www.bourseafrica.com

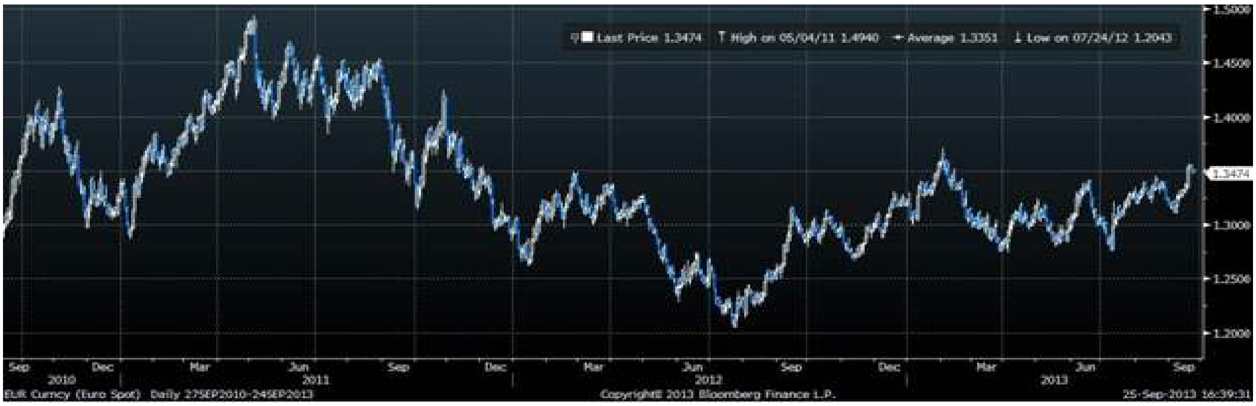
BOURSE AFRICA
AFRICAN MARKETS ▲ GLOBAL OPPORTUNITIES

THE AFRICAN HUB for
Risk Management, Trading, Investing and Capital Raising

EUR/USD

The international role of the euro has shrunk significantly since the beginning of the Euro-area sovereign debt crisis in 2010. In April 2013, the Euro's share of the foreign exchange market reached its lowest value since the introduction of the common currency. The Euro is clearly not yet a viable candidate to take-over the dollar's role as the reserve currency of the world. The currency has displayed a volatile trend since the last quarter of 2010 amid the lingering sovereign debt crisis and concerns about the economic recovery in the region. The shared currency experienced a period of huge swings in 2011 as shown in the figure below.

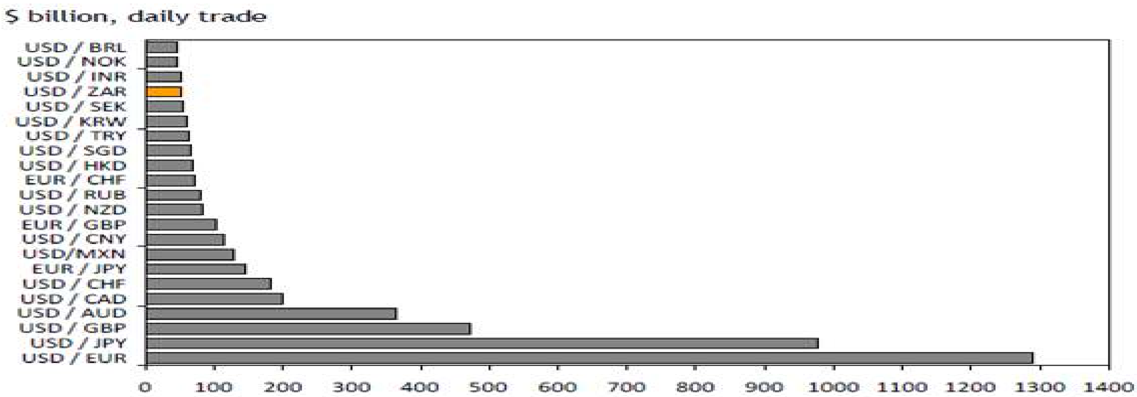
Price trend of EUR/USD from January 2010 to September 2013



The main factor that has impacted the financial market during the past few days has been the toll of US Economy shutdown on the value of the dollar. The rising concern about the constriction of economic growth had a direct and immediate impact on the foreign exchange market, leading to an appreciation of the Euro along with a fall in the value of the US dollar. The EUR/USD exchange rate as at 7th October is 1.3580.

In April 2013, the BIS (Bank for International Settlements) report highlighted that the most traded currency pair in the world is the USD/EUR which accounted for 24.1% of all transaction, down from 27.7% in 2007. This was followed by USD/JPY (18.3%) and USD/GBP (8.8%).

Traded currency pairs in the world



Source: Bank for International Settlements (April 2013)

FACTORS AFFECTING THE VALUE OF THE EURO:

A CENTRAL BANK POLICY AND INTEREST RATES

The European Central Bank determines the supply of Euro and decides the Euro zone interest rates. At high interest rates, Euro becomes more attractive and the demand for the currency increases thus bolstering the value of the Euro.

B BALANCE OF TRADE

The Euro is directly affected by the balance of trade status. Before the year 2005, the Euro zone had continuously observed trade surplus. However, since 2006, the region has witnessed more volatility with a higher tendency towards negative trade balances. This has led to a general depreciation in the value of the currency.

C INFLATION

The primary objective of the European Central Bank (ECB) is to maintain price stability. During the past years, inflation rate in the Euro zone was between 2% and 1%. Any news from ECB claiming that interest rate will rise is considered bullish for the Euro currency.

D. RESERVE CURRENCY

The Euro is presently the second biggest reserve currency in the world (according to IMF about 27% of Euro deposits are held in central banks around the world). The status of reserve currency also determines the value of the Euro.

E. UNEMPLOYMENT IN THE MAIN EURO ZONE MEMBERS

Germany, France and Italy are the biggest members of the Euro zone contributing to an important portion to the economy. (Germany contributes around 30% of EU's GDP) Unemployment variations in these countries do affect the value of the Euro. In sum, a higher unemployment rate which depicts a negative view on the economy will have an adverse effect on the value of the currency.

Hedging on Bourse Africa EUR/USD Futures contract

Suppose today a textile factory owner receives an order worth EUR 1,000,000 to export clothes to a European Company in 3 months time. In today's spot market, the Euro is exchanging at USD 1.2900 per euro, while on Bourse Africa, a futures contract matching the order payment date is available at USD 1.2910 per euro. Thus, the present value of the order is USD 1,290,000.

To lock in the price of USD 1.2910 per euro, the exporter can enter into 80 EUR/USD futures contracts on the exchange (1 Bourse Africa EUR/USD futures contract is equal to EUR 12,500) to sell EUR 1,000,000 at USD 1.2910 per euro in 3 months.

Scenario #1: EUR depreciates significantly to USD 1.2000 per euro in 3 months

At time when order payment is received, while converting the EUR 1,000,000 into USD, the investor would receive only USD 1,200,000.

As the exporter has entered into 80 EUR/USD futures contracts to sell EUR 1,000,000 at USD 1.2910 per euro in 3 months, the exporter would gain USD 91,000 [i.e. (1.2910 - 1.2000) x EUR 1,000,000] from hedging on the bourse.

Thus, overall the exporter would receive USD 1,291,000 (USD 1,200,000 from spot market plus USD 91,000 from hedging profit on Bourse Africa) for the EUR 1,000,000. This amount is equivalent to selling EUR 1,000,000 at USD 1.291 per euro, i.e. the current price of EUR/USD.

Scenario #2: EUR appreciates significantly to USD 1.3500 per euro in 3 months

At time when order payment is received, while converting the EUR 1,000,000 into USD, the factory owner would receive USD 1,350,000.

As he has entered into 80 EUR/USD futures contracts to sell EUR 1,000,000 at USD 1.2910 per euro in 3 months, the exporter would lose USD 109,000 [i.e. (1.2910 - 1.3500) x EUR 1,000,000] from hedging on the exchange.

Thus, overall the exporter would receive USD 1,291,000 (USD 1,400,000 from spot market less USD 109,000 from hedging loss) for the EUR 1,000,000. Again, this amount is equivalent to selling EUR 1,000,000 at USD 1.291 per euro, i.e. the current price of EUR/USD.

Despite the fact that the businessman can make gains or losses from hedging, the basic purpose of hedging is to know exactly how much income would have been generated from this export deal irrespective of the uncertainty associated with future exchange rate movements. This example depicts the elimination of foreign exchange risk using futures contract available on Bourse Africa.

BOURSE AFRICA LIMITED
Ebène House, 1st Floor, 33 Cybercity, Ebène, Republic of Mauritius.
T: (230) 404 0000 | **F:** (230) 464 7000 | membership@bourseafrica.com | www.bourseafrica.com