



# Working papers economics - Heterogeneous Strategies and Financial (Under)Development: Unintended Consequences of FX Policy and Regulation on Firms Hedging

Download Keep in mind

The series Working Papers on Economics is published by the Office for Economic Studies at the *Banco de la República* (Central Bank of *Colombia*). It contributes to the dissemination and promotion of the work by researchers from the institution. This series is indexed at Research Papers in Economics (RePEc).

On multiple occasions, these works have been the result of collaborative work with individuals from other national or international institutions. The works published are provisional, and their authors are fully responsible for the opinions expressed in them, as well as for possible mistakes. The opinions expressed herein are those of the authors and do not necessarily reflect the views of Banco de la República or its Board of Directors.

AUTHOR OR EDITOR Medellín-Martínez, Juan Camilo Restrepo-Ángel, Sergio

Market frictions and banking regulations limit the liquidity of the derivatives market, particularly affecting large firms. Foreign exchange interventions have asymmetric effects: they implicitly protect small firms under low intervention scenarios, but benefit large firms when intervention is high.

Publication Date: Monday, 10 of November 2025 **Approach**

This paper combines economic theory and empirical evidence to understand corporate behavior in the face of foreign exchange risk. It develops a theoretical model that incorporates financial frictions and entry costs into the derivatives market, validated with firm-level panel data from 2005 to 2013. The analysis focuses on how firm size, financial regulation, and exchange rate policies influence hedging decisions.

## Contribution

The research reveals that large firms, despite having greater access to the derivatives market, face higher hedging costs due to their need for larger volumes, which limits their ability to protect themselves. Moreover, central bank foreign exchange interventions have nonlinear effects: moderate foreign currency sales reduce the incentive to hedge, while large sales increase liquidity and favor hedging among large firms. The study suggests that although these policies aim to promote stability, they may generate vulnerabilities in the real sector.

## Findings

Empirical evidence confirms that larger firms hedge a smaller proportion of their foreign currency debt. Market frictions and banking regulations limit the liquidity of the derivatives market, particularly affecting large firms. Foreign exchange interventions have asymmetric effects: they implicitly protect small firms under low intervention scenarios, but benefit large firms when intervention is high. The study proposes that better calibration of macro-financial policies could strengthen the financial system and reduce exposure to foreign exchange risk.