## Currency Risk

- Meaning: "A form of risk that arises from the change in price of one currency against another."
- **Types of Exposures**
  - → Transaction exposure: Impact of setting outstanding obligations entered into before change in exchange rates but to be settled after the change in exchange rates
  - → Translation exposure: Accounting-based changes in consolidated financial statements caused by a change in exchange rates
  - → Operating exposure Change in expected cash flows arising because of an unexpected change in exchange rates

## Foreign currency market

- Market where currencies are bought and sold
- Both commodities are currencies.
- A foreign exchange rate is the price of one currency expressed in terms of another currency

| **Type** | **Direct quote** | **Indirect quote** |
|---|---|---|
| Expression | 1 unit of foreign currency = so many units of local currency | 1 unit of local currency = so many units of foreign currency |
| Price and commodity | Price for a commodity | Commodity for price |
| Example | 1$ = 50Rs | 1Rs = 0.02 $ |
| Convention | USD/INR | INR/USD |
| Relationship | Direct quote = 1/Indirect quote | Indirect quote = 1/Direct quote |

## Conversion rates

- Spot rate : It is the conversion rate to be paid today for immediate settlement
- Forward rate It is the conversion rate agreed today for a settlement at a later date

## Concept of spread

- The bid price is the rate at which the bank will buy the base currency from a customer. (Bid: Bank buying, Customer sell)
- The offer price is the rate at which the banker will sell the base currency to a customer (Offer: Bank Selling, Higher Customer buy)
- In general, Customer will always be at a disadvantage position
  - → He will buy at a higher price(Offer)
  - → He will sell at a lower price(Bid)
- Transaction by Bank
  - → When Bank is dealing with its customer, bank will be at advantage position
  - → When Bank is dealing with other bank(Interbank) or in market, then bank will be at disadvantage position
  - → Difference between Bid and offer rate is called as spread

## Concept of Margin

- If customer is buying, then effective buying rate
  =Offer rate + Margin %

- If customer is selling , then effective selling rate

  = Bid rate - Margin%
- When Bank is transacting with customer: Margin money is applicable
- When Bank is transacting with other bank in interbank or in market, margin is not applicable