

Understanding the currency market

Anne Louise Bannon

If you feel like there is something really mysterious and amorphous about the process of establishing exchange rates for money, you are far from alone. And you may even be tempted, especially if you are producing for the internal market with no intention to export, to just ignore the whole mess.

But the value of the dollar in other countries can have a serious effect on your bottom line, even if you are not actually doing business outside the United States. You may get your corks and barrels from an American supplier, but if that supplier is getting them from sources in the European Union (E.U.), then how much you are going to pay will have a lot to do with how many euros a dollar will buy.

That's not even counting competition issues. If you know that the dollar is really strong against the Australian dollar, you can re-think your pricing strategy and maybe consumers won't be so quick to pick up that Shiraz instead of your Syrah.

And if you are thinking about getting into the export market, knowing what the dollar is doing where will go a long way to helping you decide when and where to launch your product.

Understanding the currency market is not really difficult, even though there are many different factors that go into determining what various currencies are worth. The most important, of course, is the strength of a given country's economy. When an economy is healthy and growing, people want

to invest in it, and if they are from outside the given country, they are going to need that country's currency to do it. The more people want the money, the value grows.

But there are other factors, said Alex P. Beuzelin, a senior market analyst for Ruesch International, a currency trading firm that numbers many wineries among its clients. What is going on with a country politically, for example, can affect future economic health. If the rest of the world does not like the way a given leader is doing something, they may decide not to buy goods from that country. Social unrest, like labor strikes and coups (which are also political), can drive away investors. In either case, the currency's value goes soft, or even tanks.

All these factors play against each other in different ways, too, so that what you think would be happening sometimes does not because of some other factor elsewhere.

For example, as Beuzelin explained, the U.S. economy is slowing, so you would think that the dollar would be losing value against the yen, the euro and other currencies. But it is still going strong.

Beuzelin pointed out that people who buy currencies think that our economy is going to recover, or at least be in better shape than, say, the European economy.

"In the world of foreign currency, they retain a relatively higher level of confidence in the dollar," Beuzelin explained.

But who are "they"? "They" are the banks and other institutions that buy currencies all the time on the currency market. They buy currencies in huge amounts day in and day out either to do business internationally, themselves, or to sell to people who do international business.

The currency market, itself, is amorphous. In fact, unlike the New York Stock Exchange, it does not even exist as a physical building. Both Beuzelin and the *Wall Street Journal's* "Guide to Understanding Money and Investing" describe the currency market as a network of interconnected telephones and computers operating around the clock.

Traders working for the banks and other financial institutions tap into this network all day to buy the money their institutions need to fund currency exchanges for other, smaller businesses, such as your barrel supplier who needs to buy those French oak barrels.

But, of course, rates change every day, and even among institutions. Some banks offer more dollars to the euro than others. So why isn't there a fixed value to currency? Well, because money does not really have a fixed value. The value of money has always been determined by how much you could buy with it. For example, during the raging inflation that Germany experienced in the 1920s and '30s, you could not buy anything with the paper money, which meant that the Deutsche mark had almost no value.

So buying currency is not unlike buying antiques and collectibles. Say you want to buy a vintage Margaux. You

look it up in the collector's directory, you see that most collectors will generally sell it to you for x amount of money. But that does not mean you will pay that price. Maybe there is a run on all things Bordeaux—collectors know they can get more for it and have raised their prices. Maybe you can find a collector who will sell it to you for less. The directories that set the value of a collectible wine are listing what most people seem to be paying. The actual price that you pay is what you negotiate with the seller.

It's the same thing with money. The value of the dollar is determined by what most people seem to be paying for it, which is determined by economics, politics and social situations. That is the amount you see listed in the newspaper. But if a currency trader in the U.S. hooks up with an electronics firm in Germany that wants to buy a large amount of U.S. dollars to cash in on the falling prices of circuit chips, the American trader may be able to get more euros to the dol-

lar simply because the German firm needs the dollars right away.

Beuzelin explained that this sort of thing usually happens between banks and financial institutions in billion-dollar trades. This, of course, can work for smaller buyers, because they can shop around for the best prices.

Smaller traders can also take advantage of the different ways currencies are traded, such as options and futures, but those get complicated and require a seasoned broker specializing in currency trading to negotiate.

One of the simpler ways is called a forward contract. Let's go back to those French oak barrels. You, or your supplier, know that you are going to need to buy several barrels later this year. The dollar is going strong, but things are looking iffy with the economy, and you are worried that it might start diving when you actually need the barrels. On the other hand, you do not want to buy

the barrels now because of storage hassles. So you set up a forward contract with a currency broker, which means you agree to buy euros at today's rates, no matter what happens to the rates when you actually buy the barrels. If the dollar is stronger, getting more euros, then at least you bought some certainty. If the dollar does a nosedive, and is worth less, you are covered.

You'll note I have not said anything about francs. That is because in international trading, which is mostly electronic transfers, business with anyone in the E.U. is being done in euros. Now, if you want cash while traveling in France or Germany etc., you will be using francs or marks etc., until January 2002, when the euro takes over. Which is worth remembering. ☉

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