## Inflation Targeting and Use of the Exchange Rate as a Monetary Policy Instrument: CNB Experience

## Miroslav Singer

Governor, Czech National Bank

The Rebalancing Challenge in Europe – Perspectives for CESEE

Vienna Marriott Hotel, 24 November 2014



## 17 Years of Experience with IT

• Adoption of IT: 1998; IT framework has undergone enormous changes (evolution of inflation targets; adoption of escape clauses and switch to flexible IT; forecasting techniques; switch from conditional to unconditional forecasts; increasing transparency)

#### Positive:

- Successful disinflation, anchoring of inflation expectations
- Contributed to macroeconomic stabilisation of Czech economy
- Facilitated long-term real and nominal convergence of Czech economy to developed economies
- Flexible IT framework allowed us to add exchange rate to list of instruments used to ease monetary conditions

#### Negative:

- Frequent undershooting of targets (in 2007–2008 and 2011–2014)
- Relatively high volatility of exchange rate

The IT regime has functioned as a consistent decisionmaking framework, proving effective even at the height of the financial and economic crisis



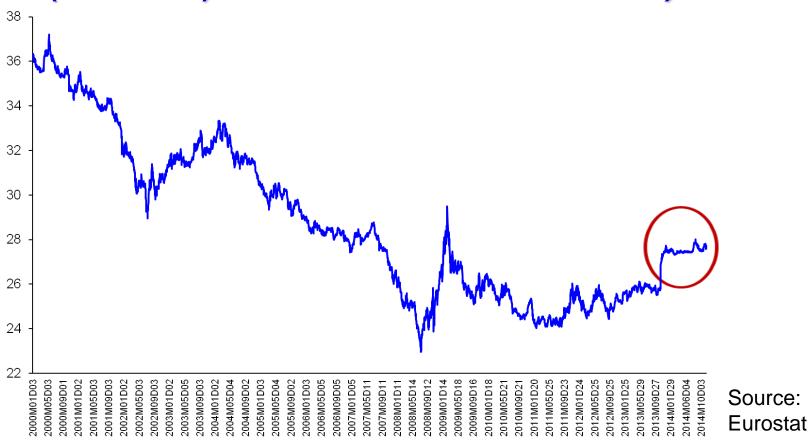
# Weakening of koruna in November 2013

- CNB weakened koruna to around CZK 27/euro (roughly equivalent to cutting rates by 1 percentage point)
- Expressed (one-sided) exchange rate commitment:
  - to prevent excessive appreciation of koruna below CZK 27/euro
  - on weaker side of CZK 27 level to allow exchange rate to float according to supply and demand on foreign exchange market
- Weakening of koruna was aimed at:
  - averting real threat of deflation
  - attaining inflation target earlier
  - helping economy to recover faster
  - exiting zero interest rate level earlier (and returning to use of main monetary policy instrument sooner)

The exchange rate became a new tool in the IT regime



### Koruna-euro exchange rate (3 January 2000 – 17 November 2014)



The November weakening of the koruna was not at all unusual by historical standards



## Key macroeconomic indicators

		y-o-y change in %			
	Available o	on 7 Nov 2013	Available	on 6 Nov 2014	
GDP (s.adj.)	II/13	-1,3	II/14	2,5	
Household consumption (s.adj.)	II/13	0,0	II/14	1,9	
Gross capital consumption (s.adj.)	II/13	-14,0	II/14	6,3	
CPI	9/13	1,0	9/14	0,7	
Monetary-policy relevant inflation (without taxes)	9/13	0,2	9/14	0,6	
Unemployment - age 15-64 years (s.adj., in %)	III/13	7,0	III/14	6,0	
Average nominal wage in business sector	II/13	1,1	II/14	2,5	
Number of vacancies	9/13	39 040	9/14	56 600	
Gross operating surplus of non-financial enterprises	II/13	1,3	II/14	14,5	
Composite confidence indicator	10/13	88,9	10/14	94,1	
Retail sales incl. cars (s.adj.)	9/13	0,3	9/14	4,5	
Industrial production (s.adj.)	9/13	1,8	9/14	5,6	
Construction output (s.adj.)	9/13	-12,7	9/14	8,4	

Source: CZSO

The key macroeconomic indicators are developing much more favourably this year than they were before November 2013



## Assessment of weakening of koruna

- Czech economy avoided deflation and emerged from recession
- Growth fostered by: 1) weakening of koruna, 2) end of budgetary restrictions, and 3) recovery abroad (albeit weaker than expected)
- Developments (except for lower inflation) in line with what we envisaged when we weakened koruna
- Low (but non-negative) inflation fostered by more deflationary (than expected) producer price developments in euro area and deeper decline in domestic administered prices
- CNB will not discontinue use of exchange rate as MP instrument before 2016; we do not expect koruna to appreciate significantly after exit
- Monetary policy faced no adverse trade-offs during crisis;
  weakening of koruna stimulated economic activity, which in turn helped lift inflation towards CNB's inflation target

The weakening of the koruna turned out to be beneficial and even more necessary than it seemed in Nov 2013

