

The Czech Republic and Euro Adoption

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CNB Board Member

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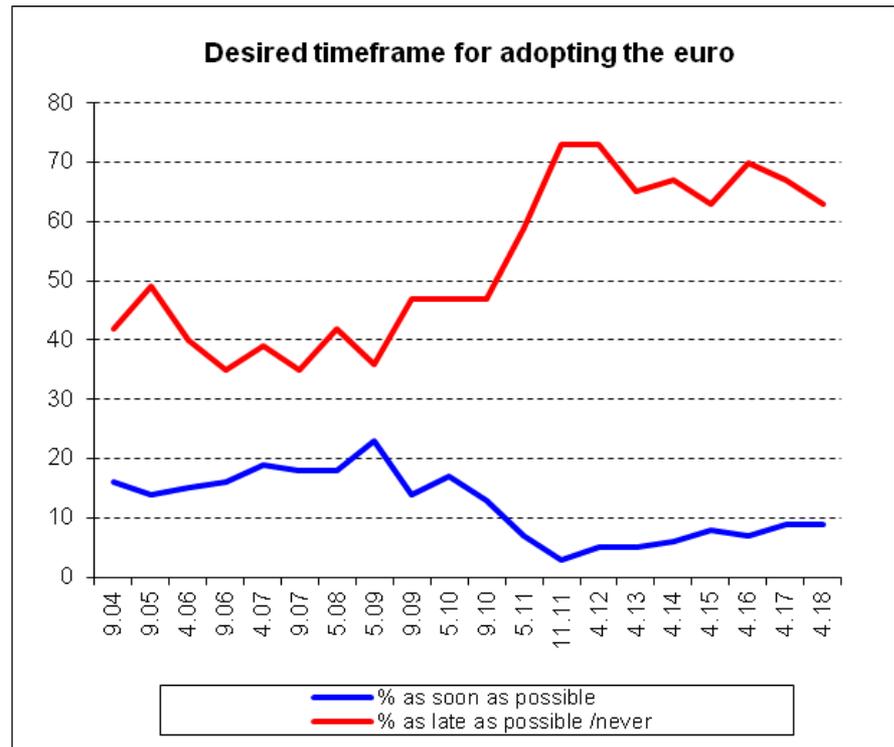
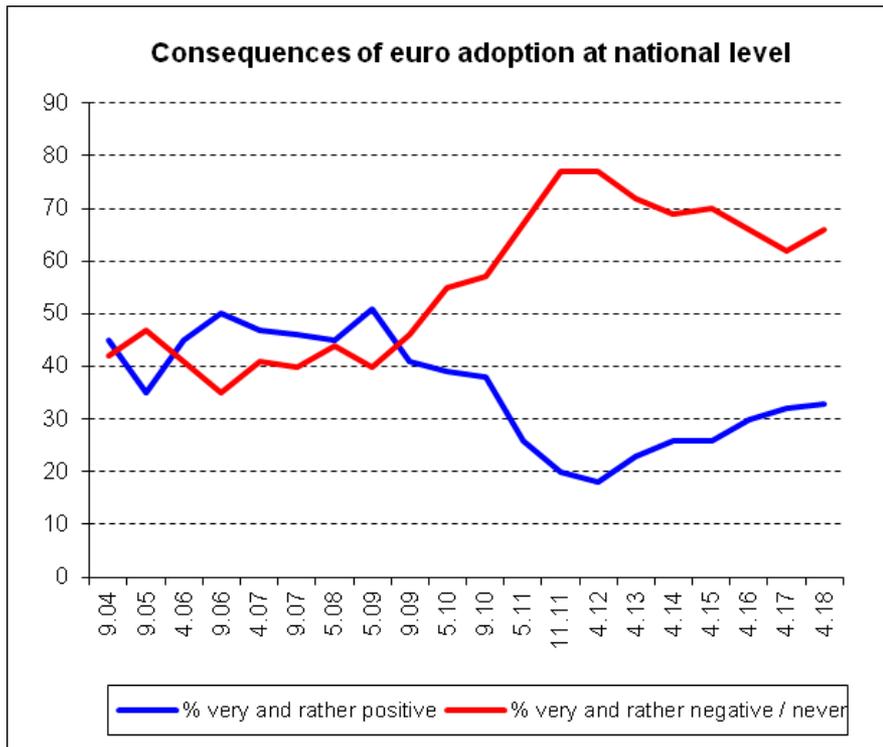
Public lecture organised by the OeNB at WU
"The EURO is turning 20 – What comes next?"

- What is Czech Republic's current stance on euro?
 - What is government's stance, CNB's stance?
 - What does Czech population think of euro area and possible euro introduction?
 - What would be economic implications of euro introduction for Czech Republic?
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- What does CNB think of possible "e-koruna"?
What is future of cash payments in Czech Republic?

CZECH STANCE ON EURO ADOPTION

- Zdeněk Tůma (2008): *"The world would not collapse, and neither would the Czech economy, if we adopted the euro in 2010. Likewise, nothing dramatic will happen if we do it on the 100th anniversary of the Czech koruna, i.e. in 2019."*
- When former CNB Governor Tůma said the above, this date was viewed as almost shocking and unduly far off.
- Nonetheless, koruna is now celebrating its 100th anniversary without any target date having been set for changeover to euro in Czech Republic.





- We did not abandon idea of euro adoption; it abandoned us, mainly as consequence of EA sovereign debt crisis.
- Since then, public support has recovered to only small extent.
- Euro adoption is political project; if there is no demand, there is no supply from government.

Each year we publish:

- *Analyses of Czech Republic's current economic alignment with euro area* – most recent: December 2018
- *Assessment of fulfilment of Maastricht convergence criteria and degree of economic alignment of Czech Republic with euro area* – published jointly with Ministry of Finance of Czech Republic

ECONOMIC ALIGNMENT OF EURO AREA COUNTRIES

-  Convergence of euro area countries' wealth levels
-  Public finance sustainability
-  Business cycle alignment
-  Monetary policy transmission (interest rate channel)
-  Financial cycle alignment as captured by credit growth
-  Inflation alignment

+ unfinished institutional reform

CZ: DIRECT ALIGNMENT INDICATORS

-  Real economic convergence
-  The Czech Republic's cyclical alignment with the euro area
-  Structural similarity of the Czech economy to the euro area economy
-  Trade links with the euro area
-  Intensity of intra-industry trade with the euro area
-  Ownership links with the euro area
-  Financial cycle alignment
-  Interest rate convergence vis-à-vis the euro area
-  Volatility of the Czech currency against the euro
-  Alignment of the Czech koruna with the euro

CZ: FISCAL POLICY

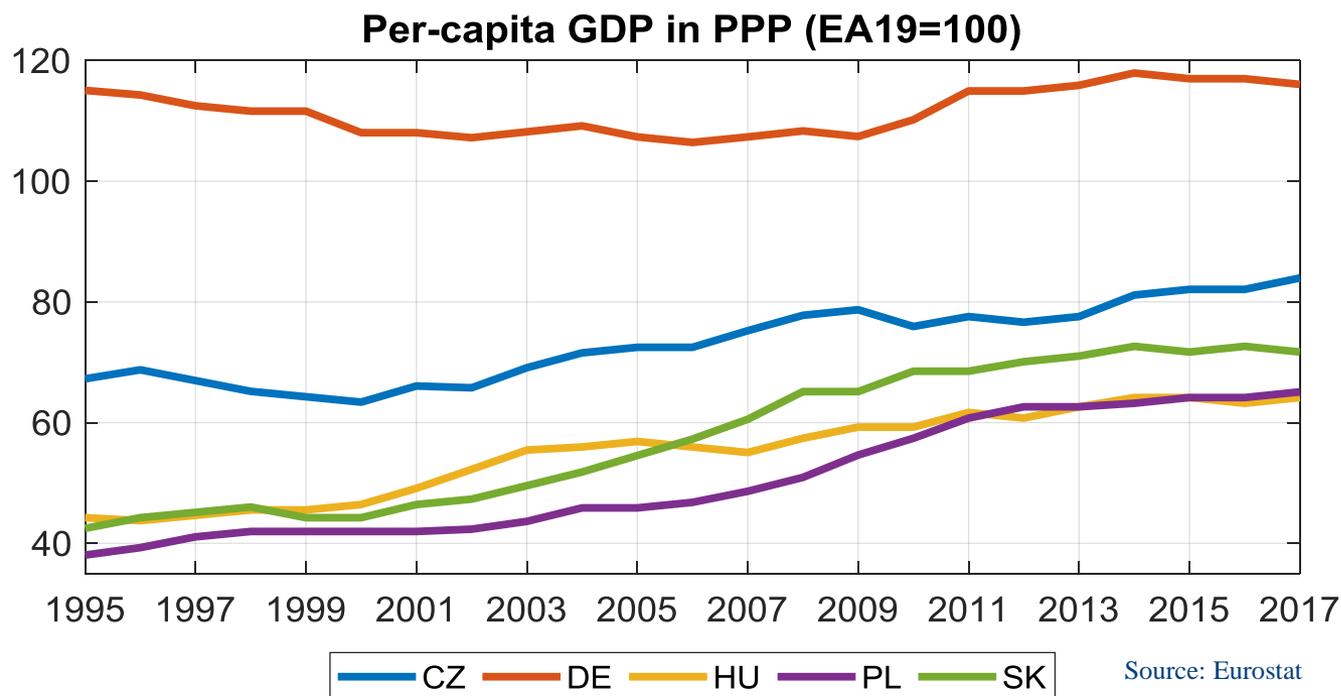
-  Cyclically adjusted general government balance
-  General government debt
-  Procyclical effect of fiscal policy
-  Long-term sustainability of public finances

CZ: THE LABOUR AND PRODUCT MARKETS

-  Geographical mobility
-  Activity rate
-  Share of part-time jobs in employment
-  Long-term unemployment rate
-  Unemployment trap
-  Labour market efficiency
-  Competitiveness

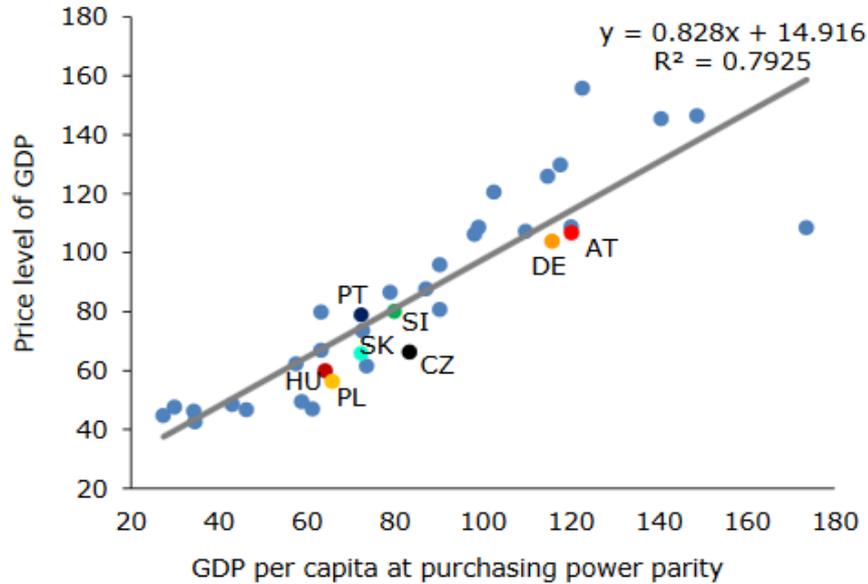
CZ: THE BANKING SECTOR

-  Capital position
-  Profitability
-  Liquidity position
-  Credit risk
-  Risks to the domestic banking sector related to the phase of the financial cycle



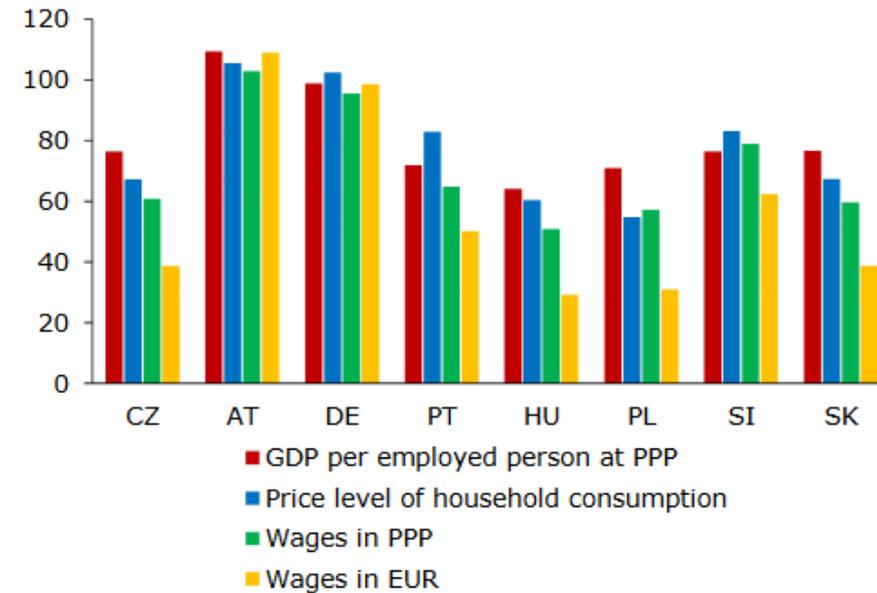
- Czech real per-capita GDP in PPP reached 83% of EA19 in 2017, resuming its convergence after slowdown of 2010–2013.
- There were originally higher expectations after joining EU and successful initial transformation to market-based economy.
 - Per-capita GDP increased by 15 p.p. in 1995–2017, i.e. by about 0.7 p.p. per year.
 - Is there risk of “middle-income trap”?

GDP per capita at purchasing power parity versus the price level (2017, EA = 100)



Source: Eurostat, CNB calculations.

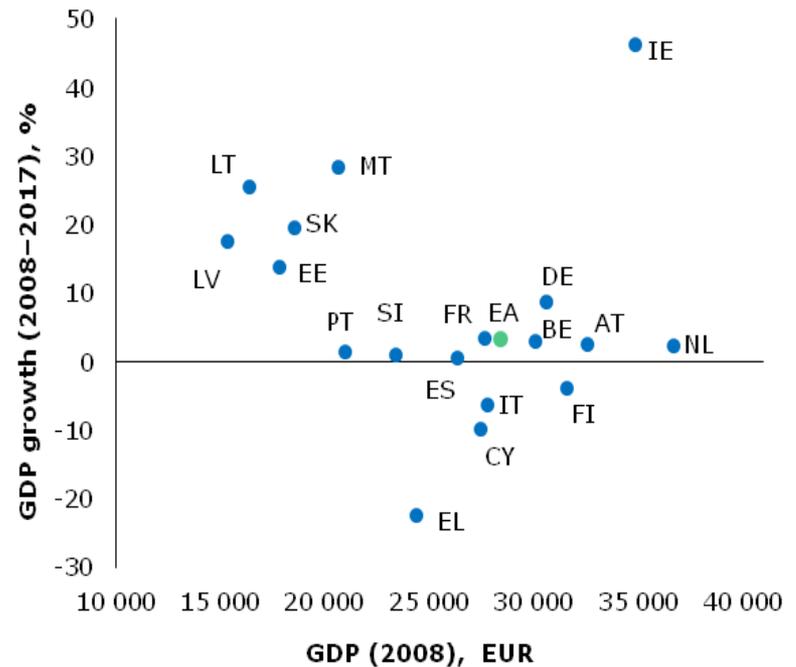
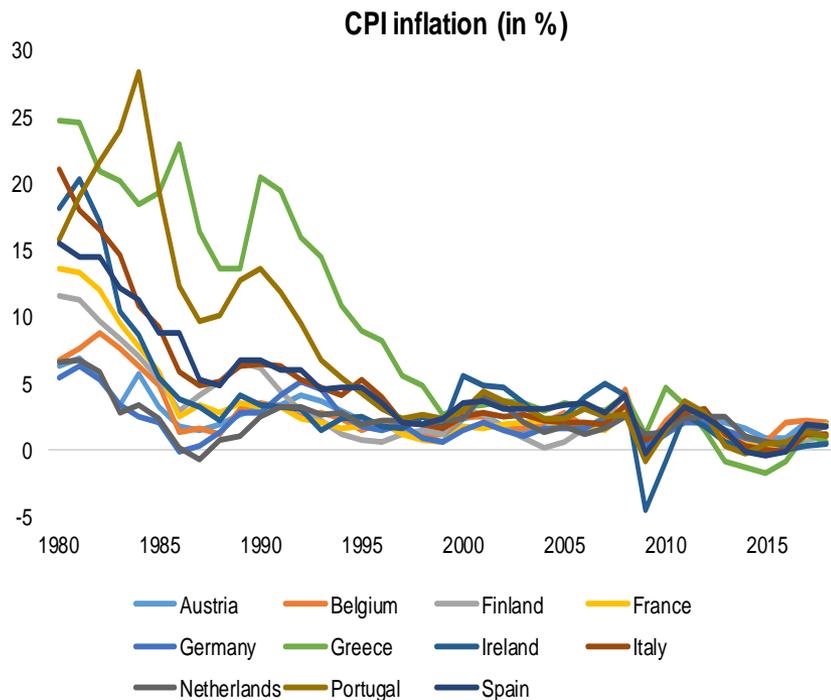
Other indicators of long-term convergence (2017, EA = 100)



Source: Eurostat, European Commission, CNB calculations.

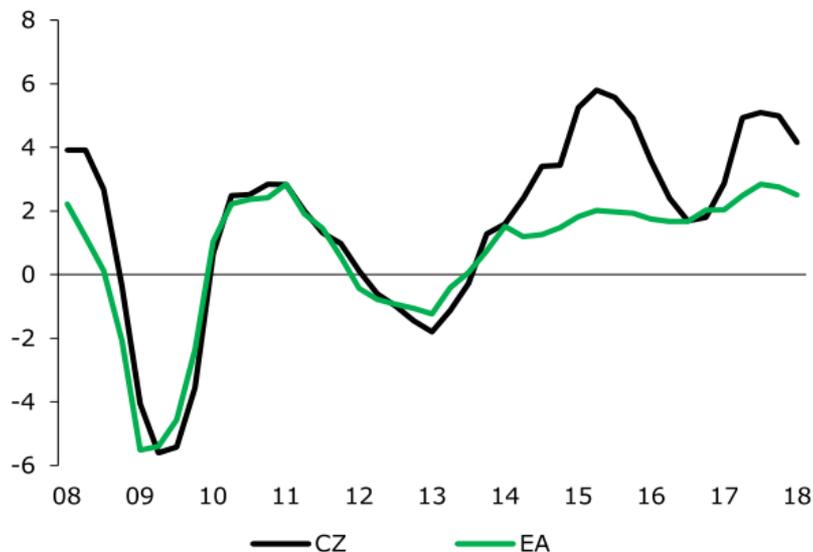
- Czech price level is below level corresponding to GDP per capita \Rightarrow ample space for real exchange rate appreciation.
- Lower wage level compared to euro area average (60% of EA average in PPP and 40% in EUR terms \Rightarrow incomplete convergence).

Why real convergence matters?



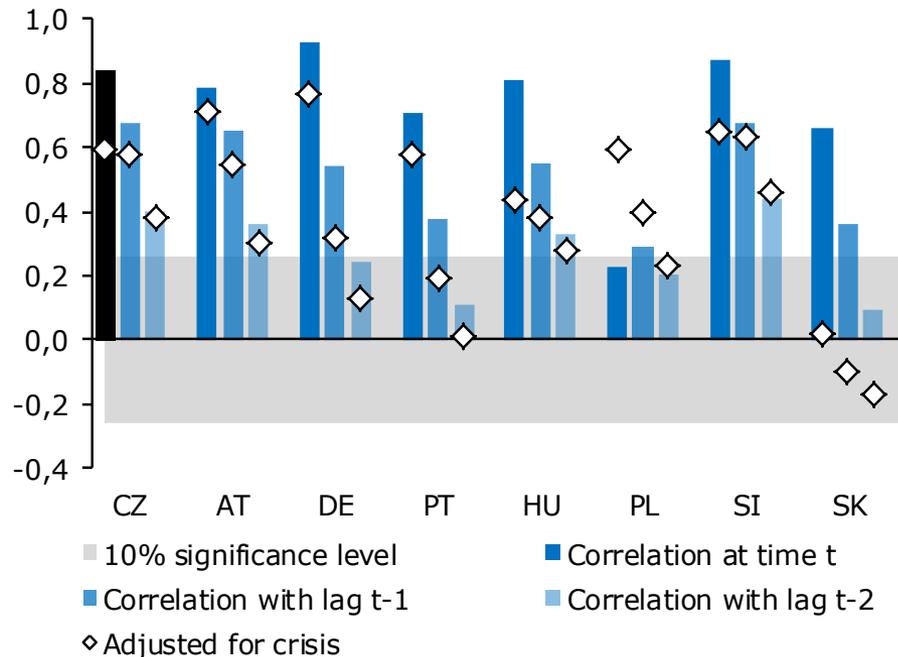
- Euro has brought significant, measurable benefit in terms of inflation convergence at low and stable level (primary objective of monetary policy).
- But this is not selling point of euro in Czech Republic. Inflation may actually go up after euro adoption due to catching-up process (nominal appreciation not possible any more).
- At the same time, there is no visible pay off to euro adoption in terms of faster growth or GDP convergence.

Year-on-year changes in real GDP (%)



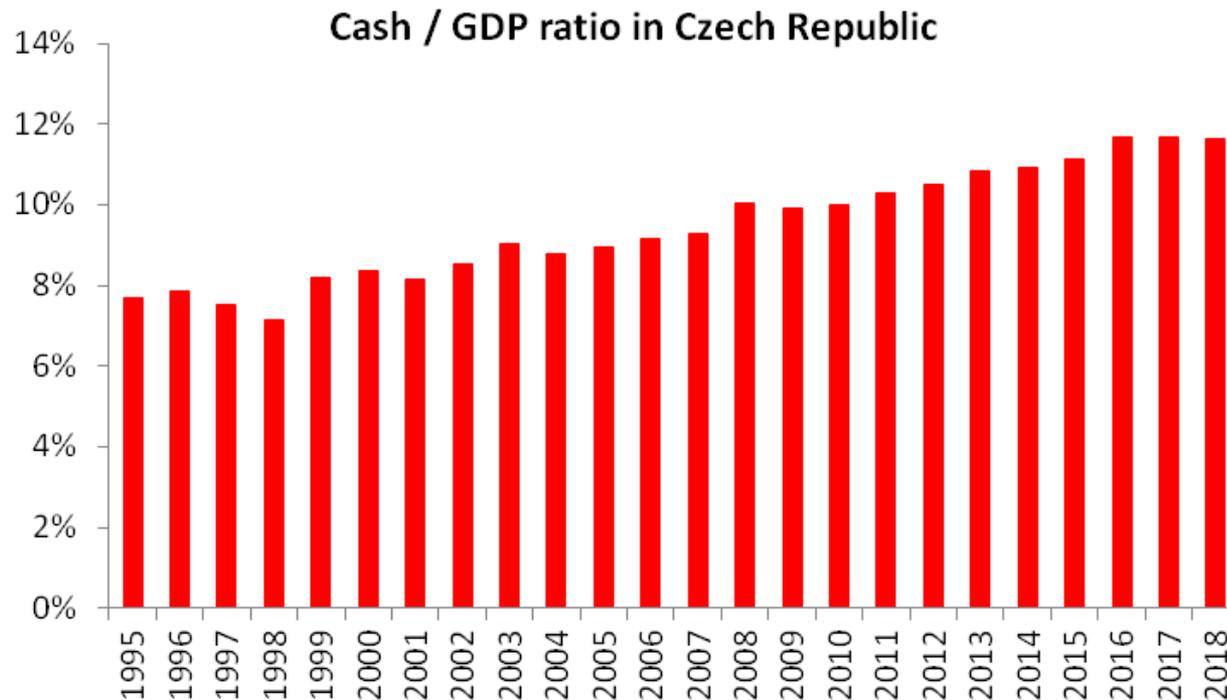
Source: Eurostat, CNB calculations.

Correlation coefficients of GDP with the euro area



- Cyclical alignment with EA was particularly strong during economic crisis and has declined during recovery on back of independent monetary policy (including unconventional measures such as CNB's FX commitment).
- Alignment remains relatively high, though, owing to strong trade links.

POSSIBLE E-KORUNA DEBATE



- Chart makes it obvious why CNB is very unlikely to be front-runner in area of central bank digital currencies (even though we are following topic with great interest).
- Czech Republic has rather high density of “bitcoin ATMs”, but this is not serious “competitor” to CZK cash either.

- Euro at 20 serves well all functions of good money: unit of account, means of transactions, store of value.
- This is thanks to fact that Eurosystem has delivered on primary objective of monetary policy, i.e. price stability. Congratulations to “happy ins”!
- Same is true for CZK at 100, though. Euro adoption could actually increase Czech inflation to some extent due to catching-up process.
- There is no obvious euro adoption dividend in terms of faster economic growth or GDP convergence.
- Institutional design of EA is still unfinished.
- Secondary objective is easier to achieve with independent monetary policy (even though Czech business cycle is fairly synchronized with EA).
- Euro is definitely better money than any crypto assets (even for “happy outs” 😊).

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