

## Hedging Foreign Exchange Risks

By Sam Vaknin, Ph.D.

### Hedging Foreign Exchange Risks

by: **Sam Vaknin, Ph.D.**

The exchange rate of the Macedonian Denar against the major hard currencies of the world has remained stable in the last few years. Because of the IMF restrictions, the local Narodna (Central) Bank does not print money and there are no physical Denars in the economy and in the local banks.

Thus, even if people want to buy Foreign Exchange in the black market, or directly from the banks - they do not have the Denars to do it with.

The total amount of Denars (M1, in professional financing lingo) in the economy is around 200,000,000 USD, according to official figures. This translates into 100 USD per capita. Thus, even if each and every citizen of Macedonia were to decide to convert ALL their Denars to Deutsch Marks - they would still be able to buy only 150 DM each, on average. These tiny amounts are not sufficient to raise the rate at which DMs are exchanged for Denars (=the price of DMs in Denars).

But will this situation last forever?

According to economic theory scarcity raises the price of the scarce commodity. If Denars are rare - their price will remain high in DM terms, i.e. they will not be devalued against the stronger currency. The longer the Central Bank does not print Denars - the longer the exchange rate will be preserved.

But a strong currency (the Denar, in this case) is not always a positive thing.

The Denar is not strong because Macedonia is rich. The country is in a problematic economic situation. The banking system is perilous and unstable. The reserves of foreign exchange are minimal - less than 30 million USD.

The currency is stable because of externally imposed constraints and an artificial manipulation of the money supply.

Moreover, a strong currency makes goods produced in Macedonia relatively expensive in outside, export markets. Thus, it is difficult for Macedonian growers and manufacturers to export. When they sell their goods in Germany, they get DM for them and when they convert these receipts into Denars - they get less than they should have if the Denar reflected the true relative strengths of the two economies: the German one

and the Macedonian one.

They pay expenses (e.g.: salaries to their workers, rent, utilities) in Denars. These expenses grow all the time as true inflation grows (as opposed to the official rate of inflation which is suspiciously low) - but they keep getting the same amount of Denars for their produce and products when they convert the DMs which they got for them.

On the other hand, imports to Macedonia become relatively cheaper: it takes less Denars to buy goods in DM in Germany, for instance.

Thus, the end result is a growing preference for imports and a decline in exports. In the long term, this increases unemployment. Export is the biggest driving force in creating jobs in modern economies. In its absence, economies stagnate and dwindle and people lose their jobs.

But an unrealistic exchange rate has at least two additional adverse effects:

One - as a rule, various sectors of the economy borrow money to survive and to expand.

If they expect the local currency to be devalued - they will refrain from taking long term credits denominated in hard currencies. They will prefer credits in local currency or short term credits in hard currencies. They will be afraid of a sudden, massive devaluation (such as the one which happened in Mexico overnight).

Their lenders will also be afraid to lend them money, because these lenders cannot be sure that the borrowers will have the necessary additional Denars to pay back the credits in case of such a devaluation. Naturally, a devaluation increases the amounts of Denars needed to pay back a loan in foreign currency.

This is bad from both the macro-economic vantage point (that of the economy as a whole) - and from the micro-economic point of view (that of the single firm).

From the micro-economic point of view short term credits have to be returned long before the businesses which borrowed them have matured to the point of being able to pay them back. These short term obligations burden them, alter their financial statements for the worse and sometimes put their very viability at risk.

From the macro-economic point of view, it is always better to have longer debt maturities with less to pay every year. The longer the credits a country (single firms are part of a country) has to pay back - the better its credit standing with the financial community.

Another aspect: foreign credits are a competition to credits provided by the local banking system. If firms and individuals do not take credits from the outside because they fear a devaluation - they help to create a monopoly of the local banks. Monopolies have a way of fixing the highest possible prices (=interest rates) for their merchandise (=the money they lend).

Access to foreign credits reduces domestic interest rates through competition with the local credit providers (=banks).

It would be easy to conclude, therefore, that it is an important interest of a country to be open to foreign financial markets and to provide its firms and citizens with access to sources of foreign credits.

One important way of encouraging people (and firms are made of people) to do things - is to allay their fears. If people fear devaluation - a responsible government can never promise not to devalue its currency. Devaluation is a very important policy tool. But the government can INSURE against a devaluation.

In many countries of the West, one can buy and sell insurance contracts called forwards. They promise the buyer a given rate of exchange in a given date.

But many countries do not have access to these highly sophisticated markets.

Not all the currencies can be insured in these markets. The Macedonian Denar, for instance, is not freely convertible, because it is not liquid: there are not enough Denars to respond to the needs of a free marketplace. So, it cannot be insured using these contracts.

These less privileged countries establish special agencies which provide (mainly export) firms with insurance against changes in the exchange rates in a prescribed period of time.

Let us examine an example:

The firm MAK buys combines and tractors from Germany. It has to pay in DMs.

An international development bank offered to MAK a loan to be paid back in 7 years time in DM.

Today, MAK would be so afraid of devaluation, that it would rather pay the supplier of the equipment as soon as it has cash. This creates cash flow problems at MAK: salaries are not paid on time, raw materials cannot be bought, production stops, MAK loses its traditional markets - and all in order to avoid the risks of devaluation.

But - what if the right government agency existed?

If governmental insurance against devaluation existed - MAK would surely take the 7 year loan. It would take, let's say, 10 million DM.

MAK would apply to the governmental agency with its business.

It would pay the government agency a yearly insurance fee of 2.5% of the remaining balances of the loan (as it is amortized and reduced with each monthly payment). This would be considered a proper financing expenditure and the firm will be allowed to deduct it from its taxable income.

The government will provide MAK with an insurance policy. An exchange rate (let us say, 30 Denars to the DM) will be stated in the policy.

If - at the time that MAK had to make a payment - the rate has gone above 30 Denars to the DM - the government will pay the difference to MAK in DM. This will enable MAK to meet its obligations to its creditors.

MAK will be able to cancel this insurance at any time. If, for instance, it suddenly signs a major contract with a German buyer of its products - it will have income in DM which it will be able to use to pay the loan back. Then, the government insurance will no longer be needed.

This very simple government assistance will have the following effects:

It will encourage firms to obtain foreign credits.

It will create competition to the local banks, reduce interest rates and encourage a wider and better range of services offered to the public.

It will encourage foreign financial institutions to give loans to local firms once the risk of re-payment problems due to a devaluation is minimised.

It will place Macedonia in the ranks of the more developed and export oriented countries of the world.

It will facilitate activities with longer term credits (such as modernization of plants for which longer terms of payments are required).

As time goes by, the private sector may step in and supply its own insurance against devaluation .

Insurance firms the world over do it - why not in Macedonia which needs it more than many other countries?

Sam Vaknin is the author of "Malignant Self Love - Narcissism Revisited" and "After the Rain - How the West Lost the East". He is a columnist in "Central Europe Review", United Press International (UPI) and ebookweb.org and the editor of mental health and Central East Europe categories in The Open Directory, Suite101 and searcheurope.com. Until recently, he served as the Economic Advisor to the Government of Macedonia.

His web site: <http://samvak.tripod.com>

## Explosive Value of Foreign Links

By Ken Kovach

Explosive Value of Foreign Links by Ken Kovach

### Explosive Value of Foreign Links Best Linking Exposure

Do you live in a Foreign Country or speak a second language? Even if you don't, you can take advantage of this easy to implement linking tip.

Do a search on a foreign language search engine for a product very similar to your own. Then simply contact the owner of the site and ask him if he would like to exchange links with you. If you have an affiliate program attached to your product, all the better, as it will give more motivation for the link exchange.

If the site owner agrees, you have just received a valuable link exchange. 1) You are linked to the site which came up first in the foreign search engine for the same product you are offering. Chances are most of the English speakers in that country will follow your link out of interest and that could be a lot of targeted traffic. 2) You have also increased your search engine positioning with linking power.

This can really get exciting if you can exchange links with websites with top search engine positioning. This may be a slower method of building advertising and take a little more of a personal touch. But in the long run the personal touch always wins. Exchanging links like this is almost like endorsing each others products to a degree.

Applying personal niche marketing tactics can bring you more customers and sales in the long run. Scatter Shooting in the Dark with get 10,000 hits type of programs just don't seem to bring in the results. But the personal touch never seems to fail and is always in style.

I opened a website in Japan last year and sent an email to about 30 of the Top English Website owners and asked if they would consider exchanging links. I also offered them a few nice e-Books for taking the time to consider the offer. Of those 30, Ten wrote back wishing me luck and were happy to exchange links. The others didn't feel our sites had that much in common.

The Result was 10 links on Ten Top Sites. These links have provided me with personal visitors and customers. What if you were to apply this link exchange idea offering your product or service instead of e-Books? You can make an offer that is irresistible that will give you good quality links. What would you like to be offered in exchange for a link? Think about it.

Written by Ken Kovach of Success Services Ezine <http://kovach-services.com/ezone> and Kovach Services Ebook & Software Store <http://kovach-services.com> This Article is copyrighted © by Success Services Ezine but may be freely distributed if the signature file and credits remain intact.

Related eBooks:

[Explosive Value of Foreign Links](#)

[Exchange Traded Funds: 7 Reasons They Beat Most Mutual Funds](#)

[Exchange Rate Board](#)

[Learn Currency Trade - Intro to The FOREX Market.](#)

[Risks of Tanning Beds - Not all they are hyped up to be...](#)

Get more Free PDF eBooks at [FreePDFeBooks.com](http://FreePDFeBooks.com)

Related Products:

[14 Profitable eBooks](#)

[English Slang Dictionary](#)

[eZy Auto Hitz](#)

[Script Jungle - You'll Get 10 Great Scripts With Resell Rights!](#)

[Super Charged Linking](#)

[Malamaal.com](http://Malamaal.com): A genuine resource center for Quality Ebooks and Softwares

Co-Sponsored Advertisement:

This PDF eBook is for free Distribution only, it cannot be SOLD  
An online Community Services Directory for the Mid-Columbia River Gorge

[Click here to know more](#)

Powered By [FreePDFeBooks.com](http://FreePDFeBooks.com)

[ReBrand this PDF eBook with your Name / URL / ClickBank Affiliate ID for Free](#)