EUROMONEY

FX risk management will remain a challenge in 2023

Paul Golden January 20, 2023

With little likelihood of currency volatility subsiding any time soon, corporates continue to face difficult decisions when it comes to how best to mitigate FX risk.

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FX volatility had a profound impact on corporate performance last year. Indeed, Kyriba's currency impact report for the second quarter of 2022 noted that the 1,200 North American and European

multinational companies it surveys sustained more than $49 billion in total impacts to earnings from currency volatility, with negative impacts rising sharply on both sides of the Atlantic.

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Scott Bilter, Atlas FX

Corporates hoping for a return to more tranquil market conditions this year are likely to be disappointed. ING’s G10 FX outlook for 2023 suggests that the year will see increased volatility with lower excess central bank reserves leading to tighter liquidity conditions.

As different countries face different risks and economic impacts, persistent FX volatility should be expected, says Scott Bilter, principal of Atlas FX.

“This will not necessarily be in the same direction as in 2022 (when the US dollar strengthened against almost every other currency), but there could certainly be shocks even greater than what have been experienced recently in major currencies,” he says. “Government debt is dangerously high almost everywhere, and this hasn't been a more pressing issue for years only due to declining/low interest rates.”

Dollar dependency

Amol Dhargalkar, managing partner and chairman of Chatham Financial, observes that as 2023 budget season rolled around, companies were debating whether to continue to hedge at much higher rates or discontinue hedges in the hope that the dollar would weaken.

“Many companies are hoping that rates will return to ‘normal’ at some point in the near future, but that is a tough assumption to make for planning purposes,” he says. “Often in these scenarios companies begin to think about using option products to protect themselves from further USD strength, but for most corporates high volatility is driving up option premia, making that strategy too expensive.”

Dhargalkar notes that some companies have decided to stop hedging until rates come back, but warns that this approach means they are unhedged if the dollar strengthens further.

Michael Quinn, group trading manager at Monex Europe, says corporates should aim to reduce their exposure to market volatility rather than eliminate it, which he suggests can be achieved through a

balanced and diversified approach.

Michael Quinn, Monex Europe

"A well-structured risk-management programme gives businesses certainty over costed exchange rates that reflects the level of certainty their underlying business has, whilst maintaining upside that allows them to take advantage of favourable FX movements," he says.

However, many senior finance decision-makers at corporates continue to utilize manual process and lack the necessary tools to mitigate this risk. Some corporate treasurers still rely on email, phone calls and sending or uploading files when trading currencies.

All this internal, manual and siloed communication is extremely inefficient, and this is just for one trade, says Eric Huttman, chief executive of MillTechFX. Many organizations execute tens or hundreds of trades every month with different products and mechanics, a process that represents a huge drain on time and resources.

Eric Huttman, MillTechFX

Huttman says corporates are balancing valid concerns around profit erosion with the need to be fluid in the face of fragile supply chains, weakening consumer demand and rising inflation.

"Shorter hedging lengths mean they have flexibility to adapt to the changing market rather than locking in a rate for a long time, enabling them to adjust their exposure if they need to," he adds.

Abhishek Sachdev, chief executive of Vedanta Hedging, refers to the example of a client that is a private equity-owned, UK, mid-market engineering company in medical technology that would in the past have sold USD once a year for the year, but is now doing this a few months at a time to avoid getting stung by the higher cost of forwards beyond the 12-month mark.

"They have bought basic option structures before, but at present they are only looking at the most vanilla of strategies – spot and forward – due to the volatility cost, even though they are executing with a global clearing bank," Sachdev explains.

Construction volatility

FX exposure for NewCold advanced cold logistics in the Netherlands relates mainly to construction projects – from an operational perspective there is more or less a natural hedge or very limited exposure. However, the FX exposure for construction projects is volatile, both in terms of amounts and timing, and the exposure reverses completely as soon as the construction financing kicks in.

“Besides these internal factors, there are external ones such as inflation and volatile exchange rates,” explains Richard Blokland, corporate treasurer. “The way we deal with this is to use instruments such as window forwards, but also leave a certain percentage to the financial markets.”

Another important element is to gather information sooner than ever before, although this poses some challenges when only limited information is available.

“We have to consider what is the right time to finalise the hedging programme or whether it should be a framework of consecutive parts, for example,” says Blokland. “This is not easy, but doing something – and agreeing on the implied risk management approach – is better than just waiting.”

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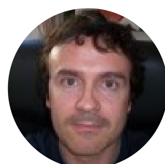

Paul Golden

Paul has written about finance since the early 2000s, with a particular emphasis on foreign exchange, treasury and wealth management. He is a regular contributor to several industry titles in addition to Euromoney.