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Currency fluctuations: How the Global Fund and PRs manage risk

Currency fluctuations are a major concern for Global Fund stakeholders, particularly recipient countries whose domestic currency can experience significant shifts over relatively short periods of time. The strength of both the US dollar and the Euro in recent years has further exacerbated this issue for many countries. However, a significant portion of Global Fund grant monies are managed in ways that limit their vulnerability to such local shifts, thereby protecting grants from major losses due to unfavorable foreign exchange rates. In this article we describe some of the strategies used by the Fund and its country-level partners to mitigate this risk.

The risk

The primary risk associated with currency fluctuations in a Global Fund context is related to devaluation of local currency, which decreases the quantities of products and services a fixed grant amount (in USD or EUR) could purchase. In the absence of mitigation measures, this could wreak havoc on the achievement of impact objectives for many countries and for the Fund overall. For example, say Country X was given a grant by the Fund totaling $150 million, which at the time of grant-signing equaled 450 million in the local currency. If, after grant-signing, the local currency were devalued by 20%, the new grant total in local currency would have the purchasing power of only $120 million, a major setback.

The mitigation

Pooled Procurement

A number of measures are taken by the Global Fund Secretariat and country-level principal recipients (PRs) to mitigate the potential risks of currency fluctuations. The most important such measure is pooled procurement of commodities. For many commodity-heavy grants, such as those in Mozambique and

Malawi, more than 80% of grant funds are used to procure commodities including ARVs, antimalarials, bed nets, diagnostic tools. With regard to grant budgets for commodities that are eligible for pooled procurement, the Global Fund actually does not disburse the funds to the PR, but rather withholds them and makes the purchase directly, in order to benefit from lower pooled procurement prices. In effect, the vast majority of commodity-heavy grant funds will never be converted to local currency, because they will be used to purchase commodities priced in USD or EUR. This protects the funds both from variability in currency exchange rates, as well as potential graft or misuse in-country. Furthermore, the massive purchase-power of the Pooled Procurement Mechanism (PPM) —$1 billion in 2017—allows participating countries to access commodities at the most competitive prices.

According to Mozambique Fund Portfolio Manager Dr. Kirsi Viisainen, local currency fluctuations have "little or no impact on procurements of health commodities and equipment". For Mozambique's grants, medicines and health equipment are procured with USD, directly by the Global Fund Secretariat, through the PPM (managed by the Fund) and the Global Drug Facility (for TB medicines; externally managed). These purchases account for 84% of the Mozambique grant portfolio, according to Dr. Viisainen, thereby limiting any major impacts to the grant due to fluctuations in Mozambique's currency, the Metical.

In addition to pooled procurement, Mozambique engages UNOPS as a procurement agent to manage some large-scale vehicle procurements. In these cases, payments are made directly from the Global Fund Secretariat to UNOPS in USD, further limiting exposure to Metical variability.

Dual accounts and precision disbursements

The majority of Global Fund grants are issued in US dollars, which affords the Fund itself some stability in financial projections. Most of the commodity purchases are transacted in USD as well, often directly by the Global Fund Secretariat. However, even for the portion of grants that is transferred to PRs at country level, much of it remains in dollars. It is common practice for PRs—most often governments—to maintain two bank accounts for Global Fund purposes: one in USD (or EUR in some cases) and one in local currency. International tenders are paid from the USD account whereas domestic tenders are paid from local currency account. And disbursements are typically held in the USD account until they need to be paid out in local currency, at which point they are converted.

Malawi manages these risks in a similar way to Mozambique. For the four grants to Malawi that ended in 2017, which totaled $350 million, about $284 million was deducted directly by the Secretariat in USD for pooled procurement purchases. According to Malawi FPM Musoke Sempala, further measures taken include "planned quarterly disbursements", also known as cash releases, which are based on need, or "utilization rate". These two measures seek to restrict the amount of cash that flows from the Fund to the country, keeping the funding flow to only what is needed on a quarterly basis so as to avoid the stockpiling of cash in-country, in order to reduce exposure to currency fluctuations.

Dual currency budgeting and 200-day averages

For many recipients, the process of mitigating currency-related risk begins in the budgeting stage. The Global Fund Budgeting Guidelines provide recommendations on the budget preparation currency (section 2.3.2) and application of exchange and inflation rates (section 2.3.3). As budgets are built they tend to consider which expenses will be incurred in USD (i.e. commodities and international tenders) and which will be incurred in local currency (e.g. salaries, local goods and services). This not only facilitates a more accurate budgeting process, but also protects the grant against changes in local currency value.

Azerbaijan is one example of a recipient country that has experienced significant devaluation of itsnational currency, the manat or AZN, in recent years. Currency devaluation was offset by inflation locally,to the tune of 12.4% in 2016 and 9% in 2017.

When the Azerbaijani CCM prepares its budget for a funding request, locally-incurred transactions such as salaries and other in-country expenses are initially budgeted in AZN and then converted to USD. But they are not simply converted based on the exchange rate on a given date. Based on the Global Fund's Budgeting Guidelines, during grant-making Azerbaijan used a "200-day exponential moving average" as a foreign exchange rate for budgeting purposes. The 200-day average is a process by which the exchange rate between local currency and USD is viewed over the preceding 200 days, and then an average rate is determined, which is then used for budgeting. Azerbaijan's Fund Portfolio Manager, Olga Avdeeva, noted that as per the Budgeting Guidelines countries have some flexibility to update their exponential moving average during a grant if, a) an important event takes places which results in lasting changes in the exchange rate, such as a managed devaluation of the currency, or b) short-term currency volatility increases, i.e. an increase of more than ten percent.

The mitigation measures discussed in this article are some of the steps taken by the Fund and others to protect against losses due to currency fluctuations, but these are not exhaustive. In addition, each CCM and Global Fund country team makes analyses of their specific context to determine the right mix of protections.

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