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Would you buy your car or boat without first agreeing the price?

Probably not. Yet this is what many people do when buying their car or boat from an overseas supplier if they have not considered how they are going to buy the foreign currency needed to pay for it.

Exchange rates play an important role in your new purchase as they determine how much foreign currency, such as Euros and US Dollars, your Pounds sterling will buy. Obviously, you will want to pay the least and buy for the cheapest price you can. Therefore you should aim to obtain the greatest amount of foreign currency for every single Pound you spend.

This document is intended to help you understand the various methods available to you to best manage your currency transaction. We will show you how simple buying an imported car or boat can be and how exchange rates should be seen as an opportunity rather than something to be feared.

SCENARIO – BUYING A NEW CAR

Many imported cars are purchased to order with a specification chosen by you. Usually a deposit will need to be paid to secure the order followed by a final balance payment prior to collection or delivery. During the weeks or months between placing the order and taking delivery, the exchange rate will continue to move up and down and you are exposed to currency risk; the risk that the exchange rate may move adversely against you within the period between you agreeing to buy the car and needing to pay for it.

No doubt, the reason for seeking to buy your new car overseas is to avoid the rip off prices often encountered in the UK; well known by manufacturers as "Treasure Island" for the inflated prices that have been traditionally charged here. So the measure of 'success' in buying your new asset is determined by:

1) How little you pay for it.
2) How simple and risk free your purchase is.

To make the process worthwhile, you will need to overcome this common 'time lag' problem. The following example will help demonstrate how this can be achieved.

If we take the scenarios of a car being imported from Germany and a boat from France as examples, the tables below outline typical payment schedules:

Price of Car	Payments	Quantity	Payment Date
EUR 80,000	10% deposit	EUR 8,000	8/6/04
	90% balance payment	EUR 72,000	8/10/04
TOTAL	**100% payment**	**EUR 80,000**	**4 Month period**

Price of Boat	Stage Payments	Quantity	Payment Date
EUR 300,000	10% deposit	EUR 30,000	8/6/04
	45% 1st payment	EUR 135,000	8/9/04
	45% final payment	EUR 135,000	7/1/05
TOTAL	**100% payment**	**EUR 300,000**	**7 month period**

For the sake of simplicity, let's examine the car purchase in more detail. As each payment will be required in Euros, you will need to exchange your British Pounds into Euros before the designated payment dates. Therefore, the exchange rates achieved will determine the amount of Pounds sterling you need to pay to buy the required quantity of Euros.

Given the three month timeframe and inherent uncertainty, you will be pleased to hear there are various ways in which you can buy your currency and make your payments effectively. You choose the plan that suits you best.

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LOW RISK STRATEGY – BUY THE CURRENCY UP FRONT

If you want to know all your costs up front, then this may be the solution for you. To reduce the ongoing exchange rate risk, this strategy involves the immediate purchase of the full EUR 80,000 on a spot contract. The 10% deposit needed for the first payment, amounting to EUR 8,000, would be immediately transferred to the supplier and the remaining EUR 72,000 balance would be held in a transaction account with Halo Financial or another Euro designated account of your choice. The Euros required for the balance payment can be debited from your account as and when required.

Key features

+ Simple and effective in eliminating currency risk
+ All costs are known at the outset
- All Sterling funds must be available from the outset
- Funds could be better invested elsewhere as EU & US interest rates are comparatively low.

If these last two points strike a chord with you, an alternative strategy might be preferred.

HIGH RISK STRATEGY – IGNORE STRATEGIES AND EXCHANGE YOUR FUNDS AT THE LAST MINUTE

This is a common course of action for importers of goods from overseas who may be unaware of the risks that exchange rate fluctuations bring. Sadly this inaction often costs them a lot of money. This, higher risk strategy, involves buying the Euros needed to pay for each payment on spot contracts as and when the payments are required.

The Pounds sterling / Euro (GBP/EUR) chart below illustrates how volatile exchange rates can be. The jagged line represents the exchange rate over the course of a 12 month period and the boxes detail when your payment would be required and how much you would need to pay.

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Remember that, in this example, each payment is required in Euros, so you would need to exchange your British Pounds into Euros by the designated payment dates. Therefore, the exchange rate available on each payment date will determine the amount of Pounds sterling you need to pay to buy the required quantity of Euros.

Car Price	Stage Payments	Quantity	Prevailing Floating Exchange Rate	Pounds Sterling Cost
EUR 80,000	10% deposit	EUR 8,000	1.5011	£ 5,329
	90% balance payment	EUR 72,000	1.4461	£ 49,789
TOTAL	100% payment	EUR 80,000	-	£ 55,118

Key features

+ You outlay no money on each payment until the last minute
- You do not know how much the car will cost until you have made all your payments and added up the costs.

+ The exchange rate may continually move in your favour over the 3 month period before you need to make your final payment.
- But they rarely do for this length of time.

By adopting this plan, you remain uncertain as to what the car will ultimately cost and run a far higher risk than is necessary. After all, would you agree to buy a car at home without knowing what it is going to cost you until the delivery date?

RISK MANAGEMENT STRATEGY – BUY THE CURRENCY ON A FORWARD BASIS (PERHAPS THE BEST OF BOTH WORLDS)

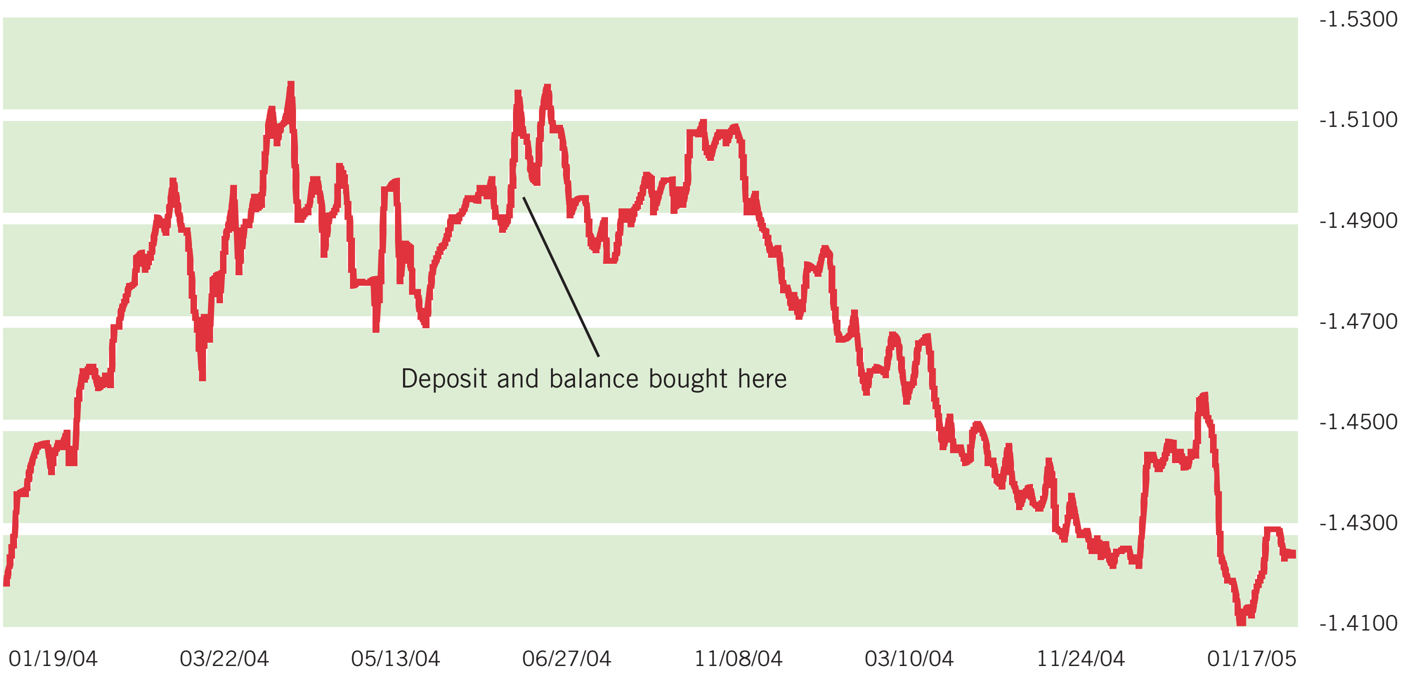
Forward contracts are beneficial as they allow you to:

- Manage your currency risk
- Identify the Pounds sterling cost of your purchase from the outset
- Keep you cash rich by not tying up large quantities of your money

In many ways they are perfect for importing from overseas as they offer a simple, risk free means of buying foreign currency.

Forward contracts enable you to fix an exchange rate at the outset for delivery and settlement of your foreign currency at an agreed date in the future. As it is fixed, the exchange rate is therefore not subject to rampant currency fluctuations so you can budget for future payments far more easily as you know your commitment in Pounds from the start.

The Pounds sterling / Euro (GBP/EUR) chart below illustrates how a forward contract can iron out currency volatility:



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In addition, a forward contract can be agreed and an exchange rate fixed without the need to pay for the contract in full, in advance. In fact, a major advantage of forward contracts is that the immediate payment of a small deposit equal to 10% of the amount you wish to buy, can fix an exchange rate against the full payment value, with the 90% balance payable upon the contracts completion. For example, if you need to buy £100,000 of currency, all you will need to send us is a £10,000 deposit immediately and £90,000 at an agreed date in the future.

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In the above example, the deposit, as requested by the supplier was paid immediately on a spot contract at an exchange rate in January. The balance payment was purchased on a forward contract to fix the exchange rate and protect it against any deterioration in its value. You will notice that the balance payment was purchased against the fixed exchange rate rather than at the prevailing market exchange rate, which had deteriorated significantly.

The financial savings from this risk management strategy versus the high risk alternative, is outlined in the table below:

Price of Car	Payments	Quantity	Prevailing Floating Exchange Rate	Pounds Sterling Cost	Fixed Forward Exchange Rate	Pounds Sterling Cost	Saving
80,000	10% deposit	8,000	1.5011	£ 5,329	1.5011	£ 5,329	£ 0
	Balance payment	72,000	1.4461	£ 49,789	1.4900	£ 48,322	£ 1,467
TOTAL	**Full payment**	**80,000**	**-**	**£ 55,118**	**1.6655**	**£ 53,651**	**£ 1,467**

Not only can forward contracts save you money, they also reduce the administration and worry often associated with currency buying. These contracts are very flexible, allowing smaller sums of money to be drawn down within the contract period should you require them. Indeed, should you experience any delay in the delivery of your imported car new purchase or should it be delivered earlier than anticipated, your contract can be amended to reflect this.

Foreign exchange therefore has a very direct impact on the price you pay for your imported car. Generally the longer the timeframe the greater the extent of a currency's volatility. However, it is worth noting that, in time of increased exchange rate volatility, shorter timeframes can be equally affected. Should you be buying a car where delivery can be affected within 30 days, do not make the mistake of assuming you will be unaffected. Risks remain – risks that could prove very expensive if not considered and managed early.

OUTCOME

The above generic examples help to explain the importance of foreign exchange within the process of importing goods from overseas. They also show that when you buy and the means you use to buy your currency will have an impact on your overall costs and cash flow, The confidence needed to manage the risks comes from knowledge and guidance – we hope we have given you a head start. However, your circumstances are unique and so the solution that bests suits you is likely to be unique as well. We recommend you contact us for a personal consultation to discuss your individual requirement.

GETTING STARTED

For further information on how we can help and to enquire about account opening documentation, please contact the private client team on:

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