

LC2 Strategy (2019-2024)

Activities and Results

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European Bank
for Reconstruction and Development

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The Local Currency and Capital Markets (LC2) initiative, established in 2010 to increase financial resilience following the Global Financial Crisis, has been key to delivery on the Bank's strategic priorities including by supporting private sector mobilisation

Guided by the LC2 Strategy (2019-2024), LC2 activities aim to increase the use of local currencies and create self-sustaining local financial markets. They are integral to how the Bank delivers transition impact, especially resilience, as financial market development contributes to all six transition qualities. As private capital mobilisation becomes increasingly central to development goals, LC2 activities play a critical role in supporting the Bank's SCF and mobilisation objectives.



Financing the green transition and achieving the SDGs is estimated to require between USD 2.5tn and 4.0tn annually. To meet these objectives, domestic and external capital must be leveraged, both of which rely on the development of local financial markets. Domestic mobilisation requires increased trust in the local currency, larger savings pools and a better functioning financial system, while foreign investors require accessible investment products and instruments to hedge risks.



Financial markets function in a virtuous cycle, as higher levels of activity and market liquidity attract more issuers and investors. Their development can have a long-term impact by creating markets that continue to deliver private financing beyond the Bank's direct involvement.



LC2 activities and local financial market development are a highly effective tool for sustainably enabling private capital mobilisation and leveraging the Bank's investments beyond our ABI.

LC2 interventions are calibrated to the level of financial development of each country of operation

In early transition countries, the aim is to establish the foundational elements of an enabling environment: a functioning regulator and sound macroeconomic policies, basic financial infrastructure and legal frameworks for the conduct of transactions. Due to their role in price-setting and the functioning of the wider financial sector, the development of money, derivative and government bond markets is a key focus.

In intermediate stages of development, corporate segments need to be activated for capital markets to serve as a source of financing for the private sector. This requires the development of a local investor base, increasing access to foreign investors, incentivising corporate issuers and upgrading legal frameworks.

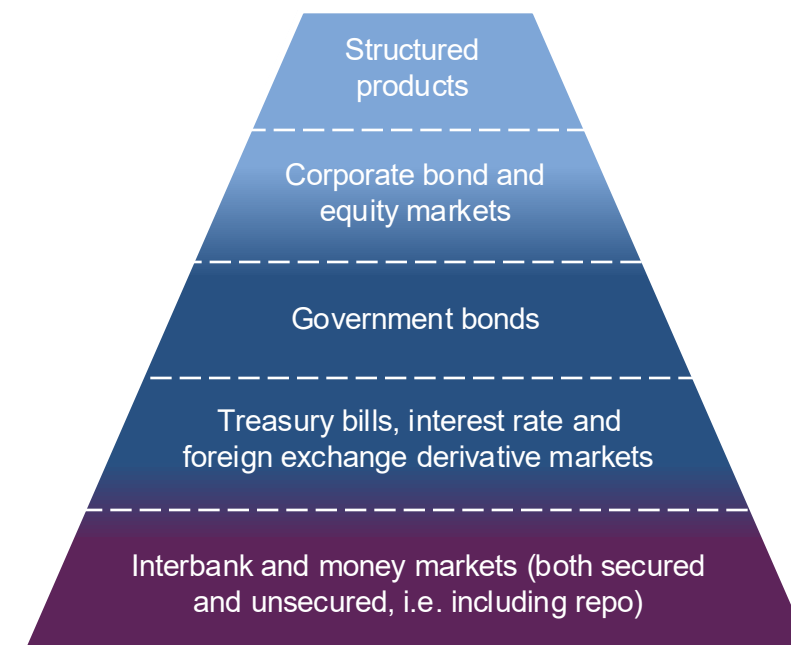
In advanced transition countries, the aim is to deepen and diversify markets. Building larger pools of capital often requires the regional integration of market infrastructure as well as legal and regulatory alignment.

Key Challenge

Effective markets depend on national authorities establishing stable local currencies, supportive monetary policy, legal and institutional frameworks, as well as well-functioning banks and market infrastructure.

EBRD and other IFIs can provide reform support to authorities, but progress is subject to changes in political commitment and priorities.

Sequencing of Financial Market Development

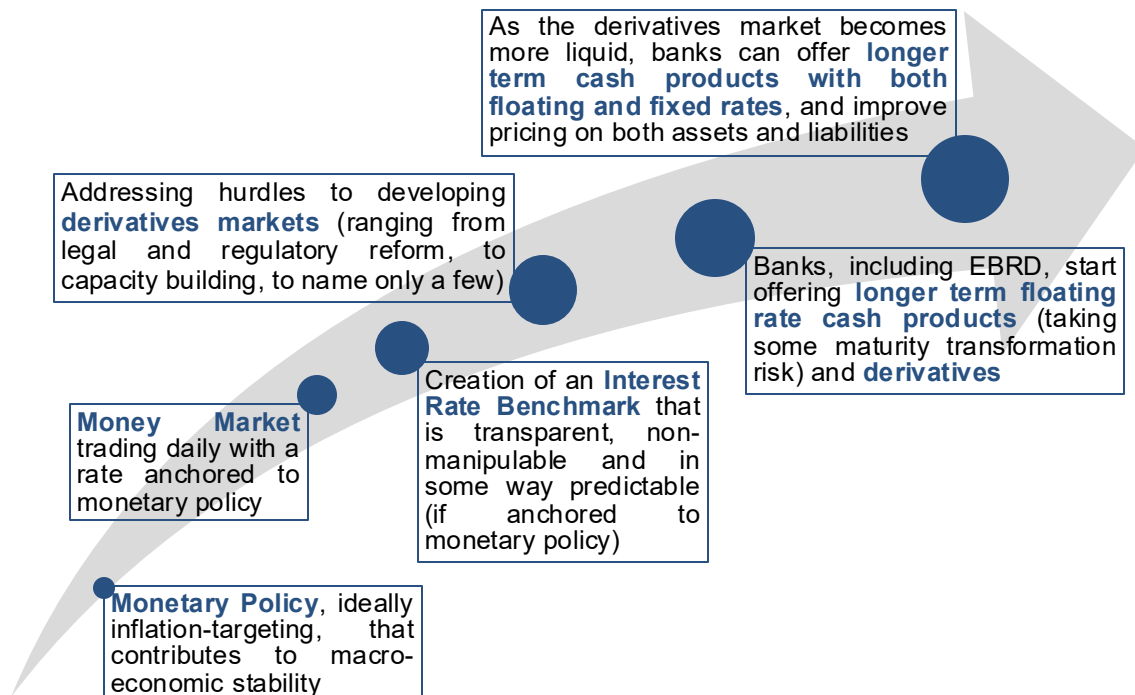


Theory of Change: Money and Derivative Markets Deep Dive

Money and derivative markets form the foundation of wider financial markets, but they are also central to local currency operations of the banking sector, including EBRD

To provide long-term local currency financing to the economy, it is crucial for banks to enhance their maturity transformation capacities (i.e., the ability to transform short-term deposits into long-term lending). This process relies on the sound management of banks' liquidity and interest rate risk through local money and derivative markets.

Process of Local Currency Market Development



Improving EBRD's LCY Sourcing Conditions

To provide local currency financing to the Bank's clients with features meeting their needs, Treasury must develop access to affordable hedging and funding instruments, which enable a shift from back-to back financing to the management of liquidity pools.

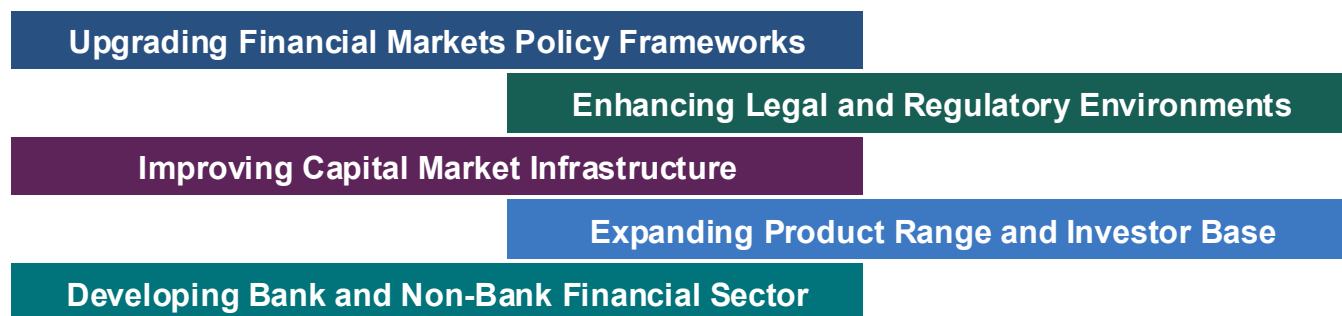
Back-to-back financing	Migration to liquidity pool	Liquidity pool
No market risk	Management of some liquidity/cash flow and interest rate risk mismatches	Dynamic risk management of market risk using a mix of cash and derivatives
Loan features constrained by funding available	More flexible and long-term floating rate loans available	Flexible and competitive fixed and floating rate loans

To develop local currency markets that enable the management of liquidity pools, Treasury works with domestic stakeholders through Money Market Working Groups, identifying issues affecting the local system and addressing them sequentially, while CFMD implements the necessary legal reforms.

LC2 priorities are advanced through policy dialogue and technical cooperation, which enable Bank investments and private capital mobilisation

CFMD and Treasury have focused on the **selectivity and impact of their policy work rather than volume of TCs**, which have been prioritised based on diagnostic tools and assessments.

Across the development timeframe, activities are organised around five thematic areas:



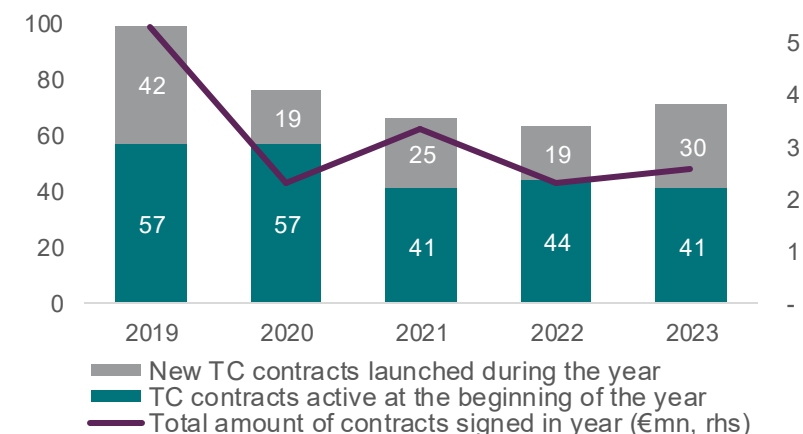
Treasury leads the Bank's efforts in the monetary policy, money and derivative markets development areas, leveraging its active market participation for local currency balance sheet management and funding purposes. It delivers most of its policy dialogue via direct advice to market regulators and domestic banks.

CFMD covers all other LC2 policy activities, collaborating closely with Treasury on assistance to central banks, legal and market infrastructure reforms and with Banking on the deployment of new capital and financial market products.

Key Figures of Treasury Activities

Money Market Working Groups deployed in	10 CoOs
Interest rate benchmarks created in	7 CoOs
Monetary policy frameworks improved in	9 CoOs
Work on developing derivative markets in	7 CoOs
Extension of (cash and derivative) instruments in	6 CoOs

Evolution of CFMD TC Portfolio, 2019-2023



Results: Developing Markets

Progress is evident in all categories of markets' development and across regions

The impact of LC2 activities is evaluated using the **LC2 Strategy Results Framework** as well as impact assessments of the **Bank's investments, local currency operations and private sector mobilisation**. Overall progress in COOs can be measured in aggregate through the evolution of the Financial Market Development Index (**FMDI**).*

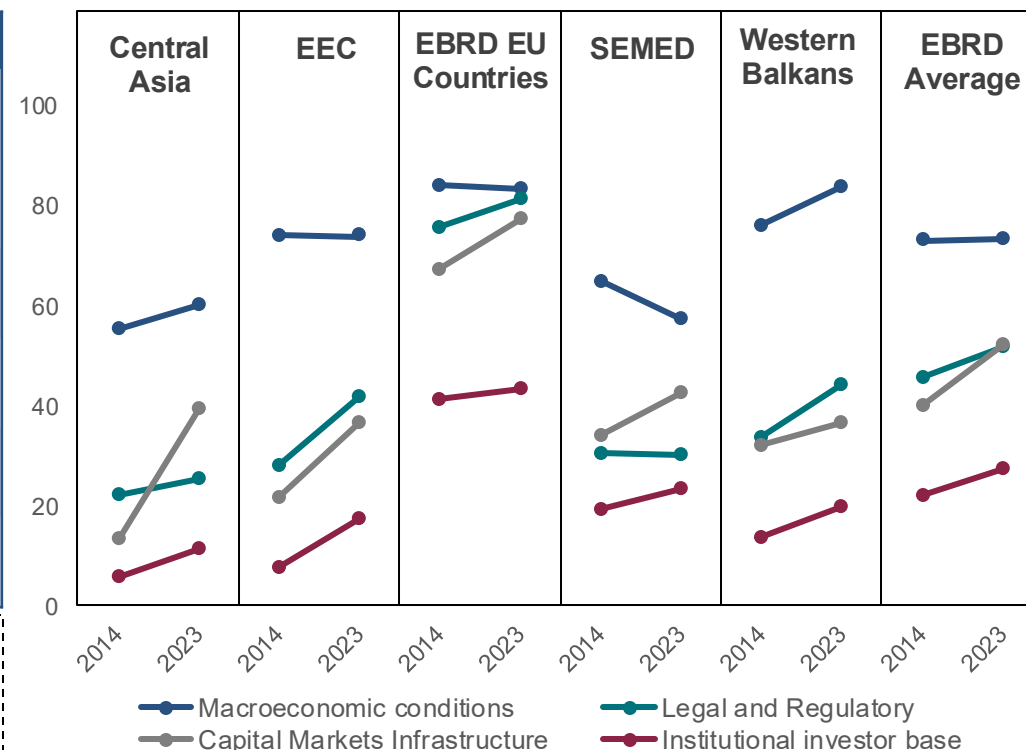
High Level Results under LC2 Strategy Results Framework**

Main Impact Indicator	Source	2014	2023	Change
Capital market infrastructure development indicator	FMDI Capital Market Infrastructure Pillar	40	52	+ 12
Percentage of LCY deposits in the banking system	IMF Financial Soundness Indicators	59	66	+ 7
Investments by institutional investors	FMDI Institutional Investor Base Pillar	22	27	+ 5
Level of approximation of legal systems to international standards	FMDI Legal & Regulatory Development Pillar	46	52	+ 6
Equity market depth, liquidity, and diversification indicators	FMDI Equity Pillar	23	27	+ 4
Fixed income market depth, liquidity, and diversification indicators	FMDI Fixed Income Pillar	18	30	+ 12

*The Financial Market Development Index, developed by CFMD jointly with OCE, measures financial markets development based on publicly available quantitative and qualitative criteria. It measures both the conditions for market development and the market depth.

**Based on averages of country scores on a relative scale ranging from 0 to 100.

FMDI Market Conditions Scores, 2014-2023



Attribution of aggregate progress to LC2 activities is difficult due to exogenous factors, but case studies can provide examples of impact

Country-level assessments also demonstrate **varying levels of progress**, as some markets have improved significantly, while others stagnated or, in some cases, experienced reversals. The **commitment and capacity of authorities is crucial for advancing markets development**. EBRD and other IFIs can support the progress of committed authorities, but **continuous engagement is necessary** as some projects take many years to succeed. Political economy considerations and macroeconomic conditions are also key determinants of progress.

Country	Estonia	Georgia	Egypt	Albania
LC2 Strategy theme(s)	Enhancing Legal & Regulatory Environment / Expanding Product Range	Upgrading CM Policy Framework / Enhancing Legal & Regulatory Environment	Improving Capital Market Infrastructure	Strengthening Financial Sector / Enhancing Legal & Regulatory Environment
Product type	Covered bond legal & regulatory framework reform	Derivatives legal reform Benchmark reform (TIBR)	CSD reform – consolidation of sovereign securities market activity at EGX	Bank prudential framework reform EU alignment Guarantee for Growth (“G4G”)
Number of impacted parties	2 banks in Estonia, 2 bank subsidiaries in Latvia & Estonia	14 local banks	All resident and non-resident investors, Ministry of Finance	12 local banks impacted by prudential framework improvement, 2 via G4G
Project stakeholders	Ministry of Finance	NBG, local banks, Ministry of Economy	CBE, Ministry of Finance, EGX	BoA, European Commission, EBA
Project impact	First pan-Baltic covered bond issued in 2022; total market size EUR 1.5bn outstanding	All local floating-rate bonds linked to TIBR OIS traded up to 2-year maturity	~80% increase in market liquidity at EGX YoY (+136% vs last 3-year average), improved price transparency	Albania’s bank prudential framework aligned with EU law ~EUR 200mn G4G (1.2x MSME lending multiple)
Time to impact	4 years (TC project launch Q1 2018)	5-6 years (TIBR reform 2018, legal framework 2019)	6 years (TC project launched in 2017)	6+ years (PD under Vienna Initiative from 2018, TC launched in 2021, EBA equivalence pending)

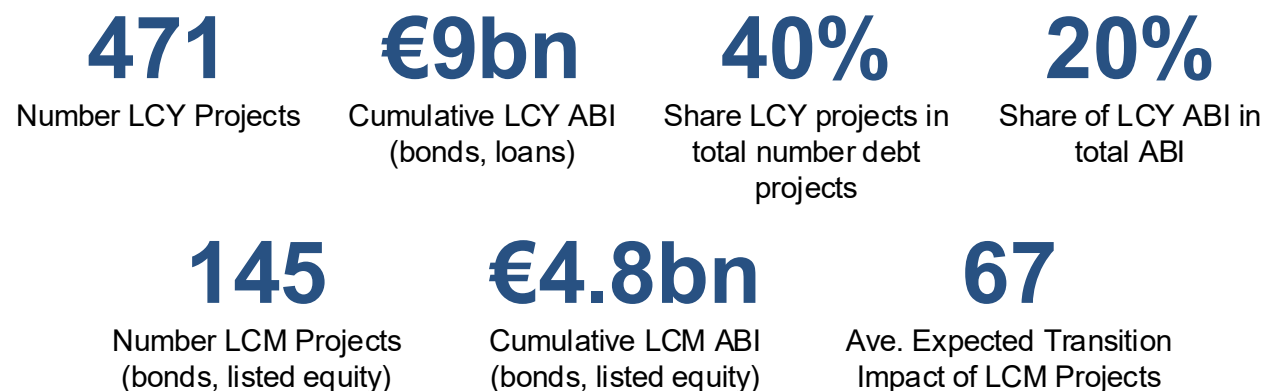
Assisting Ukraine in Wartime
Preserving financial stability
<ul style="list-style-type: none"> - Adapting the NBU micro-financial model for war and post-war conditions - Inclusion of Ukraine in the Vienna Initiative - Development of the Ukraine Recovery Guarantee Facility to enable wartime private insurance
Preparing for post-war recovery
<ul style="list-style-type: none"> - Development of sustainable, social and infrastructure bond frameworks - Supporting municipal bond issuances - Strengthening the capital market infrastructure to increase trust and access of foreign investors
Enabling EU integration through alignment of
<ul style="list-style-type: none"> - Bank regulatory and supervisory framework - NBU confidentiality and professional secrecy regime - Capital market legislation

Results: Enabling Investments

LC2 activities facilitate Bank investments, including by opening new markets through infrastructure and legal reforms, and enabling Treasury to source and operate in LCY

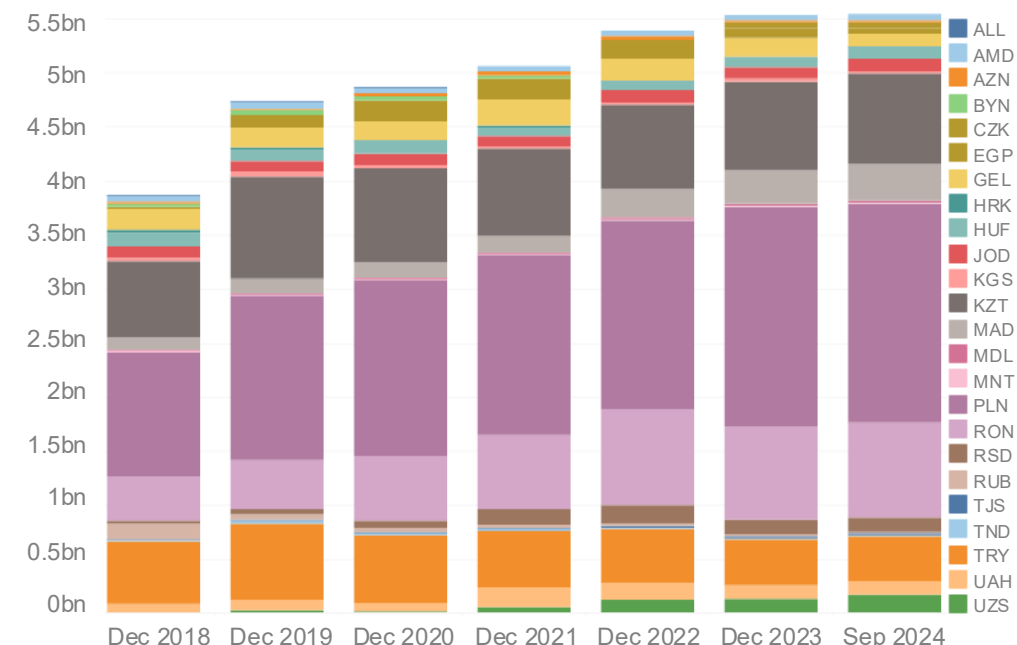
The **combination of investments and policy work**, such as the creation of new financial products, has consistently proven to be the most effective approach for the Bank's delivery of impact. However, impact does not always correlate with the largest volumes of ABI or AMI, as policy activities aim to create self-sustaining markets that continue to deliver private financing even without the Bank's participation.

Key Figures LCY & LCM Transactions, 2019-2024 (to date)



LCY operating assets continued to grow despite financial markets headwinds, with increases in domestic policy rates and currency devaluations. Poland continued to dominate LCY operations, but notable increases can be noted in Egypt, Kazakhstan, Morocco, Romania, Serbia, Uzbekistan and Ukraine.

Evolution of LCY Operating Assets (EUR equiv.), 2019-2024



Results: Enabling Mobilisation

LC2 activities enable transactions that contribute to the Bank's AMI, and they create markets that continue to develop by themselves and deliver private investments without the Bank's participation

LC2-Enabled Mobilisation Figures, 2019-2023

€2.5bn

Mobilised in green and sustainability-linked bonds

€3.1bn

Mobilised in covered bonds

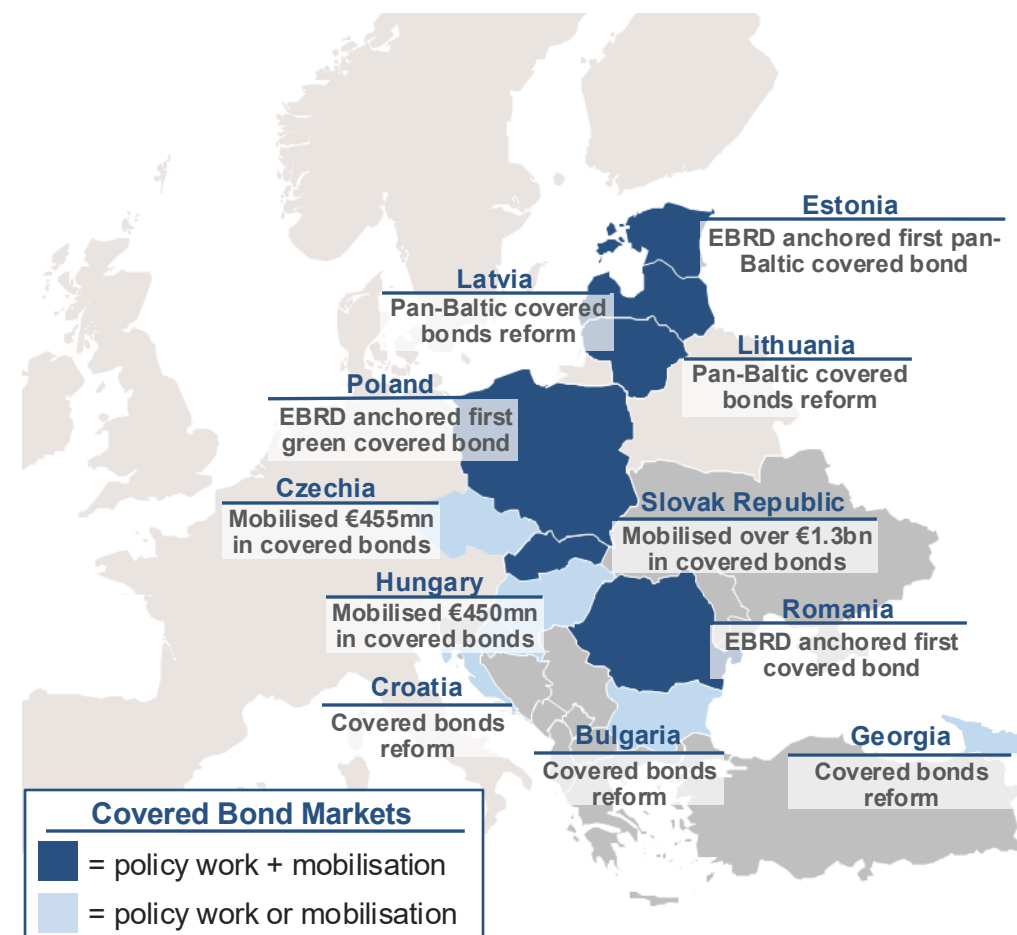
€16.1bn

Issued in covered bonds markets established via bank-supported reforms, in which the Bank did not invest

Current mobilisation figures correspond to the **Private Indirect Mobilisation** generated by transactions that came to market through enabling policy work, such as legal or regulatory reforms.

The indirect mobilisation effect of LC2 activities is wider, but difficult to measure. Improved trust in the local currency, sound monetary policy and a supportive macroeconomic environment contribute to **domestic capital mobilisation** through larger local savings pools and increased leverage in the financial system.

Local financial markets are also key to **attract private external financing**. They provide foreign investors with the instruments to hedge currency risks and with accessible investment products.



Results: Success Story in Georgia

Georgia is an example of rapid market development over the past decade, demonstrating that even small economies can develop thanks to committed authorities and IFI support

Starting in 2012, EBRD assisted authorities in **laying the foundations for local currency market development**. This contributed to the success of subsequent interventions that led to an impressive growth in corporate securities and **enabled Bank investments and mobilisation**.

Georgia Local Currency Market Development

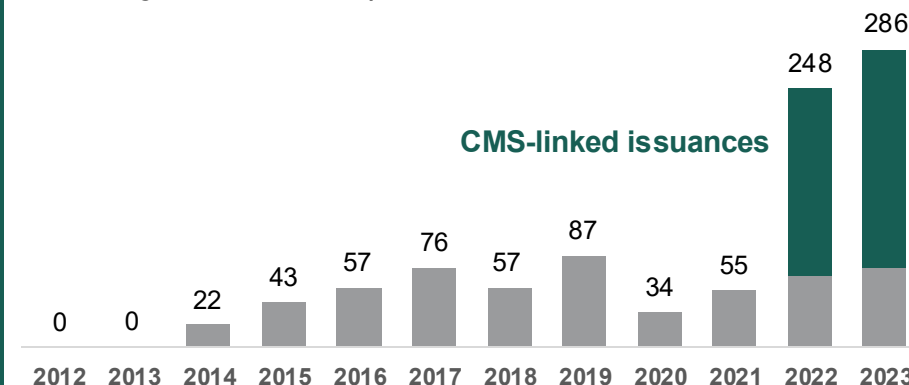
EBRD assistance:	Impact:	Measures of impact:
<ul style="list-style-type: none">Improving the NBG's economic forecasting and monetary policy frameworkMoney market development through MMWG (from 2018) and local market participationDerivatives and repo legal reformReform of benchmark interest rate (TIBR) and development of interest rate derivativesSovereign and corporate yield curves modelling	<ul style="list-style-type: none">Improved monetary policy implementationIncreased trust in the local currencyDevelopment of money market and derivative instruments, including overnight index swapAvailability of hedging instruments for banks and investorsImproved ability of the banking system to perform maturity transformation	<ul style="list-style-type: none">Steady decrease in loan and deposit dollarisationImproved pricing on both loans and deposits: flattening and extension of government yield curve and lower spreads between long-term loans and policy rateIncrease in FX and money market turnoverGrowth of the banking sector and increase in credit provision/GDP

Georgia Capital Market Development

With strong foundations in place, policy efforts shifted to supporting corporates' access to capital markets. The EU-EBRD Capital Market Support (CMS) Programme doubled the market size and led to 11 issuances, including the first local green, gender and sustainability-linked bonds.

EBRD anchored some, but not all, of these issuances.

Georgia domestic corporate bond issuances, million EUR





Please contact us at

CFMDEnquiries@ebrd.com for questions on financial sector and capital markets policy work

LCBSM@ebrd.com for questions on local currency, money markets and derivatives development work