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# IIB building up CEE identity after relocation of HQs to Budapest

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**By Levente Szilagyi in Budapest December 4, 2019**

The International Investment Bank (IIB) is perfectly placed to grow further after the relocation of its HQ s to Budapest. Of the five major international development banks operating in the EU, IIB is the only one stationed in the region and it strives to keep its CEE identity by funding local companies and international businesses in the region, IIB chief economist Elliott Auckland, told BNE IntelliNews.

The Central and Eastern Europe (CEE) region has done well to close the gap to reach the EU average in development and the region has great growth potential. It is an economic fact that CEE economies will continue to converge and growth rates to exceed old member states' such as Germany or France, the chief economist added.

Between 2008 and 2013, Hungary struggled to cope with the aftermaths of the economic crisis. Growth picked up after 2013 as the government has implemented a very open and business-friendly environment that supports growth and creates jobs and increases wages. Investment figures have gone up to 30% of the GDP, reflected in the number of quality multinational companies choosing the country for production base.

Hungary has stood out of the region as the global economic slowdown had limited impact so far as the domestic growth story is very strong, but no economy can live in isolation particularly one as open as Hungary's.

Besides external factors, IIB's chief economist sees demographics as a key factor limiting long-term growth in the region. The problem in Hungary is acute as birth rates are around 1.45, which means that each year the active workforce will drop by tens of thousands of people.

Employment rates in Romania, the Czech Republic or Hungary has reached record highs as the participation rate in these countries over the years have risen from 55% to 70% and is almost in line that of other developed countries.

There is still some potential for more people to enter the labour market but the rate of inflow seen in the past years can’t be sustained, he added.

IIB as a development bank can play a key role in financing local and multinational companies focusing on investments in the CEE area. Banks and industrial companies look at countries in the region as one with a well-integrated supply chain brewed together politically and economically.

"Historically we financed corporates inside our member states, but in the last 18 months we have begun to lend multinationals with operations in the region."

IIB has issued a loan to a Spanish multinational in the auto sector and it has also financed the acquisition of mobile telecom Telenor by Czech-based PPF group in Bulgaria and Hungary.

**Relocation of HQs**

With five emerging EU states as its members, (Bulgaria, Czech Republic, Romania, Slovakia, and Hungary) it was an obvious choice for the bank to relocate to an EU state from Moscow.

This is a vital step towards IIB new strategy implementation that was launched in 2018 and provides for a comprehensive expansion of activities in European markets, Chairman of the development bank's Management board Nikolay Kosov said before the board of governors approved the HQ shift in late 2018.

The bank's exposure to EU members in terms of its loan portfolio, funding, equity, treasury portfolio has exceeded 50%. This was not always the case when the then Moscow-based lender was faced with a high cost of funding and a low credit rating between 2012-2015 when it began to overhaul its operations.

'It was difficult to compete in these markets from a base outside of the EU", Auckland added.

Since resuming membership in 2015, Hungary has lobbied to have Budapest become the new HQs of the bank as the country has strived to become a financial centre in the region. The Orban government made efforts to strengthen ties with countries outside the EU. A policy dubbed as Opening to the East involved boosting political and economic ties to China, Russia and other developing countries in Eurasia and Asia.

"From Budapest we are perfectly placed to grow further as we approved a new capitalisation program. Member states will be paying €200mn in fresh capital from 2020 to 2022, half of that coming from European countries. In the future, we look to grow our shareholder base by a maximum of 2-3 countries", Auckland said without naming any candidates, adding that it will take a few years before new members can join IIB.

The lender is already working on its new strategy in place from 2023, which focuses on economic development, expanding the bank's international partner network, attracting new shareholders and investors said Imre Laszloczki, recently appointed Hungarian deputy chairperson of the Management Board charge of strategy and policy said at a recent press briefing.

With the appointment of Laszloczki, four of the six posts on the management board are filled by an EU member country, and they also have a more than 50% stake in equity and in voting rights.

**Focus on key sectors: Financing agriculture, tourism**

The loan portfolio over the next couple of years, including guarantees, will rise over €1.3 bn, Elliott Auckland said adding that IIB expects Hungary to have no less than 10% of the loan portfolio.

"In general we are focused on increasing the share of Hungarian projects, as it is strategically important to us because of the HQ move", he added.

IIB has disbursed €115mn in the past three years in Hungary for 5-6 projects.

“I am pretty sure we will see growth of our loan portfolio next year in Hungary, which could be one of the top countries in terms of loan disbursements”.

Agriculture, tourism, media and the auto sector are the key areas targeted by IIB, which also seeks opportunities in financing infrastructure developments.
In the medium term, the Budapest-based lender wants to have the share of the EU loan portfolio rise to 60% from 50% last year.

IIB has also increased its investment in in sustainability and as the EU has become the frontrunner for a more sustainable future, IIB wants to take part in that effort, increasing the share of investments in sustainable solutions.

“We approved a new environmental and social policy document and some 40% of the treasury portfolio is in green bonds”.

IIB is financing among others the conversion of old coal mines to biomass plants in Slovakia and in Russia it is involved in hydro and solar power projects.

Auckland also spoke of the growing importance of trade financing.

Although the bank's core business is long-term capital investments, it is also involved in trade financing of companies with at least one of the parties being a member of the bank. For instance a Hungarian company exporting pharmaceutical products to Russia received credit financing from IIB.

For funding, IIB will continue to rely on issuing debt in local currencies in Hungary Romania and the Czech Republic, after successful bond launches in the first two countries. IIB has seen huge demand from local and foreign investors for debt issues.

As the bank's credit rating improved after upgrades by rating agencies, so did the cost of funding came down. In October the bank achieved the lowest nominal yield (1.42%) and coupon (1.25%) ever paid for a fixed bond issue when it allocated €67.5mn in Hungary. IIB has raised €105mn in Romania also with near record-low yields.

The low cost of funding allows us to finance companies with favourable conditions, he added. In raising funds or lending, IIB works with great flexibility.

"We can issue loans in forints or in euros, we don't have an issue with what currency to lend".

**Development banks vs commercial bank**

As a development bank, IIB's focus is on sustainable long-term projects that support growth and job creation. Its core business is long-term financing where commercial banks see risks, offering loans up to 7-10 year maturity loans. This segment presents opportunities for international financial institutions (IFI), which see profits as not the top priority. Its leaner organisational structure also allows quick decision-making. In some cases, projects can get green light in three months.

Foreign-owned commercial banks withdrew from the region after the economic crisis, but this presented a chance for international financial institutions (IFI) to step in.

"If we were to see financial institutions withdrawing from the region, we would be stepping up activity and we would be more active," he said. Similarly,

When monetary conditions tighten and there is stress on the market, it increases the importance of institutions such as the European Investment Bank (EIB), the European Bank of Reconstruction and Development (EBRD) or IIB.

The EBRD or the World Bank invests primarily in the Middle East and Africa and Central European countries' say in the development strategy is small in proportion to their stake holdings.

But unlike large development banks, IIB is owned by CEE states, with local staff and has established a CEE identity.

"During the 2009 crisis we saw a lot of western banks, corporates withdrew their funding to the economy and that was a big issue. Governments in the region have done very well to develop their local financial systems. By creating national banking champions, the likes of Bank of Transylvania in Romania or OTP, they made their economy more sustainable and less reliant on international financial flows. IIB is part of that and supports the identity of the CEE region", Auckland added.