Intervention To Punish Speculators Can Make Profits Instead

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NEW YORK (AP-DJ)--With the dollar falling to new lows on a daily basis of late, market critics are finding themselves increasingly caught up in whether or not the U.S. monetary authorities ought to intervene in the "disorderly" foreign exchange markets to restore the value of the dollar. Typically, such arguments lead some to excoriate speculators and hold up market intervention as a necessity to "punish" their greed and hubris. Those of that opinion, however, should pause to consider a recent study that presents statistically significant evidence that the interventions they condone actually lead to abnormal profits for technical traders - making intervention a long-run incentive for speculators to operate in those markets. **William L. Silber**, Professor of Economics and Finance at New York University, wrote in last year's Journal Of Derivatives published by Institutional Investor Inc. that "occasional massive expenditures by central banks...might introduce sluggish price adjustments that could be exploited by traders. In a sense, the price-smoothing behavior of central banks subsidizes private participants in the foreign exchange market." Performing exhaustive simulation studies using moving-average trading rules, Silber demonstrates that non-profit-maximizing participants allow technical trading practices to generate "abnormal" returns for foreign currencies and some short-term interest rates. In his simulation, such returns were absent in futures markets for gold, silver and the S&P 500 - markets which lack central bank manipulation. Silber's conclusion: "The existence of central bank price-smoothing behavior in markets for foreign currencies and short-term interest rates suggests that abnormal profits from following (technical trading practices) need not disappear over time." The results should lead critics and policymakers alike to pause and consider. For example, one Asian-based foreign exchange trader asks "When is the Fed going to raise rates to defend the dollar?" While admitting that relative interest rates have little to do wth spot dollar/yen rates at the moment and seven rate hikes to date haven't helped, he goes on to add that central bank intervention alone does nothing to convince his side of the world that the U.S. is serious about the plunging dollar. "Until this is thought of as a crisis" in the U.S., markets will continue to push the dollar lower, he says.

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