Comments on "FX Interventions, Market Expectations, and Risk Premia" by *Baumeister, Mark and Mershon*

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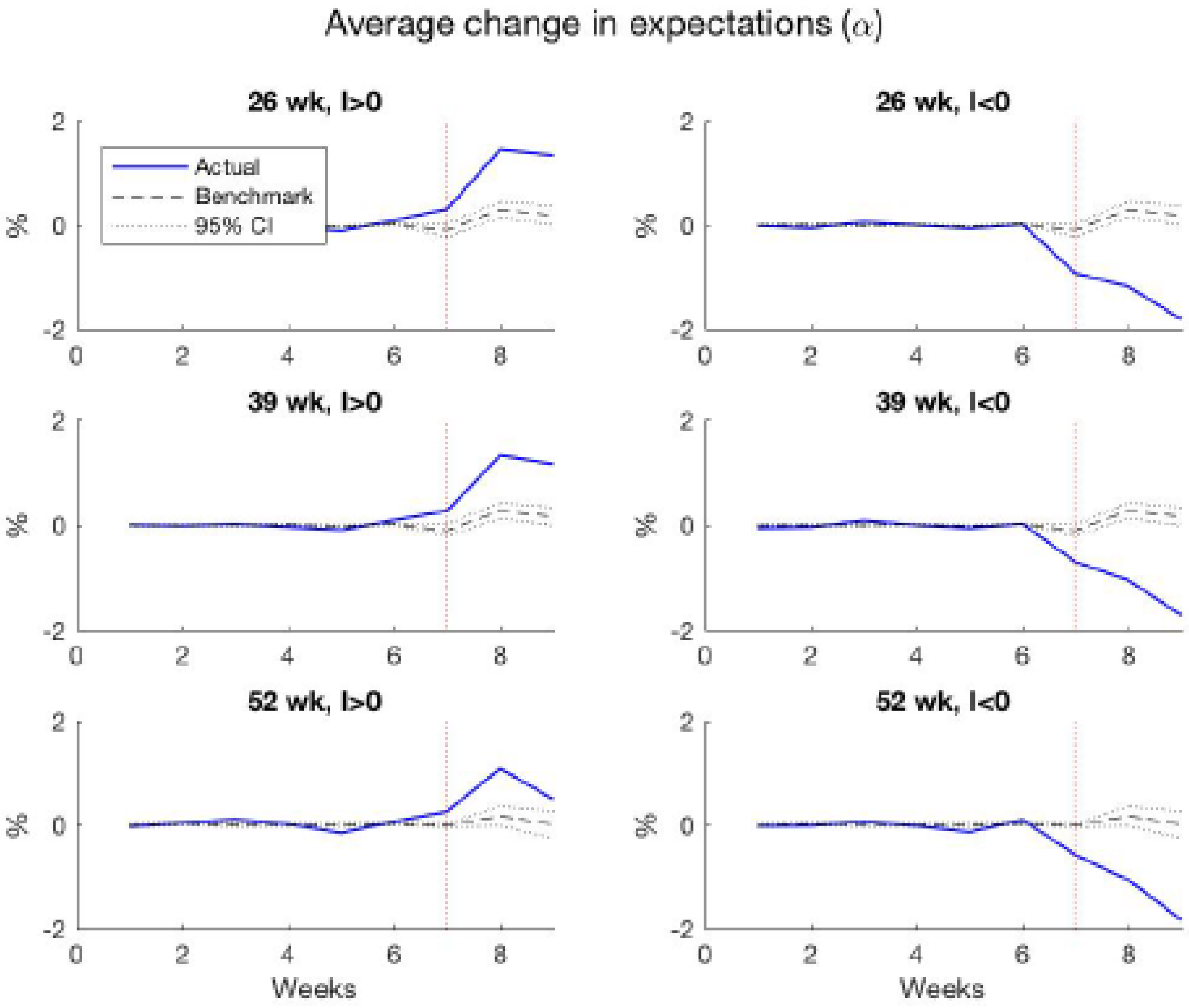
What the paper does:

- Are futures better than RW in predicting FX changes at 26W, 52W horizon – yes, 92% …
- Do futures and risk premia move in response to FX interventions – yes, large impact
- Interpretation as presence of signaling channel of monetary policy
- Good paper with novel approach focusing on FX expectations

Comment 1: Plausibility of findings

- Effects of 180 bp seem small, yet highly significant
- 52 weeks seems long - how plausible?
- 80% success rate AT ONE-YEAR HORIZON is almost too good to be true !
- Q: are these effects on futures still there e.g. one week or one month after FX interventions?
- Please test model against realized FX at time t+x, is it just risk-adjusted futures? Is it consistent? How about FX surveys?

Large impact of FX interventions on expectations



Big & “long-term”/1-year impact

Table 2: Average Change in $E_t s_{t+h}$

	Change in Expected Spot (in b.p.)			
Horizon	$I > 0$	$I < 0$	Baseline 95% CI	
26 wk	1.35	-1.80	0.02	0.35
39 wk	1.16	-1.72	0.00	0.32
52 wk	0.48	-1.82	-0.23	0.22

Remarkably high success rates of interventions

Table 3: Success rates for influencing expectations

Intervention Success Rates			
Contract	T1	T2	T3
26 wk	0.83	0.72	0.85
39 wk	0.81	0.61	0.74
52 wk	0.76	0.44	0.56

(T1): $E_t s_{t+h}$ increases (decreases) when $I > 0$ ($I < 0$). (T2): $E_t s_{t+h}$ increases (decreases) when $I > 0$ ($I < 0$) and change is statistically significant. (T3): Change in $E_t s_{t+h}$ is statistically significant

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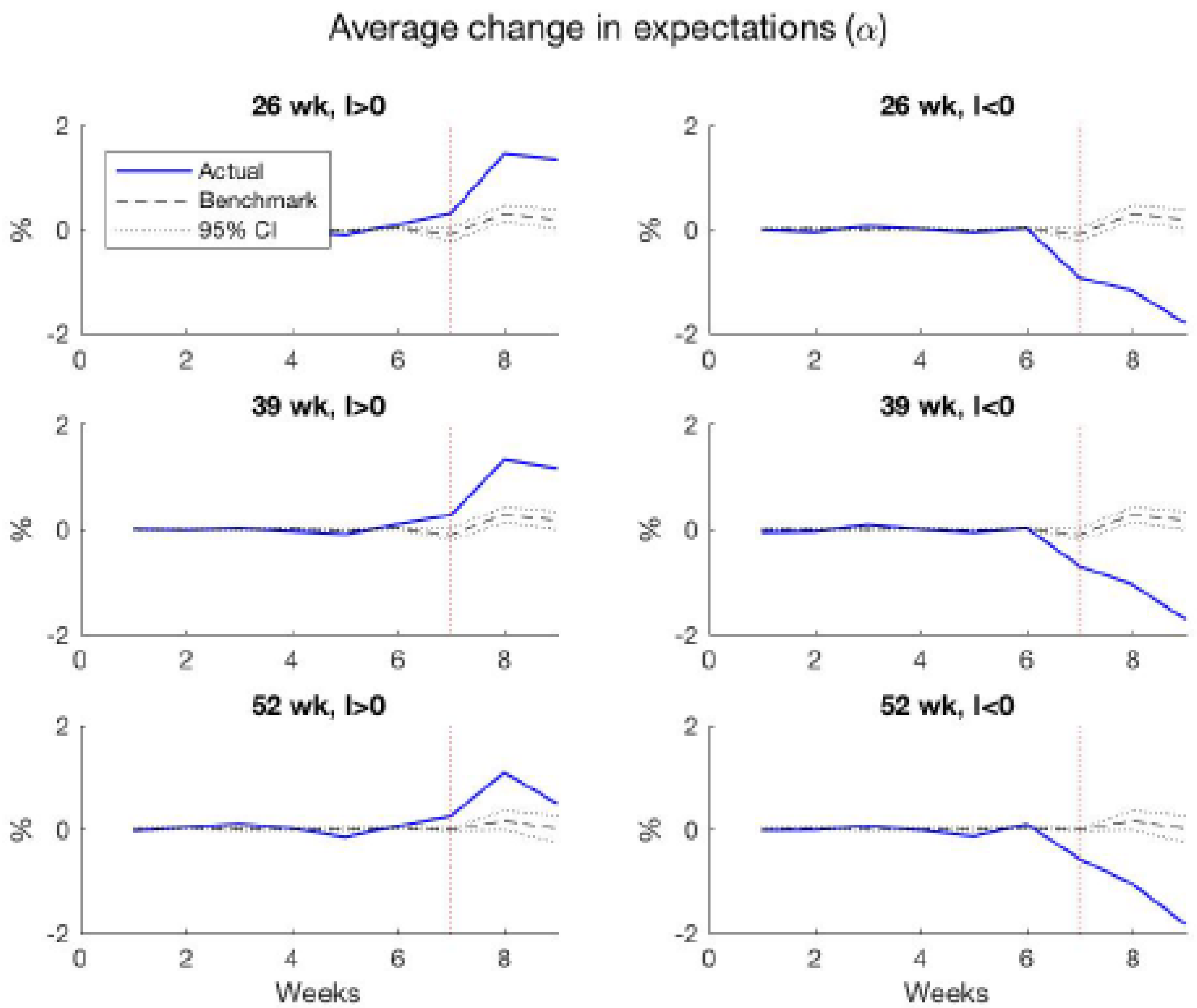
Comment 2: Contradiction to common sense/usual central bank behavior

- Fig. 1 indicates VERY strong leaning-WITH-wind behavior (LWW)
- Why would a central bank do that?
- Why inconsistent with leaning-against-wind behavior (LAW)?

Large impact of FX interventions on expectations



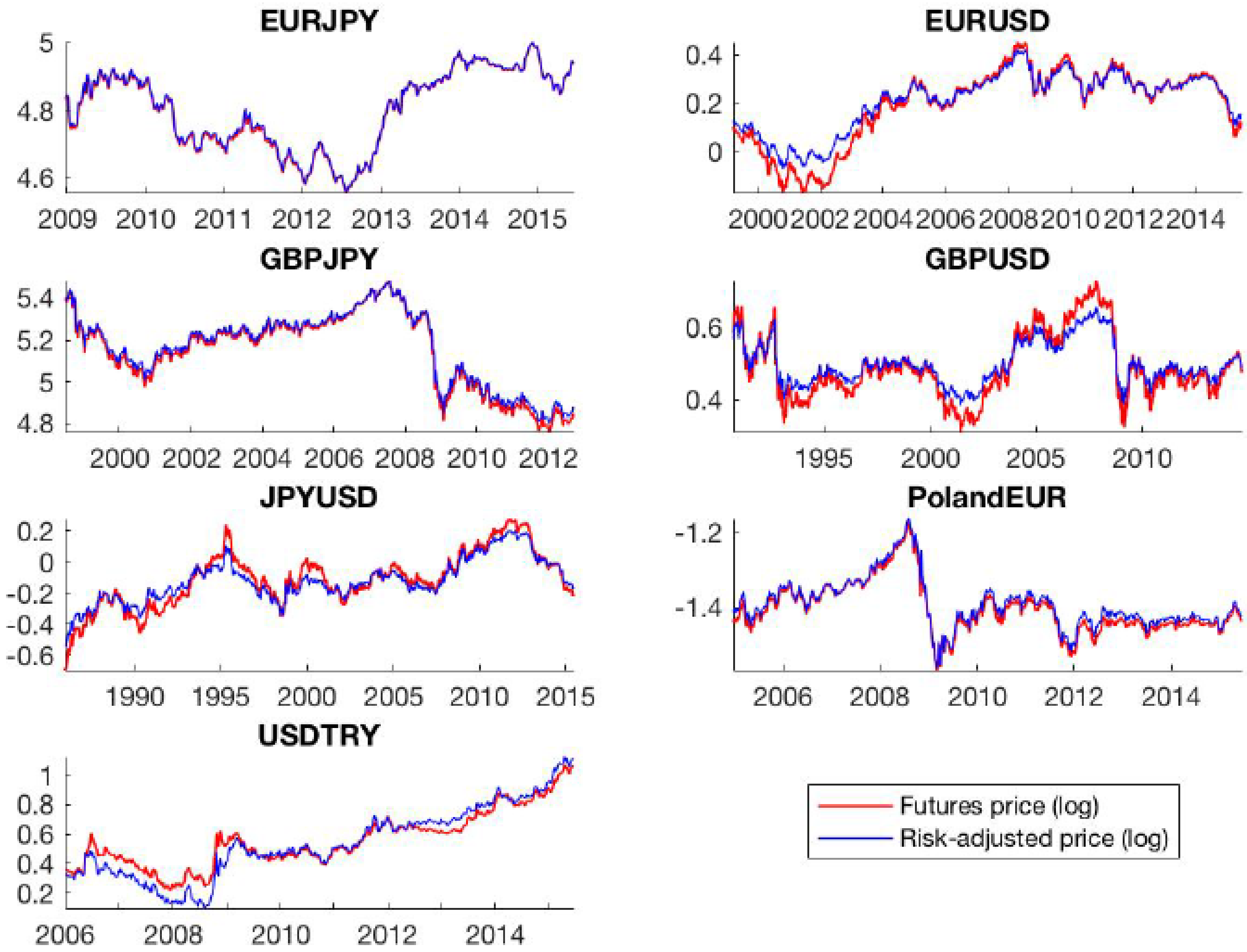
Comment 3: The channels of transmission

- Is it via monetary policy, i.e. signaling channel, vs (expected) portfolio rebalancing or coordination channel or signaling about fundamentals? (Sarno and Taylor 2001)
- Monetary policy often not consistent with desired FX -- (Mussa 1981) on signaling of monetary policy for G30, closed economies (!)
- no proof for signaling
- Would need to look at (expectations of) interest rates

Comment 4: Methodology and data

- Are futures good proxies for expectations?
- Table 1: risk-adjusted future contracts beat random walk in 92% of cases! Meese and Rogoff...?
- How good is control for endogeneity synthetic control method? Very smooth "prediction"
- Methodology: event-study methodology - success vs. direction vs. reversal criteria
- Announced versus non-announced interventions. Relationship to communication matters a lot!
- Data for AEs is old. 71 obs is small. Robustness, esp. for individual countries?

Movement of future prices



Comment 5: What do we learn for policy?

- Why did many advanced economy central banks stop intervening if these are so successful?
- Do central banks really signal future monetary policy through FX interventions ?
- Under what conditions can interventions work?
- Nice paper! Good food for thought.