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CCAMTAC- Regional Research/Analytical Economic Policy Seminar

"Foreign Exchange Interventions as a Form of Unconventional Monetary Policy"

Friday, July 1, 2022

Introduction and Moderator

Norbert Funke**,** Director, CCAMTAC

Martin Fukac**,** Macroframeworks, Financial Programming, Forecasting Policy Analysis Advisor, CCAMTAC

Presenter:

Mr. Tobias Cwik, Senior Economist, Forecast and Analysis Switzerland Unit, Swiss National Bank

Discussants:

Mr. Armen Nurbekyan, Head of Macroeconomics Directorate, Member of Executive Board, Central Bank of Armenia

***Mr.* Shalva Mkhatrishvili**, Head of Macroeconomics and Statistics Department, National Bank of Georgia

In the aftermath of the financial crisis, central banks from several small open economies have used foreign exchange (FX) interventions in order to stimulate economic activity and inflation, as their policy rates were close to the effective lower bound. How effective are such interventions and what is the broader economic impact? Putting these questions in a wider perspective, Martin Fukac noted that the topic of foreign exchange interventions also plays an important role in several CCAMTAC countries. It would therefore be of particular interest to learn from Switzerland's experience and also discuss how FX interventions can be thought of and modelled in a Dynamic Stochastic General Equilibrium (DSGE) model.

Tobias Cwik presented ongoing work, prepared together with his colleague Christoph Winter, to study the effectiveness of foreign exchange interventions as unconventional monetary policy tool, using a DSGE model applied to Switzerland. He started with some stylized facts and an explanation of the model, including the modelling of the uncovered interest rate parity and risk premium. Results suggest that FX interventions are effective and long-lasting. The effect tends to be stronger, the longer the central bank can commit to keep its policy rate constant in response to the inflationary effects of FX interventions. The authors also calculate a shadow rate: how low would the policy rate have to be to substitute FX interventions. Two counterfactual analyses showed how key variables might have developed without foreign exchange interventions. To substitute FX interventions the policy rate would have been to be substantially lower.

Both discussants appreciated the innovative analysis. In his comments Armen Nurbekyan focused on the question of how to think about FX interventions from the perspective of monetary policy and communication. A key challenge may be whether the public interprets interventions as means to achieve price stability or gains in competitiveness. It would be important that central banks have reasonably clear objectives and sufficient independence from the political process to achieve their objectives The primary role of monetary policy should be to provide an anchor for inflation and medium-term inflation expectations, hence communication of the reasoning for FX interventions would be very important.

Shalva Mkhatrishvili noted that the analysis would also be very relevant for emerging markets, including for Georgia, even though there are differences. While Switzerland as a safe haven country tried to insure against an appreciation, emerging markets often need to insure against depreciation pressures. He also suggested that it would be interesting to look closer at the implications of the analysis for a reasonable inflation target which is typically above zero to insure against the constraints of the effective lower bound. And he also raised the issue of the forward guidance puzzle where in several models the effect of an announced future policy change is larger the further into the future the announced change is.

The subsequent discussion focused on some more technical modelling issues.