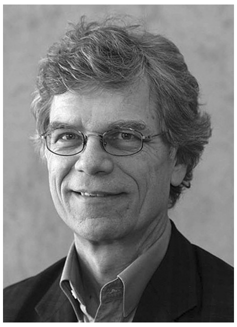

Prof. Dr. Lukas Menkhoff, Head of the Department of International Economics at DIW Berlin

SEVEN QUESTIONS FOR LUKAS MENKHOFF

»Foreign exchange market interventions take place predominantly in emerging and developing countries«

1. Mr. Menkhoff, foreign exchange market interventions (FX interventions) can be used to influence international exchange rates. Where and how frequently are FX interventions implemented? At present, these interventions take place predominantly in emerging and developing countries. In the countries that use them, an intervention takes place almost one out of every three days.

2. What does an FX intervention consist of? Foreign currencies are bought or sold, typically a reference currency that is relevant to the country in question. This is usually the U.S. dollar, occasionally the euro, and in rarer cases, a third currency that does not play an important role.

3. How much money is involved in an FX intervention? The amounts depend on the size of the respective national economy. Among all of the countries we surveyed, the average intervention amounts to 50 million USD a day—but the spread here is enormous. Projected onto the GDP of the comparatively large European Monetary Union, this would equal roughly two billion USD.

4. Currency rates fluctuate even without interventions. How is it possible to determine whether a change in the exchange rate is really due to an intervention? The problem with determining the success of an FX interventions is that a lot of things are happening at once in FX markets and it is difficult to identify whether a change in the exchange rate is causally related to the intervention, caused by other events, or merely accidental. This is the "identification question," and there are different approaches to address it. In our investigation we work with "event studies," in which we examine relatively short periods with the aim of eliminating other events that also play a role in the longer term. It is practical to limit it as closely as possible to the intervention period in order to be able to say that whatever happens here is likely related to the intervention.

5. How often are FX interventions successful and how often do they have no effect? FX interventions are successful in roughly 60 to 90 percent of the cases. How often they are without effect would thus amount to 40 to 10 percent, always taking into account the benchmark that is dependent on the respective success criterion.

6. So the probability of an FX intervention being successful is relatively high? The success rate is relatively high, but it must be kept in mind that the central banks are also strategic about when and how they intervene. If they have doubts that an intervention will be successful, they may not proceed with it. It is thus not possible to conclude that in any situation, no matter what happens in the world, you can simply intervene and be successful 60 to 90 percent of the time.

7. How much can central banks influence exchange rates? In highly developed countries, the influence is not so powerful in purely quantitative terms, because the markets are relatively larger measured against the national economy and the central bank's importance in that economy. Central banks have more leverage in developing countries and can thus be more successful. But the fundamental channel of a successful intervention is via signaling, and this of course depends on the credibility of the central banks. They should take an approach that is comprehensible for the market participants and not intervene "wildly," so to speak.

Interview by Erich Wittenberg

DIW Berlin — Deutsches Institut für Wirtschaftsforschung e. V.
Mohrenstraße 58, 10117 Berlin
T +49 30 897 89 -0
F +49 30 897 89 -200

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