Variable Forward Plus

Importers and exporters know that foreign currency movements can have a big impact on cash flow and profitability.

There are a number of different products available at NAB to help manage the impact of these movements.

A Variable Forward Plus can help manage exchange rate risk, with the aim of protecting against unwanted currency movements and potentially allowing you to take advantage of favourable ones.

Here’s an example of how a Variable Forward Plus could help a local Australian business manage their foreign exchange risk.

George imports shoes to sell online. It’s a competitive market. When his business started out, George would buy foreign currency only when he needed it, using the spot rate.

Over time, he realised that the ups and downs of a volatile currency market were impacting his profit and cash flow.

George then started using Forward Exchange Contracts to lock in pre-determined exchange rates for specific amounts of foreign currency at certain dates in the future.

This gave him more certainty over his anticipated cash flow.

George then decided to enter into a product called a Variable Forward Plus, so that he could still protect against unfavourable movements in exchange rates, but potentially also participate in favourable movements.

A Variable Forward Plus allows George to lock in a specific exchange rate, called the Transaction Rate, which will always be less favourable than the equivalent rate available under a Forward Exchange Contract.

George agrees to buy 400 thousand US Dollars at a Transaction Rate of 73 US cents per Aussie Dollar in 6 months’ time.

As part of the transaction, George selects a Trigger Rate of 72 US cents to 1 Aussie Dollar.

If the Trigger Rate is met during the term of the contract, George may potentially be able to benefit from subsequent favourable exchange rate movements.

During the life of the contract, if the spot rate does not hit the Trigger Rate of 72 US cents, the Variable Forward Plus works like a Forward Exchange Contract.

George is obligated to buy 400 thousand US Dollars at the agreed Transaction Rate of 73 US cents to 1 Aussie Dollar, no matter where the currency is trading when the contract matures.

If, at any time during the life of the contract, the spot rate hits the Trigger Rate of 72 US cents, and the spot rate is then more favourable than the Transaction Rate of 73 US cents when the contract matures, then George may buy US dollars at the current more favourable spot rate instead of the lower Transaction Rate.

However, if at contract maturity the spot rate has fallen back below the Transaction Rate of 73 US cents, George will still be able to buy 400 thousand US Dollars at the Transaction Rate of 73 US cents to 1 Aussie Dollar.

The Variable Forward Plus is a risk management strategy that can offer the comfort of protection against unfavourable exchange rate movements, with the potential to take advantage of favourable movements if the Trigger Rate is hit during the life of the contract.

However, it is important to keep in mind that because of the potential flexibility a Variable Forward Plus offers, the transaction rate offered under a Variable Forward Plus will always be less favourable than the rate available under a Forward Exchange Contract. There are benefits and risks associated with entering into a Variable Forward Plus.

Want to know if a Variable Forward Plus could help your business? Speak to your NAB Foreign Exchange Specialist or contact the NAB Markets Team on 1300 960 355.

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