
Analysis of the Financial

Sector

Armenia, Azerbaijan and Georgia

*Prepared for OeEB by Business and Finance Consulting GmbH
Zürich, August 2009*



Study: Identification of Potential OeEB Clients in the Financial Sector in Georgia, Armenia and Azerbaijan

Assessment of the Enabling Environment



Business & Finance Consulting

Address: Max-Högger-Strasse 6
CH-8048 Zürich, Switzerland
Phone: (+41 44) 784-22-22
Fax: (+41 44) 784-23-23
Email: info@bfconsulting.org
Website: www.bfconsulting.org

August 1, 2009

Table of Contents

Table of abbreviations	II
Currency conversion rates	IV
Preface.....	i
Part I: Economic Overview	1
1. Economic overview: Armenia	2
2. Economic overview: Azerbaijan	8
3. Economic overview: Georgia	14
Part II: Financial Sector Analysis.....	17
4. Financial sector analysis: Armenia	18
5. Financial sector analysis: Azerbaijan.....	27
6. Financial sector analysis: Georgia	37
Part III: Analysis of donor activities	46
7. Analysis of donor activities: Armenia.....	47
8. Analysis of donor activities: Azerbaijan.....	55
9. Analysis of donor activities: Georgia.....	61
Part IV: Target sector supply and demand analysis	67
10. Target sector supply and demand analysis	68
Part V: Analysis of supply survey	75
11. Analysis of supply survey	76
Appendices.....	84
Appendix 1: List of institutions submitting a survey.....	85
Appendix 2: Maps of Armenia, Azerbaijan, and Georgia Georgia.....	86

Table of abbreviations

AB	Aktiebolag (the Swedish equivalent of the legal form of corporation or public company)
ACBA	ACBA Credit Agricole Bank
ACDI	Agricultural Cooperative Development International
ADB	Asian Development Bank
AEB	Armeconombank
AG	Aktiengesellschaft (the German equivalent of the legal form of corporation or public company)
AG Bank	Azerigazbank
AMD	Armenian Dram (currency)
AMFA	Azerbaijan Microfinance Association
AZN	New Azerbaijani Manat (currency)
BAS	Business Advisory Services
BB	Rating
BFC	Business & Finance Consulting
BOG	Bank of Georgia
BP	British Petroleum
BSE	Baku Stock Exchange
BTA	Bank Turan Alem
CAPS	Competitive Armenian Private Sector
CARD	Center for Agribusiness and Rural Development
CAS	Country Assistance Strategy
CB	Commercial Bank
CBA	Central Bank of Armenia
CBAR	Central Bank of Azerbaijan Republic
CEEP	Caucasus Energy Efficiency Programme
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIA	Credit Implementing Agency
CJSC	Closed Joint Stock Company
COO	Chief Operating Officer
CPI	Consumer Price Index
CPS	Country Partnership Strategy
DAI	Development Alternatives International
DCA	Development Credit Authority
DEG	Deutsche Investitions- und Entwicklungsgesellschaft mbH (German Investment and Development Company)
DRC	Danish Refugee Council
DWM	Developing World Markets
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EOY	End of the Year
ETC	Early Transition Countries
EUR	Euro (currency)
FC	Financial Cooperation
FDI	Foreign Direct Investments
FMAP	Farmer Market Access Program
FMO	Financierings-Maatschappij voor Ontwikkelingslanden (Dutch: Netherlands Development Finance Company)
FSA	Financial Supervision Agency
FW	Framework
FX	Foreign Exchange
FZCO	Free Zone Company
GAF	German Armenian Fund
GDP	Gross Domestic Product
GEL	Georgian Lari (currency)
GSE	Georgian Stock Exchange
GTI	Galt & Taggart Index
HPP	Hydro Power Plant

HSBC	The Hongkong and Shanghai Banking Corporation Limited (bank HSBC)
IBA	International Bank of Azerbaijan
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDC	Islamic Development Corporation
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IOM	International Organization for Migration
IT	Information Technology
JSC	Joint Stock Company
JSIC	Joint Stock Investment Company
KFS	KOC Financial Services (company name)
KfW	Kreditanstalt-Für-Wiederaufbau (under KfW Entwicklungsbank's new branding strategy, KfW is no longer spelled out or translated)
LCO	Leasing Credit Organization
LLC	Limited Liability Company
LLP	Limited Liabilities Partnership
LTD	Limited
MCC	Millennium Challenge Corporation
MCFF	Medium-Sized Loan Co-Financing Facility
ME	Medium Enterprise
MFBA	Micro Finance Bank of Azerbaijan
MFI	Microfinance Institution
MFO	Microfinance Organization
MIS	Management Information System
MSE	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
NA	Not Available
NASDAQ	National Association of Securities Dealer Automated Quotation
NBA	National Bank of Azerbaijan (old name of Central Bank of Azerbaijan Republic, CBAR)
NBCO	Non-Bank Credit Organization
NBFI	Non-Bank Financial Institution
NBG	National Bank of Georgia
NHE	Norwegian Humanitarian Enterprise
NIS	New Independent States
OFID	OPEC Fund for International Development
OJSC	Open Joint Stock Company
OPEC	Organization of Petroleum Exporting Countries
OPIC	Overseas Private Investment Corporation
PCH	Pro-Credit Holding
PLC	Public Limited Company
RAEP	Rural Areas Economic Program
RE	Renewable Energy
REPO	Repurchase Agreement
ROA	Return on Assets
ROE	Return on Equity
SEF	Small Enterprise Foundation
SIDT	Solomon Islands Development Trust
SIFEM	Swiss Investment Fund for Emerging Markets
SME	Small and Medium Enterprises
SNS	Samenwerkende Nederlandse Spaarbanken (Co-operating Dutch Savings banks)
SOFAZ	State Oil Fund of the Republic of Azerbaijan
SWOT	Strengths, Weaknesses, Opportunities, Threats
TA	Technical Assistance
TDA	Troika Dialog Armenia
UAE	United Arab Emirates
UCO	Universal Credit Organization
US	United States

USA	United States of America
USAID	United States Agency for International Development
USD	United States Dollar (currency)
VAT	Value Added Tax
VOCA	Volunteers in Overseas Cooperative Assistance
VTB	Vneshtorgbank
WB	World Bank
WBC	World Business Capital

Currency conversion rates

Currency conversion rates

		2006	2007	2008	Q1 2009
1 USD = ___ AMD	End of period	363.50	304.22	306.73	367.77
	Average for period	416.04	342.08	305.97	325.56
1 USD = ___ AZN	End of period	0.9147	0.8454	0.8010	0.8028
	Average for period	0.8927	0.8581	0.8216	0.8013
1 USD = ___ GEL	End of period	1.7135	1.5916	1.6670	1.6700
	Average for period	1.7766	1.6706	1.4903	1.6715

Sources: Central Bank of Armenia, Central Bank of Azerbaijan, National Bank of Georgia

Preface

This project, titled “Study: Identification of Potential OeEB Clients in the Financial Sector in Georgia, Armenia and Azerbaijan”, was carried out by Business & Finance Consulting GmbH on behalf of OeEB from January 12, 2009 to July 20, 2009. The objectives of this study were to:

- Assess the enabling environment with respect to financial markets in Armenia, Azerbaijan and Georgia
- Identify up to five financial institutions with the potential to become clients of OeEB in Armenia, Azerbaijan and Georgia
- Propose adequate measures to enhance the development impact of the investment of OeEB with technical assistance in the area of know-how transfer and product development

For each of the three objectives, BFC has produced a separate document. This document represents the first objective, the assessment of the enabling environment in Armenia, Azerbaijan, and Georgia. It is divided into five parts:

1. Economic overview
2. Financial sector analysis
3. Analysis of donor activities
4. Target sector supply and demand analysis
5. Analysis of supply survey

As part of this study, BFC’s consulting team made visits to the three target countries on the following dates:

Armenia:	March 30–April 3
Georgia:	April 27–May 1
Azerbaijan:	May 4–May 8

BFC would like to thank all those individuals who contributed to the completion of this project, particularly the managers of banks and other financial institutions who agreed to be interviewed and our counterparts at OeEB.

Part I: Economic Overview

1. Economic overview: Armenia

The global economic and financial crisis aggravated the slowdown of the Armenian economy, one of the fastest growing in the world in recent years. Although Armenia has recently joined the group of middle income countries, it still has a high poverty rate, and over 45% of its workforce is employed in the inefficient agricultural sector. In the short term, a contraction of real output for 2009 is possible, propelled by a decline in remittances from abroad and weakness in the critical construction and mining sectors. In the longer term, it is expected that Armenia will continue above-average economic growth once the main effects of the crisis have passed.

Key Indicators of Economic Development in 2006–2008

Indicator	2006	2007	2008	Jan.-June 2009
GDP, million USD (current prices)	6,364.5 ¹	9,204.5	11,929.44	3,216.21
Real GDP growth rate, %	13.7%	13.8%	6.8%	(16.3)%
Population, thousand	3,222.7	3,229.9	3,238.4	3,240.7
GDP per capita (current prices)	1,975.9	2,852.8	3,688.5	993
Inflation (CPI) ²	2.9%	4.4%	9.0% ³	5.2%
Agriculture sector as % of GDP	18.1%	18.0%	15.7%	10%
Trade and services as % of GDP	32.3%	33.3%	34.3%	50.6%
Production sector ⁴ as % of GDP	17.9%	15.0%	13.0%	15.7%
Construction sector as % of GDP	24.5%	24.7%	27.1%	14.3%
Employment in agriculture sector (%)	46.2%	46.0% ⁵		
Gross Domestic Savings to GDP ratio	17.7%	18.7%		
Current account balance (% of GDP)	(1.8)%	(6.4)%	(11.6)%	(18.0)% ⁶
Trade balance (% of GDP)	(19.0)%	(23.0)%	(28.0)%	(34.1)%
Budget surplus/deficit (% of GDP)	(1.5)%	0.1%	0.0%	(7.3)%
Unemployment rate	7.5%	7.1%	8.0% ⁷	6.7%
Profit Tax rate ⁸	36.6%	36.6%	36.6% ⁹	
Poverty rate ¹⁰	26.5%	25.0% ¹¹	25.0%	
Foreign direct investment, million USD	467.4	669.8	1132.4	139.3 ¹²
Exchange rate EoP to dollar	363.50	304.22	306.73	360.06
Exchange rate EoP to euro	478.73	446.96	435.0	507.60

Sources: National Statistical Service of Republic of Armenia and Central Bank of Armenia

Slowdown from double digit growth rates. Despite a scarcity of natural resources other than metals, small territory and land-locked geographic position, during the six years before 2008, Armenia experienced double-digit economic growth and was one of the fastest-growing economies in the world. In 2006 and 2007, the country's annual GDP growth rate exceeded 13%. In 2008, however, the Armenian economy experienced a significant slowdown, caused primarily by the global financial and economic crisis. Real GDP growth in the fourth quarter of 2008 fell by 1.2%

¹ Armenian-European Policy and Legal Advice Center (2008). The Armenian Economic Trends. Annual Report 2007. http://www.aeplac.am/pdf/Annual/AET_2007.pdf

² In relation to similar period of the previous year

³ National Statistical Service of Republic of Armenia (2008). Consumer Price Index in the Republic of Armenia in January-December 2008. Press Release, <http://www.armstat.am/file/doc/99456473.pdf>

⁴ Including Mining and quarrying, Manufacturing and Electricity, gas and water supply

⁵ Calculated based on the data from National Statistical Services of the Republic of Armenia (2008). Statistical Yearbook of Armenia, 2008, <http://www.armstat.am/en/?nid=45>

⁶ As of March 31, 2009

⁷ The Armenian Observer Blog. "Unemployment up in Armenia due to World Economic Crisis." January 30, 2009, <http://ditord.com/2009/01/30/unemployment-up-in-armenia-due-to-world-economic-crisis/>

⁸ Total profit tax rate is included taking into account profit tax rate of 12.1%, labor tax and contributions of 23.4% and other taxes—1.1%

⁹ World Bank (2008). Doing Business in Armenia: Country Profile for Armenia.

¹⁰ % of population living below the complete poverty line is calculated by National Statistical Service of Armenia every year. For 2007 this indicator equaled AMD 23,168 or USD 67.7 per month (USD 2.3 per day)

¹¹ National Statistical Service of Republic of Armenia (2008). Social Snapshot and Poverty of Armenia, 2008. <http://armstat.am/en/?nid=82&id=781>

¹² For January-April 2009

compared to the same period in 2007.¹³ From January through June 2009, real GDP decreased by 16.3% compared to the same period of 2008. At the same time, in May-June the country's GDP grew by 39.7%¹⁴.

Uncertain outlook for 2009 and positive beyond. There is little agreement among forecasters on the economic outlook for 2009. The International Monetary Fund forecasts that economic growth in the Newly Independent States¹⁵ will be 0.3% in 2009 and 4.4% in 2010. The Central Bank of Armenia has revised its forecast for 2009 downwards several times and currently expects a contraction of 5.8%¹⁶. In the State Budget of Armenia economic growth was forecast at 9.2%¹⁷. The Ministry of Labor and Social Affairs considers this plan to be unrealistic and assumes an economic downturn in 2009 at the level of 3–8%¹⁸. The European Bank for Reconstruction and Development has lowered its previous growth forecast for 2009 from 8.3% to 5.5%¹⁹. Recently, the International Monetary Fund released a new forecast according to which output is expected to decrease by 5% in 2009 and stagnate in 2010²⁰.

According to the most recent forecast of the World Bank, taking into consideration the results of the first four months of 2009, the Armenian economy will shrink by 9–9.5% by the end of the year and grow by 1.5% in 2010²¹.

The Armenian economy depends heavily on the construction sector²². Construction, accounting for 27% of GDP, was the single largest sector of the economy in 2008. However, following a burst in the bubble of housing prices, the construction sector has stagnated and accounted for just 14.3% of GDP in the first half of 2009. Output from industry and agriculture fell in 2009 as well.²³ Industrial output is highly concentrated in a few industries: mining and quarrying, energy generation and distribution, food and beverages, and manufacturing of metallic and non-metallic products. The trade and service sectors were the only ones which demonstrated growth during the first four months of 2009.

The recent decrease in prices for products of the mining industry and the dramatic fall of investments in construction are two of the major drivers of the Armenian economic slowdown.

Key contributors to GDP growth

Sector	Share in GDP growth, %			
	2006	2007	2008	Jan–Jun, 2009
Construction	57.1	31.9	26.5	(73)
Trade and Services	35.3	31.9	42.7	4.3
Agriculture	0.8	13.8	2.9	(1.2)
Industry	(0.8)	3.6	5.9	(11.7)

Source: Calculated based on the data of National Statistical Service of the Republic of Armenia

¹³ National statistical service of RA (2009). "Food Security and Poverty".

http://www.armstat.am/file/article/f_seq_4_08_1.pdf

¹⁴ National statistical service of RA (2009). "Socio-Economic Situation of RA in January–June 2009". July 31, 2009.

http://www.armstat.am/file/article/sv_06_09a_111.pdf

¹⁵ International Monetary Fund (2009). World Economic Outlook Update.

¹⁶ ARKA News Agency. "World bank forecasts 9–9.5% economic decline in Armenia in 2009, 1.5–5% economic growth in 2010". June 12, 2009.

<http://www.arka.am/eng/economy/2009/06/12/15257.html>

¹⁷ Economic Growth in Armenia in the First Half of 2009 will be 1.5–3.5% – Forecast of Central Bank.

<http://www.miacum.ru/gazeta/2009/02/16/123480570372>

¹⁸ ARKA News Agency. "Armenian minister forecasts 3-8% economic downturn in Armenia in 2009", April 15, 2009.

<http://www.arka.am/eng/economy/2009/04/15/14265.html>

¹⁹ ARKA News Agency. "EBRD lowers its 2009 economic growth forecast for Armenia". January 29, 2009.

<http://www.arka.am/eng/banks/2009/01/29/12900.html>

²⁰ ARKA News Agency. "GDP to reduce 5% in Armenia in 2009". April 23, 2009.

<http://www.arka.am/eng/economy/2009/04/23/14438.html>

²¹ ARKA News Agency. "World bank forecasts 9–9.5% economic decline in Armenia in 2009, 1.5–5% economic growth in 2010". June 12, 2009.

<http://www.arka.am/eng/economy/2009/06/12/15257.html>

²² The Armenian Reporter. "IMF delegation visits Armenia". February 21, 2009.

<http://www.reporter.am/go/article/2009-02-21-imf-delegation-visits-armenia>

²³ National statistical service of RA (2009). "Socio-Economic Situation of RA in January–April 2009". May 29, 2009.

http://www.armstat.am/file/article/sv_04_09r_111.pdf

Significant role of small and medium business in economic output. According to an analysis by USAID made in April 2009, 42% of Armenia's GDP is created by SMEs. The sector accounts for around 98% of all enterprises, 41% of employment, 17.4% of exports and 25.2% of tax revenue²⁴.

Negative growth of agricultural sector. Despite good weather conditions, the contribution of the agricultural sector to economic growth decreased in 2008 compared to 2007. Gross agricultural product increased by just 1.4% in 2008 compared to 9.6% in 2007. From January to June 2009, agricultural output decreased by 2.5%²⁵. The development potential of agriculture, which accounts for over 45% of employment, is limited by the small size of most farms and outdated technologies which hinder productivity gains. Beginning in 2009, in line with Armenia's World Trade Organization obligations, VAT is levied on agricultural products which were previously VAT-exempt. Many in agribusiness expect that this will significantly complicate development prospects. The government is considering introducing supporting instruments, such as subsidies or a reduced tax rate²⁶.

Unfavorable trends in the external sector. International trade turnover demonstrated a sharp decline of over 30% from January to June 2009.²⁷ Commodity-based exports started deteriorating in 2008 when prices for key export commodities such as metals declined. Only agriculture and food processing demonstrated strong export performance in 2008. During the first six months of 2009, export growth for most categories declined, as the table below shows. The already huge trade deficit (28% of GDP in 2008) continues to widen and reached 34% of GDP in the period of January to June 2009.

Dynamics of key commodity group exports

	Share of exports in 2008, %	Growth, %		
		2007	2008	Jan-June 2009
Non-precious metals	32.4	38.9	(18.3)	(49.3)
Finished foodstuffs	16.5	52.2	21.9	(48.2)
Mining products	16.3	26.1	1.1	(47.8)
Precious and semi-precious stones, precious	16.3	(29.0)	(11.2)	(47.7)

Source: National Statistical Service of Republic of Armenia

Remittances from abroad were one of the major drivers of economic growth. Officially registered private transfers exceeded USD 1.3 billion in 2008, representing 33% year-over-year growth and making up over 10% of GDP. According to data of the Central Bank of Armenia, the total amount of private transfers significantly exceeds that of those officially registered. The economic crisis, however, is having a pronounced impact on transfers. In January to June 2009 registered private transfers decreased by 34.2% compared to the same period of the previous year, primarily due to a drop of transfers from Russia, which make up 84.0% of the total amount of registered private non-commercial transfers in Armenia.²⁸

Controlled inflation. The high rates of economic growth in 2006 and 2007 were combined with modest inflation rates of 2.0% to 4.5% and a gradual appreciation of the national currency. In 2008 the consumer price index rose to 9.0%. An increase in the prices of food products in the beginning of 2008 was a key contributor to CPI growth. However, the fastest price growth was observed in the construction sector, where the price index²⁹ reached 26.9%³⁰. From January to June 2009, inflation

²⁴ ARKA News Agency. "Armenia's small, medium businesses output 42% of GDP: USAID". April 15, 2009.

²⁵ National statistical service of RA (2009). "Socio-Economic Situation of RA in January–June 2009". July 31, 2009. http://www.armstat.am/file/article/sv_06_09r_122.pdf

²⁶ The Civilitas Foundation (2008). Armenia in 2008: Crisis and Opportunity. The Civilitas Foundation. Yerevan, Civilitas Foundation, 2008.

²⁷ National statistical service of RA (2009). "Socio-Economic Situation of RA in January–June 2009". July 29, 2009. http://www.armstat.am/file/article/sv_06_09a_411.pdf

²⁸ Central Bank of Armenia (2009), Statistical data: Transfers of individuals sent to and received from abroad through Armenian commercial banks. http://www.cba.am/CBA_SITE/downloads/stat_data_eng/eng_trans.xls

²⁹ Measured as average costs of construction and assembly works.

³⁰ National Statistical Service of Armenia (2009). Social and Economic Conditions of RA in January–December 2008". January 30, 2009. <http://armstat.am/en/?nid=82&id=829>

was modest, with a CPI increase of 2.7% compared to the same period of 2008³¹. July of 2009 was marked by 2.7% deflation³². Inflation is expected to drop as international commodity, food and fuel prices fall in 2009, but monopolies in certain of Armenia's commodity markets, especially imports, limit competition, hence weakening the price flexibility and significantly diminishing the effects of a price drop in international markets³³. Inflation is expected to stabilize around 6% to 7% in 2009. IMF forecasts consumer prices to grow by 3.6% in 2009 and by 7.2% in 2010³⁴.

Increasing budget deficit. In recent years Armenia has produced either balanced budgets or relatively modest deficits. However, the worsening economic situation is putting strain on the government's finances. For the first half of 2009, the deficit reached 7.3%, up from 3.3% in the first quarter³⁵. Recently, the government of Armenia lifted the allowable limit of the state budget deficit from 5% to 7.5%³⁶.

Dynamic foreign investment growth. Foreign investments in the real sector of Armenia (excluding investments in the public and banking sectors) grew in 2008 by 65% to USD 515 million. Foreign direct investment (FDI), which comprises about 70 percent of total foreign investment, grew by roughly the same amount. The largest share of FDI (over 40%) was directed, as in previous years, into infrastructure, primarily energy generation and distribution, including natural gas. The second largest share of investments (around 27%) was directed at telecommunications. The remainder was distributed among mining and metal processing, food processing, aviation, real estate, information technologies and tourism. As a result of recent major acquisitions in infrastructure and telecommunications, Russia has become the leader in foreign investment in the Armenian economy. In 2008 Russian investments exceeded USD 880.1 million (USD 714.5 million of which was FDI), accounting for over 46% of total foreign investments. In 2007, Russian investments in Armenia totaled USD 449.4 million³⁷. Other countries with significant investment shares are France, Germany, the US, Lebanon and Argentina. The largest foreign investment decision in 2008 was the granting of a license to France Telecom to operate the third mobile service provider in Armenia³⁸. In 2009 Russia offered Armenia a stabilization credit in the amount of USD 500 million³⁹. One of the purposes of the credit is to protect Russian investments from negative influences of the crisis. In the first quarter of 2009, foreign investments increased by 12.3%, including FDI growth of 51.8%⁴⁰.

Decreasing poverty rate. Fast economic growth in recent years facilitated a gradual decrease in the poverty rate. The International Monetary Fund (IMF) expects a further reduction of the poverty rate to 20% by 2012⁴¹ (from 25% in 2008), using the national poverty line of USD 2.3 per day. According to the IMF, Armenia has risen from the group of countries with low incomes to the group of countries with medium incomes. In its newly adopted strategic policy document, "Sustainable Development Program", the government plans to reduce the poverty rate to 6.8% by 2021, and to eradicate extreme poverty⁴² by 2015, based on the government's poverty definitions. Using the World Bank's latest poverty standard of USD 1.25 per day, 10.6% of households in Armenia live below the poverty line. Reductions in the poverty rate are connected with the growth of the

³¹ National Statistical Service of RA (2009). "Current-operative preliminary main macro-economic indicators characterizing socio-economic situation of RA for January–June 2009". July 21, 2009 <http://www.armstat.am/file/doc/99457213.pdf>

³² Arka News Agency (2009). "Deflation 2.7% in Armenia in July against June". <http://www.arka.am/eng/economy/2009/08/03/16051.html>

³³ The Civilitas Foundation (2008). Armenia in 2008: Crisis and Opportunity. The Civilitas Foundation. Yerevan, Civilitas Foundation, 2008.

³⁴ ARKA News Agency. "GDP to reduce 5% in Armenia in 2009". April 23, 2009. <http://www.arka.am/eng/economy/2009/04/23/14438.html>

³⁵ Calculated based on the data from RA National Statistical Service, "Socio-economic situation in RA, January–June 2009", http://www.armstat.am/file/article/sv_06_09a_211.pdf

³⁶ ARKA News Agency. "Armenian parliament raises state budget deficit limit from 5% to 7.5%". June 3, 2009. <http://www.arka.am/eng/politics/2009/06/03/15085.html>

³⁷ ARKA News Agency. "Russian investments in Armenia USD 880.1mln last year". April 1, 2009. <http://www.arka.am/eng/economy/2009/04/01/14029.html>

³⁸ The Civilitas Foundation (2008). Armenia in 2008: Crisis and Opportunity. The Civilitas Foundation. Yerevan, Civilitas Foundation, 2008.

³⁹ ARKA News Agency. "Russia to extend USD 500mln stabilization credit to Armenia". February 5, 2009. <http://www.arka.am/eng/finance/2009/02/05/13007.html>

⁴⁰ National statistical service of RA (2009). "Socio-Economic Situation of RA in January–April 2009". May 29, 2009. http://www.armstat.am/file/article/sv_04_09r_42.pdf

⁴¹ International Monetary Fund (2008). Press Coverage of the IMF Mission to Armenia, September 3–16, 2008. <http://www.imf.org/external/country/ARM/rr/2008/090308.pdf>

⁴² % of population living below the food poverty line is calculated/adjusted by National Statistical Service of Armenia every year. For 2007 this indicator equaled AMD 15,753 or USD 45.8 per month (USD 1.5 per day)

average nominal monthly salary, which increased by 17.7% in 2008⁴³ and by 12.7% in the first half of 2009 compared to the same period of the previous year⁴⁴.

Relatively high unemployment rate. After gradually decreasing during the past several years, official unemployment grew from 7.1% to 8.0% in 2008, but decreased again to 6.7% by June 30, 2009⁴⁵. However, a survey conducted in 2007 by the National Statistical Service of Armenia according to the methodology of the International Labor Organization identified a 28.4% unemployment rate, or four times higher than the official rate⁴⁶. Therefore, there is some reason to doubt the accuracy of the official statistics, particularly the drop in the unemployment rate in 2009. Unemployment is expected to grow in 2009 due to the slowdown in mining and the return of migrant workers.

Favorable international context for continued economic development. The balance of interests of the three centers of influence of the European Union, Russia and the US creates a favorable context for the economic development of Armenia. The European Union is interested in closer integration with Armenia to protect regional security, safeguard energy supplies and prevent migration from economically underdeveloped areas. Russia, the largest foreign investor and single-country trade partner of Armenia, is interested in deepening established economic ties as well as protecting its interests in the Caucasus. The US focuses on promoting democratic and economic development in the region; US policy is strongly influenced by a very effective pro-Armenian lobby in America. This balance of interests may continue to positively influence such important issues as the frozen Nagorno-Karabakh conflict and the possibility of opening the border with Turkey.

Depreciation of the dram. Speculation about a fall in the value of the dram became noticeable in late November 2008, at which time the CBA began to intervene to support the dram. After months of continued pressure, the CBA eventually decided to allow the dram to depreciate. On March 3, 2009, the value of the dram fell from AMD 305 to AMD 372 for one US dollar. The CBA estimates that the average weighted exchange rate in 2009 will be within the corridor of AMD 360–380, although several bankers interviewed for this project believe that the dram will fall further. The depreciation of the dram may have some positive effects on the economy. At its new level, products of Armenian companies will become more competitive in international and local markets⁴⁷, and the Central Bank of Armenia will not need to spend currency reserves to support the dram. The flexible currency allowed the country to borrow a stabilization credit of USD 540 million from the International Monetary Fund⁴⁸. However, the fall of the currency has created problems for lenders, as discussed in the financial sector overview for Armenia.

SWOT Analysis for the Armenian economy

Strengths	<ul style="list-style-type: none"> • Low-to-moderate inflation • Rapid GDP growth in recent years
Weaknesses	<ul style="list-style-type: none"> • Falling real output in 2009 • Strong dependence on remittance income and foreign investment • Falling commodity prices have severely hurt Armenian mining companies, leading to large layoffs • The housing market has collapsed and is bringing down the construction sector with it • Significant trade deficit (28% of GDP)
Opportunities	<ul style="list-style-type: none"> • The possibility of reconciliation with Turkey, which would provide a new export market and cheap imports • Export competitiveness should improve following devaluation of the dram

⁴³ National Statistical Service of RA (2009). "Social and Economic Situation of RA in January-December 2008". January 30, 2009. http://www.armstat.am/file/article/sv_01_09r_142.pdf

⁴⁴ National Statistical Service of RA (2009). "Current-operative preliminary main macro-economic indicators characterizing socio-economic situation of RA for January-June 2009". July 21, 2009 <http://www.armstat.am/file/doc/99457213.pdf>

⁴⁵ National statistical service of RA (2009). "Socio-Economic Situation of RA in January -June 2009". July 31, 2009. http://www.armstat.am/file/article/sv_06_09a_141.pdf

⁴⁶ National Statistical Service of RA (2009). "Food, Security and Poverty, January-March 2009". May 20, 2009. http://www.armstat.am/file/article/f_seq_1_09_1.pdf

⁴⁷ World Bank. "Statement of the World Bank on exchange rate policy in Armenia". March 3, 2009. <http://www.worldbank.org.am/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/ARMENIAEXTN/0,,contentMDK:22087783-menuPK:301584-pagePK:2865066-piPK:2865079-theSitePK:301579,00.html>

⁴⁸ ARKA News Agency. "IMF to allocate USD 540 million for Armenia to stabilize payment balance". March 3, 2009. <http://www.arka.am/eng/economy/2009/03/03/13432.html>

	<ul style="list-style-type: none">• Relatively high share of SME sector in the economy can ensure quick recovery from economic crisis
Threats	<ul style="list-style-type: none">• A further decrease in remittances from abroad will drive down consumption• Possibility of severed transport links with Russia in the event of renewed Russian-Georgian conflict

2. Economic overview: Azerbaijan

The growth of prices in several commodities markets, which lasted until the middle of 2008, allowed Azerbaijan, number 10 among global oil extractors and number 7 among oil exporters,⁴⁹ to become one of the world's fastest growing economies. The country made significant progress in reducing poverty and accumulating financial resources to protect the economy from the negative influences of the global economic crisis. Azerbaijan also achieved significant progress in improving its business environment. However, some fundamental problems which hinder further economic growth remain, such as insufficient diversification of output, corruption and monopolies in many economic sectors.

Key Indicators of Economic Development in 2006–2009⁵⁰

Indicator	2006	2007	2008	Q1 2009
GDP, million USD (current prices) ⁵¹	20,205.1	31,249.4	46,258.2	8,378.7
Real GDP growth rate, %	34.5%	25.0%	10.8%	4.1%
Population, thousand (end of the year)	8,533 ⁵²	8,630	8,730 ⁵³	
GDP per capita (current prices), USD	2,381.4	3,641.5	5,329.3	
Inflation (CPI)(to relevant previous period)	8.3%	16.7%	20.8%	8.4%
Share of key sectors in non-oil GDP, (%)				
<i>Trade, social and other services</i>	32.9%	36.7%	37.2%	
<i>Construction</i>	19.2%	19.4%	19.5%	
<i>Agriculture</i>	18.0%	16.8%	15.0%	
<i>Transport and communication</i>	18.3%	16.5%	18.0%	
<i>Industry</i>	10.3%	8.9%	8.4%	
Employment in agriculture sector (%)	39.0%	39%		
Savings to GDP ratio	29.90%	20.10%		
Current account balance (% of GDP)	18.35%	28.86%	35.57%	
Foreign trade balance (% of GDP)	38.33%	48.72%	49.75%	
Budget surplus/deficit (% of GDP)	0.5%	(0.2)%	3.2 /Nov	9.3% /Feb
Unemployment rate	6.8%	6.5%		
Tax rate (Corporate)	22.0%	22%	22%	22.00%
Poverty rate	46.7%	16.00%	13.2% ⁵⁴	
Gross foreign direct investments, USD million		4,526.0	3,982.6	
Exchange rate EOY to dollar ⁵⁵	0.8714	0.8453	0.801	0.8028
Exchange rate EOY to euro	1.1471	1.2450	1.1292	1.0642

Source: The National Bank of Azerbaijan Republic (2009). Statistical Bulletin 3/2009.

Rapid economic growth. Azerbaijan's economy, which is highly dependent on oil and gas prices, achieved the highest GDP growth in the world in 2006 and 2007. The growth was caused by the sharp increase in oil prices and the opening of the new Baku-Tbilisi-Ceyhan pipeline in 2006. In 2008, real economic growth slowed down to a still-impressive 10.8%. The decline of oil prices since the middle of 2008 was a key driver in this change. Growth slowed further to 4.1% in the first quarter of 2009, compared to 13.8% in the first quarter of 2008. The recent growth of oil prices will help to restore a high level of economic growth.

Positive outlook for 2009/2010. According to forecasts of the government of Azerbaijan, the economy will grow by 10% in 2009⁵⁶. The World Bank forecasts that Azerbaijan will remain one of

⁴⁹ Kianthgudaeva, E. (2009) "OPEC-Azerbaijan: coordination of actions, the opinion of Baku is important even without its the membership in the cartel" (in Russian). Kaspiy, June 27, 2009.

http://www.kaspiy.az/articles.php?item_id=20090316113900885&sec_id=19

⁵⁰ The National Bank of Azerbaijan. Statistics. <http://www.nba.az/default.aspx?go=145&lng=en>

⁵¹ Calculated based on the statistical data of National Bank of Azerbaijan using average USD/AZN exchange rates.

⁵² Groman, S. (2007). "The population of Azerbaijan exceeded 8.5 million". (in Russian). Languages Study. March 14, 2007.

<http://www.languages-study.com/demography/azer.html>

⁵³ According to the data of NIS Statistical Committee, <http://news.finance.ua/ru/-/1/0/all/2009/02/05/150921>

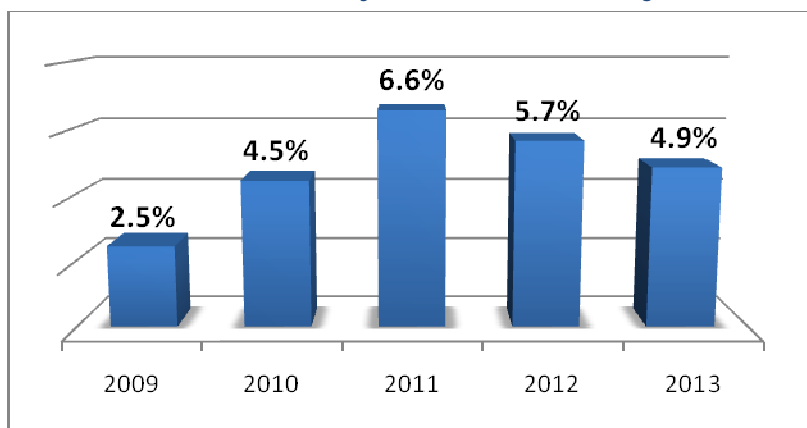
⁵⁴ International Information Agency "News-Azerbaijan". "The level of poverty in Azerbaijan has declined to 13.2%—Ilham Aliyev". (in Russian). January 16, 2009. <http://www.newsazerbaijan.ru/newsaz/20090116/42678155.html>

⁵⁵ Central Bank of Azerbaijan Republic. "Official average exchange rates of manat"

http://www.nba.az/download/statistika/pul_kredit_gostericileri/x_valyutalara_qarshi_mezenne.pdf

the fastest-growing economies in the world and will grow by 10.7 % in 2009 and 7.8% in 2010⁵⁷. The European Bank for Reconstruction and Development expects that in 2009 Azerbaijan will top Eastern Europe and South Caucasus countries with economic growth of 8%⁵⁸. The IMF projects economic growth of 2.5% in 2009 and 12.3% in 2010⁵⁹. The Asian Development Bank forecasts GDP to grow by 8% in 2009 and by 6.7% in 2010⁶⁰. The long-term forecast of the Economist Intelligence Unit⁶¹ is presented in the following chart.

Economic Growth Forecast by the Economist Intelligence Unit



The oil sector accounts for a major share of total GDP but only for a tiny share of employment. From 2006 to 2008, oil's contribution to GDP exceeded 60%⁶², demonstrating the fundamental structural problem of the economy—a high dependence on the energy sector⁶³. Meanwhile, the sector employs only around 1% of the workforce⁶⁴. According to forecasts of the government of Azerbaijan and International Monetary Fund released in mid-2008, the share of the oil sector in GDP is expected to decrease to 47% by 2011⁶⁵. Modest oil prices could accelerate this trend. In the non-oil sector, trade and services are the major contributors to gross output followed by construction, transport and communications combined and agriculture.

Uneven regional distribution of GDP. According to the data of the Ministry of Economic Development of Azerbaijan, 90% of the country's GDP is concentrated in or near Baku, while 50% of the population live in the regions⁶⁶.

⁵⁶ Faulconbridge, Guy (2009). "Azeri president sees 2009 growth at 10 percent". January 30, 2009. Reuters <http://www.reuters.com/article/idUSTRE50T2DP20090130?pageNumber=1&virtualBrandChannel=0>

⁵⁷ World Bank (2008). Global Economic Prospects 2009: Commodities at the Cross-Roads. http://siteresources.worldbank.org/INTGEP2009/Resources/10363_WebPDF-w47.pdf

⁵⁸ Ismayilova, N. (2009). "Azerbaijan tops Eastern Europe, South Caucasus for GDP growth: EBRD". News Agency Capital Trend. January 28, 2009. <http://capital-en.trend.az/finances/banks/1410140.html>

⁵⁹ Center for Economic and Social Development "IMF forecasts Azerbaijani economy growth of 2.5% in 2009" <http://www.cesd.az/imf3.htm>

⁶⁰ ABC.az. "ADB: Azerbaijan's GDP per capita to rise by 7% in 2009 and 5.5% in 2010". April 1, 2009. http://abc.az/cgi-bin/wnews_one.cgi?nid=33374&lang=eng

⁶¹ Economist Intelligence Unit. "Azerbaijan, the EU view". 2009. http://viewswire.eiu.com/index.asp?layout=VWCountryVW3&country_id=1420000342&rf=0

⁶² The National Bank of Azerbaijan (2009). Statistical Bulletin 12/2008. <http://www.nba.az/download/neshrler/bulleten/BULLETen%2012-106-2008.pdf>

⁶³ EBRD. "Azerbaijan Economic Overview." <http://www.ebrd.com/country/country/azer/econo.htm>

⁶⁴ The State Statistical Committee of the Republic of Azerbaijan. <http://www.azstat.org/publications/azfigures/2008/en/005.shtml>

⁶⁵ Information and Analytical Portal Neft Rossii (Oil of Russia). "Azer Amiraslanov: the share of oil sector in GDP of Azerbaijan will reduce to 47% from 59% by 2011" (in Russian). July 31, 2008. <http://www.oilru.com/news/79259/>

⁶⁶ United Nations Economic and Social Commission for Asia and the Pacific (2007). "Republic of Azerbaijan: report on research of general economic conditions of the country under the cooperation between Research Institute of Economic Reforms of the Ministry of Economic Development and UNESCAP. Topic: Consequences of the current system of joint planning, monitoring and assessment for income and job place formation in Azerbaijan" (in Russian). <http://www.unescap.org/pdd/projects/TC-transition/doc/Azerbaijan-paper-Russian-08.pdf>

The energy sector dominates Azerbaijan's exports. The energy sector accounts for over 95% of the country's exports. The large volume of energy exports contributes to a massive trade surplus of almost 50% of GDP.

Azerbaijan export figures

	2006	2007	2008
Share of exports in GDP	64.4	68.1	66.1
Share of oil and gas sectors in total export	92.8	94.9	95.3
Share of other sectors in total export	7.2	5.1	4.7

Source: Central Bank of Azerbaijan

Noticeable contribution of foreign remittances to economy. Although Azerbaijan is not the top recipient in the Caucasus, foreign remittances are substantial, making up over 8% of non-energy GDP in 2007.⁶⁷ As Azerbaijan is less dependent on remittances than Georgia and Armenia to support consumption, there should be less of a negative impact resulting from the economic crisis in Russia, an important destination for labor migrants in the NIS. In 2008, the Central Bank of Russia reported individual transfers to Azerbaijan of 1.06 USD billion or 2.4% of GDP. In the fourth quarter of 2008, transfers declined by 24%⁶⁸.

Cautious economic policies protected Azerbaijan from the first wave of the global financial crisis. Like Russia and Norway, Azerbaijan has set up a fund, the State Oil Fund of the Republic of Azerbaijan (SOFAZ), accumulating oil revenues for long-term investment projects and keeping them from distorting the economy. As of April 1, 2009 the assets of the fund were USD 10.9 billion,⁶⁹ a major share of which was invested in relatively safe sovereign securities⁷⁰. At the same time, Azerbaijan did not borrow heavily from international financial markets. Azerbaijan's economy is therefore more liquid than that of many other countries in the region which financed their growth from borrowed funds.

Fundamental problems which constrain economic development remain. Among these problems are the existence of formal and informal monopolies in many sectors, a high level of corruption and the low degree of economic diversification.⁷¹ In 2008 Azerbaijan was ranked 158—down from 150 in 2007—of 180 countries in Transparency International's Corruption Perceptions Index.⁷²

Decreasing inflation. Consumer prices increased by 20.8% in 2008, higher than in both 2006 and 2007. Food products represented the greatest increase at 28.7%, and services the lowest at 11.5%. In the first five months of 2009, the inflation rate decreased to around 5%⁷³ which is close to the forecast of the Economist Intelligence Unit for the year, as shown in the graph below.⁷⁴

⁶⁷ World Bank (2007). "Migration and Remittances Factbook".

<http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1199807908806/Azerbaijan.pdf>

⁶⁸ Open Armenia, World Armenian Forum. "Reduction of oil prices will result in serious negative consequences for economy of Azerbaijan—interview". March 15, 2009. <http://forum.openarmenia.com/index.php?showtopic=23038>

⁶⁹ Center for Economic and Social Development. "SOFAZ Revenue and Expenditure Statement for January-March 2009". 2009. <http://www.cesd.az/sofaz1.htm>

⁷⁰ Inter-state Television and Radio Company "Mir". "State fund of Azerbaijan has accumulated the record amount in 2008." February 11, 2009. <http://mirtv.ru/content/view/54457/15/>

⁷¹ Economist Intelligence Unit. "Azerbaijan, the EU view". 2009. http://viewswire.eiu.com/index.asp?layout=VWCountryVW3&country_id=1420000342&rf=0

⁷² UNDP. "Transparency International: Corruption in Azerbaijan increases". Azerbaijan Development Bulletin. September 23, 2008. <http://www.un-az.org/undp/bulnews63/ec3.php>

⁷³ Central Bank of Azerbaijan Republic. <http://www.nba.az/>

⁷⁴ Economist Intelligence Unit. "Azerbaijan, the EU view". 2009. http://viewswire.eiu.com/index.asp?layout=VWCountryVW3&country_id=1420000342&rf=0

Top business reformer. Azerbaijan was rated the number one business environment “reformer” in 2009 by the World Bank Group’s annual series “Doing Business”. In particular, the following improvements were cited:

- launching a one-stop shop that halved the time, cost, and number of procedures needed to start a business—business registrations increased by 40% in the first 6 months of 2008
- eliminating the minimum loan cutoff of USD 1,100, which more than doubled the number of borrowers covered by the credit registry;
- introduction of on-line tax filing and payment procedures.

Azerbaijan improved in seven of ten categories and moved from 97th position to 33rd (out of 181 economies). Azerbaijan hopes that these business reforms will attract more foreign investment which, outside of the energy sector, has been negligible⁸³.

Growth of investments in the non-oil and gas sector. In 2008 the share of investments into the oil and gas sector was only 30.9% of total investments, 15.1% less than in 2007. Investments in other sectors increased by 81.3%. In particular, investment into the electric energy and water sectors grew by 68.2%, transportation and communications by 260%, housing construction by 28.6% and agriculture by 50.2%. Investments in the manufacturing sector remained roughly at their previous level. In 2009, total investments are expected to be 8% less than in 2008⁸⁴.

Decreasing FDI. 2006–2007 and the first 10 months of 2008 were marked by:

- a decrease of foreign direct investment into the country;
- a decrease of the share of FDI into the oil and gas sector in favor of other sectors.

Summary of changes of foreign direct investment (FDIs) position of Azerbaijan

	2006	2007	2008 (as of 01/10)
Net foreign direct investment position, USD million	(6,955.7)	(1,921.2)	(1,248.0)
Share of FDI in total accumulated investments in the country, %	65.8	48.7	41.8
FDI growth, %	(4.9)	(41.9)	(6.0)
Share of oil and gas sector in accumulated FDIs, %	80.9	60.6	51.1
Growth of accumulated FDIs in oil and gas sector, %	(9.4)	(56.4)	(20.7)
Share of other sectors in accumulated FDIs, %	19.1	39.4	48.9
Growth of accumulated FDIs in other sectors, %	20.1	20	16.6

Source: Calculated based on the data of National Bank of Azerbaijan

Decrease of net foreign direct investments was compensated by growth of national investments. Internationally Azerbaijan is net investor. In January-February 2009 foreign investments accounted only for 16% of total investments into the economy, an increase of 7.5% compared to the same period of 2008⁸⁵.

SWOT Analysis for the Azerbaijani economy

Strengths	<ul style="list-style-type: none"> • Highest GDP growth rates in the world in recent years, including during the economic crisis • Stable national currency • Substantial foreign currency reserves
Weaknesses	<ul style="list-style-type: none"> • High degree of dependence on oil and gas exports • Uneven territorial distribution of economic activities, with high concentration in Baku • High level of influence of state in the private sector • Monopolies and cartels in certain industries

⁸³ Microcapital. “Press Release: Azerbaijan Named Top Reformer in Doing Business 2009”. September 11, 2008. <http://www.microcapital.org/press-release-azerbaijan-named-top-reformer-in-doing-business-2009>

⁸⁴ 1 News.az. “Investments into non-oil sector of Azerbaijan has grown 2.2 times”. March 18, 2009.

⁸⁵ <http://www.1news.az/economy/20090318092217200.html>

Opportunities	<ul style="list-style-type: none">• Accumulated resources of the government could be invested in regional development and support for non-energy sectors
Threats	<ul style="list-style-type: none">• Decrease of oil prices• Escalation of frozen conflict with Armenia• Renewed conflict in Georgia could disrupt oil supply along pipeline• Devaluation of national currency

3. Economic overview: Georgia

Key economic indicators

Indicator	2006	2007	2008
GDP (USD billions)	7.75	10.18	12.79
Real GDP growth rate	9.4%	12.3%	2.1%
Population (millions)	4.4	4.4	4.4
GDP per capita (USD)	1,763.5	2,314.6	2,920.3
Inflation (CPI)	8.8%	11.0%	5.5%
Agriculture sector as % of GDP	11.2%	9.2%	8.9%
Trade and Repair sector as % of GDP	13.6%	12.8%	13.9%
Production sector as % of GDP	21.7%	20.9%	
Services sector as % of GDP	35.3%	33.0%	
Employment in agriculture sector		55%	
Net Savings to GDP ratio	5.4%	5.1%	
Current account balance (% of GDP)	(15.9)%	(19.7)%	
Trade balance (% of GDP)	(24.2)%	(26.7)%	
External debt (USD millions)	1,964	—	
Unemployment rate	13.6%	13.3%	
Corporate profit tax rate	13.1%	14.4%	
Poverty rate	54%	54%	
Foreign direct investment (USD million)	1,190.4	2,014.8	1,564.0
Exchange rate EOY USD/GEL	1.715	1.592	1.6670
Exchange rate EOY EUR/GEL	2.255	2.332	2.3648

Sources: Georgian National Statistics Bureau, World Bank

Rapid GDP growth through mid-2008. The efforts of the Saakashvili administration to liberalize the economy led to greatly increased foreign investment over the past five years, which is partially credited with Georgia's strong economic performance over that time period. Among the government's achievements are a reduction in the number of taxes, simplification of the tax code, reduction in the number of licenses required to open a business, and a reduction of import duties. In the World Bank's 2008 "Doing Business" report, Georgia was ranked as the world's 15th easiest place to do business.

Slowdown in second half of 2008. More recently, however, Georgia's economy is feeling the effects of armed conflict with Russia and the global economic crisis. Following strong GDP growth in the first half of 2008, the economy contracted by 3.9% in the third quarter. It is difficult to determine how much of this contraction is due to the war, which would produce a shorter-term fall in output, and how much is due to the global economic crisis, which could produce a more sustained decline. A study by the IFC published in December 2008 found that 77% of enterprises experienced decreased revenues as a result of the war, with enterprises in the construction, transport, and trade sectors most seriously affected.

Outlook for 2009. According to the IMF, the drying up of capital inflows and foreign direct investment which followed the war and the global economic crisis are two of the key factors influencing the third quarter decline and will continue to limit growth in 2009.⁸⁶ Substantial funding from the international community, including USD 4.5 billion from foreign donors and a USD 750 million pledge from the IMF should help to mitigate the impact of these problems.⁸⁷ The Georgian Ministry of Finance estimates 2.6% GDP growth in 2009.

Key sectors of the economy. The largest contributions to GDP through the first three quarters of 2008 were made by public administration and defense (14.7%), trade (13.9%), agriculture (9.5%), and manufacturing (8.2%). The large contribution of defense appears to be a temporary result connected with the war, as public administration and defense accounted for only 8.5% of GDP in 2007.

⁸⁶ IMF External Relations Department. "Statement at the Conclusion of the Visit by IMF Director Masood Ahmed to Georgia." February 6, 2009.

⁸⁷ Thomson Financial News. "Georgia economy 'well placed' to recover from war—IMF."

Inflation under control. After relatively rapid price growth of 11.0% in 2007, consumer price inflation fell to 5.5% in 2008. High inflation in the housing and utilities (23.9%), transportation (15.6%), and food segments (12.9%) were the key drivers of inflation in 2007. Inflation in each of those segments has fallen below 6.0% in 2008. In a recent newspaper article, however, the former president of the National Bank of Georgia has stated that the inflation rate “is actually much higher than that given by the Department of Statistics.”⁸⁸ The recent decision of the government to make the Department of Statistics an independent body (previously it was part of the Ministry of Economics) may help improve the quality of statistical data in the future.

Massive trade deficit. The trade deficit has been deeply negative in recent years, consistently exceeding 20% of GDP, with foreign capital inflows supporting the high level of consumption of imports. The country’s main exports in 2008 included ferrous metals (USD 267 million), ferrous waste and scrap (USD 129 million), copper (USD 118 million), motor vehicles (USD 113 million), and fertilizers (USD 105 million). These were followed by gold, cement, and alcoholic beverages. The structure of exports has become less diversified in recent years, as the proportion of exports generated by the top categories of products increased, making the economy more vulnerable to shocks in prices or demand for these products.⁸⁹ The main imports in 2008 consisted of oil and gasoline, motor vehicles, natural gas, and medicine. Georgia’s main trading partners, both for imports and exports, are Turkey, Azerbaijan, and Ukraine. Negotiations continue with Russia over the re-opening of the Russian market to Georgian mineral water and wine exports, which could also have a positive effect on the trade balance. Mainly as a result of the Russian ban on Georgian wine, exports of Georgian wine fell from a high of USD 81 million in 2005 to just USD 37 million in 2008.

FDI inflows slow. One of the keys to economic growth over the last five years, FDI has slowed following the war and the onset of the economic crisis. FDI amounted to USD 1.6 billion in 2008, a decrease of 22.4% from 2007. Investment in the banking sector, one of the leading sectors for FDI in recent years, fell by 37%. The top sources of FDI in 2008 were the United Arab Emirates (20%), the Netherlands (17%), and Turkey (16%). The sectors receiving the most FDI were transportation and communications at 28.3% of the total. The National Bank of Georgia forecasts a further decline of gross FDI in 2009 to USD 815 million.

Agriculture. The share of agricultural activity in the economy continues its long-term downward trend and now stands at just 10%, despite the fact the employment in the agricultural sector remains over 50%. Small farm sizes and farmers’ continuing lack of access to financial resources to modernize their technological base have contributed to this decline. Consumers are highly dependent on imports of food products. In 2008 Georgia imported USD 943 million in food and agricultural products and exported just USD 251 million. Furthermore, production of a number of key crops—including wheat, corn, and potatoes—has fallen from 2005 to 2007. A report by the Open Society Georgia Foundation attributes much of this fall in productivity to the worsening state of the irrigation and drainage systems in rural areas.⁹⁰ Production of animal products has suffered as well in recent years, with meat production falling by 33.7% and milk production falling by 13.1% from 2005 to 2007.

Poverty. In the most recent World Bank study, the poverty rate at the World Bank’s standard of USD 1.25 in 2005 was reported at 13.4%.⁹¹ The government budget for 2009 foresees increased, although still modest, support for poor families, with about 400,000 individuals receiving an increase in aid from GEL 12 to GEL 24 per month.

Public spending. Georgia’s fiscal budget for 2009 will shrink by about GEL 1 billion in comparison with 2008, with the shortfall at least partially compensated by foreign aid. The government recently announced a GEL 2.2 billion economic stimulus package, with the majority of funding going to infrastructure projects such as roads and bridges.

⁸⁸ Nodar Jovakhishvili. “National Bank of Georgia Must Become Stronger to Rescue Georgian Banks.” *The Georgian Times*. March 3, 2009.

⁸⁹ Open Society Georgia Foundation. “Analysis and recommendations of economic challenges of Georgia and governmental strategy against crisis.” February 2009.

⁹⁰ Open Society Georgia Foundation. “Analysis and recommendations of economic challenges of Georgia and governmental strategy against crisis.” February 2009.

⁹¹ World Bank. <http://iresearch.worldbank.org/PovcalNet/povcalSvy.html>

Remittances to be impacted by situation in Russia. Official remittances from abroad grew modestly in 2008 to slightly over USD 1 billion versus USD 866 million in 2007. With 63% of remittances coming from Russia, the combination of poor relations with Russia and the Russian recession will negatively affect Georgian savings and consumption in 2009. In January 2009, remittances from Russia fell to USD 27 million compared to USD 36 million in January 2008, a decrease of 19%. In February 2009, the decline was even steeper, at 30.9%, while the total volume of remittances (including other countries) fell by 19.8%. While the Russian government slightly softened its stance on issuing visas to Georgians in March 2009, the number of Georgians who will be eligible for visas is very limited and no work visas will be issued. The Georgian Migration Agency reports that more than 500,000 laborers of Georgian ethnicity live in Russia with the single aim to work and support their families back home.⁹²

SWOT Analysis for the Georgian economy

Strengths	<ul style="list-style-type: none"> Continued support from the international community has led to commitments of more than USD 5 billion in various forms of aid; Inflation is under control.
Weaknesses	<ul style="list-style-type: none"> The economy has recently been in recession and is recovering slowly; Infrastructure damage from recent war with Russia; Heavy dependence on remittances from Russia for household consumption and savings; Enormous trade deficit resulting primarily from weak manufacturing and agricultural sectors.
Opportunities	<ul style="list-style-type: none"> The potential thawing of relations with Russia, as evidenced by a slight relaxation of the visa regime and recent comments about possibly opening the Russian market to Georgian mineral water and wine, could have a positive impact on remittances and the trade balance.
Threats	<ul style="list-style-type: none"> The economic outlook for 2009 is unclear, but a further decline in GDP is expected from many sources

⁹² Tamar Khurtsia. "Remittances from abroad hit new low, further slump expected." Georgian Business Week. 23/02/2009.

Part II: Financial Sector Analysis

4. Financial sector analysis: Armenia

Regulation and supervision

Key regulations. The Armenian financial sector is regulated by a variety of laws and regulations, most of which are relevant to the commercial banking sector, which is the most active part of the Armenian financial sector. The key regulatory acts for the commercial banking sector are the “Law on Central Bank of Republic of Armenia”⁹³ and “Law on Banks and Banking Activities”⁹⁴. Other key regulations concern bank secrecy, asset classification, loan loss provision, currency operations regulations and control, accounting, reporting and oversight standards.

The role of the CBA. The Central Bank of Armenia (CBA) is the key regulator of the financial sector. The CBA performs licensing and supervision of banks and credit organizations, securities market entities, insurance companies and other intermediaries. The CBA also oversees a deposit insurance scheme which guarantees up to USD 5,370 in local currency deposits or up to USD 2,727 in foreign currency deposits.

Positive developments in financial sector. Most managers of financial institutions and industry observers report overall satisfaction with the regulatory environment and the work of the CBA. The Armenian financial system is widely praised for its transparency, in contrast to the relative opaqueness of the Azeri financial system. The CBA has also been praised for its willingness to absorb exchange rate risk by taking loans from international donors in foreign currency and on-lending the funds to local banks in dram. The CBA has also been effective at promoting participation of foreign investors in the Armenian financial system. However, there are a number of controversial issues which remain unresolved at the present time.

Interest rate cap. One of these controversial issues is the country’s interest rate cap of two times the CBA’s refinancing rate. The cap currently stands at 24%. In theory, the interest rate cap should be very restrictive for microlenders and consumer lenders, who need to charge higher rates to compensate for high transaction costs. In practice, however, lenders are able to circumvent this cap by charging high fees, which reduces the transparency of interest rates to borrowers. A proposed law may require financial institutions to report their interest rates including all fees and commissions, but would only apply to consumer loans.

Withdrawal of term deposits. A second controversial issue is the ability of depositors to withdraw term deposits at any time without paying additional fees if the deposit has not reached maturity. In effect, there is very little difference between demand deposits and term deposits in Armenia, which makes liquidity planning difficult for banks. Both the interest rate cap and the term deposit issue are enshrined in Civil Law and changes are not likely in the near future.

Currency risk management issues. The CBA’s determined efforts to promote lending in dram have also caused some consternation among bankers. At present lenders are only permitted to make consumer loans in dram, which limits their ability to manage currency risk, as a large portion of banks’ liabilities are in foreign currency. Since the depreciation of the dram in recent months, the problem of currency risk management has become more acute, with borrowers switching deposits into dollars but demanding loans only in dram.

⁹³ The text of the «Law on the Central Bank of Republic of Armenia» is available at http://www.cba.am/CBA_SITE/downloads/legal/laws/central.pdf

⁹⁴ The text of the “Republic of Armenia Law on Banks and Banking» is available at http://www.cba.am/CBA_SITE/downloads/legal/laws/banking.pdf

Commercial banks

Key indicators of commercial banks

Indicator	2006	2007	2008	Q1 2009
Number of banks	21	22	22	22
Number of foreign-owned banks (min. 50%)			12	12
Number of branches/outlets		347	386	388
Growth rate of assets, %	20.1%	45.7%	33.0%	7.5%
Growth rate of loan portfolio, %	24.1%	78.5%	51.0%	3.7%
Share of 5 largest banks in total assets	54.2%	52.7%	51.3%	50.5%
Ratio of non-standard loans	2.3%	2.4%	4.4%	7.9%
Private sector (bank) loans/GDP ratio, %	9.5%	13.0%	16.9%	
Average interest rate to individuals ⁹⁵ , AMD (maturity up to 1 year)		19.9%	20.6%	21.6%
Average interest rate to legal entities, AMD (maturity up to 1 year)		13.6%	13.0%	15.3%
Liquid assets/total assets ⁹⁶	41.2%	33.7%	23.8%	29.1%
Capital adequacy ratio	34.9%	30.1%	27.5%	26.2%
Return on assets, %	3.5%	3.4%	3.1%	(0.04)%
Return on equity, %	16.0%	14.8%	13.5%	(0.17)%

Source: Central Bank of Armenia and Arka News Agency

Financial intermediation in Armenia centers on the banking sector. As of the end of the first quarter of 2009, banks accounted for about 93% of total assets of the financial system, 91% of the total loan portfolio, and 98% of deposits. The Armenian banking sector is comprised of 22 commercial banks with 388 branch offices. The entry of one new bank is possible in 2009, as the Dutch PostBank is in the process of registration with the CBA. The CBA reports that Societe Generale is also looking at the Armenian market, but would likely enter after 2009.

Consolidation efforts ineffective. In an effort to promote consolidation, the CBA has raised capital requirements in recent years, up to AMD 5 billion (about USD 13.6 million) at the present time. However, all banks have managed to meet the increased requirements without consolidation.

Bank liquidity and capital adequacy are high. At the end of the first quarter of 2009, the total capital adequacy ratio of banks (by the CBA's definition) was 26.2%, far above the regulatory threshold of 12%. The total liquidity indicator of 29.1%—5.3% more than at the end of 2008—is also quite high compared to the required regulatory minimum of 15%⁹⁷. High and increasing liquidity is partly due to the dramatic reduction in lending since the start of the financial crisis; many banks are holding onto cash until there are signs of economic recovery. However, this overall high liquidity hides a lack of liquidity in Armenian dram. While US dollars are abundant, mostly as a result of lending from international financial institutions and the desire of depositors to hold their deposits in the more stable US dollar, loan demand is primarily in dram⁹⁸.

Bank concentration. Concentration of bank assets is moderately high in Armenia. As of the end of the first half of 2009 the five largest banks, ACBA Credit Agricole Bank, HSBC Armenia Bank, Ardshinvestbank, VTB Armenia Bank and Ameria Bank, account for over 50% of assets of all commercial banks.

Growth slowing. In 2008 the Armenian banking sector continued its dynamic growth, although at a slower pace than in 2007. Assets of banks in 2008 increased by 33% compared to 45.7% in 2007, and capital by about 40% in 2008 compared to 34% in 2007. The volume of lending grew in 2008 by 51%. However, growth slowed dramatically in the fourth quarter of 2008, when asset volume increased by just 9.5% and loans by 3.4%. During the first quarter of 2009, growth of these indicators was 7.6%

⁹⁵ As of the last months of the year

⁹⁶ This ratio is defined by the CBA and in addition to cash and equivalents includes as liquid assets high-rated, short-term corporate bonds and treasury bills

⁹⁷ Central Bank of Armenia (2008). Main Indicators of Financial Organizations.

www.cba.am/CBA_SITE/downloads/publications/ENG_articles/articles_ENG/Monetary_Overview_2007/main_ind_2.pdf

⁹⁸ ARKA News Agency. "Armenian banks have dram liquidity problems". June 11, 2009. <http://www.arka.am/eng/banks/2009/06/11/15228.html>

and 3.7% respectively. The highest asset growth rates in 2008 were recorded by Ameria Bank (over 268%), followed by Byblos Bank (136.5%). These banks continued to be growth leaders during the first quarter of 2009, having increased their assets by over 60% and 23% respectively⁹⁹. In 2008, asset growth rates of above 50% were also achieved by Pro-Credit Bank Armenia (81.3%), ACBA Credit Agricole Bank (57.6%) and Unibank (51.7%).

Below-average level of financial intermediation. Despite this rapid growth, the level of financial intermediation in Armenia remains relatively low, with a ratio of loans to GDP of 16.9% in 2008. This ratio is one of the lowest among European and Central Asian countries and is below the averages of 25% in transition economies and 50% in developed economies.

Foreign ownership. The banking system functions more smoothly than the economy as a whole¹⁰⁰, making banks unusually attractive partners for foreign investors. There are no restrictions on foreign ownership imposed by the CBA. As of the end of the first quarter of 2009, total foreign investment in the Armenian banking sector (including loans and equity) reached USD 798 million.¹⁰¹ Most current investors in the market for banking services are members of the Armenian Diaspora (both pre- and post-Soviet waves) and carry little weight in political circles. Foreign equity participates in 21 of the 22 banks. This participation exceeds 50% at 12 banks and 95% at 10 banks. The entry of such foreign financial institutions as French Credit Agricole, German ProCredit, Russian Troika Dialog, VTB and Gazprom Bank have helped to accelerate the development of the financial sector by intensifying competition. International donors have also invested in the sector, with EBRD and IFC taking equity stakes in local banks. Most recently, the EBRD took a 25% stake in Araratbank (in late 2008).

Minimal political influence on banking system. According to the independent research organization ArmRating, Armenia's banking system is subject to only minimal political interference. "Even close ties to leading political or business figures are no guarantee of success, making banks comparatively immune to potential shifts in the power structure. Exposure to political risk is accordingly modest—a significant plus in any assessment of systemic (country) risk."¹⁰²

Decrease in portfolio quality. Portfolio quality worsened as a result of the global economic crisis. A variety of specific factors are impacting portfolio quality, including reduced remittances from overseas, reduced household income, increasing unemployment, and a decrease in homeowners' equity as real estate prices fall. By the end of March 2009, the ratio of non-standard loans jumped to 7.9%, compared to 4.4% at the end of 2008 and 2.4% at the end of 2007¹⁰³. On a sectoral basis, non-standard loan rates were 11.6% in agriculture, 9.6% in housing, 6.9% in trade and 3.0% in energy.

Sectoral structure of loan portfolio. As of March 31, 2009, loans to the trade and services sectors represented the largest share (25.8%) of the total domestic loan portfolio of banks. Consumer loans accounted for around 25%, mortgage loans for over 13.5% and agriculture for 7%. The large share of consumer and mortgage loans (38.5% total) may pose the greatest threat to portfolio quality of Armenian banks, as these loans are experiencing high delinquency rates. During the first quarter of 2009, the share of consumer loans decreased by over 3% while the shares of loans to industry and agriculture increased by over 1% each.¹⁰⁴

Decreasing profitability of banks. In previous years, profitability indicators of commercial banks were relatively good, with returns on equity ranging from 13.5% to 16.0% in the last three years. By

⁹⁹ Banker.am, Armenian Bank Portal. "Indicators of commercial banks of Armenia as of March 31, 2009" (in Russian). April, 2009. http://www.banker.am/risk_order.php?lang=3&risk_id=50&ab_id=127

¹⁰⁰ The Civilitas Foundation (2008). Armenia in 2008: Crisis and Opportunity. The Civilitas Foundation. Yerevan, Civilitas Foundation, 2008.

¹⁰¹ Calculated based on the data of National Statistical Service of Armenia, http://www.armstat.am/file/article/sv_04_09r_42.pdf

¹⁰² ArmRating (2008). "The Armenian Banking System: Better Transparency. Political Neutrality. Funding Scarcity." www.amrating.am/en/research/BS_Armenian

¹⁰³ Central Bank of Armenia. "Monetary overview April 2009." April 2009. http://cba.am/CBA_SITE/downloads/publications/ENG_articles/articles_ENG/Monetary_Overview_2007/loans_com.pdf

¹⁰⁴ The indicators are calculated based on the data of Central Bank of Armenia http://cba.am/CBA_SITE/downloads/publications/ENG_articles/articles_ENG/Monetary_Overview_2007/loans_com.pdf

the end of the first quarter of 2009, however, the total ROA and ROE of banks were -0.04% and -0.17% , respectively, primarily due to losses experienced within the banking system in March 2009.

Share of dram loans decreased. Following several years in which lending in dram increased, the recent depreciation of the dram has changed this tendency. As of June 30, 2009, loans in AMD accounted for 49.8% of total loan portfolio of banks compared to 61.8% at the end of 2008. At the same time, the demand for dram loans is increasing—the drop in the share of dram loans is only the result of converting the values at a lower exchange rate. Over 80% of loans to the agricultural sector and 74% to the industrial sector are granted in US dollars. By law, all consumer loans must be disbursed in dram.

Bank lending by currency

	2006	2007	2008	H1 2009
Share of loans in AMD	47.2%	59.3%	61.8%	49.8%
Share of loans in foreign currency	52.8%	40.7%	38.2%	50.2%

Source: Central Bank of Armenia

Growth of deposits in foreign currency. The depreciation of the dram has led many depositors to switch their deposits from dram to US dollars. The share of deposits in foreign currency have increased during the first quarter of 2009 to 73% from 51.2% at the end of 2008. Total deposits grew by 18.7% in the first six months of 2009 compared to 10.4% a year ago.

Deposit activity (including banks and credit organizations)

	2006	2007	2008	H1 2009
Share of deposits in AMD	44.4%	59.0%	48.8%	27.0%
Share of deposits in foreign currency	55.6%	41.0%	51.2%	73.0%
Growth rate of deposits	16.2%	34.7%	12.8%	18.7%
Loans to deposits	79.4%	103.1%	136.2%	113.4%

Source: Central Bank of Armenia

Increasing loan-deposit interest rate spreads. By the end of the first half of 2009, USD interest rate spreads increased both for individuals and legal entities. The dram spreads increased for legal entities but decreased for individuals. Most banks interviewed for this study report raising both interest rates on loans and deposit rates in 2009 by roughly 1–2%.

Average loan and deposit interest rates with maturity up to one year

Currency	Average interest rate	Dec. 2007	Dec. 2008	Mar. 2009	June 2009
AMD	Loans to individuals	19.9	20.6	21.6	21.3
	Deposits to individuals	6.3	8.4	11.0	11.1
	Spread to individuals	13.6	12.2	10.6	10.2
	Loans to legal entities	13.6	13.0	15.3	14.4
	Deposits to legal entities	5.8	7.3	7.6	8.3
	Spread to legal entities	7.8	5.7	7.7	6.1
USD	Loans to individuals	18.5	13.1	16.8	18.9
	Deposits to individuals	5.1	5.7	5.6	5.6
	Spread to individuals	13.4	7.4	11.2	13.3
	Loans to legal entities	13.3	14.0	14.6	13.4
	Deposits to legal entities	5.1	7.7	7.2	6.8
	Spread to legal entities	8.2	6.3	7.4	6.6

Source: Central Bank of Armenia

Declining interest rates and increasing maturities of foreign borrowings. By the end of 2008, the average weighted interest rate on loans from abroad fell by over 1% to 6.3% compared to the end of the previous year. About 57.9% of the external loans were with floating interest rates (LIBOR, EURIBOR, CBA securities). The average maturity of these loans was 3.9 years.¹⁰⁵ However, most

¹⁰⁵ Central Bank of Armenia (2009). Financial System of the Republic of Armenia, quarterly review, Q4, 2008, http://www.cba.am/CBA_SITE/downloads/periodicals/Quarterly/financial.pdf

banks interviewed for this project report that interest rates started to increase again in late 2008, and that loan terms are decreasing.

Diversification of funding instruments. In addition to deposits and loans from international financial institutions and interbank borrowing, Armenian banks increasingly attract resources through issuance of debt securities. Among the banks which have issued bonds are Ardshinvestbank, Araratbank, Armeconombank, Armenian Development Bank, Converse bank and HSBC Bank Armenia.

Rating of Armenian banks by asset size as of March 31, 2009¹⁰⁶

Bank name	Assets, USD million	Equity, USD million	# of branches	Foreign ownership
“ACBA Credit Agricole Bank” CJSC	383.1	73.65	28	28% French Credit Agricole
“HSBC Armenia Bank” CJSC	347.03	36.39	10	70% HSBC Europe B.V., 30% Wings Establishment
“Ardshinvestbank” CJSC	329.16	72.29	51	10% International Finance Corporation
“VTB Armenia Bank” CJSC	287.81	65.03	78	100% “Vneshtorgbank”, OJSC, Russia
“Ameriabank” CJSC	219.93	55.76		96,97% “TDA Holdings Limited” (affiliated with Russian investment bank Troika Dialog)
“Uni Bank” CJSC	211.82	33.9	30	50% Uniastrum Asset Management, Russia
“Converse Bank” CJSC	203.98	34.49	26	95% Advanced Global Investments LLC, USA
“ArmEconombank” OJSC	137.49	22.87	34	25%—EBRD
Ineco Bank” CJSC	131.72	25.44	7	10% IFC, 13.5%—DEG
“Armbusiness Bank” CJSC	125.96	18.57	17	35% Ukrainian Ukrprombank 35% Ukrainian Alfa-Garant Insurance Company 30% British Virginia Islands Christies Management Company
“Arexim Bank” CJSC	104.95	26.36	10	94.10% Gazprombank, Russia 5.90% Raiffeisenbank, Austria
“Anelik Bank” CJSC	103.75	15.35	9	
“Artsakh Bank” CJSC	100.66	15.64	14	82.2%—citizens of Switzerland and USA
“Ararat Bank” OJSC	76.05	20.75	21	
“ArmSwiss Bank” CJSC	69.02	16.05		
“Prometey Bank” LLC	50.57	25.35	3	92.25%—ZakNefteGazStroy Prometey, OJSC, Russia
“Byblos Bank Armenia” CJSC	47.58	22.47	3	65% “Byblos Bank” S.A.L. Lebanon; 25%—EBRD 10%—OPEC
“Armenian Development Bank” OJSC	45.14	16.2	1	10.1% East Investor LTD
“Cascade Bank” CJSC	36.23	15.18	9	100% US Based Cafesjian Family Foundation
“Pro Credit Bank” CJSC	33.27	15.34	4	67.49% Pro Credit Holding; 15.84% KfW; 16.67% EBRD
“Mellat Bank” CJSC	30.13	16.71		100% Iranian Mellat State Bank
“BTA Bank” CJSC	26.79	15.15	5	48.95% BTA Bank Kazakhstan; 31.10% Betaligunds GmbH, Germany; 16.25% Mobilex energy LTD, Kazakhstan; 3.70 % AMK Invest, Russia

¹⁰⁶ National statistical service of RA (2009). “Socio-Economic Situation of RA in January–April 2009”. May 29, 2009. http://www.armstat.am/file/article/sv_04_09r_32.pdf

Non-bank financial institutions

Summary statistics of the non-bank financial sector

Indicator	2006	2007	2008	Q1 2009
Number of insurance companies	15	10	12	12
Assets of insurance companies, USD million		25.5	38.2	33.8
Capitalization of the stock market, USD million	53.1	105.8	176.6	145.3
Number of listed companies	35	28	16	18
Number of licensed securities brokers		15	10	9
Number of universal credit organizations	17	21	25	25
Assets of universal credit organizations, USD million	56.6	142.6	215.8	201.7

Source: Central Bank of Armenia and National Statistical Service of Armenia

Insurance

The insurance market in Armenia is at a very early stage of development. By the end of 2008, the assets of insurance companies accounted for just 1.2% of the total assets of financial system, having increased by 50% during the year. In the first quarter of 2009, the assets of insurance companies in USD decreased by 11.5% due to a 19.6% appreciation of the USD during the period. The growth rate of assets expressed in AMD was 5.2%. Two new players entered the market in 2008. In six of twelve insurance companies foreign participation exceeds 50%, and in 5 it exceeds 95%. Insurance premiums in 2008 represented just 0.2% of GDP, twice as much as in 2007. Insurance companies are generally profitable, achieving an average return on assets of 8.5% in 2007, twice as much as in 2006.

The insurance industry will be given a boost in 2009 by expected legislation which will make auto insurance mandatory.

Active insurance agreements indicators as of April 1, 2009

Type of insurance	Amount, USD million	Share, %	YoY growth, %
Life	0	0	0
Personal	305.1	4.1	9.7
Property	3,151.3	41.8	110.3
Responsibility	3,300.3	43.7	193.2
Other	787.9	10.4	(8.8)
Total	7,544.7	100.0	

Source: National Statistical Service of Armenia¹⁰⁷

Leasing

Leasing providers in Armenia include banks and three universal credit organizations specialized in leasing: ACBA-Leasing, Agroleasing and Cascade Credit. The total leasing portfolio in 2008 exceeded USD 16 million, over 86% of which is accounted for by the three specialized leasing companies¹⁰⁸.

In 2008 the portfolio of specialized leasing organizations grew by over 60%. It is expected that new players, especially from the banking sector, will enter the market in 2009/2010 and the availability of services will increase. One of the newest entrants is Unileasing, established by Unibank at the end of 2008.

Stock market

The Armenian Stock Exchange, NASDAQ OMX Armenia, is a small stock market characterized by minimal trading activity.¹⁰⁹ It was purchased by Nordic OMX AB in November 2007 and, after the merger of OMX with US Nasdaq in January 2009, was renamed "NASDAQ OMX Armenia". As of April 30, 2009, there were 10 stocks of nine issuers and 12 bonds of ten issuers included on the stock

¹⁰⁷ National statistical service of RA (2009). "Socio-Economic Situation of RA in January–April 2009". May 29, 2009. http://www.armstat.am/file/article/sv_04_09r_32.pdf

¹⁰⁸ ArmInfo. "AmericaBank: the Demand for Leasing in Armenia is Growing by Stable Rates". November 17, 2008. <http://subscribe.ru/archive/media.today.arminfo/200811/18173242.html>

¹⁰⁹ All data in this section is taken from the NASDAQ OMX Armenia web site: www.nasdaqomx.am.

exchange list. In 2008, only eight stocks were traded, two of which were bank stocks—Araratbank and Armeconombank. Total trading volume in equities in 2008 amounted to less than USD 1 million. During the first four months of 2009, only eight trades with stocks of four companies were conducted, adding up to a total turnover of USD 11,100.

Indicators of Armenian stock exchange activities with different instruments

	2006	2007	2008	Jan–Apr 2009
Operations with equities				
Total value traded, USD million	5.17	4.43	0.86	0.01
Number of trades	1134	220	75	8
Capitalization, USD million	53.08	105.83	176.46	143.72
Operations with corporate bonds				
Total value traded, USD million	1.15	2.05	7.34	11.17
Number of trades	47	99	329	313
REPO operations				
Total value traded, USD million			0.14	3.35
Number of trades			1	16
Operations with Government Bonds				
Total value traded, USD million			5.42	1.16
Number of trades			81	19

Source: ArmEx-OMX-NASDAQ.am

Institutional changes. In 2008 stricter requirements regarding the equity capital of investment companies were enforced. As a result, the number of licensed investment companies decreased, and by the end of the first quarter of 2009, 19 of 26 stock exchange members were banks compared to only one bank in 2007. Listing and information disclosure requirements were also raised, leading to a reduction in the number of listed companies. At the same time, new listing rules allow stock of non-listed companies to be traded at the stock exchange.

Pension funds

Currently the only pension fund in Armenia is run by the state. However, in 2008 the government of Armenia approved a program of reforming the pension system and a schedule for implementation. As part of this program, numerous private pension funds are expected to be established to eventually replace the state pension. The law on pension funds is expected to be approved in May 2009.

Universal credit organizations and other institutions

Non-bank lending is provided primarily by universal credit organizations (UCOs). According to the Law “On Credit Organizations”¹¹⁰, a credit organization is a legal entity chartered to perform borrowing and lending transactions and investments. Credit organizations can be commercial or non-commercial cooperatives, joint stock companies (JSC) or limited liability companies (LLC). Credit organizations are regulated by the Central Bank of Armenia. UCOs are required to have at least AMD 150 million in statutory capital and a capital adequacy ratio of at least 10%.

Credit organizations growing faster than banks. As of March 31, 2009, the Armenian financial market included 25 universal credit organizations (UCOs) with 48 branch offices and total assets of USD 215 million, a 51.3% increase compared to 2007. In the first quarter of 2009 assets in AMD increased by 12.4% but decreased in USD by 6% due to AMD depreciation during the period. Fifteen credit organizations have foreign equity participation. In ten, the share of foreign participation is over 50% and in nine it is over 95%. Four new UCOs were registered in 2008.

Target markets. UCOs lend to various sectors of the economy. Several credit organizations specialize in mortgage lending, others in agrilending and leasing. As of March 31, 2009, consumer loans comprised 12% of UCOs’ total loan portfolios, half of the share found in banks, but UCOs have

¹¹⁰ Central Bank of Armenia. “Republic of Armenia Law on Credit Organizations.” http://www.cba.am/CBA_SITE/downloads/legal/laws/credit.pdf

a much higher share of agricultural loans than banks. 20.9% of UCOs' loans were made to enterprises active in trade and services, and 12.4% to mortgage lending.

Asset concentration in credit organization sector is higher than in banking sector. According to the survey of Armenian bank portal Banker.am¹¹¹, over 55% of the total assets of universal credit organizations were concentrated among three UCOs as of September 30, 2008. They are Norvik, accounting for over 30%, Aregak, accounting for almost 15% and Finca with 11.5% of total assets of UCOs. Aregak had the largest number of branches (24 total), followed by Finca and Malatia International Credit Organization with 11 branches each.

The capital adequacy of credit organizations is very high at 39.6% as of the end of 2008 and 35.0% at the end of the first quarter of 2009, far exceeding the minimal required level of 10%. The share of non-standard loans increased significantly in the first quarter of 2009 and reached 7.9%, the same level as in the banking sector.

Capital adequacy and portfolio risk indicators of UCOs

	2006	2007	2008	Q1, 2009
Capital adequacy ratio, end of the period	49.6%	NA	39.6%	35.0
Share of non-standard loans	2.9%	2.1%	3.9%	7.9%

Source: Central Bank of Armenia

Indicators of universal credit organizations lending activities

	2006	2007	2008	Q1, 2009
Share in total lending	6.4%	8.2%	8.0%	8.4%
Portfolio growth rate		135.9%	54.0%	6.2%
Share of lending in AMD	53.8%	61.2%	48.3%	54.9%
Share of lending in foreign currency	46.3%	38.8%	51.7%	45.1%

Source: Central Bank of Armenia

¹¹¹ There is no established practice of UCOs publishing financial statements on regular basis. Many UCOs still do not have web-sites.

Rating of Armenian universal credit organizations by asset size as of September 30, 2008¹¹²

	Assets, USD million	Share in total assets of UCOs, %	Number of branches
“NORVIK” Universal Credit Organization CJSC	60.9	30.81%	
“AREGAK” Universal Credit Organization CJSC	29.5	14.93%	24
“FINCA” Universal Credit Organization CJSC	22.7	11.50%	11
“ACBA LEASING Credit Organization” CJSC	15.8	7.97%	
“CASCADE CREDIT” Universal Credit Organization CJSC	10.7	5.42%	
“SEF International Credit Organization” LTD	9.6	4.85%	3
“BLESS” Universal Credit Organization LLC	6.3	3.17%	
“FIRST MORTRAGE COMPANY” UCO	6.8	3.42%	
“MALATIA International Credit Organization” LTD	6.4	3.25%	4
“IZMIRLYAN-EURASIA” Universal Credit Organization LLC	6.2	3.14%	
Express Credit” Universal Credit Organization CJSC	5.1	2.60%	
“GARNIINVEST” Universal Credit Organization CJSC	3.3	1.69%	
“NOR HORIZON” Universal Credit Organization Ltd.	3.0	1.53%	4
“WASHINGTON CAPITAL” Universal Lending Organization	1.7	0.86%	
“AVANGARD INVEST” Universal Credit Organization CJSC	1.7	0.86%	
“CARD AgroCredit” Universal Credit Organization CJSC	1.5	0.77%	
“Arfin Credit Union Company “ Co.LTD	1.4	0.71%	
“Gladzor” Universal Credit Organization CJSC	1.3	0.65%	1
“AGROLEAZING LEASING KREDIT COMPANY” LLC	1.1	0.56%	
“FARM CREDIT ARMENIA” UCO Commercial Cooperative	1.1	0.55%	
“GI EF SI General Faynenshl and Credit Compani Universal Credit Organization” Ltd.	0.8	0.40%	
“VTB leasing” LCO CJSC	0.5	0.27%	
“Ecumenical Church Loan Fund UCO” LLC	0.2	0.11%	

In the fourth quarter of 2008, two new players entered the market: “Unileasing” CJSC and “Aniv” Ltd. In the second quarter of 2009, “Cascade Credit” CJSC merged with “Cascade Bank”. In June 2009 the National Mortgage Company established by the Government of Armenia to stimulate development of the mortgage market was registered as a UCO and obtained a license from the Central Bank of Armenia¹¹³.

In addition to the above institutions, the financial sector of Armenia included at the end of the first quarter 2009: 71 pawn shops with USD 12.3 million in loans, 230 currency exchange offices, 1 currency dealer and 10 money transferring organizations. It also includes Kamurj, a microlending organization which is registered as a non-governmental organization.

SWOT Analysis for the Armenian financial sector

Strengths	<ul style="list-style-type: none"> • High overall liquidity, particularly in foreign currency • Minimal political influence on banks • High level of foreign equity investment • High degree of transparency • Relatively good supervision by Central Bank of Armenia
Weaknesses	<ul style="list-style-type: none"> • Low level of financial intermediation (16.9% loans to GDP ratio) • Reduction of lending activities in connection with crisis • Recent decrease of credit portfolio quality
Opportunities	<ul style="list-style-type: none"> • Redirection of loan investments from consumer to business sector • Low level of financial intermediation presents growth opportunities • Limited competition in smaller towns of Armenia
Threats	<ul style="list-style-type: none"> • Further worsening of credit portfolio quality and liquidity in connection with worsening economic situation • Further depreciation of the Armenian dram

¹¹² Unaudited survey data from Banker.am Armenian Bank Portal. May 2009 www.banker.am

¹¹³ Arka News Agency (2009). “Armenia to sign EUR 200 million agreement with German Government”. July 13, 2009. <http://www.arka.am/eng/economy/2009/07/13/15755.html>

5. Financial sector analysis: Azerbaijan

Regulation and supervision

Relevant laws and supervisory bodies. The banking and credit sector of Azerbaijan is regulated by the Central Bank of the Azerbaijan Republic (CBAR) which is the central state bank and is principally regulated by the:

- Law “On National Bank of the Azerbaijan Republic”¹¹⁴
- Civil Code of the Azerbaijan Republic
- “Law on the Banks”¹¹⁵

Credit organization activities are principally regulated by the:

- Constitution of the Azerbaijan Republic¹¹⁶
- “Law on the Banks”
- Law “On non-banking credit institutions”
- Civil Code of the Azerbaijan Republic
- Law “On National Bank of the Azerbaijan Republic”
- Law “On Credit Unions”¹¹⁷
- Law “On Mortgage”

Licensing. All banks and non-bank credit organizations operating in Azerbaijan are required to be licensed by the CBAR. The CBAR issues licenses for three types of institutions:

1. banking institutions
2. non-bank credit institutions, which are only allowed to offer credit but not accept deposits
3. credit unions, which can only conduct activities with members and do not accept deposits

CBAR working to consolidate and stabilize. The CBAR has been working to consolidate and stabilize the financial institutions of Azerbaijan. It has implemented a policy of bank consolidation and promoted the growth of existing institutions. Over 250 commercial banks in the mid 1990’s have been reduced to only 46 at present. While the number of institutions has decreased, the total assets have increased by a factor of 40 since 1993 and by 250% since 2006. Capital requirements were increased several times with the intention to further stabilize and consolidate the financial sector. The minimal capital requirements for new banks were increased in July 2008 to AZN 10 million (USD 12.5 million). Currently, four banks do not meet the minimum reserve requirements.

Newly created deposit insurance system. The law on deposit insurance came into effect on August 13, 2007. The original cap of AZN 6,000 was raised to AZN 30,000 recently to prevent bank runs in connection with the deepening global economic crisis.

CBAR attempts to stimulate liquidity. The CBAR has taken steps to mitigate the effects of the global financial and economic crisis. To maintain liquidity in the system, the CBAR refinancing rate was reduced from 15% to 5% between November 3, 2008 and February 2, 2009. Additionally, the 5% reserve requirement on foreign liabilities has been removed and the 12% reserve requirement on domestic liabilities has been reduced to 6%. The averaging period¹¹⁸ of reserve requirements has been extended to up to one month.

Reinvestment of profit in capital encouraged. As of January 1, 2009 banks, insurance and reinsurance companies are exempt from taxes on profits which are reinvested by increasing the charter capital of the organization.

¹¹⁴ The text of the law is available at www.nba.az/download/h_senedler/law_on_the_NBA.pdf

¹¹⁵ The text of the law is available at www.nba.az/download/h_senedler/Law%20on%20the%20banks.pdf

¹¹⁶ The text is available at www.un-az.org/doc/constitution.doc

¹¹⁷ The text is available at www.un-az.org/doc/constitution.doc

¹¹⁸ The Averaging Requirement is used to calculate the compliance with the reserve requirements. A short averaging period, such as one day, results in rapid fluctuations in interest rates. A longer Averaging Period allows more flexibility and gradual changes and increases stability.

Commercial banks

Indicators of commercial banks

Indicator	2006	2007	2008	Q1, 2009
Number of banks	44	46	46	46
Number of foreign banks ¹¹⁹	5	6	7	7
Number of branches/outlets	420	485	567	585
Growth rate of assets	67.8%	78.0%	52.8%	(14.2)%
Growth rate of loan portfolio	64.0%	98.2%	53.5%	(13.6)%
Share of 5 largest banks in total assets	65.0%	63.0%	62.0%	
Ratio of non-performing loans ¹²⁰	3.3%	2.0%	2.2%	3.1%
Private sector loans/GDP ratio	12.3%	16.7%	18.3%	
Average interest rate AZN ¹²¹	16.5%	17.0%	17.5%	17.4%
Average interest—foreign currency	17.2%	16.3%	14.5%	18.5%
Liquid assets/total assets		18.9%	16.7%	
Capital adequacy ratio	18.7%	19.9%	19.6%	
Return on assets	1.7%	2.6%	2.2%	0.8%
Return on equity	12.8%	17.6%	17.0%	4.6%

Source: Central Bank of Azerbaijan

Banks play major role in financial sector. As of the end of 2008, banks accounted for around 98% of total assets of credit organizations and the same share of the total credit portfolio. This proportion has been stable over the past three years.

After rapid consolidation, stability. The CBAR has set a course for encouraging consolidation in the banking sector. Following a period of rapid consolidation in the mid and late 1990s, when there were over 250 banks operating in Azerbaijan, the number of banks is now relatively stable. It is anticipated that there will be some further consolidation as a result of the deposit insurance law which came into effect in 2008 which resulted in nine banks working on a restricted license and becoming prohibited from receiving deposits. Currently there are licensed 46 banks. Two licenses were revoked in 2008—for Atlantbank and Postbank—and those banks are currently in liquidation.

New banks licensed in 2007 and 2008. In the third quarter of 2007, two new banks were granted operating licenses: Bank Avrasiya and Pasha Bank. In the third quarter of 2008, Nakhchivan Bank was licensed and in November 2008, a banking license was granted to the Turkish bank AZ FINANSBANK. Commerzbank and CitiBank were granted licenses to open representative offices.

State ownership of banks. Kapital Bank was fully privatized in 2008, when the remaining 50% of shares which were held by the state were sold. The remaining state owned bank, International Bank of Azerbaijan, accounts for a significant share of total loans (45%) at the close of 2008. The increased growth of the private banks and the privatization of Kapital Bank have resulted in a falling market share of the state, which declined from 66% in 2000. In the first quarter of 2009, International Bank of Azerbaijan's assets fell by 24.3%, while Kapital Bank's assets fell by 40.9%. The International Bank of Azerbaijan is in the process of privatizing but its progress has been slow and it is unclear if the privatization will be successfully completed.¹²² In addition, it should be noted that some banks are rumored to be closely connected to the government even if they are formally private.

7 of 46 banks are foreign. Of the 46 registered banks, 7 have more than 50% foreign capital, 14 have less than 50%, and 20 banks have 100% domestic funding. The rest are local branches or representative offices of foreign banks. The CBAR has the right to limit the participation of foreign capital in banks and all foreign legal entities must be approved by the CBAR. Regulations concerning the requirements are set forth in the "Law on Banks."

¹¹⁹ More than 50% foreign capital

¹²⁰ For the purpose of calculating this ratio the value given as "overdue" in the Azerbaijan statistical bulletin

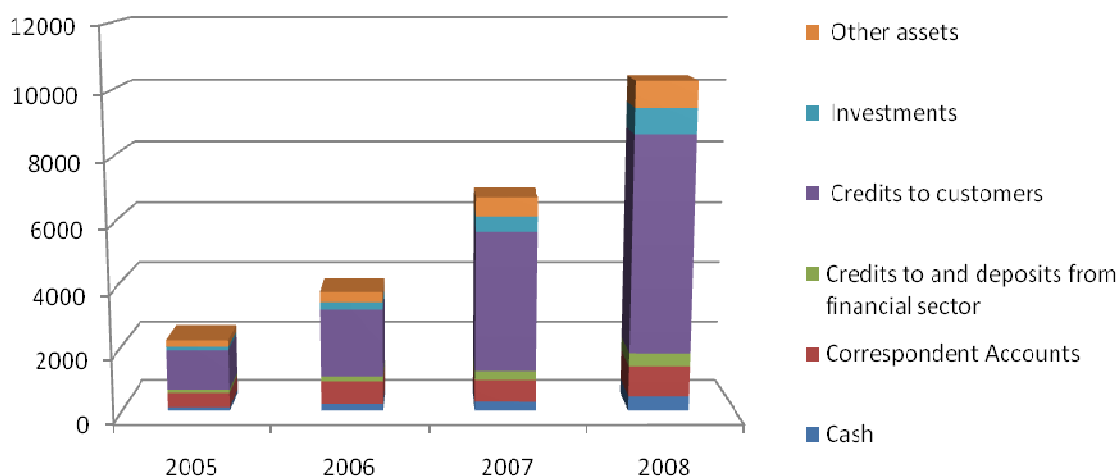
¹²¹ End of the period

¹²² ABC.az. "Azerbaijan Republic Minister of Finance declared about support of careful approach to state property privatization". November 7, 2008. <http://abc.az/eng/news/privatization/29179.html>

Number of branches is growing. The total number of bank branches has increased by 15% per year between 2006 and the end of 2008. IBA and Kapital Bank have the largest network of branches with 125 branches between them both. This number has remained steady while the private banks have been expanding their coverage. At the end of the first quarter of 2009, there were 547 private bank branches, up from 248 at the start of 2006¹²³.

Strong but slowing growth. Bank assets measured AZN 10 billion (USD 12.8 billion) at the end of 2008. This represents a 53% increase during 2008, while 2007 saw growth of 98%. The loan portfolio grew by 51% and household savings increased by 39 percent. Growth has slowed in the second half of 2008, following the onset of the global financial crisis. In the first quarter of 2009, assets of banks decreased by 14.2%¹²⁴. In April 2009 assets grew by 2.1%¹²⁵, which may signal an end to this decline.

Bank Assets (AZN million)



Source: Central Bank of Azerbaijan

Profitability. Overall the banking sector in Azerbaijan is profitable and profits are growing. 2008 saw net after-tax profit of USD 225.22 million for the entire banking system. Thirty eight banks were profitable while eight banks suffered losses in 2008¹²⁶, compared to five loss-making banks in 2007. In the first quarter of 2009, the total profits of the banking system grew by 72.6% compared to the same period of 2008, despite the fact that nine banks suffered losses and despite the decline in portfolio quality and total loan portfolio.¹²⁷

¹²³ The National Bank of Azerbaijan Republic. "Statistical Bulletin of National Bank of Azerbaijan #3 (109)". April 2009. <http://www.nba.az/download/neshrtler/bulleten/BULLETEN%203-109-2009.pdf>

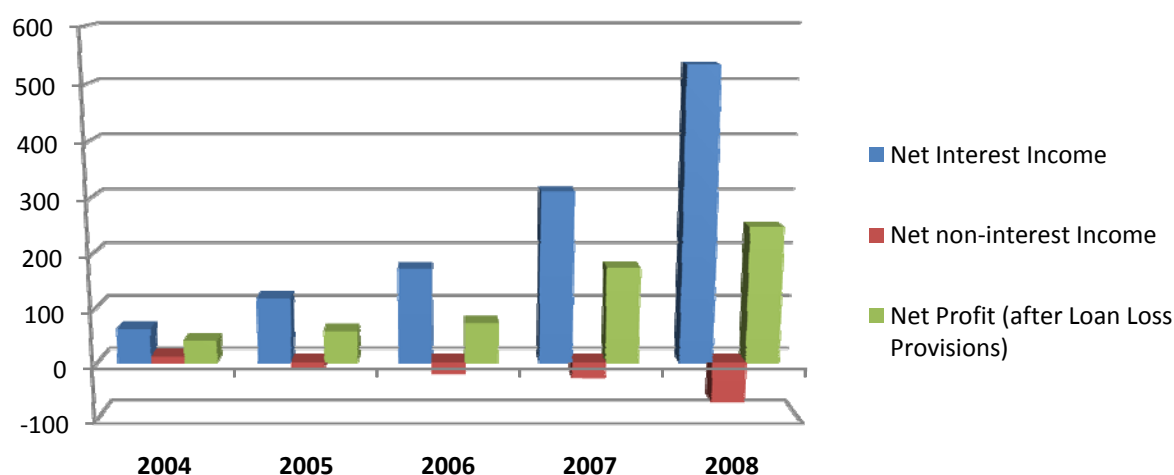
¹²⁴ The National Bank of Azerbaijan Republic. "Statistical Bulletin of National Bank of Azerbaijan #3 (109)". April 2009. <http://www.nba.az/download/neshrtler/bulleten/BULLETEN%203-109-2009.pdf>

¹²⁵ Current on-line data of Central Bank of Azerbaijan, <http://www.nba.az/>

¹²⁶ ABC.az. "Net profit of Azerbaijani banks totaled USD 307.154 million for 2008". January 29, 2009. http://bank.abc.az/cgi-bin/wnews_one.cgi?nid=31743&lang=eng

¹²⁷ Calculated based on data of Central Bank of Azerbaijan Republic, "Indicators of credit organizations : financial results of banking activity". http://www.nba.az/download/statistika/kre_teshkilat_g/maliyye_neticeleleri.pdf

Bank Profit (before tax) by Year



Source: Central Bank of Azerbaijan

Sufficient liquidity. Although the liquidity ratio of banks decreased by 2.2% during 2008, it remained relatively high at 16.7% at the end of 2008¹²⁸. BFC believes that 2009 figures will show an increase in liquidity when they are published, due mainly to a reduction in lending volumes. Many banks interviewed for this study reported having excess liquidity at the present time.

Slow-down of deposit growth. Total deposits grew 49.5% and 36.6% in 2007 and 2008, respectively, but decreased slightly from October through December 2008. In the first quarter of 2009, deposits decreased by 28.9%¹²⁹. Since 2007, deposit growth has lagged behind credit growth.

Deposit activity

	2006	2007	2008	March 2009
Share of deposits in AZN	38.8%	53.0%	44.5%	46.5%
Share of deposits in foreign currency	61.2%	47.0%	55.5%	53.5%
Growth rate of deposits	64.5%	49.7%	36.5%	(28.9)%
Loans to deposits	111.0%	146.9%	164.7%	201.3%

Source: Central Bank of Azerbaijan

Lending activities of banks declined in the first quarter of 2009. The loan portfolio of banks, accounting for over 66% of their assets, fell 13.6% in Q1 2009. The decline stopped in April 2009 when the loan portfolio of the banks increased by 1.1%. According to the classification of the Central Bank of Azerbaijan Republic, as of April 1, 2009 the key sectors of lending are households, making up 36.5%, trade and services (20.4%), construction (10.1%), industry (7.5%), and agriculture (5.6%). Roughly half of all loans are made in the local currency.

Currency structure of lending for banks and non-bank credit organizations

	2006	2007	2008	March 2009
Share of credits in AZN	49.5%	54.0%	50.9%	55.8%
Share of credits in foreign currency	50.5%	46.3%	49.1%	44.2%

Source: Central Bank of Azerbaijan

Most loan-deposit spreads are widening. As the following table shows, interest rate spreads are increasing for most categories, with the exception of manat loans to legal entities, for which the spreads have remained mostly stable.

¹²⁸ Central Bank of Republic of Azerbaijan(2009). "Annual Report 2008".

http://www.nba.az/download/neshrler/report_2008.pdf

¹²⁹ Central Bank of Azerbaijan Republic. "Statistical Bulletin of National Bank of Azerbaijan #3 (109)". April 2009.

<http://www.nba.az/download/neshrler/bulleten/BULLETEN%203-109-2009.pdf>

Average loan and deposit interest rates with maturity up to one year

Currency	Average interest rate	Jan. 2008	Jan. 2009	Apr. 2009
AZN	Loans to individuals	20.29	21.53	21.65
	Deposits to individuals	12.47	12.54	12.41
	Spread to individuals	7.82	8.99	9.24
	Loans to legal entities	15.32	14.87	14.80
	Deposits to legal entities	9.68	9.48	9.19
	Spread to legal entities	5.64	5.39	5.61
Foreign currency	Loans to individuals	21.70	21.52	22.26
	Deposits to individuals	12.47	12.43	12.62
	Spread to individuals	9.23	9.09	9.64
	Loans to legal entities	13.72	12.37	16.61
	Deposits to legal entities	7.68	5.40	6.78
	Spread to legal entities	6.04	6.97	9.83

Source: Central Bank of Azerbaijan

Portfolio quality. On December 31, 2.2% of bank loans were considered non-performing. The key factor for classification as non-performing is 90 days or more of delinquency. This is a slight increase over the record low of 1.6% in June 2008, but a significant improvement from 3.3% at the end of 2006 and 21.5% at the end of 2002. As of the end of the first quarter of 2009, non-performing loans had risen to 3.1% of the total credit portfolio¹³⁰.

Capital adequacy. The capital adequacy ratio was 19.6% at the end of 2008, which is well above the minimum 12% requirement of the Central Bank. Bank capital increased by 55% in 2008.

Banks are increasingly borrowing from abroad. In 2008, the total flow of foreign loans and investments into Azerbaijani banks grew by 51.8% to USD 1,278.5 million. This represents 16.9% of total investments into the Azeri economy from abroad¹³¹. Still, dependence of Azerbaijani banks on foreign borrowings is not high¹³². The Central Bank of Azerbaijan reported in June 2009 that since the beginning of the year, the banking system has paid off USD 900 million in foreign borrowings and attracted new borrowings in the amount of USD 450 million¹³³.

Growing medium-term concerns of international rating agencies. In June 2009 Moody's Investors Service expressed its negative outlook for Azerbaijani banking system in the mid-term (12–18 months). The rating agency admits that previously accumulated resources allowed the banking system to mitigate the influences of the first wave of the financial crisis. At the same time, such factors as a worsening operating environment, declining banks asset quality and increasing reliance on the Central Bank to refinance their obligations have had a negative impact on the system. The agency also mentions such fundamental structural problems as high concentration (70%) of banking assets among the seven largest banks, the significant level of single-borrower concentration of lending, potentially understated levels of related-party lending, and low geographic diversification of the banking system¹³⁴.

Standard & Poors, which assigned the banking system of Azerbaijan a rating of BB+/Stable/B,¹³⁵ also expressed concern regarding the weak risk management of Azeri banks. According to the estimates of S&P analysts, the share of the total problem assets in the financial system is as high as 35–50%.

¹³⁰ ibid

¹³¹ Central Bank of Azerbaijan Republic (2009). "Annual Report 2008".

http://www.nba.az/download/neshriat/report_2008.pdf

¹³² Bankir.ru. "Banks of Azerbaijan are increasingly being influenced by international crisis; S&P" (in Russian). June 1, 2009. <http://bankir.ru/news/newsline/rnews/2163785>

¹³³ ABC.az. "Since early 2009 Azerbaijani banking paid USD 900 million of foreign borrowings and raised more than USD 450 million". June 20, 2009. <http://abc.az/eng/news/main/36002.html>

¹³⁴ Finchannel.com. "Moody's: Negative outlook for Azerbaijan's banks amid challenging economic conditions". June 9, 2009. http://www.finchannel.com/index.php?option=com_content&task=view&id=39541&Itemid=2

¹³⁵ ibid

S&P placed Azerbaijan in the second most risky classification for banking and country risk¹³⁶. Fitch Rating assesses the country banking system as weak¹³⁷.

Overview of banks, March 31, 2009¹³⁸

Bank name	Assets, USD million	Branches	Foreign ownership
International Bank of Azerbaijan	4,121.57	36	
Bank Standard CJSC	671.76	37	
Technikabank OJSC	537.47	16	75%—World Wines Private Company; 10%—Kazimir Caspian Fund Limited, Cayman Islands
Bank Respublika OJSC	481.06	35	16,67%—DEG; 8,33%—SIDT
Xalq Bank OJSC	481.01	23	
Unibank OJSC	466.09	8	15,15%—EBRD , 8,33%—DEG
Kapital Bank OJSC	425.42	24	
Nikoil Bank OJSC	360.3	89	61%—Closed JSIC “Niikoil”; 29.4%—UralSib Invest LLP, Russia
AccessBank CJSC	286.24	10	EBRD, IFC, BSTDB, KfW, Access Microfinance Holding, LFS
Azerdemiryolbank OJSC	265.36	22	25% + 1—EBRD; 10%—FMO
Pasha Bank OJSC	258.87	29	
Azerigazbank OJSC	255.07		17.5%—IFC; 10%—Kazimir Partners company, USA
Bank of Baku OJSC	207.21	16	
AtaBank OJSC	191.02	15	
Zaminbank OJSC	169.91	16	
Bank of Azerbaijan OJSC	145.85	25	1% Arabian Company Nem Holdings Limited
Royal Bank OJSC	140.87	18	
Yapi Kredit Bank CJSC	139.63	29	99.8%—KOC Financial Serives (KFS), Italy, Turkey
Muganbank OJSC	135.5	4	
Rabitabank OJSC	106.63	24	
Turanbank OJSC	99.54	18	
Parabank OJSC	88.95	11	
Amrahbank OJSC	76.53	13	49%—International Investment Bank, Bahrain
Azerbaijan Industrial Bank OJSC	76.45	24	97%—Intersun Sun Group FZCO Company, UAE
Kredobank OJSC	58.97	7	
Bank Avrasiya OJSC	58.2	13	
Azer-TurkBank OJSC	55.43		46%—T.C. Ziraat Bankasi, A.S. Turkey ; 4%—Ziraat Bank International A.G., Germany
NBC Bank OJSC	50.36	2	
Atrabank OJSC	43.66	7	
United Credit Bank OJSC	40.61	11	88.79%—United Business Company, Turkey
Caucasus Development Bank OJSC	39.88	5	9.83%—individuals—non-residents, 0.84%—legal entity—non-resident
Debut Bank OJSC	38.16	2	
Ganja Bank OJSC	37.53	7	
Melli Iran Bank OJSC	37.35	2	Government of Iran
Gunaybank OJSC	35.6	1	
Azerbaijan Credit Bank OJSC	34.14	1	
Kovsarbank OJSC	20.98		2.32%—citizen of Canada, 2.32%—citizen of Japan
VTB Azerbaijan Bank JSC	20.61	2	51% VTB Bank (Russia)
EuroAsia Bank JSC	No info		
Birlikbank JSC	No info		

¹³⁶ Bankir.ru. “Banks of Azerbaijan are increasingly being influenced by international crisis; S&P” (in Russian). June 1, 2009. <http://bankir.ru/news/newsline/rnews/21637853>

¹³⁷ www.afn.by. “Fitch confirmed ratings of Azerbaijan, outlook “stable” (in Russian). June 3, 2009. <http://www.afn.by/news/i/119560>

¹³⁸ Based on unaudited survey data from <http://ratings.az/index.php#>

Bank name	Assets, USD million	Branches	Foreign ownership
National Bank of Pakistan JSC	No info		
AZFINANSBANK	No info		
Nakhchivanbank	No info		
Azernegliyyatbank JSC	No info		
Bank Silk Way JSC	No info		

Non-bank financial institutions

The formal banking sector continues to dominate the lending market in Azerbaijan. The value of all loans extended by non-bank credit institutions has grown rapidly, although their share of all loans remains less than 3%.

There are 18 non-bank credit organizations (MFIs) founded by international humanitarian organizations, 78 credit unions, and AqrarKredit, a non-bank credit organization with 99% Ministry of Finance capital which is in the process of restructuring into an agricultural bank. The total loan portfolio is USD 218.2 million and has increased by 36% over the course of 2008, following 97% growth in 2007. In contrast to banks, non-bank credit organizations demonstrated a 5% increase in their loan portfolios during the first quarter of 2009.

Indicators of non-bank financial institutions

Indicator	2006	2007	2008
Number of insurance companies	29	29	28
Assets of insurance companies (USD million)	103.3	185.7	332.1
Number of leasing companies	12	12	14
Assets of leasing companies (USD million)	n/a	n/a	294.6
Number of listed companies	10	9	9
Number of licensed securities brokers	n/a	37	36
Number of credit unions	77	77	75
Assets of credit unions (USD million)	10.1	15.0	17.6
Number of MFIs	16	18	18
Number of branches of MFIs	29	44	52

Source: Central Bank of Azerbaijan

MFIs

Non-bank credit organizations founded by international humanitarian organizations were first permitted to be licensed in 2003 when the law “On Banks” was passed in response to the Government’s 2002 Poverty Reduction Program. Initially they focused on the refugees from the Nagorno-Karabakh conflict and internally displaced persons. Twelve non-bank credit organizations were founded by international humanitarian organizations that year, and the total number has grown to 18 in 2008.

In June 2009 a new law “On non-banking credit institutions” passed the first round of voting in parliament¹³⁹. This law will:

- Increase the capital requirements from AZN 6,050 (USD 7,500) to AZN 250,000 (USD 311,400) for those institutions holding collateral deposits and AZN 25,000 (USD 31,100) for the rest;
- Establish special qualification requirements for administrators;
- Establish quasi-banking prudential requirements (for non-bank institutions willing to attract collateral deposits);
- Allow for more involvement by the CBAR in their operations; and,
- Remove the restriction against non-profit foundations receiving a license for non-bank microfinance activity.

¹³⁹ 1 News.az. “Milli Mejlis adopted the Law on Credit Organizations”. June 9, 2009. <http://www.1news.az/politics/20090609090626236.html>

The following table presents the gross loan portfolio of selected MFIs in Azerbaijan.

Selected MFIs in Azerbaijan as of December 31, 2008

Name	Gross loan portfolio, USD	Foreign affiliation
Finca Azerbaijan	66,849,593	Finca International
CredAgro	50,251,768	(ACDI/VOCA)
Agrarcredit	21,020,300	
TBC Credit	18,620,370	TBC Bank, Georgia, Shore Bank, USA
Vision Fund Azercredit	16,817,364	World Vision International
Norwegian Microcredit LLC (Normicro)	14,250,919	Norway
Credit Implementing Agency (CIA)	11,748,038 ¹⁴⁰	
Finance for Development	6,497,742	Oxfam, Great Britain
Viator Microcredit Azerbaijan	4,535,830	Norwegian Humanitarian Enterprise (NHE)
Agroinvest, Credit Union	2,606,066	
Azeri Star	2,376,089	Save the Children, USA
Komak Credit Union	1,522,268	
Nakhichivan Credit (IOM)	1,473,995	
Mikromaliyye Credit Institution	704,126	
Caucasus Credit (DRC)	536,937 ¹⁴¹	Danish Refugee Council (DRC), Denmark
Madad Credit LLC	336,000	Relief International, USA
Invest Credit	179,693	
Dayag -Credit	129,320	
UMID Credit	121,031	

Sources: Azerbaijan Microfinance Association and The MIXMarket

Credit unions

The Law "On Credit Unions," passed November 23, 2001, created a legal basis for the formation of credit unions. 45 credit unions were founded in 2003 and the number has grown to 75 by 2008. Credit Unions are required to operate with foreign funds or rely on grants as they cannot accept deposits. Most were founded as a result of a World Bank project and are aimed at promoting rural agricultural development.¹⁴²

Insurance

The insurance market is small in Azerbaijan. Total premiums written in 2008 amounted to USD 218.2 million, an increase of 21.1% compared to 2007. The three largest insurance companies are Azersigorta, Mbask and Ateshgah. In total there are 28 licensed insurance agencies.

Insurance premiums in 2008

	Premiums (USD million)	Share	Annual change
Life insurance	1.2	0.6%	(55.2)%
Non-life insurance	190.4	87.2%	25.4%
Compulsory insurance	26.7	12.2%	4.0%
Total Premiums	218.2	100.0%	21.1%

Source: Ministry of Finance of Azerbaijan

Leasing

Leasing is a relatively new product on the Azerbaijan market. The value of outstanding leases at the end of 2007 was USD 150 million, resulting from 1,659 contracts. This was more than twice the number of contracts compared to the previous year. Currently, there are 19 leasing companies, 12 of which are performing active operations. As of April 1, 2009, the six non-state-owned specialized leasing companies had a total leasing portfolio of USD 126.9 million. The largest leasing company is

¹⁴⁰ As of June 2008

¹⁴¹ As of June 2008

¹⁴² AZERBAIJAN AGRICULTURAL DEVELOPMENT AND CREDIT—L/C/TF Number: TF-29677; IDA-32360

Joint Leasing, which is owned by International Bank of Azerbaijan, and thus is indirectly owned by the government. Joint Leasing had a lease portfolio of USD 69.1 million at the end of 2008.

Leasing portfolios of specialized leasing companies on April 1, 2009

Company	Portfolio (USD, thousands)
Parex	48,380
Unileasing	42,494
AG leasing	15,172
Texnika leasing	8,477
Nikoil leasing	7,168
Ata Leasing	5,234
Total	126,925

Sources: Azerbaijan Microfinance Association

Although demand conditions in Azerbaijan are good for leasing, the market is hindered by taxation issues. Unlike bank lending, there is no VAT exception for leasing, which effectively makes leasing 20% more expensive than borrowing. As a result, demand for leasing products is low and many of the clients who apply for leases are those who were turned down for bank loans. Changes to the tax regime will be necessary in order for the leasing market to reach its potential in Azerbaijan.

Stock market

The Baku Stock Exchange (BSE) was established in 2000. There are currently 9 companies listed. In 2007 the stock trading volume doubled in comparison with 2006 to USD 285 million over 2006. However, in 2008 trading volume fell by 19% as a result of the global economic crisis. From January to May 2009, turnover decreased 4.7 times. The total BSE turnover for five months of 2009 is USD 2,913.8 million. As of the end of May 2009, the capitalization of the Azerbaijan stock market exceeds USD 4.3 billion, or 18% of non-oil GDP¹⁴³.

For 2009, the BSE announced plans to introduce a new trading platform, adopt new listing rules and modernize its internal normative framework, launch a new corporate website (www.bfb.az), and to continue the intensive work with domestic potential issuers for bringing them to the market.¹⁴⁴

Pension funds

The state pension was converted from a pay-as-you-go legacy system inherited from the Soviet era to a defined contribution system in 2001. This pension reform concept in Azerbaijan Republic lays the groundwork for a privately funded pension system. The Law on Non-State Pension Funds is prepared but has not been passed the government is concerned that the financial markets are not yet well developed enough.¹⁴⁵ Private pensions do not exist. The current minimum pension is USD 93.40 per month¹⁴⁶. The International Bank of Azerbaijan and Kapital Bank are the only banks authorized to provide pension services.¹⁴⁷

SWOT Analysis for the Azerbaijani financial sector

Strengths	<ul style="list-style-type: none"> • Good profitability • Strong growth prior to 2009 • Sufficient liquidity
------------------	---

¹⁴³ Azeri.ru. "Azerbaijani Stock Market Capitalization is estimated at approximately at 3.5 billion manats: SSC." May 27, 2009. <http://www.azeri.ru/papers/news-azerbaijan/46995/>

¹⁴⁴ Federation of Euro-Asian Stock Exchanges. <http://www.feas.org/News.cfm?ID=876&MemberID=6>

¹⁴⁵ ABC.AZ. "Azerbaijan postponed creation of private pension funds". November 12, 2007. <http://abc.az/eng/news/19042.html>

¹⁴⁶ <http://www.zibb.com/article/4687096/AZERBAIJAN+RANKS+FOURTH+IN+TERMS+OF+AMOUNT+OF+MINIMUM+PENSION>

¹⁴⁷ ABC.AZ. "Pension payment automation in Azerbaijan reached 93%". January 26, 2009. http://abc.az/eng/news_26_01_2009_31622.html

Weaknesses	<ul style="list-style-type: none">• Highly concentrated banking system, with one state-owned bank accounting for 38% of total assets• High concentration of bank assets in Baku• Recent decrease in assets and loan portfolio• Recent decline of credit portfolio quality• Underdeveloped leasing and insurance industries• Weaknesses in risk management practices of banks
Opportunities	<ul style="list-style-type: none">• Potential privatization of International Bank of Azerbaijan• Less government influence over banking activities
Threats	<ul style="list-style-type: none">• Possible worsening of financial conditions of banks if the economy will continue deteriorating

6. Financial sector analysis: Georgia

Regulation and supervision

Until May 2008, the main regulatory body of the financial sector in Georgia was the National Bank of Georgia (NBG), acting as the central bank. After amending the Law of Georgia “On the National Bank of Georgia,”¹⁴⁸ the Financial Supervision Agency (FSA) was created. This entity inherited responsibility for commercial bank supervision from NBG, leaving the national bank to focus on monetary policy and price stability. In addition to supervision of the banking system, the FSA has also assumed responsibility for the regulation of other financial services including non-bank financial institutions, securities and insurance.

The main legislative documents regulating the financial sector also include:

- The “Law of Georgia on Activities of Commercial Banks” (1996)¹⁴⁹
- Law of Georgia on Non-Bank Depository Institutions—Credit Unions¹⁵⁰
- Law on Microfinance Organizations¹⁵¹

Introduction of the Law on Microfinance Organizations. A new Law on Microfinance Organizations was approved by the president of Georgia on July 18, 2006. Three MFIs were registered by the end of 2006, 15 by December 2007, and 27 by November 2008. Some of these are newly established organizations while others are restructured companies that previously operated as other types of legal entities (for reference, please see the section “Microfinance Institutions” below). Minimum authorized paid-in capital of the newly established MFIs was set at GEL 250,000 (USD 156,000). Unlike banks, MFIs are taxed on loan loss provisions, which is a point of contention for many of the MFI managers interviewed for this project.

NBG lowers refinancing rate to 6.0%. In order to stimulate liquidity since the start of the war and the economic crisis, the NBG has aggressively reduced its refinancing rate. Since early August 2008, the rate has been continuously reduced, falling from 12% in July 2008 to 6.0% in May 2009.

Changes in minimum reserve ratios. In May 2007 the NBG made significant amendments to the regulations on required reserves of the commercial banks. New regulations eliminated different required reserve ratios and introduced a single 13% ratio.¹⁵² After the war with Russia in August 2008, the NBG lowered the minimum reserve requirements to 5%, which should free up additional liquidity for banks.

Weaknesses in the regulatory/supervisory environment. Overall, most institutions studied expressed general satisfaction with the regulatory environment and with the response of the NBG and FSA to the economic crisis. However, bank managers pointed out the following problems or weaknesses which, in their opinions, restrain the performance of the financial sector:

- The risk weight for foreign currency loans of 175% is set unrealistically high, to the degree that some banks have higher risk-weighted assets than total assets
- The NBG has yet to introduce a forward market for foreign currency swaps
- There is no deposit insurance system in the country

A representative of the FSA commented that the introduction of a deposit insurance system is unlikely in the near future. However, the FSA and NBG are looking into the possibility of supporting a forward market for foreign currency swaps.

¹⁴⁸ Link to full text of law: (Georgian) www.nbg.ge/uploads/legalacts/nbg1.4.2lawnbg.pdf; (English) <http://www.lexadin.nl/wlg/legis/nofr/oeur/arch/geo/LAWOFTHENATIONALBANK.pdf>

¹⁴⁹ Link to full text of law: (Georgian) www.nbg.ge/uploads/legalacts/nbg1.4.3lawactivitiesofcombanks.pdf; (English) <http://www.nbg.gov.ge/uploads/legalacts/nbg1.4.2combanksloweng.pdf>

¹⁵⁰ Link to full text of law: www.nbg.ge/uploads/legalacts/supervision/creditunions/lowcreditunionsnbg1.4.5.1.pdf; (English) <http://www.lexadin.nl/wlg/legis/nofr/oeur/arch/geo/LAWONNON-BANKDEPOSITORYINSTITUTIONS.pdf>

¹⁵¹ Link to full text of law (only available in Georgian):

www.nbg.ge/uploads/legalacts/supervision/microfinanceorganizations/lowmicrofinanceorgnbg1.4.5.1.pdf

¹⁵² National Bank of Georgia, Annual Report 2007, <http://www.nbg.gov.ge/index.php?m=348&lng=eng>

Commercial banks

Indicators of commercial banks

Indicator	2006	2007	2008	Q1 2009
Number of banks	17	19	20 ¹⁵³	20
Number of foreign banks ¹⁵⁴	12	14	17	17
Number of branches/service centers	122 / 298	124 / 416	124 / 559	121/550
Growth rate of assets	65.90%	70.50%	22.99%	(7.05)%
Growth rate of loan portfolio	54.96%	71.15%	30.58%	(5.54)%
Share of 5 largest banks in total assets	80.9%	85.9%	83.3%	78.8%
Ratio of non-performing loans	1.33%	1.65%	2.66%	3.92%
Private sector loans/GDP ratio	19.38%	26.95%	38.86%	n/a
Average interest rate (GEL) total	19.78%	21.07%	22.90%	n/a
Average interest rate (GEL) to legal entities	17.06%	17.06%	17.94%	n/a
Average interest rate (GEL) to households	26.03%	27.32%	26.78%	n/a
Average interest rate (FX) total	17.39%	17.43%	20.98%	n/a
Average interest rate (FX) to legal entities	16.22%	15.93%	17.45%	n/a
Average interest rate (FX) to households	20.29%	20.53%	25.11%	n/a
Capital adequacy ratio	20.6%	16.0%	13.9%	15.2%
Return on assets	2.7%	1.9%	(2.6)%	(1.4)
Return on equity	15.7%	9.7%	(12.6)%	(7.6)

* Calculated by BFC based on data available from the National Bank of Georgia,

www.nbg.ge/index.php?m=306&lng=eng

Number of banks. As of March 31, 2009, there are 20 commercial banks, with total assets of GEL 8.24 billion (USD 4.93 billion¹⁵⁵). Among these, 17 are foreign controlled (including two branches of non-resident banks and 15 joint venture companies having foreign assets in their capital), up from 12 at the end of 2007. The high proportion of foreign-controlled banks can be attributed to the combination of positive business environment and policies, high profitability and growth, and relatively high degree of transparency of the financial system observed before 2008. There are no ownership restrictions set by the government or NBG.

High concentration of assets. The top 5 Georgian banks in terms of total assets are: Bank of Georgia, TBC Bank, Bank Republic (Societe Generale Group), ProCredit Bank, and Cartu Bank. In 2008, the share of these banks in total banking assets was high at 83.3%. Before the events of August 2008, the share of the two leading banks (Bank of Georgia and TBC Bank) amounted to approximately 60%. However, due to losses in the second half of 2008 and yearly 2009, their share dropped to 55.9% in Q1 2009.

New entrants and M&A activity. In 2007, three new banks were registered with the NBG, including HSBC Bank Georgia and Progress Bank. In October 2007, the London-based Monte Cristo Capital Ltd bought 67% of Bank Tetri stocks and renamed it JSC First British Bank. The largest Azeri bank, International Bank of Azerbaijan, established a branch in Georgia, while the largest Ukrainian bank Privatbank bought 75% of stocks of the Taobank, becoming JSC TaoPrivatBank.¹⁵⁶ In 2008 the market saw the emergence of JSC Halyk Bank Georgia and JSC Constanta Bank (a former MFI). In addition, Kor Group, part of Dhabi Group, a UAE-based investment group, obtained a banking license and later acquired Standard Bank, thus changing the name to JSC Kor Standard Bank. The Latvian Parex Bank, which had considered entering the Georgian market, dismissed these plans after experiencing financial difficulties and being nationalized in November 2008.¹⁵⁷

In 2009, a potential new player could emerge since Finca Georgia—currently an MFI—also expressed interest in registering as banking institution. The same interest was shown in 2008 by two other MFIs, CREDO and TbilBusiness. However, due to the difficult financial situation, these plans were postponed.¹⁵⁸

¹⁵³ National Bank of Georgia, <http://www.nbg.gov.ge/index.php?m=403&lng=eng> (Data as of December 31, 2008)

¹⁵⁴ Foreign controlled banks

¹⁵⁵ NBG exchange rate, December 31, 2008 (USD 1 = GEL 1.667)

¹⁵⁶ NBG, Annual Report (2007)

¹⁵⁷ “Latvian Parex Leasing and Factoring Closes Operations in Georgia”, Georgian Business Consulting, 10 December 2008

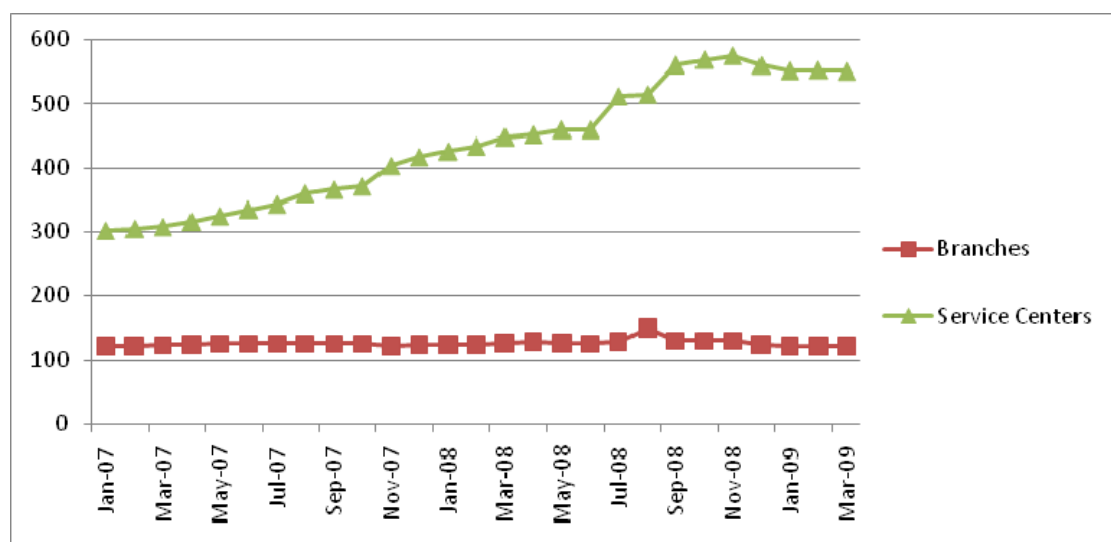
¹⁵⁸ “Credo and Tbilbusiness Change Plans to Become Banks”, Georgian Business Consulting, 28 January 2009

Exit from the market. Since the introduction of new regulations regarding increased minimum capital requirements in 2006, NBG has withdrawn the license of several banks that failed to meet these requirements and has penalized others. In 2007 the license was withdrawn from JSC “Sigmabank”, JSC “Liberty”, JSC “Transcaucasia”, and JSC “TbilBusinessBank”. The first three abovementioned banks have been liquidated, while JSC “TbilBusinessBank” was transformed into an MFI. In 2009, it is expected that some institutions will also fail to meet the requirements for minimum authorized paid-in capital.

The minimum capital requirement is currently GEL 12 million. As of December 31, 2008, 16 banks have an authorized capital over GEL 10 million, the other 4 having lower amounts.¹⁵⁹ Given the effect of the financial crisis on the banking sector, reaching these requirements will be an even harder task for these institutions, which may result in license withdrawal or stimulate transformation into MFIs.

Branch coverage. Full-size branches of financial institutions are operating in larger cities and towns, which include over 10 regional capitals of Georgia. Since 2006, following post-conflict stabilization and new government economic reforms, banks have been actively expanding in less developed regions, mainly by opening cost-effective service centers. Nevertheless, bank lending remains heavily concentrated in the Tbilisi region, which absorbs 81.2% of issued loans, followed by Adjara (4%) and Imereti (3%).

Growth of number of bank branches

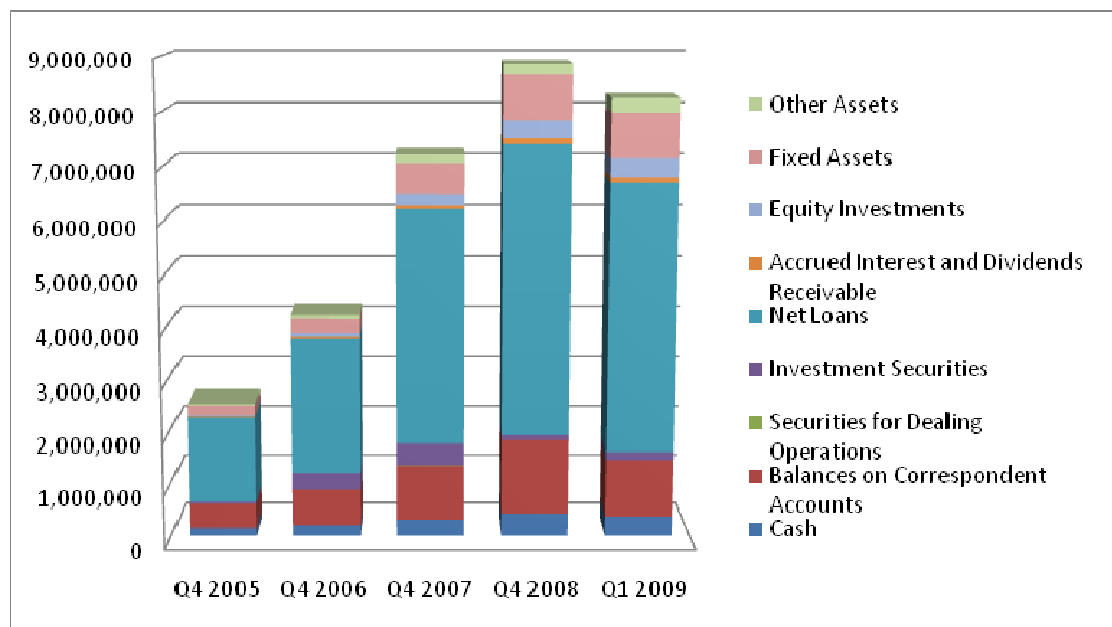


Source: National Bank of Georgia, “Financial Institutions”, www.nbg.ge/index.php?m=306&lng=eng

Growth of assets. Since 2004, the Georgian banking sector has achieved excellent growth due to economic reforms, foreign investments and aggressive lending. In 2005 banking assets grew by 50.2%, in 2006 by 65.9%, and they reached a record growth of 70.5% in 2007. The growth slowed sharply in August 2008, resulting in an annual figure of 23.0% for 2008. The decrease is also due to the fact that in the third and fourth quarters of 2008, banks experienced losses and a decrease in total assets. Total banking assets fell sharply in August 2008 (by GEL 701 million), and in October 2008 (GEL 361 million). The contraction continues in 2009, with a 7% decrease in total assets observed in the first quarter.

¹⁵⁹ NBG, Bulletin of Monetary and Banking Statistics (2008)

Bank Assets Growth Structure (GEL thousand)



Source: BFC estimates based on NBG data

Growth of loan portfolio. Georgian banks have been successful in increasing their lending volume in the last few years to GEL 6 billion¹⁶⁰ (USD 3.59 billion) as of December 2008, an increase of 30.6% compared to the previous year. About 27% (GEL 1.6 billion) constituted loans issued in national currency, compared to a share of 31% in December 2007. From December 2006 to December 2008, this figure varied between 25–35%.

Profitability. Since September 2008, the Georgian banking sector is registering significant losses, which reached GEL 215.7 million in December 2008.¹⁶¹ The downturn started in August 2008, which links these losses to the military conflict with Russia and the global financial crisis. The worst affected institution was TBC Bank, which lost GEL 67 million and laid off 300 employees. The market leader – Bank of Georgia – had to lay off 830 employees, followed by minor staff cuts in TaoPrivatBank.¹⁶² The losses continue in 2009, with a –7.6% return on equity for the first quarter.

Net income of Georgian banks

Period	Net income (GEL, thousands)
September 2008	(37,335)
October 2008	(53,625)
November 2008	(158,348)
December 2008	(215,744)
January 2009	(6,500)
February 2009	(18,738)
March 2009	(28,564)
April 2009	(35,862)

Source: National Bank of Georgia¹⁶³

Liquidity. In the third and fourth quarters of 2008, the Georgian banking sector started facing serious liquidity shortages. Some indicators were already falling before the military conflict with Russia, yet were aggravated by the events of August 2008. The sector registered a sharp decrease in total deposits, down 12.76% from GEL 4.13 billion in July to GEL 3.6 billion in August 2008. The gap between total loans and total deposits doubled from GEL 1.08 billion in December 2007 to

¹⁶⁰ Georgian Business Week, February 09, 2009 “Commercial Banks Issue 6b GEL in Loans”

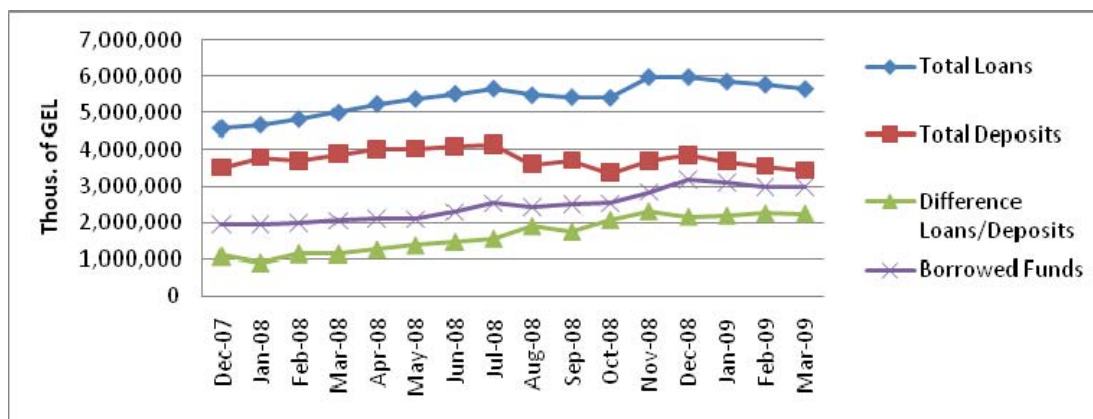
¹⁶¹ National Bank of Georgia—Financial Soundness Indicators (2008)

¹⁶² Georgian Business Week add date: “Georgian bank sector in 2008: resisting domestic and foreign pressures”

¹⁶³ “Financial Soundness Indicators”, 20/05/2009, www.nbg.ge/index.php?m=306&lng=eng

GEL 2.15 in December 2008. In order to mitigate the liquidity shortages, banks approached international financial institutions for funding. Borrowed funds increased by 63% to GEL 3.17 billion (USD 1.9 billion) in December 2008 from GEL 1.94 billion in December 2007. At the “Donor’s Conference for Georgia” held in Brussels in October 2008, international institutions pledged to provide USD 4.5 billion in 2008–2010 to Georgia, some of which will go to banking institutions.¹⁶⁴ In order to ensure that sufficient liquidity is available to Georgia’s two largest banks, the EBRD initiated the Georgian Financial Institutions Response Framework Program together with the IFC and FMO. Bank of Georgia received a USD 200 million package from IFIs, while TBC bank received USD 160 million. The liquidity situation has improved significantly for banks in 2009, with many banks now reporting excess liquidity. This is mostly due to a reduction in lending activity combined with continued support from international donors.

Capital structure of banks



Source: National Bank of Georgia, “Assets and Liabilities of Commercial Banks,” 30/04/2009, www.nbg.ge/index.php?m=306&lng=eng

Interest rates. One response to increased delinquency in credit portfolios since the start of the war has been an increase in interest rates for offered products. Interest rates at Bank of Georgia reached 43% by the first quarter of 2009. Other banks—TaoPrivatBank, BasisBank, Bank Republic—also increased annual interest rates on credit cards by 3% to 4%. On average, interest rates increased by 1% to 3%.¹⁶⁵

Capital adequacy. The NBG “Regulation on Capital Adequacy Requirements for Commercial Banks” is the main policy document on capital adequacy, approved in September 2002 and amended in December 2003. The regulation sets minimum values for Tier I Capital Ratio at no less than 8% of the risk weighted assets, and the Regulatory Capital Ratio no less than 12% of the risk weighted assets. Since the introduction of the regulation in 2002, the capital adequacy ratio did not fall below 15% until this year. In the last four months of 2008 the ratio gradually decreased from 17% in September to 13.9% in December.¹⁶⁶ However, it has improved in 2009, increasing to 15.2%.

List of commercial banks in Georgia

Name of the bank	Total assets, USD (Q3 2008)	Main institutional shareholders
JSC Bank Republic	388,474,109	Societe Generale 60.00%; EBRD 10.00%
JSC TaoPrivatBank	164,941,523	AQ ZURIFIN AG 23.78%; Privatbank 75.00%
JSC First British Bank	8,275,387	Monte Cristo Capital PCC PLC 67%
JSC TBC Bank	1,172,024,596	LIQUID CRYSTAL INTERNATIONAL N.V 9.25%; TBC HOLDING L 9.97%; DEG 9.64%; IFC 11.94%; RIKE B.V 28.60% (Changes in shareholder structure planned: EBRD 20%, IFC 20%, FMO 5% ¹⁶⁷)

¹⁶⁴ Source: Ministry of Finance of Georgia

¹⁶⁵ Georgian Business Week: “Georgian bank sector in 2008: resisting domestic and foreign pressures”

¹⁶⁶ NBG, Financial Soundness Indicators

¹⁶⁷ Georgian Business Week, April 13, 2009; <http://www.gbw.ge/news.aspx?sid=12a98dee-40d1-47aa-9acc-5cf4d0681f7a>

Name of the bank	Total assets, USD (Q3 2008)	Main institutional shareholders
JSC Bank of Georgia	1,623,546,380	BNY (NOMINEES) LIMITED 77.01%
JSC People's Bank of Georgia (R.B.G.)	214,213,150	LTD "Starcode Resources" 20.18%
JSC BasisBank	65,224,602	EBRD 15.00%
JSC VTB Bank (Georgia)	246,758,220	JSC VTB Bank Russia 84.69% EBRD 8.95% LTD "Lakarpa Enterpris Lmt" 3.56%
JSC Bank Cartu	249,080,554	JSC "Cartu Group" 100% (EBRD is expected to gain 25% ownership in May 2009 ¹⁶⁸)
JSC ProCredit Bank	363,734,121	ProCredit Holding (PCH) 100%
JSC BTA Bank	84,239,990	JSC Bank Turanalem (Kazakstan) 49% ZRL Beteiligungs Ag 18% Interfunding Facilities Limited 9% Silk Road Financial Group Ltd 24% KSN Foundation 50 %
JSC InvestBank	14,666,077	M&D International Trading AG 30% LTD "Asset Management Grup" 20%
JSC International Bank of Azerbaijan (Georgia)	22,811,256	Azeri bank
JSC Ziraat Bank A.S.*	15,037,645	Turkish bank
Transcaucasus Development Bank LTD	8,392,622	Azeri bank
JSC HSBC Bank (Georgia)	69,867,424	HSBC EUROPE (Netherlands) B.V. 70% WINGS ESTABLISHMENT 30%
JSC Progress Bank	7,820,693	LTD "KALA CAPITAL" 100%
JSC Kor Standard Bank	150,394,385	LTD "INVESTMENT TRADING GROUP" 5% Four UAE private investors have the other 95%
JSC Halyk Bank Georgia	18,635,365	JSC " Halyk Bank of Kazakhstan" 100%
JSC Constanta Bank	38,113,787	"Constanta Plus" 77%

* – Foreign bank's branches

Non-bank financial institutions

Summary statistics

Indicator	2006	2007	2008	Q1 2009
Number of insurance companies	14	15	13	13
Assets of insurance companies				
Gross Premiums Written, GEL million	70.0	119.0	215.0	
Number of leasing companies	2	3	4	
Capitalization of the stock market, USD million ¹⁶⁹	668.33	1,388.61	327.31	549.00
Number of listed companies	231	161	153	157 /Apr
Number of licensed securities brokers	N/A	17	11	
Number of credit unions	38	24	18	18
Total Assets of credit unions, GEL	1,963,393	1,340,598	1,647,293	N/A
Number of microfinance institutions	3	15	27	30
Total assets of microfinance institutions, GEL	2,628,054	68,389,318	137,051,961	145,890,153
Number of pension funds	3	3	7	7
Number of exchange bureaus	655	806	1,030	1,111

Source: National Bank of Georgia, www.nbg.ge/index.php?m=306&lng=eng

Insurance

The insurance sub-sector is very small, with gross premiums written amounting to only 1.3% of GDP in 2008. As of December 31, 2008, there are 13 registered insurance companies in Georgia. Most of the insurance companies are owned by banks, which generate most of the insurance business through cross-selling insurance products with other products. The government program of providing

¹⁶⁸ "EBRD to acquire Cartubank Shares in May", April 27, 2009; Georgian Business Week (www.gbw.ge)

¹⁶⁹ Federation of Euro-Asian Stock Exchanges (www.feas.org)

medical insurance for the poor and civil servants has helped to develop medical insurance, particularly in the regions. The legal and regulatory environment for the insurance sector remains weak, an area where the Financial Supervision Agency has indicated it will concentrate its efforts during the year 2009 with technical assistance provided by several international donors.

Georgian Insurance Market Product Breakdown, by type of products (Q3 2008)

Product	Insurance Market Share
Health Insurance	62%
Property Insurance	11%
Casco	10%
Financial Risk Insurance	6%
Life	4%
Aviation	2%
Liability Insurance	2%
Other	3%

Source: Georgian Insurance Association

Leasing

The Georgian leasing market is in the process of development. Four leasing companies are registered in Georgia. Those companies are: TBC Leasing, Georgian Leasing Company, Kor Standard leasing and AG Leasing. Three companies were established by banks, and the fourth one was established by the Alliance Group, an investment group which also owns a microfinance company. TBC Leasing and Georgian Leasing Company are subsidiaries of the two largest banks, TBC Bank and Bank of Georgia, respectively. The share of these two companies stand at about 90% of the market with total assets of GEL 80.3 million (USD 48.2 million¹⁷⁰).

Currently, only international financial institutions such as the EBRD, IFC or FMO provide outside financing to Georgian leasing companies.

Stock market

The Georgian Stock Exchange was registered in 1999 and is the principal stock exchange in the country. Galt & Taggart Index (GTI) is used as the main stock market index. GTI was founded by Galt & Taggart, a brokerage company (part of Bank of Georgia Group).

In 2008, 83 million shares were sold at the Georgian Stock Exchange (GSE), a decrease of 7 million shares compared to 2007. Total turnover in 2008 amounted to GEL 256.6 million, up 2.5 times compared to previous year. Bank of Georgia's shares accounted for 65% of all trades, 13% were accounted for by Caucasus Energy and Infrastructure, and 8% by VTB Bank. A total of 157 companies are permitted to float their shares on the Georgian Stock Exchange, but only 82 companies take active part in trading sessions. As to bonds, only Auto Finances Company trades in bonds on the GSE. In 2008 the number of brokerage companies with access to the GSE decreased from 17 to 11 companies.¹⁷¹

Microfinance Institutions (MFIs)¹⁷²

At the end of 2008, there were 27 institutions registered as MFIs under the Law on Microfinance Organizations, with a total of 80,479 clients. Their total loan portfolio was GEL 112.7 million, representing a 98% increase from previous year. Total assets of MFIs constituted GEL 137 million. The two largest MFIs account for 50% of that figure, with LLC Credo at 36.4% and JSC FINCA Georgia representing 14%. As of the first quarter of 2009, four new MFIs were registered.

In some cases, banks that were not able to meet the increased capital requirements which took effect in 2007 registered as MFIs in order to continue operations.¹⁷³ One example is JSC

¹⁷⁰ NBG exchange rate, December 31, 2008 (USD 1 = GEL 1.6670).

¹⁷¹ "Volume of Deals at GSE Halves in 2008", Georgian Business Consulting, January 27, 2009.

¹⁷² According to the Georgian law for MFIs, the official title is Microfinance Organizations (MFOs)

TbilBusinessBank, which registered as an MFI in 2008. By contrast, some MFIs are interested in accepting deposits and are being registering as banks. An example is Constanta Foundation, which registered as JSC Constanta Bank in July 2008. In 2009, similar steps were expected from CREDO, Finca Georgia, and TbilBusiness.¹⁷⁴ However, in late January 2009, officials at CREDO and TbilBusiness announced that due to the unfolding global financial crisis, registering as a bank is no longer a priority.¹⁷⁵

List of Georgian MFIs

Microfinance Organization	As of December 31 , 2008		
	Retained Earnings	Total Liabilities	Total Assets
LLC Credo	1,386,816	43,689,847	49,837,964
LLC Rico Express	874,073	8,495,141	10,205,064
JSC Lazika Capital	1,599,075	4,677,577	9,054,482
JSC Kristali	616,726	5,657,550	7,805,174
LLC Alliance Group	1,276,556	4,674,208	7,650,764
LLC Tbilbusiness	(1,084,386)	2,657,675	6,074,778
JSC Finagro	122,143	n/a	3,795,588
JSC Finca Georgia	352,631	18,617,551	19,220,182
LLC Creditservice+	996,187	3,894,669	5,140,856
LLC Intel-express Georgia	1,011,400	2,651,016	3,912,416
LLC Alfa Credit	127,049	1,906,063	2,498,112
LLC TAM Credit	132,008	1,525,071	1,909,079
LLC Georgian Credit	179,851	1,051,541	1,481,392
LLC Crystal Credit	(30,872)	1,581,718	1,800,846
JSC Imercredit	84,835	873,518	1,260,353
LLC Alfaexpress	(57,144)	960,113	1,302,969
JSC Creditservice	111,893	391,796	805,393
JSC Caucasus Credit	(15,163)	n/a	621,949
LLC Moneta Express Georgia	103,912	n/a	353,912
LLC Expresscredit	8,243	n/a	258,243
LLC Sani	73,338	6,315	329,653
LLC Cavcascredit	1,799	1,693	303,767
LLC Nike Credit	53,540	9,536	378,057
LLC Amigo+	5,279	93,328	248,607
LLC Tbilmicrocredit	18,058	n/a	484,818
LLC Intelnet	162,291	(194,748)	217,543
LLC MFO X Credit (new in 2009)			
LLC EasyCred Georgia (new in 2009)			
LLC VAM Credit (new in 2009)			
LLC MikroCredit (new in 2009)			
TOTAL	7,752,993	103,578,323	137,051,961

Source: National Bank of Georgia

Credit unions

Credit unions are decreasing in number in Georgia. Their number dropped from 42 institutions in 2003 to 18 in December 2008. Of these, only three or four are active on any kind of meaningful scale. This is partially explained by the general lack of interest in group lending products in Georgia, which were popular in late 1990s but were later replaced by more attractive individual lending products. As of December 2008, credit unions had total assets of GEL 1.53 million. Further support from donors to the sector is not expected.

¹⁷³ "AgrolInvest Bank to Become Microfinance Organization in 2009", Georgian Business Week, December 08, 2008; www.gbw.ge

¹⁷⁴ "Credo Microfinance Organization to Turn into Commercial Bank", Georgian Business Consulting, November 10, 2008; "Finca Georgia Plans to Become Bank", Georgian Business Consulting, July 01, 2008; "TbilBusiness Microfinance Organization Plans to Become Bank", Georgian Business Consulting, June 18, 2008, www.gbc.ge

¹⁷⁵ "Credo and Tbilbusiness Change Plans to Become Banks", Georgian Business Consulting, January 28, 2009

SWOT analysis for the Georgian financial sector

Strengths	<ul style="list-style-type: none"> • Liberal financial market with no evident entry barriers and a good presence of foreign capital • The National Bank and the Financial Supervision Agency have taken a number of emergency measures to ease liquidity constraints resulting from the financial crisis • The provision of financing to leading banks by IFIs is helping to address liquidity constraints and raise confidence
Weaknesses	<ul style="list-style-type: none"> • The sector registered losses in 2008 (GEL 158 million) and liquidity concerns remain • Country sovereign rating has fallen followed by downgrading the ratings of leading banks • Lending conditions have deteriorated, including the increase of interest rates on loans and requirements on collateral
Opportunities	<ul style="list-style-type: none"> • Additional support from IFIs and donors could be forthcoming • Potential for improved ties with Russia could lead to more Russian investment in Georgian financial sector
Threats	<ul style="list-style-type: none"> • Intense geopolitical situation in the region; neighboring (and internal) 'frozen' conflict areas • Increase in demand for dollars and withdrawal of deposits from the banking system; these risks would be aggravated by a deeper and prolonged economic slowdown.

Part III: Analysis of donor activities

7. Analysis of donor activities: Armenia

European Bank for Reconstruction and Development (EBRD)

The EBRD is the largest single investor in Armenia with investments of more than EUR 200 million in 52 projects in all major sectors of the economy. The EBRD's strategy in Armenia is to "target primarily the development of the local private sector, that is small and medium-sized enterprises and the banking sector." This strategy is primarily implemented through the Armenia Multi-Bank Framework II. This framework of USD 40 million, approved in March 2006, provides credit lines to selected partner banks under 17 sub-projects¹⁷⁶. It includes senior debt facilities for mortgage lending, energy efficiency lending, leasing, MSME lending, as well as convertible debt and equity investments.

EBRD's representative in Armenia reports that they are currently working to extend this programme, perhaps with an additional USD 100 million in funding. The summary of the most recent projects of EBRD in the target sectors in Armenia is presented in the following table.

Recent EBRD projects in the target sectors¹⁷⁷

Project name	Year established	Amount (USD, million)	Target Sector
ACBA Credit Agricole Bank—Syndicated Loan	2008	25 million	MSME
Procredit Bank Armenia—Equity	2007	7 (loan) 3.2 (equity)	MSME
Armenia Multi-Bank Framework II	2006	40	MSME
Armenia Renewable Energy Programme	2006	7	Renewable energy

Source: EBRD

The summary of recent EBRD disbursements to partner financial institutions is presented in the following table.

Recent EBRD disbursements by partner financial institution

Partner financial institution name	Date announced	Amount (USD, million)	Target sector
VTB Bank Armenia	Dec. 2008	10	MSE
ACBA Leasing	Dec. 2008	8	Leasing to SME
ProCredit Bank Armenia	Dec. 2008	7	MSE
ACBA Credit Agricole Bank	Nov. 2008	18	MSME
Converse Bank	Nov. 2008	10	SME
Armeconombank	Oct. 2008	3	MSE
Inecobank	Oct. 2008	5	MSME
Cascade Bank	Mar. 2008	5	SME
Ararat Bank	Mar. 2008	5	MSME
Araratbank	Dec. 2007	5	MSME
Armeconombank	Dec. 2007	5	SME
ACBA Credit Agricole Bank	Aug. 2007	6	MSME, especially in rural and remote areas
Anelik Bank	May. 2007	EUR 5 million	MSME

Source: EBRD and financial institutions concerned

EBRD has only made one loan to a non-bank financial institution, ACBA Leasing, and has no plans to work with universal credit organizations in the near future.

¹⁷⁶ EBRD. Project Summary Document. February 3, 2006. <http://www.ebrd.com/projects/psd/psd2006/36647.htm>

¹⁷⁷ EBRD. Project Summary Documents. <http://www.ebrd.com/projects/psd/country/armenia.htm>

Among the most recent EBRD equity investments is acquisition of a 25% stake in Ararat Bank to further support the bank's retail and MSME lending¹⁷⁸. As of the end of March, EBRD had not yet made any loans in 2009.

The most recent EBRD investment into renewable energy sector dates back to 2006 when a loan of USD 7 million was provided to universal credit organization Cascade Credit for investments in mini-hydro power generation and other renewable energy projects. The World Bank and the Cafesjian Family Foundation, the major shareholder of Cascade Credit, provided supplementary funds to EBRD loan under this project with total cost of USD 15 million¹⁷⁹.

EBRD invested USD 360,000 into technical assistance under Multi-Bank Framework II. This technical assistance supports the institutional development and MSE lending units of the participating banks and leasing companies.

The following technical assistance is being provided:

- Streamlining and standardizing lending methodologies;
- Strengthening credit appraisal, risk and portfolio management policies, and internal controls to ensure high portfolio quality (less than 5 % of portfolio in arrears);
- Developing documented credit policies and procedures including an integrated due diligence component, enhanced credit appraisal and risk management policies and procedures;
- Refining existing SME products and/or introducing competitive and profitable products, as well as corresponding marketing activities;
- Developing training program and materials in English and Russian/Armenian; marketing efforts geared toward SME lending, and SME loan products;
- Training loan officers and other staff on advanced cash flow-based lending and modeling (cash flow forecasting), advanced sales and marketing skills, and compliance issues related to anti-money laundering and EBRD requirements and guidelines;
- Implementing activities to stimulate SME lending, and SME loan products marketing;
- Ensuring high standards of integrity in the credit appraisal process;
- Developing documented credit policies and procedures including an integrated due diligence component, enhanced credit appraisal and risk management policies and procedure¹⁸⁰.

Technical assistance is currently being provided for SME finance under a two-year project which started in April 2008 and which is being implemented by DAI. Technical assistance for MSE lending is at present being provided by BFC to two institutions, Converse Bank and VTB Bank Armenia. In 2008, BFC provided MSE technical assistance to Araratbank and Armeconombank.

Additional technical assistance is planned for the near future, including institution-building TA for Araratbank and an upcoming trade finance program.

KfW Entwicklungsbank (Kreditanstalt für Wiederaufbau)

KfW has been active in Armenia since 1995. While a majority of KfW investments since 1995 have gone to the energy and infrastructure segments (67% through the end of 2006), in recent years KfW has more strongly emphasized the "sustainable economic development" category of projects, which includes support to financial institutions and MSMEs. A summary of major KfW projects in Armenia is presented in the following table.

¹⁷⁸ Araratbank. "EBRD has entered the capital of Araratbank with share of 25%=1 shares". October 29, 2008. <http://www.araratbank.am/index.php?pg=more&t=news&id=181>

¹⁷⁹ EBRD. Project Summary Document. January 18, 2006. <http://www.ebrd.com/projects/psd/psd2006/34841.htm>

¹⁸⁰ Development Alternatives International. "Projects: Armenia—Multi Bank Financing Framework Facility—Credit Advisory Services and Institution Building". http://www.dai.com/work/project_detail.php?pid=222

KfW projects in Armenia¹⁸¹

Project name	Year established	Amount (EUR million)	Target sector
Housing Finance I	2005	7.5	Mortgage
Establishment of a Deposit Insurance Fund	2003	3.9	Bank deposits
Promotion of Renewable Energies	2003	6.0	Renewable energy
Credit Guarantee Fund	2001	6.8	Promotion of SME lending
German-Armenian Fund (GAF)	1998	19.5	MSME

Source: KfW

Through the German Armenian Fund (GAF), KfW provides financial resources to partner financial institutions. GAF partners for MSME lending include: ACBA Credit Agricole Bank, Anelik Bank, Armeconombank, Converse Bank, and Inecobank. Partners for housing finance include: Anelik Bank, Araratbank, Ardshinvestbank, Areximbank, Armbusinessbank, Armeconombank, Byblos Bank, Inecobank, as well as two universal credit organizations First Mortgage Company and Washington Capital. In the field of renewable energy GAF partners with ACBA Credit Agricole Bank, Anelik Bank, Ardshinvestbank, Armeconombank, ArmSwissBank and Converse Bank¹⁸².

All of the project budgets include funding for technical assistance. Currently, KfW is offering TA for housing finance, which is implemented by the Frankfurt School, scheduled to end in June 2009. There is also an active TA program for renewable energy which will end in April 2009. KfW has not provided TA for MSME lending since 2005.

World Bank (WB)

In 2008, the World Bank completed implementing its Country Assistance Strategy (CAS) for Armenia for 2004–2008 and started implementing a new Country Partnership Strategy (CPS) for 2009–2012. The expected lending volume under CPS will reach USD 525 million.

Until 2009, World Bank was mainly implementing infrastructure projects through the International Development Association (IDA). However, some of the projects included lending activities to the target sectors. A summary of active WB projects in the target sectors is presented in the following table¹⁸³.

Active projects of the World Bank in the target sectors

Project name	Date announced	Amount (USD million)	Target sector
Access to Finance for Small and Medium Enterprises Project for Armenia ¹⁸⁴	Feb. 2009	50.0	MSME, Agriculture
Renewable Energy ¹⁸⁵	Mar. 2006	5.6	Renewable energy
Rural Enterprise & Small-Scale Commercial Agriculture Development Project ¹⁸⁶	Jul. 2005	21.6	Agriculture, MSME

Source: World Bank

¹⁸¹ KfW. Projects http://www.kfw-entwicklungsbank.de/EN_Home/Countries_and_Projects/Europe42/Armenia30/Projects.jsp

¹⁸² German-Armenian Fund. <http://www.gaf.am>

¹⁸³ World Bank (2008). Status of Projects in Execution—FY08, Europe and Central Asia Region, Country: Armenia.

http://www1.worldbank.org/operations/disclosure/SOPE/FY08/Country/SOPE_ECA_Armenia.pdf

¹⁸⁴ World Bank. <http://www.worldbank.org.am/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/ARMENIAEXTN/0,,contentMDK:22081296-menuPK:301597-pagePK:2865066-piPK:2865079-theSitePK:301579,00.html>

¹⁸⁵ World Bank (2008). “Status of Projects in Execution -FY08, Europe and Central Asia Region, Country: Armenia”.

http://www1.worldbank.org/operations/disclosure/SOPE/FY08/Country/SOPE_ECA_Armenia.pdf

¹⁸⁶ Including grants and loans:

http://www1.worldbank.org/operations/disclosure/SOPE/FY08/Country/SOPE_ECA_Armenia.pdf

The loan under the Access to Finance for Small and Medium Enterprises Project for Armenia announced in February 2009 will be provided by the International Bank for Reconstruction and Development (IBRD) to the CBA. The loan is to be repaid within 26.5 years with a 5-year grace period and a fixed 8.25% interest rate. Eight banks have been selected to receive funding—Converse Bank, VTB Bank Armenia, ProCredit Bank, Araratbank, HSBC Armenia, Ardshinvestbank, ACBA Credit Agricole, and Armeconombank. The final recipients of the loans will be private businesses with an annual turnover of up to AMD 500 million (USD 1.6 million).¹⁸⁷

The World Bank is in the process of organizing a technical assistance program which will consist primarily of a number of training seminars on the topic of SME lending. This TA will be available for both banks and UCOs.

International Finance Corporation (IFC)

Since the IFC started investing in Armenia in 2001, ten projects have been initiated, exceeding USD 47 million through the end of 2008. The most recent IFC investments in the target sectors of bank lending are presented in the following table.

Recent IFC investments in target sectors in Armenia by partner banks

Partner financial institution name	Date announced	Amount	Target sector
Inecobank	June 2008	USD 3 million ¹⁸⁸	SME, mortgage
Ardshinvestbank	September 2007	USD 15 million (loan) USD 10 million (equity) ¹⁸⁹	Housing finance, SME
Armeconombank	July 2006	USD 2 million ¹⁹⁰	SME, mortgage funding

Source: IFC

IFC also funds trade finance in Armenia, with a total of USD 7 million disbursed to Armeconombank and Ineco Bank.

Black Sea Trade and Development Bank (BSTDB)

As a part of its “Armenia Country Strategy 2007–2010,” BSTDB supports financial intermediaries which lend to SMEs. This support includes lending, involvement in investment funds or innovative special purpose structures, mobilizing technical assistance resources to facilitate innovation, creative structuring and assisting in upgrading managing practices and governance¹⁹¹. BSTDB lent USD 5 million to Armeconombank in February 2008 for on-lending to SMEs. Partner financial intermediaries of BSTDB also include ACBA Bank and Inecobank¹⁹².

Asian Development Bank (ADB)

Armenia joined ADB in 2005. ADB investments into the country in 2007–2008 totaled USD 66.6 million. According to its Country Operations Business Plan for 2008–2010, ADB is planning to allocate USD 88.0 million for 2009–2010¹⁹³. The priorities for the financial sector include poverty reduction through provision of long-term financial resources and improved access of private enterprises to bank financing. ADB started investments in the target sectors by providing a USD 3

¹⁸⁷ ARKA News Agency (2009). WB to extend USD 50 million worth loan for development of small and medium business. <http://www.arka.am/eng/finance/2009/02/27/13369.html>

¹⁸⁸ Inecobank. “Inecobank CJSC and the International Finance Corporation (IFC) extend cooperation”. November 22, 2008. http://www.inecobank.am/index.php?page=news§ion=news_more&id=744

¹⁸⁹ Ardshinvestbank. “IFC Partners with Ardshinvestbank to Improve Access to SME and Housing Finance in Armenia”. December 10, 2007. http://www.ashib.am/news.php?lang_id=1

¹⁹⁰ Armeconombank. <http://www.aeb.am/news.aspx?lang=eng&menuid=2id=1%CE%BCltiid=1&pageid=0>

¹⁹¹ BSTDB (2007). Armenia Country Strategy 2007–2010. Thessaloniki, 2007. http://www.bstdb.gr/pdf/Country_Strategy_20072010_Armenia.pdf

¹⁹² BSTDB. Financial Intermediaries of BSTDB. <http://www.bstdb.gr/trfininterm.html>

¹⁹³ ADB (2007). Country Operations Business Plan, Armenia 2009–2010. November 2007. <http://www.adb.org/Documents/CPSs/ARM/2007/COBP-ARM-2007.pdf>

million loan to Inecobank for development of the microfinance sector¹⁹⁴. ADB also contributes to rural development by investing in rural road rehabilitation¹⁹⁵.

International Fund for Agricultural Development (IFAD)

IFAD, a specialized agency of the United Nations, has invested USD 64.2 million in Armenia since it started its country operations in 1995. IFAD implements the strategy of poverty reduction through supporting the poorest rural areas of the country. IFAD loans support diversification of the non-farm rural economy, encouraging poor people to start up small and medium-size enterprises¹⁹⁶. The programs of the Fund are usually co-financed by other donors.

Currently IFAD operates two programs in Armenia: Farmer Market Access Program (FMAP) and Rural Areas Economic Program (RAEP). The objective of FMAP is to make financing available to rural enterprises with good potential for rapid growth. The program is co-financed by the OPEC Fund for International Development (OFID). RAEP has the objective of increasing incomes on a sustainable basis for rural people in mountain zones in the provinces of Aragatsotn, Gegharkunik, Lori, Shirak, Syunik, Tavush and Vayots Dzor. The program is co-financed by OFID and the US Agency for International Development (USAID). Among the partner financial intermediaries of RAEP is Areximbank¹⁹⁷. Information on the active IFAD investment projects in Armenia is presented in the following table.

Active IFAD investment projects in Armenia

Program name	Duration	IFAD investments	Target sector
Farmer Market Access Program (FMAP)	2008–2013	USD 11.9 million ¹⁹⁸	Agriculture
Rural Areas Economic Program (RAEP)	2005–2009	USD 15.3 million ¹⁹⁹	Agriculture

Source: IFAD

IFAD plans to contribute USD 7.3 million towards the creation of a venture fund for lending to the Armenian agricultural sector. These investments will be implemented through several means: a loan to the government of Armenia with a duration of 40 years and an interest rate of 0.75% per annum, up to USD 0.5 million participation in the share capital of businesses, loans to small agricultural businesses and farmers distributed through partner banks, and micro-credits of up to USD 5,000 to farmers for 3 to 5 years²⁰⁰.

OPEC Fund for International Development (OFID)

As of December 31, 2008, OFID investments in Armenia totaled USD 29 million. Currently, this donor in cooperation with IFAD operates two programs in the Armenian agricultural sector. The information on active OFID investment projects in Armenia is presented in the following table.

Active OFID investment projects in Armenia

Program name	Duration	OFID investments	Target sector
Farmer Market Access Program	2008–2013	USD 14 million ²⁰¹	Agriculture
Rural Areas Economic Program	2005–2009	USD 5 million ²⁰²	Agriculture

Source: OFID

¹⁹⁴ Inecobank. "International Partners: Asian Development Bank (ADB)".

<http://www.inecobank.am/index.php?page=partners§ion=more&id=367&pid=740>

¹⁹⁵ ADB. "Projects: 40610: Rural Roads Rehabilitation Project". <http://www.adb.org/Projects/project.asp?id=40610>

¹⁹⁶ IFAD. "IFAD in Armenia". <http://operations.ifad.org/web/ifad/operations/country/home/tags/armenia>

¹⁹⁷ Areximbank. "Lending under the Rural Areas Development Program (IFAD)" (in Russian).

<http://www.aremimbank.am/ru/cred/>

¹⁹⁸ ACBA Credit Agricole Bank. "KfW Bank has disbursed a loan to ACBA Credit Agricole Bank." July 23, 2008.

http://www.acba.am/index.php?page=show_news&id=42

¹⁹⁹ IFAD. "Rural Areas Economic Development Programme".

<http://operations.ifad.org/web/ifad/operations/country/project/tags/armenia/1307/project%20overview>

²⁰⁰ Express.am. "Venture Fund for lending to agribusiness". February 10, 2008. http://www.express.am/04_09/korotko.html

²⁰¹ OPEC Fund for International Development. http://www.opecfund.org/projects_operations/asia/armenia.html

²⁰² OPEC Fund for International Development. http://www.opecfund.org/news_press/2005/pr36_2005.aspx

In addition to the above programs, OFID provides direct finance to some Armenian banks. In November 2008, OFID announced a USD 3 million loan to Inecobank for the MSME and agriculture sectors²⁰³.

Millennium Challenge Corporation (MCC)

In 2006, MCC signed a USD 235.65 million “compact” with the government of Armenia targeting reduction of rural poverty through a sustainable increase in the economic performance of the agricultural sector²⁰⁴. Financial assistance is provided to farmers and agribusinesses that are beneficiaries of the irrigation infrastructure component of the compact, which is called “water-to-market”. The MCC target is to provide USD 8.5 million in bank loans to project beneficiaries and related businesses²⁰⁵. The following financial institutions are accredited as credit providers under the program: VTB Bank Armenia, BTA Investbank, Converse Bank, Cascade Bank, Anelik Bank, Armbusinessbank, SEF International Credit Organization, Farm Credit Armenia UCO, Nor Horizon UCO, Ecumenical Church Loan Fund UCO and Cascade Credit UCO. They receive loans with duration of up to 7 years and a 4% base rate²⁰⁶.

The technical assistance component is primarily focused on introducing new on-farm water management technologies and improving farmers’ skills in water management as well as their access to farm-level equipment, thereby allowing enhancement of the efficiency of water use in irrigation.

United States Agency for International Development (USAID)

USAID is one of the most active providers of technical assistance to Armenia. Increased access of business to finance and development of an efficient, reliable and cost-effective energy sector are among the economic growth objectives of the USAID country strategy for 2009–2013²⁰⁷. A summary of active USAID technical assistance projects is provided in the following table.

USAID active technical assistance programs in Armenia related to target sectors

Program	Description	Target sector influenced
Agribusiness Market Development	Identifying promising agribusiness sub-sectors and implementing enterprise-level activities that stimulate employment and identification of the new market opportunities for agricultural SMEs ²⁰⁸ .	Agriculture, SME
Competitive Armenian Private Sector (CAPS) Development	Facilitating competitive growth and increasing the competitiveness of Armenian enterprises including SMEs in selected sectors (IT, Pharmaceuticals and Tourism) ²⁰⁹	ME
Credit Authority (DCA)	Implementing credit risk sharing mechanisms (guarantees), facilitating attraction of funds into MSME lending. ²¹⁰	MSME
Business Advisory Services (BAS) Program	Training business consultants for SMEs.	SME

²⁰³ Armenbrok. “New credits to banks”. November 13, 2008. <http://www.armenbrok.com/plug-e-npnews-c-news-npid-96.html>

²⁰⁴ Millennium Challenge Account—Armenia. “Overview”. <http://www.mca.am/new/enversion/overview.php>

²⁰⁵ Millennium Challenge Account—Armenia. “Irrigated Agriculture Water-to-market”.

http://www.mca.am/new/enversion/watertomarket_implementing.php

²⁰⁶ Millennium Challenge Account—Armenia. “Irrigated Agriculture Water-to-market, Contracts”.

http://www.mca.am/new/enversion/watertomarket_contracts.php

²⁰⁷ USAID. “Country Assistance Strategy, Armenia 2009-2013”. March 2009.

<http://armenia.usaid.gov/sites/default/files/USG%20Country%20Assistance%20Strategy%20March%20Post%20Revisions%20to%20Respond%20to%20DRL-GF-%20ACE%20comments.pdf>

²⁰⁸ USAID. <http://armenia.usaid.gov/main/en/7/>

²⁰⁹ USAID. “Competitive Armenian Private Sector”. http://www.caps.am/index.php?cat_id=217

²¹⁰ MicroLinks. “DCA and other Guarantees”. http://www.microlinks.org/ev_en.php?ID=12655_201&ID2=DO_TOPIC

Program	Description	Target sector influenced
Armenia Microlending Program	Assisting partner banks to develop sustainable MSE lending operations; facilitating sustainable access of MSE to formal finance. ²¹¹ The areas of technical assistance include: human resource development, microlending products development, creating competitive MSME lending procedures, credit scoring, establishing efficient management information systems (MIS) and institution building ²¹² .	MSME
Commercialization of Energy Efficiency Project	Supporting the energy sector through SMEs developing and implementing energy efficiency activities.	Renewable energy, SME
Armenian Energy Sector Partnership	Facilitating commercialization of state-owned energy entities, increasing energy efficiency through consumer education and the introduction of new technologies. ²¹³	Renewable energy

Source: USAID

Mortgage Fund Company of Armenia

The Central Bank of Armenia started implementing its plans to financially stimulate development of the mortgage market by establishing National Mortgage Company UCO. The key aim of the company's activity is to spur the development of Armenia's mortgage market. The company will extend long-term credits to money-lending financial organizations by refinancing the mortgage credits extended by them. As of July 2009 the company's capital amounts to AMD 17 billion (USD 47.2 million). The maximum loan size is set at AMD 12 million (USD 33.3 thousand)²¹⁴.

Other Donors/Investors

A number of other smaller donors and investors also make contributions to funding lending activities in some of the target sectors. A summary of these investments is provided in the following table.

²¹¹ USAID. <http://armenia.usaid.gov/main/en/7/>

²¹² Business and Finance Consulting GmbH. "Projects". <http://www.bfconsulting.org/?proj>

²¹³ USAID. <http://armenia.usaid.gov/main/en/8/>

²¹⁴ Arka News Agency (2009). "Armenia to sign EUR 200 million agreement with German Government". July 13, 2009. <http://www.arka.am/eng/economy/2009/07/13/15755.html>

Investments by other donors

Donor, country	Partner financial institution	Date announced	Amount (USD million)	Target sector
SNS Institutional Microfinance Fund II and DWM Asset Management LLC (DWM), the Netherlands ²¹⁵	Inecobank	Feb. 2009	4	Microfinance
VDK Spaarbank n.v., Belgium ²¹⁶	Inecobank	Mar. 2008	3	MSME
Credit Agricole, France ²¹⁷	ACBA Credit Agricole Bank	Oct. 2008	42	MSME
German Investment and Development Company (DEG), Germany ²¹⁸	Inecobank	Jul. 2007	7	SME, mortgage
PlaNet Finance, France ²¹⁹	Inecobank	Mar. 2007	2	Microfinance
World Business Capital Inc. (WBC), US ²²⁰	Ardshinvestbank	Feb. 2009	10	SME
Overseas Private Investment Corporation (OPIC)	First Mortgage Company	2008	5	Housing

²¹⁵ Inecobank. News. February 18, 2009. http://www.inecobank.am/index.php?page=news&id=news_more&id=762

²¹⁶ Inecobank. "On March 28, 2008 Inecobank CJSC signed a Loan Agreement with VDK Spaarbank n.v." April 17, 2008. http://www.inecobank.am/index.php?page=news&id=news_more&id=476

²¹⁷ ACBA Credit Agricole Bank. "Credit Agricole banking group has disbursed 42 mln USD". <http://www.acba.am/index.php?page=111>

²¹⁸ Inecobank. News. July 17, 2007. http://www.inecobank.am/index.php?page=news&id=news_more&id=341

²¹⁹ Inecobank. "A credit contract worth USD 2 mln was signed between Inecobank and PlaNet Finance". March 26, 2007. http://www.inecobank.am/index.php?page=news&id=news_more&id=326

²²⁰ Ardshinvestbank. "Credit agreement for USD 10 million between Ardshinvestbank and World Business Capital, Inc." (in Russian). March 30, 2009. http://www.ashib.am/news.php?lang_id=2

8. Analysis of donor activities: Azerbaijan

European Bank for Reconstruction and Development

EBRD has participated in 77 projects with a total project value of EUR 2.6 billion since 1992, including EUR 400 million in gross EBRD disbursements. Project priorities include enterprise, financial, infrastructure and energy sectors and policy dialogue. EBRD supports the development of the financial sector through direct shareholding, various debt products, trade facilitation programmes, and technical assistance funded by donors.

EBRD project overview

Project name	Year established	Amount (USD million)	Type
ETC Non-Bank MFI Framework	2005	Not specified	NBFI lending for MSME support
Azerbaijan Multi Bank Framework Financing Facility	1997	100	Bank lending for MSME support

Source: EBRD

Frameworks: Under the USD 100 million Azerbaijan Multi Bank Framework announced in 1997, several banks were provided with loans or equity shares were purchased. These include: Azerdemiryolbank, Azerigazbank, Bank of Baku, Bank Respublika, International Bank of Azerbaijan, MilliKart, Mugan Bank, Nikoil Bank, Rabitabank MSME Loan and Unibank.

Individual loan disbursements by EBRD

Partner financial institution name	Date announced	Amount (USD million)	Target sector
Mugan bank	Feb. 2009	5	MSME
Normicro	Apr. 2008	1	MSME
Azerdemiryolbank	May. 2008	14	MSME
Azerigazbank	May. 2008	15	MSME
AccessBank—Syndicated A/B Loan I	Nov. 2008	28	MSME
Bank Respublika	Dec. 2008	10	Mortgage
Mugan bank	Nov. 2007	3	MSME
Nikoil Bank	Feb. 2007	2	MSME
Unileasing Loan	Mar. 2007	3	MSME
Azerigazbank	May. 2007	6	MSME
Bank Respublika Syndicated A/B Loan	Jul. 2007	24	MSME
Bank of Baku	Jul. 2007	2	MSME
Unibank Syndicated A/B Loan	Oct. 2007	35	MSME
Shore Overseas	Oct. 2007	2	MSME
Credagro	Oct. 2007	3	Agriculture

Source: EBRD

EBRD stops lending to MFIs: EBRD has recently taken the decision to stop lending to MFIs due to lack of clarity regarding the legal status of MFIs and in order to try to encourage the government to pass a law for MFIs.

Syndicated Loans: EBRD has recently been coordinating syndicated loans for banks and NBFIs. In 2007 and 2008, EBRD coordinated over USD 90 million in syndicated loans to AccessBank, Unibank and Bank Respublika for on-lending to MSEs.

Equity Investments: EBRD has made equity investments in four banks and one leasing company.

EBRD's equity investments

Institution	Year	Ownership
Milli Kart	2009	10%
Unileasing	2007	33.3%
Azerdemiryolbank	2005	25% + 1 share
Bank of Baku	2005	25% + 1 share
Unibank	2003	20%
AccessBank	2002	20%

Source: EBRD

Trade Finance Program: Working through select banks, the Trade Finance program offers trade financing capital with a risk sharing agreement between the bank and EBRD. This provides working capital for the purchase and importation of goods by enterprises.

Mortgage Lending: In December 2008, a USD 10 million loan to Bank Respublika was announced for on-lending to private customers for mortgage lending.

Leasing: EBRD announced its first leasing project in Azerbaijan in 2007 and purchased a 33.3% equity stake in Unileasing and provided a USD 3 million loan. It also included a EUR 250,000 technical assistance program to develop an MIS system and adopt best practice corporate planning and management techniques.

Insurance: EBRD entered the insurance market in 2005 when it purchased a 30% equity share in MBASK, one of the leading Azeri insurance companies.

KfW Entwicklungsbank

German Financial Cooperation (FC) with Azerbaijan started in 1995. KfW Entwicklungsbank provides funds on behalf of the German government to finance investments and complementary consulting services in the financial sector and the economic infrastructure. Most of the funds, roughly 85%, are disbursed as long term loans, and a smaller portion is offered as non-repayable grants. The following table shows KfW's active projects in Azerbaijan.

KfW project overview

Project name	Year established	Amount (EUR million)	Type
Deposit Insurance Scheme	2009 (expected)	5.0	Support Deposit Insurance Fund
AccessBank ²²¹	2008	USD 42M	MSME lending
Rural Banking Programme	2006	6.0	On-lending for farmers in rural areas; participating institutions are CredAgro and Bank Respublika
House Modernisation Programme	2006	4.0	Credit line for modernization or purchase of real estate
Public Private Partnership Project (completed)	2005	N/A	Support for Bank Respublika to develop into a universal bank
Introduction of Corporate Governance Standards (completed)	2004	N/A	Introduction of good corporate governance through a TA package
Microfinance Bank Azerbaijan II+III	2004	5.9	Increase in holding in microfinance bank
Microfinance Bank Azerbaijan I	2003	2.0	Foundation and buildup of a commercial bank specializing in micro and small-scale lending

²²¹ Microcapital. "Press Release: AccessBank receives USD 22 million loan from KfW." December 9, 2008. <http://www.microcapital.org/press-release-accessbank-receives-22m-loan-from-kfw/>

Project name	Year established	Amount (EUR million)	Type
Assistance for Retail Banks in SME Business / Set-up of a Bank Network	2002	N/A	Development of retail banking
Credit Guarantee Fund	2002	4.0	Default guarantee for loans granted by international commercial banks to local banks for SME lending
German Azerbaijan Fund	1998	N/A	MSME on-lending and TA

Source: KfW

On-lending: The German-Azerbaijani Fund, set up in 1998, originally consisted of EUR 5.1 million and in 2003 an additional EUR 3.6 million were provided. Azerdemiryolbank, Azerigazbank, Bank of Baku, Bank Respublika, Parabank and Unibank have been financed by the fund. The technical assistance terminated in 2006 and over 100 loan officers were trained and improved lending procedures were implemented in the partner banks. The fund continues to finance on-lending for MSME lending and the fund increased with interest payments from the partner banks.

Microfinance Bank of Azerbaijan: In 2002 KfW along with other development banks created Microfinance Bank of Azerbaijan, which is now renamed AccessBank and is one of the most active MSME lenders in the country. KfW continues to provide loan funds to AccessBank, with USD 22 million disbursed in 2008 and another USD 20 million planned for 2009.

Credit Guarantee Fund: Although the fund remains active, KfW comments that it is not being used at present, since the maximum guarantee size is EUR 1 million, too small to be meaningful to most banks.

No renewable energy projects planned: KfW does not have any projects planned to support the renewable energy sector; nor has it done any such projects in the past.

IFC

IFC initiated its collaboration with Azerbaijan in 1999. Among its activities, it has facilitated the creation of the Microfinance Bank of Azerbaijan (now AccessBank.). IFC is also providing advice to NBA to strengthen the legal and regulatory environment for SME and microfinance lending.

IFC project overview

Project name	Year established	Amount (USD millions)	Type
Azerbaijan Leasing Development Project (completed 2009)	2005	11	Provided capital and TA to AG Leasing, Bank of Baku, and Unileasing
Azerbaijan Energy Efficiency Survey Project	2008	N/A	Assess the current market for energy efficiency financing
Micro Finance Bank of Azerbaijan/Supplier Finance Facility Project	2007	15	Provide financing to suppliers of BP and other participating members
Azerbaijan and Central Asia Primary Mortgage Market Development Project (Phase II)	2006	N/A	Intended to improve legislation of mortgage market; Technikabank and Mugan Bank have received TA
Azerbaijan Corporate Governance Project (Phase II)	2008	N/A	TA for corporate governance to AG Bank, Mugan Bank, and Azercredit, as well as corporates

Source: IFC

Corporate governance: IFC is also contributing to the development of Azerbaijan's banking sector by helping Azerigazbank (AGBank) raise its corporate governance to international standards.

Expanding Mortgage Operations: The Azerbaijan Housing Program provides long term mortgage facilities in Azerbaijan. IFC and Azerdemiryolbank signed an agreement in 2008 for USD 5 million to expand the bank's mortgage operations. IFC is continuing due diligence studies of Unibank for a loan of USD 15 million and is expected to announce two additional banks in the first quarter of 2009.

IFC's Central Asia Leasing Facility: The Azerbaijan Leasing Development Project was launched in 2003 and has just finished. This project provided Unileasing with USD 5 million and AG Leasing with USD 1 million. The Association of Leasing Companies of Azerbaijan will take over the activities done by the IFC.

Energy Efficiency Survey: IFC is currently conducting an energy efficiency survey of 100 Azeri manufacturing companies. This survey will be published in the summer of 2009 and will form the basis of a future project to support energy efficiency.

Upcoming risk management project: A new project is planned for 2009 in which IFC will provide TA for risk management to Rabitabank and AG Bank as well as organizing a seminar on risk management to be attended by 20 banks.

IFC funding for on-lending

Partner financial institution name	Date announced	Amount (USD million)	Target sector
AccessBank	March 2009	15	MSME
Azerdemiryolbank JSC	2008	10 (50% mortgage program & 50% leasing projects with SMEs)	Mortgage Lending / MSME
Credagro Limited Liability Non-Bank Credit Organization	2008	10	MSME
UniBank	2007	15	Mortgage
JSC Bank Respublika	2006	6	MSME
Unibank	2005	Revolving finance credit of USD 3 million	Trade Credit
Microfinance Bank of Azerbaijan	2005	Credit line of USD 3 million	MSME

Source: IFC and financial institutions concerned

On-Lending: IFC has been active in providing on-lending services to Banks. Currently there are two projects pending: A USD 15 million loan to AccessBank to support its growth in the microfinance segment for SMEs. A USD 15 million subordinated loan to Azerigazbank for growing the retail and SME segments is pending. IFC is currently not offering funding for housing loans and is reallocating unused housing funds to MSMEs.

World Bank

The World Bank Group has focused on facilitating Azerbaijan's transition to a market economy since the country became a member in 1992. The bank has been active in developing the non-oil sector though the development of financial services and playing a key role in the privatization process of farmland.

World Bank project overview

Project name	Year established	Amount (USD million)	Type
Financial Services Modernization Project	2009 (Expected)	11.0	Improve consumer financial protection, develop the capital market, and improve access to, and transparency of, financial information
Agricultural Development and Credit Project	2006	29.2	Expanding access to credit for agricultural production
Financial Services Development Project	2005	12.3	TA to NBA to support their financial sector development strategy
Financial Sector Technical Assistance	2001	5.4	Finance

Source: World Bank

Agriculture Development. The Agriculture Development and Credit project components are Agricultural Business Services, Agricultural Support Services and Project Management components. As part of the Business Services, World Bank “increases the availability of small rural financial services by (a) strengthening and broadening credit union outreach; (b) expanding rural financial services such as credit for working capital requirements, long-term credit for investment purposes, and leasing programs for processing and agricultural equipment.”

Financial Sector Development. The Financial Sector Technical Assistance project’s objective was to provide technical assistance to the Government and the National Bank of Azerbaijan to support further implementation of the financial sector development strategy. This technical assistance was to focus on: (i) banking restructuring and divestiture; and (ii) enhancing financial sector infrastructure and banking supervision.

Financial Services Modernization Project. The World Bank plans a new project for Azerbaijan, Financial Services Modernization Project, with a total cost of USD 11 million. The purpose of this project is to improve consumers’ financial protection, develop the capital market, and improve access to, and transparency of, financial information.

Black Sea Trade and Development Bank

BSTDB is an international financial Institution established in 1998 by Albania, Armenia, Azerbaijan (having a 5% share in the bank’s capital), Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Turkey, and Ukraine. It operates as a regional development bank providing financing for key sectors of its member countries. It supports energy, manufacturing, transportation, telecommunications, small business and trade development.

Investments by BSTDB

Partner financial institution name	Date announced	Amount (USD million)	Target sector
Kapital Bank	Jun. 2008	12	Mortgage
Unibank	Feb. 2008	5	SME
Bank Standard	Feb. 2008	8	Trade Financing
Tekhnikabank	Dec. 2007	8	Mortgage
Technikabank	Jun. 2006	2	General Business Development
Azerbaijan Micro Finance Bank	Oct. 2005	Credit line of USD 3.0 million	MSME
Azerbaijan Micro Finance Bank	2002	1.75	MSME

Source: BSTDB and financial institutions concerned

SME: In 2008 BSTDB made available a USD 5 million SME on-loan to Unibank for providing sub-loans to small and medium-sized enterprises.

Mortgage Lending: Tekhnikabank and Kapital Bank have both received a series of loans from BSTDB for on-lending for mortgages.

Trade Financing: USD 8 million has been supplied to Bank Standard for extending its trade finance program. Previously the International Bank of Azerbaijan, Bank Respublika and Unibank have been involved in similar programs.

Asian Development Bank

The main focus areas of the ADB in Azerbaijan are: Transport and Communication, Infrastructure and SME development. In 2007 ADB began investing in the finance sector.

ADB project overview

Partner financial institution name	Date announced	Amount (USD million)	Target sector
International Bank of Azerbaijan	Nov. 2007	40	Tier 2 Capital
Bank Respublika	Aug. 2007	10	Tier 2 Capital
Bank of Baku	Apr. 2007	6	MSME

Source: ADB and financial institutions concerned

Renewable Energy Development: ADB allocated USD 900,000 to a TA and study package for analyzing renewable energy potential and strategies. This resulted in the publication of a final report in Dec 2007.

Other Donor Organizations

FMO—Netherland Development Bank

In June 2008, FMO provided Unibank with a USD 15 million line of credit for on-lending to purchase, modernize, repair or construct mortgage objects, as well as to re-finance mortgage credits.

In June 2007, FMO provided Azerdemiryolbank with EUR 2.2 million as a long term loan for on-lending to SMEs. In December 2006, FMO provided USD 5 million to finance SME projects and a USD 5 million line of credit for use as 2nd tier capital. FMO also provided Unibank with a USD 1.5 million credit line for trade financing.

Deutsche Bank

Deutsche Bank provided a USD 1 million loan to NorMicro in 2009.

Islamic Development Corporation

In August 2008, an agreement between the Islamic Private Sector Development Corporation and Azerdemiryol Bank was signed. This agreement provides a USD 3 million loan to be used for lending to MSMEs using Islamic Banking principles.

The IDC has been active in investing directly in SME lending through the Caspian Investment Company.

SIFEM AG

In December 2008, SIFEM (Swiss Investment Fund for Emerging Markets) granted Azerdemiryolbank a USD 7 million loan for MSME development.

On November 30, 2007, SIFEM signed a 6-year senior loan agreement in the amount of USD 6 million with Micro Finance Bank of Azerbaijan (MFBA), now AccessBank.

9. Analysis of donor activities: Georgia

European Bank for Reconstruction and Development

In Georgia, EBRD's efforts are mainly oriented towards the development of the country's private sector by providing financing to micro, small and medium-sized enterprises (MSMEs), as well as towards infrastructure projects. Between the start of country operations in 1992 and January 2008, a total of 78 EBRD projects were implemented in Georgia²²². Annual commitments in 2007 alone reached EUR 192 million. Most commitments are directed to the corporate and energy sectors, accounting for 30% and 28% of funding respectively. Other commitments target the financial sector, infrastructure and MSME financing, representing 27%, 10%, and 5% respectively.

The Georgian Financial Sector Framework is one of the largest projects addressing the financing needs of EBRD partner banks. In line with EBRD's Financial Sector Strategy for Georgia, with a budget of USD 75 million, the project provides medium-term funding. The project's partners include TBC Bank, Bank Republic, Basis Bank, and Cartu Bank.

Main projects relevant to current study (2007–2009)²²³

Project name	Date	Amount (million)	Target sector / Type	Scope / Details
Georgian Financial Sector Framework	Jun 2007	USD 75	Equity finance and lending to banks	Strengthening the financial sector in Georgia. The framework includes 8 subprojects.
Energy Efficiency Framework	Nov 2007	USD 35	Energy efficiency	Lending to banks and private enterprises for improving energy efficiency

Relevant EBRD loan disbursements by partner financial institution

Loan	Date	Amount (million)	Target sector / Type	Scope / Details
Black Sea Energy Transmission System	Feb. 2009	EUR 60	Energy efficiency finance	Extension of the Georgian main transmission network system to a new substation
MCFF–Cartu Bank	Feb. 2009	USD 10	Lending to banks	Provide medium- to long-term financing to business clients of Cartu Bank
Cartu Bank SME Loan II	Feb. 2009	USD 10	SME finance	Develop SME lending activities and expand access to finance for local SMEs
TBC Bank–Senior Loan	Dec. 2008	Up to USD 25	Lending to banks	Assist TBC in restructuring its operations following the conflict with Russia and economic downturn
TBC Bank: Subordinated Loan	Dec. 2008	USD 19.5	Lending to banks	Support in restructuring operations towards a more sustainable funding model under post-conflict market conditions and amid the global financial crisis
Vardnili HPP Cascade Rehabilitation	Aug. 2008	EUR 60	Energy efficiency finance	Rehabilitation of Vardnili Hydro Power Plant cascade.
Bank Republic–MSME	Jun. 2008	USD 20	MSME Finance	Increase supply of medium-term funding to MSMEs
MCFF–Bank Republic–Full Recourse	Jun. 2008	USD 20	Lending to banks	Provide medium- to long-term financing to business clients of Bank Republic.

²²² EBRD–Country Factsheet–Georgia (April 2008)

²²³ EBRD. Project Summary Documents–Georgia. <http://www.ebrd.com/projects/psd/country/georgia.htm>

Loan	Date	Amount (million)	Target sector / Type	Scope / Details
CEEP—Bank Republic	Jun. 2008	USD 65	Energy efficiency finance	Caucasus Energy Efficiency Programme. Credit line used for on-lending to private sector industrial entities to finance projects aimed at improving energy use.
Bank Republic Mortgage Loan II	Jun. 2008	USD 20	Housing finance	Provide long-term financing to individuals for purchasing, constructing, renovating, repairing and/or re-mortgaging their real estate
Georgian Financial Sector FW-TBC Bank Mortgage Line II	Nov 2007	USD 12	Housing finance	Provide longer-term financing to individuals for purchasing, renovating, repairing, constructing and/or re-mortgaging their residential property
Georgian Financial Sector F/W—Basis Bank (MSME Loan)	May 2007	MSME line for USD 6	MSME Finance	Increase medium-term lending to MSME sector

Source: EBRD

Technical Assistance. In 2007 alone, EBRD has signed 107 contracts for technical assistance activities conducted in Georgia. The cumulative value of these assignments totals EUR 6.47 million.²²⁴

Equity Finance. Following successful long term cooperation with Georgian financial institutions, EBRD also provides equity financing to selected partners. As of December 2008, EBRD has a 15% participation in the capital of BasisBank, and 10% in Bank Republic. In February 2009, EBRD announced the acquisition of a 17% share of TBC Bank. In spring 2009, the bank planned to acquire 25% of shares in Cartu Bank. Also in February 2009, EBRD announced plans to increase its share in VTB Bank Georgia from 17% to 19%.²²⁵

Crisis Management. In January 2009, IFC and EBRD announced the provision of a USD 200 million financial package to Bank of Georgia to help it manage the effects of the global financial crisis. The two international financial institutions will provide USD 100 million each, including subordinated and subordinated convertible loans of up to USD 50 million to support the bank's capital base, and a senior loan of USD 50 million to provide longer-term liquidity. As part of this aid, IFC and EBRD will each acquire a 5% stake.

Energy efficiency. EBRD's Energy Efficiency Framework supports TBC Bank, Cartu Bank, and Bank Republic in providing loans to manufacturing businesses to improve energy efficiency. Direct loans from EBRD to manufacturers have also been made, with seven current projects. A residential energy efficiency project has also started in 2009, with USD 6.5 million in funding along with technical assistance.

A new country strategy is to be adopted in 2009.

KfW

KfW Entwicklungsbank provides funds on behalf of the German government to finance investments and complementary consulting services in the financial sector and the sphere of economic infrastructure. German financial cooperation with Georgia began in 1993. Through 2006, more than EUR 245 million had been committed to the country.

The main target areas are energy (53% of commitments), followed by sustainable economic development and communal development (20% each).²²⁶

²²⁴ Including TAM/BAS and other EBRD divisions; Source: <http://www.ebrd.com/oppo/procure/awards/ar2007.pdf>

²²⁵ Georgian Business Week, www.gbw.ge

²²⁶ KfW Entwicklungsbank, Priority Areas of Cooperation, October 2006 (http://www.kfw-entwicklungsbank.de/EN_Home/Countries_and_Projects/Europe42/Georgia29/Foerderschwerpunk_Georgien_2006_en.pdf)

The main KfW partner bank in the country is ProCredit Bank Georgia, where KfW holds a share of 14.2%. Apart from that, KfW has allocated credits worth USD 25–30 million to Bank Republic and Bank of Georgia.²²⁷

Main projects relevant to current study²²⁸

Project name	Date	Amount (million)	Target sector	Scope
ProCredit Bank Georgia	Dec. 2008	USD 23.75	MSME Finance	The loan represents 50% of a common commitment of KfW and OeEB (total USD 47.5 million) ²²⁹
Credit Guarantee Fund for the Promotion of Small and Medium-Sized Enterprises	Aug. 2006	EUR 8.6	Finance	improve the access of SMEs to commercial loans
ProCredit Bank	Aug. 2006	USD 12	Finance	support and expand the provision of sustainable, efficient and customer-oriented financial services at market conditions to MSMEs
Promotion of Renewable Energies I	2000	EUR 5.1	Renewable energy	Credit line (via local banks) for the rehabilitation of small, private hydropower plants

The Credit Guarantee Fund has worked with TBC Bank, Bank of Georgia, and Bank Republic. However, KfW reports that it is not active at the present time.

KfW is planning an upcoming EUR 5 million project to support renewable energy. The funds will be lent to the government of Georgia and then lent to banks for funding of small hydro power plants. Technical assistance will also be provided under the project.

The World Bank

Georgia joined the World Bank in 1992. Since then, commitments to the country have totaled USD 866 million. As of March 2008, in the active project portfolio, the largest commitments were recorded for the rural sector (30.4%; USD 80.3 million), transport (30%; USD 79 million), education (15.5%; USD 40.9 million), and energy and mining (15.4%; USD 40.6 million).

The World Bank is preparing a new country strategy for 2010 which will provide additional funding for Georgian banks, although the amount of available funding is not known yet.

Main projects relevant to current study (active projects)²³⁰

Project name	Date	Amount (million)	Target sector	Scope
Rural Development Project	May 2005	USD 34.71	Agricultural lending	Aims to develop the productivity and profitability of the private agriculture sector. Component 2 improves the capacity of financial institutions to lend to agribusiness

The Rural Development Project is currently working with Bank Republic, Kor Standard, and Cartu Bank.

²²⁷ Georgia Business Consulting (www.gbc.ge), December 2008

²²⁸ KfW Entwicklungsbank, Project List Georgia (http://www.kfw-entwicklungsbank.de/EN_Home/Countries_and_Projects/Europe42/Georgia29/Projects.jsp)

²²⁹ Press Release, ProCredit Bank Georgia, December 19, 2008

²³⁰ World Bank, Status of Active Projects (Georgia, October 2008)

International Finance Corporation (IFC)

Georgia became a member of IFC in 1995. As of October 1, 2006, IFC had invested around USD 164 million to finance projects in the financial, power, oil and gas, and manufacturing sectors. In the financial sector, IFC has disbursed more than USD 80 million during last ten years, with the main purpose to finance private Georgian enterprises (SMEs) and individuals.

As of December 2008, IFC holds a 12% stake in TBC Bank.

Main projects relevant to current study (2003–2009)

Project name	Date	Amount (million)	Target sector	Scope
BOG III	Oct. 2008	USD 100	SME Finance	Loan package for SME and retail lending
TBC Bank	Aug. 2008	USD 70	Finance & Insurance	Tier I capital, subordinated debt, and senior debt, to support projected growth by 2010
JSC Bank Republic	May 2008	subordinated loan of USD 7 and a senior loan of USD 15	Finance & Insurance; Housing Finance	Develop the mortgage lending; increase an access to long-term mortgages for local borrowers
JSC Bank Republic	Feb. 2007	Up to USD 20	Finance & Insurance	SME lending
TBC IV	Jul. 2005	USD 8.5	Finance & Insurance	Purchase 21.7% of TBC Bank's shares for up to USD 8.5 million
TBC Leasing	Jun. 2005	USD 3	Finance	Expand leasing operations to SMEs

Source: IFC and financial institutions concerned

Together with EBRD, IFC will provide a financing package for JSC Bank of Georgia for USD 200 million (for details please see the above section on EBRD activities in Georgia).

Black Sea Trade and Development Bank (BSTDB)

BSTDB commenced operations in June 1999. As of December 2008, BSTDB has seven active projects in Georgia, totaling USD 36 million. Most projects provide financial support to Georgian institutions, and one project targets the infrastructure development of Poti port. BSTDB financial intermediaries in Georgia include: Cartu Bank, ProCredit Bank Georgia, TBC Bank, TBC Leasing, and VTB Bank Georgia.

Main projects relevant to current study (2005–2009)²³¹

Project name	Date	Amount (USD million)	Target sector	Scope
ProCredit Bank	Feb. 2008	10	SME Finance	SME credit line
JSC TBC Leasing ²³²	Dec. 2007	3	Finance	SME leasing facility
Cartu Bank ²³³	Sep. 2007	1.5	Finance	Revolving trade finance facility
TBC Bank	Jul. 2006 Jul. 2000	10	SME finance	Trade finance facility and SME credit line
VTB Bank Georgia	Mar. 2006	3	Finance	Trade finance facility
ProCredit Bank	Jan. 2005 Dec. 2005	11	SME Finance	SME Credit Line I & II
Bank Republic	Nov. 2005	3	Finance	Trade Finance Credit Line

²³¹ BSTDB. Operations summaries, list by country, Georgia <http://www.bstdb.org/sumsigcgeorgtxt.htm>

²³² Finchannel.com. "BSTDB launches leasing financing in Georgia". December 4, 2007. http://finchannel.com/index.php?option=com_content&task=view&id=2088&Itemid=38

²³³ Finchannel.com. "BSTDB Increases Export-Import Financing In Georgia". September 22, 2007. http://www.finchannel.com/index.php?option=com_content&task=view&id=411

Overseas Private Investment Corporation (OPIC)

In December 2008, OPIC approved USD 79 million for two projects for constructing office space in the capital and for the provision of long term funding for middle-income mortgages in the country. Of the total amount, USD 39 million will be provided to Bank of Georgia to expand its mortgage-lending portfolio to middle-income borrowers. The remaining USD 40 million will be spent on the construction of a multi-use office building in a central location in Tbilisi.²³⁴ Apart from mortgage lending, OPIC supports leasing finance of a Bank of Georgia subsidiary.²³⁵ As of October 2008, another funding project of USD 40 million was planned for TBC Bank.²³⁶ Overall, in October 2008, OPIC announced plans to provide up to USD 176 million for seven projects in Georgia.²³⁷

European Investment Bank (EIB)

The government of Georgia will receive EUR 220 million from the European Investment Bank (EIB) to finance 5 various projects in 2009–2011.²³⁸ EUR 56 million will be allocated to finance the construction of a 500kW high-voltage transmission line. The agreement on project implementation will be signed in May 2009. The European Bank for Reconstruction and Development (EBRD), KfW, and the European Investment Bank (EIB) will jointly finance the project. The project price totals EUR 220 million. EUR 90 million will be allocated for the construction and rehabilitation of hydro power plants. In 2009 the government of Georgia expects to receive EUR 65 million from EIB. The bank will also disburse EUR 11 million for the rehabilitation of the runway of the Tbilisi International Airport.

Asian Development Bank (ADB)

Georgia joined ADB in 2007. The Interim Operational Strategy was endorsed in March 2008.

Main projects relevant to current study

Project name	Year established	Amount (million)	Target sector	Scope
Bank of Georgia ²³⁹	Aug 2007	USD 25	Finance	Support the emerging banking sector; increase access to SME financing; extend maturities for leading banks

The first public sector loan for Georgia totaling USD 40 million was announced in September 2008. The loan will support rehabilitation of water supply, sanitation, waste management and road transport services, and rebuild other infrastructure that may have been damaged in the conflict with Russia.²⁴⁰

FMO

Together with the German Development and Investment Company (DEG), the Dutch FMO provided a USD 30 million subordinated loan to Bank of Georgia in 2008.²⁴¹ In January 2009, FMO was considering a USD 5 to 7 million loan to fuel the portfolio growth of TBC Leasing. Apart from that, in February 2009 FMO announced plans to become a shareholder in TBC Bank.²⁴²

²³⁴ OPIC press release, 12 December 2008 (<http://www.opic.gov/news/pressreleases/2007/pr121208.asp>)

²³⁵ "Bank of Georgia to Draw USD 40m from OPIC for Mortgage Lending", Georgia Business Consulting, 02 October 2008

²³⁶ "OPIC to Open Credit Lines to Bank of Georgia and TBC Bank", Georgia Business Consulting, 17 October 2008

²³⁷ OPIC press release, 27 October 2008 (<http://www.opic.gov/news/pressreleases/2007/pr102708.asp>)

²³⁸ Finance Ministry of Georgia, January 2009

²³⁹ Asian Development Bank (2007). "Report and Recommendation of the President to the Board of Directors. Proposed Senior Loan Republic of Georgia: Joint Stock Commercial Bank of Georgia". July, 2007. <http://www.adb.org/Documents/RRPs/GEO/41920-GEO-RRP.pdf>

²⁴⁰ ADB press release – "ADB Unveils Aid Package for Georgia", September 13, 2008

²⁴¹ The Financial, "Bank of Georgia Plans to Open 30,000 Green Deposit in 2009", February 16, 2009, http://finchannel.com/index.php?option=com_content&task=view&id=29814&Itemid=47

²⁴² Georgia Business Consulting (www.gbc.ge)

Donor Conference on Georgia

Following the military conflict with Russia in August 2008, the international donor community organized a joint conference on October 22 in order to address the needs of the country and to mitigate the effects of the confrontation in Georgia. The total commitment made by representatives of IFIs and foreign governments accounted for USD 4.5 billion for 2008–2010.

Part IV: Target sector supply and demand analysis

10. Target sector supply and demand analysis

Overview

This section provides an analysis of the supply and demand for loans among sub-borrowers in the four target sectors of interest to OeEB. Very little recent, published data from secondary sources is available on the demand for loans by the target sectors. Therefore, BFC's analysis of demand is qualitative, not quantitative, and is based primarily on comments from interviewees. By contrast, the supply analysis is based both on interviews with financial institutions and donors, and on a structured survey which was conducted in February 2009.

The following table shows the supply of loans to the target sectors for institutions participating in the survey. A list of these institutions can be found in Appendix 1.

Loan portfolios of survey respondents (December 31, 2008, USD, million)

Gross loan portfolio	Armenia	Azerbaijan	Georgia
MSME	395.3	1,195.5	700.0
Housing	123.7	200.1	394.4
Agriculture	51.7	307.4	54.5
Renewable energy	15.6	0.2	2.5

Source: BFC survey

BFC concludes that in all three countries, the supply-demand gap is highest for:

- Agricultural enterprises
- Microenterprises
- Loans to all sectors in smaller towns or rural areas

It should be noted that microenterprises comprise just one part of the MSME sector. As the size of the enterprise increase, moving from micro to small to medium, the access to credit increases. Medium-sized enterprises have much better access to credit than microenterprises.²⁴³

Other notable conclusions are:

- MSME loan portfolios are much larger than portfolios of the other sectors
- Demand for microloans and agricultural loans from farmers during the crisis has remained relatively strong, compared to weak demand for housing loans
- Interest rates are substantially higher in Georgia than in Armenia and Azerbaijan
- Demand and supply of loans to the target sectors is generally more healthy in Azerbaijan, where the crisis has been less severe
- In Armenia and Georgia, demand for foreign currency loans has dropped dramatically
- Most lenders have increased their interest rates by an average of 1–2% since the start of the crisis
- Aside from small hydro power plants, there is very little demand for loans for investment in renewable energy sources

MSME

Demand

Demand for MSME loan products remains relatively strong in all three countries despite the continuation of the economic crisis. In Georgia and Armenia, where the economic crisis is more acute, a number of managers at financial institutions stated that demand from MSME clients has not declined or has even increased, in contrast to marked decreases in other segments such as housing and corporate loans. Others reported that although demand has fallen, it has fallen less for MSME loans than for other segments. In Azerbaijan, where the economic crisis has had less of an impact, managers generally report strong demand for MSME loans, although marginally lower than in previous years.

²⁴³ There is no standard definition of a microenterprise, small enterprise, or medium enterprise among the financial institutions studied. Here the terms are used in a relative sense.

Nevertheless, MSMEs are not immune to the slowdown of the economy. Although few institutions reported that their MSME clients are going bankrupt or closing, most in Armenia and Georgia reported that revenues of MSMEs in all economic sectors (trade, production, services) have fallen and that many are struggling to repay their loans. In Azerbaijan, the drop in revenues of MSMEs is less but still noticeable. This is confirmed by rising delinquency in the respondents' MSME portfolios. Many interviewees in all three countries believe that the economy has not hit the bottom yet and that the situation for MSMEs will get worse in the future, with declining turnover leading to higher delinquency and reduced demand.

For Armenia and Georgia, demand for foreign currency loans has fallen dramatically since the recent depreciations of the local currencies. However, several financial institutions which lend to microenterprises reported that microenterprises are generally more willing to accept foreign currency loans than larger enterprises, and that MSMEs are more willing to accept foreign currency loans than housing clients. In Azerbaijan, the government's insistence that it will support the manat (and its ability to do so, with USD 18 billion in currency reserves) means that there is less pressure for enterprises to hedge their currency risk, and loans in foreign currency can still be relatively easily placed in the market.

Supply

MSME lending overview among surveyed institutions

	Armenia	Azerbaijan	Georgia
Number of surveyed institutions making loans to the target sector	19	22	20
Total loan volume (Dec. 31, 2008, USD millions)	395.3	1,195.5	700.0
MSME loans as % of loans to all target sectors	67.4%	70.2%	60.8%
Number of loans (Dec. 31, 2008)	52,195	173,162	104,558
Average loan size (USD)	7,555	6,904	6,695
Forecast portfolio growth for 2009	43.7%	51.8%	22.1%
Maximum/minimum interest rate, local currency	23.4% / 16.3%	31.9% / 16.3%	42.1% / 21.5%
Maximum/minimum interest rate, USD/EUR	22.8% / 15.6%	32.9% / 19.3%	41.2% / 20.1%
Maximum loan maturity (years)	10	7	10
Average loan maturity (years)	2.3	1.7	2.0
Maximum loan size offered (USD)	451,992	735,866	422,728

Source: BFC survey

MSME loans comprise by far a greater proportion of the loan portfolios of survey respondents than the other target sectors, accounting for between 60% and 70% of total loan volume to the target sectors in all three countries. Much of the reason for the predominance of MSME lending can be attributed to donor support. Donors have provided a much greater amount of funding and technical assistance for MSME lending and began to do so much earlier than for the other target sectors.

Both by volume and number of loans, Azerbaijan has the largest MSME portfolio, followed by Georgia and Armenia. Although the figures for Armenia are substantially understated, as the largest Armenian MSME lender did not provide data, the order of countries is almost certainly correct.

Most lenders have become more cautious in lending to MSMEs since the effects of the global economic crisis have begun to be felt, and lending volumes have decreased. This decrease in overall lending, however, has not been uniform among all institutions. A few institutions in Armenia and Georgia have ceased MSME lending altogether (along with other forms of lending); several—mostly microlenders—report no decrease or a modest increase; most report a moderate reduction in the volume of MSME lending. According to the 2009 budgets of those institutions surveyed, MSME portfolios will grow in 2009, but much less in Georgia than in Armenia and Azerbaijan. However, during interviews, many institutions in all three countries suggested that these targets were set too optimistically and that they will struggle to reach them.

The lower projections for Georgia are not surprising given that the country was hit with a war just as the global economic crisis was getting worse in Europe and Asia. However, just as important a factor in Georgia's current difficult situation is the aggressive lending approach of its banks prior to the war. Georgian lenders were much less conservative than their counterparts in Azerbaijan and

Armenia for several years before the crisis, lending larger and larger amounts with less collateral and weaker income verification procedures. This was true for MSME loans as well as other product types, and it is one of the reasons that the Georgian financial sector is suffering more than in Armenia and Azerbaijan.

One of the unique aspects of MSME lending in Armenia is the relatively low interest rates compared to other NIS countries. This is the result of Armenia's interest rate cap, which currently stands at 24%. Most institutions compensate by charging high commissions and fees, providing them with an acceptable level of profit in spite of the cap. Georgia has the highest interest rates to MSMEs, with rates often exceeding 40% annually.

Lenders have changed their loan conditions to MSME sub-borrowers since the start of the crisis. Common changes to loan conditions include:

- Interest rates have been increased on average by 1–2% (where possible given the interest rate cap) to compensate for higher funding costs
- A few institutions have decreased their maximum loan maturity
- Maximum loan amounts have been decreased

Notably, collateral requirements have generally not increased; Armenian financial institutions have always been quite strict in their collateral requirements for MSME loans.

Many institutions interviewed in all countries reported that they are carrying out a more conservative financial analysis of applicants. Approaches vary among institutions, but tend to include:

- Making more conservative cash flow projections
- Increasing the minimum debt service coverage ratio required for approval

Survey respondents identified lack of access to funding as the most significant obstacle to the growth and profitability of their MSME lending operations in all three countries, followed by credit risk and unattractive conditions of borrowed funds. However, it should be noted that most of the surveyed institutions work with a variety of international financial institutions and do not have difficulty attracting funding at the present time.

Obstacles to growth and profitability of MSME lending²⁴⁴

Obstacle	Armenia	Azerbaijan	Georgia
Lack of knowledge of how to serve this segment	1.8	1.6	1.1
Lack of access to funding	2.9	3.1	3.7
Unattractive conditions of borrowed funds (high interest rate, short term, etc.)	2.5	2.0	2.7
Limited demand from customers	1.6	1.3	1.6
High credit risk	2.6	2.0	2.4
Inappropriate regulations or laws	2.5	1.5	1.7
Average for sector	2.3	1.9	2.2

Source: BFC survey

The supply-demand gap

Financial institutions have done a relatively good job of reaching the higher end of the MSME segment—that is, small and medium enterprises—in all three countries. Nearly every bank studied offers SME loan products and competition is fierce. Outreach to microenterprises, particularly in rural areas, has met with mixed success. While there are a number of institutions in each country which are focused on lending to microenterprises in rural areas, entrepreneurs in some villages and regions have very few options.

²⁴⁴ The rating scale is 1 to 5, where 5 represents a major obstacle and 1 represents a factor which is not an obstacle.

Housing

Demand

Demand for housing loans has fallen sharply since the start of the economic crisis in connection with a lack of activity in the real estate market—that is, a lack of buying and selling. The presence of dozens of partially completed but currently inactive construction projects in Yerevan, Tbilisi, and Baku testifies to the severity of the problem. To a certain extent, the current housing bust is the consequence of overinvestment and speculation in the sector in recent years. So much money was plowed into real estate that construction reached an astonishing 27% of GDP in Armenia in 2008. While the contribution of construction to GDP was lower in Georgia and Azerbaijan, there was nevertheless a huge boom. Real estate prices ballooned, and the stage was set for a dramatic contraction at the first sign of economic trouble.

There is no general agreement on the degree to which real estate prices have fallen during the crisis. With so little buying and selling, determining market prices is extremely difficult. Many potential sellers are unwilling to part with their property at a loss or at prices far below those of mid-2008, resulting in a drying up of housing supply. Nevertheless, most interviewees in Armenia and Georgia report a fall in prices in the range of 20–40%. There is general agreement that the situation is not so dire in Azerbaijan, where the economic crisis has been less severe.

Supply

Housing lending overview among surveyed institutions

	Armenia	Azerbaijan	Georgia
Number of surveyed institutions making loans to the target sector	15	13	13
Total loan volume (Dec. 31, 2008, USD millions)	123.7	200.1	394.4
Housing loans as % of loans to all target sectors	21.1%	11.7%	34.3%
Number of loans (Dec. 31, 2008)	5,337	4,329	12,926
Average loan size (USD)	23,186	46,229	30,514
Forecast portfolio growth for 2009	15.9%	76.4%	11.7%
Maximum/minimum interest rate, local currency	19.4% / 14.6%	21.6% / 8.4%	31.1% / 18.6%
Maximum/minimum interest rate, USD/EUR	19.7% / 14.6%	25.3% / 16.8%	30.4% / 19.8%
Maximum loan maturity (years)	20	30	30
Average loan maturity (years)	8.0	12.5	5.0

Source: BFC survey

Georgia appears to have a larger housing portfolio than Azerbaijan and Armenia, based not just on the total loan volume of survey respondents but on the percentage of housing loans to all target sector loans. In general, institutions in Georgia were faster to enter the consumer lending market than their counterparts in Armenia and Azerbaijan. Curiously, they achieved these results while offering much higher interest rates and offering shorter loan terms than in Armenia and Azerbaijan. Of course, today Georgian banks are suffering the consequences of their aggressive lending practices, with very high delinquency in their housing portfolios.

Supply of housing loans has fallen more than any other product type since the economic crisis began to affect the Caucasus. Several institutions that continue to actively lend to the MSME and consumer sectors have nearly stopped their housing loan activities, due both to reduced demand and poor portfolio quality. Lenders are experiencing higher delinquency levels in their housing loan portfolios than in any other segment.

Those institutions which continue to offer housing loans have adopted stricter policies. Many banks reported lowering maximum loan-to-value ratios to 50% from 70–80% and income verification procedures are now being carried more diligently than they were during the housing boom.

The average maturity of housing loans differs by country, with short maturities of five years in Georgia, and longer maturities of 12.5 years in Azerbaijan. Although the maximum possible maturity, now 20 to 30 years, has climbed dramatically in the past five years, average maturities still are far behind. In general, Armenian lenders are not willing to take on substantial interest rate

risk, and thus the loan terms available to sub-borrowers reflect the loan terms at which they borrow from international financial institutions.

The mortgage market in all three countries is characterized by an overwhelming concentration of lending activity in the capital cities. This trend is much more pronounced than for the other target sectors—MSME lending and agricultural lending tends to be less concentrated in the capital cities than housing lending.

As with MSME lending, lack of access to funding is cited as the primary obstacle to the growth and profitability of the housing lending market.

Obstacles to growth and profitability of housing lending

Obstacle	Armenia	Azerbaijan	Georgia
Lack of knowledge of how to serve this segment	1.6	1.4	1.7
Lack of access to funding	3.3	3.7	4.1
Unattractive conditions of borrowed funds (high interest rate, short term, etc.)	3.1	2.6	3.1
Limited demand from customers	1.8	1.3	2.1
High credit risk	2.9	2.5	3.5
Inappropriate regulations or laws	2.5	1.9	1.7
Average for sector	2.5	2.2	2.7

Source: BFC survey

Not surprisingly, Georgian institutions—where the housing market is in the worst shape—rate high credit risk as a much more significant obstacle than Azeri respondents.

The supply-demand gap

It is difficult to assess the supply-demand gap for housing finance at the present time due to the lack of market activity. What is clear is that both supply and demand are at low levels in comparison with recent years, particularly in Armenia and Georgia. Interviewees, however, are often only aware of the situation in the capital city, and BFC suspects that there is still substantial demand for housing loans in the secondary cities and towns of each country, although further research would be required to confirm this.

Agriculture

Demand

According to the institutions serving agricultural enterprises, farmers' demand for loans has not fallen significantly since the start of the economic crisis. While demand for higher-priced imported and luxury food items has clearly decreased, Armenians still need to purchase basic food supplies, meaning that the majority of farmers, who produce basic food supplies, should not be seriously affected as a result of the crisis. For many farmers, reduction in the demand for their products is less of a concern than the decline in remittances from overseas, which in many cases constituted a substantial share of their total income. Some interviewees even argue that the economic crisis could have a positive effect on demand. As migrant workers return to the Caucasus from other countries, some may begin to work on land which is currently idle and could become future clients.

In all three countries, agricultural output as a percentage of GDP is much lower than the percentage of workers employed in the agricultural sector. Farmers typically have small land plots and their average income is lower than for other sectors of the economy. Therefore, loan sizes demanded tend to be smaller than for other segments. This is reflected in the small average loan size among survey respondents to the agriculture sector.

Supply

Agricultural lending overview among surveyed institutions

	Armenia	Azerbaijan	Georgia
Number of surveyed institutions making loans to the target sector	14	19	16
Total loan volume (Dec. 31, 2008, USD, million)	51.7	307.4	54.5
Agriloans as % of loans to all target sectors	8.8%	18.0%	4.7%
Number of loans (Dec. 31, 2008)	37,995	28,792	16,943
Average loan size (USD)	1,361	10,677	3,216
Forecast portfolio growth for 2009	46.1%	131.5%	14.5%
Maximum/minimum interest rate, AMD	21.6% / 13.6%	27.9% / 12.8%	33.8% / 25.5%
Maximum/minimum interest rate, USD/EUR	20.2% / 13.7%	27.8% / 20.4%	35.1% / 21.6%
Maximum loan maturity (years)	7	7	10
Average loan maturity (years)	2.8	2.2	2.2

Source: BFC survey

The data supplied by financial institutions suggests that agricultural lending comprises a relatively small proportion of total loans to the target sectors, particularly in Georgia and Armenia. However, this data may be misleading, as many institutions classify some agricultural loans as MSME loans. Nevertheless, agricultural lending is generally perceived as a high-risk business in the Caucasus, and BFC is confident that actual lending volumes are in fact much lower than for MSME lending.

Average loan size differs greatly by country, with Azeri lenders disbursing larger loans and Armenian lenders disbursing small loans of just USD 1,361 on average. As a result, although Armenia trails Azerbaijan in terms of total volume of loans, it has a greater number of loans.

Financial institutions tend to perceive agricultural lending as a high-risk endeavor. High credit risk was rated as the main obstacle to the growth and profitability of agricultural lending operations in Armenia and was rated a close second in Georgia and Azerbaijan. Surveyed institutions also indicated that lack of knowledge of how to serve this segment is more of an obstacle than for MSME and housing loans. Many lenders in Armenia do not have the expertise to train their staff to do a proper cash flow analysis of businesses engaged in crop production.

Obstacles to growth and profitability of agricultural lending

Obstacle	Armenia	Azerbaijan	Georgia
Lack of knowledge of how to serve this segment	2.4	2.0	2.0
Lack of access to funding	2.9	2.9	3.6
Unattractive conditions of borrowed funds (high interest rate, short term, etc.)	2.7	2.3	2.8
Limited demand from customers	1.7	1.4	1.9
High credit risk	3.6	2.7	3.5
Inappropriate regulations or laws	2.2	1.5	1.9
Average for sector	2.6	2.1	2.6

Source: BFC survey

Supply-demand gap

BFC believes that the agriculture sector is the most underserved in Armenia in comparison with other target sectors. High perceived credit risk, high transaction costs, and lack of knowledge of how to analyze agricultural enterprises all combine to make financial institutions very cautious about lending to this sector. This is especially true for small farmers, who can only receive loans from a comparatively small group of financial institutions. Large agricultural processing companies generally do have abundant access to credit.

There is a pronounced need for technical assistance for agricultural lending. The supply-demand gap will not decrease until institutions feel that they are capable of assessing the creditworthiness of agricultural borrowers and understanding the risks in their portfolios. Therefore, any attempt by donors to eliminate this gap should be met with a combination of funding and long-term consulting support which is focused on training branch staff and middle managers.

Renewable energy

Demand

Demand for renewable energy loans in the Caucasus countries is very limited at the present time. What little demand there is highly concentrated in small hydro power plants. Hydro is generally cheaper to produce than other forms of renewable energy. Given the low tariffs paid by governments for energy, low cost is essential. According to interviewees in all three countries, solar and wind power cannot be profitable at the current rates except on a large scale, requiring massive investment.

Just as important as cost is the lack of technical capacity to implement renewable energy projects. Very few entrepreneurs have technical knowledge or experience working with most forms of renewable energy, such as solar, wind, biomass, and geothermal. The exception is hydro power, which has been present in the Caucasus since the 1940s—it is possible to find skilled local engineers for the construction and management of hydro power plants. The development of other forms of renewable energy, however, is highly dependent on the ability of donors to provide large-scale technical assistance to educate and train locals.

Demand for loans for hydro power plants is highest in Armenia, where there are currently 49 small hydro power plants operating, and where hydro power provides about 33% of the country's total energy supply.²⁴⁵ The Ministry of Energy projects that over 100 small hydro power plants will be operating by 2015. Georgia also has good potential to add hydro power plants, given the mountainous terrain of the country. Azerbaijan has less potential, both due to geographic features and due to the availability of cheap gas and oil.

Supply

Renewable energy lending overview among surveyed institutions

	Armenia	Azerbaijan	Georgia
Number of surveyed institutions making loans to the target sector	6	2	4
Total loan volume (Dec. 31, 2008, USD)	15,610,271	212,164	2,460,180
RE loans as % of loans to all target sectors	2.7%	<1%	<1%
Number of loans (Dec. 31, 2008)	47	6	5
Average loan size (USD)	332,133	35,361	492,036
Forecast portfolio growth for 2009	55.8%	106.0%	n/a
Maximum/minimum interest rate, local currency	19.2% / 12.2%	24.5% / 22.5%	24.5% / 17.0%
Maximum/minimum interest rate, USD/EUR	21.3% / 13.3%	24.0% / 20.0%	27.2% / 16.8%
Maximum loan maturity (years)	12	2	10
Average loan maturity (years)	5.8	1.5	3.9

Source: BFC survey

The total supply of renewable energy loans among institutions surveyed by BFC was very small at the end of 2008. Only five renewable energy loans were reported in Georgia and six in Azerbaijan. While the number is higher in Armenia, with 47 loans, 31 of these are accounted for by one institution, Cascade Credit. There is also a high level of concentration by type of energy project, with nearly all loans going to fund small hydro power plants. One institution reported making an energy efficiency loan, to help insulate a factory.

The supply-demand gap

The low volume of renewable energy lending in the Caucasus is primarily a demand-side problem. With the exception of small hydro power plants, there is very little activity in areas such as solar energy production, wind, geothermal, or biomass. Financial institutions appear generally willing to lend to energy producers, although in some cases they lack the expertise to properly assess such enterprises. Hydro power continues to have the most potential for financing in Armenia and Georgia, as more small hydro power stations are expected to come online in the future.

²⁴⁵ EU-Armenia Web Portal on Renewable Energy, www.renewableenergyarmenia.am

Part V: Analysis of supply survey

11. Analysis of supply survey

Introduction

BFC, on behalf of OeEB, conducted a survey of financial institutions in Armenia, Azerbaijan, and Georgia during January and February 2009. The main purpose of this study was to explore the supply of credit by financial institutions to the four target sectors of MSME, housing, agriculture, and renewable energy.

The survey took the form of a questionnaire consisting of nine questions covering the following topics:

1. The number and volume of loans to each target sector
2. The breakdown of the loan portfolio by currency
3. The maximum and average loan maturities available to each segment
4. The maximum and minimum interest rates available to each segment
5. The borrowing history of the lender from international financial institutions
6. The desired amount of financing from international financial institutions in 2009
7. The obstacles to growth and profitability of lending
8. The types of technical assistance desired
9. The geographical distribution of the loan portfolio

In order to encourage a large number of institutions to participate, the questionnaire was designed to be relatively short. For this reason, no questions were asked about the activities of financial institutions in other product lines, such as deposits or leasing.

Participants were selected based on the size of the institution (larger institutions were preferred) and the likelihood that they would potentially be interested receiving financing or technical assistance for lending to one or more of the target sectors. Therefore, not all financial institutions in each country were contacted and the results should not be construed as representing the complete supply situation. Nevertheless, a large majority of the most active lenders in each country did participate, and BFC believes that the results present a good, if not perfect, picture of the supply of loans to the target sectors. The number of institutions participating from each country is shown in the following table.

A total of 62 financial institutions participated in the survey, with roughly equal numbers from each of the three countries. Banks comprise a majority of the sample. A list of participating institutions can be found in Appendix 1.

Number of respondents

	Banks	Non-banks	Total
Armenia	12	7	19
Azerbaijan	16	6	22
Georgia	10	11	21
Total	38	24	62

Source: BFC survey

All but one of the responding institutions are engaged in MSME lending, as the following table shows. A majority are engaged in housing and agricultural lending, while 20% report having renewable energy loans. A slightly larger proportion of respondents in Azerbaijan are engaged in housing and renewable energy lending. Banks are also more commonly engaged in housing and renewable energy lending.

Percentage of institutions engaged in lending to the target sectors

	Country			Type of institution		Total
	Armenia	Azerbaijan	Georgia	Banks	Non-banks	
MSME	95%	100%	100%	100%	96%	98%
Housing	58%	79%	61%	88%	35%	66%
Agriculture	74%	74%	83%	82%	70%	77%
Renewable Energy	16%	32%	11%	30%	4%	20%

Source: BFC survey

Number and volume of loans

The following table shows the total reported portfolios of responding financial institutions on December 31, 2008.

Number and volume of loans, Dec 31, 2008 (USD)

	Armenia		Azerbaijan		Georgia	
	Number	Amount	Number	Amount	Number	Amount
MSME	52,195	395,309,313	173,162	1,195,483,081	104,558	700,048,986
Housing	5,337	124,050,458	4,329	200,125,355	12,926	394,423,523
Agriculture	37,995	51,720,348	28,792	307,404,222	16,943	54,493,996
Renewable Energy	47	15,610,270	6	212,164	5	2,460,180

Source: BFC survey

In each sector, Azerbaijan has the largest portfolio by volume, followed by Georgia and Armenia, with the exception of the housing sector, where Georgian institutions have the largest portfolio, and the renewable energy sector. MSME loans represent the largest sector, accounting for 65% of the reported portfolios across all three countries.

Banks' share of total portfolios

	Armenia	Azerbaijan	Georgia	Total
MSME	91.3%	86.0%	90.1%	89.8%
Housing	99.5%	84.9%	98.1%	96.7%
Agriculture	87.8%	54.9%	91.8%	86.9%
Renewable Energy	100.0%	61.2%	100.0%	63.1%

Source: BFC survey

Banks account for the majority of the loan portfolio in all three countries, particularly in the housing segment.

Average loan amounts (USD)

	By country			By institution type	
	Armenia	Azerbaijan	Georgia	Banks	Non-banks
MSME	7,574	6,904	6,695	14,068	1,411
Housing	23,243	46,229	30,514	67,755	28,729
Agriculture	1,361	10,677	3,216	46,369	1,121
Renewable Energy	332,133	35,361	492,036	440,708	653,659

With the exception of renewable energy, Armenia has smaller average loan amounts than Georgia and Azerbaijan, which can be accounted for partly by more conservative lending practices. The largest loan sizes are made to the renewable energy sector, followed by housing, MSME, and agriculture, although Azerbaijan's agriculture loans are larger than its average MSME loans.

For the MSME and agriculture sectors, these country averages hide a pronounced difference between the banks and non-bank financial institutions, with banks disbursing much larger loans to these segments.

As the definition of MSMEs can vary greatly among countries and among individual institutions, respondents were asked to identify the maximum loan size which they offer to MSMEs. The following table shows the average maximum loan size and the largest reported by a single institution. Consistent with the average loan amounts shown above, Azerbaijan has the largest cap on average, although some institutions in Armenia and Georgia report offering quite large loan amounts to MSMEs.

Maximum loan size for MSME loans (USD)

	Average	Largest
Armenia	258,739	2,282,137
Azerbaijan	481,155	1,872,659
Georgia	260,156	4,237,514

Source: BFC survey

In order to understand growth patterns, respondents were asked to indicate their loan portfolios at the end of 2007 and their planned portfolios at the end of 2009. The following tables show the historical and projected loan portfolio growth for each segment.

Loan portfolio growth rates by country (2008—actual, 2009—estimate)

	Armenia		Azerbaijan		Georgia	
	2008	2009	2008	2009	2008	2009
MSME	42.2%	43.7%	34.2%	51.8%	68.7%	22.1%
Housing	66.1%	15.9%	32.3%	76.4%	66.0%	11.7%
Agriculture	59.2%	46.1%	35.2%	131.5%	27.1%	14.5%
Renewable Energy	39.8%	55.8%	(44.9)%	106.0%	—	—

Source: BFC survey

Loan portfolio growth rates by type of institution

	Banks		Non-banks		Total	
	2008	2009	2008	2009	2008	2009
MSME	46.3%	37.5%	38.7%	60.6%	45.2%	40.8%
Housing	57.6%	29.0%	23.9%	41.5%	55.8%	29.6%
Agriculture	28.5%	115.6%	81.1%	51.0%	36.9%	101.9%
Renewable Energy	(9.8)%	5.4%	83.1%	82.0%	36.5%	56.6%

Source: BFC survey

Excluding renewable energy, 2008 was characterized by substantial loan portfolio growth in all countries, ranging from 27% to 82% for the various sectors. Loan portfolios generally grew faster in Georgia and Armenia than in Azerbaijan. Growth was strong among both banks and NBFIs.

Georgian financial institutions have greatly lowered their expectations for 2009, with planned growth rates far below those of previous years. The double impact of the global economic slowdown and the fallout of war have left Georgian institutions with sizeable loan defaults. In response, institutions have tightened their lending policies and lowered their expectations for the attraction of deposits and international borrowing. Growth expectations remain optimistic in both Armenia and Azerbaijan, with the exception of housing finance in Armenia, where modest growth of 12% is anticipated following the collapse of the bubble in housing prices.

Currency

As the following table shows, use of local currency for lending tends to be much higher in Armenia and Azerbaijan than in Georgia.

Percentage of loans in local currency

	By country			By institution type	
	Armenia	Azerbaijan	Georgia	Banks	Non-banks
MSME	67%	44%	19%	41%	30%
Housing	63%	70%	1%	39%	5%
Agriculture	82%	62%	23%	54%	77%
Renewable Energy	28%	100%	28%	90%	28%

Source: BFC survey

Among the foreign currencies, US dollars are by far the most common overall, although agriculture portfolios are financed by an equal proportion of dollars and Euros.²⁴⁶

Percentage of loans by currency, all countries

	Local	USD	EUR
MSME	43%	50%	6%
Housing	32%	65%	2%
Agriculture	59%	23%	17%
Renewable Energy	52%	48%	0%

Source: BFC survey

Loan maturity

Respondents were asked to report both their average and maximum possible loan maturities to the given sectors.

Average loan maturity, years

	By country			By institution type	
	Armenia	Azerbaijan	Georgia	Banks	Non-banks
MSME	2.3	1.7	2.0	2.2	1.7
Housing	8.0	12.5	5.0	9.5	3.0
Agriculture	2.8	2.2	2.2	2.8	1.6
Renewable Energy	5.8	1.5	3.9	4.3	6.0

Source: BFC survey

With the exception of renewable energy, banks tend to offer longer loan terms than NBFIs, particularly in the case of housing loans. Although some institutions report that they are able to make mortgage loans at terms of up to 30 years, the averages are considerably lower, especially in Georgia. A number of institutions report that this is the result of a lack of access to long-term funding.²⁴⁷

For the MSME and agriculture sectors, maximum loan terms have been increasing steadily over the years, with some institutions reporting that they are willing to disburse loans with terms of up to 10 years. Intense competition for the best clients and increasing loan sizes may partly account for this trend.

Maximum loan maturity, years

	By country			By institution type	
	Armenia	Azerbaijan	Georgia	Banks	Non-banks
MSME	10	7	10	10	5
Housing	20	30	30	30	15
Agriculture	7	7	10	10	7
Renewable Energy	12	2 ²⁴⁸	10	12	8

Source: BFC survey

²⁴⁶ One Azeri bank reported a relatively small portfolio denominated in Japanese yen, but no other foreign currencies were noted.

²⁴⁷ Explanations of these results were not part of the questionnaire itself but were obtained during subsequent interviews with selected institutions.

²⁴⁸ Azerbaijan only has 6 renewable energy loans in relatively small amounts, which explains the short loan terms offered.

Interest rate

Respondents were asked to indicate the maximum and minimum interest rates which they provide to the target sectors, both in local and foreign currency. The following tables show the average of the reported maximum values and the average of the minimum reported values.

Interest rates in local currency

	Armenia		Azerbaijan		Georgia	
	Max	Min	Max	Min	Max	Min
MSME	23.53%	16.52%	31.24%	17.59%	41.61%	22.29%
Housing	19.65%	14.92%	21.00%	9.45%	30.44%	18.69%
Agriculture	21.57%	13.55%	27.86%	12.62%	33.45%	25.86%
Renewable Energy	21.50%	12.75%	25.00%	25.00%	24.50%	17.00%

Source: BFC survey

Interest rates in foreign currency

	Armenia		Azerbaijan		Georgia	
	Max	Min	Max	Min	Max	Min
MSME	22.86%	15.91%	32.41%	20.12%	41.68%	20.62%
Housing	20.04%	14.92%	26.13%	17.25%	31.36%	20.14%
Agriculture	20.18%	13.70%	28.04%	20.37%	34.07%	22.07%
Renewable Energy	21.33%	13.33%	—	—	22.00%	16.50%

Source: BFC survey

The highest interest rate ranges are reported in Georgia and the lowest are reported in Armenia, where the central bank strongly encourages financial institutions to keep rates low. Overall, little difference is observed between maximum and minimum interest rates in local and foreign currency. In a number of cases, interest rates for foreign currency loans are higher than for local currency loans, particularly in Azerbaijan, where both maximum and minimum interest rates in US dollars and Euros consistently exceed the range for local currency.

Interest rates in foreign currency

	Banks		Non-banks		Total	
	Max	Min	Max	Min	Max	Min
MSME	28.57%	14.92%	37.63%	24.86%	32.12%	18.77%
Housing	21.07%	12.80%	32.20%	20.40%	22.81%	13.98%
Agriculture	24.81%	13.13%	32.12%	24.77%	27.48%	17.22%
Renewable Energy	22.67%	16.50%	24.00%	11.00%	22.86%	15.71%

Source: BFC survey

Interest rates in foreign currency

	Banks		Non-banks		Total	
	Max	Min	Max	Min	Max	Min
MSME	29.58%	16.27%	38.97%	24.42%	41.68%	20.62%
Housing	22.48%	15.23%	36.43%	24.71%	31.36%	20.14%
Agriculture	24.89%	16.93%	35.14%	26.58%	34.07%	22.07%
Renewable Energy	21.33%	15.83%	24.00%	11.00%	22.00%	16.50%

Source: BFC survey

Interest rates at non-bank financial institutions are significantly higher than at banks, with the exception of the renewable energy sector. This result is not surprising for MSME and agriculture loans, where banks have much larger average loan sizes. However, interest rate ranges are much higher among NBFIs even for housing loans, where the average loan sizes are roughly the same for banks and NBFIs.

Obstacles to growth and profitability

Respondents were asked to identify the main obstacles to growth and profitability for lending to the target sectors. Respondents were given a list of obstacles to choose from and were asked to rate each obstacle on a scale of 1 to 5, where 5 is a significant obstacle and 1 is not an obstacle. The following table summarizes the results.

Main obstacles to growth and profitability of lending

	MSME	Housing	Agriculture	Renewable energy
Lack of knowledge of how to serve this segment	1.5	1.6	2.1	3.5
Lack of access to funding	3.3	3.8	3.2	3.8
Unattractive conditions of borrowed funds (High interest rate, short term, etc.)	2.4	3.0	2.6	3.3
Limited demand from customers	1.5	1.8	1.7	2.8
High credit risk	2.3	3.1	3.2	3.2
Inappropriate regulations or laws	1.9	2.1	1.8	2.4
Average for sector	2.2	2.6	2.4	3.2

Source: BFC survey

Lack of access to funding is considered the most significant obstacle to growth and profitability for all sectors, followed by high credit risk and unattractive conditions of borrowed funds. With the exception of renewable energy, lack of knowledge of how to serve the sector, limited demand, and inappropriate regulation are perceived as less of a hindrance.

As the sector averages show, respondents perceive greater severity of obstacles in the renewable energy segment, with the lowest severity for the MSME segment.

Technical assistance needs

Respondents were asked to identify areas in which they would be most interested to receive technical assistance, if they were given the opportunity to receive technical assistance (consulting services) provided by an international financial institution. The scale is from 1 to 5, with 5 representing a top priority, and 1 representing a non-priority.

Priority of demand for technical assistance

	Country			Type		Total
	Armenia	Azerbaijan	Georgia	Banks	Non-banks	
Training of credit staff	3.6	3.4	3.6	3.6	3.5	3.6
Human resources management	3.3	2.5	2.4	2.8	2.6	2.7
Lending procedures and policies	2.9	2.7	2.8	2.9	2.5	2.8
Development of new products	3.6	3.4	3.6	3.5	3.6	3.5
Risk management	3.8	3.8	3.6	3.7	3.9	3.8
IT system	2.9	3.4	2.7	3.1	2.9	3.0
Internal audit	2.5	2.4	2.7	2.3	2.9	2.6
Corporate governance	2.9	2.4	2.8	2.5	3.0	2.7
Credit scoring	3.7	3.8	3.5	3.5	3.9	3.7

Source: BFC survey

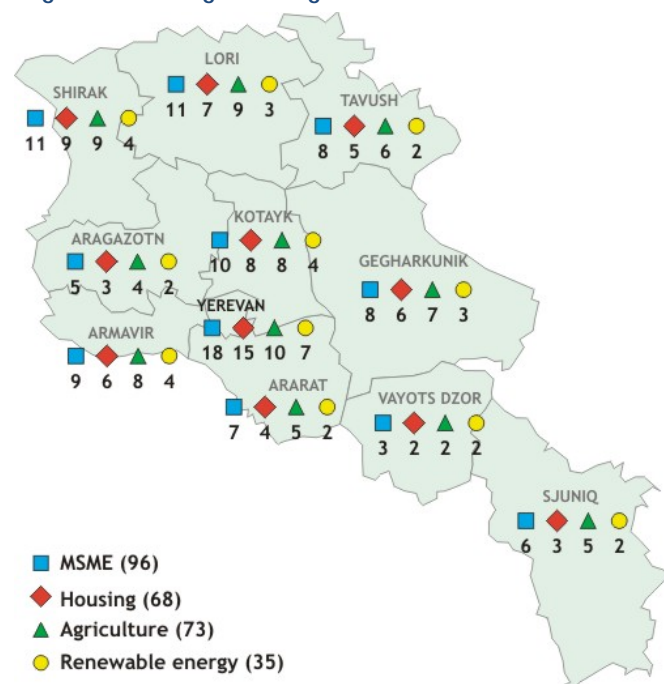
Risk management, credit scoring, training of credit staff, and new product development were rated as the highest priorities, with average scores ranging from 3.5 to 3.8. The results were generally consistent across countries, but Azeri financial institutions put greater emphasis on IT system support, while Armenian financial institutions gave greater priority to human resources management. Substantial differences were not noted between banks and NBFIs, although NBFIs

gave somewhat higher ratings to internal audit, corporate governance, and credit scoring than banks.

Regional coverage

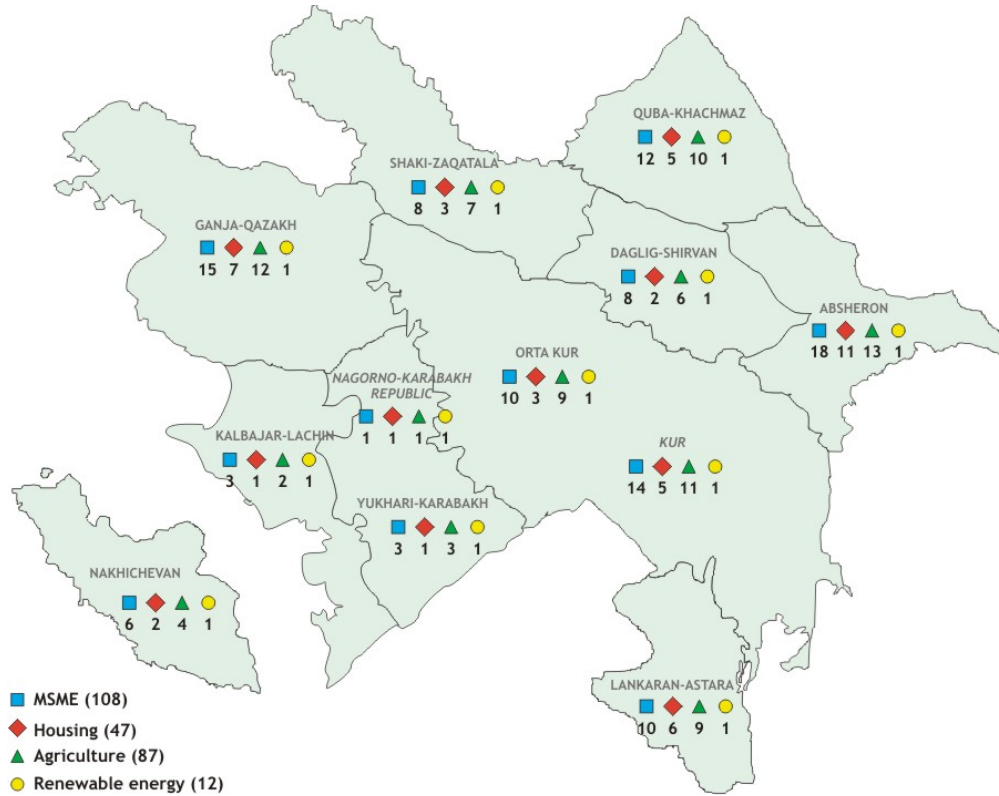
The following maps show the number of financial institutions that offer loans to the target sectors on a regional basis. For all three countries, the concentration of lenders is generally highest in the region where the capital is located (in Azerbaijan, this is the Absheron region). Generally, the concentration of institutions in other regions depends primarily on the level of economic development and population density.

Regional lending coverage in Armenia



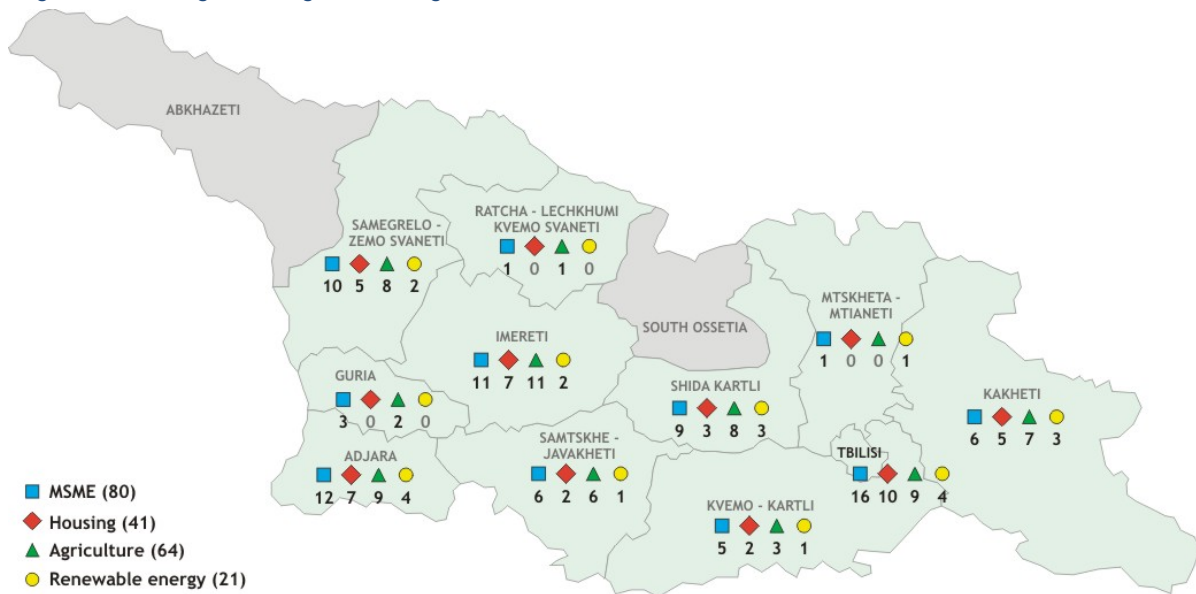
Source: BFC

Regional lending coverage in Azerbaijan



Source: BFC

Regional lending coverage in Georgia



Source: BFC

Appendices

Appendix 1: List of institutions submitting a survey

The following institutions responded to BFC's survey regarding outreach to the target sectors.

Armenia	Azerbaijan	Georgia
ANELIK BANK Co.LTD	Azerbaijan Industry Bank	Bank Republic
ARARATBANK CJSC	Bank Respublika OJSC	TAOPRIVATBANK
Ardshinvest CJSC	CredAgro (NBCO)	TBC BANK
AREGAK	TBC Kredit (NBCO)	BASISBANK
AREXIMBANK CJSC	Azerdemiryolbank OJSC	VTB BANK–(GEORGIA)
ARMECONOMBANK OJSC	AccessBank CJSC	BANK CARTU
ARTSAKHBANK CJSC	AGBank	Constanta Bank
BTA BANK CJSC	Aqrarcredit (NBCO)	FIRST BRITISH BANK
Cascade Bank CJSC	AzerCredit LLC (NBCO)	BTA BANK
CASCADE CREDIT	CJSC Bank Standard CB	BANK OF GEORGIA
CONVERSE BANK Corp	FINCA	MFI Georgian Credit
Farm Credit Armenia	International Bank of	MFI Alliance Group
FINCA ARMENIA	Azerbaijan	MFI Tbilbusiness
INECOBANK CJSC	Norwegian Microcredit LLC	MFI Alpha Express
NOR HORIZON	OJSC AtaBank	MFI Alpha Credit
NORVIK UCO CJSC	OJSC Rabitabank	MFI Riko Express
ProCredit Bank CJSC	OJSC Turanbank	MFI Credit Service
VTB BANK ARMENIA CJSC	OJSC Bank of Azerbaijan	MFI Finka Georgia
KAMURJ	OJSC NBC Bank	MFI Credo
	OJSC Unibank	MFI Cristal
	OJSC Parabank	MFI Lazika Capital
	OJSC Royal Bank of Baku	
	TechnikaBank OJSC	

Appendix 2: Maps of Armenia, Azerbaijan, and Georgia Georgia

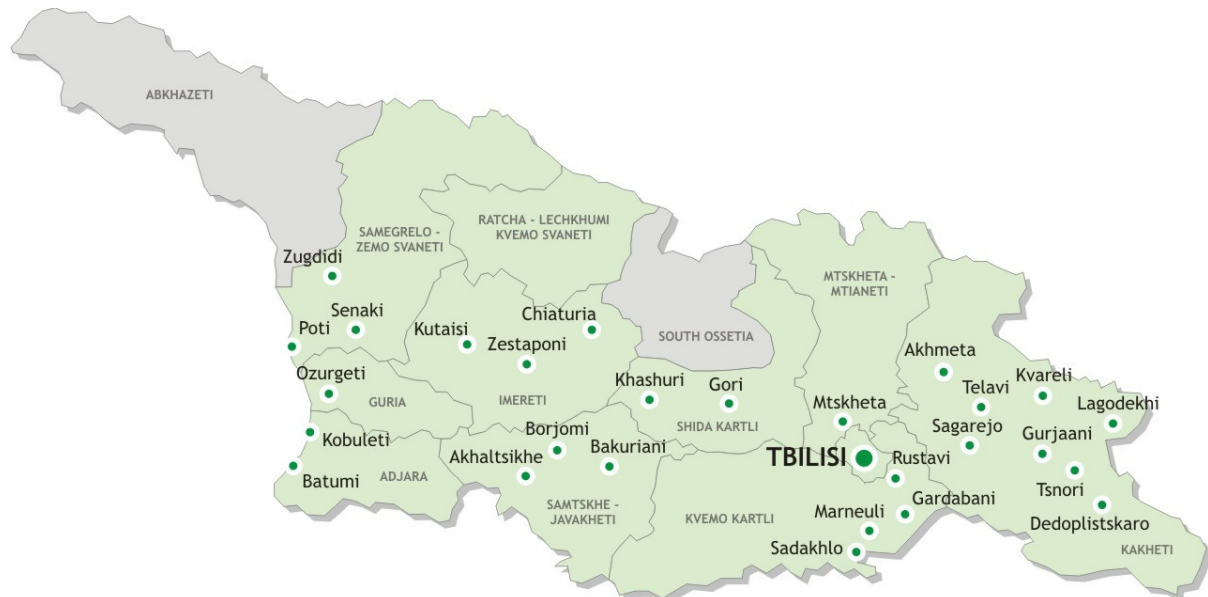
Map of Armenia



Map of Azerbaijan



Map of Georgia





Oesterreichische Entwicklungsbank AG

1011 Vienna, Austria
Strauchgasse 3
Tel. +43 1 533 12 00-0
Fax +43 1 533 12 00-5262
office@oe-eb.at
www.oe-eb.at

