Report on **Master Thesis**

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

Student:	**Bc. Tereza Veselá**
Advisor:	**PhDr. Jaromír Baxa, Ph.D.**
Title of the thesis:	**Disagreement about Expected Inflation and the Transmission of Monetary Policy in the Czech Republic**

OVERALL ASSESSMENT

Short summary
The thesis presents a regime-switching analysis of the monetary policy transmission mechanism in the Czech Republic. Using state-of-the-art econometric techniques, it shows that in periods of low dispersion in inflation expectations of households or financial market analysts, the transmission matches the mainstream economic intuition (New Keynesian approach). But in periods of high disagreement in inflation expectations, the transmission is weaker, or may even exhibit some perverse features (the price puzzle, adverse signalling channel to expectations).

Contribution
Since the resent inflation surge, it has become evident that studying possible non-linearities, e.g. in the form of regime-switching, is a promising avenue of future research in macroeconomics and monetary economics. The thesis is one of the first empirical attempts to do so when analysing the transmission mechanism of Czech monetary policy. It thus brings a significant contribution to the existing literature, with potentially far reaching policy consequences. These policy implications are spelled out in the text, but are not always clear cut; they thus constitute an ideal topic for discussion at the defense.

Methods
The methodology is in line with state of the art in this field. It essentially consists of 3 steps: i) identification of low and high disagreement periods from the available surveys of inflation expectations, which in the case of the EC's survey among households requires converting its qualitative outcomes into quantitative estimates on the mean and standard deviation of inflation expectations; ii) identification of monetary policy shocks using high-frequency financial market instruments (FRAs); iii) estimating the impulse responses of key macroeconomic variables to the identified monetary policy shocks using a (smooth) regime-switching local projection model.

A rich set of robustness checks is based on using two alternative measures of inflation expectations (a the EC's qualitative survey among households, the quantitative survey of professional forecasters by the CNB), various maturities of FRAs for identification of monetary policy shocks, a linear (i.e. a „0-1", rather than smooth) regime-switching local projection model, and sub-sample analysis for the pre-Covid period.

The applied methods have their obvious limitations. To name just two: (i) The conversion of qualitative EC's consumer survey to a quantitative measure of inflation expectations relies heavily on the assumption of normal distribution. This may be questionable especially in high inflation periods. There is some tentative evidence from the recent Czech inflation spike that the distribution of inflation expectations became temporarily bi-modal. (ii) The high-frequency-data approach to the identification of monetary policy shocks circumvents some issues of the more conventional methods, such as the recursive identification or sign restrictions. But as a result, the identified MP shocks have a different nature. Rather than identifying deviations of central bank from its standard reaction function (i.e. identifying discretion vs. rules), it identified short-term news associated with monetary policy meetings and their outcomes. For example, a very non-standard policy decision that deviates from the usual reaction function but is telegraphed to the market sufficiently in advance is not identified as a monetary policy shock (see the years 2022-2023 in Figure 4.3.). On the other hand, a decision that is fully in line with the standard reaction function but takes the market by surprise leads to a large identified shock (see the period of Governor Tůma, when the CNB often acted without pre-communicating its decisions to the market, the so-called „Tůma principle").

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The author is aware of these limitations, as evident from the text (e.g. section 6.3) and some of the robustness checks. But it will be useful to discuss these in depth at the defense.

Literature
The literature review is deep, up-to-date and well-focused.

One minor comment concerns the referencing in text. It would be better to uses the „et al." referencing standard consistently in the text for research pieces with more than two authors, rather than to spell out the names of all the authors in the first place where the reference appears. This can be changed before future publication of the research. Another minor comment concerns incomplete information in the reference to Dvořáková (2022) in the Bibliography.

Manuscript form
The manuscript form is close to perfect, it reaches the standard of a published journal article. The English is perfect, structure of the thesis is logical, and any typos are extremely rare.

Overall evaluation and suggested questions for the discussion during the defense

The thesis is overall excellent. It more than fulfills the requirements for a master thesis at IES, Faculty of Social Sciences, Charles University. In fact, it reaches the standard of a good dissertation essay, and of a published academic journal article. I thus clearly recommend it for defense with an **A grade** (with a possible nomination for distinctions by the committee).

The results of the Turnitin analysis do not indicate significant text similarity with other available sources. The thesis is – with no doubt – an original work by the student.

Suggested questions for defence:
1) Respond to the above remarks concerning the limitations of your empirical methodology.

2) The presented impulse responses are divided to "Low Disagreement" and "High Disagreement" regimes. However, except of Section 5.2.1, you use a smooth ("non-linear") approach to the regime-switching, rather than a "0-1" approach. Please, explain how you distinguish the two regimes. Is there some probability threshold?

3) Looking at Figure 5.1, the confidence bands seem to be much wider for the High Disagreement regime than for the Low Disagreement one. What is the reason behind this? Is it related to the low frequency of such adverse episodes, and thus less evidence available in the data? Or is there another explanation?

4) Does your research shed some light on the Czech monetary policy debates of 2021-2023? Should the policy response ideally have been more or less aggressive, in your opinion? It seems that one could find arguments in both directions in your thesis (but policy makers in the end have to choose just one). What should perhaps have been done differently in CNB's communication with various stakeholders?

5) The length of transmission lags to inflation that you identify is longer than in much of the previous research, and well beyond the CNB's 12-18 months monetary policy horizon. Would you advocate prolonging this MP horizon, or are there some caveats for doing that?

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

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

NAME OF THE REFEREE: doc. Mgr. Tomáš Holub, Ph.D.

DATE OF EVALUATION: 14 August 2024

Digitálně podepsáno (14.8.2024)
Tomáš Holub

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Referee Signature