

Global Markets

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Frustrated Russia blasts EBRD for funding ban

Exclusive

By Virginia Furness

The European Bank of Reconstruction and Development's decision to close five offices in Russia last week has dealt a potentially fatal blow to relations with its founding partner, Denis Morozov, Russia representative at the EBRD told *GlobalMarkets*. He said it was evidence the bank is not living up to its founding principles as a multilateral development institution.

"The EBRD is an agent of good change," he said. "If the EBRD shareholders want to see some more positive developments in Russia — private sector development, creation of a middle class, greater transparency, support for SMEs — blocking all activity of this kind in Russia is a crazy decision."

The offices closed by the EBRD last week in Ekaterinburg, Krasnoyarsk, Rostov, Vladivostok and Samara were focussed on the EBRD's Advice for Small Business Programme.



Morozov: 'crazy decision'

He believes the office closures also hint at a full exit from the country and says that even if the

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Countries must feel 'ownership' when using European Monetary Fund

By Owen Sanderson



A new financing line being touted to cover short-term economic pain in Europe needs to be marketed diplomatically to borrowing country populations, a leading eurozone politician has said.

Ricardo Mourinho Félix, Portugal's secretary of state for finance, argued for the creation of a financial instrument via a new European

Mourinho Félix: 'never a politically easy time'

Continued on page 3

Politicians rally round globalist standard as US shuns multilateral legacy

By Elliot Wilson

Political leaders and development bank chiefs are urging each other not to fall out of love with globalism and multilateralism, even as the US under president Donald Trump steps back from world affairs.

Since his election last year, Trump has rebuffed World Bank requests for extra funding, removed the US from the Trans-Pacific Partnership, a multilateral trade deal and questioned its commitment to Nafta.

Senior politicians and development bank officials fretted loudly

at this week's meetings — in public and private — that the US can no longer be relied to act as the world's policeman and funder of last resort. "There is some kind of tiredness about having to support other countries," said Takehiko Nakao, president of the Asian Development Bank. "America seems be fatigued about playing such an important role."

"It is a concern," said Philipines finance minister Carlos Dominguez. "The Trump administration talks about looking inward not outward. It should be

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Jin: China needs to play bigger role



FINAL WORD

Humberto de la Calle

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Linking People and Economies for Inclusive Development

The Asian growth miracle continues to unfold. Over the past two decades, developing Asian economies grew 6.8% yearly, faster than any other region. Yet 330 million people still live in absolute poverty, and inequality continues to rise in many economies.

For Asia and the Pacific to continue growing steadily, its economies need to work together so that more people can benefit from the region's economic gains. Cross-border collaboration and cooperation, whether in infrastructure development, financing, or knowledge sharing, will further increase the region's strength and resilience that will allow it to reach its full potential.

How and where should these links be established to pave the way toward inclusive, sustainable development?

On 3-6 May 2018, more than 3,000 people representing governments, private sector, development partners, civil society organizations, and media will gather at the Asian Development Bank's 51st Annual Meeting of the Board of Governors in Manila, Philippines. Together, they will discuss the way forward for the Asia and Pacific region as they explore solutions under the theme "Linking People and Economies for Inclusive Development."

To find out more, visit www.adb.org/annual-meeting/2018



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Politicians

Continued from page 1

'everyone together', not a combative 'them-and-us', but the US seems more interested in their own interests now."

America-philes still hope that the US under Trump will keep some ties with the outside world. European Investment Bank president Werner Hoyer said he "still believed in the wonderful heritage of the US", and in particular of America's ability to coin phrases such as "win-win" that conjured up a sense of co-operation in a troubled world.

Hoyer fretted that without the US, the concept of the West was doomed "to die". But he and others cling to the belief the US will return to the world stage, and that in the interim, other sovereign voices can fill the void.

"Our political leaders in Europe will do everything to ensure that co-operative structures and the basics of multilateralism are preserved," he said. "Europe must be at the vanguard when it comes to multilateralism. Multinational development banks must co-operate better, develop more projects together, create win-win synergies."

CHINA'S CLARION CALL

The other voice calling for a fresh approach to international development in a multipolar world is China. It sent a small army of development bank officials, politicians and civil servants to this year's meeting.

Shi Yaobin, China's deputy finance minister, urged nation states to "strengthen international co-operation", noting that "no one country alone can solve all the problems we are facing now".

Jin Liqun, chairman of the Beijing-based Asian Infrastructure Investment Bank, said it was inevitable countries like his contributed more to global trade. "Over the past 70 years, the world has benefited from valued US support," he told *GlobalMarkets*. "But as time moves on you need more help from donors, supporters and contributors to benefit the whole world. China needs to play a bigger role in international and financial areas."

And many hope this is just a blip — that the US's relative withdrawal from the world will prove temporary. "Is it really responsible for America to truly withdraw from multilateralism?" asked Jin. "Given the scale of the US economy, I wonder if it is possible for the US to truly remove itself from multilateral co-operation."

Europe sounds warning on cryptocurrencies as EMs rush to digital payments

By Katie Llanos-Small, Owen Sanderson, Olly West

Officials globally are downbeat on the role of cryptocurrencies, but hope that digital payments will take off — especially in the emerging markets.

"I have my doubts about cryptocurrencies, in a world where there's so much focus on tracking all transactions to provide security in terms of anti-terrorism, anti-money laundering and tax evasion," Frédéric Oudéa, Société Générale chief executive, said.

"I don't believe in the future of systems which provide as a main advantage the anonymity of individual transactions. And for government, the sovereignty of their control of the currency is very important."

Bundesbank executive board member Andreas Dombret also questioned the relevance of such assets.

"Cryptocurrencies are an interesting phenomenon, but in terms of economic significance of minor importance," he told *GlobalMarkets*. "They currently mainly serve as speculative investment playing almost no role as a means of payment."

But as caution continues to reign over digital currencies per se, officials — especially those in emerging markets — are keen to see an end to a cash-based economy.

Financial inclusion has leaped from 26% to 75% of the Kenyan population in a decade thanks to mobile payments services such as M-Pesa. "Fintech is not just

for people at the top, it's for everybody," Patrick Njoroge, governor of the Central Bank of Kenya, told *GlobalMarkets*. "The next step for fintech is expanding usage and expanding services," he added, pointing to a new digital savings product the government is launching.

'STILL LEARNING'

In Chile, around half the population has signed up for simplified online accounts since state-owned lender BancoEstado allowed people to do so with just their national ID number a few years ago, said central bank governor Mario Marcel. Additionally, new regulations open the way for non-account payments, he said.

"If you put the two things together, I think in the very near future we'll have a well-developed and stable system of digital transfers and payments that can cover basically all of the population," said Marcel.

The bank is also hoping that the financial services sector can speed up clearing and transfer architecture. "There are some promising developments with distributed ledger, blockchains, that over time may replace the financial infrastructures that deal with payments, settlements, clearing of transactions, that today involve a number of actors in the process of transfer or settlement, a certain cost and a certain risk," said Marcel.

But the path ahead for the central bank is not clear, Marcel added. The authority is working on a five-year strategy in



Echavarría: fintech can change the world

which "tech takes a very central role", and said that the bank is considering joining the R3 consortium, a software firm working with banks and regulators globally to develop a distributed ledger platform for financial services, to learn more about the uses of blockchain.

Juan José Echavarría, governor of Colombia's central bank, also championed the role of new technology in the financial system, saying that cutting the cost of lending transactions can "change the world".

"If we want to avoid cash and to restrict cash, we need a new infrastructure. We need banks allowing that. We need to reduce tariffs for that. What you cannot do is prohibit cash with no alternatives."

But Echavarría admits that the central bank is "still learning" when it comes to new technology to facilitate a cashless economy. "We have all these issues that nobody knows very well," he said. "You know they are important, you know they are there, but you don't know how to handle them."

EU

Continued from page 1

Monetary Fund, to mitigate the short term pain during tough labour market or public policy changes.

But it was crucial to avoid these measures looking like they were imposed from the outside, he said.

Mourinho Félix said it was important to consider how EU countries could be encouraged to take structural reform measures during good economic times. "Countries must be able to take ownership of how the credit line is to be used," said Mourinho Félix. "It cannot look like the financial assistance programme — it cannot look like the European Commission coming in and saying 'do this' and 'do that'. This was a major failure in the Greek programme...the European Stability Mechanism should be prominent, but coun-

tries themselves must be the owners."

The comments come after the eurozone finance ministers' committee, known as the Eurogroup, met last week and put the idea of a European Monetary Fund, based around an expanded European Stability Mechanism, firmly back on the table.

"It's much cleverer to implement structural reforms when things are going well," said Mourinho Félix. "But it's still difficult. If everything is going well, people say 'why change?', and if you try in a crisis, people say that you can't implement reforms and hurt living standards. So there's never a politically easy time."

IMF managing director Christine Lagarde said on Friday that the improving global economy offered "a major opportunity to secure the recovery and to expand it to those who are not yet benefiting, and to include those who are excluded or are at the risk of being excluded... Our analysis of struc-

tural reforms over economic cycles shows that labour and product market reforms are more potent during economic upswings."

There is broad consensus in Europe that the ESM should be expanded, but the idea of a credit line to ease the pain of structural reforms has only been discussed behind closed doors.

Other ideas for expanding ESM include using it to backstop the Single Resolution Fund, the bank resolution vehicle which Europe's banks are gradually paying into, and, more controversially, using ESM to back a European Deposit Insurance Scheme, which would backstop national deposit insurance.

ESM is likely to gain a much bigger role in setting the conditionality for any future financial assistance to European countries. In the last round of financial assistance, the ESM largely focused on raising the funds, with the Commission, Eurogroup and the IMF setting conditions.

OUT OF THE WOODS

Seen and heard in the corridors of the Annual Meetings

• **/Dazed and confused** Global multilaterals once had such a simple life: lending money, recouping it, clocking off for the day. But development banks are having to learn new skills that leave them dizzy and out of breath. One finance minister said he felt plain sorry for them. "It isn't easy to get nimble," he sighed. "If you have size 12 feet, you're never going to be good at ballet."

• **/Fade away to grey** But things could be worse for multilaterals. A former development bank official compared life at the World Bank to 'greyscale', a disease conjured up by the mind of Game of Thrones author George RR Martin, which turns victims' skin to stone. "The last symptom of greyscale is total madness," the official said knowingly. Cripes!

• **/Yoda yadda** Pacing around the World Bank headquarters in search of a coffee and a friendly face, *OOTW* spied a piece of A3 paper stapled to a partition wall, bearing the legend: 'Enter You Shall Not'. It left us wondering if the bank had employed Grand Jedi Master Yoda to do all its literature. Good money to hear his speeches we would pay.

• **/Fan club** Grenada prime minister Keith Mitchell was a star turn at a meeting of Caribbean leaders. The former West Indian cricketer said recent extreme weather events presented a chance to push through reforms. "A crisis is a terrible thing to waste" he boomed, prompting several "Amen!" from the crowd, plus one "You tell 'em!"

• **/Call to order** BBC reporter Lerato Mbele sought to rouse a sleepy debate by encouraging delegates to engage with the panel. But it went too far when World Bank economist Albert Zeufa praised Nigeria and South Africa for exiting recession, and Mbele willed the audience to whoop and clap. Zeufa stopped them cold, snapping that sub-1% growth was "nothing to cheer about". Quite.

• **/Oh, the humanity** Earlier this week, delegates at a panel on frontier markets were left bemused at the choice of background music: 'Jive Talkin' by the Bee Gees. But yesterday the IMF's in-house DJ was at it again, playing Rihanna's SOS at a panel on political risk in emerging markets. The lyrics? This time please someone come and rescue me/I second guess my sanity.

• **/Green neighbours** These meetings are a great chance for sovereign borrowers to explain why investors should stuff themselves silly with bonds. One nation doing a spot of IR is Ireland, whose funding officials found that their suite at the Dupont Circle hotel was located next to *GlobalMarkets'* journalistic war room. Of course, they found us so charming, they mandated us for their next sovereign bond. We are advising a green bond denominated in good old pound sterling!

African countries hope growth will prevent China repayment problems down the track

By Jackie Horne, Thierry Ogier and Lucien Chauvin

African countries are moving full steam ahead to develop their economies through Chinese-funded railway infrastructure, hoping faster growth will forestall concerns about the costs and their ability to pay it back.

One of the continent's most contentious projects is a 472km standard gauge railway (SGR) line between the Kenyan port of Mombasa and capital Nairobi, the country's biggest infrastructure project since independence. China funded 90% of the \$3.8bn construction as part of its Belt and Road Initiative.

However, a 2013 World Bank study concluded there was "no economic or financial case" for building a new railway and advocated upgrading the existing line.

There have also been questions why it allegedly cost

four times more than the original estimate and how one Chinese company got the contract without competitive bidding, or public oversight of the procurement process.

As a result, government debt to GDP has climbed 16.2 percentage points to 59.7% in five years.

However, Patrick Ngugi Njoroge, governor of the central bank of Kenya, believes that critics have missed the point, citing the problems Winston Churchill had getting the railway line he coined the "Lunatic Express" approved by Britain's parliament over 120 years ago.

"The SGR's impact on export competitiveness will be huge," he said. "We have a very dynamic private sector and they'll grab the opportunity.

"All the experts miss the point that if growth picks up, the debt won't be a concern," he added. "They also haven't

factored in how much it costs repairing the Mombasa to Nairobi road every two years because of truck damage."

The SGR's second section is now being built from Nairobi to the Ethiopian capital of Addis Ababa, which supporters say will also link landlocked neighbouring countries including South Sudan, Uganda and Rwanda to the sea.

China has also funded and built a 750km railway between Addis Ababa to its Djibouti seaport at a cost of \$3.4bn. It has cut the journey from days to just 10 hours.

Abraham Tekeste, Ethiopia's minister of finance and economic development, told *GlobalMarkets* the loans carry concessional and commercial rates, but declined to give a more detailed breakdown.

But he remains confident Ethiopia can afford it. "We're using the money for bankable



Njoroge: if growth accelerates debt won't be a concern

projects, which will generate adequate returns to repay our debt," he said.

Malawi's finance minister, Goodall Gondwe, puts forward a similar argument for his country, which he hopes will benefit from a \$2.3bn Chinese funded railway linking neighbouring Zambia to its border. "We're now getting quite a lot of Chinese support," he said. "This is very helpful since we've a great deal of demand for infrastructure."

Trump's Iran nuclear decision triggers market shockwaves

By Rashmi Kumar

US president Donald Trump's refusal to certify that Iran is compliant with the 2015 nuclear accord will have wide ramifications on everything from global commodities to the US's already fraught relationship with North Korea, analysts warned on Saturday.

Although the US officially remains part of the landmark 2015 Joint Comprehensive Plan of Action, Trump did not confirm that Iran was compliant with the agreement. This now throws open the possibility of sanctions against Iran, a decision the US congress must make within 60 days, setting the stage for an "entirely unpredictable result", Jonathan Lemco, principal and senior analyst at Vanguard Group, told *GlobalMarkets*.

Trump's move comes even as many of the US's allies — and even many in the president's administration — have said that Iran, led by moder-

ate president Hassan Rouhani, is in technical compliance with the deal.

His decision opens a can of worms as the US simultaneously deals with another nuclear threat, from North Korea. "The North Korea story is a very important one to watch because the US decision on Iran can have a proliferation impact," Helima Croft, global head of commodity strategy at RBC Capital Markets, told *GlobalMarkets*.

"That's why many Republicans were uncomfortable getting out of the Iranian deal. With this decision from the US, how do you negotiate with a country like North Korea? How will you pressure them to give up their nuclear weapons if the US did not certify Iran's nuclear agreement?"

NORTH KOREA THREAT

North Korean leader Kim Jong Un and the US have exchanged

heated words in recent months with the former threatening an outright attack and testing missiles.

Trump's stance on Iran, which has effectively paved the way for the US to kill the nuclear agreement, is less about the details of the accord and more about taking a stab at Iran's foreign policy stance, reckons Lemco.

Whatever the rationale, the consequences will be significant, especially as many European countries have hit back at Trump's take. While a trade war between the US and Europe over Iran is rather unlikely, Iran is trying to play that card, said Croft.

"At a minimum these sanctions will likely impose strains in US-EU relations as the White House is intent on trying to force foreign corporates to choose between doing business with the US and Iran."

Experts also warned about



Uncertain trajectory: Iran's Rouhani

the possible effect on the commodities market, particularly oil. Asian economies such as India and South Korea are among Iran's biggest crude oil buyers, meaning potential US sanctions on Iran could increase demand from other producers.

Blaise Antin, managing director, sovereign group head, at asset manager TCW, said: "Once the US signs on to something it sticks to it. But what we are seeing now is uncharted waters with the US. That affects the behaviour of everyone from North Korea to others doing business every day."

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Success is a journey

LatAm rushes to launch Cat bond as countries brace for earthquakes

By Katie Llanos-Small

Peru wants to move ahead with a pan-regional catastrophe bond “as soon as possible” as it braces for a big earthquake, the country’s finance minister said yesterday.

Finance ministers from the Pacific Alliance — Chile, Colombia, Mexico and Peru — met yesterday to discuss an instrument that would provide emergency funds in the case of a large quake in one of the four countries.

“Three of the four Pacific Alliance countries have suffered from very big earthquakes and in Peru the topic is in the news every day,” Claudia Cooper told *GlobalMarkets*. “We have to develop a very strong strategy on how we will deal if there is a very big earthquake, especially in Lima, where most of the population is.”

While the topic of a Pacific Alliance Cat bond has been on the radar for some time, Cooper, who took over as finance minister in Peru just last month, is push-

ing to speed up the process.

“We want a very simple decision-making variable so that we can issue the bond as soon as possible. We don’t want to wait another year to make it a reality, we want it as soon as possible.”

Peru hopes to have the Cat bond in place by early next year, she said. The instrument will have a similar format to one issued by the World Bank in August on behalf of Mexico.

The North American country paid 412bp over six-month Libor for the three year bond that offered protection against a quake measuring 7.9 or higher on the Richter scale. It is in line for a \$150m payout after an 8.1-scale earthquake in the south of the country last month triggered the bond.

The World Bank-backed pan-Pacific Alliance catastrophe bond could exploit economies of scale for the four countries, which all face earthquake risks, Cooper said. A key point of discussion ahead of issuing the bond will be the trigger event — the lower the Richter scale reading,



Cooper: must develop strategy

the higher the bond’s coupons.

For Mexico, catastrophe bonds are part of a package that includes traditional insurance and excess loss protection, José Antonio Meade, the country’s finance minister, told *GlobalMarkets*.

In Peru’s case, a Cat bond would offer insurance in addition to contingent lines and savings, Cooper said. “We have contingent lines and we have saved some money but we need insurance so that we have a combined strategy of insurance, contingent lines and savings.”

Neighbours claim immunity from late-paying Venezuela

By Katie Llanos-Small, Lucien Chauvin and Olly West

Neighbours of debt-laden Venezuela insisted yesterday they were economically insulated from its default or political collapse as investors keep a close eye on the country.

Venezuela’s increasing regional isolation means the contagion effect of a default would be limited, Claudia Cooper, Peru’s finance minister, told *GlobalMarkets*. “Our economy is not that heavily related with Venezuela,” she said.

“Our interaction has been reduced in the past 10 years. We don’t have much commerce. So we don’t need a contingency plan. We don’t own Venezuelan debt.”

Colombia’s central bank governor Juan José Echavarría said the institution had no contingency plan for a worsening situation in Venezuela. “I don’t think many people have contingency plans very well designed, particularly because it was a club of friends,” he said. “Maybe contingency plans will have to be designed.”

Mario Guillén, Bolivia’s finance minister, said the implications of a default or regime change would be more political than economic. Bolivia and Venezuela, along with Ecuador, are part of a diminishing block of left-wing countries in Latin America known as ALBA. Bolivia does not have significant trade with Venezuela to make it a point of concern, he said.

“More than a trade issue, it would affect us from an ideological point of view, because we see that Venezuela has exhibited leadership. A change in administration in Venezuela would leave us virtually alone in the region.”

The comments come ahead of elections on state governors in Venezuela today, and as the Caa3/CCC-/CC rated sovereign increasingly struggles to meet international obligations.

Coupon payments on two Venezuelan sovereign bonds, two PDVSA bonds and one Electricidad de Caracas bond that were due to be paid this week remained outstanding yesterday, according to Caracas Capital Markets. The country, which is desperately short of foreign exchange, may still pay within the 30-day grace period, said Russ Dallen, head of the boutique investment bank. “It’s possibly a strategy where they’re saving up all their pennies,” he said.

Analysts said it was not clear that Nicolás Maduro’s administration would collapse if the sovereign defaulted on its international debt.

Lebanese CB calls on world to do more to overcome refugee burden

By Olly West

Lebanon’s central bank governor has lambasted rich countries for failing to do enough to help the Middle Eastern countries that have received most refugees from the war in Syria.

Riad Salamé, governor of Banque du Liban since 1993, told *GlobalMarkets* that although multilateral development banks “treated Lebanon well”, governments needed to do more to ease the burden of more than a million Syrian refugees who are in Lebanon.

In Lebanon one in five people are refugees, the UN High Commissioner for Refugees said on October 8. In Jordan — to where over 650,000 Syrians have fled — one in 15 are refugees.

“The international community is not doing enough,” said Salamé. “On the contrary, we feel that there is fatigue from the countries that were really supporting the refugees.

“They [the international community] need to get involved, because they are asking host countries to look after these people to avoid them emigrating to Europe or the US.”

France’s president, Emmanuel Macron,

has promised Lebanese president Michel Aoun he will organise a donor conference to encourage investment in Lebanon, but the sheer scale of the refugee burden means Salamé fears not enough is being done.

The direct budgetary cost of the presence of Syrian refugees in Lebanon is around \$1bn, which is creating more of a fiscal deficit than the country can afford, says Salamé.

However, including the opportunity cost from lower growth caused by the influx, Salamé puts the cost of the Syrian war for the Lebanese economy at \$15bn over the last five years.

IMF SUPPORTS PLEA

This week the IMF reiterated the importance of more support for the countries in the region that had received most refugees. “It is crucial that the international community pursues its assistance both to Lebanon and Jordan as well as the refugee community in order to lift some of the burden on those countries,” Jizad Azour, director of the fund’s Middle East and Central Asia department, told *GlobalMarkets*.

GDP growth is expected to remain subdued in these two countries. Jor-



Salamé: rich countries seem ‘fatigued’

dan’s economy will expand just 2.3% in 2017 and 2.5% next year, the IMF predicted in this week’s World Economic Outlook, while Lebanon will see growth of just 1.5% this year and 2% in 2018.

Lebanon’s central bank puts the growth estimate higher — at 2.5% this year — while the World Bank has it at 2%. “We do not have the support that Lebanon deserves because it is a small, highly-indebted country and we cannot be left to solve this huge problem by ourselves,” said Salamé.

The Lebanese government is hoping to raise around \$1.5bn of concessional financing per year for a 10 year infrastructure plan including transport, power and water projects.



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Election season threatens new wave of political unrest in LatAm

By Thierry Ogier

Heightened political risk in several emerging market countries may become an obstacle to economic reforms in the coming months. Latin America is a good example where a daunting list of elections may lead to increased tensions and volatility, with uncertain consequences on the markets.

Venezuelans kick off a long election season today to renew the country's 23 governors amid a mounting political and humanitarian crisis. This will be followed by legislative elections a week later in Argentina, where President Macri's orthodox policies will be challenged by the opposition. "There is a risk that he loses seats to left-wing parties — including ex-president Cristina Kirchner's new party. That could lead to fiscal slippage, a rise in bond yields and a further drop in the currency. A heavy defeat could trigger a renewed crisis," said Edward Glossop, economist at Capital Economics, a consultancy.

Then as many as four presidential elections are being scheduled within a year, including in Brazil and Mexico, the region's largest economies, as well as Chile and Colombia.

"Mexico is a case in point where the anti-establishment candidate [Andres Manuel Lopez Obrador] is leading the opinion polls. In Brazil as well, but the candidate [former president Lula] may not be allowed to run," said Mario Mesquita, chief economist at Itaú, a Brazilian bank.

"We are being fairly constructive on three of these countries, and the fourth one, which is Mexico, could also go that way," said Blaise Antin, head of sovereign research at TCW.

"But Mexico is the one that has the most uncertainties. Anyone investing in Mexico today has to be obviously concerned about how the Nafta talks evolve and about the outcome of the July 2018 presidential election," he said.

In Brazil, policy continuity will also be at stake in October 2018, two years after the impeachment of Dilma Rousseff. The government of Michel Temer has since implemented orthodox policies that have managed to pull the country out of recession, but the future remains unclear as the government does not yet seem to have a popular candidate to champion such policies.

"Uncertainty will have an economic impact. It's hard to predict the electoral outcome, but reforms need to proceed," said Krishna Srinivasan, deputy director of the IMF's Western hemisphere department.

South Africa central banker warns on political wrangling

By Olly West

Political uncertainty in South Africa needs to be resolved as quickly as possible, the country's central bank governor has told *GlobalMarkets*.

"Political uncertainty is impacting South Africa's ability to deal with the structural reforms we're faced with," said Lesetja Kganyago, governor of the South African Reserve Bank. "This means we are unable to lift the potential growth rate, which puts pressure on monetary and fiscal policy."

His comments came as finance minister Malusi Gigaba said the country faced a "difficult balancing act" when he announced his first medium term budget policy statement on October 25 amid concerns in some quarters that the government might take a populist turn.

Gigaba was bullish on the economy, but Kganyago said the balance of risks to the growth outlook was on the downside. Both SARB and the World Bank are forecasting GDP growth of 0.6% for 2017.

Gigaba told *GlobalMarkets* that South Africa had to be "steadfast" in maintain-

ing its fiscal framework and implementing structural reforms, but admitted it was no easy task.

"We need to take decisions that will not let our spending patterns spiral out of control and raise our debt ratios, but at the same time we need to take decisions that will assist us to generate revenues and create confidence," said Gigaba.

David Hedley, chief economist for sub-Saharan Africa at the Institute of International Finance (IIF), told *GlobalMarkets* that the budget would be closely watched to see if Gigaba would move in a populist direction.

CREDIT RATING RISK

Moody's, the last rating agency to keep South Africa at investment grade, said last month that rising poverty and unemployment raised spending pressures, and challenged fiscal consolidation and reform commitment.

Although Gigaba said that raising growth was the "most urgent" priority for South Africa, he made it clear that maintaining the existing credit ratings of



Gigaba: difficult balancing act

Baa3/BB+/BB+ was of crucial importance.

"If we were to lose [the investment-grade rating] by Moody's it would severely impact the cost of borrowing, would make it difficult to finance infrastructure, and more expensive to take debt and balance the fiscal framework," he said. "Going forward, we would risk rising inflation and an inability to meet our budget priorities."

Moody's has the Baa3 rating on negative outlook and is due to make a decision on the rating before year-end. The minister promised that the budget would "send the right message" to rating agencies and markets regarding the government's credibility and fiscal commitment.

Rate hikes could hit indebted Asian banks — IMF

By Rashmi Kumar

Rapid increases in private sector debt across Asia could leave some countries vulnerable as interest rates return to more normal levels, Changyong Rhee, director in the Asia and Pacific department at the International Monetary Fund, has warned.

Credit growth has been seen not only in China but also in many other Asian developing and frontier economies. But while public sector debt in the region — with some exceptions — have remained stable, corporate and household debt have jumped sharply.

"That means that when normalisation happens, it can have a negative impact in domestic investment and consumption," Rhee told *GlobalMarkets*. "We're not expecting another round of crisis in Asia in the near term as it is much more resilient, but in many countries, the banks' balance sheet is not sufficient and they need more capital."

"Together with that, what we are worried about is that normalisation can have some negative impact on growth

prospects in Asia, because of tightening interest rates. Countries which have large debts and weak balance sheets will be most affected," he added.

The US Federal Reserve's slow but steady interest rate hike trajectory is not the only cause of concern. Closer to home, some are also looking at Japan. Although Japan has not explicitly announced a normalisation strategy, Bank of Japan's annualised net purchases of government bonds have declined from ¥82.8tr in July 2016 to ¥63.4tr in September 2017, according to the central bank.

Tightening monetary policies can certainly wreak havoc on capital inflows into Asia. But for some Southeast Asian economies, the fear of a slowdown in foreign direct investment is more acute.

INVESTORS UNPERTURBED

"Rising rates might affect our region, particularly in terms of movement of capital," Vathana Dalaloy, deputy government of the Laos central bank, told



Rhee: banks will need more capital

GlobalMarkets. "But because of the degree of development in the financial sector, we do not expect it to significantly affect Laos. However, in terms of foreign direct investment, that might be something we will focus on."

Laos is already taking steps to encourage FDI, by streamlining the process of foreign investment and implementing a new foreign investment law earlier this year, she added.

The IMF said in its regional Asia Pacific outlook update this week that low interest rates could exacerbate financial risks in countries such as Vietnam and the Philippines, where inflation is low but credit growth has been very high.

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India mulls recap bonds to tackle banks' capital shortfall

By Rashmi Kumar

The idea of issuing recapitalisation bonds is rearing its head in India, more than two decades after the country first sold such notes, as the authorities look for solutions to fix the capital shortfall problems ailing state-owned banks.

India is facing a triple threat in the form of a stressed banking sector, rising leverage among corporates and challenges to the public financial system. But at least on the first issue, it appears to be nearing a solution.

"India last sold recapitalisation bonds in 1995, but it is now being seriously considered by the government to boost capital among state-owned banks," Rajnish Kumar, the new chairman of State Bank of India, the south Asian country's largest bank, told *GlobalMarkets*.

Recapitalisation bonds certainly make sense. India's

banks are flush with liquidity, receiving an additional fillip recently from the government's landmark demonetisation drive. On the flip side, demand for credit is very low, resulting in banks finding other avenues to use their money, including by pumping funds into the debt market.

Marrying the two through recapitalisation bonds is a win-win for both the government and the beleaguered public sector banks, which are facing a capital shortfall of as much as \$14bn. The government will effectively sell the bonds to the banks, and use the proceeds to inject equity capital into the banks. This means the notes are not reflected in the government's balance sheet, thereby not raising its fiscal deficit — an appeal for the country.

Kumar added that if recapitalisation bonds became a

reality, the government should rake in the necessary proceeds in one go, rather than as a piecemeal process.

NO FREE LUNCH

But an economist at the Indian arm of an international ratings agency reckons the move reeks of desperation. "It's not a free lunch situation," he told *GlobalMarkets*. "In the end, the risk remains within the system. It will just look good on the government's part because the banking system looks like it has improved."

India has been struggling to revitalise its banking industry, which has clearly had an impact on its growth. On Friday the IMF revised India's growth forecast for the 2017 financial year down to 6.7% and to 7.4% in FY2018 — a direct result of structural weaknesses in the corporate and banking sectors.



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Kumar: proceeds for the state

However, the broad expectation is that growth will pick up soon enough.

"The favourable outlook for Asia, including India, provides an important opportunity to push for reforms," Kenneth Kang, deputy director, Asia and Pacific department at the IMF, said. "[India should] address the corporate and banking sector weaknesses by accelerating the resolution of non-performing loans, rebuilding capital buffers for public sector banks and enhancing banks' debt recovery mechanisms."

West Africa financial crime cops lack cash to hit terror funding

By Olivier Holmey

One of the main organisations fighting financial crime on the African continent is focusing on targeting terrorist groups such as Boko Haram, which have gained access to vast amounts of funding.

However the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA) said enforcers often lacked the funds to properly tackle the challenges at hand.

Jeffery Isima, the group's principal officer of research and planning, said GIABA had achieved much in recent years, but that it still faced obstacles, budgetary and otherwise, to executing its mandate. "We need to do more to follow the money."

Isima said there had not yet been any cases of terrorism finance money seized in West Africa, including Nigeria, where Boko Haram was prominent — a glaring gap in efforts to fight financial crime in the region.

GIABA was established by the Economic Community of West African States (ECOWAS) in 2000 to strengthen the capacity of member states to prevent money laundering and terrorist finance in the region.

Since then, significant steps have been taken to improve the response to money laundering in the region. With the support and training provided by GIABA, its member states now all have financial intelligence units (FIUs), which investigate suspicious transactions.

Despite GIABA's tireless efforts, Brian Sapati, its deputy director general, said much remained to be done to face such challenges. He says there was still political reticence to action. "Some, but not all countries, are showing good political will."

He said that the region's FIUs used outdated technology that delayed their work. "FIUs don't have state of the art software to pass on information to other countries and law enforcement," Sapati said.

He added that a lot of judges still did not consider money laundering charges, instead focusing exclusively on the "predicament" offences of, for example, drug trafficking and corruption.

GIABA's budget, which comes from ECOWAS and has fallen in recent years, is a concern for Sapati. "If our budget goes down every year, I cannot be happy," he said. "We want the resources to be able to work. We can't be pleased with limited resources."

Call to capital markets to aid in rebuilding nations after disaster

By Sam Kerr

The devastating Atlantic hurricane season of 2017 has revealed a further injustice to compound the loss of life and destruction of property — the sheer cost of a disaster which is not covered by any type of insurance.

According to risk modelling firm RMS, insured losses for Hurricane Maria alone were estimated at \$15bn-\$30bn although economic losses could be as high as \$60bn.

Efforts are underway to right this imbalance. "Capital markets can transform society," said Arunma Oteh, treasurer at the World Bank told *GlobalMarkets*.

"They offer powerful tools for eradicating poverty and building shared prosperity. At the World Bank we have been connecting capital markets to development since we issued

our first bond 70 years ago."

With investors hungry for yield, there are efforts underway to use insurance-linked securities (ILS) to bridge the gap between insured and economic loss putting more funds at the disposal of disaster stricken nations.

"There's over \$30tr in the capital markets, and investors are eager to put their balance sheets to work to generate income," said Daniel Stander, global head of the public sector practice at RMS.

"So, when you have this profound protection gap on the one hand and then on the other this vast amount of capital looking for a home, it's not inappropriate to ask whether we can bring the two together."

The World Bank is also ready to meet this challenge. "One financial tool we have to help

our member countries be more resilient in the wake of disasters is to leverage insurance-linked securities," said Oteh. "Over the past 10 years, we have executed more than \$2bn in transactions that have transferred risks from natural disasters to the capital markets."

Oteh said use of capital markets had given the World Bank a broader set of tools to build countries' resilience and was working with them put in place disaster risk management frameworks that included early warning systems and resilient infrastructure.

"Preparing for disasters saves lives and money, and is a key way to achieve our goals of eradicating extreme poverty and boosting shared prosperity," she said.

She said ILS risk management tools were effective. For example the World Bank



Oteh: capital markets can transform society

received confirmation this week that the devastating earthquake that hit Mexico on September 7 has triggered a payout from a catastrophe bond it issued in August, this year. As a result, Mexico's natural disaster relief fund, FONDEN, will receive \$150m for its relief efforts.

Similarly, she said the Caribbean Catastrophe Risk Insurance Facility, which was set up with the help of the World Bank, has made more \$50m in payouts since the start of the 2017 Atlantic hurricane season.

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This article is the fourth and final part of a series on China's Belt and Road Initiative that we are publishing during the 2017 IMF-World Bank annual meetings in Washington DC. We have devoted two articles to the Road element, and two to the Belt element, of which this piece is the second and focuses on the western part of the overland route

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GlobalCapital

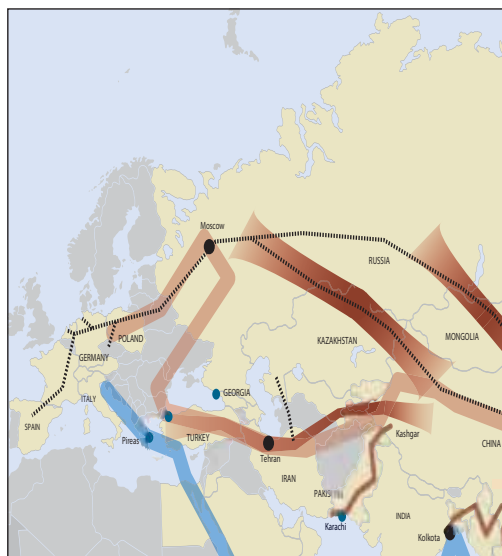
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*GlobalMarkets/Emerging
Markets* is a publication of:

Euromoney Institutional
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London, EC4Y 8AX
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+1 202-483-6000

Printing by:
Stephenson Printing Inc.
5731 General Washington Dr.
Alexandria, VA 22312
Tel: 703 642 9000
stephensonprinting.com



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All aboard for the Europe special

— Belt route crucial to China's global ambitions

By Elliot Wilson

On a warm, overcast morning in May, a bright red train set out from Yantian Port in Shenzhen, an industrial city in southern China. It moved slowly, labouring under the weight of 41 freight containers packed with car parts and mobile phones. Its destination: the Belarusian capital Minsk, separated by northern China and Central Asia and the small matter of 9,990 kilometres.

That the send-off went unnoticed in the West was no great surprise. The train was old and a little on the rusty side. When the cargo arrived in Minsk two weeks later, it still had to be unloaded and re-shipped to markets in western Europe. It was not by any measure a speedy process.

Yet the event matters in deep and lasting ways that are not immediately visible. The route, which takes in the deserts of Uzbekistan and Kazakhstan and the rich pastures of southern Russia, lies at the heart of both the old Silk Road, which reached its zenith 750 years ago, and its successor, the Belt and Road Initiative (BRI), China's grand attempt to redraw the modern trade map in its image.

Very quietly in recent years a number of routes linking China with Europe have opened for business. Chongqing, a megapolis in the southwest, has a rail cargo service to Germany's Duisburg. You can hop on a train in Yiwu, an export hub on China's eastern shores, and hop off a fortnight later in London or Madrid. Another

rail service, fiendishly challenging in logistical terms and unlikely to see the light of day before the mid-2020s, aims to connect Shenzhen with the Netherlands via India, Iran, Turkey and southeast Europe.

FAST TRAIN TO EUROPE

These routes matter and for several reasons. China has long been keen to find new ways to convey goods to Europe cheaper and faster. Overland freight ticks both boxes. It takes goods 13 days to reach Europe by rail from Chongqing but up to 42 days by sea, according to data from China's customs ministry. CLSA, a Hong Kong-based brokerage, reckons overland freight costs 40% less per kilometre travelled than the maritime alternative.

It also offers — in theory at least — greater security. This is a serious consideration for China, which fears, in the event of a trade war, being denied access to the Strait of Malacca, a chokepoint in Southeast Asia patrolled by US gunboats. That makes the overland 'Belt' portion of the BRI a greater imperative to the Chinese than the maritime 'Road', experts reckon. "The inland road is more important than the sea route, where global powers jostle for power and position," says Alexious Lee, head of China industrial research at CLSA. "Overland, China can leverage existing rail routes via countries that are more friendly and pliable."

The first point in that statement is certainly true. A total of 29 mainland cities claim overland freight links to Europe; all

currently use track that dates back to the Soviet era. (That will change: some new routes are open to business, notably a service linking China with Afghanistan and Tajikistan, while a yet more ambitious project, viewed as a crucial piece in the Belt-and-Road jigsaw, should connect southern China and Iran by 2022.)

MAKING CONNECTIONS

Another reason these routes matter is, of course, trade. Better rail infrastructure is crucial to China's ability to ship goods direct to the likes of Germany. But it will also, notes CLSA's Lee, help to improve regional connectivity. "This is not just about point-to-point trade but about boosting and maximising trade between the countries that lie along" the new Silk Road. So in theory, the BRI will enable the likes of Uzbekistan to boost trade not just with China but also with EU states and its immediate neighbours.

It is easy to assume that China is already an economic powerhouse in Central Asia. That is not the case: in 2015, according to data from the IMF, China accounted for less than 5% of total foreign investment in the region against 14% for the US and 68% for Europe. This is in part due to China's earlier focus on developing trade links with the West — but also to a deep-seated regional fear of Asia's new hegemon. Kazakhstan, Central Asia's largest economy, "doesn't trust China", notes Charlie Robertson, global chief economist at Russia-based investment bank Renaissance Capital. "They fear

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"You can paint a picture where the whole thing is a win-win"

—Michael Taylor, Moody's

"Better [CEE] access to 1.4 billion Chinese citizens... via infrastructure with lower inbuilt shipping costs, is unequivocally a good thing"

—Chris Hartwell, Center for Social and Economic Research



its power and they fear it buying up land and assets.” Russia and China have only recently mended fences after a half century of mistrust and outright hostility.

China’s influence, though, is only likely to grow. Every Central Asian state is a member of the Asian Infrastructure Investment Bank, a newish Beijing-based multilateral. So are the likes of Russia and Mongolia, Turkey and Belarus, each of which has signed a currency swap agreement with China’s central bank.

This points to another piece in the overall jigsaw. Politicians in China view the BRI as crucial to efforts to internationalise the renminbi. Thus, the more business that Chinese firms collectively do in the region the greater the opportunity to settle those trades in China’s currency rather than in US dollars.

MILITARY WEB

Security is another often overlooked facet of China’s thinking. The country has taken care to draw Russia and Central Asia into its military web, a process that began in 2003 with the launch of the Shanghai Cooperation Organisation, a security alliance. But China also sees the bigger picture. In its eyes, a strong and wealthy Central Asia would be more settled, meaning less upheaval in Xinjiang, a vast province in western China with a large and restive Muslim population. “The idea is that happier people are less likely to burn their own house down,” notes RenCap’s Robertson.

Some regional states may continue to fear China — but that’s unlikely to prevent them from seeking new trade opportunities with their neighbour. Anyway, they have little to lose. Six nations west of the new Silk Road have no sovereign credit rating at all, including Turkmenistan and Iran, while Belarus, Mongolia and Ukraine

languish at the bottom of the speculative-grade scale.

This presents both a risk and an opportunity. A risk in that any capital lent by China’s chief policy lenders — China Development Bank and Export-Import Bank of China — to regional Belt-and-Road-related projects would likely be paid back over a long period and by sovereigns with little or no risk profile and weak institutions. Moody’s reckons that 40% of all BRI-related lending by Chinese banks in the three years to the end of 2015 flowed to countries with a sub-investment grade credit rating.

And an opportunity in that many of the countries along this stretch of the BRI have substantial financing needs. “Belt-and-Road gives countries a chance to have new infrastructure built and financed,” says Michael Taylor, chief credit officer, Asia Pacific at Moody’s Investors Service in Hong Kong. “If infrastructure succeeds in raising productivity in these countries their ability to repay their debts is enhanced. You can paint a picture where the whole thing is a win-win.”

TWO-WAY TRADE

It’s important also to remember that trade flows both ways. The new Silk Road offers China the opportunity to export everything from its currency to surplus goods and labour. But it also opens doors to new and willing trading partners, be they sovereigns or corporates. The new rail-freight service that links Shenzhen with Minsk will be jointly managed by DHL Global Forwarding, a division of Germany’s Deutsche Post, and supply chain operator China Brilliant.

Finally, it’s easy to forget the countries that lie at the far western end of the overland belt. China has been slow to target for investment the sovereign states of central and eastern Europe (CEE), mostly because the region is deeply integrated with the supply chains of

Russia and western Europe.

This is changing. Last November, ICBC, China’s largest commercial lender, pledged to invest up to €10bn (\$11.9bn) into CEE-area projects and corporates, including railways, ports, retailers and technology providers. China’s best friend in the region is undoubtedly Serbia, which it sees as an integral part of the BRI. China has invested an estimated \$1bn in the Balkans country, mostly in the form of soft loans, to finance new roads and power plants; last April, China’s Hebei-based Iron & Steel signed a €46m deal to buy a steel plant on the Danube river.

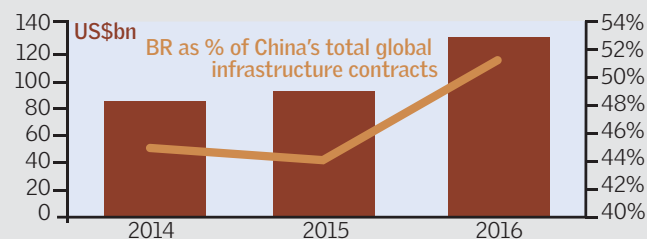
It’s not just Serbia with its long list of shovel-ready projects that stands to benefit from the BRI. A host of new pan-Eurasian railways linking the region with China is a “fantastic” development, says Chris Hartwell, president of the Center for Social and Economic Research, a Warsaw-based think-tank. “The CEE region is at its limit in terms of how much it can export to China. Better access to 1.4 billion Chinese citizens [and billions more given that trade will also flow through China to the rest of Asia], via infrastructure with lower inbuilt shipping costs, is unequivocally a good thing. The process will open up new markets to firms from the likes of Hungary, Poland and the Czech Republic.” **GM**

Self-contained

Chinese container trains running from Kunming in China through Chengdu to Lodz in Poland; from Jinhu to Kazakhstan; from Yiwu to Madrid

Digging Deep

Infrastructure contracts by China in BR countries



Sources: China Outbound Investment and Cooperation Development Report 2015 and 2016, Bank of China International, Moody’s Investors Service

Can European banks ever compete again?

American banks dominate global banking to an unprecedented extent and look set to gain yet more market share as US policymakers mull softer touch regulation. Will European firms ever be able to compete again?



By Owen Sanderson

Whether you look at league tables or capital strength, the dominance of the major US banks is clearer than ever.

Following this year's stress tests from the Federal Reserve, the biggest US firms announced monster buybacks. JP Morgan will buy back \$19bn, Citi \$17bn and Bank of America \$12bn. Morgan Stanley will buy back \$5bn.

To put it another way, JP Morgan and Citi together will return more capital to shareholders this financial year than the entire market cap of Deutsche Bank. Throw in Bank of America and Morgan Stanley's 2017 buybacks and you almost have enough for Commerzbank as well (still a ward of the German state).

Europe's banks are still at the other end of the cycle. Four of Europe's global banks, UniCredit, Deutsche Bank, Credit Suisse and Santander, raised €31.5bn equivalent (\$37.2bn) of new capital this year, much of it (some €20bn at least) to pay for non-performing assets. UniCredit and Santander ploughed their capital

straight into provisions; Deutsche and Credit Suisse are less direct about it but both banks are still working through non-core divisions and selling assets.

Look at the league tables and the story is the same. The top four banks by investment banking revenue in EMEA are all US firms, while in global fixed income, according to Greenwich Associates, Barclays was the only non-US bank in the top five.

The US banks might also benefit further from the deregulation initiatives proceeding under the Trump administration. While much of the administration's agenda has struggled, the US Treasury's thoughts on financial deregulation, published in June, seem thoughtful and moderate and so relatively easy to rally around.

INTERNATIONAL EFFORT

The really big question for international banks, though, is whether the US move means any semblance of international regulatory co-operation is over.

"It's not yet a global level playing field — in particular, the completion of Basel III has yet to be agreed on and there are

doubts whether it will ever be fully implemented by the Americans," says Michael Reuther, head of Commerzbank's corporate clients business and group treasury. "The next revision... is still in negotiations mainly between US and European standard setters. Investors need to have a firm guideline on capital requirements but I don't see it being agreed any time soon."

US and European banking regulators have been deadlocked over where to set the "output floor", which would limit the capital banks can cut by switching from standardised models to their own internal models. Senior regulators have said that the move isn't supposed to raise overall capital requirements — but it's likely to hurt banks with large low risk mortgage books, such as those in northern Europe, the hardest and faces fierce opposition from German authorities.

"What we're defending is a way of calibrating the capital according to the risk of the assets," says Frédéric Oudéa, group chief executive at Société Générale. "The work that supervisors are doing at European level, reviewing the modelling by banks, needs to be taken into account by

Stress test

White House chief economic advisor Gary Cohn; Société Générale CEO Frédéric Oudéa



ESTABLISHED 1960

Best Bank In Palestine



**Doubtful**

Michael Reuther,
Commerzbank

the people who say we have no certainty or visibility into the quality of the models and that therefore we need a floor.”

Without international cooperation, big banks may be subject to a series of tit-for-tat measures. The US introduced “intermediate holding companies” to make sure its foreign banks kept enough capital and liquidity resources onshore. Proposals from the European Commission meanwhile suggest an “intermediate parent undertaking” to achieve the same goal in Europe.

If US government bonds escape the leverage ratio for

US banks it’s possible that European government bonds could get the same treatment — though this raises the spectre of the “sovereign-bank doom loop”, which brought down peripheral countries and their banks in 2011-2012.

Olivier Osty, executive head of global markets at BNP Paribas, says: “If the US takes out Treasuries from the leverage ratio, that raises the question of whether Europe will take out sovereign bonds too — European politicians will want to keep a level playing field.”

But others disagree.

Reuther says: “The US Treasury proposals on banking regulations would certainly provide some relief for US banks but in Europe I see little room for an easing of the regulatory framework. I also don’t see the UK switching to a regulation-light regime after Brexit. Given the dominant role of the financial sector for the UK economy there’s a need to make it very safe.”

GROW YOUR OWN

Though post-crisis policy responses were different across the Atlantic — Europe’s banks weren’t forced to recapitalise and the ECB took until 2015 to unleash monetary shock and awe — there are other reasons why the Europeans fell behind.

Growth has been weaker for one thing. According to the OECD, eurozone GDP grew from \$12.06tr in 2010 to \$12.75tr in 2016, a 5.7% expansion. In the same period, the US grew from \$14.96tr to \$16.92tr, an expansion of 12.9%.

Europe’s banks are also sub-scale compared to their US equivalents. If you compare outright balance sheets, BNPP’s €2.14tr of assets looks very comparable to JP Morgan’s \$2.58tr but JP Morgan achieved that

size after selling most of its good quality mortgages to Fannie and Freddie.

The absence of European megabanks is because of their history. The US giants mostly emerged out of a series of rollups in the 1990s and another crisis consolidation wave in 2007 and 2008.

The European firms, meanwhile, still have to contend with wide variations in national legal systems, making it difficult to get mergers to pay — despite the creation of a “Banking Union” from 2013.

“There are supervisory barriers in Europe, banking systems in Europe are ring-fenced and we need to advance in terms of legal harmonisation,” said José García Cantero, chief financial officer at Banco Santander, speaking at a conference at the European Central Bank. “There are many different laws today despite Banking Union and Capital Markets Union.”

EVER CLOSER UNION?

European authorities, however, are trying to finish the work on Banking Union — but events keep getting in the way.

The European Central Bank’s Single Supervisory Mechanism took over big bank supervision in 2014 explicitly to avoid national supervisors favouring their own institutions or trapping capital behind national borders.

It was a slow start following an immense “asset quality review” examining the balance sheets of every European firm. This year, the SSM has been working on examining bank capital models in great detail through the “TRIM” exercise, which is expected to increase capital costs for some firms.

The final item on the agenda, though, is the most controversial. European officials have been pushing for a “Single Deposit Insurance” scheme for years against implacable opposition from certain countries in northern Europe. This would share the risks of bank failure across Europe since retail depositors would be able to claim their funds back not from national governments but from a European pool.

But confidence in the potential scheme is not high following a string of bank failures.

Banco Popular gained a clean bill of health before being sold for €1 to Santander in June, while Monte dei Paschi di Siena was forced into the arms of the state when its rescue plan, concocted to satisfy the ECB, fell apart.

“If you had a European deposit scheme three years ago it would quite likely have resulted in French and German taxpayer money to go into MPS and Banco Popular,” says Reuther. “There will only be acceptance for such a scheme once the banking system

is perceived to have again reached a safe and stable state. But proving safety is difficult. The trust of markets and investors in the stress tests is limited when you have banks almost failing just six months after getting a positive mark in a stress test.”

THE BANK OF THE FUTURE

The deposit scheme would only unite banks when they fail — and not necessarily help Europe’s banks to bulk up and regain their swagger. That will take time and technology and far more European integration.

“Consolidation is not just a question of regulation,” says Oudéa. “It’s also a question about the profound challenges taking place in banking, resulting in particular from the new technologies. The regulators themselves have expressed their views that given all these challenges the market is overbanked and there’s a need to have a minimal scale in each business. Domestic consolidation could make sense where there is the capacity to extract synergies in terms of systems and branch networks.”

He continues: “When you have more integrated markets you can imagine the benefits of cross border merger but you need to be realistic about the timescale: it is not for tomorrow, it’s probably in 10 years’ time. Right now, management energies are concentrated on transforming existing businesses so any such transactions will likely come later on. In the long run size does matter, both for retail and wholesale.”

Santander’s Cantero also points to technology as a driver for consolidation and says that his firm’s annual tech spend is “more than equity capitalisation of 95% of European banks”.

For banks which can afford the entry price technologies such as distributed ledger and artificial intelligence will transform their offering — and their earnings potential — by uniting disparate systems and making it far easier to bank clients across borders. US firms will benefit from the same technologies but in a fragmented market the Europeans have far more to gain.

European policymakers have also set a course that ought to help the region’s banks in the long term. A speech from French president Emmanuel Macron at the end of September laid out a vision for the future of the European Union that included a European finance minister, a European equivalent of the IMF and a big step forward in integrating financial rules across the continent.

So, far ahead on the horizon, there is a chance for European banks to compete again — it just depends on the politics. **GM**



“In Europe I see little room for an easing of the regulatory framework”

—Michael Reuther,
Commerzbank

“In the long run size does matter, both for retail and wholesale”

—Frédéric Oudéa,
Société Générale

TRUE VALUE IS ACHIEVED WHEN QUALITY MEETS QUANTITY

BEST MANAGED
ADVISORY SERVICE

BEST BANKING GROUP
LEBANON

BEST INVESTMENT
BANK

BEST CALL CENTER

EXCELLENCE
IN TRADE FINANCE

BEST BROKER

SOCIAL
ECONOMIC AWARD

MOST BANK ADVERTISING
EFFECTIVE **CAMPAIGN**

BEST TRADE FINANCE
BANK AWARD



Best Broker
MedSecurities
2011, 2012, 2013, 2014,
and 2015



Best Investment
Bank Award
2009, 2010, 2011, 2012,
2013, 2015 and 2016



Best Trade Finance
Bank Award
2014, 2015,
2016 and 2017

Dombrovskis wants EU to 'lead the world' in green finance



Exclusive GM interview

The man in charge of financial services in the EU talks up Capital Markets Union post-Brexit, green finance, fintech and just how difficult it is to push through reforms in the banking sector

By Jean Comté

When the UK voted to leave the EU in June 2016, observers feared that it was the end of the bloc's main financial project — the plan for a Capital Markets Union (CMU) between 28 national markets. Lord Hill, the British commissioner driving the project, resigned the day following the Brexit vote.

But the Commission is still moving forward on the project — indeed, moving forward with more vigour than ever, saying that Brexit “reinforces the urgent need to further strengthen and integrate the EU capital market framework”.

“*Work on risk reduction has not stopped*”
—Valdis Dombrovskis

The EU executive has unveiled new streams of work in the area such as green finance and fintech. It is now getting ready for the next steps in these fields, EU Commission vice-president Valdis Dombrovskis tells *GlobalMarkets*.

“The EU should lead the way in green finance,” says Dombrovskis. “There are estimations that limiting global warming to 2°C will require €180bn of annual investment for the next two decades — and that cannot rely only on private finance.”

Possible actions the Commission is assessing include disclosing green criteria in fiduciary duties, setting up an EU label and working on a green “supporting factor” — a cut in capital requirements for green bonds.

One of the pivotal moments in the Commission's sustainability work will be the publication of a high level experts' report, expected by the end of the year.

On fintech, the debate in the EU is less advanced. EU finance ministers held a first general debate on the subject in mid-September and the EU Commission is preparing an ac-

tion plan set to be unveiled early in 2018.

“Is there scope for EU action? How can we make EU enabling legislation? And why are fintechs scaling up more successfully in the US?” asks Dombrovskis. “One of the answers is that we have different treatments and different regulatory regimes... we need to use the full scale of the EU single market.”

New CMU priorities also include concerted work at the EU level on the reduction of the €1tr of non-performing loans. An action plan was agreed in early July laying out a list of tasks for the EU Commission and other EU supervisory bodies.

“We are working on it but we are still in the relatively early stages,” says Dombrovskis.

The Commission is working on a European blueprint dedicated to setting up national asset management companies to buy non-performing loans from banks. Markets are also expecting the result of a study commissioned from BlackRock that will compare the efficiency of the loan enforcement framework in each country.



About QNB Group

Qatar National Bank (Q.P.S.C.) (QNB Group) was established in 1964 as the country's first Qatari-owned commercial bank, with an ownership structure split between the Qatar Investment Authority (50%) and 50% held by members of the public.

QNB Group has steadily grown to be the biggest bank in Qatar and the largest financial institution in the Middle East and Africa region.

The Group has recently completed the acquisition of a 99.88% stake in Turkey's Finansbank A.Ş. (now known as QNB Finansbank), the 5th largest privately owned universal bank in Turkey by total assets, customer deposits and loans.

QNB owns a 20% stake (both ordinary and QNB convertible preference shares) in Ecobank Transnational Incorporated (Ecobank), the leading pan-African bank. In 2013, the Group successfully completed the acquisition of a controlling stake in the second largest private bank in Egypt, QNB ALAHLI (QNBAA), amounting to 97.12%.

The Group has also extended its regional reach by acquiring stakes in various financial institutions including 34.48% stake in the Jordan-based, the Housing Bank for Trade and Finance (HBTF), 40% in Commercial Bank International (CBI) based

in the United Arab Emirates (UAE), 99.96% of QNB Tunisia, 52.2% in the Iraqi-based Al-Mansour Investment Bank, 48.98% in the Libya-based Bank of Commerce & Development and 20% stake in Al Jazeera Finance Company in Doha. QNB Group also retains 50.80% stake in QNB-Syria, an 82.59% stake in QNB Indonesia.

In 2015, the Group officially started operating its "Qatar National Bank S.A.Q." Hoh Chi Minh City Representative Office in Vietnam. In 2016, the Group commenced operations in Myanmar through a representative office. In 2017, the Bank started operations officially through its branches opened in the Kingdom of Saudi Arabia and the Republic of India.

The Group's presence through its subsidiaries and associate companies now extends to more than 31 countries across three continents, providing a comprehensive range of advanced products and services. The total number of employees is more than 27,800 operating through more than 1,200 locations, with an ATM network of more than 4,300 machines.

QNB Group has maintained its position as one of the highest-rated regional banks from leading credit rating agencies including Standard & Poor's (A), Moody's

(Aa3), Fitch (AA-), and Capital Intelligence (AA-). The Bank has also been the recipient of many awards from leading international specialised financial publications. The Group provides an array of investment banking services through its subsidiary, QNB Capital, to corporate, government and institutional clients within Qatar and globally. QNB Capital has one of the best corporate finance teams in the GCC region, offering extensive transaction experience and in depth advisory – including mergers and acquisitions, equity and debt capital markets, and project financing advisory.

The Group also offers brokerage services through its subsidiary, QNB Financial Services (QNB FS), the first independently regulated, licensed brokerage company launched by a bank in Qatar. QNB FS offers a multi-market, multi-currency trading platform with access to several markets.

Based on the Group's consistent strong financial performance and its expanding international presence, QNB is currently ranked as the most valuable bank brand in the Middle East and Africa, according to Brand Finance Magazine.

Bloomberg Markets, the leading provider of Business, Financial and Economic news, has ranked QNB as "One of the World's Strongest Banks" since 2013.

Global Finance Magazine ranked QNB as "One of The Top 50 Safest Banks in the World" in its 2016 update published recently.

For two consecutive years, 2014 and 2015, the Bank was recognised as "The Best Bank in The Middle East" by Euromoney Magazine.

QNB Group has an active community support program and sponsors various social, educational and sporting events.

For further information, please contact QNB's Public Relations Department at (+974) 4497 5704, Fax (+974) 4425 2589, email: PR@qnb.com or visit QNB's website qnb.com



"There are estimations that limiting global warming to 2°C will require €180bn of annual investment for the next two decades — and that cannot rely only on private finance"

—Valdis Dombrovskis,
EU Commission

EUROPE'S FINANCE INITIATIVES — SOME PROGRESS, SOME STASIS

INITIATIVE	STATUS?	NEXT STEPS?
Green finance	<ul style="list-style-type: none"> • Commission has issued a discussion paper looking at capital costs 	<ul style="list-style-type: none"> • High level expert group to offer its views later this year
Fintech	<ul style="list-style-type: none"> • EU ministers have debated in general terms 	<ul style="list-style-type: none"> • Commission to produce 'Action Plan' by mid-2018
NPL	<ul style="list-style-type: none"> • EBA proposed pan-European asset management company; likely to be rejected • EU agreed action plan in July 2016 	<ul style="list-style-type: none"> • Consultation is underway • BlackRock will evaluate each country's enforcement framework and report • High NPL countries will need to follow EU blueprint?
Banking reform	<ul style="list-style-type: none"> • Commission issued proposals for a Capital Requirements Directive 5 in November 2016 	<ul style="list-style-type: none"> • Parliament and member states must agree
Bail-in and creditor hierarchy	<ul style="list-style-type: none"> • Carved out from CRD 5 and fast tracked 	<ul style="list-style-type: none"> • Parliament and member states must agree (quickly)
IFRS 9	<ul style="list-style-type: none"> • Carved out from CRD 5 and fast-tracked — the rules apply from 2019 	<ul style="list-style-type: none"> • Parliament and member states must agree a transition deal
Bank structural reform	<ul style="list-style-type: none"> • Proposed in Europe in January 2014 — stalled ever since • Several member states have national versions 	<ul style="list-style-type: none"> • Commission could kill the initiative
Deposit guarantee	<ul style="list-style-type: none"> • Proposed in November 2015; Commission has done technical prep 	<ul style="list-style-type: none"> • Implacable opposition from northern Europe, especially Germany. Still stalled with no end in sight

Source: GlobalMarkets

SLOW PROGRESS

But the Commission can't create a capital markets union by itself as Dombrovskis likes to put it. In the EU law-making system its role is limited to the proposal of draft legal texts, which must then be amended and adopted by the member states and the EU Parliament.

Observers remain critical, pointing to the very slow progress of Parliament and member states on some of the most important financial regulation files. For example, a large package of banking rules unveiled last year is still pending, with member states arguing on a number of technical points. Estonia, which chairs the Ecofin meetings between member states, aims to have an agreement on the package by the end of the year but sources tell *GlobalMarkets* that it won't be easy.

However, Dombrovskis thinks it is on track, pointing to a recent decision to fast track the most urgent parts of the document, which concern the new IFRS 9 accounting standards and loss-absorbing bail-in bonds for banks.

A recent proposal to strengthen oversight of 'third country' clearing houses is also proving a challenge to get through EU member states, with negotiation documents obtained by *GlobalMarkets* showing strong divergences. France and Germany are pushing for stronger control and veto rights whereas other states are more sceptical.

"There was quite a mixed welcome; views

are quite divergent," acknowledges Dombrovskis.

The Commission's proposed solution sets up a new structure inside the European Securities and Markets Authority to oversee third countries, CCPs dealing with large amounts of euro denominated transactions. But there could be additional requirements including relocation obligations for these entities. Relocation of CCPs is "not an end in itself", stresses Dombrovskis, describing his text as a "balanced proposal".

He is less optimistic about the draft euro-area deposit guarantee scheme. Dombrovskis unveiled this proposal back in November 2015, and progress has been extremely limited since then. The scheme is proving extremely controversial for member states in northern Europe, who worry about their banks paying for bank failures in southern Europe. Neither Parliament nor member states have reached an agreement though lots of technical work has been done in the last two years.

"We see relatively slow progress," concedes Dombrovskis, adding that he is planning to try to break the deadlock in early October when he will officially come out with a "package" on this issue. Details on the package are still unclear but insiders expect a non-binding communication encouraging the co-legislators to move forward on the deposit insurance scheme. "We are looking for ways to facilitate compromises," says Dombrovskis.

BANKING STRUCTURAL REFORM

The European Commission has another power: it can withdraw any file of work if it believes an agreement can't be reached. Insiders are speculating over whether the Commission could pull the plug on the Banking Structural Reform initiative.

This proposal, unveiled in 2014 by Commissioner Michel Barnier, was sharply criticised by the bankers and lobbyists. It imposes a separation of deposit and investment banking for European banks and forbids proprietary trading.

But the file has not moved forward for more than a year as left-wing and right-wing MEPs are divided — some praising the proposal and others opposing the initial draft.

When he took over as the commissioner covering banking regulation in June 2016, Dombrovskis signalled his intention to unblock the initiative. A meeting with Parliament's co-ordinators in October 2016 nevertheless proved inconclusive. "Progress on this file is blocked; we didn't see any real momentum," Dombrovskis tells *GlobalMarkets*.

But he refused to say whether he would withdraw the file. "Work on risk reduction has not stopped," says Dombrovskis, pointing to existing work on cutting risk in the banking sector. But he declined to give his views on whether the banking structural reform proposals are needed to ensure a stable and integrated financial system. **GM**

GlobalMarkets

SPONSORED REPORT



SURINAME

2017



Reforms for stability

Finance minister Gillmore Hoefdraad had a front row seat as Suriname's open economy was battered on three fronts — lower gold and oil prices, and the end of bauxite mining — leading to a recession in 2016. However, as Hoefdraad points out, the recovery is well underway and explains how, through several measures that the government is taking, it is becoming better prepared for external shocks.

GlobalMarkets: How is Suriname's economic recovery progressing?

Gillmore Hoefdraad, Minister of Finance,

Suriname: The stabilisation effort was extensive and swift, but necessary. The government reduced expenditure by 10% of GDP in 2016 and increased taxes, with palpable results. Economic growth is returning, inflation will reach single digits by end-2017, the deficit is continuously shrinking, the exchange rate has stabilised and we now have a current account surplus.

Mining and oil sectors, which are growing rapidly post-crisis, remain a visible strength. But Suriname's true strength lies in the government's ability to act courageously to address macroeconomic imbalances and restore confidence.

GlobalMarkets: With the end of the IMF programme (see macroeconomic overview), how will Suriname fulfil its financing needs?

Hoefdraad: The country maintains a constant dialogue with multilateral institutions that will provide the bulk of financing for projects in the country. Moderate access to domestic financing through the issuance of Treasury bills will complete the financing needs. There is no financing shortfall for 2017-18.

GlobalMarkets: After debuting in international markets in 2016, would you consider another bond issuance?

Hoefdraad: There is no need to issue another bond. The bond was not for budgetary support, but entirely to refinance existing debt, including debt of the state-owned oil company.

GlobalMarkets: What are your fiscal targets and how will you achieve them?

Hoefdraad: The fiscal adjustment is not complete. We aim to reduce the fiscal deficit to around 5% in 2017 and 3% in 2018. The return of economic growth is supporting fiscal adjustment thanks to a buoyant tax system, but the main support to achieve the fiscal targets is continued expenditure restraint and the introduction of a revenue-positive VAT in 2018.

GlobalMarkets: At what stage is the implementation of VAT?

Hoefdraad: A draft law and regulations have been prepared and the underlying computer system has been contracted out. VAT should be in place in 2018, replacing the sales tax and a few other minor indirect taxes. VAT brings multiple benefits as it tends to be a buoyant tax. Furthermore, VAT will help us to rely more on indirect taxes, which will stabilise fiscal revenue further and reduce the impact of future commodity price shocks. Finally, VAT systems tend to be more easily audited and are useful instruments to integrate the tax system and better target measures to improve tax fairness or combat tax evasion.

GlobalMarkets: What other measures are you taking to ensure the economy becomes more resistant to external shocks?

Hoefdraad: Besides the shift toward consumption-based taxes as opposed to income-based taxes and the creation of a sovereign wealth fund, the government is putting in place several administrative reforms to increase the administration's agility and ability to quickly adjust revenue or expenditure. One prominent reform is the automation of the budget and expenditure control systems into an integrated financial management and information system (IFMIS) using software from Canadian company FreeBalance.

GlobalMarkets: What is your strategy to ensure the gold industry not only prospers but also benefits the Surinamese people?

Hoefdraad: Suriname has a 100 year history of cordial and constructive dialogue with international investors. The same applies with the gold industry, which is investing heavily in Suriname and will be present in the country for many decades to come. Direct benefits — such as employment and technical know-how — are accruing, and the government will receive substantive fiscal revenue from gold companies via royalties, income taxes and dividends. Additionally, the government has set up a sovereign wealth fund first and foremost to stabilise fiscal revenue, moderating future commodity-related revenue fluctuations and saving



Minister of Finance Gillmore Hoefdraad

windfalls to benefit future generations and create a diversified income portfolio.

GlobalMarkets: Economists consider the sovereign wealth fund of particular importance; how advanced is its implementation?

Hoefdraad: It will begin operations on January 1, 2019 as instructed by the law. The team is being put together to plan and prepare the operations, including preparing the fund's investment and communications strategies.

GlobalMarkets: There is excitement about potential further windfalls in the oil sector. How important could the exploration agreements with the likes of Exxon, Hess and Statoil be?

Hoefdraad: Offshore oil exploration could be a game-changer for Suriname, although we do not include any projections in our balance of payments or fiscal revenue forecasts. It carries the potential of substantive revenue, but we will only begin considering the financial implications if we see a viable exploitation plan. Our role at present is to rely on state-owned oil company Staastolie to manage the process responsibly. The sovereign wealth fund would also absorb any windfall earnings from the offshore oil sector.

GlobalMarkets: Finally, what message would you send to foreign companies considering investing in Suriname?

Hoefdraad: Suriname has a long history of treating foreign investors fairly. The country and its legal system protect foreign property and investments, and its friendly, very diverse, well-integrated population is well-educated and eager to receive foreigners. Suriname is open for business.



Rich in potential

Suriname is South America's smallest nation, with an area of just 163,820km² and a population of just over 567,000. It is also its youngest: independence from the Netherlands was gained in November 1975.

Size can be deceiving. Suriname is an upper middle-income country with GDP-per-capita lower than only Chile, Uruguay, Brazil and Argentina in South America in 2016.

Unemployment has been lower than many Caribbean peers such as Barbados, Guyana and Jamaica for most of the past decade, although 2016's economic crisis pushed the figure up to 11.9% — still better than Jamaica, but higher than Barbados for the first time since 2008.

Natural resources

Moreover, the country boasts an enviable range and scale of natural resources that have made it an attractive destination for foreign direct investment.

Long before its independence, Suriname became one of the world's leading producers of bauxite — the ore that is the source of most aluminium.

US company Alcoa began operations in the country in 1916, while it was still a Dutch colony, and ceased operations there only in November 2015 as aluminium prices slumped. As recently as 2007, aluminium accounted for about half the country's exports.

Alcoa said in January 2017 that it would permanently close its mines in Suriname, but by then gold had long overtaken aluminium as the most important export — thanks largely to the Rosebel Gold Mine.

As part of the mineral-rich Guiana Shield — the craton of the South American Plate that also lies below French Guinea, Guyana and most of Venezuela — Suriname has further mining potential.

October 1, 2016 was a landmark as US gold producer Newmont began production at the Merian gold mine, which has 5.1m ounces of reserves. Another gold mine could be on the way as Iamgold has begun exploration at the Saramacca site.

In July 2017, Suriname signed production-sharing contracts with Exxon Mobil and Hess for one offshore oil block and with Statoil for

another. These blocks are in the Guyana Basin, where — in Guyanese territory — Exxon has already found oil.

Joint ventures

These investments by foreign firms in the extractive sector show the confidence that international companies have in Suriname's operating environment. Key to these joint ventures is government-owned Staatsolie Maatschappij Suriname, the national oil company founded in 1980 as a limited liability company.

Staatsolie has a 25% equity stake in the Merian mine, for instance, and will take up to a 10% stake in the oil blocks during the development and production phases.

Adjusting to the triple shock

These growth drivers therefore mean Suriname has an exceedingly open economy — one which is very dependent on commodity exports and vulnerable to international price shocks. Beginning in 2014, Suriname suffered a triple shock that any country would have struggled to deal with: both oil and gold prices plummeted, while bauxite mining neared its end.

In 2016, the economic shock hit a nadir as GDP shrank by 10.4%. But the government took decisive action, embarking on an austerity programme to cut expenditure. Indeed, despite the economy shrinking alarmingly, the fiscal deficit slightly narrowed — from 10.7% in 2015 to 8% last year.

The free float of the currency, the Surinamese dollar, was a tricky but necessary measure. It helped to ease imbalances in the external accounts, with the current account deficit narrowing from 16.2% in 2015 to 4.3% in 2016.

Inevitably in such an open economy, the floating of the currency accelerated inflation, which began to rise in November 2015 and peaked at 79.2% in October the following year. But it has decreased sharply ever since,

and fell to 16.2% in August.

External accounts are likely to show continued improvement in 2017, thanks Merian becoming operational, which should lead to higher gold exports.

Responsible priorities

Suriname is now partly focused on broadening its revenue base; a new value-added tax remains a priority and should lift revenue as the economy recovers. The government is also taking steps to ensure it is in a position to make the most of a potential medium-term increase in exports, thanks to more gold mines or oil production.

In May, parliament approved the country's first sovereign wealth fund, known as the Savings and Stabilisation Fund, aimed at harbouring windfalls from the extractive industries.

DCM debut: Suriname beats expectations

International bond investors gave their backing to Suriname's economic recovery efforts when the sovereign raised \$550m of October 2026 notes at a yield of 9.25% in October 2016.

From GlobalCapital's coverage of the bond:

"Suriname's claims to be turning around its public finances found traction with bond investors after the sovereign's debut international bond was priced tighter than many market participants expected.

"According to some investors, Suriname is trying to take steps in the right direction. 'The policy making team is strong and has embarked on a reasonable fiscal reform,' said one EM sovereign bond portfolio manager."

Credit ratings

Moody's: B1 (stable)

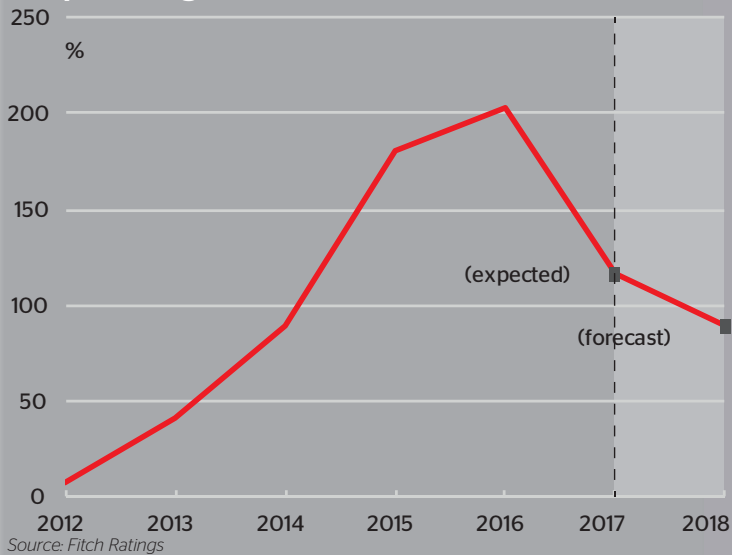
Standard & Poor's: B (negative outlook)

Fitch: B- (negative outlook)



Government finance requirement

Gross external financing requirement as a percentage of international reserves



Source: Fitch Ratings

Suriname's debut international bond issue, a \$550m 10 year, was well received by the markets in October 2016 and has performed well in secondary markets; it had traded up to about 108.5 by mid-September. The country also has access to official financing from the IADB, China and India. Although international reserves are increasing only gradually, Fitch expects the sovereign's financing requirement as a percentage of reserves to decrease in 2018.

GDP

Growth rate set to recover from commodity shock

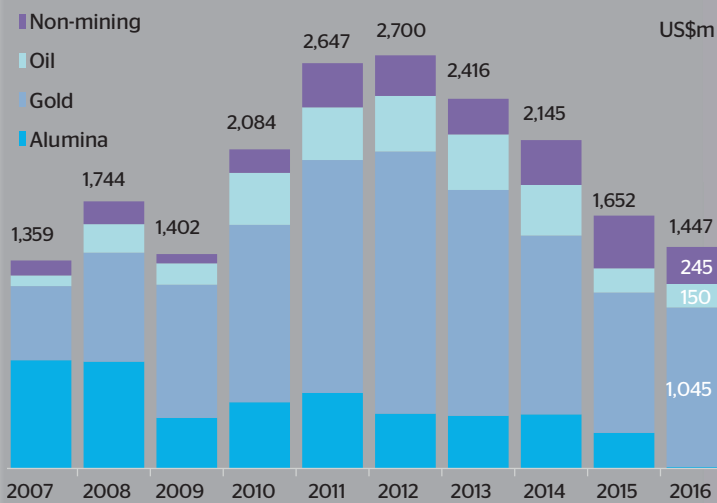


Source: Central Bank of Suriname, Fitch Ratings

Until the shock that hit commodities producers in 2014, Suriname was one of the best-performing economies in the Caribbean, with average growth of 4.3% between 2004 and 2014. The huge drop in income produced by lower gold and oil prices made 2016 a difficult year, but the economy is gradually recovering after authorities took actions including floating the exchange rate and cutting expenditure. FDI into oil exploration and development and gold mines may bring further upside.

Composition of exports

Metals dominate exports... for now

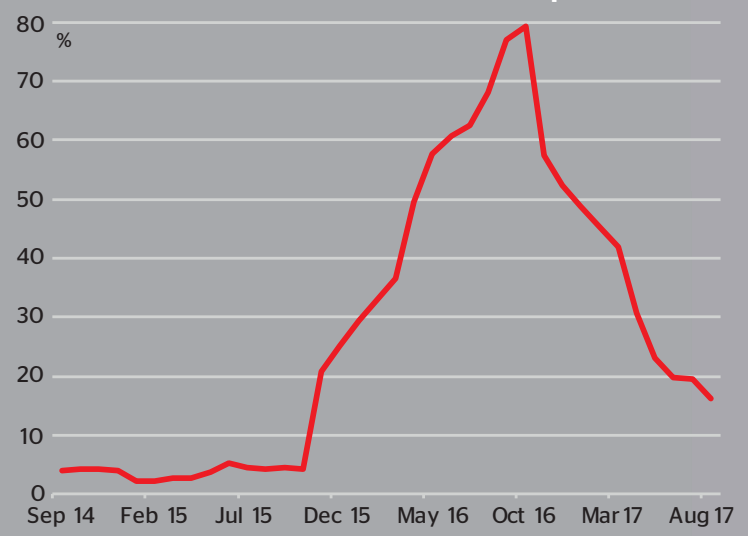


Source: Central Bank of Suriname, and mining companies

Suriname's export sector is evolving, with the previous dominance of alumina at an end and gold taking over. Although the drop in commodity prices has hurt overall volumes, positive changes await. Newmont's Merian Gold project came online in October 2016, and lamgold is reporting positive findings at its Saramacca project. Moreover, Exxon and Statoil are exploring offshore blocks off the coast in the hope that oil could become a major export for Suriname.

Annual inflation

Suriname over the worst of the inflation spike



Source: General Bureau of Statistics, Suriname

Inflation accelerated in 2016 as the inevitable result of the difficult but necessary measure taken to float the Surinamese dollar. However, external accounts have shown a marked improvement in 2017, and the currency has been stable throughout the year. Inflation has duly fallen sharply, and month-to-month price rises from July to August were just 0.6%.

Suriname making strides to fix macro weaknesses

After suffering from the end of the commodity boom more than most, Suriname's recovery is impressing many investors. Although questions linger around the fiscal consolidation plan, the government's reform agenda looks to be putting the economy on the right track.

Amid a deep recession, with inflation having just peaked at 79% and a ballooning debt to GDP ratio, Suriname surprised many observers when it approached the market looking for its inaugural cross-border bond in October 2016.

Yet those buyers who had faith in the government's plans have been rewarded handsomely: Suriname's \$550m of 9.25% 2026s had rallied to a dollar price of 108.5 by September.

In the words of one bond investor: "Suriname saw the abyss, but didn't fall."

In 2015 and 2016 Suriname underwent an adjustment the likes of which few countries see. The so-called triple commodity shock — a collapse in oil prices and gold prices combined with the end of the bauxite mining that had underpinned the economy for a century — shrunk the economy by 2.7% in 2015 and then a further 10.4% the year after.

The fiscal deficit widened sharply to 9.6% of GDP, and was still 8.1% in 2016. The external current account, which until 2012 had spent several years in surplus, posted a deficit of 16.2% in 2015. It also recovered to a deficit of 4.3% in 2016.

Suriname had done little to protect itself during the boom years. The IADB's latest quarterly bulletin says that the commodity price shock revealed several longstanding weaknesses: the lack of fiscal buffers, ineffective expenditure policy, and weaknesses in tax policy among others.

Managing the adjustment

But for a country in such a squeeze to access the bond market it must be doing something right, and the government's affirmative response to the shock has earned praise.

"The authorities launched an adjustment plan in late 2015, initially supported by the



An employee of SPCS (Staatsolie thermal plant) at work with the refinery as background

IMF, which included cuts to government expenditure and flotation of the exchange rate," says Jeetendra Khadan, economics consultant at the Inter-American Development Bank in Washington, DC. "Since then we have seen something of a turnaround in key macroeconomic fundamentals: the fiscal deficit has fallen, the current account has moved into surplus, inflation has decelerated and reserves have marginally increased."

Indeed, 2016's eye-watering inflation was the inevitable, if painful, result of the authorities making the right move. Floating the Surinamese dollar led the currency to lose more than half its value versus the US dollar from November 2015 to September 2016.

"Letting go of the currency was the right thing to do — although the government did it a little later than would have been ideal, and foreign currency reserves were drained," says Nathalie Marshik, managing director, head of sovereign research at Oppenheimer & Co in New York.

Better late than never: the currency float laid the foundations of the adjustment, and the country has swallowed the spike in inflation. By August, inflation had dropped to 16.2%, its lowest level since October 2015.

Suriname's adjustment received another helping hand as, just a few weeks before the bond issue, the Merian gold mine — a joint venture between state-owned oil company Staatsolie and international mining giant Newmont — began operations.

"As soon as the Merian gold project came online the current account came into surplus, relieving some external pressures," says Marshik.

At the same time, the current account balance was lifted by a sharp decrease in imports as the country stopped building gold and oil refineries, Marshik adds.

Still vulnerable

Suriname is not out of the woods yet. Despite the current account surplus, Suriname's FX



reserves are not recovering quickly — partly because the central bank is choosing to leave US dollars in the system to create an interbank market for FX, says Marshik.

"This is creating some appreciation pressures on the Surinamese dollar," she says. "This may help inflation, but it means the country is not accumulating FX buffers.

"If there were another external shock (a drop in gold prices for instance), the country would be very vulnerable."

Kelli Bissett-Tom, associate director in Latin American sovereigns at Fitch Ratings, says that net FX sales to support exchange rate stability "have constrained international reserve accumulation to less than the net inflows generated by the current account surpluses".

"From a ratings perspective, external liquidity looks weak," says Bissett-Tom.

No need for IMF?

Another move that some see as a vulnerability is the end of the IMF stand-by arrangement earlier this year. Moody's says that the cancellation of the programme "increases the risk of fiscal slippage", while Marshik describes it as a "setback".

For his part, finance minister Gillmore Hoefdraad says that it was "clear that the [IMF] financing would be a short-term nature", given that the current account — which had been undermining the balance of payments stability — entered a surplus in the fourth quarter of 2016.

Hoefdraad adds that "exchange rate stability and a lower fiscal deficit also lessened the need to secure foreign financing to restore confidence in the currency or finance budgetary operations".

Despite Moody's assessment, few doubt the government's willingness to reduce the fiscal deficit. As Marshik says, the ministry was hitting the IMF's fiscal targets, just not in the way agreed with the IMF.

If the IMF likes to see a combination of revenue and expenditure measures, such as raising taxes and cutting subsidies, the Surinamese government "slashed expenditures heavily, which exacerbated the recession", says Marshik.

"The Ministry of Finance is committed to keeping its finances tight, but there are political realities to meet," says Marshik. "As such the removal of electricity subsidies will have to be pared down and very much staggered over time."

Not being able to push through the removal of electricity subsidies, as the IMF would have liked, "puts greater pressure on the luck of the

natural resources sector," says Bissett-Tom.

For his part, Khadan at the IADB agrees that the government maintains its intention to implement a reform agenda even without the IMF. But would like to see more specifics.

"The elements of its stabilisation or recovery plan and timeline could be made more explicit," says Khadan. "Such information is important to provide confidence to different actors involved in the economy."

Hoefdraad is aiming to cut the fiscal deficit to 5% in 2017, saying that "continued expenditure restraint" would be the main support for this. However, Bissett-Tom says that Fitch is expecting a central government deficit of 6% or more, using its GDP and inflation forecasts.

Though it may be difficult to swallow, there is surely room for further spending cuts. Almost a third of government spending goes on wages and salaries, while another third of expenditure is subsidies and transfers.

"Such an expenditure profile can potentially stymie the effectiveness of fiscal policy and would require the attention of policymakers over the medium term," says Khadan.

Structural changes

If analysts are positive but uncertain regarding the speed of fiscal consolidation, they are upbeat regarding the government's reform agenda.

Tax is top of the list here, with Marshik describing the replacement of a sales tax with a value-added tax as a particularly important step. VAT would provide important uplift to revenue, says Bissett-Tom.

"We are not expecting VAT to be hugely revenue positive, but even if it's revenue neutral it would help to broaden the tax base as the economy recovers," says the Fitch analyst. "This would help to close the fiscal gap."

Hoefdraad, who does believe VAT will be revenue positive, says that the tax should be implemented in 2018.

Yet tax reform is not only about new taxes. According to Khadan, tax compliance when it comes to direct taxes is low — at around 40% of potential revenue — due to administrative deficiencies and resource constraints. Therefore, the IADB approved a loan in June to help strengthen fiscal institutions and address weaknesses in tax administration.

"This should enable the government to collect more non mineral-related revenues in the future," says Khadan.

Another measure that has earned universal praise is the establishment, in 2017, of Suriname's first ever sovereign wealth fund, known as the Savings and Stability Fund (SSF).



Staatsolie employees in wetlands

"It is very important that authorities transfer windfall mining revenue starting in 2018 as they have indicated, as the SSF can help to smooth adjustments in the event of future unexpected commodity shocks," says Khadan.

Of course, if these reforms are to have a real impact, Suriname's economy must return to growth. Here, estimates vary, though Fitch has put its forecast for 2017 at 0% plus or minus a percentage point, and at just 1% for 2018.

However, excitement in the natural resource sector mean there are several potential reasons to believe there is upside in those growth forecasts. Iamgold has confirmed better than expected gold discoveries at its Saramacca deposit, while state-owned Staatsolie is working with 10 international oil companies looking for off-shore oil. Given the exciting oil discoveries made in the waters of neighbouring Guyana earlier this year, hopes are high.

"Foreign direct investment into oil exploration and development and Iamgold's mine are potential upside risks to growth forecasts," says Bissett-Tom.

If these projects materialise, the benefits of the reforms could become very visible.

"If Suriname does implement the reforms that this recession has triggered [...] it will be in a positive position to make the most of these discoveries in a sustainable way," says Khadan. "To some extent, at least, the government appears to be learning from this experience."

If they have indeed learned, and if the oil discoveries meet the expectations of the companies exploring there, then those who bought Suriname's 10 year paper at 9.25% a year ago will have made one of the buys of the last few years.



Extracting growth: oil and gold generate excitement

The opening of Suriname's second large gold mine has played a crucial role in the country's economic recovery, and offshore oil discoveries in neighbouring Guyana have raised hopes for similar finds in Suriname. With the government apparently conscious of the need to be wise with the windfall, natural resources have the potential to transform the country.

The head of Suriname's state-owned oil company is excited.

"We are on the eve of a massive oil find," says Rudolf Elias, CEO of Staatsolie. "Suriname has just 500,000 people; this will change the landscape of the economy completely."

Elias lists with enthusiasm the 10 international oil companies that are partners of Staatsolie through production-sharing contracts. ExxonMobil, Statoil and Hess in July became the latest to join a list that, with one or two absentees, reads like a Who's Who of global oil giants.

"The best in the industry are with us," says Elias.

Offshore game changer?

It is easy to understand his enthusiasm. The US Geological Survey estimates that the Suriname-Guyana basin has 13.6bn barrels of oil, which make it the second most prospective unexplored oil basin in the world.

This means little until discoveries are made and proven to be commercially viable. However ExxonMobil's discoveries at the Liza well in 2015 and 2016, which confirmed a world-class find of over 1bn barrels, have served to "de-risk" the entire area, say experts.

Oil market observers agree that prospects are exceedingly good for Suriname, while emphasising that nothing is certain until discoveries are made.

"Suriname is right to be excited," says Alejandro Demichelis, director of oil and gas at Hannam Partners. "However there is a big 'but', and it's that people have been excited before only to be disappointed."

In April, Apache made what Demichelis calls a "high profile failure", failing to find commercial

quantities of oil at its Kolibrie well.

"That cooled things off a little bit on the Suriname side because it pushed operators to do some soul searching," he says. "Why is it not working on one side of the border?"

Julie Wilson, research director of global exploration at Wood Mackenzie, echoes the sentiment.

"We don't know yet whether the Liza complex in Guyana is a one-off or whether it can be replicated," says Wilson.

Suriname's finance ministry is not including any offshore oil projections in its balance of payments or fiscal revenue forecasts. But despite analysts trying not to get ahead of themselves, evidence suggests that Suriname could be on the verge of potentially transformative discoveries.

"In exploration there is always risk," says Wilson. "But then again there could be hidden fields of billions of barrels."

"Given what Exxon has achieved next door in Guyana with its string of discoveries that have exceeded expectations, there could be similar sized fields and discoveries in Suriname."

Following Liza, Exxon also made a discovery estimated at 500m of barrels at the nearby Payara well.

"What we've discovered from Liza is that the basin has an extremely good reservoir quality that will deliver high EUR (expected ultimate recovery)," adds Wilson.

Demichelis, despite his words of restraint, admits that the Guyana discoveries — which he calls "some of the largest we've seen worldwide in the past decade" — are extremely encouraging.

"It is very difficult in my mind to have something as big as the ExxonMobil discoveries and then have nothing else happen," he says.



Rudolf Elias, CEO of Staatsolie

The deals with Exxon and Statoil were seen as particularly important to get the market interested in Suriname again, and London-based Tullow is gearing up to start drilling its Araku prospect in October. This raises the possibility that a first offshore discovery could be imminent.

"What we have seen in that area over the past couple of years has put Guyana and Suriname on the world oil map," says Demichelis. "If you're a major oil company and you're not there, you may miss a very good chance."

IPO in preparation

In any case, Staatsolie is busy ensuring that, if oil is struck, it will need no time to get ready.

"Our message as Staatsolie is: Suriname should not think about if we will find oil, but should know that we will," says a bullish Elias. "This is why I say that Staatsolie must already be preparing itself for that day."

Staatsolie can take participations of up to 20% in offshore blocks if oil is found, so one of the first things it will need is money. To finance



Newmont Mining processing facilities at Merian

its participation in such big finds, the company is preparing for an initial public offering of up to 20% of its shares. A cross-border bond offering would also be likely.

"We want to be ready to push the button to attract international financing," says Elias.

The CEO says a shift in mind-set was also required, from being a production-driven company to a more value-driven one.

"We want our mind-set to be more like international oil companies so we can be equal partners in a joint venture," he says

In some ways, the offshore phenomenon is taking Staatsolie back to its roots, when in 1980 it was founded as an agent of the state to deal with international oil companies.

Back then, low oil prices meant low international interest, so the company therefore had to take the oil out of the ground itself. Suriname's onshore crude — low in sulphur and metals — was ideal for fuel oil for the alumina industry that drove the country's economy.

Thus was born Suriname's oil sector, which generated exports of just \$150m in 2016 —10% of the country's total. But these apparently modest beginnings could prove important.

"It is not difficult to deal with Staatsolie as it is a functioning oil company," says Wilson at Wood Mackenzie. "Companies are not having to work with a ministry full of officials that don't know anything about industry."

Furthermore, according to Demichelis, having a working oil industry in Suriname means that new discoveries can be developed more quickly than somewhere like Guyana.

"You have everything in place," he says. "Oil services are there, and there's a national company that knows how to do things and a government with experience."

A golden example

But it is gold mining, not oil, that is more advanced in Suriname, dominates the country's exports and brings employment to the local population.

Furthermore, though in a different industry, US-based Newmont Mining's investment in Suriname is a useful example of how joint ventures can work with Staatsolie, which owns 25% of Newmont Suriname.

Albert Ramdin, senior director for external relations at Newmont Suriname, says that Newmont's investment — which led to its Merian mine coming on line in October 2016 — has been "very successful".

"We are on target to meet our year-end production target of 500,000 ounces; our target for the first full five years of production is around 400,000-500,00 ounces per annum," says Ramdin. "We have now begun the second phase of investment — building the crushers that will allow us to process the rocks once we get into deeper ground, and expanding the energy capacity to run those crushers."

Newmont's investment in Suriname has been nearly \$1bn, and the company employs 1,250 people in the country, of which fewer than 10% are expats.

The company thinks it can be in the country for at least 13-14 years based on today's reserves alone, but Ramdin says it would like to have a longer presence in the country and has increased its exploration area.

Ramdin's view on the country's operating environment gives credence to Elias' claim that Suriname has a history of "treating multinationals with respect, and honouring contracts".

"As foreign investors, we have excellent relations with the government and everybody

is playing by the rules of the mineral agreement that we signed in 2013," says Newmont's Ramdin. "We have a very open, transparent and constructive relationship with the government and our partner Staatsolie, including regular meetings with all government stakeholders."

Newmont's investment is, after all, quite a boon for the government. The project provides the government with income in three ways, according to Ramdin. Each month it takes a 6% royalty payment for gold produced, Staatsolie takes dividends as a 25% partner, and there is indirect income through the "multiplier effect of taxes paid by employees and contractors".

Indeed, while offshore oil discoveries could provide the government with cash, they tend not to create local employment. In this respect, the gold industry will have a much more significant impact.

Bearing in mind the importance of any mine's relationship with the locals, Newmont has a co-operation agreement with the local Pamaka community.

"In the agreement it is very clearly stated that we will for instance give preferential employment to the local communities," says Ramdin. Newmont's engagement with local communities also extends to a community development fund that receives \$1 per ounce of gold sold.

"These efforts reaffirm our belief that a social licence to operate is not just a piece of paper but about being committed and respectful of the communities that live in the area," says Ramdin.

Newmont is now carrying out a social and economic impact assessment at its new discovery in Sabajo.

Savouring the boom

Suriname's gold prospects do not start and end with Newmont. Canadian Iamgold, which has been producing gold at the Rosebel mine since 2004, has been drilling at the nearby Saramacca site and in September confirmed a "significant gold discovery" that "exceeded initial estimates".

And irrespective of how the offshore oil explorations turn out, the prospects for the gold industry alone have driven it to approve Suriname's first sovereign wealth fund.

Appropriate management of that could be the key to ensuring that the excitement in natural resources has a lasting effect on Suriname, especially if offshore oil discoveries come off. This probably explains Elias's rather emotional excitement.

"I'm positive that if we have a good balanced sovereign wealth fund where we can put all the additional money that we may make, it will be able to benefit generations," he says. "It could be the fund for my children's children's children."

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Exclusive GM interview

Vujović reinforces reform agenda as Serbia's star rises

Following much needed but long delayed reforms, Serbia is turning its economy round and attracting foreign investment at an unprecedented rate. But can the Balkan country keep up the momentum? *GlobalMarkets* talks to Serbia's finance minister Dušan Vujović about the next challenges, including fiscal consolidation, trade blocs and EU accession

By Lucy Fitzgeorge-Parker

In his 3½ years in office, Serbian finance minister Dušan Vujović has overseen a remarkable turnaround in the country's prospects.

When he took on the role in mid-2014, Serbia's economy was in freefall. After a shallow recovery in 2012, GDP was shrinking again. The fiscal deficit was tipped to reach 8.8% of GDP, the current account deficit was in double digits and the debt to GDP ratio was rising at the fastest rate in the recent history.

Three years on, the picture looks very different. GDP growth resumed in 2015 and reached 2.8% in 2016. The fiscal deficit was slashed to just 1.3% of GDP last year while the primary budget was in surplus for the

first time in more than 10 years. As a result, debt to GDP peaked at 74% last year and is now down to less than 64%.

"I am very proud of the fiscal and the overall macroeconomic results achieved during the past three years of reforms, especially when viewed against the starting position," says Vujović.

Serbia's achievements have been recognised by international rating agencies. In December, Standard & Poor's upgraded the outlook on the country's sovereign rating to positive. Then in March, Moody's upgraded its rating to Ba3, bringing it into line with S&P and Fitch.

Both agencies cited Serbia's impressive fiscal consolidation and improved growth outlook as the main drivers for their actions.

Analysts at Euromoney Country Risk say

further ratings upgrades may be imminent. An ECR survey of Serbia experts in July showed that all five of the economic risk indicators measured had been upgraded over the previous 15 months. Overall, Serbia rose eight places to 76th in ECR's country ranking during the period.

Serbia has also jumped in the World Bank's Doing Business rankings, moving up 16 places to 47th over the past two years thanks to a clutch of reforms designed to improve the operating environment.

A key component of this impressive recovery was the approval of a new €1.2bn three year credit facility by the IMF in February 2015. Vujović, one of the leading architects of the programme, says it was critical to the country's recent economic success.

"IMF support was essential not only in forging commitment to a specific set of detailed macro-stability and structural objectives but also in specifying and observing structural benchmarks and constraints — especially expenditure ceilings," he tells *GlobalMarkets*.

LIFE AFTER THE IMF

With the IMF programme expiring early next year, however, some analysts are questioning whether the recent pace of reform in Serbia will be maintained. Vujović says he is "reasonably confident" but cautions that sustainability issues often loom large in transition economies.

"Serbia is no exception given its late start of reforms and the perceived and real weak ownership of reforms," he says. "It is therefore critical to complete structural reforms

in public administration, the financial sector and state-owned companies.”

Under the leadership of Alexander Vučić, who was elected president in May after three years as prime minister, Serbia’s government has promised to accelerate progress on a raft of much needed institutional reforms.

These include moves to improve public and private sector governance, strengthen the rule of law — especially in relation to creditor rights and contract enforcement — and reduce persistently high non-performing loan (NPL) ratios. Policymakers are also backing initiatives to make the tax system more transparent and predictable.

Foreign direct investors are already convinced. Serbia attracted \$2.3bn of inflows in each of the past two years and is a world leader in greenfield investment. In 2016, the number of new projects in the country reached 89, with manufacturing — mainly of electronic and automotive components — seeing the most interest from overseas firms.

Vujović warns that the level and efficiency of both public and private investment needs to increase further, however, if Serbia is to achieve higher sustained GDP dynamics and convergence in incomes and standards of living with the EU and its regional peers.

“More money for investment will not be enough if we do not continue to remove barriers to economic growth,” he says.

BALKAN TRADE BLOC

He is also a proponent of regional integration. In March, the EU’s neighbourhood policy and enlargement commissioner, Johannes Hahn, floated the idea of a common market for the western Balkans. The proposed grouping would include Bosnia, Montenegro, Macedonia, Kosovo and Albania as well as Serbia and would have a combined GDP of \$88bn.

“The countries of the western Balkans already trade a lot,” he says. “Deepening this to a common market concept makes a lot of economic sense. It will expand trade flows to free movement of capital and people, foster technological and managerial synergies and enhance the competitiveness of the region in external markets.”

He adds that the introduction of a common market would also lower or eliminate protection barriers. “It would thus better prepare the western Balkan states for eventual EU accession,” he says.

Questions have been raised over whether Serbia will be able to achieve EU membership in the near future, given the dwindling appetite for enlargement in many member states and the reluctance of policymakers in Serbia to address the question of Kosovo’s status.

Vujović insists that, if Serbia continues to open new policy chapters, the accession

process could realistically be completed by 2022. He admits, however, that this may not be achievable. “This would be a straight engaging path to EU membership,” he says. “In real life, burdened with politics and complex game plans, it is not always obvious that honest and straight strategies prevail.”

He notes, however, that the EU accession process is valuable in itself. “I see it as a test of our ability to get our institutions and policies right,” he says. “Although every country should do most of these improvements for their own benefit, EU membership as the final step in this process is important as a credible signal, a tangible target.”

OPAQUE SOES

One of the most intractable challenges facing reformers in recent years has been the restructuring of Serbia’s state-owned enterprises (SOEs). Opaque and unprofitable, many of these have been a constant drain on the public finances but have been able to muster powerful backing to resist change.

Progress is now being made, however, thanks in part to the IMF, which made the sale of these firms a key plank of its programme for Serbia although the country has a mixed record on privatisation. Attempts to sell Telekom Srbija have twice been called off late in the process to the frustration of bankers and investors.

Policymakers insist, however, that this time promised disposals will go ahead. Vujović notes that a handful of large SOEs — mostly in the metals, chemicals and pharmaceuticals sectors — are now approaching the final stages of privatisation and restructuring.

“Most of them will likely find strategic buyers and restore competitiveness in the

domestic and export markets through management and production restructuring,” he says. “If needed, we have adequate budget resources to cover severance payments and retraining programmes.”

The deal that is likely to attract the most interest from Serbia watchers over the next six months, however, is the sale of Komercijalna Banka. The country’s number two lender has been radically modernised and overhauled over the past 18 months by new CEO Alexander Picker in preparation for privatisation.

An agreement between the shareholders, which include the EBRD and IFC as well as the Serbian state, calls for the sale process to begin this year and be completed in 2018. According to Vujović, the formal privatisation process will likely be resumed this month (October).

Some M&A specialists have been sceptical of the likely extent of demand for Komercijalna, noting that Serbia is not seen as a strategic market by the big regional banking groups, most of which are in any case still in defensive mode. Interest has, however, reportedly been expressed by a number of private equity firms.

Vujović says Komercijalna has “obvious upside potential” both in the domestic market and the wider region. He notes that Serbia’s relatively fragmented banking market — 30 lenders currently serve a population of just seven million — offers good opportunities for consolidation.

“Regionally, Komercijalna can potentially develop a much stronger footprint in most western Balkan countries and effectively compete for a significant portion of the trade finance currently supported by large EU banks,” he adds. **GM**



"In real life, burdened with politics and complex game plans, it is not always obvious that honest and straight strategies prevail"

"I see it as a test of our ability to get our institutions and policies right"

—Dušan Vujović

China eyes Serbia as key Belt & Road link

For a small country, Serbia has proved remarkably adept at attracting capital from one of the world’s economic superpowers. Since 2010, China has provided nearly \$2bn of funding for infrastructure projects in Serbia, including motorways, a coal-fired power plant and a new bridge over the Danube.

An already close relationship between the two governments was deepened following the announcement by President Xi Jinping in late 2013 of plans to create a new Silk Road for trade between China and Europe.

As well as several overland routes, the Belt & Road Initiative is also due to include one that combines maritime and rail transport. The Land Sea Express Route will see cargo shipped to Greece by sea and then travel by train through the Balkans to Hungary and then on to western Europe. An initial shipment of Chinese furniture made the journey in January in a blaze of publicity.

Belt and Road

ON THE MAP

Serbia’s central position on this route combined with policymakers’ early embrace of Belt & Road has enhanced the country’s appeal for China. Last year, Chinese state-owned group Hesteel bought the Smederevo steel plant from the Serbian government, which had been forced to nationalise the loss-making facility in 2012.

In January, Bank of China opened its first Balkan branch in Belgrade. Then in May, at the Belt & Road Forum in Beijing, Serbian transport minister Zorana Mihajlovic signed contracts worth \$3bn for a clutch of new road projects including a motorway that will link Belgrade to the port of Bar in Montenegro.

Whether Serbia’s more important Belt & Road projects will come to fruition, however, is open to question. Work on a \$2.9bn high-speed rail link between Belgrade and Budapest, which began in 2015, was halted this year following reports that the European Commission was investigating whether the Hungarian government had violated EU laws in awarding the contract to a Chinese firm.—L.F.P

A new era of development banking

The EIB is stepping up support for the private sector through higher risk co-investment.

The EIB's commitment to Africa is nothing new. What is new is the bank's marked increased appetite for promoting higher risk investment, principally through its support for the private sector throughout emerging markets. "It's an over-simplification to say that private sector investment is good and public sector investment is bad," says Markus Berndt, head of the EIB's strategy and business development division. "In some countries, absorption capacity in the private sector is still poor, which is why when we launched our €3bn support package for Ukraine in 2014, for example, most of the increased investment was in the public sector."

"More generally, however, it is one of our main objectives to increase our risk-taking by supporting investment where it is most needed rather than where it is easiest and safest to provide," says Berndt. That means stepping up support for the private sector through higher risk co-investment. The EIB calls this the new paradigm in development banking.

Amboise Fayolle, the EIB Vice President responsible for Development says, "It has been clear for some time that the European Union needed to shift to a development policy using public and private funds in a more rigorous and effective way and with a greater focus on the real impact on people's lives. Here the EIB, as Europe's crowding in bank operating in more than 160 countries, has an important and valuable role to play. Given its successful



Amboise Fayolle
Vice-President in charge of Development

implementation of the Investment Plan for Europe, also called the Juncker plan, and the first projects under its own Economic Resilience Initiative in Mediterranean countries, the EIB is well placed to put this new paradigm into practice in the context of the EU's new External Investment Plan."

There are few regions where the risk is higher, but where the potential impact is more far-reaching and the need for support more pressing, than Sub-Saharan Africa. Paola Ravacchioli, senior investment officer at the EIB, says that according to one recent survey, no emerging region scores higher than Africa for the willingness of individuals to set up businesses; but none also scores higher than Africa for the number of businesses that are forced to close prematurely, which Ravacchioli attributes to the continent's incomplete entrepreneurial environment which SME's access to business development services, support and funding is extremely limited.

Heike Rüttgers, head of the development and impact finance division, says that for the EIB's activities in Africa, the first key change came in 2003, when it was endowed with the ACP [Sub-Saharan Africa, Caribbean and the Pacific] Investment Facility. This was a revolving facility, designed to be self-sustaining, aimed at promoting private sector development in the 78 countries covered by the Cotonou Agreement signed in 2000.

"In 2003 this was highly innovative, because people assumed the fund would need replenishing on a regular basis to cover the losses we were expected to incur," Rüttgers explains. "But when we reported to the member states in 2013-14, we surprised them by saying that far from needing any new funds, we would be able to increase our annual volumes."

Impact Finance Envelope

This was a landmark in the recent evolution of the EIB's strategy in the ACP, because it triggered the establishment of the Impact Finance Envelope (IFE). In exchange for additional funds from member states, this required the EIB to take a higher level of risk in its external lending activities in order to achieve a higher development impact in terms

Expected results of EIB projects outside the EU and the SDGs – potential connections*

Expected results from new projects in 2016

Source: EIB

	Cross-cutting poverty reduction impacts
	Irrigated rice production, enough to feed 160 000 people
	150 000 patients treated annually in new and rehabilitated hospitals
	37 100 additional student enrolled in higher educations
	6.7m people benefiting from improved water supply and sanitation
	1.2m households connected to electricity networks
	702 000 jobs sustained in supported SMEs, microenterprises and midcap companies
	51m journey hours/year saved through improved transport infrastructure
	1.2m passengers per day benefiting from improved urban public transport
	Energy production from renewables sufficient for 250 000 households

* The EIB is undertaking an assessment of how its operations contribute to the achievement of SDGs. The above is meant to illustrate potential connections but does not comprise the Bank's final assessment.

of economic growth skills transfer and job creation as well as environmental protection and the promotion of gender equality.

"In other words, we were required to push the boundaries by going into more fragile countries, taking more foreign exchange risk in exotic currencies, looking for opportunities in higher-risk areas such as agriculture and food security, and exploring operations targeting young and women entrepreneurs,"

says Rüttgers.

The IFE started with an endowment of €500m and a mandate which will run until 2020 to develop its operations using four different instruments. The first is equity, through participations in regional investment funds focusing principally on social impact motivated more by development objectives than pure profitability.

The second is intermediated lending, which refers to the provision of lines of credit to microfinance institutions, banks or leasing companies for SMEs. “The focus here is mainly on fragile countries and financial institutions which may be weaker and require considerable technical assistance,” says Rüttgers. “It may be based on thematic lines of credit, for smallholders for example, or by providing local currency financing in currencies previously regarded as too volatile.” Uniquely among IFIs, the IFE can invest up to 40% of its endowment capital in local currency risk, and now manages a portfolio of some 20 exotic currencies.

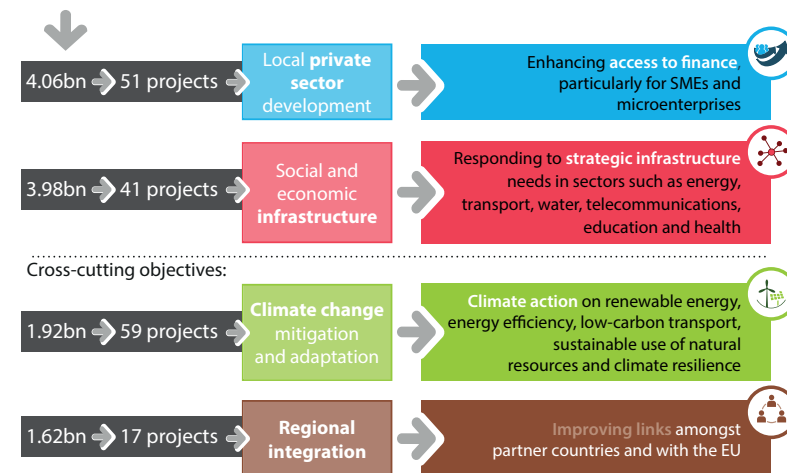
The third, which Rüttgers describes as the most innovative and risk-intensive, is providing first loss cover to motivate local banks to step up their lending to SMEs.

The fourth is direct lending to projects or corporate deals which have high development potential but would normally be rejected by the bank’s credit risk analysts, let alone commercial banks. A notable recent example is a €24m long-term investment in a project developed by Africa Mobile Networks to build 1,000 solar-powered mobile phone stations in remote areas of the Democratic Republic of Congo (DRC) and Cameroon. By connecting almost 4m people to the telecommunications network for the first time, this project will

Lending outside the EU for new projects by EU policy objectives

€8.04bn

Source: EIB



Many projects support more than one objective. “New projects” are those for which the first financing contract was signed in 2016. For each of these projects, the full approved financing volume is reported (see Annex 2).

expand access among people in previously isolated rural communities to commerce and other services. It will also support the economic empowerment of women and improve access to online health services.

The success of the IFE’s activities in Africa was endorsed within two years, when the Fund was authorised to increase its size to €800m and make the facility revolving. “We will have recycled the funds three times by 2020, and we believe that between now and 2030 we could continue doing so without member states being asked for any new contributions,” says Rüttgers.

Addressing the root causes of mass migration

Politically, this has become an especially important, sensitive and timely issue, given the severity of the migrant crisis that has intensified since 2015. The IFE does not provide humanitarian aid, but it has an indirect and — increasingly — a direct impact

on addressing the root causes of mass migration. This is because much of the investment it sustains is aimed at improving living conditions and enhancing job opportunities across many of the Sub-Saharan African countries that are the source of much of the migration flows towards Europe. The increase in the fund’s size was motivated by the recognition of the urgent need to tackle the primary socioeconomic drivers of the migrant crisis.

Since October 2016, a separate programme, the Economic Resilience Initiative, has increased the EIB’s financing in the Southern Neighbourhood and the Western Balkans directly impacted by the Syrian crisis. This is complementary to the EU’s broader External Investment Plan (EIP),

designed to create a coherent framework for improving investment in Africa and the EU neighbourhood. This in turn is aimed at contributing to the achievement of the Sustainable Development Goals (SDGs) and addressing some of the sources of uncontrolled migration.

The Results Measurement Framework (ReM), which is an important tool for all the EIB’s activities outside the EU, has been taken a step further for the IFE by broadening its scope known as ReM Plus. Instead of simply reporting how many jobs have been created by each of the investee companies in a social impact investment fund, for example, ReM Plus analyses in depth the local social impact of the investee companies.

Further strengthening the ReM process, Rüttgers says that the IFE has also engaged in a partnership with the Global Development Network where local researchers undertake so-called ‘deep dive’ impact evaluation.

Boost Africa

Another notable recent EIB initiative aimed at supporting Sub-Saharan African economic growth and job creation is Boost Africa. Launched in November 2016, this is a joint initiative between the EIB and the African Development Bank (AfDB) in partnership with the European Commission. Boost is a programme designed to support innovation and entrepreneurship based on three pillars: an investment programme encompassing equity participation in seed funds and other vehicles investing in start-ups and high growth SMEs; a technical assistance facility; and an innovation and information lab.

The Boost business model is based on the same formula that the EIB is applying to its support of growth opportunities throughout the world, which is co-investing alongside third-party investors. A notable differentiator of Boost is that the EC’s first loss guarantee is also extended to the EIB’s investing partners.

“We are hoping to catalyse investment from other DFIs and private investors thanks to the first loss piece,” says Ravacchioli. “We asked for the first loss piece to cover other investors because we believe this will be of huge benefit to fund managers looking to attract private sector support.”

EIB and AfDB have both committed up to USD 10m - and AfDB has

the Boost Africa combined investment would amount to up to USD 20m, depending on the Fund’s final size”. Ravacchioli says it is also at the due diligence stage of an enterprising project that will potentially have a very significant impact in terms of education and quality job creation for African youth.

Opportunities such as this epitomise the longer-term growth potential of Sub-Saharan Africa that the EIB is committed to unlocking through initiatives such as IFE and Boost Africa. “European companies are aware of the double-digit growth rates in a number of African countries,” says Rüttgers. “They recognise that there are opportunities there, but there is also a natural perception of the high risk involved. So we see a clear opportunity for institutions such as the EIB to build a bridge and crowd them into our projects.”



Paola Ravacchioli with her Africa Development Bank counterpart Mariam Yeo-Dembele talking with a potential final beneficiary of Boost Africa

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leadingview

How much does Trump matter?

By Joseph Nye

The United States has never had a president like

Donald Trump. With a narcissistic personality and a short attention span, and lacking experience in world affairs, he tends to project slogans rather than strategy in foreign policy. Some presidents, like Richard Nixon, had similar personal insecurities and social biases, but Nixon had a strategic view of foreign policy. Others, such as Lyndon Johnson, were highly egotistical, but also had great political skill in working with Congress and other leaders.

Will future historians look back at Trump's presidency as a temporary aberration or a major turning point in America's role in the world? Journalists tend to focus too heavily on leaders' personalities, because it makes good copy. In contrast, social scientists tend to offer broad structural theories about economic growth and geographic location that make history seem inevitable.

I once wrote a book that tried to test the importance of leaders by examining important turning points in the creation a century ago of the "American era" and speculating about what might have happened had the president's most plausible contender been in his place instead. Would structural forces have brought about the same era of US global leadership under different presidents?

At the beginning of the 20th century, Theodore Roosevelt was an activist leader, but he affected mostly timing. Economic growth and geography were the powerful determinants. Woodrow Wilson broke with America's hemispheric traditions by sending US forces to fight in Europe; but where Wilson made a bigger difference was in the moral tone of American exceptionalism in his justification of — and, counterproductively, his stubborn insistence on — all-or-nothing involvement in the League of Nations.

As for Franklin Roosevelt, it is at least debatable whether structural forces would have

brought the US into World War II under a conservative isolationist. Clearly, FDR's framing of the threat posed by Hitler, and his preparation for taking advantage of an event like Pearl Harbor, were crucial factors.

The post-1945 structural bipolarity of the US and the Soviet Union set the framework for the Cold War. But a Henry Wallace presidency (which would have occurred if FDR had not switched him for Harry Truman as vice president in 1944) might have changed the style of the US response. Similarly, a Robert Taft or Douglas MacArthur presidency might have disrupted the relatively smooth consolidation of the containment system over which Dwight Eisenhower presided.

At the end of the century, the structural forces of global economic change caused the erosion of the Soviet superpower, and Mikhail Gorbachev's attempts at reform accelerated the Soviet Union's collapse. However, Ronald Reagan's defence buildup and negotiating savvy, along with George H. W. Bush's skill in managing the end of the Cold War, were important to the final outcome.

Is there a plausible story in which, owing to different presidential leadership, America would not have achieved global primacy by the end of the 20th century?

Perhaps if FDR had not been president and Germany had consolidated its power, the international system in the 1940s could have realised George Orwell's vision of a conflict-prone multipolar world. Perhaps if Truman had not been president and Stalin had made major gains in Europe and the Middle East, the Soviet empire would have been stronger; and bipolarity might have persisted longer. Perhaps if Eisenhower or Bush had not been president and a different leader had been less successful in avoiding war, the American ascendancy would have been driven off track (as it was for a time by US intervention in Vietnam).

Given its economic size and favourable geography, structural forces would likely have produced some form of American primacy in the twentieth century. Nonetheless, leaders' deci-

sions strongly affected the timing and type of primacy. In that sense, even when structure explains a lot, leadership within the structure can make a difference. If history is a river whose course and flow are shaped by the large structural forces of climate and topography, human agents can be portrayed as ants clinging to a log swept along by the current, or as white-water rafters steering and avoiding rocks, occasionally overturning and sometimes succeeding.

So leadership matters, but how much? There will never be a definitive answer. Scholars who have tried to measure the effects of leadership in corporations or laboratory experiments have sometimes come up with numbers in the range of 10% or 15%, depending on the context. But these are highly structured situations where change is often linear. In unstructured situations, such as post-apartheid South Africa, the transformational leadership of Nelson Mandela made a huge difference.

American foreign policy is structured by institutions and a constitution, but external crises can create a context much more susceptible to leaders' choices, for better or worse. If Al Gore had been declared president in 2000, the US probably would have gone to war in Afghanistan, but not in Iraq. Because foreign-policy events are what social scientists call "path dependent," relatively small choices by leaders, even in the range of 10%-15% early on a path, can lead to major divergences in outcomes over time. As Robert Frost once put it, when two roads diverge in a wood, taking the one less travelled can sometimes make all the difference.

Finally, the risks created by the personality of a leader may not be symmetrical; they may make more of a difference for a mature power than for a rising power. Striking a rock or causing a war can sink the ship. If Trump avoids a major war, and if he is not re-elected, future scholars may look back at his presidency as a curious blip on the curve of American history. But those are big "ifs."

Joseph S. Nye, Jr. is a professor at Harvard and author of Is the American Century Over?

AGENDA

Don't Miss



10.00am – 11.00am

Fighting corruption

Moderator: **Sean Hagan**, General Counsel and Director, Legal Dept, IMF
Speakers: **Christine Lagarde**, Managing Director, IMF; **Laura Alonso**, Secretary of Public Ethics, Transparency and Fight against Corruption, Argentina; **Ngozi Okonjo-Iweala**, Chair of GAVI and former Finance Minister, Nigeria; **Susan Rose-Ackerman**, Henry R. Luce Professor of Law and Political Science, Yale University School of Law
Location: IMF HQ1, Atrium

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The Federation of Egyptian Banks Reception in the Willard Room at the Willard InterContinental



MeetingPick

8am - 11am

Euro50 Group & CIGI Breakfast Meeting Strengthening the Eurozone

Location: Willard Intercontinental Hotel
1401 Pennsylvania Ave NW, Washington, DC

7:45am - 8:00am

Registration

8:00am - 8:10am

Welcome remarks: Edmond Alphandéry,
Chairman of the Euro 50 Group

8:10am - 8:25am

Guest speaker: François Villeroy de Galhau,
Governor of Banque de France

8:25am - 8:40am

Intervention of the President of the European
Investment Bank

Guest Speaker: Werner Hoyer, President of the
European Investment Bank

8:40am - 8:55am

Strengthening the EU financial markets

Guest speaker: Steven Maijoor, Chair of the
European Securities and Markets Authority (ESMA)

8:55am - 9:20am

Discussion panel: How to strengthen
the Eurozone:

Lorenzo Bini Smaghi, Chairman of Société
Générale; René Karsenti, President of Interna-
tional Capital Market Association (ICMA);
Mahmood Pradhan, Deputy Director of the Euro-
pean Department, IMF; Klaus Regling, Managing
Director of the European Stability Mechanism

9:20am - 9:35am

Wrap-up remarks

Guest speaker: Nouriel Roubini, Professor of
Economics at Stern School, NYU; Chairman of
Roubini Global Economics

9:35am - 10:50am

Questions and Answers
With Guest Speakers and Panellists

10:50am - 11:00am

Concluding remarks
Tom Bernes, CIGI Distinguished Fellow



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Russia

Continued from page 1

EBRD does try to return, ill will in Moscow will mean that hostilities could continue. “The EBRD has sent a very strong signal that at this stage it doesn’t have any plans of coming back,” he said. “It was rather expected, so we will focus our efforts on developing our relations with other IFIs like AIIB and New Development Bank.”

EBRD spokesperson Jonathan Charles said that the institution was committed to Russia, which remains its third biggest operation globally. “There are a lot of people in the bank who feel very strongly about Russia,” he said.

The bank suspended funding to Russia in 2014 after what Morozov called “political guidance” from the European Council which called for an expansion of “restrictive measures” on Russia following the invasion of Crimea and the downing of Malaysia Airlines Flight 17. Morozov said the decision was made outside the EBRD’s established legal procedures,

“we will focus our efforts on developing our relations with other IFIs” — Denis Mozarov

under pressure from the bank’s shareholders, guided by the G7 and the European Council.

He warned that the decision to suspend lending not only undermined the credibility of the EBRD in Russia, but set a dangerous precedent and raised concerns about the bank’s operations in other countries, which shareholders are “worried about”.

“This shows the poor governance of institutions like the EBRD. They promote the best standards, but internally they can do whatever they like.”

Russia launched a complaint against the EBRD on grounds that it had breached Article 8.3 of its founding principles at the EBRD Annual Meeting in Nicosia this year. The EBRD’s board of governors voted almost overwhelmingly against the claim.

“It was a big shock to the institution,” said Morozov. “The Europeans wanted to send a signal to Russia indirectly. The decision was adopted [by the EBRD] without any proper analysis, proper consideration, and serves to violate the rules of the bank. It was a political, emotional decision and was very short sighted.”

Charles told *GlobalMarkets* that the case was considered thoroughly and was not supported by the governors’ vote. He added that if operational requirements in Russia changed, the bank would be ready to re-examine its infrastructure and staffing requirements. Four of the offices have been financed to date by the Russia Technical Cooperation Fund and the Russian Federation has decided not to fund the Programme beyond this year.

THE final word

Colombia is ready to exploit its full potential

By Humberto de la Calle

The peace agreement with Farc brings Colombia a world of opportunities. If we can turn this page in our history successfully and transit effectively to a democratic debate in which Colombians solve their differences in the voting polls and not with bullets that in itself is a reason for hope.

In no way, however, does that mean that all of our problems are solved. The end of Farc brings new security challenges that require a present, more efficient state in areas that were for many years out of its reach. It also brings an opportunity to concentrate our resources and attention on growing and transforming our society into one of equal opportunities for all.

Colombia has a fracture that needs to be mended. Two countries co-exist: one that is urban, modern, wealthy, and educated; another that is rural, poor, and invisible to many. A great challenge now is to bring these two countries together by turning the attention to rural development. I envision an economic growth model based on agricultural and agro-industrial development oriented to the international markets, sustainable and appropriate to the ecological conditions of each region, mindful of preserving our water sources, our soils and our biodiversity.

Growth will give us new possibilities. To ensure that we transit rapidly out of the deceleration our economy is going through, there are a number of measures necessary to straighten the path. One of them is adjusting our tax structure that currently places the burden more on firms than on people, exactly the opposite of what happens in more developed economies. In Colombia the wealthiest pay very little taxes. A fairer society requires a more progressive tax structure and an understanding that the productive sector is the motor of growth and should not be over-burdened because that happens at a cost for all.

Another route for reform looking at economic



growth has to do with ensuring a level playing field for investors, and a good environment for business. The Colombian state has become complex and intrusive, and special treatments for particular groups or firms are the norm. This has to end. The Colombian government has to simplify its approach to business and work for all. Systematisation of processes should go a long way in this direction and also help to prevent corruption, a scourge tinting our past and our present that also

needs to be dealt with if we want to effectively build a better future.

A third route for reform is to refocus government efforts on the provision of public goods. There are a number of large road projects we call the 4G that

“ I envision an economic growth model oriented to the international markets, sustainable and appropriate to the ecological conditions of each region

must be brought to completion, some of them still needing to secure financing. Transport infrastructure connecting Colombian producers to international markets at competitive cost is a necessary minimum for economic growth. The next president of Colombia has to build on what has been advanced on this front. The financial structuring of these projects may have to be revised to attract new investors.

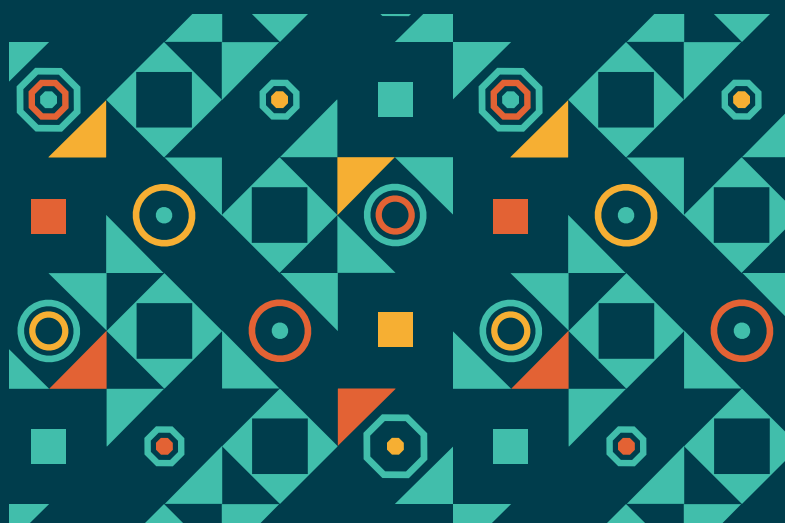
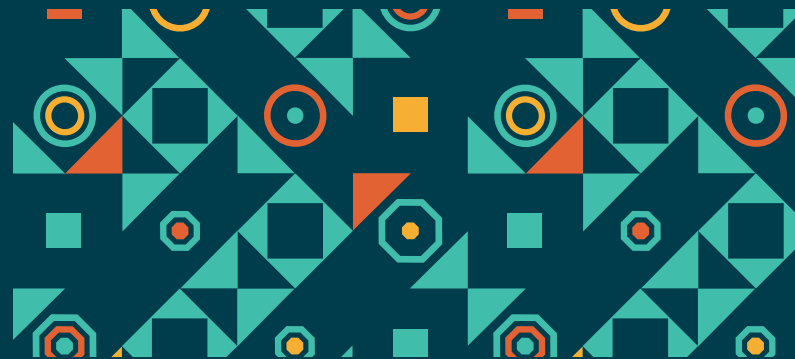
Last but not least, Colombia has to rethink its innovation policy. Government agencies in charge of innovation must be strengthened, not only in terms of increasing their budget, but also in terms of refocusing their action. Colombia has to optimise its innovation expenditure, working together with the private sector and academia towards a more effective model.

I envision a more prosperous Colombia that will live up to the new challenges, close its wounds, and be able to exploit its full potential.

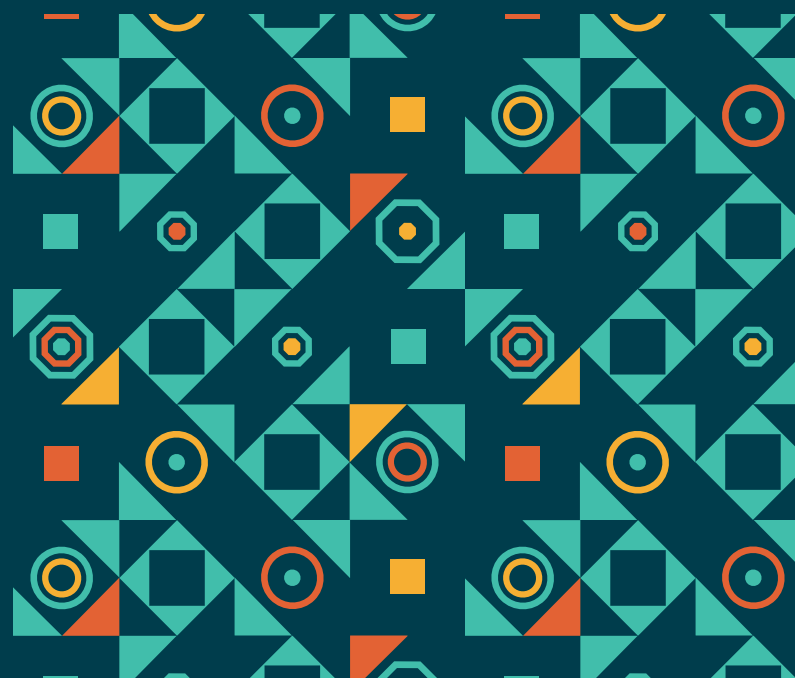
Humberto de la Calle, candidate in next year’s Colombian presidential elections and the government’s chief negotiator during the peace process with the Farc guerrilla group.

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