

# Global Markets

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## Special Report

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# 'Weak' pandemic response puts MDBs in the spotlight

By Jon Hay, Mariam Meskin and Oliver West

International financial institutions' response to the Covid-19 pandemic has been patchy, experts argue, raising questions about their role and governance that need to be addressed if they are to respond more effectively to future crises.

Multilateral development banks stepped up lending when the pandemic hit — but not nearly as much as during the global financial crisis of 2008-9, and some were much more active than others.

Yet Covid's effects have been much worse. Developing and emerging country GDP shrank 2.2% last year; in 2009 it grew 2.8%.

"The MDBs have not done a good job. Especially in terms of support for middle income countries they've been very weak," said Chris Humphrey, senior scientist at the ETH Zurich university.

A report in May by Nancy Lee at the Center for Global Development (CGD) found that the World Bank, Inter-American and Asian Development Banks and European Bank for Reconstruction and Development had increased lending by 39% last year — but in the global financial crisis (GFC) they managed 76%. The concessional arms which



David Malpass: urged G20 to suspend debt interest payments

serve the poorest countries have reacted most strongly. The World Bank's International Development Association more than doubled its commitments. The equivalent funds of the African Development Bank and Asian Development Bank also outperformed what they did in the GFC.

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Belarus forced closer to Russia as EU ties erode amid pressing sanctions

By Mariam Meskin

Belarus is set to strengthen its ties with Russia — in particular, financial ones — following the latest wave of EU-led sanctions against the former Soviet state that came into force this week, observers have warned.

The sanctions, in response to the recent high profile arrest of Belarusian opposition journalist Roman Protasevich, target a number of Belarusian oligarchs, key economic sectors and sovereign debt. The sanctions on sovereign debt, which prevent the purchase or sale of new

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# EBRD to unveil African expansion in 2022 as Covid hangs over region

## Exclusive

By Mariam Meskin and Lewis McLellan

The EBRD is preparing to finally expand into sub-Saharan Africa (SSA), ahead of a final board meeting in 2022, *Global Markets* can reveal. The bank has succeeded in quelling shareholder concerns about what expansion could mean for the bank's original members, as the bank insists there will be "no trade-off".

Last October, the EBRD's strategic and capital framework confirmed the institution's interest in a "limited and incremental expansion to sub-Saharan Africa and Iraq" between 2021 and 2025.

The final decision on expansion will likely be made at the EBRD Annual Forum in June 2022, Heike Harmgart, managing director for the Southern and

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Renaud-Basso: updating preparation work

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# EBRD

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Eastern Mediterranean region at the bank told *GlobalMarkets*.

Her comments came after EBRD President Odile Renaud-Basso said this week that the expansion into SSA had been delayed by Covid-19 as the region is ravaged by a third wave.

“The next year is critical in preparing to present our plan to the board,” says Harmgart, reiterating that the bank is on track to achieve what was discussed in October. “We are now discussing the next step of analysis; which countries are good candidates and fit in with the EBRD mandate of creating markets for the private sector, where we can add value, etc. We are doing our internal homework and speaking to existing clients in the region before we present to the board of governors.”

The push would mark another turning point for the development bank, which has historically focused on developing emerging Europe. In 2011, the bank made its push into the Middle East and North Africa region, working with borrowers in Egypt, Jordan, Morocco, Tunisia, Lebanon and the West Bank and Gaza.

Some shareholders have, however, voiced concerns about the bank’s push into emerging markets so far from its original purview.

“There are, of course, some shareholders that are worried about the expansion, but last year has shown that the bank is able to expand its lending even in times of crisis,” says Harmgart. “Our capital is stable — there is no trade-off and we have sufficient additional capital without making compromises.”

## OPENING MARKETS

The EBRD is in discussions with the African Development Bank to look at “complementary” areas they can partner on.

“We are not focusing on specific African regions, instead we are looking at countries in which the private sector already has some size that would benefit from the opening of markets and investments,” says Harmgart.

Renard-Basso said at a press event ahead of the meetings that a lot of work had been carried out to work out capital margins and projections of activity to show that the bank has “room for manoeuvre”. “But with the Covid crisis, we have to update these elements to take account of the effect of the pandemic on our loan portfolio.”

# CEE countries ranked in top 10 of new financial risk index

By Phil Thornton

Three central and eastern European economies have been flagged up by a new analysis that identifies countries most at risk of a financial crisis over the medium term.

Hungary and Poland are in the top 10 of the countries identified by Nomura investment bank as most vulnerable to a shock within the next 12 quarters — with Romania just outside on number 11.

Nomura’s economists focused on five early warning indicators: the ratio of private credit to GDP; the debt service ratio; real equity prices; real property prices; and the real effective exchange rate.

Nomura’s index, which it has dubbed Cassandra after the mythological Greek figure whose warnings were fatally ignored, is currently highlighting six economies — the US, Japan, Germany, Taiwan, Sweden and the Netherlands — as vulnerable to financial crises over the next 12 quarters, with scores over 100.

While the three CEE countries all have lower scores of 38, they contrast with 21 economies in the assessment that are deemed as having zero risk of a crisis

including countries such as Australia, Spain, and the UK that have attracted warnings from other forecasters.

Rob Subbaraman, Nomura’s chief economist and head of global macro research, said he was concerned the reason only six countries breached the threshold was due to the current historic low levels of interest rates.

“So, we did a stress test where we shocked Cassandra with an interest rate shock,” Subbaraman told *Global Markets*. Hungary and Romania both rose to 70 on the index.

“Cassandra’s suggesting that, actually, it’s not all smooth sailing going ahead. There’s quite a few countries that are getting close to that vulnerability 100 threshold. Countries that are between 70 and 100 are starting to give a bit of concern.”

He said policymakers in countries with a high reading should consider tighter macro-prudential policies, such as cutting mortgage loan to value ratios and reducing debt to income ratios.

While macroprudential measures would be preferable to tightening monetary policy, he said CEE policymakers



would be right to raise interest rates in the face of rising inflation. “If you have inflation as well as signs of financial vulnerabilities, that just adds more reason for starting to raise rates,” Subbaraman said.

The National Bank of Romania (NBR) said the analysis was “not... very plausible”, pointing to a recent European Systemic Risk Board report that gave it a low risk rating and estimated property prices as being undervalued by 36% compared to their fundamental values.

A spokesperson added: “In one paper developed by NBR, we estimated the probability of a banking crisis event that showed a relatively low and decreasing trend between 2014 and 2019.”

Nomura also added in a measure for climate change risks to account for the physical risks around climate change and the transitional risk of moving towards a greener economy. “Both result in more financial vulnerabilities,” he said.

# Belarus

Continued from page 1

Belarusian securities and lending to Belarus, came into effect on Tuesday.

The package targets some of Belarus’s most lucrative sources of income, including its potash, petroleum and tobacco exports, aiming to hit President Alexander Lukashenko — in power since 1994 — where it hurts.

The EBRD stopped investing in sovereign and sub-sovereign projects at the beginning of 2020, with “no plans to do so for the foreseeable future”. However, the development bank continues to support private sector projects.

“Our concern is the continuing deterioration of the human rights situation in Belarus,” says Anton Usov, chief spokesman for Russia, Belarus, Central Asia and Mongolia at the EBRD. “We do not want to speculate on what the future holds for Belarus, but unlike in Russia we are still looking at selected private sector projects where there are clear benefits for small and medium sized companies, female entrepreneurs and young professionals.”

The EBRD made a notable break from its historical lending relationship with Russia in 2014, following the



Protasevich: arrest of opposition journalist angered the West

Crimea crisis. But limited support from development banks in Belarus’s private sector is unlikely to compensate for the economic damage the latest sanctions will have.

“The most recent sanctions, which target both industrial sectors and individuals, will have a negative economic impact,” says Andreas Schwabe, senior economist, CEE at Raiffeisen Bank International. “They also affect Belarus’s activity in primary debt markets, as the sanctions prohibit issuance by the state and state-owned bodies, including three state-owned banks.

“Major categories of exports from Belarus are sanctioned, although there

are some exceptions, this is a strong warning signal that EU sanctions can be tightened in the future, if needed.”

## STICK AND CARROT

But Europe’s stance may be counter-productive, as the repeated use of the stick method will push the former Soviet country even further away from the democratic West and closer to its historical backer, Russia.

According to RBI, the bulk of Belarus’s wider public external financing, around \$13bn of the total debt of \$27bn, is owed to Russia and the Eurasian Economic Union.

Although historically, Belarus has been financially dependent on Russia, it has also benefited from access to euro and dollar denominated capital markets. However, many investors have reduced their exposure to Belarus since volatility escalated in May.

“Belarus as a credit itself, for the yields on offer, is pretty good — the likelihood of it defaulting or restructuring is low” says Richard Briggs, investment manager at GAM, which previously had exposure to Belarus but has since reduced it to zero. “But our issue is with sanctions — it is the reason we do not have any more exposure.

# New era awaits Sudan after historic debt relief

By Oliver West

The IMF and World Bank this week approved debt relief for crisis-hit Sudan on an unprecedented scale that will immediately cut the government's debt from \$56bn to \$28bn and potentially sets the African country on the path to wiping out 90% of its total external debt.

Freeing Sudan from its debt trap could enable it to re-engage with multilateral lenders, including eventually the EBRD which has plans to move further into Africa, and the private capital markets.

Sudan has reached the so-called decision point of the Heavily Indebted Poor Countries (HIPC) initiative, becoming the 38th country to do so since the IMF and World Bank launched the initiative in 1996. Under the HIPC operation, the country of 44m people will receive debt relief of \$23.3bn in net present value terms — equivalent to 36% of the total debt relief granted to the previous 37 countries.

A joint statement by IMF managing director Kristalina Georgieva and World Bank president David Malpass called the deal a “landmark achieve-

ment”, highlighting that other debt relief operations alongside the HIPC initiative would eventually take Sudan's total debt relief to more than \$50bn. This should leave the country with just \$6bn in debt.

The deal opens the doors for Sudan's return to the international financial system after 30 years as a pariah under the military dictatorship of Omar al-Bashir, who was ousted in 2019. The country has suffered decades of sanctions and shortages, and inflation is expected to near 200% this year. But there may be financing opportunities for adventurous investors.

“Debt relief removes a huge burden from Sudan's back and fixes the balance sheet. Now the country must solve the income statement,” said the CIO of one US-based EM investment fund. “Sudan has the chance to turn a new leaf, and desperately needs new infrastructure investments.

“The country has oil and gas and other natural resources that it has not been able to exploit because it's been



Georgieva: 'landmark achievement'

outside of the international banking world, and the opportunity set for investors in a country of nearly 45m people is abundant.”

For now, the hope is that Sudan will begin to benefit from multilateral funding. In June 2020, the transition government requested a staff monitored programme with the IMF that has brought several reforms including subsidy cuts, a floating exchange rate, and measures to strengthen governance and social programmes.

By reaching decision point, Sudan was able to receive a \$2.473bn 39 month extended credit facility that the IMF also approved on Tuesday, with the fund saying the agreement should catalyse donor financing to the country.

# CEE sovereigns impress with issuance flood as rate rise looms

By Mariam Meskin

Emerging market sovereigns across central and eastern Europe are showing off their access to capital markets, as investors say they are willing to pile in on tight trades despite mounting global concerns around rising rates and inflation.

Hawkish comments from the Federal Reserve earlier this month indicating the tapering of monetary stimulus and an increase in interest rates have not deterred issuers.

With the Fed now planning to hike at least twice by the end of 2023, issuers are wasting no time, instead taking a proactive approach to funding. Latvia mandated for a euro benchmark bond on Tuesday, just days after fellow sovereign Slovenia debuted in the sustainability bond market.

Those trades follow a busy start to the year for emerging European governments that sought to bolster their reserves as they continued to combat the impacts of the pandemic and stimulate economic recovery. A number of governments tested the market, even after volatility kicked off in the first quarter, including Romania, Slovakia, Ukraine and even Russia.

Periods of rates volatility are usually enough to force issuers, both sovereign and corporate, to play it safe. That is what happened briefly earlier this year in March, when yields on US Treasury bonds spiked to over 1.7% — around 80bp higher than where they had started the year at 0.93%. At the time, primary markets temporarily adopted the 'wait and see' approach. As of Tuesday, the 10 year was yielding 1.486%.

## MULTIPLE ISSUES

Now, investors say they are “impressed” at how easily such sovereigns have been coming to the market, with many being compared to developed market governments. Issuers, they say, are not giving up any concessions either, even earning the label of being “greedy”.

Some investors, including Barings, the US asset manager with over \$326bn of assets under management, told *Global Markets* that issuance levels across CEE, and more broadly CEEMEA, were on track for another record-breaking year.

Some borrowers have taken the opportunity to enter the market multiple times, such as Slovenia, which has now concluded its third bond of the year.

Although the fact that issuers are pricing so tight means that some trades are underperforming in the secondary market, the access to funding is no issue at all, investors said.

# EBRD's digitalisation programmes key to 'building back better' economies

By Lewis McLellan

The European Bank for Reconstruction and Development is stepping up its efforts to help its clients accelerate their digitalisation agendas to cope with the challenges of the pandemic.

As countries look to get back into gear after pandemic-enforced lockdowns, digitalisation is seen as a key part of the agenda for many of them. However, quick solutions constructed during the pandemic may bring risks and vulnerabilities.

Hannes Astok, chairman of the management board for Estonia's e-Governance academy, said that the pandemic had sparked a great leap forward in digitalisation, with many countries “making a decade's progress in one year”.

Serbia is investing heavily in digitalisation and technology, partnering with the EBRD to extend the nation's broadband coverage from 70% to 100%. Serbia's prime minister Ana Brnabic pointed out that countries and areas within countries with poor internet access “suffered much more from Covid”.

EBRD has been working with both the public and private sectors in its

countries of operation to provide technical expertise and guidance for how to manage the crisis with technology.

In the private sector, Barbara Rambousek, EBRD's director for gender and economic inclusion, said that it had been helping businesses come up with new ways to survive the pandemic, including “switching shop-based businesses to online”. She highlighted the work the EBRD had done in Uzbekistan to support the digitalisation of SMEs' operations.

## SAFEGUARDING PUBLIC INTEREST

Michael Strauss, EBRD's general counsel, said on a panel that the bank had observed that the demand for technical assistance from governments on digitalisation had “increased dramatically”, including for the development of digital medical procurement systems to manage demand for supplies in the pandemic.

But with the rapid progress, new risks and vulnerabilities emerge. Many of the solutions designed during the pandemic were done so quickly and under emergency conditions. Astok pointed out that more work will be



Rambousek: helping shops switch to online

needed to convert these quick fixes into sustainable and lasting solutions.

Astok also noted that some countries have used the crisis to expand the powers of their digital police state. “We need to be careful that while we move forward with building this digital governance globally, we make sure it's safe, secure and follows the principles of human rights,” he added.

The EBRD has a responsibility to ensure “that the roll-out and uptake of digital technologies goes hand in hand with institution building, rights protection and safeguarding of the public interest,” according to Marietje Schaake, international policy director at Stanford University's cyber policy centre.

## CEE countries top new ESG impact ranking

By Jon Hay

Central and east European countries are among the best in the world for environmental, social and governance performance, according to a new way of looking at the issue that aims to remedy some of the flaws in conventional ESG rankings.

Lithuania's government bonds are the best globally to invest in for ESG impact, according to Impact Cubed, an investment analytics firm. In the top 10 are Czechia, Poland, Estonia, Hungary and Slovenia. Romania, Croatia and Slovakia are close behind. On typical scorings from providers such as MSCI or Sustainalytics, only a couple of these would get in the top 20.

Government bond investors increasingly want to take ESG factors into account, but this presents difficulties. Most ESG analytics and methodologies are designed for equity investors. They are some help to corporate bond investors, but no use for sovereign debt.

Marisa Drew, chief sustainability officer at Credit Suisse, said a country might be committed to reducing carbon emissions to net zero, but have poor social infrastructure, putting an investor's 'E' and 'S' views in conflict.

The major ESG agencies do offer sovereign ratings. But whereas investors habitually complain that corporate ESG ratings from different providers are uncorrelated, leaving them bewildered, with sovereigns, it is the opposite. The different rankings are too similar, and seem to tell investors little they didn't know.

"In a lot of methodologies the same very wealthy countries are ranked at the top and the low income ones at the bottom," said Arleta Majoch, partner at Impact Cubed. "It is always the usual suspects — of course Finland has the best gender equality."

This is not just uninformative — it encourages investors to put money in the safest countries, not those which need help.

Mainstream ratings track countries' levels of social and environmental development, to inform investors about possible ESG risks. Impact Cubed aims to measure ESG impact, by determining which countries are improving fastest.

Impact Cubed has worked out how fast countries typically improve. For example, it might take an average of 2.5 years for a country with life expectancy of 60 to raise this to 61. Impact Cubed rates each country on whether it is advancing on each metric faster or more slowly than normal at its level of development.

## Bleak outlook for Russia as EBRD shows no signs of backing down

By Mariam Meskin

Russia continues to face isolation from western markets as the new chief at the helm of the EBRD ruled out a reconciliation between the development bank and the country.

Ties between the EBRD and Russia were severed in 2014 following the Crimea Crisis. In the years since, dialogue has been frosty, with neither side showing signs of détente.

The bank has confirmed that — despite the arrival of a new face at the head of the bank — there will be no changes to its Russia policy.

"Our shareholders have made no change to their position since 2014," said President Odile Renaud-Basso at a press event this week. "We don't finance new projects in Russia. No expectation of that changing in the year to come."

The country has in recent years earned itself the nickname 'Fortress Russia' following its pivot inwards, both economically and financially, since the outbreak of geopolitical volatility and imposition of sanctions in 2014.

Although economic growth expecta-

tions across emerging Europe err on the optimistic side, Russia's outlook is causing concern among experts. The challenging relationship with the development bank is one of a string of pressures weighing on Russia.

"Russia presents a pretty depressing picture for economic growth," said William Jackson, chief emerging markets economist at Capital Economics. "Coming into this crisis, Russia's GDP growth hovered between 1% and 2%, which if you think about Russia's income level, is pretty low."

Although Russia's reserves appear strong at around \$600bn and the central bank has moved quickly to meet domestic inflationary pressures, with the latest hike this month taking the key interest rate 50bp up to 5.5%, there are longer term concerns about the former Soviet state.

### CAUSE FOR CONCERN

Jackson points to the lack of foreign investment and the weakness in productivity growth as worrying inhibitors to Russia's economic growth.

Maintaining stability in the face of



Putin: no change for EBRD

isolation from the international community has come at a great cost.

"When will people begin to stop tolerating such weak growth and low rises in income levels?" asks Jackson. "We could envisage a scenario where this leads to major discontent, forcing the government to abandon its tight fiscal stance and become more dependent on foreign capital, which will be difficult without a shift in relations with the West."

Ravaging sanctions imposed on Russia in recent years have practically severed its access to the international dollar denominated bond market. In an attempted show of strength after the latest sanctions in April, Russia in May sold a €1.5bn bond among international investors. The bond sale racked up a disappointingly low order book of €2bn, according to sources.

## Insurers mourn missed chance of EU insurance agency

By Phil Thornton

Europe missed an opportunity to use the debate over the future of development finance to establish an insurance guarantee agency to attract private capital needed to help them hit targets for investment into emerging markets, according to experts in trade finance and insurance.

Policymakers spent two years debating whether to use the EBRD or the European Investment Bank as a platform for a new single development bank before deciding to stick with the current set-up augmented by a more collaborative approach dubbed "Team Europe".

Paul Mudde, a former trade finance professional at ABN Amro and trade credit insurer Atradius, said it would have made more sense to establish an insurance guarantee agency alongside a new development bank.

Mudde, now a consultant at Sustainable Finance & Insurance consultancy, said insurance could be used to mobilise private capital from both international and domestic banks and institutional investors. "It will allow the EU to effec-

tively co-operate with local banks in developing countries beyond providing credit lines," he told *GlobalMarkets*.

An EU development insurer could also use reinsurance to mobilise substantial amounts of non-development finance institutional capital from the private insurance market and from EU export credit agencies, Mudde said.

The problem, in his view, was that in the EU discussions about the European Financial Architecture for Development (EFAD) an insurance approach, like the World bank's MIGA, had never been considered.

"There is a lack of knowledge about the success of insurance products in mobilising capital for development. Public insurance providers are more successful in mobilising capital for development than development banks," he said. Their operational costs are in general also much lower than those of development banks. So, also from an aid efficiency and aid effectiveness point of view an insurance approach would make sense.

The importance of mobilizing capital has been debated for a decade and was

picked by the G20's Eminent Persons Group in 2018 and the "Building Bridges" report of the Islamic Development Bank in 2020, which clearly set out the benefits of an insurance approach to mobilise capital for development.

Although neither G20 reports has so far gained traction, Mudde said it would make a substantial contribution to the Team Europe approach. "Insurance could be used to mobilise private capital from both international and domestic banks and institutional investors," he said.

In addition, it could provide insurance to European development finance institutions (DFIs) that would contribute to a convergence of their operations, a more effective use of scarce economic development capital and reduce the competition between DFIs.

A spokesperson for the European Commission said some of the instruments being discussed as part of the new development architecture included the possibility of de-risking private sector investments by providing blending of grants and loans, or public guarantees covering specific investments risks.



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# Tale of two recoveries as emerging Europe and Asia escape Covid's grip

The EBRD's central and eastern European heartland faces tough challenges as it seeks to regain its economic footing after being laid low by the outbreak of the Covid-19 pandemic

By Phil Thornton

In pre-Covid days, analysts would measure the economic outlook for emerging markets through matrices such as debt, interest rates and unemployment. Nowadays the first consideration is the impact of the deaths, hospitalisations and lockdown caused by the pandemic.

On this score, emerging Europe and central Asia is in a bleak place: it remains among the emerging market and developing economy (EMDE) regions with the highest cases and deaths per capita.

According to the World Bank's benchmark global economic prospects report, published on the eve of the EBRD meetings, the true death toll is probably even higher, with excess death statistics indicating double-digit percentage increases in deaths relative to pre-pandemic years in half of the region's economies.

Borrowing from Charles Dickens, Ayhan Kose, director of the World Bank's prospects group, sees a tale of two recoveries with the best of times for advanced economies and the worst of times for

emerging and developing economies.

Within that divide, there are further divisions. Growth in Eastern Europe is projected to be the weakest among sub-regions, rising only to 1.9% in 2021 and 2.8% in 2022 — far behind the 4.7% and 4.4% forecast respectively for EMDCs overall.

## CEE FARING BETTER

This contrasts with the western end of the EBRD's area of operation where the bank projects growth in central and eastern Europe (CEE) to rebound to 4.6% in 2021 and to retain that pace into 2022, supported by a recovery in trade as activity improves in the euro area.

On top of that, countries such as Bulgaria, Croatia, Hungary, Poland and Romania have benefited from membership of the European Union and the sizeable fund packages for members states. Oxford Economics sees the EU's fiscal boost in the form of grants and loans at beneficial interest rates in the Next Generation fund and bolstered EU budget benefiting CEE economies particularly strongly, although countries' ability to disperse the funds ef-

ficiently may prove to be a problem.

The Vienna Institute for International Economic Studies — known by its German acronym wiiw — sees a similar split with CEE benefiting from both inward investment and rising inflows of EU funds but also the increasing pace of vaccinations.

Serbia and parts of the CEE that are inside the EU are proceeding relatively well with inoculations, but — based on current rates — Ukraine, Moldova and parts of the Western Balkans will take years to vaccinate their populations, it says.

"International solidarity on vaccines is going to be crucial to help the poorer parts of central, eastern, and southeastern Europe to exit this crisis, but unfortunately we don't see much of that at the moment", says Richard Grieveson, wiiw's deputy director.

Part of the reason for the rebound is the fact that it is bouncing back from a slump of 3.7% in 2020, the worst for any sub-region of Europe and central Africa other than south Caucasus. [See graph, page 8]

The challenge for policymakers who are using the increasingly over-worn phrase "build back better" is to deliver a strategy

Mass vaccination  
Ukraine (left) and Serbia  
(right)

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that both cements the economic rebound of these countries but also prepares them for a rapidly changing structural environment.

One vision for a new model for economic growth comes from the European Investment Bank (EIB), which has identified the need for what it calls a “twin transition” towards a greener and more digital economy. This shift, it believes, will stimulate economic growth in the near term and create jobs — for those countries that are prepared to undertake reforms.

In its keynote annual investment report, the EIB says that many regions that will be affected by the much needed push towards digitalisation and a greener economy are located in CEE, pointing to a need to re-examine economic growth models if these countries’ economies are to continue converging with the rest of the EU.

However, it is concerned that regions at high risk from both the digital and green transition are primarily located in CEE.

Their growth models need to be re-examined if their economies are to continue converging with the rest of the European Union.

“For sure, the region is definitely facing some challenges and some particularly strong challenges in terms of this twin transition,” says Debora Revoltella, the director of the EIB’s economics department. “Digital and green [economics] are a challenge — and a long lasting challenge — but they also offer some opportunities.”

The EIB found that areas with the greatest risk exposure to this double transition risk were clustered in CEE countries, with some 55% of CEE regions exposed to high twin transition risks, compared with 23% in southern Europe and 15% in northern and western Europe.

All of the regions in the “very high risk” group — defined as being in the top fifth for both risk types — are in central, eastern as well as southeastern Europe. In contrast, no CEE region is included in the 20% of re-

gions that have the lowest risks from automation and the green transition.

The EIB highlights Bulgaria, Hungary, Slovakia and Romania as particularly exposed to the twin risks of digitalisation and greening.

The agenda is shared by the EBRD, whose five-year strategic and capital framework up to 2025 heralds three strategic themes — transition to a green economy; accelerating the digital transition; and equality of opportunity.

### INFLATION SQUEEZE

But all these grand ambitions may come to naught if the region is hit by a surge in inflation, weakening government finances and so drawing money away from long-term investment — a fear that has risen to the top of economists’ agendas as the European summer has started to heat up.

According to the World Bank, of the 17 European and central Asian monetary

## Central Asia

### Outlook scarred by vaccines, oil and history

**S**prawling from the Caspian Sea in the west to central China in the east, and from Russia at the North and Pakistan to the south, Central Asia contains a diverse mix of countries that vary in size, political outlook and economic power.

Given its history as the centre of China’s Silk Road, the British Empire’s 19th century “great game” and the more recent Soviet rule, its eight or so member countries have enjoyed the

freedom they secured from Communism 30 years ago.

The latest challenge has been the coronavirus pandemic — albeit one shared with the rest of the world but one that has taken its toll.

Growth overall is forecast by the World Bank to recover to 3.7% in 2021 and 4.3% in 2022 — up from a 1.5% contraction in 2020 but well below historical averages. Neighbouring South Caucasus into which the Bank puts Azerbaijan and Georgia is only

just behind on 3.6% and 4.2%.

The cocktail for economic success in Central Asia may be in getting vaccines into people’s arms and natural resources out of the ground. These, at least, are the key to the economic rebound of Kazakhstan, which Oxford Economics forecasts will post growth of 5.7% this year.

Its government has succeeded in delivering almost 2.5 million vaccines, which were made from Russia’s Sputnik V produced at a local plant. This means it has given a first-dose inoculation to 13% of its citizens, second only in the region to Azerbaijan with 17% according to the Our World in Data platform. But as the graph [left] shows, some countries in the region have vaccinated fewer than 2% of their people.

Fitch Ratings recently confirmed Kazakhstan’s BBB credit rating with a stable outlook. It forecasts economic growth to rebound to 3.5% in 2021 following a contraction of 2.6% in 2020, due to a gradual return to normality for commercial and consumer activity thanks

to the vaccination programme.

### CRUDE BENEFITS

Vladimir Osakovskiy, Russia and CIS economist at Bank of America, which expects growth of 4.5% this year, points to “more fundamental support” from fiscal policy, as the government has voiced plans to use KZT850bn (about \$2bn) from its national oil fund for targeted spending measures.

On top of that, the International Monetary Fund expects the economy will be supported by a modest rise in commodity prices and relaxation of OPEC+ oil production cuts.

While Armenia, Georgia, the Kyrgyz Republic and Tajikistan are net oil and gas importers, their neighbours Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan will see the benefits of natural resources flowing into their government coffers.

The IMF forecasts Uzbekistan will grow by 5% this year thanks to the implementation of an ambitious reform agenda, which it pursued in

the face of formidable headwinds from the pandemic.

It was notable that Jürgen Riegerink, the EBRD’s first vice president, chose to travel to Uzbekistan in early June along with a senior group of managers at a time of Covid-19.

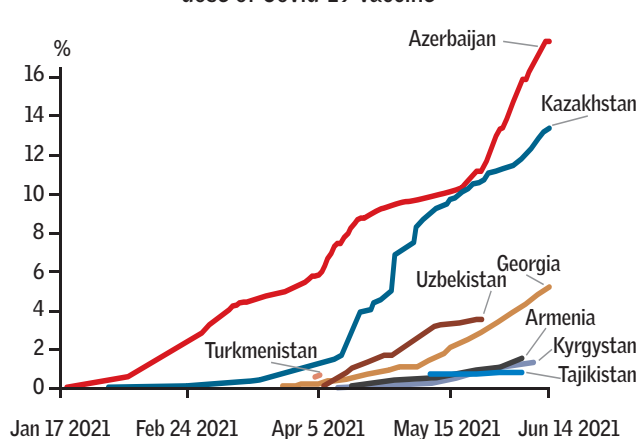
He was there to open a third EBRD Uzbek office in Urgench and to sign a deal which provides \$45m in a loan and guarantees for Uzpromstroybank, the country’s second-largest lender.

As he signed the deals, he pointed out that Uzbekistan became the largest recipient of EBRD funding in Central Asia in 2020. “It is important to keep this momentum going and expand our activity to support the post-Covid-19 recovery,” he said.

However, political tensions are never far away, with the United States, the European Union, Russia and China all moving to secure partnerships in the region. Ultimately the region’s fortunes will rest on whether it can avoid getting sucked into the geopolitical tensions that has so marked its history. —P.T.

### Safety in numbers

Share of people who received at least one dose of Covid-19 vaccine



# MODERN, DIGITAL AND SUSTAINABLE BANKING



Kyrgyz Investment and Credit Bank (KICB) was established in 2001 with the support and investment of international development agencies and the Kyrgyz Government. In an interview for *GlobalMarkets*, the Bishkek-based bank highlights its growth strategy, its focus on digital and sustainability, and how it has responded to the pandemic.

**GlobalMarkets: What new strategic initiatives are being undertaken by KICB to maintain its leading position in the domestic market?**

**KICB:** In recent years the landscape of Kyrgyzstan's financial and banking sector has changed rapidly due to several external and internal factors, including global financial crises, geopolitical challenges, the economic consequences of Covid-19, and other political and social issues in the country. In response to those factors, which negatively affected business activity in the local economy and banking sector, KICB has shown its resilience and made a strategic decision to go downstream — entering the microcredit business, and enhancing its digital footprint by focusing on further development of its alternative delivery channels (ADC).

On entering the microcredit sector, KICB has been able to reach to the lower income retail customers and drive down interest rates on microcredit products, which has increased the affordability of microcredit loans. In addition, KICB has also been able to increase its outreach to customers in remote areas of the country through its digital ADCs.

Part of the bank's strength in this area has come from acquiring a local microfinance company called, First Micro Finance Company. KICB not only has the capacity to address financial weakness among microfinance organizations, but can also potentially capture a decent share of the microcredit market through this acquisition. Ultimately, FMFC will be merged with KICB to create a single entity, which in time will generate various beneficial synergies. These will deliver overhead cost savings, an increase in the combined bank's financial outreach via an expanded branch network, and revenue growth opportunities from cross-selling of banking products to customers. KICB is targeting a 14% of market share of the country's consolidated microcredit portfolio by end of 2022.

**GM: How did the KICB respond to the pandemic and the challenging market conditions it caused?**

**KICB:** The performance of the bank in 2020 was significantly affected by unfavourable global external factors related to the pandemic, and specifically societies being in lockdown, which restricted travel. In fact, due to



Bektur Aliev, CEO of KICB

**“KICB has been constantly upgrading its main technology assets and has invested into building up robust technology platforms, which will support its major strategy on digital transformation and entering the microcredit sector.” — Bektur Aliev**

the lockdown in the local economy last year, and subsequent containment measures introduced by the government, bank loan customers experienced difficulties in repaying loans. As a result, KICB initiated a restructuring of its loan portfolio under the temporary regulations of NBKR, which provided a regulatory basis for loan forbearances.

The bank has since addressed all applications from its loan customers who suffered from the pandemic, and as a result most of them have recovered or are recovering from the negative consequences to their businesses. KICB's asset quality remains strong and its NPL ratio was 6.5% at the end March 2021, which is substantially lower than the banking sector NPL ratio of 11.2%, according to the National Bank of the Kyrgyz Republic.

Furthermore, the pandemic has caused a shift in the business models of many banks towards digital technologies and alternative delivery channels. KICB also embraced this change. The bank's first priority was to accommodate increased volumes of online banking services to customers during the lockdown

periods in 2020. KICB's ADC banking products were in high demand during this time, especially the ELSOM electronic wallet and online banking platform. Indeed, during April and May 2020 — when there was a full lockdown in the country — the bank's ADC channels were critical in providing essential banking services, such as cash withdrawals and peer-to-peer remittances, as well as merchant payments for essential grocery purchases.

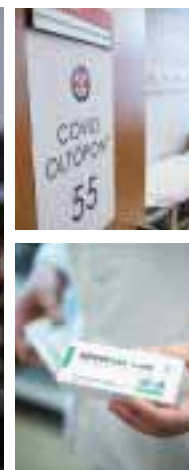
Importantly, KICB has developed a comprehensive set of measures to protect its employees and minimize the risk of infection spreading within its premises. Thanks to the measures developed and implemented, KICB has the lowest rate of cases among its employees across the country's banking industry

**GM: What technology upgrades has KICB undertaken?**

**KICB:** Since 2018, KICB has been constantly upgrading its main technology assets and has invested into building up robust technology platforms, which will support its major strategy on digital transformation and entering the microcredit sector. These upgrades included: a financial system upgrade to Oracle's FlexCube v12.4; a customer relationship management upgrade; the integration of a new sophisticated middleware solution; and a full-scale upgrade of the ELSOM electronic wallet platform. In addition, and within the strategy on digital banking, KICB is currently in the process of implementing a new internet banking solution until the end of 2021. After implementing this project, KICB will be equipped with the most up-to-date IT platforms to cover all business needs and will offer comprehensive digital banking products and services.

**GM: What are some of the main sustainable development activities KICB has implemented?**

**KICB:** In 2012, KICB established a non-profit entity called the “Green Foundation”, which coordinates sustainable initiatives by KICB and its partners. Under the Green Foundation umbrella, KICB conducts different campaigns aimed at planting new trees and preserving existing trees in the different parts of the country. Every year the bank and its partners initiate the planting of trees and new seedlings mainly in schools and kindergartens. The first tree planting within the framework of the Green Foundation project took place in 2012, and up to today more than 14,000 trees have been planted. Within its next initiative on sustainable development, KICB is planning to issue green bonds and initiate a project on improving quality of air in Bishkek, the country's capital city. We plan to start this project late in 2021. ●



### Pints allowed!

Hungary's Viktor Orbán receiving his vaccine in February and celebrating "terraces open" on April 24

authorities with inflation targets, nearly half reported headline inflation above the upper end of their target band in early 2021. As a result of those inflationary pressures, banks have hiked interest rates in a third of the region's economies thus far in 2021.

The recent sharp increase in global commodity prices is a particular issue for the CEE and southeastern Europe, says Gieversson at wiiw, given that a larger share of the consumer price basket in the region is weighted towards those items than is the case in western Europe.

Kose at the World Bank says that while the decline in inflation in the early stages of the pandemic was the most muted for a recession period, the rebound since has been the most aggressive. "As economies normalised, commodity prices increased and we had supply disruptions around the world," he says. "One thing is clear — by the end of the year we will see higher inflation in emerging markets and developing economies."

Price pressures in Central Europe are building from a broad range of sources, says Liam Peach, emerging Europe economist at Capital Economics. "While most of these are likely to be temporary, the

issue is that countries were experiencing stubbornly high inflation before these pressures emerged," he says.

But he echoes Kose, saying strains in global supply chains have intensified as demand for goods has been accompanied by shortages of raw materials and supply bottlenecks in key manufacturing countries, pushing up prices.

"The key concern now for central banks is the extent to which these price pressures will be passed through to consumer prices," Peach says.

### RISING RATES

Bond yields have risen in tandem, especially as officials have started to highlight the dangers of rising inflation. Local bond yields in Poland and Hungary, for example, have risen sharply following hawkish comments from officials. Both countries also saw inflation rise in April. Meanwhile, a surge in inflation, especially in Ukraine — the sub-region's largest economy — triggered more restrictive monetary policy in early 2021.

But for countries that borrow on the open market, a more worrying challenge is the rise in US long-term rates that would push up borrowing costs for those

countries weighted towards dollar funding. Last month US Treasury Secretary Janet Yellen caused a stir by saying interest rates "will have to rise".

The extent to which central banks are able to continue to engage in monetary stimulus will depend on inflation; there are signs that this will rise somewhat this year but will remain low by historical standards.

Rising interest rates will hit countries that have understandably increased debt to underwrite the cost of measures to support parts of their economies hit by Covid-19.

The fiscal response to the pandemic, together with last year's contraction in output, is expected to leave median public debt at 54% of GDP by end-2022 — nearly 15 ppts higher than in 2019 — according to the World Bank.

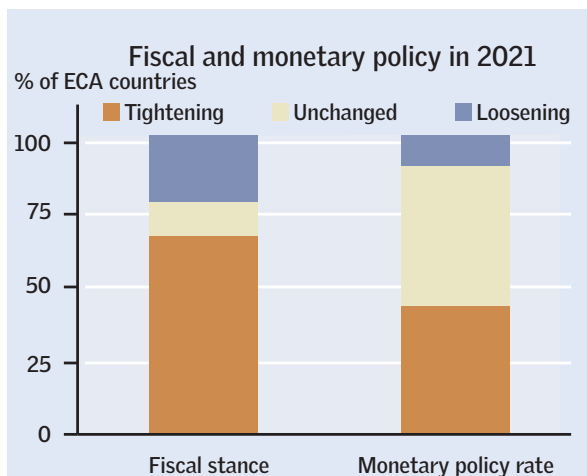
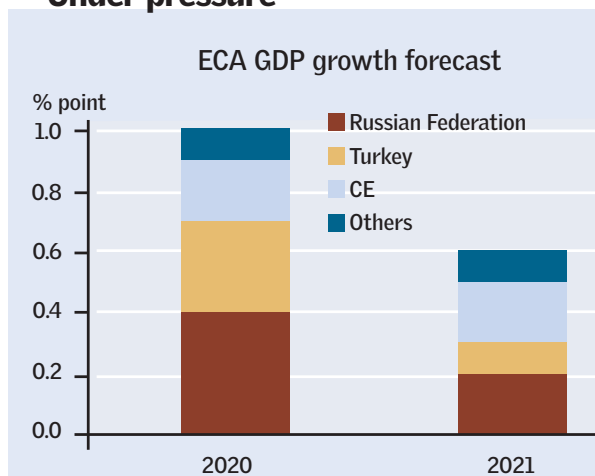
There are other worries. The banking sector remains fragile amid high dollarisation in some economies, with sharp currency depreciations and weak activity having eroded bank asset quality.

The outlook, therefore, remains very uncertain for a region that has been through so many ups and downs over the last 30 years. The withdrawal of domestic macroeconomic support measures will be weighing on the regional recovery while the uneven vaccine rollouts will foster inequalities between countries.

The risks to growth are on the downside, especially if the pandemic takes longer than expected to abate, external financing conditions tighten, or policy uncertainty and geopolitical tensions rise further.

Just as the legacy of Communist rule hung over the region in April 1991 when the EBRD took on its mission, so the long-term consequences of the pandemic will exact a price. The challenge to policymakers is to, once again, help the region regain a secure economic footing. **GM**

## Under pressure



# Global Markets Special Report Kazakhstan



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# Covid brings unexpected positives for Kazakhstan

The oil-rich nation took a blow from the global pandemic, but Kazakhstan is getting back on track

By **Simon Watkins**

**K**azakhstan's remarkable run of growth and development was derailed in 2020 as the Covid-19 pandemic slammed the brakes on the global economy.

Kazakhstan's economy shrank by 2.6% in 2020, according to the World Bank, its first annual decline for almost 20 years and a sharp reversal from the 4%-4.5% growth seen in the previous three years. Meanwhile, the national currency, the tenge (Kzt), slumped to its lowest ever level against the US dollar.

While the Covid-19 crisis has been the toughest test of its economic strategy, there is plenty of hope among business leaders that Kazakhstan can regain its former glory. The currency has recovered from its lows and the economy is expected to show headline growth again this year.

Bolat Mynbayev, head of strategy and operations for KPMG Central Asia, says: "If we look at 2021, there are forecasts from various sources, including the World Bank, that growth should be 2.5% or higher this year, so it seems like the economy is getting back on track."

Before the pandemic, there were two main

concerns for Kazakhstan's long-term economic stability. First was the question of political succession after Nursultan Nazarbayev's near three-decade presidency. While Nazarbayev remains a figurehead for the country and still wields considerable influence, elections in 2019 saw the presidency pass to Kassym-Jomart Tokayev. The transition proved smooth, and the stability and strategy of Kazakhstan has been almost unchanged.

The second question related to the country's heavy dependence on hydrocarbons. As the source of Kazakhstan's wealth and development, the significance of fossil fuels to the economy left the country exposed as global demand slumped, and with it the price of oil.

## THE WORD ON EVERYONE'S LIPS

"The word diversification is pronounced here every five seconds," says Andrey Kurilin, country officer for Citibank in Kazakhstan. "Any economy that is diverse is a stronger economy, especially when you are focused on exports of fossil fuels. In Kazakhstan, clearly there is a reliance on oil, but it is also a significant source of wealth."

As well as exposing Kazakhstan's dependence on oil and gas, 2020 also threw a spot-

light on other sectors. Government figures released in June 2021 showed that while headline GDP shrank in 2020 other sectors continued to grow. Construction grew by 11.2%; information and communications grew by 7%; agriculture by 5.6%; and manufacturing by 3.6%.

The figures led Kazakhstan Finance Minister Yrulan Zhamaubayev to declare that the real economy of Kazakhstan continued to grow in 2020.

It also continued to attract considerable foreign investment. The policy of being 'everyone's friend', pursued by Nazarbayev and continued by Tokayev — a lifelong diplomat by profession and a former deputy secretary general of the United Nations — has kept the doors open to investment through the ups and downs of geopolitics. It also appears to have helped weather the pandemic storm.

Globally, foreign direct investment fell by 42% in 2020. Kazakhstan, however, was a rare exception: according to the UN Conference on Trade and Development (UNCTAD), foreign direct investment in Kazakhstan rose by 19% last year.

Development in greenfield projects declined, but continued investment into existing projects ensured Kazakhstan's out-performance. Chief among these has been China's Belt and Road Initiative (BRI), first announced in 2013 in the Kazakhstan capital Astana, since renamed Nur-Sultan.



# AIFC. UNIQUE OPPORTUNITIES FOR INVESTING IN KAZAKHSTAN

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“  
Green finance  
development  
concerns are  
extremely significant  
both globally and  
locally in our country,  
considering the  
critical role that they  
may play in the  
transition to a more  
environmentally  
friendly economy.”

—Aidar Kazybayev, chief  
executive officer of the AIFC's  
Green Finance Centre

Kazakhstan's location and scale — a vast expanse of territory at the heart of central Asia — has made it a key link in the BRI and the continued growth in construction and communications in Kazakhstan during 2020 partly reflects the ongoing development involved.

The initiative has not moved ahead entirely smoothly. The turn of this year saw bottlenecks at the Kazakhstan-Chinese border — notably at the flagship BRI crossing point of Khorgos. Officially due to temporary Covid-19 restrictions, fears were raised that trade restrictions from China were also playing a role.

Despite such problems, Kurilin at Citibank is still optimistic: “Things have picked up big time. Belt and Road is now a visible revenue source to the government.

“I would not say it's easy to make this work well. It has to do with talking to many, many stakeholders and there will be geopolitical challenges. It's not simple, but despite that it has been positive, and it's been developing.”

KPMG's Mynbayev cites transport and logistics as one the leading opportunities for diversification in Kazakhstan, thanks to the BRI. Road and rail development have seen thousands of miles of transport routes upgraded. In a country of 1m square miles, the rail system is a crucial network and national railway company Temir Zholy is the country's largest employer with around 127,000 workers.

Elsewhere, food production is already a key element of the Kazakhstan economy, where grain production vastly exceeds its domestic requirements and 70% of crops are exported. “We see a lot of investment, especially from local investors, and there are a lot of government support programmes into the sector,” says Mynbayev.

There has also been significant foreign interest, most notably from the US group Tyson Foods, which in 2019 launched a major investment in beef and poultry processing. Its target market is not just Kazakhstan, but the wider central and east Asian market to which the country provides access.

#### A FINANCIAL HUB IN CENTRAL ASIA

Kazakhstan has high hopes of becoming not just a transport hub but also a financial centre. The Astana International Financial Centre (AIFC) is the key initiative in this plan. Launched in 2015, the AIFC has a special carve-out from Kazakhstan law and operates its own arbitration system under English common law and overseen by judges drawn from the British judiciary. It is also home to the Astana International Exchange (AIX) launched in 2017 — shareholders include Goldman Sachs and the



Shanghai Stock Exchange, and it uses a trading platform from Nasdaq.

“The AIX has built a trading ecosystem with around 30 members, including brokers from Kazakhstan, China, Russia, and Europe,” says Renat Bekturov, chief executive officer of the AIX. “And very soon, the AIX Index will be launched with the objective of improving the investing process by assessing the performance of Kazakhstan's most liquid capital market segment and allowing potential investment plans to be compared to the index.

“The AIX expects a revision of Kazakhstan's ranking in the MSCI and FTSE indexes for emerging markets, increasing demand and investments [by] passive investment funds.”

With a mission to develop capital markets inside Kazakhstan, AIX has segments dedicated to the mineral extraction sectors and infrastructure linked to the BRI, while also actively supporting fintech and green investment.

“Green finance development concerns are extremely significant both globally and locally in our country, considering the critical role that they may play in the transition to a more environmentally friendly economy,” says Aidar Kazybayev, chief executive officer of the AIFC's Green Finance Centre.

He adds that Kazakhstan's commitment to reducing carbon emissions and its ambition of becoming carbon neutral by 2060

will provide a spur to investment. “To attain these objectives, action will have to be taken, including the building of new renewable energy-driven power plants.”

The AIFC can already point to some success in its efforts. Since its inception, the organisation has attracted total portfolio investments of \$1.2bn, of which \$321m has been in equity and \$887m in fixed income. Meanwhile, direct investment attracted through the AIFC has reached \$3.2bn.

Kairat Kelimbetov, governor of the AIFC, says it aims to become a “gateway” to central Asia “to help international investors and businesses to develop and continue to grow”.

The financial community in Kazakhstan is universally supportive of the AIFC and its ambitions. It is, however, still early days. “The AIFC is not yet as developed as it could be, but it is something investors should be keeping in mind,” says Guram Andronikashvili, chairman of the management board of Kazakhstan's ForteBank.

KPMG's Mynbayev agrees that the AIFC needs more time to prove itself: “If you look at the strategy and the underlying principles of this centre then perhaps you can see that it is the right move. At least, that is what we hear from investors who are not yet invested here in Kazakhstan. Having this English common law makes it quite interesting.”

AIFC might have developed faster over the

#### Doors open

The Sputnik V vaccine administered at a mobile vaccination centre in the Almaty Palace of the Republic concert hall; President Kassym-Jomart Tokayev arrives at the Palace of Peace and Reconciliation



# NEXT GENERATION BANKING AND FINANCIAL SERVICES

The banking sector is probably the most digitized and digitally innovative industry in Kazakhstan. In an interview for *GlobalMarkets*, Guram Andronikashvili, chairman of the management board of ForteBank, talks about the Kazakhstani fintech industry and how the banking sector is leading in digital transformation.

With its head office in the capital city, Nur-Sultan, and an extensive branch network across all regions of the country, ForteBank is leading Kazakhstani bank that is pioneering in digital banking and ecosystems, too.

A good example of its digital leadership is in the Forte digital ecosystem. This not only includes standard banking services for individuals and legal entities, but also the ForteMarket goods marketplace, ForteMobile cell communications, ForteFinance investment company, ForteForex platform for trading and currency exchange, the ForteTravel service, and the ForteFood food delivery service. Importantly, the bank believes there is no room for complacency and continues to grow and develop this ecosystem.

Part of the ecosystem's strength is that it has a core. Specifically, the heart of the Forte ecosystem is the bank and its services, including everything from payment cards and deposits, to transfers and loans. Other services, while developing in parallel, receive support from this banking service core.

For example, any Kazakhstan citizen can become a customer of ForteMobile and pay for it as for a regular communication. But if the customer has a ForteBank card and actively uses it, then the communication services are offered to the customer for free. Another example is the ForteMarket marketplace, which sells more than 150,000 products. Customers can pay for them with any bank card, but if the customer wants, they can take the product on an interest-free installment plan, which Forte also provides.

"According to our clients' surveys, Forte is an advanced and, most importantly, stable financial partner," says Guram. "We have managed to achieve this status in five years of productive hard work.

And yet, we cannot stop there. We see that in the modern world, banks have the opportunity to help people solve some of their

life tasks through banking products as well as in other areas. In studying their needs, including our own, we understand in which direction it is necessary to develop the bank's product line and which non-financial services will be of interest to people. Last year, for example, we launched ForteMobile, which attracted 100,000 subscribers during 2020."

As part of improving financial services, the bank also updated its card line by issuing ForteBlue and ForteSolo cards. The main difference from previous cards is that the accounts can be opened in a couple of minutes in the Forte digital app, so there is no need to visit a branch and fill out any paper forms, even for new customers.

“Forte is an advanced and, most importantly, stable financial partner. We have managed to achieve this status in five years of productive hard work. And yet, we cannot stop there. We see that in the modern world, banks have the opportunity to help people solve some of their life tasks —Guram Andronikashvili, Chairman of the Management Board, ForteBank

According to Guram, there are several other large fintech e-commerce players operating in Kazakhstan today. He argues, however, that they are all united in a common goal – to correctly collect services in one place so that it is more convenient and easier for people to solve everyday problems.

"For us, digitalization is good because, by reducing human participation, we speed up all our processes, which is subsequently beneficial for clients since they receive services faster," he points out.

Guram adds that while a large number of existing customers and clients are already accustomed to digital services, they need to be constantly surprised by the improvement of existing and the introduction of new



Guram Andronikashvili, Chairman of the Management Board, ForteBank

services. In addition, those customers and clients outside the digital system need to be brought in.

"There is a large proportion of those on the market who use one or two of our financial products, but do not use others. Perhaps they have been using our payment card for a long time, but have not yet mastered ForteMarket. The key task is to help them understand how our services can make their lives easier," says Guram. "Now a new generation is growing up, for whom living with a smartphone and receiving services online is not something radically new. For them it is just routine stuff."

He adds: "Over the next few years, they will come to an age when they can get their first ever banking service, and for us, of course, it is important to prepare ourselves so that they make a choice in our favor. For this, we must constantly improve our products."

Looking ahead, Guram emphasises banks need to move swiftly to respond to customer demand and technological innovation. "New ideas and technologies appear at such a speed that if you do not react to them promptly, you will inevitably fall behind. At Forte, we are moving towards shorter-term planning, as well as implementing a medium-term strategy and project management in smaller teams. By applying these agile approaches this allows us to quickly understand if we are heading in the right direction and correct our course." ●



*The AIX expects a revision of Kazakhstan's ranking in the MSCI and FTSE indexes for emerging markets, increasing demand and investments [by] passive investment funds."*

—Renat Bekturov, chief executive officer of the AIX



last year had it not been for pandemic-induced delays to key listings planned for 2020 — most notably the airline company Air Astana and oil and gas group KazMunayGas.

Kazakhstan's oil and gas sector has significant involvement from overseas oil groups, which Citibank's Kurilin believes has been important to its success. "Unlike some other oil-rich countries Kazakhstan has a high proportion of foreign majors in exploration and exports," he says. "The companies that are controlled by those majors contribute a very significant share of government revenues. This makes Kazakhstan totally unique among emerging markets."

A central pillar of the oil and gas sector, KazMunayGas, is still 90% owned by the Kazakhstani sovereign wealth fund Samruk-Kazyna, and 10% owned by the central bank. KazMunayGas accounts for 25% of the country's oil and gas condensate and 15% of natural gas and associated gas. It transports 56% of oil and 77% of gas in Kazakhstan. When an IPO was first mooted, the group's value was estimated at about \$6.5bn.

KazMunayGas's listing on the London Stock Exchange and AIX was scheduled for late 2020, but the uncertainty caused by the pandemic and the slump in oil prices led to a postponement. Similarly, state-owned Air Astana was slated for an IPO in 2020, but this was delayed. Both are now expected to list in 2022.

Despite these setbacks, the commercial sector has seen significant moves, not least the flotation of finance and technology

group Kaspi in November 2020. The listing was the largest technology IPO in London last year, and since the IPO the stock has more than doubled in price valuing Kaspi at \$18bn. Global depository receipts in Kaspi are also traded on AIX.

Kaspi began as a straightforward bank but, under chief executive Mikhail Lomtadze, is now better described as a financial technology group and a symbol of Kazakhstan's digital economy. Kurilin at Citibank says: "Every person has a mobile phone so what that bank managed to do was say 'once you have a mobile phone you have bank'. They dramatically accelerated the disruption of banking services."

Kurilin's statement that 'everyone has a mobile phone' is a deliberate exaggeration, but one made for good reason. In 2018, 65% of Kazakhstanis owned a mobile phone, a higher proportion than China, Japan, or Italy and higher than any other member of the Commonwealth of Independent States (CIS). This high penetration of mobile technology is one of the most obvious indicators of Kazakhstan's developing consumer economy.

For banks such as Alfa-Bank Kazakhstan, moving swiftly to capture this opportunity has been a priority. "Before the pandemic emerged, we were already undertaking a digitalization strategy, which has accelerated in the past year," says Andrey Timchenko, CEO of Alfa-Bank Kazakhstan. "Indeed, in addition to investing in developing the speed and functionality of our mobile app, we have also moved 85% of all services for individuals and 99% of services for all legal entities online."

## CONSUMERS BOUNCE BACK

Before the pandemic, consumer spending in Kazakhstan had already been rising rapidly. Lockdown in 2020 caused a collapse, but this year that pent-up demand has been unleashed. Official figures from The Agency of Statistics of the Republic of Kazakhstan showed consumer spending in the first quarter of 2021 not only bounced back, but hit a new high of Kzt36.6trn (\$85.6bn).

The long-term trend, suggests Citibank's Kurilin, is only partly due to the rising wealth of many, if not all Kazakhstanis — cultural change is also playing a role.

"There used to be an issue around the culture of spending," he says. "People took the money they earned, put it into dollars and then put it in the bank. The banking system had 80% of its deposits in dollars. Why? Because people did not know what to do with their money. But suddenly it's about spending, spending, spending. I look at this very optimistically and many of our clients who have come here in the last three or four years are in retail and food."

State spending has gone some way to mitigating the financial damage of the crisis, including direct payments to vulnerable citizens and loans to businesses. The central bank's loan scheme to small and medium-sized enterprises made Kzt800bn (\$1.9bn) available at an interest rate of 8% — below the official central bank rate of 9%.

This in turn is not without risks. While the World Bank noted the value of continuing fiscal support to the economy until the pandemic is fully vanquished, it cautioned that easily accessible credit raised the risk

### Bouncing back

Khorgus Gateway, a key BRI link; Wind turbine blades en route to the Kostanay wind farm; Independence Day in Almaty; QR code scan to identify health status in a restaurant in Nur-Sultan

## SPECIAL REPORT: KAZAKHSTAN



“  
Unlike some other  
oil-rich countries  
Kazakhstan has a  
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foreign majors in  
exploration and  
exports.”

—Andrey Kurilin, country  
officer for Citibank in  
Kazakhstan

of future non-performing loans.

Consumer debt has been controversial, with the Nur-Sultan government facing public demonstrations on the issue earlier this year. However, as with many issues in the wake of Covid-19, the question is whether this distress is a short-term result of the pandemic, or a longer-term problem.

“I think it is difficult to judge,” says ForteBank’s Andronikashvili. “If you look at the statistics of consumer indebtedness per head of population, Kazakhstan is lower than Russia and it is definitely lower than central and eastern Europe. But a large portion of purchases here are through some sort of credit. From that perspective there is a concern, and it is wise for the central bank to be monitoring that situation.”

The government has introduced debt-forgiveness schemes for the country’s most vulnerable consumers, which it has been able to do thanks to its own fiscal security. The country’s debt to GDP ratio stands at just 22%, according to Fitch Ratings, and global debt markets appear supportive. Fitch rates Kazakhstan at BBB, and yields

on Kazakhstan debt trade at some of the lowest levels in the CIS.

As a result, The World Bank has no concerns about state finances, declaring in its outlook report: “The country has ample fiscal reserves and would face no difficulties in investing in infrastructure, education, and healthcare, as well as the green agenda put forward by the authorities.”

#### ‘KAZAKHSTAN. VERY NICE!’

The Borat films of Sacha Baron Cohen initially, and unsurprisingly, caused great offence in Kazakhstan, but they also gave the country a far higher international public profile. Late last year Kazakh Tourism adopted the character’s catchphrase: “Very nice!”

Making the most of its movie fame may turn out to be a smart move. The vast expanse of Kazakhstan — it is the world’s largest landlocked nation — offers significant potential for the tourism sector. In the 10 years between 2009 and 2019, annual tourist numbers tripled from 3m to 9m. In 2019 the tourist industry was worth \$2.9bn, or 1.6% of GDP.

Tourist numbers plummeted in 2020. With

international travel restrictions still in place in many countries, the sector is unlikely to see a full recovery in 2021. Looking further ahead, however, many are optimistic.

“Tourism has definite potential,” says Andronikashvili at ForteBank. “The problem is that there has not been so much time and money spent on the infrastructure that generally tourism needs. But there are programmes building on that, and to be honest, the Covid situation even helped a little, because there was a development of internal tourism and that helped with the demand for infrastructure.”

Once the pandemic has receded across the world, global trade, global travel and demand for oil and gas should return. The strategy of state divestment should also move forward decisively and provide a boost to the country’s own nascent capital markets. In 2022, Kazakhstan should get fully back on track.

It could turn out that the crisis has brought unexpected positives — injecting ambition and investment into the long-standing drive for diversification. **CM**

#### Diversification

720 tons of exported wheat from Kazakhstan arrives in China; KazMunayGas in the Kyzylorda region; The control centre of central Asia’s largest wind farm near Zhanatas; Passengers have their health QR codes scanned at the airport in Nur-Sultan

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# EM to take tapering on the chin

Although the US Federal Reserve has pointed towards tapering its monetary policy — warnings that in the past has spooked investors — experts say emerging markets are poised to weather the storm well. Though challenges lie in store, there will be no repeat of the ‘Taper Tantrum’ witnessed in 2013

By **Mariam Meskin**

**A**fter months of vast quantitative easing by central banks around the world since the onset of the coronavirus crisis, the inevitable has happened. The US Federal Reserve has sounded the alarm, hinting at tapering monetary stimulus and increasing interest rates by the end of 2023 amid rising inflation. Some say the hikes could come even sooner if inflation continues to accelerate faster than expected.

Back in 2013, after years of stimulus following the 2008-09 crisis, when then Fed chair Ben Bernanke suggested that monetary support would be curbed, emerging markets found themselves at the apex of global market chaos.

The “Taper Tantrum”, as it later became known, wreaked havoc on emerging markets and gave birth to the “Fragile Five” — an especially vulnerable group of nations consisting of Turkey, South Africa, Brazil, India and Indonesia.

EM assets bore the brunt of the panic over tightening as US Treasuries sold off, sending bond yields soaring, currencies weakening, and forcing countries across the developing world to shift their policies and approach.

But this time around, despite the rise in

yields and signalling of higher rates, concerns are muted. First of all, the Fed has learned some lessons about the power of its own words.

“The Fed and G7 central banks have learned from the past and they want to take the tantrum out of tapering,” says Simon Quijano-Evans, chief economist at Gemcorp Capital in London. “They are succeeding in doing so. Markets have been preparing for this for months.”

With inflation having returned, so too has volatility in fixed income markets. But having witnessed the brutal impacts on global markets of a change in rhetoric in 2013, regulators are taking a more measured and gradual approach this time around.

“Tapering will likely happen sometime this year, potentially in the second half,” says Nick Eisinger, co-head of emerging markets active fixed income at Vanguard in London. “The market should be on alert, although the Fed will take a more gradual approach. It realises there is more at stake and so it will be careful when pulling the plug. Tapering has been better signalled this time around.”

US Treasury yields have shot up since the start of the year, with the 10 year reaching over 1.7% in March from 0.93% at the start

of the year. As of June 23, it stood at 1.475%.

The Fed has made it clear that it will need to “see substantial further progress” in recovery before tapering.

While the market anticipates the Fed to begin tapering at any point between the fourth quarter and early next year, emerging market countries across CEEMEA, Latin America and Asia are set to weather the storm.

## CENTRAL BANK STRENGTH

It is not just developed markets policymakers who have learned some lessons from 2013. Certain central banks in the developing world are also demonstrating their credibility and experience.

Some EM central banks have already started a cycle of tightening in response to the rapidly changing macro-economic environment. In recent weeks, a number have pushed up benchmark rates — including Hungary, Russia and Brazil, following similar moves earlier in the year by Ukraine, Georgia and Turkey to get ahead of domestic inflationary pressures.

“We are not going to have the same tantrum because emerging markets are better prepared than in the past in terms of monetary policy,” says Elina Ribakova,

### Strongly signalled

Jerome Powell, Chairman of the US Federal Reserve

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Turkey's Central Bank struggling against fragility

“We are not going to have the same tantrum because emerging markets are better prepared than in the past in terms of monetary policy. We will see a boring taper tantrum — a more nuanced and less explosive set of events.”

—Elina Ribakova, deputy chief economist at the Institute of International Finance

deputy chief economist at the Institute of International Finance. “We will see a boring taper tantrum — a more nuanced and less explosive set of events.”

Bank of America said in a research report in late June that central bank tightening across EEMEA was “overdue”, especially if the “hawkish Fed pertains”.

Some predict a continued wave of monetary tightening in anticipation of rising US rates and a stronger dollar.

Currency volatility was one of the main features of the market chaos of 2013. That, experts say, will not be repeated.

“It is helpful that central banks are hiking; front-loaded hiking will support EM currencies and insulate them from the worst impacts, as many vulnerabilities do tend to come from the currency side,” says Trieu Pham, emerging market debt strategist at ING in London.

BNP Paribas has predicted the situation will be a “Tantrum-less Taper”, in part due to the role of regulators.

“Emerging markets will not be as badly impacted as they were in 2013 because the frameworks of central banks have improved,” says Luiz Peixoto, emerging markets economist at the French bank. “They are more objective, transparent and the focus has turned towards inflation targeting. We are likely to see the wave of monetary policy tightening across EM extending and broadening in H2 2021, adding Colombia, Chile, South Africa and Poland to the mix of rising policy rates, besides Brazil and Russia.”

#### CURRENT ACCOUNTS

Financially, emerging markets are also in a much better position today than in 2013. This, according to experts, will act as another buffer against potential rates volatility later in the year.

According to fund manager Ashmore, EM countries are running an average current account surplus of more than 1% of GDP, versus a deficit of around 2% in 2013.

Developing economies have strengthened their buffers in recent years, having experi-

enced how vulnerable the dependence on foreign capital inflows had made them.

“Emerging markets have lower non-resident capital exposures, deep local currency bond markets and more conducive real interest rate environments,” says Quijano-Evans. “Those will prevent it turning into a tantrum.”

“There will be a reaction in the market the closer the Fed gets to tapering, but that reaction will not be sustained over multiple months.”

Higher commodity prices and recoveries in export levels have helped to prop up current account balances.

Importantly, unlike 2013, emerging markets are — on average — far less dependent on non-resident capital inflows, making them less susceptible to a volatility-induced sell-off. The capacity of governments to fund themselves has improved. Countries have far bigger reserves now compared to 2013.

“EM relies much less on external funding and portfolio inflows now compared to 2013,” says Peixoto at BNP Paribas. “Local liquidity is very strong, and governments have successfully extended their maturity profiles, reducing financing pressures.”

In fact, experts say emerging market spreads have been particularly well behaved amid volatility in the rates market.

“EM spreads widened briefly in February and March, which was driven by underlying core rates,” says Pham at ING. “However, since then spreads have been well contained, in fact tightening in mid-June. Though spreads have been well behaved, it is too early to say if that will last as liquidity conditions change.”

#### CAPITAL MARKET ACCESS CONTINUES

That so many sovereigns across the credit spectrum have been able to access international capital despite the hawkish Fed rhetoric demonstrates investor confidence in emerging markets.

“There is little concern about major emerging markets finding sources of funding, even with tapering,” says BNP Paribas’

Peixoto. “The pandemic is a testament to the amount of liquidity out there.”

A number of emerging market issuers across the credit spectrum have poured into markets despite the Fed’s change in outlook.

In the last few weeks, even riskier EM credits like Turkey have managed to find strong support in international markets. In June the sovereign raised \$2.5bn in a sukuk sale, which bankers on the trade quoted as pricing especially tightly, in spite of a range of idiosyncratic investor concerns around central bank credibility and monetary policy.

#### NOT SO FAST

However, it is not all sunshine and rainbows for emerging markets. Though they are — on the whole — in a better position than in 2013, a number of challenges await the asset class, especially the more vulnerable countries.

According to the Institute of International Finance, EM current account deficits remain “small or inexistent”, as a result of strong global demand and the recovery in commodity prices. The IIF notes that this will not serve as a permanent defence. In fact, the acceleration of economic recovery across emerging markets will likely weaken the strong recent performance of external accounts.

“Eventually emerging markets will become more challenging — the asset class will be hit by the tapering over the next year or so, though it is difficult to pinpoint the exact timing,” says Pham at ING. “Current account balances will become less favourable — eventually EM countries will recover, imports will grow, and deficits will increase. Eventually, many of the countries that this year run balanced current accounts or surpluses could face deficits.”

Additionally, any withdrawal of liquidity by the Fed will naturally increase yields in the US, making emerging markets less compelling on a comparative basis. That may, some say, pose challenges for primary market issuance, particularly for high yield issuers.

Some investors are erring on the defensive, choosing to take a wait and see approach.

“The market outlook is mixed on EM,” says Eisinger at Vanguard. “In anticipation of the gradual withdrawal of liquidity, some of the frothiness in primary markets is being looked at with a bit more care. We are, and have been, positioning ourselves defensively. If the Fed continues to be hawkish, the dollar will strengthen, which is not a good recipe for emerging markets.”

Notably, while regions like central and eastern Europe are causing little concern for market participants, some frontier markets are erring on the riskier side.

“The Fragile Five have shifted — the concern is now around the frontier markets, including countries in sub-Saharan Africa, Asia and Latin America,” says Ribakova at the IIF. **GM**

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# What's happening Thursday, July 1

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All times BST

## 7:30 AM – 10:30 AM

**Board of Governors' Opening Session**  
Live streamed  
Speakers: **Rishi Sunak**, Chancellor of the Exchequer of the United Kingdom; **Paschal Donohoe**, Chair of the Board of Governors and Minister of Finance of Ireland and **Odile Renaud-Basso**, EBRD President.

## 11:00 AM – 3.00 PM

**Board of Governors' Plenary Session (Closed Session)**  
Streamed on the Virtual Attendee Hub

## 11:45 AM – 12:30 PM

**Panel: The Future of Sustainable Finance in Emerging Europe**  
Sponsored by forum partner Raiffeisen Bank International  
Moderator: **Martin Blum**, Head of Desk Strategy, RBI  
Speakers: **Maya Hennerkes**, Environmental and Social Sector Lead for Financial Intermediaries, EBRD; **Lukasz Januszewski**, Member of the Management Board Markets & Investment, RBI; **Zoltan Kurali**, Chief Executive Officer, Government Debt Management Agency Pte. Ltd; **Yerlan Syzdykov**, Global Head of Emerging Markets, Amundi Asset Management.



Odile Renaud Basso (Host)

## 1:30 PM – 2:15PM

**Panel: Sustainable Finance: how to create a win-win situation in CEE**

Moderator: **Marko Vukadinović**, Head of CEE FIG, UniCredit  
Speakers: **Robert Adamczyk**, Associate Director, Senior Environment

Adviser, EBRD; **Roberta Marra-cino**, Head of Group ESG Strategy & Impact Banking, UniCredit.

## 3.00 PM – 3:15PM

Virtual magic and mind reading show: **It's All an Illusion**

## ExtraCurricular Astana Finance Days 2021: Restoring Growth (Live-Stream)



**10:00-11:50** Afd Opening Session: Presentation of Aifc products

**12:00-12:50** Strengthening Investor Protection in the Islamic Capital Markets

**12:00-12:50** Accelerating Shift To Cashless Economy in Central Asia

**13:00-13:50** Enhancing Transparency in the Sukuk Market

**13:00-13:50** Supporting SME in Central Asia

**14:00-14:50** Strategic Investment Agreement as a New Investment Instrument for Strategic Investors

**15:00-15:50** Safeguarding Investors in a Challenging Global Environment

**15:00-15:50** Mining Club: Amendments in Mining Industry Legislation

**16:00-16:50** Legal Talks: The Future Aifc Legal Services Regulatory Framework

**16:00-16:50** Mining Club: Development of Mining Geology in Kazakhstan

**17:00-18:00 Carec Economic And Financial Stability Cluster Forum 2021:** Carec High-Level Policy Dialogue on Covid-19 Pandemic and Financial Inclusion.  
Panel Discussion 1: **Challenges To Financial Inclusion And Policy Responses – Pre-, Peri- and Post- Covid-19 Pandemic**

**18:00-18:50 Carec Economic and Financial Stability Cluster Forum 2021:** Carec High-Level Policy Dialogue on Covid-19 Pandemic and Financial Inclusion.  
Panel Discussion 2: **Drivers of Financial Inclusion: Fintech and Innovative Financial Solutions**

**17:00-17:50** Mining Club: Funding for Exploration Projects

**18:00-18:50** Closing the Gender Gap

**19:00-19:50** Women in Finance

**19:00-19:50** Restoring and Recalibrating Nation's Growth Prospects

**20:00-21:00** From Corridor to Economic Platform: The New Trade Links

**20:00-21:00** From High School to the Boardroom

## MDBs

Continued from page 1

But only the ADB managed to grow its main balance sheet more than in the last crisis. The World Bank expanded lending by 55%, against 87% then; the EBRD 9%, down from 45%.

"African Development Bank lending in 2020 actually declined," said Humphrey. "The MDBs are not providing enough fast-disbursing budget support loans, which is the quickest way to get money out of the door. Take Latin America — the entire region is middle income. It's been devastated. And in Africa, some of the worst affected countries are not the poorest, but South Africa and parts of North Africa."

There is a mixture of reasons. The AfDB was capital-constrained, Humphrey said, while the World Bank and IADB had attached too many conditions to loans.

Fortunately, private capital markets, bathed in liquidity by central banks, have been very welcoming. In 2008, EM bond issuance contracted by 19%, to \$850bn, according to Dealogic. Last year, it grew 6%, to a record \$2.27tr.

"The people who say multilaterals haven't done enough are the people who always say multilaterals don't do enough," said Ed Al-Hussainy, senior rates and currencies analyst at Columbia Threadneedle Investments in New York. "They obviously have a different

view of the role multilaterals have to play. Ultimately, the bond market has been open to EM issuers — even those of very marginal credit quality have been able to find investors."

Lee at CGD agreed that because middle income countries had been able to issue sovereign bonds at record rates in 2020, providing budget support to them "should not be the principal role of MDBs any more".

Nevertheless, she said the sector needed an overhaul. "The whole question of their risk tolerance and financial goals needs to be assessed, particularly on the private finance side, to make them more risk taking," Lee said.

Besides fresh loans, IFIs can help with debt relief. The G20's Debt Service Suspension Initiative, urged by the World Bank's president David Malpass and IMF, has given \$5bn in relief to 40 countries. But it is only temporary, and for low income countries.

Even when IFIs have restructured debts, they have been criticised. "The official sector went too far in trying to restructure debts that are avoidable," said Ricardo Adrogué, head of global sovereigns and currencies at Barings in Boston. "Argentina and Ecuador under most metrics could have paid their debts, but refused to. Now in the case of Argentina, it has no credit. The IMF fell into the trap of lending so much that Argentina basically owned the IMF and it could not voice any opposition. These countries could have rolled over their debt with private creditors with favourable conditions."

## EU Commission subsidises local currency lending to Azerbaijan

By Lewis McLellan

The European Commission, in partnership with a hedging company called TCX, is providing subsidies to make it easier for multilateral development banks to lend to their clients in frontier currencies. Among the first such projects is an FMO loan to Bank Respublika in Azerbaijan.

TCX provides swaps into exotic currencies, which can prove costly because the currencies are volatile and there is little data available to forecast their movement. Passing these costs on to borrowers can sometimes make business prohibitively expensive and means that deals fall through.

The European Commission made €20m available in April to provide financial support for up to €60m of loans into frontier currencies, effectively discounting the cost of the swap by up to 3%, depending on the maturity of the loan.

"Demand for the facility was more than 3.3

times the €60m we were able to print," said Jerome Pirouz, TCX's deputy head of structuring and sales. "We had 66 requests from 26 investors across 12 currencies." The investors were largely drawn from TCX's shareholders, most of whom are development finance institutions.

These 66 requests were ordered according to the size of the discount they required, with those requesting the smallest assistance served first. This auction system, designed by TCX, allowed 32 requests from 18 investors in 12 currencies to be served. The average discount agreed was 1.8%.

"They made €20m available, but our goal was not to deplete that immediately," said Pirouz. "Our goal was to facilitate the largest number of projects for the lowest possible cost. The auction system we use means that those projects requiring the smallest use of monies to execute are selected first.

That reduces the potential moral hazard of lenders asking for a bigger subsidy than is needed."

Many of the projects are still awaiting local approval from central banks or internal approval from the lenders, but Dutch development bank FMO has conducted one of the first loans already, lending \$10m in Azerbaijani manat to Bank Respublika, one of the largest commercial banks in Azerbaijan.

The loan will support local SMEs in the agricultural sector and young or female entrepreneurs.

The facility was an experiment both for TCX and for the European Commission. Ruurd Brouwer, CEO of TCX, said: "The stakeholders are happy and we'd be very happy to do this project again, perhaps with a larger amount."

However, TCX is in no rush to scale. "The goal is to maximise the impact and realise transactions that otherwise would not have happened," said Brouwer.

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