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Dollar under threat: US exit from global stage could trigger $800bn reserve crash sale

By Phil Thornton

A full-blown exit by the United States from the global financial and trade system could trigger a violent slump in the dollar and a spike in long term interest rates, leading experts on the US currency have warned.

In a paper published on the eve of the IMF annual meetings amid growing signs that US President Donald Trump is turning his back on multilateralism, Professor Barry Eichengreen and two European Central Bank economists warn, in their own capacity, that this could spark a move by disenchanted partners away from holding dollars.

Trump: support for the dollar will be tested by president Trump's attitude towards multilateralism

A deterioration in the relationship between the US and countries that hold dollar reserves could lead those central banks to reconsider their reliance on the dollar. Security alliances go a long way toward explaining why the US dollar so dominates the reserve portfolios of traditional US allies such as Germany,

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Pakistan's latest IMF bailout faces tricky China debt hurdle

By Elliot Wilson

Pakistan's finance minister Asad Umar will begin formal talks with the IMF in Bali this week, with the aim of finalising a $12bn bailout that will help it step back — yet again — from the brink.

But tough negotiations could be further complicated by the role of China, which is Pakistan's most important creditor investing over $60bn in Pakistan in recent years, lending $4bn in the last 12 months alone.

The South Asian state was left with little choice after foreign exchange reserves slipped to $8.4bn in September, barely enough to cover import payments until the end of the year. If approved, it will mark Pakistan's 13th and largest IMF-led support package since becoming an independent country in 1947.

In a video message, Umar blamed the previous government for the country's malaise, and said the talks, which are likely to take up to eight weeks, were necessary to address a mounting balance of payments crisis. The IMF told *GlobalMarkets* it had "not yet" received a formal request for financial support, but added: "We understand that Pakistan intends to approach [us]. Once we receive a formal request, the

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Umar: formal talks in Bali

China's corporate debt levels, trade tensions drive up fear factor for global economy

By Jackie Horne

China must reduce its debt levels before financial markets lose faith in its ability to prevent a macroeconomic shock to the domestic and global economy, bankers and analysts have warned.

Financial market participants said the fear factor was rising as trade tensions made it increasingly hard for China to manage a delicate balancing act between hitting its growth

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OUT OF THE WOODS

Seen and heard in the corridors of the Annual Meetings

• / **Dazed and confused** The sight of delegates, fresh off the plane and staggering around in search of friendly faces, never grows old. One central bank planning official, spotted loafing in a bamboo grove outside the Indonesia Pavilion, summed up the classic 'day one experience'. "I'm lost," he wailed. "This place is a maze." Fortunately for him, *OOTW* was on hand to usher him back to civilisation and safety.

• / **Virtually there** Spotted in the lobby of the Westin: promos for a virtual reality tour of the World Bank's global ops. No one was on hand to help *OOTW* pop on a VR headset, but there was a handy leaflet that guided us to a slow-loading website that contained photos of plastic pollution in the wake of the Sierra Leone mudslide. A vision of the future through a very human lens.

• / **Pool fool** Journalism is so rock-'n'roll. At least it is at *GlobalMarkets*. But rather than drive Rolls Royces into swimming pools, our journalists instead accidentally fall into them. *Out of the Woods* was heartened when a colleague of many years was so focused on taking a selfie at Ku De Ta, one of Seminyak's smarter eateries, that he failed to see the swimming pool behind him. Cue: one very bedraggled journalist and much merry laughter.

• / **Food farce** When *OOTW*'s tummy starts started rumbling mid-afternoon, the search was on for grub. But the press centre was fresh out mini-doughnuts and the Westin wasn't offering room service. An official pointed us to a café that was closed, as were all the beachside eateries. Even Odysseus didn't have to search this hard for a snack.

• / **Reddy for a crisis** Is our world filled with unforeseeable Black Swans or is it more predictable than we'd like to believe? Speaking yesterday, former Reserve Bank of India governor YV Reddy, who attended his first IMF meeting in 1978, pointed to the decennial cycle of crisis, from the 1998 Asian financial crisis, through the near collapse 2008, right up to this year's global volatility and trade tensions. Perhaps, deep down, we just have it in for ourselves.

• / **Dressing down:** There's a distinctly relaxed feel to this Bretton Woods conclave, whether due to the climate or the omnipresent batik shirts and shawls favoured by delegates. They look fab – though one wonders if 'demob-happy' is the right vibe in a world facing trade wars, climate, change, and maritime warming and plastic pollution. Still, at least chilled-out Bali has turned our frowns upside-down.

Governments must back bank efforts to end dirty financing

By Owen Sanderson

Commitments by private sector banks to end dirty financing will ultimately fail to achieve the goal without action from governments, as they are the only entities that can prevent other, less scrupulous institutions stepping in with alternative funding, a leading banker has warned.

Two weeks ago, Standard Chartered pledged to no longer finance new coal power projects, a commitment made by 17 other major banks, according to the BankTrack project, an environmental pressure group that monitors loan commitments to polluting projects. But according to BankTrack, almost all the banks stepping out of coal are European-headquartered, with US-based PNC and US Bank and South African Nedbank the only exceptions.

Standard Chartered did not pull financing for the 14 projects in the pipeline when it made the announcement, although CEO Bill Winters said: "More than 1.1bn people still do not have access to reliable power but recent developments in technology mean that alternative sources are increasingly available to meet that need without the impact of coal-fired power on the environment."

Olivier Osty, head of global markets at BNP Paribas, said it was up to governments to stop banks financing dirty polluting projects. "I don't see who else can do it," he told *GlobalMarkets*. "As banks we can only do what we're able to do, and until governments step in, there will always be someone else ready to step in. I'd like to think that because we've stepped away, the cost of financing so-called 'dirty projects' has increased, but it's hard to see that in [bond] spreads."

Winters: pulling Standard Chartered out of financing new coal power projects

'BOLD STEPS'

BNP Paribas dropped thermal coal three years ago, and since then has pledged to finance no more new coal power plants. It has also committed to dropping "unconventional fossil fuels" — arctic oil exploration, shale extraction, tar sands, and related infrastructure such as pipelines.

This decision cost a lot of money — but without government action to stop other banks stepping in, it will have little effect, Osty said. "On sustainability, our CEO sets the tone in terms of what the bank is willing to finance, and we've taken pretty bold steps," he said.

"Coming out of shale oil and gas means dropping a business where banks are very much present. The important thing is to stick to the goal of sustainable finance and not destroy the planet."

The World Bank and International Finance Corporation have been slower to commit to culling coal than private sector banks in Europe. The US Treasury guidelines for multilateral development banks introduced under the Trump administration, say that the US vote should "help countries access and use fossil fuels more cleanly and efficiently".

The IFC is mainly exposed indirectly, through its support for financial institutions in emerging markets.

Bullish Brazilian markets hail Bolsonaro's near victory

By Thierry Ogier

Financial investors have hailed the strong performance of the far right candidate Jair Bolsonaro in the first round of Brazil's presidential election. The São Paulo stock exchange soared by 4.6% and registered a trading peak of $6.5bn in transactions in a single day just after Bolsonaro, who has pledged market friendly policies, came close to clinching an outright victory with 46% of the votes. The dollar also fell by 2.3% on Monday against the real.

Bolsonaro's left wing opponent Fernando Haddad trailed him by 17 points, and investors feel that Haddad will have too much work to do to be elected in the run-off vote on October 28.

While Bolsonaro's anti-corruption stance and hard line views on law and order are popular with the electorate, markets have praised the economic programme that was prepared by his main economic adviser Paulo Guedes. "He understands what is to be done," said Luiz Fernando Figueiredo, a former central bank director and partner at Mauá Capital, an asset management firm in São Paulo. "He has said very clearly that the course [of economic policy] should be corrected. He has pointed to areas where we must act, in terms of pension reforms, in terms of lowering the tax burden and curbing the role of the state," he said.

The outgoing government has implemented some reforms, including new labour legislation, but it has failed to pass a key pension reform due to lack of support in a fragmented Congress.

Guedes, a former Chicago-trained investment banker, has pledged to restore fiscal discipline and privatise most state-controlled companies, including the oil giant Petrobras, which was at the centre of a huge corruption scandal in recent years. Some 150 companies could be sold or closed down in the coming years, he said, which would bring R$1tr (around $265bn) into public coffers. The sum would be used to reduce debt. The primary budget deficit (equivalent to some 2% of GDP) would be eliminated as early as next year.

Bolsonaro: The bar for major reforms to tackle the large fiscal deficit is high

WORD OF WARNING

Analysts said the market rally still had some way to go and that bond spreads could narrow further as the political risk declined. Bolsonaro's small Social Liberal party has become the second largest in the lower house after last Sunday's legislative elections. But even if he is elected president at the end of the month, Bolsonaro would still have to cement a majority among 30 parties. "The bar for major reforms to tackle the large fiscal deficit is high," said William Jackson, chief emerging market economist at Capital Economics. "As these hurdles become more apparent, the Bolsonaro boost may start to falter."

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Success is a journey

'IMF is losing relevance' as future crises prompt funding fears

By Phil Thornton

The resources amassed by the International Monetary Fund to fight financial crises are less adequate than they were 20 years ago, according to a report by leading academics calling for wholesale reform of the Fund to prevent it becoming irrelevant.

The report, published just a month ahead of this week's annual meetings, warned the amounts committed under programmes had continued to rise, placing a strain on the IMF's finances.

Entitled *IMF Reform: The Unfinished Agenda*, the report by the Centre for Economic Policy Research (CEPR) comes amid growing concern that the IMF will have to mount bailout programmes for Turkey and Pakistan on top of its $57bn rescue package for Argentina.

"The Fund's resources have more than tripled since 2000, but they have risen much more modestly relative to global GDP," the report said. " The resources are likely to be less adequate than 20 years ago."

Even more concerning for policymakers is the fact that resources could well be cut by half over the next few years. "The IMF is losing relevance," said Charles Wyplosz, one of the authors and a professor at the Graduate Institute in Geneva. "New institutions have appeared that are doing the job that the IMF was the only one to do in the past and further down the road I am concerned about diminished resources."

While the IMF has $1.4tr of financial resources, $450bn are bilateral loans that expire in 2020 and $265bn New Agreements to Borrow (NAB). The US commitment under the NAB expires in 2022 and if it failed to renew the loan other countries would pull out too, he said.

"Absent anything happening, the IMF is going to lose more than half a trillion dollars in resources," Ted Truman, a former US Treasury official and now a fellow at the Peterson Institute for International Economics, told *Global Markets*. "So, if you are worried whether the Fund will be able to meet the inevitable financial requirements of the 2020s, there's a lot to worry about."

The issue will come to a head as the US decides whether to back or block plans for an increase in the IMF quotas — its general resources — by 2019. If the US blocks the move to avoid losing its current share that allows it to block agreements, Truman said countries such as China would expand regional funding arrangements (RFAs) such as the Chiang Mai Initiative.

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Truman: IMF will lose $500bn in resources

The CEPR report said the financial system relied heavily on emergency bilateral currency swaps provided by a handful of central banks. "It is an intractable situation because swaps have been so successful and powerful during the global financial crisis," Wyplosz said. "But they are totally not multilateral. The Federal Reserve had its own list and those not on it could scream and cry but there was nothing they could do." The report urged the Fund to set up its own Fast Qualification Facility to take the place of bilateral swaps.

Storm Florence blows a hole in US flood insurance numbers

By Jasper Cox

After Hurricanes Harvey, Irma and Maria burnt insurance-linked securities (ILS) portfolios last year, many in the industry were expecting more trouble as Hurricane Florence headed towards land in mid-September.

"We had significant buying interest for Florence Live Cat industry loss warranties [ILWs] starting on the weekend of September 8 and 9," said Patrick Gonnelli, partner and global head of ILS distribution and trading at TigerRisk Capital Markets & Advisory.

ILWs insure investors against total industry losses exceeding a certain amount. Gonnelli saw clients wanting to buy at the $15bn industry loss trigger level, but sellers, fearful of higher losses, only wanted to sell at the $25bn-$30bn level.

As the deaths of around 50 people and the images of submerged communities attest, the storm ended up causing plenty of damage. But ILS got off lightly, which is surprising on the face of it, given how exposed the market is in the US.

As the storm arrived, it slowed down. Instead of punishing the Carolinas with the epic wind speeds predicted, it released torrential amounts of rain.

Catastrophe bonds tend to be more exposed to wind than rain. This meant ILS portfolio managers could rest easy.

"The trading in the secondary market for cat bonds has been very light right before, during and after the storm," said Gonnelli. Even the one catastrophe bond exposed purely to flood risk, issued by the National Flood Insurance Program (NFIP), may not be affected.

This in turn reflects the exposure of the US insurance industry to flooding. Data firm CoreLogic estimates $6bn-$10bn of insured flood losses from Florence versus $13bn-$18.5bn of uninsured flood losses and says around 85% of residential loss is uninsured.

In the Carolinas, NFIP coverage was scarce. Almost all inland counties had a take-up rate of less than 3%, according to data compiled by Mark Bove, senior research meteorologist at Munich Re.

Experts reckon Florence is likely to affect the earnings of insurers, rather than their solvency.

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Florence: flood losses expose insurance shortcomings

"We do see better private insurance in the commercial space but in the residential space it's shocking," said Stephen Moss, director of capital markets at catastrophe modelling firm Risk Management Solutions.

"This and Harvey last year is a good demonstration of how there is a real need for a structural change in the US flood insurance market," Moss added. RMS has been developing its US flood modelling, which Moss believes could help spur on the market.

And the shortcomings of the flood insurance market are likely to become ever more visible. Climate change is causing tropical cyclone precipitation to be 40% higher, according to Peter Sousonis, director of meteorology at AIR, another modelling firm.

London Connect throws up more questions than answers

By Rashmi Kumar

Following the success of the Shanghai-Hong Kong and Shenzhen-Hong Kong stock connects, China's regulators are keen to roll out the link to London, in what is the latest example of China's renminbi internationalisation strategy.

But the initial blueprint of the rules, published and under public consultation since the start of September that will govern the London-Shanghai Connect, has raised more questions than provided answers.

"The [China Securities Regulatory Commission] and the [London Stock Exchange] are both consulting on the London-Shanghai Connect but the consultations currently lack the necessary details," Eugenie Shen, head of the asset management group at Asia Securities Industry & Financial Markets Association (Asifma), told *GlobalMarkets*. "Besides doing public consultations, they need to work closely with the buy and sell side of the industry to iron out the operational issues of the Connect."

Among the missing details that need sorting out are issues around fungibility, currency conversion, settlement and clearing, and other operational issues, said Shen. She pointed to the example of Chinese stocks' settlement period of T+0 days, while the LSE settles on a T+2 cycle. Differences such as these will need to be worked out, as was done with the Shanghai and Shenzhen connects with Hong Kong, she added.

In its basic form, LSE listings by Chinese companies will be done through Global Depository Receipts (GDRs), which will be the same as the traditional GDRs except they will trade on a special section of the exchange, called the Shanghai Board. Foreign listings on the SSE will be through Chinese Depository Receipts (CDRs).

A big difference between China's link with London versus the Hong Kong tie-ups is the usage of depositary receipts for the former, while the latter involves shares. This change means more clarity is needed around the relationship between the depositary receipts and the underlying stocks themselves and how fungible they are, say market watchers.

And then there is the question around what currencies will be used for trading GDRs. The draft rules throw little light on that, with speculation rife about dollars, pounds or renminbi being in favour. But the dollar appears to have a natural advantage.

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Infrastructure needs unfilled despite big promises

The infrastrcuture asset class is not clearly understood or standardised; money is attracted to high value projects such as energy and telecoms but less to basic needs such as water and roads; and low income countries tend to fail one-size-fits-all assessments by investors.

Collaboration
Public private partnership: **1.** CIPREL IV Power Project in Côte d'Ivoire **2.** CMSA Manzanillo Port Terminal in Mexico **3.** Noor Ouarzazate Concentrated Solar Power Complex in Morocco **4.** Rendering of Elazig Hospital in Turkey **5.** Metro Lima Line 2 in Peru **6.** The Azura-Edo Independent Power Plant in Nigeria

By Phil Thornton

On one day in September, initiatives in two neighbouring countries highlighted the continued split in thinking over how to tackle even a small part of the multi-trillion dollar global deficit in infrastructure spending.

The Scottish National Party set a target of increasing annual capital spending by £1.5bn a year or the equivalent of about 1% of Scotland's GDP by 2026 based on new ways to draw private sector involvement into infrastructure development.

Meanwhile in England, the left-leaning thinktank, the Institute for Public Policy Research, bemoaned the failure of the private sector to provide sufficient capital, calling instead for the creation of a National Investment Bank to lend up to £200bn funded by increased public borrowing and higher taxes on wealth.

While neither initiative will do much to fill the infrastructure shortfall, particularly in emerging and developing economies, they highlight the tensions between public and private led solutions.

Global infrastructure finance needs are vast. According to McKinsey, the world must invest 3.8% of GDP, or an average of $3.3tr a year, to 2030 in economic infrastructure, just to support expected rates of growth. This adds up to a cumulative need for $49tr. Emerging economies account for some 60% of that need.

Some estimates are even higher. The Global Infrastructure Hub (GIH), an initiative of the G20 group of nations, has calculated the need as $3.7tr annually by 2040, while the OECD estimates global investment needs of $6.3tr a year in 2016-30 to support growth and development, without considering further action needed to combat climate change.

Despite these dramatic and repeated siren calls, the world is simply not spending enough. According to McKinsey, countries currently invest around $2.5tr a year leaving a vast shortfall needed to invest in the transport, power, water and telecom systems that underpin economic activity and provide essential services.

However, infrastructure investment has actually declined as a share of GDP in 11 of the G20 economies since the 2008 global financial crisis, with the European Union, the United States, Russia and Mexico among those where spending has fallen.

The fiscal fallout from the crisis is one reason why many believe direct public funding can no longer be the solution. The state bailouts of banks across the US and Europe have left many economies nursing large public deficits and less able either to fund their own infrastructure projects or contribute to multilateral efforts by the IMF and the World Bank.

Attracting institutional investors such as insurers, pension funds and sovereign wealth funds, which according to PwC together hold about $120tr in total assets under management, is therefore more important than ever. Allocations of 5% of the portfolios of these asset pools to infrastructure would equate to $6tr.

On paper at least it is a win-win situation as institutional investors are offered stable, long term, inflation protected returns to match their obligations, while governments get to deliver popular improvements in public services without racking up more debt.

Matching the two has proved to be a tough nut to crack.

But there are signs of progress. In the decade since the crisis, more than $200bn has been raised by investment funds to deploy long term capital into infrastructure investments, according to PwC and the Global Infrastructure Investment Association, whose members have $500bn assets under management.

UNBLOCKING PIPELINES

But particularly in developing countries the most important step will be to improve the pipeline of bankable projects that can

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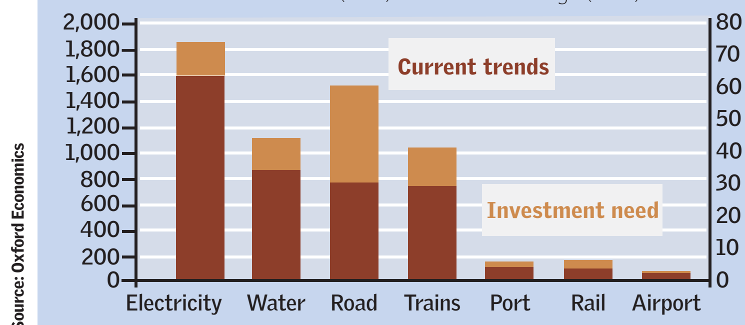
> "Attracting private sector investment into African countries remains a major challenge"
> —Chris Heathcote, GIH

attract private sector investment. A good example is Africa that faces a shortfall of £1.4tr a year of infrastructure finance through to 2040, according to a report by the GIH and Oxford Economics in July.

The analysis of 10 African countries identified $2.4tr in transport, electricity and water and other services to keep pace with economic growth and close infrastructure gaps. But only $1.4tr is expected to be delivered based on current spending levels.

"Attracting private sector investment into African countries remains a major challenge," says Chris Heathcote, chief executive of the GIH, who came from a long career in private sector banking including positions at Macquarie, WestLB and Lloyds Banking Group. "The key to addressing this is creating the right environment to encourage investors to turn their interest into action."

Keeping pace



Attracting private investment is central to World Bank president Jim Yong Kim's ambition to move the discussion from "billions" in official development assistance to "trillions" in investments by leveraging the huge volumes of capital sitting on the books of global insurance companies and pension funds.

There is an attractive pipeline for investments in the coming years. The World Bank estimated there were more than $380bn of investment-ready projects in energy generation and renewables at end-February 2017 in a wide range of countries and regions.

Gyude Moore, a former minister of public works for Liberia and now a fellow at the Center for Global Development (CGDev), agrees there is a need to develop a framework for pairing that money with the massive infrastructure deficits. "The problem is that the underlying fundamentals are not in place to allow the scale of transfer that would be necessary."

He cites three hurdles: the infrastructure asset class is not clearly understood or standardised; money is attracted to high value projects such as energy and telecoms but less to basic needs such as water and roads; and low income countries tend to fail one-size-fits-all assessments by investors. On top of those sit technical problems including a lack of an efficient market for financing the assets and constraints on the supply side of financing, including capital charges from regulations such as Basel III and Solvency II.

CREDIT ENHANCEMENT

One answer being heavily promoted by the multilateral development banks is credit enhancement schemes and financing windows. By offering, say, a first loss guarantee of 10%, the World Bank's Multilateral Insurance Guarantee Agency (Miga) can create an investment grade risk profile on a loan portfolio of emerging market infrastructure investments.

The EBRD first used an innovative credit enhancement mechanism in a €288m bond to finance a €360m state-of-the-art hospital campus in the Turkish city of Elazig, in eastern Anatolia. To boost the bond rating and increase its attractiveness to investors, the AAA-rated EBRD pledged to provide €89m as interim liquidity to mitigate the risks of construction and operation.

This unfunded liquidity facility combined with Miga political risk insurance enabled Moody's to assign a rating of Baa2, two notches above Turkey sovereign rating at the time, enabling participation by a larger pool of investors and mobilising new sources of funding. Once completed it will be a 1,038-bed facility serving a population of 1.6m.

However, the transaction only crowded in $5m in private investment derived from local pension funds and banks. "It ended up being financed by the private sector arms of the development banks," Moore says. "And this is Turkey. You can imagine the difficulties for a Ghana to be able to copy this."

Indeed, Turkey is a fast growing emerging market currently on investors' radars despite the recent turmoil caused by government interference in monetary policy. Private investors are less keen to look at poorer, developing economies.

Moore's concern is that even if the billion-to-trillions strategy could work, it will not deliver money to low income countries where the need is greater for some time to come.

At the moment the infrastructure in sub-Saharan Africa is insufficient to support a population that is expected to double within 25 to 30 years. "The timeframe required to put all the fundamentals in place to allow the billions to trillions is just not realistic for these countries."

CHINA COOLING

This story of huge needs and insufficient finance may explain the positive reception of September's Summit of the Forum on China Africa Cooperation (FOCAC). President Xi Jinping unveiled a $60bn pledge for new projects in front of the 53 African nations attending the Beijing event.

But behind the razzamatazz are emerging doubts. A groundswell of criticism of China's Belt and Road Initiative for "neo-colonialism" and creating a giant "diplomacy debt trap" for the recipient countries has raised doubts about whether China will maintain its infrastructure investment. Governments have cancelled projects including a dam in Pakistan, a Malaysian rail link and a Myanmar hydropower plant.

China courted bad publicity by taking a 99-year lease on the Sri Lankan port of Hambantota after a failure to pay its debts. CGDev's Moore plays down the debt trap fear saying that while Sir Lanka grabbed the headlines, China has also restructured 84 transactions without taking back any assets. In August Botswana and China signed a protocol exempting the African state from repaying three interest free loans worth $8m.

Research by Aid Data based at William & Mary, an American university, into Chinese-financed projects in 138 countries between 2000 and 2014 found they reduced economic inequality within and between regions.

John Ashbourne, senior emerging markets economist at Capital Economics, notes that the $60bn pledge at the triannual conference was the same as the one in 2015, the first time it had not been raised. "This may reflect a reduced African appetite for debt as much as a lack of Chinese interest, but it does suggest that the narrative of a consistently strengthening relationship is misleading," he says.

Moore believes the debate over China's investment is an opportunity for fresh collaboration between Beijing and the World Bank, which recently joined the G20 Compact with Africa aimed at helping 11 countries get project-ready. "If I were president of the World Bank, having realised that 'billions to trillions' was at least 10 years in the future, I would want to see how interactions between Bank resources and Chinese resources could deliver the same outcome."

It may not exactly be the public-private partnership the authors of the Scottish and London reports had in mind, but it could move the world a step closer to closing the infrastructure gap. GM

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Iceland's crisis ends happily ever after

No two crises are alike but Iceland's was unusual in at least three ways. More so than any other crisis — Asian, Tequila, sub-prime — Iceland's was predictable, profitable and purgative

By Philip Moore

It is easy to be wise after the event but Iceland's crisis was so predictable it even had a dress rehearsal in 2006 when the so-called Geyser crisis sent Icelandic CDS prices soaring. Issuers and investors had also been given scores of warnings, principally about excess leverage, which they either ignored or ridiculed.

One of the most notable warnings was sounded by Danske Bank in March 2006. "On top of the macro boom, there has been a stunning expansion of debt, leverage and risk-taking that is almost without precedent anywhere in the world," the bank warned. "External debt is now nearly 300% of GDP while short term external debt is just short of 55% of GDP. This is 133% of annual Icelandic export revenues." The result, said Danske, was that the Icelandic economy had become "increasingly dependent on foreign capital and international terms of lending". It added that "Iceland seems not only to be overheating but also looks very dependent on the willingness-to-lend of global financial markets. This raises the question of whether the economy is facing not just a recession but also a severe financial crisis."

Nonsense, said Icelandic bank Glitnir, which argued in an angry rebuttal that Danske's research had presented "a highly implausible forecast of a financial crisis" containing "numerous inaccuracies and errors, which... all serve to paint a bleaker picture than the facts would warrant."

Danske's was not an isolated voice. Fitch famously warned about the dangers lurking in Iceland when it changed its outlook from stable to negative in February 2006 and met with plenty of criticism for doing so. "We got into hot water for saying the Icelandic financial system looked like a hedge fund," says Brian Coulton, head of EMEA sovereign ratings at the time and one of the co-authors of the Fitch note. "But to us it was all about the staggering expansion of the banks' balance sheets in a very short period."

Iceland's banks responded to the events of 2006 not by reining in their ambitions and cutting back on their leverage but by exploring new avenues of borrowing — with calamitous results. As Jon Sigurgeirsson, director of general secretariat and international relations at the Central Bank of Iceland (CBI) puts it, Landsbanki bought its way out of the funding dilemma by offering depositors in the UK and the Netherlands some of the most generous rates available on internet savings accounts. Other banks, he says, bought their way out of the problem by paying unsustainably high spreads on their bonds, which were gobbled up by yield-hunting CDOs and European banks.

THE FALLOUT

When the inevitable collapse came, with the three large banks tumbling like dominoes in the space of three days in October 2008, it was not just the Icelandic government's grand (some say ridiculous) plans for establishing itself as a financial centre that lay in ruins. Socially, Iceland was torn apart by the events of late 2008, with many still expressing shock a decade later at the virtually unheard-of riots that disfigured Reykjavik at the height of the crisis. True, many of these were riots with a distinctly civilised, Icelandic flavour: on one occasion, a group of rioters outside the home of President Ólafur Ragnar Grímsson were reportedly invited in for coffee and a chat.

Nevertheless, although there were no fatalities during Iceland's riots the disturbances following the crash opened up deep fissures in the country's social fabric. One poll taken in October 2008 suggested that 32.5% of Icelanders were considering moving overseas. Among those aged 18 to 24, 50% were thinking of emigrating. When your population is a little over 300,000 losing that many people is socially and economically ruinous.

Yet Iceland's recovery was remarkably swift. This was in part because the authorities — notably FME, the financial industry supervisor — responded with uncharacteristic decisiveness to Iceland's predicament. Over the course of a weekend it had drafted an emergency law giving the regulator unprecedented powers to take control of the country's banks and split them into two. The new banks, led by new management teams, would absorb domestic króna deposits and assets. That would leave the old banks (or estates) to manage the remaining liabilities and see what value their so-called resolution committees could squeeze out of their overseas assets.

The speed of the recovery was also a product of its containment within a single, bloated sector. "We always emphasise that Iceland's crisis was not an economic crisis," says Gudmundur Arnason, permanent

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"what they say

"By all measures, Iceland is better off than it was in 2007"
—Sigurdur Atli Jónsson, ILTA Investments

"I think we handled the aftermath of the crisis very well"
—Birna Einarsdottir, Islandsbanki

"What was lost was lost and life went on"
—Bjarni Benediktsson, finance minister

"We always emphasise that Iceland's crisis was not an economic crisis"
—Gudmundur Arnason, Ministry of Finance

secretary at the Ministry of Finance. "It was a banking crisis."

That may be. But the real economy could not insulate itself entirely from contagion from the banking collapse, with growth contracting, inflation rising, unemployment ballooning and the debt ratio climbing from 27.3% pre-crisis to 95.1% by 2011. A number of key sectors, however, were entirely unscathed by the crisis and the sharp devaluation of the krona very quickly kicked in to buttress exports.

Then there was the sudden eruption of the Eyjafjallajökull volcano in 2010, which is described by one Reykjavik observer as having been the equivalent of a winning lottery ticket for Iceland's tourism industry because it instantly put Iceland on the global map. According to research published by Landsbankinn, tourism alone contributed between 40% and 50% of Iceland's 18.9% increase in GDP between 2010 to 2016, although it was clear long before 2016 that the economy had put the 2008 crisis behind it. "We're now marking 10 years since the crisis, but five years ago it was clear that Iceland had turned the corner," says Franek Rozwadowski, who became the IMF's resident representative in Iceland in March 2009.

THE CHALLENGES

As for the banking sector, there had never been Northern Rock-style queues outside any of Iceland's banks; nor would any have to close their doors to the public as they did in Cyprus in 2013. That, together with hard work and a more co-ordinated policy response, helped Iceland to build a new banking industry from scratch. "At the time we had no idea how big the challenge would be," says Birna Einarsdottir, who took over as CEO of the new Islandsbanki in 2008. That is a post she still holds today making her the only CEO of a new bank to have served continuously since the crisis. "I'm not always this positive, but I think we handled the aftermath of the crisis very well. The restructuring of our loan book was a huge challenge but it was something we managed in co-operation with our customers and with the support of a very fair and transparent framework from the government. I think overall the Icelandic people worked hard to get where we are today."

Winning back friends in the international investor community was also a formidable challenge, as Einarsdottir recalls. She echoes the managers of the other new banks when she recounts the dispiriting experience of knocking on doors at the IMF meeting in Istanbul in 2009 and repeatedly finding them closed.

Against that backdrop it is remarkable that within three years Iceland had returned to the capital market, generating $2bn of demand for a $1bn five year benchmark bond issued in June 2011. Iceland's re-entry into the capital market was all the more noteworthy given that the Icesave dispute was still unresolved at the time.

The banks were also back in the international capital market by 2015, a critical year that many regard as book-ending the crisis that had begun in October 2008. In June details were announced of a scheme that Sigmundur David Gunnlaugsson's government had been devising for well over a year to ease the capital controls which were weighing on Iceland's credit profile. Drawn up by a specially-created task force with advice from a number of international consultants, this allowed Iceland's creditors (which by then were overwhelmingly hedge funds) to monetise their holdings in exchange for the payment of 'stability contributions' amounting to 17% of GDP.

On paper it hardly looked like an appealing option. But many of those funds had bought into the market at deeply distressed prices when the original creditors had jumped ship. This meant that most would be able to walk away from their Icelandic holdings with modest gains rather than spend years pursuing their claims through costly and messy litigation. For Iceland meanwhile, the so-called carrot and stick deal on capital controls meant that the Treasury had emerged from the seven year crisis with a profit, with the IMF estimating that the state made a net gain in excess of 9% of GDP.

PROFITING FROM LOSS

Sigurgeirsson at the CBI thinks this may turn out to be an over-estimate, given that it is dependent on market values for the banks which today appear to be under the money. Nevertheless it is clear that Iceland has ended up profiting from its crisis. "A lot of people said that if we wrote off $6bn of debt we would be the new Argentina and never be able to borrow again," says Bjarni Benediktsson, who was finance minister at the time of the stability contributions plan and is now in the post again. "But take a look at what has happened since. A big lesson of the crisis is that markets recognise the importance of low indebtedness and understood that we were never going to nationalise the private debt of the banks. What was lost was lost and life went on."

Not all the gains that Iceland has extracted from its crisis are as quantifiable as those generated from the stability contributions. There is, however, general agreement that the Iceland that has emerged from the rubble of its financial crisis is a healthier and more cohesive society than it was immediately before the collapse of the banks.

The consensus is also that today's economy is far more durable than the unbalanced structure that characterised it in 2007. "By all measures Iceland is better off than it was in 2007," says Sigurdur Atli Jónsson, former CEO of Kvika Bank, who now runs a Reykjavik-based investment boutique, ILTA Investments. "The economy is more diversified, the savings rate is up and there is much less household and corporate debt in the system."

That suggests that there was a purgative element to Iceland's crisis, which is also reflected in the number of bankers who were prosecuted and jailed for their role in the crisis. That process, some believe, may have gone too far especially when former Prime Minister Geir Haarde was prosecuted (he was later exonerated) for failing to prevent the crisis. "It is one thing to prosecute people for wrongdoing," says Rozwadowski. "It is quite another to bring politicians to trial for their policy performance."

There may now be other crises bubbling under the surface in Iceland. Over-capacity in the tourism sector may be one especially if an ever-appreciating króna makes Iceland unaffordable. Another, as Finance Minister Benediktsson concedes, may be shadow banking, especially if regulation and taxation stifle the official banking sector.

For the time being, however, Iceland's crisis has ended so happily for the country itself that conspiracy theorists and trashy novelists could almost be forgiven for wondering if it had all been meticulously stage managed. GM

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Public transport keeps the air clean

There are close to 5 million motorbikes and scooters in the Vietnamese capital city, Hanoi. To put this figure into perspective, it means there is more than one motorbike or scooter for every two residents of the city, which has a population of about 7.8 million

This means that the motorbikes of Hanoi not only present a very immediate danger to pedestrians, as anybody who has ever crossed a street in the city will testify. It also means that alongside cars, the city's motorbikes are responsible for an estimated 70% of its dust, nitric oxide and sulphur compounds. Small wonder that Hanoi has been named as the most polluted city in southeast Asia.

The EIB is helping to address the challenge of urban pollution in Vietnam through its support for the expansion of the city's metro system. In January, it announced a €143m facility for construction of the 12.5km line 3 of the Hanoi network, which will reduce travel costs and cut emissions by encouraging commuters to swap their mopeds for the metro.

The Hanoi loan is one of a number of urban metro projects supported by the EIB. These buttress sustainable development by simultaneously helping to reduce emissions and enhance economic efficiencies through saving time and money for the residents of some of the developing world's biggest cities. The €450m loan for the Lucknow metro in 2016, for example, was the largest transport facility made by the EIB outside the EU for more than a decade. By providing finance for the 23km metro line, it is forecast that this will help increase the use of public transport from 10% to 27% in India's 11th largest city, which has a population of 3 million.

Convenient for Commuters; Protective for the Planet

Elsewhere in India, a more recent transaction announced by the EIB was a €500m facility for the Namma Metro system in Bangalore, which is the country's third largest city and home to one of India's most vibrant and innovative urban economies. This was a landmark facility and a case study for sustainable development for at least five reasons.

First, it was the largest loan ever made by the EIB to India, and the largest facility for a sustainable development transport project granted outside the EU, underscoring the bank's commitment to clean urban transportation.

Second, by reducing the average travel time on some journeys from two hours to 15 minutes, it makes a giant contribution to increased productivity among the 400,000 or so people who use the metro daily.

Third, compelling evidence is already emerging to demonstrate the environmental benefits generated by the metro: according to a recent study of air quality along two of the system's lines by the Karnataka State Pollution Control Board, air pollutants fell by 8.9% and 13.3% between June and November 2017 .

Fourth, there is also evidence to suggest that the Bangalore metro is making a notable contribution to gender equality. As well as empowering women by creating jobs for female drivers, it is promoting their security by reserving areas for women travellers.

Fifth, Angela Marcarino, Head of Asia Pacific Lending explains, "the Bangalore initiative represents an important landmark for co-operation among the world's development banks, as it was the first project of its kind to be co-financed by the EIB and the Asian Infrastructure Investment Bank (AIIB). As we step up our investments in Asia, I expect more of this kind of partnership particularly in the urban transport and clean energy sectors."

Increased Support for Sustainable Urban Development

There is nothing new about the EIB's commitment to financing cities. "In Europe we have been working closely with cities ever since our foundation in 1958," says Vazil Hudak, Vice-President of the EIB, whose areas of responsibility include oversight of the Bank's Smart Cities initiative.

There has, however, been a conspicuous increase in this support in recent years. Hudak says that between 2011 and 2017 the EIB's lending directed towards climate action in cities reached about €35bn. This increase mirrors the bank's broader pledge of investing $100bn in climate action by 2020, which will be the largest climate finance contribution of any single multilateral institution.

Hudak says that it is easy to explain why the financing of sustainable urban development has become an important priority for the EIB. "Cities already generate about 75% of the world's CO_2 emissions," he says. "And if urbanisation continues at current rates, cities will account for 85% of the global population by 2100. These numbers alone are enough to demonstrate how important cities are, both in terms of global climate change and economic development."

Vazil Hudak, EIB: "We have been working closely with cities since our foundation"

Monica Scatasta, Head of Environment, Climate and Social Policy at the EIB, adds that there is another clear reason the bank is redoubling its commitment to supporting sustainable urban development. "Aside from being the main sources of emissions, most cities are themselves also extremely exposed and vulnerable to climate-related risks," she says.

Gerry Muscat, Head of Urban Development at the EIB, says that there are a number of notable differences between financing sustainable development in cities and supporting sovereign borrowers. "Lending at a sub-national level means you are generally much closer to the projects themselves, which in turn means you are more involved in the technical structuring of the project," he says. "At the same time, you have to pay more attention to the fiscal and repayment capacity of borrowers at the municipal level."

Rising to the Global Climate City Challenge

It has been the identification of the specific requirements of municipal borrowers across the world that has driven a series of new initiatives by the EIB aimed at building a much closer dialogue between the bank and the chief representatives of the cities themselves.

A recent example of the EIB's commitment to

transposing the bank's European expertise to the global level is the Global Climate City Challenge. Launched at the Global Climate Action Summit (GCAS) in San Francisco in September, this is part of the Global URBIS initiative, it gives cities access to a one-stop-shop for technical assistance and financial support.

The Climate City Challenge is an ambitious partnership between the EIB, and the Global Covenant of Mayors for Climate and Energy, who represent more than 9,000 cities from six continents. The initiative, which is unprecedented in its scope and global reach, aims to address key technical and financing barriers to strengthen investment in green projects with the potential to play a decisive role in building cities' resilience to the ever-worsening impacts of climate change. Launched in San Francisco by Mauricio Rodas, Mayor of Quito, and the EIB's Jonathan Taylor, the Global Climate City Challenge will begin by selecting projects in six cities, the progress of which will be monitored closely by municipal authorities throughout the world. As Taylor, EIB vice-president in charge of climate and environment, said at the launch of the pilot initiative, "I invited all cities to see how this exciting new initiative can transform the impact of existing and future urban investment plans."

Scatasta says that she has been encouraged by the highly constructive response of mayors to the City Challenge. She is also impressed by their contribution to the dialogue on sustainable urban regeneration supported both by the EIB initiative and to others such as the 100 Resilient Cities (100RC) project pioneered by the Rockefeller Foundation and the C40 megacities network. "Although there have been some setbacks since Paris in 2015, it is clear that sustainable urban development is gaining political traction," she says. "I was inspired by what I heard from the mayors at San Francisco."

For these mayors, she adds, there is no one-size-fits-all approach to sustainable urban investment. "Because our experience straddles the developing as well as the developed world, we are well positioned to build a dialogue with each mayor on an individual basis, often applying the lessons learned in a city in the north to one in the south, or vice versa," she explains.

Framework Facilities

While flagship urban transport initiatives such as the Bangalore metro inevitably account for a large and highly visible share of the EIB's lending for sustainable development in cities, the bank's support for urban regeneration is by no means confined to large transport projects. Areas such as energy efficiency, waste management, social housing, health, education and sports and recreational facilities are all other examples of projects regarded as essential for sustainable development and – in many emerging regions – poverty alleviation.

Some of these projects, says Muscat, are potentially beneficiaries of the EIB's Natural Capital Financing Facility (NCFF). This combines the bank's lending with its technical assistance as a way of supporting climate adaptation initiatives such as greening paved areas to improve soil absorption capacity and thereby reducing flooding risk. "We have used this facility in our discussions with cities such as Bologna, Athens and Newcastle, and we could use a similar initiative in cities in developing countries," says Muscat.

Smaller Projects

Muscat explains that many of these smaller projects are often the beneficiaries of EIB Framework Loans. While large projects such as the construction of metro systems are generally supported by single purpose investment loans, framework loans cover tens or even hundreds of smaller schemes calling for funding of between €1m and €50m over three to five years. These projects are then clustered together within broader investment programmes of at least €100m, with the EIB typically covering no more than 50% of the total programme. An example would be the financing of the upgrading of over 200 informal settlements in small and medium municipalities in Tunisia.

Scatasta adds that as they address entire investment plans, Framework Loans are an especially useful way of helping mayors and municipal authorities to think about integrated development. "We think of climate action not as an add-on, but as something that is intrinsic to overall urban planning," she explains.

Since 2016, the EIB's Framework Loans have become an increasingly important source of funding for cities under the Investment Plan for Europe, the Bank's investment guarantee initiative designed to mobilize €500bn by 2020. In October 2016, Lisbon became the first municipal authority in the EU to use this scheme, securing a €250m Framework Loan to contribute to the urban regeneration of the Portuguese capital. Part of this funding is being channelled towards the upgrading of the drainage system, contributing to the strengthening of Lisbon's resilience to climate change and helping it to protect the city from the impact of severe weather events, such as floods and storms. Part of the facility is also being deployed to reduce social exclusion by promoting social housing. **EIB**

Monica Scatasta, EIB: "Most cities are extremely vulnerable and exposed to climate-related risk"

EIB investing in sustainable cities

In 2017, the EIB invested more than USD 26 bn in urban projects

About 1/3 dedicated to climate action

209 million additional passengers

23 million people with safer drinking water

32 million people with improved sanitation

Reducing flooding risks for 2.3 million people

Source: EIB

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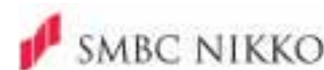

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SURINAME
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Road to recovery

Suriname's minister of finance, Gillmore Hoefdraad, tells *GlobalMarkets* that the economic recovery is on track and that the government is taking measures to ensure the country is better placed to withstand future shocks.

Minister of Finance Gillmore Hoefdraad

GlobalMarkets: How has Suriname recovered from the commodity shock?
Gillmore Hoefdraad, Minister of Finance, Suriname: The disappearance of the century-old alumina complex and the drop in oil and gold prices triggered major triple shock in 2014-16. But in place of alumina we have a brand new gold mine [Merian] that nearly doubles exports, and a new oil refinery that almost eliminates net oil imports. That, together with a recovering private sector and the end of fiscal retrenchment, has allowed the return to growth. GDP grew 1.7% last year and there are no signs that the economy will be reverting to a recession. There is a good pipeline of investment in gold, oil and other areas, which bodes well for the future.

GlobalMarkets: What are the policy challenges and priorities now to ensure a sustainable recovery?
Hoefdraad: Firstly, we must ensure that the balance of payments and monetary situation remain sustainable. The current account deficit in the balance of payments shrunk to nearly zero but will now grow slightly as imports grow. Nonetheless, reserves are growing and clearly exceed the minimum three months of imports. Secondly, we need to retain fiscal expenditure restraint and increase revenue. Economic reforms are now required to allow the government to move with agility and mitigate future commodity shocks. The sovereign wealth fund will begin operations on January 1, 2019. We must also put in place legal and administrative reforms to make fiscal management more agile and improve the investment climate. Internal reform is needed in the ministry of finance to bring our administration firmly into the first 21st century, with more automation, computerisation and a flexible human capital base to allow us to address problems when they arise.

GlobalMarkets: How do you plan to meet your fiscal targets?
Hoefdraad: Our objective is to continue to shrink the fiscal deficit, which was quite unsustainable in 2015/16. In 2017 we saw the first benefit of reforms and a continued expenditure restraint. Now we are expecting revenue to pick up back to historical norms. With VAT postponed, in the interim we are putting in place other taxes, such as a temporary increase in import taxation and an increase in road and vehicle taxes. The idea is to ease the fiscal burden away from expenditure compression to greater revenue.

GlobalMarkets: Why did VAT not go ahead as planned?
Hoefdraad: VAT is a complex creature. The world experts at Cartac (Caribbean Regional Technical Assistance Centre) in Barbados told us repeatedly that you have to make sure you implement VAT correctly; you cannot repair it afterwards. This needs a very well written law, regulations that fit, human capital and training in the ministry of finance to manage it, and to educate people and companies. We do not yet have all those conditions in place, so were risking doing it wrong if we did it in 2018. The timetable at the moment suggests it will be implemented in 2020.

GlobalMarkets: What has the government done with the funds from Staatsolie?
Hoefdraad: The funds from Staatsolie are being used for debt refinancing and reducing the country's interest burden. The government has deposited the funds in the central bank, is selling the hard currency to increase reserves, and is using local currency proceeds to retire treasury bills as they mature. This has the double benefit of increasing reserves and reducing the cost of debt. It is an ongoing process and funds that are deposited will be used in the coming months to retire bills. Moreover, buying back the treasury bills injects liquidity into the market, bringing a reduction of interest rates. There has already been a consequent pick-up in credit to the private sector.

GlobalMarkets: What effect might a significant offshore oil discovery have on Suriname's economic outlook?
Hoefdraad: To say that a significant oil discovery would be a game-changer for Suriname would be the understatement of the century. The finds in Guyana are worth a multiple of GDP and in Suriname it could be similar. Suriname is very well positioned to benefit directly from an offshore find because we have existing oil infrastructure and a very large construction industry surrounding the mining industry.

GlobalMarkets: How can Suriname diversify its economy beyond the extractive industries?
Hoefdraad: Suriname wants to diversify away from its heavy reliance on the extractive industries, and the areas most ripe for growth are agriculture and tourism. Diversifying is not easy but there has been quite a bit of recent interest in other industries, for example the establishment of an industrial park near the harbour where the bauxite refinery was. Alcoa is driving this and there is important interest from outside investors to build on this.

GlobalMarkets: What message would you send to companies considering investing in Suriname?
Hoefdraad: Suriname has vast amounts of land and fresh water resources and is more than 90% covered by pristine Amazonian jungle, which lends itself to extractive industries, agriculture and tourism. Moreover, Suriname is a peaceful country with great ethnic diversity and a well educated, motivated middle class. The literacy rate is high and nearly everybody speaks at least two languages, so we have a very large pool of workers readily available to be hired by companies investing in Suriname is open for business.

Untapped potential

South America's smallest nation is rich in economic potential, with impressive natural resources, an investor-friendly government, and a well-educated population.

With an area of just 163,820km2, of which 95% is tropical rainforest, and a population of just over 567,000, Suriname is the smallest country in South America. It is also the youngest: it gained independence from the Netherlands in November 1975.

But with GDP per capita projected at $6,800 for 2018, Suriname is a middle-income country. Literacy rates are 95% and, though Dutch is the official language, English is widely spoken.

Extracting wealth

Unsurprisingly, given a World Bank study in 2000 made it the 17th richest country in the world, based on natural resources per capita, the economy has long been orientated towards extractive industries.

Long before independence, Suriname became one of the world's leading producers of bauxite.

US company Alcoa began operations in the country in 1916 and ceased only in November 2015 as aluminium prices slumped. As recently as 2007, aluminium accounted for about half of the country's exports.

Though the end of bauxite mining, combined with slumps in oil and gold prices, brought about a triple commodity shock that wiped 8% off GDP in 2015-2016, a recovery has begun, with gold the new star player.

This started with the Rosebel Gold Mine, Then Newmont's Merian mine, which has 5.1m ounces of reserves, opened in 2016. Next to open will be Iamgold's Saramacca mine.

Recent offshore oil discoveries in neighbouring Guyana suggest another sector could become even more important. Several international oil companies have signed production-sharing contracts to look for oil on the Suriname side of the Guiana basin.

Beyond natural resources

Suriname's mining history has made it adept at attracting and dealing with big private companies. Ginmardo Kromosoeto, CEO of government-owned lender Surinaamse Postspaarbank, says: "Because it is a small economy, big investors do not have to jump through a small window, but can talk directly to the government and ministers."

Ginmardo Kromosoeto, CEO of Surinaamse Postspaarbank

This should stand Suriname in good stead as it looks to diversify its economy. Agribusiness is a particular focus, and this is a task facing the new investment promotion agency, Investsur.

Of 15 nation states in the Caribbean Community (Caricom), only Suriname and Belize have a trade surplus in fruit and vegetables, suggesting there are several natural export markets.

Suriname is also advertising opportunities in agriculture, where 66,000 acres of prime agricultural land are available; its underexploited fishing areas that boast tuna and shrimp; animal breeding; and processing facilities.

With vast swathes of rainforest, logging concessions and wood-processing opportunities are available, while at the well-attended inaugural Suriname Trade & Investment Forum in Miami in September the government highlighted the possibility of a carbon credit programme.

The rainforest also presents great potential for ecotourism. "Although airlift is a challenge, flights tend to be completely full — especially during vacation times," says Kromosoeto. "There is incredible ecotourism potential."

One big challenge in developing new industries is infrastructure, with further construction required for highways, railways, bridges and ports, among others, but its strategic position means that Suriname has high potential.

Finally, Suriname has a competitive advantage over several of its nearby states and rival agricultural producers: it is located outside of the path of most Atlantic hurricanes.

Credit ratings

Moody's: B2 (negative)
Standard & Poor's: B (stable); Fitch: B- (stable)

Suriname boosts efforts at financial inclusion

A key challenge that Suriname faces in its economic development is that the roughly 40% of the population that lives in the interior of the country is disconnected from the rest of the country.

This is also the case with the financial system, says Ginmardo Kromosoeto, CEO of Surinaamse Postspaarbank (the Surinamese Post Savings Bank). The lender is therefore "supporting the government to give access to those who did not before have the option of entering the banking system", he says.

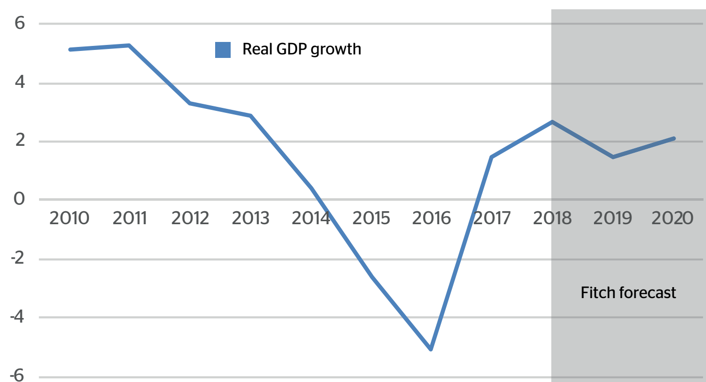
An important initiative that government-owned Postspaarbank is promoting is the creation of debit cards, known as Moni Karta, that some Surinamese people can use to receive their social support.

"This is a financial inclusion initiative that means that even people living in areas without roads – who therefore don't have a home address required to open a conventional bank account – can become visible in the banking sector," says Kromosoeto.

Postspaarbank had already signed an agreement in 2016 with financial software company Euronet to provide banking services to its customers living in more remote areas, by allowing them to conduct transactions at merchant locations rather than traditional bank branches.

Postspaarbank is also looking to encourage the development of the banking system by promoting mobile banking via Union Pay credit cards. "We hope that such a big credit card company increasing its footprint in Suriname can help the drive towards a cashless company," says Kromosoeto.

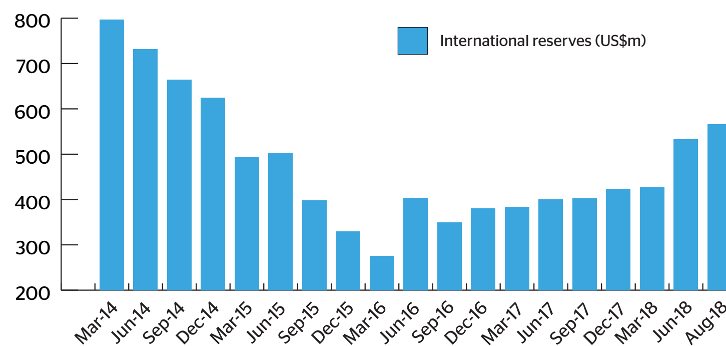
GDP – a commodity-led recovery



Suriname's economy shrunk by 8% in 2015-16 as mining revenue shrank and the sharp fiscal contraction squeezed disposable income. But GDP has returned to positive territory, and Fitch Ratings is predicting growth will reach 2.7% in 2017 — no mean feat given what Suriname lived through. However, this is still nowhere near the heights that the economic growth regularly reached before the commodities slump. Fiscal much-needed consolidation efforts are growth-negative, while Suriname struggles to find GDP drivers beyond commodity exports, leaving the recovery somewhat vulnerable.

Source: Central Bank of Suriname, Fitch Ratings

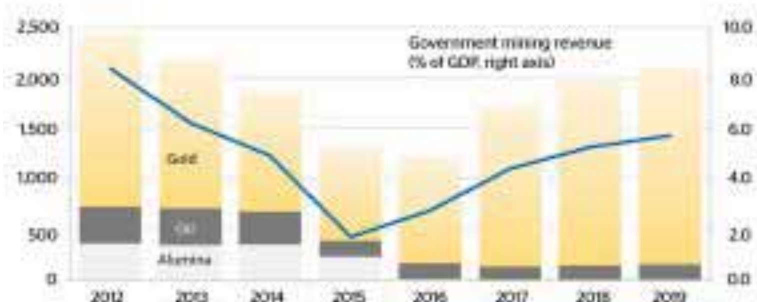
International reserves – a slow rebuild



Before finally allowing a free float the Surinamese dollar in late 2015, the central bank spent much of the country's international reserves attempting to prop up the currency. A persistent current account deficit has meant the rebuild of these reserves has been a gradual process, but it is happening. Reserves received a significant lift in May 2018 thanks to state oil company Staatsolie repaying a loan from the government and buying government shares in the Merian gold mine, though gave back some of that uptick in June due to government debt payments. Government officials now expect reserves to increase as the central bank resumes FX purchases.

Source: Central Bank of Suriname

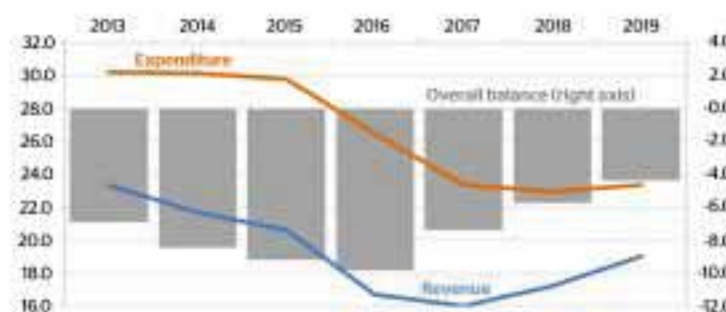
Going for gold



The composition of Suriname's exports has evolved significantly, with alumina disappearing and gold taking over. The strengthening of the gold sector has been a boon for government revenues and looks set to continue to blossom with Iamgold, which operates the Rosebel mine, set to start operating its new Saramacca mine in the second half of 2019. Although offshore oil exploration has so far proven fruitless, experts say that the successful drills in Guyana point to an exceedingly high probability of similar discoveries being made in Surinamese territory. In the long term this would have an important effect on mining revenues.

Source: Government of Suriname

Fiscal consolidation



The triple commodity forced a sharp decline in government expenditure in 2015-16 but further cuts have proved difficult. However, the revenue side of the fiscal equation is now pulling its weight, with gold royalties an important factor. Although the promised VAT law has been put on the backburner until after the election, the government has been putting in interim technical measures to help raise revenues. From 2020, the government will start to receive income tax, not just royalties, from the Merian mine. This should further improve fiscal performance.

Source: Government of Suriname

Suriname searching for sustainability after recovery

A strong policy reaction to a harsh commodity shock in 2015 has put Suriname on the road to recovery. But the government still faces challenges in making the recovery sustainable and reducing vulnerability to the commodity cycle.

If countries make their own luck, maybe Suriname was due a break. Hit by a triple commodity shock in 2015-16 that shrank the economy by 8%, the government did a lot right: it floated the currency, set to work with fiscal reforms, and slashed expenditure.

It wasn't perfect: an IMF programme lasted less than a year, for instance. But, in the words of Francisco Rodríguez, chief economist at Torino Capital, the government's handling of the negative shock "said something about its willingness to reform".

Suriname was rewarded, then, with increase in gold and oil prices that were nicely complemented by exciting gold discoveries and the completion of its oil refinery. If offshore oil lives up to its promise, the commodity windfall will be even greater.

Numbers have improved. The current account deficit shrunk from 19.1% in 2015 to virtually zero in 2017. GDP returned to positive territory in 2017, and inflation has returned to single figures having peaked at 79% in 2016. The economy is expected to continue to grow, even if most analyst forecasts are not as high as the 3% average that the government is predicting for 2018-2022.

"There has been a recovery in some key economic fundamentals," says Jeetendra Khadan, economist for Suriname at the IADB. "The gold sector is the main driver of the economic improvement, but there are important planned fiscal reforms in train to help ensure that the gold-led recovery is sustainable."

VAT in the vault

However, certain developments in 2018 have raised concern among bond market participants — who have increased their scrutiny of the country since a $550m 10 year bond debut in October 2026.

Chief among these was April's postponement of a value-added tax law previously due to be implemented on July 1.

"Suriname has a lot of potential as there is a lot of low hanging fruit, and the prospects for the natural resources sector are promising," says Petar Atanasov, co-head of sovereign research at EM investment manager Gramercy. "But the delay in VAT implementation was a huge disappointment for investors.

"The uncertainty and delays in carrying out fiscal measures mean it is hard to make a compelling investment case."

B2/B/B- rated Suriname's 9.25% 2026s have held up better in secondary than many single B credits during a torrid year for EM markets, and were trading at around 98.5 cents on the dollar in late September, according to data from MarketAxess. This equates to a yield of just above 9.5%.

But Nathalie Marshik, managing director, head of sovereign research at Oppenheimer & Co, says the bonds would be perform better "if the government delivered on their promises".

Presidential elections are scheduled for May 2020, so if VAT is to happen it will likely be at least two years away. This leaves the fiscal consolidation effort "more reliant on the luck of commodity markets", says Kelli Bissett-Tom, director in Latin American sovereigns at Fitch Ratings.

Fitch, which had anticipated that VAT would provide an additional 1.5% of GDP in permanent revenue, is now expecting a slower reduction of the budget gap, says Bissett-Tom.

"The nearing election has also closed the window for policy reforms," she adds.

Though the government is predicting the fiscal deficit will fall below 6% in 2018 from 10.6% in 2015/16 and 7.9% in 2017, Fitch is forecasting a deficit of 6.1% and Torino reckons 6.8%.

As Rodríguez of Torino says, the numbers will depend very much on mining revenues, because in such a small economy, a higher than expected take at a mine can make a huge difference.

However, the economist says that though Suriname is "partly" on the right track, "it still has plenty to do to get totally on the right track".

Nathalie Marshik, managing director, head of sovereign research, Oppenheimer & Co

With VAT on the backburner, the government is putting smaller technical measures in place to increase revenue in the interim and does forecast an increase in fiscal revenue in 2018. It has implemented several economic, administrative, and legal framework reforms aimed at ensuring that future commodity-price shocks will have a more limited impact on the economy.

Khadan of the IADB also highlights the limits imposed of fiscal deficit, and the passing of legislation to establish a Savings and Stability Fund, which will begin operations in January 2019.

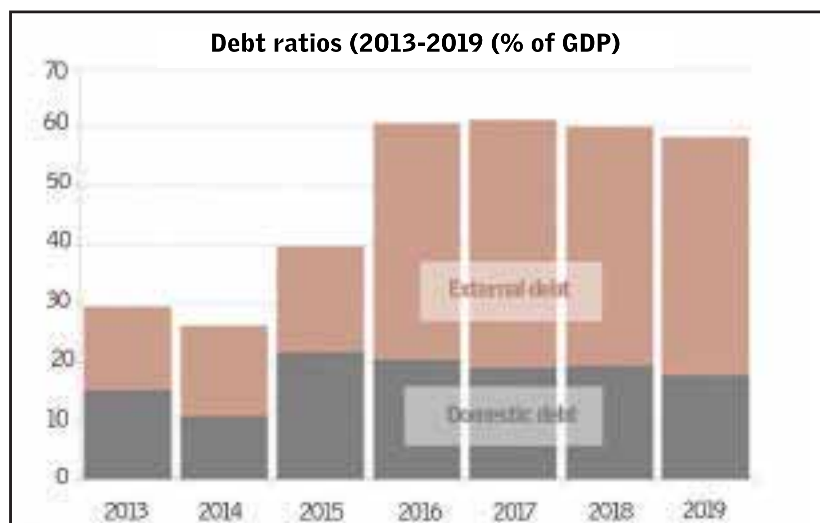
"Despite these efforts, fiscal deficits and debt continues to be an area that requires more work," he says. "The authorities have been working to address challenges on the revenue and expenditure side which can contribute to a more substantial and sustainable recovery over the medium term."

Expectation challenges

However, some still wonder whether the recovery is coming quickly enough.

Bissett-Tom says that, away from natural resources, growth, investment, and consumption in are "still quite weak".

"Growth of just under 3% over 2018-2020 is



Source: Government of Suriname

Suriname traditionally maintained low levels of debt, with external debt mostly from bilateral and multilateral sources on concessional terms.

Debt increase 2015-16 due to:
- Fall in fiscal revenue.
- Exchange rate adjustment.

Debt stabilization since 2017:
- Sharp contraction in fiscal deficit.
- Renewed economic growth.
- Stable exchange rate.

not terrible for a country that underwent such a large macro adjustment, but it is below previous rates and lower than what you might have expected given some of the positive investment stories in Suriname," says the Fitch analyst.

And in certain areas, the recovery has underperformed expectations.

"Analysts had been scratching their heads as to why Suriname had been printing a current account surplus in 2017 without seeing an increase in international reserves," says Marshik of Oppenheimer.

According to Marshik, the central bank had published a current account surplus of 7% for the first three quarters of 2017, but as international gold companies were not bringing export dollars back onshore Suriname ended up printing a current account deficit of 0.1% of GDP for the full year.

"Though this is better than what it had been it was not the surplus we had hoped for," says Marshik. "The country needs to build reserves back up to more appropriate levels for a commodity producer."

Finance minister Gillmore Hoefdraad told *GlobalMarkets* that reserves were growing and "clearly exceeding the minimum of three months of imports", and Torino's Rodríguez said that the current account was not too much of a concern. But Bissett-Tom agrees with Marshik that reserves are low for an economy where almost 85% of annual FX earnings are from commodity exports.

The current account deficit is predicted to widen again as domestic demand recovers, but this should be offset by an increase in exports when the Saramacca gold mine opens in 2019.

Yet for some bondholders the episode speaks to a major challenge in investing in Suriname.

"It can be hard for investors like me to follow Suriname closely because statistics are often on a lag and there is not great transparency in the data," says Atanasov of Gramercy.

Suriname has taken steps to improve data transparency. In January it implemented the IMF's enhanced General Data Dissemination System (e-GDDS). And the US State Department released a report in September noting "considerable progress" in fiscal transparency and the provision of quality information, according to the finance ministry.

Quarterly GDP does not exist, though Torino notes that an IMF technical assistance report published in August suggested it was targeted to be available for the end of August 2020.

Staatsolie windfall brings wins all round

Marshik agrees with Atanasov that Suriname could make itself more attractive to bond investors by providing more "timely and reliable" data, and underlines another pertinent issue where this is important.

State oil company Staatsolie used $337.5m of the proceeds from a new syndicated loan to prepay a $261.5m loan from the government and purchase the government's stake in the Merian gold mine for $76m, providing an injection to government coffers worth 9%-10% of GDP, according to Khadan of the IADB.

What the government does with these funds is Marshik's primary concern about Suriname right now, she says. "But without regular fiscal data it is hard to track how the Staatsolie money is being spent."

To be fair, the consensus among analysts is that the government is using the funds as proposed: to refinance debt and reduce the interest burden.

"Despite worries that the government would use the liquidity from the Staatsolie payment to stimulate the economy, my impression is that they have used it quite conservatively," says Atanasov.

The government has deposited the fund in the central bank and is gradually using local currency proceeds to retire expensive treasury bills. In tandem, the central bank will gradually unwind some foreign exchange swaps.

"Net benefits of this would be lower financing costs in the domestic market, while it would also create more headroom for the government's financing needs heading into 2019 and gives the government more capacity to finance itself in domestic currency in an election," says Bissett-Tom.

Additionally, the central bank is unwinding close to $115m foreign currency swaps extended by resident commercial banks to the central bank in 2015-2016 that had been "undermining" the quality of the reserves, says the Fitch analyst.

Energy opportunity

If Suriname is really going to reduce its vulnerabilities to external shocks, it needs to find another engine for growth beyond commodities, says Marshik.

As the government looks to diversify (*see Untapped Potential on page 19*) it is vital to tackle state electricity company EBS' profitability and find ways to produce cheaper electricity.

"There will be an opportunity when [aluminium producer] Alcoa returns the Afobaka dam to the government at the end of 2019," says Marshik. "Alcoa will continue to sell electricity to EBS until the handover, but the government is negotiating a new price for the electricity, which could help drive down EBS costs."

It is an opportunity Suriname must take if it is to capitalise on the lucky hand it has earned for itself in the last couple of years.

Oil optimism high as gold gives economy sparkle

The stellar performance of Suriname's gold sector continues, while the potential of offshore oil remains huge despite a couple of early dry wells. A market-friendly government is key to unlocking the country's natural resource potential.

Perhaps it's down to the pace of ExxonMobil's remarkable offshore exploration success in neighbouring Guyana, but some observers seem spooked when drilling efforts in Suriname prove fruitless. "Offshore oil remains a potential for the country but markets are questioning feasibility after last year's Araku-1 well disappointment," says Nathalie Marshik, head of sovereign research at Oppenheimer.

Indeed, after Tullow failed to find oil at Araku, Kosmos abandoned its Anapai-1A well in June after an unsuccessful drill.

Yet Rudolf Elias, CEO of Suriname's oil company Staatsolie, is "even more confident than a year ago" that there will be offshore oil discoverie s in Suriname. Oil industry experts appear to back him.

"Exploration is a journey, not an event," says Julie Wilson, director, global exploration at Wood Mackenzie. "Each well — successful or not — brings new information about the petroleum system that helps explorers better understand it."

Kosmos and Tullow continuing to explore in Suriname means they were "encouraged" by what they found in their first wells, she says.

When Tullow plugged the Araku well, it highlighted that the geological insights and seismic data it had gained from the drill had "de-risked deeper plays" in the group's acreage. And the company described Araku as an "ambitious wildcat exploration".

Wilson says explorers have to find the "sweet spot" where all elements of the petroleum system are working together. "The success in Guyana demonstrates that the sweet spots in this basin can be giant-sized, so I would not yet write off Suriname offshore exploration," she says.

Elaine Reynolds, oil analyst at Edison Investment Research, says it is "not too concerning" that there has not yet been a discovery in Suriname.

First of all, says Reynolds, the number of dry wells is small compared to the size of the basin. And while some drills have found reservoirs but not hydrocarbons, others evidence hydrocarbons but no reservoirs. This suggests there will be a successful drill at some point.

When Kosmos announced the dry well at Anapai, CEO Andrew Inglis said the company was in the "early stages" of exploring the "emerging" basins. Kosmos' next Surinamese well, Pontoenoe, is exciting as it is the first time a company will drill above the same source rock that produced Exxon's massive "Liza" discovery in Guyana.

"It looks promising because it has the same feeder system that is seen in Liza, and it is notable that Hess, which is a partner in the Liza block, has come into this block," says Reynolds at Edison.

Kosmos is giving Pontoenoe a one-in-four to one-in-five chance of success, says Reynolds, but even if it is not successful, "there are multiple further prospect options on the block".

As Elias says: "We have a lot to learn and are still only scratching the surface of Suriname's potential."

Golden boy

Yet for all the excitement over oil, Marshik points out that, even if a company struck oil tomorrow, it would take several years to get it out the ground, meaning limited near-term economic benefits.

However, the gold sector goes from strength to strength and is already providing important revenues. The government is earning royalties through its stake in Newmont's Merian mine, which came on line in 2016. There is further excitement from Canada's Iamgold, which has been operating the Rosebel mine since 2004.

In September Iamgold confirmed that its recent drilling at the nearby Saramacca site — where it plans to start mining by the second half of 2019 — would increase the company's reserves in Suriname by 1m ounces. The additional reserves increase Rosebel's life by five years to 2033, and the government, which holds a 30% stake in Iamgold's expansion, estimates that Saramacca holds proven reserves of $1.9bn at today's prices.

Economic benefits from both Merian and Saramacca are imminent. Newmont has only been paying royalties so far on its Merian investment, because its contract allows accelerated capital depreciation, in other words repaying the capital invested before paying taxes.

Julie Wilson, director, global exploration at Wood Mackenzie

But it is likely to start paying income tax from 2020, while the government should also be able to collect royalties and income tax from the Saramacca mine — which required lower capital investment than Merian — in 2020.

Newmont's delay in paying income taxes highlights just how market-friendly Suriname's gold mining contracts are, says Kelli Bissett-Tom, director for Latin American sovereigns at Fitch Ratings. Accelerated depreciation incurs short-term costs for the government — in balance of payments, slower rebuilding of international reserves, and the foregoing of tax revenues.

But Suriname's attitude is also a factor in attracting investment from so many international companies. "There is an absence of natural resource nationalism in Suriname and greater contract certainty for foreign investors," says Bissett-Tom. "Once a contract is agreed with the government, it passes into law, rendering a very stable agreement."

This could be key in unlocking Surinam's estimated 5m kg of unproven gold reserves.

Staatsolie eyes capital markets amid new era

Suriname's oil company could be on the verge of an exciting discovery that will be likely to bring a first venture into international capital markets. Work to ensure the company is prepared for this brave new world is well under way.

Rudolf Elias is a man with a mission. The former BHP Billiton project director is at the helm of state-owned oil company Staatsolie, charged — among other things — with coordinating one of the most promising offshore exploration areas in the world.

Elias is well aware that offshore oil discoveries that rival the scale of those found in neighbouring Guyana could transform Suriname forever. But it has to be managed properly. Though it would be the finance ministry's job to ensure any windfalls are put to good use, the oil is the responsibility of Staatsolie, which plans to be a partner in any successful oil finds there.

That means Staatsolie itself has to be in good health.

"We have to ensure that we are acting in the short term in a way that allows us to be successful in the long term," says Elias, CEO of Staatsolie since May 2015.

Here enters the company's 2016-2020 "Strategy for Success", which states that it needs to prepare Staatsolie to become the "partner of choice" for international oil companies drilling in offshore Suriname.

Achieving this means adapting quickly to future oil markets. Having spent the past decade investing heavily in downstream activities, Staatsolie is refocusing on finding and producing oil, while efficiency, not growth, is the name of the game for downstream.

In more volatile markets, "it is very important that everything we do will be based on the assumption that the oil price will be lower for longer", says Elias. "Therefore we want to ensure that we remain a first quartile producer."

A first quartile producer — meaning one that produces with the lowest quarter of the cost curve — can be successful for 40 or 50 years, reckons Elias, even if oil will no longer be the driver for global energy growth.

Right now Staatsolie produces around 6m barrels annually, and its immediate growth will come from near-shore and shallow off-shore exploration.

"Even if we don't find commercial quantities, near-shore drilling will be useful to tell us about the migration of oil," says Elias. "Then 2020-2025 will be an exciting period for shallow offshore."

Bond, equity market debuts in the works

In May 2018, Staatsolie raised a $625m loan from a syndicate of international banks that enabled it to repay a $261.5m loan from the government, on which it was paying 9.25% interest, and purchase the government's 25% share in the Newmont gold mine for $76m.

According to one US-based Latin America credit analyst, refinancing the expensive loan put Staatsolie "in a much stronger financial position and gives it a cleaner capital structure if it wants to approach international markets".

If a company strikes big with an offshore oil find in Suriname, this will be necessary. Staatsolie will look to be a 10%-20% partner in offshore oil finds, and the CEO believes it would require $1bn of financing to do so.

One option would be to return to the syndicated loan market, but the company "would love to raise the money via an IPO", says Elias.

First up would be a debut international bond, however, pencilled in for late 2018 or early 2019.

"One part of the process of getting ready for an IPO is issuing a bond — either at the end of this year or early next," says Elias. "That way banks and international institutional investors would begin to get to know us ahead of the IPO."

Proceeds would be used to pay off around half of the company's bank loan.

In an effort to meet the standards required by international bond markets, Staatsolie has employed Ernst & Young as accountants to go over its numbers, while the company has moved from US GAAP to IFRS accounting standards to be more transparent for capital markets.

Rudolf Elias, CEO of Staatsolie

But preparations are more than just financial. A key arm of Staatsolie's strategy is about preparing its people. Pairing up with a major international oil company means thinking more efficiently about safety, costs and production — and getting that balance right, says the CEO.

Cultural shift

To help achieve this, the company has introduced a cultural change programme and a succession planning programmes to identify young talent and bring them to managerial positions by design, rather than by default.

"If we manage to have a company where everyone enters with a sense of purpose and leaves with a sense of accomplishment each day, we'll have succeeded in becoming a world-class company and will be able to handle the big offshore projects," says Elias.

He is adamant that it is not just Staatsolie itself that must prepare for the discovery of deep offshore oil, but also Suriname's business community, as local firms are going to be needed to support the burgeoning industry.

"If they wait until we discover oil to design the strategy it will be too late," says Elias. "The local business community needs to be looking today what is necessary to be ready for tomorrow."

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MANAGEMENT REPORT

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  8-9 May 2019, Sarajevo, Bosnia-Hertzogovina
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GlobalMarkets Special Report on Kazakhstan

In association with

Confident Kazakhstan's ambitions for Central Asia's central role

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Kazakhstan is in a good spot. It has the support of the West and is benefiting enormously from China's Belt & Road Initiative. It's even becoming, in relative terms, a diplomatic power in its own right — the Geneva of Central Asia

By Elliot Wilson

Many words or phrases have been used to describe Kazakhstan since it became an independent nation in 1991. "Oil rich" is certainly one: it boasts the world's 12th largest reserves. Another is "buffer zone", with Kazakhstan sandwiched between China to the east, Russia to the north and a host of smaller and often turbulent Central Asian states to its south. It's also simply vast, covering an area the size of Western Europe.

But in recent years, a new word has entered the lexicon when Kazakhstan is summoned to mind: confident. Over the past year, it has quietly become the leader of a region that has long needed co-ordination and cohesion.

In March 2018, President Nursultan Nazarbayev hosted a meeting in Astana of the presidents of all five Central Asian states. Two things emerged from the first conclave of its kind in 20 years, each important in its own way. First, the leaders decided to make it an annual event, an idea that would have seemed outlandish even five years ago. Much has changed in the intervening period, however, notably the death of Islam Karimov and his replacement as president of Uzbekistan by the less autocratic and more technocratic Shavkat Mirziyoyev.

Second, Nazarbayev informed his presumably well briefed peers that Central Asia was now strong enough to solve its own problems and did not need any external "mentors". These, notes one Washington-based analyst, were "calculated words from a wily political operator who speaks when he has something to say. It was him telling Russia there were red lines they should not cross."

This point is worth exploring. Russia's relationship with Kazakhstan has always been changeable, veering between the strong and the brittle. Moscow views the Central Asia state as falling well within its sphere of influence, part of what President Vladimir Putin refers to as Russia's "near abroad".

In pure economic terms, the two nations have historically seen mostly eye-to-eye. Kazakhstan exports foodstuffs, including meat and organic wheat, and imports machinery and chemicals. Russia is by far the biggest buyer of Kazakh goods and services, accounting for $19.2bn of its exports

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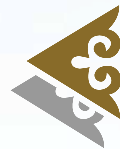
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Central role
President Nazarbayev with Vladimir Putin, Emomali Rakhmon of Tajikistan, Shavkat Mirziyoyev of Uzbekistan, Ilham Aliyev of Azerbaijan and Armenian Prime Minister Nikol Pashinyan during a meeting of heads of the Commonwealth of Independent States in September

in 2017, or 39% of the total, according to the CIA World Factbook.

But when it comes to political and security matters relations can get choppy. In August 2014, the same month that Russian tanks crossed the border into eastern Ukraine, Putin was asked at a press conference if there would be a "Ukraine scenario" when Nazarbayev was replaced as president.

Putin's reply was a dagger to Kazakhstan's pride. Rather than rebuff any suggestion that Russia might invade and annex part of the country as it has done in Ukraine and Georgia, he reminded his audience that Kazakhstan "never had statehood" prior to the demise of the Soviet Union. It did not go unnoticed in Astana that Russian nationalists view a huge strip of the country, from Petropavl to Oskemen, as part of their territory. Kazakhstan's leaders fumed and fussed but quietly and in private.

BALANCED RELATIONSHIP

Yet in recent years a once lopsided relationship that saw Moscow firmly holding the whip hand has become more evenly balanced. The reason for this is two-fold. First, Kazakhstan has grown weary and even worried at the quarrelsome, zero-sum-game way Putin treats friends and enemies alike. True, the Kazakh economy remains overly dependent on the production and export of oil. GDP slowed sharply in 2015 and 2016 when oil prices fell, then bounced back in 2017 and 2018 when they rose.

But Russia's long economic malaise, which stems partly from an inability to embrace genuine reform augmented by the impact of Western sanctions, has been keenly felt on the other side of the border — and, indeed, across the region.

"Poor growth rates in Russia drag on growth rates in Kazakhstan while a weak rouble means a weak tenge," notes Stephen Blank, senior fellow for Russia at the American Foreign Policy Council (AFPC) in Washington. "An unstable Russia is a serious problem for Kazakhstan. Putin has zero interest in economic reform and that fact alone will continue to drag down his economy and economies across Central Asia."

Kazakhstan has even begun pushing back in the security realm. The two sides have co-operated on military affairs since 1992, the year it became a member of the Collective Security Treaty Organization, a Russia-led alliance, and Astana usually supports Moscow at the United Nations.

Yet in April 2018, when America tabled a motion at the UN to identify those culpable for a deadly chemical attack in Syria that killed at least 40 people, Kazakhstan supported the motion. It caused shock and dismay in the Kremlin. "Kazakhstan is tired of the way Russia acts," notes a defence analyst who focuses on events in Central Asia. "Moscow is growing more isolated from world affairs and it doesn't want any part of that."

For its part, Astana has reacted to Moscow's irascibility by allocating more of its attention to Washington. US-Kazakh relations are strong and long-standing but the country has pushed the envelope by supporting America on security issues. In June, it agreed to allow America to use two of its Caspian Sea ports, in Aktau and Kuryk, as transit points for shipping non-military cargo to Afghanistan. Russia's heightened sensitivity to the threat of any neighbouring state aligning itself with Washington was underlined when its foreign minister, Sergei Lavrov, warned the West "not to put [the] Central Asian nation in front of a false choice".

And so to the other factor that might help to explain Astana's slow drift away from Moscow as well as its burgeoning self-confidence. In its formative years, Kazakhstan was forced to learn the hard way. It had few friends and was landlocked, dirt poor and surrounded by equally penurious or restive states.

Yet within a few short years it had, notes AFPC's Blank, gained "incredible diplomatic strength", building robust commercial, financial and political links with Europe and the US while positioning itself as an unthreatening regional ally to a sinking Russia and a rising China. "Kazakhstan has always been highly adept at maintaining the right balance with its main trading partners," says Annette Bohr, an associate fellow at Chatham House's Russia and Eurasia Programme.

As China's financial and economic power grew, Kazakhstan's leaders racked their brains about how to deal with the rising superpower. Scroll back a decade and you find a balance of power tipped firmly in Beijing's favour. China needed Kazakhstan for its oil and its minerals and for help in keeping Xinjiang, its westerly province, secure and stable — but little else. To visit Almaty, Kazakhstan's most populous city, 10 years ago was to find a place fearful of Beijing's intentions and wary of the financial clout of its big state firms.

BELT AND ROAD CENTRAL

Then in October 2013, President Xi Jinping unveiled his Belt & Road Initiative (BRI), an attempt to redraw the global trade map in China's image. In its early years, the eyes of most seasoned observers were drawn to the BRI's sheer scale and ambition and to the financial and political influence it allowed Beijing to wield over strategically important and capital poor states like Pakistan.

Yet that ignored a salient fact: that at the heart of BRI is China's desire to be able to transport finished goods to and from Europe by rail circumventing the US-controlled Malacca Strait. Beijing is focused on two overland routes: a southern path that ploughs a furrow through Iran and Turkey before entering Europe via the Balkans and a northern one that takes in Russia and eastern Europe. But both routes, once they leave China's western border, pass first through the same country: Kazakhstan.

This puts it in a very strong position. "Kazakhstan is absolutely vital to the Belt and Road Initiative," says Charles Robertson, global chief economist and head of macro strategy at Moscow-headquartered, emerging market focused investment bank Renaissance Capital. "It can be argued that it is more important than any other BRI country."

In recent years, the nature of Chinese investment in Kazakhstan has shifted. A focus on extracting and importing energy and minerals has been replaced by a far longer term strategy of transforming the Central Asian state into a valued and hugely valuable logistics and trans-shipment hub.

China is laying a fresh 2,700km long ribbon of tarmac from west to east that will complete a 7,000km highway running from Europe to Xinjiang. Last year, Cosco

bought a 49% stake in the Khorgos Gateway, a transit point on a particularly remote stretch of the Sino-Kazakh border. The state-run shipping giant plans to invest billions of dollars in the 'dry port', with the aim of slashing the time and cost of transporting goods between China and Europe by rail. It currently takes around 25 days to complete that journey but border delays and antiquated infrastructure mean sea freight is still 10 times cheaper.

Few, certainly in Kazakhstan, doubt this is the future of trade. According to Roman Vassilenko, deputy minister of foreign affairs, the number of 'intermodal' freight containers shipped by rail from China to Europe via Kazakhstan jumped from zero in 2010 to 200,000 in 2017. The number is on track to hit 2 million by 2020, generating, predicts Vassilenko, $5bn in annual transit fees.

This, analysts say, is a once-in-a-lifetime opportunity. China's commitment to BRI offers Astana a gilded chance to develop and diversify an economy that has long struggled with two limitations: its overwhelming dependence on oil revenues and a shocking lack of good infrastructure.

Perhaps the only foreseeable danger in allowing China to build new highways, railways and dry docks would be to borrow heavily from China Development Bank, Export-Import Bank of China or one of Beijing's big commercial lenders. That has been the bane of states that bought in early and heavily to the BRI, most notably Pakistan and Sri Lanka. "Getting into debt with China is poison," notes AFPC's Blank.

That seems unlikely to be a problem for Kazakhstan. Yes, it's already one of the biggest BRI beneficiaries. An estimated 62 China-led projects are underway, worth $30bn. But while Beijing's investment in the country dwarfs its exposure to almost every other belt-and-road state, its political leaders appear determined to treat the country with kid gloves. "The intent is not to annoy Kazakhstan," says a veteran development official in the Chinese capital. "We want to be partners and [the message from the top] is clear: that the money we are investing in Kazakhstan is our own. We do not expect anything in return."

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REGIONAL FOCAL POINT

Astana's growing confidence in its ability to mould and plan for its own future and to become the focal point of the region is visible wherever you look. In April 2017, it announced plans to Latinise its alphabet, abandoning the Cyrillic script imposed during Soviet rule. The decision made good sense in a country keen to integrate further into the international order — though it ruffled feathers in Moscow, already uneasy about its eroding position and influence in Central Asia.

The Kremlin has been further rattled by Nazarbayev's interpretation of 'Eurasianism'. To Russian nationalists, the concept argues in favour of the recreation of a 'Greater Russia', a single state with Moscow at its core. But Kazakhstan's president sees it as a chance to put Central Asia at the heart of world politics and for each state in the region to be allowed to build relations with external powers at its own discretion.

The country's increasingly central role in events with bearing on regional and even global affairs was highlighted in August 2018 when the leaders of Azerbaijan, Kazakhstan, Iran, Russia and Turkmenistan met in the Kazakh city of Aktau to decide on the legal status of the Caspian Sea. This was a delicate dance between five countries equally suspicious of each other's motives in the oil-rich inland sea.

To the surprise of many, the quintet reached a landmark agreement that promised to end 27 years of diplomatic wrangling. Russia was a clear winner, securing pledges from the other four nations to keep 'foreign' (i.e. US) military bases out of the Caspian. But Moscow was also forced to compromise. It promised not to block a proposed gas pipeline between Turkmenistan Azerbaijan. The treaty also opens the door to Kazakhstan "to lay a new oil pipeline across the sea to Azerbaija thereby circumventing Russia", notes Chatham House's Bohr.

Even Russia seems to be quietly buying into Kazakhstan's newfound role as an economic and political mediator. When Putin and Turkish president Recep Tayyip Erdogan met in late 2016 to determine the right venue for Syrian talks, there was only one city on the short list: Astana. In March 2018, the Kazakh capital hosted the ninth round of peace talks, with the now-named 'Astana Process' bringing together the leaders of Syria, Russia and Turkey.

This is not to say that Kazakhstan's future is guaranteed. Astana talks a good game on structural reform, and on the importance of promoting industries from agribusiness to chemicals to mineral processing. Yet its economy remains heavily reliant on the price of oil, a situation that is unlikely to change in the short term.

Nazarbayev's much-heralded '2050 Strategy', which aims to transform Kazakhstan into a top 30 economy by mid-century, is dependent on forcing through root-and-branch reform, something that is anathema to the political and commercial elites. And at some point Astana will need to direct its attention to deciding who will succeed Nazarbayev. Until that question is resolved, it will continue to hang in the minds of regional leaders and foreign investors alike. GM

"An unstable Russia is a serious problem for Kazakhstan"

—Stephen Blank, AFPC

"Kazakhstan is absolutely vital to the Belt and Road Initiative"

—Charles Robertson, Renaissance Capital

Astana is Born: A new financial centre in Central Asia

The challenge of maximizing finance for development is largely one of co-ordination. Bringing the private and public sector together is no easy task, given the different needs, and expectations of all parties. It is also a challenge to overcome the operational difficulties that arise when developed market investors take on developing market risk.

In 2015, a new international financial centre was born in Astana, the capital of Kazakhstan. It has been specifically designed to bring developed market standards of financial intermediation to one of the largest and least capital served regions in the world. The timing for this exciting new IFC could not have been better, coinciding with the roll out of China's Belt and Road Initiative, and the burgeoning green finance revolution. **In this exclusive interview with Kairat Kelimbetov, Governor of Astana International Finance Centre**, *GlobalMarkets* discusses the progress to date, how AIFC will differ from other IFCs, and what it will mean for the financial development of Kazakhstan and the wider region.

We see an opportunity to become a truly international financial hub"

—Kairat Kelimbetov, Governor, AIFC

Official launch
President Nazarbayev opens the Astana International Financial Centre

Why was it decided to establish the Astana International Financial Centre?
In 2015 the President of the Republic of Kazakhstan created the Astana International Financial Centre (AIFC). This included the formation of a special financial zone, where the principles of English common law understandable to investors are in force.

Obviously, the goal of creating such a centre has always been to improve the local financial market, introduce new instruments, and to create a completely new platform. There was a need to provide more alternatives to the traditional banking sector and to ensure that financial markets sustain long-term growth. This is why we identified the development of capital markets, asset management and private banking, fintech, and responsible investment (Islamic finance and green finance) as our main pillars.

At the same time, the creation of the centre was not only to meet local demand: we see an opportunity to become a truly international financial hub.

As the globalization of the world economy unfolds and deepens, trade and financial relations between countries grow, the role of financial centres and the demand for quality financial services have significantly increased. Even with the global trends today challenging globalization, we see increased regional integration, especially in the Eurasian region.

Kazakhstan, with its strategic location and political stability, has a great potential to become a regional centre for financial intermediation. The integration of the country into regional cooperation organizations and the Eurasian Economic Union creates additional privileges for participants in the financial sector, opening access to a market with a population of more than 300 million people.

Within a radius of more than 3500KM from Astana there is no financial centre that provides high-quality services in accordance with international standards.

How will the success of Astana International Financial Centre contribute to the economic development of Kazakhstan?
First of all, the development of AIFC should play an important role in the implementation of the current structural reforms of the country. AIFC will play a crucial role in the plan to privatize the country's largest companies. AIFC will implement best practices in different areas such as exchange activities, regulatory regime, and the legal status of investors, which will help improve the business environment of the country as a whole.

Moreover, AIFC together with other stakeholders such as the Pension Fund, Ministry of Finance and other ministries, could become a cluster of long-term capital institutions. Long-term capital management will become an important part of the Third Modernization of Kazakhstan's economic plan.

As it was noted in the State of the Nation Address by the President of the Republic of Kazakhstan, AIFC should play an important role in attracting financial resources to the economy.

What do you offer that other more established financial centres in the world do not offer?
Our approach is unique; unlike all post-So-

Photo courtesy of AIFC

viet States we are the first who decided to implement conditions like an independent court, the introduction of the principles of English law and the development of the stock market. To make this possible, appropriate changes were made to the Constitution of Kazakhstan, Constitutional Law was adopted, the conditions for the independence of the AIFC Court and its specialization were examined for the consideration of investment disputes, the working language in AIFC became English.

Also, we have a special tax regime. There is an exemption from payment of corporate, individual, land tax and property tax for a period of 50 years, until the end of 2065.

So, while the ingredients are not entirely uncommon among leading financial centres over the world, what we offer is access to regional markets via a financial centre governed by the principles of English common law.

What lessons have you learnt from other IFCs that have been established in the last 20 years and how have these lessons been incorporated into the structure — legal, physical and technological — of AIFC?

Let's start with lessons incorporated into the legal structure. A sound, clear and transparent legal framework for the conduct of business coupled with a trustworthy, impartial venue for resolving civil and commercial disputes between parties is a prerequisite for being competitive in the international market place. Therefore, leading international financial centres operate within strong and transparent legislative and judicial environments.

Driven by the prominent success of the Dubai International Financial Centre (DIFC), we developed a business-oriented legal framework based on the principles of English common law and built a trustworthy dispute resolution system for anchoring AIFC on the map of global financial centres.

What differentiates us from, say, Dubai IFC is that we want to play a prominent role on the local market as well. The Kazakh financial market will be concentrated in Astana and we will lead the development of local capital markets.

How important will China be to your future success, both in terms of general economic ties and from specific projects created by the Belt and Road Initiative?

Kazakhstan has been one of the biggest recipients of Chinese FDI in Central Asia with total FDI stock amounting to more than US$13 billion last year under China's Belt and Road Initiative (BRI) programme. The investments have been attracted into different areas, including transportation, finance, mining and manufacturing. Given the increasing role of Kazakhstan in BRI, the establishment of AIFC is a very timely decision as it might contribute and further strengthen the position of our country.

AIFC is investing considerable time and effort to build a high-tech stock exchange that will comply with the world best practices. AIFC has established a strategic partnership with the Shanghai Stock Exchange (SSE), one of the largest stock exchanges in the world. The expertise of the SSE in developing and maintaining a highly liquid capital market will allow AIFC to create a high-tech exchange that will meet world standards. Moreover, this collaboration between the AIFC and the SSE is aimed at promoting Astana as a regional hub for financial services within the framework of BRI and one of the most important ones outside Mainland China and Hong Kong.

Our platform is expected to be at the forefront of serving infrastructure projects as well as bilateral and multilateral trade, finance, investment and logistics in the context of the Belt and Road Initiative.

Which specific parts of the global financial world are you looking to attract to AIFC — investors, banks, brokers, market structure, fin tech?

We seek to attract liquidity to the market by approaching frontier and emerging markets funds, and Family offices and private investors seeking portfolio diversification and higher growth.

AIFC is interested in attracting investment and capabilities in the extractive industries. Additionally, AIX supports Belt and Road Initiative investment into Kazakhstan.

Also, to truly position ourselves as the leading fintech hub in Central Asia and the CIS, we are looking at fintech innovation across all our key pillars, namely capital markets via AIX, asset management, private banking, and Islamic finance. Technological innovation and disruption are already being seen across all these pillars. The AIFC Fintech Hub's key goal is to enable and foster greater innovation to accelerate and future-proof development of these industries, and enable greater efficiency.

Apart from developing the regional fintech ecosystem and developing a leadership position in financial technologies, the AIFC will also be focusing on addressing core issues such as financial inclusion and access to capital that will support the country's overall digitisation efforts and economic growth.

AIFC will also be partnering with leading global fintech hubs, for example, London, Hong Kong, Singapore and Dubai to access new markets and to facilitate transfer of talent and technology.

Which global firms have you already struck deals with?

In February 2018 China Development Bank (CDB) received licences from the Astana Financial Services Authority (AFSA), the regulatory body of the Astana International Financial Centre. The licences allow CDB to conduct a regulated activity of operating a Representative Office and to provide marketing services to its clients. Also on this list are such companies as China International Capital Corporation Hong Kong Securities Limited, Shenwan Hongyuan, and LUKOIL Kazakhstan Limited.

At the moment there are more than 70 companies registered at the AIFC, and this number grows week by week. The geographic distribution is dominated by those entities coming from Kazakhstan, but the country of origin of the incorporator shows a wide spectrum of firms coming from Estonia, Finland, Hong Kong, Malaysia, PRC, Russia, Malaysia, Singapore, Ukraine and the United Kingdom.

Kairat Kelimbetov

Do you see yourself developing a niche in Green Finance and Sustainable Investing?

Undoubtedly yes.

AIFC has set itself ambitious goals to become the leader in green finance in Central Asia and Eastern Europe by 2025. We see AIFC as a global provider of financial services for green industries and we aim to have more AIFC participants working in green financing and sustainable investment.

For that reason, in 2017 together with EBRD, we developed the concept of the Green Financial System for Kazakhstan, which envisages green bonds as a pilot instrument to be developed on the AIFC platform. Furthermore, in February this year we adopted the AIX Green Bond Rules defining the main regulations for green bond issuers.

AIFC also organizes a number of events targeting potential issuers and investors of green bonds. Also, we are considering launching a grant scheme to cover the cost of second opinions for issuers and creating other incentives to facilitate the development of the market. All in all, we expect the green bond market of Kazakhstan to grow from zero to $200 million by 2020.

Apart from that, in the long run the AIFC aims to develop policies for other green financing instruments at its platform, such as creation of a separate section for emission allowances trading at AIX, green insurance, green loans, green procurements and green fintech.

I cordially invite firms working in this field to try the AIFC platform and grow with us. GM

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What's happening Thursday, October 11

9.00am – 10.30am
A peek into IMF training: crash course on inclusive growth
Trainers: **Stephan Danninger**, Director, IMF-Singapore Training Institute; **Natan Epstein**, Deputy Director, IMF-Singapore Training Institute
Location: BICC, WE-2-Medan Room

9.00am – 5.00pm
Civil Society Policy Forum
Location: BICC, Rooms Jakarta A&B, Bandung and Surabaya

11.30am – 12.30pm
Harnessing technology for inclusive growth
Speakers: **Melinda Gates**, Co-chair, Bill and Melinda Gates Foundation; **Sri Mulyani Indrawati**, Minister of Finance, Indonesia; **Strive Masiyiwa**, Founder and Executive Chairman, Econet Group; **Kristalina Georgieva**, CEO, World Bank; **Jean Philbert Nsengimana**, Special Advisor, Smart Africa
Location: (BICC), WE-2-Nusantara 1 & 2

12.00pm – 12.30pm
Postcard series: **Boosting revenue mobilization: keys to successful tax policy and administration**
Opening remarks: **Carla Grasso**, Deputy Managing Director, IMF
Speaker: **Masaaki Kaizuka**, Exec. Director for Japan, IMF
Location: BICC, WE-2-Nusantara 3

SeminarPick

1.00pm – 2.15pm
The Bali Fintech Agenda
Moderator: **Geoff Cutmore**, Co-anchor, CNBC
Speakers: **Christine Lagarde**, Managing Director, IMF; **Mark Carney**, Chairman, Financial Stability Board; **Sri Mulyani Indrawati**, Chair, Development Committee; **Lesetja Kganyago**, Chair, International Monetary and Financial Committee (IMFC); **Jim Yong Kim**, President, World Bank Group
Location: BICC, WE-1-Mangupura Hall

12.00pm – 12.30pm
A conversation with the IMF's managing director on the global economy
Moderator: **Martin Wolf**, Chief Economics Commentator, *Financial Times*
Speaker: **Christine Lagarde**, Managing Director, IMF
Location: BICC, WE-1-Mangupura Hall

3.00pm – 4.30pm
Human Capital Summit 2018: a global call to action
Moderator, **Karishma Vaswani**, Correspondent, BBC Asia Business
Opening remarks: **Lee Hsien Loong**, Prime Minister, Singapore; **Jim Yong Kim**, President, World Bank Group
Speakers: **Abraham Tekeste**, Minister of Finance & Economic Cooperation, Ethiopia; **Achim Steiner**, Administrator,

Down Time

6.00pm onwards
'Taste of Bali' Evening
Hosts: **TD Securities**
Location: Pasar Malam at Rumah Bali JL, Pratama, Tanjung Benoa, Kabupaten Badung, Bali 80363

7.00pm – 10.00pm
Reception
Hosts: **Banks Association of Turkey**
Location: Museum Pasifika, Complex Bali Tourism Development Corp, Area Block P, Kuta Selatan, Benoa, Kuta Sel. Kabupaten Badung, Bali, 80361

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Location: BICC, WE-1-Mangupura Hall

5.00pm – 6.30pm
Global financing facility: investing in people
Location: (BICC), WE-1-Auditorium

Don'tMiss

5.00pm – 6.30pm
Scaling up green finance: the new role of regulators and central banks
WBG in partnership with the Network for Greening the Financial System (NGFS)

4.30pm – 4.50pm
Check-in speaker (Green Room)
5.00pm – 5.10pm
Keynote address: **Wimboh Santoso**, Chairman of the Board of Commissioners, Otoritas Jasa Keuangan (Indonesia FSA)
5.10pm – 6.10pm
Panel discussion
Moderator: **Martin Wolf**, Chief Economics Editor, *Financial Times*
Impulse remarks: **Taking stock of climate finance and mandate of NGFS**: **Frank Elderson**, Executive Director, Dutch Central Bank and Chair, Network to Greening the Financial System (NGFS)
Panelists: **Francois Villeroy de Galhau**, Governor, Banque de France; **Yi Gang**, Governor, People's Bank of China (tbc); **Mark Carney**, Governor, Bank of England (tbc); **Abdul Rasheed**, Deputy Governor, Bank Negara Malaysia; **Nezha Hayat**, CEO, Moroccan Capital Markets Authority (AMMC); **Erik Thedeen**, Director General, Finansinspektionen (Swedish FSA)
6.10pm – 6.25pm
Q & A
6.25pm – 6.30pm
Closing remarks: **Joaquim Levy**, Managing Director and CFO, World Bank Group
Location: BICC, WE-1-Auditorium

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Clearing up the crash

'Crashed' finally gives the last 10 years of financial crises the coherent narrative they deserve

Crashed: How a Decade of Financial Crises Changed the World

By Adam Tooze Allen Lane, £30

By Graham Bippart

History is not the forte of gioverments. You don't need Trump's tweets – like a recent one retweeted by the fake account of the deceased 37th president Richard Nixon, saying that a presidential campaign spying on a rival campaign has "never been done" – to know this.

It was not much of a surprise then that, in an April interview with Spanish newspaper Expansión this year, Single Resolution Board chair Elke König said the Banco Popular liquidation "proved that a bank can also fail due to a lack of liquidity", as opposed to insolvency. Lehman Brothers, Northern Rock and pretty much every other bank that failed in the aftermath of the 2008 financial crisis offered no such confirmation, apparently.

Liquidity is the financial narrative that runs through Adam Tooze's 'Crashed: How a decade of financial crises changed the world'. The important benefit of this focus is to give the lie to the many politicians, regulators and commentators who see international economic crises simply as national diseases, born of unhealthy fiscal and financial structures indigenous to those nations, which spread to innocent, healthier nations through macroeconomic imbalances such as budget and trade deficits.

By focusing on the severe dependence of international governments and institutions on dollar liquidity in the aftermath of the sub-prime debacle – and the huge transmission of that dollar liquidity from the Federal Reserve to banks around the world – Tooze is able to bring the profoundly international nature of the crisis to the fore, while also demonstrating how national politics framed reactions to the crisis, even in supposedly apolitical institutions such as central banks.

The Federal Reserve's execution of trillions of dollars in swap lines to the central banks of 14 governments from 2007 to late 2010 (and others during the taper tantrum of 2013) took place in a depoliticized context. It was an acknowledgement that the world's economies are interdependent.

It was also an acknowledgment that it is huge and rapid movements of money across sovereign boundaries that constitute the real threat – not necessarily macroeconomic imbalances. While distortions and cracks in its own financial system were building and spreading, the administration of George W Bush was distracted by the growing macroeconomic imbalance between the US and China.

But those swap lines only narrowly escaped being politically hijacked. (As Tooze noted in a recent talk, an official he spoke to said that, at the time, the lack of political debate made it seem like there was "an angel on our shoulders".) They were not secret, the governments involved all knew about them, although it was beneficial for most not to draw too much attention to these lines. This was particularly true of the European Central Bank, which was the recipient of most of those trillions of dollars when Europe's banks were frozen out of US money markets, where they did much of their short-term funding.

Liquidity provision, in all its forms throughout the decade following the crisis, seems to have largely escaped being overly politicized. Among the ECB's first reactions was to supply cheap liquidity to its banks, which then entered into the carry trade of higher-yielding sovereigns that would result in the 'doom loop' of the sovereign crisis.

As the intensity of the crisis increased, it would be highly political arguments over states' financial integrity and fiscal responsibility that would bring the eurozone to the brink.

One of the arguments of the book is that the actions of central banks are always politicized – that there are no 'independent' central banks. Jean-Claude Trichet and Germany's deeply political resistance to embarking on a Fed-style backing of the European banking system was not only unsuccessful in the end, but it also threatened the fabric of the EU itself in the long run. Moreover, it allowed European governments to reframe the sovereign crisis as one stemming from profligate state borrowing, rather than as an effect of the delay in real action.

> Jean-Claude Trichet and Germany's deeply political resistance to embarking on a Fed-style backing of the European banking system was not only unsuccessful in the end, but it also threatened the fabric of the EU itself in the long run

In Tooze's account, much blame can be laid on the ECB's feeble initial response to the crisis and Trichet's very political managing of the institution, including allowing the pressure building up in bond markets to act as a substitute for the eurozone's non-existent federal structures of fiscal and economic governance.

It was fortunate in retrospect that there was just enough cross-party willingness in the US to support the measures the Fed and Treasury took to combat the crisis more successfully than their European peers.

At a talk at *Prospect* magazine's headquarters in London in August, Tooze, who is not overly sympathetic to central bankers, was nonetheless emphatic about the need to depoliticize monetary policy.

"We need to shift the political discourse so it is better understood that it's one of these technical aspects of government that we probably don't want politicized," he argued.

Tooze's primary contribution with 'Crashed' is that he compiles a coherent and comprehensive account of the financial crash and its aftermath with an economic historian's eye. As the title suggests, the 2008 crisis and the European crisis that ensued, as well as all the political upheaval that has resulted on both sides of the Atlantic, are all still a great chaotic narrative jumble.

It is the clarity he bestows on the narrative, as in his work on World War I, 'The Deluge', that renews and enriches our understanding of just how global the crisis was, and how interconnected the fates of seemingly disparate actors are.

Much of the current political upheaval in Europe and the US is the result of that lack of narrative coherence. Far from being a crisis of Anglo-Saxon finance, as European politicians and commentators suggested at the time, it was over-leveraged European banks that overwhelmingly turned to the US Federal Reserve for emergency liquidity support. The banks most active in the Fed's second round of quantitative easing were European, offloading their portfolios of US securities and building up cash balances with the Fed. Tooze points out that no central bank benefited more from the Fed's swap lines than the ECB.

The book, which is enjoyable to read and convincing in its argument, demands that we rethink how we understand the global economy. Traditional analyses of crises like those of the last decade focus on macroeconomic imbalances in trade and budgets.

In adopting a 'macrofinancial' narrative of the crisis, Tooze filters the waters of the debate, replacing national economic aggregates with the real movers of the global economy: corporate balance sheets. In Tooze's words: "For all the pressure that classic 'macroeconomic imbalances'… can exert, a modern global bank run moves far more money far more abruptly" across national lines.

The approach allows us to understand better the international scope and pace of modern financial crises, and helps unmask where politics infiltrates supposedly apolitical processes and institutions.

It is at those times when a 'national economy to national economy' approach to understanding money flows allows commentators to start slinging blame across the lines of the geopolitical map. But in a world where Deutsche Bank can foreclose on homes in Cleveland and the Fed can pump $10 trillion dollars into foreign banks, that's clearly not the right map to help us understand how we got here. GM

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IFC in new push to build local capital markets

By Phil Thornton

Developing countries must develop local currency markets to help wean companies off borrowing in dollars that will leave them vulnerable to a rise in debt interest costs if the US currency surges, the head of the International Financial Corporation has warned.

Philippe Le Houérou, the chief executive of the World Bank Group's private sector arm, said the move was a priority for the IFC over the coming year, he told *GlobalMarkets*. "Developing local capital markets is critical," he said. "It is not a miracle solution but you have to start somewhere."

The danger of borrowing in dollars when revenues are in local currency is known in the investment community as original sin. Many borrowers in eastern Europe that had borrowed in Swiss francs were hit during the euro crisis. "We want to pursue this with renewed energy because when you have exchange rate troubles, it is a trouble only because you borrowed it in foreign exchange," he said. "If you borrow in your own currency that is not a problem but for that you need local capital markets."

Le Houérou said that he was keen to expand the volume of its local currency lending . "We have grown our local currency book but are limited by the lack of capital markets in some countries so we would like to develop that much more because it would give us better protection for our clients." The IFC has lent $20bn in 70 currencies. Local currency commitments have climbed from $800m in 2009 to $2,5bn in 2018.

The scale of borrowing by both governments and corporates in emerging and developing countries will be high on the agenda at this weekend's meetings of the Development Committee. Le Houérou said that debts were going up especially in the Highly Indebted Poorer Countries (HIPC).

"That is a source of weakness when the interest rate goes up," he said. "It will be countries that are heavily indebted on a short schedule and that means refinancing is important and there would be a lot of stress in the system and they will have to adjust and that is never easy."

THE final word

Development finance institutions are catalysts for a better world

By Ngozi Okonjo-Iweala

There is not a government, business, institution or individual in this world that does not have a stake in, or a role to play, in creating a more sustainable, equitable future for all. At the Global Climate Action Summit last month, we saw an impressive array of businesses, cities, states, and others doubling down on climate action.

At COP 24 in December, I hope to see national governments stepping up on national climate action. And at the 2018 annual meetings of the International Monetary Fund and the World Bank Group, I hope to see development finance institutions (DFIs) getting into the nitty gritty of how they can shift and scale their capital away from brown and towards green, or sustainable, investments.

The incentive to act on climate has never been clearer. New research by the Global Commission on the Economy and Climate finds that the right kind of bold climate action across sectors could deliver at least $26tr in economic benefits through to 2030, compared with business-as-usual. And this is a conservative estimate. Climate action could also generate over 65 million new low-carbon jobs (equivalent to the workforces of the UK and Egypt today combined) and avoid over 700,000 premature deaths from air pollution in 2030, compared with business-as-usual development pathways.

> *"The renewed commitment of MDB shareholders need not be an act of faith, but one based on clear mandates, evidence of what we know works, and where science tells us we need to go*

The only way to unlock these benefits is to ensure that finance is mobilised at scale and aligned with sustainability across all sectors of the economy. Multilateral development banks (MDBs), and other DFIs can provide the spark to ignite the new growth agenda. We know this because of the powerful examples of change already happening around the world.

For example, the Asian Development Bank is working with partners through the Energy for All Partnership to increase clean energy access for people in the Asia-Pacific region. Between 2008 and 2015 the Partnership brought electricity access and modern fuels to more than 100 million people. The Partnership's new goal is to bring modern energy access to 200 million people by 2020.

MOVING IN THE RIGHT DIRECTION

MDBs have started to move in the right direction. In 2017, MDBs committed to align their full portfolios with the Paris Agreement by mainstreaming climate change throughout. But more action is needed to change the way the MDBs work. Specifically, they must strengthen their mandates and governance approaches to fully integrate climate change risk assessment into project and portfolio design and target sustainability outcomes.

As a member of the Eminent Persons Group established by G20 Finance Ministers, I hope our new report will help MDBs shape how they act as well as how and where they can expand collaboration. On the 'where' — MDBs must expand efforts in all beneficiary groups, but especially fragile states and highly-indebted countries.

On the 'how', MDBs and other DFIs have the potential to collaborate in new ways with new partners such as national development banks (NDBs), other local financial institutions and the private sector. Working in partnerships, MDBs can support priority reforms in partner countries to build capacity on the ground and to enhance the quality and quantity of 'investible' projects and programmes. NDBs and MDBs can mutually benefit from collaboration with each other, and their partnership can help deliver infrastructure investment at scale to advance sustainability and new growth — a critical step towards securing future growth and prosperity.

MDBs are also capable of establishing approaches that can be replicated and leveraged to secure contributions from other governments and crowd in financing from the private sector. For example, in 2017, the MDBs committed US$35bn in climate finance in developing and emerging economies, which then leveraged an additional US$50bn in climate-co-financing in that year. For our DFIs to become more effective catalysts of change, the MDB system requires greater coherence and political commitment across shareholders.

The renewed commitment of MDB shareholders need not be an act of faith, but one based on clear mandates, evidence of what we know works, and where science tells us we need to go. The same goes for all of us. The world has a plan to deliver a safe, sustainable and prosperous future for all. Now we need to act.

Dr. Ngozi Okonjo-Iweala served two terms as Finance Minister of Nigeria. She was the Managing Director of the World Bank from 2007-2011. She now is co-chair of the Global Commission on the Economy and Climate.

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Pakistan

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IMF will consider it as it does for other members of the IMF."

On Tuesday, the director of the Fund's research department, Maurice Obstfeld, said the IMF would listen "very, very attentively, when and if" it is approached. He pointed to the country's pressure points, including "very large" fiscal and current account imbalances and a "rigid and overvalued" currency. The Pakistani rupee dropped sharply against the US dollar in the wake of the news, on fears that the IMF will, this time, force the country to implement harsh and unpopular economic policies.

Both sides want the same thing: to ensure that a new facility is also the last. Finance Minister Umar pledged publicly to break the "spiral of being in an IMF programme every few years… once and for all", while Obstfeld said the Pakistani government had "expressed a desire to enact deep structural reforms" that would break the toxic bailout cycle.

But is that possible — and what might hamper approval of a new facility? Bilal Khan, MENA and Pakistan senior economist at Standard Chartered, reckons talks may be unusually bumpy this time. China is investing $62bn in local infrastructure, under the banner of the China-Pakistan Economic Corridor (CPEC), part of its Belt & Road Initiative. The IMF, he says, "will only be able to see Pakistan's external debts by getting a full view of CPEC's obligations. China isn't going to like that."

Analysts fear another sticking point will be the US, said to be concerned that a new bailout will be partially used to repay its debts to China. Pakistan dismisses these fears, but China is by far the country's most important creditor. It lent $4bn to Pakistan in the 12 months to end-June 2018.

Dollar under threat

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Japan, South Korea, Saudi Arabia and Taiwan.

Eichengreen, an economics professor at the University of California Berkeley and an author of a number of books on global currency systems, said that being in a military alliance with a reserve currency-issuing country boosts the share of reserves held by 30 percentage points.

In a hypothetical scenario where the US withdraws from the global stage but the level of global reserves remains unchanged, the estimates suggest a roughly 30 percentage point reduction in the share of the dollar in the reserves of US-dependent states, and an increase in the share of other reserve units such as the euro, yen and renminbi.

The estimates also imply that more than $800bn of official dollar-denominated assets — equivalent to almost 6% of US marketable public debt — would be liquidated in this hypothetical scenario, while long-term US interest rates would increase by as much as 80bp, or 0.8 percentage points.

This would be the equivalent of 6% of the stock of US tradeable debt, or 4% of US GDP. "US disengagement would have significant effects on the bond market," said the authors.

Holding a currency is a way that a country effectively pays back another country that provides a security guarantee. Insofar as the two countries are partners in a security alliance, the reserve holder's investments in the partner country will be relatively secure. And the leading power, for its part, is likely to retain political leverage.

"If the world becomes a riskier place, countries may choose to increase their reserve holdings," said Eichengreen and his fellow authors. "On the one hand, dollars need to be sold because their share in the reserves of US-dependent states falls. On the other hand, dollars need to be purchased because countries increase their overall reserve holdings."

They said the research also implies that China's growing self-confidence and assertiveness on the international stage could help to support the emergence of the renminbi as an increasingly important international unit.

The research also suggests that deeper European co-operation in domains such as foreign policy and external security could boost the euro's global standing.

The paper is based on historical analysis that shows that when Germany and the US challenged Britain's economic leadership in the late 19th century, the German mark and, later, the US dollar rivalled sterling as leading international currencies. This is not unlike how China is seen as challenging the US now, and how the Chinese renminbi may challenge the dollar.

China

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and deleveraging targets.

Piyush Gupta, CEO of DBS Group, told *GlobalMarkets* that "pumping liquidity into the system will prop the economy up over the short-term, but is likely to have negative consequences over the medium term".

China's corporate leverage is what worries him the most. "It's a systemic risk to the global economy, far more than the trade war with the US," he said.

According to the Institute of International Finance, China's gross debt to GDP ratio has risen from 171% to 299% over the past decade, much of it thanks to surging corporate debt.

Brian Coulton, chief economist at Fitch Ratings, said China had made progress in reducing its credit growth rate but that most of the recent drop had been thanks to its shadow banking clampdown.

"But the overall debt stock hasn't dropped," he noted. "China still has the policy tools to stop this causing a GDP shock. But if debt to GDP starts to rise rapidly again, then financial markets will turn more sceptical about the government's commitment to deleveraging."

He said that if and when China resumed the deleveraging campaign in earnest, it would knock 1% of GDP growth for two to three years. Gupta also said it was about to translate into real pain for creditors.

"Debt restructuring will be one of 2019's key themes," he said. "Debt holders will be impacted right across the credit spectrum from government-owned to private sector debt.

"The government's attitude towards state-owned steel companies has already shown it's willing to let creditors take a hit if it feels it's necessary," he said. "Implicit state support cannot be taken for granted."

DELEVERAGING DELAYED

The government is now countering the economic impact of rising tariffs by easing off its deleveraging campaign. On Sunday, for example, the People's Bank of China cut banks' reserve requirement ratio by 100bp.

However, not everyone is worried. Wei Christianson, Morgan Stanley's co-CEO for Asia Pacific, said the government was not sacrificing its policy agenda to protect growth.

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Gupta: worried most about China's corporate leverage

"Financial clean-up has remained in focus, though likely with a slower pace of implementation," she told *GlobalMarkets*. "China has completed more than 60% and it's been smoother than expected, with only a limited impact to the real economy.

"China's credit boom has been a key factor driving economic growth over the past decade, but it won't be a bubble that bursts," she said.

Christianson highlighted the fact that that banks provided 75% of all domestic credit and that broad credit growth had moderated from a 16% peak (year-on-year) in April 2016 to 11.7% currently.