ELSEVIER

Journal of International Economics 60 (2003) 355–386

Journal of INTERNATIONAL ECONOMICS

www.elsevier.com/locate/econbase

Monetary policy, foreign exchange intervention, and the exchange rate in a unifying framework

Soyoung Kim*

Department of Economics, University of Illinois at Urbana-Champaign, 1407 W. Gregory Drive, Urbana, IL 61801, USA

Received 7 May 2001; received in revised form 19 October 2001; accepted 12 November 2001

Abstract

The structural VAR model is developed to jointly analyze the effects of foreign exchange intervention and (money or interest rate setting) conventional monetary policy on the exchange rate, the two types of policy reactions to the exchange rate, and interactions between the two types of policies. First, many interactions among the two types of policies and the exchange rate are found, which suggests that a joint analysis is important. Second, foreign exchange intervention has substantial effects on the exchange rate, reacts to the exchange rate significantly (to stabilize the exchange rate), and signals future conventional monetary policy stance changes (to back up the intervention). This suggests the importance of modeling foreign exchange intervention explicitly in the study of monetary policy and exchange rate behaviors. Many other interesting results on the interactions among the two types of policies and the exchange rate are also documented.
© 2002 Elsevier Science B.V. All rights reserved.

Keywords: Foreign exchange intervention; Monetary policy; Structural VAR; Exchange rate; Reaction function

JEL classification: F31; E52; C32

*Tel.: + 1-217-356-9291; fax: + 1-217-333-1398.
E-mail addresses: kim11@uiuc.edu (S. Kim), http://www.cba.uiuc.edu/kim11 (S. Kim).

0022-1996/02/$ – see front matter © 2002 Elsevier Science B.V. All rights reserved.
doi:10.1016/S0022-1996(02)00028-4

1. Introduction

Numerous past empirical studies addressed various questions on the relationship between monetary policy and the exchange rate. One of the trends in the literature was to examine the relationship between general monetary policy and the exchange rate. Monetary policy is typically described as the interest rate (for example, the Federal Funds rate for the U.S.) or money setting policy. Some recent studies using VAR models such as Clarida and Gali (1994), Eichenbaum and Evans (1995), Kim and Roubini (2000) examined the effects of monetary policy shocks on the exchange rate. Other, so-called monetary reaction function literature (for recent examples, Clarida et al., 1998, 2000; Kim, 2001a), addressed how the monetary authority reacts to exchange rate changes.

Another trend in the literature was to analyze the relationship between another type of monetary policy and the exchange rate. This literature analyzed foreign exchange intervention. Some of them examined how the foreign exchange intervention affected the exchange rate (for example, Kaminsky and Lewis, 1996; Lewis, 1995; Dominguez and Frankel, 1993), while others examined how foreign exchange intervention reacted to the exchange rate (for example, Neumann, 1984).[1]

Most past studies analyzed only one type of question. Even though a few studies examined more than one question, they examined each issue based on different models and did not use a unifying framework to analyze the questions together.[2] However, all these issues are related and should be analyzed together in a unifying empirical model. First, foreign exchange intervention and interest rate (or money) setting monetary policy are better when analyzed jointly since they interact with each other. For example, foreign exchange intervention may affect interest rate (or money) setting monetary policy if it is not fully sterilized. In addition, foreign exchange intervention may also signal future changes in monetary policy stance. Indeed, some past studies (for example, Lewis, 1995; Kaminsky and Lewis, 1996; Bonser-Neal et al., 1998) recognized this as a possibly important channel through which foreign exchange intervention affects the exchange rate, and examined it empirically, but failed to analyze all the issues in a unifying empirical framework. Similarly, interest rate (or money) setting monetary policy may affect foreign exchange intervention since monetary policy affects the exchange rate and foreign exchange intervention may respond to it in order to stabilize the exchange rate.

[1] Refer to Sarno and Taylor (2001) for a recent survey of the literature.

[2] Lewis (1995) and Bonser-Neal et al. (1998) are such examples. Lewis (1995) examined the effects of both types of policies on the exchange rate, and the interactions between the two types of policies, though the formal policy reaction function to the exchange rate was not examined. However, the analysis was based on bivariate VAR models, so that only two variables were included in each model and at best, interactions between two variables were examined based on each model. Similarly, Bonser-Neal et al. (1998) examined a few issues on the interactions among those variables but they examined each issue using different empirical models.

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات