

Central bank intervention and exchange rate expectations – Evidence from the daily DM/US dollar exchange rate

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In this paper we propose a generalisation of the noise trader transmission mechanism to examine the impact of central bank intervention on exchange rates. Within a heterogeneous expectations exchange rate model intervention operations are supposed to provide support to either chartist or fundamentalist forecasts, which forces portfolio managers to adjust their foreign currency positions. The empirical examination of the hypothesis is done by applying a markov regime-switching approach to daily USdollar/DEM forward rates and intervention data of the Deutsche Bundesbank and the Federal Reserve from 1979 to 1992. It is shown that the performance of simple chartist trading rules was strong whenever these central banks intervened on the foreign exchange market. A similar coincidence cannot be found within the more sophisticated fundamentalist approach.
