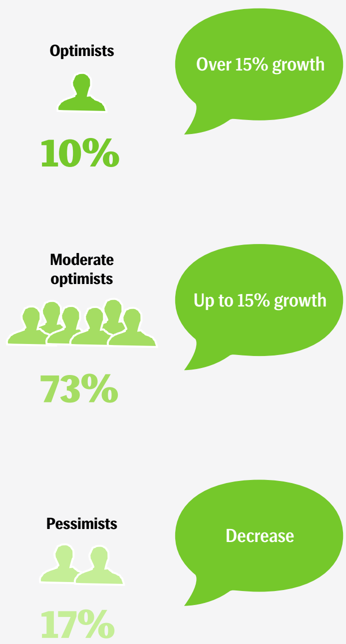
Number of employees next year...



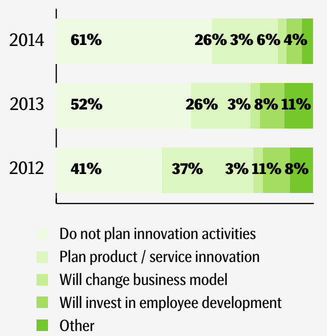
Export markets



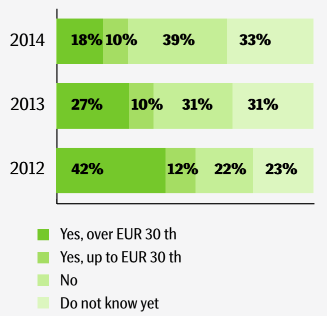
Turnover next year...



Innovations and changes

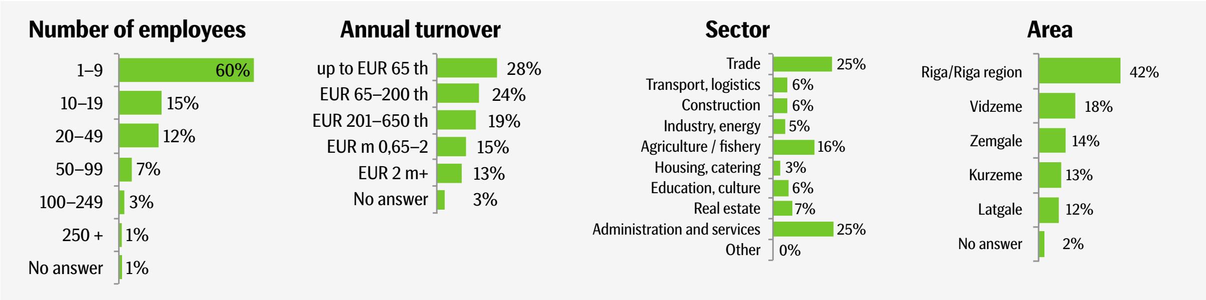


Investment projects



Profile of the Latvian survey

(2022 companies partcipated in total)



Economist's view

Dainis Gašputis
Economist
SEB Latvia

In 2014, the economic growth of Latvia has continued to slow moderately, since the Russia-Ukraine conflict broke out. Consequently, the growth of Latvia gradually slowed from 2.8% in Q1 to 2.4% in Q3. Exports struggled, caused by the falling Russian growth and anaemic Western demand. The Russian ban on food imports from countries that had imposed sanctions has played a part. However, companies are successfully reducing their dependence on Russia by turning to other markets. Capital spending, which was weak even before the Russia-Ukraine confrontation, has remained weak. Geopolitical uncertainty is probably having some impact, with companies postponing or cancelling planned projects. During 2014, private consumption continued to chug along at a healthy pace. Strong real incomes are driving the retail sector, including car sales.

Conflicting forces continue to influence GDP growth this year as well, which will not become more balanced until 2016. The Ukraine crisis and the Russian downturn will cast shadows on capital spending plans and exports as well, but a cautious recovery in these areas is expected. Capital spending will benefit more from EU funding. Slightly better Western European demand and the declining euro will help stimulate exports. This year, the economy will have both opportunities and the conditions necessary to continue to grow at the expense of domestic consumption as households enjoying favourable conditions. Consumer activity is positive and the self-assessment of their financial situation has improved.

The current wage growth is rather fickle. The lack of certainty and the ongoing slowdown will cool the dynamics a bit. This will weaken the employee's ambitions and will raise employers' resistance to cost increases. However, the pressure to raise wages will stay. Changes in wages among industries and companies, as well as employees will vary substantially. Key specialists will be in a better situation to see wages rising. We expect real wage growth of 4–5%. Economic growth will reach 2.5 and 3.0%, this and next year respectively. Due to a high degree of uncertainty, growth scenarios include very high degree of downside risks.

In the short term, inflation will remain low due to the global commodity price squeeze and a weakening Russian economic situation and will rise cautiously over time as labour costs increase. A slightly more active price increase for certain services is expected. It will be driven by wages and other cost increases, as well as consumer activity. The biggest jump in inflation will be driven by an increase in the price for electricity. Further price fluctuations will be more related to seasonal factors.

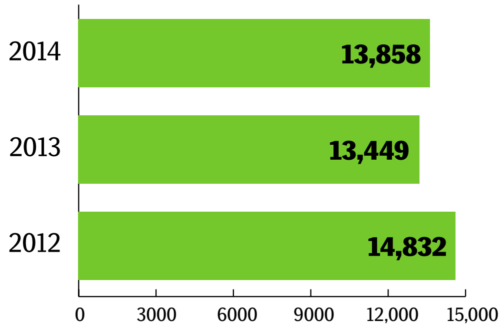
Assessing labour-market developments, one should take into account the weakening outlook. Unemployment will shrink but insignificantly. Latvia is approaching the natural rate of unemployment. The ruling precaution could weaken the demand for workers. However, the demand for specialists will remain high, especially for those who are able to provide added value. In designated areas, there will be demand also for unskilled workers. It is expected that employment growth will be more pronounced in trade and services. Meanwhile, unemployment will be characterised as regional problem. It will become more acute due to an expected Russian economic downturn, which is why in certain areas unemployment will rise. At the same time, continued emigration will contribute to a persistently growing labour shortage.

The scale of the problems in the Russian economy continues to mount and cast a shadow on Latvian prospects. At the same time, ambitious plans for the euro zone's revival are still at the planning stage. It all calls for a level of precaution. Russian and related market problems are not only rooted in economic, but also in political reasons and it may take a long time to solve them. It will be very important for the government to react decisively as it has to push forward with structural reforms, including finding solutions in order to remove obstacles in the way of more active lending in order to boost growth.

Lithuania

- In Lithuania, the SMEs expect a year of moderate turnover growth with the focus on the domestic market.
- The majority of companies (53%) believe that the turnover will grow up to 15% while the share of the SMEs indicating a turnover decrease is now 31%, compared to 11% before.
- The export activity remains largely the same when about one-third of the SMEs say they are either planning to enter new markets or expand on the existing ones.
- Investments of at least 30,000 euros belong to the plans of 17% of the companies.
- Stability is valued in the staff composition when 65% expect the employee numbers remaining unchanged. However more hiring plans are seen as the year before, the indicator going up from 22% to 29%.
- Sixty-nine per cent of the companies expect to put more emphasis on innovation, a significant increase from 42% the year before.

New companies established:



Lithuania: SME plans for 2015

65%	will keep the number of employees unchanged
67%	will remain focused on domestic market
17%	will make investments
51%	plan innovations in business model or products/ service

Up and down: Where are they?

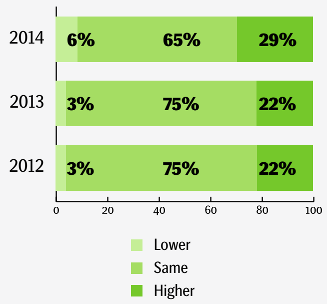
Optimists

- IT and telecommunications, construction sectors
- The smallest (up to 20 employees) and the largest (over 250) companies
- Vilnius and Kaunas counties
- Turnover up to 65,000 EUR

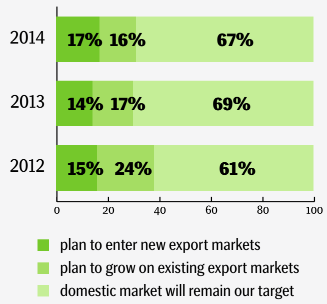
Pessimists

- Trade sector
- Up to 9 employees
- Panevėžys county
- Turnover up to 65,000 EUR

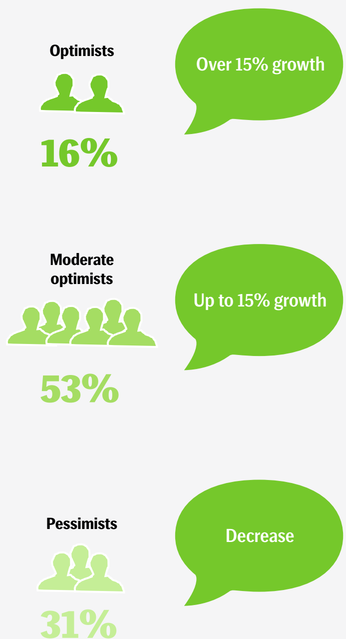
Number of employees next year...



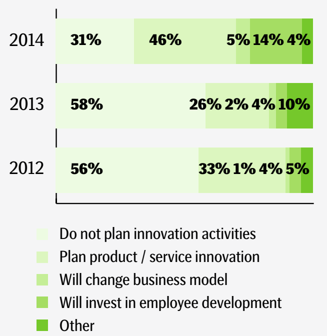
Export markets



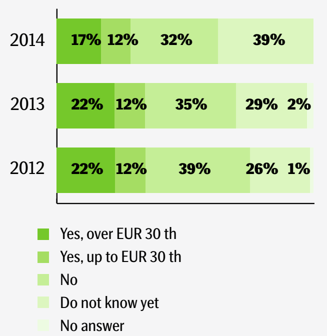
Turnover next year...



Innovations and changes

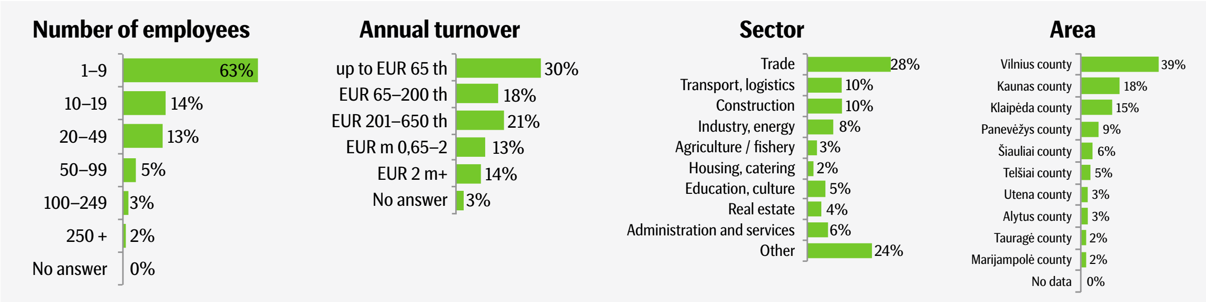


Investment projects

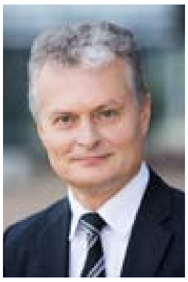


Profile of the Lithuanian survey

(1266 companies partcipated in total)



Economist’s view



Gitanas Nausėda
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The situation in key Lithuania’s export markets seems to be rather mixed in 2015. Russia, the No. 1 export market (21% of exports), is expected to fall into recession while depreciating rouble will hurt competitiveness of Lithuanian goods. The possibility of new trade or transport sanctions cannot be ruled out; however, they would hurt less due to their lower relative share. The growth in No. 2–4 export partners (Latvia, Poland and Germany) is expected to be rather firm in 2015. Belarus, the export market No. 5, will be much less attractive this year due to its stumbling economy, depreciating Belarussian rouble and widespread overdue export payments. Russian sanctions served like a wake-up call for Lithuanian exporters. As a consequence, Lithuanian exporters started looking for new export possibilities in yet unpenetrated markets. Therefore, the year 2015 may see including unseen export markets from Asia, Middle East or Americas. The weakening euro will also contribute to export competitiveness in overseas markets, e.g. United States or Canada.

Lower energy prices, rising income and shrinking unemployment will support consumption growth in 2015. Therefore, the outlook for trade sector, including both necessity and non-necessity goods, as well as consumer services is rather bright this year. The only major risk for these sectors is geopolitical uncertainty which could spoil the consumer expectations and reduce their propensity to consume. Less shoppers from Belarus and Russia also may have some negative effect on retail trade. According to preliminary announcements, relocation of service centers of large foreign companies to Lithuania will continue in 2015 and thereby support service sector. The residential construction is likely to slow down this year after more robust increase in 2014. However, the building of commercial property and infrastructure still has potential for further growth.

Manufacturing will be supported by lower prices of raw materials, but the challenge of claiming new markets and retaining the old ones makes the year 2015 quite uncertain for industry. Food manufacturing will remain among the most vulnerable ones. The nearest future for the oil refinery Orlen Lietuva, the largest industrial company in Lithuania, is unsure due to stumbling industry prospects worldwide. Transport sector will benefit from declining fuel prices, but it will suffer due to Russian sanctions and bans as well as tougher requirements in the Western countries. Tourism will face a challenge of decreasing inflows of tourists from Russia and Belarus, however, it has a chance to benefit from euro introduction.

Despite the fact that credit interest rates are very low, corporate borrowing hardly increases. Investment recovery is also relatively weak. The main factor behind sluggish credit and investment growth is lack of appetite for borrowed funds. Most of businessmen continue applying “wait-and-see” approach as long as they are able. Geopolitical tension also contributes to lingering uncertainty. Therefore, although credit conditions will be favourable in 2015, both borrowing and investment will grow only slightly this year.

Wages and salaries will continue rising this year, additionally driven by increase in minimum monthly wage as of July 1, 2015. Lately, wages and salaries started growing faster than labour productivity, however the difference does not seem to hurt competitiveness of Lithuanian companies. The wage-productivity pressure in Lithuania remains the weakest in the Baltics as well as wage level is the lowest at the moment. Noteworthy, the wage growth was notably slower in Lithuania than in its Baltic peers during the post-crisis period.

Current affairs Baltic economies

Estonia: No high hopes for investment recovery

Investment recovery hardly finds its way in Estonia as well as in other Baltic States. On the one hand, corporate capital investment has increased by quite spectacular 60% from its bottom level in 2010. On the other hand, the investment still makes up only three-quarters of its pre-crisis volume. The correction in the real estate market was one of the reasons behind the investment slump, and the gap of investment into real estate makes up as much as one-third of the pre-crisis peak, while the respective investment gap into machinery and equipment makes up around one-fifth. Investment into machinery and equipment suffered less during the crisis while investment into real estate was much more vulnerable. What is more, investment into machinery and equipment has peaked in 2012 during the post-crisis period and then trended downwards in both 2013 and 2014.

One of the most serious reasons behind weak investment appetite is lingering uncertainty. Growth prospects in the most important export partners, primarily Finland and Russia, are bleak, to put it mildly. In addition, geopolitical uncertainty gives extra reason for managers to think twice before making an investment. Capacity utilization has increased after the crisis from 57% at the bottom to 75% currently but still has some space to peak of 80% before the crisis. Thus, presumably there is spare capacity in the manufacturing, what does not exert particular pressure to invest. Capacity utilization, and respectively investment demand, is the lowest in manufacturing of chemical products, rubber and plastics, construction materials as well as food products. Recent decrease in electricity and other energy prices may at least temporarily reduce appetite for investment into energy-saving technologies.

Business investments are additionally being hampered by anaemic growth prospects as well as a decreasing foreign fund inflow. Estonian economy is expected to grow by 1.3% in 2015 which means that growth will stay below its potential for a third year in a row. The break between the two programming periods of structural support from EU funds will not help the investment to recover until 2016.

Nevertheless, in the medium and long-term Estonian economy will face a challenge of shrinking labour force and pressing labour shortage. Productivity growth has been already been weak lately what points to probable increase in investment into higher production efficiency and maintaining competitiveness. Considering short-term indicators, a decrease in stock of inventories of manufacturing companies and increase in production expectations for the nearest future are investment-friendly.

One more positive factor for investment growth is favourable financing conditions. EURIBOR is expected to remain at record-low close-to-zero levels throughout 2015 while the banks do not plan tightening in their lending policy. Actually, loan issuing to non-financial companies in Estonia has accelerated already in 2014. Given that geopolitical uncertainty does not escalate, or preferably, diminishes, higher borrowing could contribute more notably to investment recovery. Meanwhile, taking into regard all the drivers, growth of business investment most likely will be lacklustre in 2015.

Latvia: EU funds will drive SME activities

The year 2014 was full of new challenges and difficulties for many of Latvia's small and medium sized companies (SMEs). Their activities in seeking new financing peaked in the first quarter and since then demand for lending has been declining gradually. Farmers were the first to encounter problems when due to adverse weather conditions in some regions of Latvia winter crops failed to grow. They had to be re-sown and as a result after gathering the harvest the financial results in many farms were far from the excellent results of the year 2012. We should note that in order to overcome this situation the bank was able to find unique solution for each individual case.

Without doubt, a challenging geopolitical situation in our region had considerable impact on SME business during last year. Transportation companies felt the consequences in the second quarter while the food and agriculture industry faced these challenges in august when Russian sanctions were introduced. All companies with exports to Russia feel the negative consequences of the rapid decline in the value of Russian rouble, especially starting from beginning of year 2015 and the most probably is going to have the same impact within the whole year.

The long-awaited opening of EU fund programmes for farmers has happened. We see that farmers have been expecting it since the demand for financing is improving. Most likely that availability of EU funds will drive the SME sector to investment activities, which could increase the demand for bank financing. From resource pricing perspective, from one side year 2015 has brought negative one-month EURIBOR interest rates, from other side we see increasing demands from the regulatory towards capital adequacy, pushing banks to think about reviewing the added-rate which could impact the price of SME lending.

Lithuania: Economic tensions with Russia — heavy clouds but no storm

It has been widely reported that Lithuania is the most vulnerable country in the EU to Russian trade sanctions and its economic distress. That is true, as Russia remains Lithuania's trade partner No. 1 in terms of both exports and imports. On the other hand, the fact of being the most susceptible does not imply that the damage to the whole economy will be severe.

At the beginning of August last year, Russia announced its sanctions on certain food imports from Western countries, which affected 4% of total Lithuania's exports. But — surprise, surprise — Lithuanian exports to Russia increased by 7% on an annual basis in August-November 2014. As simple as that, skyrocketing reexports of machinery and equipment more than compensated for total export loss due to sanctions on food products. Furthermore, almost 90% of total exports to Russia is reexports, a transit trade, which means that transport sector is more exposed than manufacturing companies. Among industrial companies, only dairy and meat producers suffered more notably due to loss of the market and agricultural companies due to the drop in purchasing prices. However, most of affected companies reported that their income decreased but no bankruptcies are foreseen.

Luckily or not, Russia used to embargo Lithuanian exports quite often in recent years. In that way, businessmen got used to the bans and worked out different strategies of managing the risk related to Russia. Redirecting exports to alternative markets was launched right after the sanctions were announced. As a result, the exports of milk and dairy products (in tons) increased by remarkable 38% on a yearly basis in August–November 2014 while the value of exports dropped by 17%. The exports of raw milk increased spectacularly to Belarus and Poland and dairy products to Germany and Saudi Arabia. Quite probably, Belarus used a chance to increase exports of its own dairy products to Russia and indirectly provided some temporary relief for Lithuanian companies. However, due to deteriorating economic situation, Belarusian companies increasingly fail to make payments on time and therefore milk exports to Belarus may decrease in the near future.

Transport sector has lower market redirection possibilities than industrial companies. Russia accounts for as much as 28% of exports of transport services and Lithuania is the EU gate to Russia, taking up 40% of total EU exports of transport services to this country. Russia also used to practice unexpected obstacles specifically for Lithuanian vehicles, the last one (stricter customs checks) still in force since November 2014. Transport companies use alternative routes through Belarus, but the situation remains disturbing. Meanwhile Russia has disconnected from TIR system what adds more problems. The Western European countries also plan to raise new requirements for cargo transportation (e.g. sleeping requirement in France or setting minimum wage for all truck drivers in Germany). Therefore, transport companies will have to tackle numerous challenges arising in 2015.

The Russian sanctions on food products are to be scrapped in August 2015 (not for sure yet) but Lithuanian exports to Russia anyway will be negatively affected by expected recession in this country and sharp depreciation of the rouble. Consequently, the demand for imported goods in Russia is expected to shrink and these will be reexported goods mostly. Russia has already sanctioned the most vulnerable goods of Lithuanian manufacturers while other sectors would be much less affected even if sanctions are applied to them.

Once a sole supplier of natural gas for Lithuania, Russia used to have monopolistic power in Lithuania's energy market. Upon launching the LNG terminal in Klaipėda port at the end of 2014, Lithuania now has an access to diversified supply of natural gas. Even before installation of LNG terminal, Gazprom has notably lowered the price for several Lithuanian gas retailers. The situation in the global oil and gas market has substantially changed during recent months to the disadvantage of Russia, and therefore the latter will hardly use energy exports as a geopolitical tool in the near future.

CFOs of large Baltic companies concerned about falling demand

In addition to polling the SMEs in Estonia, Latvia and Lithuania, SEB has started regular surveys among the largest enterprises in the Baltics. The CFOs of respective companies are invited to participate in the survey, which was conducted in March 2014 for the first time. The second edition was held in September 2014, when CFOs of 160 largest companies, with the annual turnover of more than 20 million euros, shared their views about the economic developments.

The survey shows that in both in March and in September of 2014, 59% of the major corporations in the Baltics rated their current overall financial position in coming six months as favourable.

In comparison with the previous CFO Outlook, which was done in March 2014, the overall optimism of Baltic CFOs has somewhat declined. In the spring, 51% of largest companies estimated that during next six months the business climate will be either favourable or very favourable. Now only 41% agree with this position. Now, 15% of the Baltic CFOs feel that business conditions will be either unfavourable or very unfavourable, while 44% hold a neutral position on the issue.

Worsening geopolitical situation and the escalations of the events around Ukraine explain the attitude shift. The tensions have shaken the whole region of Eastern Europe. CFOs in Estonia are the most sceptical — only 23% are expecting the business environment to be favourable, while 18% feel that the environment is going to be either unfavourable or highly unfavourable.

In Latvia, the share of optimists has dropped by 14%, from 59% in March to 45% in September. Entrepreneurs in Lithuania are more confident with 53% believing that business conditions are favourable. Their opinion could be related to positive trends in domestic demand. At the same time, the share of entrepreneurs in Lithuania who are concerned about the future has risen from 3% to 14%.

More than a half (56%) of the CFOs of Baltic companies have cited the decrease in demand as their main cause for concern. Anxiety regarding this issue has risen in all three Baltic countries. The availability of skilled workers — which is a hallmark of long-term problems and the negative consequences of emigration — has become an issue mostly in Lithuania and Estonia. In Latvia, the issue has lost a certain amount of relevance. In the Baltics, the concern over labour costs has decreased. This shows that entrepreneurs have gained more trust in the loyalty of their employees.

The poll results indicate stabiliy in the labour market when 62% (59% in March) of the companies intend to keep the number of employees unchanged during next six months, while 26% (33%) plan to hire. Most remarkable change can be observed in Latvia where in March 43% believed that the number of employees will increase but in September, 26% are of the same opinion.

The companies do not express much concern about the availability of financing and interest rates. In September, only 12% (18% in March) of the Baltic CFOs stated the availability of financing is a problem to them and only 5% (14% in March) were worried about interest rates.

Disruptions in cooperation between Russia and western countries, along with the loss of trust, have also been at the centre of attention. Out of the CFOs of the Baltic States, 44% are convinced that these processes will have a negative impact on their business, and 12% stated that the escalating conflicts has had a particularly negative impact.

In this sense, the opinions of the CFOs of Latvia, Lithuania and Estonia are similar. At the same time, 55% of CFOs in Lithuania, 50% in Latvia and 60% in Estonia believe that the conflict between Russia and the western countries has had a negative impact on their company.