



## **TOPICAL ISSUES OF MANAGING CURRENCY RISKS OF COMMERCIAL BANKS**

Tugalov Bobur

Applicant of the Kimyo International University in Tashkent

<b>ABSTRACT</b>	<b>KEYWORDS</b>
Improving the practice of currency risk management is one of the mandatory conditions for ensuring the effectiveness of foreign exchange transactions of commercial banks. Since, in the context of an increase in the number and volume of transactions in foreign currencies, banks need to pay special attention to such transactions, since financial results are increasingly dependent on fluctuations in exchange rates. The article identifies current problems associated with the management of foreign exchange risks of commercial banks and develops scientific proposals aimed at solving these problems.	Commercial bank, currency risk, currency position, diversification, spot, forward, swap.

### **Introduction**

The Decree of the President of the Republic of Uzbekistan No. 5177 dated September 2, 2017 "On priority measures to liberalize foreign exchange policy" notes that the exclusive use of market mechanisms in establishing the exchange rate of the national currency against foreign currency, increasing the role of market instruments in the use of foreign exchange resources, creating equal competitive conditions in the foreign exchange market for all economic entities, increasing the stimulating role of foreign exchange policy in the development of exports in non-traditional industries, strengthening regional and international economic cooperation and pursuing a tight monetary policy aimed at ensuring the stability of the national currency, providing for the active and flexible use of its instruments, the development of the government securities market are priority areas of liberalization of foreign exchange policy [1] . This, in turn, necessitates improving the practice of managing foreign exchange risks in commercial banks.

### **Review of Literature on the Topic**

According to H. Backlund, the following are financial instruments of the currency risk hedging market:

- currency forwards;
- currency futures;
- currency swaps;
- currency options [2] .

According to J. Sinka, if for some reason a bank is unable to carry out hedging within the balance sheet, it can use off-balance sheet methods for hedging purposes, i.e. use currency derivatives – futures, forwards, options or swaps [3] .

L. Krasavina will conclude that an increase in the volume of conversion operations for the purchase and sale of foreign currencies on the foreign exchange market will lead to an increase in the risk of the foreign exchange position in commercial banks [4] .

F. Sytin argues that hidden currency risks represent translational, transactional and operational currency risks that are not obvious at first glance. For example, a supplier in the domestic market may consume imported resources, and the company using its services is indirectly exposed to operational risk (an increase in the cost of the supplier's expenses will force the company to raise prices for its products). Also, a hidden translation risk arises if a foreign subsidiary is exposed to risk. Hidden risks include conversion risks - a possible change in the state's currency policy, including the introduction of restrictions on currency exchange transactions [5] .

O. Pokrovskaya writes: “management of a bank’s currency risk is a system of development, adoption and implementation of decisions on influencing currency risk with the aim of preventing, limiting or minimizing losses associated with it” [6] .

T. Struchenkova claims that the first stage of risk management is risk analysis, which includes quantitative analysis, which involves determining *a quantitative assessment* for the existing risk of a commercial bank. Based on the fact that risk is defined as the possibility of losses, then risk assessment is the probability of a certain amount of losses. It can be said that quantitative risk assessment consists of two components - the probability of occurrence and the amount of possible losses. This assessment is determined for a selected time period (hour, day, week, month, quarter, year, etc.) [7] .

M. Krichevsky writes that traditional measures of currency risk have serious shortcomings: firstly, they cannot be aggregated (reduced into one indicator) regardless of risk factors; secondly, traditional risk measures do not measure “capital at risk” (capital covering losses caused by risk factors); thirdly, these measures do not allow risk control, since position limits determined by risk factors are often ineffective [8] .

A group of economists claim that the stochastic modeling method (Monte Carlo simulation) is based on modeling random processes with given characteristics. The Monte Carlo method is similar to the historical modeling method, the difference is that changes in asset prices (exchange rates) are generated pseudo-randomly in accordance with given distribution parameters. The simulated distribution can be any, and the number of scenarios is quite large (up to several tens of thousands). It is worth noting that the use of the Monte Carlo method does not give unambiguous results, since repeated modeling produces other random values of risk factors [9] .

A. Demskay writes that the modern financial market offers a number of hedging instruments, such as forwards, futures, options and swaps, but which of them is the most effective as a tool for reducing currency risk remains an open question. Developing hedging tactics comes down to answering three main questions: "What?" - which hedging instrument to choose; "Where?" - an exchange or over-the-counter instrument (with which counterparty); "When?" - how to choose the moment to conclude a transaction [10] .

### Research Methodology

The aim of the study is to develop scientific proposals aimed at improving the practice of currency risk management.

The object of the study is JSC Sanoatkurilishbank and JSC Asakabank, and the subject of the study is financial relations arising in the process of managing currency risks in commercial banks.

The research methodology is based on general scientific methods and comparative analysis. The information base of the research was the official statistical data of the Central Bank of the Republic of Uzbekistan and the data of financial reports of commercial banks.

### Analysis and Results

The level of currency risk in commercial banks is determined by the size of the bank's open currency positions. For a commercial bank, any open position (long, short position) means currency risk. It arises because the exchange rate may change by the time of fulfillment of its obligations and requirements. Therefore, banks reduce both the short currency position (prohibition of new currency deposits, discussion of negative rates on legal entities' currency accounts) and the long one (absence of new loans in dollars and euros).

**Table 1 Change in open currency positions in Uzsanoatkurilishbank<sup>1</sup>**

Indicators	Uzsanoatkurilishbank		
	2021	2022	2023
Amount of open currency positions, billion soums	1045.4	277.9	241.9
Level of open currency positions in relation to regulatory capital , %	16.7	3.6	3.2

As can be seen from Table 1, the value of open currency positions in Uzsanoatkurilishbank in 2021-2023 tended to decrease. The level of open currency positions in relation to regulatory capital tended to decrease in this period.

The results of the analysis showed that the amount of losses from foreign exchange transactions at Asakabank in 2021-2023 tended to increase.

It is important to note that the low level of diversification of foreign exchange reserves of commercial banks and their clients negatively affects the effectiveness of foreign exchange risk management.

**Table 2 Structure of currency conversion operations on the Republican Currency Exchange <sup>2</sup>, in percentages**

Indicators	2021	2022	2023
Share of US dollar in conversion transactions	89.9	99.9	99.9
Share of euro in conversion transactions	10.1	0,1	0,1
Share of other currencies in conversion transactions	0,0	0,0	0,0
<b>Conversion operations -total</b>	100,0	100,0	100,0

<sup>1</sup>Operation and market risk accounting: [www.uzpsb.uz](http://www.uzpsb.uz) (Sanoatkurilishbank).

<sup>2</sup> The table was compiled by the author based on data from the Republican Currency Exchange statistician..

As can be seen from Table 2, in 2021-2023, the US dollar occupied an absolutely high share in the volume of foreign exchange transactions on the Republican Currency Exchange.

**Table 3 Spot transactions and currency swaps on the Republican Currency Exchange<sup>3</sup>, trillion soums**

Indicators	2021	2022	2023
Spot operations	217.7	338.2	458,0
Currency swaps	0.2	0.2	0.5

As can be seen from Table 3, spot transactions account for an absolutely high share of the volume of currency transactions on the Republican Currency Exchange. This indicates that swap transactions with foreign currencies have not been adequately developed on the domestic currency market.

### Conclusions and Suggestions

We have formulated the following conclusions regarding the management of foreign exchange risks of commercial banks:

\*the exclusive use of market mechanisms in establishing the exchange rate of the national currency in relation to foreign currency, increasing the role of market instruments in the use of foreign exchange resources, and creating equal competitive conditions in the foreign exchange market for all economic entities are priority areas for the liberalization of foreign exchange policy, which necessitates the improvement of the practice of managing foreign exchange risks in commercial banks;

\*the following are financial instruments of the currency risk hedging market: currency forwards, currency futures, currency swaps, currency options;

\*an increase in the volume of conversion operations for the purchase and sale of foreign currencies on the foreign exchange market will lead to an increase in the risk of the foreign exchange position in commercial banks;

\*bank currency risk management is a system of development, adoption and implementation of decisions on the impact on currency risk in order to prevent, limit or minimize losses associated with it;

\*in Uzsanotqurilishbank, the value of open currency positions in 2021-2023 tended to decrease. The level of open currency positions in relation to regulatory capital tended to decrease in this period;

\*in 2021-2023, the US dollar had an absolutely high share in the volume of foreign exchange transactions on the Republican Currency Exchange;

\*in the volume of currency transactions on the Republican Currency Exchange, spot transactions have an absolutely high share, which indicates that swap transactions carried out with foreign currencies have not received the proper development on the domestic currency market.

In our opinion, in order to improve the practice of foreign exchange risk management in commercial banks, it is necessary to take the following measures:

1. It is necessary to improve the regulation of open foreign exchange positions of commercial banks by introducing "call" and "put" foreign exchange options into the practice of banks; diversifying the foreign exchange reserves of commercial banks and their clients; introducing foreign exchange risk hedging instruments into the practice of managing foreign exchange risks.

<sup>3</sup> The table was compiled by the author based on data from the Republic Currency Exchange statistician.

2. It is necessary to ensure the development of the forward transactions market by reducing the volatility of the nominal exchange rate of the national currency; narrowing the gap between the market rate of deposits in the national currency and the market rate of loans in foreign currencies, and increasing the liquidity of the spot market.

## References

1. Decree of the President of the Republic of Uzbekistan No. 5177 dated September 2, 2017. On priority measures to liberalize foreign exchange policy//Collection of Legislation of the Republic of Uzbekistan, 2017, No. 36, Art. 945; National Legislation Database, 06.09.2019, No. 06/19/5811/3691; 09.07.2020, No. 06/20/6021/1047, 28.09.2020, No. 06/20/6075/1330; 17.10.2024, No. 06/24/159/0828.
2. Backlund N. Currency risks and currency risk management. – Business Economics and Tourism, 2011. – P. 17.
3. Sinki J. Financial management in a commercial bank and in the financial services industry. Trans. from English. – M.: Alpina Publisher, 2017. – P. 807.
4. Krasavina L.N. Risks in international monetary, credit and financial relations of Russia in the context of global challenges//Banking. - Moscow, 2013. - No. 10. - P. 25.
5. Sytin F.M. Assessment, forecast and management of currency risks//Financial risk management. - 02(18). - 2009. - 132 p.
6. Pokrovskaya O.S. Use of derivative instruments in managing the currency risk of a commercial bank: author's abstract. dis. candidate of economic sciences. 08.00.10 / O.S. Pokrovskaya // VF Rus. Academy of National Economy and Public Administration under the President of the Russian Federation. - St. Petersburg. - 2012. - 14 p.
7. Struchenkova T.V. Currency risks: analysis and management. – M.: Knorus, 2010. – 10 p.
8. Krichevsky M.L. Financial risks: a tutorial / M.L. Krichevsky. - M.: KNORUS, 2012. - 78s.
9. Rezaie K. Using Monte Carlo simulation method for the improvement of risk management / K. Rezaie, MS Amalnik, A. Gereie, B. Ostadi, M. Shakhseeniaee // Applied Mathematics and Computation. – 2007. – p. 1495
10. Demskaya A.L. One day of a financial risk manager: currency risk (hedging) / A.L. Demskaya, A.M. Kokosh // Financial risk management. - 2013. - 01(33). - 43 p.