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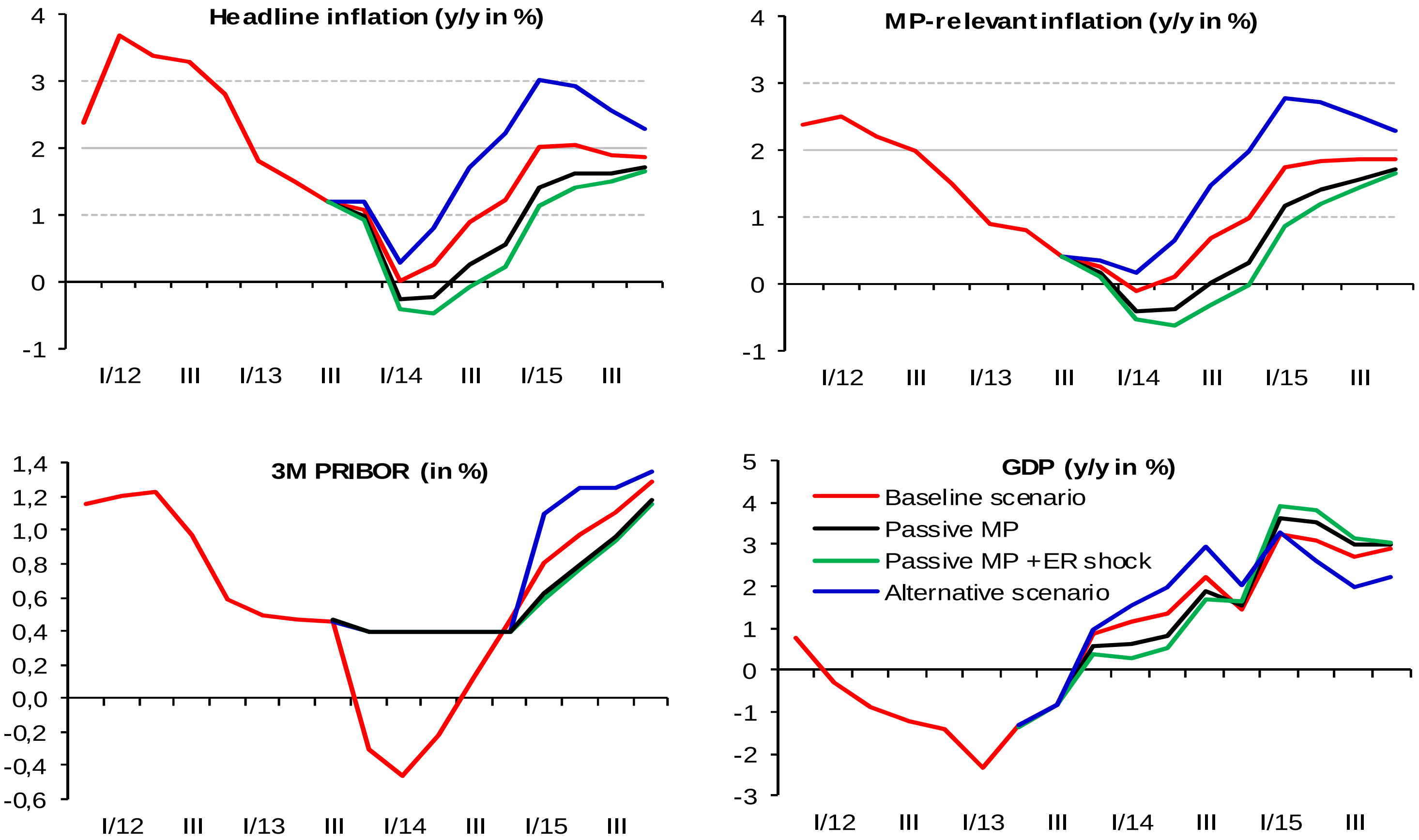
Foreign Exchange Market Interventions: Conventional or Unconventional Policy

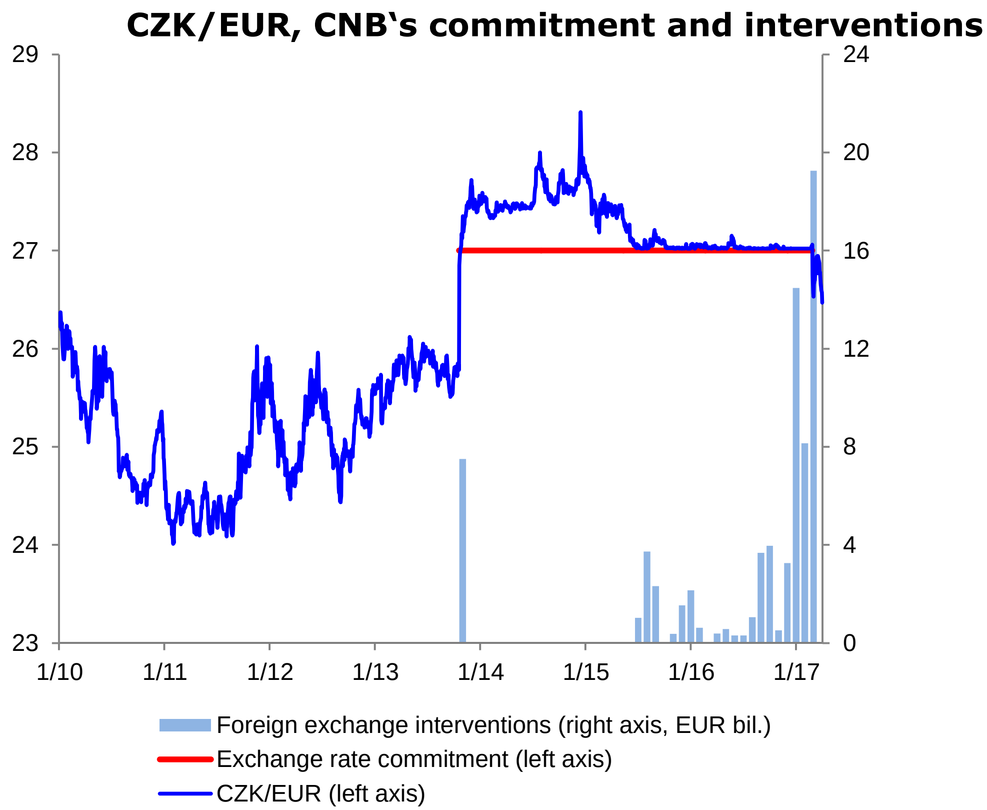
December 7, 2017, Jerusalem

Scenarios from November 2013



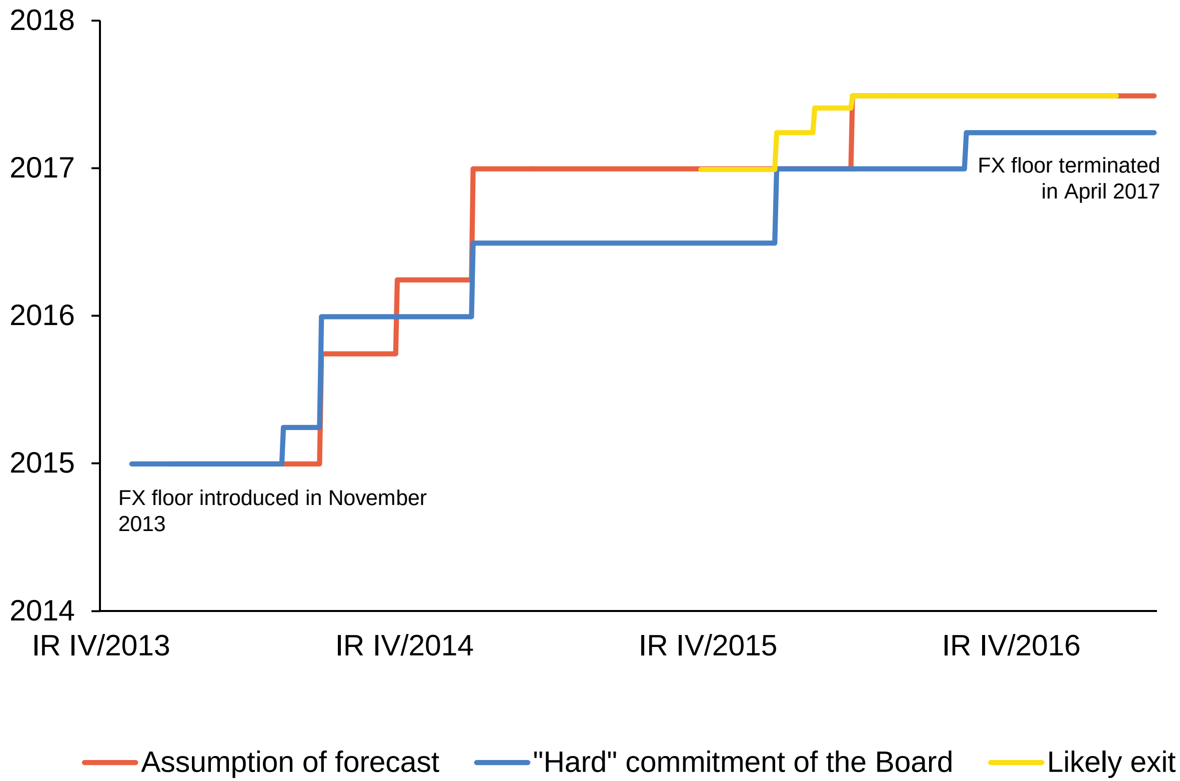
- The exchange rate floor was introduced as a tool for further easing of monetary conditions in the situation of zero policy rates

Introduction of the exchange rate floor



- The entry in November 2013 was technically successful.
- The credibility of the policy was allowing for periods of exchange rate above the floor with no interventions.
- Intervention pressures were associated with the upcoming (telegraphed) exit.

Communication of the CNB during the FX Floor



- As a communication tool about the planned discontinuation of FX commitment, CNB‘s Board primarily used a “hard commitment”, specifying the minimum duration of the ”floor“. The hard commitment was fully met.
- CNB also provided information on the exit date expected or considered likely by the Board, as well as on the timing of the exit assumed in the forecast.

Ex post outcomes

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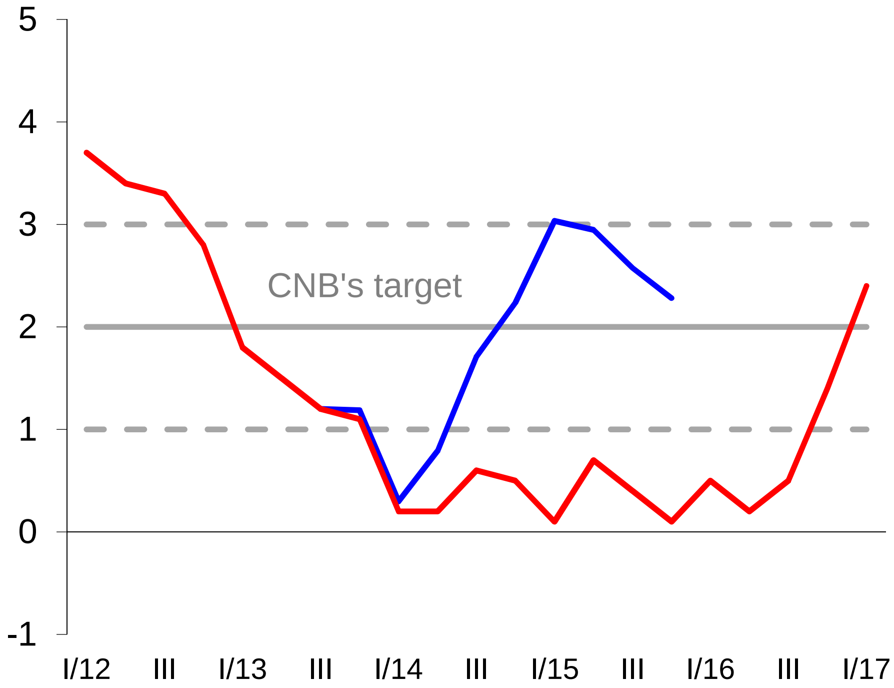
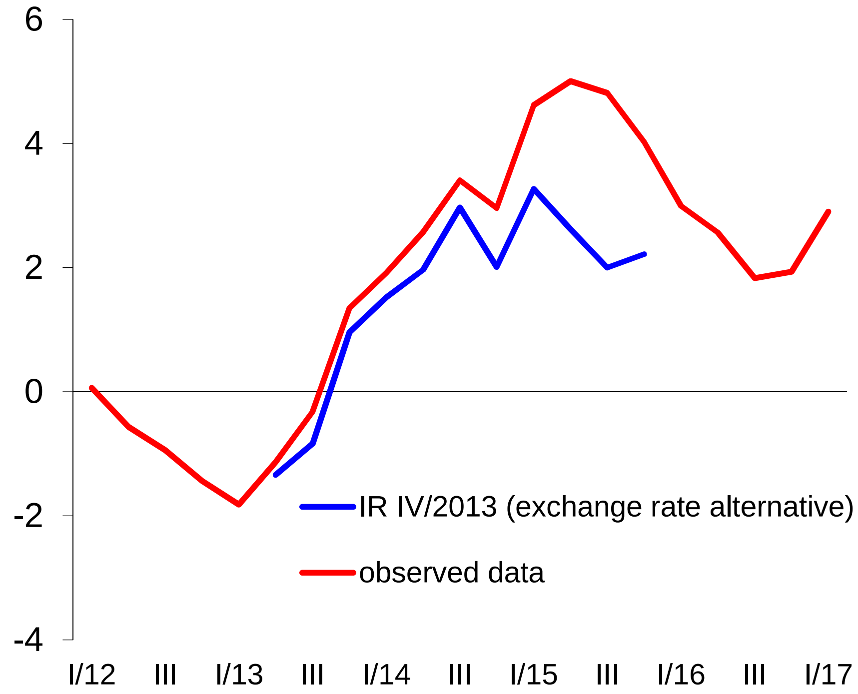
Inflation (y/y in %)



GDP (y/y in %)



- 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.

The empirical effects of CNB's commitment

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	g3	Tonner et al. (2015)	SCM	GSCM	Caselli (2017)	Independent studies
CPI inflation (2014)	1.2	1.3	0.1	0.2	0 - 0.5	0 - 1.5
CPI inflation (2015)	1.7	1.7	0.6	0.8	0.5 - 1.0	0 - 1.5
Core inflation (2014)	1.4	1.6	2.2	1.4		
Core inflation (2015)	2.1	2.0	2.2**	1.1*		
GDP growth (2014)	0.3	0.9	0.3	0.4		0 - 0.8
GDP growth (2015)	0.2	0.3	1.7*	1.8*		0 - 0.5
Unemployment rate (2014)		-0.3	-0.4	-0.1		-1.0
Unemployment rate (2015)		-0.3	-0.8	-0.5		-1.8

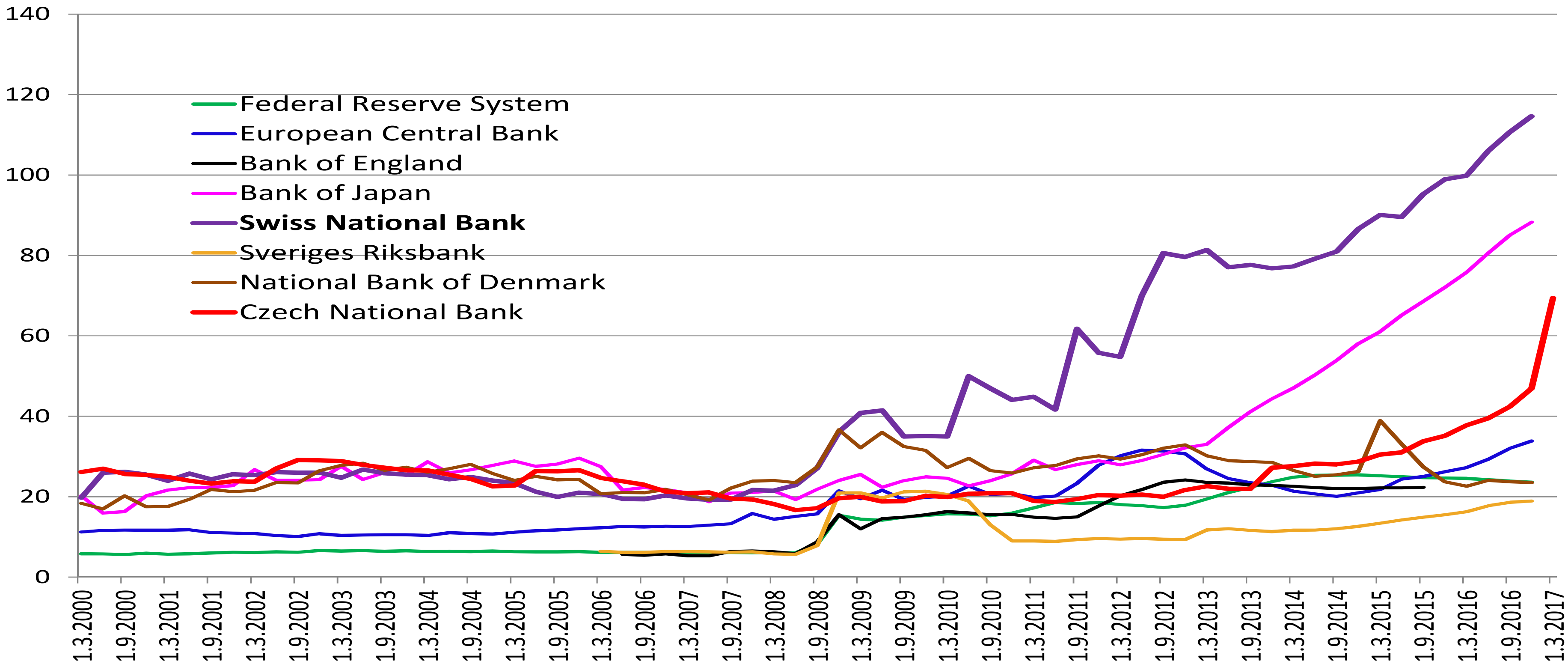
** indicates significance at 5 %, * indicates the significance at 10 %

Source: Brůha, Tonner (CNB, WP, 2017)

- 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.

Balance sheet expansion

(in % of GDP)



- There was an exponential increase in the run up to the exit

Conclusions

- Transparency has paid off.
- The 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.
- The exit (April, 2017) was a fist step towards normalizing the monetary conditions.