Retrospective Analysis of Exchange Rate Forecasts

Distribution of Analysts' Forecast Errors

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Summary

Analysts' forecasts should not be used to define a hedging strategy.

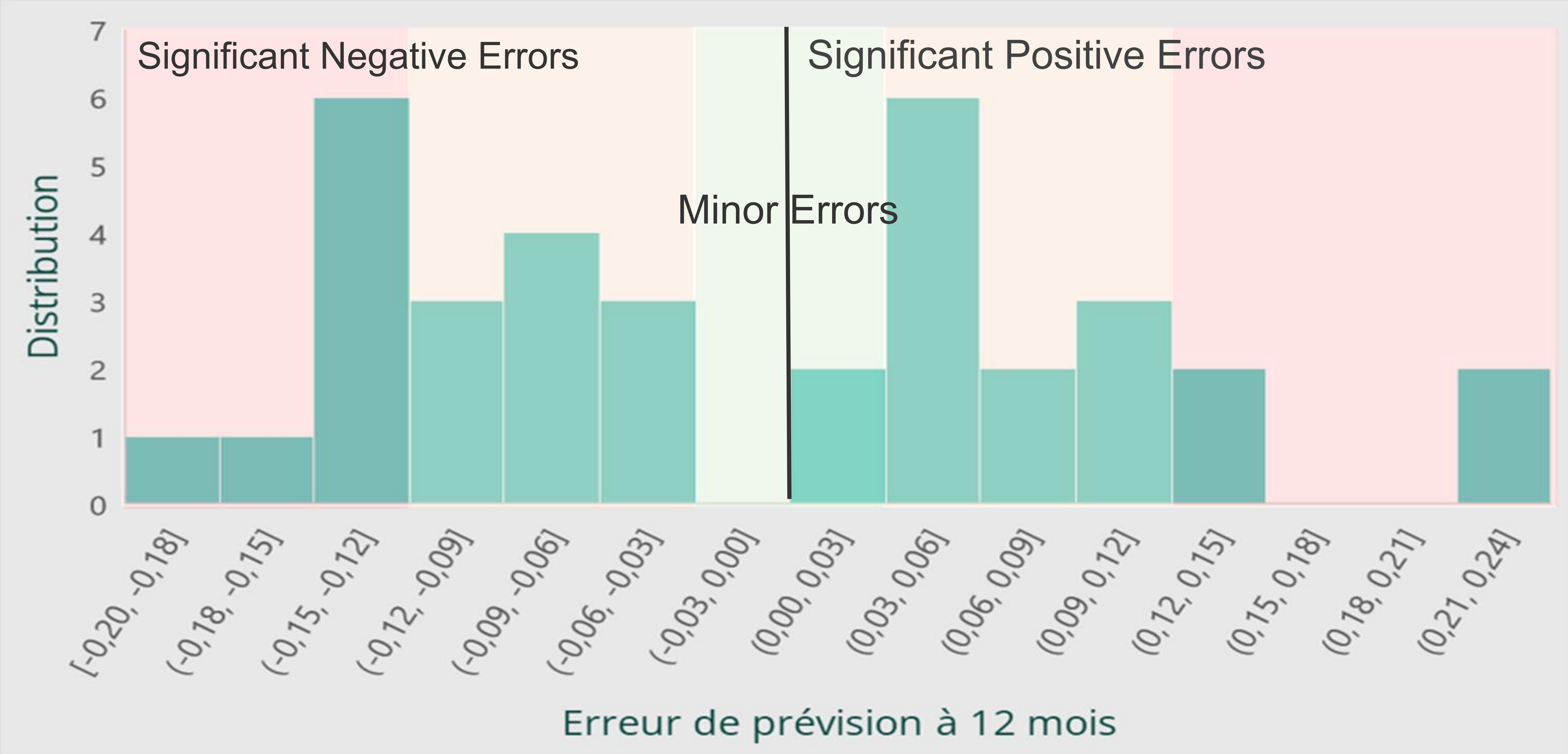
Forecasting models for exchange rates, interest rates, or commodities show no statistically significant predictive ability. They are counterproductive for predicting the future (see statistical analysis below).

Common mistakes to avoid

- Choosing products that outperform in the scenario predicted by analysts, as they carry a major risk in other cases;
- Determining a hedging date based on forecasted developments rather than on the date the risk arises (for example) exposes one to losses;
- Setting an entry level based on the favorable level of forecasts can lead to missed or poorly executed hedges.

Conclusion: never use forecasts to define a hedging strategy (product, amount, or hedging horizon), as events regularly render them obsolete within 24 hours.

Retrospective Analysis of 12-Month Forecast Errors on EURUSD



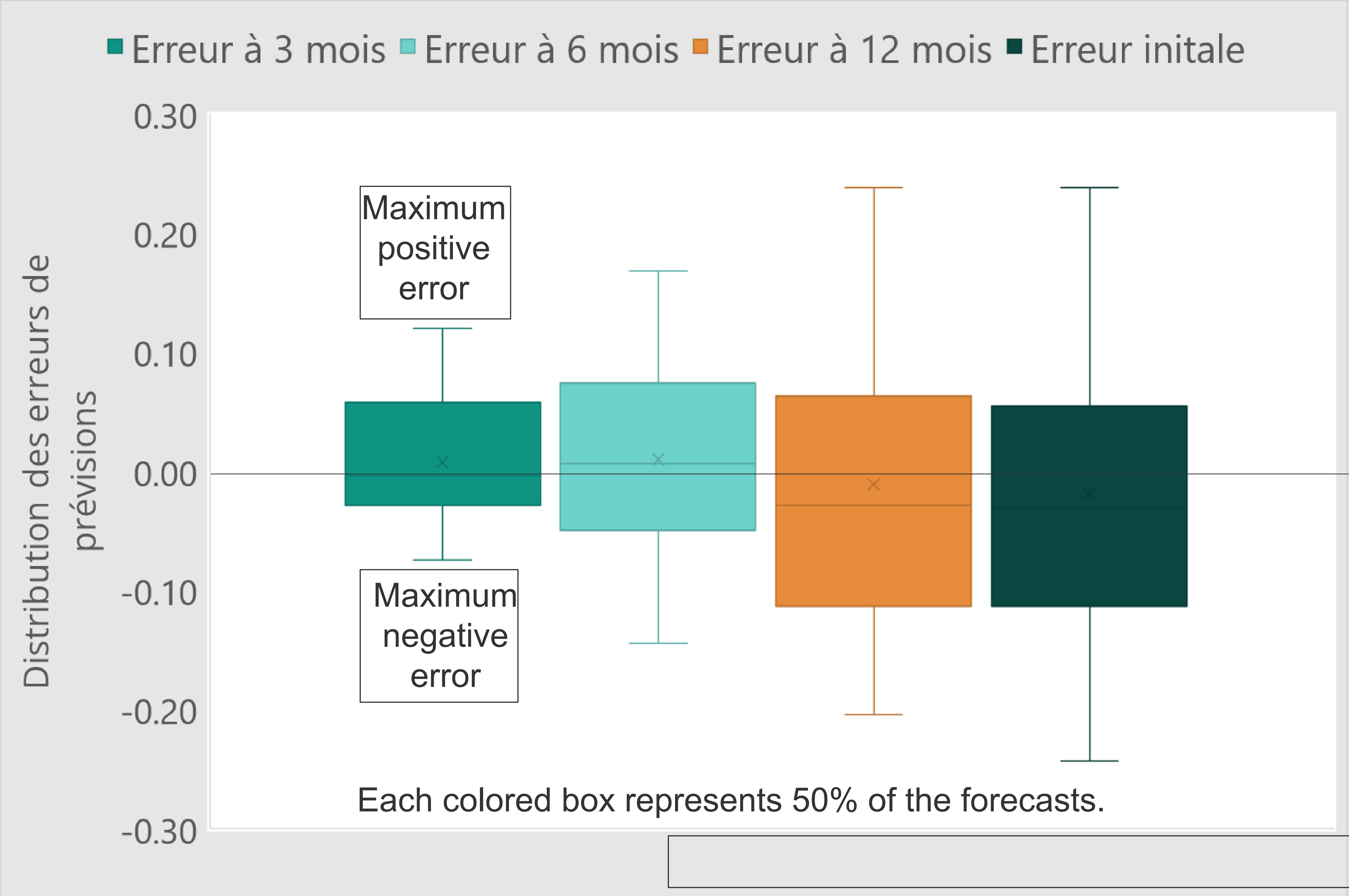
*On the sample:

- Only 2 forecasts remained within +/-3 cents of the spot.
- 4 forecasts had an error greater than 20 cents.
- In 17 out of 35 cases, the error was ≥10 cents.

Forecasts are based on a consensus of 50 market contributors.

*Samples of 35 quarterly 12-month EUR/USD forecasts made over the past 15 years

Retrospective analysis of forecast errors: EURUSD



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Essential points

Critical analysis of exchange rate forecasts

- Our recent study of 35 quarters of forecasts over more than 15 years on EUR/USD highlights a coefficient of determination (R^2) of only 0.30.

- **This complete lack of correlation between forecasts and actual exchange rates highlights a significant challenge for companies in their financial planning.**

- Relying on these forecasts to implement hedges (in particular, choosing an instrument that outperforms other simple products in certain market scenarios) can lead to significant losses or missed gains when the forecasts prove incorrect.

Recommended approach for budget rates

- Opt for forward rates (or a mix of forward rates and option rates net of premium) as the main basis for the currency budget.

- Hedge the most likely portion of the foreign exchange risk exposure when preparing the budget, in order to limit the impact of currency fluctuations and ensure better financial stability.

- The hedging horizon (6 months, 12 months, 18 months or more) should take into account the operational needs of the company.

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Informations

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