TCX INSIGHTS

Building a **global** solution
for **currency risk**

Currency risk management and debt sustainability

Recognizing what's at stake for sovereigns

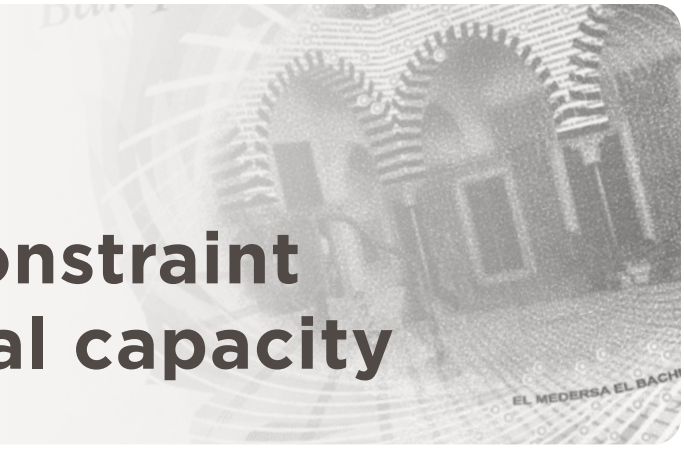
How currency crises reshape fiscal policy
and why indexing to local currency can help.

About TCX

TCX is a global development finance initiative supported by a shareholder base that includes FMO, IFC, EBRD, EIB, KfW as well as the European Commission and Dutch, Swiss, British, French and German governments and other DFIs and Microfinance Vehicles. TCX protects borrowers in emerging and frontier markets from currency risk by facilitating currency hedges that transfer the risk to TCX's balance sheet. TCX offers derivative instruments – cross-currency swaps and FX forwards – in currencies not or insufficiently covered by commercial parties. TCX started operations in 2007 and has since then hedged a total volume of over USD 16 billion in development loans in 66 currencies and hedged the currency risk for over USD 3 billion in frontier market currency denominated bonds.

1

Currency Risk – A fundamental constraint on sovereign fiscal capacity



Most developing country governments depend heavily on foreign currency borrowing, creating a fundamental vulnerability with cascading effects throughout their fiscal systems. While fiscal deficits and debt levels receive extensive attention in policy discussions, currency risk often operates as a hidden constraint that can instantly transform manageable fiscal positions into existential crises.

> **When governments borrow in foreign currency, they expose every aspect of their fiscal operations to exchange rate volatility beyond their control.**

The mathematics of currency exposure are stark – a 30% depreciation against the USD increases local currency debt service costs by approximately 43%. This isn't money that can be found through gradual adjustment or efficiency gains; it must be secured from existing budgets or through emergency fiscal measures that often target the most vulnerable spending categories and essential services, or through emergency borrowing at high costs and disadvantageous terms that further compound fiscal pressures.

Credit rating agencies systematically incorporate this vulnerability into their sovereign assessments. Fitch's sovereign criteria recognize that governments borrowing substantially in foreign currency create currency risk on their balance sheets, noting that "in the event of a devaluation or depreciation of the local currency, a sovereign will typically see its foreign-currency-denominated debt increase as a share of GDP and revenues" and that such borrowers "are more vulnerable to sudden stops in capital flows." Fitch incorporates currency composition as 3.2% of its Sovereign Rating Model, while S&P applies negative adjustments when foreign currency debt exceeds 40% of total government debt. Moody's sovereign methodology allows for notching adjustments of up to six notches based on the share of general government foreign currency debt relative to GDP. These agencies recognize that foreign currency exposure increases susceptibility to external financing shocks independent of other fiscal metrics.

"Among fiscal and external variables, the 'original sin' appears to make the largest contribution to the rating gap between SSA and advanced economies. This points to the need to develop effective solutions to address currency mismatches in EM and frontier markets."

Tatiana Lysenko
Research Fellow, Finance for Development Lab

Sub-Saharan African countries exemplify this vulnerability, with substantial portions of their public debt denominated in foreign currency. However, this challenge extends well beyond Africa - according to the United Nations Conference on Trade and Development (UNCTAD), approximately 70% of debt owed by emerging market economies and 85% of debt owed by low-income countries is in foreign currency[1], which makes them highly vulnerable to currency shocks and increases the burden of debt servicing. These levels create a self-reinforcing cycle where currency exposure both increases actual borrowing costs and raises risk premiums across the developing world.

Currency risk doesn't operate in isolation – it compounds various other fiscal challenges. When exchange rates move adversely, governments face the choice between servicing foreign debt and funding essential services, such as health and education, for their citizens. Unlike other fiscal pressures that build gradually, currency shocks arrive instantaneously and demand immediate responses that often compromise long-term development objectives. Despite this, more than 80% of international lending to low-income countries continues to be in hard currencies, ensuring that sovereign borrowers remain exposed to this fundamental vulnerability.[2]

With global debt surpassing $100 trillion in 2024 and 60% of low-income countries in or at high risk of debt distress, exposure to hard currencies, without proper mitigating efforts, will continue to be a tremendous constraint on fiscal sustainability for many developing nations.

1 UNCTAD Secretary-General Rebeca Grynspan, opening remarks at the 13th UNCTAD Debt Management Conference, Geneva, December 5, 2022, citing International Monetary Fund estimates. Visit

2 United Nations Economic Commission for Africa. Economic Report on Africa 2023. Addis Ababa: UNECA, 2023. Visit

2

The impact of currency-driven debt distress

Governments are forced to abandon strategic planning and resort to emergency measures that invariably sacrifice development priorities.

Currency crises do more than stress government finances and balance sheets. They fundamentally disrupt the capacity for coherent fiscal policy, making strategic planning extremely difficult or impossible. When foreign currency debt service costs explode overnight, governments are forced to abandon strategic planning and resort to emergency measures that invariably sacrifice development priorities to meet immediate obligations.

Historical precedents demonstrate the devastating consequences of unmanaged currency risk exposure. Mexico's debt crisis in the 1980s, triggered by peso devaluation, forced massive cuts in public spending and helped usher in what is still called the "lost decade" of development in Latin America. The 1997—98 Asian Financial Crisis saw Indonesia's rupiah collapse from 2,600 to over 14,000 per dollar, causing a 13.5% contraction in GDP and widespread suspension of government services and infrastructure projects.

Recent examples continue this destructive pattern. A 2025 IMF Working Paper on Sri Lanka's debt restructuring shows that in 2022, currency depreciation alone contributed 27 percentage points to Sri Lanka's debt accumulation, pushing total debt to 126% of GDP and contributing to foreign currency reserve depletion, economic collapse, and government inability to provide essential services.[3] Turkey's economic crisis from 2018—2022 saw the lira lose significant value while Turkish businesses held $214 billion in foreign currency debt, leading to widespread corporate failures and collapsing government revenues. Ghana's recent struggles with cedi weakness have forced difficult fiscal adjustments that constrain development spending precisely when the country needs to invest in climate resilience and economic diversification. Additionally, Nigeria's experience with naira depreciation has increased the local currency cost of debt service, limiting the government's capacity to address infrastructure needs and social programs.

Currency vulnerability creates a vicious cycle where external shocks trigger sovereign downgrades, which increase borrowing costs precisely when governments need fiscal resources most. Between January 2020 and February 2021, Sub-Saharan Africa accounted for 41% of all sovereign downgrades globally, despite having less initial economic exposure to pandemic effects than advanced economies. Currency vulnerability played an important role in driving these outcomes, as external shocks exposed the fiscal fragility amplified by foreign currency debt burdens. When sovereign ratings deteriorate, countries lose access to affordable long-term financing precisely when they need it most, forcing reliance on expensive short-term alternatives. Currency risk amplifies this problem by forcing procyclical fiscal policies during downturns. When currencies weaken during external shocks, debt service costs spike in local currency terms, forcing spending cuts that deepen economic contractions. This procyclical

3 Peter Breuer, Sandesh Dhungana, and Mike Li. "Sri Lanka's Sovereign Debt Restructuring: Lessons from Complex Processes", IMF Working Papers 2025, 175 (2025). Visit

pattern systematically undermines the policy space needed for sustainable development, with the most vulnerable countries hit hardest due to their greater exposure to hard currencies.

> ***"Rating agency frameworks recognize foreign-currency exposure as an explicit risk factor. The reality, though, is that discontinuous exchange rate movements frequently cause or are at least tightly correlated with a host of broader policy challenges – including sharply higher inflation, increased borrowing costs, various spending pressures, loss of market access, and even political instability. Currency risk is either behind or closely intermingled with many of these other symptoms, even when it's not explicitly the risk that's measured."***
>
> **Nikola Swann**
> Global Head of Governments & Multilaterals, SwissThink[4]

The cascading effects of currency crises underscore the need for developing local currency markets and the power of protection against currency fluctuations. During Azerbaijan's 2014—15 currency crisis, which resulted in the Azeri manat losing approximately half its value against the dollar, unprotected dollar borrowers faced default rates of 70—100%. However, where lending against the dollar was indexed to the local currency, TCX was able to absorb $145 million in potential losses, allowing borrowers to continue operating normally throughout the crisis. Similar results have occurred in other prominent markets including Ghana and Kenya, where currency hedging absorbed most of the depreciation impact for covered borrowers. These cases demonstrate that currency protection isn't just financially prudent – it's often the difference between maintaining fiscal capacity and losing it entirely.

4 SwissThink is an independent rating advisory, consulting, and training firm, focused on credit ratings and credit risk, comprised of sector experts with long previous careers at S&P Global Ratings, Moody's Ratings, and Fitch Ratings.

3

How countries are reclaiming fiscal control through currency risk management

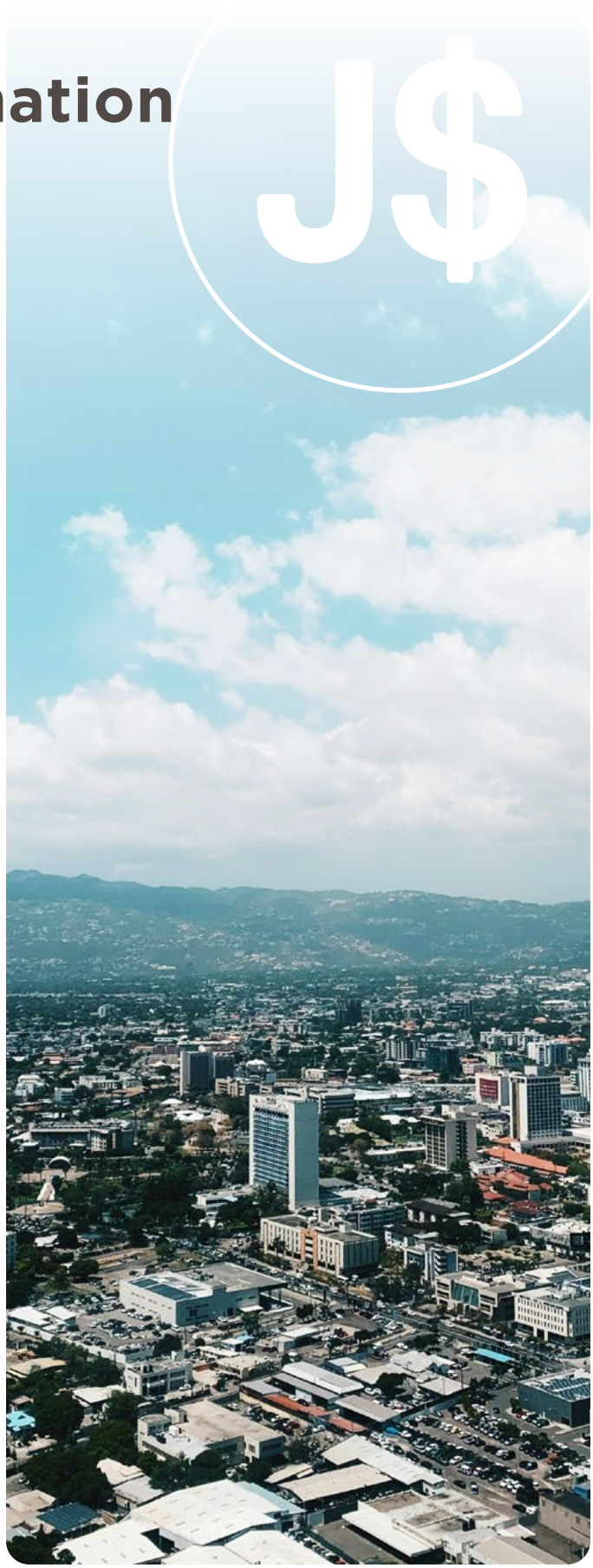
Recent sovereign experiences demonstrate that systematic currency risk management enables both fiscal stability and market development. Countries implementing comprehensive strategies to mitigate currency risk have maintained fiscal flexibility while strengthening their creditworthiness and market access.

Currency risk management is not merely a defensive financial maneuver.

The following examples illustrate how countries at different stages of development have successfully implemented currency risk management strategies. These cases share common characteristics: political commitment to addressing currency vulnerability, technical partnerships with development institutions and specialized providers, and strategic use of innovative financing instruments. Each demonstrates that currency risk management is not merely a defensive financial maneuver, but rather an enabling strategy that preserves fiscal resources for development priorities while creating pathways to deeper capital markets. The experiences reveal that systematic approaches to currency risk strengthen sovereign creditworthiness, attract international investors, and create the fiscal stability necessary for long-term development planning.

Jamaica's strategic transformation

Jamaica's achievement in reducing debt from 150% of GDP in 2013 to 77% by 2023 was supported by systematic and intentional currency risk management. With commitment from the Jamaican Ministry of Finance and Debt Management Office (DMO), Jamaica sought to reduce its overall exposure to currency risk across the 60% external debt stock. In 2021, the government utilized a swap to convert foreign currency loans to local currency for the first time. TCX helped support local currency financing by converting USD $70 million of MDB funding to indexed local currency and by hedging two bond issuances which contributed to an offshore local currency benchmark for Jamaican dollar bonds. These transactions helped pave the way for the first-ever Jamaican Dollar-linked offshore bond, demonstrating how currency risk management enables market development rather than constraining it. In this case, political consensus was essential to ensuring Jamaica's debt sustainability and fiscal predictability. Without the constant threat of exchange rate shocks undermining fiscal plans, Jamaica could maintain consistent policies across election cycles and economic volatility.



Without the constant threat of exchange rate shocks undermining fiscal plans, Jamaica could maintain consistent policies across election cycles and economic volatility.

Indonesia's multilateral partnership for currency conversion

Working with the Asian Development Bank, In May 2025 Indonesia successfully converted 27 sovereign loans totaling $3.3 billion from US dollars and Japanese yen to Indonesian rupiah. As Indonesian Vice Minister of Finance Thomas A.M. Djiwandono explained:

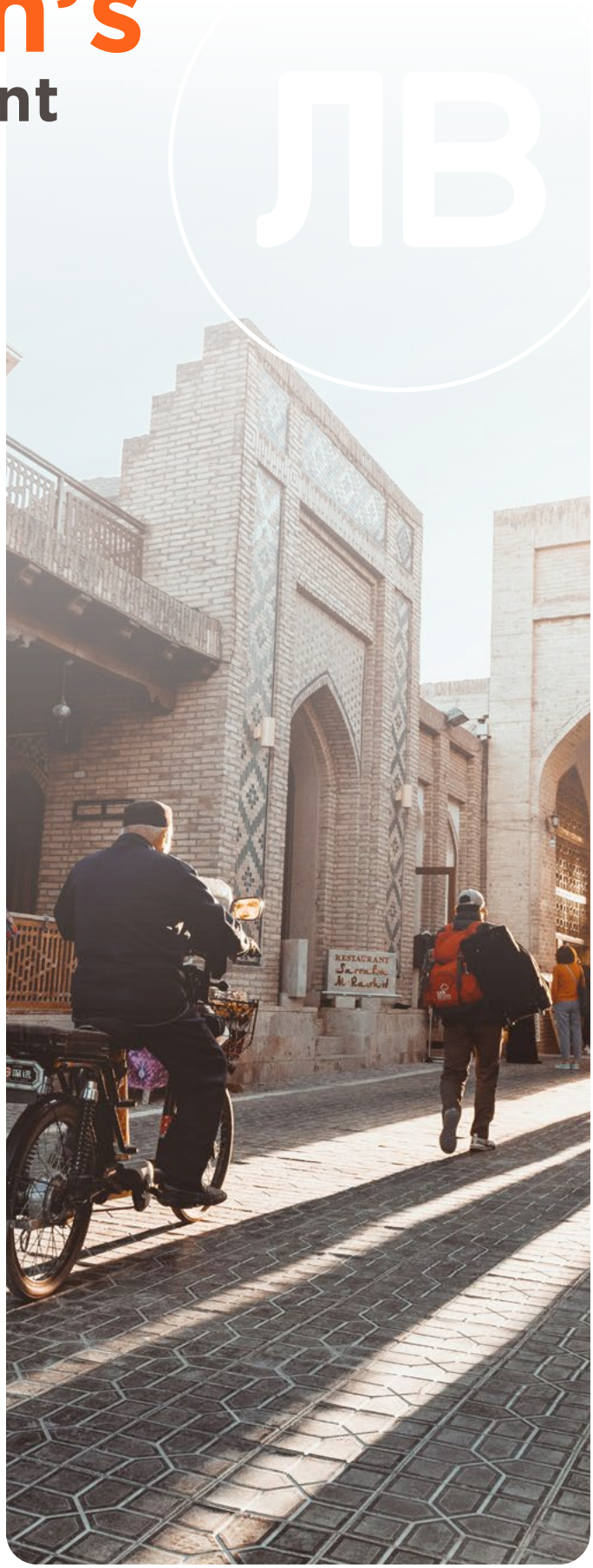
> **"With debt conversion, we can lower our financing costs and minimize financial uncertainty, which in turn provides greater fiscal space to address other pressing needs."**

This encapsulates exactly why currency risk management matters – it preserves fiscal resources for development priorities rather than absorbing them through exchange rate volatility. The transaction serves as ADB's first large-scale local currency conversion and demonstrates how multilateral development banks can systematically address borrower currency vulnerability. ADB's local currency portfolio has reached over $5 billion, with local currency loans constituting more than one-third of private sector outstanding loans and expected to grow to over 50% in coming years. This represents institutional recognition that currency risk management is central to development impact.

Uzbekistan's market development

Uzbekistan demonstrates how countries can transition from complete foreign currency dependence to meaningful financing choice. By the end of 2021, approximately 90% of Uzbekistan's external debt was denominated in hard currencies, making currency risk management a top priority. The breakthrough came with a $20 million USD/UZS cross-currency swap between the EBRD and Uzbekistan's Ministry of Finance, hedged by TCX. Notably, Uzbekistan established its DMO shortly before engaging with TCX, so executing the cross-currency swap proceeded alongside capacity building for DMO staff through coordinated support from EBRD and TCX. This parallel process, enabled by the DMO's motivated team, both completed the transaction and built essential debt management expertise within the government. By 2024, Uzbekistan had successfully increased local currency debt issuance, with domestic debt share rising from 11% at the end of 2022 to 17% by June 2024. This shift brought enhanced bond market infrastructure and growing investor confidence in the Uzbek capital market. As former Treasury Advisor Nobirbek Sobirov noted:

> **"Over the past few years, given the limited currency fluctuation in Uzbekistan, it's tempting to question the need for hedging tools. However, by using data-driven insights and long-term forecasting tools, we can see that proactive risk management is essential."**



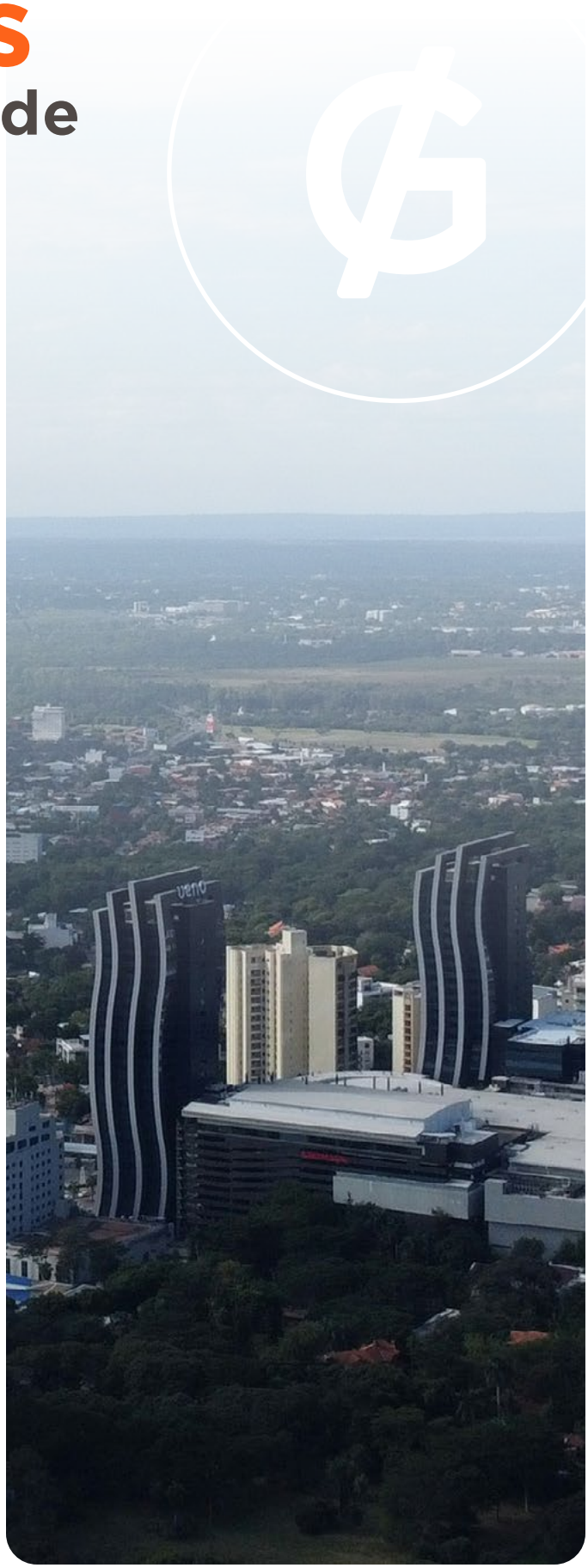
Paraguay's credit rating upgrade

Paraguay's transformation demonstrates how currency risk management serves broader development objectives. Starting with 91.5% of its debt denominated in foreign currency, Paraguay made currency risk reduction its central debt management priority. The first step was a strategic partnership with TCX to convert $100 million in existing loans through 13-year fixed-rate cross-currency swaps. This provided immediate hedging and established benchmark pricing that enabled Paraguay's first offshore guaraní-denominated bond issuance in February 2024, raising $500 million with 2x oversubscription. A larger $600 million issuance followed in February 2025, demonstrating sustained investor appetite.

Paraguay's Finance Minister framed this explicitly in terms of protecting fiscal resources:

> **"Ensuring that public resources are allocated to areas that directly impact the population's quality of life – strategic sectors such as health, education, security and social protection."**

Local currency debt increased from 8.5% in 2022 to 10.1% in 2023, with measures designed to foster greater stability and resilience against potential international market fluctuations. In July 2024, Moody's upgraded Paraguay to investment grade (Baa3 from Ba1), recognizing currency risk reduction as one supporting factor for the stable outlook. Moody's noted that "efforts to reduce the share of foreign currency debt will reduce exposure to exchange rate risk" among other factors supporting Paraguay's improved creditworthiness.



The advantage of currency risk management

These successes demonstrate that currency risk management enables fiscal stability across diverse economic contexts and development stages. Several common patterns emerge from these experiences that reveal why systematic approaches to currency risk represent a fundamental shift in sovereign debt management rather than just a technical financial tool.

- First, currency risk management enables predictable fiscal planning. When governments can forecast debt service costs in local currency terms with confidence, they can engage in medium-term development planning, maintain counter-cyclical policies during economic downturns, and protect essential spending on health, education, and infrastructure from external shocks. Jamaica's sustained debt reduction and Paraguay's investment grade achievement both demonstrate how fiscal predictability creates space for consistent policy implementation across political cycles.

- Second, hedging strategies accelerate market development by opening new financing channels. Paraguay's offshore guaraní bonds and Jamaica's dollar-linked instruments demonstrate how eliminating currency risk can attract international investors who might otherwise avoid emerging market exposure. Indonesia and Uzbekistan's experiences show how multilateral development banks increasingly recognize currency risk management as central to development impact.

- Third, systematic currency risk management can improve creditworthiness. When rating agencies observe consistent, strategic approaches to currency vulnerability, they recognize these efforts in their assessments as evidence of advanced debt management capacity and sound fiscal planning. Paraguay's investment grade upgrade, with Moody's explicitly citing currency risk reduction as a supporting factor, illustrates how these strategies can enhance credit profiles and lower borrowing costs.

Most importantly, indexing to local currency preserves financial resilience and fiscal capacity for development priorities. The difference between protected and unprotected borrowers becomes critical during crises – local currency indexing enables continued investment in essential services and infrastructure, while unprotected exposure forces emergency spending cuts and potential default. When currency risk is unmanaged, governments constantly adjust to external shocks. When debt is indexed to local currency, they focus resources on sustainable development rather than crisis management, creating economic resilience and developing domestic financial markets that further reduce currency mismatches. This fiscal stability is particularly crucial for private sector development as businesses cannot flourish when governments face constant currency-driven fiscal crises precipitated by foreign exchange risk. Predictable fiscal policy, stable public services, and consistent investment in infrastructure create the foundation that enables private enterprise to plan, invest, and grow.

4

An opportunity to strengthen assessment frameworks

The upcoming review of the IMF's Debt Sustainability Framework for Low-Income Countries (LIC-DSF) presents a timely opportunity to enhance how the framework recognizes innovations in sovereign debt management.[5] As countries increasingly adopt currency risk management strategies, the framework can evolve to better reflect these developments and provide more accurate assessments of fiscal resilience.

The LIC-DSF serves as a critical decision-making tool throughout the development finance system. Development finance institutions use its risk ratings to determine whether countries receive loans, grants, or mixed financing. The framework guides both sovereign borrowing decisions and investor assessments of debt sustainability. For many low-income countries with limited data disclosure capacity, LIC-DSF annexes published in IMF staff reports serve as the primary source of economic, fiscal, and debt data.

The LIC-DSF currently does not adequately recognize currency risk management efforts. When a country converts foreign currency debt to local currency indexation through instruments like cross-currency swaps, the framework's analysis does not fully capture the reduction in exchange rate exposure. As currency risk management has evolved, a fourth category has emerged: external debt indexed to local currencies. Recent IMF analysis demonstrates why this distinction matters – countries with higher local currency debt shares experience 58% less interest rate volatility during global financial stress. At the same time, the analysis notes that purely domestic solutions can create dangerous sovereign-bank concentration risks. External debt indexed to local currencies addresses both concerns by providing the fiscal predictability of local currency debt service while maintaining diversified international funding and avoiding the concentration risks the IMF identifies. The upcoming review offers an opportunity to incorporate recognition of currency risk management into the framework, enabling more accurate assessment of countries' actual fiscal risk exposure.

This enhancement would align the LIC-DSF with how credit rating agencies assess currency risk.

> **Rating agencies explicitly incorporate currency exposure into their sovereign assessments and recognize when countries reduce foreign currency exposure.**

Countries can achieve ratings upgrades based partly on currency risk reduction – as Paraguay did with Moody's – and the framework update would enable finance ministers and DMOs to demonstrate these improvements in debt sustainability metrics, creating stronger support for prudent risk management investments.[6]

5 Updates to the framework are ongoing and expected to be completed by 2027.

6 International Monetary Fund. "Global Shocks, Local Markets: The Changing Landscape of Emerging Market Sovereign Debt." Chapter 3 in Global Financial Stability Report: Shifting Ground Beneath the Calm. Washington, DC: International Monetary Fund, October 2025. Visit

The fiscal impact of currency risk

Recent experience illustrates the magnitude of currency risk's impact on fiscal sustainability. Analysis of the G20 Debt Service Suspension Initiative (DSSI) reveals how currency depreciation can dwarf other debt relief efforts. While the DSSI suspended $12.9 billion in debt servicing for 45 participating countries in 2020—2021, currency depreciation increased their debt burden in local currency terms by $34 billion over the same period. For Ethiopia, a $800 million payment holiday was overwhelmed by a 35% increase in debt burden due to birr depreciation, translating to $9.7 billion in additional local currency debt service costs. Zambia received $700 million in relief while kwacha depreciation increased debt burdens by $1.7 billion. Had this foreign debt been indexed to local currency, these countries would have been insulated from currency shocks.

Markets clearly recognize the value of local currency indexing. In March 2025, Côte d'Ivoire achieved a groundbreaking milestone by issuing the first-ever CFA franc–denominated bond on the international market. The transaction raised CFA 220 billion (€335 million) with a 7.625% yield over three years priced with no premium relative to the domestic yield curve and only a limited one compared to the euro, to which the CFA franc is pegged. This landmark issuance underscores growing international recognition of the West African CFA franc and could pave the way for greater participation by offshore investors in domestic capital markets, further supporting their development.

The limited ability of governments to borrow in local currency is a notable vulnerability for many SSA sovereigns. Recent analysis by Lysenko (2025) using econometric estimates based on S&P data found that the share of foreign currency-denominated debt contributes approximately 1.4 notches to the rating gap between Sub-Saharan Africa and advanced economies. High reliance on foreign-currency borrowing exposes governments to balance sheet effects when exchange rates depreciate, yet current LIC-DSF frameworks provide no mechanism to recognize when countries have mitigated this risk through local currency indexing.

Countries implementing hedging strategies pay higher upfront costs through hedging premiums, transaction fees, and sometimes higher interest rates. Recent IMF surveys reveal that very few DMOs even understand they can access indexed local currency financing – a knowledge gap that represents an opportunity for targeted capacity building and technical assistance.

Benefits of framework reform

Enhancing the LIC-DSF to recognize currency risk management would generate multiple benefits for the development finance system. Countries that invest in hedging strategies would be able to demonstrate concrete improvements in debt sustainability metrics, creating political support for sustained risk management programs. Recognition of local currency indexing would enable more accurate fiscal projections, supporting better development planning and resource allocation.

When frameworks accurately reflect fiscal capacity, countries can maintain development spending during external shocks rather than implementing emergency austerity. They can pursue countercyclical fiscal policies during economic downturns rather than amplifying contractions. Analytical credit for innovative instruments would accelerate development of local currency markets and currency hedging mechanisms, reducing systemic vulnerabilities across developing countries.

Framework enhancement would also improve policy coherence across the international development finance architecture. When technical assistance programs, credit rating methodologies, and debt sustainability frameworks all recognize currency risk management, countries receive consistent signals about prudent debt management practices. This coherence strengthens the effectiveness of capacity building efforts and creates clearer pathways for countries to improve their debt sustainability outcomes.

> ***"Sovereign borrowers can enhance fiscal and debt sustainability by securing predictable debt service through currency-risk mitigation, and debt sustainability frameworks should capture the resulting stabilizing effects."***
>
> **Global Sovereign Advisory[7]**

The upcoming LIC-DSF review provides an ideal opportunity to better distinguish between unprotected foreign currency debt and debt indexed to local currencies, enabling more accurate assessment of countries' actual fiscal risk exposure and the effectiveness of their currency risk management strategies.

7 Global Sovereign Advisory (GSA) is an independent firm advising States and State-owned entities around the world on strategic financial and economic matters.

5

The path forward

Currency risk represents one of the most critical challenges to economic resilience and fiscal stability that can be systematically addressed. Unlike external market conditions or domestic economic shocks, currency risk can be transferred, hedged, or eliminated through appropriate instruments and strategies.

The path forward requires recognition that currency protection isn't a luxury for sophisticated borrowers. Rather, it's a necessity for any government that wants to maintain fiscal capacity for development priorities. Sovereign borrowers can either continue accepting currency vulnerability as a constraint or adopt protection strategies that preserve fiscal flexibility. Countries must build political commitment to currency risk management and develop technical partnerships with experienced providers. International institutions must reform assessment frameworks to recognize and reward proven risk management strategies. The broader development finance community must support market development through appropriate blended finance mechanisms and technical assistance programs.

The successful examples from Jamaica, Paraguay, Indonesia, Uzbekistan, and Côte d'Ivoire demonstrate that systematic currency risk management is both achievable and beneficial. These countries have maintained market access while protecting fiscal capacity through various approaches – cross-currency swaps, synthetic local currency instruments, and innovative bond structures.

The tools for currency protection exist and are proven to work. The challenge now is scaling adoption beyond pioneer cases and ensuring that international frameworks support rather than discourage these risk management strategies. The upcoming LIC-DSF review provides an opportunity to align analytical tools with the reality that currency risk represents a manageable constraint rather than an inevitable burden for developing countries.

Building a **global** solution
for **currency risk**

Contact Information

For further details or inquiries

TCX Investment Management Company
Mauritskade 63
1092 AD Amsterdam
The Netherlands

+31 20 531 4851
info@tcxfund.com | tcxfund.com

DISCLAIMER