Does Intervention Alter Private Behavior?

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Abstract

A new line of theory posits that intervention in currency markets works indirectly, either by (1) coordinating private trades in the same direction or (2) damping the price impact of private trades. Using daily data on trades from three institution types—hedge funds, mutual funds, and non-financial corporations—we find strong evidence for the coordination channel. Over the period of aggressive Japanese intervention in 2003-04, the trades of corporates and hedge funds shifted significantly in the intervention direction. Evidence for the second, the damping channel, is present in periods when exchange rate stabilization was successful.

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