* * * MARKET CHAT * * * TCX creates frontier markets after hedging USD1bn (January, 2021)

Following its USD200m capital increase in November, mtn-i talked to the Currency Exchange Fund. In a conversation about the fund, better known as TCX, and its innovative role, the resilience of frontier currencies amid the Covid-19 pandemic and what the future holds for TCX, mtn-i has discussed the topics with the CEO Ruurd Brouwer, the Head of Trading Othman Boukrami, and Senior Vice President Isabelle Lessedjina.

TCX was created in 2007 as a global development finance initiative with the goal of hedging currency risks in emerging and developing countries where businesses face difficulties while borrowing long-term from abroad. By facilitating and stabilising local borrowers' revenues, TCX has been helping microfinance providers and the SME sector better function in their local markets, making a difference all over the world regardless of market developments or liquidity conditions.

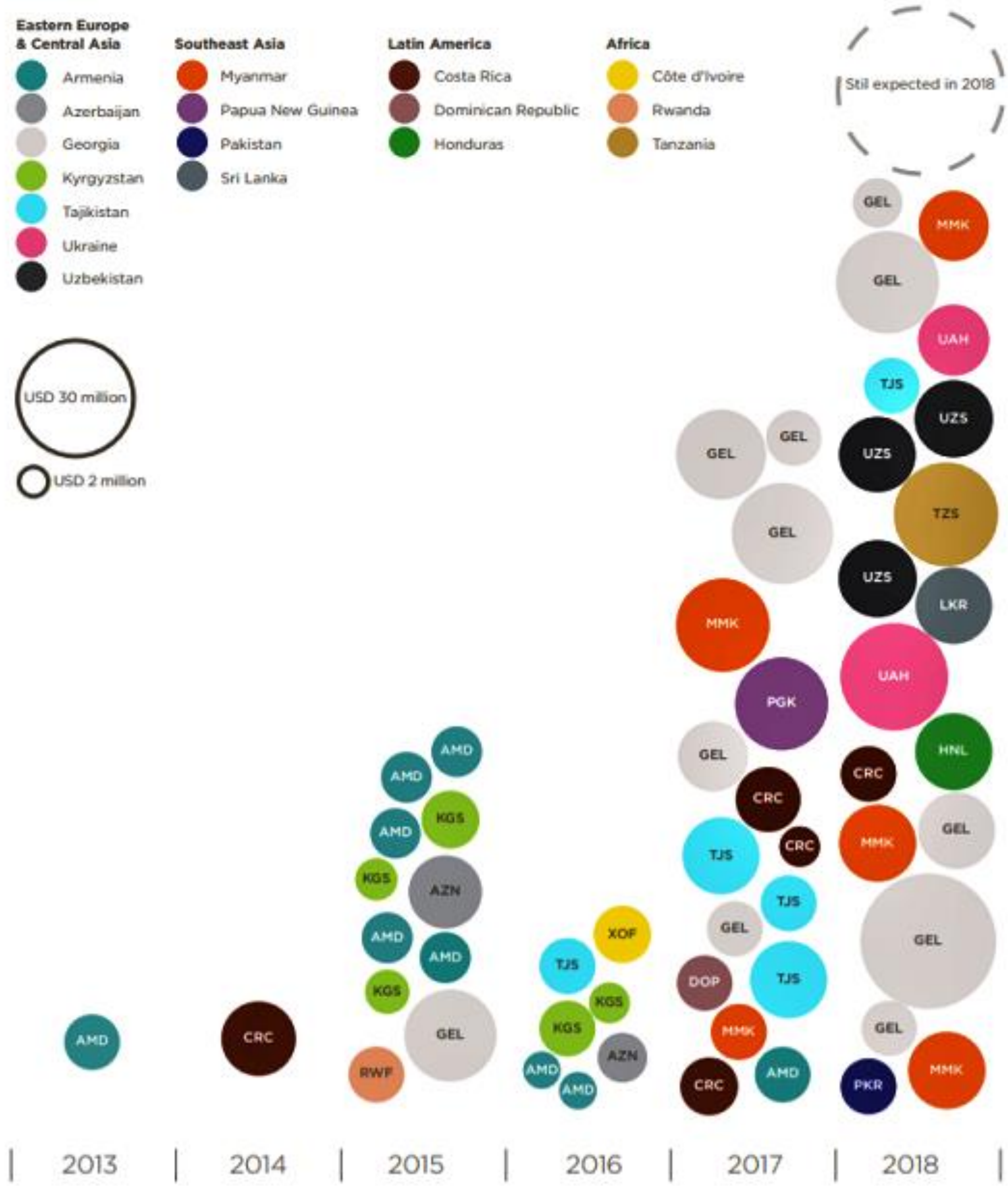
In November, it received a USD200m new investment from a group of multilateral development institutions. This capital increase was brought by the European Commission with the support of KfW, the International Finance Corporation on behalf of the International Development Association, and Proparco, a subsidiary of Agence Francaise de Developpement. With this latest investment, TCX's risk-bearing capacity has increased to USD1.25bn from USD746m in 2018.*

TCX's CEO Brouwer said that the new investment would allow the fund to continue its work full steam ahead "to absorb more risk; larger amounts and longer tenors. [And this investment] will serve to lend to local businesses and to cushion the next crises."

"What makes it different from normal fund investments is that the new investors come with a long-term vision," said the CEO. The nature of the new investors means that they are willing to take significant losses in the short term to reap rewards, financial and in terms of impact, in the long-term.

The new investments are focused on the poorest countries, especially in sub-Saharan Africa, Brouwer said, where TCX has created a yield curve for the currencies of countries like Burundi and Sierra Leone.

GRAPHIC: Local Currency Bond Issuance: 2013-18



Source: TCX

Market creator

TCX has been responsible for creating the pockets of interest in which it operates, said Othman Boukrami, the head of trading. "A market is created when there is an offer and a demand for a specific instrument. TCX has created the offer and the demand for frontier currencies' hedging."

The offer stems from the nature of TCX's business, a fund created specifically with the goal of absorbing risks and allowing cross-border productive and non-speculative investments in the currency of investees.

The private investors' demand to hold such exposure was created through a process of trust-building and the impact TCX wants to achieve in developing sustainable frontier currency markets, added Boukrami.

"When selling a risk to an investor, we often hold a multiple size of the amount sold in our balance sheet. We have a skin in the game through our exposure thus our and investors' interests are often aligned."

"There are pull and push factors when considering investing in frontier market currency notes: the pull factors are yield, impact and diversification benefits. The push factor is the absence of a positive yield from highly-rated Euro and US dollar paper as Western markets are flooded with liquidity right now," Brouwer, expanded on the fund's role in frontier markets.

TCX sees itself as an instrument to create markets, the two said, and this role has already proven successful.

Pandemic-proof

"It's risky to lend in US dollars to a company that earns local currency," added Boukrami. "A local entrepreneur cannot be prepared for an unexpected market shock such as the Covid; TCX is, given its conservative capitalisation."

Covid is precisely one element linked to the fund's capital increase. The spread of the pandemic and the March global sell-off initially hit emerging markets and especially frontier markets hard. The MSCI Emerging Markets Index, which measures the equity market performance in 26 developing economies, went through a dramatic drop in March, falling from around 1,039 on March 5 to 758 on March 23. It has slowly crept up since then, finishing 2020 at 1,291.

Hence TCX's new USD200m investment is aimed at focusing on helping borrowers in IDA countries, predominantly in Sub-Saharan Africa, and in countries close to Europe.

And the markets with European proximity have shown signs of growth and development.

Uzbek success

Boukrami highlighted the rewards reaped in the case of Uzbek government's offshore local currency foray in November as an example of TCX's successful market-opening.

Isabelle Lessedjina, TCX's Senior Vice President responsible for investor relations, explained that the fund “contributed to issue a USD50m [equivalent] UZS synthetic note by FMO earlier in the year and contributed to attract foreign investors’ interest in the currency.”

The UZS505bn (USD50m) synthetic note, which settled in USD, was issued by **FMO** in June with a 3-year maturity and a coupon of 15%. Citi arranged what is one of the largest offshore notes issued in a frontier currency.

Lessedjina highlighted that the synthetic private placement was a perfect example of how local capital markets could be built. After several synthetic UZS notes by the FMO, the **European Bank for Reconstruction and Development** and the **IFC**, in collaboration through TCX’s hedging, “we set up a benchmark yield curve that corresponds to the credit risk-free curve,” added Lessedjina.

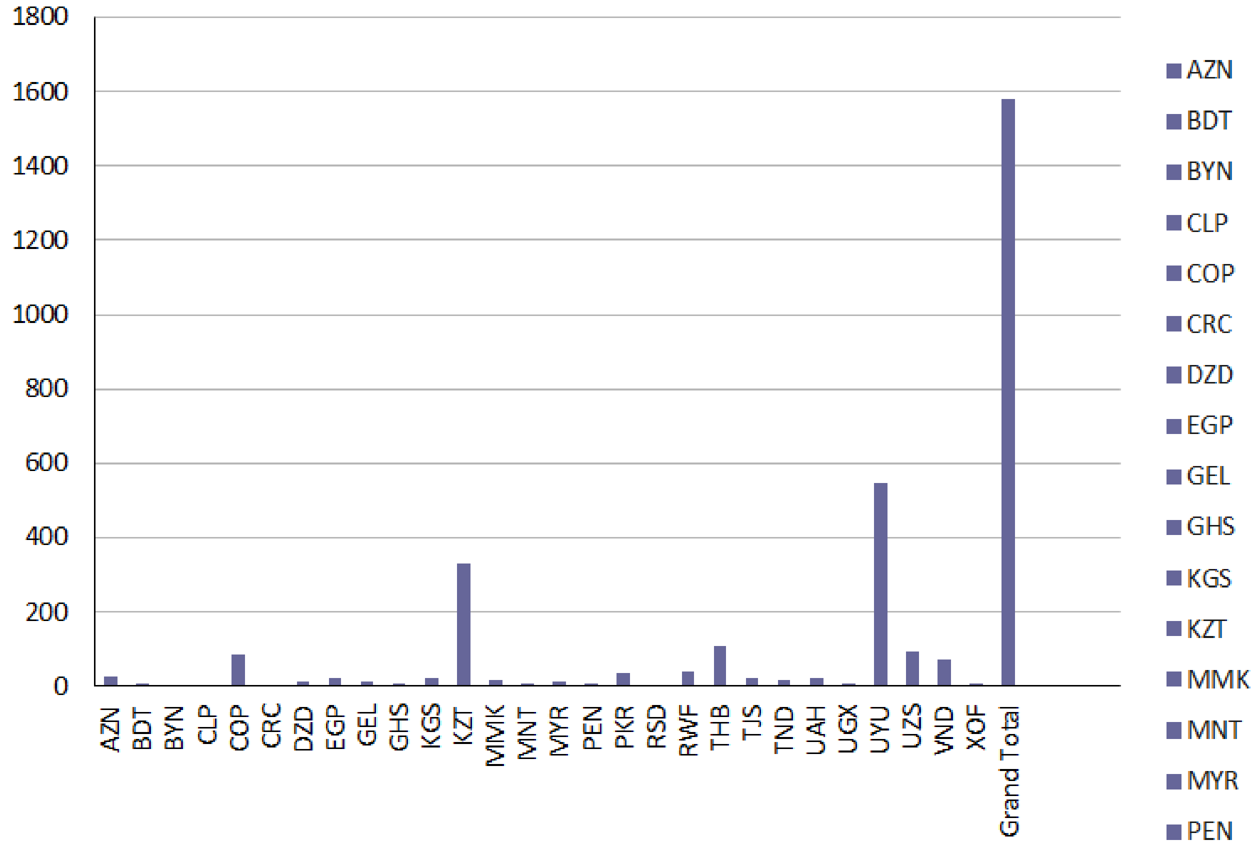
The landmark FMO deal was a milestone in the efforts for reducing the Dutch agency's partner Uzbekh banks’ exposure to USD and vulnerability to currency fluctuations. The trade came at a time when demand for UZS was growing among investors, and consolidated FMO’s presence in the UZS currency market.

The result of this work, Lessedjina said, was that “the government could issue in its own currency and investors had a risk-free curve in their mind that was already established by supranationals and development agencies.”

In November a UZS2trn (USD192m) 3-year tranche, yielding 14.5%, accompanied the B1/BB-/BB- rated **Uzbekistan**’s USD555m 3.7% 10-year global bond offering. This was “largely successful and overbid,” pointed out Lessejidna in line with market reports of the orderbook on the local currency tranche attracting demand of around UZS5trn.

A senior MTN dealer involved in frontier markets, echoed these words stressing that the FMO’s earlier large ticket of USD50m-equivalent volume was a cornerstone transaction that later allowed the public UZS benchmark from the sovereign to be sold to international investors.

GRAPHIC: SSA Frontier & Local EM Currency Offshore Issuance (In USDm): 2020



Source: mtn-i

Market in expansion

Meanwhile the uncertainty that has rippled through global markets this year has not affected TCX's activity, Boukrami, the Head of Trading, said. "TCX didn't have to adapt its strategy [to the outbreak of Covid-19] because managing and being prepared for such risks is already an integral part of our strategy."

He also pointed out that frontier currencies have better resisted the Covid crisis.

Brouwer compared TCX with an insurance company: "when a house catches fire, the insurance pays out. In March, the house caught on fire and we paid out."

During March and April 2020, the months of peak uncertainty and volatility, the temporary cost of hedging was increased, Boukrami pointed out, due to the risk materialisation causing the devaluation of a number of frontier currencies. These currencies' curves have since normalised. Boukrami added that frontier currencies' risk does not immediately materialise as a result of a systemic crisis. "It usually happens six months after the shock occurred in more liquid markets."

However, investors remain attracted by frontier market assets as the Covid-19 crisis has somewhat been counterbalanced by the excess liquidity currently available in global markets.

Discussing specific currencies that have had a strong appreciation this year, Boukrami highlighted the Vietnamese dong and the Myanmar (Burmese) kyat in South East Asia with both countries having benefited from the China-US trade war. Since the start of the commercial conflict in 2018, the value of the VND against USD has risen from VND22,710 per dollar on January 31, 2018, to VND23,075 on January 6, 2020. Boukrami also mentioned the Haitian gourde, which has had a 50% appreciation, linked to the country's central bank's unprecedented intervention.

Last year mtn-i identified pockets of offshore interest in VND where the **EBRD** met that interest in a VND585bn 1.38% 2-year note printed in January and later in October tapped by further VND585bn. Standard Chartered arranged both trades.

FMO also offered VND exposure issuing via ING USD15m in two 5-year USD-denominated synthetic noted linked to the South-East Asian currency, mtn-i data shows.

Both issuers also showed interest in printing in Myanmar kyat. FMO issued two synthetic MTNs tied to the currency in the first quarter, a USD6.8m 8.9% 2-year note in February through Citi followed by an ING-arranged USD5m 9.05% 4-year a month later. Then in August, the EBRD printed a USD6m note with a 3-year maturity and a coupon of 11% via ING.

Virtually all of these SSA frontier transactions pass through TCX, according to dealers.

Since 2007, the fund has hedged approximately USD8.5bn worth of loans provided to borrowers in emerging markets and developing countries. In 2020 TCX had a busy year, Brouwer said. The fund provided hedges to frontier currency notes from SSA issuers for about USD320m-equivalent in 2020, which is slightly lower than the previous year. However, TCX expected to finish the year with more than USD1bn-equivalent volume of local and frontier currency debt issuance which has passed through it since 2013. Lessedjina and Boukrami noted that the fund has sold an exposure close to USD500m in 2020 to private investors through Triple A SSA and bank notes.