BOURSE AFRICA
AFRICAN MARKETS ▲ GLOBAL OPPORTUNITIES

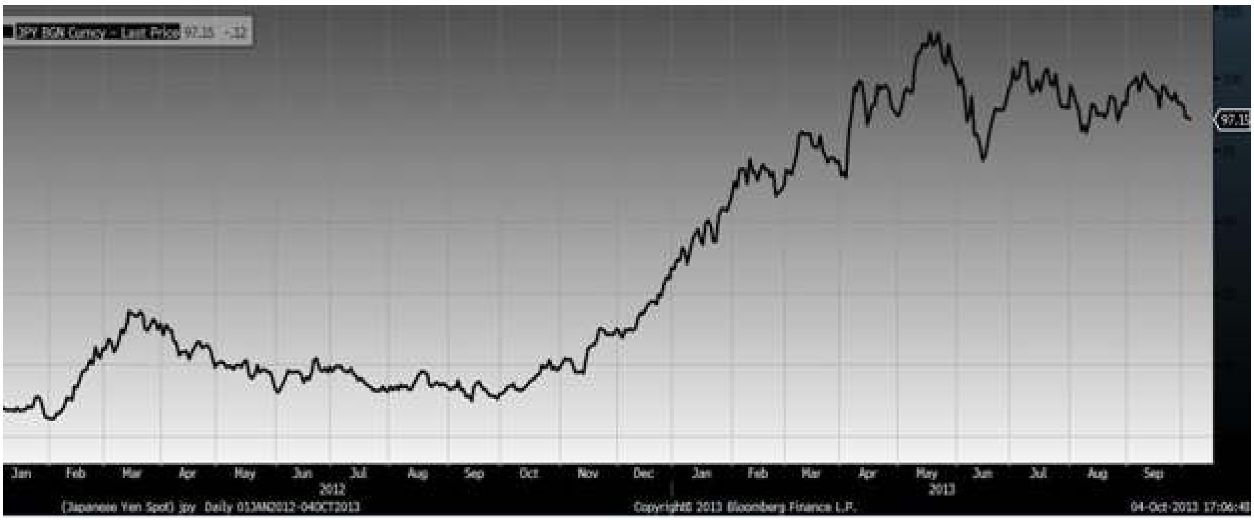
THE AFRICAN HUB for
Risk Management, Trading, Investing and Capital Raising

JPY/USD

Since the nineties, the Bank of Japan, the country's central bank, has kept interest rates low in order to promote economic growth. Low interest rates prompted investors to borrow money in Japan and invest it in other countries, which in practice are known as carry trade. This has helped to keep the value of Yen low compared to other major currencies. However, history has proved that this practice also makes the Yen extremely sensitive to the financial crisis across the globe. Renewed concerns that the recovery of global economy is stalling bolstered demand for safe haven currencies, such as the Yen.

The currency experienced huge swings in early 2013 mainly on the back of Abenomics - reviving the Japanese economy growth, which has been stagnant for the past two decades.

Price movements in USD/JPY for the past two years



Source: Bank for International Settlements (April 2013)

One of the major steps taken by Japan's current prime minister, Shinzo Abe took was to get the Central Bank to double its inflation target to 2%. He has even suggested that the bank print "unlimited yen" to help achieve its inflation target.

Earlier in 2013, the Bank of Japan unveiled a massive stimulus measure in an attempt to boost growth and meet its inflation target. The central bank said it would increase its purchase of government bonds by ¥50 trillion ($500bn) per year, the equivalent of about 10% of Japan's annual gross domestic product (GDP). This weighed significantly on the Japanese currency unit.

Significant Factors Affecting the Value of the Japanese Yen

A. CENTRAL BANK POLICY

The Central Bank of Japan promotes a policy of keeping the yen weak against other currencies so as to boost exports and aid Japan's economic growth. Since the early 1990s, the Bank of Japan (BOJ) has kept its key rate very low and the rate has been around 0.1% in September 2013.

B. INFLATION

Japan has witnessed one of the lowest inflation rates since the end of 1990s. The Japanese economy has been in a deflationary period since the year 1998. The low inflation has increased the competitiveness of Japan's products and this has boosted the economy significantly. As a result, a rise in the demand for the Yen was observed. The year-on-year Japanese consumer price inflation for August increased to 0.9%, its biggest annual rise since November 2008, as the government continued its pursuit of annual CPI growth of 2%.

Hedging on Bourse Africa JPY/USD Futures Contract

Suppose today, a local second-hand car dealer orders 100 cars worth JPY 100,000,000 from a Japanese company to be delivered in 3 months time. In today's spot market, the Japanese yen is being exchanged at US Cents 128.25 per 100 yen, while on Bourse Africa, a futures contract matching the order payment date is available at US Cents 128.50 per 100 yen. Thus, the present value of the order is USD 1,282,500.

To lock in the price of US Cents 128.50 per 100 yen, the car dealer can enter into 80 Bourse Africa JPYUSD futures contracts (1 Bourse Africa JPYUSD futures contract is equal to JPY 1,250,000) to sell JPY 100,000,000 at US Cents 128.50 per 100 yen in 3 months.

Scenario #1: JPY depreciates significantly to US Cents 125.00 per 100 yen in 3 months

At time of payment, the dealer would have to buy the 100 cars at JPY 100,000,000, amounting to USD 1,250,000.

As the importer has entered into 80 JPYUSD futures contracts to buy JPY 100,000,000 at US Cents 128.50 per 100 yen in 3 months, the importer would lose USD 35,000 [i.e. (128.50 – 125) x JPY 1,000,000] from hedging on the exchange.

Thus, the lower amount paid for the JPY 100,000,000 is offset by the loss in the JPYUSD futures market, resulting in a net proceeds of USD 1,250,000 + USD 35,000 = USD 1,285,000.

This amount is equivalent to buying JPY 100,000,000 at US Cents 128.50 per yen, i.e. the current price of JPY/USD.

Scenario #2: JPY appreciates to US Cents 130 per 100 yen in 3 months

At time of payment, the dealer would have to buy the 100 cars at JPY 100,000,000, amounting to USD 1,300,000.

As the importer has entered into 80 JPYUSD futures contracts to buy JPY 100,000,000 at US Cents 128.50 per 100 yen in 3 months, the importer would gain USD 15,000 [i.e. (130 - 128.50) x JPY 1,000,000] from hedging on the bourse.

Thus, together the gain in the JPYUSD futures market and the amount paid for buying the JPY 100,000,000 will results in a total of USD 1,300,000 - USD 15,000 = USD 1,285,000. This amount is equivalent to buying the JPY 100,000,000 at US Cents 128.50 per yen, i.e. the current price of JPY/USD.

Despite the fact that the businessman can gain or lose from hedging, the basic purpose of hedging is to know exactly how capital would be required for this import 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
AFRICAN MARKETS ▲ GLOBAL OPPORTUNITIES

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