

INCOMPASS Forex

Member of the Merchant West Group

ARE YOU CONCERNED ABOUT EXCHANGE RATE FLUCTUATIONS?

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INTRODUCTION

With increased levels of economic and political uncertainty, currency markets can be volatile and unpredictable. Due to the fluctuation of currency rates, it might be difficult to prepare for the future when making or receiving an international payment, or simply transferring your funds to an offshore investment. Fluctuations in the foreign currency market might work in your favor or, in the worst-case scenario, work against you.

Since no one can accurately predict the future price of a currency, one can only hedge against the future price of a currency, but what strategy can an individual or corporate implement to protect themselves against exchange rate fluctuations?



FORWARD CURRENCY CONTRACTS

SECURING A FUTURE EXCHANGE RATE



WHAT IS THE DIFFERENCE BETWEEN A SPOT AND FORWARD RATE?

SPOT RATE

A spot rate, or spot price, is the contracted price for the purchase or sale of a currency for immediate delivery and payment on the spot date, which is normally one or two business days after the trade date. In other words, the spot rate is the current price quoted for the immediate settlement of the contract.

FORWARD RATE

A forward rate differs from a spot rate as it is the price for the sale or purchase of a currency at some point in the future — the forward rate. A forward rate is therefore the settlement price of a transaction that will not take place until a predetermined date; it is forward-looking.

TYPES OF FORWARD RATES

- Fixed Forward Rate

A foward currency contract whereby the end date or maturity date of the purchased currency is locked in and can only be used on the date of maturity.

- Fully Optional Rate

A forward currency contract whereby the end date or maturity date of the purchased currency is not locked in and can be used anytime during the date of purchase and date of maturity.





USING FORWARD CURRENCY CONTRACTS

WHEN CAN A FORWARD RATE BE APPROPRIATE?



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WHEN CAN A FORWARD RATE BE APPROPRIATE?

TAX CLEARANCE CERTIFICATES

With the current turnaround time in SARS approving Tax Clearance Certificates (in respect of an individual's Foreign Investment Allowance) and the volatility of the rand, a person can enter into a forward currency contract to lock in an exchange rate while waiting for SARS to approve their Tax Clearance Certificate. By securing a future exchange rate, you are acquiring certainty that you will be able to transfer your funds abroad at an agreed-upon rate, protecting you from a fluctuating Rand, while SARS reviews your Tax Clearance Certificate application.

BUYING A PROPERTY ABROAD

When wishing to purchase a property in another country, a forward rate may be appropriate. It may be that you wish to 'lock in' the price of the property in rand terms, safeguarding you if the rand devalues against the currency in which the property is priced. Entering into a forward contract will lock in the forex rate so that you know how much Rand is required on the day you have to pay for the property.

FOREIGN INCOME

Are you anticipating receiving a payment of overseas revenue and worried about currency fluctuations? You may lock in an exchange rate by entering into a forward currency contract for when you expect to receive your foreign revenue. Locking in an exchange rate gives you the peace of mind of knowing how much Rand you will receive once you have traded your foreign income back into Rand, allowing you to budget accordingly.



WHEN WILL A FORWARD RATE BE APPROPRIATE?

BUDGETING FOR RECURRING INTERNATIONAL PAYMENTS

Are you an individual or corporate who needs to make recurring international payments, which due to fluctuating exchange rates, you can't accurately budget for? To solve this issue, you can enter into a forward currency contract with a maturity on the day you expect to make the international payment, thus locking in an exchange rate beforehand. Locking in an exchange rate allows you to budget ahead of time since you'll know how much Rand you'll need to make the recurring international payments.

BUDGETING FOR A FOREIGN INVOICE

Are you expecting to receive an international invoice but are concerned about exchange rate fluctuations affecting how much Rand you will need in order to pay the foreign invoice? Entering into a forward currency contract will allow you to lock in a future exchange rate. Locking in a future exchange rate allows you to budget accordingly and will give you peace of mind knowing how much Rand you would need in order to pay for the foreign invoice.

EXPORTING & IMPORTING

If your company imports, exports, or is otherwise exposed to foreign currency, utilising forward currency contracts to hedge and manage the risks of currency fluctuations may be appropriate. Forward contracts can be used by businesses to lock in a foreign currency rate for international transactions. The main advantage for businesses is that they can effectively account for foreign operations in projections and budgets, as well as protect themselves against currency fluctuations, which may cause them to pay more for imported items or earn less money from exporting goods.



ADVANTAGES OF A FORWARD CURRENCY CONTRACT

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HEDGING EXCHANGE RATE VOLATILITY

Entering into a forward currency contract enables you to lock in a future exchange rate, allowing you to hedge against exchange rate volatility should the currency market move against you. If the market takes a dramatic dip, your fixed forward exchange rate will protect you from potential losses.

PROVIDING CERTAINTY

Entering into a forward currency contract gives you or your business certainty over the exchange rate irrespective of the prevailing spot rate in the future.

BUDGETING

You can use a forward currency contract to lock in an exchange rate on an international transaction. This allows an individual or business to manage and budget cash flow before a transaction takes place without worrying about exchange rate fluctuations.



DISADVANTAGES OF A FORWARD CURRENCY CONTRACT

REQUIRED DEPOSIT

To enter into a forward contract, you are required to place down a deposit to bind you to the contract. The deposit required to enter into a forward currency contract is 15% of the total value of the currency you wish to enter into a forward contract i.e if you enter into a forward currency contract to exchange R500 000.00 to USD at a future exchange rate, you will be required to deposit R75 000.00, thus the deposit still ties up capital. You will receive your deposit back when exchanging your ZAR to USD at the forward rate as it will be included in the capital you will convert to USD.

HEDGING CAN WORK AGAINST YOU

One thing to bear in mind when looking at currency risk protection is that hedging can work against you. If you enter into a forward currency contract then you could miss out on exchange rates potentially moving in your favour. If the currency moves in your favour, you will miss the gains, therefore the disadvantage of entering into a forward currency contract is hindsight.

LESS FAVOURABLE EXCHANGE RATE

An additional spread of forward points are added or deducted making the exchange rate less favourable depending on the forward contract enterd into. The further into the future the maturity date of the forward currency contract is, the higher the bid-ask spread charged.



ADVICE ON FORWARD CURENCY CONTRACTS

No one can accurately predict where the price of a currency may be in the future and as such, Incompass is not able to provide advice on whether entering into a forward currency contract would be more beneficial than a spot rate. Your consultant will, of course, be more than happy to run you through the product and answer any questions you might have.





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