

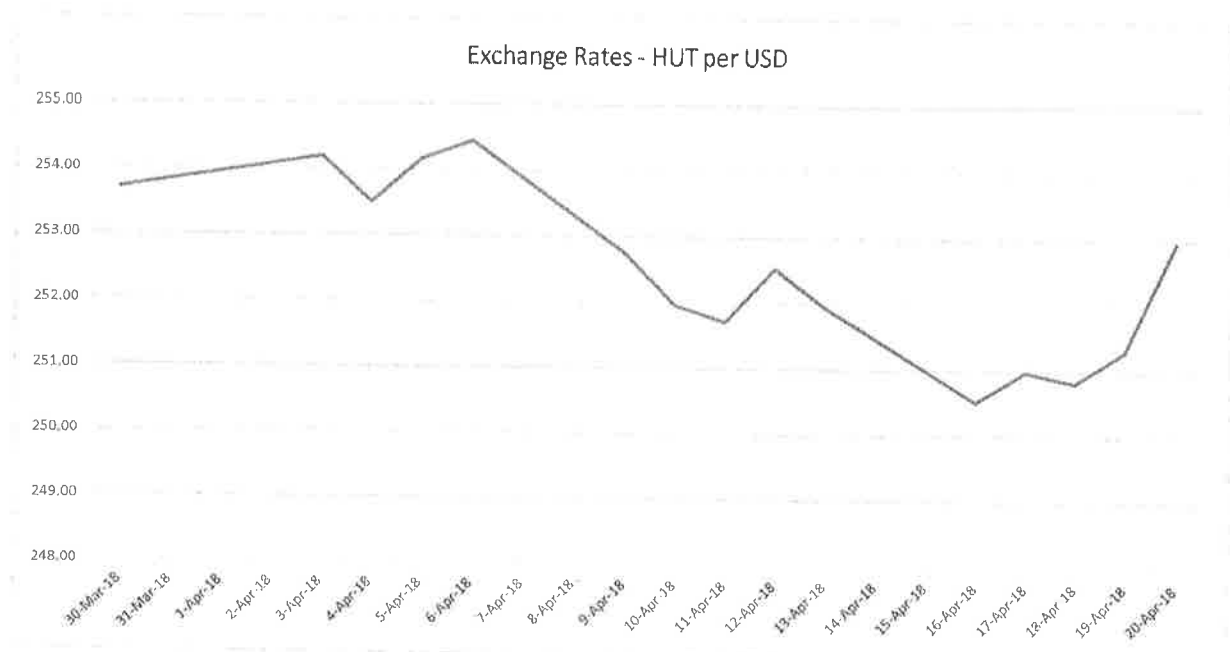


Speculation on the forint

The assignment was to select a foreign currency on which to speculate. There are many currencies from which to choose, but the one I selected was the Hungarian forint (HUF). This currency was selected since Hungary is one of the countries the EMBA cohort will be visiting later this year.

As I considered the forint, I predicted the forint would appreciate. This prediction is not based on any detailed specific analysis, but is based on the knowledge that there is currently much volatility in European currencies, politics and economies. The prediction was also based on the assumption that the Hungarian government is one of the more stable governments in that region. My thought process was that the Hungarian government would be more stable and therefore the forint would appreciate as compared against the U.S Dollar as people would move to a more secure and stable currency.

Since I believed the forint would appreciate, I took a long position in the currency. This means I converted \$1,000,000 U.S. Dollars into forint, planning to hold the forint for a short period of time, then converting the forint back into U.S. Dollars. At the end of this short holding period and the currency transactions, I believed a gain would be achieved. The currency was followed for approximately 30 days. The following graph and chart shows the exchange rates and results of the transaction.



Exchange Rates: New York Closing Snapshots

U.S.-dollar foreign-exchange rates in late New York trading

Hungarian forint HUF

Country/ currency Hungarian Forint	USD equiv Current day	USD equiv Previous day	US\$ vs. 1-day % chg	US\$ vs. YTD % chg	Currency per USD current day	Currency per USD previous day
30-Mar-18	0.00394151	0.00393918	-0.06	-2	253.71	253.86
31-Mar-18						
1-Apr-18						
2-Apr-18	0.00393577	0.00394151	0.15	-1.9	254.08	253.71
3-Apr-18	0.00393391	0.00393577	0.05	-1.8	254.20	254.08
4-Apr-18	0.00394462	0.00393391	-0.27	-2.1	253.51	254.20
5-Apr-18	0.00393437	0.00394462	0.26	-1.9	254.17	253.51
6-Apr-18	0.00393005	0.00393437	0.11	-1.8	254.45	254.17
7-Apr-18						
8-Apr-18						
9-Apr-18	0.00395632	0.00393005	-0.66	-2.4	252.76	254.45
10-Apr-18	0.00396873	0.00395632	-0.31	-2.7	251.97	252.76
11-Apr-18	0.00397267	0.00396873	-0.1	-2.8	251.72	251.97
12-Apr-18	0.00395977	0.00397267	0.33	-2.5	252.54	251.72
13-Apr-18	0.00396904	0.00395977	-0.23	-2.7	251.96	252.54
14-Apr-18						
15-Apr-18						
16-Apr-18	0.00399154	0.00396904	-0.56	-3.3	250.53	251.96
17-Apr-18	0.00398422	0.00399154	0.18	-3.1	250.99	250.53
18-Apr-18	0.00398676	0.00398422	-0.06	-3.2	250.83	250.99
19-Apr-18	0.00397915	0.00398676	0.19	-3	251.31	250.83
20-Apr-18	0.00395319	0.00397915	0.66	-2.3	252.96	251.31

US Currency
invested \$ 1,000,000
HUF 253,710,000

of days
invested 22
of days in the
year 365

HUF 253,710,000
US Currency
equivalent \$ 1,002,964.90
Gain (loss) \$ 2,965
Annualized
return 4.92%

As can be seen above, the transaction resulted in a gain of \$2,965 which equates to an annualized gain of 4.92%. This obviously means my prediction was correct in that the forint did appreciate as compared to the U.S. Dollar. There was some volatility in the forint over the time period observed, significant appreciation occurred quickly after the transaction, but then the forint began to depreciate at a steep rate.

The potential causes of the currency fluctuations observed are as follows:

- (1) Political stability with Viktor Orbán winning a third consecutive four year term as prime minister in a landslide win. It should be noted there are some allegations of election improprieties which also possibly contributed to the fluctuations.
- (2) Hungary's rolling average three-month jobless rate stood at 3.8% in December-February, level with the previous three-month period, according to a recent report from the Central Statistical Office (KSH). The Dec-Feb rate fell from 4.4% in the same period last year as well.
- (3) Hungary's cash flow-based budget, excluding local councils, ran 871.9 billion forints (EUR 2.8 billion), 64.1% of the 1,360.7 billion forints (EUR 4,3 billion) full-year target at the end of March 2018.
- (4) Hungary has received billions of euros in assistance from the EU, while the Orbán government has continued to paint the bloc in a negative light.
- (5) The European Parliament's Committee on Civil Liberties, Justice and Home Affairs (LIBE) prepared a draft report criticizing the law of rule in Hungary. Initiated last spring by Dutch Green MEP Judith Sargentini, the report recommends the Parliament should trigger Article 7 proceedings against Hungary over "the deterioration of democracy and rule of law" in the country.

Regardless of the cause, currency fluctuations can have a dramatic impact on international trade. These fluctuations can result in an increase to profits or create unexpected losses. Steps can be taken to mitigate the impact of currency fluctuations. One of the first methods that comes to mind is through currency hedging. Currency hedging is a strategy designed to mitigate the impact of currency or foreign exchange risk. Popular methods for hedging currency are forward contracts, spot contracts, and foreign currency options. Our emphasis in class has been on forward contracts which is a contract to buy or sell specific currencies now for future delivery at an agreed

to price. This basically locks in the exchange rate at a predetermined rate. There is a cost for this type of risk mitigation typically 1%, but the cost could be much less than the currency rate risk. An option contract could also be used with carries a typical cost of 3%.

Consider an example of being a US exporter of bourbon.

US EXPORTER of BOURBON			US EXPORTER of BOURBON		
Month	USD	XYZ	Month	USD	XYZ
0	1	500	0	1	500
1	1	525	1	1	475
2	1	550	2	1	450
3	1	600	3	1	400
Depreciation		-20%	Appreciation		20%
Contract Price in XYZ (\$1 million US at contract inception)		500000000	Contract Price in XYZ (\$1 million US at contract inception)		500000000
Value 3 months later		\$ 833,333.33	Value 3 months later		\$ 1,250,000.00

In the above example we show the result if the foreign currency (XYZ) depreciates and appreciates over a 3-month period. We agree to a price in the foreign currency at the beginning of the contract which is equivalent to \$1,000,000 U.S. Dollars, however we are not paid for three months. As an exporter of bourbon we would be at risk if the foreign currency in which we were being paid depreciated in value. This would translate into less profit or even a loss since it would take more of the foreign currency to equal a dollar. If the foreign currency appreciated in value this would result in higher profit to our company. One way to address this risk would be to invoice in U.S. Dollars instead of the foreign currency. Hedging options will be discussed below.

Consider the example of an importer of autos.

US IMPORTER of AUTOS			US IMPORTER of AUTOS		
Month	USD	XYZ	Month	USD	XYZ
0	1	500	0	1	500
1	1	525	1	1	475
2	1	550	2	1	450
3	1	600	3	1	400
Depreciation		-20%	Appreciation		20%
Contract Price		500000000	Contract Price		500000000
Value 3 months later		\$ 833,333.33	Value 3 months later		\$ 1,250,000.00

^{second}
In the ~~above~~ example, we import autos to the US ^{buying them} at an agreed to price in a foreign currency (XYZ). The agreed to price is equivalent to \$1,000,000 when the contract is entered into but the price is not paid until three months later. As an importer of autos we would be at risk if the foreign currency appreciated in value so that it would take more U.S. Dollars to pay for the goods being imported thereby decreasing our profits.

Under both examples above, we would be able to enter into a futures contract (or option) to mitigate the currency exchange risk present by locking in the currency exchange rate for some future date. These types of contracts are typically handled through the large money center banks. Obviously there is a monetary cost for doing this type of hedging contract. The large bank would charge a fee based on the anticipated risk being taken. This could be a significant cost depending on the currency. However, this would create value by locking the currency exchange rate in at a predetermined level and thereby eliminating the currency exchange rate fluctuation from the profit calculation. The money spent for this type of contract would not be well spent if the currency exchange rate moved in the opposite direction of the hedge. Like an insurance contract, the value of the hedge is only realized if the negative event occurs though one may argue piece of mind also carries a value.

We mentioned two types of hedging opportunities- the contract and the option. A forward contract is an agreement between two parties to buy or sell an asset at a certain future time for a certain price agreed today. An option is an agreement between two parties for the option to buy or sell an asset at a certain future time for a certain price agreed today. Generally, the cost of the option is higher than the cost for the contract.

A strengthening U.S. Dollar could also hurt the U.S. manufacturer by making the goods costlier in the foreign market thereby reducing sales. This risk could be mitigated by purchasing more imported products which are now cheaper, incorporating them into our product. A more dramatic move to combat the strengthening of the U.S. Dollar would be to move the production facility to the foreign market which would decrease costs and thereby the sales price. This would only be done when we expect the exchange rate changes to be permanent in nature.

Need to mention the cost of a full contract and option as % of the deal's volume.

Conclusion

Exchange rates can have a dramatic impact on the profitability of a company therefore they must be closely monitored and steps taken to mitigate their associated risks.

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