The Introduction of Won/Yen Futures Contract and Its Hedging Effectiveness

*Won-Cheol Yun**

Department of Economics and Finance, Hanyang University,

17 Haengdang-dong, Seongdong-gu, Seoul, 133-791, South Korea

Abstract

Despite of regional closeness and active trading between Korea and Japan, there is little empirical analysis on the foreign exchange risk of Korean won and Japanese yen. Recently, the Korea Exchange (KRX) has introduced a Japanese yen currency futures contract. The main objective of this study is to examine the hedging performance of this foreign exchange hedging tool. This study sets up a theoretical framework for four hedging scenarios of investment and capital procurement schemes with direct and cross hedge types. According to the simulation results, the 1:1 naïve and the minimum variance hedge strategies outperform no-hedge strategy. The hedging effects of investment case are far greater than those of the capital procurement case. With respect to risk reduction, the minimum variance hedge is considered to be superior to the 1:1 naïve hedge. More importantly, the hedging performances of direct hedge strategies prove to be even better than those of cross hedge strategies. The differences in the hedging performances between direct and cross hedges would be regarded as the effects of introducing Japanese yen currency futures contract.

Keywords: Won/Yen Futures Contract, Hedging Effectiveness, Direct and Cross Hedges

JEL classification: C15, F31, G32

---

*Corresponding author. Tel: +82-2-2220-1028, fax: +82-2-2296-9587

E-mail address: wcyun@hanyang.ac.kr (W.-C. Yun).