Abstract

The central bank is not able to further ease monetary conditions once it exhausts the space for managing short-term policy rate. Then it has to turn its attention to unconventional measures. The thesis provides a discussion about the suitability of different unconventional policy tools in the Czech situation while the foreign exchange (FX) interventions have proven to be the most appropriate choice. A New Keynesian small open economy DSGE model estimated for the Czech Republic is enhanced to model the FX interventions and to compare different monetary policy rules at the zero lower bound (ZLB). The thesis provides three main findings. First, the volatility of the real and nominal macroeconomic variables is magnified in the response to the domestic demand shock, the foreign financial shock and the foreign inflation shock. Second, the volatility of prices decreases significantly if the central bank adopts price-level or exchange rate targeting rule. Third, intervening to fix the nominal exchange rate on some particular target or to correct a misalignment of the real exchange rate from its fundamentals serves as a good stabilizer of prices while intervening to smooth the nominal exchange rate movements increases the overall macroeconomic volatility at the ZLB.