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The possibility to tap into the potential of domestic demand as a key benefit of currency depreciation in the face of a negative shock

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Abstract

The essential benefit of a currency depreciation in a situation of a negative shock does not have to rely on the increase of net exports. An alternative mechanism for the economy to achieve benefits from a currency depreciation may be to enable the maintenance of a high level of domestic demand without breaking the external balance. Since domestic demand usually accounts for at least ninety-five percent of GDP, and the absolute value of the foreign trade balance (net exports) usually does not exceed a few percent of GDP, the benefit of depreciation in the form of maintaining domestic demand may be much greater than the possible benefit in the form of improving the foreign trade balance. This is shown by the experiences of countries that devalued their currencies during the Great Depression of the 1930s analyzed by Eichengreen (1995). An example of this regularity is also the case of Poland during the global financial crisis of 2008 and the following years, analyzed by Kawalec, Pytlarczyk and Kamiński (2020). Kawalec, Pytlarczyk and Kamiński (2020) note that if there is a currency depreciation in crisis conditions, which is used to support domestic demand, then such a policy is also more beneficial from the point of view of the country's trading partners than the situation where there would be no depreciation and the balance or surplus in foreign trade would be achieved by suppressing domestic demand. The failure to see that the benefit of depreciation may be to create conditions for exploiting the potential of domestic demand leads to misunderstandings such as questioning by Rosati (2022) the thesis that the depreciation of the zloty was a key factor that allowed Poland to avoid recession during the crisis of 2008-2009. Rosati rightly points out that in some countries of the European Union, the improvement of net exports in 2009 was much stronger than in Poland, and yet there was a deep drop in GDP there, which means that the mere fact of increasing net exports does not explain why Poland as the only country in the EU avoided recession. Rosati also rightly notes that an important factor supporting the Polish economy in 2009 was fiscal expansion, which enabled the growth of consumption - the highest among EU countries. However, a simple simulation shows that without the depreciation of the zloty, the loosening of fiscal policy would not prevent a drop in GDP in 2009. The depreciation of the zloty enabled, in crisis conditions, stimulating domestic demand without endangering the external balance, which saved Poland from a drop in GDP.

Key words: EURO ciris, Monetary Union, Exchange Rate, economic shocks, currency depreciation.
Kody JEL: E5, E42, F15, F32

Introduction

When discussing the benefits of a flexible exchange rate in the situation of a negative shock, economists often focus on the possibility of increasing exports and net exports, as a result of a currency depreciation. Meanwhile, the essential benefit of depreciation does not have to rely on improving the trade balance at all.

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1. Mechanisms of the impact of the level of competitiveness of the exchange rate on the economy of the country

When we talk about the consequences of having a competitive (or uncompetitive) exchange rate, our attention often focuses on the impact of this situation on the volumes of exports and imports and the shaping of the foreign trade balance. A competitive exchange rate is associated with a surplus in foreign trade, and an uncompetitive rate - with a deficit. However, the level of competitiveness of the exchange rate affects not only foreign trade, but also domestic demand. There are three main channels for the impact of exchange rate competitiveness on domestic demand:

1) An uncompetitive exchange rate negatively affects the volume of exports and the revenues of the export sector. This translates into lower investments and lower employment and lower consumption of workers in the export sector. In other words, an uncompetitive exchange rate limits the domestic demand generated by the export sector and its workers.
2) An uncompetitive exchange rate limits the sales of domestic products on the domestic market, which are substituted by price-competitive foreign products. This limits the revenues of firms producing for the domestic market, which translates into lower investments of these firms and lower employment and lower consumption of these firms' workers. This means that an uncompetitive exchange rate limits the domestic demand generated by firms producing for the domestic market and by their workers.
3) An uncompetitive exchange rate negatively affects the volume of exports, and at the same time stimulates imports, which strongly negatively affects the volume of net exports. This often forces the use of macroeconomic policy limiting domestic demand, in order to prevent deterioration or improve the foreign trade balance.

With an uncompetitive exchange rate, in a situation of underutilization of potential GDP, currency depreciation allows the activation of two alternative mechanisms affecting GDP growth:

- stimulating exports and net exports,
- stimulating domestic demand.

The proportion in which currency depreciation will activate the mechanisms mentioned above depends on macroeconomic policy that accompanies depreciation. One can speak of two "pure" models of using depreciation:

a) In the case of conservative macroeconomic policy, the benefit of depreciation will be primarily a positive impact on exports and net exports.

b) In the case of expansionary macroeconomic policy, the benefit of depreciation will be primarily maintaining domestic demand.

Gąska and Kawalec (2018, p. 37) point out that since domestic demand usually accounts for at least ninety-five percent of GDP, and the absolute value of the foreign trade balance (net exports) usually does not exceed a few percent of GDP, the effects of lack of competitiveness, consisting in limiting domestic demand, may be many times greater than the possible effects resulting from changes in the foreign trade balance. Therefore, the benefits of improving the competitiveness of the exchange rate in the form of enabling an increase in domestic demand may be potentially greater than the possible benefits in the form of improving net exports. This is illustrated by the examples discussed below: the experiences of the Great Depression of the 1930s, as well as a comparison of the experiences of Poland and the countries of the South of the euro zone after the outbreak of the global financial crisis of 2008.

2. Experiences of the Great Depression of the 1930s.

During the Great Depression of the 1930s, successive countries left the gold standard system and devalued their currencies. On the other hand, there was a group of countries led by France, including Poland, which committed themselves to remain on the gold standard, guaranteeing the convertibility of their currencies into gold at a fixed parity. This group formed the so-called "gold bloc", which lasted until 1936. Comparing the experiences of countries that devalued their currencies with the experiences of countries that remained in the gold standard system, Barry Eichengreen (1995, p. 21) writes:

> According to the conventional wisdom, the currency depreciation made possible by abandoning the gold standard failed to ameliorate conditions in countries that left gold and exacerbated the Depression in those that remained. **Nothing could be more contrary to the evidence** [Our emphasis, SK and EP]. Depreciation was the key to economic growth. Almost everywhere it was tried, currency depreciation stimulated economic recovery. Prices were stabilized in countries that went off gold. Output, employment, investment, and exports rose more quickly than in countries that clung to their gold parities.

Eichengreen (1995, Table 12.1, p. 351) shows that from year to year the gap between the situation of the gold block's countries plunged into recession and the situation of countries that devalued their currencies and experienced economic recovery had been increasing. In 1936, that is, 7 years after the start of the world crisis, the indicator showing the size of industrial production in relation to the level from 1929, in the countries of the gold bloc averaged only 86%., while in the countries that devalued their currencies the indicator averaged 127-128%, and thus the difference in the value of this indicator between the two groups of countries exceeded 40 percentage points.

Eichengreen explains that the main driver of growth for countries that abandoned the gold standard was not an improvement in the trade balance at all. The key was that the country that freed itself from the obligation to exchange its own currency for gold at a fixed rate, gained the possibility of pursuing a more expansionary fiscal and monetary policy. During the world crisis, economies had unused production capacities and high unemployment. This situation created room for increasing employment and production through monetary and fiscal expansion, without causing inflation. Under the gold standard, this was not possible, however, as expansionary macroeconomic policy would cause a deterioration in the trade balance, an outflow of foreign exchange reserves and, as a result, the inability to maintain convertibility at a fixed exchange rate. On the other hand, in the case of leaving the gold standard, the country could pursue a policy of increasing domestic demand and reviving the economy, using the adjustment of the exchange rate as an instrument to prevent the emergence of a trade deficit. This brought beneficial effects in the form of economic growth, and the main factor of recovery in the countries that devalued their currencies at that time was precisely the increase in domestic demand.

In practice, countries that left the gold standard system and devalued their currencies used, to varying degrees, two opposing recovery mechanisms, which Eichengreen (1995, 357-365) describes on the example of Belgium and Czechoslovakia - two small industrial countries, largely dependent on foreign trade, which devalued their currencies in 1934-1935. Belgium took advantage of the devaluation to quickly increase domestic demand. In contrast, Czechoslovakia applied a more conservative macroeconomic policy and used devaluation to increase exports. There was an economic recovery in both countries, but it was much more dynamic in Belgium, which exploited the potential of the internal market.

3. Poland compared with the southern countries of the euro zone

Kawalec, Pytlarczyk, Kamiński (2020) compare the functioning of the Polish economy and the countries of the south of the euro zone - Greece, Spain, Portugal, and Italy – during the global

financial crisis of 2008 and the following years. It was estimated that in 2010, at the time of the outbreak of the euro zone crisis, the countries of the south of the euro zone should reduce wages in their economies by 10-30 percent (see Pill et al. 2013) to regain international competitiveness. If these countries had their own currencies, such an improvement in competitiveness could be achieved in a short time as a result of currency weakening - as it happened in Poland, where at the turn of 2008/2009 the Polish zloty weakened by about 30 percent. The countries of the south of the euro zone could not, however, count on improving competitiveness through exchange rate adjustments. They were doomed to deflationary policy, which is currently euphemistically called "internal devaluation" (see Kawalec, Pytlarczyk, Kamiński 2020, p. 32). This policy proved effective in restoring balance in trade but failed to restore the competitiveness of these economies[3]. Kawalec, Pytlarczyk, Kamiński (2020, pp. 33-35) compare the changes in the main components of GDP in four countries of the south of the euro zone and in Poland, in the period 2007-2016, as summarized below in table 1.

Table 1. **Contribution of particular components to change in GDP in Poland and four southern eurozone states, 2007–2016**

Country	Trade balance (goods and services)				Contribution of particular components to change in GDP, 2007–2016 (as a percentage of 2007 GDP)		Total change in GDP, 2007–2016 (as a percentage of 2007 GDP)
	2007		2016		Trade balance	Domestic demand	
	€ bn	% GDP	€ bn	% GDP			
Poland	−11.1	−3.5%	16.5	3.9%	8.7%	23.5%	32.2%
Italy, Spain, Portugal and Greece aggregated	−113.0	−6.6%*	91.1	1.7%*	8.3%*	−17.6%*	−9.3%*
Difference (Poland versus unweighted average for the four southern eurozone countries)					0,4%	41,1%	41,5%
Data for individual southern eurozone countries							
Italy	−5.8	−0.4%	56.9	3.4%	3.5%	−10.3%	−6.8%
Spain	−64.8	−6.0%	33.7	3.0%	9.0%	−9.3%	−0.3%
Greece	−29.0	−12.5%	−1.2	−0.7%	12.0%	−38.3%	−26.3%
Portugal	−13.4	−7.6%	1.7	0.9%	8.5%	−12.3%	−3.7%

*Unweighted average for Italy, Spain, Portugal, and Greece
Source: Kawalec, Pytlarczy, Kamiński (2020, Table 4.1., p. 33), based on Eurostat data from 11 October 2017

The four countries of the south of the euro zone, which in 2007 had a total trade deficit of 113 billion euros, in 2016 achieved a trade surplus of 91 billion euros, which means an improvement of 204 billion euros. On average, in the countries of the south, the trade balance improved by 8.3 percentage points of GDP. In the same period, Poland achieved a similar relative improvement in the trade balance - by 8.7 percentage points of GDP. The fundamental difference, however, is that Poland achieved this improvement as a result of adjusting the

[3] Kawalec, Pytlarczyk, Kamiński (2020, 36-37), as well as Kawalec, Pytlarczyk (2016, 45-47), define competitiveness as the ability of the economy to use its potential, and especially its labor resources, in the conditions of free international trade. Kawalec, Pytlarczyk and Kamiński point out that this is a narrower and more limited concept of competitiveness than what popular country competitiveness rankings try to measure.

exchange rate and thus did not have to suppress its domestic demand. The growth of domestic demand by 24% was the decisive factor of GDP growth in Poland in this period. On the other hand, the mentioned countries of the south of the euro zone, not being able to adjust the exchange rate, had to suppress domestic demand, which fell there by an average of almost 18%, which caused a deep drop in GDP despite a significant improvement in the foreign trade balance. In 2016, that is, in the ninth year since the start of the global financial crisis, real GDP in all countries of the south of the euro zone was below the level of 2007 and the average GDP index (assuming the level of 2007 as 100%) was in these countries by 41 percentage points lower than in Poland.

Kawalec, Pytlarczyk, Kamiński (2020, p. 33) write that the experiences of the southern eurozone countries demonstrate that in an open economy, over the long term, the most important effect of a lack of international competitiveness is the inability to use the potential of domestic demand, as in this situation the country must stifle such demand to maintain an acceptable foreign trade balance.

4. Impact on trading partners

Currency depreciation, especially carried out in the conditions of a global or regional crisis, may raise concerns that it will lead to an improvement in the trade balance at the expense of trading partners and is sometimes pejoratively termed: beggar-thy-neighbour policy. Kawalec, Pytlarczyk and Kamiński (2020, p. 81-82) note that depreciation, although it may, does not have to be harmful to trading partners at all. If there is a currency depreciation in crisis conditions, which is used to support domestic demand, while maintaining or restoring balance in foreign trade, then such a policy is also more beneficial from the point of view of the country's trading partners than the situation where there would be no depreciation and the balance or surplus in foreign trade would be achieved by suppressing domestic demand. This is illustrated by the comparison discussed above of the adjustment of Poland and four countries from the south of the euro zone in the period 2007-2016, presented in Table 1. The countries of the south of the euro zone could not use the mechanism of currency depreciation and had to adjust their foreign trade by deeply limiting domestic demand. As a result, these countries generated a significant trade surplus in 2016 - amounting to 91 billion euros - at the cost of a deep decline in economic activity and an increase in unemployment. This situation brings not only huge costs and suffering for their citizens, but also costs for their trading partners. If the southern countries could improve competitiveness and increase domestic demand, while simultaneously bringing their trade accounts close to balance, or even without a significant change in the trade balance, everyone would benefit. Production would increase, unemployment would fall and trading partners would benefit from higher trade, with a balance that would at least be no worse.

5. Misunderstanding resulting from not seeing the impact of exchange rate adjustment on the possibility of using the potential of domestic demand

The failure to see that the level of competitiveness of the exchange rate affects not only foreign trade, but also the possibility of using the potential of domestic demand, leads to fundamental misunderstandings in the analysis of the role of exchange rate adjustment in the case of a negative shock. An example of such a misunderstanding is the questioning by Dariusz Rosati (2022, 153-163) of the thesis that the depreciation of the zloty was a key factor that allowed Poland to avoid recession during the 2008-2009 crisis.[4].

[4] Rosati (2022, pp. 153-154) lists as supporters of this thesis, which in his opinion is wrong, among others: the authors of this article, who wrote that the depreciation of the Polish zloty was "probably the most important factor thanks to which in 2009, during the peak year of the global financial crisis, Poland was the only country in Europe that achieved economic growth" (Kawalec, Pytlarczyk, 2016, p. 11).

Rosati's argumentation and our comments

1) ***Rosati's thesis: The key to maintaining GDP growth in 2009 was the increase in household income resulting from the decision of the Kaczyński government in 2007.***

Rosati writes that in 2009 Poland avoided recession not thanks to the depreciation of the zloty, but thanks to the increase in household income as a result of loosening fiscal policy. The fiscal loosening was the result of a decision in 2007 made by the government of Jarosław Kaczyński, in which the deputy prime minister and finance minister was Zyta Gilowska. It was then decided to raise the minimum wage, lower the Personal Income Tax (PIT) tax rates, and lower the pension contribution. These decisions were made when no one expected a global crisis and came into force in part in 2008 and in part in 2009, contributing to the fact that in 2009 Poland was the country with the fastest consumption growth in the EU. Rosati writes that the merit of Donald Tusk's government was to increase the public finance sector deficit to 7.3% in 2009 and to 7.4% in 2010.

Our comment

Rosati is right that the loosening of fiscal policy resulting from the decision of the Kaczyński government in 2007 contributed to the growth of the Polish economy in 2009. Kawalec (2012) drew attention to this factor in the public debate. Nevertheless, as we explain later, Poland in 2009 despite the fiscal loosening would not have recorded positive GDP growth if there had been no depreciation of the zloty.

2) ***Rosati's thesis: Depreciation had negative consequences for the economy.***

Rosati (2022, pp. 154-155) claims that the depreciation of the zloty was a factor that negatively affected the economy and did not facilitate its overcoming of the recession:

> … depreciation was a factor increasing the general macroeconomic risk in the Polish economy. First, such a deep drop in the exchange rate, which occurred in the second half of 2008, caused a sharp increase in import costs, especially supply imports, which worsened the financial situation of many enterprises and severely limited production with high material intensity. Second, the depreciation of the zloty had a strongly negative impact on the balance sheets of enterprises and households indebted in foreign currencies, as the fall in the zloty exchange rate forced an increase in servicing costs and in many cases threatened the insolvency of debtors. Many companies found themselves in a difficult financial situation at that time. Finally, third, the rapid fall in the zloty exchange rate, which occurred in the second half of 2008, created a serious threat of a currency crisis. [Our translation – SK and EP]

Our comment

Rosati lists the real negative phenomena and threats that occurred in enterprises and households as a result of the deep depreciation of the zloty. However, this description is one-sided, as Rosati omits significant positive phenomena. In particular, Rosati omits the fact that in the situation of falling demand in export markets causing a decline in export volume, the depreciation of the zloty positively influenced the financial situation of exporters. Often, despite a much lower export volume (measured in physical units and in foreign currency), exporters' revenues in domestic currency increased or only slightly decreased at lower total costs (due to lower physical production volume). As a result, despite the decline in exports, the financial situation of many exporters improved or did not deteriorate. This meant that exporters did not have to urgently reduce their production capacities and lay off workers. Thus, the shock in the form of a sharp drop in demand in export markets did not result in either a reduction in the supply capacity of the export sector or a sharp reduction in demand that the export sector and its employees generated in the domestic market. This supported the demand in the domestic market and facilitated the rebound of exports in subsequent years.

The suggestion that depreciation had a net negative impact on the economy and was a factor increasing the general macroeconomic risk ignores the findings of Brzoza-Brzezina et al. (2014), who based on a macroeconomic model, conducted an ex post simulation, comparing the actual functioning of the Polish economy in the years 2007–2011 with the hypothetical functioning, in the case that Poland joined the euro area at the beginning of 2007. They found that if Poland belonged to the euro area in the analyzed period, both inflation and the pace of economic growth would be subject to much greater fluctuations than in the actual scenario. In particular, if Poland were in the euro area, the GDP growth rate in individual quarters would fluctuate between −6% and +9% (and with more extreme assumptions between −9% and +11%), while the actual GDP growth rate of Poland, remaining outside the euro area, ranged in individual quarters during the analyzed period from 1% to 7%. Brzoza-Brzezina et al. (2014) emphasize that the main factor stabilizing the economy in this period was the flexible exchange rate. Kawalec and Pytlarczyk (2016, pp. 269-271) discuss the simulation of Brzoza-Brzezina et al. (2014) on the occasion of a polemic with the popular opinion that belonging to the euro area is a guarantee of security and economic stability, especially in the situation of disturbances in the world economy. Kawalec and Pytlarczyk point out there that in a crisis situation, when there is a need for a rapid improvement of the current account balance, in a country with its own currency there is a weakening of the exchange rate, while in a country belonging to the euro area (or having a fixed exchange rate) there are deeper and more difficult to recover losses in the form of a drop in GDP and a drop in employment. Rosati's statement that "the rapid fall in the zloty exchange rate, which occurred in the second half of 2008, created a serious threat of a currency crisis" confuses causes with effects. The threat of a currency crisis in the period 2008-2009 - if we assume that it took place - arose as a result of the previous inflow of foreign portfolio capital, and then the global financial crisis, which caused a massive outflow of this capital from Poland. The currency depreciation was the appropriate (automatic) reaction of the economy to this situation and enabled the prevention of a currency crisis and at the same time maintaining economic growth.

3) ***Rosati's thesis: The increase in net exports does not explain why Poland avoided recession in 2009.***

Rosati shows that Poland's GDP increased by 2.8% in real terms in 2009, which was composed of a small decline in total domestic demand (with an increase in consumption and a decrease in gross accumulation) and an increase in net exports by 3.2% of GDP. Rosati stresses that in 2009 there was no increase, but a decrease in exports, and the improvement in net exports occurred only because the decline in imports was even deeper than the decline in exports. He argues that with a simultaneous decline in exports and imports, the improvement in net exports cannot be a factor explaining the fact that Poland was the only country in the EU to avoid recession in 2009, especially since in some EU countries the improvement in net exports was much stronger than in Poland, and yet there was a deep decline in GDP there. Rosati (2022, p. 160) states that the reasons for the GDP growth in Poland in 2009 must therefore lie not on the side of net exports, but on domestic demand.

Our comment

Rosati is right that in a situation where in some European Union countries the improvement in net exports in 2009 was much stronger than in Poland, and yet there was a deep decline in GDP there, the mere fact of the increase in net exports does not explain why Poland was the only country in the EU to avoid recession[5]. However, it can be said that the explanation for the lack

[5] Thus, Rosati (2022, p. 159, footnote 9) has grounds to question our statement that the improvement in net exports by 3 percent of GDP "was probably the most important factor thanks to which Poland was the only country in the EU to enjoy economic growth in 2009" (see Kawalec, Pytlarczyk (2016, p. 43). The correct explanation for the

of recession is the fact that the mentioned increase in net exports occurred while maintaining domestic demand at almost unchanged level (unlike in other countries, where the increase in net exports was associated with a dramatic decline in domestic demand).

4) Rosati’s thesis: Fiscal easing was important, not currency depreciation.

In conclusion, Rosati (2022, p. 161) states:

> In short, it was not the depreciation of the zloty that was the main factor that allowed the Polish economy to avoid the recession associated with the financial crisis. This factor was a significant easing of fiscal and budgetary policy and the resulting increase in people’s income. [Our translation – SK and EP]

Our comment

It is difficult to agree with Rosati’s basic conclusion that the depreciation of the zloty was not a key factor that allowed Poland to avoid recession in 2009. Rosati (2022) omits the impact of depreciation on the possibility of using the potential of domestic demand, which is pointed out by Eichengreen (1995)

A simple simulation performed by the authors, summarized in Table 2, shows that if there had been no depreciation at the turn of 2008/2009 and the average nominal effective exchange rate of the zloty (Nominal Effective Exchange Rate - NEER) was in 2009 at the same level as in 2008 (we define this further as: "counterfactual scenario"), then in 2009 Poland’s GDP would be lower by 3.1% compared to the factual scenario, which means that instead of GDP growth of 2.8% there would be a GDP decline of 0.3%.

Table 2. **Counterfactual experiment: no depreciation of the zloty exchange rate at the turn of 2008/2009**

<table>
<tr><td rowspan="2"></td><td colspan="2">Year 2009</td><td rowspan="4">Effects of NEER appreciation in 2009, in the counterfactual scenario, by 22.1% compared to the factual scenario (from 81.9% to 100% of the average level of 2008)</td></tr>
<tr><td>Factual scenario</td><td>Conterfactual scenario
(no depreciation of the zloty compared to 2008)</td></tr>
<tr><td>Average nominal effective exchange rate of the zloty (NEER): 2008 level = 100%</td><td>81.9%*</td><td>100%</td></tr>
<tr><td colspan="3">Contribution to the change in GDP in 2009</td></tr>
<tr><td>Domestic demand</td><td>-0.3%</td><td>-2.0%</td><td>-1.7%**</td></tr>
<tr><td>Net exports</td><td>+3.2%</td><td>+1.8%</td><td>-1.4**</td></tr>
<tr><td>Change in GDP in 2009</td><td>+2.8%</td><td>-0.3%</td><td>-3.1%**</td></tr>
</table>

* Source: Macrobond

** The estimate of the impact of changes in the zloty exchange rate (NEER) on GDP, net exports and domestic demand was made by the authors based on the published results of the econometric model of the National Bank of Poland NECMOD. Greszta et al. (2012, p. 5 and figure 5 on p. 9) show the results of simulations of exchange rate disturbances in the form of an unsupported appreciation of the real and nominal exchange rate by 10%. As a result of such disturbances, in the next 4 quarters GDP is lower compared to the previous year by 1.0%, 1.6%, 1.0% and 1.2% respectively (see Greszta et al. 2012, p. 9, figure 5, chart "GDP and components"), which would mean a ceteris paribus annual reduction of GDP by 1.4%; while the contribution of net exports to GDP is lower in the next quarters by 0.9; 0.7; 0.5 and 0.4 percentage point respectively (see Greszta et al. 2012, p. 9, figure 5, chart "External balance"), which would mean a ceteris paribus annual reduction of the share of net exports in GDP by 0.6 percentage points. Assuming linearity of effects, in the case of appreciation of the exchange rate by 22% we would have to deal with a drop in GDP annually by 3.1% and a deterioration of the contribution of net exports to GDP annually by 1.4 percentage point, which implies a drop in the contribution of domestic demand to GDP by 1.7 percentage point.

The decline in GDP by 3.1% in the counterfactual scenario, compared to the factual scenario, consists of a decline in net exports by 1.4% and a decline in domestic demand by 1.7%:

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fact that Poland was the only country in the EU that recorded an increase in GDP in 2009 should take into account the fact that the above-mentioned increase in net exports occurred while maintaining internal demand at an almost unchanged level.

- Lower net exports in the counterfactual scenario would be the result of lower exports and higher imports, which is an obvious and intuitive consequence of a stronger exchange rate.
- The decline in domestic demand resulting from the model in the counterfactual scenario would be the result of lower incomes of exporters, lower sales of domestic goods on the domestic market due to import competition, lower investment of enterprises and deterioration of the labor market situation resulting in a reduction of disposable income of households and a decline in consumption (see Greszta et al. 2012, p. 5, "Analysis of the effects of exchange rate disturbances").

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Summarizing the discussion of Poland's experiences in the crisis period after 2008, it can be said that Poland used at that time, two mechanisms mentioned by Eichengreen (1995), which were possible thanks to the restoration of the exchange rate competitiveness as a result of depreciation: improvement of net exports and utilization of domestic demand.

Eichengreen (1995) emphasizes that the main engine of growth in countries that abandoned the gold standard in the period of the Great Depression of the 1930s was the expansion of domestic demand, and at the same time states that in these countries the depreciation of the currency was the key to economic growth. As we tried to explain, there is no contradiction here. Similarly, Rosati is right that fiscal expansion in 2009 supported the growth of the Polish economy, while – what Rosati does not see – the key to exploiting the potential of domestic demand was precisely the depreciation of the zloty.

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