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NEWS

MDBs' extra-cautious capital models attract scrutiny

By Jon Hay

Hopes are rising that a longstanding paradox that limits multilateral development banks' lending could be tackled. MDBs' balance sheets are extremely conservative — even more so than necessary to support their triple-A credit ratings. Despite the apparently urgent needs for finance in developing countries and the MDBs' mandate to provide this, they lend less than they could.

Since 2015, the G20 has been calling on the MDBs to expand their activities, by making their capital go further.

Five years ago, Standard & Poor's concluded that, other things being equal, the 19 MDBs it rates could expand their lending by $1tr, or two thirds, without being downgraded.

Now, in a communiqué on June 24, the G20 said it was considering reviewing the issue of capital adequacy — something informed observers have wanted for years and which they believe could produce a breakthrough.

"The MDBs have very conservative capital adequacy policies — more conservative than necessary," said Nancy Lee, senior policy fellow at the Center for Global Development in Washington. "During crises they should use their flexibility to decrease their equity to loan ratios."

The problem arises from the unique capitalisation and governance arrangements for MDBs.

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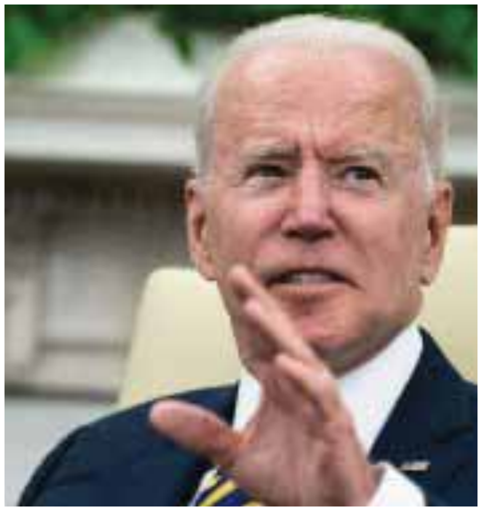

Biden: the US is now keener for MDBs to act

Inflation and Fed shift put EM central banks under pressure to hike

By Oliver West and Mariam Meskin

EM policymakers are hiking interest rates faster than expected as they look to counter concerns about rising inflation and adapt to the US Federal Reserve's gradual shift towards normalising monetary policy.

Hungary and Czech Republic last week became the first EU countries to increase interest rates since the coronavirus pandemic began, with Hungary raising its base rate from 0.6% to 0.9% and the Czech National Bank's board voting for a 25bp hike in a bid to curb inflation.

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Wounded EM economies may lag in recovery amid long-term scarring risks

By Oliver West, Phil Thornton and Jon Hay

Economies at the heart of the EBRD's area of operation are leading the economic recovery from Covid-19 among EM regions. But they are not safe from the perils of potential permanent scarring that risks jeopardising years of progress across emerging markets, according to economists worried about the long-term damage the pandemic has wrought on the capacity to grow and create jobs.

EM economies are rebounding more strongly than expected on the back of the pick-up in vaccinations and fewer restrictions of mobility and activity. The EBRD this week upped the 2021 GDP growth forecast for its countries from 3.6% in September to 4.2%.

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Gruenwald: worried about deskilling

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EMs

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The bank's chief economist Beata Javorcik said that the region had lost ground because of the Covid-19 outbreak.

"From the growth perspective, the last two years have been lost, and the catch-up with advanced economies has slowed down," said Javorcik. "Moreover, in more than half of the countries where we operate, GDP will recover to pre-pandemic levels only in 2022 or later." The bank listed "persistent economic damage from the crisis (scarring)" as one of the downside risks to its forecasts.

Yet the damage could run even deeper. Ed Al-Hussainy, a senior analyst at Columbia Threadneedle Investments in New York, said the issue of returning to pre-pandemic levels was a "pedestrian" question.

"The question is how much scarring is left ahead? We are still sorting through the degree of this recession," he told *GlobalMarkets*. "In the US we're reducing the risk of scarring by putting 25% of GDP in fiscal stimulus into the system, but you have to think that the odds of scarring in EM are much higher."

This is going to lead to some "large disparities" in terms of global growth next year. And CEE is not safe yet.

"In Latin America, it's a foregone conclusion, they going to lose a decade," said Al-Hussainy. "CEE has an OK short-term growth story and hot inflation, but it is still right on the cusp."

MORE DIGITALISATION

S&P's chief economist Paul Gruenwald highlighted the need for the recovery to accelerate across EM. "I agree that scarring is going to be larger in emerging markets," said Gruenwald. "The longer they underperform, the longer that resources lie idle, the more of the workforce that deskills, the more scarring there will be.

In this respect, those EBRD countries in the EU could have the best chance of avoiding medium-term damage.

"Being plugged into the German export machine and getting large transfers from the EU is a major advantage," said Gruenwald.

Looking ahead, Odile Renaud-Basso, the Bank's president, said on Thursday: "Relaunching the economy and addressing the scars of the crisis is a huge challenge in all our countries of operation."

She said planning and investing for long term recovery would mean "making our economies greener, more inclusive and more digital".

EBRD raises climate ambition with pledge to align with Paris in 2022

By Lewis McLellan and Jon Hay

The European Bank for Reconstruction and Development has shifted into a higher gear in its response to climate change. Its board of governors on Thursday adopted a resolution to raise the EBRD's climate ambition by ensuring all its activities are in line with the Paris Agreement by December 2022.

However, it will not cut out all fossil fuel financing yet.

The decision is a marked change from last July, when the balance between progressive and conservative forces within the EBRD was such that it was only able to say it would make a decision by the end of 2022 on when to make its investing fully aligned with Paris.

That meant it fell behind the European Investment Bank, which had said in November 2019 it would align with Paris by the end of 2020.

The EBRD had already decided last year that by 2025, it would be "a majority green bank" with at least half its new lending going to green projects. However, in July 2020 when the EBRD announced its Green Economy Transition 2.1 approach, due to come into force in January 2021, critics said it was little better than business as usual.

"Now we need to be even more ambitious," said Odile Renaud-Basso, president of the EBRD since October. "Our goal is to make the shift to net zero emissions an organising principle of the Bank and its activities."

Last week, Renaud-Basso told *GlobalMarkets*: "Our investment in fossil fuels will be declining over the next two years. We're in the process of aligning all our financing with the Paris Agreement. As part of that, we're getting out of upstream financing of fossil fuels. With midstream projects, we're taking a very targeted approach."

'NOT AMBITIOUS ENOUGH'

This is not enough for some critics. Gligor Radecic, gas financing campaigner at the CEE Bankwatch Network, said: "We were hoping EBRD would send a signal, cutting out fossil fuel financing entirely. Keeping midstream and downstream projects is not an ambitious enough goal.

Renaud-Basso: shifting to net zero emissions

"Providing financing for gas makes it less likely that recipient countries will invest in renewable energy, because they have to pay back the loans for these gas projects and their budgets are limited."

But Renaud-Basso said that the bank needed to take transition steps. "It's not easy to go straight to renewable energy sources when you're at 70% coal," she said. "Renewable energy is not easy in some countries, because of limited solar or hydroelectric opportunities, and there can be issues with intermittence."

Renaud-Basso said this was "an important discussion with shareholders. They have determined we can have midstream investment in gas as a transitional solution, but subject to clear strategic commitments from the country to implement the Paris Agreement."

Inflation

Continued from page 1

The moves came as other major emerging nations including Poland, Russia and Turkey are seeing both headline and core inflation above their target ranges, while the likes of Russia and Brazil have carried out major hikes.

"EM rate hikes have started a lot faster than expected," said Edward Glossop, EM economist at Aberdeen Standard Investments in London. "At the start of the year most analysts were not expecting significant interest rate increases, but there has been a broad-based shift in expectations in almost every EM country."

The eyes of EM investors are firmly on the Fed as it offers clues as to when it will begin to tighten monetary policy, and Treasury yields have widened sharply since the beginning of the year as the recovery in developed economies exceeded expectations.

Standard & Poor's admitted this week that it had been expecting some increase in headline inflation in emerging EMEA by late in the first quarter due to the disinflationary conditions at the start of the coronavirus pandemic last year.

Czechia's central bank governor Jiri Ruznok: making hawkish moves

However, inflation in several countries "accelerated faster than we anticipated, and price pressures appear broad-based", said the rating agency in its third quarter economic outlook.

BEHIND THE CURVE

While Hungary and Czechia are making hawkish moves, some investors are concerned that the rest of the region has not fallen suit. "We are underweight across the region because we think inflation will become a bigger issue," said Edwin Gutierrez, head of sovereign EM debt at Aberdeen Standard Investments. "It is not facing a crisis, but we think monetary policy is behind the curve."

Higher rates have so far proven to be a strong defence for EM currencies. Both the Russian rouble and the Brazilian real have outperformed EM currencies after the respective central banks caught the eye for their hawkish stance.

The Bank of Russia has raised its key rate three times already this year — a total of 125bp to 5.5% — and has signalled further increases, while Brazil's monetary authority has delivered three consecutive hikes of 75bp.

"Whereas Brazil and Russia are hi ing to re-establish their credibility with markets, much of eastern Europe has more of a macro-economic foundation to raise rates," Glossop said.

"There, recoveries are stronger, labour markets were tighter before Covid, and they have had large income support programmes that prevented a dramatic hit to labour markets. This means there are reasons to believe there are underlying price pressures in CEE."

S&P said that the uneven global recovery brings "important challenges" for emerging economies. It said that, though this was not its base case, earlier than expected hikes by the Fed risked capital outflows leading to currency depreciation and financial volatility at a time when domestic inflation pressures are significant.

EMs demand more from G7 tax plan

By Oliver West

Emerging economies in areas such as eastern Europe, Central Asia and Africa may see little benefit from the G7's recent agreement on global tax reform, finance ministers and tax justice campaigners have warned.

At the G7 meeting in the UK in June, the world's seven richest countries committed to a global minimum tax of at least 15%. US treasury secretary Janet Yellen said it would end the "race to the bottom" in corporate taxation and "ensure fairness" for the middle class and working people in the US around the world.

But the proposal already faces sharp criticism from some quarters. Tax Justice Network's CEO Alex Cobham said when it was announced that the agreement "shamelessly benefited just [the G7], leaving the rest of the world behind".

One key issue is the minimum tax rate. Before the G7 committed to 15%, the US had been proposing a 21% minimum rate. Tax Justice Network argued for a minimum effective tax rate of 25%, saying it could generate $780bn in additional global revenues, including $355bn for countries outside the G7. It said a 15% minimum rate would be "deeply unequal" and generate $170bn for the G7 and just $100bn for other countries.

With the G20 likely to set out its stance, some policymakers from developing markets argue that the deal does not allow EM to take its fair share of global tax. And if the agreement is to gain traction at the G20, it will have to overcome fierce opposition from some finance ministers within the group.

Guzmán: 15% rate is 'way too low'

'NOT ADDRESSSING INEQUALITY'

This week, Argentine finance minister Martín Guzmán told an event hosted by the G24 group of developing countries and the Independent Commission for the Reform of International Corporate Taxation (ICRICT) that the 15% rate was "way too low".

"There is a substantial risk that the minimum rate will in fact also be the maximum rate that becomes feasible," said Guzmán. "We advocate not less than 21%, and 25% would be even better."

Mathew Gbonjubuola, director of the Nigerian Federal Inland Revenue Service, said at the G24 event that though the discussion itself was "historic", the current proposals "may not be able to address" the "inequality in the current allocation of taxing rights".

Some argue that even with a higher rate, multinationals would still pay most tax in their home countries; the inclusive framework had been working on alternatives for this issue. ICRICT's chair Jose Antonio Ocampo, a former Colombian finance minister, said the G7 deal was "a step forward but not historic. The agreement has some positives and a major weakness."

Scope Ratings said this week that the G7's tax proposals posed a "moderate risk to Ireland's high growth economic model". Ireland's prevailing corporate tax rate is 12.5%.

Scarce data and EU supply to hamper CEE sustainable finance growth

By Lewis McLellan

Scarcity of good quality data is hampering the growth of sustainable finance in the CEE region, despite the movement's growing momentum, according to senior figures in this fast-growing sector.

Yerlan Syzdykov, global head of emerging markets at Amundi, said that the buy-side struggled with the paucity of data available, particularly in emerging markets. "Often, we're relying on inferences or modelling, rather than hard numbers from companies," he said.

But that could change soon thanks to the EU's border carbon tax plan, which is expected to launch in 2023. "It will mean higher taxation on companies with higher carbon footprints, that is going to push companies to disclose and decrease their carbon footprints."

While appetite for green bonds from the region is still growing, sovereign supply may be crimped over the next few years by the European Union's Next Generation EU programme — an €800bn borrowing programme designed to kickstart Europe's recovery from the Covid-19 pandemic. The EU's borrowing will comprise around one third green bonds, making it the largest green bond issuer in the world.

This is likely to slow down sovereign green bond issuance, particularly in the CEE region, according to Zoltan Kurali, head of the Hungarian national debt office. "I suspect the EU will take over a significant proportion of net green spending in the region," he said. "Finding incremental government spending over and above that — the basis of green bond issuance for the sovereign — will be difficult, especially for countries with smaller economies."

Kurali: expects smaller countries to be squeezed

SOCIAL BONDS

Marjan Divjak, director general of Slovenia's treasury, which issued its debut sustainability bond last week, said that the scope for sustainability bond issuance was reduced but that he still believed Slovenia would become a regular issuer in the format.

With the green bond sector crowded, social bonds may prove a more fertile ground. Kurali said that social bonds will come into more focus over the next few years, but that showing the benefits of social spending compared to what a government already does would prove a challenge. "The UN Sustainable Development Goals are a great help in this respect, but we need more conversation between issuers and investors on how we should measure social impact."

Both Kurali and Divjak expressed an interest in sustainability-linked bonds, and are exploring their feasibility. Kurali said that, as with green bonds, quality of data was a major stumbling block. "If the goals linked to the bond's coupon are commonly used and everyone agrees on a unified reporting framework, then it works, but that's not always the case. I hope to see this data become more routinely reported for corporates and for sovereigns. We don't want to see scrambling for data and a nightmare of reconciling various sources."

Montenegro's woes highlight risks of China loans to CEE

By Mariam Meskin

The dangers of the influx of Chinese lending into central and eastern Europe — primarily, the Balkans — are beginning to emerge, as Montenegro finds itself at the crux of a controversy around a failed infrastructure project.

The typical model of business includes the Chinese government or state-backed banks providing loans, which often come with strings attached. Untenable interest payments are a common component, while infrastructure funding contracts usually include clauses mandating Chinese companies to win tenders, experts say.

That is what happened with Montenegro, which borrowed $1bn from the Export-Import Bank of China (EIBC) in 2014 to build a controversial highway connecting it to neighbouring Serbia, having failed to find the funding among European lenders.

The highway has fallen victim to poor planning, critics say, and is incomplete. In June, Montenegro confirmed it had secured the help of a mysterious European lender, which was planning to help it repay the loan — the first repayment of which the EIBC had agreed to defer to late 2022. Experts say that could, contrary to expectation, result in even more reliance on Chinese funding.

"This may serve as a warning to other European countries," says Filip Šebok, research fellow at Prague-based think tank AMO. "However, if European institutions step in and save Montenegro, it may actually motivate other countries in the region to take Chinese loans. They will see that Europe can take the risk."

Although Chinese capital is far from flooding the continent, it is the less-economically developed countries in emerging Europe, such as Montenegro and Macedonia, which are at the highest risk of falling vulnerable to Chinese state loans, said Šebok.

The issue highlights the dangers of emerging European countries borrowing from the Chinese state, according to experts. The '17+1' relationship between central and eastern Europe and China has had a rocky few months — in May, Lithuania announced it was pulling out of the consortium, urging others to do so too.

Market participants say the cracks in China's shiny image in emerging markets are appearing. "I am starting to see more anti-China sentiment among EM countries," says Ray Zucaro, chief investment officer at RVX Asset Management. "There are several examples of projects that are not very effective and the idea of China as this major bank roller of EM infrastructure is trending away."

Ifad poised to plough loans into private sector projects

By Lewis McLellan

The International Fund for Agricultural Development, the United Nations agency, is preparing to launch its first ever private sector financing operation in July.

Ifad's 40 years of development investment has consisted exclusively of government lending operations. However, its first ever loan to the private sector is expected in the coming weeks, with more to follow this year.

Ifad will make use of loans, risk management instruments such as guarantees and credit enhancements, and equity investments. Its governing council agreed to the change in its founding agreement in February 2020 and announced its private sector financing programme, but the first deal under the programme will be launched around mid-July.

"Ifad will invest in small and medium-sized enterprises, farmers' organisations and financial intermediaries servicing small-scale farmers, which are too often neglected by investors," said an Ifad spokesperson.

Rural agricultural businesses often struggle with access to capital because of lack of visibility, expertise, or ability to post collateral. Financial service providers met only about 30% of the $240bn financing needs from rural households before the Covid-19 pandemic, according to Ifad. It calculates the lending gap to agricultural SMEs in sub-Saharan Africa is around $100bn per year.

In addition to providing financing from its own coffers, Ifad hopes to catalyse private investment in the same sectors. "Ifad's investments, combined with its 40 years of experience working with rural communities, global field presence and large portfolio in agriculture, give it an advantage in attracting private investors who may be cautious about investing in agriculture and rural economies," the spokesperson said.

Ifad plans to lend $200m via its private sector financing programme and hopes this will leverage a total of $1bn in private investment. The spokesperson said this investment would "improve the lives of up to five million small-scale farmers". The investments will be focused on job creation, women's empowerment, building farmers' resilience and accelerating climate change mitigation.

Ifad has previously been financed purely from the endowments and donations it receives. However, the agency is soon to become a capital markets borrower. CFO Alvaro Lario said the fund would be looking to raise between $1bn and $1.3bn annually via long-dated medium term notes.

'Two steps forward, one step back' — central bank revolt threatens Ukraine-IMF deal

By Mariam Maskin

A mass resignation at the National Bank of Ukraine on Wednesday has threatened to put yet another roadblock on the path to an IMF funding package, triggering concerns about Ukraine's access to much-needed financing.

The funding in question is a $5bn Standby Agreement package that was agreed to in June last year. Of the total, $2.1bn was disbursed last year. A $700m tranche, which was supposed to be disbursed in late 2020 has still not yet reached Ukraine, as the Fund continues to cast doubt on Ukraine's reform progress.

The anti-corruption drive hit a blockage earlier this year, pushing Ukraine further away from securing the financing it needs to help its economic recovery.

But progress on the reform front this week — in the form of new legislation passed around the judiciary and banking sectors — had increased hopes about inching closer to securing that disbursement.

"This week is very productive in the Parliament with progress on most of the drafts discussed with our international partners," says Yuriy Butsa, government commissioner for public debt management in Ukraine. "This demonstrates there is a clear political will to keep the current IMF programme on track. In the nearest future we expect the Parliament to support the remaining legislation needed for the progress with the next review."

But as Edwin Gutierrez, head of sovereign EM debt at Aberdeen Standard Investments said, with Ukraine "it is always two steps forward and one step back with the Fund".

A large group of licensing staff at the central bank submitted their resignations on Wednesday, penning an open letter criticising the bank's management and a lack of transparency under the new governor, Kyrylo Shevchenko, who has been in the post since July last year. They mark the latest in a string of departures from the central bank since then.

Shevchenko: received open letter from staff

INDEPENDENCE IN DOUBT

Evgeniya Akhtyrko, analyst at Concorde Capital in Kiev, says it is a "disappointing development that will send alarming signals to the IMF". The resignations are likely to revive questions about the central bank's independence — another focus of the Fund.

Some, including Concorde Capital, still hope that the disbursement will reach Ukraine by September. If it does not, however, it is likely to rollover until next year, leaving Ukraine with limited financing options for the remainder of its budget.

"There is no alternative to IMF funding," says Artem Shevalev, the EBRD's board member for Ukraine. "The EBRD plays a role in the private sector, but it cannot influence change at the government level like the Fund can because it does not provide direct budget support. Ukraine could issue Eurobonds, but it still will not be cheap and certainly not cheaper than its last issuance."

Banque de France trials CBDC as governor warns of digital yuan threat

By Lewis McLellan

The governor of the Banque de France, François Villeroy de Galhau, believes the development of China's central bank digital currency poses a threat to monetary sovereignty and that other countries must step up their efforts. The Banque de France is working on its own CBDC project, completing its latest experiment just last week.

Villeroy de Galhau said that time was running out for central banks to set up central bank digital payments infrastructure. "On both digital currency and payments, we in Europe must be ready to move as quickly as needed or risk an erosion of our monetary sovereignty," he said at a press conference on Tuesday.

Richard Turrin, author of *Cashless: China's Digital Currency Revolution*, said: "China's CBDC project is advanced, but the key factor is the degree to which it has inspired its neighbours to launch their own projects. The risk to the dollar and the euro is not that the digital yuan supplants them, but that a new trading region develops using a CBDC network."

The European Central Bank is due to make a decision on the future of its approach to a digital euro. The Banque de France is at the forefront of the experiments in Europe. "The EU will do very well with its CBDC," said Turrin. "It's pursuing it very seriously."

The Agence France Trésor simulated the sale of an government bond (OAT) on a permissioned blockchain to several participants, including BNP Paribas, BNP Paribas Securities Services, Crédit Agricole, HSBC and Société Générale.

Several secondary market operations and repo operations between private actors were conducted between June 21 and June 24. CBDC was issued against both tokenised bonds on the blockchain and securities in the T2S test platform, demonstrating how the process of intra-day financing could work with CBDCs.

The cash legs of the transactions were conducted with CBDC tokens provided by the Banque de France.

"A key goal of this experiment was to demonstrate that a CBDC/blockchain system could co-exist with legacy platforms," said Adeline Bachellerie, head of digital currency and innovation at Banque de France. "In Europe, a great deal of work has been done over the past 10 years to reduce liquidity fragmentation. The positive potential of tokenised assets is interesting, but it wouldn't be satisfactory from the financial stability perspective for CBDCs to break up liquidity pools. CBDC could play a pivotal role in connecting legacy platforms with tokenised asset exchanges on blockchain, because it's the safest and most liquid asset."

Villeroy de Galhau: 'Europe must move quickly'

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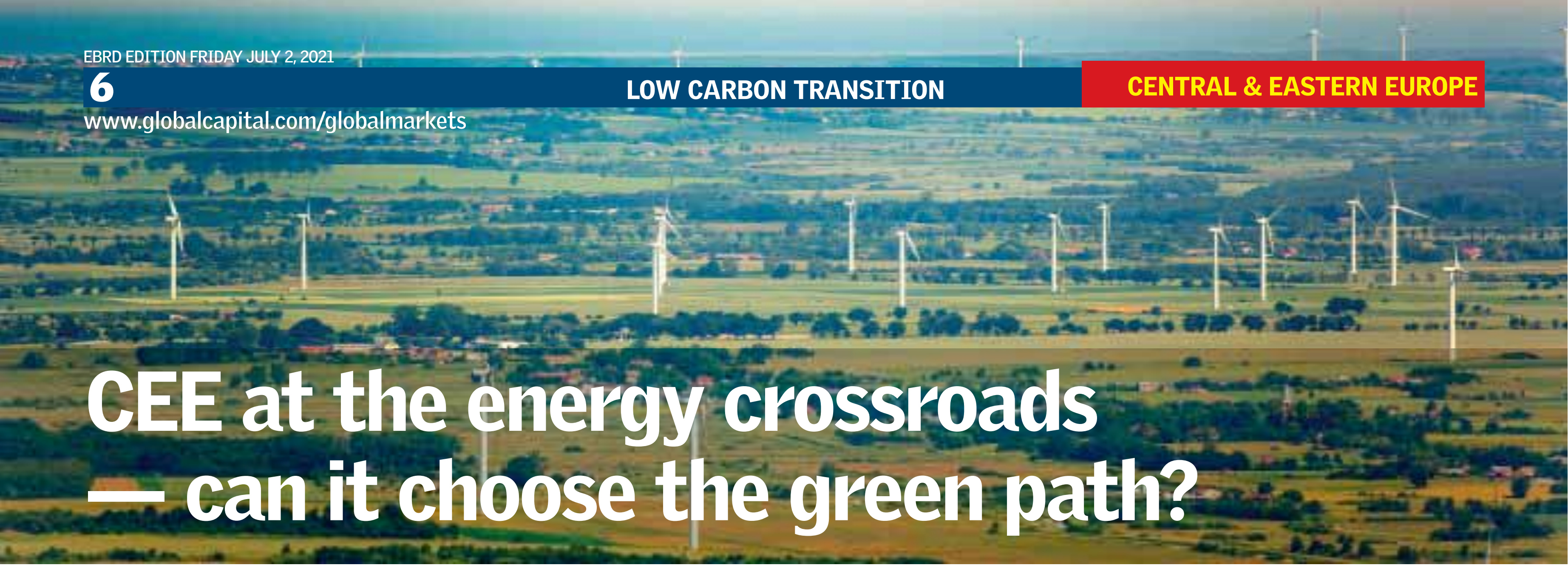

CEE at the energy crossroads — can it choose the green path?

The next 10 years will be tough for central and eastern Europe, economically and politically. Willingly or not, it will have to cut carbon emissions. States in the EU have agreed deep reductions by 2030. But exactly how, when and where the changes come remains to be thrashed out. None of it will be easy — and one of the most important tasks will be to retain the confidence of financial markets.

By Jon Hay

In December, the arcane world of EU sustainable finance regulation was rent by a fierce controversy. Ten countries so strongly disliked the bloc's draft Taxonomy — intended to guide markets on what investments are sustainable — that they threatened to veto it.

Their objection: they wanted natural gas included as a 'transition' fuel. All were from central and eastern Europe (CEE), including most of the former Communist EU members, plus Malta, Greece and Cyprus.

The fight was not over whether these countries could carry on using gas — that is not in question. The CEE countries were so sensitive about the issue that they wanted gas officially classed as sustainable. But according to the EU's technical advisers, doing so would blow the Taxonomy's credibility.

The incident points to two struggles looming in the region's path. Faced with the climate emergency, the EU has committed to cutting greenhouse gas emissions 55% from 1990 levels by 2030 — an enormous task, necessitating reform of almost every industry and domestic activity.

For Europe's poorer eastern half, where many countries rely on coal for power, it feels doubly daunting.

At the same time, the finance sector has become hyper-alert to sustainability. While this is often painted as an unmixed good, many in CEE fear the green finance craze could lead investors to cut off their access to funding.

"It is too early to tell whether the transition to a low carbon economy presents risks or opportunities to CEE."

—Sergey Dergachev, head of emerging market corporate debt, Union Investment

"We address ESG-related themes to every issuer we are speaking with," says Sergey Dergachev, head of emerging market corporate debt at Union Investment in Frankfurt. Borrowers must show they have "a credible plan to think about ESG themes, including the low carbon transition".

Union Investment considers each issuer on its merits. Other investors may not be so careful. A tick-box approach to ESG could put CEE issuers on investors' red lists.

Even Dergachev says "it is too early to tell whether the transition to a low carbon economy presents risks or opportunities to CEE".

EU MONEY AT STAKE

The battle over the Taxonomy rattled on until April, when the European Commission struck a compromise. It will propose a separate law later this year to bless certain uses of gas for their role in decarbonising the economy.

The eastern states are not worried only about private investment. In a policy drift that some consider rash, the EU has begun using the Taxonomy to guide some of its own spending.

Crucially, under NextGenerationEU, the €724bn loan and grant scheme to help the EU get over Covid-19, at least 37% of pay-outs must go to climate investments and reforms.

The struggles over this issue are a foretaste of the tensions likely to fill European politics over the next 10 years, as countries wrench their economies on to greener paths.

Late this year and in 2022, tough negotiations will be required on how the 55% commitment should be shared out between states in the revised National Climate Action Plans due in 2023.

But these arguments are over the pace and means of change — not the principle. "The energy transition is becoming more acceptable now, even in countries that had been slower and more hesitant, afraid of various challenges and pressures," says George Gkiaouris, the EBRD's head of energy for southeast Europe.

The details of NextGenEU may provoke squabbling, but overall, it is proving a magnet for green policy reform. Gkiaouris has noticed a change even in the last few months. Governments are reaching out to ask for support, especially to scale up renewables, "partially because they want to benefit from the recovery funds available.

"Even the most sceptical see a great opportunity to transition and recover from Covid," he adds. "Now the challenge is: are we doing it in the most efficient and effective way?"

DIFFERENT JOURNEYS

Grzegorz Zieliński, head of energy Europe at the EBRD, distinguishes three bands of countries in CEE. Member states are bound by EU commitments. Countries aspiring to membership want to be seen in a good light by Brussels. The third group have no prospect of joining the EU soon, and are likely to chart more independent courses, but still have reasons to go green.

Ukraine, for instance, is eager to escape

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AMERIABANK

TRANSFORMATION AND TRUST ARE IMPORTANT FOR SUCCESS IN MODERN BANKING

In an interview for *GlobalMarkets*, Artak Hanesyan, Ameriabank's CEO, explains the bank's strategy and highlights some of the key reasons for its success in the Armenian market.

GlobalMarkets: What are some of Ameriabank's main businesses, strengths and competitive advantages?

Artak Hanesyan: Ameriabank believes in the potential and future of the Armenian economy. One of our strengths is our openness to transformation. Realizing our potential, and achieving success, comes not only from recognizing the need for change, but actually leading change and transforming. That is how we successfully navigated through the 2008 global financial crisis. That is how we transformed from a leading corporate and investment bank to leading universal bank in Armenia. And that is why we have been pursuing digital transformation, investment which prepared us for some of the challenges we all faced in 2020.

Since 2008 we have played a fundamental role in the empowerment of Armenian businesses and the Armenian people. We are the largest financial institution in Armenia, committed to bringing exceptional banking services, products and experiences to our clients and partners. Our growth and development has been based on a long-term vision, strategy and set of objectives, rather than on short-term interests. In addition, we have thrived on the trust and longstanding relations with our clients, partners and shareholders. They have inspired us to develop dynamically and transform from a traditional bank to essentially a financial and technological ecosystem built around human needs.

GM: What are some of the bank's key achievements and successful projects over the past 12 months?

AH: Despite the difficulties and challenges faced by the global economy last year, we performed well and achieved some good results. As of the first quarter of 2021, Ameriabank maintained its leadership, ranking first among Armenian banks by key financial indicators, including: assets; liabilities; loans; deposits; profit; and equity capital. In fact, at the end of the first quarter, the bank's ROA and ROE were 1.5% and 14.2%, respectively. We are also leading the Armenian corporate bond market with a share of 26% of the market, and in pursuit of our strategy to transition to universal banking model, we increased the share of retail and SME loans. In addition, we have made significant progress in distance and digital banking, with our online banking penetration rate reaching 48% (up by 12pp.) in 2020.

"We have played a fundamental role in the empowerment of Armenian businesses and the Armenian people."
—Artak Hanesyan, CEO of Ameriabank

GM: Ameriabank accessed the green bond market for the first time this year. What are your plans to further develop green finance in Armenia?

AH: Successfully issuing the country's first green bonds was another significant achievement for the bank in the past year. We issued a total of €42m of green bonds in close cooperation with our long-term partner, FMO, which is a public-private development bank and an anchor investor in the bonds. Sustainalytics has verified our Green Bond Framework's alignment with the international green bond principles and global market standards in its second-party opinion. The funding raised via green bonds provides an unrivalled opportunity to finance green projects that contribute to environmental sustainability. As for the plans for the future, we aim to become the leading green bank in Armenia and look forward to greater cooperation with our partners.

GM: In what digital technologies does Ameriabank see the greatest potential? What are Ameriabank's key priorities for 2021 and strategic goals for the future?

AH: To succeed, a bank needs to adapt to rapidly changing environment. Our priorities for the current year are further digital transformation and diversification. Accordingly, we are consistently expanding the capacity of distance banking, improving the quality of digital services, increasing the share of retail and SME loans, simultaneously setting the goal of double-digit growth of the loan portfolio. This will help us achieve our strategic goals, such as enhancing the performance efficiency, achieving further growth in key financial indicators, ensuring high satisfaction of our clients, partners, team and shareholders, as well as maintaining an absolute leadership in the financial market of Armenia.

GM: In a number of recent interviews, your international partners have mentioned that Ameriabank is ready for IPO. What plans does Ameriabank have for an IPO?

AH: Over the past few years, we have become the largest bank in the country and achieved the highest level of cooperation with international partners. We are also constantly improving our corporate governance. An IPO would be a very important strategic milestone for us and would help support our long-term growth plans. Being a public company also means that we follow best practice in corporate governance, reporting and transparency. In this regard, I am proud to state that we already operate like a public company, being one of the exceptional companies in Armenia with a corporate governance system in compliance with IPO prerequisites. We are constantly following international capital markets, our listed peers, and have set relevant benchmarks for a successful IPO.

We will launch the IPO process once we reach our mid-term targets. Timing will also depend on market conditions. As important as this is for the bank, it should also be said that whatever we do to support our growth and development, it has one ultimate goal – to help improve the quality of life. The formula of our success is transformational mindset and trust in the potential of our team, our country and economy we live and work in. ●

Welcome to the neighbourhood
A supermarket parking lot in Bucharest, Romania next to the cooling towers of a coal power plant

its energy dependency on Russia. The major exception is Russia itself, where there has been very little renewable energy development. "In Russia they will fight this as long as they can," says Kingsmill Bond, energy strategist at Carbon Tracker, the climate change think tank, in London. "It's eastern Europe where the change will happen."

There are big differences within the EU, too, Zieliński points out — sometimes surprising ones. States like Latvia had been ahead of the game because of their high share of hydroelectric power. But as emissions reduction targets get steeper, they are having to get into gear on reforms, and are not used to it.

Others have zigzagged. Czechia was one of the first countries to stimulate photovoltaic power, but the over-generous scheme provoked a legislative backlash that burnt investors and angered the public. "There's still very little social acceptance of solar power," Zieliński says.

Nevertheless, in March, Czechia — the only country to have graduated from receiving EBRD support — agreed to re-engage with the Bank for five years, specifically to get help with transitioning its energy sector.

"We see more and more large companies which have to become greener because of pressure from their customers."
—Grzegorz Zieliński, head of energy Europe, EBRD

SMOKE AND SUNLIGHT

Greece has made such a screeching U-turn on coal that even enthusiasts are worried it may be going too fast. The government and state-controlled Public Power Corp have decided to close all existing coal power plants by 2023. One is still under construction — by 2025 it will have converted to another fuel or closed.

The new Greek policy was marked in March by the world's first high yield sustainability-linked bond. The €650m deal, of which the EBRD bought €50m as an anchor investor, gave PPC its first access to the capital markets since 2016.

There are ambitious moves outside the EU, too. Serbia was developing coal-fired power stations until recently. It is now designing a low carbon transition strategy.

"It's not as hard as it looks," says Bond. "A lot of countries have already passed peak demand for fossil fuels in their electricity systems."

In Poland, this happened in 2006. Like other CEE countries, Bond says, "It's a low growth market where solar and wind are coming in, providing all the growth and starting to push fossil fuels out."

EASY WINS AND LOSSES

There is plenty of low-hanging fruit in the energy transition, for two reasons.

Many CEE countries have great potential for solar and wind power. The pace at which renewables have become cheaper has astonished even their biggest fans.

In March, Voltalia, the French renewables company, won an auction in Albania to build a 100MW solar farm with a bid of just €0.03 per kilowatt hour — about half what fossil energy would cost.

And, as in western Europe, poorly designed policies leave great space for improvement at minimal cost. In Hungary, it is all but impossible to build a wind turbine — the law requires it to be at least 12km from any settlement.

Designing the right support regimes is crucial. For utility scale solar and wind, contracts for difference are now seen as the best option. Producers get paid the difference between the guaranteed price they bid and the market price for power. If the market price ends up higher, the producer pays the government.

However, there is still plenty of scope for policy errors. Hungary has brought forward its coal phase-out date from 2030 to 2025 and will close its 880MW Mátra lignite power plant. But it will replace it with a 200MW solar farm and 500MW gas plant — a classic example of "locking in" fossil fuels by building new infrastructure for them.

"The Hungarian government has decided to do something, but it's not going in the appropriate direction, or with massive enough measures," says an official in CEE.

The EBRD's attitude to gas has changed. Until recently, it was eager to finance its expansion, as a replacement for coal. Now, Gkiaouris says it is still difficult to see how rapid decarbonisation can be achieved without using gas as a transition fuel. But he adds: "We are very selective in our approach. We no longer finance coal and lignite and are increasingly moving away from all fossil fuels. Although natural gas is an important transition fuel for some of our countries of operations, eventually we will stop financing it too."

After 2035, he thinks gas will mainly be used as a back-up, with renewables providing the baseload.

ALL-ENCOMPASSING ISSUE

The transition is not just about the power sector, however. "There is so much more to be done in areas like quality of air, decarbonisation of transport, electric mobility, energy efficiency of public buildings," says Zieliński.

In these fields, investors get the need for green progress and are supportive. So do many businesses. "We see more and more large companies which have to become greener because of pressure from their customers," says Zieliński. "That's bringing a new wave of potential consumers of green energy who didn't really care a year or two ago."

The problem, again, is policy design. Buildings will only be upgraded en masse when regulations require it; complex systems such as urban transport can only be reformed by governments working with multiple stakeholders.

There is a long way to go. In Hungary, for example, "there is no transition planned in a forward-looking way to really switch the whole economy towards low carbon," says the official. "One of the main pillars of cutting back by 55% is the energy efficiency of households, but the government is not really supporting this."

DIALOGUE NEEDED

From this point of view, CEE governments may have less to fear from investors' lurch towards greenness than they think. On the contrary, it could help them.

"CEE is slightly ahead of other regions, since a lot of investors do come from the eurozone, where ESG requirements are more restrictive than in other regions," says Dergachev.

At its best, the investor-issuer relationship allows what Dergachev calls an "avenue for mutual two way feedback to improve ESG awareness". Issuers can put their best feet forward to please investors — and receive guidance on how to improve.

One opportunity for such conversations is labelled debt such as the €500m green bond from Polish oil refiner PKN Orlen in May and Slovenia's €1bn sustainability bond in June.

Bonds like this do not directly make any new green projects happen. But since they are often very popular with investors — Slovenia's was eight times oversubscribed and priced with no new issue premium — they provide valuable reinforcement and encouragement.

Bad-tempered though the arguments over the Taxonomy may be, financial markets are not the CEE region's enemy when it comes to the low carbon transition — they are its ally. GM

Alfa-Bank

INNOVATION AND GROWTH IN A CHALLENGING ENVIRONMENT

In an interview for GlobalMarkets, *Valery Smolyak, executive director of Alfa-Bank, talks about memes, "black swans," and how the bank survived 2020 and became the best in Belarus.*

GlobalMarkets: For the third consecutive year, Alfa-Bank has been recognized as the Best Bank in Belarus by Euromoney. Last year the bank also received an award for its response to the global pandemic. Tell us about the highlights of the bank's activities in 2020?

Valery Smolyak: It wouldn't be right to say that the events of 2020 radically changed Alfa-Bank's position or strategy. In recent years, the bank has been consistently improving its online services in the InSync application and Alfa-Business Mobile by expanding functionality and adding new products. Last year proved that customers had to adapt to a new digital environment. There was no lockdown as such in Belarus. However, certain restrictions were introduced. And psychologically, people tried to move less and to avoid crowded places. So, our digital focus and our customers' need for safety concurred. Digital banking was in demand and not only as a fashionable trend. Even those clients who always prefered to bank in a physical branch were forced to turn to digital solutions and realized how convenient, fast and safe they were.

The excellence in leadership award for tackling the pandemic in Belarus was one of our most significant achievements last year. It showed how quickly and efficiently we focused on the pandemic risks and introduced remote working for our employees. We helped not only our clients and ourselves, but also the community as a whole. Alfa was one of the first banks to provide assistance to the Red Cross.

GM: Your digital focus worked. What was behind your success in digital?

VS: The reason for this might be that even in pre-covid times we had a very high ratio of mobile bank clients. This distinguished us from other market players. Today we are the most digital bank for business. Over the year, all banks in the country grew in active digital clients by 2%, whereas Alfa-Bank saw a 19% increase. The penetration of digital banking into our active client base exceeded 70%.

"The excellence in leadership award for tackling the pandemic in Belarus was one of our most significant achievements last year"

—Valery Smolyak, executive director of Alfa-Bank Belarus

GM: Belarus has been in the headlines of the world news for several months. How does the situation in the country affect the bank and its clients?

VS: We try not to be extreme in our assessments. Now there is a lot of negative information, frightening rumors and forecasts. But bankers exist to weigh, analyze and manage risks. Therefore, on the one hand, we do not demonize the future, on the other hand, we are extremely careful to monitor triggers that can provoke new challenges. We understand that we are living in an era of "black swans" or dramatic events that happen once in a lifetime, but the shape of our financial fundamentals show that we are capable of assessing the situation in the right way.

GM: During a crisis, are you looking to maintain or expand your market share?

GM: A crisis can present opportunities, and one needs to choose the right business model to get out of it with dignity. The bottom line is that you do not take unreasonable risks and at the same time manage them in such a way that the best customers choose you. For example, some banks fear turbulence and refuse to lend to even successful clients. Others do the contrary. It seems to us that Alfa-Bank is just finding the right balance. Judging by previous crises, we usually come out of difficult times with a quality portfolio and new partners.

GM: The target audience of your InSync mobile app is city dwellers aged 24-35. Why do these people choose you?

VS: Residents of large cities in Belarus, especially the 24-35 year olds, value their time and are looking for the simplest solutions for daily banking. Also, the reputation, brand values and compliance with their lifestyle are important for them. InSync makes it easy to get a loan online, to buy shares through trust management, to exchange currency by offering your rate to a broker, which is especially important for our country. Our support service solves issues 24/7 in chats, Twitter, TikTok, other social networks and speaks the same language with the client - without scripts, by using memes and slang. Maybe tomorrow this model of communication with our youth audience will change and they will not need TikTok, but thanks to it they got to know Alfa-Bank.

GM: What makes Alfa-Bank Belarus unique among Alfa-Group banks?

VS: All of us in Alfa-Group are independent banks and are not subsidiaries of each other, as is often the case with other Belarusian banks. Everyone in the group has their own independent path of development. We are not developing according to the model set by the parent bank. We don't even copy the products, but we share the best experience. For example, it was Alfa-Bank Belarus that set the trend for the Mobile Only ideology within the group. ●

Flags of convenience: Euro-fudge puts paid t

The decision by the EU to reject plans for a new pan-European development bank means the EBRD, EIB and a myriad of national banks will continue to plant their own flags on projects across Europe and beyond

It ain't over
EBRD headquarters in London; Odile Renaud-Basso, EBRD president

By Phil Thornton

There is a paradox at the heart of Europe's development finance landscape. The continent's institutions represent the single largest donor group among developed nations. Official development assistance provided by the European Union and its 27 Member States hit €66.8bn in 2020, or 0.5% of gross national income — significantly above the 0.26% average of non-EU countries.

But at the same time Europe is home to a complex myriad of development bodies. It hosts both multi-billion euro institutions such as the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) but also a multitude of national development institutions. They range from the huge German KfW bank to the miniscule Slovak Guarantee and Development Bank.

As Thomas Wieser, chair of a "wise persons' group" that looked into Europe's financial development architecture, puts it: "They're all our national treasures in a way because they either do, or pretend to, transport national development principles which should be globally aligned into countries of operation and plant their small flags, medium sized flags, large flags, next to each other."

This paradox was the impetus for the European Council to establish Wieser's High-Level Group of Wise Persons in 2019 to look at options for rationalising the European development finance architecture and identify possible scenarios for its evolution.

At the end of that year, just before the outbreak of Covid-19 changed everyone's political priorities, it recommended the establishment of a dedicated European climate and sustainable development bank, setting in motion a contest between the EIB and the EBRD as to which would be most capable of fulfilling this role as its main parent.

In 2020, the European Council commissioned a feasibility study to assess the viability of the two big banks taking on this role, but also to consider a third option — dubbed "status quo plus" — with more co-operation but stopping short of a new bank.

In what cynics might see as a classic euro-fudge, it was that third option that was endorsed, despite the wise persons saying, "it was clear that maintaining the status quo is not an acceptable option for the future". While creating a brand new institution was the option favoured by the high-level group, it was quickly discarded by European governments.

At their late-April development ministers meeting, EU politicians endorsed what they called a "reinforced Team Europe approach" that would avoid fragmentation, increase synergies and enhance the collective impact of EU support on development.

STATUS QUO PLUS

In fairness, the idea of converting either the EIB or EBRD into a new national development bank would have left the problem of what to do with the orphan institution.

However, as Mikaela Gavas, co-director of the European practice at US-based think-tank the Center for Global Development (CGD) says, there is still a long way to go to decipher what exactly the "plus" means in practice. She describes it as "essentially, business-as-usual with a few extra bits of co-ordination thrown in the mix".

She says EU member states took a very risk-averse route with "a little tinkering around the edges of the current situation". "I certainly do think it was a missed opportunity," she says, adding that the door may not be closed to a future merger depending on shifts in French and German politics.

One benefit of the process, according to Pierre Heilbronn, EBRD vice president, for policy and partnerships, was to prompt the banks to think more about how they co-operate, collaborate and build on their

o EIB-EBRD merger

respective strengths. "That's a very positive achievement of the process," he says in a discussion with CGD.

So, after two years of EU politics, the EBRD is now determined to continue to pursue its own agenda under the presidency of Odile Renaud-Basso, the former head of the French Treasury who took over in November after eight years of Suma Chakrabarti.

Bankwatch, the NGO that monitors both banks and which has tracked merger talks for the last decade, is unsurprised it is not going ahead. "Creating a new institution was going to be very hard, especially at the time of massive global challenges like the pandemic," says Fidanka Bacheva-McGrath, its EBRD policy officer.

"On the one hand, we believe this is really the most practical way to go about it. On the other hand, we do think that both banks really need a lot stronger approaches to human rights, as well as to climate investments," she says.

On the surface the EBRD and EIB might look similar in terms of both themes and geography. They both operate across Europe with the EBRD expanding into the Middle East and North Africa and the EIB into sub-Saharan Africa. The EBRD has long flagged up an interest in a "limited and incremental expansion" to sub-Saharan Africa.

Both banks have used their strategic outlooks to highlight a green agenda, digital transition, and fostering equality of opportunity.

But Heilbronn is keen to highlight the space the EBRD occupies distinct from the EIB. "We have a distinct focus," he says. "It's very much creating sustainable economies based on the development of new markets and market economies. "The fact that we focus 75% of our investment on the private sector is something we are proud of.

"We understand our markets very, very well [in order] to have a real focus on local actors be they private sector actors, or sub-sovereign actors or municipalities, and we also have capacity to link our investment with business oriented sector reforms."

He insists the EBRD does not claim to be a major actor in health, or public education — areas of focus for traditional development institutions such as the World Bank. "There are institutions which are better place probably to do that."

INTO AFRICA

The move into sub-Saharan Africa looks set to be one of the dominating theme of Renaud-Basso's four-year term. The EBRD is currently not active in the region and, as Gavas points out, it is not very active in many least developed countries or fragile states.

She says the EBRD has clearly indicated it wants to take an incremental approach and build up a presence in these geographies by identifying a couple of countries where it could bring what she calls "added value and focus".

"I think it's going to be much harder done than said because there'll be instances where the EBRD business model, focused on sort of private sector investment, will not be appropriate," she says. "They may also find themselves with other actors in the same geographies with different approaches and different pricing models."

Heilbronn points to the model the EBRD used with its expansion, first into Turkey and central Asia and into the southern and eastern Mediterranean after the Arab spring.

This requires having lot of resources and boots on the ground such as in Ukraine or Egypt where he says that having 100 people in the country was a "decisive asset".

He says there is a "middle range" of sub-Saharan African countries which are emerging economies and, which are extremely important for the stability of the African continent, mentioning the Ivory Coast and Senegal.

"Our shareholders see the potential of the EBRD bringing its added value as we did in Morocco, or Tunisia or Egypt, where we didn't do the same things as the [International Finance Corporation] or the World Bank were doing," he says.

There is a growing expectation that the EBRD's shareholders will make a firm decision on expansion at this week's meetings. "It's been talked about so much now that they are definitely going to make him make a decision," Gavas says.

OUT OF GAS

The meetings will also offer Renaud-Basso an opportunity to put her own stamp on the €66.7bn institution with its 3,000 staff and operations in almost 40 countries.

One key area is climate change where the bank has committed to raise the share of green finance to at least 50% and to reduce net CO_2 by 25 million to 40 million tonnes by 2025. "Because of Covid, they've lagged a bit on those targets so I think they're going to see how they can get back on track," Gavas says.

Bacheva-McGrath at Bankwatch says there is an opportunity for Renaud-Basso, who has committed to fully align the bank's activities with the Paris climate agreement by 2023, to eliminate fossil fuels from its investment and to be clearer about what green finance means.

She points to a recent €243.5m EBRD loan for the national gas producer of Kazakhstan as being hailed as a drive towards a low-carbon and climate-resilient economy.

"Even the International Energy Agency now says gas cannot be considered a transition fuel. It's just the fuel of the past and the EBRD has to divest from all fossil fuels, including fossil gas," she says. "Otherwise all the talk about Paris alignment, all the talk about 'climate banks', it's worse even than greenwashing."

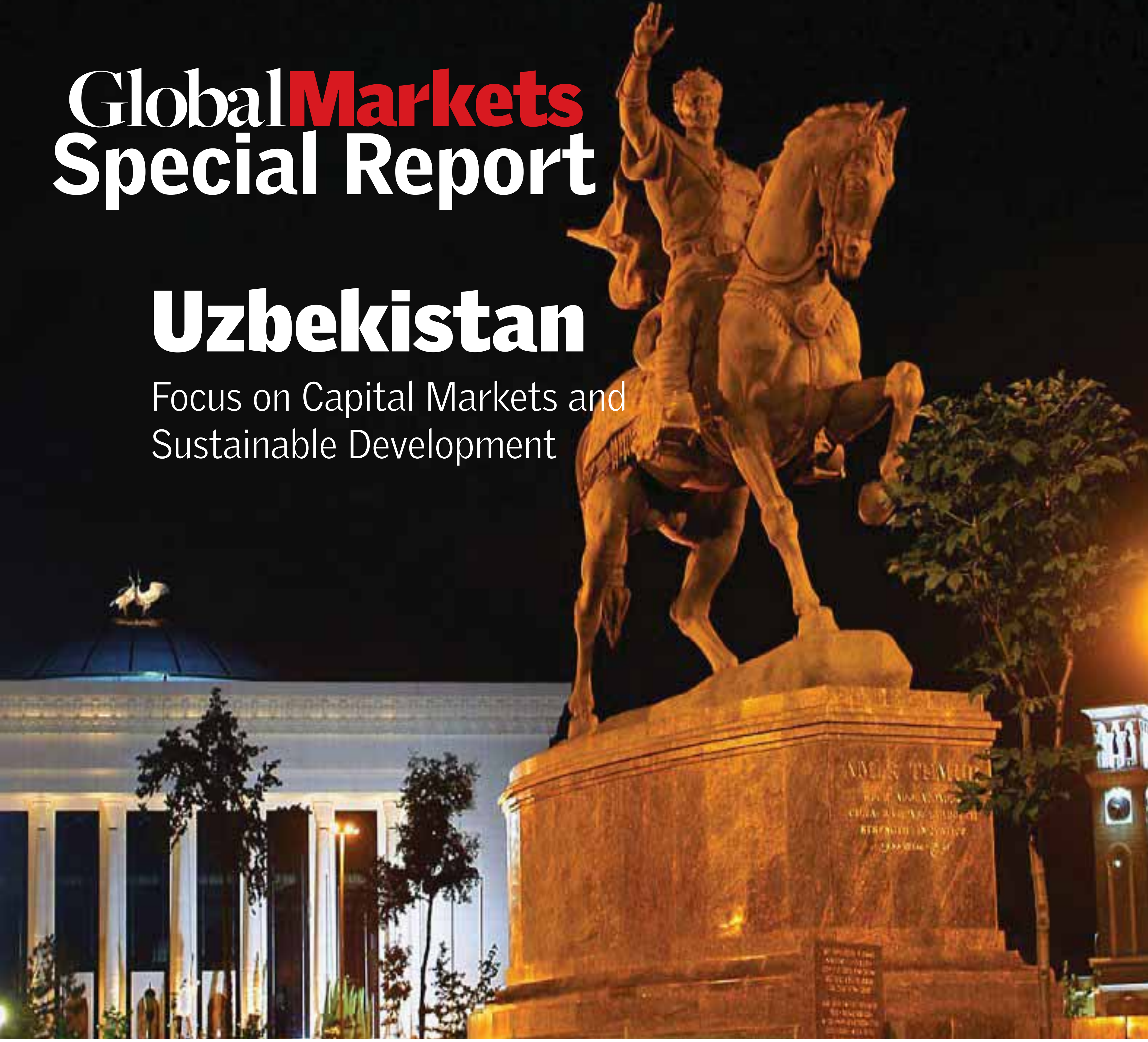
She also wants the new president to focus more on human rights in the countries it operates in. "In recent years, we can see a lot of improvements, but there are still massive gaps that can allow for human rights violations, and the bank should really strengthen this," she says.

As long as it is unclear how the bank applies its political mandate and safeguards in countries such as Egypt and Turkey, it is going to be a lot harder in sub-Saharan Africa, Bacheva-McGrath says.

"Our message to the EBRD is if you are to expand your activities in fragile countries, in conflict countries, in authoritarian regimes and repressive regimes, you have to demonstrate, you can do this responsibly [while] respecting your political mandate and applying proper safeguards." GM

"On the one hand, we believe this is really the most practical way to go about [a merger]. On the other hand, we do think that both banks really need a lot stronger approaches to human rights, as well as to climate investments."

—Fidanka Bacheva-McGrath, Bankwatch



GlobalMarkets Special Report

Uzbekistan

Focus on Capital Markets and Sustainable Development

In association with

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CAPITAL MARKETS AND SUSTAINABILITY KEY PILLARS OF UZBEKISTAN'S GROWTH AND DEVELOPMENT PLAN


Deputy Prime Minister Jamshid Kuchkarov

Uzbekistan is committed to improving its productive capacity and institutional strength on the way to achieving sustainable economic development.

Since late 2016 under President Mirziyoyev's leadership, Uzbekistan has embraced numerous economic reforms, such as foreign exchange, and trade liberalisation, as well as institutional, state-owned enterprise and banking sector reforms. In addition, the country has sought to strengthen the business environment, fiscal and monetary policy, and introduced public private partnerships (PPP).

Moreover, the President — at the end of last year — outlined the 2021 reform agenda, indicating the year would be foundational for further market liberalisation. Core to this is creating a more competitive and efficient corporate sector by transforming state-owned enterprises and state-owned banks, as well as pushing forward on privatisation.

Perhaps most promising for the country's future is the ambitious programme being undertaken to expand its capital markets footprint. By strengthening the equity markets within the country, affordable capital will ultimately become accessible to companies across all industry sectors.

In addition, a financial literacy programme aimed at creating generations of savvy retail investors will go a long way toward expanding investment portfolios and diversifying retirement portfolios.

As the economic liberalisation programme progresses, significant emphasis is also being placed on sustainability issues. Repairing irrigation systems, enhancing efficiency in electricity generation, and focusing attention on sub-soil conditions, are all parts of a programme aimed at achieving an environmental balance in the country. Significant investments in wind and solar round out the sustainability programme.

Schools and teachers are coming in for investment to bring them up to modern standards and the entire book system within the public school system is being completed, revamped and transformed.

Covid-19 has had a severe economic impact on many countries, but thanks to the President's leadership, anti-crises initiatives and swift public health response by the government, Uzbekistan's economy grew by 1.6% last year, making it one of the few countries to record economic growth.

In addition, measures such as the introduction of a government debt ceiling, annual limits on public and publicly guaranteed debt commitments, as well as initiatives to increase public investment management and coordination, have helped maintain low risk of debt distress in Uzbekistan. In parallel, contingent liabilities and fiscal risk assessment is being enhanced to cover state-owned enterprise debt and PPPs. Obtaining ratings from international credit rating agencies was also crucial to increase accountability and transparency.

Owing to the measures targeted at reducing inflation level, inflation gradually started to decline in 2020 reflecting strong anti-inflationary commitment to curb inflation levels. The ultimate objective is to bring consumer price inflation close to their medium-term target of 5%.

Furthermore, Uzbekistan is opening up to international investment. In 2019 the country successfully issued $1bn of Eurobonds for the first time. Last year, it followed that up by issuing the equivalent of $750m in Eurobonds denominated in soum and other foreign currencies. In addition, with the direct support of the Ministry of Finance (MoF), Sanoatqurilishbank (SQB), NBU, Ipoteka Bank and UzAuto Motors all successfully issued inaugural Eurobonds. In turn, these transactions help attract foreign investors to the domestic capital market.

The success of these Eurobonds, including strong demand for the local currency transactions, is testament to investors' confidence in Uzbekistan's economy, future growth prospects, and the progress the government is making on reforms.

Importantly, Uzbekistan has also issued a 2 trillion soum ($200m) denominated Eurobond for the first time, which qualified as development finance. Indeed, the JP Morgan Development Finance Institution described

"Perhaps most promising for the country's future is the ambitious programme being undertaken to expand its capital markets footprint. By strengthening the equity markets within the country, affordable capital will ultimately become accessible to companies across all industry sectors."

President Shavkat Mirziyoyev addressing the 75th session of the UN General Assembly

© UN Photo

“Covid-19 has had a severe economic impact on many countries, but thanks to the President’s leadership, anti-crises initiatives and swift public health response by the government, Uzbekistan’s economy grew by 1.6% last year, making it one of few countries to record economic growth in 2020.”

the transaction as high level development finance, contributing to the UN Sustainable Development Goals (SDGs) 1, 3, 4, 5, 6, 8 and 9. More specifically, the transaction will support projects to combat poverty, ensure healthy lives, promote quality education, advance gender equality, ensure access to clean water, promote decent work and economic growth, and foster infrastructure resiliency.

In order to improve the efficiency and transparency of the use of borrowed funds and measuring the ultimate impact of the transaction, a memorandum of understanding has been signed between MoF and UN Development Programme (UNDP), which will serve to ensure better alignment of the issuance of Eurobonds with efforts to achieve the SDGs. It will also build transparency and accountability for the Uzbek public and investors.

As part of this, an annual report on progress of the selected projects will be published online by the MoF in cooperation with UNDP and JP Morgan DFI. The report will reflect the impact of the implemented projects on improving the living standards of the population.

In addition, the MoF will continue its cooperation with the UNDP in developing the SDG bond framework, project selection procedures, including use of SDG budget tagging, monitoring the implementation of the projects as well as measuring impact.

The development of the capital markets is now under the management of the MoF, which sees the development of a government securities market as a key driver in this effort. Capital market initiatives designed to support this objective include seeking to diversify the investor base, attracting foreign investors, diversifying financial instruments, stimulating a secondary market, and introducing international standards and principles.

Special attention is also given to transforming the governance and financial reporting of state-owned enterprises (SOEs) and state-owned banks. As such, measures are being taken to implement IFRS, as well as appoint independent members with international experience to the supervisory boards and executive management. Also important is attracting reputable international consultants to participate in this transformation process. Ultimately, SOEs and SOBs must be efficient, transparent, and accountable, to help drive private sector growth, as well as sustained and inclusive economic growth.

Over the next three years, it is anticipated that 15 SOEs and SOBs will IPO or SPO, which would support the development of the local capital markets. In preparation for this, we need to have in place the best infrastructure as well as clear and robust legislation, among other important crucial elements.

All in all, under President Mirziyoyev’s multifaceted reform agenda, the development of Uzbekistan’s capital markets is accelerating in tandem with the economic liberalisation of the country and transformation of its SOEs and SOBs. The country is on a sustainable path to achieve its aim of developing the capital markets as part of a modern, efficient and stable financial system. ●

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Capital markets reform the engine of Uzbekistan's transformation

An ambitious and multifaceted reform programme is underway to take an already sound economy and open it to international markets

By John Anderson

Uzbekistan is a country today on a clear cut path to further opening its economy while gaining a stronger foothold in the international capital markets.

While such observations could have been made about scores of other emerging countries over the years, Uzbekistan is in a better position than most to actually achieve its goals.

There are a host of reasons for that, but there are two that stand out the most.

First, the drive for liberalisation has the whole-hearted support of President Shavkat Mirziyoyev and numerous governmental departments, which are well under way executing the fast-moving transformation programme.

Second, and just as importantly, the development of the capital markets was recently placed under the aegis of the Ministry of Finance, which involved integrating it into the overall economic infrastructure build. This should increase its chance of success.

"The capital market is an integral part of the modern, stable financial system that we aim to develop under the country's transformation programme," says Timur Ishmetov, Uzbekistan's Finance Minister. "Crucial to achieving this is ensuring: macroeconomic stability; consistency in our approach to developing the capital markets and wider financial system; and putting in place a robust legal framework. We are very focused on addressing these issues to achieve our aim."

Underpinning the liberalisation initiative is the fact that the Uzbekistan economy is in good condition; the country was one of only three economies in Europe and Central Asia that maintained positive economic growth despite the pandemic-related lockdowns last year.

This year, GDP is expected to be 5.5%, increasing to 5.8% in 2022 — respectable growth rates consistent with emerging economies that are in decent shape. Inflation this year is high at 10%, but it is being managed down. Current forecasts are for it to fall to 9% in 2022 and 5% in 2023, which if achieved, would bring it in line with the central bank's annual target.

Just as powerful as economic growth is Uzbekistan having one of the most diversified economies in Central Asia, with significant mineral and metals wealth, including gold, as well as textiles and services. The country also has the largest population in the region.

Importantly, Uzbekistan is attracting greater foreign direct investment (FDI) flows, which is crucial in for job creation and economic growth more widely. For instance, net FDI was $2.3bn in 2019, more than triple that in 2018, according to data from the Central Bank of Uzbekistan.

Given these positive credentials, and the country's economic potential, it is perhaps little surprising that analysts at Raiffeisen Research described Uzbekistan as the "Poland of Central Asia" in a recent research report.

In the main, the Raiffeisen analysts said this was due the connection between the country's successful economic performance and positive outlook with its resolute economic reform course, which has been consistently pursued since 2016/2017.

Such policy consistency, and progress, is something that foreign institutional investors appreciate. They also appreciate investment opportunities and generating returns.

According to Raiffeisen, the key interest rate in the country is to remain well above 10% in 2021 and 2022. In addition to containing

President Shavkat Mirziyoyev

"The capital market is an integral part of the modern, stable financial system that we aim to develop under the country's transformation programme. Crucial to achieving this is ensuring: macroeconomic stability; consistency in our approach to developing the capital markets and wider financial system; and putting in place a robust legal framework. We are very focused on addressing these issues to achieve our aim."

—Timur Ishmetov, Finance Minister, Uzbekistan

"We are excited about what the future holds. I can see the day when we are trading sukuk, derivatives, foreign exchange and bonds"

—Bekzod Usmonov, director of the TSE

"We believe that our local domestic market cannot develop in isolation. It should develop hand-in-hand with international markets with the support of international investors."

—Odilbek Isakov, Uzbekistan's Deputy Minister of Finance

inflation and the strong lending cycle, the analysts argue rates at this level would also flag the opening of the local capital market to foreign investors, and at the same time may help to avoid strong currency fluctuations.

ACCESSING INTERNATIONAL INVESTORS

Few developments flag a country is open to international investors more than a debut Eurbond issue by the sovereign.

For Uzbekistan, its inaugural Eurobond issue two years ago was a blowout success, announcing the country's arrival on the international capital markets. Investors flocked to the $1bn deal, swelling the orderbook and enabling the sovereign to print a debut Eurobond with the lowest ever yield for a debut sovereign transaction out of CIS and Turkey.

The significance of the transaction was not lost on Odilbek Isakov, Uzbekistan's Deputy Minister of Finance. "Offshore issuances will hopefully pave the way to develop our local currency market domestically, because we believe that our local domestic market cannot develop in isolation," he says. "It should develop hand-in-hand with international markets with the support of international investors."

Indeed, the debut bond issue was strategically important for the country, demonstrating several key attributes to international investors, including the economic potential and stable sovereign risk of the country. Additionally, the bond issue helped diversify the country's sources of external financing, and its trading on the secondary market provides a barometer of sustainable economic policy. Importantly, the transaction also created a benchmark for local commercial banks and companies to access the international capital markets for the first time.

Keen to seize this opportunity, Ipoteka Bank successfully issued 785bn ($75m) of soum denominated three-year Eurbonds in April this year.

"It is issuance like that that serves to reduce dollarisation and currency risks and to ensure the central bank's long-term liquidity norms in the local currency," says Jasur Karshibaev of the Finance Ministry's Debt Management Department.

Together with this, such issuance is also important for the growth and development of Uzbekistan's local capital markets. This is a strategically important issue for the country, and one supported by a presidential decree – signed several months ago – that is designed to help accelerate the pace of capital market reform across all markets, from debt to equities.

An interesting litmus test for the success of this reform programme will be the extent to which some major Uzbek companies – listed on the Tashkent Stock Exchange (TSE) — graduate to the MSCI Frontier Index.

There is a general acknowledgement among market participants that if a substantial number of Uzbek companies are added, it would be a positive inflection point for the country's economic future.

However, the size of the challenge Uzbekistan faces here should not be underestimated. Some of the fundamental issues the country needs to deal with, include: a low free-float among listed companies; a deficiency of professional participants in the stock market and limited investor base; low financial literacy of the public; and a lack of legal and regulatory frameworks that are consistent with international standards.

According to analysis by institutional investment firm Uzbekistan Equity Fund (UEF), the free-float on the TSE is currently estimated at 0.4% of GDP, or less than 4% of total market capitalisation of the exchange, while the current market capitalisation of the exchange to GDP is 11.5%.

As such, UEF says that if the free-float is to equal 5% of GDP, this would equate to roughly $2.6bn of equity value, or 43% of the current market capitalisation of the stock exchange.

UEF adds that in order for the Uzbek government to achieve its goal, it needs to expedite its privatisation process of fully state-owned enterprises as well as sell its participating stakes in already listed equities.

In fact, UEF argues that if this can be achieved, it would be a "game-changer" for the investment landscape in Uzbekistan, creating a significantly more liquid market with a much larger local and foreign investor base, which they believe will help transform Uzbekistan's capital markets into the largest in Central Asia.

Bekzod Usmonov, director of the TSE, points out that the exchange has experienced

Prime Uzbek privatisation candidates

- **Uzmetkombinat** a listed steel producer which is slated for an international dual listing
- **Almalyk Mining** a significant gold, silver and copper miner
- **Navoi Metallurgical Mining Kombinat** a mining conglomerate that owns the largest open-cast gold mine in the world – Muruntau
- **Uzbekistan Airways** the national airline
- **Uzbekneftegaz** the state-owned oil and gas monopoly
- **Uztransgaz** a natural gas distribution/pipeline operator
- **Xalq Bank**
- **Agrobank**
- **Microcreditbank**
- **Uzagrosugurta** a top five insurance company with the largest branch network
- **Kurilishmashlizing** a construction machinery leasing business
- **Uzavtosanoat** state-owned auto manufacturer and producer of Chevrolet cars

UZBEKISTAN'S LEADING BANK IS AT THE HEART OF THE COUNTRY'S GROWTH AND DEVELOPMENT

Alisher Mirsoatov, Chairman of the board of NBU

GlobalMarkets: Your president has made it clear that he expects the country's banks to improve their efficiency as part of the overall economic liberalisation programme. What is the NBU doing to accomplish this task?

Alisher Mirsoatov: Today the National Bank is the largest bank of the country. For over 30 years, we have been the main state agent in the development of major investment projects and support of social programmes aimed at modernising the industry, increasing production capacity, the welfare of the country. The Bank, first of all, builds its work on the principle of customer focus, within the framework of satisfaction of requests from our clients. At the end of last year, President Shavkat Mirziyoyev addressed the Senate and the Legislative Chamber of the Oliy Majlis (the Uzbekistan Parliament), emphasising the need for banks to adhere to international best practices. We have responded to that call.

The main goal of the bank's "Strategy 2021-2025" is not only to remain the leading bank in Uzbekistan, but also to transform the bank both organisationally and technologically. Among the specific objectives: to increase the loan portfolio by 2.5 times with an increase in high-margin loans; increase the bank's profitability ratio to 22%; increase net profit to 3.8 trillion soums; increase the active customer base to 1m customers.

> **"Our strategic goal is not just to keep the leading position in the banking sector of Uzbekistan, but to become the best bank in the country."**

GM: The liberalisation programme has caused many of the country's financial institutions to alter their ongoing strategies. What has it meant for NBU?

AM: In light of the government's strategy to liberalise the economy and open up the capital markets, we at NBU have decided to move forward with a strategy that we think best supports the government's intentions.

There are many primary components of that strategy.

They include lending to large investment projects in primary sectors of the economy, facilitating foreign credit facilities, access to international capital markets, and funds from foreign investors.

Also important is providing banking services to small businesses and private entrepreneurships, developing retail banking services, and introducing new types of digital banking services. Other key components include the bank diversifying its sources of financing, developing products and supporting the country's trade and export potential, as well as providing investment banking services to corporate clients, including the issue and placement of securities on domestic and foreign markets.

Our strategic goal is not just to keep the leading position in the banking sector of Uzbekistan, but to become the best bank in the country.

GM: NBU has been around for 30 years, but its significance to the economy of Uzbekistan isn't fully understood. Please explain how significant the bank is to the country.

AM: The Bank was established in accordance with the Decree of the President of the Republic of Uzbekistan on September 7, 1991. We are the same age as our country's independence. NBU is defined as a systemically important bank, whose activities are focused on banking services for strategically important enterprises and investment projects, as well as on providing a wide range of banking products, in particular on support of small businesses and private entrepreneurship. The stability of the bank is recognised by international ratings agencies Standard & Poor's (BB-), Fitch Ratings (BB-) and Moody's Investors Service (B1). NBU's ratings are at the same level as the Republic of Uzbekistan. Today NBU stands as the largest bank in Uzbekistan and the second largest in Central Asia. In particular, NBU is the leading universal bank of the Republic of Uzbekistan, providing both corporate and retail banking as well as investment banking services.

NBU occupies the leading position in the banking sector of Uzbekistan. The value of NBU's assets is double the value of assets at other large banks in the country. In fact, as of today, NBU accounts for 21% of assets, 22.9% of the loan portfolio and 23.3% of the capital of the country's banking system.

GM: What are the drivers of NBU's stability and financial performance?

AM: The foundation of our stable production process is the bank's clients. As of January 1, 2021, the bank had over 187 thousand corporate and just under 4 million retail customers. As part of revenue generation, we do commercial lending to the real sector of the economy which are small businesses. As an agent of the state, the bank serves and finances the country's largest industries in all strategic sectors of the economy: mining and metallurgy, oil and gas, and energy industries; transport; telecommunications and communications.

In October 2020, NBU issued its debut Eurobonds, underwritten by Citi, Natixis, SMBC Nikko and Gazprombank. The successful issue was a vote of confidence in the bank and country, and helps diversify our funding sources, which supports our stability.

In addition, despite the impact of the pandemic, NBU continued to increase its loan portfolio (in 2020 the growth was 19.3%). At the same time, the bank began to focus on increasing the share of high-margin loans, and thanks to a conservative risk management policy, the NPL ratio remains at a fairly low level of 3% for NBU's total loan portfolio.

Stable asset growth also ensures a steady increase in the bank's net profit. At the end of 2020, the bank generated a profit of 900bn soums. ●

a very steady increase in terms of both transactions and total value over the past five years.

"We are excited about what the future holds. I can see the day when we are trading sukuk, derivatives, foreign exchange and bonds," says Usmonov.

Late last year, in a preliminary step toward capital markets modernisation, the government announced it intended to privatise fully or partially more than 600 state-owned companies, including the largest cement plant in Uzbekistan, Qizilqum Cement, and glass manufacturer Kvarts, among many others [See box on page 18].

CAPITAL MARKETS REFORM

There are various keys pillars of the capital markets reform and development programme, but one of the most important priorities in this initial stage is developing the government bond market.

This is crucial because a well-functioning and liquid government bond market provides a stable source of funding, improves the overall risk profile and helps reduce the country's reliance on external debt. Just as important is the need to enhance secondary market liquidity, diversify financial instruments, introduce international standards and enlarge the investor base by providing foreign investors with access to the local market.

The Ministry of Finance has been consistently developing the government securities market in collaboration with international financial institutions and governments, including the International Monetary Fund, World Bank, Asian Development Bank and the US Treasury. As a result of these efforts, the volume of issued government bonds has increased threefold over the last two years and this year five-year bonds have been placed for the first time.

Another essential part of the capital markets reform programme is the initiative to increase financial literacy within the country. Last August, for example, the central bank launched the Finlit.uz website aimed at educating citizens about the fundamentals of finance. The user-friendly website is broken down in various segments covering articles, study materials, online services and projects.

"Enlarging the investor base by upgrading financial literacy in the country is an important initiative for all of us who want to see Uzbekistan meet this opportunity head on," says Sarvarbek Ahmedov, director of the Ministry of Finance's Capital Markets Development Department.

Such an important initiative is only one of many being pursued under President Mirziyoyev's decree, which deserves credit for how comprehensive and ambitious it is [See box 2].

In truth, it needs to be ambitious as there is so much to do in the next few years, especially in developing and enhancing key pieces of financial markets infrastructure.

Sherali Abdujabborov, director of the State Central Depository System, is acutely aware of this and says the need to construct an up-to-date system is critical to the success of the overall reform programme.

"Ultimately we need to connect with the much larger systems like Euroclear and Clearstream," he says, adding that his organisation benefits from a close working relationship with their partner in the Korean Stock Exchange. "Any technical issues that arise we know we can count on them for help."

An area that has come in for special consideration is the information and communication technologies necessary for a modern capital markets platform.

The elements that are being looked at include a communications back-up centre, the development of a mobile capability for conducting securities transactions, and the launch of software enabling the Ministry of Finance to carry out its control functions. The government has also acknowledged that its current legal and regulatory frameworks are not robust enough for this new environment.

Accordingly, the decree calls for a redrafting of the various regulations necessary to develop and maintain an advanced capital market. Key to that is creating the right frameworks to support investor participation, which is another key focus of the reform programme. In fact, the President laid out a series of initiatives he wanted embraced to ensure there would be sufficient number of investors ready for the day they have something to invest in.

These initiatives include creating additional opportunities for non-residents of Uzbekistan to acquire securities of domestic issuers, to having the country included in various indices, encouraging participation of insurance companies in the capital markets, and creating investment funds in cooperation with international financial institutions.

The stock exchange will inevitably play a major role in enabling investor participation, but similarly important for facilitating foreign exchange trades is the Uzbekistan Currency Exchange, which is the largest securities exchange in the country.

Rashid Usmanov, general director of the Currency Exchange, says that despite the pandemic, trade volumes and value have continued to grow over the past two years. Most recently the value of trades on the exchange reached $35bn – more than three times the level in 2018. "By the end of this year we intend to be offering a future market for FX and other asset classes," says Usmanov.

BUILDING FOR THE FUTURE

The capital market development plan is not only comprehensive, it has very clear and well-defined goals. These include increasing the Uzbek market capitalisation (based on free float) to 45 trillion soums; increasing the total value of securities in the free float to 5% of GDP; increasing the total value of corporate bonds issued to 3.94

Continued on page 25

Key pieces of the President's deadline-driven capital markets reform agenda

- Development of a corporate bond market by March 2022.
- Introduce sukuk bonds in accordance with Islamic finance principles. Appropriate legislation in place by April 2022.
- Bring the central securities depository up to international standards by December 2022.
- Create a unified portal for corporate information by May 2022.
- Create a non-state, self-regulated association of professional market participants. Draft legislation ready by March 2022.
- Upgrade the stock exchange in terms of listing rules, OTC policies and implement training programmes with international experts.
- Reduce the government share in the stock exchange through new share issuance.

STATE-OWNED AUTOMOTIVE CHAMPION A PRIME CANDIDATE FOR PRIVATISATION

Azizbek Shukurov, Deputy Chairman of Uzavtosanoat

GlobalMarkets: How is Uzavtosanoat benefitting from the economic reforms in the country?
Azizbek Shukurov: As the biggest state-owned company in Uzbekistan we feel very positive what we see taking place with the economic liberalisation programme. At the moment, we have a dominant 95% market share in the country. We realise that as the country opens up, we are going to have to work hard to maintain our market position. It is not something we can take for granted.

GM: Given Uzbekistan's friendly relations with its neighbours it is not surprising you've managed to make strong inroads into the export market?
AS: Growth in exports has been a real bright spot for us. Last year, exports accounted for only 7% of our profits; this year we are looking at that figure to rise to around 20%. Kazakhstan is a good example of our export strength. Last year, we had a 24% share of the Kazakhstan market; this year we expect to see that climb to 50%.

GM: The global auto industry has undergone a great deal of change in the last decade, particularly in the areas of supply change management and operational efficiency. How has Uzavtosanoat kept up with those changes?
AS: I'd like to think we are staying as current as possible to the global trends in our industry. In 2016 we implemented a rigorous efficiency programme that paid off quite well in 2019 when we managed to report profits of $350m.

GM: It's hard to imagine running an automobile assembly operation in the face of rigorous Covid-19 measures. How is Uzavtosanoat managing in the midst of the pandemic?
AS: I'm very proud of our company in that respect. We implemented all the necessary measures while keeping all the manufacturing operations running without any interruption.

GM: Everywhere one looks in Uzbekistan there is some form of education on offer. How important is education to your industry?
AS: Very important. The more knowledgeable our work force is, the higher quality product we are going to produce. Our education runs along two main tracks. Since 2009, Turin Polytechnic, one of the leading European engineering schools, has operated a campus in Tashkent. We are not the only industry to benefit from that arrangement, but it does give us access to the recent graduates in engineering. We also benefit from the close working relationship we have with General Motors. We will send our people to GM locations in Korea and Thailand and GM sends people from various plants to Uzbekistan. It is a very mutually beneficial relationship.

GM: In April of this year, your company issued a $300m Eurobond. Did the reception the bond got in the market surprise you?
AS: We were very pleased with the reception it got. To be more than four times oversubscribed is a clear indication of our standing in the international markets.

GM: Can you take us through what the proceeds will be used for?
AS: The proceeds will fund capex projects involving two new cars to come off our assembly line. In 2022 we will be building the new Chevy Tracker, a smaller version of an SUV. The following year we will be making the innovative three-cylinder Onix. The three-cylinder engine is capable of producing the same amount of power as the four-cylinder version while being more fuel efficient and more environmentally friendly.

GM: There have been reports that Uzavtosanoat would be among the early companies selected for privatisation. I would assume given your focus on economic matters within the company that would mean a lot of work for you?
AS: I think what gives a lot of us pleasure in this country is knowing that any privatisation programme will be carried out properly and not like what we saw in Russia in the early 1990s when a handful of people walked away with the prime assets. I imagine us doing an IPO within the next two years but it will be done with the proper governance and fiscal discipline.

GM: Economists look at heavy industries such as yours and calculate the benefit that accrues to all the secondary businesses that you rely. Just how big is your supply chain?
AS: We have between 130 and 140 parts suppliers, some of those are in Korea. We rely upon those companies for all sorts of component pieces that need to meet our stringent quality standards. ●

> **"We realise that as the country opens up, we are going to have to work hard to maintain our market position. It is not something we can take for granted."**

SQB: IN PURSUIT OF AN AMBITIOUS TRANSFORMATION STRATEGY

Sakhi Annaklichev, chairman of SQB

GlobalMarkets: SQB has been identified as an upcoming privatisation candidate. That usually requires a lot of work to get an institution ready for that process. What is SQB doing to prepare itself?

Sakhi Annaklichev: The next two years are going to be a time of organisational and operational change as the bank readies itself for privatisation. Our goal is to transform the bank into a competitive, client-oriented, market-based mechanism, attractive to both clients and investors. Among the priorities in that transformation, are: improving operational efficiency; improving the quality of customer service; diversification of the loan portfolio and resource base; modernisation of information technology infrastructure; compliance of the risk management system with international standards; improving the financial literacy of clients and the skills of bank employees; improving our credit policy and introducing innovative and remote services.

"Our corporate client base provides the greatest potential for growth. One of our advantages in the market is the strong expertise we have in the corporate segment."

GM: What is all of that going to mean for the clients?

SA: From the client's perspective, it is our intention to offer enhanced services. So, for our corporate clients, we will provide an individual approach, a high quality service and structured financing. For the SME clients, we will provide an individual approach, a high speed service, and individual credit and deposit products, and packaged offers. Lastly, for our retail clients, we will provide modern online banking, multi-currency deposits, credit cards, and installment cards.

GM: What is the area with the greatest growth potential?

SA: Our corporate client base provides the greatest potential for growth. One of our advantages in the market is the strong expertise we have in the corporate segment. By providing them with a high quality service we expect to see a gradual increase in our market share. We also expect to see good growth across our corporate business over the next few years. For instance, we forecast our corporate loan portfolio to grow from 25.6 trillion soums ($2.4bn equivalent) in 2021, to 27.9 trillion in 2022, and 29.3 trillion ($2.8bn) in 2023. In addition, we forecast profits to increase from 520bn soums ($49m) in 2021, to 598bn in 2022, and 637bn ($60m) in 2023. Lastly, we forecast that deposits will grow from 8.5 trillion soums ($802m) in 2021, to 9.7 trillion in 2022 ($915m), and 10.6 trillion in 2023 ($1bn).

GM: Uzbekistan is a signatory to the Paris Agreement and sustainability programmes can be seen all over the country. What is SQB doing on the environmental front?

SA: Green banking is a very important part of our product offering. At the end of July 2019, the bank, together with experts from the International Financial Corporation, defined the actions and tasks to create a green bank. As a result of this, the green banking department within our bank was created, and an effective platform for "green" financing was built.

As part of this, we have been implementing the UN Sustainable Development Goals, and not just statements and formal procedures. For instance, the bank, under these goals, has been working on changing its entire philosophy and relationships with partners, customers, employees, and broader society.

Importantly, the bank last year introduced some specialised energy efficiency products into its credit lines for corporate, small and medium-sized retail businesses. These use long-term target lines of all major financial institutions represented in the EBRD. This has become a significant contribution to the development of a sustainable and reliable energy supply, as well as the fight for the environment. Today, the volume of energy efficiency projects financed by the bank exceeds $70m and by the end of the year it is expected to be over $100m.

In addition, the bank will also actively develop programmes aimed at energy efficient housing improvements and the purchase of household appliances, including on preferential terms. We also plan to establish business relations with "green" funds, which are intended for investment in projects in the field of renewable energy sources, increasing resource and energy efficiency, waste recycling.

GM: The liberalisation programme has to have been quite a shift change for many in the Uzbekistan banking industry. How do you think it is coping with the change?

SA: The programme of economic liberalisation has turned out to be a noticeable shift from the principles that governed the banking system since the signing of the decree on priority measures for the liberalization of currency policy. As a result, the rules of the game changed from banks following soft budget constraints to accommodating hard budgets, which mean they start seeking funds on international financial and debt capital markets rather utilising state funds. As such, SQB was first to issue Eurobonds – in the amount of $300m – and attract funds without government guarantee. The liberalisation programme implies that banks would limit their participation in the state programmes involving subsidies and lower than market interest rates. SQB has managed to replace state guaranteed low margin loans with a competitive high return portfolio. This is accompanied with introduction of new methods in loan processing such as scoring models, and underwriting.

GM: One of the component pieces of the liberalisation is increasing financial literacy. What is your bank doing to help in that regard?

SA: I am very proud of the work we are doing in the field of educating and training specialists as well as clients. We have our own education centre for training employees. In fact, we recently organised some training, in cooperation with the Asian Development Bank, on trade finance for all our loan officers. Also, the EBRD has conducted online training platform where specialists can improve their knowledge in various spheres. In addition, our specialists at head office constantly share their knowledge with employees of the branches. ●

Uzbekistan making progress on the UN Sustainable Development Goals

The country's pursuit of achieving a more sustainable and equitable society has coincided with an ambitious economic reform agenda that, together, are delivering results

By John Anderson

Opening-up the economy is not the only profound initiative underway in Uzbekistan. The government is no less focused on ensuring that all Uzbeks have a good quality of life, a mission tied closely to the creation of a more sustainable environment.

This is an area of particular sensitivity to the nation, due in part to the scars of the past. Under the Soviet Union, for instance, the massive stocks of water feeding the Aral Sea were used heavily in the 1960s as an irrigation source to grow cotton in the surrounding arid plains. The Soviet Union's belief back then that they could tame nature to its own aims ultimately led to the sea drying up.

In his speech last year to the United Nations General Assembly, President Shavkat Mirziyoyev highlighted climate change as an acute problem of our time. "Today, every country feels the negative effects of this process. Unfortunately, such negative developments also pose a great threat to the sustainable development of Central Asia."

He added: "The Aral Sea region became the centre of an environmental tragedy. To mitigate the current situation, we are carrying out an enormous work to create two million hectares of new plantations and forests, to form a layer of soil."

The President also expressed concern about the reduction in the flow of transboundary rivers and biodiversity in Central Asia, which is also one of the most serious problems in the region.

However, on a more positive side, the president also noted that the widespread introduction of green technologies and the implementation of green energy projects in Uzbekistan should more than triple the share of renewable energy sources in the country over the next decade.

To support this mission, the Uzbek government in May approved a presidential decree to establish a strategy to boost development of renewable and hydrogen energy.

RENEWABLE POWER GENERATION

In reality, the government is taking on the environmental challenge on several different fronts. It has a goal, for instance, of generating 25% of its energy from renewable sources by

"Today, every country feels the negative effects of this process. Unfortunately, such negative developments also pose a great threat to the sustainable development of Central Asia."

—President Shavkat Mirziyoyev at the United Nations General Assembly

2030. To do that it is encouraging greater investment in both wind and solar power.

With the help of international development institutions, the government has already successfully kickstarted its plan for alternative energy generation. The International Finance Corporation (IFC), for example, has started its Scaling Solar programme in the country, which will support the government's grand plan to generate 1,000 MW of solar energy. The IFC programme is essentially a "one-stop-shop" initiative for governments to rapidly mobilise privately funded grid-connected solar projects at competitive tariffs.

A similar programme is being undertaken by the Asian Development Bank, whereas the European Bank for Reconstruction and Development has agreed to assist the government in securing 1,000 MW of wind energy projects under public-private partnership.

On top of this, agreements have been signed with ACWA Power of Saudi Arabia to construct a 500-1,000 MW wind power plant, with the UAE's Masdar to build a 500 MW wind power plant in the Navoi region, and with TOTAL Eren to construct a 100 MW solar power station in the Samarkand region.

Such examples show how serious a focus renewable power generation is. Just as important is the sustainable use of natural assets, such as water. The old irrigation systems are woefully out of date and leaking. To remedy that, the country is working with the ADB and the World Bank to install modern systems. Other areas of focus include protecting the groundwater quality and quantity that supports country's wheat crop – one of its biggest exports – as well as minimising the leakages in the country's gas pipeline.

FINANCING THE SUSTAINABILITY AGENDA

Applying such a dedicated focus to sustainability across the economy is to be applauded. Yet part of the challenge for the Uzbek government is financing its efforts.

In the UN Development Programme's Development Finance Assessment report, it said that for Uzbekistan to hit its sustainability targets by 2030, the country would need invest $6bn annually each year.

To be sure, creating a vibrant capital market will help the government provide the proper budgetary support to all the various sustainability initiatives. And there are many of them. Uzbekistan, as other countries, is pursuing 16 national Sustainable Development Goals.

Capital markets financing will certainly help pay for some of these initiatives, a funding channel in which Uzbekistan has already had success. The country issued a soum denominated Eurobond late last year that qualified as development finance with a high development impact. Importantly, the government is planning to report progress on the development outputs through an annual report published on its website.

The proceeds from the Eurobond are intended to fund the projects associated with the 16 national SDGs. Some of the projects include those focused on building and reconstructing schools and healthcare institutions, drinking water and sewage pipelines, and roads. Other projects focus on providing financial assistance to women and families in difficult social situations.

Uzbekistan has focused a great deal of energy on tackling these issues as well as poverty and the myriad of health and social issues that are linked to it.

In fact, to ensure people are not falling through the government's safety net, an online social register has been developed with the help of UNICEF to identify people in need of assistance. Throughout the pandemic, the number of individuals obtaining assistance has doubled from 600,000 to 1.2m.

EDUCATION AND HEALTHCARE IN FOCUS

Education offers a route out of poverty, which is part of the reason why Uzbekistan is focusing so much on improving education and is backing that up with investment. Accordingly, the government has set aside 20% of the national budget for education.

There are certain examples that illustrate this commitment to education, such as the country doubling the salaries of teachers in the past year – a move that will be the envy of teachers worldwide – as well as schools across the country being upgraded, with the installation of high-speed fibre optic cable.

In tandem with education, great strides have also been made on the health front. The government has been working closely with international partners to develop effective healthcare programmes, many of which have focused on population health management, where family physicians with a team of nurses will play a central role in prevention of chronic diseases, early detection and long-term care.

This approach is beginning to show signs of effectiveness. More broadly, the government is embarking on a far-reaching and ambitious reform agenda with an overall objective of improving the health of the whole population through universal health coverage.

While much has still to be achieved, Uzbekistan is making good progress on all its SDGs. This is partly due to the implementation of the goals coinciding with the reform programme under the government's national action strategy.

This strategy, and its five priority areas, has increased the probability of Uzbekistan achieving the SDGs. Work is underway to integrate the SDGs into national and regional development strategies and programmes, including an initiative called the concepts of comprehensive socio-economic development of the Republic of Uzbekistan until 2030.

Importantly, the government is assessing the results of the reforms through monitoring 24 global ratings, including the global SDG Index, where Uzbekistan is currently ranked 77th.

Ultimately, the country's long-term vision is to become a high middle-income country by 2030, which would mean reducing poverty and inequality.

REFORMS COINCIDE WITH SUSTAINABILITY DRIVE

To achieve this, Uzbekistan is implementing structural reforms to strengthen the market economy, the currency, the tax system, and agricultural industry.

Moreover, a range of measures have been taken to improve the business climate, stimulate entrepreneurship and formal employment, including among youth and women, as well as to attract investment and promote innovation.

However, challenges remain. These include ensuring sustainable employment for youth and women, as well as improving the effectiveness of the social welfare system.

In addition, in healthcare, measures are being taken to improve the quality and accessibility of services through improving the financing and insurance system, improving the training and professional development of medical personnel, as well as developing medical science and the widespread introduction of e-health.

Some of the key priorities in education include improving the quality and coverage of education at all levels, as well as encouraging increasing public and private investments.

The reforms in Uzbekistan are guided by one principle: "Human Interests Are Above All". This principle is closely aligned with the country's Agenda 2030 core principle of: "Leaving No-one Behind."

Importantly, since the adoption of the SDGs, Uzbekistan has made significant progress in improving the protection of human rights and strengthening rule of law. In addition, administrative reform continues apace, e-government is being improved, and reforms are being implemented to ensure the independence of the media to enhance the role of civil society.

The country has also prioritised strengthening the role and protecting the rights of women. Recently, laws have been adopted on gender equality and the protection of women from violence, the proportion of women in parliament has doubled, and women have been promoted to leadership positions at all levels of state and local authorities.

Uzbekistan pursues a foreign policy of openness, cooperation, and peace. In recent years, the country has opened borders and is deepening cooperation with the Central Asian countries in the areas of rational use of trans-boundary resources and trade. Collaboration with UN agencies and international financial institutions is being strengthened.

In the environmental area, Uzbekistan prioritizes mitigation and adaptation to climate change (including under the Paris Agreement) with a special focus on the Aral Sea region, conservation and the efficient use of water, land and energy resources, as well as biodiversity conservation.

Uzbekistan has embarked on an ambitious plan to reform its financial, health care, environmental and educational systems.

That would be a tall order for any country, but Uzbekistan has the ingredients to make this work. GM

Building forward better
Drought resistant plants part of the afforestation of the Aral Sea; The first electric bus in Tashkent; An exhibition dedicated to environmental protection at Samarkand School No. 33

Capital Markets Reform Continued from page 20

trillion soums; and increasing the share of projects financed by issuing securities in the regional investment programmes by 5%.

But how does Uzbekistan look to those outside the official governmental circles? For someone like Sardor Koshnazarov, a director at Silk Capital, the country is long on potential – a potential that needs to be unlocked in a clear and professional way.

"When you count up all our assets – natural resources, a workforce that is young, intelligent and eager to work, a stable government – there is no reason we couldn't be the most attractive investment target in Central Asia. We need to use technology to leapfrog other countries around us," he says.

For Karen Srapionov of Avesta Investment Group, a certain amount of growth in the country is being held back due to the high cost of capital.

"The banks could grow three times over every year if the cost of capital was running around 23%," he says. "We also need to figure out how to make the senior managers of some local companies comfortable with giving up control through IPOs and SPOs."

Uzbekistan is embarking on an ambitious programme at an interesting time in world affairs. Looked at objectively though it has the wind at its sails for a variety of reasons.

First, there is a stable government seeking to provide for increased opportunities for all Uzbekistan and peaceful and prosperous relations with its neighbours.

Second, there is an inclination to embrace educational opportunities as a way to advance economic development.

And third, a relationship with major development agencies, including Asian Development Banks, World Bank, European Bank for Reconstruction and Development as well as the Islamic Development Bank, should prove helpful in the challenges ahead.

Uzbekistan deserves credit not only for what it is doing but why it is doing it. It is well accepted and well demonstrated that countries with high GDP per capita are better positioned for a sustainable future when they encourage greater participation in their capital markets. GM

FROM A MORTGAGE POWERHOUSE TO A DIVERSIFIED BANKING BUSINESS

GlobalMarkets: With such a large share of the mortgage market, it doesn't seem you have much of an impetus to expand your product offerings?
Elyor Inomjonov: Actually, it is because we have such strength in the mortgage sector that we are capable of readjusting our strategy over the next two years. We are not backing down from the mortgage market, but we are stepping up our work with private businesses and retail clients. The retail strategy is built around providing alternative sales channels while the face off to small and medium-sized businesses will be in the hands of customer service managers.

GM: Various reforms are being proposed in the mortgage market, including reducing down payments and increasing subsidies. What impact will that have on your business?
EI: As a result of the implementation of reforms in the mortgage market, there is a tendency for the rapid development of this sector. As of January 2021, the bank's share in the mortgage market was more than 30%. Maintaining this market share is one of our main strategic goals. According to the forecasts, the balance of the commercial mortgage loans is expected to increase by several times in the following three years, today this goal is being successfully implemented.

What we've found is that clients who have received a mortgage loan are long-term and reliable partners of the bank, which makes it possible for the bank to offer them other types of banking products. That is a wonderful opportunity for further market penetration that we have to take advantage of.

GM: In comparison to developed countries Uzbekistan has a low availability of banking services. What is being done about that?
EI: There is certainly going to be an increase in the number of banking products offered to customers in the retail segment. In particular, within the framework of a salary project, the bank plans to increase the volume of the retail business. Today, Ipoteka Bank is the leading bank in the country in terms of the volume of loans to customers in the retail segment, and we are working to strengthen this leadership. In addition, the demand for remote services is increasing among retail customers. As part of our strategy, it is planned to increase the number of users of mobile applications to 650,000.

GM: Are there any client segments that your leadership in mortgages naturally lead you to?
EI: It makes sense if we are helping people to get into a home, that we would also be close to the people who build those homes. So naturally, we plan to update the level of interaction with business entities in the construction industry. They will be provided with banking products suitable and convenient in all respects.

GM: The economic liberalisation programme now underway is going to put a great deal of pressure on financial institutions to help achieve the objectives? What is the impact on Ipoteka Bank?
EI: Currently, our country's economic reforms are aimed at reducing the role of the state in the economy and expanding the participation of the private sector. As a result of economic liberalisation, an increase in the privatisation and economic activity of large state-owned enterprises and companies is expected, followed by the development of the banking business. Along with this, significant reforms are being carried out in our country to open and run a business, guarantee property rights, and as a result, new business entities appear. They are potential new clients for banks.

GM: Looking specifically at the mortgage market, what changes can we expect?
EI: The demand is increasing as a result of the liberalisation of the construction and mortgage markets. The activity of the private sector in the construction industry is growing. In the past, this industry functioned mainly on the basis of government-backed orders. In recent years, the number of entrepreneurs in the construction industry, as well as citizens in need of housing, continues to grow steadily. This, in turn, creates additional opportunities for development for banks, including for Ipoteka Bank.

Chairman Elyor Inomjonov

GM: The government has made it clear that if liberalisation is going to work the population must have a higher degree of financial literacy. What is Ipoteka Bank doing to help that initiative?
EI: We are involved in a number of programmes, but one that we are particularly proud of involves supporting women's entrepreneurship. Among the areas we are specifically taking part in is the organizing of classes on financial literacy for women entrepreneurs. Additionally, the European Bank for Reconstruction and Development (EBRD), in cooperation with Ipoteka Bank, has launched the Woman in Business CA programme. The Woman in Business CA project is aimed not only at financing, but also at organising training seminars in each region with the involvement of qualified specialists to provide non-financial services to women entrepreneurs, develop their business skills and increase financial literacy. ●

> **"Ipoteka Bank is the leading bank in the country in terms of the volume of loans to customers in the retail segment, and we are working to strengthen this leadership"**


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What's happening Friday, July 2

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09:30AM – 10:15AM
Press Conference
Jonathan Charles, Managing Director of Communications, EBRD; **Odile Renaud-Basso, President,** EBRD

10:30AM – 11:30AM
Discussion Panel: **Our Natural Capital and Blue Economy**
Introduction & Welcome: **Adonai Herrera-Martinez**, Director for Environmental Funds, EBRD
Moderator: **David Shukman**, Science Editor, BBC News
Speakers: **Professor Sir Partha Dasgupta**, University of Cambridge; **Anabel González**, Deputy Director General, World Trade Organization; **Dr. Jane Goodall**, DBE, Founder of the Jane Goodall Institute & UN Messenger of Peace; **Pierre Rousseau**, Senior Strategic Advisor, BNP Paribas

11:30AM – 12:30PM
Business Connect

12:30PM – 13:30PM
Discussion Panel: **Reinventing Capital Markets**
Moderator: **Katie Martin**, Markets Editor, Financial Times
Keynote Speaker: Mairead McGuinness, European Commissioner Financial Services, Financial Stability and Capital Markets Union
Speakers: **Gianfranco Bisagni,** Head of Central Europe UniCredit; **Marek Dietl**, Chief Executive Officer Warsaw Stock Exchange; **Koba Gvenetadze,** Chairman of the Board National Bank of Georgia**; Pierre Heilbronn,** Vice President, Policy and Partnerships, EBRD; **Annemarie Straathof**, Vice President Risk and Compliance and Chief Risk Officer, EBRD

2:00PM – 2:45PM
The 30th Anniversary of the EBRD — What will the next 30 years bring?
Moderator: **Sergei Guriev**, Professor of Economics, Institut d'études politiques
Speakers: **Kristalina Georgieva**, Managing Director, IMF; **Andrew Kilpatrick**, Consultant, EBRD, ADB and World Bank Group; **Odile Renaud-Basso**, President, EBRD; **Josué Tanaka**, Visiting Professor in Practice, The Grantham Institute, LSA

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

10:00-10:50 Missing Middle in Transition to the Future of Education

10:00-10:50 E-Commerce in Kazakhstan During the Boom

11:00-11:50 Transferable Skills in Digital World

11:00-11:50 Open Banking: Global Use Cases and Kazakhstan Market Insights

12:00-12:50 IPO: Transformative Learning Programme

12:00-12:50 Institutionalising Eurasian Integration Initiatives

13:00-13:50 Aifc-Eu Perspectives of Alternative Investment Funds

13:00-13:50 Official Launch of The Affiliate Centre For The 4th Industrial Revolution World Economic Forum In Kazakhstan

14:00-14:50 Presentation of The Book "The Law Of The Aifc"

15:00-15:50 Green Investment Principles for Belt And Road

15:00-15:50 The Role of Financial Centres to De-Risk Fdi Projects

16:00-16:50 Green Finance Awards Ceremony

16:00-16:50 A New Aviation Hub and Opportunities For Aviation Finance

17:00-17:50 High Level Plenary Session: Restoring Growth

17:00-17:50 Workshop on Application of Aifc Jurisdiction In M&A

18:00-18:50 Women, Peace And Security

18:00-18:50 The Role Of International Financial Centres In Attracting International Capital

19:00-19:50 Building Back Better: Central Banking In A New Era?

19:00-19:50 Fintech Disruptors Vs Banks: Choice Of The Strategic Development Model For Kazakhstan

20:00-21:00 Is Corporate Governance 4.0 Emerging?

20:00-21:00 – Research-Based Policy Making: Aifc Research Projects Highlights

MDBs

Continued from page 1

Governments have set up MDBs to promote development, but have often been stingy about handing over capital. Hence, much of the banks' capital is not paid in, but callable — meaning they could ask their shareholders to provide it if they ever needed it. No MDB has ever called on it.

The de facto regulator for MDBs' balance sheets is the rating agencies, which give them the triple-A grades that unlock very cheap funding.

The rating agencies do not give full credit for the callable capital — but they do give some. However, the MDBs act as if they got no credit — as if the callable capital was not there.

"The MDBs all say callable capital supports their bond ratings, but in the models where they work out their capital adequacy, which determine how much they lend and when they need more capital, they do not include callable capital," said Chris Humphrey, senior scientist at the ETH Zurich university, who has been writing about this issue for several years.

In the European Bank for Reconstruction and Development's balance sheet for end 2020, for example, its capital is listed as €6.2bn of paid-in capital and €11.7bn of reserves and members' equity. Its €23.5bn of callable capital is only mentioned in a note.

That €17.9bn of usable capital supports €51bn of loans, advances to financial institutions and equity investments — a ratio of 2.86. The bank has also extended €15bn of undrawn commitments. Its non-performing loan ratio is 5.5% and net loan losses last year were €37m.

Exactly why MDBs are so cautious about capital adequacy is puzzling, but experts suggest two reasons. "The wealthy country shareholders have long supported the MDBs having extremely conservative financial policies, because they are afraid their callable capital might some time get called," said Humphrey. "The callable capital was put there so the MDBs could take more risk, but it's become an excuse for them being more conservative. Now the shareholders including the wealthy countries want the MDBs to do more."

The US had traditionally been cautious, but with Joe Biden as president is eager to press for more action by the MDBs.

The MDBs themselves have been timid, to avoid upsetting their shareholders or imperilling their ratings. But Humphrey added: "They like their autonomy. They don't have any regulators, so they've opposed [change]. Now they've begun to tell which way the wind is blowing and are contributing in a positive sense."

G20 DECISIVE

The crucial factor will be the attention of the G20 — which since the 2008 financial crisis has been a vital organ of international financial governance.

Its communiqué said its International Financial Architecture Working Group was "laying the ground for an ambitious package of measures to make available more development finance and strengthen co-ordination among international financial institutions".

As part of this, the IFAWG has discussed "a possible review of MDBs' capital adequacy frameworks, [which] could free up additional resources for low and middle income countries."

Since the group's role is to prepare for ministerial decisions, the next step could be for G20 finance ministers to initiate this review when they meet in July.

The package has two other promising elements. First, "the full support of the G20 to advancing an early replenishment" of the International Development Association, the World Bank arm serving the poorest countries. During the Covid pandemic last year, IDA more than doubled its annual commitments, but this left it needing a replenishment a year earlier than planned.

Second, the IFAWG discussed MDBs' balance sheet optimisation measures. This refers to securitizations and credit insurance transactions — as pioneered by the African Development Bank in 2018 — and exposure swaps, which make the MDBs' capital go further.

Experts believe there is considerable potential for more such deals, and investor appetite. But progress was halted in 2018 by the US Treasury, which criticised balance sheet optimisation. The IFAWG talks suggest the new US administration has thawed on this.

HELPFUL CLARITY

The G20 is not poised at this stage to regulate the MDBs. Nor will it tell the rating agencies what to think.

But Humphrey believes there could be value in "having an external, official view that might encourage methodologies to converge".

Nancy Lee: MDBs should use their flexibility in a crisis

That could include guiding the MDBs' finance departments on how to manage their capital adequacy, as well as the rating agencies.

Rating the MDBs is difficult because they are so unique. This leads to the agencies having very different methodologies, which are tricky for the MDBs to navigate.

S&P's analysis in 2016 that the 19 MDBs could add $1tr of assets provoked complaints from them, so in 2017 it published a clarifying statement. The actual headroom could be lower, depending on factors such as government shareholders being downgraded.

For an AAA rated MDB, S&P counts callable capital from governments rated at least AA+. This is factored in at the end, and can give up to three rating notches of extra credit.

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