

Effects of the Exchange Rate Volatility on Financial Performance of Licensed Commercial Banks in Sri Lanka

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ABSTRACT

Purpose: The question of whether there exists a relationship between the volatility of exchange rates and the financial performance of licensed commercial banks in Sri Lanka was the subject of this research.

Design / Methodology/ Approach: The study used three types of variables as dependent variable, independent variables, and control variables. Dependent variable was financial performance. The independent variable was exchange rate volatility while control variables were inflation, interest rate, and bank size. Secondary data was collected from the banks' consolidated financial statements as well as the Central Bank of Sri Lanka. The study used the quantitative approach. The study also used panel data analysis using STATA Software Version 13.0 to aid in data analysis.

Findings: The study established the existence of a negative association between exchange rate volatility and banks' performance as measured by the returns on assets ratio. Negatively association between interest rate and ROA. There is a negative relationship between inflation change and ROA also. The bank size had a positive relationship with financial performance.

Originality: Exchange rate volatility had an influence on commercial banks' financial performance in Sri Lanka during the study period. The co-relation findings portrayed a weak negative connection between the FX volatility and the profits of banks over the study period. The correlation findings a medium negative connection between the interest rate, inflation change, and the profits of banks over the study period. The bank's total assets increased over the research period. Bank size significantly influenced financial performance at a 95% confidence level. The exchange rate also significantly influences financial performance at a 90% confidence level at a 0.1 significant level.

Keywords: *Exchange Rate Volatility, Financial Performance, Inflation, Interest Rate, Licensed Commercial Banks, Bank Size, Return on Assets*