# Types of Intervention by Central Banks in Forex Markets

## When Do Central Banks Intervene in the Forex Market?

Central Banks do not intervene often in the Forex market. In fact, the intervention by Central Banks can be considered to be a sign of significant economic weakness in a currency. As a result, **Central Bank intervention usually only happens when the currency is under some sort of crisis**. This could be a genuine economic crisis like the 2008 crisis or the Euro crisis. Alternatively, it could also be a speculative attack that a country is facing.

There are multiple ways in which Central Banks can intervene in the markets. Some of these ways require more commitment than the others and are also more effective than the others. **In this article, we have listed down the 4 prominent types of Central Bank interventions**.

## The Four Techniques

1. **Jawboning:** Jawboning is one of the basic techniques used by Central Banks to manage their Forex reserves. As the name suggests, the technique of Jawboning is more about talking than about actually conducting action. While using this technique, Central Banks start actively talking about their target currency levels and tell the media that an intervention is possible from their end if the currency goes beyond a certain point.

   The traders and other participants in the market are aware of the monetary might of the Central Banks and therefore more often than not, the currency range declared by the Central Bank becomes the range in which the currency automatically starts trading without any Central Bank intervention.

   Jawboning is essentially a technique where the threat of a Central Bank intervention to reset the rates is used to reset the rates without the intervention ever taking place! Jawboning is particularly effective when Central Banks have the reputation for periodic intervention into the open markets.

2. **Operational Intervention:** Another technique that is used by Central Banks to control their currency's exchange rates is called operational intervention. This is what we usually understand when we use the term Central Bank intervention. Here, the Central Bank actually steps into the market and starts buying and selling currency as per its objective to drive the exchange rate to a particular point. Traders are concerned about Central Bank intervention because the objective of a Central Bank is not to make money trading. They are perfectly content with losing money as long as they can meet their objective! Therefore, an operational intervention can also cause a significant dent in the Forex reserves of the Central Banks. This is the reason, why it is recommended that this policy be sparingly used.

3. **Concerted Intervention:** A concerted intervention is like a hybrid between jawboning and operational intervention. Firstly, as the name suggests, concerted intervention requires the concerted action of multiple central banks. Therefore, multiple Central Banks might start jawboning particular currency rates in the market. Then, as a part of concerted action, one of these Central Banks may actually start operational intervention to correct the currency rates whereas the other banks may increase their jawboning activity. Thus, the market participants are under threat of action from several Central Banks at one go. If multiple Central Banks were to actually simultaneously intervene, they could drastically alter the exchange rates in the markets within a matter of minutes.

   Concerted intervention only takes place when many Central Banks share the same objective i.e. they want to control a particular exchange rate. Usually jawboning from all Central Banks gets the desired results. One or two Central Banks may actually have to intervene. However, only in the rarest of the rare cases do multiple Central Banks have to conduct operational interventions to correct a currency rate.

4. **Sterilized Intervention:** A sterilized intervention is another form of operational intervention by the Central Banks. The term “sterilization” is taken from medical sciences. In this context, it means that a Central Bank conducts operations which affect the currency rates in the Forex market. However, at the same time it takes measures to ensure that none of its activities in the market have any effect on trade and commerce within its home country. Thus, it effectively sterilizes the intervention as far as the home country is concerned.

   Let’s understand this with the help of an example. Let’s say that the Fed is concerned about the dollar depreciation against the Indian rupee and wants to take action to change this. In this case, the Fed will sell Indian rupee in the market and buy dollars from it. This will lead to two effects. Firstly, it will increase the supply of the rupee and secondly it will decrease the supply of the dollars. The objective of the Fed in the Forex market will be fulfilled.

   However, there is also a side effect to this policy. The number of dollars in the United States economy would suddenly increase as a result of this transaction. This could cause inflation and other economic issues as well. Therefore, to counter the situation, the Fed would sell United States denominated bonds in the market. As a result, it will remove dollars from the domestic market (sterilizing the effect). The dollars will now be replaced with the government obligation and therefore the inflation and other effects will be controlled.