

**Title** : **Asymmetric Volatility and Exchange Rate Exposure Management**

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**The area which the paper fits into:** Financial markets-related policies

**Abstract:**

*Reliable and realistic estimates of the sensitivity of stock returns to the changes in exchange rates (exchange rate exposure of stock returns) is an essential factor 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 asymmetric volatility in stock returns is one such stylised fact that seems to be seriously neglected in the current studies of exchange rate exposure. This paper analyses the asymmetric nature of the volatility associated with exchange rate exposure of stock returns using a sample of 50 Japanese firms. The paper offers two main contributions to the literature of exchange rate exposure management and policy making: (a) it provides an eclectic theoretical explanation of the mechanism through which asymmetric volatility of stock returns comes into being in the face of exchange rate changes; (b) it estimates the exchange rate exposure coefficients at the firm level with a model that is able to capture asymmetric volatility associated with exposure. Results from the latter which sheds new light on the matter reveal that the volatility asymmetry existing in Japanese firms is too remarkable to be neglected in both exchange rate exposure management and government policy implementation towards financial markets.*

**Key Words:** exchange rate exposure; exchange rate exposure management