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The Impact of the Federal Reserve's Monetary Policy Adjustments on Exchange Rate Risk and Financing Costs for Emerging Market Companies

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Abstract. With the deepening of global economic integration and the strengthening financial ties, the Federal Reserve's monetary policy significantly affects the operating environment and financial structure of emerging market firms. These effects operate through changes in dollar liquidity, cross-border capital flows, and exchange rates. This is associated with a typical pattern of "gradual accumulation of risks during easing phases and concentrated risk release during tightening phases" across different stages of the business cycle. This paper examines the mechanisms and heterogeneous effects of the Federal Reserve's cyclical monetary policy adjustments on exchange rate risk and financing costs of emerging market firms, further revealing the underlying logic and transmission channels of its cross-border spillover effects. By reviewing relevant literature and macroeconomic background data on changes in the Federal Reserve's monetary policy cycles from 2010 to 2023, and integrating the structural characteristics of typical emerging market firms in Asia, Latin America, and Central and Eastern Europe, this paper analyzes exchange rate risk evolution, financing cost dynamics, and firm heterogeneity through theoretical and mechanism-based analysis. The results show that the Fed's easing cycle promotes the expansion of foreign currency debt and the accumulation of exchange rate risk among emerging market firms, whereas the tightening cycle triggers concentrated risk release via dollar appreciation and rising interest rates, increasing financing costs and tightening financing conditions. Export-oriented firms exhibit natural hedging capacity, while firms with high foreign currency debt and domestic demand are more strongly affected.

Keywords: Federal Reserve, monetary policy adjustment, emerging market companies, exchange rate risk

1. Introduction

As the world's most important central bank, the monetary policy of the Federal Reserve System (Fed) drives cross-border capital flows and exchange rate fluctuations via interest rate and liquidity changes, generating persistent spillover effects on emerging markets. Driven by Fed's policy shifts, global dollar liquidity has fluctuated sharply across easing and tightening cycles, hence transmitting volatility to emerging market firms via capital flows and exchange rates, as reflected in episodes like

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post-2008 quantitative easing, the 2020 balance sheet expansion, and the 2022 rapid rate hikes [1]. Meanwhile, emerging market enterprises generally rely on foreign currency financing and have high exchange rate exposure. Under dollar tightening and local currency depreciation, firms face rising debt servicing pressure and tighter refinancing constraints simultaneously. Previous studies mainly analyze the spillover effect of monetary policy from a macro-level perspective, emphasizing the changes in the global financial cycle and capital flows. Yet, existing studies largely overlook firm-level transmission mechanisms. In particular, the exchange rate risk-financing cost nexus lacks systematic study, and cross-cycle and heterogeneity comparisons remain underexplored [2, 3]. Thus, this paper explores the impact mechanism of the Fed's cyclical adjustment of monetary policy on exchange rate risk and financing costs from the micro-perspective of emerging market enterprises. Based on existing literature and case evidence, this study analyzes heterogeneous firm responses across debt structures and business models. Furthermore, it analyzes the linkage and amplification effect of risk between exchange rates and financing channels, providing an explanatory framework for understanding corporate behavior under external monetary policy shocks.

2. Impact of federal reserve monetary policy adjustments on emerging market firms

2.1. Exchange rate risk dynamics

The Fed's monetary policy, by influencing global dollar liquidity and cross-border capital flows, alters the scale of foreign currency liabilities and the exchange rate exposure structure of emerging market firms. It also generates cyclical exchange rate risk transmission through exchange rate revaluation and balance sheet effects. This mechanism is characterized by asymmetry: endogenous risks accumulate during easing periods, while exogenous risks are triggered and released in a concentrated manner during tightening periods. It further exhibits temporal lags, whereby liability expansion lags behind liquidity changes and risk release lags behind exchange rate turning points [4]. During periods of monetary easing, the low financing costs prompt companies to expand their foreign currency liabilities through dollar financing, gradually resulting in a high proportion of foreign currency leverage in their asset structures. This results in the endogenous accumulation of exchange rate risk. In an environment of low exchange rate volatility and stable expectations, the impetus for corporate risk-taking weakens, which further reinforcing the path dependence of exposure accumulation. During the normalization phase, the combined impact of a stronger dollar and the tightening of global liquidity reinforces expectations of domestic currency depreciation and heightens the implicit repayment pressure on foreign currency debt. Exchange rate risk begins to gradually become explicit from within the balance sheet, continuously eroding corporate financial soundness through exchange gains and losses. During periods of monetary tightening, a rapid rise in the dollar index and increased exchange rate volatility trigger short-term revaluation of foreign currency exposures. This process amplifies balance sheet deterioration through debt expansion and heightened cash flow pressure, while also transmitting risks from the financial level to operational domains such as financing capacity and investment decisions.

2.2. Financing cost evolution

The Fed's monetary policy influences financing conditions in emerging market firms through global dollar liquidity. The mechanism operates via rising financing costs, tighter financing channels, and higher risk premiums, which mutually reinforce during tightening cycles and intensify financing constraints [5]. In terms of financing costs,easing cycles characterized by ample global liquidity

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keep dollar funding rates low, reducing external financing costs and supporting corporate expansion. In contrast, tightening cycles, driven by rising U.S. interest rates, raise global risk-free rates, shift financing benchmarks upward, and increase corporate debt financing costs while also compressing financing options. Regarding financing channels, easing conditions facilitate cross-border capital inflows, resulting in more abundant and diversified financing supply in emerging markets. However, during a tightening cycle, the repatriation of capital to the US leads to a concurrent contraction in both cross-border credit and bond financing. This increases companies' reliance on refinancing and heightens their sensitivity to changes in the external funding supply, thereby imposing significant constraints on the availability of financing. In terms of risk premiums, tightening policies heighten global uncertainty and dampen risk appetite, prompting investors to demand higher credit spreads as compensation for increased volatility. Thus, corporate risk premiums increase, with weaker-credit and less flexible firms facing greater deterioration in financing conditions.

2.3. Differences in enterprise performance

The impact of Fed monetary policy shocks exhibits significant corporate heterogeneity in emerging markets, mainly due to differences in foreign currency exposure and financing constraints. And this heterogeneity stems from balance sheet and financing channel effects, which generate systematic divergence [2, 6]. In this context, financing structure is a key determinant. Firms with higher foreign currency liabilities face greater debt servicing costs and exchange losses during dollar tightening and local currency depreciation, accelerating balance sheet deterioration. By contrast, firms relying more on local currency financing are less exposed to exchange rate fluctuations and thus relatively insulated.

Building on this, business models alter risk hedging paths by influencing the structure of foreign currency cash flows. Export-oriented enterprises rely on foreign currency income to form a natural hedge, thus buffering the impact of foreign currency debt to some extent. Domestic demand-driven firms, lacking stable foreign currency cash flow support, are more easily constrained by financing contraction during tightening cycles, limiting investment and expansion. Meanwhile, industry and regional factors further amplify this differentiation effect. In particular, capital-intensive industries, due to their high reliance on cross-border financing, are more sensitive to rising interest rates and exchange rate fluctuations. In contrast, consumer and service industries are relatively less affected by local demand. Simultaneously, economies with strong foreign exchange reserves and capital account management capacity can dampen shock transmission through institutional buffers, while economies with weak reserves or high foreign currency debt ratios experience greater accumulation of systemic pressures. Furthermore, risk management capabilities determine the degree of shock absorption by influencing the use of hedging tools and the scope for adjusting financing structures. Large enterprises can reduce risk exposure through derivatives and diversified financing. In contrast, small and medium-sized enterprises (SMEs), restricted by the limited availability of financial tools and cost constraints, are more likely to facing financial pressure during exchange rate fluctuations and financing contraction.

3. Transmission mechanism of Fed monetary policy to emerging market firms

3.1. The spillover channels of federal reserve monetary policy

Based on the US dollar's status as a global reserve currency, the Fed's monetary policy exerts a cross-border spillover effect on emerging markets through the global financial network, and this

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effect is mainly transmitted through three channels: interest rates, capital flows, and exchange rates. These channels work together at the macro level and directly affect changes in corporate exchange rate risk and financing costs [1].

Based on the interest rate parity mechanism, the Fed's interest rate hikes increase the US risk-free rate and expand cross-border interest rate differentials, which drives capital back to the US and tightens liquidity in emerging markets. At the corporate level, this manifests as higher dollar financing rates and increased financing costs. Meanwhile, the increased pressure on the domestic currency to depreciate increases the burden of repaying foreign currency debt in the domestic currency. As a result, it amplifies both financing costs and exchange-rate risks simultaneously. Based on the international capital flow mechanism, the cyclical changes in dollar liquidity determine the scale of cross-border capital supply. During easing cycles, capital inflows lower financing thresholds and promote the expansion of foreign currency debt, leading to a temporary decrease in corporate financing costs but a continuous accumulation of foreign currency exposure. Conversely, during tightening cycles, capital repatriation leads to a contraction in financing supply and increased refinancing constraints. This reduces the availability of corporate financing and exacerbates liquidity pressures. Through the exchange rate channel, interest rate adjustments and changes in capital flows jointly drive exchange rate fluctuations. Domestic currency depreciation directly increases the cost of repaying foreign currency debt through balance sheet effects and expedites the transmission of financial pressure to the corporate level through exchange rate gains and losses. As a result, it amplifies exchange rate risk exposure and further affecting the stability of investment and financing decisions.

3.2. The relationship between exchange rate risk and financing costs

Under Fed spillover effects, exchange rate fluctuations co-move with financing costs. Instead, they form a linkage mechanism via the balance sheet effect and the financing constraint effect. This mechanism jointly affects the corporate financial structure and constitutes the core transmission path of the dual impact of "exchange rate risk-financing pressure" [7].

From the perspective of balance sheet effects, the simultaneous appreciation of the US dollar driven by the Fed's tightening and the depreciation of emerging market currencies passively expands corporate foreign currency liabilities denominated in local currencies. This directly heightens the pressure of debt repayment and reduces the size of net assets. This stock shock is quickly reflected in corporate financial conditions through exchange rate gains and losses, further altering their risk exposure structure. Simultaneously, this process also produces a differentiation effect at the operational level: export-oriented companies can partially hedge against the increased in foreign currency income, whereas import-dependent companies encounter further squeezed profit margins because of rising costs. As a result, the constraint of the balance sheet on the overall stability of enterprises is strengthened.

From the perspective of financing constraints, policy tightening, through raising global risk-free interest rates and risk premiums, simultaneously deteriorates corporate financing conditions from the incremental side. On the one hand, financing costs systematically rise as benchmark interest rates increase; on the other hand, the escalating capital risk aversion results in a contraction of credit supply and heightened refinancing difficulties. This creates a dual constraint of situation where financing availability decreases and financing costs increase, and the marginal impact is stronger on companies with weaker creditworthiness. Based on this, the two effects form a closed loop through the corporate balance sheet. When exchange rate shocks lead to a deterioration of financial conditions, they will further intensify the risk assessment and credit contraction behavior of

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financial institutions, thus exacerbating financing constraints. In turn, the tightening of financing weakens the risk-buffering capacity of enterprises, reduces their ability to roll over foreign currency debt, and amplifies their exposure to exchange rates. These feedback effects form a self-reinforcing loop that explains the concentrated rise in corporate risk during tightening cycles.

4. Risk management and policy implications for emerging market firms

4.1. Enterprise risk management and financing adjustment

In response to exchange rate risk, rising financing costs, and tighter financing constraints arising from Fed monetary policy spillovers, emerging market firms need to undertake coordinated adjustments. These adjustments should focus on two main dimensions: exchange rate risk control and "financing cost stability" to mitigate the combined impact of balance sheet deterioration and tightening financing conditions [8].

In terms of exchange rate risk management, the core lies in reducing foreign currency exposure and strengthening cash flow hedging mechanisms. Enterprises can lock in the exchange rate cost of foreign currency debt by utilizing financial hedging tools, such as forward contracts and currency swaps. As a result, the amplifying effect of exchange - rate fluctuations on debt repayment pressure can be reduced. Simultaneously, through the optimization of their operational structure, they can enhance their natural hedging capabilities, raise the proportion of foreign currency income, or adjust their export layout to align foreign exchange income with foreign currency liabilities in terms of currency and maturity. Consequently, they can mitigate the impact of exchange rate fluctuations on the balance sheet at the source.

Regarding financing cost control, the priority is to reduce reliance on single-currency and short-term financing while stabilizing refinancing conditions. On the one hand, firms should increase the share of domestic currency financing and optimize debt maturity structures, thereby reducing sensitivity to the US dollar interest rate cycle and smoothing refinancing pressure from clustered maturities. On the other hand, by expanding access to domestic bond markets, regional financial markets, and diversified financing instruments, firms can alleviate rising costs and financing constraints caused by the contraction of cross-border financing, thereby enhancing the stability of funding sources. Accordingly, exchange rate risk management and financing structure optimization should be pursued in tandem. By reducing foreign currency exposure, the impact of exchange rate revaluation can be mitigated. At the same time, by diversifying financing, the impact of rising interest rates and liquidity contraction can be reduced, thereby jointly weakening the dual impact of monetary policy cycles on corporate financial soundness.

4.2. Policy implications from risk mitigation practices

Based on the analysis of the linkage mechanism between the cyclical spillover of Fed monetary policy and the dual shock of "exchange rate risk-financing cost," core principles of risk governance for emerging market firms can be identified. In this context, risk exposure follows a pattern of cyclical accumulation, transmission operates via cross-channel linkages, and responses are shaped by structural dependence. These features yield broader insights into corporate financial stability [9, 10].

Specifically, risk exposure exhibits clear cyclical dependence. This pattern is reflected in easing cycles, which are typically accompanied by a gradual buildup of foreign currency exposure and debt structures, while tightening cycles involve the release of exchange rate revaluation effects alongside

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financing contraction. As a result, corporate risk does not evolve linearly but instead follows a pattern of "phased accumulation and concentrated release."

In addition, risk transmission is reinforced by a linkage mechanism between exchange rates and financing conditions. Exchange rate depreciation weakens corporate balance sheets via valuation effects, which intensifies risk pricing and credit tightening by financial institutions. Meanwhile, rising financing constraints reduce firms' risk absorption capacity, forming a mutually reinforcing negative feedback loop.

Moreover, risk exposure is highly structurally dependent. Differences in financing structures, operating cash flows, and external market dependence lead to heterogeneous outcomes under identical external shocks. This suggests that the severity of monetary policy spillovers is ultimately determined by firms' internal structural vulnerability rather than external shocks alone. Accordingly, effective risk management for emerging market firms does not rely on a single instrument but on aligning external financial cycles with internal structural resilience. In essence, improving shock absorption capacity requires reducing structural fragility.

5. Conclusion

This paper analyzes the impact of the Federal Reserve's cyclical adjustments to monetary policy on exchange rate risk and financing costs for emerging market enterprises. Within a unified framework, it conducts a systematically examination of the transmission path and mechanism of action, and summarizes the basic patterns at the enterprise level. The structure reveals that the Fed's monetary policy exhibits certain cyclical asymmetric spillover characteristics, with phased differences in risk accumulation and release between easing and tightening phases. Furthermore, policy shocks are transmitted via exchange rate and financing channels, manifesting at the firm level as a combined effect of balance sheet pressures and shifts in financing constraints. Moreover, the magnitude of this impact varies across firms and regions, depending on structural factors such as foreign currency exposure and the surrounding financial environment. However, it exhibits limited differentiation across different policy shock scenarios, does not fully incorporate exogenous factors, and leaves room for further expansion in the quantitative analysis of heterogeneous effects. Future research could further enhance this framework by more precisely classifying policy shock types, expanding the analysis of interactions among multiple exogenous variables, and strengthening micro-level quantitative identification. This would, in turn, enhance the explanatory power of the transmission mechanism and improve its ability to capture heterogeneous effects.

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