



THEMATIC EVALUATION

Evaluation of EBRD LCY operations (2016-23)

Country case studies

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Abbreviations

AMX	Armenia Stock Exchange	LCF	Local currency financing
AMD	Armenian dram (currency)	LCY	Local currency
CBA	Central Bank of Armenia	MM	Money Market
CFMD	Capital and Financial Markets Development team (EBRD)	MMDF	Money Market Diagnostics Framework
CS	Country Strategy	MMWG	Money Market Working Group
FMDI	Financial Market Development Index	OIS	Overnight Index Swap
GMRA	Global Master Repurchase Agreement	PPO	Priority Policy Objectives
ISDA	International Swaps and Derivatives Association	SME LCYP	SME Local Currency Programme

Summary

EBRD's LCY activities in Armenia show mixed results across policy, funding and financing pillars, with successful delivery of foundational elements but limited market uptake due to structural constraints and incentives for banks. Armenia has been an early adopter of EBRD's money market development framework since 2011 and was the first country to pilot the Money Market Diagnostic Framework in 2018, demonstrating strong institutional commitment to reform through sustained policy dialogue.

EBRD successfully delivered key policy and legal infrastructure through technical cooperation, including derivatives legislation and repo market frameworks, but commercial banks' behaviour has changed little. While the Money Market Working Group provides a valuable forum for dialogue among stakeholders, banks' limited incentives to change trading practices, driven by profitability and access to central bank funding have prevented the development of more sophisticated market practices and a credible benchmark rate.

Treasury has pioneered innovative funding approaches in Armenia but faces structural competitiveness challenges. Moving beyond early reliance on TCX, Treasury established an AMD liquidity pool in 2020 and developed diverse funding instruments including bonds and cross-currency repos and swaps. However, the shallow money market and uncompetitive benchmark rates based on T-bills, as well as subsidised finance in some segments, continue to constrain lowering EBRD's funding costs.

EBRD's LCY financing remains largely confined to the financial institutions sector and relies on LCYP subsidy support for competitive pricing. While recent economic growth, increased awareness of FX risks, and strengthened banking regulations have supported demand for LCY lending, EBRD's competitiveness is limited by banks' access to cheap funding sources, in both hard and local currency. The Bank's LCY lending totalled €153m in 2016-23, with vast majority directed to financial institutions and supported through the subsidised SME Local Currency Programme.

The efficiency of Treasury's multi-pronged approach in Armenia is demonstrated through successful delivery of both policy dialogue and funding operations, though market outcomes remain modest. Despite Treasury's proactive engagement in policy dialogue through the Money Market Working Group and innovative funding approaches including liquidity pools and cross-currency swaps, banks' continued reliance on traditional funding sources and trading practices has limited the development of a more sophisticated money market.

1 Country context

Money markets

Armenia follows an inflation targeting monetary policy and a floating exchange rate regime. The CBA intervenes in the foreign exchange market only to smooth excessive exchange rate volatility. The de facto exchange rate arrangement is classified as *floating*. Since 2006, the CBA has been implementing inflation-targeting framework. The CPI inflation target is 4% with a $\pm 1.5\%$ tolerance band. The policy rate of the CBA is the refinancing rate, which is the lower bound for 7-day repo agreement auctions by the CBA. During 2020–2021, the refinancing rate was first decreased from 5.5% to 4.25% in September 2020, after which it was gradually increased reaching 9.5% in August 2022.¹

There is no actively trading money market in Armenia. Utilisation of the secured and unsecured segments of the money market is limited by excess liquidity, with banks holding liquid assets in excess of regulatory requirements and the bulk of liquidity in unremunerated CBA reserve accounts. Banks trade OTC repo with one week maturity but mainly on Wednesdays, when the CBA conducts its main operations. There is little to no activity for the rest of the week, and while an overnight repo platform was launched on the AMX in March 2023, it has not been used since then.²

There is no reliable overnight benchmark. The lack of money market activity prevents the creation of an overnight interest rate benchmark, which is key for further financial development. The regulatory framework for both derivatives and repos is robust, but derivatives market liquidity is still low and the take up of global master repo agreements by local banks has been relatively slow, partly because the interbank

¹ IMF 2023: Annual report on exchange arrangements and exchange restrictions 2022

² Armenia – Financial Market Country Brief, 2024

repos tend to be relatively small size and short duration, thus reducing exposure and contractual concerns.³

Credit dollarisation is still high but declining. While deposit dollarisation is on a decreasing trend, at around 50% (down from c.80% in 2010) it increased momentarily over 2022-2023 due to the growth in non-resident FX deposits. However, this did not affect loan dollarisation, which is at a historical low of around 33% as at end 2023, down from about 50% five years ago.⁴

Armenia has slightly dropped in its score of the Money Market pillar of the Financial Market Development Index (FMDI) over the evaluation period. The FMDI is a composite index that aims to measure the development of capital markets, money markets and derivative markets in EBRD COOs. The index is designed and maintained by the CMFD team. Each sub-index is itself a composite of a number of indicators.⁵

EBRD strategy & priorities

Country strategic priorities in Armenia included LCF in the first part of the evaluation period (2015-18), while the most recent country strategy (2019-24) prioritises LCY for policy engagement. The initial Country strategy (2015-2018)⁶ included *Developing capital markets and promoting local currency financing* as one of its three strategic priorities, with *Increase availability of local currency financing* as a specific objective. This was accompanied by operational response activities in both lending and policy, and one monitoring indicator on the LCY loans extended by local banks. The following CS (2019-24)⁷ included LCF/money market development as a lending and policy activity under its *Broader access to finance* objective (*Policy engagement on local currency, money and capital market (such as enhancing money market, including repo, supporting the development of the money market benchmark via money market working group, development of derivatives, crowd-funding, capacity building) in close cooperation with development partners*). This was supported by a monitoring indicator on the lending side. It also indicates LCY and MM development as a reform area broadly agreed with the authorities.

Policy priorities outside of Country Strategies only sporadically supported MM development. Despite the initial CS focus on LCY in operations and policy, this was only reflected in the Priority Policy Objectives (PPOs) once. The PPOs for 2020 included the overall direction on the *Development of money, derivatives and capital markets – Development of a new AMD interest rate benchmark*. The Policy compact of 2024, which replaced the PPO system, formulates *Support the CBA with Development of money market, including support in the adoption of ISDA Master Agreements* as one of its top priorities for the next 12-18 months as of January 2024.⁸

CMFD priorities for 2024 onward specify the particulars of the upcoming policy focus. As per the CFMD, Market development efforts should continue to focus on supporting money markets and local securities issuance. Specific actions include:⁹

- Implementing an overnight repo platform through AMX, to allow concentrating interbank repo liquidity in a single tenor (O/N) through a single platform creating an efficient mechanism for private market participants to face each other without CBA intermediation.
- Working with the MMWG on developing a local benchmark rate index and an interest rate based derivatives market using overnight interbank repo transactions as basis [Treasury-led];
- Continuation of support to CBA with enhancing its monetary policy operational framework [Treasury-led];
- Tailored training where deemed necessary to enhance market development [Treasury-led].

³ Armenia – Financial Market Country Brief, 2024

⁴ Armenia – Financial Market Country Brief, 2024

⁵ The Methodology of the FMDI design and calculation is described in the 2021-22 Transition Report: <https://2021.tr.ebrd.com/financial-market-development/>

⁶ BDS/AR/15-1 (Final): Strategy for Armenia

⁷ BDS/AR/19-01 (Final): Strategy for Armenia (2019-2024)

⁸ POLICY COMPACT - ARMENIA, January 2024

⁹ Armenia – Financial Market Country Brief, 2024

2 Findings

2.1 EBRD sustained money market development efforts produced limited market outcomes due to market conditions, despite successful delivery of legal framework and infrastructure

Armenia authorities demonstrated sustained engagement with EBRD's money market development framework

Armenia joined the ETC LCYP – the predecessor of SME LCYP – in 2011. Armenia was in the first group of ETC countries joining the ETC LCYP, and signing the MoU in May 2011. The MoU was then subsequently renewed in 2016. The engagement began with a comprehensive action plan for Local Currency and Capital Market Development, to be through a high-level Steering Committee co-chaired by the CBA and EBRD, marking a strong institutional commitment to reform.¹⁰

Armenia became a pilot country for the EBRD's diagnostic approach to money market development in 2017-2018. The country was the first to undergo the Money Market Diagnostic Framework (MMDF) assessment, leading to specific recommendations for market development. This diagnostic work was complemented by technical cooperation on inflation targeting and communication, aiming to enhance monetary policy transparency. The establishment of the Money Market Working Group (MMWG) in 2018 represents EBRD contribution to sustained market development dialogue. The MMWG was established following the MMDF assessment.

The MMWG was resumed after the pandemic slowdown, with the objective of creating and overnight repo market and developing a credible and reliable benchmark. The long delayed plan to build an overnight repo market through the local stock exchange was restarted.

MMWG provides valuable forum for dialogue but shows limited concrete results

The Money Market Working Group has been helpful in providing a forum for policy dialogue, even though its results have been muted so far. The MMWG allows the main stakeholders to share views and recommendations. It groups participants from the Central Bank, the Stock Exchange (AMX), commercial banks and the EBRD. No other IFI is participating. The members interviewed were unanimous in praising the engagement of EBRD staff and their relentless commitment to the development of the Armenian money market. They recognised that, without EBRD proactive involvement, such meetings would probably not happen. The MMWG provides a useful platform for dialogue among the main players and gets the commercial banks out of their comfort zone. However, the commercial banks' behaviour has changed little and the MMWG's achievements have been limited so far.

EBRD successfully delivered legal framework and market infrastructure, but banks remain reluctant to change trading practices

The EBRD has participated in the development of a well-articulated legal framework for the Armenian money market. As early as 2016, the EBRD provided technical cooperation to the Central Bank of Armenia (CBA) for the drafting of a package of laws regarding the derivatives market. This project was also coordinated with, and supported by ISDA. The new legislation provided for the enforceability of derivatives transactions, including netting, close-out netting and financial collaterals. It saw amendments over 17 laws and introduced more than 15 new regulations to Armenia's financial legislation. More recently in June 2022, the ICMA legal opinion on GMRA (netting) was issued by TK & Partners with the support of the CBA and the Asian Development Bank. The opinion considered the enforceability of the GMRA and, in particular, its netting provisions, as it relates to Armenian banks, companies and investment funds. In addition, the opinion also covered the Central Bank of Armenia. Today, the legal Framework on derivatives and repos is satisfactory and provides a good basis for trading.

The new legal framework enabled market developments in 2018-2019, particularly in repo markets. The adoption of legal reforms implementing a derivatives framework and GMRA [Global Master Repurchase Agreement] with local annexes in 2018 created the legal underpinning for a number of large, long-term

¹⁰ CSDRs 2016

repo transactions. This included three one-year repos worth AMD 2.0-2.5 billion each.¹¹ These transactions demonstrated the practical value of the reforms in enabling larger and longer-term market operations.

In spite of the enabling legal framework, the commercial banks make little use of the money market, which remains under-developed. The fast growing Armenian economy generates liquidity needs that commercial banks fund through the central bank's weekly repo window and through the National Mortgage Company, which refinances their mortgages on concessional terms. Commercial banks are relatively small and do not have large balance sheets from which to lend to each other. This is accentuated by the proportion of their resources in foreign currencies. While there is sufficient liquidity in USD/EUR, it is not the case in AMD. Sometimes, there are only lenders, sometimes only borrowers on the interbank market. Therefore that market is shallow, and primarily an OTC one, where traders tend to know each other and transact in a quasi-informal way.

The EBRD has been consistently promoting a professionalisation of the interbank market but with limited success

EBRD's efforts to establish centralised trading infrastructure through AMX platform have seen limited uptake due to banks' preference for existing bilateral trading practices. CFMD and Treasury have jointly tried to develop a mechanism for commercial banks to seamlessly face each other on bilateral operations in local currency. First, they contemplated introducing a central clearing counterparty (CCP). However, the feasibility study concluded that the current volumes did not warrant the high expense associated with implementing such a CCP. Then, the EBRD sought to implement a repo platform hosted by the AMX. It was supposed to bring sporadic, weekly traded OTC repo transactions to the overnight AMX repo market where interbank repo trades would be seamlessly done through straight-through processing. This would enable price discovery of cost of risk-free AMD funding at overnight tenor. The infrastructure has been in place at AMX for some time and although it has experienced teething problems, it is functioning. However, it has met with little success so far due to challenges related to ease of execution, incomplete automation, and the existence of fees. Banks have not moved to AMX repo platform by themselves as where there is little or no incentive. In the absence of a regulation or incentive from the local authority compelling them to trade on the AMX platform, banks preferred to continue using the current unstructured and decentralised system. At the end of 2024, they promised to try and use the AMX platform in earnest, to test the systems. However this is based on their goodwill.

Lack of trading volumes prevents development of credible money market benchmark despite EBRD efforts

The Armenian money market still does not have a credible risk-free benchmark. One of the key achievements of EBRD in other countries of operation was the development of an indicator for the overnight cost of borrowing local currency. Such indicator is a key component for the pricing of derivatives and loans, the elaboration of reliable yield curves and the assessment of interest rate risk. A proper money market benchmark helps commercial banks with the pricing of long term maturities. However, a credible benchmark has to capture the essence of the money market activity.

Low trading volumes and market fragmentation prevent establishment of reliable benchmark despite EBRD efforts. In Armenia, the money market is traded mainly on OTC and a few times a week; resulting in low daily trading volumes that prevent the establishment of a robust and reliable indicator. The Treasury with the support of the CBA has actively encouraged banks to move their weekly OTC trades to the overnight AMX repo platform, in the hope that the moving market activity to overnight would create sufficient volume that would make possible the creation of a reliable indicator. Until this happens, the Armenian money market will not benefit from a risk-free benchmark and will continue using T Bills yields as an indicator of the price of money. This is an imperfect tool with a weak transmission of adjustments to the CBA policy rate.

Market conditions and banks' profitability reduces incentives for money market development, though EBRD continues capacity building efforts

Current market conditions and business models reduce commercial banks' motivation to reform money market practices.. Armenian banks are very profitable at the moment. They have benefitted greatly from the inflow of foreign currencies since 2022 and the buoyancy of the economy. In addition, the still high liquidity in USD and EUR mitigates the focus on local currency. Therefore, a reform of the monetary market is not a priority for commercial banks as they do not see clearly the benefits.

¹¹ Armenia – Financial Market Country Brief, 2024

Treasury is addressing banks' limited interest rate risk management capabilities through targeted capacity building. Among the consequences are the absence of instrument for managing interest rate risk in AMD and the prevalence of 6m T Bills to price floating loans, which does imperfectly reflect the cost of money. In order to raise the capacity of Armenian banks to manage interest rate risk, the Bank has secured EU funding for an Interest Rate Risk in the Banking Book¹² assessment for 6-7 banks, similar to what was done in Georgia. This is expected to increase the awareness of banks about interest rate risk and consequently stimulate the appetite for hedging instruments such as Overnight Index Swaps (OIS). Since OIS require a market index or benchmark, which does not yet exist in Armenia, it may progressively lead banks to acknowledge the importance of a fully functioning money market and its various components.

2.2 Treasury has pioneered innovative LCY funding approaches, but structural constraints in money markets continue to limit competitiveness

Treasury operates an innovative but structurally constrained AMD liquidity pool, limited by shallow money market and uncompetitive benchmark rates

The state of development of the Armenian money market makes EBRD LCY funding structurally uncompetitive. The interbank money market is shallow, and it has not been possible to develop a risk-free benchmark. In the absence of such indicator, EBRD uses the Armenian T Bill rate in its funding operations (cross currency swaps and floating bonds). The Armenian money market is characterised by a distortion in that T Bill yields have been for some time higher than the commercial banks cost of funds of the same maturity. It means that the EBRD funding based on T Bill is not competitive.

In Armenia, the EBRD Treasury manages a currency pool which gives more flexibility in funding Banking operations. The Treasury has started to run a liquidity pool in AMD from 2020. This involves funding a “book”, i.e. a portfolio of operations taken as a whole rather than individually. This contrasts with other IFIs which fund their LCY lending strictly back-to-back. Fund raising and investment can be disconnected from day-to-day transaction needs, although and compared to other countries of operation, the relatively small size of the Armenian market means that the funding activity is still closely linked to the expectation of transactions. Having a currency pool allows Treasury to fund complex financing structures more easily, while participating in the money market and gaining first-hand experience that can inform its policy dialogue.

Treasury takes calculated risks in response to Banking demands. The management of the currency pool supposes taking some limited interest rate risk, for instance when cash flows are not exactly matching or in the case when Banking needs long term fixed rates and Treasury takes refinancing risk. The inherent risk contained in the currency pool approach is mitigated by the versatility of instruments Treasury can use to raise liquidity, such as cross currency swaps, cross currency repos and onshore bond raising which can be issued as quickly as 5 days. Finally, Treasury holds Armenian Ministry of Finance bonds that can be used in repo transactions, ensuring there is always liquidity in case of need. Although risks appear limited and well controlled, EBRD is the only IFI running a currency pool in Armenia, the others having adopted a much more conservative approach and funding their operations back-to-back.

Treasury's funding sources have evolved from TCX towards more diverse and flexible instruments

The EBRD Treasury has moved away from over-reliance on TCX. At the beginning of the evaluation period until roughly 2021, the TCX Fund¹³ was a large provider of offshore funding and EBRD was a price taker from TCX. However, it is considered generally more expensive and less flexible than onshore funding. Sometimes volumes are too limited, especially in less liquid currencies, and it can be “shut” in times of market turmoil, effectively not being able to price floating rates. This created difficulties for EBRD because during crisis periods, TCX rates went up steeply and the Bank had to convert its local currency agreements into dollars, which put considerable strain on the relationship with clients.

Treasury has been able to diversify the funding instruments it uses, creating more liquidity and flexibility for clients of the Bank. In January 2014, the EBRD issued its first one-year bond for a total of AMD 2 billion (approximately USD \$5 million). A string of issuances followed, for a total over the evaluation period of about EUR 48m.¹⁴ From 2016 till 2022, this was complemented by trades with TCX amounting to about EUR 69m. From 2020, Treasury started to more systematically source funds onshore, using cross-currency

¹² Interest rate risk in the banking book (IRRBB) is part of the Basel capital framework's Pillar 2 (Supervisory Review Process).

¹³ TCX shareholders and counterparties include most major Development Finance Institutions, including EBRD, and several privately managed Microfinance Institutions.

¹⁴ Exchange rates varied over the period making these figures approximative. They are intended to provide an order of magnitude only.

swaps for a total of about EUR 38m, making the use of TCX unnecessary since the beginning of 2022. This diversification ensured that the Bank was able to obtain liquidity and fund its projects in a more secure and price-efficient manner.

Table 1: EBRD bonds issued 2016-2024

Issued	Ccy	Amount	Note	Coupon	Maturity
27-09-2024	AMD	2,000,000,000		9.25 per cent	27 September 2027
18-11-2022	AMD	2,000,000,000		FRN (6mo AMD Tbill -0.6%)	22 November 2027
16-11-2023	AMD	2,500,000,000		FRN (6mo AMD Tbill -0.6%)	22 November 2027
14-01-2020	USD	10,000,000	AMD Linked	5.1 per cent	16 January 2023
23-10-2019	USD	15,000,000	AMD Linked	FRN (6mo AMD Tbill -0.9%)	24 October 2022
24-10-2018	AMD	2,400,000,000		7.25 per cent	26 October 2021
09-02-2018	AMD	7,250,000,000		FRN (6mo AMD Tbill -0.55%)	13 February 2022
15-12-2017	USD	3,000,000	AMD Linked	FRN (6mo AMD Tbill -0.65%)	18 December 2021
02-08-2017	AMD	2,392,900,000		8.25 per cent	4 August 2022
09-01-2017	AMD	2,400,000,000		FRN (6mo AMD Tbill -0.5%)	10 January 2020
10-08-2016	AMD	1,250,000,000		9.7 per cent	12 February 2021

Source: EBRD <https://www.ebrd.com/bonds-issued.html>

Treasury pioneered new funding approaches from its early adoption of AMD bonds to market based operations

The EBRD has been innovative in the funding instruments it is using. EBRD has been a pioneer among IFIs when it issued its first AMD bond in 2014. In March 2018, the Treasury entered its first AMD reverse repo transaction with an Armenian bank to warehouse excess AMD liquidity. In 2022, a few weeks before the Ukraine war, Treasury did a cross-currency swap with Amundi-ACBA. EBRD is the only IFI doing cross currency swaps with an asset manager in Armenia, although Amundi seeks to diversify its counterparties and explore working with other IFIs. The February 2022 transaction was followed by a string of similar transactions carried out under an ISDA CSA, which took time to negotiate and as such developed the capability of this Armenian financial institution.

The funding partnership with asset manager Amundi-ACBA is a good example of a natural hedge between two counterparties. The EBRD Treasury has opened a new avenue for funding by partnering with asset manager Amundi-ACBA,¹⁵ which manages three mandatory pension funds with total Assets Under Management of USD 1.5bn. There is a strong rationale for Amundi and EBRD to trade together. As a pension fund, Amundi accumulates stable resources in AMD which can be lent to EBRD for its medium- to long-term projects. Amundi diversifies its portfolio by investing up to 35-40 percent abroad, essentially in ETF. The resulting foreign currency need can be partially filled by EBRD. It is a great illustration of a natural hedge between two market counterparties with opposite positions. Amundi foreign assets portfolio creates a foreign exchange position that incurred losses from March 2022 with the strong appreciation of the AMD. The cross currency swaps between EBRD and Amundi allow the latter to hedge its FX exposure while providing the Bank with medium-term AMD resources.

Treasury provides valuable longer-term local currency funding options

Treasury is able to fund projects over the medium to long-term. The average maturity of funds raised from TCX and onshore is four years. This provides banks (the majority of EBRD clients) with a longer term funding alternative compared to what is available on the local market. This contributes to the stability of

¹⁵ Amundi-Acaba Asset Management was established in Armenia in 2013. It is a joint venture between Amundi, the leading European asset manager and Acba Bank, one of the major corporate banks listed in Armenia Securities Exchange in February 2022.

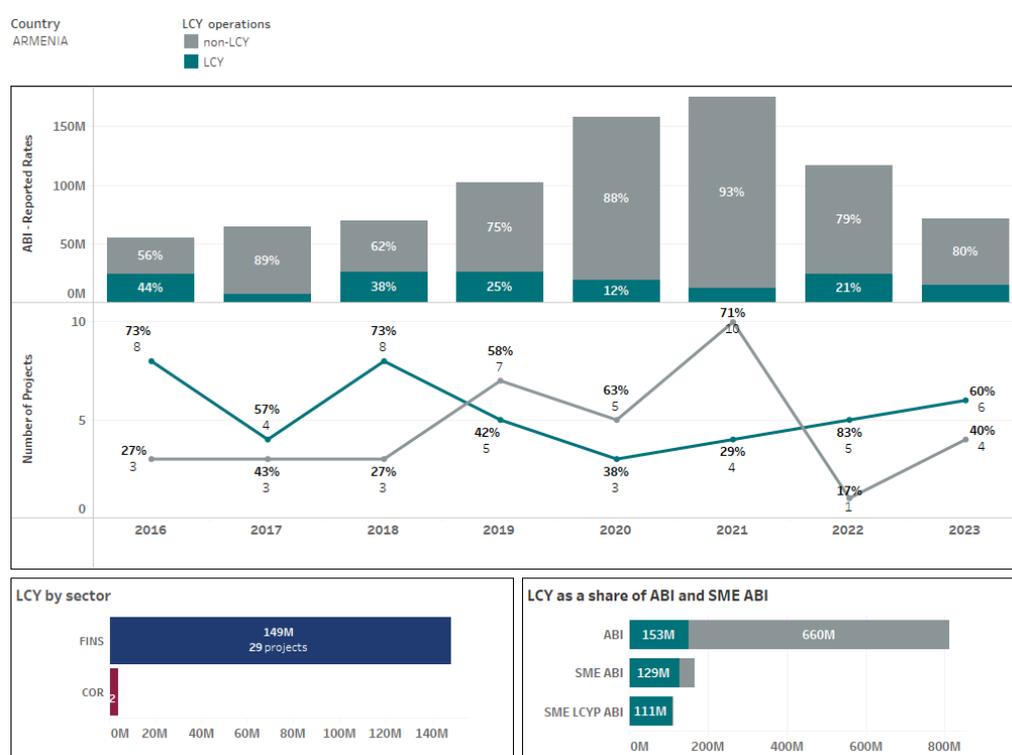
the financial system. EBRD would be able to fund infrastructure or corporate projects in LCY up to 10-year maturity if the need arose, although there are no transaction requiring such maturity at present.

The complexity of the EBRD cost of funds structure is sometimes hard to understand by clients. Treasury charges margins in addition to the cost of funding to account for mismatches (convertibility risk,¹⁶ refinancing risk, etc.). This makes the pricing structure more complex than what local banks are proposing (cost of funds plus a credit margin). Treasury passes the Cost of Funds as FTP to Banking. No margin is charged except when there is a potential mismatch like convertibility risk (in the case of deliverable swaps), refinancing risk or market risk.

2.3 LCY financing requires subsidy support due to banks' access to cheap funding sources, with limited opportunities beyond FI sector

The total LCY ABI in Armenia was €153m over the 2016-23 period, representing 19% of overall debt ABI. The LCY finance was delivered almost exclusively in the FI sector (€149m). SME finance represented €129m, majority of which was supported by the SME LCYP (€111m).

Figure 1: Armenia LCY financing, 2016-23



NB: ABI includes debt and guarantees only, equity excluded; LCY financing data is based on LCY flag.

Macroeconomic improvements and regulatory measures drive lending de-dollarisation, though significant foreign currency savings persist

The Armenian economy has experienced an incomplete de-dollarisation. From a high of 63 per cent ten years ago, lending in hard currencies (essentially USD) has declined to 31 percent today.¹⁷ This trend results from improving macro-economic conditions (for instance, inflation coming down); and flexible exchange rates. Unlike a decade ago, it is not possible any more to take advantage of discrepancies between the shadow rate and the official one. The CBA has accompanied this transition through regulatory measures, such as prohibiting individual loans and mortgages in foreign currencies, making AMD tranches

¹⁶ In case funding is offshore and the lending is deliverable, there is a convertibility risk

¹⁷ Central bank of Armenia: <https://www.cba.am/en/SitePages/statmonetaryfinancial.aspx>

compulsory in bond issuances and higher reserve requirements.¹⁸ However, there are important factors which make de-dollarisation gradual, such as the reliance on imports for energy and other goods imported from Russia, the main trade partner. Demand for LCY loans is also influenced by the fluctuations of the AMD interest rate. When interest rates in AMD decrease, the gap with hard currencies narrows down, making an AMD loan a more attractive proposition. In that regard, the historic level of AMD versus USD achieved recently stimulates demand for AMD loans, to protect borrowers from an anticipated correction in the exchange rate.

On the savings side, the USD has kept its status as safe heaven. Large depositors (e.g. >\$200,000) save in USD as they do not consider the interest rate differential high enough to justify investing in local currency. The proportion of FX denominated savings among residents is about 36 percent. This has consequences on the banks' behaviour, as a significant proportion (often above 50%) of their resources are denominated in foreign currencies. They are happy to hedge their FX risk by lending in the same currency, which perpetuates the status quo.

Strong economic growth and FX rate movements drive increased demand for LCY borrowing

External factors have created exceptional economic conditions supporting AMD lending growth. In a booming economy, demand for AMD is high and borrowing in AMD makes sense for financial institutions. The Armenian economy experiences a high growth rate,¹⁹ propped up by a large diaspora²⁰ but more recently (2023-24) by the massive influx of foreign currencies following the Ukraine war and the flow of refugees from Nagorno-Karabakh, who receive financial support from the government and other institutions.²¹ This has created a booming demand for mortgages, which many describe today as a bubble.

Recent exchange rate volatility has increased borrower awareness of FX risks, making AMD lending more attractive. The dollarisation of the economy and the interest rate differential with AMD has long made borrowing and lending in hard currencies a viable alternative for banks and clients alike. However, a sudden episode of devaluation in 2021 caused significant losses among borrowers. This was followed in 2022 by a sharp appreciation of +36 percent against the US dollar which has endured up to this day. Borrowers have started to worry about the foreign exchange risk. This is particularly the case at this point in time, when the AMD has reached an all-time high against the USD due to the influx of foreign currencies. The market consensus is that this situation is due to external circumstances and therefore should not last. AMD borrowing and lending makes more sense today and the interest rate differential does not justify taking foreign exchange risk.²²

Armenian banks' funding dynamics limit EBRD's market competitiveness despite growth opportunities

EBRD is an expensive funding option for Armenian banks in foreign currency. The market is characterised by an abundance of FX depositors, who are not seeking to optimise their returns through more sophisticated and better remunerated instruments. As a result of this, the banks have been able to keep the deposit interest rates low and ended up with cheap FX funding, not linked to international rates. In the last two years (2023-24), Armenian banks funding costs are estimated to be three to four percent whereas the SOFR, the USD reference rate, was five percent.²³ This situation had an impact on EBRD activity, which USD funding benchmark is SOFR. When adding the EBRD credit margin, this becomes unattractive to local banks.

Despite the favourable market conditions for LCY lending in Armenia, EBRD's LCY financing for FIs has remained stable due to pricing challenges and evolving funding dynamics in the banking sector. The de-dollarisation, liquidity needs and level of exchange rate should facilitate the absorption of LCY lending. However, the stable level of EBRD LCY financing for FIs observed in Armenia reflects the relatively higher cost of EBRD loans. The wholesale funding market for banks wasn't existent until 5-10 years ago in Armenia. The main source of funding were the deposits and savings by the population. The very low rates paid on deposits meant that borrowing from EBRD did not make sense commercially for banks. The need for liquidity experienced recently is primarily satisfied by the CBA, although banks have expressed a need to obtain more stable, long term funding if the terms are right. The funding of banks through bonds, which

¹⁸ Reserve Requirement rate are 2% for AMD funds and 18% for FX funds.

¹⁹ 12.6 % and 8.3% in 2022 and 2023 respectively. It is expected at 6% and 4.9% in 2024 and 2025 respectively (IMF)

²⁰ There are 9 million Armenians living outside of the country.

²¹ The EBRD is one of them. Unique among IFIs, it has a Refugee Response Plan for the benefit of refugees from Nagorno-Karabakh.

²² As an example, Inecobank, a long term partner of EBRD, issued in June 2024 a USD 5m 2-year bond with a coupon of 4.5%. and on the same day a AMD 5bn 30-month bond with a coupon of 10%.

²³ The SOFR 180-day average was above 5% for the best part of 2024, now 4.62% (13 March 2025).

<https://www.newyorkfed.org/markets/reference-rates/sofr-averages-and-index>

command higher interest rates than deposits, but provide a more stable source of funding, is now promoted by commercial banks to their retail clients. This is supported by government incentives: (1) covering some of the cost of issuances (2) Making bond coupons tax exempt. This shift to long term funding may represent an opportunity for EBRD. Decreasing market rates may also offer opportunities for EBRD lending in the future. Once the interest rates go down again, the local banks will not be able to reduce their funding rates in the same proportion.

LCY lending in Armenia therefore relies on LCYP subsidy for competitive rates, while program features and long tenors provide additional value

The SME LCYP has improved EBRD's competitiveness when lending to FIs. The SME local currency program allowed EBRD to lend to FIs with reduced credit margins to one / two percent depending on the market situation. Otherwise, the Bank's risk margin would be four to five percent, making the all-in cost uncompetitive. The additionality was ensured by assessing the lending rates to a market benchmark, in the case of Armenia the government six months yield of T bills deposit rates in the market. The lending does not exceed the average deposit rate available in the market. In this way the EBRD does not undercut the market. In spite of this, the lending rate remains slightly higher because of the link to T bills, which yields are higher than market rates.

Non-financial additionality factors have allowed EBRD to bring value to FI clients. During the interviews, partner banks pointed that the attractiveness of EBRD lied in special programmes (gender- or green-focused), with their accompaniment of Technical Cooperation (in the case of gender) and grants/cash backs (in the case of green lending). The recently started portfolio risk-sharing programme represents also an attractive product where EBRD plays to its strength. However, it is worth noting that it is effectively a risk sharing agreement, covering 50 percent of the credit risk of the portfolio. Currencies are not specified as they are the choice of the FI. Finally, the ability to lend over long maturities in AMD was also mentioned as an additionality factor. Banks have started to take a more strategic view of their Asset/Liability Management and may want to stabilise their balance sheet with the support of a long term, prestigious lender such as EBRD.

Limited EBRD LCY competitiveness in corporate and infrastructure lending, compounded by underdeveloped floating rate market

EBRD's attractiveness in the corporate and infrastructure sectors remains limited to long tenors in hard currencies. The rapid expansion of the mortgage market observed for the last couple of years in Armenia takes place at the expense of corporate lending. Banks have significantly increased their balance sheets through the distribution of AMD mortgages but have not expanded their corporate portfolio. This has not converted into a LCY lending opportunity for EBRD because of its pricing and other market factors. In the corporate sector, clients with hard currency revenues (often the largest corporates in Armenia) prefer to hedge naturally with borrowings in those currencies, taking advantage of the lower pricing. In the energy and infrastructure sectors, which need long-term capital, EBRD can provide in USD up to 17-year maturities, when local banks can only do 8-10 years. This is not really possible in LCY due to the absence of long term funding in AMD, itself linked to a shallow capital market and absence of interest rate benchmark. In the corporate sector, long tenors are rare. The EBRD additionality is reduced because the liquidity of Armenian banks mean they can provide 4-5 year loans without difficulty, which was not the case a few years ago. Another hurdle for EBRD in the corporate sector is the long lead time to execute a project as opposed to commercial banks which are much faster.

Floating loans remain marginal and linked to the Armenian T Bill, an imperfect benchmark. Large clients and infrastructure companies have understood the benefits of floating interests, especially when the SOFR rate was very low. This is not really true of the dominant SME sector in Armenia for which the lending market remains primarily a fixed rate market. Banks fund their fixed rate loans through the issuance of similar fixed rate bonds. When floating rate loans are required, banks don't have a monetary benchmark to price efficiently their cost of funds and therefore their loans. They rely instead on 6-month T Bill daily average, whose connection to the cost of money is weak. This creates an awkward situation where the T Bill rate can be higher than the interbank rate on some occasions and is likely to slow the adoption of floating rates on the market in general.

DATA ANNEX

Context

Economic context

Armenia's monetary policy has shown consistent responsiveness to economic conditions, successfully managing inflation through active interest rate adjustments over 2015-2023. The Central Bank of Armenia (CBA) implemented an easing cycle in 2015-2017, lowering the refinancing rate from 10.5% to 6% in response to deflation and weak domestic demand. When inflation pressures emerged in 2021-2022 due to food and energy prices and currency depreciation, the CBA tightened policy, raising rates to 10.75%. This hawkish stance, combined with falling global commodity prices and dram appreciation, helped bring inflation close to zero by late 2023, allowing the CBA to cut rates back to 9.25%. This policy flexibility was supported by improving fiscal conditions from robust economic growth and better public finance management.²⁴

Box 1: Armenia – macroeconomic dashboard

<ul style="list-style-type: none"> Overview: resilient economy despite challenges <ul style="list-style-type: none"> Armenia has navigated significant challenges over the evaluated period, including the 2018 Velvet Revolution, the COVID-19 pandemic, the 2020 conflict with Azerbaijan, the displacement of over 100,000 ethnic Armenians in 2023. Despite these adversities, prudent macroeconomic policies—such as inflation targeting and fiscal responsibility—have bolstered economic resilience. 	
<ul style="list-style-type: none"> Economic growth <ul style="list-style-type: none"> Armenia's GDP growth moderated to 8.7% in 2023, down from 12.6% in 2022. The decline in growth can be attributed to slower monetary inflows from the Russian Federation, which impacted private consumption. 	
<ul style="list-style-type: none"> Inflation and real interest rates trends <ul style="list-style-type: none"> Inflation peaked following the onset of the Ukraine war but has since subsided, dropping from 8.6% in 2022 to 2.0% in 2023 (Fig. 1). This decrease in inflation can be attributed to: (i) effective monetary policy; (ii) the appreciation of the dram against the dollar; (iii) falling food and fuel prices; (iv) lower prices for imported goods. Real interest rates have aligned with inflation trends, decreasing from 8.6% in 2022 to 1.98% in 2023 due to proactive interventions by the Central Bank (Fig. 1). 	<p>Fig.1 Real interest rate vs. inflation, 2014-23</p> <p>Source: IMF- International Financial Statistics (2024).</p>
<ul style="list-style-type: none"> Financial sector developments <ul style="list-style-type: none"> Reduced dollarization: Foreign-currency loans decreased from 66% in 2014 to 29.8% in 2023, reflecting Armenia's commitment to strengthening local currency financing (Fig. 2). Interbank rate spread: The spread narrowed from 300 basis points in 2014 to 100.66 in 2023, indicating enhanced market stability and confidence (Fig. 3). Narrowed interest rate spread: The interest rate spread—the difference between lending and deposit rates—has narrowed in Armenia, indicating reduced lending risk and increased competition. This trend improves credit access for businesses and consumers, supporting economic growth (see Fig. 4). 	

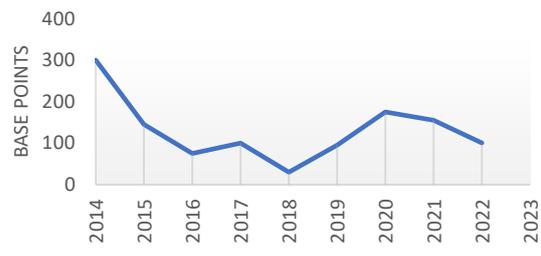
²⁴ Armenia CSDRs 2016-2023

Fig.2 Foreign-currency-dominated loans to total loans, 2014-23



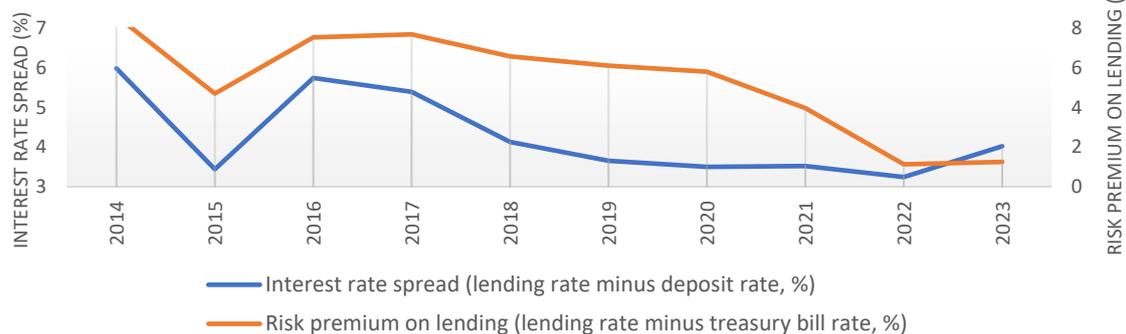
Source: IMF-Financial Soundness Indicators (2024).

Fig.3 Spread between highest and lowest interbank rates (base points), 2014-23



Source: IMF-Financial Soundness Indicators (2024).

Fig. 4 Interest rate spread vs. risk premium on lending, 2014-23

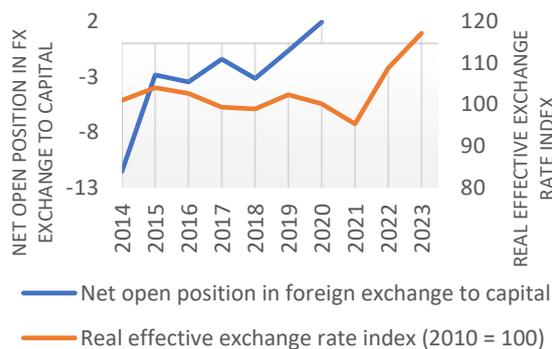


Source: IMF- International Financial Statistics (2024).

Mitigated foreign exchange risks

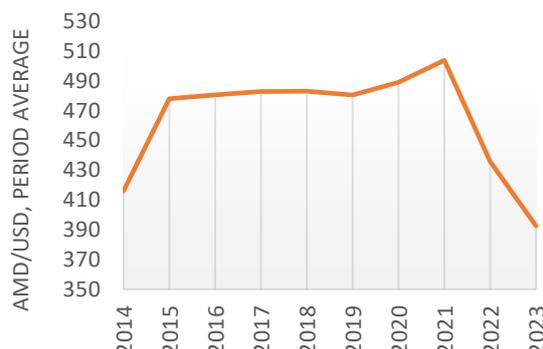
- Armenia's exposure to foreign exchange risk has improved significantly, with its net open position relative to capital shifting from -11.56% in 2014 to a more stable level in recent years (Fig. 5).
- The official exchange rate (AMD per USD) followed a relative stable pathway from 2016-21; strong appreciation in 2022 due to FX inflows following the war (Fig.6)

Fig.5 Net open position in FX to capital vs. real effective exchange rate index, 2014-2023



Source: IMF-International Financial Statistics (2024).

Fig.6 Official exchange rate (AMD per US\$, period average), 2014-23



Source: IMF-International Financial Statistics (2024).

Outlook

- Despite ongoing challenges, Armenia's economic outlook is cautiously optimistic. Continued growth is anticipated if sound macroeconomic policies and regional stability are preserved.

Notes on Figures:

Fig.1 Real interest rate is the lending interest rate adjusted for inflation as measured by the GDP deflator. The terms and conditions attached to lending rates differ by country, however, limiting their comparability. **Inflation** as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly. The Laspeyres formula is generally used.

Fig.2 Foreign-currency-denominated loans to total loans measures deposit takers' exposure to exchange rate risk, indicating the portion of total loans that are in foreign currency. It is a proxy for foreign currency exposure/dollarisation.

Fig.3 Spread between highest and lowest interbank rates (base points) indicates perceived risk in interbank lending, reflecting the cost and risk premiums deposit takers' face.

Fig.4 Interest rate spread (lending rate minus deposit rate, %) is the interest rate charged by banks on loans to private sector customers minus the interest rate paid by commercial or similar banks for demand, time, or savings deposits. The terms and conditions attached to these rates differ by country, however, limiting their comparability.

Fig.5 Net open position in foreign exchange to capital indicates deposit takers' exposure to foreign currency risk by comparing net foreign currency positions to capital. It is intended to identify deposit takers' exposure to exchange rate risk relative to capital. The capital here refers to total regulatory capital. It is a proxy of the vulnerability of the banking sector to foreign exchange shocks.

Fig.6 Official exchange rate refers to the exchange rate determined by national authorities or to the rate determined in the legally sanctioned exchange market. It is calculated as an annual average based on monthly averages (local currency units relative to the U.S. dollar).

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IMF (2024). Republic of Armenia: 2023 Article IV Consultation
Armenia Overview: Development news, research, data | World Bank
<https://www.worldbank.org/en/country/armenia/overview>

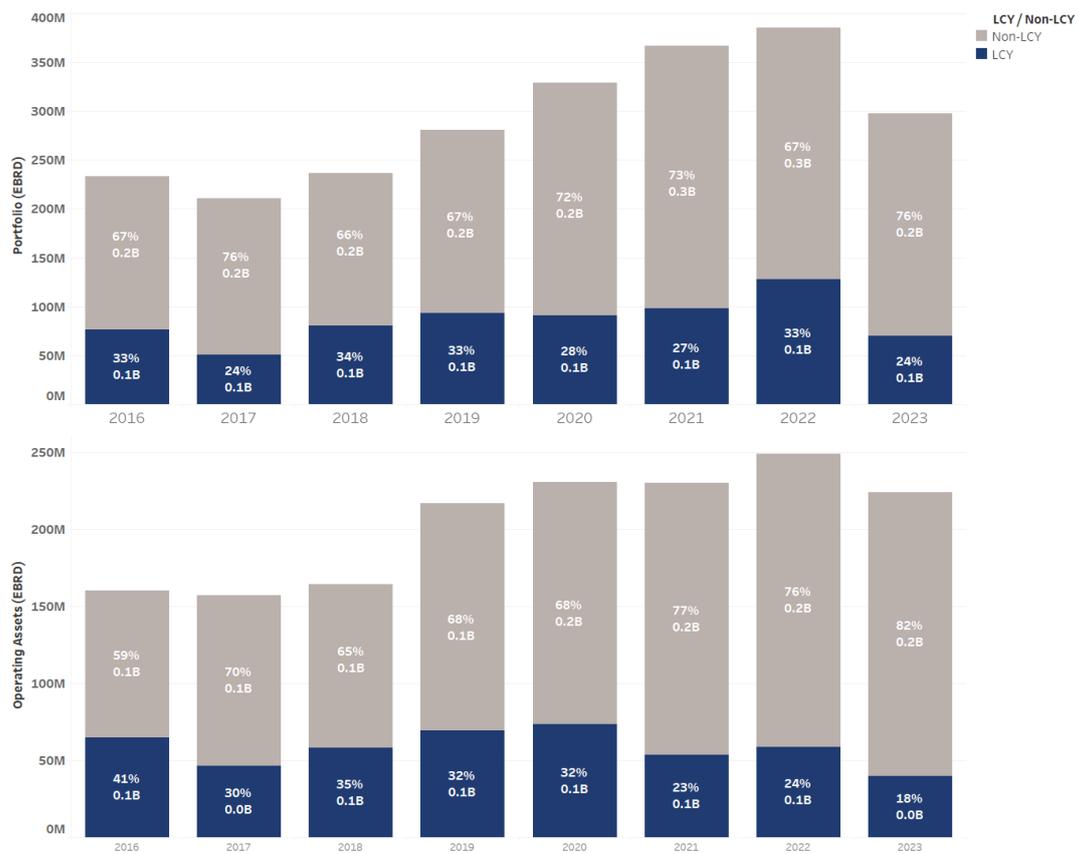
Table 2: Country context dashboard

Indicator name	Indicator value, year of measurement	Indicator source
Policy		
Exchange rate arrangement	Floating	IMF (2023)
Monetary policy framework	Inflation targeting framework	IMF (2023)
EBRD Financial Markets Development Index (FMDI)		
Money Market Pillar Score	2014: 24.9 2020: 19.0 2022: 19.75	EBRD CFMD (2024)
Reliable benchmark (no/yes) [0,1]	No [0]	EBRD CFMD (2024)
Benchmark used by market participants (MOF, IFIs, local banks) [0,1]	No [0]	EBRD CFMD (2024)
CCY Basis swap/Interest Rate Swap curves on Bloomberg or Thomson Reuters Eikon priced out of the benchmark [0,1]	No [0]	EBRD CFMD (2024)
	2020: 1.20	

FI LCY bonds: Aggregate outstanding nominal of corporate bonds issued by banks or financial institutions with maturity of more than 1 year issued in LCY as a share of GDP (USB, bn)	2021: 1.31 2022: 1.25	Cbonds (2023), provided by CFMD team
Corporate LCY bonds: Aggregate outstanding nominal of corporate bonds (excl. issued by banks or financial institutions) with maturity of more than 1 year issued in LCY (USD) as a share of GDP (USB, bn)	2020: 0.06 2021: 0.40 2022: 0.37	Cbonds (2023), provided by CFMD team

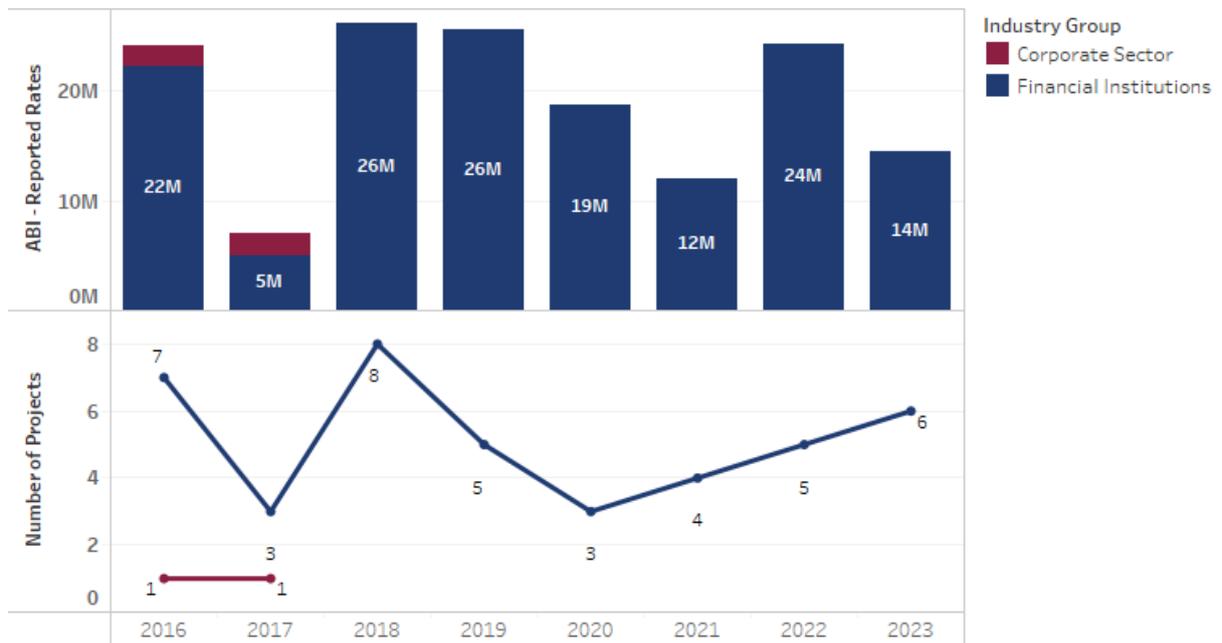
EBRD LCF financing

Figure 2: LCY operations as a share of portfolio and operating assets, 2016-2023



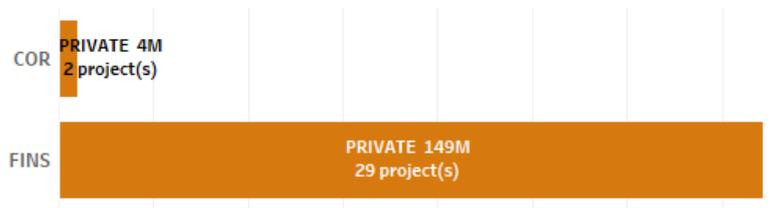
Source: dw_banking_operational dataset

Figure 3: LCY ABI and number of projects by sector, 2016-2023



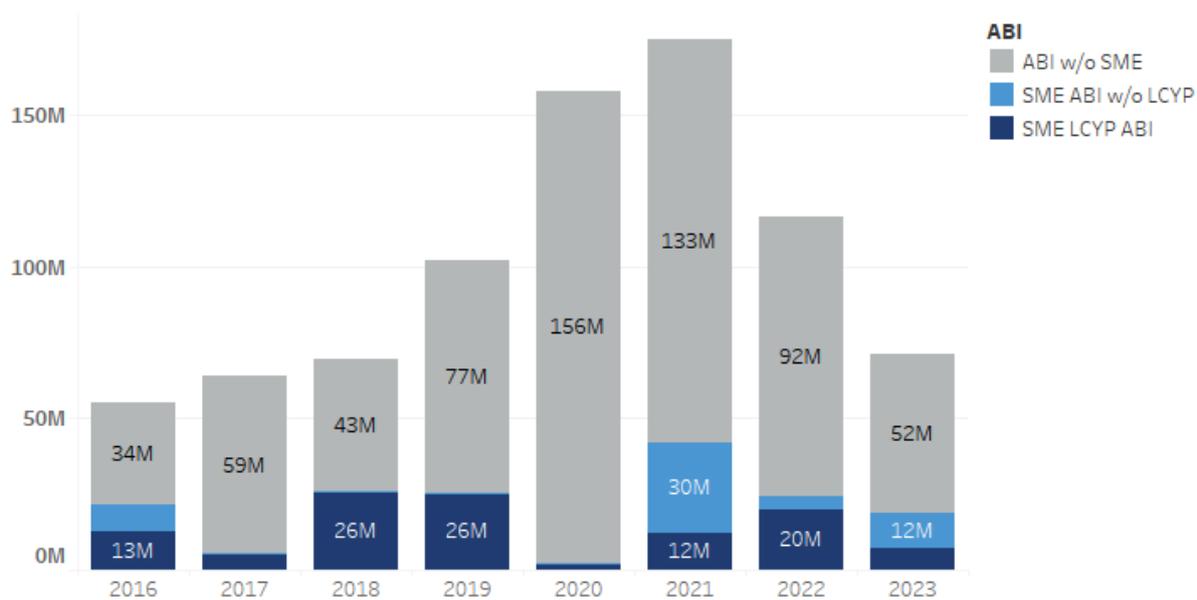
Source: dw_banking_operational dataset

Figure 4: LCY ABI and number of projects by portfolio class, 2016-2023



Source: dw_banking_operational dataset

Figure 5: Share of SME LCYP in SME ABI, 2016-2023



Source: ABI includes debt and guarantees only, equity excluded; source of data dw_banking_operational; SME ABI identified based on SME flag at OpID level; LCYP ABI based on the "Local currency risk sharing" product indicator

Kazakhstan

Country case study

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Abbreviations

AIFC	Astana International Financial Centre	LCY	Local currency
ARDFM	Agency for Regulation and Development of the Financial Market	MM	Money Market
CFMD	Capital and Financial Markets Development team (EBRD)	MMDF	Money Market Diagnostics Framework
CPI	Consumer Price Index	MMWG	Money Market Working Group
CS	Country Strategy	NBK	National Bank of Kazakhstan
FMDI	Financial Market Development Index	OIS	Overnight Index Swaps
KASE	Kazakhstan Stock Exchange	PPO	Priority Policy Objectives
KZT	Kazakh Tenge (currency)	SME LCYP	SME Local Currency Programme
LCF	Local currency financing	TONIA	Tenge Overnight Index Average

Summary

The total LCY ABI in Kazakhstan was €2.9bn over the 2016-23 period, representing 64% of overall debt ABI. Kazakhstan is the largest EBRD country in terms of LCY ABI proportion and LCY financing is particularly dominant in the infrastructure sector (€2bn). LCY lending in Kazakhstan did not benefit from the SME LCYP subsidy, as the country only joined the programme in 2024.

The formal strategic prioritisation of LCY financing in Kazakhstan has weakened over time, though policy engagement continues. While the 2017-2021 country strategy explicitly prioritised LCY financing with specific objectives and indicators, the current strategy (2022-2027) does not prioritise this area, though relevant policy actions remain in the Policy Compact. This does not seem to have impacted the LCY activity of the Bank.

EBRD has achieved significant success in LCY financing in Kazakhstan through an integrated approach combining policy reform, innovative funding solutions, and substantial lending volume, particularly in infrastructure. The three pillars reinforced each other, with EBRD's active participation in the Kazakh financial market enhancing its credibility in policy dialogue, while policy achievements like revamping the TONIA benchmark and derivatives reform enabled more sophisticated funding approaches.

EBRD leads money market development in Kazakhstan through Treasury-driven policy dialogue, achieving key reforms despite operating outside the formal LCYP framework. The establishment of the TONIA floating rate benchmark and successful derivatives reform represent major progress in market development, though adoption remains gradual due to conservative banking practices and developing legal frameworks.

Treasury's approach to KZT funding demonstrates strong innovation and flexibility, establishing EBRD as the only MDB with full treasury operations in Kazakhstan. The successful management of a KZT funding pool, combined with pioneering bond issuances and new financial instruments, has enabled EBRD to meet growing lending needs while supporting broader market development, including through knowledge sharing with other MDBs.

While EBRD has built a substantial KZT portfolio, lending faces varying degrees of competitiveness across sectors. Infrastructure and renewables show particular strength due to natural LCY demand and EBRD's ability to provide long-term financing, while corporate and SME sectors face challenges from subsidised state programs and competitive local bank pricing.

EBRD's LCY activities in Kazakhstan demonstrate strong additionality through the provision of long-term committed funding in KZT, which remains scarce in the market. However, the transition from inflation-indexed to market-based instruments has created some disconnects with client needs, highlighting the challenge of balancing market development goals with client preferences.

1 Country context

Money market

Kazakhstan's money market remains fragmented, with activity concentrated in specific instruments and tenors. The most liquid segment is the overnight repo market traded on KASE, with average daily volumes of USD 670 million, while interbank lending is constrained by tight credit limits and longer-tenor transactions are shallow. Other key liquidity management tools include NBK deposits and securities, while offshore FX swap markets show inconsistent activity.²⁵

The development of TONIA as a benchmark rate represented progress but challenges remain. While TONIA was successfully established through collaboration between KASE, NBK, EBRD and key financial institutions, leading to EBRD's first TONIA-linked bond issuance in 2021, subsequent market development has faced headwinds. The challenges are evidenced by elevated spreads on TONIA-linked issuances (Kazakh Rail at TONIA+300bps, government at TONIA+75/90bps) and pricing inconsistencies since TONIA was trading at 13.5% against a 14.5% policy rate amid structural surplus liquidity, which forced EBRD to postpone its planned second issuance in 2022.²⁶

Kazakhstan significantly improved its score in the Money Market pillar of the Financial Market Development Index (FMDI) over the evaluation period. The FMDI is a composite index that aims to

²⁵ Kazakhstan – Financial Market Country Brief, CFMD 2023

²⁶ Kazakhstan – Financial Market Country Brief, CFMD 2023

measure the development of capital markets, money markets and derivative markets in EBRD COOs. The index is designed and maintained by the CFMD team. Each sub-index is itself a composite of a number of indicators.²⁷

EBRD strategy & priorities

The two country strategies over the evaluation period saw a manifest de-prioritisation of local currency and money markets development. The initial strategy (2017-2021)²⁸ identified a specific objective to *Deepen financial intermediation through increased local currency financing solutions and capital markets development* under the strategic priority of Broadening access to finance. The activities foreseen under this objective included LCY financing to PFIs and clients, funding (issuances of LCY bonds), and policy (advisory on the development of money and capital markets). These were underpinned by two tracking indicators (*issuances and PFI LCY lending*). In contrast, the following strategy (2022-27)²⁹ does not have any objectives or outlined activities in this area.

The current country strategy does not prioritise local currency financing or the development of money markets. While this area is mentioned in the ‘reform areas broadly agreed with authorities’ (*Further develop money and capital market infrastructures and enhance the use of Tonia reference rate*), this is not translated to any strategic priorities or objectives or specific activities for the strategic period. The objective of improved access to finance remains but is tackled through focus on inclusion, and reducing gender and regional disparities. There are likewise no indicators supporting local currency financing or money markets development.

Reflecting the first strategy (2017) priority of LCY, the Priority Policy Objectives (PPOs) in that period included relevant policy actions. From 2018 to 2020, the PPOs focused on developing and enhancing capital and money markets in Kazakhstan, with specific milestones targeting the improvement of the legal framework for derivatives and bankruptcy rules. Key initiatives included drafting legislation, conducting capacity-building activities, developing a roadmap for the derivatives market, implementing TONIA reform, and working towards Kazakhstan's upgrade to emerging market status.

Despite the current strategy lack of LCY prioritisation, the present Policy Compact³⁰ includes policy actions related to this area. Due to the lack of direct link to the Country Strategy objectives, the policy priorities in this area are somewhat uneasily linked to the *Fostering Private Sector Competitiveness, Connectivity and Strengthening Economic Governance* objective. The priorities indicated are:

- Active: Conduct money market diagnostics and assist issuance of TONIA-linked bonds (by EBRD and other issuers)
- Planned: Strengthen Kazakhstan appeal to foreign banks via Banking Sector Strategy for ARDFM [Agency for the Regulation and Development of the Financial Market]

Relevant CFMD country brief priorities for 2023+:³¹

Enhancing Money and Derivatives Markets

- Advising the Money Market Working Group on the development of products indexed to TONIA: loans, funding and Interest Rate Derivatives [Treasury-led].
- Running of Money Market Diagnostic Framework on Kazakhstan to analyse existing gaps and commendations to improve money markets. [Treasury-led].
- Continuation of TC projects to NBK to enhance monetary policy [Treasury-led]. Tailored training where deemed necessary to enhance market development [Treasury-led].

Developing Financial Market Infrastructure

- Supporting the consolidation of liquidity pool of equity markets between AIX and KASE [CFMD-led with Treasury; PD ongoing].

²⁷ The Methodology of the FMDI design and calculation is described in the 2021-22 Transition Report: <https://2021.tr-ebird.com/financial-market-development/>

²⁸ BDS/KA/17-1: Strategy for Kazakhstan

²⁹ BDS/KA/21-01: Kazakhstan Country Strategy (2022-2027)

³⁰ Policy Compact – Kazakhstan, June 2024

³¹ Kazakhstan – Financial Market Country Brief, CFMD 2023

2 Findings

2.1 EBRD leads money market policy reform in Kazakhstan, and has achieved key development milestones through active engagement

EBRD Treasury drove money market policy dialogue in Kazakhstan outside formal LCYP framework

Kazakhstan only joined the SME LCYP in 2024. Kazakhstan did not join the Programme over the evaluation period (2016-2023), but joined recently in 2024.

EBRD was engaged in policy dialogue for MM development throughout the whole evaluation period. In 2016, EBRD Treasury co-organised with the Resident Office a round table on Money Markets and Derivatives in Almaty to discuss the main issues and proposals to develop domestic money and domestic markets. The roundtable was organised as part of the work done by the “Money Markets and Derivatives” working group chaired by EBRD Treasurer under the work done for Astana International Financial Centre (AIFC). The working group concluded that the reform of the legislative framework enabling derivative transactions was the highest priority item to support the development of Kazakh derivative and money markets.³²

Policy dialogue platform, the Money Market Working Group (MMWG), was established in 2018 despite Kazakhstan not formally being part of the SME LCYP. While in principle MMWGs were established in SME LCYP countries contingent on signing an MoU committing to policy dialogue on MM development, there was no such MoU signed with Kazakhstan, and the country was not a part of the LCYP. MMWG was initially established in 2018 with three meetings focused on reforming KZT money market interest rate benchmark, specifically the overnight interest rate benchmark TONIA (Tenge Overnight Index Average). This foundational work led to two follow-up meetings in 2019, culminating in the NBK's official announcement of TONIA reform in October 2019.^{33,34} Money Market Diagnostics Framework (MMDF) was carried out in 2023.

EBRD is widely acknowledged as the most active MDB involved in policy dialogue on LCY/MM development in Kazakhstan. The MMWG includes the NBK, the Kazakhstan Stock Exchange (KASE), large Kazakh commercial banks and one investment bank. Counterparts interviewed in the course of the evaluation confirmed that the MMWG had brought value to the NBK and to the market participants in general. The involvement of EBRD in the MMWG is widely recognised. Unique among MDBs present in Kazakhstan, the EBRD Treasury participates directly in the policy dialogue, bringing the concrete perspective of a market operator. A sign of the usefulness and sustainability of the policy dialogue fostered by the MMWG among its members, the NBK even alluded to the continuation of this dialogue with local banks without the necessary presence of EBRD.

TONIA benchmark represents major progress in Kazakhstan's money market development

The development of the TONIA reference rate was a key achievement of the MMWG. In December 2020, the Kazakhstan Stock Exchange KASE started to publish TONIA according to a new calculation methodology. TONIA is the weighted average interest rate on repo transactions for a period of one business day³⁵ and represents the risk-free rate of money in Kazakhstan. TONIA and the indexes based on it serve as a benchmark for the pricing of financial products. The new calculation methodology uses international best practice applied by SOFR in the USA or SONIA in the UK. It was promoted by EBRD within the framework of the MMWG and is viewed by market participants as one of the greatest achievements of EBRD's policy dialogue in Kazakhstan.

TONIA has proven superior to previously used benchmarks in Kazakhstan's money markets. TONIA appears superior to other indexes it has entirely or partially replaced but still encounters teething problems. Commercial banks and the NBK acknowledge the superiority of TONIA over other indexes used in the past, such as Consumer Price Index (CPI) or KazPrime. The latter had been calculated since 2007, based on quotes by a panel of banks for placing and attracting bank deposits. The number of participant banks had gradually decreased and KASE decided to suspend its publication in September 2020. The CPI on which many loans in Kazakhstan are still based, is an imperfect reference. It is volatile and difficult to predict, with the government publishing targets and plans for the coming period, which on many occasions

³² CS/FO/17-14: Annual Report on Treasury Activities: 2016/2017

³³ CS/FO/19-30: Annual Report on Treasury Activities 2018/2019

³⁴ CS/FO/20-18: Annual Report on Treasury Activities: 2019 - 2020

³⁵ <https://kase.kz/en/indexes-and-indicators/repo/tonia>

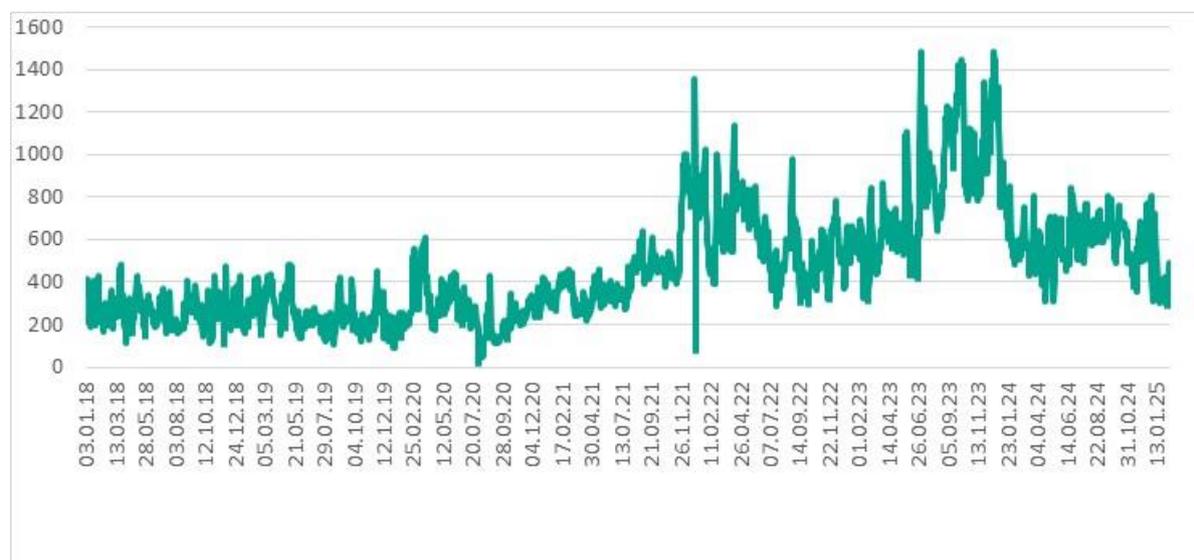
proved to be incorrect. More importantly, the CPI is a measurement of inflation but does not indicate the market cost of money. It cannot be hedged in any way.

TONIA adoption shows initial progress: improved market metrics but slow uptake by banks

Despite its clear advantages, TONIA faces some initial implementation challenges Moving to TONIA, a market-based benchmark, brought a more understandable, transparent and predictable reference. It is also providing some financial education. However, the index is sometimes criticised for not being sufficiently reliable when, for instance, its level is substantially below the government borrowing or when it falls outside of the NBK defined corridor. These teething problems should disappear with more adoption and liquidity in the market.

While TONIA's introduction has boosted repo market activity, overall market liquidity remains constrained by banks' reliance on central bank facilities. TONIA is anchored in the overnight KZT repo market. The liquidity of that market remains limited due to banks being very liquid and not actively managing this liquidity. They predominantly use the NBK windows as the main liquidity channel. Figure 6 demonstrates that the daily volume of repo transactions, previously stable between KZT 200 and 400 billion, surged from September 2021 to KZT 800-1000 billion (EUR 1.5-2 bn). Volumes decreased in subsequent years but remain at levels much higher than observed in the past. In 2022, 2023 and 2024, the average daily volumes amounted to KZT 596bn, 831bn and 604bn respectively, still low but an improvement from the past.

Figure 6: Repo transaction volumes traded in KZT



Source: https://kase.kz/en/money_market/repo-indicators/tonia/

Market adoption of TONIA remains gradual due to conservative banking practices and lack of appropriate legal frameworks. In spite of TONIA's merits, the adoption by the market is slow. Banks tend to observe the behaviour of the index before they are fully confident to use it in their transactions and this may take some time. One should take into consideration that floating rate lending has started only 5-10 years ago in Kazakhstan, which remains a fixed rate market. The NBK policy rate remains a widely used reference. Commercial banks' conservative behaviour in the management of their liquidity also explains this, many preferring to use the NBK as their main source of refinancing. The slow development of derivatives indexed to TONIA primarily reflects banks' limited experience with using derivatives to manage interest rate risk, requiring them to first develop greater understanding of these instruments. Another factor is due to the banks operating under ISDA Master Agreements, international framework agreements which are widely recognised but can prove burdensome for local banks because many sections on cross currency and cross border issues are not relevant in the local context and are complex to negotiate, though this represents an operational challenge rather than the primary constraint on TONIA adoption. A new framework has been finalised by the NBK in cooperation with the Association of Financiers of Kazakhstan. While this local agreement is important for market development, the main driver for increased uptake will be banks'

growing familiarity with derivative instruments themselves. Once banks develop this expertise and begin utilising these products between themselves, it should enhance market activity.

Key legal reform enables development of derivatives market and new financial instruments in Kazakhstan

EBRD supported successful derivatives reform. The efficient functioning of the derivatives market supposes the “netting out” of multiple financial obligations between market participants. This reduces the risk in financial contracts after a default occurs. Substantial policy dialogue took place with the Agency for Regulation and Development of the Financial Market (ARDFM) and the NBK. EBRD hired the law firm Dentons Kazakhstan to draft the necessary amendments to laws and regulations. The policy dialogue continued when the amendments made into the Civil Code and a number of key laws had to be sponsored by government ministries and passed by Parliament. Close-out netting and other important changes were finally adopted in 2022. The local ISDA Master Agreement was subsequently finalised in early 2025, enabling the enforceability of close-out netting for derivative transactions between domestic counterparties trading under this local master agreement. The derivatives market allows banks and investors to better manage their interest rate and other market risks, thus making the financial system more stable and financial markets in Kazakhstan more attractive.

The derivatives reform will allow the introduction of new financial instruments in Kazakhstan and the development of the money market. Commercial banks tend to have portfolios with fixed interest rates but short durations, which is how they manage the interest rate risk. Long term facilities are often not fully committed, banks having the possibility to cancel their loans if the interest rates follow an adverse direction. With interest rate swaps, banks will avail themselves of an instrument to manage interest rate risk and that could lead to longer tenors in the market. While interest rate swaps have traditionally taken place on the OTC market, the derivatives reform opens the gate to new types of instruments like Overnight Index Swaps (OIS) or futures on an organized and secure market. Demand may be limited initially as it requires educated participants. EBRD Treasury has been addressing this gap through a advisory on the Money Market Working Group, supporting counterparties in executing the first transactions, and conducting practical training sessions, including a one-week program at EBRD offices in London in 2024. The State social and pension funds for instance do not use these instruments. However, the possibility of using derivatives and align the Kazakh market to international standards can only contribute to a development of the market.

2.2 Treasury's approach to KZT funding combines innovation, market development and knowledge sharing

Treasury successfully established and manages a flexible KZT funding pool to meet growing lending needs

Over the evaluation period, the EBRD Treasury has been able to adapt its funding methods to varying circumstances and supply Banking with the KZT it required. EBRD first entered into repo arrangements with the National Bank (NBK) in 2011, with the same terms offered to all MDBs active in Kazakhstan. However, this swap line was for limited amounts and came with a number of controls exercised by the NBK such as the use of proceeds, the banks or microfinance organizations the loans would be extended to, additional financial covenants and reporting requirements. Recognising the limitations of this arrangement, EBRD began transitioning to alternative funding sources, issuing its first CPI-linked bond in November 2016 while the repo facilities remained operational. When the NBK suspended these operations in 2019, the EBRD Treasury continued using CPI-linked bonds as an interim funding solution until the TONIA reform enabled new indexing possibilities. The transition to TONIA-linked instruments occurred in phases, with the first TONIA-linked bond issued in November 2021, followed by TONIA-indexed loans beginning in 2022, and derivatives products including the first Overnight Index Swap in 2023. During the entire evaluation period, continuity was maintained and the EBRD Treasury was able to fund increasing amounts of KZT ABI without disruption.

The KZT currency pool has proved to be a flexible way to fund a large pipeline. In Kazakhstan, the EBRD Treasury is managing a currency pool. The pipeline of Banking projects, added with the disbursements and reflows from existing loans, determines the overall net envelope to be funded. However, the exact timing of the various cash flows, particularly disbursements, is hard to predict, making necessary in the meantime to place with commercial banks any excess liquidity coming from bond issuances or otherwise. This approach is supported by the large EBRD portfolio in Kazakhstan, with regular flows of repayments and disbursements. The Treasury does not always need to go to the market when it can rely on the cash inflows

from existing loan repayments. Mismatches and timing differences are managed dynamically like would be the case with EUR or USD in any treasury operation. Over time, the flexibility has increased, and Banking has confirmed that it has always been possible to fund the clients' requirements and disburse projects even at short notice.

EBRD has led innovation in Kazakhstan's money market and its active market participation enhances its credibility and influence beyond funding

The Bank is an innovator in an otherwise developing money market. In November 2021, shortly after the new calculation methodology for TONIA was introduced, EBRD issued the inaugural TONIA-linked bond for KZT 12.5 bn (EUR 25.4m equivalent). The three-year bond was to fund the Bank's activities in the country. It showed EBRD's confidence in the new index and demonstrated its practical use. Following that, the Ministry of Finance of Kazakhstan has also issued bonds linked to TONIA, constituting a further endorsement. The Bank also experimented with the new derivatives regulation when it entered in the first currency interest rate swap agreement with a local bank. The instrument, technically an Overnight Indexed Swap (OIS) in which the overnight rate TONIA is exchanged for a fixed interest rate, took place in December 2023 with Bank CenterCredit, one of Kazakhstan's largest commercial lenders. The transaction had the other advantage of demonstrating how TONIA can be used as a reference in KZT derivative products.

The EBRD Treasury's active participation in the financial market gives EBRD a wider profile than just that of a lender. Through its issuance of bonds, its money market operations and its lending, EBRD participates in several segments of the financial market, providing it with a unique insight on the demand, trends and practices of the Kazakh market. The EBRD Treasury has developed tight relationships with counterparty banks in all products: Money market, foreign exchange, derivatives. EBRD is a source of income for its counterparty banks, and brings liquidity to the market. This was recognised during the interviews when banks acknowledged EBRD as a significant counterpart not just in terms of volumes but developing the market, identifying and trading new instruments and building their capabilities. This active and versatile participation of EBRD Treasury in financial market operations is unique among MDBs present in Kazakhstan and gives the Bank credibility in its policy dialogue with the authorities and in its dealings with counterparty banks.

EBRD shares LCY funding expertise while remaining the only MDB with full treasury operations in Kazakhstan

EBRD has cooperated with the Asian Development Bank (ADB) to share the LCY funding approach. Today, EBRD is the only MDB with full scale treasury operations in Kazakhstan. The other IFIs fund projects back-to-back, which limits greatly their flexibility. It is important that EBRD Treasury disseminates LCY knowledge among its peers because in the broader sense it will create a more liquid and efficient local currency market. An example of such cooperation took place in 2022 when EBRD signed a large LCY project co-financed with the ADB. The latter relied heavily on EBRD's experience on how to raise this funding effectively and how to analyse the risk. The ADB has confirmed that LCY lending was a strategic rather than opportunistic activity for them, even though it remains small overall. For the time being the ADB funds back-to-back but Kazakhstan could be the next country where ADB operates on the basis of a currency pool. A currency pool adds flexibility but the absence of an interest rate hedging instrument limits ADB's room to manoeuvre, because as a rule it does not take any interest rate or currency risk in its lending operations. The introduction of the derivative market in Kazakhstan with the first OIS being traded could be a step forward enticing ADB and other international institutions to increase their LCY operations.

EBRD's pragmatic bond issuance approach successfully taps long-term investors while supporting market development

EBRD has been able to tap long term investors with its KZT bonds issuances and source in this way increasingly long term funding for its projects. Unlike other countries of operation, Kazakhstan has large State-owned institutional investors. The nature of these cash rich institutions is to seek to invest their long term resources into long term, safe investments. Some commercial banks, which tend to be over-liquid, are also keen to diversify their investments into an attractive instrument, issued by a AAA institution, that can be used for repo transactions. EBRD managed to exploit this conjunction of interests to raise long term funding that fits its lending goals. The issuance of bonds has become the main source of funding for EBRD. The term of KZT fixed funding available to Banking has increased from 7 years in September 2021 to 15 years in May 2023.

The EBRD Treasury approached bond issuance in a pragmatic way, which does not go without regulatory risk. The regulatory framework in Kazakhstan does not yet accommodate the special status of IFIs. EBRD had the choice of building this infrastructure first, or follow a more pragmatic approach. The former can be very protracted as evidenced by the EBRD experience in other jurisdictions, regulators being wary of introducing legal changes just for the sake of a few multilateral institutions. Instead, given the urgency of raising KZT to fund the pipeline, EBRD issued bonds internationally (offshore) using its well established MTN programmes. The bonds were placed privately with international banks in 2018. In a second stage EBRD sought to access the larger (and more suitable for clients) deliverable Tenge market, which meant gradually moving onshore and placing its issuances with local investors. This approach was favoured by the NBK and it has served EBRD well: bonds have become the main funding instrument of the Bank in Kazakhstan. However, the domestic placement of bonds issued under offshore regulations introduces a regulatory risk.

The EBRD bond issuances in KZT supports the building of an efficient domestic financial market.

Although large by regional standards, the Kazakh bond market remains relatively shallow, even in government bonds. The corporate bonds market is dominated by private placements of large companies, often in USD. Long term issuances (7 years and above) are done by the Ministry of Finance, but buyers are very few and trading on the secondary market remains limited. The EBRD issuances provide a 3-year maturity high quality paper (AAA rated) which insurance companies are keen to include in their balance sheets as a sign of stability. EBRD, as a large issuer on the market, effectively fills a gap and helps build the medium-term bond market in this way. And finally by issuing in the domestic market, the Bank becomes acquainted with, and highlights the issues that need to change in the capital market in order to service an investor base that exists.

Table 3: EBRD bonds issued 2016-2024

Issued	Ccy	Amount	Coupon	Maturity
16-09-2024	KZT	5,000,000,000	10.00% Notes	1 October 2025
31-07-2024	KZT	2,500,000,000	10.50% Notes	31 July 2025
08-07-2024	KZT	10,000,000,000	11.50% Notes	10 July 2025
26-03-2024	KZT	9,400,000,000	Floating Rate (TONIA Index Linked +0.00%) Notes	28 March 2029
06-02-2024	KZT	33,500,000,000	Floating Rate (TONIA Index Linked +0.00%) Notes	8 February 2027
19-12-2023	KZT	40,000,000,000	13.60% Notes	21 December 2025
24-10-2023	KZT	14,100,000,000	Callable Amortising Fixed Rate Notes (14.00%)	24 October 2026
15-08-2023	KZT	8,900,000,000	Callable Amortising Fixed Rate Notes (14.00%)	17 August 2026
28-06-2023	KZT	5,000,000,000	13.50% Notes	15 July 2024
14-06-2023	KZT	6,500,000,000	13.00% Notes	16 June 2025
12-05-2023	KZT	5,000,000,000	13.50% Notes	15 July 2024
28-04-2023	KZT	5,000,000,000	13.50% Notes	15 July 2024
26-04-2023	KZT	15,000,000,000	13.50% Notes	28 April 2025
24-03-2023	KZT	7,500,000,000	10.00% Notes	28 March 2026
21-02-2023	KZT	48,500,000,000	Floating Rate (TONIA Index Linked +0.90%) Notes	23 March 2024
15-11-2022	KZT	16,000,000,000	15.35% Notes	17 November 2024
09-11-2021	KZT	12,500,000,000	Floating Rate (TONIA Index Linked +0.00%) Notes	11 November 2024
07-04-2021	KZT	5,000,000,000	7.50% Notes (payable in USD)	9 April 2023
04-12-2020	KZT	60,000,000,000	CPI linked (+1.00%)	8 December 2029
10-11-2020	KZT	80,000,000,000	CPI linked (+1.00%)	12 November 2024
17-08-2020	KZT	60,000,000,000	CPI linked (+1.00%)	19 August 2028
13-12-2019	KZT	58,000,000,000	CPI linked (+0.75%)	19 December 2027
13-12-2019	KZT	58,000,000,000	CPI linked (+0.75%)	19 December 2026
16-07-2019	KZT	60,000,000,000	CPI linked (+0.50%)	18 July 2027

19-06-2019	KZT	60,000,000,000	CPI linked (+0.50%)	21 June 2026
14-05-2019	KZT	2,500,000,000	7.00% Notes	24 April 2020
13-05-2019	KZT	60,000,000,000	CPI linked (+0.50%)	15 May 2025
30-04-2019	KZT	5,500,000,000	7.00% Notes	24 April 2020
23-04-2019	KZT	60,000,000,000	CPI linked (+0.50%)	25 April 2024
18-04-2019	KZT	3,000,000,000	7.00% Notes	24 April 2020
26-02-2019	KZT	20,000,000,000	CPI +100bps Notes	28 February 2026
22-06-2018	KZT	1,700,000,000	7.00% Notes	24 April 2020
13-06-2018	KZT	1,050,000,000	7.00% Notes	24 April 2020
14-05-2018	KZT	1,750,000,000	7.00% Notes	24 April 2020
20-04-2018	KZT	3,500,000,000	7.00% Notes	24 April 2020
30-01-2018	KZT	7,000,000,000	Zero coupon (accrual yield 6.900%)	31 January 2019
13-12-2017	KZT	50,000,000,000	CPI linked (+0.025%)	15 December 2021
14-11-2017	KZT	4,000,000,000	Zero coupon (accrual yield 7.375%)	10 May 2019
07-11-2017	KZT	17,500,000,000	Zero coupon (accrual yield 7.375%)	10 May 2019
12-10-2017	KZT	30,000,000,000	CPI linked (+0.025%)	21 November 2021
12-10-2017	KZT	30,000,000,000	CPI linked (+0.025%)	15 December 2021
02-10-2017	KZT	15,000,000,000	CPI linked (+0.025%)	15 December 2021
02-10-2017	KZT	15,000,000,000	CPI linked (+0.025%)	21 November 2021
27-03-2017	KZT	10,000,000,000	FRN 91d KZT Tbill -1.15%	29 September 2019
17-02-2017	KZT	11,350,000,000	FRN 91d KZT Tbill -1.30%	21 February 2019
03-02-2017	KZT	3,300,000,000	FRN 91d KZT Tbill -1.30%	7 February 2019
27-05-2016	KZT	2,400,000,000	10%	01 June 2018
17-11-2016	KZT	34,000,000,000	CPI linked (+0.025%)	21 November 2021
13-12-2016	KZT	34,000,000,000	CPI linked (+0.025%)	15 December 2021

Source: EBRD <https://www.ebrd.com/bonds-issued.html>

2.3 High KZT lending volume driven by infrastructure and long-term loans, but faces competitiveness challenges in other sectors

Kazakhstan's shift to LCY use has been driven by currency volatility and regulatory measures

The Tenge (KZT) has gradually become the currency used in economic transactions in Kazakhstan. On 15 November 1993, Kazakhstan introduced the tenge as its national currency. From its creation to 2014, it enjoyed prolonged periods of stability followed by sharp devaluations, the latest in 2015, when it lost nearly 85 percent of its value against the USD.³⁶ Since then, fluctuations have been less pronounced but nevertheless significant. During the evaluation period (2016-2023), the KZT lost 25 percent of its value against the USD, and again 17 percent in the year 2024 alone. This regular depreciation has made Kazakh clients wary of borrowing in hard currencies, which could end up being very expensive in spite of the apparent attractive interest rate differential. Having become FX risk averse, they are prepared to pay more for a financing which hedges their financial risk and borrow in KZT. Today about 88 percent of loans are denominated in KZT,³⁷ although about one third of deposits remain in USD/EUR, still considered a safe haven by retail depositors.

The de-dollarisation of the economy was encouraged by the regulator. The NBK introduced stricter requirements for foreign currency denominated loans provided by banks (including a 100% provisioning of FX loans to borrowers who do not have export revenues) and microfinance organizations (barred from lending in FX altogether). The regulator has imposed a one percent cap on interest paid on USD/EUR deposits. It is now forbidden to price or advertise products in foreign currency when only a few years ago

³⁶ For an overview of the history of the tenge vs US dollar, please see <https://en.inform.kz/news/diving-deep-into-the-history-of-us-dollar-and-kazakh-tenge-dynamics-4421b3/>

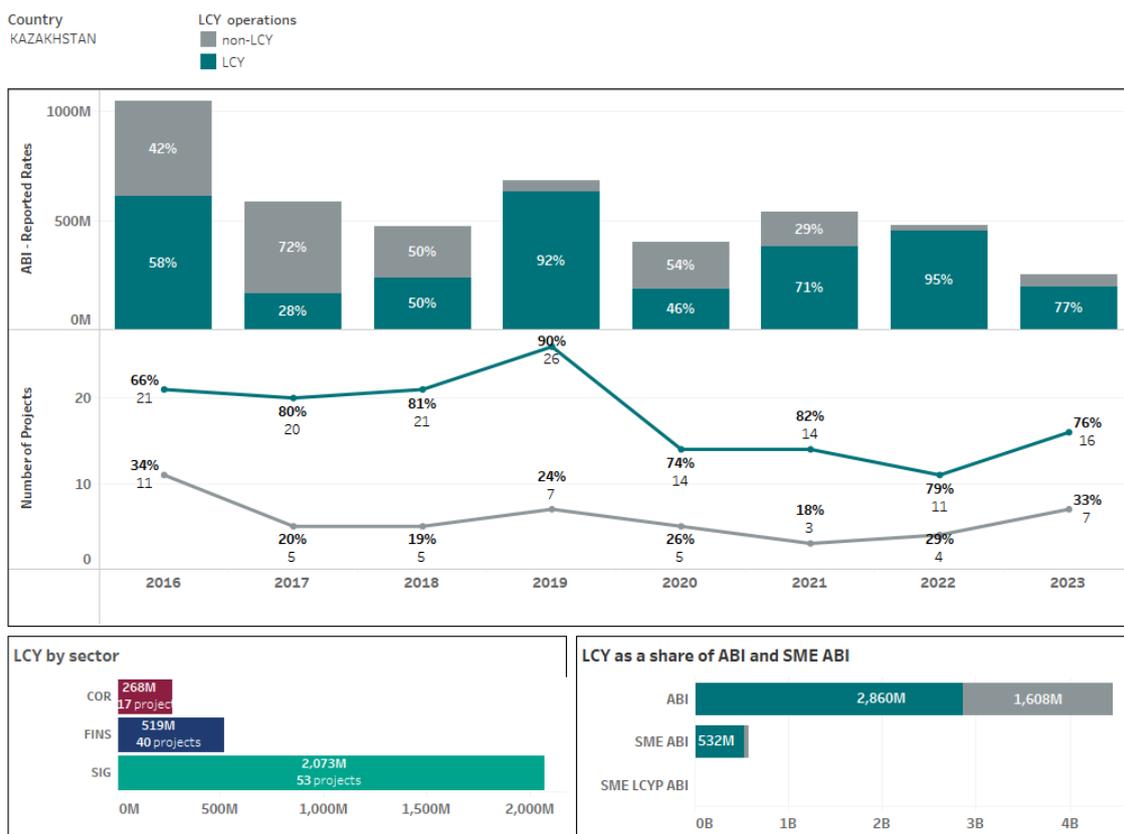
³⁷ According to NBK statistics as of 31.12.2024, 73% of loans to businesses are denominated in KZT and nearly 100% to individuals. This makes a weighted average of 88%. Source: <https://nationalbank.kz/en/news/kredity-bankovskogo-sektora-ekonomike>

the price of flats, cars, was quoted in FX. Finally, the relatively large subsidised programmes run by Government agencies function exclusively in local currency. In light of this, the public has gradually started thinking in Tenge terms.

Kazakhstan leads EBRD LCY financing, with exceptional share in the infrastructure sector

In this context, EBRD has managed to build a considerable portfolio denominated in KZT, particularly in the infrastructure sector. In the Infrastructure sector, for natural monopolies and regulated business entities with revenues in KZT, it is of paramount importance to have LCY funding so that they are not subject to foreign exchange risk. LCY funding is much more expensive than hard currency one, but at the same time due to the past history of devaluations, local entities are keen to have local currency funding. EBRD has been trying to ensure that it could offer this liquidity in LCY to the clients.

Figure 7: Kazakhstan LCY financing, 2016-23



NB: ABI includes debt and guarantees only, equity excluded; LCY financing data is based on LCY flag.

The total LCY ABI in Kazakhstan was €2.9bn over the 2016-23 period, representing 64% of overall debt ABI. Kazakhstan is the largest country in terms of LCY ABI proportion in the countries within the scope of this evaluation. Kazakhstan also stands out in terms of LCY financing in the infrastructure sector (€2bn), representing the largest LCY sector in Kazakhstan. LCY lending in Kazakhstan did not benefit from the SME LCYP subsidy, as the country only joined in 2024.

The renewable energy sector has offered EBRD a large business opportunity, extending long term financing in KZT. The existing financial risks of investors in the renewable energy market associated with the volatility of the Tenge against the US dollar, led in 2016 to the introduction of a tariff indexation system: 70 percent linked to CPI and 30 percent to USD. Following the introduction of the auction system in 2018, and the necessity to attract foreign investors, the opposite formula applied, i.e. 70 percent linked to USD and 30 percent to the CPI. These indexation mechanisms have led to projects being financed as a combination of USD and KZT. EBRD got involved early in policy dialogue initially with the legal and regulatory framework and then 10 years ago with the first project. Today the Bank is the largest investor in the renewables sector, effectively creating that market on the project and financing side.

LCY lending to FIs demonstrated strong adaptation to market conditions, though with some limitations on growth potential. Large lending to FIs in USD collapsed after 2009, and most FI business after 2009 was in TFP guarantees, while LCY lending was picking up volumes. In 2016, FI LCY lending reached €73m ABI. All FI lending is now conducted in LCY. FI clients have a preference for fixed rates driven by regulatory requirements that limit sub-borrower rate increases to once annually, EBRD's market penetration remains constrained by sector concentration and ownership issues. Commercial banks that were previously frequent borrowers now rely primarily on deposits and state funding, with EBRD's exposure limited to 5-10% of liabilities for bank partners and around 7% for microfinance institutions. Though these arrangements have enabled EBRD to maintain annual business volumes of over €100m in the FI sector, future growth potential will likely depend on changes in ownership structure of major banks and possible diversification into new products like bond investments.

Despite Kazakhstan's strong LCY demand, EBRD faces competitiveness challenges in both corporate and SME sectors

Kazakhstan's bond market, dominated by quasi-sovereign entities, provides critical long-term financing for large corporations while commercial banks focus on smaller enterprises and individuals. The bond market is relatively large and more active than in other countries of operation but dominated by quasi-sovereign issuers, SOEs or government funds. At the equivalent of \$35bn, the corporate bond market is almost as large as the government bond market. It is over three times the size of the commercial loan market. The corporate bond market services the blue chips which are dominated by state-owned enterprises in the extractive industries. It provides the long term funding at attractive terms that these blue chips require. Commercial bank lending tend to focus more on medium-sized enterprises and individuals, or relay State-subsidised lending available to SMEs.

In recent years, EBRD struggled to be competitive in KZT in the corporate sector. The prevalence of large export-oriented groups creates a natural demand for hard currency financing in the corporate sector. These large corporations often require USD or EUR in keeping with their export sales revenues or the indexation on USD of the commodities they sell. Only two EBRD corporate clients (out of 5-6) use LCY. EBRD interest rates in KZT are higher than what local banks are offering, because those can fund cheaply from their deposits and remain over-liquid. In addition, EBRD has special requirements linked to Transition Impact and the environment, and its processes for approval are seen as slower and sometimes bureaucratic, even for simple requests. This makes EBRD less attractive overall. One possible solution is to use Risk Sharing Facilities with partner banks. However, large corporates are less likely to follow this route and rather would use the quicker and easier route of going with their local banks.

There is historically a high level of financial subsidies flowing to the private sector, making it more difficult for EBRD to compete in the SME segment. State organisations like Baiterek Holding have programmes which allow companies in the SME sector (DAMU) or agricultural sector (AgroCredit Corporation) to get subsidized funding over sometimes long tenors (7 years in the case of DAMU). The government has started to realise that it is a drag on the budget and that there are adverse economic effects of these interventions, like market distortions. It is considering reducing budget contributions to these programmes by attracting financing from external sources. In the meantime, the SME LCYP can provide a solution to the lack of competitiveness of EBRD in this segment – Kazakhstan joined in 2024 (outside of the evaluation period).

EBRD's LCY financing evolved from inflation-indexed to money market-based instruments, creating a disconnect between Treasury approach and some client needs

EBRD's lending in Kazakhstan has undergone significant structural changes in its reference rate approach since 2016, reflecting adaptation to market conditions and policy priorities. Starting with the first CPI-indexed loans in 2016, the Bank transitioned from central bank rate linkage to inflation indexing in 2019. In the first quarter of 2019 Treasury proactively transitioned a number of clients' KZT denominated loans from a central bank interest rate linkage to KZT inflation index. The change of funding basis was triggered by the cancellation of the Repo facility with the NBK with nine months' notice.^{38,39}

Market conditions in 2022 created challenges for EBRD's CPI-linked portfolio in Kazakhstan, leading to a temporary contraction in lending. The reversal of the traditional positive real interest rate environment to negative real rates (from +3% to -3%) following high inflation triggered client prepayments and reduced

³⁸ CS/FO/17-14: Annual Report on Treasury Activities: 2016/2017

³⁹ CS/FO/19-30: Annual Report on Treasury Activities 2018/2019

new lending appetite, resulting in a €29 million portfolio reduction. However, this setback was partially reversed in 2023 as inflation moderated, with Operating Assets increasing by €33 million.^{40,41}

The reliance on TONIA for funding is sometimes at odds with clients' wishes. The CPI-linked financing remains in high demand, for example by the renewable energy companies or the utilities whose tariffs are indexed to inflation. For them, it forms a perfect hedge. For that reason it could be beneficial to have the optionality of CPI-linked vs TONIA-linked funding which today is no longer offered by EBRD Treasury.

The cost of funds structure in LCY remains difficult to explain to clients. When EBRD quotes a price, it adds a credit margin on top the cost of funds communicated by Treasury. This cost of funds is composed of a published index, which is easily verifiable, and a “spread” which does not depend on the client but varies according to market circumstances. Clients understand the EBRD pricing structure as far as cost of funding (TONIA, CPI-linked) and credit margin is concerned. They do not understand the spread charged by Treasury over the index.

EBRD's LCY financing offers additionality through long-term lending in a market gap

True long term lending in KZT remains scarce in Kazakhstan and this is a source of additionality for EBRD. Local banks finance mostly short term, working capital loans are limited to one year. EBRD provides longer working capital loans, which gives comfort to clients to smooth their cash flows. Capex projects also benefit from EBRD's longer grace periods and tenors since construction periods are elongated due to the harshness of the winter. In the infrastructure segment, local banks cover short to medium term maturities up to three to five years financing, where EBRD is not present. However, medium-term tenors provided by local banks are often one-year loans rolled over, meaning the banks are not actually committed. During the crisis of 2015, banks simply cancelled their loans, leaving only the Development Bank of Kazakhstan and EBRD providing finance during that period. EBRD is clearly additional providing longer LCY tenors in Kazakhstan. However this comes at a cost since the committed funds that EBRD is providing appear more expensive than what local banks propose.

Other sources of additionality are real but not specific to LCY lending. During interviews, EBRD counterparts have mentioned the halo effect provided by EBRD's name and its reputation for thorough due diligence which acts as a form of certification for clients. Occasionally, protection from political interference has been mentioned. The long-term and stable relationship offered by EBRD is also valued by certain clients, especially among banks. Alongside loans and credit lines, EBRD provides technical assistance in the areas of Fintech, risk management, secondary sanctions risk, which is appreciated and additional for FI clients. Finally, some foreign clients prefer dealing with an international organisation like EBRD rather than local banks. However, none of these additionality factors are specific to LCY financing.

⁴⁰ CS/FO/23-09: Annual Report on Treasury Activities in 2022

⁴¹ CS/FO/24-16: Annual Report on Treasury Activities in 2023

DATA ANNEX

Context

Economic context

Kazakhstan's economic growth moderated to 3.2% in early 2024, with strong performance in manufacturing and trade but stagnation in mining.⁴² Growth is projected to reach 4% in 2024, driven by expansion projects like the Tengiz oil field, but risks include dependency on Russian transit infrastructure and global commodity volatility.⁴³

The tenge experienced modest appreciation against the US dollar in 2024 due to higher foreign exchange sales by the National Fund. However, it slightly depreciated later, aligned with a reduction in transfers from the National Fund. Foreign reserves remain robust at \$41.8 billion, covering approximately six months of imports, reinforcing currency stability and debt resilience.⁴⁴

Kazakhstan's monetary policy has navigated severe inflationary pressures during 2021-2024, demonstrating increasing policy effectiveness despite significant external shocks. From an initial breach of the 4-6% target in 2021 at 8.4%, inflation surged to 20.3% in 2022 due to the Ukraine war's impact and tenge depreciation, prompting aggressive monetary tightening with rates reaching 16.75%. The NBK's decisive response, combining interest rate hikes with new regulations, proved effective - inflation fell to 9.8% by December 2023 and further to 8.6% by July 2024, allowing gradual policy rate reduction to 15.75% to support growth while maintaining price stability..⁴⁵

Fiscal policy faces ongoing challenges, with the budget deficit projected at 2.6% of GDP in 2024 due to elevated spending and lower revenue collection.⁴⁶ Public debt increased by 5.8% in the first half of 2024, supported by solid reserves but underscoring the need for better fiscal management. The draft 2025 budget targets a similar deficit while seeking to improve tax mobilization.

Kazakhstan's structural reforms emphasize economic diversification and green investments, aligning with its National Development Plan. The plan, launched in 2024, aims to double GDP by 2029, with significant investments in education, healthcare, and green technology. Additionally, Kazakhstan joined the Global Methane Pledge to bolster decarbonization, and renewables now make up 6.5% of energy generation.⁴⁷

Box 2: Kazakhstan – macroeconomic dashboard

- **Overview: navigating economic shifts and global pressures**
 - Kazakhstan has weathered several global disruptions during the evaluated period, maintaining a steady economic trajectory despite external challenges. The country's economic structure, heavily reliant on energy exports, has been diversified in recent years, with notable growth in sectors like agriculture and manufacturing.
 - From 2016 to 2023, the country experienced moderate growth, supported by favourable energy prices and successful reform programs. In 2022, Kazakhstan saw a strong recovery, boosted by increased demand for oil and a resurgence in key export markets.
 - Moving forward, the IMF projects a growth rate of 3.5% by YE-2024, driven by continued reforms aimed at stabilizing the economy and fostering investment in non-energy sectors. The government's strategy of building a more resilient and diversified economy will be critical to long-term stability
- **Economic growth**
 - GDP growth is projected at 3.5% for 2024, following robust growth rates of around 4.5% in 2022.
 - The evaluation period from 2016 to 2023 saw Kazakhstan benefit from high oil prices, which supported strong growth, though recent global economic uncertainties have moderated expansion.

⁴² IMF (2024). World Economic Outlook, October 2024.

⁴³ EBRD (2024). Transition Report.

⁴⁴ IMF (2024). Global Financial Stability Report, October 2024.

⁴⁵ IMF (2024). World Economic Outlook, October 2024.

⁴⁶ IMF (2024). Fiscal Monitor, October 2024.

⁴⁷ EBRD (2024). Transition Report.

- The economy continues to diversify, with growth now more evenly spread across non-oil sectors, including agriculture and services, which are expected to sustain future growth.

Inflation and real interest rates trends

- Inflation reached a high of 10% in 2022 but dropped to below 5% in 2023. The National Bank of Kazakhstan raised interest rates to 4% in response, aiming to stabilize inflation and maintain economic confidence.
- Inflation is projected to remain under control with a targeted rate of around 5%, supported by proactive monetary policies.

Fig.1 Real interest rate vs. inflation, 2014-23



Source: IMF- International Financial Statistics (2024).

Financial sector developments

- Dollarization remains a concern, although progress has been made with a steady decrease in foreign-currency-denominated loans (Fig. 2). The banking sector’s exposure to foreign currency risk is still notable but has improved.
- The narrowing of the interbank rate spread (Fig. 3) indicates improved liquidity and reduced risk premiums, suggesting more favourable lending conditions.
- The interest rate spread (Fig. 4) remains stable, reflecting a competitive banking environment and relatively low risk for domestic borrowers.

Fig.2 Foreign-currency-dominated loans to total loans, 2014-23



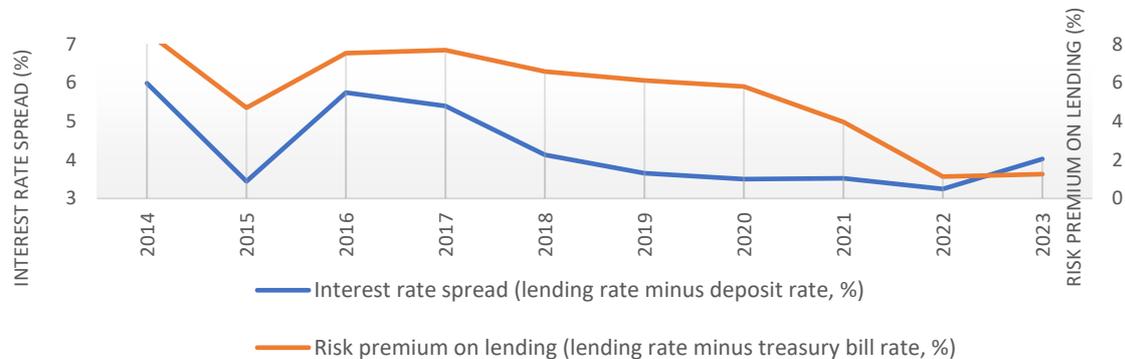
Source: IMF-Financial Soundness Indicators (2024).

Fig.3 Spread between highest and lowest interbank rates (base points), 2014-23



Source: IMF-Financial Soundness Indicators (2024).

Fig. 4 Interest rate spread vs. risk premium on lending, 2014-23

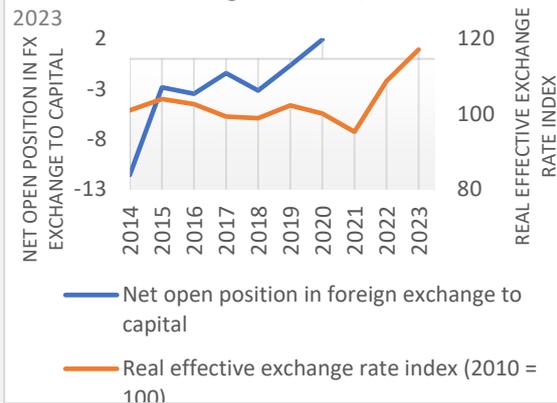


Source: IMF- International Financial Statistics (2024).

- **Foreign exchange risks**

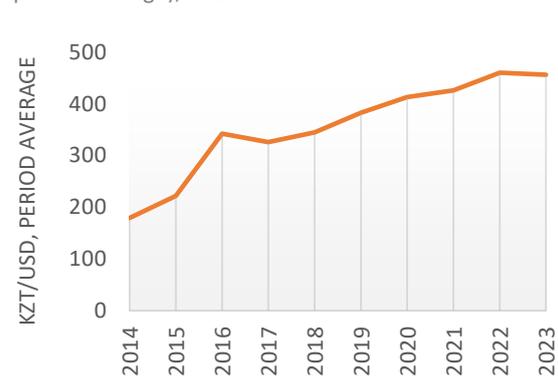
- The country has seen a gradual increase in its net open position in foreign exchange to capital (Fig. 5), signalling heightened exposure to currency risk. This, alongside a rising Real Effective Exchange Rate (REER), suggests greater vulnerability to exchange rate fluctuations, especially as the tenge appreciates.
- While the stability of the official exchange rate (Fig. 6) has been maintained, further exchange rate appreciation could impact export competitiveness.

Fig.5 Net open position in FX to capital vs. real effective exchange rate index, 2014-2023



Source: IMF-International Financial Statistics (2024).

Fig.6 Official exchange rate (KZT per US\$, period average), 2014-23



Source: IMF-International Financial Statistics (2024).

- **Outlook**

- Kazakhstan's economy is projected to grow by 3.8% in 2024, with oil production and ongoing structural reforms driving expansion.
- Efforts to diversify the economy, particularly in technology and manufacturing, will continue to reduce the country's dependence on oil.
- External risks, including geopolitical tensions and potential global economic challenges, remain a concern for future growth but are mitigated by continued reforms and fiscal policies aimed at stabilizing the economy.

Notes on Figures:

Fig.1 Real interest rate is the lending interest rate adjusted for inflation as measured by the GDP deflator. The terms and conditions attached to lending rates differ by country, however, limiting their comparability. **Inflation** as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly. The Laspeyres formula is generally used.

Fig.2 Foreign-currency-denominated loans to total loans measures deposit takers' exposure to exchange rate risk, indicating the portion of total loans that are in foreign currency. It is a proxy for foreign currency exposure/dollarisation.

Fig.3 Spread between highest and lowest interbank rates (base points) indicates perceived risk in interbank lending, reflecting the cost and risk premiums deposit takers' face.

Fig.4 Interest rate spread (lending rate minus deposit rate, %) is the interest rate charged by banks on loans to private sector customers minus the interest rate paid by commercial or similar banks for demand, time, or savings deposits. The terms and conditions attached to these rates differ by country, however, limiting their comparability.

Fig.5 Net open position in foreign exchange to capital indicates deposit takers' exposure to foreign currency risk by comparing net foreign currency positions to capital. It is intended to identify deposit takers' exposure to exchange rate risk relative to capital. The capital here refers to total regulatory capital. It is a proxy of the vulnerability of the banking sector to foreign exchange shocks.

Fig.6 Official exchange rate refers to the exchange rate determined by national authorities or to the rate determined in the legally sanctioned exchange market. It is calculated as an annual average based on monthly averages (local currency units relative to the U.S. dollar).

References:

[Republic of Kazakhstan and the IMF](#)

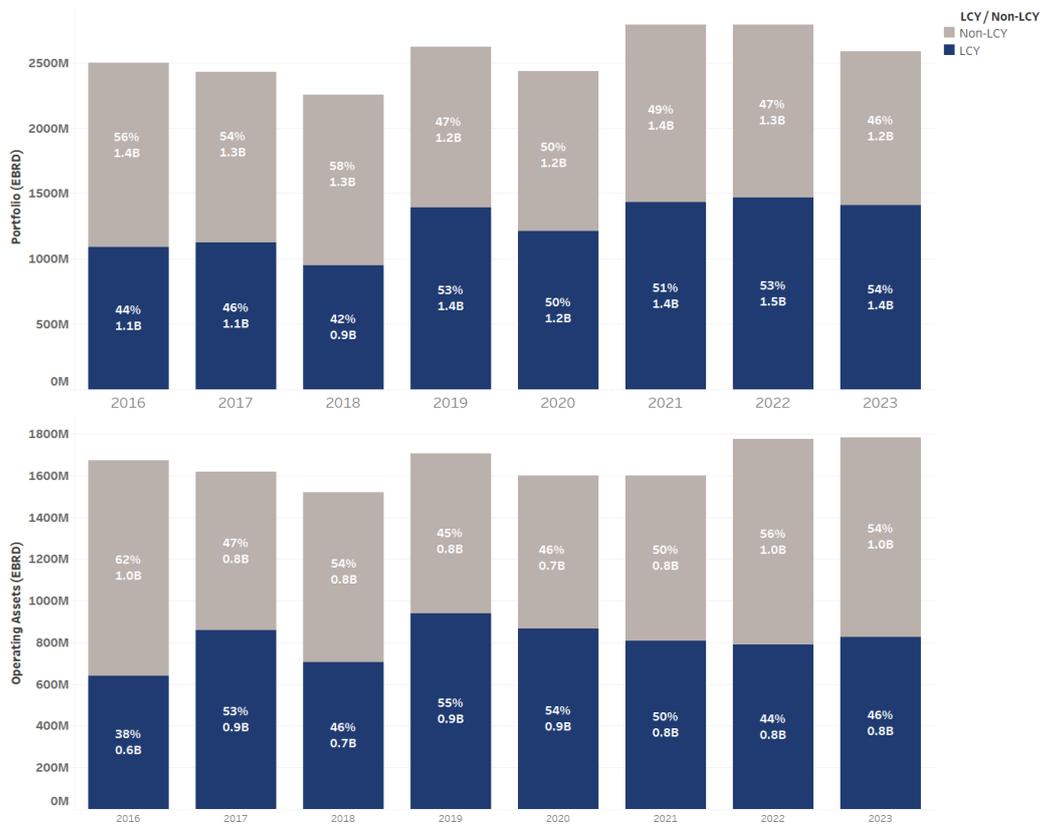
[Kazakhstan Overview: Development news, research, data | World Bank](#)

Table 4: Country context dashboard

Indicator name	Indicator value, year of measurement	Indicator source
Policy		
Exchange rate arrangement	Floating	IMF (2023)
Monetary policy framework	Inflation targeting framework	IMF (2023)
EBRD Financial Markets Development Index (FMDI)		
Money Market Pillar Score	2014: 9.9	EBRD CFMD (2024)
	2020: 23.3	
	2022: 37.24	
Reliable benchmark (no/yes) [0,1]	Yes [1]	EBRD CFMD (2024)
Benchmark used by market participants (MOF, IFIs, local banks) [0,1]	Yes [1]	EBRD CFMD (2024)
CCY Basis swap/Interest Rate Swap curves on Bloomberg or Thomson Reuters Eikon priced out of the benchmark [0,1]	No [0]	EBRD CFMD (2024)
FI LCY bonds: Aggregate outstanding nominal of corporate bonds issued by banks or financial institutions with maturity of more than 1 year issued in LCY as a share of GDP (USB, bn)	2020: 13.98 2021: 4.64 2022: 4.31	Cbonds (2023), provided by CFMD team
Corporate LCY bonds: Aggregate outstanding nominal of corporate bonds (excl. issued by banks or financial institutions) with maturity of more than 1 year issued in LCY (USD) as a share of GDP (USB, bn)	2020: 3.97 2021: 9.30 2022: 9.16	Cbonds (2023), provided by CFMD team

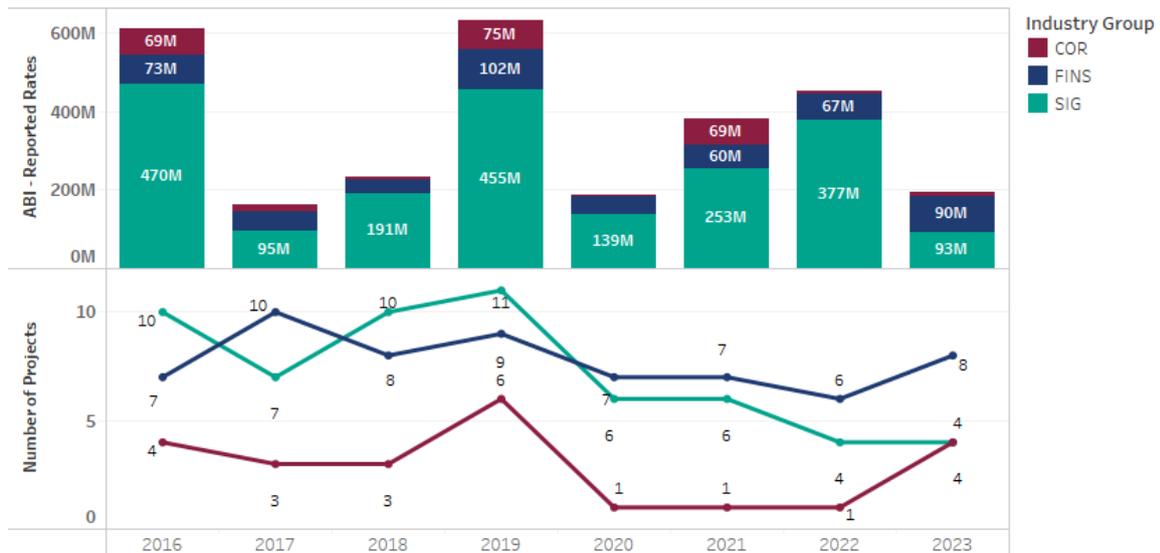
EBRD LCF financing

Figure 8: LCY operations as a share of portfolio and operating assets, 2016-2023



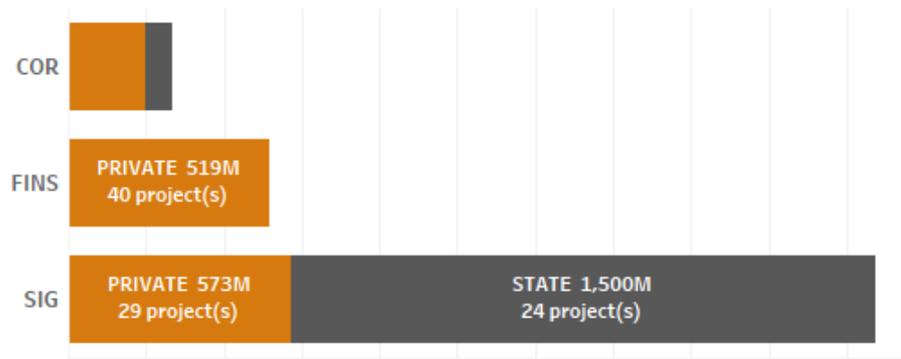
Source: dw_banking_operational dataset

Figure 9: LCY ABI and number of projects by sector, 2016-2023



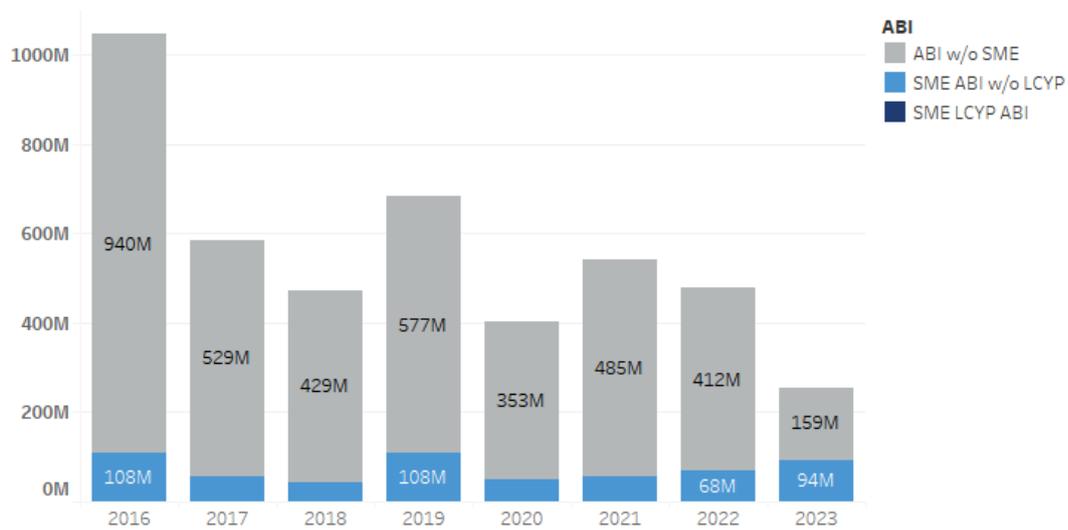
Source: dw_banking_operational dataset

Figure 10: LCY ABI and number of projects by portfolio class, 2016-2023



Source: dw_banking_operational dataset

Figure 11: Share of SME LCYP in SME ABI, 2016-2023



Source: ABI includes debt and guarantees only, equity excluded; source of data dw_banking_operational; SME ABI identified based on SME flag at OpID level; LCYP ABI based on the "Local currency risk sharing" product indicator

Morocco

Country case study

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Abbreviations

BAM	Bank Al-Maghrib	MAD	Moroccan Dirham (currency)
AEB	Agreement Establishing the Bank	MM	Money Market
AMMC	Autorité Marocaine du Marché des Capitaux	MMDF	Money Market Diagnostics Framework
BCP	Banque Centrale Populaire	MMWG	Money Market Working Group
BMCE	Banque Marocaine du Commerce Extérieur	MONIA	Moroccan Overnight Index Average
CS	Country Strategy	OIS	Overnight Index Swap
DFF	Direct Financing Framework	OTC	Over-the-counter market
EFSD	European Fund for Sustainable Development	PPO	Priority Policy Objectives
FMDI	Financial Market Development Index	SGG	Secrétariat Général du Gouvernement
GEFF	Green Economy Financing Facility	SME LCYP	SME Local Currency Programme
IOSCO	International Organization of Securities Commissions	TFP	Trade Facilitation Programme
ISDA	International Swaps and Derivatives Association	TMP	Taux Moyen Pondéré
LCF	Local currency financing	WiB	Women in Business
LCY	Local currency		

Summary

Strategic priorities were well-designed but faced implementation challenges in policy reform component. The 2015 Country Strategy for Morocco accurately diagnosed key market constraints around local currency financing and set relevant priorities across funding capabilities and policy reforms to address them. While EBRD largely succeeded in implementing operational priorities around expanding LCY financing through innovative funding approaches and management of liquidity, progress on policy objectives remained limited, leading to their continuation in the 2024 Strategy albeit with less specific articulation of reform goals.

Progress in EBRD's funding capabilities played a catalytic role in expanding LCY financing in Morocco, even without full policy reform implementation. Treasury's shift from back-to-back financing to maintaining a MAD liquidity pool enabled more competitive pricing and flexible terms for clients, leading to significant growth in LCY financing from virtually none in 2016 to 79% of debt ABI in 2024. This progress was achieved despite incomplete policy reforms, suggesting that funding innovation can create momentum for business development.

The growing business volume now reveals the limitations of relying primarily on funding management without corresponding policy progress. While Treasury successfully established itself as the only IFI actively participating in Morocco's money market, EBRD growing LCY business volume now faces constraints due to limited cross-currency swap capacity and inability to issue domestic bonds. These limitations stem from pending policy reforms, particularly around derivatives legislation and IFI bond issuance regulations, highlighting how incomplete policy progress can ultimately constrain funding capabilities and thus LCY financing growth.

Mixed results in policy reform created only partial enabling conditions for market development. The successful introduction of the MONIA index through the Money Market Working Group represents tangible progress in establishing market infrastructure, though its adoption by banks remains limited. However, other key reforms – including derivatives legislation, tax treatment, and enabling IFI bond issuance – remain pending despite years of engagement. This incomplete policy progress creates a ceiling effect, where funding innovations alone cannot fully overcome structural market limitations.

1 Country context

Money market⁴⁸

Morocco implements pegged exchange rate within horizontal bands. It is the only country classified as such by the IMF.⁴⁹ Morocco tracks a euro and US dollar basket weighted, respectively, at 60% and 40%. Bank Al-Maghrib (BAM) is implementing exchange rate policy in connection with the exchange regime. The limit exchange rates for the fluctuation band around the central rate of the basket have been (+) and (–) 5% since March 2020.

The active money market segments are the unsecured interbank market, the repo market, and the secondary government securities market. Banks are active in all of these market segments, but the repo market is also a major conduit for the financial intermediation of savings through the non-bank financial firms, resulting in high transaction numbers. The annual turnover is highest in the unsecured interbank and the repo market due to the very short-term tenors where counterparty risk is considerably lower than on term transactions, but turnover is also sizeable in the secondary government securities market. Further development of repo markets requires the adoption of the derivatives law.⁵⁰

The regulation on derivatives drafted in 2016 with EBRD contribution has not yet been adopted. When adopted, the law would foster the development of OTC transactions and repo operations. EBRD's potential expansion to sub-Saharan Africa and the ongoing efforts to bring the capital markets framework closer to international standards could support the authorities' efforts to position Morocco as a financial hub for Africa.⁵¹

Morocco has improved its score of the Money Market pillar of the Financial Market Development Index (FMDI) over the evaluation period but dropped since 2020. The FMDI is a composite index that aims to measure the development of capital markets, money markets and derivative markets in EBRD COOs. The

⁴⁸ Morocco – Financial Market Country Brief; CFMD

⁴⁹ IMF 2023: Annual report on exchange arrangements and exchange restrictions 2022

⁵⁰ Morocco – Financial Market Country Brief; CFMD

⁵¹ Morocco – Financial Market Country Brief; CFMD

index is designed and maintained by the CMFD team. Each sub-index is itself a composite of a number of indicators.⁵²

EBRD strategy & priorities

Support for diversification of financial instruments and capital markets development was part of the country strategy covering the entirety of the evaluation period. The Country Strategy for Morocco adopted in 2015⁵³ was not replaced by another Strategy until 2024. The Strategy recognised the EBRD's own challenges in the previous period in doing business in the country, including *'the Bank's inability to lend in local currency in an environment of very tight currency exchange restrictions that prevent number of companies from borrowing in foreign currency.'* The strategic objective of *Facilitating access to finance, in particular for SMEs*, emphasised direct and indirect lending, where possible in *local currency*. In addition, a strategic priority was dedicated to Capital Markets Development, with two objectives – *Broadening the range of financial instruments*, including local currency lending, and *Supporting equity and bond market liquidity*.

The Strategy included priorities on policy support to regulatory environment to facilitate the expansion of local currency lending. The Strategy noted that the primary market has several weaknesses, including: (i) absence of a reliable benchmark government yield curve to determine “risk-free” interest rate levels; (ii) absence of price differentiation among different corporate bonds, which largely ignores credit quality considerations or the bond's structures and seniority. In response, as part of the Deauville Partnership⁵⁴ initiative and the agreed allocation of activities among IFIs, EBRD would *support the Ministry of Finance in establishing a regulatory framework allowing for the enforceability of close-out netting and opening the market to OTC derivatives*. The potential inability to fund local currency was recognised as a risk to EBRD implementation: *'EBRD's ability to provide local currency finance will be conditioned on access to local currency funding. Slow progress in the development of local capital markets and/or an absence of market-based instruments such as currency swaps would pose risks to the delivery of part of EBRD's projects.'*

The current Country Strategy from 2024⁵⁵ continues to prioritise local currency finance including related policy. The new Strategy includes objective of *Strengthening resilience via further development of capital markets and local currency products*. While the anticipated activities largely focus on the broadening and deepening of capital markets as an alternative source of finance, local currency financing is also prioritised. Related policy in terms of continued policy engagement and capacity building with the Ministry of Economy and Finance, Central Bank and Capital Market Authority is noted, without outlining specific policy objectives.

Relevant priorities as described in the capital markets brief for 2024 and beyond⁵⁶

- Continue working with MMWG on **promoting the usage of MONIA** by market participants. Following the MAD FX liberalisation, the need for floating rate instruments including interest rate derivatives linked to a robust benchmark. [Ongoing PD, led by Treasury]
- Pursue efforts with the MoF for the **adoption of a new derivatives legislation** [Ongoing PD].

2 Findings

2.1 Some progress on market development but fundamental reforms remain pending

Policy framework well established under LCYP

Morocco joined the SME LCYP in 2017. EBRD signed the prerequisite MoU with the Ministry of Economy and Finance and the Central Bank (Bank Al-Maghrib) in September 2017. The MoU contained a Co-operation and Action Plan with the objectives of promoting LCY usage and local funding and capital markets. The AP mentions Morocco's monetary policy *'evolving towards inflation targeting'*, and the following actions:

- Strengthening of the banking sector stability through the re-definition of a money market index

⁵² The Methodology of the FMDI design and calculation is described in the 2021-22 Transition Report: <https://2021.tr.ebrd.com/financial-market-development/>

⁵³ BDS/MR/14-1 (Final): Strategy for Morocco

⁵⁴ <https://www.ebrd.com/deauville-partnership.html>

⁵⁵ BDS/MR/23-01 (Final): Country Strategy for Morocco (2024-2029)

⁵⁶ Morocco – Financial Market Country Brief; CFMD team

- Update of the regulatory framework to ensure that all transactions in the primary and secondary markets are reported in real time to Maroclear
- Development of a yield pricing model for government securities.

EBRD's engagement in Morocco's money market development through the Money Market Working Group (MMWG) started in 2017. The Bank's engagement began in 2017 with the establishment of a Money Market Working Group (MMWG), which was followed in 2018 by missions to implement the Money Market Diagnostic Framework (MMDF) – a comprehensive assessment tool that identified gaps and provided recommendations for enhancing domestic money markets. While the MMWG's early work focused on defining a new risk-free rate, its focus shifted after resuming post-Covid activities in 2022 toward developing the interest rate derivative market, with particular attention to resolving fundamental issues such as derivatives' legal reform and tax treatment through dialogue with the Ministry of Economy and Finance and tax authorities.^{57 58 59 60}

Active policy engagement yielded some progress in a regionally advanced market

EBRD Treasury conducts active policy dialogue in Morocco and has achieved some successes despite challenges stemming from the country's relatively advanced financial sector development and authorities' strong sovereign approach. The Moroccan authorities acknowledge this work although it has sometimes run into difficulties or not led to the expected results. The Bank has come relatively late to Morocco (operations started in 2012). Considering the advanced level of development of the Moroccan market overall, and in particular the sophistication of the banking sector and its exposure to international trends, policy dialogue may have been more challenging. The Moroccan authorities are assertive and display a willingness to remain in control. Since EBRD does not do policy lending and the Moroccan economy shows strength, the EBRD can influence but not prescribe. In spite of this, EBRD has scored a number of successes, with limited financial means but a great involvement of its staff. Those are detailed below.

MONIA Index: successful progress in capital markets but limited banking adoption yet

The EBRD-created Money Market Working Group has emerged as a valuable forum for monetary market dialogue between Moroccan authorities and private sector stakeholders. Among the positives of policy dialogue is the creation of the MMWG in 2017. Ever since, the MMWG has been a forum where the central bank, the Ministry of Economy and Finance, the regulator (AMMC) and the private sector were represented to discuss issues linked to the Moroccan monetary market. Operators acknowledged that the MMWG was a useful tool, evolving gradually from a formal committee to become a true place of exchange of views about the market. EBRD was instrumental in the creation but also in the moderation of the MMWG. The personal involvement of EBRD Treasury staff was widely recognised.

One of the successes of EBRD in Morocco was the creation of the MONIA index. The Moroccan Overnight Index Average (MONIA) is representative of the risk-free rate for overnight money. It is calculated as the average (weighted by volumes) of the interest rate paid by operators in repo transactions which use Treasury bills as collateral. It is published daily by the central bank. MONIA was developed with a decisive contribution from the EBRD Treasury, based on a reliable methodology aligned to IOSCO. This methodology is transparent and published on the Bank Al-Maghrib website.⁶¹ MONIA was officially launched in January 2020.⁶² It has increased liquidity on the repo market. It is used as the reference for derivatives, and as the benchmark for mark-to-market fixed rate instruments. All regulators and operators interviewed for the evaluation have acknowledged that EBRD had been instrumental in promoting this new index, and in supporting its design with advice and TC.

EBRD was not only an adviser but also demonstrated the use of MONIA in a number of transactions. One competitive advantage of EBRD is its concrete involvement in markets and its use of the MONIA. By being an actor, the Bank can test the new tool put at the disposal of the monetary market, showing its faith in it, and demonstrating its use when dealing with banks. The EBRD Treasury linked its cross-currency and interest rate swaps to MONIA in its market operations. This concrete angle is appreciated by operators.

⁵⁷ CS/FO/18-28: Annual Report on Treasury Activities: 2017/2018

⁵⁸ CS/FO/19-30: Annual Report on Treasury Activities 2018/2019

⁵⁹ CS/FO/23-09: Annual Report on Treasury Activities in 2022

⁶⁰ CS/FO/24-16: Annual Report on Treasury Activities in 2023

⁶¹ https://www.bkam.ma/en/content/download/685023/7858447/Termes_reference_MONIA_17122019.pdf

⁶² <https://www.bkam.ma/en/Press-releases/Press-releases/2020/Introduction-of-the-new-monetary-index-monia-moroccan-overnight-index-average>

MONIA represents a significant progress compared to the other indexes used previously but has not yet been fully adopted by the banking market. Market players recognise the introduction of MONIA as an important step forward in the development of Morocco's monetary market even though its acceptance is only gradual. Some mutual funds have adopted it as a benchmark and derivative instruments are based on it. For instance, MONIA will be the index traded in the Overnight Index Swap (OIS) instrument planned on the derivatives market to be launched in the first quarter 2025.⁶³ However, MONIA is less used in the banking sector. Before MONIA, the main reference was the Taux Moyen Pondéré (TMP), calculated as the average of the yields of Treasury bills issuances over various maturities. Despite not being a market rate for the cost of overnight money, the TMP remains the compulsory reference for a number of banking products. As a consequence banks continue using it in floating rate loans, although our counterparts confirmed that its utilisation was declining in favour of MONIA.

Yield curve: the EBRD proposed technical solution was delivered but another solution was finally adopted due to institutional preferences

EBRD's support for developing a sovereign yield curve in Morocco originated as part of the country's 2017 SME LCYP Memorandum of Understanding. The MoU specified the development of a yield curve pricing model for government securities, with the objective of creating tools to model, compute and publish daily reference rates across various tenors.^{64 65} A reliable yield curve provides a pricing benchmark necessary for the development of new products.

The implementation of the yield curve modelling project faced technical and institutional challenges. While technical assistance was provided to both the Ministry of Economy and Finance and Central Bank during 2018-19 as part of broader capital markets reforms, progress stalled at the testing phase. Though consultants completed the model as specified, the Ministry of Economy and Finance made only limited use of it.⁶⁶

The project ultimately reached an impasse. According to internal reporting, this was due to lack of integration with the existing IT infrastructure – a broader technical upgrade that fell outside EBRD's scope of services. However, in the course of the evaluation, the Ministry expressed a preference for a different IT solution to the one proposed in the TC and for maintaining direct oversight of the calculation methodology, noting they would have preferred greater involvement in developing the terms of reference to ensure alignment with their institutional approach. The new methodology adopted by the Ministry, the BAM and the AMMC was finally introduced in March 2023 and published on the central bank website.⁶⁷

Derivatives Reform: EBRD facilitating new dialogues but fundamental reforms remain pending

EBRD's engagement with derivatives reform in Morocco began in 2016 with advisory support to the Ministry of Economy and Finance on the legal framework. At that time, the Bank assisted in preparing draft legislation on derivative transactions that was ready for submission to Parliament, though the reforms were not immediately enacted.⁶⁸

Morocco's derivatives market still needs the finalisation of its legal framework. A well organised derivative market would make the hedging of foreign currencies and interest rates easier, fostering the development of the financial market in general. While derivatives are currently dealt by banks over-the-counter (OTC), the primary constraint on their broader use stems from legal rather than structural limitations. The current legal framework does not adequately cover OTC derivatives, creating regulatory uncertainty that restricts market development. Consultants hired by EBRD drafted a law on derivatives back in 2016, which would address this gap by providing coverage of OTC derivatives transactions. However, this law is still under review by the Secrétariat Général du Gouvernement (SGG), the governmental body screening all laws before they are submitted to Parliament. In the local context, derivatives are touching a number of sensitive areas, like the law on gambling, and are still seen as speculative instruments.

Issues related to derivatives trading are still not solved in spite of EBRD involvement. One of these issues is that Morocco is a “non-netting jurisdiction” in the sense of ISDA Typical derivatives transactions are secured by collateral arrangements between counterparties. When close-out netting and collateral arrangements are legally enforceable, the collateral can be netted against the net value of outstanding

⁶³ This has happened, according to updated Treasury information.

⁶⁴ MoU between the Ministry of Economy and Finance, Bank Al-Maghrib, and EBRD, 2017

⁶⁵ Morocco – Financial Market Country Brief; CFMD team

⁶⁶ Morocco – Financial Market Country Brief; CFMD team

⁶⁷ <https://medias24.com/content/uploads/2023/03/20/Methodologie-de-calcul-de-la-courbe-des-taux-de-reference-BDT.pdf?x99137>

⁶⁸ CSDRs 2016

derivatives between the two parties in the event of bankruptcy of one party, thereby reducing overall exposure.. In case of default of one counterparty, where netting is not enforceable, the value of transactions cannot be netted, significantly increasing each party's exposure to the other. Furthermore, where collateral enforceability is uncertain, collateral held by the non-defaulting party cannot be readily utilized to settle the closing value obligations with the defaulting party.. This type of situation is avoided by recognising an exception in bankruptcy laws, known as “netting-out” the obligations of both parties. This has not yet been achieved in Moroccan legislation. To mitigate the counterparty risk arising from these legal uncertainties, banks dealing with derivatives currently limit the transactions maturity to one year.

The issue of the taxation of derivatives has allowed EBRD to show its clout, although results are yet to be seen. While the Parliamentary adoption of the derivatives legal reform remains pending, the immediate focus has shifted to resolving fundamental issues around the tax treatment of derivatives through discussions with both the Ministry of Economy and Finance and tax authorities. Until now, the tax treatment of derivatives was unclear. Even though they are hedging instruments, they may bear VAT and income tax on both legs. This limits their attractiveness to the corporate sector, although this is not a concern for mutual funds which are tax exempt. Moroccan banks have traded these instruments in a fiscal vacuum. They attempted to organise a meeting on this issue several years ago with the Moroccan Tax Department (DGI – Direction Générale des Impôts), without success. The formal involvement of EBRD allowed for the first time to open a dialogue with the DGI. A TC was launched, a fiscal consultant (Mazars) was hired, and meetings were held. This has led to an unexpected outcome as the DGI recently notified banks in writing of a possible penalty on past transactions (which was not enforced). Instead, banks are seeking an opinion from the DGI recognising an exemption for derivatives transactions. The discussion is on-going.

In spite of these difficulties, Morocco has made considerable progress towards the creation of a derivatives market. It started with a restructuring of the Casablanca Stock Exchange (CASE) as an integrated financial group consolidating the cash market, futures market, and Central Clearing Counterparty (CCP) and holding a significant stake in Maroclear (the central securities depository). However, the effectiveness of the CCP remains constrained without the enforceability of close-out netting provisions, underscoring the continued importance of adopting the derivatives law prepared in 2016 to ensure the CCP can function effectively. The futures market opened in November 2024 with only simple products such as index futures. Interest rate futures (for instance Overnight Index Swaps) are expected to launch in the first quarter of 2025. Although, as noted, the absence of a fully-fledged legal and tax framework will limit the development of the derivative market for now, these practical achievements are important steps towards equipping Morocco with a modern financial infrastructure.

Efforts to create preconditions for domestic LCY bond issuances by IFIs have not delivered results

EBRD began exploring the possibility of issuing local currency bonds in Morocco's domestic market in 2017, but results have not been achieved. The Bank engaged external legal counsel to assess the legal framework, which identified several requirements including disclosure requirements that would need modification before EBRD could proceed with a domestic MAD bond issuance. These requirements were discussed with key stakeholders including the capital markets regulator (AMMC), Central Bank of Morocco, and Ministry of Economy and Finance already in September 2016, with subsequent follow-up correspondence, but the necessary regulatory changes have not yet been introduced.^{69 70}

The Ministry of Economy and Finance seems reluctant to amend legislation in a way that would allow IFIs to issue bonds in MAD. One of the concerns comes from a potential market displacement from IFI bond issuances. While the potential volume of EBRD issuances would be relatively modest compared to those of the MEF, which raised MAD 174 billion (EUR 16.8 bn) in 2024, the Ministry sees a risk of displacement effect of potential combined IFI issuances, particularly during periods of market tensions. Their position is that any supranational issuances should be carefully coordinated with government bond issuance schedules, similar to requirements for large domestic issuers, and should be priced at a premium to sovereign bonds to maintain an orderly market. All issuances in MAD fall under Article 20.1 of the Agreement establishing the Bank, which requires consent from the shareholder concerned.

EBRD Treasury continues to work on a needed capacity building in financial risk management

The EBRD Treasury has provided training and capacity building in monetary markets, which have been highly appreciated. Treasury has utilised shareholder resources to create and host seminars for banks on

⁶⁹ CS/FO/17-14: Annual Report on Treasury Activities: 2016/2017

⁷⁰ CS/FO/18-28: Annual Report on Treasury Activities: 2017/2018

a range of salient financial risk topics including asset and liability management, derivatives, bank regulation and liquidity management and funds transfer pricing. Some trainings have involved visits to the London Headquarters and other market actors in the City, such as Bloomberg. The Bank has also organised seminars jointly with the BAM to raise the profile of interest rate risk management and the utilisation of derivatives. The participants have confirmed the relevance and quality of this capacity building work.

2.2 [REDACTED]

EBRD Treasury active market presence stands out among IFIs and contributes to market development

Treasury has adapted its modus operandi to provide flexible MAD to the Banking Department. Until 2016, MAD operations were limited in volume and financed back-to-back. During negotiations, clients requested quotations which could not be guaranteed until disbursement, when Treasury entered into an actual transaction of same size and maturity with a funding counterpart. The lack of certainty about the ultimate pricing was a major impediment for clients. To address this issue, Treasury started to pre-finance the Banking operations, i.e. to enter into funding transactions during the final stages of negotiation, providing borrowers with a firm price before the time of the actual disbursement, which could take place weeks or months later. This ultimately means that the funding swaps are not in the same structure as banking deals with clients, which results in some residual risk within the limits of the Treasury risk directive. The benefit of this approach is improved cost of funding and more flexible terms for banking clients.

In 2016 EBRD was the first IFI to successfully source MAD in Morocco to finance local currency projects. This was made possible following the pioneering signing of swap agreements after receiving official confirmation by the authorities that they would allow domestic banks to enter cross-currency swaps with EBRD.

EBRD has established itself as the only IFI actively participating in Morocco's local monetary market through its shift from back-to-back financing. Pre-financing transactions offers more flexibility to Banking in dealing with clients' needs. However, this approach requires active management of the liquidity resulting from the funding transactions, until the disbursements actually happen. Nowadays, Treasury finances its book dynamically, and invests excess liquidity in safe instruments such as Moroccan government bonds or certificate of deposits with commercial banks. Based on available information, this modus operandi has not been matched by other IFIs in Morocco, which have not developed the same capabilities. They continue to finance either back-to-back in case of very limited local currency operations, or provide EUR or USD to their clients. The currency pool gives EBRD a distinctive edge on the Moroccan market, bringing it closer to commercial banks in terms of flexibility.

EBRD's active market participation is critical for demonstrating new financial instruments in practice. The Bank does not only promote new financial instruments in theory but actively trades them. In 2020-21 for instance, Treasury has executed a few MONIA-linked OIS (overnight indexed swap) shortly after the launch of the MONIA index. It tested the new index and showed to their counterparties how the instrument works in practice and what benefits they can derive from it. Such operations allow EBRD to gain practical experience in these innovative instruments in the Moroccan context and inform the policy dialogue carried out by the Bank, giving it credibility and accuracy. Trading the new instruments also has a capacity building effect on the Moroccan banks which weren't fully aware of how they could use the swaps to their advantage, like raising foreign currencies more cheaply.

[REDACTED]

[REDACTED]

2.3 Favourable market conditions and enhanced MAD funding have driven LCY business growth, supported by concessional instruments

Stable currency and low interest rate environment create natural demand for LCF

The Moroccan economy is based on Dirham (MAD). The MAD is pegged to a currency basket made of 60% euro and 40% US dollar. The currency has been quite stable over time against this basket. In 2018, the BAM instituted a band of fluctuation of ± 2.5 percent, increased to ± 5 percent in 2020. The BAM is gradually moving towards a floating exchange rate regime and inflation targeting. The macro-economic

environment is favourable. The GDP is growing, inflation has been kept low and trade flows are balanced. In this context, the MAD can hardly be considered a soft currency. Morocco is only lightly dollarised/euroised and the MAD is the borrowing and lending currency used across the country for most transactions. Foreign-currency-denominated loans amounted to only 13.13% of total loans in 2023.

Interest rates in MAD are close to European ones, which makes financing in MAD a natural choice for Moroccan borrowers. There was a time during the Covid period when MAD interest rates were even lower than those on euro. The central bank (BAM) was quick to react to changes in the environment during the pandemic. The BAM was the first in SEMED to decrease interest rates when inflationary pressures subsided after Covid. As a result Moroccan borrowers benefited from lower interest rates while the currency remained relatively stable (maximum spread of 17% between the lowest point and the highest one in 2020-2024). This unusual circumstance meant that borrowing in MAD was a logical decision for Moroccan players, reinforcing the need for EBRD to provide MAD loans if it is to play a role in the market.

LCF is not a source of additionality but a necessity for business expansion

It follows that, in Morocco, the mere lending in local currency cannot be considered an additionality factor. Providing MAD in a lending market which is MAD denominated is not a source of additionality for EBRD. It is merely an enabler, which allows EBRD to carry out its activity and finance its projects. To an extent, financing in USD and EUR may be more additional in that EBRD is able to offer those foreign currencies more naturally than Moroccan banks and on terms they are not always able to match.

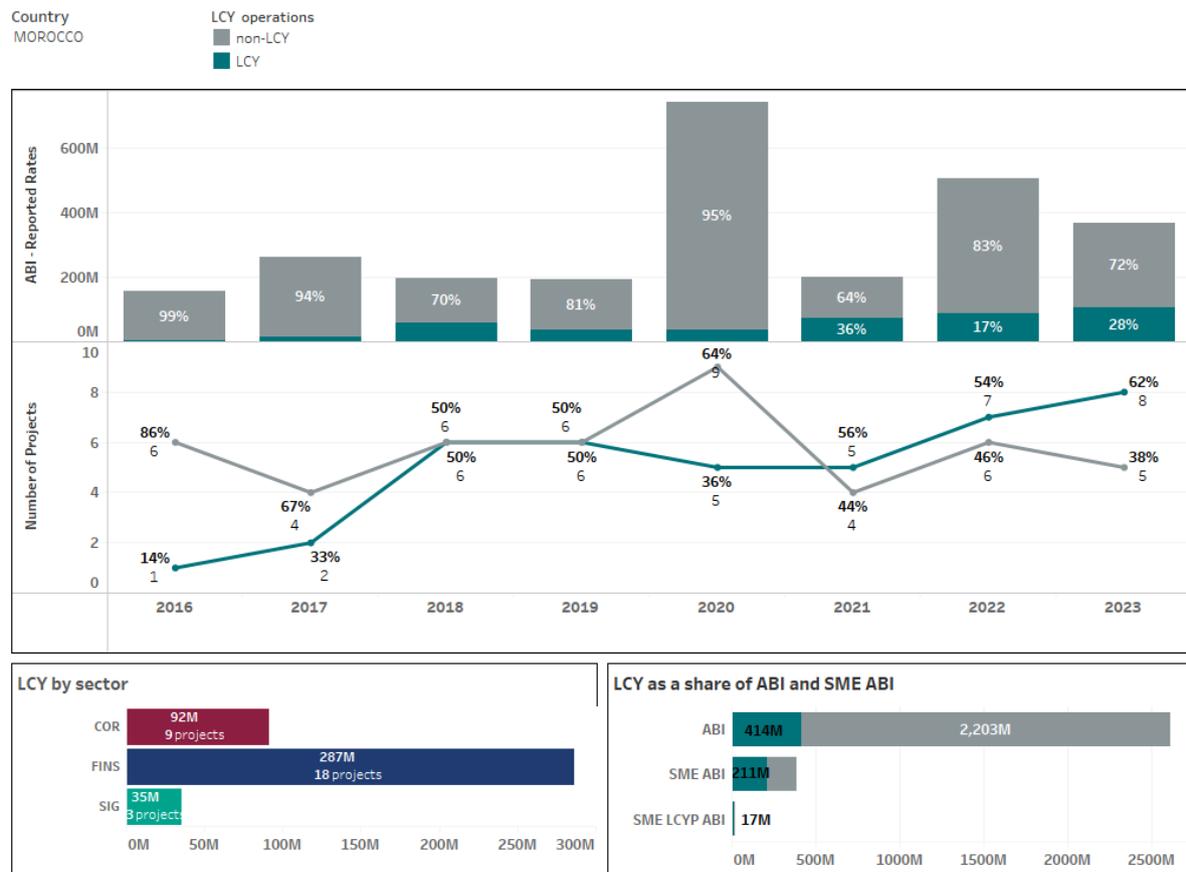
EBRD's additionality resides in other characteristics. The Moroccan banking sector is well developed and sophisticated. Interviewees noted that Moroccan banks were able to provide long term loans easily up to 10 years if the projects required it. They are able to offer FX hedging instruments to their clients. In addition, there is strong competition among the top three domestic banks which represent 70 percent of the market. However, several counterparts mentioned the benefits of financing with EBRD, among which a stable partnership in times of uncertainty like Covid, the policy dialogue and ability to “open doors” with the authorities, the ESG angle brought into loans as well as the credit lines focused on green, gender, SME and youth and the TC and non-TC (grants) that accompanies them.

Access to MAD facilitated significant growth in LCF volumes

Against this background, the Bank has been successful in gradually increasing volume of MAD financing transactions over the evaluation period. The total LCY ABI in Morocco was €414m over the 2016-23 period, representing 16% of overall debt ABI. The majority of LCY finance was in the FI sector (€287m). (Figure 12)

- **There was a growing trend in LCY financing over the evaluation period**, from virtually non-existent in 2016 to 28% of debt ABI in 2023, €103m equivalent. In terms of the number of projects, this was 62% (8) of ABI projects (vs 5 non-LCY).
- **There was a significant step-change in LCY financing in 2024.** While outside of the evaluation period, 2024 registered a significant growth in the volume of LCY financing in Morocco. There was a €410m equivalent of LCY finance, representing 79% of the debt ABI of 2024 (€510m).
- **At the end of 2024, the EBRD Operating Assets in MAD were at €0.6bn** (up from €0.3bn at the end of 2023), representing a third of OAs in the country (up from 20% at the end of 2023).

Figure 12: Morocco LCY financing, 2016-23



NB: ABI includes debt and guarantees only, equity excluded; LCY financing data is based on LCY flag.

Very small share of LCY finance is supported by the SME LCYP. Morocco joined the SME LCYP in 2017. However, financing supported by the LCYP subsidy represented only €17m since then – two SME projects through direct finance (DFF) and one FI credit line (WiB). The low use of LYCP is explained by the fact that large part of the FI LCF is in the form of credit lines which are not eligible or benefit from other guarantee mechanisms such as the EFSD.

Enhanced MAD funding capabilities, combined with concessional support mechanisms, have expanded client base across sectors despite remaining constraints

Treasury's improved MAD funding capabilities have expanded EBRD's corporate client base, though projects still benefit from additional support mechanisms. Prior to enhanced local funding capacity, EBRD's corporate lending was largely limited to exporters and foreign subsidiaries with hard currency needs, as MAD financing could not be offered at competitive rates. The improved cost of funding has enabled EBRD to serve new types of corporate clients, marking a significant expansion of its market reach. However, these local currency operations often still rely on various support mechanisms including guarantees, concessional finance, and investment grants.

Likewise enhanced MAD funding capabilities have expanded LCY FI business, while recent rate increases may affect this momentum. The ability to source MAD locally has transformed EBRD's engagement with financial institutions, with LCF representing the majority of FI business outside of trade finance programme (TFP) over the evaluation period. The primary demand comes from European bank subsidiaries and microfinance institutions that lack access to local deposit funding.

EBRD's entry into infrastructure LCY financing since 2022 has opened opportunities with new municipal and state-owned enterprise clients. LCY financing in the infrastructure sector was non-existent before 2022, but improved access to MAD funding enabled EBRD to engage with municipalities at a time of

increasing fiscal decentralisation in Morocco. The Bank's first municipal sector LCY project was an investment in Agadir's municipal bond – the first such issuance in the country – under the Green Cities programme.⁷¹ This was followed in 2023 by a €12 million investment with the Guelmim-Oued Noun region, also under Green Cities. Additionally, EBRD invested €18 million in a green bond issued by the national railway operator ONCF in 2022. Each of these transactions benefitted from further support mechanisms: ONCF marked the first IFI use of the state guarantee mechanism by Société Nationale de Garantie et de Financement de l'Entreprise (SNGFE),⁷² the Guelmim project combined a US\$1 million GEF investment grant with EFSD first-loss cover guarantee, and the Agadir bond was supported by a €650k Financial and Operational Performance Improvement TC.

Despite significant progress made in LCY financing ability, Banking still faces some constraints in their offering against local banks. [REDACTED]

⁷¹ 53815 p. Kasbah, €36m ABI – the project is not LCY flagged in the internal system and does not therefore feature in the data visualisations.

⁷² CSDR 2022

DATA ANNEX

Context

Economic context

Morocco's economic growth has slowed to an estimated 2.5% in early 2024, impacted by prolonged droughts and the effects of the 2023 earthquake in the High Atlas region, which disrupted agriculture and tourism.⁷³ Agriculture, accounting for 14% of GDP and nearly 30% of employment, has faced significant challenges, while non-agricultural sectors, though stable, have also seen moderated growth.

The Moroccan dirham has remained stable within its managed fluctuation band, benefiting from Bank Al-Maghrib's (BAM) cautious monetary policies and rising foreign reserves.⁷⁴ BAM's policy rate was reduced by 25 basis points to 2.75% in June 2024, making Morocco the first in North Africa to adopt a monetary easing stance amid declining inflation, which fell from 8.5% in February 2023 to 2.1% by mid-2024. The central bank's interventions have ensured stability in the dirham, mitigating currency risks in an otherwise volatile regional setting.

Foreign reserves have strengthened, reaching €34 billion by August 2024, equating to approximately five months of import coverage, bolstered by lower energy imports, steady remittances, and rebounding tourism revenue.⁷⁵ This reserve level provides a buffer against external shocks, reducing Morocco's vulnerability to currency volatility and supporting the local currency's stability. Moreover, Morocco has proactively managed its exposure to currency risks, with BAM's foreign currency interventions acting as a safeguard for the dirham and reinforcing investor confidence in the Moroccan financial system.⁷⁶

Morocco's fiscal policy is focused on consolidation, targeting a budget deficit reduction to 4.3% of GDP in 2024 and a decrease in public debt to 70.4% of GDP.⁷⁷ The government is advancing VAT reform and optimizing social protection programs to ensure fiscal sustainability and improve revenue mobilization.⁷⁸

Structural reforms position Morocco as a regional leader in renewable energy, with the "Morocco Offer" initiative attracting foreign and local investment in green projects. By mid-2024, Morocco had received 40 proposals for green hydrogen and renewable energy projects, emphasizing its strategy to diversify the energy mix, enhance energy security, and reduce dependency on imported fuels.⁷⁹

Box 3: Morocco – macroeconomic dashboard

- **Overview: solid growth amid economic challenges**
 - Morocco's economy has displayed resilience in navigating domestic and external challenges, including droughts, the September 2023 earthquake, and global economic pressures. Real GDP growth reached 3% in 2023, driven by strong export performance in automotive and electronics, tourism recovery, and robust domestic demand.
 - Structural reforms and public investments in infrastructure, social protection, and energy are critical to fostering sustainable and inclusive growth. The IMF projects medium-term growth at 3.5%, supported by reconstruction efforts and continued economic diversification (IMF, 2024).
- **Economic growth**
 - Morocco's GDP grew by 3% in 2023, recovering from the drought-impacted 1.3% in 2022. Key growth drivers included a rebound in exports and investments, although unemployment remained elevated at 13.3%, reflecting job losses in agriculture due to water scarcity.
 - Medium-term growth is expected to remain around 3.5%, supported by infrastructure projects in water and energy, post-earthquake reconstruction, and pro-business reforms targeting private sector growth (IMF, 2024).

⁷³ IMF (2024). World Economic Outlook, October 2024.

⁷⁴ IMF (2024). Global Financial Stability Report, October 2024.

⁷⁵ IMF (2024). World Economic Outlook, October 2024.

⁷⁶ IMF (2024). Global Financial Stability Report, October 2024.

⁷⁷ IMF (2024). Fiscal Monitor, October 2024.

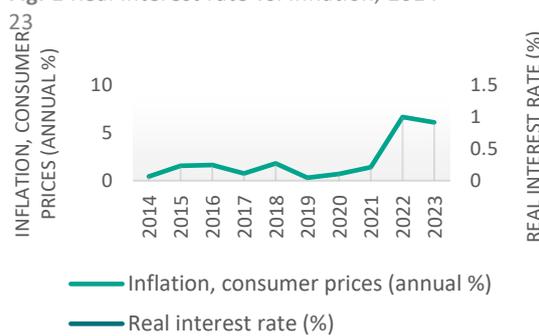
⁷⁸ IMF (2024). Global Financial Stability Report, October 2024.

⁷⁹ EBRD (2024). Transition Report.

Inflation and real interest rates trends

- Inflation eased from a peak of 6.6% in 2022 to 2.3% in 2024, as supply shocks subsided. Food inflation remains a concern due to ongoing climate-related disruptions in agricultural production.
- Real interest rates turned positive, with Bank Al-Maghrib (BAM) pausing its policy rate hikes at 3% in mid-2023. Lower inflation and a stable monetary policy stance have supported price stability.

Fig. 1 Real interest rate vs. inflation, 2014-23

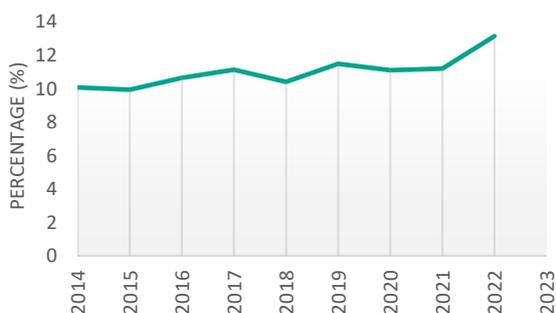


Source: IMF- International Financial Statistics (2024).

Financial sector developments

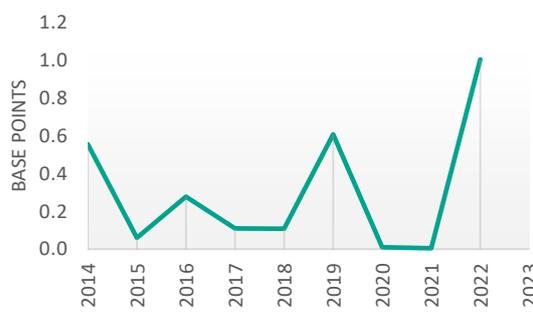
- The financial sector remains stable, with gradual improvements in banking sector profitability. Return on equity (ROE) improved to 11.8% in 2023, reflecting higher lending rates and low-cost funding through savings accounts.
- Fig. 2 indicates persistent dollarization within Morocco's financial sector, driven by the country's reliance on international trade, external borrowing, and exposure to foreign markets. Morocco's trade activities, particularly with the EU, and reliance on energy imports, are contributing factors to the ongoing dollarization of loans.
- The spread between the highest and lowest interbank rates fluctuated significantly, peaking at 6.00 basis points in 2015 and narrowing to just 1.00 basis point by 2023. This reflects increased liquidity and more stable financial conditions in the Moroccan banking sector (Fig. 3).
- Non-performing loans (NPLs) increased slightly in 2023, particularly in private sector companies, highlighting the lingering risks from pandemic-related credit schemes. However, BAM's initiatives to enhance liquidity management and supervisory frameworks are expected to strengthen financial stability.

Fig.2 Foreign-currency-dominated loans to total loans, 2014-23



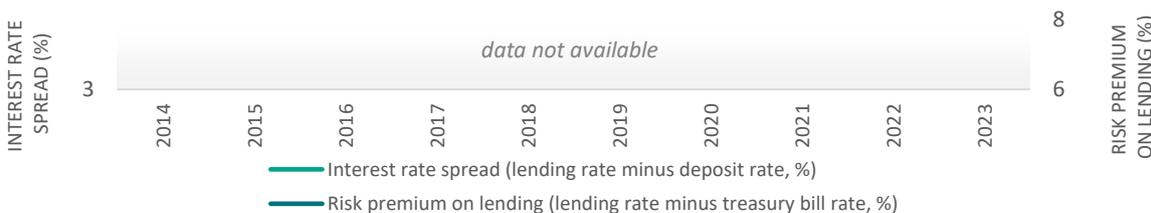
Source: IMF-Financial Soundness Indicators (2024).

Fig.3 Spread between highest and lowest interbank rates (base points), 2014-23



Source: IMF-Financial Soundness Indicators (2024).

Fig. 4 Interest rate spread vs. risk premium on lending, 2014-23

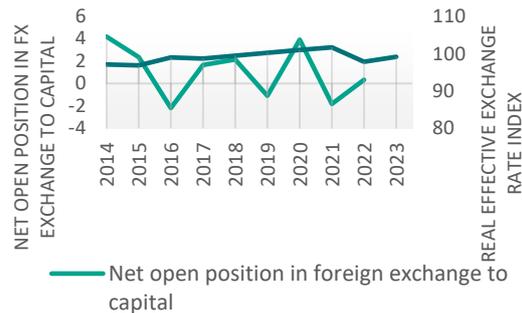


Source: IMF- International Financial Statistics (2024).

Foreign exchange risks

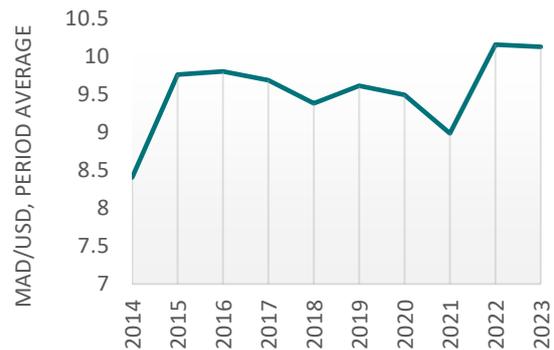
- Morocco's net open position in foreign exchange to capital improved to 0.32% in 2023, reflecting effective foreign exchange risk management. However, external vulnerabilities persist due to the reliance on energy imports and exposure to global market shocks (Fig. 5).
- The dirham remained stable within its fluctuation band and appreciated by 5.3% against the USD in 2023, contributing to reduced inflationary pressures and supporting external stability. Gross reserves increased to \$36.3 billion, covering 5.6 months of imports.

Fig. 5 Net open position in FX to capital vs. real effective exchange rate index, 2014-2023



Source: IMF-International Financial Statistics (2024).

Fig.6 Official exchange rate (MAD per US\$, period average), 2014-23



Source: IMF-International Financial Statistics (2024).

Outlook

- Morocco's economic outlook is positive, with growth projected at 3.5% in 2024 and beyond, driven by infrastructure investments, continued structural reforms, and improved private sector participation.
- Inflation is expected to stabilize around 2.5%, supported by steady monetary policy and lower global commodity prices.
- Key risks include geopolitical tensions, drought impacts on agriculture, and global economic uncertainties. The successful implementation of reforms in social protection, education, and state-owned enterprises (SOEs) will be essential for fostering inclusive growth and long-term economic resilience.

Notes on Figures:

Fig.1 Real interest rate is the lending interest rate adjusted for inflation as measured by the GDP deflator. The terms and conditions attached to lending rates differ by country, however, limiting their comparability. **Inflation** as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly. The Laspeyres formula is generally used.

Fig.2 Foreign-currency-denominated loans to total loans measures deposit takers' exposure to exchange rate risk, indicating the portion of total loans that are in foreign currency. It is a proxy for foreign currency exposure/dollarisation.

Fig.3 Spread between highest and lowest interbank rates (base points) indicates perceived risk in interbank lending, reflecting the cost and risk premiums deposit takers' face.

Fig.4 Interest rate spread (lending rate minus deposit rate, %) is the interest rate charged by banks on loans to private sector customers minus the interest rate paid by commercial or similar banks for demand, time, or savings deposits. The terms and conditions attached to these rates differ by country, however, limiting their comparability.

Fig.5 Net open position in foreign exchange to capital indicates deposit takers' exposure to foreign currency risk by comparing net foreign currency positions to capital. It is intended to identify deposit takers' exposure to exchange rate risk relative to capital. The capital here refers to total regulatory capital. It is a proxy of the vulnerability of the banking sector to foreign exchange shocks.

Fig.6 Official exchange rate refers to the exchange rate determined by national authorities or to the rate determined in the legally sanctioned exchange market. It is calculated as an annual average based on monthly averages (local currency units relative to the U.S. dollar).

References:

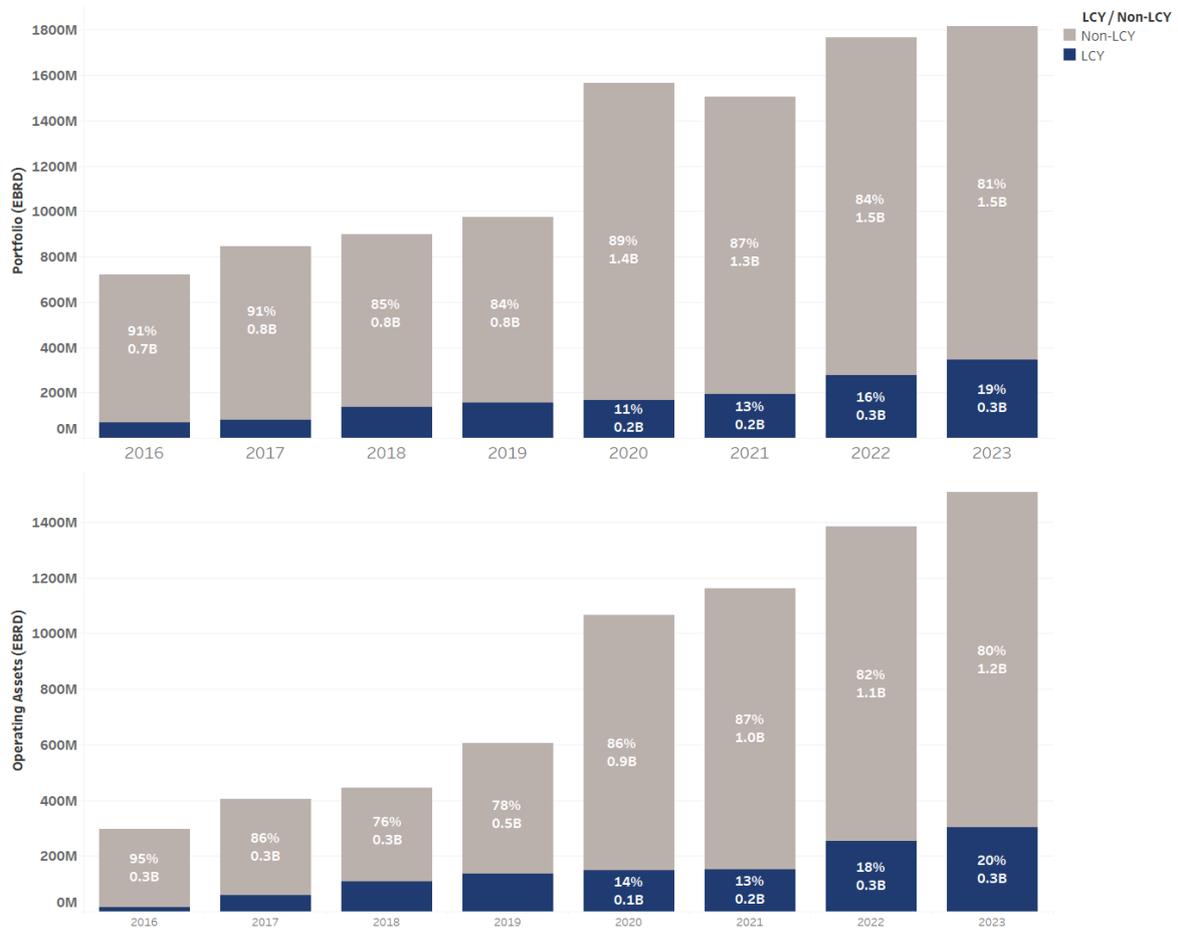
<https://www.imf.org/en/Publications/CR/Issues/2024/05/01/Morocco-2024-Article-IV-Consultation-Review-Under-the-Flexible-Credit-Line-Arrangement-548442>

Table 5: Country context dashboard

Indicator name	Indicator value, year of measurement	Indicator source
Policy		
Exchange rate arrangement	Pegged exchange rate with horizontal bands	IMF (2023)
Monetary policy framework	Exchange rate anchor - Composite (Within the framework of an exchange rate fixed to a currency composite, the Bank Al-Maghrib adopted a monetary policy framework in 2006 based on various inflation indicators, with the overnight interest rate as its operational target to pursue its main objective of price stability)	IMF (2023)
EBRD Financial Markets Development Index (FMDI)		
Money Market Pillar Score	2014: 0.0 2020: 13.3 2022: 8.33	EBRD CFMD (2024)
Reliable benchmark (no/yes) [0,1]	Yes [1]	EBRD CFMD (2024)
Benchmark used by market participants (MOF, IFIs, local banks) [0,1]	No [0]	EBRD CFMD (2024)
CCY Basis swap/Interest Rate Swap curves on Bloomberg or Thomson Reuters Eikon priced out of the benchmark [0,1]	No [0]	EBRD CFMD (2024)
FI LCY bonds: Aggregate outstanding nominal of corporate bonds issued by banks or financial institutions with maturity of more than 1 year issued in LCY as a share of GDP (USB, bn)	2020: 2.07 2021: 1.48 2022: 0.85	Cbonds (2023), provided by CFMD team
Corporate LCY bonds: Aggregate outstanding nominal of corporate bonds (excl. issued by banks or financial institutions) with maturity of more than 1 year issued in LCY (USD) as a share of GDP (USB, bn)	2020: 1.33 2021: 0.78 2022: 0.37	Cbonds (2023), provided by CFMD team

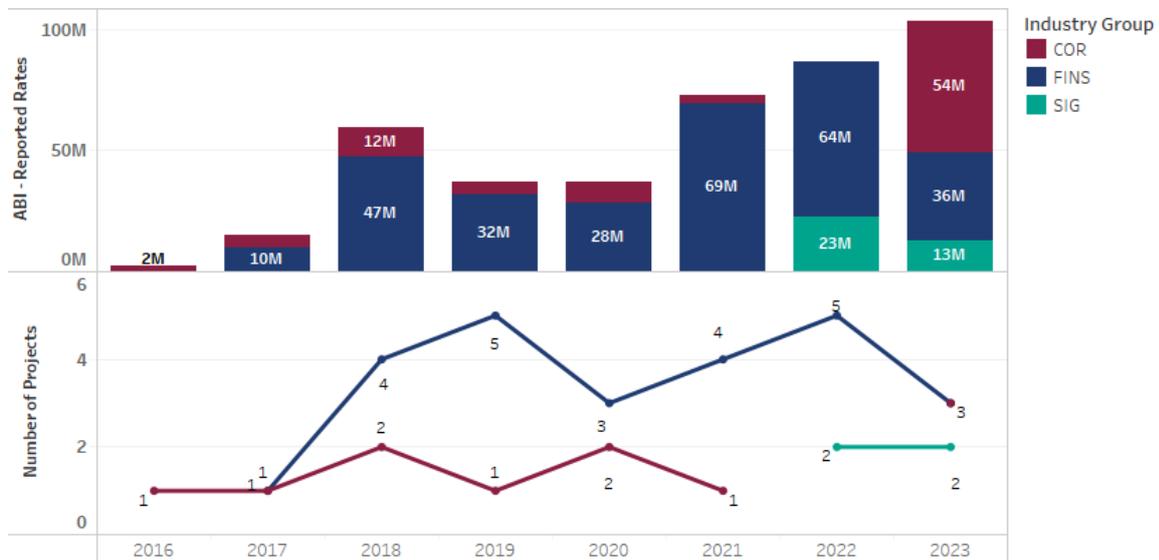
EBRD LCY financing

Figure 13: LCY operations as a share of portfolio and operating assets, 2016-2023



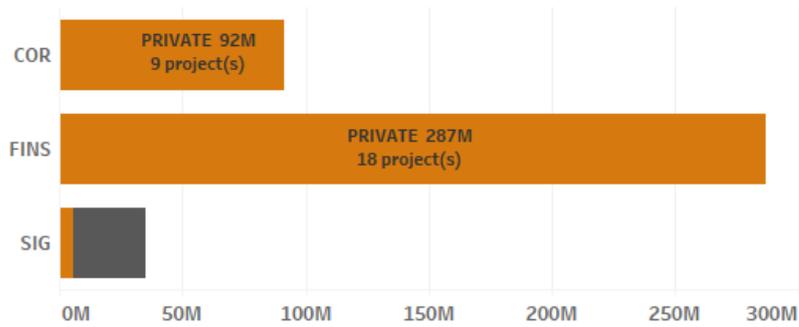
Source: dw_banking_operational dataset

Figure 14: LCY ABI and number of projects by sector, 2016-2023



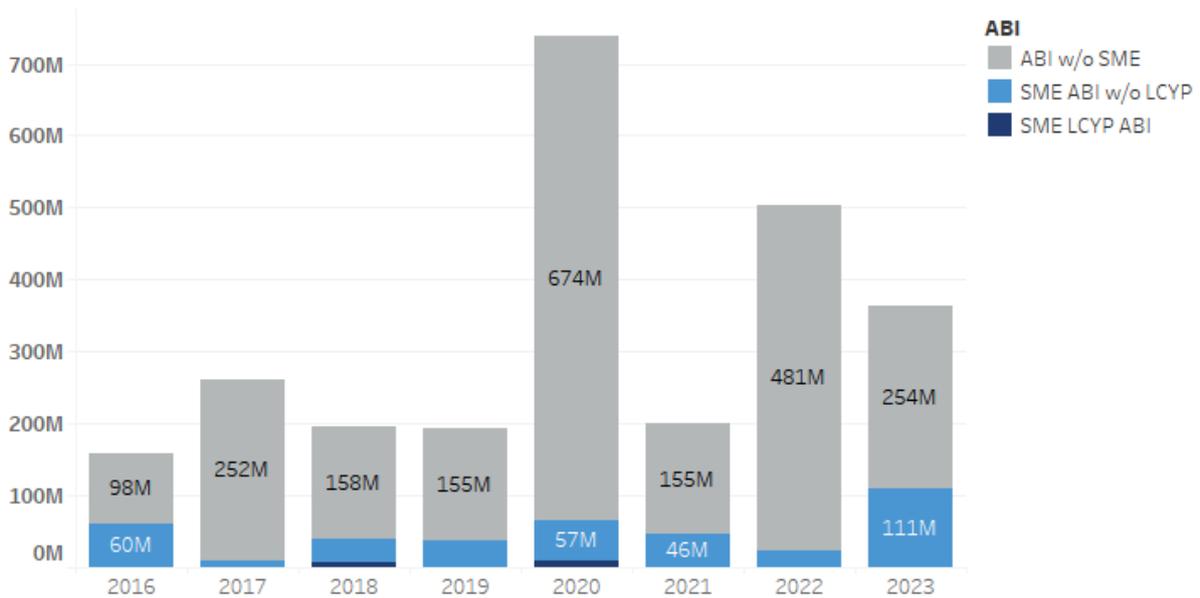
Source: dw_banking_operational dataset

Figure 15: LCY ABI and number of projects by portfolio class, 2016-2023



Source: dw_banking_operational dataset

Figure 16: Share of SME LCYP in SME ABI, 2016-2023



Source: ABI includes debt and guarantees only, equity excluded; source of data dw_banking_operational; SME ABI identified based on SME flag at OpID level; LCYP ABI based on the "Local currency risk sharing" product indicator