Available online at www.sciencedirect.com
ScienceDirect
Journal of Comparative Economics 35 (2007) 387–413
Journal of COMPARATIVE ECONOMICS
www.elsevier.com/locate/jce

Central bank interventions, communication and interest rate policy in emerging European economies

Balázs Égert *

Oesterreichische Nationalbank, Vienna, Austria
EconomiX at the University of Paris X, Nanterre, Paris, France
William Davidson Institute, Michigan, USA

Received 21 January 2007

Available online 23 April 2007

Égert, Balázs—Central bank interventions, communication and interest rate policy in emerging European economies

This paper analyses the effectiveness of foreign exchange interventions in Croatia, the Czech Republic, Hungary, Romania, Slovakia and Turkey using the event study approach. Interventions are found to be effective only in the short run when they ease appreciation pressures. Central bank communication and interest rate steps considerably enhance their effectiveness. The observed effect of interventions on the exchange rate corresponds to the declared objectives of the central banks of Croatia, the Czech Republic, Hungary and perhaps also Romania, whereas this is only partially true for Slovakia and Turkey. Finally, interventions are mostly sterilized in all countries except Croatia. Interventions are not much more effective in Croatia than in the other countries studied. This suggests that unsterilized interventions do not automatically influence the exchange rate. *Journal of Comparative Economics* **35** (2) (2007) 387–413. Oesterreichische Nationalbank, Vienna, Austria EconomiX at the University of Paris X, Nanterre, Paris, France William Davidson Institute, Michigan, USA.

JEL classification: F31

* Mailing address: Oesterreichische Nationalbank, Foreign Research Division, Otto-Wagner-Platz 3, 1090 Vienna, Austria. Fax: +43 1 40 420 52 99.

E-mail addresses: balazs.egert@oenb.at, begert@u-paris10.fr.

0147-5967/$ – see front matter
doi:10.1016/j.jce.2007.02.004

Keywords: FX intervention; Central bank intervention; Communication; Verbal intervention; Interest rate moves; Event study; Central and Eastern Europe; Turkey

1. Introduction

The empirical literature on the effectiveness of—mostly sterilized—foreign exchange (FX) interventions in developed market economies remains fairly mixed despite the recent emergence of some more supportive evidence.[1] In this context, Canales-Kriljenko (2003) argues that foreign exchange interventions may be more effective in emerging market economies than in well-established industrialized countries, because

(1) central bank interventions are not always fully sterilized,
(2) the size of interventions is large relative to market turnover in narrow foreign exchange markets,
(3) the market organization and the regulatory framework may be more conducive to interventions, or
(4) moral suasion may play a bigger role.

Nonetheless, there is little empirical evidence with regard to the proposition that central bank interventions might be more effective in emerging market economies. This is also true for emerging European market economies, even though the number of country-specific studies has been on the rise recently.[2] Against this backdrop, we add to the literature by scrutinizing the impact of daily FX interventions on the exchange rate in a large number of emerging European countries—Croatia, the Czech Republic, Hungary, Romania, Slovakia and Turkey—for episodes of flexible exchange rate policies. In this endeavor, we have recourse to the event study approach, which is claimed to be superior to econometric analysis if interventions take place only sporadically (Fatum, 2002; Fatum and Hutchison, 2003).

In addition to the broad country coverage, our contribution to the literature is threefold. First, we scrutinize the role of central bank communication and interest rate news and study how they can reinforce the effect of actual interventions. Second, we do not only analyze the effectiveness of FX interventions, but also attempt to clarify whether actual interventions are fully, partially or not at all sterilized. This is crucial, given that unsterilized interventions are thought to be more effective than sterilized interventions. We also discuss under what conditions unsterilized interventions are more effective than sterilized ones. Finally, the success of central bank interventions is interpreted not only in terms of the statistical success criteria but also in the light of the officially stated objectives of FX interventions.

[1] For a survey, see e.g. Sarno and Taylor (2001).

[2] Turkey and the Czech Republic are the two countries for which daily FX interventions are analyzed most extensively. For Turkey, see Domaç and Mendoza (2004), Guimarães and Karacadag (2004) and Akinci et al. (2005a, 2005b). For the Czech Republic, examples are Disyatat and Galati (2005), Égert and Komárek (2006) for daily data and Geršl and Holub (2006) for monthly and daily data. Scalia (2006) matches daily intervention data with intraday koruna/euro data. Gereben et al. (2006) study FX interventions in a FX microstructure (order flow) setup for Hungary. While not directly linked to the issue of the effectiveness of FX interventions, it is worth noting that Radulescu (2004) and Chmelarova and Schnabl (2006) estimate reaction functions of central bank interventions for Romania and Croatia, respectively.