Czech vs. Swiss Exchange Rate ”Floor“

CZECH NATIONAL BANK

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The exchange rate as a monetary policy instrument

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Outline

1. Swiss vs. Czech case

2. A closer look at the Czech case

3. Conclusions

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Swiss vs. Czech case

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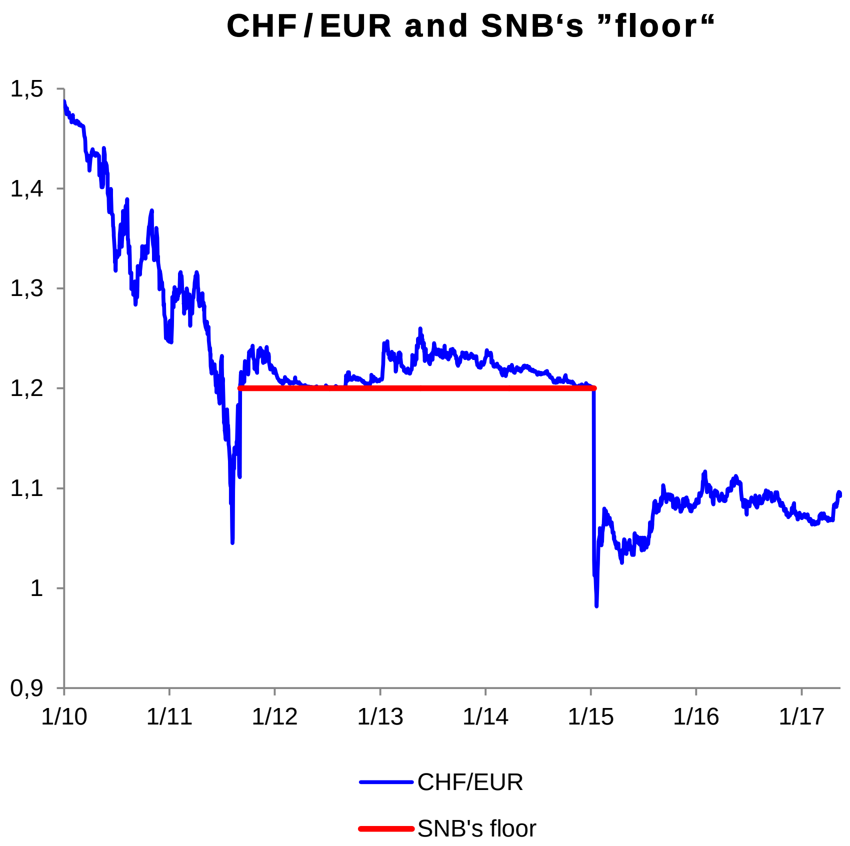
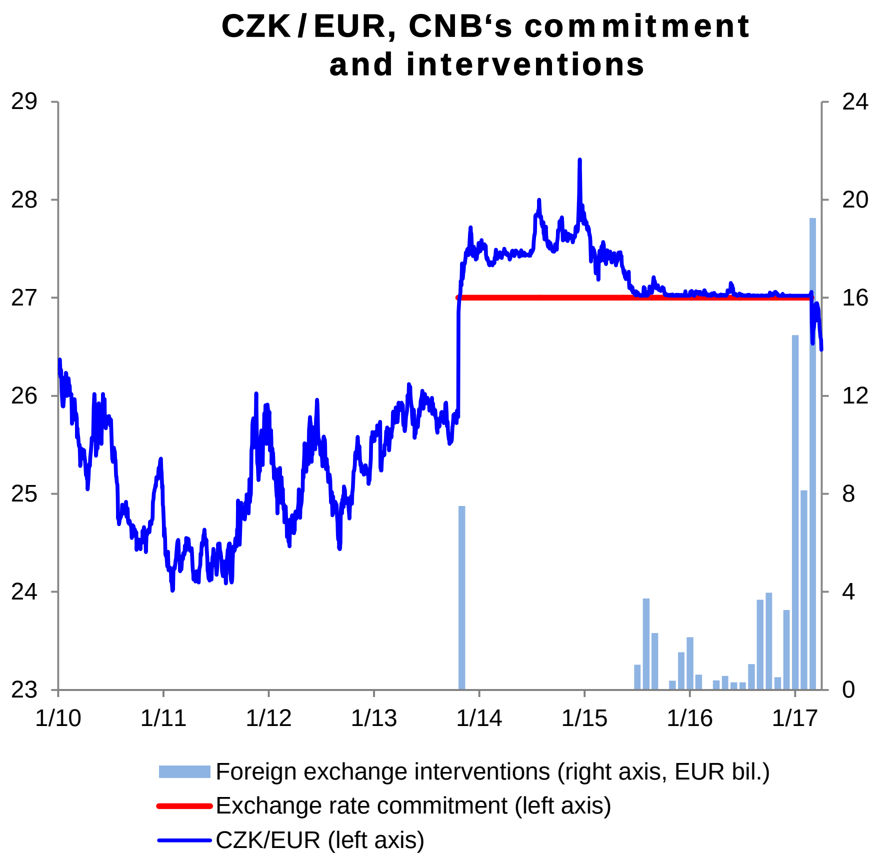
	Swiss	Czech
MP regime	officially not inflation targeting free float	inflation targeting officially managed float
Reason for entry	sharp appreciation export competitiveness	deflation risk, undershooting of inflation target
Design of the "floor"	publicly announced unlimited interventions	publicly announced unlimited interventions
Duration of the "floor"	1227 days	1246 days
Safe haven	yes, on global scale	no
Balance sheet constraints	quite important	none
Communication of exit	none	from the very beginning
Characteristics of the exit	discretionary, surprising	rule-based, telegraphed
Exchange rate after exit	jump appreciation	mild appreciation (so far)
Inflation after exit	deflation	return to target from above
Economy after exit	temporary slowdown, small unemployment increase	likely some acceleration and small unemployment decline
Interest rates after exit	cut further below zero	scope for normalization

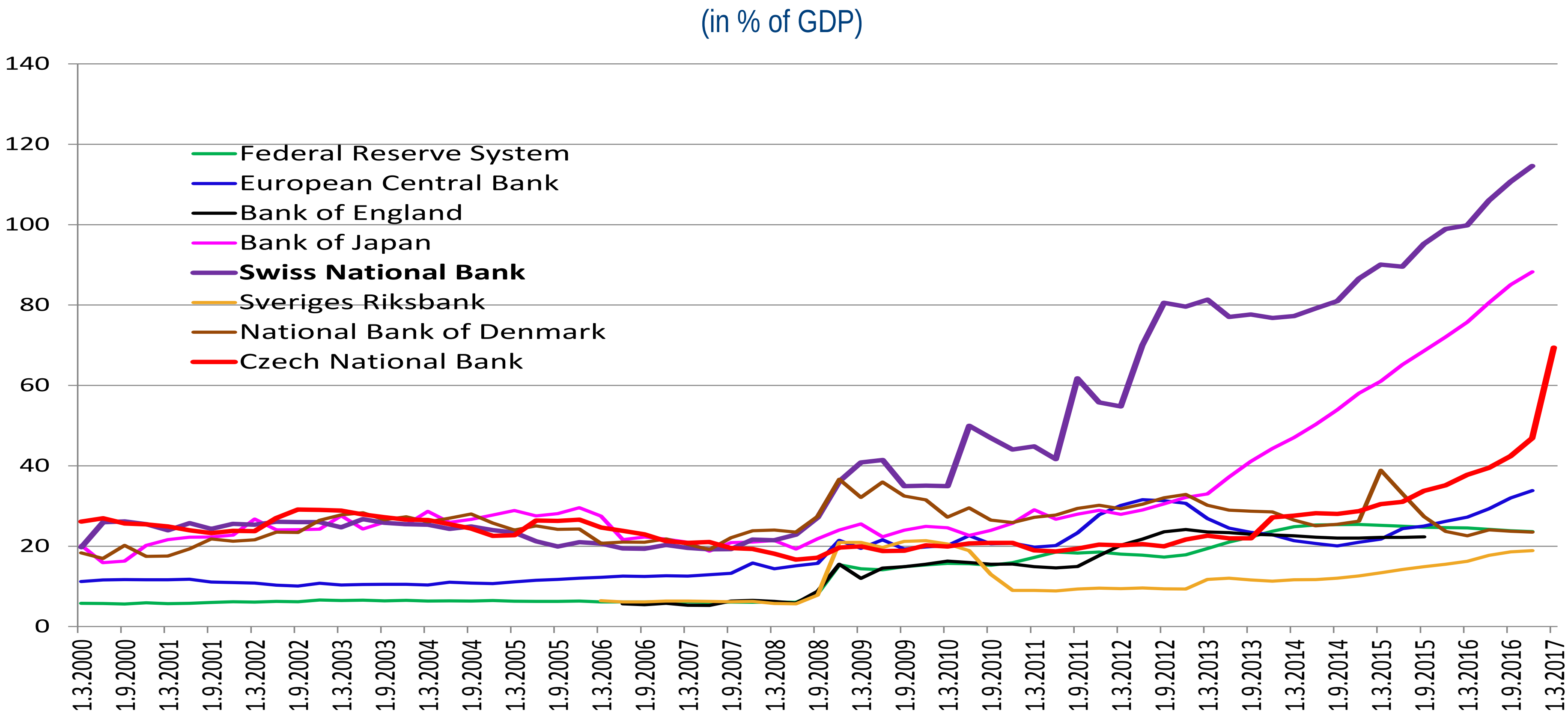
CHF/EUR vs. CZK/EUR





- Both cases show that the entry can be technically very successful.
- In both cases, the credibility of the policy was allowing for periods of exchange rate above the floor with no interventions.
- SNB was facing pressures on interventions related to external factors. In CNB's case, they were associated with the upcoming (telegraphed) exit.

Balance sheet expansion



- The Swiss exit is hard to discern from the SNB‘s balance sheet size. Apparently, FX interventions have continued even after the exit.
- In the Czech case, there was an exponential increase in the run up to the exit, but that is hopefully the end.

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Ex post outcomes

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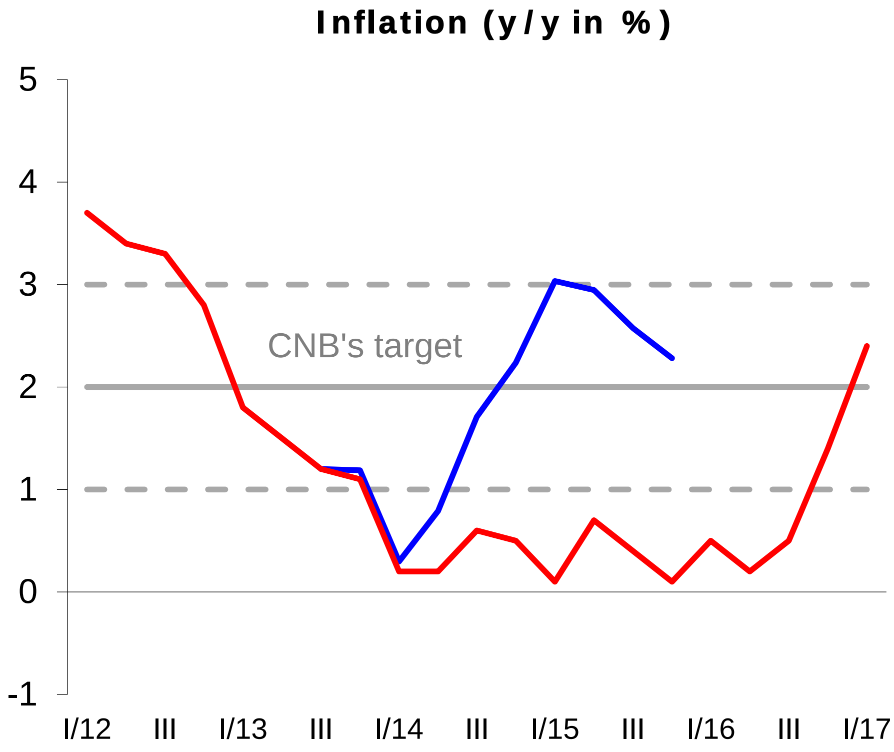
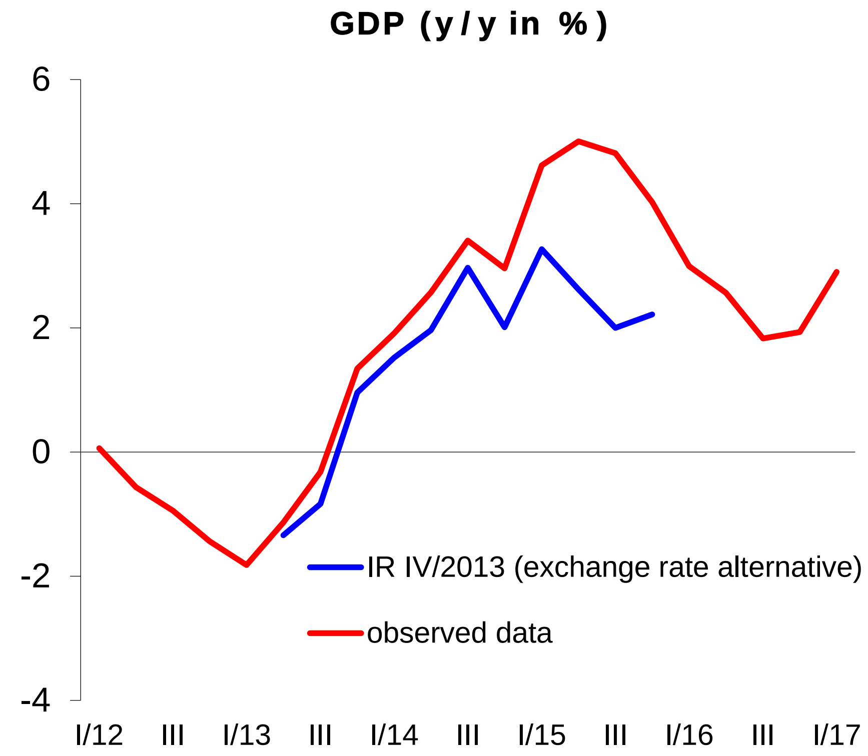
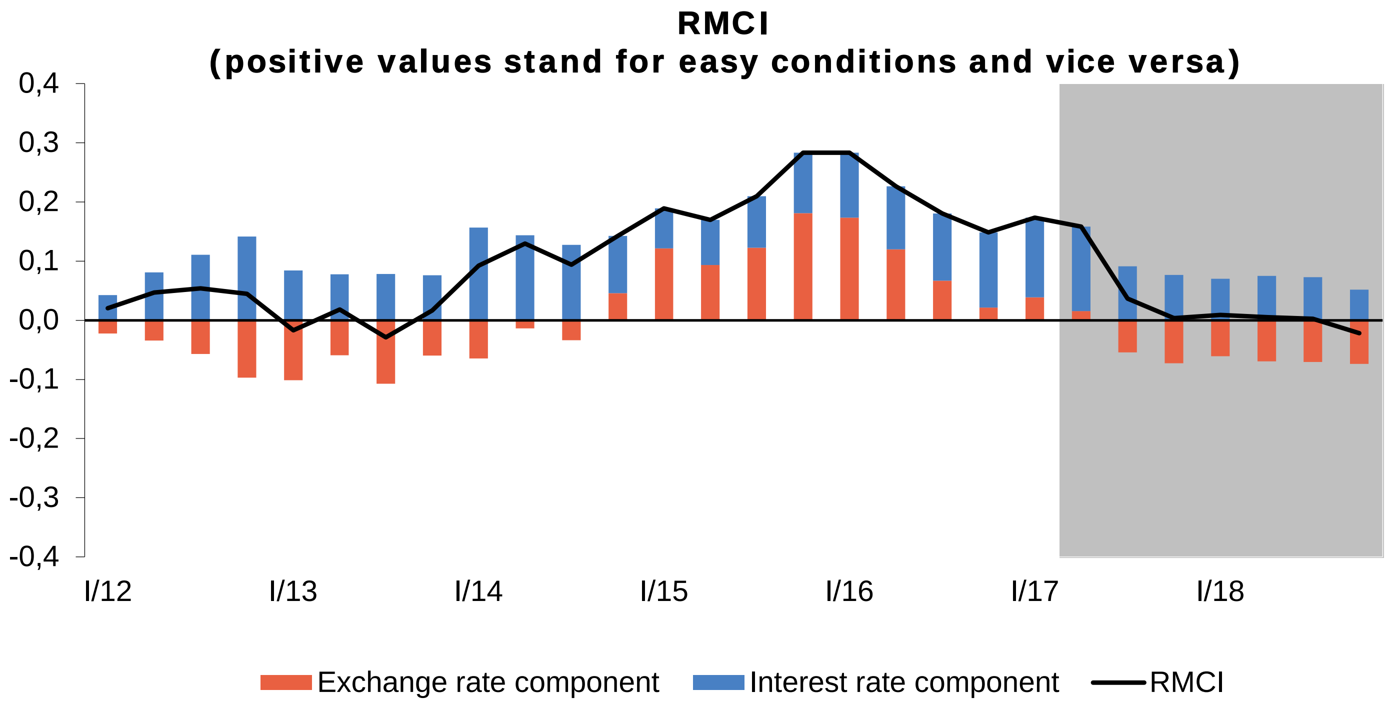




- The revival of economic activity was even faster than predicted in November 2013 (in 2015 fostered by EU funds and the effect of oil price drop).
- Deflation was successfully avoided.
- But inflation reached the upper half of the tolerance band around the CNB’s 2% target two years later than originally envisaged due to external disinflation.

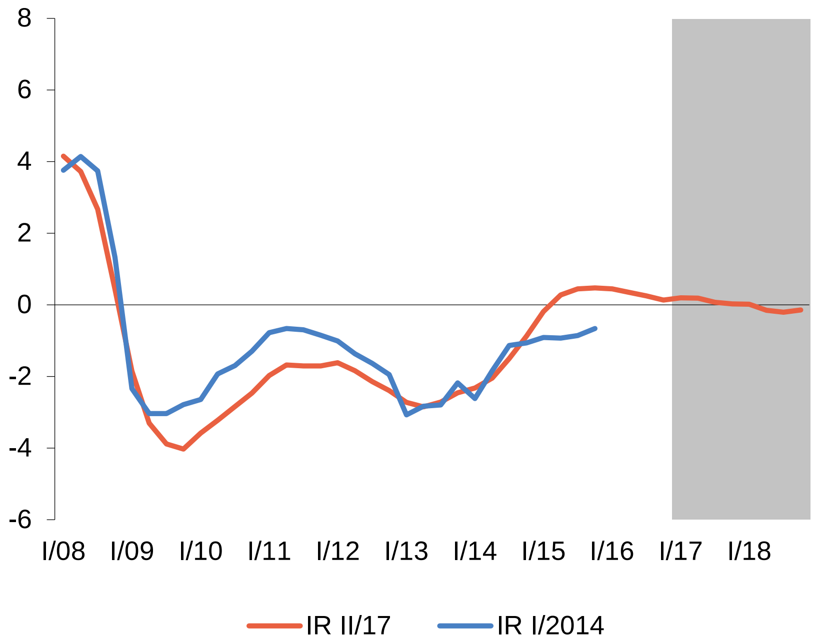
Monetary conditions index

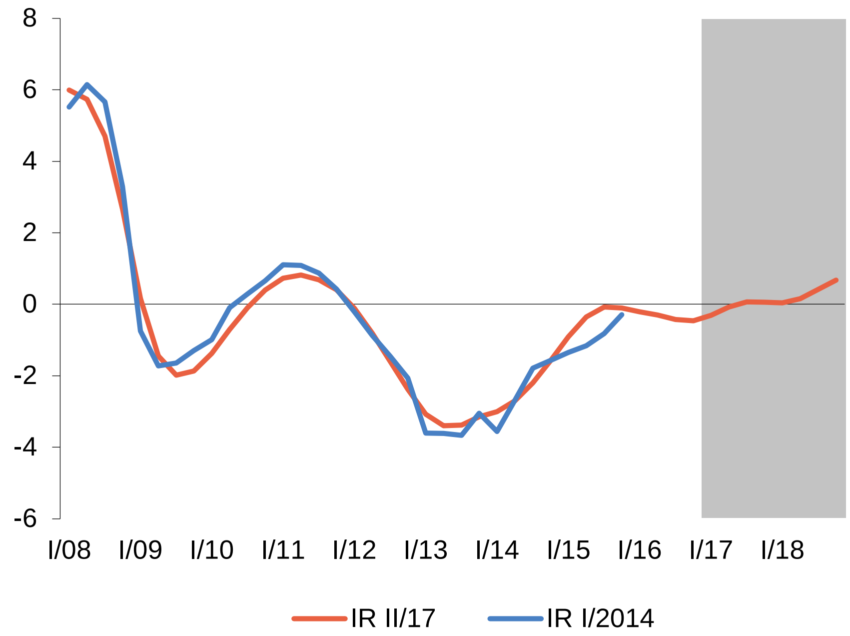


- The CNB‘s exchange rate commitment eased the overall monetary conditions significantly, both in their interest rate (↑ inflation expectations) and exchange rate components (slightly overvalued → slightly undervalued).
- Note that at the time of exit, koruna was only very mildly undervalued in real terms due to the pass-through of weaker nominal ER to prices and wages.
- Exit is the first step towards normalizing the monetary conditions.

Output gap

Small structural model **Production function approach**
(in % of estimated potential output)





- The negative output gap closed in line with the original expectations, or even slightly faster.
- The secondary objective of monetary policy in terms of stabilising output was thus achieved under the exchange rate commitment.

The empirical effects of CNB's commitment

	g3	Tonner et al. (2015)	SCM	GSCM	Caselli (2017)	Independent studies
CPI inflation (2014)	1.3	1.3	0.1	0.2	0 - 0.5	0 - 1.5
CPI inflation (2015)	1.6	1.4	0.6	0.8	0.5 - 1.0	0 - 1.5
Core inflation (2014)	1.6	1.6	2.2	1.4		
Core inflation (2015)	1.9	1.7	2.2**	1.1*		
GDP growth (2014)	1.1	0.7	0.3	0.4		0 - 0.8
GDP growth (2015)	0.5	1.2	1.7*	1.8*		0 - 0.5
Unemployment rate (2014)		-0.3	-0.4	-0.1		-1.0
Unemployment rate (2015)		-1.1	-0.8	-0.5		-1.8

** indicates significance at 5 %, * indicates the significance at 10 %

Source: Brůha, Tonner (2017; forthcoming)

- Most studies find a positive effect on inflation and economic growth, even though the size of estimated effects differs and some estimates are not statistically significant.
- The estimates may represent a lower bound for the actual effects of the exchange rate commitment.

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- There are more differences than similarities between the Swiss and Czech cases.
- Transparency has paid off in the Czech case.
- The Czech exchange rate commitment delivered the desired easing of monetary conditions via both its components.
- It helped to avoid deflation, to return inflation to the target and to bring the Czech economy back to its potential.
- In the Czech case, exit is the fist step towards normalizing the monetary conditions.

Thank you for your attention

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