

Essays on Economic Policy (ESPE in Spanish) - Risk Premium Shocks, Monetary Policy and Exchange Rate Pass-Through in the Czech Republic, Hungary and Poland

Download Keep in mind

In the journal Essays on Economic Policy (ESPE) - we disclose the results and policy proposals that arise from academic research carried out at the *Banco de la República*. When you read us, always keep in mind that the content of our articles, as well as the analyzes and conclusions derived from them, are the sole responsibility of their authors. The material disclosed in our ESPE magazine does not compromise or represent the opinion of *Banco de la República* or that of its Board of Directors.

AUTHOR OR EDITOR Vonnák Balázs Publication Date: Sunday, 1 of August 2010

This paper investigates the role of monetary policy in a small open economy, where exchange rate shocks are important. VAR models are estimated for the Czech Republic, Hungary and Poland. Contemporaneous and sign restrictions are imposed in order to identify the effect of monetary policy and risk premium shocks. Estimates from the same model for Canada, Sweden and the UK are used as a benchmark for developed economies with low inflation. The results suggest that the typical size of a risk premium shock renders it almost impossible for the interest rate policy to smooth the exchange rate with the aim of minimizing inflationary consequences. On the other hand, low inflation may decrease the exchange rate pass-through, which helps the monetary policy ignore exchange rate shocks.