2003 annual report

Black Sea Trade & Development Bank

5 years of operation

2003
annual report

Black Sea Trade & Development Bank

Annual Report 2003

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Board of Governors

As of 31 December 2003

Republic of Albania	Governor: Ms. Adriana Berberi, *Deputy Minister of Finance*
Republic of Armenia	Governor: Mr. Vardan Khachatryan, *Minister of Finance and Economy* Alternate Governor: Mr. David Avetissian, *Deputy Minister of Finance and Economy*
Republic of Azerbaijan	Governor: Mr. Farhad Aliyev, *Minister of Economic Development* Alternate Governor: Mr. Avaz Alekperov, *Minister of Finance*
Republic of Bulgaria	Governor: Mr. Ivan Iskrov, *Governor of the Bulgarian National Bank* Alternate Governor: Mr. Krassimir Katev, *Chairman of Prime Capital Management Co.*
Georgia	Governor: Mr. Merab Kakulia, Vice President, National Bank of Georgia Alternate Governor: Mr. David Keresselidze, *Director, International Economic Relations Department, Ministry of Foreign Affairs*
Hellenic Republic	Governor: Mr. Georgios Zanias, *Secretary General, Ministry of Economy and Finance* Alternate Governor: Mr. Giannis Papanikolaou, *Director General, ICBSS*
Republic of Moldova	Governor: Ms. Mariana Durlesteanu, *First Deputy Minister of Finance* Alternate Governor: Ms. Tatiana Lapicus, *Head, Economic and International Relations Department, State Chancellery*
Romania	Governor: Mr. Mihai Nicolae Tanasescu, *Minister of Public Finance* Alternate Governor: Mr. Cristian Diaconescu, *Secretary of State, Ministry of Foreign Affairs*
Russian Federation	Governor: Mr. Ivan S. Materov, *First Deputy Minister of Economic Development and Trade*
Republic of Turkey	Governor: Mr. Ibrahim Canakci, *Undersecretary of Treasury* Alternate Governor: Mr. Aydin Karaoz, *Deputy Undersecretary of Treasury*
Ukraine	Governor: Mr. Valeriy I. Khoroshkovskiy, *Minister of Economy and European Integration* Alternate Governor: Mr. Sergiy Yaremenko, *Board Member, Director Foreign Exchange Regulations Department, National Bank of Ukraine*

Board of Directors

As of 31 December 2003

Republic of Albania	Director: Mr. Marian Gjermeni, *Director of Monetary Operations Department, Bank of Albania*
Republic of Armenia	Director: Mr. Arthur Javadyan, *Vice Chairman, Central Bank of Armenia* Alternate Director: Mr. Nerses Mkrtchian, *Acting Head, International Economic Cooperation Department, Ministry of Foreign Affairs*
Republic of Azerbaijan	Director: Mr. Samir Sharifov, *Executive Director, State Oil Fund* Alternate Director: Mr. Adalet N. Aliyev, *Division Chief, Foreign Economic Relations Department, Ministry of Finance*
Republic of Bulgaria	Director: Ms. Sophia Kassidova, *Deputy Minister of Transport and Communications* Alternate Director: Ms. Nina Stavreva, *Head of State Treasury & Debt Department, Ministry of Finance*
Georgia	Director: Mr. David Aptsiauri, *First Deputy Minister of Foreign Affairs* Alternate Director: Mr. Georgi Chikava, *Head of Credit Operations Division, National Bank of Georgia*
Hellenic Republic	Director: Mr. Vassilios Kanellakis, *Director General for Policy Planning and Implementation, Ministry of Economy and Finance* Alternate Director: Mr. Nikolaos Symeonidis, *Director for International Organizations and Policies, Ministry of Economy and Finance*
Republic of Moldova	Director: Ms. Lilia Razlog, *Head of Public Debt Department, Ministry of Finance* Alternate Director: Ms. Lidia Grachila, *Head of International Financial Department, Ministry of Finance*
Romania	Director: Ms. Diana Peligrad, *Head of Division, General Directorate for External Public Finance, Ministry of Public Finance* Alternate Director: Mr. Stefan Petrescu, *General Director, General Directorate for External Public Finance, Ministry of Public Finance*
Russian Federation	Director: Mr. Andrei I. Denisov, *Deputy Minister of Foreign Affairs*
Republic of Turkey	Alternate Director: Mr. Melih Nemli, *Deputy Director General, Undersecretariat of Treasury*
Ukraine	Director: Mr. Valeriy Pyatnytskiy, *First Deputy Minister of Economy and European Integration* Alternate Director: Mr. Sergiy Manokha, *Deputy State Secretary, Ministry of Finance*

Audit Committee
As of 31 December 2003

Chairperson
Ms. Lilia Razlog,
BSTDB Director for the Republic of Moldova

Members
Mr. Arthur Javadyan,
BSTDB Director for the Republic of Armenia

Mr. Samir Sharifov,
BSTDB Director for the Republic of Azerbaijan

Management
As of 31 December 2003

Mr. Mustafa Gürtin
President

Ms. Valentina Siclovan
Vice President Banking

Mr. Vitaly Lisovenko
Vice President Operations

Mr. Andrei Vernikov
Vice President Finance

Mr. Charalampos Tsarouchas
Secretary General

To the Board of Governors

In accordance with Section 10 of the By-Laws of the Black Sea Trade and Development Bank, I submit to the Board of Governors the Annual Report 2003 as endorsed by the Board of Directors. The Bank's Fifth Annual Report has been prepared in compliance with the Bank's requirements for financial reports and audits and includes the financial statements for the Bank's Special Fund, as prescribed in Article 35 of the Agreement Establishing the Bank.

Mustafa Gürtin
Chairman of the Board of Directors
President
Black Sea Trade and Development Bank

Statement by the President

In 2003 the Black Sea Trade and Development Bank moved forward in line with its broad aims and objectives, achieving significant growth in its lending operations and a steady expansion of its other business activities in the region. The progress achieved was due in part to the global economic recovery evident in the second half of 2003. The Black Sea region saw a faster upturn than many other areas and was able to benefit from a favourable global distribution of investment and trade flows. This economic environment enabled the Bank to almost double its loan portfolio in 2003 without compromising on asset quality.

Lending activity in 2003 was targeted to meet the developmental requirements of the countries of the Black Sea region. The distribution of operations saw an emphasis on projects in the manufacturing sector and on funding, through financial institutions as intermediaries, for trade and the SME sector.

Notwithstanding the more promising global and regional economic outlook in 2003, the Bank maintained a conservative and prudent stance in risk evaluation and financial management, adhering to its established principles and policies.

The Board of Directors approved 21 operations in 2003, corresponding to a total commitment of SDR 145 million. Of this total, 7 were trade finance operations and 4 related to the financing of SME activities. Given the developmental impact and high positive externalities anticipated from these operations, their ultimate overall contribution to the economy of the Black Sea Region is expected to be a multiple of the sums that were financed.

The Banks disciplined approach to its mission of assisting the economic and institutional development of the Black Sea Region has earned growing recognition of its status within the global financial community. Further evidence in this respect was provided in March 2004 when Moody's Investors Service assigned the Bank an investment grade credit rating, citing among the positive aspects of the institution its preferred creditor status, sound management, qualified professional staff, prudent internal guidelines, good asset quality and comfortable liquidity.

I am convinced that the continued firm commitment of the management and staff to the mission given by the shareholders, and an increasingly fruitful cooperation with the international financial community, will carry the Black Sea Trade and Development Bank to new peaks of achievement in the period ahead.

Mustafa Gürtin
Chairman of the Board of Directors
President
Black Sea Trade and Development Bank

Annual Report 2003

Highlights of 2003

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Highlights of 2003

BSTDB expanded its trade finance programs in Georgia and Azerbaijan and developed its presence in the leasing market in the Region through agreements with intermediary banks in Romania and Russia.

SME support and development remained a key objective of the Bank with new initiatives in Armenia, Bulgaria, Russia and Ukraine.

BSTDB developed strong corporate relationships with major Greek, Russian and Turkish companies that are expanding their manufacturing activities and creating new employment opportunities in the Black Sea Region, such as Efes (breweries), OPET (petroleum), Severstal (steel), Alumil (aluminum products) and Yioula (glass).

The Bank's loan portfolio increased from SDR 85.08 million at the end of 2002 to SDR 170.4 million at the end of 2003.

BSTDB signed, in June 2003, a Memorandum of Understanding with the European Commission that will enable the Bank to co-finance EU funded projects in future accession countries such as Bulgaria, Romania and Turkey.

In 2003, BSTDB achieved a positive income of SDR 244,000 from its core businesses before provisions.

The Bank received credit ratings of long term Baa2 and short term P2 from Moody's Investor Services, published on March 23, 2004.

The Bank's loan portfolio has improved in credit quality while increasing in size and has, as yet, no assets at non-accrual status.

The Bank hosted a successful Annual Meeting and "Black Sea Business Day" in Thessaloniki and launched its first investment promotion conference in one of its member countries, in Odessa, Ukraine.

BSTDB

Annual Report 2003

Global Economic Outlook & Prospects

The global economy, which had stagnated in 2002, staged a significant recovery from the second quarter of 2003 onwards, led by favourable expectations for the prospects of the US economy, following the cessation of major hostilities between the US and Iraq within a shorter time span than had originally been expected.

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Global Economic Outlook & Prospects

This having been said, investment activity in the United States still has not yet fully recovered and the country's economy continues to be burdened by the adverse effects of overcapacity, high structural budget and external deficits and equally high consumer indebtedness. There are also further risks related to government finances. Specifically, the tax cuts and the increases in defense spending that were implemented in 2003 have resulted in the federal budget posting elevated deficits, which are likely to continue into the next decade, possibly worsening as the 1950s' baby-boomers begin to retire.

These factors are already beginning to have an impact upon financial markets. In particular, a combination of the current account deficit, which necessitates capital inflows from the rest of the world of US$ 550bn a year, and foreign investors unwillingness to buy additional Dollar assets in such large volumes at prevailing exchange rates, is the main reason underlying the declining value of the US Dollar against other mainstream currencies for much of 2003 and the first months of 2004. One advantageous by-product of this situation is that it allows the US to enhance its own export-driven growth in a presidential election year. In contrast, an adverse effect of a weak dollar is that it effectively nullifies any efforts by the US corporate sector to reduce production costs, to the extent that these depend on imports.

The evident acceleration of US growth from the second half of 2003 may intensify the focus of the international financial community on the country's elevated current account deficit. This will, in turn, increase the possibility that the current US administration might assume a more trade-protectionist policy stance in the run-up to the November 2004 presidential elections.

Under these circumstances, the US economy, which until the late 1990s relied chiefly on private capital inflows to fund its massive public financing deficit, is currently becoming increasingly dependent upon official flows from Japan, China and other emerging Asian economies, as well as upon private investors' purchases of US government debt instruments, to be able to continue rolling over its Dollar-denominated debt. This poses a substantial risk for the US economy, to the extent that, if for any reason (*economic, political or otherwise*), central banks were to withdraw their funds invested in US government debt instruments, this would be quite likely to precipitate a further decline in the US Dollar and a possible currency crisis.

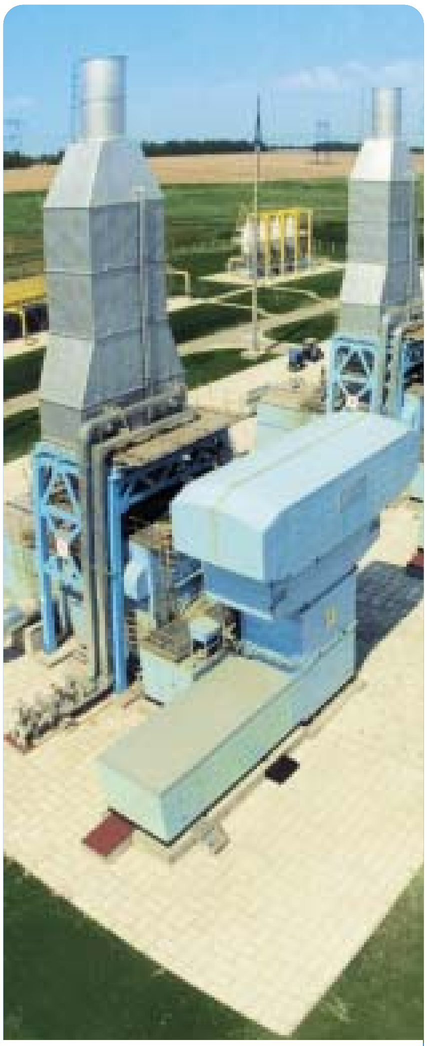
As regards the Eurozone economy, the prospects for a recovery from the current stagnant conditions, which reflect an inherent weakness in consumer spending and investment activity, remain fragile and will likely continue to be so for most of 2004. During the course of 2003, aggregated Eurozone government deficits as a proportion of the total Eurozone GDP increased to 2.7% from 2.3% in the previous year, with all of the 11 countries experiencing some deterioration. The government debt to GDP ratio for the Eurozone also increased to 70.4%, from 69.2% in 2002, reversing the downtrend of recent years.

Against this backdrop, the soaring Euro constituted a major hindrance to an export-led recovery of the Eurozone and supported the belief that, in 2004, the region could remain on a slow track for a second year in a row. Given the rigidity of Asian currencies, the Euro is bearing most of the unfavourable impact of the US Dollar depreciation, which itself is essentially driven by a very high trade deficit. One fact that worsens the situation is that the major part of the US trade imbalance stems from Asian (*not Eurozone*) imports. This implies that any further rise in the Euro against the US Dollar is likely to have only a very limited impact in improving the US trade deficit in the period ahead.

Japan's economy remained locked in a deflationary spiral. Industrial production and GDP growth remained very low, against the backdrop of a strong Yen and an unemployment rate that hovered around the country's post-war record. While signs of a possible gradual recovery in the period ahead did emerge in the latter half of the year, the strength of the Yen, which threatens an export-driven recovery of the country's economy, remains an obstacle to any significant pick-up in economic activity.

Overall, prospects for favourable developments in the world economy in 2004 are stronger than was the case a year earlier. The relatively strong recovery experienced by the US economy is likely to impact positively upon the Eurozone and Japan, through increased trade and capital flows, creating good prospects for the global economy at large.

This seemingly favourable outlook is not however without risks. The already high level of indebtedness of the United States accelerated further in 2003 and the likelihood of an improvement in 2004 remains weak. The current account deficit for the year stands at the equivalent of more than 5 % of GDP, taking the US external debt to close to 30 % of GDP. To the extent that foreign investors may lose their appetite for US government paper and thus exhibit less willingness to finance the US deficit, the low interest rate environment experienced in 2003 is under threat. Should such a possibility materialise, a fully-fledged recovery of the global economy could be delayed for some time yet.



Gas compressor station in Tarutino (Ukraine). BSTDB financed, in two stages, a total of 18 million US dollars of the Trans-Balkan gas pipeline project bringing Russian gas through Ukraine to Romania, Bulgaria, Greece and Turkey.

Global Economic Outlook & Prospects

Summary Economic Outlook of the Black Sea Region

During 2003, economic growth in the Black Sea Region continued to be robust, despite generally unfavourable external conditions, in particular the prolonged weakness of the EU economy. This healthy performance owed a great deal to the inherent diversity of the Region which, while reducing systemic risks associated with individual countries, generated significant potential for strong regional development and positive cross-country cooperation. Economic growth in the Region during 2003 was sourced mainly in domestic demand. High global energy prices benefited the resource-rich countries of the Region. Private consumption increased strongly on the back of rising household incomes, an increasing propensity to consume, and expanding consumer credit, the latter being facilitated by the downtrend in interest rates. Gross fixed investment sustained healthy growth rates thanks to key structural changes and to modernisation of production technologies. That in turn led to expanding and differentiating supply capacities. Stronger domestic demand also triggered significant import growth. Exports expanded on the back of labour productivity gains and favourable labour costs, even though their growth rate was less than the speed of expansion of imports. Thus, the merchandise trade deficits of most BSEC countries widened, creating some deterioration of current account balances. Net transfers *(including workers remittances)*, net services payments and foreign direct investment (FDI) inflows financed current account deficits, at least partly.

The distribution of FDI inflows to transition countries favoured the Black Sea Region, during 2003. Thanks to GDP growth rates which, on average, materialised above those in Central Europe, as well as to accelerating privatisation and other structural reforms, the Region benefited from an environment characterised by relatively low wages and assisted by strong government incentives.

Macroeconomic stability also improved in 2003. In most of the Region inflation was kept at bay, despite strong expansion in domestic demand, without much need for governments to implement over-restrictive fiscal and monetary policies. Prudent monetary and exchange rate policies assisted disinflation, without undermining the nominal competitiveness of exports. Fiscal consolidation helped reduce state budget imbalances, while - *by lowering the monetisation of the economy* - many governments of the Region facilitated the disinflation process. In general BSEC countries accelerated progress as regards structural reforms, thereby improving the future prospects of the Black Sea Region as a whole.

In the period ahead, the significance of the Black Sea Region within an increasingly global economy is certain to grow considerably, due to its geo-strategic location and size: spanning 20 million square kilometers, a total population of 340 millions and rich natural resources, which represent a significant percentage of world deposits of natural gas, coal and oil. The human capital potential is equally impressive, with a well-educated and trained labour force. New economic and geopolitical structures and alliances that are being created in the Region, by making due use of its comparative advantages, will positively influence regional living standards in the period ahead. These are among the motives for a significant number of international market players to strengthen their presence and influence in the Region.

Indeed, in 2003, the Black Sea Region as a whole recorded its fourth consecutive year of GDP growth at levels above those of the US and the EU. The maintenance of macroeconomic stability and achievement of evident progress as regards institutional development and reform in much of the Region have supported the favourable output growth trends and have been rewarded by a growing interest in the Region from the international financial community. One definite sign of improving economic conditions in the Black Sea Region has been the upsurge in foreign direct investment inflows, as a result of several large and successful privatisation deals and new and very promising investment projects.

Still, in the period ahead, further efforts will need to be spent on enhancing mutually beneficial economic cooperation, both within the Region itself and from other countries and international institutions. This will require the establishment of a common long-term vision among the countries of the Region, to serve the interests of the Black Sea Region as a whole.

Such a vision should acknowledge that cross-country cooperation is in fact a key component of the Region's process of integration into the global economic and financial arena. This, in turn, will involve enhancing further the regional business environment and promoting individual and collective initiatives by those public and private entities that are directly involved in the process of economic cooperation. It will also necessitate that due account be taken of the specific economic conditions and interests of each of the Region's countries. Such a framework would constitute a sound basis for a broad dialogue, development and realisation of joint projects and programs, with benefits that would permeate into the whole of the Black Sea Region and ultimately the global economy.

Sovereign Ratings BSTDB Member Countries

As of May 10, 2004

	Short Term Rating			LongTerm Rating		
Country	***Moody's***	***S&P***	***Fitch***	***Moody's***	***S&P***	***Fitch***
Albania	NR	NR	NR	NR	NR	NR
Armenia	NR	NR	NR	NR	NR	NR
Azerbaijan	NR	NR	B	NR	NR	BB-
Bulgaria	NP	B	B	Ba2	BB+	BB+
Georgia	NR	NR	NR	NR	NR	NR
Greece	P1	A-1	F1	A1	A+	A+
Moldova	NP	NR	B	Caa1	NR	B-
Romania	NP	B	B	Ba3	BB	BB
Russia	NP	B	B	Baa3	BB+	BB+
Turkey	NP	B	B	B1	B+	B+
Ukraine	NP	B	B	B1	B	B+

NR = Not Rated, NP = Not Prime

Banking Operations in 2003

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The Black Sea Trade and Development Bank has established its niche in areas where it can promote development directly or be additional to the efforts of other donors or local institutions. It has selected as its main target market medium-sized locally incorporated companies that exhibit some or all of the following characteristics: dynamic and rapidly expanding operations, export-oriented, involved in the transfer of technology and know-how, users of environmentally friendly processes, generating high levels of value added and creating employment. The sectoral focus differs from country to country, according to the priorities of both the authorities and the country's business organisations. The Bank has concentrated its attention, regionwide, on a few sectors that are the driving force of economic growth in member countries at this time: energy, gas and oil, transportation, manufacturing, the financial sector, construction and telecommunications.

Banking Operations in 2003

The Bank has built up a portfolio of good quality assets mainly comprising short-term revolving facilities and medium to long-term project and corporate finance loans, complemented by occasional equity investments and guarantee products. This asset strategy allows a flexible approach to market conditions and generates relatively moderate concentrations of exposure. The Bank maintains its asset quality by following a rigorous due diligence process and by adhering to strict monitoring procedures. As of December 31, 2003, the Bank had no loans at a non-accrual status.

The Bank offers its clients a range of financial products, principally: loans, equity investments and guarantees, but also other hybrid formats to meet specific situations. The terms of these products are tailored to meet the requirements of each client and operation and may be adjusted during the term of the operation. Such adjustment may, if so provided in the original documentation, extend to the conversion of one product type to another during the life of an operation. The product choice is however determined primarily by client requirements within the framework of the Bank's policies.

Operations normally include some form of security, dependent on each operation's specific credit risk characteristics. Given the vastly differing operating environments in each of the Bank's Member Countries, security structures for each operation tend to be highly customised. Exceptionally, an operation may be approved on an unsecured basis. However, the requirements for such operations are high, and the potential client must clearly demonstrate a track record of successful unsecured borrowing, as well as the unqualified ability under any reasonable circumstances to meet debt-service expectations over the lifetime of the operation.

The Bank seeks to ensure that at all times its operations are well balanced among member countries, well diversified in terms of products and maturity, and tailored to meet specific country needs.

The Bank has two main lines of business: Project/Corporate Finance and Trade Finance. In line with its established policies and to most effectively achieve its objectives, the Bank makes two types of operations: direct lending and through financial intermediaries.

Korteks Textile plant in Bursa (Turkey). Korteks, a major exporter in the Black Sea region, will benefit from BSTDB financing to expand its production capacity.

Project and Corporate Finance

Loans

The Bank provides financing for private and public sector activities, tailored to meet the particular requirements of each project.

The Bank's Structured and Project Finance transactions typically involve the financing of projects in the energy, telecommunication and transportation sectors for modernisation and expansion purposes. When the Bank is involved in larger Structured and Project Finance transactions its flexibility in the structuring of operations and its relatively fast internal decision-making process allow a quick response to requests from other IFIs for participation as co-financier. These same qualities of speed and flexibility have allowed the Bank to acquire and lead the structuring of smaller-size transactions. The Bank, at this stage, has only limited potential to participate in large public-sector structured financed deals and prefers to focus on limited-scale transactions where it is able to play a leading role.

The Bank's Corporate Finance activity focuses principally on the manufacturing sector. Transactions mostly fund capital expenditure for modernisation and expansion as well as, to a lesser extent, working capital, refinancing and general corporate purposes. The Bank concentrates on well-established companies in all its countries of operations and selects those whose activity involves a high degree of regional cooperation and development in the Black Sea region. The main advantage for the Bank in this area is that, with the exception of Greece, the corporate sector in the Black Sea region has still limited, albeit improving, access to long-term finance. The role of the Bank is thus that of improving the financial flexibility of the corporate sector by offering medium to long-term financing.

Equity transactions

The Bank's equity investments may be made in a variety of forms; investing in existing or new ventures and special purpose companies. Equity financing is provided either as a direct operation or through the intermediation of specialised investment funds. The Bank may subscribe to both common and preferred equity in an enterprise, but in general as a result of private equity placements rather than public offerings. The Bank may also make quasi-equity investments in various forms, including but not limited to certain types of subordinated loans, debentures, income notes and redeemable preference shares. The decision to keep equity as a small proportion of its operations reflects the aim of the Bank to keep a low-risk portfolio profile at this stage.

Guarantees

The Bank provides full-risk financial guarantees or partial guarantees, where either (i) it provides all-inclusive risk cover for a portion of debt service, or (ii) it covers specific risk events for all or part of the debt service. Guarantees are an important instrument for the Bank in its efforts to stimulate credit and capital markets in the region, mobilise additional capital, encourage capital investments from outside the region and provide facilities otherwise unavailable on reasonable terms. Operations involving guarantees are appraised, processed and supervised in the same manner as those involving direct credit extensions and are subject to the same limits and requirements.

This type of product has proved effective in attracting international funds into the Black Sea Region. All project finance, trade finance or other financial operations involving cross-country transfer of funds can qualify. Guarantees are not intended to play a dominant role in the Bank's portfolio, but rather to function as a strategic instrument to aid resource mobilisation and increase trade flows and investment in the region. Interest in having the Bank's guarantee has been shown thus far principally by financial institutions which have reached, or are close to reaching, exposure limits in BSTDB's countries of operation but still have funding available.

Banking Operations in 2003

Trade Finance

In accordance with the Bank's mandate, the promotion of trade between the member countries is a high priority and has been developed as a core business. Trade financing and promotion are seen by the Bank as effective means of increasing intra-regional cooperation, bringing stability to the region, and accelerating economic development in the shareholder countries.

Trade Finance Program Loans

The governments and the business communities of the member countries have welcomed the Banks focus on trade financing. In response, the Bank has developed a comprehensive Trade Finance Program tailored to the needs of the BSEC market. The Bank has successfully introduced the following trade finance products to the market under the Trade Finance Program:

- Pre-Export Finance Facility
- Multiple Buyer Credit Facility
- Single Buyer Credit Facility
- Single / Multiple Supplier Refinancing Credit Facility

The Bank's Trade Finance Program is designed to ensure that the Bank's funds are used primarily to promote intra-regional trade financing and is available for the following trade transactions:

- Imports to a member country from another member country, and
- Exports from a member country to another member country

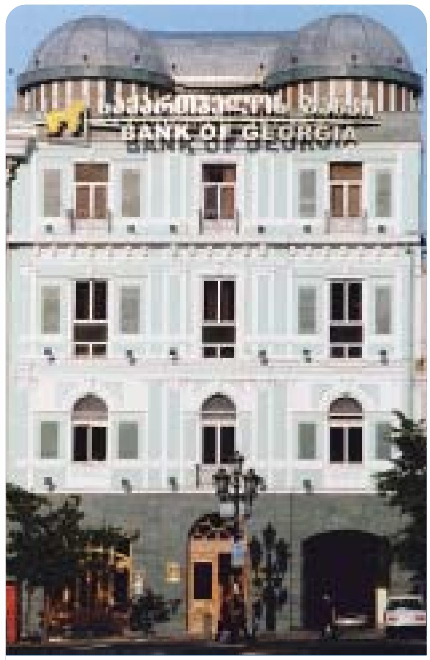
The option of exports from a member country to a non-member country is available only if at least 50% of a trade finance facility opened directly in favor of a client, or to a group of clients through financial intermediaries, is used to finance exports to another member country.

Trade Finance Guarantee Facility

One of the major factors limiting trade volume in the BSEC region to date has been a finite appetite for the assumption of risk by potential lenders. By providing country and commercial risk cover on short-term trade finance instruments the Bank goes some way to alleviating the situation. The Bank's Guarantee may be applied to trade-related payment instruments issued by selected banks and export credit agencies within the BSEC region. In this way, the payment risk of the issuer is assumed, while the issuing and confirming banks or ECAs assume importer and exporter risk. The confirming banks should be able to discount the resulting instrument and provide liquidity to the exporter or importer.

Leasing Credit Facility

The Bank views this instrument as an effective financing tool for the promotion of regional trade. Medium-term credit lines opened to leasing companies will enable them to offer their customers finance for capital expenditures on imports from other countries in the region. The Bank will continue to offer these products, together with new variations, according to market conditions and client requirements.



Headquarters of the Bank of Georgia in Tbilisi. In the year 2000 Bank of Georgia was one of the first banks in the Black Sea region to participate in BSTDB's programs supporting exports and SME financing. Since then, BSTDB has extended credit lines to two more financial intermediaries in Georgia.

Operations through Financial Intermediaries

The Bank seeks to play the role of a stable partner for the region's financial institutions using them as intermediaries for the funding of trade and of the SME sector, key elements for economies in transition.

Additional advantages to conducting business through financial intermediaries are as follows:

- Most trade finance products, such as pre-export financing, will normally require a financial intermediary to perform due diligence on the exporter (local company) and assume that risk.

- In the interest of facilitating economic development in member countries, BSTDB aims to support local financial intermediaries and help this important sector of the economy grow. By not competing with local banks, but rather including them in transactions, the Bank will most effectively fulfill its mandate. Small and medium sized enterprises which represent the largest and most dynamic part of the private sector in the majority of BSEC countries, can most effectively be supported by the Bank through the use of financial intermediaries.

The Bank's SMEs financing products are tailored to the specific needs of each individual country, in line with their regional development and restructuring policies. Typically this involves credit lines extended to financial institutions dedicated to funding their SME customers' capital expenditures and working capital requirements.

For facilities to be utilised efficiently by financial intermediaries, an effective system for generation of eligible transactions has to be established. This generally requires significant marketing efforts and the Bank stands ready to work with financial intermediaries in the promotion of these lines to their final customers.

Terms and Conditions for Financing

Like other IFIs, the Bank is not profit-oriented, but performance targets are set in order to maximise solvency and to secure organic growth of its activity. The Bank generally provides loans in hard currencies and interest rates are usually on a variable basis (linked to Libor and Euribor) with the possibility available to opt for fixed rates, if required. Margins are set with the aim of covering provisioning, administrative and funding costs.

For project / corporate finance, maturities usually range between three and seven years for manufacturing projects while infrastructure projects may be granted longer maturities of up to 10 years and more, in special circumstances.

The average tenor of Trade Finance transactions is under 1 year. Pre-Export Finance and Multiple Buyer Credit facilities do not usually exceed 180 days and medium-term trade finance products have a maximum maturity of 3 years, with an average maturity of 1.5 years.

SME facilities have a maximum maturity of 3-4 years with an average maturity of around 1.75 years

Banking Operations in 2003

Portfolio Description

Portfolio Structure by Country
Since its inception, the Bank has approved 55[1] operations for a total of USD 547 million, distributed as follows:

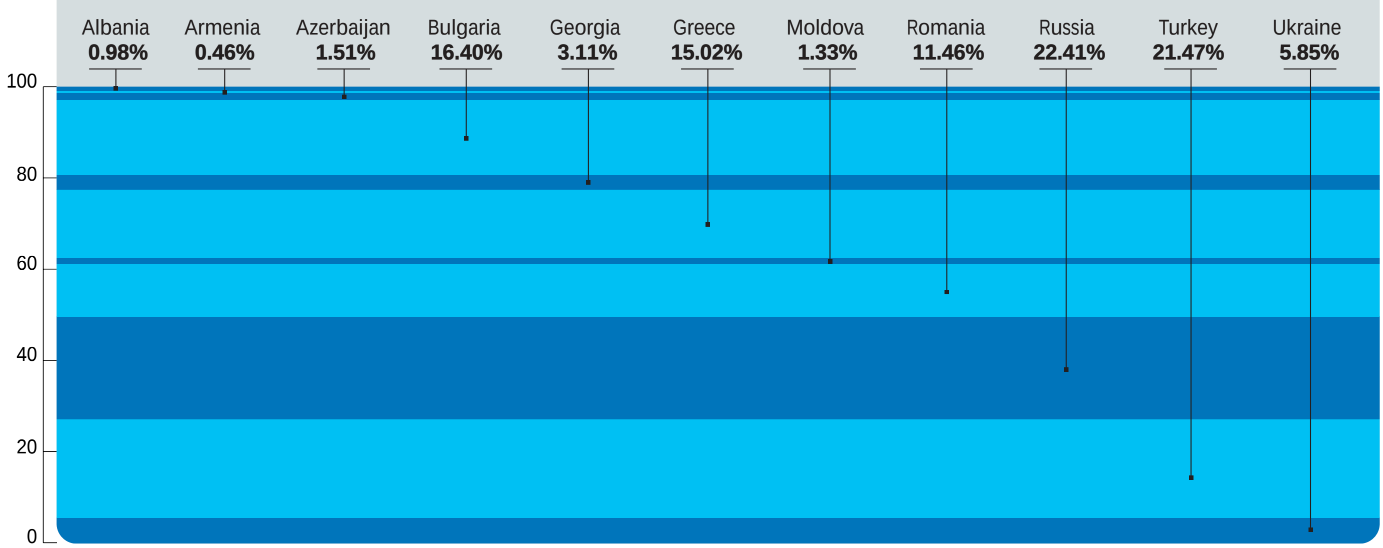
Country	Number of Operations
Albania	2
Armenia	1
Azerbaijan	2
Bulgaria	10
Georgia	4
Greece	4
Moldova	2
Romania	8
Russia	12
Turkey	8
Ukraine	4
Total	**57**

Co-financing
Of these 55 operations, 12 are co-financed with other institutions. The total project cost of these co-financed operations is USD 1,317 million, of which the Bank's financing represents 11%. Among the co-financiers are international financial institutions (EBRD, IFC and MIGA both part of the World Bank Group), official development institutions of developed countries (JBIC in Japan, DEG in Germany, Norfund and Finnfund in the Nordic countries) and commercial banks (Citibank, Marubeni, National Bank of Greece, Piraeus Bank, EFG Eurobank, Commercial Bank of Greece, Cyprus Popular Bank). The co-financiers, including BSTDB, have provided 77% of the total project costs, with the balance being the responsibility of the promoters.

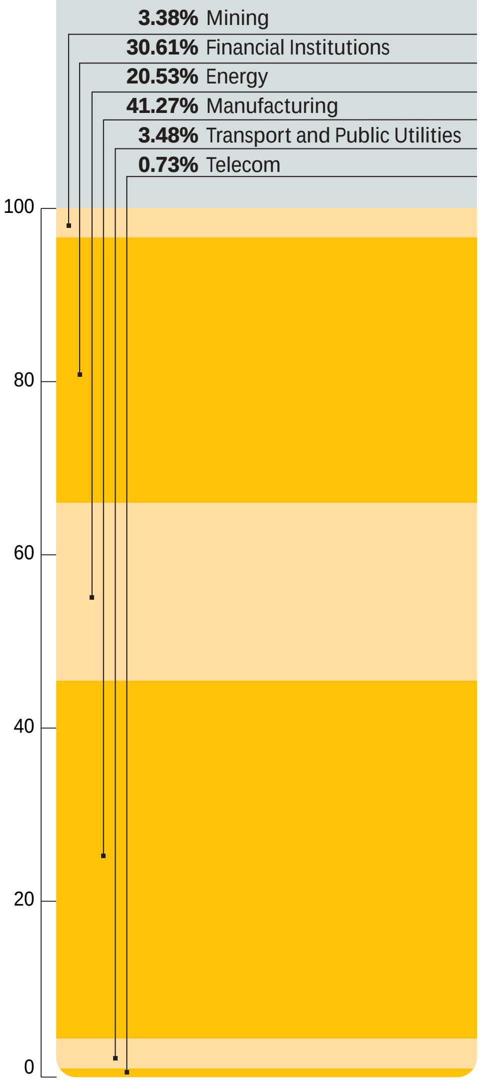
Portfolio Structure by Sector
By sector, the Bank had, at end of 2003, 29 approved operations through financial institutions, 15 in manufacturing, 7 in energy, 2 in transport and public utilities, 1 in telecommunications and 1 in mining.

[1] *The total number of approved active operations is 55, but one operation (SEAF – SME equity investment fund) is split among the three beneficiary countries, Albania, Bulgaria and Romania, resulting thus in a total number of operations by country of 57.*

Approved Operations by Country (percentage of total amount in USD)



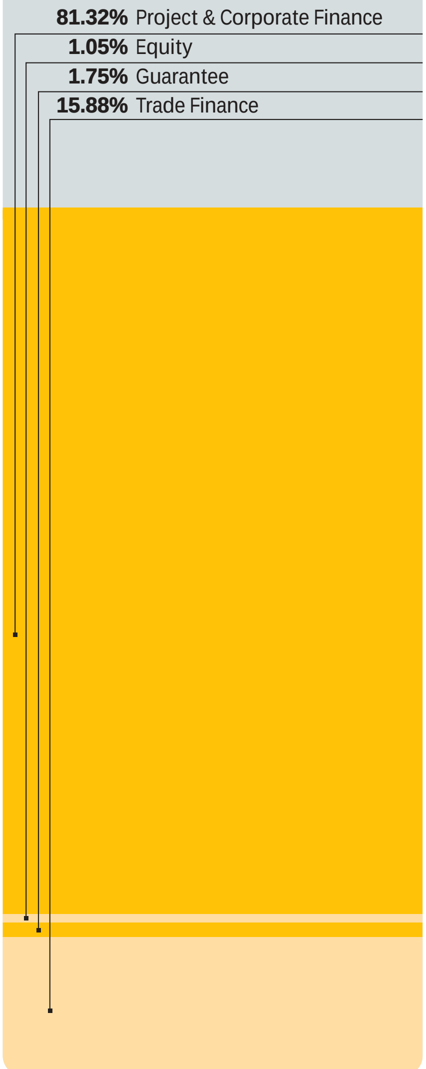
Approved Operations by Sector
(percentage of total amount in USD)



Portfolio Structure by Product

Of the 55 operations approved by the Bank's Board of Directors, 36 were in project and corporate finance (of which 14 were for SME support), 15 in trade finance, 2 in equity and 2 in guarantee operations.

Approved Operations by Product
(percentage of total amount in USD)



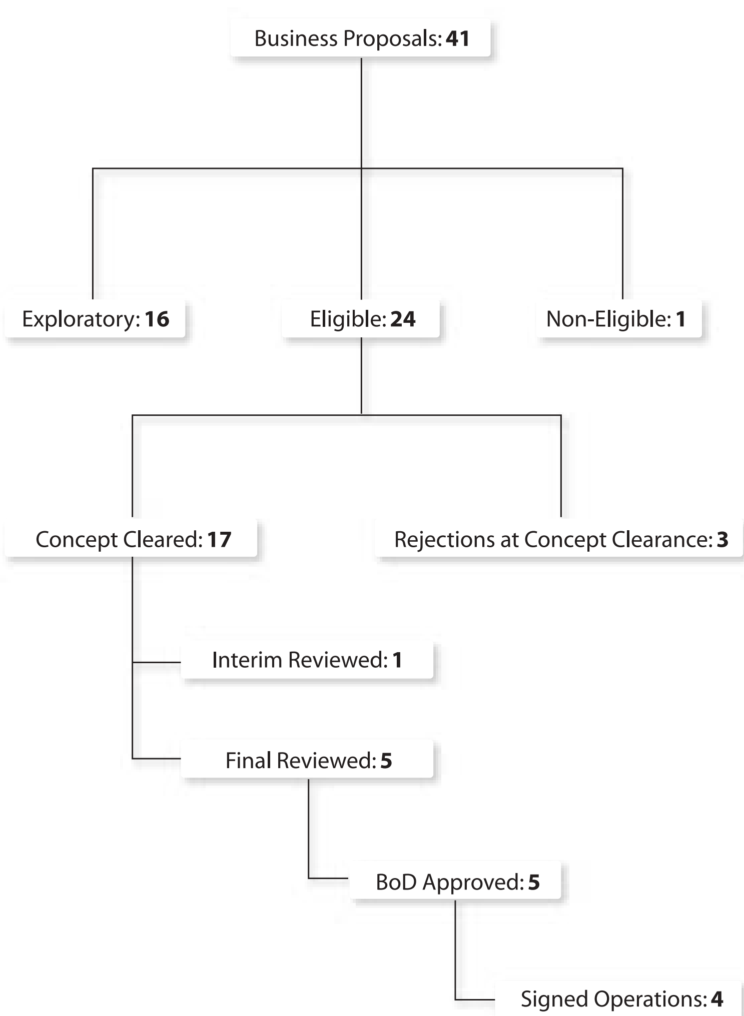
At the end of 2003, the Bank had 40 operations outstanding[2], of which 22 (USD 89 million) were in the financial sector, 10 (USD 110 million) in manufacturing, 5 (USD 45 million) in energy, 2 (USD 13 million) in Transport and public utilities sector and 1 (USD 7.5 million) in mining. By product, 26 transactions were in project and corporate finance (USD 211 million), 10 in trade finance (USD 42 million), 2 guarantees (USD 7 million) and 2 equity (USD 4 million).

[2] *Outstanding operations include guarantees*

Banking Operations in 2003

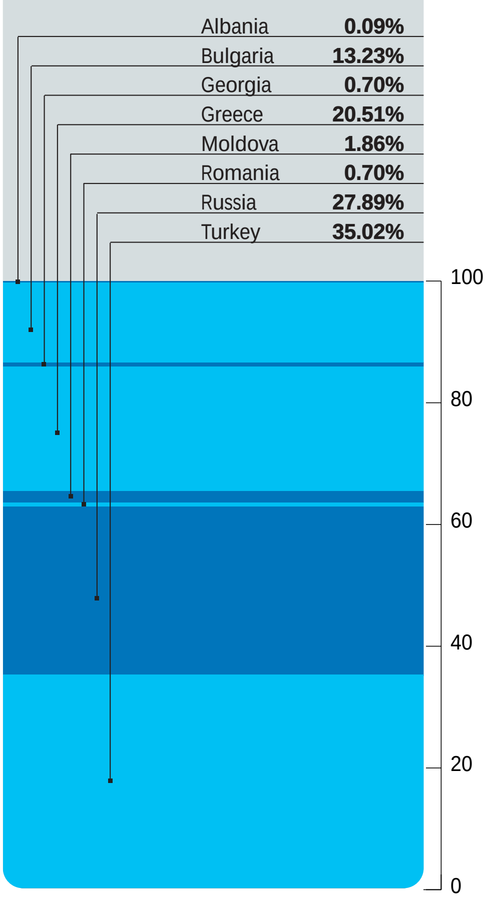
Operations Approved in 2003

During the course of 2003 the Bank has received 41 applications for financing. The following diagram illustrates how these applications have progressed through the Banks evaluation process:



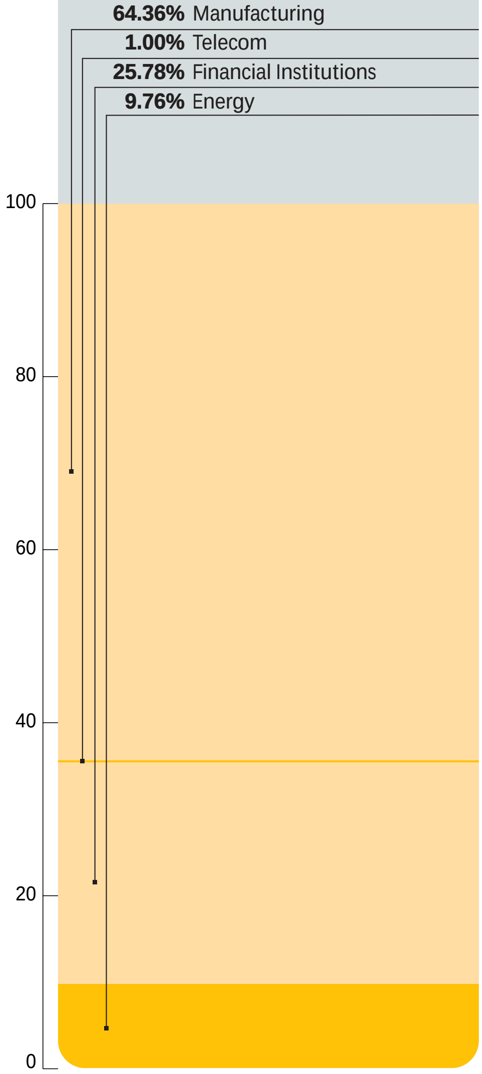
In 2003, the Bank's Board of Directors approved 21 operations for a total amount of USD 215 million. Of these operations, 8 were in manufacturing, 1 in energy, 1 in telecommunications and 11 through financial intermediaries (7 trade finance and 4 SME). The breakdown of these operations by country and sector is presented in the adjacent tables:

Operations Approved by Country
(percentage of total amount in USD)



Operations Signed in 2003

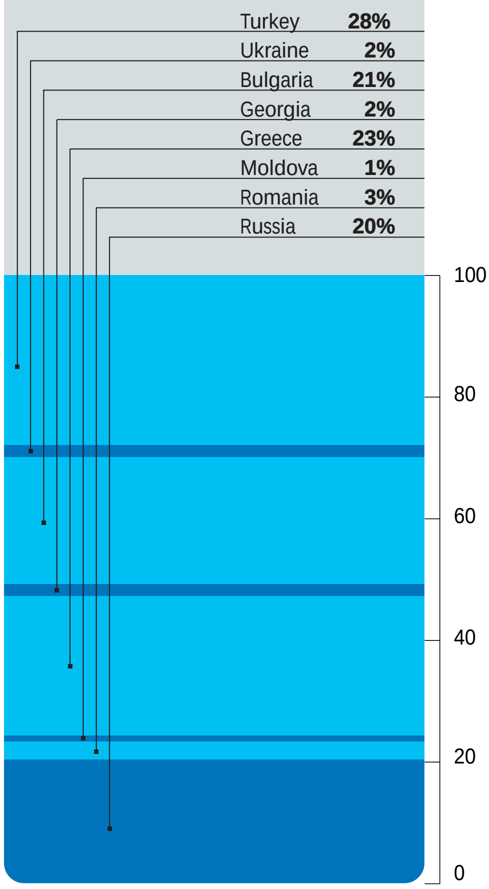
Operations Approved by Sector
(percentage of total amount in USD)



In 2003, 21 operations were signed for a total amount of USD 223 million. By sector, 12 operations were signed with financial institutions, 7 in manufacturing and 2 in energy. By product, 15 were project and corporate finance loans, 5 were trade finance loans and 1 guarantee.

The breakdown of the signed operations by country is depicted in the following graph:

Operations Signed by Country
(percentage of total amount in USD)



Banking Operations in 2003

Operations in 2003 by Country

Headquarters of the International Bank of Azerbaijan (IBA) in Baku. BSTDB is providing IBA, the largest bank in Azerbaijan, with a Multi-Buyer credit facility totaling 6.5 million USD to finance intra-regional trade.

ALBANIA

Albania continues to exhibit a pattern of development characterised by sustained high GDP growth, low inflation, high external deficits and exchange rate stability. Albania's GDP grew by 6 % in 2003, up from 4.7 % in 2002. This GDP growth has materialised against a background of impressive fiscal consolidation – an estimated deficit of below 4% of GDP.

Inflation is low at 3% year on year, undershooting the official target of 4%. However, the unemployment rate remains high at 15% of the labor force. Albania's current account deficit is expected to fall to around 7.1% of GDP in 2003 and to 5.9% of GDP in 2004.

Albania's economy has maintained steady progress and shown a generally balanced trend and composition of GDP growth, accompanied by low inflation, against the backdrop of a decisive adherence to the reform agenda. Growth has been fuelled by increased productivity, primarily in construction, services, and agriculture. This has resulted in price and exchange rate stability, in an environment where foreign currency reserves stand at comfortable levels of more than four months' worth of imports. Favourable developments notwithstanding, the country's financial sector remains in need of external support to enable it to supply the level of financial resources required to adequately promote further development of private sector activity.

The BSTDB-supported **MOBITEL** project is aiming to provide a medium-term loan for the expansion of local telephone services in rural areas of Albania. The financing will allow for the introduction of 9000 fixed lines by the private independent licensed operator and the purchase of additional equipment to extend the capacity for uninterrupted power supply to subscriber units.

ARMENIA

Armenia maintained a strong economic performance during 2003, with GDP expanding at a rate of 13.9% in real terms. Such growth, which was to a large extent supported by grant-financed investment and was most evident in the manufacturing *(particularly diamond-processing)* and construction sectors, also reflected booming exports and deepening import substitution. During 2003, Armenia showed the largest year-on-year industrial production growth (14.9%) in the CIS region. Fiscal policy remained by-and-large prudent and the fiscal deficit as a proportion of GDP declined substantially compared to 2002. The 2003 budget deficit is estimated at 2.2% of GDP.

Unemployment in Armenia stands at around its historically lowest levels (9.8%) and although this is to some extent attributable to increased economic activity, it also stems from the evident success achieved by a range of job-creation programs and to new legislation designed to improve the overall business climate. Monetary policy has also remained on track and the growth in net international reserves has exceeded initial forecasts as a result of lower-than-anticipated government spending. Year-end inflation at 5.2%, compared with 2% in 2002, was high, owing to a strong rise in food prices.

The government has secured new investment in the energy sector. Considerable strides were taken during 2003 to implement Armenia's energy sector reform agenda. In this respect, two electricity-generating plants were privatised during the course of the year and the financial management of the nuclear power plant was entrusted to a foreign entity. Reflecting the efficiency of the implementation of energy sector reforms, collection rates for electricity bills have stood at virtually 100 % throughout the year. In contrast, reforms in the water and irrigation sectors have remained limited.

On the whole the macroeconomic outlook and long-term prospects for Armenia remain positive. The country's output should continue to grow in the period ahead, as the current reform program continues to impact favourably on the economy at large.
In November 2003, the first operation under the Armenian Direct Line Facility was approved. This financing covers the working capital requirements and modernisation of fixed assets of **TOSP company**, an integrated manufacturer of knitted and crocheted wear and ready made garments. The clothing industry plays an important role within the Armenian economy and has been targeted for resources by both the government and other international organisations. The TOSP project is co-financed with the Izmirlian Foundation.

AZERBAIJAN

Continuing the trend of recent years, during 2003 Azerbaijan continued to take significant steps towards stabilising its economy. The oil sector has been the main driver of strong economic growth and has continued to attract a substantial volume of foreign direct investment. Azerbaijan's overall economic performance remains strong as the result of a favorable external environment and the implementation of prudent macroeconomic policies. 2003 saw real GDP growth rate of 11.2%, although industrial output growth was lower at only 6.1%.

One of the main achievements of Azerbaijan's macroeconomic stabilisation program has been price stability. The tight monetary and fiscal policies pursued by the authorities have resulted in a stable national currency, low levels of inflation (3.6% year-on-year) and a balanced consolidated government fiscal position. While the current account in 2003 recorded a deficit of 18% of GDP despite a small trade balance surplus, FDI of about 30% of GDP was more than enough to finance the deficit and increase official foreign exchange reserves to about 40% of annual imports, reducing thus the risks that would otherwise have been associated with a high current account deficit to GDP ratio. Strong commitment to the current economic policies should ensure steady economic growth in 2004 and beyond, although over-reliance on the hydrocarbons sector does represent a risk for the long-term sustained growth of Azerbaijan. Several major investment projects in the oil and gas sector, undertaken by international consortia, are currently progressing successfully at various phases of design and implementation. Overall, the key challenge facing Azerbaijan's economic policy is to ensure a balanced development of the country's economy, particularly by stimulating steady growth of the private non-oil sectors *(namely, manufacturing, services and agriculture)*, in a manner that will prove sustainable in the long run. The level of financial intermediation in Azerbaijan remains modest. The banking sector in particular remains rather small and risk-averse, with a low propensity to lend to the non-oil private sector.

Banking Operations in 2003

Micro Finance Bank of Azerbaijan enjoyed its first year of operations, promoting micro, small and medium-sized enterprises through the provision of financing. This bank was established by a group of international institutions with BSTDB playing an important role. The promotion of the SMEs sector is seen as one of the most promising channels for diversification of the Azerbaijani economy.

An increased trade finance facility allowed the **International Bank of Azerbaijan** to finance the purchase of capital goods from other parts of the Black Sea region (Russia, Turkey, Ukraine).

BULGARIA

The growth of Bulgaria's real GDP slowed down marginally in 2003. Expectations are for an average annual real GDP growth rate of around 4.5 %, given the favorable performance of both fixed investment and private consumption, in line with rising real wages and declining unemployment. Manufacturing, construction, tourism and other services provided the highest contributions to the growth of aggregate output.

During 2003, the government's fiscal performance continued to be very impressive and the government budget benefited from strong revenue growth. The budget deficit target for 2004 is 0.7 % of GDP, 0.2 percentage points higher than the original target.

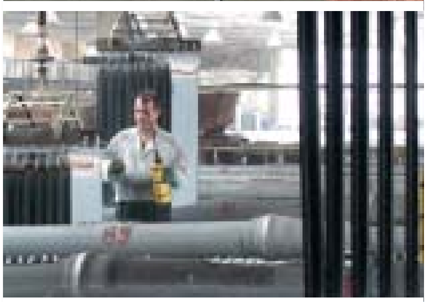
Inflation accelerated somewhat during 2003 as a combined result of hikes in the state-regulated prices of electricity, district heating and fixed telephony tariffs and a poor harvest. Under the prevailing currency board arrangement, the Lev is tied to the Euro, thereby allowing the Bulgarian National Bank little discretion in setting monetary policy.
The appreciating Euro may have impacted positively on inflationary prospects, while negatively affecting competitiveness in export markets.

The current account deficit continued to widen throughout most of 2003. Imports, fuelled by the strength of domestic demand, rose much more rapidly than exports during much of the year, leading to an estimated current account deficit of about 8.5% of GDP. This deficit was financed largely by inflows of foreign direct investment of about the same magnitude. A source of concern is that most of the FDI inflows recorded in 2003 were in the form of intra-company loans, rather than equity investment, implying future capital outflows from loan repayments. Furthermore, rising dividend payments to foreign investors will place additional pressure on the current account balance. However, Bulgaria enjoys an increasingly comfortable foreign exchange position with a falling foreign debt to GDP ratio and significant foreign exchange reserves covering about 7.5 months of imports. Industrial and financial sector privatisation in Bulgaria is virtually completed, and during 2004 the process is expected to continue with the utilities, coupled with further liberalisation in telecommunications and energy.

The Bank has extended a loan to help rehabilitate and improve the environmental performance of the lignite-fired 840 MW **Maritza East III power plant**, situated near the southern city of Stara Zagora. The plant is majority privately owned. Additional financing for this important project is provided by the European Bank for Reconstruction and Development (EBRD) and a group of international commercial banks, including Société Générale, Crédit Agricole Indosuez, Banca Mediocredito (UniCredito group) and Bank Austria Creditanstalt, as well as four leading local banks: Biochim, Bulbank, SG Expressbank, and United Bulgarian Bank.

The financing provides support to the Bulgarian power plant to cover its developmental needs, in particular for the facility to be in full compliance with Bulgarian and EU environmental standards. The project meets Bulgaria's requirements for reliable capacity replacement rather than additional capacity and will contribute to improvement in the efficiency of the Bulgarian energy sector. The Maritza East III project fulfills BSTDB's mandate for contributing to the regional cooperation in the Black Sea region as it creates the potential for continuing electricity sales from Bulgaria to neighboring countries, which are experiencing a high level of growth in electricity demand.

A medium-term loan was extended to the **Bulgarian-American Credit Bank (BACB)**. The financing is used by BACB to extend loans of up to EUR 600,000 to Bulgarian private sector SMEs. The **ProCredit Bank** has received a medium-term SME facility for on-lending to over 180 Bulgarian micro, small and medium enterprises operating in various sectors including food processing, industry, transport and trade. A change in the business profile of **CB Unionbank** led to a new Short-Term SME Loan Facility replacing the existing Pre-Export Finance loan agreement. These three facilities are part of an SME lending strategy focused on encouraging dynamic entrepreneurial companies in sectors that are leading the economic recovery in Bulgaria, while also supporting the local financial sector.



KCM zinc-lead smelter in Plovdiv (Bulgaria). BSTDB is supporting an environmentally safe extension and modernisation program at KCM, one of the leading exporters in Bulgaria.

GEORGIA

Georgia's real GDP growth rate remained robust in 2003 at 8.6% year-on-year, reflecting the positive impact of the preliminary work in progress on the Baku-Tbilisi-Ceyhan (BTC) oil pipeline and the South Caucasus Gas Pipeline Project (SCP), on the country's economy at large. Pipeline activity will have important spillover effects on related sectors and a favorable impact on wages. Such positive repercussions should become more evident when construction of the SCP progresses.

The fiscal policy has been tight, with a consolidated budget deficit of about 2.2% of GDP. Reforms in the fiscal sphere, which were implemented in the recent past, have strengthened expenditure management and revenue administration, while to some extent reversing the erosion of the tax base. Consumer price inflation increased to 7% at year-end, while unemployment is estimated at about 11%. Georgia's monetary policy in the period ahead will aim to continue keeping inflation in check and to reduce pressure on the exchange rate.

Georgia's current account deficit will probably remain wide (at between 6 and 7% of GDP) for some time yet, due to substantial increases in import costs originating from the gas pipeline projects. Export revenue is also expected to grow strongly in 2004 and balance of payments financing is expected to be forthcoming, mostly from foreign direct investment. Nevertheless, prospects for a broad-based sustainable growth in the Georgian economy may remain modest for some time yet, due to outstanding structural economic problems. Georgia continues to remain rather vulnerable to external shocks, considering the high level of external indebtedness, the limited volume of international reserves and the high concentration of exports, both geographically and in terms of the range of tradable commodities. Still, in the period ahead, some significant stimulus to Georgia's economy should come from buoyant construction activity and from transit fee revenues related to energy pipelines.

TBC Bank

The Pre-Export Finance Facility for TBC Bank is used for providing pre- and post-shipment financing to Georgian exporters selling to customers in the BSTDB member countries and beyond.

This Facility provides Georgian exporters with greater access to the working capital required to perform under export contracts. In addition, they are able to offer more competitive payment terms to their clients, therefore making Georgian exports more competitive.

TBC Bank became the third financial intermediary for the BSTDB Trade Finance Program in Georgia following Bank of Georgia and Procredit Bank of Georgia.

Terms and conditions of the operation:
Amount:
USD 2 million
Type of financing:
Revolving Pre-Export Finance facility
Maturity:
180 days

GREECE

Greece's economy continued to perform strongly in 2003, recording a GDP growth rate of 4.7%, with encouraging prospects for growth in coming years.

During 2003, private consumption in Greece was strong, while investment spending remained linked to the financial flows from EU Structural Funds and the accelerating preparations for the Olympic Games. Buoyant fixed investment was the main driver of Greece's economic expansion with gross capital formation posting a nominal growth rate of 26% of GDP. Year end annual inflation, at 3.1 per cent, was higher than the Eurozone average, driven by robust growth rates, high oil prices and rising food prices.

In the fiscal sphere, during 2003, a small deviation from the target for the general government deficit emerged. While this was essentially the result of higher spending due to the Olympic games, it also reflected increased expenditures on compensatory payments to households and firms for damages suffered from natural disasters in the first half of 2003. Meanwhile, the growth of the stock of public debt continued to decelerate and is expected to have reached some 101.7 % of GDP, as at end-2003.

The deficit pertaining to the external sector remained high, with a trade balance deficit of 14.7% of GDP in spite of the fact that merchandise exports increased considerably faster than merchandise imports. The increase in import expenditures was in part due to high oil prices. Lower tourism receipts in 2003 were to some extent due to the negative consequences of the war in Iraq and terrorist activity worldwide. Consequently, the current account deficit stood at 6.4% of GDP. Domestic demand for imports *(particularly capital goods)* is expected to remain strong at least until end-2004, as the expected recovery of the international economy - *including the Eurozone* – will favor export activity and contribute towards narrowing the external imbalances, thereby making the country's cyclical position better-aligned with other EU member countries.

A long- term corporate loan was concluded with **Alumil**, the largest aluminum-extrusion company in Greece. The loan will be used to support Alumil's capital-expenditure program, which will involve investment in new equipment and in industrial sites in Greece, Albania, FYROM, Serbia, Romania and Bulgaria.

A corporate loan was provided to **Yioula Glassworks**, a leading producer of glass packaging products in Greece and Bulgaria. The loan is part of syndication led by Citibank and involving leading Greek commercial banks. This financing will allow Yioula to enlarge its product range and increase its exports to other countries in the Black Sea Region

Alumil production facilities in the North of Greece. Alumil is a leading European producer of aluminium extrusion products with strong positions in South Eastern Europe. BSTDB is financing part of Alumil's strategic regional investment program in Albania, Bulgaria and Romania.

MOLDOVA

Moldova's GDP grew by 6.3% in 2003 according to preliminary official data. Domestic demand driven by strong household consumption, as well as external demand, were the main drivers of this growth. The industrial base remains relatively narrow and heavily dependent on a food & beverages sector concentrated on wine production and accounting for a sizeable proportion of the country's total production.

Fiscal conditions improved during the course of the year, as evidenced by the continuing downtrend in the consolidated budget deficit as a proportion of GDP.

Inflation in Moldova accelerated considerably from mid-2003 onwards, as a result of unusually high increases in food prices reflecting a poor harvest and a sharp rise in the prices of services, which resulted from increased gas and electricity tariffs. Rising incomes also constituted a stimulant to inflation.

External demand, which benefited from strong growth in Russia, also constituted a significant driver of Moldova's economic performance. The growth in exports was robust, growing by more than 20% in the first eleven months of 2003. Russia accounted for just above 36 % of Moldova's total exports, compared to 16.3% in the same period of 2002.

Banking Operations in 2003

Total imports grew by an estimated 30% in 2003, compared to an increase of 18.2% in 2002. The trade deficit was somewhat reduced by large unilateral transfers and work remittances. In the period ahead, imports are expected to continue rising on the back of strong domestic demand. Exports should also continue to grow due to continued robust demand from Russia. Still, the sustainability of Moldova's current account deficit continues to face risks stemming from the structural nature of its trade deficit, the low level of FDI inflows and the difficulties in accessing international capital markets. Additional risks stem from Moldova's high indebtedness and the resulting large debt-servicing burden.

In November 2003, the Bank approved an increase in the size of its Guarantee Facility for **MEC Moldova** to 2.3 million Euro. This facility covers amounts lent by KFW to support private micro and small enterprises.

ROMANIA

Romania's real GDP increased by 4.9%, during 2003, at the same rate as in the previous year. Construction activity was the main source of growth, followed by industry. Meanwhile investment activity expanded, with machinery and vehicles seeing above average increases. For the entire year, the growth rate of industrial output was 3.2%, while gross capital formation represented almost 25% of GDP.

The current account deficit increased to a preliminary 5.8% of GDP compared to 3.4% in 2002. The EU countries, Romania's main export market, account for almost 70% of total exports. FDI inflows amounted to €1,381 million and financed roughly half of the current account deficit. Portfolio investments doubled year-on-year, amounting to some €676 million. Foreign exchange reserves represented at year-end about 4 months of imports. While being rather high in general terms, the current account to GDP ratio does not pose a major problem for Romania, to the extent that the economy continues to exhibit balanced economic growth and investors' confidence remains positive. Moreover, in the medium-to-long term, growth in Romania's exports should be assisted by a recovery in the Eurozone's economic growth and by improved competitive conditions for Romanian exporters.

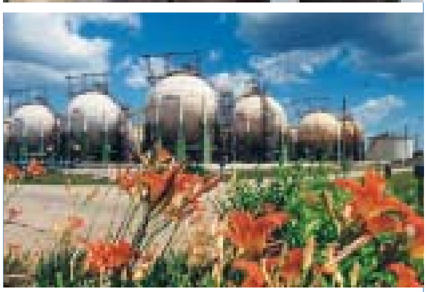
The strong economic growth and active measures for job creation resulted in a low rate of unemployment, at 7.2% of labor force, and counterbalanced the effects of ongoing structural reforms.

Inflation marginally exceeded official projections with a year end figure of 14.1%. The tight fiscal policy proved effective leading to a decline in the consolidated budget deficit to 2.4% of GDP. However, the quasi-fiscal deficit raises some concern. Although there is no accurate figure on the quasi-fiscal deficit, it is currently estimated at about 2.5% of GDP.

The government will make efforts to reduce this level by about half of a percentage point in 2004 and, along with further fiscal consolidation, it will be used as an instrument to contain the current account deficit. Important economic issues that Romania needs to address in the period ahead include maintaining tight fiscal and monetary policies, controlling the expansion of consumer credit and reducing the current account deficit.

The Bank has provided an SME Leasing Facility to be used by **UniCredit Leasing Romania S.A.** for financing the leasing of capital goods and equipment to Romanian small and medium sized enterprises. Large companies can also benefit from the Facility if the leased goods originate from one of the BSTDB member countries.

UniCredit Leasing Romania S.A is one of Romania's leading leasing companies, with an estimated 20% market share in equipment leasing in the country. The Company, majority owned by Unicredito Italiano, has developed an efficient leasing franchise and is well positioned to deliver BSTDB's financing to end-users – Romanian SMEs - through an established distribution network.



Oil refinery in Romania. BSTDB is financing the modernisation of the Romanian oil industry through major loan facilities extended to Petrom and Rompetrol, the two leading companies in the energy sector in Romania.

RUSSIA

GDP growth in the Russian Federation has been strong since the end of the 1998 crisis and has averaged some 6 % per year – a level just below the targeted annual 7.25 % rate of growth, that would be required to double real GDP over a decade. The GDP growth rate of 7.3% achieved in 2003, was the second highest in the country's recent economic history. Industrial output increased by 7%, while unemployment settled at 8.1 per cent.

Even though the current expansion of Russia's economy is being driven by strong private consumption, buoyant private sector investment activity and higher world market energy prices, recent GDP growth in Russia has been narrowly based, driven by natural resources and closely related sectors. Non-energy-related exports and investments have tended to lag.
In fact, although investment growth did exhibit a marked increase in 2003, GDP growth was essentially prompted by a resumption of net export growth, which resulted from higher world energy prices.

As regards the balance of payments, international reserves, which declined to around $12 billion at the time of the 1998 crisis, have risen steadily ever since, reaching a figure in excess of US$73 billion. Foreign direct investment inflows into Russia have increased significantly in recent years and have more than doubled in 2003, with respect to 2002, reaching US$ 5.2 billion. Improved external and fiscal balances are also illustrated by the dramatic decline in external debt. In fact, external public debt has fallen from nearly 80 % of GDP just after the crisis, to under 30 % at present.

Until recently, fiscal surpluses had helped sterilise foreign exchange purchases by the Central Bank while generating a strong increase in international reserves. This resulted in declining inflation and a relatively slow rise in the real exchange rate. In 2003 the consolidated government budget yielded a surplus of 1.35% of GDP. Russia's current monetary policy seeks to maintain a delicate balance between combating inflation – *which stood at 12% in 2003* - and containing the real appreciation of the ruble, that is generated by foreign exchange inflows.

Momentum from the economic growth witnessed in 2003 should continue in 2004, leading to high GDP growth. While strong commodity prices will indisputably play an important role, domestic demand will remain the key driver of growth, as incomes rise and consumption continues to increase at a faster pace than the expected GDP growth rate.

BSTDB has provided a loan for the corporate development program of **Akrihin,** a leading Russian pharmaceutical company. This facility will assist Akrihin in the completion of its USD 40 million medium-term investment program. The funds will be directed at modernisation of the company production facilities and the production launch of its latest generic medicine.

Banking Operations in 2003

BSTDB has extended an SME Leasing Facility to **DeltaLeasing** company in Russia. This Facility is to be used for the leasing of capital goods and equipment to Russian small and medium-sized enterprises. DeltaLeasing, one of Russia's leading SME sector leasing companies, is expected to be well positioned to reap the benefits of growing interest in direct financing leasing among potential customers. Thanks to the company's strong market presence and aggressive expansion strategy, BSTDB will be able to reach a range of Russian SMEs and deliver much-needed medium term financing.

BSTDB extended a further loan to **KMB-Bank** to support expansion of their lending to Russian small businesses. This new facility follows on from the first BSTDB credit line extended to KMB Bank in December 2001. KMB Bank is owned by the EBRD, DEG (Germany), and the Soros Foundation and is a market leader in SME lending in Russia. The facility is for the financing of specific projects or investment programs for the creation, modernisation, expansion and diversification of industrial production and service-related facilities.

The Bank also extended a Single Buyer Credit Facility to **Probusinessbank,** a Russian commercial bank, to finance a specific transaction for one of Probusinessbank's clients importing railcars from Ukraine. This financing met the dual objectives of both supporting the lending activities of the financial intermediary and of promoting trade between Russia and Ukraine.

SEVERSTAL Project

The Bank has extended a secured corporate loan facility of USD 20 million to the Russian joint-stock company SEVERSTAL, one of the leading Russian steel producers.

This financing will support a project involving the purchase of equipment manufactured by two Ukrainian manufacturers, Novokramatorsk machine-building plant and Dneprotehservice. The loan will also be directed at further improving the quality of Severstal's specialised steel products and the modernisation and the technical upgrading of production facilities.

Terms and conditions of the operation:
Amount: USD 20 million
Type of financing: Corporate Loan
Maturity: 7 years

Efes premium beer production in Russia. BSTDB is financing part of the expansion of Efes Breweries International in the Black Sea region. Efes has expanded beyond its home market in Turkey to successfully produce premium beers in Romania, Russia, Moldova and Ukraine.

TURKEY

The Turkish economy staged an impressive upturn in 2003, paving the way for a period of healthy GDP growth coupled with low inflation. This situation resulted from the improved outlook for oil prices, better market expectations, a stronger Turkish Lira and success in keeping public sector price increases under control. During 2003, GDP grew by 5.8% in real terms as a consequence of the 7.8% and 8.1% real annual growth rates recorded in the industrial sector and in trade activity, respectively. The increase in industrial production during 2003 amounted to 8.8%, reflecting strong growth in the output of the manufacturing and utilities industries. Unemployment still remains high at 10.5 per cent.

Tight fiscal policies were implemented during the course of 2003 and efforts are continuing towards restructuring and consolidating the country's financial sector. The 2003 target for the consolidated budget primary surplus at 5.0% of GDP was thus attained, while the budget deficit remained at 11.1% of GDP. There has also been a significant decline in annual inflation.

Turkey's trade balance recorded a deficit of about 5.3% of GDP, while the current account deficit widened to 2.6% of GDP, essentially reflecting a wider trade deficit and declining investment income. A higher-than-forecast surplus in the services balance helped limit any possible negative impact from the trade deficit. The promising recovery in the tourism sector and increasing workers' remittances attracted by the strong Turkish Lira, should ensure some offsetting of the negative effects of the expanding current account deficit that are inflicted upon the balance of payments. The capital account trend was also generally supportive during 2003. Meanwhile the government's net external borrowing increased, but access to international capital markets remained solid. Private sector borrowing also held up well, with many of the private sector repayments duly rolled over and some net new borrowing carried out. On the whole, foreign and local market sentiment towards Turkey improved visibly in 2003, as did access to local and foreign capital markets, helping nominal and real interest rates to fall faster than expected. This trend appears set to continue in 2004.

Increased export activity for **Vestel Beyaz Esya A.S.** was supported by the BSTDB through the extension of a medium-term loan facility. The funding was used to finance the completion of the washing machine and refrigerator manufacturing plant of Vestel Beyaz Esya A.S. in Manisa, Turkey. The operation is co-financed with Fortisbank. This loan from BSTDB is expected to lead to the creation of over 500 new jobs and it is anticipated that around 60% of the production of the two plants will be exported.

BSTDB has also provided finance for the expansion and modernisation program of textiles company **Korteks Mensucat Sanayi ve Ticaret**, a prominent member of the Zorlu Group in Turkey. The facility was used to purchase machinery and equipment to expand Korteks' production capacity for textile yarns and chips. The investment is expected to lead to an increase in Korteks' export revenues of 30%, as well as the creation of about 200 new jobs. This project was co-financed with West LB Bank of Germany.

BSTDB funding contributed to financing **Efes,** one of Turkey's leading brewing companies, in its expansion and modernisation investment program in Russia, Ukraine, Moldova and Romania. The overall investment undertaken by the company is expected to lead to increased production capacity, new brands, modernised production processes, improved product quality, and enhanced environmental protection. The overall investment is expected to lead to an increase in Efes' production capacity of 35% in Russia, by over 50% in Ukraine and by about 85% in Moldova.

OPET Project

The transaction is a BSTDB long-term corporate loan of USD 21 million to OPET Petrolcülük A.S, one of the leading petroleum companies in Turkey. OPET Petrolcülük A.S. is a privately owned Turkish company active in the distribution and marketing of refined petroleum products and lubricants in Turkey with more than 1,100 retail petrol stations under the OPET and SUNPET brands.

BSTDB financing will assist OPET in boosting its retail business and give an impetus to further expansion in the Black Sea Region.

Specifically, the loan proceeds will be utilised for the financing of OPET's Retail Network Expansion Programme including an increase in the company's distribution capacity.

Terms and conditions of the operation:
Amount: USD 21 million
Type of financing: Corporate Loan
Maturity: 6 years

Vestel production facility in Manisa (Turkey). Vestel is the leading Turkish exporter of refrigerators and washing machines. BSTDB is financing part of the expansion of the plant's capacity, creating over 500 new jobs.

UKRAINE

Ukraine's economy expanded more strongly than anticipated during 2003, with annual real GDP attaining a cumulative growth rate of 9.3%, supported by an impressive increase in industrial output of 15.7%. The country's strong economic performance in 2003 was assisted not only by strong domestic demand, but also by the CIS countries and Southeast Asia, where demand for Ukrainian exports, particularly those in the metallurgy sector, remained strong.

Favourable conditions for domestic demand were reflected by strong investment activity. This provided considerable impetus for fresh construction activity that in turn increased the demand directed to the metals, engineering equipment and construction materials industries. Coupled with rising incomes, these developments generated growth in private consumption, which helped support the wholesale and retail trade sector, the energy sector as well as consumer lending. Electricity production is expected to increase further in 2004 and beyond, as economic recovery and reforms gather pace. Privatisation activity in the country's energy sector is also likely to continue over the foreseeable years. Strategic investors are likely to bring much needed investment and improved efficiency, thereby helping to stabilise the country's energy sector.

The monetary policy line pursued by the National Bank of Ukraine since 2001 has enabled achievement of single-digit inflation and low interest rates, against the backdrop of improved nominal currency stability, sound fiscal policies and productivity increases. Favourable economic developments in 2003 notwithstanding, inflation exhibited a volatile outlook during the year, essentially because of a poor grain harvest which added to supply-side inflationary pressures, and as of end December inflation recorded an increase of 8.2% year-on-year.

On the balance of payments front, favourable world prices and sustained foreign demand for Ukraine's key exports, together with gas re-exports, enabled Ukraine's foreign trade turnover to grow rapidly in 2003. This being said, the acceleration of imports in the latter half of 2003, due to the surge in grain imports following the disastrous harvest in addition to higher energy imports, resulted in a low trade surplus. However, the current account showed a much higher surplus, of about 5% of GDP.

Procredit Bank Ukraine (former Microfinance Bank of Ukraine)

BSTDB signed, with Procredit Bank Ukraine, a Term Loan Facility for financing and developmental support of the micro and small business sector in the Ukraine.

Procredit Bank Ukraine is a sister bank of a network of specialized micro- and small-lending institutions established by a number of IFIs and other development oriented entities for the purpose of strengthening the banking system in Ukraine and supporting small and medium sized enterprises.

Terms and conditions of the operation:
Amount: USD 5 million
Type of financing: Term Loan
Maturity: 3 Years

Grain terminal in the Port of Illychevsk (Ukraine). BSTDB financing is contributing to make this terminal one of the leading installations of its type in the Black Sea region, with a yearly capacity of six million tons.

Annual Report 2003

Use of Resources

4

Use of Resources

Resources

Corporate Governance
BSTDB is committed to maintaining effective corporate governance through a well defined framework of responsibilities and controls. Transparency and accountability supported by clearly defined reporting systems enable maintenance of an appropriately controlled business environment.

Human Resources Management
BSTDB recognizes that human resources are a key factor in the ultimate success of the institution and strives to maintain its status as a competitive employer by following the best international standards and practices.

Recruitment
The Bank's recruitment policies provide for the hiring of employees on a wide geographical basis, preference being given to the citizens of member countries. At the end of 2003, the Bank had 97 employees, from 16 countries, including representatives from all its 11 member states.

Training and Career Management
It is one of the Bank's top priorities to emphasise professional growth through the development of new skills and competencies. With this objective in mind the Bank offers its staff both internal and external training programs to learn and develop those skills required for both current jobs and future career progression.

Compensation

The Bank operates a market–oriented staff compensation policy designed to match the employment standards of other IFIs.

Pension Plan

The BSTDB Pension Plan, implemented in January 2003, is comprised of a fully funded defined benefit scheme and a matched contribution plan. This combination offers the flexibility crucial to best meet the needs of a multinational work force.

Information Technology

SAP

BSTDB remains committed to the concept of an integrated computer system, closely aligned with all its business needs. The implementation, in 2003, of the SAP system to handle the Banks accounting functions is seen as a significant step towards this goal.

Security

The Bank has adopted industry best practice to ensure the security of its IT systems and electronic assets. Perimetric IT security allows only certain protocols to enter the network, and monitors the content of the electronic messages and information for possible security infringement. Internal security is based on advanced antivirus and intrusion detection software monitoring all IT devices connected to the Bank's network.

Intranet Development

The implementation of the Bank's Intranet has facilitated business process automation, information and document management and project collaboration, building towards a knowledge based system.

Use of Resources

Administration
With productivity depending, to a significant extent, on easy access to information, the Bank has introduced and implemented, in 2003, updated rules for the creation and circulation of internal documents, shifting the emphasis from a paper-based to an electronic system evolving within the Bank's Intranet. In the same framework, a comprehensive effort was initiated, in 2003, for the mapping of document and record management needs of the various departments, which will lead within 2004, to the installation of appropriate EDMS and ERMS [electronic document & record management] applications for optimal use of the Intranet platform.

External Relations and Communications
BSTDB places great emphasis on developing and maintaining its contacts with member state governments, international institutions and those entities with business activity in the region.

In 2003 BSTDB established an observer status to provide the opportunity for regional and non-regional governments and international financial institutions to develop a closer association and learn more about the Bank and the region.

Relations with the European Commission were enhanced in 2003 by the BSTDB joining the new Memorandum of Understanding between the Commission and other IFIs on co-operation for EU accession of Central and Eastern European countries. The Memorandum provides a mechanism for coordinated action and for co-financing development projects in the accession countries, including Bulgaria, Romania and Turkey.

In its drive to develop additional contacts and promote investment in the region, the Bank hosted a number of promotional events during 2003 including the Black Sea Business Day in Thessaloniki and a regional investment conference in Odessa.

2003 Black Sea Business Day in Thessaloniki

On the occasion of its Fifth Annual Board of Governors Meeting, BSTDB hosted the Black Sea Business Day in Thessaloniki, which focused on issues involved in attracting investment to regional projects in the industry and energy sectors, as well as on mobilising international financing for the Black Sea region. The Business Day gathered over 350 international and regional political decision-makers, business people and bankers, who had the opportunity to discuss development projects, financing programs and prospects for business activities in the region.

The audience of the Business Day was addressed by H.E. Mr. Nikolay Vassilev, Deputy Prime Minister and Minister of Economy of Bulgaria, H.E. Mr. Akis Tsochatzopoulos, Minister of Development of Greece, and Mr. Ivan Materov, First Deputy Minister of Economic Development and Trade of Russia.

Investment Conference in Odessa

In 2003 BSTDB launched a new initiative of holding annual investment conferences focusing on a specific member country. On October 2-3, 2003, the Bank held a business conference "Promoting Investment in Ukraine" in Odessa in close cooperation with the Ukrainian Government and the Union of Industrialists and Entrepreneurs of Ukraine. 260 representatives of local and foreign companies and banks, as well as IFIs, participated in discussion on ways to facilitate international investment in energy, manufacturing, agriculture, and services sectors, with keynote speeches made by the Ukrainian Minister of Economy, by Mr. Anatoliy Kinakh, President of the Union of Industrialists and former Prime Minister of Ukraine, and by the Governor of the Odessa region.

From left to right:

Mr. Mustafa Gürtin, BSTDB President
Mr. Anatoliy Kinakh, President of the Union of Industrialists and Entrepreneurs of Ukraine and Mr. Vitaly Lisovenko, BSTDB Vice President Operations.

Environment Protection

The Bank has a mandate to protect the Black Sea against pollution and to promote sound environmental practices and sustainable development in all its loan operations. To ensure that potential environmental risks arising from its financing activities are properly identified, assessed and mitigated the Bank undertakes independent environmental assessment of all proposed operations. The Bank then incorporates salient environmental issues and effective mitigation measures into its overall decision-making process before making a commitment to finance. During 2003 the Bank commissioned a number of environmental audits for its operations, including the JSC Severstal (Steel Manufacturing in Russia) modernisation project and the OPET Petrolculuk A.S. (Petroleum distribution in Turkey) expansion project.

Post Evaluation

Post evaluation is the assessment of operations, programs, activities and strategies through systematic and rigorous analysis of their outputs, outcomes and impact against expected results and the overall mission of the Bank. It serves two important objectives:
(i) *accountability* – to reveal the results of the Bank's operations/activities and assess their contribution to the Bank's mission; and
(ii) *learning* – to derive lessons learned from past experience.

OPET petrol station in Turkey. BSTDB incorporates high environmental standards in all its financing agreements.

Use of Resources

Financial

Special Fund

The Bank received, in 2001, an initial amount of €800 thousand from the Government of the Hellenic Republic to fund the Technical Cooperation Special Fund (the Hellenic Fund) under the Contribution Agreement between the Government of the Hellenic Republic and the Bank dated July 4, 2001. The Fund responds to a real need expressed by the project and trade finance teams, concerning the quality of information (feasibility studies, technical studies, financial accounts) provided by our prospective clients.

The Hellenic Government provided an additional amount of €500 thousand that was received on January 2, 2003. This amount will further enable the Bank to assist potential investors of the Region in implementing their business plans.

The Fund as provided by the Greek Government is administered by the BSTDB according to the Rules and Regulations pertaining to its establishment.

BSTDB always acts on the basis of a written request from prospective clients to help them upgrade their work from the proceeds of the Fund, whenever the Bank considers that additional or higher quality information is required. The Fund is tied to consulting firms based in Greece. However, up to 25% of the assignment cost may be allocated to consultants who are nationals of the BSTDB member countries.

In 2003, the Fund has provided €150 thousand out of a total contract cost of €244 thousand. Those funds have been used for payment of consultancy services for the preparation of four operations in Albania, Georgia, Greece and Russia.

Financial Management

Revenues

During 2003, the Bank increased the size of its lending portfolio to SDR 170,373 thousand from SDR 85,081 thousand at the end of 2002. As a result total income from Project and Trade financing operations rose to SDR 6,639 thousand in 2003 from SDR 5,400 thousand in 2002. Treasury activities in 2003 generated total interest income of SDR 3,251 thousand from placements with financial institutions and investment in short term money market instruments. Total operating income for the year was SDR 9,668 thousand, substantially unchanged from the previous year.

Expenses

General administrative expenses, including depreciation, for the year were SDR 9,424 thousand, an increase of SDR 603 thousand on 2002. Salaries and benefits, totalling SDR 6,664 thousand, increased by SDR 412 thousand primarily due to recognition of a supplementary obligation for the Bank's pension plan.

Capital Base

As specified in the Establishing Agreement, the BSTDB's initial authorized capital stock is one billion (1,000,000,000) Special Drawing Rights (SDR) divided into one million (1,000,000) shares, each with a par value of one thousand (1,000) SDR.

All participating Member States of the Bank have fully subscribed to their portion of the initial authorised capital stock. The subscribed capital is composed of:

- ten per cent (10%) fully paid shares;
- twenty per cent (20%) paid by promissory notes (eight equal annual installments, encashment starting from the year 1998); and
- seventy per cent (70%) callable shares.

The aggregate par value of the initial authorized fully paid shares is SDR 100 million and that of the capital paid by promissory notes is SDR 200 million. The Board of Governors shall at intervals of not more than 5 years review the capital stock of the Bank. The first such review will take place in June 2004.

As of 31 December 2003, two hundred and fifty million SDR's were due to be paid-up by the participating Member States, in accordance with the schedule stipulated in the Agreement. This included the ten per cent fully paid shares and six of the eight equal annual instalments of the twenty per cent shares payable by promissory notes. Of the SDR 250 million due as at 31 December 2003 more than SDR 239 million had been received. The total initial authorised capital stock of the Bank of SDR one billion remained unchanged.

Gearing Ratio

The Establishing Agreement places limitations on the use of the Bank's capital for its ordinary operations. Treasury investments, comprising those assets held for liquidity purposes, are considered auxiliary to the Bank's ordinary operations.

The Bank's institutional gearing ratio - the statutory limit on the total amount of ordinary operations (outstanding loans, equity investments and guarantees) is 150% of the Bank's unimpaired subscribed capital, reserves and surpluses and as at 31 December 2003 stood at slightly above SDR 1.5 billion. During the 36th meeting of the Board of Directors held in December 2003, the operational gearing ratio was set at 100% of the Bank's unimpaired paid-up capital, reserves and surpluses and the usable portion of callable capital[3]. This limit on the total amount of operations as of 31 December 2003 stood at about SDR 920 million and will amount to approximately SDR 1 billion when all paid-in capital is received by the Bank.

[3] *That part of callable capital where the associated paid in capital due has been paid up.*

Use of Resources

Planning and Budgeting

The Banks planning process, carried out within the scope of Board of Directors approved guidelines, aims to prioritise the Bank's operational objectives within the scope of its mission statement. The process incorporates the formulation of operational priorities, country and sector strategies, preparation of the annual budget and the resource allocation process. It may also include the preparation of operational policy papers supporting the implementation of specific strategy initiatives. The planning cycle is designed to ensure effective utilisation of resources, while also establishing review and control processes to monitor actual performances against targets.

The Bank is committed to budgetary discipline within the framework of established policies and guidelines. Execution of the Budget is monitored on an ongoing basis and the results reported to the Board of Directors on a quarterly basis.

Management of Market Risk

Market risk management is overseen by the Bank's Asset and Liability Committee and implemented within a framework of conservative risk limits and policy documents approved at the highest level by the Board of Directors. More specific subsidiary documents detailing credit risk parameters, liquidity restrictions, interest rate and foreign exchange risk are approved on an ongoing basis by the appropriate executive committees.

It is the policy of the Bank to take no significant interest rate or foreign exchange positions. Asset and liability maturities and interest rate tenors are matched wherever possible. The SDR denominated capital and reserves are invested in the SDR constituent currencies at weightings intended to keep foreign exchange exposure to a minimum.

Liquidity

The Bank's surplus funds, totalling SDR 84,603 thousand as at 31 December 2003, were invested in two types of money market assets:

- Short term deposits with institutions long term rated at minimum of A/A2 by either Standard & Poors or Moody's credit rating agency.
- Euro commercial paper rated at a minimum of short term A2/P2 by either Standard & Poors or Moody's credit rating agency.

Investments are denominated in one of the four SDR component currencies and performance is monitored monthly against the Merrill Lynch 3 month Libid index.

The Banks liquidity ratio, calculated as liquid assets / 12 months net cash requirement, was comfortably in excess of 100% for the majority of the year and 99% on 31 December 2003.

Rating

The Bank has obtained, from Moody's Investor Services, initial investment grade ratings of long term Baa2 and short term rating of P2, effective March 2004.

Funding

As of the end of 2003 the Bank had not found it necessary to access the capital markets, relying on its own resources to fund its lending activity. This situation seems likely to change during the later part of 2004 and with this scenario in mind the Bank has formulated its funding strategy within the following general areas:

Other international financial institutions and government agencies are potential providers of long term funding and to this end the Bank has developed a number of close relationships.

Commercial banks are another potential source of funds, therefore raising the Bank's profile in this sector has been a long-standing objective and, with the aid of an investment grade credit rating, this will be pursued vigorously in 2004.

Credit Risk Management

The BSTDB is exposed to credit risk in both ordinary operations and treasury activities. The majority of credit risk lies in the lending portfolio which stood at SDR 170,373 thousand as at the end of 2003.

The Bank addresses all aspects of its credit risk exposure within a robust credit risk management framework, based on quantifying related risk exposures and properly assessing risk mitigants.

The Bank assigns ratings to countries, financial institutions and individual projects, based on a variety of quantitative and qualitative methodologies, thus determining product pricing, tenor of instruments/investments, as well as the level of provisions.

Preferred creditor status

As an international financial institution, the Bank has preferred creditor status. This means that the Bank usually will:

- not reschedule debt payments or participate in debt rescheduling agreements with respect to its loans to, or guaranteed by, its member countries of operations
- not reschedule its loans to private sector borrower where the borrower's inability or anticipated inability to service its debt is due to a general foreign exchange shortage in the borrower's country.

Sovereign Risk

Sovereigns risks are rated, following an in-house methodology, on a scale of 1 to 5. During 2003 the Bank made no significant adjustments to its internal ratings of its member countries despite continued improvement in credit standings across the region.

Portfolio Risk

Under the terms of the project cycles all operations were subject to review during 2003. Although one project was downgraded by year end, overall portfolio quality improved year-on-year following the signing of several large projects co-financed with other IFIs.

The growth in portfolio size has led to increased emphasis on the monitoring of sectoral distribution and concentration limits have been devised in preparation for the time when overall portfolio volume justifies their implementation.

Risk Analysis

An independent financial analysis is performed for each of the Banks operations. Corporate entities are initially subject to an assessment of creditworthiness based on historical financial statements. This is followed by cashflow modelling for the life of the proposed operation and stress testing of key assumptions. For financial institutions risk analysis is based on quantitative methodology (i.e. capitalisation, asset quality, liquidity and foreign exchange risk) supported by comparisons of key ratios to industry standards.

Provisioning

The IAS-compliant BSTDB provisioning policy is designed to ensure that the level of general provisions is commensurate with overall portfolio risk levels. While each project contributes to the general provisions, specific provisions are only allocated if and when a specific operation encounters difficulties. Total provisions at end 2003 stood at SDR 9,375 thousand equivalent to 5.4% of the outstanding loans and equity investments.

The target to be achieved for total provisions, over time, is set at 10% of disbursed loans and 25% of disbursed equity investments.

Risk mitigation

The Bank will normally require its operations to benefit from some form of security or risk-sharing in order to mitigate the credit risks involved. When the Bank lends to public or private sector borrowers, it will normally require certain guarantees and, in all cases, will ensure that the parties involved share risks in a reasonable manner.

Reporting and Disclosure

The BSTDB's corporate governance structure is supported by appropriate financial and management information reporting. Through its reports and disclosures the Bank, in line with its policy of maintaining industry best practice, follows the reporting conventions of other international financial institutions. The Accounting Policies adopted by the Bank are based on International Financial Reporting Standards.

With respect to external financial reporting, the Bank presents financial statements in its quarterly Summary Statements and in the Annual Report. Pursuant to Article 35 of the Agreement, these reports are transmitted to the Governments of the Member States (Annual Report only), members of the Board of Governors and Directors and the BSEC Permanent International Secretariat. The Annual Report for 2003 is the fifth report published following the commencement of operations of the Bank.

In its financial reporting, the Bank aims to provide appropriate information on risk and performance. Industry best practice will guide the evolving disclosure practice both in public financial reports and management information reporting, with the ultimate aim of enhancing accountability throughout the organisation.

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Annual Report 2003

Financial Statements and Notes

Financial Statements and Notes

Financial Statements for the Year Ended
31 December 2003

INCOME STATEMENT
For the year ended 31 December 2003

Expressed in thousands of SDR	Note	2003	2002
Interest and similar income			
From loans		5,816	4,760
From placements with financial institutions		391	289
From investment securities		2,860	4,232
Interest expense and similar charges	13	(130)	(129)
Net interest income		8,937	9,152
Net fees and commissions	3	823	640
Net income (loss) on foreign exchange		(93)	(27)
Other income		1	6
Operating income		**9,668**	**9,771**
General administrative expenses	4	9,019	8,417
Depreciation	11	405	404
Income before provisions		**244**	**950**
Provisions for losses	5	5,378	2,436
Net (loss) for the year		**(5,134)**	**(1,486)**

The accompanying notes are an integral part of this statement.

BALANCE SHEET
At 31 December 2003

Expressed in thousands of SDR	Note	2003	2002
Assets			
Cash and bank balances	16	16,890	107
Placements with financial institutions	16	30,054	29,263
Investment securities	16	37,659	117,870
Total deposits and securities		84,603	147,240
Loans	8	170,373	85,081
Equity investments	9	2,625	2,499
Less: provisions for losses	5	(9,375)	(4,417)
Net loans and equity investments		163,623	83,163
Receivables and accrued interest		1,566	2,662
Share capital replenishment portion not received	7	0	854
Share capital short-term subscription receivable	6	10,926	10,407
Paid-in share capital not received		10,926	11,261
Property, technology and equipment	11	1,418	1,205
Intangible assets	11	1,023	721
Less: accumulated depreciation	11	(1,504)	(1,099)
Net property, technology and equipment		937	827
Other assets	12	2,285	168
Total Assets		**263,940**	**245,321**
Liabilities			
Payables and accrued interest	14	659	3,004
Deferred income	3	2,177	1,116
Total liabilities		2,836	4,120
Members' Equity			
Subscribed share capital	6	1,000,000	1,000,000
Less: callable share capital	6	(700,000)	(700,000)
Less: payable share capital	6	(50,000)	(75,000)
Advance against future call	6	57	20
Paid-in share capital		250,057	225,020
General reserve	15	3,666	3,666
Retained earnings		7,381	12,515
Total members' equity		261,104	241,201
Total Liabilities and Members' Equity		**263,940**	**245,321**
Off-balance-sheet items			
Commitments	10	100,144	74,329

The accompanying notes are an integral part of this statement.

STATEMENT OF CHANGES IN MEMBERS' EQUITY
For the year ended 31 December 2003

Expressed in thousands of SDR	Share capital					
	Subscribed	Callable	Payable	General Reserve	Retained Earnings	Total
At 31 December 2001	**1,000,000**	**(700,000)**	**(90,929)**	**3,666**	**4,937**	**217,674**
Paid-in share capital			25,000			25,000
Reversal of cumulative translation adjustment			(9,064)		9,064	0
Advance against future call			13			13
Net (loss) for the year					(1,486)	(1,486)
At 31 December 2002	**1,000,000**	**(700,000)**	**(74,980)**	**3,666**	**12,515**	**241,201**
Paid-in share capital			25,000			25,000
Advance against future call			37			37
Net (loss) for the year					(5,134)	(5,134)
At 31 December 2003	**1,000,000**	**(700,000)**	**(49,943)**	**3,666**	**7,381**	**261,104**

The accompanying notes are an integral part of this statement.

STATEMENT OF CASH FLOWS
For the year ended 31 December 2003

Expressed in thousands of SDR	Note	2003	2002
Cash flows from operating activities			
Net (loss) for the year		(5,134)	(1,486)
Adjustment for:			
Provisions for losses	5	5,378	2,436
Depreciation	11	405	404
Interest and similar income		(9,067)	(9,281)
Interest expense and similar charges	13	130	129
Foreign exchange adjustments on provisions	5	(420)	(276)
Operating profit before working capital changes		(8,708)	(8,074)
Decrease (increase) in other assets	12	(2,117)	6
Increase (decrease) in accounts payable	14	(2,394)	903
Increase in deferred income	3	1,061	663
Cash generated from (used for) operations		(12,158)	(6,502)
Interest and similar income received		10,163	9,162
Interest and similar charges paid		(81)	(131)
Net cash from (for) operating activities		(2,076)	2,529
Cash flows from investing activities			
Proceeds from repayment of loans	8	51,430	59,164
Proceeds from maturity of investment securities	16	58,376	109,767
Funds advanced for loans and equity investment	8,9	(136,848)	(88,995)
Purchase of investment securities	16	(39,454)	(59,416)
Purchase of property, technology and equipment	11	(515)	(112)
Net cash (used in) from investing activities		(67,011)	20,408
Cash flows from financing activities			
Increase in paid-in share capital	6	25,000	25,000
Share capital replenishment portion received	7	854	0
Decrease (increase) in share capital S.T. receivable	6	(519)	2,421
Increase in advance against future call	6	37	13
Paid-in share capital received		25,372	27,434
Borrowings	13	15,334	20,451
Repayments of borrowings	13	(15,334)	(22,923)
Net cash provided by financing activities		25,372	24,962
Net increase (decrease) in cash and cash equivalents		**(43,715)**	**47,899**
Cash and cash equivalents at beginning of year		128,318	80,419
Cash and cash equivalents at end of year	16	**84,603**	**128,318**

The accompanying notes are an integral part of this statement.

Notes to the Financial Statements
31 December 2003 (All amounts are expressed in thousands of SDR)

1. ESTABLISHMENT OF THE BANK

1.1 Agreement Establishing the Bank

The Black Sea Trade and Development Bank ("the Bank"), whose headquarters is located at 1 Komninon Street, Thessaloniki, in the Hellenic Republic, was established as an international financial organisation under the Agreement Establishing the Bank dated 30 June 1994 ("the Agreement"). In accordance with Article 61 of the Agreement, the Bank was established and the Agreement entered into force on 24 January 1997. The Bank commenced operations on 1 June 1999.

As at 31 December 2003 the Bank's shareholders comprised of 11 countries: Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russian Federation, Turkey and Ukraine.

The financial statements for 2003 have been submitted by the Management Committee to the Board of Directors for approval on 16 April 2004. Pursuant to Article 23 of the Agreement, these financial statements shall be subject to the approval by the Board of Governors in their Annual Meeting to be held on 6 June 2004.

1.2 Headquarters Agreement

The status, privileges and immunities of the Bank and persons connected therewith in the Hellenic Republic are defined in the Headquarters Agreement between the Government of the Hellenic Republic and the Bank ("Headquarters Agreement"). The Headquarters Agreement was signed on 22 October 1998.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of financial statements

The financial statements have been prepared in accordance with the Bank's Accounting Policies, which comply with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board.

The financial statements have been prepared on a historical cost basis except for the measurement at fair value of available for sale financial assets. The Bank has not applied any IFRS before their effective dates.

The Bank's measurement and reporting currency is Special Drawing Rights (SDR), which is the unit of account for the Bank's authorised share capital, pursuant to Article 4 of the Agreement.

2.2 Foreign currencies

Foreign currency transactions are initially recorded in SDR by applying to the foreign currency amount the exchange rate between the SDR and the foreign currency at the rate prevailing on the last day of the month, preceding the date of the transaction, as provided by the IMF. Exchange gains and losses arising from the translation of monetary assets and liabilities at year-end exchange rates are taken to the income statement.

For the purpose of the preparation of the financial statements, the following end of year exchange rates were used for monetary assets and liabilities:

		2003	2002
1 SDR =	United States dollar	1.48597	1.35952
	Euro	1.17897	1.29589
	Japanese yen	158.86500	161.29300
	Pound sterling	0.83262	0.84348

2.3 Investments

All investments are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment.

Investments intended to be held to maturity are measured at amortised cost, by applying the effective interest rate method less any provisions for impairment. Gains and losses are recognised in income when the investments are derecognised or impaired as well as through the amortisation process.

Investments in equity instruments that do not have a quoted market price and for which other methods of reasonably estimating fair value are inappropriate, are measured at cost less provision for impairment, where there is objective evidence of impairment. The same policy is also followed for investments in associates. When equity investments are sold the difference between the net proceeds and the carrying value is recognized in the income statement as a gain or loss on sale of equity investments.

2.4 Loans and provisions for losses

Loans by providing money directly to a borrower are categorised as loans originated by the Bank and are carried at amortised cost. All loans and advances are recognised when cash is advanced to borrowers. Loans on which either interest or capital is unpaid for 90 days are classified as non-accruals and interest on such loans is not recognised until collected.

A provision for loan impairment is established if there is objective evidence that the Bank will not be able to collect all amounts due. The amount of the impairment is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, including amounts recoverable from guarantees and collateral, discounted based on the interest rate at inception.

A specific provision is made for loans that are individually identified as impaired. A general loss provision is also made taking into consideration the risk rating of each asset, the country risk and the operations risk applicable by industry segment.

When a loan is deemed uncollectable or there is no possibility of recovery of an equity investment, the principal is written off against the related specific or the general loss provision. Loans are only written off when the borrower is liquidated. Recoveries of loans previously written off are credited to the income statement.

2.5 Property, technology and equipment

Property, technology and equipment are stated at cost, less accumulated depreciation. Depreciation is provided so as to write off the cost of each asset to their residual values on a straight-line basis over their estimated useful lives. The annual depreciation rates applied are as follows:

– Furniture, furnishings and appliances	20.0%
– Personal computers, related software and peripherals	33.3%
– Office and telecommunication equipment	20.0%
– Transportation vehicles	20.0%

Expenditure on leasehold buildings and improvements are depreciated over the remaining term of the lease.

2.6 Income and expenses

Interest income and expense are recorded on an accrual basis, with the exception of interest on loans that have been placed on non-accrual status that is recorded when received. Loan commitment and guarantee fees and fees received in respect of services provided over a period of time are recognised as income on an accrual basis matching the period during which the commitment exists or the services are provided. Dividends are recognized when received. General administrative expenses are recorded on an accrual basis.

2.7 Staff retirement plan and termination benefits

The Bank has established a pension plan, where the fund's assets are held separately from the Bank's own assets, for all its permanent employees consisting of three pillars:

- The first pillar is a defined benefit scheme financed entirely by the Bank. The Bank's contributions are determined on the basis of actuarial valuations using the projected unit credit method, performed annually by qualified, independent actuaries;
- The second pillar is a defined contribution scheme to which both the employee and the Bank contribute equally at a rate of 0-7.5% of basic salary. Each employee determines his/her contribution rate and the mode of investment of the contributions; and
- The third pillar is a defined contribution scheme funded entirely by each employee, up to 40% of his/her basic salary.

Local staff are also entitled to retirement benefits from the State Sponsored Social Insurance Fund (IKA), which is a defined contribution scheme.

Current service costs in respect of both the pension plan and social insurance contribution schemes (IKA) are recognised as an expense and included in "General administrative expenses".

Employees are also entitled to termination indemnities, prescribed in the termination policy of the Bank. However, no provision has been recorded as there is no commitment by the Bank as of end 2003.

2.8 Taxation

In accordance with Article 52 of the Agreement, the Bank, its assets, property, income and its operations and transactions are exempt from all taxation and all customs duties in Greece. The Bank is also exempt from any obligation for payment, withholding or collection of any tax or duty. Also no tax shall be levied on salaries or emoluments paid by the Bank to employees. These tax exemptions are enforced by the Headquarters Agreement of Article 12, and have been implemented by the Greek Government by virtue of the ratification of Law 2380/No.38/7.3.1996.

2.9 Derivative financial instruments

In the normal course of business the Bank is a party to spot and forward foreign exchange contracts. These instruments are used to hedge currency exposure associated with the Bank's assets and liabilities and are stated in the balance sheet at fair values, with any revaluation of gain or loss taken to the income statement.

2.10 Use of estimates

The preparation of financial statements involves management estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. NET FEES AND COMMISSIONS

Net fees and commissions in the income statement are analysed as follows:

	2003	2002
Front-end fees	326	341
Commitment fees	276	141
Guarantee fees	65	13
Management fees	70	71
Appraisal fees	71	63
Reimbursement undertaking fees	0	7
Other	15	4
Net fees and commissions	**823**	**640**

Front-end fees pertaining to loans are amortised through the income statement using the effective interest rate method, over the maturity of the loans. In case of early repayment, cancellation or acceleration of the loans the outstanding deferred income for the related fees are recalculated taking into account the new maturity date. The deferred income balance as of 31 December 2003 amounts to SDR 2,177 thousand.

4. GENERAL ADMINISTRATIVE EXPENSES

General administrative expenses in the income statement are analysed as follows:

	2003	2002
Salaries and benefits	5,543	5,331
Staff retirement plan (note 20)	1,121	921
Other administrative expenses	2,355	2,165
General administrative expenses	**9,019**	**8,417**

The average number of staff employed during the year was 97 (2002: 98). The number of staff at 31 December 2003 was 97 (2002: 97).

5. PROVISIONS FOR LOSSES

Loans and equity investments are stated net of provisions. Included in the general provision is an amount relating to guarantees. A summary for movements in provisions for losses during the year were as follows:

	2003			2002		
	General	Specific	Total	General	Specific	Total
At 1 January	3,939	478	4,417	2,066	191	2,257
Charges for the year	4,429	949	5,378	2,133	303	2,436
Foreign exchange adjustments	(220)	(200)	(420)	(260)	(16)	(276)
At 31 December	**8,148**	**1,227**	**9,375**	**3,939**	**478**	**4,417**

At 31 December 2003 the Bank categorised one loan and one equity investment as impaired. The total exposure amounts to SDR 3,683 thousand and the specific provisions on these assets amounted to SDR 1,227 thousand. Interest income was not excluded from the income statement as a result of the impairment since the interest on the impaired loan was received.

6. SUBSCRIBED SHARE CAPITAL

In accordance with Article 4 of the Agreement, the initial authorised share capital of the Bank is one billion SDR divided into one million shares having a par value of one thousand SDR each. All participating members have fully subscribed to their portion of the initial authorised share capital in accordance with Article 5 of the Agreement.

The issued share capital at end of year is analysed as follows:

	2003	2002
Subscribed share capital	1,000,000	1,000,000
Less: callable share capital	(700,000)	(700,000)
Less: payable share capital	(50,000)	(75,000)
Called-up share capital	250,000	225,000
Advance against future call	57	20
Paid-in share capital	**250,057**	**225,020**

In accordance with paragraph 2 under Article 6 of the Agreement, all Member States were required to pay their share of the first issue of shares of SDR 100 million within 60 days after the date on which they became members of the Bank. In accordance with paragraph 3 under the same Article, a second issue of shares of SDR 200 million was made in 1998 and payment for these shares shall be made by each Member State by promissory notes or other obligation issued by such Member in eight equal successive annual instalments in the years 1998 to 2005.

At 31 December 2003 seven Member States had not yet fully settled the called up portion of their capital obligations. Three of the seven members have settled more than 99.9% and their amount due of SDR 36 thousand represents primarily foreign exchange difference. The balance of share capital due but not received at 31 December 2003 was SDR 10,926 thousand and at 31 December 2002 was SDR 10,407 thousand.

The capital subscription status and voting power, which is based on the paid amount, of each Member at 31 December 2003 is analysed as follows:

		Subscribed	Callable	Payable	Paid	
Member	Shares	Expressed in thousands of SDR				Voting Power
Albania	20,000	20,000	14,000	6,000	4,999	2.1%
Armenia	20,000	20,000	14,000	6,000	1,999	0.8%
Azerbaijan	20,000	20,000	14,000	6,000	3,398	1.4%
Bulgaria	135,000	135,000	94,500	40,500	33,750	14.1%
Georgia	20,000	20,000	14,000	6,000	2,000	0.8%
Greece	165,000	165,000	115,500	49,500	41,250	17.3%
Moldova	20,000	20,000	14,000	6,000	1,713	0.7%
Romania	135,000	135,000	94,500	40,500	33,725	14.1%
Russian Fed.	165,000	165,000	115,500	49,500	41,240	17.3%
Turkey	165,000	165,000	115,500	49,500	41,250	17.3%
Ukraine	135,000	135,000	94,500	40,500	33,750	14.1%
Total	**1,000,000**	**1,000,000**	**700,000**	**300,000**	**239,074**	**100.0%**

7. SHARE CAPITAL REPLENISHMENT PORTION NOT RECEIVED

In accordance with Article 6 of the Agreement, each Member State shall be free to select the currency or currencies and the proportion thereof in which the capital payments will be made. The portion of the national currency of the respective Member State in each payment shall not exceed 50% of the amount due for such payment.

Romania exercised this option and its 50% contribution to the first issue of 10% of the fully paid-up share capital equivalent to SDR 6,750 thousand or ROL 66,021,750 thousand was initially deposited in a local currency account with the Central Bank of Romania and transferred to a US$ denominated account with an international bank in August 2001.

At 31 December 2002 an amount of SDR 854 thousand was due to make up for the loss in exchange on the ROL deposit prior to the above transfer. This amount was paid in the year to 31 December 2003.

8. LOANS

The Bank offers a range of financial instruments for both project and trade financing, tailored to meet an individual operation's requirements. The Bank may also make equity-financing investments and provide guarantees. Loans may be denominated in any convertible currency, or a combination of convertible currencies in which the Bank is able to fund itself.

	2003	2002
At 1 January	85,081	56,717
Disbursements	146,983	85,398
Less: repayments	(52,181)	(50,654)
Foreign exchange movements	(9,510)	(6,380)
At 31 December	170,373	85,081
Less: accumulated specific provision	(1,118)	0
Net loans outstanding at 31 December	**169,255**	**85,081**

At 31 December 2003 only one loan was not performing as per the loan agreements for a total amount of SDR 243 thousand of overdue principal repayment. There were no overdue interest repayments and no amounts of loan outstanding disbursements in non-accrual status.

Interest is primarily charged at 3 and 6 months Libor for USD loans and Euribor for EUR loans in their respective denomination plus a margin. The margin depends on the risk category of each loan. The fair value of the loan portfolio is approximately equal to book value because all loans bear a variable interest rate and are given at market conditions and terms.

9. EQUITY INVESTMENTS

A primary focus of the Bank is to facilitate access to funding for those small and medium size enterprises with the potential for positive economic developmental impact. With this objective in mind, the Bank, together with a number of other institutions invested in the below entities.

As the Bank does not prepare consolidated financial statements such investments that fall under the definition of associated companies are carried at cost less provisions for impairment, following the option allowed by IAS 28.

	2003	2002
At 1 January	2,499	1,032
Disbursements	379	1,580
Less: repayments	(13)	0
Foreign exchange movements	(240)	(113)
At 31 December	2,625	2,499
Less: accumulated specific provision	(109)	(478)
Net book value	**2,516**	**2,021**

The valuation of such investments has been based on their latest audited accounts as of the 31 December 2002. The investees' details and their net equity as of 31 December 2003 as per their un-audited management accounts are as follows:

	Percentage of investment	Total net equity
SEAF Trans-Balkan Fund LLC	18.33	5,663
Micro Finance Bank of Azerbaijan	35.00	2,796

10. OPERATIONAL ANALYSIS

The analysis of operational activity of the Bank by geographical area, instrument and sector are as follows:

	2003		2002	
	Outstanding disbursements	Undrawn commitments	Outstanding disbursements	Undrawn commitments
Analysis by country				
Azerbaijan	3,667	1,885	3,739	2,329
Bulgaria	25,011	27,584	4,609	18,911
Georgia	5,319	4,103	3,712	4,599
Greece	18,957	23,436	2,178	5,888
Moldova	0	1,957	0	749
Romania	23,603	9,653	26,970	12,685
Russia	34,090	15,305	12,578	25,303
Turkey	43,800	14,132	16,505	0
Ukraine	17,103	857	16,076	2,134
Regional	1,448	1,232	1,213	1,731
At 31 December	**172,998**	**100,144**	**87,580**	**74,329**
Analysis by instrument				
Loans	170,373	91,899	85,081	67,992
Equity investments	2,625	1,232	2,499	1,730
Guarantees	-	7,013	-	4,607
At 31 December	**172,998**	**100,144**	**87,580**	**74,329**
Analysis by sector				
Financial institutions	38,682	9,524	26,147	20,697
Manufacturing	91,141	39,034	26,905	13,913
Infrastructure	43,175	51,586	34,528	39,719
At 31 December	**172,998**	**100,144**	**87,580**	**74,329**

11. NET PROPERTY, TECHNOLOGY AND EQUIPMENT

Property, technology and equipment in the accompanying balance sheet at end of year are analysed as follows:

	Buildings (leasehold)	Furniture, office accessories and vehicle	equipment	Computers and office Intangibles	Total
Cost					
At 1 January	114	363	728	721	1,926
Additions	15	12	186	302	515
At 31 December 2003	**129**	**375**	**914**	**1,023**	**2,441**
Accumulated depreciation					
At 1 January	72	214	467	346	1,099
Charges for the year	32	71	148	154	405
At 31 December 2003	**104**	**285**	**615**	**500**	**1,504**
Net book value					
At 31 December 2003	**25**	**90**	**299**	**523**	**937**
At 31 December 2002	**42**	**149**	**261**	**375**	**827**

12. OTHER ASSETS

Other assets in the accompanying balance sheet at end of year are analysed as follows:

	2003	2002
Advances and prepaid expenses	125	124
Guarantee deposits	49	44
Valuation of forward foreign exchange contracts	2,111	0
Other assets	**2,285**	**168**

The net valuation of the foreign exchange contracts represent the forward foreign exchange position of the Bank's currency swaps at 31 December 2003.

13. BORROWINGS

The Bank utilises short-term financing in the form of borrowings from major commercial banks. At 31 December 2003 the Bank had no borrowings.

14. PAYABLES AND ACCRUED INTEREST

Payables and accrued interest in the accompanying balance sheet at end of year are analysed as follows:

	2003	2002
Interest payable	49	0
Social contributions	9	108
Pension plan obligation (note 20)	322	2,547
Suppliers and other accrued expenses	279	349
Payables and accrued interest	**659**	**3,004**

15. GENERAL RESERVE

In accordance with Article 36 of the Agreement, the Board of Governors shall determine annually what part of net income or surplus of the Bank from operations shall be allocated to reserves, provided that no part of the net income or surplus of the Bank shall be distributed to members by way of profit until the general reserves of the Bank shall have attained the level of ten (10%) per cent of the subscribed capital including all paid, unpaid but payable, and unpaid but callable share capital.

16. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, placements with other financial institutions and debt securities with maturities of three months or less. At end of year are analysed as follows:

	2003	2002
Up to 1 month	55,411	101,935
From 1 month to 3 months	29,192	26,383
Cash and cash equivalents	**84,603**	**128,318**
From 3 months to 1 year	0	18,922
Total deposits and securities	**84,603**	**147,240**

For the purposes of the Statement of Cash Flows, the Bank considers as cash and cash equivalents balances maturing up to three months of SDR 84,603 thousand at 31 December 2003 and SDR 128,318 thousand at 31 December 2002.

The Bank's portfolio of debt securities consists of commercial paper with a short term rating of A2/P2 and above, in accordance with the Bank's financial policies.

17. CURRENCY RISK

The SDR being the Bank's measurement currency and pursuant to the financial policies, the Bank shall take no significant foreign exchange position, investing its SDR denominated capital and reserves in the SDR constituent currencies in proportion to their weight in determining the value of SDR.

The table below provides a currency breakdown of the Bank's assets and liabilities.

	United States dollar	Euro	Japanese yen	Pound Sterling	Special Drawing Right	**Total**
Assets						
Cash and bank balances	49	96	16,672	73		**16,890**
Placements with financial institutions	310	29,294		450		**30,054**
Investment securities		8,466		29,193		**37,659**
Net loans	135,906	33,349				**169,255**
Net equity investments	2,516					**2,516**
Accumulated general loss provision	(6,907)	(1,241)				**(8,148)**
Receivables and accrued interest	834	448	102	182		**1,566**
Paid-in share capital not received					10,926	**10,926**
Net property, technology and equipment					937	**937**
Other assets					2,285	**2,285**
Total assets	132,708	70,412	16,774	29,898	14,148	**263,940**
Liabilities						
Payables and accrued interest		610	49			**659**
Deferred income					2,177	**2,177**
Members' equity					261,104	**261,104**
Total liabilities and members' equity	0	610	49	0	263,281	**263,940**
Net assets (liabilities)	132,708	69,802	16,725	29,898	(249,133)	0
Derivative financial instruments	(35,229)	20,597	16,743	0	(2,111)	0
Net currency balance at 31 December 2003	**97,479**	**90,399**	**33,468**	**29,898**	**(251,244)**	**0**
Correct SDR weights *	97,558	90,783	33,211	29,692	251,244	
Currency position at 31 December 2003	(79)	(384)	257	206	0	
Net currency balance at 31 December 2002	**97,204**	**75,257**	**30,082**	**26,931**	**(229,474)**	**0**

* As per IMF rule (effective as of 1 January 2001)

18. LIQUIDITY RISK

Liquidity is a measure of the extent to which the Bank may be required to raise funds to meet its obligations. The Bank's commitment to maintaining a strong liquidity position is established in policies, approved by the Board of Directors, that require a minimum target liquidity ratio of 50% of the net cash requirements for the next 12 months. Liquid assets are maintained in short-term placements and negotiable securities.

The table below provides an analysis of assets, liabilities and members' equity by relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates where options or repayment patterns allow for early repayment possibilities. Therefore, in the case of liabilities the earliest possible repayment date is shown, while for assets it is the latest possible repayment date. Those assets and liabilities that do not have a contractual maturity date are grouped together in the "maturity undefined" category.

	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Maturity undefined	**Total**
Assets							
Cash and bank balances	16,890						**16,890**
Placements with financial institutions	30,054						**30,054**
Investment securities *	8,467	29,192					**37,659**
Net loans	935	18,745	22,589	117,632	9,354		**169,255**
Net equity investments						2,516	**2,516**
Accumulated general loss provision						(8,148)	**(8,148)**
Receivables and accrued interest		1,566					**1,566**
Paid-in share capital not received	10,926						**10,926**
Net property, technology and equipment						937	**937**
Other assets	125			49		2,111	**2,285**
Total assets	67,397	49,503	22,589	117,681	9,354	(2,584)	**263,940**
Liabilities							
Payables and accrued interest		659					**659**
Deferred income	2,177						**2,177**
Members' equity						261,104	**261,104**
Total liabilities and members' equity	2,177	659	0	0	0	261,104	**263,940**
Liquidity position at 31 December 2003	**65,220**	**48,844**	**22,589**	**117,681**	**9,354**	**(263,688)**	**0**
Liquidity position at 31 December 2002	**112,560**	**43,314**	**32,055**	**45,374**	**5,050**	**(238,353)**	**0**

* The fair value of investment securities maturing up to one year approximates the book value.

19. INTEREST RATE RISK

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is determined on a financial instrument indicates to what extent it is exposed to interest rate risk. The Asset and Liability Unit monitors on a daily basis the interest rate exposure of the Bank.

The table below provides information on the extent of the Bank's interest rate exposure based either on the contractual maturity date of the financial instruments or, in the case of instruments that re-price to a market rate of interest before maturity, the next re-pricing date.

	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Non-interest bearing	Total
Assets							
Cash and bank balances	16,882					8	**16,890**
Placements with financial institutions	30,054						**30,054**
Investment securities	8,467	29,192					**37,659**
Net loans	4,009	119,261	47,103			(1,118)	**169,255**
Net equity investments						2,516	**2,516**
Accumulated general loss provision						(8,148)	**(8,148)**
Receivables and accrued interest						1,566	**1,566**
Paid-in share capital not received						10,926	**10,926**
Net property, technology and equipment						2,285	**937**
Other assets						937	**2,285**
Total assets	59,412	148,453	47,103	0	0	8,972	**263,940**
Liabilities							
Payables and accrued interest						659	**659**
Deferred income						2,177	**2,177**
Members' equity						261,104	**261,104**
Total liabilities and members' equity	0	0	0	0	0	263,940	**263,940**
Interest rate risk at 31 December 2003	**59,412**	**148,453**	**47,103**	**0**	**0**	**(254,968)**	**0**
Interest rate risk at 31 December 2002	**102,477**	**95,571**	**30,670**	**0**	**0**	**(228,718)**	**0**

20. STAFF RETIREMENT PLAN

The Management Committee has approved the Trustees and the establishment of the Bank's Pension Plan Trust Instrument and Rules as of January 2003. The related funds have been transferred to the Trustee (Royal Bank of Canada) in early 2003.

The defined benefit scheme covers all eligible employees of the Bank. At normal retirement age (60 years), a staff member is entitled to a pension equal to 1% of his pensionable salary (ie: average of the last five years of service) multiplied by his/her years of service at the Bank. Also, upon retirement, a staff member will be entitled to receive in cash the full balance standing to the credit of his/her individual account for the second and third pillars.

An actuarial valuation of the defined benefit scheme shall be performed each year by a qualified actuary taking into consideration the Bank's human resources strategy and policies.

The charge to the income statement represents the current service costs as estimated by an actuarial valuation in 2000, when the plan was established, and includes the past service obligation as indicated in the most recent actuarial valuation at 30 June 2003.

	2003	2002
Amounts recognised in the balance sheet		
At 1 January	2,726	1,664
Current service costs	1,230	1,113
Past service obligation	322	0
Contributions paid	(3,947)	(51)
At 31 December	**331**	**2,726**
Amounts recognised in the income statement		
Current service costs:		
Define benefits scheme	470	448
Define contributions scheme	293	439
Greek social insurance fund	36	34
Past service obligation	322	0
Total included in general administrative expenses	**1,121**	**921**
Principal actuarial assumptions used		
Discount rate	5.0%	5.0%
Expected return on plan assets	6.0%	6.0%
Future salary increases	3.0%	3.0%
Average remaining working life of employees	22 years	22 years

The principal assumptions above were used by the qualified actuary during the actuarial evaluation at 30 June 2003 and were unlikely to differ from a more recent actuarial valuation.

21. OPERATING LEASES

The Bank has entered into lease contracts for its Headquarters facilities. These are standard operating leases and include renewal options, periodic escalation clauses and are non-cancellable in the normal course of business. Rent expense for the year included in "General administrative expenses" totalled SDR 521 thousand (SDR 455 thousand in 2002).

22. SPECIAL FUNDS

Special funds are established in accordance with Article 16 of the Agreement and are administered under the terms of rules and regulations as adopted by the Bank. At 31 December 2003 the Bank administered one Technical Cooperation Special Fund

The objective of the fund as initiated by the Hellenic Republic, is to contribute to the economic development of the Black Sea Region's Member Countries. The fund extends technical assistance grants for preparation of high quality project documentation including business plans, feasibility studies and financial reporting methods and standards. The movement in the fund for the years 2003 and 2002 shown below is translated into SDR by applying the respective end of year SDR exchange rates.

	At 31 December 2003	At 31 December 2002
Fund statement of movement		
Balance of fund brought forward	487	617
Contribution received	424	0
Interest and other income	18	18
Less: disbursements	(127)	(188)
Less: other operating expenses	0	(4)
Balance of fund available	**802**	**443**
Fund balance sheet		
Assets		
Placements with other financial institutions	802	443
Total Assets	**802**	**443**
Liabilities		
Allocated fund balance	0	59
Unallocated fund balance	802	384
Total Liabilities and contributor's resources	**802**	**443**

To the Board of Directors of the
Black Sea Trade and Development Bank

We have audited the accompanying balance sheet of the Black Sea Trade and Development Bank (hereinafter called the Bank) for the year ended 31 December 2003 and the related income statement and statements of changes in members' equity and cash flows for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

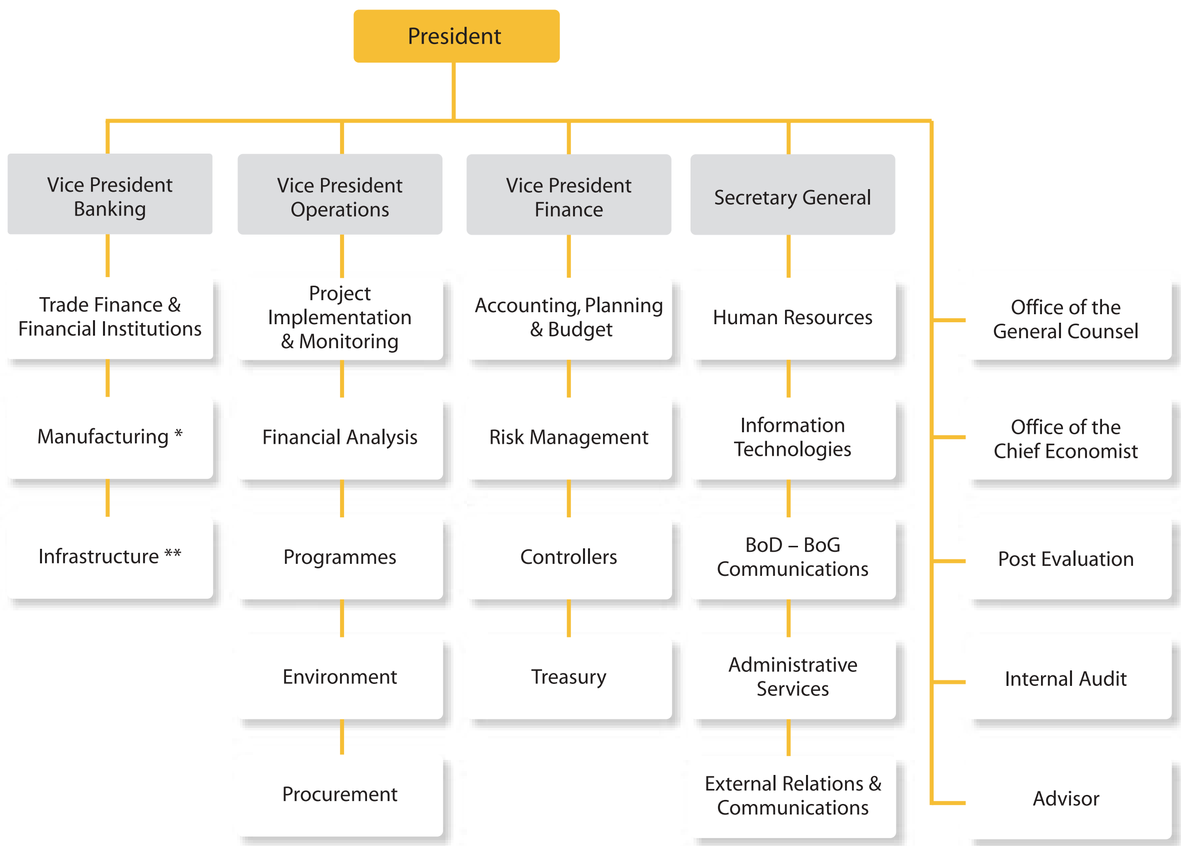
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of 31 December 2003 and the results of its operations and cash flows for the year then ended, in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Ernst and Young,

Athens, Greece,
24 March 2004

Annex A

Organisational Structure



* Principal activity areas of the department are manufacturing, including agriculture, tourism and construction.
** Principal activity areas of the department are infrastructure, including energy, telecommunications, transport and public utilities.

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