BMW bets on rebound for falling US dollar: German carmaker stops long-term hedging

By STEVE JOHNSON and JAMES MACKINTOSH

BMW, the German luxury carmaker, has stopped all long-term hedging of the dollar, seeing an end to the US currency's two-year decline.

The company is one of Europe's heaviest users of currency hedging to protect its revenues from volatile foreign exchange markets. But it now believes the US currency is "significantly" undervalued and must bounce back.

The dollar has fallen by 29 per cent against the euro in the past two years, pricing many European exporters out of US markets. As the US currency approached the Dollars 1.30 mark against the euro earlier this year, European politicians clamoured for a cut in interest rates to make the eurozone more competitive.

BMW said it believed the "correct" value for the dollar was Dollars 1.10 to the euro compared with Dollars 1.22 - the level it reached in late trading yesterday.

But the carmaker could be premature in its belief in a dollar rebound as few strategists are confident of a dollar bounce in the near-term, and currency traders remain concerned about the twin US deficits.

Bob Sinche, head of currency strategy at Citigroup, said the "panic mentality" that set in as the dollar fell rapidly late last year was diminishing, but few companies seemed to be ready to go completely unhedged. "We have not seen a lot of discussion (from companies) about whether the process of dollar weakening has come to an end," he said. "The general notion remains one of concern about the dollar on a medium-term basis, and corporates are using periods of dollar strength to put on some hedging."

Volkswagen, Europe's biggest carmaker, increased its hedging at the end of last year after the falling dollar knocked Euros 1.2bn (Pounds 810m) from annual profits.

Pension funds buying US assets appear to be reducing their level of hedging, however. "There are indications that institutional (pension fund) investors do not seem as keen to hedge their dollar exposure as they were in 2003 or even 2002," said Michael Metcalfe, currencies strategist at State Street Bank.

BMW said it was limiting its use of derivatives to protect against the weak dollar to short-term "buying on the dips".

"We think that the euro will go down again," said Stefan Krause, finance director. "In such a period of significant under-valuation of the US dollar it is important to remain consistent and to have the courage not to hedge at unattractive currency rates."

Hedging the dollar has become important to BMW because the US last year passed Germany as the company's largest market. But the strength of the euro against the dollar is also a wider issue for the German economy.

Mr Krause said BMW remained "widely" hedged this year, with between two-thirds and all of the US turnover covered. He also said the company had other hedging options, such as cutting the allocation of vehicles to sell.

The company still has short-term hedges in place for next year, but surprised analysts by saying it had not increased these beyond the one-third of turnover already covered.
Currency hedging

BMW believes the US dollar is undervalued and will rebound. It would do well to remember John Maynard Keynes' remark: in the long run we are all dead.

Econometric modelling offers support for the view that the dollar is below its long-run equilibrium rate. But the it needs to remain undervalued for some time if the US is to rein in its current account deficit and growing international indebtedness.

Regardless of whether BMW's view is correct, its decision to stop hedging raises wider issues. Denominating debt in different currencies and shifting production overseas can help match assets and liabilities, reducing both the translation and transaction impact of currency fluctuations. For the remaining exposure, one view is that hedging is a speculative punt to be avoided. But leaving cash flows unhedged is as much of a punt. Imagine the furore if companies did not manage their debt. But the choice between fixed and floating rate structures is dependent on a speculative view of interest rates.

BMW has not stopped taking a view on the dollar. It has an explicit opinion and has offered some transparency on the extent of its existing hedges. However, with the availability of increasingly sophisticated hedging instruments perhaps it can be criticised for the bluntness of its approach. Numerous companies have cited dollar weakness for earnings shortfalls. The question should be why more are not actively managing their currency exposure.