

**Czech University of Life Sciences Prague**

**Faculty of Economics and Management**

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**Diploma Thesis Abstract**

**Czech National Bank's Foreign Exchange Interventions  
and Their Impact on Czech Republic's Economy**

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## Summary

This diploma thesis focuses on the role of the Czech National Bank and on monetary policy and the steps taken by the Czech National Bank in order to meet its obligations and objectives, especially in the area of price stability and also in support of the growth of the economy. Attention, in this thesis, is paid mainly to interventions taken by the Czech National Bank in the foreign exchange market in November 2013, which were supposed to be the main tool for suppressing the increasing deflationary pressures faced by the Czech Republic in the course of 2013. The aim of this work is to analytically vindicate the correctness of the decision of the Czech National banks.

This diploma thesis is divided into two parts. The theoretical part accounts for roughly half of this work and focuses on the role of the Czech National Bank, its monetary policies and the instruments and mechanisms related to it, as well as concepts such as inflation and deflation, which led the Czech National Bank to intervene in the foreign exchange market.

The second part of this work focuses on the evaluation of the real effects of the Czech National Bank's actions on the foreign exchange market on the Czech economy, its growth and development. This analysis is undertaken with the help of basic macroeconomic indicators.

**Keywords:** Exchange rate, Czech National Bank, Monetary policy, Inflation, GDP, Export, Balance of payments, CZK/EUR, Economic development, Deflation

## Objectives

The main aim of this diploma thesis is to evaluate the impact of interventions, introduced by the Czech National Bank in the foreign exchange market at the end of 2013, on the main macroeconomic indicators and on the economy as a whole.

As first, the analysis of the role of the Czech National Bank, its monetary policy, instruments and mechanisms that are used to manage monetary policy was conducted. The theoretical parts describe the mechanisms and their possible impacts on the economy of the Czech Republic. Also, in the theoretical part, the thesis focuses on inflation and deflation and analyzes possible causes, effects and consequences.

The second, the practical part of this thesis, is focused on the analysis and its evaluation in terms of five major macroeconomic indicators in the economy of the Czech Republic. These indicators are: inflation, gross domestic product, foreign trade, employment and exchange rate. The analysis focuses on the individual contributors to those indicators and the indicators' individual contribution to the economic development, and the possible causes or consequences are also analyzed.

The primary hypothesis of this work is the assumption that the interventions introduced at the end of 2013 by the Czech National Bank have had a generally positive effect on the overall development of the economy and have met their main objective of reducing deflationary pressures on price development.

## **Methodology**

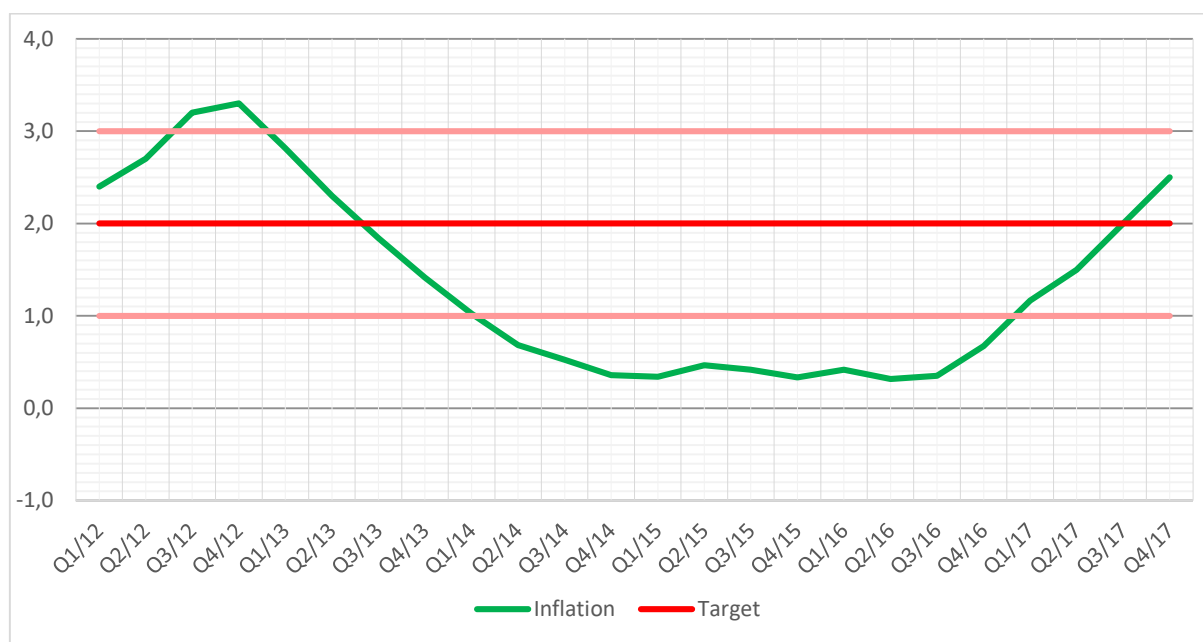
Methodology and processing of this thesis is based on secondary research. Firstly, an analysis of individual sources, literature, but also sources online were used. An analysis of statistical data relevant to the topic was carried out as a follow-up part of the thesis. Data from the websites of the Czech National Bank and the European Central Bank, as well as the Czech Statistical Office and the Ministry of Labor and Social Affairs were used for this work.

On the basis of a quantitative and qualitative analysis of these data, a final evaluation and interpretation of the results could be made. The final result of this thesis is based on the descriptive and comparative method of analyzing the data.

## **Selected Results and Comments**

As the main goal of the Czech National Bank prior to the intervention period was to fight deflationary pressures, this extract from the diploma thesis was selected, including a graph showing the development of inflation in the monitored period. The quoted passage below the graph is taken from the diploma thesis.

**Graph 1: Inflation rate development**



Source: cnb.cz, author's presentation

The decline in inflation continued in the first quarter of 2014 and was gradually slowing down with the end of the year coming. The biggest contributors to the drop in price level were mainly prices of regulated products which, as a group, faced a year-to-year decline in prices. This trend did not get turned even by a typical pro-inflationary group of consumer goods, especially food products, including alcoholic products and tobacco. The declining inflation rate was further strengthened by the reduction of indirect taxes and, above all, the VAT. In the last quarter there was a large contribution to the declining by fuel prices, which dropped by 1.2%, which can be considered a very good result due to the drop in oil prices by 29.5% for the barrel only in the last quarter of 2014.

If it wasn't for the never-ending decline of fuel prices in 2015, the inflation might have turned up a little sooner. The fuel prices dropped again for almost 13% in 2015 but the prices of raw oil dropped by mesmerizing 46%. If it wasn't for the fact of weakened exchange rate this would have had much greater impact on the decline of inflation in 2015. The trend held on up until the fourth quarter of 2016 when prices of oil finally began to rise up again.

In 2016 the monetary policy of CNB finally started to show results in regards to the inflation rate. The price of imported goods started rising, followed by food, tobacco and alcoholic products.

## Conclusion

The situation of the Czech economy was not in good shape before the interventions of the Czech National Bank. At the end of 2012 and the beginning of 2013, the economic crisis culminated, and the Czech National Bank tried to stimulate the economy by reducing interest rates to technical zero. However, this was not enough and less common tools were needed. The CNB chose the interventions on the FX market and launched its first purchases on November 7, 2013. By April 6, 2017, the Czech National Bank spent a total of 2,049 billion crowns for the purchase of euros. It was already clear during the interventions that this tool would be functional and most of the concerns were proved to be unjustified.

Interventions can be considered successful in all monitored sectors of the economy, with the help of evaluation of selected macroeconomic indicators. Inflation was finally rising at the end of 2016, but the CNB's projections spoke of inflation growth in the earlier period. This, of course, was caused only by the unpredictable development of fuel prices. After the arrival of 2017, it turned out that this trend was not short-termed or isolated, so CNB abandonment this tool of monetary policy and intervention had ended.

It is also clear that intervention, the depreciation of the crown, helped to trigger the economy's growth of through favoring exporters and supporting domestic demand which was at long-term low at that time. Although the dynamics of foreign trade did not reach the intensity as expected, however, there was a significant growth in both export and imports. Although total foreign exports reached record values, it is expected to decline in 2018 due to a return to the koruna's market exchange rate against the euro.

Higher domestic and foreign demand has led to larger domestic sales of companies and therefore they have been able to further invest in expanding production and have begun to demand more labor, more workers. This trend has also been positively reflected in the labor market, where unemployment has fallen sharply to current levels where there is only the very low potential for further decline.

The CNB also raised interest rates in the third quarter of 2017 to avoid overheating the economy and, on the contrary, to curb inflationary pressures. The initial increase was 0.25% and then 0.5% in the fourth quarter.

This assessment confirms the original idea and the main hypothesis of this work and that the Czech National Bank's intervention in the foreign exchange market has had a positive influence on the development and growth of the economy in the Czech Republic.

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