EURASIAN DEVELOPMENT BANK
STRATEGY FOR 2013-2017
(revised)

Acronyms and abbreviations

AIIB – Asian Infrastructure Investment Bank
BRICS Bank – New Development Bank
CIS – Commonwealth of Independent States
DSGE – Dynamic Stochastic General Equilibrium
EBRD – Eurasian Bank for Reconstruction and Development
EDB – Eurasian Development Bank
EEC – Eurasian Economic Commission
EEU – Eurasian Economic Union
EFSD – Eurasian Fund for Stabilisation and Development
EIB – European Investment Bank
EU – European Union
EUR – euro
FDI – foreign direct investment
GDP – gross domestic product
IFC – International Finance Corporation
IFI – international financial institution
IIASA – International Institute for Applied Systems Analysis
KZT – Kazakh Tenge
MDB – multilateral development bank
PPP – purchasing power parity
PXF – pre-export financing
RUB – Russian Ruble
SME – small and medium-sized enterprises
TAF – Technical Assistance Fund
UNDP – United Nations Development Programme
US – United States of America
USD – US dollar

Contents

1. The Current Economic Situation in EDB Member States

EDB's six member states (Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan) together form the hub of the region's economic development and its main market. The countries' combined population is 190.4 million. In 2014, their annual GDP at current dollar rates totalled US $2.2 trillion (about 2.8% of global GDP). PPP GDP at current rates was US $4.2 trillion.

On 1 January 2015, five EDB countries joined the Eurasian Economic Union (EEU) and, as a consequence, entered a common customs zone. The accession to the EEU of EDB's sixth member, Tajikistan, is being negotiated.

In 2000-2014, the economic development of EEU member states was dominated by primary sectors and exports, and the region was highly vulnerable to external shocks. The favourable international environment and an upsurge in raw material prices over a period of time had boosted GDP growth, generated significant increases in household incomes and helped countries to accumulate reserves. However, because exports were dominated by raw materials, the region was very exposed to fluctuating world prices for those materials (especially for energy resources). In addition to this, the region faces a number of common structural problems, such as the weak institutional environment, the high level of state involvement in the economy, low competitiveness, the low representation of high-tech products as a percentage of total exports, and inadequate investment in infrastructure.

However, despite their shared history, their similar structural problems and their participation in regional integration, EDB member states are very diverse economically.

In 2015, economic growth indicators in most EDB countries showed a deterioration. The region's GDP dropped by 3.1% in 2015, compared to growth of 1.1% in 2014.

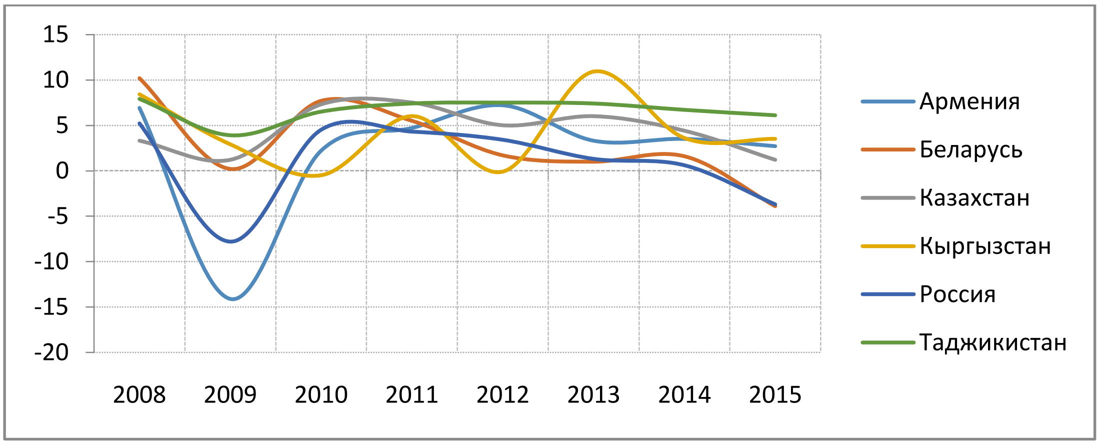
The decrease was primarily due to the worsening international economic climate. In December 2015, energy prices were down by 39.1% year-on-year. Prices also declined in metallurgy and agriculture, although the drop was much less severe. Metal prices fell by an average 28.4% and prices of agricultural produce by 12%.

These negative external factors had a different impact on the economies of Russia and Kazakhstan, the Bank's key oil and gas exporting countries. Declining oil prices and the extended foreign trade and investment sanctions had the most noticeable and predictably negative effect on economic growth in Russia. In 2015, annual growth was -3.7% in Russia, compared to growth of 0.6% in 2014. GDP growth in Kazakhstan remained positive at 1.2%, compared to 4.4% in 2014. The main supply-side negative was a reduction in oil and iron production and, on the demand side, lower consumption due to a decrease in real household incomes.

In 2015, GDP growth also decreased in labour-exporting countries. Their economies faced the effects of Russia's declining economic growth and the depreciation of the Russian ruble. As a result, remittances declined, foreign trade slowed and investment was cut. In addition, the central banks of these countries had to tighten their monetary policies to support national currencies that were pegged to the US dollar more than the Russian rouble, which also affected GDP growth in this group of countries.

In 2015, declining investment and consumer spending in Belarus created the deepest economic recession in the last decade. The country's GDP fell by 3.9% in 2015, compared to growth of 1.6% in the previous year.

GDP growth in EDB member countries (2008-2015)



Source: EDB

Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, Tajikistan

The significant decline in the prices of raw materials, which are the main source of export and fiscal revenues for EDB member countries, also affected national budgets in 2015. In most member states, budget balances worsened year-on-year as revenues contracted due to the economic slowdown, reduced remittances, negative changes in the external environment and declining foreign trade.

In addition to worsening fiscal conditions, EDB member states also saw a deterioration in their balances of payments, partly due to unfavourable economic conditions internationally and adverse dynamics in accounting balances resulting from lower investment inflows. However, despite a decline in the prices of energy resources and metals, the region’s balance of trade improved in 2015. This was mainly due to national currency depreciation in many countries and improved domestic demand, which helped to lower imports in practically all countries.

2. Economic Development Scenarios for EDB Member States

Based on the assumed growth of international energy and key raw materials prices, and the conditions governing economic development in Eurasian countries, the Bank has prepared three economic development scenarios for its member states: base, optimistic and pessimistic.

Table 4. **Economic development scenarios for EDB member states**

	2016	2017	2018	2019	2020
GDP growth, %					
Pessimistic scenario	**-3.1**	**-1**	**0.1**	**1.1**	**1.4**
Base scenario	**-1.6**	**0.7**	**2.2**	**2.4**	**2.1**
Optimistic scenario	**0.2**	**2.4**	**3.8**	**3.7**	**3.4**
Inflation, %					
Pessimistic scenario	**9.9**	**8.6**	**7.9**	**7.9**	**7.9**
Base scenario	**8.8**	**7.1**	**6.2**	**5.2**	**5.2**
Optimistic scenario	**7.2**	**5.4**	**4.6**	**4.6**	**4.6**

Source: EDB

The base scenario assumes that the annual average price of Brent crude will increase from approximately US $35 per barrel in 2015 to US $65 in 2020. It assumes that GDP growth in Russia will stabilise at moderate rates of around 2-3% in 2018-2020, when foreign trade and investment restrictions will also be relaxed or Russia will have adapted to them. In 2016, enterprises in the member states will face a significant shortage of cash for investment, since the national economies will have limited capacity to support such financing and banks will have limited access to foreign capital (particularly in Russia). There will also be a decline in inward foreign direct investment (FDI). Nevertheless, the Bank's economies will begin to recover gradually from 2017. The base scenario is the key scenario and its probability is assessed at 60%.

The optimistic scenario assumes that foreign policy and macroeconomic conditions will improve significantly as early as 2017. The improvements will be in the form of a stable increase in Brent crude prices (the expectation being that these will reach US $80 per barrel by 2020); moderate economic growth in Europe; and the lifting of US and EU sanctions against Russia. Investment will be the main growth driver. Economic growth in the Bank's member states is expected to reach 3-4% per year in 2018-2020. National currencies, which depreciated significantly against the US dollar in 2014-2015, may appreciate compared to end-2015. However, they are expected to start getting weaker again by the end of the forecast period. The probability of this scenario is 15%.

The pessimistic scenario is based on the assumption that the economic situation in the Bank's member states will worsen as a result of deteriorating foreign trade conditions, the extension of sanctions against Russia, and Kazakhstan's maintenance of its oil production and export rates at 2015 levels. This scenario also suggests that oil prices will decline significantly after sanctions against Iran are lifted and its exports begin to grow. As a result, the Brent price will average US $25 per barrel in 2016 and will increase gradually to US $50 in 2020. At the same time, capital outflow from Russia will remain at levels seen in 2015, the banking sector will weaken, and industrial production in Russia and Belarus will be in deep recession due to a contraction in investment. The average decline in the member states' GDP will be 3.1% in 2016 and in the future their average growth will remain at or below 2% per year. Inflation will decrease at slower rates than in the base and optimistic scenarios as a result of currency instability in the member countries. The probability of the pessimistic scenario is 25%.

The key macroeconomic risks expected in 2016-2020 are:

- an increase in the US interest and dollar rates, which may result in lending being more expensive for developing countries and crisis conditions will begin to develop in the most vulnerable developing markets;
- persistent low prices of raw materials or further price decline;
- the continuation or toughening of sanctions against Russia;
- the downgrading of the member states' sovereign and corporate ratings;
- the weakening of the banking sector and borrowers' financial circumstances as a result of slow economic recovery.

However, certain economic development drivers may have a positive effect on the Bank's investment activity and operations in the region:

- lower inflation compared to the peak figures of 2015-2016;
- normalised/reduced key interest rates due to lower inflation;
- less volatile exchange rates which could promote investment in the region;
- the reduced pressure of sanctions and lower capital outflow compared to 2015;
- persistently high demand for infrastructure development in the region

Overall, economic recovery in Eurasia will, most probably, be dependent upon greater investment. This is expected to boost demand for the Bank's project financing services.

While the optimistic scenario identifies a significant increase in investment as the key driver of overall economic growth, with infrastructure development boosting labour productivity and economic diversification, the base scenario assumes investment will develop at a slower pace and this will reduce return on investment in the region's restructured economy. The pessimistic scenario suggests that negatives such as significant state involvement in economies and limited industrial diversification will persist.

The overall balance of positive and negative risks relative to the base scenario is shifted more towards the pessimistic scenario and therefore its probability (25%) is assessed as being higher than the optimistic scenario (15%). If macroeconomic risks increase, there will be negative consequences for the Bank, i.e.,:

- a downgrade in sovereign ratings may affect the Bank's ratings;
- difficulties faced by the banking sector may lead to a decline in interbank lending and limit the Bank's ability to provide financing for SMEs, syndicated loans and project finance in conjunction with commercial banks; and
- a worsening in the corporate sector and the financial position of borrowers may affect the Bank's investment portfolio and have a negative impact on the economic indicators of Bank-funded projects. In particular, it is likely that payback periods and sensitivity to interest/exchange rate fluctuation will increase.

3. Key Reasons for Revising EDB's Strategy

Revision of EDB's Strategy is necessary for the following key reasons.

Eurasian integration. The EEU was formed with the aim of strengthening, converging and modernising its member economies and improving their competitiveness in the global market. Its formation presents new challenges for the Bank.

The Bank intends to develop dialogue with Eurasian national and supranational authorities within the EEU, using existing opportunities and arranging new forums to jointly initiate and consider projects and coordinate joint project finance.

It should be noted that work within the EEU has already begun. The EEC has developed *Key Areas for Industrial Cooperation within the Eurasian Economic Union*, setting out the roadmap and mechanisms for industrial cooperation in the EEU, the list of economic priorities for industrial cooperation between the EEU member states and the potential to create new value chains.

The document foresees that the EEU member states will create the conditions necessary for improving the investment climate and boosting finance for national industrial complexes by developing instruments for financing joint programmes and EDB projects which foster cooperation.

Member states' priorities. The Eurasian countries' individual and common industrial, investment and social priorities, revised in the wake of the crisis, were no longer in harmony with EDB's Strategy for 2013-2017.

Crisis and mutual restrictions in trade and investments. The crisis of 2014-2015, coupled with the effects of trade and investment sanctions against Russia and Russia's response, and existing structural problems in national economies, brought economic growth into decline. This resulted in economic stagnation and negatively impacted industrial enterprises and infrastructure, both of which are highly dependent on imports of raw materials and components. The crisis also impacted their ability to borrow. Significant changes in key macroeconomic indicators (growth forecasts, inflation, investment, etc.) were not factored into the Bank's approved strategy and for this reason it needed to be revised.

Emergence of new players and withdrawal of existing ones. Development project financing schemes have changed throughout Eurasia, in particular due to the emergence of powerful new players (the Asian Infrastructure Investment Bank and the New Development Bank BRICS) and the withdrawal of traditional players such as the EBRD and the EIB from Russia. On the one hand, the changes opened up new channels for projects that were previously financed by international financial institutions (IFIs) that had now suspended their activity in Russia. On the other hand, they boosted competition for projects whose project finance opportunities improved because newly established multilateral development banks (MDBs) have greater capital and higher credit ratings and, hence, offer cheaper finance. The significant changes in competition patterns, the emergence of new opportunities for the Bank's development, and the need to react to challenges posed by new competitors, also underpin the need to revise the Bank's strategy.

Drawbacks in the Bank's current practices. The above factors, the impact of which became particularly acute in 2014-2015, have affected the Bank directly, resulting in the need to re-evaluate the Bank's role in project finance in Eurasia. At the current time it is particularly important for the Bank to focus on the operations that are essential for its member states, and adapt its structure, products and scope of operations to current and forecast changes in the Eurasian economic landscape.

4. EDB's Current Situation

The Bank's revised Strategy factors in, *inter alia*, the strengths and weaknesses, opportunities and challenges brought into being by changes in the the external environment, and the Bank's own experience in executing previous strategies.

Since it began operating, the Bank has developed competitive advantages that have become its key **strengths**.

- **Financial stability.** The Bank has paid-in capital of US $1.5 billion. Its high ratings, conservative liquidity policy and its internal standards have helped it fulfil all its direct liabilities during this period of turbulence. This is what distinguishes the Bank from the overwhelming majority of national financial institutions. The member states supported EDB by increasing its unpaid, callable capital.
- **Experience.** Since its inception, the Bank has grown into a reputable financial institution capable of financing large investment projects on terms acceptable to borrowers.
- **The Bank's brand as a centre for integration studies.** The Bank has become a recognised centre of excellence in the field of integration. It is heavily involved in the work of Eurasian state and interstate bodies and provides these bodies with information and analysis. This is the Bank's indisputable strength, enabling it to understand growth patterns in member economies and thus seek out projects for its portfolio which have a high integration effect.
- **No barriers or restrictions.** The Bank is not restricted in its involvement with state-owned enterprises, which sets it apart from other international financial organisations and financial institutions with foreign capital. Given the extent of the government involvement in member state economies, the Bank's opportunities in terms of structuring investment projects, in particular relating to infrastructure development, are widened significantly.
- **Relatively high effectiveness.** The Bank's operational effectiveness is higher than that of other development and international financial institutions in terms of operating costs and personnel involvement, which are measured by the Bank annually.

Nevertheless, some **problem areas** have arisen for the Bank and EDB needs to resolve these in order fully to perform to its potential. Problems include:

- **Restricted range of liquidity instruments and access to funding in national currencies.** The Bank's competitiveness is lower than that of national development institutions which have access to different liquidity instruments offered by national central banks.
- **Products.** The Bank's range of products does not fully meet the needs of investment projects and could be extended, for example by adding business acquisition loans and finance leasing.
- **Mechanisms of cooperation with government bodies, regional organisations and IFIs.** The Bank is extensively involved in the work of Eurasian supranational institutions and in joint enterprise with member state government bodies, however, this does not translate into the initiation of new projects. Moreover, coordination with other IFIs has not generated the anticipated number of new projects.
- **Credit rating.** The Bank's credit ratings are determined by the sovereign ratings of its member states and are at present lower than those of many IFIs. This means that EDB is forced to set higher financing rates than other development banks whilst at the same time having more limited access to capital markets.

Changes in the global economy and Eurasian macroeconomic circumstances have nonetheless created a range of **new opportunities** for EDB.

- **Expansion of the Bank's membership.** The economic and political situation in Eurasia has created new opportunities for expanding the Bank through the accession of new members, either countries or IFIs. This will help to expand the Bank's resource base for new projects and, in the longer term, lift the Bank's credit rating.

- **Restrictions on financial institutions and capital deficit in the member markets.** The restricted access to capital markets affecting Russian banks and businesses has boosted demand for financing from the EDB. Though it continues to be assiduous in its scrutiny of the financial standing of its borrowers and project risks, EDB is well placed to secure new projects and to select from the high quality project applications now coming in.
- **Import substitution.** Although trade and investment restrictions on some sectors and businesses in Russia have an unequivocally negative impact, they have nevertheless driven demand for import substitution projects in the Bank's priority sectors. This increases opportunities for the Bank to finance projects that are supported by member governments.
- **Integration processes and changes in Asian transboundary flows.** The promotion of integration with Asian countries opens up potential new project opportunities for the Bank. Recent crises and sanctions have boosted trade and investment flows between the Bank's member states and China/Southeast Asia. This is an opportunity for the Bank to expand its portfolio, enlarge its funding base and generate more income.
- **Expansion of transboundary integration links in Eurasia.** Integration of the member states creates value chains involving businesses from these countries. This increases the number of projects that could be included the Bank's investment portfolio.
- **The reduced role of international development institutions.** A number of international development institutions, in particular the EBRD and the EIB, have announced a suspension of new project financing in Russia. This may result in an investment shortfall in sectors which are strategically important to EDB, and which the Bank could potentially cover.
- **Cooperation with development institutions.** EDB recognises that there is significant potential for it to expand cooperation with national development institutions (for example, with regard to accessing finance in national currencies and joint financing, which could extend the Bank's project financing opportunities) and international development institutions.
- **Growing need for new forms of finance and transactions.** Investment opportunities are available to support manufacturing projects undertaken jointly by businesses in the Bank's member states. These have not been taken up by other financial institutions and require innovative forms of finance. The Bank is in a strong position to provide support to such projects given its status and its experience of cooperating with government bodies and financial institutions.
- **The national economies in the member states are export-oriented.** Many businesses in the Bank's member states are export-oriented. Given the depreciation of national currencies, exporters are in need of additional export finance and funding for development projects with significant export potential.
- **Post-crisis recovery expectations.** The base scenario suggests that the Bank's member economies will recover from the crisis in the period 2015 to 2020. This should stimulate business activity and demand for investment, in turn increasing demand for the Bank's financing services.

Given the current external environment and the volatility of external economic factors, from 2015 to 2020 EDB will face **<u>challenges</u>** that may affect its financial circumstances and its ability to achieve its strategic objectives.

- **Worsening economic climate.** High investment risk may weaken the financial standing of our borrowers, causing the number of non-performing loans and provisions to grow and reducing funding opportunities. These changes may affect the Bank's performance. The potential changes in the Bank's member economies and related issues are covered in more detail in Section 2 herein: *Economic Development Scenarios for EDB Member States*.

- **Potential contraction of the Bank's investment portfolio.** The weakening of collateral foundations and of borrowers' financial robustness may have a significant negative impact on the quality of the Bank's investment portfolio. This is likely to affect the Bank's financial position and to divert human and financial resources toward the resolution of critical situations and issues affecting current borrowers, and away from the divisions of the Bank that research and plan new projects.
- **Risks for the financial system.** The financial structures of the member states, and their banking sectors in particular, are exposed to risk, which may affect their liquidity and weaken their credit worthiness. This in turn may reduce the Bank's ability to conduct transactions with counterparty banks, including in the interbank market, which will inevitably affect the Bank's financial performance.
- **Condition of international capital markets.** If the economic situation worsens as a result of macroeconomic and political instability, this will make attracting investment in international capital markets more complex and investment will become more expensive. This will affect the Bank's ability to expand its investment portfolio and will reduce interest margins.
- **Political instability.** The risk of political instability in certain countries in the region may make it more difficult for the Bank's to operate in these countries.
- **Volatility.** The persistent high volatility of stock markets and the instability of national currencies may have a negative impact on the profitability of the Bank as it is engaged in accessing finance for borrowers who require funds to be extended in national currencies.

5. EDB's Mission and Values

EDB's mission, international status and special role in financing development projects in Eurasia determine the values that underpin the Bank's work to support member states and determine the parameters for all the decisions the Bank makes.

Promoting integration and economic growth. The Bank's mission is to support the development of market economics in its member states and to promote their sustainable economic growth and the expansion of trade and other economic ties by means of investment.

Openness. The Bank is open to new members, including countries and international institutions.

Supremacy of international law. The Bank's operations are governed by generally accepted principles and rules of international law and relevant international treaties.

Corporate governance. The Bank adheres to international corporate governance principles aimed at protecting the rights of its members, having due regard for stakeholders' interests, consolidating investors' trust and building the Bank's reputation as a reliable and stable international institution.

Supporting national economic priorities whilst maintaining a focus on integration. The Bank's member economies are very different in terms of their industrial structure, size, technical advancement and sovereign risk. In financing investment projects the Bank pursues its own objectives and mission but has due regard for the national economic priorities of its member states and their economic differences.

Non-interference. The Bank, its management and personnel are not involved in any way with political events in any of its member states. The Bank is an international institution and its member states have committed to refrain from any attempt to influence its management and personnel in their official capacity.

Proportionality. All member states participate in decision-making on key areas of the Bank's operations. Decisions are taken by a qualified majority of votes *pro rata* the country's share of the Bank's capital.

Transparency. The Bank aims to ensure reasonable transparency of its operations, publishing information on its investments and other reliable data to ensure that it executes its obligations to its member states, investors and counterparties, without prejudice to its business interests.

Conformity to generally accepted banking standards. Finance for projects is provided in accordance with international banking practices, which accept that the funding is extended for a fixed period of time, for a fee, against collateral and is to be repaid.

Priority of interstate projects. In financing investment activities the Bank unconditionally prioritises the areas covered by interstate and intergovernmental agreements between the Bank's member states.

Financing projects in cooperation with IFIs. The Bank aims to cooperate with IFIs, commercial banks and other stakeholders in the joint financing of projects that correspond to the Bank's Charter, mission and strategy, to diversify sources of investment for such projects, and to increase the number and scale of such projects on an ongoing basis.

Conformity to mission and strategy. The Bank aims to finance projects that conform to its mission and strategic objectives and conducts a preliminary eligibility analysis on all projects to this end.

Non-competition with commercial banks. The Bank finances investment projects when borrowers cannot attract finance in the commercial market on terms that are suitable for the scope of that project.

Cost-effectiveness of investments. The Bank does not aim to maximise profit but does aim to cover costs.

Social and environmental responsibility. The Bank finances projects in accordance with its current *Environmental and Social Responsibility Policy* and is a participant in the Multilateral Finance Institutions' Working Group on Environment. The Bank does not finance: a) business activities involving the use of forced and child labour; b) production and distribution of tobacco and alcohol; c) gambling; and d) activities prohibited under the legislation of the member countries or international conventions related to the protection of biodiversity or cultural heritage. The Bank will review its *Environmental and Social Responsibility Policy* to harmonise it with those of other IFIs for the purposes of co-financing and formulating uniform requirements for all projects.

Investment diversification. The Bank seeks to achieve reasonable diversification in its investments, avoiding disproportionate use of resources for the benefit of any member or project.

Liquidity and renewal of assets and liabilities. The Bank restructures its assets and liabilities from time to time by selling investments to other investors on terms which conform as fully as possible to internationally recognised standards for the free sale of such assets and liabilities.

Income-to-risk ratio in investments. The Bank adheres to the principle that revenue should be commensurate with risk for the projects it finances in the member states and in other countries whether or not they have signed an agreement on the Bank's presence in their territories.

High credit ratings. The Bank is conservative in maintaining its liquidity and strives to attain higher credit ratings in order to gain access to more favourably priced financial resources with a view to protecting its own interests and the interests of its member states.

One of the Bank's main tasks for the next five years will be to continue to pursue these values in all areas of its operations, in every deal and transaction and in the work of every employee, so that these values become standard for all our operations and conduct.

6. EDB's Strategic Development Priorities

6.1. Strategic goal

As a regional development bank, EDB promotes integration in the region by financing member countries' joint projects and industrial cooperation projects that have a strong integration effect.

As an international institution, it seeks out opportunities for integration between the countries and aims to strengthen existing production chains in the region, especially in the industrial sector. The Bank will continue to plan and execute infrastructure projects in the member states.

EDB aims to ensure that integration projects in the region make up at least 50% of its investment portfolio.

6.2. Strategic objectives

The main strategic objectives of the Bank are to:

- research and finance integration projects and industrial cooperation projects with a strong integration effect and retain a focus on:
    - deeper industrial integration aimed at stimulating growth in industrial production and joint manufacture;
    - increasing the penetration of member state products in common market trade and improving localisation;
    - the manufacture of competitive new products with high potential for industrial cooperation; and
    - the development of interstate infrastructure;
- enhance cooperation with member states' government bodies, IFIs, national development institutions and commercial banks in order to research and discuss potential new projects:
    - the Bank intends to develop dialogue with Eurasian national and supranational authorities, using existing contacts and arranging new opportunities to jointly initiate and discuss projects and coordinate joint project finance;
    - the Bank will cooperate with IFIs, join other IFIs as an observer or a member, and arrange joint finance for development projects with other international development institutions in order to enhance its capacity for financing projects and to reduce investment risk;
    - the Bank will pursue direct and open dialogue with national development institutions and will create groups, information exchange channels and other forums to jointly initiate and consider projects and coordinate joint activities related to project finance.

The Bank's internal objectives during the period covered by this Strategy will be to:

- change its approach to researching and structuring projects. Over and above its existing role in responding to applications, the Bank will be proactive in generating a substantial increase in project applications. To this end, EDB will initiate projects and undertake a preliminary study as to how to increase the number of project applications and improve their quality. The study will aim to identify promising channels by carrying out an extensive sector analysis and identifying projects that will boost competitiveness in the economies and industries which are the most important to the Bank's member states and are attractive to the Bank in terms of their integration effects and income-to-risk ratio;
- enhance the range of products to meet the needs of major infrastructure projects and industrial cooperation projects;

- develop competence in studying and providing analysis and finance for integration projects; and
- function effectively as the EFSD Resources Manager.

6.3. Target sectors

EDB will focus on projects with an integration effect in the following sectors:

- the power sector;
- mechanical engineering;
- the chemical sector;
- mining;
- oil and gas;
- infrastructure

These sectors have been selected based on the priorities of the Bank's member states, which have been revised since the previous Strategy for 2013-2017 was published, and on the revised common Eurasian benchmarks for industrial and investment policies.

The Bank has reviewed *Key Areas for EEU Economic Development*, *Key Areas for Industrial Cooperation within the Eurasian Economic Union* and the national programmes of its shareholders. It has also conducted its own analysis of the competitive advantages of its member states (competitive sectors with export potential) and their ability to attract investment.

A more detailed explanation of the Bank's activities in each of the above sectors is given below.

(a) In the power sector, the Bank will focus on:

1) project financing for different types of power plant; building of new power infrastructure in areas experiencing power shortages; and heat production;

2) financing projects that aim to reduce power loss using technology and equipment produced in the EEU;

3) small power projects which are a priority for the member states and are linked to the construction of hydro, wind and solar power plants (renewable energy sources), and small gas plants; and

4) energy efficiency projects and finance for subcontractors involved in the reconstruction of generating facilities and power grids (municipal infrastructure). In the power sector, the Bank will aim to support green projects.

(b) In mechanical engineering, the Bank will concentrate available resources on targeted financing and sales promotion in interstate value chains in transport, rail and aircraft engineering, shipbuilding, power and electrical engineering, machine building, manufacture of construction machinery and equipment, agricultural and radio-electronic engineering, and on financing industrial sites, assembly franchises and workshops run by EEU-incorporated companies that develop export technologies.

The Bank will aim to:

1) promote intra-regional consumption and cooperation on technology and production between mechanical engineering enterprises and component manufacturers;

2) develop ties between mechanical engineering enterprises and consumers; and

3) improve the competitiveness of EEU-manufactured mechanical engineering products in terms of their export potential and technical specification.

(c) In the chemical sector, the Bank will promote the creation of new production facilities and provide targeted finance to promote sales of chemical products (including mineral fertilisers) manufactured in the EEU to end-product manufacturers, including those which aim to substitute raw material imports with domestically produced analogues. For example, finance may be used to upgrade production facilities and promote the sale of goods by EEU chemical enterprises to metallurgical enterprises. In addition, the Bank will be involved in projects creating and developing production facilities with high export potential.

(d) Targets in the mining sector include:

1) financing ore field development projects as prioritised by member states and which are included in their national development plans and programmes or create integration opportunities within the EEU;

2) financing facilities which produce feedstock that is more processed or has potential to substitute imports and which are not financed by commercial banks on market terms;

3) financing comprehensive resource development projects aimed at overcoming the infrastructure limitations which restrict economic growth in EEU countries, including the development of transport and power infrastructure.

(e) In the oil and gas sector, the Bank will finance projects aimed at developing transportation and processing.

(f) Infrastructure. The Bank will finance transboundary infrastructure projects or sub-projects of large infrastructure projects, sea and river ports, airports and national projects with a strong integration effect. The estimated investment requirement for large projects in the Bank's operating region exceeds US $35 billion. With this in mind, the Bank will finance infrastructure projects with high integration potential, including transport corridors and joint transportation and transit projects, and will help to stimulate development in related service sectors.

These sectors will be given priority but the list is not exhaustive. The Bank intends to develop its sector competencies and monitor priority sectors.

6.4. Target projects

Taking these priorities into account, the Bank will focus on financing the following project types (listed in order of priority).

Projects with a strong integration effect:

- projects which foster corporate integration between companies in the Bank's member states to create an end product or service (projects in global and regional production chains);
- trade transactions between counterparts from the Bank's member states involving fixed assets and capital goods;
- interstate infrastructure projects promoting economic ties and trade: transboundary roads, bridges, oil and gas pipelines, telecommunication lines, power transmission lines and related infrastructure (grids, substations, etc.), and national infrastructure projects to develop intra-country infrastructure (regional river and sea ports, airports, multimodal transport terminals) promoting trade and cargo mobility;
- projects with a significant proportion of mutual investment from EDB member states.

National development projects: National development projects with longer payback periods and somewhat higher risk, which commercial banks are reluctant to finance, provide opportunities for EDB to enact the principle of complementarity:

- projects which innovate, aiming to change the technological configurations, technology or production modes deployed by domestic companies, with R&D costs included in their structure, and which aim to reduce major costs and improve competitiveness;
- green-field and brown-field projects with the potential to increase the country's participation in one or more value chains (by developing domestic production to replace imports);
- regional and municipal projects in different sectors (utilities, water supply and sewerage, household waste treatment, power infrastructure, energy efficiency); and
- replicated medium-sized (US $20-50 million) and small (US $10-20 million) investment projects and development programmes in selected (limited) sectors, which adhere as fully as possible to the imperative for sustainable development, and whose structure and operations may be relevant to, and replicated in, more than one of the Bank's countries.

EDB will select projects based on their compliance with the Bank's criteria and their financial sustainability.

6.5. Target products and instruments

The Bank's target products will be optimised and aligned with the specific features and requirements of integration and industrial cooperation projects.

The Bank will continue to provide the following core services:

- limited recourse project financing, solely and in syndicates involving other financial institutions;
- investment loans;
- equity participation;
- trade finance (for value chains and projects with a significant integration effect), including structured export finance and pre-export financing (PXF); and
- advisory services, including those related to project finance.

In addition, borrowers may have access to:

- leveraged acquisition finance, leveraged/management buy-out; and
- finance and operating leasing.

The main financial instruments made available under these services will be:

- term credits and credit lines;
- revolving credit lines;
- subordinated debt (first loss tranches/second lien tranches), mezzanine loans, convertible debt/convertible preferred stock;
- syndicated loans; and
- financial guarantees and stand-by letters of credit.

The Bank will also be able to arrange and structure securitisation deals; its loans may be secured with bond issues collateralised with a proportionate pool of receivables. This is expected significantly to increase the number of loan transactions. The Bank may also secure loans provided by other institutions and/or lend to companies. Such loans will be collateralised subsequently with loan-backed bond issues for investors.

The Bank's target customers will be medium-sized companies, including industrial entities active in regional value chains. The size of projects and/or the Bank's participation in a syndicated project may range from US $30 million to US $300 million.

6.6. Alliances and partnerships

EDB will strive to attract co-investors to participate in syndicated financing of joint programmes, mitigating credit and investment risk through joint lending.

During the period covered by this strategy, the Bank's key partners will be:

- other MDBs and IFIs operating in Eurasia. The Bank plans to enhance cooperation with IFIs, joining some in an observer capacity where appropriate, or in another acceptable capacity. It will also begin to work on joint projects with the newly established BRICS Bank and AIIB (memoranda and agreements);
- interstate and supranational institutions, including the EEC, respective ministries, entrepreneurship support agencies, export and import agencies, trade and industrial organisations, and other institutions with objectives similar to or conforming to the Bank's objectives; and
- commercial banks, investment funds, institutional investors and other capital market players, in partnership with whom the Bank will expand its base for financing investment projects and diversify credit risk. This will enhance the Bank's financing capabilities through participation in syndicates, joint investments, the creation of investment funds, the pooling of the Bank's funds with export insurance products, trade finance, the investment potential of national development institutions and state-run targeted initiatives. The Bank will aim to act as an integrator, the finance it provides having a significant multiplier effect.

7. Expansion of EDB Membership

In accordance with its Charter, the Bank is willing to accept new member countries and international institutions subject to ratification by the Bank's Council.

The further expansion of EDB membership is likely to reflect the expanding geography of integration in the region, primarily within the Eurasian Economic Union.

The accession of new Bank stakeholders, including Eurasian countries and international development institutions operating in the region, will help to increase its capital and credit ratings, facilitate its access to local and international capital markets and create new opportunities for expanding the area in which it operates.

A geographical analysis of foreign trade and investment flows shows that current EDB member states are especially attracted to the financial resources and potential new markets in Asia and the Middle East.

This conclusion was based on the intensity of reciprocal trade with EDB countries, the scale and nature of investments with EDB countries, intensity of integration processes with EDB's shareholders, the status of negotiations relating to membership of the Bank (as key indicators), and average GDP growth, average annual FDI, the sovereign rating of a potential member, and the scale of IFI activity in the country (as additional indicators).

The advantages for the Bank's new shareholders lie in gaining access to new sources of funding for development projects and to a new region, with substantial markets now opening up in response to the trade and investment sanctions against Russia.

Furthermore, joining the Bank creates the requisite conditions for intensifying trade, economic and investment relationships between the new member states and between these countries and the Bank's existing shareholders, since the Bank will finance investment projects in several member countries.

An obvious advantage for EDB's potential members is the Bank's wide network of representative offices. In addition to its headquarters, the Bank currently has offices in all member states.

The Bank's may also extend its membership through cooperation with IFIs.

8. Research and Analysis

According to its founding documents, one of the Bank's main functions is to advise its members on economic development, the efficient use of resources, the expansion of trade and economic ties, and research and analysis in the sphere of public and international finance. In this regard, one of the Bank's key objectives is to carry out economic and financial analysis and forecasting in its member states, assessing investment opportunities and monetary and foreign exchange relations, including macroeconomic and financial risk.

The Bank conducts research as part of its strategic role to study and support, through its analyses, integration between the member states and project execution. All investment projects considered by the Bank are judged according to the degree to which they conform to the Bank's mission and strategy. Part of the Bank's strategy is to monitor the integration, social and economic effects of its investment portfolio.

The Bank publishes research papers, sector reports, specialist studies and reviews analysing macroeconomic issues and providing economic development forecasts for the region. It also undertakes major research and applied projects and arranges conferences and round tables. The Bank monitors, on an ongoing basis, the work of development banks and economic integration processes in the area in which it operates. It also undertakes joint research projects with other international organisations (for example, in 2015 EDB and the UNDP prepared a joint report on *Labour Migration, Remittances and Human Development in Central Asia*) and provides technical assistance.

Having revised its project selection process and identified specialisation opportunities, the Bank intends to enhance its research capabilities considerably in order to identify projects that contribute to the region's value chains. The Bank will therefore develop skills and knowledge in new areas and sectors including new financial instruments, transaction structuring models and public private partnerships.

Research will be more embedded the Bank's business practices. Systematic analysis of Eurasian economies and geographic and sector clusters will help to identify specialist opportunities and elements of value chains with significant growth potential.

As part of its quest for new business opportunities, the Bank will find geographical and sector clusters in member economies which have the greatest potential to improve regional competitiveness and will arrange programmes to develop them. This will allow member state targeted funding and sub-regional/regional budgets to be used in co-financing projects to enhance the social and economic impact of the Bank's projects.

Analysis of potential new value chains will focus on aggregate trade flows between the Bank's member states and their main trading partners. This will be combined with analysis of the competitive strengths and weaknesses of EEU member states and other countries, enabling the Bank to identify sectors and enterprises in which the Bank's investment, trade finance and technical assistance will help to mitigate competitive weaknesses and boost strengths. Identifying added value in domestic and foreign projects will also help to focus the Bank's efforts on import substitution projects fostering competitiveness and integration in Eurasia.

The Centre for Integration Studies was established by EDB in 2011. It undertakes research and drafts reports and recommendations for EDB member state governments on issues related to regional economic integration.

The Centre will continue to develop its projects and databases to 2017. Key projects include the EDB Integration Barometer, Monitoring and Analysis of Investments in the CIS and Eurasian Countries, and the Regional Integration Database.

The Centre will continue to engage in international cooperation, including with the World Bank Group, the UNDP and the EBRD, and with leading research institutions and communities in the

EEU and abroad. One of the Centre's key foreign partners is the International Institute for Applied Systems Analysis (IIASA; Austria). The Centre will continue to work with the IIASA on the long-term international project *Challenges and Opportunities of Economic Integration in the European and Eurasian Spaces*, which is a unique, independent, high-level discussion and research platform aimed at converging the EEU and the EU by devising proposals for deepening comprehensive cooperation between the two unions.

In 2015, the Bank set up the Chief Economist Group. Its objectives are to undertake macroeconomic research, unify methodologies and improve macroeconomic modelling and forecasting. The Group analyses Bank member states economies and prepares forecasts and reports about their economic situation. The quarterly *Macromonitors* reports it publishes provide a review of macroeconomic circumstances in the member countries.

The Chief Economist Group works with the EEC to provide forecasts regarding the Bank's member states. Together these bodies are improving the models used to analyse the macroeconomic situation in the member states.

One of the Bank's tasks is to provide macroeconomic modelling and forecasting for the EEU countries using the DSGE (Dynamic Stochastic General Equilibrium) models. This set of models can be used to conduct comprehensive research into monetary, foreign exchange, financial and other aspects of Eurasian integration, including on a paid basis.

The Bank also plans to develop cooperation with the EEC on major research projects.

9. Strategy Fulfilment

1. The Bank has the means to attract external finance to execute its revised Strategy under the different scenarios. It has registered programmes for issuing euro medium term notes and European commercial papers to place its long-term and short-term USD and EUR-denominated securities worth US $1.8 billion and US $3.3 billion respectively (as at end 2015). The Bank has also registered rouble and tenge bond issues (totalling RUB 10 billion and KZT 220 billion respectively) and bilateral framework agreements with commercial banks and export credit agencies.
2. The Bank’s successful execution of the revised Strategy will be possible as long as the Russian Federation and the Republic of Kazakhstan support it by providing sustainable access to resources in national currencies and provided that it maintains investment-grade credit ratings.

   In this regard, the Bank and its shareholders will work to ensure its access to liquidity instruments provided by the central banks of Russia and Kazakhstan, and to long-term investment resources offered by their respective governments and public finance management programmes, such as pension resources, on terms not inferior to those established for national credit institutions.
3. The Bank’s business model (its organisational structure, business processes, human resources and information systems) will be revised according to the new Strategy.

ANNEX 1

Strategic Benchmarks

The Bank's strategic performance indicators are divided into four equally important groups relating to its key areas of operation:

- *portfolio volume* – indicators characterising the scale of the Bank's activities and operations;
- *portfolio quality* – indicators characterising the Bank's investment projects in terms of their contribution to its mission, promotion of a market economy in the member states, their sustainable economic growth, the expansion of trade and economic ties they generate through investment. They also characterise projects in terms of the Bank's compliance with risk management principles and procedures aimed at reducing losses and ensuring its sustainable functioning;
- *financial performance* – indicators characterising the Bank's commitment to ensuring loss-free operation and maintaining appropriate profitability; and
- *independent appraisal* – a comprehensive, independent assessment of the Bank as a borrower.

In light of the above, the following Bank performance indicators will be considered as strategic indicators for the period of the revised Strategy in the base economic development scenario as described in Section 3 of this Strategy.

Table 5. **Strategic performance benchmarks**

No.	Group of indicators	Indicator	Unit of measurement	2016	2017
1	Portfolio volume	Current investment portfolio	US $ billion	2.9	3.3
2	Integration effect	Share of projects with an integration effect	%	Not less than 50	Not less than 50
3	Portfolio quality	Share of provisions in the balance-sheet portfolio	%	Not less than 5	
4	Financial performance	Net profit	US $ million	30	33
5	Independent appraisal	The Bank's credit ratings[1]	Notch	One of the Bank's ratings higher than, and one equal to, Russia's ratings	

Source: EDB

In 2016-2017, the portfolio may be increased within the base scenario due to GDP growth accelerated by recovering oil prices. The growth of economic activity in the Bank's member states over this period will also reduce the risk that the quality of its portfolio will deteriorate.

Achieving the above performance benchmarks is a key task for EDB's management in 2015-2017. The Bank's management and employee incentive scheme will link pay bonuses to the achievement of these benchmarks, subject to specific job functions.

[1] The Bank's long-term credit ratings assigned by Standard & Poors and Moody's as compared to Russia's long-term credit ratings from the same ratings agencies.

The strategic benchmarks are considered as reference targets and may be adjusted as budgets are established for each financial year ahead.