



THEMATIC EVALUATION

# Market development leadership meeting market realities

## Evaluation of EBRD's local currency operations (2016-23)

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## Abbreviations

<b>ABI</b>	Annual Bank Investment	<b>MMDF</b>	Money Market Diagnostics Framework
<b>Capex</b>	Capital expenditure	<b>MMWG</b>	Money Market Working Group
<b>CFMD</b>	Capital and Financial Markets Development (EBRD)	<b>MSME</b>	Micro, Small and Medium-sized Enterprise
<b>COO</b>	Country of Operation	<b>MoU</b>	Memorandum of Understanding
<b>COR</b>	Corporate sector	<b>OTC</b>	Over-the-counter
<b>CSG</b>	Client Solutions Group	<b>SME</b>	Small and Medium-sized Enterprise
<b>DFI</b>	Development Finance Institutions	<b>RSF</b>	Risk Sharing Framework
<b>DCFTA</b>	Deep and Comprehensive Free Trade Agreement	<b>SCF</b>	Strategic and Capital Framework
<b>DFF</b>	Direct Financing Framework	<b>SDG</b>	Sustainable Development Goals
<b>ETC</b>	Early Transition Country	<b>SEMED</b>	Southern and Eastern Mediterranean
<b>FI</b>	Financial Institution	<b>SI</b>	Sustainable Infrastructure
<b>FIF</b>	Financial Intermediaries Framework	<b>TC</b>	Technical Cooperation
<b>FX</b>	Foreign Exchange	<b>TCX</b>	The Currency Exchange Fund
<b>GEFF</b>	Green Economy Financing Facility	<b>TFP</b>	Trade Facilitation Programme
<b>IFC</b>	International Finance Corporation	<b>TI</b>	Transition Impact
<b>IFI</b>	International Financial Institution	<b>TQ</b>	Transition Quality
<b>LIBOR</b>	London Interbank Offered Rate		
<b>LC2</b>	Local Currency and Capital Markets		
<b>LCY</b>	Local Currency		
<b>LCYP</b>	Local Currency Programme		
<b>MDB</b>	Multilateral Development Bank		
<b>MM</b>	Money Market		

## Summary of key findings and recommendations

The European Bank for Reconstruction and Development (EBRD) has developed a distinctive approach to local currency (LCY) operations. Anchored in a three pillar model – policy dialogue, funding and lending – this approach aims to build resilient domestic money markets (MM) by integrating Treasury-led reforms with practical market engagement. The evaluation assesses the relevance and implementation of this model across 19 countries from 2016-23, focusing on whether the intended synergies between the pillars have materialised to deliver transition outcomes.

### EBRD's approach establishes the Bank as a leader in local currency market development in the EBRD region

The evaluation confirms that EBRD has established a unique position in LCY operations through its Treasury-led market-building approach that combines active market participation with targeted policy dialogue. Initially launched in response to the vulnerabilities exposed by the 2008-09 global financial crisis, the Bank's LCY approach has matured into an integrated three pillar model. This addresses both supply and demand constraints for LCY financing by building foundational market infrastructure that enables sustainable market development.

As LCY solutions gain prominence in global development and climate finance, EBRD Treasury has emerged as a leading advocate and practitioner. With private investors increasingly highlighting foreign exchange (FX) volatility as a barrier to scaling investment in emerging markets, EBRD

Treasury has been actively promoting its approach and gaining recognition for its expertise, as confirmed by interviews. The Bank now co-leads multilateral development banks' (MDB) coordination efforts on LCY financing and serves as an advisor to other institutions seeking to expand their LCY operations, reflecting the growing strategic importance of currency risk management in achieving development and climate objectives.

### Policy dialogue and funding activities demonstrate concrete market development results, though progress varies by country context

EBRD Treasury's dual role as a market participant and policy advisor has created a particularly effective synergy in developing money markets. The Bank's Treasury engages in policy dialogue while simultaneously participating directly in local markets for LCY funding and liquidity management. The evaluation confirms that this direct market experience provides credibility in policy discussions and helps focus reform priorities on practical market needs, with the establishment of Money Market Working Groups (MMWG) and the implementation of the Money Market Diagnostic Framework (MMDF) providing structured, country-specific platforms for reform dialogue.

This integrated approach has yielded tangible results in receptive countries, with EBRD successfully driving money market benchmark modernisation, securing regulatory frameworks for local bond issuances and developing sophisticated funding approaches. The Bank has supported the design and implementation of new risk-free overnight reference rates in multiple countries and established necessary regulatory preconditions for bond issuance in several markets. The Bank has

also progressively developed funding capabilities ranging from basic cross-currency swaps to active portfolio management across multiple instruments. Evidence shows that these evolving Treasury operations build local counterpart capacity through direct engagement and create demonstration effects that catalyse broader market development.

**Implementation remains opportunistic with results varying significantly based on local conditions and reform commitment.** While the MMDF has strengthened the structured nature of policy engagement, evidence shows uneven follow through on recommendations across countries and varying levels of working group activity. Benchmark reforms have achieved mixed adoption success due to several factors, including conservative banking practices, inadequate regulatory frameworks and external shocks.

### Market development has expanded EBRD's local currency capabilities, though structural disadvantages persist

**The development of money markets and funding instruments have enabled EBRD to move beyond basic back-to-back structures and towards more flexible funding models.** The evaluation shows that a transition to active liquidity management and more flexible risk management approaches have improved the Bank's ability to offer longer tenors and tailored products, particularly in more mature markets. Case study evidence indicates improved additionality in both pricing and loan tenors, with banking teams reporting enhanced flexibility in structuring transactions to meet clients' needs.

**EBRD faces inherent structural disadvantages in LCY operations that limit competitiveness, despite improving product design.** Local banks benefit from natural advantages through deposit collection and

central bank facilities that provide cost-effective funding. In a number of countries, these structural challenges have intensified as regulatory de-dollarisation efforts and market maturation have shifted EBRD's challenge from developing market appetite for LCY financing to maintaining competitiveness in growing LCY markets. This evolution makes LCY capabilities essential for reaching transition-relevant clients rather than primarily serving currency market development objectives, while EBRD's market-based funding approach often cannot match local funding sources.

### Local currency lending has expanded in volume, but remains uneven in reach

**EBRD has increased the absolute volume of its LCY lending; the volume was 40 per cent higher in 2024 than the previous peak of 2019.** However, the share of LCY operations relative to total lending has remained flat over the evaluation period. This reflects both structural challenges and external shocks, including the COVID-19 pandemic and the war in Ukraine, which widened interest rate differentials and made EBRD LCY lending less attractive despite its risk mitigation benefits.

**The geographic distribution of LCY operations is highly uneven.** Kazakhstan alone accounts for nearly half of all LCY volume of countries within the scope of the evaluation, benefiting from a mature market, supportive regulatory developments and subsequently, the Treasury's ability to manage a local liquidity pool. Early Transition Countries (ETCs) showed a higher relative share of LCY, supported by the concessional support of the SME Local Currency Programme (LCYP), which provided first-loss guarantee to enable competitive pricing.

**LCY financing is predominantly delivered through the Financial Institutions (FI) sector, with Infrastructure concentrated in**

**Kazakhstan.** This reflects both the Bank's strategic focus and the practical advantages of intermediated finance in reaching smaller borrowers. Infrastructure lending in LCY, despite its natural alignment with local revenue streams, has so far been meaningfully represented only in Kazakhstan.

## Local currency operations deliver tangible resilience benefits but systematic impact measurement frameworks remain underdeveloped

**EBRD LCY lending demonstrates alignment with resilience objectives, particularly through its focus on SMEs and ETCs.** The SME LCYP has proven instrumental in enabling this targeting. This focus addresses markets where strengthening resilience is most relevant.

**The contribution of LCY operations to financial sector resilience lacks systematic measurement.** While Treasury's activities have strengthened financial market resilience through market development, these contributions remain outside formal transition impact (TI) assessment frameworks. In LCY lending projects, currency-linked resilience is rarely a part of their Transition rationale and monitoring.

**The evaluation demonstrates that EBRD's three-pillar approach to LCY operations represents a conceptually robust framework that has achieved meaningful results in market development and product delivery.** However, success remains highly dependent on external factors and country-specific contexts, requiring continued concessional support and realistic expectations about the

pace of market development in challenging operating environments.

## Recommendations

**The following recommendations are based on these findings and in the context of the upcoming new approach to local currency operations, EBRD's expansion into sub-Saharan Africa and the ongoing revision of the transition assessment system..**

### Strategic-level recommendation

1. To achieve objectives in financial markets development and LCY lending in new countries of operations (COOs), Management should ensure that the upcoming Capital and Financial Markets Development (CFMD) and Treasury Approach to Financial Market Development explicitly addresses the unique market characteristics and development stages of sub-Saharan African countries, providing guidance that supports effective country-by-country adaptation in these new regions of operation.

### Operational-level recommendations

2. To ensure strategic coherence and operational effectiveness, the upcoming CFMD and Treasury Approach to Financial Market Development should establish clear alignment between strategic positioning and an implementation framework.
3. To strengthen accountability and enhance institutional learning while ensuring appropriate recognition of LCY operations' contribution to transition impact, Management should integrate LCY activities into the Bank's transition assessment and monitoring framework.

## Evaluation snapshot

<b>Objective</b>	<p>The <b>EBRD's approach to LCY operations</b> as articulated in the 2016 SME LCYP consists of three interrelated pillars: <b>policy, funding and lending</b>.</p> <p>The objective of the evaluation is to assess:</p> <ul style="list-style-type: none"> <li>• The extent to which the pillars of LCY operations interact and reinforce each other to achieve broader transition objectives.</li> <li>• The factors that influence the success of LCY operations.</li> </ul>
<b>Scope</b>	<p>Time scope: 2016-23</p> <p>Geographic scope: 19 countries of operations</p>

### Evaluation Questions and Key messages

<b>EQ1 Relevance and additionality:</b> <i>To what extent have EBRD's activities in LCY financing been additional and adapted to the needs of countries of operations?</i>	<p><b>EBRD's Treasury-led market-building approach positions the Bank as a leader in LCY advancement, with evolving tools matching country contexts.</b></p> <p><b>The approach combines standardised tools with sustained engagement and flexible implementation in money market development.</b></p> <p><b>Non-financial additionality elements not unique to LCY lending strengthen EBRD LCY value proposition.</b></p>
<b>EQ2 Effectiveness:</b> <i>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?</i>	<p><b>EBRD Treasury's dual role in policy dialogue and market operations has demonstrated concrete results in market development.</b></p> <p><b>Market development activities have successfully expanded EBRD LCY product range and transaction flexibility.</b></p> <p><b>However, market impact of policy engagement remains dependent on local context and reform commitment.</b></p> <p><b>LCY lending has expanded in volume, but remains uneven in reach.</b></p>
<b>EQ3: Efficiency:</b> <i>To what extent have EBRD LCY activities been efficiently executed and delivered value for EBRD and its counterparts?</i>	<p><b>Three-pillar approach has strong, internally coherent conceptual design.</b></p> <p><b>EBRD Treasury takes a leading role in advancing MDBs' progress on LCY solutions in EBRD's regions of operation.</b></p> <p><b>LCY operations show comparable financial performance to non-LCY where data is available.</b></p>

# 1. Introduction

## 1.1. EBRD Local Currency operations rationale

1. **EBRD's local currency (LCY) operations approach evolved to a comprehensive market development strategy following the global financial crisis.** The EBRD recognises the importance of developing domestic capital markets in its establishing Agreement. This includes support to local currencies and money markets development (Box 1). The 2008-09 global financial crisis exposed the vulnerabilities arising from excessive foreign currency lending in the EBRD's COOs. In response, the EBRD launched its Local Currency and Local Capital Markets (LC2) Initiative in 2010. Whereas earlier EBRD efforts focused on enabling its own LCY funding and lending, the LC2 Initiative adopted a more holistic approach in recognition that both supply and demand for LCY need to be developed. The ETC Local Currency Programme (LCYP), launched in 2011 for eligible Early Transition Countries (ETCs), aimed to overcome the high costs of EBRD LCY funding in these markets. In 2013, the EBRD formalised its approach through the LC2 Strategic Initiative and set up a dedicated LC2 team.

2. **The EBRD's approach to building efficient money markets harnesses the interconnected nature of policy, funding and lending activities.** The 2016 SME LCYP, an extension of the ETC LCYP, articulated the approach to EBRD LCY operations across three pillars: policy, funding and lending. The three pillars of EBRD LCY operations intend to form a reinforcing system:

- **Policy dialogue** with the authorities helps build market foundations that are key to enhancing domestic markets. This includes working with central banks on strengthening monetary policy, working with all stakeholders on developing money markets and money market benchmarks and on strengthening risk management capacity of domestic financial institutions.
- A strengthened market infrastructure enables EBRD Treasury to pursue more diverse and cost-effective **LCY funding** strategies, including domestic bond issuances and cross-currency swaps with local counterparties, rather than relying solely on external providers like the Currency Exchange Fund (TCX).<sup>1</sup> This allows the Treasury to transition to maintaining liquidity pools and manage risks dynamically while reducing funding costs.
- The improved funding terms then translate into more competitive **LCY lending** products for EBRD's clients with better pricing, longer maturities and terms that match borrowers' revenue profiles.

### Box 1: Money market overview

**The money market represents a segment of the financial system where short-term debt securities with maturities of one year or less are traded.** This market primarily serves institutional participants, including banks, corporations, government entities and investment funds. It facilitates the exchange of highly liquid instruments, such as Treasury bills, commercial paper, certificates of deposit and repurchase agreements.

The money market functions as a critical liquidity mechanism, enabling organisations with temporary cash surpluses to lend to those experiencing short-term funding needs. These securities are characterised by high credit quality and minimal interest rate risk due to their short maturity, making them essential tools for cash management and capital optimisation.

<sup>1</sup> <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.

## 1.2. Objective and scope of the evaluation

### 3. The Independent Evaluation Department (IEVD) conducted an evaluation of EBRD LCY operations to assess their contribution to financial sector development and economic resilience.

The evaluation examined these operations from 2016-23,<sup>2</sup> assessing their effectiveness and understanding factors that influenced their success. The time scope of the evaluation is connected to the articulation of the three-pillar approach in the SME LCYP in 2016 and it provides sufficient time to assess policy reform outcomes that typically require longer implementation timelines than investment operations.

4. **The evaluation has two main objectives.** First, it aims to identify the merits of EBRD LCY operations by examining how policy, funding and lending dialogue activities work together to achieve broader transition objectives. Second, it seeks to understand the factors that influence the performance of LCY operations, recognising that many determinants may lie outside EBRD's direct sphere of influence.

5. **The timing of the evaluation aligns with increased focus on LCY financing in global climate and development finance discussions.** Recent joint statements by MDBs have emphasised scaling up LCY finance and hedging instruments to catalyse private sector investment. Within EBRD, the new Strategic and Capital Framework (SCF) highlights the role of the development of money markets and LCY financing in mobilising private capital, providing further impetus to examine these operations.<sup>3</sup> The evaluation is also timely as EBRD expands its operations to new countries in sub-Saharan Africa, where the findings from the evaluation will provide insights for developing LCY operations strategies in these emerging markets.

6. **The geographic scope of the evaluation covers 19 COOs included in the SME LCYP or eligible for inclusion, outside of the EU (Table 1).** This means a focus on countries in early and intermediate stage of financial markets development, where Treasury-led policy and capacity building activities target the fundamentals of monetary policy implementation, risk management and derivatives development, as well as benchmark reforms.

**Table 1: Geographic scope of the evaluation**

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

Note: Countries in bold are case studies for the evaluation

<sup>2</sup> Reference is made to developments in 2024 where relevant

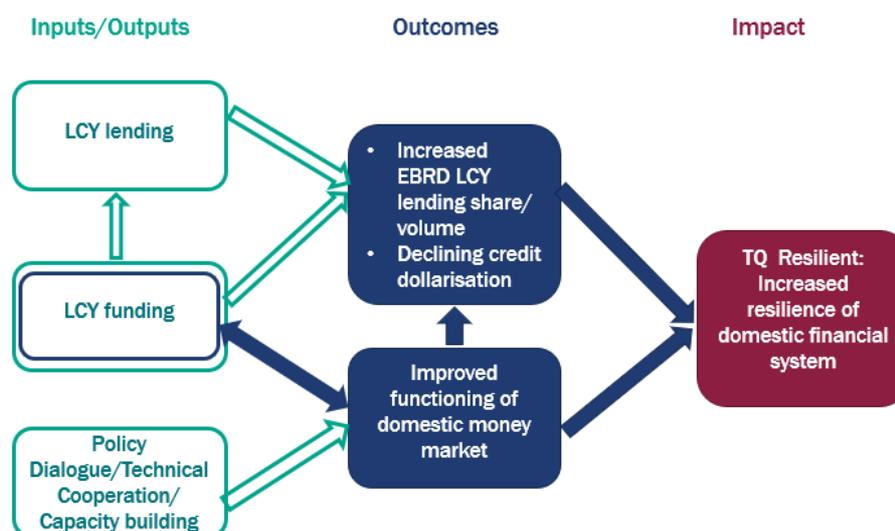
<sup>3</sup> BDS25-020 (Rev 4): Report of the Board of Directors to the Board of Governors: Strategic and Capital Framework 2026-30; "The EBRD will continue to deliver impact and mobilise private sector resources through this channel in the SCF2026-30 period through its mature and effective approach to supporting both the development of local currency usage and local capital market development through combining expertise from the Bank's Treasury and its dedicated capital markets policy team, while collaborating closely with other IFIs." p.19

### 1.3. Approach, methodology and limitations

7. **The evaluation assesses EBRD LCY operations as a modality of finance, requiring a distinct understanding of what constitutes results in this context.** As discussed above, the approach to LCY operations rests on the integration and mutual reinforcement of the three pillars: policy, funding and lending. The evaluation therefore focuses on the achievements in each of these pillars and whether they effectively reinforce each other. For example, if effective policy dialogue leads to improvements in money market development (policy), and this subsequently allows the EBRD Treasury to more effectively fund or manage LCY liquidity on-shore with local counterparts (funding), this can lead to lower cost of LCY funding and therefore more competitive terms offer for EBRD's own LCY clients (lending). Such improved terms are therefore not only an element of additionality or relevance to clients (as they may be seen in other evaluations), but a fundamental result delivered by the three-pillar approach.

8. **The evaluation followed a mixed methods theory-based design, with a theory of change recognising the non-linear relationships between EBRD's three main pillars of LCY operations.** Unlike traditional linear models, this framework (Figure 1) acknowledges that outcomes from one activity often enables progress in others. For instance, EBRD's ability to provide competitive LCY loans depends on its capacity to source LCY funding through Treasury operations. However, both lending and funding activities require functioning money markets, which EBRD helps develop through policy dialogue and technical cooperation (TC). This interconnected approach reflects how EBRD LCY operations work as a system, rather than isolated interventions.

Figure 1: Simplified Theory of Change for LCY operations



Source: IEvD elaboration

9. **This approach combines quantitative and qualitative data collection methods to provide an understanding of the performance of the operations and the underlying causal mechanisms.** The evaluation methods combined analytical tools, including portfolio data analysis, systematic country reviews covering all countries in scope, in-depth country case studies for selected countries, plus interviews with relevant internal and external stakeholders. In-depth country case studies were developed for Armenia, Kazakhstan and Morocco. The remaining 16 countries

within the scope were covered by country reviews based on data and document reviews and internal interviews.<sup>4</sup>

**10. The evaluation does not cover the totality of EBRD LCY operations.** The focus on countries within the SME LCYP framework means it does not cover some countries where EBRD provides LCY lending, notably Poland and Romania. This selection was intentional as discussed above, supporting a focus on the LCYP three pillar approach. The specifics of financial and capital market development in the more advanced transition countries are evaluated in complementary evaluations. This includes the evaluation of the MREL instrument,<sup>5</sup> the upcoming evaluations of EBRD operations in advanced transition economies and the regional evaluation of EBRD operations in Baltic states.

**11. The evaluation examines money market development activities while recognising their interconnected nature with broader capital market building work.** The focus centres on foundational elements – including policy frameworks for monetary operations, market functioning and LCY funding capabilities – though these often require supporting legal and regulatory reforms like derivatives trading frameworks or local bond issuance regulations. The evaluation examines these broader reforms to the extent they facilitate money market functioning and LCY operations, aligning with EBRD's organisational approach where the Treasury leads money market development in coordination with the CFMD team's broader mandate. The evaluation considers these complementary activities where they directly enable LCY funding and money market development, particularly in the detailed country case studies. This is done while noting that broader capital market activities will be covered in upcoming evaluations of advanced transition economies and Baltic states' operations.

**12. The evaluation covers countries with diverse economic contexts and transition trajectories, requiring a tailored approach to presenting findings in the main report.** Rather than attempting to catalogue all outcomes across the 19 countries in scope, the main report focuses on illuminating the critical interplay between EBRD's policy, funding and lending operations in developing LCY markets. This selective approach allows for deeper examination of how policy reforms enable expanded market activities and funding options, which in turn support more flexible lending solutions for EBRD clients. While the main report emphasises these systemic relationships, country-specific outcomes and contextual factors are documented in individual case studies and country reviews, providing comprehensive supporting evidence for the evaluation findings.

## 1.4. Relevant existing evaluation findings

**13. The Asian Development Bank's (ADB) retrospective of two decades of LCY financing<sup>6</sup>** identifies three key success factors:

- Systematic development of derivative markets that enabled sophisticated liquidity management and risk hedging.
- Strategic focus on borrowers whose revenue streams naturally align with LCY obligations.
- Coordinated efforts with regional regulators and market participants to build comprehensive LCY capital market infrastructure.

<sup>4</sup> Country case studies form an annex to this evaluation (separate volume); summaries of country reviews are presented in Annex 2

<sup>5</sup> Evaluation of the Transition Impact and Additionality of the EBRD's MREL & Bail-in-able Products (2016-23)

<sup>6</sup> ADB and Local Currency Financing: A 20-Year Journey (2025); <https://www.adb.org/news/features/adb-and-local-currency-financing-20-year-journey>

ADB's experience demonstrates that LCY financing serves dual development objectives by both avoiding currency mismatches for borrowers and creating demonstration effects that crowd in additional foreign investment to developing country markets.

14. The **World Bank Group's evaluation of Enabling Environment for Private Sector Climate Action** identifies FX risk as a fundamental barrier limiting private sector engagement in climate infrastructure and energy projects, where revenue generation typically occurs in LCY while financing often relies on foreign currency denominations. Climate-related investments concentrate in non-tradable sectors, such as energy and transport infrastructure, creating systematic currency mismatches that deter private investment and expose projects to financial volatility. The evaluation concludes that supporting policies enabling long-term financing in LCY represents a critical intervention for addressing this constraint, positioning LCY financing as essential infrastructure for scaling private climate, with particular importance for large infrastructure projects that involve substantial capital requirements and extended payback periods where currency alignment becomes fundamental to project viability.<sup>7</sup>

15. The **evaluation of the African Development Bank's (AfDB) Thematic Evaluation Role in Increasing Access to Finance in Africa** found that strengthening market institutions and providing guarantees for LCY risk hedging are effective strategies for developing money markets. Technical assistance and support for regulatory reform are crucial for building robust financial infrastructure. However, restrictions on providing lines of credit in local currencies have been identified as a limiting factor. For example in Nigeria, the AfDB provided a credit line to a partner bank in hard currency, but only 12 per cent was on-lent to SMEs, based on a central bank stipulation that restricted commercial banks from FX lending loans to entities that had no capacity to generate FX proceeds.<sup>8</sup>

**Table 2: LCY success factors and constraints – insights from other MDB evaluations**

LCY Success Factors	Implementation Constraints
<ul style="list-style-type: none"> <li>• <b>Portfolio-based risk management</b> outperforms transaction-specific hedging approaches.</li> <li>• <b>Central bank partnerships</b> and regulatory development are essential for sustainable market creation.</li> <li>• <b>Market infrastructure development</b> through MDB operations creates demonstration effects.</li> <li>• <b>Crisis periods validate LCY financing benefits</b> for borrower access and financial resilience.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Institutional capacity gaps</b> across Treasury, Legal and Risk Management functions require systematic development.</li> <li>• <b>Risk management frameworks designed for foreign currency operations are</b> inadequately adapted for LCY complexities.</li> <li>• <b>Limited integration with country engagement</b> strategies constrains scale and impact potential.</li> </ul>
<p>Sources: IEG Early Assessment of the World Bank Group's Experience with the IDA Private Sector Window (2021); ADB and Local Currency Financing: A 20-Year Journey (2025); Creating an Enabling Environment for Private Sector Climate Action (2023)</p>	

<sup>7</sup> Creating an Enabling Environment for Private Sector Climate Action: An Evaluation of World Bank Group Support, Fiscal Years 2013–22 (2023); <https://ieg.worldbankgroup.org/evaluations/creating-enabling-environment-private-sector-climate-action>

<sup>8</sup> Evaluation of the AfDB's Thematic Evaluation Role in Increasing Access to Finance in Africa (2020)

## 2. Key message 1: EBRD plays a leadership role in the development of local money markets, enabled by a conceptually robust three-pillar model

### 2.1. EBRD's Treasury-led market-building approach positions the Bank as a leader in MDBs' local currency advancement

#### Local currency solutions emerge as key priority for MDBs, highlighting the strategic relevance of EBRD's operations

16. **The importance of developing LCY financing has gained renewed prominence in recent global policy discussions about climate and development finance.** Private investors have increasingly highlighted FX volatility as a barrier to scaling investment in emerging markets, creating pressure on development institutions to provide financing solutions that match local revenue streams. Major international policy initiatives, including the G20's work on MDB reform and the United Nation's (UN) Common Agenda, have highlighted LCY financing as a key priority for making development finance more effective and sustainable. This heightened focus reflects growing recognition that reliance on hard currency financing creates vulnerabilities, particularly as development banks scale up their climate and Sustainable Development Goals (SDG)-related lending.

17. **The G20's commitment to make MDBs "bigger, better, and more effective" specifically calls for expanding LCY solutions through a comprehensive approach.** The G20 roadmap calls on MDBs to increase both the quality and quantity of LCY financing options across different maturities and features, while supporting borrowers through technical assistance to build capacity in currency risk management. The recommendations emphasise collaboration between MDBs and specialised institutions like TCX to develop innovative hedging solutions, recognising that a coordinated approach across development institutions is needed to achieve meaningful scale in LCY financing.<sup>9</sup>

18. **These calls for expanded LCY financing are closely tied to broader efforts to mobilise private capital for development.** The UN Common Agenda recommends that MDBs adapt their business models to better leverage private finance while managing risks through diversification, with increased LCY lending as a key component. This reflects an understanding that reducing currency mismatches not only protects borrowers, but also makes investments more attractive to private investors. The focus on developing LCY markets and instruments thus serves the dual purpose of reducing systemic risks while creating conditions for greater private sector participation in development finance.<sup>10</sup>

19. **Internally, the EBRD strategically positioned LCY operations as a key pillar for building financial market resilience.** The LC2 Strategic Initiative in 2013 and the 2016-20 SCF primarily

<sup>9</sup> G20 roadmap towards better, bigger and more effective MDBs; October 2024;

[https://coebank.org/documents/1577/G20\\_Roadmap\\_towards\\_better\\_bigger\\_and\\_more\\_effective\\_MDBs.pdf](https://coebank.org/documents/1577/G20_Roadmap_towards_better_bigger_and_more_effective_MDBs.pdf)

<sup>10</sup> UN: Our Common Agenda Policy Brief 6: Reforms to the International Financial Architecture; May 2023;

<https://www.un.org/sites/un2.un.org/files/our-common-agenda-policy-brief-international-finance-architecture-en.pdf>

positioned LCY development in terms of building resilient financial systems and economic structures following the global financial crisis. This was also reflected in the 2019 LC2 Strategy, which linked LCY operations primarily to the Resilient transition quality (TQ), with a vision of promoting more efficient and self-sustaining financial markets.

**20. The strategic emphasis of LCY operations has evolved toward mobilisation without fundamentally changing EBRD's operational approach to LCY development.** The 2021-25 SCF began integrating LCY work more broadly across sectors and highlighted its role in creating conditions for inward investment, while the upcoming 2026-30 SCF positions LCY development squarely within the Bank's mobilisation agenda. This evolution reflects EBRD's recognition that sustainable private sector development requires mobilising domestic savings through strengthened local financial systems, starting with sound monetary policy implementation and market benchmarks that enable banks to transform local deposits into long-term financing. By developing these benchmarks and risk management instruments for domestic banks first, EBRD creates conditions that can ultimately attract foreign investment in LCY markets while building local financial institutions' capacity to better intermediate savings and facilitate the maturity transformation essential for private sector financing.

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### Treasury-led market-building strategy sets EBRD apart from other MDBs in the EBRD's regions of operation

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**21. The EBRD Treasury employs a distinctive dual approach that combines active market operations with targeted policy dialogue to help develop domestic money markets.** At its core is the progressive implementation of liquidity pools rather than relying solely on back-to-back funding, which enables EBRD to lock in attractive funding opportunities as they arise. Where successful, this approach allows to offer more flexible loan features to EBRD clients, particularly floating rate loans indexed to domestic interest rate benchmarks. This approach requires accepting some controlled market risks (interest rate risk, refinancing risk, cash flow mismatches), and therefore more sophisticated risk management through derivatives and careful development of relationships with domestic counterparties. As markets in many EBRD COOs are not sufficiently developed to support such risk management, the EBRD Treasury engages in focused policy work through dedicated policy platforms, to build the necessary market infrastructure, with benchmark development being particularly crucial for enabling maturity transformation and interest rate risk management.

**22. EBRD's Treasury-led approach to LCY funding sets it apart from other MDBs in the EBRD region through its unique combination of market participation and development.** This distinctive approach was consistently highlighted in discussions with other international financial institutions (IFIs) and country counterparts (both country authorities and market actors) during the evaluation. EBRD has been developing its unique approach since the aftermath of the global financial crisis with the establishment, of the Local Currency and Capital Markets (LC2) Initiative in 2010 and further accelerated after 2018 when Treasury leveraged the global London Interbank Offered Rate (LIBOR) transition to advance domestic benchmark reforms. As domestic markets needed to prepare for LIBOR's discontinuation, this created an opportunity to simultaneously work on developing local benchmark rates. Ultimately its approach to LCY funding allows EBRD to provide more flexible and competitively priced LCY products, while simultaneously supporting market development through active trading relationships with local counterparties.

## EBRD Treasury takes a leading role in advancing MDBs' coordination on local currency solutions in EBRD's regions of operation

**23. MDBs are placing increased emphasis on scaling up LCY financing as a key priority for development finance.** The recent MDB Viewpoint paper on "Working as a System for Impact and Scale" explicitly calls for expanding LCY finance and hedging instruments to reduce FX risks. The paper acknowledges that while most MDBs do provide some LCY financing, their approaches tend to be inflexible and focused on more developed markets, with limited appetite for onshore operations that could contribute to local market development.<sup>11</sup>

**24. In response to this high-level commitment, MDBs have established a dedicated Working Group on LCY and Hedging Instruments, co-led by EBRD along with the International Finance Corporation (IFC) and the Inter-American Development Bank (IDB).** The Working Group, comprising treasury and capital market development specialists from across MDBs, has articulated potential action items around four key areas: expanding MDBs' market risk-taking capacity, developing capital markets, enhancing FX hedging solutions and securing necessary resources and member country support. These recommendations align closely with EBRD's established approach, though they are framed in tentative language that reflects the institutional constraints many MDBs still face.<sup>12</sup>

**25. EBRD Treasury has emerged as an advisor to other MDBs seeking to expand their LCY operations.** This advisory role is evident both through EBRD's co-leadership of the aforementioned MDB Working Group and through extensive bilateral engagement at treasury and country levels, as confirmed in evaluation interviews with multiple MDB counterparts. Through these channels, EBRD Treasury shares its experience in managing liquidity pools and conducting maturity transformation; practices that many MDBs are interested in, yet restricted from fully implementing due to internal risk management rules. For instance, while some MDBs have established liquidity pools in more developed markets, they cannot undertake maturity transformation due to limitations on interest rate risk-taking. This highlights how EBRD's more flexible approach to market risk management has enabled it to develop more sophisticated LCY solutions.

## 2.2. EBRD's distinctive market-building approach is conceptually strong, but implementation can be challenged by local context

### The three-pillar approach has strong conceptual design

**26. The integration of money market development as a prerequisite for LCY financing reflects a foundational market-building approach.** The EBRD approach is predicated on the understanding that sustainable LCY financing requires robust underlying market infrastructure, including reliable benchmarks, effective risk management instruments and sufficient market liquidity to support ongoing operations. Without developed money markets, LCY financing remains vulnerable to

<sup>11</sup> 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.adb.org/sites/default/files/news-release/962971/Heads-of-MDBs-Viewpoint-Note.pdf>

<sup>12</sup> MDB Viewpoint: Local currency finance and hedging instruments for foreign exchange risk Summary on Working Group Discussions; December 19, 2024; <https://www.eib.org/files/documents/mdb-viewpoint-local-currency-finance-en.pdf>

pricing distortions, limited hedging options and insufficient market depth to accommodate regular funding needs.

**27. The three-pillar approach to LCY operations represents a conceptually sound framework that effectively addresses key market development needs.** The three-pillar approach aims to build market foundations that enable not only EBRD's own operations but also catalyse wider LCY financing activity, creating more resilient and self-sustaining financial markets. Its strength lies in its integration of policy dialogue, funding operations and lending activities, which sets EBRD apart from other development institutions that often focus on more narrow elements of LCY operations. The framework has also demonstrated adaptability over time, evolving from Memorandums of Understanding (MoUs) with set action plans to more dynamic engagement through Money Market Working Groups (MMWGs) that can provide an effective dialogue platform with authorities, as well as key market actors, and can better respond to changing market conditions.

### The approach combines standardised tools with sustained engagement and flexible implementation in money market development

**28. The EBRD Treasury has developed a structured policy approach to LCY market development, centred on standardised diagnostic tools and dedicated policy platforms.** The EBRD Treasury conducts policy dialogue in countries at the early and intermediate stages of money market development, focusing on critical building blocks starting with central bank cooperation on functions like liquidity forecasting, transition to inflation targeting and monetary policy

*“[EBRD Treasury] has a different approach to market development; they do not come and advise and disappear, they walk with us and are a partner.”*  
Central Bank official

implementation. Where feasible, the EBRD Treasury facilitates establishing reliable reference risk-free market benchmarks and developing risk management derivative tools, while the CFMD team leads on regulatory and legal reforms. Through MMWGs, nominally established in 12 and active in 7 out of 19 countries within the evaluation scope, the EBRD Treasury brings together relevant authorities and key financial institutions to drive market development.

**29. The implementation of the Money Market Diagnostic Framework (MMDF) since 2018-19 has strengthened the structured nature of EBRD's policy engagement, though results and follow through have advanced unevenly across countries.** The MMDF, completed or ongoing in 13 countries,<sup>13</sup> provides a detailed methodology for money market assessment. This can be used to guide policy engagement and prioritisation within the MMWGs. These assessments have been considered a useful resource by the authorities interviewed for the evaluation. While the core elements of this approach are fairly standardised across countries, evidence from country reviews and case studies shows that its implementation remains opportunistic, advancing primarily in countries where authorities demonstrate receptiveness and reform momentum.

**30. The formalisation of EBRD's policy engagement through the SME LCYP has helped institutionalise the approach while maintaining flexibility in its application.** Initially, countries' participation in MMWGs were formally tied to joining the SME LCYP through MoUs that committed authorities to active policy engagement and later through Beneficiary Agreements (committing to MMDF implementation). However, this structured approach has proven valuable even outside the formal LCYP framework, as demonstrated by its successful implementation in Kazakhstan prior to the country officially joining the LCYP in 2024. At the same time, the varying levels of MMWG

<sup>13</sup> Figures on MMWG and MMDF include developments formally outside of the evaluation period, in 2024 and early 2025

activity across countries and uneven follow-through on MMDF recommendations, as outlined in country reviews and case studies, highlight that formal structures alone do not guarantee sustained progress.

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### Implementation success in practice depends on external factors

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**31. The EBRD's three-pillar approach to LCY operations intends to create a mutually reinforcing cycle between policy dialogue, funding and lending operations.** Where successful, each pillar supports and enables the others. Policy dialogue helps create the market infrastructure and regulatory environment needed for Treasury's funding operations, which in turn enables more competitive LCY lending. In markets where basic infrastructure is not yet developed, policy work focuses on establishing critical elements from monetary policy frameworks to reliable interest rate benchmarks and legal frameworks for derivatives. As these foundations are put in place, Treasury can increasingly engage in domestic funding and liquidity management operations with local counterparts, moving from primarily back-to-back funding toward more sophisticated liquidity pool management. This market presence provides demonstration effects and helps build capacity of local counterparts, as well as building Treasury's direct market experience that can feed into the policy dialogue. The resulting enhanced funding flexibility and lower costs then enable EBRD to structure more competitive LCY products that better match clients' needs.

**32. While conceptually robust, the framework's success in practice depends to a large degree on external factors that can limit the intended reinforcing effects between the pillars.** This approach requires not only formal agreements but sustained political will for implementing regulatory reforms and enabling decisions for onshore funding operations. This strong influence of contextual factors also complicates the assessment of ultimate impact. While EBRD considers growth in its own LCY lending as one measure of success, this metric is influenced by market structure and demand factors beyond what market development operations can achieve at least in the short and medium-term. Similarly, while de-dollarisation has been indicated in internal documents as an ultimate contextual indicator of success, in many countries a decrease in dollarisation has been the result of regulatory restrictions on foreign currency lending and has been acting as an enabling factor by creating increased demand for LCY products and market development.

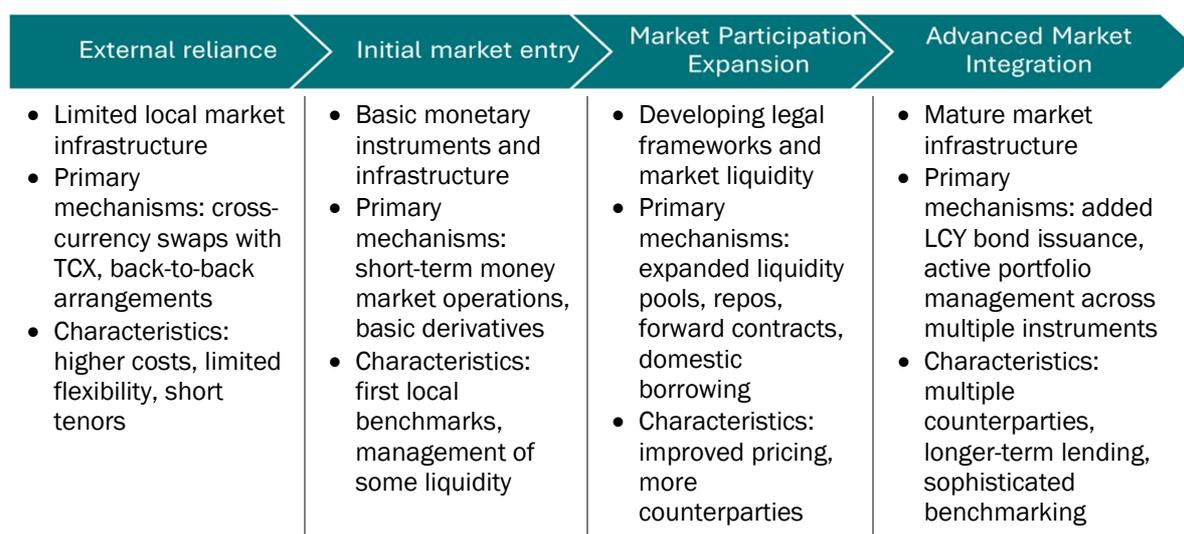
## 3. Key message 2: EBRD achieved concrete results in developing local money markets but countries ultimately drive the pace of reforms

### 3.1. EBRD Treasury's dual role in policy dialogue and market operations has demonstrated concrete results in market development

**EBRD Treasury's combined role as actor and advisor has proven effective in supporting the growth in maturity of money markets**

33. **EBRD Treasury LCY funding approaches evolve with market development through identifiable stages, though progression is not strictly linear.** EBRD often relies on cross-currency swaps through external providers like TCX or back-to-back arrangements in nascent markets, accepting higher costs and limited flexibility due to underdeveloped infrastructure. As markets develop, EBRD expands into short-term money market operations and basic derivatives, then progresses to diverse liquidity pools using repurchase agreements, forward contracts and domestic borrowing. Advanced markets enable LCY bond issuance of increasing tenor and volume, culminating in active portfolio management across multiple instruments to support longer-term lending at local benchmark rates. This progression serves as an indicative framework rather than a prescriptive sequence, since EBRD's market participation often catalyses development, creating a reinforcing relationship between funding operations and market maturity.

**Figure 2: LCY Funding Evolution Model**



Source: IEvD elaboration. A simplified model of LCY funding progress. Actual progression varies between countries based on their unique market characteristics and regulatory environments.

**34. EBRD Treasury's combined role as both an active market participant and policy advisor creates a particularly effective synergy in developing money markets.** Treasury's direct market operations give it firsthand experience of market inefficiencies and operational challenges, which builds credibility in policy dialogue and helps focus reform priorities on practical market needs. The MMWGs have proven to be an especially effective policy platform, bringing together authorities and key market participants in a forum where Treasury can speak from direct operational experience while building relationships with critical stakeholders. Interviews with MMWG counterparts also highlighted the value of expertise and continued dialogue provided by EBRD Treasury staff over the medium-term, rather than advisory being provided by one-off consultancy inputs.

**35. This approach has demonstrated concrete results in market development.** EBRD Treasury's involvement as an active money market participant is widely recognised as successful by stakeholders, with instances where initial operations have had demonstration effects for other market participants, such as in Kazakhstan where the success of EBRD's first bond issuance linked to TONIA – a new risk-free overnight reference rate implemented in Kazakhstan – prompted the Ministry of Finance to subsequently issue its own TONIA-linked bonds. Similarly, there are cases where policy achievements have enabled new types of market operations. For example, the EBRD policy dialogue in Armenia helped secure key legal reforms in 2018 by implementing a derivatives framework, which EBRD Treasury then utilised by executing innovative repo transactions and cross-currency swaps with local counterparties. While this contribution to transition through market development is not captured in EBRD's formal transition impact scoring/monitoring system, there are examples of Treasury's effectiveness in combining practical market operations with targeted policy dialogue to advance LCY market development (Box 4 in Annex1).

*“EBRD has a trailblazing approach to market operations – it works with situation as is, does not wait for everything to be perfectly in place.”*  
Treasury market counterpart

### EBRD has driven benchmark reforms with mixed adoption success

**36. The EBRD Treasury has driven the modernisation of money market benchmarks across multiple countries through a coordinated policy and market approach.** Through dedicated MMWGs, EBRD has supported the design and implementation of new risk-free overnight reference rates (Table 3) in six countries: Egypt (CONIA), Morocco (MONIA), Georgia (TIBR), Kazakhstan (TONIA), Ukraine (UONIA) and Uzbekistan (UZONIA). These reforms have been strengthened by Treasury's ability to draw parallels with the global LIBOR transition, using it both to raise awareness among domestic stakeholders about benchmark reforms and to demonstrate the practical implementation of overnight risk-free rates.

**Table 3: Overnight rates and risk-free benchmarks**

**The overnight money market rate serves as the foundation for virtually all financial pricing throughout the economy.** This rate, such as the Secured Overnight Financing Rate (SOFR), represents the cost of borrowing cash overnight. As the closest approximation to a true risk-free rate, overnight money market rates provide the baseline against which other financial instruments are priced. While central banks set policy target rates, the overnight market rates reflect real trading activity. For derivatives markets, these overnight rates serve as fundamental building blocks for valuation models. Interest rate swaps, forward rate

agreements and other derivative instruments rely on overnight rate curves to establish fair value pricing.

**37. The success of benchmark reforms ultimately depends on the alignment of technical design with broader market conditions and policy implementation.** While all six benchmarks were designed following international best practices, their adoption rates vary significantly based on local conditions and supporting frameworks (Box 5 in Annex1). The evaluation evidence supports the following insights:

- **Active market participation and regulatory backing support benchmark success.** Evidence from the Georgia case study demonstrates the most comprehensive success, where the Tbilisi Interbank Rate (TIBR) achieved 100 per cent adoption for floating rate issuances in 2022-23. This was driven by mandatory adoption requirements, improved market infrastructure through Bloomberg integration and EBRD's pioneering use across multiple instruments including floating loans. The success is reflected in concrete market metrics, with money market turnover approximately ten times higher than 2010 levels and reduced short-term interest rate volatility.
- **Traditional banking practices and inadequate regulatory frameworks can undermine technically sound benchmarks even where initial policy dialogue succeeds.** Evidence from country reviews shows how monetary policy choices can render benchmarks commercially unattractive. For example, where the Central Bank's interventions in Egypt pushed the Cairo Overnight Index Average (CONIA) rates above standard market corridor rates, leading to EBRD to renegotiate pilot transactions due to cost issues. Similarly, the Morocco case study shows that the Moroccan Overnight Index Average (MONIA), despite gaining traction in capital markets and being used by EBRD in cross-currency swaps, faces gradual banking sector adoption due to regulatory requirements still mandating the TMP benchmark for certain products.
- **External shocks can fundamentally disrupt benchmark adoption, as evidenced by Ukraine's experience.** Russia's invasion in 2022 severely impacted Ukrainian Overnight Index Average's (UONIA) functioning by disrupting interbank markets, and the benchmark became dependent on central bank transactions rather than genuine interbank activity. This affected the benchmark's credibility and usefulness.
- **Initial technical success requires sustained engagement to achieve full market adoption.** Evidence from the Kazakhstan case study and Uzbekistan country review highlights a pattern where initial technical success requires sustained engagement to achieve full market adoption. Kazakhstan's TONIA, reformed in 2021 following EBRD's MMWG establishment, shows improved market metrics. This includes increasing daily repo transaction volumes, yet full adoption remains gradual due to banks' conservative practices. Similarly, Uzbekistan's UZONIA, the Uzbek Overnight Index Average, has achieved technical improvements, maintaining spreads of less than 50 basis points to the policy rate since May 2023, but ongoing MMWG discussions indicate further refinements are needed to establish it as a fully trusted market reference rate.

### EBRD supported successful reforms in several countries for LCY bond issuances while efforts continue elsewhere

**38. Expanding the ability to fund LCY through bond issuances represents an important step in providing more flexible LCY financing.** Issuing LCY bonds (onshore or offshore) is a practical way to raise LCY funding by tapping financial markets, which may offer better terms than direct bank transactions, such as swaps. The liquidity raised in this way can enable more competitively priced

LCY lending. Beyond the direct funding benefits, successful onshore LCY bond issuance can contribute to local market development. Enjoying the full benefit of this method presupposes that EBRD has the ability to efficiently manage LCY liquidity created by the bond issuances, i.e., it is the Bank's flexibility to transform the proceeds of the issuances that is the key to material change of LCY products to EBRD clients.

### 39. Legal consent from countries of operations is a prerequisite for EBRD LCY bond issuances.

As stipulated in Article 20.1 of the Agreement Establishing the Bank (AEB), EBRD must obtain explicit approval from member countries before making any bond issuances in their territory or denominating obligations in their currency.<sup>14</sup> This requirement has important implications for the Bank's privileges, as issuing bonds means waiving certain special rights including immunity from litigation, thus allowing domestic investors to pursue legal action against EBRD if needed. To facilitate these issuances while managing legal risks, EBRD works with national authorities to establish special legal provisions recognising IFIs' unique characteristics, which can exempt them from some standard requirements while still complying with both the AEB consent provisions and essential domestic regulations. Obtaining issuance consent and securing the necessary legal changes and regulatory provisions can be a lengthy process spanning many years (Box 6 in Annex 1).

40. **Countries may not wish to grant consent for LCY bond issuances due to concerns about competition in their domestic markets.** The permission required from the national authorities in the context of Article 20.1 of the AEB means that in practice they have complete control, but implementation remains nevertheless challenging given the sensitivity around sovereign funding operations. Some authorities consider that issuances from an AAA-rated institution could compete with sovereign issuances, fragment liquidity and thus complicate their own funding operations. Moreover, granting consent to EBRD could set a precedent, triggering a request for similar access by other MDBs, amplifying the competitive impact. Such concerns could be alleviated by, for example, limiting IFI issuance to bonds (the proceeds of which must be on-lent domestically in LCY), or establishing issuance coordination mechanisms between MDBs and Ministries of Finance.

41. **EBRD Treasury's bond issuance strategy balances domestic and international markets to optimise both funding costs and market development objectives.** LCY bonds can contribute to local capital market development by lengthening liability maturities, providing credit diversification opportunities for domestic investors and reinforcing market indices, as has been the case in Kazakhstan and Georgia. Moreover, domestic issuance allows EBRD to work with local authorities on improving market infrastructure and regulations, while potentially accessing a more stable long-term investor base. Achieving sustainable market development requires regular market presence, as isolated or infrequent issuances have limited impact. Domestic bond issuances also present operational challenges that limit their role as a primary funding mechanism. The costs of issue are typically higher (due to often higher domestic issuance fees and more time-consuming documentation compared to international issuances), and pricing domestically rarely below government bond levels. Meanwhile, offshore bond investors often require returns higher than those seen on domestic issuances.

42. **The complementary nature of domestic and international issuance provides EBRD with strategic flexibility in meeting LCY funding needs.** Evidence from interviews indicates that while international Eurobonds offer advantages of simpler documentation through Global Medium-Term

<sup>14</sup> AEB Art 20.1: *The Bank shall have, in addition to the powers specified elsewhere in the Agreement, the power to;*  
*i) borrow funds in member countries or elsewhere, provided always that; a) before making a sale of its obligations in the territory of a country, the Bank shall have obtained its approval; and b) where the obligations of the Bank are to be denominated in the currency of a member, the Bank shall have obtained its approvals;*

Note (GMTN) programmes and typically lower costs due to EBRD's strong credit rating, maintaining a presence in both markets serves different objectives. EBRD optimises its funding by combining occasional domestic issuance to support market development with more frequent international issuance to ensure competitive funding costs. This dual approach allows EBRD to maintain its commitment to domestic market development while ensuring efficient funding for its LCY lending operations.

**43. While EBRD has secured the necessary consent and regulatory preconditions for LCY bond issuance in several markets, it has not achieved this result in a number of countries yet.** Through sustained engagement with central banks and regulatory authorities, EBRD has successfully established the necessary regulatory frameworks and obtained consent for bond issuance in Armenia, Serbia and Georgia, while the process is on-going in others (Box 7 in Annex 1).

**44. The EBRD Treasury has successfully developed synthetic LCY funding solutions to enable more competitive LCY funding cost where direct bond issuance remains unfeasible.** For countries where direct LCY issuance is not yet feasible, either domestically or offshore, EBRD Treasury has successfully implemented alternative solutions, such as USD-denominated bonds linked to LCY performance. This synthetic approach to LCY funding, implemented in countries like Egypt, Tajikistan, Uzbekistan and the Kyrgyz Republic, has enabled EBRD to offer more competitively priced LCY loans compared to traditional hedging mechanisms. It does this while continuing to work toward establishing conditions for direct issuance.

### 3.2. Market impact of policy engagement remains dependent on local context and reform commitment

**45. Policy progress remains highly dependent on country context and reform momentum, with both structural market features and institutional dynamics playing crucial roles.** As demonstrated by evidence from country case studies, even successful policy and legal reforms may not translate into market development when underlying conditions remain challenging.

**46. LCY bond issuance provides a good illustration of such challenges.** The evidence from the case studies and country reviews highlights the following insights:

- **The time required to establish preconditions for IFIs' bond issuance varies dramatically.** This is based on existing regulatory frameworks and institutional alignment, ranging from under two years in Armenia to more than a decade in Serbia and Ukraine (incomplete). The most successful cases demonstrate that progress accelerates when key institutions' objectives are aligned and committed. Armenia's straightforward two-year timeline benefited from broad institutional support and building on earlier capital markets reforms, while Georgia's experience shows how initial issuance can catalyse broader market development, growing from EBRD's first Georgian Lari (GEL) 50 million bond (€16 million) in 2014 to a total IFI market of GEL 2 billion (€638 million) by 2023.
- **Government concerns about market impact and coordination challenges represent the primary obstacles to establishing IFI bond frameworks.** Morocco's stalled progress illustrates how authorities' concerns about multiple IFIs accessing markets during stress periods can override technical feasibility, with the Ministry requiring careful coordination with government bond schedules and premium pricing to sovereign bonds. Similarly, Ukraine's protracted process reflects divergent views between key stakeholders.

- **There are benefits and potential risks of pragmatic approaches that circumvent incomplete regulatory frameworks.** Kazakhstan's alternative structure using English law bonds listed locally, but not issued under Kazakh securities law, has enabled EBRD to establish a significant LCY funding programme without waiting for comprehensive legal reforms. However, this approach introduces regulatory uncertainty that would not exist with conventional domestic issuance, highlighting the trade-offs between immediate funding needs and long-term regulatory clarity. This case exemplifies how the three pillars of the LCY approach can operate with different timelines, where funding solutions may advance ahead of policy frameworks to support immediate lending objectives.
- **Successful policy dialogue in creating bond issuance preconditions requires sustained engagement beyond initial regulatory changes to address operational complexities and maintain stakeholder alignment.** The incomplete cases in Azerbaijan and Ukraine demonstrate that securing legislative amendments represents only the initial step, with final implementation often delayed by operational details, regulatory approval processes and shifting stakeholder priorities. This reinforces the importance of the policy pillar in supporting the funding pillar, as regulatory frameworks must be sufficiently robust and comprehensive to enable sustained market participation rather than one-off transactions.

47. **The interdependence between LCY operations and domestic market conditions creates both opportunities and constraints for EBRD's effectiveness.** Unlike foreign currency lending, LCY operations make EBRD more dependent on the state of money markets and legal frameworks in each country. While this creates natural incentives for EBRD to engage in policy dialogue and market development, the Bank's inability to engage in policy-based lending means it cannot directly condition its interventions on reform progress. However, EBRD's strategic commitment to LCY lending objectives drives the Bank to maintain engagement in policy dialogue even when receptiveness is limited, using relationship building and capacity development as tools to create opportunities for future reform when political and market conditions become more favourable. The evidence from case studies supports the following insights:

- **Successful policy reforms require alignment between technical solutions and existing market incentives,** as demonstrated by Armenia's experience where legal frameworks achieved limited market adoption.
- **Political economy factors can be as important as technical merit in determining reform success,** as shown by Morocco's prolonged legislative process on derivatives reform.
- **EBRD's effectiveness depends on realistic sequencing that accounts for both market structure constraints and institutional capacity for implementation,** rather than assuming that well-designed reforms will automatically translate into market development.

#### Box 2: Policy implementation challenges in practice

##### Armenia: policy progress faces market realities

Armenia demonstrates how successful policy and legal reforms may not automatically translate into market development when underlying market conditions and incentives remain challenging. Despite EBRD's sustained efforts across both policy and funding dimensions, two key "broken links" emerged:

**From policy to market development:** EBRD successfully delivered critical policy and legal infrastructure through TC, including derivatives legislation and repo market frameworks adopted in 2018-19. The reforms enabled some initial demonstration transactions by the Treasury. However, commercial banks' behaviour changed little overall. Banks continue to rely primarily on central bank facilities and bilateral over-the-counter (OTC) trading, showing limited interest in adopting more sophisticated market practices or using the new EBRD-facilitated

AMX trading platform. This reflects both structural constraints – banks' relatively small balance sheets and limited Armenian Dram (AMD) liquidity served primarily by the OTC market – and a lack of regulatory pressure to change established practices.

**From funding innovation to market competitiveness:** While EBRD Treasury developed more sophisticated funding approaches over time, moving beyond early reliance on TCX to establish an AMD liquidity pool and diverse funding instruments, structural market features continue to constrain competitiveness. The shallow interbank market has prevented the development of a credible risk-free benchmark rate. As a result, EBRD must rely on Treasury bill rates for floating rate pricing, which have been consistently higher than commercial banks' cost of funds at similar maturities. This creates a structural barrier to EBRD offering competitive LCY financing.

#### Morocco: reform momentum stalled by implementation complexities

Even with initial reform momentum progress can stall when faced with complex institutional and regulatory challenges. EBRD's engagement with derivatives reform began promisingly in 2016 with advisory support to draft legislation. However, fundamental reforms remain pending due to several interconnected challenges.

The draft derivatives law has been stalled in government review since 2016, partly due to sensitivities around derivatives being perceived as speculative instruments. This has left Morocco as a "non-netting jurisdiction", limiting banks to short-term derivative transactions of under one year to manage counterparty risk. While some practical progress has been made, such as establishing a futures market and central clearing counterparty in 2024, the absence of a comprehensive legal framework continues to constrain market development. EBRD's intervention has helped open new dialogues, particularly on tax treatment of derivatives – an issue where local banks had previously failed to engage tax authorities.

### 3.3. Non-lending LCY operations face persistent challenges in systematic measurement and monitoring

#### Market building activities combining policy and EBRD Treasury market operations are not subject to formal TI assessment or reporting

48. **EBRD's standard transition assessment frameworks do not fully capture Treasury's role in developing LCY markets.** While it is standard practice that non-transactional policy and TC work does not undergo formal transition impact assessment and monitoring, in the case of LCY operations this limitation extends to Treasury's market operations for LCY funding and liquidity management. These activities constitute a distinct pillar of EBRD LCY approach and generate transition benefits both directly and by enabling other LCY operations. This transition rationale of the three-pillar approach is well-articulated (and forms a basis for the evaluation), but is not translated into formal transition assessment frameworks. This creates challenges in fully recognising and documenting the transition impact of Treasury's role in developing LCY markets.

#### LCYP's enhanced approach is moving toward more systematic monitoring, but limitations remain

49. **The SME LCYP's revised reporting framework represents a positive step forward in monitoring non-lending LCY activities.** In 2022, the Programme formally transitioned from MoU-

based policy dialogue to the standardised Money Market Diagnostics Framework (MMDF). It also introduced more systematic reporting through a 'three directions of travel' framework that covers LCY sourcing conditions, reform implementation and policy engagement for each country. This enhanced reporting structure, first implemented in the 2022 Small Business Initiative (SBI) annual report,<sup>15</sup> has improved transparency around the contextual factors and non-lending elements of LCY operations.

**50. However, the current reporting approach still has notable limitations in providing a comprehensive or transition-focused view of EBRD LCY operations.** The framework's brief and activity-focused reporting style does not fully capture results or the critical interactions between different pillars of LCY operations. Further, its restriction to SME LCYP countries means it excluded important success stories like Kazakhstan, where EBRD has been very active in LCY market development even outside the formal LCYP framework. Despite these constraints, in the absence of transition impact reporting for LCY operations, this enhanced framework has provided valuable baseline information about EBRD's country-level activities in this space.

## 4. Key message 3: EBRD has expanded its local currency financing product range and flexibility, but delivery remains constrained by market conditions

### 4.1. Local currency lending has expanded in volume, but remains uneven in reach

#### The strategic objective of increasing LCY share was challenged by external shocks

**51. Overall, the objective of increasing the share of EBRD investments in LCY has not been achieved over the evaluation period.** The objective of increasing the share of LCY investments was a strategic objective of the LC2 Initiative established in 2013,<sup>16</sup> as well as the LC2 Strategy 2019-24.<sup>17</sup> The most recent annual report of the EBRD Treasury states unambiguously: '*The EBRD tries to achieve a single outcome: local currency lending.*'<sup>18</sup> The analysis of whether this objective has been achieved over the evaluation period requires some nuance. Overall, however, there was no obvious upward trend in LCY lending share in volume or in the number of operations.

**52. For countries within the scope of the evaluation, there has been a growth in LCY share over the long-term, but a declining trend over the evaluation period.** The countries within the scope of the evaluation saw a slight growth trend of LCY Annual Bank Investment (ABI) share over the long-term (2013-23), with this trend being more pronounced in terms of share in number of

<sup>15</sup> BDS15-050 (Addendum 153): Regional: Small Business Initiative Annual Review 2021 and Strategic Priorities

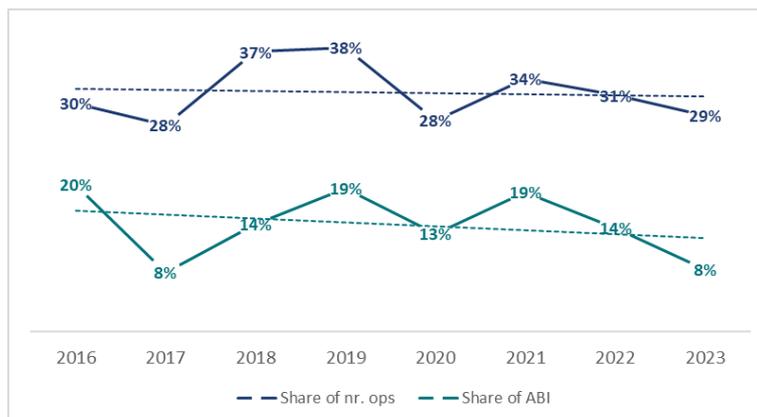
<sup>16</sup> BDS/13-271 (Final): Local Currency and Capital Markets (LC2) Development – Strategic Initiative

<sup>17</sup> BDS18-210: Local Currency and Capital Markets (LC2) Strategy 2019-2024

<sup>18</sup> CS/FO/24-16: Annual Report on Treasury Activities in 2023; p11

operations. However, the trend in the share of projects has remained flat over the evaluation period (2016-23), while the trend in the share of LCY ABI was in slight decline (Figure 3).

**Figure 3: Trend in LCY share of ABI and share in number of projects, 2016-23**



Source: IEVD analysis based on dw-banking\_operational dataset

**53. While the share of LCY business has not increased, it has largely kept pace with the growth of ABI, demonstrating EBRD's ability to deliver larger volumes of LCY financing in absolute terms.** The most recent data from 2024 (outside of the evaluation period) shows LCY volumes in the evaluation scope countries reaching €1.5 billion. This represents a 40 per cent increase over the previous peak achieved in 2019, even though the share of LCY business at 17 per cent remains below historical highs of 19 per cent (2019, 2021). This growth trend in absolute volumes suggests that while EBRD may not be increasing the proportion of its business done in LCY, it is nonetheless expanding its ability to deliver larger volumes of LCY financing. The challenge appears to be growing LCY business even faster than the overall business growth to achieve a higher share, rather than an inability to grow LCY business in absolute terms.

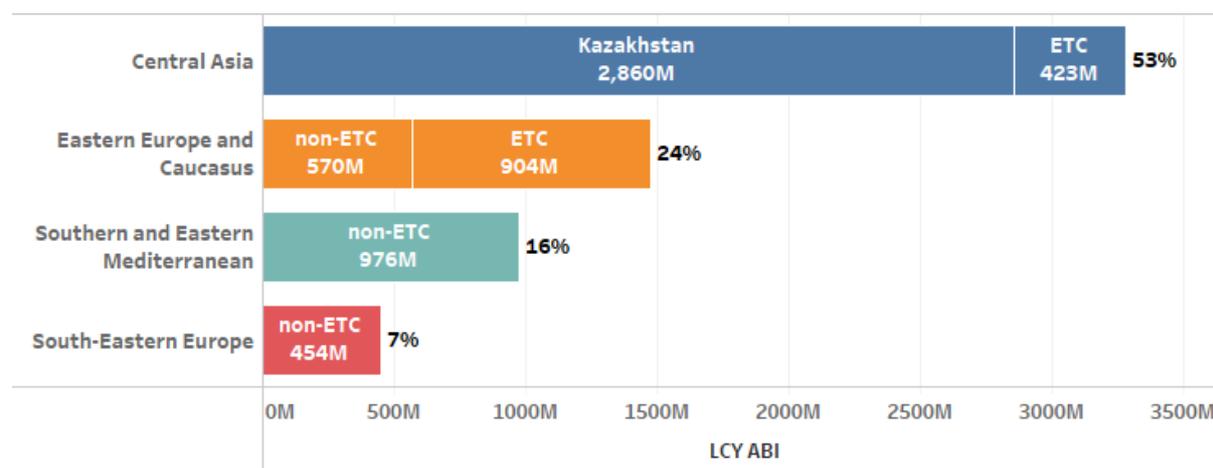
**54. The post COVID-19 inflationary period and the war on Ukraine were the key contributors to declines in LCY shares over the evaluation period.** At the beginning of the LC2 Initiative the share of operations in LCY was negatively affected by the discontinuation of EBRD operations in the Russian Federation – then the largest country of LCY operations. There was an upward trend in the years preceding the COVID-19 pandemic, with a peak in LCY operations in 2019 (19 per cent of debt ABI, 38 per cent of operations by number). The trend was then reversed after COVID-19 with widespread inflation and monetary tightening and further affected by the war on Ukraine. Interest rate differentials widened during this period, with central banks in the region raising policy rates significantly to combat inflation. This monetary tightening, combined with currency depreciation in several countries with economic links to Russia and Ukraine, triggered higher risk premiums for LCY instruments. These risk premiums further widened the cost gap between local and hard currency financing, making LCY lending relatively more expensive and less attractive despite the FX risks inherent in hard currency alternatives.

### Early Transition Countries (ETCs) show stronger relative LCY performance, while Kazakhstan dominates absolute volumes

**55. The geographic distribution of LCY operations is highly uneven, with Kazakhstan as a singular outlier.** In the countries within the scope of the evaluation, the overall volume of LCY ABI

was €6.2 billion, representing more than 14 per cent of debt ABI. The geographic distribution of LCY operations was highly uneven across countries. Three countries had no LCY operations (Lebanon, North Macedonia, Turkmenistan). Countries with LCY operations ranged from 3 per cent ABI share (Egypt) to 64 per cent ABI share (Kazakhstan). Kazakhstan represents an outlier not only in its share of LCY ABI, but also in absolute LCY volume (€2.9 billion), which is almost half (46 per cent) of the absolute LCY volume across all countries within scope (Figure 4).

Figure 4: LCY ABI by region and country group, 2016-23



Source: IEVD analysis based on dw-banking\_operational dataset

56. **ETCs<sup>19</sup> achieved higher relative shares of LCY financing compared to more advanced economies outside of Kazakhstan.** ETC countries surpassed non-ETCs with an overall LCY share of 12 per cent of debt ABI, while the same figure for non-ETCs outside of Kazakhstan was only 7 per cent. The absolute volumes remain larger in non-ETC countries due to their larger overall business volumes. The relative overperformance of ETC countries was aided by support mechanisms, such as the SME LCYP, as well as difficult LCY operating context in some non-ETC regions, in particular Southern and Eastern Mediterranean (SEMED) and Southeastern Europe.

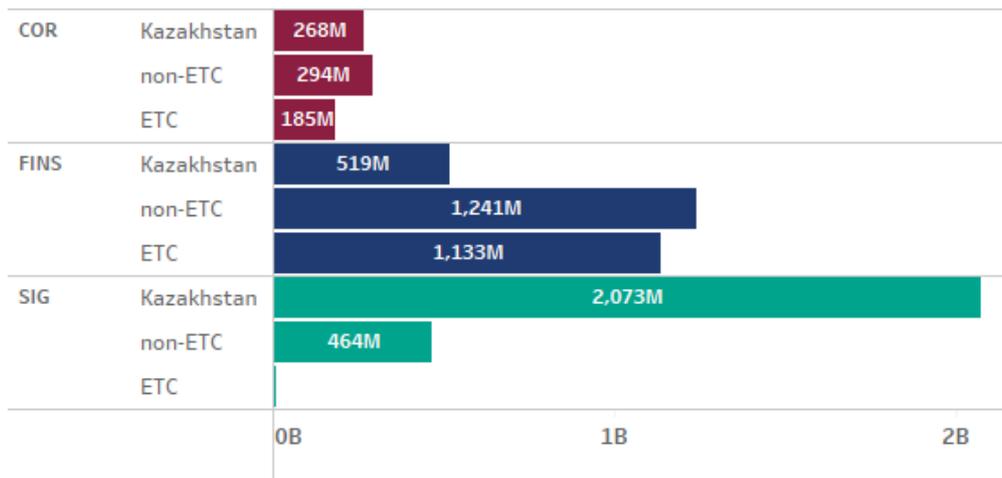
### Financial Institutions sector leads LCY delivery with focus on SME finance in early transition countries, while LCY Infrastructure shows declining trend

57. **LCY financing is predominantly delivered by the FI sector, with the exception of Infrastructure in Kazakhstan.** LCY financing is a domain of the FI sector, with infrastructure only significantly present in Kazakhstan. Almost half of the total LCY ABI was delivered by the FI sector (47 per cent, €2.9 billion), closely followed by Sustainable Infrastructure (SI) (41 per cent, €2.5 billion), with the Corporate sector representing the remainder (12 per cent, €0.7 billion). However, this breakdown is skewed due to the large Infrastructure LCY ABI in Kazakhstan (€2.1 billion).

<sup>19</sup> Early Transition Countries (ETCs) include Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan, Turkmenistan and Uzbekistan. Belarus, which was included in the ETC group, is not considered within the scope or data of this evaluation, as EBRD ceased operations in the country.

With Kazakhstan excluded, FI sector accounts for 71 per cent of LCY ABI in all remaining countries<sup>20</sup> (Figure 5).

Figure 5: LCY ABI per sector by country group, 2016-23



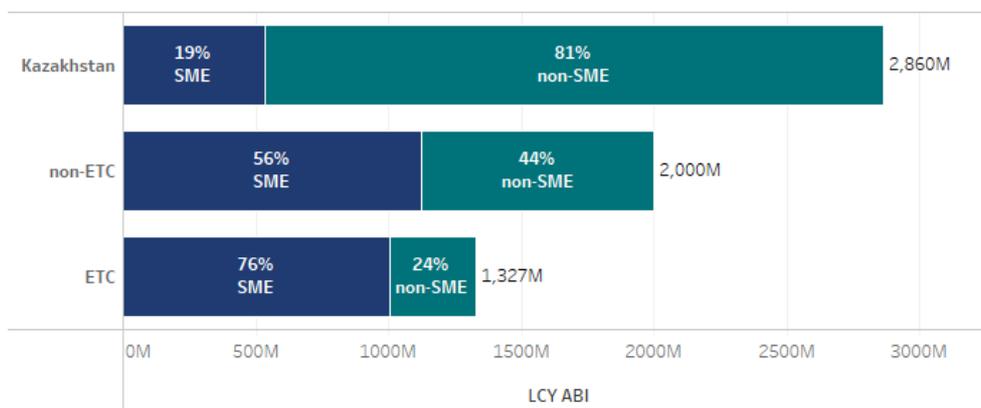
Source: IEvD analysis based on dw-banking\_operational dataset

#### 58. LCY financing plays a considerably more important role for SME operations in ETCs

**compared to non-ETCs.** In ETC countries, SME operations account for three-quarters (76 per cent) of all LCY financing, compared to 56 per cent in non-ETCs (excluding Kazakhstan) and only 19 per cent in Kazakhstan. This high share of SME financing in ETCs is closely tied to EBRD's strategy of delivering LCY through financial intermediaries. When trade facilitation guarantees are excluded, LCY represents 60 per cent of financial sector debt ABI in ETCs, compared to 21 per cent in non-ETCs. This suggests that EBRD has been particularly successful in using LCY financing as a tool to reach SMEs in ETCs using intermediated finance, addressing both FX risk and access to finance objectives simultaneously. It is however also still dependent on the SME LCYP guarantee, as discussed above (Figure 6).

<sup>20</sup> The EBRD organises its operations into three main sector groups: Financial Institutions (FI) covers banking, leasing, and other financial services; Sustainable Infrastructure (SI) encompasses energy, municipal infrastructure, transport, and other infrastructure investments; and Corporate (COR) (former Industry, Commerce and Agribusiness (ICA)) includes manufacturing, services, agribusiness, property, tourism, and other commercial sectors. These sector classifications guide the Bank's operational structure and portfolio reporting.

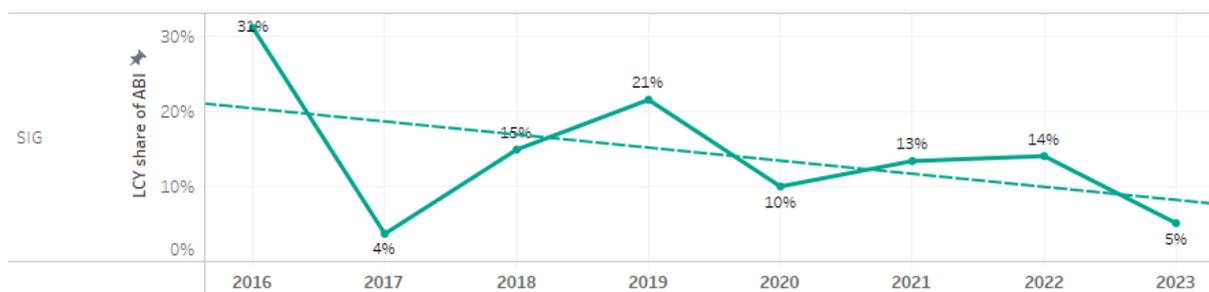
Figure 6: SME LCY as a share of LCY ABI, by country group, 2016-23



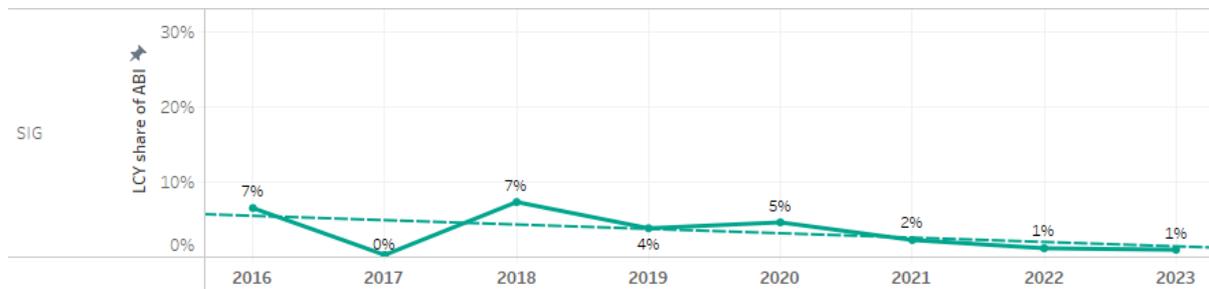
Source: IEvD analysis based on dw-banking\_operational dataset

59. **LCY financing in Infrastructure has been declining as a share of overall SI ABI.** While the trend for FI and Corporate sectors has been fairly stable in terms of their share of LCY finance, the trend for SI has been declining. This trend holds even when Kazakhstan is excluded from the data (Figure 7).

Figure 7: Trend in the share of LCY ABI in Infrastructure sector, 2016-23



Infrastructure sector, Kazakhstan excluded:



Source: IEvD analysis based on dw-banking\_operational dataset

## Market development gaps continue to limit infrastructure LCY lending

**60. The Infrastructure sector remains an emerging frontier for LCY financing, despite the natural alignment with LCY revenues of many infrastructure clients.** The strong theoretical case for LCY lending to municipalities and utilities, which predominantly earn revenues in LCY, suggests potential for expansion as domestic financial markets mature and EBRD LCY capabilities strengthen. Nevertheless, the overall share of LCY in SI ABI has been on a declining trend, which is at odds with the strategic importance of infrastructure financing and the natural alignment between infrastructure projects and LCY revenues. Currently, successful LCY infrastructure lending is concentrated in a small number of non-ETCs where market development enables onshore funding and offers longer tenors typically required for infrastructure projects. The limited geographic reach reflects both Treasury's constraints in offering extended maturities in LCY across most markets and the complexities of structuring such projects (Box 8 in Annex 1). The evidence from the case studies and country reviews highlights the following insights.

- **Sophisticated Treasury operations and supportive policy frameworks can enable substantial LCY infrastructure financing in advanced markets, as demonstrated by Kazakhstan's market-leading position.** Kazakhstan dominates EBRD LCY infrastructure lending with €2.1 billion invested over 2016-23, representing more than 80 per cent of EBRD's total LCY infrastructure ABI. This success stems from Treasury's management of a LCY liquidity pool, combined with regulatory changes promoting de-dollarisation that particularly benefit natural monopolies and regulated entities with LCY revenues. This includes legal frameworks for renewable energy (RE) projects with tariff indexation mechanisms linking to both the US dollar and local inflation.
- **Establishing LCY funding capabilities can unlock new infrastructure financing opportunities in emerging markets, particularly in the municipal sector during periods of fiscal decentralisation.** Evidence from the Morocco case study shows how LCY infrastructure financing, while modest at €35 million over the evaluation period, has enabled EBRD to engage with new municipal and state-owned enterprise (SOE) clients through pioneering transactions, including the country's first municipal green bond with Agadir and subsequent investments with the Guelmim-Oued Noun region and national railway operator ONCF. These early successes have built momentum and created a platform for expanding infrastructure financing as fiscal decentralisation increases the importance of LCY municipal finance.
- **Market structure constraints and economic conditions can significantly limit LCY infrastructure expansion despite successful innovation in specific segments.** Egypt's experience illustrates these challenges, where infrastructure LCY financing reached only €146 million compared to €2.7 billion in hard currency infrastructure financing, with the majority coming through two municipal bond investments with the New Urban Communities Authority. Several factors constrain broader adoption, including the dominance of sovereign projects typically financed in hard currency, relatively low private sector participation, high local interest rates combined with economic uncertainty and EBRD's reduced competitiveness against local bank pricing in LCY markets where blending with concessional finance provides fewer advantages.

## 4.2. Market development activities have successfully expanded EBRD's LCY product range and transaction flexibility

### To remain additional in an evolving market, greater flexibility has been achieved in EBRD LCY transactions structuring

**61. The ability to offer tailored LCY financing remains a key challenge for EBRD.** While the Bank aims to design loans that fit each client's specific needs, this is more challenging in LCY compared to major currencies. Local commercial banks have natural advantages in offering flexible LCY products due to their liquidity in LCY. This allows them to respond more quickly and flexibly to client requests.

**62. The development of effective money markets is crucial for expanding EBRD LCY product offerings.** Banks require robust market infrastructure, including reliable benchmarks, yield curves and swap markets to structure and price loans effectively. These fundamental market elements are often underdeveloped or absent in EBRD's COOs, limiting the Bank's ability to match the product flexibility it achieves in major foreign currencies. This underscores why Treasury's policy dialogue work on money market development is essential for expanding LCY lending capacity.

**63. EBRD has successfully evolved beyond simple back-to-back funding to enhance its LCY capabilities.** Recognising the limitations of strict back-to-back structures in meeting client needs, EBRD Treasury has gradually developed more sophisticated approaches in many COOs. The transition to more flexible approaches and, where feasible, to liquidity pools has significantly improved EBRD's ability to offer flexible loan structures. Banking teams report that the Treasury is able to fund almost any structure, though some constraints remain.

**64. Evidence suggests the liquidity pool approach, where implemented, has improved EBRD's competitiveness in both pricing and loan tenors.** While systematic comparison data is limited, especially for specialised products, there are clear indications that the Bank has enhanced the terms of its LCY loans in both maturity and pricing through this more flexible funding approach. For example, in Kazakhstan the term of the local currency KZT fixed funding available to Banking has increased from 7 years in September 2021 to 15 years in May 2023.

**65. EBRD Treasury's pragmatic risk management approach has been key to implementing successful liquidity pools.** EBRD Treasury manages market risks within established limits, taking a more nuanced approach compared to peer institutions. Within this framework, Treasury accepts limited FX risk and manages interest rate risk actively, while the Banking side maintains no FX exposure. Treasury manages its transaction book holistically, accepting some limited mismatches in short-term cash flows and refinancing risk for longer-term transactions where matching funding is not available. This calculated approach to risk management has enabled EBRD to develop more extensive LCY lending compared to other institutions that maintain stricter interpretations.

### The Bank can offer a range of LCY products to match clients' needs

**66. The Client Solutions Group (CSG) serves as a bridge between Treasury and Banking teams in optimising LCY solutions.** Operating independently from trading desks, CSG reviews all projects going to EBRD's Operations Committee to identify opportunities where LCY might be more appropriate than hard currency. They act as advisers during project structuring, incorporating

funding considerations in the design of projects and serve as an intermediary between Banking and Treasury teams, with traders not directly interfacing with clients.

**67. EBRD's ability to fund onshore and through liquidity pools provides crucial stability in its LCY offering.** During periods of market turbulence when TCX or offshore markets become constrained or prohibitively expensive and in countries where the EBRD Treasury was able to diversify its funding approach through domestic bond markets and local institutional investors, this provided more resilience. Local market participants typically maintain more stable pricing in their home currency compared to international investors during uncertain times, enabling EBRD to maintain consistent LCY lending capacity for clients.

**68. EBRD Treasury's use of derivatives serves the dual purpose of enabling operational flexibility while simultaneously supporting local market development.** Treasury's derivatives operations allow the Bank to warehouse market risks and achieve greater LCY financing capacity than would be possible under traditional back-to-back funding constraints. This approach enables Treasury to capitalise on funding opportunities, take controlled maturity transformation risk and offer more flexible loan features to Banking clients while managing risks more efficiently. Beyond operational benefits, derivatives serve as practical capacity building tools for local financial institutions, as demonstrated through EBRD's transactions which introduce counterparties to new instruments and build local market capability (Box 9 in Annex 1).

**69. The Bank is expanding market instruments through the promotion of a floating rate in traditionally fixed-rate markets.** While the EBRD region is traditionally a fixed rate area, the EBRD Treasury has helped introduce and enhance market-based benchmarks and yield curves, which form the basis of an efficient floating rate market. The development of these market-based floating rate benchmarks, coupled with interest rate risk management instruments indexed to them, delivers several benefits. It enables more accurate pricing and improved interest rate risk management across the market, while ultimately allowing EBRD to offer longer-term financing in both floating and fixed rate formats. Although market acceptance of these new approaches remains gradual as understanding of interest rate risk continues to develop, the foundational infrastructure for more sophisticated financial markets is being established.

**70. One enabler of this capability has been EBRD Treasury's development of yield curves in countries where reliable market-based curves are not available** This includes Georgia, Armenia, Kazakhstan, Ukraine, Mongolia, Uzbekistan and Azerbaijan. This approach combines macroeconomic forecasting using central bank methodology with available market data to create hybrid Overnight Index Swap and Synthetic Cross-Currency Swap curves that enable daily valuations of LCY instruments and pricing of fixed-rate products. These curves, now also published on Bloomberg, serve as both an operational tool for EBRD's own LCY operations and public goods that support broader market development by providing local banks and other market participants with reliable pricing references for LCY financial instruments (Box 10 in Annex 1).

**71. EBRD has developed the capability to offer genuine long-term fixed rate LCY loans through innovative funding approaches.** While fixed rate lending dominates in many countries of operations, it is typically limited to shorter tenors of three years or less, often locally structured as revolving facilities that do not provide true long-term commitment. Through its funding policy and development of new instruments like interest rate derivatives, EBRD can now offer truly committed long-term fixed rate loans. This advantage that becomes particularly valuable during financial market stress when uncommitted facilities may be withdrawn.

## 4.3. Longer tenors and non-financial elements differentiate EBRD's LCY offer, but support mechanisms remain essential in early transition markets

### Longer tenors differentiate EBRD's offering

**72. Multilateral banks are at a structural disadvantage when operating in LCY compared to domestic financial institutions.** One of the key functions of the banking sector in an efficient market economy is to take deposits and lend the resulting liquidity to borrowers, carrying out maturity transformation in the process. Local banks benefit from natural advantages in LCY operations through their ability to collect deposits, access interbank markets and utilise central bank facilities – all of which provide flexible and cost-effective funding. In contrast, EBRD and other MDBs primarily fund themselves in hard currencies through international markets where they leverage their AAA ratings. While this gives EBRD a clear advantage in foreign currency lending, domestic institutions are inherently better positioned for LCY operations.

**73. Local lending markets have become more mature, raising the bar of EBRD additionality.** Although the countries within the scope of the evaluation vary greatly in terms of maturity, their banking sectors are developing in terms of competence and sophistication. This capacity remains often imperfect, geared towards blue chip companies and are essentially short to medium-term. However, the growing strength and competitiveness of the local banking sectors pushes the boundaries of additionality and obliges EBRD to differentiate its LCY lending even further.

**74. Financial additionality therefore rarely comes from offering LCY on its own.** Financial additionality of EBRD LCY lending faces challenges in competing with established local bank offerings. In many countries LCY products on their own rarely provide sufficient additionality, as local banks can typically offer similar or cheaper LCY loans using their deposit base or the central bank's backstop facilities. This creates a more demanding test for EBRD's additionality compared to hard currency lending.

**75. EBRD's ability to provide longer-term LCY funding addresses a key market gap in many COOs.** Financial institutions in COOs are increasingly taking a more strategic approach to Asset/Liability Management, seeking to better match the duration of their assets and liabilities in LCY. While banks can typically access ample short-term LCY funding through deposits and central bank facilities, longer-term financing options remain limited in many markets. EBRD's capacity to provide extended tenors in LCY helps partner banks build more resilient balance sheets and reduce maturity mismatches. This advantage in tenor appears more durable than pure pricing competitiveness, as it stems from structural market limitations rather than just funding costs. For example, lending to the FI sector in the Kyrgyz Republic has been almost exclusively in LCY. Through the SME LCYP subsidy, EBRD has established itself as the primary source of extended-tenor LCY financing among development finance institutions (DFIs). This capability has proven particularly valuable for financing intermediated green investments, where longer repayment periods are needed to match capital expenditure (Capex) requirements.

**76. The tenor advantage is particularly valuable in Infrastructure or Corporate Capex financing, though this usually requires more sophisticated Treasury capabilities.** Infrastructure projects require extended financing periods to match their asset life and revenue generation patterns, making longer-term LCY financing especially important for reducing currency mismatches. For example, the Bank provides committed long-term LCY loans in Kazakhstan with extended grace

periods for Infrastructure projects, contrasting with local banks that typically limit themselves to short-term working capital loans or medium-term facilities. However, EBRD can only offer such long-term LCY products in more mature markets where the Treasury has developed sophisticated funding capabilities (Box 11 in Annex 1).

## Non-financial additionality elements not unique to LCY lending strengthen the EBRD LCY value proposition

**77. EBRD's additionality in LCY lending is strengthened through complementary non-financial elements, particularly in the dominant FI sector.** The Bank enhances the value proposition of its LCY credit lines by bundling them with TC support, non-TC incentives for specific purposes like green finance or inclusion and advisory services, like risk management assistance for financial institutions. Long-term relationships also play an important role, as partner FIs value EBRD as a prestigious IFI that they are proud to be associated with and which provides stable and reliable funding source through market cycles. However, these additionality elements are not unique to LCY operations. They are equally applicable to EBRD's hard currency lending, and indeed in many countries partner FIs are both LCY and non-LCY clients.

### Box 3: Non-financial additionality complements LCY lending

#### Armenia: non-financial elements drive LCY additionality beyond pricing

While the SME LCYP helps keep lending rates competitive by reducing credit margins, partner banks emphasised that EBRD's value proposition comes primarily from specialised programmes. For instance, gender-focused credit lines are bundled with TC support, while green lending comes with grant incentives for sub-borrowers. The recently introduced portfolio risk sharing facility (RSF), while currency-agnostic, demonstrates how EBRD leverages its risk appetite to create an attractive product for FIs.

#### Serbia: high LCY funding costs drive focus to subsidised green finance

Serbia was the largest non-ETC user of the SME LCYP, but no new LCYP transactions have been signed since 2021 due to pricing challenges and increased LCY deposit liquidity in banks. EBRD maintains competitiveness in longer LCY tenors (four to five years) where local funding sources are limited. However, more recent LCY lending has come primarily through subsidised green credit lines (Western Balkans GEFF I-III frameworks). These frameworks are not eligible for LCYP support (not SME targeted), but combine TC funds for both partner banks and sub-borrowers with substantial investment incentives (15-35 per cent) for eligible residential energy efficiency projects. This demonstrates how targeted sector programmes with comprehensive support packages can create demand for LCY products even when pure pricing competitiveness is challenging.

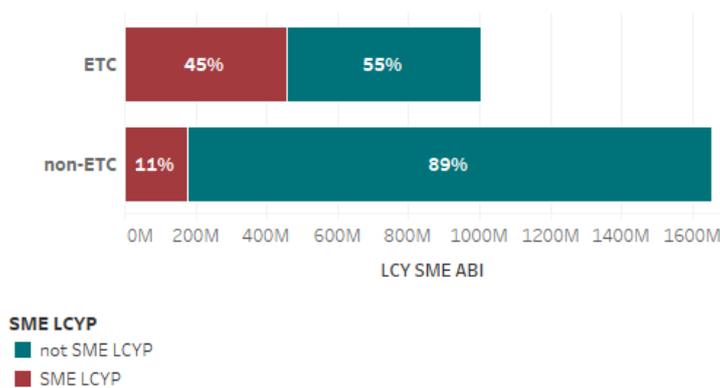
## The SME LCYP lending facility remains essential for early transition markets

**78. The SME LCYP lending facility introduced a first loss cover guarantee on eligible SME LCY lending.** The LCYP Lending Facility provides donor-funded first loss cover on EBRD's portfolio of LCY loans (both to local FIs and direct), enabling the Bank to lower its credit margin, thus offering SMEs LCY financing at rates comparable to domestic market levels. The facility aimed to increase LCY intermediation to SMEs by demonstrating the viability of LCY products to FIs, recognising that building functioning money markets and accessing cheaper onshore funding were longer-term objectives. The transition rationale of the lending facility was tied to increased resilience via

limiting the exposure of SMEs to FX mismatches. While the LCYP acknowledged that its transition impact was constrained by the presence of a subsidy through the first loss cover, this support was envisioned to be gradually phased out as domestic money markets developed. To prevent market distortion, the LCYP establishes pricing benchmarks for each country.

**79. Despite the 2016 extension of eligibility beyond ETCs, the LCYP facility remains predominantly utilised in ETC countries.** The Programme represented 11 per cent of annual LCY ABI on average in countries within the evaluation scope during 2016-23, but this participation was highly skewed. ETC countries accounted for approximately three-quarters of the LCY ABI. This concentration is particularly pronounced in SME LCY financing, where the Programme enabled 45 per cent of SME LCY ABI in ETCs, compared to only 11 per cent in non-ETC countries over the same period (Figure 8).

**Figure 8: Share of SME LCYP in SME LCY ABI by country group, 2016-23**



Source: IEvD analysis based on dw-banking\_operational dataset

**80. The LCYP continues to play an instrumental role in enabling LCY financing in ETCs that joined before 2016.** In these early adopter countries, the Programme accounts for a substantial majority of overall LCY ABI; 73 per cent in Armenia, 75 per cent in the Kyrgyz Republic, 93 per cent in Tajikistan and 63 per cent in Mongolia during 2016-23. In Georgia, which stands as the Programme's largest user by absolute volume, the LCYP represented 21 per cent of LCY ABI. These shares of LCYP utilisation demonstrate the Programme's continuing importance for facilitating LCY financing in markets where it would otherwise be challenging or prohibitively expensive.

**81. While the LCYP lending facility remains crucial for ETCs, it faces several operational constraints that limit its effectiveness.** In Georgia, Azerbaijan and Uzbekistan, single obligor limits, unchanged since 2016, have been cited as overly restrictive by Banking, constraining business growth with existing clients. For example, Georgia saw significant growth of partner banks over the period and the Programme's limits have led banking to adopt a blending approach, combining LCYP and commercial tranches to achieve competitive overall margins. The focus on SMEs is perceived as creating adverse selection challenges in direct lending and funded risk sharing facilities, as it offers more favourable terms to smaller companies compared to larger corporates. This issue has been highlighted by banking in Azerbaijan and Mongolia. The previously discussed inability to use funded risk sharing for LCY projects in some countries due to legal constraints is not a LCYP-specific issue, but these types of transactions would typically be supported by LCYP in ETCs. Additionally, LCYP pricing benchmarks have been reported by Banking as too high in some markets, limiting competitiveness even with the LCYP subsidy.

**82. The expansion of the SME LCYP beyond ETCs in 2016 has not delivered the anticipated growth in these new markets.** The experience across non-ETC countries reveals diverse reasons limiting LCYP utilisation, as follows.

- Morocco: 4 per cent of LCY ABI is supported by LCYP. This was due to a combination of factors, including the prevalence of non-eligible credit lines that either benefited from investment grants or alternative risk coverage. Meanwhile, the country's more developed Treasury funding options had already enabled competitive pricing.
- Ukraine: 3 per cent of LCY ABI is supported by LCYP. The direct interest rate subsidies available through SME Competitiveness facilities proved more attractive.
- Albania: No LCY lending. LCY financing remained uncompetitive even with the Programme support
- Egypt: 5 per cent of LCY ABI is supported by LCYP. LCYP FI lending has been confined to non-deposit taking microfinance institutions, while banking FIs remain hard currency clients.
- Serbia: the largest non-ETC LCYP user at 32 per cent, but the country has not originated new LCYP projects since 2021 due to the implementation of non-eligible residential green financing and competitiveness issues
- Tunisia: there is a relatively high LCYP share at 48 per cent. However, this represents a small overall LCY investment volume constrained by funding access, with the LCYP only used in unfunded risk-sharing facilities since 2020.

**83. The LCYP has facilitated EBRD's transition away from exclusive TCX dependency for currency risk management in ETCs.** The Programme's critical contribution lies in facilitating this shift in markets where sophisticated onshore funding and liquidity management options remain limited due to market underdevelopment. By providing a foundation for LCY operations through its risk sharing mechanism, the Programme has enabled EBRD to supplement TCX coverage with alternative funding sources. This has enhanced flexibility and stability in the Bank's LCY product offering to clients and supported gradual market development.

**84. The Programme's original premise of needing to demonstrate LCY lending viability to FIs has been overtaken by market and regulatory developments.** While initially conceived as a demonstration tool to show local FIs the viability of LCY lending, this objective has been largely superseded by regulatory developments and market evolution. Many countries now have de-dollarisation regulations limiting foreign currency lending and banks often maintain adequate short-term liquidity from LCY deposits and have demand for longer-term LCY funding if the price is right. Consequently, the programme's primary value proposition has shifted toward enabling EBRD to offer competitively priced LCY products to FIs/SME clients, thereby supporting broader transition objectives at both the sub-borrower and partner FI levels. This revised understanding better reflects the Programme's current role in EBRD's LCY context and its contribution to market development.

## 4.4. Structural disadvantages and market realities continue to constrain the competitiveness and reach of EBRD LCY lending

### Inherent constraints limit the market appeal of EBRD LCY instruments despite their improving design

#### 85. The timing of interest rate fixing creates particular challenges for LCY lending operations.

While clients seeking fixed rate loans need certainty on interest rates during loan negotiations, EBRD cannot definitively fix rates until disbursement, which can take considerable time especially for complex projects with multiple conditions precedent. This is not an issue with local commercial banks, which display a relative insensitivity to interest rate risk. The Bank's market-based funding and more prudent approach to managing interest rate risk affects its ability to finance longer-term projects that require extended disbursement periods. While variable rate solutions might address some of these constraints, the Bank's market-based funding faces limited acceptance in markets where fixed rate financing is the norm. This constraint affects all EBRD lending, but it is more pronounced in LCY operations, where local banks can offer more immediate rate fixing due to their access to stable deposit funding.

#### 86. Managing liquidity in multiple local currencies requires careful coordination between Treasury and Banking teams.

While there is generally good cooperation between departments, with systematic pipeline information sharing and CSG engagement on structuring, the relatively small volume of operations in niche currencies means that changes to anticipated project schedules can create challenges for Treasury's liquidity management. These coordination challenges are an inherent aspect of maintaining LCY lending capabilities across multiple markets.

#### 87. The complexity of EBRD's loan documentation can present obstacles, particularly in LCY operations.

While documentation complexity is not unique to LCY lending, it becomes more apparent when clients can compare it with simpler local bank documentation. The CSG plays an important role in explaining EBRD's pricing and funding approach to clients. However, certain English law provisions like unwinding costs and market disruption clauses remain unfamiliar to many local borrowers. Conversely, the use of local law constrains EBRD's ability to execute certain transactions, like funded risk participation agreements. This challenge emerges in funded RSF, where local FIs' loan agreements lack the protections that EBRD uses for LCY transactions with critical provisions, such as market disruption clause or unwinding costs clause. This disallows the use of funded RSF in a number of countries.

### Models of LCY concessionality demonstrate trade-offs between market alignment and effectiveness for transition

#### 88. The relationship between concessionality and additionality in LCY operations requires careful consideration to maintain market principles.

While concessional support through programmes like the SME LCYP can help EBRD offer competitive LCY products, it is important to recognise that concessionality itself does not constitute additionality – projects must demonstrate their additional value independently of subsidies. This principle is reflected in the LCYP's use of market benchmarks to ensure lending rates remain aligned with local market conditions rather than undercutting them.

### 89. The approaches to concessional LCY support range from market-aligned risk sharing to direct subsidies (Box 12 in Annex 1):

- **SME LCYP: using risk sharing to enable market-aligned pricing.** The programme uses donor-funded first loss guarantees for eligible operations to reduce EBRD's risk and enable competitive pricing. This model preserves market discipline by addressing risk rather than artificially lowering costs, while creating a sustainable structure where guarantee funds are preserved when no defaults occur.
- **SME Competitiveness Programme: direct LCY interest rate subsidy combined with investment incentives.** The programme combines direct interest rate subsidies with investment incentives. Though the lending rates are still using LCYP floor benchmarks to prevent market undercutting, this direct subsidy approach is a suboptimal practice, which continuously depletes the support funds.
- **Tunisia: proposed guarantee facility aims to restart LCY lending by reducing hedging costs.** EBRD is developing<sup>21</sup> a €20 million EU-backed guarantee facility to restart LCY lending, protecting TCX against exchange rate movements to enable competitive swap rates. Though innovative in addressing Tunisia's specific market LCY funding constraints, this continued reliance on donor-supported mechanisms highlights the persistent challenges in developing purely market-based solutions for LCY operations.

90. **The competitive environment for LCY lending is further complicated by the prevalence of subsidised financing from various sources.** Many EBRD COOs have various non-market-based financing programmes available through government initiatives or other DFIs, especially as EBRD LCY in large part targets SME lending. These subsidised alternatives can make it challenging for EBRD to maintain competitiveness while adhering to market principles, or even with its own concessional support mechanisms. This creates a complex operating environment where EBRD might recognise that some markets are too distorted for a market-based intervention in LCY, and target instead other transition or market gaps.

91. **The use of concessionality in EBRD operations often serves as a vehicle for delivering broader transition objectives rather than LCY being the primary goal itself.** The concessionality in LCY operations is frequently linked to supporting specific transition impacts such as Green Economy Transition (GET) or SMEs' competitiveness. LCY financing helps reach target clients while protecting them from currency mismatch risks. In these cases, the choice of LCY is driven by risk management considerations and market access rather than currency market development objectives, though the operations may still contribute to increasing the share of LCY financing.

### Risk sharing and guarantee products showed limited additionality in LCY market development, with niche exceptions

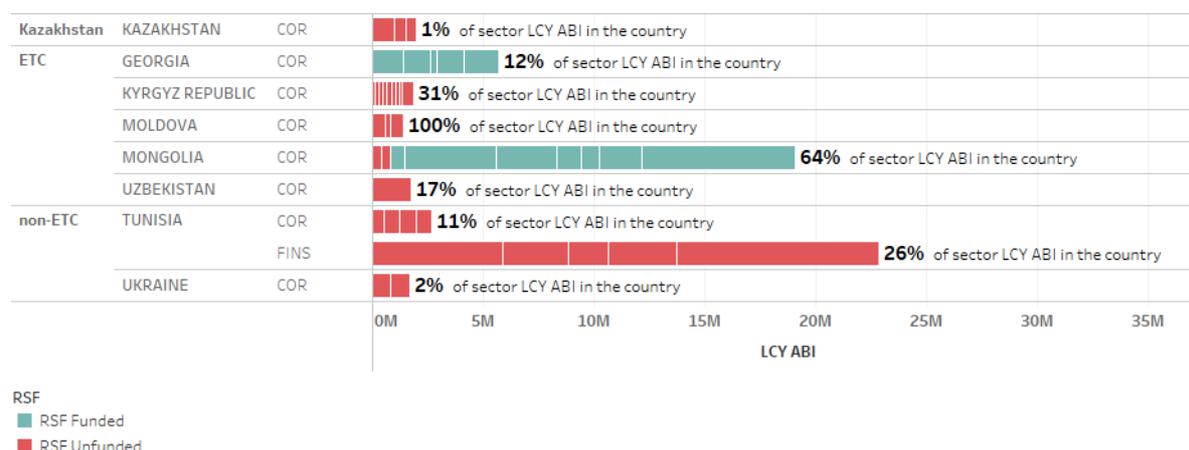
92. **Use of guarantees was limited and sometimes had a tenuous link to LCY.** Direct lending dominated EBRD LCY financing, with guarantees playing only a minor role at €312 million of ABI over the period. They were the domain of the FI sector and the vast majority of the volume came from two Guarantee for Growth (G4G) programmes in Albania (€203 million ABI) and Ukraine (€74 million ABI), together representing €277 million of ABI over the period. However, the G4G programme has limited contribution to LCY market development, as the Programme does not specify or track the currency of the resulting MSME lending. It is primarily serving to address

<sup>21</sup> The Facility was Board-approved and subsequently signed in July 2025.

regulatory capital constraints and general MSME lending, rather than promoting LCY lending or market development (Box 13 in Annex 1).

**93. While risk sharing represented a negligible portion of overall LCY financing, it provided targeted additionality in select small markets where Corporate LCY lending faced challenges.** RSF projects (both funded and unfunded) amounted to only €59 million over the period across all countries, but their presence was meaningful in specific contexts. In Mongolia, RSF represented 64 per cent of LCY ABI in the Corporate sector, primarily through funded RSF. The Kyrgyz Republic saw unfunded RSF account for 31 per cent of Corporate LCY ABI, while in Moldova, three small unfunded risk-sharing facilities comprised the entirety of Corporate LCY activity (Figure 9).

**Figure 9: LCY risk sharing projects by country, 2016-23**



Source: IEvD analysis based on dw-banking\_operational dataset

## Even with available support mechanisms, LCY operations remain unviable in some markets

**94. Despite combining financial and non-financial additionality elements with concessional support mechanisms, EBRD LCY operations face persistent competitiveness challenges in certain markets and segments.** In some countries and market segments, even subsidised LCY products struggle to be additional to domestic alternatives, particularly where local banks have access to abundant deposits or central bank funding at preferential rates. Albania exemplifies this challenge, where high deposit liquidity in the bank-dominated system has made EBRD LCY funding uncompetitive even with SME LCYP guarantee availability, resulting in virtually no LCY lending over the evaluation period. Similarly, Egypt's substantial banking sector maintains high liquidity in the Egyptian pound (EGP) and regulatory requirements for LCY lending, limiting EBRD's €2 billion FI portfolio to only €10 million in LCY operations, exclusively with microfinance institutions that lack deposit bases and require LCY funding to avoid FX exposure (Box 14 in Annex 1).

## 5. Key message 4: Local currency operations have delivered tangible resilience benefits, but systematic measurement is lacking

### 5.1. Focus of local currency lending on SMEs aligns with resilience objectives, yet these impacts are not meaningfully captured in projects' transition frameworks

#### Local currency linked resilience is rarely a part of transition rationale and monitoring of lending projects

95. **For lending operations, Resilient transition quality is often associated with LCY lending.** The most common primary TQ for LCY projects was Competitive (nearly half of LCY operations). This comes largely from their being part of frameworks targeting SME Competitiveness, mostly the Financial Intermediaries Framework (FIF) and Direct Financing Framework (DFF). Resilient TQ was the primary TQ for only approximately 10 per cent of projects; these were mostly projects under risk-sharing (RSF), other guarantees, or under crisis response frameworks. However, this somewhat conceals the presence of Resilient TQ overall; it was a secondary TQ for a majority of TQ Competitive projects. In total, projects with Resilient TQ as either primary or secondary TQ represent more than half of LCY projects, both by ABI volume and by number of projects (Box 15 in Annex 1).

96. **However, the Resilient TQ is rarely tied to currency denomination and the resulting reduction in FX risks.** While the Resilient TQ appears in approximately half of LCY projects, this transition rationale typically stems from general indicators like portfolio quality of partner financial institutions – metrics that apply equally to both local and hard currency lending. Notably, the likely potential contribution to financial sector resilience – through providing partner banks access to longer-tenor LCY funding enabling better asset-liability matching – is not captured in either the transition rationale or the monitoring indicators of these projects. The LCY rationale is often instead connected to SME Competitiveness, reflecting an existing market demand for LCY financing and improving access to finance. While direct financing projects and stand-alone operations occasionally demonstrate examples of resilience benefits specifically tied to LCY lending through reduced FX exposure, these represent only a small fraction of the overall LCY portfolio.

#### Local currency lending has resilience links for SMEs and ETCs, with more limited impact in Infrastructure

97. **EBRD's lending to SMEs and ETCs in LCY demonstrates strong alignment with resilience objectives.** This targeting is especially relevant since SMEs typically lack sophisticated hedging capabilities and may underestimate FX risks when borrowing in hard currency. Similarly, the focus on ETCs addresses markets where strengthening resilience is most critical, given their higher levels of dollarisation and underdeveloped financial systems. The SME LCYP has been instrumental in enabling this targeting by making LCY lending viable in contexts where market underdevelopment or high costs would otherwise make it impractical. On the side of FIs, the

resilience benefits come from both extending tenor beyond typical deposit funding and improving risk management practices through Treasury's capacity building. However, for SME sub-borrowers through FI, while LCY lending supports resilience, the size of EBRD's impact is less clear as regulatory restrictions might have increasingly prevented hard currency borrowing in this group anyway.

**98. The limited uptake of LCY lending in Infrastructure has constrained potential resilience benefits for theoretically appropriate clients.** Infrastructure projects, particularly those undertaken by municipalities or utilities with primarily LCY revenues, would be natural candidates for LCY financing to strengthen resilience against exchange rate shocks. Kazakhstan provides a positive example where demand for LCY infrastructure borrowing is explicitly driven by past experiences with currency devaluations. However, in other countries like Jordan and Morocco, the infrastructure LCY lending shows more limited links to resilience enhancement, due to a currency peg regime in Jordan and because LCY use is driven more by business necessity in Morocco than by the active promotion of financial resilience.

**99. Analysis of financial performance provides mixed evidence on the resilience benefits of LCY operations, though sample size limitations affect the robustness of these findings.** A detailed comparison of LCY versus non-LCY operations across Armenia, Kazakhstan and Morocco shows that in segments with sufficient sample sizes for comparison, LCY operations generally demonstrated comparable or superior financial performance to non-LCY lending. In Kazakhstan, where the sample was most robust across all project sizes, LCY operations showed higher risk-adjusted returns (RAROC) than non-LCY projects in most size segments, though they also experienced more corporate recovery cases in small projects.<sup>22</sup> In Armenia and Morocco, where sample sizes were more limited, LCY operations in the small project segment showed stable credit quality and improving returns respectively, matching or approaching non-LCY performance over time. However, these findings should be considered indicative rather than definitive given the small sample sizes in many segments, particularly for Armenia and the larger projects in Morocco (Annex 4).

## 5.2. EBRD Treasury's market-building activities demonstrate impact, but remain outside formal transition assessment

**100. EBRD Treasury's market-building activities (combining policy and market operations) have demonstrably strengthened financial market resilience, even though measuring this contribution remains challenging.** The results discussed in Sections 3 and 4 demonstrate how EBRD's three-pillar approach to LCY has enhanced the development of money markets in COOs. The interplay between EBRD Treasury's market operations and policy work has been particularly effective, as evidenced by the development of MMWGs, expansion of LCY funding options and the establishment of benchmark rates in several countries. These achievements align with EBRD's strategic goal of improving financial market resilience by developing LCY capabilities and reducing FX risks. However, the lack of a formal assessment framework makes it difficult to precisely specify this contribution.

**101. The MMDF shows promise as a monitoring tool, but its effectiveness remains to be proven.** The transition from MoU-based policy dialogue to standardised diagnostics was designed to provide both a more objective approach to policy prioritisation and a systematic way to track progress through regular reassessments every three to five years in participating countries. This

<sup>22</sup> Corporate recovery cases in Kazakhstan were outside of the SME LCYP, as Kazakhstan was not part of the Programme over the evaluation period.

monitoring framework aims to enable comprehensive evaluation of both key money market indicators and the implementation status of previous recommendations. However, since countries are still completing their initial diagnostic assessments, no country has yet undergone the intended periodic reassessment that would demonstrate progress over time. In addition, important questions remain about how the diagnostic results will be integrated into EBRD's institutional reporting processes. Specifically, how/whether findings will be linked to transition impact reporting and incorporated into regular reporting to the Board.

**102. The Financial Markets Development Index (FMDI) has some limitations as a measurement tool for assessing money market progress across EBRD countries.** The FMDI, developed by the CFMD team and the Office of the Chief Economist and annually updated in-house by CFMD, aims to provide a standardised way to track financial market development. It is a composite index that aims to measure the development of capital markets, money markets and derivative markets in EBRD COOs.<sup>23</sup> There are some limitations to the diagnostic value of this measure for money markets due to data availability challenges in accurately capturing money market activity levels,<sup>24</sup> as well as potential structural issues in how the index components are weighted and aggregated.

### 5.3. The repositioning of LCY operations may pose challenges for future impact measurement and recognition

**103. The development of money markets and increased use of LCY has been consistently linked to strengthening resilience in COOs.** This strategic focus emerged prominently following the global financial crisis, when the LC2 Initiative was launched as part of EBRD's response to address vulnerabilities arising from excessive foreign currency exposures. This link to resilience was then translated into the 2019 LC2 Strategy and formally linked to Resilient TQ under the revised transition concept.<sup>25</sup> Likewise, Treasury-led policy dialogue in the development of money markets was discussed in its importance in enhancing domestic economic stability and resilience.<sup>26</sup> The SME LCYP is '*aligned with the EBRD's goal of strengthening resilience in its COOs*'.<sup>27</sup>

**104. The shift of framing LCY activities from a direct focus on resilience towards enabling private mobilisation and broader transition impact will have implications for impact recognition.** The strategic shift in how EBRD positions LCY activities, from emphasising their direct contribution to financial sector resilience to being increasingly viewed as enablers of private sector mobilisation and transition across all qualities, has implications for the measurement of transition impact. This repositioning recognises that access to LCY funding allows EBRD to reach clients who would otherwise not engage with the Bank, thereby creating opportunities to achieve a variety of transition objectives. The ability to offer LCY products is becoming increasingly critical as more countries require LCY lending, making it an essential capability for maintaining EBRD's market relevance. This might be particularly relevant in new COOs in sub-Saharan Africa. However, this evolving strategic framing poses challenges for measuring and attributing impact. While the transition impact of individual investments will continue to be captured through standard monitoring frameworks, the broader market development and mobilisation effects of LCY activities may remain difficult to quantify. The trend appears to be towards treating LCY

<sup>23</sup> The Methodology of the FMDI design and calculation is described in the 2021-22 Transition Report: <https://2021.tr-ebrd.com/financial-market-development/>

<sup>24</sup> The CFMD team addresses issues of data availability from public sources by issuing data requests to authorities but not all countries provide updated data.

<sup>25</sup> BDS18-210: Local Currency and Capital Markets (LC2) Strategy 2019-2024

<sup>26</sup> SGS22-149: Scaling up Local Currency Financing: Session I – Policy Dialogue

<sup>27</sup> BDS15-050 (Addendum 233): Regional: Small Business Initiative Annual Review for 2023; ANNEX 3 - SME Local Currency Programme

capabilities as an enabling modality that expands EBRD's reach and effectiveness, rather than as a direct source of transition impact through resilience enhancement.

## 6. Conclusion and recommendations

### 6.1. Key insights

**The evolution of market demand has transformed LCY lending from a specialised offering into a market necessity, even as EBRD faces structural disadvantages compared to domestic banks.**

While macroeconomic stabilisation and regulatory de-dollarisation have increased demand for LCY products in many countries, EBRD's reliance on market-based funding creates inherent cost disadvantages versus local banks' access to deposits and central bank facilities. This has pushed EBRD to maintain additionality through a combination of complementary elements. These include longer tenors, technical support, as well as concessional mechanisms, such as donor-funded risk-sharing facilities and direct subsidies.

**EBRD's three-pillar approach to LCY operations represents a conceptually robust and operationally effective framework, while its success often depends on country-specific factors beyond the Bank's control.** The integration of policy dialogue, funding operations and lending activities sets EBRD apart from other development institutions. Countries with macroeconomic stability, functional interbank money markets and developed risk management instruments typically enable successful LCY operations. Those with high inflation, exchange rate volatility and underdeveloped legal frameworks for derivatives present significant obstacles. Between these poles lie transitioning markets where EBRD-facilitated Money Market Working Groups and diagnostic frameworks can systematically address gaps in regulatory environments and benchmark development. Notably, progress depends critically on sustained political commitment from authorities and reform momentum to implement recommended changes.

**EBRD Treasury's dual role as both a market participant and policy advisor has proven particularly effective in developing money markets and in turn enabling further market access to EBRD.** The combination of practical market operations with targeted policy dialogue has delivered concrete results in areas like benchmark reform and market infrastructure development. These policy achievements in turn enable EBRD to access more cost-effective funding and offer more flexible loan structures to clients, demonstrating how policy and market operations can reinforce each other to expand EBRD LCY capabilities.

**The SME Local Currency Programme remains essential for early transition countries and will be relevant to the context of sub-Saharan Africa.** In these markets, the Programme's risk sharing mechanism has facilitated EBRD's transition away from exclusive reliance on TCX for currency risk management while supporting market development. The Programme's primary value proposition has shifted towards enabling EBRD to offer competitively priced LCY products to FIs and SME clients, thereby supporting broader transition objectives at both the sub-borrower and partner FI levels.

**The strategic repositioning of LCY operations from resilience to enabling private sector mobilisation aligns with evolving development finance priorities.** This shift in framing reflects growing recognition that LCY solutions are crucial for making development finance more effective and sustainable, particularly as development banks scale up their climate and SDG-related lending. EBRD's distinct market-building model positions it well to contribute to these broader policy objectives. Its focus on strengthening domestic financial institutions' capacity to mobilise local savings also represents a more sustainable path than solely developing government bond markets, and aligns well with the Bank's private sector orientation.

**EBRD's frameworks for measuring transition impact do not adequately capture the market development contributions of EBRD Treasury's LCY activities.** Standard transition assessment mechanisms, which are presently only applied to Banking investments and to some extent transactional TCs, exclude Treasury's market operations and their combined effect with policy dialogue, despite evidence of their positive impact on financial market resilience. The 2022 introduction of the Money Market Diagnostics Framework and enhanced SME LCYP reporting represent improvements in monitoring, but significant gaps remain in comprehensively assessing results across all three pillars of EBRD LCY approach. This measurement challenge is further complicated by the strategic repositioning of LCY operations as enablers of mobilisation and broader transition objectives rather than direct contributors to resilience. This potentially obscures their distinct value in strengthening domestic financial markets.

## 6.2. Recommendations

### Strategic recommendations

**Recommendation 1: Ensure that the upcoming *CFMD and Treasury Approach to Financial Market Development* explicitly addresses the unique market characteristics and development stages of sub-Saharan African countries**

Issue	Recommendation
<ul style="list-style-type: none"> <li>EBRD's expansion to new sub-Saharan African countries presents significant opportunities to establish LCY operations, with country assessments identifying LCY financing and targeted policy support as part of strategic objectives.</li> <li>The LCY approach has demonstrated over a decade of implementation that success depends critically on country-specific factors, including policy engagement capacity, reform momentum and institutional readiness.</li> <li>The evaluation evidence shows that EBRD's effectiveness in LCY operations requires realistic sequencing that accounts for market structure constraints and institutional capacity, particularly as the Bank gradually develops capabilities to manage local counterparty relationships for currency funding and risk management beyond traditional back-to-back structures.</li> </ul>	<p>To achieve objectives in financial market development and LCY lending in new COOs, Management should ensure that the upcoming <i>CFMD and Treasury Approach to Financial Market Development</i> explicitly addresses the unique market characteristics and development stages of sub-Saharan African countries, providing guidance that supports effective country-by-country adaptation in these new regions of operation.</p> <p>The Approach should specify:</p> <ul style="list-style-type: none"> <li><b>Market entry sequencing and policy priorities:</b> define a phased approach to policy dialogue that prioritises objectives based on diagnostics, with country-specific timelines that reflect local institutional capacity and political economy factors.</li> <li><b>Programme adaptation and eligibility criteria:</b> outline the parameters of the extension of the SME LCYP sub-Saharan African countries (concessionality levels, eligibility criteria and any operational parameters modified to address different market structures, regulatory environments and development needs in these markets).</li> <li><b>Risk management framework assessment:</b> assess whether current risk policies governing Treasury operations with local counterparties require adaptation for sub-Saharan African markets and outline in the strategy any necessary adjustments to</li> </ul>

	<p>counterparty risk standards, collateral requirements and operational risk management procedures to address different regulatory frameworks and institutional development characteristics in these new COOs.</p> <ul style="list-style-type: none"> <li>• <b>Resource allocation and implementation capacity:</b> outline the internal resources needed to ensure effective delivery of the three-pillar approach in markets where EBRD has limited operational history and where building local relationships will be essential for success.</li> </ul>
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**POTENTIAL RISK FOR THE EBRD:** Without implementing this recommendation, the EBRD risks entering sub-Saharan African markets with an inadequately tailored LCY financing approach that could undermine the Bank's effectiveness in these new COOs.

Without a strategic framework that addresses the unique institutional, regulatory and market development characteristics of sub-Saharan Africa, the Bank may encounter similar challenges to those observed in other regions where LCY uptake remained limited, potentially resulting in underutilised programmes, ineffective policy dialogue and missed opportunities to establish the foundational market infrastructure necessary for sustainable LCY operations.

## Operational recommendations

### Recommendation 2: Align strategic objectives and operational framework in the upcoming CFMD and Treasury Approach to Financial Market Development

Issue	Recommendation
<ul style="list-style-type: none"> <li>• EBRD is undergoing a strategic evolution in positioning LCY lending, transitioning from emphasising direct contributions to financial sector resilience towards framing them as enablers of private sector mobilisation and broader transition impact.</li> <li>• This shift reflects changing institutional priorities and the growing recognition of LCY capabilities as essential for maintaining market relevance.</li> <li>• Additionally, LCY operations demonstrate geographic and sectoral concentration, with heavy reliance on concessional support mechanisms.</li> </ul>	<p>To ensure strategic coherence and operational effectiveness, the upcoming CFMD and Treasury Approach to Financial Market Development should establish clear alignment between strategic positioning and implementation framework.</p> <p>The new Approach should address:</p> <ul style="list-style-type: none"> <li>• <b>Strategic objective clarification:</b> define whether increasing LCY financing volume and share remains an institutional objective in itself, or it serves primarily as an enabling capability for broader transition goals.</li> <li>• <b>Diversification strategy and implementation pathway:</b> outline approaches for addressing current geographic and sectoral concentration in LCY operations. Define specific mechanisms for expanding LCY financing beyond the current focus on intermediated SME finance, particularly identifying pathways for Infrastructure financing where natural currency alignment opportunities exist.</li> </ul>

	<ul style="list-style-type: none"> <li>• <b>Concessionality principles and market development progression:</b> establish clear principles governing the appropriate use of concessional mechanisms versus market-based solutions in LCY operations. Articulate the intended progression from concessional support towards sustainable market-based LCY financing as markets mature.</li> </ul>
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**POTENTIAL RISK FOR THE EBRD:** Without implementing this recommendation, the EBRD risks operating with strategic misalignment between its evolving institutional priorities and the operational framework for LCY financing, potentially undermining the effectiveness of LCY operations across the portfolio.

Without clear strategic direction on whether LCY financing represents an institutional goal in itself or an enabling capability, the Bank may experience suboptimal resource allocation, missed opportunities for market development progression and continued geographic and sectoral concentration that limits the Bank's ability to leverage natural currency alignment opportunities in Infrastructure.

### Recommendation 3: Integrate LCY operations in Transition Impact assessment and monitoring

Issue	Recommendation
<ul style="list-style-type: none"> <li>• EBRD LCY operations lack a comprehensive framework for assessing their contribution to transition impact, creating a gap between their strategic importance and institutional recognition.</li> <li>• For lending operations, the specific benefits of reduced FX exposure are seldom explicitly connected to transition impact measurement.</li> <li>• Treasury's market-building activities, which combine policy dialogue with market operations and constitute a distinct pillar of the LCY approach, remain outside formal transition assessment despite generating transition benefits.</li> <li>• Recent initiatives like the SME LCYP revised reporting framework and the standardised MMDF represent progress towards more systematic monitoring, but substantial gaps remain in linking these activities to TI assessment.</li> </ul>	<p>To strengthen accountability and enhance institutional learning while ensuring appropriate recognition of LCY operations' contribution to transition impact, Management should integrate LCY activities into the Bank's transition assessment and monitoring framework.</p> <p>This integration should leverage the ongoing revision of the transition assessment system and the development of theories of change for transition qualities.</p> <p>The framework should address:</p> <ul style="list-style-type: none"> <li>• <b>Transition contribution pathway articulation:</b> outline the specific mechanisms through which LCY operations contribute to transition, establishing distinctions between direct contributions to financial sector resilience and instrumental roles in enabling private sector engagement and mobilisation across all transition qualities. This articulation should recognise both the immediate benefits of currency risk mitigation and the longer-term systemic effects of money market development.</li> <li>• <b>Treasury activity integration:</b> incorporate Treasury's policy dialogue and market</li> </ul>

	<p>operations into formal transition impact assessment and monitoring systems. This integration should acknowledge their contribution to systemic market development that extends beyond individual transaction impacts.</p> <ul style="list-style-type: none"> <li>• <b>Institutional framework alignment:</b> ensure integration of this assessment approach into the upcoming CFMD and Treasury Approach to Financial Market Development performance framework and the Bank-wide theories of change being developed for transition qualities, creating coherent measurement systems that support both operational decision-making and institutional reporting requirements.</li> </ul>
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**POTENTIAL RISK FOR THE EBRD:** *Without implementing this recommendation, the EBRD risks continuing to operate LCY activities without adequate recognition of their transition contributions. This could lead to the undervaluation of these operations in institutional decision-making and resource allocation processes.*

*The absence of systematic transition impact assessment for LCY operations, particularly Treasury's market-building activities that generate systemic benefits beyond individual transactions, may result in missed opportunities to demonstrate the Bank's effectiveness in building resilient financial systems. It could also undermine the strategic case for maintaining and expanding LCY capabilities as the institution evolves its approach to measuring and reporting transition impact across all operational areas.*

# ANNEXES

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## Annex 1. Supporting evidence

This annex presents extended evidence base supporting the evaluation findings as presented in the main report. The findings in this annex are themselves based on the country case studies and country reviews conducted for the evaluation.

### EBRD Treasury's combined role as actor and advisor has proven effective in supporting the growth in maturity of money markets

#### Box 4: The policy-market nexus – examples of EBRD Treasury's dual role in practice

##### Armenia: Harnessing policy progress to enable new market operations

In Armenia, Treasury has progressively introduced more sophisticated instruments as market conditions and legal frameworks have allowed. In 2014 EBRD became the first IFI to issue an AMD bond after successfully negotiating the necessary regulatory changes to enable IFI issuances. The adoption of key legal reforms in 2018, particularly implementing a derivatives framework and establishing the Global Master Repurchase Agreement (GMRA) with local annexes, created the foundation for expanding market operations. Treasury utilised this improved legal framework to execute three one-year repo transactions with Armswissbank, each worth AMD 2.0-2.5 billion, demonstrating the practical value of the reforms in enabling larger and longer-term operations. In early 2022, Treasury completed a cross-currency swap with Amundi-ACBA, becoming the only IFI conducting such transactions with an asset manager in Armenia. This initial swap led to multiple follow-on transactions under an ISDA Credit Support Annex (CSA), with the negotiation process itself helping develop the counterparty's capability in these instruments.

##### Georgia: Facilitating benchmark market adoption through funding operations

The Bank issued its first GEL-denominated bond worth GEL 50 million in 2014, becoming the first IFI to issue in the local market. The process helped identify regulatory barriers and led to the National Bank of Georgia (NBG) implementing changes to accommodate IFI issuers. In April 2017 Treasury issued the first GEL-denominated and payable Eurobond, a GEL 120 million five-year instrument. This required establishing settlement infrastructure between domestic and international markets through work with the NBG and Clearstream. By 2019, EBRD had further innovated by creating a structure combining bond issuance with buyback arrangements, enabling more flexible and cost-effective GEL funding.

The Bank's market operations have been important in establishing the Tbilisi Interbank Interest Rate (TIBR) as the market benchmark following its reform through the Treasury-facilitated MMWG in 2018. EBRD led market adoption through a series of firsts – issuing the first TIBR-linked bond in March 2019, extending the first TIBR-linked loan in April 2019, and executing the first GEL Overnight Index Swaps (OIS) with major domestic banks in October 2019. This market leadership, combined with the NBG's decision to make TIBR-indexing mandatory for floating-rate instruments in monetary operations from June 2022, has driven market adoption – all floating rate issuances in 2022-23 were TIBR-linked, compared to previous reliance on certificate of deposit rates.

##### Kazakhstan: Pioneering new market instruments following benchmark reform

EBRD Treasury effectively demonstrated the practical application of policy reforms in Kazakhstan's financial markets through pioneering transactions. Following the introduction of a new calculation methodology for the TONIA benchmark rate, EBRD issued the country's first TONIA-linked bond in November 2021, raising KZT 12.5 billion (EUR 25.4 million equivalent)

with a three-year maturity. The success of this issuance helped validate the new benchmark, with the Ministry of Finance subsequently following EBRD's lead by issuing its own TONIA-linked bonds. Building on this momentum, EBRD further leveraged Kazakhstan's improved derivatives regulation by executing the first currency interest rate swap (OIS) with Bank CenterCredit in December 2023, where the overnight TONIA rate was exchanged for a fixed interest rate. This transaction not only tested the new regulatory framework but also demonstrated another practical application of the TONIA benchmark in derivative products.

## EBRD has driven benchmark reforms with mixed adoption success

### Box 5: Money market benchmark reforms: Strong technical design alone does not guarantee market adoption

#### CONIA benchmark in Egypt: Sound technical design undermined by monetary policy implementation challenges

Egypt's experience with the Cairo Overnight Interbank Average Rate (CONIA) illustrates how the success of new market benchmarks requires alignment between technical design and broader policy implementation. While EBRD's policy dialogue through the MMWG led to the successful technical design and official launch of CONIA in 2019, its practical implementation faced significant obstacles. The Central Bank's monetary policy interventions pushed CONIA rates above standard market corridor rates, making CONIA-linked products commercially unattractive. This resulted in limited market adoption, with both EBRD and market participants continuing to rely on the Central Bank's policy rate. Even EBRD's attempt to pilot CONIA through a test loan required renegotiation due to cost issues. The case demonstrates that while technical expertise in benchmark design is necessary, the success of money market reforms ultimately depends on supportive and consistent policy implementation in the broader economic context.

#### MONIA benchmark in Morocco: Strong policy progress but limited banking sector adoption yet

EBRD's establishment of the MMWG in Morocco in 2017 led to the successful launch of the Moroccan Overnight Index Average (MONIA) benchmark in 2020. The new risk-free overnight rate, developed with EBRD Treasury's technical expertise following IOSCO principles, represents a significant improvement over the previously used Treasury bill-based TMP benchmark. EBRD strengthened MONIA's credibility by actively using it in its own cross-currency and interest rate swap transactions, providing practical demonstration of the benchmark's utility. While MONIA has gained traction in capital markets, with some mutual funds adopting it as a benchmark and its planned use in upcoming overnight index swap derivatives, banking sector adoption remains gradual due to regulatory requirements still mandating TMP for certain products. The case highlights how EBRD can leverage its combined role as policy advisor and market participant to drive money market modernisation, while also showing that full market adoption requires sustained engagement and supportive regulatory frameworks.

#### TIBR benchmark in Georgia: Comprehensive reform approach and EBRD's market participation drive adoption and improved market functioning

Through the Money Market Working Group, the National Bank of Georgia reformed the Tbilisi Interbank Rate (TIBR) in 2018 to align with international standards and subsequently expanded the framework to include term rates and a compounded index. EBRD played a pivotal role in establishing TIBR as the market standard by pioneering its use across multiple instruments. EBRD floating loans are likewise linked to TIBR. The NBG's decision to make TIBR-indexing mandatory for floating-rate collateral from June 2022, combined with EBRD's

successful advocacy for improved market infrastructure through Bloomberg, led to market adoption with 100% of floating rate issuances being TIBR-linked in 2022-23. The success is reflected in concrete market metrics, with money market turnover approximately ten times higher than 2010 levels and reduced short-term interest rate volatility.

#### **TONIA benchmark in Kazakhstan: Successful policy dialogue driving market development**

The reform of Kazakhstan's Tenge Overnight Index Average (TONIA) benchmark demonstrates how EBRD's policy dialogue through MMWGs can drive meaningful market development. Following EBRD's establishment of the MMWG in 2018 and subsequent technical engagement, Kazakhstan adopted a new TONIA calculation methodology in 2021 based on international best practices. This market-based reference rate has proven superior to previously used benchmarks like KazPrime and CPI, providing a more transparent and predictable measure of the cost of money. While initial results show improved market metrics, including increasing daily repo transaction volumes, the full market adoption remains gradual due to banks' conservative practices and ongoing need for appropriate legal frameworks. TONIA's implementation challenges highlight how benchmark reforms require sustained engagement beyond the initial policy changes to achieve their full market development potential.

#### **UONIA benchmark in Ukraine: War disrupts promising early progress**

Ukraine's experience with the Ukrainian Overnight Index Average (UONIA) demonstrates how external shocks can fundamentally disrupt money market benchmarks despite strong initial implementation. Through EBRD's policy dialogue via the MMWG, UONIA was successfully launched in June 2020 as a credible overnight reference rate, typically trading 70 basis points below the policy rate. However, Russia's invasion in 2022 severely impacted UONIA's functioning by disrupting interbank markets. With banks now relying almost exclusively on NBU liquidity facilities, UONIA's calculation has become heavily dependent on central bank transactions rather than genuine interbank activity, raising concerns about its compliance with IOSCO principles. An August 2024 review by the Oversight Council highlighted the need to explore alternative calculation methods to maintain a viable benchmark under wartime conditions.

#### **UZONIA benchmark in Uzbekistan: Initial progress in technical implementation**

The reform of Uzbekistan Overnight Index Average (UZONIA) benchmark illustrates how targeted technical collaboration between EBRD Treasury and central bank authorities can achieve initial progress in establishing market reference rates. Through this partnership, the Central Bank of Uzbekistan (CBU) launched reformed UZONIA and term UZONIA rates in July 2022, with subsequent performance improvements showing the benchmark staying within the interest rate corridor and maintaining a spread of less than 50 basis points to the policy rate since May 2023. However, ongoing discussions at the MMWG indicate that further refinements are needed to establish UZONIA as a fully trusted market reference rate.

## **EBRD supported successful reforms in several countries for LCY bond issuances while efforts continue elsewhere**

### **Box 6: Creating regulatory frameworks for IFI local bond issuance**

**IFIs require tailored regulatory frameworks for local bond issuance due to their unique status and operational model.** Unlike corporate entities, IFIs are established by international treaties between sovereign states which grants them special legal status with specific immunities and

privileges. This fundamental difference necessitates adapting standard national securities regulations that are typically designed for domestic corporate or public issuers.

**Several key regulatory areas need adaptation to enable IFI bond issuance.** The issuance rules must explicitly recognise IFIs as eligible issuers and either exempt them from standard securities market requirements or create simplified procedures aligned with IFI operational capabilities. Information disclosure requirements need modification to allow IFIs to follow their established international disclosure practices rather than local requirements. The international AAA credit rating should be recognised domestically. Additionally, use of proceeds restrictions and various operational requirements like bank account opening rules may need adjustment to accommodate IFI operations.

**The development of such frameworks requires extensive engagement with local authorities and careful attention to market infrastructure.** Beyond the legal and regulatory changes, successful onshore IFI bond issuance depends on having adequate market infrastructure including functional settlement systems, proper depository services, and a sufficient investor base. The process of creating these frameworks often takes years of sustained dialogue with authorities, but provides lasting benefits by introducing international best practices that improve market function for all participants.

Source: Sulima, E. (2022): Development of Domestic Capital Markets, EBRD experience

## Box 7: Policy-funding nexus: Enabling LCY bond issuances

### Armenia, Georgia, Serbia: Successfully creating preconditions for IFI bond issuances

Armenia presented the most straightforward case of creating preconditions for IFI bond issuance, taking less than two years. The process benefited from support across key institutions – the Central Bank, Stock Exchange, and Ministry of Finance – and built on earlier capital markets reforms that had already exempted IFIs from standard securities regulations. EBRD issued its first AMD bond in 2014.

Georgia's experience shows how initial issuance can catalyse broader market development. EBRD became the first IFI to issue locally in 2014 with a GEL 50 million bond, helping identify and address regulatory barriers. The NBG implemented changes to accommodate IFI issuers, including recognition of their specific characteristics and simplified procedures. This paved the way for more sophisticated instruments, including EBRD's first publicly listed Georgian bond in 2016. By 2023, the total IFI bond market reached GEL 2 billion.

Serbia demonstrates the potentially lengthy timeline for establishing preconditions, with EBRD's first Serbian dinar bond in 2016 following over ten years of negotiations. The process required extensive coordination between the Ministry of Finance, National Bank of Serbia, and Securities Commission to implement necessary legislative and regulatory reforms.

### Azerbaijan, Ukraine: Long process remains incomplete

Azerbaijan has made substantial progress toward enabling IFI bond issuance, but final implementation remains pending. EBRD's engagement began in 2016 with a legal assessment that identified key barriers in the issuance process, following which the EBRD worked with authorities to develop necessary reforms. While these reforms secured broad stakeholder support and critical amendments to the Securities Markets Law were enacted in July 2023, final approval of the IFI Bond Issuance regulation by the Central Bank of Azerbaijan is still pending.

In Ukraine EBRD's work began in 2008 and achieved some progress, including 2017 amendments to the Securities Market Law permitting IFI private placements and removal of

investment restrictions for banks. However, subsequent regulatory initiatives expanded beyond the original scope, introducing new complexities. While a regulation on IFI bonds was published in 2020, it failed to address crucial operational aspects regarding post-issuance reporting and secondary market trading. Progress has been further hampered by divergent views between the Ministry of Finance, which supports IFI issuance, and the Central Bank, which has expressed concerns about market liquidity impacts.

#### **Kazakhstan: Pragmatic approach but not without risk**

In Kazakhstan EBRD developed an alternative structure to meet immediate funding needs for its growing KZT pipeline. The approach initially involved offshore issuance, with bonds placed privately with international banks in 2018. EBRD then gradually expanded to reach domestic investors, with bonds becoming its primary funding instrument in Kazakhstan. Rather than pursuing lengthy regulatory changes to accommodate IFI status, the solution entails using English law bonds listed locally but not issued under Kazakh securities law, which introduces some measure of regulatory uncertainty. While this approach has enabled EBRD to establish a significant LCY funding program without waiting for comprehensive legal reforms, the regulatory ambiguity around domestic placement of offshore-issued bonds creates potential risks that would not exist with conventional domestic issuance. Despite being one of EBRD's largest LCY markets, Kazakhstan still lacks a framework for direct domestic bond issuance by IFIs as of 2024.

#### **Morocco: Government concerns stall IFI bond issuance plans**

EBRD began exploring domestic Moroccan dirham bond issuance in 2017, engaging external counsel to assess legal requirements and initiating discussions with key stakeholders. Despite identifying specific regulatory changes needed, particularly around disclosure requirements, reform efforts have not gained traction. The resistance primarily stems from the Government's concerns about potential market impacts of IFI issuance. While EBRD's individual issuance needs would be modest compared to government funding volumes, the authorities are concerned about the combined effect of multiple IFIs accessing the market, particularly during periods of market stress. The Ministry's position is that any supranational issuance would need to be carefully coordinated with government bond schedules and priced at a premium to sovereign bonds to maintain market order.

## **Market development gaps continue to limit infrastructure LCY lending**

### **Box 8: LCY Infrastructure financing: from market leadership in Kazakhstan to early steps in SEMED**

#### **Kazakhstan: LCY Infrastructure enabled by Treasury innovation, policy reform and market development**

Kazakhstan's experience demonstrates how sophisticated Treasury operations and active market participation can enable substantial LCY infrastructure financing. Kazakhstan dominates EBRD LCY infrastructure lending with €2.1 billion invested over 2016-2023, representing over 80% of EBRD's total LCY infrastructure ABI. This success stems from a combination of Treasury's market development work and regulatory changes promoting de-dollarisation, particularly benefiting natural monopolies and regulated entities with LCY revenues.

The renewable energy sector exemplifies how policy dialogue can create opportunities for LCY financing - EBRD's early involvement in developing the legal framework, coupled with the

introduction of tariff indexation mechanisms linking to both USD and local inflation, enabled projects to be financed through a mix of currencies. Treasury's sophisticated management of a LCY liquidity pool has been crucial in supporting this lending - the large portfolio generates regular repayment flows that can be recycled into new disbursements, while mismatches are managed dynamically similar to major currencies. EBRD has also played an innovative role in market development, as demonstrated by its issuance of the first TONIA-linked bond and pioneering use of new derivative instruments with local banks. While EBRD LCY loans may appear more expensive than local banks' shorter-term rolled facilities, they provide genuine additionality through committed longer-term financing that has proven resilient through market stress periods.

### Morocco: LCY capabilities opening doors to municipal infrastructure finance

Morocco demonstrates how establishing LCY funding capabilities can unlock new infrastructure financing opportunities, including in the municipal sector. While LCY infrastructure financing only began in 2022 and remained relatively modest at €35 million over the evaluation period, it has already enabled EBRD to engage with new municipal and state-owned enterprise clients during a period of increasing fiscal decentralisation. The Bank's entry was marked by pioneering transactions: the country's first municipal green bond with the city of Agadir under the Green Cities program, followed by a €12 million investment with the Guelmim-Oued Noun region, and an €18 million investment in the national railway operator ONCF's green bond. These early successes have built momentum, with a €66 million port modernisation project added in 2024 [outside of the evaluation period]. All these transactions benefitted from various support mechanisms, including state guarantees and investment grants, to create viable financing structures. Morocco's experience suggests that establishing LCY capabilities can create a platform for expanding infrastructure financing, particularly as fiscal decentralisation increases the importance of LCY municipal finance.

### Egypt: Limited LCY infrastructure progress despite municipal bond innovation

Egypt illustrates how market structure and economic conditions can constrain LCY infrastructure financing despite successful innovation in municipal bonds. While infrastructure represented the largest LCY sector in Egypt at €146 million during the evaluation period, this was dwarfed by €2.7 billion in hard currency infrastructure financing. The majority of LCY infrastructure volume came through two pioneering municipal bond investments with the New Urban Communities Authority (NUCA), one of the few sub-sovereign entities with borrowing capacity - a €133 million investment in 2019 that included innovative Short Term Debt Instruments, followed by a €27 million investment in 2023. Beyond these landmark transactions, infrastructure LCY financing has been limited to select small projects in e-mobility and port development, typically under €15 million. Several factors constrain broader adoption: the infrastructure sector remains dominated by sovereign projects typically financed in hard currency, private sector participation is relatively low, and high local interest rates combined with economic uncertainty dampen private sector demand. EBRD's competitiveness in LCY infrastructure is further challenged by local bank pricing and limitations on blending with concessional finance, where EBRD has greater advantages in hard currency lending.

## The Bank is able to offer a range of LCY products to match the clients' needs

### Box 9: Derivatives as enablers of flexible LCY operations and market development

**Treasury use of derivatives integrates operational efficiency with market development objectives.** Treasury derivatives operations serve a dual function in the EBRD LCY approach.

Treasury uses derivatives not only as funding and risk management instruments but as active market development tools that demonstrate the practical application of new financial instruments and build local institutional capacity. Where local markets are underdeveloped, EBRD supports market development including money market indices, monetary policy advice, valuation tools, legal and regulatory reform, and derivatives market development.

**Risk warehousing through derivatives expands EBRD's local currency financing capacity beyond traditional funding constraints.** The warehousing of market risks through derivatives enables greater LCY financing capacity than would be possible under back-to-back funding constraints, particularly on a floating rate basis indexed to domestic interest rate benchmarks. This approach allows Treasury to take advantage of funding opportunities when available in the market, take controlled maturity transformation risk, and offer more flexible loan features to Banking clients.

**Proactive market engagement through derivatives delivers both relationship-building benefits and operational efficiencies.** Being proactively present in the market through derivatives operations allows EBRD to develop relationships with counterparties while managing risks more efficiently than would be possible through balance sheet adjustments alone. The flexibility gained through derivatives operations is particularly valuable in markets with limited liquidity, where the ability to manage timing mismatches and cash flow variations dynamically can mean the difference between successful LCY operations and operational constraints that limit the Bank's effectiveness.

**Case study evidence confirms that derivatives enable operational flexibility.** The evidence from case studies demonstrates that derivatives enable operational flexibility that would be impossible with traditional funding approaches.

**EBRD's derivatives-enabled approach provides distinctive competitive advantages in local markets.** In Morocco, EBRD's shift from back-to-back financing to pre-financing through cross-currency swaps with local counterparts allowed the Bank to offer firm pricing to clients before disbursement, addressing a competitive disadvantage. This approach requires active liquidity management through derivatives that other IFIs in Morocco have not replicated, giving EBRD a distinctive operational advantage.

**Derivatives also serve as demonstration and capacity building tools for local financial institutions.** In Armenia, the cross-currency swap arrangements with asset manager Amundi-ACBA required negotiating an ISDA CSA, which developed the local institution's derivatives capability. Similarly, in Kazakhstan, EBRD's first currency interest rate swap with Bank CenterCredit demonstrated the practical use of TONIA as a reference rate in derivative products, while in Morocco, Treasury's execution of MONIA-linked overnight indexed swaps shortly after the index launch showed counterparties how the instruments work in practice.

#### Box 10: Market infrastructure-lending nexus: Yield curves development

**The EBRD Treasury has developed an innovative approach to creating yield curves in markets where reliable market-based curves are not available, enabling more competitive LCY financing.** Since 2018, the Treasury has been developing and maintaining yield curves for seven countries where market activity is insufficient to generate reliable pricing data, including Georgia, Armenia, Kazakhstan, Ukraine, Mongolia, Uzbekistan and Azerbaijan.

**The approach combines macroeconomic forecasting with available market data points to create hybrid curves.** The methodology uses a Forecasting and Policy Analysis System (FPAS) model, typically employed by central banks, to generate forecasts for key variables like inflation, foreign exchange rates, and policy rate volatility. These forecasts are then combined with actual market data points where available, with the weight of market data increasing as

markets develop. This creates both Overnight Index Swap (OIS) curves and Synthetic Cross-Currency Swap curves that market participants can use for pricing and valuation.

**The yield curves serve multiple purposes in supporting LCY market development.** First, they provide EBRD with essential tools for its own operations – enabling daily valuation of LCY instruments and pricing of fixed-rate products in markets where such pricing references did not previously exist. Second, they support broader market development by giving local banks and other market participants reliable tools for pricing and valuing LCY financial instruments. Finally, they serve as reference points for policy dialogue with authorities on further market development.

**The initiative has evolved from an internal EBRD tool to a public good available to other market participants.** Initially funded from EBRD's budget, the yield curves are now supported by SECO donor funding and published on Bloomberg, making them available to other international financial institutions and market participants. This broader availability has attracted interest from other IFIs, with AIIB already using the curves for select countries. The methodology is also shared with TCX, though TCX applies its own risk preferences in pricing.

**This approach fills an important gap in market infrastructure.** While central banks typically publish government bond yield curves, the EBRD's OIS curves serve a different and complementary purpose. Even in markets with sufficient government bond market activity, OIS swap curves may not be feasible due to limited market activity. The EBRD approach provides an objective, market-oriented solution that helps overcome this limitation and supports the development of LCY markets.

## Longer tenors differentiate EBRD's offering

### Box 11: LCY longer tenors support EBRD additionality

#### Kyrgyz Republic: Long-term LCY fills market gap in de-dollarising economy

The lending to FI sector has been almost exclusively in LCY. While local banks have abundant KGS deposits following regulatory de-dollarisation efforts, these funding sources are predominantly short-term. Through the SME LCYP subsidy, EBRD has established itself as the primary source of extended-tenor LCY financing among DFIs. This capability has proven particularly valuable for financing green investments under KyrSEFF frameworks, where longer repayment periods are needed to match capital expenditure requirements. The Bank's ability to provide longer-term KGS lending aligns with both market needs and policy priorities, as historical currency volatility and post-covid regulations have pushed FI to reduce foreign currency exposures.

#### Kazakhstan: Committed long-term LCY lending critical for infrastructure development

Kazakhstan illustrates EBRD's unique role in providing extended-tenor LCY financing for infrastructure and renewable energy projects. While local banks typically limit themselves to short-term working capital loans or medium term facilities (sometimes uncommitted and revolving each year), EBRD provides committed long-term KZT financing that matches the needs of regulated utilities and renewable energy developers. The Bank's ability to provide longer grace periods is especially important given Kazakhstan's harsh winters that prolong construction periods. However, even in this market where EBRD has clear tenor-based additionality, the higher cost of committed long-term LCY funding can present competitive challenges relative to shorter-term local bank offerings.

### Jordan: LCY financing less significant under strong USD peg

Jordan is one of the few countries with LCY lending in infrastructure – projects under the Municipal Resilience Refugee Response framework total over €110m in LCY ABI. Jordan's experience highlights the limited role of currency choice in markets with strong currency pegs. The borrower demand was driven by administrative convenience rather than currency risk mitigation, given the Jordanian dinar's stable peg to the US dollar. EBRD's additionality came primarily from offering longer tenors and comprehensive technical cooperation, advantages not specific to currency denomination. Indeed, since 2021, infrastructure clients have increasingly opted for USD financing despite LCY revenues, as interest rate differentials favour hard currency borrowing – demonstrating how FX risk becomes a secondary concern in a stable peg environment.

## Models of LCY concessionality demonstrate trade-offs between market alignment and effectiveness for transition

### Box 12: Approaches to concessional LCY support: From market-aligned risk sharing to direct subsidies

[REDACTED]

## Risk sharing and guarantee products showed limited additionality in LCY market development, with niche exceptions

### Box 13: Guarantee for Growth (G4G) - Guarantee mechanism focused on regulatory capital and general MSME lending rather than LCY development

**The G4G programme in Albania uses EBRD guarantees on LCY government bonds to incentivise lending to MSMEs.** Through guarantees, EBRD covers the risk of non-payment on LCY government bonds held by partner banks, in exchange for their commitment to increase MSME lending.

**The programme addresses regulatory capital constraints faced by international banking groups operating in Albania, but does not directly promote LCY lending.** When consolidated at the group level, Albanian sovereign exposures receive high risk weightings that limit local subsidiaries' lending capacity. G4G reduces Raiffeisen Bank International's risk weight on sovereign bonds held by Raiffeisen Bank Albania to zero, freeing up risk-weighted asset capacity for MSME lending.

**Despite its classification as an LCY operation, G4G's contribution to LCY development or lending is limited.** While the guarantees cover LCY denominated sovereign bonds, EBRD Treasury does not need to source LCY since the guarantees are unfunded. Importantly, the Programme does not specify or track the currency of the resulting MSME lending. G4G likewise does not sustainably address fundamental challenges in the financial system like high euroization of deposits and credit, limited retail investment options, and illiquid money markets.

## Even with available support mechanisms, LCY operations remain unviable in some markets

### Box 14: Market conditions can create barriers to LCY operations

#### Albania: LCY lending unviable despite LCYP availability

Albania demonstrates how LCY operations may remain uncompetitive even with available concessional mechanisms. In a bank-dominated system with high deposit liquidity, EBRD's cost of funding in LCY cannot match local market rates, even when the SME LCYP guarantee is available. This has resulted in virtually no EBRD LCY lending in Albania over the 2016-2023 evaluation period, despite the country being part of the SME LCYP since 2018.

#### Egypt: LCY FI lending limited to microfinance institutions

While EBRD had a substantial €2bn FI ABI (TFP excluded) in Egypt, LCY FI lending represented only €10 million over the entire 2016-23 period. This was exclusively with microfinance institutions, supported by the SME LCYP. This segmentation reflects market dynamics – banks maintain high liquidity in EGP and primarily lend in LCY due to regulations, making EBRD LCY funding uncompetitive for this segment. However, non-deposit-taking microfinance institutions require LCY funding to avoid FX risk exposure, creating a viable niche where EBRD can operate by combining LCYP subsidies with favourable Treasury cross-currency swap arrangements with local banks seeking USD. The case illustrates how even in markets where broader LCY lending remains uncompetitive, EBRD can identify specific segments where its LCY offering meets market needs.

## LCY-linked resilience is rarely a part of Transition rationale and monitoring of lending projects

### Box 15: Frameworks drive transition rationale away from LCY link to Resilience, while direct financing offers rare but compelling instances of LCY resilience argument

#### FIF: Weak link between TQ Resilient and LCY denomination

Two thirds of all LCY projects are sub-operations of the three largest frameworks (FIF, DFF, RSF). FIF represents by far the largest share – 42% of all LCY projects were sub-operations of FIF. This includes projects under FIF sub-frameworks such as Women in Business (WiB).

FIF projects target SME competitiveness through access to finance as their primary transition rationale. The framework does not have any LCY-related monitoring indicators at the framework level. About two thirds of FIF LCY projects have TQ Resilient as a secondary TQ. These are usually linked to 'maintaining adequate portfolio quality (NPL share)', an indicator used for both HCY and LCY loans and with no specific LCY rationale.

[REDACTED]

At partner FI level, the FIF notes that *'by ensuring that banks have adequate underwriting and risk management practices in place, the FIF also seeks to encourage sustainable lending practices, supporting the resilience of the financial system'* – this again is not a rationale specific to currency. In principle, if banks have sustainable lending practices, this can also include not exposing SME clients to unhedged FX risks. However, at the level of partner FIs, the more significant resilience benefit of LCY operations stems from providing partner banks access to longer-tenor LCY funding compared to their typically shorter-term deposit base,

enabling better asset-liability matching. This aspect of transition resilience is however not captured by the only resilience indicator used (NPL ratio).

#### **DCFTA/ SMEC: LCY link to competitiveness**

The regional frameworks for SME competitiveness under FIF, represent 30 LCY credit lines with partner FIs. This programme includes concessional blending in LCY operations with an interest rate subsidy and has an operational target for a share of LCY sub-projects at 50%. Here the LCY transition rationale is also linked to competitiveness and the LCY share is a benchmark under TQ Competitive, rather than Resilient, which continues to only have a NPL monitoring benchmark. This likewise points to the case for transition being made in the ability to meet existing demand for LCY finance and improving SME competitiveness.

#### **RSF: The only framework with a LCY share benchmark**

Out of the three major frameworks that comprise the majority of LCY operations (FIF, DFF, RSF), RSF is relatively the smallest with 9% of LCY operations being under RSF. It is however the only one that has a LCY transition monitoring benchmark at framework level at all – targeting a share of LCY sub-operations (15%) as a component of TQ Resilient.

RSF LCY sub-operations are also by far the most likely to include TQ Resilient rationale, at 86%. This is mostly justified by references to the capital relief that local banks benefit from thanks to the EBRD guarantee or with references to capacity building at the level of the partner FI – neither being currency specific. In select cases, the Resilient rationale refers to the presence of the country in SME LCYP (*'RSF Loan will be provided in local currency in a country where a far reaching MoU for the development of local money markets has been signed.'*)

#### **Crisis Response Frameworks: Resilience not linked to currency choice**

Some frameworks were targeting resilience in the sense of crisis response – this was specifically the case of projects under the Resilience Framework (addressing Covid response), and the Municipal Resilience Refugee Response Framework (addressing response to refugee migration). So while their LCY sub-operations have a primary TQ Resilient, this has no connection to LCY as such.

#### **Direct financing and stand-alone operations: Rare but convincing examples of LCY link to resilience**

[REDACTED]

## Annex 2. Country reviews summaries

[REDACTED]

## Annex 3. Local currency financing – data analysis

### Summary

#### 1. Overall trend

##### The share of LCY operations in ABI has not increased over the evaluation period

- Share of LCY operations on debt ABI across all EBRD COOs has been declining in the long term, as well as over the evaluation period.
- For countries within the scope of this evaluation, there has been a growth in LCY share over the long term but declining trend over the evaluation period.
- In the countries within the scope of the evaluation, the overall volume of LCY ABI was €6.2bn, representing over 14% of debt ABI.

#### 2. Geographic distribution

##### Geographic distribution of LCY operation is uneven, with Kazakhstan a singular outlier

- Non-ETC countries outside Kazakhstan show notably lower LCY financing activity than ETCs on average, representing 32% of LCY ABI despite accounting for 65% of total debt ABI.
- Central Asia has the largest share of LCY ABI due to Kazakhstan's contribution, while Eastern Europe and Caucasus has the largest share for LCY in ETC countries.

#### 3. Sectoral distribution

##### LCY financing is predominantly delivered by the FI sector, with infrastructure dominated by Kazakhstan

- FI sector delivered 17% of its ABI in LCY, for Sustainable Infrastructure this share was 13%. Outside of Kazakhstan, LCY represented only 3% of SI debt ABI.
- The importance of FI LCY lending is especially pronounced in ETC countries. LCY represents 31% of FI debt ABI overall in ETCs, and when TFPs are excluded, this share rises to 60%.
- LCY financing in infrastructure has been declining as a share of overall SI ABI.

#### 4. SME finance

##### LCY financing plays a considerably more important role for SME operations in ETCs compared to non-ETCs

- Overall, 43% of LCY finance was in SME sector. This share was 76% in ETCs and 56% in non-ETCs excluding Kazakhstan.
- SME LCYP supports significant share of LCY ABI in ETC countries. Almost three quarters of SME LCYP-supported ABI was in ETCs. This represented 35% of LCY ABI in ETCs.

#### 5. Portfolio class

##### The majority of LCY finance was in Private portfolio class

- Overall, 68% of LCY financing was in Private portfolio class. This proportion was 98% in ETC countries and 79% in non-ETC countries excluding Kazakhstan.
- In Kazakhstan, majority (55%) of LCY was in State portfolio due to its large share of SI LCY finance. Kazakhstan was the only country with any LCY in State sovereign guaranteed finance (16% of overall LCY ABI).

#### 6. Instruments

##### Limited use of guarantees and risk-sharing

- Only €312m ABI in LCY guarantees and €59m ABI in LCY risk-sharing across all countries.
- LCY Risk-sharing represented a meaningful share of LCY in a handful of ETCs in the COR sector.

#### 7. Transition objectives

##### Resilience objectives feature prominently in LCY portfolio despite primary focus on competitiveness

- The most common primary TQ for LCY projects was Competitive, but approximately half of LCY projects feature TQ Resilient as either primary or secondary TQ.

## Scope and Approach

The data in this evaluation considers countries and time periods within the scope of this evaluation, unless otherwise stated. The time scope of this evaluation is 2016-2023. The geographic scope of this evaluation comprises countries included in the SME LCYP programme or eligible for inclusion, outside of the EU (Table 4). Jordan and Kazakhstan are included in the 'LCYP eligible' countries set, as they were not part of LCYP within the evaluation period. They however joined LCYP in 2024. The data presented in this annex includes countries within the geographic scope unless otherwise specified – in the initial overview of LCY trends data for all EBRD COOs is also presented. Where reference is made to ETC countries, this excludes Belarus.

**Table 4: Geographic scope of the evaluation**

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

**Kazakhstan is an outlier in LCY terms and has been isolated in some analysis.** Kazakhstan is by far the largest country of LCY operations as a share of debt ABI. This, combined with the absolute volume of ABI in Kazakhstan (third largest within the scope) means that its presence significantly skews aggregate data on LCY operations. Therefore, for some measures, Kazakhstan has been isolated in the data to allow more nuanced view of the LCY developments in other countries. All such instances are clearly noted.

**Data on LCY financing were identified by internal LCY flag.** LCY flag present in internal databases was used for identifying LCY operations. This has proven to be a reliable indicator of LCY operations even if individual cases of missing/wrongly assigned flag were found. These were marginal and did not fundamentally affect the quality of the data in aggregate. LCY flag is assigned at facility level, so for operations with facilities in different currencies, only the LCY entered the LCY ABI data. Nevertheless, some facilities are multicurrency in the sense that the client can decide at disbursement which currency to draw. This means that some LCY-flagged facilities were disbursed in hard currency. These are then included in the aggregate LCY ABI data. Data on all LCY-flagged projects' disbursement currencies are presented in the country reviews. Overall, this also did not represent a fundamental challenge to the data in aggregate.

**The primary proxy used for LCY financing is ABI.** There are a number of possibilities to analyse LCY financing trends and characteristics, each with some limitations – ABI, disbursements, number of projects, portfolio, operating assets, to name the most prominent options. The data in this Annex is primarily based on ABI figures. This choice was made as it is most closely related to annual business developments and reflects the changing context over years. Some limitations are acknowledged – there are individual cases of large cancellations (i.e. LCY ABI without actual disbursements), as well as above-noted potential disbursements in hard currency. Using ABI as a measure also includes unfunded guarantees in LCY – this may or may not be viewed as desirable, as these projects do not require LCY funding. Some data on number of LCY projects are also

presented throughout this Annex; sometimes number of projects is seen as a preferred measure of LCY business, as these projects tend to be relatively smaller in volume compared to HCY due to their weighting towards SME business. However this also means that ‘one project’ is a single direct loan to an SME as well as an SME credit line to an FI, which cannot be considered directly comparable. Individual country reviews present data on LCY portfolio and operating assets for each country.

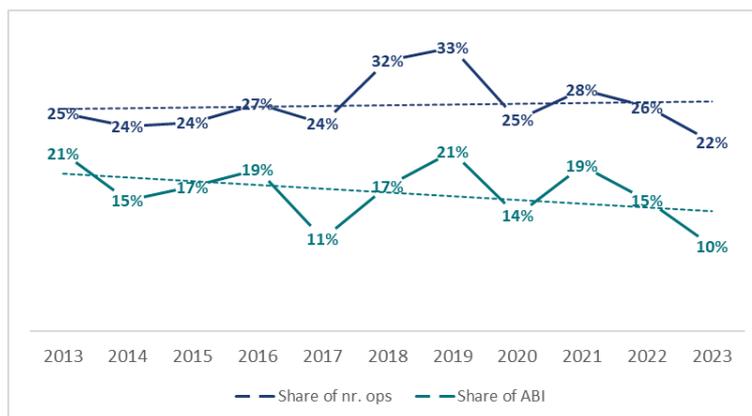
Source of all data is *dw\_banking\_operational* dataset, unless otherwise stated. ABI/operations data include debt and guarantees only, equity excluded. Analysis by IEvD.

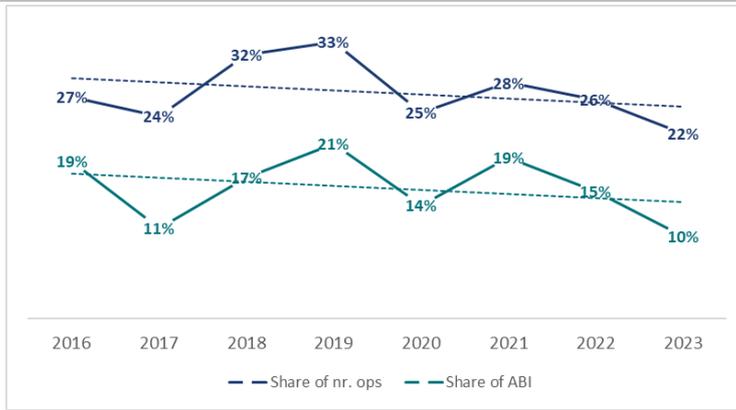
## Findings

### The share of LCY operations has not increased over the evaluation period

The share of LCY operations on debt ABI across all EBRD COOs has been declining in the long term, as well as over the evaluation period. This evaluation excludes EU countries and countries not eligible for SME LCYP from its scope; however, the analysis of the share of LCY across all COOs is germane to the LC2 initiative (2013) and LC2 Strategy (2019). While there has been considerable year on year volatility in the share of LCY in debt ABI as well as in the number of operations over the years, there is no discernible upward trend. Over the long term (2013-23) LCY on number of operations remained flat, while there has been a declining trend in LCY ABI share. Over the evaluation period (2016-23), both measures were in decline. (Figure 10)

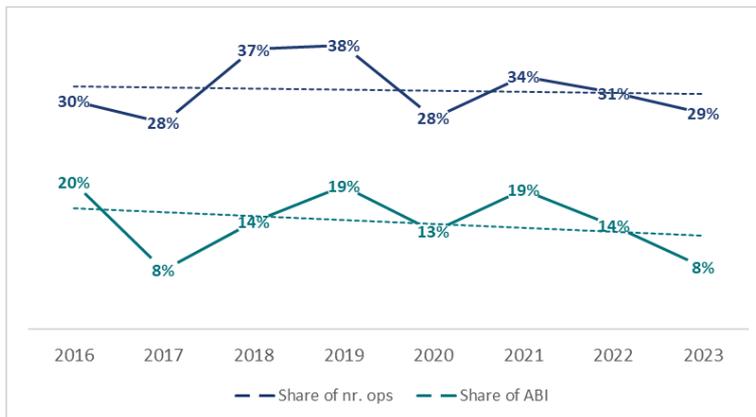
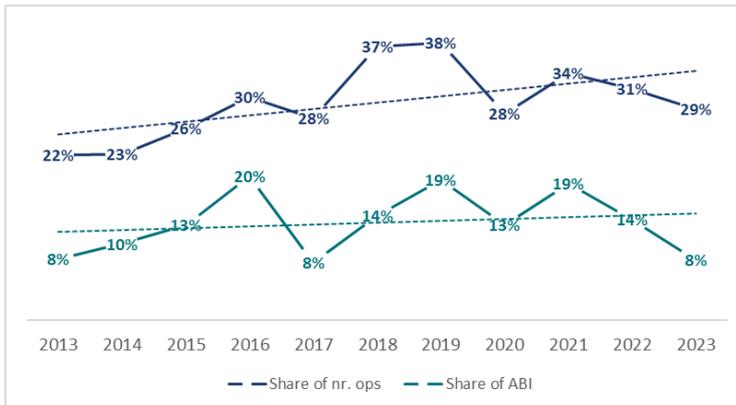
Figure 10: Trend in LCY share of ABI and share in number of projects – all countries of operations, 2013-23 and 2016-23





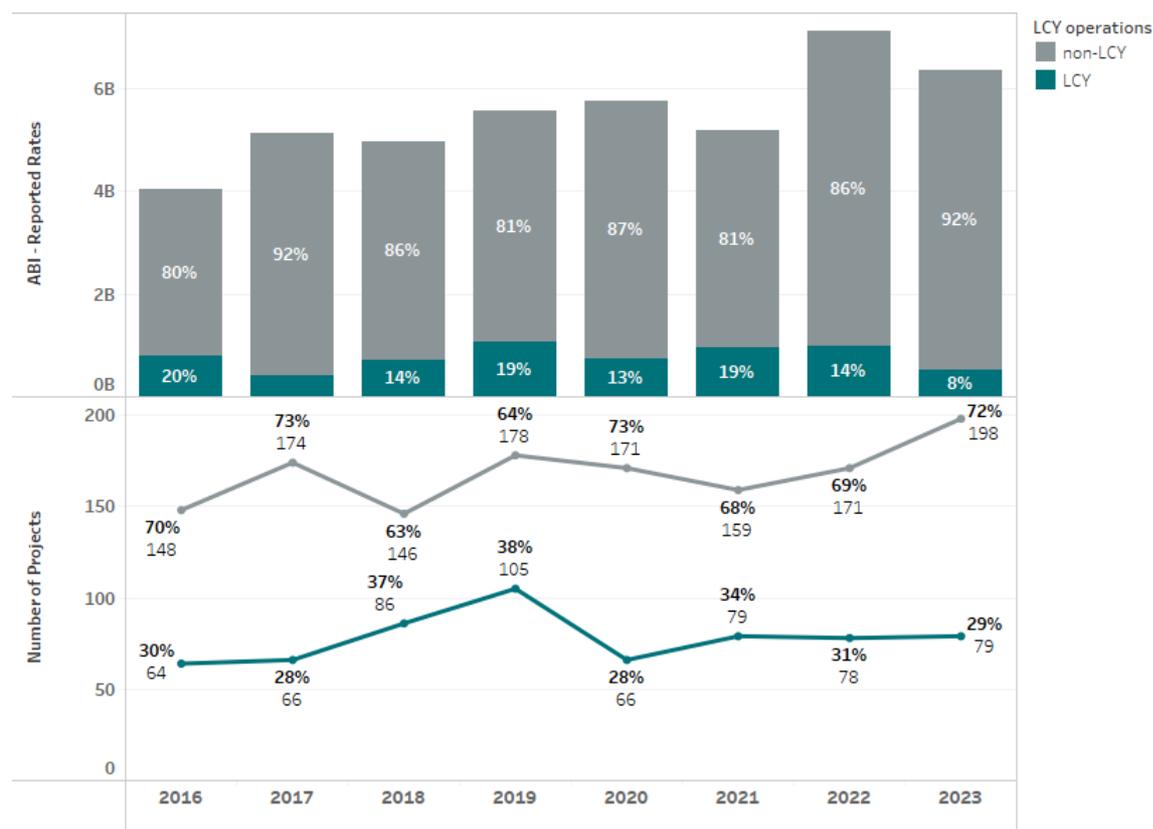
For countries within the scope of this evaluation, there has been a growth in LCY share over the long term but declining trend over the evaluation period. The countries within the scope of this evaluation saw a slight growth trend of LCY ABI share over the long term (2013-23), with this trend being more pronounced in terms of share in number of operations. However, over the evaluation period (2016-23) the trend in share of projects has remained flat, while the trend in share of LCY ABI has been in slight decline. (Figure 8)

Figure 11: Trend in LCY share of ABI and share in number of projects – countries within scope, 2013-23 and 2016-23



In the countries within the scope of the evaluation, the overall volume of LCY ABI was €6.2bn, representing over 14% of debt ABI. The peak year for LCY operations was 2019 when they represented €1.1bn or 19% of debt ABI. The share in number of operations was 30% on average over the period. (Figure 12)

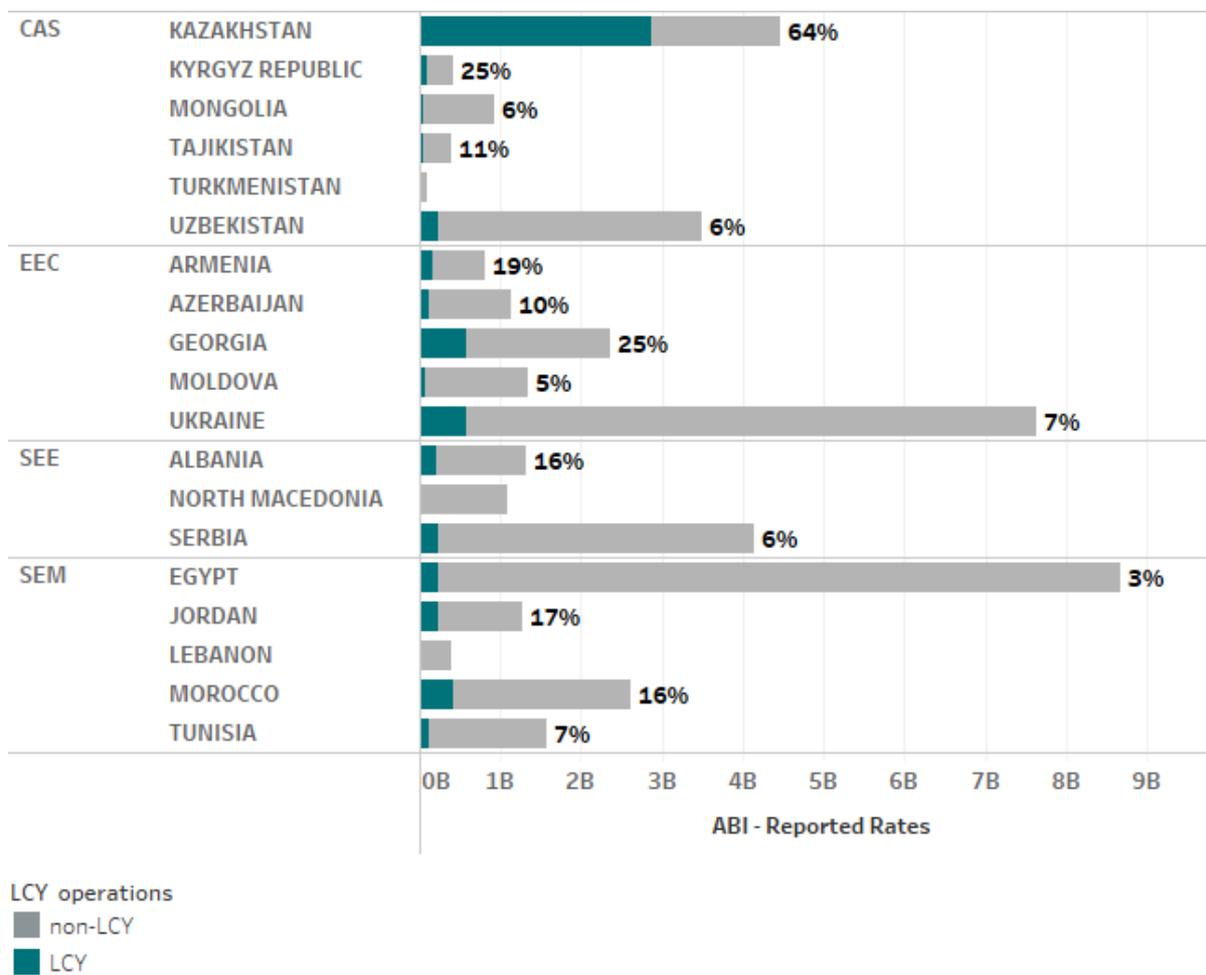
Figure 12: Share of debt ABI and number of projects in LCY, 2016-2023



### Geographic distribution of LCY operation is uneven, with Kazakhstan a singular outlier

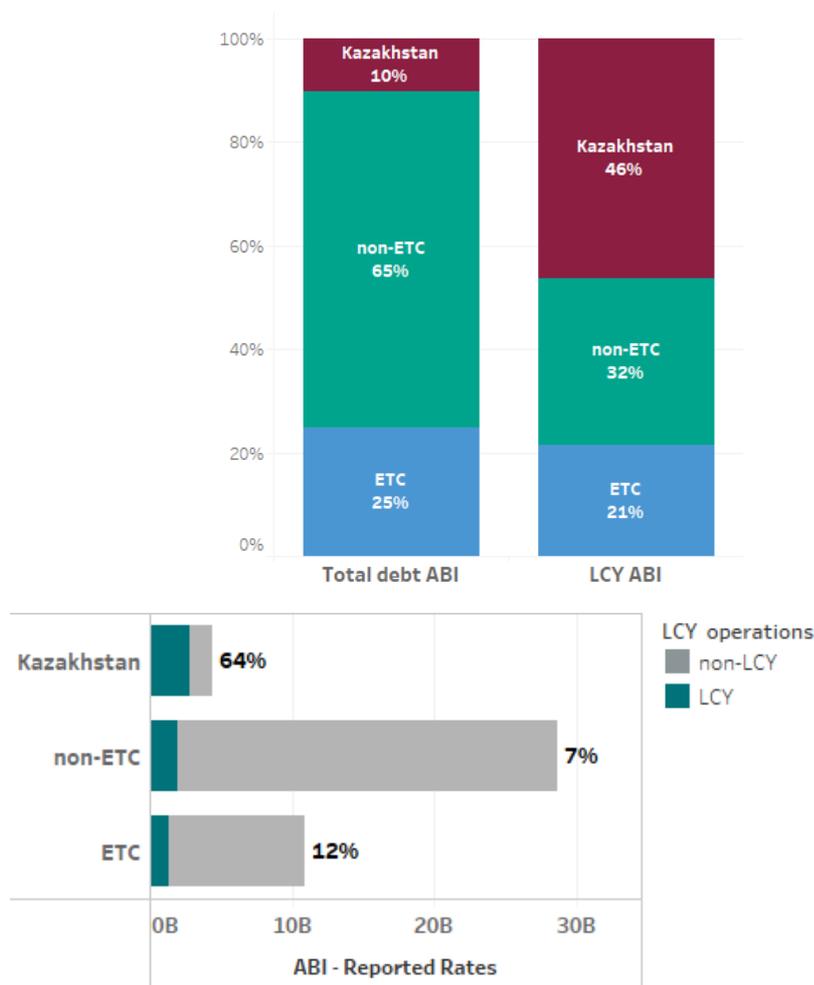
The geographic distribution of LCY operations was uneven across countries, with Kazakhstan standing out as an outlier. The share of LCY in debt operations varied widely across countries. Three countries had no LCY operations (Lebanon, North Macedonia, Turkmenistan). Countries with LCY operations ranged from 3% share (Egypt) to 64% share (Kazakhstan). Kazakhstan represents an outlier not only in its share of LCY ABI but due to its large ABI overall also an outlier in terms of absolute LCY volumes (€2.9bn). 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), Albania (16%, 213m), and Morocco (16%, 414m). (Figure 13)

Figure 13: Share of LCY on debt ABI by country, 2016-2023



**Non-ETC countries outside Kazakhstan show notably lower LCY financing activity on average, representing 32% of LCY ABI despite accounting for 65% of total debt ABI.** ETC countries' share of LCY ABI is similar to their share of overall debt ABI over the period (25% share of ABI vs. 21% share of LCY ABI). This is not the case for non-ETC countries outside of Kazakhstan, which assumed 65% of ABI but only 32% of LCY ABI. The balance shows Kazakhstan's outsized weight in LCY financing – with only 10% debt ABI over the period, it accounts for almost half of all LCY ABI (46%). Non-ETC countries' LCY ABI represented 7% of their debt ABI, while for ETC countries this share was 12%. (Figure 14)

Figure 14: Share of country group in ABI vs. LCY ABI, 2016-2023



Central Asia has the largest share of LCY ABI due to Kazakhstan's contribution, while the Eastern Europe and Caucasus region has the largest share for LCY in ETC countries. Central Asia represented 53% of LCY ABI overall, due largely to Kazakhstan's outsized contribution. The rest of the countries in the region, five ETCs, assumed only 13% of LCY ABI in Central Asia. Eastern Europe and Caucasus represented close to a quarter (24%) of all LCY ABI. The four ETCs in this region represented over half of the LCY. SEMED and South-Eastern Europe represented 16% and 7% of total LCY ABI, while there are no ETC countries in these regions. (Figure 15, Figure 16)

Figure 15: LCY ABI by region and country group, 2016-2023

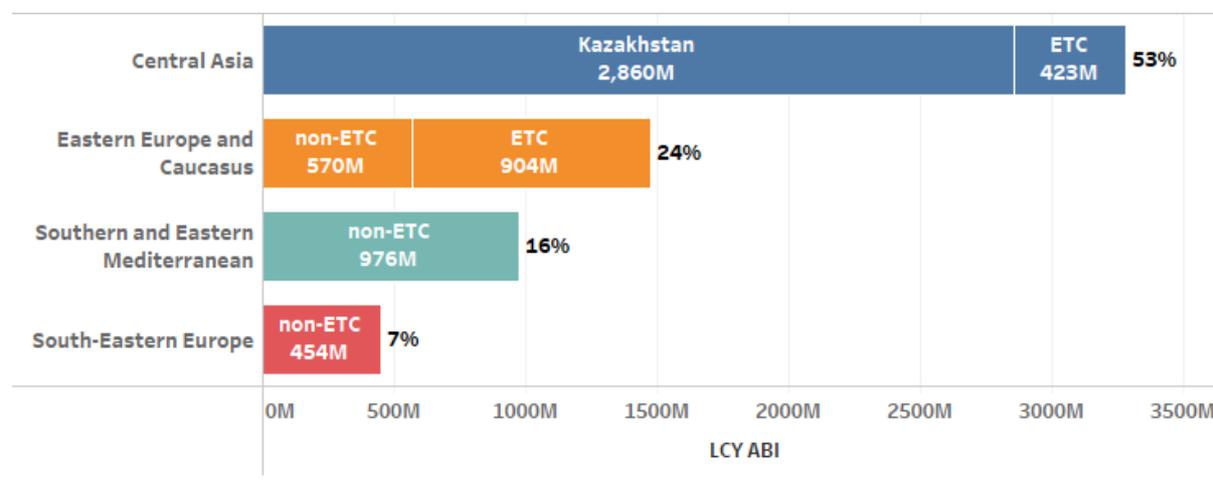
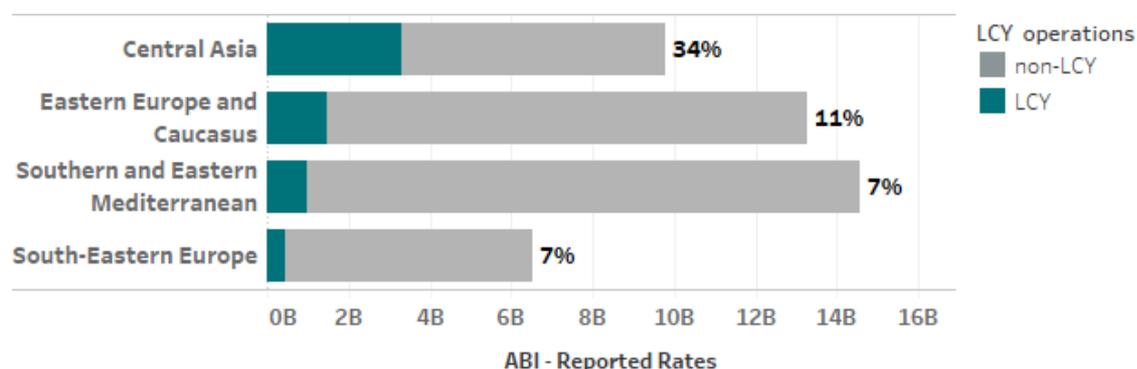


Figure 16: Share of LCY ABI in debt ABI by region, 2016-2023

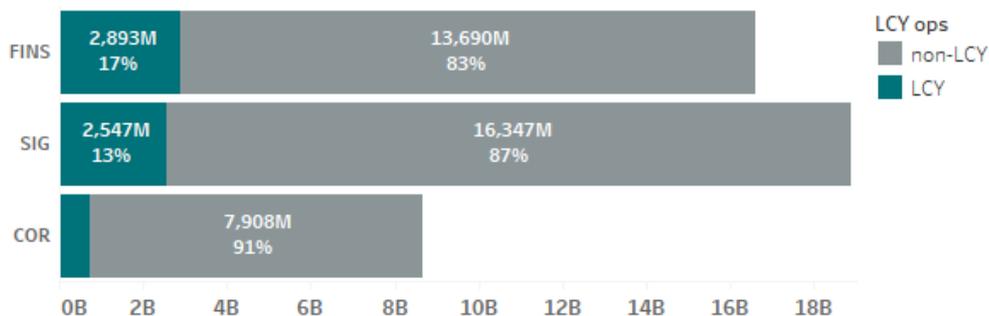


### LCY financing is predominantly delivered by the FI sector, with infrastructure dominated by Kazakhstan

LCY financing is a domain of FI sector, with infrastructure present significantly only in Kazakhstan. Almost half of total LCY ABI was delivered by FI sector (47%, €2.9bn), closely followed by Sustainable Infrastructure (41%, €2.5bn), with Corporate sector representing the remainder (12%, €0.7bn). However, this breakdown is skewed due to the large infrastructure LCY ABI in Kazakhstan (€2.1bn of LCY ABI). With Kazakhstan excluded, FI sector accounts for 71% of LCY ABI in all remaining countries. To put it differently, FI sector has 15% of LCY in its debt ABI in countries outside Kazakhstan, while for SI and COR this share is 3% and 6% of debt ABI respectively. LCY in SI is likewise practically not present in ETC countries. (Figure 17, Figure 18)

Figure 17: Share of LCY in debt ABI by sector, 2016-2023

All countries in scope



Kazakhstan excluded

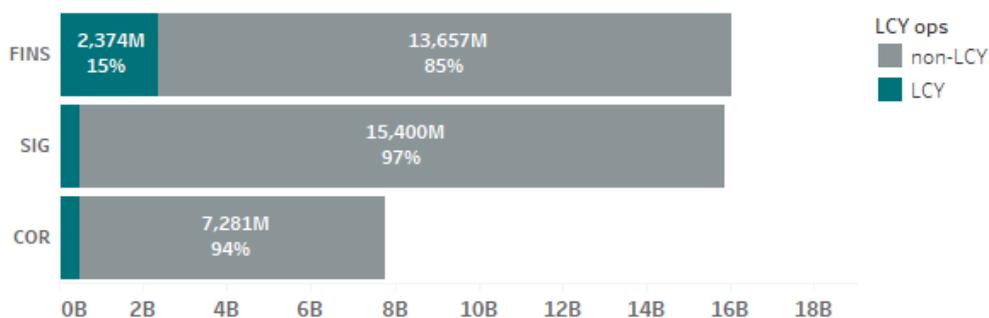
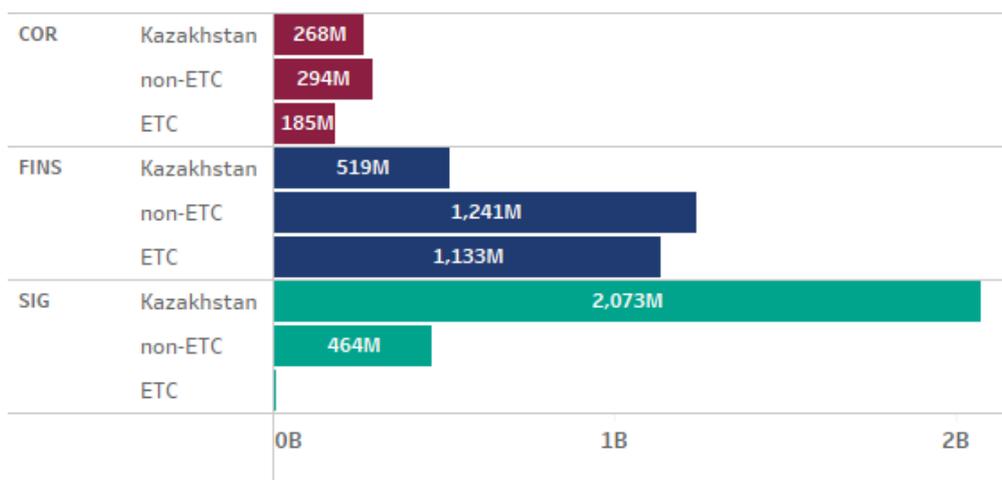
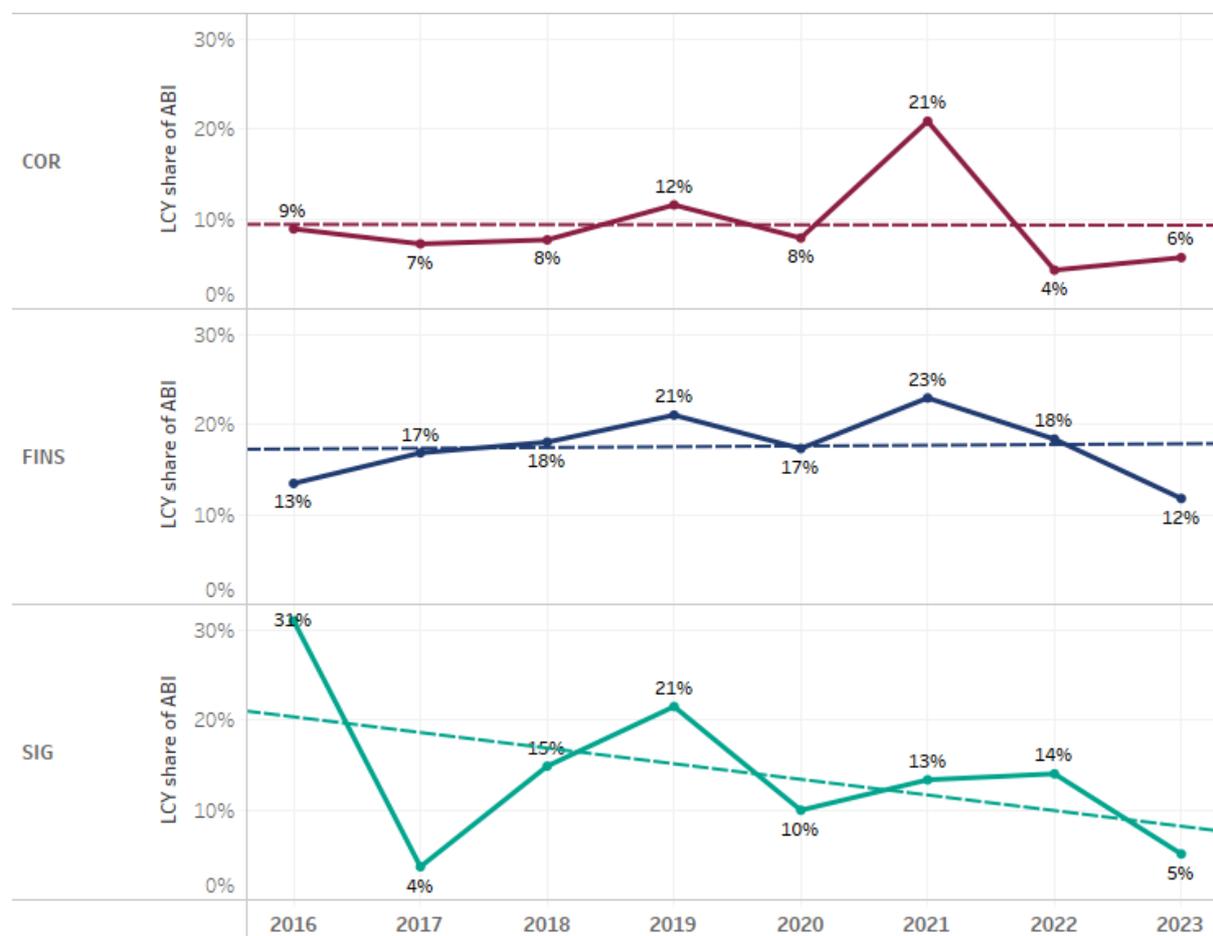


Figure 18: LCY ABI per sector by country group, 2016-23

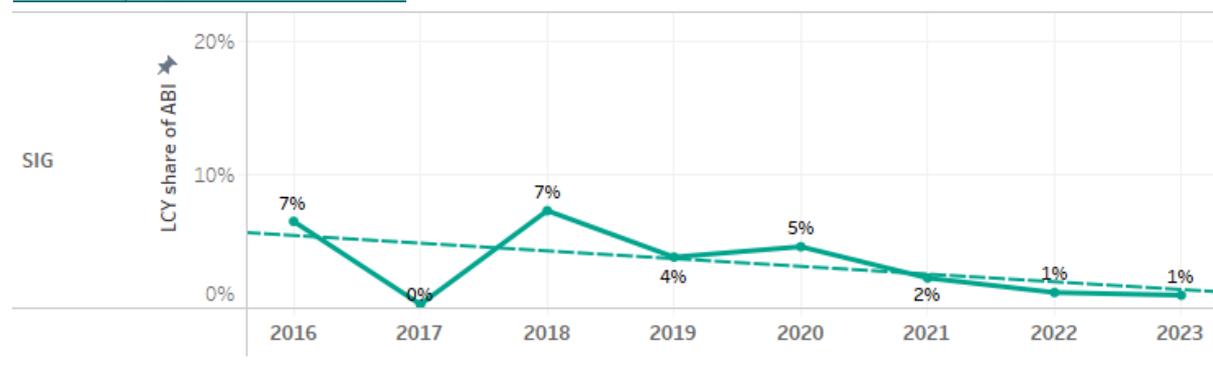


LCY financing in infrastructure has been declining as a share of overall SI ABI. While the trend for FI and COR sectors has been fairly stable in terms of their share of LCY finance, the trend for SI has been declining. This trend holds even when Kazakhstan is excluded from the data. (Figure 19)

Figure 19: Trend in the share of LCY ABI on debt ABI by sector, 2016-23

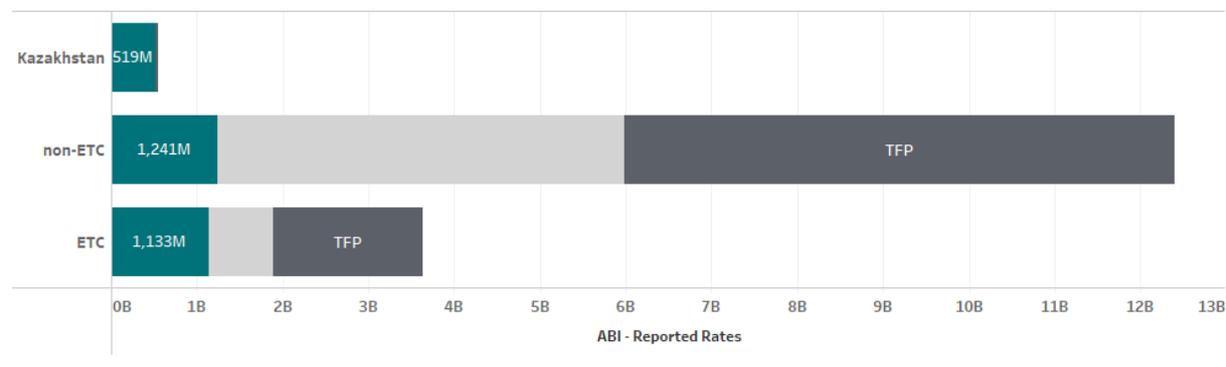


#### SI sector, Kazakhstan excluded



**The importance of FI LCY lending is especially pronounced in ETC countries.** FI sector lending in ETC countries is mostly delivered in LCY. This is especially evident once trade facilitation guarantees (TFP) are excluded from the FI ABI. While LCY represents 31% of FI debt ABI overall in ETCs, when TFPs are excluded, this share rises to 60%. For non-ETC countries outside Kazakhstan, while not nearly representing such a large proportion, the share of LCY ABI in FI also doubles when TFPs are excluded (from 10% to 21%). In Kazakhstan practically all FI ABI is delivered in LCY and TFPs are virtually not present. (Figure 20)

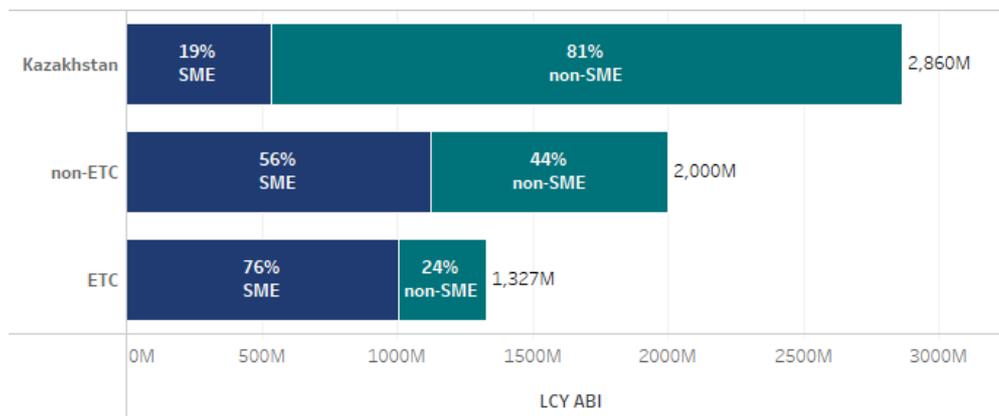
Figure 20: LCY in FI ABI by country group, 2016-23



### LCY is particularly pertinent to SME finance

LCY financing plays a considerably more important role for SME operations in ETCs compared to non-ETCs. Overall, 43% of LCY finance was in SME sector. In ETCs, more than half (56%) of all SME financing was provided in LCY, while in non-ETC countries this share was lower at 38%. The difference is even more pronounced when looking at the composition of LCY operations – in ETCs, three quarters (76%) of LCY financing went to SMEs, whereas in non-ETCs excluding Kazakhstan over a half (56%) did. In Kazakhstan, 19% of LCY finance went to SMEs. (Figure 21)

Figure 21: SME LCY as a share of LCY ABI, by country group, 2016-23



**SME LCYP supports significant share of LCY ABI in ETC countries.** Over the evaluation period, 14 countries were part of SME LCYP. While the Programme's eligibility was extended beyond ETC countries since 2016, ETCs remained the main beneficiaries. SME LCYP supported €642m of LCY ABI overall in 2016-23 – almost three quarters of this (73%) was in ETC countries. (Figure 22) For some countries LCYP supported significant share of their overall LCY ABI over the period – Tajikistan (93%), Kyrgyz Republic (75%), Armenia (73%). In absolute volume Georgia was the top beneficiary of LCYP support (€123m) even though this was just 21% of Georgia's LCY ABI. These countries are all ETCs, which joined the programme already in 2011. The largest beneficiaries of LCYP in non-ETC countries were Tunisia (48% of LCY ABI) and Serbia (32%) – but they were also the only non-ETC countries with any significant LCYP use. (Figure 23)

Figure 22: LCYP ABI by country group, 2016-23

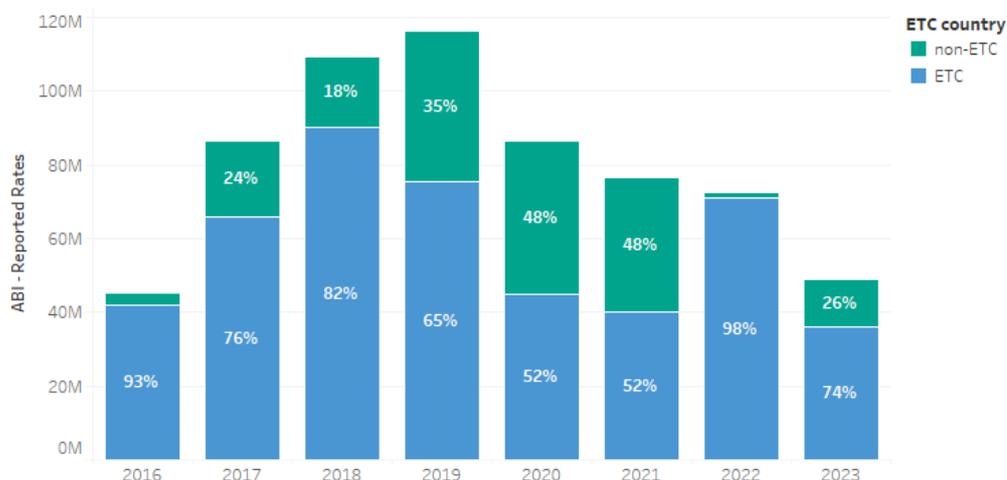
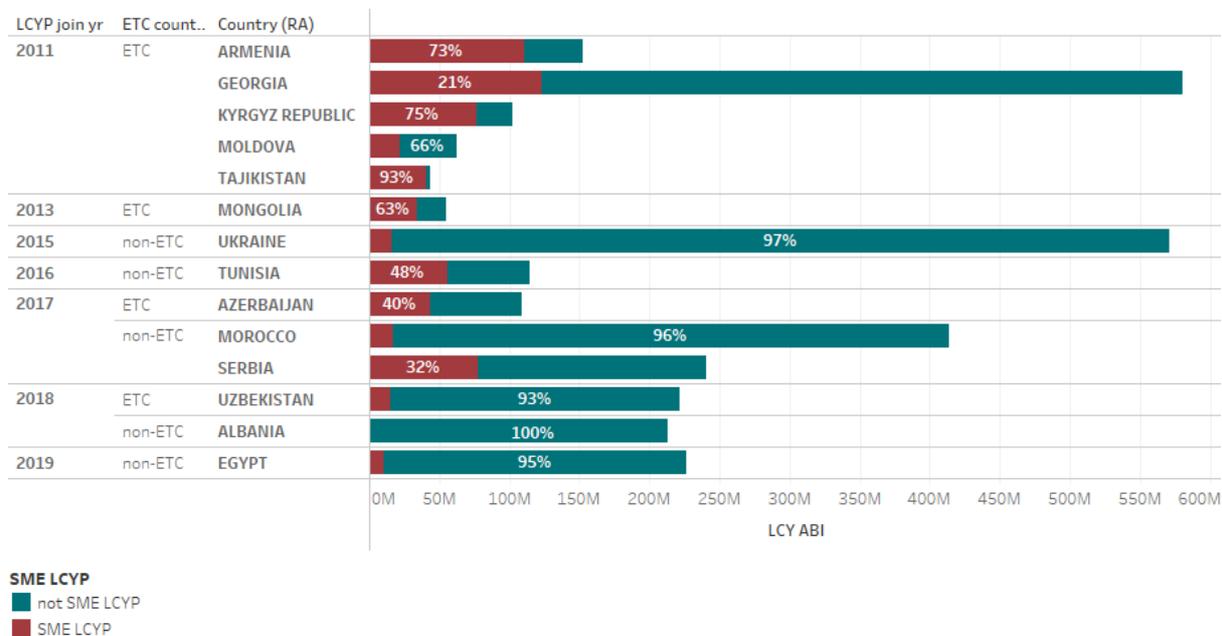


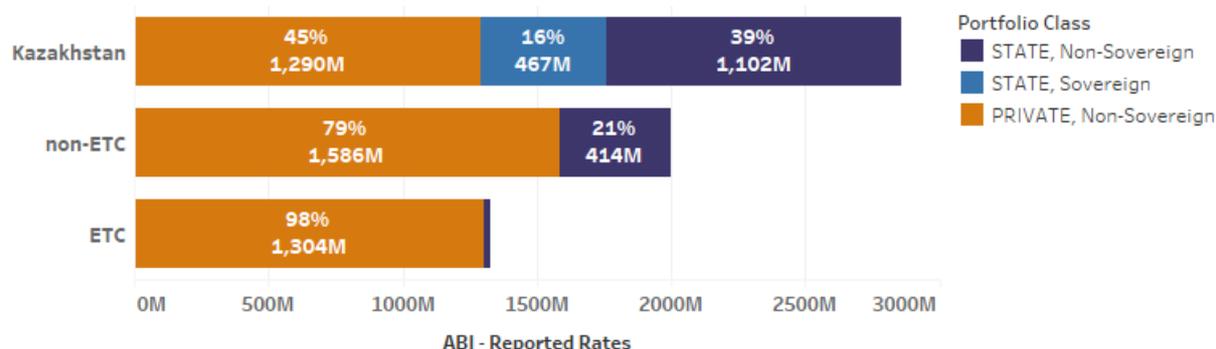
Figure 23: Share of LCYP in overall LCY ABI, by country; 2016-2023



The majority of LCY finance was in Private portfolio class

Overall, 68% of LCY financing was in Private portfolio class. This proportion was full 98% in ETC countries and 79% in non-ETC countries outside Kazakhstan. In Kazakhstan, majority (55%) of LCY was in State portfolio due to its large share of SI LCY finance. Two other countries had majority of State portfolio in LCY, albeit in much smaller absolute volumes – Egypt (59%) and Jordan (50%). Kazakhstan was the only country with any LCY in State sovereign guaranteed finance (16% of overall LCY ABI).

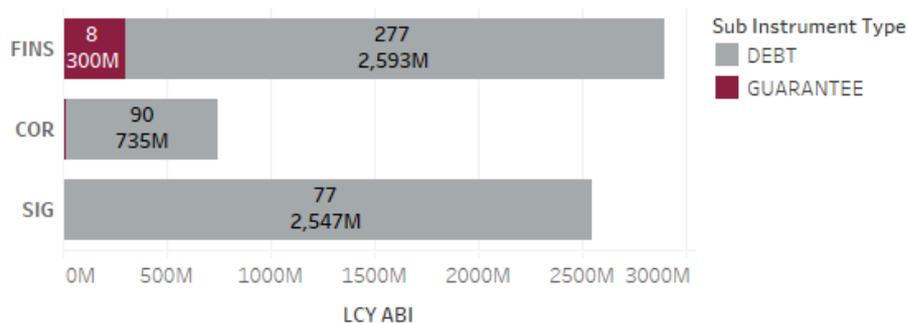
Figure 24: Share of LCYP in overall LCY ABI, by country; 2016-2023



### Limited use of guarantees and risk-sharing overall, but RSF meaningful in select ETCs

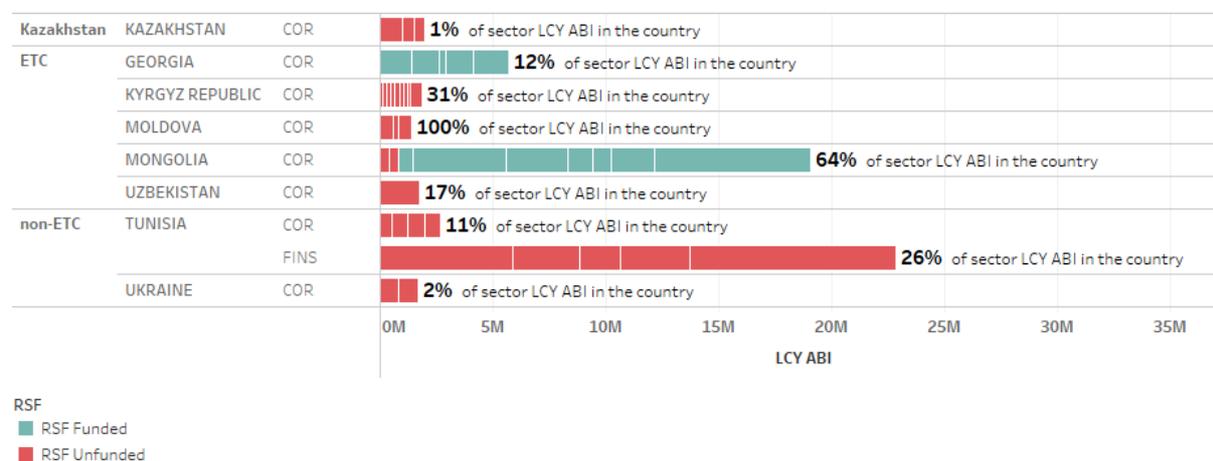
**Direct lending dominated EBRD's local currency financing, with guarantees playing only a minor in total LCY investment.** Guarantees represented only €312m of ABI over the period. They were the domain of the FI sector, and the vast majority of the volume came from two Guarantee for Growth (G4G) programmes in Albania (€203m ABI) and Ukraine (€74m ABI), together representing €277m of ABI over the period. The remaining balance (€35m) was delivered through RSF unfunded guarantees. (Figure 25)

Figure 25: LCY ABI by instrument type and sector; 2016-2023



**While risk sharing facilities represented a very small portion of overall LCY financing, they proved important for corporate lending in select markets.** RSF projects (both funded and unfunded) amounted to only €59m over the period across all countries, but their presence was meaningful in specific contexts. In Mongolia, RSF represented 64% of LCY ABI in the corporate sector, primarily through funded RSF. The Kyrgyz Republic saw unfunded RSF (guarantees) account for 31% of corporate LCY ABI, while in Moldova, three small unfunded risk-sharing facilities comprised the entirety of COR LCY activity. (Figure 26)

Figure 26: LCY Risk-sharing projects by country; 2016-2023



### Resilience objectives feature prominently in LCY portfolio despite primary focus on competitiveness

While most LCY projects were primarily under the Competitive TQ, over half of all LCY projects incorporated Resilience as either a primary or secondary transition objective. The most common primary TQ for LCY projects was Competitive (nearly half); this comes largely from their being part of frameworks targeting Competitiveness, mostly FIF and DFF. TQ Resilient is the primary TQ for only about 10% of projects – these are mostly projects under risk-sharing (RSF) or other guarantees, and under crisis response frameworks (Resilience framework for covid response, Municipal resilience refugee response framework). This however somewhat conceals the presence of TQ Resilient overall – TQ Resilient was a secondary TQ for a majority of TQ Competitive projects. In total, projects with TQ Resilient as either primary or secondary TQ represented over half of LCY projects both by ABI volume and by number of projects. (Figure 27)

**Figure 27: Primary and secondary TQ distribution on LCY projects, ABI and nr of projects, 2016-2023**



Primary TQ – rows (bold); Secondary TQ – columns

Size of bubble based on aggregate ABI

NB: Only projects for which data on TQs are included in the database are presented; this is about two thirds of the LCY projects in the 2016-2023 period. Projects from the earlier years (2016-18) are disproportionately more likely not to have TQ data included.

## Annex 4. Financial performance analysis: LCY vs. non-LCY operations

[REDACTED]

## Annex 5. Context overview

### 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<sup>28</sup> 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.**<sup>29</sup> Whereas earlier EBRD efforts focused on enabling its own local currency funding and lending, the LC2 Initiative adopted a more holistic approach in 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.<sup>30</sup>

**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.**<sup>31</sup> 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.

<sup>28</sup> EBRD: Transition Report 2009: Transition in Crisis?

<sup>29</sup> SGS10-142 (Addendum 1): Information Session: Local currency & Local capital market development

<sup>30</sup> 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](https://www.ebrd.com/downloads/news/local_currency.pdf)

<sup>31</sup> BDS10-323: Regional: ETC Local Currency Loan Programme & Establishment of the ETC Local Currency Risk-Sharing Special Fund

**In 2013, the EBRD formalized its approach through the LC2 Development Strategic Initiative and setting up a dedicated LC2 team.**<sup>32</sup> 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.**<sup>33</sup> 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<sup>34</sup> 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<sup>35</sup> beyond ETCs.**<sup>36</sup> 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.<sup>37</sup> Yet, despite the efforts of EBRD to increase SME financing in LCY, only about 22% 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.

<sup>32</sup> BDS13-271 (Final): Local Currency and Capital Markets (LC2) Development – Strategic Initiative

<sup>33</sup> EBRD Transition Report 2015: Rebalancing finance

<sup>34</sup> EBRD’s Banking Environment and Performance Survey

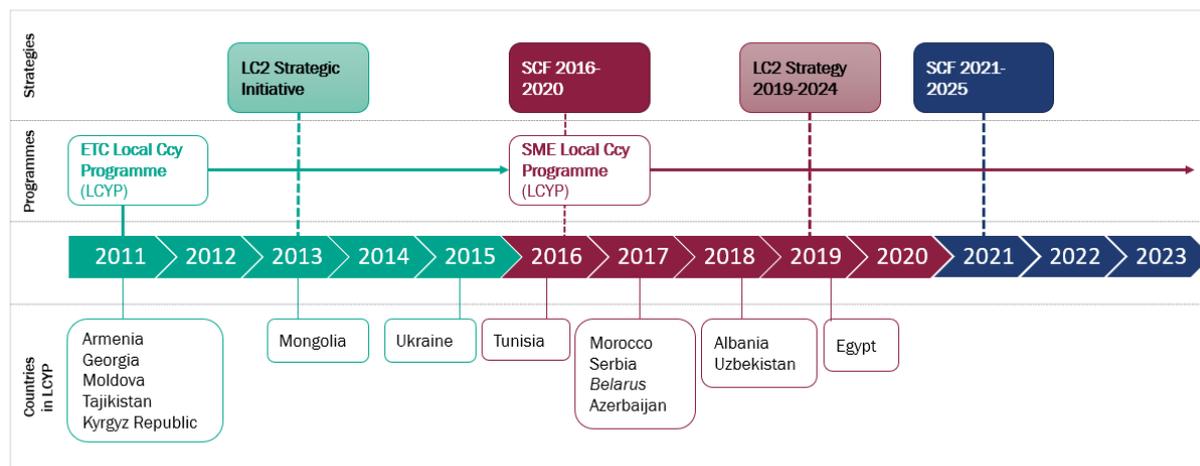
<sup>35</sup> Any country (i) where the local currency was not the Euro or US Dollar (*de facto* or *de jure*) nor tied to the Euro or US Dollar in a currency board arrangement; and (ii) which was assessed in the Bank’s 2015 Transition Report as having “Large” or “Medium” transition gaps for financing SMEs.

<sup>36</sup> BDS15-317 (Rev 1): Regional: SME Local Currency Programme

<sup>37</sup> Armenia, Georgia, Kyrgyz Republic, Moldova, Mongolia and Tajikistan.

**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.*<sup>38</sup>

**Figure 28: Timeline of LCY strategic and operational developments**



Source: IEvD elaboration

## Strategic background

**The 2013 LC2 Strategic initiative established clear objectives in the growth of LCY operations, linked to targeted policy dialogue.**<sup>39</sup> 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.**<sup>40</sup> 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.

<sup>38</sup> 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>

<sup>39</sup> BDS13-271 (Final): Local Currency and Capital Markets (LC2) Development – Strategic Initiative

<sup>40</sup> The tracking of the share of Local Currency and Capital Market operations (combined) was a part of the institutional scorecard. This was later discontinued.

Reflecting on the 2015 Transition report, the Strategic and Capital Framework (SCF) for 2016-2020<sup>41</sup> 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.

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.<sup>42</sup>

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.<sup>43</sup> 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 16.

### Box 16: 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.<sup>44</sup> 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.

<sup>41</sup> BDS15-013 (Final): Report of the Board of Directors to the Board of Governors: 2015 Annual Meeting – Strategic and Capital Framework 2016-2020

<sup>42</sup> SGS16-275 (Addendum 1): Information Session: LC2 Update and the way forward

<sup>43</sup> BDS18-210: Local Currency and Capital Markets (LC2) Strategy 2019-2024

<sup>44</sup> In many regions, especially ETCs, dollarisation levels are even higher, pointing to less trust in / usage of the LCY.

- **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.
- **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)<sup>45</sup> 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.

## Operational background

### 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.*<sup>46</sup>

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

<sup>45</sup> BDS20-030 (Final): Report of the Board of Directors to the Board of Governors: Strategic and Capital Framework 2021-2025

<sup>46</sup> BDS15-317 (Rev 1): Regional: SME Local Currency Programme

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.

### 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 had already signed the MoUs under the previous ETC LCYP.<sup>47</sup> 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.**<sup>48</sup> 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.<sup>49</sup>

**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).**<sup>50</sup> 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, regular 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.<sup>51</sup> 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

<sup>47</sup> Armenia, Georgia, Kyrgyz Republic, Moldova, Mongolia, Tajikistan

<sup>48</sup> SGS21-096: Information Session: Local Currency & Market Building in the Context of Early Transition

<sup>49</sup> CS/FO/23-09: Annual Report on Treasury Activities in 2022; countries: Egypt, Morocco, Kazakhstan, Uzbekistan, Georgia, and Armenia

<sup>50</sup> BDS15-050 (Addendum 153): Regional: Small Business Initiative Annual Review 2021

<sup>51</sup> <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.

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.<sup>52</sup>

**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 of the few IFIs which maintains and manages LCY liquidity portfolios operations in key currencies as part of its treasury operations.*<sup>53</sup> 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.*<sup>54</sup> 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

Overview of EBRD LCY financing is presented in a separate Annex.

## 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.<sup>55</sup> 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 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

<sup>52</sup> 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

<sup>53</sup> BDS13-271 (Final): Local Currency and Capital Markets (LC2) Development – Strategic Initiative

<sup>54</sup> EBRD (2019): Local currency finance: Development must or nice to have?

<sup>55</sup> BDS13-271 (Final): Local Currency and Capital Markets (LC2) Development – Strategic Initiative

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.'*<sup>56</sup>

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<sup>56</sup> CS/FO/21-36: Annual Report on Treasury Activities: 2020-2021