

# [Management of foreign exchange risk, therefore, was](https://assignbuster.com/management-of-foreign-exchange-risk-therefore-was/)

Management of foreign exchange risk, therefore, was not really one of the crucial inputs of an organisation with international operations in those days. The priorities have, however, changed dramatically in the present era of floating exchange rates, when management of foreign exchange risk has become very important and simultaneously also very complex. External values of currencies are affected by a variety of causes such as purchasing power parties, capital flows, political developments, changes in the price of oil, changes in monetary policy, chart signals from technical analysts, etc.

Given the volatility of exchange rates in recent years, profits or losses that may be sustained through exchange rate variations can often be more than the trading profit on the underlying transactions. Although some sort of a consensus seems to be veering round the view that the experiment with floating currencies may have been a failure and that the time has come to peg currencies once again in some manner, until an alternative system emerges, banks and corporations should continue with their efforts to insulate themselves from the ravages of exchange rate volatility. Exchange risk (currency exposure) is commonly classified into two main types transaction risk and translation risk. The effect of exchange rate fluctuations on imports, exports, assets and liabilities of a corporation, denominated in foreign currencies, is termed as translation risk. Translation risk would arise only in respect of investment in foreign subsidiaries. In countries where corporations are required under law to prepare consolidated statements of accounts (unlike in India) the investments in foreign subsidiaries would have to be re-valued at the prevailing exchange rate, which is called translation risk.