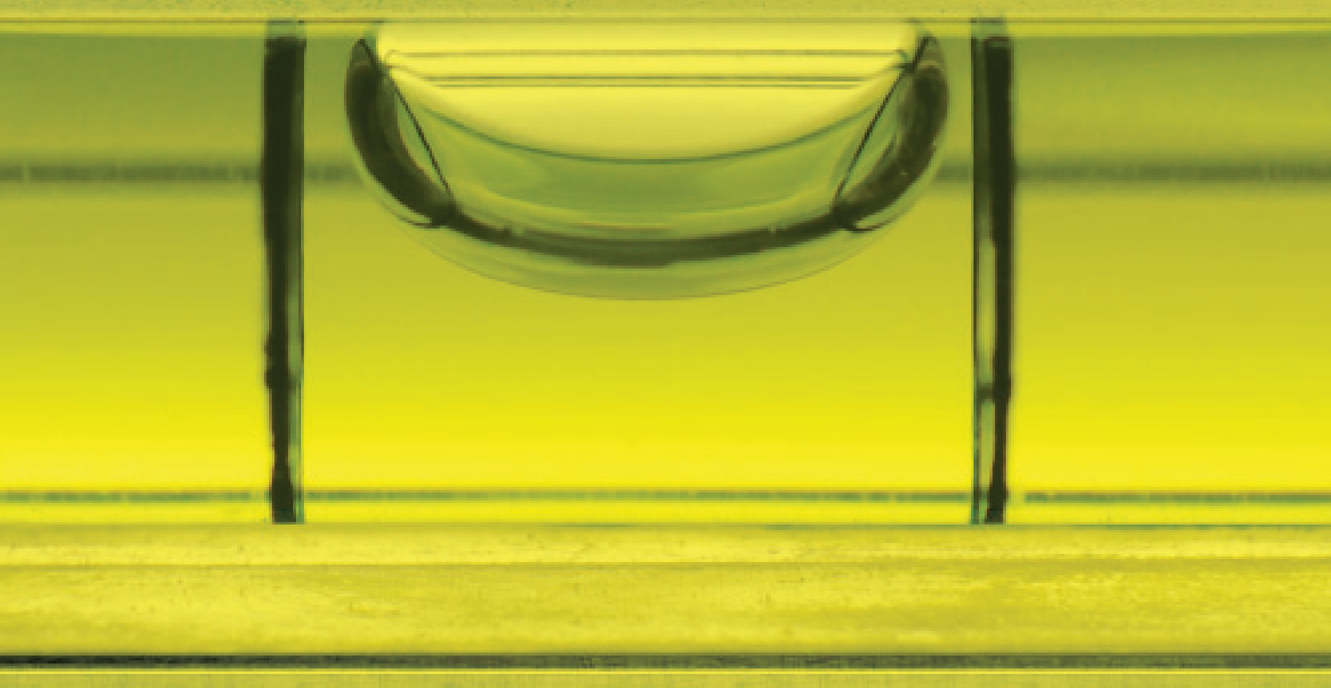
TRANSITION REPORT 2015-16 DIGEST

European Bank
for Reconstruction and Development

REBALANCING FINANCE



AN ESSENTIAL GUIDE TO THIS YEAR'S REPORT

ABOUT THE TRANSITION REPORT

The EBRD seeks to foster the transition to an open market-oriented economy and to promote entrepreneurship in the countries where it invests. To perform this task effectively, the Bank needs to analyse and understand the process of transition. The purpose of the *Transition Report* is to advance this understanding and to share our analysis with partners.

The responsibility for the content of the publication is taken by the Office of the Chief Economist. The assessments and views expressed are not necessarily those of the EBRD. All assessments and data are based on information as of early October 2015.

A full version of the *Transition Report 2015-16* is available at **tr-ebrd.com**

REBALANCING FINANCE
Diversifying funding to foster growth

It has been almost a decade since the *Transition Report* last looked in detail at the EBRD region's financial sectors. In that time, the global financial system has undergone major changes, particularly in the countries where the EBRD invests.

This report looks at the evolution of finance in the transition region following the crisis of 2008-09 and considers the question of how finance should be rebalanced to provide more diverse and stable funding flows in support of economic development.

The four chapters in this *Transition Report* argue that the financial system needs to be rebalanced in a number of ways in order to provide more diverse sources of funding in support of growth. Equity financing, in particular, needs to play more of a role.

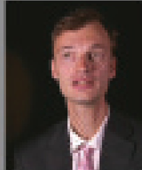
This report does not seek to cover all major areas of finance, as that would be impossible to do in any depth. Instead, it focuses on a few specific issues and is very much forward-looking.

Hans Peter Lankes
Acting Chief Economist
EBRD

REBALANCING FINANCE AND BOOSTING INVESTMENT

123%
DEBT-TO-GDP RATIO OF THE REGION'S NON-FINANCIAL SECTOR

25
PERCENTAGE POINTS
INCREASE IN THAT DEBT-TO-GDP RATIO BETWEEN 2007 AND 2014



“”
PHYSICAL INVESTMENT HAS DROPPED SIGNIFICANTLY SINCE THE CRISIS…IN FACT, THE LEVELS HAVE BEEN BELOW THOSE OF SIMILAR COUNTRIES.

http://bit.ly/1OKomcp

The global financial crisis has triggered a dramatic reduction in external imbalances in the transition region, but this rebalancing has come at the expense of investment. The region needs to invest around US$ 75 billion more per year to bring investment back to the levels expected of economies at this stage of development. However, despite those lower levels of investment and the credit crunch, the debt of the non-financial sector in the region has actually increased. Meeting those additional investment needs will require financial sector rebalancing, with greater use of equity instruments, resolution of non-performing loans and more diverse cross-border funding.

AROUND
US$75
BILLION
A YEAR CONSERVATIVE ESTIMATE OF THE REGION'S ADDITIONAL INVESTMENT FINANCING NEEDS

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SMALL BUSINESSES AND THE CREDIT CRUNCH

Credit conditions for small businesses have tightened significantly in recent years, both during and after the global financial crisis. Structural adjustments in banking systems – particularly reduced reliance on cross-border and wholesale funding – explain a large part of this tightening. The composition of local banking markets also plays a role since small businesses are more likely to borrow from banks that have less hierarchical lending procedures, a greater focus on building relationships with clients and more confidence in local courts. Access to credit may therefore benefit from both stronger legal enforcement and more effective and efficient bank lending techniques.

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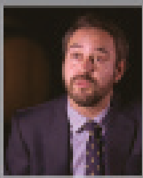
THE PERCENTAGE OF CREDIT-CONSTRAINED FIRMS RANGES FROM JUST 13 IN TURKEY TO

85%

IN EGYPT

48%

OF CREDIT-CONSTRAINED FIRMS ARE DISCOURAGED FROM APPLYING FOR LOANS BECAUSE INTEREST RATES ARE TOO HIGH



“”
THERE IS A HUGE DIFFERENCE IN THE INTENSITY OF THE IMPACT OF THE CRISIS ON SMEs.

http://bit.ly/1GW2Yc4

51%

OF FIRMS REPORTING A NEED FOR CREDIT IN THE 2013-14 BEEPS SURVEY WERE UNABLE TO OBTAIN IT – UP FROM 34% IN 2005

Private equity can generate both financial value for investors and economic value for the companies involved. Despite the strong growth of private equity globally, the transition region receives only a small share of these global flows. Compared with advanced economies, private equity funds in the transition region rely less on debt financing and more on selecting high-growth companies and implementing operational improvements to create value.

76%
SHARE OF GROWTH AND VENTURE CAPITAL IN THE EBRD REGION BY NUMBER OF DEALS BETWEEN 2009 AND 2014 INVESTED IN PRIVATE EQUITY

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1%
OF GLOBAL PRIVATE EQUITY IS INVESTED IN THE EBRD REGION

TRENDS AND VALUE CREATION IN PRIVATE EQUITY

BETWEEN 2008 AND 2014 PRIVATE EQUITY CAPITAL INVESTED IN THE EBRD REGION TOTALLED

US$21.4 BILLION

“”

PRIVATE EQUITY IS AN UNDERUTILISED SOURCE OF FINANCE FOR COMPANIES IN THE EBRD REGION.

http://bit.ly/1jCllwT

PRIVATE EQUITY AS A SOURCE OF GROWTH

Private equity funds in the transition region not only target companies with high growth rates but also assist their growth by implementing operational improvements. They also relax companies' credit constraints and increase both employment and physical investment. The transition region is home to a sizeable pool of companies that could potentially benefit from these positive growth effects associated with private equity investment. However, in order for a larger segment of the economy to reap the benefits of private equity investment, policy-makers need to address a number of institutional constraints.

THE TOTAL VOLUME OF ADDITIONAL PRIVATE EQUITY CAPITAL THAT THE EBRD REGION COULD POTENTIALLY ATTRACT IS

US$30.5 BILLION

ON AVERAGE

30

ADDITIONAL JOBS ARE CREATED BY EACH COMPANY IN THE EBRD REGION THAT RECEIVES PRIVATE EQUITY INVESTMENT

"PRIVATE EQUITY…CAN HELP TO BOOST INVESTMENT LEVELS IN THE REGION AGAIN."

http://bit.ly/1Mb0azp

18%

AVERAGE ANNUAL REVENUE GROWTH OF INVESTEE COMPANIES IN THE EBRD REGION PRIOR TO RECEIVING PRIVATE EQUITY FINANCING

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READ THE FULL REPORT IN ENGLISH OR RUSSIAN ON OUR RESPONSIVE, DUAL-LANGUAGE MICROSITE
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MACROECONOMIC OVERVIEW

Over the past year the economic outlook in the transition region has been shaped by a significant decline in the price of oil, persistent geopolitical uncertainty, the launch of a quantitative easing programme in the eurozone and the ongoing crisis in Greece. Although economic growth in many commodity-importing countries has picked up, average growth in the region has been weighed down by the negative shocks faced by Russia, other commodity exporters and countries with strong economic ties to Russia. As a result, the annual growth rate of the transition region as a whole is projected to decline for the fourth consecutive year in 2015.

IN 2014 THE ANNUAL GROWTH RATE IN THE TRANSITION REGION WAS

1.9%

DOWN FROM 2.3% IN 2013

AROUND

40%

DECLINE IN REMITTANCES FROM RUSSIA TO CENTRAL ASIA, THE CAUCASUS AND MOLDOVA IN US DOLLAR TERMS IN THE FIRST HALF OF 2015

STRUCTURAL REFORM

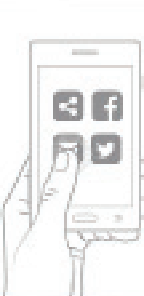
While the political and economic environment remains challenging, the outlook for market reforms appears to have improved. There are opportunities for reform in many sectors and countries that could help to bring economic structures and institutions more into line with those of advanced market economies. However, many transition countries still lag behind best practices when it comes to promoting the sustainable use of resources and inclusion.

POSITIVE DEVELOPMENTS IN SECTOR-LEVEL TRANSITION INDICATORS OUTNUMBER NEGATIVE DEVELOPMENTS BY

30 TO 8

COMPARED WITH THE NEGATIVE OVERALL TREND LAST YEAR

MORE CONTENT AVAILABLE ONLINE



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COUNTRY ASSESSMENTS

The digital *Transition Report* contains a country-by-country review of reform progress and macroeconomic developments for 36 countries in the EBRD transition region from mid-2014 to the third quarter of 2015. It also includes sector transition indicators and a brief table of macroeconomic indicators for each country, as well as forecasts and key priorities for 2016. The "cut-off" date for data and other information was early October 2015.

More detailed data, both historical and current, covering structural, institutional and macroeconomic developments are available on the EBRD website at www.ebrd.com/economic-research-data

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