Five themes to watch for multilateral financial institutions

By Kalin Anev Janse, Kim Skov Jensen

15 May 2024

Europe currently faces a global landscape characterised by security threats, higher inflation, increasing environmental risks, and interest rates at their highest in more than a decade. Additionally, the rapid advancement of artificial intelligence harbours the potential to reshape much of what we do.

Against this backdrop, the role of the Chief Financial Officer in a multilateral financial institution becomes even more important. Organisations like the Nordic Investment Bank (NIB) and the European Stability Mechanism (ESM) serve different mandates but similar purposes. Both are international financial institutions that borrow and invest in markets, and both are policy-driven bodies representing sovereign countries that support mitigating the current and evolving challenges that members face.

The NIB is owned by its eight member countries, whilst the ESM by its 20 euro area member states. There are four overlapping shareholders: Estonia, Finland, Latvia, and Lithuania.

This blog post delves into five themes that our multilateral organisations mutually face in 2024 and beyond.

1. Keeping momentum in the green transition

With 2023 the hottest year on record, focus and momentum on the green transition is needed now more than ever. The Paris Agreement target to limit global warming to 1.5°C above pre-industrial levels looks increasingly ambitious. As the target year 2050 for net zero emissions looms, we need to work double time to reach that goal. This means that on the path to net zero, what is required is the equivalent of a ‘negative split’ – a racing strategy that involves completing the second half of a race faster than the first half. In other words, we need to catch up.

To achieve this, we will need to finance significant additional investments in our member countries and facilitate the allocation of capital towards sustained investments. Here, multilateral development institutions, such as the NIB, have the ability to mobilise and crowd in private investment, and have an immense role to play. As part of those efforts, the NIB has put in place a climate strategy that includes interim decarbonisation targets for 2030 to better support member countries in their transition. The ESM, which doesn't finance projects, integrates environmental, social, and governance considerations into its investment activities and financial assistance instruments. In particular, the ESM has implemented an ESG scoring approach for its investments, as has the NIB for both its lending and treasury activities.

2. Helping our member countries stay resilient

Russia's invasion of Ukraine has awakened Europe to new security threats previously thought improbable. In addition to the tragic loss of life, Russia's invasion of Ukraine has highlighted the need for Europe to invest more in its defence and physical security as well as diversify its energy supply. Geopolitical tensions have the potential to further disrupt the free flow of trade and complicate the green transition.

In such circumstances, the NIB has an important role to play in assisting member countries by financing investments in industries that build greater resilience of our economies and increase the security of member countries. By contributing to financial stability and supporting access to capital markets for euro area countries, with €422 billion in available firepower, the ESM is there to reassure markets and provide effective financial support to countries in need.

3. Funding the activities of our institutions

Higher interest rates have weighed on the budget of euro area countries and put pressure on yield spreads. Similarly, higher interest rates have increased banks' financing costs, weighed on their asset quality, and reduced demand for credit from customers. Higher yields for longer have also meant increased cost of funding for both the NIB and the ESM. This has created upward pressure on the pricing of both institutions' loans.

For both institutions, maintaining diversified funding, the highest possible credit rating, and a prudent distribution of maturities will continue to be key focal points as we navigate a challenging macroeconomic environment. At the same time, the continued exploration of new financing opportunities, such as leveraging private capital for the NIB and the addition of a commercial paper facility to its list of financing instruments for the ESM, offer possible solutions to the Herculean financing challenges of the European economies.

4. Managing risks on our balance sheet

Risks in the global economy abound. Although significant progress has been made in bringing down inflation, it is still not fully tamed, leaving the risk of continued rate volatility. Pockets of credit weakness, particularly within commercial real estate, have the potential to weigh on bank lending and stifle the broader economy.

Maintaining resilience in our balance sheets is crucial. For the NIB, stress testing, economic capital frameworks, and prudent risk-taking help bolster the bank against these risks. Guarantee schemes, and risk-sharing agreements are tools to help mitigate balance sheet risks while also not sacrificing lending volume crucial in realising the impact we strive to deliver. At the ESM, the implementation of a robust risk management system based on strict limits, the extensive use of hedging instruments, and state-of-the-art risk governance guarantee the strength of the institutional balance sheet and its flexibility to take up new tasks, should such a call arise.

5. Adapting to new technologies

The year 2023 has seen heightened innovation in artificial intelligence (AI). Despite its origins dating back to the 1950s, progress in AI had been almost imperceptible for decades, with use cases mostly confined to niches. That all changed last year with the introduction of generative AI applications like ChatGPT, Microsoft Copilot, and Gemini. Their broad utility, simplicity, and flexibility has brought about rapid mass adoption.

We are still just beginning to understand the potential of AI, but one thing is clear: finance functions must embrace technological advancements and leverage them to enhance financial and institutional processes. Implementing advanced financial systems, data analytics tools, and automation solutions can streamline financial reporting, improve decision making, and increase operational efficiency. At the ESM, an AI steering committee has been launched – attended by some members of the management board – and AI is used across the institution, from coding for our financial systems to social media creation and optimisation.

And it’s not just AI. Innovations like robotics, batteries, life sciences, hydrogen, and space travel offer enormous potential. Harnessing it will require investment in research, development, and education. Again, multilateral organisations are poised to help finance or promote these projects.

Themes shaping the future

These five themes are interwoven and have the potential to be virtuously reinforcing. Investment in the green transition by its very nature helps boost resilience by securing a diversified and reliable energy supply. Progress on these issues will also help reduce the macroeconomic and financial impact of climate and transition risks for our member states. New technologies can unlock new productivity frontiers that could help reduce the burden of transition.

The path ahead and our ultimate trajectory involves balancing audacity with prudence. We must be bold enough to tackle the hard challenges like the green transition and security threats while also safeguarding our institutions and protecting society.

New times present new challenges, but also opportunities. Multilateral financial institutions have always been at the forefront of groundbreaking change, from rebuilding after crises to investing in leapfrogging innovations. It will not be different this time.

Acknowledgements

The authors would like to thank Zach Dhruve from the NIB and Olivier Pujal from the ESM for their valuable contributions.