Monetary policy in the period of deflation

The Case of the National Bank of Czechoslovakia
(1929–1934)

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• Deflationary periods in Czechoslovakia
• 1929-1934 Deflation
• Concept of deflation
• Monetary policy of the NBC
• Concept of monetary experiments and the NBC
• Conclusion
Deflationary periods in CSR

I. deflationary period of 1922-1925
- The Banking Office of the Ministry of Finance
- via forex transactions
- 1922-1923 deflationary crisis
- 1923-1925 stabilization of exchange rate of Kč (100 Kč = 2.90 – 3.03 USD)

II. deflationary period of 1929-1934
- The National Bank of Czechoslovakia
- 1929 gold exchange standard 1 Kč = 44.58 mg Au (100 Kč = 2.9629 USD)
- 1934 devaluation of Kč (1/6); 1 Kč = 37.15 mg Au
Deflation 1929–1934 I.

II. deflationary period of 1929–1934

- Decrease in production 39.8% (1933)
- Decrease in employment 24.6% (1934)
- Decrease in export 60.3% (1933)

Source: Obzor Národních hospodářských, 1937
Deflation 1929–1934 II.

- **1928–1934 fall in prices (1928 = 100)**
  - Total wholesale 32% (1933)
  - Retail 27% (1934)
  - Sensitive prices 60% (1933)
  - Cost of living (worker’s family + clerk's family) 7% (1934/1932)

Source: Zprávy Národní banky Československé, 1929-1937
Deflation 1929–1934 III.

- 1929–1934 discrepancy between agricultural and manufacture prices
- Agricultural crisis starts in 1928
- Reason: organization of industry (cartels)
- 1934 reversal of price scissors (Act No 137/1934 Coll.)

**Development of agricultural and manufactural prices in the CSR, 1929–1934**

- Index of wholesale prices (VII. 1914 = 100)
- Index of wholesale prices of foodstuffs, provisions and fodder (VII. 1914 = 100)
- Index of wholesale prices of manufacture (VII. 1914 = 100)

**Source:** Zprávy Národní banky Československé, 1929-1937
• 1929–1934 discrepancy among indices of prices (wholesale, retail, cost of living)
• Problem of advance in deflation – adjustment of wages
• Reasons:
  • profit of intermediate trade, unsuccessful decrease in other production costs than commodity prices
Deflation 1929–1934 V.

- 1929 –1934 discrepancy between the domestic and foreign price level
- CSR and USA wholesale indices in gold – difference:
  - 1929 – 1932 35%, 1933 25%
  - 1934 (devaluation) 7%
- Dynamics of deflation (1929–1933):
  - CSR 32%
  - but France 40%, Netherlands 47%

![Development of the gold index CSR and USA, 1928–1934](chart1)

Source: Zprávy Národní banky Československé, 1929-1937
Concept of deflation

- **The National Bank of Czechoslovakia**
  - Mandate by the Act of Parliament No 347/1920 Coll. – stability of currency (via exchange rate)
  - Rapid fall in prices – discussions in the bank board

- **Concept of deflation**
  - 1929-1931 deflation = reduction of money and credit in the economy
  - 1932–1934 deflation = conservative monetary policy
  - Inspiration by Germany – reduction in price of credit, price adjustment, rationalization of public administration
  - Problems of deflation (1929–1934): extent, unpredictability of calculation, delay in consumption, missing incentive to investment
  - Crown is deliberately overvalued – moral impetus to reduce costs

- **Interpretation of crisis**
  - Disparity between consumption and production, etc.
  - Reports of the Gold Delegation of the League of Nations
Monetary policy of the NBC I.

- Dealing with deflation - reduction in price of credit
  - Decrease in interest rates - considered instrument of deflation
- Credit policy - conservative approach
  - Main instrument – interest rates: discount (real bills), Lombard
  - Interest rates – follow the development of the commercial interest rates
    - Till the end of 1931 – interest rate reflects international money market
    - Since the end of 1931 – interest rate reflects only domestic financial market, controlled system of the foreign exchange

**Discount and Lombard rate of the NBC, 1929–1934**

Source: Zprávy Národní banky Československé, 1929–1937
Monetary policy of the NBC II.

- Monetary easing via credit policy
  - Organization of credit – effort to influence the behavior of financial institutions with change of the interest rates of the NBC
  - Help to financial institutions – banks and saving banks
  - Help to the state – extension of state credit (indirect)
  - Help to export companies
  - Help to agriculture

Development of quantity of money and prices in the CSR, 1928–1935

Source: Zprávy Národní banky Československé, 1929-1937
Monetary policy of the NBC III.

Development of the active side of balance of the NBC, 1928–1935

Development of the credit volume of the NBC, 1928–1935

Source: Zprávy Národní banky Československé, 1929-1937
Concept of monetary experiments and the NBC I.

- Monetary experiments – considered as protraction of crisis
- Since 1931/1932 (example of the USA) – rejection of them in the Bank Board
- Indirect
  - Open market operations (OMO)
  - Straight credit
  - Liberalization of credit (e.g. reduction of quality of collateral)
  - Cut in gold cover
- Direct
  - Suspension of gold standard
  - Devaluation
• Devaluation
  • Struggle agrarian party + Prof. Engliš
  • Considerations (1932, 1933)
  • Realization (1934)
• Concept of Karel Engliš – stabilization of price level
  • 1931-1934 ca 33% disparity in prices (domestic and foreign)
    • Ca 16% reduction in prices via deflation
    • Rest of 16% by devaluation
  • Extension of credit but only by the securities of quality (Československý reeskontní a lombardní ústav)
Concept of monetary experiments and the NBC III.

- Result of the devaluation, 1934

**Economic activity in the CSR, 1928–1935**

<table>
<thead>
<tr>
<th>Year</th>
<th>Production (Maiwald's index)</th>
<th>Consumption of raw materials</th>
<th>Employment</th>
<th>Export</th>
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</thead>
<tbody>
<tr>
<td>1929</td>
<td>100</td>
<td>80</td>
<td>90</td>
<td>70</td>
</tr>
<tr>
<td>1930</td>
<td>90</td>
<td>70</td>
<td>80</td>
<td>60</td>
</tr>
<tr>
<td>1931</td>
<td>80</td>
<td>60</td>
<td>70</td>
<td>50</td>
</tr>
<tr>
<td>1932</td>
<td>70</td>
<td>50</td>
<td>60</td>
<td>40</td>
</tr>
<tr>
<td>1933</td>
<td>60</td>
<td>40</td>
<td>50</td>
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</tr>
<tr>
<td>1934</td>
<td>50</td>
<td>30</td>
<td>40</td>
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<tr>
<td>1935</td>
<td>40</td>
<td>20</td>
<td>30</td>
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</tr>
<tr>
<td>1936</td>
<td>30</td>
<td>10</td>
<td>20</td>
<td></td>
</tr>
</tbody>
</table>

**Development of prices in the CSR, 1932–1936**

<table>
<thead>
<tr>
<th>Year</th>
<th>Index of wholesale prices (VII. 1914 = 100)</th>
<th>Cost of living of worker’s family of 5 members in Prague (VII. 1914 = 100)</th>
<th>Cost of living of cleric’s family of 4 members in Prague (VII. 1914 = 100)</th>
<th>Index of retail prices (VII. 1914 = 100)</th>
<th>Index of sensitive prices (1.9.1927 = 100) right axis</th>
</tr>
</thead>
<tbody>
<tr>
<td>1932</td>
<td>630</td>
<td>650</td>
<td>670</td>
<td>690</td>
<td>710</td>
</tr>
<tr>
<td>1933</td>
<td>650</td>
<td>670</td>
<td>690</td>
<td>710</td>
<td>730</td>
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<td>1934</td>
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<td>1935</td>
<td>690</td>
<td>710</td>
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<tr>
<td>1936</td>
<td>710</td>
<td>730</td>
<td>750</td>
<td>770</td>
<td>790</td>
</tr>
</tbody>
</table>

Source: Zprávy Národní banky Československé, 1929–1937 and Obzor národnohospodářský, 1937
Thank you for your attention

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