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Effective Sterilized Foreign Exchange Intervention? Evidence from a Rule-Based Policy*

Guido M. Kuersteiner† David C. Phillips‡ Mauricio Villamizar-Villegas§

Abstract

This paper investigates the effectiveness of sterilized foreign exchange interventions by exploiting a discontinuous policy rule used by the Central Bank of Colombia. We use a unique data set comprised of tick by tick intervention and order book data, daily capital in- and outflows, and balance sheet information of financial institutions. We apply regression discontinuity methods to identify the surprise component of rule-based interventions and use this variation to measure how they affect exchange rates and capital flows. Our findings indicate that interventions had significant effects on the exchange rate, albeit short-lived (2-3 weeks). Moreover, capital controls amplify the effect of intervention, though some effect remains even in the presence of free capital flows. A methodological contribution of the paper is to extend regression discontinuity designs to a time-series environment and to show how these techniques can be used to identify and estimate local non-linear impulse response functions. A clearly defined policy rule and high frequency data are crucial in exploiting local variation around the policy cutoff.

Key Words: Rule-Based Intervention, Portfolio Balance, Foreign Exchange Policy, Regression Discontinuity, Non-linear Impulse Response.

JEL Codes: E58, F31, C22

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