

Report on Bachelor / Master Thesis

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

Student:	Alexandra Katinová
Advisor:	Doc. PhDr. Tomáš Havránek, Ph.D.
Title of the thesis:	How Can the Czech National Bank Eliminate the Zero Lower Bound on Interest Rates? A Case Study

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

Please provide your assessment of each of the following four categories, summary and suggested questions for the discussion. The minimum length of the report is 300 words.

Contribution

A typical response to an average recession in industrial economies has been a cut of 5 percentage points in the main policy rate of the national central bank. Last decades, however, have witnessed a significant decrease in the natural real interest rate, globally. In consequence, policy rates hover close to zero even in countries with apparently booming economies. It is clear to most commentators that when the next recession arrives, central banks will once again need unconventional monetary policy tools. Options include quantitative easing, FX interventions, and direct support of consumption ("helicopter money"). But perhaps there is a more conventional and elegant way how to support the economy in a recession. Perhaps the lower bound on the policy rate is not a natural law but a policy choice. This notion has been put forward by several economists during the last few years, most prominently by Miles Kimball and Ken Rogoff. Alexandra Katinová takes Kimball's proposal, examines it in detail and shows how this framework can be implemented by the Czech National Bank. Step by step, she describes all the legal and operational obstacles to negative interest rates and suggests how these could be overcome. **The thesis is exceptionally careful, well written, and policy relevant.** It may serve as a template for changing the framework of Czech monetary policy when the next recession arrives. As such, it provides a unique contribution both to the research literature and economic policy.

Methods

The thesis uses both the econometric and case-study approach. First, in what I think is the first serious attempt in the literature to do so, she examines the transmission of negative policy rates (in several European countries) using the VAR framework. It should be noted that VARs are not taught during the econometrics courses of our BA program, so Alexandra had to learn all this stuff by herself. I find the application adequate, even though (as Alexandra admits) the time span of the data is short for most countries. So, we are not sure whether negative interest rates applied in Europe are really quite inefficient (given the existence of the effective lower bound at around -1% at which households would switch to cash) or whether we simply don't have enough data. But still, this examination is the best we can do, and Alexandra should be congratulated for this attempt. Second, the main part of the thesis rests on the case-study methodology, where Alexandra goes to extreme details (for example, in relation to the Czech tax code) to identify many issues that seem problematically compatible with negative interest rates. **Alexandra shows that these issues are solvable, and hence deeply negative policy rates are possible in practice.**

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Literature

So how does it work? The main problem with negative rates is that at some point, it becomes more profitable to hold cash than bank money (this point is not necessarily zero, because holding cash is generally costlier than holding e-money, one has to pay for insurance, storage, etc.). In consequence, when rates are below -1%, many people would rush to ATMs and withdraw cash. Kimball's ingenious solution (or my slightly altered implication of it) is to offer a time-variant bonus for cash withdrawal. When you withdraw money, you get more cash than what is deducted from your electronic account. Crucially, you know that **the bonus will be greater tomorrow, so you have no incentive to withdraw the money now.** Kimball shows how this scheme can ensure that holding cash and e-money achieves the same profitability and there is no opportunity for arbitrage. All these issues and related proposals are described well in the thesis. Alexandra's work with the literature is superb; I can think of no major paper on the topic that would be missing.

Manuscript form

The manuscript is typeset beautifully in LaTeX and presented with substantial care. The level of English is excellent.

Summary and suggested questions for the discussion during the defense

This is the best BA thesis I have ever supervised. Of course, it depends on the committee's assessment, but my recommendation is that **the thesis should be awarded.**

Question for defense: What is the greatest advantage of Kimball's proposal in contrast to alternatives (quantitative easing, FX interventions, direct support of consumption)?

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

CATEGORY	POINTS
Contribution (max. 30 points)	29
Methods (max. 30 points)	28
Literature (max. 20 points)	20
Manuscript Form (max. 20 points)	20
TOTAL POINTS (max. 100 points)	97
GRADE (A – B – C – D – E – F)	A*

NAME OF THE REFEREE: Doc. PhDr. Tomáš Havránek, Ph.D.

DATE OF EVALUATION: 10.5.2018


Digitally signed by Doc.
PhDr. Tomáš Havránek,
Ph.D.
Date: 2018.05.10 13:29:54
+02'00'

Referee Signature

EXPLANATION OF CATEGORIES AND SCALE:

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.*

<i>Strong</i>	<i>Average</i>	<i>Weak</i>
30	15	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.*

<i>Strong</i>	<i>Average</i>	<i>Weak</i>
30	15	0

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

<i>Strong</i>	<i>Average</i>	<i>Weak</i>
20	10	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.*

<i>Strong</i>	<i>Average</i>	<i>Weak</i>
20	10	0

Overall grading:

TOTAL	GRADE
91 – 100	A
81 - 90	B
71 - 80	C
61 – 70	D
51 – 60	E
0 – 50	F