HOW IMPORTERS USE TRAILING FORWARDS

Sometimes, businesses want protection for their FX exposures as well as the flexibility to participate if exchange rates move in their favour. You might know about Forward Exchange Contracts, and how they could help manage your business’ FX risk. You may also know that Forwards don’t provide any participation in favourable moves in the spot rate. In this short video, we’ll look at the difference between a Forward and a Trailing Forward, to compare the certainty and flexibility they could provide to your business.

A Forward Exchange Contract works by securing a known exchange rate with a specific amount, for a date sometime in the future. So whether you’re making payments to an overseas supplier, or receiving payments from overseas, Forwards can give you certainty in the ups and downs of a volatile market.

With a Forward Exchange Contract, you are protected against any movements in exchange rates for the value of your contract, regardless of how exchange rates move.

However, if at maturity the spot price is more favourable than your Forward Exchange Contract, Forwards won’t allow you to participate in the favourable exchange rate. This is where a Trailing Forward can help businesses that want the certainty of a Forward plus some ability to participate in favourable spot rates, where possible.

Trailing Forwards provide similar protection to a Forward Exchange Contract, with an important additional feature. An option, or rebate level, is included in your Forward Exchange rate. At expiry, if the spot rate is better than the rebate level, NAB will credit you the difference.

Let’s look at an example.

Maria runs an online organic food store and pays her suppliers in the United States.

She needs to make a payment in US Dollars of $200,000 to a supplier in 3 months’ time.

Maria decides to lock in a Forward for USD $200,000 at 0.7300.

If at the same time, Maria buys an option with a 3 month expiry, to sell USD $200,000 and buy Australian Dollars at 0.7350, it creates a Trailing Forward. Let’s fast forward 3 months. If at the end of Maria’s Forward Contract, the Australian dollar spot rate is at 0.7500, NAB will exercise her option and credit the difference between the rebate level of 0.7350, and 0.7500 into Maria’s nominated account, being $5,442.18 Australian Dollars. If however, the spot rate is 0.7300 at the end of the contract, Maria would not receive a credit because the spot rate is below the rebate level and therefore the option is not applicable.

By combining the Forward Exchange contract with an option, a Trailing Forward gives Maria both the protection from adverse rate movement and peace of mind that if the Australian dollar moves favourably above an agreed spot rate, she still benefits.

But please keep in mind, the cost of the rebate option is built into the Forward Exchange rate. This means that the protection level of your Forward Exchange Contract within the Trailing Forward will always be less favourable than if you entered into a simple standalone Forward Exchange Contract.

The Trailing Forward has its own unique costs and benefits. They are however, another valuable tool available to importers and exporters to help manage their international payments.

To find out more and see if a Risk Management strategy can work for your business, speak to your Business Banker or call the NAB Markets Team on 1300 960 355.

NAB. More than money.

Examples are for illustrative purses only and does not reflect current prices or outcomes. The information provided on this webpage is intended to be of a general nature only. It has been prepared without taking into account your objectives, financial situation or needs. Before acting on the information on this webpage, National Australia Bank Limited (ABN 12 004 044 937, AFSL and Australian Credit License 230686) (NAB) recommends you consider whether it is appropriate for your objectives, financial situation and needs. NAB recommends that you seek independent advice before acting on any information on this webpage. NAB recommends you consider the Product Disclosure or other disclosure document, available from NAB, before making any decisions regarding these products including whether to acquire or to continue to hold a product or service mentioned.