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Russia sweet-talks AIIB as Oreshkin vents fury at EBRD loan ban

By Elliot Wilson

A furious public row broke out on Wednesday between the EBRD and the Russian government, which accused the development bank of being a tool of foreign policy in an attack that threatens to take their relationship to new lows.

The diatribe by Russian economy minister Maxim Oreshkin came after EBRD rejected a complaint by Russia that the development bank's investment freeze in the country had breached internal EBRD rules. He said his

country would now turn its attentions to the Asian Infrastructure Investment Bank, the recently inaugurated multilateral based in Beijing in which China holds a 30% share.

EBRD president Suma Chakrabarti emerged from a meeting of the bank's board of governors to say that they had "overwhelmingly agreed that the bank had complied with its own internal rules". That, he added was a "final and binding resolution".

Russia has long argued that the EBRD's ban negatively affected all lending in the country rather than, as is the case with EU and US sanc-



Oreshkin: EBRD is a tool of foreign policy

tions, targetting specific individuals or corporates.

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CEE in the clear after QE but fears grow for EU weaklings Italy and Greece

By Virginia Furness, Phil Thornton, Elliot Wilson

Fears CEE economies will be hit by rising US interest rates and the reduction in the European Central Bank's quantitative easing programme have been played down by EBRD and private economists. They instead have pointed the finger at eurozone strugglers Greece and Italy.

Central and eastern Europe has benefitted enormously from low borrowing costs and highly liquid capital markets thanks to the US Federal Reserve's low interest rates and the ECB's accommodative monetary policies. But leading bankers in the EBRD region believe that



Draghi: scaling back QE, pushing up CEE yields?

Continued on page 3

Croatian governor insists Agrokor will survive but issues warning

By Virginia Furness

The high profile liquidity crisis at Agrokor, Croatia's largest company and southeast Europe's second largest retail corporation, will not result in its failure, the governor of the central bank insisted

in an exclusive interview with *Global Markets*.

Boris Vujcic said the liquidity crisis, which has seen the company freeze payments to all existing creditors for 15

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FINAL WORD

Liviu Voinea

Page 19

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QE

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weak EU states such as Greece and Italy will fall victim to a spike in yields sooner than more resilient economies in the CEE.

Speculation that yields will rise across the continent has built up since ECB president Mario Draghi said in December the bank would scale back the amount of bonds it buys every month under its QE programmes from €80bn to €60bn from March.

Sergei Guriev, the EBRD's chief economist, told *GlobalMarkets* that the multilateral was working on calculations on the likely impact of ECB tapering on its countries of operation, but he said: "We think QE will continue for the time being. For us the bigger challenge is the [US] Fed."

"If you ask me about what will happen in EU, it is that if rates go up, rising interest rates will be a problem mainly for highly indebted countries in western Europe. We see Italy facing the biggest challenge. It's a country with very high sovereign debt and huge banking system issues that will continue to be the main priority for the ECB."

Even US rate rises hold little fear for some in the CEE region. "The Fed has already started [raising rates] and it has not impacted Croatia adversely so far," Boris Vujcic, Croatia's central bank governor told *GlobalMarkets*. "The key thing for Croatia looking forward to the next two years is that its bond spreads are high compared to its peer group. It has significant space for further compression of spread, in order to absorb increase in interest rates without the medium term cost of funds going up."

Marinos Vathis, CEO of Vojvodanska Banka, a Serbian institution, said that as the ECB started to taper QE and interest rates started to rise then "lots of things" would change. But he added: "It will hurt certain countries more than others — Greece for example will be hurt, definitely."

Research two years ago by ECB economists found "strong evidence" that bond purchases by the ECB under its Securities Market Programme (SMP) had had direct impacts on bond yields in EU countries in the CEE that did not use the euro.

While they only looked at the impact of bond purchases, it may imply the reverse effect as tapering takes effect.

FINANCIAL INSTABILITY UNLIKELY

Liam Carson, emerging Europe economist at analysts Capital Economics, said he expected the impact on CEE economies would be moderate as tapering would be gradual. "In any case, external vulnerabilities in the CEE economies are far smaller than they were during the global financial crisis and the eurozone debt crisis," he said.

"Most notably, current account deficits are smaller in Poland and Romania, and in the case of Hungary and the Czech Republic, current accounts are now in surplus. As such, ECB tapering is unlikely to cause any financial instability in CEE."

But in its regional economic outlook published later today the IMF is likely to warn that risks arising from higher interest rates in advanced economies could spark capital outflows from countries in central, eastern, and southeastern Europe.

Final frontier — will EBRD boldly go into war-torn Syria?

By Elliot Wilson

As the EBRD's centre of gravity continues to shift southward with the expected accession of Lebanon as a member country by the end of the year, bank officials are starting to debate the inclusion of war-torn Syria.

The idea of the bank taking on Syria — when the country remains entangled in a vicious civil war with no end in sight — would be the biggest long-term reconstruction job of them all.

But all wars end, and when this one does, the EBRD can expect a knock on the door. Would it consider making Syria into an EBRD member state — and perhaps the biggest sovereign beneficiary of them all? "God willing," a senior EBRD official told *GlobalMarkets*, using the Arabic word *InShallah* and nodding their head in happy approval.

The idea raises the question of what the EBRD and development will look like in 10 years' time — or indeed 20. What will delegates discuss at events like this — and more pertinently, from what countries will they hail?

It is an important question, given the bewildering speed with which the bank is changing. An institution set up in 1991 to

manage the free market transition of former Soviet states, is ever more focused on nation states that are in no way European, yet which in the wake of the Arab Spring are desperate for advice and financing as they reconstruct and develop their tattered economies.

Since December 2011, the EBRD has channelled €4.79bn (\$5.2bn) into 128 projects scattered across four nations — Tunisia, Morocco, Egypt, Jordan — far removed commercially, culturally and politically from its original remit. Egypt and Morocco, it should be noted, are longstanding friends of the bank, having joined on day one, originally as donors, not recipients.

LENDING TO EGYPT

Since 2011 that quartet, comprising the Southern and Eastern Mediterranean (Semed) region, has been handed an increasing share of the bank's budget. In 2012, the EBRD apportioned €181m to Semed, or just 0.2% of its overall budget. By 2016, the respective numbers



Hama province, Syria, April 30: no end in sight to conflict

had risen to €1.37bn and 15%.

And still the numbers grow. Egypt, by far the biggest economy in this grouping of states, was the third-largest sovereign beneficiary of EBRD capital in 2016. Semed chief Janet Heckman told *GlobalMarkets* it would rise to second in the rankings this year, behind Turkey.

How long before a country of 92m people, with problems small, great and at times insuperable, tops the table? Two more 'firsts' were announced on Wednesday, with the EBRD unveiling its inaugural projects in the Gaza Strip and the West Bank.

The EBRD's centre remains committed to former Soviet states, of course. It is re-engaging with Uzbekistan, supporting Kazakhstan's privatisation plan, and remains committed to states from the Balkans to the Baltics.

Croatia

Continued from page 1

months, would have a negative impact of around 0.3%-0.4% on Croatia's GDP growth for 2017 which he revised down to 2.8% from 2.9% last year.

However, he refused to be drawn on concerns that Agrokor's crisis might have an adverse impact on the economies of its operating companies. Agrokor employs 60,000 people in Croatia, Slovenia, Serbia, Bosnia-Herzegovina and Hungary and its revenues account for 15% of Croatia's GDP.

He said the near collapse of the food and retail conglomerate was a warning to companies not to over-extend their balance sheets. "The company will not fail," he said. "It is a company with very valuable assets but a bad balance sheet. It is a very good warning."

His comments came as one bondholder told *GlobalMarkets* that a committee of creditors were working on a new funding scheme.

Concerns about Agrokor's debt stock were raised when Agrokor failed to secure commitments to increase a bank loan in January. This caused a "supplier run on the company," according to a bondholder who spoke to *GlobalMarkets*.

Agrokor is a highly leveraged company which in 2014 acquired Serbian retail chain Mercator to form one of the largest retailers in central and eastern Europe outside of Russia.

Agrokor overpaid, and overleveraged itself to acquire this stake, according to analysts, which they said was the root of

the problem. Agrokor's net leverage on a fully consolidated basis was 5.9 times as at the third quarter of 2016.

In a bid to understand exactly how much debt is outstanding, the company — now under the control of the government — and all of its subsidiaries have asked creditors to report all their claims within the active timeframe of the extraordinary administration which lasts until June 9.

Only after this point will the full extent of the company's indebtedness become clear. In addition, it has €890m of Eurobonds and loans totalling €1.74bn as of May 10 outstanding.

LIQUIDITY INJECTION

Agrokor is now in talks with creditors to secure a new liquidity injection which Vujcic said was the "final one." Talks started yesterday and the "final number" is still being calculated.

According to Aleksej Gren, an analyst at Exotix Partners, the government will want to have order restored quickly. "It is a political move" he said. "The minister of finance was employed there and with local elections coming up in Zagreb on May 21, in order to keep control politically, the government is going to have the Agrokor situation under control."

It is unclear who will provide the financing as Sberbank, the company's largest creditor, is already owed €1.1bn by the company.

According to Gren, "Sberbank is looking to sell on its loans but there seems to be a substantial difference between the asking price and what people are willing to pay.

Additional funding will likely come



Vujcic: final number still being calculated

from the bondholders, or local banks," he added. "I don't think Sberbank will give them any more money now."

The bondholder said that there was a growing likelihood that a committee of suppliers, bondholders and lenders who were closely working on a solution would come up with the required funding.

For his part, the bondholder was very confident in the actions taken by the government. He did not believe he would have to take a haircut on his obligations. The bonds were trading around 40 on Wednesday. However, a person with knowledge of the matter said it looked like there "had to be a haircut".

The situation has also taken its toll on Croatia's ruling political party. Last week finance minister Zdravko Maric survived a no confidence vote. Before joining the government in 2016 Maric was executive director of strategy and capital at Agrokor for four years.

GLOBAL MARKETS

MANAGING EDITOR

Toby Fildes
toby.fildes@globalcapital.com
+44 20 7779 7327

ASSOCIATE EDITOR

Phil Thornton

ON-SITE REPORTERS

Lucy Fitzgeorge-Parker

+44 (0) 7595 727 780

Virginia Furness

virginia.furness@globalcapital.com

+44 (0) 7532 413 765

Elliot Wilson

+44 (0) 7795 110 628

CONTRIBUTORS

Jon Hay

Ralph Sinclair

HEAD OF OPERATIONS

Sara Posnasky

PRODUCTION EDITOR

Vicki Robinson

SPECIAL PROJECTS EDITOR

Phil Moore

CEO ASIA

Tony Shale

tony.shale@euromoneyasia.com

+852 2912 8008

MANAGING DIRECTOR

John Orchard

DIRECTOR

Ruth Beddows

ruth.beddows@globalcapital.com

+44 20 7779 7386

PUBLISHER

James Andrews +44 20 7779 8074

james.andrews@globalcapital.com

ASIA PUBLISHER

Marcus Langston +852 2912 6948

marcus.langston@euromoneyasia.com

ASSOCIATE PUBLISHER

Melissa Roach +44 (0) 20 7779 8276

m.roach@globalcapital.com

LATIN AMERICA PUBLISHER

Soledad Contreras +44 (0) 7408 865 672

CENTRAL ASIA PUBLISHER,

Mine Hekimoglu +90 5324131686

PUBLISHER,

MIDDLE EAST & TURKEY:

Adil Jilla of MEIAC ajjilla@meiac-uk.com

ASSOC. PUB., MIDDLE EAST &

TURKEY **Kaersi Jilla of MEIAC**

kjilla@meiac-uk.com

(UK): +44 (0) 797 384 310 (Dubai):

+971 4 4548690

Shatha Tower, Office No. 1906, Media

City PO Box. 502118, Dubai, UAE

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Investor PLC

8 Bouverie Street, London, EC4Y 8AX

Telephone: +44 (0) 20 7779 8888

Directors: Directors: John Botts (non-executive

Chairman), Andrew Rashbass (CEO),

Sir Patrick Sergeant, The Viscount Rothermere,

Colin Jones (Finance Director), David Pritchard,

Andrew Ballingal, Tristan Hillgarth, Paul

Zwillenberg

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Litho Web Limited

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Nicosia, 260

Cyprus

+357 22872081

Economies sound alarm on Trump threat to EBRD trade

By Elliot Wilson

Economies across the EBRD region sounded a warning bell on Wednesday over the impact on regional growth from the threat of protectionist policies launched by US President Donald Trump.

In an interview with *GlobalMarkets*, EBRD chief economist Sergei Guriev said several countries were worried Trump would implement his campaign promises to protect American jobs and companies.

He said that while protectionist rhetoric had softened in recent months, "every country" across the EBRD region "benefits from free trade and globalisation.

"We don't see specific protectionist measures [emerging from the US] at the moment," he said, adding that nothing could be ruled out. "[Trump's] protectionist agenda scared a lot of the countries around the region, and it still does."

Donald Trump had indicated he is prepared to risk triggering a trade war whether by raising tariffs, or introducing border taxes that penalise imports relative to exports.

According to the White House's formal trade policy agenda, the administration wants to devise a new trade policy that "defends American sovereignty, enforces US trade laws, uses American leverage to open markets abroad and negotiates new trade agreements that are fairer and more effective both for the US".

One senior European banker at the

EBRD meetings who declined to be named said the economies most affected would be those that were more dependent on flows of capital continuing to flow into emerging markets.

"Turkey and Russia will be hit hard," he said. "If Trump cuts corporate tax rates and gives amnesty to capital flowing back to the US, that money will no longer be committed to emerging markets, which will lead to some funds flowing out of Russia, out of Turkey, out of central Asia, out of the Caucasus."

Elmir Hasanov, chairman of the board at Azerbaijan lender MuganBank, agreed his country would be hit in the short term but insisted it would benefit in the long run as US firms lost faith in their president.

"Short term effects are negative because Trump wants capital to flow back into the US. But in the longer term, people will realise that Trump's not going to do anything good for America, it will leave again. That will benefit us," he said.

WORRIED BY CHINA, TURKEY

Guriev cited other risks to EBRD growth. He warned that any nasty surprises in China, which faces a series of painful challenges ahead as it seeks to rebalance its economy, slash debt and deflate a vast property bubble, would hit the region hard. "If something happens to China, we will feel the pain," he said.



Donald Trump's trade position scares a lot of the region

Events in Turkey continue to vex analysts and global investors, Guriev said. Beset by currency and political volatility, low levels of producer and consumer confidence, Turkey's economy is set to shrink this year.

"The biggest threat to Turkey's economy is related to politics and security," Guriev said. "Other major challenges relate to [waning inward] capital flows and currency volatility and depreciation. What Turkey needs is equilibrium."

There are good signs: growth in central Europe and the Baltics will accelerate in 2017 to 3%, remaining static in 2018. Guriev also highlighted positive recent and pending monetary policy developments, most notably the recent decision by Egypt to allow its currency to float freely, and signs that Uzbekistan was planning a similar move.

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Chakrabarti hails Cyprus as blueprint for rescue model

By Elliot Wilson

Cyprus's remarkable revival from near-bankruptcy four years ago to a flourishing economy that has rid itself of the legacy of a once-toxic banking system, is a model for any nation that finds itself in financial and economic dire straits.

"The reason we are having this meeting here is to showcase a genuine success story," said EBRD president Suma Chakrabarti. "And it really is a success story — one of recovery and return to growth. There is still a lot to do, but we have had a good start."

The London-based development bank has invested €223m in six local projects since the country received recipient country status in May 2014. Capital was focused at first on the financial sector, the source of much of the woes during the 2012-2013 financial crisis, which stemmed from a banking system overleveraged to local property companies and contagion from the Greek sovereign debt crisis.

In its wake, the EBRD channelled capital into two local lenders, Hellenic Bank and Bank of Cyprus, making equity investments in both. In recent

years, it has widened its approach, seeking to aid small businesses, boost inclusion and grow the island's nascent renewables sector. This week, the bank unveiled a new, 1.5 megawatt solar power plant in Nisou, a market town south of Nicosia.

HIGH JOBLESS RATE

Looking ahead, EBRD officials said there was much cause to cheer, but also reason to guard against overconfidence. Libor Krkoska, head of the bank's Cyprus office, said the island's revival was due to a series of decisions, each carefully considered, planned, supervised, and followed to the letter.

"We focused on key issues, starting with recapitalising the banking system and putting in place a framework for dealing with non-performing loans [NPLs]," Krkoska said. "And we didn't lose faith, even during those difficult early years. Who would have thought that three years on from our arrival here, no one would remember capital controls, or the effort involved in listing Bank of Cyprus on the London Stock Exchange?"

Krkoska reserved special praise for Harris Georgiades, who has been finance



Solar power plant, Nisou

minister since 2013, and who was seen as crucial to steering Cyprus through the initial squalls, then setting it on an even keel.

Challenges remain. Unemployment is still north of 10%, with jobless rates particularly high among young people. Banks also face a long slog in dealing with a huge backlog of soured loans, with the NPL ratio standing at an eye-watering 45% at the end of 2016.

Then there is the issue of reunification, which seems to get closer every year without ever quite arriving. The EBRD will remain present on the island until the end of 2020. By then it is hoped that both sides can settle their differences and knock down the wall that divides Nicosia and the rest of the island. "Reunification is a must for the island," said Krkoska. "It would help the economy, and it would improve regional stability."

EBRD pushes western Balkan bloc but Kosovo warns of history repeating

By Lucy Fitzgeorge-Parker

A common market in the western Balkans could help unblock flows of much-needed foreign direct investment, the EBRD's regional director Holger Muent told *GlobalMarkets*.

However, the idea, which he said would "not only boost trade between countries but also encourage external investors to come into the region and use it as a base from which to service larger markets" has encountered profound scepticism from neighbours. Albania and Kosovo are expected to push back against what they are fearful of, attempts by Serbia, the region's largest economy, to dominate the project.

Although the initiative was announced at a regional summit with the theoretical backing of all six countries, Kosovan prime minister Isa Mustafa took to Facebook to express his scepticism about the project. "The common market is not in the same interest of all countries," he posted. "I don't expect Kosovo to be enthusiastic about the proposal. We don't want the past to return to us in different packaging."

Proposals for a unified market covering the six non-EU countries in the region — Serbia, Bosnia, Montenegro, Macedonia, Kosovo and Albania — were announced

in March by the bloc's commissioner for neighbourhood policy and enlargement negotiations, Johannes Hahn.

Combining the six countries would create a market with a population of 18.3m and GDP of \$88.1bn. "The individual countries are very small so it makes sense to look at the whole region as one market," said Muent.

NEXT STOP — EU

The six states are already members of the Central European Free Trade Agreement, another EU-sponsored project launched in 2006. The initiative has failed to produce the expected boost to intraregional trade and inward investment, however, prompting the EU to launch the new proposals.

Representatives of the EU have also indicated that the establishment of a common market could facilitate the eventual integration of the member countries into the larger bloc.

"What is important is that it is all framed in the context of EU approximation, so it is not a distraction from that process but part of the process," said Muent. "If these countries become members of the EU that would obviously mean that trade barriers need to



Muent: Balkan boost

be removed, and standards and regulation harmonised.

"There is still a long way to go to accession, particularly for those countries that have not yet achieved candidate status, but providing something along the way that is tangible and makes sense is a positive step."

Only Serbia, Macedonia, Albania and Montenegro have so far been granted official candidate country status by the EU.

Despite the benefits of integration, however, Muent warned that it would not be easy. "There would be a lot more to do in terms of harmonisation of standards, certification etc."

Slowing Semed drags on overall EBRD growth pick-up

By Virginia Furness

Political uncertainty in the South and East Mediterranean (Semed) region remains a drag on growth in the EBRD region, offsetting the expected return to positive growth for Russia, and accelerated growth in southeastern Europe and central Asia, the bank said on Wednesday.

At 2.4%, the projected average rate of growth for 2017 is higher than the 1.8% reported in 2016, but slightly weaker than projected. Growth is forecast to accelerate to 2.8% in 2018.

Growth in the Semed region slowed to 3.4% in 2016 and the EBRD has revised 2017 growth down slightly to 3.7%. However, the bank expects it to reach 4.1% by 2018 as agricultural output normalises after a year of poor rainfall, and Egypt returns to competitiveness.

While economic and political uncertainty persists, global market stability has remained the prevailing theme over the past six months. The election of Donald Trump as US president in November 2016 initially shocked global markets, but emerging markets quickly recovered.

The EBRD has not revised its growth outlook since the US election though it noted that, along with the UK's decision to leave the EU, economic policy uncertainty had increased. It also noted that

higher rates in the US had not had a detrimental impact on EM growth.

Russia has returned to growth for the first time since the introduction of US sanctions following its invasion of Crimea, though the EBRD will not unfreeze financing to the country at this stage.

The pick-up in Russia, combined with higher oil prices in 2017, is expected to support a slight increase in growth in central Asia, eastern Europe and the Caucasus (EEC), although Azerbaijan and Belarus are projected to remain in recession.

Growth in southeastern Europe averaged 2.9% in 2016, and is expected to strengthen to 3% in 2017 despite internal political problems, along with that in central Europe and the Baltic States, whose GDP is expected to grow at 3.1% in 2017.

TURKEY'S TWIN DEFICITS

The International Monetary Fund will say today (Thursday) that it is less optimistic and expects overall growth in central, eastern and southeastern Europe to reach 2.2% in 2017, although this is a jump from the 1.5% it reported in 2016.

The EBRD revised down its projection for Turkish growth to 2.6% in 2017 from 2.9% in 2016, and expects to lend less to the country than in the previous two years. Turkey remains the EBRD's largest market, with the bank investing



Chakrabarti: lending less to Turkey

€1.9bn in the last two years.

While EBRD president Suma Chakrabarti said the bank planned to maintain its commitments despite the increasingly autocratic regime, he expected it would lend around €1bn to Turkey this year.

"The political context has an impact on market sentiment and how our partners are looking at investment plans," he said. "The lending will not be as large as in previous years."

Security concerns and geopolitical risk have compounded concerns about Turkey's twin deficits, and capital outflows, weaker tourism receipts and a weaker investment climate have largely accounted for the drag on growth in the Semed region as a whole.

Calling EM banks: could a green bond help you?

By Jon Hay

National Bank of Abu Dhabi, China's Harbin Bank and Bank of Beijing, Davivienda in Colombia... these diverse banks all issued green bonds in April, according to the Climate Bonds Initiative, an NGO.

But while green bonds are spreading fast, emerging market banks still make up only a tiny share of issuance. That is likely to change — indeed, EM banks could end up being the group for which the product makes most sense.

"Banks remain the natural aggregator of green loans," said Jean-Marie Masse, chief investment officer of the financial institutions group at the International Finance Corp in Washington. "In eastern Europe, for example, debt capital markets are typically not developed enough that there is debt via a bond, usually it comes from a bank. The bank accumulates green loans and projects are not always very big, so they can be a natural issuer of green bonds."

Why should a bank bother? At the moment, there is no very clear answer, apart from looking good.

An innovative attempt to give banks a reason to bother is being made by the IFC and Amundi, the French asset manager. They are constructing a \$2bn fund to invest only in bank green bonds from emerging markets.

To bridge the gap between cautious Western investors and EM banks with speculative grade ratings, the fund will have two layers of credit enhancement: \$125m of junior capital from IFC and \$75m of mezzanine from other investors.

The plan addresses the main weakness of green bonds: that the green nature of a bond does not alter its credit quality, so it does not substantially change the quantity or price of funds available to the issuer.

For green bonds issued through the IFC-Amundi fund, credit quality will be improved, as far as the end investor is concerned, meaning the banks should be able to reach investors on much better terms than those normally open to them.

"The point is to create a market that doesn't exist today," said Frédéric Samama, deputy global head of institutional clients at Amundi in Paris. "We want to create the demand through the fund, so banks feel comfortable to issue.

When they know they can get attractive funding for green projects, that means they will finance more green projects."

As well as creating demand, the IFC will try to stimulate supply. It will use its extensive connections with EM banks to drum up deals, and help banks with the skills and money needed to structure a green bond programme.

Choosing banks as the medium is apt, the promoters believe, since they can pile up green loans big and small for diverse purposes suited to local conditions.

And there is another advantage: the IFC and Amundi will not need to do any new or complex credit analysis on the green bonds. From a credit point of view, they will be plain vanilla risk of the banks, whose shareholders will stand first in line for any loan losses.

EBRD cash for Tajik banks hangs on sector reform

By Lucy Fitzgeorge-Parker

The recapitalisation of Tajikistan's two largest banks will be ineffective unless the country's government follows through with a radical transformation of the sector, according to the EBRD's head of financial institutions.

Nick Tesseyman told *GlobalMarkets* that the EBRD wanted to see progress on restructuring before it would consider direct investment in Agroiinvestbank (AIB) and Tojik-sodirobank (TSB).

"There may be longer term opportunities to get more conventionally involved in those banks but that's for the future," he said. "We need to figure out how they are going to operate first. They need to become regular operating banks, they need to be stabilised, they need to have good management in place."

AIB and TSB suffered severe liquidity crises last year, leading both banks to impose freezes on deposit withdrawals. Customers of AIB were unable to withdraw cash for six months.

Development banks operating in Tajikistan, including the EBRD, were suggested as potential investors in TSB but no deal had materialised by the end of 2016.

"We were seeking a comprehensive long-term road map for the Tajik banking sector in concert with our fellow IFIs, including the IMF, but it was obviously difficult to reach agreement on many of these issues," said Tesseyman. "In the end the authorities took the decision that time was crucial and therefore used their own funds to recapitalise the two largest banks."

On December 21, the Tajik parliament approved a recapitalisation of the two lenders. TSB received a Ts2.25bn (\$264m) equity injection, while AIB received Ts1.7bn.

LOCAL BANKS

Problems at both banks have persisted, however, with limits on daily withdrawals remaining in place. Non-performing loans (NPLs) also remain high across the sector, particularly at public sector banks. "This reflects different approaches to governance and lending in the past," said Tesseyman.

He noted that the EBRD was well placed to help address this issue. "Local capacity for resolving, restructuring and working out NPLs is limited — as it is in many of the countries where the EBRD operates — so our role will be to support and facilitate that rather complex and difficult process," he said.

At present, the EBRD has only one equity investment in Tajikistan. The development bank holds a 21.1% stake in Eshkata Bank, a small private sector lender. Tesseyman said the EBRD had continued to work with other local banks.

"We are continuing to work carefully with a small number of banks and non-bank financial institutions that we have long-term relationships with, both to signal ongoing support and to provide actual ongoing lending support rather than investment," he said.

Markets nervous ahead of Ukraine CB governor appointment

By Lucy Fitzgeorge-Parker

Concerns are mounting this week over the identity of Ukraine's next central bank head as the outgoing governor, Valeria Gontareva, quits her post later today (Thursday, May 11).

The choice of her replacement is seen as central to the success of Ukraine's reform efforts. "The National Bank of Ukraine (NBU) has been a reform leader among government institutions and key to securing macro stability," said Tim Ash, an emerging markets strategist at Blue Bay Asset Management. "It is important that the institution doesn't go backwards."

A leading Western banker in Kiev agreed. "The central bank appointment is key because the job isn't finished yet," he said. "Gontareva did a lot but there's still much more that needs to be done."

Gontareva tendered her resignation on April 10 after three years in the post. Potential replacements include former deputy finance minister Igor Umansky, NBU council chairman Bohdan Danylyshyn, and Kostyantyn Vorushylin, the head of Ukraine's deposit guarantee fund.

The preferred candidate of the foreign investor and donor community is local banker Volodymyr Lavrenchuk. A Kiev native, Lavrenchuk has been chairman of the board of Raiffeisen

Bank Aval, Ukraine's largest foreign-owned bank, since 2005.

"Lavrenchuk is apolitical and technocratic, which is important for assuring the NBU's independence," said Ash. "I wouldn't want to see a political appointee or any of the names mentioned who either have served in the NBU in the past. It is crucial that the position of governor is not given away in some political patronage play."

OBSTACLES REMAIN

The change at the central bank comes at a critical time for Ukraine. More than three years after the Maidan revolution, the economy has returned to growth and significant progress has been made on structural reform but endemic corruption remains a major bar to urgently needed investment.

"The more Ukraine makes progress into reforms, the more apparent it becomes that the number one obstacle remains law enforcement, rule of law, and property rights — the things that enable investors to sleep at night," said Francis Malige, head of Eastern Europe and Caucasus at the EBRD.

Ash agreed, saying: "Corruption is still the number one issue for foreign and domestic investors — and there's



Lavrenchuk: in demand

not much evidence of improvement. "Institutions are being [improved] but people need to be brought to account. There have been a number of high profile arrests but almost no one has been convicted. It's not good enough."

The post of central bank governor is not the only one investors are watching. Malige said the choice of new heads of Ukraine's state fiscal service and state property fund would also be key.

"All three appointments can have a very significant impact on the shape of the Ukrainian economy going forward if the right person is chosen," he said. "These appointments will be a very good test of the commitment of the leadership of the country to move forward with reform."

Moldova banking sector clean-up on schedule, says governor

By Lucy Fitzgeorge-Parker

The clean-up of Moldova's troubled banking sector is on track and sales of stakes in the country's largest lenders could be completed before the end of the year, central bank governor Sergiu Cioclea told *Global Markets*.

"We are in discussions with potential investors and I am more confident today that sales of stakes in two or three banks can be achieved this year," said Cioclea.

On offer are 40% of Moldova Agroiindbank (MAIB) and 63% of Moldindconbank. The current holders of both stakes have had their voting rights suspended and been ordered to dispose of their shares by the National Bank of Moldova (NBM) based on evidence of working in concert.

Moldindconbank has also been taken under temporary administration by the central bank.

Several European Union-based banking groups are reported to be interested in Moldindconbank, while MAIB is expected to attract private equity interest.

The sales are part of a wider overhaul of Moldova's banking sector in the wake of a 2014 fraud that drained \$1bn — equivalent to more than 10% of the country's GDP — from the system.

The three banks at the centre of the

fraud — Banca de Economii, Unibank and Banca Sociala — were shuttered in 2016. Concerns around governance and non-transparent shareholdings also resulted in MAIB, Moldinconbank and Victoriabank being put under central bank supervision.

The fraud also cost Cioclea's predecessor, Dorin Dragutanu, his job. The former central bank governor resigned in September 2015 following popular protests against his handling of the crisis.

STOLEN ASSETS

Cioclea, a former BNP Paribas banker, took office in April 2016 with a mandate to clean up the banking sector. One of his first achievements was to put together a reform plan for the IMF, which convinced the Fund to approve a \$179m support package for Moldova in November.

The last condition for unlocking the second tranche of IMF funding, the establishment of a central securities depository, was approved by Moldova's parliament in April.

Meanwhile, Moldovan authorities are also moving ahead with attempts to recover some of the \$1bn stolen in 2014. In April, the NBM published the results of a fourth report by US investigators Kroll into the fraud.



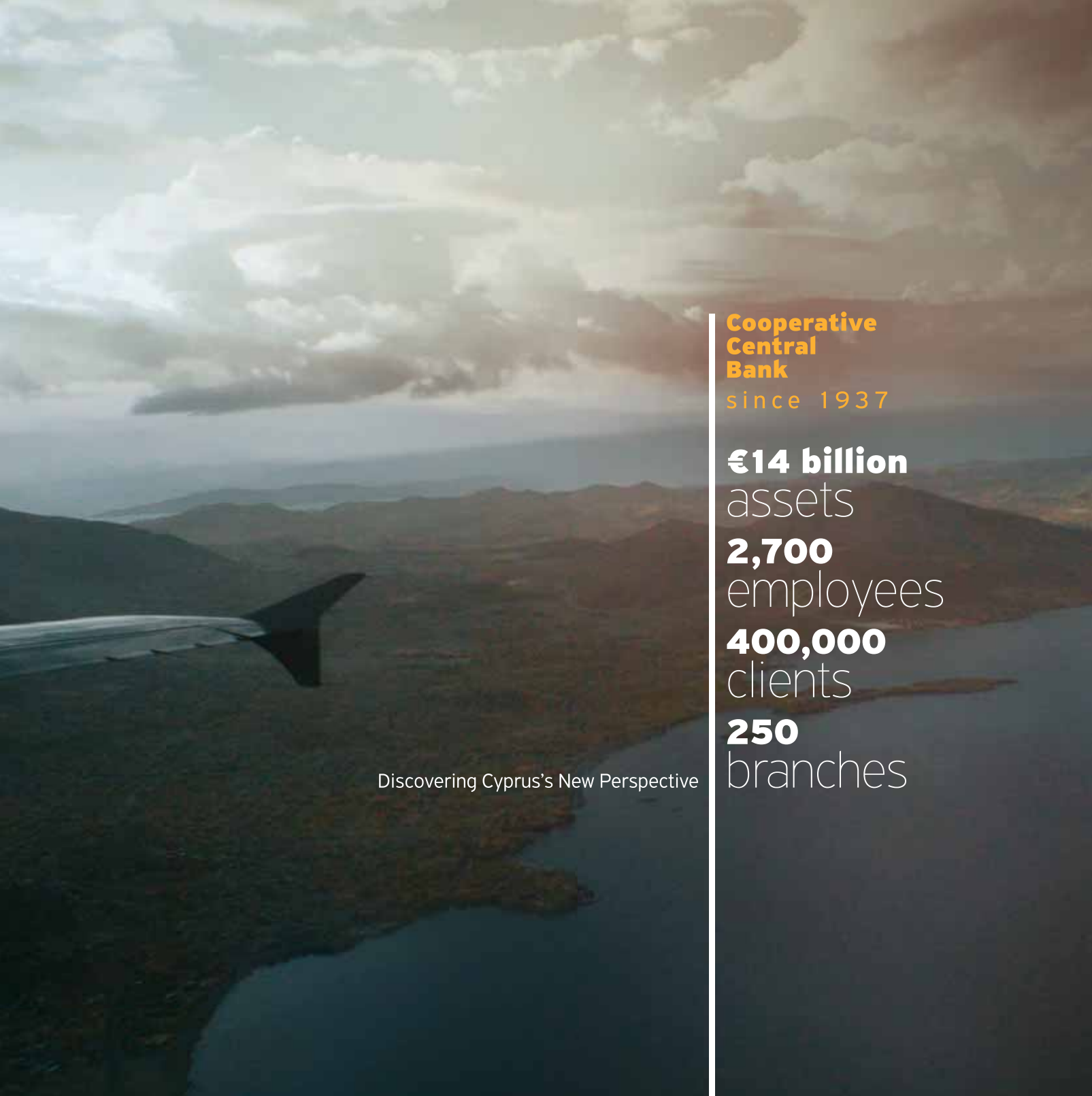
Cioclea: in discussion with investors

A young Moldovan businessman, Ilan Shor, has been named as the main instigator of the scheme. Funds from the theft have been traced to multiple jurisdictions, including Cyprus (\$63m), China and Hong Kong (\$61m) and Switzerland (\$23m).

Around \$200m also passed through two banks in Latvia, which has also undertaken a major clean up of its banking sector over the past two years to address recurring issues with money-laundering.

The NBM has this year signed a memorandum of understanding with the Central Bank of Cyprus to pursue funds located in the jurisdiction. No concrete results have been reported as yet, however.

"The social demand to recover stolen funds and punish those guilty continues to be huge," said Cioclea. "Authorities will decide about legal actions soon."



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Rebalancing act: Cyprus aims



Knowledge-based franchises such as accountancy, law and financial services are all sectors that are helping Cyprus to rebalance its economy towards high value-added drivers of growth

By Philip Moore

It is easy to see why Cyprus is sometimes wrongly perceived as a mono-economy dependent on sun, sea and sand. After all, according to the World Travel & Tourism Council (WTTC), tourism's total contribution to the economy will rise from 19.3% in 2015 to 22.9% by 2026. In 2015, according to the same source, the industry accounted for 20.1% of total employment; this, too, will climb to 22.9% in 2026.

The government recognises that it would be hazardous to rely on tourism for several reasons. The first is that although the island's tourism industry has clearly been a beneficiary of the regional geopolitical climate in recent years, Cyprus potentially remains exposed to external events well beyond its control. A reminder of this came last June when the shock outcome to the UK's EU referendum and subsequent fall in sterling prompted concerns that the industry would be impacted by reduced demand from British tourists.

Perhaps surprisingly, demand from the UK has remained strong, contributing alongside a surge in Russian visitors to a 26% rise in arrivals in the first two months of this year. Nevertheless, given that the UK accounted for 37% of all arrivals in 2016, Brexit is an uncomfortable reminder of the potential vulnerability of the industry to events over which Cyprus has no control.

The second is that capacity constraints, twinned with the seasonality of the tourism industry, mean that its expansion potential is not inexhaustible. "Tourism will continue to grow, but the rate of growth will inevitably slow down unless we can find new markets and extend the tourism season," says Ioannis

Tirkides, head of economic research at Bank of Cyprus.

Third and most important, to over-emphasise the role of tourism in the Cyprus economy is to belittle the contribution played by other sectors. After all, as Tirkides says, although it has an indirect impact on virtually every sub-sector of the economy, the tourism sector itself — defined as accommodation and food — accounts for only about 7% of total gross value-added (GVA).

That, according to Tirkides, means that tourism is smaller than professional services, the importance of which should not be overlooked. He points to accountancy as one example of a flourishing area of the professional services sector, which accounts for about 8% of GVA. "Increasingly, we are seeing the Cypriot offices of major international firms providing accounting services to companies overseas," he says.

Knowledge-based franchises such as accountancy, law and financial services, Tirkides adds, are all good examples of sectors that are helping Cyprus to rebalance its economy towards high value-added drivers of growth. "Between the early 1980s and the eve of the crisis, the three pillars of growth were tourism, trade and construction, all of which are labour-intensive, low value-added sectors," he says. "The challenge is to change this model and move towards areas of enhanced productivity and value-added."

GROWING AGRICULTURE

One area where improved productivity is urgently needed is the agricultural sector, which still accounts for no more than about 2% of GDP. "Agriculture is the most unproductive sector of the Cypriot economy, because farmers' plots are fragmented into small holdings which keeps the profit margins on their production very low," says Tirkides. "We're starting to see farmers looking at ways of pooling and mechanising their production, which would help them to increase their margins and lift their output. Given that about 15% of Cyprus's imports are food, it would also help to replace some imports."

The recovery in the Cypriot economy over the last 12-24 months has by no means been

restricted to tourism and professional services. "We're seeing increased activity in real estate and property development, which is a sector that was dead and buried a couple of years ago," says Nicholas Hadjiyiannis, CEO of the Cooperative Central Bank (CCB). "We're now seeing companies investing in refurbishment and expansion of their facilities."

Others agree. "Even in construction, which was the sector that was most severely hit by the recession, there has been encouraging evidence of a recovery," says Andreas Charalambous, director of financial stability at the finance ministry in Nicosia. The numbers speak for themselves. According to research published by Bank of Cyprus, local sales of cement rose by 25.5% in 2016, compared with a rise of just 2.4% in 2015, while the volume of building permits rose by 18.8% last year, up from 12.3% in 2015. Cement sales continued to grow in early 2017, rising by almost 25% in the three months to February.

"Aside from contributing to economic growth and job creation, this is important because it will help to preserve and enhance the value of banks' collateral and help them to take more real estate assets off their balance sheets," says Charalambous (*see box*).

This should help banks to support growth in a range of sectors, in turn promoting increased economic diversity. So too should the expansion in the banks' deposit base, which have been recovering steadily since their dramatic decline during the crisis.

For now, however, as Bank of Cyprus comments in its most recent update, net deleveraging continues to be the dominant feature within the industry. Total loans outstanding fell by 12% in 2016, with lending to financial companies plummeting by almost 50%. Loans to non-financial corporate borrowers fell by a much lower 8.7%, while declines in personal and household lending were in the low single digits.

"Deleveraging is continuing," says Hadjiyiannis at CCB. "But the banks are becoming more active in trying to limit the effects of deleveraging and finding new areas of business to deploy the significant level of liquidity in the system."

Some local bankers argue that rebuilding

Value added, knowledge-based

Diversifying with energy, environment and water research; computation-based Science and Technology; science and technology in archaeology

higher with economic diversity



loan books will be a challenge, given a shortage of lending opportunities in the domestic market. This is an argument that is given short shrift by John Hourican, who has overseen the turnaround at Bank of Cyprus since his appointment in 2013. "Some of the banks have been unable to deploy surplus liquidity," he says. "I think there are plenty of lending opportunities in the domestic market, but these have to be priced appropriately."

SORTING THE CYPRUS PROBLEM

New lending opportunities would arise if a solution is found to the so-called Cyprus problem that has divided the island since 1974. "Normalising our economic relations with Turkey would be a game-changer both for the country and for the banking industry," says Irena Georgiadou, chairwoman at Hellenic Bank in Nicosia.

Few industries would be more positively impacted by a speedy resolution to the Cyprus problem than the shipping sector, which accounts for about 7% of the island's GDP and employs 4,500 people ashore. "Shipping would be the first beneficiary of a settlement, because since 1987 Turkey has imposed a unilateral restriction on Cypriot flagships calling at Turkish ports," says Thomas Kazakos, director general of the Cyprus Shipping Chamber. "Should there be a settlement, this ban would be lifted

immediately, which would lead to a substantial growth in our fleet and a noticeable expansion in the use of Cypriot ports."

The numbers are eye-catching. Kazakos says that a fleet of about 2,500 ocean-going vessels with 56m gross tonnes is under Cypriot control today. Of these, 1,000 sail under the Cypriot flag, making it the 11th largest fleet in the world. "If all our non-Cyprus flag carrying vessels were put under the Cyprus flag, this would become the world's fourth largest fleet overnight," says Kazakos.

Even in the absence of a reunification agreement, Kazakos says there are plenty of reasons why the prospects for the Cypriot shipping sector remain compelling. One of these is the interlinkage between shipping and the energy sector. "We always say that shipping is the first cousin of the energy sector because it is such an important provider of maritime services to the offshore industry," says Kazakos. "On top of that, if substantial natural gas reserves are discovered in the eastern Mediterranean, the Cypriot shipping sector will play an important role in transportation, because you can't build a pipeline from here to Taiwan."

Another of the shipping industry's trump cards is a highly attractive tonnage tax (TT) regime which has been approved by the EU and applies to ship owners, charterers and

managers. "Whereas other EU countries tend to specialise in one of these areas, we offer all three, which makes Cyprus very attractive to ship-owning, chartering and ship management companies," says Kazakos. **GA**

NPL reduction: the carrot and the stick

Over the last two years, there have been three key drivers of the reduction of non-performing loans (NPLs) in the Cypriot banking system.

The most obvious and important of these has been the economic recovery. But Nick Smith, director of the restructuring and recoveries division at Bank of Cyprus in Nicosia, points to at least two other reasons explaining why Bank of Cyprus was able to reduce its NPE (non-performing exposure) portfolio by €3bn in 2016. NPEs are a tougher nut to crack than NPLs, because an impaired exposure needs to have performed for at least 12 months post-restructuring before it can be reclassified as a performing loan.

The first driver of the NPE reduction at Bank of Cyprus was the energy it channelled into negotiating accelerated consensual foreclosures via debt-for-asset swaps. "2016 was game-changing because we proved that we could deal with heavy delinquencies via recoveries, which reached about €900m," Smith says. "We were able to do this because we have a recoveries book that is covered in terms of collateral value and provisions by roughly 65% and 60% respectively, resulting in total coverage in excess of 120%. This means we can cut debt-to-asset swaps at realistic values, which incentivises borrowers to say yes rather than no."

STRONG LAW

If this represents the carrot in Bank of Cyprus's discussions with delinquent borrowers, a second driver of reduced NPEs is the stick of a law with teeth. "The new law gives us recourse to a real, live non-consensual foreclosure process," says Smith. "This is a critical piece of the jigsaw because since last June it has allowed us to accelerate the pace of non-consensual auctions."

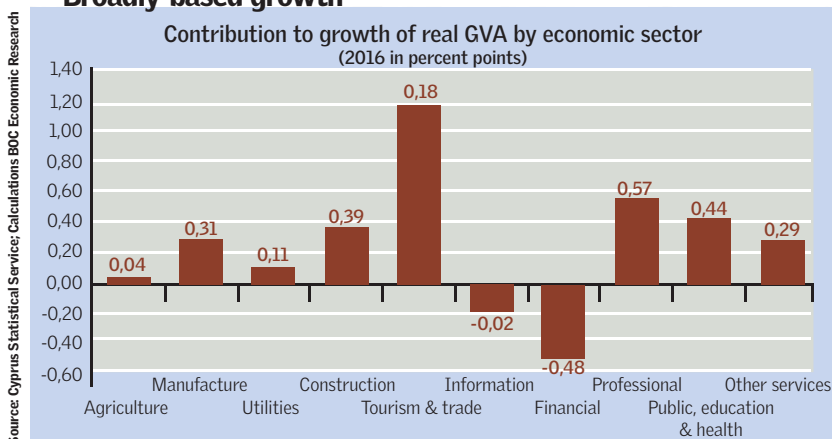
There is another key requirement for addressing the NPE problem in the Cypriot banking system, which Smith says will become an increasingly important feature of Bank of Cyprus's strategy this year. This is finding willing buyers for unwanted assets that have found their way on to the banks' balance sheets.

"Asset sales are very important because foreclosures, be they consensual or non-consensual, often deliver physical assets on to the bank's balance sheet," Smith explains. "But it doesn't deliver cash. And it is only when we deliver cash that we get full resolution to the original NPE problem."

Successful asset sales, says Smith, have been gathering encouraging momentum since the second half of 2016, driven by a healthy mix of international and local buyers. "Demand for tourism-related coastal properties has been especially strong, allowing us to off-board assets at good prices," he says.—P.M.

Broadly-based growth

Contribution to growth of real GVA by economic sector (2016 in percent points)



Note: The chart is constructed on the basis of quarterly data of gross value added by sector or groupings of sectors. Growth in real gross value added differs from growth in real GDP by the amounts of indirect taxes and import duties.

COOPERATIVE CENTRAL BANK

COOPERATIVE
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Preparing for a stock exchange listing

The Co-operative Central Bank (CCB) of Cyprus was originally founded in 1937 as the central governing body of Cyprus's 18 affiliated Co-operative Credit Institutions (CCIs), giving the bank unrivalled access to retail customers on the island.

Following its recapitalisation in March 2014, CCB has been undergoing an extensive restructuring programme. An important landmark in this restructuring process was passed at the end of 2016, with the approval of the CCB's merger with the 18 co-operative lenders it administers, paving the way for a stock exchange listing later this year. CCB is now the second largest bank in Cyprus.

In this interview, CCB's Chief Executive Officer (CEO), Nicholas Hadjiyiannis, provides an update on the bank's restructuring programme and some insights into its plans for 2017 and beyond.

GlobalMarkets: How is CCB's restructuring programme progressing?

Hadjiyiannis, CCB: We have almost completed our restructuring plan ahead of schedule. Originally, the plan envisaged CCB being privatised between the end of 2018 and 2020, with the government selling up to 75% of its stake.

We will now be able to bring this forward, because we have accelerated a radical transformation plan culminating in the radical decision which we took in December to merge the bank's 18 subsidiaries into a single entity, opening the way for a stock exchange listing in 2017.

GlobalMarkets: To what extent has this transformation plan been driven by an improvement in CCB's key performance indicators?

Hadjiyiannis, CCB: When we were recapitalised in 2014, the idea that we would be ready in many aspects for a stock exchange listing by early 2017 would have been beyond any realistic expectations.

Since then, we have met key goals in our capital plan and we are making good progress in terms of other key financial indicators.

Over the last year, we managed to accrue additional capital of between 2% and 2.5% through increased operational efficiencies, risk-weighted asset (RWA) optimisation and improved balance sheet management. Our capital ratio is now around 16%.

In terms of liquidity, we have been flooded with deposits over the last two years, which reflects our pedigree as the preferred bank for local individuals to entrust their savings. This has pushed our liquidity ratio up to just over 30%.

GlobalMarkets: A notable feature of Cyprus's economic recovery has been the decisive way in which the banking industry has tackled the challenge of non-performing loans (NPLs). Has CCB



“ WE PROVIDED €1BN IN NEW CREDIT TO THE CYPRUS ECONOMY LAST YEAR DESPITE THE FACT THAT THE ECONOMY HAS BEEN DELEVERAGING, AND WE PROVIDED THE CONFIDENCE FOR PEOPLE TO INVEST BEYOND CONSUMPTION INTO WEALTH-CREATING INVESTMENTS, —JOHN HOURICAN, CEO BANK OF CYPRUS

also seen an improvement in its asset quality?

Hadjiyiannis, CCB: Yes. We began to deal with our NPLs much later than the other banks, because we had a highly fragmented legal and operational structure and we lacked the necessary expertise to start the restructuring process. As our loan portfolio is concentrated among retail borrowers with an average size of about €200,000, the process is very time-consuming, so we needed to establish a new NPL framework within the bank adopting international best practices.

In 2015 and 2016, we implemented restructurings of €2.3bn, or about 1000 accounts per month, with a cure ratio of more than 75%. This has kept our NPL ratio at around 60%. But the stock was reduced by 6% in 2016. We have also created a big gap of about €1.4bn, or 12%, between loans categorised as NPLs and 90 days past due. We now have a provision coverage ratio of NPLs of close to 45% and a collateral coverage value of more than 70%, so we are encouraged by the progress we have made on the asset impairment front.

GlobalMarkets: Has preparation for a stock exchange listing also involved cost-cutting?

Hadjiyiannis, CCB: Yes. In 2014 we introduced a significant cost-cutting initiative, including a voluntary redundancy scheme, which reduced total costs by about 30%. Following a similar scheme in the autumn of 2016, we are now operating with about 10% fewer staff than at the end of 2013.

At the same time, however, we have a significantly increased workload in new areas such as NPL management. So as well as reducing our headcount, we have been continuously retraining our existing staff to ensure that they can deal with the requirements of the ECB's Single Supervisory Mechanism (SSM).

GlobalMarkets: CCB's origins and philosophy are similar to Rabobank's. But will a stock exchange listing change your business model? Will there be any conflict between maintaining the social role that has traditionally been played by CCB, and delivering the returns on equity demanded by external investors?

Hadjiyiannis, CCB: CCB is similar to Rabobank in the sense that both are very close to their local communities. But the key difference between the banks is that while Rabo's shareholders are still its members, 99% of CCB is now owned by the government.

We believe that through a phased stock exchange listing we can retain our links to our community by building a large and diverse local shareholder base. At the same time, we are confident that a stock exchange listing will bring more transparency and flexibility to our organisation, making us more competitive in today's market.

We have always aimed to be a profitable bank. But the difference between CCB and some European banking models is that our focus is on delivering sustainable, long-term profits. One way of looking at it is that we aim to operate like a utility, but in the banking sector.

GlobalMarkets: Will CCB also be aiming to support the local community by increasing its lending to SMEs in Cyprus?

Hadjiyiannis, CCB: Historically, we have done very little outside the retail and household sectors, which form the basis of our heritage, because in order to lend to borrowers other than physical persons we needed special permission from the regulator. However, we are now increasing our presence in the SME sector which is an important part of the economy, and to all other categories of banking products and services suitable for a retail bank of our size.

BANK OF CYPRUS

Bank of Cyprus



Shrinking to strengthen

Bank of Cyprus is comfortably the largest lender in Cyprus, with market shares of 39.7% in loans and 30.8% in deposits as of January 2017. It is also the only Cypriot bank listed on the London Stock Exchange (LSE), making it a natural proxy for the economy.

In this interview, Bank of Cyprus's CEO, John Hourican, shares his views with *GlobalMarkets* on the recent performance of the bank and on the outlook for the Cypriot financial services industry and economy.

GlobalMarkets: What have been the key features of the Bank of Cyprus recovery story since your appointment as CEO in 2013?

Hourican, Bank of Cyprus: We have stabilised a difficult situation, normalised the liability stack of the balance sheet and recapitalised the bank. We have also contributed to the continued recovery of the country through the repayment in its entirety of Emergency Liquidity Assistance (ELA), the raising of deposits and the lifting of all capital controls.

Operations in countries such as Russia, the Ukraine and Serbia have been retrenched in line with our mantra of "shrink to strength" and our business model is now based on building an increasingly strong bank in Cyprus and a small but promising operation in the UK.

We provided €1bn in new credit to the Cyprus economy last year despite the fact that the economy has been deleveraging, and we provided the confidence for people to invest beyond consumption into wealth-creating investments, which we see as our job. If the bank is weak the country generally feels weak, and as the bank becomes stronger, it begins to reflect the sentiment across the country.

GlobalMarkets: Does the bank's new lending in 2016 mean that the phase of deleveraging is decelerating and being replaced with a more expansionary lending strategy by the banking system?

Hourican, Bank of Cyprus: That is our objective, as long as we can find acceptable and creditworthy borrowers in the context of an economy that is still deleveraging.

We expect to double our volume of lending this year, although at the same time we expect our balance sheet to marginally contract and then to start growing again next year.

GlobalMarkets: Which sectors are you targeting as the most promising for new lending?

Hourican, Bank of Cyprus: The mainstay of the

Cyprus economy is tourism. But we are seeing opportunities across the board, especially in areas such as education and health, and some of the pharmaceuticals companies are also doing very well. Services are also growing,



“ WE PROVIDED €1BN IN NEW CREDIT TO THE CYPRUS ECONOMY LAST YEAR DESPITE THE FACT THAT THE ECONOMY HAS BEEN DELEVERAGING, AND WE PROVIDED THE CONFIDENCE FOR PEOPLE TO INVEST BEYOND CONSUMPTION INTO WEALTH-CREATING INVESTMENTS, —JOHN HOURICAN, CEO BANK OF CYPRUS

although that sector tends to be self-funded with less capital investment.

GlobalMarkets: Non-performing exposures (NPEs) are still seen as the main challenge faced by the banking industry in Cyprus. What progress has the bank made in reducing its NPE ratio?

Hourican, Bank of Cyprus: The deployment of our restructuring strategy has resulted in a reduction in our NPE ratio over the last seven consecutive quarters.

This has manifested itself in a reduction in NPEs equivalent to 22% of GDP since the peak, which is a pleasing result. If you compare our progress to banks elsewhere in Europe, the next best-performing bank is Unicredit, which removed about 2% in the same period. So we've made good progress, but there is no room for complacency.

GlobalMarkets: Following Bank of Cyprus's successful €250m tier 2 issue in January, are you comfortable with the bank's capital position?

Hourican, Bank of Cyprus: Yes. We're very

comfortable with a total capital ratio just shy of 16%. We are alert to the fact that we are generating capital modestly on an organic basis through deleveraging, which is positive. We're also conscious that we will need to reduce our risk-weighted intensity to cope with new challenges such as MREL. But we are confident that the liability stack of the balance sheet from equity through to sub-debt and deposits compares very well with any European average.

GlobalMarkets: The bank's investor presentation describes its profits of €64m in 2016 as "modest". Will the London listing exert more pressure on the bank to deliver higher profits?

Hourican, Bank of Cyprus: My main focus is on ensuring the bank's balance sheet is in good shape, that our liabilities are organised in an appropriate stack and that our asset quality is strong. We still have to finish the job on asset quality. When that has been achieved, the bank will have sufficient profitability to support a rating in excess of book value.

The pressures on us are the same as those faced by banks all over the world. We run the bank to make it profitable. We operate in a sub-investment grade economy which is capable of generating a positive net interest margin. Our job is to retain as much of that as possible to deliver returns to our shareholders. But we don't expect that to come through until the asset quality is fully under control.

GlobalMarkets: How do you view the outlook for the economy, and more particularly the potential impact of wild cards such as reunification and the discovery of substantial reserves of gas in the Eastern Mediterranean?

Hourican, Bank of Cyprus: Both offer significant upside potential for the economic prosperity of the island. The division of Cyprus has been an intractable problem for 40 years and it looks as though we are closer to a solution than we have ever been, but I don't think we should be counting any chickens just yet. The two sides will need to work through the political and security aspects of reunification before addressing the economic implications.

On the question of energy, the level of investment from top multinational companies including ExxonMobil, Total, Eni and others suggests that there is real potential in the Eastern Mediterranean. I think we'll see some early investment in the infrastructure required to harness the potential of gas reserves in Cypriot waters in 2018 and 2019.



Investors still guessing after tight Turkey referendum

Turkey's story is an unstable one. Though the referendum was supposed to signal clearly its direction of travel, it is too early to tell what Turkey's identity will be — whether open to business and a secular progressive society, or one which turns its back on Europe, on open society and on making the big changes Turkey needs to realise its full growth potential

By Virginia Furness

Turkey's referendum was meant to be a milestone vote that would carve out the country's future either as a traditional republic or something more autocratic and inward looking.

But the vote was remarkably close, with only 51.4% voting to increase President Recep Tayyip Erdogan's executive powers. Investors are no surer about the direction Turkey, and its economy, will take.

The referendum on April 18 was billed as a defining moment, a stimulus for change that would see Erdogan either sharply improve Turkey's fortunes or play a despotic hand that exacerbated its many structural problems.

Turkey faces a myriad of challenges ranging beyond a new direction in politics and religious and constitutional affairs. Twin deficits, a heavy reliance on foreign borrowing and unorthodox monetary policy are all dragging on growth. Tourism, one of the biggest contributors to GDP, has all but collapsed.

There are two prevailing schools of thought when assessing Turkey in the aftermath of the referendum, says Carmen Altenkirch, emerging market sovereign analyst at Axa Investment Managers in London. The first is that Erdogan, having achieved his ambition of establishing an executive

presidency, will get on with the business of reform. The second is less optimistic.

There is good precedence to argue that the former will be the case, says Roger Kelly, the EBRD's lead economist for Turkey. Kelly takes the view that the government can focus on the economy. He recognises that his view may be a leap of faith but says that the Justice and Development Party (AKP) has in the past proven its commitment to spurring growth.

BLESSING IN DISGUISE

Other economists agree that reforms are needed to modernise the economy, tackle high youth unemployment, increase female participation rates and increase the savings rate so that Turkey can become less reliant on foreign investors.

"The AKP is very conscious of the fact that it has been successful in the past because of its ability to produce growth," Kelly says. "The government recognises that it needs to undertake structural reforms to achieve lasting growth before the next election cycle and we hope it will do so."

"It's easy to take a cynical view of the economy but there are opportunities," he says. "It would be unwise to turn back on the successes of the last 16 years. I can't see the incentives to upset investors."

While Erdogan's narrow victory is evidence of an increasingly polarised Turkish society, the slim majority could be a blessing in disguise for the economy.

Greg Saichin, chief investment officer of Allianz Global Investors, believes Erdogan will focus on improving the economy to shore up support ahead of the 2019 election.

"Yes, there are some ideological hang-ups on interest rates and a lack of understanding of how global and money markets work, but the bottom line is that he has to improve the macro outlook to be successful in the next election. If he doesn't do well, the opposition may seize the opportunity to not only challenge the referendum but also his leadership."

Indeed, Erdogan's strength as a leader has translated favourably into a strong support for Turkish assets, particularly in the face of rising geopolitical risks.

"Of course people are concerned," says Jan Dehn, head of research at emerging markets specialist Ashmore in London. "But the one thing they like less than a powerful leader is a weak government and political instability."

Dehn points to the relief rally in Turkish assets every time Erdogan wins an election as evidence of this. "It's a case of better the enemy you know," he says.

BRIGHT SPOTS

There is plenty that appeals to investors. Turkey's favourable public debt dynamics (29% debt to GDP ratio) and well-capitalised banks have helped the sovereign to weather shocks, both internal and external.

Investors have held firm in their belief in Turkey's strong growth prospects, favourable demographics and strong, independent institutions, particularly the banks. In the last 12 months investors have stuck by it through

“*Turkey sits on a ticking time bomb in terms of stability of its primary source of growth*”

—Jan Dehn, Ashmore

a roller coaster of terrorist attacks, an attempted coup and ensuing purge.

In addition, the sovereign has maintained its ability to fund and has a proven track record of debt repayments. As such it had already raised \$4.5bn in the capital markets by the end of April 2017. Bank debt has also proved popular, with financial institutions placing some \$2.65bn worth of Eurobonds over the same time frame.

EM bankers have no doubt that favourable market conditions, specifically accommodative monetary policies worldwide, have worked in Turkey's favour. Low global returns have fuelled a hunt for yield that has helped stabilise Turkish spreads.

STRUCTURAL PROBLEMS

But there is much to be concerned about, and the second camp has a much more negative outlook. Many portfolio managers and market commentators believe that over the medium to short term, Erdogan's executive presidency will serve only to exacerbate long term structural problems and that it is the continuation of a trend that has been in existence for some time.

The question investors should be asking about Turkey, says Tim Ash, emerging markets strategist at BlueBay Asset Management, is why growth is not better.

The EBRD expects GDP growth to be 2.6% in 2017, and while country head Paul Kelly takes a positive view on Turkey's economic outlook, he says that potential growth is 4.5%.

"Everyone is always amazed how durable Turkey is, how despite everything including two parliamentary elections, a coup and all the news flow around Syria, growth is 2.9%," says BlueBay's Ash. "But they're looking at it the wrong way. Considering public finances and demographics, the question is, why isn't growth better, particularly given that global financing conditions are so favourable."

One of the reasons for lower growth is that the government has not implemented the necessary reforms to increase savings as well as other measures needed to encourage foreign investment.

While Nomura's EM economist Inan Demir says he can understand why people expect structural reforms, he does not expect this to be the case. "The indicators we have seen so far suggest that we will see a greater role from the new sovereign wealth fund on fiscal policy and lower rates/credit support measures on monetary policy, which doesn't quite fit the reform agenda that the markets expect," he says.

Turkey's newly created sovereign wealth fund has a murky mandate. The government transferred the control of two state owned banks — Ziraat Bank and Halkbank — to it as well as Turkish Airlines, oil company TPAO and Turk Telecom among others, and plans to use the fund to finance large infrastructure projects. But investors believe that the fund will reduce transparency, which will

not help Turkey attract the funding it needs.

Investors are expecting a calming down of political tensions but Erdogan's victory speech did not show this, Demir points out. The president's confrontational attitude is evidence that he will take full advantage of weakened checks and balances that once constrained policy making, particularly economic policy making, he says.

"On a structural level, there are serious questions raised by international observers about the referendum results, and the accusations of the contraction of the rule of law is an important consideration for anyone long term investing in Turkey. FDI has begun to slow down substantially."

Axa's Altenkirch agrees that undermining institutions and reducing checks and balances seldom has a good long term outcome. "The risk over the medium term is that Turkey returns to its old boom and bust cycle," she says. "Loose monetary and fiscal policy aimed at boosting growth and supporting the regime adds to external imbalances. This would leave Turkey extremely vulnerable in the event that markets turned sour towards EMs."

BANK INDEPENDENCE

Once a key driver for investment, the independence of Turkey's institutions has already begun to erode, and with Erdogan's increasing ability to drive policy making, his influence over the Central Bank of Turkey is expected to increase. This is bad news for an economy that is reliant on benign external funding conditions.

Commentators already believe Erdogan is to blame for the CBT's refusal to raise interest rates and to adopt a more orthodox monetary policy to help ease the burden on Turkey's current account deficit.

Turkey is the only one of the five countries — Indonesia, South Africa, Brazil, Turkey and India — dubbed by Morgan Stanley as the "fragile five" on account of being most at risk once tapering begins, to have failed to correct its current account deficit.

"Turkey's economic strategy is not appropriate to the characteristics Turkey has," says Ashmore's Dehn. "Turkey has a low savings rate so it can't finance a high investment, high growth economy domestically. The president is trying to force investment by putting pressure on the central bank to lower interest rates."

Oliver Weeks, CEEMEA economist at Emso Asset Management, an EM-focused fixed income manager with \$3.3bn of assets under management, agrees that an end to European quantitative easing and a big FX move could have material consequences for the economy.

"At the moment, export numbers are strong just thanks to global demand, and banks are having no trouble rolling over short term debt from European banks given where we are in the central bank policy cycle.

"But the banks have lent to companies

that won't be able to pay them back when there is a big FX move and there will be a point when they [the banks] can't just roll over their debt."

Dehn acknowledges that the government's loose fiscal policy is fine when there is a steady flow of foreign investment, which in the benign global environment continues.

"As soon as something bad happens, this money will turn away leading to a duration mismatch. This means that Turkey sits on a ticking time bomb in terms of stability of its primary source of growth."

INTEREST RATE RISK

The weak lira is expected to help reduce the current account deficit as are low oil prices, but Erdogan is not expected to allow the central bank to raise rates or to check government spending.

"A lot of people had thought they would unwind some of the pre-referendum fiscal tightening over the next few months and that that would give them the chance to ease on the monetary policy side but that is not the message they are giving," says Weeks.

Weeks says he is surprised by the government's stance as it is not an obvious one "given where we are in the electoral cycle".

In short, the balance of Turkey's economy remains extremely vulnerable to changes in the global interest rate environment. A tightening of European monetary policy could be devastating.

Ultimately, investors are aware of the risks, and as Allianz IG's Saichin points out, have been "ever since Erdogan moved the axis of Turkey away from the EU". But Saichin believes the next two to three years are key to what sort of country Turkey will become.

And in the meantime, however, with global valuations so low, concern about Turkey's fundamentals is not enough to stop investment. "Most EM investors share the concerns I have but that doesn't preclude them from trading it aggressively," says Ashmore's Dehn. "We have a smaller position than we would have [were it not for the political noise] but we are very value orientated, which doesn't mean we can't trade it from the long side." **GM**



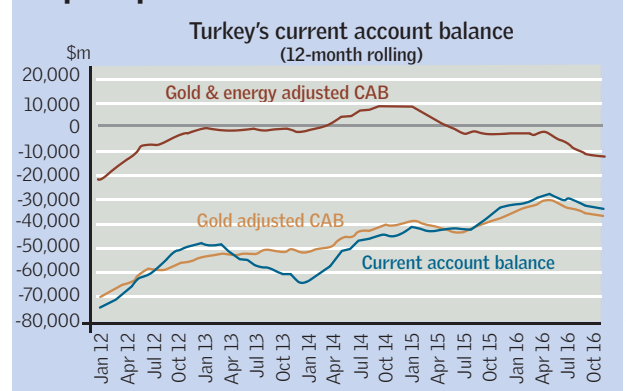
"I can't see the incentives to upset investors"

—Roger Kelly, EBRD, Turkey

"The risk over the medium term is that Turkey returns to its old boom and bust cycle"

—Carmen Altenkirch, Axa

Upside pressure





Halkbank General Manager
Ali Fuat Taşkesenlioğlu

Halkbank a leader in SME banking in Turkey

Net income was up 10.5% in 2016, with equity profitability reaching 12.6%. Which factors played defining roles in this strong performance? Was Halkbank able to report similar figures at the start of 2017?

At Halkbank, we believe that cost control and efficiency are at the root of sustainable banking. The fact that we can implement measures which increase the returns on equity plays an important role in the uninterrupted increase in our Bank's financial performance. For us, the efficiency of our investments, resources and customers are crucial elements when it comes to profitability. In 2017, we will continue to work with the same principles, and through working on lowering our operational costs and diversifying our non-deposit resources, we will continue to increase equity profitability.

Asset quality was maintained in 2016 with a non-performing loan (NPL) rate of 3.2%. What is the picture when we compare this value with those of other Turkish banks? In a time where macroeconomic indicators are getting worse and political risk is on the rise, how can Halkbank maintain the quality of its credit?

Experience plays an important role in financial stability in banking. As a bank which has been operating for 79 years, we have become one with our customers; we have always been by their side on their journeys of growth and development. This means we can maintain a balanced portfolio and be more controlled in our risk management. Our NPL/total cash loans ratio is one of the most important asset quality indicators at this point. In 2014, our NPL was at 3.6%, but by 2016 we had reduced this to 3.17%, and continue to manage problematic credit effectively. We are committed to perform better than the sector average in this regard.

In 2016 loans increased by 25% thanks to an enormous 37% rise in corporate lending. Where does Halkbank see the greatest opportunity when it comes to continuing to increase the credit portfolio, and how does it plan to maintain a balance between asset quality and growth?

As a complement to economic reforms, we are aware that Turkey's growth has directly contributed to the growth of our Bank. Maintaining economic stability, gradually reducing the current account deficit and inflation, and increasing our growth performance are the focus of our development strategy in this new period. Our performance priorities are to support sectors producing goods which increase our international competitive strength in external trade, and in this context, to incentivise investment. We will take innovative steps in areas where we are internationally competitive. Through this we will continue to develop our credit portfolio.

More specifically, will credit for SMEs continue to be an area of expertise for Halkbank? Which sectors promise the most growth in SME loans?

In line with our founding mission, our priority is certainly to support the engine room of our economy, which is tradespeople and SMEs. With the knowledge of being a leader in SME banking in Turkey, we are keeping our promise to maintain the strength of our tradesmen and to maintain our work to help SMEs and entrepreneurs grow. As the biggest supporter of the real economy, our SME loans rose by 18.3% in 2016, reaching 57.1 billion TL. With the growth performance realised in the sector in 2016, our Bank alone was able to achieve an increase of 27% in the total growth in SME cash loans. Increasing market share in the banking sector is a real challenge; it is the most competitive environment and even making small improvements is hard. In SME loans, in the previous year our market share was 12.4%, and this had risen to 13.54% by the end of 2016. Support for SMEs is support for Turkey, and this increase was a success and great source of pride for us.

“Maintaining economic stability, gradually reducing the current account deficit and inflation, and increasing our growth performance are the focus of our development strategy in this new period”

We will continue to take the necessary proactive measures by observing the needs of our SMEs and our tradespeople personally, through our experience and expertise in SME Banking. Regardless of sector and taking the needs of our customers into account, we will continue to provide support through appropriate credit solutions to companies with business, investment and refinancing needs.

With the loan-deposit ratio still well above 100%, what is Halkbank doing to accumulate more deposits?

The main function of the banking sector is to mediate by creating a buffer zone between those providing funds and those requesting them. Our most important financial resource at this point is deposits. Especially with the recent uncertainty over exchange rates, the TL is being put forward as a safe port. While our customers are turning to deposits as the area where their savings will be put to best use, our Bank continues to increase its market share in this competitive area through the advantages it provides.

We will maintain our deposit management strategy through dynamic deposit management based on the optimization of cost, market share, liquidity and non-deposit opportunities. With this understanding, we are trying to serve a wide target audience with the deposit products we have developed. We are managing our Bank through a dynamic strategy based on a heavy weighting of deposits within a sound funding structure, cost, market share and liquidity. With the prediction that 2017 will be a year that sees deposits prioritised, we will continue to create a customer-focused, stable and available deposit structure.

How have the turbulence and rising economic risks in the Turkish economy affected Halkbank's strategy on funding from international capital markets?

First of all, it is necessary to say this: the door has opened on a new era that will be dominated by Turkey's economic stability and structural reforms. At this point, we are not convinced that economic risks are rising. As banks, we are trying

to cope with high funding costs in this process. The most important item on our agenda is to cope with the narrowing of loan yield/cost of deposits. On the other hand, there is another reality. Today, Halkbank is a brand known around the world, not just in Turkey. We are developing new collaborations through our financial stability and international brand awareness.

Last year, we contributed to the introduction of a major resource of 1.2 billion dollars into the country, through both Eurobonds and syndication. I would like to state that this export is the first Central and Eastern Europe - Middle East and Africa, and the first Emerging Markets Financial Institution Eurobond to be issued after the Brexit referendum. The fact that the demand for this export from 225 financial institutions from the USA, Europe, Asia and the Middle East exceeded supply by 4 times is an indication of Halkbank's and Turkey's strength in the international market.

What kind of performance are Halkbank's operations in Serbia and other countries displaying? Does the bank have any existing transatlantic development plans?

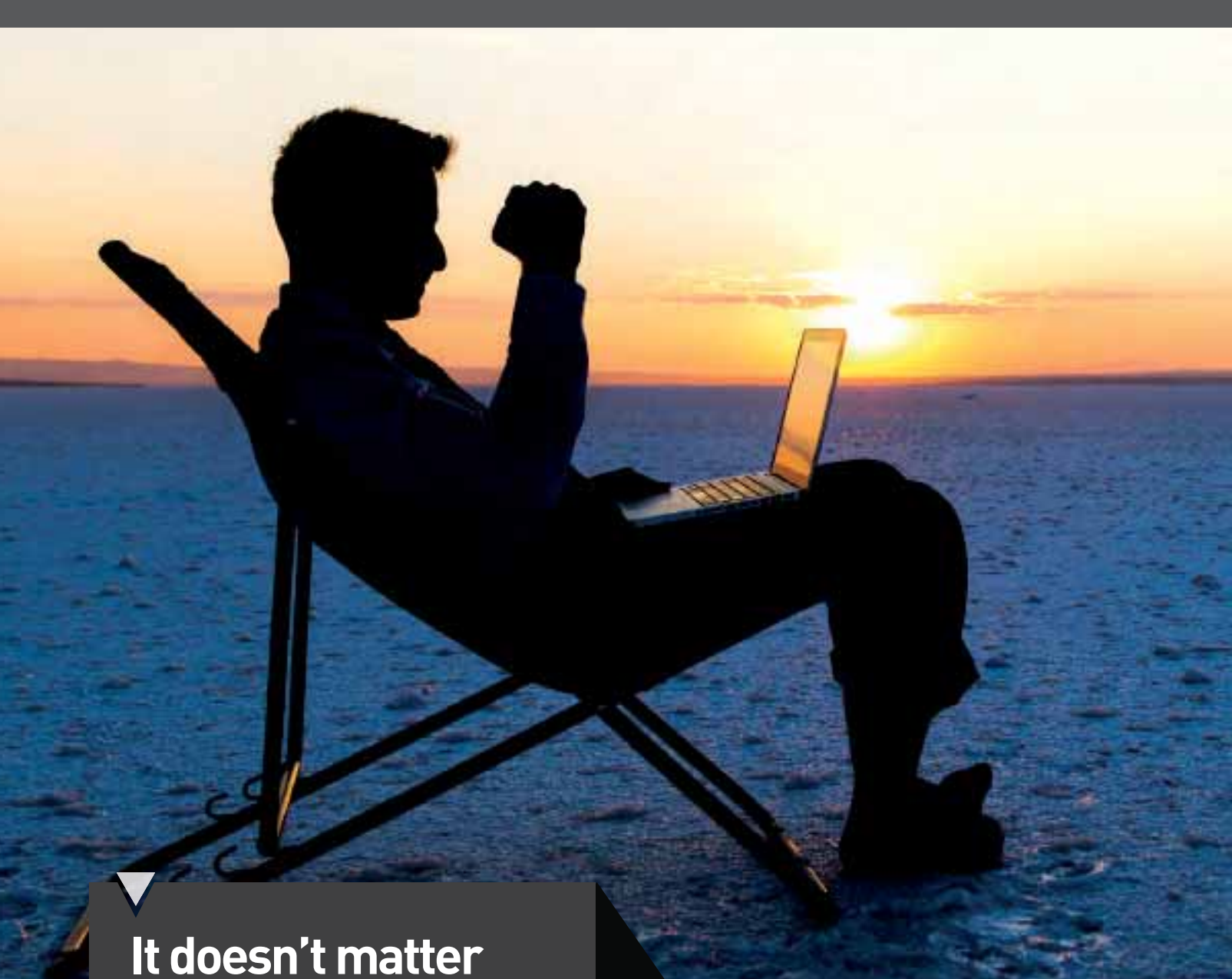
In recent years, our Bank has increased its efficiency in international money and capital markets through successful public offering, syndication, bond issuances and long-term loan agreements made with international finance institutions, and has also carried its activities to Asia. Our Representative Office was opened at the Ocean Financial Centre to develop relationships with international corporate investors and correspondent banks in the Asia-Pacific region.

Our Singapore Representative Office ensures that Asian investors are informed of recent developments with regard to Halkbank, and informs investors of periodic financial statements and activities. Our bank also offers up-to-date information on organizational changes, decisions made by regulatory agencies, and related legislative changes to Asian investors. In addition, our Representative Office also provides the chance for representatives of the international finance sector to meet face to face at seminars, conferences and meetings. This in turn strengthens the network of correspondent banks and operations in this area.

Generally speaking, what are your predictions for the growth of the Turkish economy, inflation and the current account deficit in 2017 and beyond?

In the period after 2002, Turkey achieved an acceleration in output. We want to maintain this and write new success stories. The economic upturn, which stalled on 15 July, will continue in a climate of confidence that we have succeeded in re-establishing. We believe that the profitability of economic reforms will continue, that our rate of growth will exceed 5%, and that we will achieve our goal of lowering the current account deficit/national income rate to 3.5%. ■





It doesn't matter
where you watch the
sunset,
as long as you have
made the right
choice.

► With over 79 years of presence, expertise, sustainable and solid financials. Our extensive service network and customer portfolio, Halkbank is leading the way as a trusted partner to meet our customers' expectations.

Serving close to 10 percent of the entire population of Turkey with more than 950 branches and an asset size of 60 billion USD, we are truly a local bank with local knowledge.

Our network of branches in Europe, representative offices in London, Bahrain and now in Singapore.

Whatever your needs, Halkbank is your local & international trusted partner.

What's happening Thursday, May 11

For the most up-to-date schedule information, please download the MyEBRD app available from the Apple, Android and Blackberry store



8.30am – 9.00am

Networking Breakfast

Location: Arcades, Filoxenia Centre

9.00am – 10.30am

Cyprus in the Eastern Mediterranean region: attractive investment opportunities with a secure business environment

Moderator: **Jonathan Charles**, Managing Director, Communications, EBRD

Keynote speakers: **Suma Chakrabarti**, President, EBRD; **Harris Georgiades**, Minister, Ministry of Finance, Republic of Cyprus

Speakers: **Yiorgos Lakkotrypīs**, Minister, Ministry of Energy, Commerce, Industry and Tourism; **Mark O'Neil**, President, Columbia Shipmanagement; **Lapo Pistelli**, Executive Vice-President of International Affairs, ENI, ENI SpA; **Nikolaos Zamboglou**, Founder, German Oncology Centre; **Peter de Proft**, Director-General, European Fund and Asset Management Association (EFAMA)

Location: Zenon Kitiēvs A, Level 0, Filoxenia Conference Centre

9.30am – 11.00am

Civil Society Working Level Session: **EBRD Projects in Transport and Agribusiness**

Moderator: **Cristina Buzasu**, Acting Principal Manager, Civil Society Engagement, EBRD

Speakers: **Sue Barrett**, Director, Head of Transport, EBRD; **Ekaterina Miroshnik**, Head of Infrastructure in Russia and Central Asia, EBRD; **Alistair Clark**, Managing Director, Environment and Sustainability, EBRD; **Dariusz Prasek**, Director, Operations, Environment and Sustainability, EBRD; **Michaela Bergman**, Director, Chief Social Counsellor, Environment and Sustainability, EBRD; **Mark Hughes**, Associate Director, Environment and Sustainability, EBRD

Location: Elia, Level 0, CSO Meeting

Room 2, Filoxenia Conference Centre

10.30am – 1.00pm

World Café Roundtables

Facilitator: **Biljana Radonjic Ker-Lindsay**, Head of Civil Society Engagement, EBRD

Location: Elia, Level 0, CSO Meeting

Room 1, Filoxenia Conference Centre



10.30am – 11.30am

Romania Investment Outlook Session:

The path to dynamic sustainable growth

Moderator: **Alain Pilloux**, Vice-President, Banking, EBRD

Speakers: **Lucian Anghel**, President of the Board, Bucharest Stock Exchange; **Attila Gyorgy**, Secretary of State, Ministry of Public Finance; **Matteo Patrone**, Regional Head of Romania & Bulgaria, EBRD, Bucharest; **Dan Stefan**, Managing Partner, Autonom Rent a Car; **Liviu Voinea**, Deputy Governor, National Bank of Romania

Location: Yiasemi, Level 0, Filoxenia Press Centre

11.30am – 1.00pm

Banking on full recovery? The financial sector post-crisis

Moderator: **Nick Tesseyman**, MD, Financial Institutions, EBRD

Speakers: **Fokion Karavias**, CEO Eurobank SA; **Wojciech Sobieraj**, CEO, Alior Bank; **Carlo Vivaldi**, Head of CEE Division, UniCredit; **Boris Vujcic**, Governor, Croatian National Bank

Location: Kerynia, Level -1, Filoxenia Conference Centre

12.00pm – 1.00pm

Georgia Investment Outlook Session:

From challenges to achievements

Moderator: **Bruno Balvanera**, Director, Regional Head Caucasus, Moldova & Belarus, EBRD, Georgia

Speakers: **Lasha Abashidze**, Vice Mayor, Tbilisi City Hall; **Valeri Chekheria**, CEO, Adjara Group Hospitality; **Lok Home**, President, The Robbins Company; **Dimitry Kumsishvili**, Minister of Finance, Ministry of Finance of Georgia

Location: Jean Monnet Auditorium, Level 0, Filoxenia Press Centre

1.00pm – 2.00pm

Networking Lunch

Location: Networking Lunch Marquee

2.00pm – 3.00pm

Poland Investment Outlook Session:

Poland: solid and inclusive growth

Moderator: **Pawel Samecki**, Member of the Board, Narodowy Bank Polski

Speakers: **Pawel Chorazy**, Undersecretary of State, Republic of Poland; **Piotr Nowak**, Undersecretary of State, Ministry of Finance; **Piotr Wiesolek**, Vice-President, First Deputy Director, Narodowy Bank Polski;

Grzegorz Zielinski, Regional Director, Poland and the Baltics, EBRD

Location: Kerynia, Level -1, Filoxenia Conference Centre

2.00pm – 4.00pm

The private sector as an engine for economic inclusion

Suma Chakrabarti, EBRD President will open the session with the launch of the Bank's first Economic Inclusion Strategy

Moderator: **Barbara Rambousek**, Lead Economist, Economic Inclusion, EBRD

Keynote: **Iveta Radicova**, Prime Minister of the Slovak Republic (2010-2012)

Speakers: **Adel Boseli**, Cofounder, Shekra; **Andrii Dykun**, Chairman, Ukrainian Agri Council; **Dragica Pilipovic Chaffey**, Vice-President, Corporate Affairs, United Group RS; **Uwe Wieckenberg**, Director of Programmes, STA – Elsewedy Technical Academy

Don't Miss

10.30am – 11.30am

Egypt Investment Outlook Session:

Business environment: achievements and reforms

Speakers: **Sherif El Kholi**, Partner, Actis; **Ahmed El Alfi**, Chairman of the Board, Sawari Ventures; **Basil El-Baz**, CEO & Chairman, Carbon Holdings; **Malek Fawaz**, Advisor to the Minister, Ministry for International Cooperation; **Ashraf Ghazaly**, CEO, NI Capital; **Janet Heckman**, Managing Director, SEMED, Cairo, EBRD, Cairo; **Terje Osmundsen**, Senior Vice President, Scatec Solar

Location: Jean Monnet Auditorium, Level 0, Filoxenia Press Centre



Location: Jean Monnet Auditorium, Level 0, Filoxenia Press Centre

Location: Zenon Kitievs A, Level 0, Filoxenia Conference Centre

2.00pm -4.00pm

The journey to green growth ... seeking solutions to the challenges

Moderator: **Jonathan Charles**, Managing Director, Communications, EBRD



Speakers: **Cameron Hepburn**, Director of Economics of Sustainability Program, Institute for New Economic Thinking at the Oxford Martin School; **Jacqueline McGlade**, Division Director, UN Environment Programme; **Dimitri Zenghelis**, Joint-Head Climate Policy, London School of Economics

2.30pm - 3.30pm

Forum Partner Session: Eurobank Cyprus 'Shipping and shipping prospects in Cyprus'

Moderator: **Platon Monokrousos**, Deputy General Manager, Eurobank S.A.
Speakers: **Marios Demetriades**, Minister of Transport, Communications and Works, Ministry of Transport, Communications and Works; **Acis Montanios**, Managing Partner, Montanios & Montanios LLC, Advocates & Legal

Consultants; **Philippos Philis**, Chairman & CEO, Lemissoler Navigation Co. Ltd
Location: Yiasemi, Level 0, Filoxenia Press Centre

2.30pm - 3.30pm

Ukraine Investment Outlook Session: **Time to convert reforms into investments**

Seminar Pick

10.30am - 12.00pm

Competitiveness in the 21st century

Moderator: **Sergel**

Guriev, Chief Economist, EBRD

Speakers: **Maria Demertzis**, Deputy Director, Bruegel; **Simeon Djankov**, Executive Director, Financial Markets

Group, London School of Economics; **Herman Gref**, CEO, Sberbank; **Ran Senderovitz**, Vice-President CCG, General Manager, Intel Israel
Location: Halkos, Level -1, Filoxenia Conference Centre



Moderator: **Francis Malige**, MD, Eastern Europe & Caucasus, EBRD, Kiev

Speakers: **Sevki Acuner**, Director, Head of Ukraine, EBRD, Kiev; **Oleksandr Danylyuk**, Minister of Finance, EBRD Governor, Ukraine; **Oleg Churiy**, Deputy Head, National Bank of Ukraine; **Alex Lissitsa**, Executive Director, CEO, IMC;

Andrii Mitchenko, CEO, Ecosoft

Location: Halkos, Level -1, Filoxenia Conference Centre

4.30pm - 6.00pm

EBRD Alumni Reception

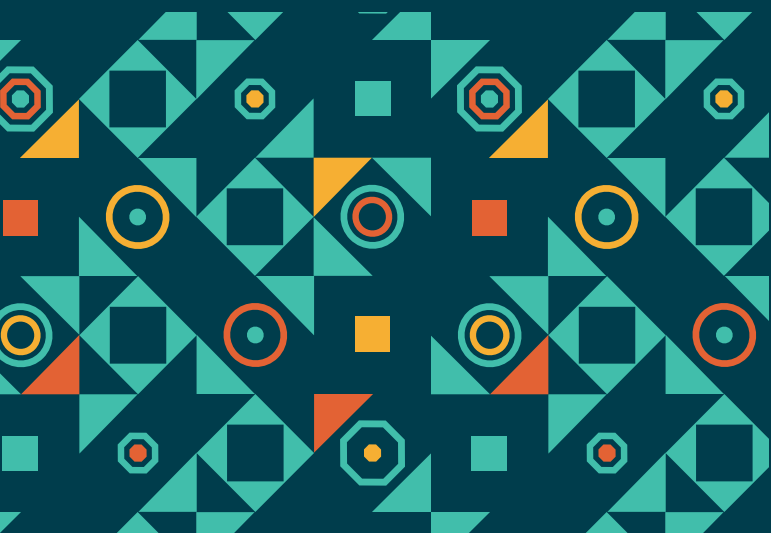
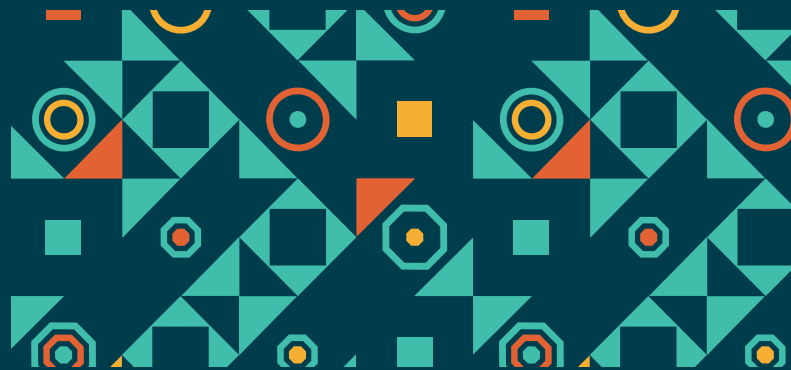
Location: Yiasemi, Level 0, Press Centre, Filoxenia Press Centre

Turkey's Innovative Asset Manager

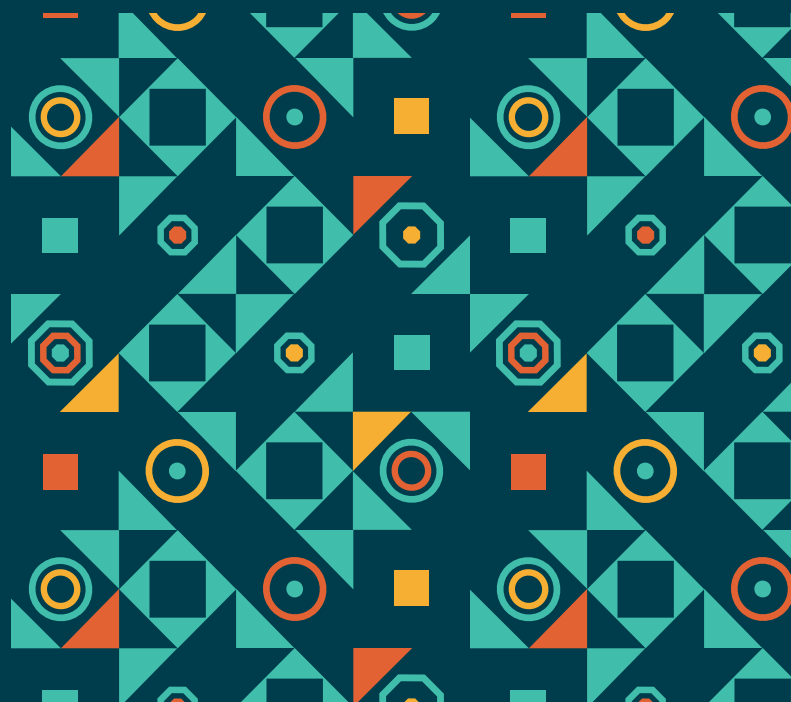
Ak Asset Management provides you with an opportunity to invest in traditional and alternative asset classes in Turkey.

2018 Annual Meeting and Business Forum

We look forward
to welcoming you
next year in **Jordan**
8-10 MAY 2018



The EBRD Business Forum
will bring together prominent
investors, senior business
executives and policy-makers
from around the world for an
extensive programme.



JORDAN 2018



European Bank
for Reconstruction and Development

Oreshkin

Continued from page 1

On Wednesday, at a meeting of board of governors, Oreshkin made yet another plea to have the lending ban lifted, arguing that it was “unfair” and “not underpinned by international law”. He used an external legal opinion to claim the bank failed to follow its own rules when imposing the freeze, which followed the annexation of Crimea and the downing of a Malaysian jet by Russian-backed rebels over eastern Ukraine.

But the pleas to ministers from the bank’s 65 country shareholders, present in Nicosia, fell on deaf ears.

Despite the resolution, Chakrabarti talked fondly about Russia, which remains one of the bank’s largest theatres of operation, with seven full-time officers, an SME advisory service, and an outstanding lending portfolio worth €3.7bn (\$4bn). “We maintain a deep and special relationship with Russia,” he said.

But that did not stop Oreshkin from venting his fury in public. After Chakrabarti left, the Russian minister took the stage. Clearly agitated and reading from a pre-planned script, he tore into the EBRD, claiming the lending freeze “created an extremely dangerous precedent in international financial rela-

“Directors overwhelmingly agreed that the bank had complied with its own internal rules ...[this is a] final and binding resolution”

—Suma Chakrabarti

tions”, and “turned the EBRD into a tool of foreign policy rather than a development bank”.

‘WE CHOOSE AIIB INSTEAD’

He then took aim at the bank’s finances, claiming that the EBRD’s cost-to-income ratio was 42%, far above the 33% required to maintain its triple-A credit rating. The bank later disputed the figure, a spokesman saying the ratio was “well below” the 33% ceiling. Oreshkin thundered that costs had risen 71% since 2011; EBRD’s Russian-born economist Sergei Guriev said that figure was “factually untrue”.

But the minister was not finished. He said the EBRD had “deviated from its original mandate” by focusing in recent years on leveraged buy-outs and investing directly in IPO-ready private vehicles. “The bank is taking an ‘Uber’-[style] approach to lending,” he said. “It is not Russia that needs the EBRD, but the EBRD that needs Russia.”

In truth, independent analysts believe both sides need each other. Chakrabarti remained a staunch defender of the bank’s commitment to Russia. He added that “at no point has there ever been, or was there today, any suggestion of the bank” cutting its ties to Russia. In a statement released later through Russian news agency TASS, Oreshkin stated publicly that despite its bitter disappointment, Russia had “no intention” of leaving the EBRD.

But he could not resist a final, departing barb. “We are doing very well,” the minister said, in a nod to the Russian economy, which is set to return to growth this year after two years of recession. “So we won’t be needing to get in touch with [the EBRD] about any new investments. We will focus on the [new China led-multilateral], the AIIB instead.”

THE final word

Romania determined to maintain economic stability

By Liviu Voinea

Romania saw strong economic growth in 2016, while the fiscal and the current account deficits were kept at bay. The 4.8% real GDP growth rate was not only markedly above the European average, but also the highest level in the six consecutive years of economic growth in the post-crisis period.

The main driver of the advance in GDP was private consumption, fuelled not only by tax cuts — the standard VAT rate decreased from 24% to 20% and the VAT rate for food items and non-alcoholic beverages dropped from 24% to 9% — but also by a sizeable increase in the minimum wage and hefty rises in public sector wages. Such measures resulted in a widening of the fiscal deficit, without breaching the 3% of GDP reference value laid down in the Stability and Growth Pact. As regards the external balance, after a period of sustained adjustment of the current account deficit, to levels close to 1%, the closing of the negative output gap entailed a trend reversal. However, at 2.3% of GDP in 2016, this deficit remains significantly below the levels recorded before 2008, underpinned not only by robust growth in exports of manufactured goods, but also by an increasing surplus in the services account. Moreover, despite its widening, the current account deficit remains fully financed by non-debt creating inflows such as FDI and EU capital transfers.

The National Bank of Romania has reached all three stabilities that matter for a central bank. First and foremost, price stability has been achieved. The policy interest rate is at an historically low level (1.75%), while the country faces low inflation. In 2016, there were actually negative inflation rates, yet we did not call it deflation, because domestic consumption grew very strongly. The inflation story in Romania has changed significantly in later years, as we went from relatively high annual levels (close to 6% in early 2013, above the 3.5% upper bound of the ± 1 percentage point variation band of the target) to below-target readings ever since, and even negative values between June 2015 and December 2016. These developments were largely prompted by sizeable successive indirect tax cuts (in VAT and excise duties), adding to the “perfect storm” of deflationary supply shocks in recent years (especially regarding energy and food prices). Currently the annual inflation rate stands at 0.2%. Excluding the first-round effect of the aforementioned tax cuts, headline inflation would have hovered around +1.2% in early 2017.



“Romania’s macroeconomic position is currently favourable, but it will take a careful policy design in order to properly manage the risks and to ensure the preservation of gains achieved with considerable efforts.”

The still below target figure against the background of buoyant economic activity, employment and wages is a possible indication of a flattening of the Phillips curve, a widespread tendency reflecting increased relevance of global inflation dynamics to the detriment of domestic conditions in explaining local inflation developments.

RETURN TO PROFIT

I would also like to point to some dimensions of financial stability. We managed to break the back of non-performing loans (NPLs), reducing the NPLs’ ratio from 22% in early 2014 to 9.6% in early

2017. This fast progress was due to implementing a fit-for-purpose action plan, while the coverage of NPLs by provisions continued to be the highest in Europe. Moreover, the sector is well capitalised,

with a total capital ratio that is more than double the required minimum level. Liquidity has remained comfortable, on the back of the stronger domestic deposit base (offsetting the downward, yet orderly, trend in funding from parent banks), implying a lower contagion risk. Profitability and asset quality indicators have also improved. Thus, after recording a negative financial result in 2014 — amid massive provisioning in a bid to clean up the balance

sheets — the banking sector returned to profit in 2015 and consolidated its positive financial result in 2016. The banking sector has also overcome the risks induced by two legislative initiatives (one regarding the mortgage debt discharge and another one on the conversion of Swiss franc loans at historical exchange rate) after the Constitutional Court declared them partially or totally unconstitutional. In the challenging context generated by the outbreak of the global crisis, appropriate capital adequacy was maintained without any resort to public funds.

Finally, Romania has enjoyed a lower volatility of the exchange rate than its peers. Net international reserves have further increased, despite reducing the minimum reserve requirements for commercial banks, and the international liquidity ratio has continued to improve.

To sum up, Romania’s macroeconomic position is currently favourable, but it will take a careful policy design in order to properly manage the risks and to ensure the preservation of gains achieved with considerable efforts. **GM**

Liviu Voinea is Deputy Governor, National Bank of Romania

Many talk about Capital Market Transactions
in Central and Eastern Europe and beyond.

We do them.



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