# Expectation Heterogeneity and Signaling Effects of Foreign Exchange Interventions

Kentaro Iwatsubo,[a,*] Satoshi Kawanishi[b] and Junko Shimizu[c]

[a] *Graduate School of Economics, Kobe University, Hyogo, Japan*

[b] *Department of Economics, Sophia University, Tokyo, Japan*

[c] *Department of Economics, MeikaiUniversity, Chiba, Japan*

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This paper explores whether the efficacy of foreign exchange interventions hinges not only on the firmness of signals but also on market conditions. We empirically show that announced interventions significantly affect the level and reduce the volatility of the yen/dollar rate when traders' expectations of future exchange rate are relatively heterogeneous. We then explain the evidence by demonstrating a market microstructure model in which asymmetric information across agents produces a deviation of exchange rate from the fundamental value and, even though the monetary authority has no more accurate information than investors, intervention signals help to wipe out the "bubble" by enhancing the accuracy of rational speculators' information on the future exchange rate. This model is also consistent with our finding that interventions in high implied volatility period become infrequent, but are the most successful once they take place.

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[*] Corresponding author. *tel.*: +81-78-803-6875; *fax*: +81-78-803-6875.
*e-mail address*: iwatsubo@econ.kobe-u.ac.jp (K. Iwatsubo).