The Effects of Conventional and Unconventional Monetary Policy

on Exchange Rate Volatility

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Abstract

In response to the 2007 financial crisis and recession, the Fed lowered the Federal funds rate in order to stimulate the economy, employing conventional monetary policy. However, the Federal funds rate reached its zero-lower bound in October 2008, as a result, the Fed began to implement unconventional monetary policy, by making large-scale asset purchases.

This paper examines the impacts of U.S. conventional and unconventional monetary policy announcements on the volatility of six exchange rates, namely Australian dollar, British pound, Canadian dollar, Euro, Japanese yen, and Swiss franc against the U.S. dollar. Narrow windows around policy announcements and high frequency second-by-second intraday data are used in the analysis. To examine the impact of announcements on the volatility, I divide the announcement period into pre-announcement period (five minutes before the announcements), contemporaneous period (five minutes after the announcement), and post-announcement period (fifteen minutes after the “contemporaneous period.”) Results show that monetary policy announcements significantly impact the exchange rate volatility, while these impacts are different under different monetary policy regime and across exchange rates.

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