



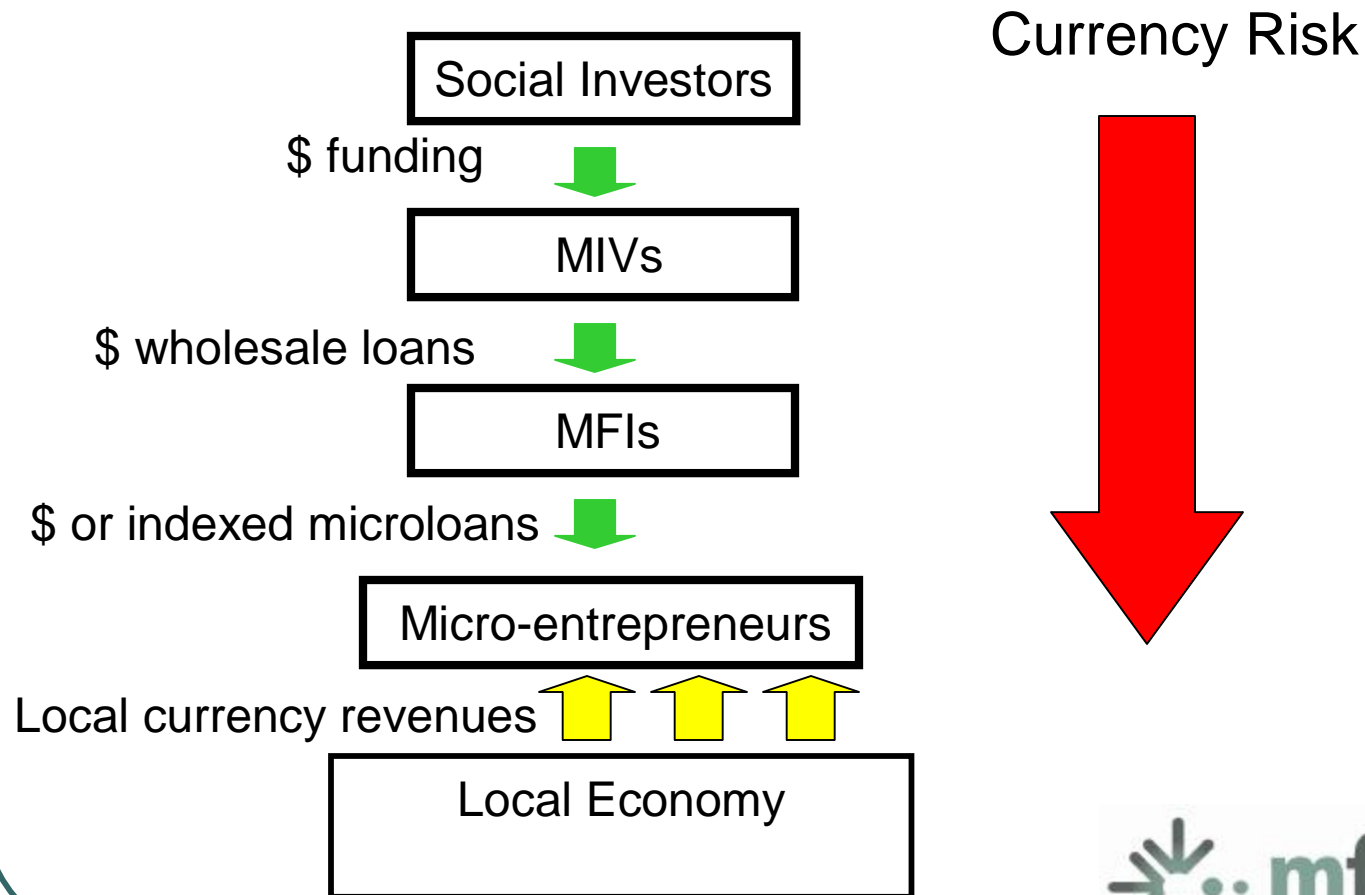
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Brian Cox
Executive Director, MFX Solutions
Currency Risk: An MFI perspective
November 20, 2008

Currency risk is pushed down microfinance value chain



Until the current crisis MFIs generally complacent about currency risk

- Currency mis-match not in the top 10 risks for MFIs in latest CGAP Banana Skins report. (But in the top 3 for investors.)
- Appreciating EM currencies vs. the dollar in last eight years meant MFIs profiting as accidental currency speculators.
- MFIs often unwilling to pay higher interest rates for local currency.



Global financial crisis raises the currency risk burden on MFIs

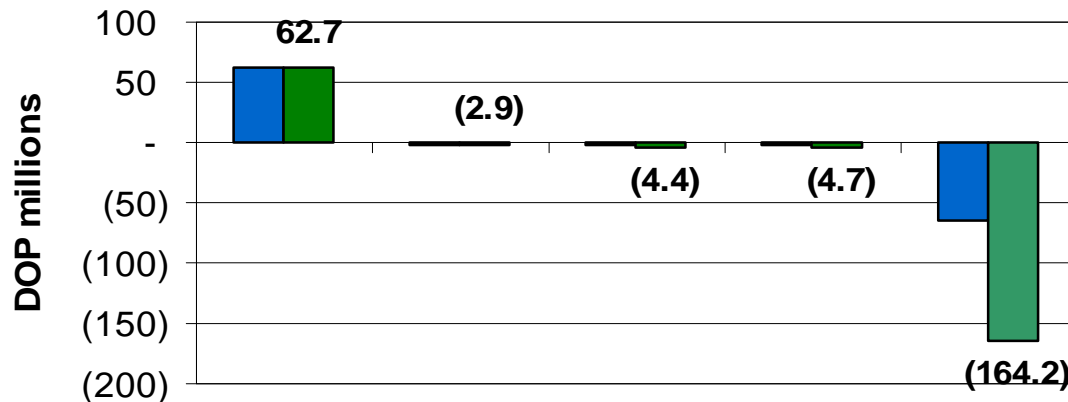
- | Currency devaluations impacting MFI balance sheets.
- | Drying up of local financial market liquidity gives MFIs fewer local currency options, making them more reliant on international lenders.
- | Food crisis, falling commodity prices, climate change, etc. making micro-borrowers more vulnerable to pass-through of currency risk.
- | Given the benign conditions in emerging markets until the current crisis, many MFIs are not ready to deal with currency volatility.



Effect of a currency devaluation on MFI funding

Ex: Dominican Republic 2002-2004

Local currency cash flow on a 2 yr \$ loan (7/1/02-7/1/04)



- Repayment at original exchange rate
- Repayment at actual exchange rate

Interest rate in dollars = 8%
Effective interest rate = 91%

Effect of a currency devaluation on an MFI balance sheet

Ex: Dominican Republic 2002-2004

MFI Balance Sheet*

Before Crisis (7/1/2002)

	Assets	Liabilities	%	
Loans	\$10,000	\$ 3,500	35%	\$ debt
		\$ 4,500	45%	LC funding
		<u>\$ 2,000</u>	20%	equity
		\$ 10,000		

After Crisis (7/1/2004)

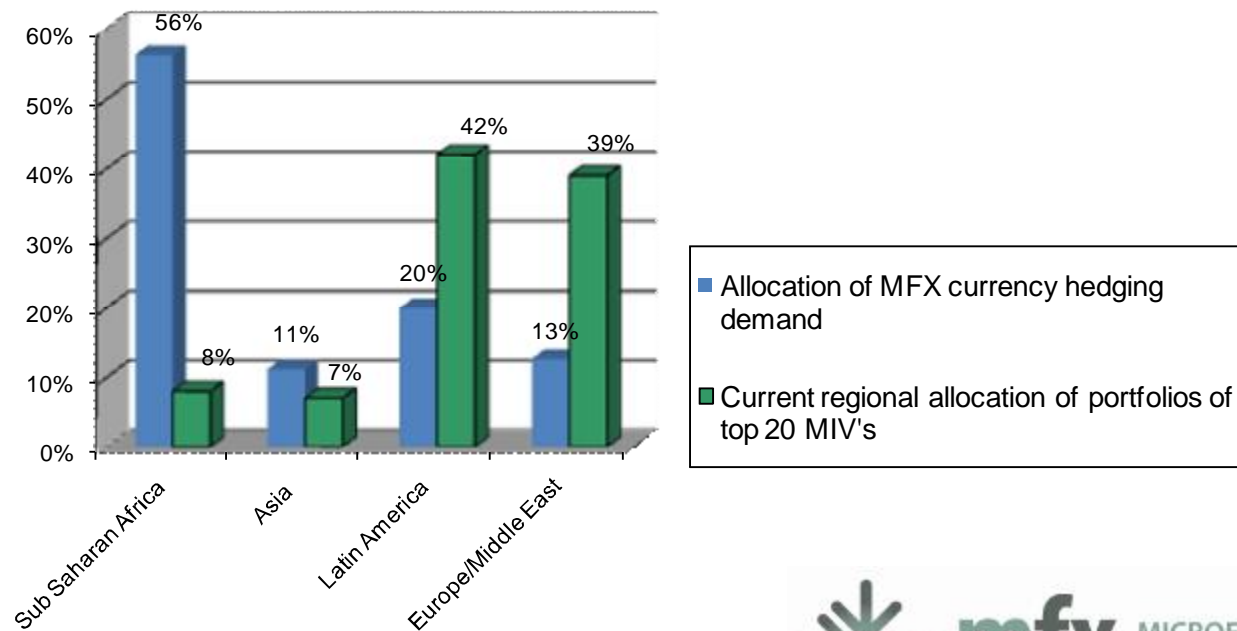
	Assets	Liabilities	%	
Loans	\$ 4,802	\$ 3,500	73%	\$ debt
		\$ 2,572	54%	LC funding
		<u>\$ (1,269)</u>	-26%	equity
		\$ 4,802		

*Assumes 10%/year asset growth and 20% deposit growth



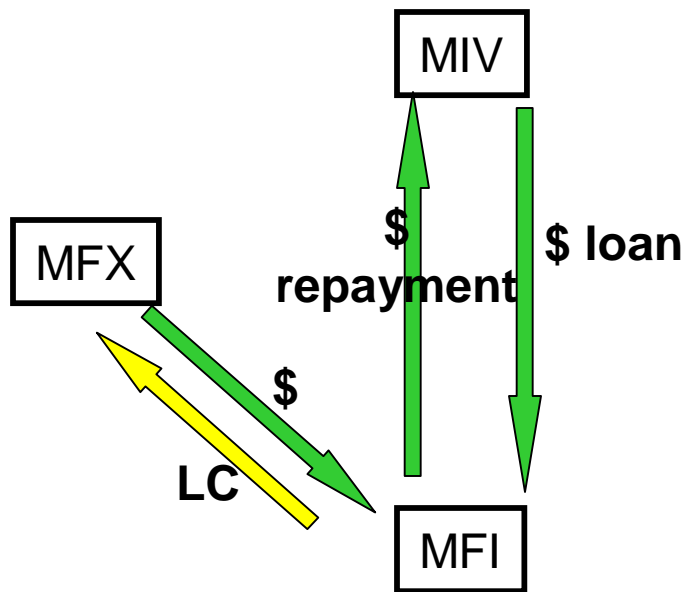
MFIs in Africa are underserved because of currency risk.

MFX's demand survey uncovered strong pent up demand for hedging in Africa if currency risk can be mitigated. Hedging therefore has the potential to fundamentally shift MF lending toward underserved markets.

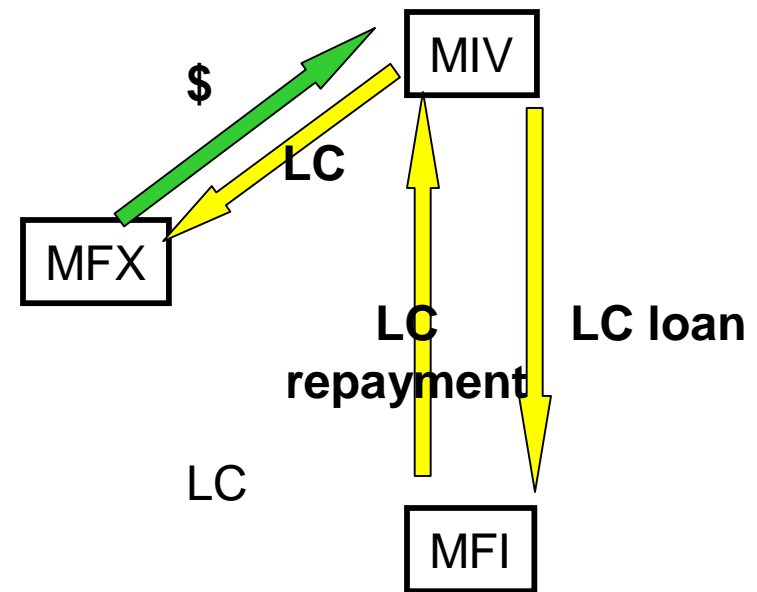


Two ways to help MFIs through hedging

Swap with MFI



Swap with MFI



Helping MFIs bridge the knowledge gap in dealing with currency risk

- Help MFIs quantify their risk using their own balance sheet data.
- Help them model scenarios and compare funding options.
- Help MFIs sell their clients on local currency loans.
- Free access.





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