

Multiple Asymmetries and Exchange Rate Exposure Management

Abstract

Reliable and consistent estimates of the sensitivity of stock returns to the changes in exchange rates (exchange rate exposure of stock returns) is an essential piece of information needed in exchange rate exposure management and government policy implementation towards financial markets in a country. Obtaining reliable estimates may be hindered by the negligence of the stylised facts associated with the exposure process. Existence of asymmetries in both stock returns and volatility of stock returns underlying exchange rate exposure are some of those stylised facts that seem to be seriously neglected in the current studies of exchange rate exposure. This paper analyses three types of asymmetries using a sample of 50 Japanese firms. The main contribution of the paper to the literature of exchange rate exposure management and policy making is two fold: (a) with an appropriate model, it simultaneously examines both sign (arising from appreciations and depreciations) and magnitude (arising from small and large changes in exchange rate) asymmetries of exchange rate exposure of stock returns and the asymmetry of volatility of stock returns underlying the exposure process; (b) in line with our objective of generating more reliable estimates that can be used for exchange rate management of firms, the study is carried out at the firm level. While the presence of sign and magnitude asymmetries can be supported by moderate evidence, our results show strong evidence for the presence of asymmetric volatility underlying exchange rate exposure of Japanese firms. We believe that these results have direct implications for exchange rate exposure management and government policy implementation towards financial markets.

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