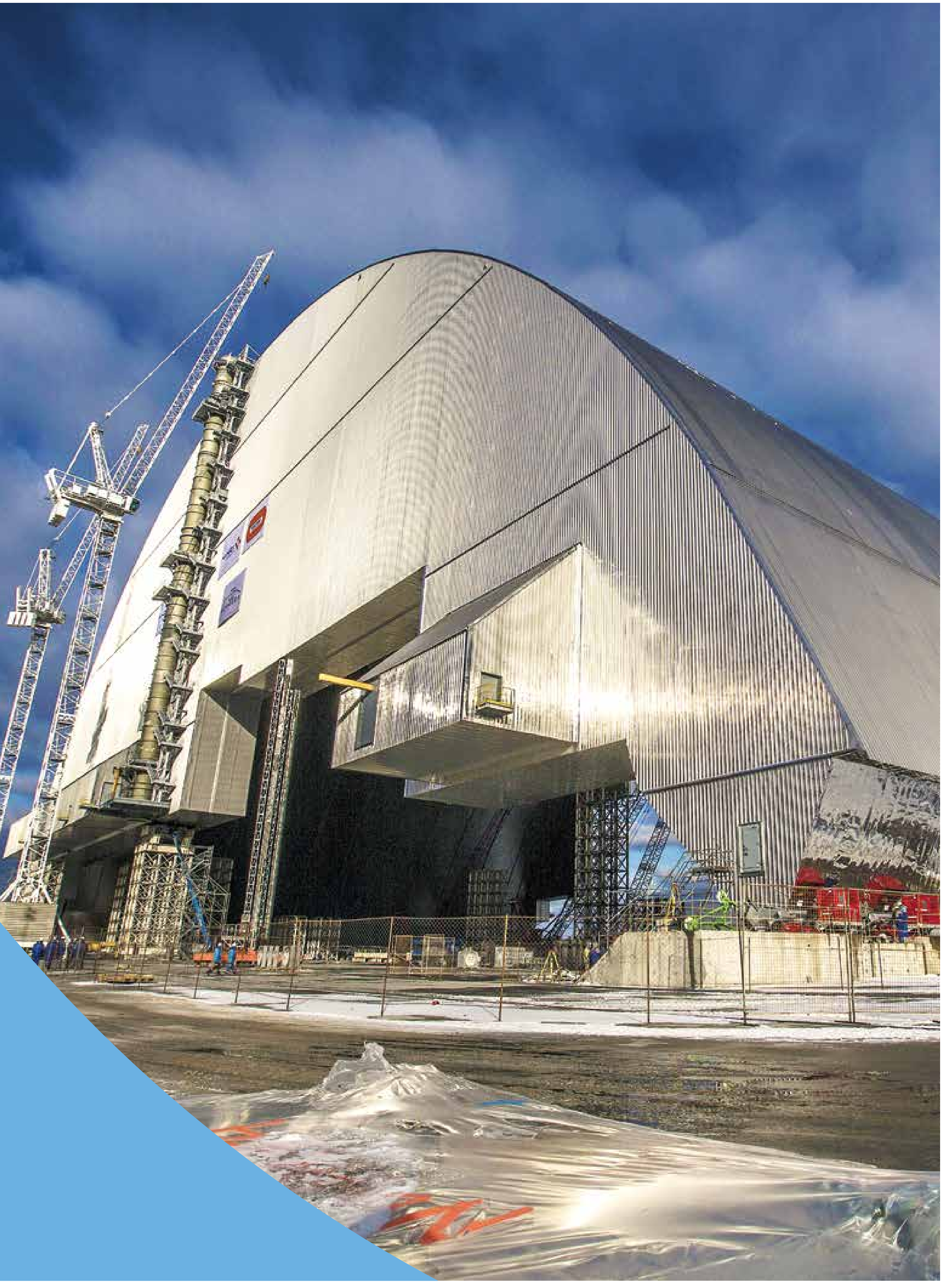
OVERVIEW

During 2016 the EBRD bolstered the process of transition and economic recovery by investing a record-equalling €9.4 billion through 378 projects across 35 countries and a variety of sectors. Increased policy dialogue and support from donors strengthened the Bank’s efforts to make economies in the region competitive, well-governed, green, inclusive, resilient and integrated.



Operational results

In 2016 the EBRD responded to ongoing economic and geopolitical uncertainty with increased efforts to re-energise the transition process and create sustainable growth for the benefit of millions of people across the region where it operates. Annual Bank Investment[1] (ABI) reached €9.4 billion, matching the record level of financing seen in 2015. This was accompanied by intensified policy dialogue in support of deep and durable reforms in emerging economies. Donor assistance proved to be more important than ever in helping the Bank achieve these objectives.

The number of EBRD projects remained high at 378, compared with 381 in 2015. Business activity was strong in Turkey, with €1.9 billion invested and 43 projects signed across a variety of sectors. The Bank continued to increase its investments in Kazakhstan (€1.05 billion), Poland (€776 million) and temporary recipient country Greece (€485 million). It remained a major investor and champion of reform in Ukraine at a time of ongoing severe difficulties.

Altogether, the EBRD invested in 35 countries in 2016, with investment by region as follows: Central Asia €1.4 billion, central Europe and the Baltic states €1.4 billion, Cyprus €64 million, eastern Europe and the Caucasus €1.2 billion, Greece €485 million, south-eastern Europe €1.6 billion, southern and eastern Mediterranean €1.4 billion and Turkey €1.9 billion.

In line with its operational strategy, the EBRD continued to support sectors that are important to regional recovery and growth. ABI in the financial sector reached €3.1 billion in 2016, in the diversified corporate sectors (covering industry, commerce and agribusiness) €2.5 billion, in the energy sector €2.2 billion, and in the infrastructure sector €1.7 billion.

Projects remained highly relevant to the transition process. Of those signed in 2016, 97 per cent were assessed as having good, very good or excellent transition impact potential. Some 95 per cent of active projects well into implementation were assessed as generally on track to achieving the transition objectives envisaged for them (see transition impact charts on page 5).

The private sector share of ABI was 76 per cent in 2016, compared with 78 per cent in 2015, reflecting the EBRD's mandate to foster transition and reform by working with the private sector. The Bank provided €725.6 million of equity directly through investments in 21 companies (€506.1 million) and indirectly via seven equity funds (€219.5 million).

2016 marked the first year of implementation of the Green Economy Transition (GET) approach, which helps EBRD countries of operations deliver the emission reductions pledged at the United Nations climate conference in Paris in 2015. GET expands the scope of EBRD climate finance activities, tackling water and materials efficiency, energy efficiency, renewable energy and climate resilience. During 2016, the Bank invested €2.9 billion in 151 projects under the approach, accounting for 33 per cent of total Annual Bank Investment and generating estimated annual reductions of 5 million tonnes of CO_2 emissions.

The Small Business Initiative streamlines and bolsters EBRD assistance to small and medium-sized enterprises (SMEs). In 2016, in addition to investments of €1.0 billion in 81 financial intermediaries for on-lending to SMEs, the Bank directly invested a total of more than €400 million in 66 SMEs.

Establishing viable local currency financing and nurturing the development of efficient and self-sustaining local capital markets are vital to ensuring economic resilience. This is recognised by the EBRD's Local Currency and Capital Markets Development Initiative, under which the Bank signed 93 local currency loan and bond projects – 29 per cent of the total number of debt transactions by the EBRD during the year.

The Strategy for the Promotion of Gender Equality 2016-2020, rolled out in 2016, seeks to economically empower women in the EBRD region and foster more equality of opportunity to benefit all members of society. Of the projects undertaken by the Bank in 2016, 29 incorporated a component promoting gender equality.

Working in the EBRD's less economically advanced countries of investment, the Early Transition Countries (ETC) Initiative seeks to increase financing and strengthen the business climate. The Bank signed 114 projects, many of them in support of SMEs, and invested €902 million in the ETCs in 2016.

Other strategic themes of Bank activities are the promotion of economic inclusion, the development of knowledge-based economies, improving the investment climate and governance, fostering a better legal environment for businesses and bolstering food security.

At the end of the year, the Bank's portfolio of investment operations (including undisbursed commitments) had increased from €41.6 billion in 2015 to €41.8 billion.

Gross disbursements reached a record €7.8 billion in 2016, compared with €6.5 billion in 2015, with loan repayments of €6.0 billion and equity divestments of €0.7 billion resulting in operating assets of €29.7 billion at end-2016, up from €28.6 billion at end-2015.

In keeping with the aspects of its mandate that cover the mobilisation of domestic and foreign capital for clients, the EBRD maintained a strong record of raising debt and grant co-financing from a variety of sources, despite difficult economic and geopolitical circumstances. Projects signed in 2016 mobilised non-EBRD finance of around €11.4 billion (2015: €14.0 billion). The Bank directly mobilised €1.7 billion of investment from co-financiers, of which €1.4 billion came from private sources. Private direct mobilisation was principally achieved through 24 projects that incorporated €1.0 billion of syndicated loans using the Bank's A/B loan structure (2015: €1.6 billion in 16 projects).

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1 See footnote 1 on page 2.

Financial results

The EBRD recorded a net realised profit in 2016 of €0.6 billion before provisions, unrealised gains on share investments and other unrealised gains (2015: €0.9 billion profit). The main contributor to realised profit is the Bank's strong net interest income with variability primarily attributable to its equity portfolio, where profits on divestments were lower than the previous year.

Including provisions and unrealised amounts, the EBRD's overall net profit before income allocations of €1.0 billion showed an improvement on the €0.8 billion profit recorded for 2015. Excluding the one-off release in 2015 of general provisions of €0.3 billion following a revision to the estimation methodology, net profit improved by €0.5 billion, with both Banking and Treasury activities delivering improved financial performance in 2016.

The ratio of non-performing loans decreased slightly to 5.5 per cent at year-end from 5.9 per cent at the end of 2015, while the average credit rating of the loan portfolio overall continued to equate to B+.

General administrative expenses for 2016, inclusive of depreciation and amortisation, were €467 million (2015: €431 million). The increase was mainly due to the higher conversion rate from pounds sterling, in which expenses are predominantly incurred, into euros, reflecting the rate at which the Bank hedged its 2016 budget at the end of 2015. The pound sterling equivalent of this figure was £343 million (2015: £332 million).

The Bank's reserves increased to €9.2 billion at the end of 2016 (2015: €8.4 billion), reflecting both the net profit for the year and net income allocations. The EBRD's capital strength is illustrated by the level of members' equity, which represented 27.4 per cent of total assets at 31 December 2016 (2015: 26.5 per cent), including Treasury assets with an average risk rating between AA and AA- and an average maturity of 1.3 years, unchanged from 2015. Members' equity represented 56.3 per cent of Banking assets ('development-related exposure') at 31 December 2016 (2015: 55.8 per cent).

The EBRD maintained its triple-A rating, reaffirmed by all three major rating agencies in 2016.

The geopolitical uncertainty in the EBRD region is likely to continue contributing to volatility in the Bank's earnings, particularly in the valuations of its equity portfolio and the level of provisioning against its loan book.

Full details and financial statements are provided in the EBRD's *Financial Report 2016* (see fr-ebrd.com).

The EBRD and Chernobyl

In the 30th anniversary year of the Chernobyl nuclear accident, the arch-shaped steel structure designed to enclose the remains of the power plant's destroyed reactor 4 reached its final resting place. The achievement was a defining moment in one of the most ambitious projects in engineering history.

The EBRD played a vital role in securing the Chernobyl site through its management of international funds for decommissioning activities. It is also the largest single contributor to Chernobyl-related projects.

The New Safe Confinement (NSC) is the biggest moveable land-based structure ever built, with a span of 257 metres, a length of 162 metres, a height of 108 metres and a total weight of 36,000 tonnes when equipped. With a lifetime of 100 years, the NSC will make the accident site safe and allow for the eventual dismantling of the temporary shelter put up in 1986 as well as supporting the management of radioactive waste.

In November, workers moved the NSC 327 metres from the area where it was assembled to its end position above reactor 4 in a unique sliding operation. Remaining tasks include the completion of a building that will serve as the control centre for future operations of the NSC, the installation and testing of systems and connections between the NSC and other facilities, and the handover to Ukrainian operators that is scheduled for late 2017.

Since 1997, the EBRD has managed the Chernobyl Shelter Fund, which finances the €1.5 billion NSC and related projects. Their combined cost is expected to reach €2.1 billion. (For more information about the EBRD's work on nuclear safety, see page 49.)

Backing the first wind farm in Georgia

The EBRD is helping to introduce wind power to Georgia with a venture in the central municipality of Gori that will serve as a model for other projects in the renewables sector.

The wind power plant, the first in Georgia and the first commercial wind farm in the Caucasus region, will have a total installed capacity of 20.7 MW and an expected electricity output of 85 GWh per year. Around one-third of this will be exported to neighbouring Turkey while the rest will help Georgia to meet its winter energy needs without additional carbon emissions. The project encourages the diversification of renewable resources in the country, which relies heavily on hydropower generation.

The Bank extended a US$ 10 million (€9.6 million equivalent) loan and arranged an additional US$ 12 million (€11.5 million equivalent) in syndicated lending from three commercial co-investors to the state-owned firm Qartli Wind Farm under a project finance structure. This will fund the construction and operation of the power plant. The EBRD also facilitated technical assistance funds to help the Georgian government design and implement an electricity trading platform.

Transition concept review

In 2016 the EBRD Board of Directors approved a new way of conceptualising the transition to a market economy, the process that the EBRD seeks to promote through investment projects and policy dialogue. This change reflects the global evolution, since the Bank was established 26 years ago, in the definition of a successful market economy to include an emphasis on strong markets as well as state institutions.

The modernised transition concept gives more weight to the desired outcome of the transition process. In other words: what does a sustainable market economy look like? As EBRD countries of operations each have diverse needs for reform, the answer to this question requires country-specific responses.

Drawing on the recommendations of external experts and following extensive consultations with the Board, the revised transition concept argues that a well-functioning, sustainable market economy should be more than just competitive. In order to avoid reform reversals and to address weaknesses highlighted by the 2008 financial crisis, market economies should also be well-governed and resilient. Moreover, to ensure the long-term sustainability of the transition process, markets need to be inclusive, for instance by taking into account the needs of women and disadvantaged groups, and green – that is, environmentally friendly. Lastly, it is desirable for market economies to be integrated, as internal and cross-border connectivity promote competitiveness and resilience.

All six qualities (competitive, well-governed, green, inclusive, resilient and integrated) are implicit in the founding articles of the EBRD. They have been reflected in the evolving activities of the Bank since its creation, with some receiving focused attention earlier than others. In 2016, the Bank explicitly attended to each quality through its investments and policy dialogue.

The process of revising the transition concept began in 2015 with the appointment of an external panel chaired by Professor Tim Besley (London School of Economics) and including Beata Javorcik (Oxford University) and Sergei Guriev, who was a professor of economics at Sciences Po, Paris, before joining the EBRD as Chief Economist in 2016. The panel provided recommendations and engaged in extensive discussions with the Board before Directors approved the new concept.

Formal implementation of the revised transition concept from 2017 will take place through individual country strategies, for which a new methodology is being prepared. The EBRD is also designing a fresh way of assessing the expected transition impact of engagements to reflect the revised transition concept.

Refugee crisis response

In line with its mandate, and joining international efforts to tackle the refugee crisis caused by the civil war in Syria, in 2016 the EBRD announced a financing package of up to €900 million. The package will support private sector and infrastructure projects in Turkey and Jordan, which host some 2.8 million and 1.4 million Syrian refugees, respectively.

In order to help build economic resilience in these countries and support refugee-hosting communities, the EBRD committed over €70 million alongside €50 million of grants in 2016, the first year of the financing package. The Board pledged €100 million in grant financing over three years, contingent on the Bank's profitability, to be administered through a separate window in the EBRD Shareholder Special Fund (SSF). Of this amount, €35 million was allocated from net income in the first year, running from mid-2016 to mid-2017.

Examples of refugee response investments in 2016 included a loan worth the equivalent of €22.5 million to the Water Authority of Jordan for improvements to wastewater treatment infrastructure that serves 690,000 people, including some 250,000 refugees. Donor co-financing for the investment was provided by the United Kingdom (for the equivalent of €16.3 million), the EBRD SSF (€4.7 million equivalent) and the World Bank Concessional Finance Facility (€1.89 million equivalent).

In addition, the EBRD provided 40 million Jordanian dinars (€53 million equivalent) as part of a tranched loan to the Greater Amman Municipality to finance better solid waste infrastructure in the Jordanian capital. An associated £5 million (€5.8 million equivalent) grant from the UK complemented the loan.

Furthermore, a €5 million extension to an existing EBRD loan and a €5 million grant from the SSF to the city of Gaziantep in south-eastern Turkey will fund an expansion of the local bus fleet that travels to underserved areas in the city, providing refugees with greater access to schools, safer journeys, jobs and services.

Unleashing the potential of Kazakh businesswomen

Providing women with the finance and advice they need in order to grow their businesses is a priority for the EBRD in Kazakhstan. In 2016, the Bank extended the equivalent of €23 million in local currency financing as part of its Women in Business programme in the country.

Credit lines under the initiative were signed with CenterCredit, ForteBank, the microfinance organisation KMF and Shinhan Bank. The first Women in Business credit line in Kazakhstan was extended to CenterCredit in late 2015.

The programme combines support for partner financial institutions and businesswomen to unleash the economic potential of a section of the population that has traditionally been underserved by the financial sector. Although conditions are improving, women-led firms in Kazakhstan often face obstacles in obtaining credit and developing managerial skills.

Energising telecommunications in Greece

A €389 million financing package arranged by the EBRD for OTE, the leading telecommunications operator in Greece, will support the company's ambitious investment plans, including the development of next-generation networks chiefly targeting regions with relatively low broadband coverage.

The EBRD provided €150 million as part of a €339 million syndicated loan, which supported the re-opening of the loan syndications market in Greece and is aimed at helping the country return to growth. In parallel, the Black Sea Trade and Development Bank provided a €50 million loan to OTE.

In 2015 the EBRD started investing in Greece on a temporary basis to support the country's economic recovery.

Boosting Ukraine's grain export sector

Grain exports are a vital source of foreign revenue for Ukraine at a time of ongoing economic uncertainty and the agribusiness sector is important for attracting foreign direct investment to the country. Last year, the EBRD invested in two projects aimed at easing transport bottlenecks in Ukraine's grain export sector.

A US$ 40 million (€38 million equivalent) loan to G N Terminal Enterprises will enable the company to expand the capacity of the grain terminal it operates in the port of Odessa. The Bank also extended a US$ 34 million (€32 million equivalent) loan to local company MV Cargo for the development of a modern, deep-water grain terminal in the port of Yuzhny.

Donor-funded activities

The EBRD relies on support from donors to successfully fulfil its mission of advancing transition. Donors provide funds that act as a catalyst for Bank investments and support other activities. They are particularly active in those parts of the EBRD region facing the biggest obstacles to recovery and growth and in the infrastructure, sustainable energy and small business sectors.

In 2016, donors signed agreements to contribute €445 million in new grant financing for EBRD use. During the year, the EBRD used €409 million of grants in support of its work. The Bank increasingly used products that blend commercial financing with grant-funded elements in order to maximise the impact of EBRD investments. Typically, donor funds support a third of EBRD investment projects per year.

For more information on donor activities, see "Donor partnerships" on page 44.

Democratic reforms

Article 1 of the Agreement Establishing the Bank states that the EBRD operates in "countries committed to and applying the principles of multiparty democracy, pluralism and market economics".

The Governance and Political Affairs team, in the Vice Presidency - Policy and Partnerships group, monitors and assesses compliance with Article 1.

Formal political assessments for each country are prepared as part of the country strategy process and are included in each country strategy, following an updated methodology approved by the Board of Directors in 2013 which is available on ebrd.com.

The assessment covers 14 criteria related to free elections and representative government; civil society, media and participation; rule of law and access to justice; and civil and political rights.

In 2016, the following country strategies were approved by the Board, including the political assessments found in Annex 1 of each strategy: Albania, Belarus, Estonia, Georgia, Greece, Hungary, Kosovo, Latvia and Lithuania.

Market reforms

During the year, the overall outlook for market reforms improved across the EBRD region, although reversals occurred in isolated cases and the challenging context in some countries should be recognised. The Bank continues to encourage governments to pursue reforms that will support the business climate. These observations are borne out by the EBRD's annual analysis of structural reforms, as detailed in the EBRD *Transition Report 2016-17* and in the online country pages of the publication. The Report contains an updated assessment of transition challenges. This highlights reforms and other significant developments of the past year that warranted either an upgrade or downgrade in the relevant scores, or placement on positive or negative watch for future adjustments to the scores.

There was a noticeably positive set of developments in the infrastructure and energy sectors. Highlights included the ongoing extension of electronic tolling in Belarus so that it now covers significant sections of the country's road network. Reforms have advanced in the energy sector in numerous countries in recent years, reflecting a continued appetite for change. Progress in the past year was particularly noticeable in south-eastern Europe (SEE), with important restructuring efforts under way in Albania, Bulgaria and Serbia. Also noteworthy in 2016 were the efforts of the Ukrainian government to tackle inefficiencies in the governance of the energy company Naftogaz. In July, the authorities approved Naftogaz's plan to unbundle the firm.

Some financial sectors remained rather vulnerable and fragile. High levels of non-performing loans – a legacy of various crises during the past decade – held back credit growth and confidence in many countries. However, developments in the private equity and capital markets were mostly positive. The SEE Link platform for stock markets in south-eastern Europe was launched in the past year, linking stock exchanges in Bulgaria, Croatia, FYR Macedonia, Serbia and Slovenia.

With regard to the business environment and reforms in the corporate sector, progress was mixed. Egypt restricted imports and rationed access to foreign exchange for some time, although the devaluation of the national currency in November and the signing of a new arrangement with the International Monetary Fund should restore macroeconomic stability and promote growth and employment. In the ICT field, the Slovak Republic was upgraded as the completion of Slovak Telekom's privatisation in 2015 had addressed one of the key remaining challenges to transition in this sector.

Transition for all: Equal opportunities in an unequal world

The EBRD's *Transition Report 2016-17* focuses on inequality and several key aspects of inclusive growth: the distribution of income, the impact of transition on people's well-being and happiness, equality of opportunity, and financial inclusion. The analysis in this report draws on the third *Life in Transition Survey*, a household survey conducted by the EBRD and the World Bank in 34 countries during late 2015 and the first half of 2016.

The publication reiterates that the process of transition from planned to market economies has been far from smooth. In the early years of transition, the social, economic and even physical costs of reforms were so substantial that people born at the time of price liberalisation are an average of around 1 cm shorter than their peers born just before or after that period. It is no wonder, then, that most people in the transition region were, until recently, less happy than people with similar income levels elsewhere. Now, though, that is no longer the case: the happiness gap has finally closed.

The EBRD region has not only caught up with richer countries in terms of happiness; it has also closed some of the income gap. Not everybody, however, has benefited equally from economic progress: only 44 per cent of all men and women in post-communist countries have enjoyed total income growth that is higher than the average for the G7 advanced economies. The report discusses ways to spread the benefits of growth more equally.

Read the full *Transition Report 2016-17* at tr-ebrd.com