Aleš Michl: Remarks on euro adoption

Remarks by Mr Aleš Michl, Governor of the Czech National Bank, for the panel discussion "Should the Czech Republic adopt the euro?" at the Bloomberg event "The future of the euro in CEE", Prague, 10 June 2025.

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Delivering on our mandate of price stability

The new Bank Board was appointed in mid-2022. At that time, inflation in the Czech Republic was 17.5 percent. Today, it is back under control, down to just 2.4 percent.

The base repo rate is currently at 3.5%, and I expect it will remain at this level for some time.

Our strategy is clear: to keep interest rates higher for longer compared to the period before COVID, to avoid any unconventional policies, and to follow the vision that in monetary policy, less is more (Michl, 2024b).

This year, our currency – the koruna – appreciated by 11% against the US dollar and by 2% against the euro. This helps us in the fight against inflation.

The Czech National Bank is the most trusted institution in the country (STEM, 2025)[1]. We take this trust seriously.

The pros and cons of having an independent monetary policy

Two main advantages:

First, exchange rate flexibility. A stronger koruna makes imports cheaper, which helps fight inflation. On the other hand, a weaker koruna supports exports during a recession. We can call it an adjustment mechanism for the economy – or, to be exact, an adjustment mechanism for the balance of payments.

And the second one:

The current policy of the European Central Bank does not fit the Czech economy. Our key interest rate is 3.5%, while in the eurozone it is 2%. We still need high interest rates to keep inflation low. We also need positive real interest rates to maintain price stability.

In Croatia and Slovakia, inflation is around 4%, which means they currently have negative real interest rates. That makes it harder for them to fight inflation.

Our goal is price stability – not to support exporters. The key is to keep the growth of money in the economy under control.

One key disadvantage:

Everyone can make mistakes. In the history of the Czech National Bank, there were two major ones: keeping real interest rates negative for more than 10 years before COVID, and increasing the money supply (banking liquidity) by 100% in 2017 in order to weaken the koruna. This is one of the reasons why core inflation after COVID was higher in the Czech Republic than in the eurozone. We must not repeat these mistakes.

That is why our strategy is to keep interest rates higher for longer, avoid any unconventional policies, and follow the vision that in monetary policy, less is more.

The "perfect" timing of euro adoption

Just to remind you, the government makes the final decision about euro adoption, not the central bank.

My PhD thesis was about the perfect timing for euro adoption. And the main conclusion was that one day, the exchange rate adjustment mechanism may stop working for the economy.

Let me give two situations as examples:

First, a weaker koruna might help exporters – but at the same time, it brings very high inflation into the country (Michl, 2016).

Second, if there is already a large amount of loans in euros in the economy – like in Croatia (Croatia: 70%, vs 20% in the Czech Republic) – independent monetary policy effectively stops working. A weaker koruna in such a situation could lead to large-scale defaults.

For now, the exchange rate adjustment mechanism still works. There is no need to rush to adopt the euro. We should remain a country with a strong koruna, an independent monetary policy, and robust FX reserves – not follow the example of Croatia.

Our experience with fighting high inflation

Inflation was 17.5% in July 2022 and still rising. The key interest rate was already at 7%. Then, a new Bank Board was appointed – and we changed the strategy.

The gamechanger was the strong koruna strategy, which we introduced in late 2022 (Michl, 2022). We announced that we would keep interest rates stable for an extended period. At the same time, we clearly communicated that a strong koruna is crucial for the Czech economy.

This strategy worked. In spring 2023, we saw the strongest koruna in our history. The strong koruna helped reduce inflation by making imported raw materials cheaper. It also created tougher conditions for exporters – a necessary trade-off.

The market understood and trusted our strategy because we communicated it openly and transparently. And that was enough. Sometimes, less is more in monetary policy. It is better to maintain a steady and credible restrictive stance than to keep interest rates at zero for a decade – and then hope to control inflation with a sudden, sharp rate hike.

On FX volatility and risk premia

Yes, FX volatility brings hedging costs for companies. But the mission of monetary policy is price stability – not cheap financing.

Let me measure the risk premium using the asset swap spread: the difference between the 5-year government bond yield and the interest rate swap rate, measured in percentage points. Currently, this spread stands at 0.2 percentage points in Croatia, 0.3 percentage points in Slovakia, and 0.2 percentage points in the Czech Republic.

We aim to keep the risk premium low through credible and independent monetary policy – and by putting pressure on the government to balance public finances.

Within the eurozone, governments often feel less pressure to save money or balance their budgets. The bailout system reduces the risk premium – but it also weakens the incentive for fiscal responsibility. In a country without market pressure, politicians become less motivated to reduce deficits, and a real estate bubble can form more easily.

We also learned the wrong lesson from the eurozone fiscal rules – the idea that a deficit under 3% of GDP is always acceptable. It's not. What really matters is maintaining balanced public finances over time.

Cheap euro loans and the koruna's higher borrowing costs

Yes, corporate loans in euros are cheaper, but interest rates on savings are higher in our country. In the Czech Republic, we need higher interest rates to fight inflation.

Those higher rates help slow down borrowing – for everyone: households, the government, and businesses (Michl, 2024a).

Monetary policy's mission is price stability – not cheap financing.

Keeping money too cheap for too long was one of the mistakes in the past that led to high inflation.

References

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[1] https://www.cnb.cz/en/cnb-news/press-releases/Czechs-Now-Trust-the-Central-Bank-the-Most/