BSTDB: Navigating Through Uncertainty in the Black Sea Region

Black Sea Trade & Development Bank

Annual Report 2013

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Board of Governors

As of 31 December 2013

Republic of Albania

Governor:	Mr. Erjon LUCI, Deputy Minister of Finance
Alternate Governor:	Mr. Dorjan TELITI, General Secretary, Minister of Finance

Republic of Armenia

Governor:	Mr. Arthur JAVADYAN, Chairman, Central Bank of Armenia
Alternate Governor:	Mr. Andranik GRIGORYAN, Director, Financial System Stability & Development Department, Central Bank of Armenia

Republic of Azerbaijan

Governor:	Mr. Samir SHARIFOV, Minister of Finance
Alternate Governor:	Mr. Shahin MUSTAFAYEV, Minister of Economic Development

Republic of Bulgaria

Governor:	Ms. Daniela BOBEVA, Deputy Prime Minister for Economic Development
Alternate Governor:	Ms. Nina STAVREVA, Secretary General, Council of Ministers

Georgia

Governor:	Mr. George KADAGIDZE, President, National Bank of Georgia
Alternate Governor:	Mr. Nodar KHADURI, Minister of Finance

Hellenic Republic

Governor:	Mr. Notis MITARACHI, Deputy Minister of Development, Ministry for Development and Competitiveness
Alternate Governor:	Mr. Christos GEROULANOS, Desk Officer for European & International Affairs of the Competitiveness Advancement Directorate, Ministry for Development and Competitiveness

Republic of Moldova

Governor:	Mr. Anatol ARAPU, Minister of Finance
Alternate Governor:	position vacant

Romania

Governor:	Mr. Daniel CHITOIU, Vice Prime Minister & Minister of Public Finance
Alternate Governor:	Mr. Claudiu DOLTU, Secretary of State, Ministry of Public Finance

Russian Federation

Governor:	Mr. Sergey STORCHAK, Deputy Minister of Finance
Alternate Governor:	Mr. Sergey BELYAKOV, Deputy Minister of Economic Development

Republic of Turkey

Governor:	Mr. Ibrahim H. CANAKCI, Undersecretary of Treasury, Undersecretariat of Treasury
Alternate Governor:	Mr. Cavit DAGDAS, Deputy Undersecretary of Treasury, Undersecretariat of Treasury

Ukraine

Governor:	Mr. Ihor PRASOLOV, Minister of Economic Development & Trade
Alternate Governor:	Mr. Mykola UDOVYCHENKO, Deputy Governor, National Bank of Ukraine

Board of Directors

As of 31 December 2013

Republic of Albania	
Director:	Mr. Gentian OPRE, General Director, Public Debt Management Directorate, Ministry of Finance
Alternate Director:	position vacant
Republic of Armenia	
Director:	Mr. Vardan ARAMYAN, First Deputy Chief of Staff, Office of the President of the Republic of Armenia
Alternate Director:	Mr. Nerses MKRTCHIAN, Director, Multilateral & Bilateral Economic Cooperation Department, Ministry of Foreign Affairs
Republic of Azerbaijan	
Director:	Mr. Mikayil JABBAROV, Minister of Education
Alternate Director:	Mr. Famil ISMAYILOV, Deputy Head, International Relations Department, Ministry of Finance
Republic of Bulgaria	
Director:	Ms. Milena BOIKOVA, Director, Government Debt & Financial Markets Directorate, Ministry of Finance
Alternate Director:	Mr. Nikola SHERLETOV, Parliamentary Secretary, Ministry of Finance
Georgia	
Director:	Mr. David LEZHAVA, Deputy Minister of Finance
Alternate Director:	Mr. David EBRALIDZE, Deputy Minister of Finance
Hellenic Republic	
Director:	Mr. Serafeim TSOKAS, Secretary General, Ministry for Development and Competitiveness
Alternate Director:	Mr. Petros KONTOS, Director, International Economic Organizations Directorate, Ministry for Development and Competitiveness
Republic of Moldova	
Director:	Ms. Elena MATVEEVA, Head, Public Debt Department, Ministry of Finance
Alternate Director:	Ms. Ina GOREA, Deputy Chief, On-Lending Directorate, Public Debt Department, Ministry of Finance
Romania	
Director:	Ms. Diana PELIGRAD BLINDU, Head Operations I, General Directorate for Treasury & Public Debt, Ministry of Public Finance
Alternate Director:	Mr. Stefan PETRESCU, Head of Operation Division, External Public Finance, Ministry of Public Finance
Russian Federation	
Director:	Mr. Alexander GORBAN, Director, Economic Cooperation Department, Ministry of Foreign Affairs
Alternate Director:	position vacant
Republic of Turkey	
Director:	Mr. Hakan TOKAC, Acting Director General, General Directorate for Foreign Economic Relations, Undersecretariat of Treasury
Alternate Director:	Mr. Tahir CANATAN, Deputy Director General, Foreign Economic Relations, Undersecretariat of Treasury
Ukraine	
Director:	Mr. Valeriy PYATNYTSKIY, Commissioner for European Integration
Alternate Director:	Mr. Serhiy RYBAK, Deputy Minister of Finance

Audit Committee

As of 31 December 2013

Ms. Milena Boikova, Director for the Republic of Bulgaria & Chairperson of the Audit Committee;

Mr. Vardan Aramyan, Director for the Republic of Armenia and Audit Committee member;

Mr. Famil Ismayilov, Alternate Director for the Republic of Azerbaijan and Audit Committee member;

Mr. David Lezhava, Director for Georgia and Audit Committee member

Management

As of 31 December 2013

Vitalii Mygashko	**Valentina Siclovan**	**Andrey Kondakov**	**Orsalia Kalantzopoulos**	**Mustafa Boran**
Vice President Operations	Vice President Finance	President Chairman of the Board of Directors	Secretary General	Vice President Banking

To the Board of Governors

In accordance with Article 35 of the Agreement Establishing the Black Sea Trade and Development Bank and Section 10 of its By-Laws, I submit to the Board of Governors the Bank's Annual Report for 2013 as endorsed by the Board of Directors. The Fifteenth Annual Report contains the Bank's financial statements; separate financial statements for the operations of the Bank's Special Funds have also been issued, as prescribed in Section 12 of the Bank's By-Laws.

Andrey Kondakov

Chairman of the Board of Directors

President

Black Sea Trade and Development Bank

Statement by the President

Five years removed from the global financial crisis which left an indelible mark on financial markets and the world economy, its repercussions still very much affect the Black Sea region, too. To be sure, the countries of the Black Sea region have showcased remarkable resilience in the face of adversity. Despite being the hardest hit geographic region in the global economic slump of 2009, suffering a contraction in excess of 6% of GDP, the region rebounded quickly and impressively, more than covering the lost ground in the subsequent 2010-2011 two year period and sustaining positive growth in 2012 and 2013, despite the adversity in the European Union. Three Black Sea region countries are members of the EU, and the EU remains by far the largest trade partner for countries in the Black Sea and the main source of foreign investment and external financing. Therefore, the Eurozone financial crisis and its attendant economic recession acted as a brake on economic activity in the Black Sea region, on average halving growth rates in 2012-2013.

Although the momentum of growth has been maintained, the crisis has left relics such as stubbornly high rates of non-performing loans in the financial sector, and worrying levels of unemployment in the economy of many countries. In addition, it has left a lingering sense of uncertainty, since not only is financing more expensive now, its uninterrupted availability can no longer be taken as a given for banks and firms active around the Black Sea.

A legacy of the uncertainty is that investment in the Black Sea region has been slow to recover in the five years after the crisis. Consumption – especially private consumption – and rising international trade have been the pillars upon which economic growth has taken place since the crisis. By way of contrast, domestic and foreign investment have been much slower to recover, something which at this point looms as a potential capacity constraint in coming years, with lower growth rates resulting than would otherwise be possible.

For the Black Sea Trade and Development Bank, 2013 represented another solid year of progress operationally and institutionally. In line with the revised Medium-Term Strategy and Business Plan for the 2011-2014 period, approvals of new operations by the Bank's Board of Directors reached EUR 266.9 million, and signing of new operations amounted to EUR 225.3 million. Due to adverse exchange rate movements and a year end rise in pre-payments, the portfolio of outstanding operations evolved modestly, reaching EUR 779.3 million at the end of 2013. Significantly, for the ninth consecutive year the Bank registered a healthy and positive net income. Income before provisions reached EUR 11.9 million, while net income for 2013 was EUR 13.3 million.

Beyond its operational achievements, the Bank enjoyed considerable success in its efforts to increase external interest in the region and to deepen ties with other institutions. Developing networks, bringing parties together and nurturing forums for knowledge sharing are important activities for development finance institutions, helping to enhance the impact of traditional 'core' activities such as the provision of financing on attractive and competitive terms and country risk mitigation in ways tailored to the requirements of investors. As an institution devoted to regional cooperation, the Bank is naturally inclined favorably to seek opportunities for collaboration, alliances and partnerships that may further enhance fulfillment of its mandate. As a result, the Bank actively participates in a number of associations and working groups that bring development finance institutions together in order to (i) discuss issues of common interest and share knowledge and best practices,

(ii) seek to harmonize procedures, indicators, and measurement methods where this can improve transparency and simplify interaction with clients, (iii) lay out strategic directions and focus upon the evolution of the global development agenda, and of course (iv) to seek potential co-financing opportunities.

In June, the Bank hosted its Annual Business Day in Baku, Azerbaijan which included a stimulating discussion about economic diversification, an issue of growing importance not just in the Black Sea region but globally, as economies seek to broaden their bases of production and reduce dependence on one or two productive factors. In addition, the Bank hosted in Thessaloniki a meeting of the International Development Finance Club (IDFC) in September. IDFC is a global group of leading national and sub-regional development banks that share a mandate to promote sustainable development and seek to put forth common issues in the international development agenda and other areas of similar interest, to identify joint business opportunities, and to share know-how and best practice experiences.

As BSTDB grows and matures, it has sought innovative ways to broaden its outreach and improve fulfillment of its dual mandate to promote economic development and regional cooperation in order to create value for its shareholders. As a wholly locally owned organization that is devoted to promoting the interests of the region in which it operates, the Bank has taken an expansive view in order to maximize interest in the region and attract new actors that wish to invest or otherwise engage in what is a highly promising, but often overlooked and underrated region. In this respect, the Bank has also sought to be an anchor of stability, offering its support to banks, firms and agencies that invest in the Black Sea region despite the prevailing uncertainty.

Andrey Kondakov

Chairman of the Board of Directors

President

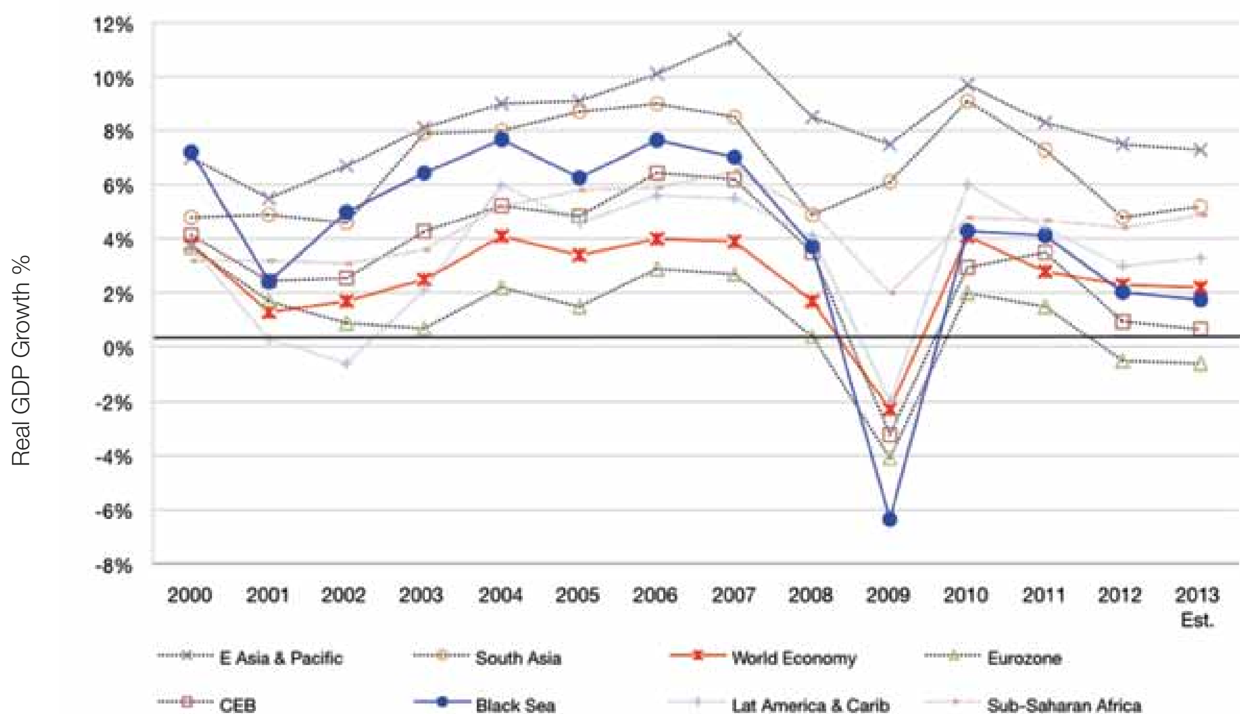
Black Sea Trade and Development Bank

Living in Sustained Uncertainty – Overview of Economic Developments in the Black Sea Region in the Five Years since the 2008 Global Financial Crisis[1]

The 2008 Global Financial Crisis

More than five years have passed since the Global Financial Crisis that occurred in the aftermath of the bankruptcy of the investment bank Lehman Brothers in September 2008. The global panic that gripped financial markets resulted in a sudden halt to lending and a near meltdown of the global financial system.

Figure 1: Global and Selected Regional Real Annual Growth Rates Since 2000



Source: National Statistical Agencies, World Bank & IMF-IFS

1 Note on Sources: Unless otherwise specified, Black Sea Region data based on calculations from National Statistical Agencies of the countries of the Black Sea region and the IMF IFS Database. Additional sources include Global Economic Prospects 2013 of the World Bank (& previous years' GEP editions), and the IMF's World Economic Outlook publications.

All over the world, governments responded with massive interventions to support their respective financial systems, employing a broad range of tools including taking of distressed bank assets onto government books, provision of guarantees for loans to private banks, enhanced deposit insurance to reduce the risk of capital flight, emergency loans to distressed institutions, equity injections and outright nationalizations or takeovers of financial institutions. While the tools varied, the common feature in each case was the use of public financing in some manner in order to shore up financial institutions normally operating in a commercial environment. These interventions were expensive, politically unpopular, and widely perceived as unfairly favouring banks and wealthier segments of the population; nonetheless, they also succeeded in averting a total collapse of financial systems. However, one important casualty of the financial turmoil was overall economic activity. Beginning in the last quarter of 2008 and extending through most of 2009, the global economy experienced a slowdown, with global GDP contracting by -2.3% in real terms for the year (See Figure 1).

Impact of the Financial Crisis on Europe

Although the crisis began in the United States, its impact proved to be much more severe in Europe, particularly for economic activity. The contraction in 2009 was greater in Europe (-4.5% to -2.8% for the US), the recovery in 2010-2011 was weaker, and most of Western Europe and parts of the East fell back into recession in 2012 and 2013 as a result of the Eurozone crisis, a sovereign debt crisis which evolved directly from the 2008 financial crisis.

For analytical purposes, Europe can be broken down further into a number of groupings, of which three are of greatest interest for illustrating overall trends:[2]

(i) the countries of the Eurozone which share a common currency and comprise most of the largest and wealthiest economies of Europe (with the notable exception of the UK);

(ii) the eight countries of Central Europe and the Baltics ('CEB') which joined the European Union in 2004. The CEB are former 'transition countries' which, as a group, provide a useful comparison to the Black Sea region, since they are all former 'transition countries' which are generally wealthier than Black Sea region countries, and they are considered to have made the transition from a centrally planned to a market oriented economy more quickly and thoroughly. Four CEB countries became members of the Eurozone between 2007 and 2014; and

(iii) the countries of the Black Sea region. Ten out of the 12 countries of the Black Sea region are former 'transition countries', while three are EU members, and one overlaps as a member of the Eurozone as well.

The Eurozone

The Eurozone has significantly underperformed the United States in the years since the crisis. Whereas both suffered contractions in 2009, the US recovered much more rapidly and today output is higher than it was in 2008, whereas in the Eurozone (and much of the rest of the non-Eurozone EU) it is still below pre-crisis levels. The US stabilized its financial system and restored functionality after the financial panic. Economic output recovered from the crisis more robustly via a combination of 'stimulative' fiscal policy, and expansionary and innovative monetary policy, in order to preempt a severe downswing and to avert deflation. In the EU, financial stability and functionality were restored as well after the outbreak of crisis in 2008, but the output decline was steeper, and fiscal and monetary responses in support of economic growth were far less aggressive. In addition, the financial crisis metastasized into a sovereign debt crisis in a number of vulnerable Eurozone states, thus setting of a new round of crises and panic, with negative consequences for overall economic output.

While reform of the financial system in the US remains a work in progress, and considerable controversy exists as to whether it is safe today and less vulnerable to future crises and panics, the US has done far more than the Eurozone (and the EU as a whole) to (i) clean up problem assets via programs such as the TARP[3] (ii) shut down or resolve a number of non-systemically significant financial institutions and (iii) enact tougher regulatory reforms to address system vulnerabilities. By way of contrast, the Eurozone, having rejected the ideas of fiscal union or debt mutualization throughout the common currency zone, has instead spent much time (i) rescuing

2 For purposes of this paper, the term 'Black Sea Region' comprises the 12 member states of the Black Sea Economic Cooperation – Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Serbia, Turkey, Ukraine. The term 'CEB' covers the eight Central Europe and Baltic states which joined the EU in 2004 – Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia. These are in the process of converging (some already have) with the key economic indicators of the 15 European Union members before the EU expansion of 2004. The term 'Eastern Europe' covers all the aforementioned states, minus Greece and Turkey, but with the addition of Belarus and the Western Balkans.

3 The Troubled Asset Relief Program. Much analyzed, one useful starting point is the US Treasury Department: http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/Pages/default.aspx.

financial institutions in distress and members facing debt crises at taxpayer expense and (ii) wrangling over how to enact a banking union with common institutions for supervision and bailout funds as an alternative to fiscal union. It has achieved limited institutional progress and while belatedly aggressive European Central Bank monetary policy has helped to stabilize perceptions, risks and uncertainties persist as to how Eurozone governance and economic performance will evolve in coming years.

As Figure 1 shows, the Eurozone collectively suffered a decline in output equivalent to -4.1% of GDP in 2009, nearly twice the -2.3% contraction for the global economy. While GDP growth recovered to 2.0% in 2010 on the back of a swift global recovery, this rate was less than half the 4.1% economic growth registered globally. Growth in the Eurozone slipped to 1.5% in 2011, as the Eurozone crisis intensified, and the Eurozone slipped back into recession in 2012, suffering a GDP contraction of -0.5%. The Eurozone became the main drag on World economic growth, a dubious distinction it retained during 2013 as well, during which GDP shrank by a further -0.6%, although in the latter half of 2013 most countries posted positive growth. This in turn, has led to improved expectations for 2014, but a number of downside risks remain that could derail the observed recovery. Chief among these are the continuing high debt burdens of many Eurozone states – in the periphery as well as the 'core' – and the fragile state of Eurozone lending institutions, which remain saddled by high non-performing loans, and a legacy of overlending and low capital levels which has forced them to retrench, leading to a protracted deleveraging that is one key factor behind the poor output performance.

The Eurozone also faces a unique set of uncertainties emanating from its halting moves towards banking union. With member states unwilling to undertake a fiscal union or to mutualize debt, even partially, they have instead sought to move towards a banking union with centrally coordinated regulation of financial institutions active in the Eurozone, and a joint financial resolution mechanism and common rules for handling banking crises, including bailouts. By end 2013, substantial progress had been achieved in establishing a common supervisory mechanism. With respect to the resolution mechanism, by way of contrast, there was agreement on common principles but considerable disagreement and uncertainties lingered with respect to the specific rules and technical details.

Unique among geographic regions, Eurozone GDP levels at end 2013 were still below those achieved in 2008 prior to the onset of the global financial crisis. However, this generalization also hides a considerable degree of disparity in economic growth among individual Eurozone members. As a rule, those in the so-called periphery, around the Mediterranean in particular as well as Ireland, suffered the most severe and protracted declines whereas those in central and northern Europe had higher outturns, although their rates still lagged behind the USA and other geographic regions.

The Central European and Baltic States

As members of the EU and, in certain cases, as Eurozone Members, the Central European and Baltic countries (CEB) were significantly affected by difficulties in the Eurozone crisis, as Western Europe represents the main market for CEB produced goods, and the principal source of foreign direct investment and financing, with many financial institutions in the CEB owned or controlled by EU (usually Eurozone) based banks. Dating back to the mid 1990s, the CEB collectively had posted positive outturns every year and had averaged nearly 4.5% annual real GDP growth. As with other parts of Eastern Europe, in most countries the growth had gradually shifted from being due to investment to being based on consumption, and was fueled by high credit growth, much of it foreign currency lending.

The dependence on foreign capital left most CEB countries vulnerable when global markets seized up in September 2008. The worst hit were the three Baltic countries, which had achieved near double digit growth rates on the back of a credit fueled growth boom that had created sizeable speculative bubbles and overleveraged banks. Moreover, each had adopted a fixed exchange rate regime (such as a currency board) in order to prepare for entry into the Eurozone. The collapse in financial flows, and the requirement to adjust entirely via spending cuts due to the inability to devalue resulted in dramatic GDP contractions ranging from -14% to nearly -18% in each country, in 2009. Most Central European states experienced a similar sudden reversal to high GDP growth. The downturns were less severe than in the Baltics, but still significant, ranging from -4.4% to -8.1%. Poland was the very notable exception to this trend. GDP growth slowed in 2009, but remained positive at +1.6% thanks to lower dependence on exports for growth, higher levels of domestic demand, and a financial sector that relied less on foreign lending thanks to a more developed deposit base.

For the CEB region, the aggregate change in GDP output of -3.2% for 2009 hides the considerable disparities (See Figure 1). By way of contrast, the return to decent GDP growth rates of 3.0% in 2010 and 3.5% in 2011 more accurately represents the regional trend. Growth was higher than in the Euro area, and divergences among individual countries were much smaller, as in 2010 only Latvia experienced a contraction of -0.9%,

and in 2011 all CEB countries achieved growth. The Eurozone crisis in 2011-2012 and the Eurozone countries' slipping back into recession in 2012 and 2013 inevitably impacted CEB countries. The Czech Republic, Hungary and Slovenia experienced economic contractions in 2012 and either negative or near zero growth in 2013. The other countries maintained positive but lower growth rates, the exception being Latvia which, having experienced the most severe decline among CEB countries between 2008-2010, maintained its recovery momentum in 2012-2013 and posted the highest growth rates. CEB GDP growth slipped to 1.0% in 2012 and 0.7% in 2013.

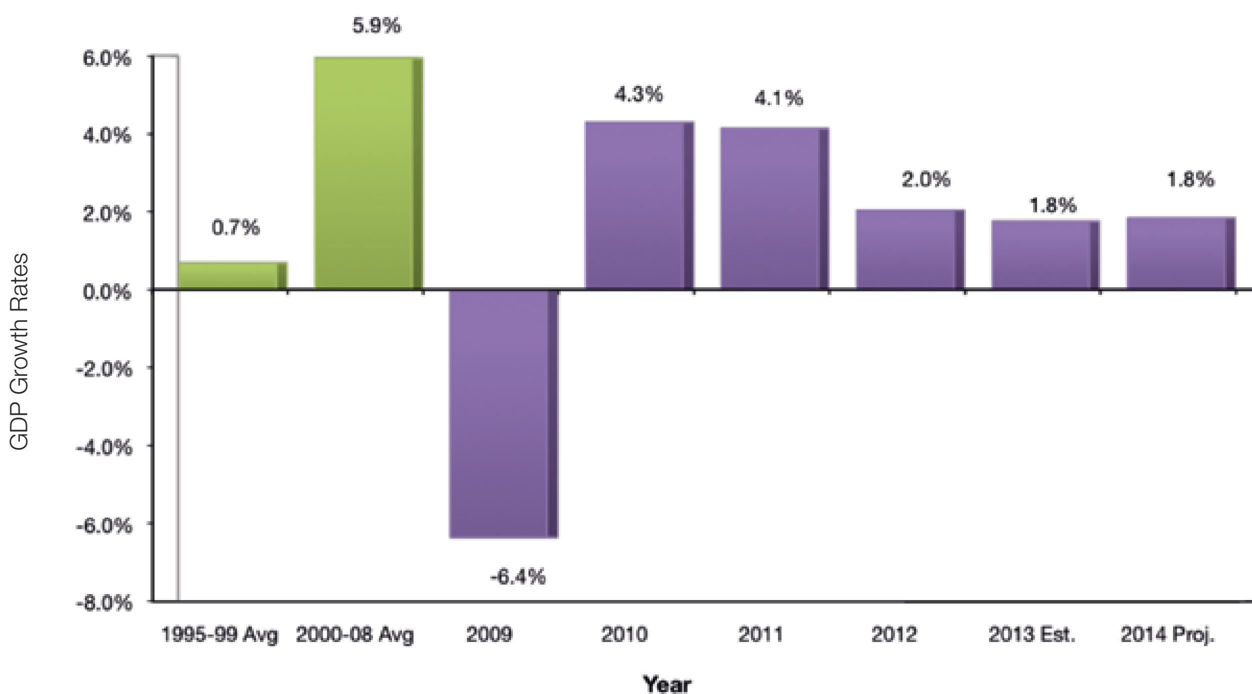
Interestingly, at the start of the crisis, only Slovenia from among CEB states was a Eurozone member, having joined in 2007. Cumulatively, it also suffered the greatest contraction as its GDP at end 2013 was nearly 11% lower in real terms than it was at end 2008. Two more countries joined the Eurozone during the crisis period – Slovakia in 2009 and Estonia in 2011 – while Latvia became the fourth CEB state to join at the start of 2014. By end 2013, Latvian GDP was around 5.5% below 2008 levels, Estonian GDP had recovered to 2008 levels, while Slovakian GDP was around 5% higher, the second best CEB performance after Poland's economy (around 13.5% higher).

The Black Sea Region

The Black Sea region, and the countries which comprise it, shared similar experiences with the CEB countries, albeit with more pronounced swings (See Figure 2). The impact of the crisis was swift and negative. It brought to a sharp halt an extended period of robust economic growth dating back to 2000. Buoyed by favourable global economic conditions and reaping the benefits of difficult fiscal and structural reforms that had been undertaken in the course of the 1990s, Black Sea countries experienced a prolonged period of robust growth from 2000-2008, with every country posting positive growth rates every year from 2002 to 2008.

During this period, regional GDP growth rates averaged 5.9% per annum, incomes and living standards rose while poverty rates declined substantially. Typical of many growth cycles, in the early phase productivity gains and rising investment levels contributed a higher share of the growth whereas in the later phase, growth became more consumption dependent, with rapid credit growth fueling much of the increase. For this reason, concerns existed that many regional economies were overheating, having (i) pursued pro-cyclical fiscal policies, (ii) experienced rising wages, asset prices, and consumer prices, and (iii) increased private sector borrowing levels from abroad. Rising current account imbalances emerged as a key risk factor.

Figure 2: Black Sea Region GDP Growth 1995-2014



Source: National Statistical Agencies & IMF-IFS

The seizing up of global financial markets in the fall of 2008, halted the flow of financing to the Black Sea region. Large external imbalances could no longer be financed and mass default loomed for exposed private firms, banks, and government dependent upon continued foreign flows in order to finance accrued deficits and debts.

The inability to access financing quickly spread across the entire economy and recession took hold in most Black Sea countries. First, it affected the more globally integrated countries, not only due to their relatively greater reliance on foreign financing but also because such countries tended to have developed stronger commercial and investment links externally, particularly with EU countries. The economic contraction in the EU sharply reduced foreign demand for exports from the Black Sea, a situation further exacerbated by the decline in commodity prices which hit resource rich and commodity dependent countries. Before long, recession also struck the less globally integrated economies, which tend to be smaller, more isolated and poorer, dependent upon large emigrant populations in neighboring countries that send home remittances. When the larger more integrated economies suffered recessions and an upward spike in unemployment, remittance flows into labor exporting countries declined, reducing domestic consumption and pushing them into recession as well.

For 2009, the Black Sea region experienced GDP contraction of -6.4% in real terms. Globally, this was the most severe decline experienced by any region (See Figure 1), and underscores the extent to which the real economy of countries was hurt by the cessation of external financing, the inability of domestic financial systems to fill the gap due to their relative underdevelopment (even though they were less affected by the crisis than financial systems in Western Europe and the USA), and the amplified impact effect of the slowdown in the EU, the Black Sea region's most important trade partner, and primary source of foreign investment and other financing. Overall, external trade declined by 34%.

Another factor amplifying the downturn was the lack of mitigating policy responses available to most countries. When the reduction in credit availability resulted in a sharp decline in private consumption and investment, the response in Western Europe was increased public spending – both discretionary as well as automatic stabilizers (e.g. unemployment benefits) – in order to mitigate some of the decline in private activity.

Such a response, however, presupposes access to additional resources which, typically, involves either drawdown of accumulated reserves, or increased borrowing. In the Black Sea region, commodity exporting countries with large reserves were able to draw upon these in order to offset the decline in private activity, and also in order to stabilize the financial system. Most Black Sea countries, however, lacked these options and were left with sudden fiscal retrenchment as the sole available policy to follow. Deficits ballooned, mainly due to reduced tax receipts, but government spending was constrained by the lack of access to resources, and thus public spending cuts exacerbated the recession caused by reduced private spending.

Fortunately, the downturn in most countries was short-lived, and by end 2009 they had begun to recover. As the global economy recuperated, so did most of the Black Sea region, and in certain cases in very robust fashion throughout the course of 2010. Private domestic demand, which had declined sharply in reaction to the panic and ensuing uncertainty, picked up vigorously and was the most important factor behind the return to growth. Another factor was that the financial sector in most countries survived relatively unscathed, either due to its small size or because it was less exposed to the ruinous lending that caused the global crisis in the first place.[4] A further lift to growth was the recovery of external trade flows which were further boosted by a general rise in commodity prices and grew by over 25% relative to 2009. As a result, for 2010 regional GDP grew 4.3% in real terms.

The growth's momentum extended into 2011, with the same two factors – private consumption and external trade, leading the way. External trade again grew impressively by nearly 29%, reaching new highs as both exports and imports surpassed the old peak levels reached in 2008 prior to the crisis. However, in the latter part of the year, the rate of growth began to slow down after a series of destabilizing shocks took place. These included the natural disasters in Japan, as well as geopolitical developments such as the Arab Spring which

4 In addition, in many countries the financial sector was stabilized by successful, albeit expensive, government support programs.

created much upward volatility in energy prices. Most importantly, the Eurozone crisis worsened and resulted in a recession in the Eurozone region and significant uncertainty in financial markets. Given the significant economic links with the EU generally, the Eurozone crisis capped the rising trend from the recovery and dampened overall output growth in the Black Sea region.

While regional GDP growth dipped only slightly and reached a still impressive 4.1% for 2011, the Eurozone crisis extended well into 2012 and had a more protracted effect on the Black Sea region. Nine out of 12 countries experienced lower growth rates, out of which three experienced contractions, and three others essentially stagnated with growth less than 1.0%. The weaker performance was observed in the western part of the Black Sea region, the economies of which are more tightly linked to the EU since they include a Eurozone member, two more EU members, and countries with EU membership perspectives. The decline in growth in the eastern part of the Black Sea region was less pronounced, and it contained the four fastest growing economies in the region.

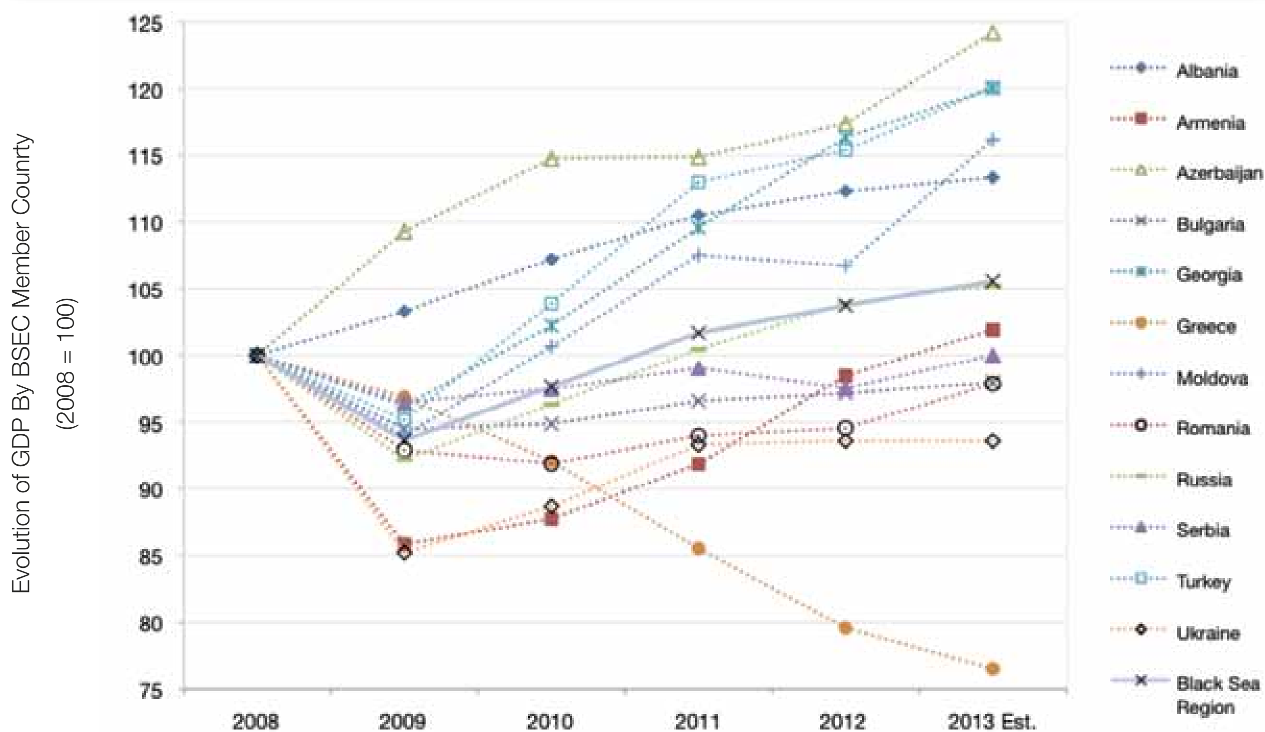
Overall, Black Sea region GDP growth halved to around 2.0%. On the supply side, agricultural production suffered a disastrous year in many countries due to adverse conditions, while industrial production growth was positive, but significantly lower than in the previous two years due to the deteriorating external environment. The service sector, by way of contrast, was relatively stable and sustained the steady trend which has seen it achieve a growing share of the economy in all countries, while in many it has become the largest in terms of formation of GDP. On the demand side, private consumption again was a positive driver of growth, with private investment sluggish and all government spending restrained. External trade ceased to contribute significantly to growth, as after the two years in 2010-2011 export growth fell sharply to 2.7%, while imports were essentially flat.

In 2013, the overall result was a bit more subdued with real GDP growth on the order of 1.8%. However, there were important shifts in the contributing factors to this figure. Agricultural production rebounded robustly in 2013 in most countries and though it accounts for a small (and declining over time) share of GDP formation in most countries, for a change it was a positive contributor to growth. Industrial production was more mixed and linked to external trade developments. These in turn were generally weak, with exports for the region as a whole up only 1.3%, whereas import growth was 4.2%.

Geographically, the performance of countries that had previously experienced downturns or stagnation in 2012 improved, while the slowdown occurred in the previous drivers of regional growth. Part of this can be explained by recovery effects. In the eastern part of the region, the post-crisis recovery had been fully realized. However, since it was mainly consumption driven, the persisting lag in investment activity had become a drag on national economies and has led to the appearance of capacity constraints. Countries in the western part of the region benefited from a recovery effect from the output dip in 2012. In addition, their external trade received a proportionately greater boost from the nascent recovery in the EU.

Five years on from the outbreak of the financial crisis, one consequence for the Black Sea region is that generalizations have become much more difficult. In the 1990s and the period from 2000-2008, there were easily identifiable region-wide trends, since what applied to the region as a whole more or less applied to the individual countries – or at least the overwhelming majority of them. In the post 2009 period, discerning common trends has become much more difficult, particularly as regards economic growth. As Figure 3 shows, economic performance during this period appears to have become increasingly divergent among countries. Whether the lack of a neat thread common to all countries in the region is positive, negative or neutral remains an interesting question for debate, since on the one hand it can be argued that this reduces the risk of contagion while on the other it may be a function of slowing regional integration and foregone opportunities for countries to cooperate or achieve greater complementarities. Nonetheless, there has re-emerged a positive trend of continued convergence progress towards – and a narrowing of the development gap with – richer neighbors in Western Europe, albeit at a reduced pace relative to the pre-crisis boom period.

Figure 3: GDP Growth since the 2008 Global Crisis by country (2008 = 100)

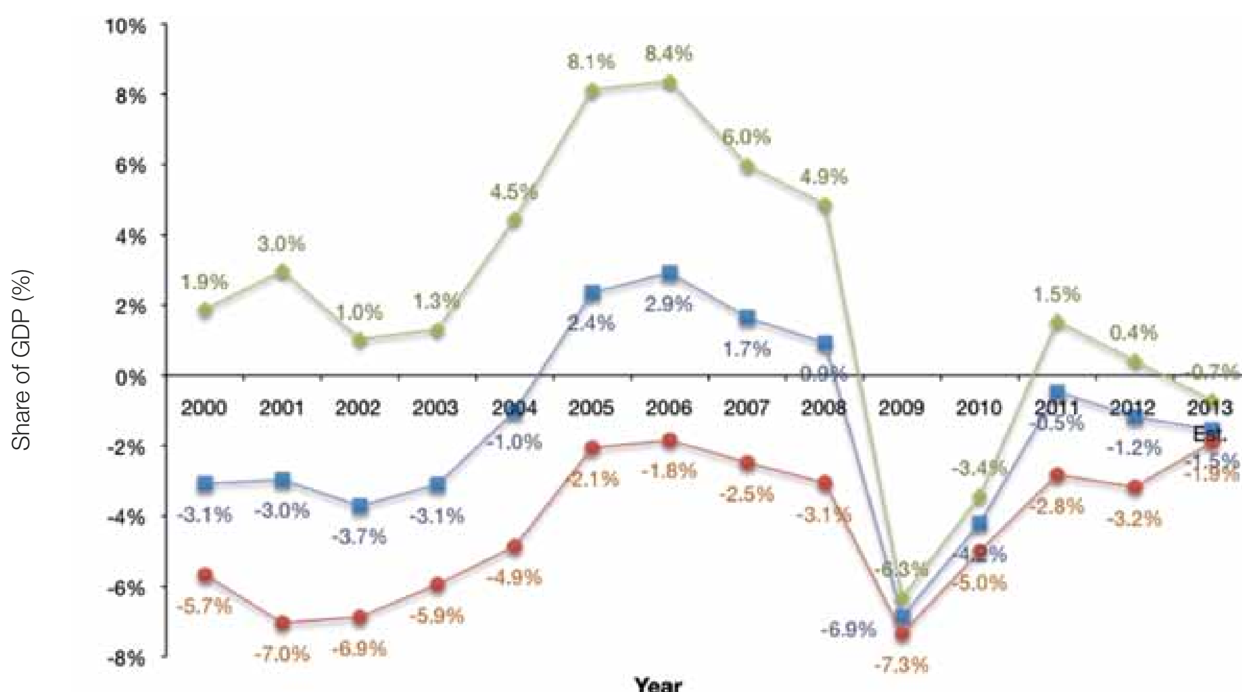


At end 2013, GDP in real terms stood about 5.6% higher than in 2008, and the average growth rate for the region between 2009-2013 was slightly below 1.2%. However, these figures hide sizeable disparities in the performance of individual countries. A couple have grown consistently throughout the crisis, one has contracted for five consecutive years, while the rest contracted sharply in 2009 and then followed varying paths of recovery, some enjoying robust growth and others slipping back into recession in 2012 but climbing back in 2013.

Instead of being swayed by broader global or regional trends, the relative decoupling suggests that individual country performance has been determined to an increasing degree by each country's structural issues, policies, and overall economic situations. Of the latter, a lingering legacy of the crisis is the extra scrutiny, and heightened sensitivity (at least a far as markets are concerned), of a country's external position. And while the focus on figures such as current account balances, foreign exchange reserve levels, import cover ratios, short and long-term external financing needs, etc. is not new for identifying possible vulnerabilities and perceived dependence upon inflows of external financing, there is also heightened concern about ease of access to foreign funding. To this, one must incorporate the consideration that entrenched stereotypes persist and are difficult to alter, with added negative implications on access to funding for sovereign borrowers. Put differently, whereas the focus used to be primarily on calculations of solvency, while liquidity – at least in recent years – was more or less assumed, liquidity has greatly grown in importance post-crisis. It represents a more prominent and volatile factor which is difficult for countries to control or even gauge, and it has affected risk premiums adversely.

The heightened focus on the external position conceals the fact that most key macroeconomic indicators are better at end 2013 than they were prior to the crisis. Unemployment rates are a significant exception to this, as they remain stubbornly higher than during the pre-crisis period, despite the resumption of growth. Going forward, reducing unemployment will be a central challenge for certain Black Sea countries for a number of years. As a rule, public debt levels are also higher than they were at the end of 2008. This is a legacy of the sharp rises in fiscal deficits in 2009 as a result of diminished receipts and in some cases higher spending due to fiscal stimulus programs. However, while the region has experienced one sovereign debt crisis, in the majority of cases the increase in public debt as a share of GDP has been less than 10%, and debt levels have

Figure 4: Trends in Average Fiscal Deficit of Black Sea Region as a Share of GDP



Note: Black Sea Region Average – Blue, Russia Alone – Green, Black Sea Region Minus Russia – Red

been stable or even slowly declining since the resumption of growth. In other cases where the increase in public debt reached double digits, initial sovereign debt levels were extremely low – at or below 20% of GDP – and thus countries had considerable 'headroom' available without running the risk of a debt crisis, and in any case debt levels have begun to come down.

Otherwise, the picture is very positive and a testament to the commitment of Black Sea countries to sustained macroeconomic stability. Current account imbalances, for example, still persist, but they are far more muted with perennial deficit countries having achieved considerable strides towards rebalancing, and generally relying more on increased exports rather than reduced imports (which imply a certain degree of impoverishment). Inflation rates are also, as a rule, much lower than they were prior to the crisis, and as Figure 4 shows, Black Sea countries have achieved impressive fiscal consolidation in the years since 2010, quickly restoring finances to sustainability and adjusting to the new lower growth environment, where simple reliance on rising receipts can no longer be assumed.

With respect to economic growth, an exception to the inability to generalize is that the three EU members were among the countries with the worst economic performance, in terms of GDP growth, and at the end of 2013 they had not yet recovered to 2008 pre-crisis levels of GDP. This is not surprising, given their EU membership status and thus their tight economic and political links to the EU, which in turn has fared very poorly. However, Ukraine, which does not enjoy an EU membership perspective, and Serbia which does but has yet to begin accession negotiations, also fared poorly and have failed to reach 2008 levels. Turkey, on the other hand, has been in EU accession negotiations for years, is adopting economic legislation and standards that are EU consistent/ compliant and has significant economic ties to the EU; yet, it has been among the fastest growing states in the region, particularly during 2010-2013.

Thus, closeness of relationship with the EU appears inversely related to economic performance during 2009-2013. Because ties with the EU are tighter in the western part of the Black Sea region than in the eastern part, this trend also applies geographically, although here Albania, too, represents an exception, since it has experienced some of the highest GDP growth in the region, recent sluggishness and growing macroeconomic imbalances notwithstanding.

This lack of easily identifiable trends or developments with respect to economic growth leads to the need to take a brief look at each country in the Black Sea region individually, with reference to Figure 3.

Albania

Albania was one of two economies in the Black Sea region to avoid recession in the aftermath of the 2008 global financial crisis. While growth rates dropped relative to 1998-2008 – when real GDP growth had averaged 7.0% per annum – growth of 3.3% was achieved in 2009, and positive growth has been sustained in the years since. Certain structural features of the Albanian economy left it less exposed than other economies at the outbreak of the crisis. One is that the Albanian banking system has traditionally been highly liquid and has enjoyed an adequate, if not large, domestic deposit base compared to other countries in Eastern Europe. This meant that there was a low degree of exposure – and dependence – upon foreign financing. Even though private borrowing in foreign exchange quadrupled (as a share of GDP) between 2006-2008, it began from such a low base that it was still a very manageable 11-12% of GDP in 2008. Another factor is that Albania's exports accounted for only around 10% of GDP, therefore even though they contracted by around 30% in 2009, the impact on overall economic output was limited. In addition, remittance flows, which represent an important source of foreign exchange and underpin domestic consumption, declined by only around 10-15%, far less than occurred in other high remittance countries.

Albania also benefited from a flexible exchange rate regime, which allowed authorities to permit currency depreciation to act as a 'shock absorber' and to follow an accommodative monetary policy. This was complemented by a fiscal stimulus, partly financed by privatization receipts, which provided a countercyclical boost to the economy by helping sustain demand. Growth remained steady during 2010 and 2011, above 3% in real terms, as private consumption remained strong and exports picked up notably on the back of hydroelectricity production growth in 2010 and oil production coming on stream in 2011.

However, the Eurozone crisis, and its particularly acute impact on peripheral Eurozone members with which Albania has significant economic links, led to a notable slowing of economic growth in 2012 (1.6%) and 2013 (0.9%), still positive but below the level of the previous three years. The negative impact of this external shock was made worse by persisting domestic imbalances such as high public debt – including a still modest but rising dependence on external financing – and a difficult fiscal situation.

Armenia

Armenia suffered a severe contraction of real GDP of -14.2% in 2009, a 'turnaround' of -21.1% year on year which represented the largest single year negative swing in all of Eastern Europe. Even though the financial sector had low exposure to the global crisis, a sharp decline in exports, remittances and other external inflows resulted in a crisis of confidence and in sharp declines in private demand and investment. In particular, the downturn exposed Armenia's high degree of dependence on remittances which had reached 15-20% of GDP but can be volatile, since they in turn depend on economic activity in source countries.

The government responded with significantly increased stimulus spending in order to replace a portion of the decline in private consumption and investment, and a return to a flexible exchange rate regime which resulted in a devaluation of the Dram of over 20%, but which restored external balance more rapidly. Aided by an upturn in commodity prices in late 2009 and 2010, and the recovery in Russia, the principal source country for remittances, the crisis proved short-lived. GDP grew 2.2% in 2010, dampened by a decline in agriculture due to poor weather, but picked up in 2011 to 4.7%, and in 2012 Armenia posted GDP growth of 7.2%, the highest in the Black Sea region. Growth in 2013 softened as domestic demand weakened after rises in energy and food prices. However, it still exceeded the regional average, reaching 3.5%, and was relatively broad based, as exports have grown steadily, and other key drivers such as construction and agriculture have fared well. At end 2013, Armenia's credit ratings remained a couple of notches below investment grade, but they have held steady since before the global financial crisis and there were no downgrades even during the worst part of the economic recession.

Azerbaijan

Azerbaijan maintained its status as the region's biggest positive outlier, albeit with somewhat reduced rates of growth relative to previous years. Between 1998-2008, annual real GDP growth averaged an exceptional 15.2%. For the period 2009-2013, real GDP growth slowed to an average 4.5% annually. This represents the highest average in the region, and Azerbaijan is one of two countries not to experience a contraction in any one year. The economic downturn of 2008-2009 served primarily to cool down an economy which had been growing at a torrid and unsustainable pace – since from 2005-2007, real GDP growth had exceeded 28.6% each year and inflation had risen into double digits.

In 2009, the worst year of the economic crisis regionally, GDP growth slowed to a still vigorous 9.3%. In contrast to other countries, instead of picking up in 2010-2011, economic performance slowed further and bottomed out at 0.1% in 2011, before recovering modestly in 2012 (2.2%) and more robustly in 2013 (5.8%). Because energy resource extraction has been the main driver of economic growth, Azerbaijan's economic performance is closely correlated to levels of oil and gas production and their respective global prices. GDP growth accelerated as new energy development projects were inaugu-

rated, and then declined as production growth slowed between 2011-2013. Growth in the non-energy sector, led by non-tradables such as construction and services, has picked up since 2010 and has overtaken energy production as the principal driver of growth in recent years.

During the 2009-2013 period, Azerbaijan attained investment grade status with all three major credit rating agencies. Domestic credit has grown rapidly, with consumer credit accounting for much of the growth. Nevertheless, financial intermediation remains low, as the share of credit to GDP remains a modest 26%. Private borrowing from abroad is limited. Income levels have continued growing, and Azerbaijan has been reclassified as an upper middle income country by the World Bank. GDP per capita has exceeded US$ 7500, and official poverty rates have continued their precipitous decline, from over 60% in the late 1990s to 7.6% in 2011.[5]

Bulgaria

As a member of the EU since 2007, Bulgaria's close political and economic ties increase the impact upon the domestic economy of developments in the EU. The EU's struggles have thus resulted in relatively weak recovery and low growth – by BSEC regional standards – since the 2008 crisis. Bulgaria suffered a -5.5% contraction of GDP in 2009, due to a sudden drop in exports (-27%) and domestic demand. Investment spending, including FDI which had been among the highest in Eastern Europe (as a share of GDP), also fell sharply.

Because Bulgaria maintains a currency board regime, with an exchange rate fixed to the Euro, it was unable to use monetary policy (e.g. depreciation) to cushion the negative demand shock. Instead, most of the demand reduction passed through to the economy; the fiscal surplus turned to deficit due to a decline in revenues, but the Government was unable to employ a substantial fiscal stimulus to mitigate the decline, even though Bulgaria enjoys extremely low public debt levels. Imports highlight the reduction in consumption, as they declined even more than exports (-37%), and helped bring about a sizeable correction to the current account deficit, which had mushroomed to nearly -23% in 2008.

Bulgaria returned to positive GDP growth in 2010, but at a weak 0.4% as exports rebounded, but private consumption recovered more meekly. The trend continued in 2011 and the GDP growth rate rose to 1.8%. Export growth outpaced the rise in imports both years, and thus Bulgaria shrank its trade deficit significantly and posted a current account surplus for 2011. However, the Eurozone crisis took its toll in 2012, as Bulgaria experienced a slowdown in GDP growth in 2012 (0.6%) and 2013 (0.9%). While the economy managed positive growth in every year after 2009, the rates have been low and at end 2013 Bulgaria's GDP had not yet recovered to pre-crisis levels.

Georgia

Georgia's economy suffered a double shock in the latter part of 2008, from the global financial crisis as well as from armed conflict. In order to restore confidence, the government quickly reached agreement with the IMF on a Stand-By Arrangement and also benefited from an international donors conference which pledged assistance of US$ 4.5 billion in grants and concessional loans. Combined with a track record of prudent fiscal and macroeconomic management, Georgia suffered a relatively small downturn of -3.8% of GDP in 2009 and rebounded robustly from 2010-2012 with real GDP growth exceeding 6% each year.

The growth has been relatively broad based in the industrial and services sectors, whereas agriculture has stagnated. Best performing areas include manufacturing, construction, transport, retail trade, tourism, and finance. Foreign direct investment lags relative to the astounding levels achieved before the crises, but has steadily been around 6-7% of GDP, among the highest levels observed in the region. In 2011 and 2012, Georgia's credit ratings were upgraded, reversing the downgrades received during the crises, and have returned or exceeded pre-crises levels. While the overall picture has been positive, one area of concern is that the high growth has not been very inclusive. Poverty rates have declined moderately, income inequality has worsened, unemployment remains high, and key indicators in health lag behind comparators elsewhere in Eastern Europe.

As a result of political and policy uncertainty, and a weak external environment, growth began to slow in the latter part of 2012, a trend which extended into 2013. Export growth slowed slightly, planned public investments were delayed, and consumers and firms reacted to uncertainty by cutting back on spending and investment. For 2013, GDP growth slowed to 3.2%.

Greece

Faced with a deteriorating economic environment following the 2008 crisis, the Government responded with a stimulus program financed by increased borrowing. Despite high fiscal deficits, a double digit current account deficit, and public debt levels in excess of 100% of GDP, borrowing costs were low due to Greece's membership in the Eurozone. However, in late 2009, when revised figures showed a large increase in budget deficit and public debt levels, markets panicked and the resulting

5 World Bank, World Development Indicators

sell-off of Greek bonds rendered further financing of the deficit prohibitively expensive. Cut off from markets and faced with the prospect of default, Greece embarked on a €110 billion program of fiscal austerity financed by the IMF and other Eurozone members. After the initial program faltered, additional financial packages were prepared together with a partial write-off of privately held debt known as the 'Private Sector Initiative'.

The austerity program succeeded in reducing the fiscal deficit and in generating a primary surplus in 2013, while the current account has also improved dramatically and posted a surplus for 2013. Internal devaluation – the nominal reduction of wages, asset prices and prices of non-tradable goods and services due to the inability to devalue the currency – has occurred, particularly for items the price of which is not determined by the Government. However, the massive tax rises that underpinned the program have mired the economy in a depression, with unemployment rocketing to around 27% and poverty rates rising sharply. Spending cuts have been more subdued, thus increasing the Government's share of control over the economy and in turn crowding out the private sector. Exacerbating this liquidity crunch has been the effective government takeover of banks and the frequent changing of laws and regulations that have increased uncertainty and stoked capital flight. As a result, new investment has collapsed. Furthermore, genuine structural reform has been limited, thus for its income level, the economy remains relatively uncompetitive with the increases in productivity being overwhelmed by uncertainty, and the imposition of new and more onerous taxes and regulations that increase the Government's intake of resources but reduce the ability of firms to operate.

In terms of economic performance, Greece has been hit the hardest by the aftershocks of the 2008 crisis, not just in the Black Sea region but globally. It has experienced negative economic growth every year since 2008, and the cumulative contraction from 2008 to 2013 has been on the order of 25% of GDP.

Moldova

The economic downturn that followed the 2008 global financial crisis struck the Moldovan economy in 2009. GDP contracted by 6% as industrial production and agricultural output both declined. Foreign direct investment also fell sharply, and together with a decline in remittances resulted in the halving of investment levels and a drop in private consumption. Faced with collapsing demand and supply, the Government responded with expansionary fiscal and monetary policies that contained the decline, but led to a sharp increase in the fiscal deficit to -6.3% of GDP (from 1.0% in 2008) and a near 50% increase in public debt levels (albeit from a comfortably low starting point of around 21.6% of GDP at end 2008).

The global and regional upturn in 2010 and 2011 fed through to the Moldovan economy as well, with real GDP growth rates of 7.1% and 6.8% respectively. Export growth was robust, and the recovery of remittances, which amount to around 30% of GDP, helped private consumption recover quickly. The government also achieved an impressive fiscal consolidation bringing the deficit down to -2.4% of GDP in 2011 and putting public debt levels on a declining trajectory again.

A weak external environment in 2012, due to the Eurozone crisis on the one hand and weaker growth in Russia on the other, combined with a bad drought that led to a 22% decline in agricultural output, resulted in real GDP contracting by -0.7% in 2012. However, the economy recovered in 2013, with export growth initially, and then household consumption and a strong recovery in the agricultural sector, driving GDP growth which reached 8.9%, the highest in the region. Moldova remains dependent upon external conditions, as well as on the relatively volatile agricultural sector. Nevertheless, it has achieved steady export growth in recent years and has built a track record of solid macroeconomic management.

Romania

Romania experienced a contraction of GDP of -7.1% in 2009, with declines in private consumption and exports the principal culprits. Unlike most other BSEC countries, it also suffered a contraction of -1.1% in 2010, as domestic demand continued to decline, with private consumption weak and public spending being cut in order to achieve fiscal consolidation targets under an IMF support program. However, exports recovered strongly (nearly 29%), and combined with a smaller increase in imports, resulted in a large correction in the trade balance and the current account, both of which had reached double digit levels (as a share of GDP) prior to the crisis.

GDP growth resumed in 2011, reaching 2.3%, with investment as well as consumption recovering, while exports rose nearly 29% again. However, the Eurozone crisis, an extremely harsh winter at the beginning of the year, and a severe drought which hurt agricultural output combined to reduce GDP growth to 0.6% in 2012.

Despite the weak growth, Romania's economy demonstrated impressive resilience as evidenced by the significant improvement in the fiscal and current account balances; low public debt, the structure and tenure of which have improved; stable inflation; and, perhaps most impressively growth in employment. These unemployment figures stand in stark contrast to trends throughout most of Europe, where unemployment has risen to dangerously high levels and has shown limited improvement.

In 2013, Romania's economy grew at its fastest pace since the crisis, spurred by a bumper harvest and export

growth. On the demand side, exports private consumption and investment emerged as key drivers of growth, alongside increasing of competitiveness, including declining unit labor costs and improvements in the terms of trade. GDP grew by 3.5% for the year, while the fiscal deficit stood at -2.5% of GDP, and the current account deficit shrank to -1.1% of GDP.

Russia

Following a decade of high economic growth during which the economy nearly doubled in real terms, GDP contracted by -7.8% in 2009 as a result of a combination of (i) the freezing of global capital markets which left over-exposed corporations unable to access external financing, (ii) capital flight and mass withdrawals from the banking system, (iii) a halt in domestic lending which led to a significant decline in consumer demand, and (v) a sharp contraction in exports, exacerbated by a decline in commodity (especially energy) prices. Low public debt and high foreign exchange reserve levels allowed the Government to cushion the decline with a fiscal stimulus program which included sizeable but stabilizing liquidity injections into the banking system. When global commodity prices and external demand recovered, economic growth resumed, and together with a rise in domestic demand resulted in growth rates of 4.5% in 2010 and 4.3% in 2011, fully reversing the 2009 downturn.

Economic growth continued into 2012 (3.4%), but began to slow as investment remained weak, and external demand fell in the Eurozone, Russia's largest trade partner and main destination for energy exports. The weakness continued into 2013, with GDP growth of 1.3% coming mainly from private demand fueled by rising real wage levels. While the overall macroeconomic situation remains strong, with low public debt levels, inflation in single digits, and both a fiscal and a current account surplus, there are causes for concern. These include challenges such as demographic decline, continued weak investment, and a growing dependence on international commodity prices, the persistence of which risks eroding the solid fundamentals, as evidenced by steady declines in both the fiscal and the current account surplus. These require difficult structural reforms with upfront political and financial costs, and back-loaded benefits such as an improved investment climate, a broader based and more open economy, and reduced future pension and health liabilities.

Serbia

By regional standards, Serbia suffered a small recession in 2009, with a reduction of real GDP of -3.5%. Although Serbia was displaying symptoms of overheating towards the end of the 2000-2008 boom period including a current account deficit which had swelled to nearly -22% of GDP in 2008, this was not due to heightened foreign borrowing but rather to high consumption relative to income levels and thus declining national savings. The Serbian financial sector is fairly small relative to GDP, thus limiting its impact on the overall economy, and while it grew rapidly prior to the crisis, the credit expansion was funded mainly by domestic deposits. In addition, Serbia employs a flexible exchange rate regime and was thus able to use currency depreciation and counter cyclical monetary policy to cushion the shock and help mitigate the reduction in domestic demand. In January 2009 Serbia agreed a Stand-By Arrangement with the IMF to support an adjustment program and restore macroeconomic and financial stability.

Serbia experienced positive growth in 2010 and 2011, but at low rates (1.0% and 1.6% respectively) that lagged behind regional averages. Recovery was hampered by lingering macroeconomic imbalances. In contrast to the fiscal consolidation achieved in neighboring countries, Serbia's fiscal deficit worsened during these two years, leading to a rise in public debt levels. Inflation rates were among the highest in the region, as continued depreciation of the domestic currency passed on higher costs to the economy. The current account deficit fell sharply due to a large reduction in imports. While export performance improved, its positive impact was overshadowed by other structural impediments in the economy which resulted in weak consumption and investment.

In 2012, the economy slipped back into recession (-1.5% GDP growth) mainly as a result of adverse weather, which led to a -17% contraction in agricultural production, and the effects of the Eurozone crisis. Inflation remained high, due to a spike in food prices and continued effects of currency depreciation, while the budget deficit and the current account deficits both widened notably. While the imbalances largely remain, GDP growth rebounded to 2.5% in 2013 on the strength of a recovery in agricultural production and a boost to industrial production by the opening of a new automobile plant, which also provided a boost to exports and helped to reduce the current account deficit.

Turkey

Turkey represents another positive outlier, and five years after the 2008 crisis continues to enjoy some of the highest growth rates in Europe. The cessation of capital inflows and the sharp decline in key external markets resulted in a short but sharp decline in output in late 2008 and early 2009. For 2009, the economy contracted by -4.8%, but by the end of the year growth had resumed at a faster pace than during the global 'boom' years prior to the crisis. The GDP decline was largely due to a halt in production and the drawing down of inventories. This meant that when (i) the initial panic of the crisis passed and domestic demand picked up, and (ii) the global recovery turned out to be faster and more pronounced than anticipated, Turkish firms were well placed to resume production, thus resulting in rapid recovery. In ad-

dition, the financial system suffered limited stress, due to substantial structural reforms and strengthened regulation and supervision frameworks dating back to 2001.

Real GDP growth in 2010 soared to 9.2%, and in 2011 reached 8.8%, sparking fears of overheating. However, while the current account deficit grew rapidly, Turkey reaped the benefits of a decade of solid macroeconomic management characterized by sound fiscal accounts, declining public sector debt, and a deepened and well regulated financial sector with low dependence on external financing. In addition, major structural reforms implemented in previous years helped to mitigate the impact of the global downturn and provided for a diversified basis of growth.

Growth slowed markedly in 2012, as the Eurozone crisis negatively impacted economic activity and raised uncertainties, but it also had the unintended benefit of helping to reduce overheating risks. GDP growth slipped to 2.1%, and for 2013 rose to 4.1%. This implies cumulative real economic growth of nearly 20% since 2008, more than triple the regional average and by far the best outturn of any large country in Europe.

Ukraine

When the global financial crisis of late 2008 struck, Ukraine's economy was displaying symptoms of overheating, including rising inflation and a deteriorating current account balance, as a boom of foreign capital inflows fueled a domestic property bubble, rising consumption and a shift in sources of growth from tradable to non-tradable sectors.

These factors left the economy particularly vulnerable when inflows of financing suddenly stopped, and together with a sharp decline in export demand and in the terms of trade, resulted in a sharp and sudden reversal of economic growth and a banking crisis. Real GDP declined by -14.8% in 2009, among the most severe contractions globally. A recovery began in the latter part of 2009 and continued into 2010 and 2011, as prices for steel exports rose, and were further aided by an upturn in private consumption and investment, GDP grew 4.1% in 2010 and 5.2% in 2011. The banking sector was stabilized, with Banks being recapitalized.

However, a weakening of international steel prices in 2012 and the economic slowdown in the EU – the main destination for exports – resulted in a sharp drop in growth rates in 2012 and 2013 (0.3% and 0.0% respectively). One consequence is that at end 2013, Ukraine's GDP has yet to return to 2008 levels. Combined with a tightening of monetary policy in order to reduce inflationary pressures, investment and growth prospects have been further constrained. The monetary tightening resulted in reduced currency flexibility and a rise in imports which, together with a stagnation of exports has led to a worsening current account deficit and a decline in foreign reserves. While less so than prior to the crisis, Ukraine remains vulnerable to shortages of external financing, due to the requirements of the Government, large corporations and banks. The sudden reversal of flows in mid-2013 from emerging markets brought about by expectations of a 'tapering' of US monetary policy affected Ukraine disproportionately, further increasing pressure on the economy. In the absence of a program with the IMF, this has led to rising concerns about how Ukraine will meet its external financing needs. Ukraine has suffered a series of downgrades and its credit ratings are several grades below their pre-crisis peak.

Heightened Uncertainty Part of the 'New Normal'

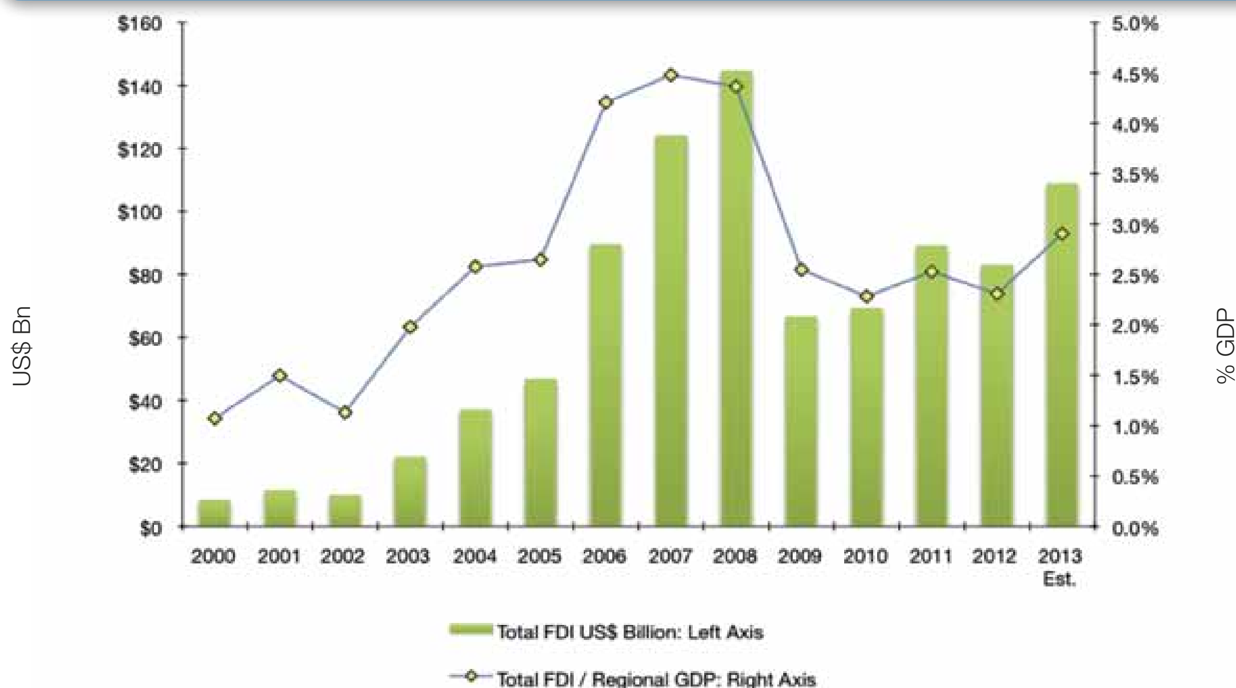
After their seizure in September 2008 and their near crash, global financial markets gradually returned to functionality in the subsequent five years and have experienced upswings and downswings. These shifts have been influenced by natural disasters, economic shocks (e.g. volatility in food and energy prices), political crises (e.g. Arab spring and the Eurozone crisis), and significant policy measures such as major economy fiscal stimuli in 2009, the ongoing highly stimulative monetary policies of the world's most influential central banks, and the steps announced in 2013 to begin the move back to more conventional policies (e.g. 'Tapering'). As elsewhere, the Black Sea region has felt the push and pull of these swings and countries have responded accordingly.

One important difference that pervades the post-crisis environment, and stands in contrast to the reckless pursuit of return in the boom period prior to the crisis, is an underlying sense of uncertainty. On one level, this represents a positive development, since it deters the recklessness which had become a hallmark of the latter phase of the pre-crisis boom, during which over-leveraging had reached dangerous levels and both borrowers and lenders were stuck in an unsustainable spiral which ultimately unraveled at high economic and social cost.

However, as with any reaction to an adverse event, there is always the risk of overreaction, and until the right balance between confidence and caution is found, persisting uncertainty can easily result in excessive risk aversion, which deters investment. Lower investment levels over a prolonged period are particularly pernicious since they not only reduce growth in the present, they also constrain potential output in the longer term. Insufficient investment may result in capacity constraints, reduced productivity, over-reliance on antiquated or inefficient processes with potentially permanent unfavorable impact upon economic growth rates.

In many countries, investment in the Black Sea region has been weak in the five years since the crisis, and whatever growth has been observed has relied mainly on private consumption and exports, both of which rebounded quickly after 2009. By way of contrast, public

Figure 5: Foreign Direct Investment in the Black Sea Region 2000-2013



investment, like public consumption, has been hindered by fiscal constraints and the efforts of governments to reduce budget deficits and public debt levels. But unlike consumption, private investment has been relatively muted throughout the five year period, with uncertainty, higher risk premiums, and fear of continued and unfettered access to financing, among the principal reasons for the abandonment or deferral of investment decisions.

Foreign direct investment (FDI) data (See Figure 5) underscore this ongoing tepidness. FDI into the Black Sea region peaked in 2008, at USD 144 billion or nearly 4.5% of regional GDP. It more than halved, to USD 66 billion in 2009, and in the subsequent four years rose slowly and uncertainly, reaching USD 109 billion in 2013 or approximately 2.9% of GDP. While ahead nominally with respect to 2006 results, in real terms FDI is much lower today and as a share of GDP over one third off the peak levels achieved. In recent years, FDI appeared to have settled at 2.5% of GDP. The improvement in 2013 thus represents a hopeful sign, but levels still remain fairly low for emerging economies which aspire to converge towards the wealth levels of Western Europe. The figures are likely suppressed by the turmoil in the Eurozone, since EU members remain the principal sources of FDI and external financing. Nevertheless, the weaker FDI levels underscore the problem of foregone potential growth and provide a telling clue about the lingering sense of uncertainty (at least from outsiders interested in investing in the region).

Table 1: Summary of Key Economic Indicators for 2013

	GDP Growth	Inflation	Cur Acct Bal / GDP	Budget/ GDP	Public Debt / GDP	FDI/GDP
Albania	0.9%	1.9%	-8.4%	-4.7%	70.5%	7.7%
Armenia	3.5%	5.8%	-10.5%	-0.3%	45.4%	5.3%
Azerbaijan	5.8%	2.4%	18.1%	0.6%	13.9%	2.7%
Bulgaria	0.9%	0.9%	1.9%	-1.8%	17.5%	3.8%
Georgia	3.2%	-0.5%	-7.7%	-3.3%	32.3%	6.0%
Greece	-3.9%	-0.9%	0.7%	-2.1%	176.0%	0.6%
Moldova	8.9%	4.6%	-4.8%	-1.1%	25.9%	2.9%
Romania	3.5%	4.0%	-1.1%	-2.5%	39.3%	1.9%
Russia	1.3%	6.8%	1.6%	-1.3%	13.8%	3.8%
Serbia	2.5%	7.8%	-4.9%	-5.0%	67.5%	2.5%
Turkey	4.1%	7.5%	-7.9%	-1.2%	35.4%	1.6%
Ukraine	0.1%	-0.3%	-8.9%	-5.6%	40.4%	0.1%

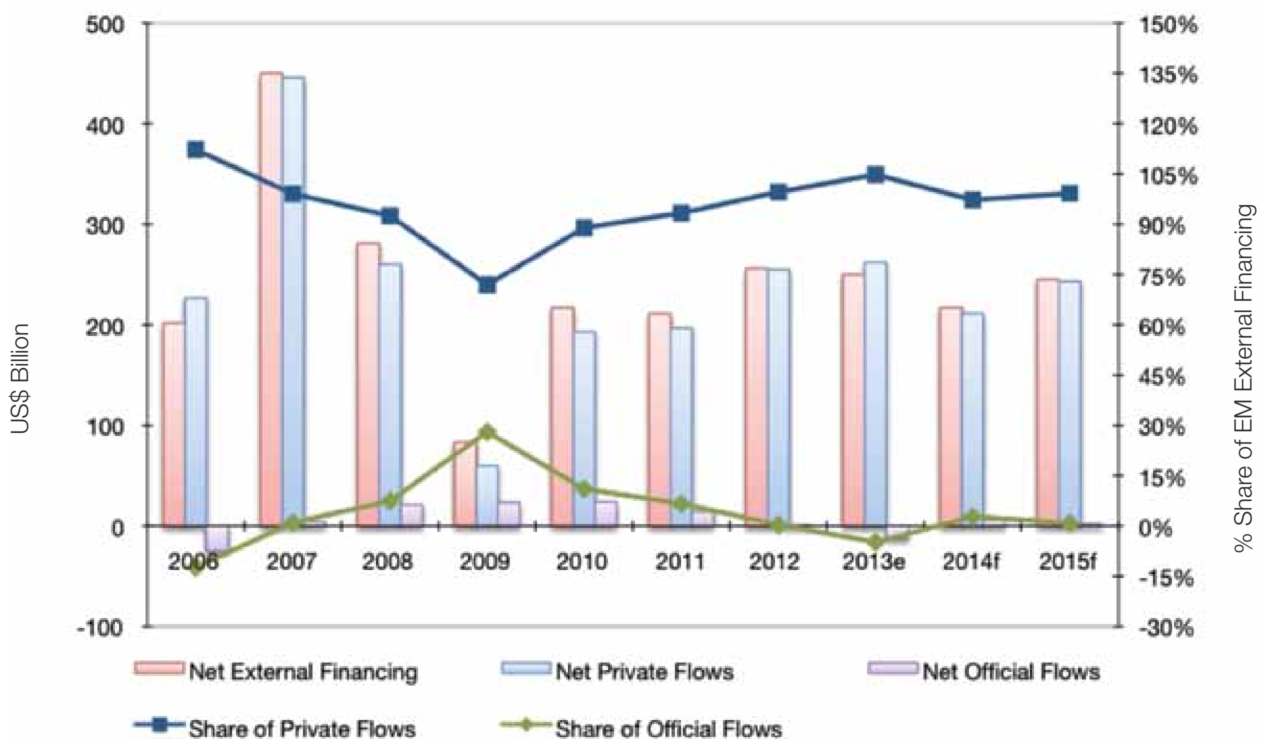
The Black Sea Region Post-Crisis Changes to the 'Model of Growth'?

As Table 1 summarizes, the differentiated performance of Black Sea countries continued in 2013, in terms of real growth as well as in terms of other key economic indicators. Beyond the continuously improving fiscal performance, also highlighted in Figure 4, other discernible trends – albeit with individual country exceptions – were that inflationary pressures were generally muted, public debt ratios remain for the most part low as well as manageable despite the increased volatility of markets caused by external policy decisions taken by dominant actors in the global financial system (e.g. the US Fed's 'tapering') and foreign direct investment outturns, while varied, generally lag the levels achieved in the years prior to the 2008 crisis, as also shown in Figure 5.

Five years after the outbreak of the global crisis, a much debated question with respect to the Black Sea region – and indeed to Eastern Europe as a whole – is to what degree the model upon which growth in the region was based has changed.

In the 2000-2008 boom period, external financing fueled the growth to a considerable degree. To a certain extent this was both desirable and necessary, since domestic financial markets in most Black Sea countries were too small and underdeveloped to be able to mobilize the large amounts of capital necessary to finance accelerated growth; external financing made the higher growth rates possible. However, by the latter stages of the boom, the external financing had shifted from mainly financing investment (particularly for tradable goods and services) – which increases productivity and economic capacity over a longer period of time and is thus considered more sustainable – to primarily financing either inward oriented investment (for non-tradable goods and services) and consumption (including asset purchases) which provides a short-term boost to growth but also tends to exacerbate imbalances that almost inevitably arise over the course of a business cycle. In particular, rapidly rising levels of imports had resulted in the mushrooming of trade and current account deficits in many countries.

Figure 6: External Net Financing Flows to Eastern Europe



Relatedly, maintenance of the high rates of growth depended upon ever increasing amounts of financing continuing to flow into the region, either to re-finance obligations or else to further feed consumption. Figure 6 shows external financing glows into Eastern Europe since 2006, how they peaked in 2007 and then fell dramatically, bottoming out in 2009, a year in which official flows rose sharply in order to provide a counter-cyclical boost to the collapse in private flows, but achieving a fairly minor impact. Private flows have recovered since, but they remain lower and subject to fluctuation, driven in large part by exogenous factors.

Ultimately, re-balancing was necessary not just for macroeconomic indicators such as the current account, but also for the structure of the economy, since the basis of growth is important for its sustainability. An appropriate balance between (i) domestic demand driven and export driven growth, and (ii) investment in tradable sectors and non-tradable sectors, is required. Where an economy's structure tilts too far in one direction, imbalances appear (on the current account, for example) while vulnerability also rises since the economy's diversification is reduced and its resilience to shocks is potentially weakened.

For countries which were overheating and dependent upon continued and ever greater flows of external financing, reducing this reliance has been and remains the priority. This requires taking measures to increase domestic savings levels so as to strengthen and help to deepen domestic financial systems, as well as updating and building upon the generally solid track record of bank regulation.

Building up domestic financial systems is necessarily a slow and deliberate process, if it is to be done correctly, and the promotion of domestic savings implies reduced domestic consumption in the short term which in turn would translate into lower economic growth rates. While excess external financing is problematic, insufficient external financing raises investment costs, and can limit available maturities and instruments in the market. It thus suppresses growth and results in higher unemployment, lower living standards, and less poverty reduction than might otherwise be achieved. The key is to strike an appropriate balance between the two, since external financing can provide lower cost / longer maturity / more sophisticated financing that can be highly beneficial when channeled into productive uses, and will remain a necessity for convergence towards wealthier country income levels to occur.

Where external financing takes the form of FDI, especially in tradable sectors, it generally plays a more constructive role in improving the competitiveness of an economy and increasing its wealth generating capacity. It is also likelier to have durability, since it cannot enter and exit quickly like flows into capital markets which can increase volatility. This also applies to domestic investment in tradable sectors.

A prerequisite for such investment is a solid, stable business environment, and while Black Sea countries have achieved substantial progress in this respect, as measured by external bodies that rank country business environments such as the World Bank's Doing Business and Euromoney's country risk evaluations, there is always room for further progress, particularly since standards constantly change and other countries elsewhere are improving their environments as well. An additional requirement is a public sector which implements effective fiscal and monetary policies, maintains good standards of governance and a competent and diligent regulatory regime.

In the aftermath of the crisis, the Black Sea region continues to enjoy a number of competitive advantages including (i) proximity to the wealthy markets of the EU, (ii) improving business environments, and (iii) high quality of human capital (education, skills) at a relatively low cost. Most countries have memories of dealing with crises over the last 25 years, and this provides resilience, a wealth of experience upon which to draw, and greater flexibility in implementing policy responses than that observed in the wealthier but more rigid economies of Western Europe. They are thus well placed to sustain growth.

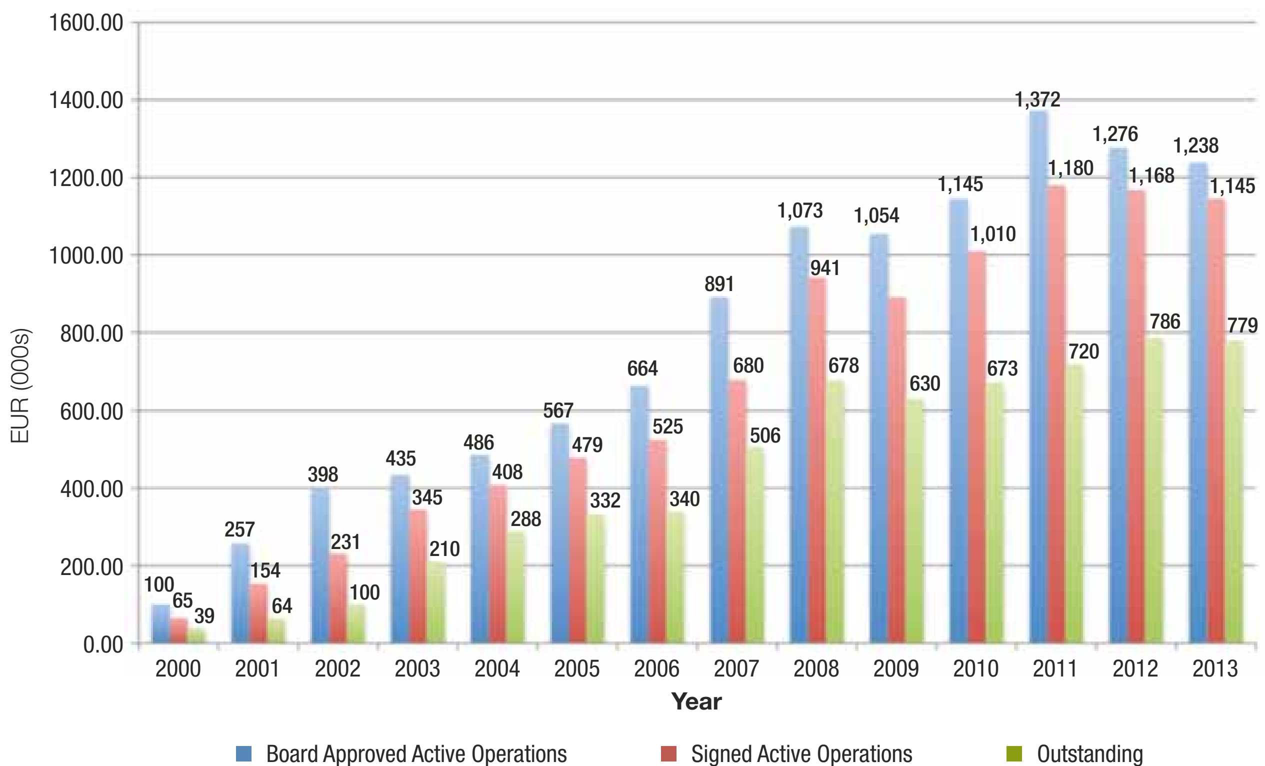
However the economic models evolve, output growth rates are unlikely to return to the levels observed during the 2000-2008 period. Given the current state of Black Sea economies and the constraints they face, higher growth would require sustained high investment rates. This in turn would require a return to reliance on foreign capital flows to provide a portion of the required financing, since the domestic financial base may be growing and governments are seeking to nurture its development further, but it is not yet large enough to provide necessary levels of financing for more rapid growth. Foreign capital can be beneficial if employed prudently in order to increase wealth creating capacity, and not merely to fuel consumption or speculative asset purchases. The latter tend to increase dependency on growing foreign inflows as well as vulnerability to shocks, while they create imbalances which complicate macroeconomic management.

BSTDB in the Black Sea Region

Portfolio Description

Since the beginning of operations in June 1999, the Bank has approved 277 operations amounting to about EUR 2.9 billion. Throughout this period, there were 240 signed operations for a total signing amount of EUR 2.4 billion. A total of 191 operations for about EUR 1.8 billion were repaid. At end 2013, there were 100 operations in the active[6] outstanding portfolio for EUR 779.3 million. At end 2013, the Bank had only three problem loans, representing 5.2% of the value of the total outstanding portfolio.

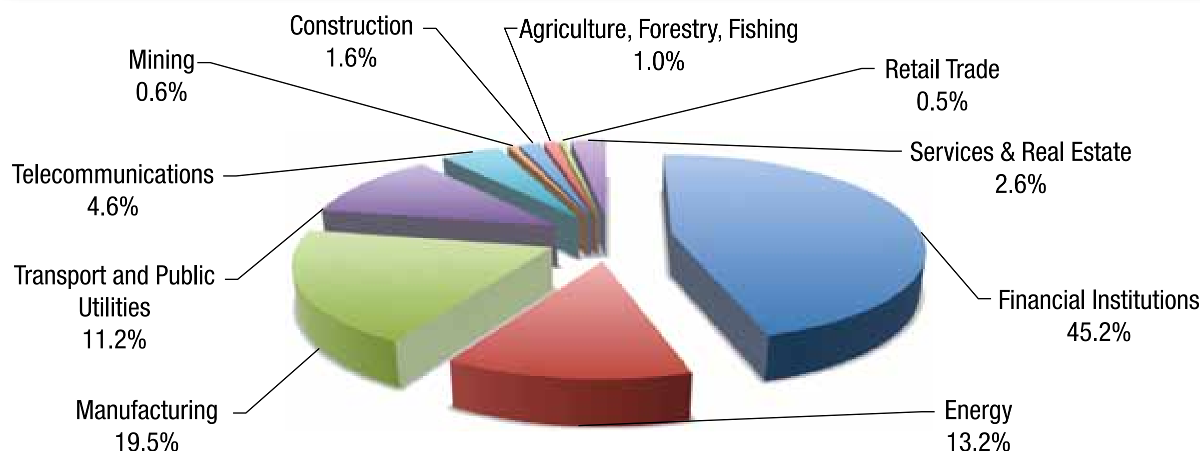
BSTDB Portfolio Development from 2000-2013



Source: BSTDB

6 The active operations in the Bank's portfolio are those currently in any of the phases from Board approval to full repayment (approved, signed, disbursed and in repayment).

Cumulative Signed Operations by Sector



Source: BSTDB

Selected BSTDB Financings in 2013

Galnaftogaz IV (Ukraine)

BSTDB extended a USD 20 million long-term debt financing to "Concern Galnaftogaz" to support the expansion of company's retail network of gas filling stations in Ukraine. The Bank has a long-lasting business relationship with Galnaftogaz and closed in 2004, 2007 and respectively 2011 three other transactions with the company, for a total amount of USD 67 million.

The project contributes to the development of the retail petroleum sector in Ukraine and provides economic benefits for the Ukrainian economy, the most relevant being the tax revenue gains and new job creation.

The total project cost is USD 220 million and involves the provision of USD 180 million of corporate long-term financing from BSTDB, other IFIs (IFC and EBRD) and commercial banks.

BSTDB amount	**USD 20 million**
Type of financing	**corporate loan**
Total Operation cost	**USD 220 million**
Maturity	**7 years**

Euroterm II (Armenia)

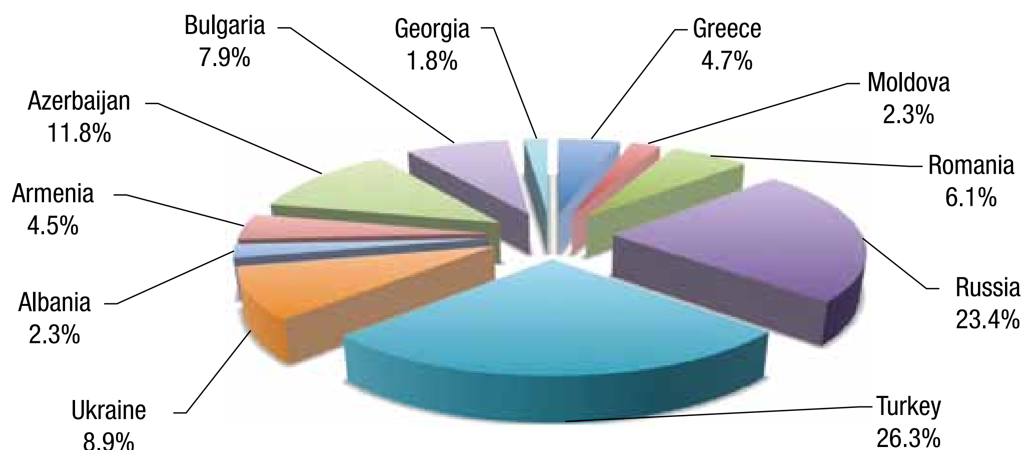
BSTDB extended a senior corporate long-term loan to its existing client Euroterm CJSC, for financing the capital expenditure and working capital requirements related to the operation of company's new production line. The Bank financing was complemented by a parallel loan provided by IFC.

The BSTDB facility is expected to contribute to the development of Armenia's food processing industry and agribusiness sector. It supports the further development of a local producer, enabling it to become more competitive, increase production capacity and efficiency, thus enabling access to markets previously not accessible for the company. The new production line has created about 50 new jobs in the first year of operation and is expected to create other 60-70 jobs in the second year.

BSTDB amount	**EUR 2.05 million**
Type of financing	**corporate loan**
Total Operation cost	**EUR 4.55 million**
Maturity	**7 years**

Outstanding Operations by Country

As of end 2013 the outstanding operations of the Bank (cumulative disbursements less repayments for active operations) represented EUR 779.3 million, distributed by country as per the following graph:



Source: BSTDB

Selected BSTDB Financings in 2013

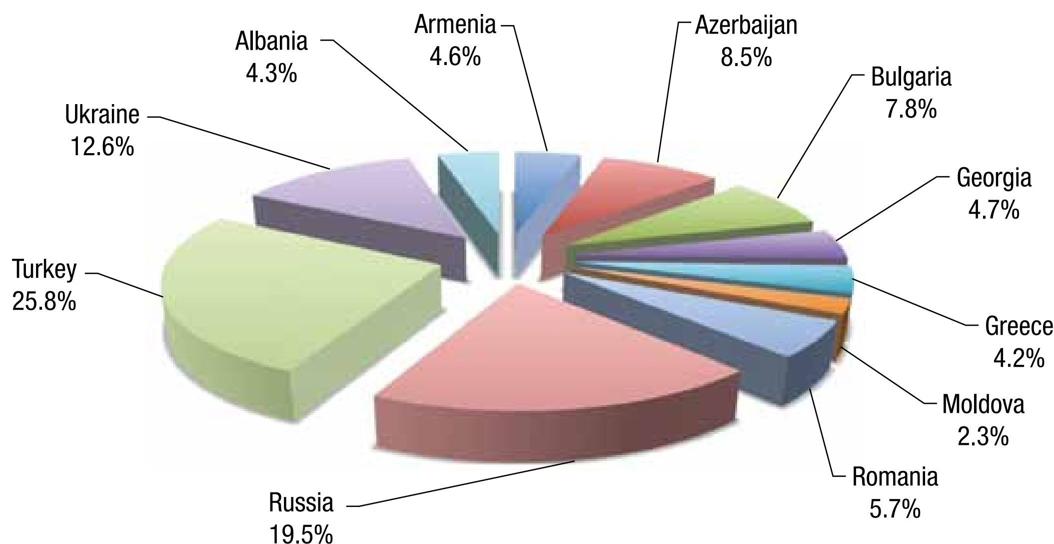
Agricover Group (Romania)

BSTDB provided a EUR 15 million medium-term corporate loan to "Agricover Group" to support the Group's further vertical integration and geographical expansion strategy. Half of the loan will be diverted to Agricover Credit IFN, which provides finance for the grain farmers in Romania which are suppliers of the Group's processing and trading companies.

The project has economic development potential for the Black Sea Region, as it contributes to the activities of a successful Group in Romania and promotes cooperation among member states via investments and exports.

BSTDB amount	**EUR 15 million**
Type of financing	**corporate loan**
Total Operation cost	**EUR 15 million**
Maturity	**5 years**

Active Signed Operations by Country



Source: BSTDB

Selected BSTDB Financings in 2013

FINCA Azerbaijan

BSTDB signed a USD 10 million medium-term Micro-credit/SME (MSME) loan facility to finance the activities of FINCA Azerbaijan, the largest non-bank credit organization in the country operating since 1998. The mission of FINCA Azerbaijan is to provide financial services to Azerbaijan's lowest-income entrepreneurs so they can create jobs, build assets and improve their standard of living. The project represents an excellent mechanism for BSTDB to extend medium-term funding to numerous micro-borrowers, which cannot be otherwise accessed by BSTDB directly. By the end of 2013, close to 4,000 sub-loans were financed through the BSTDB loan facility.

FINCA Azerbaijan is a subsidiary of FINCA, a leading international microfinance organization that currently reaches more than one million clients through its 22 subsidiaries in Africa, Eurasia, Latin America, and the Middle East and South Asia. FINCA is supported with investments from socially responsible international investment partners.

Their operational countries include Azerbaijan, Armenia, Russia and Georgia from among the BSTDB member countries.

The MSME facility enhances the financing options for micro and small sized companies and complements the BSTDB's SME program in Azerbaijan.

BSTDB amount	**USD 10 million**
Type of financing	**microcredit/SME**
Maturity	**3 years**

2013 Portfolio Developments

In 2013, as a result of business development efforts, the Board of Directors approved 22 new operations for a total of EUR 266.9 million. This represents a 40% increase over 2012. Twenty-two new operations were signed for a total of EUR 225.3 million, an increase of 25% compared to 2012.

As a result, the Bank had 98 outstanding operations to 81 borrowers at the end of 2013.

Portfolio structure by sector remained broadly in line with the Bank's historical trends. As in previous years, the most significant exposures were in financial institutions, transport, public utilities, manufacturing and energy. Exposure to financial institutions of 47.6% mainly reflects BSTDB's strategic focus on the SME sector development, trade finance, leasing and mortgage lines of credit extended through financial intermediaries in member countries. The Bank's participation in regional SME equity funds represented a further 3.6% of the outstanding portfolio. Sectoral exposure to transport and public utilities was 15.8%, while manufacturing corresponded to 13.3%, and energy to 8.2%.

Selected BSTDB Financings in 2013

International Bank of Azerbaijan (Azerbaijan)

The Multiple Buyer Credit Facility (MBCF) amounting to USD 15 million provided to the International Bank of Azerbaijan (IBA) will be used to finance IBA customers that import to Azerbaijan capital and other goods from BSTDB member countries. This is the third increase, by a total USD 8.5 million, of the existing facility (limit) after its successful implementation. Under the initial facility of USD 6.5 million, the cumulative disbursements of IBA reached USD 30.2 million by the end of 2013.

IBA is Azerbaijan's largest bank and is majority owned by the Ministry of Finance. IBA has a clear policy function role given its size, importance and scale of operations in the country's banking system and its socio economic life. Being by far the largest bank in the system, it contributes to ongoing development of a number of industries in Azerbaijan. All key borrowers of IBA play systemic importance for the industry they operate in, both by size and scale of operations.

By the end of 2013, the cumulative disbursed amount under the Trade Finance Program of BSTDB reached USD 685 million within a total credit limit of USD 242 million.

BSTDB amount	USD 15 million
Type of financing	import financing
Maturity	up to 3 years, revolving

TBC Kredit (Azerbaijan)

BSTDB provided a medium-term SME facility of USD 4 million to support TBC Kredit's activities in financing eligible SMEs in Azerbaijan. By working with TBC Kredit, BSTDB will be able to reach a larger number of SMEs in Azerbaijan and contribute to the increase of non-oil sector business in the country.

This operation is expected to have favorable economic benefits for the Azerbaijani economy, the most relevant being additional tax revenues from increased economic activity. The SME financing provided will help further enhance benefits such as employment creation and increased competitiveness, together having multiplier effects for other parts of the economy.

The loan is expected to have also a positive regional cooperation effect. First, the operation involves the Azerbaijani subsidiary of a Georgian bank – TBC Bank, so it promotes inter-regional investment. Second, there will be some regional cooperation benefits resulting from the activities of the SMEs receiving financing from this facility. Other BSTDB countries are important trade partners for Azerbaijan so to the extent these SMEs either import inputs from BSTDB countries or engage in export activities, there will be positive impact.

BSTDB amount	USD 4 million
Type of financing	SME finance
Maturity	3 years

Co-Financing

The Bank values its cooperation with other financiers in mobilizing investment in the Black Sea region and realising cross-country operations. Such operations possess high shareholder value for the Bank and are therefore priority activities.

In the course of 2013, 14.4% of signed portfolio was co-financing. In terms of total signed active portfolio in the amount of EUR 1.1 billion, 37.4% of operations are co-financing. The share of co-financed active operations to total active outstanding portfolio is 42.0%.

In 2013 the Bank co-financed the following operations:

1. Galnaftogaz IV with EUR 14.5 million for a total amount of EUR 159.6 million with EBRD, IFC and equity holders
2. Kurum International III with EUR 18.0 million for a total amount of EUR 132.5 million with IFC , FMO, commercial banks and equity holders

Selected BSTDB Financings in 2013

Patria Credit (Romania)

BSTDB increased its support to the financial sector in Romania with a EUR 7 million loan to Patria Credit, the largest non-banking microfinance institution in the country. Enhancing the access to finance for small enterprises, particularly those outside of capital cities, is crucial for the development of the Romanian and other economies in the region. In the current economic environment, the BSTDB loan is expected to improve the confidence in the non-bank financial sector by contributing to the overall expansion and strengthening the financial services in Romania.

Patria Credit will use the proceeds of the loan for on-lending to micro and small businesses in urban as well as in rural and remote areas, where access to finance is limited. Being a non-deposit taking entity and not being affiliated with any major financial institution, the company has been successful to attract interest from major IFIs operating in the region such as EBRD, IFC, European Investment Fund (EIF) and European Fund for Southeast Europe (EFSE).

BSTDB amount	**EUR 7 million**
Type of financing	**microcredit/SME**
Maturity	**5 years**

Iş Leasing (Turkey)

Financial Leasing is a perfect tool of financing investments of SMEs for capital goods, in case of lack of sufficient collateral. The SME Leasing Facility provided to Iş Leasing in the amount of EUR 30 million is expected to have positive development impact on the SME sector in Turkey. The BSTDB loan will allow Iş Leasing to meet its medium-term funding needs associated with SMEs and respond to demand from local businesses for longer term leasing contracts.

Since its inauguration, BSTDB had signed 15 leasing operations amounting to EUR 72 million in Bulgaria, Georgia, Moldova, Romania and Russia. This operation is the first involvement of the Bank in the leasing sector of Turkey, increasing the amount of signed leasing operations of the Bank to EUR 102 million.

Iş Leasing is one of the strong and reliable leasing companies in Turkey. The company is ranked 5th by total lease receivable among the leasing companies in Turkey.

BSTDB amount	**EUR 30 million**
Type of financing	**SME leasing**
Maturity	**5 years**

Technical Cooperation Special Funds

In 2013, as a result of business development efforts, the Bank administers a Special Fund (the "Hellenic Fund") established in July 2001 by a Contribution Agreement between the Government of the Hellenic Republic and BSTDB. The Fund was set up with an initial amount of EUR 800,000 and replenished in 2003 with the amount of EUR 500,000. This is the Bank's first Special Fund and it responds to a real need expressed by the Bank for higher quality of the information provided by Bank's prospective clients. The Fund is tied to consulting companies based in Greece. However, up to 25% of an assignment cost may be allocated to consultants who are nationals of the other member countries of the Bank. Since its inception, the Hellenic Fund disbursed around EUR 1,100,000 for 31 consulting assignments. The sectors benefiting from these funds included manufacturing, telecommunications, oil and gas, transportation, agribusiness, renewable energy, tourism, real estate and banking. These funds were used for consultancy services in nine BSTDB Member States – Albania, Armenia, Bulgaria, Georgia, Greece, Moldova, Romania, Russia and Ukraine. In 2013, the Fund financed four assignments related to the commercial, market and financial due diligence of potential projects for the Bank in Greece, Romania and Ukraine. The total amount used in 2013 for these assignments was EUR 67,500.

Also, the Bank administers a Technical Cooperation Special Fund (the "Fund") established in October 2008 with the Development Bank of Austria (the "OeEB"). The OeEB contributed to the Fund an initial amount of EUR 500,000 provided by the Government of Austria as Official Development Assistance (ODA). The Fund is an untied facility offering financing for a wide range of technical assistance services related to project preparation and training needs of BSTDB clients in the eligible countries of the Black Sea region. The Fund represents the first financial facility of this kind provided to BSTDB by a non-regional institution. It can be used for assignments in the BSTDB member countries that are eligible to receive ODA. In 2013, the Fund co-financed a cost allocation project for a private commercial bank which is a BSTDB client in Azerbaijan. The purpose of the assignment was to increase the effectiveness of client's branches and improve client services. The total cost of the assignment was paid 50% by the Fund and 50% by the beneficiary of the assignment. Since its establishment, the Fund has disbursed EURO 223,000 mainly for project preparation assignments.

Selected BSTDB Financings in 2013

Kürüm International (Albania)

BSTDB extended a EUR 18 million long-term corporate loan to "Kürüm International" to finance the acquisition and rehabilitation of four hydroelectric power plants (HEPPs) previously owned and operated by the Albanian state. The acquisition of these HEPPs is expected to lead to substantial reduction in energy costs and improve the reliability of the energy supply for the company.

Since Kürüm is a major employer in its region of operation, its presence has a positive multiplier effect on the local economy contributing to increased business activity in the area, employment, exports and tax revenues. The Project also serves to BSTDB's cross-country cooperation mandate, as the Sponsor is a Turkish company investing in Albania.

The total project cost is EUR 132.5 million and involves the provision of EUR 106 million of corporate long-term financing from BSTDB, other IFIs and commercial banks.

BSTDB amount	**EUR 18 million**
Type of financing	**corporate loan**
Total Operation cost	**EUR 132.5 million**
Maturity	**8 years**

Environmental and Social Performance

In 2013, the Bank made another important step in strengthening the sustainability of its development financing activities by adopting a new Environmental and Social Policy. The new document is intended to further promote the environmental and social sustainability in its Member States by applying sustainability principles to its business management. These relate primarily to pollution prevention and mitigation; respect for fundamental human rights in the working environment; protection of the Black Sea against pollution; addressing climate change; promoting sustainable use of natural resources, protection and conservation of biodiversity; disclosure of information on environmental and social performance of its operations, etc. Thus, the Bank committed to follow these principles in its financing and undertake a more comprehensive environmental and social assessment and monitoring of its operations commensurable to their potential risks and impacts, and ensure that these are structured and implemented in accordance with the existing good environmental and social practices. By good practices the Bank recognizes the European Union standards, the World Bank Group Performance Standards, EBRD's Performance Requirements, International Labor Organizations Core Labor Standards, International Environmental Conventions, as well as the national environmental, labor, health and safety, and public information laws and regulations of its Member States, including national commitments under international law. The new Policy is in effect as of January 1, 2014 and it replaced the former Environmental Policy of the Bank.

Selected BSTDB Financings in 2013

Center-invest Bank (Russia)

BSTDB signed a second loan agreement with Center-invest bank for EUR 20 million for financing eligible SMEs in Russia. Center-invest Bank is the market leader of SME lending in Southern Russia and with its well-established market presence and developed branch network can easily be reached by SMEs.

This loan continues a long and fruitful cooperation between BSTDB and Bank Center-invest which commenced in 2007 when BSTDB extended a subordinated loan of USD 10 million with a maturity of 7 years.

The operation supports the development of the real economy sector which is one of the BSTDB's key priorities, particularly in the current challenging environment where access to funding is limited. The loan is expected to help raise the competitiveness of SMEs, while also providing a boost to the banking sector in Southern Russia.

BSTDB amount	EUR 20 million
Type of financing	SME finance
Maturity	5 years

Basisbank (Georgia)

The Trade Finance (TF) Facility of USD 6 million, which is an extension to the already existing USD 4 million TF Facility (limit) to Basisbank, is used to finance sub-loans made by Basisbank for short-term pre-shipment and/or post-shipment export and/or import financing to those customers in Georgia who export goods to all countries or import goods from BSTDB member countries.

Each disbursement under the Trade Finance Facility has a maximum maturity of 360 days and can be re-borrowed after repayment. As of end 2013, the cumulative disbursements under this facility amounted to USD 14 million.

The project has favorable economic benefits for the Georgian economy from increased economic activity. Furthermore, it contributes to an increase in employment, export capacity and competitiveness, and multiplier effects for other parts of the economy. Other BSTDB countries are important trade partners for Georgia. Such transaction has a positive impact on the regional cooperation, helping to enhance inter-regional trade.

BSTDB amount	USD 6 million
Type of financing	trade finance
Maturity	360 days, revolving

Along this, the Bank also had revised its Environmental and Social Exclusion List. The newly approved document brings more clarity as to which transactions are prohibited for financing or severely restricted. The Exclusion List is intended to further eliminate the risk for the Bank of entering into financing operations that facilitate dealing in controversial environmental and social issues or specifically banned products and services under national and international law, and United Nations economic sanctions.

In terms of operations financed in 2013, the Bank continued to favor operations with strong developmental impact, which create job opportunities, apply cleaner technologies and energy efficiency, and promote use of renewable sources.

One such operation was financing rehabilitation and modernization plans of Ukraine's largest power distribution Company – DTEK, which is expected to result in improved quality of services, energy efficiency and minimizing electricity losses in the network. The Bank also committed to assist DTEK in phasing out the PCB (PoliChlorinated Biphenils) containing equipment which is still in use, and which is banned due to its significant health hazard risk.

Another important operation was co-financing Euroterm – one of Armenia's leading producer of fruit and vegetable concentrates and beverages, for construction of its new production plant in Armavir Region. The Client will introduce comprehensive environmental, occupational health and safety, and food safety management systems at the new facility, provide new job opportunities and apply good labor and working conditions, as well as implement efficient pollution prevention and mitigation measures.

Co-financing Kurum Metallurgical Complex's acquisition of four Hydro Electric Power Plants (HEPPs) in Albania and their rehabilitation is an operation which is expected to result in significant impacts on the general environmental and social performance of the Company's iron and steel production business. After the rehabilitation these HEPPs will supply a renewable and clean energy and will greatly offset Kurum's greenhouse gas emissions.

In 2013, the Bank also continued to cooperate fruitfully with its counterparts in the area of development finance and explored together opportunities for further harmonization of the environmental and social requirements, as well as addressed such important issues as trans-boundary Environmental Impact Assessment, measuring carbon footprint in financing, improving the management of cumulative impacts, and other important topics.

New Project Registration System at BSTDB

In 2013, BSTDB established a custom application for registration of written enquiries and business proposals. Registration may take place either by BSTDB employees internally over the Bank's intranet, or by potential clients and sponsors via the Bank's external website. The system then offers a centralized assignment process (to avoid omissions or duplications) and a user friendly 'dashboard' that provides integration of correspondence and easy access to all documentation and any important links.

The system employs dynamic interactive reporting, virtual folders for specific view of information by different group of users, and automated follow-ups in order to improve monitoring and facilitate reporting. The application allows the Bank to register and manage in a structured and standardized way new Business Proposals and customers' written enquires. Its benefits include:

- Ability for potential BSTDB clients to submit proposals directly and easily
- Ensuring that all business proposals and written enquires are registered and receive an evaluation
- Improved timing of customer responsiveness
- Enhanced identification of possible bankable operations
- Facilitated management of the pipeline of operations
- Consolidation of all business proposals in one database irrespective of the source of generation or registration (internal or external)
- Provision of a dashboard to help bankers to store and access correspondence with clients and documentation
- Simplifies and expedites Monitoring and Reporting procedures focusing in Business Intelligence dynamic dashboards that can be also accessed remotely by smartphones and tablets
- Linkage to SAP ERP system providing '360^0 degree' overview of complete business proposals registered as operations in SAP, permitting breakdown into different types of groupings (e.g. by country, by sector)
- Improved Records Management since all content of a Business Proposal dashboard is treated as a unique record

Annual Evaluation Overview:
ANALYSIS OF THE EX-POST EVALUATION OF COMPLETED OPERATIONS

A. Introduction

According to the BSTDB's Evaluation Policy, the Independent Evaluation Office of the Bank presents this annual evaluation overview to highlight key findings and trends from the conducted post-evaluations since 2000.

This overview and other evaluation products ensure accountability and quality management improvement of the Bank's performance, based on a rigorous, internationally harmonized independent evaluation of the BSTDB operations. Each annual evaluation overview is presented to the Management, the Board of Directors and the Board of Governors to highlight key findings and trends in operational and institutional performance.

The evaluation overviews aggregate and compare the findings of the conducted post-evaluations on an annual cumulative basis. They produce an overall picture of performance and reveal important trends and causal links. These reports do not contain commercially sensitive / operation-specific information and, therefore, represent the main vehicle for broader disclosure and accountability on the Bank's overall performance.

The annual evaluation overview presents a synthesis of the findings of the Bank's evaluated operations over the past 13 years, focusing on BSTDB's mandate fulfillment and overall performance. It preserves the corporate memory of the Bank by distilling the essence of "Lessons Learned" from the Bank's evaluations in a diversity of operations.

B. Independent Evaluation and Methodology

The BSTDB Post Evaluation Policy commits the independent evaluation to Good Practice Standards on Evaluation, as maintained by the Evaluation Cooperation Group (ECG) of the IFIs. These standards, inter alia, ensure the organizational and behavioral independence of the evaluation function, safeguarding the important accountability role of the evaluation for the Boards of Directors/Governors. The Evaluation Office is an observer at ECG since 2010 and maintains pro-active role in enhancing and applying the respective IFI-specific standards in independent evaluation. In September 2012, the ECG, represented by IFC and EIB, performed a peer review on the BSTDB's Evaluation Office, assessing its methodology, rigor and overall practice against the respective IFI standards. The review concluded that BSTDB meets the key standards on evaluation independence and made a number of enhancement recommendations that were implemented by BSTDB in 2013.

This report provides an overall picture of BSTDB performance over the period of 2000-2013, with a highlight of the latest trends and developments (2010-2013), based on the analysis of 80 evaluations of completed operations and a dozen of related evaluation studies.

The analysis covers three multiyear periods, to smooth-out annual fluctuations, as required by the applicable evaluation methodology. The 2010-2013 data is compared with the target of reaching 70% positively performing sample of evaluated operations set in the Bank's Medium-Term Business Plan for 2011-2014.

The IFI-harmonized evaluation methodology uses 4 ratings for ranking performance of operations, 2 positive and 2 negative: Excellent, Satisfactory, Partially Unsatisfactory, Unsatisfactory. These ratings apply to each of the 5 evaluation criteria:

- RELEVANCE: Consistency of operation objectives with the BSTDB mandate;
- EFFECTIVENESS: Extent to which objectives are achieved;
- EFFICIENCY: Extent to which benefits are commensurate with inputs;
- SUSTAINABILITY: Likelihood that results will be maintained;
- INSTITUTIONAL IMPACT: Covers improvements in norms and practices.

The ratings on those 5 criteria form the overall rating, a single measure of overall operation's performance.

C. Performance of Evaluated Operations since 2000

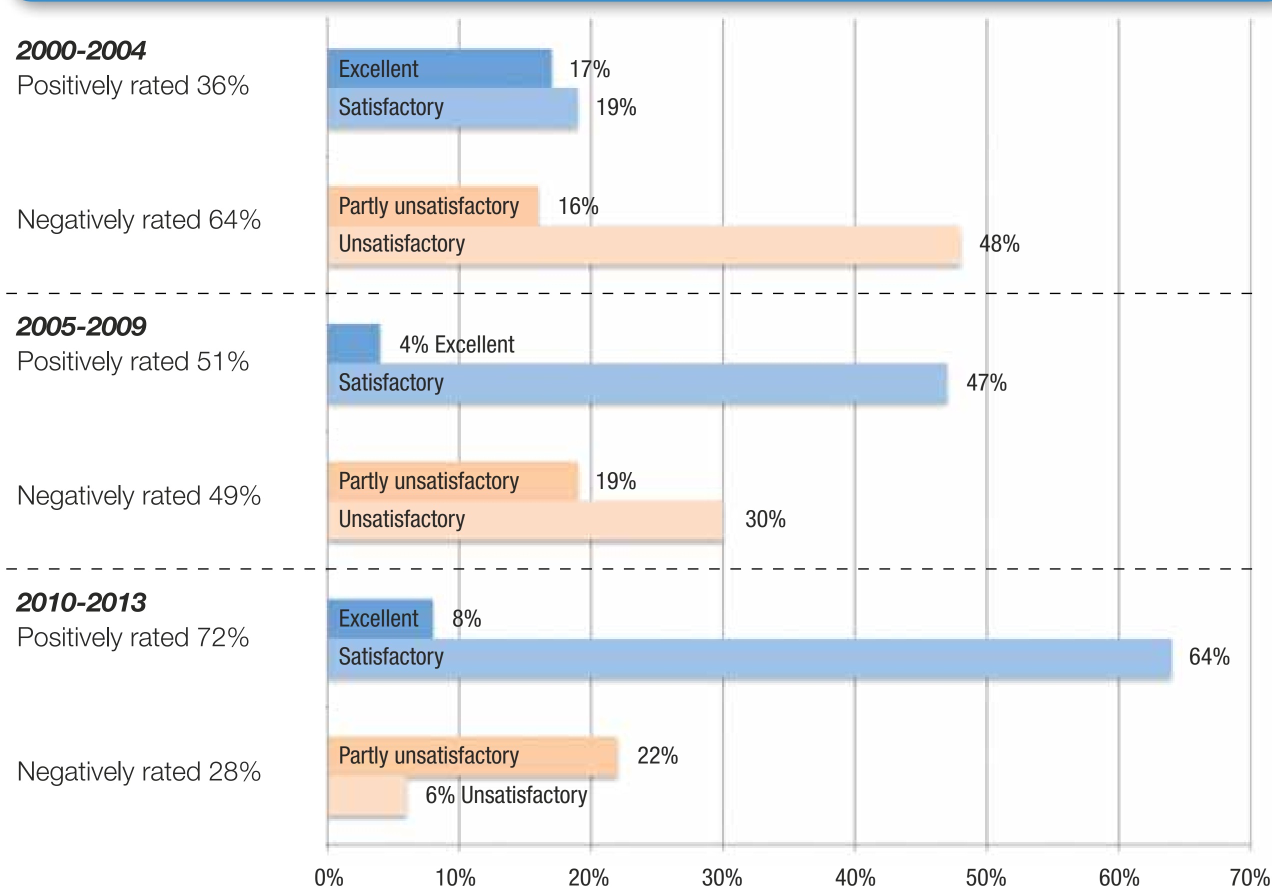
C.1 Overall Performance

In the latest aggregate period (2010-2013) BSTDB's positively rated operations reached 72%, the highest level of all periods. This denotes a substantial positive trend (upwards from 36% in 2000-2004 and 51% in 2005-2009), indicating a likely achievement of the 70% target set in the Bank's Medium-Term Business Plan for 2011-2014.

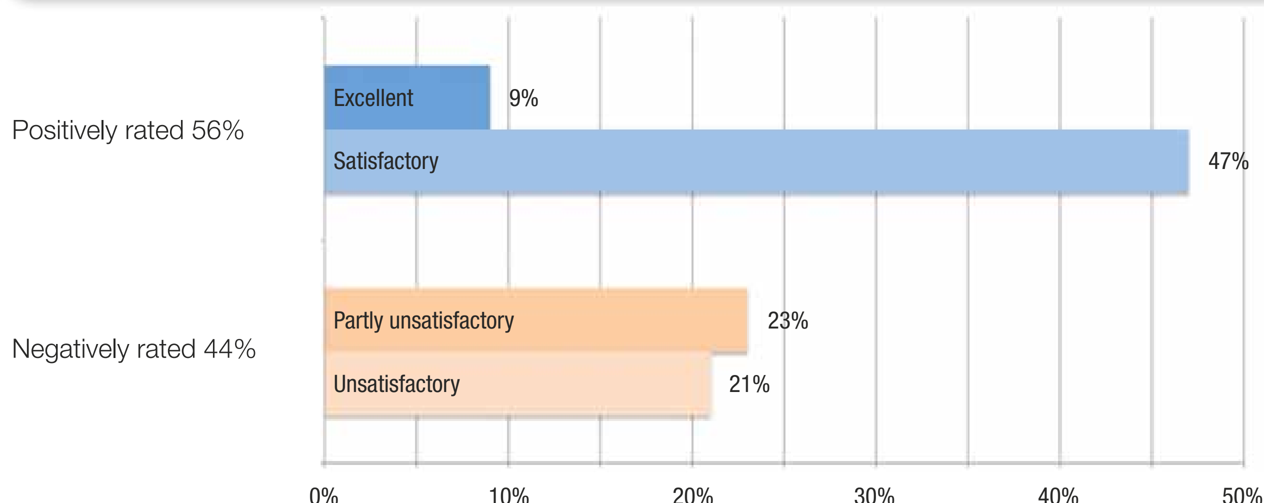
On the upper end of the ratings, the share of "Excellent" ratings moved from 17% in 2000-2004, to 4% in 2005-2009 and 8% in 2010-2013.

The share of BSTDB operations rated negatively (Partly Unsatisfactory or Unsatisfactory), indicates a positive trend, as the lowest-rated share (Unsatisfactory) decreased from 48% in 2000-2004 to just 6% in 2010-2013.

For the entire period of 2000-2013, BSTDB has a positively rated (Excellent or Satisfactory) overall performance in 56% of all evaluated operations.



Cumulative results for 2000-2013



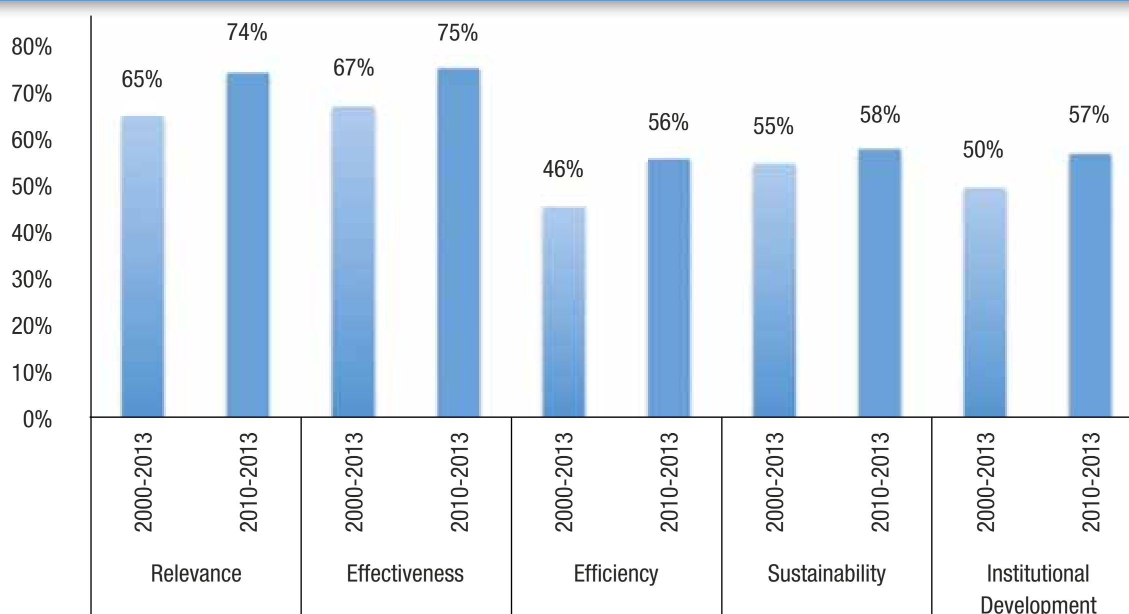
Sample of 80 operations, signed 2000-2007 (96% of all completed)

C.2 Relevance, Effectiveness, Efficiency, Sustainability and Institutional Development

A more analytical review of the evaluation ratings under each of the five criteria (Relevance, Effectiveness, Efficiency, Sustainability and Institutional Development) is helpful to understand the broader picture, as well as where the Bank needs more efforts, to enhance overall performance. An outline of the share of positively rated operations, out of all 80 evaluated operations since 2000, is presented below:

- Relevance of operations – 65% (2000-2013) and 74% (2010-2013) positively rated
- Effectiveness – 67% (2000-2013) and 75% (2010-2013) positively rated
- Efficiency – 46% (2000-2013) and 56% (2010-2013) positively rated
- Sustainability – 55% (2000-2013) and 58% (2010-2013) positively rated
- Institutional Development – 50% (2000-2013) and 57% (2010-2013) positively rated

BSTDB'S PERFORMANCE IN DETAIL: 2000-2013



D. Validation of Self-Evaluation Reports by Independent Evaluations

The Bank's Operation Teams prepare self-evaluation reports on each operation (Operation Completion Reports – OCRs). The Independent Evaluation Office's evaluation normally differs in performance ratings relative to the ratings assigned by the operation teams in the respective OCRs. The divergence between the OCRs and the independent evaluations, expressed in binary terms (i.e. reflecting only the cases where the independent evaluation resulted in a change from positively rated self-evaluation to negatively rated,[7] or vice-versa) is as follows:

- The overall OCR performance ratings on 80 operations were validated by the Evaluation Office without change in 59% of the cases.
- The OCR ratings that were upgraded and downgraded by the independent evaluation were 2% and 39% of the total, respectively.

E. Follow-Up of Evaluation Recommendations

To date, all evaluation recommendations accepted by the Management have been either implemented or are under implementation. There are no outstanding issues. In 2013 the Bank implemented all the recommendations of the IFI Evaluation Cooperation Group (ECG) peer review (2012) towards enhancing the independence and credibility of the evaluation function. This improvement was duly acknowledged in April 2014, when the Bank was admitted as an official member of ECG. The membership represents a high recognition of excellence in evaluation and overall corporate governance.

F. Conclusions

F.1 Overall Performance in Line with the BSTDB Medium-Term Business Plan for 2011-2014

There is a clear upward trend, with latest results being in line with the target of 70% positively rated operations set in the Bank's Medium-Term Business Plan for 2011-2014. The Bank is very likely to meet the target upon completed implementation of the Business Plan in 2014.

F.2. Declining Share of Excellently Rated Operations Deserves Further Attention

While overall performance increased over the years, the share of operations rated excellent has declined from 17% in the early years to 4-8% during latest periods. This merits attention as highly successful operations are a key source of valuable learning and motivation. Further dedicated analysis will be performed to reveal eventual causality and potential for improvement. So far, the diminishing cases of excellently rated operations seem to reflect a combination of unrealistic expectations (driven by efforts to obtain approval) and lower achievement. There are several cases which imply that a closer alignment of operations with country analysis/strategies tends to deliver a higher number of outstanding performance, both at operational and institutional planes.

F.3. Common Causes for Underperformance

The two most frequent key causes of underperformance are:

(i) Risks identified at due diligence are not always covered by adequate covenants and/or monitoring;

(ii) Mitigating the risk of poor corporate governance is very challenging, particularly when not done at the outset of operation handling.

F.4. Incentive-Based Enhancement of Self-Evaluation Quality

The quality of operational self-evaluations varies widely, exhibiting inadequate realism standards. First steps for enhancement were already undertaken by the Evaluation Office and Management and are expected to deliver results in the next periods. It is therefore hoped that future annual reviews will be able to show a narrowing of the ratings gap, denoting an improvement in the quality of self-evaluation.

F.5. Comparisons with IFI Peers

Since 2008 BSTDB maintains its performance generally in line with the comparable IFIs. The dramatic increase in the share of well-performing operations from 36% in 2004 to 72% in 2013 came as a result of proactive measures to analyze and mitigate shortfalls, with a particular reference to the "approval culture", prevailing until 2006 (focusing on volumes of new operations with less effort on the quality and sustainability), as well as the related large wave of cancellations in the 2002-2004 period.

7 Positive: Excellent or satisfactory; Negative: Partly Unsatisfactory or Unsatisfactory

Use of Resources

Resources Management

Human Resources

Human capital and staff resources are a key factor in the success of BSTDB. The institution strives to maintain its status as a competitive employer following international standards and best practices, applying meritocratic recruitment, and a remuneration system that promotes excellence and positive incentives.

HR Development

In 2013, BSTDB entered the final stage of the HR Reform design and implementation, in line with the institutional goals as set out in the BSTDB Strategy. Revised policies were approved by the Board of Directors, introducing new remuneration and performance management systems and updating the benefits and allowance package to address staff specific needs, based on experience, current living conditions, and in line with the best practices of other IFIs.

The revised remuneration policy marks a shift to the more flexible and transparent broad-banding system. Intended to increase the fairness and transparency of human resources management, the policy promotes the institution's competitiveness in the labor market.

The new performance management system features increased objectivity, introduces performance-related rewards, and links individual performance to the performance of the institution through a system of key performance indicators (KPIs).

Staffing and Recruitment

BSTDB conducts recruitment on a wide geographical basis. While preference is given to citizens of the member countries, recruitment is competitive and is based on the professional qualifications of the candidates. At the end of 2013, the BSTDB had a total of 103 employees, from 13 member and non-member countries.

Staff Development

BSTDB offers learning opportunities, addressing the development needs of its staff within the context of organizational business requirements. The revised policy on training, learning and development establishes a clear link between the institution's business needs and the development of the staff. In 2013, staff training focused on professional and technical skills' development.

Staff Benefit System

BSTDB operates a market-oriented staff compensation and benefits system designed to match the employment standards of other International Financial Institutions.

The BSTDB medical, life and temporary incapacity/long-term disability insurance plan provides adequate coverage emphasizing preventive medical care. The BSTDB also offers an optional post-separation medical coverage.

The BSTDB pension plan, launched in January 2003, is comprised of a fully funded defined benefit and a matched defined contribution component. This combination offers the necessary flexibility for best meeting the needs of a multi-national work force.

Information Technologies

Technology is a BSTDB strategic management tool to help increase efficiency, operational excellence, and transparency in the Bank. System modernization, integration, and alignment of business processes continued throughout the year.

Upgrades of the main IT infrastructure – servers, storage, and computing environment – were completed during 2013, building increased capacity and performance across the Institution. In parallel, the Virtual Desktop infrastructure has been implemented, providing for maximum workplace productivity, independent of work location.

Improvements introduced in the SAP system allow the management of the Bank's own bonds, cross currency Interest Rate Swaps, FX forwards, spot transaction evaluation, and Effective Interest Rate (EIR) calculation in accordance with IFRS.

Major upgrades of the Open Text Enterprise Information Management (EIM) software and SAP system enhancements completed during 2013 now allow seamless information sharing between the two systems, and for a single view and monitoring capabilities of information through the Bank's Enterprise Information Management (EIM) system. In parallel, a newly created dashboard provides different views and reporting of business registration proposals, while a complementary system of Digital Signatures, integrated with OpenText/EIM will, further facilitate business processes, records management, and approvals.

A program for Vital Records Management through digitization, filing, and safekeeping of original vital records in a secure outside location was initiated. This reduces dramatically physical space needs in the Bank's headquarters while ensuring the safeguard and accessibility of critical information.

A fully functioning Disaster Recovery Site was inaugurated in September 2013, allowing for the implemen-

tation of the Business Continuity Management Policy, while enhanced video and audio conference capabilities allow for direct external communications with customers and other IFIs.

External Relations and Communications

The External Relations and Communications Department supports the Bank's strategic and business objectives by promoting the corporate image and increasing awareness of the Bank in the Black Sea region and beyond. During 2013, the focus has been on strengthening the Bank's cooperation with governments and with the development and business communities, while enhancing corporate transparency in line with international best practice.

Updated Public Information Policy

The Bank's updated Public Information Policy, approved by the Board of Directors in 2013, reflects key disclosure principles and good practices of peer International Financial Institutions (IFIs). Following an extensive review, the policy now includes an enlarged list of public disclosure categories and revised provisions on public consultations for draft policy documents that have a broad impact on the Bank's operations, countries, and communities concerned. Environmental and Social Information on operations with significant environmental and social impact and risks (Category A) are to be disclosed for public consultation before approval by the Bank's Board of Directors, for periods of 30 and 60 days for private and public sector operations respectively. The Bank's budget, in summary form, will be made public after Board approval. Summary minutes of the Board of Directors and of the Board of Governors will also be made public. Importantly, a comprehensive appeals procedure for applicants not satisfied with the Bank's reply to information requests has been introduced.

Multilateral Consultations with the Development Community

BSTDB continues to participate actively in multilateral consultation mechanisms to facilitate knowledge sharing and promote developmental effectiveness.

In January 2013, BSTDB signed a joint communiqué with IFC and 27 other IFIs to work collaboratively to facilitate employment creation in developing countries.

As a founding member of the International Development Finance Club (IDFC), a group of 20 national and sub-regional development banks from around the globe, BSTDB hosted the IDFC Sherpa meeting in Thessaloniki in September 2013. The IDFC meeting focused on climate financing, cleaner technologies, and urban infrastructure.

As in previous years, BSTDB continued to contribute to discussions on Corporate Governance, Procurement, and Information Disclosure. The Bank maintained information exchange and knowledge sharing as an active member of the Interact Group of the Association of the European Development Finance Institutions (EDFI) and the Institute of International Finance (IIF).

BSTDB shared knowledge with newly established or reforming development institutions. Upon the request of the Development Fund of the South Asian Association of Regional Cooperation (SAARC), BSTDB provided comprehensive advice and assistance to the Fund's management team in establishing institutional and business policies and procedures. The Bank continued extending support to the Moscow-based International Investment Bank, a BSTDB Observer institution, in its institutional and operational reformation.

Support for Regional Cooperation

BSTDB contributed to the efforts of the Organization of the Black Sea Economic Cooperation (BSEC), the Parliamentary Assembly of BSEC, the Business Council of BSEC, and the International Centre of Black Sea Studies.

On the occasion of the 2013 BSTDB Annual Meeting in Baku, the Bank organized a Business Forum with Azerbaijani policy makers and development financial institutions aimed at elaborating policy recommendations on economic diversification based on international experience. Business development sessions, organized in cooperation with the Azerbaijan Investment Promotion Agency and the UNDP Special Program for the Black Sea, allowed business leaders from the Region to discuss trade and investment opportunities in Azerbaijan and the wider Region.

BSTDB contributed to the Conference of the Union of Central, South and Eastern European Capitals hosted by the Athens municipality in October 2013, and to the discussions at the Global Meeting of Regional Organizations, hosted by the World Economic Forum in Abu Dhabi in November 2013.

Administrative Services

During 2013, the Administrative Services Department continued efforts to improve the overall efficiency of the department and provide higher quality of service to the Bank staff. Outsourcing of non-essential services, staff redeployments, and enhanced team behaviors allowed for greater flexibility in work programs and increased productivity at the staff and unit level.

The department implemented significant improvements in the management of facilities, including the creation of an area assigned for corporate and Board meetings and for hosting external consultants. The unification of catering areas was completed allowing for space

rationalization and vastly improving the infrastructure for staff and visitors. Furthermore, the department assumed the comprehensive management of the building which enabled more efficient monitoring of the facilities, improved control of related outsourced services, and timely maintenance of systems.

Financial Management

Business Volume

The Bank's outstanding loan and equity portfolios totaled EUR 779,339 thousand compared to EUR 785,904 thousand in the previous year. Funds committed but not yet disbursed stood at EUR 148,146; an increase of 39% on the previous year amount of EUR 106,859 thousand.

Revenues

Total income from lending activities was EUR 38,820 thousand for the year, down from EUR 43,347 thousand in 2012. Treasury activities in 2013 generated total income of EUR 2,021 thousand from its available for sale and held to maturity portfolios. Operating income for the year was EUR 28,774 thousand compared to EUR 34,881 thousand in 2012. Although the Bank's average outstanding loan and equity portfolio balance was only marginally lower than in the previous year, operating income decreased due to lower than anticipated base interest rates and reduced realized gains from the Bank's equity investments.

Expenses

Interest and similar expense for the year was EUR 12,495 thousand compared to EUR 14,964 thousand in 2012. This decrease was due principally to lower borrowing costs and to lower average borrowings, which were partially replaced by share capital receipts and internally generated profits.

Administrative expenses in 2013 including depreciation were EUR 16,919 thousand, an increase of EUR 955 thousand over the previous year. Administrative expenses include salaries, benefits, and other administrative costs.

Personnel expenses, in the amount of EUR 12,674 thousand, showed an increase of EUR 548 thousand from the previous year. Other administrative costs also showed a slight increase from the previous year in an amount of EUR 276 thousand.

Overall, administrative expenses were well within the 2013 Budget, reflecting the Bank's focus on budgetary discipline and effective cost controls.

Net Income

Income before impairment during the year was EUR 11,855 thousand compared to EUR 18,917 thousand in 2012. Net impairment gains in an amount of EUR 1,429 were due to a provision release of EUR 2,104 thousand on debt investment securities that were held by the Bank.

The Bank posted net income of EUR 13,284 thousand for the year, while the quality of the lending portfolio remained sound, experiencing no additional impaired loan operations.

Capital Base

In accordance with Resolution 131 of the Board of Governors, as unanimously adopted, paragraph 1 of Article 4 in the Establishing Agreement and certain related provisions were amended, effective 21 June 2013. As per such Resolution, as of this effective date the unit of account of the Bank was changed to the EUR and all of the Bank's authorized share capital was redenominated from SDR to EUR.

Initial Share Capital

The initial authorized share capital of the Bank was EUR 1.15 billion divided into one million shares having a par value of EUR 1,150 each. Member States subscribed to all of the initial authorized share capital. Each of Armenia, Georgia and Moldova voluntarily agreed to reduce its share from 2% to 1% in June 2004 leaving EUR 34.5 million unsubscribed. At the Board of Governors meeting in October 2008, it was decided that Azerbaijan would take up this 3% of unsubscribed shares. The additional subscription amount was fully paid in 2009.

New Share Capital

The Board of Governors decided in December 2007 to approve an increase to the Bank's authorized capital from EUR 1.15 billion to EUR 3.45 billion. They further approved a EUR 1.15 billion increase in the subscribed capital to be subscribed by the existing Member States, thereby increasing subscribed capital to EUR 2.3 billion. An announcement that this additional EUR 1.15 billion was fully subscribed was made after the Board of Governors meeting in October 2008. Georgia declined to take up its 1% allocation and this was taken up by Romania. Upon completion of the subscription, Greece, Russia and Turkey remained the largest shareholders of the Bank with 16.5% stake each, followed by Romania with 14%, Bulgaria and Ukraine with 13.5% each, Azerbaijan with 5%, Albania with 2%, Armenia and Moldova with 1% each, and Georgia with 0.5% stake. In October 2011, the Board of Governors accepted Moldova's request and reduced its portion of the subscribed capital, from 1% to 0.5%, and, therefore, those shares were released to unallocated.

The new subscribed capital was to be paid according to the following schedule:

- Payment of the paid-in portion of the new subscribed capital, equivalent to 10% of the subscribed number of shares (totaling EUR 114 million), was to be paid in cash by the Member States in 2010.
- Payment of the paid-in portion of the new subscribed capital, equivalent to 20% of the subscribed number of shares (totaling EUR 228 million), was to be made by each Member State in eight equal successive annual installments between 2011 and 2018.
- Payment for the remaining callable portion of the new subscribed capital, equivalent to 70% of the shares (totaling EUR 797 million), represents a firm commitment on the part of the Member States to pay such amount when due in conformity with the relevant provisions of the Establishing Agreement.

As of 31 December 2013 the paid in share capital was EUR 518 million.

The Board of Governors may also authorize additional subscriptions from the remaining EUR 1.15 billion of authorized capital in three instances:

- To satisfy demand for shares expressed by Member States.
- If in conformity with the provisions of Article 3 (Membership) of the Establishing Agreement, any BSEC Member State not yet a member of the Bank (currently Serbia) wishes to subscribe for BSTDB shares.
- If in conformity with the provisions of Article 3 (Membership) of the Establishing Agreement, a multilateral bank or financial institution expresses a desire to become a member.

Gearing Ratio

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, which at the end of 2013 stood at about EUR 3.7 billion.

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, which limits the total amount of operations to approximately EUR 2.2 billion.

Provisioning

Provisions are recorded in two ways:

- General provisioning rate applied to the entire portfolio.
- Specific provisions applied against certain assets and are determined following an impairment test, carried out if evidence of credit deterioration is found during regular monitoring.

Starting with 2011, BSTDB has moved to a Basel II approach to include Loss Given Default and Discount Factors for security.

At the end of 2013, total provisions for loans stood at EUR 41,163 thousand, equivalent to 5.7% of the outstanding loan portfolio. The institutional target to be achieved for general provisions and reserves, over time, is set at 10% of total outstanding exposures, less the gross value of non-performing operations.

Reserves and Surplus

Reserves represent the internal generation of capital through the retention of earnings. Pursuant to the Bank's financial policies, reserves are the ultimate protection of the Bank's share capital against impairment resulting from credit losses, in excess of provisions, or losses due to market, operational, and compliance risks. The Bank targets a level of profitability guided by the desire to build an appropriate cushion of reserves against the risks inherent to its normal operations, and subsequently to grow its capital base consistent with its financial and growth objectives.

In addition to building up a cushion of reserves, the Bank also sets aside retained income to enable it to maintain the real value of its share capital funds, and increase its investment headroom through internally generated funds.

Market Risks

Market risk management is conducted within a framework of conservative risk limits and policy documents approved by the Board of Directors.

It is the policy of the Bank to take no significant interest rate or foreign exchange exposure. Asset and liability maturities and interest rate tenors are matched wherever possible.

Operational Risks

The Bank, like all financial institutions, is exposed to operational risks, defined as the risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events, which are risks other than those falling within the scope of credit and market risk. The definition includes legal risk but excludes strategic and reputational risk.

Appropriate measures are taken to achieve a high level of operational risk awareness and to enhance the operational risk management system. The Bank adopts market best practices and methods to manage and coordinate its operational risks. Key processes for the management of operational risk include, amongst others: (i) internal controls (e.g. the "four eyes principle",

proper segregation of duties) within its offices and departments, (ii) the establishment of disaster recovery and business continuity plans that take into account different types of plausible scenarios to which the Bank may be vulnerable, (iii) the constant safe storage of the Bank's Vital Records, (iv) the purchase of corporate and property insurance policies to confront potential losses which may occur as a result of various events and natural disasters, and (v) the approval process of New Products to identify and assess the operational risk related to each new product, activity, process, and system.

The Bank utilizes the Standardized Approach (SA) as issued by the Basel Committee to monitor operational risk incurred[8] and the adequacy of its operational risk-related capital charges (Reserves).

Should the Bank quantify the operational risk embedded in its operations, it would, with the use of SA, amount to EUR 7.8 million for 2013 and EUR 8.1 million for 2012, constituting a fraction of the Bank's total reserves amount, which represents the ultimate protection of the Bank's capital against impairment resulting from credit losses in excess of provisions, or losses due to market, operational, and compliance risks. There is no general accepted methodology for calculating risks associated with compliance and other "black swan" type of events.

Based on the above quantified operational risk, it is deemed that the Reserves of the Bank are adequate to cover, at least, all potential losses arising from events of an operational risk nature, and because the Establishing Agreement requires the Bank to maintain reserves at a relatively high percentage of its portfolio,[9] there is no need, for operational risk purposes, to make supplementary allocations.

Short-Term Liquidity

As indicated in the statement of cash flows, the Bank's short-term liquidity totaling EUR 159,849 thousand as of 31 December 2013 was invested in two types of money market instruments:

- Short-term deposits with institutions long-term rated at a minimum of A2/A by either Moody's or Standard & Poor's credit rating agency.
- Euro commercial paper rated at a minimum short-term A1/P1 by either Moody's or Standard & Poor's credit rating agency.

Investments are primarily denominated in EUR or USD currencies, and performance is monitored monthly against the Merrill Lynch 3 month Libid index.

The Banks liquidity ratio, calculated as liquid assets over 12 months net cash requirements, stood at 120% on 31 December 2013.

Borrowings Utilized

As of end 2013, the Bank had issued a four-year fixed rate bond for CHF 200,000 thousand and had swapped the proceeds, through the use of derivative instruments, into USD 209,534 thousand at a floating rate. The Bank had also signed loan agreements equivalent to EUR 86,278 thousand and USD 51,428 thousand. As the size of the Bank's operations portfolio continues to increase, and taking into consideration its minimum liquidity requirements, the Bank might access sources of long-term funds in 2014.

The Bank has a long-term investment grade credit rating from Moody's Investor Service of A2 and a short-term rating of P1. The Bank also has a long-term investment grade credit rating from Standard and Poor's Investor Service of A- and a short-term rating of A2.

Risk Analysis

An independent financial analysis is performed for each of the Bank's operations. Corporate entities are initially subject to an assessment of creditworthiness based on historical financial statements. This is followed by cash flow modeling 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. capitalization, asset quality, liquidity, and foreign exchange risk) supported by comparisons of key ratios to industry standards.

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 either public or private sector borrowers, it normally requires certain guarantees and, in all cases, ensures that the parties involved share risks in a reasonable manner.

Evaluation

The Bank conducts assessments of completed and current operations, programs, activities, and strategies through rigorous systematic analyses. This evaluation process serves two key objectives: (i) accountability – to reveal the results and impact of the Bank's operations and (ii) learning – to derive lessons learned from past experience, maintain a corporate memory, and enhance future performance.

8 International Convergence of Capital Measurement and Capital Standards, a Revised Framework, June 2004.

9 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 10% of the subscribed capital including all paid, unpaid but payable, unpaid but callable capital (Article 36 – Allocation of Net Income).

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.

Corporate Governance

Management Structure

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

BSTDB's governing constitution is set out in the Agreement Establishing the Bank. This document requires that the institution be managed by a Board of Governors, a Board of Directors, a President, Vice Presidents, a Secretary General, and such officers and staff, as may be necessary.

Each of the Member States of the Bank is represented on the Board of Governors. All powers of the Bank are vested in the Board of Governors. With certain exceptions, the Board of Governors has delegated the exercise of these powers to the Board of Directors, while still retaining overall authority.

The Board of Directors, chaired by the President of the Bank, is responsible for guiding the general operations of the Bank. Each of the Bank's Member States appoints a Director and an Alternate Director, with full powers to act for the Director when the Director is not present.

The Audit Committee is established by and reports directly to the Board of Directors. The composition of the Audit Committee is three Board of Director members, one being appointed as Chairman.

The President, as chief executive of the Bank, is its legal representative. In this capacity, and as Chairman of the Management Committee, he conducts the current business of the Bank under the direction of the Board of Directors. The President is appointed by the Board of Governors.

The Management Committee comprises of the President (as Chairman), three Vice Presidents, and the Secretary General. In the absence of the President, one of the Vice Presidents chairs the meetings of the Management Committee. The Vice Presidents and Secretary General are appointed by the Board of Directors on the recommendation of the President.

Compliance

The Compliance function of the Compliance and Operational Risk Management Office (DCR) of the Bank assists management in effectively managing the compliance risks faced by the Bank. To this end, it identifies, assesses, advises on, monitors and reports accordingly on the Bank's compliance risk.

With regard to internal integrity issues, DCR monitors, administers and advises on Code of Conduct-related issues for Bank Officials and staff.

With regard to the financing operations, anti-fraud, corruption, money laundering, and terrorism financing due diligence is – among other types of due diligence – integrated into the Bank's normal approval of new business and into the monitoring of existing activity. The Bank screens all transactions to ensure that they do not represent such risks. The Head of the Compliance function advised the business groups, upon their request, inter alia, on the Customer Due Diligence process and integrity issues.

Reporting and Disclosure

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 in compliance with 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 Establishing 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 Secretary.

In its financial reporting, the Bank aims to provide appropriate information on risk and performance. Industry best practice guides the evolving disclosure practice both in public financial reports and management information reporting.

Internal Audit

Internal Audit is an independent, objective, assurance, and consulting activity that examines and evaluates the activities of the Bank as a service to Management

and the Board of Directors (primarily through its Audit Committee). The Audit Committee has the responsibility, inter alia, of satisfying itself that the internal audit process is adequate and efficient through reviewing the policy, scope, work program, and reporting relating to the Bank's internal audit.

According to the Bank's Internal Audit Charter, the internal Audit Department's main objective is to help Management and the Board of Directors discharge their responsibilities and accomplish the objectives of the Bank by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes. The Internal Audit's mission is to foster an environment of continuous improvement in controls and risk awareness.

Enterprise Risk Management

Recognizing the need for effective internal controls and acknowledging that Enterprise Risk Management (ERM), including internal controls over financial reporting, is a fundamental approach for the management of an organization, the Bank has established a functioning, consolidated, and on-going Enterprise Risk Management system. This system includes certification in the Annual Report as to the effectiveness of internal controls over external financial reporting, using the standards and practices prescribed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), Internal Control Framework, and Enterprise Risk Management.

Upon the overall assessment of the effectiveness of internal controls over financial reporting, coordinated by the Internal Audit Department and a Working Group with representatives of all the Divisions of the Bank, an annual certification statement is issued, signed by the President and the Vice President Finance and subject to review and an attestation of the Bank's external auditors.

The external auditors review and offer their opinion on Management's assertion as to the effectiveness of internal controls over financial reporting.

External Auditors

The External Auditors are appointed by the Board of Governors upon the recommendation of the Board of Directors. They are qualified outside auditors of international reputation and appointed for a term of one year, renewable further on such terms and conditions as approved by the Board of Directors.

The External Auditors' services are limited only to audit related services but may be subject to certain exceptions that are in the interest of the Bank. The performances and independence of the External Auditors are assessed by the Audit Committee.

In addition, the External Auditors review and offer their opinion on Management's assertion as to the effectiveness of internal controls over financial reporting. This opinion is given as a separate report to the audit opinion. At the conclusion of their annual audit, the External Auditors prepare a management letter for the Board of Directors, which is reviewed in detail and discussed with the Audit Committee, setting out the External Auditor's views and Management's response on the effectiveness and efficiency of internal controls and other matters.

Financial Statements and Notes

Financial Statements for the Year Ended 31 December 2013

Together with Auditor's Report

Internal Controls Over External Financial Reporting

Responsibility for External Financial Reporting

Management's responsibility

Management's report regarding the effectiveness of internal controls over external financial reporting

The management of the Black Sea Trade and Development Bank (the "Bank") is responsible for the preparation, integrity, and fair presentation of its published financial statements and all other information presented in this report. The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board.

The financial statements have been audited by an independent accounting firm, which has been given unrestricted access to all financial records and related data, including minutes of all meetings of the Board of Directors and committees of the Board. Management believes that all representations made to the external auditors during their audit were valid and appropriate. The external auditors' report accompanies the audited financial statements.

Management is responsible for establishing and maintaining effective internal controls over external financial reporting for financial presentations in conformity with IFRS. The system of internal controls contains monitoring mechanisms, and actions are taken to correct deficiencies identified. Management believes that internal controls for external financial reporting, which are subject to scrutiny and testing by management and internal audit, and are revised as considered necessary, support the integrity and reliability of the financial statements.

There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and the circumvention of overriding controls. Accordingly, even an effective internal controls system can provide only reasonable assurance with respect to financial statements. Furthermore, the effectiveness of an internal controls system can change with circumstances.

The Bank's Board of Directors has appointed an Audit Committee, which assists the Board in its responsibility to ensure the soundness of the Bank's accounting practices and the effective implementation of the internal controls that management has established relating to finance and accounting matters. The Audit Committee is comprised entirely of members of the Board of Directors. The Audit Committee meets periodically with management in order to review and monitor the financial, accounting and auditing procedures of the Bank and related financial reports. The external auditors and the internal auditors regularly meet with the Audit Committee, with and without other members of management being present, to discuss the adequacy of internal controls over financial reporting and any other matters which they believe should be brought to the attention of the Audit Committee.

The Bank has assessed its internal controls over external financial reporting for 2013. The Bank's assessment was based on the criteria for effective internal controls over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Based upon this assessment, management asserts that, at 31 December 2013, the Bank maintained effective internal controls over its financial reporting as contained in the Financial Statements for 2013.

The Bank's external auditors have provided an audit opinion on the fairness of the financial statements presented within this report. In addition, they have issued an attestation report on management's assessment of the Bank's internal controls over financial reporting.

Andrey Kondakov
President

Valentina Siclovan
Vice President, Finance

Black Sea Trade and Development Bank
Thessaloniki
12 April 2014

Independent Reasonable Assurance

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

Report on the effectiveness of internal control over financial reporting

We were engaged by the Board of Directors of the Black Sea Trade and Development Bank to report on the effectiveness of the Black Sea Trade and Development Bank (the "Bank") internal control over financial reporting as of 31 December 2013 in the form of an independent reasonable assurance conclusion about whether the internal control over financial reporting is effective based on criteria established in "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission ("the COSO criteria").

Bank's responsibilities

The Bank's Management is responsible for maintaining effective internal controls over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying management's report.

Our responsibilities

Our responsibility is to express an opinion on the Bank's internal control over financial reporting based on the evidence obtained. We conducted our audit in accordance with the International Standard on Assurance Engagements (ISAE) 3000. That standard requires that we comply with ethical requirements, including independence requirements, and plan and perform our procedures to obtain reasonable assurance about whether the internal control over financial reporting is effective, in all material respects.

The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the effectiveness of internal control over financial reporting whether due to fraud or error.

Our engagement also included obtaining an understanding of internal controls over financial reporting, evaluating the management's assessment and performing such other procedures as we considered necessary in the circumstances. Reasonable assurance is less than absolute assurance.

A bank's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

A bank's internal control over financial reporting include those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Bank; (2) provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with International Financial Reporting Standards, and that receipts and expenditures of the Bank are being made only in accordance with authorisations of management and directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Conclusion

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our conclusion.

In our opinion, Black Sea Trade and Development Bank maintained, in all material respects, effective internal control over financial reporting, as of 31 December 2013, based on the COSO criteria.

12 April 2014

KPMG Certified Auditors A.E.
Athens, Greece

INCOME STATEMENT

For the year ended 31 December 2013

Presented in thousands of EUR	Note	2013	2012 (as Restated)
Interest income	7	40,303	45,699
Interest expense	8	(12,495)	(14,964)
Net interest income		**27,808**	**30,735**
Net fees and commissions	9	538	1,041
Dividend income	15	1,203	0
Net profit on sale of equity investments		0	19
Net gains from available-for-sale equity investments		0	3,350
Net (losses) from debt investment securities		(47)	(245)
Net (loss) income on foreign exchange		(748)	(1)
Other (expense) income		20	(18)
Operating income		**28,774**	**34,881**
Personnel expenses	10,25	(12,674)	(12,126)
Other administrative expenses	10	(3,585)	(3,309)
Depreciation and amortization	17,18	(660)	(529)
Income before impairment		**11,855**	**18,917**
Impairment (losses) on loans	11	(665)	(3,051)
Impairment (losses) on guarantees	21	(10)	(4)
Impairment gains (losses) on debt investment securities	12	2,104	(899)
Net income for the year		**13,284**	**14,963**

The accompanying notes are an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2013

Presented in thousands of EUR	Note	2013	2012 (as Restated)
Net income for the year		13,284	14,963
Other comprehensive income:			
Items that will not be reclassified subsequently to profit or loss:			
Remeasurements of defined benefit liability (asset)	23	331	(2,967)
Items that may be reclassified subsequently to profit or loss:			
Net change in available-for-sale financial assets	23	1,428	2,068
Net amount transferred to profit or loss		1	0
Total comprehensive income for the year		**15,044**	**14,064**

The accompanying notes are an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION

At 31 December 2013

Presented in thousands of EUR	Note	2013	2012 (as Restated)
Assets			
Cash and cash equivalents	24	14,849	18,227
Debt investment securities:			
Available-for-sale	12,24	157,812	17,963
Held-to-maturity	12,24	0	182,500
Derivative financial instruments – assets	13	16,210	11,517
Loans	14,16	726,405	742,614
Less: deferred income	14	(6,146)	(6,694)
Less: impairment losses	11,14	(41,163)	(42,026)
Loans net of impairment		679,096	693,894
Equity investments available-for-sale	15,16	52,934	43,290
Property and equipment	17	805	699
Intangible assets	18	660	816
Other assets	19	9,832	11,678
Total Assets		**932,198**	**980,584**
Liabilities			
Borrowings	20	286,344	373,355
Payables and accrued interest	21	4,761	8,346
Total liabilities		291,105	381,701
Members' Equity			
Authorized share capital	22	3,450,000	3,494,085
Less: unallocated share capital	22	(1,161,500)	(1,177,397)
Subscribed share capital	22	2,288,500	2,316,688
Less: callable share capital	22	(1,601,950)	(1,623,876)
Less: payable share capital	22	(168,584)	(198,094)
Cumulative translation adjustment	22	0	(337)
Advance against future call	22	5	11
Paid-in share capital		517,971	494,392
Reserves	23	50,519	41,902
Retained earnings		72,603	62,589
Total members' equity		641,093	598,883
Total Liabilities and Members' Equity		**932,198**	**980,584**
Off-balance-sheet items			
Commitments	16	148,146	106,859

The accompanying notes are an integral part of these financial statements.

STATEMENT OF CHANGES IN MEMBERS' EQUITY

For the year ended 31 December 2013

Presented in thousands EUR	Share capital: Subscribed	Share capital: Callable	Share capital: Payable	Reserves	Retained earnings	Total
At 31 December 2011 (as restated)	**2,349,300**	**(1,653,115)**	**(228,968)**	**40,766**	**49,661**	**557,644**
Total comprehensive income						
Net income for the year	0	0	0	0	14,963	14,963
Other comprehensive income:						
Fair value reserve (available-for-sale financial assets)	0	0	0	2,068	0	2,068
Pension reserve	0	0	0	(2,967)	0	(2,967)
Total comprehensive income	0	0	0	(899)	14,963	14,064
Transactions with owners, recorded directly in equity						
Members' contributions:						
Paid-in share capital	0	0	27,300	0	0	27,300
Cumulative translation adjm.	(32,612)	29,239	3,252	0	0	(121)
Advance against future call	0	0	(4)	0	0	(4)
General reserve	0	0	0	2,035	(2,035)	0
Total contributions by owners	(32,612)	29,239	30,548	2,035	(2,035)	27,175
At 31 December 2012 (as restated)	**2,316,688**	**(1,623,876)**	**(198,420)**	**41,902**	**62,589**	**598,883**
Total comprehensive income						
Net income for the year	0	0	0	0	13,284	13,284
Other comprehensive income:						
Fair value reserve (available-for-sale financial assets)	0	0	0	1,429	0	1,429
Pensions reserve	0	0	0	331	0	331
Total comprehensive income	0	0	0	1,760	13,284	15,044
Transactions with owners, recorded directly in equity						
Members' contributions:						
Paid-in share capital	0	0	23,248	0	0	23,248
Cumulative translation adjm.	(28,188)	21,926	6,599	3,587	0	3,924
Advance against future call	0	0	(6)	0	0	(6)
General reserve	0	0	0	3,270	(3,270)	0
Total contributions by owners	(28,188)	21,926	29,841	6,857	(3,270)	27,166
At 31 December 2013	**2,288,500**	**(1,601,950)**	**(168,579)**	**50,519**	**72,603**	**641,093**

The accompanying notes are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2013

Presented in thousands of EUR	Note	2013	2012 (as Restated)
Cash flows from operating activities			
Net income for the year		13,284	14,963
Adjustment for:			
Impairment losses (gains)		(1,429)	3,954
Depreciation and amortization		660	529
Interest income		(7,061)	(7,703)
Interest expense		3,703	4,258
Realized gains on equity investments		0	(3,369)
Foreign exchange adjustment on provisions		(1,528)	(877)
Operating income before changes in operating assets		7,629	11,755
Changes in:			
Derivative financial instruments		(4,693)	(11,693)
Other assets		1,204	(1,645)
Accounts payable		(3,040)	(73)
Deferred income		(548)	(219)
Fair value movements		1,429	1,469
Cash generated from operations		1,981	(406)
Proceeds from repayment of loans		188,821	153,449
Proceeds from repayment of equity investments		475	962
Proceeds from sale of equity investments		0	19
Funds advanced for loans		(193,085)	(215,269)
Funds advanced for equity investments		(7,984)	(9,184)
Foreign exchange and other adjustments		20,772	(1,712)
Interest income received		7,703	7,258
Interest expense paid		(4,258)	(1,167)
Net cash from / (used in) operating activities		14,425	(66,050)
Cash flows from investing activities			
Proceeds from available-for-sale investment securities		7,921	23,811
Purchase of available-for-sale investment securities		(2,770)	(15,245)
Purchase of property, software and equipment		(609)	(565)
Net cash from / (used in) investing activities		4,542	8,001
Cash flows from financing activities			
Payments received from share capital		23,248	27,300
Exchange rate difference on conversion		3,924	0
Decrease in advance against future call		(6)	(4)
Paid-in share capital received		27,166	27,296
Proceeds from borrowings		13,420	390,795
Repayments of borrowings		(100,431)	(285,524)
Net cash from / (used in) financing activities		(59,845)	132,567
Net increase in cash and cash equivalents		**(40,878)**	**74,518**
Cash and cash equivalents at beginning of year		200,727	126,209
Cash and cash equivalents at end of year	24	**159,849**	**200,727**

The accompanying notes are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. Establishment Of The Bank

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 organization under the Agreement Establishing the Bank dated 30 June 1994 ("Establishing Agreement"). In accordance with Article 61 of the Establishing Agreement, following establishment of the Bank the Establishing Agreement entered into force on 24 January 1997. The Bank commenced operations on 1 June 1999.

The purpose of the Bank is to accelerate development and promote cooperation among its shareholder countries. As a regional development institution it is well placed to mobilize financial resources and to improve access to financing for businesses in the whole region as well as for those active only in its individual Member Countries. The Bank offers project and trade financing facilities, equity participations and guarantees. Bank financing of projects and programs is available directly or in cooperation with other national and international development institutions. The Bank may also, where appropriate, provide technical assistance to potential clients.

As at financial position date the Bank's shareholders comprised 11 countries: Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russian Federation, Turkey and Ukraine.

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") signed on 22 October 1998.

2. Basis Of Preparation Of Financial Statements

Statement of Compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB"). The financial statements for 2013 were submitted by the Management Committee to the Board of Directors ("BoD") for approval on 12 April 2014, and were approved on that date. Pursuant to Article 23 of the Establishing Agreement, these financial statements shall be subject to approval by the Board of Governors ("BoG") in their Annual Meeting to be held on 22 June 2014.

Basis of Measurement

The financial statements have been prepared on a historical cost basis except for those financial assets that have been measured at fair value, that are the available-for-sale financial assets and derivative contracts. In addition, financial assets and financial liabilities subject to amortized cost measurement and which form part of a qualifying hedge relationship have been accounted for in accordance with hedge accounting treatment (see: "Derivatives" under this section). The Bank has not adopted any IFRS before their effective dates.

Functional and Presentation Currency

The Bank's functional currency is the Euro ("EUR") as defined by the European Central Bank ("ECB"). The Euro is most representative of the Bank's operations and environment as a significant percentage of the Bank's lending operations are in Euro, and the administrative expenses and capital expenditures are primarily denominated and settled in this currency. The Bank's presentation currency is the EUR.

In accordance with Article 4 of the Establishing Agreement, the Bank denominated its authorized share capital in the Special Drawing Right ("SDR") as defined by the International Monetary Fund ("IMF").

Pursuant to Resolution 131 of the Board of Governors unanimously adopted on 21 June 2013, paragraph 1 of Article 4 in the Establishing Agreement was amended. As of this effective date, the unit of account of the Bank became the EUR and all of the Bank's authorized share capital was redenominated from SDR to EUR.

Judgments and Assumptions

The preparation of the financial statements in conformity with IFRS requires Management to make judgments and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimations uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are included in Note 4.

3. Significant Accounting Policies

A summary of the Bank's accounting policies applied in the preparation of these financial statements are presented in this section. These policies have been consistently applied to all the financial periods being presented, unless otherwise indicated.

Foreign Currencies

Foreign currency transactions are initially recorded in EUR by applying to the foreign currency amount the exchange rate between the EUR and the foreign currency at the rate prevailing on the date of transaction. Exchange gains and losses arising from the translation of monetary assets and liabilities at the end of year exchange rates are recorded in the income statement.

The Bank uses the official exchange rates published for the EUR by the ECB, and used the official exchange rate published for the SDR by the IMF for share capital. Exchange rates used by the Bank at the financial position date were as follows.

			31 December 2013	31 December 2012
1 EUR	=	United States dollar	1.37910	1.31940
	=	Pound sterling	0.83370	0.81610
	=	Azerbaijan manta	1.07650	1.03640
	=	Special drawing right	-	0.85782

Recognition and Derecognition of Financial Instruments

The Bank recognizes a financial asset or financial liability in its statement of financial position when, and only when, it becomes a party to the contractual rights or obligations.

The Bank derecognizes a financial asset or a portion of financial asset when, and only when, it loses control of the contractual rights that comprise the financial asset or a portion of the financial asset. The Bank derecognizes a financial liability when, and only when, a liability is extinguished, that is when the obligation specified in the contract is discharged, cancelled or expires. The evaluation of the transfer of risks and rewards of ownership precedes the evaluation of the transfer of control for derecognition transactions.

Cash and Cash Equivalents

For the purposes of the statement of cash flows, cash and cash equivalents consist of cash on hand, placements with other financial institutions and debt securities with original maturities of three months or less. These are highly liquid assets that are readily convertible to a known amount of cash and are subject to insignificant risk of change in value due to the movements in market rates.

Financial Assets

The Bank classifies financial assets in the following categories; loans and receivables, held-to-maturity investments and available-for-sale financial assets. Their classification is determined at the time of initial recognition.

Held-to-maturity investments and available-for-sale financial assets are recognized on a trade date basis, which is the date the Bank commits to purchase or sell the asset. All loans are recognized when cash is advanced to borrowers at settlement date.

The Bank did not reclassify any non-derivative financial assets out of the fair value through profit or loss category in any particular circumstance nor did the Bank transfer any financial assets from the available-for-sale category to the loans and receivables category.

a) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction. Subsequently, loans are measured at amortized cost using the effective interest rate method less any provision for impairment or uncollectability. All other fees and relating income generated are reported in the income statement (see note 9).

b) Held-to-maturity

Financial assets with fixed or determinable payments, and fixed maturity dates are classified as held-to-maturity when the Bank has the positive intention and ability to hold to maturity. These financial assets are measured at amortized cost using the effective interest rate method, less any impairment. Amortized cost is computed as the amount initially recognized including the premium or discount that may arise on the date of acquisition, as well as transaction costs. Interest arising from these investments is reported in income.

c) Available-for-sale

Financial assets such as equity investments, Euro Commercial Paper (“ECP”) or bonds are classified as available-for-sale and are intended to be held for an indefinite period of time, and may or may not be sold in the future. After initial recognition at cost, these financial assets are measured at fair value. The fair value of the available for sale securities that are traded in organized financial markets is determined by reference to quoted market bid prices. For those assets where there is no active market, the fair value is determined using accepted valuation techniques. These valuation techniques used are net asset value and earnings-based valuations using comparable information and discounting cash flows.

The unrealized gains and losses that arise from fluctuations in fair value are recognized as a separate component of equity until the financial asset is sold or derecognized for any other reason or until the investment is determined to be impaired, at which time, the cumulative gain or loss previously reported in equity is included in income. Foreign exchange gains or losses and any income accrued, by using the effective interest rate method, for these assets are recognized directly in income. Dividends received are included in income.

Financial Liabilities

Financial liabilities include borrowings and other liabilities.

a) Borrowings

Borrowing transactions are recognized in the statement of financial position at the time the funds are transferred to the Bank. They are measured initially at cost, which comprises the fair value of the funds transferred, less any transaction costs. In instances where the Bank uses derivative instruments to hedge the fair value of borrowing transactions, such borrowings are subsequently carried in the statement of financial position at fair value where the amortized cost value is adjusted to fair value by the hedged risks, with any changes in value recognized in income. Relevant interest expenses are reported in the income statement using the effective interest rate method.

b) Other liabilities

Other liabilities that are not derivatives or designated at fair value through profit or loss are recorded at amortized cost. The amounts include accrued finance charges on borrowings and other accounts payable.

Offsetting of Financial Assets and Liabilities

Offsetting of assets and liabilities in the financial statements is permitted if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Derivatives

In the ordinary course of business, the Bank enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instruments, reference rates or indices.

Derivatives can include interest rate and cross currency swaps, forward foreign exchange contracts, interest rate future contracts, and options on interest rates and foreign currencies. Such financial instruments are initially recognized in the statement of financial position at cost and are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in fair value of derivatives are included in the income statement. Fair values are obtained from quoted market prices, to the extent publicly available, discounted cash flows and options pricing models as appropriate.

a) Hedge accounting

In order to manage particular risks, the Bank applies hedge accounting for derivate transactions which meet specified criteria relative to debt securities issued by the Bank. A valid hedge relationship exists when a specific relationship can be identified between two or more financial instruments in which the change in value of one instrument (the hedging instrument) is highly negatively correlated to the change in value of the other (the hedged item). The Bank only applies hedge accounting treatment to individually identified hedge relationships on a one-to-one basis.

The Bank documents the relationship between hedging instruments and hedged items upon initial recognition of the transaction.

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is discontinued prospectively. Any fair value adjustment is recognized immediately in the income statement. At 31 December 2013, the Bank did not have any cash flow hedge.

i) Fair value hedge

Changes in the fair value of the derivatives that are designated and qualify as fair value hedges, and that prove to be highly effective in relation to hedged risk, are included in the income statement as fair value hedges under “net gains or losses at fair value on hedging activities”, along with the corresponding change in fair value of the hedged asset or liability that is attributable to that specific hedged risk.

Impairment

An impairment loss for the Bank is the amount by which an asset’s recorded carrying amount exceeds its expected recoverable amount.

a) Financial assets carried at amortized cost

For amounts due from loan and receivable portfolios, losses under guarantees, commitments, held-to-maturity and other investments carried at amortized cost, the Bank first assesses whether objective evidence of impairment exists individually for those that are individually significant, or collectively for those that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed asset, whether significant or not, it includes the asset in a group of assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest,
- Cash flow difficulties experienced by the borrower,
- Breach of loan covenants or conditions,

- Initiation of bankruptcy proceedings,
- Deterioration in the borrower's competitive position, and
- Deterioration in the value of collateral.

If there is objective evidence that an impairment loss has been incurred, that the Bank will not be able to collect all amounts due (principal and interest) according to original contractual terms, such assets are considered as impaired. The amount of the loss is measured as the difference between the asset's carrying amount and the present value of expected future cash flows (excluding future credit losses that have not yet been incurred). The carrying amount of such an asset is reduced to its estimated recoverable amount through the use of an allowance for impairment account and the amount of loss is recognized in income. Interest income continues to be accrued based on the original effective interest rate of the asset. The Bank ceases to accrue interest on those assets classified internally as non-performing for more than 90 days, or earlier when there is reasonable doubt as to actual collection, and for which the recoverable amount is determined primarily in reference to fair value of collateral.

An asset together with the associated allowance is written off when all or part of it is deemed uncollectible by liquidation, or all legal and other avenues for recover or settlement are exhausted, or in the case of debt forgiveness. Write-offs are charged against previously established allowances and reduce the principal amount of an asset. Whenever an amount of the estimated impairment loss increases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased by adjusting the allowance account. Recoveries of such assets written off in earlier periods are included in the income statement.

The present value of the estimated future cash flows is discounted at the asset's original effective interest rate as determined under the contract. If an asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, assets are grouped on the basis of the Bank's internal credit rating methodology that considers credit risk characteristics such as asset type, industry and geographical location. The Bank's analysis is currently based on the Global Emerging Markets ("GEMs") data base. The GEMs risk database standardizes the data collection process of member International Financial Institutions. The standardization process used by the Bank was also reviewed independently by Moody's Analytics. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any difference between loss estimates and actual loss experience.

Impairment losses for guarantees are recognized while a guarantee is in effect and the amounts are determined based on the level of utilization of the guarantee. The methodology is consistent to that of loans, and such losses are included in "Other liabilities".

If the amount of impairment subsequently decreases due to an event occurring after a write-down, the release of the provision is credited to the provision for asset losses expense. Unwinding of the discount is treated as income and remaining provision is then reassessed.

b) Available-for-sale financial assets

At each financial position date, the Bank assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. For equity investments carried at fair value, a significant or prolong decline in the fair value below its cost is considered in determining whether the assets are impaired. If any such evidence exists, the cumulative impairment loss, which is measured as the difference between the acquisition cost and the current fair value, net of any impairment loss previously recognized in net income, is removed from reserves and included in income. Impairment losses once recognized and included in income on these equity investments carried at cost, are not reversed.

For debt securities, the Bank assesses at each financial position date whether there is objective evidence of impairment. The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Downgrading of the issuer below minimum eligibility levels for Treasury exposures,
- Issuer failure to pay amounts contracted under the security,
- Covenant breaches, default events and trigger level failures,

- Deterioration of credit enhancement including diminution of collateral value, and
- Legal proceedings such as bankruptcy, regulatory action or similar.

If any such evidence exists, the cumulative impairment loss measured as the difference between the acquisition cost and the current fair value is removed from reserves and included in income. If in a subsequent period the impairment indications of such securities cease to exist, related to an event after the impairment loss was recognized, that loss is reversed through income.

c) Non-financial assets

At each financial position date the Bank reviews the carrying value of the non-financial assets and assesses whether there is any indication of impairment. If such indications exist, an analysis is performed to assess whether the book value of the specific assets can be recovered. The recoverable amount is the higher amount between the net value of sale (value of sale reduced by sale expenses) and of the value in use (as calculated from the net cash flows). If the carrying value of an intangible asset exceeds its recoverable value, then an impairment loss is recorded in income.

d) Renegotiated loans

When necessary, the Bank seeks to restructure loans that may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due, but the impairment will remain for at least another two quarters to review the performance of the loan.

Risk Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. These loans continue to be subject to an individual impairment assessment, calculated using the loan's original effective interest rate.

Financial Guarantees

Issued financial guarantees are initially recognized at their fair value, being the premium (fee) received and subsequently measured at the higher of the unamortized balance of the related fees received and deferred, and the expenditure required to settle the commitment at the financial position date. The latter is recognized when it is both probable that the guarantee will require to be settled and that the settlement amount can be reliably estimated. Financial guarantees are recognized within other financial assets and other financial liabilities.

Property and Equipment

Property 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 were as follows:

• Expenditure on leasehold buildings and improvements are depreciated over the remaining term of the lease	-
• Transportation vehicles	20.0%
• Furniture and office accessories	20.0%
• Personal computers	33.3%
• Office and telecommunication equipment	20.0%

Intangible Assets

Intangible assets comprise software expenditures and other intangible assets. These assets are amortized on a straight-line basis over the best estimate of their useful lives, which is normally five years. Their carrying values are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Taxation

In accordance with Article 52 of the Establishing Agreement, the Bank, its assets, property, income and its operations and transactions are exempt from all taxation and all customs duties in all Member Countries. 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 also included and elaborated upon in Article 12 of the Headquarters Agreement with the Hellenic Government, ratified by Greek Law 2380/No.38/7.3.1996.

Provisions

The Bank raise non-risk management provisions for potential obligations and risks when the following circumstances exist: (a) there is an existing legal or constructive obligation as a result of past events, (b) for the obligation to be settled an outflow of resources embodying economic benefits is possible, and (c) a reliable estimate of the amount of the obligation can be made.

Share Capital and Dividends

In accordance with Article 36 of the Establishing 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 10% of the subscribed capital including all paid, unpaid but payable, and unpaid but callable share capital.

Reserves and Retained Earnings

In accordance with the Establishing Agreement of the Bank, the general reserve is created from the profits of the Bank for meeting any unforeseeable risks or contingencies.

The revaluation reserve represents the accumulated change in fair value of available-for-sale investments of the Bank, which have not been impaired.

The retained earnings of the Bank is the accumulated undistributed and unallocated net income over the years.

Revenues and Expenses

Interest income and expense are recorded in income for all interest bearing instruments on an accrual basis using the effective interest rate method based on actual contractual terms, with the exception being those assets that are individually identified as impaired for which interest is recognized through unwinding the discount arising from the present value calculations applied to the expected future cash flows. The effective interest rate method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash flows (inflows and outflows) through the expected life of the financial instrument, or when appropriate, a shorter period to the carrying amount of a financial asset or financial liability.

In accordance with IAS 18, front-end fees and where applicable commitment fees pertaining to loans are amortized through income using the effective interest rate method over the life of the loans. This calculation however, does not include costs that any other party is directly responsible for as: taxes, notary fees, insurance, registration, etc. In the case of early repayment, cancellation or acceleration, the outstanding deferred income from the related fees is recalculated taking into account the new maturity date. If the commitment expires without a loan being drawn down, the related fee is recognized as income on expiry.

Other commitment and guarantee fees and fees received in respect of services provided over a period of time are recognized as income on an accrual basis matching the period during which the commitment exists or the services are provided. Additionally, fees from negotiation, cancellation, arrangement, etc are recognized on completion of the related transaction. Dividends are recognized when received. Administrative expenses are recorded on an accrual basis.

Staff Retirement 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 performed annually by qualified, independent actuaries. Actuarial and asset gains or losses are recognized in "Other comprehensive income", and net gains or losses are in-

cluded in remeasurements where any change in the effect of the asset ceiling, excluding those amounts that have been already included in personnel expenses, are also included.

- The second pillar is a defined contribution scheme to which both the employee and the Bank contribute equally at a rate of 0-12% of basic salary. Each employee determines his/her contribution rate and the mode of investment of the contributions.
- The third pillar is a defined contribution scheme funded entirely by each employee, up to 40% of basic salary.

As an alternative, staff are entitled to retirement benefits from the Greek State Social Insurance Fund ("IKA"), which is a defined contribution scheme.

Current service costs in respect of both the pension plan and IKA are recognized as an expense and included in "Personnel expenses".

The Bank may offer termination benefits to employees that are terminated before the normal retirement age. These indemnities, including any related retirement benefits, are recognized in income as an expense in the same period which they are incurred.

Government Grants

Government grants are recognized where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Grants relating to fixed asset expenditures are recognized in income on a straight-line basis over the same period as that applied for depreciation purposes. Those relating to administrative expenses are recognized in income matching with the expense incurred.

Operating Leases – the Bank as a Lessee

For the Bank, an operating lease is a lease other than a finance lease. Under such agreements, all the risks and benefits of ownership are effectively retained by the lessor. The Bank has entered into this type of lease for its Headquarters building. Payments made under operating leases are charged to income on a straight-line basis over the period of the lease term. Any benefits received or that are receivable are also recognized on a straight-line basis over the lease term. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor, by way of penalty, is recognized as an expense in the period which the termination takes place.

New Accounting Standards and Interpretation of IASB

The accounting policies applied by the Bank in preparing the condensed interim financial statements are the same with those applied in the published financial statements for the year ended 31 December 2012. In addition, the accounting policies applied by the Bank after taking into account the following new standards, amendments of standards and Interpretation 20 which were issued by the International Accounting Standards Board (IASB), adopted by the European Union and applied on 1 January 2013:

a) Amendment to IAS 1 «Presentation of Items of Other Comprehensive Income» (Regulation 475/5.6.2012)

The adoption of the above amendment by the Bank had no financial impact; however, it resulted in modification in the presentation of the Statement of Comprehensive Income. In particular, the Statement of Comprehensive Income was amended so that items of other comprehensive income that may be reclassified subsequently to profit or loss are presented separately from those in which subsequent reclassification is not allowed. Income tax is also presented separately for each of the above groups.

b) Amendment to IAS 19 «Employee Benefits» (Regulation 475/5.6.2012)

The main impact from the adoption of the above amendment is the removal of the option to defer actuarial gains and losses (corridor approach). Actuarial gains and losses should be recognized in other comprehensive income that are not reclassified in profit or loss. In addition, according to the revised standard, interest on the net defined benefit liability (asset), which is recognized in profit or loss, shall be determined by multiplying the net defined benefit liability (asset) by the discount rate used to discount post-employment benefit obligation, as determined at the beginning of the annual reporting period, taking into account of any changes in the net defined benefit liability (asset). The difference between the total return on plan assets and its part that has been included in the interest on the net defined benefit liability (asset) is recognized in other comprehensive income and it is not reclassified in

profit or loss in a subsequent period. The application of the revised IAS 19 is retrospective and the impact from its adoption is presented in notes 25 and 28.

c) Amendment of International Financial Reporting Standard 7 "Disclosures – Offsetting Financial Assets and Financial Liabilities" (Regulation 1256/13.12.2012)

On 16.12.2011 the International Accounting Standards Board issued an amendment of IFRS 7 relating to offsetting financial assets and liabilities. The amendment requires additional disclosures not only for the recognized financial instruments that can be offset in accordance with the provisions of IAS 32, but also for the instruments that are subject to an enforceable master netting agreement or a similar agreement irrespective of whether the netting criteria of IAS 32 are met.

The adoption of the above amendment had as a result additional disclosures which are presented in note 13.

d) IFRS 13 «Fair Value Measurement» (Regulation 1255/11.12.2012)

On 12 May 2011, the International Accounting Standards Board issued IFRS 13 which:

i. Defines fair value

ii. Sets out a single framework for measuring fair value, and

iii. Specifies disclosures about fair value measurements

The adoption of the above standard had as a result additional disclosures which are presented in note 5 under "Classification and fair value".

Standards relating to investment in subsidiaries, associates and joint ventures:

IFRS 10 «Consolidated Financial Statements» (Regulation 1254/11.12.2012)

e) IFRS 11 «Joint Arrangements» (Regulation 1254/11.12.2012)

f) IFRS 12 «Disclosure of Interests in Other Entities» (Regulation 1254/11.12.2012)

g) Amendment of IFRS 10 «Consolidated Financial Statements», of IFRS 11 «Joint Arrangements» and of IFRS 12 «Disclosure of Interests in Other Entities»: Transition Guidance (Regulation 313/4.4.2013)

h) Amendment of IAS 27 «Separate Financial Statements» (Regulation 1254/11.12.2012)

i) Amendment of IAS 28 «Investments in Associates and Joint Ventures» (Regulation 1254/11.12.2012)

IFRS 10 prescribes the accounting principles for the preparation of consolidated financial statements and establishes a new definition of control of other entities. IFRS 11 prescribes the accounting for interests in joint arrangements, i.e. in cases that decisions about the activities of the arrangement require the unanimous consent of parties sharing control. IFRS 12 describes the disclosures required for interests in subsidiaries, associates, joint arrangements and non-consolidated structured entities in the consolidated financial statements of the investor. The issuance of the above standards caused the amendment of IAS 27, which now only applies to separate financial statements, and of IAS 28 that now includes joint ventures, since they are now mandatorily accounted for under the equity method.

Due to the adoption of the above standards and amendments, joint ventures are accounted under the equity method instead of the proportionate consolidation method. The application of the above amendment had no impact on the financial statements of the Bank.

It is noted that according to the Regulation 1254/11.12.2012, which adopted the above new standards and amendments, their effective date is, by the latest, the annual period beginning on or after 1 January 2014.

Standards the adoption of which had no impact on the financial statements of the Bank:

j) Amendment of IFRS 1 «Government Loans» (Regulation 183/4.3.2013)

k) Improvements to IAS (Regulation 301/27.3.2013)

l) Interpretation 20 «Stripping Costs in the Production Phase of a Surface Mine» (Regulation 1255/11.12.2012)

The below standards are effective for annual periods beginning on or after 1.1.2014:

On 31.10.2012, the International Accounting Standards Board issued the above amendment which defines "investment entities" and introduces an exception to consolidating particular subsidiaries for investment entities. An investment entity shall not consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9. The above does not apply to subsidiaries that are not held for the purpose of obtaining returns from the investment, but for providing services that relate to the investment activities of the parent. However, a parent of an investment entity, that is not itself an investment entity, shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary. The Bank is considering the impact from the adoption of the above amendment on its financial statements.

m) Amendment of International Accounting Standard 32 "Offsetting Financial Assets and Financial Liabilities" (Regulation 1256/13.12.2012)

On 16.12.2011, the International Accounting Standards Board issued the amendment of IAS 32 regarding offsetting of financial assets and financial liabilities. The amendment of IAS 32 relates to the addition of application guidance concerning the right to offset. The Bank is considering the impact from the adoption of the above amendment on its financial statements.

n) Amendment of International Accounting Standard 36 "Recoverable Amount Disclosures for Non-Financial Assets" (Regulation 1374/19.12.2013)

On 29.5.2013, the International Accounting Standards Board issued an amendment of IAS 36 with which it removed the requirement, introduced following the issuance of IFRS 13, to disclose the recoverable amount of each cash generating unit to which a material amount of the carrying amount of goodwill or intangible assets with indefinite useful life has been allocated, regardless of whether an impairment loss had been recognized. Furthermore, the above amendment added the following disclosure requirements:

- The recoverable amount of the asset (or cash-generating unit) for which an impairment loss has been recognized or reversed during the period;
- If the recoverable amount is fair value less costs of disposal, the level of the fair value hierarchy;
- For fair value measurements categorized within level 2 and level 3 of the fair value hierarchy, a description of the valuation techniques and the key assumptions used for their determination, as well as the discount rate used if fair value less costs of disposal was calculated using a present value technique.

The Bank is considering the impact from the adoption of the above amendment on its financial statements.

o) Amendment of International Accounting Standard 39 "Novation of Derivatives and Continuation of Hedge Accounting" (Regulation 1375/19.12.2013)

On 27.6.2013, the International Accounting Standards Board issued an amendment of IAS 39 which provides an exception to the requirement to discontinue hedge accounting when the hedging instrument expires or is sold, terminated or exercised. The exception is provided when the over-the-counter (OTC) derivative designated in a hedging relationship is novated to a central counterparty and at the same time the novation meets all the following conditions:

- It arises as a consequence of laws or regulations;
- It achieves the replacement of the previous counterparty with a central one which becomes the new counterparty to each of the parties and finally;
- No changes are expected to the contract's initial terms other than changes directly attributable to the change in the counterparty (changes in the collateral requirements, rights to offset receivables and payables balances and charges levied).

The Bank examines the impact from the adoption of the above amendment on its financial statements.

4. 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. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Consequently, the specific considerations regarding the use of management judgment in each area of estimate have been outlined in the respective accounting policy and disclosure note. The Bank's critical accounting judgments and estimates are as follows:

- Provisions for the impairment of loan operations. The Bank's method for determining the level of impairment of loan operations is described in the "impairment" accounting policy and further explained under "credit risk" of risk management. Portfolio provisions for loans not individually assessed as impaired amounted to EUR 9,303 thousand as indicated in note 11.

  In determining the probabilities of default the Bank applies a collective provisioning rate on the entire loan portfolio from the GEM's database, maintained by the European Investment Bank and the International Financial Corporation. This calculation formula of the GEM database takes into account Basel II criteria such as loss-given default and discount factor multipliers.

  There was no increase on specific provisions during the year. Specific Provisions are assigned according to the degree of potential impairment resulting from the impairment test that is conducted on the basis of objective evidence obtained through a risk asset review process.

  An impairment test includes projected cash in-flows and out-flows, available for debt service until maturity, which are discounted at the effective rate to reach a net present value for a particular operation, less any collateral that can be realized. Impairment losses incurred from specific provisions are recognized to the income statement.

- Staff retirement benefits. The Bank's has established a pension plan for its staff which is described in "staff retirement and termination benefits" accounting policy and is detailed under staff retirement plan in note 25. The present value of retirement benefit obligations is sensitive to the actuarial and financial assumptions used, including the discount rate applied. At the end of each year, the Bank determines the appropriate discount rate and other assumptions to be used to determine the present value of estimated future pension obligations, based on interest rates of suitable long-term bonds and on currencies as the EUR and USD. The Bank's liability to the staff retirement plan at 31 December 2013 was EUR 121 thousand.

Actual results could differ from those estimates mentioned above, although such differences are believed not material and do not affect these financial statements.

5. Risk Management

Risk is inherent in the Bank's activities and is managed through an ongoing process of identification, measurement and monitoring, as well as being subject to risk limits and controls. A conservative approach to risk taking together with effective risk management, are critical to the Bank's continuing operations and profitability. The Board of Directors has approved risk management policies and guidelines that are delegated to the Management of the Bank for the identification and control of risk.

The Bank's lending risk management policy documents describe the procedures for approval, management and review of lending activity exposures. The Bank's Treasury investment policy documents define the risk parameters to be observed by the Treasury in managing its exposures. The Bank is exposed to risks identified in this section.

Financial Risk

The Bank's exposure to financial risk is through its financial assets and liabilities including any receivables from these financial assets. Two key aspects of financial risk are (i) credit risk and (ii) liquidity risk.

a) Credit risk

The Bank is subject to credit risk, which is the risk that customers or counterparties will be unable to meet their obligations as they fall due. Credit risk arises principally from the Bank's lending activities. Regular reviews are conducted of all exposures within the lending portfolios, typically on a semi-annual basis, though exposures that are perceived to be more vulnerable to possible default are reviewed more frequently.

At each review there is (i) an assessment of whether there has been any change in the risk profile of the exposure, (ii) recommendations of actions to mitigate risk, and (iii) reconfirming or adjusting the risk ratings, and for equity investments, reviewing of fair value. Where relevant, the level of collective impairment or specific provision is evaluated and reconfirmed or adjusted. Responsibility for operations considered to be in jeopardy may be transferred from the original lending department to a corporate recovery team in order to most effectively manage the restructuring and recovery process.

Provision and reserve amounts are calculated each month using the default rate, recovery rate and sector risk analysis provided by the GEMs risk database (see section of the accounting policies: Impairment). Default and Loss Given Default data is updated annually and provides objective evidence of impairment, using separately each operation's risk profile and adjusting it for current circumstances when necessary.

For credit risks incurred by the Bank's Treasury in its investment and hedging activities, the Board of Directors has approved policies and guidelines for the determination of counterparty and investment exposure limits. The Bank's Risk Management Department assigns and monitors these counterparty and issuer credit risk limits. Treasury credit risks are also reviewed on a monthly basis by the Bank's Asset and Liability Committee.

The table below summarizes the maximum exposure to credit risk and indicates the worst-case scenario, without taking into consideration collateral, other credit enhancements or provisions of impairment.

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Cash and bank balances	14,849	18,227
Debt investment securities	157,812	215,533
Derivative financial instruments	16,210	11,517
Loans	726,405	742,614
Equity investments	52,934	43,290
Other assets	9,832	11,678
On-balance-sheet	**978,042**	**1,042,859**
Undrawn commitments	148,146	106,859
Total	**1,126,188**	**1,149,718**

b) Analysis by rating agency

The tables below provide an analysis of financial investments in accordance with their Moody's rating as follows. The Bank's loans as of 31 December 2013 are not externally rated by any credit rating investor services.

	2013					
Presented in EUR (000)	**Aaa – Aa3**	**A1 – A3**	**Baa1 – Baa3**	**Caa1 – Caa3**	**Unrated**	**Total**
Analysis by Moody's rating						
Cash and bank balances	14,849	-	-	-	-	**14,849**
Debt investment securities	1,502	145,000	11,310	-	-	**157,812**
Equity investments	-	-	-	-	52,934	**52,934**
At 31 December	**16,351**	**145,000**	**11,310**	**0**	**52,934**	**225,595**
Of which issued by						
Governments	1,502	-	-	-	-	**1,502**
Corporates	-	145,000	11,310	-	-	**209,244**
Deposits at banks	14,849	-	-	-	52,934	**14,849**
At 31 December	**16,351**	**145,000**	**11,310**	**0**	**52,934**	**225,595**
Of which classified as						
Available-for-sale	1,502	145,000	11,310	-	52,934	**210,746**
Held-to-maturity	-	-	-	-	-	**0**
Amortized cost	14,849	-	-	-	-	**14,849**
At 31 December	**16,351**	**145,000**	**11,310**	**0**	**52,934**	**225,595**

	2012					
Presented in EUR (000)	**Aaa – Aa3**	**A1 – A3**	**Baa1 – Baa3**	**Caa1 – Caa3**	**Unrated**	**Total**
Analysis by Moody's rating						
Cash and bank balances	18,227	-	-	-	-	**18,227**
Debt investment securities	-	182,500	12,430	20,603	-	**215,533**
Equity investments	-	-	-	-	43,290	**43,290**
At 31 December	**18,227**	**182,500**	**12,430**	**20,603**	**43,290**	**277,050**
Of which issued by						
Governments	-	-	-	20,603	-	**20,603**
Corporates	-	182,500	12,430	-	43,290	**238,220**
Deposits at banks	18,227	-	-	-	-	**18,227**
At 31 December	**18,227**	**182,500**	**12,430**	**20,603**	**43,290**	**277,050**
Of which classified as						
Available-for-sale	-	-	12,430	20,603	43,290	**76,323**
Held-to-maturity	-	182,500	-	-	-	**182,500**
Amortized cost	18,227	-	-	-	-	**18,227**
At 31 December	**18,227**	**182,500**	**12,430**	**20,603**	**43,290**	**277,050**

c) Collateral and credit enhancements

The Bank mitigates credit risk by holding collateral and other credit enhancements against exposure to customers and counterparties where it believes such security is necessary. The Bank defines security as mechanisms, procedures and assets negotiated in transactions that are meant to protect it against loss in case of non-performance. Security includes, but is not limited to, material assets, financial instruments, guarantees, covenants and comfort letters.

- Loans and advances. The Board of Directors approved guidelines for taking security under lending operations set the levels and types of collateral and other credit enhancements recommended for a given risk profile. The main types of collateral that may be obtained by the Bank are: mortgages on properties and equipment, pledges of equity shares and investment instruments, assignment of rights on certain contracts, cash or blocked deposits, and other third party guarantees. When needed the Bank reassesses the change in the market value of collateral and, if necessary, requests the pledging of additional collateral in accordance with the relevant agreement.
- Other financial instruments. Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Bonds and Euro Commercial Paper held by the Bank as investment securities are generally unsecured. The Bank may hold cash or government securities as collateral against its derivative contract counterparties. At 31 December 2013, the Bank holds cash collateral an amount of EUR 11,438 thousand.

d) Liquidity risk

Liquidity risk concerns the ability of the Bank to fulfill its financial obligations as they become due, and is a measure of the extent to which the Bank may require funds to meet those obligations. The Bank's liquidity management is concentrated on the timing of cash in-flows and out-flows, as well as the adequacy of available cash and liquid securities. For this, the Bank estimates and relates all expected cash flows from assets and liabilities.

The Bank's commitment to maintaining a strong liquidity position is established in policies, approved by the Board of Directors, including a minimum liquidity ratio of 50% liquid assets to the next twelve months net cash requirements. The Bank's liquid assets are maintained in short-term placements and negotiable securities.

The table below presents the cash flows payable on financial liabilities placed into relevant maturity groups, based on the remaining period from the financial position date to the contractual maturity date. It indicates the earliest maturity dates that the Bank's counterparties have the ability to demand repayment.

The figures represent undiscounted cash flows, and included estimated interest amounts, and therefore do not match to the statement of financial position.

Presented in EUR (000)	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	Total
Borrowings	-	1,429	49,703	244,205	15,410	**310,747**
Payables and accrued interest	-	4,640	121	-	-	**4,761**
Financial liabilities at 31 December 2013	**0**	**6,069**	**49,824**	**244,205**	**15,410**	**315,508**
Borrowings	-	1,400	91,546	299,649	15,408	**408,003**
Payables and accrued interest	-	7,587	759	-	-	**8,346**
Financial liabilities at 31 December 2012	**0**	**8,987**	**92,305**	**299,649**	**15,408**	**416,349**

For the Bank's financial assets, the majority mature from one year and over taking into consideration the latest possible repayment date.

Market Risk

Market risk refers to the possibility of losses due to changes in the market prices of financial instruments, interest rates and exchange rates. The Bank funds its operations by using its capital and by borrowing in the international capital markets. The Bank aims to match, wherever possible, the currencies, tenors and interest rate characteristics of its borrowings with those of its lending portfolios. When necessary, the Bank uses derivative instruments to reduce its exposure to exchange rate and interest rate risk.

a) Foreign exchange risk

Exchange rate risk is the impact of unanticipated changes in foreign exchange rates on the Bank's assets and liabilities, and any impact that could mirror on the income statement. The Bank monitors its assets and liabilities in order to ensure the Bank takes no significant foreign exchange risks. In doing so the Bank matches, to the extent practicable, the assets in any one currency, after swap activities, with liabilities in the same currency.

Furthermore, to avoid currency mismatches, borrowers are required to service their loans in the currencies disbursed by the Bank.

The effect of any currency fluctuations on the net exposure of the Bank is minimal. The tables below provide a currency breakdown of the Bank's assets and liabilities.

Presented in EUR (000)	Euro	United States dollar	Swiss franc	Other *	Total
Assets					
Cash and bank balances	8,886	5,950	-	13	**14,849**
Debt investment securities	146,502	11,310	-	-	**157,812**
Derivative financial instruments	16,210	-	-	-	**16,210**
Loans	376,111	350,294	-	-	**726,405**
Deferred income	(3,888)	(2,258)	-	-	**(6,146)**
Impairment losses on loans	(7,225)	(33,938)	-	-	**(41,163)**
Equity investments	21,164	10,573	-	21,197	**52,934**
Total	557,760	341,931	-	21,210	**920,901**
Liabilities					
Borrowings	86,278	37,291	162,775	-	**286,344**
Payables and accrued interest	2,087	2,607	-	67	**4,761**
Total	88,365	39,898	162,775	67	**291,105**
Net financial instruments	469,395	302,033	(162,775)	21,143	**629,796**
Derivative financial instruments	123,396	(286,171)	162,775	-	**0**
Currency balance at 31 December 2013	**592,791**	**15,862**	**0**	**21,143**	**629,796**

** Primarily represents the Access Bank equity investment which is denominated in Azerbaijan manats.*

Presented in EUR (000)	Euro	United States dollar	Swiss franc	Other *	Total
Assets					
Cash and bank balances	14,619	3,592	-	16	**18,227**
Debt investment securities	188,033	12,430	-	-	**200,463**
Derivative financial instruments	11,517	-	-	-	**11,517**
Loans	339,431	403,183	-	-	**742,614**
Deferred income	(4,153)	(2,541)	-	-	**(6,694)**
Impairment losses on loans	(6,382)	(35,644)	-	-	**(42,026)**
Equity investments	16,991	6,777	-	19,522	**43,290**
Total	560,056	387,797	-	19,538	**967,391**
Liabilities					
Borrowings	114,574	93,224	165,557	-	**373,355**
Payables and accrued interest	5,512	2,834	-	-	**8,346**
Total	120,086	96,058	165,557	0	**381,701**
Net financial instruments	439,970	291,739	(165,557)	19,538	**585,690**
Derivative financial instruments	103,553	(269,110)	165,557	-	**0**
Currency balance at 31 December 2012	**543,523**	**22,629**	**0**	**19,538**	**585,690**

** Primarily represents the Access Bank equity investment which is denominated in Azerbaijan manats.*

b) 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 Management Unit monitors the interest rate exposure of the Bank.

The tables below provide 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 as at the financial position date.

Presented in EUR (000)	Interest bearing					
	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Non-interest bearing	Total
Assets						
Cash and bank balances	14,847	-	-	-	2	**14,849**
Debt investment securities	125,000	21,502	11,310	-	-	**157,812**
Derivative financial instruments	-	-	-	-	16,210	**16,210**
Loans	147,744	223,095	275,136	80,430	-	**726,405**
Equity investments	-	-	-	-	52,934	**52,934**
Total	287,591	244,597	286,446	80,430	69,146	**968,210**
Liabilities						
Borrowings	-	9,000	107,569	169,775	-	**286,344**
Payables and accrued interest	-	-	-	-	4,761	**4,761**
Total	0	9,000	107,569	169,775	4,761	**291,105**
Derivative financial instruments	(167,896)	(1,879)	0	169,775	-	**0**
Interest rate risk at 31 December 2013	**119,695**	**233,718**	**178,877**	**80,430**	**64,385**	**677,105**

Presented in EUR (000)	Interest bearing					
	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Non-interest bearing	Total
Assets						
Cash and bank balances	18,225	-	-	-	2	**18,227**
Debt investment securities	90,000	94,000	-	16,463	-	**200,463**
Derivative financial instruments	-	-	-	-	11,517	**11,517**
Loans	113,529	315,357	274,407	39,321	-	**742,614**
Equity investments	-	-	-	-	43,290	**43,290**
Total	221,754	409,357	274,407	55,784	54,809	**1,016,111**
Liabilities						
Borrowings	26,906	27,947	146,010	172,492	-	**373,355**
Payables and accrued interest	-	-	-	-	8,346	**8,346**
Total	0	27,947	146,010	172,492	8,346	**381,701**
Derivative financial instruments	(160,492)	(12,000)	-	172,492	-	**0**
Interest rate risk at 31 December 2012	**34,356**	**369,410**	**128,397**	**55,784**	**46,463**	**634,410**

c) Sensitivity analysis

The Bank's interest rate sensitivity analysis comprises two elements. Firstly, there is the differential between the interest rate the Bank earns on its assets and the cost of borrowing to fund these assets. For this element the Bank does, as closely as possible, match interest rate periods, thus minimizing sensitivity. Secondly, there is the absolute rate earned on assets that are funded by the Bank's equity resources. The majority of these equity resources are currently invested in the Bank's loan portfolio at floating rates; therefore, subjecting earnings on equity resources to some degree of fluctuation.

As the Bank matures and its financial position grows, it is the intention that earnings on equity resources be stabilized by an increased investment in fixed rate instruments.

The table below details the re-pricing gap by currency. A parallel upward or downward shift in the EUR curve of 50 basis points would have generated the maximum loss or gain respectively.

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Euro	104,700	225,600
United states dollar	152,700	109,200
Total re-pricing gap	257,400	334,800
Shift of 50 basis points in the EUR curve	**1,287**	**1,674**

Operational Risk

The Bank defines operational risk as all aspects of risk related exposure other than those falling within the scope of financial and market risk. This includes the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events and legal risk. The Bank has a low tolerance for losses arising from the operational risks it is exposed to.

Where any such risks are identified, appropriate mitigation and control measures are put in place. The Bank's operational risk management focuses on proactive measures to mitigate the operational risk.

Classification and Fair Value

a) Classification

Investment securities classified as "available for sale" include government and corporate bonds and Euro Commercial Paper, and their fair value has been determined using quoted prices.

Equity investments classified as "available for sale" include investments in that are not quoted on an exchange (i.e. private equity), the fair value of which has been estimated with techniques that use inputs not based on observable market data.

b) Financial assets and liabilities

The tables below identify the Bank's financial assets and financial liabilities in accordance with IAS 39 categories. The fair value of the financial assets and financial liabilities is disclosed as equal to the carrying value, plus accrued interest, as all bear a variable interest rate and are given at market terms and conditions.

Presented in EUR (000)	At 31 December 2013			
	Held-to-maturity	Loansand receivables	At amortized cost	Carrying amount
Assets				
Cash and bank balances	-	-	14,849	**14,849**
Loans	-	726,405	-	**726,405**
Deferred income	-	-	(6,146)	**(6,146)**
Impairment losses on loans	-	(41,163)	-	**(41,163)**
Other assets	-	9,832	-	**9,832**
Total financial assets	**0**	**695,074**	**8,703**	**703,777**
Liabilities				
Borrowings	-	-	286,344	**286,344**
Payables and accrued interest	-	-	4,761	**4,761**
Total financial liabilities	**0**	**0**	**291,105**	**291,105**

Presented in EUR (000)	At 31 December 2012			
	Held-to-maturity	Loans and receivables	At amortized cost	Carrying amount
Assets				
Cash and bank balances	-	-	18,227	**18,227**
Debt investment securities	182,500	-	-	**182,500**
Loans	-	742,614	-	**742,614**
Deferred income	-	-	(6,694)	**(6,694)**
Impairment losses on loans	-	(42,026)	-	**(42,026)**
Other assets	-	11,678	-	**11,678**
Total financial assets	**182,500**	**712,266**	**11,533**	**906,299**
Liabilities				
Borrowings	-	-	373,355	**373,355**
Payables and accrued interest	-	-	8,346	**8,346**
Total financial liabilities	**0**	**0**	**381,701**	**381,701**

c) Fair value hierarchy

The Bank held the below financial instruments measured at fair value, and uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: Quoted market prices in active markets for identical assets or liabilities,
- Level 2: Other techniques for which all inputs that have a significant effect on the recorded fair value are observable, either directly or indirectly, and
- Level 3: Techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

The tables below identify the Bank's financial instruments measured at fair value.

Presented in EUR (000)	Level 1	Level 2	Level 3	Carrying amount
Available-for-sale:				
Debt investment securities	157,812	-	-	**157,812**
Equity investments	-	-	52,934	**52,934**
Derivative financial instruments	-	16,210	-	**16,210**
At 31 December 2013	**157,812**	**16,210**	**52,934**	**226,956**

There have been no transfers between Level 1 and Level 2 during the year. For Level 1 and Level 2, the valuation techniques used are broker quotes and observable market data, or discounted cash flow models. For Level 3, the valuation technique used is the net asset value (NAV).

Presented in EUR (000)	Level 1	Level 2	Level 3	Carrying amount
Available-for-sale:				
Debt investment securities	-	-	-	**33,033**
Equity investments	33,033	-	43,290	**43,290**
Derivative financial instruments	-	11,517	-	**11,517**
At 31 December 2012	**33,033**	**11,517**	**43,290**	**87,840**

d) Fair value measurement in level 3

The table provides a reconciliation of the fair values of the Bank's Level 3 financial assets of the fair value hierarchy.

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
At 1 January	43,290	31,656
Total gains or (losses) for the year recognized in the income statement	-	-
Total gains recognized in other comprehensive income	5,091	1,932
Purchases, sales, issues and settlements	4,553	9,702
Transfers into or out of level 3	-	-
At end of year	**52,934**	**43,290**

e) Sensitivity analysis for level 3

The table below indicates a possible impact on net income for the Level 3 financial instruments carried at fair value at 31 December 2013, on an estimated 5% increase or decrease in net assets value of the equity investments based on the Bank's participation.

Presented in EUR (000)	Carrying amount	Favorable change	Unfavorable change
Equity investments	52,934	2,647	(2,647)

Capital Management

At the inception of the Bank initial authorized share capital was SDR 1 billion, which was fully subscribed by the Member States. In December 2007, the Board of Governors approved an increase of the Bank's authorized share capital to SDR 3 billion and authorized the offering of SDR 1 billion to the existing Member States for subscription, with the objective of increasing subscribed capital to a total of SDR 2 billion. The increase allows the Bank to implement its operational strategy to a substantial degree. The Bank does not have any other classes of capital.

In October 2008, the above new shares in the amount of SDR 1 billion that were offered for subscription to the Bank's Member States were fully subscribed and allocated. Accordingly, the Bank's paid-in share capital was doubled from SDR 300 million to SDR 600 million. The remaining SDR 1 billion of authorized share capital has not yet been allocated.

Pursuant to Resolution 131 of the Board of Governors, a unanimously adopted first amendment to the Establishing Agreement became effective on 21 June 2013. As of this effective date, and as per Resolution 131 of the Board of Governors, the unit of account of the Bank became the EUR and which all of the Bank's authorized share capital was redenominated from SDR to EUR. The conversion rate applied was SDR to EUR fixed at 1:1.15.

The capital usage of the Bank is guided by statutory and financial policy parameters. Article 15 of the Establishing Agreement limits the total amount of outstanding loans, equity investments and guarantees made for ordinary operations to 150% of the Bank's unimpaired subscribed capital, reserves and surpluses, establishing a 1.5:1 institutional gearing ratio. Additionally, disbursed equity investments shall not at any time exceed an amount corresponding to the Bank's total unimpaired paid-in capital, surpluses and general reserve.

At the 36th meeting of the Board of Directors in 2008, the operational gearing ratio was set at 100% of the Bank's unimpaired paid-up capital, reserves and surpluses, and the usable portion of the callable capital. This limit on the total amount of operations which includes all callable capital is approximately EUR 2.2 billion.

The Bank preserves an actively managed capital to prudently cover risks in its activities. As a multilateral financial institution, the Bank is not subject to regulatory capital requirements. However, the Bank uses standards proposed by the Basel II Capital Accord as a benchmark for its risk management and capital framework. Pursuant to Article 5 of the Establishing Agreement, the Board of Governors shall at intervals of not more than five years review the capital stock of the Bank. In substance, the primary objective of the Bank's capital management is to ensure adequate capital is available to support the Bank's operations.

6. Operating Segments

The Bank is a multilateral financial institution dedicated to accelerating development and promoting cooperation among its shareholder countries. The Bank operates in a specific geographical area and the primary reporting format for business segments includes Lending and Treasury operations. Lending activities represent investments in projects such as loans, equity investments and guarantees, which in accordance with the Establishing Agreement, are made to accelerate development and promote co-operation among the Bank's shareholder countries. Treasury activities include raising debt finance, investing surplus liquidity, and managing the Bank's foreign exchange and interest rate risks.

	2013			2012		
Presented in EUR (000)	**Lending**	**Treasury**	**Total**	**Lending**	**Treasury**	**Total**
Income statement						
Interest income	38,282	2,021	40,303	42,306	3,393	45,699
Net fees and commissions	538	-	538	1,041	-	1,041
Total segment revenues	38,820	2,021	40,841	43,347	3,393	46,740
Less: interest expense	(10,121)	(2,374)	(12,495)	(14,383)	(581)	(14,964)
Net fair value, foreign exchange and other	1,223	(795)	428	3,369	(264)	3,105
Less: personnel and other admin. expenses	(15,251)	(1,008)	(16,259)	(14,391)	(1,044)	(15,435)
Less: depreciation and amortization	(654)	(6)	(660	(527)	(2)	(529)
Segment income before impairment	14,017	(2,162)	11,855	17,415	1,502	18,917
Less: impairment (losses) release	(675)	2,104	1,429	(3,055)	(899)	(3,954)
Net income for the year	**13,342**	**(58)**	**13,284**	**14,360**	**603**	**14,963**
Financial position						
Segment assets	743,327	188,871	932,198	750,377	230,207	980,584
At end of year			**932,198**			**980,584**
Segment liabilities	291,105	-	291,105	381,701	-	381,701
Members' equity	-	-	641,093	-	-	598,883
At end of year			**932,198**			**980,584**

The geographical segment reporting of the Bank is presented in note 16 "Operational analysis".

7. Interest Income

Interest and similar income is analyzed as follows:

Presented in EUR (000)	**Year to 31 December 2013**	**Year to 31 December 2012**
From loans and advances	38,282	42,306
From placements with financial institutions	2	8
From investment securities available-for-sale	791	643
From investment securities held-to-maturity	583	2,677
From derivative financial assets at fair value	645	65
Interest and similar income	**40,303**	**45,699**

8. Interest Expense

Interest and similar expense is analyzed as follows:

Presented in EUR (000)	Year to 31 December 2013	Year to 31 December 2012
From borrowed funds	4,517	7,570
From issued debt	4,475	5,919
From derivative financial liabilities at fair value	2,287	510
From amortized issuance and arrangement costs	1,129	894
From other charges	87	71
Interest and similar income	**12,495**	**14,964**

9. Net Fees And Commissions

Net fees and commissions is analyzed as follows:

Presented in EUR (000)	Year to 31 December 2013	Year to 31 December 2012
Guarantee fees	27	2
Management fees	173	196
Appraisal fees	36	-
Administration fees	15	11
Arrangement fees	51	600
Surveillance fees	19	20
Prepayment/cancellation fees	204	197
Other fees	13	15
Net fees and commissions	**538**	**1,041**

10. Personnel And Other Administrative Expenses

Administrative expenses are analyzed as follows:

Presented in EUR (000)	Year to 31 December 2013	Year to 31 December 2012
Salaries and benefits	10,294	10,220
Staff retirement plans	2,380	1,906
Personnel expenses	**12,674**	**12,126**
Professional fees and related expenses	707	426
Utilities and maintenance	1,390	1,309
Other administrative	1,488	1,574
Other administrative expenses	**3,585**	**3,309**

The average number of staff employed during the year was 104 (2012: 103). The number of staff at 31 December 2013 was 103 (2012: 105). Further analysis of the staff retirement plan is presented in note “Employee benefits”.

11. Impairment Losses On Loans

Loans are stated net of provisions. A summary of the movements in provisions for impairment were as follows:

Presented in EUR (000)	Collective	Specific	Total
At 31 December 2011	11,388	28,455	39,843
Charge for the year	-	5,445	5,445
Release for the year	(2,394)	-	(2,394)
Foreign exchange adjustments	(170)	(698)	(868)
At 31 December 2012	8,824	33,202	42,026
Charge for the year	665	-	665
Foreign exchange adjustments	(186)	(1,342)	(1,528)
At 31 December 2013	**9,303**	**31,860**	**41,163**

The Bank's collective impairment evaluation, which was previously based on the banking systems in the BSEC countries, is currently based on the Global Emerging Markets ("GEMs") data base. The GEMs risk data base standardizes the risk rating and data collection process of member International Financial Institutions. The Bank's rating scorecards which determine operation risk levels were developed by the Bank with the assistance of Moody's Analytics.

At 31 December 2013, the Bank categorized three non-performing loans and two sub-standard loans as impaired with an exposure amount of EUR 68,061 thousand (2012: EUR 68,937 thousand) and the provision on these assets amounted to EUR 31,860 thousand (2012: EUR 33,202 thousand). Management estimates that the allowance for the impaired loans is adequate to cover potential or unforeseen uncollectible amounts in the existing portfolio.

12. Debt Investment Securities

Debt investment securities are analyzed as follows:

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Government bonds	1,502	20,603
Corporate bonds	11,310	12,430
Commercial paper	145,000	182,500
Total	157,812	215,533
Less: impairment loss	-	(15,070)
Debt investment securities	**157,812**	**200,463**

In 2012, the Hellenic Republic initiated and completed through the introduction via legislation of collective action clauses a bond swap ("PSI") in respect of certain series of bonds, including bonds held by the Bank. The Bank had purchased the original bonds that had a nominal value of EUR 20,000 thousand, at EUR 19,470 thousand. These were replaced in the PSI via the activation of such collective action clauses with new bonds having a nominal value of EUR 9,300 thousand. The 'acquisition cost' of these replacement Hellenic government bonds was the fair value of the bonds at the exchange rate.

In November 2013, the above bonds were sold and provided the Bank a gain of EUR 2,104 thousand.

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Nominal value of original bonds	20,000	20,000
Discount received	(530)	(530)
Acquisition cost	19,470	19,470
Less: impairment loss	(15,070)	(15,070)
Fair value of new bonds	4,400	4,400
Net release of impairment from sale of bonds	2,104	-
Realized proceeds from sale of bonds	**6,504**	**0**

13. Derivative Financial Instruments, Net

The table below shows the Bank's outstanding forward foreign exchange contracts. The first column shows the sum of notional amounts, which is the amount of a derivative's nominal value, and is the basis upon which changes in the value are measured. The second column shows the market value of the notional amounts and also the net valuation attributable to fair value hedges.

Presented in EUR (000)	At 31 December 2013		At 31 December 2012	
	Notional amount	Fair value	Notional amount	Fair value
Currency swap purchases	123,396	123,396	106,500	106,500
Currency swap sales	(121,849)	(121,793)	(103,634)	(103,553)
Designated as fair value hedges	-	14,607	-	8,570
Derivative financial instruments	**1,547**	**16,210**	**2,866**	**11,517**

The above derivative financial instrument contracts with financial counterparties have been documented under International Swaps and Derivative Association ("ISDA") Master Agreements with Credit Support Annexes ("CSA"s). Pursuant to such arrangements the Bank is eligible to offset assets and liabilities in the event of a counterparty default occurrence.

The Bank's hedge accounting is based on a clearly documented relationship between the item hedged and the hedging instrument, having a one-on-one relationship, which is documented at the time a hedge transaction is entered into. This relationship arises within the context of the Bank's borrowing activities in which the Bank's issued bonds are combined with swaps to achieve floating-rate debt in a currency sought by the Bank.

14. Loans

The Bank offers a range of loan facilities directed to investments for both project and trade financing, tailored to meet an individual operation's requirements. Loans may be denominated in any convertible currency, or a combination of convertible currencies in which the Bank is able to fund itself.

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
At 1 January	742,614	688,218
Disbursements	193,085	215,269
Less: repayments	(188,821)	(153,449)
Foreign exchange movements	(20,473)	(7,424)
Loans total	726,405	742,614
Less: deferred income	(6,146)	(6,694)
Less: impairment losses	(41,163)	(42,026)
Loans net of impairment	**679,096**	**693,894**

As of 31 December 2013, all loan facilities are classified as standard apart from five that were impaired. As of this date, the amount of interest and similar income that has not been accrued related to impaired loans was EUR 8,736 thousand, out of which an amount of EUR 1,485 thousand refers to the current year.

At 31 December 2013, the Bank had restructured one loan operation an amount of EUR 20,221 thousand.

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Individually impaired	68,061	68,937
Less: allowance for impairment	(31,860)	(33,202)
Carrying amount	36,201	35,735
Collectively impaired	658,344	673,677
Less: deferred income	(6,146)	(6,694)
Less: allowance for impairment	(9,303)	(8,824)
Carrying amount	642,895	658,159
Past due but not impaired	-	-
Neither past due nor impaired	-	-
Total carrying amount at amortized cost	**679,096**	**693,894**

Interest is generally based on Libor for USD loans and Euribor for EUR loans plus a margin. Margins are dependent on the risk category of each loan and typically range from 1.5% to 8.0%. The fair value of the loan portfolio is approximately equal to carrying value plus accrued interest as all loans bear a variable interest rate and are given at market terms and conditions. Further analysis of the loan portfolio is presented in note "Operational analysis".

15. 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 entities as detailed below.

Presented in EUR (000)	% of Investment	At 31 December 2013		At 31 December 2012	
		Cost	Fair value	Cost	Fair value
SEAF Caucasus Growth Fund	21.39	4,529	4,012	2,356	2,212
Access Bank, Azerbaijan	20.00	15,792	21,197	16,403	19,522
Balkan Accession Fund	9.09	7,663	6,583	7,589	6,271
A-Park Kaluga, Russia	19.99	1,714	2,951	1,714	2,694
Emerging Europe Accession Fund	10.15	2,109	1,716	315	6
Rusal	0.01	4	92	4	203
ADM Ceecat Recovery Fund	5.65	10,036	9,913	8,178	8,019
European Virgin Fund	21.05	5,996	6,470	4,799	4,363
Equity investments available-for-sale		**47,843**	**52,934**	**41,358**	**43,290**

The valuation of such investments, which are unlisted, has been estimated using the most recent management accounts or the latest audited accounts, as of 31 December 2013, as management considers that is the best available estimate of the investments fair value.

The increase of EUR 5,091 thousand corresponds to the difference between acquisition cost and fair value as of 31 December 2013.

During the year, the Bank had realized a dividend income of EUR 1,203 thousand from its investment in the Access Bank.

As of 31 December 2013, the Bank has a committed amount of EUR 15,895 thousand towards the above entities participation. Further analysis of the equity investment portfolio is presented in note "Operational analysis".

As at 31 December 2013, the Bank has three equity investments where it holds slightly more than 20% of the investee share capital, but does not exert significant influence, hence the investment is not accounted for as an investment in an associate under IAS 28.

16. Operational Analysis

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

Presented in EUR (000)	At 31 December 2013		At 31 December 2012	
	Outstanding disbursements	Undrawn commitments	Outstanding disbursements	Undrawn commitments
Analysis by instrument				
Loans	726,405	116,251	742,614	66,847
Equity investments	52,934	15,895	43,290	24,012
Guarantees *	-	16,000	-	16,000
At end of year	**779,339**	**148,146**	**785,904**	**106,859**
Analysis by country				
Albania	17,074	18,000	42,563	-
Armenia	33,828	820	31,196	1,061
Azerbaijan	90,635	20,929	76,476	5,699
Bulgaria	58,586	-	72,863	-
Georgia	12,750	24,447	15,572	27,536
Greece	36,841	-	43,516	-
Moldova	14,408	363	15,040	758
Romania	42,400	10,600	45,000	-
Russia	179,949	14,405	190,940	8,562
Turkey	200,186	7,338	155,028	32,978
Ukraine	63,988	35,349	76,840	6,253
Regional	28,694	15,895	20,870	24,012
At end of year	**779,339**	**148,146**	**785,904**	**106,859**
Analysis by sector **				
Financial institutions	368,405	53,402	323,842	34,051
Energy and infrastructure	59,040	51,349	110,956	22,253
General industries***	351,894	43,395	351,106	50,555
At end of year	**779,339**	**148,146**	**785,904**	**106,859**

* *Trade finance guarantees primarily represent stand-by letters of credit issued in favor of confirming banks that have undertaken the payment risk of issuing banks. Other guarantees include unfunded full or partial risk participations.*

** *The sector analysis is based on per Banking Team responsibilities.*

*** *Also includes transport and tourism.*

The Bank is restricted to operating in its 11 Member States and individual country limits are set as a maximum at 30% of approved commitments. This limit is calculated on the basis of the Board of Directors approved operations, minus repayments and cancellations. Individual operations are further constrained by the Single Obligor Limit and by monitoring of Sectoral Exposure.

Operations are monitored according to a schedule prepared by the Bank's Department of Risk Management, in conjunction with the originating Banking Teams. Monitoring reports are completed by the Bank's Department of Project Implementation and Monitoring based on financial analysis prepared by the Department of Financial Analysis. Risk asset reviews, based on the mentioned monitoring reports, are performed by the Department of Risk Management, and may result in a downgrade or upgrade of an operation's status and, if a significant deterioration is noted, trigger an impairment test.

17. Property And Equipment

Property and equipment is analyzed as follows:

Presented in EUR (000)	Buildings (leasehold)	Vehicle	Furniture and office accessories	Computers and office equipment	Total
Cost					
At 31 December 2011	197	95	554	1,709	2,555
Additions	140	-	56	184	380
Disposals	-	-	-	(5)	(5)
At 31 December 2012	337	95	610	1,888	2,930
Additions	195	-	6	245	446
Disposals	(1)	-	(59)	(695)	(755)
At 31 December 2013	**531**	**95**	**557**	**1,438**	**2,621**
Accumulated depreciation					
At 31 December 2011	193	14	475	1,318	2,000
Charges	11	19	29	177	236
Disposals	-	-	-	(5)	(5)
At 31 December 2012	204	33	504	1,490	2,231
Charges	79	19	29	213	340
Disposals	(1)	-	(59)	(695)	(755)
At 31 December 2013	**282**	**52**	**474**	**1,008**	**1,816**
Net book value					
At 31 December 2013	**249**	**43**	**83**	**430**	**805**
At 31 December 2012	133	62	106	398	699
At 31 December 2011	4	81	79	391	555

18. Intangible Assets

Intangible assets comprising computer software are analyzed as follows:

Presented in EUR (000)	Total
Cost	
At 31 December 2011	2,999
Additions	185
At 31 December 2012	3,184
Additions	163
At 31 December 2013	**3,347**
Accumulated amortization	
At 31 December 2011	2,075
Charges	293
At 31 December 2012	2,368
Charges	319
At 31 December 2013	**2,687**
Net book value	
At 31 December 2013	**660**
At 31 December 2012	816
At 31 December 2011	924

19. Other Assets

Other assets is analyzed as follows:

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Accrued interest	7,061	7,703
Advances and prepaid expenses	2,526	2,791
Other prepayments	175	237
Rental reimbursement receivable	-	875
Guarantee deposits	70	72
Other assets	**9,832**	**11,678**

20. Borrowings

Borrowing facilities arranged at the financial position date are analyzed below. In addition to medium or long-term borrowings, the Bank utilizes short-term financing in the form of ECP issuance or borrowings from commercial banks for cash management purposes. At 31 December 2013, the Bank had issued debt securities in the amount of EUR 174,775 thousand.

Presented in EUR (000)	At 31 December 2013		At 31 December 2012	
	Amount used	Borrowings arranged	Amount used	Borrowings arranged
Euro	86,278	146,278	114,574	174,574
United States dollar	37,291	88,049	93,224	146,278
Swiss franc	162,775	162,775	165,557	165,557
Total	**286,344**	**397,102**	**373,355**	**486,409**

The interest rate on borrowings falls within a range of Euribor or USD Libor of +0 to +300 points. There is no collateral against the above borrowed funds. The fair value of the borrowings is approximately equal to their carrying value.

21. Payables And Accrued Interest

Payables and accrued interest is analyzed as follows:

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Accrued interest	3,703	4,258
Social insurance fund (IKA) contributions	16	29
Pension plan obligation	121	2,999
Suppliers and other accrued expenses	907	1,056
Other	14	4
Payables and accrued interest	**4,761**	**8,346**

22. Share Capital

From the Bank's inception, and in accordance with Article 4 of the Establishing Agreement, the Bank denominated its authorized share capital in the Special Drawing Right ("SDR") as defined by the International Monetary Fund ("IMF"). Resolution 131 of the Board of Governors ("BoG") unanimously adopted the requisite amendments to paragraph 1 of Article 4 and Articles 23 and 24 of the Establishing Agreement, to expressly include among the

exclusive powers of the BoG the change of the unit of account of the Bank, and the redenomination of all capital stock of the Bank. These amendments to the Establishing Agreement became effective on 21 June 2013 (the "Effective Date"). In accordance with such Resolution 131 of the Board of Governors, as of the Effective Date the unit of account of the Bank became the EUR and the authorized capital stock of the Bank was redenominated into three billion four hundred and fifty million EUR (3,450,000,000), divided into three million (3,000,000) shares having a par value of one thousand and one hundred and fifty EUR (1,150) each, inclusive of all subscribed and unallocated shares. Accordingly, as of the Effective Date, all outstanding share capital commitments of participating members in respect of their subscribed shares were converted into EUR.

The authorized capital stock of the Bank may be increased at such time and under such terms as may seem advisable.

The Bank's capital stock is divided into paid-in shares (fully paid and payable in installments) and callable shares. Payment for the paid-in shares subscribed to by members was made over a period of years in accordance with Article 6 of the Establishing Agreement for the initial capital raising purpose of the Bank, and as determined in advance by the Bank for capital increases (in the only capital increase of the Bank so far, the structure of payments specified was similar to the one in Article 6). The same Article states that payment of the amount subscribed to in respect of the callable shares is subject to call only as and when required by the Bank to meet its obligations.

Under Article 37 of the Establishing Agreement, any member may withdraw from the Bank by transmitting a notice in writing to the Bank at its Headquarters. Withdrawal by a member shall become effective and its membership shall cease on the date specified in its notice, but in no event less than six months after such notice is received by the Bank. However, at any time before the withdrawal becomes finally effective, the member may notify the Bank in writing of the cancellation of its notice of intention to withdraw. Under Article 39 of the Establishing Agreement, after the date on which a member ceases membership, it shall remain liable for its direct obligations to the Bank, and also remain responsible for its contingent liabilities to the Bank, incurred as of that date. No member has ever withdrawn its membership, nor has any ever indicated to the Bank it might do so. Were a member to withdraw from the Bank, at the time a member ceases membership, the Bank shall arrange for the repurchase of such a member's shares by the Bank as part of the settlement of accounts with such a member, and be able to impose conditions and set dates pursuant to the same Article 39 of the Establishing Agreement. Any amount due to the member for its shares shall be withheld so long as the member, including its central bank or any of its agencies, has outstanding obligations to the Bank, which may, at the option of the Bank, be applied to any such liability as it matures.

If losses are sustained by the Bank on any guarantees or loans which were outstanding on the date when a member ceased membership and the amount of such losses exceeds the amount of the reserves provided against losses on the date, the member concerned shall repay, upon demand, the amount by which the repurchase price of its shares would have been reduced if the losses had been taken into account when the repurchase price was determined.

Under Article 42 of the Establishing Agreement, in the event of termination of the operations of the Bank, the liability of members for the unpaid portion of the subscribed capital of the Bank shall continue until all claims of creditors, including all contingent claims, have been discharged.

All participating members had fully subscribed to the initial authorized share capital in accordance with Article 5 of the Establishing Agreement. Subsequently, at the Sixth Annual Meeting of the Board of Governors held on 6 June 2004 three Member States, Armenia, Georgia and Moldova requested a 50% reduction of their portion of subscribed capital, from 2% to 1% of the initial authorized capital the Board of Governors approved their request. On 5 October 2008, the new shares pursuant to the capital increase of the Bank were offered in the same structure as the initial authorized share capital, in the amount of EUR 1.150 billion, and were fully subscribed by the Member States. Furthermore, Azerbaijan also subscribed to the 3% of the initial authorized share capital that remained unallocated, after the above mentioned participation reduction, while Romania subscribed both to their allocation of new shares and to those that would have been allocated to Georgia had it chosen to participate in the capital increase. This subscription process followed a decision taken by the Board of Governors in December 2007 to triple the Bank's authorized capital to EUR 3.450 billion and to double the subscribed capital to EUR 2.3 billion, while leaving authorized capital of EUR 1.150 billion unallocated. On October 2011, the Board of Governors approved the request from Moldova for a 50% reduction of its portion of subscribed capital, from 1% to 0.5%, and those shares were released to unallocated share capital.

The above share capital is analyzed as follows:

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Authorized share capital	3,450,000	3,494,085
Less: unallocated share capital*	(1,161,500)	(1,177,397)
Subscribed share capital	2,288,500	2,316,688
Less: shares not yet called	(1,601,950)	(1,623,876)
Less: shares payable but not yet due	(155,695)	(182,950)
Less: shares payments past due	(12,889)	(15,144)
Cumulative translation adjustment	-	(337)
Paid-up share capital	517,966	494,381
Advance against future call	5	11
Paid-in share capital	**517,971**	**494,392**

** Shares available to new or existing Member States.*

For the period from the change (from SDR to EUR) of the share capital currency of the Bank to the Effective Date of Resolution 131 of the Board of Governors, the translation gains or losses on callable and payable share capital have been credited or debited to the "Cumulative translation adjustment", to duly reflect the fluctuations of the SDR value of the members' equity.

Initial Capital

In accordance with paragraph 2 under Article 5 of the Establishing Agreement, the initially authorized capital stock was subscribed by and issued to each Member as follows: 10% (EUR 115 million) fully paid and 20% (EUR 230 million) payable by promissory notes or other obligations which were not negotiable and non-interest bearing in eight equal successive annual installments in the years 1998-2005.

Capital Increase

The capital increase of EUR 1.150 billion is divided into EUR 345 million paid in capital and EUR 805 million callable capital. Pursuant to the Board of Governors decision in October 2008, the EUR 345 million paid in portion is divided into 10% (EUR 115 million) fully paid shares in 2010 and 20% (EUR 230 million) payable shares by promissory notes or other obligation issued by members in eight equal successive annual installments in the years 2011 to 2018. As of October 2011, the capital increase was reduced by EUR 11.5 million of the subscribed share capital, due to an approved reduction by the Board of Governors in participation by Moldova.

The initial and capital increase that was issued is analyzed as follows:

	At 31 December 2013		
Presented in EUR (000)	Initial capital	Capital increase	Total
Authorized share capital	1,150,000	2,300,000	**3,450,000**
Less: unallocated share capital	(34,500)	(1,127,000)	**(1,161,500)**
Subscribed share capital	1,115,500	1,173,000	**2,288,500**
Less: shares not yet called	(780,850)	(821,100)	**(1,601,950)**
Less: shares payable but not yet due	-	(155,695)	**(155,695)**
Less: shares payments past due	-	(12,889)	**(12,889)**
Paid-up share capital	334,650	183,316	**517,966**
Advance against future call	40	(35)	**5**
Paid-in share capital	**334,690**	**183,281**	**517,971**

Statement of Subscriptions

A statement of capital subscriptions illustrating the number of shares and the amount subscribed by each member is shown below, including their respective callable, payable and the amount paid. The capital subscription status at 31 December 2013 is analyzed as follows:

Member	Shares	Subscribed	Callable	Payable	Paid
		Presented in EUR (000)			
Albania	40,000	46,000	32,200	6,759	7,041
Armenia	20,000	23,000	16,100	1,438	5,462
Azerbaijan	100,000	115,000	80,500	7,188	27,312
Bulgaria	270,000	310,500	217,350	19,420	73,730
Georgia	10,000	11,500	8,050	-	3,450
Greece	330,000	379,500	265,650	23,718	90,132
Moldova	10,000	11,500	8,050	-	3,450
Romania	280,000	322,000	225,400	20,844	75,756
Russian Fed.	330,000	379,500	265,650	23,718	90,132
Turkey	330,000	379,500	265,650	23,718	90,132
Ukraine	270,000	310,500	217,350	41,781	51,369
Total	**1,990,000**	**2,288,500**	**1,601,950**	**168,584**	**517,966**

23. Reserves

Reserves are analyzed as follows:

Presented in EUR (000)	General	Available-for-sale	Other	Total
At 31 December 2011	37,659	2,444	663	40,766
Gains on revaluation of available-for-sale	599	1,469	-	2,068
Remeasurements of defined benefit scheme	-	-	(2,967)	(2,967)
Transferred from retained earnings	2,035	-		2,035
At 31 December 2012	40,293	3,913	(2,304)	41,902
Gains on revaluation of available-for-sale	-	1,429	-	1,429
Remeasurements of defined benefit scheme	-	-	331	331
Exchange rate difference due to conversion	-	-	3,587	3,587
Transferred from retained earnings	3,270	-	-	3,270
At 31 December 2013	**43,563**	**5,342**	**1,614**	**50,519**

The Bank's general reserve is maintained for meeting any unforeseeable risks or contingencies that do not qualify as provisions for impairment and is normally built-up from those released impairment charges during the year.

The exchange rate difference due to conversion relates to the value of EUR against the SDR and the redenomination of all capital and fixing of all outstanding obligations of Member States in respect thereof into EUR, pursuant to Resolution 131 of the Board of Governors.

24. Cash And Cash Equivalents

Cash and cash equivalents are analyzed as follows:

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Cash on hand	2	2
Investments maturing up to 1 month:		
Bank balances	14,847	18,225
Available-for-sale portfolio	125,000	-
Held-to-maturity portfolio	-	182,500
Investment maturing from 1 month to 3 months:		
Available-for-sale portfolio	20,000	-
Cash and cash equivalents	**159,849**	**200,727**

The commercial papers held in the Bank's portfolio and issued by other financial institutions were short-term rated at a minimum of A2 by Standard and Poor's or P2 by Moody's, in accordance with internal financial policies.

25. Employee Benefits

At normal retirement age (60 years), a staff member is entitled to a pension equal to 1% of his pensionable salary (i.e. average of the two best out of the last five years) multiplied by his/her years of service at the Bank, under the defined benefit scheme. 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.

Defined Benefit Scheme

The defined benefit scheme covers all eligible employees of the Bank. A qualified actuary performs an actuarial valuation of this scheme at each end of year using the projected unit method, which is rolled forward to the following year accounts. The most recent valuation date was 31 December 2013. The present value of the defined benefit obligation and current service cost was calculated using the projected unit credit method.

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Amounts recognized in the statement of financial position		
Present value of the defined benefit obligations	13,879	12,381
Fair value of plan assets	(13,758)	(9,382)
Net liability at end of year	**121**	**2,999**
Amounts recognized in the income statement		
Service cost	1,258	919
Net interest on the net defined benefit liability/(asset)	97	(17)
Administration expense	51	50
Total included in personnel expenses	**1,406**	**952**
Remeasurements recognized in other comprehensive income		
At 31 December	(2,304)	663
Liability gain (loss) due to changes in assumptions	443	(2,706)
Liability experiences gain (loss) arising during the year	(284)	(474)
Return on plan assets excluding income statement amounts	172	213
Total amount recognized during the year	331	(2,967)
Cumulative in other comprehensive income (expense)	**(1,973)**	**(2,304)**
Principal actuarial assumptions used		
Discount rate	4.00%	3.85%
Expected return on plan assets	4.00%	3.85%
Future salary increase	2.50%	2.50%
Future pension increase	2.00%	2.00%
Average remaining working life of employees	14 years	11 years

The discount rate arises from the yield curves that use data from double A-rated iBoxx bond indices produced by the International Index Company.

The expected return on assets as per provision of the revised IAS 19, has been set equal to the discount rate assumption, i.e. 4.00% pa.

The following table presents the major categories and reconciliation of the plan assets:

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Major categories of plan assets		
Cash instruments	10%	15%
Fixed interest	62%	49%
Equities	25%	29%
Other	3%	7%
Reconciliation of plan assets		
Market value at 1 January	9,382	7,788
Expected return	380	413
Contributions paid	3,952	1,067
Benefit pensions and lump sum paid to pensioners	(77)	(49)
Expenses	(51)	(50)
Asset gain	172	213
Fair value of plan assets	**13,758**	**9,382**

The actual investment return on assets of the Fund was 5.4%. The expected return on plan assets has been based on asset structure allowed by the Fund as well as the yield of high quality corporate bonds. The Bank estimate of contributions to be paid in 2014 will not materially differ from those paid in the current year.

The funding status at period end and at the end of the last four years was as follows:

Presented in EUR (000)	2013	2012	2011	2010	2009
Defined benefit obligations	13,879	12,381	7,935	7,095	5,967
Plan assets	(13,758)	(9,382)	(7,788)	(6,860)	(5,851)
Plan deficit (surplus)	121	2,999	147	235	116
Net experience adjustments on plan liabilities (assets)	**(443)**	**2,706**	**(809)**	**177**	**677**

Defined Contribution Scheme

The pension expense under this scheme was EUR 883 thousand (2012: EUR 845 thousand) and is included in “Personnel expenses”.

Greek State Social Insurance Fund

The pension expense of staff that is alternatively entitled to retirement benefits from this fund was EUR 91 thousand (2012: EUR 109 thousand) and is included in “Personnel expense”.

26. Operating Leases

The Bank has entered into lease contracts for its Headquarters and other premises. These are operating leases and include renewal options and periodic escalation clauses. There is no commitment at end of year for non-cancellable lease contracts. Rental expenses for the period included in “Other administrative expenses” totaled EUR 781 thousand (2012: EUR 831 thousand).

27. Related Parties

The Bank has the below related parties.

Key Management Personnel

Key management personnel comprise: the President, Vice Presidents and Secretary General. They are entitled to a staff compensation package that includes a salary, covered by medical insurance, participate in the Bank's retirement schemes and are eligible to receive other short-term benefits. The amounts paid to key management personnel during the period were EUR 1,203 thousand (2012: EUR 1,189 thousand). Key management personnel do not receive post employment benefits, other long-term benefits, termination benefits nor any share based payments.

The members of the Board of Directors are not personnel of the Bank and do not receive any fixed term salaries nor any staff benefits. The governments of the Member States are not related parties.

Special Funds

Special funds are established in accordance with Article 16 of the Establishing Agreement and are administered under the terms of rules and regulations adopted by the Bank. Special Funds are audited on an annual basis and their assets and fund balances are not included in the Bank's statement of financial position. During 2013, the Bank administered two special funds. Extracts from the audited financial statements are included under the "Summary of special funds".

28. Restatement Of Prior Year's Accounts

As of 1 January 2013, the revised IAS 19 now requires immediate recognition of all gains or losses in other comprehensive income, which is a part of Members' Equity, and therefore the 10% corridor option of IAS 19 for spreading gains or losses is no longer available. As such, net gains or losses are included in remeasurements, where any change in the effect of the asset ceiling, excluding amounts included in net interest, is also included. This change has been accounted for retrospectively and the comparative statements for 2012 have been restated to comply with the revised IAS 19.

Income Statement

Presented in thousands of EUR	Published	Restatements due to IAS 19	Restated
Interest income	45,699	-	45,699
Interest expense	(14,964)	-	(14,964)
Net interest income	30,735	-	30,735
Net fees and commissions	1,041	-	1,041
Net profit on sale of equity investments	19	-	19
Net gains from available-for-sale equity investments	3,350	-	3,350
Net gains from debt investment securities	(245)	-	(245)
Net (loss) income on foreign exchange	(1)	-	(1)
Other (expense) income	(18)	-	(18)
Operating income	34,881	-	34,881
Personnel expenses	(12,159)	33	(12,126)
Other administrative expenses	(3,309)	-	(3,309)
Depreciation and amortization	(529)	-	(529)
Income before impairment	18,884	33	18,917
Impairment (losses) on loans	(3,051)	-	(3,051)
Impairment (losses) on guarantees	(4)	-	(4)
Impairment gains (losses) on debt invest. securities	(899)	-	(899)
Net income for the year	**14,930**	**33**	**14,963**

Statement of Comprehensive Income

Presented in thousands of EUR	Published	Restatements due to IAS 19	Restated
Net income for the year	14,930	33	14,963
Other comprehensive income:			
Items that will not be reclassified subs. to profit/loss:			
Remeasurements of defined benefit liability(asset)		(2,967)	(2,967)
	-		
Items that may be reclassified subseq.to profit/loss:			
Net change in available-for-sale financial assets	2,068	-	2,068
Net amount transferred to profit or loss	-	-	0
Total comprehensive income for the year	**16,998**	**(2,934)**	**14,064**

Statement of Financial Position

Presented in thousands of EUR	Published	Restatements due to IAS 19	Restated
Assets			
Cash and cash equivalents	18,227	-	18,227
Debt investment securities:			
Available-for-sale	17,963	-	17,963
Held-to-maturity	182,500	-	182,500
Derivative financial instruments – assets	11,517	-	11,517
Loans	742,614	-	742,614
Less: deferred income	(6,694)	-	(6,694)
Less: impairment losses	(42,026)	-	(42,026)
Loans net of impairment	693,894	-	693,894
Equity investments available-for-sale	43,290	-	43,290
Property and equipment	699	-	699
Intangible assets	816	-	816
Other assets	14,677	(2,999)	11,678
Total Assets	**983,583**	**(2,999)**	**980,584**
Liabilities			
Borrowings	373,355	-	373,355
Payables and accrued interest	9,105	(759)	8,346
Total liabilities	382,460	(759)	381,701
Members' Equity			
Authorized share capital	3,494,085	-	3,494,085
Less: unallocated share capital	(1,177,397)	-	(1,177,397)
Subscribed share capital	2,316,688	-	2,316,688
Less: callable share capital	(1,623,876)	-	(1,623,876)
Less: payable share capital	(198,094)	-	(198,094)
Cumulative translation adjustment	(337)	-	(337)
Advance against future call	11	-	11
Paid-in share capital	494,392	-	494,392
Reserves	44,206	(2,304)	41,902
Retained earnings	62,525	64	62,589
Total members' equity	601,123	(2,240)	598,883
Total Liabilities and Members' Equity	**983,583**	**(2,999)**	**980,584**

29. Events After The Reporting Period

In February 2014, Albania has paid an amount of EUR 413 thousand against its share payment which related to a past due amount of EUR 434 thousand for the year 2013.

30. Summary Of Special Funds

With the Hellenic Government

The Technical Cooperation Special Fund's objective 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 is shown below.

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Statement of movements		
Balance brought forward	291	345
Net income for the year	-	1
Less: disbursements	(68)	(55)
Balance of available funds	**223**	**291**
Financial position		
Placements with other financial institutions	223	291
Total Assets	**223**	**291**
Unallocated fund balance	223	291
Total Liabilities and Contributor Resources	**223**	**291**

With the Development Bank of Austria

The Technical Cooperation Special Fund's objective is to cover reasonable technical cooperation activities in the Bank's member countries, with a strong potential to generate an opportunity for the Development Bank of Austria to co-finance a project in the private sector in connection with a technical cooperation activity. The movement in the Fund is shown below.

Presented in EUR (000)	At 31 December 2013	At 31 December 2012
Statement of movements		
Balance brought forward	318	332
Net income for the year	-	1
Less: disbursements	-	(15)
Balance of available funds	**318**	**318**
Financial position		
Placements with other financial institutions	318	318
Total Assets	**318**	**318**
Unallocated fund balance	318	318
Total Liabilities and Contributor Resources	**318**	**318**

Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Black Sea Trade and Development Bank (the "Bank") which comprise the statement of financial position as of 31 December 2013, the statements of income and comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

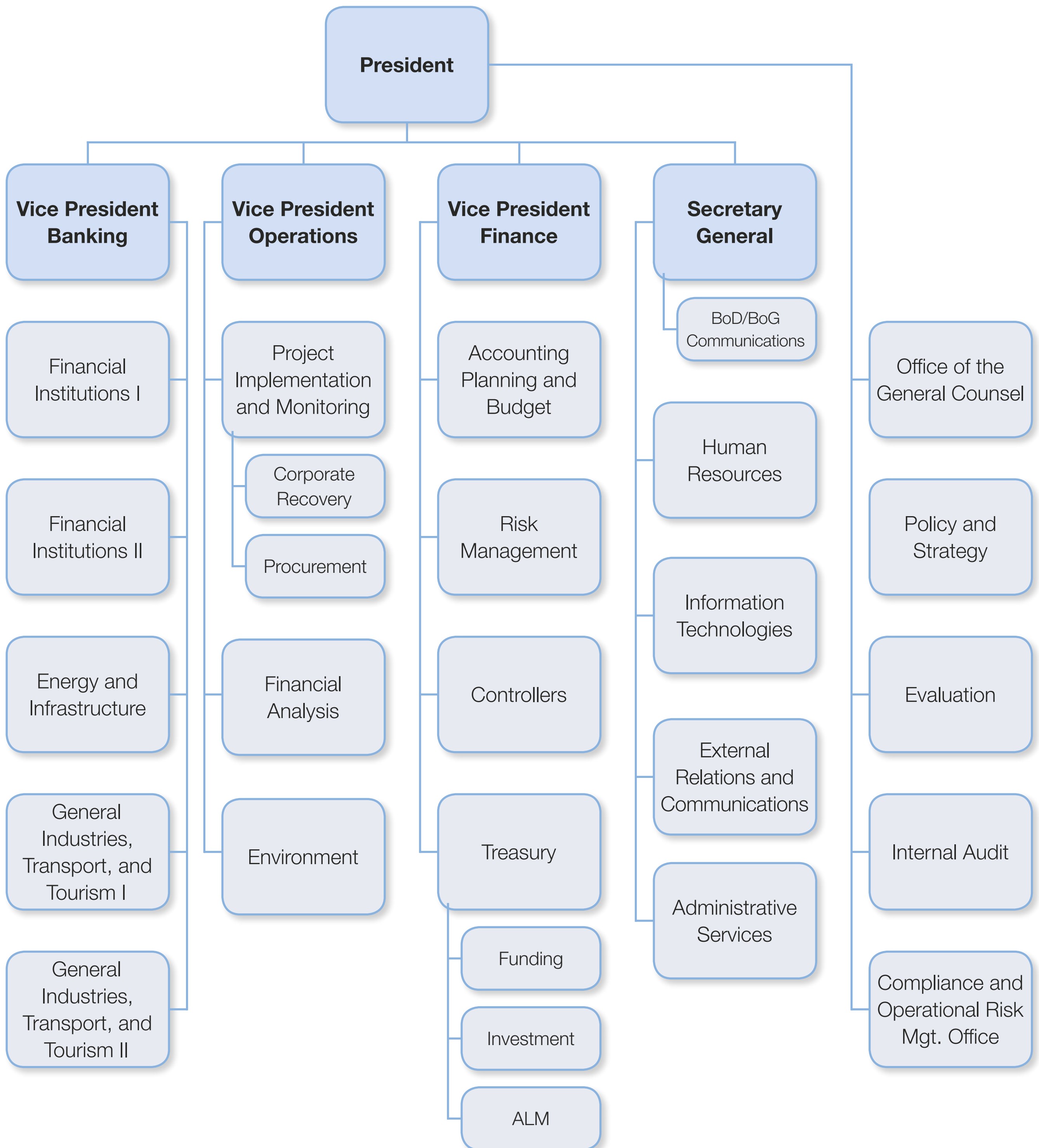
In our opinion, the financial statements give a true and fair view of the financial position of Black Sea Trade and Development Bank as of 31 December 2013 and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

12 April 2014

KPMG Certified Auditors A.E.
Athens, Greece

Annex A

Organizational Chart



As of 31 December 2013

Annex B

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