

Monetary policy in the period of deflation

The Case of the National Bank of Czechoslovakia

(1929–1934)

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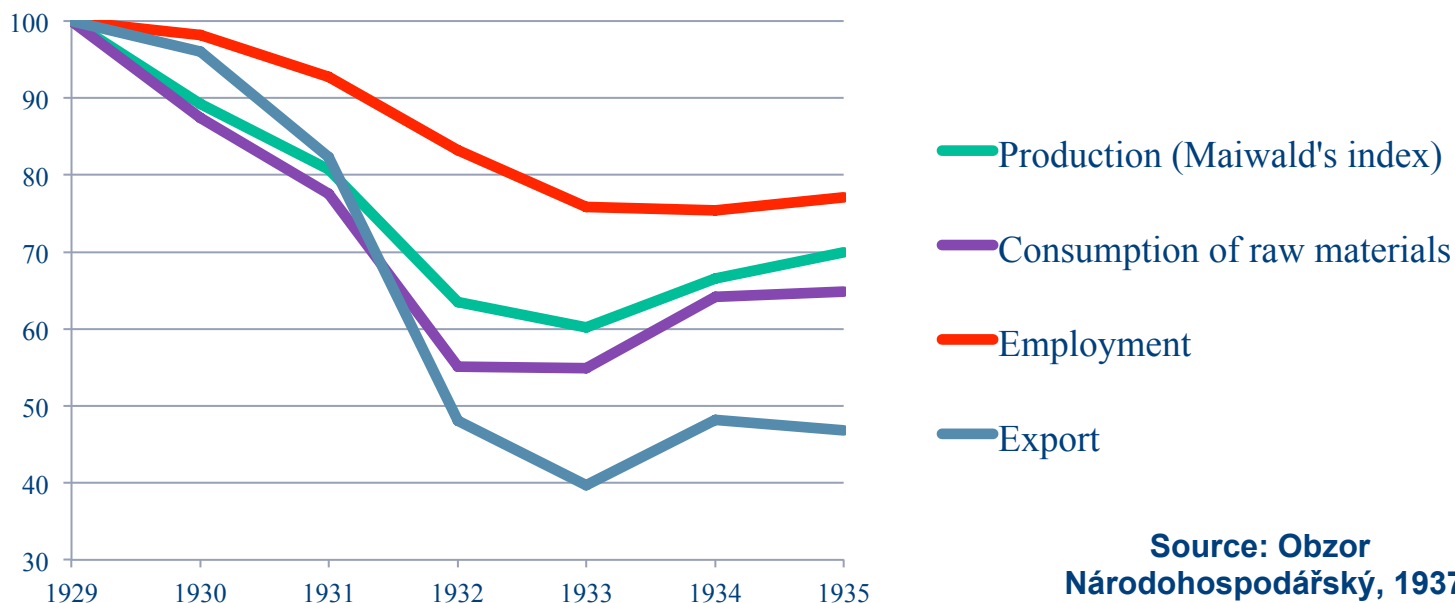
- Deflationary periods in Czechoslovakia
- 1929-1934 Deflation
- Concept of deflation
- Monetary policy of the NBC
- Concept of monetary experiments and the NBC
- Conclusion



- **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 Kc (100 Kc = 2,90 – 3,03 USD)
- **II. deflationary period of 1929-1934**
 - The National Bank of Czechoslovakia
 - 1929 gold exchange standard 1 Kc = 44,58 mg Au (100 Kc = 2,9629 USD)
 - 1934 devaluation of Kc (1/6); 1 Kc = 37,15 mg Au

- II. deflationary period of 1929–1934
 - Decrease in production 39,8% (1933)
 - Decrease in employment 24,6% (1934)
 - Decrease in export 60,3% (1933)

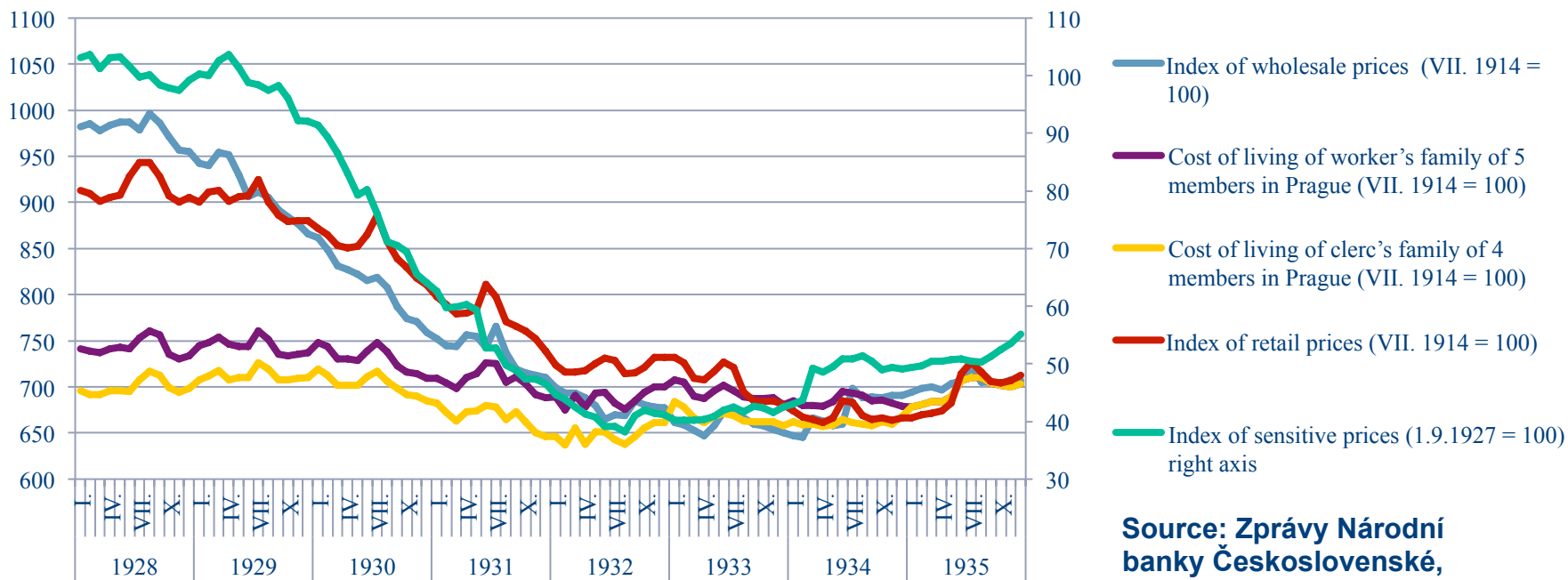
Development of Czechoslovak Economy, 1929–1934 (%)



Source: Obzor
Národohospodářský, 1937

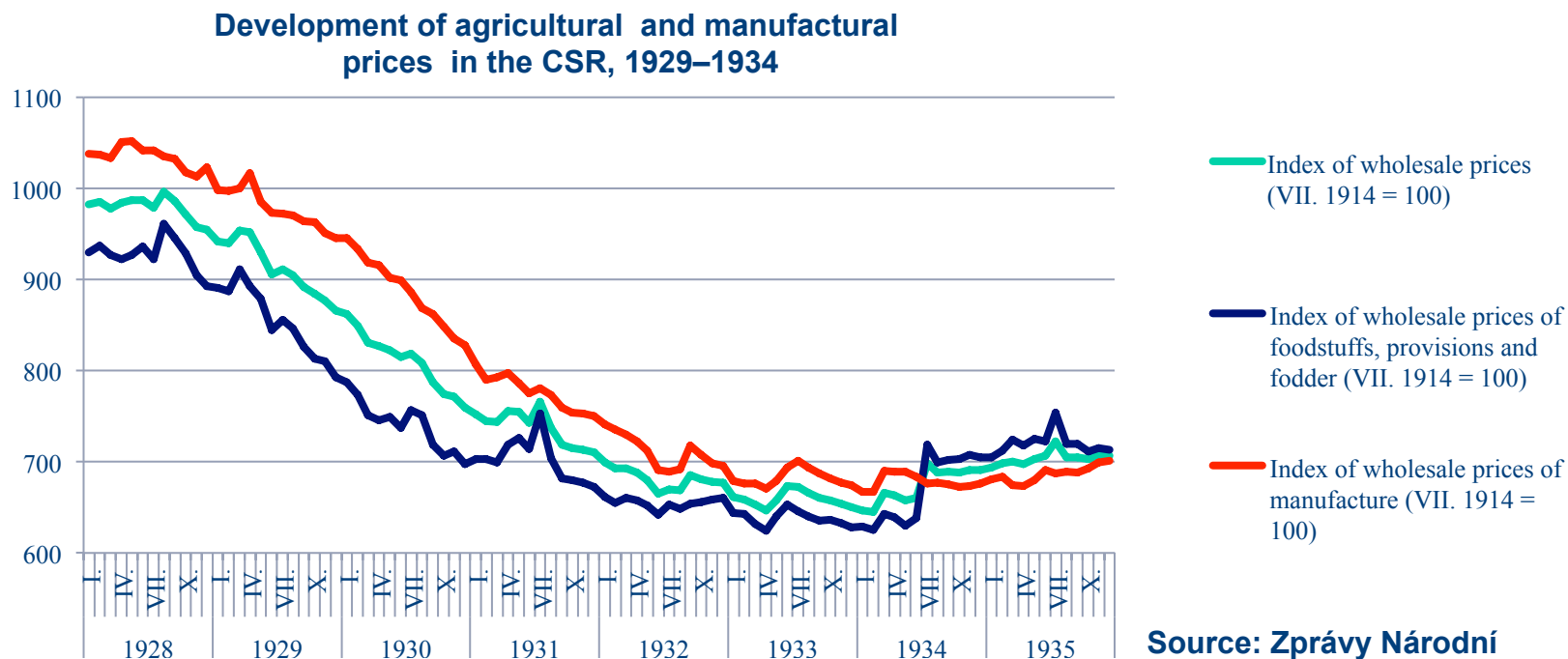
- 1928–1934 fall in prices (1928 = 100)
 - Total wholesale 32% (1933)
 - Retail 27% (1934)
 - Sensitive prices 60% (1933)
 - Cost of living (worker's family + clerk's family) 7% (1934/1932)

Development of Prices in the CSR, 1929–1934



Source: Zprávy Národní banky Československé, 1929-1937

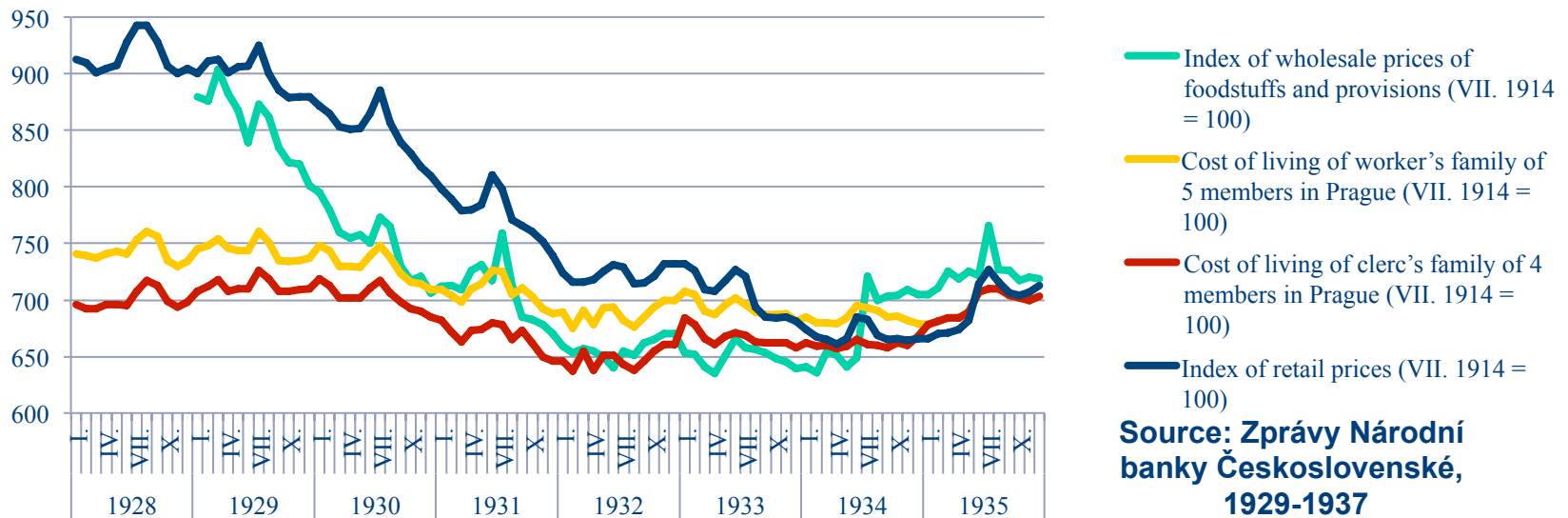
- 1929–1934 discrepancy between agricultural and manufacture prices
- Agricultural crisis starts in 1928
- Reason: organization of industry (cartels)
- 1934 reversal of price scissors (Act No 137/1934 Coll.)



Source: Zprávy Národní banky Československé, 1929-1937

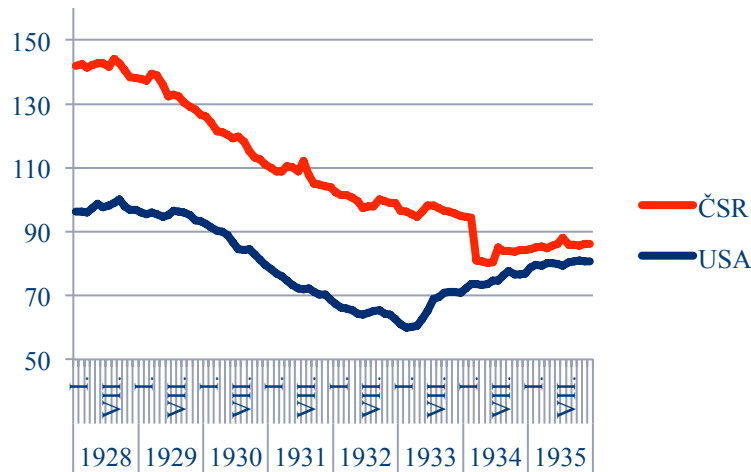
- 1929–1934 discrepancy among indices of prices (wholesale, retail, cost of living)
- Problem of advance in deflation – adjustment of wages
- Reasons:
 - profit of intermediate trade, unsuccessful decrease in other production costs than commodity prices

Development of wholesale and retail prices
in the CSR, 1929–1934

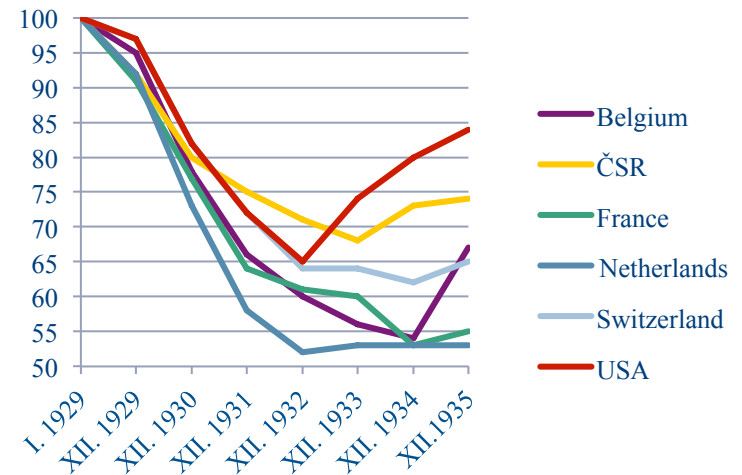


- 1929 –1934 discrepancy between the domestic and foreign price level
- CSR and USA wholesale indices in gold – difference:
 - 1929 – 1932 35%, 1933 25%
 - 1934 (devaluation) 7%
- Dynamics of deflation (1929–1933):
 - CSR 32%
 - but France 40%, Netherlands 47%

Development of the gold index
CSR and USA, 1928–1934



Dynamics of deflation,
1929–1934



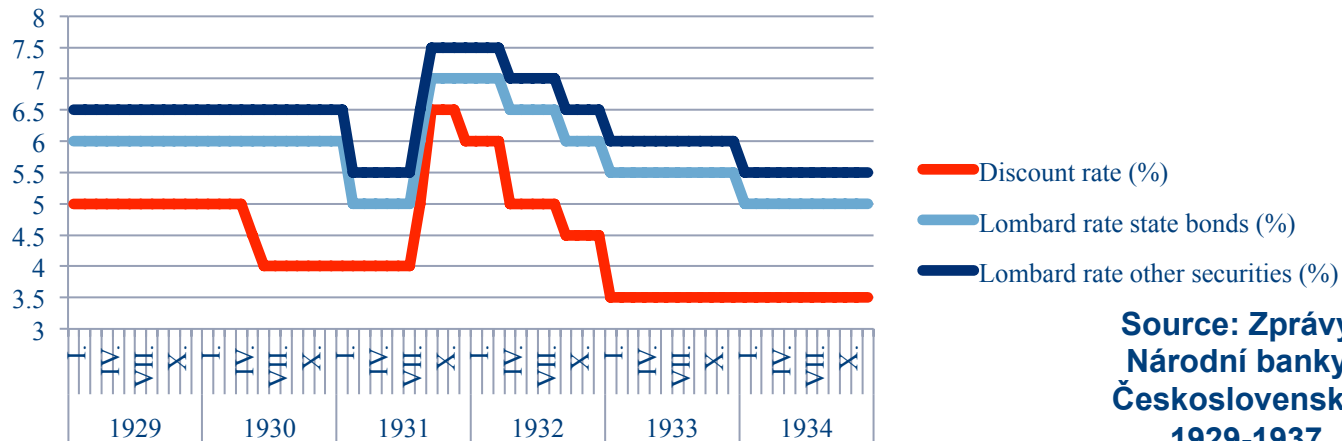
Source: Zprávy Národní
banky Československé,
1929-1937

- **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



- 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

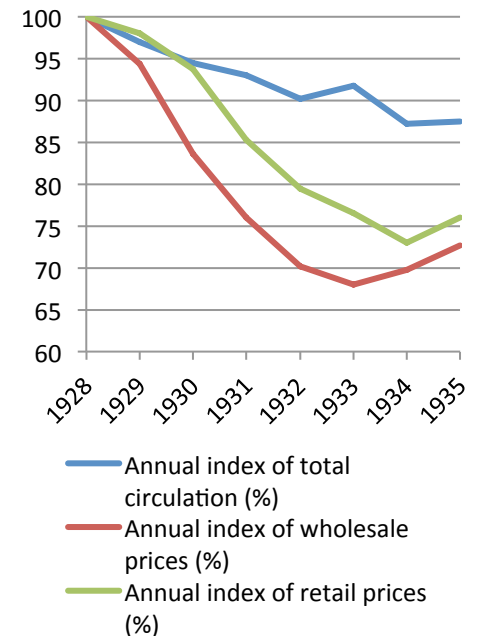
**Discount and Lombard rate of the NBC,
1929–1934**



**Source: Zprávy
Národní banky
Československé,
1929-1937**

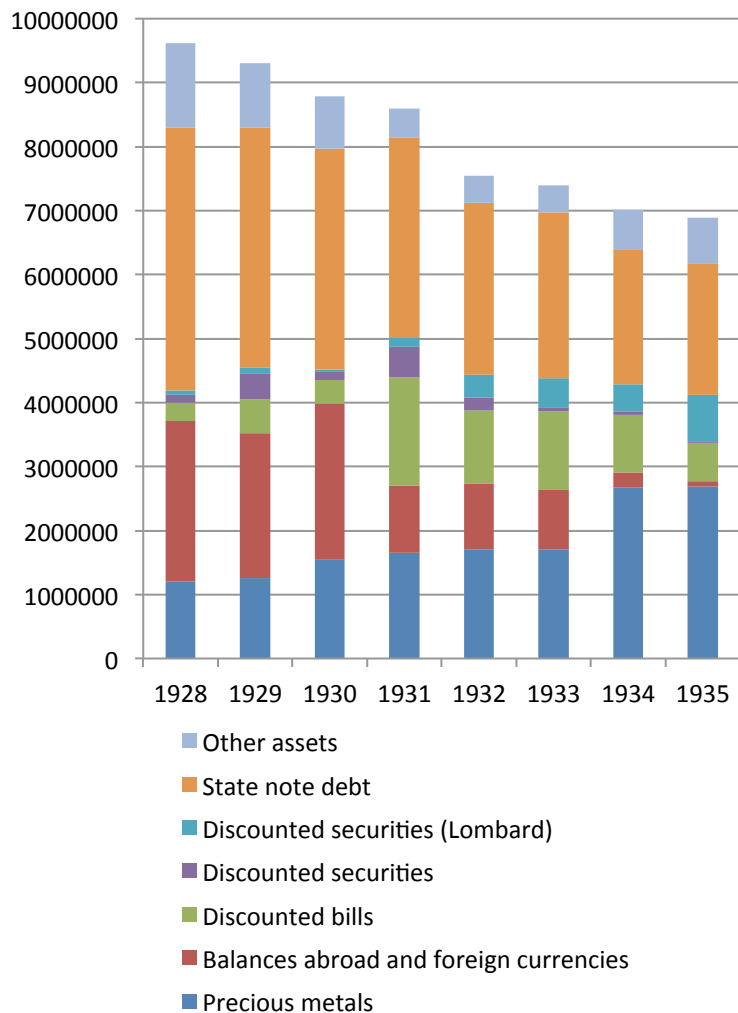
- Monetary easing via credit policy
 - Organization of credit – effort to influence the behavior of financial institutions with change of the interest rates of the NBC
 - Help to financial institutions – banks and saving banks
 - Help to the state – extension of state credit (indirect)
 - Help to export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

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

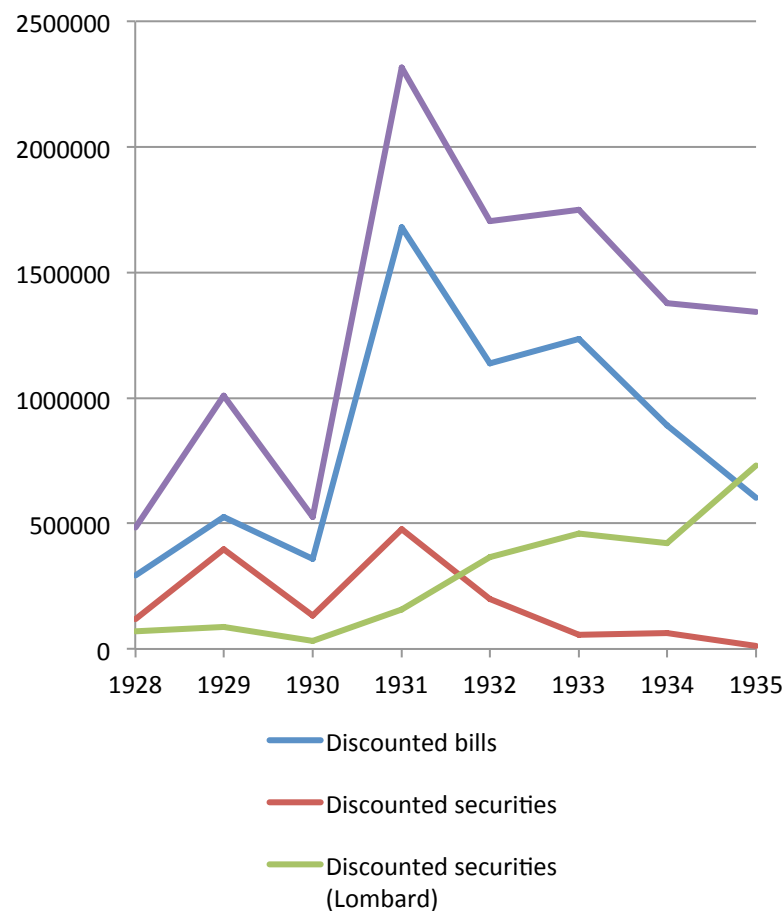


Source: Zprávy Národní banky Československé, 1929-1937

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

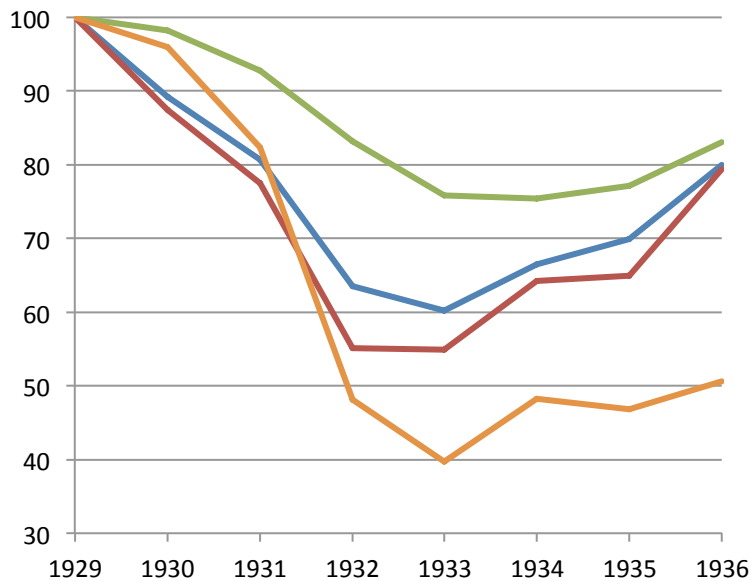
- Monetary experiments – considered as protraction of crisis
- Since 1931/1932 (example of the USA) – rejection of them in the Bank Board
- Indirect
 - Open market operations (OMO)
 - Straight credit
 - Liberalization of credit (e.g. reduction of quality of collateral)
 - Cut in gold cover
- Direct
 - 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)



- Result of the devaluation, 1934

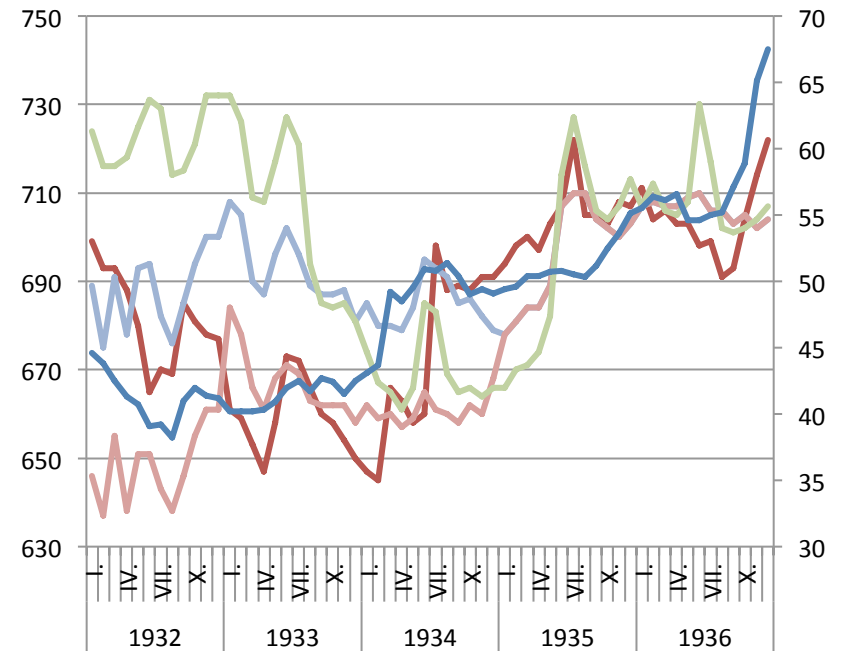
Economic activity in the CSR,
1928–1935



- Production (Maiwald's index)
- Consumption of raw materials
- Employment
- Export

Source: Zprávy Národní banky Československé, 1929–1937 and Obzor národohospodářský, 1937

Development of prices in the CSR,
1932–1936



- Index of wholesale prices (VII. 1914 = 100)
- Cost of living of worker's family of 5 members in Prague (VII. 1914 = 100)
- Cost of living of cleric's family of 4 members in Prague (VII. 1914 = 100)
- Index of retail prices (VII. 1914 = 100)
- Index of sensitive prices (1.9.1927 = 100) right axis

Thank you for your attention



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