Moving money globally

OFXpert Handbook

Managing FX for your business

Rachael, OFXpert since 2017
and Ryan, OFXpert since 2012

Business moves fast. So do we.

OFX was created from the idea that there had to be a better, fairer way to move money globally.

But we deliver more than just a money transfer. We have OFXperts, currency experts who can help businesses like yours develop strategies to take advantage of market opportunities and manage cash flow, even in times of market volatility.

We'll cover a lot in this guide, but if you have any questions or would like help building a plan for your business, our OFXperts are available day or night, 24/7. So you can always get real help, from a real person.

Let's get into it!

Contents

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Understanding currency

Business owners with an understanding of foreign exchange (FX) market fundamentals will be in a much better position to manage their FX risk exposure. Let's look at some of the basic concepts of the global currency market.

OFXpert Tip

Click here to view our glossary of frequently used currency terminology on page 12.

Major vs exotic currencies

Currencies can be broadly categorised as being **major** or **exotic**. These categories reflect the volume and geographic diversity in which a currency is traded.

The US dollar and euro are major currencies because of the high volume and large number of international markets in which they are traded. Exotic currencies are illiquid – meaning that little foreign trade activity takes place in these currencies, resulting in a low volume being traded.

We can help you do business in 55 currencies (and counting).

Click here to see the full list of the **major** and **exotic currencies** we specialise in

Exchange rates explained

An exchange rate is the rate at which one currency is "exchanged" for another. In international markets, the "base" rate has traditionally been the USD, which means that currencies will be expressed against US$1.00.

In Australia, however, the practice is for all exchange rates to be quoted with the AUD as the base rate. For example, when the Australian media reports that the AUD is currently 0.6900 US cents, this means that for every one AUD paid, 0.69 US cents will be exchanged.

The table on the right provides examples of foreign currency market rates quoted against the AUD.

AUD exchange rates

Currency	Jan 3	Apr 3	Jul 3
USD	0.6950	0.5997	0.6939
CAD	0.9037	0.8516	0.9402
GBP	0.5312	0.4887	0.5560
EUR	0.6228	0.5950	0.6171
NZD	1.0432	1.0226	1.0624
SGD	0.9383	0.8629	0.9679
HKD	5.4070	4.6460	5.3792

Source: Bloomberg 2020

Click to view a larger version of this table

Some common rate terminologies that you may come across when undertaking a foreign exchange transaction include:

The market rate

Also known as the “interbank rate” or the “mid-market rate,” this is essentially a ‘wholesale’ rate that is available only to large financial institutions or those who purchase large volumes of currency. Generally, people wishing to exchange currency will not be offered the market rate, but instead will be provided with a ‘retail’ rate. Similar to the sale of goods and services, the retail rate typically is the market rate plus a mark-up added by the provider.

Spot rate

The exchange rate that is quoted for the sale of currency with a value date (the date that settlement is due for a foreign exchange contract) of two business days from the date of the quote.

Forward rates

Where the foreign currency rate is fixed at the time of the deal with a value date beyond two business days.

Silvana, OFXpert since 2017

Bryan, OFXpert since 2018

> **Need currency confidence?**
> We can help you navigate exchange rates with advanced currency tools.

What factors influence exchange rates?

Global economics

In global markets, Australia is typically considered to be a resource-rich country. This means that commodity prices will often impact demand for the AUD. When commodity prices rise, demand for the AUD can increase as international resource investors seek to purchase AUD.

Overseas data can also influence a currency more than its own domestic data. For example, the AUD is seen as a barometer for Asian growth and particularly for Chinese growth. As a result, Chinese economic data often has greater influence over a rise or fall in AUD than Australian domestic data.

Other factors that typically influence the demand for a foreign currency include economic indicators such as; interest rates, GDP, inflation, currency speculation and employment rates.

World events

Global instability, such as political and military conflict, natural disasters and pandemics, also impact current demand and supply. During times of global instability investors tend to buy “safe haven” currencies such as the US dollar (USD), Japanese yen and Swiss franc, selling off other currencies which subsequently see a fall in their value.

This was illustrated during the COVID-19 pandemic which stalled the global economy as international borders closed and normal free trade conventions came to a halt. During the period of 8-23 March 2020, the AUD lost over 11 cents as liquidity dried up and markets panicked. In that environment, traditional fundamental factors such as GDP were no longer driving currency direction.

What is FX risk?

Exchange rates are constantly changing, can be volatile and represent one of the major risks for businesses making international payments.

A sharp rise or fall in a particular currency can have a significant impact on costs and profits.

If your business exports goods or services, currency movements could mean that you receive less of your local currency than originally intended on the date you issued an invoice to your customer.

FX risk can also be a factor for importers who have post-paid arrangements with their suppliers. Changes to currency rates could mean paying more for goods than you planned to sell them for.

OFXpert Tip

Currency fluctuations can affect your bottom line. But, if you put a risk management strategy in place, you won't be distracted by volatility.

Client spotlight

Why managing currency risk matters

Family-run business Zoratto Enterprises imports kitchenware products to Australia from all over the world. With cross-border payments adding up to millions of dollars, Operations Manager Andrew Zoratto needs to mitigate the risk of currency fluctuations.

Zoratto Enterprises pay all invoices in USD and use Forward Contracts for significant orders.

When the Australian dollar dropped to an 18-year low of $0.55 in March 2020, Zoratto Enterprises were protected, they had secured a locked in rate of 0.69 USD in January. This saved them money and prevented an immediate price increase on goods, which could have affected the business in the short term.

USD$100k invoice

AUD cost comparison

January 23 2020
$144,928

Vs

March 19 2020
$181,818

A$36,890 extra

The cost comparison is based on a single transfer of USD$100k to AUD using the Market Rate for demonstration purposes only. Customer transfers use OFX's Customer Rate and this combined with other factors such as different currency exchange amounts, currency types, dates and times will result in different actual costs.

Matthew, OFXpert since 2019

Managing FX risk

There are many ways to manage foreign exchange risk. The examples opposite are some common methods, and often companies will use a combination of them to their advantage.

OFXpert Tip

If you have any questions when determining the strategy that is best for your organisation, contact an OFXpert 24/7.

Spot Transfer

When you agree on an exchange rate on the day you want to buy or sell your foreign currency. This approach offers flexibility by allowing participation in daily market fluctuations. However, it can be a high risk strategy, as the currency market is volatile and when rates fluctuate a business may experience additional costs.

Forward Contract

An agreement that allows you to fix an exchange rate now for a future transfer (between two days to 12 months) so that you know what the exchange rate will be at the time the transfer takes place. This type of transaction allows you to protect against adverse movements in exchange rates between the date an order is placed and the time when payment is required.

Target Rate Transfer

Also known as a Limit Order, for when you can be flexible on the date of delivery of your funds. The day you receive your funds may not be the best day to transfer your money, so a Limit Order lets you target a rate that works best for your business. If the rate is reached, a transfer will be processed automatically, so you don't have to worry about missing out because you weren't monitoring the market.

Currency Option

There are a number of FX option products with varying terms and features. A common feature of most options is the ability to protect a rate for a period of time without a participation obligation – insuring against adverse movements in exchange rates – and allowing you to participate in favourable conditions between the order date and payment date. A premium (an upfront fee) to undertake this transaction is required.

It is important that you carefully consider your foreign currency provider's product disclosure statements and seek advice on how these products work and their risks before dealing in options.

As with any type of risk, there's an upside and a downside to consider. For businesses, currency risk could mean a few things:

Upside

If the currency you need to buy weakens against your home currency, your costs fall → Lower costs increase your company's profit margins → Higher profits boost your business capabilities → Makes your business more competitive → Helps accelerate key investment decisions

Downside

If the currency you need to buy strengthens against your home currency, your costs rise → Increasing costs compress your profit margins → Lower profits limit your business capabilities → Makes your business less competitive → Delays key investment decisions

If you leave your foreign exchange to chance, you have no control over whether you will be facing an upside or a downside. If you buy goods or services overseas every month then the risk is multiplied because of the number of transactions you make.

Measuring FX risk

It's vital to have a clear understanding of what your foreign exchange risk is. This can be done in a number of different ways.

To analyse your currency sensitivity, you can prepare a table showing how foreign exchange movements will affect the selling price of exported goods, or overall potential profits.

To give you an idea, in the first half of 2020 the AUD/USD saw a high of 0.7021 and a low of 0.5743. This wide range could cause a lot of unintended consequences for businesses.

OFXpert Tip

Understanding what your business break even rate is can allow you to plan ahead and manage risk.

Do you know your **break-even** rate?

Sensitivity analysis example

Let's say an Australian importer needs to pay a US$10,000 invoice, when they receive it, the exchange rate 0.6400 (AUD $1 buys USD $0.64) and so they budget for that. If AUD/USD rises to 0.7100, the importer would save AU$1,540.49 because the USD is worth fewer AUD. Conversely if the AUD/USD falls to 0.5500, the importer will suffer a loss of AU$2,556.82.

AUD/USD rate (AUD $1 buys USD$)	Amount received from customer after conversion to AUD	Variance
0.7300	$13,699	+ $1,953
0.7000	$14,286	+ $1,366
0.6700	$14,925	+ $727
0.6400 (budgeted rate)	**$15,625**	**No variation**
0.6100	$16,393	- $741
0.5800	$17,241	- $1,589
0.5500	$18,182	- $2,530

While these swings may seem extreme, we're increasingly seeing this range of exchange rate movements. The good news is, FX risk can be managed by implementing a hedging strategy.

Your first steps to **more certainty**

Vani, OFXpert
since 2013

Managing your foreign exchange risk doesn't have to be complicated. Here are seven key steps that could help you get started when looking at hedging for the first time.

1 Identify what foreign exchange risk means for your business

- What proportion of your business results in the need for foreign exchange payments? The higher this amount, the greater your likely exposure.
- What countries do you do business with? Some countries suffer much more political instability and therefore have much higher currency volatility.
- How frequently do you make payments? The more often you transact, the more you'll encounter exchange rate variations.
- How tight are your operating margins? At what exchange rate can you sell or buy goods and still remain profitable?

2 Consider ways of removing foreign exchange risk from the start

Is there a simple change in process that can help remove or minimise the foreign exchange risk, such as aligning a customer billing cycle with supplier payments?

3 Set out clear risk management objectives

- What is the ultimate attitude/culture of your business (from the top down) towards risk? Is it conservative or progressive towards risk in general?
- Are there banking covenants that need protecting?

Consider all of these issues before creating a written plan for your currency hedging. It's important to avoid making emotional decisions as markets move.

4 Do your research into foreign exchange products available

It's important to gain a good understanding of the various products available and how they can help you manage your foreign exchange risk. All businesses are different and there is no one best plan to suit everyone.

For example, a portfolio approach with 70% hedged and 30% unhedged could allow a company to protect its profit margin while still benefiting from any positive currency movements.

5 Seek professional assistance from the marketplace

Managing currency risk is a specialised area, and if you do not have the necessary skills within your business to formulate a strategy, it's wise to seek outside help. If you prefer not to outsource this function, then ensure you and/or relevant staff are properly educated about what it involves.

6 Regularly review hedging performance

Continually monitor and review any hedging against your objectives (quarterly, semiannual or annual).

Do not judge performance solely by the 'opportunity cost' of implementing an appropriate risk management framework, which is a very common mistake. Also, do not be distracted by short-term currency rate movements. Consider any changes within the framework of your business that may need to be reflected in the policy over time.

7 Diversify your risk

Consider blending a number of different strategies for example, a mix of spot and forward contracts or spot, forward and options. While this may add complexity, some dynamic/fine margin business models may require such diversification.

Adam, OFXpert since 2010
and Cissy, OFXpert since 2020

Business moves fast. So do we.

We covered a lot in this guide and hope you're feeling a little more knowledgeable about managing FX for your business.

Sometimes we all need a little help – that's why our OFXperts are available 24/7, day and night.

Find out how much your business could save by working with an OFXpert.

Email **corporate@ofx.com** or call us:

Australia
1300 300 524

New Zealand
0800 161 898

Register now

Login now

Glossary of terms

Budgeted rate

The Budget Reference or Budget Rate is the exchange rate that a company's financial management uses to draft budgets and establish business objectives.

Forex/FX

An abbreviation of foreign exchange.

Forward rate

Where the foreign currency rate is fixed at the time of the deal with a value date beyond two business days.

Forward Contract (or Forward Exchange Contract or FEC)

A Forward Contract is an agreement that allows you to fix an exchange rate for a future transfer (between two days to 12 months) so that you know what the exchange rate will be at the time the transaction takes place.

Hedging

A hedging transaction is one which protects an asset or liability against a fluctuation in the foreign exchange rate.

OFXpert(s)

OFXpert (noun): A foreign exchange specialist. The partner businesses need to save money and help reduce currency risk.

"OFXperts saved my business thousands."

We believe real help from real people counts, and that's why we offer our clients the best of both worlds – an easy to use digital platform, combined with 24/7 phone access to our currency experts (we call them OFXperts). Our clients are all over the globe, so we are too. We operate in offices in London, Sydney, Auckland, Hong Kong, Singapore, Toronto and San Francisco. It's global expertise, delivered locally.

Settlement

The physical exchange of one currency for another between dealer and client.

Spot rate

Also called Spot FX. This is the exchange rate that is quoted for the sale of currency with a value date of two business days from the date of the quote.

Value date

The date that settlement is due for a foreign exchange contract.

Volatility

A measure of price fluctuations.

Appendix

We can help you move money in the following 55 currencies:

Majors

Currency	Code	Currency	Code
United Arab Emirates dirham	**AED**	Mexican peso	**MXN**
Australian dollar	**AUD**	Norwegian kroner	**NOK**
Canadian dollar	**CAD**	New Zealand dollar	**NZD**
Swiss franc	**CHF**	Polish Zloty	**PLN**
Chinese Yuan Renminbi	**CNH**	Solomon Island Dollar	**SBD**
Czech Koruna	**CZK**	Swedish Kroner	**SEK**
Danish kroner	**DKK**	Singapore dollar	**SGD**
European euro	**EUR**	Thailand baht	**THB**
Fiji dollar	**FJD**	Tongan Pa anga	**TOP**
Pound Sterling	**GBP**	Turkish lira	**TRY**
Hong Kong dollar	**HKD**	US dollar	**USD**
Hungarian forint	**HUF**	Vanuatu Vatu	**VUV**
Israeli Shekel	**ILS**	Samoan Tala	**WST**
Indian Rupees (RDA)	**INR**	CFP Franc	**XPF**
Japanese yen	**JPY**	South African Rand	**ZAR**

Exotics

Currency	Code	Currency	Code
Azerbaijani Minat	**AZN**	Peruvian Nuevo Sol	**PEN**
Bulgarian Lev	**BGN**	Papua New Guinea Kina	**PGK**
Bahraini Dinar	**BHD**	Philippine Peso	**PHP**
Brunei Dollar	**BND**	Pakistan Rupee	**PKR**
Chinese Yuan Renminbi*	**CNY**	Russian Ruble	**RUB**
Egyptian Pound	**EGP**	Saudi Riyal	**SAR**
Indonesian Rupiah	**IDR**	Seychelles Rupee	**SCR**
Indian Rupees	**INR**	Taiwanese Dollar	**TWD**
South Korean Won	**KRW**	Tanzanian Shilling	**TZN**
Kuwaiti Dinar	**KWD**	Vietnamese Dong	**VND**
Sri Lankan Rupee	**LKR**	CFA Franc	**XOF**
Moroccan Dirham	**MAD**		
Malagasy Ariary	**MGA**		
Malaysian Ringgit	**MYR**		
Omani Rial	**OMR**		

AUD exchange rates

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