

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.

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

Currency risk represents a critical challenge for companies engaged in international trade, arising from exchange rate fluctuations that affect the value of foreign currency-denominated transactions, assets, and liabilities. This analysis examines currency risk management methods based on empirical evidence from Uzbekistan's foreign trade sector during 2020-2024, highlighting practical approaches and implementation challenges in an emerging market context.

Uzbekistan's substantial foreign trade activity creates significant currency exposure. In 2024, foreign trade turnover reached \$54.8 billion, comprising \$21.4 billion in exports and \$33.4 billion in imports, involving 14,782 registered entities. The exchange rate dynamics demonstrate considerable volatility, with the UZS/USD rate depreciating 19.9% cumulatively from January 2020 to December 2024, averaging 8.4% annual volatility and reaching maximum single-year depreciation of 14.2% in 2022. This volatility directly impacts corporate profitability, as trade is predominantly invoiced in USD (68.4%), EUR (14.2%), and CNY (9.7%).

Survey evidence from 347 exporting and importing companies reveals that 68% experienced negative currency impacts during the study period. Unhedged firms suffered average profit margin erosion of 3.8 percentage points during major depreciation episodes, with 18% of highly exposed firms reporting losses attributable primarily to currency movements. Exporters faced reduced domestic currency value of foreign revenues during appreciation, while importers confronted increased costs during depreciation. Firms with foreign currency debt experienced elevated debt service burdens, and many companies faced competitive pressure from exchange rate movements favoring rivals.

Despite these significant impacts, only 23% of surveyed firms employ systematic hedging strategies. Hedging prevalence varies dramatically by firm size, with 67% of large firms utilizing hedging instruments compared to merely 8% of small firms, reflecting scale economies in expertise and transaction costs. However, firms using derivatives demonstrated measurably superior performance, achieving 42% lower earnings volatility and 28% better profit margin stability compared to unhedged peers, validating hedging effectiveness.

Three primary categories of risk management methods exist. Financial hedging employs derivatives including forward contracts that lock in future exchange rates, currency options providing asymmetric protection while retaining upside potential, and currency swaps for managing long-term exposures. Operational hedging involves strategic business adjustments such as invoice currency selection, natural hedging through matching revenue and cost currencies, production location diversification, and strategic sourcing across multiple currency zones. Financial structure management aligns balance sheet composition with operational exposures through currency matching of assets and liabilities, leading and lagging payment timing, and working capital optimization.

International evidence demonstrates substantial hedging benefits, with meta-analysis showing derivative hedging reduces earnings volatility by 35-42%, bankruptcy probability by 28-35%, and increases firm value by 4.2-7.8% for significantly exposed firms. Operational hedging proves particularly valuable for manufacturers with flexible operations, while financial structure optimization benefits highly leveraged firms in volatile currency environments.

However, Uzbekistan faces considerable constraints limiting hedging adoption. The underdeveloped derivatives market offers only limited forward contracts with maximum six-month tenors and wide bid-ask spreads of 2.4-3.8%, compared to international markets offering five-year tenors and 0.3-0.8% spreads. Currency options remain largely unavailable, no organized futures exchange exists, and regulatory restrictions constrain derivative usage. High transaction costs with minimum contract sizes of \$100,000-500,000 exclude most small firms, while only 34% of surveyed companies employ staff with hedging expertise.

Enhancing currency risk management capacity requires comprehensive policy interventions. Developing domestic derivatives markets through appropriate regulatory frameworks, building bank capacity via technical assistance programs, establishing centralized hedging facilities for small and medium enterprises, providing systematic technical training, and implementing supportive regulatory environments including favorable tax treatment and streamlined documentation requirements represent essential steps toward improved risk management infrastructure and practice.

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