Coming to America

FX expert Jiro Okochi discusses the impact of the European sovereign debt crisis

AFP: Where do you think the euro is going, over the short term and over the long term?

Okochi: That's a very good question. Yesterday, we had our user group meeting and we had a bunch of folks offering their predictions and the general consensus is the euro is going to continue to weaken. The question is, how much and how soon? Certainly 1.20 seems to be an easy target to reach. The question is, how long will it take to get to 1.10? There was an interesting comment in the user group meeting that this is where the euro always should have been as opposed to how high it did actually get. The recent incident is a simple test of how the euro can function long term when it's so hard to control the individual countries and their fiscal discipline.

AFP: Would you say the drop to 1.10 will come in the short term or more over the long term?

Okochi: It's possibly that by end of the year we could see it close to the 1.10 level.

AFP: How can companies hedge themselves against the euro's volatility?

Okochi: In theory, if a company has a good risk management policy and hedging strategy these types of things should be exactly what they take into account. Frankly, it's difficult to predict where market prices will go especially with extraneous factors like governments writing trillion-dollar checks. A good hedging program should stand on its own two feet. That should be the answer for all corporates.

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I think where corporates run into challenges is if they don't have a hedging program much past 12 months. You can get caught on the wrong side into 2011. And outside of buying collars, most corporates don't take advantage of buying out-of-the-money options to protect against some of the more drastic scenarios, and perhaps you could call this a drastic scenario.

AFP:What currencies will benefit from the euro's volatility?

Okochi: Clearly the U.S. dollar is seeing some benefits, since the U.S. now isn't the only one writing trillion-dollar checks. The yen always has remained relatively strong despite Japan's own fiscal challenges over the last decade, and the Swiss franc not being part of the euro and being one of those flight-to-quality-type currencies has picked up.

AFP: How will all this impact the BRIC countries—Brazil, Russia, India and China?

Okochi: Whenever you have a sovereign debt crisis everyone reminds themselves of what typically are the sovereign debt crises that occur in Latin America or Eastern Europe. So, on the one hand the BRIC countries are breathing a sigh of relief that it's not them. On the other hand, although they are far removed from this current problem, when you get this mad rush for flight to quality I think people also pull back with exposures to the BRIC countries. Brazil just announced some deficit cutting and that's helped their currency, but we haven't seen much movement in the Mexican peso or in Argentina's currency, which has its own challenges. It's just another reminder that when sovereign debt troubles do occur the flight to quality quickly comes back to the U.S.

This article was adapted from an interview with Jiro Okochi, CEO of Reval. The entire interview is available as podcast here: www.AFPonline.org/podcast.