

Forward Discount Puzzle and Official Interventions: Evidence from Yen/US Dollar Exchange Rates

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ABSTRACT. Can the consideration of the official intervention in foreign exchange markets help to resolve the forward discount puzzle? This paper presents a qualified yes to this question by examining empirically the time-series of yen/US dollar exchange rates between 1991 and 2004. The intensive and frequent yen-selling (purchasing) intervention by the Japanese government, in particular its unpredictable component, tended to generate a yen appreciation (depreciation) subsequently possibly because such large scale interventions might have invited opposite transactions from speculators. When Japanese (US) interest rates increase (decrease), the Japanese government may intervene in foreign exchange markets by selling yen in order to ease appreciation pressures on yen. Consequently, when yen forward rates are depreciated currently by covered interest parity, yen spot rates are appreciated subsequently. This paper points out that such intervention-induced opposite movement between forward and subsequent spot rates is partially responsible for the forward discount puzzle.

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