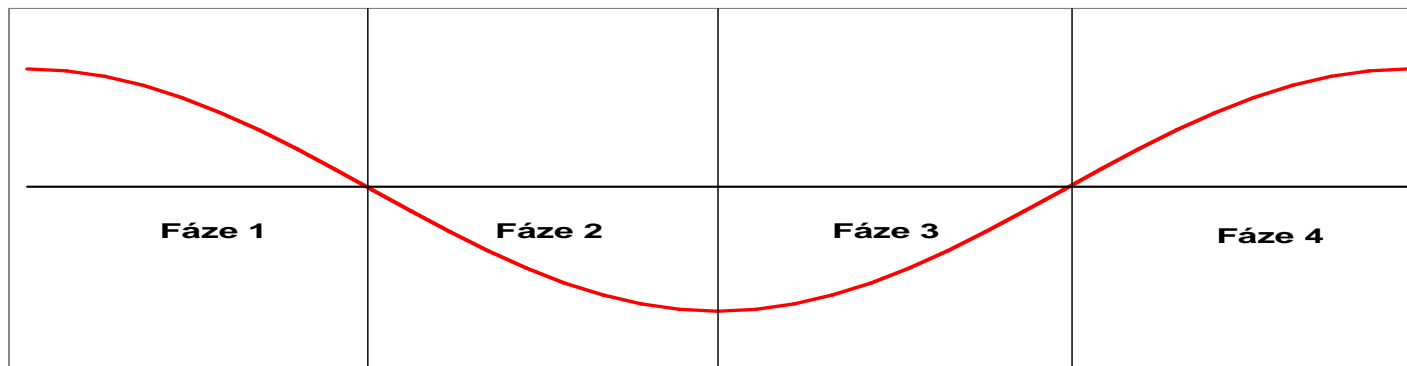

What are financial markets signaling to the economy?

Pavel Sobíšek

Investment opportunities alter within an economic cycle

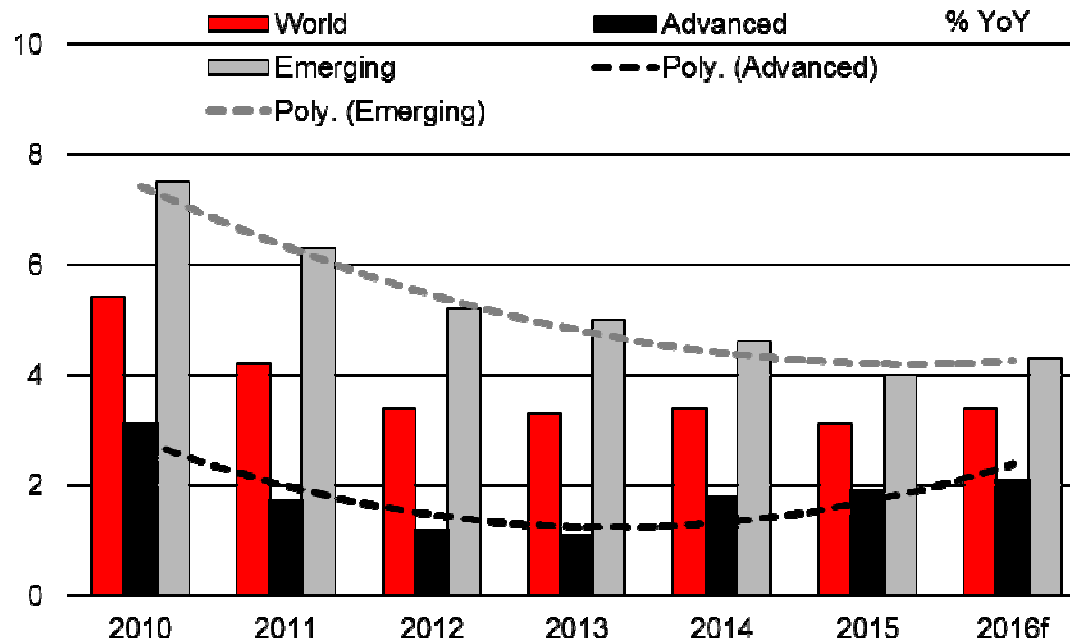
Phases of an economic cycle and the preferred investment classes



	State of economy	State of financial markets	Preferred investment
Phase 1	Above potential and slowing	Corporate profits decreasing Interest rates high	Cash, Bonds
Phase 2	Below potential and slowing	Corporate profits low Interest rates decreasing	Bonds, Stocks
Phase 3	Below potential and accelerating	Corporate profits increasing Interest rates low	Stocks
Phase 4	Above potential and accelerating	Corporate profits high Interest rates increasing	Cash

Global growth remains weak, gap between groups narrowing

Breakdown of global GDP growth by groups of economies

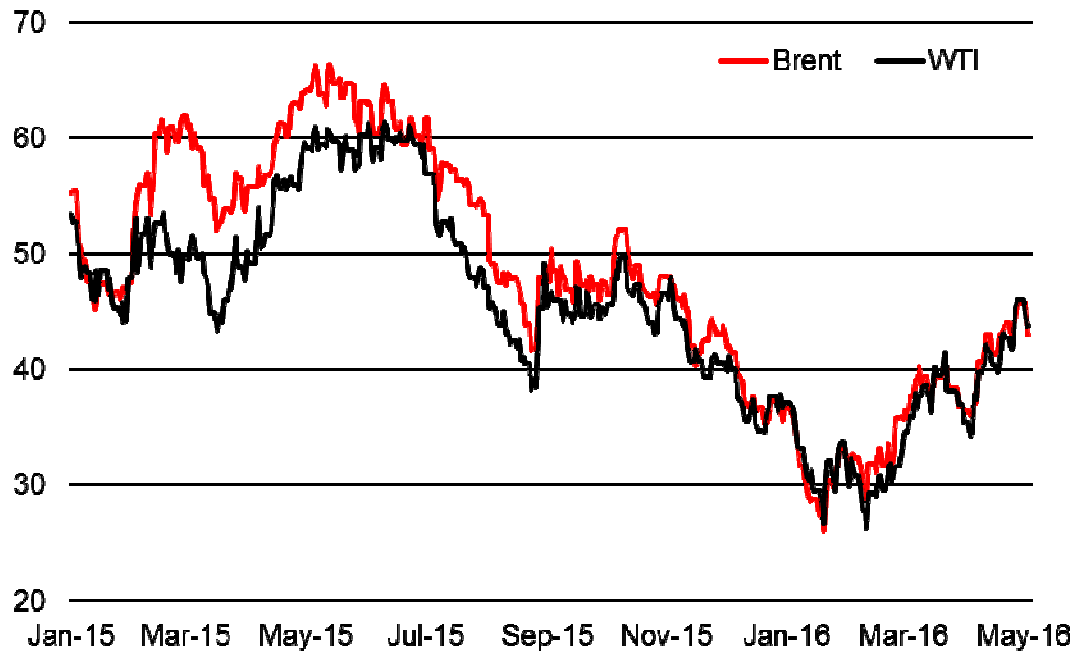


- Global GDP growth remains at a half of a 2007 reading
- The pace has lately been recovering in the developed but slowing in the emerging world
- That said, growth is still twice as high in emerging than in developed economies

Sources: IMF, UCB CZ+SK Economic Research

Lower oil prices boost global economic output... up to a limit

Crude oil prices (USD/b)

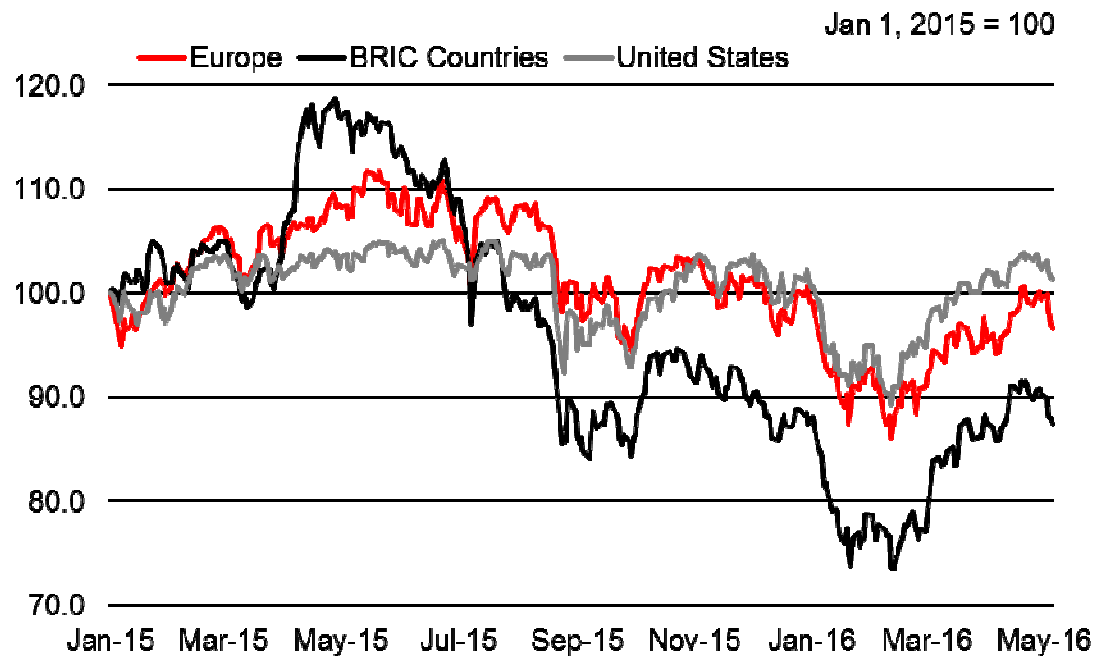


- A decrease in oil prices tends to boost economic output in the countries which are net importers of oil
- Global output should also be boosted, given that major economies are net importers
- However, the relation is non-linear – in case of oil prices too high or too low, drags for one group may outweigh drives for the other

Source: Macrobond

Stock markets have been performing poorly for the second year running

Stock markets performance since the start of 2015

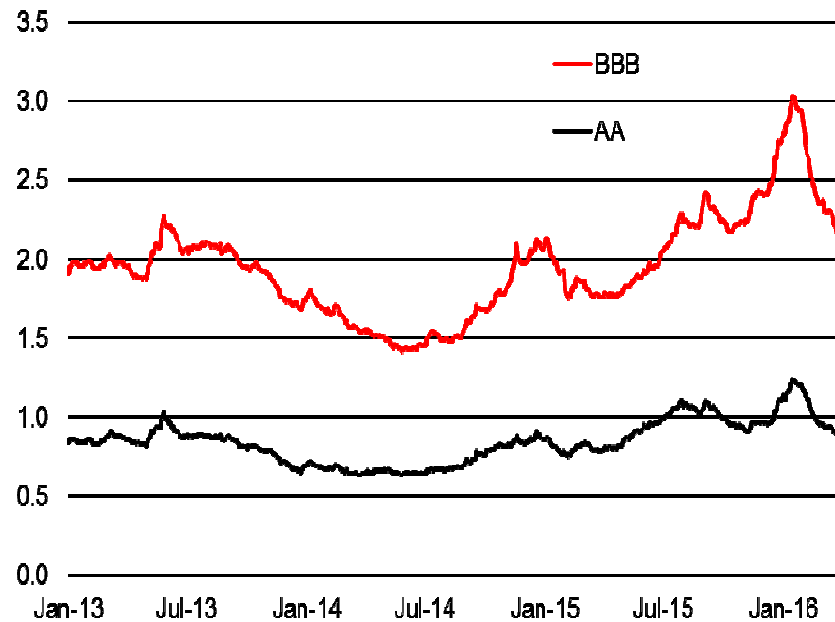


- Stock market indices are well below their peaks from 1H15
- Sharp price corrections are pretty frequent
- Emerging markets are clearly underperforming, influenced by bursting the China market bubble

Source: Macrobond

The long-term rise in credit spreads in 2015 was viewed at a start of 2016 as a recession-like signal for global economy

Credit spreads in p.p. (investment grade)



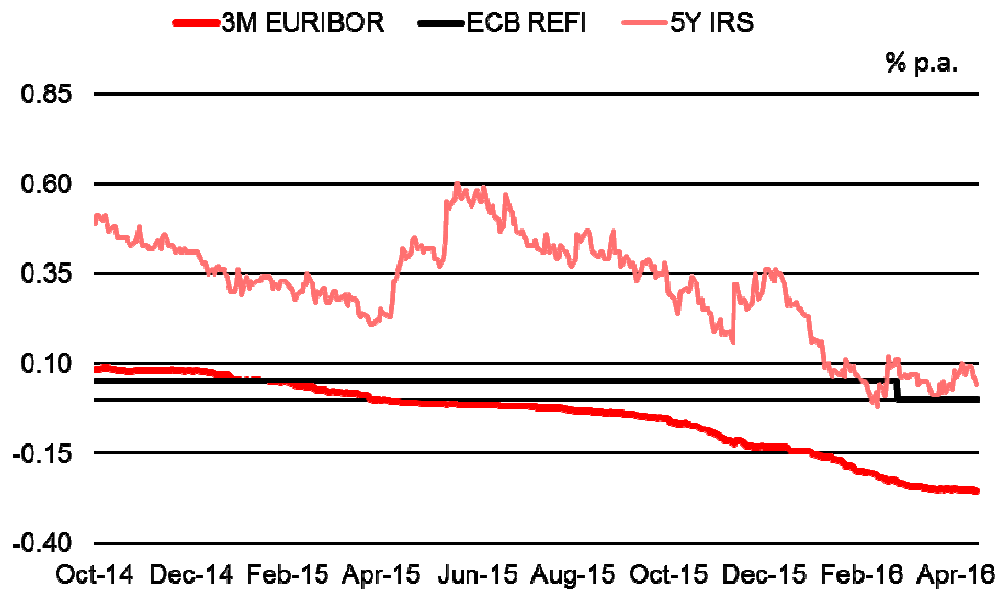
Credit spreads in p.p. (high-yield)



Source: Macrobond

Policy easing tends to be helpful for growth, but how about negative rates?

Interest rates in the eurozone

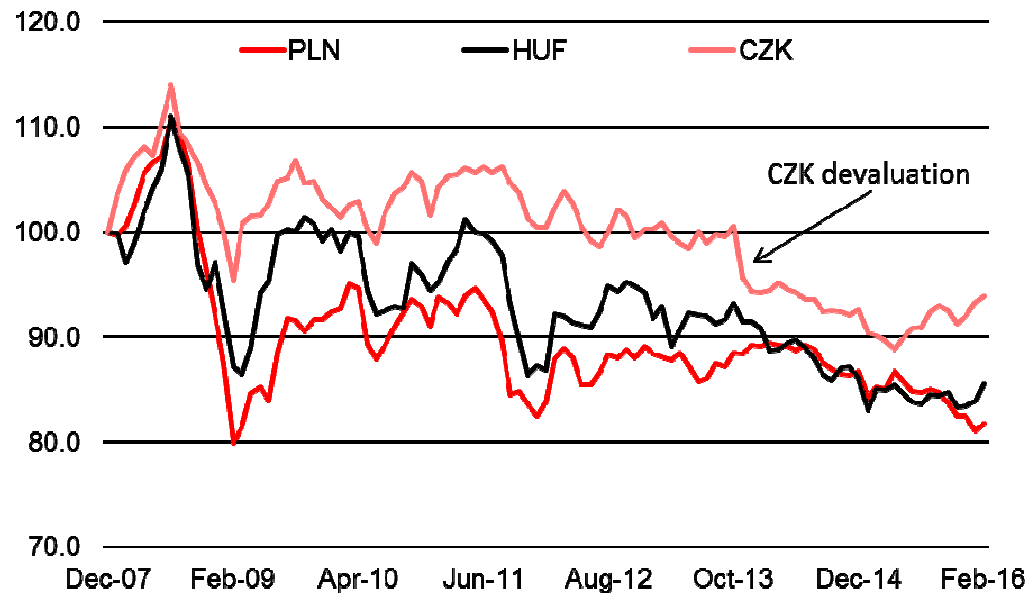


- Eurozone inter-bank rates have been negative for more than a year, which has been feeding through to banks' profits
- Interest rate cost for debtors have declined but there are few signs of lending dynamics picking up
- Central banks act alone in their attempt to boost economic activity; structural reforms are inadequate
- Ramifications of the negative rates experiment may yet to show up

Sources: Macrobond, UCB CZ+SK Economic Research

Despite the CNB interventions, CZK remains firmer than PLN, HUF

Real effective FX rates of CE3 currencies (12/2007=100)

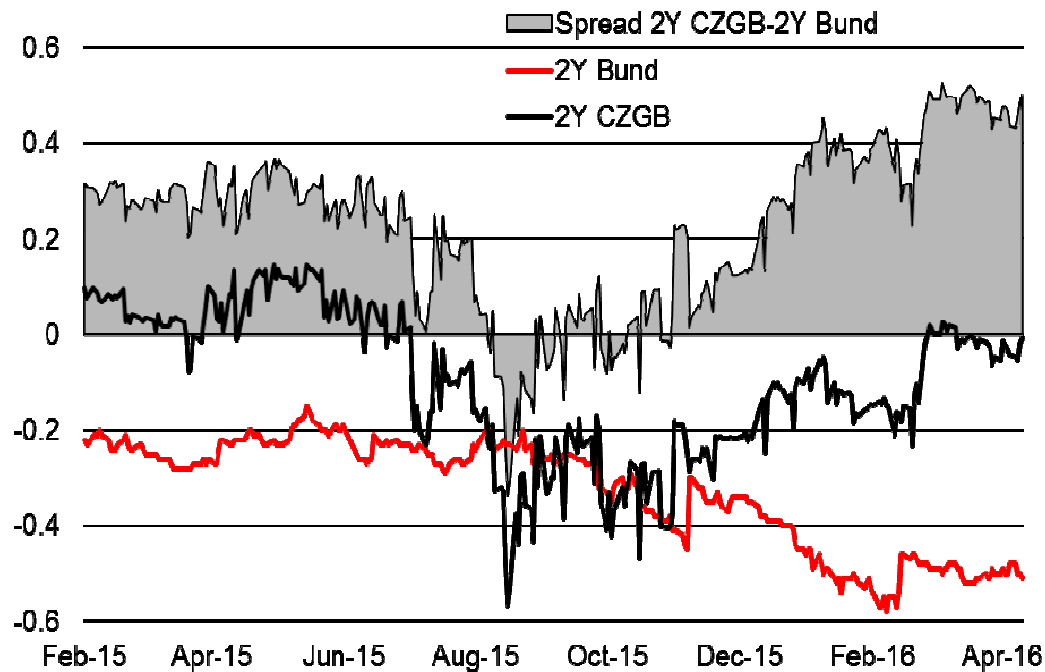


- After the 2009 financial crisis, CZK got firmer than PLN, HUF, which was not supported by economic fundamentals
- The CNB intervention in 2013 narrowed the gap but since the start of 2015 the gap has been widening again
- Speculations on an exit from the CNB intervention policy may keep CZK firmer than it would be based on market forces

Source: UCB CZ+SK Economic Research

German government bond yields are deeply negative, Czech yields affected

German and Czech 2Y government bond yields



- The ECB's QE policy has turned government bond yields negative
- Czech government bond yields followed suit after the CNB FX interventions in summer 2015
- The shallow market with Czech bonds temporarily wiped out CZK-GER yield spreads
- Since then, the spreads have been restored but is 2Y CZGB yield at 0% at a right level?

Source: Macrobond

Thanks for your attention
