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Research Seminars in Macroeconomic and Structural Issues

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JVI Residence, Schmalzhofgasse 12

12:30 p.m.

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Foreign Exchange Interventions at Zero Interest Rates

(with Shu Wu)

Abstract

This paper uses a nonlinear structural vector autoregressive model to investigate empirically the effectiveness of official foreign exchange (FX) interventions in an economy when interest rates are constrained at the zero level based on Japanese data from the 1990s. The model allows us to estimate the effects of FX interventions operating through different channels. We find that FX interventions are still capable of influencing the foreign exchange rate in a zero interest-rate environment, even though their effects are greatly reduced by the zero lower bound on interest rates. Our results suggest that while it might be feasible to use the exchange rate as an alternative monetary policy instrument at zero interest rates as proposed by McCallum (2000), the exchange rate-based Taylor rule may not be very effective in achieving the ultimate policy goals.

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