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MDBs unite in breakthrough pact but Banga ducks capital increase call

By Steve Gilmore, John Crabb, Oliver West, Elliot Wilson, Dominic O'Neill

Ten multilateral development banks unveil collaboration agreement

World Bank president Ajay Banga unveiled a new agreement with nine other multilateral development banks on Friday, at last bringing the kind of inter-MDB coordination that reformers have long called for.

The fragmented sector, which has common shareholders but no regulator or well-organised overarching governance system, has long suffered from conservatism, partly as a result. Mounting calls for MDBs to do more to meet gaping needs in the developing world have kicked the sector into action over the past 15 months, leading to more change than had occurred for decades.

"We have a completely new situation at the World Bank, which might not be the biggest of multilateral development banks but is the most important one," Werner Hoyer, president of the European Investment Bank, told *GlobalMarkets*. The EIB has joined the group. "With the new leadership in the World

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US rift with China threatens EM supply chain hopes

By Steve Gilmore

The US's political distancing from China is reshaping supply chains in a way that will have profound and lasting effects. As it tries ever harder to cut China out of its plans to create new North American supply chains for green technologies, it is creating problems for emerging countries such as Morocco and Indonesia which have been busily setting up joint ventures

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West keeping grip on IMF risks global 'fragmentation'

By John Crabb and Dominic O'Neill

The IMF Board of Governors risks causing splits in international financial governance if it does not heed calls to rebalance its quota formula when it releases its latest General Review in December. The US is against radical change but emerging market experts have been sharply disappointed by its proposals.

Developing economies claim they are under-represented in the existing system and are calling for the lines to be redrawn in their favour to reduce the hegemony of Western states.

While the US has proposed some concessions, Mahmoud Mohieldin, an executive director at the IMF from Egypt, said: "Everybody was expecting much more than what's being offered."

"Today there are substantial risks of fragmentation at a global level," Ignazio Visco, governor of the Bank of Italy, told *GlobalMarkets*. "This pushes the necessity to find a solution

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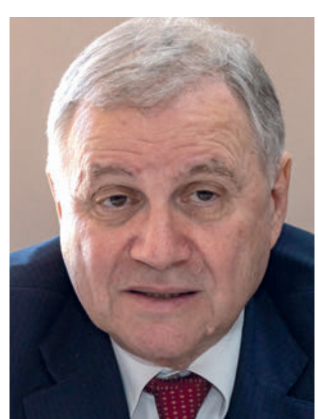

Visco: called for a 'more balanced approach' to IMF quotas

NEWS

Hybrids to grow

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Bank, I think the sky's the limit. We can really move forward with this new impetus and drive at the World Bank that [can] take everybody else with them. I think we can move towards a breakthrough."

A crucial step will be to get the MDBs working together on important policy issues, not just informally, as they have done in the past, but in a more concerted way. One key issue is their relations with the rating agencies, which are their de facto regulators as issuers of their triple-A ratings.

Working together to use hybrid capital and portfolio guarantees, make collective assessments of Paris Agreement alignment and climate reporting, collaborate better in-country and harmonise processes for co-financing and private sector investments could unlock $300bn to $400bn more lending over the next decade.

But with annual development financing needs in the trillions, some were disappointed Banga did not make an explicit request for more shareholder capital.

"What I found a bit disappointing is that he did not really go into the issue of going after major shareholders to push them to actually make a capital increase," said Hung Tran, non-resident senior fellow at the Atlantic Council's Geoeconomics Center.

International tensions, disagreements among G20 members and high sovereign debt levels make it difficult to convince MDB shareholders to provide more capital. "But that doesn't mean the World Bank and other supporters of the Bank shouldn't raise the issue and say to leaders: get your act together," Tran said.

Paul Cadario, a former director at the Bank and now a fellow at the University of Toronto's Munk School of Global Affairs and Public Policy, said the financial engineering in the collaboration would "not be a piece of cake… The MDBs all have slightly different approaches to capital, not all of which are minor to harmonise."

Luiz Vieira, coordinator of the Bretton Woods Project NGO network, said the collaboration was based on a drive to leverage massive amounts of additional private capital.

"We're already concerned that this entire process is not evidence-based," he told *GlobalMarkets*.

Banga highlighted the potential of hybrid capital and credit guarantees to leverage every dollar of government finance six to eight times over 10 years.

His wording is significant, because until this summer, the World Bank used a leverage ratio of six as a rule of thumb in its announcements.

But Vieira said: "One has to ask: given that billions have not been converted into trillions in the past, the assumption of this six or eight-to-one leverage seems quite problematic and unrealistic."

BILLIONS AND TRILLIONS

The issue of a capital increase is partly about sequencing. Governments including the US want the MDBs to reform first, before they ask for more capital.

Banga highlighted the World Bank's plans to "spend better" and be more efficient with its existing resources. Once the World Bank has optimised it will be easier to convince shareholders to — in Banga's words — "bring their ambition to this fight."

Karen Mathiasen, a project director at the Center for Global Development in Washington, said Banga had handled the issue of a general capital increase deftly — he signalled a way forward that should reassure supporters of a capital increase, without antagonising the Bank's biggest shareholder.

The US wants MDBs first to leverage their callable capital and crowd in more private investment. US treasury secretary Janet Yellen used a speech in Marrakech to urge the World Bank to fully implement the recommendations of the G20's Capital Adequacy Framework report of July 2022.

In a meeting on the sidelines of the IMF conference, the G20 presented its new Independent Expert Group, which is focused on the 'Triple Agenda' pushed by the Indian G20 presidency of making MDBs bigger, better and bolder.

"MDBs are an essential piece of this equation to get us to where we need to be," Danny Alexander, vice-president for policy and strategy at the Asian Infrastructure Investment Bank, told *GlobalMarkets*. "MDBs can't do that by themselves, you need support from shareholders. That's both financial support, and in some cases more policy support for changes that need to be made."

The G20 issued a communiqué on Friday encouraging MDBs to collaborate on areas like hybrid capital and guarantees. It said each MDB's board would be "best placed to determine if and when a capital increase is needed" alongside CAF measures.

Yesterday *GlobalMarkets* broke the news that the European Bank for Reconstruction and Development, another member of the group, plans to issue hybrid capital to investors for the first time. It is also seeking a €3bn-€5bn capital increase.

"I think shareholders would like to see some outcome by the end of the year," said Odile Renaud-Basso, EBRD president, on the callable capital discussions. "It's quite difficult to see how the callable capital which doesn't appear in governments' balance sheets, in a way, can have more value for us without having an impact on governments. That's a bit to square the circle."

She added: "It's going to be tricky, I think, but it's good to have that discussion because we need to clarify that point, to avoid saying, 'You should take that more into account', but the rating agencies are not able to do it."

Asked what the breakthrough in the MDB sector might look like, Hoyer said: "Firstly, the removal of artificial barriers to strengthening lending," he said. "Secondly, in some cases, probably better capitalisation of the institutions. And thirdly, extremely important for me, is the production of synergies between the institutions. If we all work in our separate boxes, we will not get the huge impact that we need. … in the readiness for more cooperation, coordination, co-financing … we are making progress."

EIB 'must strengthen' global path so EU looks outward, says Hoyer

By Oliver West and Toby Fildes

The European Investment Bank must continue to develop operations and partnerships outside the European Union, the bank's president Werner Hoyer told *GlobalMarkets* at what will be his last IMF-World Bank annual meetings in the role, as his term ends next year.

In 2022 the EIB launched EIB Global, its arm for investing outside the EU. It did 14% of the group's financing last year — including as a major supporter of Ukraine. Hoyer called EIB Global "a big step forward", but said this path "must be strengthened, expanded and resolutely pursued, which requires a lot of convincing work with our shareholders".

Hoyer said the EIB's mandate to support the EU's strategic objectives should include "more attention to our situation in the world".

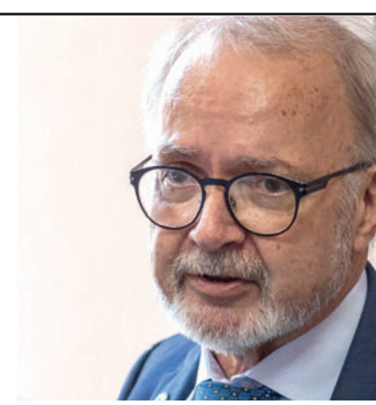
"Many countries in Europe [were] for a very long time inward-looking," he said. They would say "'we are busy enough with our own problems — why should we talk about the neighbour's problems?' That time is over: we are now thinking more European. But as Europeans, again, we are looking inward. We must overcome that as well."

The emergence of new MDBs had made this even more crucial.

"One must not be naïve to the context," said Hoyer. "Map the locations of critical raw materials in the world, and the processing of these raw materials, and then put the BRICS map to it, and you get nervous. This is why the Europeans must develop partnerships with countries around the world. That requires a little bit more further thinking on development than just saying 'we have to extract your lithium' — or whatever it is."

Events in other areas had shown the importance of the EIB's presence outside its home market, he said. The bank on Wednesday announced €1bn of support for Morocco's post-earthquake reconstruction. And the EIB is the only multilateral development bank that has projects in all of Israel, the West Bank and Gaza.

"It's a little bit amazing to me, to be quite honest, that you're together here with the top guns of the multilateral financial institutions and the issue does not play a big role," said Hoyer. "I mentioned it everywhere, because I think it would be a little bit artificial if we would sit here and do business as usual, without saying that the world is on fire."



Hoyer: EIB Global 'must be strengthened'

Quota reform is a zero sum game that could leave no one happy

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which also involves a more balanced approach in terms of representation at the IMF."

Without greater representation, there is a significant risk that countries like China, Brazil and India could distance themselves from the Fund.

Consensus in emerging markets is that the quota system used to determine voting power in key Fund decisions no longer reflects the economic and demographic weight of its constituent members and must be amended.

However, this is a zero sum game. Emerging countries can only gain influence if rich countries lose it, and they are clearly reluctant.

Kristalina Georgieva, managing director of the International Monetary Fund, said: "We must continue to work towards adapting our governance structure to better represent our membership and the dynamic changes in the global economy."

She suggested giving Africa a third seat on the executive board, raising it to 25 members, as the US Treasury suggested in September, could be "a welcome step in the right direction".

The Treasury also offered creating a fifth deputy managing director and an "equiproportional" increase in IMF quotas, meaning enlarging contributions but keeping shares the same.

"In the absence of a new formula, an equiproportional increase is the only viable outcome that avoids arbitrarily picking winners and losers," said US treasury secretary Janet Yellen this week. She said the Treasury was "exploring ways to give more voice to developing countries through changes in the management and board structure of the Fund".

However, IMF watchers said these ideas failed to address EMs' concern, because they would not increase their voting power.

It could be difficult for them to resist, however. "Because emerging markets do not have a common champion to coalesce around, they will not be able to have leverage, to be able to offer a credible alternative plan that achieves both greater representation for emerging markets as well as increased quotas," said Reza Baqir, managing director at Alvarez & Marsal and former governor of the State Bank of Pakistan.

China's economic heft means it would be likely to gain most, as it did at the last revision, which took effect in 2016.

Baqir said: "The fact that one big emerging market would benefit a lot more from any revision to their shares undermines the incentive of other emerging markets to rally behind a common cause."

A BIGGER SLICE OF THE PIE

"The challenge facing the IMF today is to make sure that it is fit for purpose and relevant for the 21st century," Mohieldin told *GlobalMarkets*.

Since the last quota realignment was agreed in 2010, China has become ever more important, while India's population is now the largest in the world.

While the IMF has evolved, it has not done so with "the pace and ambition" to match these changes, Mohieldin said, especially for countries that "depend on these institutions more than others".

He said the US Treasury's proposals were "a step in the right direction," but not a particularly strong one, and had left much of the membership frustrated.

"However, it's a process that we hope we can learn from. In the next review we hope to see adequate realignment and full realisation of the dynamics of today's world, not yesterday's world," he said. "We need some sort of flexibility on both sides. Institutions that are based on pragmatism, not politics, would be very much appreciated."

Chikumbutso Ngosi, programme manager for young urban women at ActionAid International, from Malawi, went as far as to call the existing system a "new form of colonisation". She said Africa was severely underrepresented. It has 6.2% of the votes.

"Most of the decisions are not in favour of African countries," she said. "We talk about the loan conditions, the money that we are borrowing — even in the context of a crisis — we are either borrowing at a higher interest rate or an amount less than adequate to meet our needs, that comes with a large amount of austerity measures."

Italy, Portugal central bank chiefs warn against new tightening tools

By Dominic O'Neill

As speculation mounts that the European Central Bank may unleash new weapons to fight inflation, Italy's and Portugal's central bank governors have told *GlobalMarkets* they do not support this, arguing against using tools other than the interest rate.

Analysts believe the ECB is not satisfied that its interest rate rises have contained inflation and is considering going further. One possibility would be to raise the minimum reserve requirement on banks from 1% of their deposits and short term funding to 3%, 4% or even more.

Another would be to start selling some of the €5tr of bonds it amassed during quantitative easing. These moves would push up yield curves and drain liquidity from banks.

In one of his last interviews as Bank of Italy governor before he hands over to Fabio Panetta, Ignazio Visco argued this would be futile or even counter-productive.

"I think we are very well placed in using our now conventional monetary policy," he said. "Some are questioning the balance sheets of central banks. Others may think that if you raise the percentages on reserve requirements or reduce the rates on them, you can achieve something. That's not my experience."

He added: "If we start selling [bonds] very much, the slope of the yield curve may increase to a level where we don't want it to be, with effects on the economy."

Another potential unintended consequence of quantitative tightening is government bonds flowing back to banks in their own countries, a pattern held to have exacerbated the eurozone sovereign debt crisis.

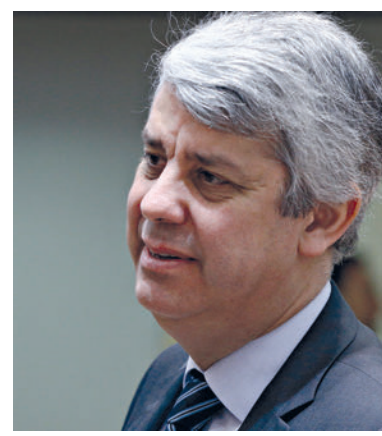
Asked about the risk of a renascent sovereign-bank doom loop, Visco said smaller Italian banks were naturally inclined to switch from SME lending to buying more government bonds if the economy was in trouble. "So far, this has not created a problem," he said. "It might create a lot of problems if you intervened in a sharp way and, therefore, I would suggest a gradual approach."

In a separate interview, Bank of Portugal governor Mário Centeno said: "We are very happy with the transmission mechanism [of interest rates], and we don't need to increase the passthrough of monetary policy. I don't see a reason to discuss the minimum reserve requirement right now."

Both governors warned against the danger of pushing too hard against inflation, including through interest rates.

"My impression is that where we are is where we should stay," said Visco. "Let's observe the effects that monetary policy is having on the real economy: credit has been falling in the last few months. Money supply dynamics is substantially negative. Interest rates are up. Loan rates are up. Demand for credit is falling, which has a counterpart in the real economy. There is no wage-price spiral. My impression is that much of the effects of monetary policy are still in the making."

"Doing too much on the monetary policy front now will threaten all the success we have had, especially in the labour market," said Centeno. "We need



Centeno: 'we need to preserve labour market conditions'

to work to preserve the labour market conditions that we have today, which are a pillar of the success of the European economy. We should not threaten that situation, by no means."

Centeno said it was natural for monetary policy's effects to lag rate rises because fixed rate borrowing was prevalent in parts of the euro area.

Visco agreed: "Monetary policy operates with lags which are variable and long," he said. "If there are no further shocks, expectations are anchored. We will reach 2% inflation in the medium term, by the second half of 2025. The risk is doing too much."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US sharpens regulatory knife for Chinese EV suppliers

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with Chinese manufacturers.

The electric vehicle battery industry, which must expand enormously to decarbonise transport, is a prominent example. In the face of increasing hostility from the US and Europe, Chinese battery makers are looking for new production sites and corporate structures.

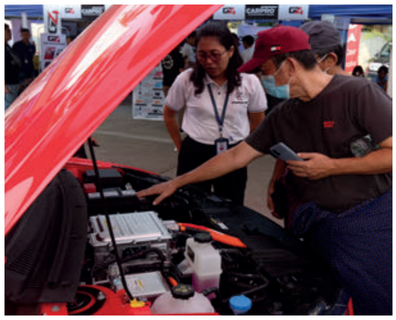
The European Commission launched an anti-subsidy investigation into Chinese EV batteries this month.

Yet just weeks ago, China's CNGR Advanced Material announced a $2bn cathode materials plant project in Morocco to supply the EU and US, which it will build in collaboration with Al Mada, a conglomerate owned by the Moroccan royal family.

Mehdi Tazi, vice-president of the Confederation of Moroccan Businesses, thinks other Chinese manufacturers will follow suit.

"We are 14km from Spain, we have green energy, we have the infrastructure — ports, highways, airports — and around 60 free trade agreements," Tazi said. Among those free trade partners is the US.

Joint ventures like this are occurring in many countries. From nickel in Indonesia to lithium in Zimbabwe, Chinese JVs are omnipresent in supply chains.



EV battery supply chains are being wrenched by geopolitics

But such partnerships are now in the spotlight. The US Inflation Reduction Act offers lucrative tax treatment for EVs if a large percentage of the materials and components are sourced from, or processed in, free trade partner countries.

But in the coming year, that treatment will be removed if any of the materials or components involve a Foreign Entity of Concern (FEOC). China is explicitly listed as a FEOC.

What developing country firms are waiting to see is whether their JVs with Chinese partners are treated as FEOCs.

The US government is preparing to publish regulation on this point. But analysts see worrying signs.

Ford Motors had planned to build a $3.5bn EV battery factory in Michigan, licensing tech from China's Contemporary Amperex Technology (CATL). Just weeks ago, Ford announced it was halting work, saying there were multiple considerations and it wanted to be confident the plant could be competitive.

Ford did not say so, but this may have been linked to an investigation into the partnership, begun by a US House of Representatives committee in July.

"The Ford-CATL deal has been under a microscope from both the US and Chinese governments and the postponement of the plant construction I think is really due more to political pressure than anything else," said Chris Berry, president of House Mountain Partners, an advisory firm specialising in battery metals.

Sources say it is interesting to see Chinese firms setting up partnerships in US free trade partners like South Korea and Morocco to access IRA subsidies, when the US is preparing to wield a regulatory knife that could cut out Chinese JVs, regardless of the country.

"We're heading into an election year in the US and the only thing Republicans and Democrats can agree on is that China is the enemy," Berry said.

South Asia's debt-stressed frontier markets face more pain

By Elliot Wilson

South Asia is caught in a vicious circle, since governments failed to store up enough financial liquidity when markets were benign and interest rates low, leading bankers and analysts have told *GlobalMarkets*.

Pakistan, Sri Lanka and the Maldives are all suffering from a similar cocktail of problems.

Reza Baqir, a former governor of Pakistan's central bank, now global practice leader of Alvarez & Marsal's sovereign advisory services in Dubai, described the outlook for the region as "one of the worst times that I have ever seen".

"Troubled South Asian states have low levels of foreign reserves relative to the needs of the country [and] high current account deficits," he said. They also have high debt-to-GDP ratios, he said, making them vulnerable to high interest rates and oil prices.

On Thursday Sri Lanka, rated 'selective default' by S&P, said it had reached an agreement with the Export-Import Bank of China covering $4.2bn of debt. Earlier this week Fitch Ratings affirmed the Maldives' long term rating at B- with a negative outlook. In July Pakistan, rated CCC, secured its latest $3bn bailout from the International Monetary Fund.

"I spend a lot of time looking at the region," said Avanti Save, Asia head of credit strategy at Barclays Capital in Singapore. "I'd say the smaller countries in South Asia are facing their most serious debt challenge for at least 20 years."

Save: 'most serious debt challenge for at least 20 years'

LIVING WITHOUT BUFFERS

Taimur Baig, chief economist at Singapore's DBS Bank, said South Asian countries were "living beyond their means" before they were hit by an oil price shock. "They did not boost buffers, so when the tide turned — and when shocks come fast and hard, everyone needs more reserves — the capital markets shut down."

Baqir said he wanted Pakistan to "stand on its own two feet, and to do so without repeatedly having to go to the IMF for help".

"This requires better governance and better institutional frameworks for decision-making that take more of a whole country approach," he said.

But experts do not expect gloom to become doom. Baig said bankers and policymakers at the World Bank/IMF annual meetings in Marrakech were committed to helping South Asia's fragile frontier states back on their feet.

"The region has friends," he said. "I don't think a disorderly debt default outcome is on the cards. The vibe I'm getting here is that a lot of work is being done to aid debt restructuring. These countries are not alone. They have the attention of multilateral development banks — but solving these issues will require a lot of domestic pain."

Sustainable finance rules need harmony to help transition

By Marianne Gros

Sustainable finance rules in emerging markets need to be standardised, to help increase private sector financing of development projects, experts have told GlobalMarkets.

As well as risk-sharing mechanisms like public-private partnerships, creating clear and consistent regulatory frameworks could help attract investors eager to fund sustainable assets.

In a panel at the annual meetings in Marrakech, James Mwangi, CEO of Equity Group Holdings, said one of the biggest challenges for emerging markets was how to get their projects started.

"People feel we need a coherent ecosystem for financing," he said.

Ensuring that financial regulatory frameworks were evolving and integrating new market principles of sustainable, green and transition finance was essential, he said.

"Regulating matters when it comes to attracting private capital into projects in emerging countries," said Nezha Hayat, chairperson of Morocco's Capital Market Authority. "As developing countries, we are bank-based economies, so regulators that have the main mission to protect investors can ensure good functioning of markets."

Helping countries develop their financial regulations has long been a priority for multilateral development banks. "My message to MDBs here today is: do both — invest and promote capital markets," Hayat said.

'ACTION IS LACKING'

Regulators want sustainable finance frameworks to reduce confusion in the market, over how potentially sustainable assets are labelled and categorised, especially in sectors like energy.

"The polarisation between brown and green investments is slowing down progress, it's missing the transition point," said Emmanuel Givanakis, CEO of Abu Dhabi Global Markets. "As a regulator our job is to establish a framework so that the finance industry can bring about sustainable finance solutions in green and transition finance products in an open, fair and transparent way, in order to inform through clear disclosure and protect investors."

Ahead of the COP28 climate summit, the United Arab Emirates has accelerated its work on fostering a strong sustainable finance ecosystem, he said.

"Action is important. We've created a lot of awareness in the last decade, but action is lacking. We moved quickly to issue our regulatory framework because we felt that time was of the essence, and we shouldn't wait for the rest of the world to be proactive," said Givanakis.

The UAE has been investing heavily in green assets across developing African markets to cement its position as a regional and global frontrunner in this space.

Morocco powers ahead in green energy race

By Marianne Gros and Steve Gilmore

Political and economic disruption in North Africa means that Morocco is increasingly seen as the golden child for renewables investment, as investors recognise the region's potential as an energy export powerhouse on Europe's doorstep, according to bankers and analysts.

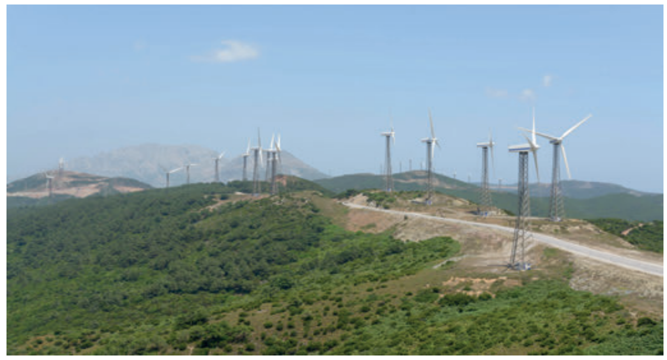
The North Africa region is a solar factory waiting to be turned on. Equipping just 1% of the Saharan desert area with concentrated solar power plants would — in theory — meet the energy demands of Europe, the Middle East and Africa, Amin Mohseni-Cheraghlou, a macroeconomist at the Atlantic Council's GeoEconomics Center, told *GlobalMarkets*.

Solar will also be the foundation of a transformational green hydrogen industry. But where this solar power is based matters, and as an investment destination Morocco is increasingly stealing the limelight.

"Morocco is one of the markets that has the greatest potential in the world to produce green hydrogen at a [low] 'levelised' cost," says Antoine Salle de Chou, head of operations in Morocco for the European Bank for Reconstruction and Development, noting that this was due in part to the country's incredible endowment of solar irradiance and wind potential.

REPOWERING WIND

Morocco's solar is already world class. The EBRD is financing wind assets to make that energy source more competitive, including the repowering of the Koudia Al Baida wind farm in the north of the country with a senior loan of up to €44m.



Koudia Al Baida wind farm, Morocco

The green hydrogen market has such huge growth potential that there is room for multiple producers. "[But] there is a high need for fixed investments so it will be about where the setup is best and where the regulation is more accommodating," says Heike Harmgart, managing director for the Southern and Eastern Mediterranean region at the EBRD.

Morocco is finalising the 'Morocco offer,' a framework specifically designed for investors seeking to develop hydrogen projects. The country's new Investment Charter offers firms a subsidy of up to 30% of the equity investment. Understandably, investors' focus has shifted away from Libya, Algeria, and Tunisia. Even Egypt — a first mover in green hydrogen — is losing some of its lustre amid a serious bout of economic and political volatility.

Egypt was once a leader in the region, having signed eight framework agreements to develop green hydrogen and ammonia projects following COP27. But Lerato Monaisa, senior analyst at BMI, said very few of these agreements had been translated into projects. There are only two green hydrogen projects under construction, with a combined capacity of 2.1GW, according to BMI.

Morocco has a 10GW green hydrogen project valued at over $10bn, which BMI expects to begin construction in 2025. "Morocco is basically becoming the safe country in North Africa for all these massive investments to go into," said Mohseni-Cheraghlou. "German and Dutch companies are coming in strong on green hydrogen."

SOCIAL DIMENSION

Critics are less enthusiastic about the green hydrogen potential from broader development concerns in the region. "While all the attention is on the green potential of it, we forget the fundamental governance and social dimensions to these projects on how they will be managed and how they will serve the local population," said Rabah Arezki, Director of Research at the French National Center for Scientific Research.

There has been little diversification in terms of how energy sector projects are run in the region, he said: "For these projects to yield any social impacts, I would urge these MDBs to give us much more information about the jobs involved, how transparently the revenues will be distributed, how this time will be any different."

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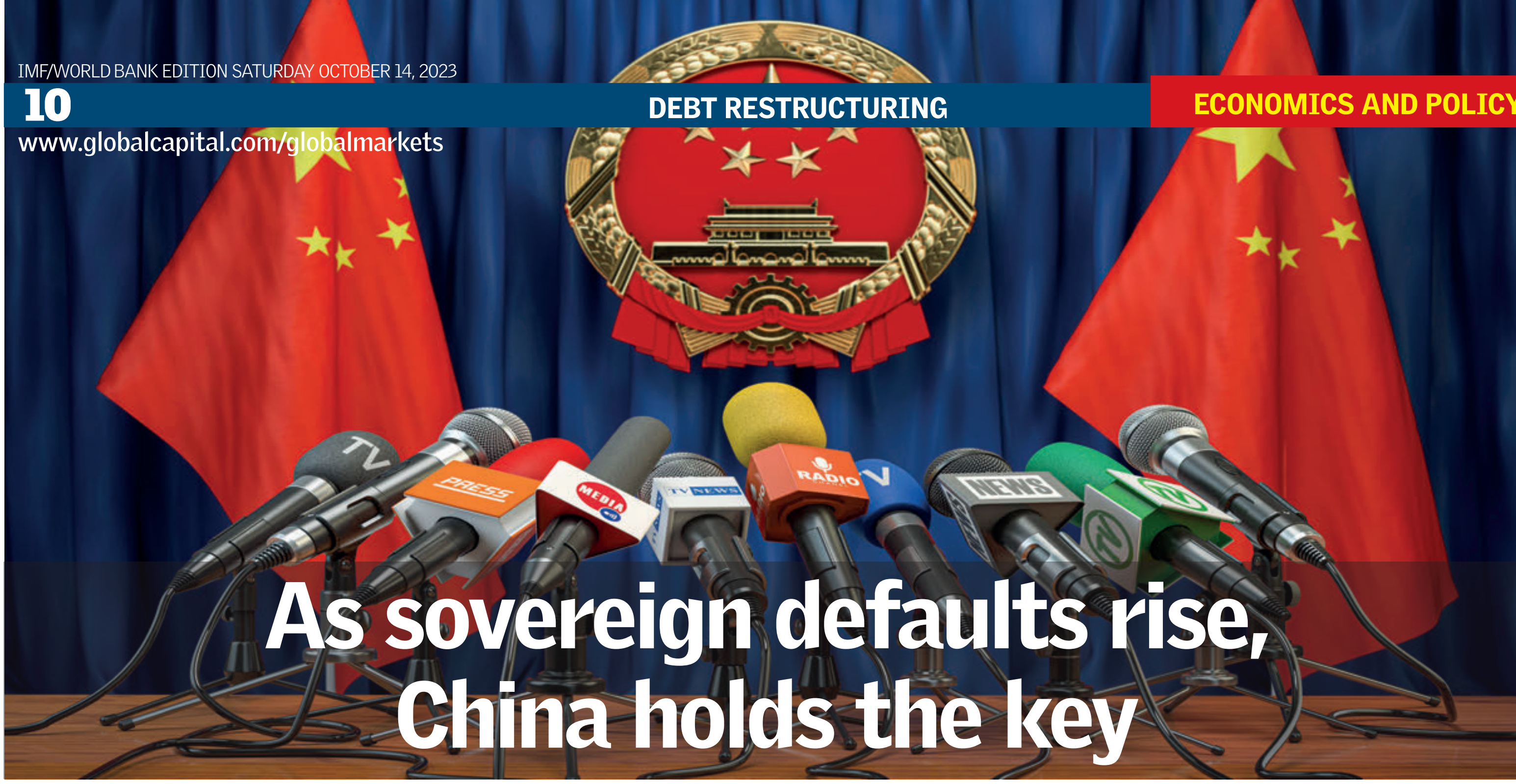

As sovereign defaults rise, China holds the key

The huge growth in China's lending to developing country governments, especially those with debt problems, makes it an indispensable player when they can no longer pay their debts. Reconciling the interests and wishes of Western and Asian creditors will need compromise and patience — but is the only way to achieve debt relief

> *"The growth in Chinese official lending is unprecedented — and it happened fairly quickly — and the scale is enormous"*
>
> *—Hamza Ali Malik, United Nations ESCAP*

By Rashmi Kumar

Developing countries around the world are in trouble. As economies grapple with uncertainties exacerbated by the Covid pandemic, more than 70 low income nations are struggling to bear a collective burden of $326bn of debt, according to the International Monetary Fund.

Many face rising costs to service their external debt in the next two to five years. Alarmingly, over half of them are teetering on the brink of debt distress.

The fate of these nations hinges on the delicate balance between debt restructuring, financial assistance offered by multilateral and bilateral lenders — and the role of China, a global economic leader which has emerged as a pivotal lender to numerous Asian, African and other emerging market countries.

Of the 137 countries rated by S&P Global Ratings, says Roberto Sifon-Arevalo, its global head of sovereign ratings, more now have negative credit outlooks, especially emerging and frontier markets. Seven are in default, an "unusually high number compared to before".

A lot of these countries have benefitted over the past decade from low interest rates, which allowed them to raise debt at levels that appealed to both the governments and investors on the hunt for returns.

"Fast forward to 2019, and cracks started showing around the fiscal positions of countries," says Sifon-Arevalo, who is based in New York. "The Covid-19 pandemic just exacerbated all the weaknesses across countries."

The disease emergency triggered a slew of support measures from multilateral development banks and developed countries. The G20 agreed a Debt Service Suspension Initiative that allowed the poorest countries to stop servicing debt to public sector lenders during the worst of the health crisis.

But the DSSI expired at the end of 2021. Despite the G20's invitation to the private sector to join in, "regrettably, only one private creditor participated", said the World Bank.

Then came another critical development — the Common Framework, a mechanism through which struggling countries could restructure their debt.

This, too, is an initiative of the G20, but it marks a significant change from previous restructuring agreements as it brings to the table not just the developed creditor countries that are members of the Paris Club, but also major bilateral creditors like India and China, both of which have steadily been increasing financial support to troubled countries across Asia and Africa.

The idea was that a country overburdened by debt needed to be able to restructure all its official loans in one process, fair to all the creditors.

But the results of the Common Framework so far leave much to be desired.

COMPLICATED EVOLUTION

A breakthrough came in June when Zambia finally reached a preliminary agreement to restructure roughly $6.3bn of its bilateral debt, having first sought relief under the Common Framework after defaulting in early 2021.

The deal — still waiting for official sign-off — is the first agreement under the Framework, and includes China as a party.

That is certainly a landmark, but getting there was not easy. As the first to use the Framework, Zambia may have had a tougher time — the negotiations took two and a half years.

"The assumption when starting this [the Common Framework] was that it would be easier to bring everyone, or at least the bilateral creditors, on one table," says Jan Friederich, head of EMEA sovereigns at Fitch Ratings in Hong Kong. "But it initially hasn't played out so well, partly because the Framework was a departure, and it needed a fair bit of sorting things out and clarifying questions like who qualifies as a bilateral lender among the major Chinese

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lending institutions, and who qualifies as commercial."

China undertakes a lot of its international lending through two policy banks — the Export-Import Bank of China (Chexim) and the Agricultural Development Bank of China — and five big state-owned commercial banks. Many projects financed by the state-owned banks are insured by Sinosure, the state export credit agency.

Typically, Paris Club agreements include claims insured by ECAs, and they are restructured alongside other government claims. That was the initial plan with Zambia's Sinosure-backed loans. But in the end, the restructuring only covers loans provided by Chexim. Claims of the state-owned commercial banks and debt backed by Sinosure were handled in a separate commercial restructuring.

Chexim agreed to cut the interest on its claims to 1% for the remaining life of Zambia's IMF relief programme. But if Zambia's recovery exceeds expectations, the interest jumps to 4% and the pace of amortisation will pick up.

There are different schools of thought on what this agreement means for China, developed market creditors and other nations facing a debt restructuring.

"The Chinese offer the Zambia example as a model of what can be done, but it's still quite burdensome for Zambia," said Alicia Garcia Herrero, chief Asia Pacific economist at Natixis CIB in Hong Kong. "One reason is because the legal framework in China is such that it's very, very difficult for banks to accept a haircut, because they have to put their capital to account for it and it's very costly. So they avoid that and instead extend duration and lower the interest rate."

Others say the agreement is still a good sign and shows the innovation that may be possible on future government debt restructurings, by combining traditional traits from Paris Club agreements with twists that cater to Chinese lenders and sovereign bondholders.

DISTRESS RISES

That kind of compromise by all creditors will be important, considering how far China's reach has grown.

A study this year by researchers at AidData, the World Bank, the Harvard Kennedy School and the Kiel Institute for the World Economy revealed that by the end of 2021, China had undertaken 128 rescue loan operations in 22 debtor countries, worth a whopping $240bn.

In 2010, less than 5% of China's overseas lending went to countries in distress, but this had soared to 60% by 2022, the research showed. That was driven in large part by lending to the nearly 150 countries involved in China's ambitious Belt and Road Initiative to fuel infrastructure development.

"It goes without saying that the role of China as a trading partner, as an investor, a lender and a creditor has certainly increased over time in Asia and the Pacific," says Hamza Ali Malik, a director in the macroeconomic policy and financing for development division at the United Nations' Economic and Social Commission for Asia and the Pacific, in Bangkok. "The growth in Chinese official lending is unprecedented — and it happened fairly quickly — and the scale is enormous. But for many countries adopting that influx of money, it creates problems."

Kim Eng Tan, S&P Global's Asia Pacific sovereigns head in Singapore, points out that the countries that received early Belt and Road funding are now "experiencing quite a bit of debt distress". Restructuring attempts are complicated by tensions between China and the US.

For example, Sri Lanka — which has in the past relied on China, India and the IMF for financing support — defaulted on its international and domestic debt in 2022.

The government wrapped up a revamp of some of its local currency debt in September, but a restructuring of its dollar debt, including bonds and bilateral loans, is still in the works.

China is also a big lender to Pakistan, long a supporter of the Belt and Road. In recent months Beijing rolled over nearly $8bn of debt to prevent a default by Pakistan.

China's importance as a lender of last resort means countries and MDBs will need to think differently about how best to tackle sovereign debt restructuring in the future.

Herrero at Natixis argues that with China just an observer to the Paris Club, it is very hard to coordinate restructurings with different creditors. She says: "I'm hoping that the Paris Club gets reformed, and China becomes a full member, because it's such a large creditor." GM

"The Chinese offer the Zambia example as a model of what can be done, but it's still quite burdensome for Zambia"

—Alicia Garcia Herrero, chief Asia Pacific economist at Natixis

Debt sustainability in Asia may need longer term thinking

Home to 4.3bn people — three out of every five on Earth — Asia and the Pacific countries are facing an unprecedented challenge.

High inflation, fiscal stress, rising public debt and slowing economic growth have put pressure on governments. Market watchers are hunting for solutions on how best to help nations achieve the Sustainable Development Goals when faced with such obstacles.

The problem with assistance from the International Monetary Fund or multilateral development banks is that the loans often come with onerous policy requirements, like raising taxes, cutting spending and abolishing subsidies.

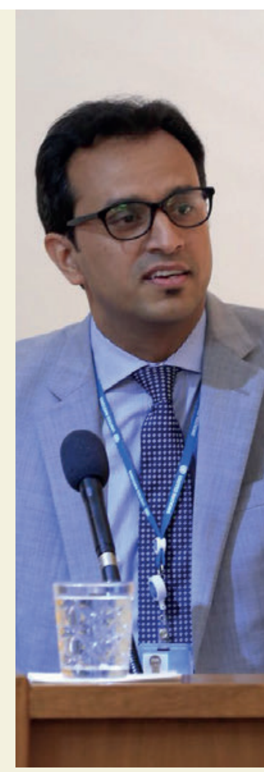
These measures often have unpalatable economic costs in the short term, impacting people's lives, leading to spikes in poverty and periods of austerity.

Hamza Ali Malik, director at the UN Economic and Social Commission for Asia and the Pacific, argues that countries should instead think long term, with the IMF's help, and invest in three broad areas: social development, green development and digital transformation.

"We call this the Build Forward Better policy package," says Malik, who previously worked in the State Bank of Pakistan's monetary policy team. "We assess this over the long run, modelling for 2040, and we see that countries can actually benefit on all fronts: economically, socially and on the environmental front."

Making these investments will cause the debt levels of already beleaguered countries to spike.

But Malik says: "The traditional approach would be to raise alarm bells and red flags and countries being asked to contain their fiscal spending. But we are saying: don't do that. Wait and see the impact of how those investments mature over time." —RK



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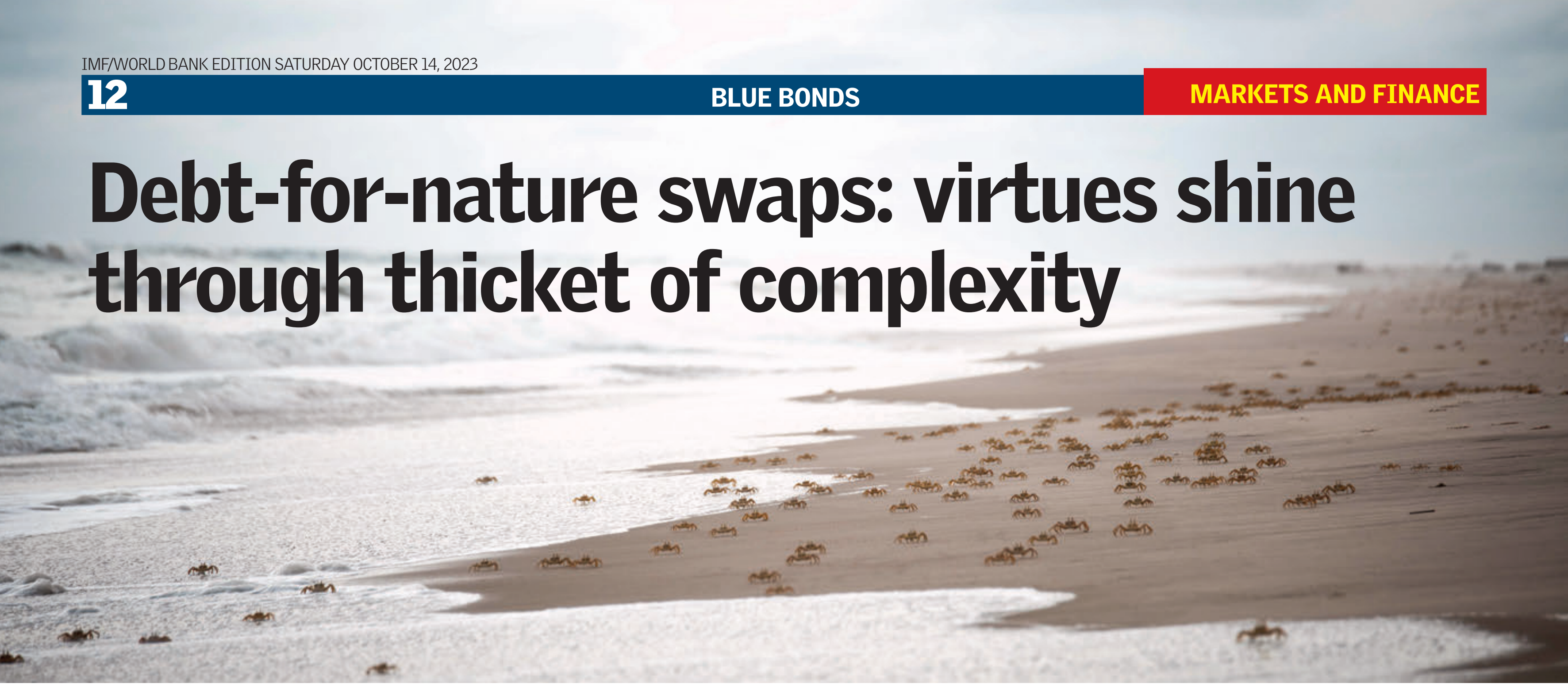
Build Forward Better
Hamza Ali Malik calls for Asia Pacific countries to invest in social, green and digital development

Debt-for-nature swaps: virtues shine through thicket of complexity



Critics are poking holes in debt-for-nature swaps, and they may need improving, but the technique has power

By Oliver West

> "Stakeholders are asking questions. Is this product really what it was intended to be?"
> —Nathalie Marshik, managing director, Latin America fixed income at BNP Paribas

Debt-for-nature swaps are a hot topic at this week's World Bank and IMF annual meetings, as they offer a compelling prospect: a new way for countries to finance conservation projects without having to incur debt. But not everyone is convinced.

The International Monetary Fund is suggesting swaps with key performance indicators linked to a country's National Determined Contribution. The Commonwealth is designing guidelines for debt-for-nature swaps for small nations. Fiji and others have hinted that they are looking into them. Sri Lanka and the Bahamas have previously expressed interest.

So far there have been four deals in two years, along essentially the same principles. Belize in 2021, Barbados in 2022 and Ecuador and Gabon this year have all raised new funding — so far dubbed 'blue bonds' because they relate to marine environments — at far lower interest rates than they could otherwise achieve, thanks to credit enhancement from a higher-rated entity. This entity is motivated by a wish to promote conservation.

The governments use proceeds to buy back some of their older international bonds at a discount. The savings generated from that discount and the low interest cost of the new bonds are channelled to marine conservation projects. There is optimism that more transactions are to come.

"Over $800m of conservation funding through four transactions in two years is no mean feat, and we are enthusiastic about the prospects for more debt-for-nature swaps or — as we prefer to call them — debt conversions," says Slav Gatchev, managing director for sustainable debt at The Nature Conservancy, which has been the sponsor of all the deals so far except Ecuador, where the Pew Charitable Trusts led.

There would appear to be little not to love. Gatchev argues that combining "conservation, climate funding and implementation assistance" with a debt deal makes "truly sustainable capital markets issues".

And the opportunity is huge. TNC estimates that at least a third of the roughly $2.2tr of commercial debt to the developing world is in some form of distress. Many of those countries are in the tropics, with high biodiversity and real climate challenges. The organisation wants to do more, and sees high interest.

LINGERING DOUBTS

Yet sceptics abound. Criticisms range from the peripheral — like how these deals are labelled — to more prickly topics such as the fees counterparties make for arranging the deals.

Some are suspicious because they struggle to grasp how the savings are made and how exactly the funding is channelled.

"Initially there was a lot of excitement," says Nathalie Marshik, managing director, Latin America fixed income at BNP Paribas. "However, stakeholders are asking questions. Is this product really what it was intended to be? How much really goes towards nature conservation, when the biggest component of a deal is a debt buyback?"

Several bankers who have worked on the deals insist that these deals are being criticised for failing to live up to claims they never made. For example, is it right to allege that the use of the term "blue bond" is wrong, when no marketing materials have ever claimed that they are traditional use of proceeds style ESG-labelled debt like green bonds?

TNC is moving to describe its strategy as "nature bonds", rather than blue bonds, as future deals are likely to encompass terrestrial conservation, freshwater and climate. Gatchev hopes this will "eliminate any concerns over the labelling".

Other lines of questioning give more room for pause. One sovereign debt adviser says he has seen government officials enthused by promising proposals from inexperienced NGOs to carry out debt-for-nature swaps, only for a quick revision of the numbers to show that the economics did not make sense.

Even Gabon's transaction, issued in August to arguably even more scrutiny than others, as the new financing was — unlike the first three deals — syndicated in traditional bond market fashion, left some observers wondering about the extent of the savings.

Where Belize and Ecuador had repurchased their debt at such deep discounts that the financial benefits were obvious even at a superficial glance, Gabon bought back bonds at between 85 and 96.75 cents on the dollar.

"Some criticised Gabon for the lack of nominal savings, but that comes from misunderstanding a complex product," says Gatchev. "The deal produced roughly 7% money for a sovereign that had bond yields of 12%, plus $125m of conservation funding that will stay within the country. It's not just

Sandowners
Crabs move along the shoreline at sunset in Gabon

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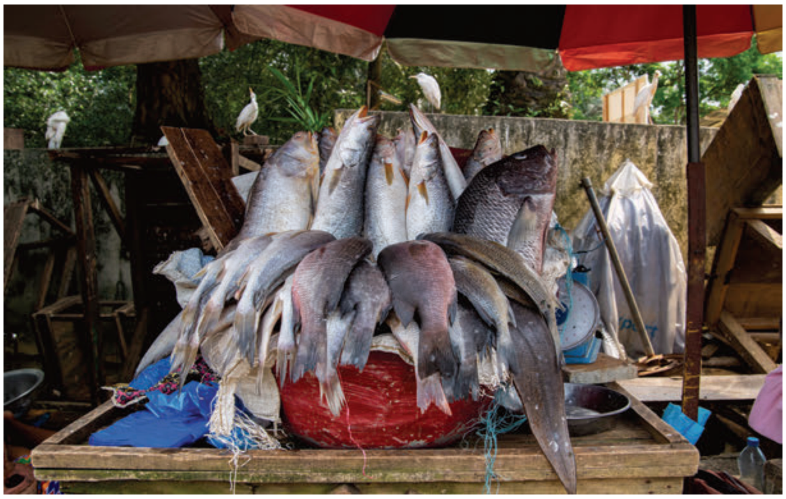

Respect the product
Marine artisanal fishing landing site of Amboue in Libreville

© Roshni Lodhia

> *"This product is not as easy as some people perhaps expected, and all banks looking at getting into this space need to give the product the respect it deserves"*
>
> *—Jake Harper, investment manager at LGIM Real Assets*

about the discount on the tender offer."

Those close to the deal say there is little point comparing one country with another. And though bankers see plenty of potential in countries with debt distress on the scale of Ecuador or Belize, enthusiasts hope the product will gain traction beyond distressed exchanges.

"To some extent Gabon was a refinancing and I think there will be more like that," said a banker who has worked on previous deals. "In those cases, I see it as being about the opportunity cost dynamics. It's not just a financial decision, it's a public policy analysis and working out how you want to maximise the benefit of the credit enhancement."

Broader acknowledgment that these conversions do not only apply when a country is in debt crisis might help the product gain a wider audience.

When Colombia's President Gustavo Petro spoke in July of a debt "swap" to fund climate change mitigation and adaptation, finance minister Ricardo Bonilla felt he had to speak out quickly to insist Colombia was not planning a debt swap, because that is what countries like Ecuador, which don't have market access, do.

RESPECT THE PRODUCT

None of these concerns, however, show that the essential concept does not work. If there is some confusion, this may be an inevitable result of the complexity of the structure and how recently it has appeared.

Greater definition, education, and transparency about debt-for-nature swaps may be needed.

So far, and for the foreseeable future, each deal is unique, and none is easy to put together. Deals must align with the objectives of multiple parties. There needs to be a committed and credible government with suitable conservation projects and an experienced, sophisticated sponsor, and the maths must work for a particular borrower's debt stack and policy.

"Today we are seeing that this product is not as easy as some people perhaps expected, and all banks looking at getting into this space need to give the product the respect it deserves," says Jake Harper, investment manager at LGIM Real Assets, which bought $250m of Ecuador's $656m blue bond. "We like these deals, but they do require a lot of work. For us, it's key to be involved early on in the process, to enable us to be familiar with the ESG story, the sovereign itself and the structure."

Some of those closest to the evolution of this market are anxious that its build-out should not be too cavalier. The deals done so far have been notable for strict environmental KPIs with consequences for failure that go way beyond anything in the larger sustainability-linked bond market.

"The incentives for the borrowers to behave correctly are well thought-out," says Harper. "There are occasions where not meeting targets could trigger a default, and sometimes the financial penalties target the budget of the relevant ministry, which should be more effective [than just a slightly increased interest rate for the issuer]."

Harper hopes that TNC's Belize Blue Bonds progress report, published in March, "sets the standard" for other transactions, as it was prepared by the people on the ground managing the projects, and clearly details how funds are traced.

"We must avoid a dilution in the strength of the commitments and the consequences of breaches, in the interest of getting deals over the line more quickly," said a banker.

MORE PARTIES INVOLVED, MORE DEALS

Yet excessive caution can also be dangerous: there is an urgent need for more financing. TNC estimates that global biodiversity requires around $700bn of funding a year.

It thinks it could manage two or three deals a year. It is aiming for $10bn of new debt issues by 2030, and for at least 25% of this to be channelled to conservation. Though this is "not a small number", says Gatchev, it's "not going to solve all the world's problems".

"It will certainly help directly and by example," he said. "We need others to be doing the same, as we saw in the Galapagos with Pew. The biggest challenge is to make sure more investors and multilaterals get involved."

Undoubtedly, expanding the list of NGOs that sponsor projects and entities that provide credit enhancement would increase the pace of issuance.

So far, the US International Development Finance Corp has provided an insurance policy to deals in Belize, Ecuador and Gabon, while the Inter-American Development Bank complemented Ecuador's credit enhancement with a smaller guarantee. The IADB also guaranteed $100m of the $150m Barbados blue bond, with TNC itself guaranteeing the rest.

More counterparties are understood to be getting on board with the idea.

"Getting an institution like the IMF or the World Bank involved would make sense, so everyone's on the same page," says Marshik at BNP Paribas. "I think a proper framework, one that addresses some of the issues, would benefit everybody too."

Growth in the market will require growth in the options for credit enhancement.

"DFC and IADB have leant into this, above and beyond their traditional mandates, and have appetite to do more," says Gatchev. "Their pioneering efforts are spurring the other multilaterals to take this seriously, and we've had productive conversations with institutions like the African Development Bank, Asian Development Bank, World Bank and EIB."

The presence of multilateral lenders would be particularly welcome, as the IADB guarantee used by Barbados is understood to have carried lower transaction costs than the DFC-led insurance models.

The IADB's $85m guarantee on Ecuador's blue bond, though paling in size compared with the DFC's $656m of political risk insurance, acted like a liquidity reserve for the deal — and was vital for its success.

Ecuador's debt-for-nature swap was estimated to have generated financial savings of over $1.125bn and savings for conservation funding of $323m — by far the largest of any of the deals.

"When it comes to keeping costs low, sovereigns get the most bang for their buck when they don't have to prefund reserves, with reserves covered by other means or external parties," says Harper. "As these structures become more common, hopefully fees for these transactions fall and the overall economics continue to improve for the sovereign."

Practitioners and observers continue to learn lessons from the deals that have happened. There is no short term prospect of an International Capital Market Association framework, nor a consensus on whether one would be helpful.

Debt-for-nature swaps are clearly not a silver bullet, for either conservation funding or a country's debt woes — nor do they claim to be.

But when they are done well, they have an edge over the vast majority of conventional ESG-themed bond financings: they offer a genuine solution to funding something that otherwise would not be financed.

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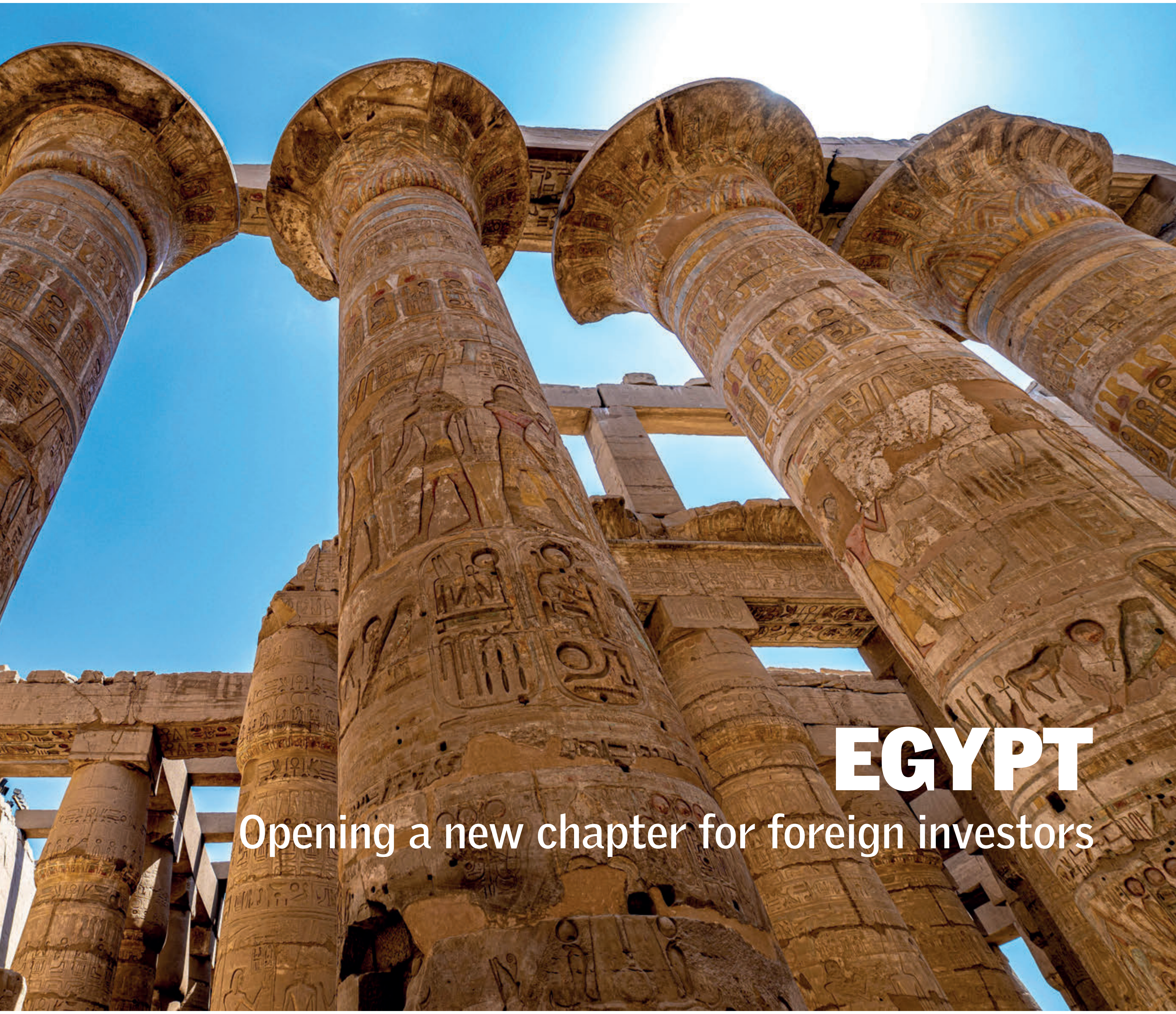

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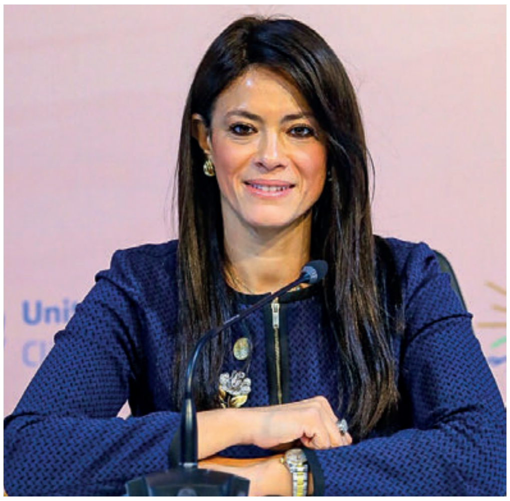


Has hosting COP27 helped create momentum for Egypt's own environmental and energy goals?

The government has recognised the grave danger of climate change and the necessity of orchestrating a cohesive international response to combat it. The monumental steps it has made since taking over the presidency of the COP show how much of a game-changer it was for Egypt's green potential. COP27 allowed for the concentration of national efforts in delivering a holistic programmatic approach to tackle the environmental, social and economic impacts of climate change. In line with this, the Government launched Egypt's platform for the Nexus of Water, Food, and Energy to affirm its dedication to national environmental and energy goals.

We are targeting an annual reduction of GHG emissions of 17 million tons CO2 through two projects. The first entails constructing and operating a 504MW onshore windfarm in the Gulf of Suez area, which will be the largest windfarm in Africa. The second a 200MW solar project in Kom Ombo, Upper Egypt. The success of NWFE allowed Egypt to update its NDCs, reflecting a commitment to accelerating the transition towards a low-carbon development pathway by increasing the deployment of renewable energy to reach the target of 42% installed capacity by 2030 instead of 2035.

How is the country balancing its commitment to sustainability with the development of key natural resources?

By setting clear strategic objectives, promoting innovation and green technologies, sustainably managing resources, facilitating green finance and raising human capacities, Egypt is committed to striking a balance between development and sustainability.

The government has created a platform to promote green technologies, amplify the sustainable management of resources, broaden the adoption of smart agriculture and facilitate the availability of green finance. Egypt is constructing 22 new-generation green cities. Cities like the New Administrative Capital and the New Alamein City rely on green buildings, advanced technologies and renewable resources. These are a continuation of an overarching commitment to climate action and the gradual transition to renewable energy.

The main challenge that low- and middle-income countries face in transitioning towards a greener economy is access to finance. This is exacerbated at a time of economic crisis, where many countries unfortunately face the dilemma of picking between immediate developmental needs and sustainability objectives.

The international community must play a significant role in creating an environment that facilitates financing and empowers low- and middle-income countries to commit to sustainability through the development of key natural resources via the implementation adaptation and mitigation projects. Egypt launched an international framework for innovative finance, the "Sharm El Sheikh Guidebook for Just Financing", on the sidelines of COP27. Egypt accepts its responsibility for shaping the dialogue to ensure the availability of green finance to enable the implementation of mitigation and adaptation projects in developing countries.

"Egypt is committed to striking a balance between development and sustainability."

SMEs still make up a huge proportion of Egyptian firms, how has the environment for smaller firms improved?

More than 95% of formal business in Egypt are micro-sized, and the government has exerted tremendous efforts in improving their access to finance, raising their capacities and opening more markets for them. In 2016, the Central Bank of Egypt introduced an initiative to encourage banks to allocate approximately 20% of their credit portfolios to financing SMEs, setting an immediate target of offering EGP200 billion to 350,000 SMEs and creating 4 million jobs.

In 2020, the Small and Medium-sized Enterprises (SMEs) Development Law provided financial incentives, including exemptions from stamp tax/duty, documentation fees and the first month's fees for the establishment contracts of companies and facilities, credit facilities contracts, mortgages and land registration contracts.

In 2023, the Supreme Council for Investments created an environment conducive to private sector engagement in all economic sectors. The Council also approved the appointment of the IFC as a strategic advisor to the Government to boost private sector engagement in the economy though enhanced competitiveness and job creation.

The partnership with IFC is an extension of Egypt's strong partnerships with bilateral and multilateral partners to empower the private sector. The World Bank's 2023-2027 Country Partnership Framework for Egypt has three high-level outcomes, one of which is the creation of more and better private sector jobs by supporting the creation of "an empowering environment for private sector-led investments".

How big a priority is digitalisation and innovation across the economy?

The Government has identified innovation and digitisation as key priorities in the path towards an inclusive and green economy. The "Digital Egypt" initiative will foster innovation in Egypt and advance the country's digital infrastructure by expanding broadband and telecommunications networks, digitising governmental services, developing smart cities, broadening digital and financial inclusion via e-commerce and digital payments, and introducing digital innovation hubs.

But you can only advance digitization and innovation as much as your workforce allows you. Therefore, the government has made raising the digital capacity of individuals another major priority. Egypt's technical and vocational education and training system has witnessed unprecedented public and private investments over the past decade, and more that 46 applied technical schools have been launched.

Human development will be crucial for long term growth. What is the country's strategy for investing in skills and training?

Given that 27% of Egypt's 110 million population are aged between 10-24, human development becomes an absolute necessity. The government has set forth multiple initiatives to foster investing in skills and training. Such an approach is even more critical in the aftermath of recent global economic shocks that resulted in unprecedented learning losses and many people losing their jobs.

The National Training Academy was established to empower youths in their transition from education to employment by raising their capabilities across different sectors. The Ministry of Education and Technical Education launched the 'Education 2.0' programme, which included smart classrooms, 2 million+ tablets, revamping the online Egyptian Knowledge Bank, achieving gender parity in primary and secondary education, and introducing digital exams. These showcase the government's recognition of human development as the cornerstone of sustainable growth and the subsequent prioritisation of investing in skills and training. ●

EGYPT'S INVESTORS SEE LIGHT THROUGH THE STORM

Egypt's strategic importance, resilient banking industry and huge population remain strong fundamentals for the country. Although it faces economic volatility, investors say the government is on the right track to unlock Egypt's immense investment opportunities.

For many decades, the old Arabic expression Umm Al-Dunya or 'Mother of the World' has underpinned how the country itself and the wider Arab world thinks of Egypt. The phrase encompasses the weight of Egypt's long history, its cultural influence and its political importance.

Through recent electoral and economic uncertainty, this belief in Egypt's pivotal contributions to the region's past and future have given investors faith that it will weather the current round of challenges and come through stronger.

Many of the issues facing Egypt are not the country's fault. The Covid-19 pandemic was a colossal economic blow. Heavily reliant on imports of food and other commodities, Egypt has struggled with the rampant inflation exacerbated by the war in Ukraine. Perhaps Egypt's most pressing issue is a foreign exchange crisis brought on by a current account imbalance. The lack of foreign currency circulating is seriously dampening economic activity.

"The big question is around the dollar exchange rate," says Tarek Abdel Rahman, managing partner of Compass Capital in Cairo. "There is a 25%-30% difference between the bank rate and the black market. So if you are seeking a return on investment then this is a huge problem."

Egypt has traditionally balanced its import/export imbalance through tourism, remittances, Suez canal receipts and foreign investment. Each of these sources may have taken a serious hit in recent years, but several are showing signs of recovery. Tourism has been dented by terrorist attacks and most recently Covid, but visitor numbers are now higher than they were pre-pandemic.

The tourism ministry reported that 11.7m visitors arrived in 2022, attracted by simplified visa procedures and a growing array of destinations. In April this year, tourism numbers hit a record monthly high of 1.35m. Fitch expects tourism revenue to hit $14.4bn in 2023, up from $13bn in 2022. The government is hoping to attract 30m tourists a year by 2028, which will require a dramatic expansion in hotel capacity.

The picture also looks brighter on canal receipts. Recovering global trade, combined with severe supply chain shortages, have pushed up the canal's takings to record highs. In the second half of 2022, remittances fell 23% to their lowest level since 2016, according to central bank data. But this is largely due to the economic uncertainty and dual exchange rate. The government's plan to address both will allow remittances to return.

FDI RISING

When it comes to investment, there are also positive signs. UN data show foreign direct investment (FDI) more than doubling in 2022, to $11.4bn. There is huge scope for foreign capital flows to continue to reach new highs.

Before the pandemic, government investment was highly focussed on megaprojects, some of which are unlikely to generate immediate cash flow. This not only consumed large amounts of foreign currency but also crowded out the private sector and foreign investors.

One silver lining from the current set of economic challenges is that they are prompting vital reforms and policy changes that will bring FX inflows and private sector dynamism back to Egypt's economy.

"We've been seeing encouraging signs," says Rahman. "There have been appointments of investor-friendly people to certain important institutions and the investment authorities are working overtime to make investors' lives easier."

In December 2022, President Abdel Fattah el-Sisi approved a transformational state ownership policy that outlines the government's vision for the future role of the state in the economy. This includes raising the participation of the private sector in public investments

"There have been appointments of investor-friendly people to certain important institutions"

—Tarek Abdel Rahman, managing partner of Compass Capital in Cairo

Egyptian state companies scheduled for partial privatisation

FINANCE

Banque du Caire
United Bank of Egypt
Arab African International Bank (AAIB),
Misr Life Insurance
Misr Insurance

INFRASTRUCTURE

Elnasr Housing and Development
Maadi Company For Development & Reconstruction
El Mosktabel for Urban Development,
Misr Concrete Development

CHEMICALS AND MANUFACTURING

Helwan Fertilizers
Wataniya Company for the Sale and Distribution of Petroleum Products
Egyptian Polypropylene & Polypropylene (EPP)
Chemical Industries Development Company (CID)
Paints and Chemical Industries (PACHIN),
Alamal Alsharif Plastics
The Egyptian Ethylene and Derivative Company (ETHYDCO)
Egyptian Linear Alkyl Benzene (ELAB)

METALS AND MINING

El Nasr Mining
Egyptian Drilling Company (EDC)
Sinai Manganese Company
Egyptian Ferrous Alloys Company

TRANSPORT AND LOGISTICS

Canal Company for Mooring and Lights
Port Said Container & Cargo Handling Company (PSCCHC)
Damietta Container and Cargo Handling Company (DCHC)

OTHER

Salhia Investment and Development Company,
Hotels owned by the Public Sector Ministry
Misr Technology Service (MTS)
Misr Pharma.
Safi Waters

ENERGY

Gabal El Zayt Wind Power Plant
Zafarana Wind Farm
Beni Suef Power Station

"Reform policies will reduce the state's involvement and increase transparency in state-owned enterprises."

—Hussein Abaza, chief executive officer and managing director, CIB

from 30% to 65% within three to five years.

Enhancing private sector participation should lead to higher growth — the government wants GDP to grow at 7% to 9% — boost exports and provide new, higher paying jobs for a growing population.

Under the new policy, the state will exit sectors including passenger and cargo transport, food and beverages, retail, and commercial insurance.

SWATHE OF PRIVATISATIONS

Hussein Abaza, CEO of Egypt's Commercial International Bank, points to government plans to sell or list its stakes in 32 state-owned firms, in a privatisation programme covering a range of sectors from tourism and energy to banking and insurance.

Government holdings of United Bank of Egypt, Banque du Caire and Arab African International Bank are all scheduled to be sold. "Selling state assets will enable the Egyptian economy to weather the crisis inflicted by the Russia-Ukraine war, since the war has sparked a huge outflow of foreign investments," he says. "Reform policies will reduce the state's involvement and increase transparency in state-owned enterprises."

This privatisation approach is also likely to be crucial in unlocking additional funding from the International Monetary Fund and the country's Gulf allies. This funding has been delayed until certain reforms were implemented — not least the introduction of a flexible exchange rate.

The IMF wants to see solid progress, while the Gulf states want to make a return on any assistance, which means the ability to buy state-owned assets.

Analysts say the Egyptian authorities are understandably waiting for the initial inflow of foreign currency from asset sales before adjusting the exchange rate. This will enable them to adjust the value of the Egyptian pound from a stronger position.

"This would also hopefully reduce the amount of adjustment needed, limiting the inflationary impact on the population," says Trevor Cullinan, director at S&P Global Ratings in Dubai.

In short, privatisation is to raise foreign currency, allowing a currency adjustment that would in turn unlock a new wave of donor funding. All this should go a long way to calming domestic and international investors, especially at a time of broader unease across emerging markets.

S&P analysts note that, under its agreement with the IMF, the government aims to raise $4.6bn from asset sales in the 2023-24 fiscal year, having broadly achieved its initial target by raising $1.9bn over the six months to June 2023.

Together with the Gulf governments' pledge to invest in Egyptian companies, the government has a plan that should have real impact.

STRONG FUNDAMENTALS

Egypt also benefits from a host of strong fundamentals that will support investment. One is a strong, well-regulated banking sector able to cope with the rapid rise in interest rates and inflation.

"Banks are the backbone of the economy and we are blessed with very strong banks and very strict regulations on what banks are allowed to do," says Rahman.

The banks do not rely on foreign funding nor have exposure to risky financial products. Fitch Ratings says the average Tier 1 capital adequacy ratio across the banking sector is above 17% — higher than international standards. Banks have enough reserves to cover the expected rise in non-performing loans, and Fitch analysts expect payment facilities to prevent a significant deterioration in asset quality.

"Banks like CIB responded to high interest rates by issuing foreign and local certificates of deposit with varying annual interest rates," says Abaza at CIB. Such certificates are intended to support local currency saving and are in line with central bank efforts to strengthen the pound and stop the black market sale of dollars.

"The Central Bank of Egypt is taking the necessary steps to safeguard people's local currency savings and establish a price for the Egyptian pound against the US dollar," Abaza says.

Fitch expects the central bank to devalue the currency in the third or fourth quarter this year, hoping to relieve the main source of pressure on the banking system.

"Egyptian expatriates will resume remitting money through official channels, while receding FX risk will encourage portfolio investors to re-enter the Egyptian debt and equity markets," the rating agency said in an August outlook.

FDI flows will also improve the financial sector's net foreign asset position, which hit a record low of minus $27.1bn in June, according to Fitch. It expects Egyptian banks' net foreign asset position to improve by the end of this year or early 2024.

Egypt's financial sector was already entering a new phase of dynamism even before the gov-

Production and construction

Clockwise from top left: the production of drugs used in the treatment of Covid-19 at Eva Pharma in Cairo; New Mansoura City; The site of the Central Business District in the new administrative capital, east of Cairo and the new Cairo monorail on track

ernment announced its privatisation plans. The authorities have made fintech a priority, not least to boost financial inclusion.

Looking at the numbers, Egypt is a financial start-up's dream. It is a country of over 100m people with mobile penetration of almost 95% and internet use north of 72%. But financial inclusion is still less than 65% for adults, and under 60% for women. The possibilities are immense, and fintechs are already making inroads.

In 2017, the authorities surveyed how many fintech firms and payment service providers there were in the country — they found 38. In 2022, that number had grown to 199, of which almost a quarter had offices overseas.

Over the same period, venture capital and private equity investment in fintechs rose from $15.5m to almost $800m. More than half of firms in 2022 said they were planning to expand in the next 12 months, with key markets including the Mena region, Turkey, Pakistan and parts of Africa.

Payments and remittances account for more than a third of the fintechs, but the alternative lending, data analytics and business-to-business marketplace segments are expanding quickly.

Egyptian banks and global lenders like HSBC and Standard Chartered are enthusiastically partnering with nimble start-ups to help tap into underserved client groups like small and medium sized enterprises.

HEALTH AND HOUSING

Egypt's population of almost 110m and its solid long term growth outlook mean there are huge opportunities for investors, both domestic and international.

The real estate market has long been one of the most attractive options. Almost one fifth of Egypt's population is aged between 10 and 19, and there are around 26m people aged 24 or below. This massive pool of young people will drive demand for retail space and later housing.

The government is building an array of large real estate infrastructure projects — including the New Administrative Capital, New Mansoura City and New Alamein City — that blend residential, commercial and industrial spaces.

"If you look at the last 10 years, real estate has returned around 22% per year in terms of total investment return," says Rahman. "Nothing else even comes close, and real estate also acts as a hedge against inflation."

Healthcare is another sector analysts expect to be very attractive to investors, and which enjoys the same fundamental support as housing. Egypt aims to provide universal health coverage as part of its Vision 2030 strategy, but private hospitals and care providers are becoming increasingly important.

The government has opened state-affiliated hospitals to private investment. Healthcare providers have continued to expand despite the economic difficulties.

In May this year, outpatient provider Dawi Clinics announced it would open 30 new clinics with E£250m ($8.1m) raised in a funding round led by National Bank of Egypt's AlAhly Capital Holding, with a co-investment by the Egyptian-American Enterprise Fund. Egypt is an increasingly popular destination for medical tourism across the region.

Not only is Egypt's population the largest in the Middle East and North Africa, but it is forecast to grow by almost 50% by 2050. For investors in the education sector, this puts the country front and centre of any growth strategy.

Enrolment rates are higher than the global average. The population places incredible importance on education, and private schools are among the priorities for households even on modest incomes. "It's an industry that a lot of corporations have entered over the last few years — especially universities and even schools," says Rahman.

Egypt has had a difficult year, but there is cause for optimism that a new generation of targeted reforms will allow the country and its highly educated, industrious population to reach their true potential. ●

HUSSEIN ABAZA,

CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR, CIB

How has hosting COP27 helped Egypt and CIB strengthen their commitment to sustainability and the energy transition?

COP27 demonstrated the power of well organised climate-vulnerable nations pursuing collective, purposeful action for climate justice. The Middle East and Africa were core actors at COP27, since they were considered to be the most vulnerable to climate change. CIB is committed to working with stakeholders to achieve decarbonisation and climate goals. By collaborating and providing leadership, the bank aims to support the transition towards a green economy that benefits communities, the environment, and the economy.

Our bank has partnered with the International Finance Corporation in developing a climate risk management framework according to the Task Force on Climate-related Financial Disclosures' recommendations and guidance. The advisory services include initial portfolio screening against transition and physical risks, along with scenario analysis and stress testing framework. CIB has also collaborated with the IFC in issuing Egypt's first private sector corporate green bond — a $100m transaction — to help unlock finance for climate-smart projects. This is in addition to another $100m from the IFC as a green trust fund for climate mitigation and adaptation finance.

CIB's client transition programs are helping support clients to develop carbon emission reduction solutions, in addition to innovating sustainable finance instruments. Our Sustaining Sectors and Sustaining SMEs Program helps corporates in different sectors leverage sustainability to realise their growth potential while driving system transformation toward a circular economy. An ESG Data Digitalisation programme, meanwhile, will develop an innovative hub to track sustainability performance.

What is the bank's strategy for expansion into new markets?

Looking for lucrative opportunities whenever and wherever they arise has always been an integral part of CIB's overall growth strategy. Egypt is the gateway to Africa, which makes the continent a logical market for a focus of expansion. Expansion into the African continent serves to accelerate balance sheet and earnings growth and follow our corporate customers who are moving into Africa. It also allows us to capture a significant share of the fast growing Egypt-Africa trade, export CIB's competitive advantage in data and consumer markets to select African countries, and have CIB play a national role in serving the sovereign mission to maintain close economic ties with the entire continent.

CIB has looked to Kenya as the most economically developed market in East Africa and for its relative geographic proximity. The bank recently acquired Mayfair Bank, making CIB the first Egyptian bank to expand its operations into Sub-Saharan Africa. Kenya is widely viewed as the region's commercial and industrial hub, due to its political stability, macroeconomic fundamentals, business environment and logistical services that place the country very close to all regional trade transactions.

CIB Kenya will enable the bank to capitalise on Kenya's position as a trade hub by providing trade finance and credit facilities for Egyptian mid-sized corporates. Firms will benefit from the strength, safety and security of Egypt's leading private sector bank. Importantly, having an established and fully operational bank will allow for a focus on SMEs, in addition to high net worth individuals. Finally, I would like to note this acquisition is a first step in our continued identification and evaluation of further opportunities in Africa.

> **"CIB's client transition programs are helping support clients to develop carbon emission reduction solutions"**

Digitalisation, innovation and fintech hold great potential for Egyptian banks. How is CIB engaging with these trends?

Digitalisation has the potential to revolutionise Egypt's banking industry. By adopting digital technologies, banks can improve efficiency, reduce costs and reach a wider range of customers. They can also offer new and innovative products and services that meet the needs of a changing customer base. CIB is one of the leading Egyptian banks in engaging with digitalisation trends. Our commitment to innovation and digitalisation led to the creation of our Bank of the Future program in late 2020. Its six key pillars are service digitalisation; operations centralisation; robotics; branch digital experience; branch classification; and digital sales. The program has improved several customer service areas including internal and external fund transfer migration rates, cost synergies and transaction volumes.

The bank has invested heavily in digital infrastructure and technologies, and has launched a number of innovative digital products and services. Our focus has been — and continues to be — on innovative solutions, digital channels, data analytics and the customer journey. This has allowed us to create unique digital value propositions and sales efficiency and to manage costs. Our digital readiness enables us to support our customers as well as the wider community.

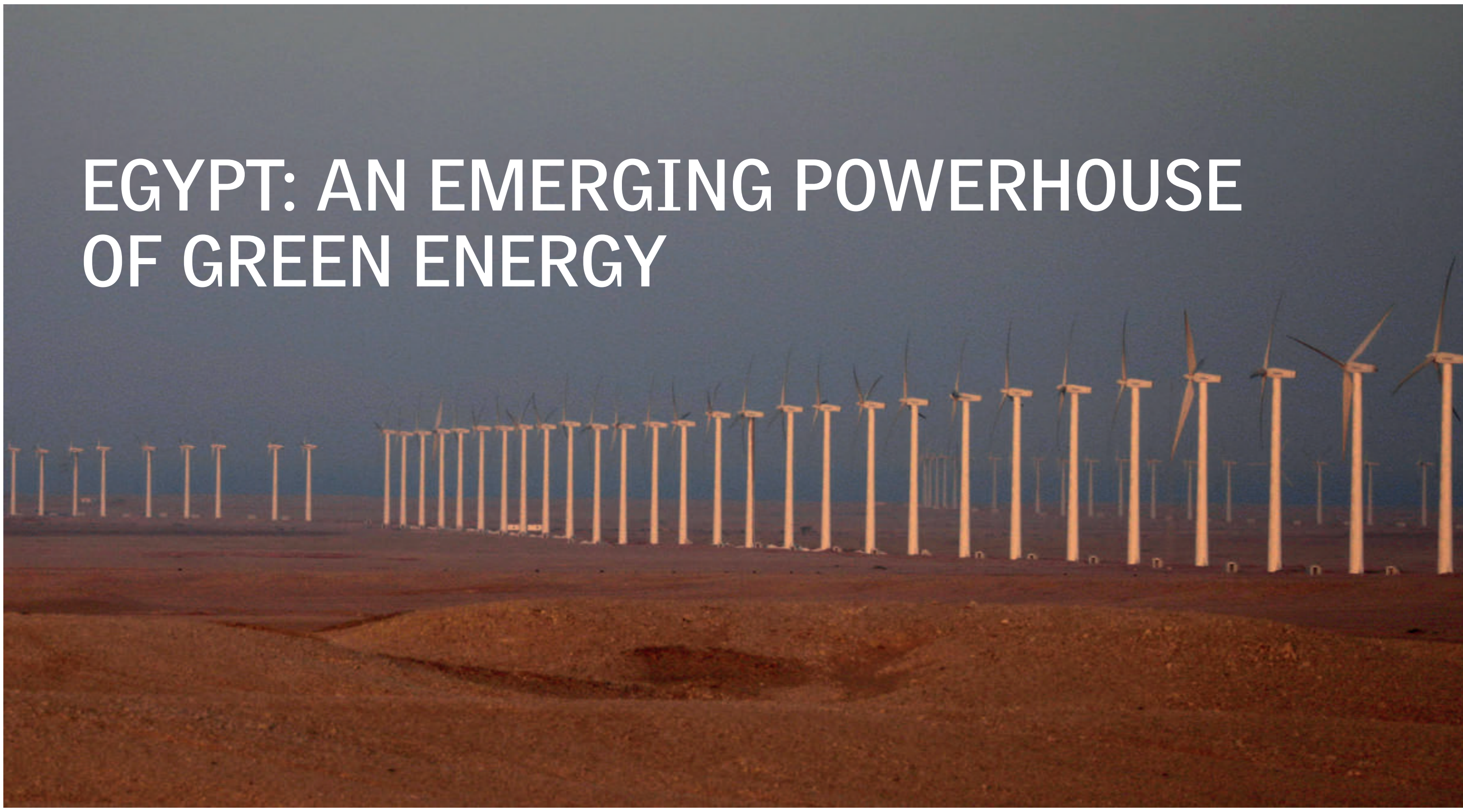
Online platforms have become a highly effective digital sales channel. They now contribute 48% of the bank's total annual certificates of deposit and term deposit booking by volume and 44% by value. This has enabled CIB to reduce branch traffic and enhance the customer experience. Almost 66% of the bank's customer base uses online banking, with 2.2 million internet banking transactions totalling around EGP 65.6bn executed last year — a 13% year-on-year increase. The online banking customer base reached 1.3 million users in 2022 — an increase of 25% — and mobile banking transactions increased by 57% to 11.4 million. Zaki the Bot — CBI's AI-powered chatbot — conducted over 488,000 interactions on both the public website and Facebook Messenger.

CIB's 'bank-as-a-service' infrastructure enables fintechs and corporates to interact directly through application programming interfaces or APIs, and it has adopted new technologies, such as the instant payment network (IPN) that creates a real time, interoperable ecosystem allowing instant, seamless transfers through digital channels or payment service provider applications.

How is CIB using collaboration and partnerships to expand its services?

Egypt is a country with a large population of over 105 million people. Most Egyptians are either entirely unbanked or underserved, meaning they lack access to basic financial services such as payment products, savings accounts, credit facilities and insurance. CIB is partnering with fintechs and other technology-enabled platforms to develop innovative tailored solutions that can help facilitate access to financial services to vulnerable segments of society in a more sustainable manner. CIB is providing entrepreneurs with the mentorship, infrastructure and banking services needed to complement CIB's strategy and drive the national agenda of sustainable financial inclusion for all segments of society. ●

EGYPT: AN EMERGING POWERHOUSE OF GREEN ENERGY



© REUTERS/Amr Abdallah Dals

Egypt may lack the Gulf region's capacity for state-directed investment, but its savvy policy choices and private sector dynamism have still made it a regional leader in renewable energy growth.

From endless desert sunshine to strong coastal winds, the Middle East and North Africa is not short of potential for green energy. Looking at the countries expected to drive most of the region's renewables growth, Egypt is at the head of the pack.

Given the country's abundant supply of sunlight, solar power is often what comes to mind when thinking about green energy in Egypt. But the Gulf of Suez is a world class wind source.

BMI Renewables Industry Research expects wind capacity in the MENA region to increase by almost 14GW over the next 10 years. Easily the largest source of growth — providing over half of the predicted increase — will be Egypt.

The government deserves much of the credit. The authorities have worked hard to expand renewables capacity with the aid of international partners. Egypt has used its Sovereign Fund along with collaboration from a range of multinational entities and international investors to tap into its wind potential.

One such project — Gulf of Suez II — will be one of the largest wind farms in Africa. Located in the Ras Ghareb area some 300km southeast of Cairo, the 500MW project is due to come online in 2025 and supply more than 800,000 Egyptian homes with green energy.

Egyptian authorities think the project could reduce Egypt's CO2 emissions by about 1m tonnes a year. In late 2022, the authorities announced the 500MW Amunet wind project — a joint venture between Japan's Sumitomo Corp and AMEA Power of the United Arab Emirates.

This year, Egypt has continued to build momentum for wind investment. In July, the New and Renewable Energy Authority announced an agreement with Norwegian firm Scatec to develop a 5GW wind power plant in West Sohag, in the south of the country.

In August, NREA signed a deal with a consortium of Orascom Construction, France-based Engie and Japan's Toyota Tsusho to provide land for a 3GW wind farm in the same area.

Egypt is also moving forward with a colossal 10GW wind project — which would be one of the largest in the world — first agreed on the sidelines of COP27. NREA recently signed an agreement with a group of firms — including Egyptian-Abu Dhabi joint venture Infinity Power — to provide land for the project, which would avoid 23.8m tonnes of CO2 and an estimated $5bn in natural gas costs each year.

PRIVATE SECTOR SUPPORT

Wind might be driving much of the increase in renewable capacity, but the possibilities for solar are no less impressive. Estimates put the country's total annual sunshine at up to 4,000 hours, or 11 hours a day.

Egypt is undertaking a mix of large,

Desert storm
The Zafarana Wind Farm outside Cairo

"The Central Bank of Egypt is establishing an enabling environment for Egyptian banks to benefit from the opportunities provided by sustainable financing"

—Hussein Abaza, CEO of Commercial International Bank

utility-scale solar projects and using targeted policies to help grow solar in the retail and small scale segment. Financial assistance programmes for farmers are helping them roll out solar-powered irrigation systems that save money and reduce reliance on diesel generators. The government has introduced net metering and feed-in tariffs, meaning residential and commercial property owners can sell excess electricity they generate to the grid.

On the larger end of the scale, Saudi firm Acwa Power recently closed financing for the 200MW Kom Ombo power plant — expected to come online early next year. Funding from multilateral agencies and private banks will create a utility-scale solar plant able to power 130,000 homes.

This touches on a key aspect of Egypt's progress. Unlike the Gulf states — the other regional green energy powers — in Egypt it is the private sector, foreign investment and debt financing that will drive green growth.

The NREA reported that foreign investment into Egyptian energy projects doubled to $3.5bn in the 2021-22 financial year. Again, sound policy is part of the story. New cross-border power connections are making projects more appealing by boosting export capacity. Moves to raise electricity prices and lower fuel subsidies will make green power more competitive and support profits in the private sector power industry.

MAKING BANKING BETTER

Financial sector support for the energy transition is soaring as Egypt's banking sector embraces green and sustainable finance as part of its own transformation.

In the last few years, the Central Bank of Egypt and the Financial Regulatory Authority have introduced new regulatory directives across the financial industry.

In late 2022, just before the start of COP 27 in Sharm el-Sheikh, the CBE issued binding sustainable finance regulations with specific requirements and timelines (see table).

Egyptian banks have to introduce sustainable finance products, increase their green portfolios and analyse environmental risk from projects. This requires new policies, creating and staffing new departments, and publishing annual sustainability reports. Mandatory reporting and disclosures started in the second half of 2023.

"The Central Bank of Egypt is establishing an enabling environment for Egyptian banks to benefit from the opportunities provided by sustainable financing, while managing risks and benefiting all stakeholders' groups," says Hussein Abaza, CEO of Commercial International Bank. "The infrastructure base for the Sustainable Finance Roadmap is now being implemented, which starts with sustainable finance capacity building for the Egyptian financial sector, through training programmes and workshops to build up the necessary knowledge and skills in this field."

In the capital markets, the Egyptian government showcased its commitment to sustainability and inspired other emerging markets by issuing its inaugural green bond for $1.9bn in 2020. The banks have followed in its footsteps. CIB issued Egypt's first corporate green bond during the pandemic — a $100m note fully subscribed by the International Finance Corp — to increase financing for sustainable solutions to climate change.

Abaza sees potential for green and sustainable financing in many fields — renewable energy, industrial energy efficiency, green buildings, waste and water treatment, sustainable transport, tourism and agriculture.

This also benefits Egypt's economy, he says, "by increasing the percentage

Binding Sustainable Finance Regulations

In November 2022, the Central Bank of Egypt issued binding sustainable finance regulations as part of the country's commitment to the UN Sustainable Development Goals and Egypt's Vision 2030. The regulations include:

Banks must incorporate sustainable finance policies within their existing credit and investment policies. In addition, banks must set procedures consistent with the CBE's Guiding Principles for Sustainable Finance, and submit the new policies and procedures to the central bank by October 1, 2023.

A bank's board of directors should ensure the new policies and procedures are put in place and validate the required reports.

Banks must establish an independent Department for Sustainability and Sustainable Finance that reports directly to their CEO or deputy CEO by April 1, 2023. This department should include individuals who have expertise in credit and risk, and who can coordinate between the various departments within the bank.

These new departments will take responsiblity for implementing sustainability and sustainable finance policies through the bank.

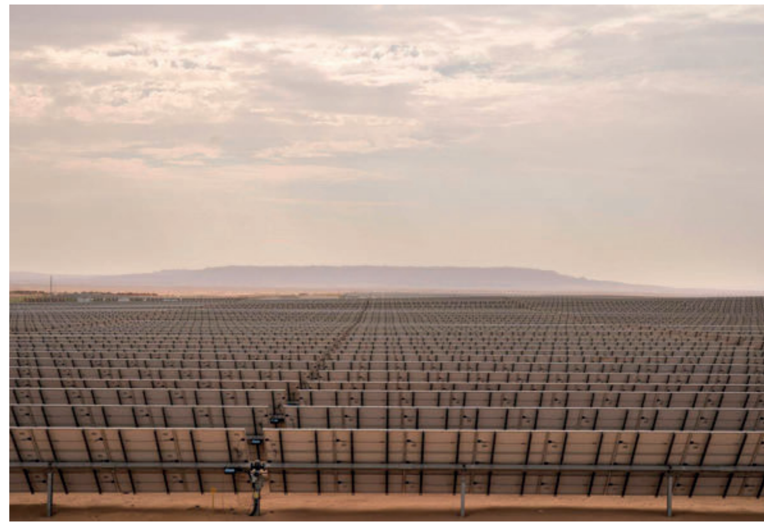
Banks must consult an environmental expert accredited by the Ministry of Environment to assess environmental risks of large corporate projects from July 2023.

Banks must prepare periodic reports to be provided to the central bank's own Sustainability Department. These reports include:

Semi-annual status reports on the implementation of the Sustainable Finance Guiding Principles starting from July 2023.

Quarterly quantitative reports on sustainable financing activities starting from July 2023.

Annual sustainability reports approved by the bank's board, which should be prepared in accordance with the Global Reporting Initiative. These must be provided on March 31 each year, starting in 2024.



Let the sun shine
Benban Solar Park, Aswan. —one of the world's largest solar power plants; an aquaponic farm, which recycles water in fish tanks to grow vegetables, in Cairo

of renewables in the nation's energy composition, promotes green buildings throughout the country, and develops resource efficiency best practices in the industrial sector."

In 2023, CIB signed a $100m green funding mechanism for climate finance with IFC to finance mitigation and adaptation projects in several sectors including tourism, transport, agriculture, industrial sectors and water and waste management.

The bank has also expanded its sustainable financing portfolio to include 12 new product offerings designed to serve companies, as well as small and medium-sized enterprises (SMEs) from both the public and private sectors. Applications include water desalination, energy management systems, retrofitting buildings, pollution prevention and control, sustainable agriculture and sustainable transport.

Abaza says CIB's efforts to increase its climate finance offerings "aim to provide convenient financial solutions to complex environmental challenges for carbon-intensive industries, enabling their transition toward a low carbon economy."

SUSTAINING SMES

The SME space, which accounts for over 90% of Egyptian firms, is full of firms in carbon-intensive sectors facing new pressure to adapt. Egyptian garment exporters, for example, serve Europe as a vital market, which increasingly requires high sustainability standards.

SMEs are looking for financial assistance to shift to green production and future-proof their businesses. The pressure on exporters is greater, but domestic firms are also responding to the new dynamic.

Catering to this demand, CIB has its own Sustaining SMEs lending initiative and a Sustaining Sectors programme adapted to different industries.

Major firms face even more security. Listed Egyptian companies now bear the same mandatory environmental, social and governance reporting requirements as banks.

Meanwhile, oil and gas is still a critical part of the Egyptian economy. Yet Egypt is making impressive strides to improve efficiency and lower emissions. Hosting COP 27 was an important catalyst.

At the event, Egyptian firms and government entities signed multiple agreements aimed at creating a more environmentally friendly oil and gas industry.

Egyptian Liquefied Natural Gas Co is working on the possibility of a zero-flaring system at gas terminals. In July this year, Egyptian Natural Gas Holding Co (EGAS) and partner Wintershall Dea announced that their joint venture Disouco had become the first firm in Egypt to achieve zero routine flaring.

EGAS is also working with global firms like Shell and TotalEnergies to study options for decarbonising the petroleum industry.

The combination of banks keen to boost their green portfolios and fossil fuel firms eager to clean up their operations is a winning one.

One emerging energy solution that holds promise for Egypt and its lenders is green hydrogen. In August this year, Swiss firm Smartenergy said it was in discussions to construct a green hydrogen facility in Egypt. In March, Egypt's government said China Energy Engineering Corp would begin work on a colossal $5bn project using solar and wind generation to produce 140,000 tonnes of green hydrogen a year. Much of this will be exported to European markets as ammonia, enlarging Egypt's access to foreign exchange.

The outlook for cleaner natural gas, burgeoning renewables and cutting edge green hydrogen could turn Egypt into an energy export powerhouse. Its electricity grid is already connected to many regional neighbours including Jordan, Turkey and Sudan. Recognising the export potential, the government is collaborating with other African countries to improve interconnections through the Nile Basin Initiative.

Even more ambitious projects could strengthen connections with Europe. The Greek and Egyptian governments have held discussions on the GREGY interconnector — a visionary project that has its origins in the private sector.

Infinity Power and Greek conglomerate Copelouzos are driving the plans, which would see a colossal 3GW capacity subsea cable transmit Egyptian solar and wind energy to Greece.

Located at the crossroads of Africa, Asia and Europe, Egypt has been a regional power and crucial source of commodities for hundreds of years. As the world undergoes an unprecedented energy transition, the country looks set to carry its historic role into a new future. ●

Paraguay to follow Uruguay with World Bank sustainability loan

By Oliver West

After Uruguay announced an innovative sustainability-linked loan from the World Bank, it took just two days for a second country to express interest in using the structure, an encouraging portent for the Bank's hopes of a broad take-up among sovereign borrowers.

Uruguay and the World Bank said on Wednesday they had agreed terms on a loan whose interest rate will step down if the country hits certain climate targets — a first for a multilateral loan. It is still awaiting final sign-off by the Bank's board, but will be about $350m.

If Uruguay reduces the intensity of methane emissions from its livestock sector further than promised in its Paris Agreement commitment, it could save up to $12.5m in interest payments.

The World Bank wants to encourage other countries to seek similar loans.

On Friday in Marrakech, Paraguay's minister of economy Carlos Fernández Valdovinos told GlobalMarkets his country would also like to link multilateral loans to environmental targets, part of a broader push into sustainable finance likely to include a debut green bond as early as next year.

"As Paraguay's productive structure is quite similar to Uruguay's, and what is being measured [in Uruguay's loan] is methane gas emissions from livestock, we also want to explore this," said Fernández. "We want to look [at sustainable finance] in a way that has clear environmental targets, and that when those objectives are met the interest rate can be a bit lower."

This is something Paraguay could do in bonds and multilateral loans, said the minister. In 2022, Uruguay became the first dollar bond issuer to include an interest step-down in a sustainability-linked bond. The SLB also includes an interest step-up if the government fails to meet sustainability targets, but the loan does not.

Uruguay already had targets in its framework with the Bank that formed the basis of the new loan's parameters.

The loan is a way of aligning these targets with financial incentives, part of the Bank's plan to "incentivise countries to provide global public goods".

The targets will be measured and verified ever year from 2028 until the loan maturity in 2038. Each year, the interest rate can go down or stay flat.

All the World Bank's loans already have KPIs, but the lender must always be made whole — so replicating this product will depend on finding trust fund or bilateral financing to fund the interest rate reduction. In Uruguay's case, the coupon reduction will be financed by a trust fund.

THE final word

Bullet bonds are making sovereign distress worse

By Sebastian Espinosa

There has been much discussion at these annual meetings about the need to reform practices for dealing with sovereign debt distress. The restructuring architecture certainly needs to be revamped, to deal with shifting creditor landscapes, higher debt loads and evolving borrowing practices by developing countries.

But we must not take our eyes off something else — the steps we can all take to make sovereign debt distress less likely in the first place.

Making governments more financially resilient is of course a multi-faceted challenge. Making debt instruments more resilient, on the other hand, is a somewhat less daunting proposition. Or at least it should be.

Innovation can create debt instruments that adapt to a sovereign borrower's ability to repay, making a debt crisis less likely. Already we have an active discussion about the powerful role circuit-breaking features such as climate-resilient debt clauses can play, by providing immediate and automatic breathing space to countries affected by a climatic shock, without triggering a credit event.

With their origins in the Caribbean, CRDCs are now being widely adopted by official sector lenders and must soon become common in sovereign bonds.

Work also continues on other types of contingent debt instruments that respond to a government's payment capacity as it evolves.

Yet the focus on innovation should not make us overlook some very simple changes that could make temporary deteriorations in economic conditions less flammable.

HARMFUL CONVENTION

The bullet bond, in which all the principal is repaid at maturity, has been the standard structure for Eurobond issuance since the early 1960s.

As Eurobonds came to replace syndicated bank loans as the main conduit for private sector hard currency lending to developing countries, the typically smooth, gradual repayment profiles of syndicated loans were replaced by large bullet maturities, which can often amount to a material percentage of a developing country's GDP.

Eurobond bullet maturities are predicated on the expectation of ready access to deep markets that will allow smooth refinancing ahead of maturity dates.

While highly rated, frequent emerging market sovereign issuers can generally expect markets to remain open to them in all but the most difficult conditions, the same cannot be said for sovereigns further down the rating scale, with weaker economic fundamentals.

Such countries often face outsized bullet redemptions, since they are tempted to 'max out' on capital market access when it does come their way. The trouble with large bullet bond maturities is that they very frequently become an unhelpful focal point for both markets and governments, magnifying fears when there are concerns about the economic outlook.

The dynamics that emerge as investors hold back, governments dither, yields rise and rating agencies downgrade very frequently lead to a vicious circle. Fear of default can become a self-fulfilling prophecy.

Many a recent sovereign debt crisis has been triggered, if not caused, by an approaching bullet, or a wall of bullet maturities, on which the market fixates.

Beyond that, the very nature of bullets — the basic fact that they are never truly intended to be repaid — is not conducive to prudent economic planning by governments.

The reason why we have become accustomed to bullet structures for emerging market sovereign bonds is no more than market convention.

A BETTER WAY

Investment banks have very little incentive to stray from the norm. They also bring out the old argument about amortising bonds becoming increasingly illiquid as they are repaid and become smaller.

While there may be some truth to this, most bullet Eurobonds issued by low rated sovereigns tend to be illiquid anyway, due to their relatively small size and rarity, even if they exceed the $500m threshold for EMBI eligibility.

Amortising structures are not a panacea for sovereign debt crises, and they will not succeed in averting defaults when a country's debt sustainability has been fundamentally compromised.

Countries like Sri Lanka and Ghana would almost certainly have defaulted even in the absence of bullets, such was the sheer weight of their debts.

But smooth repayment profiles reduce flashpoints and do not generate the unhelpful dynamics that occur when legitimate concerns about economic fundamentals are magnified and projected on to the big screen of a looming Eurobond maturity.

Bullets can create a distraction that actually makes it less likely that the government will take corrective action.

We have become lazy in our approach. It is now time for all involved in helping sovereigns — especially those further down the rating scale — to borrow from the international capital markets, to discourage them from sowing the seeds of future debt distress by opting for more manageable amortising bonds over problematic bullets.

Investment banks can play a big role in bringing about this shift, as issuers will typically take on board their views on what works for the market.

Their job could be made easier by a standard amortising bond template, which could be prepared by the International Capital Market Association for issues by countries eligible for IDA or 'blend' financing from MDBs.

Where there are genuine concerns about liquidity, we can come up with mechanical innovations that address this.

But we should not lose sight of the fact that the bigger prize is more sustainable capital market issues that are tailored as much to sovereign issuers' needs as they are to market conventions.

Sebastian Espinosa is managing director at White Oak Advisory

Fahad Al-Jarallah, Minister of Finance, Kuwait (left), Ali bin Ahmed Al Kuwari, Minister of Finance, Qatar (centre)

Abdulla Mubarak Al-Khalifa, Group CEO of QNB (right)

Bassel Gamal, Group CEO, QIB

Ali bin Ahmed Al Kuwari, Minister of Finance, Qatar (left)

From left: 1. Hamad Al-Mulla, Assistant Governor for Supervision, Central Bank of Qatar
2. Sheikh Abdulrahman bin Fahad bin Faisal bin Thani Al Thani, Group CEO, Doha Bank, 4. Fahad bin Abdullah Al Khalifa, Group CEO, Masraf Al Rayan

Sheikh Bandar bin Mohammed bin Saoud Al-Thani, Governor, Central Bank of Qatar

Ali bin Ahmed Al Kuwari, Minister of Finance, Qatar (left), Sheikh Bandar bin Mohammed bin Saoud Al-Thani, Governor, Central Bank of Qatar, Hassan Abdullah, Governor, Central Bank of Egypt

Jasem Mohamed AlBudaiwi, Secretary General for the Arab States of the Gulf

Fahad Badar, Executive General Manager, International Banking, Commercial Bank of Qatar (right)

Ali bin Ahmed Al Kuwari, Minister of Finance, Qatar (left)

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