

**SOUTH CAUCASUS AND UKRAINE INITIATIVE**

# **THE NEED TO ADDRESS FINANCIAL MARKETS DEVELOPMENT IN THE REGION**

**Working Group on Financial Markets Development and  
Impact of Central Banks**

17 November 2009  
Warsaw, Poland



# The Need to Address Financial Markets Development

## Agenda

---

- 1. Financial Markets Development Challenges in the South Caucasus and Ukraine (SCU) region**
- 2. The OECD South Caucasus and Ukraine Initiative and way forward**

# PART 1: Financial Markets Development Challenges in the South

## Caucasus and Ukraine (SCU) region

---

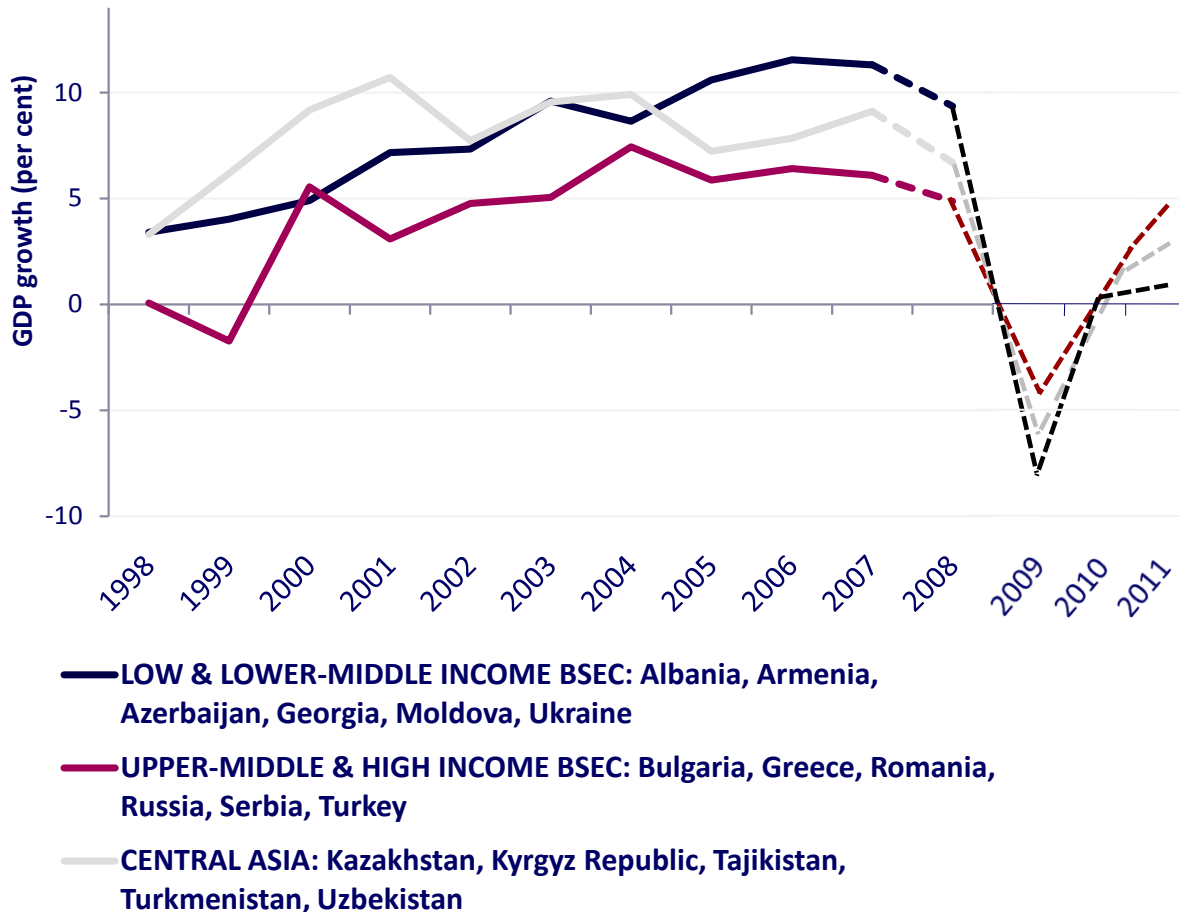
- **Challenging Economic Environment...**
- **... and Financial Markets Environment**
- **A focus on Access to Finance for SMEs**

# GDP growth in the region is impacted by the financial crisis

Average GDP growth falling in 2009

## Growth in BSEC-CA Countries

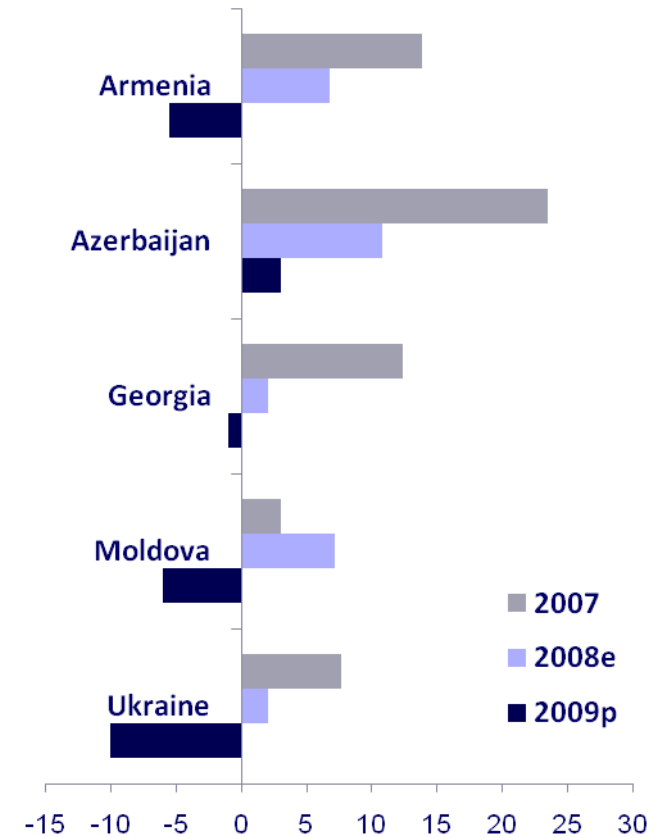
1998 - 2008



Source: OECD Development Centre / IMF forecast; BSEC. Black Sea Economic Cooperation

## GDP Growth

2007-2009

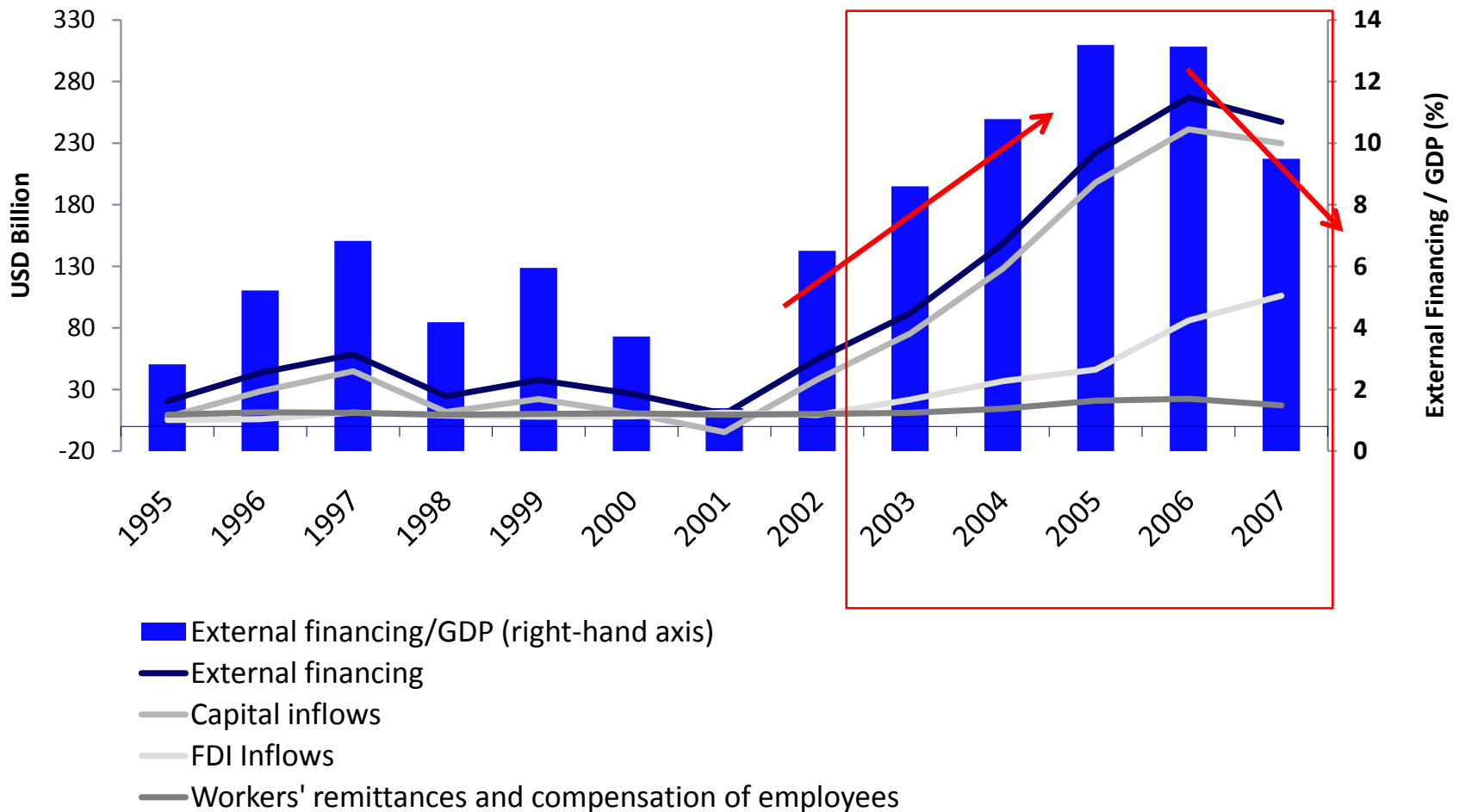


Source: EBRD; e. estimate; p. projection

# Reliance on external financing is increasing

On average 13% of GDP for BSEC region

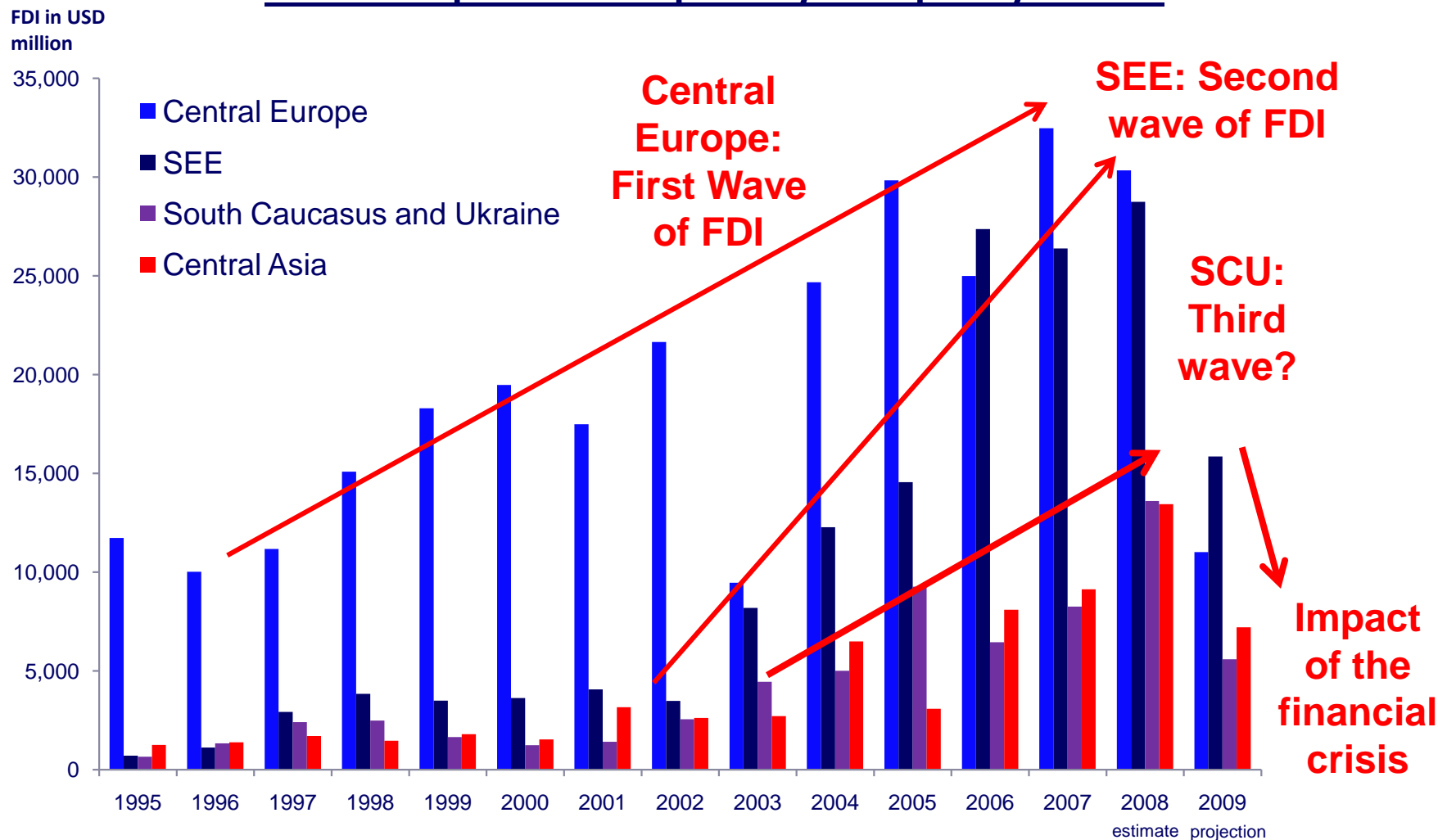
## External Financing - BSEC



# A measure of competitiveness: FDI growth is slowing down

## How to support the quality and quantity of FDI?

### How to improve both quantity and quality of FDI?



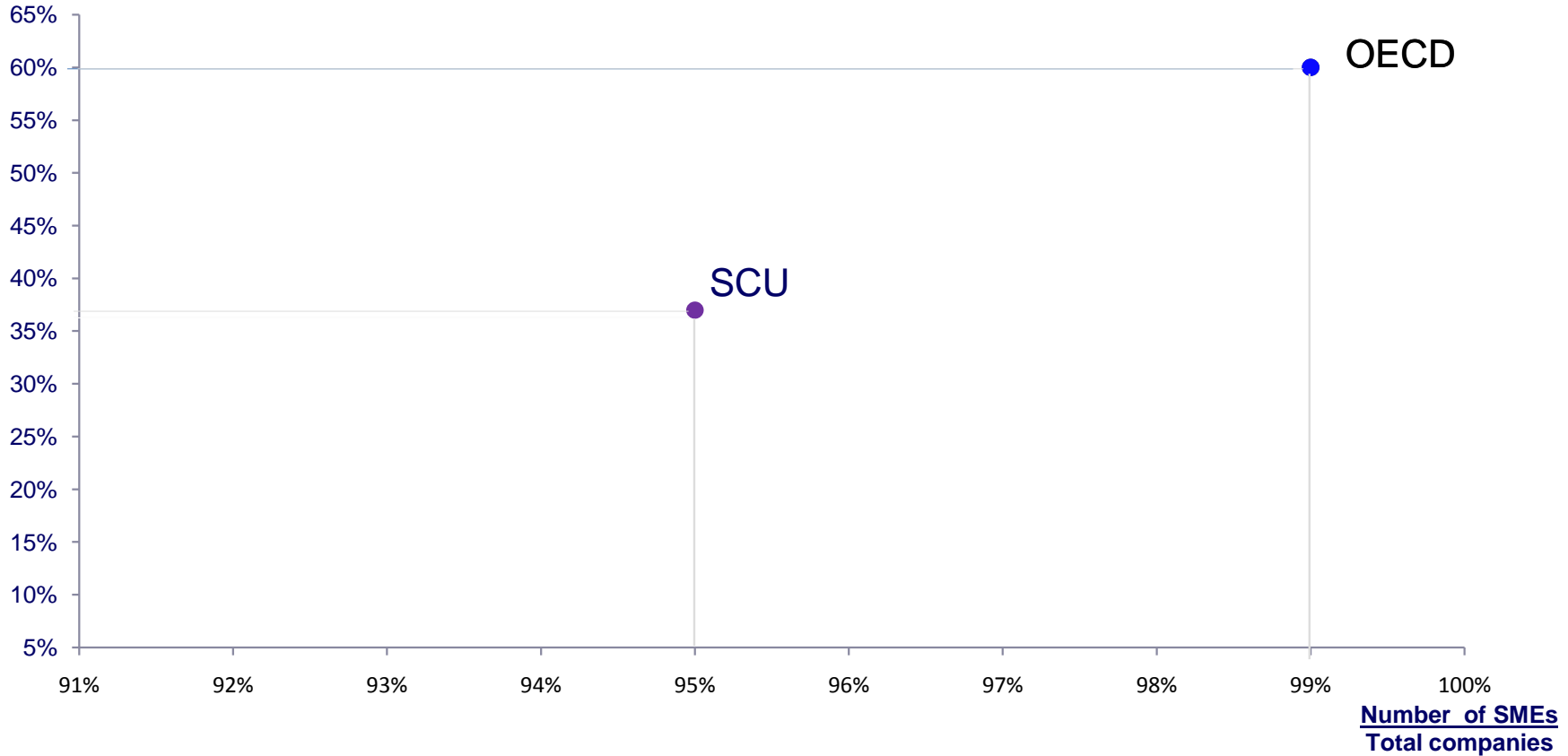
# A measure of private sector development: SME fragmented

Representing 95% of companies but 37% of GDP

## SMEs share of GDP and of total companies

Percentage, 2005

SMEs share of GDP  
Total GDP



Access to finance one of the key elements contributing to SME development

# PART 1: Financial Markets Development Challenges in the South

## Caucasus and Ukraine (SCU) region

---

- **Challenging Economic Environment...**
- **... and Financial Markets Environment**
- **A focus on Access to Finance for SMEs**



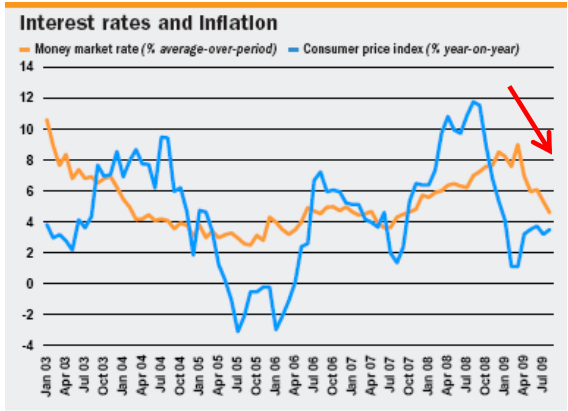
# Relative high cost of borrowing

Lately declining after the impact of the financial crisis

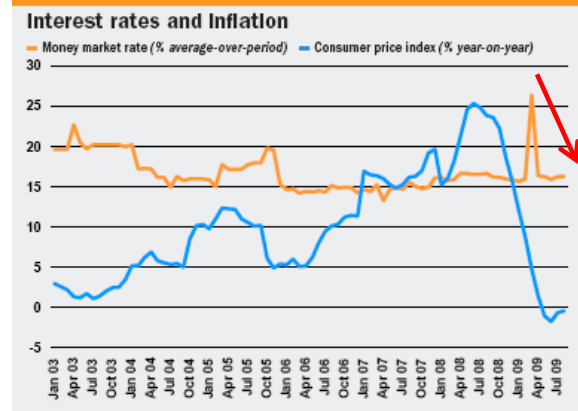
## Market interest rate

Weighted average across maturities

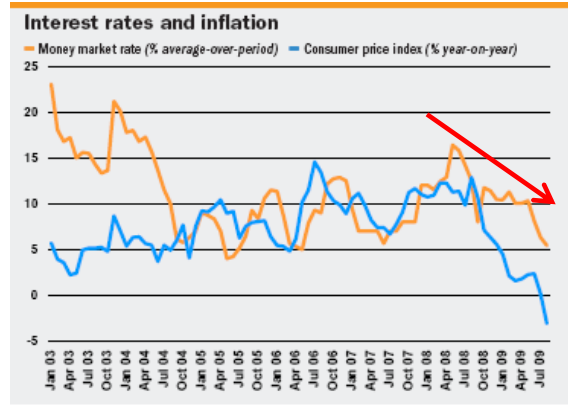
### Armenia



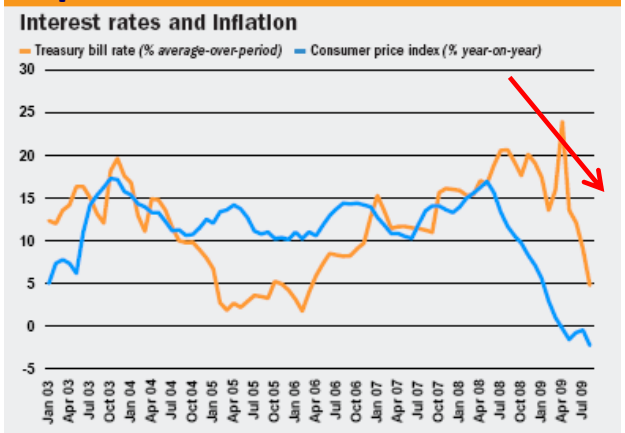
### Azerbaijan



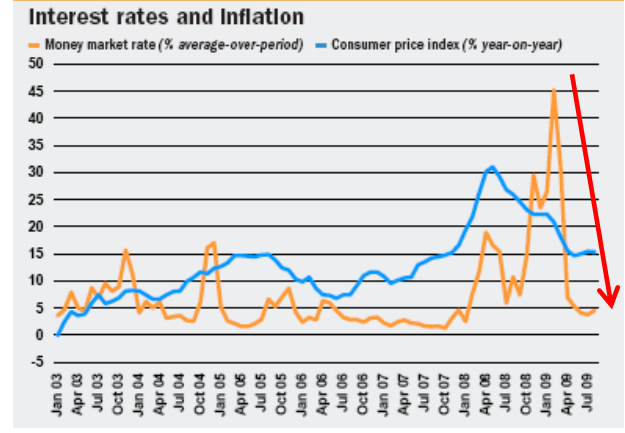
### Georgia



### Republic of Moldova



### Ukraine



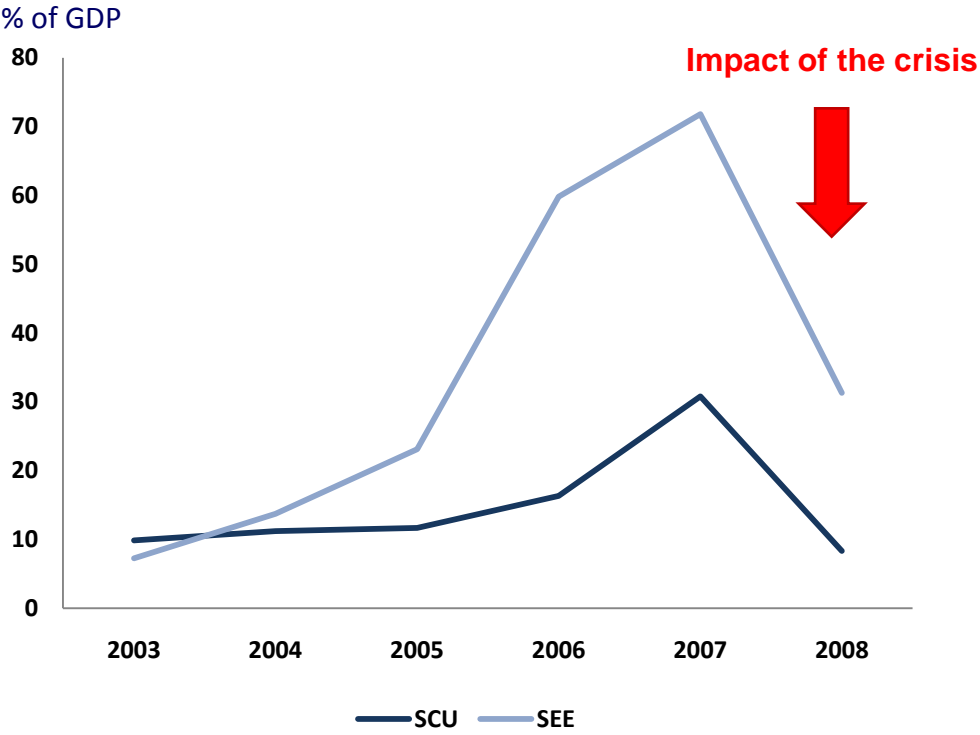
→ Trend

# Stock market capitalisation impacted by the financial crisis

However domestic credit to private sector increasing

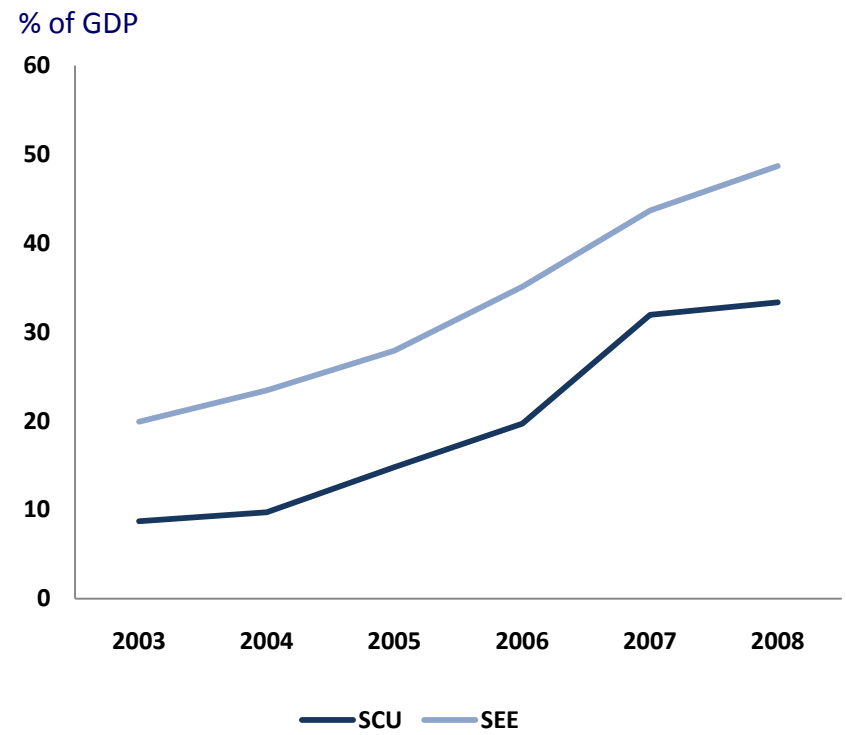
## Stock market capitalisation

As percent of GDP, 2003-2008



## Domestic credit to private sector

As percent of GDP, 2003-2008



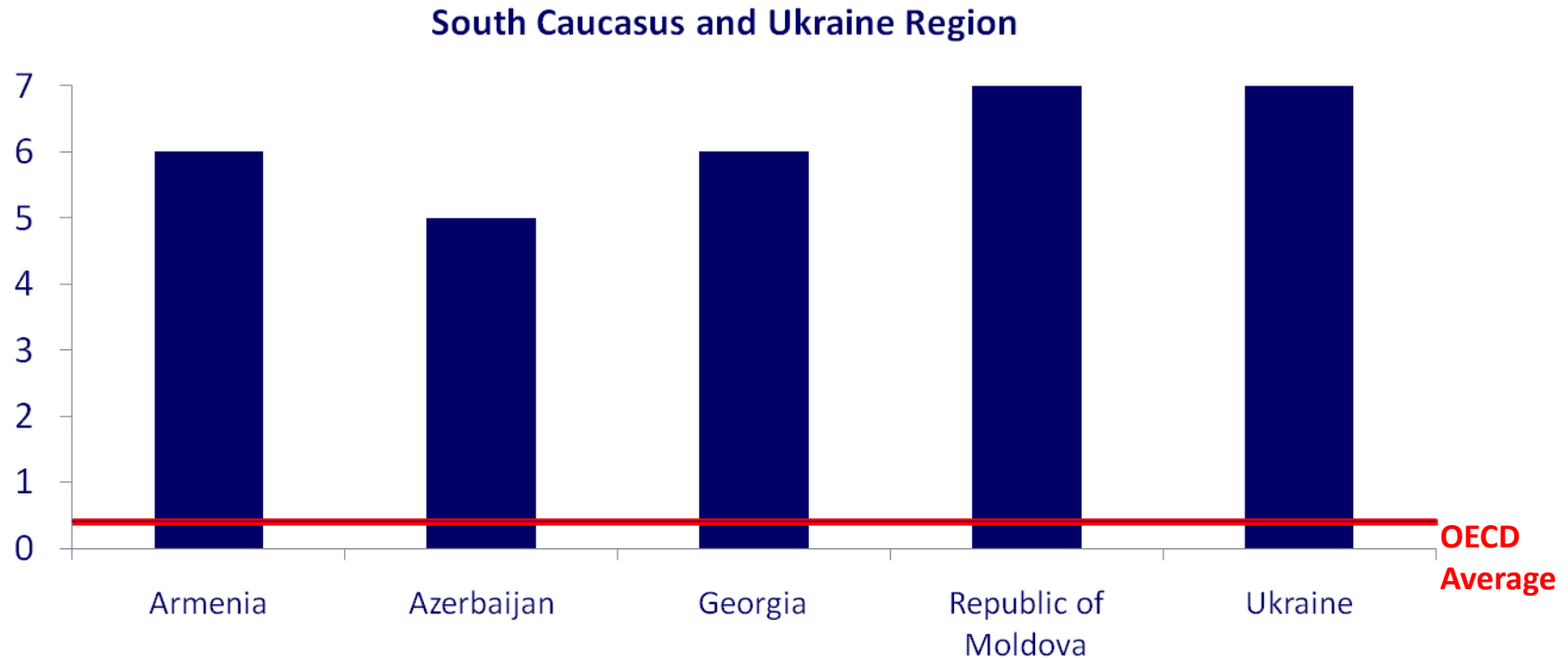
**On average, stock market capitalisation 30 percentage points lower in the SCU region.**

**On average, domestic credit to private sector 12 percentage points lower in the SCU region.**

SEE average based on data for Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Montenegro, Serbia

# High risk of not servicing external debt according to OECD export credits risk classification

## OECD Country Risk Classification under the arrangement on “Officially Supported Export Credits” (2008)



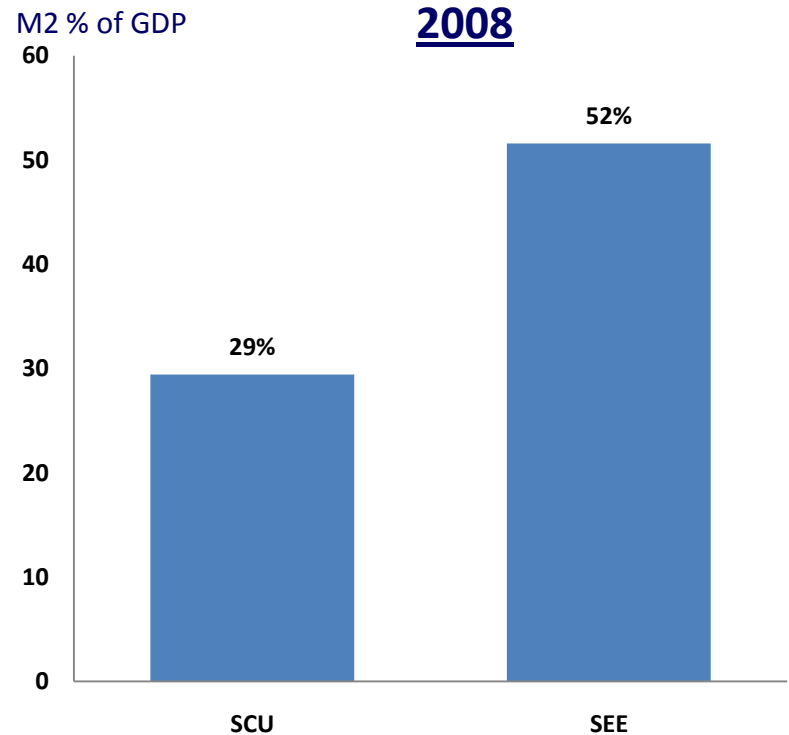
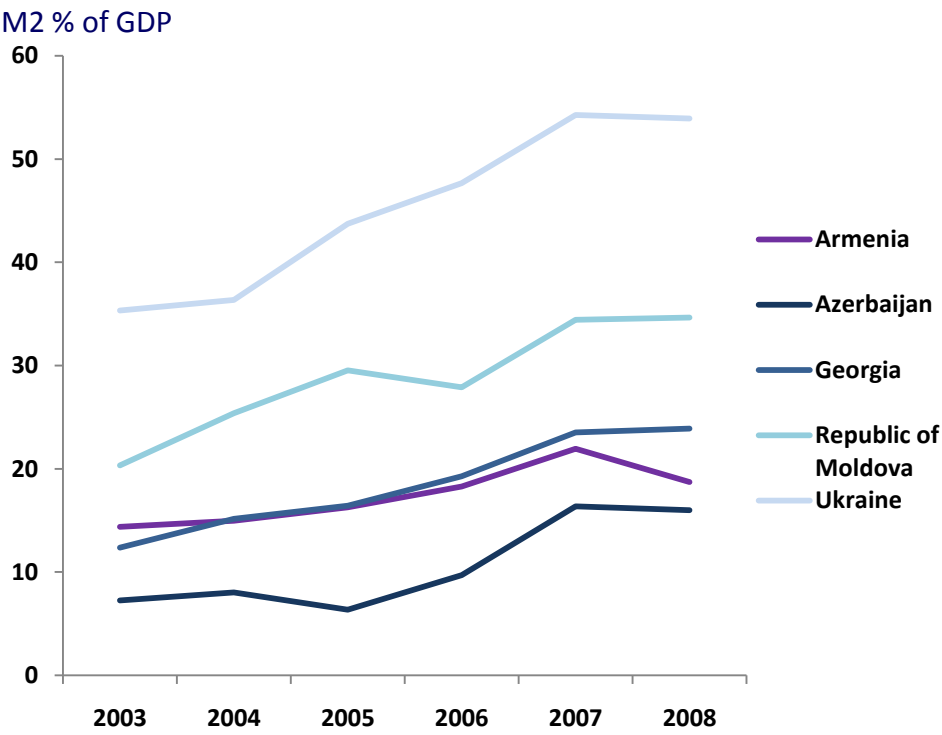
Measurement of likelihood that a country will service its external debt.

# Liquidity (Broad money share of GDP) is increasing

However remains lower than in South East Europe

## Broad Money M2

As percent of GDP, 2003-2008



**Broad money increase follows similar patterns throughout the SCU region .**

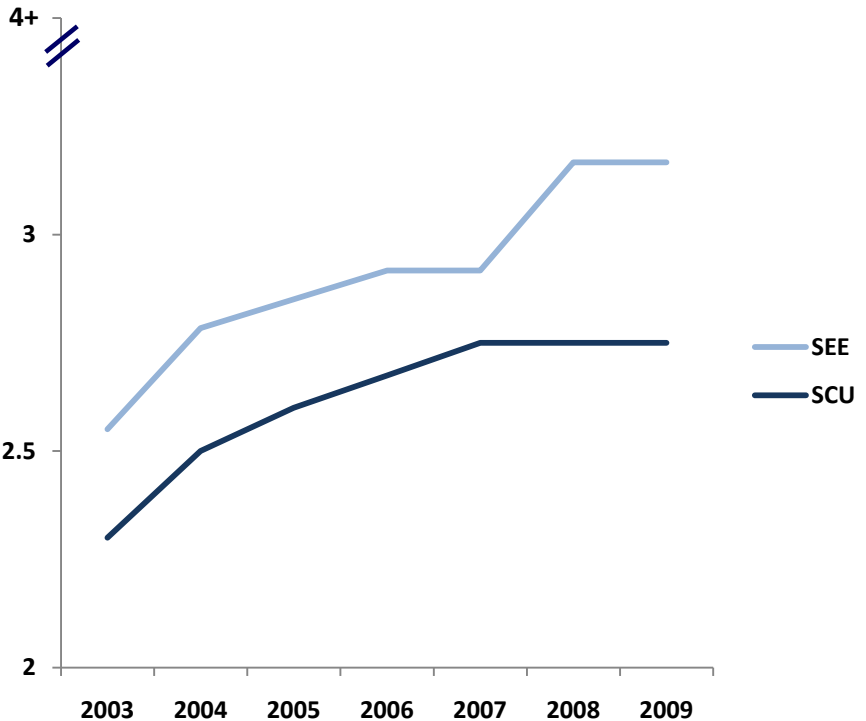
**In 2008 broad money is 23 percentage points lower than in the SEE region.**

Broad money is the sum of money in circulation outside banks and demand deposits other than those of the central government. It also includes quasi-money (time, savings and foreign currency deposits of the resident sectors other than the central government). Data sourced from the IMF, International Financial Statistics, IMF country reports and monetary authorities.

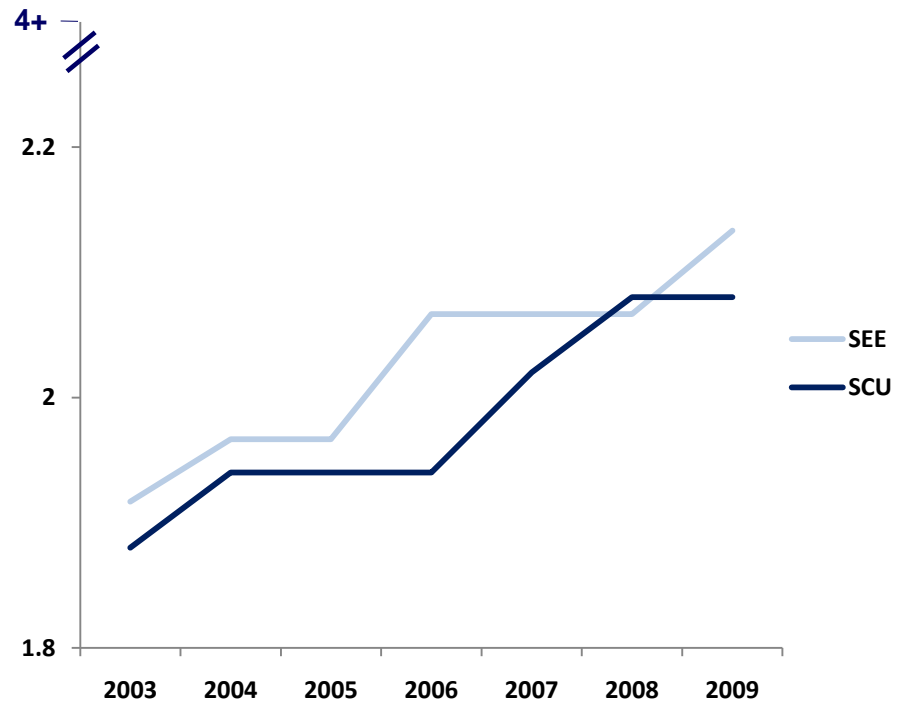
SEE average based on data for Albania, Bosnia and Herzegovina, Bulgaria, Kosovo, Montenegro, Romania, Serbia

# Level of reform improving for banking and non-banking sector although below SEE - according to EBRD Index

EBRD Index of banking sector reform



EBRD Index of reform of non-bank financial institutions



**SCU and SEE regions follow similar patterns.**

**SCU is closely aligned with the SEE region.**

The values of EBRD index range from 1.0 to 4.0+, with 1.0 indicating a rigid centralized economy and 4.0+ implying the highest level of reform, which corresponds to a fully industrialized market economy.

SEE average based on data for Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Montenegro, Serbia

# PART 1: Financial Markets Development Challenges in the South

## Caucasus and Ukraine (SCU) region

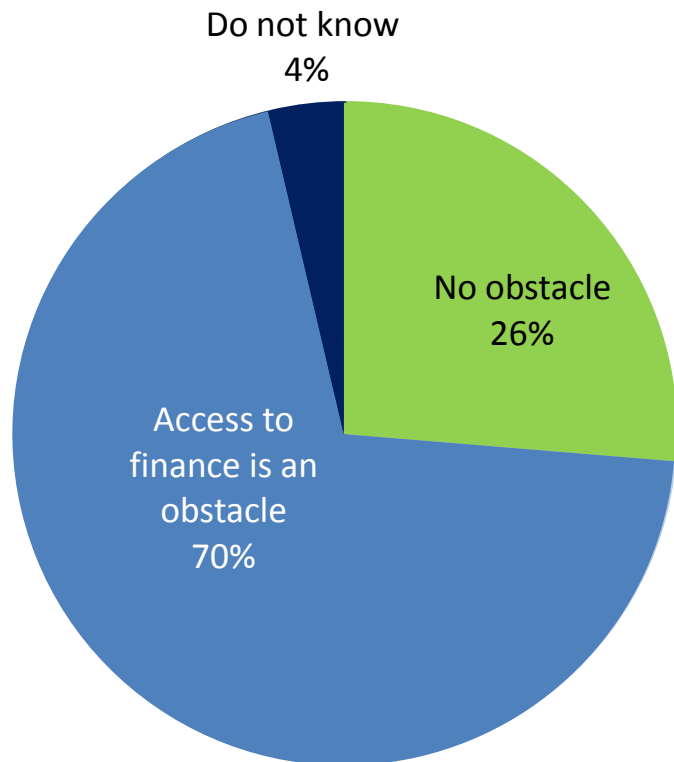
---

- **Challenging Economic Environment...**
  - **... and Financial Markets Environment**
- **A focus on Access to Finance for SMEs**

# Access to finance perceived as key obstacle to private sector development

## Is access to finance an obstacle for firms?

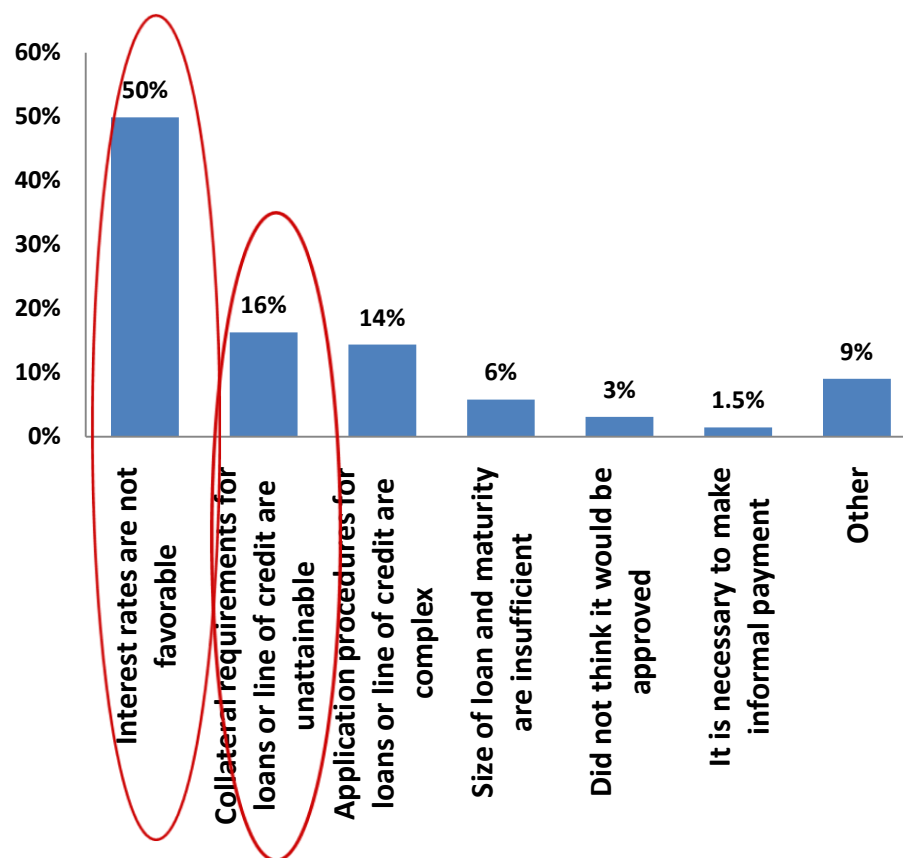
SMEs represent 80% of respondents, 2007



**70% of firms report access to finance as an obstacle to their business.**

## Why did the firm not apply for a loan?

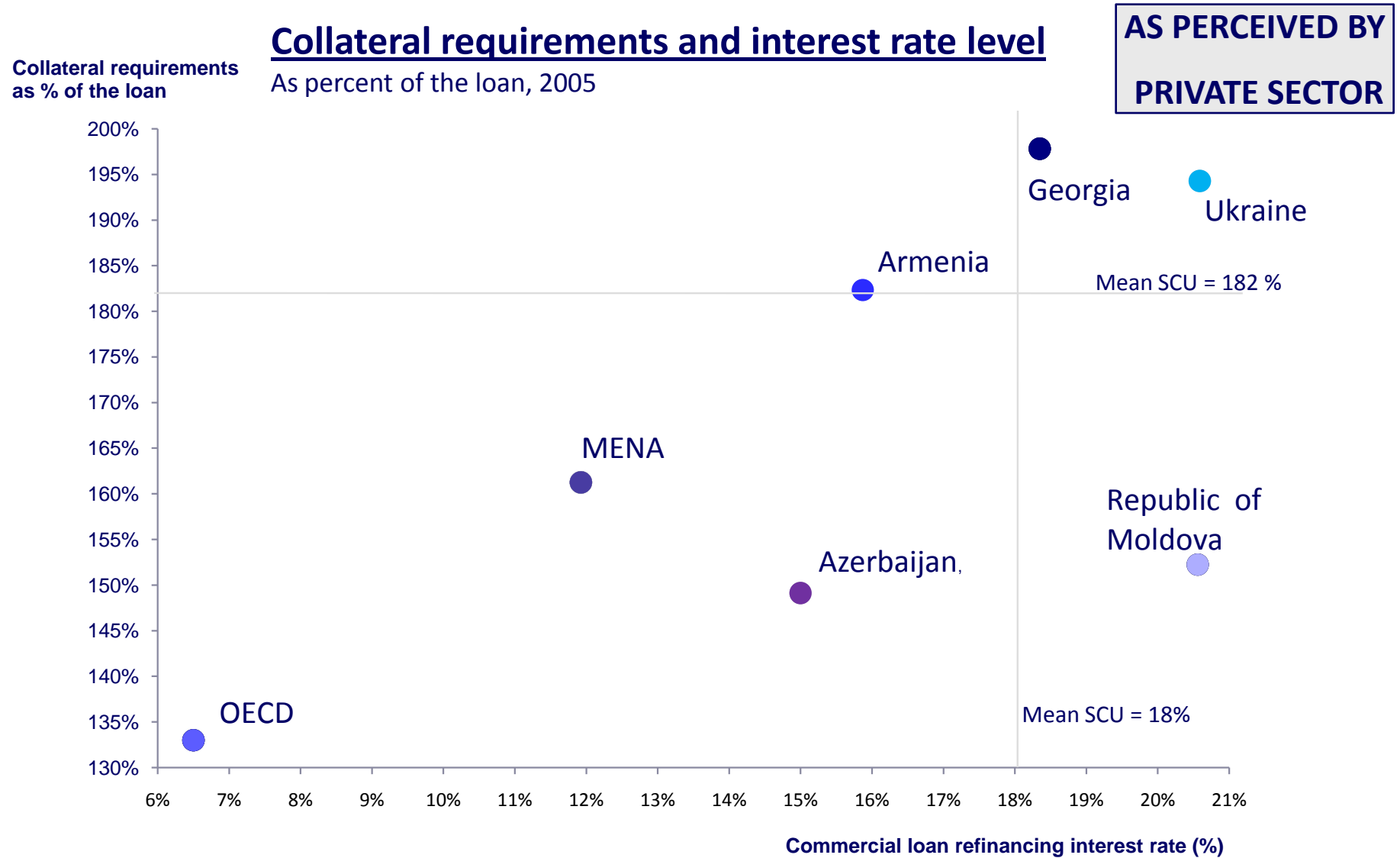
Percentage below includes only firms in need for a credit



**Interest rates and collateral requirements identified as the main barriers.**

# Higher barriers to access to credit than peers

Measured by collateral requirement and cost of borrowing





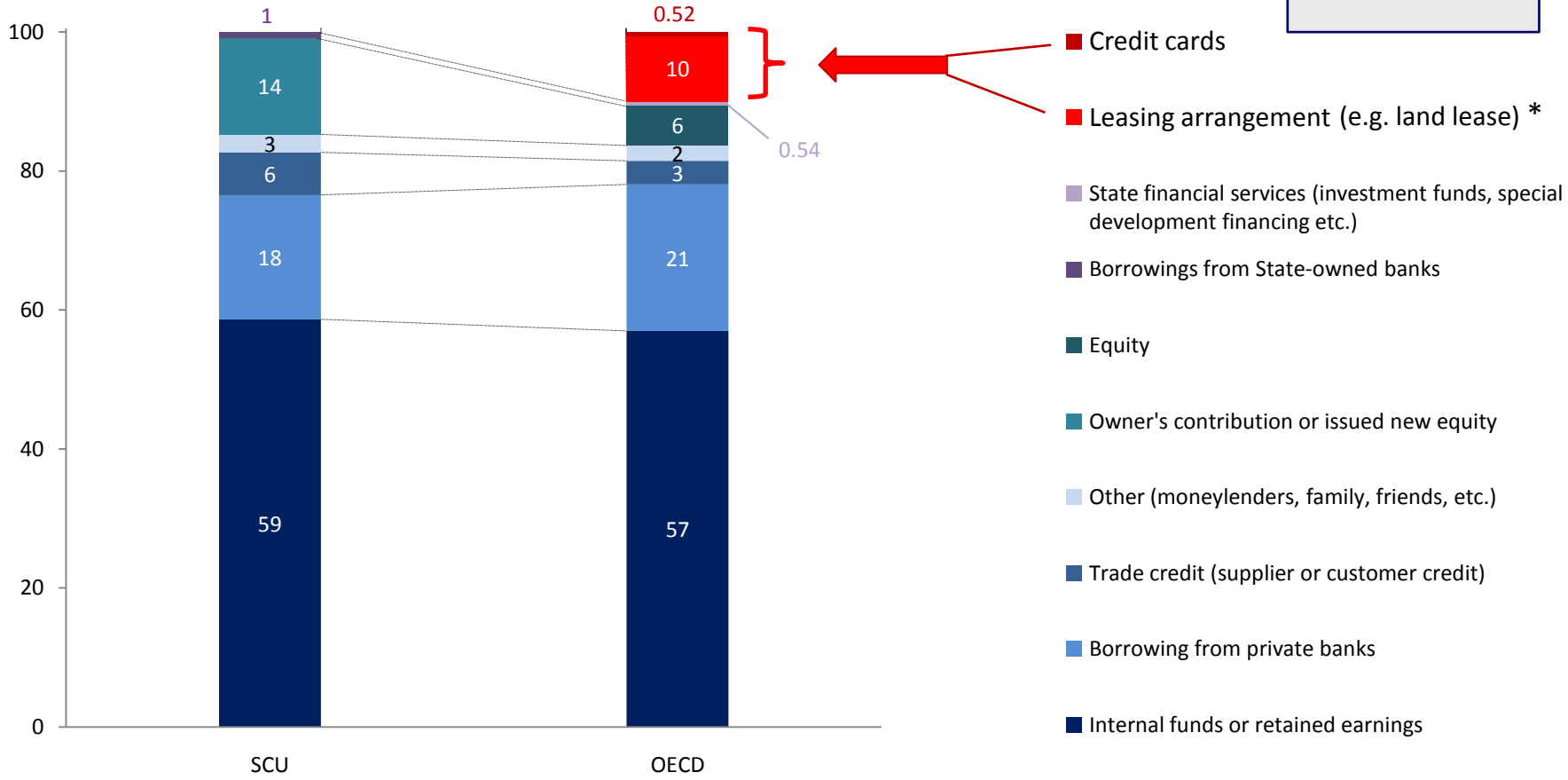
# Sources of financing could be further diversified in the SCU region

## Structure of financing for new investments

Percentage share, 2005, 2008

**INDICATIVE**

% share of a specific source in total structure of financing



**In the SCU region owner's contribution is one of the major sources of financing.**

\* Leasing arrangement: a contract granting use or occupation of property during a specified period in exchange for a specified rent.

# The Need to Address Financial Markets Development

## Agenda

---

**1. Financial Markets Development Challenges in the South  
Caucasus and Ukraine (SCU) region**

**2. The OECD South Caucasus and Ukraine Initiative and way  
forward**

# OECD Initiative for the South Caucasus and Ukraine

## Enhancing Regional Business Climate

- **Prioritisation of policies to improve the business climate**
- **Policy Working Groups**
- **Competitiveness report on the South Caucasus and Ukraine**

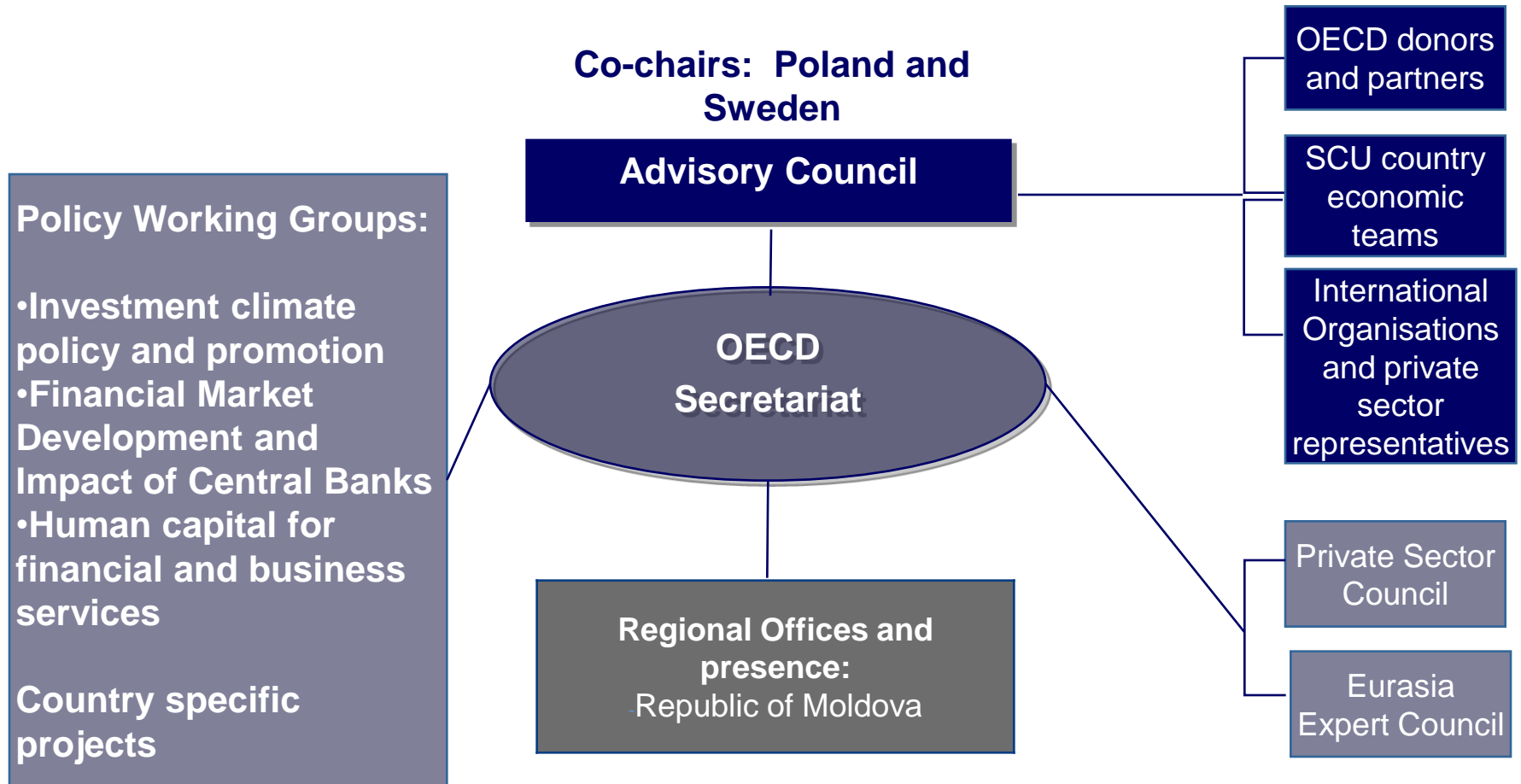
## Improving National Competitiveness

- **OECD Sector Competitiveness Strategy**
- **Surveys of investors and private sector perception**
- **Evaluation of policy reforms**
- **Supporting in implementing reforms**

## Building Capacity

- **Training and coaching focused on policy makers and SME business intermediaries**

# Governance: Strong collaboration with regional bodies and the private sector

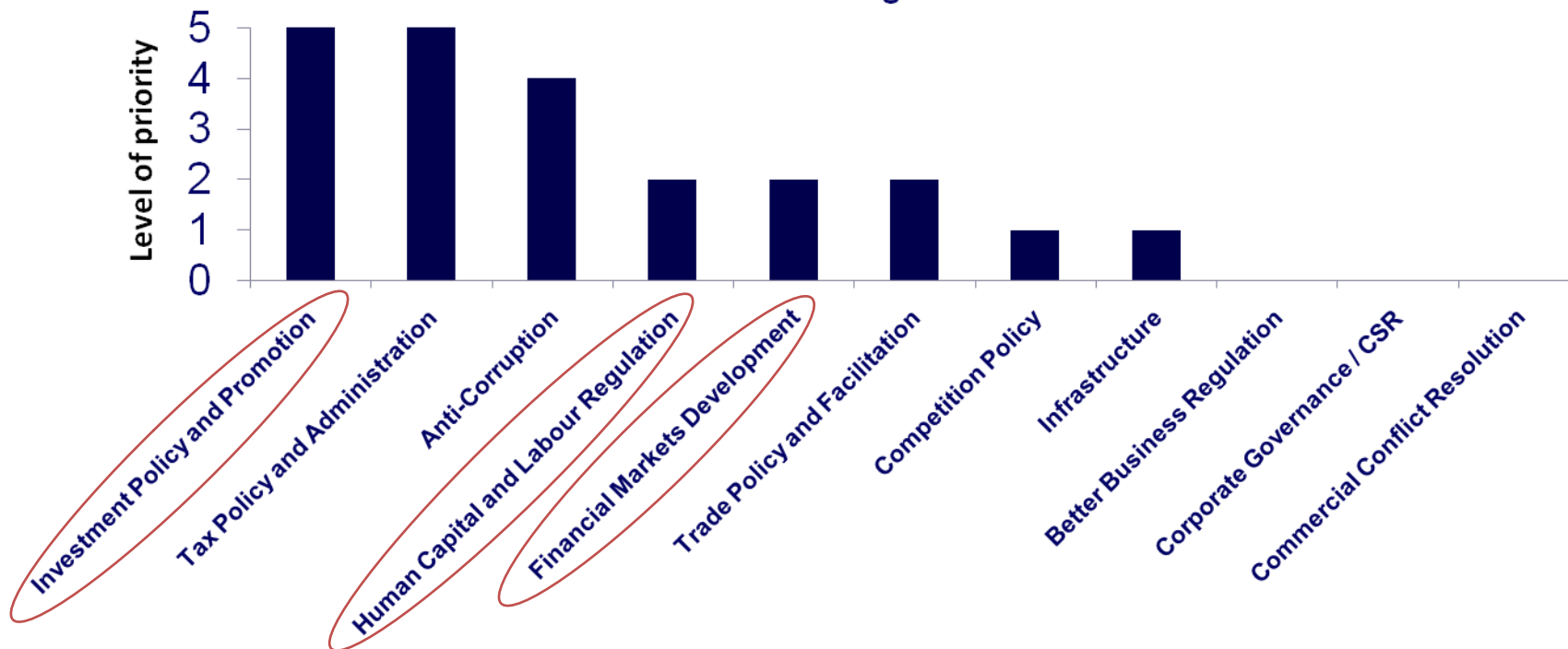


**Working group on FMD co-chaired by the Czech Republic  
Collaboration with EU Eastern Partnership**

# Determining policy priorities across the region

## PfC – SCU results overall

Which policy dimensions are of priority to improve investment, competitiveness and private sector development in the South Caucasus and Ukraine region?



**Financial Markets Development identified as one of the key policy priorities to support competitiveness**

# Financial markets development

## Four pillars to address policy reforms

### PfC – Financial Markets Development

Level 2 and 4

Initial focus

#### Institutional Framework

- Coordination of supervisory responsibilities
- Central Bank independence
- Capital Market Authority
- Off-shore Financial centres
- Financial sector openness
- Financial education

#### The Banking Sector

- Competition
- Foreign entry and ownership
- Basel capital adequacy requirements
- Domestic credit to Private Sector (as % of GDP)
- Non-Performing Loans
- Transaction technology infrastructure

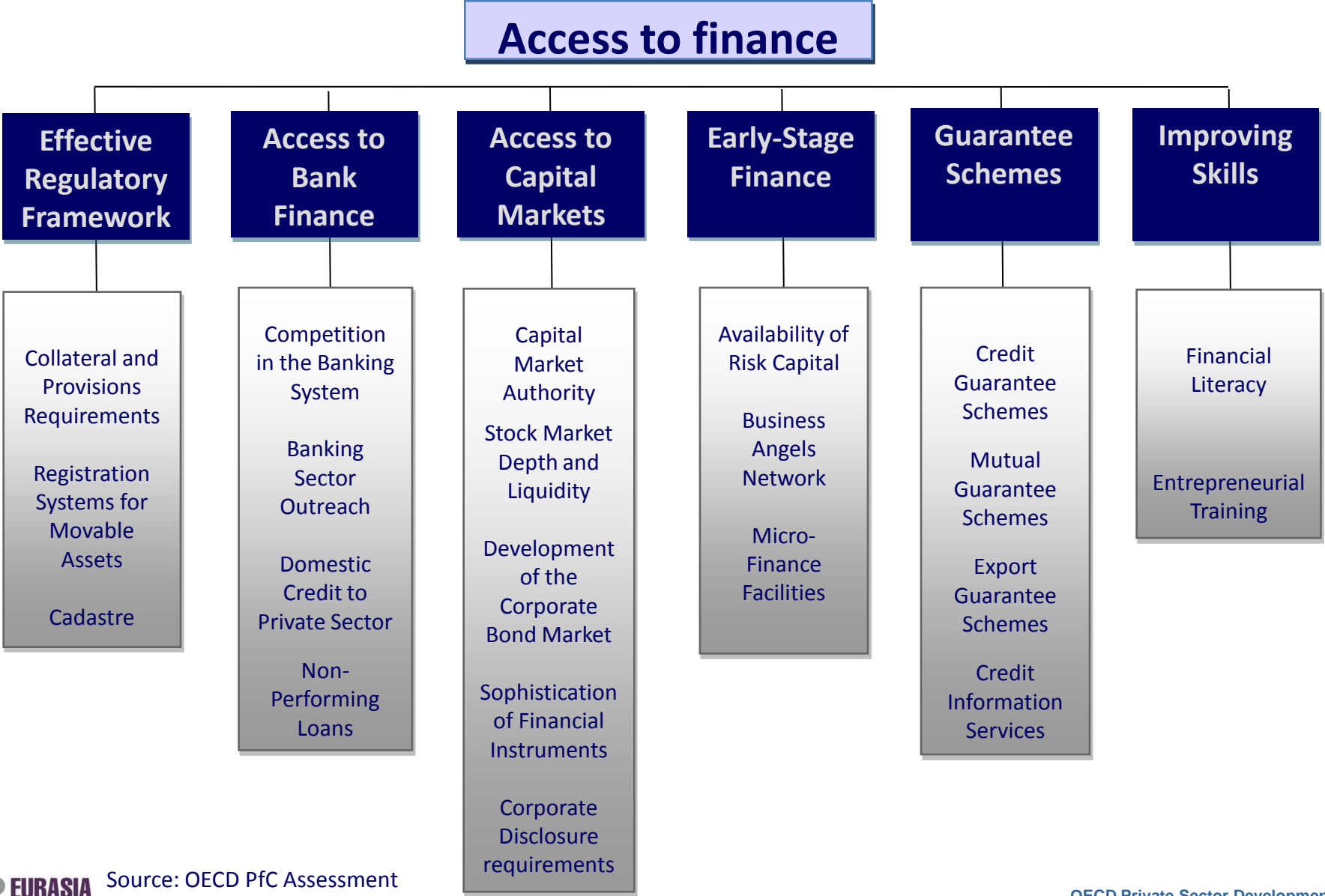
#### The Capital Markets

- Stock market depth and liquidity
- Sophistication of financial instruments
- Technical Infrastructure
- Development of the Corporate Bond Market
- Government benchmark curve

#### Access to Finance

- Credit guarantee schemes
- Collateral and provisioning requirements
- Cadastre
- Availability of risk capital
- Registration systems for movable assets
- Micro-finance facilities

# OECD Policies for Competitiveness Assessment Framework: Example for Access to Finance



# Example for Access to finance

## PfC – Access to Finance

Level 3 and 4

### 3 ACCESS to FINANCE

3.1 Effective Regulatory Framework

3.2 Access to Bank Finance

3.3 Access to Capital Markets

3.4 Early-Stage Finance

3.5 Guarantee Schemes

3.6 Improving Skills (Quality of Demand)



### 3.1 Effective Regulatory Framework

3.1.1 Collateral and provisions requirements

3.1.2 Registration systems for movable assets

3.1.3 Cadastre



### 3.1 Effective Regulatory Framework

	Level 1	Level 2	Level 3	Level 4	Level 5
3.1.1 Collateral and provisions requirements	Very high collateral requirements (more than 200%).  Restrictive collateral definition and/or rigid provisioning requirements for uncollateralised loans.	Collateral requirement ranging 150-200% of loan amount.  Restrictive collateral definition and/or rigid provisioning requirements for uncollateralised loans.	Flexible collateral definition and/or flexible provisioning requirements for loans under EUR 20 000.	Flexible collateral definition and/or flexible provisioning requirements for loans under EUR 20 000 and central collateral registry in place.	Flexible collateral definition and/or flexible provisioning requirements for loans under EUR 20 000 and central collateral registry covering most bank loans.

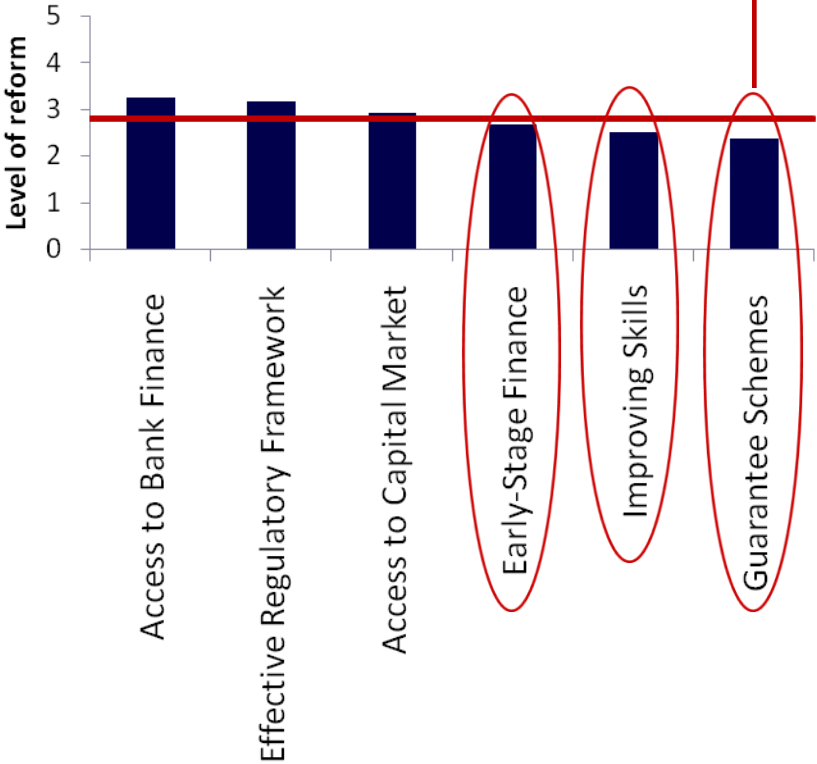


# PfC survey for SCU: Access to Finance identified as a key priority

Based on a sample of assessments completed by SCU countries, 2009

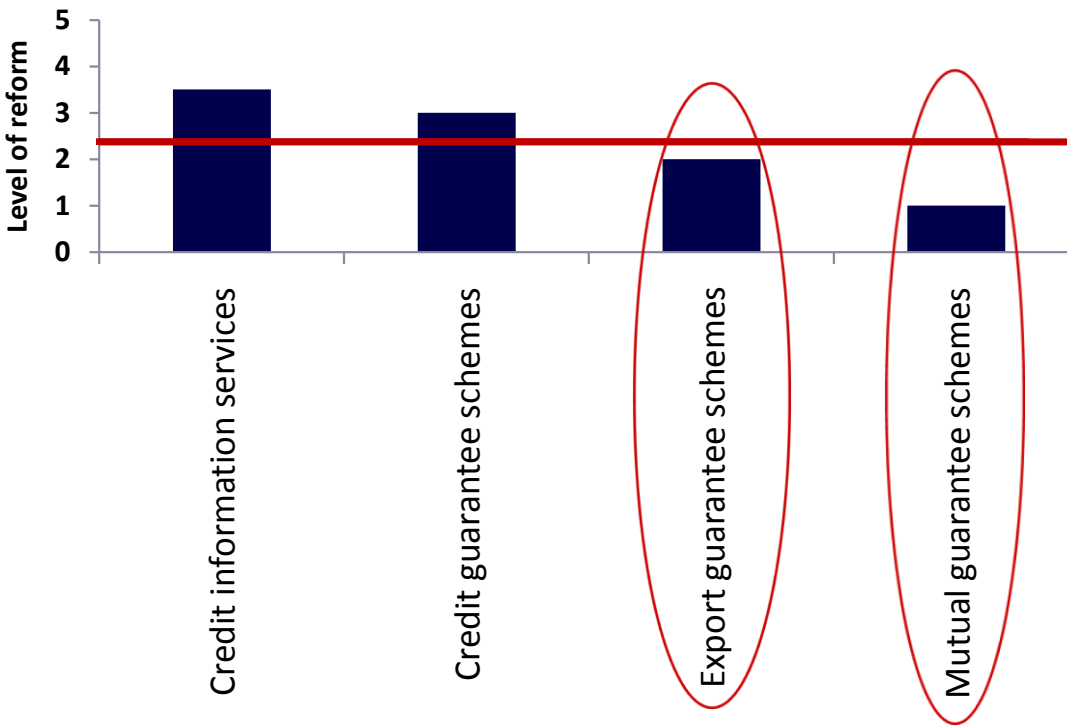
## Access to finance

Level 3



## Guarantee Schemes

Level 4



**Guarantee schemes, improving skills and early-stage finance identified as top priorities.**

**Mutual guarantee schemes and export guarantee schemes identified as priority sub-sectors to address.**

# Example of next steps: Monitoring the evolution of policy reforms for private and banking sectors

## OECD SME Policy Index 2009: Access to Finance

Example for South  
East Europe

### Scores for sub-dimension : Access to finance

		ALB	BIH	HRV	XK	MK	MNE	SRB
Credit guarantee schemes	2009	3.00	2.00	3.00	2.00	5.00	2.00	3.00
	Change since 2007	+0.50	0.00	-0.50	0.00	+1.50	0.00	0.00
Collateral and provisioning requirements	2009	4.00	5.00	4.00	2.00	3.00	2.00	3.00
	Change since 2007	+2.00	+3.50	+0.50	0.00	-1.00	0.00	+0.50
Laws and procedures on distressed companies	2009	3.00	4.00	4.00	3.00	3.00	4.00	4.00
	Change since 2007	0.00	+0.50	0.00	+2.00	0.00	0.00	0.00
Cadastre	2009	3.00	3.00	4.50	3.00	3.00	4.50	3.00
	Change since 2007	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Leasing industry	2009	4.00	3.00	4.00	2.00	4.00	4.00	5.00
	Change since 2007	+1.00	+1.00	0.00	0.00	0.00	0.00	0.00
Venture capital/equity funds	2009	2.00	4.00	4.00	1.00	4.00	3.00	3.00
	Change since 2007	0.00	+0.50	0.00	0.00	0.00	-1.00	+0.50
Registration systems for movable assets		3.00	3.75	3.00	2.25	3.00	3.75	3.75
Credit information services		3.00	3.75	2.25	1.50	1.50	3.00	3.75
Overall weighted average for sub-dimension 7.2: Access to finance	2009	<b>3.50</b>	<b>4.25</b>	<b>3.75</b>	<b>2.50</b>	<b>3.25</b>	<b>3.75</b>	<b>4.00</b>
	Change since 2007	+0.75	+1.50	-0.25	+0.50	-0.25	+0.25	+0.75