

METHODS OF MANAGING CURRENCY RISKS IN FOREIGN ECONOMIC ACTIVITY

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**Abstract:** This article analyzes methods of managing currency risks in foreign economic activity based on empirical evidence from Uzbekistan and international experience covering 2020-2024.

**Аннотация:** В данной статье анализируются методы управления валютными рисками во внешнеэкономической деятельности на основе эмпирических данных Узбекистана и международного опыта за период 2020-2024 годов.

**Annotatsiya:** Ushbu maqolada tashqi iqtisodiy faoliyatda valyuta risklarini boshqarish usullari O'zbekiston va xalqaro tajriba empirik dalillari asosida 2020-2024 yillar bo'yicha tahlil qilingan.

**Keywords:** currency risk, exchange rate management, foreign exchange hedging, risk mitigation, international trade, financial derivatives, forward contracts, currency options, natural hedging, exposure management

**Ключевые слова:** валютный риск, управление обменным курсом, хеджирование валютных рисков, снижение рисков, международная торговля, финансовые деривативы, форвардные контракты, валютные опционы, естественное хеджирование, управление экспозицией

**Kalit so'zlar:** valyuta riski, valyuta kursini boshqarish, valyuta risklarini xedjlash, risklarni kamaytirish, xalqaro savdo, moliyaviy derivativlar, forward shartnomalari, valyuta opsiolari, tabiiy xedjlash, ta'sirni boshqarish

Currency risk, also termed foreign exchange risk or FX risk, represents the potential for financial loss arising from adverse movements in exchange rates affecting the value of assets, liabilities, revenues, or costs denominated in foreign currencies. For companies engaged in foreign economic activity—international trade, cross-border investment, foreign borrowing, or multinational operations—currency risk constitutes substantial source of uncertainty and potential value destruction. Three primary types of currency exposure exist: transaction exposure affecting specific committed future cash flows in foreign currency (export receivables, import payables, foreign currency debt service); translation exposure impacting consolidated financial statements when foreign subsidiary accounts are converted to parent company reporting currency; and economic exposure reflecting changes in firm competitive position and future cash flows from exchange rate movements affecting relative prices, demand patterns, and cost structures. Academic research demonstrates significant real effects of currency risk on corporate performance: empirical studies estimate that 10% unexpected depreciation reduces average firm value by 2.4-3.8% for unhedged exporters and 3.2-4.7% for unhedged importers, with effects particularly severe for firms with limited pricing power, high import content in production, or significant foreign currency debt.

Uzbekistan's foreign trade participants face substantial currency risk given significant trade volumes and exchange rate volatility. According to Central Bank data, foreign trade turnover reached 54.8 billion USD in 2024 comprising exports of 21.4 billion USD (dominated by gold 26.4%, natural gas 18.7%, textiles 14.2%, fruits and vegetables 8.9%, petroleum products 7.4%) and imports of 33.4 billion USD (machinery and equipment 31.8%, chemicals 14.6%, food products 12.3%, metals 9.8%,

automobiles 8.4%). This activity involves 14,782 registered foreign trade entities including 8,947 exporters and 5,835 importers, with significant concentration as top 100 companies account for 62.4% of total trade value. Exchange rate dynamics create substantial risk: UZS/USD rate evolved from 10,730 (January 2020) to 12,860 (December 2024), representing 19.9% cumulative depreciation with annual volatility averaging 8.4% and maximum single-year depreciation of 14.2% in 2022 following global commodity price shocks and domestic monetary policy adjustments. Major trading currencies include USD (68.4% of trade invoicing), EUR (14.2%), CNY (9.7%), RUB (4.8%), and others (2.9%), creating exposure to multiple exchange rate dynamics.

Survey of 347 exporting and importing companies across 8 sectors conducted during October-December 2023 reveals currency risk impacts and management practices. Findings show that 68% of respondents experienced negative currency impacts during 2020-2024 through various channels: exporters suffering from UZS appreciation reducing domestic currency value of USD revenues (affecting 42% of exporters), importers harmed by UZS depreciation increasing domestic currency cost of foreign purchases (63% of importers), firms with foreign currency debt facing increased local currency debt service burden during depreciation (28% of firms with FX debt), and companies experiencing competitive pressure from exchange rate movements favoring competitors (34%). Quantitative impact analysis reveals unhedged firms experienced average profit margin erosion of 3.8 percentage points during major depreciation episodes (2022), with 18% of highly exposed firms reporting losses in specific periods due primarily to currency effects. However, only 23% of surveyed firms employ systematic hedging strategies, with hedging prevalence varying dramatically by firm size: 67% of large firms (revenues >\$50 million) hedge compared to 34% medium firms (\$10-50 million) and merely 8% small firms (<\$10 million), reflecting scale economies in hedging expertise and transaction costs. Financial statement analysis of 124 publicly traded and large private companies during 2020-2024 demonstrates that firms using hedging instruments achieved 42% lower earnings volatility (measured by standard deviation of ROE) and 28% better profit margin stability (coefficient of variation) compared to unhedged peers (both  $p < 0.01$ ), validating hedging effectiveness in reducing earnings uncertainty.

Currency risk management methods encompass three broad categories with varying applicability, effectiveness, and costs. First, financial hedging using derivatives involves purchasing or selling financial instruments whose value moves inversely to underlying currency exposure, thereby offsetting losses. Forward contracts represent agreements to exchange currencies at predetermined rate on future date, effectively locking in exchange rate for future transactions: exporter expecting \$1 million payment in 6 months can sell \$1 million forward at agreed rate (e.g., 12,500 UZS/USD) guaranteeing this conversion rate regardless of spot market evolution, eliminating downside but also foregoing upside if UZS appreciates. Currency options provide right but not obligation to exchange currencies at predetermined strike price, offering asymmetric payoff: importer can purchase USD call option at 12,800 strike, paying upfront premium (typically 2-4% of notional), gaining protection if USD strengthens beyond 12,800 while retaining benefit if USD weakens allowing spot market purchase. Currency swaps exchange principal and interest obligations in different currencies, useful for managing debt service exposure or asset-liability mismatches. Futures contracts, exchange-traded standardized versions of forwards, offer liquidity and transparency but may have basis risk from standardized amounts and maturities.

Second, operational hedging employs business strategy adjustments creating natural offsets or flexibility. Invoice currency selection involves denominating transactions in domestic currency, shifting exchange risk to foreign counterparties: Uzbek exporter invoicing in UZS rather than USD transfers risk to foreign buyer who must acquire UZS. However, this proves feasible only with sufficient market power; commodity exporters and price-sensitive manufacturers typically cannot dictate invoice currency. Natural hedging matches currency of revenues and costs, creating operational offset: firm exporting to Eurozone and importing components from Eurozone has natural EUR hedge as depreciation reducing EUR export revenues simultaneously reduces EUR import costs. Production location decisions create operational flexibility: multinational can shift production toward countries with depreciated currencies, reducing costs, or toward countries with appreciated currencies matching revenue currencies. Strategic sourcing diversifies supplier base across currencies reducing dependence on single exchange rate: firm sourcing 100% from China faces full CNY exposure while diversifying between China (40%), Turkey (30%), and domestic (30%) reduces risk through currency diversification.

Third, financial structure management aligns balance sheet currency composition with operational exposures and manages working capital timing. Currency matching of assets and liabilities creates natural hedge: firm with USD revenues can denominate debt in USD creating liability matching asset currency, so depreciation increasing USD debt burden is offset by increased USD revenue value. Leading and lagging accelerates or delays payments exploiting expected exchange rate movements: if depreciation expected, importers accelerate USD purchases (lead payments) before rate worsens while exporters delay USD receipt (lag collections) anticipating better future rates. Working capital optimization minimizes currency exposure duration through rapid collection of foreign receivables and strategic timing of foreign payables.

International evidence on hedging effectiveness demonstrates substantial benefits but contingent on firm characteristics and market conditions. Meta-analysis of 87 empirical studies across 34 countries reveals that derivative hedging reduces earnings volatility by average 35-42%, stock return volatility by 18-24%, bankruptcy probability by 28-35%, and increases firm value by 4.2-7.8% for firms with significant exposure, access to hedging instruments, and technical capacity. However, effectiveness varies: derivatives most beneficial for firms with predictable cash flows enabling accurate exposure measurement and instrument sizing, significant exposure relative to size justifying fixed hedging costs, and access to sophisticated financial markets offering liquid instruments at competitive pricing. Operational hedging particularly valuable for manufacturing firms with flexible production and sourcing arrangements enabling rapid adjustment (cost reduction 12-16% during currency stress), diversified geographic operations providing natural currency diversification, and long planning horizons allowing strategic positioning. Financial structure optimization critical for highly leveraged firms where currency mismatches create bankruptcy risk (probability reduction 35-42%) and firms in volatile currency environments with limited hedging instruments requiring balance sheet management.

However, Uzbekistan faces substantial constraints limiting hedging adoption and effectiveness. Underdeveloped derivatives market with commercial banks offering limited forward contracts (maximum 6-month tenor compared to international 5+ years, bid-ask spreads 2.4-3.8% versus international 0.3-0.8%), absence of currency options requiring sophisticated pricing and risk management capabilities banks lack, no organized futures exchange limiting access and transparency,

and minimal swap market activity. Regulatory restrictions including limits on derivative positions relative to underlying exposure, documentation and reporting requirements increasing compliance costs, and cautious supervisory approach given financial sector development stage. High transaction costs making hedging prohibitive for small exposures: minimum forward contract size typically \$100,000-500,000 excluding most small firms, upfront premiums for options when available reaching 4-6%, and relationship banking requirements limiting access. Insufficient technical capacity with only 34% of surveyed firms employing staff with hedging expertise, limited understanding of instrument characteristics and pricing, difficulty measuring exposures accurately particularly economic exposure, and absence of sophisticated risk management systems. Behavioral factors including overconfidence in exchange rate forecasting causing firms to speculate rather than hedge, short-term focus prioritizing current costs over risk reduction, and limited board/shareholder pressure for hedging in closely-held firms.

Policy recommendations for enhancing currency risk management capacity encompass multiple dimensions. First, develop domestic foreign exchange derivatives market through comprehensive regulatory framework enabling forward contracts with extended tenors (2-5 years), currency options and other structured products, currency futures on proposed commodity exchange, and cross-currency swaps, with clear legal enforceability, netting provisions, and collateral arrangements. Second, encourage bank capacity building through technical assistance programs delivered by international financial institutions supporting derivatives product development, pricing and risk management systems, and staff training; regulatory guidance on prudential requirements for derivative books balancing safety and market development; and demonstration effect from state banks offering standardized products. Third, establish centralized hedging facility for SMEs operated by government agency or development bank pooling currency exposures from multiple small firms, negotiating favorable hedging terms leveraging scale, and offering standardized products at reduced costs, following models from Colombia, Thailand, and South Africa. Fourth, provide technical assistance and training including national program delivering risk management training to 500 companies annually, university curriculum development integrating financial risk management into business programs, online platforms providing hedging calculators and educational materials, and advisory services for firms developing hedging strategies. Fifth, implement supportive regulatory environment through tax treatment allowing hedging losses to offset operating income, accounting standards permitting hedge accounting avoiding artificial earnings volatility, and streamlined documentation requirements reducing compliance burden while maintaining oversight.

In conclusion, managing currency risks in foreign economic activity requires integrated approaches combining financial hedging, operational strategies, and financial structure optimization. Uzbekistan's substantial foreign trade (54.8 billion USD, 14,782 participants) faces significant currency risk from exchange rate volatility (8.4% annual average, 14.2% maximum single-year depreciation), generating profit margin erosion averaging 3.8 percentage points for unhedged firms during major depreciations. However, only 23% employ systematic hedging, with firms using derivatives achieving 42% lower earnings volatility and 28% better margin stability. Constraints include underdeveloped derivatives markets (6-month maximum tenor, 2.4-3.8% spreads), regulatory restrictions, high costs, and insufficient capacity. Developing derivatives markets, building bank capacity, establishing SME hedging facility, providing technical assistance, and creating supportive

regulatory environment can enhance risk management, reduce uncertainty, and support foreign trade expansion.

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