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## NEWS

Banks deal with negative rates 3

Europe's Green New Deal 4

Lebanon works on budget 4

EM debt crash fears 6

IMF accused over unfair quotas 6

'I'd take JP Morgan private!' 6

IMF's Ecuador memory lapse 8

Egypt hopeful of IMF deal 8

Climate action call to rich nations 8

India moves into the infra space 9

Indonesia's climate pledge 9

Kenya debt cut plan 9

Currency hedging tool 38



## FINAL WORD

Mariana Mazzucato  
Page 39



## EUROPE

Capital Markets Union: can it reboot?

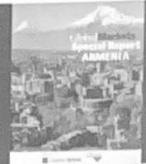
PAGES 12-13



## CHARITIES

Tapping financial markets for aid

PAGES 14-16



## SPECIAL REPORT

Armenia

PAGES 17-23

## US trade hostility cracks post-war order: new system will be Asia-led

By Rashmi Kumar, Tyler Davies and Thierry Ogier

The trade wars launched by the US against China and the European Union are breaking down the old structure of globalisation, which will give way to a new global trading system, centred on Asian powers, leading figures have argued.

Raghuram Rajan, former governor of the Reserve Bank of India, told *GlobalMarkets* that trade relations between countries were crumbling, because of the US's feeling that it had been cheated on trade for a very long time.

"The old structure we have for globalisation is breaking down," said Rajan, now a professor at the University of Chicago Booth

School of Business. "But one must recognise that there are enormous benefits from trade, and that as we shut down the system, we lose all of that."

Rajan said the global economy would have to break down first before it could be put back together, at which time the foundations for a different trading system would be laid.

"There will be more places for three or four big players, rather than the US being at the centre and being the crust that manages everything," Rajan said. "The crust is broken, and other players will want more



Rajan: it will "be a new G4 or G5"

power as well as responsibility." The new world trading order would definitely include China, the US and EU as major blocs, with Japan potentially having the fourth spot, he predicted.

*Continued on page 3*

## Finance ministers grasp 'growth story' of climate action

By Jon Hay

The new Coalition of Finance Ministers for Climate Action met in Washington on Saturday for what were described as "very constructive" discussions by people there. It was the group's third meeting at finance minister level, after it began life as the Bali Breakfast at the IMF/World Bank annual meetings a year ago.

"There was a real buzz in the room," said Lord Stern, the climate economist. Mark Carney, governor of the Bank of England, Kristalina Georgieva,

*Continued on page 3*

## 'Great moment of truth' for EU as Brexit demands finance reforms

By Tyler Davies, Jon Hay and Elliot Wilson

Leading ministers and financiers have told *GlobalMarkets* that the EU is likely to redouble efforts to reform its financial system, as member states brace for Brexit and try to protect themselves against a shift away from globalisation.

Europe has been caught in the middle of the US-China trade war, as falling international demand has worsened the slowdown in eco-

nomical growth across the region.

Member states are beginning to work with more urgency to overhaul the bloc's financial infrastructure.

Sylvain Broyer, chief EMEA economist at S&P Global Ratings, said the US-China trade war was already having a "huge impact on EU policy. It is a difficult task, but Europe now has no other choice than to reinforce the international role of the euro," he said.

*Continued on page 39*



Kukies: EU has to improve its capital markets

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## US trade

Continued from page 1

Eventually they could be joined by India and other emerging markets. "It won't be a G7, but a new G4 or G5," added Rajan. But he warned that they would not be able to run the system, and would instead tweak it to find their places.

Trade tensions have been on the minds of delegates at the IMF and World Bank annual meetings this week, as global growth sputters. The IMF slashed its global growth forecast for 2019 to just 3%, down from 3.8% in 2017. Its gloom was provoked by tit-for-tat trade spats, policy uncertainty and geopolitical risks, against a backdrop of limited room for policy adjustments and rising debt around the world.

Kristalina Georgieva, the new managing director of the IMF, called for policymakers to take seriously their obligations to co-operate on international trade.

She said the problem was no longer the salvos of mutual tariffs China and the US have been imposing on each other's goods, but more the unpredictability of trade in the future.

A clear chain of repercussions had begun, she added. It started with trade tensions and uncertainty, which caused a slowdown in investment, falling growth, job losses and ultimately the erosion of confidence.

China's economy grew by 6% year-on-year in the third quarter of 2019, its slowest rate for almost three decades. Some of the fall is blamed on trade tariffs.

Joyce Chang, chair of global research at JPMorgan, said in a panel at the Institute of International Finance conference that every percentage point fall in growth in China would shave 0.4 points from global growth.

Trump's belligerent trade policy has had impacts around the world. Julio Velarde, Peru's central bank governor and chairperson of the G24, told *GlobalMarkets* that trade tensions would remain for some time, even though the US and China were in the middle of hashing out the first phases of a potential truce.

There are new twists to the tariff wars, too. Velarde added that the US was targeting Mexico now because of migrants. "When you see that tariffs are going to apply to conditions different from trade, almost everybody must be afraid," he said. "Just the idea to impose tariffs because you don't do what their president wants is a problem."

## Negative rates as 'new normal' to push European banks towards charging customers

By Tyler Davies

European banks are facing hard questions about how to deal with negative deposit rates, after the European Central Bank's decision to lower its deposit rate to -0.5% last month. Signs appeared this week that they might decide to pass the rates through to individual customers.

The Italian bank UniCredit has made waves by beginning to charge rich customers for depositing their money. Although the charges only apply to customers with more than €1m in their accounts, this could be the start of major changes in the European banking market.

"The problem is linked to the big question for European banks, which is how to recover decent profitability," Giovanni Sabatini, chairman of the executive committee of the European Banking Federation and director general of the Italian Banking Association, told *GlobalMarkets*.

"If negative interest rates are a temporary solution to address a situation of crisis, we can withstand the consequences. If negative rates become the

new normal and become a structural component of the financial market, this will make being a commercial European bank extremely difficult."

The ECB has introduced measures to help ease some of the pain negative interest rates could bring for European banks. Most importantly, it has said it will not charge financial institutions for some of the excess liquidity they store in its accounts, as part of a two-tier system for reserve remuneration.

But the ECB has also signalled that it is more than willing to keep its interest rates at a very low level for a sustained period of time, as it waits for better growth and inflation in Europe.

"In the stronger economies, banks have been willing to charge their corporate depositors negative rates," Philip Lane, an executive board member at the ECB, told an audience at the Brookings Institution in Washington this week. "If you look at the banks that have been brave enough to pass on negative rates, they have been fine. They



Lane: "banks are not losing depositors"

have been able to grow loans, and they are not losing depositors in any significant way."

This has become a keen point of debate in European finance. "I don't agree with the idea that negative rates aren't an issue. It is an issue," said Michala Marussens, chief economist at Société Générale, on a panel at the Institute of International Finance's annual meetings.

"There are several factors that will impact banks. One is a very low, flat rate curve, with negative deposit rates with the ECB that cannot be passed on to retail savers. That is a major headwind."

## Climate

Continued from page 1

managing director of the IMF, and Ángel Gurría, secretary general of the OECD, were also present.

The group is co-chaired by Felipe Larraín Bascuñán and Mika Lintilä, finance ministers of Chile and Finland.

It was launched at the IMF/World Bank spring meetings in April, when about 20 members adopted the six Helsinki Principles, aligning with the Paris Agreement, taking climate change into account in all aspects of economic policy, working towards effective carbon pricing, mobilising private capital and sharing experiences.

"We had 50 finance ministers here and the major international institutions," Stern told *GlobalMarkets*. "There is a very clear understanding that this is the inclusive growth story of the 21st century. It's the job of finance ministers to be at centre stage and help make it happen."

### CARBON TAXES

The group will release a communiqué on October 24, which Axel van Trotsenburg, managing director of operations at the World Bank, will announce in Paris.

"It went very well, it was very positive,"

said Amar Bhattacharya, senior fellow at the Brookings Institution. "They started with 20 finance ministers and they have 50 now. The most central thing is there is a recognition that there is a climate emergency, and the agenda for tackling it puts finance ministers fair and square in the heart of it. The meeting was all about trying to mobilise people—it's a real change from a couple of years ago, when finance ministers were on the sidelines."

In December, at the COP 25 meeting in Santiago, the Coalition will publish its plan of action.

At the meeting, finance ministers shared experiences of policy measures. Helen Mountford, vice-president at the World Resources Institute, said ministers talked about "integrating climate into budget frameworks. Indonesia has done it." By tagging all climate-related spending, governments could coordinate better and spot gaps.

Carbon taxes were discussed. "There is support—there needs to be a lot more," said Stern.

If countries take strong action, Stern said. "They will see advantages in rising living standards and to some extent government revenues, to help them manage the transition. The realisation of that, and of the real prize in their hands, was crystal clear."

An important strand of the work will



Stern: climate action a 'real prize'

be making sure finance ministries have the expertise they need to make climate-wise policies. Bodies like the IMF can help.

Away from the meeting, Margaret Kublow, head of the finance practice at WWF, said. "They need to put together a set of objectives that they will push together, and in their own countries. They need to be thinking about the relationship between climate and nature as well. We need nature for both adaptation and mitigation. If we lose a million species we can't count on the earth's absorption and resilience when the physical impacts hit. This is going to hit them much sooner than they think and will hit the poorest hardest."

OUT OF THE WOODS

**• / Sustainable & Plastic:** Ratings solousus S&P's sales stand at the IIF conference offered passers-by a conundrum. On the one hand, the strawberry smoothies they served up came with ocean-friendly paper straws. On the other, all the packaging, including the drink cups, were very much of the stuck-up-the-turtle's-nose plastic variety.

**• / Hogartian hecklers:** Meanwhile, a stone's throw from the White House, two weathered gentlemen were offering a new take on street theatre. The first sat underneath a big yellow umbrella, calling Donald Trump what sounded like "a [expletive-deleted] crumpet," while 10 yards away, a man with faraway eyes and a Muppet puppet on his hand, intermittently belched. Who says satire is dead?

**• / Out of the Woodfords:** Wonder why the imposition of star fund manager Neil Woodford's empire gripped Britain's press so tightly? At a closed-door briefing with the UK's financial regulator, it emerged two leading business hacks had invested in his funds — and had some strong feedback for the unfortunate PCA boss.

**• / Holidays from hell:** Robin Brooks seems to be suffering from a bad case of vacation whymy. At a panel at the Ronald Reagan building, the IIF's chief economist would not shut up about his holidays, meaning that every place he went was mired in some kind of currency crisis. Memo to Buenos Aires: forget about fiscal stability and US-dollar debt. Just bung Brooks a few quid to stay away and the peso will be golden.

**• / International Monetary Fund:** When IMF chief Kristalina Georgieva stepped up to deliver a keynote speech on Saturday, she surely didn't expect to be audio-bombarded by an audience member's phone blaring the song Baby Shark. On and on it went... Daddy Shark, Grandma Shark, do-do-da-do-do, full-on big time earworm.

**• / Big bash:** Out of the Woods was delighted to find Mizuho's annual bash at the St Regis had survived the frightening new world of bank budget cuts. The Japanese lender always puts on a good show in the nation's capital and insiders reckon that even if climate crisis, cryptocurrencies and social protest shake the global financial system to the core, Mizuho's will be the last standing standing. Twelven all round!

Green New Deal's first test in Europe is imminent

By Jon Hay and Elliot Wilson

Europe is likely to be the first laboratory in which a large scale test is made of the Green New Deal—a political idea attracting attention around the world, from the US to Africa. Ursula von der Leyen, incoming European Commission president, has made a gutsy opening bid, though some are not expecting much to come of it.

The idea unites two urgent needs: massive investment to turn the economy green and the Just Transition—ensuring these wrenching changes do not impoverish anyone.

"We're not going to have sustainable economic development if we're not aware of the climate," said Helen Mountford, vice-president at the World Resources Institute. "It poses a real, material risk to the economy. You do need to address climate change, both mitigation and adaptation. But we're not going to achieve our climate goals if we do it in a way that exacerbates poverty." A Green New Deal is a package of

policies addressing environmental, social and economic needs together.

The biggest attempt is von der Leyen's ambitious pledge to introduce, in her first 100 days in office, a European Green Deal to make Europe carbon-neutral by 2050. She promises tougher carbon pricing, a carbon border tax, a €1tr green investment plan, new green financing and industrial strategies and a Just Transition Fund.

Othmar Karas, a vice-president of the European Parliament from the Austrian People's Party, played down near-term expectations of the Green Deal, and when asked what Europe needed most, emphasised other priorities such as the Banking Union plan. He said it was important to "wait for the details" of the Green Deal.

Supporters have lots of examples of policy win-wins. British Columbia has imposed a carbon tax in 2008, but has used revenues to cut other taxes. "Low income and middle income families are better off with the carbon tax than with-



Von der Leyen: ambitious Green Deal

out it," said Mountford.

But there are challenges. "Governments are often very siloed, ministry by ministry," said Mountford. "And a lot of the tools we have are not well equipped to look at things together. Fiscal and macroeconomic models don't look at the environment. If we use natural resources, or if we have more traffic in Jakarta or Delhi, they count it as a benefit."

Measures do not have to come from government, however. Enel, the power company, has to close 23 power plants in Italy. "They started to have dialogues with workers, unions, local communities, to help them find jobs elsewhere in the company," said Mountford.

Lebanon close to new rescue plan as EIB steps up MENA funding

By Lewis McLellan and Virginia Furness

The political fragility of the Middle East and North Africa is uppermost in the minds of lenders to the region, most recently after Lebanon descended into violent protests over the state of the economy last week. The country's central bank governor told *GlobalMarkets* the country had a plan to restore economic stability. Meanwhile, the European Investment Bank is stepping up its lending.

The EIB hopes to drive private investment in a regional push for infrastructure development.

Luca Lazzaroli, EIB's deputy head of operations, said the bank was paying increased attention to the MENA region for geopolitical reasons such as the displacement of people. It has launched an Economic Resilience Initiative Fund.

"It's a particularly important region for us—it's our neighbourhood, so it carries specific relevance," he said. "There's a shared desire to increase the region's integration economically and socially with the EU."

Meanwhile, Riad Salame, Lebanon's central bank governor, told *GlobalMarkets* the country would unveil a radical

structural reform programme to save off imminent default through a budget that would cut the deficit without resorting to taxes.

Egypt, fresh from a punishingly austere IMF programme, is, according to Lazzaroli, the EIB's most important Mediterranean partner. Egypt is leaning on the EIB and other development partners like the ADB and World Bank to help it finance an ambitious programme of infrastructure reforms to boost growth and attract foreign investment.

Mohammed Maait, Egypt's finance minister, said: "When private investors see EIB investing in the country, it gives them confidence and encourages them to invest too."

The EIB helped Egypt fund the largest solar plant in the world, commissioned this year at a cost of \$4bn. Benban Solar Park, together with investments in oil and gas infrastructure, is allowing Egypt to become an exporter of energy. "Bringing down the cost of energy is a big help to the steel industry, and we are freezing energy tariffs so there will be no more hikes," said Maait.

Garbis Irdian, chief MENA economist at the Institute of International Finance,



Salame: aiming for near-zero deficit

said Egypt had "made progress in improving the business environment but a great deal more will be needed."

The EIB has around €2bn of exposure to Lebanon and a strong pipeline of investments. Salame said on Saturday evening that the government and prime minister were working to set a budget. "We are expecting the government to meet, resignation is out of the way," he said. "This meeting might take place in the coming two days. The prime minister has given 72 hours for himself to come up with a solution."

The reform would cut the deficit almost to zero in three years. The government is contemplating privatisations and laws to deter corruption. Infrastructure investments will be financed by external lenders in the CEDRE group and the private sector would be involved, itself an important reform.

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## Worries for EM debt sustainability rise as growth slows

By Lewis McLellan, Tyler Davies and Oliver West

While debt is important for development, investors are becoming concerned that the market access enjoyed by low income countries is slowing up problems for the future, economists have told *GlobalMarkets*.

Myriam Vander Stichele, a senior researcher at the Centre for Research on Multinational Corporations, said: "It's creating a vicious circle. Funds go into riskier bonds and investments, but that reinforces the volatility in developing countries. Index managers should think about the indebtedness of countries to see whether it is responsible to put a given country in an index."

She cited Ghana's 32 year bond — a \$1bn 2051 deal with a coupon of 8.95%. "That means Ghana is paying \$2bn to borrow \$1bn."

In Latin America, benevolent EM bond market conditions also allowed risky sovereign credits free access to funding. Argentina sold around \$45bn of international bonds between April

2016 and January 2018, while Ecuador has tapped US dollar buyers for \$19bn since June 2014 — around 20% of GDP.

Gabriel Iradian, chief economist at the Institute of International Finance for the MENA region, listed Bahrain and Oman as countries where he was concerned about the debt ratio. "Bahrain and Oman have high fiscal breakeven prices for oil, and with the slowdown in growth, they are vulnerable and will continue to accumulate higher debt. Bahrain will get bailed out by Saudi, but Oman doesn't have that option and cannot easily cut spending because of security concerns."

### SEARCH FOR YIELD

Both bond curves have suffered in recent weeks as investors worry that these countries' debt ratios have become unsustainable.

Emerging markets assets, particularly hard currency debt, have provided excellent returns for investors this year, thanks partly to an unexpectedly dovish pivot from the US Federal Reserve. "This time last year, we weren't expecting 13%



Iradian: concern over Bahrain and Oman

returns," said Gorky Urquieta, global co-head of EM debt at Neuberger Bergman.

Tania Reif, investment manager at Alphadyne Asset Management, said: "Often people say that bearishness and risk factors for EM are priced in, but the fact is that flows and positioning to EM are very strong because, with most of the world in negative rates, people are still looking for places to put cash."

However, some investors are much more bullish about the prospects of emerging markets. Janet Henry, HSBC's global chief economist, said: "Europe and much of the developed market world is out of room for fiscal stimulus, but where we'll see outperformance is in countries with room for domestic stimulus, many of which are in emerging markets."

## Asian countries call for more room at the IMF table

By Rashmi Kumar

Asian central banks have slammed the IMF for not doing more to increase developing countries' ownership quotas at the fund, a failure they say could pose grave challenges if the world faces a financial crisis.

When a country joins the IMF, it is assigned an initial quota in the same range as those of existing members of broadly comparable economic size and characteristics. The quota, which is reviewed every five years, is key to determining a country's financial commitment to the IMF: its voting power as well as the extent of its access to financing from the fund.

But governments in Asia have a bone to pick with the IMF, saying the current ownership structure does not reflect the growing strengths of some of the countries in the region.

Nandlal Weerasinghe, senior deputy governor of the Central Bank of Sri Lanka, told *GlobalMarkets* developing countries were trying to encourage the IMF to "have more resources built into the fund so if there are global vulnerabilities and member countries need IMF assistance, the IMF should be prepared with more resources in its wallet to help

address all the financial vulnerabilities. It is here that the IMF has so far failed to approach the situation of quota reviews."

Weerasinghe added that emerging market countries are willing to contribute more to the IMF, but the US and the European Union countries are unwilling to take the money, as their shareholding will then come under pressure.

"There is no willingness to accept the reality that global economic power is now not skewed to advanced countries, but more to China, India et cetera," he added. "And they should be able to share more ownership in these multilateral organisations."

Quotas are the IMF's main source of financing. But it also has in place the new arrangements to borrow where a number of member countries and institutions stand ready to lend additional resources to the fund as a second line of defence. Its third line of defence are bilateral borrowing agreements.

Dedy Budi Waluyo, deputy governor of Bank Indonesia, told *GlobalMarkets* that the debate around the representation of developing countries at the IMF was an "unfinished issue". "It is better for the fund to relook at the systems of



Waluyo: quotas are unfinished issue'

voting power," he added. "This is part of the process to improve governance."

### ALTERNATIVE ARRANGEMENTS

Very few of the IMF's quota reviews have ended with an increase. Only one review, the 14th conducted in 2010 that became effective in 2016, ended with a 100% increase after about 13 years of no rise in quotas. The 15th review saw no progress.

"We regret that the 15th review did not lead to an increase of quotas," said Kristalina Georgieva, the IMF's managing director. "However, we are encouraged by the commitment to maintain the fund's financial resources at \$1tr."

"We are even more encouraged by the fact that there is broad consensus within the membership that we will step into the 16th review with a commitment that quotas will be a more reliable financing foundation for the fund."

## Jamie Dimon: I'd take JP Morgan private if I could

By Owen Sanderson

JP Morgan boss Jamie Dimon highlighted the burdens of being a public company at the Institute for International Finance on Friday, saying that he'd take the giant bank private "if I could". Morgan Stanley's James Gorman, meanwhile, said that being a public company was a "burden".

"Being a public company has real negative downsides," said Dimon, highlighting the risk of litigation, excess bureaucracy, and public scrutiny of specialised compensation packages.

The US equity market is shrinking in absolute terms, contracting by around 2% last year, according to statistics from Citi. Stock buybacks and leveraged buy-outs remove equity value from the public markets, while some companies are choosing not to go public at all.

Securities law is increasingly used in the US to challenge companies for wrongdoing that, at first glance, has little to do with markets — the State of New York's suit against Exxon Mobil over climate change, for example, is framed as a failure of shareholder disclosure.

"It shouldn't be that way," said Dimon. "It takes away the ability of the public to invest, and should be looked at very seriously as a matter of public policy, because these alternative sources of capital are going to be around for a long time."

In practice, taking JP Morgan private would be impossibly large — the bank's market capitalisation is \$385bn, making it more than eight times larger than the largest LBO in history.

The US hosts many of the world's "unicorns" — startups valued at more than \$1bn — though several of them went public this year, with Uber, Lyft and Peloton all listing in New York. However, the failure of WeWork's listing may encourage others to delay going public.

Gorman described being a public company as a "burden", agreeing with Dimon, saying "the funny thing about quarters, is they come around with an alarming frequency... why wouldn't we just report revenues every three months and do full report every six months?"

He said that Morgan Stanley's shareholder meetings had more security and maintenance people than attendees, as most shareholders are institutional and vote remotely.

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## Vulnerable nations urge rich economies to do more on climate

By Oliver West and Thierry Ogier

Countries on the frontline of climate change have called on the rest of the world to do more to recognise their vulnerabilities, saying they have taken steps to pool resources and protect their finances against disasters.

Baroness Scotland, secretary general of the Commonwealth, told *GlobalMarkets* that for many small island nations, it was not a "question of keeping fiscal rectitude — as many people were telling them for so many years — but a question of survival."

"When a hurricane wipes out roads, schools and infrastructure, it does not wipe out the debt," she said. "The Commonwealth has been arguing there is a direct correlation between climate crises and indebtedness, but this has only recently been broadly recognised."

Ma Motley, prime minister of Barbados, told *GlobalMarkets*: "The world needs to take a closer look at who is vulnerable and who is not."

Africa accounts for no more than 4% of greenhouse gas emissions but "suffers disproportionately" in terms of climate change impact, said Akinwumi Adesina, president of the African Development Bank.

With the US having dropped out of the Paris climate accord in 2017, efforts to reduce carbon dioxide emissions were hit. And as climate disasters become more frequent, better financing is required to ensure they do not translate into economic disasters.

Several of 31 small states in the Caribbean, for example, are classified as high middle-income countries, for example, complicating access to cheap financing.

"High income countries are asking how they can get loans at appropriate levels to rebuild," said Baroness Scotland. "How do you manage [a huge reparation bill] if you don't have preferential rates?"

Motley said the difficulty of accessing money for middle-income countries like Barbados and the Bahamas, where at least 20 people died in Hurricane Dorian in September, "fails to appreciate our vulnerability as small island states and the fact that everything can be reduced to rubble overnight."

Adesina said his role was to "find solutions, not complain", adding that the bank had launched the Africa Disaster Risk Insurance facility to provide payments in the event of catastrophic risk events. So far the facility covers Niger, Gambia and Madagascar and it is looking to mobilise \$250m for a new facility.

## Fury as IMF admits 'cannot recall' meeting indigenous Ecuador groups ahead of \$4.2bn loan

By Thierry Ogier and Oliver West

The International Monetary Fund was caught in the middle of a furious row on Saturday after indigenous groups in Ecuador accused the multilateral of "going behind their backs" when it agreed a \$4.2bn rescue package for the Latin American economy.

The IMF's deputy director for the Western Hemisphere told *GlobalMarkets* he "cannot recall" if the mission to Ecuador met indigenous groups before implementing a programme that is now in danger.

Conaie, Ecuador's indigenous group confederation, led 11 days of protests that forced president Lenin Moreno to back down earlier this week on the IMF-backed plan to cut fuel subsidies as part of the programme package. The cuts had been expected to save around 1.5%-2% of GDP.

Moreno has invited Conaie to negotiations over a new decree, but the confederation slammed the IMF yesterday, saying the policies that it recommended "make no sense, because they impose an idea of development that does not

respond to our specific needs"

In a letter, signed by Conaie president Jaime Vargas, the group said: "All change and policy must be agreed upon with the people, not be done behind their backs."

Asked why the IMF had not consulted with indigenous groups as it done with business leaders and other NGOs, Krishna Srinivasan said the fund had "met a lot of people from civil society". "It is not clear who is from an indigenous group," said Srinivasan. "I cannot recall [if we met indigenous leaders]. We met a lot of people, we meet the civil society, we meet NGOs, we meet trade unions."

"[Conaie president] Jaime Vargas is a high-profile figure and it is quite clear that you meet an indigenous leader," one source close to the situation, who did not want to be identified, said. "They visit everyone else so why not the indigenous leaders?"

### FUEL SUBSIDIES

Ecuador's IMF programme is now in the middle of its second review, with the fund now waiting for the new decree regard-



Srinivasan: "we met a lot of people"

ing government fuel prices, Alejandro Werner, director of the IMF Western Hemisphere department, said yesterday. For the fuel subsidy cuts to be reversed is a big blow, but could have been avoided, said one market source.

The IMF is doing some "excellent things" for Ecuador, said the source, that should be able to win the backing of indigenous groups. This includes obliging the country to sign up to the Extractive Industries Transparency Initiative. Moreover, an IADB paper in June showed that the fuel subsidies — which it says account for 7% of public spending — were not benefiting the poorer segments of society.

"The IMF has done a poor job of explaining itself and much of the indigenous community see it as a force for evil to be beaten," said the source.



Maait: wants to wrap up talks by March

Egypt's reform programme but are seen to see progress continue. Incoming IMF head Kristalina Georgieva urged Egypt yesterday to reduce red tape in the private sector to encourage investment.

Maait said he remained committed to implementing structural reforms. "We know we have to take a lot of steps to open the door to more private sector participation in our economy and attract new foreign investment," he said.

Recent measures taken last week included launching a website through which investors can directly purchase industrial land, reducing the cost of energy for certain industries, freezing the cost of electricity, and working on a system to automate trade procedures to reduce the time and cost, according to Maait.

"We aim to complete five to six IPOs by June 30 next year from different sectors," he said. "Two are ready to go. The listings will be domestic, but we would love to see foreign investors coming in."

The IMF completed the fifth review of its current extended fund facility earlier this month.

## India's new infra fund to lure cautious investors with 18% returns

By Rashmi Kumar

A combination of juicy returns and a maturing regulatory framework makes it the "perfect time" for investors to pump money into India's nascent infrastructure financing market, the chief executive officer of the country's sovereign wealth fund told *GlobalMarkets*.

In an exclusive interview, Sujay Bose, the managing director of India's National Investment & Infrastructure Fund (NIIF), said that recent developments around infrastructure in the world's most populous democracy had made investing in the sector a very attractive proposition.

"Indian infrastructure is at a point where the regulatory system has actually matured," he said. "The World Bank said it has one of the more mature regulatory frameworks for infrastructure in emerging markets."

"There are a lot of assets that can actually be acquired so you no longer only a development game as you can play operating assets. The returns of those operating assets are quite attractive relative to the risks that they pose. It's a market that is not only sizable, but also has breadth and depth."

Depending on the kind of project and the size of deal, investors can make as much as 13%-18% in rupee returns, Bose

said — an incredibly attractive number in a world of negative interest rates.

NIIF, which is 49% owned by the Indian government with the rest held by a combination of Indian and international investors including Singapore's Temasek Holdings and the Abu Dhabi Investment Authority, is working hard to make investors understand the potential of the country's infrastructure market. The government chipped in \$3bn to the fund manager, with NIIF also separately raising money from other investors.

### RISKS AND REWARDS

Investors will want to know the country can shed its reputation for overregulation. "The regulatory environment in India is challenging," the CEO of an India bank said. "The [central bank] has made efforts to simplify rules around tax and investment caps many times, but there are cases where they announce something and then do a U-turn on the rule, making it difficult to keep up with the new regulation."

An ECM banker in India said there had only been a handful of IPOs from infrastructure trusts this year. "There is interest, but it's going to take investors time to get their heads around this new asset class before they can become comfortable



Bose: regulatory system has matured

investing in this sector. There are risks and there are rewards, but in some cases, the risks outweigh the rewards."

The fund is looking at infrastructure development and financing through a sustainability lens, given the rising importance for regulators, sovereigns, funds, investors and developers, of the need for sustainable infrastructure. NIIF has adopted the environmental, social and governance (ESG) standards of the multilateral development bank, the Asian Infrastructure Investment Bank.

Vishakha Mulye, executive director at ICICI Bank, said that India was increasingly paying more attention to sustainable financing, including in the infrastructure sector. "Until now, this portfolio was not profitable," she said. "But given the wealth that is getting created, many of these segments are now getting quite profitable."

## 'We can deliver on our climate promises' — Indonesia

By Elliot Wilson

Indonesia's top climate policymaker insisted that the country remains committed to preserving its forests, despite its reputation being scarred by images of its wooded areas burned to order for palm-oil conglomerates, turning the skies of Jakarta bright red.

Speaking to *GlobalMarkets*, Suhasthi Nazara, chairman of the Indonesian finance ministry's fiscal policy agency, said southeast Asia's largest economy remained "firmly committed to our promise to cut our long-term carbon emissions by 30%. With international support and funding, and using the right multilateral mechanisms and checks, we are certain we can deliver on our promises."

A year on from the Bali Bretton Woods conference, and 20 months since the Republic of Indonesia became the first Asian nation to sell "green" bonds to international investors, Nazara said it was crucial to get a form of carbon trading back on the global agenda. While it had fallen out of fashion in

recent years, emissions trading or cap-and-trade schemes, which let firms or countries buy or sell credits, were essential by Indonesia — and the world — were to hit deforestation targets, and find new ways to prevent the release of billions more tonnes of carbon dioxide.

### CARBON CAPTURE

He pointed to the inherent value of forestry, not as a timber resource, but as an oxygen reserve for future generations. "There isn't much value in timber anymore," he insisted. "The real value of our forests is stored in carbon capture and in the credit it creates, and that fact is becoming ever more embedded in the minds of Indonesian policymakers."

"We need to promote carbon credits as a tradable commodity, and we travel the country, visiting villagers and telling them that the forest is more valuable to them — and to us — if it remains intact," he added. Last week, the country's environment ministry launched a new green fund, capitalised to the tune of \$140m, with the aim of repairing environmental



Nazara: forests' values lies in carbon capture

damage. It included the creation of a new carbon-trading programme to help Indonesia meet its emissions targets.

Nazara said there was "more of a need for a multilateral approach" than ever to curb climate change, slashing emissions, and creating a viable carbon trading system that benefited poorer nations still blighted with significant primary forest cover. "Climate change can only be halted by working together, and successfully, across borders," he said.

## Kenya fin min says 'entire debt stock' to be assessed

By Virginia Furness

Kenya will work to reduce its debt burden as it seeks to secure a new standby loan facility with the International Monetary Fund, despite reports it has increased its debt ceiling, acting finance minister Ukur Yatani told *GlobalMarkets*.

Kenya is working on an "elaborate roadmap" to manage its debts, which includes retiring short-term commercial loans and increasing concessional funding, as it looks to finance the country's vast infrastructure needs.

At around 60% to its gross domestic product, Kenya's debt levels are notably higher than the 55% level beyond which the IMF considers there to be a strong risk of debt distress, raising concerns about its ability to service the debt load. These concerns were exacerbated by reports that Kenya's parliament recently approved an increase in the country's debt ceiling to some \$87bn.

Kenya has held long term talks with the IMF on a new standby loan facility and negotiations are expected to conclude this year. "We are keen to be engaging directly in a programme with them, so they support and complement our efforts," said Yatani.

Kenya has borrowed large amounts to finance infrastructure projects, with big amounts coming from China as part of its Belt and Road Initiative. The government is focussed on improving the sustainability of its debt stock, and on securing concessional funding from multilateral partners such as the IMF, Yatani said. It will focus on green and sustainable development projects.

While infrastructure spending remains a key priority, Kenya is looking at ways to finance development more sustainably, reducing its debt load by replacing expensive short-term commercial loans with more concessional terms. "We have an elaborate roadmap on managing our debts and we are focussed on making sure we go the concessional way with multilateral organisations, [as well as] trying to retire some expensive commercial debt," he said.

Kenya may also turn to the capital markets to raise funding at a lower price though has no imminent plans to return to the bond market after issuing a \$2.1bn Eurobond in May this year. Proceeds of any new bond will be used for debt management and to pay down expensive debts, rather than for spending, he said.

## Economics &amp; Policy

12 EUROPEAN CAPITAL MARKETS UNION  
TOUGH GOING

The new European Commission has its work cut out for it if it wants to re-launch efforts to create a single market for capital in Europe. The easy wins were banked by the previous administration while Brexit complicates an already highly complex initiative.

14 GLOBAL CHARITIES  
SCALING UP HUMANITARIAN AID

There are justifiable fears around the humanitarian aid sector using the capital markets but if executed well it will allow charities and development agencies to bring in much more funding.

## Special Report

17 ARMENIA  
TAKING THE ECONOMY TO A NEW LEVEL18 | EXCLUSIVE INTERVIEW: NIKOL PASHINYAN  
Armenia's prime minister Nikol Pashinyan

## 19 | FROM REVOLUTION TO REFORM

Despite the political upheaval following its 2018 political revolution, Armenia has launched an aggressive and wide-ranging series of reforms that, if carried through successfully, should propel the economy to a new level.

## 22 | BANKING

Armenia's restrictions on lending are starting to pay off, as its banks are able to lend effectively to the country's burgeoning private sector and so help drive economic growth.

## Special sponsored section

24 EIB REPORT III  
OCEANS

One year after the launch of the Clean Oceans Initiative, the European Investment Bank wants to use its success in tackling plastic pollution as a springboard to safeguard the wider blue economy.

## Special sponsored section

27 SURINAME  
COUNTRY REPORT

## News

38 WORLD BANK  
PROVIDING PROTECTION FROM  
EXTERNAL SHOCKS

## Opinion

## 39 FINAL WORD

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## Going gets tough for Europe's capital markets union

The new European Commission has its work cut out if it wants to re-launch efforts to create a single market for capital in Europe. The easy wins were banked by the previous administration while Brexit complicates an already highly complex initiative

By Tyler Davies

When the European Commission first started advocating a "capital markets union" in 2014, there was little doubt that the City of London was going to be the driving force behind the initiative.

It was telling that Jonathan Hill, the UK Commissioner, was selected to run the project. And it was easy to see how London, with its outsized focus on financial services, might end up operating as the hub in a hub-and-spokes model for European capital markets.

After the UK voted to leave the European Union in June 2016, this vision was torn apart. The state that is home to the largest capital market in the EU is set on a course towards becoming a third country, putting its close relationship with the remaining 27

member states in jeopardy.

Nicolas Véron, a senior fellow at Bruegel, a think-tank in Brussels, argues that the Brexit vote has completely undermined the usefulness of the term "capital markets union."

"The capital markets union was launched as a slogan for what was really a UK feel-good project," he explains. "That motivation is no longer there. The spin has now disappeared."

The incoming commission, headed by Germany's Ursula von der Leyen, will nonetheless be looking to give the moniker a new lease of life in the next legislative term.

In a speech following an informal session of the Economic and Financial Affairs Council (Ecofin) last month, Valdis Dombrovskis, the Latvian commissioner in charge of financial services, said that he was committed to making sure that the capital markets union can "go to the next level" in the next five years.

Brexit is certainly one of the most obvious obstacles in the way of achieving this objective.

"Though market participants have often been frustrated by the difficulty in pinpointing what the EU means when it talks about developing a capital markets union, it is clear that some part of the project envisages deepening the pools of capital available to companies in Europe.

It is hard to see how this would be possible unless the EU is able to maintain very close ties with the UK, which has yet to decide on what it wants from its relationship with the EU after Brexit.

According to research from New Financial, the EU's share of global capital markets activity will fall by nearly a third if it loses the UK as a member. The country dominates EU finance, taking an average share of 30.6% of capital market activity across 26 different sectors.

"The UK was the biggest EU capital market," says Jonathan Faull, a former top official in the European Commission. "It was open to the rest of the world. It was outside the euro but inside the single market. The situation was already complicated. Now you add in Brexit — with no clear understanding of the direction that everybody will take

afterwards — it makes the whole thing even more difficult."

### THE HIGHEST HANGING FRUIT

For now Dombrovskis is looking to home in on the things that are easier for him to influence directly.

Having taken stock of the Brexit vote on several occasions — including in a mid-term review of the capital markets union in June 2017 and in a progress report this March — the Commission determined that the UK's departure from the bloc made it more important than ever for the EU to develop its capital markets infrastructure.

"It is not worth pretending that it has all been very easy to set up a capital markets union," says Faull, who is now chair of European public affairs at Brunswick, an advisory firm based in Brussels. "All of the difficulties that don't involve the UK are still there. How do you make progress? Who supervises what? Should there be a decentralised model or a centralised model?"

Jean-Claude Juncker will argue that he was able to lay down the "building blocks" of a single market for capital during his term as president of the European Commission, between 2014 and 2019.

The Juncker Commission adopted 11 of the 13 legislative files that it put forward for the project. But many of the proposals, including changes to the rules on prospectuses, covered bonds and securitizations, were largely uncontroversial in the context of EU politics.

"Thanks to significant progress in CMU since 2015, the so-called easy work has already been done," says Mika Lintila, minister of finance for Finland, which holds the presidency of the Council of the EU until January.

Lintila explains that the EU will look to address more "complex" problems in the next legislative term, including looking at making tax and insolvency laws more consistent across the bloc.

These issues have already been discussed in the context of the capital markets union. But they have so far been met with a lot of pushback from member states, which have tended to resist any encroachment into their ability to make and enforce their own insolvency and tax regimes.

"Some differences in national laws, such as in insolvency, corporate, securities, and tax law, form a barrier to cross-border capital flows, but they also extend beyond the competence of the Ecofin," says Lintila.

"Thus, progress is only possible with a high level of ownership across the relevant Commission formations."

This is still an ambitious proposition by any stretch of the imagination, particularly

with regards to harmonising tax frameworks. In this area, any amendments to national rules require a unanimous vote of the European Council, making conversation on the subject notoriously difficult to get going.

"It might be that there is significant progress on these issues," says Bruegel's Véron. "But I wouldn't make it the metric for determining the effectiveness of the European Commission, because it depends so much on the member states."

Véron argues that there are other outstanding issues that the Commission should concentrate on if it wants to make another push towards creating a single market for capital in Europe.

In particular he says that the EU should overhaul the governance and funding arrangements of the European Securities and Markets Authority (ESMA), with a view to expanding its role in capital markets.

At the moment, ESMA covers rating agencies, trade repositories and a number of other market participants within its supervisory remit.

But there is plenty of room for its authority to be extended over other parts of the market with pan-European significance, including central clearing counterparties (CCPs), trading platforms and settlement providers.

"I think anybody in the business would agree with the proposition that a fragmented supervisory framework has a lot to do with the proliferation of fragmented market structures," Véron explains.

### THERE IS POWER IN A UNION

The new European Commission will need to make a choice about where it wants to focus its efforts in the next phase of the capital markets union.

Alongside calls to strengthen the supervisory framework and proposals to harmonise certain features of insolvency and tax law, there have also been appeals for the EU to improve market transparency by revisiting MiFID II — the Markets in Financial Instruments Directive.

Some market participants believe in stricter prudential oversight of systemic institutions like CCPs and complex investment firms, and others feel strongly about the need to establish new frameworks for combatting money laundering and financial crime.

Given the potential breadth of the project, the new Commission needs

to be able to give a definite sense of its overarching goals for capital markets union from the outset of its term.

"The next steps should be to take stock of the achievements and shortfalls in order to form a clear picture and to identify gaps and the need for further work," says Lintila.

Nobody is forgetting why Europe is so keen to strengthen and consolidate its capital markets, however.

Fragmentation along national borders is preventing companies from accessing a broad and more diverse pool of financial resources, forcing too many of them to rely too heavily on a banking system that is still in the middle of a long process of restructuring.

"From a capital markets perspective, Europe is significantly behind Asia and the US across all of the key proxies: daily equity trading volumes, number of IPOs, number of listed companies, amount of capital raised, as well as retail participation levels," says Niels Brab, head of government relations at Deutsche Boerse in Brussels.

These problems have profound implications for growth in the EU. The IMF expects euro area countries to increase their economic output by 1.3% in 2019, compared with a 2.6% increase in the US and 6.2% of growth in emerging and developing markets in Asia.

A seemingly endless stream of monetary stimulus from the European Central Bank has done little to alter this outlook, and member states have so far been reluctant to chip in with any fiscal stimulus, even where they have sufficient headroom to do so.

But the incoming Commission remains convinced that there are significant gains to be made from public policy initiatives.

"It is critical to realise the importance of the reflections around the capital markets union and their ability to significantly boost the overall growth contribution capacity," Brab says.

"With Brexit on the horizon, this reasoning is only going to be reinforced in the EU27." **BM**



"The capital markets union was launched as a slogan for what was really a UK feel-good project. That motivation is no longer there. The spin has now disappeared"

—Nicolas Véron, senior fellow at Bruegel

"All of the difficulties that don't involve the UK are still there. How do you make progress? Who supervises what? Should there be a decentralised model or a centralised model?"

—Jonathan Faull, chair of European public affairs at Brunswick





## Harnessing the financial markets to scale up humanitarian aid

There are justifiable fears around the humanitarian aid sector using the capital markets but if executed well it will allow charities and development agencies to bring in much more funding

By Jasper Cox

We know how to eradicate cholera. Unlike some other diseases, all deaths from cholera are preventable with the tools the world has available today, according to the World Health Organisation (WHO).

But the financial investment required in water, sanitation and hygiene (Wash) to control cholera, which is normally spread through faecally-contaminated water or food, has often been thought of as prohibitive, according to the WHO.

So how can we find that investment? One answer is through the capital markets. The worlds of finance and humanitarian aid appear poles apart, but they are starting to converge.

Pointing to crises in Syria, Yemen and South Sudan, a report from earlier this year commissioned by think-tank ODI says that while traditional donors are increasing grants to traditional emergency responders, the gap between needs and funding is growing. Last year only 58.5% of requested needs were covered.

"There is a sense that we need to move from grant-making toward employing a wider range of financial tools and scaling up investment in poor countries under the sustainable development goals (SDGs) financing frameworks — and that private finance has a part to play," the report said.

Driving this is the abundance of private capital versus traditional sources. In 1990, official development assistance (ODA) was the biggest flow to low and middle-income countries, compared with foreign direct investment (FDI), remittances, and private debt and portfolio equity, according to the World Bank (see graph).

Now, remittances and FDI are much larger flows than ODA, and the category of private debt and portfolio equity generally is too, although this is unstable.

What this graph shows is very significant, according to Simon Meldrum, of the International Federation of Red Cross and Red Crescent Societies' (IFRC) global innovative finance team (GIFT) in London. He

says that aside from ODA, humanitarian actors have virtually no penetration into any of the capital flows. "Some proportion of ESG investing, and specifically impact investing, is relevant," he says. "If you're serious about addressing big humanitarian issues, why limit your response to working in the smallest pond?"

### LEVERAGING DONATIONS

The IFRC is trying to move into larger ponds for its cholera eradication programme.

That it is known how to solve cholera means plugging in more money has a reasonable chance of bringing results. This is what gives the IFRC, working with the Islamic Development Bank (IsDB), confidence in using an output based funding model for its Wash fund.

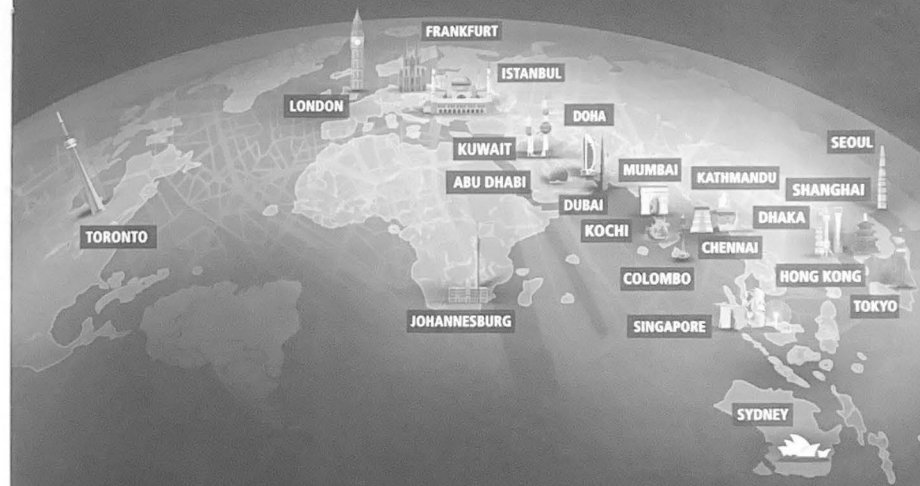
The amount donors put into the fund will be based on the outcomes achieved.

If the Wash fund were a normal corporation, we could say that the outcome based funding gives it a future revenue stream, if all goes well. Meanwhile, the entity also receives fixed funding from some donors, not dependent on outcome. This is like an equity base it has from the start. These two planks allow it to adopt a novel funding structure for a charity.

The plan is for it to raise debt through a bond, with the funding costs effectively



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—Adam Bernstein  
Dana O'Neil Gross

backed by the obligations of the donors. Bond holders can take comfort from the income stream as well as the equity lever underpins cutting down ethanol-related debts in member countries of the Organization of Islamic Cooperation (OIC). It was deemed appropriate to devolve the security as a liability on the state bond, given the ethical use of proceeds for assistance as targeted for each next year according to a three-up-date from the IFRC's GFI.

The IFRC's bond idea is not completely unprecedented. It's similar to the International Finance Facility for Humanitarian (IFFHM). This facility has received long-term donor pledges from developed-country governments, which help it issue vaccine bonds and sublets offering a market-based return. Meanwhile, for investors more generally, the IFRC is commissioned by ODI to recruit investors should it reach stages of development, in the sporting domain or specific areas within the humanitarian sector.

• **Highlight this:** Preventive investment, this involves insurance mechanisms, allowing money to be available when most needed and encouraging investment in reducing the impact of disasters.  
• **Investments in job creation and social support** for refugees and host communities.  
• **Investments in anti-epidemics or assets** for humanitarian work, for example, procurement of temporary housing, portable toilets, the energy firms and infrastructure leaders.

**DOES IT WORK?**  
This type of thinking is not without criticism. For one, it means private investment getting involved in what is essentially healthcare, an area often seen as the realm

of the public sector. This is a steep beyond involvement in sectors such as infrastructure, which has similarly been seen as ripe for private-sector investment.

"We see very different roles for public funds and private finance, especially when it comes to the health sector," says Bobo Dillers, head of policy at the European Network on Debt and Development in Brussels. Dillers is a network of civil society organizations. He says that privatized health systems are less efficient at spending money. Why would this be different for humanitarian aid?

It's a matter of government. It's that the paucity of public aid meant that humanitarian aid needs all the help it can get. But Dillers says that this deficiency would not be so great if developed countries next to target to devote 0.7% of GDP to development assistance, and if tax evasion and tax avoidance was less prevalent. This extra money could be used to help less developed countries invest in their health systems.

Dillers focuses in particular on the World Bank's pandemic bond, this is an example of the "preventative investment" solution he's identified. In part, because of a coupon investors face being tied to a pandemic outbreak, the trigger terms include speed of contagion, number of confirmed deaths and the disease crossing national borders. Across the bond and additional swaps, the total amount of cover is \$420 million to all countries eligible for support from the World Bank's International Development Association (IDA), covering six diseases listed by the WHO as likely to cause major epidemics if they continue to spread across national borders.

Companies are supposed to be efficient, so if we find that it's more cost-effective to produce products, I think that as an aid appeal, there is no lag before governments and aid agencies go further when it is cost-effective. And rather than triggering once a disaster has occurred, like a typical cat bond, the idea of the pandemic bond was that the bond would trigger before an outbreak reached pandemic proportions.

Investors on the tranche of the bond received a 1% over bid. The Democratic Republic of Congo struggling with what the WHO calls the second largest Ebola outbreak since 2014, with more than 2,000 deaths since the outbreak was declared in August 2018. But with a largely illiquid PR pandemic bond still has not triggered, leading

The World Bank has, however, paid out \$1.1 billion to fight Ebola in DRC. From a crash in demand that is part of the same Pandemic Emergency Financing Facility (PEF) as the pandemic bond but designed to be more flexible. With these types of instruments, there is also a risk of moral hazard. If actors are incentivized to let a disaster reach a certain scale in order to receive the payout. Furthermore, the unique nature of the bond and triggers mean calculating loss is difficult, perhaps requiring an intermediary presence for investors.

DISRUPTIVE ACTIVITY

It's possible to criticize aspects of the pandemic bond without dismissing the entire use of private-sector investment in humanitarian aid.

"The cost to donor countries of responding to a pandemic disease outbreak would far outweigh the cost of paying the insurance premiums," says Michael Bennett, head of derivatives and structured finance for the World Bank treasury in Washington, DC. Medtrium points out that traditional fundraising is not free either. Charity Partners on diabetes, reported last year that the British Red Cross Society's fundraising cost represented 12% of the total income.

There's a huge cost of raising philanthropic and investment that's public advertising agency for grant, on engaging account managers and some take a fee. Medtrium says. And some take a fee. Medtrium says. And some take a fee of capital markets. There are funds going to come from elsewhere.

"Using capital markets is one way of bringing in private capital for global public goods," says Bennett. "It provides a way of leveraging small amounts of public monies to transfer risk to capital markets and to raise large amounts of private capital."

Like the World Bank, the IFRC is developing a cat bond in its case to provide payouts to communities near 12 volcanoes. With the trigger based on ash plume heights. This represents a discontinuity and disruption of the traditional model of humanitarian aid provision, where an event triggers the flow of funds because of the original provider and the end users of the organization.

"What's our organization... we've been immediately transfer cash proceeds from the cat bond directly to the communities in the... In the past, says Adam Bernstein of the Danish Red Cross and based in Adis Abeba. Subscribing to alternatives and traditional funding mechanisms, ensure our humanitarian aid is more effective and efficient."

Source: World Bank Staff estimates, World Development Indicators



Global Markets  
Special Report

ARMENIA

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Armenia's prime minister Nikol Pashinyan tells *Global Markets* how his government's agenda to reform the economy and eradicate corruption will lead to both stronger exports and the creation of technology 'unicorns'

pursue opportunities to expand our footprint in global trade.

Focusing on exports across industries is one of the main value drivers in our strategy. Our strategic engagement with both the Eurasia Economic Union (Eurasian Economic Union) and the Comprehensive and Enhanced Partnership Agreement (CEPA) with the EU is a solid foundation for achieving this goal.

We have made a strong start towards meeting our export target of around 50% of GDP over the long term.

Some 1.65m international tourists visited Armenia in 2018, and the figures for the first half of 2019 are 12% higher. The high-tech sector is also booming, growing 20%-30% per annum. We already have several start-up companies (such as PicsArt) that have successfully attracted US venture capital and are approaching several hundred million dollar valuations.

Finally, by implementing our long-term transformation strategy and building our cutting-edge innovation ecosystem, we hope to host many homegrown unicorns with some of them reaching \$10bn in valuation.

**What are your plans to encourage foreign direct investment in Armenia? Corruption is one of the main obstacles. Can you outline how you hope to address that?**

Foreign direct investment (FDI) is going to be the backbone of our new growth and development model. This requires a systemic overhaul. Bold efforts in this direction are underway. We're moving away from investments based on captured assets by a few vested groups that enjoy unjustified privileges towards a fair and transparent investment environment.

This will open up avenues for forward-looking competitive investment initiatives, and most importantly help us to attract multinational companies to create high quality and competitive jobs.

Attracting FDI became more challenging after the global crisis in 2008 because everyone, including advanced countries, was competing for it. We must therefore take risks ourselves. We need to mobilise domestic savings and channel them into productive investments. Without that, FDI will be confined to a narrow channel of opportunities.

In this context, developing our domestic capital markets (including collective investment schemes) has become one of our major

priorities. This requires good corporate governance and full transparency in the corporate sector.

For the first time since independence, our citizens are confident that the government is serious about eradicating corruption. For example, the recent study performed by the European Business Association among SMEs has shown that corruption didn't even come up among the top 15 problems that businesses face in Armenia. However, we are not satisfied yet and much more needs to be done to ensure the necessary FDI.

**Global economic growth is under threat. Is Armenia at risk? What measures are you taking to ensure the Armenian economy is resilient?**

Indeed, the global economy is currently facing massive uncertainty and Armenia as a small open economy is exposed to external shocks. Our main actions to ensure the resilience in the long-term are our wide-ranging structural reforms. These measures are intended to increase the potential of the economy.

In the short term, preserving our macro economic stability is our first line of defence. Public debt is sustainable, which allows us to build buffers for countercyclical fiscal policy in case of an adverse shock. On the monetary and financial stability side, the Central Bank of Armenia has advanced policy frameworks, which have been tested many times. Results speak for themselves — inflation has been under control and banks have been resilient despite massive regional volatility.

**What message would you send to foreign companies considering investing in Armenia?**

The anticipated transformation will open up new opportunities, especially in the high-tech sector.

In a world of closing doors, Armenia can be the key to markets in our region. Our joint integration programmes with both the EEU and EU will build a bridge between advanced markets and our neighbours in the region with large populations.

We are open to new ideas and ready to show regulatory flexibility in attracting high quality investments that will help us to learn and implement international best practices. We understand that the best resource we have is our human capital and we are ready to collaborate with potential investors in developing our talent pool to meet global standards. **GM**

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*In a world of closing doors, Armenia can be the key to markets in our region”*

—Nikol Pashinyan, prime minister of the Republic of Armenia

**How is Armenia's five-year economic plan progressing? What are the main goals and how will you achieve them?**

Our government's five-year programme will transform Armenia into a modern, high tech and well-governed democratic society. It will be free from corruption, with well-established institutions ensuring our nation's security and the protection of human and property rights. On the economy, the programme is built on three principles: zero tolerance to corruption, improving revenue mobilisation through ensuring fairness in the tax system; and structural measures to foster inclusive growth through achieving a business-friendly environment and healthy competition in the private sector.

In this context, enhancing the government's spending capacity and its efficiency, especially in human development, is a key success factor.

Our programme also includes a new economic growth strategy. We are moving from a model driven by domestic demand to one focused on exports and investment.

We are only at the beginning of the journey, but some results are already apparent. Our economic growth rates are above the average for the region and for the world. Tax revenues have also increased by more than 25% in the first half of this year, showing strengthened trust in the government.

We are developing a long term country transformation strategy called Vision of Armenia for 2050. This will kick-start wide ranging public and professional consultations and set strategic goals and actions for the next 10 years. It also aims to build consensus among all Armenians around the world.

**One of the aims of the economic plan is to increase exports from 20% to 43%-45% of GDP by 2024. How will you achieve this?**

One of the key lessons learned since Armenia gained independence in 1990 is that expanding our export potential is a crucial goal. We must



# From revolution to reform: Armenia sets sights on next economic level

By Lewis McLellan

A political revolution can often throw a small and developing economy like Armenia's into disarray, but after the Velvet Revolution of May 2018, Armenia and its new regime have enjoyed GDP growth of 5.2% in spite of a period of difficult political transition.

The nation's partnership with international financing institutions like the IMF and the World Bank has helped smooth over the bumpy period and is now shepherding the country through a challenging programme of institutional reforms.

Among the biggest challenges facing the new regime was Armenia's history of endemic corruption. Former prime minister Tigran Sargsyan said in 2008 that corruption was Armenia's number one problem obstructing reforms. Armenia still ranks 160th in Transparency International's Corruption Perceptions Index, although it has steadily crept up the rankings from 113th in 2016.

Previous efforts at tackling the problem have had little success. An anti-corruption council was established in 2004 but was widely regarded to have achieved little of value. In 2015, a second attempt was made, and the anti-corruption council was re-launched. If anything, the results were even worse. The council was quickly beset by accusations of lavish spending, and an unwillingness to pursue investigations into senior politicians robbed the initiative of credibility.

"Previous governments failed to tackle the problem effectively, largely because they were corrupt themselves," says Hovhannes Toronyan, head of strategy and research at America CJS, one of Armenia's top consultancy and advisory companies. "It's different this time.

Despite the political upheaval following its 2018 political revolution, Armenia has launched an aggressive and wide-ranging series of reforms that, if carried through successfully, should propel the economy to a new level

The new government is quite radical on fighting corruption within the public sector."

Part of this is achieved through reforms to the judicial system, making the judiciary more independent, but the enforcement aspect is perhaps more important. "The new government has taken the fight against corruption to a completely new level," says Tigran Jrabshyan, head of management advisory services at America CJS. "Now they are quite radical on fighting corruption and shadow economy. There's a clear message to public officials that things have to be done above board. However, fight against corruption should be accompanied with building effective institutions."

New prime minister Nikol Pashinyan announced in September that there would be two new bodies set up to tackle corruption, and that they are moving towards establishing an independent judiciary.

Armenia has also set up a register of beneficial ownership that will provide public information on the real owners of businesses operating in Armenia. The bill has been signed and the register should be fully operational by December 2020.

"The focus on corruption should help to improve investors' confidence in doing business in Armenia.

"Transparency, rule of law and consistency should create a new level of trust, both in Armenia and abroad," says Jrabshyan. "That

is also an important prerequisite for foreign direct investment. In the mid-term, FDI should improve."

## ATTRACTING FOREIGN INVESTMENT

Low FDI has plagued Armenia for many years. It remains static at around 2.3% of GDP, much of which is concentrated in Armenia's mining and commodity export businesses.

"The history of corruption has deterred international investors, but there are other factors that are less easily tackled. "It's a small country in a rather challenging location, which is nevertheless full of opportunities," says Artashes Shaboyan, chief researcher at America CJS. "Large investors focus on the region and don't delve into the particular features of each country. The government has to invest resources to get international international investors to recognise it as an opportunity."

"That often means missing out on Armenia's unique strengths. Unlike the rest of the region, Armenia's currency has enjoyed remarkable stability over the past few years, its inflation too has remained in check and its banks have been subject to some of the most stringent regulation in the region and, as such, have had fewer non-performing loans than most of the regional peers.

The Armenian dram has appreciated around 20% over the past 10 years, compared to 50% for most of its peers in the CIS region.

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*"Transparency, rule of law and consistency should create a new level of trust, both in Armenia and abroad. FDI should improve"*

—Tigran Jrabshyan, head of management advisory services, America CJS



“The technology sector of its economy is growing strongly, and we expect it to prove resilient in the face of slowing growth”

—Christian Fang, senior analyst for Armenia, Moody's

“From a macro stability point of view, Armenia has been very impressive,” says Shabayon. “After the global financial crunch, growth has been remarkably stable, and we do expect further positive developments in this regard. Armenia has proved to be outstanding in the region with an average inflation of 3%-4% for the last 10 years, only 1%-2% fluctuation of exchange rate over the last five years and much better diversified economy, where the largest sector of economy has less than 14% share”

The government's new tax code, which it will implement between 2020 and 2023, will lessen the tax burden for smaller businesses and entrepreneurs in an effort to create a better environment for business.

But despite cutting and simplifying taxes, government tax receipts climbed hugely this year and are expected to continue rising. “Armenia is pursuing an e-governance concept that would give a leap to transparency and reporting, as well as enable many online services both by the public and private sectors,” says Jrbashyan.

Christian Fang, senior analyst for Armenia at Moody's, agrees. “Expanding digitisation to include invoicing as well as revenue collection has really helped cut down on tax avoidance. Over the next year or so, the filing of income taxes will become automated, which should improve things even more.”

But beyond the government's attempt to reform itself, it is working on structural changes to the Armenian economy. Fang says: “These reforms, if effectively implemented, will increase Armenia's economic competitiveness and its attractiveness as a business destination.”

Armenia is working hard on developing various sectors of its economy. It has never been a manufacturing powerhouse, although the manufacturing sector output increased by 10% in 2018, but the jewel of Armenia's economy and the sector that will likely drive the bulk of its economic growth in years to come is technology.

Armenia has become a hub for software development, industrial computing and general information technology services.

#### RESILIENCE AGAINST EXTERNAL SHOCKS

Armenia has experience in riding out periods of domestic and regional turmoil, but with the world facing a slowdown in growth, Armenia will have to adapt to survive.

Where many economies around the world will suffer from the slowdown in economic growth and the spillover of reduced demand thanks to the trade war between the US and China, Armenia will only be indirectly exposed to the conflict.

“Armenia has a pretty limited exposure to US and China trade tensions,” says Fang. “Its main trading partners are the EU, Switzerland and Russia, not the US or China.”

But should the decline in global growth result in a fall in commodity prices, it is likely that Armenia would suffer as a result. Mining, particularly of copper, is still an important part of the Armenian economy.

However, as the importance of the technology sector grows, Armenia's reliance of mineral production will fall. The World Bank has been pursuing a programme of trade promotion in Armenia, seeking to address the country's reliance on low value-added commodity products.

“The technology sector of its economy is growing strongly, and we expect it to prove resilient in the face of slowing growth,” says Fang. “Armenia services a wide region as a provider of technology solutions, and they'll likely be needed even in times of slow growth.”

#### CHALLENGES FACING ARMENIA

Most agree that if Armenia successfully accomplishes its programme of reforms, it will reap the rewards—a stable, diverse economy with dynamic growth. However, that it is successful in its reforms is not a foregone conclusion.

“The government is currently working

on the transformation strategy of the country. We are proud to have developed innovation-led industrial strategy, yet implementation of all those great ideas is still a big challenge. It will require detailed and consistent implementation,” says Jrbashyan.

The government was elected with a 70% majority in December 2018 and appears to still enjoy much of the goodwill that carried it to victory. That goodwill will go a long way towards facilitating reform.

But that goodwill will not last forever. Unless the government is able to produce results in line with the public's expectations, it could begin to evaporate quickly.

“Apart from quality of decision making, there is a huge time pressure and I expect that more public sector operations should be outsourced to the private sector to enable swift and efficient implementation of good intentions of the government,” says Jrbashyan.

Some of Armenia's structural challenges are less amenable to improvement through reform. It is a landlocked nation, and two of its four borders are closed. Poor diplomatic relations with Turkey and Azerbaijan mean that those countries are barred as routes for trade.

Its borders with Georgia and Iran are open, but the economic sanctions on Iran make it a difficult option for trade opportunities. There is little that can be done to address this, but Armenia's membership of the Eurasian Economic Union provides a valuable outlet for trade.

Although Armenia's GDP is growing at an impressive rate, and projected to continue to do so, its current account deficit and trade balance are both substantial. The World Bank projects that these deficits will fall, thanks to structural reforms calculated to boost exports and tourism.

Armenia's new government, although it was born out of a revolution, has proved an ambitious but credible body. Its reform programme, though daunting, has the advantage of public support and the backing and confidence of the international investment community.

## AMERIABANK



# Next Level of Transformation is the Switch to Digital Banking

**GlobalMarkets:** Mr. Hanesyan, what is behind the growth of the Armenian banking sector in the last year?

**Artak Hanesyan, Ameriabank:** One of the reasons I would like to highlight is the growth of Armenian economy over the last two years. After the Velvet Revolution, Armenia undertook political and economic reforms and a huge fight against corruption.

This has greatly improved Armenia's image internationally and helped to generate trust in our country, its economy and its real estate.

Banks have also played a significant role in economic growth by financing the private sector. Armenia's assets to GDP ratio is 83%, which is approaching that of Eastern European countries, demonstrating the increasingly important role the banks play in the Armenian economy.

**The growth rate of the banking sector is impressive. Loans alone grew by 16% in 2018. We are pleased to note that the growth is represented in both retail and business, as well as the mortgage sector where demand is currently higher than supply.**

The volume of deposits in Armenian banks increased by 12% during the year. The market is becoming more active by the day, and even during the vacation period, the number of operations was comparable with the highest season of the previous year.

What we observe now is the synergy of banking and the economy—growth of lending stimulates the economy and economic growth in turn stimulates the demand for loans and other banking products.

The Armenian banking system has faced two global financial recessions in the last 10 years, as well as the Velvet Revolution. It came through all of them without any serious consequences or bankruptcies. Our financial system is stable and our banks are sustainable, highly transparent and enjoy the trust of their clients.

**How is Ameriabank able to remain the leader in the Armenian banking sector year after year amid such tough competition?**

We have always made a point of putting long-term projections at the core of all our strategies. We strove to keep pace with global trends even where local market was still centered on traditional models. Innovation is and has always been our signature move.

Moreover, we develop Ameriabank's products

based on detailed analysis of our clients' needs. That's why they meet our clients' expectations to



“WE HAVE ALWAYS MADE A POINT OF PUTTING LONG-TERM PROJECTIONS AT THE CORE OF ALL OUR STRATEGIES. WE STROVE TO KEEP PACE WITH GLOBAL TRENDS EVEN WHERE LOCAL MARKET WAS STILL CENTERED ON TRADITIONAL MODELS. INNOVATION IS AND HAS ALWAYS BEEN OUR SIGNATURE MOVE —ARTAK HANESYAN, CEO AMERIABANK”

the highest possible degree. We offer a wide palette of distance banking services, actively promoting online lending. We do everything to deliver the best service to our clients, protect their operations and save their time. This is what makes it possible to be the leader—good customer experience, up-to-date methods and professional staff.

**Moody's has recently raised Ameriabank's rating to Ba3. What does this mean for you?**

The new rating was affirmed after Moody's reviewed and raised Armenia's sovereign rating from B1 with positive outlook to Ba3 with stable outlook earlier this year. Since the credit rating of a company is constrained by the sovereign credit rating of the country, Ameriabank has the highest possible rating for an Armenian company, which is the same as the Armenia's sovereign rating.

The upgrade of Ameriabank's long-term local cur-

rency deposit rating from B1 to Ba3 was driven by the upgrade of its Baseline Credit Assessments (BCAs) reflecting a combination of the Armenian banking system's improved macro profile and the bank's consistently sound financial metrics such as asset quality, strong capital position, high ROA and ROE, sufficient liquidity and diversified funding base.

Ameriabank's long-term foreign currency deposit rating was upgraded from B2 to B1 and the long-term counterparty risk from Ba3 to Ba2. These ratings are very important for attracting equity market investments and international funds.

**The market is always changing, from technology to consumer attitudes. How has Ameriabank changed, and what will be next?**

10 years ago nobody could have imagined how impressive Ameriabank's transformation would be during those years. From a small bank with \$45 million in assets and \$9 million in equity Ameriabank has grown into the dominant leader of the Armenian banking system. Our asset base is 36 times larger than it was 10 years ago, while our loan portfolio is 130 times larger.

We have been the leader in terms of assets and loans for some time now, we are the 11th largest taxpayer in the country, far ahead of all other Armenian banks. Since 2008 we have raised more than \$1 billion from IFIs—a strong indication of our partners' trust. We are also number one in investment banking with a 30% share of corporate bond issuance.

We have grown from a petty bank to become the leading financial institution in Armenia by financial ratios, service quality and global-level innovation. We did not grow with the market, we surpassed it.

The main change over these 10 years is technological breakthroughs. Instead of remaining a purely financial company, we decided to venture into technology, actively promoting digital solutions and distance banking.

Due to robust corporate governance systems in line with best international practices and balanced HR policy we have been able to bring together a brilliant team of like-minded professionals. The success of our business rests on people and technology.

As for further transformation, I am confident that technology is and will remain the key to success in banking. For Armenia, with its small domestic market, digital transformation in banking will be especially important as the foundation of development for years to come. ●



# Armenia's banking sector — the region's strong man

Armenia's restrictions on lending are starting to pay off, as its banks are able to lend effectively to the country's burgeoning private sector and so help drive economic growth

By Lewis McLellan

“Most of the banks apply best practice corporate governance and high level of transparency in reporting per IFRS standards”

—Artashes Shaboyan, chief researcher at Ameria CJSC

“I expect credit to expand quite dramatically over the next few years”

—Christian Fang, senior analyst for Armenia, Moody's

High standards  
The Central Bank of Armenia's new training and research headquarters in Dilijan

Regulation of Armenia's banks is among the toughest in the Commonwealth of Independent States region, and Central and Eastern Europe, and it's only getting tougher. The central bank is set to introduce Basel III, requiring the nation's banks to maintain the capital buffers the regulation mandates.

While the 2014 economic slowdown hit Armenia as it did everyone else in the region — credit quality has still not yet recovered according to the IMF — the response in Armenia was more muted than elsewhere.

“Overall, the Armenian banking sector has been extremely stable over the last 20 years and is rather overcapitalised,” says Artashes Shaboyan, chief researcher at Ameria CJSC, one of Armenia's top consultancy and advisory companies. “Most of the banks apply best practice corporate governance and high level of transparency in reporting per IFRS standards.”

With 17% total capital to risk weighted assets and 15% as common equity tier one, Armenia is well ahead of the capital requirements imposed by most regulators. Even with the planned phase-in of the Basel III capital requirements, and the IMF's counter-cyclical buffer, the average Armenian bank is holding more than enough capital.

Banks have had to struggle against regulation to make risky loans and preserve profitability. However, the restraint has stood Armenia in good stead, setting it up with a stable financial system.

“The Central Bank of Armenia was swift in implementing international regulatory standards in the early 2000s, and up until now they are in many cases even ahead of

Western countries with applying Basel and other relevant standards,” says Shaboyan.

That has led Armenia to hold a smaller proportion of non-performing loans than most of its peers in Eastern Europe. Christian Fang, senior analyst for Armenia at Moody's says: “NPLs rose over 2015 and 2016 on the back of the large economic shock that hit the region in 2014, but only to around 10% or so. Many of the other countries in the Eurasia region had much higher levels of impaired assets.”

Now, with the economy enjoying growth of more than 5%, and banks holding generous capital buffers, credit has been growing robustly in Armenia over the past few years — a period in which banking systems with less proactive supervisory policies have contracted, according to Fang.

“Investment accounted for a significant share of lending in 2018,” he says. “Such investment in productive capital will contribute to future growth.”

“There's growth in demand for loans, thanks to the growing economy, and growth in financial liquidity among customers,” he adds. “I expect credit to expand quite dramatically over the next few years.”

Of course, there remains room for improvement in any banking system. Despite strong capitalisation, around 50% of deposits in Armenian banks are in foreign currencies. The high dollarisation of the Armenian economy is a structural challenge for the banking system.

With growth in the global economy slowing, many will opt for the safe haven trade and keep their funds in dollars. Should the dollar strengthen against the Armenian dram, Armenia's liabilities will increase dangerously.

The Armenian central bank has taken steps to mitigate these risks, imposing higher risk weights on dollar assets, for which it received the IMF's commendation. The IMF has also suggested more measures to address the risk of Armenia's FX exposure: a stressed debt service to income ratio limit and a requirement for banks to maintain foreign currency reserves against foreign currency liabilities.

## DIGITALISATION TO DRIVE CONSOLIDATION

The Armenian banking sector is undergoing changes from within, as well as reacting to impositions from regulators.

Armenia's banks are pursuing an aggressive digitalisation strategy, updating their processes both internally and externally. The moves should lower costs of running business and increase sales, according to Armenian analysts.

But the drive to digitalise is not just going to make Armenian banks more efficient and competitive internationally, it will change the make-up of the industry.

“Over the next couple of years, I expect to see another round of consolidations in the Armenian banking system,” says Tigran Jrhshyan, head of management advisory services at Ameria CJSC. “I would be surprised to see small and low efficiency banks that have not adopted a digital transformation strategy survive in Armenia past the next few years.”

Although the IMF will always have suggestions for improvements to Armenia's banking regulation, the country's central bank deserves praise for managing a stable and secure banking system, which will help power Armenia's growing economy. **CSJ**



Expanding horizons in mining



# Protecting the heart and lungs of the planet

One year after the launch of the Clean Oceans Initiative, the European Investment Bank wants to use its success in tackling plastic pollution as a springboard to safeguard the wider blue economy

The floods that submerged Benin in September 2010 were the worst the small West African country had suffered for almost half a century. The disaster was reported to have been directly responsible for 46 deaths, destroyed 50,000 homes and left 100,000 people without shelter. At an economic level, the damage caused to crops, farmland and infrastructure was estimated at over \$250m, or 2% of Benin's GDP in 2010.

The irreversible damage caused by the flooding to the Atlantic Ocean is considerably harder to quantify. But in Cotonou, Benin's largest city and economic centre, where the unpaved roads are inadequately maintained, its drainage infrastructure substandard and many of its houses lacking access to modern sewers, tonnes of highly polluting waste had nowhere to go but the Gulf of Guinea.

The tragedy of disasters such as the Benin floods of 2010 is that the devastating impact they have on people's lives and on the environment is largely preventable. This is why the European Investment Bank (EIB) recently signed a €50m loan to help Cotonou improve storm water management and protect the city's 460,000 residents from similarly destructive cyclical floods in the future.

Co-financed by the European Investment Bank (EIB), the World Bank (WB) and Agence Française de Développement (AFD), this project is part of a wider programme, which includes other catchment areas and emergency works, that will be financed by the African Development Bank (ADB), the Islamic Development Bank (IsDB) and the West African Development Bank (WADB).

By upgrading storm water drainage and fortifying Benin's coastal shores, the project will reduce flooding of houses and the stagnation of rainwater in urban areas. It will also serve the global public good by stemming the discharge of plas-



Benin. The damage caused to crops, farmland and infrastructure was estimated at over \$250m, or 2% of Benin's GDP

tics and other waste pollution into the Atlantic Ocean via the Gulf of Guinea.

It does not take extreme weather events such as the Benin rains, however, to cause millions of tonnes of rubbish and effluent to be disgorged into the world's fragile oceans. With as many as 2 billion people still living in communities with no or inadequate waste collection, garbage is routinely dumped in rivers and the sea.

By providing cities throughout the developing world with more efficient waste and stormwater management facilities, initiatives such as the Cotonou project will have a decisive role to play in slowing and preventing the discharge of waste into the oceans.

## PLASTIC DELUGE

Above all, projects of this kind will help address the damage created by the estimated 8m tonnes of plastic waste and 1.5m tonnes of microplastics that are discharged into the oceans each year. If nothing is done to arrest this flow, it has been estimated that by 2050 there will be more plastics than fish in the world's oceans.

The impact would be devastating at an economic as well as an environmental level. Oceans are a key source of food, medicines, renewable energy and natural resources for billions of people, and an irreplaceable source of economic activity and job creation in coastal communities around the globe, many of them in poor countries. Worldwide, it is estimated that the value of goods and services produced by marine and coastal resources is €2.5tr a year.

Aside from the critical contribution they make to sustainable development and poverty alleviation, the oceans absorb close to a third of the planet's carbon dioxide and as much as 90% of the excess heat created by global warming. This puts them in the front line of the battle against climate change, which is why protecting the world's oceans is every bit as important in buffering the impact of global warming as reducing the planet's dependence on fossil fuels.

If any arguments were needed to signal the urgency of this issue, the latest report from the Intergovernmental Panel on Climate Change (IPCC) report provides it very starkly. EIB vice president Emma Navarro, who oversees climate policy at the Bank, says: "This new IPCC report is another critical reminder of the

importance of protecting the oceans.

"It will provide valuable scientific information about how rapidly climate change is affecting the oceans and glaciers. This report is an urgent call for all of us to act."

"The European Investment Bank is ready. As the EU's climate bank, we have been at the forefront of global efforts to address the climate emergency, investing over €125bn since 2012 in climate action, including ocean and coastal projects and we are strongly committed to continue supporting investment and initiatives to address these crucial challenges. We are now ready to step up what we are doing as part of a broader commitment to more climate and environmental actions."

Werner Schmidt, director of the environment and sustainable territorial development department at the EIB, who leads a team of almost 100 engineers and economists dedicated to addressing water, wastewater, solid waste and flood-related challenges, echoes that. "We consider oceans to be the real heart and lungs of the planet," he says.

## CLEAN OCEANS INITIATIVE

It was recognition of the long-term threats caused by the discharge of plastic and other waste into oceans that was behind the launch in October 2018 of the Clean Oceans Initiative.

Supported by the EIB alongside AFD and the German promotional bank, KfW, it is an important source of loans, grants and technical assistance for projects reducing the discharge of plastics and other waste into the oceans. This can be achieved by increasing the collection, treatment, recycling and proper disposal of plastics and other waste in coastal and river-based cities, and in ports and harbours.

The initiative also supports schemes dedicated to improving wastewater management, reducing plastics and microplastics, and improved stormwater management as exemplified above.



Emma Navarro, EIB vice president. "The true potential of the blue economy can only be achieved if our oceans' health is secured"

The originally stated goal of the Clean Oceans Initiative was to provide €2bn of financing over five years to public and private sector projects. A year after its launch, the Clean Oceans Initiative had already achieved more than a third of this target, with loans worth around €700m signed.

While its scope is global, the principal focus to date of the Clean Oceans Initiative has been on rivers and coastal areas in Asia and Africa. The Cotonou storm water management project is one vivid example of a project financed under this scheme with demonstrable economic and environmental benefits.

A second example in Africa is the Kitchener Drain project in Egypt, a €441m initiative supporting the depollution of the Nile Delta. The Nile is one of the 10 rivers collectively responsible for an estimated 80%-90% of waste discharges by rivers into the ocean.

The EIB is providing a loan of €214m in support of the wastewater and sanitation component of the Kitchener Drain. This will help to reduce the flow of waste into the Mediterranean Sea from the 69km drain, which is the leading source of irrigation water for close to 200,000 hectares of agricultural land.

It is a model of multilateral co-operation as the project comprises investments financed by the EIB, grants under the EU's Neighbourhood Investment Facility (NIF), and the European Bank for Reconstruction and Development in wastewater and sanitation, solid waste, and drain rehabilitation. It is the first of its kind in Egypt. As a result, approximately 6 million people are expected to benefit from improved and new sanitation and solid waste services.

A third notable example of a project that has been supported by the EIB alongside the Inter-American Development Bank under the Clean Oceans Initiative is a water and sanitation development in the district of Partido Escobar in Buenos Aires, where only a small number of households are connected to sewers.

An \$80m loan approved by the EIB to upgrade the district's sewer network and wastewater treatment plant will improve access to sanitation services for more than 24,000 residents.

From the perspective of the global environment, meanwhile, the Argentine wastewater treatment plant will capture and reuse the methane produced in the process, restricting the emission of harmful greenhouse gases. By addressing the issue of plastic pollution in the Rio Reconquista, it will also reduce the flow of harmful plastics and microplastics into the Atlantic Ocean.

## DROP IN THE OCEAN

Although he is delighted by the progress made by the Clean Oceans Initiative in its first year, Schmidt says the EIB's next challenge is to explore ways of safeguarding the blue economy in areas extending well beyond preventing land-generated aquatic pollution.

"The success of the Clean Oceans Initiative in its first year triggered reflections within the EIB that to focus purely on removal of plastics from the oceans won't be sufficient," he says. "We recognise that we now need to take a big step forward and tackle the broader issues raised by the sustainable development

of the blue economy."

Over the longer term as far as the oceans are concerned, this will mean focusing increasingly on areas such as coastal protection, aquaculture, sustainable seafood production, blue biotechnology and green shipping — all of which will support innovation and job creation, as well as the protection of vulnerable ecosystems.

The EIB recognises, however, that the resources it has at its disposal to counter and reverse environmental destruction is a drop in the ocean compared to what will be needed if irreversible damage is to be forestalled. "We have to be humble and recognise that this is not a problem that we can solve on our own," says Navarro.

"We regard ourselves as a crowding-in bank, which means using our firepower to promote private investment. As with the climate challenge, it is clear that public intervention alone will be insufficient to combat marine pollution."

Schmidt says he is encouraged by the interest that has clearly already been stimulated by the Clean Oceans Initiative. "As well as being on track to meet our targets, we have attracted a number of peer institutions and private sector investors which have expressed an interest in partnering with us in the area of marine protection," he says.

The EIB's advisory and technical assistance will play a pivotal role in encouraging more investors to put their weight behind combating marine pollution. "The next step for us is to identify innovative projects and operations that have tangible benefits, but which are also demonstrable as case studies for others," says Jonas Byström, lead engineer in the EIB's urban development divisions.

"Solid waste is one example of an area which is under-represented in our portfolio and where we will be using technical assistance funds to identify and prepare replicable projects with high impact and demonstration potential."

## BLUE CIRCULAR ECONOMY

Another key component of the EIB's oceans strategy will be supporting the blue circular economy

## Recycling plastic waste so the oceans can breathe

8 million tons of plastic waste flows into the oceans every year  
If we do not act, by 2050 there will be more plastic than fish in the oceans

The Clean Oceans Initiative  
By EIB KfW AFD  
will finance the collection, sorting and recycling of waste before it reaches the ocean.



Argentina. An \$80m loan approved by the EIB to upgrade the Partido Escobar sewer network and wastewater treatment plant will improve access to sanitation services for more than 24,000 residents

by, for example, exploring sustainable solutions for turning the problem of the discharge of waste into an economic opportunity.

"A priority is to find ways of improving the collection of plastics and other waste and ensuring this does not end up in landfills, many of which are located in coastal or riverine areas," explains Byström.

"Good quality plastics are to a large extent already being recycled, but the challenge now is to explore ways to extend this recycling even further, and explore ways in which the private sector can valorise poorer quality plastics and thus support the growth of the circular economy."

Another important challenge is to address the ocean discharge microplastics, which Juan Bofill, senior water engineer at the EIB, explains are generally defined as plastic fragments less than 5mm in length. These have an especially destructive impact on the environment, because as well as threatening marine biodiversity, they could aggravate global warming by accumulating in ice. This in turn could affect the degree of light reflection and may increase the solar radiation absorbed by the surface, thus contributing to global warming.

"More than 1.5 million tonnes of microplastics are discharged into the oceans each year," says Bofill. "Some new solutions are currently being studied using microbes that degrade and eliminate microplastics. Our strategy will be to find pilot projects in areas such as this and promote their replication on a larger scale."

While developing countries are the main target of the EIB's commitment to safeguarding the oceans and supporting the growth of the sustainable blue economy, it also recognises the importance of extending assistance to Europe.

According to a report published by the European Commission in 2018, the EU's blue economy has a gross turnover of €566bn, creates €174bn of added value and sustains almost 3.5m jobs.

As Emma Navarro, who as a Spaniard comes from a country whose maritime economy accounts for the livelihoods of millions of people, says: "This is an economic, environmental and climatic emergency. And it is happening right now."

"Our oceans and seas are under threat and they simply cannot afford not to act. In the EU, around a third of the population lives within 50km of the coast and these areas generate over 30% of EU's GDP. The true potential of the blue economy can only be achieved if our oceans' health is secured."



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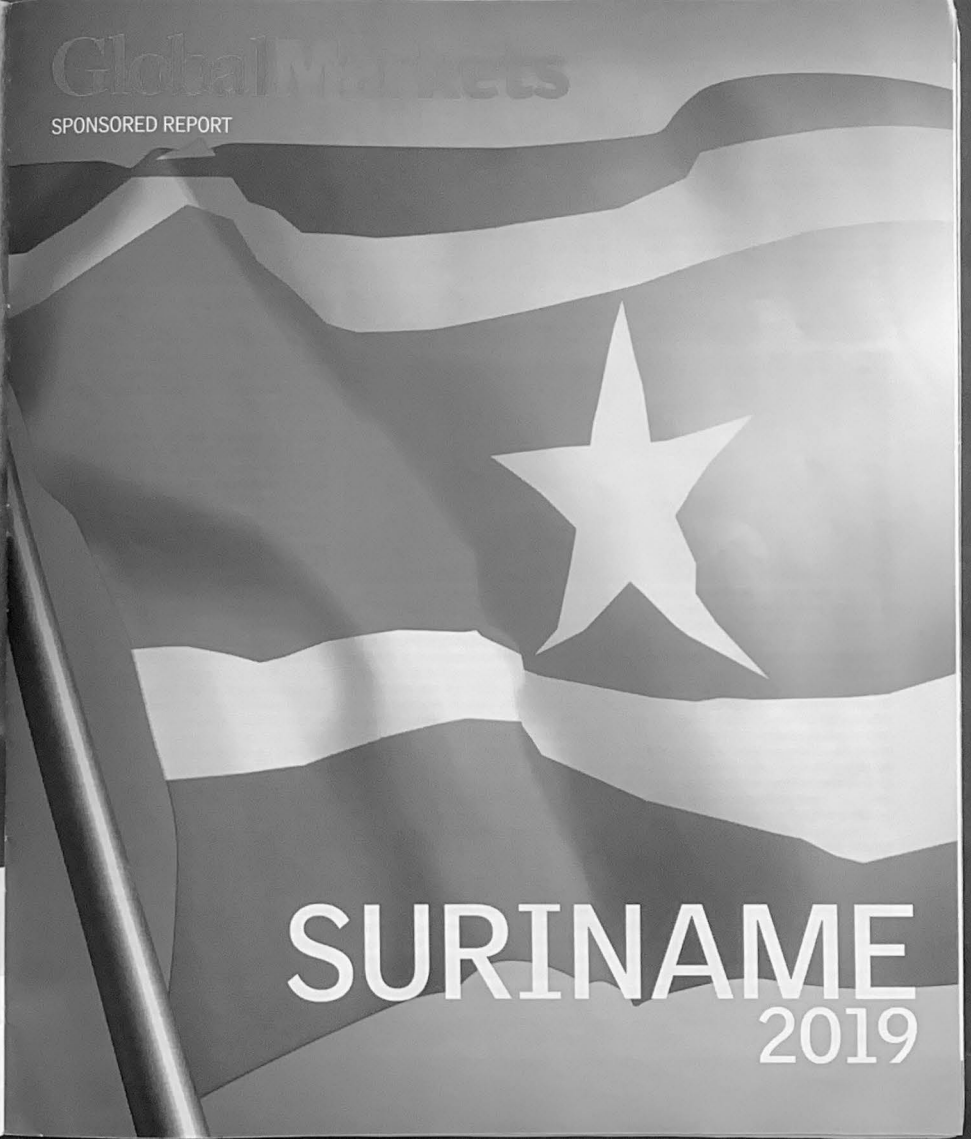
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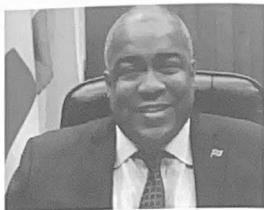
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**SURINAME**  
2019

# Reforms for stability

Suriname's finance minister Gillmore Hoefdraad tells *GlobalMarkets* that reforms are under way to bring structural improvements to the resource-rich economy



Minister of Finance Gillmore Hoefdraad

**What comfort can you provide to bond investors concerned about the upward revision, in April, of the fiscal deficit forecast?**

The deficit has not improved as fast as expected mainly due to the retroactive payments resulting from the 2017 healthcare reform and the retroactive element of wage increases.

These additional payments expire in the coming months and the outlook is positive: we estimate that Newmont will begin to pay substantially higher income tax on the Merian mine during 2020; Iamgold will soon be extracting ore from its Saramacca concession, which should increase its profits and the government's tax revenue; while Newmont is preparing two new mines.

Importantly, the government will acquire the Afokaba dam from [mining company] Alcoa before December 31, 2019. The immediate effect will be that the profits Alcoa has been generating by selling electricity will end up in the hands of the government, helping to gradually reduce the cost of energy subsidies. Subsidies were around 5% of GDP in 2018 and account for around two thirds of the fiscal deficit. We will also implement a value-added tax.

**What other impacts will the Afokaba dam transfer have?**

The transfer is a key and initial element in a broader five-year electricity reform. Under the reform, all generation assets will come under centralised ownership and management, allowing for efficiency gains. A five-year tariff adjustment process will eliminate subsidies at the consumer level, which will also reduce electricity consumption as users adjust to market-orientated prices.

**Will this transfer require additional financing?**

Yes, we will seek financing to purchase the dam and place the electricity reform on a secure financial footing. Given the costs of subsidies and the inherent inefficiencies of the system, this financing will provide a significant return on investment for Suriname.

**What is the status of the VAT reform?**

In collaboration with the IADB and IMF, we are working on VAT reform to be implemented in 2021. The law is almost ready to be presented to Parliament, while the IT system is

in place and being integrated with central Integrated Financial Management Information Systems (IFMIS). The implementation plan foresees that, during 2020, regulations will be issued and stakeholder education meetings will take place. Overall, we will institute a VAT rate, threshold, and exemption levels that will increase net revenue by 2% of GDP.

**Some analysts are worried spending will go over budget in the run-up to elections. How do you plan to control this?**

There are clear differences between 2019 and any previous pre-election year. Our IFMIS allows for faster and more granular expenditure control. The results are clearly visible, as expenditure has not expanded in real terms in 2019 and we plan to keep it that way. Additionally, the 2020 budget recently discussed in Parliament is almost identical in nominal terms to 2019's and has no additional expenditure items.

**There are concerns that the Surinamese dollar may be allowed to depreciate after the 2020 elections. Are these justified?**

Given the history of post-election devaluations, this is understandable. To a certain extent, such pre-election depreciation fears are self-fulfilling: the more people fear a devaluation, the more the exchange rate depreciates in the spot market. Let's be clear that the authorities cannot devalue the currency, as it is already floating. The spot rate is a clear reflection of the foreign exchange rate market. This spot rate is being negatively affected by the usual pre-election jitters and the pernicious effects of the unlawful cash seizure by the Dutch authorities. Both will end soon. Furthermore, international reserves continue to build consistently, and foreign direct investment has a strong present and future.

**What measures are being taken to ensure markets have up to date data about Suriname?**

Our provision of information has improved leaps and bounds in five years and analysts and investors must only browse the internet to obtain the latest data sets. The Central Bank now provides monthly data on monetary and financial developments, while fiscal data are now largely presented on a GFS basis on the Ministry's website. The IMF has certified that

Suriname's data provision is now consistent with the General Data Dissemination Standards. Authorities also hold regular investor presentations and are available for phone calls and on-site visits.

**What does Suriname need to do to make the most of a potential major offshore oil find?**

In 2019, Suriname's Savings and Stability Fund became operational, and we are now defining the exact mechanism of transfer, following the Santiago Principles so it meets world-class standards. Thus Suriname is prepared to properly manage any windfall that would follow a major offshore oil find.

The country is well prepared to absorb higher investments in the extractive industries, with a century-old tradition of working cooperatively and amicably with foreign investors. Our domestic industry and commerce has also extensive experience providing ancillary services to large investors. Finally, the peaceful, diverse, friendly, and well-educated Surinamese society has always welcomed and integrated foreign nationals.

**Are there plans to dredge the river to increase local benefits of any oil discovery?**

Dredging the river is imminent; we signed a project loan agreement in September 2019 to dredge the river and it should begin in the coming months.

**What work is underway to diversify the economy away from a reliance on natural resources and bring greater dynamism to the private sector?**

Diversifying an economy that is highly dependent in extractive industries is a challenge but is an important objective. Our investment promotion agency Investsur is active in attracting investment in agriculture and tourism, while we are working with the World Bank and IADB to improve the competitive environment, specifically in the case of doing business. ●

# Suriname seeks to show off credentials

A well-managed mining sector, falling inflation and increasing reserves continue to underpin Suriname's recovery. However, further robust policy action is still needed to lay a sustainable base for stability and growth

Suriname received a shipment of an extremely valuable commodity, direct from the source, in September. The country is rich in gold, and optimistic about discovering transformational quantities of oil, yet the delivery of US dollars, in cash straight from the US Federal Reserve, has arguably been its most precious acquisition this year.

The Central Bank of Suriname (CBvS) took the unusual step of asking the Fed for a delivery of dollars to combat the impact of the April 2018 seizure of a €19.5m shipment of euro banknotes from Suriname by Dutch authorities.

Suriname says the seizure was illegal, and has filed a complaint with a Dutch court that will be heard in November. Yet the economy is already suffering the effects.

Euros — brought mostly by Dutch visitors and shoppers from French Guyana — have piled up in central bank vaults as the country has been unable to ship them abroad and exchange them for dollars.

Exchange houses known as Cambios, which populate capital Paramaribo's landscape, offer US dollars at 10%-15% above the official rate, and the central bank estimates that scarcity has triggered an average increase in their cash value of 1% a month. Euros, on the other hand, trade well below international market rates.

With cash payments in the dominant gold and fishing sectors made in US dollars, and deposit dollarization around 65%, demand for the US currency is high. Banks, prevented from making transfers to their nostro accounts, have been forced to restrict cash withdrawals of US dollars, diminishing confidence in the banking system.

Authorities hope the move will alleviate some of the severe strains the economy has suffered as a result of the euro seizure.

"It is important to understand that we have



The processing plant at the Merian gold mine

coped with the situation and worked very hard to provide our country with a solution," Robert van Trikt, governor of the central bank since March 2019, tells *GlobalMarkets*.

**Building reserves**

Analysts welcomed the Fed shipment, with Stephen Ogilvie, director at Standard & Poor's, telling *GlobalMarkets* that it "looks to be good news for bondholders, as would be any news that frees up official foreign exchange."

With a general election to come in 2020, Suriname is particularly keen to remove pressure on the exchange rate, the sharp falls in the Surinamese dollar that followed president Desi Bouterse's victories in 2010 and 2015 have left some worried that a similar depreciation is looming for next year. Indeed, a weaker parallel FX has previously indicated a future depreciation.

The question is whether this time things are different. The dollar shortages and consequent distortions are certainly anomalous. Moreover, Suriname's foreign currency reserves are recovering, in contrast to 2014, the

most recent pre-election year.

"As long as Suriname's international reserves keep growing, the FX rate should remain stable," says Tiffany Grosvenor-Drakes, senior manager, strategy and economics at CIBC FirstCaribbean International Bank.

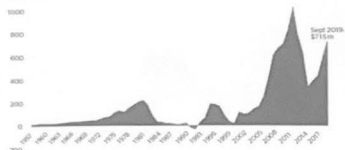
Suriname's \$715m of international reserves, as of September this year, equate to 5.3 months of non-mining imports (the mining sector finances its own imports), and the amount has increased steadily from a low of \$212m in May 2016.

Yet, as Suriname is a leading gold producer with the ability to buy the commodity in local currency, the central bank knows reserves should be higher. Van Trikt is confident that reserves will soon surpass the all-time high of \$1.008bn, reached back in 2012.

His optimism partly emanates from a June 1 measure from the CBvS that obliges commercial banks to hold at least half of their US dollar and all their euro-denominated required reserves at the central bank. The banks' assets are ring-fenced and CBvS has set up a Strategic Investment Committee to manage them.

Van Trikt also highlights an agreement with

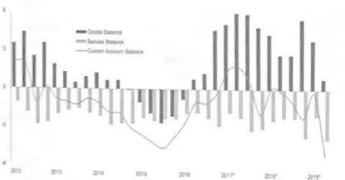
## International reserves — solid growth



Robert van Trikt, governor of Suriname's central bank since March 2019, is particularly proud of the growth in the country's international reserves, which have a history of shrinking in the years before elections. The central bank in July took measures to bring stability to the reserves, including closing commercial banks to hold at least half their US dollar and all their surpluses in international reserves at the central bank. Therefore, van Trikt is targeting continued growth, and believes reserves can soon top the all-time high of \$100Bn recorded in late 2012. As mining revenues should continue to increase, prudent management will make this a real possibility. "International reserves play an important role in building trust in the country, defending the stability of the currency, and how rating agencies view you."

Source: Central Bank of Suriname

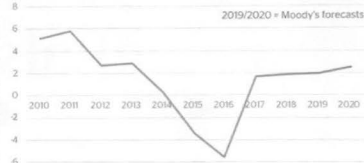
## Current account — imports gain pace



Having briefly returned to surplus in 2017, Suriname's current account has been deteriorating steadily, but it is not overly worrying analysts. Net foreign direct investment, mostly in the mining sector, covered the current account deficit during 2016-2018, according to Fitch. And though FDI could fall as the Saramacca gold mine enters production, exports should correspondingly increase. Growth in imports has been the main driver of the return to a current account deficit, but this could level off soon. Furthermore, the income account includes the transfers of profits from gold mining company Newmont, which is not yet paying income tax in Suriname, due to accelerated depreciation in its contract. When it does 36% of these profits, the income tax rate, will remain in the country

Source: Central Bank of Suriname

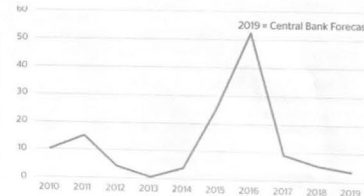
## GDP — a gradual expansion



The good news is that Suriname is growing again. But if commodities caused the economy's last slump, thanks to drops in the oil and gold prices and the end of Alcoa's alumina mining operations, they are the principal driver behind the recovery. Gold production has increased and prospects are looking good at lamipids Saramacca project, which should provide a further lift to the economy. Yet Suriname urgently needs to diversify its economy. Tourism has plenty of potential, though it suffers from a lack of international connections, while the needs of the Caribbean Community (CARICOM) present a good opportunity for Suriname to expand its agricultural exports. An industrial baseline study looking at how local businesses would benefit from an offshore oil discovery made it plain that the domestic private sector has a lot of work to do to become more competitive and productive, which would be a big help in making growth less vulnerable to commodity prices.

Source: Central Bank of Suriname, Moody's

## Inflation



After ballooning to a peak of over 50% in 2016 on the back of a sharp depreciation in the Suriname dollar, inflation in the country has come down steadily and is well into the single digits. Improved monetary policy tools are giving the central bank a better handle on excess liquidity in the system and have allowed the monetary authority to reverse its end of year inflation projections down. As long as international reserves continue to build, and given the promising outlook for foreign direct investment, analysts say the exchange rate should remain stable, keeping inflation under control. However, investors will keep an eye on 2020 elections, with the dollar having previously depreciated in post-election periods.

Source: Central Bank of Suriname

gold exporters to buy gold in local currency, which he believes will provide annual net income of \$120m-\$140m on international reserves.

"Five years ago, the possibility of a default on foreign currency obligations was the biggest concern," says Ogilvie. "The increase in international reserves does provide comfort, especially in the year before an election."

"This also reduces the probability of a spike in the exchange rate, though we will look out for any movement in the parallel rate, as this weakened substantially before the last major devaluation."

S&P's expectation is that, as reserves build, "the central bank resists the temptation to over-manage the currency," says Ogilvie.

Inflation has also dropped sharply from the commodity crunch peak of 79% in 2016, down to 5.4% by December 2018 and 4% as of August 2019. This has occurred in the context of recovering GDP growth. After a deep recession, the economy grew 1.8% in 2017 before expanding by an estimated 2.0% in 2018.

## Fiscal challenge

Given the dire dollar shortage, it seems unusual that some holders of Suriname's sovereign bonds were unaware of the Fed deal when *GlobalMarkets* spoke to them in the week after the first shipment — despite announcements, in English, on the websites of both the CBvS and finance minister Gillmore Hoefdraad.

If historical patterns such as pre-election policy are important concerns for bondholders, it may be because several say that updated numbers are trickier to find.

Suriname has taken steps to improve data provision over the past decade, and in 2018 implemented the IMF's General Data Dissemination System (e-GDDS).

Yet with only one \$500m international bond, it is only a small part of emerging market indices, so experts on the country are at a premium. Limited flight connections can also make it a logistical challenge to carry out field research.

The resultant secondary market illiquidity and perceived opacity could have prompted some bond investors to turn away from the country completely when it gave them a fiscal shock. In April 2018, the government revised its historic deficit numbers for 2018 and projections for 2019 are much higher, while also revealing the accumulation of previously unknown budget arrears.

As Moody's reported, a fiscal deficit on a cash basis of 9.9% of GDP for 2018 was wider than its expected 7.2%, and more than the 8.7% reported in 2017.

The sovereign's 9.25% 2026s plunged from a secondary market price of around 104 to the mid 90s in the following weeks, and have continued to drift lower. They ended September at around 89 cents on the dollar, yielding 11.55%.

"The fiscal bad news "explains the negative trajectory by the 2026 bonds year-to-date", says Petar Atanasov, co-head of sovereign research at Gramercy.

"As obtaining timely and reliable data about Suriname is challenging, and given that 2020 is an election year, it is hard to get comfortable with the credit in the short term," he says.

Other analysts echo Atanasov's election concerns. Grosvenor-Drakes at CIBC FirstCaribbean says she does "not expect 2019's deficit to improve on last year" due to increased spending, "a pattern observed in the run-up to the last elections."

S&P's Ogilvie, says that while the government does "a lot right", particularly in its use of the mining sector, "the worry is how it spends money", also referencing the pre-2015 election spending.

In late 2018, Moody's said that higher public sector salaries and capital spending "already point to some increased spending leading up to elections", though in February the rating agency removed its negative outlook on Suriname and then in August said that it believes the fiscal deficit will narrow to 6.6% in 2019 and 5.2% in 2020.

Grosvenor-Drakes at CIBC notes that capital spending in 2015 to 13%-14%, according to the government, "should contribute to greater productive capacity."

What have been termed as arrears were mostly the result of a 2017 healthcare reform and pension changes that required big retroactive payments. These payments, which cost more than 3.5% of GDP in 2018, will continue into next year, and the government still predicts a fiscal deficit of 7.2% for 2019.

Yet the finance ministry believes the outlook is positive for Suriname's fiscal situation, in part because Newmont, which operates the Merian gold mine, has so far only paid royalties on the investment because its contract allows accelerated capital depreciation.

Though regulation prevents the company from informing the government exactly when this agreement will end, the finance ministry has told *GlobalMarkets* that it projects that Newmont will be paying income taxes by the end of 2020. The ministry believes this alone could bring \$80m-\$120m into government coffers, around 2.3%-3.5% of 2018 GDP.

Furthermore, when lamgold begins to extract ore at its Saramacca mine, possibly as ear-

ly as this year, tax revenues could also benefit.

## Strong potential

However, income is not necessarily investors' main concern: for while revenues increased by 17% year-on-year in 2018, according to Moody's, the big concern was that this was overshadowed by the 20.5% increase in spending.

Suriname's government has taken measures to ensure more stability spending in future. The Savings and Stability Fund began operations in January and will receive a portion of mining windfalls above a certain threshold, creating a buffer to a downturn in commodity prices.

Meanwhile, the Afobaka dam, built by bauxite miner Alcoa during its century-long operation in Suriname, will be transferred to the government on December 31.

Until now, Alcoa has sold the electricity produced by the dam to the government. As of 2020, the government will be able to pocket those profits, allowing it to begin much-needed subsidy reductions (see *interview with finance minister Gillmore Hoefdraad*). Broader electricity reform is also in the works.

In addition, the forthcoming VAT law, scheduled for 2021, will aim to bring a net revenue benefit of 2.5%.

While elections can prompt market uncertainty, Suriname's outlook should remain on track, regardless of the result.

"Whichever party gains power at the next election, we would expect them to follow a similar path of economic policy," says Steven MacAndrew, director of the Suriname Trade and Industry Association. "There is a need to reduce Suriname's debt, curb the budget deficit, and introduce measures — such as VAT — to ensure a positive outlook."

Given the sound management of its rich commodity sector, the recovery from the triple commodity shock should continue, and nobody needs convincing of Suriname's potential.

"After the election, the promised implementation of VAT and expenditure restraint, particularly on subsidies, would be crucial to setting deficits on a downward path," says Grosvenor-Drakes.

Yet, for all this to be sustainable, the country must take the measures that it has done a good job of identifying as needed, and turn promises into action in the form of pre-election control and post-election policies.

"It is clear that the economy has good growth potential," says Atanasov at Gramercy. "If the policy outlook turns positive after the elections, Suriname could become an interesting story." ■



# A mandate for modernisation

Suriname's new central bank governor has had an immediate impact, ringing the changes and setting out his vision for 2030

Robert van Trikt took the reigns at the Centrale Bank van Suriname (CBVS) in March 2019, with far-reaching ambitions for the institution. "Suriname is the 17th richest country in the world in natural resources," van Trikt tells *GlobalMarkets*. "The central bank must ask itself what its role should be in ensuring the country fulfils its potential and is up to speed with international markets."

"I want to see Suriname lay out a vision for where it should be in 2030."

International hot topics such as financial inclusion and financial technology immediately climbed the priority list. The bank moved to get up to speed in areas of monetary policy. The National Risk Assessment was launched to examine money laundering and terrorism financing risks ahead of Suriname's mutual evaluation assessment by the Caribbean Financial Action Task Force in 2020.

Meanwhile, the governor addressed urgent concerns such as excess liquidity in the banking system and the crippling lack of US dollar notes due to the seizure of euros by Dutch authorities back in April 2018 (see macroeconomic overview).

One executive in the private sector comments that the central bank has done "three years of work in six months".

Maya Parboe, chief executive of OroX, a fintech start-up, highlights the central bank has implemented "several measures" to improve the financial and monetary policy in recent months.

These include asking banks to transfer part of their required FX reserves, previously held abroad, to the central bank, setting up a market-based monetary policy framework directed at conducting open market operations, and amending financial legislation.

"This should contribute to a more modern and sophisticated management of the economy," says Parboe.

First of all, the bank had to put certain fundamentals straight. In his first press conference, van Trikt dismissed local speculation that he would help the government use additional central banking financing to boost

pre-election support.

"With regard to the financing of the state, I guarantee that I will not act above the legally permitted 10% standard," said van Trikt at the time. "The development of domestic financial markets is urgently required so that the state can finance part of its budget deficit in a responsible manner."

As of August, Moody's said that "a larger central bank balance sheet" was not its base case, highlighting it would be a credit-negative should that situation change.

## Monetary moves

In recent months, the CBVS has modernised its monetary policy framework in conformity with



Robert van Trikt, governor of the central bank

## BANKING ON PRODUCTIVITY

When Suriname posted a 17% increase in government revenues in 2018, a curious point about the figure was that it was driven largely by a 33% increase in mining revenues.

Non-mining revenues increased by just 10%, which Moody's highlighted as below normal GDP growth and a slower pace than the 23% growth recorded in 2017.

This deceleration in non-mining revenue, Moody's believes, points to "slowing economic activity," and anecdotal evidence from the private sector backs this up.

"The operating environment remains difficult for the private sector in Suriname, and the government remains the main driver of economic activity," says Steven MacAndrew, director of the Suriname Trade and Industry Association. "The SME community was badly hit by the economic downturn [that began in 2015], and small businesses suffered when the government had financial issues."

MacAndrew highlights the Association's desire to see progress in sustainable development, far com-

petition, and the ICT sector as well as continuing to advocate for a greater diversification of the economy — particularly in agriculture, tourism and manufacturing.

"Though the mining sector is a vital revenue earner for the government, we would like to see more focus on other sectors," says MacAndrew. "Suriname has huge opportunities."

As it looks to encourage this, the Association has made better dialogue with authorities a priority and MacAndrew notes that "it is a positive development that we have been able to hold several meetings with the new governor of the central bank since he took office."

These more frequent discussions speak to van Trikt's vision for a broader role for CBVS. Authorities are well aware of the need to diversify the economy to reduce the vulnerability to commodity shocks, while the IMF has said that the lack of a non-mineral engine of growth "could further erode potential growth" but finding this engine is not an automatic process.

The new governor believes the central bank can play what he sees as an "incubator" role as part of the task of "promoting the balanced socioeconomic development of Suriname."

"The central bank cannot forget to be the adviser on how to best use all our resources and bring Suriname forward," says van Trikt.

In part, this involves the central bank taking seriously its role as the institutional and financial capacity of the economy, and working to improve the productive cycle.

"Yet perhaps the most ambitious part of the plan is for a new sovereign wealth fund — distinct from the already operating Savings and Stability Fund Suriname."

Separate to this intergenerational, rainy-day fund, the central bank envisages a further investment vehicle that will deploy assets for the benefit of government and society.

"This will be where we can deploy assets to increase production, exports, and growth in the style of Norway, Belgium or the Emirates," says van Trikt.



recommendations from the International Monetary Fund. After visiting Suriname in October 2018, the IMF highlighted that the monetary framework "lacks standard instruments" and that the bank "does not have in place standing facilities that are common to most central banks".

After officially moving to a floating FX rate in May 2016, CBVS announced a monetary targeting regime, which will initially be used internally before switching to formally announcing operational targets to the public.

It continued to smooth the exchange rate via interventions and manage liquidity through ad hoc instruments such as unwinding FX swaps and occasional deposit facilities to banks.

Recognising the necessity for more indirect instruments to influence the amount of money in circulation under a floating FX regime, in July CBVS introduced deposit certificates and gold certificates, while in September it introduced its open market operations with an intraday liquidity facility, short-term liquidity facility, and deposit facility. These were facilities recommended by the IMF in its 2018 article IV report.

Of course, more sophisticated policies require improved visibility on the liquidity needs of the system, and the central bank has also worked to update its monetary monitoring and forecasting system.

Van Trikt credits Suriname's decreasing inflation levels in part to these new tools for managing excess liquidity. As of September, he was confident that inflation would end 2019 at about 3.6% — compared to an initial estimate of 4.3%.

## Tackling risks

If the list of measures implemented by the central bank is extensive, the new governor also wants to send a message about the way things will be done in Suriname.

Take the cash shipment of US dollars from the US Federal Reserve (see *macroeconomic overview*). Not only did this move address a severe imbalance in the country, but it also showed the standards at which Suriname could operate.

"The on-boarding with the US Fed was an in-depth, tough process," says van Trikt. "Passing this level of due diligence is worthy of international prestige."

Completing the process is a promising sign for Suriname's National Risk Assessment, for which the central bank received the full commitment of the government in van Trikt's first month in office.

A project management team including employees from the Ministry of Justice and Police, Ministry of Finance and CBVS was set up in May, and it was launched — with technical support from the Inter-American Development Bank — in July.

Complying to anti-money laundering and terrorism finance standards is an urgent matter — especially in the Caribbean, where de-risking of correspondent banking relationships by foreign institutions is becoming a serious problem.

"We have not been affected by derisking to the extent that certain other Caribbean nations have been, but if we fall the mutual evaluation with the Caribbean Financial Ac-

## TOWARDS A DIGITAL CAPITAL MARKET

With a market capitalisation of just 6% of GDP the Suriname Stock Exchange remains small — despite a Capital Market Act passed in 2014 that aimed to set up a new exchange.

But private investors have taken an interest in the plans. In April this year, OroX, a Suriname-headquartered fintech start-up in Latin America and the Caribbean signed an agreement with the Association for Securities Trading in Suriname (AVES) for OroX to operate the exchange.

Maya Parboe, CEO of OroX, told *GlobalMarkets* that Suriname needs a "modern, transparent, digital capital market compliant to international standards".

She feels there is an opportunity for at least 50 further companies large enough to be publicly traded in the next 18 months, today there are 11 companies and one State sole bond listed on the exchange.

"Suriname has very high national savings to GDP and private credit to GDP ratios, which are perfect conditions for the creation and growth of a capital market," says Parboe. "Suriname also has large pension funds that can only invest up to 20% abroad, it is vital to provide them with better investment options."

The company also wants to create a modern government bond market that would allow commo-

"Suriname is the 17th richest country in the world in natural resources. The central bank must ask itself what its role should be in ensuring the country fulfils its potential and is up to speed with international markets." — Robert van Trikt

nic Task Force the consequences could be catastrophic," says Steven MacAndrew, director of the Suriname Trade and Industry Association.

Conducting a National Risk Assessment will be "critical" in mitigating money laundering and terrorism financing risks and "effectively communicating the government's efforts to foreign correspondent banks", according to the IMF.

In an effort to increase standards, CBVS has also this year prioritised corporate and social responsibility, set up a compliance department, and held more than 50 meetings with players in the economy to discuss how and why they should help Suriname comply with the task force's requirements.

Furthermore, CBVS is looking to ensure stability of the financial sector with a draft Bank Resolution Act and a contingency plan for systemic risk — both expected by the end of 2019. The National Risk Assessment also ties in closely with the central bank's targets to improve financial inclusion and grow the cashless economy. ●

cial banks, pension funds and the general populace to participate.

"This would also give the central bank a more effective and liquid market to perform open market operations," says Parboe.

"The central bank has set up an innovation hub to develop a fintech ecosystem and Parboe believes conditions are ideal for Suriname to create a modern exchange."

"The silver lining of being so far behind when it comes to financial technology is that there is a lot of room for innovation," she says. "We can effectively start with a blank slate and begin with the latest technologies."

# Drilling deep

As drilling advances off the coast of Suriname, the CEO of the state-owned oil company Staatsolie is calling for the country to prepare itself for a big oil discovery

Guyana — Suriname's neighbour to the west — had no oil industry until recently. However, after 14 deep-water offshore oil discoveries from ExxonMobil alone since 2015, it now has more oil reserves per capita than any other country. Interest has followed on the Surinamese side of the basin, as a host of international oil companies — including Exxon, Hess, Chevron, Apache, Tullow and Kosmos — have begun exploration activities.

As of September this year, all the successful drills have been on the Guyanese side of the basin. Yet Rudolf Elias, chief executive of Staatsolie, Suriname's state-owned oil company, is not deterred.

"It is almost certain that we will have a find between now and the end of 2020," says Elias. "We don't know if it will be next month or the end of next year."

Tom Fauria, vice president and country manager for Kosmos Energy Suriname, agrees there is reason for optimism. Though Guyana might currently overshadow Suriname, Fauria says that "remarkable discoveries" there validate this optimism.

"We know that the petroleum system is working, since the heavy oil found onshore in Suriname was generated far offshore and migrated to the coast," Fauria tells *GlobalMarkets*.

It is still early days for Surinamese deep-water exploration, and a few unsuccessful wells "are no reason to be overly negative" about prospects, says Fauria. Kosmos's position is one of cautious optimism.

"In this business there are no guarantees of success, and the risk in this play is higher because the traps are stratigraphic rather than structural," he adds.

No matter, Elias has been emphatic in his message to the country: the government, businesses and people need to prepare immediately for a big oil find. Similarly to Guyana, such a find in a country of fewer than 1m people will inevitably have a huge impact.

"How we deal with an oil find needs to be a

broader national discussion held before we have this find," says Elias.

#### Bracing for business

Suriname's history with mining may serve it well in the case of a big offshore oil find. The government has already set up the Savings and Stability Fund Suriname to ensure it is saving a portion of gold revenues, and this should protect against the risk of splurging any oil windfalls.

Stephen Ogilvie, director at Standard & Poor's, says that the government is "sophisticated in dealing with mining companies" and has a "robust royalty regime".

Even an immediate oil find would not bring in royalties for several years, however, and the country must first face the challenge of ensuring that the investment that would follow a discovery would benefit the economy.

Staatsolie and the IOCs say they are committed to a strategy that would ensure any find brings "high impact local content development", and they commissioned private development company DAI to carry out an industrial baseline study looking at the impact of a hypothetical find.

DAI found that the maximum value of business for which local firms would be able to compete would be just 6.3% of the total investment. In reality, given the low competitiveness of the domestic private sector, DAI forecast that this number would be just 1.6%.

"We have a few companies that have worked for the likes of [bauxite miner] Alcoa and [gold miner] Newmont and they understand the way of working and standards required," says Elias. "But for now there are only a few."

One change that would sharply increase the opportunity pool for Suriname's businesses would be if the offshore developers could set up an onshore base in the country. So far, the shore base for exploration activities in Surinamese seas has been Trinidad, as Paramaribo's harbour is inaccessible to large ships.

"It is not ideal to have to go to Trinidad, and



Rudolf Elias, chief executive of Staatsolie

we are hoping Suriname will dredge the river to enable large supply vessels to work from a local base," says Fauria.

Dredging the river, which would enable developers to set up a shore base in Suriname, is imminent, finance minister Gillmore Hoofdgraaf told *GlobalMarkets*, and the government signed a project loan agreement in September 2019 to finance this. The benefits would be substantial. DAI found that — with an onshore base — the maximum local content value would increase from 6.3% to 14.3% of expenditure in case of a discovery, while the forecast local content would nearly quadruple to 6.3% as Surinamese firms would be able to participate in areas like civil works, facilities management and logistics.

Work is also underway to improve Suriname's workforce.

"Suriname has a large enough workforce to service the offshore oil industry, but needs to update its technical schools because the employment that will be generated will require specific vocational skills," says Fauria. "The oil industry is very much engaged in this opportunity and is helping to fund a multi-year programme to support and enhance the quality of technical education in the country."

#### Staatsolie set to hit markets

As Staatsolie looks to become a joint venture partner in any oil find, the company is laying down bases to raise financing via the capital markets.

An international bond issue, likely to be a secured deal to ensure a better rating than the sovereign, of \$300m, would be subject to market conditions. Proceeds would be used to pay off part of a bank loan, while Elias feels the issue would also help to put Staatsolie on the radar of the international investment community.

"We are working hard to make the company ready to IPO in case of an oil find," he says. ●

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## Bank talks up commodity hedging as risks grow

The World Bank is hoping to step up its activity as an intermediary in commodity hedging transactions, providing credit enhancements for its clients in their arrangements with insurers to protect them from external shocks

By Lewis McLellan

World Bank clients are looking to the development bank to help them cope with likely falls or volatile moves in commodity prices as demand and production shrink thanks to trade wars between the US and China.

Jingdong Hua, treasurer of the World Bank, said the bank was seeing increased interest from client countries on how to use commodity hedges to protect their budgets from commodity volatility. "It's positive for our clients to have predictable budgets, so they can progress with expenditures to achieve development goals," he said. "Slower growth implies a reduced demand for commodities and a decline in their price, but much depends on the Chinese economy."

This trend is likely to dispropor-

tionally affect emerging market countries, since commodity exports form a large part of many developing economies. The IMF forecasts that global economic growth will recover to 3.4% in 2020, but Neil Mackinnon, global macro strategist at VTB Capital, believed this might be optimistic, saying "Global economic headwinds, which seem to be getting stronger, could easily derail the IMF's forecasts."

### OFFERING COMFORT

The bank offers technical assistance and advice on such transactions but, more importantly, enables its clients to obtain better terms than they could obtain on their own through a form of blended finance. "If an insurance company or hedging solutions provider is writing a policy directly to a country with a lower credit

rating, the premium will be higher and there are other potential issues to price in," said Hua. "With our triple A rating, we can step in between and offer the provider better comfort."

One potential beneficiary is Rwanda, which imports 100% of its oil so when global oil price spikes, it has a huge effect on the budget and can prevent infrastructure spending. "With a commodity hedge, we can use the capital markets to protect infrastructure development projects and preserve budget discipline," said Hua.

Since the hedge can work in both directions, the product can also be used to protect countries from price collapses in the commodities they export. Mongolia, for example, is reliant on exports of copper and coal. During the last copper price collapse, Mongolia was forced to enter an IMF programme.



Hua: has seen huge interest from countries

The tool can be used to protect clients against eventualities other than commodity price fluctuations, including weather. For countries with hydroelectric power generation, a lack of rainfall can cause budget pressures because the country will have to buy diesel to make up the shortfall in power generation.

The World Bank first participated in such a transaction in 2018, acting as an intermediary for Uruguay, which purchased an insurance hedge against a lack of rainfall.

## EU reform

Continued from page 1

Much of the political focus is likely to be on creating a Capital Markets Union in the EU. In the last 16 months, policymakers have penned 13 pieces of legislation on it.

"[Brexit] is why Capital Markets Union is so important," said Jörg Kukies, state secretary for financial market policy and European policy at the German Ministry of Finance. "We are losing what is the biggest capital market in the European Union by miles. It is not a close second, London is by far the most important market for financing a lot of the big European corporates."

"On the one side we have to make sure that relationship remains strong, but on the other side, the EU now has to improve its own capital markets."

Paul Sheard, senior fellow at Harvard Kennedy School, said: "This is a giant moment of truth for the EU. On the one hand, you have the UK, its second largest economy, set to leave the club. On the other, there is all of this leftover homework from the last 10 years and it all needs to be done."

### EXPERT REPORT

Earlier this month, an EU expert group published a paper detailing priorities for reforming capital markets. The group had been set up at the behest of the German, French and Dutch finance ministers, with backing from seven other member states.

"There was a danger of losing momentum, especially with Brexit," said Panagiotis Asimakopoulos, a senior research analyst at think-tank New Financial. "But they are clearly now starting to realise in the EU 27 just how important it is to build stronger capital markets."

European companies have traditionally relied on banks for financing. But in their October report, the EU expert group recommended that the EU massively develop equity markets.

Ignazio Angeloni, until recently a supervisory board member of the European Central Bank, said: "There is a potential to develop SME financing more, if we have a complete capital market alongside banks," he told *GlobalMarkets*. "Banks are now reluctant to lend to SMEs, but if you can bypass them, probably I think that would help remove some of the financing constraints, especially if you do it on a cross-border basis."

Wolfgang Köhler, the board member at DZ Bank responsible for investment banking, made a different emphasis: "A lot of the SME backbone are family companies and privately held," he said. "They are not willing or able to tap capital markets — we need to find other vehicles, like investment funds, SPVs, structured products. Not all financing failed in the financial crisis — there was not a credit crunch in Europe. Loans and savings banks made sure SMEs kept going."

# THE final word

## Walking the purpose talk

By Mariana Mazzucato

In August 2019 corporate bosses including Jeff Bezos, Jamie Dimon and Tim Cook used their Business Roundtable platform to declare that the purpose of business had to change in ways that moved attention away from shareholder value to a more purposeful approach that improved our society. This followed Larry Fink who, in January 2018, wrote a letter to 500 CEOs asking them to rethink their sense of purpose. "To prosper over time," he wrote, "every company must not only deliver financial performance, but also show how it makes a positive contribution to society."

Both statements argue that companies' excessive short-term focus is hurting their ability to create more value in the long run. Some prominent politicians — including US Senator Elizabeth Warren — are advocating a more inclusive and less predatory form of capitalism.

But despite these calls, little seems to be changing. The financial sector invests mostly in other parts of finance, insurance, and real estate. Companies also are spending more on share buybacks and dividends than on human capital, machinery, and research and development. And the buyback mania is getting worse. Many businesses talk soothingly about corporate social responsibility, impact, and social purpose, but very few put these at the core of their operations.

Real change means putting purpose at the centre of how value is defined by firms, governments, and economic theory which informs policymakers. As I argue in my new book *The Value of Everything*, Adam Smith and Karl Marx made the objective conditions of production — the division of labour, machinery, and capital-labour relations — central to their understanding of value. In neoclassical economics, however, value is merely a function of exchange. Only what has a price is valuable, and "collective" effort is omitted, because only individual decisions matter.

Unsurprisingly, public officials, long accused of "crowding out" business, have internalised the belief that they should do no more than fix market failures. Yet the public organisations that put a man on the moon and invented the Internet did more than just correct market failures. They had ambition, a purpose, and a mission.

To get real about purpose, we need to recognise that value is created collectively and build more symbiotic partnerships between public and private institutions and civil society. In doing so, we must address three questions: what value to create, how to evaluate the impact, and how to share the rewards.

Paul Polman, the departing CEO of Unilever, has rightly tried to focus companies on creating value in line with substantial targets, especially the United Nations' 17 Sustainable Development Goals. Of course, neither the public nor



the private sector alone can meet all 169 specific targets underpinning the SDGs. But governments can use the goals to create initiatives that require investment from many organisations.

### PICKING THE WILLING

To do so, companies evaluating their social impact should ditch fuzzy objectives and focus on concrete steps to help solve problems. Financial institutions would no longer evaluate their loans on the basis of categories of firms or countries, but rather in terms of activities that help fulfil specific missions — such as

removing plastic from the ocean or creating more sustainable cities. Likewise, governments should give fewer handouts to companies and instead rely more on procurement and prize schemes to nurture corporate innovations aimed at achieving the SDGs. In other words, there should be less picking winners and more picking the willing.

Finally, a truly stakeholder-driven model means sharing not only risks but also rewards. Business has benefitted enormously from public investment not only in education, research, and basic infrastructure, but also in technologies like those powering today's smartphones. Governments could, therefore, retain more of the upside returns to cover the downside losses that risk-taking involves. In my 2013 book *The Entrepreneurial State*, I argued that this could be done both via equity stakes in companies that the government supports. There could be conditions on reinvestment back into production for those companies that have received public benefits. Bell Labs was formed in a time when there was pressure on monopolies like AT&T to reinvest their monopoly profits. That courage has been lost.

For the financial sector this means finding ways to steer finance in more productive ways, such as the EIB's Clean Oceans Initiative, as well as building new types of financial institutions — including public banks — that can not only steer investments towards societal goals but also share the rewards.

In sum, a more purposeful capitalism requires more than just letters, speeches, and goodwill gestures. Business, government, and civil society must together frame the problems to be tackled, invest together, and share together — otherwise the purpose talk will remain just that — talk.

Mariana Mazzucato (PhD) is Professor in the Economics of Innovation & Public Value and the Founding Director of the UCL Institute for Innovation & Public Purpose (IIPP). She is the author of *The Entrepreneurial State: debunking public vs. private sector myths*, and *The Value of Everything: Making and Taking in the Global Economy*.


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