THE IMPORTANCE OF BANKS IN FOREIGN EXCHANGE AND THE IMPLICATIONS OF THE CURRENCY RISK OVER THE BANK MANAGEMENT

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ABSTRACT
*The concentration and the role of the banks in the development of the **currency market** represents the first element on influencing the major players and their strategies on a global scale. The currency market is considered the system of the relations between financial and currency exchanges explained by the relation of buying and selling currency or buying-selling deposits throughout foreign coins. This market is also called **FOREX (Foreign exchange market), being the biggest financial market in the world.** The overcome of borders and the globalization of markets and countries conducted to the internationalization of monetary markets that have great implications in the currency risk of the banks.*

This paper aims to highlight the main features of the Forex currency market in the light of the extraordinary needs and ability of the banks and the financial system to assure the stability, which not only support the economy but also develop a complex sistem of instruments, transactions - both in the capital market and especially on the currency market - but also by products and derivatives in order to complete the proper satisfaction of clients and other banks. Next to these we add an imminent importance is established by the currency risk, which tend to ensure stability in the current crisis and understanding the tools and policies in global banking, the main goal being the control of national and international financial standards in banks and economy by conducting a stable bank management.

KEYWORDS: *currency market, financial markets, currency risk, bank management, globalization and internationalization, transaction, exchange, derivatives implications of currency risk*

The role of banks in the development of the currency market

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The currency market – main characteristics[2]

The currency market is a **decentralized market, OTC (over-the-counter)** known also as Interbanking market. The main competitors are the commercial banks, the central banks, multinational corporations, financial speculants and investment banks. [5]

This market has been developing since 1973, year which represents the beginning of a new era in financial markets and online transactions since 1990. It is the biggest market in the world, with daily volume transactions over 7000 billion dollars opened up 24 hours a day, seven days a week. The market opens first in New Zeeland, than in Australia, Asia, Middle East, Europe and finally United States of America (the main competitors and markets being represented by USA - with the American dollar and United Kingdom with the pound).

The main target of this market is to buy and sell currency, the interesting approach is that 95% of the transaction are those made in order to make profit and speculations, so that the other 5% could easily be used as daily simple transactions managed by corporations or the governments (in this private case transactions are used with the help of speculations methods – using foreign currency such as: USD, EUR, JPY, GBP, CHF, AUD, CAD).

Although dealers actions are made with anticipation in relation with the news of the market, **Forex is also called the Rumor market**, which at a transactional level represents an imbalance factor, that many times can be considered an advantage creating a calm down of the negative reactions of the market it self. The way that the market reacts to the rumors being often sintetized in the motto: **„BUY THE RUMOR, SELL THE CERTITUDE!"[7]**

None the less, the tendency of global commerce liberalisation increase the economical trades between states, that determine the importance of the currency market, phenomenon regulated by the currency-financial mechanisms with the following types of operations: SPOT (made immediately) the exchange takes place in two days and FORWARD (at a time being) – where the transactions take place at a subsequently time.

The **biggest number of transactions take place in England**, even though the national coin, the pound, is less transacted in comparison with other currency coins; never the less the biggest amount of volume transactions that take place on the currency market (FOREX) are unrolled in England.

The type of transactions on this market are OTP, actually over the counter, a decentralized market where a big amount of the instruments of the market are being transacted at the stock exchange. Due to the extended process of globalization, financial markets are being developed very easily with the help of derivative products, which have proved them to be very reliable in the coverage of the currency risk. Even if derivative products are at an inception level of their "life", the figures that are being speculated over the Forex market sum up billions of dollars (at a global level the stock exchange world is being **dominated by the**

one in Chicago, followed by the American Stock Exchange, NYSE, London, Paris and Amsterdam.

It is estimated at a global financial level that the market of derivative products is in the hands of few people that not only control the stock exchange this way, buy also have a big impact on the fluctuations and stability on a general note in reference to the currency rates and currency market all around the world (the main advantage in this being the fact that derivative products helped in a decisive way the banks to become more and more flexible).

Businesslike, all of the currency market and the derivative products are being controlled and owned by the biggest financial corporations and banks in the world.

The series and mergers in the last few years have marked the currency and financial market of every developed state with an important economical revenue status; because at the birth of the system stayed important and complex political mechanisms that seen the prosper and profitable potential of the future and **newest top 10, 25 and 100 financial corporations and banks all around the world. [9]**

Top 10 finacial corporations and banks in the world

Nr. Crt.	Name of the bank	Country	Assets
1.	Mizuho Financial Group	Japan	1 285 471
2.	Citigroup	USA	1 264 032
3.	UBS	Switerland	1 120 543
4.	Credit Agricole Groupe	France	1 105 378
5.	HSBC Holdings	Great Britan	1 034 216
6.	Deutshe Bank	Germany	1 014 845
7.	BNP Paribas	France	988 982
8.	Mitsubishi Tokyo Financial Group	Japan	974 950
9.	Sumitamo Mitsui Financial Group	Japan	950 448
10.	Royal Group of Scotland	Great Britan	806 207

Source: The Bank for International Settlements, http://www.bis.org

In conclusion, the sequence of financial attributes and activities on the markets and the usage of simple and far more important - derivative products, are the key of financial institutions that can eliminate or reduce important risks, in the same time compensate the usage of other risks that have the **final goal to reduce**

the apparition of economical and financial crises, given the dual attribute of the hedging and speculations.

Justifying the operative need of all financial products on all types of markets, risks cannot always be controlled or prevented from happening. In account with this statement, to avoid risks is almost in all cases the way to failure (instead of avoiding the risk by all means – which it is practically impossible – financial corporations and banks should understand the way they can transform potentially negative results in opportunities).[8]

The implications of currency risk over the bank management

The overcome of borders and the globalization of markets and countries conducted to the internationalization of monetary markets that have great implications in the currency risk of the banks.

Generated by the lack of equivalence between the assets and the passives (liabilities), joined together by the same quotations, the **currency risk began** to make his apparition especially in the case of some heterogeneous products and managerial implications of the banks such as: call loans, acceptance loans – in all currency forms; **attracting deposits, currency trading, investments in securities or denominated debt issuance in currency securities.[6]**

Knowing the banking risk as a side effect of the external markets in a continue development, it is obvious that a performant banking strategy must contain programs and procedures of risk management that actually aimed at minimizing the probability ratio of potential exposure of the hazard of banks to markets and the evolution of exchange rates.[3]

In the case of Romania, currencies with the largest share in banking assets and liabilities are EUR and USD.

Currency risk has gained increasing importance in the sea following the boom recorded in foreign currency lending. That is why risk management is complicated by the high volatility of quotes euro/dollar in international markets and reduced availability in the hedging instruments of the Romanian market.

Romanian banks are highly exposed in case of sudden exchange rate movements in terms of both asset quality, and also because of the discrepancies between open positions and currency exposures and maturities of assets and liabilities (external exposure of the banking system has tripled within two years, reaching about 6 billion Euros, given that foreign banks have repatriated assets and began to borrow, especially from parent banks to fund credit growth).[1]

These developments have taken place in a context where the share of deposits in foreign currency in total **deposits declined from 56%** in the last two years, to **36% along with foreign currency loans**, which have already reached about 60% of the total loan balance for the private sector.

Having regard to capital account liberalization, something which creates numerous fluctuations in the exchange rate, here are two major effects on banking

activity: **loss record** (if unfavorable evolution of the exchange rate) and **getting the profits** (if there is a favorable evolution exchange rate).[4]
Of those listed above under the main implications of the event on the manage currency risk bank, here are some of the most important aspects: development and updating of currency risk management policies, **exchange rate-dynamics analysis on domestic and international currency market**, the development of econometric methods for forecasting the exchange rate, developing their own internal methods of measuring currency risk, develop and improve methods forecast of profits and losses on long and medium term, periodic reporting, acquisition and implementation of computer applications and awareness of the importance of modern technology, especially the information by developing an IT infrastructure – databases, and not least the widespread use of sophisticated products and development of exchange risk management, such as **derivatives category (vanilla options, binary options and double barrier).**

Finally, the implications for **bank management in the short term** will increase bank costs which are reflected in the **price bank products** and thus affecting the competitiveness of products offered on the market. **In the long term**, we will assist to produce positive effects on activity, with the final aim to maximize **customer satisfaction and maximize bank profits.**

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