

The Impact of Exchange Rate Movements on Stock Returns: Evidence from Commercial Banks in Sri Lanka

Bandara, A. W. M. S. S. C.¹ and Thilakarathne, P. M. C.²

Foreign exchange rate is the price of the local currency stated in terms of another currency. Exchange rate movements is a crucial cause which creates risk in banking institutions. This paper investigates the impact of exchange rate movements on stock returns of commercial banks listed in Colombo Stock Exchange. Data were extracted from the Central Bank of Sri Lanka (CBSL) and Colombo Stock exchange (CSE). Data were analyzed using linear regression analysis for the period of July 2013 to June 2018 using monthly observations. The results of the study indicate that there is significant exposure of Sri Lankan commercial banks to exchange rate movements of US Dollars, Japanese Yen and Market Rate of Return. All banking institutions from the selected sample banking firms are sensitive to the US Dollar exchange rate movements. As per the results, depreciation of domestic currency value against US Dollar delineates negative as well as impact on stock returns of the selected banking institutions. Moreover, Japanese Yen exchange rate movement found to be sensitive towards two of the selected banks stock returns. Results indicate that movements in Japanese Yen exchange rate affects stock returns of respective banking institutions either positively or negatively. None of the selected banks stock returns are sensitive to Euro and Great Britain Pounds exchange rate movements. Importantly Market rate of return is found to sensitive towards the stock return generating process of all the selected banking institutions.

Keywords: *Commercial Banks, Exchange Rates, Sri Lanka, Stock Returns*

¹ Ernst and Young, Sri Lanka (*sandunischapa@gmail.com*)

² Department of Accountancy, University of Kelaniya, Sri Lanka