

Overview

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- Impact of fluctuations in interest rates on industries
- Impact of credit risk on industries
- Market Risk and Westpac Bank
- Conclusion

Market Risk Definition

- Market risk is the potential volatility in a firm's income due to changes in market condition.
- Caused by extreme market conditions such as interest rates, liquidity, economic growth, etc.
- Typically measured for a time period of one year or less and can be measured over periods as short as one day.
- Usually measured in terms of dollar exposure amount or as a relative amount against some benchmark.
- 4 main categories of risk: interest rate risk, credit risk, liquidity risk and FX risk.

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n interest

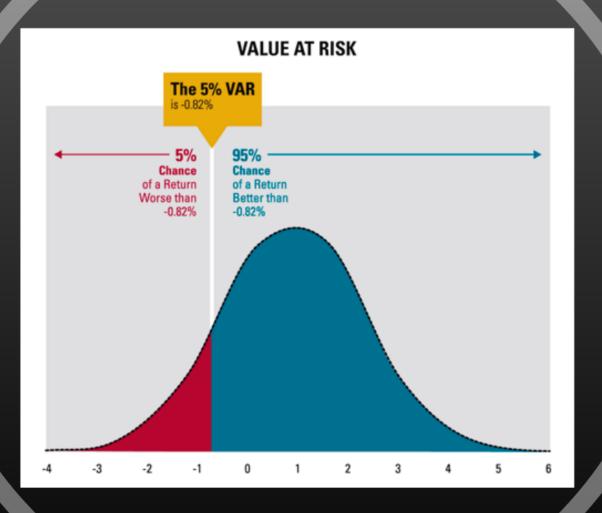


Value at risk (VaR) limits TheCaseSolutions.com

- Value at risk (VaR) is a statistical technique used to measure and quantify the level of financial risk within a firm or investment portfolio over a specific time frame.
- Focus on the downside risk and potential losses.
- 3 keys elements: a specified level of loss in value, a fixed time period over which risk is assessed and a confidence interval.
- 3 methods to calculate VaR: historical simulation method, variance covariance method and Monte Carlo simulation method.



For example



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Impact of fluctuations in interest rates on industries

Borrowers: are concerned about rising rates Increased cost of funds =

- · Decreased profitability = decrease in market
- Decreased ability to undertake capital expenditure
- Decreased ability to pay dividends
- · Increased chance of a breach of borrowing
- · Increased borrowing margins due to deterioration in financial ratios

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- Reduced cost of funds
 Decreased profitability = decrease in market

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Investors – in general are concerned with falling rates

- Reduced cost of funds
- Decreased profitability = decrease in market value
- Decreased ability to pay returns to stakeholders
- Decreased competitive returns = decreased ability to attract investors
- Decreased ability to meet future outgoings