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IMPROVING FOREIGN EXCHANGE RISK MANAGEMENT PRACTICES IN COMMERCIAL BANKS OF UZBEKISTAN

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Abstract: Currency risk is defined as the risk of bank losses due to exchange rate fluctuations and is one of the main types of banking risks. The liberalization of currency relations in Uzbekistan, which began in 2017, has led to increased attention to currency risk management in the country's commercial banks. The article analyzes the current state of practice of currency risk management in commercial banks of Uzbekistan and develops scientific proposals aimed at improving this practice.

Key words: commercial bank, currency risk, exchange rate, currency position, spot, forward, swap.

Annotatsiya: Valyuta riski valyuta kurslarining o'zgarishi natijasida bankning zarar ko'rish xavfi sifatida talqin qilinadi va bank risklarining asosiy turlaridan biri hisoblanadi. O'zbekistonda 2017-yildan boshlab boshlangan valyuta munosabatlarini liberallashtirish respublika tijorat banklarida valyuta riskini boshqarish masalasining dolzarbligini oshirdi. Maqolada O'zbekiston tijorat banklarida valyuta riskini boshqarish amaliyotining zamonaviy holati tahlil qilingan hamda ushbu amaliyotni takomillashtirishga qaratilgan ilmiy takliflar ishlab chiqilgan.

Kalit so'zlar: tijorat banki, valyuta riski, valyuta kursi, valyuta pozitsiyasi, spot, forvard, svop.

Аннотация: Валютный риск трактуется как опасность потерь банка в результате колебания обменных курсов валют и являются одним из основных видов банковских рисков. Либерализация валютных отношений в Узбекистане, начатое с 2017 года привело к повышению вопроса управления валютным риском в коммерческих банках республики. В статье анализировано современное состояние практике управления валютным риском в коммерческих банках Узбекистана и разработаны научные предложения, направленных на совершенствование данную практику.

Ключевые слова: коммерческий банк, валютный риск, валютный курс, валютная позиция, спот, форвард, своп.

INTRODUCTION

According to the Decree of the President of the Republic of Uzbekistan "On Priority Measures for the Liberalization of Foreign Exchange Policy," the exclusive use of market mechanisms in determining the exchange rate of the national currency against foreign currencies, enhancing the role of market instruments in the utilization of foreign exchange resources, creating equal competitive conditions in the foreign exchange market for all business entities, implementing a strict monetary policy aimed at ensuring the stability of the national currency through the active and flexible use of its instruments, developing the government securities market, as well as introducing open market operations and liquidity provision operations for banks secured by government securities into practice, are identified as priority directions of the state economic policy in the field of liberalization of foreign exchange relations [1]. This necessitates the improvement of foreign exchange risk management practices in the commercial banks of the republic.

REVIEW OF LITERATURE ON THE SUBJECT

According to F. Sytina and E. Kayasheva, there are four types of foreign exchange risks:
- translation foreign exchange risk;
- transaction foreign exchange risk;
- operational foreign exchange risk;
- hidden foreign exchange risk [2].

According to T. Struchenkov, foreign exchange risks arise during foreign trade, credit, investment, settlement, and conversion operations, as well as transactions on stock and commodity exchanges, due to changes in the value of assets, liabilities, monetary claims, and obligations denominated in foreign currency as a result of exchange rate fluctuations [3].

According to D. Piskulov, foreign exchange risk frequently arises when commercial banks conduct international settlements and international foreign exchange operations. In particular, such risk may emerge during the execution of a foreign exchange contract if the counterparty faces default. In this case, foreign exchange risk becomes a form of credit risk. In addition, so-called settlement risk may arise as a result of payments conducted across different time zones. During the period between the first and the second payment, the counterparty may enter a state of default. Furthermore, interest rate risk may occur during foreign exchange operations if there is a mismatch in the maturity periods of foreign currency positions [4].

H. van Greuning argues that revaluation risk arises when a bank's foreign currency positions are revalued into the national currency or when a parent company periodically consolidates financial statements, while operational foreign exchange risk reflects the impact of exchange rate changes on foreign accounts receivable and payable, namely on the difference between the value at which they are recorded in the local currency in the bank's financial statements [5].

M. Labudeva states that the Value at Risk (VaR) method of quantitative assessment enables a more accurate determination of potential losses arising from foreign exchange risk. At the same time, various criteria for the qualitative assessment of foreign exchange risk necessitate its classification into the following groups:
- minimal foreign exchange risk;
-medium foreign exchange risk;
-critical foreign exchange risk;
- unacceptable foreign exchange risk [6].

According to N. Jumayev, the instability of deposit and lending interest rates in the republic negatively affects the stability of forward exchange rates, since deposit and lending interest rates are factors determining the size of premiums and discounts. Premiums and discounts, in turn, are the only factors distinguishing the forward exchange rate from the spot exchange rate [7].

According to T. Bobakulov and U. Abdullayev, accounting for unrealized losses on forward operations has significant practical importance in the management of foreign exchange risk in commercial banks. This is explained by the fact that, in banking practice, it is quite common for forward contracts either not to be executed at all or to be executed with delays. This is due to the possibility that one of the parties to the forward contract may become insolvent upon the expiration of the contract term [8].

RESEARCH METHODOLOGY

The research methodology is based on the use of statistical data from the Central Bank of the Republic of Uzbekistan, the Republican Currency Exchange, and commercial banks for 2020–2025. The study employed comparative, dynamic, and structural analysis methods, as well as an assessment of exchange rate volatility and the structure of foreign exchange operations to determine the level of foreign exchange risk within the banking system.

ANALYSIS AND RESULTS

The level of foreign exchange risk in commercial banks directly depends on the volatility (fluctuation) of the nominal exchange rate of the national currency and foreign currencies (Figure 1).

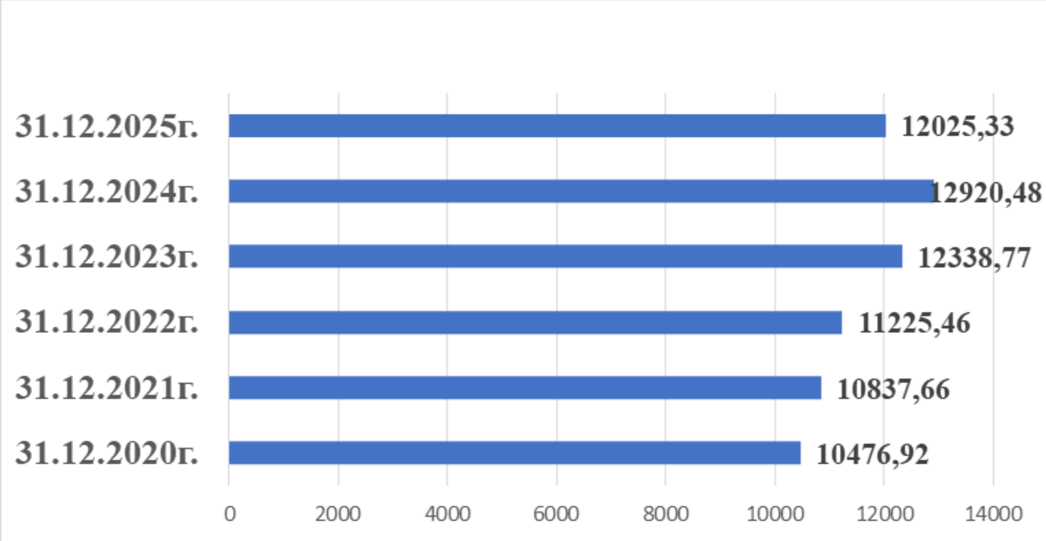

Figure 1. Nominal exchange rate of the national currency — the soum against 1 US dollar, in soums[1]

As can be seen from Figure 1, during 2020–2025, the volatility level of the national currency of Uzbekistan against the US dollar remained relatively high (14.8%).

One of the important factors affecting the level of foreign exchange risk in commercial banks is the degree of diversification of foreign exchange reserves (Table 1).

Table 1. Volume of Foreign Exchange Operations on the Republican Currency Exchange and Their Currency Structure[2]

Indicators	2020	2021	2022	2023	2024
Volume of foreign exchange operations, trillion soums	266.0	217.9	338.3	458.0	466.6
Share of the US dollar in the total volume of foreign exchange operations, %	69.1	98.8	99.9	99.9	99.2
Share of the euro in the total volume of foreign exchange operations, %	8.9	0.1	0.1	0.1	0.3

As can be seen from the data presented in Table 1:

- in 2021–2024, the volume of foreign exchange operations on the Republican Currency Exchange showed an upward trend;

- in 2021–2024, transactions involving the US dollar accounted for an exceptionally high share of the total volume of foreign exchange operations. This clearly demonstrates the insufficient diversification of the foreign exchange reserves of business entities and commercial banks;

- in 2021–2024, foreign exchange operations involving the euro accounted for a very low share of the total volume of foreign exchange operations (Table 2).

Table 2. Structure of Foreign Exchange Operations of the National Bank for Foreign Economic Activity, in percentages[3]

Types of foreign exchange operations	2020	2021	2022	2023	2024
Spot operations	96.3	100.0	98.7	95.4	93.2
Forward and swap operations	3.7	0.0	1.3	4.6	6.8
Total foreign exchange operations	100.0	100.0	100.0	100.0	100.0

As can be seen from the data presented in Table 2:

- in 2020–2024, spot operations accounted for a very high share of the total volume of foreign exchange operations of the National Bank for Foreign Economic Activity;

1 The figure was compiled by the author based on statistical data from the Central Bank of the Republic of Uzbekistan.
2 Source: compiled by the author.
3 Source: compiled by the author.

- in 2021, forward foreign exchange operations and swap operations were absent from the total volume of foreign exchange operations of the National Bank for Foreign Economic Activity.

CONCLUSIONS AND SUGGESTIONS

We have formulated the following conclusions regarding foreign exchange risk management in commercial banks:

- foreign exchange risks arise during foreign trade, credit, investment, settlement, and conversion operations, as well as transactions on stock and commodity exchanges due to changes in the value of assets, liabilities, monetary claims, and obligations denominated in foreign currency as a result of exchange rate fluctuations;
- revaluation risk arises when a bank's foreign currency positions are revalued into the national currency or when a parent company conducts periodic consolidation of financial statements, while operational foreign exchange risk reflects the impact of exchange rate changes on foreign accounts receivable and payable, namely the difference between the value at which they are recorded in the local currency in the bank's financial statements;
- the instability of deposit and lending interest rates in the republic negatively affects the stability of forward exchange rates;
- in the management of foreign exchange risk in commercial banks, accounting for unrealized losses on forward operations has important practical significance, since in banking practice it is quite common for forward transactions either not to be executed at all or to be executed with delays.

In our opinion, the following measures should be implemented to improve foreign exchange risk management practices in commercial banks:

It is necessary to reduce the volume of open foreign currency positions of commercial banks through the development of forward operations, by ensuring quantitative balance in spot transactions, and by introducing currency options and futures operations into banking practice.

It is necessary to reduce the level of foreign exchange risk in spot operations by improving default management in the spot foreign exchange market.

In the spot foreign exchange market, if a dealer fails to fulfill obligations, the dealer is recognized as a defaulting dealer, and the following procedures are carried out:

- the dealer is given the opportunity to independently fulfill its net obligations;
- in order to transfer the position related to the unfulfilled obligation, the Republican Currency Exchange of the Republic of Uzbekistan concludes an overnight swap transaction on behalf of the defaulting dealer and at the expense of its net claim;
- positions of bona fide participants are closed through opposite transactions at prices aimed at minimizing overall damage to the system;
- if the funds of the defaulting participant are insufficient, the reserve funds of the clearing center are utilized, including contributions from other participants and the capital of the exchange itself.

The exchange blocks and liquidates the available assets and guarantee fund (stress collateral) of the debtor in order to cover the debt owed to the counterparty of the transaction.

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