

Forex Risk Management in Imports & Exports

World Textile Conference, Mumbai

September 17, 2016

Agenda

Macros – clear in long term, but what will happen tomorrow??

Risk comes from not knowing what you are doing.

- Warren Buffett

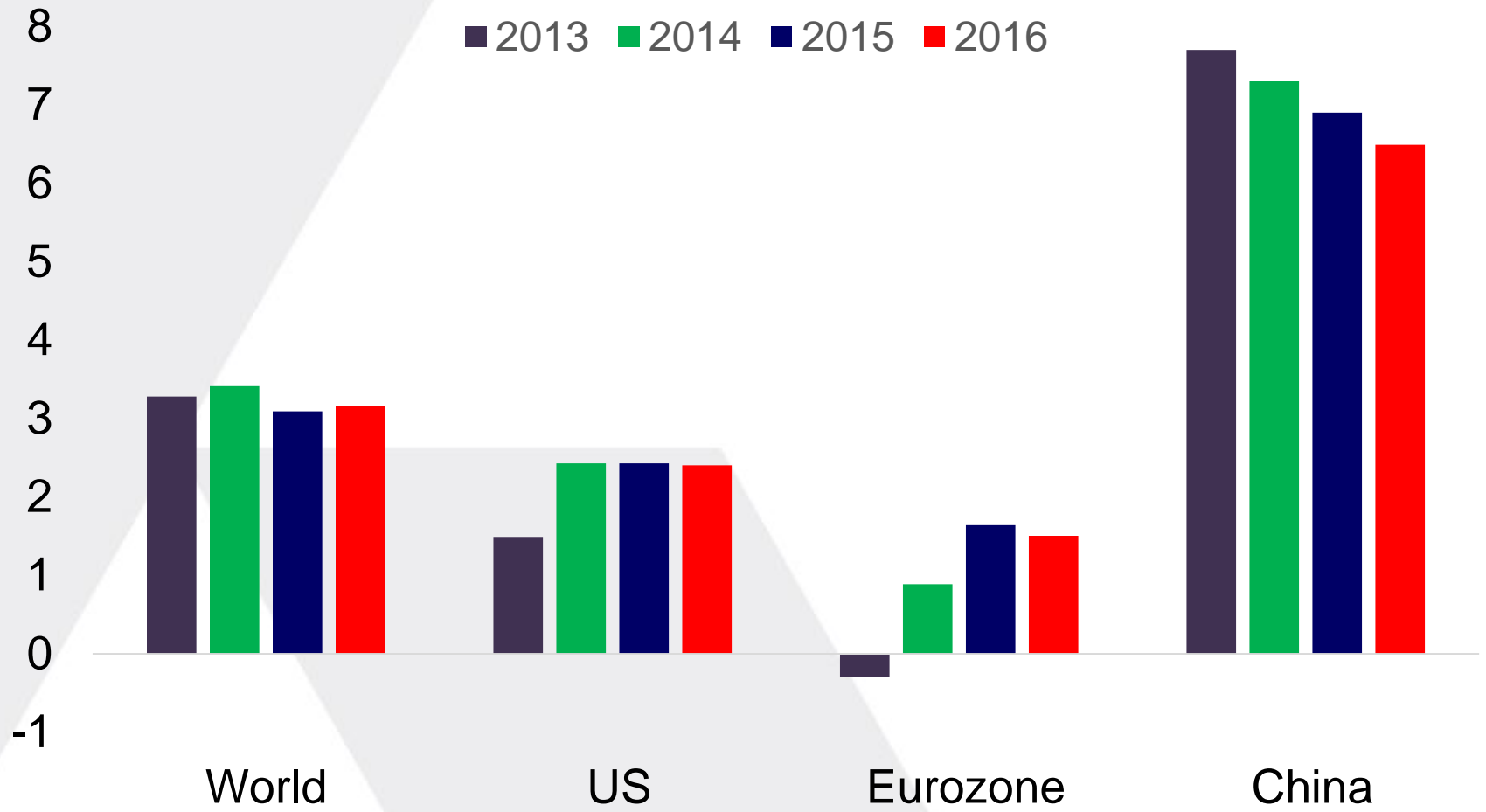
Risk management – tools or mindset?

Macros – clear in the long term, but tomorrow??

- ➡ Developed world seeing anaemic growth rates, debt has crippled the Chinese growth engine
- ➡ India still a shining star (relatively)
- ➡ INR has held on against USD, unlike other emerging market currencies
- ➡ RBI has managed INR value in a band against a basket of currencies (Nominal Effective Exchange Rate – NEER)

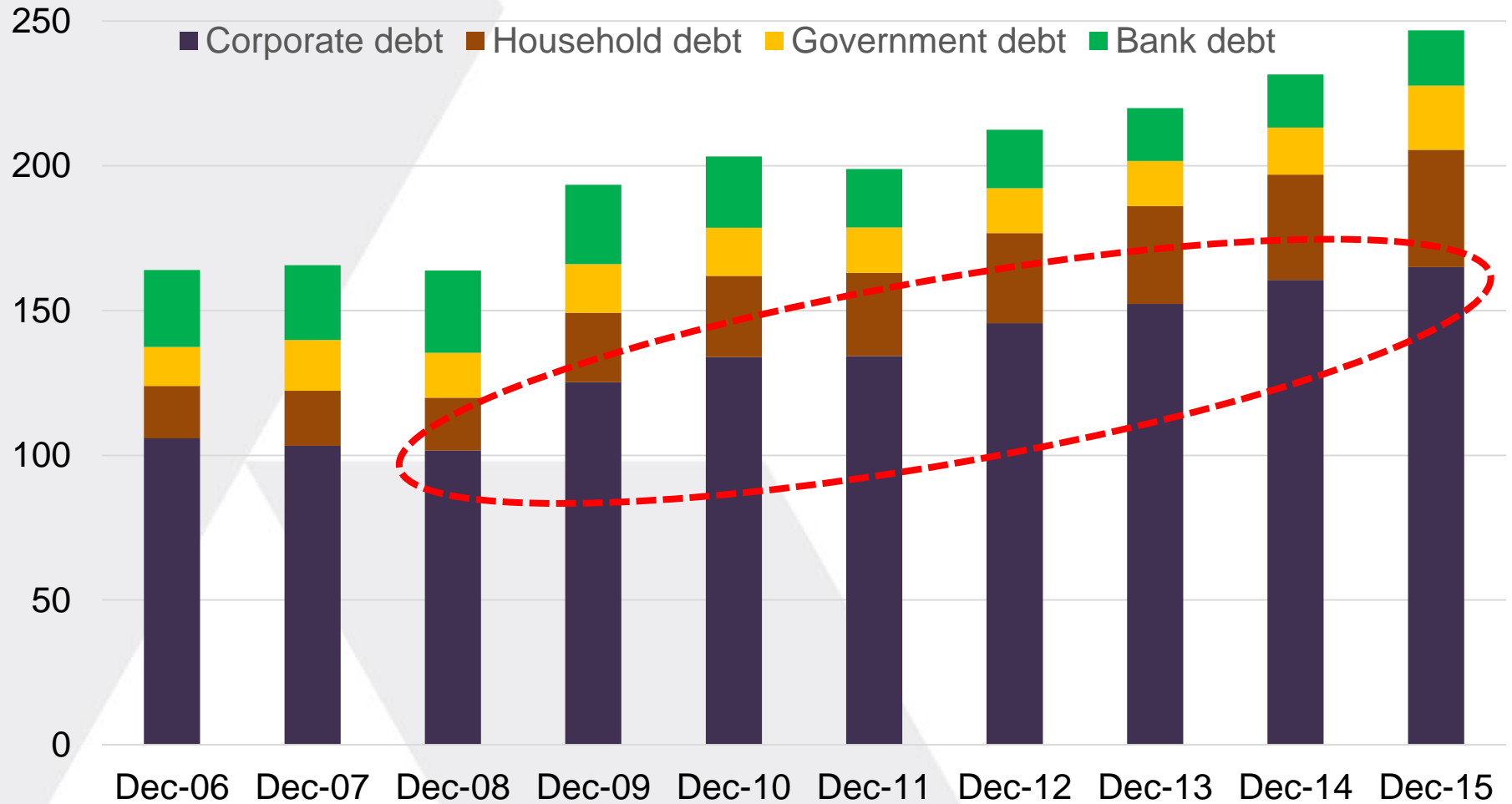
Developed world seeing anaemic growth rates, Chinese growth engine slowing sharply

GDP Growth YoY (%)



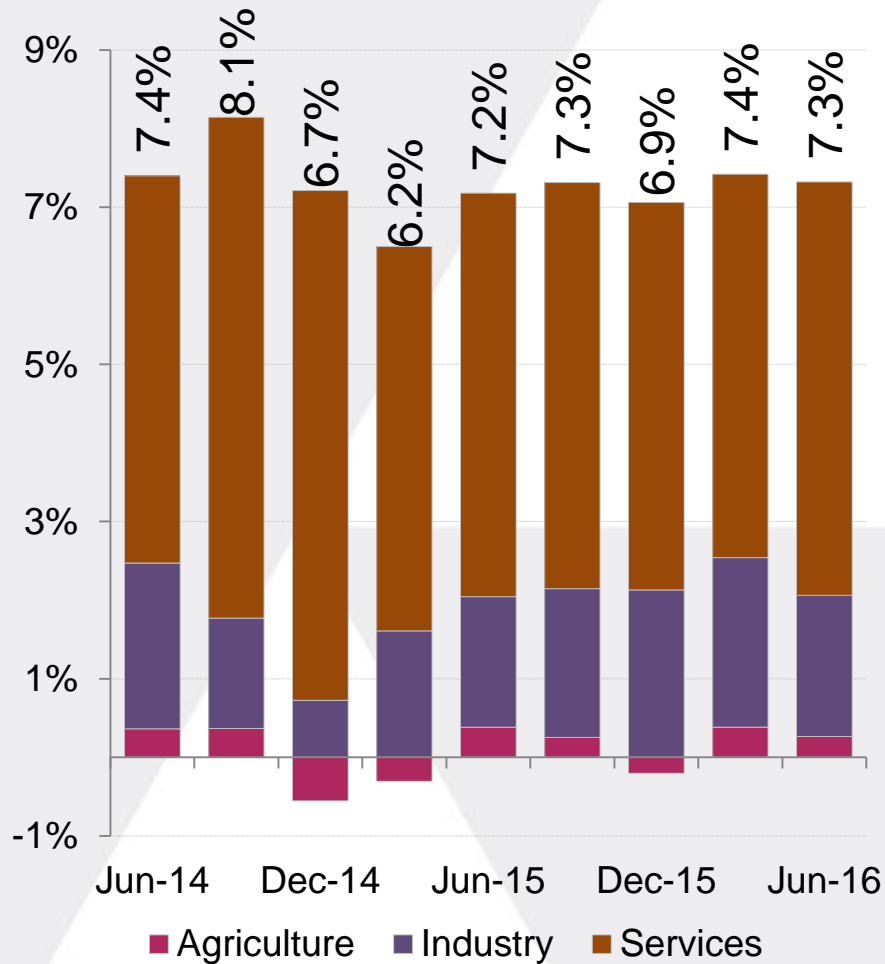
Sharp pickup in China corporate debt

China debt (% of GDP)

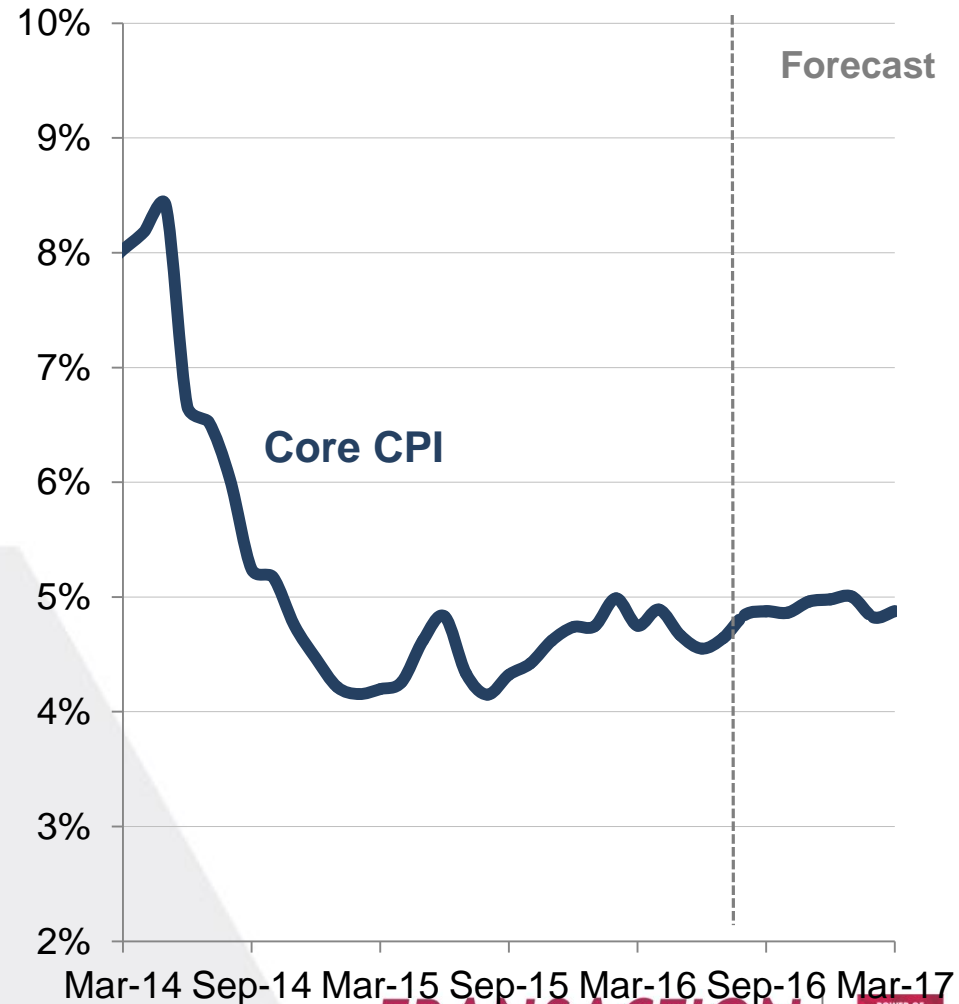


India a shining star: consistent growth rates, moderating inflation

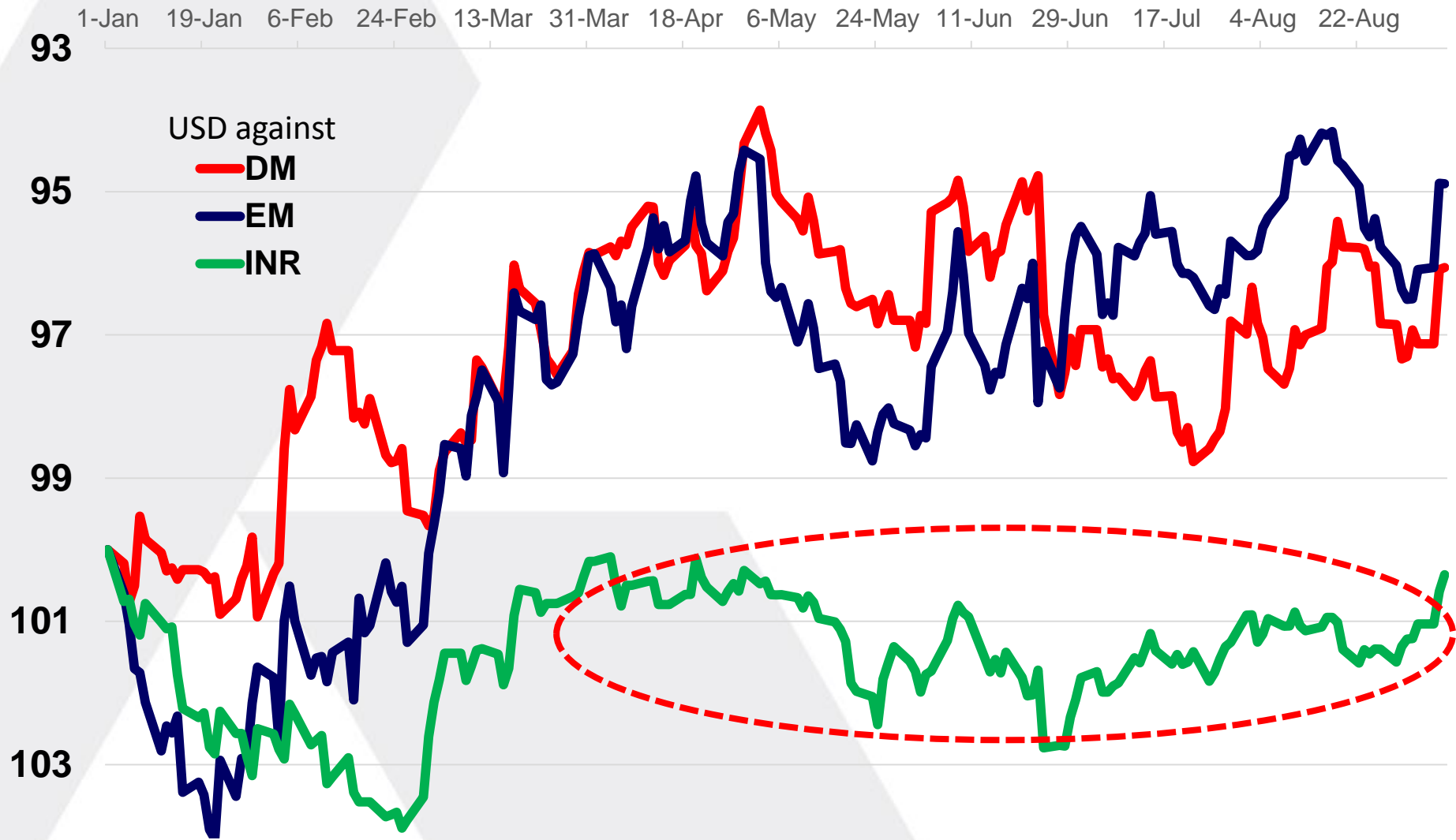
Consistent GDP growth rates



Moderating inflation



INR has held its own against USD



Macros – clear in the long term, **but tomorrow??**

- ➔ How will central banks of developed world react to low growth and diminishing returns of quantitative easing?
 - Since Aug 2014, **Euribor has fallen from -0.2% to -0.4%, ECB's balance sheet has grown by 50%**, but to no effect
- ➔ How will INR react to abrupt capital flows caused by actions of other central banks?
 - **\$ 3 bn FPI inflow** into equities in last 2 months, tenor highly unpredictable
 - Brexit, for example!
- ➔ What if the Fed raises rates and the RBI goes the other way?
 - **60% probability** of rate increase by Fed in 2016, actual rates way below Fed forecast/ intent

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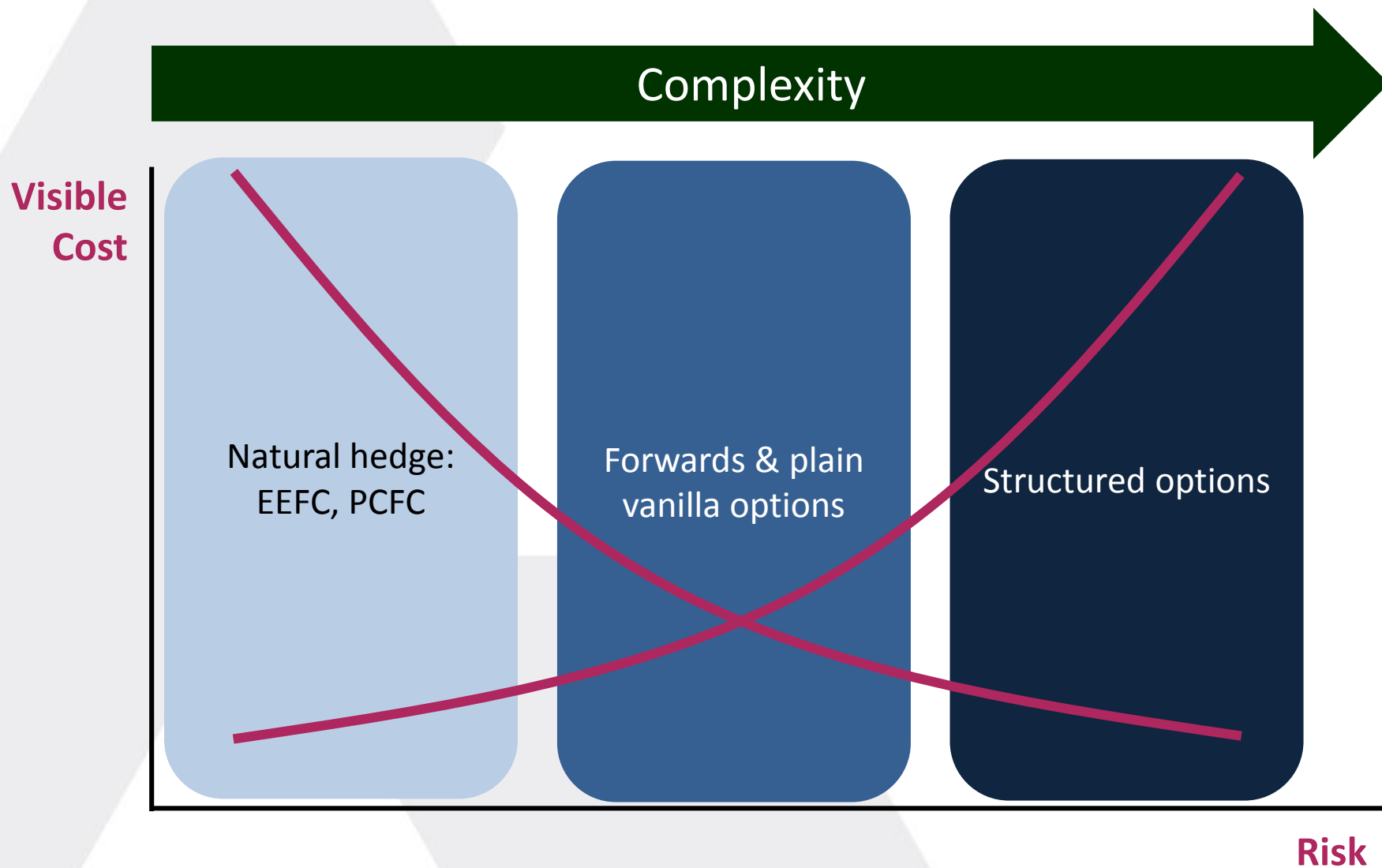
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Risk management – tools or mindset?

When models turn on, brains turn off

- Til Schuermann

Overview of tools for hedging forex risk (1/2)



Overview of tools for hedging forex risk (2/2)

	Modus operandi	Impact	When to use
Natural hedge: EEFC, PCFC	<ul style="list-style-type: none"> • EEFC: FCY a/c for export proceeds & import payments • PCFC: Finance in FCY against exports 	<ul style="list-style-type: none"> • EEFC: Funds are blocked • PCFC: Short-tenor hedged, but long tenor remains open 	<ul style="list-style-type: none"> • Regular, almost daily imports & exports • USD price adjusts to exchange rate
Forwards & plain vanilla options	<ul style="list-style-type: none"> • Forwards: Contract to buy/sell FCY at agreed rate • Option: Option to buy/sell FCY at agreed rate 	<ul style="list-style-type: none"> • Forwards: Rate locked, no transaction charges • Options: Upside available but for premium payment 	<ul style="list-style-type: none"> • Forwards: Almost always!! • Options: Depends on company policy, but works well in high volatility
Structured options	<ul style="list-style-type: none"> • Combination of options to create intended payoff (eg seagull options) 	<ul style="list-style-type: none"> • Reduced/ nil premium • Upside capped, some downside risk 	<ul style="list-style-type: none"> • Depends on company policy, but works well in high volatility

What should be company policy?

- **CFO's role: Deliver budgeted margins, reduce downside risk**

- 100% hedging is the base case!

- **Scale makes some risk affordable**
- Can adopt partial hedging strategy, use structured products
- Capital allocation & internal transfer pricing is a must

- Run **Treasury as a profit centre**
- Balance sheet hedging, eg FCY loans to hedge export receivables
- In addition to capital allocation & internal transfer pricing, tools and skill sets are critical

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Thank You