

## **FX Risk: a Risk Worth Taking?**

**Rosmalin Apichartvongvanich**

**Senior Analyst**

**Exchange Control and Credits Department**

The solid recovery of the Thai economy since the start of 2010 is likely to continue through the rest of the year.

Nonetheless, no one can rule out the possibility that external factors will have an impact on capital flows. Emerging economies in Asia have tended to rebound more quickly from the crisis and have begun their policy normalisation by raising their interest rates. But this means they are prone to massive capital inflows from investors with risk appetite in search of higher returns. That said, uncertainties over the global recovery still loom, especially after recent data from the US economy pointed to a poor outlook, particularly for employment. These uncertainties could lead to risk-aversion which in turn could trigger substantial capital outflows.

Such volatile capital movement may cause exchange rates to fluctuate. Thus looking ahead, one of the challenges for Thai business enterprises - especially importers and exporters - might be how to handle exchange rate volatility.

The answer is simple: hedge your exchange rate exposure.

Several hedging options are available, including netting of receipts and payments of the same foreign currency. Export proceeds can also be freely deposited in foreign currency accounts opened with domestic commercial banks for future payment obligations regardless of maturity. Such natural hedge approaches help avoid conversion of foreign currencies, thus containing the risk.

In addition, FX derivatives such as forward contracts and options are alternative hedging tools that can now be deployed with much more flexibility following the Bank of Thailand's relaxation of hedging

regulations. To protect themselves from fluctuations in exchange rates, exporters and importers can now use FX derivatives based on one-year forecasts of their future receipts or payment in foreign currencies.

For greater flexibility, exporters and importers are now allowed to freely unwind the FX derivatives contracts to hedge export proceeds or import payments.

With an array of convenient hedging alternatives now readily available, the hedging ratio of the Thai business sector has increased. Enterprises can now embark on a more active but disciplinary hedging scheme with less administrative burden, thus enhancing their ability to adjust to exchange rate volatility. Shielded against the exchange rate risk, they can refocus on forging their competitiveness.

Certainly, protection comes at a cost but that cost may not be as high as some would expect. You could argue that leaving your exposure unhedged offers a chance of foreign exchange gains, but the harsh truth is it probably provides an equal if not greater possibility of incurring losses.

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**(The views expressed are the author's own.)**

**Published in The Nation on Thursday, August 19, 2010**