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## MDB capital ice floes begin to move as G20 report heats up action

By Jon Hay

The long-static apparatus that surrounds the capital structures of multilateral development banks is beginning to creak into motion, jolted by a G20 report on boosting MDBs' investment capacity.

The report, published in July by an independent expert panel, has succeeded in putting on the agenda several issues that had previously been taboo in MDB circles, and focusing minds on matters that had lain unattended because MDBs, shareholders and rating agencies were not communicating fully.

The panel called on MDBs and their shareholders to rethink their risk appetite frameworks and to boost lending capacity by using



Photo courtesy World Bank Group

Malpass: talking to shareholders about more resources

the billions of callable capital — the bulk of their total capital — which most of them leave unused.

Decades of caution and reticence have led to the MDBs

punching far below their weight, even as policymakers urge them to find new ways to increase their impact by crowding in more private sector dollars.

Even before publication, the panel won support from several MDB shareholders, including the US. But the MDBs themselves have been wary, even at times hostile to the group's ideas. Their initial joint statement on the report's publication was distinctly cool.

But the tide is turning. The report was mentioned frequently in discussions at this week's IMF/World Bank annual meetings, often with approval.

The World Bank was initially the most vocally reluctant MDB in private discussions with its

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## Common Framework not enough in face of rising debt distress

By Oliver West, Elliot Wilson, John Crabb

The need for a framework to enable stressed countries to swiftly restructure their debt is becoming more urgent, but the G20's Common Framework is not up to the task in its current state and many countries who may need help are not eligible.

A paper from the UN Development Programme this week identified 54 developing economies as having "severe" debt problems. Though only 3% of the global economy, the countries account for 18% of the population and over half the people living in extreme poverty.

"As interest rates rise to tackle inflation, we could see a number of disorderly defaults in developing countries," said Eric LeCompte, executive

*Continued on page 3*

## Political strife hinders multilateralism amid burning need for co-operation

By Jon Hay, Oliver West, Rashmi Kumar, Elliot Wilson

Tensions between countries and power blocs have put severe strain on efforts to secure multilateral co-operation at the Annual Meetings, just when it is most needed to tackle issues pressing down on developed and developing countries alike — inflation, the surging dollar, debt distress, food

insecurity and climate change.

"We need a lot of international co-operation, especially to fight the biggest issue that confronts us, which is climate change," Raghuram Rajan, former governor of the Reserve Bank of India, told *GlobalMarkets*. "But I don't see a huge amount of global goodwill. And this is really my concern."

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Photo courtesy of UK COP26

Indrawati: synchronised policies

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## Final Word

Sergii Marchenko

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## Multilateralism

*Continued from page 1*

We need all the collective will and co-operation that we can summon if we are to keep climate change from overwhelming us.”

Internal disagreements prevented the IMFC, the fund's policy arm, and the G20 finance ministers and central bank governors from putting out a joint communiqué, because G7 countries wanted strong language against Russia's invasion of Ukraine.

Rather than make a direct statement on the war, the IMFC simply recalled that a majority of countries had “deplored” the invasion at the UN General Assembly in March and October. And instead of a communiqué, Sri Mulyani Indrawati, Indonesia's finance minister and chair of the G20, gave a summary of the discussions.

“Not just economic factors but geopolitical factors require us to co-operate even more to co-ordinate and synchronise policy, which is becoming so difficult under this fragmented situation,” said Sri Mulyani. “During our meetings, member countries underlined the importance of preserving the G20 as a premier international forum for economic co-operation.”

### SUBMERGING MARKETS

Speaking at the IIF annual meetings on Friday, former US treasury secretary Larry Summers said he could not remember such a complex set of challenges facing the world in the past 40 years, yet argued that the “fire department is still in the station”.

“The sense of an international community response to what is happening has just not been there this week,” he said.

Despite lots of talk about the need to mobilise financing and support, “emerging market after emerging market is becoming a submerging market as it loses market access,” said Summers.

“If you don't have market access, you don't get large scale private finance, to do a green transition,” he said. “This meeting is not going to be remembered for anything except being a missed opportunity.”

Russia is not the only flashpoint. Relations between the US and China are poor, while a newly assertive India has frustrated Western diplomats by refusing to side strongly against Russia.

“You can argue Washington is driving the decoupling,” said Andy Rothman, head of China research at Matthews Asia. “You can argue Washington is pushing its allies to choose DC or Beijing. Both sides are locked in a cycle of difficult relations which is feeding on itself, and they need to break out of that, as neither country is going away and the reality is that everyone in the region needs to have a good relationship with both.”

## AfDB to innovate again with hybrid capital, risk transfer

By Jon Hay

The African Development Bank is working on two first-of-a-kind transactions that will put it back at the forefront of multilateral development banks in financial innovation.

If successful, the deals could stimulate wider efforts among MDBs to make their capital go further by using techniques employed in the private sector.

“The challenges African countries have — the infrastructure gap, poverty, inequality, climate change and then you add a layer of Covid, which we are not out of yet, then add the Russia-Ukraine war and food insecurity — it's a lot,” said Hassatou N'Sele, chief financial officer at the African Development Bank. “We view ourselves as a financier; but also as a catalyst for bringing additional capital to Africa. Our capital is small compared to our mandate. Optimising our balance sheet is another way to provide more resources to the continent.”

In 2018 the AfDB won widespread attention with a synthetic securitization of \$1bn of project finance, corporate and financial institution loans and a \$500m guarantee of financial institution loans by insurance companies. Together, they

freed up capital for \$1.1bn of new loans. The deals were expected to be widely emulated, but other MDBs have been less active than enthusiasts had hoped.

Now after a long gestation, the AfDB has completed a new risk transfer on government loans — harder because they carry less yield. Insurance companies, supported by the UK government, will absorb much of the risk on \$1bn of loans to African governments, generating substantial capital relief.

Next year should come a deal that causes a big stir in capital markets. “We have been working for a year and a half to have hybrid capital approved by the Bank and to design a structure which would work for MDBs,” said N'Sele.

Any equity credit AfDB can obtain with the hybrid can be leveraged with senior bonds to produce three to four times its volume in development lending.

Some MDBs have subordinated debt, but there has never been a full scale public hybrid capital issue. It could open the way to a new asset class.

After much back and forth with the rating agencies and some criteria revisions, the AfDB has designed an instrument that



Hassatou N'Sele: optimising the balance sheet

earns 100% equity credit from at least S&P and Fitch. It will be perpetual and any coupon deferral will be irrevocable. BNP Paribas and Goldman Sachs have helped with the structuring.

The next stage is to place the hybrid with investors. One option is a private placement to supportive investors such as the AfDB's shareholders, but the Bank is leaning towards a market transaction.

This will require extensive roadshows, probably next year; “to explain the strategy of the bank, and also to explain the credit.”

The AfDB has defined what triggers would cause the hybrid to take losses. These have to be “plausible and remote,” said N'Sele. “But just because of the way we are structured as an institution, the instrument will never get to that level. Because internally we have all the buffers and if there is an external crisis, we will have shareholder support.”

## Debt distress

*Continued from page 1*

director of the Jubilee USA Network. “The financial system does not have the tools to deal with multiple debt crises.”

The G20 Common Framework for debt restructuring was conceived in November 2020 to make it easier for the 73 low-income countries to achieve debt relief. But only Zambia, Chad and Ethiopia have signed up, and none has completed its restructuring negotiations.

Marcello Estevao, the World Bank's global director for macroeconomics, trade and investment, said he was “disappointed” and that it was “puzzling” why there was so little demand for the framework.

“Some countries say: ‘Oh, let's see how Zambia goes, then we'll apply’, or ‘I don't want a blemish on my financial reputation’, but this is denying reality, as some of the countries that would benefit from debt restructuring are in bad shape,” he said.

But LeCompte said there were no signals from the G20 that would “encourage borrowers” to use the framework, while IMF managing director Kristalina Georgieva said the Fund was “pressing for a more effective debt resolution mechanism” and called for the Common Framework to become more “predictable”.

“It is like you are entering a tunnel,” said Georgieva. “You do not know where the other side of the tunnel is, because the way we bring all creditors [in] is lumpy.”

In August, Chinese lenders expressed their support for Zambia's restructuring, which several observers saw as a significant step forward. Estevao said he was hopeful the process would “set a very good example for how the common framework can work well”.

But one bond investor who has participated in several sovereign restructurings said he “strongly disagreed” that Zambia was a sign of success.

“It's been two years and there's still no deal,” he said on the sidelines of the Annual Meetings. “The median time for a debt restructuring negotiation is a year and a half. Objectively we can say that the Common Framework has slowed things down in Zambia.”

### SQUEEZED MIDDLE

Sri Lanka became the most recent EM sovereign bond issuer to default on sovereign debt in April, suspending all international bond payments as it suffers a painful economic downturn. But the country cannot use the framework as, under World Bank criteria, it is a middle-income, not a low-income, country.

“This is one way [the framework] can



Georgieva: extending donor co-ordination to middle income countries

improve,” said Estevao. “It can expand its parameters and let more countries qualify for treatment.”

Georgieva said the IMF was “looking for ways” to expand such “donor co-ordination” to middle-income countries. Several crisis-ridden middle-income countries have campaigned for their needs to be better recognised, as their classification means they do not have the same access to international support as poorer countries.

“It is crucial to change the way middle-income countries are treated,” said Sergio Masa, Argentina's economy minister, at an event in Washington on Friday. “Argentina is [classified as] a middle-income country but two out of three children are in poverty.

## Chinese growth slowdown 'may fuel social unrest'

By Elliot Wilson

The forecast slowdown in the Chinese economy has led to fears that the world's largest country by population will face an economic and social crisis, analysts have told *GlobalMarkets*.

The World Bank tips output to expand 2.8% in 2022, lagging Asia for the first time in more than 30 years. In its latest World Economic Outlook, the IMF forecast a growth rate of 3.2% this year and 4.4% in 2023. It makes official state projections of 5.5% look deluded.

Other projections are worse. Chen Zhiwu, a professor in Chinese finance and economy at the University of Hong Kong, reckons the economy is "already shrinking in dollar terms due to depreciation of the renminbi".

Alicia Garcia-Herrero, chief Asia economist at Natixis, said China would be "in negative growth next year in absolute terms, which will increase social unrest".

Experts are sharply divided over the cause of China's first real crisis in decades. To Andy Rothman, head of China research at Matthews Asia, the main threat to economic stability stems from president Xi Jinping's controversial zero-Covid policy.

"Families and firms are worried about more lockdowns and that's leading them to cut back spending and hiring."

### VICIOUS CIRCLE

On Thursday, Shanghai tightened Covid-19 restrictions after 47 infections were reported in a day, the most since July. It comes at a sensitive time for the Communist Party, which is convening in Beijing to usher in Xi's third term in office. Two people were arrested in the capital after unfurling protest banners, proof of rising discontent about draconian pandemic controls.

Anne Stevenson-Yang, co-founder of J Capital Research, pointed to real estate, which makes up 30% of output and is now on its knees. Housing prices fell in September in 46 of the 50 cities tracked by consultancy Shanghai E-House.

"Property is the problem," she says. "It's the foundation of everything: investment into it, the production of glass, steel and cement, the jobs lost. When people see ghost towns, they are even less likely to buy. It's a vicious circle."

Worse is ahead. Experts agree Covid-19 case rates are underreported and likely to spike in winter. That will make any



Xi Jinping: zero-Covid policy

attempt to open borders, let alone convince a fearful population the pandemic is over, even harder.

Looking ahead, one issue is whether an increasingly cash-strapped China — proof of which is offered by a rising reticence to fund projects along the once-trumpeted Belt and Road Initiative — has the wherewithal to tackle its mounting crisis.

Chen at HKU said that banks and local government financing vehicles [LGFVs, used to fund local infrastructure projects] were excessively in debt. "All the talk about quality of growth not quantity is just talk. Pretty much every trick China's officials are trying — none of them work any longer."

An even bigger threat comes from the fact some 30% of China's local governments are reckoned insolvent.

Rajan: EMs need to step up to stop deglobalisation, tackle climate change

By Rashmi Kumar

Emerging market countries that want to play a serious role in the global world order need to "show some creativity" and articulate clearly their agenda and vision for the future, rather than simply adding more "platitudes" to the conversations, said Raghuram Rajan, a former governor of the Reserve Bank of India.

Speaking exclusively to *GlobalMarkets* this week, Rajan said countries such as China and India kept insisting that they wanted to create a new multilateral order but tended to fall short on their promises.

"They need to show some creativity and start creating an agenda," said Rajan, who is now a professor at the University of Chicago Booth School of Business. "What is India doing as it takes the leadership of the G20? Does it have a serious climate plan for the world? Does it have a way of stopping the deglobalisation that is happening?"

"Emerging markets that want a serious role in the world have to come to the table with their thoughts, their views and their vision for the world, rather than simply saying no to what the Western alliance puts forward."

This is critical, given the rising potential in emerging markets. In late June, S&P Global Ratings raised its 2022 growth forecast for European, Middle East and Africa emerging markets by 1.1 percentage points to 4.7%. For Asian emerging markets, growth is forecast to be 4.6% this year.

In comparison, the US and eurozone growth for the year is expected to come in at 2.2% and 2.6%, respectively.

Despite China's GDP coming under pressure due to its zero-Covid policy, tight border controls and pandemic restrictions still in place, it is also expected to record growth of 3.3% this year. This means the role these major markets and regions play in global multilateral circles is of importance, Rajan said.

## Frontier markets' future hinges on IFI support as debt levels spiral

By Rashmi Kumar

The escalating financial crises in Sri Lanka and Pakistan, both of which have reached out to the International Monetary Fund for a lifeline, shed light on the long and painful debt restructuring expected from frontier markets that are tackling both the aftermath of the Covid-19 pandemic and navigating uncharted waters around rising rates and inflation.

Sri Lanka defaulted on most of its international bonds and debt in May, after having suspended foreign debt payments in mid-April. This followed a large-scale economic mismanagement that saw its former president flee amid protests across the country in July.

Pakistan, which has also faced political upheavals this year, got an 11th-hour lifeline from the IMF in August when the multilateral said it would provide \$1.1bn to the beleaguered nation to avoid a default. IMF officials are planning to travel to Pakistan in November to prepare another review following devastating floods that hit the country in mid-June, accelerating its funding needs.

These are just two examples of the travails of frontier market economies that

are combating rising global rates, weaker currencies and domestic issues exacerbated by the pandemic.

Both Sri Lanka's and Pakistan's ratings have been downgraded this year — but their future, and that of other frontier countries on the edge, is dependent on support from multilateral development banks and other international financial institutions.

"One of the key factors will be to what extent IFIs like [the] IMF are willing to step in and provide additional liquidity to these economies, which are essentially locked out of the capital markets at this stage," Nishad Majmudar, an analyst in Moody's sovereign risk group, told *GlobalMarkets*. That, he added, was the biggest risk for frontier countries.

David Loevinger, a sovereign analyst at US asset manager TCW, said what had happened to Sri Lanka was "tragic" and had been driven by a government unwinding older — but stronger — reforms. But its next hurdle would be even bigger.

"The challenge is... a lot of their debt is to non-Paris Club bilateral creditors, China and India, multilaterals that don't provide haircuts and [investors] like us,"



Nandalal Weerasinghe: seeking IMF concessions

said Loevinger during a panel organised by the Institute of International Finance. "So, it's going to be a long and painful drawn-out [debt restructuring] process."

Sri Lankan central bank governor Nandalal Weerasinghe, as well as state minister of finance Shehan Semasinghe, were in Washington DC this week to negotiate with the IMF for concessions.

The pressure on frontier markets is only going to go up. The surge in the dollar and rampant inflation have made frontier central banks in 19 of the 35 markets rated by Fitch raise interest rates in response, the agency said this week.

Only Angola — which has benefitted from a high oil price, a strong local currency and falling inflation — and Uzbekistan cut policy rates.

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# Red, blue or green: the battle over the ESG consensus



With anti-ESG sentiment on the rise amid a global financial tightening, John Crabb asks if it is time for investors to listen to the anti-woke agenda or double down on social responsibility

By John Crabb

Anti-ESG sentiment is on the rise. As the global economy weakens daily, investors are debating how much value they gain from paying attention to environmental, social and governance issues. For many, the chance of improving the real world is worth the risk of losing a few basis points of performance — or could even make them money. Others insist the whole idea is bunk.

Finance has joined the ESG movement in great volumes, to the point where responsible investing is, if not the norm, at least very much part of the mainstream.

But is it genuinely having a positive impact on climate or social issues — or just revelling in a festival of greenwashing and false labelling?

In the world of international development — for which the UN's 17 Sustainable Development Goals, which also guide much of the ESG movement, are like the Ten Commandments — there is ample precedent for something being widely accepted, but later rejected as the wrong approach.

It was once International Monetary Fund and World Bank policy to implement structural adjustment programmes, imposing free market economic reforms on developing countries in exchange for funding. These schemes are now deemed by many to have done more damage than good.

In Africa, for example, policies to integrate the continent into the global economy failed because of a boilerplate approach. The same economic remedies were prescribed, without due attention to individual countries' ailments and needs — or the policies' impacts.

There is an argument to be made that ESG investing, too, ignores real world scenarios and

imposes an ideology unthinkingly.

ESG investing may have worthy intentions, but it is important to question its methods and what they mean for investors.

"If I want to say that I am for or against ESG, first I need to define what I mean by ESG," said Eila Kreivi, chief sustainable finance adviser at the European Investment Bank in Luxembourg. "If you have two people in the room there are three opinions about what ESG is. We have to agree what we mean before we decide whether we are for or against it, because it's all over the place."

The World Bank issued its first green bond in 2008, responding to demand from Swedish pension funds for an investment that would protect the climate. Three years earlier, the term ESG is said to have been coined in an International Finance Corp conference report called *Who Cares Wins*.

Since then, there has been something of an ESG consensus in Washington — and increasingly, in the wider capital markets.

## TWO CAMPS FORM

At the COP26 conference last year in Glasgow, a coalition of banks, investors and other finance companies with more than \$130tr of assets pledged to support net zero emissions in their investments by 2050. This was seen as real progress — finance to the rescue.

But ESG isn't for everyone, especially in the US. Four years of the Trump administration empowered an anti-'woke' movement that rejected anything the Democrats supported, including attempts in financial markets to fight climate change or show responsibility to disadvantaged human beings.

States like Florida and Texas are at constant and rising risk of hurricane damage. Neverthe-

less, anti-ESG sentiment has risen there so much that their legislatures have passed laws forbidding the state from doing business with financial firms that 'discriminate' against fossil fuel companies.

In Brazil, President Jair Bolsonaro has rejected ESG and pulled support for many initiatives. Worse, he has allowed deforestation and fires to worsen in the Amazon rainforest.

The Russian invasion of Ukraine has sparked an energy crisis in Europe that is threatening a harsh winter. Countries at risk of gas shortages may turn to coal, despite years of pledges to move beyond fossil fuels.

And within the European Union's finance sector itself, layers of regulation, guidelines, recommendations, principles and ratings are causing ESG fatigue. Given the perilous state of the economy, investors are asking if the benefits are worth the effort — or whether they exist at all.

## FATAL CONCEIT?

Corrado Pistarino, chief investment officer and chair of the climate risk forum at Foresters' Friendly Society, a small UK mutual fund, questions how much value can really be gleaned from an ESG strategy.

"I've been working in this sector for years," he said. "My experience tells me that it's very difficult to make money, it's very difficult to generate alpha and it's very difficult to find yourself in a position in which you have an information advantage on your competitors. My baseline assumption is that most of the information is already captured in the prices you can see. Most likely, in terms of performance, I will be at best tracking the index."

Pistarino argued that an investor restricting itself to companies with better ESG attributes inevitably reduced portfolio diversity by

“People are asking the question of whether, when money is being managed, it's being managed for the benefit of the investor — the client — or is it being managed for the benefit of the asset manager?”  
—Hester Peirce, SEC

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favouring and disfavouring certain industries.

“Of course, if you produce cement you will have a terrible ESG rating, but we need cement,” he said. “The economy has a lot of building blocks, and each building block is equally important. It’s important to have some cement if you want to build back Ukraine.”

Another vocal voice against the ESG movement is Vivek Ramaswamy, co-founder of Strive, an asset manager in Ohio, which promotes investments that do not push political agendas.

Its US Energy exchange-traded fund and recently launched Semiconductor ETF are determinedly anti-ESG in conception. According to Ramaswamy “the real problem, as I see it, is not that BlackRock is divesting from oil and gas, but that they’re investing in oil and gas firms and changing the purpose of what these firms are supposed to do”.

Changing the fabric of companies, especially in energy, would have disastrous ramifications, he argued.

“The danger of getting fossil fuel companies to transition away from being fossil fuel companies is that we have systematic underinvestment in fossil fuel production, which leaves us shorthanded when there’s a massive supply and demand imbalance for global fossil fuels, as we’ve seen this year,” Ramaswamy said.

“The fatal conceit, as Friedrich von Hayek called it, is to think that we can know in any central model, government or private sector, what the right ways are to settle the fundamental and complex questions that cause us to suffer in otherwise unpredictable ways, such as the global energy crisis we’re facing now.”

The fact that Europe is still financing Russia’s war machine because of its inability to produce its own oil and gas was, he argued, a wake-up call to what really constitutes “playing it safe”.

## MORALS AND RISK

At the other end of the spectrum are investors convinced they must think about more than the bottom line on the quarterly report — either because it is morally right, or simply out of financial prudence.

Like the Swedish pension funds in 2008 that called for green bonds, these actors want their capital to help develop the world. They believe their clients expect it, too. Surveys and hard evidence suggest that many savers — especially younger ones — do want their cash to be invested responsibly.

Triodos Investment Management, a Dutch asset manager, handles \$5.7bn invested in the real economy for social and environmental benefits, with full transparency.

“We are ethical investors — we do impact investing because we think the world should become more sustainable. That’s what our clients expect from us and that’s how we invest,” said Hans Stegeman, chief investment strategist at the firm. “I completely understand that some people think differently. But even if you think differently, every investor should take all the risks into consideration.”

What Triodos does, he said, “is look from the inside out perspective at how we can make the world a better place, which is completely normative, ethical, and you could say it is complete rubbish, but that’s what we do,” he said. “If you don’t want to do that, you should still see

ESG factors as risk factors on sustainability. It’s your proprietary duty as an investor to take all the possible risks into consideration, so that’s why I don’t get the [reluctance] in the US.”

Even if you don’t care about climate change, many ESG proponents argue, it is clearly happening. Droughts, fires and floods will intensify, and affect investments. Bad governance is always a risk. Investors can leave their ethics at the front door, but still take ESG into consideration and include it in their risk models.

## VOICES OF DOUBT

In Europe, investors are now required, not to take ESG into account, but at least to declare their approach to it, and disclose considerable ESG information about their investments.

The US is in a very different place. The Securities and Exchange Commission introduced proposals for a climate disclosure regime in March, but they have yet to be ratified.

A backlash against them has spread across the US financial markets. There is even opposition within the SEC itself. Republican commissioner Hester Peirce, for example, has expressed concerns about the proposals.

“There are different strands of the anti-ESG sentiment, some of which are a direct response to SEC climate rule proposals and investor company rulemaking,” she told *GlobalMarkets*. “People are asking the question of whether, when money is being managed, it’s being managed for the benefit of the investor — the client — or is it being managed for the benefit of the asset manager?”

“One of the things our rules are looking to address is this concern that advisers are not telling their clients how they are managing their money and whether they are representing that accurately or not,” Peirce said. “Clients asking questions is good and healthy. ESG is so nebulous, but if someone claims to be managing with an ESG strategy, they should explain what that is, and then let the client decide whether they want it or not.”

Another country experiencing ESG pushback is Brazil. However, it is not domestic regulation worrying investors there, but US ones. Gustavo Santos, head of ESG at Alvarez & Marsal in São Paulo, said his clients — mostly private equity companies — were more concerned about the SEC’s proposals and the EU’s Sustainable Finance Disclosure Regulation than domestic laws.

“They are afraid that the capital flow from Europe or US might diminish in Brazil if they do not comply to these regulations,” he said. “Clients are not really concerned about the environmental aspects, just capital flows.”

## SAFETY AND SOUNDNESS

The US bank regulators, the Office of the Comptroller of the Currency, Federal Reserve and Federal Deposit Insurance Corp, also issued guidance in a co-ordinated way around the same time as the SEC, but were careful to distance themselves from promoting climate action for ethical reasons.

The agencies said then, and have since repeated, that climate poses risks to the banking sector — but that

this is not the same as banks setting carbon targets or pushing against fossil fuels. The regulators do not want to step out of their mandate of protecting the US banking system.

“Consistent with the draft principles and our legal mandate, the OCC is laser-focused on the safety and soundness aspects of climate change risks,” said Michael Hsu, acting OCC comptroller. “Unlike regulators in some other jurisdictions, we do not (yet) have a mandate to help meet carbon reduction targets. This means we cannot take supervisory measures specifically designed to accelerate the transition to a carbon-neutral economy, such as limiting credit to fossil fuel companies.

“Rather, we are focused on large banks’ climate risk management capabilities: identifying, measuring, monitoring and mitigating climate-related exposures and risks. Weaknesses in risk management could adversely affect a bank’s safety and soundness, as well as the overall financial system.”

The federal view is straightforward: safety and soundness come first.

## A FORK IN THE ROAD

In Florida, however, regulators are going in the opposite direction. In August, Governor Ron DeSantis, a potential presidential candidate, approved a rule that would prevent the state pension fund from even considering ESG when making investment decisions, suggesting that ESG policies “are dead on arrival in the state of Florida”.

Florida was not the first state to take action like this and will probably not be the last. So far, 17 Republican-leaning states have introduced anti-ESG legislation.


Far from being treated as a neutral matter of risk management, ESG has become politicised in the US — another battleground in the culture wars.

Financial punches are being landed. BlackRock — a member of the United Nations’ Glasgow Financial Alliance for Net Zero — has reported losing more than \$1bn of asset management business in Republican states so far. States including South Carolina and Utah have dropped the world’s largest asset manager on the grounds that its CEO Larry Fink is too heavy handed with his green pronouncements.

Which side is being truer to its fiduciary duty to its ultimate investors may never be settled, because each interprets this duty in a different way.

But markets will have the last word as to which turns out to have been the wiser investment strategy.

“You can call it whatever you like — woke, ESG, or just doing your normal financial analysis with risks and expected returns — but to me, saying that you should not invest in the green transition at all is stupid,” said Kreivi at the European Investment Bank.

“Some governor in the US may think something, but if the whole world is against him then they have to go with the flow, with what the best investment is, because if you’re the only one in the world investing in brown coal, despite what you think, you’re going to lose. Don’t fight the trend and make it your enemy. If I’m a retail analyst working for an asset manager, I don’t need to believe in Santa Claus, but I still need to look at the Christmas sales.” 



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# Finance for the global challenge

Jorge Familiar, the World Bank's treasurer, sits down with Toby Fildes, managing editor of *GlobalMarkets*, to discuss ways of boosting investment capacity, innovative structures including the Bank's recent 'Rhino Bond', the prospects of issuing 'Food Bonds' to help draw attention to the food crisis and whether the opponents of 'woke capitalism' have a point.



**The World Bank issued the first labelled green bond in 2008 and while the market for green bonds has grown tremendously in the past years. Why has the World Bank chosen to move most of its issuance into Sustainable Development Bonds, with just a small share of green bonds every year?**

It's a transition that makes a lot of sense for the World Bank. We have a holistic approach to sustainable development — it is at our core. We are focused on the eradication of poverty and the reduction of inequality in a sustainable way.

We have green projects which are 100% geared towards mitigating or adapting to climate change. We finance renewable energy projects in multiple countries around the world. But that's not the only way in which we approach climate. When we finance projects in other sectors and other fields we also look at them from an environmental lens.

So we feel that the sustainable label better encompasses all of what we do. When investors are looking for some risk and return profile, but they also want to make a difference from a perspective of impact, our approach to sustainability tells a more comprehensive story of what we do. And as you also know, we trace the funds we raise through markets, we trace them to our activities.

**What do you think of the historical model of the World Bank that crowds in private capital, directing it to development? Do you think it is fit for purpose to help tackle climate change in emerging markets? And what about the International Development Association also issuing bonds — how is that the same, or different?**

The world put together an incredibly effective machine to mobilise private resources

for development. The IBRD has \$20bn of paid-in capital — this is what we have received since the bank was formed. And with this paid-in capital, and the reserves we have accumulated from our operations, we have financed over \$800bn in sustainable development projects all over the world. That's quite an impressive story to tell.

We also have IDA, which started as a fund with very strong donor support for the benefit of the poorest countries. The IBRD — the very efficient private capital mobilisation engine — has also transferred resources to IDA, making it stronger. And now IDA is also going to the markets, so that it can do even more.

It's a very strong and long track record of private capital mobilisation for the benefit of the world's poorest countries.

**Some suggest that the IBRD has additional headroom in its rating and that it should use this to increase the leverage on its balance sheet, as implied by the work of the expert panel which produced the report *Boosting MDBs' Investment Capacity for the G20's International Financial Architecture Working Group in July*. Is the World Bank reviewing that and other recommendations of the report?**

We certainly are — we really look forward to engaging with our board and our governors in looking into this and continuing to optimise our financial model, because it is a never ending journey.

I'd also like to take this opportunity to list all the innovations that we have brought to the table in terms of doing more with what we have.

I was talking about cat bonds earlier and they are a good example. Cat bonds are part of our funding programme. But they are like

an insurance product that help our client countries transfer risks to financial markets and open up more space so that the available multilateral financing is used for other types of projects.

More recently we issued a "rhino bond", the very first outcome-based wildlife conservation bond in the world. It's another innovation — part of our regular funding programme but inviting investors to set aside part of the interest they would be receiving and support wildlife conservations project in South Africa.

If the project is successful and the black rhino population grows above certain levels, a donor will come to make the investors whole, and maybe even, depending on the level of success, pay a premium. This is a type of innovation that we're always looking for, in terms of doing more with what we have, beyond our regular activities.

**So can we expect to see more of these types of innovative structures, dedicated to specific projects?**

Our goals are quite significant — the challenges facing the world are significant. And of course our shareholders embrace institutions like ours with very strong financial management. But we certainly want to do more with what we have.

Just bringing it back to cat bonds, I've always felt that for them to be truly successful for countries like Mexico, then the rating agencies need to reward them for having these bonds in place.

One fantastic story I was closely involved in when I was in the region on the operational side was Jamaica's cat bond. Jamaica, in partnership with the Bank, built a very robust disaster risk management safety net.

Jamaica had done a tremendous job in

“  
*Just bringing it back to cat bonds, I've always felt that for them to be truly successful for countries like Mexico, then the rating agencies need to reward them for having these bonds in place.*



terms of fiscal consolidation for many years. But there was a piece of risk they could not hedge on their own, and they needed support. Donors came in to pay the premium of a cat bond. And credit rating agencies noted the cat bond as a credit positive, because of the higher level of protection. That's exactly an example of what you're saying.

**The Net Zero Asset Owners' Alliance have called for new blended finance vehicles, outside the MDBs, to leverage private investment in green solutions in EM. Do you think that's a good idea?**

Blended finance has a role to play. It's important that when it comes to blended finance there need to be a good balance between risk and returns. What I am not convinced would work is a model in which the risk remains with multilateral institutions and the returns remain with the private sector. You need to have an appropriate balance between risk and return.

Instruments like guarantees also have a role to play in de-risking projects and making things more attractive for private sector participation. There are some great examples that come to mind, like renewable energy projects in Argentina, where significant mobilisation of private capital was catalysed through a World Bank guarantee.

It was interesting that when we came to repeat it a year later, we provided a smaller guarantee but the level of mobilisation was even higher.

The other side of the story is providing countries with financing on attractive terms, so that certain projects can happen ahead of others. For example, decommissioning a coal energy plant has financial costs and social costs. It's important that we find ways of making it attractive for countries to go for cleaner alternatives, like lowering the cost of funds.

**Food insecurity and agriculture are big topics right now, given the war in Ukraine, inflation and droughts. The heads of the FAO, IMF, World Bank, World Food Programme and WTO made a highly unusual joint statement in July that highlighted the urgency of the**

**crisis. How can the international capital markets play a role here?**

There is a clear need to mobilise resources and put together projects that can help countries cope with the situation. This is a corporate priority that is very high on the agenda, like you say — it's top of the agenda of the operational side of the Bank.

There is also space to look at this through a long term lens. Capital markets can certainly play a role when it comes to risk management in the longer term. We will need to be very creative and use all the tools at our disposal to help countries come up with solutions to this very complex situation.

**The International Fund for Agricultural Development, the United Nations agency, earlier this year issued two private placements, basically capital markets bonds a bit like yours. Given that you do labelled green bonds, and, as we have seen, deals like the Rhino bond, would the World Bank ever consider doing a bond with a food or food security label?**

Well, we don't label our bonds beyond "green" or "sustainable" but could emphasise certain topics when we issue bonds from time to time to draw attention to some of our activities. For example, in some of our sustainable bonds, we highlight themes such as gender. So we could certainly do something like this if we felt it would add value to draw attention to this very relevant development-related topic.

**I asked this question of your predecessor, Jingdong Hua — in the past few years there have been some political challenges to the idea of multilateralism. Do you think Covid-19 and the current crises might usher in a new golden age of multilateralism, since so much international co-operation is needed?**

We are having our first in person Annual Meetings after more than two years and if you look at the level of attendance, just by walking through the corridors of the buildings and surrounding streets you can feel the energy that comes from multilateralism. Our stakeholders are showing up in force to take advantage of this very powerful network we have here.

The challenges the world is facing are global. If you think about the pandemic, it starts very locally and then its effects are felt in every single corner of the world. Challenges like these require global co-ordination and global efforts.

I certainly believe that multilateralism has served us well in many areas in the past and has a huge role to play going forward. Especially in areas such as climate change. It's a global challenge that affects us all. But the solution is very much local. The projects that will lead to a more sustainable future are local but generate global benefits.

**Do you think using ESG or sustainable finance approaches to either manage financial risks or deliver positive impact is advancing today?**

The numbers speak for themselves. We issued the first

green bond in 2008 and since then \$2tr have been issued in the green, sustainable and social bond markets.

We approach this holistically — we look at this from the perspective of a multilateral development bank, an issuer, an asset manager and a provider of advice. And we see lots of interest around this space now.

There are two elements to it. Some of the environmental, social and governance-related issues are relevant for financial decision making. When we think about climate change, and if we agree that it is the biggest challenge facing humanity, it's hard not to consider environment-related elements when assessing the risk and return profile of an investment. The other aspect is that investors will always focus on risk and return. But more and more they also want to have a positive impact. These two things are not at odds with each other — they can be brought together.

**At the same time, though, we do have a bit of push-back on ESG, for example in the US in Florida and Texas. Do the opponents of "woke capitalism" have a point? Has the attempt to inject social values into capital markets gone too far?**

I believe we need to continue working, for example, on the quality of [ESG] information available for decision making, because these issues have an impact on risk and return. Investors need to have the tools to incorporate them into their decision making processes.

So yes, I believe we have a way to go [to] having a single set of high quality disclosure standards that will be applied on a consistent basis and will allow investors to make better informed decisions. That is one part of the equation.

And then there will also be investors who start looking at this third axis of investment — focussing not just on risk and return but also on their impact. Again, we need to continue in this journey of providing investors with what they need to fulfil their objectives.

**You are a trustee of the IFRS Foundation. From that perch you must be watching the ISSB consultations closely and other country or regional developments to improve climate disclosures and transparency? What do you think will be the outcome of all this? Do you see risks?**

I have mentioned quality of information and standards. As I was starting as treasurer at the World Bank I also had the opportunity to support the efforts of the IFRS Foundation as a night job, becoming a trustee.

I'm fully convinced that we need a single set of high quality sustainability standards to face the challenges we have been talking about. What is my hope and expectation? I hope we will get there.

What are the challenges? Well, the biggest challenge is fragmentation. Multiple standards do not meet investor needs. It's great that there has been this convergence around the IFRS Foundation, which has a proven track record on creating high quality accounting standards at the global level. So I am very hopeful and positive. The reason why I have taken on this night job is precisely because it's extremely important at this particular point in time. **GM**

See [www.globalcapital.com/globalmarkets](http://www.globalcapital.com/globalmarkets) for the full interview

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# Investing in EGYPT



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## MINISTER OF INTERNATIONAL COOPERATION



### **COP27 is a significant annual global event. But what is the significance for Egypt, and indeed Africa, this year? What is it a symbol of?**

Global warming is an increasingly pressing issue that necessitates collaborative actions of all stakeholders involved in the development agenda. Importantly, developing countries, and Africa, in particular, do not receive the climate finance they need despite being the most vulnerable to climate change. Moreover, Africa contributes only 3.8% to global greenhouse gas emissions, which is the lowest level among all continents. So, there is an imbalance that needs to be addressed. And specifically, even though substantial amounts of capital was pledged during COP26 (\$1.7 billion in philanthropic pledges, and \$130 trillion in pledges by banks, insurers, pension funds and other financial services firms), this capital doesn't flow to developing countries. The main objective of COP27 is therefore to address this and move from pledges to implementation. In this regard, the Egyptian government will be launching several initiatives during COP27, one of which is the "Sharm El Sheikh Guidebook for Just Financing," which outlines the key role of all stakeholders in translating financial commitments into implementable projects and captures opportunities to leverage and catalyse public and private finances and investments to support the climate agenda. It illustrates how to scale up financing through better alignment of different sources of capital while also achieving more just and equitable outcomes.

**Striking a balance between the need to address climate change and the rights of developing societies is one of the challenges of a just transition. What does a successful approach to this issue look like?** Addressing climate change and developing

countries' right to development should come hand in hand as they are not mutually exclusive. Therefore, the concept of just financing addressed in the guidebook focuses on the right of developing countries to pursue their development trajectory, and the need of international community to support their transition to low carbon development models in-line with the climate agenda and the UN's Sustainable Development Goals (SDGs). The guidebook provides guidelines for developing and emerging economies to access and deploy sources of climate finance into climate-related investment projects and fosters coordinated collective action to facilitate a green, resilient, and inclusive transition. The principle of "common but differentiated responsibilities" shall be at the centre of addressing the climate change challenge, as the principle balances, on the one hand, the need for all states to take responsibility for global environmental problems and, on the other hand, the need to recognise the wide differences in levels of economic development between states.

### **Transition financing is one of many important areas of focus for COP27. What are the key points to agree, and what do you hope will be achieved on the issue of financing?**

There is now a dire need to align finance flows with 'a pathway towards low greenhouse gas emissions and climate-resilient development'. Recognising the importance of a transition financing, the Ministry of International Cooperation, through the launch of the "Sharm El Sheikh Guidebook for Just Financing" emphasises the need to scale-up investments towards climate adaptation and mitigation projects, while highlighting the importance of improved access to quality and quantity climate financing that leaves no one behind.

### **Does the Egyptian government plan to use COP27 as a platform to attract foreign investment in the country, and if so, what is the strategy for this?**

The Ministry of International Cooperation has launched Egypt's Nexus for Water, Food and Energy programme, which is a key initiative for COP27, providing opportunities for mobilising finance and private investments to support Egypt's green transition, reflecting interlinkages and complementarity between climate action and development efforts. This platform aims to leverage Egypt's partnerships with multiple stakeholders to mobilise finance, avail technical assistance, and attract private investment, through innovative financing modalities including blended finance.

### **Digital technology and innovation play an important role in enabling greater sustainability across industries. How is the government supporting this area, and the technology entrepreneurs needed to drive it?**

Recognising the centrality of the digital transformation, MOIC, in partnership with the Ministry of Environment, Ministry of Communication and Information Technology, USAID, Afreximbank, World Food Programme, Google and the United Nations Population Fund, among other institutions, launched the "ClimaTech Run". This initiative aims to engage both tech startups and digital artists from around the world to address global climate challenges by finding new climate action innovative solutions. The initiative underpins the role of youth as well as the weight of research, innovation and entrepreneurship in finding new solutions for climate change. Technology and innovation are key to address the climate change crisis. In fact, artificial intelligence and digital technology has been identified as potential enablers to reduce the global CO2 emissions by 10-20% by 2030. To that end, this competition aims to embed green innovations and breakthrough technologies in the global climate change agenda. In addition, Egypt is undergoing unprecedented developments in the ICT sector. As part of the digital transformation, the Egyptian government has launched the 'Digital Egypt' initiative which aims to transform the economy into a knowledge-based economy strengthened by a highly skilled workforce. Part of this involves training 100,000 young Egyptians to develop their ICT skills. This initiative comes four years after the Egyptian government initially began developing the digital economy to ensure success in transforming the Egyptian economy. At the core of those plans, were four pillars: infrastructure development; investing in human capital; supporting for digital entrepreneurship; creating a business-friendly environment. Finally, and importantly, global supply chains are very prone to large disruptions in cases of natural disasters, wars, global imbalances. Therefore, the deployment of technology to ensure a more resilient system of global supply chains is a must nowadays. To that end, tools such as machine learning, artificial intelligence, blockchain, internet of things and advanced analytics help drive automation and deliver insights that promote efficiencies in production and mobility of goods. ●



# EGYPT'S RESILIENCE TESTED AMID GLOBAL TURBULENCE

The country has needed to pivot and adjust to a mix of economic headwinds that have threatened to disrupt its ambitions on economic growth, development, and sustainability. The investment opportunity, however, remains compelling.

**E**gypt's economy is reeling from global events. As a major importer of grain from Russia and Ukraine, the current conflict between those countries has caused the cost of food to soar. Egypt's foreign reserves, particularly US dollars, are also running low, which is forcing the country to negotiating a fresh rescue programme with the International Monetary Fund (IMF).

While the immediate causes of Egypt's current travails are new, economic woes are familiar territory. However, some investors hope, indeed believe, the country can now break out of the cycle that has dominated its economy for the last six years.

"Egypt has been constantly buffeted by various shocks and it always seems to be struggling to get back to where it should be," says Krisjanis Krustins, director at Fitch Ratings. "Terrorist attacks have hit its tourism industry. It had the Covid pandemic, then the war in Ukraine," says Krustins, listing a succes-

sion of storms that have repeatedly tested Egypt's economic resilience.

On paper at least, Egypt should be a powerful economic force in the Middle East. It has a population of 103 million, the largest in the Arab world, coupled with a sunny climate and rich history that attracts tourists from all over the world. Further, its favourable location plus control of the Suez Canal should make Egypt an attractive hub for global logistics.

The Suez Canal is an economic jewel. In 2021, it generated revenues of \$ 6.3 billion. Located at the crossroads of trade between Europe, Africa, the Middle East and Asia, the Suez Canal carries 10% of global trade. Egypt's GDP stood at \$404 billion in 2021, and the latest IMF forecasts suggest full year growth in 2022 will reach 4.8%.

Inflation is rampant in Egypt, however. It hit 14.6% in August. The value of the Egyptian pound also been hit amid rising

interest rates in the US — in early October it was trading around EGP20 to the dollar. Its own interest rates are at 11.25%.

So, once more, Egypt is at a crossroads, geographically and economically. The country faces a familiar question: How can it build a solid foundation of foreign investment?

## UNBALANCED PAYMENTS

According to credit-rating agencies and domestic financiers, Egypt's balance of payments, which has made the country dependent on non-resident cash flows, remains a key issue to address.

The liquidity of this cash flow, much of it in the carry trade, has created a cycle of vulnerability. Raising Egyptian interest rates has stimulated those cash flows, but an external or internal shock could easily reverse that trend.

"Over the years, Egypt began to rely on non-resident flows as a way covering shortfalls in traditional sources of

**“ Among other mandates, COP27 will provide a critical venue to advance investments in sustainability projects in Egypt and Africa at-large. ”**

**—Hussein Abaza, CEO and managing director, Commercial International Bank**



external receipts,” says Krustins. “Non-resident investment in the debt markets can temporarily plug that gap. It worked after 2016, [Egypt] had a devaluation, and the IMF programme and reforms. And it seemed to work again after the pandemic.”

He adds: “Those flows became quite a large consideration for policymakers in terms of maintaining very high interest rates compared to what might be considered optimal. But it does create a vulnerability. Heading into 2021, foreign investors began to feel their exposure to Egypt was maxed out and you started seeing these flows come off.”

The criticism of this vulnerability is shared by domestic financiers. Tarek Abdel Rahman, managing partner at Egyptian private equity group Compass

Capital, says: “Egypt has had the wrong economic policy of trying to plug that balance of payments gap through the carry trade and therefore we had to have high interest rates. And we have a specific mechanism where we guarantee that carry trade investors can take their dollars out of the country.”

Currently, Egypt is in the process of agreeing a further IMF programme and has recently attracted direct investment from Qatar and Saudi Arabia. Now, the country needs to refocus on opening its economy to investment that will create the foundations of a thriving private sector economy. Such foundations, Abdel Rahman argues, will free the country from the in-out cycle of investment and build a more resilient economy.

#### OPENING UP

There are positive signs that the Egyptian authorities are more willing to make the changes necessary, according to Krustins. The Central Bank of Egypt’s Governor, Tarek Amer, stood down in August and Krustins places some hope on the new incumbent, Hassan Addalla, taking a more market-friendly approach.

Allowing the currency to float more freely rather than intervening to attract short-term carry trade would be a vital step in the right direction.

A long-standing privatisation programme is also back on the agenda, albeit delayed by this year’s turmoil. Unusually, Egypt’s military is a major owner of nationalised companies, including consumer, industrial and service sectors. The hope is that these businesses can be released into private sector ownership.

“The public sector needs to take a step back for a more competitive private sector to emerge. That includes the military, which has been a convenient tool to generate domestic demand. Although you could argue they stepped in to support the economy when the private sector did not want to, there’s now a perception that the private sector has become reluctant to step on their toes.”

Of course, lurking behind all of these factors is a political backdrop of unrest, which has tarnished Egypt’s reputation for stability for more than a decade now. Here too, there are positive signs of change. Compass Capital’s Abdel Rah-

man believes the 2011-2012 revolution is a fading memory among foreign investors and that Egypt can now be sold as a stable political environment.

It is worth noting, however, that in its latest note on Egypt, Fitch Ratings struck a note of caution that “the potential for political instability remains a significant tail risk” particularly considering current economic difficulties coupled with youth unemployment. On the plus side, Krustins notes there are good signs of the government acknowledging the importance of creating social and economic safety nets.

Finally, Egypt is set to host the COP27 conference on climate change in November. This will provide an opportunity for the country to show it can take a lead role in global issues and showcase its potential to global political and business leaders, and its investment attractiveness.

“Among other mandates, COP27 will provide a critical venue to advance investments in sustainability projects in Egypt and Africa at-large,” says Hussein Abaza, chief executive officer and managing director of Commercial International Bank (CIB).

The government has a series of country-critical projects — in total valued at \$14.7 billion equivalent — that require investment. They include everything from clean energy projects to agricultural projects aimed at improving adaptation and resilience, and water-specific projects to modernise irrigation systems and increase the efficiency of rainwater collection and storage.

#### BUREAUCRATIC BARRIERS MUST FALL

Administrative burdens are a major obstacle to Egypt attracting private investment. “It’s just a difficult market to get into,” says Krustins. “The Egyptian bureaucracy is reputedly byzantine. If you don’t know the market well — for example, if you’re a Western multinational — then it might not seem immediately worth it. Of course, for those who are familiar with the market and who get in there, it can be very profitable. But the barriers to entry seem high. The government is trying to change this, but it’s a huge state apparatus and there are many vested interests.”

He adds: “Foreign direct investment is

the component that's been missing [for] several years, due to excessive regulation [on] foreign direct investment. Too much regulation, too many approvals needed."

The Egyptian government, investors, and credit rating agencies, all agree that Egypt must attract investment into sectors and infrastructure that can generate more export activity and, therefore, create more reliable sources of foreign money.

Hydrocarbons have always been part of Egypt's economy and naturally generate foreign income. The country is also a net exporter of electricity. These sectors, however, cannot be counted on in the long run, according to Krustins. "As Egypt still growing, its energy demands are growing, so it won't be able to continue to be an LNG (Liquified Natural Gas) exporter in the very long run," he says.

Renewable energy is an area where private sector investment is leading the way and there are high hopes that the country can develop its solar-based energy sector, combining it with the vital Suez Canal assets to become a hub for renewable fuels. (See our separate section of Egypt's sustainability drive)

According to Krustins and Abdel Rahman, the key is for Egypt to move up the value chain in all areas – to shift from raw or near-raw materials exports to producing and exporting finished products and higher-value services.

### MANUFACTURING POTENTIAL

Egypt has long been famous for its cotton, and textiles are a significant potential source of export growth. Yarn, too, has traditionally been a major component of exports. What's more, inexpensive labour has attracted international investment in making finished clothing products. The textile sector accounts for 30% of industrial production and 10% of the country's exports. Egypt also enjoys a tariff-free trade agreement with the European Union and its textile industry aims to double global exports by 2025.

Meanwhile, several multinational companies have already capitalised on Egypt's potential as a manufacturing centre for domestic appliances, despite the administrative challenges associated with establishing operations in Egypt and the periods of political turmoil.

For example, in 2010 Electrolux bought

a 52% stake in Egyptian manufacturer Olympic Group and pressed ahead with its development plans, even after the revolution of 2011-2012. The group now operates four sites across Egypt generating sales of \$200 million and exporting whitegoods across the region.

Korean household electronics group, LG, also has manufacturing facilities in Egypt and recently announced its aim to export 70% of its Egyptian production of washing machines and TVs.

In 2019, the last full year before the pandemic, total video display exports from Egypt were worth \$675 million. Exports of washing machines were worth \$32 million and refrigerator exports almost \$35 million.<sup>4</sup>

While these may be modest sums in global terms, these industries are now firmly established in Egypt and the hope is that they will develop into even more significant sources of foreign income for the country.

For now, tourism remains Egypt's largest source of foreign revenue. While the sector plunged during the pandemic with revenues in 2020 of \$4 billion, down from about \$13 billion in previous years, it is now recovering and will remain one of Egypt's major sources of overseas income for the foreseeable future. However, looking ahead, Abdel Rahman believes the focus must be on attracting higher-value tourism.

"Unfortunately, we've been focused on mass cheap tours and this needs to be upgraded to attract more high-end tourists, especially in light of what Saudi Arabia is doing. But it doesn't need to be a zero-sum game. The beauty of Egypt is it doesn't have to become purely high end. We have so many different destinations."

### GETTING EGYPT TO WHERE IT 'SHOULD BE'

To date, the Egyptian economy has been highly vulnerable to forces beyond its control – European wars, global pandemics and now inflation and rising interest rates. Nevertheless, it is now recognised that the solution going forward is to encourage long-term investment in businesses and assets that will provide resilient foreign income.

The foundations are in place. Egypt's economy displays many of the character-



istics present in other successful emerging economies, notably a high population and an inexpensive labour market. But it has the added advantage of proximity to affluent exports markets in Middle East and Europe coupled with the Suez Canal, which is vital to trade and logistics.

Despite the obstacles, a growing number of foreign investors have put down roots in Egypt's manufacturing and renewables sector. Even its famous tourist sector has the potential to deliver more for the country's economy.

However, the extent of Egypt's future success will hinge on its ability to maintain political and social stability, removing the State from economic activity, and encouraging private sector activity. ●

# HUSSEIN ABAZA,

## CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR, CIB

### Do you believe COP27 can be a platform for Egypt to attract foreign investment, and specifically in sustainability projects?

The main task of COP27 is to build on earlier decisions made by earlier COPs, which started as early as 2005 in Berlin and follow up and assess carbon emission commitments made by member states. Thus, COP27 is a robust platform where the world's key stakeholders from governments, the private sector, investors, financial institutions, and development finance partners come together to offer climate action. Accordingly, among other mandates, COP27 provides a critical venue to advance investments in sustainability projects for Egypt and Africa at large. Egypt, among other African nations, is submitting a pipeline for sustainability projects for the first time. In alignment with the National Climate Change Strategy for 2050, Egypt has defined a set of highest priority projects to be implemented by 2030, targeting projects in the Nexus of Water, Food and Energy (NWFE). These existential projects, with a total estimated investment cost of \$14.7 billion equivalent, cover highly vulnerable geographical areas across Egypt and will be promoted at COP27. These areas include clean energy projects with positive impacts on mitigation targets, food-specific projects aiming to improve adaptation and resilience of agricultural lands, and water-specific projects aiming to modernise irrigation systems and increase the efficiency of rainwater collection and storage, leading to a more resilient agricultural system. The project finance equation includes the government, the private sector, and the development partners.

### How exactly is your bank supporting the government's sustainability (Vision2030) drive?

CIB is entirely focused on advancing Egypt's transition towards a low carbon economy and its sustainable development, meeting the objectives of Egypt's Vision 2030, Egypt's Climate Change Strategy 2050, and the newly revised Nationally Determined Contributions. This mandate requires lots of work beyond the traditional scope of a bank. That is why we launched the 'Sustaining Sectors' initiative, which is a sector-focused multi-stakeholders platform including clients, policymakers, and science and technology experts to help clients successfully meet the decarbonisation challenge. To this end, the programme provides clients and potential clients with new knowledge and understanding of the business case of sustainability, sustainable finance products that improve their bottom line, and accreditation opportunities. Of course, such a level of

advocacy wouldn't be possible unless the bank has a solid sustainable finance infrastructure, and this has been successfully addressed through different well-synchronised initiatives. In addition, with CIB issuing Egypt's first corporate green bond (a \$100 million transaction to finance projects in energy efficiency, renewable energy, green buildings, sustainable transport, waste and water efficiency) during 2021, the bank now has the structural capacity to further innovate new climate finance instruments. Also, financing SMEs and financial inclusion of women, youth, disabled, and the underprivileged, is one of CIB's main focus areas, whereby new products, services, and initiatives are continuously introduced.

### What factor or element do you think is most important in enabling the country to achieve its sustainability objectives?

Sustainable development urges the efficient functioning of a collaborative yet complex ecosystem that includes the government, the public sector, the private sector, the financial institutions, the regulatory bodies, the development finance institutions, the investors, and the community. A well-designed mechanism is needed to manage and monitor this complex ecosystem to make it work in harmony, creating synergies, overcoming challenges, and striving to achieve sustainability objectives. However, I believe the role of commercial banks is critical as they stand in the centre at an equal distance from other stakeholders. They are stationed on the ground where the rubber hits the road. I would argue that sustainable finance is the shortcut and accelerator towards achieving the sustainable development of all countries.

### ESG and sustainability is one of the most important strategic topics for the banking industry. What significant developments or initiatives has your bank led in the past year that demonstrate how important ESG and sustainability are to your institution?

CIB has introduced a proprietary and structured approach called the sustainable finance institutional pillars, which includes six major components: sustainability governance; sustainable finance policies and frameworks; sustainability systems; sustainable finance strategy; sustainable finance education; and sustainable finance innovation. This framework has helped us conceive and synchronize a number of different initiatives across the bank.

For example, CIB has integrated its ESG principles across the bank's policies and standard operating procedures, with guidelines aligned with



local and global standards and frameworks by analyzing and evaluating key performance indicators of sustainable finance principles. In addition, CIB's board of directors have approved the integration of the sustainable finance strategy within the bank's five-year strategy, whereby eight workstreams will drive the implementation to ensure the involvement of all parties in the bank-wide ESG integration process. CIB has also launched an educational and capacity-building programme for its clients titled 'Sustaining Sectors – Sustaining Growth'. Supporting this, CIB, in collaboration with the IFC, has also become the first bank in Egypt to issue a corporate green bond in the local market, and the first commercial bank in Africa to issue an ecological footprint report. This groundbreaking report is proof of the bank's intention to go beyond standard carbon footprint reporting and evolve from carbon to ecological.

### Banks are in fierce competition with one another to develop and launch innovative digital banking products and services. What are some of the new and significant digital banking products and services that your bank has launched in the past year, and what success have they achieved?

CIB is the first bank in the market to acquire the IPN (Instant Payment Network) certification, which is a new payment network with instant capability to send and receive money between banks using an enhanced experience, with the ability to transact between different account types such as bank accounts, Meeza cards, and Meeza digital wallets using mobile applications. This allows customers to access their accounts in different banks through the desired mobile application provided by banks or Payment Service Providers (PSPs). CIB believes the new concept introduced by IPN is a unique model, which will disrupt the payment approach, and contribute positively to the payment ecosystem and support our mutual efforts to expedite the digital transformation and shifting the consumer behavior towards digital payment. ●



## EGYPT SHOWING LEADERSHIP ON GLOBAL SUSTAINABILITY DRIVE

Egypt takes centre stage in the global struggle with climate change next month as it hosts the COP27 conference. But the country is also on the front line of environmental danger in a very practical sense. Sustainability is essential for Egypt's own national environment and prosperity, and the transition to renewable energy is also key to the development of its economy from a state-dominated market to a dynamic realm of private sector investment.

For millennia Egypt has depended on the Nile and its delta as the source of irrigation and fertility for its civilisation and agriculture remains a vital sector in its economy. Climate change puts this at risk.

Rising sea levels threaten not just its shoreline but salination in the Nile, which in turn poses a risk to the fertile tracts that fringe the river. Heatwaves or other extreme weather events are also an obvious risk. For a country that is self-sufficient in vegetable and fruit crops, and which exports five million tons of produce every year, the dangers of climate change are very real.

At the same time Egypt is tackling climate change at the source – energy

generation and consumption. The country's energy sector reflects a global story in which hydrocarbons are currently vital economically, but where future prosperity lies clearly in the world of solar power and renewable fuels.

Egypt's immediate challenges from rising sea levels and the direct effects of climate change may help explain the high level of environmental awareness among Egyptian consumers. According to professional services firm PwC's Global Consumer Insights Survey, 76% of consumers in Egypt, will pay a higher price for goods that are made from recycled, sustainable, or eco-friendly materials. This high awareness of environmental issues

among the population naturally helps support and drive governmental initiatives.

The Egyptian government has established a Council for Climate Change. Its role is to promote adaptation and mitigation. Adaptation to face those climate change affects that are now unavoidable, and mitigation through the development of renewable energy, water management and green finance.

Importantly, Egypt was the first country in the MENA region to issue a green bond, raising \$750 million in 2020 to help finance a portfolio of green projects – in renewable energy, clean transportation, sustainable water and wastewater management,

“CIB is entirely focused on meeting the objectives of Egypt's Vision 2030, Egypt's Climate Change Strategy 2050, and the newly revised Nationally Determined Contributions.”

—Hussein Abaza, CEO and managing director, CIB



and pollution prevention and control – valued at \$1.9bn. Egypt’s largest private commercial bank, Commercial International Bank (CIB), followed this up in 2021, issuing \$100m of green bonds to finance or re-finance eligible green projects, the first from the country’s private sector.

The bond may be a single transaction, but it’s the first of more to come, and importantly emblematic of the bank’s broader determination to play a key role in the country’s sustainable development.

“CIB is entirely focused on advancing Egypt’s transition towards a low carbon economy, and its sustainable development, meeting the objectives of Egypt’s Vision 2030, Egypt’s Climate

**“Egypt has all the prerequisites to become a green hydrogen giant. Sitting between three continents and with the Suez Canal carrying approximately 12% of all the seaborne freight in the world, Egypt can supply renewable energy near and far.”**”

—Dr Minh Khoi Le, head of hydrogen at Norwegian energy research group Rystad Energy

Change Strategy 2050, and the newly revised Nationally Determined Contributions”, says Hussein Abaza, chief executive officer and managing director, CIB.

Such groundbreaking developments are important for the country, and the broader region, in the pursuit of creating and sustaining a more sustainable economy.

Yet, no one is underestimating the challenge of achieving that; oil and gas loom large over the Egyptian economy.

#### HYDROCARBONS ARE STILL CENTRAL TO ENERGY AND EXPORTS

Following the political turbulence of 2011-2012 Egypt’s hydrocarbon sector was set back. Gas production declined between 2012 and 2016 and for a period the country became a net importer of gas. But since then, there has been a significant turnaround. New discoveries, notably the El Zohr offshore gas field identified in 2015 have seen gas production rise, until in 2019 Egypt became a net exporter of hydrocarbons.

The state retains a significant role in the sector, but there is plenty of foreign investment, too, from both global multinational oil groups including Chevron and BP, as well as many smaller exploration and production groups.

Liquefied Natural Gas (LNG) is a vital component of exports. LNG exports rose 150% in 2019 alone according to the Central Agency for Public Mobilisation and Statistics. Gas exports in 2021 reached \$3.9 billion. Rising prices and supply disruption from Russia has expanded the potential market for Egyptian LNG and 15% of those exports went to Europe. Imports of gas from other regional producers for turning into LNG and then further export could see Egypt become regional

hub for LNG. The location of the Suez Canal as a gateway from the Mediterranean to Asia is a bonus.

At first glance, the improving prospects for Egypt’s hydrocarbon sector may not appear to be a sign of a nation tackling climate change. But this is to underestimate the importance of LNG as a transition fuel – cleaner than coal – that, in fact, plays a major role in reducing carbon emissions in comparison with the past. As LNG production boomed, Egypt itself cancelled the construction of its own coal plant.

Even as the world moves to renewables, Tarek Abdel Rahman, managing partner at Egyptian private equity firm, Compass Group, thinks it is far too early to call time on Egypt’s hydrocarbons sector.

“I don’t think it’s going to die anytime soon. People look at it as a uniform sector all over the world and that’s not really true,” he says, pointing out that as long as hydrocarbons have any role in global energy, extraction costs in the Middle East are likely to continue to be far lower than in other regions, such as the North Sea.

Abdel Rahman also cites the value of gas as a transition fuel allowing the world to move away from coal, and points to the importance of equity in global development.

“If you look at what is going on the ground most greenhouse emissions come from the 50 most advanced countries. So why should the next 200 countries in the world really stop their own development in hydrocarbons when the 50 most advanced countries are not,” he says.

#### A SUSTAINABLE FUTURE IS WITHIN REACH

Given the recent expansion in gas production, it is hardly surprising that Egypt depends on gas for the vast majority

(about 94%) of its electricity generation. But its climate change strategy has set ambitious targets for renewable energy.

In June, Egypt's Minister of Electricity and Renewable Energy, Mohamed Shaker, said the country's target is for new and renewable energy to account for 42% of energy generation by 2035.

And if there is one energy source that Egypt has in even greater abundance than gas, it is sunlight. "Egypt is abundant in pristine desert for possible energy generation," says Krisjanis Krustins, director at Fitch Ratings.

The renewable drive underway in Egypt is also a central plank of its opening up to foreign investment. Embedded infrastructure investment is vital for Egypt if it is to free its balance of payments from dependence on the short-term carry trade that has made its economy vulnerable to every twist and turn of global interest rate and currency markets (see our main report on Egypt's economy).

Abdel Rahman of Compass Group, points to renewables as one area where the government has cleared the way for private foreign investment.

"Renewables are generally a private sector driven initiative. The government has design a very good initiative where they have this huge framework, around locations and regulations for renewable energy, and the private sector money poured in," he says.

The shining example of solar energy generation is the Benban Solar Park in Egypt's western desert. The site has a planned capacity of 1.8GW, which will give it an annual energy production of more than 4Twh per year. The site is owned by Egypt's New and Renewable Energy Authority, but financing was sourced from banks from other Middle Eastern countries and Europe, with Germany's Bayerrische Landesbank providing 85% of the debt.

Meanwhile, Egypt's Red Sea coast is proving a highly suitable location for wind farms. The Gabal El-Zayt wind-farm, begun in 2015 and linked to the grid in 2018, is the largest wind farm in the region.

To encourage overseas investment in its renewable plan, Egypt has allowed private sector investment in en-

ergy generation since 2015. The first fully independent wind power project is now in place at Ras Ghareb, close to the Red Sea coast. The operation is jointly owned by French group Engie (40%), Toyota Tsusho (40%) and Orascom Construction (20%).

Egypt's potential for renewable electricity generation also has regional significance, with electricity grid connections being established with neighbouring markets including Saudi Arabia and Sudan. Already a net exporter of electricity, Egypt could prove to be a renewable electricity hub for the Middle East and North Africa.

### A GREEN HYDROGEN GIANT?

For all the domestic focus, Egypt's green horizons could end up being global. The country's renewable electricity is also a way to produce green fuel, more specifically green hydrogen.

"There seem to be some very promising developments in the area of green hydrogen," says Fitch Ratings' Krustins, pointing to the Suez Canal and Egypt's global location as a boon.

Indeed, if Egypt can develop as a hub for the production and global distribution of LNG, then the same goes for green hydrogen. "The Suez Canal Zone may bring together a lot of the factors that could make Egypt into a very successful player in that space," says Krustins.

In the first half of 2022, Egypt announced a pipeline of green hydrogen projects with total investment estimated at \$40 billion. The plans have attracted considerable international interest and the first such plant, located near the Suez Canal, is scheduled to open in November to coincide with COP27.

The long-term potential for Egypt as a green hydrogen producer is being hailed by some as transformational.

Earlier this year Dr Minh Khoi Le, head of hydrogen at Norwegian energy research group Rystad Energy, said: "Egypt has all the prerequisites to become a green hydrogen giant. Sitting between three continents and with the Suez Canal carrying approximately 12% of all the seaborne freight in the world, Egypt can supply renewable energy near and far."



The path ahead for Egypt's sustainable economy is clear to see. The country has the natural hydrocarbon resources and the LNG facilities to play a role in energy transition, but also has the potential to shift its own electricity generation towards renewables. Green hydrogen could provide an even wider market for Egypt's nascent sustainable energy industry.

This path may also hold the key to bringing lasting foreign investment and green finance to Egypt. As well as being a contribution to tackling climate change, it may also be a vital contribution to bringing economic stability and sustainable growth in every sense. ●



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## India's economic 'scarring' to hobble growth, pressure authorities

By Rashmi Kumar

India has missed the boat for offering fiscal support to propel household demand and fuel economic growth, with the focus on monetary policy and rate hikes unlikely to revive business and investment confidence, senior economists have told *GlobalMarkets*.

In its World Economic Outlook report released this week, the International Monetary Fund cut India's 2022 growth forecasts by 0.6 percentage points to 6.8%, blaming a weaker-than-expected outturn in the second quarter and more subdued external demand.

Similarly, the Asian Development Bank last month sliced India's growth forecast for the year ending March 2023, to 7% from its earlier projection of 7.5% due to pressure stemming from high inflation and a global slowdown in growth.

"People had expected pent-up demand to trigger a sharp bounce-back, but they missed out on the fact that the pandemic caused deep economic scarring in India, mainly because India had a rather weak fiscal intervention," Kunal Kundu, India economist at Société Générale, told *GlobalMarkets*.

However government does seem to be aware of some of the limitations from its moves so far, he said. Since the beginning of the pandemic, India's fiscal deficit has risen, showing it has been spending to prop up the economy.

### WEAK GROWTH

In its recent budget, finance minister Nirmala Sitharaman talked up a fiscal strategy for growth focused on boosting tariffs, increasing production and developing infrastructure projects, with the hope that household demand would flow through in return.

But Kundu said demand recovery would remain "extremely weak" and was unlikely to be the growth driver that it was before the pandemic.

"Household incomes have been adversely affected," he said. "Also, the government hasn't provided enough fiscal support to the micro and small and medium enterprises, which had to let go of workers during the pandemic and their employment numbers haven't recovered yet. But we are well past the time to do these interventions now."

The Reserve Bank of India (RBI) has



Sitharaman: fiscal growth strategy

been doing its bit to tame inflation by raising rates and intervening in the currency markets to support the rupee, which has been depreciating against a stronger dollar. But market watchers said monetary policy could not on its own impact growth without the authorities unleashing more fiscal support.

The other challenge is the Narendra Modi-led government's sharp focus on becoming a manufacturing hub, including by providing production-linked subsidies to domestic manufacturers.

Raghuram Rajan, former governor of the RBI, said the country was "too focused on emulating the Chinese way of growth, by focusing on manufacturing. But given everything that's happening on climate, can the world absorb another goods-producing nation after China? That's a big question."

## Companies focus on new supply chain priorities

By Chris Wright

Companies are emerging from the pandemic with new priorities in supply chain financing, with an emphasis on resilience and flexibility, industry analysts have told *GlobalMarkets*.

"If the last few years taught us anything, it's that visibility, agility and resilience are key components of your supply chain," said Andrew Verona, head of supply chain for Singapore and Malaysia at Unilever.

Supply chain disruption, the cost of living crisis and spiralling energy prices have brought these issues into sharp relief and have been one of the major talking points at this week's IMF Annual Meetings.

"We have seen a dramatic shift in the last two years in the way supply chains work, here in Asean in particular," added Christopher Ong, managing director, DHL Express Singapore, referring to the 10 members of the Association of Southeast Asian Nations bloc. "From the trade war starting in 2019 we started to see shifts away out of China."

While a diversification away from China has been the most visible learning from the trade wars and pandemic disruption, corporate treasurers report a number of other amendments they have had to make to processes.

### LIQUIDITY SQUEEZE

Joseph Chua, executive director and deputy treasurer for Lenovo, said one lesson of the pandemic was around liquidity — and making sure it reached everyone in a company's chain. "We want to make sure that our second tiers, our third tiers, are stable in terms of being able to get the right financing," he said.

"We found that in the pandemic, there was a liquidity squeeze in the market. Everybody drew upon financing lines, and interest rates shot up double digits because everybody wanted cash on hand in case everything went wrong. We found down the line the second and third tier were being squeezed out."

The best way to ensure stability, Chua said, was digitisation, and ensuring that platforms reach down to the second and third tier of supply.

"We need to digitise our processes to make them more efficient, and track trade flows from a cash perspective to ensure the entire supply chain will not collapse."

Sustainability has also become a key part of supply chain management. "The hardest thing is to decarbonise scope 3 emissions," said Fang Eu Lin, partner at PwC, referring to indirect emissions in a company's value chain as defined by the Greenhouse Gas Protocol.

## Australia's visits highlight mounting weaponisation of Pacific islands

By Chris Wright

Australia's decision to undertake eight visits to the Pacific islands in just over four months is being seen as an illustration of the importance that major advanced nations are attaching to the region.

Penny Wong, its minister for foreign affairs, is midway through a tour of the Marshall Islands and Nauru that comes against a backdrop of Chinese and US aid to the Pacific. In late September the US pledged \$210m to Pacific island nations soon after an earlier \$600m pledge made by US vice-president Kamala Harris in Fiji in June.

These pledges followed China signing a security pact with the Solomon Islands in April, following years of increasing engagement with states including Fiji, Papua New Guinea, Tonga and Vanuatu — the four nations in the region with a standing military. It is thought that China seeks a Chinese security pact with 10 Pacific island countries, and sent its foreign minister Wang Yi on a 10-day regional tour in June to this end.

Wong will officially open Australia's

embassy in the Marshall Islands and will meet newly elected Nauru president Russ Kun. In a statement from her office, Wong said the trip "demonstrat[ed] the priority the new Australian government places on the region."

Australia and the US, along with the UK, New Zealand and Japan, launched an initiative called Partners in Blue Pacific in June, ostensibly to help island nations tackle climate change and illegal fishing, but widely understood to be an effort to counter Chinese expanded influence in the region.

### PACIFIC FAMILY

Benjamin Herscovitch, a research fellow at Australian National University with a focus on Australia-China relations, said the Pacific had for decades been one of the core regions of focus for Australia's foreign policy, as a geographic neighbour with strong historical and personal ties.

"But the recent refocusing of Australia's foreign policy on the Pacific has largely been driven by fears about China," he told *GlobalMarkets*.

"The Australian government sees China's growing diplomatic, trade and investment role in the Pacific as a threat



Penny Wong: visiting Marshall Islands

to Australia's position in the region."

There is, though, a danger of overstating Chinese influence to the Pacific. A study by the Stockholm International Peace Research Institute in June found that China's military aid to the four standing-army nations between 2000 and 2020 stood at \$27.4m, most of it to Papua New Guinea. Over the same period, the study found, Australia provided \$963m of military aid and the US \$52m.

The Lowy Institute maintains the Pacific Aid Map, which says that China accounts for only 6% of total aid to the Pacific region, at \$160.6m. The same map finds that Australia accounts for 35% of aid spending, at \$864.6m, and the US 5%.

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## MDB Capital

Continued from page 1

shareholders, sources say.

But Janet Yellen, US treasury secretary, decisively backed the report in a speech last week and asked the World Bank to produce an “evolution roadmap” by December.

David Malpass, president of the World Bank, said at a press conference it had discussed the findings with its board on Wednesday. “We embraced the concept of how do you get more resources,” he said. “We understand how vital it is for people in the developing world. One of the solutions [to the development crisis] is more resources, including more resources through the World Bank. We’ll be talking with shareholders about the ways to do that.”

Frannie Léautier, chair of the panel, has held many meetings in Washington this week with MDBs, shareholders, rating agencies and investors. “Our report struck a chord in different communities, and has been embraced very well by a subgroup of MDBs,” she said. “All are looking at it and interpreting what it means for them.”

She said the worsening crisis in the world had helped sharpen minds. “We’ve seen a change in attitude of the MDBs in terms of how important this report is,” she said. “In many meetings they’re saying ‘it’s great, it’s helped us open up discussion on issues and engage in dialogue with shareholders. It’s a very positive and recent change compared to July.’”

The Asian Development Bank had gone furthest, she said, because it had already been moving towards the recommendations.

“Issues like the capital headroom of MDBs are of crucial importance and I can only value every opportunity to find out whether we can explore it better and more deeply,” said Werner Hoyer, president of the European Investment Bank. “Because I think Janet Yellen is right, there is manoeuvre space left.”

On the other hand, he said, “this is something where you cannot find a one size fits all solution because every [MDB] is different, their share ownership, portfolio composition, risk situation. You can’t say they must all increase their lending by 25%. That is something every institution must do by itself, but at least we see a huge encouragement to go in this direction and test the water with our shareholders.”

Asked what the EIB’s shareholders thought, Hoyer said: “There are different opinions. As always, some shareholders [think] we could do more, others that we should not touch anything that might jeopardise our triple-A status or the preferred creditor status. But I think all in all the MDBs should, under the present challenges, exploit the manoeuvre space more.”

# THE final word

## WHY IS RUSSIA STILL PART OF THE WASHINGTON COMMUNITY AFTER ITS WAR ON UKRAINE?

By **Sergii Marchenko**

**F**ebruary 24, 2022, the day of the full-scale Russian invasion of Ukraine, will go down as a tragic date not only for the Ukrainian people, but also for the whole civilised world.

Many of humanity’s achievements, such as global peace, security and rule of law were hugely undermined. Now we are in mid-October, and I am reflecting more and more on what has happened during these months.

The majority of countries at these meetings are already dealing with internal problems caused by Russia — high energy prices, spiralling inflation, food insecurity and the increased cost of borrowing. Many were forced to recalibrate their budgets towards higher military spendings, replacing those things that mattered to them before the war.

Increases of energy, gas and oil prices caused the replenishment reduction in ESG expenditures in order to use the money to purchase fossil fuels, which again is contrary to the environmental plans that existed in many of our countries before the Russian war. Populist politicians have come to power and made reckless spending pledges. There is a danger that in many countries budgets, deficit and debt could spiral out of control.

There is no blueprint for how to deal with a budget in a country caught up in a full-scale war. Now is the time for large economies and IFIs to find new tools and solutions for countries such as Ukraine. The IMF must be the premier institution for global macroeconomic policy and financial stability. In September, the World Bank, the Government of Ukraine and the European Commission presented a joint report that estimated the cost of reconstruction needs at more than \$349bn, which exceeds the GDP of Ukraine in 2021 by more than 1.6 times.

Coming to Washington for these Annual Meetings, I was ready to present the forecast budget deficit and our financing needs for a rapid recovery. But on the first day of my stay in Washington, on Monday, a massive Russian missile attack on Ukraine took place, with more than 80 missiles launched. These attacks killed people but hardly damaged our critical infrastructure, including thermal and electric power stations. Emergency shutdown was activated. Twenty-nine objects of electricity infrastructure have been damaged, including communications facilities, residential buildings. All together more than 140 objects have been hit.



“*Now is the time for large economies and IFIs to find new tools and solutions for countries such as Ukraine*”

### FUNDING FOR RUSSIA?

I now have to do another round of assessment of the damage and of our needs, as my previous figures are no longer up to date.

What is unfair is that Russia still receives more funding than Ukraine does — although it is a huge number — which fuels its capacity to continue its fight against Ukraine. The killing of thousands of Ukrainian soldiers and civilians is causing a dramatic loss of revenues and increased military and humanitarian expenditures.

Since the beginning of the war, our tax revenues have collapsed while military spending has soared. We have managed to increase tax collection in comparison with the first months of the war. During that whole time we had a

fixed need of \$5bn per month. But unfortunately, despite the huge efforts all the countries have made towards helping us, we have not reached the amount needed to fill the gap. It also took a lot of time between commitments announced and disbursements made.

We are assuming for 2023 that the war drags on. Prolonged war will exacerbate infrastructure damage, population displacement, economic hardship and can increase poverty. If our needs are not fully addressed this will result in immediate and severe economic disruption. In our draft 2023 Budget we have compressed non-priority expenditures and reoriented spending towards critical needs and to support our defence efforts and our citizens most affected by the war.

On the good side, we need less. We have done the latest phase of a contraction in expenditures, and our monthly gap for the next year is now around \$3bn-\$4bn. 2023 is also a multitasking year for the Ukrainian government. We need to move towards attracting external concessional funding and grants to cover priority social budget spendings on the one hand, and make a well-structured, good-footed and trusted fundraising exercise for a rapid recovery, on the other.

Among the G20 are those countries which have been supporting Ukraine throughout this period, despite having internal problems caused by the Russian war. Also, there some other countries which remain neutral, due to different reasons. But here and now the joint question for everyone here at the table is why Russia is still the part of this community.

*Sergii Marchenko is Minister of Finance of Ukraine*



# ANNUAL MEETINGS

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