

## **CHAPTER 11 – Managing Transaction Exposure**

### **US firms cut FX insurance, enjoy weak dollar-survey**

LONDON, April 22, 2008 (REUTERS) - U.S. companies have lowered their shield against unfavorable currency moves while euro zone businesses have stepped up their protection compared with last year as the dollar hits record lows, a survey shows.

The JP Morgan survey suggests U.S. businesses are less keen to pay the premium to hedge -- buying the right to exchange money at a pre-determined rate at a later date, which makes it easier to predict future earnings.

U.S. firms have hedged 63.1% of their 2008 currency exposure and just 6.7% for 2009 as the dollar's nearly 7% fall against a basket of major currencies so far this year makes U.S. export prices more competitive. A year ago, equivalent insurance levels stood at 66.4% and 11.7%, respectively.

JP Morgan surveyed 61 companies with a combined market capitalization of USD 1.28 trillion between March 26 and April 4.

The reduced U.S. protection may in part be explained its rising cost as interest rate differentials move in favor of the euro. A year ago, the U.S. benchmark rate was 150 basis points higher than the European Central Bank's, but now it is 175 basis points lower and set to fall further.

On the flip side, of course, that makes it cheaper for Europe's exporters to hedge their dollar exposure. The survey showed European firms have hedged 70.7% of their FX exposure for this year and 44.7% for next. In March 2007, the comparable figures were 68.5% and 24.8%.

Industry insiders have reported European companies using any dips in EUR/USD in recent months to buy the euro forward.

With the exchange rate denting profits at high profile European automobile and aviation firms, hedging has also become a more visible topic, with some companies facing criticism for not having sufficiently insured their earnings in 2007.

In Japan, the situation is more mixed, with the yen near record lows versus the euro, but at 13-year highs against the dollar. With Japan's interest rates still at just 0.5 percent, Japanese firms remain significantly less hedged than U.S. and European corporates. So far, they have protected only 35.3% of their FX risk for this year and 0.1% for 2009.

### **Questions**

1. Why are U.S. companies speculating more? What does it tell you about FX expectations?
2. Explain why Europe's exporters, with USD exposure, benefit from lower U.S. interest rates. Give an example.
3. Which U.S. companies benefit more from the relative change in U.S. interest rates: companies with EUR payables or companies with EUR receivables?
4. Why are Japanese firms hedging less, relative to European and U.S. companies?
5. If a U.S. company is able to price its foreign transactions in USD, does it eliminate transaction exposure? What about economic exposure?
6. Given the current situation, would you advise short-term maturities for FX transactions? Why?