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## NEWS



## SPECIAL



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# EIB planning new development bank to push EU's global 'impact and influence'

**Exclusive**

**By Elliot Wilson and Toby Fildes**

The European Investment Bank, the international lending institution of the European Union, is engaged in talks to transfer all its non-EU business to a new entity that will focus on sustainable projects with an aim to be up and running as early as 2020, *GlobalMarkets* has learned.

Sources close to the Luxembourg-based EIB said the new unit, tentatively called the European Bank for Sustainable Development (EBSD), had been warmly received in Brussels.

"The European Commission has fairly won over," said a senior EIB staffer. "The next stage is to convince the Council of the European Union and the member states. We are broadly looking at coming online with it over the next one to two years."

EIB: new unit to focus on sustainable projects

The new lending institution will likely be housed under the group's umbrella and modelled on the structure and style of the European Investment Fund, an EU agency that channels financing to SMEs.

Sources said it was born out of a pressing internal need to draw together all the strands of the EIB's non-European lending and suck them into a single subsidiary.

"Around 10% of our annual lending — around €7.5bn ($8.4bn) — goes to projects outside the EU, and this number is in turn around a third of total EU development assistance," a source said. "There was a very strong imperative to ensure this capital was invested wisely and visibly, helping to

*Continued on page 31*

# CEE 'behind the curve' on green bonds

**By Mariam Meskin**

The use of green financial instruments by emerging European countries remains disappointing despite climate change shooting to the top of the EU and EBRD's agenda, industry experts warned yesterday (Wednesday).

Of the $589bn of green, social or sustainability-linked bonds ever issued, only $6.1bn or 1% have been from CEE, compared to 4% of vanilla bonds, according to Dealogic data. Of those, four deals from the Republic of Poland account for 70%.

*Continued on page 31*

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Ruhe: need for clearer principles

# EBRD's Africa push met with scorn in Sarajevo

**By Elliot Wilson and Jasper Cox**

The EBRD's plans for a harder and faster push southward into sub-Saharan Africa (SSA) has run into opposition from some delegates at the bank's annual meeting in Sarajevo.

They told *GlobalMarkets* the multilateral bank should focus on markets in Central Asia and the Western Balkans, which struggle to attract private sector investment and suffer from a paucity of infrastructure and good financial and economic management.

Senad Softić, governor of the Central

*Continued on page 2*

# Europe risks driving Ukraine to Russia through neglect

**By Lewis McLellan**

Ukraine has warned that Russia will step in to fill a vacuum left by the European Union unless the bloc reciprocates the overtures being made by its president-elect Volodymyr Zelensky.

Artem Shevalev, EBRD's alternate board director for Ukraine, said Russia had been pouring money into Ukraine and "exerting every kind of leverage to bring Ukraine into the fold".

Zelensky sent a delegation to Brussels earlier this week, headed by Oleksandr Danylyuk, who was a finance minister under the previous administration.

Shevalev said Europe's lukewarm response to Ukraine's vote to enshrine its relationship with the EU in its constitution had been disappointing. "It plays into Russia's narrative that Ukraine is not wanted in Europe," he said.

"It's not just about the money — although Ukraine has received far less European financing than, say, Poland — but it's the symbolic side of things. I don't see why the EU didn't say that, subject to reaching various milestones of governance and development, Ukraine could be an EU member in the future. That would have helped a great deal.

"I'm aware that talk around adding new EU members is unpopular just now, but if it were a question of Ukraine potentially joining in 2030, I don't see how that could have been a problem."

*Continued on page 2*

# Ukraine

*Continued from page 1*

Zelensky meeting Emmanuel Macron at the Elysee Palace in April

Zelensky appears to have planted his flag firmly in favour of European integration. With the president-elect's reputation as a political unknown, an early mission to make contact with the EU and discuss reforms, particularly one headed by well-known figures of stability like Danylyuk, is an early sign of Zelensky's warm intentions to Europe.

Vilius Šapoka, minister of finance for Lithuania, said: "I do believe that Ukraine has already chosen its European path and will continue."

Vasile Tofan, a partner at Horizon Capital, a private equity firm with operations in Ukraine, agreed.

"Ukrainian integration into the EU is irreversible on many levels, economically and socially," he said. "It's not about who is the president. I think any president will have to accept that reality."

### HONEYMOON PERIOD

However, the EU would do well not to take Ukraine's friendship for granted. Zelensky is in what one emerging markets portfolio manager in New York called "his honeymoon period" with Europe. "But Russia is there, and Ukraine will be forced to get along with them."

Said another investor: "Zelensky has made it clear he is no Russia fan by any means. But he is a pragmatist in terms of negotiating with Russia."

If Zelensky were to jeopardise Ukraine's relationship with the IMF and other international stakeholders — perhaps by allowing oligarch and Zelensky supporter Ihor Kolomoisky to force the reversal of Privatbank's nationalisation — it could open a window for Russia to bring Ukraine into the fold. Shevalev said that such a development would be "disastrous" for Ukraine's relationship with the international community.

"Could Ukraine service its external debt without IMF support? Possibly, but it would be very expensive," said Shevalev. "That would open a huge window for Russia to gain influence over Ukraine by bailing the country out."

Russia has a track record of attempting to manipulate Ukraine through debt. In 2013, the country lent Ukraine $3bn. Russia is suing Ukraine for non-payment, but Ukraine alleges that Russia used threatening behaviour to coerce it into accepting the money, calling Russia's lawsuit a "tool of oppression". The case is awaiting trial in an English court.

# Bosnia and Herzegovina rails against delays to EU accession

**By Elliot Wilson**

Senior Bosnia and Herzegovina officials vented frustration at the stalled process of EU accession talks yesterday (Wednesday), warning that Europe's foot-dragging was stymying growth and investment and threatened to undermine belief in the process.

"Accession is definitely going too slowly," Senad Softić, governor of the Central Bank of Bosnia and Herzegovina, told *GlobalMarkets*. "When you look at the projections from the EU, they say we may have to wait five, six, seven years before entering the second phase. In the modern world, that is just too slow."

Bosnia became an EU "potential candidate country" in 2003 but is still waiting for promotion to the next stage, where it becomes an official candidate to join the EU as a member state.

Asked if the EU could do more to inject pace into the process, Softić, said: "This process is too slow, but that is not only dependent on us. It's a process of local politics but also regional politics. I feel Europe can do more to help us overcome the obstacles in a faster way."

He pointed to the list of 600 answers that Bosnia submitted in response to questions from the EU in March 2019, five months after its deadline had expired. Twenty of the questions remained unanswered, largely due to the fact that Bosnia simply did not have the required data. "The EU could have worked with us on these questions, to simplify and speed up the process," he said.



Softić: Europe needs to help us

### SLIPPING BEHIND

Bosnia has made remarkable strides at key institutional levels. Its central bank works hand in hand with the European Central Bank, and its data collection system uses Eurostat standards.

Bosnia has slipped behind every regional sovereign in the accession race bar Kosovo, whose existence as an independent state Serbia disputes. "We have better indicators than all of those countries," the governor said.

That it may take another 15 or 20 years before Bosnia and Herzegovina becomes a member state — or worse that talks may stall in perpetuity, leaving the country permanently locked out of the single market — leaves officials frozen in fear.

"We can't think about that future. The EU is our way, it is the only way, we can't bear to think about any future where we are not a member," said Gordan Milinic, director, council of ministers, at the country's Foreign Investment Promotion Agency.

Softić added: "The fear is that we will remain at this level of development [if accession talks do not speed up]. And if that happens, the departure of young people to EU member states will intensify.

"Europe needs to help us, to get more involved in what we are doing, to help us move forward. Greater and deeper economic integration would provide us with better living standards, and a higher pace of development. That would mean more people, instead of leaving, want to stay."

# EBRD

*Continued from page 1*

Bank of Bosnia and Herzegovina, told *GlobalMarkets* the EBRD should focus its money and attention on "Bosnia, not Africa".

"We live in a global world [but the EBRD] should focus on European countries. Europe should be the priority, then the rest [of the world]," he said. "Can you imagine if they move into all of Africa, how much slower the process and pace of development and reform in the Balkans would be?"

Dmitry Pankin, president of the Black Sea Trade and Development Bank, went even further. "It's a totally wrong decision," he said. "Maybe it's a very important area of activity for Europe, for the European Union. I can understand very well that Europe has a lot of problems with sub-Saharan Africa, immigration, and this issue should be resolved.

"But the [original] idea was totally different. It was a bank made especially for helping the transition in central and Eastern Europe from a planned economy to a market economy. Is it possible to say that this task is completed? Maybe for some countries like Czech Republic, like Poland, it's more or less OK, but we can see how many problems we have in the Balkans, how many problems we have in eastern Europe, especially Ukraine, Moldova."

Sergey Verkashanskiy, executive director for the Russian Federation, Belarus and Tajikistan at the EBRD, told *GlobalMarkets* the move was contingent on the multilateral mending its relations with Moscow before embarking on a new adventure.

"You cannot start on a major geographic expansion without having your legacy issues sorted," he said. The EBRD halted all lending to Russia in the wake of president Vladimir Putin's annexation of Crimea in 2014. "A step further, into sub-Saharan Africa, will require special deliberation on the part of shareholders. We are quite cautious. It would be very much gradual, and a case has to be made for this extension."

### 2020 VISION

Officials told *GlobalMarkets* that a decision would be made in 2020, with its expansion into the sub-Saharan region not taking place before the start of 2021 and the beginning of a new five-year operational cycle at the EBRD.

The gradual migration south would have seemed wildly unlikely a decade ago, but in the intervening period, the development bank has rolled out operations in seven southern and eastern Mediterranean (SEMED) economies, including Morocco, Tunisia and Egypt, investing in private sector lenders and corporates, and in the build-out of much needed energy grids at least partially powered by renewables.

So successful has this roll-out been that Egypt has become the bank's largest single market of operation, with an outstanding portfolio of €3.5bn ($3.9bn), 56% of which is in the private sector.

Janet Heckman, managing director of the SEMED region at the EBRD, told *GlobalMarkets* she was "very optimistic about the whole region". She added: "We have clients in Tunisia, Egypt and Morocco who see sub-Saharan Africa as ripe for investment opportunities."

Branko Babic, head of public affairs at the economic department of Bosnia's ministry of foreign affairs, said it was crucial to support sub-Saharan Africa "so that it can function, and so that people aren't coming over the sea on rubber boats.



Heckman: '...our clients see sub-Saharan Aftrica as ripe for investment'

"The whole of Europe is affected by what is happening in a region that isn't stable, isn't financially viable. If the region is not prospering, we will have constant problems. There is no way for sub-Saharan Africa to become prosperous without our support."

### FIRST, NORTH AFRICA

For the bank's president, Suma Chakrabarti, and the board of governors, a more near-term challenge is to focus on adding three new sovereign states to its sphere of operations — Algeria, Libya and Syria.

Of the three, Algeria, which will host its presidential elections on July 4, is widely expected to be the next market to join the bank's fold. "We would very much like Algeria to be a member, though the political situation …[means]… one needs to wait until the time is right for them to be ready for our investment," said Heckman.

# PrivatBank 'confident' of resisting nationalisation unwind

**By Jasper Cox**

PrivatBank, the Ukrainian bank that used to be owned by a supporter of president-elect Volodymyr Zelensky, believes that it has a strong legal case to prevent its nationalisation being undone.

Days before Volodymyr Zelensky won Ukraine's presidential election, a court in the country declared that the nationalisation of PrivatBank was illegal — a boost to Ihor Kolomoisky, its former owner who has close ties to the incoming president.

"The legal and political situation seems to be changing but the bank's lawyers are confident in its legal position," said a source close to PrivatBank. Meanwhile, the bank has seen nothing unusual in depositor outflows, according to the source, despite the news about the court case.

Engin Akçakoca, head of the bank's supervisory board, told *GlobalMarkets*: "Reversing the nationalisation will mean that those who have invested capital in PrivatBank— the state—will have to have it returned to them,"

"In mathematical terms, or in terms of accounting, if the bank returns this capital, it will again return to negative capital indicators. That is, someone will have to again capitalise this bank. This would be a blow to the financial stability of Ukraine."

The EBRD and other multilateral institutions see the decision to take the bank into state control as an important plank of Ukraine's recent reforms.

Those around the lender are concerned that Kolomoisky's allies are gaining influence over the judiciary, as president Petro Poroshenko, his nemesis, departs. But this may not allow him to win a large chunk of compensation for the nationalisation or to take back his share in the bank.

Ukraine's central bank plans to appeal the court's April 18 ruling. The court ruling is timely because of Zelensky's ties to Kolomoisky. Best known as a comedian, the incoming president received copious airtime on a television channel owned by the oligarch in the run-up to the election.

### MATERIAL IMPACT

According to Moody's, the links between the two "pose a specific risk to Ukraine's reform agenda". The fear is that Zelensky could exert influence on the legal system in Kolomoisky's favour.

"The crucial question is who makes decisions for Zelensky. Is he an empty suit or is there a cabal behind him?" said Mary Mycio, president of Kipling Global Media and a commentator on Ukraine.

But a partner at a Ukrainian investment firm said: "Zelensky will play a much more independent game than expected."

Kolomoisky: close ties to Zelensky

Moody's said: "Although we attach a low probability to this scenario, it would have a material adverse impact on the country's credit profile if it were to materialise."

Western institutions are supportive of the nationalisation and concerned by the potential of it being unwound. The EBRD indicated that the nationalisation had "already resulted in stronger performance and sustainability of the entire banking system".

In December 2016, Ukraine nationalised PrivatBank, its largest bank, declaring that this saved the entire banking system. The state still owns all the shares, but the new supervisory board aims to sell the bank to "an appropriate investor" by 2022. Kolomoisky has been challenging the original decision.

# Lithuania 'distinguished' from other Baltics on money laundering

**By Jasper Cox**

Lithuania is less exposed to money laundering scandals than its neighbours, according to finance minister Vilius Šapoka. His remarks come amid growing fears that foreign banks which dominate the Baltics could pull out of region following the scandals.

"We never tolerated, we are not tolerating and we are not going to tolerate any kind of money laundering," said Šapoka. "Talking about the Baltics, Lithuania is distinguished in terms of the lowest systemic risk as regards money laundering because for many years the proportion of non-resident deposits was approximately 2% of the whole pool of deposits and in our neighboring countries that figure sometimes was even more than 50%."

Šapoka also said that fintech and especially blockchain could be "part of the solution" for risks including money laundering.

There is a strategic lesson to be drawn from the money laundering scandals, according to André Küüsvek, director for local currency and capital markets development at the EBRD.

"There is a big need to develop other parts of the financial sector," he said. "If the Scandinavian banks were to pull the plug that would be a very significant shock to the economy as a whole. We would need to develop other parts of financial markets."

However, contrary to some reported fears in the region, Küüsvek does not believe Swedish banks will follow Danske Bank in pulling out.

In February, the Estonian government ordered Danske to leave the country, after the bank revealed €200bn of non-resident money went through its Estonian branch between 2007 and 2015. It said it would pull out of not just that country but the Baltics as a whole.

### PROFITABLE BUSINESS

Swedbank has also been embroiled in a high-profile money laundering scandal.

Scandinavian banks dominate the three Baltic countries: notably SEB, Swedbank and Luminor Bank. The latter is owned by DNB and Nordea, but a majority stake is being sold to Blackstone.

"If you look through the lens of these banking groups, even though they are very dominant banks in the Baltics, the Baltics still only represent a small fraction of their overall balance sheet or profits," said Küüsvek. He added that when incidents like the money laundering reports crop up, shareholders ask about their operations there.

© EBRD

Šapoka: Fintech could be part of the solution

But the Swedes may be more likely to remain. "The Baltic business actually is very, very profitable," he said. In contrast: "Danske was the one that tried to catch up and never really managed."

SEB said: "The three Baltic countries constitute three of our nine home markets and we look forward to continue to grow together with our customers."

In its first quarter report, Swedbank referred to higher lending volumes and the launch of new pension funds in the countries.

# Foreign lenders committed to Turkish banks despite Istanbul re-run

**By Mariam Meskin**

Turkish banks have retained the support of international lenders despite the latest political controversy that will see fresh municipal elections in Istanbul later this year.

Turkey's decision to re-run the city's municipal elections, which President Recep Tayyip Erdogan's AKP party lost, led to a weakening of the lira.

However, that appears to have had a minimal impact on the appetite of international lenders, which continue to plough money into the Turkish borrowers. A survey by the Loan Market Association showed that across CEE and CIS, emerging market bankers saw the most opportunities for syndicated lending in Turkey, beating Poland and Russia.

Arvid Tuerkner, managing director for Turkey at the EBRD, said: "There isn't a lot of [domestic] lending so the banks don't have huge funding needs. Generally, we're seeing smaller rollovers, but there's no indication that the market won't be happy to lend to them. The banks are still reasonably well capitalised."

A loans banker at a European firm said: "It's not ideal — no one wants to see another political back and forth in an already troubled market. But [Turkey's] banks will be still be able to continue their international refinancings.

"If things continue to be rocky, maybe margins will widen again, but the [lender-borrower] relationships and ancillary business that Turkish banks guarantee are too big to walk away from."

### OFFERS OVERSUBSCRIBED

The currency crisis last August in which the lira weakened to TL6.95 to the dollar following a spat between US President Donald Trump and Erdogan caused a momentary pause on Turkish activity in capital markets.

But international lenders demonstrated their commitment during a crisis. Within a month of the catastrophe, Turkish banks had re-entered the syndicated loan market, refinancing billions of dollars of outstanding debt with international lenders.

Although borrowers, including Turkey's largest bank, Ziraat Bank, received margins that were 25bp wider, all major bank loans were oversubscribed, demonstrating continued strong international demand for Turkish debt.

Penelope Smith, head of developing markets corporate loan origination at Commerzbank said: "Turkey has showed some recovery since last summer's crisis. The Turkish banks repriced their semi-annual borrowings — they're not back to the previous levels but there is some recovery as deal volumes remain strong."

High levels of demand for Turkish bank loans in the secondary trading market are testament to the resilience of the banking system, despite the monetary and economic crisis.

Smith added: "Secondary trading in such issues initially stopped altogether, but after a few weeks it restarted. Trading of Turkish assets is one of the busiest sectors in the secondary trading market."

GlobalMarkets

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

ASSOCIATE EDITOR
**Phil Thornton**

ON-SITE REPORTERS
**Jasper Cox**
+44 7985 919 236
**Lewis McLellan**
+44 7908 828 904
**Mariam Meskin**
+44 7455 204 187
**Elliot Wilson**
+44 7450 221 989

SENIOR OPERATIONS MANAGER
**Barbara Fertalova**

PRODUCTION EDITOR
**Vicki Robinson**

CEO – BANKING & FINANCE GROUP, EUROMONEY INSTITUTIONAL INVESTOR PLC
**John Orchard**
CEO ASIA

MANAGING DIRECTOR
**Ruth Beddows**
ruth.beddows@globalcapital.com
+44 20 7779 7386

GROUP PUBLISHER
**Oliver Hawkins**

PUBLISHER
**Melissa Roache** +44 (0)20 7779 8276
m.roach@globalcapital.com

SENIOR ADVISOR
**Christopher Garnett**
cg@chutecourt.com +447710306856

CENTRAL ASIA PUBLISHER
**Mine Hekimoglu**
minehekimoglu@aol.com
+90 5324131686

RUSSIA & CIS PUBLISHER
**Alex Korol**
akorol@euromoney.com
+7 903 720 8050

PUBLISHER, MIDDLE EAST & TURKEY:
**Adil Jilla of MEIAC** a.jilla@meiac-uk.com
ASSOC. PUB., MIDDLE EAST & TURKEY **Kaersi Jilla of MEIAC**
k.jilla@meiac-uk.com
(UK): +44 (0) 797 384 310 (Dubai):
+971 4 4548690
Shatha Tower, Office No. 1906, Media City PO Box. 502118, Dubai, UAE

FROM THE PUBLISHERS OF
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8 Bouverie Street, London, EC4Y 8AX
Telephone: +44 (0)20 7779 8888

Directors:
**Leslie Van de Walle**, Non-Executive Chairman of the Board
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**Printing by:**
CPU Printing Company
+387 33 766 880
info@cpu.ba

# West lagging in race to finance Uzbek reforms

**By Lewis McLellan**

Uzbekistan is pursuing ambitious reforms as it opens up to international investors, but Russia and China have a head start on the West as the country embarks on a programme of privatisations.

"The very big state-owned enterprises are not on the block as yet, but there is a list of several dozen companies in which the government will be selling its strategic interests through IPOs and auctioning systems," said Sardor Koshnazarov, managing director at Silk Capital, which is advising the Uzbek government on its privatisations. "There is another resolution awaiting approval by the president that will unlock another wave of privatisations."

China and Russia are clamouring to provide Uzbekistan with financing.

Koshnazarov said: "We've seen Chinese and Russian investors coming into the oil and gas sector. Russia is also building a nuclear power station, while China is active in the manufacturing sector. Unfortunately, we haven't seen American and European players represented as yet, because they wait for certain market conditions and regulatory considerations to be addressed, but we expect that to change soon."

British Petroleum has signed a deal with Uzbekistan to explore the country's oil fields.

Uzbekistan must be careful about the sources of funds it accepts as it reforms its huge state sector. A source familiar with the country who asked not to be named said: "The privatisation will be a tremendous challenge and must be handled very carefully. It's important that the financing for the process comes from international financing institutions or the international investor community. If Russia provides the cash, or local vested interests and oligarchs, there will be serious problems in Uzbekistan's future."

## MULTILATERAL ENGAGEMENT

So far, the country's operations have focussed on international, rather than domestic investors.

While Western investors are lagging behind Russia and China, international financing institutions are already deeply involved in guiding Uzbek economic development. "We're seeing unprecedented engagement from multilaterals, both in lending and in providing technical assistance," said Koshnazarov. "The EBRD, World Bank, IFC and ADB are all heavily involved. The ADB in particular has dominated infrastructure lending."

Uzbek president Shavkat Mirziyoyev arrives for a meeting with Chinese President Xi Jinping in April

Uzbekistan has allowed its currency to float freely, liberalised trade, improved its statistics, and strengthened the independence of its central bank and transition to inflation targeting. Following its Eurobond debut in February, Uzbekistan is intending to introduce a new tax code, liberalise prices and work on reforming state-owned enterprises, according to deputy finance minister Odilbek Isakov.

Alkis Drakinos, head of EBRD's resident office in Uzbekistan, said the reforms were "key to improving the investment climate in Uzbekistan".

# Kazakhstan privatisation on track with KMG listing in 2020

**By Sam Kerr**

Emerging markets bankers are eyeing a series of privatisations in Kazakhstan as the government implements a programme of economic and political reform launched by outgoing president Nursultan Nazarbayev.

First on the block is likely to be a multi-billion dollar flotation of KazMunayGas (KMG), the state-owned oil and gas giant that is majority-owned by Samruk-Kazyna, Kazakhstan's sovereign wealth fund.

"KazMunayGas is gearing up for an IPO in the second quarter of 2020," said an investment banker who has met with Samruk-Kazyna in recent weeks. "My sense is that the oil price is going to remain supportive, which will benefit the deal."

Rising global oil prices make KMG an attractive opportunity for investors, and potential growth in Kazakh production could make it an even more enticing opportunity.

Expansion of Kazakhstan's most important oil field in Tengiz, a larger surface area than Paris and the world's deepest producing supergiant oil field, is set to be completed in 2022. Tengizchevroil, a joint venture between Chevron and other oil producers in which KMG has a 20% stake, leads the project.

KMG is not the only prestige IPO on the market and is set to be followed by Air Astana — likely to be a smaller deal of between £100m and $200m according to investment banks — and Kazakhstan's national telecommunications operator Kazakhtelecom.

Samruk-Kazyna is said to be looking to replicate the model it used in the Kazatomprom IPO for future listings. Last November saw Samruk-Kazyna sell a stake in Kazatomprom, the state-owned uranium company, in London.

KMG has a 20% share in the joint venture behind a supergiant oil field

This means future deals could potentially come to the UK capital, where emerging markets investors largely see an economy that is rich in minerals and resources, and is growing and modernising.

## LEADERSHIP TRANSITION

Kazakhstan is one of the most exciting emerging equity market opportunities slated for the next two years, with bankers and investors keen to gain exposure to the country.

The Central Asian republic is in the middle of an economic and political transformation. Nazarbayev — the country's only post-Soviet leader and affectionately known as Papa — resigned the presidency in March, starting a slow transition of power. The Speaker of the Senate, Kassym-Jomart Tokayev, will serve as interim leader before the next presidential election.

Before his resignation Nazarbayev, who remains the most powerful political force in Kazakhstan, initiated a privatisation programme designed to stimulate the economy to encourage more foreign investment in the country.

At the end of 2017 Kazakhstan was the world's 14th largest oil producing nation with 1.8bn barrels produced a day — its oil production rose by 10.5% that year.

Kazakhstan's GDP growth slowed to around 1% in 2015 and 2016. However, recovering oil prices meant that GDP growth was 4% in 2017. GDP growth has hovered around the 4% level through to the end of the first quarter of 2019.

# Global Markets

# Special Report
# HUNGARY



In association with

# Can Orbanism echo its success in Hungary in the wider region?

Hungary has again demonstrated a willingness to tread its own path. Moves such as bank nationalisation, building barriers and increased protectionism have incurred the wrath of Brussels but have been copied by other EU member states

**Shake on it**
Prime Minister Viktor Orban and Central Bank Governor Gyorgy Matolcsy



**By Elliot Wilson**

Historically, culturally, linguistically, even financially and economically, Hungary has always been an outlier. It was the least likely CEE state to be drawn into Russia's orbit after World War Two, and the first to rebel against Muscovite rule. Though many link the fall of the Berlin Wall to the collapse of the Soviet Union, the first cracks in the communist edifice appeared in June 1989, when Hungary opened its border with Austria.

In the 1990s, Hungary became a vociferous advocate of free trade. German carmakers rushed in to set up production units, while local banks were sold to lenders from the likes of Belgium, Italy and Austria. Even now, notes Julia Kiraly, a former deputy governor of financial stability at Hungary's central bank, the MNB, the country "remains the region's most open economy".

To the casual observer, that may come as something of a surprise. Under Viktor Orban, who has led the country since 2010, Hungary has again demonstrated a willingness to tread its own path. The prime minister's second election victory (he was also prime minister between 1998 and 2002) was a classic cry of frustration from a disenfranchised electorate sick of the country's dire economic climate. At the start of the decade, four million Hungarians out of a population of 10 million lived in poverty, while more than 12% of working-age adults were unemployed.

The prime minister railed against his predecessors, focusing on the decision, at the height of 1990s free-market fervour, to sell valuable state assets to foreign investors in sectors ranging from telecoms to banking to utilities, often at knock-down prices. In 2015, the state paid $700m to wrest back control of Budapest Bank from GE Capital. MKB Bank was bought from Munich-based Bayerische Landesbank, nationalised, and then re-sold to Hungarian investors.

A year later, the government joined forced with the EBRD, each buying 15% of the local operations of Austria's Erste Group, thereby cutting the share of the banking sector controlled by foreign lenders to "around 45%, from 70%-80% a decade ago", reckons Gunter Deuber, head of economics, fixed income and foreign exchange research at Raiffeisen Bank International (RBI),

Orban's policies, many of them drawn up by MNB governor Gyorgy Matolcsy, went thoroughly against the grain of mainstream European thinking. They even garnered their own term: Orbanomics. Punitive new levies were imposed on local and foreign banks, while lenders were also forced to swallow losses by converting foreign exchange loans back into Hungarian forints at artificial rates. To cut yawning levels of national debt, citizens were forced to transfer 75% of any privately held pension into the public pot. Anyone who refused to do so, was denied a state pension.

**DEBT, DEFICIT REDUCED**

Officials from Strasbourg to Frankfurt to Brussels waited for Orbanomics to fail openly and painfully or, at the very least, to die quietly, behind closed doors. Yet it did not. Government debt as a share of GDP, which stood at a shade under 70% at the end of 2017, according to IMF data, may be high by regional standards, but it has fallen by 10 percentage points since the start of the decade.

Under Orban, Hungary's budget deficit has been halved, while growth rates have quadrupled. Wages have risen strongly, to the point where rising prices are a concern: core inflation rose by 3.8% year-on-year in March 2019, according to data from the Central Statistical Office, the highest reading since December 2012.

The country's credit ratings meanwhile have steadily improved. Moody's Investors Service, which rates the sovereign Baa3 with a stable outlook, said in a December 2018 research note that policies designed to cut government debt and to keep the budget deficit below 3% of GDP, had "increased the sovereign's ability to withstand external shocks."

Growth looks set to remain robust through 2019 and 2020. Zoltán Kovács, the state secretary for international communications, told *GlobalMarkets* that 2018 had been "an especially good year with GDP growth of 4.8%". He added: "The government is working to maintain this high growth rate. Provided the economy continues to perform this well and the debt ratio is reduced further, upcoming ratings are also set to improve."

Hungary continues to confound in other ways. Kiraly, the former MNB official, notes that the economic cycle appears for now to have parted ways with Germany. "In the past, when Germany did well, so did we, and when it was in recession, so were we. This time, that isn't the case." In March, Germany's Ifo Institute tipped output in Europe's largest economy to expand by 0.6% in 2019, against an earlier forecast of 1.1%, due to weaker foreign demand for industrial goods and stronger headwinds for exporters.

KIraly also points to the fact that exports, the key long-standing driver of domestic growth, had been replaced by internal demand. Retail sales jumped 8.4% year-on-year in February 2019, driven, says Peter Virovacz, ING's senior Hungary economist, by double-digit wage growth and a vibrant real estate sector.

A strong and steady flow of capital from Brussels to Budapest also helps. The EU spent €4.05bn ($4.5bn) in Hungary in 2018, much of which is channelled into road building and environmental projects. Total EU spending as a share of Hungarian gross national income in 2018 was 3.43%. Romania aside, no other member state benefits more, on a relative basis, from European largesse.

This matters, if only because, on the surface at least, Brussels and Budapest have been engaged for years in an increasingly incendiary war of words. Orban has accused European Commission president Jean-Claude Juncker (a man who once referred to the Hungarian prime minister as a "dictator") of plotting to impose mandatory migrant quotas on member states, Hungary included.

### EU FRETS, INVESTORS INVEST

In March 2019, Orban's ruling Fidesz party was suspended from the European People's Party, an alliance of centre-right political groups, of which Juncker is also a member. And in September 2018, the European parliament said the Hungarian government posed a "systematic threat" to democracy and the rule of law, but stopped short of imposing sanctions or suspending its federal voting rights.

European officials wring their hands, fretful that Orban's stated desire to build an "illiberal state" run according to Hungarian rules and needs, will be copied and emulated across central and eastern Europe. Hungary's decision in 2015, at the height of the migrant crisis, to build a wall along its border with Serbia, was widely castigated in Western circles.

Yet political bickering has been almost wholly ignored by corporate and portfolio investors. Inward FDI hit $3.8bn in 2018 according to data from Unctad, scattered across 98 greenfield projects, up from $2.5bn and 83 projects the previous year. Most of the capital, notes international communications secretary Kovács, came from US and German corporates. Adds Marek Drimal, an EMEA strategist at Société Générale in London: "In recent years, a lot of foreign capital has been put to work in the automotive sector, and across oil and gas and construction."

If anything, Hungary's economy is these days even more deeply embedded in the single market. "There has been noise about Hungary, but most of the big Western investors in the FDI space remain committed" to the country, says Raiffeisen Bank's Deuber. "Big companies, when they invest heavily in a country, don't leave quickly." He adds that the Hungarian premier has played a canny hand with foreign investors. "Orban has been wise, keeping very close contact with the business community, particularly the big manufacturers."

### ORBANISM REVISITED

It is worth revisiting for a moment the underlying tenets of so-called Orbanism. Its mere existence and its acceptance, in investment, banking and policy-making circles across Europe, suggest that Hungary's prime minister and his inner circle have, either by accident or design, chanced upon a new and effective economic model. Mention of the term usually requires the commentator to remind the reader, either with approval or with a sneer, that Orbanism refuses to cleave to the rules of contemporary economic orthodoxy.

But is this fair? While some aspects of Hungary's model are indeed unorthodox, "many others fit neatly and simply into the mainstream global economic discussion", says Raiffeisen Bank's Deuber. "Yes, the government is pushing for low rates and cheap financing conditions, but you see that elsewhere in Europe too."

It can also be argued that Hungary, often by pure accident, regularly manages to be ahead of the curve. Its decision to put a sizeable chunk of the banking sector back in domestic hands went against prevailing wisdom and could have been handled with greater care. But protectionism is now back in vogue across the continent. France's president Emmanuel Macron, a self-styled liberal, is retreating into the past, directing state aid into the maw of national and continental champions, with the aim of competing with China and the United States. The same shift is taking place in the likes of Germany and the Netherlands.

As for barrier-building, it is easy to overlook the fact that seven of the EU's 28 member states, including Spain and Latvia, have built new walls or reinforced existing national boundaries since 2015. The Transnational Institute, a Netherlands-based think tank, reckons EU countries have built more than 1,000km of border walls since 1989.

Hungary's influence is also visible in the strict taxes (long since eased) that it imposed on locally licensed lenders in 2010. Austria imposed a similar levy on its own banks the following year, and Romania is in the final throes of introducing a tax on banks' financial assets, based on market share. Orban's more autocratic tendencies, and his willingness to stir the pot to heat up his political base, has found favour in Poland, where the ruling Law and Justice Party has assumed political control over state-funded radio and television. But there is as yet little sign of his illiberalism spreading across the rest of the region.

### SOUND FOUNDATIONS?

One final issue needs to be addressed. By any measure, Hungary's economy has outperformed this decade. Foreign capital continues to flow in, and to be eagerly put to good and productive use. But will the tenets of Orbanism prevail? How sturdy, really, are its economic foundations?

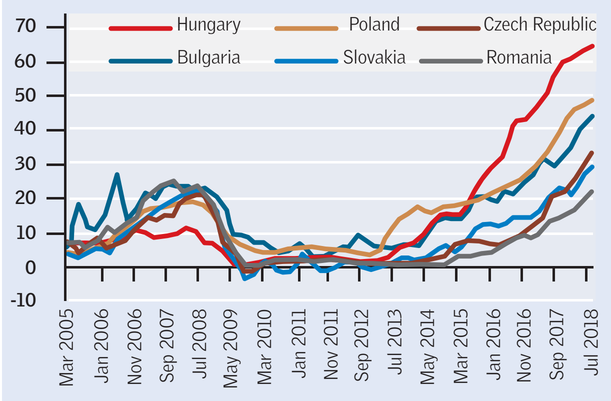
In its latest World Economic Outlook, published in April, the IMF tipped output to expand by 3.6% in 2019 and by 2.7% in 2020 — a slower rate of growth than Bulgaria, Serbia, Poland and Romania. In its latest CEE Quarterly, published in March 2019, Italian lender UniCredit warned that the "honeymoon was over" for an economy whose "best year's of economic growth" were now behind it. It is also worth noting that while an unbending approach to immigration has been a vote-winner, it has produced some unpleasant side effects. "Because the labour force is not expanding, there is a huge upward pressure on wage growth," notes SocGen's Drimal.

And while Orban's workfare programme, introduced in the dark days of 2010, has provided employment for hundreds of thousands of jobseekers, most of the work is menial and transient. While the official jobless rate at the end of January 2019 was 3.5%, according to data from Eurostat, most economists put the real rate at 7%-8%. "The cities are doing fine, but in the east of the country there is a big and hidden unemployment problem," says Kiraly. "The country is being torn into two parts. What looks healthy and positive is not real. It's simply a disguise." GM

> "*The country is being torn into two parts. What looks healthy and positive is not real. It's simply a disguise*
>
> *—Julia Kiraly, former deputy governor of financial stability at Hungary's central bank*

**Acute shortage?**

% of managers reporting labour as a factor limiting their business across the region




Source: Eurostat, Moody's Investors Service



# Hungary's banks thrive in era of nationalisation

Since Viktor Orban came to power in Hungary, more than half of the share of the banking sector is controlled by the government. But the sector is healthier, more profitable and showing an appetite to expand into the wider region

**By Elliot Wilson**

For commercial lenders of all shapes and sizes operating in Hungary, the last decade has been a roller-coaster ride. When Viktor Orban swept to power in 2010, becoming leader of the CEE region's most open and investor-friendly economy for the second time, the prime minister and his inner circle were quick to target the fading fortunes of the banking sector.

In a December 2018 research note, Moody's Investors Service said that in the five years to the end of 2015, Hungary's authorities "enacted a series of policies that benefitted taxpayers at the expense of the banks". The list included a punitive "crisis tax" levied on local and foreign banks, a financial transaction tax, and new legislation that helped mortgage borrowers, often at the expense of lenders.

Keen to put more of the sector back in local hands, Orban made it clear that any foreign lender unwilling to commit fully to the market would be welcome to sell up and head for the exit. Many Western banks, scarred by the global financial crisis and busy scaling back to focus on core markets, were only too happy to oblige.

The first to walk away was BayernLB, which sold a controlling stake in MKB Bank to the government in 2014, for €55m ($49m). The German lender, bailed out by its government after racking up bad loans in 2008, was desperate to divest a unit that lost €409m the previous year. A year later, commercial lender Budapest Bank was also nationalised; its former owner, GE Capital, pocketed $700m.

MKB, busy rebranding itself as a pioneer of digital banking, was quickly re-privatised and sold to a tight-knit circle of local investors. The bank's largest shareholder is now Lorinc Meszaros, a key associate of the prime minister, with a 46.8% stake. MKB is being touted as a possible buyer of Budapest Bank, the eight largest lender by assets, which was put up for sale by the state in early 2019.

A trio of foreign lenders — the Austrian pair of Raiffeisen Bank International and Erste Group, and Belgium's KBC — have also signalled their interest in buying Budapest Bank. Another suitor is Takarékbank, a local savings and loan group transitioning into a full-service commercial bank. The government is believed to be keen to see the lender wind up in Hungarian hands.

All told, in the years following the global financial crisis, the state nationalised or bought minority stakes in six domestic lenders including Granit Bank, Erste Bank Hungary and Szechenyi Kereskedelmi Bank, boosting the share of the banking sector controlled by the government to 50.5% at the end of 2018, from 30% five years earlier.

Some critics saw the acquisitions as part of a catalogue of protectionist measures from an instinctively nativist government, but many analysts were more sanguine. "Every government wants its banking sector to be strong and relevant and in the main under local control," notes Gunter Deuber, head of economics, fixed income and foreign exchange research at Raiffeisen Bank International (RBI).

"If you ask a French citizen if they want their banks owned 70% or 80% by CEE-region lenders, imagine what the answer would be. [The Orban administration] was not forcing banks to leave completely, or kicking everyone out and saying it wanted 100% national ownership — that was not their approach."

## REGIONAL EXPANSION

Combined post-tax profits posted by Hungarian banks rose 10% year-on-year in 2018, to Hfr648bn ($2.24bn), according to central bank data. Total banking assets rose 8% year-on-year, to Hfr42.1tr, with net interest income rising sharply, and sector-wide non-performing loans falling to 5.4% at the end of 2018, against 7.5% a year earlier.

In December 2018, Moody's said it maintained a "positive outlook on Hungary's banking system for [the] second year running. The outlook reflects our expectation that improved operating conditions will benefit banks' loan quality and capital, and support sound profitability."

Hungary's bigger financial institutions are also making significant inroads into the region. OTP Bank, the country's largest and most acquisitive commercial lender, with a 25% market share, is eyeing new targets across the Balkan region, as it seeks to tap into under-exploited and under-resourced markets, many of which offer double-digit returns on equity. OTP employs more than 36,000 staff at 1,500 branches across nine markets in emerging Europe and central Asia, including Russia, Ukraine, Serbia and Romania.

It is looking for assets in Croatia, where it is already the fourth largest lender, with a 10% market share, due in large part to its 2017 acquisition of Splitska Banka. Analysts say it is weighing up a bid for the local assets of either Erste Group or another Austrian lender, Addiko Bank. OTP generated a post-tax profit of Hfr180.4bn in the full year 2018, up 7% year-on-year.

There can be little doubt that Hungary's financial service sector is in a better state and a healthier place. But challenges persist, while the decisions that defined the industry in the middle years of the decade continue to reverberate.

Even with over half the banking sector now under local control, RBI's Deuber says there is "still talk about [more] renationalisation" in the Hungarian halls of power. And in December 2018, Moody's warned that higher domestic ownership of local banking assets also "heightened the risk that contingent liabilities could crystallise on the government's balance sheet", particularly at a time when the wider economy, after years of strong performance, is starting to slow. GM

> *"The Orban administration was not forcing banks to leave completely, or kicking everyone out — that was not their approach*
>
> *— Gunter Deuber, head of economics, fixed income and foreign exchange research at Raiffeisen Bank International*

## EXIM BANK

# Promoting the export of Hungarian goods and services to foreign markets

The Hungarian Export-Import bank and the Hungarian Export Credit Agency fulfil the role of Hungary's official export credit agency, operating within an integrated framework, under the common name of EXIM. In the following intrview we asked Gergely Jákli, EXIM's CEO, about last year's results, the facilities offered by the institutions and also about their international activities.

**What are the main results for EXIM Hungary in 2018?**
EXIM has closed a very successful year. In 2018 our total loan portfolio was €2.7bn, while our insurance portfolio stood at €689m. We are proud to announce that 2018 has been the fifth year in a row when our yearly disbursements exceeded €1bn. It is also important to note that as per our 2017-2021 strategy we are aiming to increase the proportion of micro, small and medium enterprises among our clients. Accordingly, in 2018 89% of our operations were carried out with SMEs. Our steady expansion is also reflected in the overall number of our clients; while in 2013 we worked with just under 300 companies, now there are more than 1,600 enterprises using at least one EXIM product. We are really satisfied with our results so far, but as always, we strive to do more in the future and aim to play a crucial part in the life of the exporting Hungarian companies.

**In what ways is EXIM integrated in international networks?**
EXIM, as the export credit agency of Hungary is a member of several international associations and other financial institutions. These alliances give us a chance to learn from each other, exchange information and benchmark our products against the ones offered by different institutions in other countries, which allows us to provide Hungarian companies with the most up-to-date and most adequate export financing and insurance facilities.

Apart from this, we have established relations with banks all around the world, providing us with a steady network that helps us carry out our projects in a seamless way.

**What facilities can EXIM offer to finance foreign buyers?**
As part of our classic export credit agency activities, we promote the export of Hungarian goods and services to foreign markets. One of the most important tools for achieving this is the classic buyer's credit facility, which allows the exporter to receive payment for the exported goods or services immediately, while the foreign buyer is paying back the amount to EXIM.

Concerning Central Eastern Europe, the Western Balkans and the CIS regions, we have established country limits for nearly all of the countries, which means that — after carefully considering the specifics of the projects and the involved parties — we are ready to provide financing for export transactions targeting these relations. Moreover, due to the aforementioned bank relations we are also able to provide interbank buyer's credits (within the individually established bank limits).

> WE ARE PROUD TO ANNOUNCE THAT 2018 HAS BEEN THE FIFTH YEAR IN A ROW WHEN OUR YEARLY DISBURSEMENTS EXCEEDED €1BN

**What is the best insurance solution to use in case of deferred payment to mitigate risks?**
To complement the financing products, MEHIB (Hungarian Export Credit Insurance) offers several different insurance facilities for — amongst others — export transactions, export-oriented investments and international aid projects, backed by state surety. For example in the case of a classic export receivables insurance, should the Hungarian exporter not receive the payment for their goods or services due to political or economic events or the non-payment of the buyer, MEHIB will cover the costs.

**What kind of investment activity does EXIM do in the CEE region?**
EXIM is an investor in 10 equity funds with varying investment volumes and sectoral focus, catering to the needs of Hungarian companies and other enterprises from the region in their growth period. The following three funds focus on the Western Balkans region and partly on the CIS countries as well.

- **China CEE Fund II:** The aim of the Fund is to support the development of trade relations between Central Eastern European countries and China by providing equity investment for mostly mid-cap companies in the energy, telecommunications, infrastructure, technology, innovation, manufacturing, agriculture, education, healthcare, tourism and finance sectors. Since the fund typically targets bigger companies the ticket size is between $20m-$100m.
- **Enter Tomorrow Europe Private Equity Fund:** The Fund targets early-stage companies with high growth potential and supports them with financing and consulting services, therefore realising high shareholder capital gains mainly in the areas of research, investment, technology and product development, manufacturing and sales. The geographical focus of the fund covers the Central and Eastern European region, and the sectoral targets are the following: energy, chemical industry, mobility, Internet of Things, sustainability, automotive industry, machine manufacturing, smart city, 3D printing and artificial intelligence. The ticket sizes vary between €0.5m and €10m.
- **EXIM Export Promotion Private Equity Fund:** Accordingly to its goals of accelerating the economy and promoting export, the Fund's primary investment targets are European, but mostly Hungarian companies that plan to sell their products and services on foreign markets, or enterprises who are already active on international markets but wish to expand their geographical scope and need equity financing for enhancing their export credit capacities. These companies can not only increase their export of products and services, but also enter the world market as foreign investors. The ticket sizes are between HUF200m and HUF7.5.

**What other international development activities is EXIM involved in?**
In 2015 we established a new department within EXIM, dealing with international business development. The aim of this activity is to promote the projects of different international financial institutions, such as the World Bank Group, the EBRD, the European Commission, the EIB and so on, and support Hungarian companies in getting involved in these opportunities. Over the past three years we have built up a database of more than 130 companies who are actively involved in this activity, and we see a growing success rate among them, which is represented in more and more submitted and awarded tenders each year. ●

# Capital market reform — Hungary's quiet revolution

Interventions by the Budapest Stock Exchange and Hungary's financial regulators have enabled the country's capital markets to play a lead role in attracting homegrown innovators and foreign investors

**By Elliot Wilson**

Say what you like about the political shenanigans that affect and often infect its relations with near-neighbours — the perpetual rows with Brussels; the intermittent cosying-up to Russia; a once-liberal leader's very public embrace with illiberalism — but there is nothing dull about Hungary under prime minister Viktor Orban.

In its latest World Economic Outlook, the IMF tips Hungary's economy to expand by 3.6% in 2019, slightly down on last year's 4.9% but a far sight better than anything mustered up in the more developed half of the continent. Inflation has ticked up in recent months but is expected to stay under control, hovering at just over 3% over the next two years. Joblessness, once the scourge of the central European state, has been all but eliminated: strong inward investment, a workfare-style programme and strict immigration policies have pushed the country close to full employment.

But while the eye is naturally drawn to macro-economic factors, it is easy to overlook the quiet revolution that has transformed Hungary's capital markets over the past decade. The Budapest Stock Exchange (BSE) is the region's second biggest bourse by liquidity and market capitalisation, although in recent times it has consistently outperformed its larger rival to the north.

Warsaw's main board is down 4.3% since the start of 2018, while the BSE is up 12.6% over the same period, driven by national champions such as OTP Bank and oil and gas group MOL. Average daily turnover on the BSE was Hfr11.4bn ($40m) in 2018, up 6.7% year-on-year, with daily turnover on the main board's cash equity market up 4% over the same period, to Hfr2.8bn.

Under chairman and CEO Richard Vegh, the Budapest Stock Exchange favours evolution over revolution. A two-year old deal with Elite, the London Stock Exchange's international business support programme, helps firms to embed capital-raising opportunities into strategies. BSE Xtend, the main listing venue for small and medium-sized enterprises, has been a quiet hit since its launch two years ago.

Over the past year, a number of young local technology firms, including Cyberg Corporation and Megakran, have listed on the junior board, attracted by a tax abatement scheme and an injection of capital from the Szechenyi Investment Fund, a Hfr20bn EU-supported venture capital fund first unveiled in 2017. In January 2019, regulators tweaked the rules, requiring any corporate seeking to be included on BSE Xtend to boast a minimum market cap of Hfr250m, and either a 10% free float or at least 100 shareholders.

This chimes with government efforts to promote and champion homegrown innovators. State secretary for international communications Zoltan Kovacs told *GlobalMarkets* that the emphasis was shifting from manufacturing to R&D, noting: "Innovation and research and development must be greatly encouraged [as it will] play the leading role within the Hungarian economy in the future".

© Sergio Delle Vedove / Alamy Stock Photo

## DEBT MANAGEMENT

Another largely unnoticed shift has taken place since the return to power of Premier Orban, and the emergence of a core group of influential and creative public officials, notably central bank chief Gyorgy Matolcsy. Over the past decade, says Marek Drimal, an EMEA strategist at Société Générale in London, Hungary "has shifted from a country that was once highly dependent on external sources of debt capital, to one that is increasingly reliant on domestic sources of financing to fund its deficits".

This has utterly transformed Hungary's reputation among global investors. What was once, notes Drimal, a market that "gyrated and oscillated, exposed to wild swings in global sentiment toward emerging market bond prices and currencies, is now far more stable". That reversal of fortune is, analysts say, due to three factors: political stability; a well-run if occasionally unorthodox central bank; and the patience and financial prudence of the Government Debt Management Agency, or AKK, Hungary's debt management office.

Key to this process has been the introduction of calibrated policies such as the Self-Financing Programme. Introduced in April 2014, it actively and coherently set out to cut the government's reliance on foreign-currency debt, and to place a greater emphasis on domestic retail investors and the banking sector.

When Hungary does engage with global investors, its forays are usually well timed and carefully planned. In September 2018, the sovereign returned to the international bond market for the first time in a year, raising €1bn ($1.12bn) via a smoothly priced seven year trade managed by Deutsche Bank, Erste Group and JP Morgan.

Despite prevailing political headwinds — the European parliament had only just voted to sanction Hungary for flouting EU rules on democracy and civil rights — the sale dragged in more than €3.8bn in orders, underlining both the appetite for emerging market debt, and also the respect accorded Hungary's financial and economic planners.

The sovereign made a second trip to the well in December 2018, printing Rmb2bn ($300m) worth of Panda bonds, in a sale targeted at the domestic Chinese market. The bonds, which carried a coupon of 4.3%, were issued in China's interbank market, and made available to offshore investors via the Bond Connect scheme, which allows international investors to buy mainland debt securities via Hong Kong. Hungary sold Rmb1bn worth of Panda bonds in July 2017, bearing a coupon of 4.85%, a little over 12 months after printing a Rmb1bn Dim Sum bond that it marketed direct to international investors. GM

" *Innovation and research and development must be greatly encouraged as it will play the leading role within the Hungarian economy in the future*

*—Zoltan Kovacs, Hungarian state secretary for international communications*

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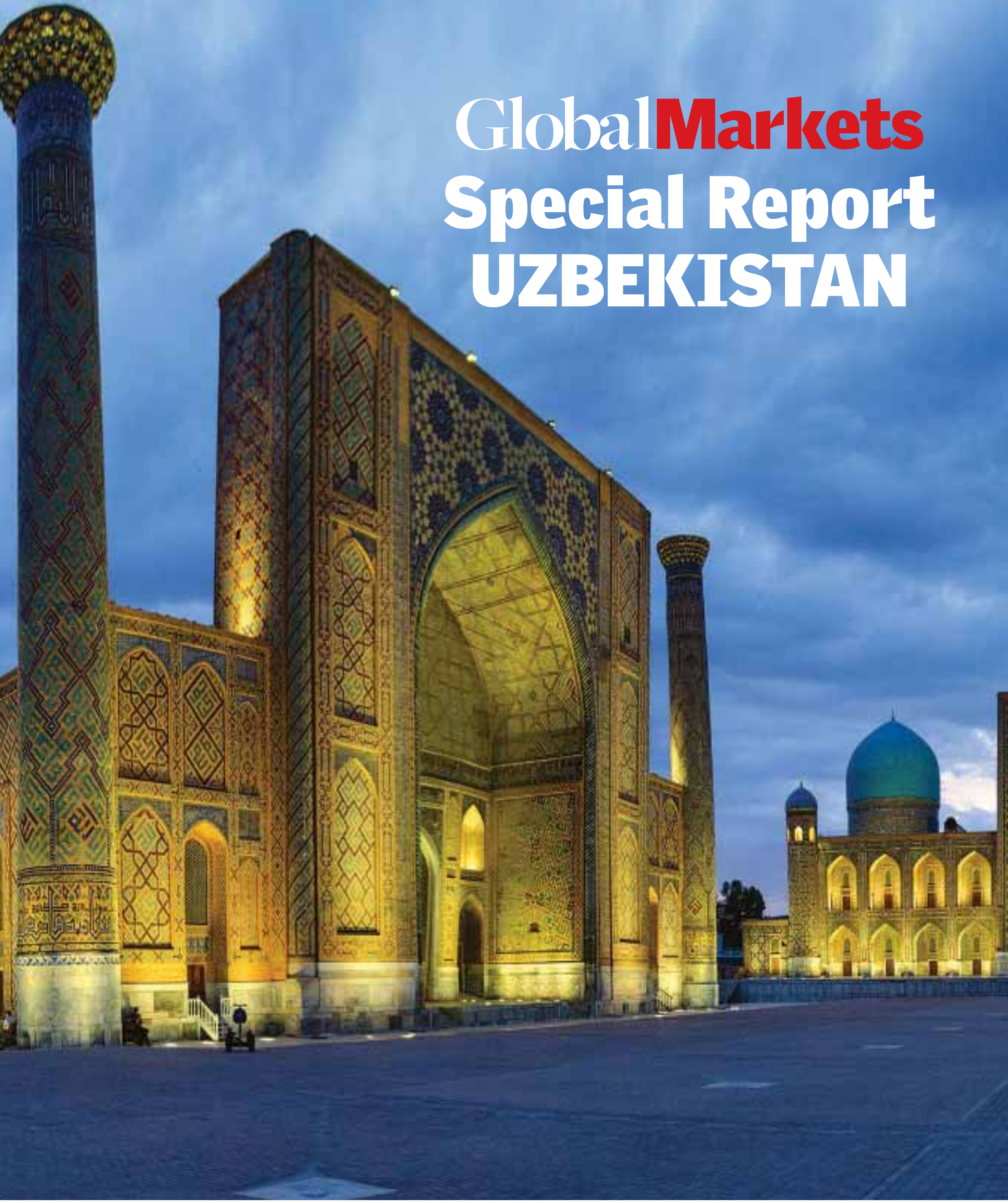
# GlobalMarkets Special Report UZBEKISTAN



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# UZBEKISTAN IS REFORMING AND OPENING UP TO THE WORLD

Since late 2016, Uzbekistan has embarked on large-scale institutional, economic and social reforms under President Mirziyoyev's administration.

Looking at the economic reforms, we have liberalised the currency markets (2017), significantly lifted trade restrictions (2017-2018), started liberalising administrative prices (from 2018), improved the quality of statistics (joined e-GDDS in 2017) and strengthened Central Bank's independence. Early results are very encouraging. We have managed to improve the business climate — World Bank's Doing Business ranking improved to 76 in 2018 from 166 in 2012 — increased the foreign trade turnover (by 40% within 2 years) while retaining macro-economic stability. Uzbekistan has also recently received good international credit ratings (BB- with stable outlook by S&P and Fitch) and joined the club of emerging nations active in global capital markets —$1bn of 5-year and 10-year Eurobonds were issued in February this year creating a transparent benchmark to price the sovereign credit.

Odilbek Isakov, Deputy Minister of Finance

> "The government is keen to implement large scale reforms in a sequenced and transparent manner in close cooperation with international organisations"

The priority reform agenda for this year includes adoption of a new tax code, and further price liberalisations which go hand-in-hand with reforming the State Owned Enterprises (SOEs). We would like to create an attractive eco-system for businesses (including SOEs) to operate efficiently and profitably. In parallel, we are drastically improving the corporate governance and commercialisation of the SOEs to prepare them for successful privatisations (including IPOs in global markets).

## STRONG ECONOMIC FOUNDATIONS

Uzbekistan's strong economic foundations support reforms and underpin future development. Average GDP growth constituted 5.3% during 2016-2018 outpacing the world average while the IMF forecasts real GDP growth will accelerate from 5.5% to 6.0% during 2019-2021.

Low external debt provides a margin of safety for the economy as both Uzbekistan's private and public sectors have largely avoided debt financing for growth. As of 2018, total external debt amounted to 33.7% of GDP, of which 19.8% of GDP is external public debt.

Solid economic and fiscal management has kept the budget in surplus, and the fiscal stance remains prudent as the government undertakes public spending initiatives. Moreover, the tax reforms are aimed at reducing the tax burden while bringing more small businesses into the formal economy.

## GLOBAL RANKINGS

Uzbekistan's strong external position is reflected in remaining in a significant net lender position for several consecutive years and holding robust foreign exchange reserves equivalent to 16 months of imports.

The government is keen to implement large scale reforms in a sequenced and transparent manner in close cooperation with international organisations such as the World Bank, IMF, Asian Development Bank, EBRD and UNDP to adopt the best international practices.

We have introduced compulsory online publication of legislative acts during drafting stage to ensure high levels of transparency and public involvement. This way we have achieved overwhelming public support on reforms, however painful these can be.

Uzbekistan is also tracking the reform progress based on 24 international ratings and indices, among which are sovereign credit ratings, Doing Business ranking, Global Competitiveness Index, Economic Freedom Index, Global Innovation Index, Worldwide Governance Indicators and OECD country risk classification (Uzbekistan was upgraded to 5th classification in February 2019). These together with investor perception in capital markets will serve as barometer of reform success ensuring irreversibility of our strategic course.

Some key challenges will remain as we reform and open our economy. These include the impact of price liberalisation on low-income households. We are currently working on a targeted subsidies programme to address this issue. Lifting trade restrictions has exposed Uzbek companies to global competition. Therefore, through the SOE reforms and privatisation, we intend to increase the efficiency of our companies which will thrive at home and abroad.

With an open minded approach and benefitting from the experience and advice from our international partners, we will overcome these challenges and transform Uzbekistan into a modern and competitive economy.

Uzbekistan is open for business! ●

## Uzbekistan: a solid platform

**The most populous nation in Central Asia with 33.2m people, Uzbekistan is pursuing reforms to more productively and positively leverage on its favourable demographics, natural resources and strategic location.**

**According to the World Bank, the country is among the leaders in the world with 99.98% literacy rate. It is a young nation with people of working age exceeding those in retirement by nine times.**

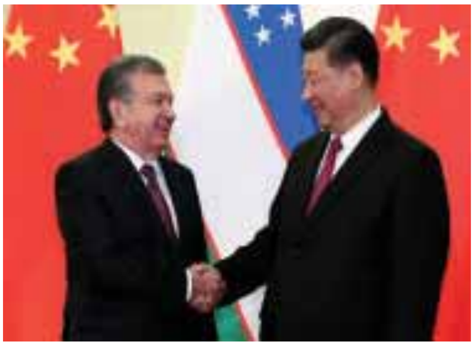
**The country's diverse and rich natural resources endowment provide a solid platform for growth — globally Uzbekistan ranks within the top three in gold deposits, top nine in production and is among the top 10-20 countries in natural gas, copper and uranium deposits and production.**

**With 320 days of sunshine each year, the country is ideally positioned to transform its energy system to sustainable solar energy.**

**Given its strategic location in the heart of Eurasia, Uzbekistan benefits from access to markets with over 3.3bn people within 950kms. The country's Silk Road trade location central to China's Belt and Road initiative links Uzbekistan to large-scale investment in infrastructure connecting Asia to Europe.**

# Uzbekistan: coming in from the cold



After years of isolation, Uzbekistan has started to forcefully address its economic challenges and exploit its inherent advantages in a way that offers the potential to make this resource-rich market a stronger player in the global economy

**By Elliot Wilson**

The Republic of Uzbekistan has spent most of the past four decades doing precious little. For most of the 1990s and 2000s it was all but economically inactive, while to most Western investors, if it had an identity, it was as a flyover state on the way to the likes of Kazakhstan. According to World Bank data, Uzbekistan's economy was actually smaller in 2007 than it was in 1991, the year it declared independence from the withered husk of the Soviet empire.

Life began to change in 2016 with the passing of former president Islam Karimov, a figure of stability in his early years who came to rule with an iron fist, jailing opponents and keeping foreigners, including most potential investors, at arm's length. Karimov was replaced by Shavkat Mirziyoyev, prime minister since 2003.

But despite being part of the old, entrenched system, Mirziyoyev appears to be cut from a different cloth. Once president, he freed political prisoners, sacked many of Karimov's cronies, and promoted capable, forward-thinking technocrats. A "virtual reception hall" was launched, allowing normal Uzbeks to vent their spleen against the authorities online without fear of repercussion. Millions did so in the first few months.

But there has been no Uzbek spring: reforms have been progressive and steady, not sharp and jolting. Travel restrictions were eased, and in September 2017, Mirziyoyev lifted exchange restrictions on the Uzbek som, devaluing the currency to 8,100 per dollar, from 4,210. A decision that at a stroke eliminated one of the key obstacles to foreign investment and trade. He made all the right noises, promis-ing to champion the private sector and break up state monopolies, and to convince leading corporates to issue shares and bonds and sell them to global investors.

By any measure, the process appears to be working. In its latest World Economic Outlook, published in April 2019, the IMF tipped economic output to expand by 5% in 2019 and 5.5% in 2020, rising to 6% by the middle of the 2020s. In a credit opinion published by Moody's in February 2019, the ratings agency highlighted the country's "robust growth potential", underpinned by "positive demographic trends and relatively low government debt". It said the economy would continue to post "strong nominal GDP growth" and a modest budget deficit of around 1.5%.

"Uzbekistan is on an exciting path to opening up its economy," Alkis Vryenios Drakinos, head of the resident office in Uzbekistan at the EBRD, tells *GlobalMarkets*. "It welcomes investors that are ready to take a long-term approach", and who look for "impressive reforms, macro-economic robustness, a young and growing population and an economy rich in natural resources."

## DEBT ISSUANCE

In June 2018, the International Finance Corporation, the private sector arm of the World Bank, issued UZS80bn ($9.5m) worth of two-year bonds on the London Stock Exchange. The so-called 'Samarkand' bonds were a global first for the country and the multilateral, with the proceeds used to boost funding to local SMEs.

Another key moment in Uzbekistan's development came in February 2019, when it secured an international credit rating, and printed $1bn worth of Eurobonds — the state's first foray into the international capital markets. More sovereign prints are set to follow, with Uzbekneftegas, the dominant local oil and gas firm, looking to sell debt to international investors before the end of the year.

In its first quarter 2019 investor presentation, Tashkent-based Ipak Yuli Bank pointed to three key reforms helping to drive change and boost growth. Liberalising foreign currency rules made it easier, the bank said, to repatriate profit, while lower business taxes encouraged firms to reinvest.

Finally, efforts to slash red tape created a more responsive government willing to support inward foreign investment.

In the World Bank's 2019 Doing Business Rankings, Uzbekistan ranked 76th, up from 87th in 2017, the first full year of Mirziyoyev's rule, and 141st in 2015, the year before he was elected and sworn in as president. In its latest survey, the bank pointed to a host of positive moves made by the new administration, from strengthening the rights of minority investors, to making it easier to pay taxes and trade across borders.

In his first year in office, Mirziyoyev chose to stay close to home, shoring up power in Tashkent and meeting friends and allies around the region. The new leader travelled to Turkmenistan and Tajikistan — brokering a peace deal with the latter that included the re-opening of the shared land border — and visited Kazakhstan on no fewer than four occasions. Despite having a smaller population, Kazakhstan, with president Nursultan Nazarbayev at its helm until he left office in March 2019, spent decades courting global investors, sucking foreign capital into energy and mining projects.

### NATURAL AND HUMAN RESOURCES

Kazakhstan and its canny former president can act as handy benchmarks for, respectively, Uzbekistan and Mirziyoyev. The two sovereigns are very similar to one another. They are blessed with an overwhelmingly young population keen to build better, richer lives. Ipak Yuli Bank reckons that 72% of Uzbekistan's 33m people are under the age of 40. Both are also incredibly rich in natural resources, including oil and gas, gold and silver, and copper and cotton. Uzbek officials have estimated the total value of all of the country's mineral and energy resources at $5.7tr.

It is surely only a matter of time before the world's energy and natural resources giants strike profitable commercial joint ventures with leading local groups. The EBRD's Drakinos reckons reforms will transform Uzbekistan into "a more open, mainstream and private sector-oriented economy that is already well positioned to become one of the most advanced in the region".

Whether it has the capacity to transition into a middle or higher-income market, digitally and financially innovative and with a strong manufacturing base, remains to be seen. "Mercedes-Benz and [the Norwegian telecoms firm] Telenor found it very challenging to invest here, and those memories are still fresh," notes Gunter Deuber, head of economics, fixed income and foreign exchange research at Raiffeisen Bank International. "It will take time to turn that [reputation] around, so I don't see sizeable FDI flowing in — first we will need to see more progress on opening up."

Yet Mirziyoyev is clearly keen to continue to forge ahead with reforms. In the final years of Karimov's life, Uzbekistan was a virtual no-go zone for foreign corporates and capital. After peaking at $1.6bn in 2010 and 2011, according to data from UNCTAD, inbound FDI fell off a cliff, tumbling to $133m in 2016, and $96m in 2017. More promising news arrived in 2018, when FDI rebounded to $255m, scattered across 13 greenfield projects.

### GLOBAL TOUR

That may explain why the president has emerged in the past 18 months as something of a globe-trotter. In the second half of 2018, he visited Russia, the United States, Saudi Arabia and also China, to attend the second Belt & Road Forum, held in Beijing in November. Uzbekistan is integral to the Belt & Road Initiative, China's grand plan to redraw the world trade map in its image. All overland trade routes between Beijing and Europe that pass north of Afghanistan and south of the atrophied body of the Aral Sea, have to pass through Uzbekistan.

Belt & Road capital has not been welcomed everywhere with open arms. Soft loans from China's twin development banks, China Exim Bank and China Development Bank, have, critics say, caused endemic indebtedness in a host of emerging states, from Tajikistan to Sri Lanka and Pakistan to Djibouti.

But Uzbekistan, so far at least, has been amenable to Beijing's overtures, and more than happy to channel mainland money into infrastructure projects. China has helped to electrify a 355km rail line linking Bukhara with Misken, and co-financed a highway connecting Tashkent with Turkmenbashi on the Caspian Sea.

Mirziyoyev has continued this year to operate as a one-man international investment bureau. In February, he visited the United Arab Emirates, signing $10bn worth of deals with the sovereign and with the Abu Dhabi-based Mubadala Investment Company, spanning a number of sectors ranging from renewable energy to infrastructure to agriculture. Another key trip, scheduled for the second half of 2019, will see the president visit Belgium, with the aim of strengthening sovereign relations with the European Union. In February, Uzbekistan held the first round of negotiations in Tashkent, on an Enhanced Partnership and Cooperation Agreement.

### ROAD TO REFORM

But while much has already been achieved over the past two years, this is a country that is by any measure still at the beginning of a very long sovereign journey. Four decades of self-imposed isolation is not going to be negated overnight. Scroll back to the start of the decade, and you find a country ranked 172nd in Transparency International's Corruption Perceptions Index, ahead of just four other nation states, including Afghanistan and Somalia. It has inched up steadily ever since, but it was still ranked 158th in 2018, sandwiched between Mozambique and Zimbabwe.

Uzbekistan's capable president is making all the right moves: visiting old friends and making new ones; opening once-closed borders; securing credit lines from China's big development banks; and seeking to strike economic and co-operation partnerships with Europe.

But Deuber's point about Western corporate reservations remains important and relevant. In 2014, a Swiss money-laundering investigation targeting four Uzbek men with links to the daughter of then-president Karimov, also ensnared a Swedish telecoms firm and, indirectly, Telenor. It eventually cost the chairman of the Norwegian telecoms firm his job. Events like these are not quickly forgotten by Western CEOs. They linger for years in the collective corporate memory.

Nor is the overhaul of an economy kept isolated from the world for decades an inevitable and foregone conclusion. Uzbekistan has little experience of trading with the outside world, let alone dealing with the labyrinthine complexity of adhering to the ever-evolving tenets and rules of Western-style corporate and financial governance. There will inevitably be growing pains as a conservative country used to following its own, self-penned rule book, learns to adapt.

The road to reform in any country is strewn with obstacles, whether economic, financial, societal, political — or all of the above. Mirziyoyev's route to power was linear and, as these things go, unusually seamless and painless. But he wasted no time in removing individuals close to his predecessor from positions of power. They may be gone, but will they have forgotten the manner of their departure?

Little wonder Moody's, in its February credit note, warned the biggest threat to future stability stems from political risks that "stem from potential opposition to the reform programme in the face of short-term economic and social costs". There are trials and tests ahead for an economy still finding its feet and its identity as it opens up to the outside world. But they are challenges that are worth facing, and which, moreover, will only make this resource-rich market stronger. GM

> *"Uzbekistan is on an exciting path to opening up its economy. It welcomes investors that are ready to take a long-term approach*
> *—Alkis Vryenios Drakinos, the EBRD's resident office in Uzbekistan*

## UZPROMSTROYBANK

# Uzpromstroybank builds on economic reform

**UZBEKISTAN'S OLDEST BANK IS REINVENTING ITSELF TO MEET THE DEMANDS OF A DYNAMIC NEW GENERATION OF CORPORATE AND RETAIL CUSTOMERS**

Few countries are generating as much exciment among the global investor community as Uzbekistan. Over the past three years, Central Asian's most populous state has undergone an unprecedented economic and social transformation.

Under the leadership of reformist president Shavkat Mirziyoyev, the government has pushed through a series of landmark measure to liberalize the economy, including the introduction of free conversion of the national currency, and the removal of barriers to foreign trade and investment.

Further measures to improve the business climate and attract investment are promised under the government's Development Strategy 2022, including a reduction of the tax burden and improvements to the customs administration, negotiations on accession to the World Trade Organization (WTO) are underway.

Active work on obtaining credit ratings from international agencies paved the way for Uzbekistan's hugely successful $1bn debut on the eurobond market in February.

With a rapidly growing population of 32 million — half of whom are under 30 — and a wealth of natural resources, Uzbekistan offers unparalleled opportunities for investment. Funding for sectors from manufacturing to tourism has surged as locals and foreigners fight to finance the country's economic recovery.

The greatest interest, however, has centred on the financial sector. Not only do local banks offer unique exposure to Uzbekistan's broader growth story, but banking penetration in the country is low even by regional standards, offering huge potential for expansion and profitability.

### LEADING LENDER

As one of the country's oldest and most respected financial institutions, Uzpromstroybank is ideally positioned to play a key role in this economic renaissance.

The history of Uzpromstroybank began in 1922 with the opening of the Central Asian office of Prombank (Industrial Bank) in Tashkent. Ten years later, the lender was transformed into a specialized bank for long-term investments, responsible for financing capital construction, local industry and foreign trade.

After the country's independence was declared, Uzpromstroybank was transformed into a Joint-Stock Commercial Bank.

In 2018, Uzpromstroybank conducted a rebranding. A new brand and logo reflect the improvement in business processes, quality of services and types of products. The rebranding is an important step towards excellence in Uzbekistan's banking.

Within Uzbekistan, the lender now operates under the Sanoat Qurilish Bank (SQB) brand, with a new three-colour circular logo that represents its commitment to the national interest, its support for industry and construction, and its pledge to find banking solutions for every corporate and individual customer.

"The new image of Uzpromstroybank is devised to become a symbol of large-scale changes within its structure, reflecting the bank's ambition to become more transparent and flexible, professional and attentive to the needs of the clients and anticipating their expectations," says chairman Aziz Voitov.

2018 was a special year for the bank, as it made a quantum leap in development and successfully started its aggressive growth, taking leading positions in many segments of the banking business and fulfilling the vast majority of the tasks set in the strategy.

As of January 1, 2019, the bank's total capital amounted to US$ 341.6 million, which is 127% higher than the beginning of 2018, the authorized capital amounted to US$ 225.1 million and increased by 129% compared to the beginning of 2018, assets reached US$ 3.67 billion and increased by 127% from the beginning of 2018. Credit investments represent 90% of the bank's assets.

The bank is constantly striving to increase its resource base. As of January 1, 2019, the balance of customer deposits was US$ 576.7 million, or 147% growth year-on-year.

In 2018, Uzpromstroybank JSCB actively participated in financing investment projects that were included in the modernization, reconstruction, technical and technological renewal programs in the oil and gas, chemical, electric power industry, electrical engineering and other leading industries.

Key projects funded by the bank in recent years include the construction of the Bukhara refinery, the expansion of the Angren thermal power plant and the electrification of the Samarkand-Bukhara railway line.

In total, in 2018 Uzpromstroybank allocated investment loans worth US$ 427.2 million.

In 2018, much attention was paid to the aggressive development of operations with the private sector. Investments in retail lending increased by 2.7 times to total US$ 185.9 million (5.7% share in the loan portfolio), investments in small business lending grew 2.9 times to reach $ 182.5 million (6% share in the loan portfolio).

According to the results of activities in 2018, the bank as a whole received a net profit of US$ 28.4 million. The bank ensured an increase in net profit by 276% year-on-year while its overall profitability was at the level of 11.4%.

Based on its traditional strengths, today the bank is undergoing radical transformations to meet the needs of the rapidly developing economy of Uzbekistan. This involves changes in all areas of banking, including the introduction of new products, changes in operating technologies and modernization of the branch network.

The bank is also working to position itself at the forefront of digital development in Uzbekistan through investment in IT modernization, upgrades of software and hardware, and the introduction of cutting-edge multichannel banking technology.

Also, given the dynamic growth of the insurance market in Uzbekistan (in 2018 alone, the total insurance premiums for the market grew by 90.5% and reached US$ 143.9 million), in March 2019, the insurance company "PSB Insurance" was created in the

## LEADING BY DESIGN

**Promstroybank's new three-dimensional logo in the form of a three-color ring combines the first letter of Uzbekistan's name in three key languages: 'U' in English, 'O' in Uzbek and 'У' in Russian.**

**The colour scheme of the logo visualizes the main initial tasks of Uzpromstroybank in supporting industry and construction. Grey represents metal, red symbolizes fire melting and cutting metal, and blue stands for water, an essential element of industrial production.**

**This choice demonstrates the bank's strong commitment to the interests of Uzbekistan, its direct participation in all major national projects for the construction of industrial, urban and rural infrastructure, as well as its role in ensuring the economic and financial stability of the state.**

Aziz Voitov, Chairman

form of a limited liability company. The company will carry out voluntary insurance in the 17th class of the general insurance sector in such areas as insurance against accidents and diseases, insurance of ground transportation vehicles, aviation and marine insurance, property insurance in transit, insurance of property against fire, natural disasters and harm, third party motor liability insurance, insurance of loans and collateral and other financial risks.

## BANKING ON HISTORY

**Uzpromstroybank's Mirzo-Ulugbek branch is both a historical and architectural landmark. Built at the end of the 19th century, the two-storey building — now part of Amir Temur Square — was designed by architect V. Geinzelman. The exterior design of the bank is made in the neoclassical style typical of buildings of that period. The interior is a collection of parts preserved from the times of the State Bank of the Russian Empire and recreated in our time. Visitors will be able to appreciate the original architectural elements of the 19th century and enjoy the historical photos of Uzbekistan in the era of the Russian Empire.**

### RETAIL FOCUS

Another key focus is increasing Uzpromstroybank's share of the Uzbek retail banking market. In 2018 the bank made a qualitative breakthrough in the development of retail business by offering a wide range of products and services to individuals. In one year, the retail loan portfolio grew 2.7 times.

The active increase in retail volumes has allowed a significant increase in its share in the bank's business as a whole. Thus, the share of loans to individuals in the structure of the bank's loan portfolio increased from 2.8% in 2017 to 5.7% at the end of 2018.

The bank's retail customer base includes employees of large customers and their small business partners. Today, the number of employees of the bank's corporate clients is more than 650,000 people while the number of employees of the SME enterprises exceeds 56,000.

In 2019-21 the bank intends to build a retail business of new scale and efficiency, while continuing to aggressively increase its share in this segment.

In addition, with the rapid development of information technologies, characterized by a high level of development of software and telecommunications systems, the requirements for banks' software and hardware are changing.

Taking into account the increasing requirements for the quality of the services provided, the bank began upgrading its own IT infrastructure for the issuance and servicing of international plastic cards such as Mastercard, Visa, UnionPay International and JCB.

Belgium's OpenWay Group, one of the leading international companies for building automated systems in the area of cashless payments, was chosen as Uzpromstroybank's partner. Cooperation with the OpenWay Group will allow the bank to improve its banking platform, increasing its reliability, safety, speed and productivity, which in turn, will allow bank customers to enjoy modern banking services anywhere and anytime.

Based on the products of the WAY4 solution, it is planned to implement projects that will allow the bank itself and partner banks serviced at Uzpromstroybank's processing center to introduce new products and services, such as contactless payments, issuance of virtual cards, international credit cards and installment payment cards, e-commerce on the basis of 3D secure technology.

### CORPORATE COMMITMENT

Meanwhile Uzpromstroybank has maintained its commitment to providing an outstanding service for its rapidly growing corporate client base.

As well as a full range of settlement and cash services, the bank boasts correspondent relations with leading Uzbek and foreign credit institutions. It has been improving its offering in cash management, as well as ensuring the availability of a comprehensive range of services Uzbek firms operating internationally.

Uzpromstroybank participates actively in the interbank lending market and constantly raises and places short-term loans with banks in Uzbekistan, Europe and CIS, including the Russian Federation. Interest rates and the amount of raised and allocated interbank loans are set through supply and demand on the national and international financial markets.

On the credit side, Uzpromstroybank's offering for corporates includes project financing for new investment projects, as well as the expansion and renewal of existing operations. These loans cover purchasing equipment, materials, new product samples, other material values and technologies.

In addition, in order to facilitate the promotion of investment activities and the financing of projects of domestic entrepreneurs and foreign investors, at the beginning of this year, the bank opened the Center for the Coordination of Investment Activities and Project Management.

Services are provided on the basis of the "single-window" principle, which contributes to the development of business plans, feasibility studies, identification of mechanisms and sources of financing. The center assists foreign investors in successfully starting a business in Uzbekistan, obtaining funding and finding a local partner. Such centers are already open in all branches of the bank throughout the country.

### SOCIAL RESPONSIBILITY

The bank actively participates in social projects and pays special attention to the development of corporate social responsibility. In particular, the bank helps families from remote regions of the republic to open their business and succeed in family entrepreneurship. The bank, together with the International Finance Corporation, has identified Green banking as one of the strategic directions for future activities.

The bank also pays attention to increasing the potential of young professionals and makes sure they obtain up-to-date training. Together with the Korean Inha University in Tashkent and SAP, the bank created the Financial and Technological Center, which provides university students with the opportunity to test their theoretical knowledge in all areas of the banking business and hone their skills in this area with the help of modern IT technologies.

### INTERNATIONAL RELATIONS

In 2018, Uzpromstroybank has continued to cooperate with leading international financial institutions (IFIs) and foreign banks to establish joint support for companies of the real economy, as well as small businesses and private entrepreneurship.

IFIs that have provided funding to the bank include Asia Development Bank, European Bank for Reconstruction and Development, World Bank Group, Islamic Development Bank Group and others.

Uzpromstroybank also has more than 380 correspondent banks, including 361 foreign institutions in 58 countries, represented by first-class banks in Europe and the USA, such as Commerzbank AG, Landesbank Baden-Württemberg, Banque de Commerce et de Placements SA, Raiffeisenbank International AG, Citibank NA, JP Morgan Chase Bank NA.

The bank's financial credentials have been ratified by international rating agencies. Fitch rates the bank at BB- with a stable outlook, while Standard & Poor's has assigned a B+/B rating. The bank provides over 50 types of traditional and advanced banking services for all fields of the economy. ●

**Contacts details:** Uzpromstroybank JSCB
100000, Uzbekistan, Tashkent, Shakhrisabz str., 3
**Afzal Musakhanov**, Department for cooperation with IFIs and banks
Tel: +998 78 120 4500, email: info@uzpsb.uz
**www.uzpsb.uz**


# Investors attracted by lure of Uzbek capital markets

Three decades after declaring independence, a successful Eurobond issue and major reforms show Uzbekistan is finally growing up and engaging with the world on its own terms

**By Elliot Wilson**

When the Republic of Uzbekistan sold $1bn of Eurobonds in February 2019 — its first foray into the international debt markets since declaring independence from the Soviet Union — global investors jumped all over the sale.

And for good reason. The inaugural print by the Central Asian state was well timed, shrewdly managed, and marketed directly at global money managers on a desperate quest for yield, arriving less than 18 months after neighbour Tajikistan printed its own $500m inaugural bond.

The deal was telegraphed long in advance, with JP Morgan hired the previous year as global co-ordinator, joined on the books by Citi and Gazprombank. The dual-tranche trade raised $500m worth of five year bonds priced at 4.75%, and $500m worth of 10 year bonds, priced at 5.375%. The sale drew $3.8bn in orders, ensuring the books were comfortably oversubscribed.

> *“Issuing bonds offered diversification of funding. It is an opportunity to establish a relationship with the capital markets, and it anchors reform progress*
>
> *—Odilbek Isakov, head of Uzbekistan's debt management office*

Alkis Vryenios Drakinos, head of the resident office in Uzbekistan at the EBRD, says the sale was an “important and very successful venture” for the country. “The Eurobonds helped place Uzbekistan on the map, confirmed the recently obtained international rating, and provided an affordable benchmark for further international borrowings.”

Officials in Tashkent hope this is just the start. The print, notes Gunter Deuber, head of economics, fixed income and foreign exchange research at Raiffeisen Bank International, was priced “relatively tight, and lost a bit in secondary trading”. But it was, he added, a big hit among emerging market investors who bought into “the clarity on the [country's] macro-economy, statistics, and resources story”.

**INVESTOR FRIENDLY**

These are key points worth exploring. While other regional economies, including Tajikistan's, rely heavily on earnings from inward remittances from labour migrants, Uzbekistan's tale is clear, consistent and avowedly investor-friendly. After becoming president in 2016, and replacing hardline leader Islam Karimov, Shavkat Mirziyoyev set out to transition the economy from closed shop to open market.

Currency controls were eased, along with some travel restrictions. Slowly, investors began to take notice of a market whose credit profile was, Moody's Investors Service noted in February 2019, “supported by robust growth potential, underpinned by positive demographic trends, and relatively low government debt, which is currently financed at a low cost”.

Yes, there are inherent weaknesses, many likely to persist for decades. There is scant competition in an economy still dominated by a powerful and overweening state. It is poor — nominal per capita income was less than $1,300 in 2018, according to IMF data, ranking it 156th worldwide. And while there is strong support for the reform programme, Moody's questions the government's “institutional capacity to deal with significant and challenging reforms” if growth slows, prices rise, and political stability makes a unwelcome return.

For the time being, though, the outlook is bright. In February this year, Moody's assigned Uzbekistan its first ever long-term issuer rating: B1 with a stable outlook, based on low government debt and positive demographic trends. While an upgrade was unlikely in the near-term, its credit profile would, the ratings agency said, be enhanced by “a sustained increase in productivity growth and competitiveness”.

Like so many countries in the region, Uzbekistan, cut off from the world for so long, is also a beneficiary of simple circumstance. Yes, a reform programme driven by President Mirziyoyev has helped to put the country on the investment map. But it also has a story — actually, several of them — to tell investors.

For one thing, it stands to benefit from China's desire to link Beijing with Europe overland by road and rail, putting Uzbekistan at the heart of the Belt and Road Initiative. For another, it is blessed with an abundance of natural resources, including oil and gas, coal, copper, uranium, gold, and cotton. In 2018, the State Committee for Geology put the sum value of all of the country's mineral and energy resources at $5.7tr. Global exploration giants are regular visitors these days to Tashkent, while an Uzbek-German investment summit, held in Berlin in January 2019, saw €4bn ($4.5bn) worth of deals inked on day one.

**FLUSH WITH CASH**

Yield-hungry emerging market investors who covet diversity and variety in their portfolios will continue to eye the country with interest. It boasts a budget surplus, a large sovereign wealth fund, and around $27bn worth of foreign reserves. In its latest World Economic Outlook, published April 2019, the IMF tipped economic output to expand by 5% in 2019 and 5.5% in 2020, rising to 6% by the mid-2020s.

This year's sovereign bond sale is likely to be the first of many, with the government hoping to return to the market on an annual basis. In February, Odilbek Isakov, head of the country's debt management office, said pointedly that issuing bonds offered “diversification of funding. It is an opportunity to establish a relationship with the capital markets, and it anchors reform progress. This will help companies to improve in terms of corporate governance, such as getting credit ratings. These are important steps as companies become more resilient and better governed.”

A host of corporates are keen to issue bonds in the wake of the sovereign print, led by Uzbekneftegas. In January 2019, Ulugbek Sayidov, deputy chairman of the state-run energy group, said the first order of business was to secure an international credit rating, allowing it to “expand co-operation… with foreign partners [and to] attract credit funds from world financial markets”. He said Uzbekneftegas was “conducting a systematic review for the preparation of a debut issue of Eurobonds this year”.

The EBRD's Uzbekistan head Drakinos says upcoming IPOs and bonds sales by local firms will “boost corporate sector valuations and capital markets by introducing international reporting standards, better governance and transparent decision making”. It is another sign that, three decades after declaring independence, Uzbekistan is finally growing up and engaging with the world on its own terms. GM

## IPOTEKA BANK

# Leadership in targeted markets

**Please describe the history, background and development of Ipoteka-Bank.**

Our launch dates back to 1996, when Tashkent Housing Savings Bank opened following governmental efforts to support Uzbekistanis' welfare, particularly to improve the facilities for housing. Later it becomes Uzbek Housing Savings Bank, as Presidential Decree from March 1997 points out the necessity of nation-wide dissemination of capital's experience on housing financing. In 2005, the Uzbek Housing Savings Bank was merged with Zamin bank and established as JSCBM "Ipoteka-bank" as the first in the country specialized mortgage lending bank.

Today we are offering our services in all industries of economy. Ipoteka Bank has received stable outlook in Moody's and Standard and Poor's ratings.

**What are your Bank's areas of operation, products and services that Ipoteka-bank can offer to institutions in Uzbekistan and abroad?**

To date, we render our services to our corporate and individual clients through 39 branches and 150 mini banks in the country, deserving leadership among Uzbekistan's banks by the scope of services.

In 2018, Ipoteka-bank upgraded its activity in all of its branches, designing new banking products. Now Ipoteka-bank wants to keep growing along with country's economic reforms. We are committed to investing in various sectors of national economy, financially supporting small businesses and entrepreneurs and offering mortgage and consumer lending to wide population.

**What are some of your financial fundamentals — capital, turnover, RoE, market share, etc. ?**

As of January 1, 2019:

- Authorized capital: UZS 985,6 billion ($118,2 million),
- Total capital: UZS 1.610,7 billion ($193,2 million),
- Loan portfolio: UZS 17.195,8 billion ($2.062,7 million),
- Net assets: UZS 19.754,9 billion ($2.369,7 million),
- Deposit base: UZS 6.749,2 billion ($809,6 million),
- Net profit: UZS 250,2 billion ($30,0 million), ROE – 15,5%,
- Market share (assets): 9,22%, market share (capital) – 6,06%.

**Please tell us more about your cooperation with the international financial institutions such as the IFC.**

With our agreement signed during the visit of the President of the Republic of Uzbekistan to New York in September 2017, IFC has been helping to Ipoteka-bank prepare for privatization, strengthening corporate governance, ensuring operational autonomy and improving banking model.

In late November 2017, we had the first working mission of the IFC that included experts on corporate governance, strategic development and business process optimization as well as experts on sales, risk management, loan processing, technologies and HR.

The mission evaluated the efficiency of our bank's interaction with clients, its lending processes, branch networking and capacity of transforming to commercialize as well as the vision of its strategic growth. Following the evaluation report and recommendations of IFC experts, we have discussed the ways we can advance our operation in all terms and started stepping up to reach strategic goals.

The proposed IFC investment in the Bank comprises a senior loan for IFC's own account. The senior loan will have a conversion option at IFC's full discretion.

As part of agreements, more than 10 IFC experts are working with different divisions of the bank on 14 key areas of the Transformation Plan.

> WE ARE COMMITTED TO INVESTING IN VARIOUS SECTORS OF NATIONAL ECONOMY, FINANCIALLY SUPPORTING SMALL BUSINESSES AND ENTREPRENEURS AND OFFERING RETAIL AND CONSUMER LENDING TO WIDE POPULATION
>
> — SHUKHRAT ATABAYEV, CHAIRMAN OF THE BOARD

**Which segments and products currently offer the greatest growth opportunities for banks in Uzbekistan?**

With $48,8 billion, Uzbekistan's GDP increased by 5.1 percent in 2018. Main contributor for this was the 10.6 percent growth of the industry, which, in its turn, was affected by 25.4 percent boom in mining industry and quarrying as well as 22.6 percent increase in water supply, sewerage, waste collection and disposal.

Construction is one of the most significant areas of the economy and one of the attractive areas of investment here. At the time, service industry comes next as an important market for developed economies. In Uzbekistan it is one of the fastest growing sectors, as stats from January 2019 says that around 213 thousand enterprises out of 323.5 thousand are active service providers.

Therefore, rapid growth in the important segments such as construction, service industry, mining industry and quarrying, manufacturing, electricity, gas, water supply, sewerage, waste collection and disposal businesses are attractive spheres for banks in Uzbekistan.

**How important are technology and innovation in the Uzbekistan banking sector?**

Digital banking optimizes the processes, it introduces a new organizational culture and flexible technological solutions that eventually speed up the product launches and helps personalize the offers. That is how we see the importance of technology and innovation.

With gradual increase of smartphone users and tech-savvy population, we strive preserving our competitiveness with smart solutions as using AI-driven consultants, including chat bots and virtual assistants, digitalizing back-office operations and boosting automation and predictive analytics.

Currently, banks are investing heavily in developing digital banking business model in Uzbekistan.

**What can Ipoteka-Bank do to promote the development of Uzbekistan's economy and financial system?**

Today, an attraction of foreign and local capital to our economy is a specific source of funds for a financing large investment projects.

Ipoteka-bank has great potential for financing large investment projects. In 2018, we have further grew in terms of selecting, evaluating and funding investment projects.

For instance, in 2018, we allocated UZS 2.825,5 bln ($338,9 mln) in credits of investment nature and by the year-end, the investment credits portfolio amounted to UZS 7.300,5 billion ($875,7 mln).

**What are your strategic plans and major goals for 2019 and beyond?**

Considering the expected changes in the banking market and the current strengths and weaknesses of the Ipoteka-bank, we plan to:

- Improve the quality of customer services, standardize and optimize services processes;
- Diversify bank assets and liabilities and balance their maturity;
- Develop marketing and branding service;
- Transform Ipoteka-bank into a bank that meets international standards.

As for financial results for 2019, we plan to reach:

- An annual average annual net profit growth of 63%;
- An increase in the share of non-interest income in total revenues up to 40%;
- ROE (return on capital) ratio of 18%, and ROA (asset profitability) ratio not less than 1.7%;
- Cost income ratio around 46%. ●

100000, Uzbekistan, Tashkent, st. Shahrisabz, 30
Phone: +998(78) 150-89-56, (78) 150-18-88
Fax: +998 (78) 150-98-25
Website: www.ipotekabank.uz
Email : info@ipotekabank.uz

## AGROBANK

# A systemically important bank for Uzbekistan's economy

Agrobank JSCB has played a key role in the transition of Uzbekistan as a Soviet satellite state into a market economy. In an interview with *GlobalMarkets*, Rustam Mamatkulov, the bank's chairman explains how Agrobank is gearing up to meet the challenges of the 21st century

**What is the history, background and development of Agrobank.**

The history and development of Agrobank is inextricably linked with the independence of Uzbekistan in 1991, when the economy and financial system experienced a difficult and turbulent process of transformation from the Soviet administrative and planning environment into a market system. From the early days of independent Uzbekistan, Uzagroprombank became one of the four commercial banks established by the state. First of all, the need to create such a bank was due to the important role of the agrarian sector in the structure of the economy and employment. The newly created bank played a major role in financing projects to support and restructure agriculture in the difficult conditions of transition to the market economy.

The objectives and branding of the bank changed in the course of reforms to the economy and the banking system. Our accumulated banking experience, increased banking competition, and the development of our competitive advantages constantly required us to search for our own niche in the banking system. Therefore, for almost two decades after the country gained its independence, the name of the bank changed twice.

In 1995, Uzagroprombank was transformed into Pakhta-bank in order to concentrate the predominant share of banking operations in lending and servicing the agrarian sector of the republic. In 2009, the bank acquired the brand Agrobank, which emphasises its mission as a major player in serving the needs of various participants in the agricultural sector.

If in its first years most attention was paid to agriculture, today Agrobank is a universal bank providing quality services to a wide range of corporate and retail customers. Successful strategy and well-balanced diversification of banking operations allow Agrobank to consistently be in the top five banks of Uzbekistan.

**What are your bank's areas of operation, products and services as well as strengths and competitive advantages?**

The mission of Agrobank is, above all, the promotion of sustainable development of the agricultural sector. Such a mission is based on a solid competitive basis: as part of its operations, the bank has accumulated considerable know-how in working with participants in the agrarian sector.

In 2018, the contribution of the agricultural sector to Uzbekistan's GDP amounted to almost a third (about 29%). The potential here is huge given the prospects for the development of the agricultural sector, a gradual increase in productivity and efficiency of agriculture. Various participants of the agricultural sector today are engaged in the production and collection of agricultural products, their storage and transportation, and processing into products with higher added value.

The agricultural sector accounts for more than a third of Agrobank's loan portfolio. Agrobank covers more than 35% of this sector's borrowing needs, thereby maintaining its leading position in the country's agriculture.

Our branch network allows us to provide a wide range of banking services not only for the agricultural sector, but also for other sectors of the economy, as well as for the public. Today, Agrobank's network includes 13 regional offices, 178 branches, 248 points of sale (mini-banks) and 231 money transfer kiosks. Such a competitive advantage today allows more than 8,000 employees of the bank to provide quality services to more than 250,000 corporate clients and over 2.5m retail customers.

**Please provide some of your financial fundamentals**

Agrobank has a good track record of capital support to ensure the solvency of its liabilities. Over the past two years, the size of the bank's own capital has increased four times from $63.8m at the beginning of 2017 to more than $260m at the end of 2018. This represents about 8.3% of the capital of all banks.

The bank's assets grew 2.5 times over the same period. As of December 31, 2018, the size of assets exceeded $1.2bn, twice than at the beginning of the year. The income-generating assets by the end of 2018 amounted to $1.1bn, or 88.5% of total assets. The loan portfolio maintained a similar trend and by the end of 2018 reached a size of over $1bn, which means an increase of almost 2.6 times year-on-year.

**What is the bank's current market share in Uzbekistan's banking sector? Do you have plans to increase it?**

2018 was an important milestone in the growth of Agrobank's financial indicators, as the bank significantly strengthened its position in the banking sector at the end of last year. In particular, in terms of assets and liabilities, it ranked ninth in 2017, and by the end of 2018, it rose to fifth place.

Today, our bank is the leader in the number of issued bank cards in national currency, as well as POS-terminals for cashless payments. In addition, the bank ranks second in Uzbekistan in terms of the number of branches and employees. These positions help the bank to maintain and increase its market share.

The bank does not stop at this; today, projects are being developed and implemented to improve the skills of personnel, introduce new business processes in the branches, introduce information technologies to improve the quality, and reduce the cost of banking services. This trend should further increase the competitiveness of Agrobank in the country's financial markets.

The bank consistently holds fifth place in terms of assets, which at the end of 2018 amounted to 4.8% of the market share. Also, the growth of the loan portfolio ensured the bank's rise in this position to the fifth position in the ranking of local banks, with 5.2% of the market share. In the new strategy that is being developed today, we forecast a twofold growth of assets and the loan portfolio in 2021 compared to the 2018 level.

**What have been your bank's key achievements over the past 12 months and your most successful projects that you have managed to implement?**

In 2018, Agrobank was twice awarded the prestigious Asian Banking & Finance Awards in the categories Best Corporate and Investment Bank of the Year and Best Technological and Operating Bank of the Year. In 2018 for the first time in its history Agrobank began the introduction of international quality management standards. In early 2019, the bank successfully passed a certification audit and was awarded the ISO 9001:2015 international standard certificate.

An important event was the upgrade of ratings by the international rating agency Fitch Ratings, which at the beginning of the year raised its long-term issuer default rating for the bank from B+ to BB- with a stable outlook. This brought the bank's rating in linewith the country's sovereign rating. This confirms the increasing resilience of the bank to changing market conditions.

**Which segments and products currently offer the greatest growth opportunities for Agrobank?**

The bank's attention is focused on retail clients, as well as on servicing the agricultural sector as promising directions for business development.

In particular, in the retail business, the bank carries out a series of activities to develop areas such as co-branded products and loyalty programmes, new online banking opportunities, including fully-fledged customer experience in mobile banking, long-term and short-term lending to retail customers, including on the basis of a revolving microcredit and cross-sales.

In the corporate sector, the bank adheres to a steady increase in the customer base and an active credit policy, offering bundled products along with comprehensive services, as well as developing new products such as credit cards for farmers. Also, the development of financing of foreign economic activity and foreign exchange operations is one of the areas of development.

To ensure a stable resource base and an adequate liquidity level, the bank intends to take steps to attract external funding on the international capital markets, including the issue of corporate debt securities.

**Please tell us more about your bank's cooperation with the international financial institutions.**

One of the bank's top priorities is to attract loans, investments and grants from international financial institutions and leading foreign banks, which help to successfully deal with support, restructuring, technological modernisation of the production base and customer infrastructure, including agriculture.

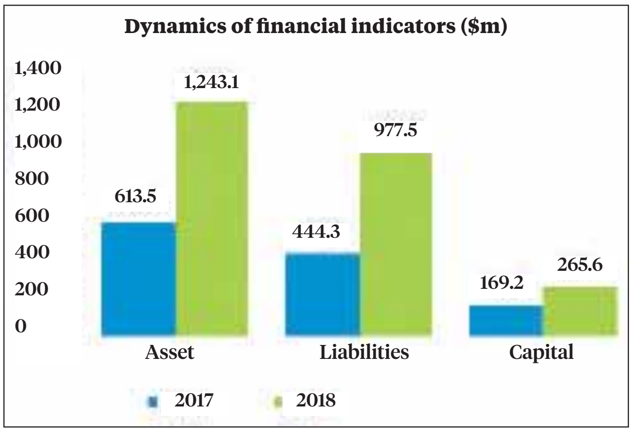
Today Agrobank is working closely with such banks as Ziraatbank in Turkey, the Islamic Corporation for the Development of the Private Secto, Landesbank Baden Wurttemberg, and Commerzbank. As a result of cooperation with nine international financial institutions and foreign banks, in 2019 the bank expects successful attraction of foreign credit lines worth about $370m to finance promising investment projects.

Agrobank plans in the near future to attract borrowings from reputable banks such as the China Development Bank and the Industrial and Commercial Bank of China.

**How important are technology and innovation in the current Uzbeki banking sector? What is Agrobank's position in this segment?**

In the face of growing competition, our bank attaches great importance to improving the level of technology and innovation in the provision of its services.

The bank continues the policy of developing digital banking services for its corporate and retail business and provides a wide range of online banking services. In particular, at the end of 2018, the internet banking service was used by about 40,000 clients, which is almost 20% of all corporate clients.




The popular mobile banking service Agrobank Mobile has more than 100,000 users. It provides access to more than 100 services, including bank account management, payments for various utilities and communication services, tax payments and loans for individuals.

Agrobank continues to develop its own plastic payment card system. More than 2m bank customers use this service for cashless payments for goods and services through POS terminals.

We try to raise the standards of technologies and introduce innovations not only in offering financial products and services to customers, but also in our management system. Increasing competition requires the implementation of technologies and innovations in a wide range of business processes like marketing, communications, planning, budgeting, control, and risk management.

**What can Agrobank do to promote the successful development of Uzbekistan's economy and financial system?**

Historically, Agrobank has been a systemically important bank for the country's economy: a significant amount of lending goes to the agricultural sector of Uzbekistan. In this direction, Agrobank will continue to meet the growing demand for loans from businesses in this sector.

We can help enterprises to fully exploit the potential of agriculture, to contribute to increasing income in the agricultural sector and maintaining the sustainability of economic growth. The state strives to raise agriculture to a qualitatively new level by increasing the competence of managers and entrepreneurs, updating the production base and expanding access to new technologies and know-how.

**What are your strategic plans and goals for 2019 and beyond?**

An important strategic plan is the development and implementation of a long-term strategy based on international standards. For this, the bank works closely with KPMG consultants. Our experts also continue to actively explore the useful experience of leading advanced foreign banks such as Ziraatbank (Turkey) and Sberbank (Russia).

The new strategy will take into account trends and forecasts of economic development in the horizon of three to five years. By 2021, the bank expects to double its total volume of assets, including loans for all categories of customers, compared with 2018.

Of course, our active credit policy will be accompanied by the introduction of modern risk management systems to monitor the bank's financial stability. Developing new banking products and services for a wide range of corporate and retail customers is an important task for the bank. Our goal is to become the best bank for the public and business.

Improving IT systems, digitising banking operations and providing online services are among the most important goals in the bank's long-term strategy.

Special attention will be paid to our HR policy. The liberalisation of the country's markets, the growth of openness of the economy and financial system for the world market make it necessary to invest in raising the qualifications and skills of our bank's staff and management. ●

www.agrobank.uz

# Uzbek banks open doors to foreign money

After being off limits to foreign investors for many years, Uzbekistan has raced to catch up for lost time by seeking investments by European banks and international financial institutions

By Elliot Wilson

There was an era, not so very long so, when deregulation was *de rigueur* in banking. Regulators strove to break down walls harder and faster than their peers, with some seeking to be as invisible as possible, while foreign investment, notably in markets emerging from the grip of communism, was actively sought and put to good work.

Across central and eastern Europe, huge swathes of countries' banking sector came under the control of mostly western European lenders, from Italy, Austria, Germany and the Benelux countries. In June 2018, Raiffeisen Bank noted that while the overall market share of foreign lenders was inching lower, after peaking in 2006, they still exerted an unusually high level of control across the CEE region.

At the end of 2017, according to data from the Vienna-based lender, foreign institutions collectively owned over 80% of the banking sectors of Albania, Romania, Bosnia and Herzegovina and the Czech Republic, while in Slovakia, the share is close to 100%. But most of the deals that saw Western lenders crowd into the region were completed long ago. It has been years — a decade, perhaps longer — since a banking sector in emerging Europe or Central Asia flung open its doors to foreign investors.

But very quietly, a question is being asked: will Uzbekistan be next? It is not such an outlandish idea. Until Islam Karimov, a dictator who jailed opponents and brooked no dissent, passed away in 2016, the country's financial sector was all but off limits to outsiders. Few expected his successor, Shavkat Mirziyoyev, to be any different: after all, he was part of Karimov's inner circle, having been prime minister since 2003.

> "This used to be an isolated market, but across the banking sector, the feeling is that Uzbekistan is really starting to open up'
>
> — Gunter Deuber, head of economics, fixed income and foreign exchange research at Raiffeisen Bank

## NEW BROOM

Yet the new president surprised everyone by reaching out to financial investors, foreign lenders, and multilaterals. The EBRD was invited back in after a decade's absence and quickly got to work, extending credit to local banks in order to spur private sector credit growth. Funding also flowed in from the Asian Development Bank (ADB) and the World Bank and its private sector arm, the International Finance Corporation (IFC).

In September 2017, Mirziyoyev lifted exchange restrictions on the Uzbek som, devaluing the currency to 8,100 per dollar, from 4,210. At a stroke, that eliminated a key obstacle to foreign investment, and brought the official rate in line with the prevailing rate on the black market. Capital controls were eased, albeit partially, and in February 2019, the country celebrated a much-coveted double-first, by securing its inaugural sovereign credit rat-ing, and printing $1bn worth of Eurobonds, which it marketed and sold, with consider-able success and no little fanfare, to international investors.

Foreign direct investment started to flow in.

That process has been hesitant: some of the world's most valued corporate brands, accustomed to posting profits in the toughest conditions and markets, have been badly burned in the past. But it seems inevitable that Uzbekistan will strike an abundance of deals in the years ahead, enabling foreign mining and energy giants from London, Melbourne, Beijing and Rio de Janeiro, to tap into its vast reserves of energy and minerals. If Uzbekistan gets it right, the partnerships it strikes will benefit everyone.

The banking sector looks set to open up too. True, the government is still "heavily involved in the economy, especially in banking", Moody's said in a credit opinion on the sovereign, pub-lished in February 2018. State-run banks are overwhelmingly predisposed to chan-nelling valuable capital to state-run firms, as is the case not just in Central Asia, but in other big economies like Russia, China and India.

Meanwhile, the few local private-sector lenders that do exist, while ambitious, are hamstrung by a paucity of capital and funding. Hamkorbank, the largest of its kind in Uzbekistan, a well-run outfit that focuses on SMEs and micro-lending, posted total assets of 5.43tr som ($669m), according to Moody's latest report on the lender, dated September 21, 2018.

But there is little doubt that the sector is, slowly but surely, opening its doors to foreign investors. The ADB owns an 11.05% stake in Ipak Yuli Bank, a joint-stock commercial lender founded in 1990 that employs 1,700 staff across 16 branches. In November 2018, Ipoteka Bank asked the IFC to plan and oversee a complete overhaul of its oper-ations and strategy. And in November 2018, Zurich-based impact investor responsAbil-ity bought half of the IFC's 15.4% stake in Hamkorbank.

TBC Bank, Georgia's largest commercial lender, has also entered the fray, securing a licence to operate a mobile banking serv-ice called Space, with the aim of becoming an onshore leader in the digital space. Next up, TBC aims to open physical branches in the country's leading cities. And in 2018, Sturgeon Capital, a London-based investment manager that specialises in buying assets in frontier markets along the New Silk Road, bought a 39.6% stake in Universal Sug'urta, an insurer that owns a little under 10% of Universal Bank, a local joint-stock lender founded in 2001.

"If you look at the overall data, it is still astonishing how little exposure foreign banks have to the country — around $4bn in total funding and loans," says Gunter Deuber, head of economics, fixed income and foreign exchange research at Raiffeisen Bank. "It's next to nothing. But it has changed and it continues to change. The overall exposure is increasing. This used to be an isolated market, but across the banking sector, the feeling is that Uzbekistan is really starting to open up." GM

| Foreign direct invesment | 2015 | 2016 | 2017 |
|---|---|---|---|
| **FDI Inward flow** (million USD) | 66 | 133 | 96 |
| **FDI Stock** (million USD) | 9,023 | 9,156 | 9,252 |
| **Number of greenfield investments** | 18 | 23 | 10 |
| **FDI Inwards (% of GFCF)** | 0.3 | 0.3 | n/a |
| **FDI Stock (% of GDP)** | 13.6 | 13.5 | n/a |

UNCTAD – latest available data

Country comparison for the protection of investors

| | Uzbekistan | Eastern Europe & CEE | United States | Germany |
|---|---|---|---|---|
| Index of transaction transparancy | 8.0 | 7.0 | 7.0 | 5.0 |
| Index of manager's responsibilty | 3.0 | 5.0 | 9.0 | 5.0 |
| Index of shareholders' power | 6.0 | 6.0 | 4.0 | 8.0 |
| Index of investor protection | 5.7 | 6.4 | 6.5 | 6.0 |

*Doing Business* – latest available data

Source: Santander

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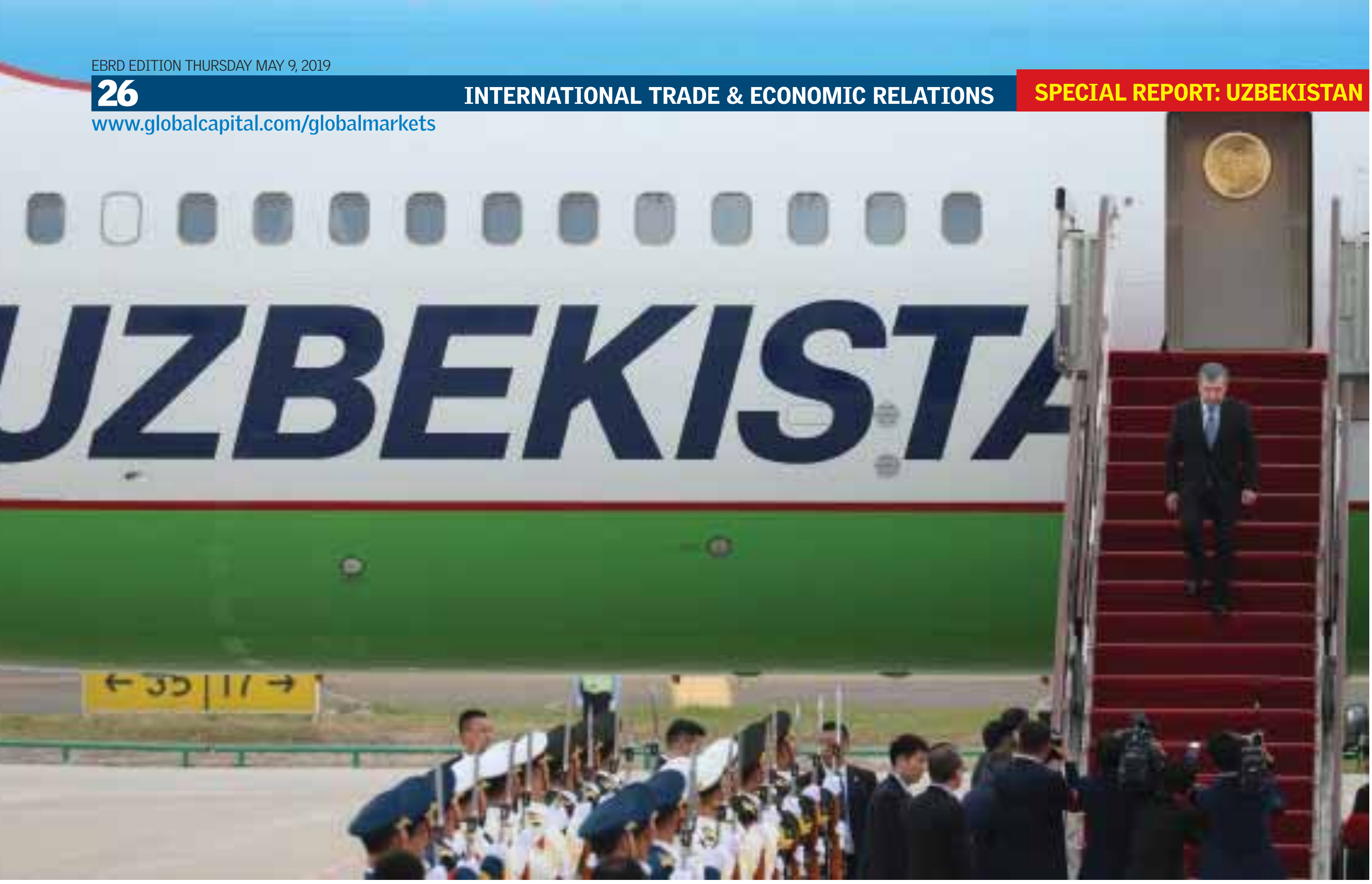


# The heart of the New Silk Road

**By Elliot Wilson**

When talk turns to cities or states that lie at the heart of regional or global trade, certain names and places spring inexorably to mind. In the late 20th Century, Germany, Japan and the United States dominated global trade. Before that, it was the turn of the commercially oriented British Empire. Receding further into antiquity the names of Athens and Aden, Calicut and Colombo, Siraf and Singapore spring to mind. Then of course there is China, the sovereign giant that dominated global trade until the 18th Century and looks ready to do so again.

Yet such lists tend to overlook a region and more specifically a country that for more than 16 centuries lay at the crossroads of commerce. Between 130 BCE, when China's Han Dynasty formally opened trade routes to the West, and 1453 AD, when the Ottoman Empire closed them, the Silk Road was the greatest trading network the world had ever seen. Paper, spices, gunpowder and, naturally, silk, flowed west from China and the littoral states of the Pacific, while new technologies like glass-making, invented in the Islamic world, spread east. The old Silk Road wasn't a point-to-point affair: it ruptured and reconnected multiple times along its route, interconnecting with key rivers: the Indus in modern-day Pakistan, and the Tigris and Euphrates, which empty into the Persian Gulf. But at the heart of the Silk Road stood a handful of trading hubs, rich oasis-cities like Bukhara, Samarkand, Fergana and Andijan, all located in modern-day Uzbekistan, a country with a troubled and turbulent past that, if all goes to plan, it hopes to transform into a bright and brilliant future.

## HERMIT STATE

To understand how far Uzbekistan had fallen off the trade map, it is important to understand its recent history. After the dissolution of the Soviet Union in 1991, it declared independence but, unlike some regional sovereigns, notably the more external-facing Kazakhstan, it shrank into itself, choosing to fear rather than embrace the outside world. Under Islam Karimov, a tyrant-president who ruled with an iron fist, it became Central Asia's hermit state, regularly ranked low by democracy watchdog Freedom House alongside North Korea on issues such as political freedoms and civil rights.

Most foreign investors wisely gave it a wide berth, and Uzbekistan slowly and systematically fell behind its regional peers. According to data from Unctad, foreign direct investment as a share of gross fixed capital was 6.8% in the three full years before the global financial crisis of 2008 — a time when the price of everything from coal to copper to oil and gas, resources found in abundant supply beneath Uzbekistan's rich soil, were going through the roof. Compare that with Kazakhstan, where FDI as a share of gross fixed capital, during the same pre-crisis period, came in at 26.9%.

Yet for a long time, that was as good as it got for political leaders in Tashkent. Inward investment fell steadily through the post-crisis era, hitting a nadir in 2017, when Uzbekistan attracted just $96m in foreign capital. The same year, just shy of $40bn worth of total FDI flowed into the five nation states that make up Central Asia. In the quarter-century to the end of 2016, according to World Bank data, Kazakhstan attracted $52bn in total FDI, against just $9.6bn for Uzbekistan.

## A NEW DAWN

Perceptions began to change in 2016. In September of that year, Karimov died and was replaced by long-standing prime minister

© Wu Hong/Pool via Reuters

After decades of self-imposed isolation, Uzbekistan is embarking on a range of projects with the help of Chinese assistance — and finance — to slowly start to stitch a recently remote country back into the global economy

*Uzbekistan is opening up fast financially and economically, with foreign portfolio investors, notably funds that specialise in unlocking investable assets in frontier markets, taking their first, tentative onshore steps*

Shavkat Mirziyoyev. The new president quickly got to work, pushing through reforms that included easing visa requirements and making the Uzbek som fully convertible. Azim Akhmedkhadjaev, chair of the state committee for investments, said it promised to usher in a "new epoch… of intense development".

In the wake of the presidential elections of December 2018, Mirziyoyev worked hard to burnish Uzbekistan's badly tarnished image, meeting corporates and investors, and leading policymakers in Delhi and Beijing, Tokyo and Washington. He applied to restart talks to join the World Trade Organisation, stalled for a decade, and embarked on lucrative investment trips to Russia, India, China and the United Arab Emirates. Seven special economic zones were created, offering favourable tax breaks to investors.

The EBRD re-opened its office in Tashkent after a decade's absence from the country. Since September 2017, the European multilateral has signed and started 23 onshore projects, financing hotels, power stations and wastewater facilities, and extending credit to local lenders including Ipak Yuli Bank, Ipoteka Bank and Davr Bank.

Mirziyoyev is peering east and west in his quest for everything from working capital to institutional and geopolitical support. This makes good sense. To the east stands China, whose Belt & Road Initiative (BRI), also known as the New Silk Road, aims in the long-term to convey billions of dollars of goods a year (priced, China hopes, in its currency, the renminbi) overland by road and rail between East Asia and Europe.

For Uzbekistan's president, the initiative could not have arrived at a better time. China's desire for the bulk of its trade to bypass the US-controlled Strait of Malacca works to Uzbekistan's favour. The New Eurasian Land Bridge and the China-Central Asia-West Asia Economic Corridor, two of the BRI's chief trade routes, pass through Uzbekistan: the former officially terminates at the Dutch seaport of Rotterdam, while the latter comes to a full stop on the shores of the Mediterranean. For both routes to operate at full capacity, China knows there cannot be any missing links.

That explains its drive to channel capital into a host of key infrastructure projects across the country. A new and fully electrified $5bn rail line linking western China with Tashkent is already underway, the first phase of which is funded by a $400m loan from the Export-Import Bank of China (Chexim). The two countries are working on a host of other projects, ranging from water management to logistics to astronomy.

In June, Mirziyoyev is slated to attend the next Shanghai Cooperation Organisation summit, which brings together the leaders of China, Russia and the Central Asian states, and is set to take place in Tashkent for the first time.

Some nation states, fearing the consequences of rising levels of national debt, are reluctant to accept funding from Chexim and China's other big development lender, China Development Bank, but so far at least, Uzbekistan, a country long on ambition and short on high quality infrastructure and investment partners, is not one of them.

**LOOKING WEST**

Then there is the vast single market at the western end of the Belt & Road. In February, Uzbekistan and the European Union held the first round of talks on an Enhanced Partnership and Cooperation Agreement, which aims to boost two-way trade with the EU.

Later this year, Mirziyoyev is sched-

## Zones of influence

China, history tell us, is one of the most inventive of countries. Over the centuries, it has given us everything from paper to gunpowder, tea to silk, and the compass to movable type printing. But perhaps no invention is more relevant in the modern economic and financial world than the special economic zone (SEZ).

The secret to their success lies in context. China was judicious from the outset, setting out a master plan but infusing it with enough institutional flexibility. Its more advanced cities (Shenzhen, Shanghai) started the ball rolling, focusing on heavy manufacturing (clothes, shoes, plastics).

As these SEZs moved upstream into higher-margin goods and services (robotics, AI, biotechnology), old-style manufacturing moved inland, to second or third-tier cities, or, increasingly, overseas. China was careful not to build too many SEZs, thus avoiding a surfeit of price competition, but it promised to move heaven and earth to keep its key investors happy, and usually delivered.

Foreign corporates set down productive roots, often for decades. Developed and developing nations, recognising the model's simple, elegant effectiveness, sought to replicate it.

Now, Uzbekistan, a fast-growing country rapidly opening up to the outside world, has jumped on board. SEZs of all types and sizes are springing up across the Central Asian state, with the aim of sucking in foreign capital and giving the country's 33m people a better and richer life. In October 2018, president Shavkat Mirziyoyev set out plans to build seven special zones dotted around the country, including an SEZ in Sirdrayo, an area located between Tashkent and Samarkand, that will offer corporate tax breaks, and free investors from the cost of paying a land tax. Other special zones, in Tashkent, Samarkand, Bukhara and the eastern Fergana valley, are springing up, focusing on industries including logistics, agribusiness, light industry, pharmaceutical production and tourism.—E.W.

Syr Darya river crossing, Sirdrayo

uled to visit Belgium and Switzerland. His administration continues to ease travel restrictions on tourists and business travellers. In February 2019, Uzbekistan said it would allow visa-free travel to the country for visitors from 45 countries, including the UK, Italy, France, Germany, Singapore, Japan, and Austria.

An e-visa scheme introduced in 2018 will be extended in the second half of the year to cover nationals from 76 countries and will permit double and multiple entries — a boon for regular business travellers. It seems to be working: according to data from the foreign affairs ministry, 5.3m people visited the country in 2018, more than double the previous year's figure of 2.6m.

Air travel, once costly and rare, is booming as the sector opens up. Uzbekistan Airways, the national flag carrier, is adding new routes to Europe and Asia, and expanding its roster of Airbus A320s and Boeing 787 Dreamliners.

In 2017, the president inked a $250m loan from Export-Import Bank of Korea, to finance the construction of a new terminal at Islam Karimov Tashkent International Airport. Set to open in 2021, it will be able to process 3m-4m passengers a year and accommodate up to 36 aircraft. Plans are also under way to convert Tashkent-Vostochny Airport, a military-and-cargo facility to the east of the capital, into a business aviation hub by 2020, a project slated to cost $150m.

Thanks to projects like these, and dozens of others either planned or pending, a once-isolated country is slowly being stitched together. Global mining and energy firms from Europe, Asia and the Americas are engaging with the government, with the aim of forging joint ventures with leading corporates, and of exploiting vast reserves

# Russia wanes, China rises

For decades after the collapse of the Soviet Union, Russia's influence in Central Asia endured. Then as now, Russia saw the area as part of its "near-abroad", or natural sphere of influence. It maintained a strong military presence in the likes of Uzbekistan, and financed projects aimed at, among other things, cutting poverty and fortifying society.

The Collective Security Treaty Organisation (CSTO), an intergovernmental military alliance founded in 1992, may have been regional in theory, but it was heavily reliant on Russian minds and money. In 2014, Russia unveiled the Eurasian Economic Union (EEU), in the hope of permanently binding the region together, economically and financially.

Russian influence remains, but there is little doubt it has waned sharply in recent years, across Central Asia in general, and more specifically in Uzbekistan. When Islam Karimov, a hard-line dictator, died in 2016 and was succeeded by current president Shavkat Mirziyoyev, Russia wasted little time reminding the new guy who was boss. One of Mirziyoyev's first official trips abroad was to Moscow, where he signed a slew of energy, food and military deals worth $15bn.

Yet Mirziyoyev has been more than willing to tread his own path. His predecessor withdrew from the CSTO in 2012, and the current president has evinced no desire to re-engage militarily with Russia. Nor does he show any wish to join the dead-in-the-water EEU, a paper tiger of a multilateral project.

Russia's dilemma is exacerbated by the fact that there is now a more powerful and ambitious superpower operating in its own backyard. Regional sovereigns that once instinctively turned to Russia for funding and protection, now court China, coveting its diplomatic strength and seemingly limitless capital reserves.

Chinese development banks, operating under the aegis of president Xi Jinping's flagship Belt & Road Initiative, are financing and facilitating much-needed infrastructure, building airports, highways, and new rail lines. In November 2018, while attending the second Belt & Road Forum in Beijing, Mirziyoyev revived plans for a high-speed railway linking the eastern Uzbek city of Fergana, with Xinjiang in western China. A few months earlier, he returned from his maiden overland voyage to the People's Republic, having inked dozens of deals worth $23bn, spanning sectors from oil refining to power plants, and chemicals to agriculture.

Once the region's primary trading partner, Russia now ranks second or lower in many markets, Uzbekistan included. The country posted exports of $11.5bn in 2017, according to data from the CIA World Factbook, of which more than half, mostly in the form of energy and minerals, was shipped west to Switzerland and east to China, with Russia accounting for a tenth of the total. In 2017, China overtook Russia, to become, for the first time, Uzbekistan's largest source of imports.

**ECONOMIC WINTER**

The long, slow decline in Russian influence is easy to explain. Russia's economy grew by an annual average of 0.4% over the half-decade to the end of 2018. Events such as the 2014 annexation of Crimea and the subsequent rouble crisis acted as a destabilising force in a region desperate for financial, economic and political stability. Western sanctions did not fatally undermine Russia, but they did remind regional nation states like Uzbekistan that Russia would always march to the beat of its own drum.

By contrast, China, with its constant and comfortable refrain of "trade and more trade", came to appear to be a far more reliable long-term commercial partner. "China's Belt & Road Initiative is everywhere in Central Asia," notes Gunter Deuber, head of economics, fixed income and foreign exchange research at Raiffeisen Bank International. "You see it in trade and cropping up in FDI data across the region, and the stark truth is that Russia has completely lost out. Central Asian states will always seek to manage the balance of their relations with both countries, but China matters far more these days and Russia matters far less."—E.W.

of energy, metals and cotton. Better infrastructure, again, is key to its success.

**IN FROM THE COLD**

Uzbekistan is opening up fast financially and economically, with foreign portfolio investors, notably funds that specialise in unlocking investable assets in frontier markets, taking their first, tentative onshore steps. The Tashkent stock market's free float is a mere $300m, but it is set to grow as more firms, in the private and the public sector, sell shares to local and foreign institutional investors.

A key moment in the country's capital markets development took place in February, when the Republic of Uzbekistan sold $1bn of Eurobonds to international investors; leading local corporates are set to follow suit, with oil and gas group Uzbekneftegas tipped to print its inaugural corporate bond by the end of 2019.

And while foreign lenders are in most cases barred from buying stakes in Uzbek banks, those restrictions are widely expected to be removed or eased in the coming years.

Looking ahead, there are many good reasons for investors to put their money to work in the Central Asian state. China is ploughing untold capital into infrastructure projects that will link Beijing with Europe via one of the youngest and fastest-growing economies anywhere in the developing world. In its latest World Economic Outlook, published in April 2019, the IMF tipped economic output to expand by between 5%-6% every year through the mid-2020s, and pointed to a host of other positive macroeconomic signs, including narrowing deficits and easing inflation. It seems that after years of self-imposed isolation, Uzbekistan is finally, to the delight of global investors, corporates, lenders and policymakers, coming in from the cold. GM

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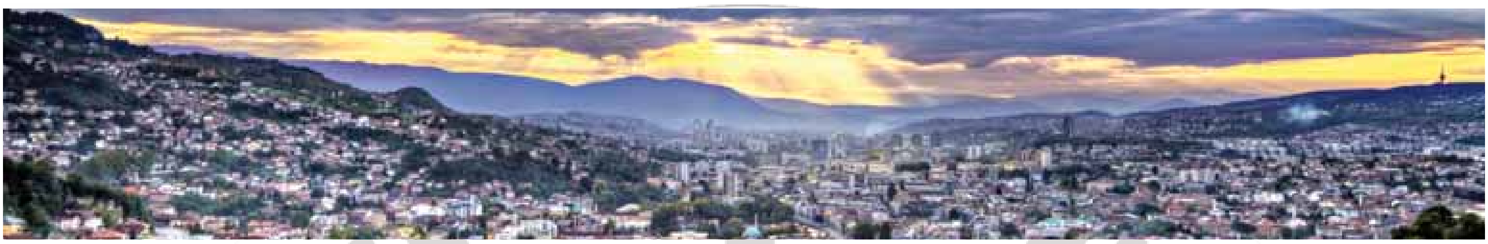
# What's happening Thursday, May 9

**For the most up-to-date schedule information, please download the MyEBRD19 app available from the Apple and Play store**



## 8.00am – 8.30am
**Networking breakfast**
Location: Congress Hall, Level 4, Swissotel

## 9.00am – 5.00pm
**CSO exhibition**: '*Connecting for Solutions*'
Location: Networking Area, Level 1

## 9.15am – 10.30am
Civil Society Programme: **Public procurement: open to businesses and local communities**
Moderator: **Milica Delevic**, Director, Governance & Political Affairs, EBRD
Speakers: **Karolis Granickas**, Senior program manager, Open Contracting Partnership
Location: Main Hall, Level 1, Hotel Holiday

## 9.30am – 11.00am
Host country outlook: **Bosnia and Herzegovina: invest in profitable projects**
Moderator: **Charlotte Ruhe**, Managing Director, Central & South Eastern Europe, EBRD
Keynote: **Suma Chakrabarti**, President, EBRD; **Denis Zvizdić**, Chairman, Council of Ministers of BiH
Speakers: **Edin Deljkic**, President, Bit Alliance; **Igor Gordic**, Representative, Olympic Centre Jahorina; **Almir Jazvin**, Member of Supervisory Board, Prevent Group; **Zdravko Markov**, Commercial Manager, Mljekara Livno; **Gordan Milinić**, Director, Foreign Investment Promotion Agency; **Branimir Muidž**, General Manager, Tvornica Cementa Kakanj-Heidelberg Cement; **Dino Osmanbegovic**, Advisor to the Management Board, MS&WOOD d.o.o.
Location: Great Hall, Level 1

## 11.00am – 12.00pm
EBRD/European Commission special event: **Promoting investment and improving living standards in the Western Balkans through European integration**
Moderator: **Tatjana Veselinović**, Producer/Presenter, N1 TV
Speakers: **Majlinda Bregu**, Secretary General, Regional Cooperation Council; **Christian Danielsson**, Director General, European Commission, DG NEAR; **Pierre Heilbronn,** Vice President, Policy & Partnerships, EBRD; **Zdravko Marić**, Minister of Finance, Ministry of Finance of the Republic of Croatia
Location: White Hall, Level 2

## 11.00am – 12.00pm
Special event: **The EBRD Literature Prize: Connecting the Western Balkans**
Location: Sala 101, Level 1

## 11.15 – 12.15pm
Country Investment Outlook: **Egypt**
Moderator: **Janet Heckman**, Managing Director SEMED, EBRD – Cairo
Speakers: **Heba Ali**, Managing Director, Egypt Ventures; **Joseph Boulos,** Vice-President, Farm Fresh; **Reham El Beltagy**, Vice President, Group Corporate Treasury, Orascom Construction Industries; **Malek Fawaz,** Advisor to the Minister of Investment & International Co-operation for Promotional Affairs; **Menatalla Sadek**, CEO, Hassan Allam Holding; Hesham Taha, Group Chairman, Mwasalat Misr
Location: Congress Hall, Level 4, Swissotel

## 12.00pm – 12.45pm
Panel: **Ready or not: mega trends shaping our future**
Moderator: **Jonathan Charles**, Managing Director, Communications, EBRD
Speakers: **Neil Buckley**, Chief Leader Writer, Financial Times Ltd; **Sergei Guriev**, Chief Economist, EBRD; **Tim Judah**, Reporter, *The Economist*/Fellow at IWM, Institute for Human Sciences; **Alexia Latortue**, Managing Director, Corporate Strategy, EBRD; **Kerrie Law**, Associate, Corporate Strategy, EBRD
Location: Blue Hall, Level 4

## 12.00pm – 1.00pm
Special event: **Launch of the new EBRD good governance policies**
Moderator: **Alistair Clark**. Managing Director, Environment & Sustainability, EBRD
Keynote: **Suma Chakrabarti**, President, EBRD
Speakers: **Sarah Hanes**, Principal, PCM, EBRD; **Anna Samolis**; Principal, Board and Institutional Affairs, EBRD, **Mikko Venermo**; Associated Director, Lead Adviser, Environment and Sustainability, EBRD
Location: Main Hall, Level 1, Hotel Holiday

## 12.00pm – 1.00pm
Country Investment Outlook: **Ukraine: staying on course**
Moderator: **Matteo Patrone**, Managing Director, Eastern Europe & Caucasus (EEC), EBRD – Kiev
Speakers: **Oksana Markarova**, Minister of Finance, Ministry of Finance of Ukraine **Katarina Mathernova**; Deputy Director General of DG NEAR, European Commission, DG NEAR; **Andrey Stavnitser**, Partner at SD Capital
Location: Great Hall, Level 1

## 1.00pm – 2.00pm
**Networking lunch**
Location: Marquee

## 2.00pm – 2.30pm
Special event: **Charitable donation by the EBRD Community Initiative with Dzenan Hakalovic**, Acting Head, United World College, Mostar
Location: Networking Area, Ground Floor

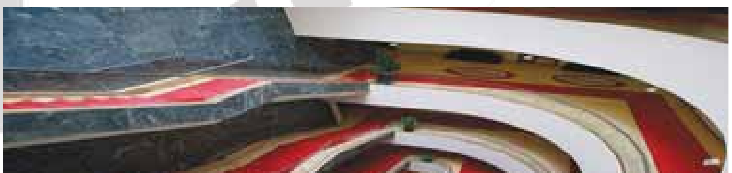
## 2.00pm – 3.00pm
Country Investment Outlook: **Uzbekistan**
Moderator: **Bruno Balvanera**, Managing Director, Central Asia, EBRD - Astana
Speakers: **Prakash Kejriwal**, Director, Indorama Corporation Pte Ltd **Giorgi Kvirikashvili**, International Advisor, EBRD – Tashkent; **Olga Ponkratova**, First Deputy CEO, Navoi Mining and Metallurgical Combinat (NMMC); **Sardor Umurzakov**, Minister of Investments and Foreign Trade of Uzbekistan
Location: Blue Hall, Level 4

## 2.00pm – 3.00pm
Panel: **United group session: The Potential of South-East Europe – An Investor's View**
Moderator: **Amir Zukic**, News Director, Adria News
Speakers: **Victoriya Boklag**; CEO and Vice President Marketing and Media, United Group; **Stelios Elia**, Managing Director, BC Partners Limited; **Zsuzsanna Hargitai**; Director, Regional Head of Western Balkans, EBRD – Belgrade; **Wolfango Piccoli**, Co-President, Political Risk Advisory, Teneo
Location: White Hall, Level 2

## 2.30pm – 4.00pm
Panel: **Migration in the EBRD region: turning a challenge into an opportunity**
Moderator: **Lyse Doucet**, Chief International Correspondent, BBC
Keynote: **Mehemed Bougsea**, CEO & Co-founder, Think-it
Speakers: **Sergei Guriev**, Chief Economist, EBRD; **Haris Memic**, Co-founder and CEO, Symphony Group; **Barbara Rambousek**, Director, Gender and Economic Inclusion, EBRD
Location: Great Hall, Level 1

## 2.30pm – 4.00pm
Special event: **EBRD's sustainability event**
Location: Congress Hall, Level 4, Swissotel
Moderator: **Jonathan Charles**, Managing Director, Communications, EBRD
Speakers: **Alistair Clark**, Managing Director, Environment & Sustainability, European Bank for Reconstruction and Development; **Sanda Midžić Kurtagić**: NCPC Program Director, Center for Energy and Resources CENER

## 4.00pm – 5.30pm
Special Networking Event: **EBRD Alumni**
Location: Sala 101, Level 1



*All events will take place in the Parliamentary Assembly Building unless otherwise noted

# EIB

*Continued from page 1*

maximise the EU's impact and influence."

It is perhaps the clearest sign yet that more than a decade after the eurozone debt crisis, and in the wake of the decision by Britain to be the first state to leave the union, the European project is finally regaining some of its power, influence and focus.

**POWER BLOC**

Sources said an overriding aim, at a time when the world was breaking up into competing and co-existing power blocs, was to "ensure the EU 'gets a credit' for its work outside the single market".

"The political importance of this new project for the EU is huge," the source said. "We don't want to make this part of what we already do, but ensure it is a separate lending

The new lender will be driven by a tacit need to direct EU lending into sustainable projects

institution with the autonomy to experiment with new financial tools and instruments in a way that is totally transparent.

"There was a big question mark over whether the fragmentation [of our non-EU lending] helped or hindered it and the sense was that it hinders. So it is a tidying-up exercise but one that, given the financial entities involved, can yield a very significant positive margin."

**SUSTAINABLE PROJECTS**

While it may be months before full details emerge, a picture is starting to form. The new lender will be driven by a tacit need to direct EU lending into sustainable projects, such as the €2bn Clean Oceans Initiative, launched in 2018 by the EIB in alliance with KfW and Agence Française de Developpement (AFD), the international lending arms of the German and French governments.

While it will be global in nature and scale, including projects in Asia and Latin America, the bulk of its lending will "in the first instance focus on Europe's neighbourhood and Africa," sources said. The first part of that sentence points to the uncertainty hanging over the future role of the UK in long-term European projects, including the EIB.

After the EBSD is launched, the near-term aim will be to ensure it works on projects with "as many multilateral development banks as possible" the sources said. They said it "wasn't clear yet if the new entity would be open to shareholding by" national development banks such as KfW, but "working more efficiently with those lending institutions" would be key to its future.

Despite intense French lobbying, the headquarters of the new lending institution is likely to be the Grand Duchy, not Paris. While no decision has been made yet, it would, sources said, be "very strange if the subsidiary was based anywhere else than Luxembourg".

# Russia to EBRD: talk or we walk

**By Mariam Meskin**

Russia yesterday (Wednesday) issued a veiled threat to walk away from the EBRD five years after its shareholders agreed to cease funding for new projects in the country.

Sergey Verkashanskiy, board director for Russia at the EBRD told *GlobalMarkets*: "We will start thinking about going elsewhere, including other regions closely interconnected with the existing geographical scope of the EBRD. This may well imply Africa."

Talks between the EBRD and Russia have yet to lead to any reconciliation. As the EBRD plans to expand into sub-Saharan Africa and Russia weighs up alternative potential avenues of engagement, there is growing pressure for both parties to come to an agreement.

Although Russian capital markets have been forced to develop independence in the absence of international funding, a resumption of international capital inflow would stimulate growth for the isolated economy.

Russian growth is expected to slow in 2019, reversing a short-lived period of economic recovery that had developed since US and EU sanctions were applied in 2014. Growth in Russia in 2018 rose to 2.3% — the highest level since 2013. But the EBRD expects growth to decline to 1.5% in 2019.

Sergei Guriev, chief economist at the EBRD, said: "In today's world, no economy can exist in isolation. Russia depends on global markets, foreign investment and exports. If interaction with global capital markets and technology is cut off, then of course an economy cannot grow."

**FILLING THE VOID**

In 2013, the EBRD was investing €1.82bn in Russia, in what was its largest country of operations. By 2015, a year after Russia's annexation of Crimea, that figure dropped to €106m, and by 2016, to zero. Russia's existing portfolio in Russia is €1.92bn including undisbursed commitments.

But Russia is not short of interest from other supranationals that are willing to fill the void left. Dmitry Pankin, president of the Black Sea Trade and Development Bank said: "For us, the EBRD took a political decision not to work in Russia. [This was a] huge opportunity for us because there [are] a lot of very good projects, especially in PPP [public-private partnership]. Previously, the EBRD was financing these projects. Our strategy is to grow the share [of Russian lending on our balance sheet]."


Pankin: our strategy is to grow

While its activity in Russia has diminished, the EBRD has continued its expansion past Europe. This year, Egypt will be the EBRD's largest country of operation, a perhaps unconventional dynamic for a bank built on the principles of European, post-Soviet reconstruction.

Verkashanskiy said: "Since 2014, the EBRD has tried to replace Russia with Turkey and other countries. By curtailing spending and activities in Russia, the EBRD has lost a chunk of its DNA, history, substance and place. The EBRD cannot embark on a major new adventure in Africa without having its legacy in Russia sorted out."

But there remains a deep underlying desire among Russian officials to repair relations with EBRD and restart borrowing. Referring to potential reconciliation between the EBRD and Russia, Verkashanskiy said: "The EBRD should relaunch its line of business with Russia, and forget about the past. This would bring results for the bank and Russia."

# CEE 'behind the curve' on green bonds

*continued from page 1*

Charlotte Ruhe, managing director for central and south eastern Europe at the EBRD, said: "I don't agree with some others that these developing countries are 'just focused on growing their economies' and therefore not on green — I just think they are behind the curve. But they will get there."

The EU's 2030 climate and energy framework aims to reduce greenhouse gas emissions by at least 40% below 1990 levels, while also increasing energy efficiency and the use of renewable energy.

This is expected to increase financing requirements of member states in order to fund sustainable projects. "This is where the green bond comes into play", said Andrea Diamanti, head of CEE corporate and investment banking and private banking at UniCredit in a panel at the EBRD annual meeting.

The region is lagging behind its emerging market peers, having issued only 40% as much as Latin America or southeast Asia. But some people are confident that the CEE region is on its way to fuller participation in the sustainable and responsible investment (SRI) bond market.

"While CEE issuance is still behind the rest of Europe, the discussions are happening, which is good to see. I'm confident that at least two more countries will issue green bonds by the end of 2020," said Marko Vukadinovic, head of CEE FIG at UniCredit in the same panel.

**NEED FOR CLEAR PRINCIPLES**

But there are several obstacles that need to be addressed before CEE borrowers can fully embrace the green bond market. Ruhe said: "One of the key things restricting green bond issuance is how 'taxonomy' is defined. There is some work underway on that now in the European parliament. When rules around how we can define certain principles are clearer for market participants, this will facilitate more green bonds."

"The second thing restricting growth is size. In the Baltics in particular, we're working on a pan-Baltic framework. These countries and their banks are not large — combined they have the market size of Slovakia. So, banks can only issue a green bond if they aggregate and get the attention of bigger institutional investors."

But despite the challenges, more interest is being seen in green bond issuance in the region than in previous years. In 2018 and 2019 so far, the Polish and Lithuanian sovereigns, Lietuvos Energija and the Slovene Export and Development Bank have all issued green bonds.

Vilius Šapoka, minister of finance for Lithuania says: "We are not going to stop. I do believe that in the nearest future, consumers, investors, institutional investors will put far more pressure on seeking for sustainability goals."

Some bankers are of the opinion that emerging market sovereigns and corporates do not issue green bonds in abundance as they are not as financially solid as their developed counterparts in the West.

Although the issuance outlook remains challenged, market spectators are hopeful that green bond issuance will grow as both borrowers and investors see the business and environmental appeal of these products.