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REPORT ON AWARENESS SEMINAR ON "FOREIGN CURRENCY HEDGING: TOOL TO MINIMISE CURRENCY RISK AT NEW DELHI ON 25th JULY, 2015". AT THE CONFERENCE HALL, 3RD FLOOR, RAJIV GANDHI HANDICRAFTS BHAVAN, BABA KHARAK SINGH MARG, CONNAUGHT PLACE, NEW DELHI

The Export Promotion Council for Handicrafts regularly conducts seminars for member exporters to educate on new and emerging issues related to exports. On 25th of July, 2015, the Council organised a seminar on "**FOREIGN CURRENCY HEDGING: TOOL TO MINIMISE CURRENCY RISK**" at the Rajiv Gandhi Handicrafts Bhavan, Baba Kharak Singh Marg, Cannaught Place, New Delhi.

Mr Passi welcoming the participants

Participants interacting with speaker

The seminar was attended by around 35 delegates and the guest speaker for the event was Mr. Harkirat Singh, Professor, Indian Institute of Foreign Trade. Mr. Ravi Passi member of EPCH board inaugurated the session with welcome speech and offered memento to Professor Singh on behalf of EPCH.

Professor Harkirat Singh started the session with the example of how JSW steel lost more than 500 Cr. in 2012 due to the volatility in the financial market. He explained that hedging is an important tool in the global financial markets, hedging is used in every asset class to mitigate losses. This can be utilised by anyone, whether it is an individual or corporate, to overcome the negative impact of price volatility. Currency exchange rates can improve or reduce investment returns when translated into your home currency. But hedging an international investment will limit the effect of exchange rate fluctuations. A decision to hedge will seek the return of the underlying investment only, minus expenses (including hedging costs). It'll also forgo positive or negative returns from a currency's relative strength or weakness.

Hedging, in any asset class, is ultimately a strategy to decrease or transfer risk in order to protect one's portfolio or business from uncertainty in prices. In case of hedging in the foreign exchange market, a participant who is entering a trade with the intention of protecting the existing position from an unexpected currency move, is said to have created a forex hedge.

Questions put up by the participants –

Q: What is exchange rate risk?

Ans: The exchange rate risk is faced by all companies with an asset-liability currency mismatch in the conditions of a more or less fluctuating exchange rate. Due to the nature of their business, international trade companies are particularly vulnerable to this type of risk.

For exporters, home currency strengthening means a potential loss as they would get less rupee when exchanging export proceeds, while domestic currency weakening means a potential gain or more rupee earned when exchanging export proceeds.

Q: What is the best way to hedge against exchange rate risk?

Ans: The best way to hedge against exchange rate risk is for a company to achieve a full matching of cash flows (revenues and expenses), thus entirely eliminating the foreign exchange risk from its operations (natural hedge).

This is the best way to hedge against exchange rate risk as it is cost free and related exclusively to the operations of the company. However, it is only a few companies that can achieve such type of risk protection.

Q: Which are the main financial derivatives used in FX hedging?

Ans: The main derivatives used in FX hedging are:

1. forex forwards – contracts to buy or sell a particular currency for another at an agreed future date and at an exchange rate agreed in advance;

2. forex swaps – involving simultaneous purchase and sale of two currencies at predetermined exchange rates but at two different value dates;

3. forex options – giving the option buyer the right (but not the obligation) to buy or sell a specific currency at a predetermined exchange rate within a predetermined time period or at a predetermined future date, for which the option buyer pays a premium.

Q: How to offset the shortage of one currency by a surplus of another, while at the same time hedging against exchange rate risk?

Ans: In this case, a company can enter into a forex swap arrangement. In the first leg of this transaction, the company would sell foreign currency for rupee, and buy such foreign currency back at the forward rate after a certain time period. In this way, the company eliminates the exchange rate risk and ensures adequate pricing of its products. An example of currency swaps is provided in the publication Financial Derivatives.

The seminar was concluded after giving vote of thanks to all the participants and the honourable guest speaker of the seminar.

We welcome suggestions and feedback to make this initiative more productive. Do write to us at: focusregion@epch.com.