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The Great Foreign Exchange Intervention of 2011

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A 9.0-magnitude earthquake rocked Japan on March 11, 2011, and caused a tsunami that killed more than 15,000 people. The property damage totaled hundreds of billions of dollars.¹ The Japanese yen (JPY) appreciated rapidly in the days following the earthquake: From March 10 to March 17 the value of the yen rose by about 5 percent against the U.S. dollar (USD). In addition, foreign currency markets became extremely volatile. The financial press cited expectations that Japanese investors, including insurance companies, would need to repatriate assets—for example, stocks and bonds—held abroad to pay for earthquake damages as the reason for the yen's increased value.

In response to these volatile market conditions, the G-7 financial authorities—the finance ministers of Japan, Canada, the United States, the United Kingdom, and the president of the European Central Bank—announced late on Thursday, March 17, that they would jointly intervene the next day to reduce the value of the yen. The G-7 authorities cited concerns about “excess volatility and disorderly movements” in their press release. As the chart shows, the yen immediately depreciated by about 3 percent and was much less volatile in the subsequent week.

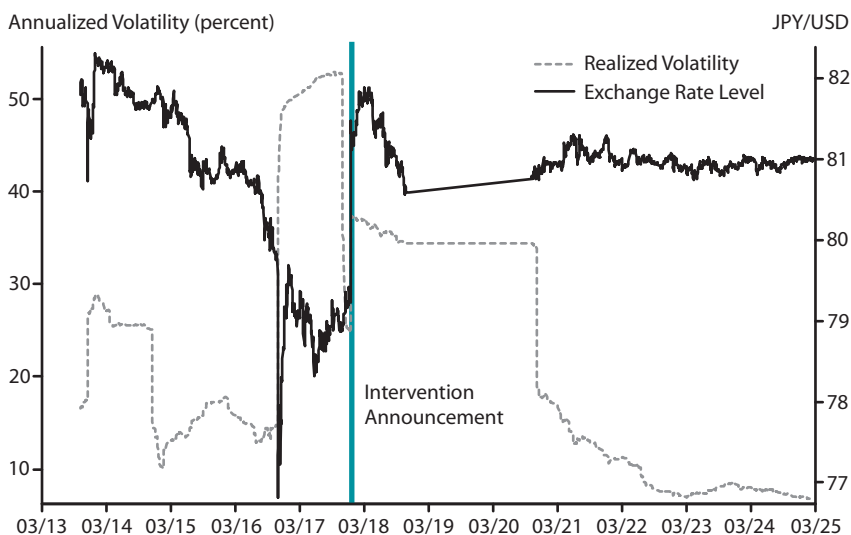
This foreign exchange intervention was very unusual. Since 1995, most governments and central banks of economically advanced countries have avoided using intervention as a policy tool. Still, they retain it in their toolkits and have employed it successfully to move the exchange rate in the desired direction and relieve markets on several unusual occasions.

Why is exchange rate policy, including intervention, important? Foreign exchange markets are large and interconnected with stock and bond markets. Disorder, or lack of both buyers and sellers in foreign

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exchange markets, can affect other asset markets, and large swings in exchange rates can affect the balance sheets of banks and other financial firms. Further, exchange rates are important prices for international trade in goods and services. For example, a rise in the value of the yen could

JPY/USD Market Behavior Near the March 17, 2011, G-7 Intervention Announcement



NOTE: The chart shows daily annualized realized volatility (the square root of a backward-looking 24-hour average of 5-minute squared returns) and the exchange rate for the JPY/USD market from March 13, 2011, to March 25, 2011.

harm Japanese tradable goods industries, and excessive volatility could discourage international trade. Exchange rates can even affect inflation by passing through to the prices of imported goods.

The circumstances leading up to the March 18 G-7 intervention and its immediate results were similar to those of coordinated interventions in June 1998 to support the yen and in September 2000 to support the euro. In each case, special circumstances—an earthquake, a recent financial crisis, or a new central bank and incipient recession—made exchange rate misalignments more costly than usual, and excessive volatility made financial markets disorderly. Press reports of intervention discussions might have produced modest exchange rate movements prior to the actual intervention (or announcement). Nevertheless, exchange rates reacted strongly and quickly to each intervention (or its announcement), moving about 4 percent in the desired direction and volatility declined substantially. ■

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National Police Agency of Japan. “Damage Situation and Police Countermeasures Associated with the 2011 Tohoku District.” May 2011;
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¹ See Hosaka (2011) and National Police Agency of Japan (2011).