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Thematic

Approach Paper

EBRD Local Currency Financing

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This Approach Paper is circulated under the authority of the Chief Evaluator, Véronique Salze-Lozac'h. It was prepared under the supervision of Samer Hachem, Director of Sector, country and project evaluations division, by Regina Husakova, Senior evaluator and Natalia Kryg, Principal evaluator at IEvD. Internal Peer Reviewers are Beatriz Perez Timermans and Oskar Andruszkiewicz, Senior evaluators at IEvD.

Contents

1. Rationale

The Independent Evaluation Department (IEvD) 2024-2026 Work Program and Budget[1] includes a thematic evaluation of EBRD Local Currency Financing. This document presents the proposed approach to this evaluation, based on a review of relevant strategic and operational context and portfolio analysis and preliminary scoping interviews. It also presents the administrative arrangements and expected timeline for the evaluation.

Local currency lending plays a crucial role in reducing exchange rate risks and fostering the development of local capital markets. By providing loans in local currency, international financial institutions like EBRD can help improve the creditworthiness of projects that generate local currency income by avoiding foreign exchange risk and enhance domestic economic stability and resilience. This is particularly important for supporting the private sector in countries undergoing economic transition, where local currency financing can help to build more robust and self-sustaining financial systems.

There has been an increasing focus on local currency (LCY) lending since the global financial crisis; more recent turbulences affecting the EBRD region provide new impetus for building more resilient economies. From the Global Financial Crisis (GFC) there has been an increasing focus on mitigating FX imbalances in lending, and on addressing LCY demand and supply in a systematic manner to increase the resilience of economies to crises. More recently, the post-pandemic increased inflation and tightening monetary policy, combined with a war at the heart of the EBRD region put a strain on economic recovery. These shocks also highlighted the vulnerability of minor currencies in the EBRD region to external factors.

Internally, the EBRD Local Currency and Capital Markets (LC2) strategy 2019-2024 is coming to an end. The Strategy covers the two key elements of the of the LC2 strategic initiative (money markets and capital markets development), which, over the course of its implementation, became more distinctly delineated in objectives and implementation. It is not clear that there will be a follow-up joint strategy, but the activities with their specific approaches and transition objectives are certain to continue.

The purpose of this evaluation is to contribute to both accountability and learning. Firstly, the evaluation will contribute to institutional accountability by evaluating past operations against expectations. Secondly, it will foster institutional learning by offering insights and lessons that may be relevant for the design and implementation of future operations.

This evaluation is complementary to other recent and upcoming evaluations. The evaluation delineates its scope in particular with a view to complement other evaluations where remits could overlap to avoid duplication and to build on existing findings. This concerns the upcoming evaluation of EBRD's support to Advanced Transition Countries (ATCs), where foundation-building money market activities are less relevant and focusing on more advanced capital market development activities; these ATC countries will not be within the scope of this evaluation. EU countries were also the focus of recent evaluation of MREL operations, which were to some extent implemented in LCY, especially relevant in Romania. The on-going evaluation of the Small Business Initiative (SBI) on the other hand will not be exploring the policy activities related to the

[1] BDS23-166: IEvD Work Programme and Budget 2024-2026

development of money markets, or the specifics of SME Local Currency Programme, which will be covered by this evaluation.

Previous relevant evaluation work has been considered in the preparation of this evaluation approach. The last EBRD evaluation specifically focused on LCY financing was published in 2013. Since then, the strategic and operational context of these activities has developed considerably and merits a new review. Other relevant evaluations both internal and external were reviewed, and the summary of key findings is presented in Box 1.

Box 1: Relevant existing evaluation findings

EBRD evaluations

Special Study on Local Currency Lending and Borrowing 2000-2010 (2013)

- The study highlighted the Bank's efforts in **reducing exchange rate risks and fostering the development of local capital markets by the use of LCY lending**. However, the EBRD's LCF was constrained at that time by **immature markets and significant interest rate risks** due to predominantly floating rate loans. The study emphasized **the need for EBRD to improve regulatory frameworks and strategic alignments to maximize the benefits of local currency financing** in its countries of operation.
- The study recommended to consider **taking on more interest rate and FX risks** to support local financing needs more effectively. Additionally, there was an emphasis on improving risk analysis for currency choices in projects and advocating for better coordination with other IFIs to align policies that foster local currency financing.

Special Study of the Bank Support for Local Capital Markets Development (2017)

- A 2017 evaluation showed that while the Bank has strategically emphasized LCF to mitigate foreign currency exposure risks, actual implementation has faced significant challenges **due to limited resources and complex regulatory environments.**
- The study found a notable gap between the EBRD's ambitious goals and its practical capacity to execute these strategies effectively. To enhance LCF impact, the study suggested several recommendations in relation to the improvement of the strategic framework, increased resource allocation, and strengthened collaboration with other IFIs.

Evaluations from other IFIs

- The IEG Evaluation of the *World Bank Group's Support to Capital Market Development* (2016) illustrates how effectiveness of initiatives to develop local currency bond markets hinges critically on the **interplay between market size, regulatory frameworks, and market readiness.** These factors collectively determine the adaptability and success of such interventions**, underscoring the importance of tailored, context-sensitive strategies that align closely with broader market development goals.** This variability in outcomes highlights the necessity for comprehensive planning and coordination within local economic conditions to optimize the impact of financial market innovations.
- Similarly, the *IEG Early Assessment of the World Bank Group's Experience with the IDA Private Sector Window (2021)* shows that the effectiveness of local currency financing can vary significantly based on **local financial conditions and market liquidity, underscoring, once again, the importance of tailoring financing strategies to the specific economic landscapes of developing markets**. The IDA's Local Currency Facility (LCF) has proven essential in mitigating currency exchange risks and enhancing investment viability in underdeveloped financial markets. Its substantial utilisation highlights the critical need for such mechanisms in IDA and FCS countries, where local currency solutions are often sparse. This demonstrates the acute relevance of adaptive financial tools in promoting sustainable development.

Box 2: Relevant lessons from validations

- IEvD identified 20 relevant LCF projects that were subject to IEvD validation since 2015 in search of lessons in relation to the application of LCF in previous operations.
- The vast majority of projects attributed the used LCF as evidence of additionality. This was challenged in few instances by IEvD review.
- Three lessons were identified from validations at project level:
  - **Matching revenue and debt currencies for robust economics**: Aligning revenue and debt currencies, as demonstrated in Kazakhstan, enhances project stability against FX risks. Promoting accessible and competitively priced local currency financing is essential for robust project economics.
  - **Comprehensive financial ratios**: Financial ratios in loan agreements should include all balance sheet items, such as derivatives, to accurately reflect financial performance and mitigate the impact of currency fluctuations, as seen in Turkey where the exclusion of derivatives led to a misleading debt ratio.
  - **Importance of rigorous financial planning**: Projects benefit from benchmarking input costs, performing sensitivity analyses, and using conservative assumptions to withstand economic shocks and currency volatility, ensuring funding stability even under fluctuating exchange rates.

2. Background

2.1. EBRD context

The EBRD recognises the importance of developing domestic capital markets in its establishing Agreement. This includes support to local currencies. The EBRD issued its first LCY bond in 1994 in Hungary, and followed with other currencies in subsequent years. By 2006 the EBRD had made loans in eight local currencies, including Polish, Kazakh and Russian. The Bank also engaged in policy dialogue on regulatory reforms, most notably in Russia, and worked to establish a new money market benchmark, MosPrime.

The 2008-09 global financial crisis exposed the vulnerabilities arising from excessive foreign currency (FX) lending in the EBRD's countries of operations. The 2009 Transition Report[2] highlighted how the development model's heavy reliance on FX borrowing had created risky currency mismatches. It concluded that while *financial integration cannot and should not be reversed, its risks must be better managed. This means addressing the bias toward foreign currency lending through macroeconomic policies, regulation, and the creation of legal frameworks and market infrastructures supporting local currency finance*. The report emphasised the role of sound and credible macroeconomic policies, whereby regulation limiting FX exposures does not make sense where foreign currency lending is primarily a response to a volatile inflation environment.

In 2010, the EBRD launched its Local Currency and Local Capital Markets (LC2) Initiative as a systemic multi-stakeholder response.[3] Whereas earlier EBRD efforts focused on enabling its own local currency funding and lending, the LC2 Initiative adopted a more holistic approach in

[2] EBRD: Transition Report 2009: Transition in Crisis?
[3] SGS10-142 (Addendum 1): Information Session: Local currency & Local capital market development

recognition that both supply and demand for local currency need to be developed – supporting policy reforms, upgrading legal/regulatory environments, building market infrastructure, and expanding the range of local currency instruments and investor base across EBRD countries. It would develop a diagnostic framework to underpin the policy response and reform priorities specific to each country. The 'Vienna Plus' initiative provided a cooperation platform for coordinated actions by authorities, IFIs, and private sector in the context of EU and its neighbourhood. Its Working Group on local currency developed recommendations for key stakeholders, including for IFIs to support local capital markets through the development of local currency longer-term funding instruments and markets, the investor base and own lending in local currency.[4]

The ETC Local Currency Loan Programme, launched in 2011 for eligible Early Transition Countries (ETCs), aimed to overcome high costs of EBRD's local currency funding in these markets.[5] Consistent with the objectives of LC2 initiative as well as the ETC initiative, the Programme created a donor-funded risk sharing facility that allowed the EBRD to price its ETC local currency loans closer to market rates, aiming to increase local currency lending share in ETCs. Eligibility of countries for participation in the Programme was initially tied to signing MoUs, committing authorities in participating countries to policy dialogue and programme of reforms to create an enabling environment.

In 2013, the EBRD formalized its approach through the LC2 Development Strategic Initiative and setting up a dedicated LC2 team.[6] A core focus was on properly sequencing reforms based on an analytically-grounded pyramid model – only moving to more advanced capital markets after building foundational elements like macroeconomic stability and money markets. The LC2 team was established to coordinate activities across banking, legal transition, and economics teams while supporting transactions and developing policy dialogue and technical assistance actions based on country assessments.

The 2015 Transition report entitled Rebalancing finance found growing investment gap in the EBRD region since the GFC despite increasing debt levels.[7] While the primary source of the investment deficit was identified as the external adjustment and decline on cross-border capital inflows that previously financed higher investment rates in the region, the high existing foreign currency debt exposures contributed to rising overall debt when local currencies depreciated against EUR and USD. The report also found that the level of credit dollarisation continued to be high in most countries in the region and was higher than in most emerging markets. The results of the BEPS II survey[8] highlighted the demand for foreign currency lending due to lower interest rates and longer maturities and competitive pressures on banks to meet this demand.

The ETC Programme was expanded into the SME Local Currency Programme in 2016, made available to all eligible EBRD countries[9] beyond ETCs.[10] The programme document noted that the existing ETC LCYP had allowed EBRD to increase its proportion of SME financing denominated in local currency '*from negligible in 2009 to around 50%*' in the six ETCs where the Programme had been active.[11] *Yet, despite the efforts of EBRD to increase SME financing in LCY, only about 22%*

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[4] The European Bank Coordination ("Vienna") Initiative: Report by the Public-Private Sector Working Group on Local Currency and Capital Market Development; 2011 https://www.ebrd.com/downloads/news/local_currency.pdf
[5] BDS10-323: Regional: ETC Local Currency Loan Programme & Establishment of the ETC Local Currency Risk-Sharing Special Fund
[6] BDS13-271 (Final): Local Currency and Capital Markets (LC2) Development – Strategic Initiative
[7] EBRD Transition Report 2015: Rebalancing finance
[8] EBRD's Banking Environment and Performance Survey
[9] Any country (i) where the local currency was not the Euro or US Dollar (*de facto* or *de jure*) nor tied to the Euro or US Dollar in a currency board arrangement; and (ii) which was assessed in the Bank's 2015 Transition Report as having "Large" or "Medium" transition gaps for financing SMEs.
[10] BDS15-317 (Rev 1): Regional: SME Local Currency Programme
[11] Armenia, Georgia, Kyrgyz Republic, Moldova, Mongolia and Tajikistan.

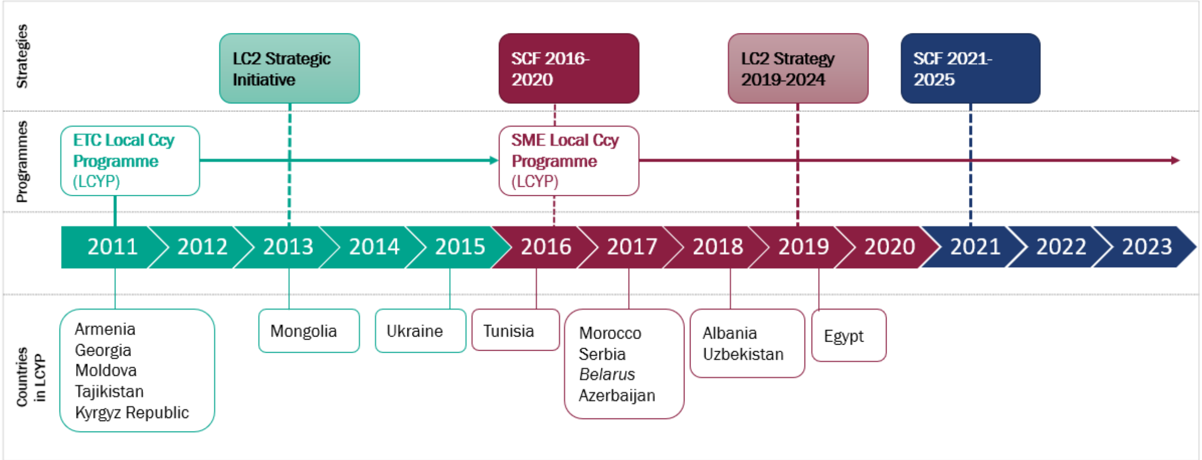
of SME financing was denominated in LCY [in all countries] in 2011-14. Therefore the Programme was extended to all eligible countries, with the objective *'to enable EBRD (and financial institutions more generally) to access local currency wholesale funding at terms that are considered competitive in the domestic markets in the current macroeconomic environment, to be intermediated to SMEs*.'

The past five years have been tumultuous for the global economy, marked by new challenges and disruptions, highlighting the vulnerability of minor currencies in the EBRD region to external factors and reinforcing the case for LCY financing. The Covid-19 pandemic in 2020 brought about widespread lockdowns, supply chain disruptions, and a sharp economic downturn. As economies reopened, pent-up demand and supply constraints led to increased inflation rates, prompting central banks to raise interest rates. This tightening of monetary policy caused fluctuations in currency markets, with the US dollar strengthening against most other major currencies. The Russian invasion of Ukraine in 2022 exacerbated inflationary pressures by disrupting global energy and food supplies, further straining the global economic recovery. Some countries in the EBRD region with economies reliant on commodity exports or remittances witnessed substantial depreciations against major currencies. Turkey and Egypt saw their currencies plummet to record lows against the dollar, eroding purchasing power and fuelling domestic inflation. The conflict in Ukraine also destabilised neighbouring economies and their exchange rates. Overall, the economic shocks of the past five years underscored the need for economic diversification, stronger institutions, and resilient policy frameworks.

Scaling up local currency finance is also on the agenda of strengthening MDB cooperation. The recent joint statement by 10 MDBs emphasised, among others, scaling up LCY finance and hedging instruments for private sector catalysation. It notes that current approaches tend to be inflexible and few institutions have the risk appetite for on-shore operations. While a few institutions including the EBRD have created local currency liquidity pools, these efforts are largely uncoordinated. AIIB and EBRD are currently working on the Delta initiative, which would create an on-shore vehicle for shared liquidity pools for multiple MDBs. *Delta would be replicating globally the EBRD approach to local currency financing combining liquidity pools with policy work to develop local markets.*[12]

[12] Viewpoint Note: MDBs Working as a System for Impact and Scale; Document endorsed by the Heads of the following Multilateral Development Banks. Washington, D.C., April 20th, 2024; https://www.ebrd.com/news/2024/multilateral-development-banks-deepen-collaboration-to-deliver-as-a-system-.html

Figure 1: Timeline of LCY strategic and operational developments



Source: IEvD elaboration

2.2. Strategic background

The 2013 LC2 Strategic initiative established clear objectives in the growth of LCY operations, linked to targeted policy dialogue.[13] The Initiative sought to achieve *more efficient and self-sustaining financial intermediation in CoO through broader use of LCY and the development of local capital markets*; this was to be measured by an *increase in the number of LCY denominated investments in total Bank operations, an increased number of transactions that contribute to the development of capital markets in CoOs and the establishment of a sustained track record of successful implementation of country assessment recommendations through targeted policy dialogue*.

The importance of the 2013 LC2 Strategic initiative was reflected in the inclusion of its tracking in the institutional scorecard.[14] The Initiative placed importance on the appropriate sequencing of reforms as well as their tailoring to each country. It emphasised the iterative nature of country assessment (diagnostics) and planning of further reforms, and the strong element of policy dialogue and advice.

Reflecting on the 2015 Transition report, the Strategic and Capital Framework (SCF) for 2016-2020[15] **pointed to the need to rebalance finance and strengthen local capital markets.** It noted that while the crisis had led to a cyclical increase in domestic funding in most banking systems in the region, more efforts are needed to rebalance finance in favour of home-grown sources through local capital market development. The LC2 initiative was therefore one of the SCF strategic priorities in re-energising transition through addressing Resilience by supporting robust economic structures.

[13] BDS13-271 (Final): Local Currency and Capital Markets (LC2) Development – Strategic Initiative
[14] The tracking of the share of Local Currency and Capital Market operations (combined) was a part of the institutional scorecard. This was later discontinued.
[15] BDS15-013 (Final): Report of the Board of Directors to the Board of Governors: 2015 Annual Meeting – Strategic and Capital Framework 2016-2020

The LC2 initiative was linked primarily to the Resilience of economies in the updated framework for EBRD mandate of Transition Impact (TI). Within this strategic period the TI framework was updated, with references to six Transition Qualities (TQ). The key contributions of LC2 activities were linked to Resilient TQ; local capital market development improves access to finance, while underdeveloped LCY markets force local borrowers and investors to take on excessive currency risk. Access to local currency financing and enhanced capital market efficiency are therefore important contributors to increasing the resilience of financial systems and economies.[16]

The LC2 Strategy 2019-24 outlined the strategic directions for the overall dual objective of the Initiative – i) increasing the share of EBRD investments in local currencies, and ii) identifying and supporting sequenced reforms in local and regional capital markets.[17] The Strategy outlined four strategic priority areas (thematic pillars): i) Upgrading Capital Markets Policy Framework; ii) Enhancing Legal & Regulatory Environment; iii) Improving Capital Market Infrastructure; iv) Expanding Product Range and Investor Base. The transition challenges and strategic priorities related to LCY and money market development are summarised in Box 3.

Box 3: Supporting LCY and Money Market development priority under the LC2 Strategy

Key transition challenges for local currency financing

1. Money market development: Money markets show limited activity directly between local market participants and often focus on operations via the central bank. Need for a diagnostic tool to assess money market development and ensure a standardized approach across IFIs.

2. Legal and regulatory reforms: Outdated legal frameworks impede the use of money market instruments like repos and derivatives. Need for reforms to enable netting, collateral, and risk management tools crucial for local currency financing.

3. Low usage of local currency: On average across [non EUR] COOs, 42% of bank deposits are still in foreign currency.[18] Adoption of sound risk management practices for local currency lending remains fragmented.

4. Lack of benchmarks and pricing: Lack of data-based sovereign yield curves and money market indices makes local currency debt pricing inconsistent. Need to bring risk pricing and management in line with international best practices.

5. Underdeveloped investor base: Limited institutional investor base like pension funds to provide demand for local currency instruments. International investors deterred by low market liquidity.

6. Government support and macroeconomic stability: Global developments and changing local market conditions can delay reforms. Macroeconomic and financial stability are essential for efficient local currency operations.

LCY priorities
Primary TQs targeted: Resilient, Well-Governed

- **Develop a diagnostic tool for money market assessments** and **coordinate efforts with other IFIs** to agree on a joint standardised approach on money market assessments and developments.
- **Reinforce the credibility of the central bank** with technical assistance and policy dialogue that will contribute towards adoption of an adequate and enabling monetary policy framework and exchange rate regime, an effective operational framework, dependable data, modelling and forecasting, appropriate governance, and a consistent communication strategy.
- **Encourage effective regulation and concerted market place coordination** through policy dialogue on money, foreign exchange and broader financial markets, technical assistance and capacity building that will facilitate easy access to and conversion of LCY, liquid FX, repos, and interest rate markets in LCY, and adequate macro-prudential measures supportive of the use of LCY.
- **Strengthen and diversify the local savings pool in LCY**, through investments, technical assistance and policy dialogue that will contribute towards creating a healthy banking sector, proactive asset managers, well recognised pension funds, and a developed insurance/life insurance sector.

[16] SGS16-275 (Addendum 1): Information Session: LC2 Update and the way forward
[17] BDS18-210: Local Currency and Capital Markets (LC2) Strategy 2019-2024
[18] In many regions, especially ETCs, dollarisation levels are even higher, pointing to less trust in / usage of the LCY.

- **Support the adoption of fair pricing and reliable benchmarks for LCY** through capacity building and technical assistance that will contribute to building the sovereign yield curve on a range of maturities, well designed and accepted money market indices, fair credit pricing and cash flow based credit analysis across market participants, and effective credit risk mitigation including through enforceable security taking.

Source: LC2 Strategy 2019-24

The current SCF (2021-25) [19] **does not refer to the LC2 initiative but continues to place importance on local currency operations without any specific targets.** The SCF considers the achievements of the previous strategic period, noting that the Bank has an *excellent track record of providing local currency financing and supporting capital market development, as evidenced by the increasing number and proportion of local currency committed investments, which stood at 30 per cent as of December 2019*. The SCF commits to broaden and diversify the financial sector by developing deeper and more liquid capital and local currency markets, and to preserve access to local currency financing in the ICA sectors. The development of local currency and capital markets is cited as an area of strong policy expertise, and is also expected to support increasing inward investment and mobilisation.

2.3. Operational background

2.3.1. Operationalisation of LCY activities

The 2016 SME Local Currency Programme outlined the operationalisation of activities related to the building of efficient money markets beyond solely SME LCY financing. The Programme was a reflection of the SCF's strategic priority placed in LC2 and represented an extension of the existing Programme that had targeted ETCs only. Within the context of the overall spirit of the LC2 Initiative, the Programme recognised the need for related policy reforms to create an enabling environment, going beyond support to SME finance only. The objective of the Programme was therefore *to support the development of local money markets and capital markets and ultimately improve financial intermediation in local currency for SMEs in the priority countries*.[20]

The Programme has three key components:

- Policy Dialogue and Technical Cooperation to Improve Domestic Financial Intermediation in LCY
- Local Currency Funding
- SME Local Currency Lending Facility

These three components are therefore useful for structuring the assessment of EBRD activities in LCY, and are reflected in the theory of change for the evaluation in section 3.2.1.

Policy dialogue & technical assistance

The SME LCYP conditioned the eligibility of countries on active engagement in policy dialogue and implementation of reforms. To participate in the Programme, countries had to sign an MoU with an Action Plan developed based on country assessments, committing authorities to active implementation. The primary counterparts for these activities are central banks, ministries of finance, and financial sector regulatory authorities. By the creation of the SME LCYP, six countries

[19] BDS20-030 (Final): Report of the Board of Directors to the Board of Governors: Strategic and Capital Framework 2021-2025
[20] BDS15-317 (Rev 1): Regional: SME Local Currency Programme

had already signed the MoUs under the previous ETC LCYP.[21] The anticipated themes of policy dialogue were related to: i) monetary policy implementation and money market creation and functioning; ii) bank regulatory framework and prudential policies with respect to FX lending; iii) development of interbank money and derivatives markets; and iv) improvements in the functioning of local currency debt markets.

EBRD has developed platforms for policy dialogue in the form of Money Market Working Groups (MMWG) since about 2018.[22] The MMWGs are a platform for interaction between the Central Bank and industry-wide market professionals involved in domestic money markets to develop domestic money markets and money market indices. In 2021 management reported running MMWGs in 10 countries, and in 2023 another report noted that post-covid MMWGs were restarted in five countries.[23]

In 2022 the approach to policy dialogue (PD) under the SME LCYP was revised from being anchored in MoUs to standardised Money Market Diagnostics Framework (MMDF).[24] As part of its annual reporting under SBI, the SME LCYP presented for Board approval changes to the approach to LCY PD. It noted that *while conceptually sound, MoUs, signed with qualifying countries' authorities between 2011-19 to guide policy engagement, had become less relevant over time in terms of anchoring and incentivising reform delivery and enabling robust monitoring*. The new approach now follows a detailed and systematic diagnostic methodology, the MMDF. This anchors local currency and local financial market development recommendations within a common framework. The MMDF is also intended to be used for monitoring progress with country re-assessments to be conducted every 3-5 years. In collaboration with CFMD, annual assessments of the quality of policy engagement, local currency sourcing and management conditions, and direction of reform developments in each country are also conducted. Participation in the MMDF is conducted following the signing of Beneficiary Agreements with central banks, committing them to support the completion of diagnostic assessments.

Funding

EBRD expanded Treasury LCY funding options and risk management approaches to enable more LCY lending. Broadening the EBRD's ability to source, manage, and hedge LCY funding aims at reducing the cost of funding and increase the availability of LCY to finance EBRD projects. The first LCY loans in ETC currencies were made possible following the creation of, and EBRD's investment in, TCX in 2008.[25] Later the EBRD Treasury started issuing bonds in some ETC currencies. Switching from a back-to-back hedging approach with TCX to a bond funding approach with the market implied switching to a more dynamic liquidity book approach, requiring a capacity for cash and liquidity management. Reports also pointed out that the ability to rely on TCX was drying up – TCX's internal guidelines limited its country concentration, margins were high, and swaps were not provided in some CoOs, so EBRD was obliged to look elsewhere. [26]

EBRD Treasury has been developing liquidity pools in local currencies to enable more competitive pricing for EBRD LCY clients. The 2013 LC2 Initiative already noted that *EBRD is one*

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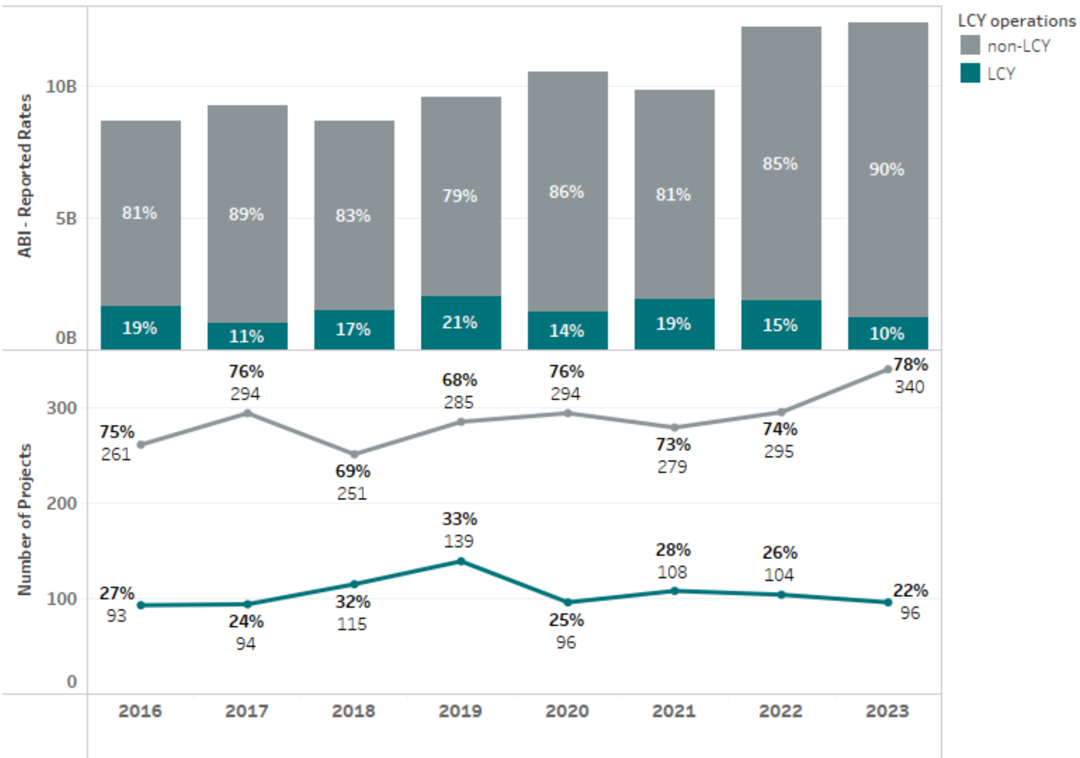
[21] Armenia, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan
[22] SGS21-096: Information Session: Local Currency & Market Building in the Context of Early Transition
[23] CS/FO/23-09: Annual Report on Treasury Activities in 2022; countries: Egypt, Morocco, Kazakhstan, Uzbekistan, Georgia, and Armenia
[24] BDS15-050 (Addendum 153): Regional: Small Business Initiative Annual Review 2021
[25] https://www.tcxfund.com/ The Currency Exchange Fund (TCX) was founded in 2007 by a group of development finance institutions to manage currency risk in developing and frontier markets. These solutions consist of financial instruments – swaps & forward contracts – that enable TCX's investors and clients to provide their borrowers with financing in their own currency, while shifting the currency risk to TCX.
[26] BDS15-317 (Rev 1): Regional: SME Local Currency Programme: The limits were especially challenging for the ETCs where TCX has been EBRD's source of currency risk management for all or majority of EBRD's SME local currency loans in Azerbaijan, Armenia, Belarus, Georgia, Kyrgyz, Moldova, Mongolia and Tajikistan

of the few IFIs which maintains and manages LCY liquidity portfolios operations in key currencies as part of its treasury operations.[27] A more recent 2019 Treasury paper made the case for the strengthening of the link between LCY funding, development of local markets, and LCY lending. It noted that efforts by IFIs in LCM development were mostly limited to creating the ability for LCY issuances but the *on-lending of the proceeds of bond issuance were hardly ever the reason to want to issue*, and the proceeds were rather just swapped back into HCY. In contrast, *the EBRD focuses first and foremost on creating a local currency loan offering that is in the best interest of our local clients.*[28] For this to happen, EBRD has to overcome the issues of lack of capacity of IFIs to borrow local currency, legal and regulatory constraints, and timing mismatches between investor demands and borrowers. Borrowing from domestic investors (mostly banks), allows Treasury *to depart from the traditional restricting back-to-back financing approach, provided we are ready to manage risks on our balance sheet to be able to borrow and on-lend at different times in different forms.*

LCY financing

The share of LCY in overall ABI debt operations in 2016-23 has been at 16% on average, and with no significant trend. In absolute value, the LCY ABI was an equivalent of over €12.5bn in the 2016-23 period. LCY operations represented 27% of debt operations in terms of number of projects on average. Financial Institutions (FI) represented the biggest share of LCY investment (40%) over the period, followed by Sustainable Infrastructure (SI) operations (36%). SME operations represented on average 26% of LCY ABI annually. (Annex 3 for LCY portfolio overview)

Figure 2: Share of debt ABI and number of projects in LCY, 2016-2023

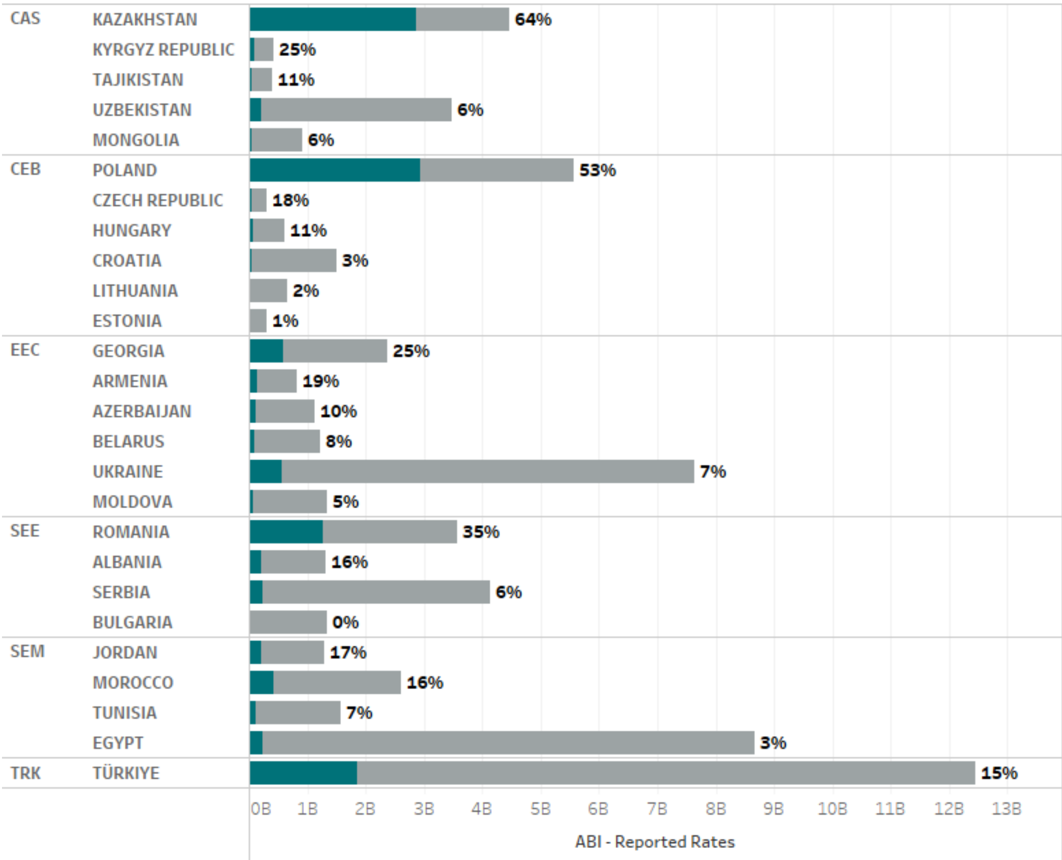


NB: ABI includes debt and guarantees only, equity excluded; source of data *dw_banking_operational;* LCY ABI identified based on LCY flag at OpID level

[27] BDS13-271 (Final): Local Currency and Capital Markets (LC2) Development – Strategic Initiative
[28] EBRD (2019): Local currency finance: Development must or nice to have?

In countries with LCY operations, the average share of LCY in debt ABI over the 2016-23 period was 15%. Two outliers where LCY represented over half of ABI were Kazakhstan and Poland (64% and 53%). (Figure 4) This variability of the share of LCY in debt ABI is one of the characteristics underpinning the selection of case studies in section 3.3.

Figure 3: Share of LCY in country debt ABI in 2016-23



NB: ABI includes debt and guarantees only, equity excluded

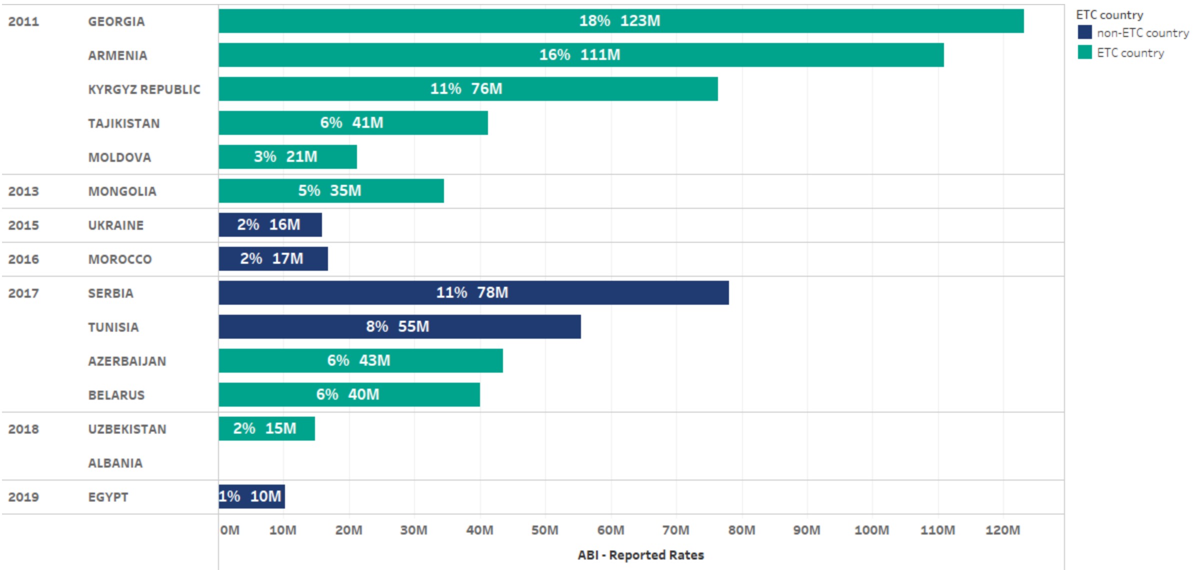
SME LCY lending is supported by the SME LCY Programme (LCYP). The SME LCYP extended the use of the Local Currency Lending Facility. The existing Facility for ETC LCYP was extended for the use of the SME LCYP as well with some adjustments. The size of the Facility was set at USD 500m[29] on revolving basis complemented with donor risk-sharing funds at USD 62.5m. While open to all SME LCYP countries, at least 85% was to be committed in ODA-eligible countries per OECD classification.

The eligible projects in SME LCYP are projects in Small Business Initiative financing frameworks for both intermediated, direct, and risk-sharing SME financing (FIF, DFF, RSF). The purpose of the Special Fund resources (donor risk-sharing) is to provide first loss guarantee on the portfolio of eligible projects. The operational objective of the donor support within the Facility is to reduce the loan interest rate on EBRD's local currency loans towards domestic market rates.

[29] On a revolving basis, lesser of (i) USD 500 million and (ii) 8 times the available balance of donor funds in the SME Local Currency Special Fund.

SME LCYP represented a total of €682m in ABI over the 2016-23 period, with three quarters in ETC countries. The countries which had joined under the previous ETC LCYP in 2011 (Armenia, Georgia, Moldova, Tajikistan, Kyrgyz Republic) still represented the majority (55%) of SME LCYP ABI in the 2016-23 period. Overall, despite the eligibility of the Programme being extended in 2016 beyond ETCs, ETC countries represented 74% of ABI and 88% of projects under SME LCYP. (Annex 3 for LCYP portfolio overview)

Figure 4: SME LCYP total debt ABI by country and year of joining, 2016-23



NB: ABI includes debt and guarantees only, equity excluded; SME LCYP ABI identified based on the "Local currency risk sharing" product indicator

2.3.2. Organisational set-up

The LC2 strategic initiative created a dedicated LC2 team to coordinate LCY activities distributed across teams. The responsibilities for the implementation of the LCY-related activities were distributed across a number of teams within the Bank, as outlined in the LC2 initiative.[30] Banking was responsible for delivering the quantitative measures of the Initiative, represented by the inclusion of the share of LCY projects in the institutional scorecard.

Treasury is an active market participant, engaging in a *broad range of debt market transactions, as an investor as well as a borrower in money, FX, bond and derivatives markets*. It maintains and manages EBRD's LCY liquidity portfolios. In addition, Treasury engages in creating enabling environment through policy and technical cooperation. The economist department (then OCE) contribute to country assessments and policy dialogue. The legal team (OGC) contributes through Legal Transition (LTT), Finance team and Banking teams. The newly created LC2 team was tasked with *identifying and supporting sequenced reforms and policies that contribute to the development of efficient and self-sustaining local capital markets, including the increased use of LCY*, and systematically engaging with banking transactions related to LCY.

In 2020, the LC2 team was reorganised and renamed Capital Markets Development (CMD) team, and the delineation of responsibilities with Treasury was further defined. This reorganisation meant more focus of the CMD team (later further renamed to Capital and

[30] BDS13-271 (Final): Local Currency and Capital Markets (LC2) Development – Strategic Initiative

Financial Markets Development team, CFMD, following the integration of a financial sector reform pillar) on capital markets policy, legal and regulatory environment, expanding product range and investor base, strengthening the local financial sector and improving capital market infrastructure. The team also developed and maintains the Financial Market Development Index (FMDI), a tool to measure progress over time as well as the impact of reforms. The Treasury focuses on policy activities related to money markets: '*a clearer split was created between the activities of Treasury, focussed on the foundations of local currency through both onshore activity and policy dialogue related to monetary policy implementation and money market creation/functioning and the distinct activities of the CMD team.'*[31]

3. Evaluation approach and methods

3.1. Evaluation objective and scope

The objective of the evaluation is to identify the merits of EBRD local currency operations. The evaluation will assess the relevance, additionality, effectiveness and efficiency of the LCY operations, recognising their multifaceted nature comprising not only lending activity but also policy dialogue and funding operations, which are intrinsically linked to the expected transition impact . This means evaluating the LCY lending against its objectives but also evaluating the wider strategy for the promotion of LCY lending, which includes lending, funding and policy activities.

This evaluation will contribute to the understanding of the factors that influence the success of LCY financing. The evaluation will review the operations related to local currency financing in particular, including lending, funding and policy contributions. It will examine the factors that influence the success and growth of LCY financing, with the understanding that in this particular area such factors may be outside of EBRD sphere of influence more than in others. This will also enhance the relevance of the evaluation going forward, with the planned expansion of EBRD operations to new countries in Sub-Saharan Africa.

The subject scope of the evaluation covers the three key components of the Local Currency Programme: Lending, Funding and Policy activities related to Local Currency. The evaluation will focus on the three pillars of LCY promotion as presented in the SME LCYP (2016) and later in the LC2 Strategy (2019):

- In terms of LCY lending, this will cover all EBRD LCY lending within the geographic scope of the evaluation, including project lending, not only SME or FI intermediated lending. This includes investments in LCY bond issuances where relevant. The focus will be on assessing the ability of the Bank to provide a choice of flexible, competitive products in LCY to clients. To the extent possible, the link to promoting inclusion in access to finance will be explored.
- In terms of LCY funding, this will cover the sourcing of LCY by the Treasury, and the focus will be on the contribution of these activities to both EBRD lending competitiveness and to the development of domestic currency markets, rather than on the implications of these activities for EBRD's own balance sheet and risk management.
- In terms of policy dialogue and technical cooperation, this will the cover the elements related to the development of risk management products and building benchmarks to

[31] CS/FO/21-36: Annual Report on Treasury Activities: 2020-2021

strengthen money market functioning, as implemented largely by EBRD Treasury, and their contribution to systemic/transitional change. It is understood that other market development activities as implemented by the CFMD team will not be possible to be fully separated in all cases, especially for legal and regulatory contributions, and these will be considered to the extent feasible and essential for the understanding of the developments of LCY markets.

The geographic scope of the evaluation covers countries included in the SME LCYP programme or eligible for inclusion, outside of the EU. The SME LCYP programme currently comprises 14 countries of operations.[32] To be a part of the Programme, the authorities of these countries expressed their commitment to cooperate with the Bank in respect of the Programme and facilitate diagnostic assessments of macroeconomic policies, legislation, regulation and practices required to improve, broaden and deepen local financial intermediation and financial markets. This was initially actioned via MoUs/ Action Plans, and more recently through money market diagnostic framework Beneficiary Agreement. These agreements serve as a basis for the policy dialogue and technical cooperation in the area of domestic currency markets development and are therefore indicative of countries where this work is relevant and where there is political will on the side of authorities to engage with EBRD on reforms.

In addition, there are five COOs eligible for participation in the Programme, which are not formally part of it.[33] Nevertheless, two of these already completed the MMDF.[34] These countries can provide a useful reference comparison in terms of the extent of policy dialogue and volume of LCY financing.

Table 1: Geographic scope of the evaluation

	Evaluation scope		Out of scope
	Countries in LCYP	Countries eligible for LCYP	Other countries with LCY activity
ETC	Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, Uzbekistan	Turkmenistan	
Non-ETC	Albania, Egypt, Morocco, Serbia, Tunisia, Ukraine	Jordan, Kazakhstan, Lebanon, North Macedonia	Bulgaria, Czech Republic, Poland, Romania, Türkiye

This geographic scope also reflects other relevant current or recent IEvD evaluations in terms of complementarity. IEvD is launching an evaluation of EBRD operations in Advanced Transition Countries (ATCs) this year – this will also assess capital markets development activities beyond LCY, which are more relevant in these countries, and include Poland as one of the largest LCY countries, which is not part of the LCYP due to its advanced stage of development. Similarly, the recent evaluation of MREL operations covered LCY operations in Romania, another large EU LCY country, where the majority of LCY investments have been part of the MREL programmes.

The time scope of this evaluation covers the period of 2016-2023. The expanded SME LCYP was launched in 2016 and represents a realistic milestone of the articulation of the approach and

[32] Albania, Armenia, Azerbaijan, Egypt, Georgia, Kyrgyz Republic, Moldova, Mongolia, Morocco, Serbia, Tajikistan, Tunisia, Ukraine, Uzbekistan. Belarus joined the Programme in 2017 but EBRD operations in Belarus were suspended in 2022.
[33] Jordan, Kazakhstan, Lebanon, North Macedonia, Turkmenistan. According to information from the SME LCYP team, Kazakhstan and Jordan will join the Programme this year.
[34] Jordan, Kazakhstan

expectations of the LCY operations along the three key pillars of Policy, Funding and Lending. The same year was also the start of a new institutional strategic period (SCF), representing overarching institutional priorities. Finally, the time scope is long enough to be able to capture some developments and outcomes in the policy reform area, which are commonly delivered on longer timeline than those of investment operations.

3.2. Evaluation design

3.2.1. Evaluation approach

The evaluation will follow a mixed methods theory-based design. This approach combines quantitative and qualitative data collection methods to provide a comprehensive understanding of the performance of the operations and the underlying causal mechanisms. The theory-based aspect involves reconstructing the program's theory of change, which articulates the logical sequence of inputs, outputs, and intended outcomes. This serves as a framework for assessing the design, implementation, and progress towards achieving the objectives of LCY financing.

By triangulating data from various sources, including document reviews, interviews, portfolio analysis, and market data, the evaluation aims to validate the theory of change, and identify contextual factors that may have influenced the achievement of outcomes. This approach not only evaluates the effectiveness (achievement of expected results) but also explores the reasons behind the successes or challenges, enabling evidence-based recommendations for future operations.

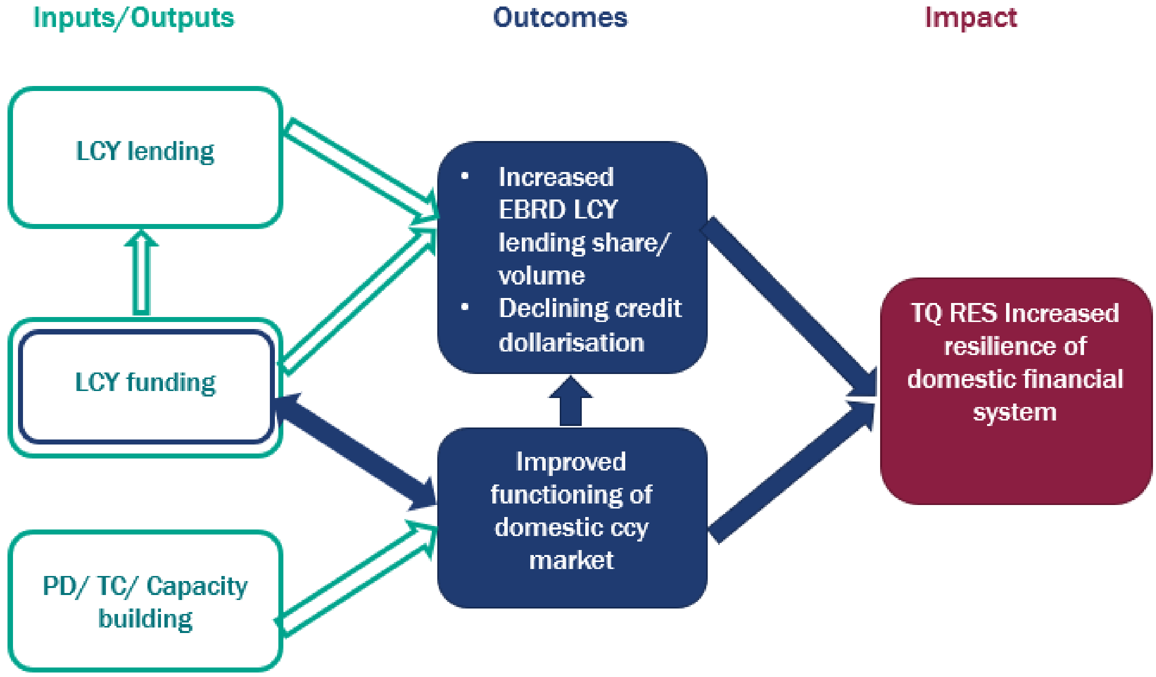
The reconstructed theory of change (ToC) is based on the three pillars of LCY operations and recognises their non-linearity. The ToC is reconstructed by IEvD for the purpose of this evaluation. It is based on the reading of key documents articulating the approach and expectations from LCY operations[35], and preliminary scoping interviews with Treasury and CMFD teams. While commonly ToCs follow a simplified linear format of inputs > outputs > outcomes, it is important to recognise in this case the intended non-linearity of these operations. This means that the outcomes of some activities represent also an input to others. This interplay between the main pillars of the LCY operations was articulated e.g. in a recent presentation:[36]

- **LCY lending**: The EBRD established institutional capacity to lend in local currency to help improve the creditworthiness of projects, which solely generate local currency income by avoiding FX risk, and to enhance domestic economic stability and resilience.
- **LCY funding**: To offer relatively affordable local currency loans in incomplete markets with features that meet borrowers needs EBRD develops liquidity pools where possible.
- **Policy Dialogue and Technical Cooperation**: LCY lending and funding requires capacity to manage market risks with domestic counterparties, which cannot happen without functioning domestic currency markets. Thus, the need to support local market development, starting with money and derivatives markets.

Figure 5 presents the schematic ToC outlining the results chain and the linkages between the pillars.

[35] Primarily the SME LCYP programme document and related reporting, LC2 2019 Strategy, Annual Treasury reports
[36] SGS22-149: Scaling up Local Currency Financing: Session I – Policy Dialogue

Figure 5: Simplified Theory of Change for LCY operations



Source: IEvD elaboration

The ToC relies on a set of assumptions not all of which are within the control of the EBRD. For the desired outcomes to materialise, more than just EBRD inputs need to be in place. There are factors that facilitate progress, including the actions of authorities and other market actors, as well as broader context. The evaluation will attempt to identify these factors and their influence on the achievement of LCY objectives. The recent paper summarising the EBRD experience in Georgia provides some insights of the factors that contributed to what is considered a successful cooperation by both Treasury and Georgian authorities:[37]

- Continuity of action and support in implementation;
- Active market participation by EBRD;
- Legal reform;
- Supportive political and macroeconomic environment.

Annex 2 presents more detailed content for the components of the ToC.

3.2.2. Evaluation Questions

The evaluation will address an overarching Evaluation Question.

[37] EBRD (2024): Building the foundations for financial market development: a retrospective of more than 10 years of EBRD engagement in Georgia; https://www.ebrd.com/financial-market-development-in-georgia.pdf

To what extent have EBRD's local currency activities contributed to enhancing the resilience of clients and financial markets in its countries of operations?

The overarching question will be answered through three evaluation questions addressing primarily the evaluation criteria of relevance and additionality, effectiveness and impact, and efficiency.

EQ1: To what extent have EBRD activities in LCY financing been additional and adapted to the needs of countries of operations?

This question will assess the relevance and additionality of EBRD LCY operations in COOs. Rather than general relevance and link to EBRD's own mandate, which are unlikely to be disputed, and are discussed fairly comprehensively in EBRD's strategic and programme documents, this question will look more closely at relevance to the specifics of individual countries and clients. This means for example assessing whether the nature of policy dialogue was adapted to individual countries' context in terms of its ambition and objectives.

This also means a look at EBRD's own strategic prioritisation and link of LCY activity to country strategies and prioritisation of non-transactional policy. If there is little LCY activity where high needs/ transition gaps are identified, what are the external factors that prevent EBRD from engagement? At the level of clients, looking at whether EBRD LCY operations were targeted at clients who were exposed to elevated FX risks where reducing these through LCY lending is most/ least relevant. Closely related is the assessment of EBRD additionality – offering products at competitive prices that are additional to the market without crowding out private lenders. Have new EBRD LCY funding approaches been additional to existing TCX options to provide EBRD with options to better match clients' needs?

EQ2: To what extent have EBRD LCY activities contributed to the expansion of LCY use in COOs and to the sustainable development of domestic money markets?

In the first order, this question examines the effectiveness of EBRD LCY financing i.e. the response to the declared objective of increasing the share of own LCY lending to clients. The portfolio analysis already shows that the answer to this question is not the same across countries. Overall there appears to be some decline in LCY activity in the most recent years from the peak in about 2019. What are the internal and external determinants in this regard? For SME LCYP specifically, while extended beyond ETCs since 2016, ETCs still dominate in its utilisation – what are the key factors that hinder uptake in non-ETC countries?

This is then related to the broader expected outcomes of the LCY activities across the other two pillars of Funding and Policy engagements. As discussed in the Theory of change, the outcomes of these operations are reinforcing and facilitating progress in a mutually dependent way. This question will look at whether and how the increase of EBRD LCY lending activity can be traced to new ways of funding through loans, bond issues or derivatives, and how patterns of LCY lending have changed (e.g. benchmarked to reliable domestic rates). Has the base of EBRD LCY clients expanded? How did EBRD hedging / funding position adapt to local market characteristics? Did EBRD activities have catalytic/ demonstration effect on other lenders/ local banks? To what extent did total credit in the economy move towards LCY (decline in credit dollarisation)?

EQ3: To what extent have EBRD LCY activities been efficiently executed and delivered value for EBRD and its counterparts?

This question will examine selected issues of efficiency relevant to LCY operations. This includes the financial performance of LCY lending (share of NPL), and the utilisation of donor funds including the LCYP risk guarantee (SME Local Currency Special Fund). Elements of internal incentives for the promotion of LCY lending and their efficiency will be discussed. Coordination/ cooperation with other IFIs e.g. via joint diagnostics or division of labour will be evaluated at country level with a view to understand improved complementarity where possible. Internally, the coherence between activities of different departments, most prominently Treasury and CFMD, will be considered.

3.3. Evaluation methods

This evaluation will use a combination of analytical tools, including – portfolio data analysis, systematic desk based country reviews covering all countries in scope; in-depth country case studies for selected countries, and interviews with relevant internal and external stakeholders.

Country reviews

A country review will be developed in a standardised format for each country within the scope of the evaluation. Given the considerable variance between countries in the portfolio in terms of LCY lending and policy, this broad approach will allow for capturing the links between country priorities, activity, contextual developments and factors facilitating/hindering LCY operations. The reviews will therefore strive to capture not only what progress has been achieved through LCY operations, but what are the factors in countries where little activity may be taking place. Each overview will be 2-4 pages, depending on country specifics, including:

- Overview of EBRD approach:
  - Country and policy strategic priorities linked to LCY,
  - LCY portfolio analysis,
  - LCY funding activity, diagnostics and advisory.
- Trends in contextual data relevant to domestic market developments, including e.g. data/trends on:
  - Credit/ deposit dollarisation; Domestic interest rates, extension of maturities, spread over policy rate; LCY exchange rate and Inflation;
  - Trend in EBRD Financial Markets Development Index; trends in the 'direction of travel metrics' as per CFMD assessment where available.
- Summary of key factors affecting LCY operations, e.g.
  - Contextual developments, Policy measures (FX controls present, Inflation targeting), regulatory or legal gaps, etc.

The main sources of data for Country reviews will be:

- Document review – Country strategies, Policy compacts, Country Strategy Delivery Reviews, Project documents and monitoring, Annual Treasury reporting, Capital Markets country briefs (developed by the CMFD team), SBI/SME LCYP reporting;

- Banking data on lending, Treasury data, Financial Markets Development Index trend data, Contextual data publicly available;

- Interviews with country Banking on LCY operations within local context.

Country case studies

In-depth country case studies will be developed for 3 countries. The case studies will develop the evaluation of EBRD LCY operations in more detail, supported by field missions to allow for interviews with key country counterparts, including the Central Bank, other relevant authorities, local partner FIs, and selected EBRD clients. To the extent possible, interviews with stakeholders not directly involved with EBRD operations, such as non-partner FIs or business associations will be added for local context. If possible and context-suitable, local FI partners or clients may be addressed through a survey to allow for standardised data collection.

The selection of countries for the case studies is purposeful, and intended to reflect the diversity of contexts and EBRD approaches that exists within countries in the scope of this evaluation. The countries and the key selection criteria are presented in Table 2. More detailed LCY portfolio data on the selected countries are in Annex 3.

Table 2: Selection of case study countries

Country	Key characteristics
Armenia	• ETC country; EEC region • Explicit LCY country strategic objective under past CS (2015-2018) • Part of SME LCYP; joined in 2011 (then ETC LCYP) • Has conducted MMDF assessment; MMWG established • Approximately average LCY share of operations: over 2016-23 LCY represented 19% of debt ABI • Majority of LCY finance through SME LCYP
Kazakhstan	• Non-ETC country; CA region • Explicit LCY country strategic objective under past CS (2017-2021) • Not part of SME LCYP but eligible • Has conducted MMDF; MMWG established • Significant share of LCY operations: over 2016-23 LCY represented 64% of debt ABI • Majority of LCY finance in infrastructure
Morocco	• Non-ETC country; SEMED region • Part of SME LCYP, joined 2017 • No MMDF yet; MMWG established • Approximately average share of LCY operations: over 2016-23 LCY represented 16% of debt ABI • Majority LCY finance in FI sector, 22% in ICA, 9% SI

Interviews

The evaluation will also make use of interviews for collection of non-country specific information, including:

- Internal EBRD stakeholders, including Treasury, CFMD, Economists, Risk and Banking;
- External stakeholders, including IFIs, TCX, and subject experts.

Possible cross-evaluation case study

Resourcing permitting, an additional case study would be developed between this evaluation and the Phase 2 of the evaluation of the Small Business Initiative focusing on effectiveness. Such case study would be designed to feed into both evaluations, and, for this evaluation, examine the evaluation questions with a specific support to SMEs lens, possibly in one selected country of operations.

3.4. Limitations

The evaluation will rely on the cooperation of EBRD teams engaged in LCY activities, especially EBRD Treasury and Banking. This includes the provision of information on policy activities conducted in the countries of operations within the scope of the evaluation, and the provision of data on Treasury funding activities over time. IEvD will also rely on the cooperation of Treasury and Banking in providing contact with counterparts in the countries of operations, including relevant authorities and partner institutions. While the cooperation of various EBRD departments is a necessary part of any evaluation and not a limitation per se, potential strained resources and capacity for collaboration could limit the data available to IEvD.

There may be limited data availability on relevant contextual indicators related to money markets and their development over time, or this data may not be available for all countries or consistently.

More broadly, this evaluation recognises that this area, perhaps more than other areas of EBRD activity, is subject to the influence of multitude of external factors. Establishing a direct attribution between EBRD activity and transitional progress is not likely to be possible in many cases.

The focus will be on discussion of the three pillars of EBRD activity underpinned by quantitative indicators where possible, and contribution analysis along the lines of the Theory of Change. The evaluation will also endeavour to identify those external factors that facilitate or hinder the progress in this area, whether these are somewhat under EBRD control or not.

4. Administrative arrangements

4.1. Evaluation team

The evaluation will be led by Regina Husakova, Senior evaluator at IEvD. The evaluation team will further include Natalia Kryg, Principal evaluator at IEvD, and will be supported by an independent consultant(s) with expertise in international finance.

Samer Hachem, Director of Sector, Country and Project division will provide overall guidance on the evaluation, in close coordination with the Chief Evaluator, Véronique Salze-Lozac'h.

Internal peer reviewers include Beatriz Perez Timermans, and Oskar Andruszkiewicz, Senior evaluators at IEvD. Independent external peer reviewer will be identified at a later stage.

IEvD will follow established protocols for key communication with focal points on the Management side in Impact and Portfolio Management. For working day to day relationship, IEvD will request Management to nominate counterparts in Treasury and Banking.

4.2. Timeline

Milestone	Delivery
Approach Paper finalised	End of July 2024
Desk reviews	July – September 2024
Case study visits	Oct-Nov 2024
Draft Report for internal comments and peer review	February 2025
Draft report for Management comments	March 2025
Final report	April 2025
Final report distributed and presented to the Board	**May 2025**
External publication of the report, dissemination activities	from June- 2025

ANNEXES

Annex 1. Evaluation matrix

EQ	Judgment Criteria	Indicators	Sources
EQ1: Relevance & Additionality	Relevance to country context	• Policy dialogue objectives based on diagnostics, appropriate for country specifics (incl. macroeconomic context, FX regime) • Links of LCY operations to country strategies and policy priorities • Alignment of activities with gaps in Capital Market briefs and through Financial Markets Development Index assessments	Country overviews/ Country case studies (incl. review of country diagnostics and action plans) Country strategy review, PPOs/policy compacts Document review Interviews – Treasury, Banking
	Financial additionality	• Profile of EBRD LCY lending – maturities, pricing, competitiveness vs. market (local banks) • Utilisation of LCYP guarantee for SMEs • Additionality to clients – flexibility, decreased FX risks	Country case studies Analysis of available market data – proportion offshore, proportion onshore, spreads between different issuers, analysis of offtake (increased variety of LCY investors?) EBRD data Interviews – Clients, PFIs
EQ2: Effectiveness	Increased LCY lending share/ volume	• Variety and adequacy of instruments in LCY (incl. risk sharing, guarantees, synthetic ccy) • EBRD LCY lending trends • Adequacy of LCY pricing; EBRD risk policy supportive of LCY operations • Reduction in LCY interest rate spreads • Increased LCY lending in local PFIs, evidence of demonstration effects	Portfolio analysis Country overviews/ Country case studies EBRD data on PFI lending Interviews – Clients, PFIs, Banking
	Improved functioning of domestic currency market	• Systematic approach to reform based on diagnostics and implementation of recommendations, incl. capacity building • Contributions to effective regulation supportive of the use of LCY	Country case studies Interviews – country stakeholders including Central bank, banks and Treasury

		• MM indexes developed • Instruments indexed to new benchmarks • Reduced credit/deposit dollarisation • Improved Financial Market Development Index score • Volumes on the market (intra-bank lending, SWAP market)	Interviews – Treasury, Country counterparts/ authorities, PFIs, IFIs
	Effective LCY Funding	• Creating preconditions for LCY issuance (by IFIs) in the domestic market • LCY bond issuances & characteristics (index, type of investors, size, tenor) over time • Liquidity pool dynamics • Lower cost of funds achieved • More flexible and attractive loan features for EBRD's local currency borrowers • Increased EBRD access to domestic markets	Country overviews/ Country case studies Interviews – Treasury, Banking, CFMD Legal & Regulatory team Treasury data
EQ3: Efficiency	Financial performance of LCY operations	• NPL ratios • Utilisation of donor funding, incl. LCYP guarantee	EBRD data
	Internal coherence	• Coherence and coordination of activities between departments • Efficiency of internal incentives for LCY lending	Interviews
	IFI coordination	• Instances of IFI coordination at country level (joint diagnostics, division of labour, etc.)	Interviews

Annex 2. Theory of Change

The schematic diagram of the Theory of Change outlined in Section 3.2.1 presents the linkages between inputs outputs and outcomes in the LCY operations, including their non-linearity.

This table complements the ToC with more detailed, if non-exhaustive, list of components within the ToC blocks.

Components of the Theory of Change for LCY operations

Inputs/ Outputs	Outcomes	TI/ Impact
Input: LCY Lending		
Outputs • Competitive, flexible, commercially viable LCY products • LCYP risk guarantee	• Increased EBRD LCY lending volume/ share and type; • Increased EBRD LCY SME lending volume/ share • Increased LCY lending by local FIs • Increased LCY lending/ holding by other IFIs	TQ RES
Input: Policy Dialogue, Technical Cooperation, Capacity Building		
Outputs • Undertaking of diagnostics and dialogue with partners • MoUs/ Action Plans agreed • Development of MM diagnostic tool • MM diagnostics and periodic revisions • Money Market Working Groups (MMWG) establishment and participation	• Systematic approach to reform based on diagnostics and implementation of recommendations • Movement away from detailed road maps and standard approaches towards flexible, dynamic dialogue with the Central Bank using the MMWG as a convening mechanism • IFI coordination	TQ RES
• MM indices development • Derivatives legal reform • Development of spot and forward markets in FX • Development of yield curves in LCY for which no reliable curves exist for fixed i.r. transactions pricing; pricing analytics	• Well-designed and adopted MM indices – credible Interest Rate Reference, Overnight Index Swap • Fair pricing and reliable benchmarks in LCY; Instruments indexed to new benchmarks • Legal framework developed ensuring the enforceability of derivatives (including close-out netting) and availability of collateral • Standard Master Repurchase Agreements have been developed • Effective credit risk mitigation including through enforceable security taking • Catalyst to other IFIs based on increased liquidity and better defined risk-free rates	TQ RES

	• Decreased credit/ deposit dollarisation	
• Financial risk education programme for Fis • Workshops for banks on financial risk topics such as asset and liability management, derivatives, bank regulation and liquidity management and funds transfer pricing	• Fair credit pricing and cash flow based credit analysis across market participants	TQ RES
Input: LCY Funding		
Outputs • Creating preconditions for LCY issuance (by IFIs) in the domestic market; legal infrastructure for LCY bond issuance • LCY bonds issuances • Warehousing of risk through liquidity pools thereby providing more flexibility to volume and timing by borrowers. Increasingly proactive management of such pools through an increased range of instruments (derivatives repos in addition to swaps) • Creating relationships with authorities and market participants facilitating funding • Cross-ccy swaps with local banks	• Legal framework developed allowing for IFI bond issuance in local currency in domestic markets • Lower cost of funds; more flexible and attractive loan features to EBRD's LCY borrowers • Convergence of interest rates in LCY between Central Bank rates and spreads offered by other lenders including local banks and IFIs • Increased EBRD access to domestic markets	TQ RES

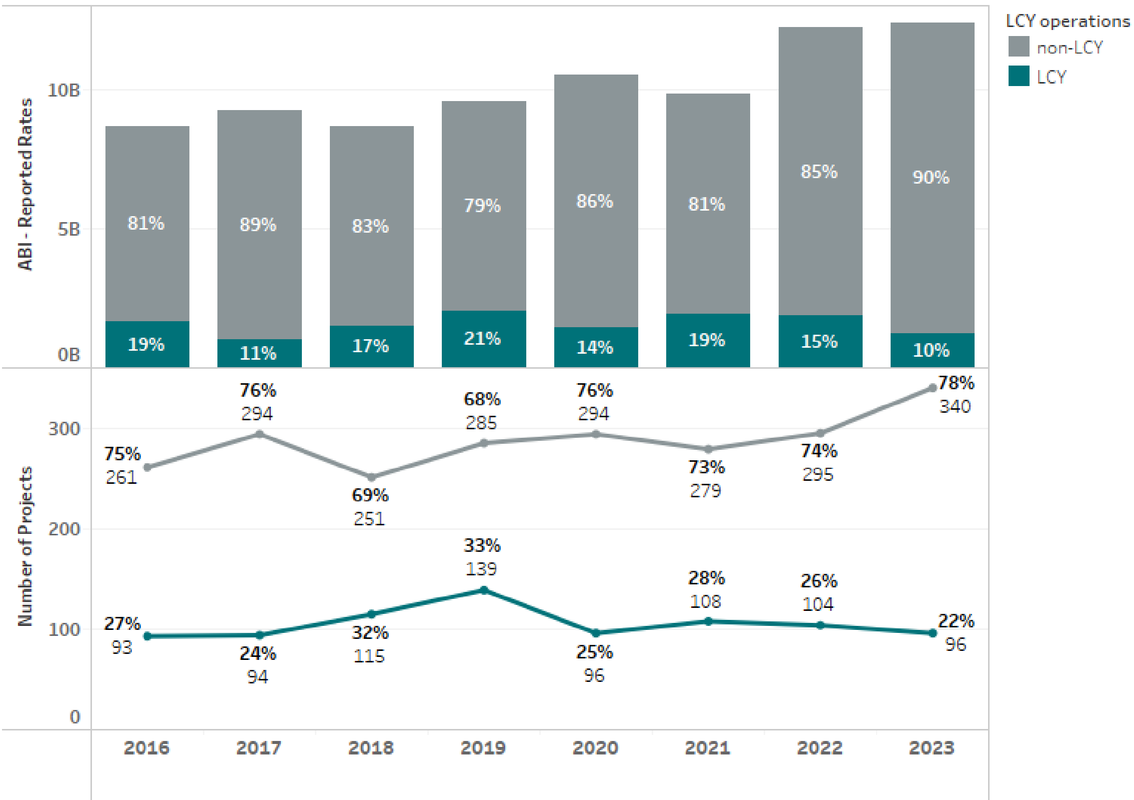
Annex 3. Portfolio analysis

NB: All data sourced from dw_banking_operational unless otherwise indicated. Operations in LCY identified based on the LCY flag at OpID level unless otherwise indicated.

LCY investments volume and number of operations

The share of LCY in overall ABI debt operations in 2016-23 has been at 16% on average, and with no significant trend. The peak year for LCY operations was 2019 when they represented 21% of debt ABI. Conversely, the most recent year registered notable drop in LCY ABI at 10% of overall debt ABI, the lowest in the whole period. In absolute value, the LCY ABI was an equivalent of over €12.5bn in the 2016-23 period. LCY operations represented 27% of debt operations in terms of number of projects on average, with a maximum of 33% in 2019. (Figure 2)

Figure 6: Share of debt ABI and number of projects in LCY, 2016-2023

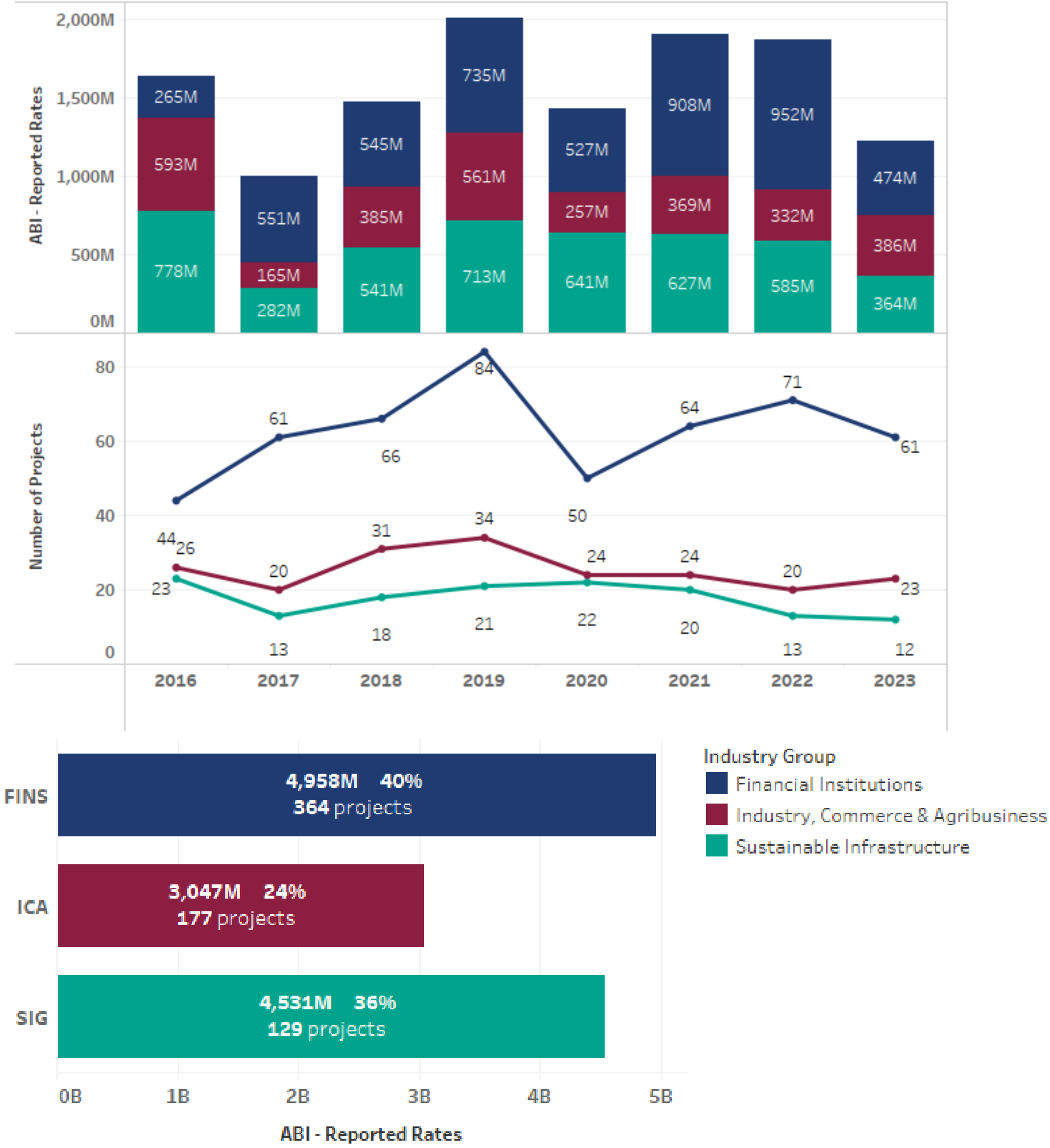


NB: ABI includes debt and guarantees only, equity excluded

LCY investments by sector, portfolio class and product

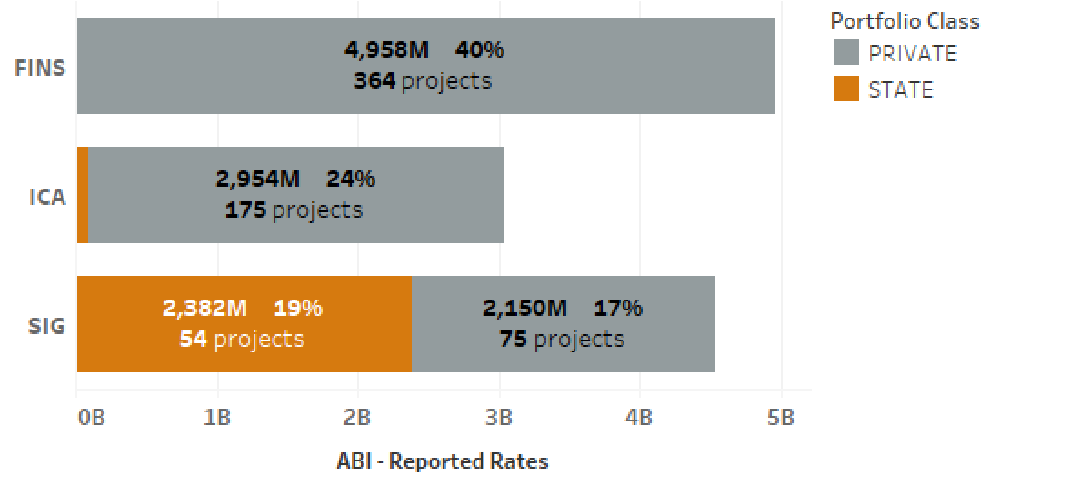
Financial Institutions (FI) represented the biggest share of LCY investment (40%) over the 2016-23 period, followed by Sustainable Infrastructure (SI) operations (36%). The FI sector represented almost €5bn in LCY operations, SI followed with €4.5bn, and Industry Commerce and Agribusiness (ICA) represented the smallest share with €3bn. (Figure 7).

Figure 7: LCY operations by sector group, ABI and number of projects, 2016-23



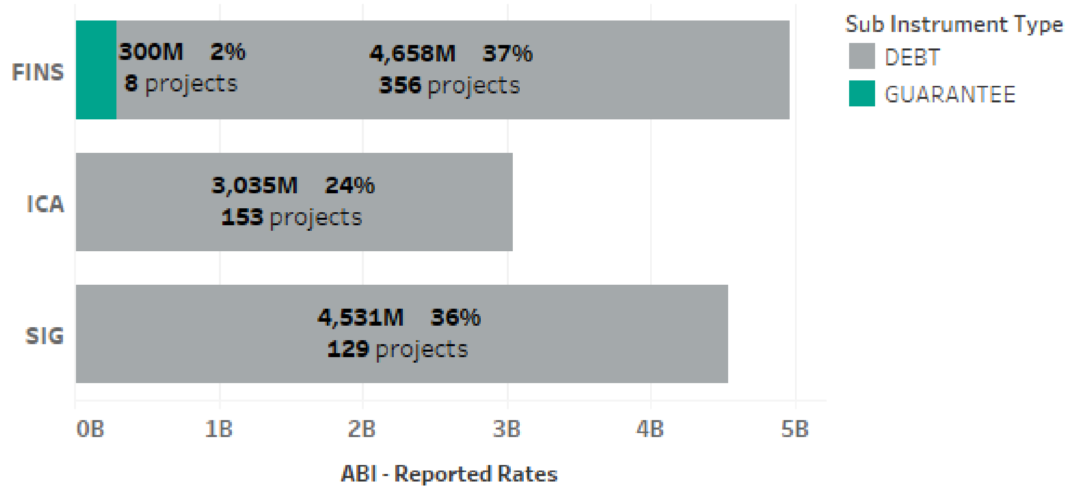
The majority of LCY operations is in Private portfolio class overall, but over half of LCY investment in SI is in State portfolio class. Majority of LCY operations were in Private portfolio, representing 81% LCY ABI, over €10bn. LCY operations in FI and ICA were fully and predominantly in Private portfolio, while SI investment in State represented majority of the sector and 19% of overall LCY ABI. (Figure 8)

Figure 8: LCY operations by sector group and portfolio class, 2016-23



LCY operations in the form of guarantee were used in the FI sector at the overall value of €300m, or 2% of all LCY investment. (Figure 9)

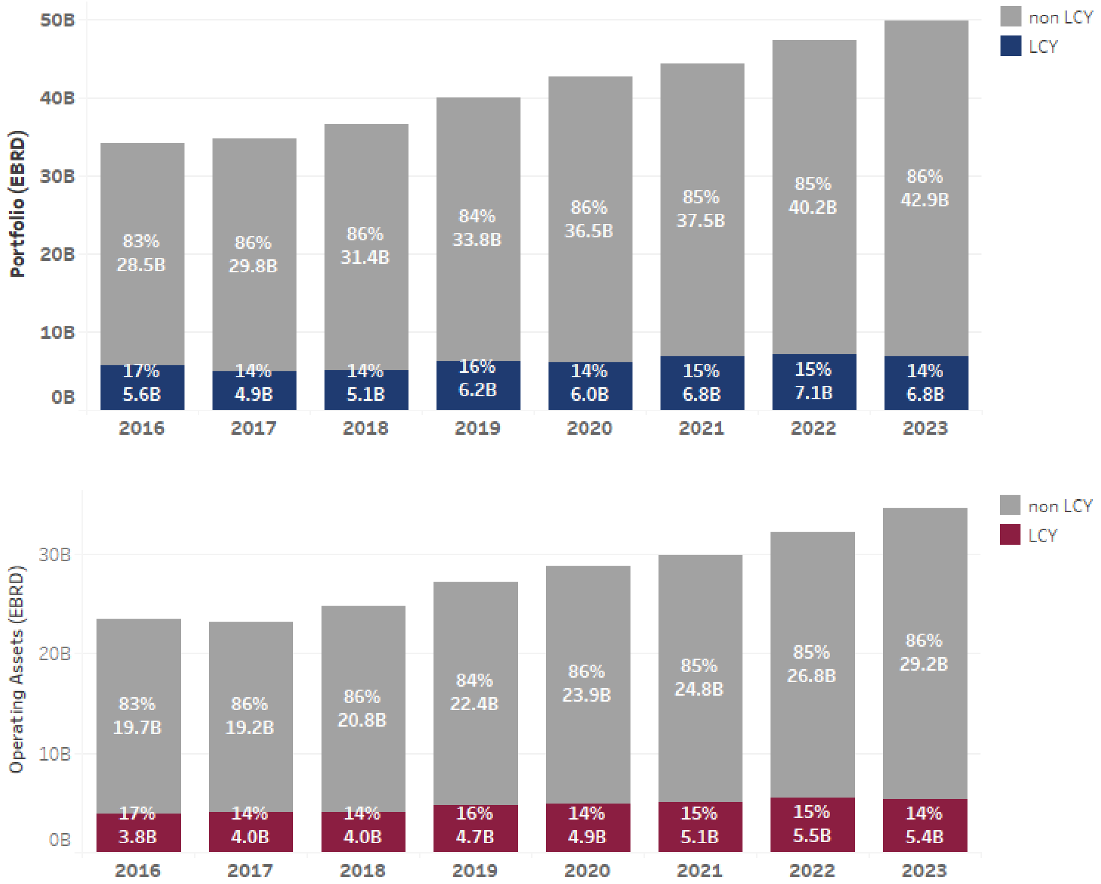
Figure 9: LCY operations by sector group and instrument, 2016-23



LCY Portfolio and Operating Assets

LCY operations represented on average 15% of both Portfolio and Operating Assets of debt operations over the 2016-23 period. At the end of 2023, these operations represented €6.8bn in Portfolio and €5.4bn in Operating Assets. (Figure 10)

Figure 10: LCY operations as a share of Portfolio and Operating Assets, 2016-23

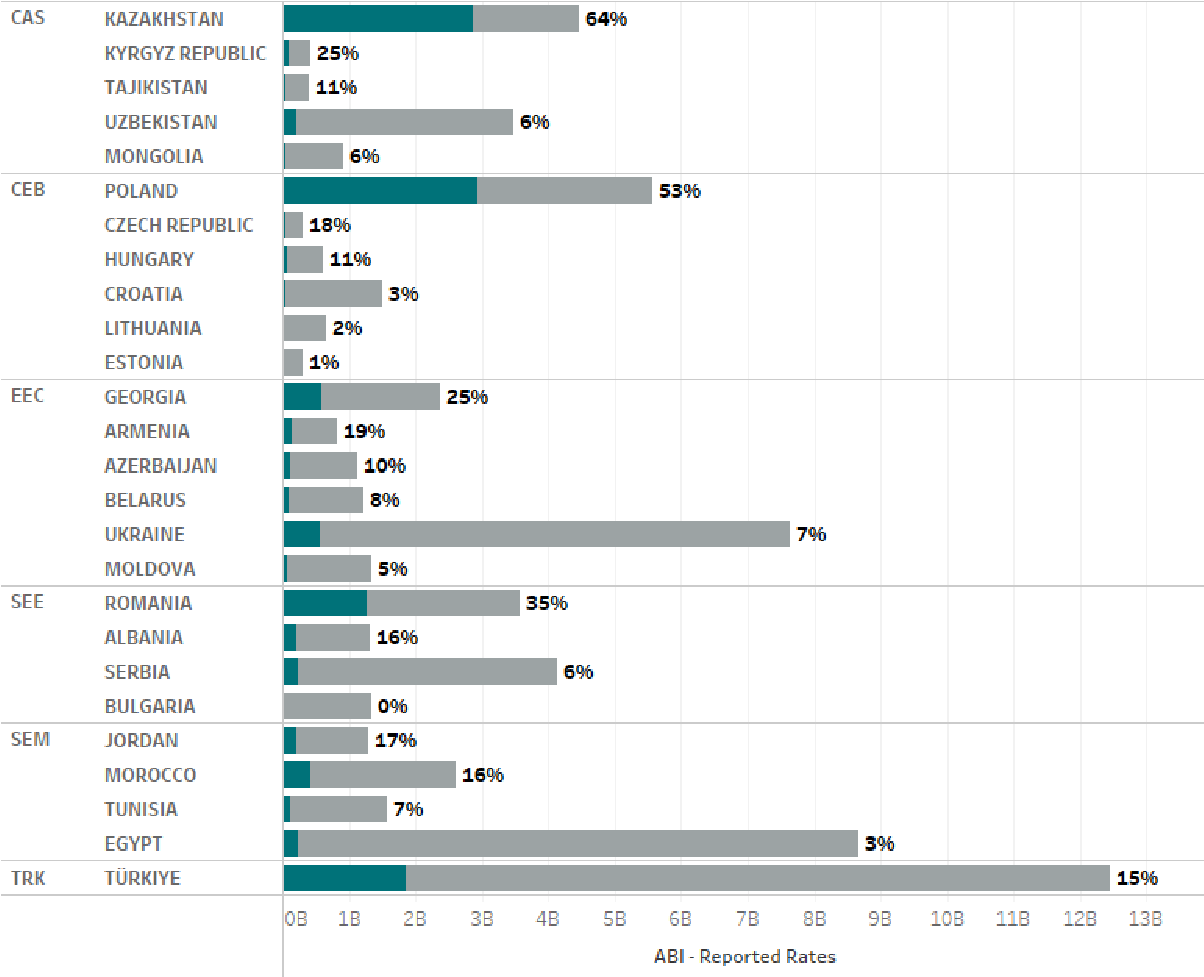


NB: Overall Portfolio/Oas include debt and guarantees only, equity excluded

LCY operations by country

In countries with LCY operations, the average share of LCY in debt ABI over the 2016-23 period was 15%. Two outliers where LCY represented over half of ABI were Kazakhstan and Poland (64% and 53%). Countries where LCY operations were at least 10% of debt ABI over the period and at the same time also cumulatively at least the equivalent of €100m were: Kyrgyz Republic (25%, 102m), Georgia (25%, 581m), Azerbaijan (10%, 109m), Armenia (19%, 153m), Romania (35%, 1.3bn), Albania (16%, 213m), Morocco (16%, 414m), and Türkiye (15%, 1.9bn). (Figure 3)

Figure 11: Share of LCY in country debt ABI in 2016-23

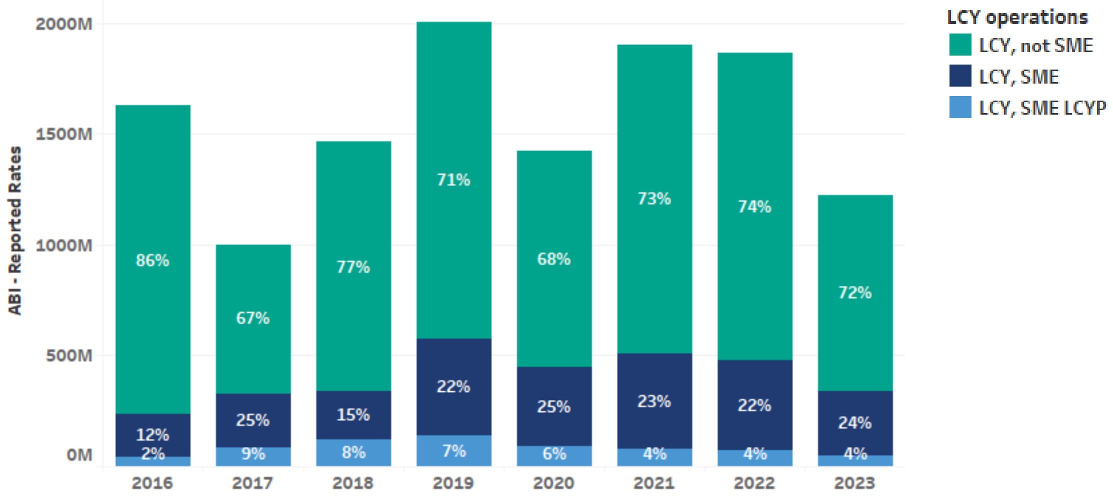


NB: ABI includes debt and guarantees only, equity excluded

SME LCY operations and SME LCYP

On average, SME operations represented 26% of LCY operations annually by ABI in the 2016-23 period, including SME LCYP. Of SME LCY operations, the LCYP represented over a quarter annually on average (27%). (Figure 12)

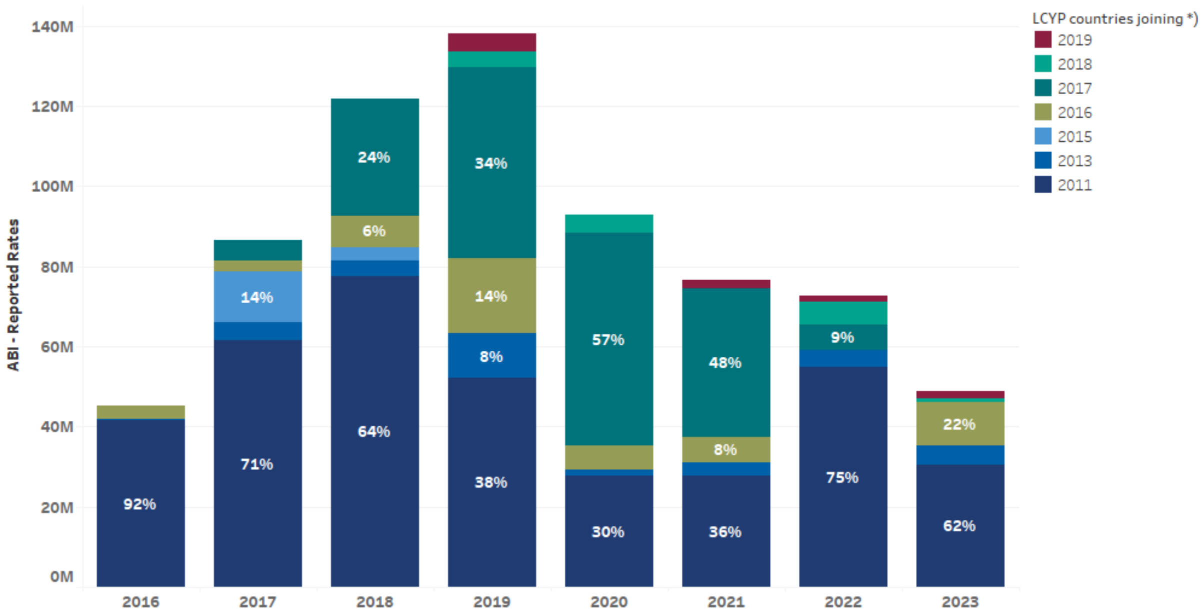
Figure 12: Share of LCY ABI in SME and SME LCYP, 2016-23



NB: SME operations based on SME flag. SME LCYP operations based on the “Local currency risk sharing” product indicator

SME LCYP represented a total of €682m in ABI over the 2016-23 period, with three quarters in ETC countries. The SME LCYP programme established in 2016 was an extension of the ETC LCYP, which was in place since 2011. The countries which joined in 2011 represented the majority (55%) of SME LCYP ABI in the 2016-23 period as well. Overall, despite the eligibility of the Programme being extended in 2016 beyond ETCs, ETC countries represented 74% of ABI and 88% of projects in SME LCYP. (Figure 13, Figure 14, Figure 4)

Figure 13: SME LCYP share of ABI based on country group by year of joining, 2016-23



*) Countries joining LCYP:
2011: Armenia, Georgia, Moldova, Tajikistan, Kyrgyz Republic
2013: Mongolia

2015: Ukraine
2016: Tunisia
2017: Morocco, Serbia, Belarus, Azerbaijan
2018: Albania, Uzbekistan
2019: Egypt

Figure 14: SME LCYP ABI and number of projects by ETC status, 2016-23

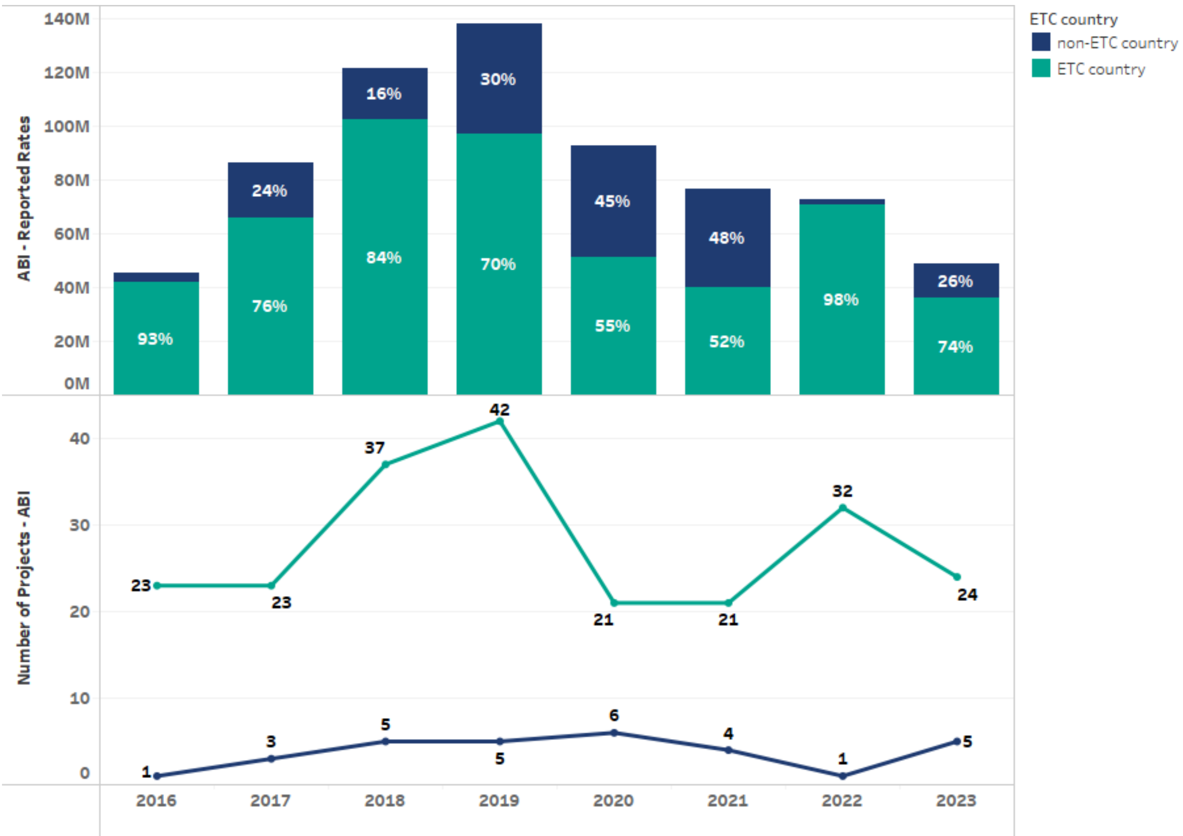
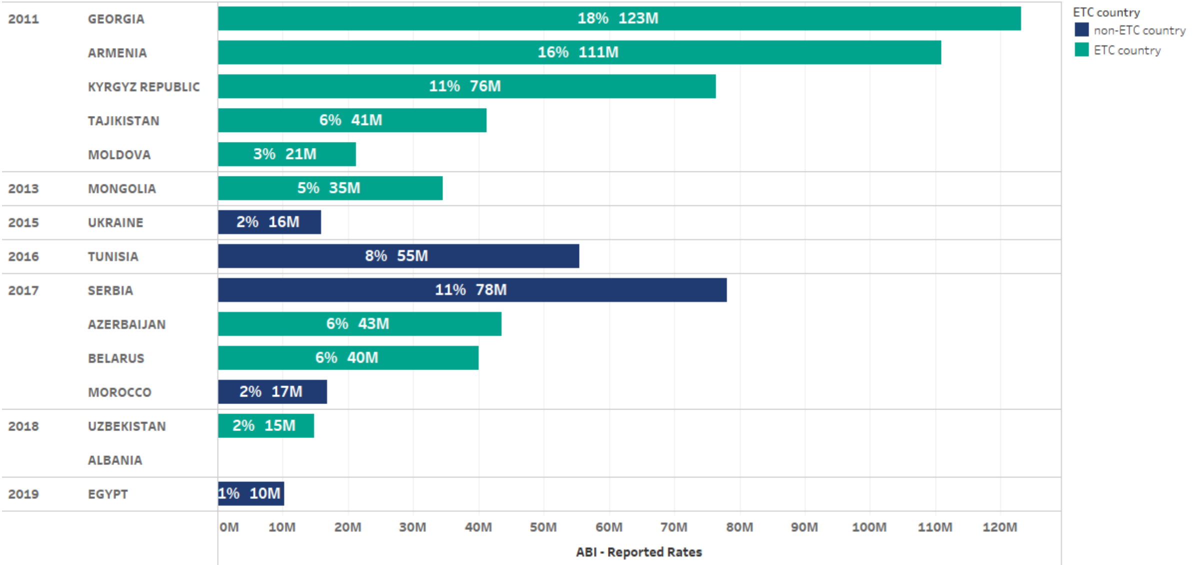


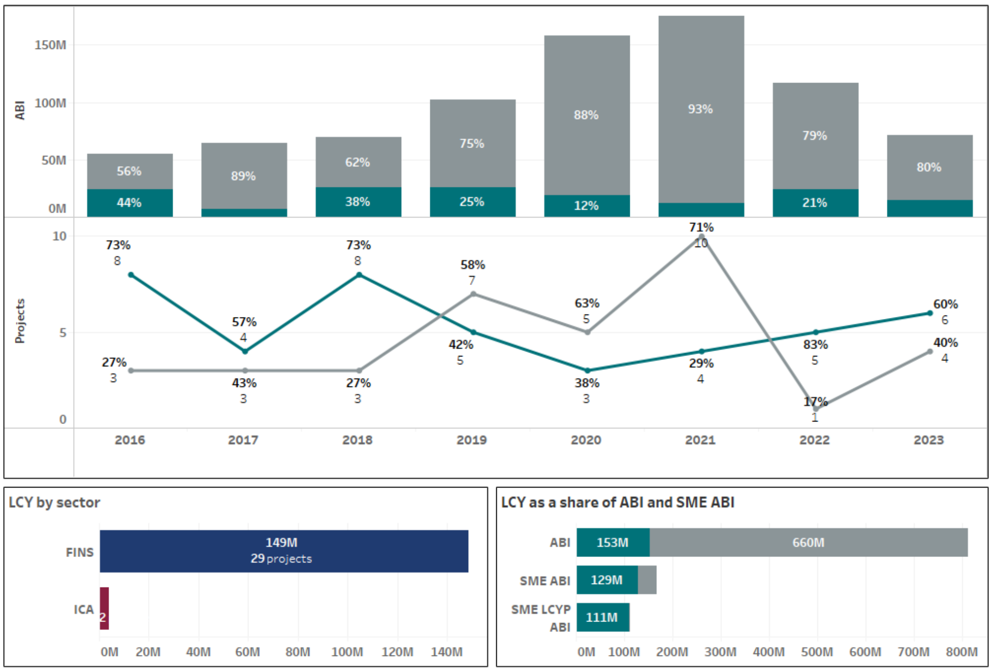
Figure 15: SME LCYP total debt ABI by country and year of joining, 2016-23



Overview of case study countries LCY financing

The total LCY ABI in Armenia was €153m over the 2016-23 period, representing 19% of overall debt ABI. The majority of this LCY finance was delivered in the FI sector (€149m). SME finance represented €129m, majority of which was channelled through the SME LCYP (€111m). Armenia is an ETC country, which joined the ETC LCYP in 2011. (Figure 16)

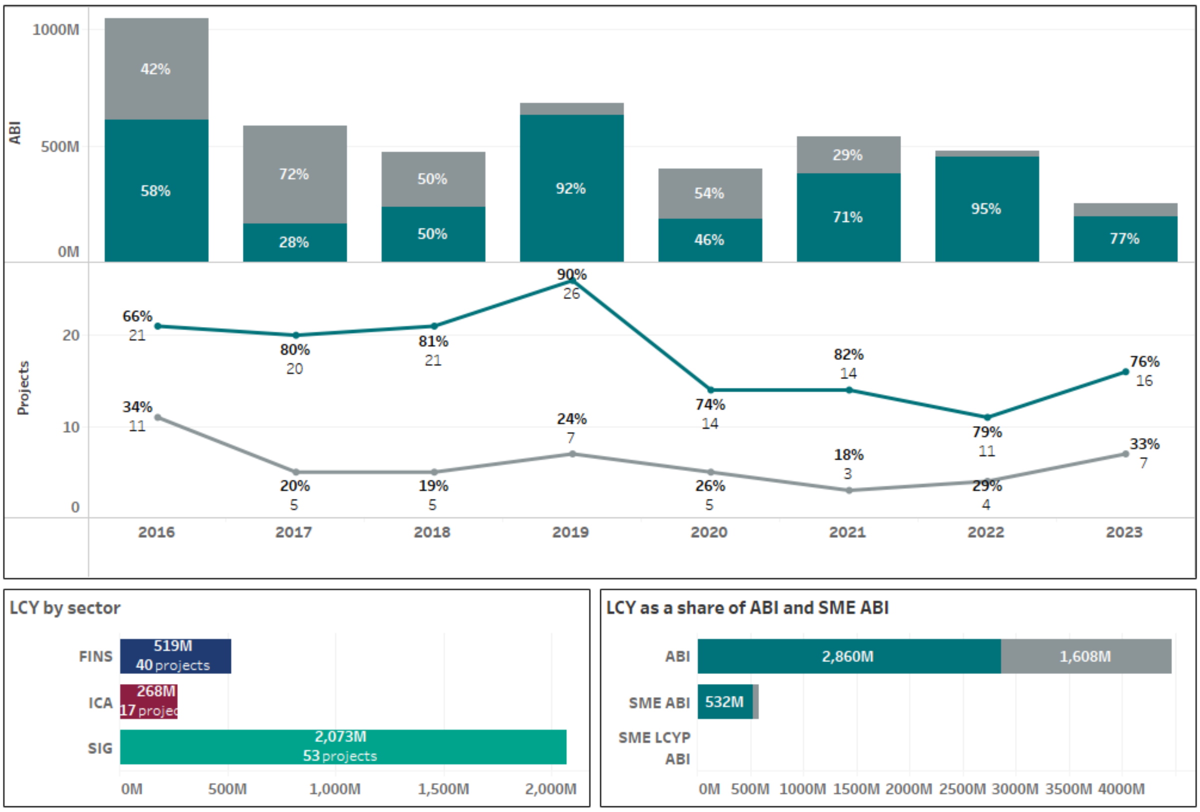
Figure 16: Armenia LCY financing, 2016-23



NB: ABI includes debt and guarantees only, equity excluded

The total LCY ABI in Kazakhstan was €2.9bn over the 2016-23 period, representing 64% of overall debt ABI. Kazakhstan is the largest country in terms of LCY ABI proportion. Kazakhstan also stands out in terms of LCY financing in the infrastructure sector (€2bn), representing the largest LCY sector in Kazakhstan. Kazakhstan is not in the SME LCYP programme, although it is eligible for it, and will join in 2024. (Figure 17)

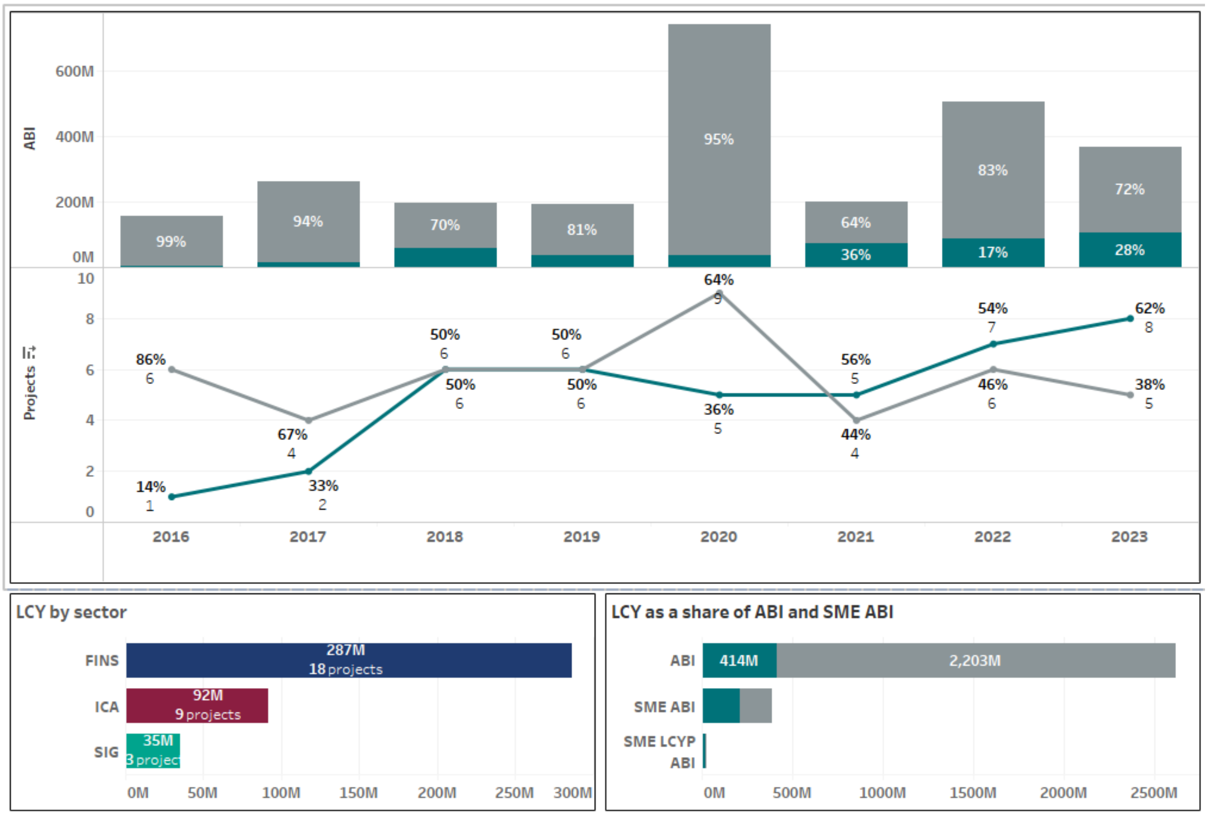
Figure 17: Kazakhstan LCY financing, 2016-23



NB: ABI includes debt and guarantees only, equity excluded

The total LCY ABI in Morocco was €414m over the 2016-23 period, representing 16% of overall debt ABI. The majority of LCY finance was in the FI sector (€287m), SME LCY finance represented €211m out of which €17m was through SME LCYP. Three LCY projects were in SI with total ABI volume of €35m, two of which were investments in LCY bonds. Morocco is not an ETC country, and joined the SME LCYP in 2017. (Figure 18)

Figure 18: Morocco LCY financing, 2016-23



NB: ABI includes debt and guarantees only, equity excluded