Report on Bachelor / Master Thesis

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

Student:	**Šestořád, Tomáš**
Advisor:	**Jaromír Baxa**
Title of the thesis:	**The Exchange Rate Pass-Through at the Zero Lower Bound The Evidence from the Czech Republic**

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

The main aim of the thesis is to empirically examine the prediction of Svensson (2000) who suggests the pass through of the exchange rate shocks to consumer prices is higher when a country reaches zero nominal interest rate which may be seen as a lower bound for the central bank's space for interest-rate-based interventions. The author uses time-varying vector autoregression with stochastic volatility to evaluate the impact of the recent exchange rate intervention by the Czech National Bank. Contrary to the expectations the author find no evidence for the higher pass through at the lower bound.

Overall, I believe the thesis analyzes an interesting and highly relevant topic (see below), but unfortunately, it is not well crafted, which severely limits its research value. My initial enthusiasm about the topic was soon reduced very mixed feelings (at best) as I encountered the problems when reading through the thesis. I believe that the author's approach is indeed rather negligent, which I find very unfortunate. Below, I list my specific objections that are mostly related to the (i) motivation of the author's original contribution, (ii) the precision in the presentation of the material, (iii) the reliability of the findings. Due to these problems I consider the thesis only moderately good.

Topic
I appreciate that the author of the thesis chooses to investigate the impact recently implemented non-conventional central bank policy measures. The fact that the measures have been recently used by the Czech National Bank suggests that the investigation is relevant for contemporary policy decisions. In addition, the fact that the measures are indeed rather unconventional implies that their effect has not been extensively investigated, which increases the interest in the author's findings. However, at the same time the focus on one specific country over one specific time period constitutes a challenge about the lack of comparable counterfactuals and the generalizability of the findings.

Presentation of the Text and Motivation
I would prefer a much softer introduction with a gradual presentation of the individual issues. The very first paragraph makes a direct jump into the topic without providing much context or motivation (Pgs 1 - 2). I suggest the very term "exchange rate pass-through" should have been defined in one of the first paragraphs and a clear motivation should be provided for why it is an important phenomenon to examine.

I would welcome a more comprehensive explanation of why reaching the zero lower bound should increase the pass-through. "These results seem to be contradictory to Svensson's model (2000) which states that the pass-through is higher at the zero lower bound." (p. 8).

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Contribution

It is not clear to me what is the incremental contribution of the thesis relative to Jašová et al. (2016) "More recently, Jašová et al. (2016) estimate time-varying pass-through separately for advanced and emerging economies before and after the crisis." (p. 8). And also: "The evaluation of the effectiveness of the exchange rate management on macroeconomic variables is the main contribution of this article to recent literature. Our results are similar to other empirical studies (Iwata & Wu 2006; Jašová et al. 2016; Özyurt 2016), which find only limited support for the higher pass-through at the zero lower bound." (p. 49).

In the very last paragraph the author states the following. "The identification of determinants of the pass-through is a possible extension of this paper. How important is re-exportation of the Czech export and whether the depreciation of the euro can significantly stimulated the demand for the Czech intermediates in the euro are is another option for further research." (p. 50). Well, perhaps that is exactly the analysis that would have some contribution over the existing research. Given that performing such analysis should be fairly simple I do not understand why the author did not provide it.

Methodology

Some of the methodology discussion in the section "3.1.2 Bayesian Inference" is textbook-like. The author should concentrate on the method choices he makes for the sake of the thesis.

Precision (Examples)

The author tends to be imprecise in his formulations. For example, consider the following section: "The nominal interest rate had declined in developed countries during last two decades until the zero lower bound (ZLB) was reached after the Great Recession. Since the nominal interest rate has been traditionally considered as the main instrument of monetary policy (namely under inflation targeting regime), monetary authorities lost their main tool. In this situation, central banks are not able to stimulate output by lowering the nominal interest rate when the negative shock hits the economy." (p. 4).The author does not define what he means by the term "the Great Recession". I do not think that it is a conventional term to denote the recent financial crisis after a year 2008. The central banks did not lose the interest rate will fall together as the interbank interest rate may be negative such as they are in Sweden. The central banks effort to stimulate economic growth is independent of negative shocks. I suggest the author should be more careful in the statements he makes

Sometimes the author does not provide sufficient motivation for the claims he makes. Consider for example the following statements: "Quantitative easing is used when the finance sector of the economy has insufficient amount of liquidity. Qualitative easing decreases the amount of risky assets on the market. These two tools are relevant only when the economy faces to problems on the financial markets." (p. 4). I would not say that providing liquidity is the main aim of QE. Neither would I say that EQ reduces the amount of risky assets (especially when sovereign debt is bought). Nor would I say that problems of capital markets

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(whatever the author means by it) are key to the QE decision. If the author thinks otherwise he should either support his claims with references to other work that supports his point of view or to make his argument explicit so that the reader can independently evaluate its validity.

I find the following statement highly questionable: "When the financial sector of a small open economy is in good condition, the exchange rate management and foreign interventions are only reasonable, possibilities of the unconventional monetary policy." (p. 4).

I find the following explanation imprecise. Good that are produced fully domestically with local production factors, should be affected: "The nominal depreciation influences price level and the development of real macroeconomic variables through direct and indirect effects (Savoie-Chabot & Khan 2015). The depreciation has two direct effects. Firstly, prices of finished imports are higher. Secondly, imported inputs become more expensive and production costs of domestic firms rise." (p. 5).

Well, my understanding is that the weak (rather than "high") demand is at the heart of the problems arising during a crisis. I do not think firm "have to" increase prices. "Because of high demand for domestic goods and limited sources of inputs which become more expensive, firms have to increase their prices." (p. 5).

A better explanation of the "zero" and "one" is missing. "According to a macroeconomic theory, the size of the pass-through moves between zero (none pass-through) and one (complete pass-through) (Goldberg & Knetter 1997)." (p. 7).

Are there any armies involved in these "foreign interventions"? "Iwata & Wu (2006) find that the effectiveness of foreign interventions is higher in normal times than at the zero lower bound." (p. 8).

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

CATEGORY		POINTS
Literature	*(max. 20 points)*	16
Methods	*(max. 30 points)*	26
Contribution	*(max. 30 points)*	23
Manuscript Form	*(max. 20 points)*	16
TOTAL POINTS	*(max. 100 points)*	**81**
GRADE	**(1 – 2 – 3 – 4)**	1

NAME OF THE REFEREE: Jiří Novák

DATE OF EVALUATION:　　*June 12, 2017*

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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