Referee Report

on

"Did the exchange rate interventions enhance inflation in Switzerland?"

The present paper studies the exchange rate policy in Switzerland. Motivated by the Swiss National Bank's (SNB) recent shift from a one-sided target for the CHF to a policy of occasional interventions, the paper uses a VAR model to study the response of various measures of inflation to a change in the exchange rate.

I like the question addressed in this paper, but have several concerns as regards the way the research question is pursued:

1. I think the title and the motivation of the paper are misleading. The paper does not study "exchange rate interventions" or the floor on the CHF, but simply the response of prices to a reduced-form shock to the exchange rate. This exchange rate change could be the result of policy interventions, but could also result from several other factors. The discussion of the floor of CHF 1.20 per euro is misleading because a serious analysis would require a model that is able to handle the nonlinearity of the exchange rate introduced by the SNB's commitment to the floor. Instead, the authors simply use a standard VAR model which, by construction, assumes linear relationships among the endogenous variables.

2. The discussion of the literature presented in this paper stops in the late 2000s. There is only pre-crisis literature covered. In particular, there is not a single paper on the SNB's exchange rate floor cited in the paper. The SNB alone produced several papers on that. The literature section urgently needs an update.

3. The VAR model estimated in this paper is supposed to consist of "six endogenous and one exogenous variable". However, the paper is silent about what the exogenous variable is. It cannot be the oil price as it is included in the vector of endogenous variables. I think it would be appropriate to use euro area GDP as an exogenous variables in a VAR model for Switzerland.

4. The "exchange rate shock" is identified recursively based on the ordering of the endogenous variables. I think a consensus ordering in the literature is to order output and inflation before the policy variable followed by asset prices. This is not what the authors do in this paper. Here, the policy instrument responds contemporaneously to output but not to inflation. This should be discussed as Switzerland follows an inflation-targeting framework that would justify using the consensus ordering of the variables.

5. Since the paper is supposed to be about exchange rate policy, I wonder whether the 3M Libor as the SNB's policy instrument really captures all policy decisions.

When the 3M Libor reached the zero lower bound, the SNB adopted unconventional measures not reflected in this model. In addition, the paper wants to analyze exchange rate interventions. These could also be included in the VAR model.

6. The results are difficult to interpret as there are no confidence bands shown.