

CURRENCY HEDGING A 'MUG'S GAME' - STUDY

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Many businesses which selectively hedge to take advantage of currency movements or an increasing spread in interest rate differentials are wasting their time, according to a substantive study.

On average across the exporting sector, selective hedging strategies are a failure, say the Reserve Bank's Richard Fabling and Arthur Grimes, from Motu Economic and Public Policy Research.

"Exporters are not successful in improving their results through the practice of selective currency hedging," the pair say in a report - "Do Exporters Cut the Hedge?" - prepared for the Ministry of Economic Development.

"They do not have superior knowledge of future currency movements relative to the market as a whole." Their findings - that taking a punt on the currency is a mug's game - is consistent with overseas research but this is the first comprehensive New Zealand survey using data from Statistics New Zealand, Customs and Inland Revenue to "cover the universe of merchandise exporting firms for a [single] country".

Roger Bowden, Victoria University's professor of economics and finance, said exporters should hedge only when there is a danger of the NZ dollar appreciating.

Taking advantage of currency fluctuations to put in place short-term hedging arrangements invited disaster, Bowden said, pointing to the hundreds of millions of dollars lost by the Dairy Board, the Apple and Pear Board and Solid Energy.

People do it because they want "the certainty of being able to buy at a certain rate - and they like that. It's been a bad idea for the last few years".

About 60% of all exports are transacted in foreign currency, mainly in the United States and Australian dollars, and about two-thirds of this is hedged, Fabling and Grimes report.

Only about a third hedge when transacting in

Australian dollars because businesses believed they could predict AUD-NZD movements which "moved within a much smaller band and with a greater degree of reversion to the mean".

That was not the case with the more volatile USD-NZD and nearly 70% of exports by value in US dollars are hedged.

The study showed when the Kiwi dropped against the greenback, the proportion of exporters hedging rose sharply.

But selective hedging, on average and in the long run, was a failure, they said.

"The short horizon over which most hedges are apparently taken implies that many exporters are materially exposed to the medium-term volatility displayed by exchange rates.

"The lack of success associated with selective hedging suggests public and private advisers to exporting firms should be wary about promoting the practice of selective hedging, especially where the exporters' costs and risks are increased." Although large companies were the most frequent hedgers, the next largest group was small companies.

This was, the pair suggest, because of financial stress.

Hedging strategies usually don't cut it, statistics show.

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