Selected European topics and euro adoption in the Czech Republic

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Contents

I. INTRODUCTION

This is our first survey of analysts on current economic issues related to the EU and the Czech Republic's expected entry to the euro area after a long break caused by major events such as the Covid-19 pandemic and the outbreak of war in Ukraine.

The results of the survey, conducted on a relatively small set of respondents, show significant differences of opinion in the vast majority of responses, making it very difficult to pinpoint the main thrust of the arguments. However, this also indicates that analysts have no problem sharing their opinions on the given topics, even if these views are unconventional and unorthodox. This undoubtedly benefits the survey. An open critical approach can often at least provide food for thought.

We would like to express our gratitude for contributions to the survey. They are very much appreciated. However, it should be noted that the views expressed in this survey are those of the participating respondents and do not necessarily reflect the official views of the CNB.

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II. EU RISKS AND OPPORTUNITIES

What do you consider the most important challenges for the EU and how do you think they should be resolved?

According to the analysts, the main pressing problem facing the EU is naturally the war in Ukraine and the future geopolitical order. The war in Ukraine has strengthened and unified defence policy in the EU, which is now more united in its approach. However, the armed conflict has also brought huge costs, which will burden the national budgets of the Member States. It is also argued that Europe does not have the power to resolve the war and it will thus have to wait and see if Russia, which has no interest in ending the war, runs out of steam or if President Putin is ousted. The conflict has further highlighted – and accelerated – the need for structural change, especially in the area of energy.

Another issue that the EU will have to tackle as soon as possible is the energy situation. There will be the need to strengthen energy security independence. Climate policy and environmental sustainability are very much connected with this topic. Some respondents believe that efforts by the EU to achieve its environmental objectives do not take sufficient account of the EU's technological and material potential or the costs of the regulatory framework. The automotive industry is now becoming particularly risky. A change in priorities is required, i.e. economic calculation needs to return to social discussion. The measures adopted must be based to a greater extent on reality, expertise and the opportunities available, instead of relying on a high level of bias based exclusively on ideological assumptions.

We will need an economic model for the future. This will not only include the future of car production, but also the extent to which Europe should be deindustrialised or, conversely, how to return production to Europe, as the continent is heavily dependent on imports from China. This raises the question on how to deal with globalisation. Ultimately, the process of deglobalisation (or the shift of production to more reliable territories with a more expensive workforce) combined with an ageing population (and shrinking workforce) will result in lower unemployment and higher upward pressure on wages. This will inevitably create inflation pressures. And inflation is another very topical (albeit not the smallest) problem mentioned by the analysts that is facing the EU.

What will be the long-term impact of the energy crisis on economic developments?

The responses to this issue are diverse. On the one hand, it is expected to take at least until next year for the energy situation to stabilise fully. It is argued that energy markets cannot be expected to fully return to the pre-Covid situation, and therefore household and corporate behaviour patterns will change for a long time to come. The long-term effects can be both negative and positive. Even a short-term negative shock may have a positive effect in the longer term.

Energy prices will be permanently higher than in the last decade (estimated at tens of percentage points higher). One contributory factor will be developments in the price of emission allowances. It is estimated that energy prices will be two to five times higher than in the USA, leading to a loss in Europe's international competitiveness and thus slowing its economic growth. In some cases, manufacturing companies (such as glass works) will be forced to shut down. In others, firms will pass the higher costs on to their customers or to consumers. This may foster an inflation spiral. Consumers have already been forced to limit consumption as higher energy prices have curbed some of the spending on consumer goods and services, especially for the poorest households. It will take time for future wage increases to fully offset the huge impact of high inflation on the decline in the population's purchasing power.

By contrast, one positive aspect of the energy crisis will be the acceleration of structural change in the right direction, i.e. towards low-emission production. At the same time, Europe will increase its domestic self-sufficiency and reduce dependency on imports from one dominant supplier.

What is your current opinion on ESG policy and the European Green Deal?

Respondents' opinions on ESG policy, the Green Deal, are mixed, even negative. Most of the positive statements are followed by the word "but". For example, it is argued that ESG policy is sound, but there is a need to make it less superficial. The Green Deal is considered necessary, but it may be problematic for many Member States in its current form. There is also the pragmatic assessment which considers it an irreversible process that countries must embrace so as not to be left outside the mainstream. Of course, the Green Deal brings opportunities, but also risks. The European ESG policy is also considered the right approach in some respects, while in others excessively strict. Another view is that it is a remarkable initiative that increases company accountability in areas where the state has been unable or unwilling to bear such responsibility.

A neutral or slightly negative approach is that it leads to some investors changing their preferences. However, the result is often "greenwashing"[1], where the real change is small but "painted green". The respondents noted that companies are taking many steps because they feel compelled to do so. They are not motivated by their wish to be leaders in the field. The preferred approach is to do the regulatory minimum only. Sceptics among the respondents believe that efforts to address the environmental issues of the whole world (albeit in good faith and with noble objectives) have unintended consequences and give rise to a potential loss of competitiveness in the European region. We often merely deal with the effect, without looking at the cause. Shortcomings in the methodology are also highlighted. For example, in the case of electromobility, emissions arising from the production of the electricity used to fuel electric cars are not taken into account. Some measures have weaknesses which are yet to be addressed fully, such as the volatility of electricity production from renewable sources. In this case, the production cycle does not coincide with consumption and the storage of surplus electricity is not yet adequately guaranteed by the available technology. In addition, a shift towards electromobility and photovoltaics will lead to greater consumption of industrial and precious metals. No solution has been found for the disposal of related waste, which reaches new record volumes every year. A large proportion of the waste cannot be sorted and recycled. In addition, we are unlikely to completely rid ourselves of our dependence on fossil fuels and nuclear power.

Is European sovereign debt sustainable?

The responses to this issue are again mixed. Some of the respondents believe that European sovereign debt is unsustainable. This is currently only relevant for the most indebted countries. However, if there is no change, this problem could later affect virtually all Member States. After the financial crisis in around 2008, countries got used to generating huge fiscal deficits and this trend will probably only stop when the most indebted countries start going bankrupt. This could force other countries to act in a more responsible manner.

The argument against this is that the sustainability of debt is dependent on basic parameters. If interest rates remain low and nominal GDP growth is solid, the debt should be sustainable. Interest on euro area sovereign debt amounted to 4–6% of GDP in the 1990s, while in 2021, the euro area average was 1.5% of GDP. Thus, even with higher interest rates, debt can be managed but requires changes in budgetary expenditure. In addition, one respondent considers debt to be unequivocally sustainable in the case of euro area countries, as it is guaranteed by the ECB.

III. MONETARY POLICY

Did the Czech Republic benefit from having independent monetary policy when dealing with the pandemic and energy crises?

One respondent is of the opinion that the Czech economy would have been better able to deal with the pandemic and the energy crisis if it was in the euro area. If that were the case, inflation would be lower.

However, against this argument is the view that the ECB's monetary policy has its own problems. First, it flooded the markets with a huge amount of liquidity and then announced that inflation would fade quickly. It can be seen that its decision-making is inflexible and cumbersome. In addition, monetary policy should generally take into account a country's economic conditions and a single monetary policy in an economically heterogeneous grouping such as the euro area is ineffective. One respondent even considers the extent to which those in senior positions at the ECB should have an education in economics, in addition to having a proven track record.

The vast majority of respondents believe that it is better for the Czech Republic to use its own monetary policy to overcome difficult economic periods. In addition, each instrument is considered useful. According to the analysts, one of the benefits of monetary policy is the ability to manage external shocks. The weakening of the koruna certainly helped with the pandemic shock. By contrast, higher rates and a stronger koruna help dampen inflation and reduce the import of inflation pressures. Another positive impact was an earlier cooling of the property market. The stronger koruna may ease demand for pro-export firms, on which the rate hike had a smaller impact due to financing in euros. Independent monetary policy is also beneficial for the Czech Republic from the perspective of the tight labour market. Labour shortages persisted during the pandemic and energy crises, and inflation was thus significantly affected, among external factors, by strong demand, which monetary policy can regulate using interest rates.

Most of the respondents consider monetary policy useful, but some admit that its use in practice may not necessarily be entirely optimal, and indeed was often not so in the past. They mildly criticised the timing of some steps. In the last cycle,

[1] Spreading disinformation in an effort to present oneself as environmentally responsible.

for example, the tightening should have come earlier. Higher susceptibility to local political and other interest factors can also be regarded as a disadvantage of independent monetary policy over a single European monetary policy.

How long will the ECB reinvest at least part of its previously purchased maturing assets? Will the ECB also actively sell off assets from its balance sheet in the future?

The analysts are not expecting active sales of accumulated financial assets in the ECB's balance sheet in the foreseeable future. The ECB is more likely to use conventional monetary policy tools if they are effective. At least until the end of 2023, the analysts are only expecting a reduction in reinvested funds. This is based on the official information on a gradual reduction in reinvestment, with one analyst estimating an increase in the monthly reduction in the APP from the current EUR 15 billion to EUR 20–25 billion in September. In June 2024, reinvestments under the pandemic programme may also be reduced by EUR 15–20 billion. Another view is that reinvestment in the PEPP will remain unchanged until at least the end of 2024. Another respondent estimates that the ECB could even continue its reinvestment for the next 5–10 years, or even longer.

How big a constraint for the ECB's monetary policy is the debt of southern euro area countries and the related developments on their government bond markets?

The analysts clearly perceive the debt of the southern euro area countries as a monetary policy constraint, but not all of them perceive the extent of this constraint with the same intensity. However, the prevailing view is that the constraint is fundamental or significant. This is seen to some extent as being due to the strongly heterogeneous nature of the euro area, which could jeopardise its very existence. The analysts believe that the ECB is undermining the standards of independent and neutral monetary policy by covertly helping some Member States to the detriment of others through the reinvestment under PEPP. As a result, this reduces the priority of the ECB's main (inflation) target and creates "multi-targeting", i.e. a focus on inflation, euro area stability, financial stability and climate goals. There is view among the respondents that the ECB has knowingly become the largest creditor of the over-indebted southern countries and will not simply ignore potential shocks on the bond markets there. On the one hand, there is speculation that rates will not be able to remain high for long. On the other hand, the very cautious launch of quantitative tightening will compel the ECB to tighten its monetary policy through higher interest rates. However, more conciliatory assessments are also mentioned, i.e. the ECB has been historically able to partially tackle the negative impact of the large debts of southern European countries and to calm the markets, and there is the argument that this could still work today.

IV. INTEGRATION

How do you assess the common European bonds under NGEU? Is this a step towards a fiscal union? Should the EU or the euro area become a fiscal union? Why?

Again, there is no consensus among analysts on this topic. Some of the analysts regard NGEU bonds as a one-off issue and do not believe that they are strongly related to the establishment of a fiscal union. Their impact is thus considered positive, as these bonds made it possible to obtain more favourable financing than if the funds had been obtained by each country individually.

By contrast, another group of analysts view these bonds as part of the "salami method" (step-by-step method) of EU integration. Conversely, they consider them the next step towards a fiscal union, the emergence of which is a matter of political preference. However, this is yet to become a clear political priority for anyone. In addition, it would probably be rejected as a comprehensive and one-off decision, so the "salami method" is likely to continue.

The analysts have a negative view of the fiscal union itself. So far, the benefits are small relative to the vector of all costs. There are huge differences between Member States' social systems, taxation and state executives. Many countries have major unresolved issues with their pension systems, representing a huge burden for the future. It is difficult to imagine how this area would be governed by an autonomous unelected bureaucratic apparatus from Brussels. Given the high level of fragmentation of the EU in terms of public finances and country-specific challenges, a fiscal solution at the national level appears to be more effective. At the same time, however, there should be common fiscal rules which are flexible and easily enforceable.

How do you assess the Czech Presidency of the EU Council? Was it a success? Why?

Those respondents who believe that the Czech Presidency was not a success were critical of what they considered time wasted by the government which should have been devoted to combating the energy crisis in the Czech Republic. This, in their view, should also have been the government's top priority. Czech citizens obtained state supports late in the energy crisis compared to the EU average. In addition, the supports were across-the-board, which meant that poorer households received less than they could have. Some firms went bankrupt before receiving information on the conditions for obtaining state supports. Plans that will fundamentally change both the automotive industry and the availability of car transport are also negatively assessed. The Czech Republic did not use its presidency to fight against the Euro 7 standard, against which it later sought allies.

By contrast, those who assessed the Czech Presidency as being successful argued that it did not encounter any major problems and, in the circumstances, it was well handled. The Czech Republic took on the presidency during a difficult period, at a time when it was necessary to discuss the energy crisis, the war in Ukraine and climate issues. The impartial stance taken by the Czech Republic during its presidency can also be assessed as positive. This cannot be said for all the presidencies of other countries in the past. The change in public perception of the EU to "we are the EU" is also well received.

What is your view on the requirement for a country to join the banking union at the same time as entering ERM II, which was applied to Croatia and Bulgaria?

Some of the analysts are less clear on this issue. Those who have a clear opinion tend to favour the approach that entry of an EU Member State into the euro area should not be linked with its entry into the banking union. One of the respondents considers this requirement to be unfortunate and actually humiliating from the perspective of the candidate country. Joining the banking union would make more sense only after the adoption of the single European currency, which would make the conditions for all countries the same and transparent. One respondent regards this as an inappropriate effort by Brussels to gain direct influence over the banking sector and its liquidity.

How do you assess Brexit from the current perspective?

Although Brexit was decided on by the electorate and thus has to be accepted, the majority of respondents believe that Brexit did not have a positive outcome for the UK. The UK has been through a very difficult period, with the pandemic and the energy crisis coming on top of Brexit. The combined effect of these factors led to a sharp drop in GDP, the trade balance and even a fall in population. The UK had to address the problems of labour and food shortages (for example, fruit and vegetables were rationed in supermarkets). The UK is facing a mild recession this year, while the EU as a whole can avoid recession. Population sentiment is also bleak, with more than half of the British population currently negatively assessing Brexit.

However, the benefits of Brexit are also perceived. No catastrophic scenarios have materialised. The benefits are not so much economic, but political. Although the UK remains tied to the EU, a certain degree of economic autonomy may help its economy.

V. THE CZECH REPUBLIC'S ACCESSION TO THE EA

Do the economic pros of the Czech Republic joining the euro area currently outweigh the cons?

All six respondents answered this yes/no question. The data show that most respondents are leaning towards a more negative view, i.e. the economic advantages of the Czech Republic's entry to the euro area do not currently outweigh the disadvantages. This opinion is shared by four analysts, while the remaining two believe that the advantages can more than offset the related disadvantages.

What are the main pros and cons (risks) of the Czech Republic joining the euro area?

The loss of domestic autonomous monetary policy and, with this, a limited ability to respond to specific economic shocks is considered to be the main disadvantage for the Czech Republic of joining the euro area. A separate currency can also act as a buffer which partially absorbs external shocks, thereby preventing their full pass-through to the real economy. Thus, an increase in fluctuations in economic activity cannot be ruled out, at least temporarily, in the event of euro adoption. By abandoning the independent domestic currency, we also remove the possibility of faster price convergence via the exchange rate. Euro area entry also results in wealth fixation in the administratively set exchange rate forever more. In a very heterogeneous euro area, the ECB's inadequate monetary policy may also be disadvantageous for the Czech Republic. The latter would probably result in a more inflationary environment in the Czech Republic and a gradual loss of price competitiveness. Experience with euro area entry also indicates a short-term jump in inflation connected with changes in price lists or rounding. The Czech Republic's potential contribution to the European Stability Mechanism (ESM) was also mentioned as a disadvantage.

One respondent even expressed scepticism that given the condition of the Czech financial sector (the condition of banks, regulation, etc.), and the macroeconomic developments in the Czech Republic and the heterogeneous euro area over the last 10–20 years, he sees no significant nor specific benefit to adopting the euro in the Czech Republic.

On the other hand, due to the high openness of the Czech economy, some analysts believe that if the euro was adopted, we would expect to see significant savings in transaction costs for firms and households, greater transparency of pricing of tradables and hence easier price comparisons. The single currency also eliminates exchange rate fluctuations and exchange rate risk. However, this benefit is not seen as broad-based, as it applies only to some economic agents, especially exporters. It was also mentioned that euro area membership could lead to better absorption of some economic shocks as well. If we look for the benefit of the loss of independent monetary policy, we must not forget the possibility of participating in co-deciding on the euro area's monetary policy.

What does Croatia's entry into the euro area and Bulgaria's aspirations for such entry mean for the Czech Republic?

In answer to this question, the prevailing assumption is that it is not an important or a key factor from an economic and financial point of view that should have any significant effect on the Czech Republic. No tangible impact is expected. The introduction of the euro in Slovakia did not ultimately have any significant effect either. The greatest effect of Croatia's entry into the euro area may be in terms of policy and political debate.

Should the Czech Republic step up its preparations for euro adoption? What initial steps should the government take in this area?

Here, too, the analysts' views diverge completely, with wide variety of opinions on this topic – ranging from clear agreement and a recommendation to launch a public debate through gaining sufficient support for a political decision to "go for it". If this decision is reached and there is a strong resolve to introduce the euro in the Czech Republic, we will then meet the binding convergence criteria. However, regardless of its interest in joining the euro area, the Czech Republic should strive to fulfil the convergence criteria in its own interest. Thus, the Government must first decide to "go for it". And it's about time this issue was raised and discussed. After all, the spontaneous "euroisation" in the production and business sectors is undeniable. At the opposite end of the opinion spectrum, there is a distinctly negative view, complemented by the argument that the government should primarily address the budget problem and not waste time with the euro at the moment.

When do you expect the Czech Republic to join the euro area?

Opinions also differ greatly on the date of the Czech Republic's expected entry into the euro area. The most pessimistic approach is that it would be better to stay out of the euro area for at least 30 years and then reassess. Another opinion is that the chances of adopting the euro in the Czech Republic in the foreseeable future (i.e. in the next five to ten years) are minimal. This is due to the current lack of necessary political will. It will become clearer after the parliamentary elections in Poland. Poland's entry into the euro area could be the main stimulus for a similar decision in the Czech Republic. Three respondents found the courage to embark on the difficult task of estimating the year in which the Czech Republic could join the single European currency area. The arithmetic mean of these estimates is the first third of 2031.

As the chart below shows, the assumed length of time until expected euro adoption in the Czech Republic gradually increased over the history of our survey. In 2007-2009, survey respondents estimated on average that the Czech Republic would be using the euro in around five years, but now it is estimated at more than eight years away.

Number of years until the Czech Republic's expected entry into the euro area (in the individual survey years)