ETC Local Currency Loan Programme

European Bank
for Reconstruction and Development

September 2013

The EBRD's ETC Local Currency Loan Programme helps borrowers in early transition countries reduce their exchange rate risk.

The EBRD has set up the ETC Local Currency Loan Programme to increase local currency lending in the Bank's early transition countries (ETCs), which still face the most significant transition challenges, namely: Armenia, Azerbaijan, Belarus, Georgia, Moldova, Mongolia, Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan.

In these countries the global financial crisis in 2008-09 demonstrated the danger of lending almost exclusively in US dollars as local currency devaluation reached 30 per cent and investors shied away from risky emerging markets.

The objective of the ETC Local Currency Loan Programme is to better match the lending currency to revenues, in order to reduce default/insolvency risk at the micro level and to reduce increasing systemic risk of dollarisation in the financial sector at the macro level.

Risk sharing and donor support

The Programme is supported by international donors through the ETC Local Currency Risk Sharing Special Fund. The Fund combines EBRD capital and donor grants to share the risks of a portfolio of new local currency loans. Grants from the multi-donor ETC Fund, from the US and Swiss governments allow the EBRD to extend around $300 million of local currency loans directly to local corporates and to banks and microfinance institutions for on-lending to micro, small and medium sized-enterprises (MSMEs).

The risk-sharing mechanism allows the EBRD to significantly reduce the interest rate on local currency loans to levels that will influence borrowers to take loans in local currency as a better alternative to the current pervasive practice of borrowing in foreign currency.

Encouraging capital market development

Providing local currency loans will have a lasting impact when country authorities are committed to creating a local currency-friendly environment.

As part of the ETC Local Currency Loan Programme governments and central bank officials sign a Memorandum of Understanding confirming their intention to implement economic reforms aimed at reducing dollarisation and inflation and at developing, over time, local capital markets.

As of September 2013 memoranda had been signed with Armenia, Georgia, the Kyrgyz Republic, Moldova, Tajikistan and Mongolia, which are thus eligible to participate in the Programme.

Supporting technical cooperation

The ETC Local Currency Loan Programme offers technical cooperation support to train central bank staff in ETCs through specially-tailored training courses on currency risk management, improving monetary frameworks to sustainably reduce inflation and dollarisation, and local currency market development.

Technical cooperation also focuses on policy advice to improve the legal and regulatory environment.

ETC Local Currency Loan Programme benefits

- Increased local currency loans help reduce the level of dollarisation in ETCs. This contributes to stabilising the financial sector and improving financial intermediation, and assists economic development
- Primary beneficiaries are expected to be microfinance institutions and MSMEs
- The Programme incentivises governments and central banks to make the reforms necessary to improve local capital markets
- Every euro provided by the donors translates into seven euros of loans.

Contacts

Early Transition Countries Initiative Team
Christopher Clubb, Director
clubbc@ebrd.com
Tel: +44 20 7338 7294

Web site
www.ebrd.com

First loans under the ETC Local Currency Loan Programme

One of the first loans under the ETC Local Currency Loan Programme was signed in June 2011 in Tajikistan. The EBRD extended 13.6 million Tajik somoni (equivalent to US$ 3 million) to a micro-lending organisation, Imon International, to provide more affordable credit to small businesses.

In September 2011, the Bank provided the equivalent of US$ 4 million in Kyrgyz som to Kompanion Financial Group, one of the leading non-bank microfinance institutions in the Kyrgyz Republic. The deal will boost the availability of som-denominated loans to local small entrepreneurs.

The wider initiative

The ETC Local Currency Loan Programme falls under the EBRD's wider Local Currency and Local Capital Markets Initiative. In coordination with the International Monetary Fund (IMF) and the World Bank, the Initiative addresses the systemic risks of over-reliance on foreign-denominated debt which have been exposed by the financial downturn. It has the objective of improving local currency and capital markets to build a more secure and sustainable financial environment in the EBRD's countries of operations.

Since the launch of the Initiative in 2010, the Bank has steadily increased its lending in local currencies and worked to further develop capital markets in the ETCs.

Supporting the Georgian agribusiness

Georgian farmers like milk producer Pavle Khutsishvili have an extra opportunity to get loans and sustain their small businesses thanks to the Georgian Agricultural Financing Facility (GAFF).

Thanks to a small GAFF loan, last winter Pavle could afford to buy enough cattle feed (more costly during the cold season) for his two cows and continue to sell their milk to a local dairy company Ecofood. Ecofood, in turn, is able to reach more smallholdings such as Pavle's thanks to a GAFF loan used for working capital financing and to refurbish the milk collection warehouse in the Kakheti region.

One of the aims of GAFF, a €40 million credit line in Georgian currency that targets farmers and agribusinesses through local financial institutions, is precisely to help develop this type of food value chain by improving coordination. The Facility also encourages participating intermediaries to diversify loan portfolios and re-start lending to this underserved sector of the real economy.

The EU Neighbourhood Investment Facility has provided €4 million of donor funds to use as a first-loss which provides a "cushion" for banks encouraging them to take on more risk.

Through support from donors to the Early Transition Countries Fund, from the US government and the Swiss State Secretariat for Economic Affairs (SECO), who all contributed to the EBRD's ETC Local Currency Loan Programme, it became possible for both Pavle and Ecofood to borrow and repay the loans in Georgian lari, which means they do not have to worry about foreign exchange risk and can better manage their debit.