The Effect of Central Bank Foreign Exchange Interventions on Exchange Rate Volatility: Evidence from Costa Rica

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I. Summary

• This study is aimed to determine the Central Bank of Costa Rica’s (BCCR) effectiveness in lowering nominal exchange rate volatility through interventions at the foreign exchange market.

• Empirical analysis is based on two methods: i) a GARCH model; and ii) a propensity score matching system to estimate exchange rate volatility counterfactuals.

• The study is based on intraday data (real time data) for the period 2006-2015. During this period the exchange rate evolved from a crawling peg system with bands, to a managed floating scheme.

• Results confirm that BCCR’s interventions have lowered the nominal exchange rate volatility, particularly during the floating scheme era, and in shorter horizons. Results are robust to alternative model specifications.

• It is argued that a lower exchange rate volatility is consistent with the goal of a low and stable inflation.
II. Comments and Suggestions

• Thank you for allowing me to read this document, from which I have learned a lot about the evolution of the Costa Rican’s exchange rate system in the recent past.

• It might be worth to add:
  • A differentiation between purchase/sale interventions, (to compare their effects on volatility), and their relative size with respect to daily market demand;
  • The GARCH model specification, to complement references within the text;
  • It there something to say/suggest about the intervention mechanism itself? Are they sterilized in the money market?
Thank you.