CNB monetary policy since 2012

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Monetary policy before November 2013

- In autumn 2012 CNB announced that if it became necessary to ease monetary conditions further, it would do so by weakening exchange rate of koruna.

- In November 2012 CNB:
  - lowered its key interest rates to 0.05% ("technical zero")
  - halted sale of yields on its forex reserves

- During 2013 CNB made verbal interventions aimed at weakening koruna:
  - verbal interventions had some effect (tenths of koruna)
  - for roughly one year they delivered unusually stable exchange rate in historical terms
  - but effectiveness of interventions gradually faded

In November 2012 the CNB exhausted its main monetary policy instrument, i.e. interest rates.
2013: strengthening disinflation

- Czech economy was more subdued than its neighbours
- Estimates of output gap were strongly negative in mid-2013
- Decline in fixed investment lasting more than two years
- Lowest-ever wage growth in private firms
- Falling inflation in euro area ⇒ further ECB interest rate cuts
- Price declines: PPI in manufacturing, construction, services, agriculture
- Inflation expectations had fallen to historical lows
- Falling growth of monetary aggregates and velocity of money
- Several-year-long fall in property prices (except in Prague)

The constantly rising disinflation risks were indicating an ever-increasing decline in inflation well below the inflation target and increasing risks of negative inflation
On 7 Nov 2013 exchange rate commitment announced:
• koruna would not appreciate below CZK 27/euro
• on weaker side of CZK 27 koruna was allowed to float
• CNB was prepared to make unlimited FX interventions
• commitment was roughly equivalent to cutting rates by 1 p.p.

Aim of commitment:
• to further ease monetary conditions at zero lower bound
• to tackle disinflationary/deflationary pressures
• to revive economy and achieve inflation target more quickly

Commitment was prolonged several times due to:
• strong and longer-lasting (mainly external) disinflationary pressures
• more (and longer-lasting) accommodative ECB monetary policy

Final “hard” commitment lasted until end of 2017 Q1

The commitment became an unconventional MP instrument; the CNB joined other CBs using unconventional instruments (albeit in different forms) in a disinflationary environment
In mid-2015 the CNB started intervening (buying euro for koruna) to maintain the commitment; interventions in each month of 2017 Q1 were larger than in Nov 2013.
Exchange rate commitment: exit

- Weakening of koruna contributed to economic recovery and gradual rise in inflation in 2014
- Other factors that aided recovery:
  - growth in external demand
  - end of restrictive domestic fiscal policy
- In late 2016/early 2017 domestic inflation pressures (core inflation) and food and fuel prices started to rise quickly:
  - condition of sustainable fulfilment of inflation target was met
  - continuation of commitment was no longer necessary to fulfil CNB’s primary objective of maintaining price stability
- Exchange rate commitment was ended on 6 April 2017

The exit from the commitment was the first step towards normalising monetary policy, i.e. towards using interest rates as the main instrument again
Normalisation of CNB monetary policy

- Return to managed float
- CNB has raised 2W repo rate seven times since April 2017:
  - **August 2017:** from 0.05% to 0.25%  
    (first central bank in advanced Europe to increase rates)
  - **November 2017:** from 0.25% to 0.50%
  - **February 2018:** from 0.50% to 0.75%
  - **June 2018:** from 0.75% to 1.00%
  - **August 2018:** from 1.00% to 1.25%
  - **September 2018:** from 1.25% to 1.50%
  - **November 2018:** from 1.50% to 1.75%
- Rate hikes were facilitated by relatively depreciated koruna
- Starting with February Inflation Report, CNB returned to publishing projected exchange rate path
- Monetary policy tightening goes hand in hand with macro-prudential policy tightening, which CNB embarked on earlier

The gradual return of monetary policy to normal is a sign that the economy has overcome the 2008–2013 crisis
The somewhat weaker koruna in 2018 Q3 and Q4 implies a faster increase in interest rates.
ER commitment: economic outcomes

(percentage points)

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<th>Model-based approach</th>
<th>Empirical approach</th>
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<td>Inflation (CPI)</td>
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<td>2014</td>
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<td>2015</td>
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<td>GDP growth</td>
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<td>Household consumption growth</td>
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<td>2014</td>
<td>1.4</td>
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<td>2015</td>
<td>0.9</td>
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<td>Unemployment</td>
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<td>2014</td>
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<td>2015</td>
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Note: Model-based approach I: simulation with core prediction model used at CNB
Model-based approach II: simulation with core prediction model explicitly including labour market
Empirical approaches I and II: based, respectively, on synthetic control method and its generalised variant

Source: Brůha, Jan and Jaromír Tonner, An Exchange Rate Floor as an Instrument of Monetary Policy: An Ex-post Assessment of the Czech Experience, CNB WP 4/2017

Model-based and empirical approaches confirm that the commitment had positive effects on inflation and the real economy
Concluding remarks

- CNB opted for ER commitment due to following features:
  - Czech economy is very open
  - has positive net exports and high share of manufacturing
  - exchange rate pass-through to inflation is strong and fast
- After adoption of ER commitment CNB was exposed to heavy criticism; public generally did not understand that:
  - weakening of CZK relaxes (not tightens!) monet. conditions
  - weakening of koruna by 5% is not “end of the world”
  - there is difference between short and long run (J-curve)
- Adoption of ER commitment was not costless in terms of central bank credibility
- ER commitment proved to be beneficial as envisaged: delivered faster recovery and higher inflation
- Exit from ER commitment was (surprisingly) smooth
- Despite ongoing normalisation of monetary policy we are not in normal situation yet

CNB experience with ER commitment is positive
Thank you

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