

Regional Dimension: Life Beyond the Eurozone

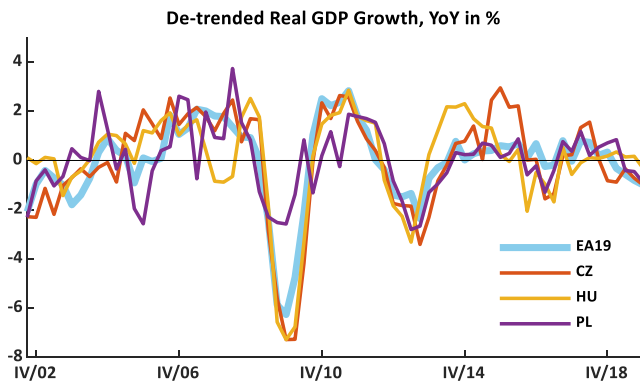
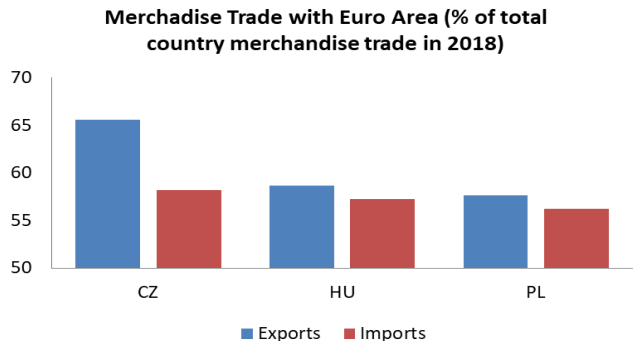
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- Weighing the pros and cons of retaining sovereign monetary policy
- What kind of monetary policy would be most appropriate for non-euro Central European countries, bearing in mind their country-specific characteristics and economic performance?
 - In general
 - At the current juncture



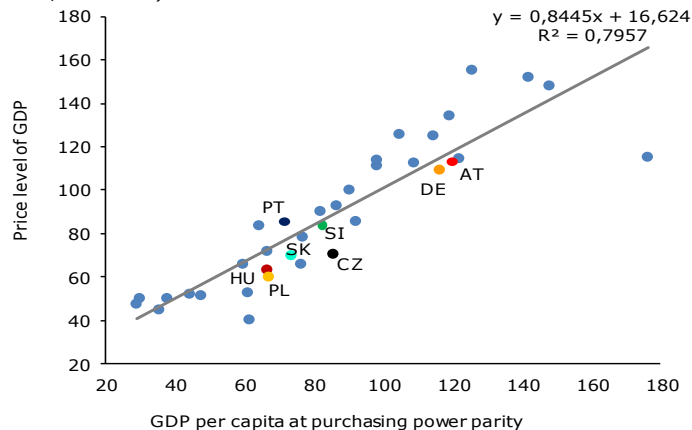
Source: Eurostat and IMF's DOTS

- More than half of CZ, HU, and PL **merchandise exports and imports** are to/from euro area countries (2/3 in the case of CZ)
- About 1/3 of merchandise is traded with **Germany**
- **Strong business cycle correlation** with the euro area

Euro area macroeconomic developments are key drivers of the business cycle in CEE countries (traditionally an argument for euro adoption)

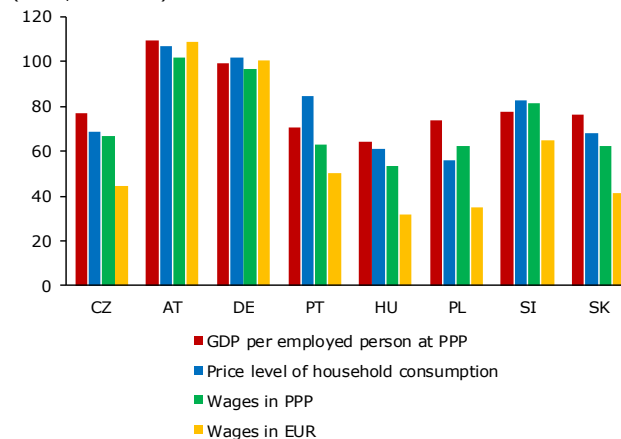
GDP per capita at purchasing power parity versus the price level

(2018, EA = 100)



Other indicators of long-term convergence

(2018, EA = 100)



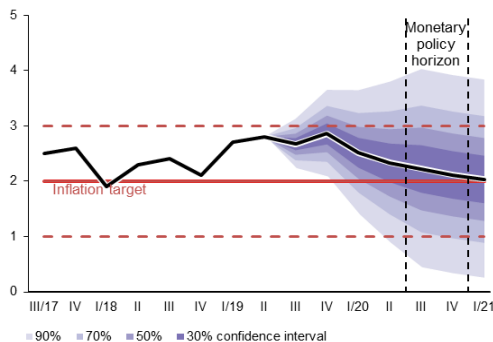
Source: Eurostat and CNB's calculations

- GDP per capita at PPP, price and wage levels in the region remain **well below those of the advanced EA countries**

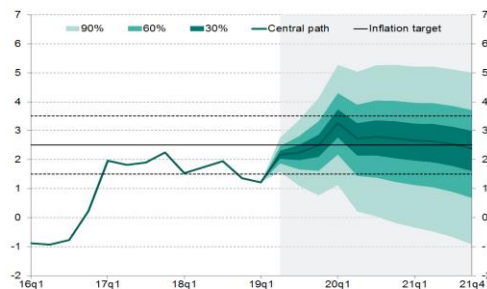
This may create challenges in case of euro adoption
(e.g. higher inflation and lower real interest rates than in the EA)

Inflation and Inflation Targets

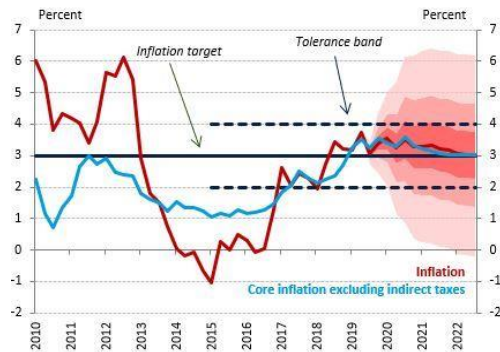
CNB – YoY Inflation and Inflation projection (%)



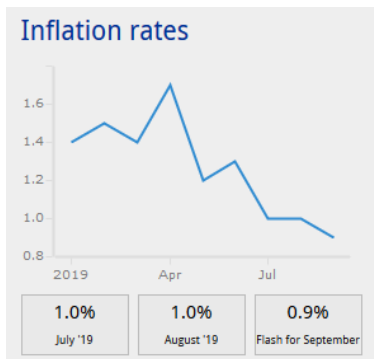
BNP – YoY Inflation and Inflation projection (%)



MNB – YoY Inflation and Inflation projection (%)

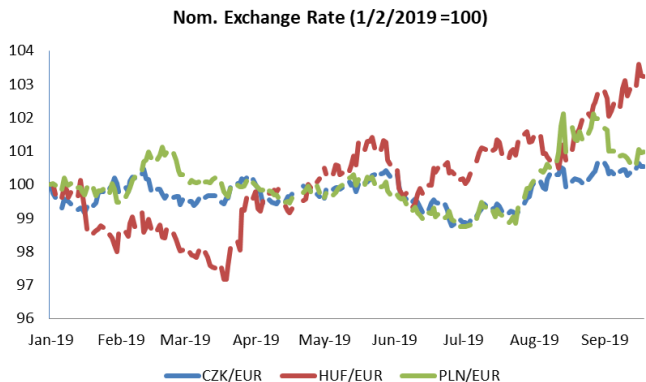
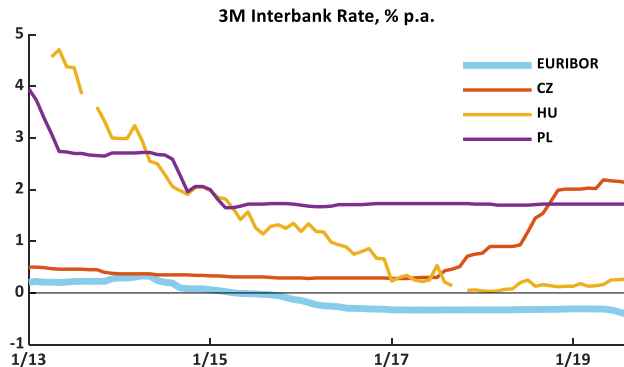


ECB – YoY Inflation (%)



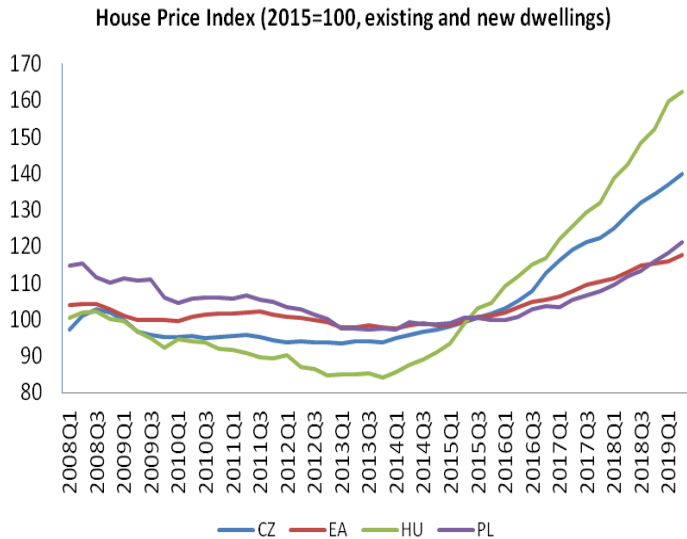
- **Inflation** (in CZ) is above or close to the target in the non-euro countries
- Low and decelerating inflation in the **euro area** has led to the ECB's recent response

Inflation trends differ from the EA (currently seen as an advantage, but potential challenge after losing independent monetary policy)



- **Positive interest rate differential** vis-à-vis the euro area
- **Normalization** of monetary policy in CZ after the exit from the CNB's exchange rate commitment
- Relatively stable nominal exchange rates, but some **regional co-movement**, CZK and PLN in particular
 - In general, CZK/EUR serve as a shock absorber

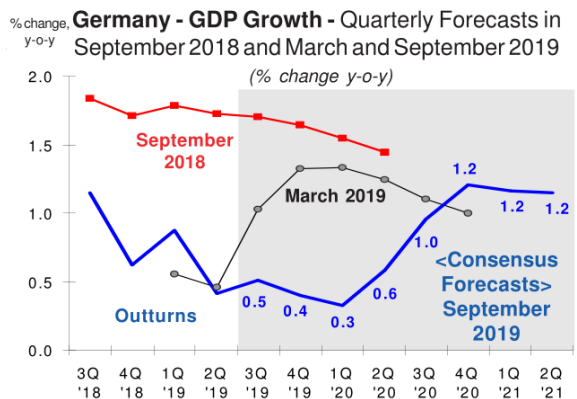
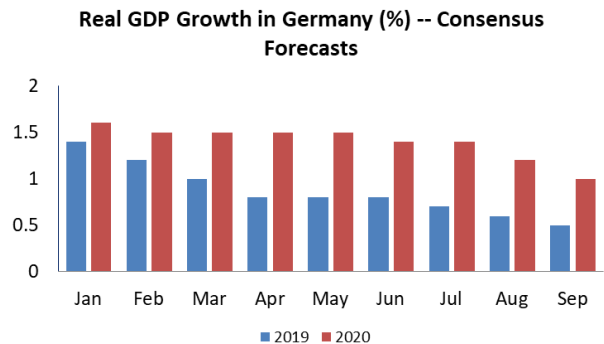
The region seems to benefit from autonomous monetary policy



Source: Eurostat, ECB

- **Housing price developments** in CZ and HU differ from the EA
 - Why are they more similar in PL?
- Even though it is not the task of monetary policy to control housing prices, **euro adoption may have side effects** in terms of fuelling the boom-bust cycle in residential real estate market
 - Via lower real interest rates (but possibly also other channels)

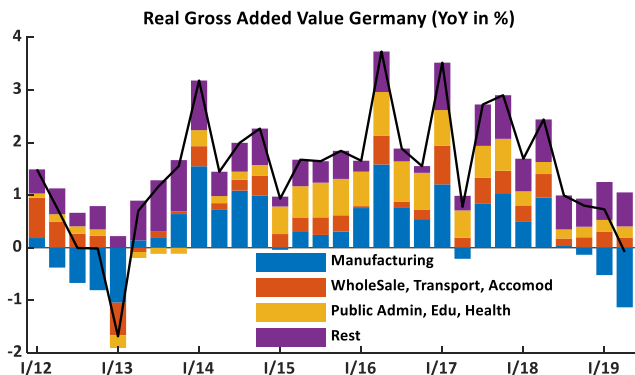
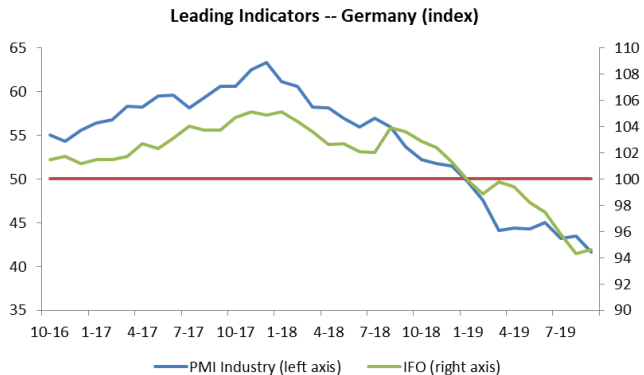
Stronger macro-prudential mandates may be needed to offset the future loss of monetary sovereignty



Source: Consensus Forecast

- Consensus Forecast (CF) has gradually **revised down** the euro area outlook, for Germany in particular
- Based on the September CF, analysts seem to believe that the **slowdown in Germany is temporary**
- **Financial markets** seem to be **more sceptical** in this regard

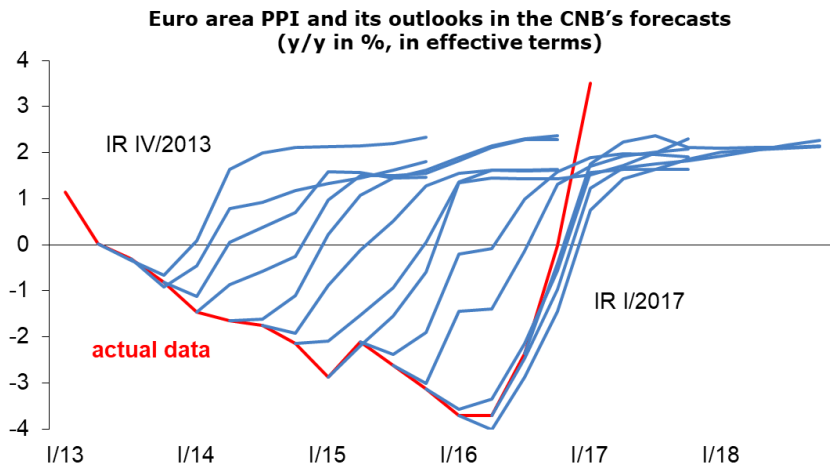
Will the slowdown in Germany be only short-lived? This is a key issue for the CNB's current monetary policy...



Source: Datastream and Eurostat

- Leading indicators in September – PMI and IFO – suggest that the **slowdown will continue this year**
- The contribution of **manufacturing** to real growth is **negative**
 - The car industry is contributing to the decline in manufacturing
- Risks: Brexit, trade wars, car industry developments

Are these adverse risks building up or receding?



Source: CNB

- **Past experience with EA PPI** outlook revisions in 2013–2016
- **External deflationary pressures** proved to be much stronger and more persistent than originally assumed

Any risks of repeating the same experience?

- Strong trade links and business cycle synchronization with the EA traditionally speak in favour of euro adoption.
- At the same time, they imply that the CEE is unlikely to stay immune from the “German malaise” if it continues.
- CEE region benefits from autonomous monetary policy due to:
 - Unfinished catching up process;
 - Differences in inflation developments compared to EA;
 - More pronounced growth in residential real estate prices;
 - Prevailing shock-absorbing role of nominal exchange rates.
- The CNB has managed to normalize its monetary policy.
- Our debate now focuses on domestic inflationary factors versus external risks. The CNB is thus unlikely to follow the ECB’s recent easing in the near term.



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