RESEARCH FINDINGS

Unlocking Capital Efficiency Through Portfolio-Level FX Risk Management

GLOBAL PARTNERSHIPS Dalberg mfx currency risk solutions

Disclaimers

All statements and findings in this white paper are based on analysis conducted by Global Partnerships, in collaboration with Dalberg Capital and MFX Solutions, in 2025 utilizing a specific data set, specified time periods, and selected methodologies. They do not predict future performance or results.

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Executive Summary

Access to appropriately structured capital remains one of the defining constraints on social enterprises serving low-income populations. While the volume of impact-oriented capital has grown, it is not reaching the poorest segments.

The SDG Innovative Finance Initiative (SIFI) and Dutch Entrepreneurial Development Bank (FMO) funded the exploration of innovative approaches to solving these challenges.

Research conducted by Global Partnerships, in collaboration with Dalberg Capital and MFX Solutions, examined a central structural barrier: foreign exchange (FX) risk and the way it is managed.

Drawing on analysis of real and simulated transactions across a ten-year period (2015–2025), the findings suggest that prevailing approaches to FX risk introduce avoidable inefficiencies that constrain both capital flows and enterprise growth.

This paper highlights a different approach. FX risk is not simply a cost to be hedged away. Rather, it is a portfolio-level variable that can be managed with discipline.

When addressed in this way, it becomes possible to improve capital efficiency, expand access to local currency financing, and potentially strengthen risk-adjusted performance.

The Structural Challenge: Capital That Does Not Fit

Across emerging markets, capital is available, but often not in forms that align with the realities of social enterprises serving people in poverty.

Three structural dynamics define the problem:

→ **CAPITAL REACHES FAR, BUT NOT DEEP.**
Impact financing has grown in aggregate, yet smaller enterprises serving lower-income, rural, and female clients remain underfunded.

→ **CURRENCY MISMATCH IS EMBEDDED IN THE SYSTEM.**
A large share of impact financing is denominated in hard currency, while revenues are earned in local currency. This introduces persistent FX exposure at the enterprise level.

→ **EXISTING SOLUTIONS IMPOSE TRADE-OFFS.**
Fully hedged structures reduce FX risk but increase cost. Unhedged structures reduce cost but concentrate risk. Neither approach, at scale, fully resolves the constraint.

As a result, capital is too expensive, too short-term, and/or too misaligned to support sustained, inclusive growth.

> *A majority (65–85%)[1] of development finance to microfinance institutions is denominated in hard currency, while hedging to eliminate potential currency mismatch can add an average of ~7%[2] in additional cost.*

1“The development impact of local currency solutions.” TCX and Carnegie Consult, 2017. https://www.tcxfund.com/wp-content/uploads/2017/10/Impact-report-TCX-10Y.pdf

2 “Women and Equitable Growth in a Resource-constrained World.” Bill and Melinda Gates Foundation, 2024. https://docs.gatesfoundation.org/documents/bill_and_melinda_gates_foundation_women_and_equitable_growth_unleashing_capital.pdf

Research Approach

The analysis integrated empirical data and forward-looking modeling to understand how FX risk behaves within a portfolio context.

DATA ANALYZED

- 400+ transactions by Global Partnerships Social Investment Fund 6.0
- With social enterprise investees in 18+ currencies
- Over a ten-year period with remarkable global volatility (2015–2025)

METHODS USED

- Principal Component Analysis (PCA) to assess FX drivers
- Conditional Value at Risk (CVaR) to evaluate downside exposure
- Portfolio simulations across macroeconomic stress scenarios
- Credit modeling to isolate FX-driven default risk

The objective was not to predict currency movements, but to understand how FX risk could be better structured, absorbed, and strategically managed.

What the Analysis Showed[3]

1. FX RISK IS MISPRICED WHEN MANAGED LOAN-BY-LOAN

Hedging loans individually is a common practice. While it protects lenders from variance in currency exchange rates, it often overstates the likelihood for depreciation (raising costs) and understates the potential for appreciation (which could offset losses).

In practice, this leads to:

- Higher borrowing costs for enterprises
- Reduced capital efficiency for investors
- Limited scalability of local currency lending

3 All statements and conclusions are limited to the findings from the analyses performed on a specific data set analyzed for selected time periods and do not predict future performance or results. Outcomes of analysis, and conclusions reached, may differ materially with different data sets, different time periods, different assumptions with respect to hypothetical future events, and/or different analytical approaches.

At the same time, FX risk does not behave independently across loans. It accumulates and interacts across a portfolio.

Insight: When every loan is fully hedged, it adds excessive cost as it doesn't account for the potential positive outcomes in some portfolio currencies that can offset losses in others.

2. DIVERSIFICATION REDUCES OVERALL RISK

FX movements are not driven by a single global factor. They are shaped by multiple time-varying drivers, which can have different effects across currencies.

This has important implications:

- Depreciation in one currency is often offset by stability or appreciation in others
- Regional diversification reduces concentration of risk
- Scale and disciplined construction determine whether diversification is effective

Insight: A diversified portfolio behaves differently than any single loan: risks begin to offset rather than accumulate.

Analysis across 18 currencies showed that diversified, regionally balanced portfolios can materially reduce exposure to extreme FX outcomes.

3. HIGHER LOCAL INTEREST RATES ABSORB FX VOLATILITY

Loans in emerging market currencies generally carry higher interest rates than dollar loans.[4] This creates structural income that can help offset currency fluctuations at the portfolio level.

4 Interest rates in emerging markets are generally higher than interest rates in more developed markets as they reflect the premium that less developed economies pay to compensate for higher economic and political risk. In emerging and fragile countries, we have observed that: 1) inflation tends to be higher and more volatile; 2) fiscal and external deficits put pressure on local currencies against the USD or Euro; 3) capital markets are shallower, with lower liquidity and higher volatility; 4) less robust institutional frameworks exist.

The analysis found that:

- Higher local rates provided a natural buffer ("carry") in many cases, and a diversified portfolio can offset the occasional cases where carry becomes negative when FX depreciates
- Longer tenors reduced the impact of short-term volatility
- Portfolio outcomes were driven by risk efficiency, not risk elimination

Insight: The additional income from local lending can absorb currency losses, meaning FX risk does not automatically translate into lower returns.

Back-testing indicated local currency portfolios outperformed USD-denominated alternatives, even after accounting for FX depreciation. Forward-looking simulations consistently showed the same.

4. RISK CAN BE MANAGED THROUGH STRUCTURE, NOT AVOIDED ENTIRELY

Effective FX risk management does not depend on full hedging. Instead, it relies on disciplined and diversified portfolio construction and management.

This may include:

- Currency tiering based on volatility, correlation, and macro conditions
- Exposure limits to cap downside risk
- Selective hedging where risk is highest or most difficult to assess

Insight: Thoughtful portfolio design can control risk more efficiently than trying to eliminate it in every transaction. This shifts FX from a transactional cost to a design variable within a portfolio.

5. FX SHOCKS ARE NOT A PRIMARY DRIVER OF CREDIT RISK

A central concern is whether FX volatility increases default risk. The analysis found limited evidence that it does.

Key findings include:

- Credit losses in local currency portfolios were minimal (~0.1% of deployed capital in simulations)
- USD-denominated portfolios exhibited higher credit losses than local currency portfolios, due to currency mismatch
- Borrowers' business fundamentals, more than local currency exposure, drove default outcomes

Historical data reinforces this conclusion. Periods of significant currency depreciation did not correspond to increased default rates during the ten-year period analyzed.

Insight: Currency movements may affect borrowers at the margins, but they are rarely the reason social enterprises fail.

Simulated USD-only portfolios showed higher credit losses (~1.0%) compared to local currency portfolios with reduced mismatch (~0.1%).

Implications

The implications extend beyond FX management. They point to a broader reconsideration of how capital is structured for impact.

FROM HEDGING → STRUCTURING

Risk can be reduced through disciplined and diversified portfolio construction and management, not only through financial instruments like hedging individual transactions.

FROM COST MINIMIZATION → EFFICIENCY

The objective shifts from eliminating risk at any cost to managing it efficiently. For example, through setting proper limits on currency exposure and drawdowns, holding local currencies over time, and properly evaluating the best currencies to work in from both risk and return standpoints.

FROM CONSTRAINT → CATALYST

When FX is managed at the portfolio level with operational discipline, local currency lending rates come down and lending becomes more scalable, driven by improved economics that can crowd in more aligned capital and enable it to reach underserved segments.

This creates a practical pathway to increase both reach and effectiveness without departing from disciplined risk management.

Conclusion

The persistence of poverty and financial exclusion reflects not only a shortage of capital, but a misalignment in how capital is structured.

FX risk has long been treated as an external constraint; something to hedge, transfer, or avoid.

This research suggests a more constructive approach: to manage it deliberately, at the portfolio level, with discipline and transparency.

Doing so could reduce inefficiencies, strengthen resilience, and expand access to appropriately structured financing.

The opportunity is not to remove risk, but to manage it in ways that better align capital with the social enterprises—and their clients—it is intended to serve.

Global Partnerships (GP) is an impact-first fund manager dedicated to expanding opportunity for people living in poverty. It blends philanthropic and investment capital to help social enterprises scale products and services that meet the needs of people living on dollars a day. GP has 20 years of impact-first investing experience, 15 of which have involved local currency transactions.

Dalberg is a global group that for over 25 years has existed to serve those who serve the world. Dalberg Capital, the firm's capital advisory practice, accelerates the deployment of impact capital across the full investment lifecycle—from investment research, fund design, and blended finance structuring to transaction advisory, impact measurement and management, and post-investment value creation. The practice has advised DFIs, asset owners, foundations, and investment managers across Latin America, Africa, Asia, and beyond on innovative financing approaches, including local currency instruments, sustainable capital markets development, and results-based financing mechanisms.

MFX is a socially oriented provider of currency risk management services for impact investors and borrowers. MFX provides accessible currency hedging instruments in nearly all emerging and frontier markets as well as education on currency risk strategy. In the last 15 years, MFX has worked with hundreds of impact clients to protect over $8 billion of impact loans from FX loss in over 60 currencies.