

State of Play:

Currency Risk Challenges and Potential Solutions

Fourth International Conference on Financing for Development
(FFD4) and International Business Forum (IBF)

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About this document

The objective of this document is to summarize perspectives from publicly available private sector-oriented documents and from the FFD4 preparatory process. It is intended to serve as a concise, neutral overview of public information, providing background context for IBF participants.

This document seeks to summarize the challenges and recommendations highlighted in these sources. It does not reflect BCG's perspective, does not advocate for specific actions, and does not constitute a set of BCG recommendations.

The sources reviewed and insights generated are non-exhaustive and intended to illustrate key themes rather than provide a comprehensive account of all relevant perspectives or initiatives.

Sources

Author	Title	Year
GISD Alliance & UN DESA	Working Paper on Managing Currency Risks to Scale Up SDG Investments in Developing Countries	2025
OECD	Unlocking local currency financing in emerging markets and developing economies	2025
MDB Treasury Working Group	MDB Viewpoint: Local currency finance and hedging instruments for FX risk	2025
Climate Policy Initiative	Managing Currency Risk to Catalyze Climate Finance	2024
G20 Brazil, Global Infrastructure Facility & International Monetary Fund	Addressing Exchange Rate Risk in Infrastructure Projects in EMDEs	2024
The Currency Exchange Fund (TCX) & Making Finance Work for Africa	FX Risk in the African Banking Sector: Survey Report	2024
FSD Africa	Local Currency Solution for Multilateral Development Bank Portfolio Transfer: Feasibility Study	2024
Bridgetown Initiative	The Reform Of The International Development And Climate Finance Architecture	2024
Bretton Woods Project	Sustainable development requires sustainable finance: Why local currency financing is part of the solution	2024
Centre for Global Energy Policy (CGEP), SIPA, Columbia University	A Potential Path for Alleviating Currency Risk in Emerging Market Green Bonds	2023
The Currency Exchange Fund (TCX)	Scaling Up Currency Risk Hedging for Low and Lower Middle-Income Countries	2023
International Growth Centre (IGC)	Mitigating foreign risk in local currency lending in fragile states	2023
Convergence	FX Risk Workshop Summary	2017
IFC	Local Currency and Hedging Solutions	2017

Executive summary: Currency Risk Challenges and Potential Solutions

Why it matters

- **Currency risk (or FX risk) is identified as a major hurdle** to scale sustainable investments
- To close the shortfall in required SDG finance, investments will also need to come from international investors. Since the revenues are in local currencies, **international investments introduce currency risk either for the borrower** (if they borrow in a hard currency) or **the lender** (if they lend in a local currency)
- The problem is **especially acute in the least developed countries** (LDCs), which face access issues to FX risk mitigation tools and at prohibitive costs
- Without urgent actions, unhedged FX exposure in developing countries can triple by 2030, impacting SDG progress

Barriers

- **Five key types of barriers** vis-à-vis developing countries have been identified:
 - Lack of cost-effective currency risk mitigation solutions, particularly in volatile currencies
 - Underdeveloped local capital markets, with limited access to local currency financing
 - Lack of sufficient scalable and innovative financial mechanisms, as most efforts are ad hoc and small-scale
 - Institutional and policy gaps faced by MDBs & DFIs, major anchor institutions, due to mandate and risks constraints that limit local currency lending
 - Ecosystem gaps, including siloed guidance and local capacity constraints

Recommendations

- Leading organizations and reports make **five key recommendations** to unlock local currency finance and tackle FX risk:
 - Develop innovative solutions (e.g., publicly-funded FX risk pooled facility) and scale up existing initiatives (e.g., TCX)
 - Develop long term risk-mitigation solutions (e.g., guarantees, indexed loans, FX reserve buffers)
 - Expand local currency lending (e.g., MDBs/DFIs to keep assets in local currencies) and local bond markets
 - Clarify MDB mandates and align approaches between MDBs/DFIs, donors and private sector to manage FX risk systemically
 - Promote standardized frameworks and toolkits and provide technical assistance to guide SDG-aligned investments

Potential impact

- **Short-term:** (1) Lower cost of capital through effective management of currency exposures; (2) FX risk shifted away from borrowers through coordinated approaches such as a publicly funded FX risk facility; (3) Larger volumes of capital unlocked by enabling greater risk transfer and investor participation; (4) Standardized FX risk tools, product innovation and center of excellence
- **Long-term:** (1) Deepened local capital markets through increased local currency lending; (2) Scaled local currency lending by MDBs & DFIs; (3) Systemic co-creation with private actors, leading to replicable FX risk-sharing vehicles; (4) Greater investor confidence and long-term capital flows expansion through stable policies at local level; (5) Growth in international SDG-related investments

Currency risk is a major threat to development finance

~10%

of MDB flows indexed to or denominated in local currency could result in **\$43B of additional hedging demand in LICs and LMICs** being met by 2030¹

3x

increase in **unhedged currency exposure** of developing economies is predicted by 2030 (from current level of USD 2T) as climate change and geopolitical tensions are expected to further increase currency volatility²

70%

of **African banks and non-bank financial institutions** are being **exposed to foreign exchange risk**³

22%

is the **rate of return to attract private capital** for solar projects in EMDEs due to FX volatility, compared to just 8% in the EU⁴

~25%

of **debt on average of EMDEs** is in foreign currency⁵

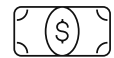
Sources: 1. TCX, Scaling Up Currency Risk Hedging for Low and Lower Middle-Income Countries, 2023; based on baseline scenario of expected hedging flows in 2030; 2. Ibid 1; 3. TCX & Making finance work for Africa, FX risk in the African Banking sector: Survey report, 2024; 4. CPI, Managing Currency Risk to Catalyze Climate Finance, 2024; 5. Centre on Global Energy Policy, Colombia University, 2023

What are the different forms of exposure?

Illustrative

What is currency risk?

Currency risk, or exchange rate risk (FX risk), refers to the exposure faced by investors or companies in regard to unpredictable gains or losses due to changes in the value of one currency in relation to another currency



Main forms of currency risk associated with transactions involving different currencies



Illustrative examples on implications in developing country context

Currency depreciation or devaluation risk: Refers to an unfavorable change in the exchange rate between the domestic currency and the denominated currency before the date when the transaction is completed

A solar power project in Nigeria secured a loan in USD but earns revenue in Nigerian naira. When the naira depreciates against the dollar, the cost of servicing the debt increases significantly, putting financial pressure on the project

Convertibility risk: When a payment is received in a local currency but cannot be converted back to dollars (or another hard currency)

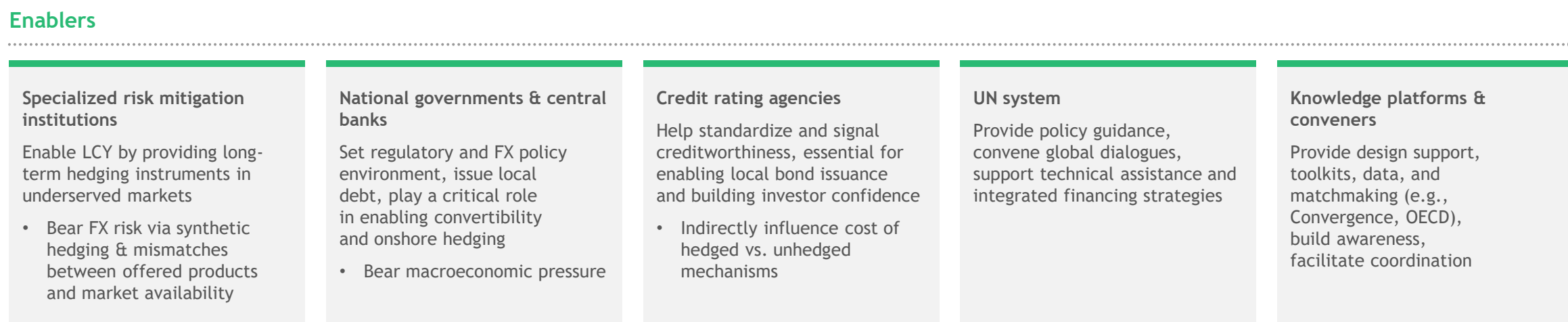
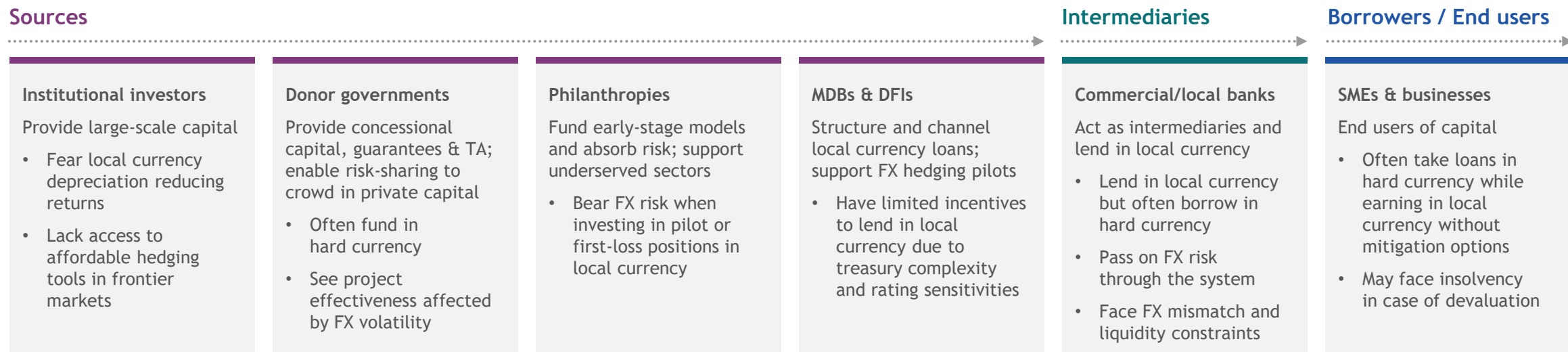
A health clinic in Ethiopia supported by international donors receives revenues in Ethiopian Birr. Due to convertibility restrictions, the clinic is unable to convert sufficient local currency into USD to repay international suppliers of medical equipment, disrupting the delivery of essential services

Transfer risk: When funds cannot be repatriated due to capital controls or, more broadly, the inability to move currency in and out of a country freely

A microfinance institution in South Asia receives funding from international impact investors in foreign currency but collects repayments in local currency. Due to FX controls, it struggles to convert and transfer repayments to repay foreign debt, limiting its ability to scale financial inclusion efforts

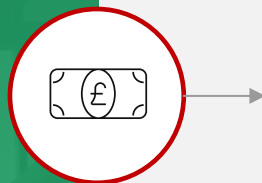
Overview of stakeholders involved in and/or supporting local currency lending, and how they are affected by FX exposure

Illustrative



Note: LCY= Local currency, TA = Technical assistance; Source: BCG analysis

5 key barriers related to addressing currency risk have hindered the mobilization of private capital for development



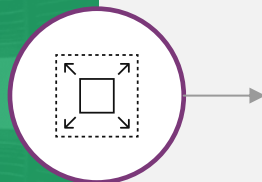
Lack of cost effective and long-term currency risk mitigation solutions

- Hedging instruments are often too expensive or unavailable for long tenors
- Private investors are discouraged from financing long-term infrastructure or climate projects in local currency



Weak local capital markets and limited access to local currency financing

- Many EMDEs have shallow domestic capital markets
- Investors prefer hard currency, creating a mismatch with project revenue streams



Lack of scalable and innovative financing solutions

- Even if solutions are available, many are not scalable, limiting their use
- The absence of pooled, portfolio-based tools deters institutional participation



Policy and institutional coordination gaps

- Many developing countries lack stable macroeconomic policies
- Fragmentation across donors, DFIs/MDBs, and private sector limits efficiency
- Many DFIs/MDBs are restricted from taking on FX risk



Insufficient guidance and local capacity constraints

- No central FX risk playbook exists in the context of SDG investments
- Local officials lack access to capacity and knowledge due to administrative and technical constraints

Potential solutions to address these barriers can generally be categorized into 5 categories, with ~30-35 initiatives observed

Non exhaustive

Category	Objectives	Barriers addressed	Ongoing efforts observed
Standard financial solutions	Mitigate FX risk through traditional instruments such as guarantees, swaps, and forwards	<ul style="list-style-type: none"> High FX risk deterring private capital Risk mitigation tools too costly or unavailable in frontier markets 	<ul style="list-style-type: none"> MIGA TCX Frontclear GuarantCo
Innovative financial solutions	Develop new and innovative structures and mechanisms that are market shaping at systemic-level	<ul style="list-style-type: none"> Complex or inaccessible tools for wider use Lack of diversified risk mitigation platform Lack of innovative and at-scale instruments 	<ul style="list-style-type: none"> EcoInvest Brazil TCX Donor Guarantee Facility GISD/UN DESA proposal of publicly funded FX risk facility (similar to Bridgetown Initiative proposal)
Domestic market building	Strengthen local markets by expanding access to local currency financing through bonds and other instruments	<ul style="list-style-type: none"> Lack of access to local currency financing Weak local capital markets Borrower currency mismatch 	<ul style="list-style-type: none"> Africa Local Currency Bonds (ALCB) Fund IDA Private Sector Window Local Currency Facility
Policy & institutional alignment	Realign MDB/DFI mandates, including treasury policies and coordination across key actors	<ul style="list-style-type: none"> MDB/DFI reluctance to hold FX risk Lack of aligned cross-institutional engagement 	<ul style="list-style-type: none"> MDB Treasury Working Group DFI Fragility Forum
Technical assistance	Build local capacities and provide targeted toolkits to support implementation and scaling	<ul style="list-style-type: none"> Fragmented guidance and best practices Weak local capacity in FX and debt management 	<ul style="list-style-type: none"> OECD World Bank and IFC Joint Capital Market Program (J-CAP) World Bank Public - Private Infrastructure Advisory Facility (PPIAF)

Examples

Zoom: Analysis of ~30-35 existing initiatives to tackle currency risks show that most are still in early stages, small-scale, or not cost effective

Non exhaustive

Category	Example initiatives	How do they contribute?	What are their limitations?	What is needed moving forward?
Standard financial solutions	<ul style="list-style-type: none"> DFIs and commercial banks risk mitigation and hedging products TCX MIGA 	<ul style="list-style-type: none"> Offer risk mitigation instruments (partial credit, FX guarantee) where commercial markets do not operate to crowd in private investment 	<ul style="list-style-type: none"> Expensive without subsidies Only used in isolated deals Bespoke tools that remain poorly understood by most investors 	<ul style="list-style-type: none"> Scaling subsidized solutions and pool demand Standardized tools Integrating solutions into mainstream investment processes
Innovative financial solutions	<ul style="list-style-type: none"> GISD/DESA Publicly funded FX risk pooled facility (proposal) TCX Donor Guarantee Facility EcolInvest Brazil Project Delta (design phase) FSD Africa MDB Portfolio shift (proposal) 	<ul style="list-style-type: none"> Propose lifecycle-aligned tools (e.g., pooled vehicles) for broader adoption Treat FX exposure as an opportunity, not just as a risk, by managing it prudently 	<ul style="list-style-type: none"> Limited coverage across currencies and volumes Not scaled yet Lack of anchor funders 	<ul style="list-style-type: none"> Capitalizing pilot facilities Expanding geographic & currency coverage Identifying operational anchors
Domestic market building	<ul style="list-style-type: none"> ALCB Fund IDA Private Sector Window - Local Currency Facility DFIs and banks local currency lending 	<ul style="list-style-type: none"> Anchor local currency finance (e.g., through bond issuances) and create market benchmarks to catalyze investor confidence 	<ul style="list-style-type: none"> Country or geography specific Bond issuance often small-scale and episodic Heavy dependence on donor funding 	<ul style="list-style-type: none"> Supporting repeat issuance by governments and banks Providing TA to expand local benchmarks Exploring pooled guarantee mechanisms
Policy and institutional alignment	<ul style="list-style-type: none"> MDB Treasury Working Group EcolInvest Brazil DFI Fragility Forum 	<ul style="list-style-type: none"> Recommend adjustments to MDB mandates and promote systemic FX solutions 	<ul style="list-style-type: none"> No clear mandate yet Action limited to technical dialogue Lack of leadership to push through institutional reform 	<ul style="list-style-type: none"> Securing a mandate for joint MDB platform Engaging executive boards for institutional buy-in Integrating FX into capital adequacy frameworks
Technical assistance	<ul style="list-style-type: none"> Benchmarks & reports by OECD, Convergence, Global Infra. Hub J-CAP program Project Delta (design phase) 	<ul style="list-style-type: none"> Publish guidance, convene stakeholders and develop toolkits for structuring FX mitigation 	<ul style="list-style-type: none"> Fragmented and not operational Few hands-on advisory services available Weak uptake at local level 	<ul style="list-style-type: none"> Creating shared guidance platform or center of excellence Funding tailored technical assistance to DFIs, banks, and ministries of finance

Market-based solutions

Zoom: Mapping of innovative financial solutions to manage currency risks span a broad spectrum of mechanisms across key actors

Non exhaustive

Solution	Initiative, lead organizations & description	Status	Actors mobilized	Benefits	Limitations
Guarantee facility for TCX	Donor-funded guarantee facility (TCX): A donor fund is used to guarantee TCX a return of 1.6% on a portfolio of supported hedges. The set return allows TCX to significantly reduce its uncertainty premium for supported hedges, leading to an overall cost to clients that is well below TCX's standard, risk-reflective rates	Piloted	Private sector investors	<ul style="list-style-type: none"> Enables expansion to high-risk markets Supports donor derisking goals Acts as a catalytic tool 	<ul style="list-style-type: none"> Scale of donor guarantee capital remains limited
Long-term FX liquidity Facility	Ecolvest (IADB & Government of Brazil): IADB provides a hard-currency credit line (intermediated by the Brazilian government) to allow climate projects to service foreign-currency debt. Draws upon this credit line would be repaid over the short- or medium-term as Brazil's real exchange rate appreciates again, and project increase their revenues in line with general inflation	Active	Local financial institutions, central banks, MDBs	<ul style="list-style-type: none"> Brings down cost of swaps Extends tenor of hedging Avoids reliance on expensive short-term hedging tools 	<ul style="list-style-type: none"> Dependent on government willingness to intermediate foreign currency lines Limited replicability without broader policy support or sovereign guarantees
Onshore DFI hedging platform	Project Delta (EBRD & AIIB): The platform would borrow local currency in EMDEs from multiple sources, including domestic banks, on a relatively short-term basis. The bulk of this local-currency liquidity would be lent or swapped to DFIs over longer terms, allowing DFIs to fund their local currency loans on a back-to-back basis	Design phase	Local financial institutions, MDBs, DFIs	<ul style="list-style-type: none"> Standardized product Encourages onshore market development Potential for replicability 	<ul style="list-style-type: none"> Not below market rate Setup will take time in each market Requires strong collaboration with domestic banks and regulators
MDB portfolio shift	MDB Portfolio Transfer (FSD Africa): The proposal explores the potential to transfer MDB-financed private sector loan portfolios to local institutional investors in EMDEs. Loans targeted for sale to the local investors would be for "brownfield" assets (i.e., assets that are operating and generating cash flow for debt service)	Proposal	Local institutional investors	<ul style="list-style-type: none"> Crowds in local capital Frees up MDB balance sheets Builds local markets 	<ul style="list-style-type: none"> Adjusting MDB operations would take time Difficult to find buyers for lower-rated or non-standard assets
Publicly funded global FX risk facility	Publicly-funded pooled FX risk facility (GISD Alliance & UN DESA): The proposal suggests creating a pooled FX risk facility managing currency exposure at a portfolio level rather than hedging currencies individually. By leveraging high interest rates in developing countries and using G10 currency hedges, such a facility could even generate returns. To scale, it would require public capitalization, treating currency risk management as a global public good	Proposal	MDB, DFIs, international and domestic financial institutions	<ul style="list-style-type: none"> Potential for scale and access Improves efficiency through diversification Supports local capital markets through bond issuance, co lending and distribution 	<ul style="list-style-type: none"> Risk appetite and ability of IFIs to manage FX portfolio Support of government needed to cover transfer risk

Source: Climate Policy Institute, Managing Currency Risk to Catalyze Climate Finance, 2024; official websites of initiatives listed; BCG summarization

Despite momentum, most efforts are in early stages and not yet positioned for sufficient scale and market shaping, and six limitations persist

Non exhaustive

Risk mitigation remains prohibitively expensive

Hedging a currency individually means paying for the volatility, thus undermining the cost-effectiveness of projects despite availability of subsidized facilities in some pilots

- ! FX hedging premiums can reach **10-15%** annually in volatile frontier markets, making projects unviable¹

Technical complexity of available tools deters private sector engagement

Instruments developed so far tend to be bespoke, hard to scale, and poorly aligned with institutional investor needs

- ! Most FX risk mitigation tools remain bespoke and are not standardized, increasing transaction costs and limiting replicability

Private sector appetite remains low without guarantees or risk-sharing mechanisms

For instance, many blended finance efforts have not fully integrated FX risk into design, leading to limited uptake

- ! Less than **10%** blended finance deals have active institutional investor participation²

Market gap between demand and available risk capital & at lower cost

Solutions like TCX and MDB treasury tools currently cover only a fraction of currency pairs and deal volumes; risk mitigation costs are still falling short of market needs

- ! TCX has been able to cover for only **\$5B** worth of hedges currently while demand is estimated at \$50B to \$100B per year¹

MDBs have limited incentives to prioritize local currency lending

Despite recognition of the issue, institutional and mandate constraints have limited traction in shifting core lending practices

- ! More than **80%** of lending to LICs/LMICs by MDBs and DFIs is denominated in hard currencies, especially in US dollar³

Structural challenges persist in local currency lending and bond issuance

Structural challenges persist in weak capital markets, despite efforts in select geographies

- ! In sub-Saharan Africa, the market capitalization of securities exchanges (excl. South Africa) averages **less than 20% of GDP**, compared to 50% in other developing economies⁴

Key reports suggest strategic actions to strengthen currency risk management

Category	Strategic actions	Applicability	Reports
Standard financial solutions	Improve affordability and availability of FX risk mitigation solutions	MDBs	6 9
	Scale up long-term risk mitigation solutions (e.g., liquidity lines, swaps, and guarantees)	DFIs, export credit agencies, donors	6 4 9
	Use concessional capital to absorb first-loss and enable private investor participation	Donors, investors	6
Innovative financial solutions	Create a local currency facility to pool currency risk exposures through diversification	DFIs, MDBs, bond investors	1 8
	Scale up existing market-building initiatives	Donors, investors	3 4 5
	Embed FX risk pricing in blended finance structuring	Donors, investors	5
Domestic market building	Support local market development	DFIs, official creditors	1 4 7 9
	Deliver targeted advisory support to strengthen local financial markets and deepen capital market infrastructure	DFIs, MDBs	4 6
	Keep a certain percentage of MDB/DFI assets in local currencies and increase this share over time	DFIs, MDBs	1
Policy & institutional alignment	Expand MDB mandates and coordinate efforts between MDBs, DFIs, donors, and private sector	All	3 4 6
	Provide stable policies and develop domestic capital markets to encourage investments from international investors	Local governments, central banks	1 6
Technical assistance	Identify key FX risk barriers and solutions pertaining to risk mitigation and access to local currency financing	Banks, International Financial Institutions	1

1 GISD/DESA Working Paper 2 International Growth Centre 3 Bretton Woods Project 4 OECD Report 5 Convergence 6 MDB Treasury WG 7 IFC 8 CGEP 9 Bridgetown Initiative

Implementing these actions could unlock more scalable, cost-effective FX solutions and stronger domestic markets, helping accelerate SDG investments

Short-term impact

Long-term impact

Non exhaustive



- 1 Lower cost of capital for borrowers through effective management of currency exposures (e.g., through risk mitigation tools)
- 2 FX risk transfer from borrowers to shared vehicles (e.g., through multi-stakeholder FX liquidity pools with shared risk absorption mechanisms co-managed by MDBs, DFIs and central banks)
- 3 Larger volumes of capital unlocked by enabling greater risk transfer and investor participation (e.g., through originate-to-distribute models)
- 4 Standardized FX risk tools, product innovation and center of excellence

- 1 Deepened local capital markets through increased local currency lending
- 2 Scaled local currency lending by MDBs/DFIs, reducing FX risk for borrowers
- 3 Aligned efforts and systemic co-creation with donors and private actors to harmonize regulatory standards, enhance market efficiency and boost liquidity
- 4 Greater investor confidence and long-term capital flows expansion through stable policies implemented at local-level
- 5 Growth in international SDG-related investments due to reduced FX risks, leading to development outcomes

This call for action is reflected in the final draft of the FFD4 Outcome Document and the recommendations of the FFD4 Business Steering Committee

Category	Final Draft of the FFD4 Outcome Document (June 2025)		Business SteerCo Recommendations (Dec 2024)	
	Cl.	Excerpt	AA.	Excerpt
Standard financial solutions	33p	"We will work with MDBs, DFIs and the private sector to support the development of cost-effective, long-term foreign exchange risk mitigation and hedging solutions for investments in sustainable development"		
	33h	"We will work to increase the mobilization ratio of private finance from public sources by 2030 by strengthening the use of risk-sharing and blended finance instruments, such as first-loss capital, guarantees, local currency financing, and foreign exchange risk instruments"		
	32m	"We encourage DFIs, including the IFC, to continue promoting finance for these enterprises (MSMEs), including through guarantees or national guarantee facilities, on-lending via domestic financial institutions and enhanced local currency financing."		
Innovative financial solutions	37g	"We take note of ongoing discussions among MDBs and public development banks on platforms to improve liquidity management and risk diversification in local currency lending"	2(ii)	"Establishing a portfolio of many currencies (including G10 currencies), that could be jointly managed by a few MDBs/DFIs, is much more efficient and cost effective than hedging currencies individually"
			2(ii)	"Take a portfolio approach to currency risk management that takes advantage of diversification"
Domestic market building	33n	"We encourage private sector arms of MDBs to expand local currency lending, and enhance private equity, venture capital, and microfinance ecosystems, where appropriate"		
	37g	"We urge governing bodies of the MDBs to explore scaling up local currency lending, to help better meet local development needs and reduce recipient countries' exposure to exchange rate risks. We encourage the development of tools at the MDBs to facilitate local currency lending and support efforts to strengthen the capacity of MDBs to issue local currency bonds, which can also contribute to the development of local capital markets"	2(ii)	"Grow the volume of local currency financing available to developing countries, projects, and companies by a) IFIs issuing local bonds, b) IFIs offering cross-currency swaps"
	48f	"We urge official creditors to scale up, to the extent possible, lending in local currencies in developing countries to address currency risks and identify solutions to reduce the costs and other challenges associated with such lending"	2(ii)	"IFIs partnering with local commercial banks to on-lend their excess deposits including by scaling subsidies for currency platforms for frontier markets"
Policy & institutional alignment			2(ii)	"IFIs can work with governments to improve local currency debt management practices"
Technical assistance	32d	"We will support demand-driven technical assistance and capacity development programmes, including by multilateral development banks, for domestic financial sector development and the creation of enabling environments for sustainable development, particularly for countries in special situations"		



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