



# The Evolution of Local Currency Markets

*How TCX helps shape local currency market development through FX hedging in emerging and frontier markets*

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## About TCX

TCX is a development finance initiative backed by a shareholder base that includes FMO, EBRD, KfW and IFC, 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. Since starting operations in 2007, TCX has hedged a total volume of nearly USD 21 billion in development loans across 71 currencies.

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### Disclaimer

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## Executive Summary

In 2025, TCX added several new currencies to its portfolio, including the Ethiopian Birr (ETB), Fijian dollar (FJD), North Macedonian denar (MKD), and Bhutanese ngultrum (BTN), and reintroduced others such as the Papua New Guinean kina (PGK). While each trade provided much needed protection from FX risk for individual borrowers, they also represent more than an isolated transaction. Rather, each of these hedges is the first step in establishing the offshore infrastructure that local currency markets need to develop. Simply put, it marks the beginning of a market development journey.

This paper explores what market development means in the context of TCX's work as a provider of local currency solutions. Using a simple framework – frontier, developing, and emerging markets – it examines how TCX's role evolves as markets mature, from sole provider creating pricing where none exists, to market anchor deepening investor participation, to selective participant closing the gaps in domestic local currency markets. Critically, this progression is also about unlocking private capital: markets move from DFI-only financing, to emerging private investment, to broad private participation. The goal is markets where private capital flows in local currency terms.

The five new currencies highlighted in this paper all enter at the frontier stage. Whether they progress along the spectrum will depend on domestic policy choices, macroeconomic conditions, and investor appetite. Uzbekistan's journey from 2017 to 2024 illustrates what is possible when enabling reforms meet sustained institutional engagement. From capital controls and no offshore hedging to a market with multiple commercial providers and direct private investor participation, it shows what market development requires: political will, patient capital, coordinated actors, and time.

For borrowers in emerging and frontier markets, local currency finance means the difference between resilience and vulnerability. All the countries within TCX's portfolio have their unique context, stories and path towards greater sustainability and resilience, but many share a common starting point – a first hedge.

## 1. The Market Development Challenge

Emerging market and developing economies' sovereign bond markets have grown substantially over the past two decades. According to the OECD's Global Debt Report 2025, outstanding bond debt reached nearly USD 12 trillion in 2024, up from USD 4 trillion in 2007, while annual borrowing from markets tripled over the same period to over USD 3 trillion. This growth has brought significant benefits – expanded access to capital, diversified funding sources, and deeper domestic markets in many countries – but it has also concentrated currency risk at an unprecedented scale.

The reliance on foreign currency borrowing remains high, particularly for smaller economies. Excluding China and India, foreign currency-denominated debt accounts for around 20% of the total debt of emerging markets and developing economies (EMDEs), compared to just 6% for the OECD average. For smaller EMDEs, foreign currency debt has constituted approximately 40% of total outstanding debt since 2018. This structural exposure creates vulnerability that manifests most acutely during periods of global financial tightening.

The costs of this exposure have become increasingly visible. The OECD's analysis reveals a sobering pattern: high-risk credit countries saw the value of their currencies fall by nearly 80% against the US dollar from 2000 to 2024. For a 20-year USD bond issued in the early 2000s, the cost of redeeming the principal in 2024 was five times higher in local currency terms than at issuance. When currency depreciation is factored into the total cost of debt, the median FX-adjusted annual yield to maturity of USD-denominated debt exceeded 15% during the recent tightening cycle for high-risk countries, increasing the real cost of debt service for many countries.

The burden is compounded by concentrated refinancing needs. Between 2025 and 2027, almost USD 4.5 trillion in EMDE bond debt will mature – accounting for nearly 40% of the total outstanding amount. For low-income and high-risk countries, the pressure is greatest: more than half of their debt comes due during this period, with over 20% maturing in 2025 alone. Countries with low credit ratings face disproportionate exposure to foreign currency refinancing: for those rated above single B, the average share of foreign currency debt maturing between 2024-2026 is below 8%; for countries with lower ratings, it exceeds 30%.

The result is a growing number of countries in distress. Currently, 13 countries are in or nearly in default according to credit rating agencies – the highest number in 24 years – representing a combined population of nearly 400 million people. Another 13 countries are at significant risk of default, with a combined population exceeding 700 million. As of Q1 2025, 47% of low-income developing countries face moderate-to-high risk of debt distress.

The 2022-2023 global tightening cycle demonstrated the value of local currency market development. Large emerging market economies with developed local currency bond markets weathered the storm relatively well, with the main consequence being increased interest expenditure that pressured budgets, but remained manageable. For smaller economies lacking such markets, the consequences were far more severe: either repaying debt in a currency that had depreciated substantially, or refinancing at significantly higher rates. The costs of not having access to (synthetic) local currency are high and growing.

It is widely recognized that public resources and official flows (including aid and lending from development banks) alone cannot meet investment needs in emerging and frontier markets. Closing the financing gap to meet the Sustainable Development Goals (SDGs) – estimated at several trillion dollars annually – depends on creating conditions where institutional investors can participate. Currency risk is a binding constraint as most private investors cannot or will not take unhedged frontier currency exposure. Without mechanisms to manage this risk, private capital remains locked out the markets that need it most.

While countries work to develop their domestic markets, local currency-indexed financing can bridge the gap. Developing domestic markets requires sound monetary policy, legal and regulatory frameworks, settlement infrastructure, a domestic savings base, and a diversified investor base. Through currency swaps or forwards, development finance can be tied to local currency performance, providing fiscal predictability without requiring full domestic market infrastructure. Local currency-indexed financing can bridge the gap if and when domestic markets develop, creating the conditions for private capital to follow

## 2. The Market Development Spectrum

TCX operates across a spectrum of market development, from currencies with no offshore hedging availability to those with active commercial markets. Its role differs fundamentally depending on where a currency sits on this spectrum.

The investor base also evolves along this spectrum. At the frontier stage, DFIs and MDBs are typically the only participants, as private investors have limited mechanisms to take currency exposure. As markets develop, private capital enters through intermediated structures, then directly as commercial hedging options emerge. The goal is deeper local capital markets - markets with the liquidity, financial instruments, and investor diversity that allow local currency finance to function at scale.

Central to TCX's market development role is transferring currency risk from its balance sheet to private investors. This happens through two channels. First, TCX on-sells currency exposure directly to commercial counterparties through derivative transactions. Second, TCX hedges local currency bonds issued by its shareholders - when FMO or IFC issues a frontier currency bond, TCX provides the hedge that makes issuance possible. Since inception, TCX has on-sold approximately USD 8.8 billion in currency risk to commercial counterparties and hedged 277 local currency-indexed bonds across 35 currencies, worth over USD 3 billion. Both activities recycle TCX's capacity for new transactions, and the shareholder bond program builds investor familiarity with currencies where no market previously existed. How these functions operate differs at each stage of market development.

### Frontier Markets

In frontier markets, local capital markets are nascent or non-existent. There are no observable offshore prices, no liquid onshore instruments, and no commercial hedging alternatives. Domestic institutional investors are undeveloped. Sovereign bond prices, that provide a benchmark for pricing other financial products (typically 'risk free rate'), may not exist or are confined to very short tenors.

TCX frequently serves as the only provider of offshore hedging at this stage, building pricing from macroeconomic fundamentals and local data as available,

executing transactions where no market previously existed. Every transaction generates new information about achievable pricing, operational feasibility, and market dynamics. The pricing TCX establishes becomes the first observable reference for that currency's offshore value.

- **On-selling:** At the frontier stage, on-selling options are limited. Commercial counterparties rarely have appetite for currencies with no track record. While commercial appetite for frontier currencies is limited, TCX has pioneered risk transfer in several of these markets, becoming the first to introduce the currency as an investable exposure to international counterparties. These early transactions build the track record that makes broader market participation possible over time.
- **Local currency-indexed bonds:** Shareholder bond issuance requires sufficient transaction volume to justify the operational costs. At the frontier stage, this volume often doesn't exist yet. TCX is building the foundation for future issuances.
- **Local market deepening:** At this stage, the focus is establishing that the currency can be hedged at all. Domestic market development is a longer-term prospect, dependent on policy reforms, macroeconomic stability, and institution building.

The new currencies added in 2025 — ETB, FJD, MKD, and BTN — all enter at this stage, along with the reintroduced PGK.

## Developing Markets

In developing markets, local capital markets are emerging but remain shallow. Some hedging activity exists, but coverage is incomplete across tenors and counterparties. Sovereign yield curves are relatively short-dated. International investors have limited familiarity with the currency. Without reliable hedging options, private investor participation in these markets remains limited. TCX's role in providing and catalyzing that coverage helps make broader private capital mobilization possible

- **On-selling:** TCX on-sells currency exposure directly to commercial counterparties through derivative transactions. This crowds private capital into the market and recycles TCX's capacity for new transactions.

- **Local currency-indexed bonds:** TCX hedges local currency bonds issued by its AAA-rated shareholders. These bonds are the mechanism through which international investors first gain exposure to developing market currencies - comforted by the issuer while building familiarity with the currency. Over time, that exposure builds analytical capability and institutional comfort, the preconditions for direct participation.
- **Local market deepening:** As offshore activity accumulates, it creates conditions for onshore development. Domestic pension funds and insurers begin matching local currency liabilities with local currency assets. Sovereigns establish benchmark issuances. International investors start accessing onshore instruments directly. This deepening - driven largely by domestic actors and policy choices - is what ultimately reduces dependence on offshore solutions.

Currencies like the Tanzanian shilling, Kenyan shilling, Georgian lari, and Vietnamese dong sit at this stage.

## Emerging Markets

In emerging markets, local capital markets have developed meaningful depth. Commercial hedging providers are active, domestic institutional investors participate, and sovereign yield curves extend across multiple tenors. International investors access both onshore and offshore instruments, though domestic hedging options may not extend to longer tenors.

TCX's role is more limited at this stage. Commercial providers cover most needs, so TCX focuses on what they don't: longer-dated hedges, smaller borrowers who lack access to commercial banks, and maintaining availability when markets tighten and commercial providers step back.

- **On-selling:** Commercial counterparties actively seek exposure to these currencies. TCX can transfer risk easily but often faces competition from commercial alternatives.
- **LCY bond program:** Shareholder bonds face strong investor demand. But the market increasingly functions without them - sovereigns and corporates issue local currency bonds directly to international investors.
- **Local market deepening:** The market operates largely on its own. Private investors participate directly - buying local currency bonds, trading with commercial hedging providers, including the currency in their portfolios. The market has become investable without TCX

intermediation. This is the end goal of market development, and the point at which TCX's role may appropriately decrease.

Currencies like the Colombian peso, Indian rupee, Mexican peso, and South African rand sit at this stage.

## How Markets Progress

Movement along this spectrum is neither automatic nor inevitable. It requires enabling policy reforms, macroeconomic stability, investor appetite, and sustained engagement over years. TCX can contribute to conditions for markets to progress, but the outcome depends on the broader ecosystem.

### BOX 1: Offshore to Onshore

#### From Offshore to Onshore

Local currency market development typically progresses from offshore to onshore activity.

**What is offshore?** Offshore activity happens outside a country's domestic financial system. Loans are funded in hard currency but indexed to local currency performance. Hedges settle in USD or EUR rather than the local currency itself. Bonds are issued in international markets under foreign law. None of this requires domestic market infrastructure - it can proceed even where local capital markets barely exist.

**Why start offshore?** For currencies with capital controls, settlement risk, or limited convertibility, offshore structures are often the only option. They allow international investors to gain currency exposure without navigating unfamiliar domestic systems or taking on settlement risk. They create pricing benchmarks and track records that domestic markets can eventually reference.

**What is onshore?** Onshore activity happens within a country's domestic financial system. International investors buy domestic government bonds directly. They transact with local banks. They participate in primary auctions. Domestic pension funds and insurers match local currency liabilities with local currency assets. Domestic savings get recycled into domestic investment.

**How does the transition happen?** As offshore activity accumulates, it creates conditions for onshore development. Investors who bought offshore bonds develop analytical frameworks applicable to domestic instruments. Pricing

benchmarks established offshore inform onshore issuance. The demonstration that international capital will take local currency exposure can encourage domestic market reforms. Eventually, the domestic market develops enough depth that offshore solutions become less necessary. Sections 4a and 4b provide an example of how this has played out in practice.

### 3. Currency Additions in 2025

In 2025, TCX expanded its coverage to several currencies, each representing a distinct geography and development context. What these currencies share is that they all required TCX to build pricing capability from the ground up - creating hedging availability where none existed offshore. Each represents the beginning of a potential market development journey, entering at the frontier stage of the spectrum.

#### Ethiopia Birr (ETB)

Ethiopia is Africa's second most populous country and one of its fastest-growing economies, with the IMF projecting GDP growth of around 9% for 2025/26. For decades, the National Bank of Ethiopia managed the exchange rate, which kept the birr artificially strong and produced foreign currency shortages and a parallel market where the birr traded at more than twice its official rate. In July 2024, as part of broader economic reforms, Ethiopia moved to a more market-determined exchange rate. The birr immediately depreciated by 30% and has continued to weaken, but the shift also unlocked a \$3.4 billion IMF program and over \$1.5 billion in immediate World Bank financing.

TCX's entry into the birr provides the possibility for structuring development finance in local currency terms in Ethiopia, where no other commercial hedging solutions are available. TCX's first hedge in the birr supported an IFC investment in Ethiopia's telecommunications sector, part of a broader effort to modernize and digitize the Ethiopian economy. With no observable offshore market references and limited onshore references also, pricing required models built entirely from macroeconomic fundamentals - a defining characteristic of frontier-stage currencies. Offshore financing (with FX risk mitigation tools) is still challenging, but recent FX regulation developments suggest the market may significantly open up in the coming years.

#### Fijian Dollar (FJD)

Fiji faces the existential challenge of climate vulnerability. In 2016, Tropical Cyclone Winston - the most intense tropical cyclone in the Southern Hemisphere on record - caused economic losses amounting to almost one-third of GDP. Average asset losses from tropical cyclones and floods exceed FJD 500 million per year, representing more than 5% of GDP.

Fiji has been a pioneer in climate finance for developing countries. In November 2017, it became the first developing country to issue a sovereign

green bond, raising FJD 100 million (approximately USD 50 million). The bond was listed on the London Stock Exchange in April 2018. In November 2023, Fiji issued its first sovereign blue bond to fund ocean conservation and coastal protection. In late 2025, Fiji launched its Green Finance Taxonomy and Sustainable Finance Roadmap - frameworks developed with IFC and the Climate Bonds Initiative to guide green investments.

TCX's first FJD transaction provided a hedge for the Asian Development Bank's first local currency loan in Fiji, supporting a local financial institution's lending to women-owned SMEs. TCX's initial hedge is an initial step in supporting the development of Fiji's local currency market, allowing investments that generate local currency returns to be financed without currency mismatch - which will be critical in achieving the country's climate agenda.

### **North Macedonian Denar (MKD)**

North Macedonia is an EU candidate country in Southeast Europe, though the accession process is likely to remain stagnant in the near term. The denar has been pegged to the euro for over two decades, providing exchange rate stability. However, 75% of government debt remains denominated in foreign currency, and the economy faces significant refinancing needs with a EUR 700 million Eurobond maturing in 2026.

Despite the peg, domestic borrowers generating revenues in denar face currency mismatch if their liabilities are denominated in euros - and peg arrangements can come under pressure during stress. Central bank interventions in the currency market are sizeable, and the IMF highlights the risk of large capital outflows straining the currency peg.

TCX's entry into the denar provides the possibility for structuring development finance in local currency terms in North Macedonia, where no other commercial hedging solutions are available. The fund helped a European bank with operations in the Balkans to hedge its balance sheet exposure.

### **Bhutanese Ngultrum (BTN)**

Bhutan is a small Himalayan kingdom with an economy centered on hydropower exports to India, tourism, and agriculture. It is one of the world's few carbon-negative nations and graduated from the UN's Least Developed Country category in December 2023. Growth is projected at 7.4% in

FY2025/26, among the fastest in South Asia, driven by new hydropower projects coming online.

The ngultrum has been pegged 1:1 to the Indian rupee since 1974, and the rupee is also legal tender throughout Bhutan. Around 70% of imports come from India, and inflation tends to follow Indian trends. Hydropower projects generate revenues in both ngultrum (domestic sales) and rupees (exports to India), creating complex currency dynamics.

In September 2025, IFC announced its first infrastructure investment in Bhutan: a USD 20 million ngultrum-linked loan to Bhutan Power Corporation for grid modernization. TCX provided the hedge, marking the first offshore hedging transaction in the ngultrum. The deal followed Bhutan's revision of its External Commercial Borrowing Guidelines in May 2025, which allowed local entities to borrow from foreign lenders in local currency terms for the first time.

### Papua New Guinean Kina (PGK)

Papua New Guinea is a resource-rich Pacific nation that has faced chronic foreign exchange shortages since 2015. The IMF estimates PNG's economy would be USD 3 billion larger had currency rationing not been introduced. Despite current account surpluses from mineral and petroleum exports, foreign exchange remains scarce domestically because project development agreements allow export earnings to stay offshore.

Access to foreign exchange has improved under an IMF-supported reform program launched in 2023, but shortages persist. Businesses still face delays of several weeks to access foreign currency, constraining imports and investment. The kina has gradually weakened as the central bank works toward restoring full convertibility under the IMF program.

TCX's re-entry into the kina provides an offshore hedging solution for a market where onshore currency access remains constrained. For infrastructure and SME financing, borrowers cannot hedge through commercial channels and cannot prudently bear unhedged currency risk. TCX offers a bridge while PNG's forex reforms proceed.

## 4. Market Development in Practice

Two currencies in TCX's portfolio illustrate what progression along the market development spectrum looks like in practice. Uzbekistan's som moved from a closed market to commercial pricing in seven years, showing the full arc. Tanzania's shilling, where domestic foundations are solid and offshore hedging is well established but the transition to emerging is still underway, shows a process along the same journey. Together, they illustrate that market development is not a single event but a sequence of conditions, reforms, and transactions that build on each other over time.

### 4a. Uzbekistan: From Closed Market to Commercial Pricing

#### *Starting Point*

Prior to 2017, Uzbekistan was effectively closed to international capital markets. The country maintained capital controls, operated dual exchange rates with massive distortions between them, and required exporters to convert a portion of their foreign currency earnings to som at unfavorable rates. There was no offshore hedging availability and no international investor base. Development finance flowed exclusively in hard currency, with all exchange rate risk borne by local borrowers who had no tools to manage it.

#### *Reform Environment*

In 2017, Uzbekistan's new president launched sweeping economic reforms. Capital controls were removed and the exchange rate unified. The government abolished the conversion requirement and allowed companies to receive international payments in som without restrictions. Structural reforms followed, including price and trade liberalization, banking sector modernization, and steps toward international financial integration. Fitch upgraded Uzbekistan to BB- in 2018.

In 2019, Uzbekistan issued its first Eurobond - a USD 500 million, 10-year instrument - signaling commitment to international capital markets. The adoption of a Capital Markets Development Strategy in 2021 and introduction of inflation targeting further demonstrated dedication to financial market development.

#### *TCX's Role*

TCX began offering hedging solutions in the Uzbek som in 2018, immediately following the reform breakthrough. For several years, TCX was the sole provider of offshore hedging. Demand came primarily from the private sector through large local banks, microfinance organizations, and corporates receiving international financing who wanted to hedge currency exposure. TCX's transactions created pricing references where none had existed.

As TCX built som exposure, it transferred that exposure to international investors through bonds issued by its shareholders - institutions like FMO and IFC that carry top credit ratings. By the end of 2024, TCX had facilitated nearly USD 1 billion in Uzbek som exposure. These shareholder bonds offered international asset managers and pension funds a way to gain som exposure through familiar instruments. Investors were not taking direct Uzbek credit risk, rather they were buying bonds from institutions they knew, while at the same time building familiarity with the som. Because these bonds were publicly listed, their pricing provided reference points for subsequent activity.

In November 2020, the Ministry of Finance issued Uzbekistan's landmark Eurobond, including both a USD portion (USD 555 million, 10 years, 3.7%) and a portion denominated in local currency (UZS 2 trillion, approximately USD 200 million, 3 years, 14.5%). This was the first local currency sovereign Eurobond within the CIS region. Over 20 international investors placed orders, and the local currency portion was 2.5x oversubscribed. The successful issuance reflected multiple factors: the government's reform track record, the rating upgrade, growing investor comfort with Uzbekistan, and the familiarity some investors had built through shareholder bond exposure.

In February 2022, another milestone followed when the Ministry of Finance, in collaboration with EBRD and TCX, executed the country's first sovereign currency hedge - a USD 20 million transaction that converted foreign currency borrowing to local currency terms. The transaction proceeded alongside capacity building for staff at the Debt Management Office through coordinated support from EBRD and TCX.

### *Where Things Stand*

By 2024, the market had matured. Where TCX was once the sole provider of offshore hedging, there are now numerous commercial institutions offering som pricing. Since 2019, the government has issued six international bonds including local currency portions. Domestic debt share rose from 11% at end-

2022 to 17% by June 2024. The ADB issued its inaugural som-denominated bond in August 2025.

TCX's role has evolved accordingly. No longer the sole provider, TCX now fills gaps where commercial providers don't reach, which is the intended outcome. The Uzbek som has moved from the frontier stage to the emerging stage of the market development spectrum.

## 4b. Tanzania: Building the Foundations

### *Starting Point*

Tanzania has never been a closed market in the way Uzbekistan was. The Bank of Tanzania established the Inter-bank Foreign Exchange Market in 1994, and the government has issued domestic treasury bonds across maturities from 2 to 25 years. What had not yet developed was an offshore hedging market: international lenders financing projects in Tanzania had limited options for managing shilling exposure, and most development finance still flowed in hard currency as a result. TCX executed its first shilling hedge in 2008 within a year of beginning operations.

### *Reform Environment*

Tanzania's reform trajectory has been more gradual than Uzbekistan's dramatic 2017 opening. Macroeconomic stability has been the constant: GDP growth averaged over 5% for the past decade, inflation has remained below 4%, and the Bank of Tanzania has maintained a broadly stable monetary framework noting the 2024 shift from reserve money targeting to an interest rate framework. The country's transition to lower-middle-income status, while a marker of progress, means that access to concessional finance is gradually decreasing and makes market-based financing more important.

Since 2021, President Samia Suluhu Hassan's government has signaled a more investment-oriented approach. The IMF approved a USD 1 billion Extended Credit Facility arrangement in 2022, supporting reforms to fiscal management, revenue mobilization, exchange rate flexibility, and financial sector development. A joint IMF-World Bank mission in 2024 conducted a diagnostic of Tanzania's domestic bond market and concluded that the preconditions for market development are all met: sound macroeconomic management, prudent fiscal policy, and stable monetary conditions.

The domestic market has also seen innovative issuance. In 2024, the Tanga Water Infrastructure Green Bond became Tanzania's first subnational green bond and one of the first in Sub-Saharan Africa, raising capital for water infrastructure expansion with 103% oversubscription, including 65% from domestic institutional investors. NMB Bank established a TZS 1 trillion multicurrency sustainability bond program, the largest thematic corporate bond program in Sub-Saharan Africa, with IFC investment supported by the IDA Private Sector Window.

### *TCX's Role*

Since that first transaction in 2008, the Tanzanian shilling has grown into one of TCX's most active currencies and is now consistently among the top five by hedging volume and the top in Sub-Saharan Africa each of the past four years. Activity accelerated sharply in recent years: since 2020, TCX has executed over 90 shilling transactions across more than 20 counterparties, with annual deal volumes roughly doubling between 2022 and 2025.

The counterparty base reflects the breadth of development finance flowing into Tanzania in local currency terms. Primary hedging transactions have supported lending by FMO, IFC, EIB, AFD, BIO, and Oikocredit, alongside microfinance and impact vehicles such as MFX and the African Local Currency Bond Fund (ALCB Fund). Sectors have diversified beyond microfinance into SME finance, renewable energy, and water infrastructure.

TCX has also on-sold shilling exposure to numerous commercial counterparties that have taken TZS risk from TCX's balance sheet. This has been mainly through non deliverable forwards (NDFs) with international banks and synthetic TZS note issuances with investors. Over the last couple of years, the tenors and sizes banks can do in NDFs have slowly but steadily expanded whilst investor appetite for TZS risk has also been increasing. The shilling is also included in TCX's frontier currency bond index, which tracks shilling-linked Eurobonds issued by AAA-rated shareholders such as FMO, IFC, and AfDB, therefore giving international investors exposure to shilling returns through familiar instruments.

These offshore activities reinforce onshore development. As hedging builds a track record and pricing transparency, it supports the conditions under which domestic market participants (pension funds, banks, insurance companies) expand their own local currency activity.

## *Where Things Stand*

The Tanzanian shilling sits in the developing stage of the market development spectrum. The foundations are solid with a functional domestic bond market, a growing institutional investor base, stable macroeconomic conditions, and an active offshore hedging market with commercial counterparties already taking exposure. GDP growth reached 5.5% in 2024, with 6% projected for 2025. The current account deficit narrowed to 2.6% of GDP in 2024, supported by strong exports.

The next phase of development will depend on broadening the investor base (currently, foreign participation in government securities is limited to East African Community and Southern African Development Community residents) and continuing to deepen secondary market liquidity and foreign exchange market functioning, areas the IMF-World Bank diagnostic identified as priorities. These are familiar challenges for markets at this stage of development, and Tanzania's track record of steady reform suggests the foundations are in place to address them. A debut Eurobond, which has been discussed at various points over the last decade, could mark another significant step in establishing an international sovereign benchmark and broadening visibility of the shilling among global investors.

Where Uzbekistan's market opened through a single decisive reform moment in 2017, Tanzania's progression reflects a different model: steady, reform-driven, and building on strong domestic foundations. TCX's role remains active and growing, which is itself an indicator of both the opportunity and the momentum in the shilling market.

### **BOX 2: Two Market Development Timelines**

Year	Uzbekistan (UZS)	Tanzania (TZS)
2008	—	First TZS hedge
2013	—	Tanzania's last foreign currency sovereign bond issuance
2017	New government removes capital controls, unifies exchange rate	Domestic bond market steady; Bank of Tanzania issues across 2–25 year tenors
2018	TCX begins offering som hedging; Fitch upgrades to BB-	TZS among most active TCX currencies in SSA

2019	First USD Eurobond (USD 500 million)	—
2020	First LCY Eurobond (UZS 2 trillion, 2.5x oversubscribed)	—
2021	Capital Markets Development Strategy adopted	President Samia Suluhu Hassan takes office; signals reform priorities
2022	First sovereign currency hedge with EBRD and TCX	IMF approves USD 1 billion ECF; Tanzania reaches lower-middle-income status
2023	—	TCX activity accelerates: 26 TZS transactions across 12 counterparties
2024	4-5 commercial providers offer som pricing; domestic debt share rises to 17%	IMF-WB bond market diagnostic; Tanga subnational green bond (103% oversubscribed); NMB Bank TZS 1 trillion sustainability bond with IFC/PSW
2025	ADB issues inaugural som bond; issuance reaches USD 3.7 billion in first seven months	31 TZS transactions across 16 counterparties; commercial banks on-selling TZS exposure; IMF approves USD 448 million disbursement

## 5. What Market Development Requires

Across 71 currencies and nearly two decades, TCX has seen markets progress, stall, and occasionally regress. That experience points to several conditions that matter.

1. **Reforms come first:** Legal and regulatory barriers, including capital controls, that fragment markets or distort prices create barriers that no hedging capability can overcome. The enabling environment must exist before market development tools can be effective.
2. **Price discovery is foundational:** Markets can't function without reference points. Before investors can participate, they need to understand what the risk is worth - what yield compensates for currency exposure, how the currency behaves, and what terms are achievable. Early transactions establish these benchmarks. Without visible pricing, there's no basis for others to follow.
3. **Coordination matters:** No single actor develops a market alone. Governments drive reforms. DFIs and MDBs provide lending. Technical assistance builds institutional capacity. Rating agencies provide validation. Investors gradually build familiarity. Market development requires these pieces to work together.
4. **Investors need on-ramps:** Private capital doesn't leap into frontier currencies. It needs intermediate steps - familiar instruments, observable pricing, track records. Each creates comfort that eventually enables direct participation.
5. **Success builds on success:** Demonstration effects matter. Successful transactions attract attention. Visible pricing creates benchmarks. Investor familiarity compounds. Each step builds credibility for the next step.
6. **The goal is graduation:** The ultimate measure of success is whether the market functions on its own - and whether private capital flows in local currency.

## Conclusion

Local currency market development is measured in years, not transactions. Its objective is straightforward: enabling private capital to flow in local currency to borrowers who need it. For governments, businesses, and households across emerging and frontier markets, that capability is the difference between resilience and vulnerability – and often whether a project succeeds or not.

TCX started as a hedging provider - a product that allowed development finance investors to transfer currency risk. That remains the core function, but the work has evolved over the past 19 years to where TCX plays a more pronounced role as a market maker. Through on-selling to commercial counterparties, hedging shareholder bonds that build investor familiarity, and engaging with sovereigns on debt management, TCX has become part of a broader market development process.

Each newly added currency brings TCX into a new market with its own context, opportunities, and challenges. Where these markets go from here will depend on reforms, conditions, and sustained engagement over time.

Uzbekistan shows what is possible. Seven years from capital controls to commercial providers and oversubscribed sovereign local currency bonds, with private investors now participating directly in local currency. Tanzania shows what the middle of the journey looks like with strong domestic foundations, active offshore hedging, commercial counterparties already taking exposure, and a reform trajectory that suggests continued progression. While Uzbekistan and Tanzania are the examples used in this paper, they are not unique. The market development journey has taken place in several other countries within the TCX portfolio (Jamaica, Paraguay, and Côte d'Ivoire for instance). While each is unique, they all share similar ingredients and intentionality by making deliberate decisions to deepen their local capital markets which have led to market development advancement.

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