



Announcements are not Enough: Foreign Exchange Intervention under Imperfect Credibility

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Central banks in emerging countries frequently build-up (diminish) reserves while attempting to depreciate (appreciate) their domestic currencies. Even if these interventions are effective, they often entail various costs. Basu (2012), nonetheless, proposes a model in which the sole announcement of an intervention schedule leads to a desired exchange rate without actually buying or selling foreign currency. In this paper we present a generalization that allows for imperfect credibility of foreign exchange intervention. Namely, market dealers know that the central bank carries strategic incentives when announcing its schedule and may not perfectly believe it. We show that, under this setup, it may be impossible for central banks to achieve the desired exchange rate level without changing their position of international reserves.