Which Currencies to Borrow in?

Follow-up Q&A

18 May 2026

TBC Group Chief Economist Office

We've received quite a few follow-up questions regarding our [March one-pager] summarizing which currencies businesses should borrow in. This can mean one of two things: we either did a good job – or a terrible one. We hope it's the former. If it's the latter, well, we did warn at the outset that we are not particularly fond of one-pagers. Shota Rustaveli, author of the Georgian national epic *The Knight in the Panther's Skin*, has an often-quoted line: "in few words he utters a long discourse: herein lies the excellence of poetry". Then again, Rustaveli also wrote that "those are not called poets who cannot compose a long work". We try to adhere to both. In any case, we're always glad to hear from readers, and we'll take up some of the questions here.

Before jumping into the Q&A, we'd like to emphasize once again that the exchange-rate business strategy, at its core, is a strategy – not by name, but by substance. A strategy is not a plan, even if the two are often conflated in practice. A plan is a sequence of actions; a strategy is a set of choices, including what not to do. As Roger Martin put it, "if the opposite of your strategy sounds stupid, you don't have one". Because real strategies involve real choices, much depends on each business's risk appetite and individual profile. The core value proposition, however, holds: increasing profitability and reducing risk through a synthesis of company-level (micro) and economy-level (macro) analysis.

The questions selected for the Q&A in this note:

- In May 2014, when USD/GEL was at 1.76, the recommended GEL share in borrowing was 44.1%. In March 2026, with USD/GEL 55% higher at 2.72, the recommended share is basically the same at 44.2%. How come?
- As of March 2026, the EUR/USD has appreciated to 1.16 from 1.10 in May 2023. However, the recommended EUR borrowing share has increased only marginally. If one looks at the EUR share in FX borrowing, it has actually declined. How does this fit the methodology?
- What were the selection criteria behind the illustrated episodes in the table?
- How is the GEL 6.3 billion gain calculated?
- Potential gains sound great. However, has the framework actually been used in practice?
- What is implied by the mean reversion-style strategy? What is the mean?
- My project has a shorter-term duration, around 2 years. Does the framework still apply?
- Will the tables be updated regularly? Could they be tailored?
- Is the framework relevant only for Georgia or could it be used in other countries?

Q: In May 2014, when USD/GEL was at 1.76, the recommended GEL share in borrowing was 44.1%. In March 2026, with USD/GEL 55% higher at 2.72, the recommended share is basically the same at 44.2%. How come?

A: The bilateral USD/GEL rate is only one input. What actually drives our recommendation is how far the GEL sits from its long-run equilibrium in effective terms, as well as our broader outlook.

At the end of each month, we estimate an equilibrium USD/GEL level, drawing on both global and local macroeconomic conditions. This gives us an opportunity to assess whether the GEL is currently overvalued or undervalued against the USD. That said, while the greenback is certainly important, it's not the only currency that matters for the GEL – indeed, perhaps not even the most important one.

For this reason, we also use the effective exchange rate – the GEL against a basket of partner currencies, weighted by their respective shares in net foreign currency inflows in Georgia. This lets us examine longer-term trends rather than short-term, news-driven dynamics, while also capturing the passthrough of various currencies. Suppose the TRY depreciates significantly against the USD, whereas the USD/GEL exchange rate is unchanged. The effective exchange rate could then become overvalued, i.e. the GEL could become overly expensive, implying depreciation pressures that would go unnoticed if one only focuses on the USD/GEL.

Final recommendations also incorporate our expert judgment on the outlook. The 2000s commodity boom, for instance, raised the probability of a subsequent bust and USD appreciation that eventually materialized in 2014-2015, making borrowing in the GEL – and the EUR – more attractive at the time.

Today, our medium-term GEL outlook is tilted bearish due to the expected reversal – at least to some extent – of post-2022 inflows whenever the Russia-Ukraine war is resolved. This illustrates how multiple overlays feed into the final magic number: while the GEL is currently undervalued in both bilateral and effective terms – which in isolation would imply borrowing less in the GEL – the outlook pulls in the opposite direction. In short: it's complicated, but it works.

Recommended borrowing structure, selected episodes
Mean reversion-style strategy mainly for project financing
For illustrative purposes, other than for exporters

BUY LOW, SELL HIGH*	May-2014	April-2021	October-2022	May-2023	24-March-2026
USD/GEL	1.76	3.45	2.80	2.48	2.72
EUR/USD	1.39	1.21	0.97	1.10	1.16
GEL Share (%)	44.1	18.3	40.4	53.3	44.2
EUR Share (%)	53.3	44.1	9.2	15.1	17.7
USD Share (%)	9.6	37.6	50.4	31.6	38.1

Q: As of March 2026, the EUR/USD has appreciated to 1.16 from 1.10 in May 2023. However, the recommended EUR borrowing share has increased only marginally. If one looks at the EUR share in FX borrowing, it has actually declined. How does this fit the methodology?

A: Thanks for this question – the reasoning is entirely in line with the framework. The EUR is undervalued against the USD. EUR appreciation reduces this misalignment; all else equal, that lowers the probability of further EUR appreciation, which in turn raises the implied EUR borrowing share. Yet, the recommended share is 17.7%, only slightly up from 15.1%. If we compare the EUR share in recommended FX borrowing, it is indeed lower: 31.7% in March 2026 as opposed to 32.3% in May 2023.

There is only one thing missing in this sequence: the outlook. As touched upon in the answer to the previous question, the Russia-Ukraine war resolution scenario looms large in our analysis, even if the timeline and terms are highly uncertain. Therefore, the "all else equal" above doesn't really hold. Even though the EUR is currently closer to its equilibrium value – EUR/USD 1.29 by our estimates – than it was in 2023, we expect it to appreciate strongly toward the equilibrium once the war ends.

Note that the EUR share in total borrowing and FX borrowing can move in opposite directions: though the absolute EUR share has risen, the GEL share has fallen between 2023 and 2026, increasing the FX slice of the borrowing pie. In May 2023, the GEL was highly overvalued, both against the USD and in effective terms. Since this implied a high probability of GEL depreciation, the GEL share in borrowing exceeded half at 53.3%. In 2026, even though our GEL outlook is tilted bearish, the misalignment has both narrowed and reversed in sign.

So we now have multiple forces tugging on the EUR share. Higher FX borrowing mechanically translates into a higher absolute EUR share. The EUR's current undervaluation, which is smaller than in 2023, pushes in the same direction. But the expected post-war appreciation pulls the other way, which is why the EUR share within FX borrowing has actually edged down even as the absolute share has risen.

Another argument for a relatively higher USD share concerns the weakening of the greenback's safe-haven status. Historically, the USD appreciated during times of stress, which made it less attractive for borrowing – after all, it is not ideal to borrow in a currency that strengthens when sales and profitability are down. However, lately we have been highlighting the gradual erosion of the USD safe-haven status, with the USD outlook bearish over the medium term. All other things equal, this implies a higher USD share in FX borrowing.

Q: What were the selection criteria behind the illustrated episodes in the table?

A: The March one is straightforward – it reflects the recommended structure as of the date of the publication. We chose the other four to illustrate how the framework adjusts across different extremes:

- May 2014 – significantly overvalued EUR, slightly undervalued GEL;
- April 2021 – grossly undervalued GEL, broadly neutral EUR;
- October 2022 – extremely undervalued EUR, broadly neutral GEL;
- May 2023 – substantially overvalued GEL, undervalued EUR.

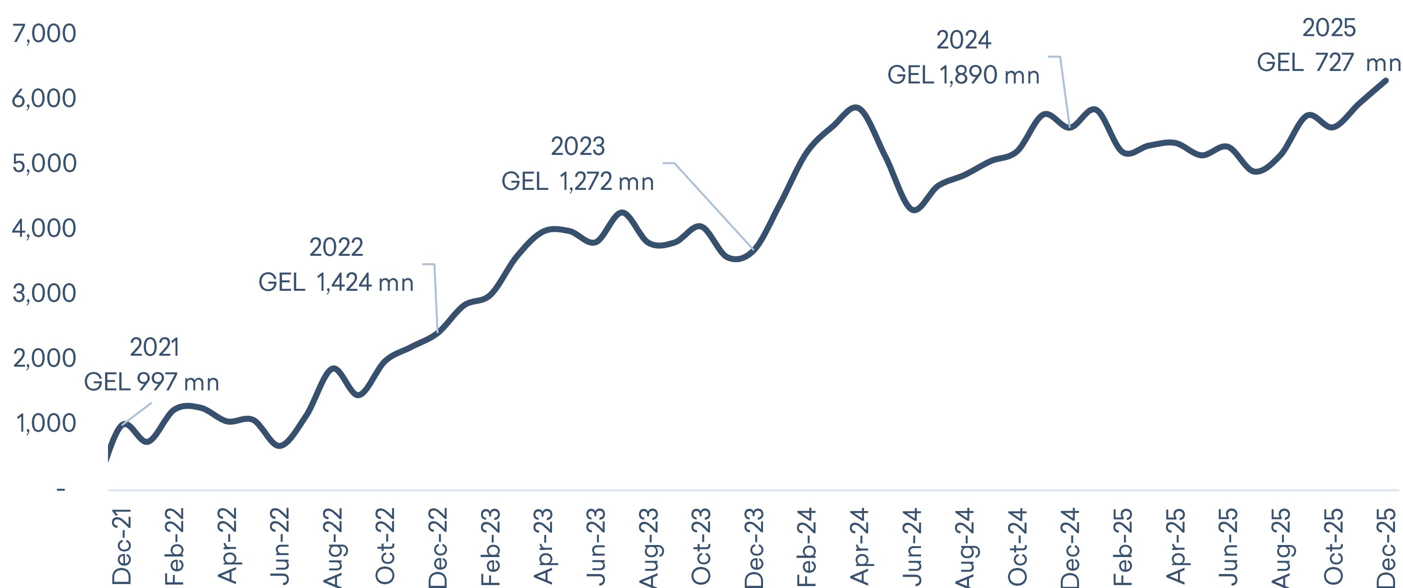
The general principle is that during episodes of strong overvaluation, the recommended borrowing share rises – all else equal, the probability of depreciation is higher. Conversely, during sizeable undervaluation episodes, the recommended shares shrink – sometimes to single digits, as the table illustrates – since the currency is expected to strengthen toward equilibrium. Final recommendations also incorporate judgment regarding the outlook, alongside a range of other factors detailed in the one-pager.

Q: How is the GEL 6.3 billion gain calculated?

A: To calculate the GEL 6.3 billion gain since 2021, we compare the actual credit portfolio in the Georgian corporate sector to the hypothetical portfolio that follows our framework, adjusting GEL/EUR/USD weights – but only to a reasonable extent. Don't worry, we don't require businesses to act like hedge funds. If they did, potential gains would be much greater.

To put things in perspective, the average credit stock in the Georgian corporate sector was GEL 16.9 billion-equivalent over the same 5-year period. As we like to joke with businesses, this goes some way to indicate who's actually – pun intended – on the money.

THE FRAMEWORK HAS GENERATED ENORMOUS VALUE OVER THE PAST YEARS*



*Potential gain compared to the actual portfolio calculated only from the last step of the framework – currency misalignment estimates. Calculations incorporate the existing trends on the market and only real-time information at any given moment. See here for more details.

Q: Potential gains sound great. However, has the framework actually been used in practice?

A: In general, frameworks like this don't go viral overnight – fitting, given their very design. Even so, happy to say that it has been gaining significant traction, and we already have several success cases – as well as a small collection of told-you-so moments. Backtesting, though essential, is of course no guarantee for the future. This is why we'd like to once again thank our partners for fruitful cooperation. We continue to meet with stakeholders – not just businesses, but also IFIs, rating agencies, banks, central banks and financial sector regulators – with the goal of further promoting and integrating the principles of this approach in multicurrency economies. The catch? When implemented correctly, all parties are better off – a rather rare case of Pareto improvement for those familiar with the topic.

Q: What is implied by the mean reversion-style strategy? What is the mean?

A: The idea behind leveraging on currency misalignment estimates is that there exists an equilibrium value toward which exchange rates converge over the medium-to-long run. In the near term, the spot rate might be different from the equilibrium due to news, exogenous shocks, sentiment shifts, or other factors. This is why exchange rates are notoriously volatile and difficult to predict over short horizons. On the other hand, the existence of a longer-run equilibrium value provides an anchor beyond observed fluctuations, giving researchers an edge for modelling exchange rates.

A useful analogy for understanding this concept is the “drunk man and his dog”, often used in statistics to illustrate cointegration. The drunk man represents a random walk process, moving randomly and unpredictably. The dog, while also moving randomly and independently, is tied to the man with a leash. As a result, while the two may diverge temporarily, they cannot drift apart indefinitely and tend to move back toward one another over time. Cointegration refers to a long-run relationship between two variables, rather than a variable and its long-run trend, but the core idea is the same – there exists an anchor, the proverbial leash, toward which exchange rates tend to converge, however much they diverge along the way.

This is what makes the framework actionable. Persistent undervaluation implies a higher probability of appreciation, all else equal, making it less attractive to borrow in such a currency and more attractive to invest in it. Persistent overvaluation implies the opposite.

The real problem, of course, is how to determine whether a currency is overvalued or undervalued amid all the noise in the data. Our in-house models are designed to do exactly that. In our framework, the mean is not a fixed number but a time-varying equilibrium estimated from structural fundamentals, for both the GEL and EUR/USD.

For the GEL, we estimate a trend for the effective exchange rate, based on productivity differentials between Georgia and its trading partners. For EUR/USD, we construct a purchasing power parity (PPP) estimate adjusted for productivity differentials and fiscal balances. We then compare spot rates to these trends in order to derive the degree of misalignment. This informs our judgement on the likely path of the exchange rates, which then feeds into borrowing recommendations.

The strategy is also akin to the “buy low, sell high” principle, as it aims to uncover the underlying “low” and “high” points and capitalize on this information. A fair counterpoint is that convergence toward equilibrium can take a very long time, and nobody can say for sure when convergence will happen, or what might accelerate or delay it. We fully agree, which is why the strategy is primarily intended for project financing, where investment horizons are longer by design. As Warren Buffett once put it, “the stock market is a device for transferring money from the impatient to the patient”.

Q: My project has a shorter-term duration, around 2 years. Does the framework still apply?

A: Absolutely – it is not only the destination that matters for optimizing borrowing decisions, but also the direction of travel. If one knows the path the exchange rate is likely to follow over time, one can leverage this information even if the convergence is not fully complete by a specific cut-off date.

This is particularly relevant for relatively shorter-term projects, including those around 2 years. While our main focus is on the medium-to-long term, the framework incorporates near-term models that help fill in the path of adjustment, such as the equilibrium USD/GEL estimates described earlier. We believe that understanding the long-run drivers matters even for short-term decisions, and short-run factors matter even when the focus is long-term.

Furthermore, the medium-term guidance specifies the target and the trajectory, and this convergence might happen in two years as easily as in five. The recent EUR appreciation is a good example of this, as the partial correction in sustained undervaluation was triggered relatively abruptly due to USD-related issues.

BOX: TBC CAPITAL OPTIMAL FUNDING CURRENCY STRUCTURE

1. What would be the optimal liability FX funding composition for the firm to be hedged?
2. Business cyclicality, price elasticity of sales
3. Expenditure – interest rates, currency conversions
4. Currency deviation/variation from equilibrium, or how to apply exchange rate projections

Q: Will the tables be updated regularly? Could they be tailored for our company?

A: Not only could, but most definitely should – and will be. The one-pager only serves as an indicative guide to illustrate the general principles and ideas. We are already working on company-tailored assessments and are open to further cooperation. The bulk of the framework consists of individual, idiosyncratic features, which means the tailored approach is essentially unavoidable. That said, we will continue updating the indicative tables regularly to showcase how the framework adjusts in light of new information and to provide general guidelines for all those interested, evidently rather useful.

Q: Is the framework relevant only for Georgia or could it be used in other countries?

A: The framework is designed for multicurrency economies, of which Georgia is only one example. We have provided examples of multiple sectors across multiple countries that would benefit from this approach, including but not limited to Armenia, Azerbaijan, Chile, Czechia, Egypt, Hungary, Kazakhstan, Moldova, Montenegro, Peru, Russia, South Africa, Turkey, Uganda, Ukraine, Uruguay, Uzbekistan. As one can see, the selection is rather eclectic. The core principle: partially hedged exposure can also partially be in foreign currency. As mentioned earlier, of course, much also depends on the individual business's risk appetite and profile.

The strength of the framework is that it can apply common underlying principles to generate actionable insights across different operating environments. For example, the Georgian and Armenian economies have received substantial boosts due to post-2022 Russia-Ukraine war-related inflows. This translates into a relatively higher optimal share of local currency borrowing over the medium term and a lower EUR share. Why? Because the war resolution scenario implies at least somewhat reversal of these inflows coinciding with a stronger outlook for the EUR and a weaker one for the GEL and the AMD, all other things equal. Compare this to Uzbekistan, which has benefitted significantly less from these inflows, and is thereby less exposed to reverse spillovers going forward. Conversely, for the UZS, the effective exchange rate outlook is of particular importance – and our outlook is tilted bullish, implying a lower share of local-currency borrowing.

That's the most we can fit into a not-quite-one-pager. There are many other topics that we could touch upon:

- how exactly to determine which currency a business is hedged in;
- whether borrowing 100% in local currency could truly be a risk;
- why a larger basket of foreign currencies implies a lower share in GEL borrowing;
- why it might be optimal to borrow in FX even if the underlying price is in GEL;
- whether the passthrough from hedging to FX risk is nonlinear;
- how economic sectors in which businesses operate affect optimal decisions;
- etc.

However, in the spirit of Rustaveli, as cited above, the question is not whether we could, but whether we should. So, we end here for now. As always, we welcome further questions, and look forward to revisiting these themes as the framework evolves.

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