

A Summary Economic Outlook of the Black Sea Region¹: The EIB Contribution

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First of all I would like to express my gratitude for your invitation. Thessaloniki is my home town and I always felt that the countries that around this table today were my natural neighborhood!

I was asked to speak briefly, on behalf of the European Investment Bank, on the current economic situation and outlook of the Black Sea Region. This is a challenging task not only because the Black Sea region encompasses a collection of very heterogeneous economies but also because we are in the middle of an acute economic and financial crisis which add a large degree of uncertainty to any forecasts.

The Black Sea region is an interesting mixture of one or two developed, services-based economies, a number of countries which rely mostly on commodity exports as well as some others which are still trying to define their development model.² Accordingly, income per capita levels vary widely across the region, ranging from USD 1,800 in Moldova, a lower-middle income country, to USD 32,000 in Greece, a high-income country.

In recent years, economic developments in the region have been broadly favorable. Real GDP growth averaged³ 8.7 percent during 2004-2007 – ranging from 4 percent in Greece to over 22 percent in Azerbaijan – before slowing to 5.4 percent on average in 2008. Economic activity was supported by a favorable global environment, booming commodity prices (in commodity exporters) and surging capital inflows, which together with a rapid credit expansion fueled consumption and investment. At the same time, however, internal and external imbalances widened sharply, and signs of overheating emerged widely across the region, with the exception of Albania, Greece and to a lesser extent Turkey. External current account deficits increased on average from 4.3 percent of GDP in 2004 to 8.3 percent of GDP in 2008 (or to 12.6 percent of GDP excluding Azerbaijan) and were largely financed by borrowing. Fiscal imbalances also worsened in most countries, and inflation reached double digits in many of them. Consequently, the region became quite vulnerable to exogenous shocks and has been hit hard by the global financial and economic turmoil.

The global crisis has impacted on the region's economies through a sharp reduction in access to external finance, as well as by slumping external demand. Furthermore, commodity exporters have also suffered from the related fall in commodity prices. In particular, due to their heavy reliance on all

¹ Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Turkey, Ukraine.

² Commodity exporting countries in the region are Russia and Azerbaijan (oil and gas), Ukraine (steel), Armenia (copper), Georgia (copper, ferro alloys).

³ Unweighted average

kinds of capital inflows (funding from Western banks, remittances, portfolio and foreign direct investment) some of the countries in the region – notably Ukraine and to a lesser extent Russia – are among the hardest hit by the financial crisis in all of the emerging market world. Stock markets have plunged and sovereign and corporate bond spreads have widened significantly, most currencies have undergone significant depreciation and the banking sectors have come under stress as parent banks experienced liquidity tightness.⁴ Moreover, in countries with relatively more developed financial sectors, except for Greece, fast credit growth, together with reckless lending in some countries, has significantly increased credit risk in the banking sector, while banks have not build up sufficient reserves to cover future loan losses. Russia and Ukraine have already felt the consequences, with the governments recapitalizing banks.⁵ With capital inflows/external financing drying up significantly, several countries have received or are likely to receive IMF support to sustain their balance of payments.⁶

Consequently, the region's real GDP is now forecast to contract by almost 3 percent this year, followed by a small recovery in 2010. Unemployment has already increased in most of the countries and this trend is expected to continue in the near term. In line with weaker economic activity, inflation rates are likely to decrease in most countries – from an average of 11.8 percent in 2008 to 5.9 percent this year, but are expected to stay elevated in countries experiencing further currency pressures. Similarly, current account positions are expected to improve broadly across the region, except for Russia and Azerbaijan, whose current account surpluses will substantially shrink mostly due to oil and gas market developments.

In conclusion, the outlook remains highly uncertain and risks are on the downside, closely linked to the global economy. A continued deterioration in world growth (particularly in the region's export markets) or another drop in commodity prices would further reduce growth in the region. Similarly, renewed stress in global financial markets could further worsen external financial constraints and make it impossible for many countries in the region to roll over large amounts of short-term debt.

The European Investment Bank, like most of the other IFIs working in this region are currently stepping up their efforts to assist the economies of the Black Sea region to mitigate the effects of the crisis. The EIB is mandated to operate in all 11 BSTDB Member countries and is currently active in 8 of these: Russia, Ukraine, Moldova, Romania, Bulgaria, Albania, Greece and Turkey. The total amount of financing provided by EIB in the Black Sea Trade and Development Bank Member countries in the last 5 years exceeded 19 billion Euros, with 5.6 billion Euros made available in 2008.

⁴ For example, during August 2007 and November 2008, equity prices dropped by 77 percent in Bulgaria, 71 percent in Romania, 65 percent in Russia, 51 percent in Turkey, and 74 percent in Ukraine. During the same period sovereign spreads increased by 355 bps in Bulgaria, 823 bps in Romania, 662 bps in Russia, 392 bps in Turkey, and 2000 bps in Ukraine.

⁵ In Ukraine, 26 banks or 80 percent of total banking sector's assets have been nationalized.

⁶ Armenia, Romania, Ukraine, Turkey (had a pre-crisis Stand-by Arrangement, but is negotiating a new one), Moldova (Government indicated it would likely turn to the IMF), Georgia (received a Stand-by Arrangement due to the war with Russia).

Allow me now to briefly run through the key developments on EIB's side in the main countries of common operations with the Black Sea Trade and Development Bank:

In the Eastern Neighbourhood and Partner Countries of Russia, Ukraine, Moldova and the Southern Caucasus republics, the EIB financing is carried out on the basis of an EU Council decision on our external mandates, with a ceiling of operations currently set at 3.7 billion Euro for the period 2007-2013. In 2009, we will continue to develop a portfolio largely based on infrastructure investments – including water, wastewater, energy and transport – but we will also look into the possibility of meeting the EU Council request to broaden our areas of intervention to SMEs. This development would be of particular importance to EIB, allowing us to leverage our expertise and longstanding experience in the European Union, where our Bank has modernised and simplified its products in favour of SMEs and has significantly stepped up financing volumes following the financial crisis (+50%, up to 15 Bn Euros per year for EU countries alone).

In Turkey, where the European Investment Bank has been active for more than 40 years, the EIB has strongly reinforced its action following the country's inclusion amongst the list of Accession Countries. In 2008, we have financed an all-time record total of 2.7 billion Euros in new projects in Turkey alone, and opened two offices in the country (Ankara and Istanbul). In very close collaboration with the European Commission, we will keep on implementing a three pillar strategy based on i) co-operation with the public sector – particularly on infrastructure, environment, communication and education, ii) support for SMEs and iii) support to the private corporate sector – primarily for energy, communication and industrial projects. Annual financing volumes should remain above 2 Bn Euros per year, with a particular effort in 2009 in order to help counteract the effects of the crisis.

Closing my intervention I would like to highlight that public financing institutions such as the Black Sea Trade and Development Bank and the EIB have a particular and unique role to play in the current context and I see the IFI cooperation at the core of the crisis response actions. Working together will increase our chances of adequately addressing some of the challenges that many countries of operations are facing.

Thank you very much!