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ISSN 2059-2736

Please direct comments, letters, press releases and other editorial enquires to editor@bne.eu

bne Intellinews is published by
Emerging Markets Direct OU

Print issue:
£4.50 /$6.75 /€5.90 · €499 / year

COMPANIES & MARKETS


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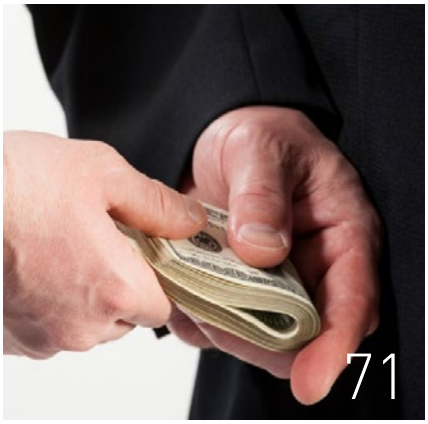
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The Czech central bank has long opposed adoption of the euro, which would reduce its power and independence. / bne IntelliNews

Spontaneous euroisation of the Czech economy undermines Eurosceptic prejudices

Albin Sybera

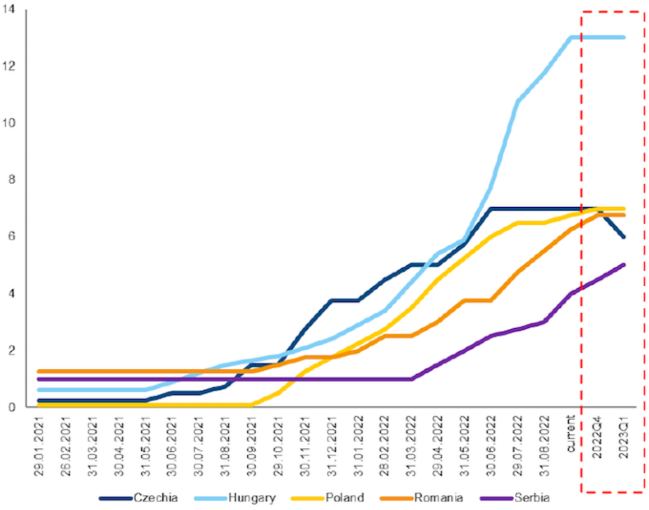
In 2022 Czech companies increasingly resorted to the euro in their business transactions, with the largest Czech company Skoda Auto switching its books to use the euro as of January 2023. The popularity of the euro was also on the rise among ordinary Czechs last year, Eurobarometer showed.

Investment banker Ondrej Jonas told a Czech Radio debate last week that pragmatically speaking Czechia already is a dual system in which many companies and residents operate in euros.

"Here you have part of the population which has dual [bank] accounts in [the Czech] koruna and in the euro. Transition to the euro is occurring naturally," argued Jonas.

The difference between inflation in the eurozone of 9.2% and the national one of 16.2%, as well as the difference in interest rates between the ECB's 2% and the Czech National Bank's 7%, has reinforced the argument of the euro supporters that the country should adopt the euro because the export-oriented Czech economy is so dependent on the euro currency.

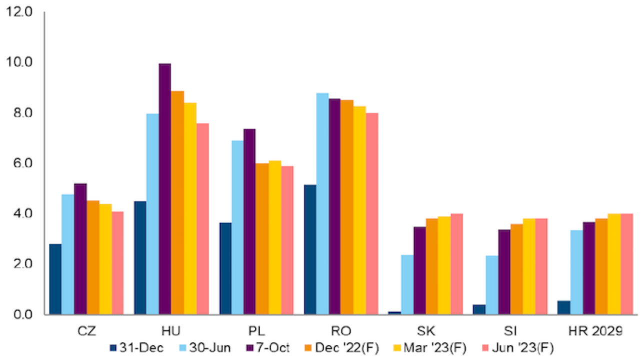
The key interest rates %



Source: Bloomberg, Erste Group Research

The current advantage of the eurzone is also shown by bond yields, though the margin compared to eurzone countries such as Slovakia and Slovenia is less pronounced:

Forecasted 10Y government bond yields (%)



Source: Bloomberg, Erste Group Research

"I think it is much smarter to try and influence the functioning of the eurozone at least a little bit than laugh at what others are doing wrong without taking part in it," Radek Spicar, the vice president of the Confederation of Industry of the Czech Republic, told *Seznam Zpravy* recently.

Under its treaty of accession when it joined the EU in 2004, Czechia has to adopt the euro but no timeframe is given. Up until now there has never been a committed majority in parliament for long enough to approve accession.

In August, civic platform "Euro v Cesku" [Euro in Czechia] surveyed parliamentarians from across the political parties, showing that only those from the neoliberal ODS, the far-right and anti-EU SPD and the populist ANO party are against euro adoption.

ODS is the only party against the euro adoption inside the five-party center-right ruling coalition. ODS is also the strongest party in the coalition and, together with the opposition parties, can block euro adoption in parliament. The governing coalition agreed in its programme at the end of 2021 not to pursue euro adoption in its four-year term.

Czechia's long-delayed euro currency adoption has been fuelled by Eurosceptic currents in Czech politics which have for long been voiced by ODS. However, its current leader, Prime Minister Petr Fiala, has signalled the ODS's shift towards a milder form of Euroscepticism. This was also a strategic move that contrasted ODS with the populist ANO of billionaire Andrej Babis and helped the ODS-led SPOLU bloc of centre-right parties win the election in October 2021.

Fiala has so far been able to attract voters who are worried that having someone like Babis in power may sway Czechia in the direction of semi-authoritarian Hungary. At the same time, he has been keeping the more staunchly Eurosceptic wing of ODS, represented by its MEP Jan Zahradil or the party's chief economist Jan Skopecek, at bay by not criticising ODS' partners from the European radical rightwing ECR bloc such as Poland's PiS or Italy's Brothers of Italy. Zahradil is a onetime ally of the ODS's founder and former prime minister and president Vaclav Klaus, who has since left the party and has turned into a supporter of the far-right SPD.

Minister for European Affairs Mikulas Bek (Mayors party) told Czech Radio in an interview that "even the ODS is undergoing some development of their point of view" when reviewing the recently ended Czech presidency, which included Czechia presiding over Croatia's euro adoption.

"I am not the only one who is standing on the barricade backing the euro," the former environmental minister and ODS party member Pavel Drobil was quoted as saying by *Seznam Zpravy* recently. "It may well happen that politicians will wake up one day and realise that even though the official currency is the koruna the economy is running on a different currency," Drobil added.

Bek thinks that Fiala's cabinet will not be the one adopting the euro despite Czechia increasingly "becoming an island" inside the eurozone. This cabinet may "reach a compromise" on a timetable or something such as "entry to the [pre-member] ERM II", inching Czechia "closer to euro adoption", Bek hinted. Bulgaria is already in the ERM II.

Supporters of the euro point out that in the end arguments in favour of the koruna come down to nationalist nostalgia, tacitly fed by what Jonas called "ideological prejudice".

Some supporters also think euro adoption is vital in anchoring Czechia in the EU and blocking far-right and populist parties who might otherwise try to pull the country out of the euro and into Russia's orbit.

Nevertheless, opponents can point to the fact that, in the current economic environment, Czechia does not meet the formal criteria for euro adoption.

Former Czech National Bank (CNB) governor Miroslav Singer, currently the chief economist at Generali CEE Holding, told Czech Radio that the Czech currency also serves as a monetary buffer during turbulent times, enabling more independent steering of the country's economy. The CNB is currently intervening to prop up the koruna as a way of driving inflation down, after previously being among the first countries in the EU to raise interest rates in the summer of 2021 at a time when the ECB was still keeping rates at virtually zero. ●

"I think it is much smarter to try and influence the functioning of the eurozone at least a little bit than laugh at what others are doing wrong without taking part in it"

Danske Bank pays $2bn to settle Estonian money-laundering scandal

bne IntelliNews

Denmark's Danske Bank will pay a $2bn penalty to settle its huge money-laundering scandal in Estonia, the *Financial Times* reported on December 13.

The US Department of Justice (DoJ) said in a statement that Danske had defrauded US lenders over its anti-money-laundering measures at its Estonia branch, allowing "high-risk customers", including many from Russia, to access the US financial system.

According to court documents cited by the DoJ, Danske's Estonia branch attracted foreign customers between 2008 and 2016 by allowing them to transfer large sums of money through it "with little, if any, oversight". The DoJ added the branch processed $160bn through US institutions on behalf of these clients, and conspired with these individuals to mask the real nature of the transactions, sometimes via shell companies.

According to a *bne IntelliNews* investigation in 2019, Danske even laundered money for the Ukrainian arms mafia's sanctions-busting activities in North Korea and Iran.

All three Baltic states have struggled to control the influx of dubious money from the East into their banking systems, but have been forced to improve their supervision following pressure from the European Union and, in particular, from US prosecutors and regulators.

Denmark's largest bank pleaded guilty to one count of conspiracy to commit bank fraud and agreed to pay about $1.2bn in criminal forfeiture to the US. It will also pay $672mn to Danish authorities, as well as a civil penalty of roughly $178mn to the US regulator, the Securities and Exchange Commission.

The SEC has also charged Danske with fraud for misleading investors on anti-money-laundering compliance shortcomings in the Estonia branch.

US authorities said that while the bank knew by at least February 2014 that some of these customers were involved in potentially criminal behaviour, it lied to US banks about the Estonia branch's anti-money-laundering programme.

"Danske even laundered money for the Ukrainian arms mafia's sanctions-busting activities in North Korea and Iran"

The $2bn penalty is the largest forfeiture imposed by the US Department of Justice on a financial institution compared to its market capitalisation, Kenneth Polite, assistant attorney-general for the DoJ's criminal division, told the *Financial Times*.

Danske's chair, Martin Blessing, said: "We offer our unreserved apology and take full responsibility for the unacceptable failures and misconduct of the past, which have no place at Danske Bank today."

Danske's $2bn penalty is the largest forfeiture imposed by the US Department of Justice on a financial institution compared to its market capitalisation.

In 2018 Danske ousted its chief executive and chair after revealing that much of the €200bn of cash that flowed through its Estonian branch from 2007 and 2015 was suspicious.

Danske withdrew from Estonia when the scandal broke in 2018, selling its operations to local player LHV Pank. Danske Bank has also withdrawn from Russia and Latvia.

Danske booked a charge of DKK14bn ($1.9bn) in October, on top of an initial provision of DKK1.5bn from 2018, to resolve all money-laundering probes.

The lender still faces several civil lawsuits from shareholders, and on December 13 it said it would defend itself "vigorously" against them.

Thomas Borgen, Danske's chief executive from 2013 until 2018, last month won a court case against more than 100 institutional investors suing him for $350mn over the scandal, though it is being appealed. In 2021 prosecutors in Denmark dropped all criminal charges against Borgen.

The former head of Danske's Estonian branch, Aivar Rehe, was found dead in September 2019, two days after being reported missing. The Estonian police determined he had committed suicide. ●

Hungarian PMO unveils size of Russian assets frozen in Hungary after months of silence

Hungary's National Bank ordered the liquidation of Sberbank Hungary on March 2

bne IntelliNews

Hungary has frozen Russian assets worth €870mn, the majority of which are owned by failed Sberbank, Minister of the Prime Minister's Office Gergely Gulyas said at a weekly press briefing last week, fielding a question, ending months of news blackout on the issue.

In December, leftist broadsheet Nepszava reported that the Orban government had informed the European Commission of the size of Russian assets frozen in Hungary at the end of November. Previous reports put the value of seized assets at just €3,000.

The Orban cabinet ordered a news blackout on the issue, Nepszava wrote in December, adding that all of its requests for information were turned down. In other member states, governments were much more open about disclosing related information, it added.

The composition of seized assets, (real estate, cash, or business assets) remains unknown, the daily noted.

Sberbank was put on the sanctions list in July 2022 after the EU introduced financial sanctions against Russia.

The Hungarian subsidiary of the Russian lender was wound up in March 2022, after its Austria-based parent failed amid international sanctions against Russia. The company had deposited HUF100bn (€252mn) in Austrian Sberbank Europe. The Austrian parent company went bankrupt on March 1. A few days later, the National Bank began the liquidation of the bank and the compensation of depositors.

Hungary's insurance deposit fund OBA paid out close to HUF147bn to over 65,000 clients.

The credit portfolio of Serbank Hungary was taken over by MKB Bank, member of the Magyar Bankholding group, boosting its loan book by HUF330bn. The bank took over about 35,000 retail clients and 3,000 corporate clients.

Sberbank Magyarorszag had total assets of HUF511bn at the end of 2020, public records show. ●

> "Hungary has frozen Russian assets worth €870mn, the majority of which are owned by failed Sberbank"

Reports say Russia offered Uzbekistan gas deal but wanted Gazprom to take over country's transmission system

bne IntelliNews

Russia offered Uzbekistan a gas supply deal that might have saved the country from the ongoing heating crisis it is enduring amid a big winter freeze – but only at the cost of the Uzbeks transferring their gas transmission system to Gazprom at market value and also signing over their contract for gas exports to China.

Gazeta.uz has reported on how it learned that the proposal was put to Uzbekistan at the end of November. The conditioned offer of gas, which was rejected by Tashkent, was reportedly made after Moscow urged Uzbekistan and Kazakhstan to join Russia in a tripartite gas union that would protect and enhance their commercial interests, with no political provisos. The gas was to be provided by reversing flows on the Gazprom-controlled Central Asia – Center (CAC) pipeline system that links Russia, Kazakhstan, Uzbekistan and Turkmenistan. Neither Kazakhstan or Uzbekistan have shown much enthusiasm for Russia's gas union idea.

Gazeta.uz further reported: "As a result of bilateral negotiations in December, the conditions set by the Russian side were lifted.

"There are plans to hold a series of additional meetings to assess the technical feasibility of gas supplies. However, the scale of the necessary work requires the mobilisation of significant amounts of funding. In this regard, the practical possibility of organising supplies is unlikely, sources say."

On January 16, Uzbek President Shavkat Mirziyoyev fired the mayor of Tashkent, Jahangir Artykhodjayev, protesting at his "empty words" amid power and gas outages afflicting the capital during severe cold weather.

Given its relatively limited domestic gas resources, Uzbekistan struck a deal with Turkmenistan for CAC winter deliveries of 1.5bn cubic metres (bcm) of Turkmen gas to flow until March. But in the past week, Turkmen has halted its gas flows to Uzbekistan citing difficulties caused by sub-zero temperatures. The extremely cold weather has, according to Ashgabat, caused the formation of gas hydrates at Turkmen oil and gas fields, disrupting operations.

Given its lack of available gas, Uzbekistan has halted gas exports to China and cut off the power supplies it sends to Afghanistan, which are made at gas-fired power plants.

On the domestic market, it has suspended sales of natural gas-based motor fuel – such fuel is popular as a cheaper option than gasoline in the country – and has restricted gas deliveries to industrial consumers. ●

Russia is said to have offered Uzbekistan gas via reverse CAC pipeline flows of supplies sent to Kazakhstan. / Vance Painter, cc.

Analysts say Turkmenistan told US diplomats 'it's not interested' in Caspian gas-to-Europe connector project, wants major pipeline

Will Conroy in Prague

Turkmenistan has informed US diplomats that it is not interested in a modest connector project that would allow some substantial Turkmen gas flows to cross the Caspian Sea for further transit via Azerbaijan, Georgia and Turkey to European markets, according to two academics.

"[Turkmenistan] is signaling that it won't get out of bed for anything less than the decades-old idea of a 30 bcma [billion cubic metres per annum] pipeline. Building such a line, and more importantly arranging the onward transportation and sales in Turkey and EU, would be far more complicated than a simple connector," wrote John Roberts, a a senior nonresident fellow at the Atlantic Council Global Energy Center and Julian Bowden, a former economist with BP and a senior visiting research fellow with the Oxford Institute for Energy Studies (OIES), in an analysis published by the Atlantic Council.

They added: "Moreover, Turkmenistan would probably demand a long-term contract structure which the EU itself cannot provide, and which European companies might be reluctant to sign. Overall, nothing could be completed before 2030, by which time the EU should have resolved its current [energy] supply crisis and be far along the path to a renewables-based energy future."

The authors of the analysis acknowledged in a footnote that they are on the advisory board of a project to lay a 78-kilometre connector line between the Petronas-operated Magtymguly field in Turkmenistan and gas-gathering facilities operated by BP in Azerbaijan's Azeri-Chirag-Gunashli oilfield.

They also observed: "On November 25, Azerbaijan's President Ilham Aliev delivered the most pertinent summary of the current impasse. Asked by one of the writers of this piece about the status of discussions on a trans-Caspian Pipeline, Aliyev said it was up to Turkmenistan: 'They have to make a decision. They want us to do it. They will have to take some action. We will not initiate action.'"

Turkmenistan has the fifth largest gas reserves in the world, but China stands as its sole major gas export market. Moscow might frown on any Turkmen willingness to enter into a project that could replace vast amounts of Russian gas no longer available to Europe given the fallout over the Ukraine war.

Roberts and Bowden concluded that the "problem is the near-total mismatch between European requirements and Turkmenistan's aspirations. Europe wants gas now. In technical terms, this could be accomplished in relatively short order, such as through the Trans Caspian Connector project. This would link Turkmenistan's and Azerbaijan's offshore facilities with a 78-km pipeline, and could be put in place at an estimated cost of around $400-600 million within a few months of securing the necessary approvals of both countries and the necessary financing."

On the other hand, they said, "a 30-bcma system from Turkmenistan to Italy, roughly twice the size of the SGC [Southern Gas Corridor already running from Azerbaijan to Italy], would cost vastly more than the $20 billion required for the SGC's initial pipeline components".

Turkmenistan already has some capacity to feed gas to Europe via the Azerbaijan route, thanks to gas swap pipeline arrangements made with Iran. The analysis authorts noted, however: "Although the current swap via Iran demonstrates that gas from Turkmenistan can already reach Azerbaijan by pipeline, either directly or indirectly, lack of transparency and a 3 bcma limit to Iranian pipeline capacity render it almost irrelevant in the context of European supply." ●

The idea of a major trans-Caspian pipeline has been going nowhere for decades, but a simple connector line linking offshore fields would open up significant Turkmen capacity to supply Europe with gas. / Strati.vaz

IEA expects an inflection in oil markets in 2023 when demand will exceed supply

Ben Aris in Berlin

The International Energy Agency (IEA) reports that oil demand this year will grow by 1.9mn barrels per day, to a record 101.7mn bpd, and supply by 1mn bpd, to 101.1mn bpd, in its first monthly report for 2023 released on January 18. Russia's federal budget is already under pressure from tumbling oil and gas revenues but with a bit of luck a rise in oil prices in the second half of this year could take some of the pressure off.

The oil market has already been hit by the oil price cap scheme and EU embargo on the import of Russian crude that went into effect on December 5. It will receive a second blow when a similar two-speed embargo and price cap regime is introduced by the EU on February 5 that will further affect supplies. However, oil prices for Brent rose to $85 after the IEA released its report on January 18.

So far, the EU ban on crude has led to a fall in Russia's exports of crude as international tanker companies shy away from Russian oil, afraid of secondary sanctions. The discount on the Russian Urals blend of oil has also blown out to almost 50% against the benchmark Brent blend.

However, analysts speculate that these changes in price and volume will be temporary while the market and Russia find new routes and customers for its oil products. A similar thing happened in the first months of the war in Ukraine where Russian exports fell as traders avoided buying the Urals blend and the discount increased then as well. However, after a few months traders in Asia – in India and China in particular – stepped in to buy the very cheap Russian oil driven by market forces. Analysts assume that something similar will happen now, but where the export volumes and prices will settle remains a matter of debate.

The IEA predicts that there will be a turning point in the international oil market in the middle of this year. The latest IEA's Monthly Oil Statistics report including October 2022 data shows that for the main areas within the OECD:

- Total OECD production of crude oil, NGL and refinery feedstocks increased by 4.3% in October 2022 compared to October 2021.
- Refinery gross output of total products grew by 1.9% on a year-on-year basis.
- Net deliveries of total products decreased by 1.5% in October 2022 compared to October 2021.
- Oil stock levels on national territory grew by 396,000 tonnes in October 2022 compared to the closing stock levels in September 2022 and closed at 472mn tonnes.

In the first quarter, the IEA predicted an excess of oil on the market of about 1mn bpd, but in the second that figure will decrease significantly. By the third and fourth quarter, demand will already exceed supply by 1.6mn and 2.4mn bpd respectively, pushing up prices, The Bell reports.

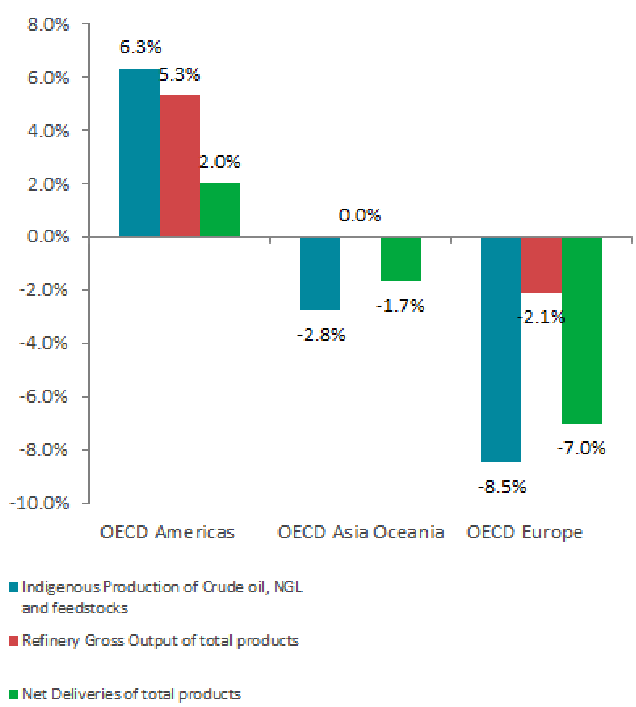
Just when the inflection point arrives will depend on two factors: the speed of China's economic recovery and the reaction of Russian production to the EU embargo on petroleum products.

The IEA is not optimistic about the prospects for the Chinese economy, but nevertheless predicts that China will account for almost half of the global growth in oil demand (850,000 bpd) in 2023, and will outstrip India.

If the recovery turns out to be stronger than the forecast, "the cushion of stocks in storage will disappear very quickly," said the head of the IEA, Fatih Birol, in the latter's latest oil bulletin.

Russia remains the "dark horse" in this year's oil outlook, as it is not clear how it will respond to the new sanctions due in February. In December, production decreased slightly to 11.2mn bpd, but the consequences of the embargo on petroleum products, which are much more widely distributed

Growth rate per flow and OECD region in October 2022 (y-o-y)



in Europe, will be much more severe, the IEA says. Currently the agency is forecasting a decline in production of 1.6mn bpd in the first quarter and of 1.3mn bpd to 9.7mn bpd on average for the whole year compared to 2022, The Bell reports.

Russian President Vladimir Putin has already lost the winter energy battle with the West thanks to record imports of LNG and an unusually warm winter. Birol believes that Russia will also lose the wider energy war with the West starting with defeats in the coming quarters in the expanding oil sanctions war, and even more so in the coming years as Europe remakes its energy supplies. It will become increasingly clear that India and China will not be able to entirely replace Russia's European customers, the IEA believes.

On the same day the world's largest oil company, Saudi Aramco, released its outlook for 2023. It also hopes for a Chinese recovery and predicts additional demand for jet fuel, pointing to a shortage of new production of 4mn-6mn bpd.

After the IEA's forecasts of record demand, the price of Brent rose above $87 – the level of early December – before falling back to $85 by the close of trading.

For Russia the price of Brent is critical for the budget. The introduction of the crude embargo has already seen Russian budget revenues tumble in December to end the year with a 2.3% of GDP deficit, almost all of which was due to a collapse in Urals oil prices in December. For 2023, the government is now forecasting that the deficit will widen from around 2% to 3% as a result of the changes in oil and gas revenues expected this year.

Currently it's not unclear how the price of Urals will be affected by the new sanctions after February 5, but it is obvious that Russia cannot replace Europe with new customers for all oil products it currently exports there. Russia will have to reduce both refining and oil production as a result. Domestic experts consider $40 per barrel as the level that will cause severe problems for the budget and in December-January, Russian oil already approached this level. However, Russia's budget revenues may be rescued by the inflection in demand in the second half of the year, which could push oil prices up sharply. ●

Foreign investment has transformed Eastern Europe, says wiiw report

Equity investments by German carmakers into greenfield plants in Central Europe have helped convergence much more than investments through loans in Southeastern European countries such as Montenegro, Serbia and Bulgaria, a path often followed by Chinese companies. / bne IntelliNews

Robert Anderson in Prague

Foreign direct investment (FDI) has stimulated economic growth in Central, East and Southeastern Europe (CESEE) over the past 30 years, helping convergence with Western Europe, but some forms of FDI have been much more beneficial than others, according to econometric research by the Vienna Institute for International Economic Studies (wiiw) published on November 30.

At a press conference, speakers from the wiiw and the German Eastern Business Association (which commissioned the report) insisted that despite a slowdown in FDI flows since the Global Financial Crisis, foreign investment would continue to have a vital role to play in the region's development, particularly now that international companies are rethinking their supply chains.

Phillipp Haussmann of the German Eastern Business Association admitted that the German economy had benefited more than almost any other from the opening of markets and the lower production costs in Eastern Europe since 1989.

At €360bn, German trade with the CESEE region was now one fifth of Germany's total trade, bigger than that with the US and China combined. "Our close economic ties with the region made a decisive contribution to Germany's global competitiveness," he said.

But he added that the investment and trade relationship between Germany and Eastern Europe had benefited both sides and was not a "one-way street".

The report, entitled "Economic and Social Impacts of FDI in Central, East and Southeast Europe", in fact showed that German and Austrian FDI had the most impact on the region in terms of growth, creating jobs, raising wages, as well as reducing poverty and not widening inequality, largely because it was concentrated in the sectors such as manufacturing, and via means such as retained earnings, that had the biggest effects.

Haussmann added that the efforts by some states to weaken these investment links were therefore misguided. "Efforts to disadvantage foreign investors or to force them out of strategic sectors are a loss for both sides," he warned. Viktor Orban's regime in Hungary has regularly launched such campaigns against foreign investors.

"The shortening and regionalisation of supply chains play an important role in this. There are tremendous opportunities for Central and Eastern Europe if the framework conditions are right"

The report dismisses populist arguments against FDI, such as that it crowds out domestic investment, arguing that the weak linkages between domestic and foreign companies in the region meant that FDI had had no effect on domestic investment either way.

Tremendous opportunities

The panellists also pointed out that there would also still be great opportunities for CESEE countries from planned nearshoring or "friendshoring", as multinationals seek supplies from nearer countries or those that share Western values following the disruption to supply chains caused by the COVID-19 pandemic in China, as well as the Ukraine war and sanctions on Russia.

"Right now, German companies are reorganising their international supply chains against the backdrop of global upheavals," Haussmann said. "The shortening and regionalisation of supply chains play an important role in this. There are tremendous opportunities for Central and Eastern Europe if the framework conditions are right."

Gunter Deuber, chief economist of Raiffeisen Bank, one of the biggest banks in the region, added: "A lot of companies are currently looking at projects," though he said the new investment cycle would start in two to three years.

The European Bank for Reconstruction and Development's 2022/23 Transition Report published last week included a survey showing that three quarters of German manufacturing companies in global supply chains have implemented at least one measure to improve the resilience of their supply chains and that Central European suppliers were seen as much more reliable than Chinese or other Asian ones. Already in Hungary and Slovakia more than 35% of output comes from work for global supply chains.

However, the panellists said that the rule of law – currently a serious problem in Poland and Hungary – and labour shortages were big obstacles to a new FDI wave. Haussmann warned: "The shortage of qualified labour is becoming more and more a problem. That is the biggest problem – as long as the rule of law is guaranteed."

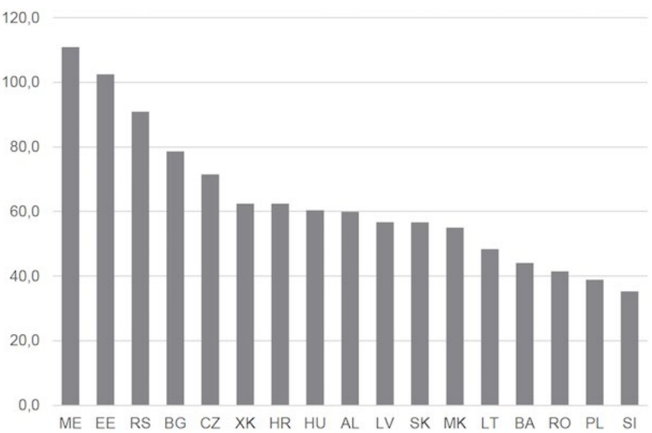
According to the report, since the collapse of communism, CESEE countries have had a wave of FDI that has completely transformed their economies. Between 1993 and 2020 the world as a whole has been receiving annual FDI inflows of around 2.5% of global GDP, while foreign investment in the 17 countries in CESEE has averaged 4.4% of GDP (the report excludes post-Soviet countries apart from the Baltic states).

After an early focus on Central Europe and the Baltic states, over the past decade investment has been moving into the Western Balkans.

In relation to GDP, the highest stock of FDI is in Montenegro at 110% of GDP, followed by Estonia at 100% and Serbia at 90%; the lowest were in Slovenia, Romania and Bosnia & Herzergovina, at around 40%.

In the four main states of Central Europe, Czechia has the highest stock of FDI as a percentage of GDP, followed by Hungary, Slovakia and then Poland – by far the largest economy – bringing up the rear.

Total stock of FDI in 17 CESEE economies in 2020 (% of GDP)



Source: wiiw FDI database

Most of these inflows into CESEE – around 60% of the total – have come from the nearby EU15 countries, with Germany focussing most on Central Europe, while Austria has carved out a niche in the Western Balkans, and the Nordic countries in the Baltic states. By contrast, Russia, China, Turkey and companies registered in Switzerland have been big players in the Western Balkans.

According to the report, FDI inflows representing 1 percentage point (pp) of GDP are associated with 0.19 pp higher GDP growth, indicating a causal link between FDI and GDP growth via increased household consumption and higher exports.

For FDI from Germany and Austria, this effect is five times higher – FDI inflows of 1 pp of GDP have led to 0.9 pp higher GDP growth. Germany had invested some €190bn in the region by the end of 2020, while Austria had contributed €76bn.

FDI has also lowered unemployment, though normally after a two-year lag, and has also increased wages.

> "CESEE economies should not give up on their efforts to attract more FDI, but also their endeavours should be more targeted, focusing on investments that have greater economic and social impacts"

Investment into manufacturing and services has had more impact on economic growth than investment into the primary sector (agriculture and mining), and FDI via equity injections or retained earnings has been more beneficial than investment via debt instruments (such as loans to affiliates), the research found.

"FDI in debt instruments or FDI in the primary sector does not have the same effect on GDP growth, and sometimes it has negative effects," Branimir Jovanovic, one of the authors of the report, told the press conference.

This would indicate that equity investments by German carmakers into greenfield plants in Central Europe have helped convergence much more than investments through loans in Southeastern European countries such as Montenegro, Serbia and Bulgaria, a path often followed by Chinese companies.

Targeting investment

The report admits that overall, FDI has had no significant impact on inequality and poverty, but adds that FDI from European countries has been found to reduce both inequality and poverty, likely because it has benefitted mainly lower-income persons. By contrast investment through loans or into primary industries such as mining have had much less impact.

"CESEE economies should not give up on their efforts to attract more FDI, but also their endeavours should be more targeted, focusing on investments that have greater economic and social impacts," the report recommends.

The report argues that foreign investment should not be criticised for widening inequality, or the fact that the region has the highest poverty rates in Europe, but instead, the causes of this should be sought in domestic factors.

"Our results indicate that the reasons for the perhaps unsatisfactory economic and social outcomes in the CESEE countries – such as the limited economic growth and the significant level of social disparities – should not be attributed to the foreign investment," the report says. "Instead, one should look at domestic factors, such as weak support for domestic private investment, insufficient public investment in infrastructure, a modest level of spending on public services and the limited scope of government redistribution."

At a press conference, Doris Hanzl-Weiss, one of the authors of the report, concluded that, "FDI is still important for the growth model of the region. We don't see any big alternative growth model for the region without FDI as a cornerstone."

Maria Holzner, executive director of wiiw, also insisted that FDI still had a big part to play in the region's development. "Foreign direct investment continues to be the basis of the growth model in Central and Eastern Europe," he said. "Those countries in the region that have the highest incomes are also closely integrated into the Central European industrial cluster through high levels of foreign direct investment. A good example is the direct investments of the German automotive industry, which have created tens of thousands of jobs for qualified skilled workers who were particularly hard hit by the collapse of large state-owned industrial enterprises in the course of the economic transformation after 1989." ●

> "Foreign direct investment continues to be the basis of the growth model in Central and Eastern Europe"

McDonald's revokes licence of Bosnian franchise after series of scandals

Denitsa Koseva in Sofia

McDonald's has revoked the licence of its franchise in Bosnia & Herzegovina and all the local restaurants were closed at the beginning of January.

No official comment has been made on the reasons for the decision, but it follows a series of scandals. Unnamed Bosnian employees of the former franchisee, the company Gliese 581g, told local media that unpaid rents to Raiffeisen Bank and the company's alleged involvement in a political campaign are behind the decision.

The revoking of the licence was confirmed by Edin Forto, governor of the Sarajevo Canton.

"The announced exit of McDonald's from Bosnia is bad news for our economy," Forto wrote on Twitter. He added that no country needs negative stories by investors.

At the end of 2022, Gliese 581g, owned by local businessman Haris Ihtijarevic, lost a case against Raiffeisen Bank's Bosnian arm over unpaid rent. At the beginning of December 2022, the Cantonal Court in Sarajevo ordered the return of a space where one McDonald's restaurant was located to Raiffeisen Bank due to unpaid rents, Indikator.ba reported. Although there was no official information on the accumulated debt, the Sarajevo Times reported that it amounted to €500,000.

Gliese 581g has claimed the rent was not paid as it had to make a significant investment in the renovation of the facility, although the contract had a clause that Gliese 581g would have to adapt the location at its own risk.

Avaz reported that the licence was taken due to Gliese 581g's involvement in politics. The company allegedly provided marketing space to the main Bosniak party, SDA, during the election campaign ahead of the October 2 general election. If true, this would have violated McDonald's policy of non-involvement in politics.

The first McDonald's restaurant was opened in Bosnia in the beginning of 2011. However, it failed to expand – as seen in neighbouring countries – and had just five restaurants open by the end of 2020.

In Bosnia, the chain was competing with local brands as Cevapi. According to Sarajevo Times, McDonald's was too expensive for the Bosnians.

Despite this, the Bosnian company has generated significant revenues. For 2022, revenues reached BAM17.75mn (€9.1mn), while for 2021 they stood at BAM11.53mn, the Bosnian daily Avaz reported. Profit stood at BAM2.32mn in 2022 versus BAM778,000 in 2021.

McDonald's reported closure in Bosnia follows the shutdown of its outlets in first Russia and later Kazakhstan in 2022.

The fast food chain was among numerous international brands to leave Russia after sanctions were imposed following the invasion of Ukraine. McDonald's initially announced the suspension of its operations in Russia, but kept paying the salaries of its 62,000 staff. Then in May 2022, McDonald's sold its Russian assets to Russian licensee Alexander Guvnor.

Its successor on the Russian market is Vkusno – i Tochka, is understood to have hoped to enter Belarus as well. However, Belarus' authoritarian President Aleksander Lukashenko is understood to have wanted a local rather than Russian successor to the fast food giant's Belarusian operator, famously commenting: "we know how to cut a bun in half".

In Kazakhstan, McDonald's restaurants were temporarily shuttered in November due to supply issues. The general director of the Kazakh franchisee of McDonald's, Food Solutions KZ, Asset Mashanov, said in December that McDonald's plans to stay in Kazakhstan and the company is working on putting its restaurants back in operation." ●

> "The announced exit of McDonald's from Bosnia is bad news for our economy"

Romania's car production accelerates past 500,000 for the first time

Iulian Ernst in Bucharest

Romania's automobile industry boasted its best year in 2022 when both of the two car factories Dacia and Ford produced roughly 20% more units compared to 2021, surpassing altogether, for the first time, the 500,000-unit threshold.

The outlook indicates robust growth and deep transformations within the national automobile industry. The region's dependence on the automobile industry is seen as a vulnerability, but among Romania's industries, automobile production is perhaps among the least dependent on outsourcing from parent groups therefore more likely to generate value-added locally.

Renault's CEO Luca de Meo recently admitted in an interview that the profit margin at Dacia is three times larger than that at its parent company Renault (15% versus 5%).

Ford Otosan, the new owner of the Ford factory in Craiova, plans to invest €490mn in the plant over the next three years to expand production growth and play a key role in Ford's electrification journey in Europe.

Dacia will also join the electrification trend, with a hybrid Jogger already launched and a new version of the all-electric Spring soon on the market. Separately, Renault's engine factory in Romania (Renault Mecanique Romania) will be a driving force behind Renault's Horse project for the internal combustion division.

Despite the disruption of the distribution chains that continued last year and the semiconductor crisis, Romania's production rose by 21% y/y to nearly 510,000 units in 2022.

For comparison in 2004, when Renault launched the first brand-new model after it took over the factory in 1998, Romania produced less than 100,000 units – Dacia Solenza and Logan and Matiz, a model produced by Daewoo at the factory now owned by Ford.

"Renault's CEO Luca de Meo recently admitted in an interview that the profit margin at Dacia is three times larger than that at its parent company Renault"

In 2022, Dacia assembled nearly 315,000 units and Ford over 195,000.

Notably, compared to the year 2019 – when the last record in terms of aggregate production was marked (490,000 units) – Dacia produced fewer units in 2022.

Ford, in contrast, boosted its output by one-third compared to 2019, thanks to the launch of the Ford Puma model.

Dacia has also launched new models such as the seven-seater Jogger – but its entry into the electric vehicles market was pursued through the import of a model produced entirely in China, Spring, which quickly became popular. ●

Dacia Logan. www.shutterstock.com

bne:Funds

Southeast Europe sovereigns start 2023 with return to capital markets

bne IntelliNews

Serbia became the latest country from emerging Europe to tap the international capital market on January 19, raising $1.75bn with two heavily oversubscribed dollar-denominated eurobonds.

Serbia followed Slovenia to the market, where the other Southeast European country issued a 10-year sustainability bond worth €1.25bn on January 4. Slovenia was the first country in the region to enter the capital market in 2023.

Other countries including Albania and Bulgaria are understood to also be preparing for bond issues early in 2023, in anticipation of an increase in yields later in the year.

Serbia records record-high investor interest

Serbia's Finance Minister Sinisa Mali said investor interest in the January 19 offer was at a record high for Serbian bonds, with the demand six times higher than the offer, at $11bn, a government statement said.

"More than 500 respectable investors from all over the world have shown interest in our securities," said Mali, attributing this to Serbia's solid economic results.

During the issue process, due to high demand, the Ministry of Finance managed to reduce the yield compared to the initial offer, the government said.

New bonds with a maturity of five years were issued in the amount of $750mn at a coupon rate of 6.25%. Ten-year bonds were issued in the amount of $1bn at a coupon rate of 6.5%.

Mali commented that "Serbia achieved an excellent interest rate, especially considering that on the capital market our country fared similarly to Hungary, which is a member of the European Union and has an investment rating, and better than Romania, which also has an investment rating and is a member of the EU."

Belgrade decided to issue the bond at the start of the year in anticipation of further growth of yields on the international market.

Mali commented that "the global crisis, the conflict in Ukraine and energy instability are raising the price of money on the market, so we will have to wait for the end of this crisis in order to reach the 2% interest rates that were available to us in 2021."

The funds will be used to maintain financial stability and support economic growth.

Slovenia gets away second sustainability bond

Slovenia, meanwhile, raised €1.25bn with its second sustainability bond, with a coupon of 3.625%, as announced by the finance ministry. Inflows from the bond are intended to finance investments that support environmental and social goals.

At the same time, Slovenia expanded the outstanding Eurobonds due in August 2045 by additional issue of €250mn with a coupon 3.125%.

The ministry said that the total demand for the sustainability bond issue due on March 11, 2033 exceeded €10bn.

Previously, the government mandated BNP Paribas, Citi, Deutsche Bank, Erste Group, Nova KBM and UniCredit to organise meetings with investors on January 3 to present the bond issue.

Slovenia issued its first 10-year sustainability bond of €1bn at the end of June 2021. The coupon rate of the issue was 0.125%.

Romania issues $3.75bn of FX bonds

Romania plans more Eurobonds this year, and is considering Samurai issues. The country needs to borrow RON160bn (€32bn, over 10% of GDP) from the domestic and foreign markets to finance the budget deficit and refinance previous debts.

Romania issued $3.75bn of FX bonds with maturities of five, 10 and 30 years on January 7, as the first move. The finance ministry initially announced a target volume of up to $4bn and said that part of the money would be used to redeem in advance the issues maturing in August ($1.28bn) and January 2024 ($0.88bn).

The US dollar issues were heavily oversubscribed, with investors placing orders adding up to $11bn with a particular interest in the 30-year maturity, according to *Ziarul Financiar* daily.

Romania plans to issue €11bn-12bn worth of FX bonds this year in an attempt to ease the pressure on the local market. Stefan Nanu, State Treasury head, told Bloomberg that the financing should not put pressure on local investors and that Romania will continue to rely on foreign borrowing for a large part of the funds it needs. On the day the FX bonds were launched, January 5, the yield on 10-year bonds denominated in local currency fell by 15bp to 8.23%.

Bulgaria to sell 10-year Eurobond

Bulgaria's finance ministry plans to sell a new 10-year bond, seeking to raise €3bn on international markets, MP Vladislav Panev revealed on January 17.

"You have not yet heard the news of the day but surprisingly the Ministry of Finance has issued a new 10-year bond. Without a roadshow, without preliminary information," Panev wrote on Facebook.

According to Panev, the proposed coupon is 5.23% per year.

"So far, the orders [placed] are for €3bn, let's see how many will be approved," he said.

According to GlobalCapital, the joint book runners of the issue are BNP Paribas, Citi, JP Morgan and UniCredit. It quoted a syndicate banker as saying that the deal was going "very well".

Albania eyes international issue

Albania is also planning an issue on international markets, and Monitor.al reported at the end of 2022 that the finance ministry in Tirana has already picked law firm Dechert LLP for the transaction.

Finance Minister Delina Ibrahimaj said in November that Albania plans to raise at least €500mn through a Eurobond issue in 2023. She said at the time that preparations for the Eurobond issue had already started, but it would only go ahead if market conditions proved favourable.

The bond issue has been included in the 2023 budget, but Ibrahimaj stressed that the government has other options if it decides not to proceed with the issue.

Albania issued its fifth Eurobond in November 2021, to support its budgets for 2021 and 2022. The €650mn 10-year sovereign Eurobond was issued with a coupon of 3.50%, down from 3.625% on the previous Eurobond". ●

Uzbekistan fights gloom as stock market fails to spark

bne IntelliNews

Long-awaited developments expected to benefit Uzbekistan's stock market did not come to pass in 2022, Kursiv has reported.

One example, it said, was the much-anticipated initial public offering (IPO) of sole major Uzbek automaker UzAuto Motors. It was postponed to a date a month from now after the company failed to obtain a sufficient number of share subscription applications by a deadline of December 28.

The UzAuto IPO was to pave the way to a massive privatisation campaign, according to government plans. A government decree in August named more than two dozen companies that were to list on the stock exchange. Steel producer Uzmetkombinat, an Uzbek blue chip, was in a queue of some of the country's largest state-owned enterprises (SOEs) that were ready to place shares after UzAuto.

To make the shares of UzAuto more attractive to investors, the automaker even arranged compliance with international halal requirements. Initial plans envisioned the placement of up to 5% of the company's shares to raise up to $90mn. But after the underwriter's assessment of demand, it became clear that the market would be able to absorb only up to 1%. At the announced prices, the IPO volume would have only amounted to $17.3mn to $19.5mn.

The plan was to close the subscription application book for UzAuto shares on December 22, with the IPO supposed to take place on December 23. But these plans did not come to fruition – and the deadline for accepting share applications was postponed firstly to December 28, and then to February 15.

Behruzbek Ochilov, investment banking manager at underwriter Freedom Broker, told Kursiv: "The IPO fell at the end of 2022. It was just the time when the international investment banks and funds were going for a long weekend. And it turned out to be impossible to cover the entire

Global headwinds have been a big factor in blowing the stock exchange off course. / wiki.

volume of the offer only at the expense of local investors. The market is still young. It will take time for its full development."

After the announcement of the postponement of the IPO, some investors withdrew their applications for the purchase of UzAuto securities. By December 28, almost 1,200 share requests had been processed. Investors it turned out were ready to buy only 8.65%, or 233,500 securities, of the proposed IPO volume. A total of 2.7mn shares were put up for sale. As of January 10, the number of applications had decreased to 1,160, with a purchase volume of 176,170 shares (6.52% of the total available).

Head of Tashkent Republican Stock Exchange Georgy Paresishvili said that the unfinished IPO of UzAuto was, on the one hand, caused by unfavourable market conditions, while, on the other hand, it was explained by the fact that the investment infrastructure in the country was not yet fully ready to accept foreign investors.

"Foreigners have the opportunity to buy shares, but not everyone trusts the local infrastructure, so they prefer to store securities in international depositories, for example, in Clearstream. Last year, we already started actively working to make such institutions work in Uzbekistan, but it takes time to comply with all the procedures. We will not have time to complete for the IPO of UzAuto. Unfortunately, this is a long process. Therefore, the company will not be able to count on global financial investors," said Paresishvili.

“There are still reasons for optimism,” he added. “The number of transactions and trading volume are growing. That allows us to hope for the completion of not only this IPO, but also other placements scheduled for 2023.”

Bahodir Atakhanov, chairman of the National Association of Investment Institutions, was more pessimistic. He said he thought 2023 would be a difficult year for the stock market. “Many factors play a role. One of the main ones is the ongoing conflict between Russia and Ukraine. Practice shows that investors leave emerging markets during crises. Therefore, last year they were reluctant to come to our country, as well as to other similar markets,” Atakhanov said. “They went in different directions.”

In 2022, 80,700 transactions involving securities worth Uzbekistani som (UZS) 4.8 trillion ($424.7mn) took place on the stock exchange. The number of purchase and sale transactions increased by 12%, while the volume rose almost fourfold.

Atakhanov noted that the UzAuto IPO experience has shown that the stock market in Uzbekistan is not deep enough. It suggested that 2023 would be difficult. It was necessary to attract the resources of Uzbek citizens, but achieving this objective was hindered by a number of factors. "I would mention five points that hinder the development of the stock market. The first factor is the lack of confidence among the population and business in the correctness of the social and economic reforms carried out in the country, given that approaches change very often. It seems that the authorities do not have a long-term strategy and vision, therefore, the planned medium-term plans are not being completed, and state funds are being used irrationally.

“It must also be admitted that the formation of a sceptical mood was significantly influenced by the global lockdowns that were due to the outbreak of covid, an unpredictable dangerous neighbour, Afghanistan, and now the global crisis caused by the armed conflict in eastern Europe with the participation of Russia, Uzbekistan's strategic partner, in the main role," Atakhanov said.

“Foreigners have the opportunity to buy shares, but not everyone trusts the local infrastructure, so they prefer to store securities in international depositories”

According to Atakhanov, another significant factor was the state policy on preferential lending to businesses. "This inevitably leads to an imbalance between the sectors of the financial market, the competitive environment is disrupted. Some economic entities receive advantages in the form of state support, and it becomes unprofitable for their potential and existing competitors to attract the necessary resources through the stock market," he concluded. ●

bne:FX

Croatians start shopping in neighbouring Slovenia after euro price hikes

bne IntelliNews

Kreso Beljak, the leader of the Croatian Peasant Party, has admitted he now crosses the border into neighbouring Slovenia to do his shopping to avoid “shameful” price rises following Croatia’s adoption of the euro.

Many Croatians complain that retailers are rounding up prices in breach of the guidelines issued by the central bank after the switch to the euro on January 1. Price increases were seen in earlier entrants to the eurozone too, but in Croatia they follow months of steep inflation.

The government has said that it will introduce measures to stop the unreasonable price hikes, including blacklisting retailers who don’t follow the rules.

Beljak said the price hikes were not surprising. "Prices of items are determined by the market, and I am not surprised that they have risen. Obviously, it is determined by the demand. It is a simple rule of the market economy — the higher the demand for something is, the higher the price for it would be," Beljak said in an interview with N1.

However, he added that the differences in prices of goods between Croatia and neighbouring Slovenia are “shameful” for his country.

"For me or the people in Samobor [a small town between Zagreb and the Slovenian border] there is no difference whether we go to Zagreb or Slovenia to do our shopping [in terms of distance]. In Slovenia, instead of €100, I spent 70. My wife was on the phone back in Samobor comparing the prices. It is shameful,'' Beljak said.

He argued that it was not the government’s job to intervene on the market in the current situation as the market would self-regulate based on demand.

"The market forms the prices, not the state. The state is there to ensure a higher salary, to make so people able to buy more in such cases. The state needs to reduce the taxes and levies so that net wages rise, increasing the purchasing power of people," Beljak said. ●

Remittances between the EU and Ukraine expected to recover in 2023 after 10% fall in 2022

bne IntelliNews

Remittances between the EU and Ukraine will expand in 2023, after declining by between 5% and 10% in 2022, according to money transfer system Tempo France.

The total volume of remittances to Ukraine exceeded $17bn last year, with money sent from the EU accounting for over 40% of the total.

The fall in transfers between the EU and Ukraine will decline by another 5% in the first quarter of this year, according to the company, but then be followed by a pick-up in the spring, and eventually volumes will expand by 5% for the full year compared to 2022.

The decline in remittances in 2022 was due to both the war with Russia leading to a decrease in the number of potential recipients in Ukraine and weakened economic activity in the EU.

Poland dominates as the origin of money sent to Ukraine, accounting for 30% of remittances, more than all the other EU countries combined.

There are over 3.4mn Ukrainians now living in Poland, up from an estimated 2mn before the war, and the country has issued over 1.3 resident permits to new Ukrainian nationals throughout 2022.

In 2022, the average remittance cheque from Poland to Ukraine slipped from €175 in January to €140 in December, which Tempo France attributes to increasingly difficult conditions for expat Ukrainians sending money home.

In 2023, Tempo expects many Ukrainians to return home and positive European economic trends that will lead to approximately 5% growth per annum in both the EU-Ukraine and Poland-Ukraine money transfer corridors.

Service providers eliminated tariffs in 2022 to make transfers more affordable. In 2023, competition in the corridor is anticipated to increase and companies will offer new technological solutions and convenience to attract clients, Tempo France has already implemented a mobile app that can convert Polish zlotys directly to Ukrainian hryvnias, whereas previously users had to convert to euros first before converting into either of the two national currencies.

Tempo has also integrated its app into the Stellar blockchain to improve transparency and the speed of the transaction, and reduce costs to a minimum.

The company said that if the situation in Ukraine stabilises by the end of 2023, money transfer volumes between the EU to Ukraine could grow from 15% to 20% in 2024. ●

Russia's VTB bank defies US sanctions on Iran with cross-border Iranian rials transfers

VTB is the first Russian bank to open Iranian floodgates in rial transfers / bne IntelliNews

bne IntelliNews

VTB, the Kremlin's second-largest bank, has announced it will launch cross-border bank transfers in Iranian rials, in direct contravention of US sanctions, *Kommersant* newspaper reported on December 19.

Retail and commercial account holders of VTB will be able to transfer amounts of up to $300,000 (RUB20mn) in an equivalent rial (IRR) amounts.

According to the bank, all transfers will pay a 1% commission at a minimum of RUB15,000 with funds credited to an Iranian bank account on the next business day.

"Cross-border transfers are available both in favour of individuals and legal entities in compliance with the requirements of currency legislation" the bank noted in its press release.

Customers will need to open a new Iranian rial account with VTB by purchasing currency from the bank via its mobile application. Transactions can also be done via depositing rials in VTB branches.

"We have become the first bank to implement international money transfers to Iran and, taking into account the strengthening of business ties, the growth of economic cooperation and the development of tourism, we expect that they will be in demand" the bank added.

VTB has past experience with dealing with bank transfers with Iran but was fined $9.5mn by the US for violating bank sanctions in 2014.

Earlier in November, the bank announced it was shutting down operations in London after a "100+ year history" in the City of London, according to its latest regulatory filing.

The London operation, which can trace its lineage back to Tsarist times via its Moscow Narodny subsidiary based near Cannon Street since the Revolution in 1917, has been a prestigious calling card for the Kremlin in the UK.

The US Department of the Treasury's Office of Foreign Assets Control penalised Bank of Moscow (a VTB subsidiary) for authorising 69 financial transfers, worth roughly $41mn, for a Russian subsidiary of Iran's Bank Melli between 2008 and 2009. ●

bne:Deal

Mutual FDI in Eurasia has been dominated by Russia, but war and sanctions make the outlook uncertain

In the early years after the collapse of the Soviet Union eastern Europe was hoping western investors would remake their economies. Three decade on and increasingly FDI has become a regional phenomenon. / bne IntelliNews

Ben Aris in Berlin

The mutual Foreign Direct Investment (FDI) stock in the Commonwealth of Independent States (CIS) countries grew fast until Russia went into recession in 2012, when its GDP growth sank to zero. However, it started to recover after the recession ended in 2016. As of the first half of 2022 the mutual FDI was on track to slightly exceed that of 2021, but the outlook is now in doubt after the war in Ukraine began in February, according to research released by the Eurasia Development Bank (EDB) in December.

The mutual FDI stock in Eurasia (CIS countries and Georgia) totalled $44.6bn by mid-2022, of which Russian investors accounted for approximately 80%. Kazakhstan imported the largest amount of investments, $10.8bn or 24.3% of the total.

The mutual FDI stock in the narrower member of the Russia-lead Eurasian Economic Union (EUU) countries amounted to $24.5bn in first half of 2022. Investors in EEU countries are mostly interested in greenfield projects (up 1.6 times over the last six years) and private investment dominates (56%), according to the EDB.

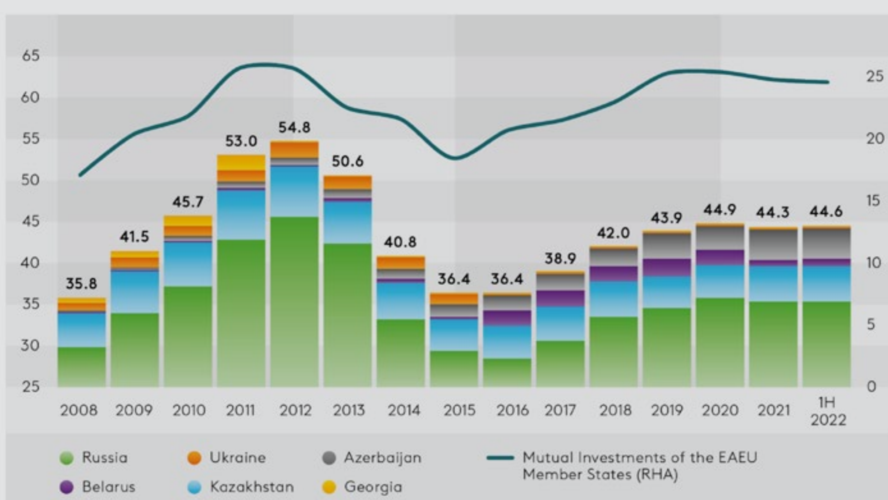
Two periods of growth

Mutual FDI in Eurasia has seen two periods of significant growth. The first was between 2008-2012, when it increased from $35.8bn to $54.8bn. The second period was between 2016-2020, during which the FDI stock rose from $36.4bn to $44.9bn. However, by the end of 2021, the mutual FDI stock had declined to $44.3bn. As of mid-2022, the mutual FDI in the Eurasian Economic Union (EAEU) countries was estimated at $24.5bn, according to the EDB.

Russia is by far the largest investor in the CIS, with its FDI accounting for 79.2% of total CIS mutual investment by mid-2022. For decades Russia has been a net exporter of capital as its business invest in the “near abroad”, as Russian investors have dubbed the countries of the Former Soviet Union (FSU).

Kazakhstan and Azerbaijan come in second and third, with shares of 9.5% and 8.4% respectively. Azerbaijan is particularly active in the region, with its outward FDI amounting to 6.7% of the country's GDP. This indicates that Azerbaijani companies have increased their investment capacity and are now expanding into other CIS markets.

Mutual FDI stock in CIS and EAEU countries, US $ billions



Regional investments

In the early days of the post-Soviet era, governments and businesses were expecting a flood of western FDI to come and remake their economies, but volatility and corruption stymied direct investors' enthusiasm and apart from the countries that joined the EU, the levels of FDI elsewhere in Eurasia was low, or focused on a few mega raw materials and energy projects.

In the last decade regional governments have increasing turned inwards and begun to mutually invest into their neighbours, promoting trade and mutually beneficial infrastructure projects. In particular, Azerbaijan, Georgia and Turkey formed a golden triangle of mutual investment with each of the three playing to their mutually complementary strengths. A similar, but less pronounced, effect has been seen amongst the countries of the CIS.

"In the last decade regional governments have increasing turned inwards and begun to mutually invest into their neighbours, promoting trade and mutually beneficial infrastructure projects"

"Azerbaijan is an active investor in the region. Its outward FDI amounted to 6.7% of the country's GDP (compared to 2% in Russia). This suggests that Azerbaijani companies have enhanced their investment capacity and are now expanding into other CIS markets," the EDB said in a report.

In terms of inward mutual FDI, Kazakhstan has the largest share at 24.3% as of the first half of 2022, followed by Uzbekistan (20.1%) and Belarus (12.6%).

In 2022 there have been significant changes in the investment structure compared to 2016, with Ukraine's share declining threefold from 12.0% to 4.0%, after it broke off relations with Russia and turned to the EU instead. Uzbekistan, on the other hand, saw the largest increase in inward investment, from 11.7% to 20.1%, due to an improved investment climate following the election of Uzbek President Shavkat Mirziyoyev in 2016.

The top five FDI destinations in the CIS are Kazakhstan, Uzbekistan, Belarus, Azerbaijan and Armenia, all receiving the lion's share of investments from Russia. Other important destinations include Russia (for Kazakhstan's FDI), as well as Georgia and Ukraine (for Azerbaijan's FDI), according to the EDB.

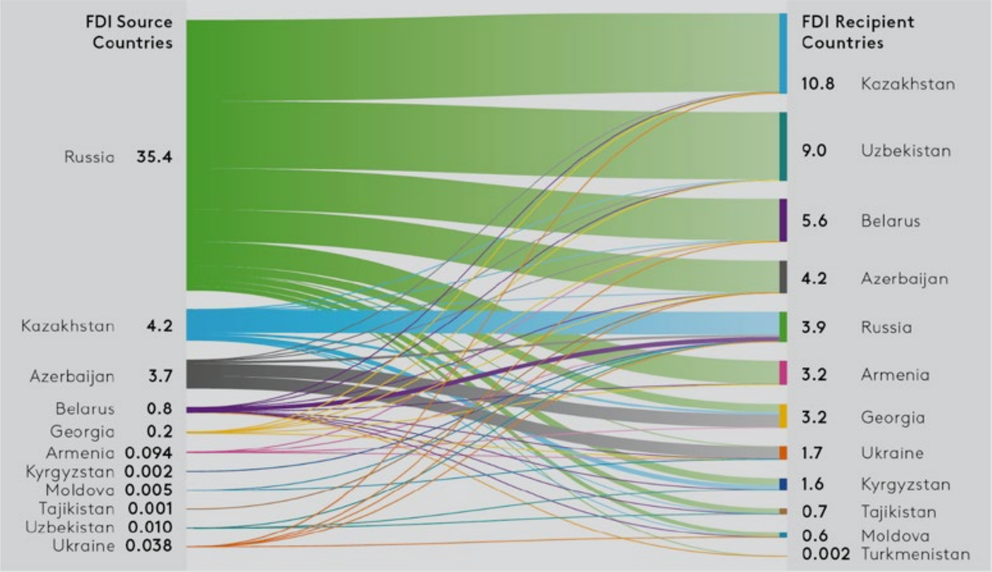
In addition to Kazakhstan, which accounted for 53% of Russia's FDI in the EAEU and 30% of its FDI in the CIS as at mid-2022, Russian investors have been boosting investments in Uzbekistan and Azerbaijan. Over the past six years, Russian FDI in Uzbekistan has grown by a factor of 2.1 and in Azerbaijan 1.7, the EDB said.

Corporate investment

The leading corporate investor in the region is Russia's privately owned oil major Lukoil, which has doubled its presence in Azerbaijan's Shah Deniz oil and gas project.

Intra-regional investment has largely formed the profile of the FDI made by international companies into the FSU countries, as it remains heavily concentrated in the raw materials and hydrocarbon sectors. Lukoil and the Russian state-owned gas behemoth Gazprom (including its oil production arm, Gazprom Neft) account for over 40% of the mutual FDI stock in the CIS.

Mutual FDI as at mid-2022, US $ billions



Source: EDB MMI database

The sectoral structure of mutual investments in the EEU and CIS varies. While the extraction of oil and natural gas accounts for 24% of the FDI stock in the CIS, it only ranks fourth in the EAEU, where the top investment-recipient sector is mining of metal ore (19.5% of EAEU mutual FDI).

Financial services also play a significant role, accounting for 12.4% of mutual FDI by EAEU countries. In the first half of 2022, Russia's state-owned banking giant Sberbank was the leader in terms of mutual FDI stock in the banking sector, followed by its sister banks VTB, Gazprombank and the privately owned Alfa Bank.

Iran and China FDI

There is potential for growth in mutual investments between the CIS countries and China, Iran, and the most developed Arab states. China's FDI stock in the twelve post-Soviet countries exceeded $67.5bn as of mid-2022, including $12.5bn invested in Russia, although enthusiasm for inbound Chinese FDI has cooled more recently.

Chinese investors have become more active in Russia, with China's FDI stock in the country growing by 27.4% from 2016 to 2022. Meanwhile, Iran's total FDI in CIS countries reached $1.8bn, with Azerbaijan being the main recipient. CIS investments in Iran have been small so far. The Arab countries receive more FDI from CIS countries, mainly Russia, than they invest in the region's countries.

Evgeny Vinokurov, EDB chief economist, notes three key trends in EAEU countries' mutual investments: "Firstly, a long-term trend is increased FDI in the greenfield projects. These have grown by a factor of 1.6 over the past six years, to 32%. Secondly, FDI by 100% private investors has increased by almost 1.3 times over the same period. These projects accounted for 56% of EAEU countries' mutual investments as at mid-2022. We believe that the share of private companies in mutual FDI could grow further, given cuts in public companies' transboundary investments. Thirdly, transboundary green investments have great potential, but their absolute amount is still insignificant." ●

Mercedes plans to build €1.3bn e-van factory in Poland

Mercedes' eSprinter van. / Mercedes

Wojciech Kosc in Warsaw

Mercedes-Benz Group announced plans on December 12 to build an electric van factory in southern Poland in an investment worth €1.3bn.

The plant will employ an estimated 2,500 people, Mercedes representatives said, speaking at a press conference alongside Poland's Prime Minister Mateusz Morawiecki. The factory will be Mercedes' first to build only electric vans in what the head of the company's vans division Mathias Geisen called a "step towards emissions-free mobility".

The investment proves that Poland no longer needs to compete with other countries on labour costs alone, PM Morawiecki said.

"We now want high-quality work," Morawiecki said, adding that the quality of the Mercedes brand will meet the "quality of Polish engineers, project managers, and employees".

The factory will be located in Jawor, southwestern Poland, where Mercedes already operates facilities producing petrol and diesel engines as well as batteries for electric vehicles.

The factory is expected to start production in 2025.

Poland has long been an attractive location for car manufacturers, though it has tended to lag behind its neighbours in the region. Only in recent years have brands like Volkswagen or Stellantis (the new name of Fiat Chrysler Automobiles and Peugeot, which merged in 2020) begun production in Poland.

Poland also has ambitions to make its own electric cars.

In November, Zhejiang Geely Holding Group, China's leading privately-owned automotive technology group, signed an agreement to become a technology partner of ElectroMobility Poland (EMP), an electric vehicle manufacturer backed by the Polish government.

EMP plans to develop multiple electric models for its Izera e-car using the Chinese company's modular platform. ●

bne:Tech

#boycottAustria campaign goes viral after Vienna blocks Romania and Bulgaria from joining Schengen

Angry Romanians called for a boycott on travel to Austria after Vienna blocked the country's Schengen entry. / bne IntelliNews

bne IntelliNews

The #boycottAustria hashtag has gone viral on social media after Vienna blocked Romania and Bulgaria from joining the EU's Schengen border-free zone.

The two countries were both turned down at the EU Council summit on December 8, with the Netherlands also vetoing Bulgaria's accession. Other members of Schengen backed entry for the two states, but unanimity is required for new members to be allowed in.

Romanians started posting on Twitter and other social networks under the #boycottAustria hashtag earlier in the week when Austrian Chancellor Karl Nehammer said at the EU-Western Balkans summit in Tirana that Vienna does not back Romania's accession to Schengen.

That prompted Romanians to declare they would no longer go skiing at Austria resorts, and would close their accounts at Austrian banks.

Austria's Erste is the owner of BCR, one of the biggest banks in Romania, and Raiffeisen also has a presence in the country.

When the decision was formally confirmed on December 8, others rushed to join.

One posted a picture of a notice spotted on a restaurant door saying credit cards issued by Austrian banks are not accepted.

"Credit cards emitted by Austrian banks in RO are not accepted any longer by some restaurants. That's extreme but I love that! I closed my account with them yesterday," read the caption.

"Oh look, Austrian companies are feeling the heat already," tweeted another user of the social network.

"Romanians and Bulgarians: keep boycotting, and soon there will be a nice line of angry business people at Nehammer's door, asking why they need to lose money for his senseless xenophobia."

Those to have joined the boycott include the Universitatea Craiova football club. It announced on Facebook that "Following the revolting attitude of the Republic of Austria, to block Romania's access to the Schengen Area, the University of Craiova, faithful to the principles rooted in its DNA, took the decision to sanction the Austrian partner companies with a total boycott. This includes shutting its accounts at Raiffeisen Bank, no longer filling up at OMV Petrom stations and cancelling its traditional summer camp at a mountain resort in Austria."

There were also mentions of Austrian companies exploiting Romania's natural resources. Vienna-based OMV controls Romania's OMV Petrom, the largest producer of oil and gas in Southeast Europe. Another company, Holzindustrie Schweighofer, part of Austria's HS Timber Group, has been involved in illegal logging scandals in Romania, that sparked protests by Romanians campaigning to end logging of their forests by foreign companies.

Other users vented their feelings by simply tweeting "f*** Austria" or posting pictures of the Nazi dictator Adolf Hitler, who was born in Austria.

Austria's objections are related to the country's doubts that the two countries can deal with illegal migrants crossing their borders. This is particularly valid for Bulgaria, which was harshly criticised by Vienna.

Meanwhile, the Netherlands believes that Bulgaria has failed to make any progress in the fight against top-level corruption and organised crime.

Top Romanian politicians criticised the Austrian decision. Romanian President Klaus Iohannis said in a statement that Austria's attitude is "regrettable and unjustified" and risks affecting European unity.

"A single member state chose to ignore the reality and blocked the European unanimity, in a way that was inexplicable and difficult to understand by the entire European Union. The regrettable and unjustified attitude of Austria in today's meeting risks affecting European unity and cohesion, which we need so much, especially in the current geopolitical context," he said.

The Austrian ambassador in Bucharest was summoned to the Ministry of Foreign Affairs, which said it considers Vienna's attitude against Romania's Schengen bid "inadmissible, unjustified and unfriendly".

"This will have inevitable consequences on bilateral relations," according to a statement from the ministry.

Most Bulgarian politicians, albeit unhappy with their rejection, appeared to accept the decision as fair. Most of the blame in Sofia was cast internally, with politicians blaming each other for the situation.

One exception was Stefan Yanev, the leader of the smallest party in Bulgaria's parliament, Bulgarian Ascend, who called for boycott of the Netherlands.

Vassil Vassilev, chairman of the Association of the Industrial Capital in Bulgaria (AIKB), an organisation that includes many big companies, said the decision of the Netherlands to separate Bulgaria from Croatia and Romania was unacceptable.

In an open letter, AIKB called on the government, the president and the parliament to summon the Bulgarian ambassador to the Netherlands – a symbolic gesture that would show the country cannot be "taught" in this way.

Like Yanev, AIKB wants the Bulgarian authorities to apply reciprocity, by boycotting the Netherlands in every possible way. Moreover, AIKB believes that Bulgarians should stop buying Dutch products and stop tourist trips to the country, while students should stop attending universities in the Netherlands. However, this seems highly unlikely to be accepted seriously by the majority of Bulgarians, who enjoy travelling to Amsterdam, while students prefer the universities there due to the reasonable fees and good living conditions. ●

Serbia reports massive cyberattack on interior ministry

bne IntelliNews

The website and IT infrastructure of Serbia's Ministry of Internal Affairs have been targeted by cyberattacks for the last 48 hours, the Serbian government said in a statement on January 7.

The attacks followed a previous attack on the defence ministry website, which was claimed by Anonymous, the world's largest hacker collective.

Serbia's government said on January 7: "the [interior] ministry's website and IT infrastructure have been constantly under a massive DDoS attack for the last 48 hours, and so far five large attacks aimed at disabling the IT infrastructure of the Ministry of Interior have been repelled."

Ministry IT experts worked with those from Serbia Telecom to repel the attacks.

The ministry has activated enhanced security protocols to protect its data which, the official statement warned, can lead to slower work and occasional interruptions of certain services.

Anonymous has continued its criticism of Serbia over its failure to take a stance against Russia over the invasion of Ukraine in the last couple of days.

"Serbia is Russian backdoor to Europe and needs to be fixed," said a post on the Anonymous Operations Twitter account. Another criticised Serbia for not recognising the Srebrenica genocide in Bosnia & Herzegovina.

Earlier in the week, the collective stated its intention to target Serbian government infrastructure. "#Anonymous has launched #OpSerbia taking numerous government websites down the past few days. Targeting government infrastructure," said a tweet from the Anonymous Operations Twitter account. ●

Albania's first satellites launched into space

bne IntelliNews

Albania's first two satellites were launched into space from Cape Canaveral Space Force Station (CCSFS) on January 3.

Tirana plans to use the satellites to detect crimes such as drug cultivation, illegal construction and logging. They will also make it easier to monitor traffic and border security, and fight wildfires — a growing problem in Albania and other countries in the region.

The two satellites, Albania-1 and Albania-2, were part of SpaceX's Transporter-6 rideshare mission from Space Launch Complex 40 at Cape Canaveral.

The mission lifted off at 9.56 am EST on January 3. The launch follows Albania's $6mn deal with US-based Satellogic USA Inc. signed in 2022, to develop a dedicated satellite constellation that will enable satellite monitoring of the country's territory.

"Just launched from the Cape Canaveral base in Florida, USA, the Falcon 9 rocket, the joint SpaceX Transporter 6 mission that carries our two satellites into space, ALBANIA1 and ALBANIA2," Prime Minister Edi Rama wrote on Facebook.

"From today Albania has more high-tech capabilities to control, protect and administer the territory, providing in real time important data on a number of key aspects for sustainable development," the prime minister added.

Rama previously announced in 2022 that the satellites will take Albania to a "new era in law enforcement in fighting corruption and strengthening the rule of law".

Under the three-year deal with Satellogic, Albania will get priority access to the Albania-1 and Albania-2 satellites. Satellogic will provide Tirana with satellite imagery capabilities, training government specialists to analyse data from the satellites and provide information to government bodies.

Continued efforts to tackle drug cultivation are needed in Albania, which is one of the top countries worldwide for cannabis cultivation and distribution, the World Drug Report 2022 from the United Nations Office on Drugs and Crime (UNODC) revealed last year.

This is despite well publicised efforts by the Albanian government to eradicate its cultivation, notably with the large-scale operation at Lazarat – dubbed Europe's 'marijuana mountain' back in 2014, shortly before Albania secured EU candidate status. However, reports since then indicate that drug cultivation has been rising since then, and the country also lies on the Balkan route for transportation of heroin to Europe. ●

Turkish defence firm celebrates maiden flight of 'fighter jet drone'

bne IntelliNews

Turkish defence firm Baykar has announced that its first jet-powered unmanned aerial combat vehicle (UCAV), sometimes referred to as a "fighter jet drone", completed its maiden flight on December 14.

Baykar has gained international renown for military successes in the field of its Bayraktar TB2 combat drones, used by the Azerbaijani and Ukrainian armed forces, among others.

Promoting the first flight of the UCAV, Baykar released a video showing the aircraft, the Kizilelma ("Golden Apple"), taking off and then returning to an airbase in the northwestern Corlu province, 85 kilometres west of Istanbul.

Selcuk Bayraktar, Baykar's chief technology officer, said in the video that the Kizilelma successfully completed its maiden flight. "We couldn't hold it on the ground any longer! It flew! Thank God," said Bayraktar, sharing footage of the Kizilelma's departure from the runway and the moment of its ascent into the skies.

The new drone powered by a jet engine has similar exterior features to fifth-generation fighter jets. Crucially, however, little is known of the proven technical specifications of the UCAV that translate into combat potential. Baykar says that it will be able to conduct both conventional drone missions and air-to-air engagements.

The Kizilelma, said Bayark, would be able to carry 1,500 kilograms of payload, such as weapons and devices. Its flight range is 930 kilometres, while its operating altitude is 10,668 metres, it added. The aircraft can operate in the air for five hours at a time and has a maximum speed of 900 km/h, the company further disclosed.

Turkey, meanwhile, is completing a vertical take-off small aircraft carrier. It is expected it will carry the Kizilema and other drones used by the Turkish military.

Separately, Janes reported on December 15 that Turkey's Ares Shipyard in partnership with Meteksan is developing a new variant of its ULAQ unmanned surface vessel (USV) configured for anti-submarine warfare (ASW).

On December 8, the defence trade publication reported that the first of six Type 214TN Reis-class submarines on order for the Turkish Navy had started initial sea trials.

Earlier in the week, the collective stated its intention to target Serbian government infrastructure. "#Anonymous has launched #OpSerbia taking numerous government websites down the past few days. Targeting government infrastructure," said a tweet from the Anonymous Operations Twitter account. ●

Bulgaria raids offices of crypto lender Nexo

bne IntelliNews

Bulgaria's prosecution has launched a probe into alleged financial violations by cryptocurrency lender Nexo, raiding more than 15 sites in the capital Sofia on January 12, Siyka Mileva, spokeswoman for chief prosecutor Ivan Geshev, told reporters as quoted by Dnevnik news outlet.

Nexo confirmed the information, saying the police did not provide a search warrant for hours and nor did they tell the company's management what the accusations were.

Mileva said, as quoted by Dnevnik news outlet, that the police were carrying out an operation related to a large-scale financial fraud scheme. She added that the accusations include money laundering, tax crimes, unlicensed bank operations and computer fraud.

More than 300 people from several Bulgarian investigation bodies were involved in the operation.

Mileva also said that for five years the turnover of Nexo was $94bn and among its clients was an individual financing terrorist activities. She added that Nexo has been operating through many companies, many of which were just "post boxes".

Nexo commented on Twitter that the actions of the prosecution resemble racketeering.

"Unfortunately, with the recent regulatory crackdown on crypto, some regulators have recently adopted the kick first, ask questions later approach. In corrupt countries, it is bordering with racketeering, but that too shall pass," Nexo wrote on twitter.

In a letter to bTV, the company said that it will sue Bulgaria as the authorities have not presented any official documents for the raids or for the arrests.

"We have not yet received official documents that would present any claims against Nexo. However this is being compensated with unnecessary demonstrative operation with the participation of individuals who refuse to legitimate themselves and have not shown raid warrants for hours," Nexo wrote.

It added that people were arrested without arrest warrants and that everything that was happening was in violation of the laws.

Nexo said that it will take Bulgaria to court over the raids and this would cost the taxpayers hundreds of millions.

Nexo, founded and managed by two Bulgarians – Kosta Kunchev and Antoni Trenchev – in 2017, accepts deposits in cryptocurrencies on which it pays interest to clients. It also provides loans using cryptocurrencies as collateral.

Gbolally, Nexo operates through companies registered in the UK, Switzerland, the US and offshore destinations, according to Capital weekly.

In Bulgaria, Nexo owns NDS, a company with around 600 employees.

The company has also faced over a dozen charges in the US for illegal operations and fraud. ●

bne:Green

Apocalypse 2050: World on course for 15% GDP fall

Drought / bne IntelliNews

Richard Lockhart in Edinburgh

The world is set to see global GDP plummet by a catastrophic 15% by 2050 if current emissions trends are not reined in and global warming reaches 2.2°C by 2050.

Oxford Economics warned in the latest report of its Global Climate Service that climate catastrophe was a major threat to the global economy, with cooler countries no longer benefiting from modest warming.

Yet the extend of the threat is staggering, with a 15% contraction likely if global emissions paths are followed. Indeed, total economic annihilation could happen if global warming continues at its current rate towards a 5°C increase by 2100, the report warned. This would mean mass extinction of most animal species, reinforcing the concern that the world cannot physically or economically cope with continued temperature rises.

Findings

The research group identified a tipping point of 1.1°C for temperature anomalies from average levels. Its research found that if temperatures rise beyond this departure from historical norms, then productivity growth will begin to flatline and fall.

In aggregate, 2.2°C of warming by 2050 has the potential to reduce global GDP levels 10-20%. Crucially, this compared to the 6.5% reduction that Oxford Economics previously forecast.

Looking further ahead, warming of up to 5°C by 2100 would lead to economic annihilation, consistent with scientific research on mass extinction thresholds.

Put simply, if climate change continues at current rates, or even just fails to meet the Paris Agreement targets of 1.5°C, then large swathes of the world could no longer become inhabitable, leading to mass human suffering, mass migration patterns from hot to cooler countries and the meltdown of the global economic system.

The report chimes with one of the conclusions to come out of COP27: that climate change is no longer just a climate or environmental problem, but is now a political, economic and social issue that must be addressed if humankind is to continue living the life it currently knows and to avoid a human apocalypse.

However, while the conference's final communique reaffirmed the UN and governments' desire to meet the 2015 Paris Agreement's 1.5-degree goals, it did not make any new agreements that are binding on governments on how to it.

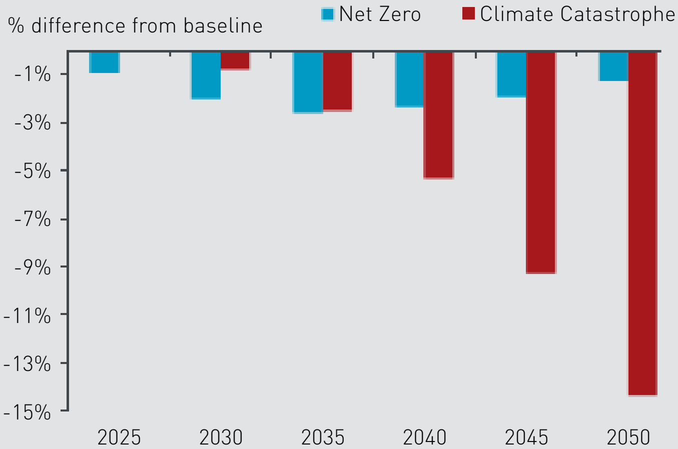
This lack of any new agreement on climate targets raises the importance of Oxford Economics' apocalyptic warnings.

While COP27 failed to lay out new concrete targets, such measures are needed with the utmost urgency in order to protect the world's people from the economic fallout of climate change.

Yet not is all bad news. The world has slowly started to make inroads into boosting renewable energy, even if CO_2 emissions growth has yet to turn the corner.

The International Energy Agency (IEA) said earlier this month that solar was set to overtake coal as the world's leading source of power supply by early 2025. It also

World: GDP, real



Source: Oxford Economics / Haver Analytics announced its "largest ever upward revision" for its renewable energy forecasts.

The world is now set to add 2,400 GW of green capacity – an amount equal to the entire power capacity of China today – between 2022 and 2027, twice as much as it did in the previous five years.

Yet there is no room for lethargy, and governments need to maintain the green momentum and to avoid any slippage in the race to net zero.

For example, the UN recently identified greenwashing by business and finance as the biggest danger facing this race to net zero, urging them to avoid a toxic cover-up and to ensure that any climate pledges they keep are in line with the 1.5-degree targets.

"The UN recently identified greenwashing by business and finance as the biggest danger facing this race to net zero"

Greenwashing, weak regulation and intensive lobbying by fossil fuel proponents were the greatest impediments to fighting climate change. The business sector cannot be trusted to police itself, the UN said, and must be subject to strict national and international laws and regulations on green investment.

Meanwhile, the world's wealthiest people must also step up and make a greater contribution to fighting climate change.

Oxfam recently said that the investments of the world's 125 wealthiest people produce the same amount of CO_2 as the whole of France, while each of them emits a million times more greenhouse gases (GHGs) than the average person.

Billionaires' investments create an average of 3mn tonnes per year per person of CO_2, compared with 2.76 tpy per person for the bottom 90% of humanity, and the NGO found that an average of 14% of their investments were in polluting industries such as energy and cement.

More than half of the 50 largest sources of GHG emissions are associated with oil and natural gas fields, and those emissions are vastly under-reported, Oxfam said.

Research

In its report, Oxford Economics went beyond average historical temperature to provide a deeper assessment of climate change to show how temperature anomalies from historical norms may be more consequential economically than average temperature levels. This means that the when temperatures differ the most from their underlying historic averages, the economy is more vulnerable to collapse than when average temperatures are rising across the board.

This means that current warming of the earth's atmosphere will have a greater impact on people's jobs, incomes and economic well-being than previously thought.

It identified a climate damage function that separates economic impacts into two categories: global-warming effects due to temperatures trending away from their long-run means; and broader climate change attributed to changes in temperature volatility and the likelihood of extreme events.

The report follows on previous research by Oxford Economics, which found that reaching net zero by 2050 and facilitating the green transition would create economic opportunities worth $10.3 trillion by 2050, in 2020 prices, equivalent to 5.2% of global GDP in that year.

The picture put forward by Oxford Economics is apocalyptic, and can only be avoided if governments and corporations push green issues to the top of their investment agendas and do not allow the issues to slide.

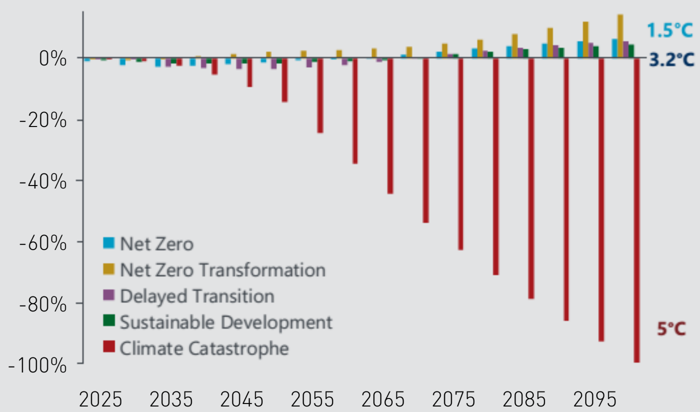
Just this week, the EU finally approved its proposed CBAM scheme, which is effectively the world's first carbon border tax.

CBAM is designed to protect against "carbon leakage" – the risk that EU companies could move carbon-intensive production abroad to countries where less stringent climate policies are in place, or when EU products are replaced by more carbon-intensive products.

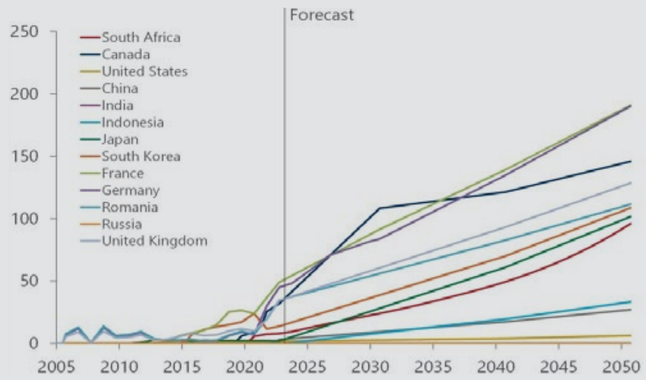
This is one of the many financing loopholes that must be closed to meet green targets. The CBAM follows G7 plans to establish a "climate club" to strengthen international co-operation on climate change mitigation. The "climate club" aims to support increasingly ambitious plans to achieve global net-zero GHG emissions by or around 2050. ●

World: GDP

% difference from baseline



Green transition is $10.3 trillion opportunity for the global economy by 2050, new report finds



The effective carbon prices of China and the US – the two biggest polluters – will barely break $30/tCO2e in 2050. / Arup, Oxford Economics

Roberta Harrington in London

New green industries could be worth $10.3 trillion to the global economy by 2050, equivalent to 5.2% of global GDP that year, finds a new report by Arup and Oxford Economics.

The green transition is often seen as a cost, but the report demonstrates the substantial benefits and the need to move quickly to capture them.

Investment in green technologies, expertise and renewable energy sources is crucial to addressing urgent climate challenges, say the authors in Global Green Economy, Capturing the Opportunity.

“Transitioning to a green economy is an inevitable end game for all countries, and many have already started their journey,” notes the report.

The report highlights ways innovation and strategic policymaking can address existential issues for the planet in a way that also builds broad prosperity and social well-being. Climate change is clearly an existential issue, with even a 1.5-degree Celsius rise in average temperatures seen as leading to devastation.

"As economists, we have to be honest about the fact that mitigating climate change will be expensive," said Oxford Economics' chief executive, Adrian Cooper. "But the transition to a carbon-neutral global economy also presents compelling opportunities."

New green industries – carbon-neutral goods, such as renewable-energy facilities, as well as services – are an essential part of reaching the Paris Agreement net-zero target.

"This includes the direct contribution to GDP of electric vehicles manufacturing, renewable power generation, clean energy equipment manufacturing, renewable fuels and green finance; plus the activity supported across global supply chains," said the report.

Indeed, former Bank of England governor Mark Carney has said that a net-zero emissions future will allow banks, fund managers and insurers to invest in private sector plans – and profit from the “greatest commercial opportunity of our time.”

And a peer-reviewed study using probabilistic cost forecasts by University of Oxford researchers, published in 2022, found that transitioning to a decarbonised energy system by mid-century could actually save the world at least $12 trillion, compared with a scenario in which current levels of fossil fuel use continue, says the study.

A decarbonised energy sector would not only result in lower energy system costs than a fossil fuel system – by ramping up solar, wind, batteries, electric vehicles (EVs) and clean fuels such as green hydrogen – but it would also provide more energy to the global economy and expand energy access to more people internationally.

“There is a pervasive misconception that switching to clean, green energy will be painful, costly and mean sacrifices for us all – but that’s just wrong,” said Professor Doyne Farmer, the mathematics professor who led the research at the Institute for New Economic Thinking at the Oxford Martin School.

Oxford Economics even found that a failure to act could dent global GDP by some 5% by mid-century. In 2021, the researchers estimated that the cost of weather-related interruptions to economic activity had already reached $233bn.

"This report shows the green transition is not a burden on the global economy, but a substantial opportunity to bring about a greater and more inclusive prosperity," said Arup’s global strategy skills leader, Bryce Richard.

Meanwhile, a second report by Arup and Oxford Economics issued the same day on carbon prices found that they must rise higher as climate ambitions rise.

While carbon prices historically have been low and limited, this should change with rising climate ambitions, say the researchers. Countries with established carbon markets and ambitious climate agendas will take the lead, they continued.

Norway is expected to have the highest effective price among European nations, reaching $212/tonne of carbon dioxide equivalent (tCO2e) in 2030. Elsewhere, Canada is estimated to have an effective price of $93/tCO2e by 2030. Meanwhile, the effective carbon prices of China and the US – the two biggest polluters – will barely break $30/tCO2e in 2050.

In the absence of stated policies, other economies like India and Saudi Arabia are not expected to price carbon anytime soon. For these countries, technical, administrative and political barriers remain, said the researchers.

Carbon prices should not have a notable impact on inflation and competitiveness, said the authors. The literature on the impact of carbon prices is mixed, with inflation from higher prices potentially mitigated by policy design and targeted fiscal spending. Furthermore, pricing carbon provides an incentive to switch to low-carbon energy sources, which should reduce the price impact over time.

Carbon prices will be necessary to reduce carbon emissions, they state. A carbon price sets a signal to market players to either reduce their emissions or pay to pollute. This then allows the market to internalise the costs carbon imposes on the environment – such as air pollution and extreme weather events – shifting the burden of responsibility and increasing accountability for large emitters.

Decarbonisation at scale and pace will not happen without a high enough carbon price. Current carbon prices are too low and limited in scope.

Finland introduced the first tax on carbon in 1990, followed by a few European countries such as Poland, Norway and Sweden. The EU emissions trading scheme (ETS) was not introduced until 2005, and it was followed by other developing countries like New Zealand, Australia and Japan. Initiatives from emerging markets did not start until the early 2010s, and Africa just had its first carbon tax introduced in 2019 in South Africa.

Despite their introduction decades ago, prices have been too low. For example, carbon in the EU ETS was priced below €20/tCO2e ($21/tCO2e) between 2009 to 2018. To put this in perspective, the Report of the High-Level Commission on Carbon Prices wrote that the carbon price needs to be within the $50-$100/tCO2e range by 2030 for warming to stay below 2 degrees Celsius." ●

Renewables to overtake coal in electricity generation soon

Martin Armstrong for Statista

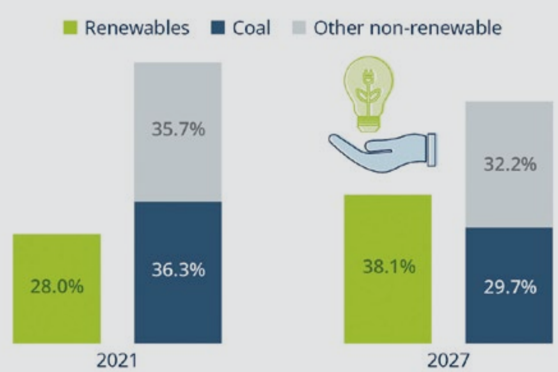
With hundreds of protesters currently trying to halt the continued development of a coal mine in Germany, which would involve the destruction of the now abandoned village of Lützerath, the further pursuit of fossil fuels in a country ostensibly seeking to phase them out is under the spotlight, Statista reports.

The main justification used by the German government is that the country's hand has been forced by the massive gap left by Russian oil and gas. At least in the short to medium term, coal has been selected as one answer to Germany's significant problem.

Longer term, it's renewables that are planned to dominate Germany's electricity mix, and this is something reflected by an International Energy Agency (IEA) forecast. As this infographic shows, global use of coal for electricity generation outweighed that of renewables by 8 percentage points. By 2027, this is predicted to flip, with renewables accounting for 38% of global electricity production against 30% from coal.

The IEA report, released since the Russian invasion of Ukraine, says that the war has led countries "to increasingly value the energy security benefits of renewable energy." Although some of the shorter-term solutions may be focused by necessity on fossil or nuclear sources, the future is looking more green. An additional factor in this ongoing shift quoted in the report were the "high fossil fuel and electricity prices resulting from the global energy crisis" that have "made renewable power technologies much more economically attractive". ●

Renewables Soon to Overtake Coal in Electricity Generation
(Forecast) distribution of global electricity generation, by technology



Source: International Energy Agency

RUNNING OUT OF AMMO

Ben Aris in Berlin

Ukraine could face a shortage of ammunition in the second half of this year unless the West invests in new production, as stocks are already running low and the existing production can't keep up with the rate of fire as the fighting becomes a grinding war of attrition, the Center for Strategic & International Studies (CSIS) has warned in a recent study.

Since the war started Ukraine has been increasingly supplied by the West with materiel, starting with the US-made Javelin missiles and up to most recently the UK promise of 14 Challenger 2 main battle tanks, just as the US has promised a total of $113bn worth of arms. Ukraine's own military production facilities have been largely destroyed by an unrelenting Russian missile barage.

Having sent most of their Soviet-era stock of arms and ammo, which were compatible with Ukraine's own legacy weapons, former Warsaw Pact members now in Nato are increasingly dipping into their own stocks of modern, Western-made weapons. Increasingly the Nato members are dipping into their own stocks of modern Western made weapons. And those stocks are starting to run low.

"It's getting harder and harder," Republican Mike Quigley, a member of the House Intelligence Committee, told CNN. "This is a war we thought would be over in days but now could be years. At a time when global supply chains are melting down, the West is going to have a very difficult time to meet demands at this very high level."

The degree to which weapons stockpiles are running low varies system by system, as the US defence and industrial base is better equipped to ramp up production of some weapons, while others are more difficult – or the production line has been shut down altogether and can't be easily resumed.

The problem is that, after years of fighting asymmetric wars against terror organisations like Al Qaeda and Boko Haram, the West has shut down its conventional arms production and focused more on developing high-tech precision arms. As the US in particular relies on private companies to produce arms, if there are no orders for a particular weapon or munitions then the companies simply shut that production line down.

It has left the West ill-equipped to supply the classic confrontation that is the Ukrainian war, where hundreds of thousands of troops face off against hundreds of thousands of opponents, burning through thousands of rounds of artillery shells and hundreds of missiles a week.

Wary of getting sucked into a direct confrontation with Russia and mindful of the cost of putting their economies on a war footing, the West has been reluctant to invest in building up military production to supply Ukraine in a long war with Russia.

In the midst of a polycrisis that has already cost Europe around €1 trillion, governments have been slow to sign off on the multiyear procurement contracts that defence groups need to invest in a major revamp of their production. The *Financial Times* reports that many of Europe's leading arms producers are in talks with governments about investing in new production, but few contracts have been signed and little invested yet. For Europe at least, the Rubicon has not yet been crossed.

But increasingly it looks like a long war is on the cards. Russian President Vladimir Putin said in December that he expects a "long war" in Ukraine, but that he saw "no sense" in mobilising additional soldiers at this point.

Ukraine intelligence predicted a second mass mobilisation in January to follow the partial mobilisation that started on September 21 and recently said Russia is trying to build a 2mn-strong army. Mobilisation units, including legislative amendments and the preparation of educational centres, are already underway in Russia and the Duma ended the military service exemption for fathers of three or more children. Both sides are reportedly preparing for major counter-offensives in the spring.

With a deep gulf between both sides' starting position for peace talks – Russia wants Ukraine to concede the four regions it annexed in September, while Kyiv says it won't start talks until Russia retreats to beyond the 1991 borders – there is little hope of a ceasefire anytime soon.

Rate of fire

Reports from the intense fighting currently underway for Bakhmut in the Donbas say that both sides have begun to ration their ammunition. Ukrainian officers report that the number of shells arriving has dropped by a third and military experts report that Russia has also reduced its rate of fire, as it is also struggling to resupply its guns.

CSIS senior adviser Mark Cancian asked in his report: "Are inventories getting too low? How long will it take to rebuild those inventories?" An early CSIS study already suggested that the Nato inventories were at risk of running dangerously low as a result of the transfers to Ukraine.

Ukraine is burning through its supplies of ammunition far faster than the Nato members can make more. For example, the US has already transferred just over 1mn 155mm standard artillery shells to Ukraine, but its current production capacity to make more is capped at

> "The West has been reluctant to invest into building up military production to supply Ukraine in a long war with Russia"

Ukrainian fighter with a portable anti-tank missile system Javelin. www.shutterstock.com

93,000 rounds a year. Even if production surged and the production capacity rose to 240,000 a year, there would still be a 750,000 deficit given the rates of fire in the 11 months the war has been running so far.

The problem is the same with the Javelins that have been so effective in destroying Russian tanks in the first months of the war. The US has sent 8,500 pieces to Ukraine so far – about a third of its entire stock – but only has the capacity to make 1,000 new ones a year. Likewise, the US has sent a third of its Stinger missiles that can take down Russian fighter jets, which also can't be easily replaced.

And despite the spectacular success of the HIMARS precision missiles, the US has only sent 20 units to Ukraine, which is the same amount as it manufactures a year, according to Department of Defence (DoD) and other open-source information, CSIS reports. The DoD has a total of about 30,000 HIMAR rockets, but Ukraine's 20 units have been reportedly used only 400 times. However, as the HIMAR production line is "hot" the US could supply this number of rockets indefinitely, says CSIS.

Of all the mismatches between supplies and production rates, military experts consider that with the 155mm shells to be the most serious, as artillery is currently the backbone of the clashes on the ground. The war has already depleted the US stocks of some kinds of this ammunition and more cannot be made fast enough, as the US has geared production rates to cover its own training programme for US personnel, not to fight a major set-piece war in another country.

"Rebuilding inventories at the current production rate is probably not possible because of routine US training needs," Cancian said. "Artillery units must fire a certain number of rounds every year to be proficient... Annual training requirements are likely equal to the recent production levels since these programmes have been around for a long time, the budget levels have been relatively constant for several years, and there has been no need to increase inventories."

Currently producing 3,250 rounds a month, the DoD says it could get that up to 20,000 rounds a month in the spring of this year and 40,000 by 2025, but even at this surge rate it would take six years for the US to replenish the stock of shells it has sent to Ukraine, according to CSIS.

And that won't help Ukraine, which estimates it is currently firing 4,800 rounds a day – more than the US is making in a month.

"Combined with shells fired from Ukraine's Soviet-era artillery, this is in the vicinity of the 6,000–7,000 per day that Ukraine has said it was firing (and which was considered inadequate). Even the 2025 surge rate would satisfy only a third of this need. To bridge the gap, other countries will have to provide ammunition, and a lot of it," Cancian says.

The same arguments apply to the more sophisticated version of the 155mm shells, where Ukraine's army is burning through the equivalent of an entire year's worth of production in under a month. The upshot is, these precision munitions have to be reserved for the highest value targets but should not be used in day-to-day combat operations.

Ammo crisis on the cards

The clock is now ticking on how long Ukraine can keep up its barrage. Kyiv scored spectacular successes in September with the Kharkiv offensive that took back hundreds of square kilometres of occupied territory, and ended that month by retaking the regional capital of Kherson that was lost in the first week of the war.

But since the partial mobilisation in September, the Russians have stabilised the line and the fighting has descended into an artillery duel and WWI-style bitter trench warfare. In this style of fighting artillery has become the decisive weapon and Russia still outguns Ukraine by ten to one, according to reports.

"Ukraine will never run out of 155mm ammunition – there will always be some flowing in – but artillery units might have to ration shells and fire at only the highest priority targets. This would have an adverse battlefield effect. The more constrained the ammunition supply, the more severe the effect," Cancian says.

A Kyiv Independent battlefield report says this is already happening, with gunners sitting behind the lines waiting for calls, sometimes for hours, from the command centre, ordering strikes on selective targets when the infantry gets into trouble.

"Soviet-standard munitions, the main stocks of which had been largely depleted back in summer. According to the 24th Brigade artillerists, at the beginning of Russia's war, each battery used to get up to 150 full loads of munitions a day (which corresponds to up to 6,000 rounds). Now they're getting only up to 30 full loads a day," Illia Ponomarenko reported from Bakhmut on January 5.

The bottom line is that by the summer the US may start cutting so deep into its own stocks of shells and similar weapons that it starts to become a strategic problem for its own national defence and it will be forced to curtail supplies.

The tensions in the South China Sea with China over Taiwan lie in the background as well as a potential direct conflict with Russia. If either of these fronts open up – and in the worst case if they both open at the same time – then the US will likely be forced to abandon its support of Ukraine, at least temporarily, as it will need its materiel for its own military efforts.

This has already happened with Javelin supplies to Ukraine. The US has sent 8,500 pieces to Ukraine, but only makes 1,000 a year. Used to deadly effect in the early stages of the war, the US has stopped supplying them because inventories are now so low they threaten other war plans. At current production rates it will already take the US twelve and half years to replace those already fired in Ukraine. Even at accelerated rates it would still take six and half years to replace them, according to the DoD.

All in all, the US can continue to supply Ukraine with arms and will not run out in the foreseeable future. More than 100mn units of small arms ammunition have been supplied, but the US produces 8.6bn rounds a year. But the longer the fight goes on the more constrained US supplies will be.

"As the September commentary noted, low inventories do not mean the end of equipment transfers. They do mean that the United States will need to pursue other mechanisms," says CSIS.

Allies to the rescue

One option to keep the supplies coming is to turn to the other Nato allies. The UK and Germany have been amongst the most active and both are major European arms manufacturers. Despite having earned a reputation for its hesitancy to transfer weapons, Germany is the second-largest supplier of arms to the fight after the US.

But if the US has not begun major investments into expanding its arms production, then Europe is even further behind. "Ukraine expends as much ammunition in a day as Germany produces in six months," former head of the Munich Security Conference and top German diplomat Wolfgang Ischinger told *Die Welt*.

There has been much talk of sending German-made Leopard 2 tanks to Ukraine, although so far no transfers are planned. However, an unnamed German security official told *bne IntelliNews* that it would take more than a year to produce new tanks

"The bottom line is that by the summer the US may start cutting so deep into its own stocks of shells and similar weapons that it starts to become a strategic problem for its own national defence"

if they were to go into action and German plans to set up production of munitions like the 155mm shells remain just that – plans.

The leading German arms company Rheinmetall said it would not be able to deliver Leopard tanks to Ukraine before 2024, even if the German government orders the transfers to go ahead tomorrow, according to *Spiegel*.

Some more 155mm shells are now being bought from US ally South Korea and the Russians are also buying materiel from the likes of North Korea and Iran as Moscow has the same supply problems as Washington does.

However, facing military production delays and mounting battlefield losses, Putin told his government to cut through bureaucracy to "crank out enough weapons and supplies to feed his troops in Ukraine," in September, when Russia was already running low on artillery shells.

By December, Russia's ex-president Dmitry Medvedev was making tours of arms factories to inspect production as Russia increasingly goes into war mode. Medvedev said the country was "ramping up production of new-generation weapons to protect itself from enemies in Europe, the United States and Australia."

The problem of the low level of production of munitions is not a new issue and the potential bottlenecks were widely reported in the early stages of the war. It will take about a year to set up new production once a contract with an arms producer is signed, as staffing and facility bottlenecks hamper the process. But as the war approaches its first year, few of those final investment decisions (FIDs) have been made. The DoD has expanded its orders for Javelins from their maker Lockheed Martin, but new factories and production lines are needed for many of the other items on Kyiv's wish list and no action has been taken on many of those weapons. ●

Every year *bne IntelliNews* releases a series of reports on all the markets in our region. These reports take a look forward to the main events of the upcoming year and try to identify the trends that will spill over which are already identifiable.

CENTRAL EUROPE AND THE BALTIC STATES

The two most important events in Central Europe in 2022 were, first, the invasion of Ukraine by Russian dictator Vladimir Putin, and, secondly, the long-awaited hardening of the European Union's stance towards the breach of its values by the radical right-wing regimes in Poland and Hungary.

The invasion boosted the significance of the region (particularly Poland) through its role as a supply base for Ukraine, its sheltering of many refugees, as well as for its foresight in long warning of the threat from the Kremlin during a period when many in Western Europe were continuing to counsel appeasement.

However, the region struggled to cash in this new potential clout inside the EU and Nato because of the deepening rift between Brussels and Budapest and Warsaw.

Many expected – and Viktor Orban counted on it – that the EU would give up prosecuting Hungary and Poland's flagrant breaches of the rule of law because of the need to present a united front to Russia.

Nevertheless, the bloc has stood firm and will withhold both Recovery and Resilience Facility (RRF) and Cohesion Funds until both countries fulfil a series of key reforms this year. Orban has blinked and agreed to the EU's demands; Poland has yet to do so amid infighting within the ruling coalition.

By threatening to hold up financial flows if the rule of law is breached and EU money put at risk, the European Commission finally seems to have found a credible weapon to fight the populist contagion.

In Hungary, despite winning re-election in flawed elections in April, Orban ended the year isolated within the EU and even within the Central European Visegrad Group because of his continuing links with Putin and his refusal to give significant help to Ukraine. As Russian influence in Europe has collapsed, Orban has cut a lonely figure as one of Putin's last remaining friends, together with Aleksandr Vukic's Serbia. Even the election of radical right-wing allies in Italy and Sweden last year has so far done little to ease his isolation because they do not agree with his stance on Russia either.

This year will show whether Hungary can continue to balance its EU membership and its close relations with the Kremlin or whether it will finally have to make a choice as the war drags on.

In Poland, relations with the EU could worsen in the short term ahead of the elections this autumn, but if voters then unseat Jaroslaw Kaczynski's Law and Justice Party the country could realise the promise of its new geopolitical position by becoming a key player in Brussels.

In an optimistic scenario, if both countries head back to the political mainstream, the whole region could finally become much more embedded in the EU; however, in a pessimistic scenario, Budapest and Warsaw could once more unite against Brussels and the region could instead suffer a new wave of self-defeating populism as the cost of living crisis bites.

Leading the downturn

Turning to the economic outlook, Central Europe is currently facing rocketing inflation and recession, at a time when the region has barely emerged from the downturn caused by the COVID-19 pandemic.

As a region heavily dependent on Russian energy, Central Europe is entering the downturn earlier than Western Europe. Rises in energy prices – in large part due to the Ukraine war and the sanctions on Russia – have pushed up inflation, increased external deficits, squeezed businesses and households, and pushed most economies into recession. The region's downturn is forecast to last until the middle of this year, followed by feeble growth.

The Baltic states already entered recession (two consecutive quarters of quarter-on-quarter negative growth) around the middle of 2022 and are not expected to emerge from it until mid-2023.

Czech GDP growth turned negative in Q3 and is expected to also be negative in Q4, meaning the economy is probably already in recession. According to ING, the country will suffer the deepest recession in the region.

Hungarian growth also already turned negative in Q3 and is expected to be negative in Q4, putting the economy in recession. It is then forecast to be close to zero for much of 2023.

Poland could suffer negative growth in Q1 but is currently predicted by most economists to return to growth in Q2. This should help the populist Law and Justice Party ahead of the elections in the autumn, particularly if the government and its central bank try to engineer a pre-election boom as in Hungary.

Slovak growth remained in positive terms in Q3 and the economy is currently forecast to escape recession but with minimal growth.

At the same time, Central Europe is suffering the highest inflation in the EU because of the high weighting of food and energy prices in its CPI baskets, with the rise

> "Central Europe is suffering the highest inflation in the EU because of the high weighting of food and energy prices in its CPI baskets"

in consumer prices reaching 25% year on year in Estonia in August. Wages are not keeping up, with workers in all countries suffering falls in real wages.

Central banks have reacted to the soaring inflation by hiking interest rates, which is depressing investment. On the positive side, as the region began tightening monetary policy earlier than Western Europe – in June 2021 – economists expect central banks led by the Czech CNB to start loosening monetary policy beginning in the middle of the year.

Fuel for populism

For citizens, the fall in real wages comes on top of lingering discontent with the region's slowness in catching up with Western living standards, particularly since the global financial crisis. Only Czechia (at 92% of the EU average GDP/capita on a purchasing power parity basis in 2021), Estonia and Lithuania (89%), have almost converged with EU levels – and are ahead of Spain, Portugal and Greece – while the remaining Central European countries still all hover around 70-75%. Czechia is the only CEE4 country classified by the IMF as an 'advanced economy' rather than an 'emerging economy'.

Some low-income groups – notably pensioners, rural dwellers, those with less education and skills – already felt they had not benefited from the transition from Communism since 1989. The risk is that they are becoming permanently disaffected with democracy and will keep voting for populist parties, which are already in power in Hungary and Poland, and are leading the opposition in Slovakia, Czechia and Estonia.

Radical right-wing populism continues to be fuelled by social disparities created by the transformation from communism, the cultural shock from accession to the EU and its values – on issues such as LGBT rights – as well as phantom fears about migration and other topics spread by misinformation.

This growing disgruntlement could also spill over into the international sphere, because patience could run thin with the cost of imposing sanctions on Russia in terms of higher energy prices, as well as the burden of looking after hundreds of thousands of Ukrainian refugees. At a demonstration in Prague in September, 70,000 protested against the government, but speakers also railed against sanctions, refugees, the EU and Nato.

To contain discontent, most governments have put in place energy price caps at a heavy cost, sometimes funded by windfall taxes. But across the region opposition parties are calling for governments to do more, at a time when budgets are already stretched from dealing with the pandemic.

The challenge of helping citizens cope with the cost of living crisis is also accentuating tensions in the ruling coalitions, with Estonia's Prime Minister Kaja Kallas reconstructing her government in June and the Slovak coalition being brought down by a vote of no-confidence in mid-December.

But the risk of a new populist wave in Central Europe is limited, given that only in Slovakia is there a real danger of populist parties seizing power this year. Former premier Robert Fico could return to power at snap elections sometime in the middle of the year, but his left-wing nationalist Smer party will struggle to find allies.

In Estonia, the radical right-wing EKRE party is expected to do well in April's general election, but Kallas' Reform Party is still far ahead in the opinion polls.

In Czechia, polls indicate "centrist populist" Andrej Babis would lose the run-off of this month's presidential two-round election to either of the two main government-supported candidates.

Moreover, this cost of living crisis may not necessarily benefit the existing radical right-wing governments in Hungary and Poland, precisely because they are the ones that are struggling to cope with it. Populist governments such as Hungary's were among the worst performers in the COVID-19 pandemic, and they are now being found wanting by the current cost of living crisis.

In fact the country facing the gravest economic challenge is Orban's Hungary itself, with the forint the worst performing European currency last year.

Orban is now in a very weak position to protect Hungarians' living standards because his pre-election spending spree had already pushed up inflation and blown out the budget deficit.

According to ING, "high levels of public and net foreign debt, combined with fiscal and current account deficits potentially raise concerns about medium-term sustainability, especially in an environment of rising interest rates".

Hungary's future economic stability will now depend on fulfilling the milestones to release EU funds, the flow of which will narrow the budget and external deficits and boost the economy and international confidence in the forint. But if the European Union maintains its surprisingly tough stance and the milestones actually work properly, these reforms will also start to undermine Orban's semi-authoritarian regime, making the country's future political 'stability' much more interesting and the next elections potentially much fairer.

Read the full report
https://online.flipbuilder.com/myab/frgu/

POLAND

"Every year is like no other but some years are even more like no other" is perhaps the best summary of what is to come in 2023. A war next door, polycrisis at home, and an election to top it all off are nearly certain to result in a year rife with volatility and uncertainty.

Politics will trump everything else in Poland in 2023, as the ruling right-wing coalition of the Eurosceptic United Right – made up of Law and Justice (PiS) and its more radical partner United Poland – will scramble to secure an unprecedented third straight term in office.

Should they win, further consolidation of power and more democratic backsliding are in store. In fact, governance could deteriorate well before the actual election, as the ruling camp will not hold back – or so it is feared – from anything to make sure it defeats the opposition.

A win for the opposition will not, of course, magically bring Poland back to the pre-PiS era (which had so many problems that it proved a fertile ground for PiS to win in the first place). A new government will face a PiS-linked president until 2025 and a PiS-linked head of the central bank, to name just two centres of power that will remain under the influence of the incumbent government.

Economy-wise, Poland is in for a year of faltering growth and still elevated inflation, both of which could dent PiS' chances to win. On the other hand, if analysts' prediction of a returning economic rebound in the second half of 2023 prove true, the ruling party may well try to sell the "we have got you through the worst safely" story in the campaign.

A big question mark is Russia's war in neighbouring Ukraine. The winter months could increase the inflow of refugees to a country struggling economically and in which political acrimony is only set to intensify ahead of the election.

On the EU front, the government must scramble to make sure that billions from the bloc's pandemic recovery fund finally start flowing. That will be subject to much politicking – including possible tactical support from the opposition for legislative changes necessary for the funds to arrive.

If the funds are lost, a bitter blame game will ensue and could strengthen the currently small anti-EU sentiment in the general population.

In a country where polarisation matches that of the UK or the US, an election year will only give rise to more polarisation and accompanying acrimony. The actual vote will not take place until around October – the exact date will be set by

President Andrzej Duda in the summer – but campaigning had begun already in 2022 as economic and political crises converged in the wake of Russia's war against Ukraine.

The election's framing is simple. The ruling United Right coalition aims at winning an unprecedented third straight term in office. The opposition wants to take the power back from PiS, which, it says, has ruined the economy and pushed it to the very margins of the European Union by subjugating the country's judiciary, trampling on media freedom, discriminating against minorities and refugees, all the while beating the war drums as Russian missiles keep raining down on neighbouring Ukraine.

The panoply of crises might suggest that voting patterns are in for a tectonic shift back to the centre-right led by the Civic Coalition's Donald Tusk (with the Left maybe getting a couple of seats in the new government).

But fantasy it does not need to be; PiS may have weakened in the polls but it has not collapsed and if it can weather the difficulties of the winter, the election's outcome is anything but given.

That is a big if, of course. The ruling party is being hammered for rampant inflation and what seems a botched response to it by the PiS-friendly National Bank of Poland (NBP) that has plunged the economy into a downturn, the real extent of which is only expected to become clear in 2023.

PiS has reasons to expect that its popularity will dwindle further as the cost of living crisis gathers momentum. If winter proves harsh, even the most dedicated voters could eventually question their allegiance to the ruling party as prices soar for essentials such as food, gasoline, or coal for heating (securing the affordable supply of which PiS had made one of its priorities, with mixed results). Depending on how deep the economic downturn will turn out to be, a possible rise in the unemployment rate is another headache for PiS.

In an election year, PiS will be tempted to further loosen fiscal policy and will most certainly try doing so. But it will have less and less wiggle room unless, warns the opposition, it wants the energy and economic crises to become underpinned by a financial one. The latter could be further exacerbated by the stalemate over €36bn from the EU's pandemic recovery fund, the disbursement of which is on hold as Brussels considers PiS' judiciary reforms anti-democratic and in breach of EU laws.

If the ruling party thinks it can weather all that, they may not be being irrational. Inflation is already showing signs of abating, feeble as they may be. Poland's economy is diverse enough to give analysts grounds to say that it could start rebounding from the bottom of the cycle (expected in Q1) as soon as around June. Any signs of economic recovery in the Eurozone will only improve the odds for a relatively clean escape from the current melee.

PiS also needs to make peace with its increasingly unruly coalition partner, United Poland, a small party that nonetheless has enough MPs to guarantee the government majority in the parliament. United Poland has dug in its heels over the reform of the judiciary, painting the EU as a Germany-controlled behemoth on a mission to end nation-states, no less.

The rogue coalition partner has PiS in a difficult position. The party keeps manoeuvering between what seems an achievable compromise with the EU over the recovery fund money and cosying up to United Poland over the EU's alleged usurpation of powers and, more generally, the perceived attempts by the West at uprooting traditional gender roles.

The staunchly pro-EU opposition is not without problems, either. The key issue is whether the main opposition parties – Tusk's Civic Coalition, its fellow yet separate centrist liberals from Polska 2050, the Left, and the agrarian party PSL – should run as one, giving voters a clean-cut choice between continuation and change. Simulations of how Poland's election system could work in favour – or against – the single opposition block do not offer decisive answers.

"Although opposition parties know that contesting the next election as separate lists favours the right-wing incumbent, a single united bloc remains extremely unlikely given their diverse electorates and because it would mean accepting [Civic Coalition's] hegemony," political scientist Aleks Szczerbiak wrote in an analysis earlier this year.

"Most have adopted a wait-and-see approach, and final decisions about the configuration of opposition lists may not be taken until spring," Szczerbiak added.

Amidst all the crises and uncertainty brought by Russia's war in Ukraine, Poland taking in well over a million Ukrainian war refugees without much friction seems a small miracle. Poles opened up their houses and wallets to help in the weeks and months immediately after the invasion.

Nearly a year on, Ukrainians have blended in, finding jobs and sending their children to Polish schools. Joint effort by the people and the government – which granted refugees most basic rights that Poles have – has not resulted in a backlash yet. The question is open whether a deepening economic crisis will make nationalistic fervour a factor in politics.

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RUSSIA

The Russian economy is starting 2023 in a far better state than many had anticipated in the spring following the invasion of Ukraine and ensuing Western sanctions. The fall in GDP has only amounted to about 3% or even less, and the US dollar is still trading at less than 65 rubles. Even the Western ban on high-tech imports, although challenging, has proved manageable. But none of this means that Russia's economy is out of the woods: many risks still remain. We asked economists from Russia's leading investment banks to highlight the new warning signs that have emerged in recent months.

Oil and gas revenues started to fall sharply. In November, oil and gas revenues contributed RUB866 billion ($13 billion) to the state budget – down 2.1% year on year. This is not a critical fall in revenues. However, in reality, almost half of that sum ($6.4 billion) came from a one-off payment of Gazprom's mineral extraction taxes. Without that money, oil and gas income was down 48.9% compared with 2021.

There are two possible reasons for this. First is the near-total cessation of pipeline gas exports to Gazprom's lucrative European market following the closure and subsequent explosions on the Nord Stream gas pipeline. Second is the fall in prices for Russian oil, which led to November's oil revenues being down 25.4% y/y.

Russia's finance ministry is printing money to cover this deficit. Part of the hole can be filled using the National Welfare Fund, but this alone will not be enough. Relying solely on the NWF would mean the liquid part of that fund would run out by 2025, according to the projected budget deficit, central bank analysts reported.

This fall, the finance ministry turned to large-scale borrowing in the federal loan bond market to cover the rest of the deficit. These internal loans raised RUB1.44 trillion ($22 billion) for the ministry. Of this sum, 77% derives from bonds floating rates, which will ultimately be tied to central bank rates. The main buyers of these bonds were leading banks, which previously borrowed RUB1.39 trillion ($21 billion) through repo transactions. Therefore we are effectively looking at hidden money emission.

This has obvious consequences: it will likely increase inflationary pressure, forcing the central bank to raise interest rates and sacrifice economic growth. However, not every economist regards this scheme as inflationary. Economist Viktor Tunev believes that, from the point of view of modern monetary theory, this borrowing algorithm will have no significant economic consequences. He calls these loans "Russian QE": the central bank creates liquidity in the form of federal loan bonds, simultaneously improving standards in assets and enhancing money supplies to the banks' liability without involving capital.

Unemployment levels in Russia remain close to historic lows even as foreign companies have left the market and factories have closed. The latest official figures show that 3.9% of the workforce was unemployed in October (the all-time low of 3.8% unemployment was set in August).

There are several possible explanations for this paradox. First, Russia's labour market always responds to a crisis by cutting salaries first, not jobs. Second, the low level of benefit payments in Russia means that people who do lose their jobs are likely to grab any job they can as soon as possible.

On top of this, Russia launched its military mobilisation amid this "compressed" labour market, said Rostislav Kapelyushnikov, deputy director of the Center for Labour Market Studies at Moscow's Higher School of Economics. The loss of approximately 1-1.5 million people from the labour market due to war-related mobilisation and emigration will exacerbate the situation with a growing pool of unfilled vacancies.

This serves as a wake-up call that Russia's labour resources are limited, says Alexander Isakov, an economist specialising in Russia and Central & Eastern Europe at Bloomberg Economics. Because there are no spare resources in the economy, mobilisation requires those working in "productive" industries (such as processing, construction and transport) to be diverted into the state sector. All of this impedes potential economic growth: increased defence and public sector spending have structural side-effects that will limit potential annual growth to about 0.5% over the coming five years, Isakov says.

> "Unemployment levels in Russia remain close to historic lows even as foreign companies have left the market and factories have closed"

Russia's real estate market is currently experiencing a bubble due to cheap mortgages. The current programme of discounted mortgages at a rate of 7% was due to end in Russia at the end of this year. Both the central bank and the Accounts Chamber have repeatedly called for the scheme to be cancelled. However, President Vladimir Putin recently announced that the programme would continue, albeit at a slightly higher rate of 8%. These discounted mortgages are causing Russia's real estate market to overheat. The primary and secondary housing markets are unbalanced (the price difference between a new apartment and a "maintained" apartment is now 40%).

"Russia's real estate market is currently experiencing a bubble due to cheap mortgages"

Subsidies have made housing more affordable for more citizens, who have decided to take out mortgages now rather than wait. Demand has risen sharply – faster than supply can adapt – and prices are soaring. In Moscow, it is now impossible to buy a comfort-class apartment in a new building without taking out a mortgage. However, this bubble is unlikely to burst, according to independent financial analyst Sergei Skatov: developers have already sold more than 51% of the housing due to come onto the market by the end of 2023. They need to sell a further 10-20%, which is entirely achievable even if demand falls to summer levels. Defaults on mortgage portfolios could also burst the bubble, but with a failure rate of just 0.4% (and 0.15% in the primary market), this is also unlikely, Skatov said.

Economic outlook

The EU saw a €1 trillion bill for gas prices, since the beginning of the Russian war on Ukraine. The subsidies of EU states accounted for ~ €700bn. 2023 will be as difficult as prices will be above €1,000 per 1,000 cubic metres, while budget costs in 2022 were 2-7.5% of GDP.

The cost to Russia is probably even higher. According to a *bne IntelliNews* back of the envelope calculation, the war has cost Russia around $200 billion, just counting the military spending plus the value of a 3% contraction, but that is equivalent to some 7%-8% of GDP. Those costs are bound to rise in 2023 as the effect of sanctions start to bite.

Russia's invasion of Ukraine in February has changed everything for everyone. The tragedy is that in October 2021, just before this crisis started, Russia's economy was booming. A dozen companies had done billion-dollar IPOs. Incomes were rising. The leading companies were expanding abroad. The budget was healthy and in surplus. It appeared that Russia had finally emerged as a first world country.

Then Russian President Vladimir Putin wrecked it all by insisting on his no-Nato for Ukraine deal, a demand he backed with the threat of force and when no deal was forthcoming he followed through on his threat. The upshot is we are now living in a fractured world that is fuelling a polycrisis from which it is unlikely that we will emerge for several years.

Remarkably, Russia's economy has had a very good year in 2022 considering the "massive package" of the sanctions inflicted on it in March about a week after it crossed the border into Ukraine.

At the start of the war the consensus was that Russia's economy would contract by at least 15% – worse than the 8% contraction Russia suffered in both the 1998 and 2008 crises. As the year drew to an end the consensus was the contraction would be a little less than 3%.

Most of the macroeconomic results have done far better than expected. Inflation is high but as the Central Bank of Russia (CBR) was one of the first to start hiking well before the war started, it is falling now and is around 12% – far better than the circa 20% that is across Central Europe.

Everything is of course down, but only mildly. Life on the streets of Moscow is pretty much normal and although many of the international brands have left Russia, the parallel imports (mainly via Turkey, but also via Serbia, Central Asia and the Caucasus) are kicking in, so most of the international brand names are available again.

The ban on seaborne shipments of Russian crude oil to EU countries went into effect on December 5. The ban does not apply to crude oil transmitted by pipeline. Germany and Poland, the largest European buyers of Russian pipeline crude, have announced that they will also suspend their pipeline imports, which have already fallen close to zero.

A few EU buyers (Hungary, Czech Republic and Slovakia) will at least temporarily continue to import Russian pipeline oil for about a year. Most EU crude oil imports from Russia, however, are now ending.

Read the full report
bit.ly/3Ycrp3d

UKRAINE

Since the war began, Ukraine has collected about $32bn in macro-financial aid. According to Prime Minister Denys Shmyhal, Ukraine needs $38bn in 2023 to cover the budget deficit and another $17bn to implement rapid reconstruction projects. He added that the EU has promised €18bn in macro-financial aid, and the US will allocate €13bn. Also, the start of the IMF programme to finance Ukraine is anticipated by the end of the first quarter.

Attracting macro-financial aid is one of the main directions of diplomatic work to strengthen Ukraine's internal capacity, the prime minister of Ukraine added.

Shmyhal also emphasised the need to create the diplomatic corps to expand Ukrainian exports, which have decreased by more than 30% in 2022. He believes that it is necessary to strengthen work with traditional export markets and to expand the geography of trade and economic co-operation with the countries of Africa and Latin America.

In December European Commission President Ursula von der Leyen accidently revealed the cost to Ukraine of the war in a speech. "It is estimated that more than 20,000 civilians and 100,000 Ukrainian military personnel have died to date," she said. The comment drew a sharp backlash and the EC later deleted the comments from video recordings of the address. Bankova has made casualty figures a state secret, but von der Leyen's comment shows just how much Ukraine is paying for Russia's invasion. Prior to the war, in the eight years of fighting in Donbas against separatists Ukraine had lost a total of some 14,000 people.

Despite the death toll, Ukrainians remain almost universally committed to continuing the war until they win. Ukraine has some million people (many women have also volunteered, and for frontline duty too) in uniform, with several hundred thousand in active service in the fight. They face around 400,000 Russians serving in the Russian army, but with a new mobilisation being prepared – probably for around April when the weather improves – this war could last for years.

Ukraine has lost an estimated 20% of its territory. At least 22% of Ukrainian farmland is under Russian control. These areas are a large part of the territories identified in the Minsk II agreement that would have been governed as autonomous districts. Due to the failure of the Minsk II agreement, Russia launched its "special military operation" to free these areas from the grip of the Ukrainian government. As of today, it appears Russia has come close to achieving some of its initial goals.

Leaders in the West are starting to wake up to the fact that this war could drag on for years.

Ukraine's economy has been devastated by the war with Russia and at the start of 2023 the situation has only been getting worse as Ukraine's power and heating infrastructure have been targeted.

Economic forecasts have steadily worsened in December. Mid-year forecasts for an economic contraction of 30-35% have been increased following the disabling of the power sector, with some economists forecasting a 50% contraction and another 10% next year, depending on the development of the war.

However, the official forecasts are slightly less apocalyptic: Ukraine's GDP will grow by 1% in 2023, according to an IMF's macro forecast. "Economic activity is expected to stabilise in 2023, with economic growth of 1% under the baseline scenario after the economy contracted by 33% this year," IMF mission chief Gavin Gray said. In addition, the fund predicts that the annual inflation rate in Ukraine will remain at an average of 25% next year.

In its forecast in September, the EBRD also thought Ukraine's economy would shrink by 30% this year but would grow by 8% next year; but that was before the Russians started bombing the power plants.

The Bloomberg consensus says Ukraine will have -34% growth in 2022, which makes sense given the Q2 GDP collapse. It also says 2023 growth will be +5%. For that you need +33% Q4/Q4 2023 growth, i.e. immediate end to war and then a big boom to overcome a huge negative base effect.

Estimates of the cost of physical damage have also risen from around $100bn mid-year to some $400bn in November and new forecasts of up to $630bn by some analysts in December.

There is no way that Ukraine can pay for this reconstruction and currently it can't even pay for the maintenance of its own economy. The government forecast revenues of some $36bn equivalent in 2023, but that is only a third of what it has as budget spending. The forecast deficit is $38bn, which the West has promised to cover. Finance Minister Sergey Marchenko has said just one-third of Ukraine's budget revenue comes from domestic sources, while the rest consists of foreign grants and loans. Even if the war were to end soon, Ukraine will be heavily dependent on international aid for years to come. A new comprehensive IMF programme is due to be agreed in the spring but even this will be a moving target.

Poverty due to the collapse of the economy was already in double digits in the second half of 2022 and the World Bank estimates it could rise to 50% in 2023.

Labour shortages were already an issue after some 3mn Ukrainians left the country prior to the war to look for better paid work in neighbouring countries such as Poland and Romania. However, after the war broke out an estimated additional 7mn people have left and recent polls say that a third of them don't intend to return. On top of that, Ukraine was already suffering from a demographic crisis that will only get worse now.

"Poverty due to the collapse of the economy was already in double digits in the second half of 2022 and the World Bank estimates it could rise to 50% in 2023"

The economy is struggling with a massive trade deficit, reliant on international aid to shore up its FX reserves, which had fallen to $25.2bn in December. The hryvnia has already been heavily devalued, but analysts expect the National Bank of Ukraine (NBU) to allow further depreciation of the hryvnia in the first half of 2023 as the financial crisis deteriorates.

With business on its back the budget is now entirely dependent on external aid. The Ministry of Finance estimates next year's deficit will reach $38bn and Ukraine's Western allies have said they will cover all of this. But again, as the economic situation continued to deteriorate further in December, bigger estimates of the deficit were already appearing, with some saying the deficit could reach $50bn in 2023, creating the need for more funding to be raised from partners.

Public expenditures have been driven by defence and essential social spending and have led to an unprecedented fiscal deficit of about 20% of GDP in 2022. Since the war began until the end of October, Ukraine has disbursed $23bn in financial assistance to the population.

The EU has confirmed it will provide Ukraine with €18bn in 2023, distributed in tranches of €1.5bn per month, according to Prime Minister Denys Shmyhal. At the same time, the USA has promised to match the EU and send $9.8bn in 2023, bringing a combined $28.7bn. Other donors like the International Monetary Fund (IMF), World Bank and other multilateral agencies have all promised more funds.

There is still no sign of peace talks starting any time soon. The initial attempt in March and April came close to striking a deal, but after that failure the two sides have too much distance between them to be able to come to the table. In November and December the Kremlin signalled that it was ready to start talks, but Ukrainian President Volodymyr Zelenskiy was adamant that no talks could start until Russia had quit Ukraine's territory entirely – a position the Kremlin rejected out of hand.

Negotiations could start in the New Year as a certain Ukraine fatigue was appearing in November, according to the US, as the cost of the war and the associated polycrisis it has fuelled start to weigh on Europe. The cost-of-living crisis in the West has already spurred demonstrations, although the energy crisis in 2022 seems to have been contained as Europe's gas tanks were filled to the brim by the start of the heating season. However, energy analysts are already warning that the energy crisis in the winter of 2023 could be even worse. Russia sent the EU 60bn cubic metres of gas in the first half of 2022, but since the two Nord Stream pipelines were blown up in September the volume of gas Russia can send will be dramatically reduced. The International Energy Agency (IEA) forecasts that Europe will go into next year's heating season with a 30 bcm deficit that will cause an even bigger energy crisis.

Political outlook

There is little in the way of politics at the moment as the situation is politically frozen by the war. Ukrainian President Volodymyr Zelenskiy is fully focused on keeping the aid and arms from donors flowing. The population is solidly behind the president and determined to fight to the bitter end to expel the Russians, come what may.

Read the full report
https://online.flipbuilder.com/myab/ekrf/

SOUTHEAST EUROPE

The war in Ukraine had a seismic effect on the security, political and economic landscape of Southeast Europe. It is just across the border for Moldova and Romania and in the near neighbourhood for most of Southeast Europe.

Fears of a spillover into the region were not realised in 2022, but there are still concerns that Russia could seek to embroil Moldova — part of which is controlled by Russia-backed separatists — in the war, or to cause tensions to overflow in existing hotspots such as northern Kosovo or Bosnia's Republika Srpska.

Moldova is the only country in the region facing a potential military threat from the war. Ever since the invasion in February there has been speculation that Russia might push through from Ukraine to the separatist republic of Transnistria in Moldova, or that Moldova itself might be dragged into the war.

This has not happened, mainly as a result of Chisinau's caution — it has not imposed sanctions on Russia despite moving closer to the West during 2022 — and because of the efforts by both Chisinau and Tiraspol to ensure that the conflict between the two sides of the country does not escalate. However, towards the end of the year tensions increased as cuts in deliveries of Russian gas put the squeeze on both Moldova proper and Moscow-backed Transnistria.

Most of the other countries in the region are either Nato members or aspiring members. The Nato presence has been stepped up in countries like Romania that are on the Alliance's Eastern Flank.

Western Balkan flashpoints

Other security issues facing the region are internal, though some of these divisions have been amplified by the conflict further east.

At the beginning of 2022, EU foreign policy chief Josep Borrel identified Bosnia & Herzegovina as one of the two most critical flashpoints in Europe, along with Ukraine. The international security presence in both Bosnia and Kosovo was stepped up after Russia's invasion of Ukraine over fears Moscow might destabilise one or both of the volatile situations in the Western Balkans.

In Bosnia, Milodad Dodik, president of the country's Serb entity Republika Srpska, has been loudly repeating threats that the entity will secede from Bosnia for years. However, fears that a more serious attempt to secede might be made in 2022 — possibly at the instigation of Dodo's political ally Russian President Vladimir Putin — did not materialise.

Additional tensions came from the actions of the international community's high representative in Bosnia, Christian Schmidt, whose high-handed decision to change the electoral rules on October 2 — election day in Bosnia — drew widespread condemnation from within and outside the country.

On the other hand, Bosnia was drawn closer into the Western camp in December when it was given long-awaited EU candidate status, despite the sluggish pace of reform resulting from repeated political deadlocks. Another positive development was the unusually speedy formation of new governments at state and entity level following the October elections.

Stand-off in northern Kosovo

The other major security flashpoint in the Southeast Europe region in northern Kosovo, where the situation deteriorated dramatically in the second half of 2022. A stand-off was triggered by the mundane but politically sensitive issue of car number plates; the Kosovan government required that cars across the country including the mainly ethnic Serb northern Kosovo have number plates with the RKS code rather than the old neutral status KS.

Tensions over the issue led to mass protests, road barricades and a walkout of state institutions by ethnic Serb officials. The situation was only eased right at the end of 2022, under heavy pressure from the EU and the US. However, the situation remains volatile and the next crisis point is expected to be reached in April, when local elections to replace officials that quit in 2022 are due to take place.

Between Russia and the West

Even where there was no security threat, the war in Ukraine and the new geopolitical situation added to existing tensions and created new political rifts in a number of countries in the region. In much of Southeast Europe, even some EU members, the question of whether to steer Westwards or maintain a close relationship with Russia remains open.

This has become problematic for Serbia, where President Aleksander Vucic has continued with his long-standing policy of seeking friendly relations with both Russia and the West, as well as China. This has served the country well in the past, but post-invasion Belgrade has been under heavy pressure to join sanctions on Russia. So far, the Serbian government has refused to do so because of Belgrade's long-standing relations with Russia as well as Moscow's backing over the Kosovo issue.

This has damaged Serbia's standing with the West and led to calls from MEPs and other European politicians for Serbia's EU accession process to be frozen. Moving into 2023 there seems no immediate prospect of a change of stance by Belgrade; such a step would be highly difficult politically given the loud pro-Russian voices within Serbia.

Moldova has long had a highly polarised political landscape. The landslide victories of President Maia Sandu and her Party of Action and Solidarity, in 2020 and 2021 respectively, looked set to propel the small country on a Western course. However, despite notable steps such as securing EU candidate status, Sandu's promised reforms have foundered amid the country's pressing economic problems.

The window for Sandu and her PAS to make long-lasting reforms on issues such as corruption and the rule of law is closing as elections loom in 2024 and 2025 that may see the return to power of the pro-Russian Socialists or parties tarnished by corruption such as the Democratic Party or Shor Party. 2023 will be critical in this regard. The PAS' government is already under heavy pressure from regular mass anti-government protests organised by the Shor Party.

> "Orientation vis a vis Russia and the West also emerged as a new rift in Bulgarian politics ahead of the October 2022 general election"

Power vacuums

Orientation vis a vis Russia and the West also emerged as a new rift in Bulgarian politics ahead of the October 2022 general election. This delivered a fragmented new parliament and the loose alliance that had previously been working to tackle corruption — the reformist Change Continues and Democratic Bulgaria together with the Bulgarian Socialist Party and President Rumen Radev — collapsed, with the former firmly in the Western camp and the latter two taking a more pro-Russian tack.

Three months on from the general election there is little hope of a new government being formed — much less a reform-oriented one with the will and political capital to tackle corruption — and yet another snap election is expected in March.

A third country in political disarray is Montenegro, where efforts by a coalition of around 20 small parties to install a government under Demos leader Miodrag Lekic fell through in January. This followed a lengthy standoff with President Milo Djukanovic, who refused to give a mandate to Lekic. Early elections are now anticipated in March.

Progress on EU enlargement

EU enlargement is the common goal of the Western Balkan countries. With the war in Ukraine giving EU members a prod to embrace European countries outside the bloc, 2022 saw some of the biggest progress on enlargement in recent years. Not only did Albania and North Macedonia get the long-awaited nod to start accession talks, but EU members also extended candidate status to Bosnia, Moldova and Ukraine.

At the start of 2023, Croatia was admitted into both the Eurozone and the Schengen area, overtaking Bulgaria and Romania, which joined the EU six years earlier. Romania in particular plans to make a concerted effort to secure Schengen membership in 2023.

Overall, however, less action on EU integration is expected in 2023. North Macedonia's government now has the politically difficult ask of getting unpopular constitutional amendments through Parliament for the country to progress with its accession talks. Meanwhile, of the two frontrunners in the process, Serbia's progress appears stymied by its refusal to fall into line with EU foreign policy on Russia, and Montenegro's by its political instability.

Romania had a relatively calm year politically, but 2023 is expected see the emergence of cracks in the grand coalition between the country's two largest parties, the National Liberal Party (PNL) and Social Democratic Party (PSD). The first challenge will be the handover of the prime minister position from the PNL to the PSD. After that, as the super-election year of 2024 approaches, the two parties can be expected to assert their differences as they art to woo the electorate.

Economic crisis

All this is happening against the backdrop of the economic crisis caused by the war in Ukraine and related sanctions. The final months of the year saw the start of a slowdown as rampant inflation took its toll on companies and households.

For most of the region, growth continued relatively robustly in 2022, albeit slower than during the rebound from the coronacrisis in 2021. Three small Southeast European economies — Croatia, Montenegro and Slovenia — appear to have clocked up some of the fastest growth in the Emerging Europe area in 2022, helped by the recovery of international tourism, even though by the end of the year their expansion had started to slow.

The region's largest economy, Romania, saw its growth decelerate slightly during 2022 but to a still robust 4.6% annual rate, from 5.1% in 2021. But it is expected to grow by only 2-3% in 2023 and to recover marginally towards growth rates of not much above 4% in the coming years.

Like other countries, Romania is affected by the recession in Europe; Germany and other Central and Western European countries are important markets for goods produced across the Southeast Europe region. Another factor for the EU members is the funding under the EU budget and under the Resilience Facility.

By contrast, it was a terrible year for Moldova, where the economy is expected to have contracted by 4% or more in 2022 — much worse than anticipated by the government, international financial institutions (IFIs) and independent analysts. Moldova experienced difficulties on multiple fronts — from disruptions to trade caused by the war in neighbouring Ukraine, lower demand from Western countries as inflation took its toll on spending and a poor harvest due to drought. Already one of the poorest countries in Europe, Moldovans' standards of living have been eroded dramatically by inflation that soared to over 30%. On top of this, Moldova is still hosting tens of thousands of Ukrainian refugees.

Rampant inflation

While inflation in Moldova was exceptionally high, inflation across the region accelerated sharply during most of 2022 due the economic effects of the Russian war in Ukraine. It was also well into the double digits in Bulgaria, Romania, Serbia and some other countries.

This prompted central banks to hike rates across the board. In an early sign of the decrease in inflation expected in 2023, however, some countries have seen a modest slowdown in price growth in the final months of 2022.

With the hike in prices, the consumer spending that has been an important driver of growth in the past slowed as disposable incomes were whittled away.

It also had a damaging impact on tourism in Montenegro, where Prime Minister Dritan Abazovic warned early in the season that prices were as high as on France's Cote d'Azur. Elsewhere in the region, however, rising prices across Europe benefited lower-cost destinations such as Albania, which saw a record season amid the arrival of thousands of bargain-seekers.

Debt ratios continued to decrease in 2022 after the hikes in borrowing and economic slumps during the pandemic. Debt had reached high levels in Albania, Croatia and Montenegro in particular. However, with the economic slowdown from late 2022, concerns have again been raised about the sustainability of Montenegro's debt burden, and the threat to fiscal stability from the borrowing envisaged in 2023.

Input costs soar

The war and sanctions hit a variety of important sectors, including energy, grain and metals.

With much of the gas supplied to Southeast Europe coming from Russia, governments have been scrambling to diversify their sources, looking to alternative suppliers such as Azerbaijan. This prompted a speeding up of pipeline and other infrastructure projects.

Croatia's strong performance so far has been down to a combination of its relative resilience to the energy crisis, thanks to a large extent to its construction of the offshore floating liquefied natural gas (FLNG) terminal on the island of Krk, and partly to the continued post-Covid rebound of its tourism sector. The FLNG terminal contributes to Croatia's energy independence, and the country has ambitions to become an LNG hub for the region. Zagreb intends to double the capacity of the terminal from 2.9bn cubic metres to 6.1 bcm.

Romania is also seeking to develop its offshore gas resources in the Black Sea. BSOG has already started production in the Black Sea and will add 1 bcm of gas to the country's depleting production (under 10 bcm per year) and OMV Petrom/Romgaz should begin production in 2027.

Serbia has benefited from its good relations with Russia, securing a new gas supply deal on favourable terms in spring 2021. Other countries have fared less well; Gazprom cut off Bulgaria's supplies in April when former prime minister Kiril Petkov refused to pay in rubles, while deliveries to Moldova were cut in autumn 2022, apparently for political reasons, and there is considerable uncertainty about how much the country will receive, or even whether.

Metals industries across Europe were hit by the higher energy prices, with some announcing production cuts as prices started to rise post-pandemic but before the invasion of Ukraine. Among those affected in Southeast Europe are aluminium producers such as Romania's Alro, Slovakia's Slovalco and Talum in Slovenia, as well as KAP in Montenegro.

Read the full report
online.flipbuilder.com/myab/howu/

TURKEY

In 2022, Turkey continued to collapse in all fields.

The year ended with an ill omen, namely bloodbaths on Istanbul's main shopping thoroughfare, when a bomb left on a bench exploded, and in the conflict with adversaries gathered in locations around the Turkish-Syrian border.

None of this came as a surprise. *bne IntelliNews*' Outlook 2022: Turkey read: "If Turkey cannot manage to somehow smoothly get rid of the [President Recep Tayyip] Erdogan reign, nothing would be a surprise amid the turmoil engulfing the country. Erdogan could at any time engage in wars, fuel violence at home, create more economic dilemmas, announce he is moving against another attempt at a 'coup', or conspire in and engender many other things that we can scarcely imagine at the moment."

The coming year, 2023, requires Erdogan to call presidential and parliamentary elections. They must be held by June at the latest. Thus, in store are 12 months that could bring markedly more dramatic and tragic events that will stain modern-day Turkey's history. Prepare for a possible boom in terror and violence.

As 2022 progressed, there were some predictions that Erdogan would go for snap polls, perhaps before the end of the year. Some current rumours anticipate elections slightly earlier than in June, perhaps in April or May.

Erdogan has lately been rearranging his foreign policy in order to secure a free hand at home. The major players of the United Nations as a whole, ranging from the US to China, appear to be part of a consensus supporting a continuation of the Erdogan regime.

Court cases abroad that pose some threat to Turkey's autocrat are advancing only very slowly (in terms of the US, for example, look up the latest on the Halkbank case, the "SBK" case, the assaults by Erdogan's security detail on protesters in Washington and the sanctions move against Sitki Ayan).

The only exception so far to this relative foreign policy comfort for Erdogan has been Syria's Bashar al-Assad. Media reports have suggested that Assad is refusing to smooth relations in a way that would benefit Erdogan's election campaign. Erdogan is, however, still pushing for a meeting with Assad. He would use it to portray himself as sending a great number of Turkey's Syrian migrants back home.

The tragic grip of today's authoritarianism held over so many Turks is, note, not only maintained thanks to inaction from foreign partners. The state of the so-called opposition within Turkey is more heart-wrenching.

Nevertheless, in a fair contest, Erdogan would have no chance at the polls. In an unfair contest he will, of course, declare another "victory" during the early evening hours of election day while the votes are still being counted. Heads of foreign states will queue to congratulate the despot on his victory on the phone. Their congratulations will translate as: "We recognise you as the political authority in Turkey. Feel free to do what you would like to do."

The opposition will play its role by turning tail and disappearing. It's all been seen before, such as in the general election of 2018 and the constitutional referendum on forming an executive presidency, held in 2017. Once more, observers will watch to see whether, post-election, it is possible to keep Turkey stable.

In the most positive scenario, Erdogan would leave his post in a somehow-contrived peaceful transition. The scenario could, in a certain sense, be seen as mirroring what was seen in 2002. In such an eventuality, Turkish assets, led by the lira, would see a sharp rally. It would begin as soon as the market became convinced that Erdogan was set to peacefully hand over the reins of power.

Turkey would then fall into another "hot money" trap. The value of the lira would boom, the current account deficit would leap and domestic production would collapse. And, Turkey would become ready for the next portfolio outflow shock.

An actual recovery, which could be described as at least returning to the 2015 settings, would require, at a minimum, five years of uninterrupted healing, with programmes covering each and every corner of life.

It should be noted that, in the post-Erdogan period, any government, democratic or undemocratic, would have to politically and economically surrender to an International Monetary Fund (IMF) programme. And past experience with IMF programmes shows that political ructions would be in store.

Turkey still has access to borrowing on the global markets – though each instance of borrowing at the required high costs brings the country closer to the ultimate end, namely the IMF programme. A new version of the ruling Justice and Development Party (AKP), working under an IMF programme, is the likeliest potential major political change you might see on the road ahead.

Read the full report
https://online.flipbuilder.com/myab/nxgf/

UZBEKISTAN

The past year has seen Uzbekistan, in common with the rest of Central Asia, braced for economic impacts of the Russian invasion of Ukraine and the Western sanctions imposed on the Russian economy as a result of the Kremlin's choice to wage war.

The effects have yet to register on anything like a critical scale in the region, while there have been some positive outcomes such as a rather cornered Moscow's increased readiness to compromise in the pursuit of badly needed trade and investment deals, but some conclusions on economic damage can already be drawn and there is the worry that, combined with the global economic downturn, 2023 could bring some serious setbacks. The latest IMF Outlook found that the poverty level across the countries of Central Asia and the South Caucasus looked set to worsen by around 1%.

At the beginning of 2022, experts were quick to predict a sharp decline in Central Asia, given how its economies are substantially interlinked with the Russian economy. That has not really come to pass with, for instance, remittances from the region holding up as Russia fought to defend its economy. Yet there are renewed fears that as some of the more medium-term effects of the war sanctions and international downturn start to eat into the Russian economy, there could be a more pronounced fall-off in jobs and earnings available in Russia to Uzbek and other migrants, causing a significant reduction in remittances sent home. That's causing anxieties. In Uzbekistan's case, for instance, migrants generate some 6% of GDP.

The Uzbek central bank has compiled both basic and alternative economic scenarios the country might face in the years ahead. Whereas the pandemic was the dominant irregular factor for a couple of years, geopolitical shocks have now come to the fore.

Basic scenario

In its basic forecast, the central bank foresees a scenario in which global economic growth continues, albeit at a slower pace of around 3%. Also in this outlook, the exchange rates of the main partner currencies to the Uzbek som (with the exception of the ruble) would remain relatively stable, while the oil price would hover at around $80-90 per barrel. Remittances would decrease slightly in 2023, but would then increase.

Foreign investment in Uzbekistan would continue to grow, facilitated by the further opening up of the capital market to foreign investors and IPOs/SPOs. A gradual transition to market prices for energy and structural reforms applied to various industries would be expected.

According to the central bank basic scenario calculations, Uzbekistan's GDP would grow by 4.5-5% in 2023. With a normalisation of the global economy, the growth rate would be expected to accelerate to 5-6% in 2024 and 6-6.5% in 2025.

The situation would allow for a resumption of fiscal consolidation and a reduction of the budget deficit by a percentage point or so.

The tight phase of monetary policy would last until the end of 2023/start of 2024. Inflation would fall to 8.5-9.5% in 2023 and the targeted 5% in 2024.

Alternative scenario

In the central bank's alternative scenario, continued uncertainty would beset the energy market, the conflict between Russia and Ukraine would escalate – as would the sanctions regime applied to Moscow – and investors would likely become more cautious. They might be given more pause for thought by a further tightening of monetary policy around the world.

Global economic growth would slow to 1.5%, while oil and raw material prices would fall sharply due to the risk of recession. This would weaken the main partner currencies to the som and squeeze remittance inflows. On a brighter note, food prices might fall.

Uzbek GDP growth in 2023 would fall to 3-3.5%. With a revival of world trade in 2024, something around 4-4.5% would be expected, with 5% around the corner.

To support the economy, the fiscal stimulus would continue through 2023, meaning the budget deficit would remain at the current 4-4.5% of GDP. Starting from 2024, against a background of fiscal consolidation, it would decrease to 3.5–4% of GDP.

The liberalisation of regulated prices would have to be postponed. That would make it possible to reduce inflation to 7-8% in 2023. Subsequently, inflation would decline at a slower pace – to 6-7% in 2024 and the targeted 5% in 2025.

In either scenario, the regulator would stick with a moderately tight monetary policy.

Read the full report
https://online.flipbuilder.com/myab/amoy/

KAZAKHSTAN

Kazakhstan has just endured one of its most jarring and challenging years since independence was gained in 1991.

The year got under way with "Bloody January". Major countrywide civil unrest turned into a coup attempt. The president, Kassym-Jomart Tokayev, warned violent protesters he was applying a 'shoot-to-kill' crackdown. Russian troops were even invited in as part of a Collective Security Treaty Organisation (CSTO) response approved by Tokayev to underline that he was deadly serious about staying in power.

From late February, when Russia invaded Ukraine, the economic impacts of the ensuing war, including those related to the Western sanctions response against Moscow, were unavoidable for Kazakhstan. Its economy is heavily intertwined with that of Russia.

By the end of the year, political power in Kazakhstan was fully reconsolidated under its second president since independence, Tokayev. But wary of showing too much outward closeness to traditional strategic partner Russia, turned into an international pariah by its actions towards Ukraine, Astana found itself juggling foreign relations between Russia, the West and China more than ever.

Tokayev trod a fine line. He stayed on good terms with the West by voicing respect for the war sanctions imposed on Russia and at the same time he shrewdly worked to ensure Kazakhstan remained an ally of Russia by staying within the limits of the Kremlin's tolerance. With Russia rather overstretched by its difficulties with Ukraine, that proved possible despite Tokayev publicly declining to recognise the so-called independence declared by the Russia-occupied Donbas and Luhansk territories snatched from Kyiv.

Simultaneously, fully aware that the new mood in Kazakhstan meant it was wise to increasingly sideline predecessor and former mentor Nursultan Nazarbayev, Tokayev made sure to do so.

On the economic side, nothing highlights Kazakhstan's dependence on Russia more than the reliance on the Caspian Pipeline Consortium (CPC). It provides the export route for around 80% of Kazakh oil flows to the West. The route's vital infrastructure is a pipeline that passes through Russia to the Russian Black Sea port oil terminal in Novorossiysk. S&P Global Ratings has lowered its outlook on Kazakhstan to negative from stable, given concerns over how dependent the country's oil industry is on the CPC export provision.

Since the Kremlin invaded Ukraine, Kazakhstan has several times experienced CPC restrictions beyond its control on oil exports from Novorossiysk. The S&P downgrade was triggered as analysts digested just how vulnerable the CPC pipeline remains to disruption. Each time CPC announces that technical, or other difficulties, are hindering Kazakh oil flows through its pipeline, sceptics wonder whether the real story relates to a political decision taken by Vladimir Putin's Russia.

On top of the anxieties and infrastructure vulnerabilities plaguing Kazakhstan's oil sector, the country's economy more generally is now highly exposed to supply chain disruptions. The hindering of trade that runs through Russia is a distinct factor in the major surge in inflation experienced by Kazakhstan in the past year. The inflation woes added to existing economic anxieties of Kazakh citizens who were dissatisfied with their lot even prior to the setbacks caused by the COVID-19 pandemic.

"By the end of the year, political power in Kazakhstan was fully reconsolidated under its second president since independence, Kassym-Jomart Tokayev"

In the year 2023, assuming that there are no new 'black Swan' surprises, Kazakhstan will face more of much of what's been outlined above. It's likely that the coming year will see a continued surge in inflation, further worries centred on the exodus into Kazakhstan of Russians fleeing the war mobilisation and, at the same time, the high expectations of many – or extremely low expectations, depending on whom you ask. Tokayev has pledged to alleviate chronic poverty and dismantle Nazarbayev's oppressive legacy. Kazakhs will want to see good evidence of near-term progress.

On the positive side of things, Kazakhstan is enjoying a great expansion in the transit of goods dispatched from China to Europe and vice versa. Its territory plays a key role in the Trans-Caspian International Trade Route (TITR), also known as the "Middle Corridor". Use of the route has kicked into full gear as traders shy away from sending consignments via sanctions-embroiled Russia.

Read the full report
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Ukrainian refugees at Przemysl station. / bne IntelliNews

Tide of Ukrainian refugees transforms Polish society

Wojciech Kosc in Warsaw

Almost immediately after Russian tanks rolled into Ukraine on February 24 last year, there was a forced exodus across Poland's 535-kilometre long border on a scale not seen since World War Two.

To date, nearly 8.1mn Ukrainians have crossed into Poland – the main refugee exit route – according to the Polish Border Guard's daily reports. Almost 6.2mn have since crossed back.

Of the remaining 1.9mn, some have moved on elsewhere in the European Union, but Poland estimates that more than one million have made Poland their more or less permanent home, attracted by existing Ukrainian communities in the country and linguistic affinities between Ukrainian and Polish.

These migrants have been encouraged to stay the winter by Ukrainian President Volodymyr Zelenskiy, as constant Russian bombardments of infrastructure make life in the country increasingly difficult.

This influx should be compared with 7.8mn registered refugees across the whole of Europe, including 4.5mn in the EU. Poland has received by far the largest number in total in the EU, although Czechia has received more in relation to its population.

Such an influx over just a few months – the bulk of the arrivals came in the first weeks and months of the war – have had a profound impact on Poland's society and economy.

Poland predicts that by the end of 2022, it will have spent PLN18bn (€3.83bn) to help Ukrainian refugees, including welfare payouts, organising education for Ukrainian children, or providing refugees with health care – all that and more on a par with what Poles receive.

Poles have, in fact, spent much more helping refugees, as hundreds of thousands – if not millions – rolled out privately funded relief efforts, ranging from one-off donations of money and essentials to long-time renting out of apartments or rooms in their own homes.

Ukrainians are not just receivers, however. Over one million new consumers have helped prop up retail sales, which have declined as inflation ate away household incomes.

While the average Polish consumer cut spending because of the diminishing purchasing power of his or her income, Ukrainians kept on shopping.

Ukrainian spending on clothing, food and other essentials boosted Poland's retail sales figures in March and April, just after the invasion. For example, sales of textiles, clothing and shoes jumped 41.9% year on year in March before going up by 121.4% y/y in April, data from Poland's statistical office GUS show.

It took until October for inflation and the creeping economic slowdown to significantly affect spending, and refugees apparently still drove sales of textiles, clothing and footwear, as well as of pharmaceuticals and cosmetics.

Since the early months of the exodus, Ukrainians have moved on from just finding a refuge to seeking to earn a living, though as many refugees are mothers with young children they are often constrained in how much work they can do. Some 71% of the refugees are women and 47% are children under 18, according to the EBRD Transition Report.

A recent study carried out by the University of Lodz, covering the period between the outbreak of the war and the end of September, showed that half of refugees worked, while 25% were seeking employment. Ukrainians have therefore also become significant contributors to the tax system through social security payments.

Some are even active as small businesspeople, a recent report by ZPP, a business lobby, showed. Only until the end of September, Ukrainians in Poland started close to 10,000 businesses, the report said. Most – over 1,100 – were hairdressers and beauty parlours, typically owned by women. But Ukrainians also set up software service companies as well as firms offering construction and renovation services.

With more sophistication in life comes more sophistication in using services, such as banking. Ukrainians' loans in Polish banks made up an estimated 0.8% of Polish banks' entire loan portfolio and are worth PLN6.34bn – four times the figure in 2018, BIK, a market analysis company, reported in late November (data includes Ukrainians who lived in Poland before the war).

Over three quarters of Ukrainian loans in Polish banks are housing loans, with 18% cash loans, BIK data also showed.

The influx of over one million more people could help alleviate Poland's problems with the tight labour market and – if they stay longer term – its low birth rates and ageing society.

According to the Transition Report, this refugee inflow could increase the EU's labour force by 0.5% by the end of 2022, twice the impact of the flow of migrants across the bloc's southern borders in 2015-6.

These refugees are also well educated. The University of Lodz study showed that as much as half of Ukrainian refugees have higher education.

"People who leave their counties are 'positively self-selected' as economists say," EBRD Chief Economist Beata Javorcik told *bne IntelliNews* in November. "They are better educated, more entrepreneurial. They provide a benefit to their recipient countries."

The Ukrainian influx has already improved the hitherto hostile Polish attitudes to refugees, which had attracted criticism during the 2015-16 wave from Syria. Positive attitudes have increased by 19 percentage points compared to 2021, according to an Ipsos poll in April and May quoted in the EBRD's Transition Report. The percentage of Poles supporting people's right to seek refuge in another country rose from 66% to 85%.

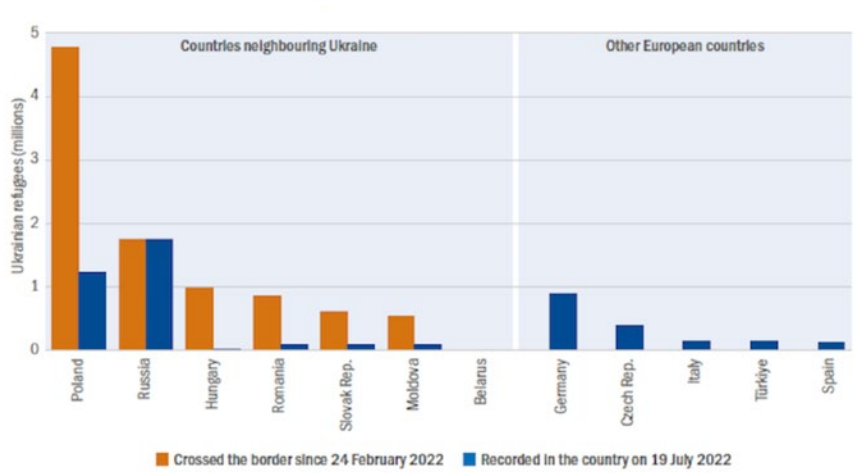
However, the pretty picture of a great mass of people settling in a friendly country after a brutal war forced them out of their homes is marred a little by research suggesting that Poles may be overwhelmingly in support of Ukraine but do not necessarily like Ukrainian refugees next door. There are also fears that the Polish welcome to refugees may soon wear out.

"Ukrainians have become victims of dissatisfaction with the deteriorating economic situation of Poles, fears related to the paralysis of the state and the low level of public services, rampant inflation and skyrocketing energy prices," a report "Poles for Ukraine but against Ukrainians," claimed after in-depth interviews with several dozen Poles and a representative poll of 1,000 people.

"Most of the respondents, and in some groups all of them, especially in the working class, believe that refugees are privileged, demanding and treated better than Poles," wrote the authors of the report, sociologists Przemyslaw Sadura and Slawomir Sierakowski.

"There is concern about the loss of priority in access to benefits and public services like health, education, or care) ... Refugees are accused of pushing in and getting what the patiently waiting Poles can only dream of: a place in a nursery or kindergarten, a visit to a specialist, an upcoming surgery appointment. ●

Several European economies are hosting large numbers of Ukrainian refugees



EU ambassadors reach megadeal on global minimum tax, Ukraine aid and Hungary's RRF funds

Tamas Csonka in Budapest

EU permanent representatives on December 12 reached a deal that should pave the way for Hungary to receive €5.8bn from the post-pandemic recovery fund (RRF) in exchange for the country's support for the global minimum corporate tax and €18bn in aid for Ukraine.

The deal will help Viktor Orban's regime fill its yawning budget deficit and should steady the forint, the EU's worst performing currency this year.

The Czech rotating presidency announced early on December 13 that member states in principle had agreed on the package of issues requiring unanimity. Hungary was widely viewed as blocking the two major EU policy decisions – the global minimum corporation tax agreement and the immediate short-term financial relief for war-torn Ukraine – to put pressure on the EU to release EU funds earmarked for the country but frozen over its violations of the rule of law.

The EU Council agreed to avoid the Hungarian veto on the Ukraine aid by making each member state take on financial responsibility individually, so that the money will not be loaned at EU level. The loan would be provided based on bilateral agreements between 26 member states and the European Commission.

Hungary finally agreed to drop its veto over the OECD-agreed global minimum corporate tax of 15% to be applied to large multinational companies with a combined annual turnover of at least €750mn, as well as its veto of the €18bn relief package for Ukraine.

In return, the permanent representatives of the member states approved Hungary's €5.8bn recovery fund, following a recommendation by the Commission earlier this month. The failure to approve the plan before the end of the year would have meant Hungary would lose 70% of the funds. According to financial website Portfolio.hu, only the Netherlands abstained from the vote.

In order for Budapest to access these funds or vital Cohesion funds from the EU budget from 2021-2027, however, it needs to fulfill strict milestones set by the European Commission, which are set to spark future conflicts between Budapest and Brussels next year.

EU member states stood by the ongoing conditionality mechanism against Hungary that ties access to EU Cohesion funds to implementing widespread reforms to tackle corruption and guarantee the independence of the judiciary, among other issues.

But member states agreed to freeze only €6.3bn of the three Cohesion funds, which is €1.2bn less than originally proposed by the EC, "given the degree of cooperation" by Hungary.

Member states acknowledged the work done by the Hungarian authorities but decided that these remedial measures do not sufficiently address the identified breaches of the rule of law and the risks these entail for the Union budget.

"It's a humiliating night for Orbán," one diplomat told Politico. "He had to swallow his vetoes and hardly got a reduction on the conditionality mechanism. All to salvage his RRP [recovery plan] and thereby calm the markets at least a little bit for now."

Orban has also squandered what remains of the goodwill towards Hungary among member states by trying to block the minimum corporate tax and the Ukraine aid.

It is also the first time that the European Council has agreed to implement the rule-of-law conditionality mechanism,

Prime Minister Viktor Orban and Commission President Ursula van der Leyen. / bne IntelliNews a vital new tool against rogue EU states such as Hungary.

The Commission waited until after the Hungarian elections in April 2022 to trigger the mechanism, which is aimed at ensuring that EU countries adhere to the bloc's general principles as well as safeguarding the EU's budget.

In September, the European Commission proposed freezing €7.5bn from the EU budget for 2021-2027 to Hungary, covering three Cohesion funds, as well as the €5.8bn RRF money, over concerns about the rule of law, despite Budapest's pledges to implement reforms.

Hungary had until November 19 to approve a set of laws but the EC's assessment deemed Hungary's efforts to tackle corruption and improve the rule of law as insufficient and set 27 essential milestones to meet.

Efforts by Budapest in recent months to tackle corruption and improve the rule of law with the aim of appeasing Brussels were not sufficient to unblock the money, the Commission declared in a statement on November 30.

The Commission in a recent report found that systemic irregularities, deficiencies and weaknesses in public procurement still exist, there are limitations to effective investigation and prosecution of alleged criminal activity. The government had set up an anti-corruption working group and the Integrity Authority, a state administrative body, autonomous of the government, but there is lack of a comprehensive anti-corruption strategy covering also the most relevant corruption prevention areas. Public interest trusts remain outside the scope of EU public procurement directives, the EC said.

To suspend the funds to Hungary, approval by a qualified majority of EU countries is needed, meaning at least 15 of the 27 EU states, which together must make up at least 65% of the total population of the EU. ●

Czech populist leader Andrej Babis found not guilty in EU subsidy fraud trial

Albin Sybera

Former Czech premier Andrej Babis was pronounced not guilty in his long awaited trial in Prague over the alleged €2mn Stork's Nest subsidy fraud. The verdict comes only a few days ahead of the first round of the presidential election, where the opposition leader is one of the favourites, and could give his campaign a fillip.

"INNOCENT" tweeted the billionaire populist leader from the court room as Judge Jan Sott read out the justification for his verdict. "I am very happy that we have independent justice and that the court confirmed what I have been saying and that I have done nothing illegal."

The judge said the prosecution had not proved intent to defraud. The state prosecutor has said he will consider whether to launch an appeal against the verdict once he has read it.

Babis has accused the country's legal and political establishment of mounting a witch hunt against him over the case, which dates back 15 years, from before he entered politics. The billionaire has fought to stop the case from coming to trial since 2017, which only happened after he lost the October 2021 election in which current Prime Minister Petr Fiala rode a wave of discontent over Babis' business links to victory.

Babis leads the most recent opinion poll for voting in the first round on Saturday with 27.9%, with his most likely challenger, General Peter Pavel, just behind at 26.7%. The two highest polling candidates will go through to a run-off on January 27, a contest that Pavel is favourite to win.

In the Stork's Nest case, Babis and his former manager Jana Nagyova – who was also cleared – were accused of trying to conceal the conference centre's ties to Babis' large food, chemical, and agricultural conglomerate Agrofert in order to claim an EU subsidy designed for small and medium-sized enterprises.

Anti-corruption NGOs such as Transparency International have been ringing alarm bells about the case since Babis entered politics at the national elections in 2013. The centre had originally been owned by Agrofert but was then transferred to a new company, owned by Babis' family members, with his estranged son testifying that he was never the owner and his signature was most likely forged. The judge accepted that this was probably the case but said this had no bearing on Babis' guilt or otherwise over the subsidy.

UK bank HSBC also provided a loan to this new unknown company because of its links to Agrofert, and Agrofert advertised heavily at the conference centre. In 2015 Babis was even caught on camera boasting that Stork's Nest was his idea and was one of his best projects. Babis refused to answer police or the court's questions over the case.

The case was embarrassing for the billionaire as his main pitch when he entered politics was as an anti-corruption tribune against the country's traditional parties. But once in office Babis and his party did little to fight corruption and have also been plagued by their own series of scandals.

Erdogan in campaign mode at the weekend. / Turkish Presidency.

Challenger to Erdogan to be named

bne IntelliNews

Turkey's six-party opposition alliance looks set to announce their presidential candidate for the country's elections in February. May 14 was confirmed as date of the polls.

"The name of the presidential candidate will probably be declared sometime in February," Unal Cevikoz, an adviser to the main opposition Republican People's Party (CHP) leader Kemal Kilicdaroglu, informed media on January 20.

Cevikoz added that leaders of the six opposition parties would on January 30 set out their proposals for a transitional period to a parliamentary system from the executive presidential system brought in by President Recep Tayyip Erdogan and their government programme.

Erdogan, who has served as Turkey's leader for 20 years, will stand for re-election as the head of his Islamist-oriented Justice and Development Party (AKP). The AKP is allied with the far-right Nationalist Movement Party (MHP). Together, the parties make up the Public Alliance.

The opposition alliance, named the Nation Alliance, is made up of Turkey's two main opposition parties, the secularist Republican People's Party (CHP) and the centre-right nationalist IYI Party, who are allied with four smaller parties.

Parliamentary elections will be held in parallel with the presidential contest.

The elections are the last chance for the opposition to forestall Turkey's descent from a country with independent institutions and centres of power into what would be a personalist regime revolving around its leader, Gonul Tol, director of the Middle East Institute's Turkish Studies programme and author of "Erdogan's War: A Strongman's Struggle at Home and in Syria," was on January 22 cited as saying by The Intercept.

Tol added: "Turkey has become a textbook 'competitive authoritarian' country. It is authoritarian in the sense that Erdogan jails his opponents and institutions have been hollowed out, but it's competitive enough that we can talk about meaningful elections.

"Obviously the playing field is not level, and the opposition are having a hard time, but there are elections and there are limits to how much they can be rigged, particularly in the big cities."

The academic also noted that "the biggest weakness of the opposition is where they stand on the Kurdish question. From a simple math point of view, if the opposition coalition manages to appeal to the Kurdish population, they will likely win the elections, whereas if they don't have that support, it will be very difficult, if not impossible."

Around 42% of Generation Z in Turkey would support the Nation Alliance and 22% the Public Alliance if elections were held in January, according to an ORC Research opinion poll reported by Turkish Minute on January 20. ●

Kick Turkey out of Nato? Members will start considering it, warns ex-commander

bne IntelliNews

No-one wants to have to choose between having Turkey in Nato or Finland and Sweden, but it is up to Turkish President Recep Tayyip Erdogan to ensure that that doesn't have to happen.

That's the view of ex-supreme allied commander of Nato James Stavridis, who, writing for Bloomberg on January 22, looks at how Turkey is taking the "counterproductive stance" of standing in the way of the Nordic nations joining the military alliance over what Ankara sees as their "support for terrorist groups among Turkey's Kurdish minority, in particular, their refusal to extradite dozens of Kurds wanted by the government".

Stavridis, asserting that "the great challenge to the alliance isn't terrorism: It is the unconscionable invasion of Ukraine by Russia", writes: "At some point soon, some NATO members are going to begin asking, 'If it is a choice between Sweden/Finland and Turkey, maybe we should look at our options.' That would be a mistake. Turkey boasts the second-largest army in NATO, has important facilities including Incirlik Air Base, and hosts NATO's overall land-warfare command in Izmir.

"NATO needs Turkey to continue being an active and positive member. It also needs to add Finland and Sweden. No one wants to have to choose between them."

The prospect of Turkey relenting and moving to ratify the Swedish and Finnish applications to join the defence bloc grew even more remote over the weekend when a far-right politician, Rasmus Paludan, gave an hour-long speech against Islam and immigration outside the Turkish embassy in Stockholm before setting fire to a copy of the Qur'an.

The previous day, Turkey's foreign ministry summoned Sweden's ambassador over the permission granted to Paludan's protest. It was the second time Sweden's ambassador to Ankara has been summoned this month. Previously, the envoy had to offer explanations when on January 12 a Kurdish group was able to hang an effigy of Erdogan, outside Stockholm city hall.

On January 21, ahead of Paludan's stunt, Ankara cancelled a January 27 visit by Sweden's defence minister, Pal Jonson, intended to be a discussion about Turkey's refusal to ratify Sweden's Nato accession. Turkey's defence minister, Hulusi Akar, said the meeting was cancelled because it "has lost its significance and meaning".

"The burning of the Holy Qur'an in Stockholm is a clear crime of hatred and humanity," Ibrahim Kalin, chief adviser to Erdogan, tweeted. "We vehemently condemn this. Allowing this action despite all our warnings is encouraging hate crimes and Islamophobia. The attack on sacred values is not freedom but modern barbarism."

Swedish Foreign Minister Tobias Billstrom said that Islamophobic provocations were appalling. "Sweden has a far-reaching freedom of expression, but it does not imply that the Swedish Government, or myself, support the opinions expressed," Billstrom said on Twitter.

Another factor that makes it unlikely that Erdogan will back down over his blocking of Finland and Sweden's accession into Nato is the Turkish national elections set for May 14. Erdogan's core vote will expect him to keep up a tough line in this foreign policy matter. ●

> "The burning of the Holy Qur'an in Stockholm is a clear crime of hatred and humanity"

James Stavridis. / US Dept of Defense.

EU ministers agree to grant Bosnia candidate status

bne IntelliNews

EU general affairs ministers agreed on December 13 to give Bosnia & Herzegovina accession candidate status.

The decision, which still had to be endorsed by EU leaders on December 15, comes amid increased emphasis on enlargement following Russia's invasion of Ukraine. It was a top priority for Slovenia that has been pushing to give Bosnia candidate status for months.

In October, the European Commission decided to recommend that the EU grant Bosnia candidate status despite its slow progress, in an attempt to strengthen Western influence and weaken the Russian influence in the politically divided Balkan state.

European Commission and member state officials confirmed the decision to back candidate status for Bosnia, the fifth of the six Western Balkans countries to become an accession candidate, on December 13.

"Good news: Council recommending candidate status for Bosnia and Herzegovina is a message to all citizens of BiH that their future is in the EU. Looking forward to the European Council's endorsement," Josep Borell, EU's High Representative on Foreign Affairs, wrote on Twitter.

"Steadfast progress on reforms is key to take this perspective forward," he added.

"Europe delivers! Today we reached another milestone in the [EU] Enlargement Policy. Council agreed to grant candidate status to Bosnia and Herzegovina," wrote Enlargement Commissioner Oliver Varhelyi on Twitter.

"EU path is open! We have high hope & expectations that 14 key priorities will be delivered for [Bosnian] citizens' benefit," he added.

The EU's special representative to Bosnia, Johann Sattler, noted that the decision was a message to Bosnian citizens who strongly support the EU membership and a clear message to politicians to quickly form state institutions and start implementing key reforms.

Bosnia was expected to be granted candidate status, despite concerns over the lack of reforms in recent years.

Given the calls for secession from the Serb-dominated entity Republika Srpska, and the ties between Republika Srpska President Milorad Dodik and Moscow, granting candidate status increases Bosnia's integration with the EU and helps to counter Russian influence in the country.

Future reform progress is still uncertain, however, given the slow formation of governments at state and entity level following the October elections.

Meanwhile, Milorad Dodik, the secessionist pro-Russian leader of Bosnia's Republika Srpska refrained from comments on the EU's decision.

On the other hand, Bisera Turkovic, state-level foreign affairs minister, said

"Good news: Council recommending candidate status for Bosnia and Herzegovina is a message to all citizens of BiH that their future is in the EU"

this was a historic moment.

"The European path is a union of all citizens in the hope for better future. The candidate status comes as incentive and recognition," Turkovic wrote on Twitter.

"Despite all problems we are finishing this mandate with a huge, historic step towards the EU membership," she added.

There was no official statement from the government.

However, a survey carried out by Bosnia's Directorate for EU integration, showed that just 34.7% of Bosnians believe their country will become member of the EU within ten years versus 40.6% a year ago.

When it comes to the country's two entities, the majority of those in the Muslim-Croat Federation believes that EU membership would strengthen relations within the country, while the majority of the Serbs living in Republika Srpska believes that the EU will not survive.

Ahead of December 13, many Bosnians, even those who are most keen joining the bloc, were sceptical, expecting that the country would get another delay.

Bosnia formally applied for EU membership in February 2016, but it took three years for its politicians to complete and approve the questionnaire sent by Brussels. Meanwhile, reforms in the deeply divided country have been stalled for years.

The authorities in Kosovo have said they plan to formally apply for EU membership this week, even though five EU member states do not recognise Kosovo as an independent state.

Earlier this year, both Moldova and Ukraine were given candidate status, while Albania and North Macedonia were given the green light to start accession negotiations. ●

Turkish doctors' chief convicted of terrorist propaganda amid claims army hit Kurds with chemical weapons

bne IntelliNews

Sebnem Korur Fincanci, a forensic specialist who is head of Turkey's medical association, was on January 11 convicted of spreading terrorist propaganda over her call for an independent investigation into the alleged used of chemical weapons against Kurdish militants by the Turkish army.

Fincanci was sentenced to nearly three years in jail. However, under Turkish law, she was already eligible for release as people are rarely imprisoned in Turkey for sentences of under three years. It was expected that Financi would be freed imminently, more than two months after her arrest.

Rights groups have protested that her detention amounted to a bid by the authorities to silence her and other activists.

Fincanci, also a well-known human rights activist, was arrested after calling for a probe into claims that the Turkish military deployed banned chemical weapons against Kurdish militants in northern Iraq. Her comments on the matter were published by pro-Kurdish media.

The BBC's Zeynep Erdim was in court to hear Fincanci in a brief address state that her trial was politically motivated and was targeting democratic values and freedom of expression. Supporters of Fincanci chanted "this is only the beginning, we will carry on fighting" and "the Turkish Medical Association [TTB] will not be silenced", Erdim reported.

Emma Sinclair, head of Human Rights Watch (HRW) in Turkey, welcomed the fact that Fincanci was to be freed but said that her case "sends a strong message to everyone to be silent". Sinclair also said that she was anxious as regards other board members of the TTB. They could, she noted, face similar action to that experienced by Fincanci if portrayed as members of a terrorist organisation.

The TTB said in a tweet, apparently referencing upcoming national elections to be held by June, that Fincanci's return to the organisation meant she "will play our role at the turning point in front of our country".

It added: "We will ensure that neither the TTB nor our country surrenders to the darkness!"

Last October, the Kurdistan Workers' Party (PKK), outlawed in Turkey as an insurgent terrorist organisation, released video footage that it said showed Turkish troops releasing a substance into a cave as well as its effects on a male fighter and a female fighter. The group also gave the details of 17 of its members whom, it said, had lost their lives recently to chemical weapons.

The Turkish government has strongly denied using chemical weapons against the PKK.

Bulgaria to hold new snap general election after parties fail to form government

Denitsa Koseva in Sofia

Bulgaria will hold a snap general election at the end of March as none of the parties in the current parliament, formed after the October general election, managed to put together a new ruling coalition.

The third and final mandate to form a government, given by President Rumen Radev to the Bulgarian Socialist Party (BSP), failed on January 20.

The most likely date for the next vote – the fifth in two years – is March 26 or April 2.

In a final step before calling the vote, Radev summoned the leaders of all parliamentary parties to a meeting on January 20 to discuss whether a majority could be formed.

Along with the BSP, only three other parties accepted the invitation – Gerb, the Movement for Rights and Freedoms (DPS) and Bulgarian Ascend.

Four-party coalition planned
Although the four parties decided not to form a coalition in this parliament, they agreed that they could form a ruling coalition in the next parliament.

Despite their very different political orientation, the four parties were widely expected to join forces at some point after they worked together to back a return to paper ballots – a move seen as creating space for electoral fraud. They were even dubbed “the paper coalition” for that reason.

If the four parties do form a ruling coalition, however, they would form a programme government with specific tasks.

The mooted coalition drew criticism from the reformist parties in the current parliament, Change Continues and Democratic Bulgaria.

“Why are we going to have the next election as today Gerb, the BSP and the DPS have pledged to work together and form a government? Why they don’t they do it now?" Nikolai Denkov of Change Continues commented.

Assen Vassilev, co-leader of Change Continues, said that if Gerb, the DPS, the BSP and Bulgarian Ascend join forces in the future, this would take the country back to the past.

Democratic Bulgaria’s co-leader Hristo Ivanov also said the four parties would drag the country back.

For her part, BSP leader Kornelia Ninova criticised Change Continues and Democratic Bulgaria for refusing to attend the meeting with Radev. She accused them of being responsible for the failure of the third mandate.

Reformist coalition planned
Meanwhile, Change Continues and Democratic Bulgaria are discussing running together in the next general election. That coalition could also include Save Sofia and other reformist formations that are not currently represented in parliament.

A similar coalition was proposed by Ivanov ahead of the October 2 vote, but at the time Change Continues decided that it should run on its own and join forces with Democratic Bulgaria after the election.

The two formations have many similar priorities, but Democratic Bulgaria is positioning itself as a right-wing formation, while Change Continues says it want to achieve “right measures with left goals”, focusing more on social spending and reforms.

Following the failure of the last mandate, Radev said he would keep the caretaker government led by Prime Minister Gulub Donev in place, and accused the political parties in parliament of lacking the will to take responsibility for the crisis in the country.

Kosovo's leaders to submit application for EU membership

bne IntelliNews

Kosovo's leaders have signed an application for EU membership on December 14, a move opposed by neighboring Serbia, of which Kosovo officially was part until 2008.

The application was expected to be filed on December 15 to the Czech EU Presidency, just days EU general affairs ministers decided to approve candidate status for Bosnia & Herzegovina. However, five EU member states do not recognise Kosovo as independent.

The document was signed by Kosovo's President Vjosa Osmani, Prime Minister Albin Kurti and speaker of the parliament Glauk Konjufca.

According to Osmani, this is an historic day for Kosovo.

"December 14 has a double importance in the modern history of our Kosovo. On the one hand, we are applying for EU membership, and on the other hand, we are celebrating the anniversary of the founding of our army. Both acts are directed towards the realisation of our Euro-Atlantic vision," Osmani said.

Kosovo is not a member of the UN or Nato.

Kosovo, predominantly inhabited by Kosovan Albanians, declared independence from Serbia in 2008 following a bloody conflict in 1998-99, but Serbian officials clearly stated they don't intend to recognise it as a separate state. In line with this policy, Serbia is opposing Kosovo's bids to join international organizations.

The application comes at a time of high tensions between Belgrade and Pristina ahead of extraordinary elections initially scheduled for December 18 to fill vacant posts after Serbs in northern Kosovo decided to abandon the state institutions in protest against the authorities' insistence on continuing with re-registration of cars with Serbian number plates. ●

"December 14 has a double importance in the modern history of our Kosovo. On the one hand, we are applying for EU membership, and on the other hand, we are celebrating the anniversary of the founding of our army"

President Vjosa Osmani says signing of application makes December 14 a "historic day" for Kosovo.

Europe just released a report saying it had been "largely spared" pain from the sanctions but Russia's economy is also doing surprisingly well. / bne IntelliNews

Ukraine fatigue builds, but Western support for Kyiv unlikely to falter soon

Ben Aris in Berlin

In December the EU commissioned a secret report to assess just how badly the war in Ukraine, and the polycrisis it is fuelling, is hurting Europe's economy. Good news: the conclusion was that the bounce-back effect of sanctions imposed on Russia has "largely spared" Europe's own economy. In all, the EU member states have spent a total of €525bn on relief and subsidies, and given the size of the EU economy (€16.6 trillion) that is a relatively modest amount – 3.1% or less than many countries spent on stimulus during the coronacrisis.

However, the same is true of Russia. Sanctions have not badly hurt its economy either. In the first month of the war Russia's economy was widely expected to contract by at least 15% and things like its oil production and banking sector were supposed to collapse. Not only did that not happen, but Russia is actually making more money than it has ever made before. This year the current account surplus is predicted to be $270bn by the end of the year – more than twice as much as the $120bn it had in 2021, and that was already an all-time record.

Calculating the cash cost to Russia is very difficult. The budget has earmarked a total of $75bn (RUB4.7 trillion) for military spending this year, which is planned to double to $84bn next year. However, you could include the spending on the police, which is set to be almost as much as on the military and is presumably to prevent anti-war demonstrations or make sure they are easily crushed if they happen. All-in-all as part of the new three-year budget passed in December, Russia intends to spend a total of $600bn on defence and security out to 2025.

Another way to look at the cost is the cost of the 3% contraction this year. Russia's economy was worth $1.8 trillion in 2021, so a 3% contraction is only worth about $53bn. That is a lot less than the $267bn that a 15% contraction would have been worth.

In relative terms the sanctions war is costing Europe about 3% of GDP so far (just counting subsidies), whereas adding Russia's contraction and budget spending and the cost is of the order of 7% of GDP, although it still remains well within Russia's means to finance it just from the windfall $150bn extra it has earned this year from commodity exports. If you add in the spending on the police the total rises to around $200bn, but Russia can easily afford that too, as it has another approximately $180bn in the National Welfare Fund. Russia still has plenty of money.

Of course, both the EU and Russia have suffered considerable economic pain. In Russia the automotive sector has almost completely collapsed. At its low in March Russia turned out a mere 3,000 cars, as opposed the 100,000-plus a month it usually makes. Since then output has recovered somewhat but overall production remains down by about 60%. Many sectors have been deeply wounded and will not fully recover in the foreseeable future.

And long term, Russia's growth potential has been cut from an already flaccid 2% to a mere 1% – far behind the global growth rates on the order of 4%. Russia is doomed to stagnate over the coming decades and steadily fall behind the rest of the world.

The EU has not gotten off scot-free either. The disappearance of Russian gas has been especially painful. As *bne IntelliNews* reported, Europe's heavy industry has been shutting down as things like the fertiliser, chemical and other industrial subsectors that rely on gas as an input or a fuel have been forced to close because they can't afford to buy gas, can't get enough, or have simply become economically unviable with gas prices more than ten times their usual level.

Both Russia and the EU have to some extent de-industrialised as a result of the sanctions war.

In this context to ask "who's winning" is to oversimplify the problem. Europe can replace Russia's gas with LNG and import the chemicals it can no longer make. Russia also can offset the pain of sanctions with the higher prices of the commodities it produces, as economists say that higher prices are here to stay as a result of the unprecedented attempt to inflict sanctions on one of the world's biggest producers of nearly every commodity under the sun. Nevertheless, much of the damage done to both sides is directly comparable, even if the sectors worst affected are different.

Sanctions weakness

One of the issues underpinning the EU's relative good performance is that it has pulled its punches at nearly every stage of implementing the nine packages of sanctions so far.

The first "massive package" of sanctions imposed in the first week of the war have probably done the most damage and will continue for the foreseeable future. Even if Russian President Vladimir Putin were to die tomorrow and the war ends, it is unlikely that any of the biggest sanctions would be withdrawn for decades, as was the case with the Soviet-era Jackson-Vanik sanctions.

The first sanctions to target energy were the fifth package of sanctions in April that included coal and limits on providing shipping services to Russia. But as this disproportionately hurt the Greek economy, its shipping lobby successfully won exemptions, so a month after the shipping bans went into effect on August 10 Russia was exporting more coal than ever before and at prices that are 165% higher than last year.

As *bne IntelliNews* detailed in a recent blog, as the sanctions regime progresses they are becoming increasingly more symbolic as Europe is being as careful to not hurt itself as it is enthusiastic to punish Russia. Moreover, as the boomerang effects of sanctions become more pronounced the remarkable unity shown by the EU in March is already visibly cracking. In this context it is no surprise that Europe's economy has been "largely spared" a lot of damage from the sanctions as they were specifically designed with that goal in mind. And they had to be, as the support for sanctions runs the whole gamut from Poland, which see Russia as an implacable foe, to Hungary, which is energy dependent, and its leader Prime Minister Viktor Orban admires Putin's strength.

Given the EU's prerequisite for a unanimous approval amongst all 28 member states, each package is subject to a laborious process of negotiation and compromise that inevitably waters down their impact at each stage.

Even with the oil price cap scheme imposed on December 5 – potentially the most damaging sanction to date – set the cap at a level that makes no difference to the Russian budget at all: the cap was set at $60 per barrel of oil, whereas Russia currently sells its Urals blend at $55 or less. The stated aim of the sanction is to cut the Kremlin off from its oil revenues but $60 allows the Kremlin earn just as much as before.

Effect on Europe

The main channel transmitting the effect of sanctions on Russia to Europe and the rest of the world has been through the polycrisis that has induced soaring inflation, fuelled by rising food, commodity and energy prices that have done significant damage that can't be avoided.

As *bne IntelliNews* has written elsewhere, inflation, and food price inflation particularly, is infectious. The US has suffered far less damage than Europe, as it is largely self-sufficient in most of the commodities Russia sells. Yet because of the way the food commodities market works, sky-high prices for grain in Cairo will immediately push the cost of wheat in Kentucky up to the same level, even if the US imports no grain at all. (It's because the farmer in Kentucky could

"The first sanctions to target energy were the fifth package of sanctions in April that included coal and limits on providing shipping services to Russia"

Idled steel plants in EU, as of 06.09.2022

GMK CENTER

export at the higher prices if he wanted to that prices rise.)
The energy crisis and cost-of-living crisis has also been especially damaging in the West, with the UK suffering the most. Thousands of small and medium-sized enterprises (SMEs) are being put out of business by unaffordable power bills and it is here that the EU member states have been spending their money to alleviate the pain.

More specifically, the EU report on the sanctions impact found the restrictive measures have caused supply issues in sectors like wood and precious metals, but wider disruptions have mostly been because of the macroeconomic problems already described and Moscow's own retaliatory steps like cutting off gas supplies to Europe over the summer.

For example, steel producers from Spain to Germany are beginning to slow down or entirely stop their output as the high energy costs make production unsustainable, even with steel prices up to near record levels. Construction steel is typically made in power-intensive electric furnaces that have been hit hard by the record power prices in Europe. So far, more than 3mn tonnes of annual capacity are already being affected by sharply rising costs, reports Steel News. At the start of September India's ArcelorMittal, one of the largest steelmakers in the world, said it was planning to close two of its plants in Germany amid soaring electricity costs.

European fertiliser producers are also shutting down across Europe, unable to get the gas that is one of their main feedstocks for production.

The German chemicals powerhouse BASF, Germany's biggest user of gas, has already temporarily shuttered 80 plants worldwide and is slowing production at another 100 as it plans further output cuts depending on what happens to gas prices. Rival ammonia makers Yara and CF Industries said last month they were also slashing ammonia production in Europe due to soaring gas prices.

And Warsaw-listed Polish chemicals powerhouse Azoty and its listed unit Pulawy have suspended or reduced production of some products, including nitrogen fertilisers and ammonia, due to skyrocketing prices of gas, the companies said on August 23.

In Romania, the operations of fertiliser producer Azomures have been disrupted since December 2021 by high gas prices. Azomures produces 50% of the fertilisers used by Romanian farmers and is the largest natural gas consumer in the country, accounting for 10% of total consumption.

The list goes on.

As of the end of November the EU has approved more than 150 national measures to mitigate the shock of Russia's invasion against Ukraine as part of a temporary crisis framework that allows flexibility within state aid rules, which will add up to €525.5bn, according to the assessment.

At this stage it is impossible to say if German petrochemical, plastic and fertiliser plants that have been forced to shut down due to the sanctions war will ever be able to restart, but according to the EU assessment Europe can live without them if it has to.

Effect on Russia

Russia's macroeconomic position is good, with most of the headline numbers registering surprisingly mild contractions given the severity of the sanctions. However, the effect of high commodity prices masks the pain most of the country is feeling; oil, gas, metal and grain revenues are all earned at the federal level, whereas the regional economies are dependent on income and local company corporate taxes, and so local economies are much more exposed to economic problems than things like Russia's current account surplus suggest.

A drilldown into Russia's industrial production by region by political analysts Andras Toth-Czifra highlights the impact on various Russian regions.

November was the seventh consecutive month of industrial production contractions as output went down for mining (-2.7% vs -1.8% in September); electricity, steam, and air conditioning (-2.4% vs -1.5%); manufacturing (-2.4% vs -4%) and water supply, wastewater disposal, and the collection and organisation of waste (-7.4% vs -7.5%).

Most of Russia's internal regions are specialist producers based on their natural resources and have been differently affected depending on the product. For example, Toth-Czifra says there are continued problems in the timber producing regions of the Northwest, as well as regions which are heavily exposed to carmaking, such as Kaluga, Tartarstan and Tolyatti, after the automotive industry collapsed. Entire cities are dependent on carmaking, so the collapse of the sector is causing local crises that can't be easily solved.

Machine building, coal mining, metallurgy and more recently gas producing regions, all of which are either facing export bans or logistic bottlenecks thanks to the railways clogging up, are all feeling pain.

These problems are manifest in the region tax revenue collection, which was holding up well in the first half of this year but began to tumble in the third quarter, says Toth-Czifra. While the regional budgets are currently on track to end the year on plan, it is already clear that the centre will have to start paying subsidies or offering credits to a lot more regions in 2023 as their financial situation worsens. At the end of July only nine of Russia's 82 regions had collected less than half their due taxes. But November 17 regions had fallen behind the budget plan for tax collection.

"Siberia and the Far East are still doing relatively OK, with some notable exceptions. But due to a lack of infrastructure and very concentrated investments into a handful of big projects, there's a limit to how much these regions can heat up as others cool down," says Toth-Czifra.

The picture Toth-Czifra's deep dive paints is that Russia is not in trouble yet, but is clearly already feeling some pain and the situation is deteriorating, but not crashing.

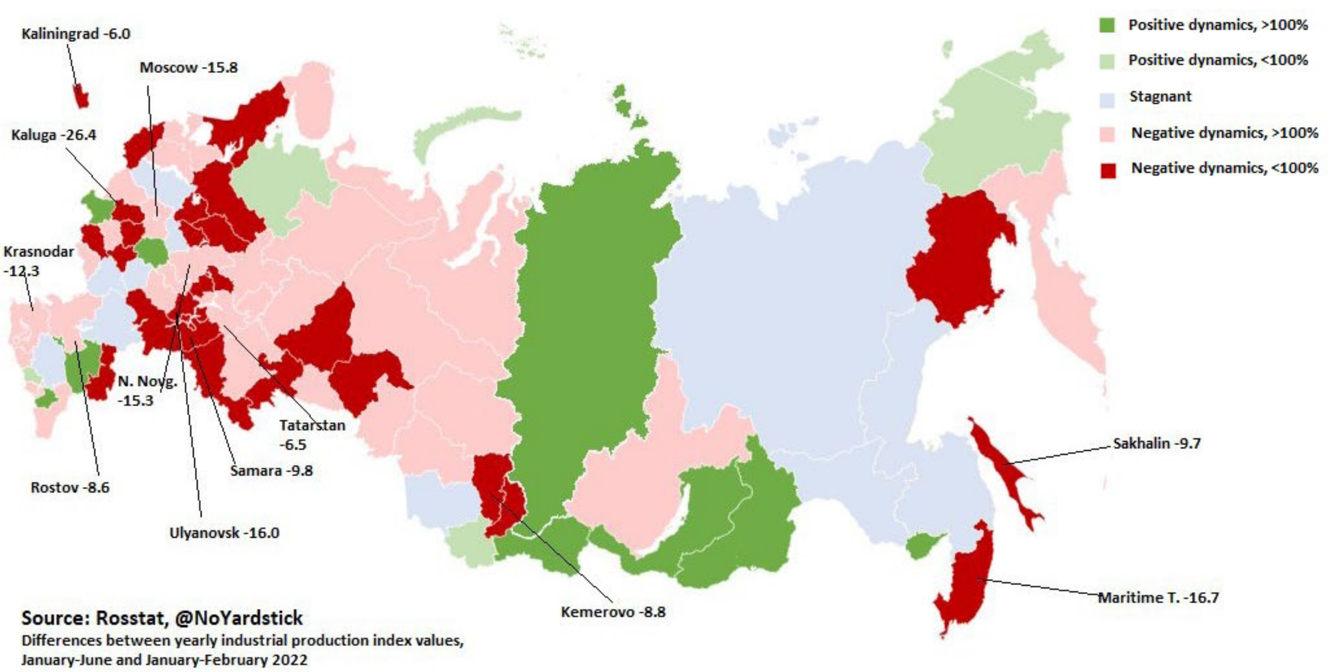
"Even if the situation still worsens before the end of the year, the federal budget will likely simply increase transfers for now. But these problems will continue and receipts – including personal income tax, which has been fairly stable so far – will drop further in 1H2023," Toth-Czifra said in a post on social media.

In the long term Europe has already won. Russia has been through five big crises in the last three decades and it has bounced back from each stronger and richer. However, it cannot recover from this crisis like it has done from the others.

Since 1991 Russia has been a market economy and outward looking, trading actively with the whole of the rest of the world. The difference with this crisis is that is no longer true. It has turned inward and the sanctions seek to restrict its trade.

Russian oil exports are a perfect example. Until February, Russia was selling oil at market rates and had finally joined the OPEC+ cartel to be better able to manipulate international prices. Since February Russia has been happy to offer discounts as deep as 35% on the market price, simply to keep the revenues coming in. The Kremlin is now more focused on earning enough cash to pay for the war and economic support at home than it is on profitability. And this mentality will have to remain in place until sanctions are lifted and it is returned to the

Industrial production dynamics, February to June 2022



http://forest.by

How companies in Central Asia help Belarus bypass Western sanctions

bne IntelliNews

In the EU's 2022 March sanctions package against Belarus, sanctions were expanded to cover all wood working products (i.e. everything under customs code 44). Moreover, the Forest Stewardship Council (FSC) chose to suspend its trading certificates for Belarus, which made it even harder for Belarus to sell its products on the global market.

The including of products under customs code 44 in the EU sanctions has resulted in a drop of more than 30 times for the export of Belarusian wood products to the EU since June 2022.

Woodwork products are an important extra income for the Belarusian state budget and have previously been especially expanded during times when major income sources such as revenues from refined oil products falter. This year, Western sanctions have deprived Belarus of some major export revenues meant for its state budget such as those derived from fertiliser and oil product exports.

However, Minsk was not about to roll over and accept that its woodwork products had been shut out from the EU market. On September 5, 2022, Belarus' Deputy Prime Minister Piotr Parkhomchik told state Belarusian media that "there will be private companies that will build bridges so that the products (woodwork products) we produce could enter the European market." A few days later, the chairman of Belarus' State Customs Committee, Vladimir Orlovsky, said that Belarus' "old tricks" weren't working anymore. Instead, Belarus would have to resort to "unconventional approaches" to get around Western sanctions.

"There will be private companies that will build bridges so that the (woodwork products) we produce could enter the European market"

In a recent investigation, Belarus' Investigative Centre (BIC) has revealed how private companies in Central Asia, often set up by former Belarusian government officials, help customers to circumvent the EU sanctions.

Minsk's new tricks

In late June 2022, Belarus classified its trade statistics not only with Western countries but also with the CIS countries; a convenient timing, as EU wood imports from Kazakhstan and Kyrgyzstan began rising rapidly immediately after the EU sanctions came into effect in June. By October 2022, the EU's wood imports from Kazakhstan and Kyrgyzstan had risen by 74 and 18,000 times year on year respectively. In total, this amounts to €30mn in export revenues for the two Central Asian countries.

There's certainly something fishy about this increase, since Kazakhstan and Kyrgyzstan only have 5% and 6% respective coverage in woodland area; Belarus' forest cover, on the other hand, is 40%, according to Belarus' Ministry of Forestry. In June and August last year, Kazakhstan's government and Kyrgyz authorities also prohibited the export of certain wood products in order to protect their domestic wood industries.

Wary of Minsk's new tricks, Lithuanian customs were the first to notice this sharp increase in wood imports from Central Asia. According to the deputy director of Lithuanian customs, Vygantas Paigozinas, "The tell-tale signs are absolutely undeniable. We find markings on packaging, extra sets of documents that directly show that the goods come from Russia or Belarus and not from the countries in which the declaration was made at the initial stage. There are such cases, we recorded it, and not just one."

Supplying sanctioned products

The BIC found several companies that are engaged in the export of Belarusian wood products to the EU through Kyrgyzstan and Kazakhstan. The products are traded under forged certificates and their document claim that they originate in one of the Central Asian countries.

The BIC received a tip that the private Belarusian expert reviews centre "Quality Standard" was offering services for the re-export of EU goods to Belarus through Kyrgyzstan. Acting as a potential client, BIC journalists talked to the company's manager and found out that it was also possible to get Belarusian wood products to the EU through Kyrgyzstan. Quality Standard offered the help of another company called "Certificate KG", which helps Belarusian wood suppliers obtain Kyrgyz documents to re-label their products so they can pass EU Customs.

One of the founders of Certificate KG was Oleg Narchuk, who previously worked for Belarus' State Standardisation Committee (Gosstandart). In October 2022, Narchuk spoke at a webinar organised by Belarus' National Centre for Marketing and Price Studies about the "Imports of goods into the Republic of Belarus under sanctions."

Other companies also engaged in delivering Belarusian products to the EU using forged documents were Agro KG, SK Grand and Admit company. The latter is engaged in wood waste processing, producing pellets, briquettes and various other wood-based fuels. On its website, (registered in July) it claims to receive 40, 000 tonnes of wood waste "yearly".

Pretending to be potential customers, the BIC asked to have Belarusian pellets delivered to the EU. Admit agreed to this and said it would be done with the help of their production facility in Kyrgyzstan; they would send the Belarusian products along with their own products produced in Kyrgyzstan, that way the products would enter the EU on Kyrgyz certificates.

Russia reports its first "kraken" coronavirus case

bne IntelliNews

Russia recorded its first official case of the so-called Kraken subvariant of the Omicron variant of COVID-19, the Rospotrebnadzor state monitoring agency reported on January 12.

The highly contagious subvariant was reported in the Penza region, 625 km southeast of Moscow.

The World Health Organization (WHO) has declared the Kraken variant "the most transmissible known COVID-19 variant" on January 4. It was first detected in the United States in October and has since spread to several European countries.

Now it has reached Russia, according to the press service of Rospotrebnadzor. However, despite being highly infectious, the effects of the virus are mild, according to WHO experts.

Currently there are a wide range of Omicron varieties established in Russia, which reported 4,201 new cases of coronavirus infection in the last week and 48 patients fatalities. The dominant variant in Russia is the BA.5 variant, nicknamed "kraken", RFE/RL reports.

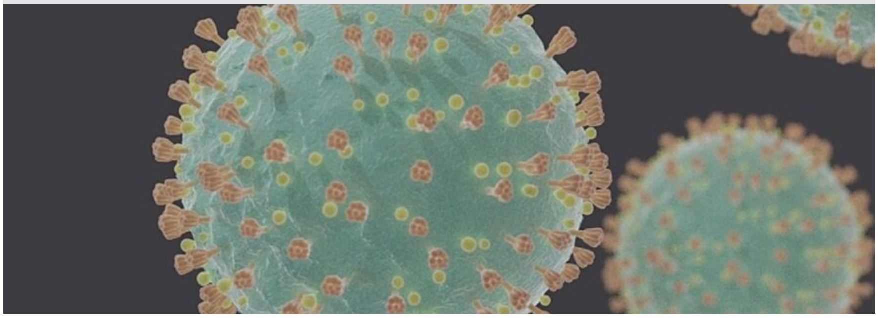
Last autumn a number of isolated cases of infection with the Delta strain were also detected in Russia, which dominated in the second half of 2021 and caused the death of several hundred thousand people. Rospotrebnadzor has not identified other strains in recent months.

In total, about 22mn cases of COVID-19 infection were registered in Russia (including the annexed Crimea) during the pandemic. The total number of fatalities in Russia to date according to official figures is 394,214.

Kraken usually progresses as an acute respiratory viral infection, Kamil Khafizov, who heads a group working on genomic research at the sanitary watchdog's Central Scientific Research Institute of Epidemiology, told TASS on January 13.

"The disease caused by this virus is mild, usually progressing as an acute respiratory viral infection; at least such data is available from abroad where XBB.1.5 has spread widely, though the disease may progress not that mildly with people from vulnerable categories of population," he said.

Following the first incidence of kraken in Russia, the authorities have no plans to impose restrictions, the watchdog said.



In Poland, the Polish registered import company "Belarusian Forest Company" (BLK) had by September 2022 transferred $17mn to its parent company, the Mostovdrev Belarusian state woodwork enterprise.

When reached for a comment, Mostovdrev told BIC that BLK did not receive the money for selling products subject to EU sanctions. However, information on the BLK's website shows that it only trades in products under the prohibited customs code 44. When contacted by BIC journalists posing as potential buyers, the BLK seller said that while it did still have Belarusian wood in stock, it was going to run out of it soon. However, the BLK had apparently instead begun working with new suppliers from Ukraine and Kazakhstan.

These recent findings by BIC details how Belarusian suppliers use third countries to access the EU market and this circumventing sanctions. While several Western experts, custom's offices and government officials have warned that Belarus and Russia circumvent sanctions through third countries, Belarusian officials have also themselves already hinted that they actively seek to do this. These findings puts the comments by Parkhomchik and Orlovsky in a new light and adds to the currently ongoing discussion in EU circles about the creation of an EU agency like the US' OFAC.

Bne IntelliNews has previously covered other investigations by BIC. The latest one detailed the high life of Lukashenko's son Dimitry and his wife Anna Lukashenko. ●

The McDonald's question in Belarus

bne IntelliNews

On November 11, it became known that the company KSB Victory Restaurants that managed the 25 McDonald's restaurants in Belarus had signed a franchise agreement with the successor to McDonald's in Russia, "Vkusno I tochka", to replace McDonald's in Belarus. This sparked outrage among Belarusians on social media channels. The lines were long at McDonald's restaurants during its last opening days both inside and in the drive-throughs, as many Belarusians wanted to get a taste of the McDonald's burgers before they're replaced.

On November 18, Belarusian President Alexander Lukashenko commented on the matter during a speech to farmers from state agri-companies, saying: "Good riddance" and "we know how to cut a bun in half." However, he also believed that McDonald's should be replaced by a Belarusian company.

As of yet, Vkusno i tochka has not entered the Belarusian market. The company's owner, Alexander Govor, recently told Interfax that the replacement of McDonald's by Vkusno i tochka had in fact not yet been discussed.

Lashing out against foreign companies leaving Belarus, Lukashenko once again reiterated his statement from mid-November on December 12: that a foreign company is nationalised from the moment it leaves Belarus. According to him, whatever is left after McDonald's is now "our enterprise".

Lukashenko said this in connection to the question of Ukrainian, Polish, Swedish (specifically IKEA) and Finnish investors leaving the country. This makes one wonder if the Belarusian state actually has the capacity to successfully (if at all) run all the businesses that are left by foreign investors.

Today, the old McDonald's restaurants remain, but they are run without a brand and the text outside of the restaurants simply reads "We are open!" The restaurants also have a new menu which has not been well received by Belarusians.

When independent Belarusian media outlet Zerkalo took a closer look at who owned the restaurants, it turned out that they're still owned and run by KSB Victory Restaurants. The company is owned by "KSB victory restaurants pte. Ltd.," which is based in Singapore and has two shareholders: Rapid food holding pte. Ltd and Sengermen pte. Ltd.

Rapid food holding pte. Ltd. is owned by Kazakh businessman Kairat Boranbayev, who was detained by Kazakhstan's Financial Monitoring Agency in March this year on embezzlement charges. Sengermen pte. Ltd. is owned by Belarusian businesswoman Victoria Danko, who is also listed as the director of KSB Victory Restaurants. Danko has worked in the McDonald's franchise since 1996; she has not commented on the recent developments on the fast food market in Belarus.

Perhaps it will take some time for KSB to rebrand its restaurants but being wary of the Belarusian economy's immense dependence on Russia, Lukashenko will likely continue to favour Belarusian companies before Russian ones. This indicates that Belarusian businessmen and women will probably take on and play a larger role in filling out the market void left by Western companies leaving the country. ●

A former Mcdonald's restaurant in Minsk, which today simply reads "We are open!" / Realt.by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After three decades of transition Central Asia has finally reached the point where its economies are strong enough for a middle class to emerge. That will transform these countries again and as this mass market opens up it is already creating new opportunities for business and investment. / bne IntelliNews

A middle class emerges in Central Asia

Ben Aris in Berlin

Central Asia is bouncing back from the coronavirus (COVID-19) pandemic and after three decades of growth, incomes have risen to a point where a middle class is emerging in the steppe. And nothing says middle class more than a hoover.

"Incomes are going up and one of the first thing people will spend their money on is the appliances that help to make household chores a little easier. That means buying a hoover," Bektemir Murodov, the CFO of Artel, Central Asia's biggest maker of white goods, told *bne IntelliNews* in an exclusive interview.

Central Asia is coming of age and Uzbekistan, as by far the most populous country in the region, is going through a dramatic transformation since President Shavkat Mirziyoyev opened the country up to the rest of the world in 2016. It has been putting in 6% growth a year and it is rapidly embracing its role as the natural production centre for the region; Uzbekistan is by far the largest of the five 'Stans, by virtue of its young and fast-growing population, and is the only one of the five countries in the region to have borders with all the others.

Consumer electronic sales are mushrooming in the large domestic market of 38mn consumers, the third-largest consumer market in the CIS, which provides a solid base for the growing manufacturing base. With an average age of only 29 years, Uzbekistan's population is due to double to 70mn by 2050, according to the UN. Leading companies like Artel and the national car maker UzAvto have also started to export to their neighbours, with Kazakhstan as the richest country in the region, thanks to its oil, being the most popular destination.

The low cost of labour and good transport connections to the rest of the Former Soviet Union (FSU) have made manufacturing in Uzbekistan a profitable business.

Rising income

In the first half of this year Central Asia became the world's leader in wage growth, according to the International Labour Organisation, while almost all of the other countries in the FSU are seeing incomes decline, led by Ukraine. According to its Global Wage Survey, average earnings in the region rose by 2.5% in six months, showing the most positive dynamics. For comparison, in 2021 it was 12.4%.

The increase comes at a time when for the first time in 20 years, global wage growth has not been able to outpace inflation and has fallen by an average of 0.9%, and excluding China, was down by 1.4%.

The maximum decline among the regions of the world is in Eastern Europe (3.3%), where Ukraine saw the biggest fall and could lose some 15% of its jobs, according to the ILO. By contrast, the biggest gains were recorded in the countries of Central Asia (up 2.5%) and the Asia-Pacific region (1.3%).

What is creating the middle class, and the shopping habits that comes with it, has been rising incomes. Nominal wages have been climbing consistently since 2000 and the trend continued after President Mirziyoyev took over from Islam Karimov, Uzbekistan's first and only president, after he died in 2016.

Looking at incomes in dollar terms and the story is a bit more complicated, as Karimov, shocked at the ballooning current account deficit as consumers rushed to buy imported products in the late 1990s, introduced a harsh exchange rate regime to keep most of the hard currency in the state's coffers, and killed off international investors' interest in the process. However, Karimov did manage to diversify the economy during the boom years of the noughties, which led to genuine quality of life gains in both nominal and dollar terms.

A "feel good" factor arrived in decade-long boom after the US sub-prime crisis. Both nominal and dollar-term incomes were rising by 20-50% a year, with real incomes climbing too as the Central Bank of Uzbekistan managed to hold inflation to between 3%-8% for two decades.

The pace of growth of nominal wage growth slowed in the next "teenies" decade to 15-20% a year but remained well ahead of the official inflation rate.

Everything changed after Mirziyoyev took over and began to remove the tight controls on the economy. Inflation soared in about 2017 as price controls came off, and then in August 2017 the currency controls were removed. Inflation jumped to around 20% and income in dollar terms halved, although continued to rise in nominal terms.

In 2000 the soum was trading at UZS24 to the dollar but sank a 100-fold over the next two decades to UZS2,000 at the end of Karimov's life.

The soum slumped in value again from UZS4,153 to the dollar at the start of August 2017 to UZS8,105 a week later after exchange rate was freed.

Since then, the soum exchange rate has become more stable but continues to depreciate slowly. It is currently hovering at UZS11,198 to the dollar as of November 21.

All in all, between 2000 and 2022 the soum has experienced a 146-fold devaluation.

The currency dynamics have had a big impact on real wages in dollar terms. At the start of the new millennium annual incomes in Uzbekistan looked relatively high, rising to around $3,600 in 2002, but this was deceptive, as without a freely traded currency the local currency was kept artificially strong. The dollar-equivalent wages shown in the chart for the noughties should be taken with a pinch of salt as a result.

It wasn't until the teenies decade following the US sub-prime crisis that real incomes started to significantly get better, and Uzbeks remain grateful to Karimov for the real material improvement he brought.

Under Mirziyoyev nominal annual incomes have continued to accelerate to top UZS400mn a year – double the level they were when he took office – which has been fuelling the "feel-good" factor.

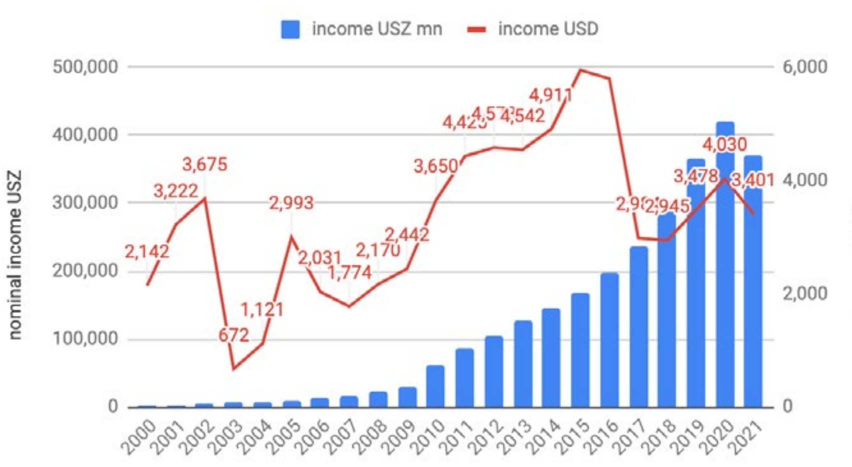
Real incomes have also risen, as in parallel to freeing the currency the CBU has also launched a successful campaign to anchor inflation and bring rates down, further improving the spending power of the average household.

Inflation has risen from a low of 9.7% in March to 12.2% in October, fed by the global food and energy crises, but it is expected to fall back to 11% next year, according to the Asian Development Bank.

Taken together, the rising nominal incomes and falling inflation have resulted in big gains in spending power for the average household in the last few years. When Mirziyoyev stood for re-election in 2021, he won by a landslide.

While Uzbekistan has come in for some criticism because the elections were not free and fair by international standards, with vox-popping voters on election in Tashkent, this correspondent could not find a single person who voted against Mirziyoyev: he is genuinely popular with the electorate. When asked why, all the voters had the same answer: their lives had materially and visibly improved since he came to power.

Uzbek nominal and dollar annual income



Source: State Commitee for Statistics, bne IntelliNews

The story is similar in Kazakhstan, but wages, both nominal and in dollar terms, have been rising for decades on the back of the booming oil business and are much higher than in Uzbekistan.

The per capita income in PPP terms (purchase power parity) in Kazakhstan was $24,970 in 2021, the second highest in the Commonwealth of Independent States (CIS) after Russia ($32,000), and way ahead of Uzbekistan ($8,520).

Of course, the Kazakh oil money is not evenly distributed amongst the population, where there is significant income inequality; nevertheless, the Kazakh consumer market is significantly richer than Uzbekistan's.

Wages in dollar terms have also been climbing steadily from KZT12,890 ($172) per month in February of 2000 and have averaged KZT101,375 over the last two decades, rising to an all-time high this September of KZT322,900 ($696) per month, according to Trading Economics. That compares with Russia, where salaries decreased to RUB59,907 ($974) per month in August, down from an all-time high of over $1,000 a month shortly after the war in Ukraine started.

In Uzbekistan, the average salary in September was UZS1,716,330 ($153), although there are substantial differences between the various wage surveys, and the different classes of job command large differences in pay. Much depends on a worker's profession and in which city they live.

White goods a burgeoning business

The growing wealth of the residents of the Former Soviet Union (FSU) and now Central Asia has drawn in most of the international household names, but it has also fuelled the growth of the Soviet-era manufacturers that have modernised and compete on the same market, albeit mostly in lower price brackets.

White goods manufacturing is already well established in the CIS, with most of the factories exporting across the whole region, including Central Asia.

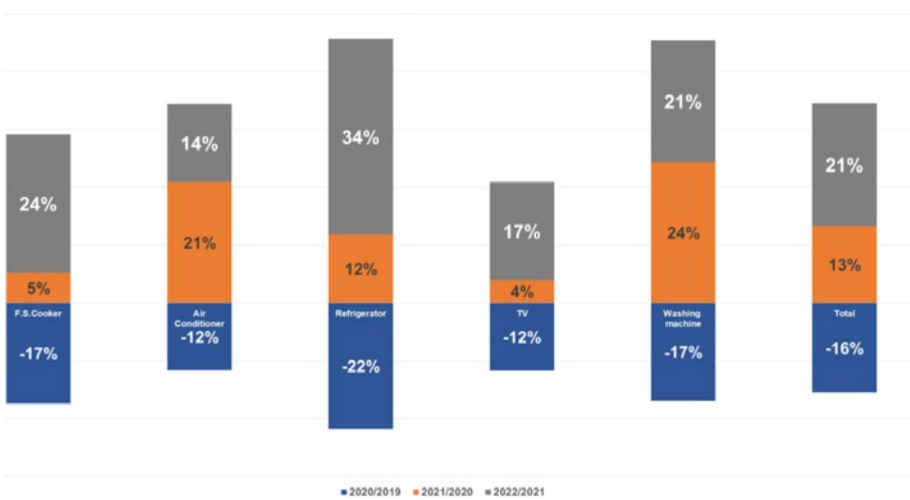
Long ignored by the international manufacturers, Uzbekistan's leading maker of white goods Artel has had the market largely to itself and built up a business that dominates the region. It is now expanding into other markets as it can price its goods below those of the international names, but increasing can offer products comparable to the international brands. And in July, Artel signed off on a deal to supply M.Video, Russia's leading consumer electronics retailer, with goods, as many international names suddenly disappeared from the Russian market.

As the biggest consumer market of all, most of the international brands traditionally set up production in Russia, which has 18 major factories, of which five are Western household names (Ariston, Bosch, Indesit, LG and Samsung).

These factories make everything from Samsung TV sets, through LG's refrigerators, Indesit's microwave ovens, to Ariston's boilers. More changes are in the works as international brands continue their exit from Russia, and according to reports, LG is amongst those looking at Central Asia as a destination if they relocate to a different FSU country.

The factories' production is exported regionwide, but the bulk of the sales are targeting Russia, where the population enjoyed the highest per capita incomes in the CIS.

Market growth 2020-2022



The leading Russian producers have a narrower product range, typically concentrating on fridges, washing machines and ovens. Outside Russia there are more factories in Belarus (4), Ukraine (3), Kyrgyzstan (1) and Turkmenistan (1), which are all exclusively Eastern European brands, except for an Electrolux factory in Kyiv that makes washing machines.

Belarus has the longest history of consumer electronics production, as it was the leading producer during the Soviet era; the "Minsk fridge" is still well-known across the CIS with a competitive offer of low price but decent quality.

In the last three years these producers have modernised, and new companies have entered the market. Belarus' Atlant is the biggest, producing 1.2mn pieces a year, including refrigerators, freezers and washing machines. Gefest is another leading brand, making 900,000 pieces a year but focusing on ovens and cookers.

Ukraine has the second-largest population in the CIS of some 42mn people, although it will soon be overtaken by Uzbekistan, as Ukraine's demographics are collapsing while Uzbekistan's are swelling. Apart from the Electrolux factory in the capital, Ukraine is also home to Greta that makes gas ovens and DonFrost that makes fridges and air conditioners – although production has been suspended thanks to the war.

Kyrgyzstan has one factory, Avangard, that makes around 180,000 washing machines and fridges a year. And Turkmenistan produces TVs and computers at the Aydyn Gijeler factory.

Artel is one of the unsung success stories of the "new Uzbekistan" that Mirziyoyev is trying to build. The company already dominates its home market, selling to the ballooning middle class, and has seen exports explode in the last few years.

Like many of the successful companies emerging from the chaos of the 1990s, the holding group that gave birth to Artel began life as a trading operation. The company imported aluminium and plastic products such as door and window frames that were in high demand in the noughties, before eventually going into the production of white goods in the teenies to become Uzbekistan's leading privately owned company today.

Starting with gas cookers, the company quickly expanded into things like vacuum cleaners, including a joint venture with Samsung, but today makes over 50 different items, including the de rigueur washing machines, fridges and TVs.

The pandemic caused a pause in the company's growth, thanks to supply chain disruptions, but as Uzbekistan's economy bounced back strongly, so have the company's sales. Across the majority of product lines, Artel Group products now occupy 40-60% market share.

Regional market in the making

One of the changes Mirziyoyev has brought is increasing regional integration amongst the Central Asia states. Kazakhstan may be richer than Uzbekistan but with only 19mn inhabitants spread out over a territory the size of Europe, it is a dilute market and not an obvious production centre. Now Uzbekistan's manufacturing sector is coming of age, exports to Kazakhstan are an obvious next step. The same argument applies to Tajikistan and Kyrgyzstan, which are also important export destinations, and increasingly to Azerbaijan, another oil-rich country with only 10mn people.

Since 2018 Artel's exports to Kazakhstan have exploded and will hit a forecast $50mn for this year, an increase of 124% year on year. Those to Tajikistan are up by a quarter over the same period, while Artel is now in the process of opening the Kyrgyz and Azerbaijani markets.

"We are exporting the same goods as we sell in the local markets, but we decided to export with 0% profit while we build up our market share. In Kazakhstan we already earn profits, as we have a strong presence there now, but most of the other markets, particularly in the CIS, are still in development," said Murodov. "Next year we will further build on our export to MENA countries as well and expect good growth there too."

Artel is also looking further afield and has begun exports Africa in the last couple of years. Certain product lines have now also received certification that will allow them to be exported to Europe. For example, since Uzbekistan won export duty privileges to the EU in the last years, textile exports have exploded. Domestic sales still account for more than two thirds of its business. ●

Emerging Europe's greatest scams

bne IntelliNews

As thousands of Mongolians besiege the government offices in Ulanbataar over the alleged embezzlement of up to MNT44 trillion ($12.8bn) in state coal export revenues, *bne IntelliNews* takes a look at some of the other great scams across Emerging Europe, Central Asia and Iran over the last three decades.

The 'Wild East' years of the early transition proved fertile ground for people to get rich quick while their less savvy (or less ruthless) compatriots were still adjusting to the new capitalist era. That period of barely regulated capitalism and murky privatisations led to the emergence of a new class of super-rich in a region where most people were struggling to survive. Even now, more than 30 years later, persistent corruption and cosy relationships between government officials, businesspeople, bankers and criminal elites have facilitated a series of multi-billion dollar scams, of which the events in Mongolia are just the latest.

1990s

Ponzi schemes prey on financially illiterate East Europeans

The first really big financial scams in the Former Soviet Union (FSU) were a raft of pyramid schemes inflicted on the financially illiterate people who were just coming to grips with capitalism.

One of the most famous was the MMM scheme, set up in 1989 by small-time computer trader Sergei Mavrodi and his brother. It quickly ballooned into one of the biggest Ponzi schemes in history, pulling in 5mn-10mn people who sunk their life's savings into the scam and quickly lost everything.

At its peak MMM was taking in millions of dollars a day and Mavrodi himself has obtained a sort of cult status amongst Russians. He died in 2018 at the age of 62 from heart problems. The quirk in the story is most investors knew it was a scam but hoped to get their money and profits out before it collapsed.

If Russia had a very large scheme that duped a lot of people, then Albania had a plague of huge pyramid schemes, many of them endorsed by government officials, that started to collapse in 1997.

Lax financial regulation and a lack of financial literacy led to around two-thirds of the entire population sinking an estimated $1.2bn into these schemes.

Violent protests and demands for then president Sali Berisha, still an influential figure in Albanian politics today, to resign erupted into mass unrest, bringing the country to the verge of civil war.

Albania was flooded with firearms as rebels looted army stockpiles in the south, while in the north Berisha opened depots to allow citizens to arm themselves against rebel groups. Virtually every man and boy over the age of 10 had at least one firearm.

The government managed to bring the situation under control in the north, but rebel groups and criminal gangs seized control of much of the south. The unrest only ended when an international peacekeeping force was sent in. More than 2,000 people were killed.

The Albanian author and academic Lea Ypi lived through the violence. In her memoir, Free, Ypi recalls crying in her room as fighting raged on the streets, and being told to stay away from the window to avoid stray Kalashnikov bullets.

The collapse of the pyramid schemes and subsequent violence continued to have repercussions decades later. Some of the weapons that Albanians took hold of during the unrest have still not been accounted for, despite a series of amnesties encouraging people to hand in illegal weapons. The vigilante gangs formed during this period were the precursors of some later criminal organisations. Distrust in the financial sector has held back the development of the local capital market.

2000s

Boom and bust for BTA in Kazakhstan

In Kazakhstan, BTA was the country's largest bank in the boom years of the mid-2000s, when the country experienced an explosion in real estate prices that rivalled those in Western financial centres. But when the subprime crisis broke in the US, the inflated real estate market in Kazakhstan also started to unravel, which in turn hit the banking sector, with disastrous consequences for its biggest bank.

Mukhtar Ablyazov was chairman of the board of directors at BTA, until it defaulted on $12bn of debt in 2009. BTA accuses Ablyazov of diverting much of those funds for his own gain. Investigators claim Ablyazov developed several complex schemes aimed at financing investment projects in Russia, enabling him to systematically embezzle the bank's funds in large amounts.

The ex-banker – who represents himself as an exiled dissident campaigning for political reforms as head of the banned Democratic Choice of Kazakhstan (QDT) party and is a constant thorn in the side of the Kazakh ruling establishment, using online means to prompt street demonstrations of his supporters – stands charged with abuse of office, nine instances of serious fraud, three instances of money laundering and causing significant damages via fraudulent misrepresentation carried out by an organised group.

Ablyazov, a critic of former president Nursultan Nazarbayev, has been living in self-imposed exile in Europe since 2009. He was tried in absentia in the Kazakh business capital Almaty in June 2017 and sentenced to 20 years in prison on charges of organising and leading a criminal group, abuse of office, embezzlement of around $6bn and financial mismanagement. He has protested his innocence, describing his trial as politically motivated.

The fugitive banker's lawyers maintain that Ablyazov, rather than embezzling the $6bn claimed by the Kazakh government, restructured the bank's holdings with the goal of protecting them from a government takeover of the bank that took place in 2009.

A year later, another court in Kazakhstan sentenced Ablyazov to life in prison in absentia following his conviction for orchestrating the murder of ex-head of BTA Bank Yerlan Tatishev. Ablyazov is accused of hiring Muratkhan Tokmadi in 2004 to assassinate Tatishev to gain control over the bank. According to the special inter-district court of Jambyl region, businessman Tokmadi shot Tatishev on December 19, 2004. Ablyazov was elected as the chairman of the bank's board of directors after Tatishev's death.

Ablyazov initially fled Kazakhstan to the UK, where he was granted political asylum. After a British court issued an order to arrest him for contempt of court, he then fled to France, where he is last known to have resided until now. He has reportedly recently been denied refugee status in France, according to reports by local Kazakh news agency KazTAG. It is unclear what the removal of the refugee status would mean for his future.

2010s

Daylight robbery in Moscow's Garden Ring

In the decade after the boom years of the noughties Russia's banking sector became the scene of a daylight robbery as banker after banker helped themselves to their depositors' money. When the Central Bank of Russia (CBR) finally stepped in and started closing down banks it eventually cost the country the equivalent of 5% of GDP to bail out the strategically important banks and reimburse the depositors under the deposit insurance scheme.

When the regulator got round to shuttering a dodgy bank it typically found at least a $1bn hole in the balance sheet and the owners long gone. As the first RUB1.4mn ($23,555 at 2017 exchange rates) of deposits are covered by an insurance scheme the clean-up cost the government about $50bn by 2017, and that was before it that year took on the really big commercial banks, the so-called Garden Ring banks, that could threaten the entire financial system's stability if they collapsed.

It took the regulator almost two decades to tackle the problem of insiders stealing from their own banks. The campaign started when the central bank decided to close the aptly named Sodbiznesbank in July 2004. It was the first time the CBR had pulled a bank licence and accused the management of breaking money-laundering laws. The decision came as such a shock it caused a mini-banking crisis as rumours flashed around the market that the CBR had a "blacklist" of smaller banks it wanted to shutter.

The closure of Sodbiznesbank was the start of a campaign championed by the CBR's deputy governor Andrey Kozlov, but he paid a high price for cutting off some of Russia's most powerful businessmen from their easy gains. Kozlov was shot dead on September 13, 2006, just as the bank sector clean-up was gathering momentum.

Many of Russia's banks are little more than sham Potemkin fronts or glorified treasury operations for their oligarch owners. "Bank-like institutions" Renaissance Capital analyst Kim Iskyan famously dubbed them.

But to date the biggest of all the shutdowns was Bank of Moscow, which at its peak in 2011 was the fifth-largest bank in the country. The bank collapsed in spectacular fashion after it became clear its management was robbing it blind, and it was eventually rescued by VTB in 2016.

A pocket bank of the Moscow city government, the bank was set up during Moscow mayor Yuri Luzhkov's tenure and became an "authorised" bank of the city government, allowing it to hold city company funds and run the payroll for its civil servants. Just how badly the bank had been robbed only became clear after VTB took control.

"There were two banks," VTB's former CFO Herbert Moos told *bne IntelliNews* in an exclusive interview at the time. "Downstairs there was a normal and successful commercial bank, but upstairs in some small offices we found a loan factory." The former chairman

> "There were two banks. Downstairs there was a normal and successful commercial bank, but upstairs in some small offices we found a loan factory"

Andrey Borodin was allegedly cutting up hundreds of millions of dollars' worth of credits to fictitious companies into small enough pieces that they wouldn't trigger the CBR money-laundering red flags, and to obfuscate inspections due to the sheer volume of the paperwork.

In the final tally, VTB estimated that there was a $9bn hole in the bank's balance sheet, which required the largest bailout in Russia's banking history of $14bn – more than the entire amount lent by the CBR to shore up the entire banking sector during the worst of the 2008 financial instability.

Borodin skipped town after an investigation into his bank started, and now lives in London, where the British government has granted him and his supermodel wife "political asylum" despite the fact he has never been involved in opposition politics, or any other sort of politics either. The British press write breathless articles after he bought a GBP140mn-plus ($170mn) house in Henley, dubbing him an "alleged fugitive" rather than being accused by the Russian regulator of probably being the most successful bank robber of all time.

Almost as bad, but not on the same scale, Russia's other most notorious bank robbery involved International Industrial bank (Mezhprombank), owned by Sergei Pugachev, who came to fame as being a key Kremlin-insider source for Catherine Belton's award winning book "Putin's People". Mezhprombank was amongst the very last banks to be bailed out by the CBR in the immediate aftermath of the 2008 financial crisis. Formerly a close associate of Russian President Vladimir Putin, Pugachev was for a time considered to be the last of the old-school oligarchs that rose to prominence under Boris Yeltsin in the 1990s, as he seemed to have successfully made the transition to the Putin regime.

The 2008 crisis wrecked his bank, but the CBR stepped in with a $1bn bailout loan. Except rather than use the money to shore up Mexhprombank's rocky balance sheet, Pugachev skipped town and moved to London. In 2010 the state appropriated all his Russian assets and started a legal campaign to try to recover its cash.

Unlike Borodin, Pugachev has not had an easy time in exile, as detailed in a *bne IntelliNews* profile of him after he became famous to the international audience. The DIA successfully brought a case against him in London accusing him of extracting money from the bank for his personal benefit after it became insolvent but had already been bailed out by the central bank. He was convicted of contempt of court in the UK in 2016 for lying to the court during the case and sentenced to two years in prison, but had already jumped bail and moved to France where, as a French passport holder, he cannot be extradited.

The Kremlin has put Pugachev's name on the Interpol wanted list and successfully managed to get the UK courts to freeze $1bn of his assets, limiting him to GBP10,000 ($12,100) a week spending money. There is a warrant on Interpol on charges of "misappropriation or embezzlement" outstanding.

"The Kremlin has put Pugachev's name on the Interpol wanted list and success fully managed to get the UK courts to freeze $1bn of his assets"

Privat investigations

Ukraine's banking sector was as rotten as that of Russia, only even more so. In the last decade the National Bank of Ukraine (NBU), under the leadership of former NBU governor Valeria Gontareva, took a leaf out of the CBR's playbook and carried out an identical clean-up of the sector, which is now considered to be healthy and well run. But that was not until the state had shelled out $5bn in 2016 to bail out the country's biggest lender PrivatBank, which had been virtually emptied of all its money by its owners oligarch Ihor Kolomoisky and his partner, Hennadiy Boholyubov.

bne IntelliNews played an instrumental role in the collapse of PrivatBank. In November 2016 we carried out an investigation after sources leaked a copy of its loan book. Checking the names of the bank's creditors on the list it transpired that about two thirds of the names were fake shell companies that were connected to the owners.

The results of the *bne IntelliNews* investigation were published as a cover story "Privat Investigations" the same month and caused a scandal in Ukraine. The local press followed up with their own investigations that showed even more the names on the list were fake. By December the scandal had become so big that the NBU stepped in and nationalised PrivatBank, which remains in state hands to this day.

After the bank was nationalised, the NBU carried out its own audit and found that 95% of the loans were sham, leaving a $5.5bn hole in its balance sheet. As by far the largest retail bank in the country, the Ministry of Finance had to step in to bail the bank out with a $5bn cash injection – in relative terms to the size of their respective economies, the Ukrainian bailout of PrivatBank was far bigger than the CBR's bailout of Bank of Moscow.

The NBU hired corporate investigator firm Kroll to find the missing money and then started civil cases against the owners in both London and Cyprus. A lot of the money was also found in Cleveland in the US, which triggered a Grand Jury investigation there and got Kolomoisky sanctioned by the US. The London court has frozen some $2bn worth of Kolomoisky's assets as the legal battle continues and the Cypriot case is ongoing.

Almost none of the money has been recovered, yet no charges have been brought against Kolomoisky, who has been living openly in Ukraine and until the war started was lobbying vigorously for the state to return the ownership of PrivatBank to him or pay him $2bn in compensation for capital he says he had in the bank at the time. In 2019 the NBU accused Kolomoisky of orchestrating a "terror campaign" against its staff as part of this effort. Among other things Gontareva's house in Kyiv was burnt down by unidentified arsonists. She told *bne IntelliNews* that she quit her job as NBU governor after a coffin with a mannequin dressed up as herself was delivered to the front door of the central bank and said Kolomoisky had personally threatened her with violence.

Kolomoisky has also been a mentor to Ukrainian President Volodymyr Zelenskiy and threw his media empire's weight behind Zelenskiy's presidential election campaign in 2019, although the president has since distanced himself from his oligarch friend, and stripped him of his citizenship in July this year.

Moldova's $1bn bank frauds

In Moldova's notorious $1bn bank frauds around $1bn was stolen via three local banks in one of Europe's poorest countries. The money was siphoned off from three major Moldovan banks, Banca de Economii, Unibank and Banca Sociala. The funds were transferred to shell companies in the UK and Hong Kong and then deposited in Latvian bank accounts opened under various names.

News of the frauds rocked Moldova when it was revealed that the central bank had extended MDL13.6bn ($1bn) in emergency loans to the three banks, which were later liquidated. In 2016, Moldova's government issued bonds to compensate the central bank for the loans. This means that unless the funds can be recovered, ultimately the cost will be borne by Moldovan taxpayers, as the bonds will be repaid from the public purse over a 25-year period.

Like Ukraine's NBU, the Moldovan authorities called in Kroll, which identified businessman and politician Ilan Shor as the visible beneficiary of the frauds. Shor has been convicted, but he fled the country before receiving a final sentence. He remains a key player in Moldovan politics, directing from abroad the regular protests against the pro-EU government in Chisinau his Shor Party has been holding this autumn.

Former prime minister Vlad Filat and reputed corporate raider Veaceslav Platon received prison sentences in connection to the frauds, though both have since been freed. Several other former top politicians, central bank officials and businessmen are suspected of either involvement in the frauds or of turning a blind eye while the money was siphoned off.

Years later, the authorities in Chisinau still hope to recover at least some of the stolen money but progress is slow. After the new parliament was elected in 2021, with the reformist Party of Action and Solidarity (PAS) having a majority, MPs strongly criticised both the General Prosecutor's Office and the National Anticorruption Centre for their lack of progress in recovering the money.

To give an idea of the sheer scale of the frauds, estimated at around 10% of Moldova's GDP at the time, in 2017 local artist Stefan Esanu created an installation of 10mn pieces of paper the size of dollar bills, each representing $100. The installation, with papers stacked in ten huge blocks, was intended to give the abstract notion of $1bn a concrete representation for Moldovans.

Iran's 'traitorous hands'

It was October, 2011 when Iran's supreme leader Ali Khamenei exclaimed on state TV: "God willing, the traitorous hands will be cut!"

The reason? Stunned Iranians were digesting "The 3,000 billion toman embezzlement scandal" in which scammers had got their greedy paws on ill-gotten gains equivalent then to just short of a billion dollars by using forged documents to obtain credit from at least seven Iranian state and private banks.

The credit, fraudulently drawn over a four-year period, was supposedly required to purchase recently privatised state companies. When the scandal broke, the focus fell on Iranian businessman Mahafarid Amir Khosravi (also known as Amir-Mansour Aria), the mastermind of the scam. Aria was executed for his sins in 2014. It was his Aria Investment Development Company that was the primary recipient of the loans.

Police raid on home of Mongolian rail official said to discover $2mn of cash in four currencies

Anand Tumurtogoo in Ulaanbaatar

Mongolian police allegedly discovered more than $2.1mn of cash in four currencies when they raided the home of S. Batdul, deputy head of the Transport Organisation Department of national rail operator Ulaanbaatar Railways (UBTZ).

Batdul remains in police custody following the January 5 raid. On January 9, a court ordered his detention for a month.

The rail official responded to the court decision on detaining him by saying that it was spurred by what the prosecution had said about him on social media.

Batdul said: "There is a process in Mongolia where people are prosecuted online without a court decision. I believe there was no need to detain me in this case. I am involved in a minor crime. There is no need to detain me. It is very irritating and I understand the court was [under pressure to make this detention]."

The case comes with Mongolians still in a state of shock over revelations that a "coal mafia" may have stolen billions of dollars in proceeds made on thieved coal that was exported to China.

On top of confiscating a large amount of cash from Batdul's home, police said they took away six real estate certificates worth $1.1mn. Batdul is under investigation for money laundering, tax evasion, unjustified enrichment and bribery.

On January 10, the Union of Railway Workers of Mongolia held a press conference in response to Batdul's alleged crimes. The union alleged that the claimed crimes were the result of a collaboration and that two other UBTZ officials, who were superiors in charge of Batdul, were the main culprits. The union representatives pointed to how cargo trains move ahead on rail lines if they are classified as cargo trains under the purview of one of the officials. They also called for an examination of the role of the son of that official. The son is in charge of inspecting cargo trains as they enter Mongolia.

Since 2021, the number of managers in UBTZ has increased by more than 20. The salaries and amenities enjoyed by these executives continue to inflate costs at a time when the country is in an economic downturn.

Mongolia's border crossing authorities and customs have a bad reputation for being the source of a great many of the country's problems, including corruption. It was reported in 2020 that UBTZ was responsible for the first COVID-19 infections that hit Mongolia. Its claimed disregard for COVID-19 prevention rules allowed the virus outbreak to spread via the national railway network, critics claim.

For years, UBTZ has escaped political scrutiny due to the fact that the company is jointly owned by the Mongolian and Russian governments, each holding a 50% stake. The company has a bad reputation in terms of failing to innovate and improve its system and trains.

Another suspect, Bank Melli chairman Mahmoud Reza Khavari, fled to Canada, where, now 70, he remains a fugitive to this day, denying all wrongdoing.

Mostafa Pour Mohammadi, the then head of a judicial investigations unit, described the case as "the most unprecedented financial corruption case in the history of Iran".

Some defendants argued that while prosecutors focused on pursuing small fry involved in the fraud, senior regime officials, without whom it could not have taken place, walked away. To this day, many Iranians remain convinced that was the case.

Danske's Estonian money-laundering scandal

Even banks in EU countries are not immune from scandal. In the late 2010s, Denmark's Danske Bank was revealed to be involved in a huge money-laundering scandal in Estonia in which around $160bn was processed on behalf of customers deemed high risk by the US Department of Justice (DoJ).

Danske defrauded US lenders over its anti-money-laundering measures at its Estonia branch, allowing "high-risk customers", including many from Russia, to access the US financial system, according to the DoJ.

Court documents cited by the DoJ show Danske's Estonia branch attracted foreign customers between 2008 and 2016 by allowing them to transfer large sums of money through it "with little, if any, oversight". The DoJ says the branch processed $160bn through US institutions on behalf of these clients, and conspired with these individuals to mask the real nature of the transactions, sometimes via shell companies.

According to a *bne IntelliNews* investigation in 2019, Danske even laundered money for the Ukrainian arms mafia's sanctions-busting activities in North Korea and Iran.

Now the bank will pay a $2bn penalty in relation to the scandal, the Financial Times reported on December 13. US authorities said that while the bank knew by at least February 2014 that some of these customers were involved in potentially criminal behaviour, it lied to US banks about the Estonia branch's anti-money-laundering programme.

The $2bn penalty is the largest forfeiture imposed by the US Department of Justice on a financial institution compared to its market capitalisation, Kenneth Polite, assistant attorney-general for the DoJ's criminal division, told the *Financial Times.*

Danske withdrew from Estonia when the scandal broke in 2018, selling its operations to local player LHV Pank. Danske Bank has also withdrawn from Russia and Latvia.

The former head of Danske's Estonian branch, Aivar Rehe, was found dead in September 2019, two days after being reported missing. The Estonian police determined he had committed suicide.

The lender still faces several civil lawsuits from shareholders, and on December 13 it said it would defend itself "vigorously" against them.

All three Baltic states have struggled to control the influx of dubious money from the East into their banking systems, but have been forced to improve their supervision following pressure from the European Union and, in particular, from US prosecutors and regulators.

> "Prosecutors focused on pursuing small fry involved in the fraud, senior regime officials, without whom it could not have taken place, walked away"

2020s

Mongolia's 'coal mafia'

The latest massive scandal to break in the region is the "coal mafia" scandal in Mongolia. Officials and company executives allegedly stole billions of dollars of export proceeds for coal clandestinely hauled to China.

The fact that huge volumes of coal have allegedly been pilfered in the past decade at least was discovered after officials compared Mongolian export data with import data reported by China, which buys almost all of Mongolia's coal exports.

Coal accounted for more than half of Mongolia's export revenue in the first 10 months of this year, according to central bank data.

The authorities said that part of the coal mafia investigation was focused on 7,373 trucks that repeatedly carried coal to the Chinese border between 2013 and 2017 but appeared to have arrived "empty".

Reports of the alleged embezzlement sparked mass protests. Among protesters braving sub-zero winter cold to maintain protests were some who set up traditional tents, gers, to allow them to stay in the capital's central square overnight.

On December 13, the Independent Authority Against Corruption (IAAC) announced the arrest of 17 people for coal theft. Former President Battulga Khaltmaa, two of his former staff and seven MPs were named, along with four South Gobi Province lawmakers, both current and former, and former ETT directors.

However, some protesters told *bne IntelliNews* that names of suspects provided by the authorities in the affair so far were "just scraps" and that the government was protecting some of the criminals.

In a lament often heard after similar scandals broke in other parts of Emerging Europe and Central Asia, protesters are slamming those who "stole prosperity from the people". ●

Wrestling champ turned mayor grapples with tough challenges in Mongolia's capital

Ulaanbaatar Mayor Sumiyabazar Dolgorsuren. / Jargal DeFacto, screenshot.

Michael Kohn in Ulaanbaatar

Two decades ago, Sumiyabazar Dolgorsuren was battling opponents on the wrestling mat as an Olympic athlete. Now he spends his days trying to put a stranglehold on Ulaanbaatar's traffic and air pollution problems as mayor of the Mongolian capital.

While his wrestling career is over, Sumiyabazar is still taking on challenges that result in both wins and losses. He's credited with improving parks and open spaces, but has been blamed for the increasingly intolerable traffic.

There is a lot riding on his success. The population of Ulaanbaatar has nearly tripled in the past two decades to 1.6mn people, putting a heavy strain on its ageing infrastructure, which mostly dates to the Soviet era. Many residents are looking to the 48-year-old mayor to fix their city's multitude of problems, which range from affordable housing to air pollution to traffic.

The challenges are immense but Sumiyabazar is no stranger to pressure. He won the wrestling tournament in 2006. He has also represented Mongolia in the Atlanta and Sydney Olympics. He even had a short stint as a mixed martial arts (MMA) fighter.

His unique ability to successfully throw his competitors to the ground runs in the family – his three brothers and his father have all wrestled at the national tournament level. One brother, Dagvadorj, went to Japan where he became a Yokozuna, the highest honour in sumo wrestling.

While some snickered at a wrestler trying to govern the nation's capital, politics and wrestling have mingled before in the North Asian country.

Mongolia's most famous wrestler, Bat-Erdene Badmaanyambuu, won the national Naadam tournament 11 times and then went on to a successful career as a member of parliament. Another wrestler and judo phenomenon, Batulgaa Khaltmaa, served as Mongolia's fifth president.

Boxers and wrestlers beyond Mongolia's borders have also achieved political success after retirement. Kyiv's current mayor, Vitali Klitschko, has won multiple heavyweight titles as a boxer. And the flamboyant professional wrestler Jesse Ventura had a run as Minnesota's governor in the early 2000s.

Sumiyabazar has followed their lead and is looking to make a name for himself as a problem solver. He has slashed spending to tighten up the city's budget, going as far as banning end-of-year holiday parties for city staffers.

Bespectacled and fond of dark suits, Sumiyabazar does his work with an air of modesty. In a recent promotional video with the International Finance Corporation (IFC), he appears seated next to a chess board, busily arranging papers on his desk while speaking excitedly about transportation upgrades in the city.

As for alleviating city congestion, he's made decentralisation a priority for his administration. A plan to build six commercial and administrative hubs in different corners of the capital is in motion to minimise the need for residents to go downtown.

City Hall has already moved from the central square to the southern outskirts. A new suburb close to the new airport is being planned. Sumiyabazar has been busy ordering the demolition of unsightly and illegally-placed garages, storage units and fences across the city.

Improving the city's greenspace and public gathering areas has also been a priority. Especially downtown, where he's transformed vast areas of waste ground into public parks.

The Children's Park – a downtown fixture of the city that has been partially boarded up for years following an attempted land grab – is also going back to public hands. The mayor has vowed to redevelop the park and has enlisted financial aid from mining giant Rio Tinto.

Tree planting is also high on the city's agenda. In March Sumiyabazar announced that 120 million trees will be planted by 2030, as part of the government's plan to plant 1 billion trees across the country.

"The Amusement Park area should be turned into a green space," Sumiyabazar said in a public address. "The one billion tree national movement is important for establishing parks and green space in every district to create a comfortable living environment for citizens."

The mayor has also taken steps to stop the destruction of historic Russian buildings in his city and has taken measures to have them preserved.

"The various beautification and livability projects of the downtown core have been pursued with some drive and competence," said Julian Dierkes, a Canadian professor of public policy and a frequent visitor to the city. "It's less clear that this is earning him much public approval."

As Dierkes indicates, many have expressed doubt that Sumiyabazar's public improvement projects have amounted to money well spent. Social media critics have lashed out at some of the efforts, forcing the mayor to pull the plug on at least one of them, a plan to improve the flow of the Selbe River through the city.

Many locals want the city to focus on improving infrastructure beyond downtown. The city's shambolic outskirts, known locally as ger (or yurt) districts, are still in a dire state.

Most of these areas lack many basic utilities such as central heat and running water. Paved roads, public schools, emergency services and other features of urban fabric are also lacking or absent. Families heat their homes with coal briquettes which pollutes areas around the city.

Sumiyabazar, a member of the ruling Mongolian People's Party (MPP), appears to favour a policy of replacing the ger districts with apartment complexes, giving residents an option to swap their land for a condominium.

The mayor announced earlier this year that 30bn tugrik ($8.8mn) would be set aside in the capital city budget to improve infrastructure in ger districts. It's far short of what is needed to overhaul these areas but Mongolia's budget has been constrained by a drop in foreign investment and global economic headwinds that have sent inflation soaring.

In order to pay for improvements Sumiyabazar has tried opening doors to new businesses, promoting the free market economy, and loosening restrictions. Last year he lifted most restrictions on closing times, allowing business owners to work through the night.

"There should be nightlife and business in Ulaanbaatar," he said in a release. "If you have a dedicated building for your service and trade you can not only open bars and discos but also restaurants, coffeeshops and grocery stores until 5:00 am., increasing your income and expanding your business."

"We aim to create city streets that promote Mongolian customs, culture, national cuisine, and livelihoods to support citizens and businesses and to actively implement policies in Ulaanbaatar to support tourism and development."

Despite the visual enhancements in Ulaanbaatar, Sumiyabazar still faces public opinion challenges. He gets credit for improving the atmosphere downtown. But he also gets panned by netizens looking for officials to blame for the city's traffic woes.

Others are just wary of Ulaanbaatar politicians, given the city's history of corruption and land grabs committed under previous administrations. Escaping clouds of controversy is not easy in a country where the public assumes most politicians are running shady side hustles, made all the more apparent by recent headlines of a "coal mafia" profiting off the country's mining industry.

"I am very sceptical that the Sumiyabazar team can change Ulaanbaatar into a better place," said Sumati Luvsandendev, head of the Sant Maral Foundation, a public polling organisation. "All consecutive city governments have a reputation for high level corruption, mismanagement, and low professionalism."

In order to succeed he'll need to stay above the finger-pointing and allegations that threaten to topple other senior leaders in power. But Sumiyabazar is not one to compete in a popularity contest. He grew up resolving issues less with charm and more with brute strength.

Personality may not be Sumiyabazar's strong suit. But fixing the city's multitude of problems will require a different sort of effort, a full-throttle approach that might be well suited to a person who rose to power through a sport that requires not just strength, but considerable strategy too. ●

Kazakhstan: One year on from Bloody January, officials stick to their story

Almaz Kumenov for Eurasianet

On the first anniversary of the bloody unrest that brought death and destruction to Kazakhstan's largest city, the general prosecutor addressed lawmakers and delivered what looks like the state's definitive verdict on what occurred. Many questions linger, however.

Berik Asylov told parliament on January 5 about what investigators have described as a coup attempt executed by organised criminal groups and plotted by a man once considered an ultra-loyalist of the ruling regime. He spoke too about the excesses of the police, dozens of whom reacted to the strife by torturing people scooped up, often arbitrarily, amid the chaos.

On the same day, President Kassym-Jomart Tokayev paid his own tribute to the 238 people killed over four days of what has come to be known in Kazakh as Qandy Qantar, or Bloody

January, by saying prayers at the Khazret Sultan mosque in Astana. Last month, Tokayev unveiled a memorial in Almaty consisting of a few austere black and white steles honouring the dead.

That gesture was met with hostility among Tokayev's critics, who recalled how the president had ordered security forces to use "lethal force" against violent demonstrators, whom he called "bandits and terrorists."

The presentation that Asylov, the state's leading prosecutor, gave to the lower of parliament, known as the Majilis, was in large part a reprisal of a well-rehearsed script.

Training for the January events, which the authorities typically portray in broad strokes as having been constituted almost entirely of unruly and yet coordinated riots, is said to have been carried out throughout 2021.

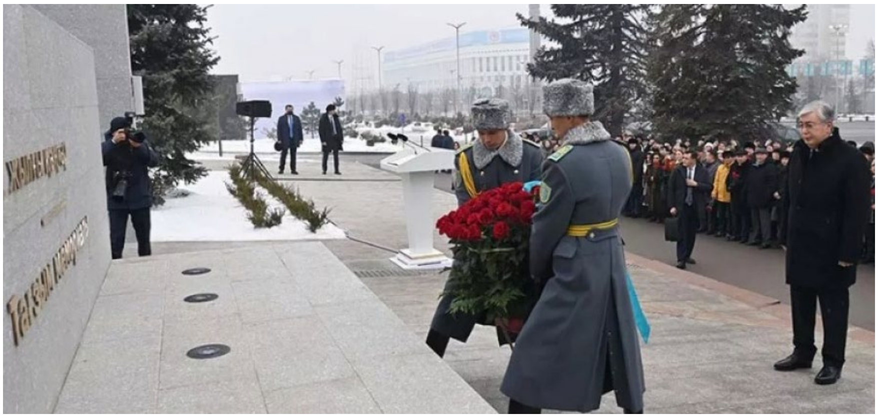
"I am unable to enter into the specific details of the plot. I can only say that throughout 2021, the plotters were readying in secret to adopt radical measures. Organised criminal groups were among the perpetrators. They recruited people, armed themselves, and bought walkie-talkies and transportation," he said.

Behind the underworld gangs lay a subversive wing of the security services, the prosecutor said.

Investigators continue to cling to the need to maintain secrecy in the interests of protecting national security, so only sparse details are known.

"The case contains information relating to foreign policy, counterintelligence and operational-investigative activities. Their disclosure may harm the interests of national security," Asylov told lawmakers.

In November, the Prosecutor General's Office referred treason charges against Karim Masimov, the former head of the National Security Committee, or KNB, and two seconds-in-command, Anuar Sadykulov and Daulet Yergozhin, to the courts. At least another three KNB officials are facing abuse of power charges.



President Kassym-Jomart Tokayev opened a memorial in Almaty last month to the victims of the January violence. / Government handout

After his address to parliament, Asylov was pressed by journalists on whether prosecutors were operating on the specific working assumption that the entire alleged coup plot had been cooked up by Masimov.

"You could say that, yes," he responded.

While demurring when it comes to the details of the alleged attempted coup, the authorities have been more expansive in detailing the former security services chief's purported excesses. In March, the KNB produced a slew of images of mansions, luxury Swiss watches, a huge fleet of premium cars, and suitcases stuffed with dollars said to have belonged to its ex-chief.

The secrecy of the case is enabling prosecutors to avoid having to justify what many observers find to be puzzling omissions.

Another one-time second-in-command to Masimov, Samat Abish, a nephew of the former president Nursultan Nazarbayev who was fired around 10 days after the unrest subsided, is not among those in the dock, although it is widely suspected he too may have played a role in fomenting violence. Asylov was asked about Abish, but he responded evasively.

"It is difficult to answer this question. Right now, investigations are under way," he said, adding that Abish has until now only been questioned in the capacity of a witness.

Abish had been in his post as first deputy chairman of the KNB from 2015. According to the state's narrative, it was the connivance of security services leaders and the initial inaction of the armed forces that opened the way for gangster-led mobs to take the initiative by seizing on the disarray that ensued after riot police aggressively put down a peaceful demonstration late on January 5.

"Ultimately, [the cities] of Almaty and Taldykorgan fell completely under the control of armed bandits for two days. A whole arsenal fell into their hands: almost 3,000 units of [items such as] automatic rifles, pistols, sniper rifles and tens of thousands of ammunition [were stolen from abandoned KNB and police buildings]," Asylov said.

Two-thirds of those weapons were never recovered, officials say.

In a twist of irony, rights advocates who have for years campaigned on behalf of people targeted for arrest by the KNB are now in turn calling for fairness in the prosecution of Masimov.

In November, the Almaty-based Kazakhstan International Bureau for Human Rights and Rule of Law published a statement calling for the authorities "to ensure maximum openness of court proceedings" against Masimov and fellow defendants.

"Even in cases where the public is denied access to a trial, the judgment, the main findings, evidence and legal reasoning must be made public," the group said. ●

The vast majority of Serbian President Aleksander Vucic's supporters don't see anyone as an eventual successor.

What politics after Vucic will look like is Serbia's billion-dollar question

Ann Smith in New York

For almost a decade Serbia's President Aleksandar Vucic has been the dominant political figure in the country (even in the region) as well as its international representative. So when he makes his periodic announcements that he is going to leave politics they raise a lot of questions, in Serbia and abroad.

During those ten years, he didn't only succeed in maintaining and increasing his power, but also in completely minimising the opposition. Vucic managed to become and remain the seemingly irreplaceable number one among his own people.

As a result, the vast majority of his supporters don't see any of the people working with him as an eventual successor. Meanwhile, most of his opponents do not have anyone (yet) to put forward to replace him. This is a result of Vucic's continuous hard work because he is in campaign mode every day, and every day is another chance to create a crisis and solve it (uniquely and gloriously) in order to boost his popularity.

Vucic himself works hard and he works in every field. He does the job of a statesman, but he also helps ordinary people with ordinary issues. As a statesman, he has elevated himself enough to be able to say: "L'etat, c'est moi". By showing constantly how he also lives the life of a little man, he has come far enough to become a leader that many not only respect or support, but really love.

The ones that truly love him are mainly elderly and for them seeing the back of him is not just scary but unimaginable. Comments like these can often be heard on public transport or in public parks where pensioners sit and chat or play chess: "we are safe as long as we have him", "we won't be hungry while he is the president", "there won't be war while Vucic represents us", "he is staying in politics because he cannot entrust us to anyone else" and so on.

Public expressions of admiration from those who work for Vucic are also quite common. Both groups are crucial for his political future.

A tricky legal question

Raising the subject of a third presidential mandate for Vucic started early — he just started his second five-year term in the spring of 2022. With his Serbian Progressive Party (SNS) the largest party in parliament, his position is safe for the next few years.

However, thinking about the distant future is what he does (and what has kept him in power this long), and talking about the end of his political career is another common theme. According to local media, since 2017, he announced about ten times that he is resigning from the position of SNS head. He also often repeats that he is leaving politics, but he never actually says when.

The latest announcement was made during the president's annual address to the nation on January 4, when Vucic said: "this is my last mandate, I'm not going to change the constitution, it's not happening… In the first half of next year, I will not even be a president of a political party."

When the statement is carefully read, nothing actually new was said. "Last mandate" as president still doesn't mean last political mandate. Is "next year' the lapse that everybody makes in the first week of January when they still call the new year next year, or he is talking about 2024? He won't lead "a political party", but what about coalition of parties or a citizen movement? There are so many options to stay in politics without being president of a political party. Serbs say: "every word has a tail". In Vucic's case that's indeed true.

According to the Serbian Law on the President, no one can be president more than twice. The only way to do so is through a change to the Constitution Act.

By saying he does not plan to change the constitution to extend his term, Vucic has set himself apart from leaders

"According to the Serbian Law on the President, no one can be president more than twice. The only way to do so is through a change to the Constitution Act"

of former Soviet countries such as Russian President Vladimir Putin or Belarus' Aleksander Lukashenko, who, by changing the way the role of the president is defined in their constitutions, effectively reset the clock and allowed themselves to stand for two additional terms as president.

Should he change his mind and decide to go down this route (which can't be ruled out), making a change to the Serbian constitution is a complex process. The first step would be to initiate a constitutional amendment in the parliament and obtain a two-thirds majority. Once a proposal for a constitutional change is approved, the parliament begins to work on the amendment and initiates a public debate. After this phase, the parliament again votes on the constitutional change and the votes of two-thirds of MPs are needed for approval. For some issues, including changes related to the role of the president, the parliament has to call a referendum. A constitutional amendment is considered accepted if the majority of people who vote in the referendum support it. This procedure (defined in the Article 206 in the Constitutional Act) is a long process and can take several years, which could be why Vucic has already spoken out loud about his thoughts.

At this moment, Vucic wouldn't be able to easily secure 167 votes in the parliament (two thirds of the 250 MPs). According to the latest report of the Serbian Electoral Commission, the coalition around the SNS currently has 120 mandates. The coalition around its partner the Socialist Party of Serbia (SPS) adds 31. A small number of votes comes from parties of ethnic minorities, so Ana Brnabic's SNS-led new cabinet passed parliament with 157 votes of support. However, before 2027, Serbia should hold one more round of parliamentary elections; the current parliamentary term ends in 2026, though Vucic has several times called early parliamentary elections.

When it comes to a referendum, that shouldn't be a problem for Vucic, as his fans always vote. Supported by the SNS's members and their families (the SNS is the largest political party in the country counting about 700,000 members), it could be an easy win over those that would bother to go and vote against. But, this still requires some work because of the anti-Vucic segment of society.

A cabinet post or ruling from the shadows

If amending the constitution is not an option for whatever reason, Vucic still has plenty of ways to stay in politics and keep ruling the country. As long as the SNS has a parliamentary majority or is able to create a coalition, Vucic will have a job — he can be prime minister, which he actually was for a couple of years before he became president. As PM, he could just continue doing what he already does with a different title.

If not PM, he can be a first deputy PM (PPV), a title created especially for him in 2012 when the SNS formed a government with the SPS and had to give the PM position to its president Ivica Dacic (Dacic never admitted it, but sitting in that chair was understood to be his condition for leaving his previous partner the Democratic Party and joining the SNS). Vucic can be a minister (of defence, perhaps, like he was while he was PPV). As long as he is president of the SNS, he won't be unemployed.

In this, he would follow the example of Milo Djikanovic, current president of Montenegro but permanent de facto ruler of the country since the 1990s. Djukanovic has been president of the Democratic Party of Socialists (DPS) since before Montenegro was an independent country. Even when Djukanovic didn't hold a position in government, he always had power over it — just because he was president of the ruling party.

That could be a way to go for Vucic if he doesn't want to constantly run election races. To date, his frequent announcements about a withdrawal from politics have been just part of these races. Whenever he says something like this, it sets the public on fire. It is not yet clear what's the reason for such acts — political spin, to test the public and improve his rating, or just because he truly feels overwhelmed in the moment and has to vent. However, the way his media reports on his announcements is disturbing and creates panic in the country — some are scared that no one could be better than him while others are scared that he could be replaced by extremists who might cause disasters in the country.

No obvious successor

At this moment it is impossible to pick a potential successor as Vucic has surrounded himself with people whose political careers developed only once they became his close associates. Those people are extremely loyal and do not represent competition. They are known primarily as members of his team, making it difficult to single out any one of them to label as a future president.

Some, who have been close to Vucic since he first came to power, have a relatively high profile within Serbia. One of them is Sinisa Mali, current minister of finance and former mayor of Belgrade. However, he can't hope to emulate Vucic's popularity because he has been embroiled in numerous scandals — from media reports that he owns 24 apartments in Bulgaria, to accusations that he plagiarised his PhD.

"At this moment it is impossible to pick a potential successor as Vucic has surrounded himself with people whose political careers developed only once they became his close associates"

Serbia's Prime Minister Ana Brnabic is also very loyal and a hard worker, but as Serbia's first openly gay PM she cannot be seen as a successor because Serbs are not yet ready to directly vote for a lesbian to become their president.

A third name from within the government ranks is the former mayor of Novi Sad who is now minister of defence, Milos Vucevic. His is a new name on the national scene and a name that Vucic promotes. Most voters still do not know him though, and for ordinary people, a minister of defence is not a key figure whose work they would follow and value.

On the opposition side it is hard to find anyone able to bring together multiple small parties and collect all their votes in order to really gain visibility and credibility. Vucic and his SNS used all available tools to destroy the opposition in the country but the opposition itself helped them by fighting among themselves and failing to unite effectively.

There are rumours that former minister of energy Zorana Mihajlovic might form a party and challenge Vucic, but nothing has happened yet. Mihajlovic is openly for faster EU integration, sanctions against Russia and energy diversification (or a decrease in Serbia's dependance on Russia). As such, she is not a favourite with official Moscow and a lot of effort was put into destroying her reputation. She may be a choice of some that hold similar views, but that still wouldn't be enough for a victory.

Right now, Serbia is poisoned by Putinism and "Zrbism", a pejorative title for Serbian nationalists that support the invasion of Ukraine and believe that Russia is Serbia's mother and its protector from the West. Most Serbs do not want someone with these views to come anywhere near the country's institutions because Serbia is still a way more democratic society than Russia. Even for Serbs sympathetic to Russia and with strong anti-Vucic sentiment, the arrival of a successor from among the "Zrbs" is a scary idea.

The only thing really known about the succession in Serbia is that if Vucic was to resign today, the acting president would be current parliament speaker Vladimir Orlic — a 40-year-old SNS member since 2008 and holder of a PhD in telecommunication.

Tito after Tito, but after Vucic who?

Even though almost nothing about Vucic is certain, one thing is for sure — he wants to become part of history. Some in Serbia hope his final goal is to reach a deal with Pristina and earn a Nobel Peace Prize and then retire. If that is indeed his dream, it would secure a better future for the whole region. People that don't like him don't believe that this is his dream, instead, they say that he dreams of being the new Tito.

Joseph Broz Tito, the president and self declared marshal of post WWII Yugoslavia, was indeed loved throughout the federation and many still miss him and that country. Tito's mandate only ended when he died. Those that remember the day of his death in May 1980 claim that there wasn't a single person in Yugoslavia that didn't cry.

Tito kept Yugoslavia outside of the Iron Curtain because of his antagonism with Joseph Stalin, head of the Soviet Union. Both were communists and, just like Stalin, Tito didn't like those who had different political views from his, who usually ended up in political prisons. Vucic doesn't like to hear criticism and doesn't deal well with it, but is still far away from such political repression. But, just as Vucic's supporters believe that if he leaves politics something bad will happen, many Serbs, Croats, Bosniaks and even Slovenians still remember Tito nostalgically and claim that the good life ended after his death.

This belief is in line with the main slogan of Tito's communists: Tito after Tito. Yugoslavia broke up barely 10 years after Tito's death. Many songs were written for Tito during his life but also after his death, as well as shortly before the collapse of the country he led. One of those, performed by the Sarajevo band Index even had words of this communist slogan: "and what now, southern country, if anyone asks us, we will say: Tito again, Tito after Tito!"

This slogan is often used to make fun of Vucic and the extent and duration of his power. However, the question of what comes after Vucic remains open, and it looks like even he doesn't have a precise answer to it. ●

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THE MITTELEUROPEAN VIEW

Western banks go back to square one in CEE

Gunter Deuber of Raiffeisen Research

The key messages of this year's Raiffeisen Research CEE Banking Sector Report at the industry level are as follows: Geopolitically, the leading CEE banks in Eastern Europe (Russia, Ukraine, Belarus) were not naïve; on the profitability side, things are still running smoothly in Central and Southeastern Europe for the time being, while market concentration continues to increase. However, increasing competition and repeated government interventions will limit the full earnings potential, especially in 2023.

At the individual bank level, the large Austrian CEE banks still lead the regional banking ranking, but re-emerging players such as Belgium's KBC are catching up, while OTP is now overtaking the first cross-border Western player "historically" rooted in the region (Societe Generale) and is catching up on UniCredit. Depending on the further woes of the Russian market (especially at RBI and UniCredit), the EU bank ranking in CEE could be shaken up again in 2023 – possibly in favour of KBC and OTP. In the Western Balkans, local banks tended to benefit from the regulatory-induced Sberbank wind-down in 2022, while the long-term EU advantage in CEE banking appears to be increasing.

The dramatic events in Ukraine have clearly upset the applecart for the CEE banking sector this year. Not only Ukrainian banks had to deal with an unprecedented level of economic hardship and operational risk, but also Russian lenders faced a much stricter sanctions environment (60% of the sector "de-Swifted", some 80% is under Western sanctions). The latter triggered unseen losses for the Russian banking sector on aggregate (RUB1.5 trillion or ~€18bn in H1 2022, driven, inter alia, by forced liquidation of derivative positions, while the loss has narrowed to RUB400bn or ~€5.6bn as of 10M2022).

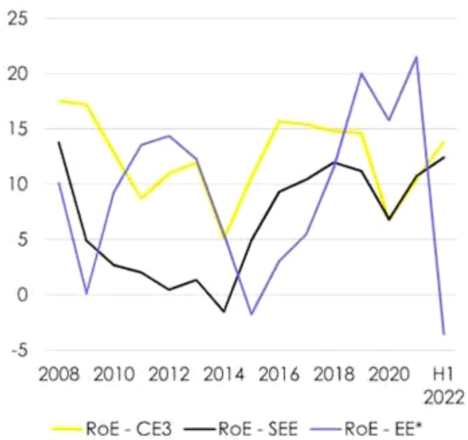
On a positive note, geopolitical upheavals in the context of the Ukraine war do not pose an existential threat to the large Western-owned CEE banks, some of which are also active in Russia. We attribute this to cautious regional market strategies that have been in place since 2014/2015. Since 2014/2015, the share of Russia and Eastern Europe in the portfolios of Western CEE banks has fallen from just over 20% to below 10%. Geopolitical naivety is not evident here. Since 2013/2014, major Western banks have adjusted their regional portfolio allocation in such a way that a significant geopolitical escalation in the Eastern European region does not endanger the existence of regional CEE business strategies. As a result of the careful banking business strategies in Eastern Europe in recent years, the Russian banking market has been about as important for Western banks as Slovakia as of Q1 2022.

"Bonanza times" will not be easily repeated

Central banks and their monetary policies have been the key factors for commercial banks' profitability in 2022. This is especially true for the largest CE/SEE markets, which led front-loaded tightening cycles in the region and where lenders capitalised on the steep ascent in policy rates. Average monetary policy rates in CE/SEE (i.e. in countries with active and independent monetary policies) are currently at 9%+, higher than prior to the Global Financial Crisis and in the times of the CE/SEE "bonanza boom". However, "bonanza times" will not be easily repeated. Despite massive short-term support from rising rates, the mid-term outlook has to been taken with a dose of cautiousness.

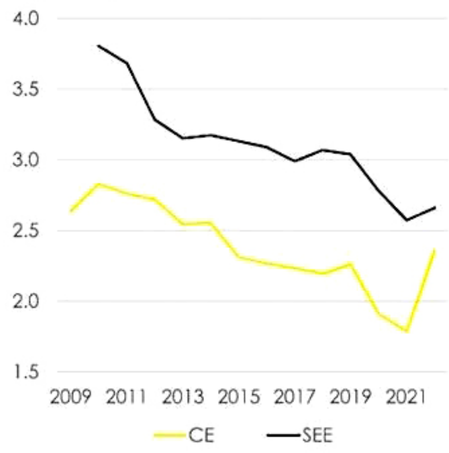
Firstly, in a longer-term retrospective the transmission of the upswing in policy rates into banks' margins is now much more limited than historically. Thus, the recent recovery

Return on equity (%) weighted by total assets



* end point for EE is 10M 2022 with the RoE of -4.2% (RU), +5.8% (UA), +12.7% (BY)
CE-3: CZ,HU,SK; SEE: RO,BG,HR,RS,BH,AL,KO; EE: RU,UA,BY
Source: National sources, RBI/Raiffeisen Research

Net interest margin (%)* weighted by total assets



* Net interest income/average total assets
CE: PL,CZ,HU,SK; SEE: RO,HR,RS,BH,AL,KO
Source: ECB, IMF, national sources, RBI/Raiffeisen Research

in net interest margins (NIM) constituted only a marginal move as compared to the central banks' key rates, which have largely approached (and in some cases topped) the levels of 2008/2009. We attribute this to the changed operating environment in terms of increased market penetration levels and stiffer competition.

We expect these factors to keep a lid on further widening of margins, while some central banks also look ready to call time on the rate-hiking cycle (Poland, Czechia, Hungary). Moreover, most of the rise in interest income is mainly coming from the Czech market, where we see the most leeway for rate cuts going forward. Due to the high gearing towards the country, approximately 75% of the pre-tax profit growth at major Western-owned CEE banks stems just from this country, followed by Croatia and Romania.

An important adverse factor in 2022 was the massive government intervention in Hungary (worth ~€1.2bn, including the windfall profit tax and various interest rate caps), which as a result triggered a pre-tax profit erosion of 15% y/y and hence led to the negative contribution from local banks of approximately -14% y/y in our Western/EU CEE bank coverage universe.

Secondly, the overall situation is becoming less favourable as compared to the COVID-19 years of excess liquidity and declining loan-to-deposit ratios, as deteriorating real incomes make households draw down their savings, while the high-rate environment spurs bank competition for new deposits. It is probably not yet a wide transformation but the customers' shift toward higher-yielding term deposits is happening. Looking for instance at Czechia, Hungary and Romania, in terms of new business volumes, term deposits have supplanted around 5-7% of current/overnight accounts in the household segment since the beginning of 2022.

At first blush, this shows only a marginal change in composition, however its impact on the blended cost of deposit funding is actually non-trivial when one considers the large difference in the applied interest rates. Thus, while the market rates on overnight accounts in the given countries have barely bottomed out from virtual zero, the cost of new <1y term deposits in local currency has exceeded mid-single digits. Notably, the latter represents the most expensive bucket in the term structure, reflective of the inverted benchmark yield curves in the markets.

Thirdly, funding profiles of major international and local CEE banks are now also challenged by required MREL debt issuance. Here, in contrast to Western markets, the eastern part of the EU proved slower to implement the bail-in regulation on both the national and single-bank levels. As a result, the lenders are now running into a pitfall of generally uneasy borrowing conditions coupled with the short time before the final legally binding MREL targets (1 January 2024).

In principle, the banks have some leeway in terms of the local debt markets' capacity and support from multilateral creditors — we calculate that the EBRD alone invested more than €300mn in MREL bonds (local and international) of CEE banks in 2022, for a ~20% participation rate on average. Indeed, MREL issuance in local currency is actively used, for example, by Czech and Romanian systemic banks, where they can often secure a relative price advantage as compared to the international market (we envisage a similar strategy for Polish majors given the relative depth of the local debt market).

Having said that, there is still little alternative to the Eurobond market when seeking to borrow larger amounts. International investors, moreover, prove much more demanding when it comes to CEE risk these days, so even the established subsidiaries of European MPE [Multiple Point of Entry resolution strategy] banks and entrenched investment-grade local players have to pay considerable premiums currently to get the deal done.

On top of all the funding challenges described above, banks also face a round of step-ups in capital buffer requirements. Among others, these include sector-wide countercyclical capital buffers (in Croatia, Hungary, Romania – for the first time ever) and further bank-specific add-ons for systemic importance (major O-SII buffers increases in Hungary and Poland).

Coupled with the gloomier economic outlook, this does not set an inviting backdrop for active organic credit growth, but rather adds incentive to the banks' more defensive stance on underwriting standards – something we read from both lending surveys and actual high-frequency data on real (net of inflation) loan growth. Overall, we should not get confused by bumper nominal loan growth rates. Currently deflated real loan growth rates are similar, i.e. just slightly positive or even negative, to the times of regional banking sector weakness in 2012/2013.

In the meantime, it is not all rosy as some governments target banks among other sectors for skimming off "excessive" profits in order to help them close budget gaps. The "windfall tax" has already entered into force in Hungary, will be imposed in the Czech Republic in 2023-2025 and is being discussed in Croatia.

Based on all available information about already implemented, approved and announced government interventions (excluding increased regular deposit insurance charges), we calculate the total burden at around €6.4bn, with the biggest chunk coming from Poland (€3.8bn, excluding FX mortgage provisioning) and the rest from Hungary (€2.0bn, of which €1.25bn was in 2022), Czechia (€0.6bn, 2023) and Croatia (€70mn, 2023).

Moreover, additional costs will enter banks' P&L through other lines (typically as a "loan modification loss"). Negative mark-to-market revaluation of fixed income securities due to higher (government) benchmark yields adds another piece to the mosaic, though a large part of this has probably already materialised during 9M2022 and for single banks could have been mitigated by a shorter duration of the portfolios.

In sum, the high interest rates are a low-hanging fruit for lenders; however, it is not exceptionally sweet given the broader context it has emerged in.

Russian market affects bank rankings

The environment in the CEE banking business is certainly not a foregone conclusion. However, the attractiveness for deep-rooted players seems to be given, as multi-layered market trends show.

Within the cohort of major Western cross-border CEE banking groups the Austrian friendly competitors Erste and RBI continue to lead, while KBC has been clearly catching up as #3, closely rivalling RBI, followed by UniCredit as #4.

On the other side, upon the exit from Russia in April 2022, SocGen remained active in only two CEE markets (Czechia, Romania) and hence eventually lost the race to be regional #5 to OTP, which topped the €90bn mark in asset size this year (including Slovenia's Nova KBM). The chance of further market share reshuffling, largely benefiting KBC and OTP, cannot be ruled out.

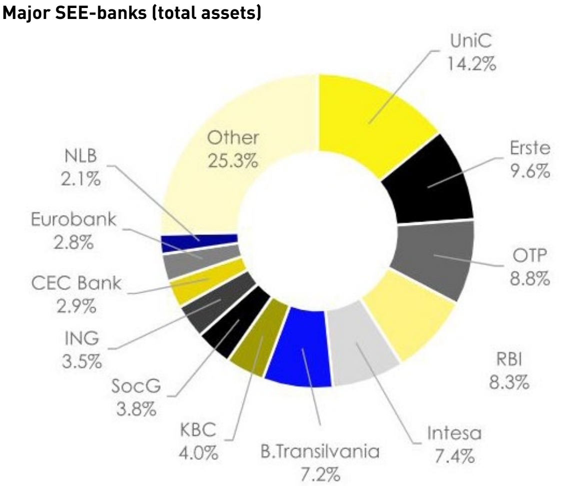
To a varying degree, a local presence in Russia remains a factor for five Western CEE banks, incuding RBI (Q3 2022: €13bn in loans to customers), UniCredit (€9.6bn), OTP (€2.6bn), ING (€0.6bn) and Intesa (€0.3bn). Depending on further rouble exchange rate developments, possible further local balance sheet reduction and/or active exposure reduction (until market exit), the further fate of Russian business at RBI and UniCredit could again significantly shift the CEE bank ranking in 2023.

The sketched market trends do show the willingness of dedicated players to expand in the region – and beyond. Belgium's KBC Group, at number three, is catching up strongly and is now the largest foreign cross-border player in Central Europe, ahead of Erste.

The regulatory enforced Sberbank windown also offered interesting M&A opportunities, largely benefiting locally-embedded players. Ironically, Sberbank Europe had been already on track for an orderly sale of select CEE subsidiaries at the end of 2021, however the deal largely failed upon the bank's crisis and the sanctions hit in February/March 2022. Eventually, among the acquirers in the course of selective bail-outs, local players were able to make a swift decision on the takeover and hence gained market share, including markets such as Croatia, Slovenia or Bosnia and Herzegovina.

Overall, we see the much-needed resolution of Sberbank Europe as managed rather smoothly. Sberbank's (enforced) withdrawal hence added to the changing balance of market

Major SEE-banks (total assets)



Mix of balance sheets from YE 2021 and Q2/Q3 2022, adjusted for occurred/announced M&A
SEE: RO,BG,HR,RS,BH,AL,KO
Source: National sources, company data, RBI/Raiffeisen Research

power towards domestic banking groups in smaller markets of the Western Balkans, which has already been underway in the last five years.

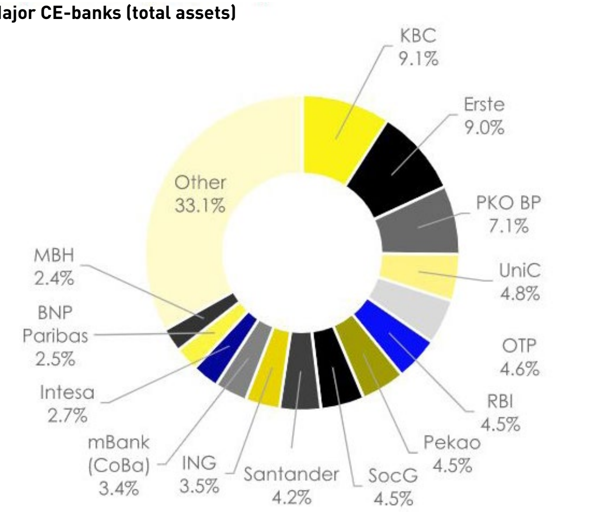
Otherwise, in larger CE/SEE markets the lively consolidation trend did not alter much the participation rate of foreign players in 2021/2022, i.e. recent redistributions and combinations of market shares were largely within the groups of either foreign or local players. From a longer-term view, Serbia is perhaps a rare exception where the market share of foreign banks has increased notably in the last five years to top 75% on the back of acquisitions of local banks by OTP and NLB.

Echoing the brisk M&A activity in the last few years, the market concentration ratios (top-5 banks) have trended up across the largest CE/SEE markets, which, in turn, mean that there are now fewer "easy" options to pick up business scale, so a more prudent approach to choose future M&A targets will be warranted.

Refocus on Central Europe
Overall, it seems that Western players are more and more coming back to square one of their regional banking sector expansion. The longer-lasting regional re-focussing of Western CEE banks – well ahead of the Ukraine war – has translated in a rise of the CE banking markets and (current) EU markets in regional portfolios of Western-owned CEE banks.

Currently, EU markets represent 86% of exposures (2013 "only" 71%, 2003: 84%), Central European markets are back to the all-time heights at the early stages of the regional CEE banking boom at close to 70%, relative exposure ratios last seen in 2002-2005.

Major CE-banks (total assets)



Mix of balance sheets from YE 2021 and Q2/Q3 2022, adjusted for occurred/announced M&A
CE: PL,CZ,SK,HU,SI
Source: National sources, company data, RBI/Raiffeisen Research

The "return" to EU and Western CEE markets reflects a complex interplay of various factors over time. First, simple "convergence bets" have not materialised on many levels. The adoption of the euro by CE/SEE markets has progressed more slowly than expected at the beginning of the 2000s or has been put on the back burner in some cases. Moreover, through-the-cycle profitability in more risky/exotic markets had been possibly less favourable than assumed (or economic/political convergence had been less successful than hoped for).

"Overall, it seems that Western players are more and more coming back to square one of their regional banking sector expansion"

Secondly, political and geopolitical risks have long been a relevant factor in CEE business. This applies to the issue of Russia/Ukraine and also the Western Balkans. It remains to be seen whether clearer EU-perspectives in the Western Balkans may change the calculus once again. On an interesting note, the traditionally more emerging market risk tolerant RBI is currently gearing towards CE markets, having grown into #4 market position in CE-3 (Czechia, Hungary, Slovakia).

European or EU banks have been particularly exposed to the Russian market for years. Some European banking sectors (among them France, Italy and Austria) have even made significant (market share) gains there in some cases. In the short term, these trends could intensify. In the future, EU banks should be careful with strategies that carry an element of catching market share from "geopolitical more sensitive actors" such as banks from the USA or UK. Credit institutions from the Anglo-Saxon world trimmed their Russia-related exposures much earlier than EU banks.

However, it should also be noted that EU banks are currently less exposed to China than credit institutions from the USA or UK. As we will show later on, further differentiated country or geographic strategies of international banks should continue to emerge, driven by country-specific risk factors related to relevant ESG classifications or ESG country ratings.

Russian exit dilemmas
Moreover, recent developments in the international banking business in Russia show how complex it is to scale back exposure once a geopolitical confrontation is well underway. And the potential market exit in case of Russia is currently hitting several regulatory and practical hurdles. This holds especially true for major cross-border CEE banks. In this environment, many of the Western players resort to a downsizing strategy (increasing local loss absorption

capabilities), despite certain benefits to revenues currently. Longer-term business prospects lie in a haze of uncertainty, while no rouble earned is allowed to leave Russia in the meantime. Basically, we see an "exit" dilemma on various fronts.

Firstly, any transaction would require an eligible counterparty plus full local consent, i.e. by Russian and Western authorities. Russian authorities, by and large now represented by the Kremlin, are possibly a more consolidated counterpart to negotiate with. Hence a sanction waiver might be more feasible to get (depending on the discount). The same holds possibly true for the US and OFAC. However, within the complex EU structures European banks would have to negotiate a more complex market exit deal with several competent national and/or supra-national authorities.

Secondly, any divestment is definitely not a "normal" M&A transaction where long due-diligence periods and/or deal walk-away options are feasible. Not to mention complex accounting issues plus valuation topics given overall (FX) market dislocations and blocks to outright capital transfers. Furthermore, the question of operational feasibility of previous "Western banking models" under new ownership is not given.

Thirdly, currently the feasibility of any bold strategic movement is getting more and more limited in light of ever tightening sanctions and worsening of the conflict. Among the big foreign lenders only SocGen managed to arrange a quick withdrawal in April, which cost the group €3.2bn, though it still seems to have been a special case (divestment of the Rosbank subsidiary basically to the same investor – Interros Group – from whom it was purchased in 2006-2008). Otherwise, the window for orderly exits was promptly shut

"The window for orderly exits was promptly shut with the adoption of a presidential bill that banned foreign banks from selling their stakes in Russian entities"

with the adoption of a presidential bill that banned foreign banks from selling their stakes in Russian entities. Even though special waivers are possible, the government clearly has an upper hand in negotiations over exit strategies for investors from "unfriendly states".

And let's not forget that for the time being both sides possibly have a certain interest in keeping channels for (limited) economic and financial exchange open. Any further divestments by Western/EU owners would possibly change the rules of the game here.

For the time being EUR and USD payments are still in demand, although note the high speed of switching to alternative currencies in Russian export settlements. The Q4 respective shares of dollar and euro were down to 33.9% and 18.7% (FY 2021: 54.5% and 29.7%, correspondingly), replaced mainly by the RUB and CNY already representing 50% of export settlements (close to 15% in CNY), up from just below 20% in 2021. Here we assume the largest local state banks will dominate in payment services on the Russian side.

The Russian military aggression against Ukraine has caused a super-adverse environment for the Ukrainian banking sector. In particular, credit and operational risks increased tremendously due to the seizure and destruction of assets as well as a significant deterioration in the financial performance of both customers and the banks.

It was not a surprise to us to see a deterioration in the quality of banks' loan portfolios caused by the war. Hence, NPL rates have increased from 31.5% to 37.5% for the corporate sector and from 15.9% to 27.6% for the household sector over the first seven months of the war. We expect that NPLs will continue to increase on the risks tied to war, but it is unlikely they will exceed the 55% maximum recorded after the previous crisis in 2014-15 given the clean-up effort made by the regulator since then.

Therefore, the probability of a mass bankruptcy of the sector (in the manner of 2014-2015) remains low, while recapitalisation needs will be possibly shared within the IFI community (if needed). It is worth noticing that the war has not been as disastrous for the hryvnia as during the previous crisis in 2014-2015. A sound volume of foreign currency reserves and emergency measures applied by the NBU saved the market from collapse at the beginning of the war. Therefore, in the first nine months of 2022, the banking sector posted still a remarkable positive (!) return on equity of 4%.

So much for the "good" news from the war-torn country. In the context of the previously sketched geopolitical risk awareness of Western banks, it is somewhat bitter that risk reduction in the case of Ukraine has led to Western banks now having lower exposures here (at around 1% of their CEE assets) than in the case of Slovenia. Definitely, this is not the exposure needed for a sustainable rebuilding of Ukraine. ●

This opinion piece was written Gunter Deuber, Ruslan Gadeev, Jovan Sikimic and Oleksandr Pecherytsyn of Raiffeisen Research in Vienna & Kyiv.

The full report it was based on can be accessed here.

BUCHAREST BLOG

What the Andrew Tate case says about corruption in Romania


Andrew Tate's arrest in Romania. / DIICOT

Clare Nuttall in Glasgow

When he moved to Romania in 2017, the disgraced influencer Andrew Tate notoriously commented that he chose to relocate from the UK because he liked living in countries "where corruption is accessible".

That blasé statement has come back to bite him; Tate and his brother Tristan are now in custody while a criminal investigation into suspected human trafficking, rape and forming an organised crime group is carried out.

The Tate brothers were detained in Romania on December 29. They are suspected of using local women to produce lucrative pornographic content for social media sites, allegedly luring them in initially by pretending to want a romantic relationship, then using force or coercion to get them to perform on camera.

"Victims were recruited by British citizens by misrepresenting their intention to enter into a marriage/cohabitation relationship and the existence of genuine feelings of love (the loverboy method). They were later transported and housed in buildings in Ilfov county where, by acts of physical violence and mental coercion ... they were sexually exploited by group members by forcing them to perform pornographic demonstrations for the purpose of producing and disseminating material of such a nature through social media platforms," said a statement from Romania's Directorate for Investigating Organised Crime and Terrorism (DIICOT) on December 29.

A video released by DIICOT shows guns, knives and money at the location where the Tates were arrested.

A former kickboxer, Andrew Tate has become a social media sensation in the last few years. He is now banned on most mainstream channels for infringements such as breaching hate speech rules, but an August 2022 profile by *The Guardian* says videos of Tate had been watched 11.6bn times on TikTok.

Styling himself as a self-help guru, he peddles outdated notions such as that women belong in the home, are a man's property and are partially responsible for getting raped, finding a receptive, mainly male, audience online.

He presents an aspirational lifestyle to his millions of followers, showing himself smoking cigars and with fast cars – his fleet of vehicles was confiscated by Romanian prosecutors after his arrest – as he gives out tips on seduction and getting rich. As reported by *The Guardian*, he revealed in one podcast that he makes money by persuading girlfriends to video chat, then sharing their profits.

Some of his comments are so extreme they raised concerns among NGOs of young men being radicalised or encouraged to commit violence against women. His misogynist comments eventually got him banned by major platforms for hate speech, but he was allowed to return to Twitter after it was taken over by Elon Musk last year.

While there is now extensive coverage of the arrests and investigation on Romanian TV and in the print and online media, he was relatively little known inside the country until the end of 2022, when he became embroiled in an online spat with climate activist Greta Thunberg.

Tate made an ill-advised boast to Thunberg on Twitter about his collection of 33 cars. He ended the post "Please provide your email address so I can send a complete list of my car collection and their respective enormous emissions."

In a response that went viral and racked up almost 4mn likes and 300mn views, Thunberg wrote back: "yes, please do enlighten me. email me at smalldickenergy@getalife.com."

What brought the influencer to the attention of Romanians was the pizza box from Romanian chain Jerry's Pizza in the foreground of a video Tate posted to Thunberg. When he was arrested shortly afterwards, this sparked a frenzy of online speculation that the pizza box had given away his location, though prosecutors later refuted this, saying the arrest followed a months-long investigation.

Fifteen of Tate's luxury cars as well as over 10 properties and land plots have now been seized by prosecutors. A spokesperson for DIICOT confirmed to local media that the cars, including a Rolls-Royce and a Bugatti, had been seized to cover the costs of the investigation. They may also be used to compensate the alleged victims in the case if a conviction is made.

On January 11, a Romanian judge extended the Tate brothers' detention for 30 days, pointing out that due to their "financial capacity" they might flee the country for a destination that does not allow extradition.

The investigation continues. On January 12, DIICOT carried out additional house searches in the Bucharest, Ilfov and Prahova regions as part of its investigation, a spokesperson for the agency said.

Tate's defence lawyer says there is no substance to the allegations. Lawyer Eugen Vidineac told Romanian news site Gandul that the criminal investigation file had not been made available to the defence team. He claimed there is "not a single piece of evidence, apart from the victim's statement, leading to the idea that a crime of rape was committed", or evidence of human trafficking or organised crime.

As pointed out by Tate, corruption is an issue in Romania. It remains one of the more corrupt countries in the European Union – of the 27 members only Bulgaria and Hungary were more corrupt, according to Transparency International's 2022 Corruption Perceptions Index (CPI).

Some of the items found at the location where the Tate brothers were detained. Source: DIICOT/Romanian Police.

However, the country has made great strides in the fight against corruption in recent years, notably under the former head of the National Anticorruption Directorate (DNA), Laura Codruta Kovesi. Despite some controversies over the methods used by the DNA, the agency's success in prosecuting high level current and former officials has inspired efforts to replicate it in other Emerging European countries.

"There is not a single piece of evidence, apart from the victim's statement, leading to the idea that a crime of rape was committed", or evidence of human trafficking or organised crime"

Government officials eventually succeeded in removing Kovesi from the helm of the DNA, but she was then picked as the first head of the European Public Prosecutor's Office with a pan-EU mandate.

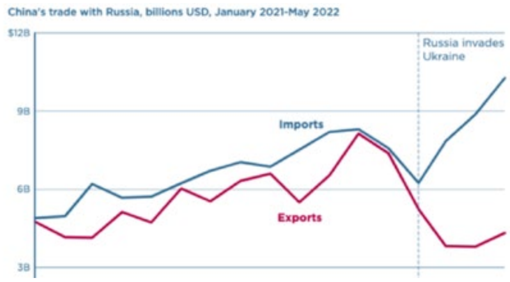
Nor is corruption tolerated by the Romanian population. The year Tate moved to Romania, 2017, was also the year that hundreds of thousands of Romanians took to the streets to demonstrate against official corruption in the largest protests the country has seen since the fall of communism.

The trigger for the protests – covered extensively by *bne IntelliNews'* correspondents in Bucharest – was government efforts to change the law by emergency decree to pardon certain sentences and decriminalise abuse of office. These were widely believed to have been tailored to help corrupt politicians. At the peak of the protests, more than half a million Romanians were out on the streets.

Romania made a breakthrough in November 2022 when the European Commission recommended terminating the Cooperation and Verification Mechanism (CVM) aimed at monitoring Romania's progress in the area of justice. The CVM was introduced after Romania and Bulgaria joined the EU in 2007 to monitor their progress on the rule of law, fighting corruption and – for Bulgaria – organised crime. Its lifting thus confirms how far Romania has come.

Progress on fighting corruption happens in fits and starts, with advances and setbacks, in Romania. But, as Tate has now found, it is far from being a haven for corrupt or criminal acts to be committed without consequences. ●

China's exports to Russia have plummeted even without formal sanctions, but imports from Russia are booming



Source: General Administration of Customs of the People's Republic of China

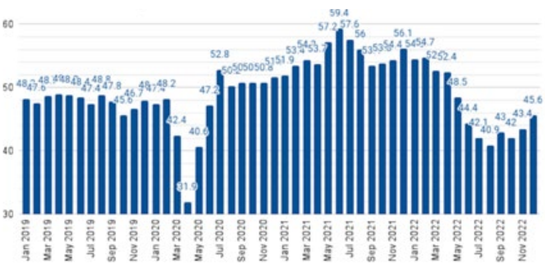
Russo-China trade up 30% in 2022, on course to hit $200bn early

Trade between Russia and China reached a new all-time high in 2022, with a 29.3% increase compared to the previous year, totalling $190.27bn, according to the General Administration of Customs (GAC) of China.

China's exports to Russia saw a 12.8% increase, totalling $76.12bn. Meanwhile, Russia's imports from China climbed by 43.4% to $114.15bn.

Russia's surplus in the trade relationship with China amounted to $38bn, a three-fold increase from 2021. The trade turnover between the two countries equalled $17.8bn in December 2022, which is a decrease of 3% compared to November.

Poland PMI



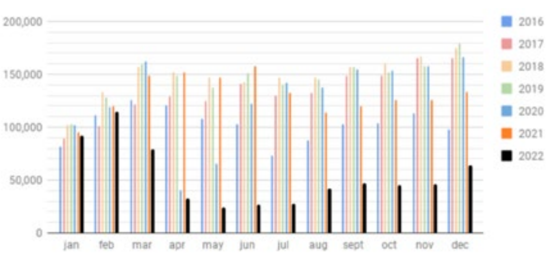
Source: S&P Global Market Intelligence

Polish industry ends 2022 in less depressive mood, PMI shows

Poland's Purchasing Managers' Index (PMI) rose 2.2 points to 45.6 in December, remaining below the 50-point mark separating contraction from growth, where it has stayed for eight consecutive months now, the economic intelligence company S&P Global said on January 2.

Output and new orders drove the December fall, while employment and purchasing continued to be cut, S&P Global said in an analysis. "However, rates of decline were generally softer than those seen in November, and there was some positive news on the inflation front as costs rose to a noticeably weaker degree," the index's compiler added.

Russian car sales (units per period)



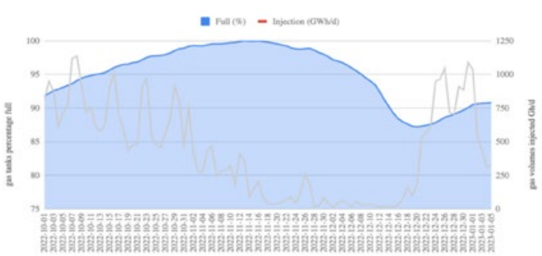
Source: AEB

Car sales in Russia collapsed by 58.8% in 2022 to 687,370 units, up by a quarter m/m

Car sales in Russia collapsed by 58.8% in 2022 to 687,370 units, the Association of European Businesses (AEB) said on January 12, as the sector continues to make a slow recovery from a collapse following the start of the war in February.

Production of cars in Russia almost completely ceased in the summer months as the sector came to a screeching halt. Most of the major international producers suspended operations and many of them have since exited the country.

Germany gas tanks full (%) vs injection (GWh/d)



Source: GIE, October 2022-January 2023

Warm weather allows Germany to refill gas tanks in the middle of winter

Record-high December and January temperatures have allowed Germany to inject more gas into its gas tanks to hit 90% full as of January 6, from 87% a few weeks ago, in an unprecedented result.

Europe has scrambled to buy LNG supplies mainly from the US and Qatar after it was plunged into an energy crisis in 2022 after Russia cut supplies of piped gas to next to nothing in the second half of the year.

Europe's average gas tank storage was 83% as of January 6 and although Europe as a whole has continued to receive new and record level supplies of LNG, it had been withdrawing gas from storage since November.

Mortality rates from the Ukraine war are highest in Russia's poorest regions

bne IntelliNews

Russian opposition publication Mediazona released a map on social media that shows the highest mortality rates from the war in Ukraine are in Russia's poorest regions.

The map shows the confirmed mortality rates per 100,000 of male population in Russia's regions after ten months of the war on January 4. The data was gathered from open sources and was verified, according to Mediazona.

The publication points out that the highest mortality rates were from Tuva and Buryatiya, two of Russia's poorest regions where the bulk of recruiting took place during Russia's partial mobilisation that started on September 21. In total at least 300,000 men were press ganged into service.

However, the affluent cities in the northwest of the country such as Moscow, St Petersburg and Moscow region are at the bottom of the mortality league.

The purpose of a "partial" mobilisation that targeted the poorest regions was an attempt by Russian President Vladimir Putin to not compromise his unspoken social contract with the Russian population: you stay out of politics and we will stay out of your daily lives.

Given that 300,000 people is 0.2% of Russia's total population of 146mn people, Putin did successfully raise fresh troops without interfering with the lives of the vast majority of the Russian population – especially those living in the European part of Russia where life goes on more or less as normal.

However, that may change. In his New Year's Eve address, aimed specifically at the Russian population, Ukraine's Defence Minister, Oleksiy Reznikov, warned that the borders would be closed on January 5, martial law declared and a mass mobilisation would begin.

Reznikov called on regular Russians to refuse to be mobilised and argued that they were not fighting for their country, but simply to keep the "criminals, murderers and rapists" out of jail. ●

Most of the Russian soldiers dying in the Ukraine war are from Russia's poorest regions. / bne IntelliNews