

# Report on Master Thesis

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

Student:	Jan Timko
Advisor:	Tomáš Holub
Title of the thesis:	<b>The Effects of Foreign Exchange Interventions in a Small Open Economy: The Case of the Czech Republic in a World Context</b>

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

This thesis analyses the effects of foreign exchange interventions / weakening of the exchange rate carried out by the Czech National Bank (CNB) in November 2013. The first part models exchange rate volatility before and after the intervention using the standard GARCH model. In the second part, the author uses a VAR model to analyse the impact of exchange rate shocks on the macroeconomic dynamics of the Czech Republic and to simulate a counter-factual scenario showing how would have the Czech economy developed without the CNB's unconventional monetary policy action.

The literature review is not too extensive, but is sufficient for the subject. Perhaps a few more empirical analyses of the exchange rate pass-through in the Czech Republic could have been added in section 5.3.

The methodology is a standard one in both parts of the thesis, but the author has manifested his ability to apply it to Czech data and draw policy-relevant conclusions. One area where I have some doubts is the form the data applied in the VAR analysis. While the domestic and foreign GDP and domestic CPI enter the model as year-on-year changes, the CZK/EUR exchange rate and global commodity prices are in levels. At the defence, the author might be asked to explain this choice, which looks a bit non-standard.

The contribution of the thesis is clear. While there has been a very lively public debate of the exchange rate depreciation carried out by the CNB, the empirical evaluation of its effects has been so far scarce and almost exclusively limited to authors affiliated with the central bank. The thesis of Jan Timko thus provides one of the first independent assessments. His conclusions are as follows? (i) the CNB's intervention resulted in a temporary volatility decrease of the exchange rate, which was several months delayed after the beginning of intervention, but the volatility increased again to pre-intervention level from August 2014; (ii) the CNB's policy measure averted deflation, which would have reached 1% in late 2014; (iii) there was no significant effect on Czech GDP (apart from a short-term boost in late-2013). Especially the last conclusion differs from the CNB's analyses suggesting that the GDP growth was boosted at least by 1 percentage point by the weaker exchange rate. It is thus important to understand what drives the economic recovery in the VAR counter-factual analysis. This is, however, a point where the thesis is not fully clear. In particular, on page 51 the author states: "In our model it is explained mainly by external variables, especially GDP growth in the Euro area which strongly influence Czech economy." But this seems to be at odds with page 44: "The last variable which is associated with GDP growth is GDP growth in Eurozone. However the size of coefficient is rather small. One unit increase of Eurozone GDP growth is associated only with 0.035 unit increase of Czech GDP growth." This is actually way below the CNB's calculations which suggest that the Czech GDP tends to move about one-to-one with the GDP growth in the (effective) euro area. This apparent inconsistency of the VAR results' interpretation could be another subject of the defence.

The structure of the thesis is logical, and it is written in decent English. Unfortunately, it contains some typos in a few important places which reduce the overall impression from the manuscript form.

Overall, **I recommend the thesis to be accepted, and** – provided that the author can address the above questions in my review at the defence satisfactorily – **to grade it with 1 ("výborně")**.

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

CATEGORY	POINTS
Literature (max. 20 points)	17
Methods (max. 30 points)	25
Contribution (max. 30 points)	28
Manuscript Form (max. 20 points)	16
<b>TOTAL POINTS</b> (max. 100 points)	<b>86</b>
<b>GRADE</b> (1 – 2 – 3 – 4)	<b>1</b>

**NAME OF THE REFEREE:** doc. Mgr. Tomáš Holub, PhD.

**DATE OF EVALUATION:** 10 August 2015



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**Referee Signature**