

INTERNATIONAL CORPORATE FINANCE

Foreign Exchange - INTRODUCTION

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FX Rate

- Fixed vs floatation
- EURPLN 4.2560 4.2590
(watch the tricks e.g. at airports:
4.2560 5.2580)
- Appreciation vs Revaluation

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Market quote

- **FX market-maker gives two prices:**
 - **BID**, quote at which they buy from others
 - **ASK / OFFER**, quote at which they sell

The image shows two screenshots of a financial data terminal. The top screenshot displays the EURPLN market quote, and the bottom screenshot displays the PLN market quote. Both screenshots show a table with columns for Bid/Ask, Contributor, Loc, Source, Deal, Time, High, and Low. The EURPLN quote shows a bid of 3.8607/57 and an ask of 3.8612/43, with a high of 3.8767 and a low of 3.8620. The PLN quote shows a bid of 2.8316/31 and an ask of 2.8316/32, with a high of 2.8502 and a low of 2.8316. The date and time for both quotes are 14APR10 10:45.

EURPLN=	Bid/Ask	Contributor	Loc	Source	Deal	Time	High	Low
EURPLN=	3.8607/57	ERSTE BANK	VIE			10:45	3.8767	3.8620
	3.8606/45						Close	
	3.8612/43							

PLN=	Bid/Ask	Contributor	Loc	Source	Deal	Time	High	Low
PLN=	2.8316/31	SOC GENERALE	PAR	SGAX	SGSP	10:43	2.8502	2.8316
	2.8301/44						Close	
	2.8316/32							

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SEGMENTS OF THE FX MARKET

- **Interbank OTC market**
 - Dominant volume
 - Bank-to-bank (b2b) relationship
 - Squaring customer deals and opening speculative positions
- **Customer OTC market**
 - Smaller notional and bigger quantity of deals
 - Bank-to-client (b2c) relationship
 - Hedging of currency risk and speculation on currency exposure
- **Exchange traded market**
 - Lowering significance
 - Private customers and small business

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KEY DEFINITIONS

- **Value date**
 - Date on which the currencies are settled (through physical delivery or cash settlement)
- **Currency exposure**
 - Balance of foreign currency which value is dependent on FX rate (long or short; balance or off-balance)
- **Liquidity position**
 - Balance of local or foreign currency proceeding from mismatch of value dates of assets and liabilities
 - Liquidity position is sensitive on interest rate swings

CURRENCY EXPOSURE

- **Long position**
 - Assets in foreign currency → gives profits if FX rate of foreign currency goes up
- **Short position**
 - Liabilities in foreign currency → gives profits if FX rate goes down
- **Balance position**
 - Assets or liabilities on the current value date
- **Off-balance / cash flow position**
 - Settlement of FX cash flows will be done in the future
- **Indirect FX exposure**
 - FX changes affects competitiveness or volumes

FOREIGN EXPOSURE - examples

- Long balance sheet exposure
 - Foreign investments
- Short balance sheet exposure
 - Foreign denominated debt
- Long cash flow / off balance exposure
 - Expected FX revenues (e.g. in export)
- Short cash flow / off balance exposure
 - Expected FX payments (e.g. in import)
- Indirect FX exposure
 - FX appreciation makes export less competitive

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FX TRANSACTION

- Transaction changing the currency exposure
- Fore currency against counter currency (XXX/YYY)
- Rate measure is quantity of counter currency paid for the unit of the fore currency [YYY/XXX]
 - Big figures and pips, i.e. 1.3212 USD per 1 EUR
- The price is shown by market maker as
 - BID (I buy) / OFFER (ASK) (I sell)
- Market user buys at offer (so called MINE) and sell at bid (so called YOURS)
- BID/ASK difference is called SPREAD

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