

Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Bc. Jan Kadlec
Advisor:	doc. Mgr. Tomáš Holub Ph.D.
Title of the thesis:	Central Bank's Financial Strength and Monetary Policy

OVERALL ASSESSMENT (provided in English, Czech, or Slovak):

The objective of this thesis is to see how effectively central banks can conduct monetary policy under specific circumstances. Four hypotheses were examined on the case study of five central banks - the Czech National Bank, the Central Bank of Chile, the Bank of Jamaica, the Central Bank of Argentina and the Swiss National Bank. The thesis analysis several issues related to the monetary policy, specifically influence of central bank loss and negative equity with respect to the monetary policy, the impact of the expectations on the actual inflation and the possibility to influence the financial strength of the central bank by the change in the monetary policy. The first part of the thesis comprises the literature review and the descriptive part focusing on the monetary policy in each individual country that was chosen. The second part of the thesis is devoted to testing the main hypotheses.

The author picked an actual topic of monetary policy for his thesis specifically the thesis is devoted to the operation of the central bank with loss or even with negative equity which is still widely discussed issue. The thesis is of descriptive and comparative nature. On one hand, what I like on the thesis was the descriptive part regarding the monetary policy from the current and historical perspective for each chosen country. On the other hand, I found the literature review rather short (approx. 1 page per hypothesis), the analytical tools to test the hypotheses are either relatively simple or those more sophisticated methods might be described more in details with direct references to the existing literature.

Specifically, with respect to the analytical parts of individual hypothesis:

- 1) Construction of the indicator "inflation targeting success rate" (ITS) used for testing the hypothesis 1:
 - a. To test the hypothesis 1 regarding monetary policy of the central bank which operate with loss, the indicator "inflation targeting success rate" (ITS) is used. Any potential caveats of this simple indicator are not discussed in the thesis at all. E.g. the indicator might be influenced by the higher inflation volatility in countries with higher inflation target (or bands), which might influence the central bank's ability to target inflation within bands and thus influence the total ITS score.
 - b. The indicator ITS has in numerator the symbol for the sum which shows that something should be summed via the index "i". However, I do not see any variable with the sign "i" in the numerator, so it is not clear what should be actually summed.
 - c. The results are based on the comparison of two groups, each with five central banks, hence the results might suffer to some extent from selection bias.
- 2) Vector autoregressive model (VAR) used for testing the hypothesis 2:
 - a. The construction of the VAR is not fully explained. Why the author uses VAR with one lag? I have not found any test regarding the optimal number of lags for the VAR model in the thesis. Why the author uses within the VAR model the exchange rate CZK/USD instead of CZK/EUR as the euro is still more relevant for the Czech economy than USD?
 - b. There are no considerations regarding inclusion of potentially relevant control variables in the thesis. E.g. control variables representing the phase of the economic cycle like output gap.
- 3) Simple correlation between seigniorage and inflation is used to test the hypothesis 3. This simple relation might suffer from omitted variable bias as there are other potential factors influencing the inflation, hence testing the hypothesis should not be based just on the simple correlation measure.

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- 4) "Testing" the hypothesis 4 is based on a discussion. Here I would appreciate more structure in the text (the relevant chapter 4.4 has approx. 5 pages and only 3 paragraphs) and more citations in the text with respect to statements like:
- "The public and government react differently to the negative equity in the time of crisis."
 - "Politicians and other subject in the market still tend to usually explain weak finances as the signal of corrupted CB's policy. This could lead into self-fulfilling prophecies."

The results in the chapter 4.2 are quite surprising while they show that the inflation expectation negatively influence the inflation based on data for the Czech Republic. Here I would expect deeper discussion on the results (than just one paragraph on pp. 72), specifically discussion connected to the empirical results in relevant literature. Do other studies come to the same result as this thesis? What implications have the author's results for the inflation targeting regime? **I would recommend discussing the author's results and the empirical results in the relevant literature during the defense.**

In the case of successful defense, I suggest to evaluate the thesis with grade 3 ("good").

SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY	POINTS
<i>Literature</i> (max. 20 points)	10
<i>Methods</i> (max. 30 points)	15
<i>Contribution</i> (max. 30 points)	15
<i>Manuscript Form</i> (max. 20 points)	10
TOTAL POINTS (max. 100 points)	50
GRADE (1 – 2 – 3 – 4)	3

NAME OF THE REFEREE: PhDr. Jitka Lešánovská

DATE OF EVALUATION: 15.6.2015

Referee Signature

EXPLANATION OF CATEGORIES AND SCALE:

LITERATURE REVIEW: *The thesis demonstrates author's full understanding and command of recent literature. The author quotes relevant literature in a proper way.*

Strong Average Weak
20 10 0

METHODS: *The tools used are relevant to the research question being investigated, and adequate to the author's level of studies. The thesis topic is comprehensively analyzed.*

Strong Average Weak
30 15 0

CONTRIBUTION: *The author presents original ideas on the topic demonstrating critical thinking and ability to draw conclusions based on the knowledge of relevant theory and empirics. There is a distinct value added of the thesis.*

Strong Average Weak
30 15 0

MANUSCRIPT FORM: *The thesis is well structured. The student uses appropriate language and style, including academic format for graphs and tables. The text effectively refers to graphs and tables and disposes with a complete bibliography.*

Strong Average Weak
20 10 0

Overall grading:

TOTAL POINTS	GRADE		
81 – 100	1	= excellent	= výborně
61 – 80	2	= good	= velmi dobře
41 – 60	3	= satisfactory	= dobře
0 – 40	4	= fail	= nedoporučuji k obhajobě