

Business

Risks in money market and foreign exchange operations

By KA Majid

The convertibility of Taka (although partial at the present time) and its entry into the elite club of floating currencies coupled with deregulation of interest rates offer both challenges and opportunities to banks and corporate treasurers. In the past they had no choice but to operate under the fixed rates handed down by Bangladesh Bank. The new system will throw them in a competitive environment requiring enormous skill, foresight and logistics to operate with finesse and ease. If handled properly, they can profit from the changed situation or else they may incur losses. Banks and corporate treasurers would now need to learn to interpret the signals emanating from macro-economic indicators. These factors influence interest and exchange rates requiring appropriate strategies to avert the risks.

The problems and opportunities of each participant in the money and foreign exchange market are all present in the operations of the Funds or Treasury Manager. The objective of this individual is to manage the cash flows in various currencies in the most efficient and profitable way. The management of cash flows involves making sure that payments are made when due, and that funds received are invested for the best possible return. When dealing in international markets, the funds manager must also maintain the

appropriate positions in various currencies. The desired position in each currency depends on the currencies of the cash flows involved as well as on the managers view of their future values.

The activities of the funds manager are, however, fraught with various risks and unless he has a clear understanding of the risks inherent in each transaction, he is most likely to make mistakes for his organisations.

In the following paragraphs I shall discuss the risk in money and foreign exchange operations:

Types of risk: We can identify three types of risks when operating in the money and foreign exchange markets: rate risk, credit risk, and liquidity risk.

Rate risk: If a Fund Manager anticipates that interest rate is likely to go up the will lead short and borrow long. We can profit in the financial markets by anticipating changes in the rates currently prevailing. It is this anticipation that leads the funds manager to produce "mismatched" cash flow positions.

In the money market, the rate risk arises when the maturities of the placement and the borrowings are not matched. For example, when we lend funds for six months while borrowing with a one month maturity, the interest rate on the six month loan has been locked in from the be-

ginning. However, at the end of the first month, additional borrowings are necessary to repay the initial debt or to roll over the debt. But, at the beginning of the transaction, we do not know with certainty what the interest rate will be at that time. Most likely, the funds manager in this situation is speculating that interest rates will decline after a month. If the assumption proves correct, the funds manager would have look into a high interest rate on the loan for six months while refinancing the operation at a lower interest rate after the initial first month (so he will make profit). If the initial expectation proves to be wrong and interest rates actually increase and keep doing so for the remainder of the loan period, however, the funds manager will be forced to obtain financing (to borrow) at rates which might prove to be higher than the one at which the funds were placed or lent initially (he will incur loss).

In foreign exchange transactions, the rate risk appears in two forms: (1) In net exchange positions, and (2) in swap positions or mismatched maturities. The most obvious case of rate risk is the maintenance of a net exchange position in a given currency. If the position is long or overbought and there is a depreciation of the currency, a loss is sure to occur. On the other hand, if an upvaluation occurs while

the funds manager is holding a long net exchange position, there will be a profit from such a change in exchange rates. The opposite result would occur if the net exchange position was short or oversold in that currency.

The other way in which rate risk appears when one operates in the foreign exchange market is through swap positions. A swap transaction does not affect the net exchange position. By definition, a swap involves a simultaneous buy and sale of currency for two different maturities. For example, the fund manager may buy German Marks against Taka for three-month delivery and sell German Mark against Taka for one-month delivery. Let's say that the forward Mark is selling at a premium against Taka. In this case, in order to make a profit, the funds manager must be expecting that, when the one-month transaction matures, it will be possible to square the two-month gap at a premium larger than the one that prevailed initially. That is, the spread on a per annum basis at which the Mark was purchased for three-month delivery must increase after a month so that the Mark is sold for two month delivery at a premium larger than the one paid to acquire them on the initial three-month contract. If the Mark had been selling at a discount, the funds manager, when entering into

this specific swap, would have expected that the discount would decrease.

This expectation of an increase in the premium or a decrease in the discount of the Mark against the Taka must be based on a change in the relative interest rates. If the initial situation was one of a forward premium on the Mark against the Taka, then in this case, the interest differential was in favour of the Taka. In other words, the interest rate for Taka was higher than Mark, and the forecast implied that the interest differential would become even more strongly in favour of the Taka. If the initial situation was one of a discount on the Mark against the Taka, then interest differential must have been in favour of the Mark. Therefore, the expectation behind the swap transaction described earlier must have been that the differential would narrow (become less favourable to the Mark) either because the Mark rate would decrease or the Taka rate would increase.

Credit risk: The credit risk has to do simply with the ability of the other party to a transaction to meet the agreed upon obligations. Any time one operates in a market, a second party must be brought into the picture if a transaction is to be completed. In financial markets, the ability to meet a contracted obligation translates into the ability to pay

when the obligation to deliver funds matures.

In the money market, the credit risk is very obvious. In this market, one borrows and lends, or places, funds. From our point of view, there is no credit risk when we do the borrowing; however, on the lending (or placing) side, there is always the risk that the borrower will be unable to repay the funds we have lent. In spite of a very profitable rate on the loan, if the borrower is not able to pay back the debt, the funds manager is sure to have a loss.

In the foreign exchange market, one can distinguish between two types of risk. The less serious one appears when the partner is unable or unwilling to fulfill a delivery of a currency promised under a forward contract. In this case, the funds manager is expecting and inflow of funds on the contracted date. Chances are that an outflow had already been planned to ensure the proper use of the inflow promised by the forward contract. However, if the other party to the transaction does not meet the specified obligation and the funds manager needs the funds, the party will have to go to the spot market to obtain those funds. The actual gain or loss in the spot transaction depends on the then-prevailing spot rate of the desired currency relative to the rate contracted through the now-defaulted contract. This risk has

traditionally been called the 10 per cent risk, though the term is quickly going out of style.

A more serious credit risk in the foreign exchange market is the one that has appeared prominently in a few major losses in commercial banks. This situation occurs when the other party to a transaction goes bankrupt on the day of maturity and settlement of the contract or fails to pay settlement funds after the initial leg of the transaction has been completed. Given the time differences among various financial centers, one party may transfer the funds corresponding to his part of the transaction while the other party fails to do so. This loss amounts to 100 per cent of the funds involved.

A subgroup within the credit risk is the sovereign risk. At any point of time, a given country has the prerogative of closing its foreign exchange window. Particularly in countries whose currencies are very sparsely traded in the market, the central bank can be the only source of foreign exchange. Thus, we can have the situation of a very good credit risk in a company located in a country with a high sovereign risk. For example, one can be fairly certain that the corporation will be able to general the necessary local currency to repay a loan we have made in foreign currency. However, if the central bank makes it impossible to convert

the local currency into foreign exchange, the proceeds from the repayment of the loan will not be available in the desired foreign currency.

Liquidity risk: The liquidity type of risk is closely associated with rate risk, liquidity risks arise because the case flows in a transaction are not "square". These case flows are not balanced on purpose because of the expectation of a change in rate (hence the rate risk). However, there is also a risk which arises from the question of ability to obtain the funds when a cash inflow has not been prearranged; this is the liquidity risk.

In the money market, the liquidity risk appears when the funds are placed for a period longer than the source of funds which made the placement possible. Using the same example that we used in the discussion of the rate risk, if we lend funds for six months while borrowing for only one month, a risk exists that at the end of the month when refinancing must be arranged, it will not be found. A tight money market may make it impossible to raise funds in the market regardless of the rate offered; this is liquidity risk.

The liquidity risk in the foreign exchange market also arises from uncertainty or the inability to obtain the funds in the currency desired.

(The author is the Managing Director of Pubali Bank Ltd.)

India fails to utilise donors' aid : ADB

NEW DELHI, Nov 6: Asian Development Bank (ADB) Vice President Gunther Schulz Friday criticised India's failure to use up aid committed to it by donors, reports AFP.

The ADB had allocated four billion dollar worth of assistance to power and highway projects in India which had not been utilised, Schulz told reporters at the end of a three-day visit.

India, he said, had the worst record among borrowers in utilising aid pledged to it, contrasting poorly with Indonesia and South Korea where project

implementation was far swifter. Schulz is the head of a special task force trying to improve the implementation of projects and programmes financed by the Manila-based ADB.

The task force will complete its report by the end of the year after talks with officials of borrowing countries.

Indian officials say they lack matching funds they are required to allocate to projects funded by global lenders has prevented central and state governments from utilising aid and speeding up projects.

Schulz, who met Prime

Minister P V Narasimha Rao and Finance Minister Manmohan Singh during his visit, also cited bureaucratic hurdles impeding faster implementation of projects.

The Indian leaders had told him the government would set up a monitoring system to ensure faster disbursement of aid, and he hoped the situation would change for the better soon, he said.

The ADB plans in India include the financing of energy conservation, environmental improvement and urban development projects.

US accused of inciting illegal Cuban emigration

MEXICO CITY, Nov 6: Cuban Foreign Minister Roberto Robaina prated Mexico for "refusing to serve as a trampoline" for Cuban refugees headed for the United States via Mexico, reports AP.

In rare public comments during a visit Thursday to Mexico, Robaina also accused the United States of inciting illegal Cuban emigration.

"There are 20,000 Cubans currently on lists to leave the country through the normal emigration procedures, but the United States is hindering that process and inciting illegal emigration," Robaina said. He did not elaborate.

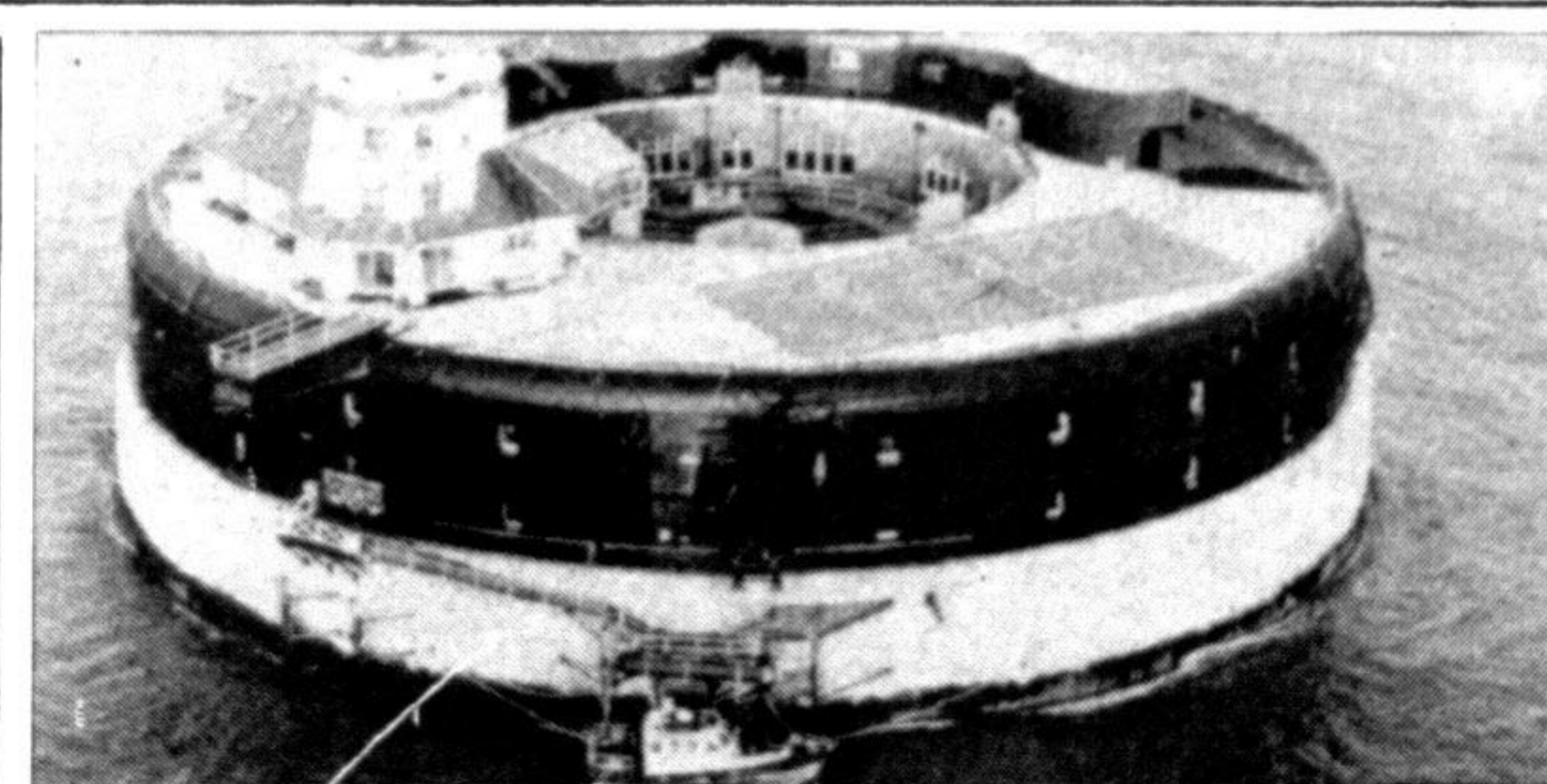
The US Coast Guard concluded a record month by picking up 610 Cubans at sea in October. More than 2,800 Cubans have been picked up this year. US officials have warned that Cuba's worsening economy could bring many more.

Mexico in recent weeks has discouraged Cuban refugees who have gone to its embassy in Havana and tried other means of using this country as a back door to the United States.

In other remarks, Robaina said Cuba's Fidel Castro was wary of heightened activity at the American Naval base at Guantanamo, Cuba, under the "pretext" of problems in Haiti. The base also has long been used by the US Coast Guard to repatriate Haitian refugees.

"We have taken appropriate measures," said Robaina without elaboration.

Robaina was on a mission to invite Mexicans to invest in the slumping Cuban economy. The communist island country is reeling from the collapse of its socialist trading partners in Eastern Europe and the American trade blockade.



A 1990 flier of a converted Victorian fort in the middle of The Solent near Southampton. The fort from the mid-19th century complex with its own lighthouse, helicopter pads and tennis court, has been sold Friday after being for sale for three years after the asking price of 5.75 million pound was cut to 950,000 pound — AFP photo

China expects \$4.9b in ad sales by century end

BEIJING, Nov 6: Spending on advertising in China will soar over the next decade to reach 28 billion yuan (4.9 billion dollar) per year by the century's end, a Chinese official predicted Friday, reports AP.

Liu Baofu, director of the advertising department under the State Administration for Industry and Commerce, said advertising spending will total eight billion yuan (1.3 billion dollar) this year, and is growing at an annual rate of 60 per cent.

Liu was speaking to more than 200 Chinese businessmen and government officials at a daylong seminar on the power of advertising sponsored by Dentsu, Young and Rubicam Partnership.

The seminar included a sampling of advertisements made for American, Japanese and Chinese consumers, which drew some laughs and gasps when shown on a large movie screen.

Liu said the government eventually plans to cut funding to state-run advertising agencies, which dominate the industry, in order to weed out the less professional ones.

A number of foreign advertising companies have entered the China market since the mid-1980s hoping to cash in on the country's rapid economic growth, only to discover that many Chinese companies are reluctant to spend money on advertising.

That is starting to change, said Gary Burandt, president of Dentsu, Young and Rubicam. He said his agency's clients in China include Shanghai-based vitamin and chocolate makers, as well as foreign-Chinese joint ventures.

Another barrier to growth is the government's strict limit on the amount of newspaper space and television time that can be devoted to advertising.



A Chinese amputee plays the organ for passers-by in a Beijing street Friday. Though Chinese law is supposed to protect the rights and provide welfare for the nation's 5.64 million handicapped, reality has many of them fendng for themselves. —AFP photo

Russia to restrict foreign banking activity for 3 yrs more

MOSCOW, Nov 6: Russia intends to restrict foreign banking activity for up to three more years to protect the country's domestic banking industry from large western competitors, Interfax news agency said yesterday, reports AP.

Finance Minister Boris Fyodorov published a statement saying his ministry would uphold current restrictions on granting licenses to foreign banks and disagreed with the central bank's policy of boosting the number of licenses, the report said.

Several senior government officials including first Deputy Prime Minister Yegor Gaidar agreed on the need to limit foreign banking operations in Russia which could have "dangerous consequences" if allowed to expand unchecked, Interfax said.

"Hasty access for foreign banks, which have vast experience and resources, could leave Russian banks in an unequal position," the report said.

Top Russian financial officials agreed foreign banks should hold no more than 12 per cent of all statutory capital in the commercial banking sector, it added.

In an interview with the government Daily Izvestia, Gaidar stated that the government was looking at "supplementary steps" to regulate

foreign banking activity in Russia.

He said discussion in the government on giving foreign banks greater access to the Russian banking sector was "very delicate and important for the national economy" but added he opposed quickly lifting all restrictions on foreign banks.

The newspaper said five more foreign banks, including Citibank and Chase Manhattan, were recently awarded licenses to operate in Russia but so far only the French Bank credit Lyonnais had the right to operate on a par with Russian commercial banks.

Gaidar said the list of foreign banks seeking licenses to operate in Russia had grown in recent months amid signs of economic stabilization and warned "the current haste to satisfy the needs of this waiting list could have dangerous consequences."

"I am not convinced this haste is justified," he stated, adding that while strong competition in Russia's banking sphere as needed it should not come at the expense of the country's fragile domestic banks being overrun by western giants.

The headline over the interview stated that foreign banks "could have a strong influence on the balance of political forces" in Russia and an introduction to the interview said the growth of foreign bank operations in Russia could "push Russian banks against the government."

Dmitri Tulin, a Russian central bank vice-president, said however that so far foreign banks accounted for less than five per cent of all capital in the Russian commercial banking sector and noted increased competition would benefit clients.

The daily reported that some 500 large and medium-sized domestic banks were worried about the "easy access" to the Russian market for large western competitors and were planning to protest to the government.

Hoffman-La Roche sells its equity in India

BOMBAY, Nov 6: The Swiss pharmaceuticals giant Hoffman-La Roche Ltd has sold its equity in its Indian venture Roche Products Ltd to the local business group Piramal Enterprises, company officials said yesterday, reports AP.

Hans-peter Ruede, a senior executive of Hoffman-La Roche Ltd, told reporters here that the Piramal group had taken over Roche's 74 per cent interest in Roche Products Ltd.

But he said the sale did not mean that Roche was pulling out of India.

"We have signed an agreement with the Piramal Group to reinforce the presence of our pharmaceutical products in the Indian market," Ruede said.

"We are restructuring our set-up here in collaboration with a strong and dynamic Indian partner," he added. "Piramal will have full operational responsibility in India while Roche will continue to supply new products and technologies."

"It will result in a win-win situation for everybody," he said.

Ajay Piramal, Chairman of Piramal Enterprises, said his group had entered into a collaboration with Hoffman-La Roche.

"It will be a long-term strong alliance. We will have access to the latest drugs from Roche, which is very strong in research and development," he said.

World trade talks US launches counter-offensive against EC campaign

BRUSSELS, Nov 6: US embassies in European Community countries have been instructed to launch a counter-offensive against an alleged EC propaganda campaign concerning GATT world trade talks.

In a cable to the embassies obtained by AFP, the US State Department ordered them to approach EC governments before Monday to "set the record straight" about allegedly generous European tariff-cutting concessions.

The State Department's action was aimed to pre-empt an expected attack on the United States and Japan by EC foreign ministers during their scheduled meeting here at Monday.

In a report for the meeting

EC Trade Commissioner Leon Brittan blamed the United States and Japan for holding up progress in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT).

The seven-year round of negotiations faces make-or-break deadline of December 15. Brittan said the EC might withdraw tariff-cutting concessions it has made in Geneva because of US and Japanese failure to match them.

But the US State Department said in the cable that the EC offer — made last month in accordance with an agreement in Tokyo last July with the United States, Japan and Canada — fell far short of its promise.

"Since the tabling of its revised offer on October 18, the EC has been engaged in a propaganda campaign touting the alleged benefits of the offer," the cable said, adding that the community's claims were unfounded.

It instructed embassies to "set the record straight" with EC governments before Monday's meeting, which was expected "to reinforce the perception that the EC's offer is generous and merits a big response from the United States."

The US State Department criticised the EC offer particularly for avoiding major tariff cuts in natural resources such as fish products, non-ferrous metals, wood and paper.

Gore-Perot debate on NAFTA Wednesday

WASHINGTON, Nov 6: Vice President Al Gore and Texas billionaire Ross Perot will go head-to-head in a televised debate on the North American Free Trade Agreement (NAFTA) next week, reports AP.

"I hope it will be an honest discussion, not a show," President Bill Clinton said before terms were finally agreed for a 90 minute debate to be held at 0200 GMT Wednesday on Cable News Network.

"What Ross Perot wants is a show, not a debate," Clinton said. "Perot's arguments have been largely discredited when he's been questioned."

The administration, concerned that Perot's populism is detracting from its exhaustive efforts to sell the NAFTA accord, challenged Perot to a debate on Thursday.

Perot, last year's third candidate in the presidential election, sought three separate debates but the White House insisted there be only one, terms were finally agreed on Friday.

Perot Thursday called the White House debate offer an act of desperation and called NAFTA another stupid agreement rammed through by special interests.

The NAFTA accord, if finalised, will link the United States, Canada and Mexico in the world's largest free trade

zone in terms of population. It comes before a House of Representative vote November 17.

Perot and Clinton, along with then-President George Bush, took part in three prime-time televised debates shortly before last year's November 3 presidential election.

Since then, Perot has remained active in politics and has made NAFTA his rallying cry, saying that it would mean the loss of thousands of US jobs to cheap Mexican labour.

Japan's electronics giants offer lower bonuses

TOKYO, Nov 6: Japan's electric and electronics companies, hurt by almost three years of economic slowdown, on Thursday offered their labour unions smaller annual bonuses, averaging five months' salary for each member, reports AP.

Last year, major electronics companies paid summer and winter bonuses that added up to an average 5.2 months' pay for each employee.

Summer and winter bonuses are a regular part of income for Japanese workers, but their sizes vary from industry to industry and depend on business conditions.

Sylhet Gas Fields Limited
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Tender Notice

Memo No: 11.22.28/06 Dated : 27-10-93

Sylhet Gas Fields Limited invites sealed tenders from internationally reputed bonafide suppliers/importers/dealers for purchase of "Desk Top Photocopy Machine" (dry system).

Tender schedule containing terms & conditions can be purchased by 20-11-93 on payment of Taka 400/= (four hundred) per set (non-refundable) on any working day during office hours from the undermentioned offices.

A) Head Office, Sylhet Gas Fields Limited, Post Office : Chiknagol, District : Sylhet.

B) Dhaka Liaison Office (Sylhet Gas Fields Ltd.), 74-B, Green Road, Dhaka.

Tender should be dropped in the tender box kept at the above offices by 11-00 am on 21-11-93, which will be opened on the same day at 11-30 am in presence (if any) of the tenderers or their representatives. In case the offices remain closed under any circumstance of the prescribed date. The tenders will be received/opened on the next day at the same time.

The authority reserves the right to accept or reject all tenders without assigning any reason.

Md. Rahikur Rahman
Deputy General Manager
(Admin & Pur)

DFF (G) 17771-31/10
G-1512
for General Manager (Admin)