



THE LKA PERSPECTIVE

EUR/USD: When the Currency of Capital and the Currency of the Asset Diverge

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The exposure is not always where you expect it

Currency risk in infrastructure is often discussed in terms of the currency in which a project earns its revenues. That matters, particularly in emerging markets, but it is only part of the picture.

The financing structure itself can create the exposure.

A fund may raise capital in euros, invest into an asset whose revenues are denominated or indexed in US dollars and ultimately return capital and distributions to investors in euros. At project level, local currency can add another layer.

The result is a chain of currency exposures that can remain even where the project appears to have removed much of its local currency risk.

EUR/USD is a useful example because it is deep, liquid and readily hedgeable. That can make the problem look straightforward. In practice, the difficult questions are often not whether the exposure can be hedged, but where it should be hedged, for how long and what happens to the hedge when the investment changes.

A useful market backdrop

EUR/USD is again providing a useful reminder that those questions matter.

On 10 September the ECB raised its three key policy rates by 25 basis points, taking the deposit facility rate to 2.50%. Its September projections put euro-area headline inflation at 3.0% in 2026 and growth at 0.9%.

Six days later the Federal Reserve raised the federal funds target range by 25 basis points to 3.75-4.00%. The Fed's September projections put 2026 GDP growth at 2.3%, PCE inflation at 3.7% and the median appropriate year-end federal funds rate at 4.1%, up from 3.8% in June.

There is plenty in that backdrop from which to construct a view on EUR/USD. For an infrastructure investor, I think there is a more useful question:

What happens if that view is wrong?

The forward curve matters

Spot is only one part of a long-term currency hedge.

At 14:31 UTC on 21 September, FXEmpire showed EUR/USD spot at approximately 1.14734. Its indicative mid forward rates were approximately 1.15169 at three months, 1.15598 at six months, 1.16451 at one year, 1.18170 at two years, 1.19849 at three years and 1.23044 at five years.

Forward pricing principally reflects the relative economics of the two currencies, including interest-rate differentials and the relevant cross-currency basis.

That distinction matters. An investment committee may quite reasonably have no conviction about where EUR/USD will trade in five years. That does not mean it has no EUR/USD risk today.

Tenor	EUR/USD indicative mid
Spot	1.14734
3 months	1.15169
6 months	1.15598

Tenor	EUR/USD indicative mid
1 year	1.16451
2 years	1.18170
3 years	1.19849
5 years	1.23044

Putting the forward curve into money

Consider a fund expecting to receive USD100 million and ultimately needing euros.

At spot of 1.14734, USD100 million is equivalent to approximately EUR87.16 million. At today's indicative one-year forward of 1.16451, it is approximately EUR85.87 million. At three years, using 1.19849, it is approximately EUR83.44 million. At five years, using 1.23044, it is approximately EUR81.27 million.

Conversion date	EUR/USD	EUR received for USD100m
Spot	1.14734	EUR87.16m
1 year	1.16451	EUR85.87m
3 years	1.19849	EUR83.44m
5 years	1.23044	EUR81.27m

The difference between today's spot conversion and the five-year forward conversion is therefore about EUR5.9 million.

That is not a forecast of what the investor will ultimately receive. It illustrates what today's forward market implies for locking in those future conversions.

For a sizeable infrastructure portfolio, these are not rounding errors. Nor does waiting avoid the decision. It leaves the future conversion rate exposed to whatever happens to EUR/USD in the meantime.

The currency of capital can create the exposure

Take a simplified structure in which a fund raises EUR capital and invests through a EUR-denominated shareholder loan into a project whose PPA revenues are USD-denominated or USD-indexed.

The project earns dollars. Its shareholder-loan obligations are euros. Somebody therefore has to sell USD and buy EUR.

The mismatch is no less important because both are major developed-market currencies.

If the shareholder loan is expected to run for ten or fifteen years, the apparent answer might be to hedge the corresponding EUR/USD cash flows for ten or fifteen years.

That removes one risk. It can create another.

The hedge may outlive the investment

Infrastructure assets rarely remain static for the life assumed in the original financial model.

Projects reach COD. Debt is refinanced. Shareholder loans are accelerated. Capital structures change. Investors sell interests. Assets move between vehicles.

A ten-year FX hedge entered into today does not disappear because the underlying investment is refinanced after three years.

If the exposure has reduced or disappeared, the hedge has to be unwound, novated or applied elsewhere. Depending on the movement in EUR/USD and the forward curve, its mark-to-market value could by then be substantial.

This creates a tension I have encountered repeatedly in infrastructure hedging: the longer the hedge, the greater the certainty over the currency risk - but potentially the greater the mismatch between the hedge and the evolving investment.

The answer is not necessarily to hedge for a shorter period. Rolling short-dated hedges introduces repricing and refinancing risk of its own. The hedge needs to reflect the expected life and behaviour of the exposure, not simply its contractual maturity.

Fund, HoldCo or project?

There is also the question of where the hedge belongs.

At SPV level, the hedge can closely match the underlying project cash flows. But an emerging-market SPV can introduce complications around credit, collateral, capital controls and access to hard currency.

Moving the hedge to HoldCo or fund level can provide greater liquidity and flexibility. An exposure released following a refinancing or asset sale may potentially be offset against another portfolio exposure rather than terminated. The trade-off is that the hedge becomes further removed from the asset generating the cash flows.

There is no universally correct answer. The appropriate location depends on the fund structure, jurisdictions involved, credit arrangements and expected investment lifecycle.

But it should be decided deliberately.

Credit and liquidity are part of the hedge

A long-dated FX forward may have no upfront premium, but that does not make it costless.

A ten-year FX hedge can be very credit intensive. The bank is taking exposure to the future mark-to-market of the transaction over a long period, and the potential exposure can become substantial as both the exchange rate and forward curve move. That credit requirement can affect pricing, available tenor and the amount of hedge capacity a counterparty is prepared to provide.

Depending on the documentation and credit arrangements, adverse mark-to-market movements can also generate collateral requirements. For a project or fund with limited liquidity, the resulting cash requirement can become more important than the accounting value of the hedge itself.

This is one reason why hedge tenor cannot be considered independently of credit. A strategy designed to remove ten years of FX risk may look attractive from a market-risk perspective while consuming a disproportionate amount of credit capacity.

A strategy designed to reduce market risk should not inadvertently create a credit or liquidity problem.

Mandatory breaks can help - but they do not remove market risk

One possible response is a long-dated hedge incorporating a mandatory break.

The currency exposure can be protected beyond the break date, while the hedge counterparty initially provides credit only until that date. This can make particular sense where a refinancing is expected after construction.

But a mandatory break should not be mistaken for eliminating the mark-to-market exposure. At the break date, the market value still exists.

What has principally been shortened is the counterparty's credit commitment, not the underlying market risk. That distinction matters when modelling the consequences of refinancing or disposal.

Options solve a different problem

Options can be particularly useful where the existence, size or timing of the future exposure is uncertain.

A purchased option establishes a worst-case exchange rate while retaining the ability to benefit from a favourable currency movement. If the anticipated transaction disappears, there is no obligation to exchange currencies under the option. The price for that flexibility is the premium.

Forwards may therefore be entirely appropriate for highly certain cash flows, while options can be more appropriate where the exposure is contingent or flexibility has genuine economic value.

The decision should not begin with "forward or option?"

It should begin with: **How certain is the exposure?**

Hedging is not forecasting

This brings me back to EUR/USD today.

There are reasonable arguments for both a stronger dollar and a stronger euro from current levels. Relative monetary policy, inflation, energy prices, fiscal policy, geopolitics and economic growth will all influence the pair.

But a fund with a material EUR/USD mismatch does not need to determine where the exchange rate will be in five years before deciding how to manage the exposure.

It needs to understand the consequences of different outcomes.

The relevant analysis is what happens at 1.05 or 1.25; what an earlier-than-expected refinancing or partial shareholder-loan repayment does to the hedge; whether an adverse mark-to-market creates a material collateral requirement; and where those risks ultimately sit within the investment structure.

Those questions are considerably more useful than trying to predict the next ten cents in EUR/USD.

The currency risk starts before the hedge

Perhaps the most important point is that the date on which a hedge is executed is not necessarily the date on which the economic exposure begins.

Once an investment has been approved on assumptions involving different currencies, changes in those currencies can alter its economics even if the project has not yet reached the point at which management is prepared - or permitted - to hedge.

That period deserves explicit treatment within the investment and hedging framework.

Waiting is itself a risk decision.

The objective is not to eliminate every currency exposure. Nor is it necessarily to hedge every future cash flow from day one.

It is to identify where the currency risk sits, who is carrying it, how much can reasonably be retained and what happens to the hedge when the investment does not follow the original model.

EUR/USD happens to provide a timely illustration.

The principle applies much more widely.

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Sources: European Central Bank, 10 September 2026 monetary policy decision; Federal Reserve, 16 September 2026 FOMC statement and Summary of Economic Projections; FXEmpire EUR/USD forward rates, 21 September 2026, 14:31 UTC.

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