

## **ABSTRACT**

In this study, we use Grangers' Causality test and GARCH (Generalized Autoregressive Conditional Heteroskedasticity) model to analysis the effectiveness of SBP's daily foreign exchange intervention on exchange rate levels and volatility from July 3, 2000 to December 31, 2004 (1292 trading day observations). The result of the Granger Causality test indicates that there is uni-directional causality from SBP's intervention to exchange rate volatility, i.e., SBP's intervention does cause exchange rate volatility. The results of GARCH model show that SBP's intervention operation is very effective, in the sense, it not only affects the exchange rate levels but it also reduces the exchange rate intervention. These results are consistent with most of the developing countries experiences. In addition, monetary policy and the foreign exchange reserves also affect the exchange rate level and its volatility. Higher interest rate (MONR) and higher foreign exchange reserves (FOREXCOV) are associated with appreciation of exchange rate levels and vice versa. Similarly, the rise in interest rate and higher foreign exchange reserves also reduce the exchange rate volatility. In sharp contrast to the no days-of-the week effects on exchange rate level, the result show that there is some evidence of significant days-of-the-week effects of intervention on exchange rate volatility.