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79. Methods of protection of currency risks

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Introduction: All participants in the international currency market incur currency risks, i.e. risk of loss in the exercise of those or other operations. Currency risks are

associated with inflation and currency fluctuation. If exchange rates were fixed, there would be no currency risk. The objective basis of currency risk is that in the long run, exchange rates depend on the economic situation of different countries, but in short - on the decisions of public authorities on economic issues, speculative transactions, rumors and expectations, political events, and, finally, on the wrong solutions of dealers.

Resources and methods: Research papers, manuals, online resources

Results: Any foreign trade transaction involves a foreign exchange risk, i.e. the risk of currency losses caused by changes in foreign currency in which payment is made to the national.

Unfortunately, the company cannot always choose the currency rates at their discretion, and even more difficult to predict the movement of the exchange rate.

As one of the protective measures against loss, you can use the simultaneous conclusion of export and import contracts in the same currency and with approximately the same maturity. In this case, the profits of the export contract and the loss of import are mutually compensated. But all gains and losses could be cut only when the balance of exports and imports. Practically, the enterprise is commonly dominated by imports or exports. Then, in order to reduce risk are encouraged to enter both the export and import contracts in different currencies, with opposite trends in the fluctuations.

Thus, along with other methods the method of protection can be used as support.

A more reliable way to protect against currency losses is a currency clause. Its essence is in the fact that the currency in which payment is made under a contract linked to a more stable currency and the amount of the payment is made dependent on changes in the course of a more stable currency. At the same payment currency may coincide or may not coincide with the currency rates.

In the first case, the currency is called the reservation line, in the second case - indirect.

However, neither direct nor indirect reservation does not ensure a full guarantee against loss. The degree of assurance against loss depends on the successful choice of "anchor currency" is actually on correctly predicted the trend in the change rate of the currency. The degree of assurance, if the "anchor currency" to take not one but several, and more, the better the degree of assurance.

The question of whether or not to include in the contract currency clause shall be decided by the parties in the transaction, depending on specific conditions. If the payment currency is stable and the payment will be made after a short period from the date of the contract, this is not necessary. When installment payment on a long term reservation should be included as to predict the movement in exchange rates over a long period is impossible. And you must include, if the payment currency is unstable, even with a small gap between the time of payment and the term of the contract.

Conclusions: So, to control bank risk, you must create a reserve of funds to insure their activities to reduce lending and deposits, hedging, and the most effective method - divide the risk of partner banks. Risk control shall be based on a top-down approach at the bank's hierarchy. Control targets shall be identified at lower management levels so that violations of risk limits and other facts are revealed in a coherent and effective manner provided that a proper-functioning communication infrastructure is used. Banks shall, on a consolidated basis, monitor financial performance and profit-loss status of their direct or indirect participations they control, and establish and maintain risk management function. Subsidiaries that are excluded from consolidation shall be taken into account in assessing the risk structure and financial performance.

Banks shall set up a separate unit to monitor operations of their participations. The parent bank shall monitor large-volume transactions and fund transfers among its participations, and identify and be aware of the risk profile of overseas banks under its control.

The parent bank shall regularly monitor risks its local and overseas participations are exposed to, and determine whether such risks are within legal limits based on such criteria related to financial strength such as capital base and own funds.

References

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