Power of (Temporarily) Aligned Policies:

Lessons from the Covid Shock

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CNB Board Member

New Monetary Policy Era for Emerging Markets

Central Banking in a Post-covid Economic World

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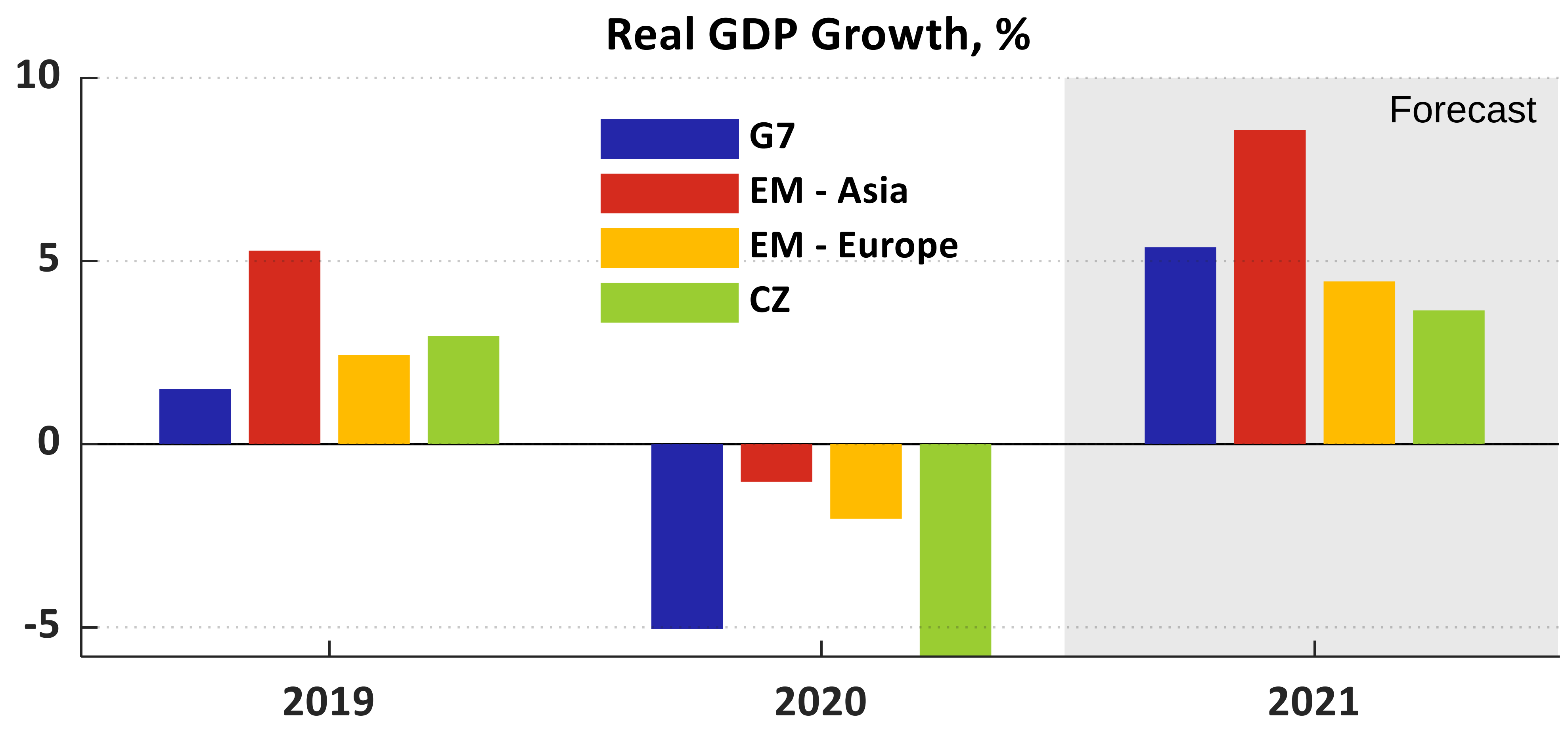
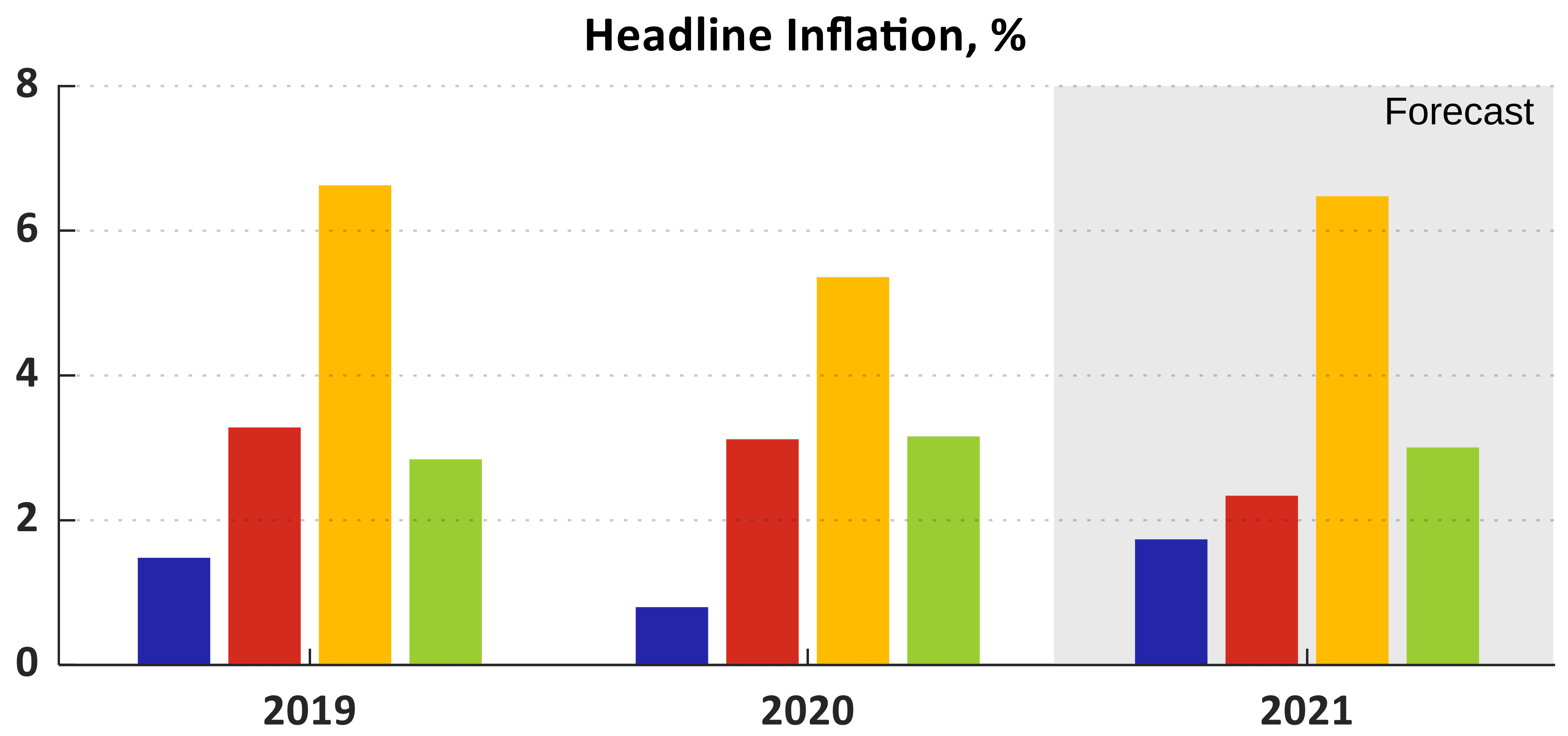
Ongoing fast recovery

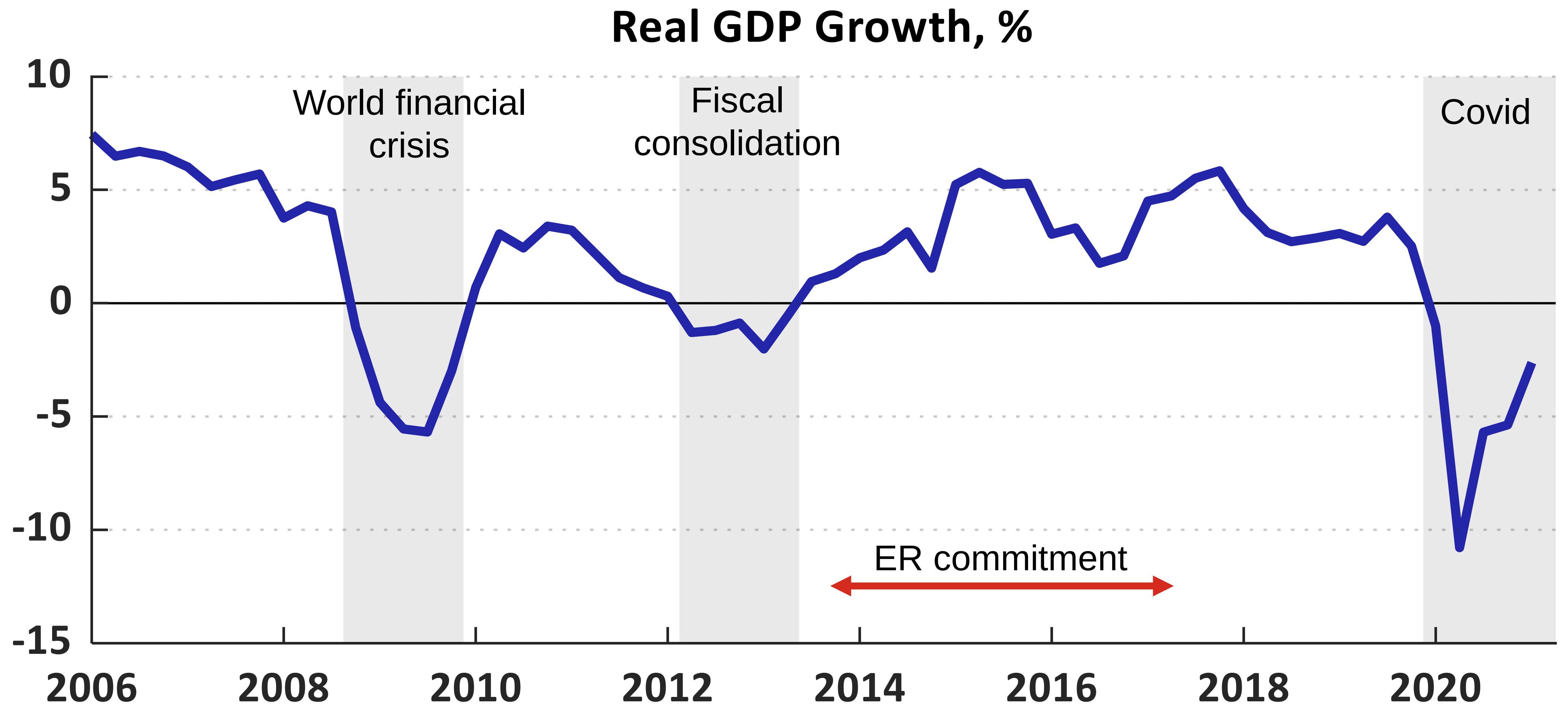


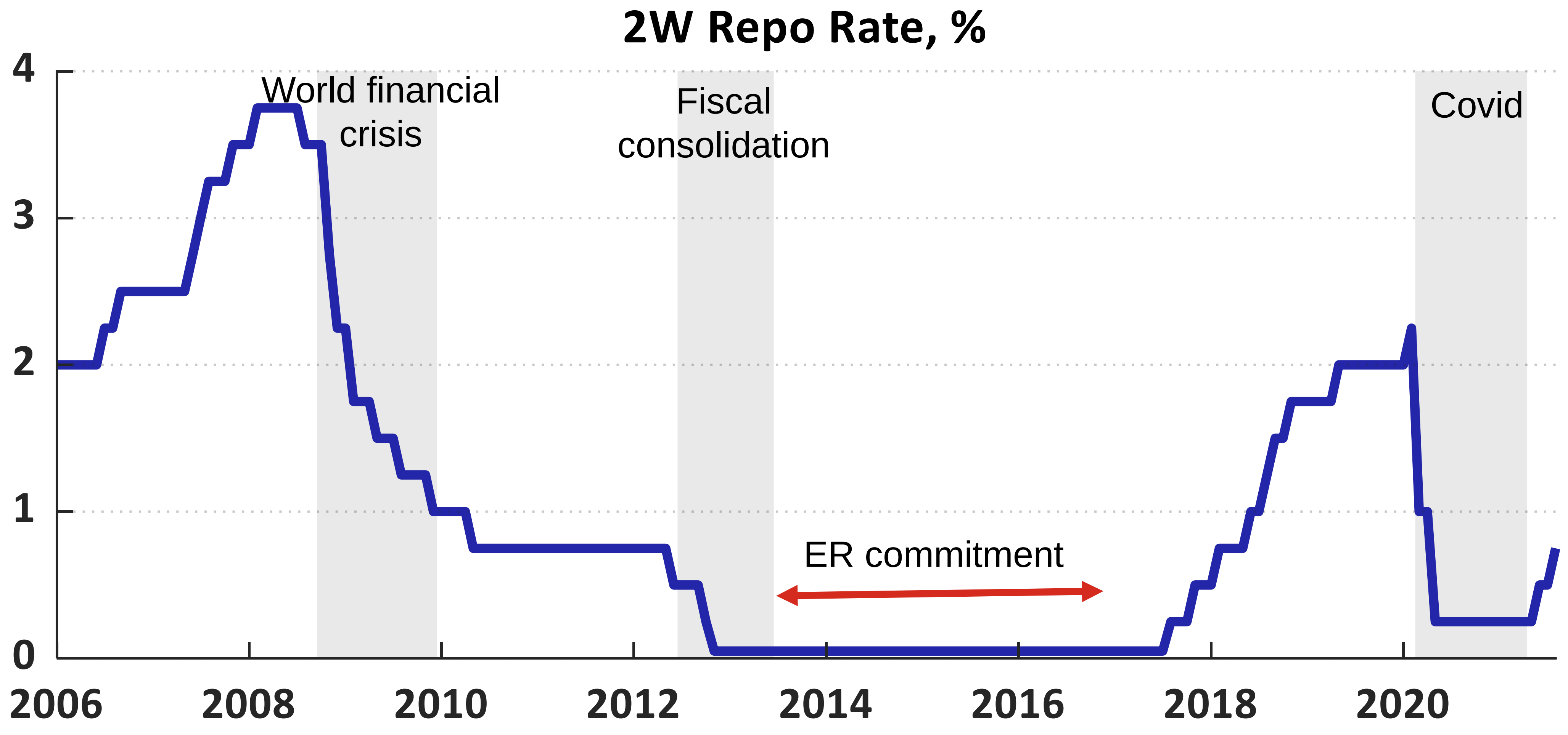


Source: G7, EM – Asia, and EM – Europe: April 2021 WEO forecast
CZ: CNB

- Lockdowns and Covid-related restrictions brought a deep and wide-spread recession.
- However, the recovery is fast and inflationary so far …
- … enabled by prompt and strong monetary and fiscal policy accommodation on the back of vaccination and adaptation of economic processes (however, with major bottlenecks in the global supplier chains).
- **What has been the role of monetary and fiscal policy actions in triggering the recovery?**

Monetary policy accommodation – Czech case





Source: CNB

- Since the adoption of IT regime, three recessions have taken place, triggered by: global financial crisis, domestic fiscal consolidation in the context of EA sovereign debt crisis (2010-2013), and Covid.
- Measured by the drop in GDP, the Covid recession has been the deepest one, while the recession stemming from the fiscal consolidation was the mildest.
- However, only the mildest recession (triggered by the fiscal consolidation) **required to resort to unconventional measures – ER commitment** – in the Czech Republic (unlike in the EA).

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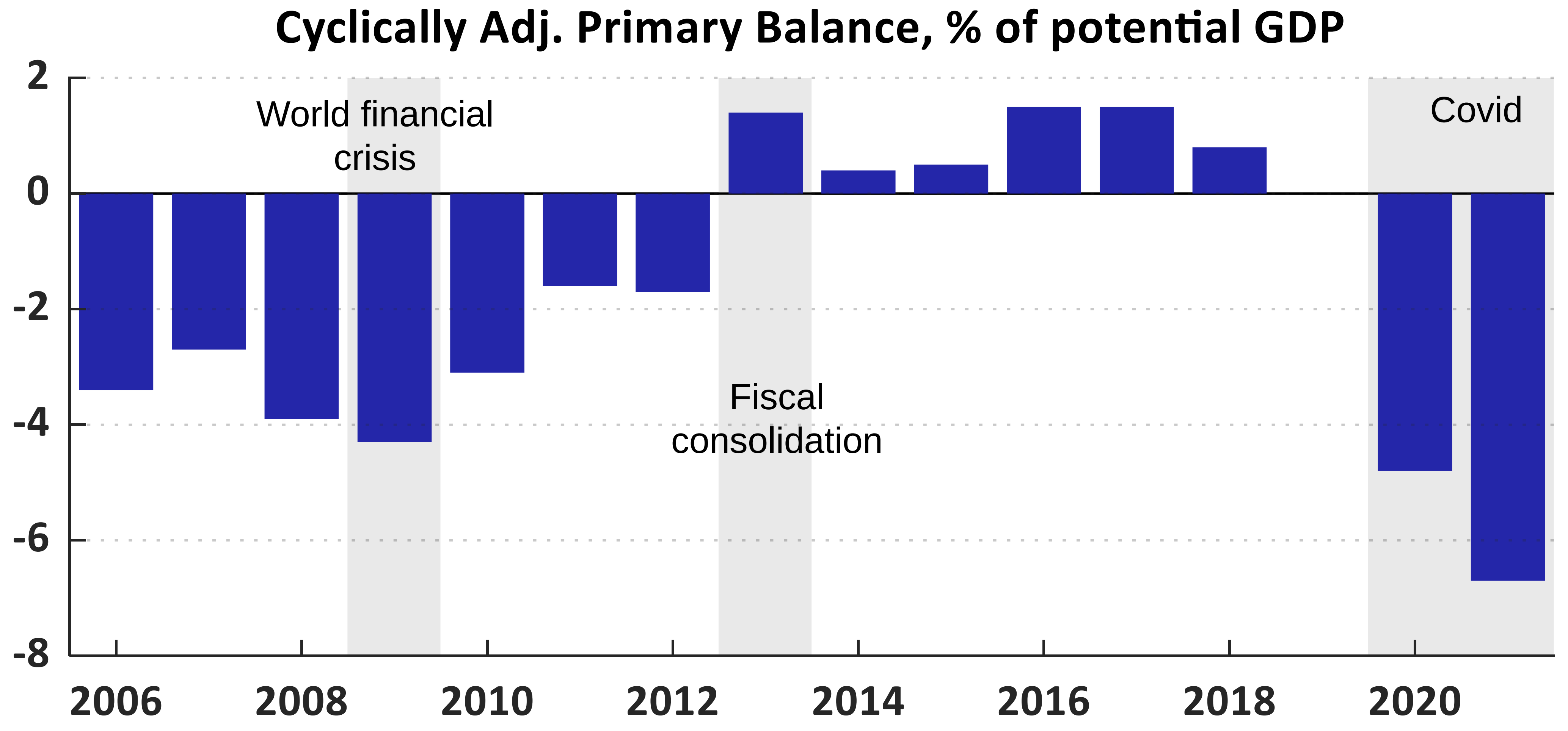
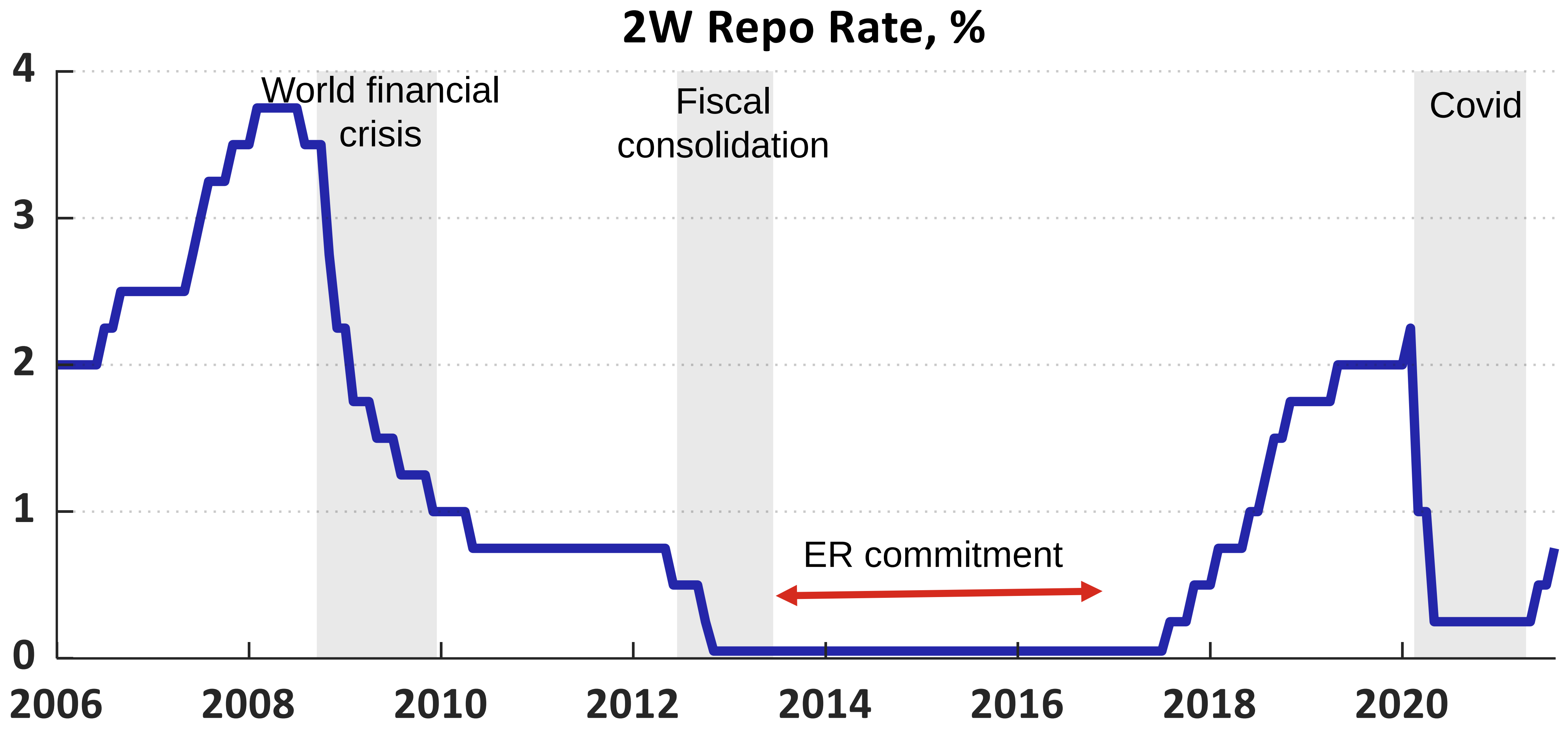
Power of aligned policies – Czech case



Source: IMF Fiscal Monitor



Source: CNB

Fiscal consolidation 2010-2013

- Introduced in time of already limited space for an interest rate response.
- Strong fiscal restriction and subsequent real economic decline brought risk of deflation.
- **ER commitment** (Nov 2013—Apr 2017) introduced once the lower bound of the interest rate had been reached.

Covid shock

- Fast and even pre-emptive cuts in policy interest rate.
- Strong fiscal stimulus.
- Depreciated exchange rate of CZK.
- **Coincidence of monetary and fiscal accommodative policies has proven to be very powerful**.

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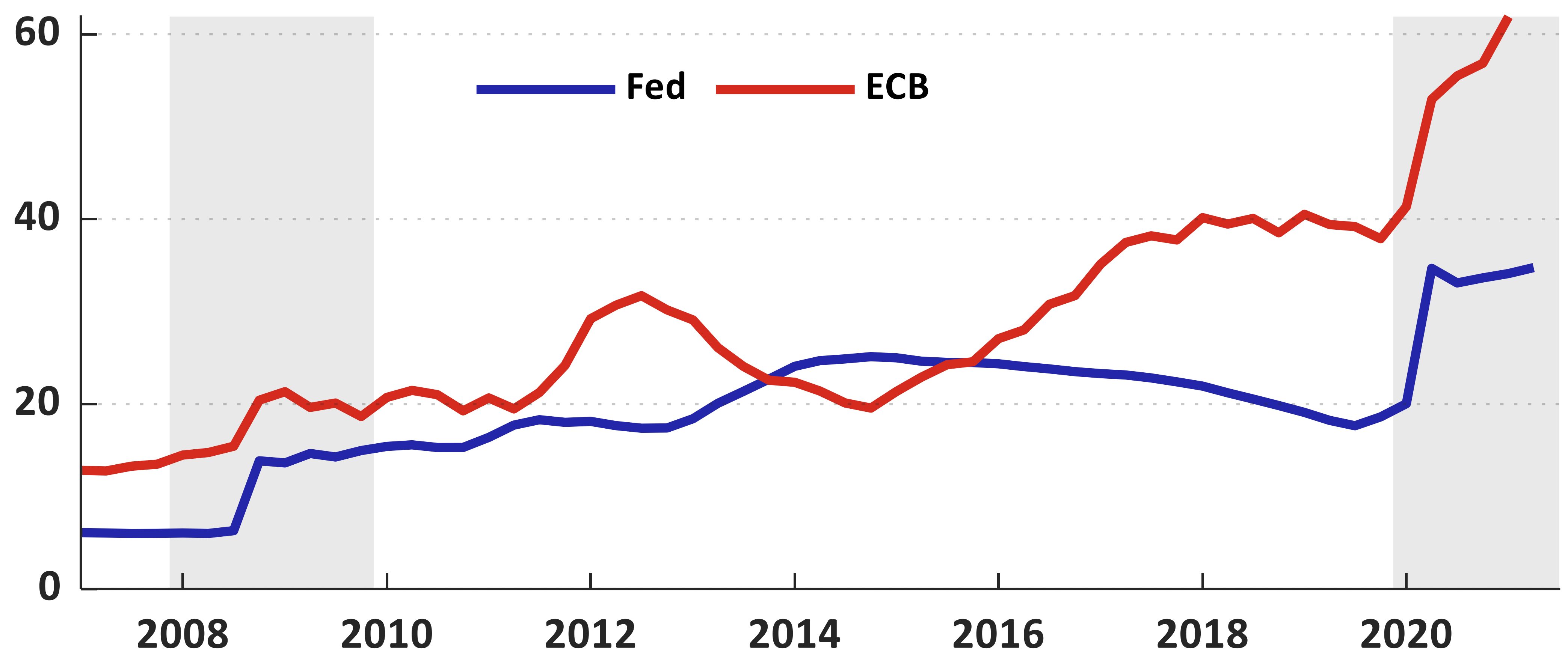
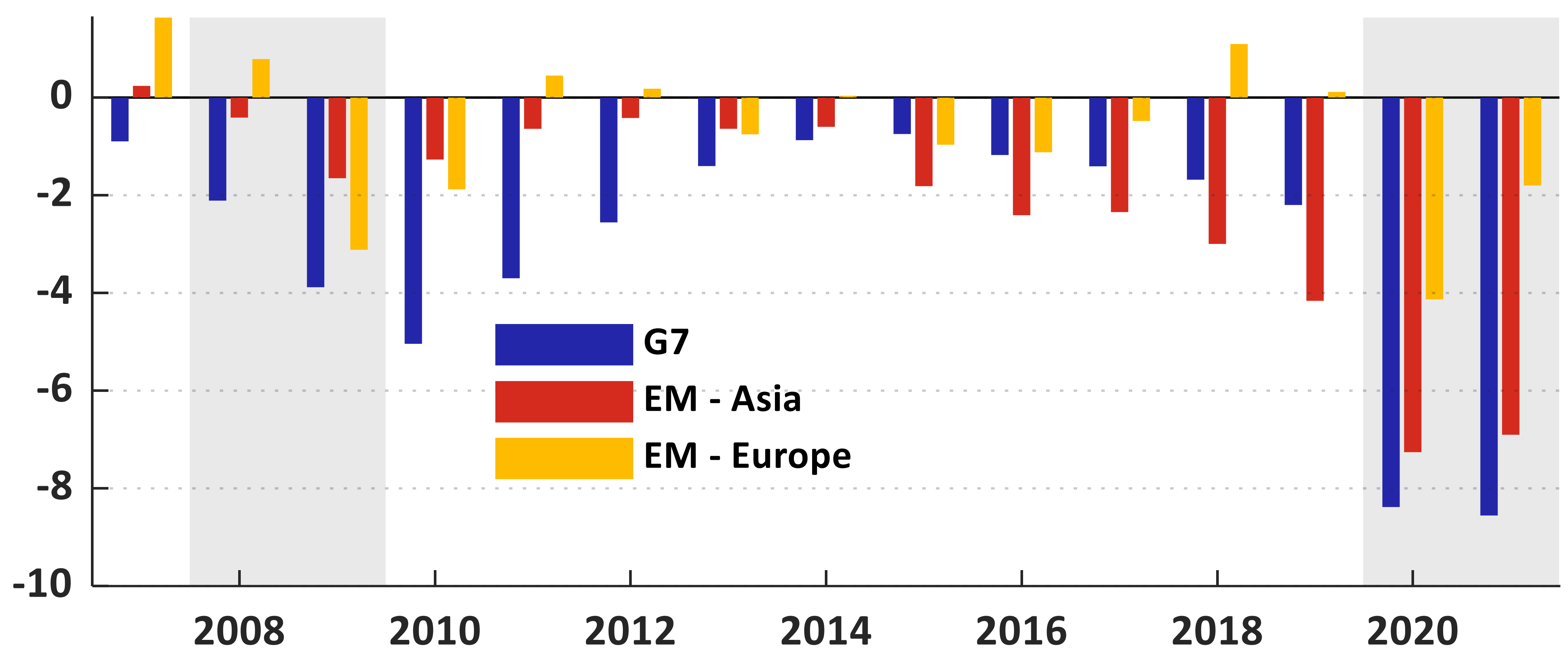
Power of aligned policies

Central Bank Assets on GDP, %



Source: Fed, ECB

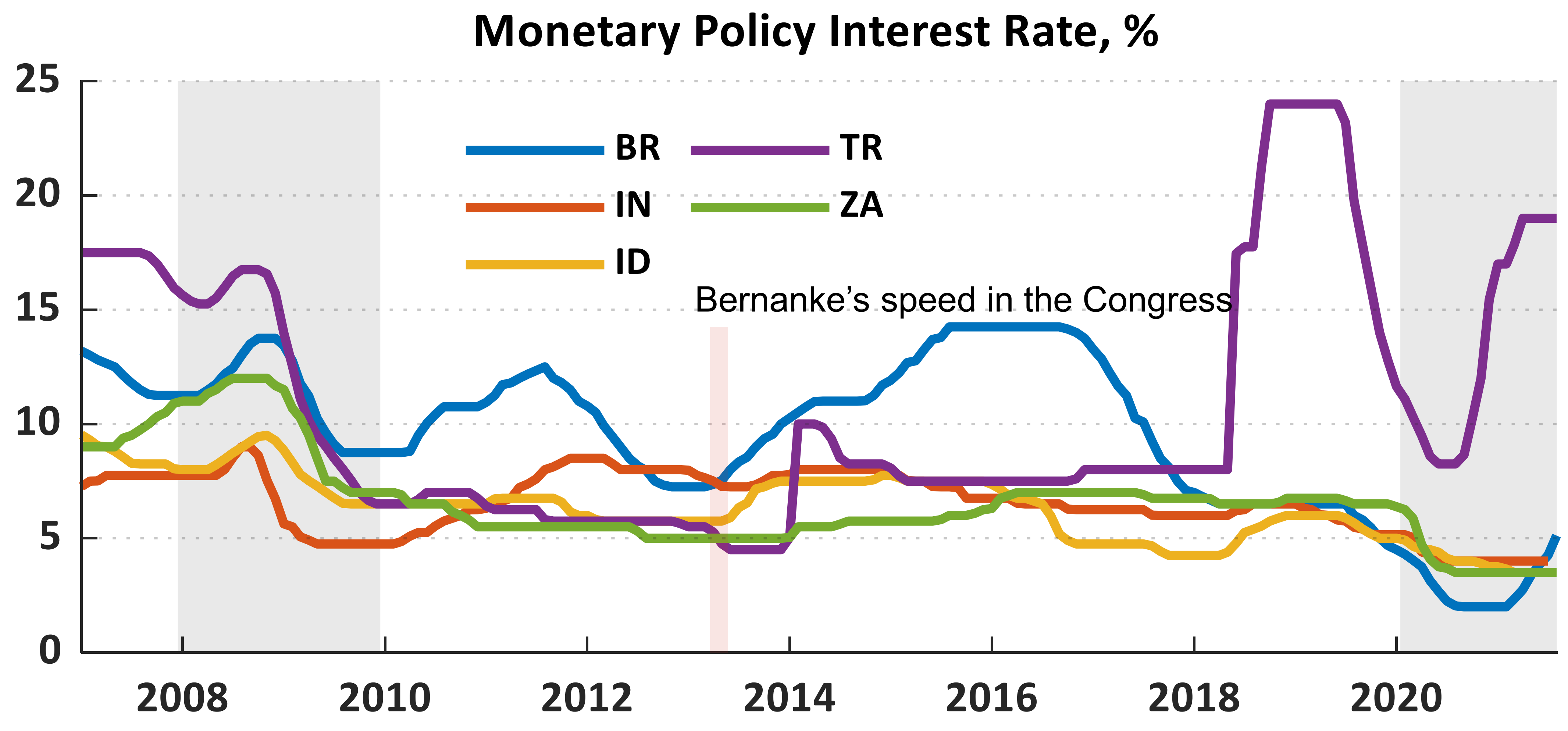
Cyclically Adj. Primary Balance, % of potential GDP

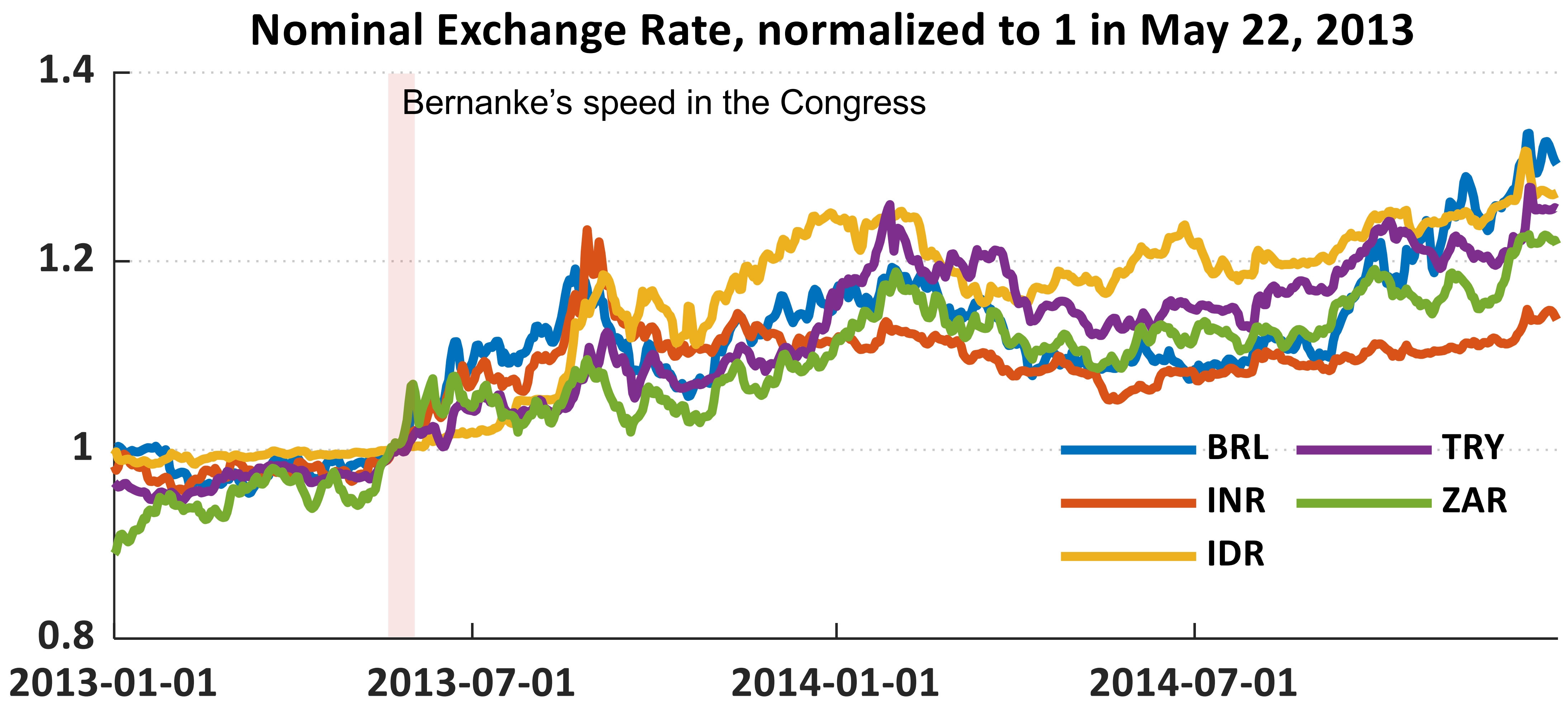


Source: IMF Fiscal Monitor

- Some advanced countries have re-introduced QE due to limited or even non-existing space for interest rate easing.
- Interest rates have reached the lowest levels since the global financial crisis in emerging markets.
- Massive fiscal stimulus – almost twice as big as during the world financial crisis.
- **Experience learned in the period of global financial crisis have unleashed prompt and large monetary and fiscal accommodation.**

Withdrawal of QEs and emerging markets





- Fed's QE has been almost twice as large as in response to the global financial crisis.
- What will asset prices do when the Fed starts tapering purchases of bonds? Another "taper tantrum" as in 2013?
- Taper tantrum in 2013 led to a massive withdrawal of capital from EM countries and to depreciation of their currencies (in the Czech Republic, this factor contributed to slower than anticipated exchange rate appreciation).

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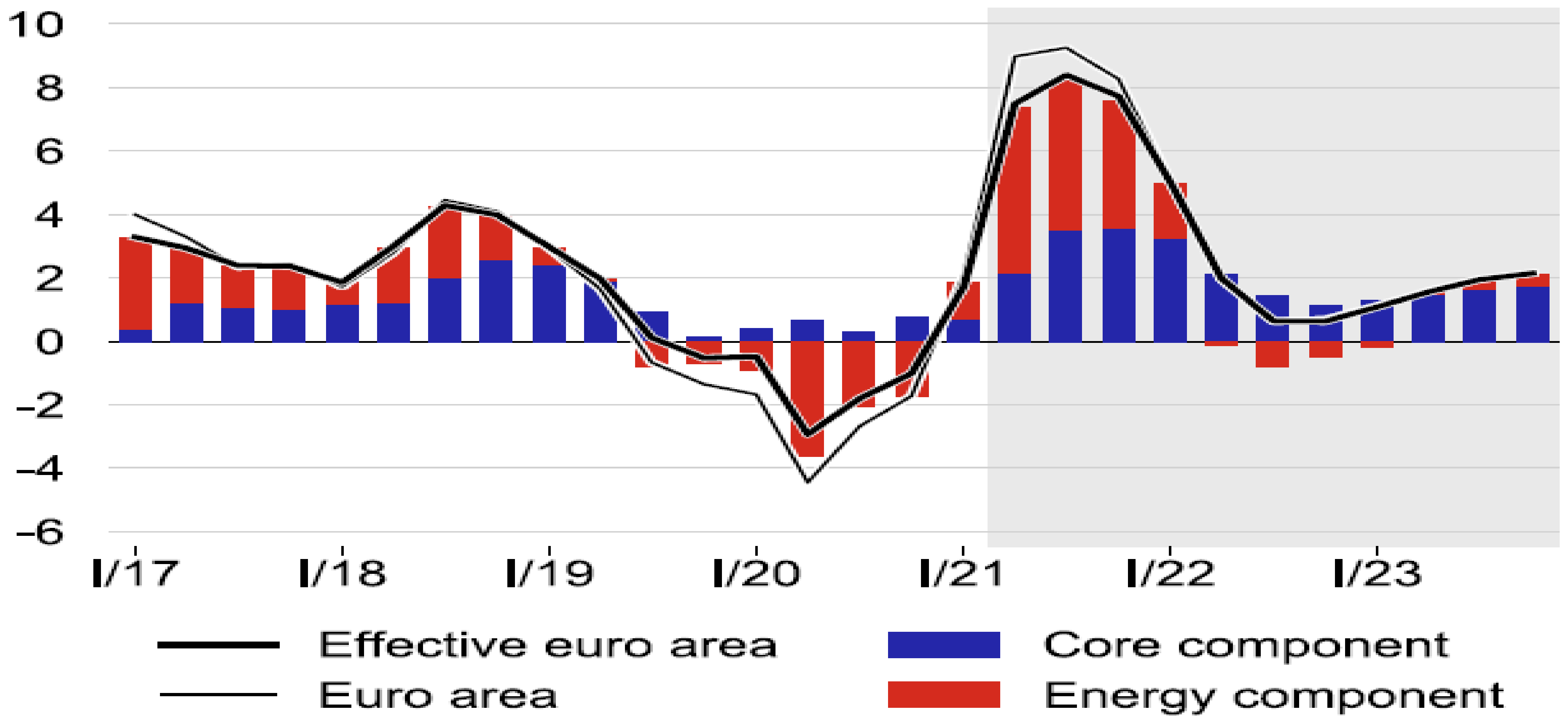
Time to De-Align (?)

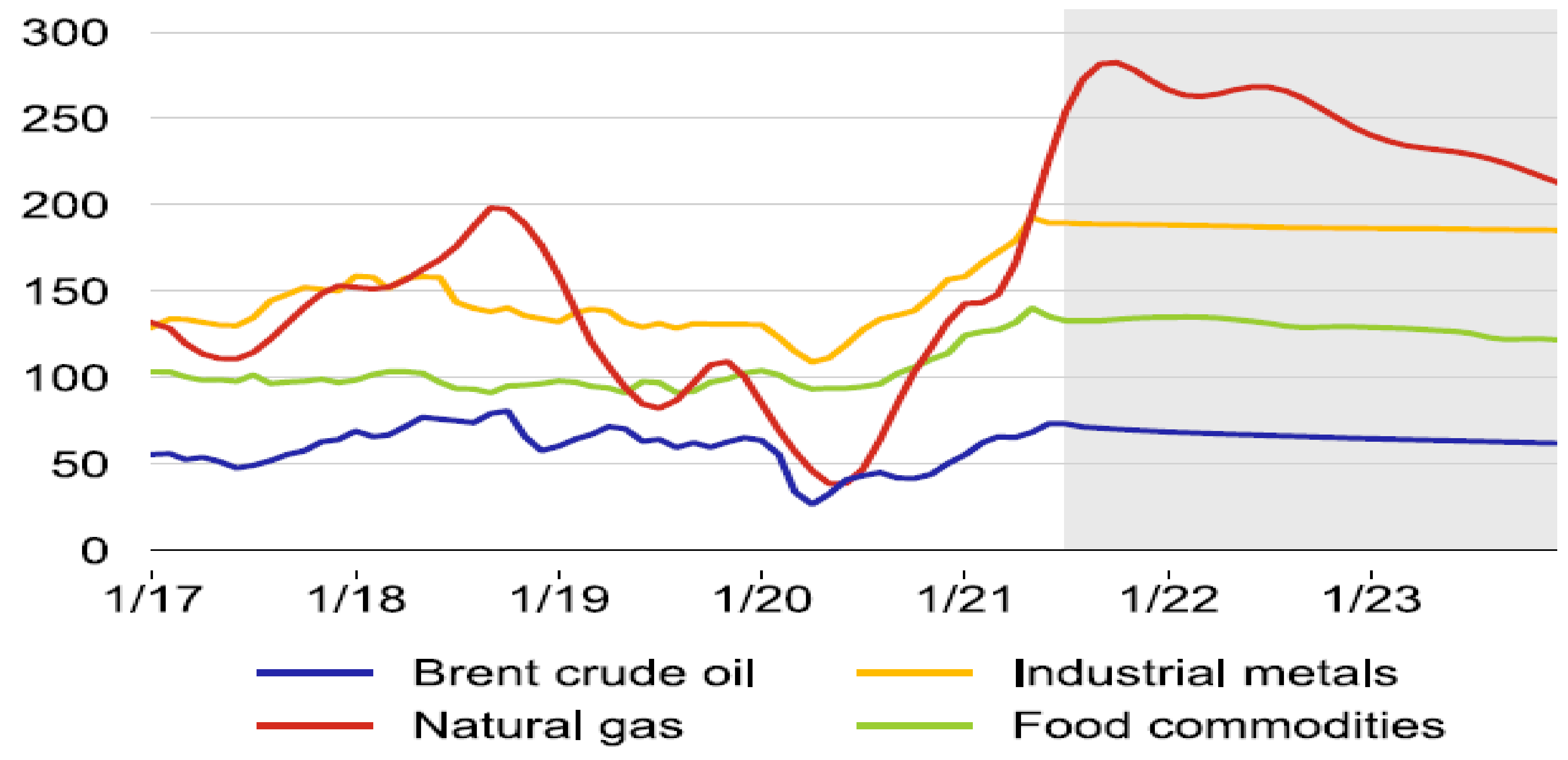
Industrial producer prices in euro area

y-o-y changes in %; contributions in pp; seasonally adjusted



Prices of crude oil and other commodities

oil in USD/barrel; other commodities: index (January 2016 = 100); average price of natural gas in Europe



- While the lessons from global financial crisis facilitated a fast and coordinated policy response, it is now time to admit that the Covid crisis has been more of a stagflationary nature.
- While many of the underlying roots of price pressures are likely temporary, there are also longer-term issues (the impact of anti-carbon policies on energy prices, de-globalisation tendencies, etc.).
- It is natural that monetary policies start to return to normal sooner than fiscal policy (concern about inflation expectations).

Thank you for your attention

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