WORKSHOP SUMMARY

FX RISK IN DEVELOPMENT – MANAGING CURRENCY RISK THROUGH BLENDED FINANCE SOLUTIONS

EXECUTIVE SUMMARY

In February 2017, European Commission, EDFI, the OECD, Convergence, and TCX hosted members of the development community and private sector at the European Commission for one of the largest workshops dedicated to identifying and advancing best-practice foreign exchange (FX) risk solutions. FX risk is one of the most significant barriers to sustainable development in developing countries. More than 90% of debt financing to developing countries is denominated in foreign currency, causing the most vulnerable and least-equipped borrowers to bear the risk of debt crises in times of local currency depreciation.

The morning sessions of the workshop focused on the current state of FX risk in developing countries, how to deepen domestic financial intermediation in local currency, and ways to increase cross-border flows in local currency and hedged currency. Currently, developing countries face significant systemic risk due to large scale currency mismatches in the financial and public sector. Efforts in the development community have tried to deepen domestic financial intermediation in local currency, but there is still a need for systemic change in developing countries, by improving policy frameworks and addressing regulatory barriers.

The afternoon sessions of the workshop focused on barriers to scaling local currency debt and hedged equity investment. Barriers to scaling local currency debt and hedged FX debt include lack of awareness among development practitioners around the importance of the issue, dependence on enabling local macroeconomic frameworks, and the need for creativity in illiquid or otherwise constrained markets. Barriers to scaling hedged international equity investment include the availability of hedging products in the required geographies and tenors, the cost and collateral requirements for these products, and the delivery risk associated with unknown exit timing.

The workshop concluded with a consensus around three necessary actions. First, FX risk needs to shift from the most vulnerable borrowers to well-capitalized organizations that can best bear and manage the risk. Second, blended finance solutions have the potential to reduce the FX risk for developing countries and attract the investment dollars required to achieve the Sustainable Development Goals (SDGs). Third, more work is required to understand how to drive down the cost of covering FX risk and to scale proven solutions that accelerate investment needed during the SDG implementation period.

The workshop participants are committed to advancing best-practice solutions to reduce FX risk in developing countries and development finance. The workshop organizers – European Commission, OECD, EDFI, TCX and Convergence – will be coordinating efforts to maximize the impact of blended finance solutions to this problem.

SYNOPSIS

Sponsors: European Commission (EC), Organisation for Economic Cooperation and Development (OECD), Association of European Development Finance Institutions (EDFI), Convergence, The Currency Exchange (TCX)

Location: Berlaymont Building, European Commission, Brussels

Date: 1 February 2017

Participants: Over 150 participants from development finance institutions, donor organizations, and the private sector

Discussion topics:

- Current state of FX risk in developing countries
- Deepening domestic financial intermediation in local currency
- Increasing cross-border flows in local currency and hedged currency
- Barriers to scaling local currency debt and hedged FX debt
- Barriers to scaling hedged international equity investment
- Best practice blended finance approaches to achieve scale