Session II: FX interventions: objectives, strategies, and tactics

XII BIS–CEMLA Roundtable: Reserve management and FX intervention
Introduction

- Reserve accumulation and interventions extensively used in EMEs and the region...
  - in spite of, in many cases, monetary policy regimes defined as inflation targets and flexible exchange rates.
  - used as monetary policy, macroprudential tool.

- FX intervention goals, strategies and tactics:
  - Main goals and intermediate objectives
  - Transmission channels and effectiveness
  - Methods and techniques
  - Strategies and tactics (communication and sterilization)

- BIS survey of 13 Latin America and the Caribbean countries and 16 other emerging market economies.
Goals and intermediate objectives

- **Goals** refers to the ultimate purposes of the intervention.
  - Intervention often responds to unwelcome financial developments that give rise to destabilizing exchange rate dynamics.

Curbing FX speculation and building reserves are key concerns for central banks

Number of countries

![Graph 1](image-url)
Goals and intermediate objectives

- **Intermediate objectives** - set to operationalise goals.
  - Limiting exchange rate volatility strongly linked to most intervention goals.

<table>
<thead>
<tr>
<th>Number of countries</th>
<th>Graph 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limit exchange rate volatility</td>
<td></td>
</tr>
<tr>
<td>Provide liquidity to thin market</td>
<td></td>
</tr>
<tr>
<td>Smooth trend path of exchange rate</td>
<td></td>
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<tr>
<td>Influence level of exchange rate</td>
<td></td>
</tr>
<tr>
<td>Other(^1)</td>
<td></td>
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<tr>
<td>Limit pressure caused by international investors</td>
<td></td>
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</tbody>
</table>

\(^1\) Mostly non-floating exchange rate arrangements.
Effectiveness can be judged only against goals and objectives.

- Empirical cross-country studies find that FX interventions have a strong impact on the level and volatility of the exchange rate.

FX interventions are mostly effective in the short to medium run, but not beyond

As a percentage of respondents who pursue the respective objective

1 Based on the responses of four instead of five central banks, as one central bank did not make an assessment.  
2 Up to one month.  
3 One to six months.  
4 More than six months.
Transmission channels and effectiveness

- **Portfolio balance** - agents regard assets dominated in different currencies as imperfect substitutes.
- **Signaling** - shifts market participants expectations about macroeconomic fundamentals or future policy

Signalling is considered the most important channel of FX intervention

Number of countries

Graph 4

- **Signalling**
- **Signalling future monetary policy stance**
- **Signalling future exchange rate and interventions**
- **Portfolio balance**
- **Other**

<table>
<thead>
<tr>
<th>Often</th>
<th>Sometimes</th>
<th>Rarely</th>
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</thead>
<tbody>
<tr>
<td>Latin America and the Caribbean</td>
<td>Other emerging market</td>
<td></td>
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</table>
Methods and techniques: instruments

- The use of derivatives has continued to expand (eg. FX swaps):
  - Increasing importance of financial stability considerations.
  - Bigger role of non-bank financial intermediaries.

**Toolkit has continued to expand, but spot market interventions most common**

<table>
<thead>
<tr>
<th>Number of countries</th>
<th>Graph 5</th>
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<tbody>
<tr>
<td>Interventions in spot markets</td>
<td></td>
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<tr>
<td>Normally</td>
<td></td>
</tr>
<tr>
<td>Occasionally</td>
<td></td>
</tr>
<tr>
<td>Other derivatives (futures, swaps, options, other)</td>
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<tr>
<td>Forwards</td>
<td></td>
</tr>
<tr>
<td>Derivatives</td>
<td></td>
</tr>
<tr>
<td>Off-shore interventions (national currency/USD)</td>
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</tbody>
</table>

- Increasing importance of financial stability considerations.
- Bigger role of non-bank financial intermediaries.
Predominant use of **discretion** may be the result of:

- CB aim to prevent detection
- Maximise market impact
- Rules may be difficult to formulate based on real-time information.
Strategies and tactics: disclosure of information

- **Advantages of transparency:**
  - Indispensable if the CB intends to provide a signal.
  - Strengthens portfolio balance channel.
  - Prevails when CB rely on rules and wish to anchor expectations.

Transparency is still a key issue

Number of countries

Graph 7

Central bank pre-announce FX interventions

FX intervention data made public ex post

![Graph showing transparency data]
Strategies and tactics: sterilisation

- Interventions are always sterilised in Latam
- Trade-offs of **sterilisation** instruments
  - Non-market-based instruments are less costly but may hinder smooth market function.
  - Market based instruments may help the development of deep and liquid domestic bond markets.

Central bank securities are the most used instrument for sterilisation

Number of countries

Graph 8