Does transparency in central bank intervention policy bring noise to the FX market? 
The case of the Bank of Japan

Jean-Yves Gnabo\textsuperscript{a,c}, Sébastien Laurent\textsuperscript{a,b},
Christelle Lecourt\textsuperscript{a,c,*}

\textsuperscript{a} CeReFiM, University of Namur, Belgium
\textsuperscript{b} CORE, Université catholique de Louvain, Belgium
\textsuperscript{c} LSM, Louvain School of Management, Belgium

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Abstract

This paper empirically investigates the induced effect of a more and less transparent central bank intervention (CBI) policy on rumors that can emerge. Using the case of Japan, we estimate a dynamic-probit model that explains the main determinants of false reports (i.e. falsely reported interventions) and anticipative rumors (i.e. rumors about future interventions) with reference to the intervention strategy adopted by the central bank for actual and oral interventions, and the uncertainty climate of the market captured by two volatility measures. Our results suggest that the induced effect of a transparent CBI policy on market rumors critically depends on the type of speeches made by officials.

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1. Introduction

The exchange rate policies managed by many countries have changed radically since the mid-1990s. Before then, central banks (CBs hereafter) had a tendency to entertain secrecy by
not clarifying their objectives. Along with a trend towards greater independence and under
pressure from governments, there has been a move towards more communication and trans-
parency in both monetary and exchange rate policy. As a matter of fact, most CBs, such as the
Fed and the ECB, have become increasingly reluctant to intervene and have shifted towards
the use of communication policy to manage their exchange rates. Only Japan has continued
to intervene actively and unilaterally in recent years, and it has done so both actually and
orally.

This shift towards the use of official communications coupled with unclear results on the
effectiveness of actual interventions \(^1\) led research on exchange rate policies to focus on the desir-
ability of a more transparent intervention policy (Vitale, 1999; Gnabo and Lecourt, 2005) and
more specifically on the effectiveness of communication policies (Fatum and Hutchinson, 2002;
Fratzscher, 2004; Beine et al., 2006). The goal pursued by most of these studies is to test the
direct effect of CBs’ transparency and communication policy on the dynamics of exchange rates.
In particular, Fratzscher (2004) shows empirically for the CBs of the G3 that “oral interven-
tions” concerning the exchange rate and interventions policy are useful policy tools to influence
exchange rates independently of whether or not they are supported by actual FX interventions.
By contrast, Beine et al. (2006) argue that official speeches aimed at confirming or commenting
on the intervention operations complement, rather than substitute for, actual foreign exchange
interventions.

Up to now, few studies have focused on the indirect effect of CBs’ transparency and commu-
ication in the intervention policy. Chiu (2003) suggests that the degree of transparency adopted
by the monetary authorities in their exchange rate policy may favor or reduce the speculation
and the dissemination of rumors in the market. More precisely, Gnabo and Lecourt (2005) in
a descriptive empirical paper, find that the ambiguous policy practiced by the Japanese author-
ities increased the market uncertainty about past and future actions of the CB, resulting in the
emergence of false intervention reports. Inversely, a too transparent policy on CB’s targets may
favor speculative attacks from market participants by giving explicit targets for speculators to
challenge, increasing the occurrence of anticipative rumors, i.e. news reporting the expectations
of the market concerning a future intervention.

In line with these studies, the aim of this paper is to analyze the economic desirability of
transparency in central bank intervention (CBI hereafter) policy and more precisely to assess the
effects of a more and less transparent intervention policy on the market’s perception and rumors.
Using the case of the Bank of Japan (BoJ) which has continued to intervene actively and unilaterally
in recent years we estimate a dynamic-probit model that explains the main determinants of the
BoJ’s intervention rumors in the foreign exchange market.

In turn, the paper offers to address two central questions:

**Question 1.** Does transparency in CBI policy (i.e. intervention strategy concerning actual and
oral interventions) introduce noise into the market?

Literally “noise is contrasted with information” (Black, 1986). In our context, we consider
market rumors and more precisely rumors about CBI episodes as noise. We make the distinction
between false intervention reports (called false reports) – when the market mistakenly believes
that a CB has intervened – and anticipative interventions rumors—news reporting the expectations

\(^1\) Sarno and Taylor (2001) and Neely (2005) provide comprehensive surveys of the recent literature on actual interven-
tions.
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