Czech Republic, CEE and Global Economy

Miroslav Singer

Prague   November 22, 2019

Outline

1. Global Economy

   a. Political uncertainty

   b. EU after elections

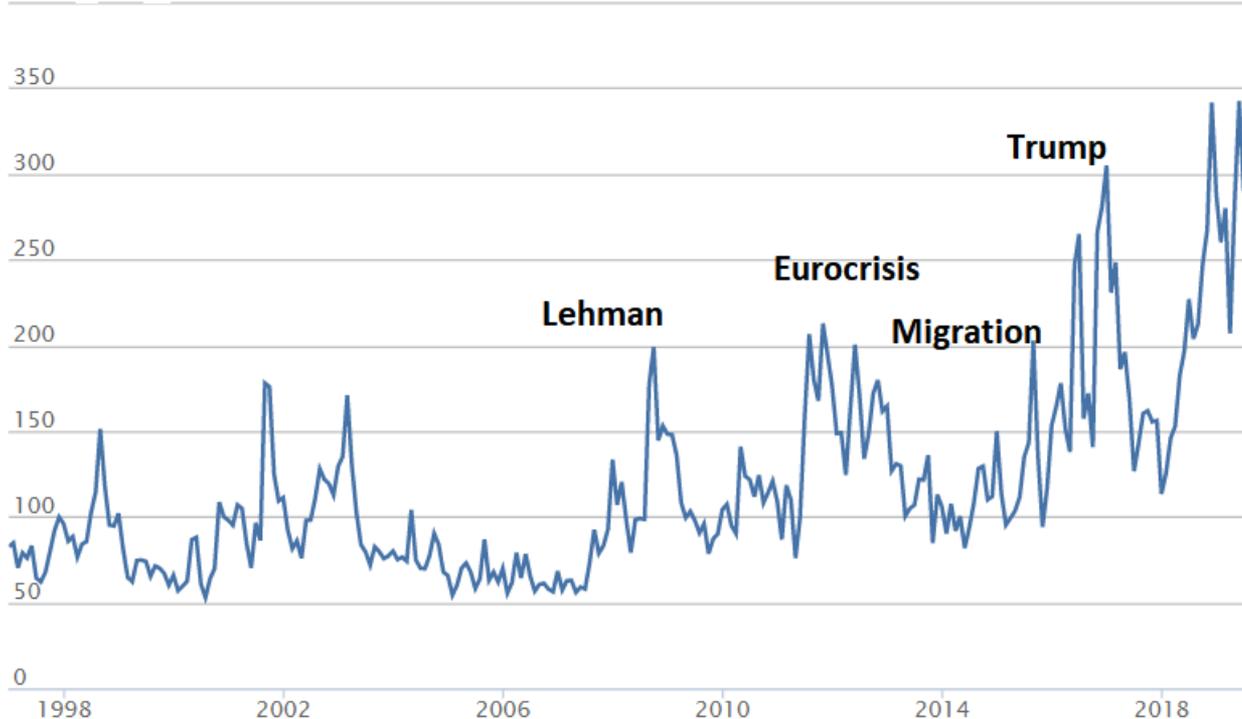   c. Position on the cycle

   d. Central banks and their policies

2. CEE and Czech Economy

   a. Common features

   b. Czech economy

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1.a. Political uncertainty as THE new significant phenomenon

Monthly Global Economic Policy Uncertainty Index

From: Dec 31, 1996 To: Sep 30, 2019


Index created out of 3 components (Baker et al.):

- ✓ *Intensity of mentioning of uncertainty in media*
- ✓ *Share of tax laws expiring*
- ✓ *Relative mistakes of economic forecasts*

Current crucial political risks:

- Trade
- Brexit
- Middle East
- Far East
- Eurozone, Italy

1.a. Causes of political uncertainty

Figure 4. Change in real income between 1988 and 2008 at various percentiles of global income distribution (calculated in 2005 international dollars)
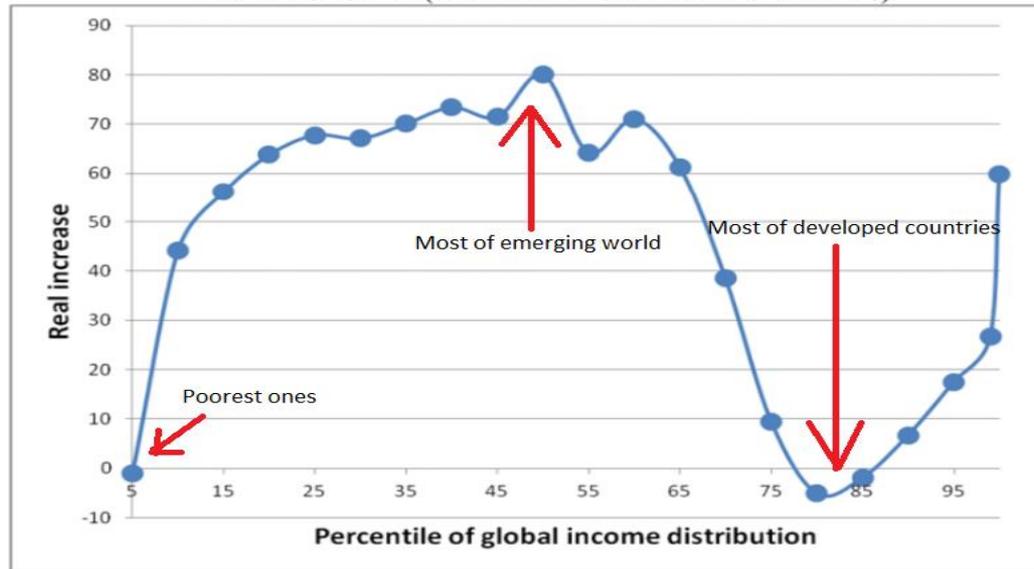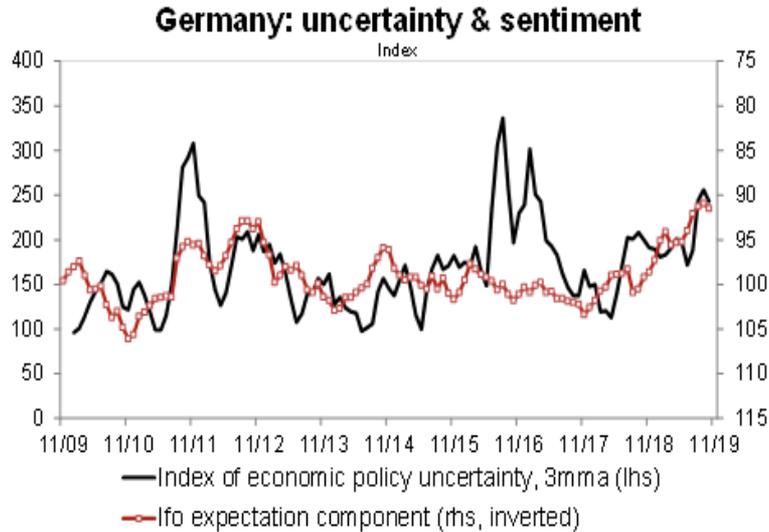

Note: The vertical axis shows the percentage change in real income, measured in constant international dollars. The horizontal axis shows the percentile position in the global income distribution. The percentile positions run from 5 to 95, in increments of five, while the top 5% are divided into two groups: the top 1%, and those between 95th and 99th percentiles.

Source: Branko Milanovic

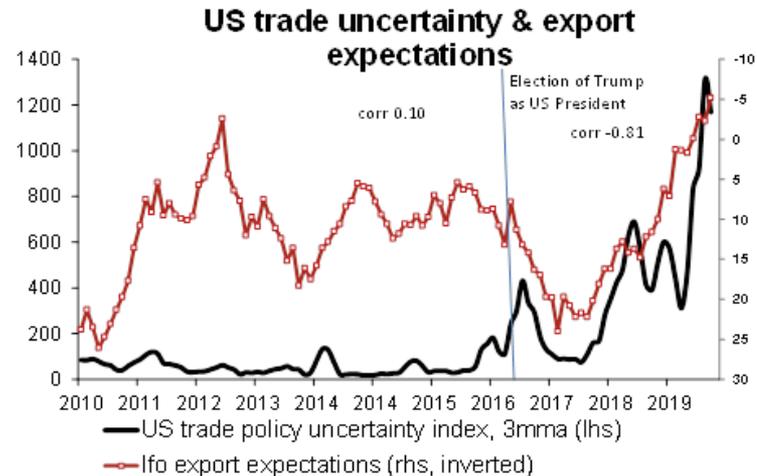<u>Why is successful "new" EU restless</u>:

- Picketty – profit outflows higher than EU funds inflows
- Darvas (Bruegel) – larger firms get most of EU funds
- Bershidsky – low corporate taxes
- EU unpredictability on accession
- Sufficiency of domestic financial capital – emergence of domestic financial investors

Germany: uncertainty & sentiment

Index of economic policy uncertainty, 3mma (lhs)
Ifo expectation component (rhs, inverted)

Theory is clear:

- Capex, investments
- Consumer's behavior
- Financial markets

US trade uncertainty & export expectations

Election of Trump as US President

corr 0.10

corr -0.81

US trade policy uncertainty index, 3mma (lhs)
Ifo export expectations (rhs, inverted)

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1.a. Particular source of uncertainty – EU rift?
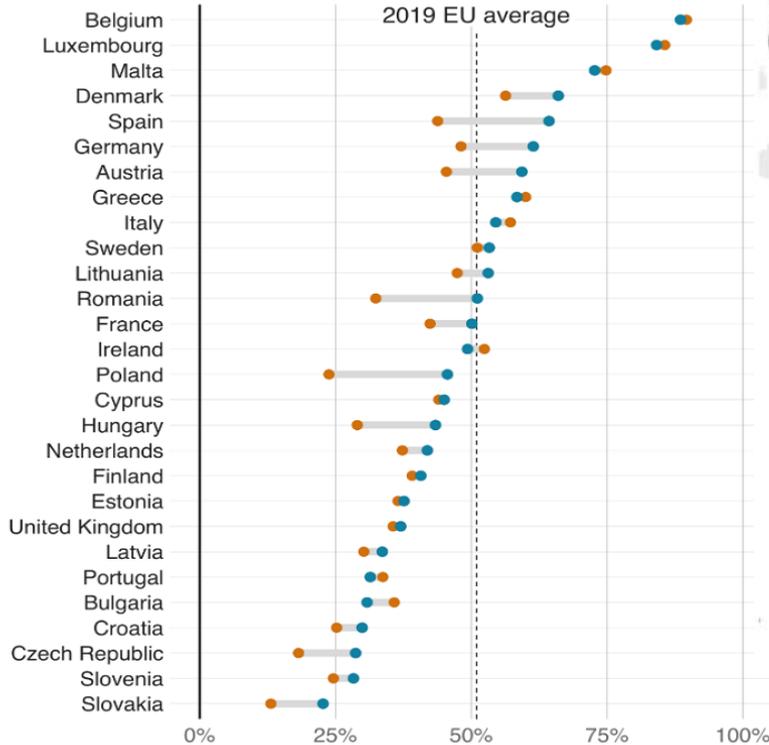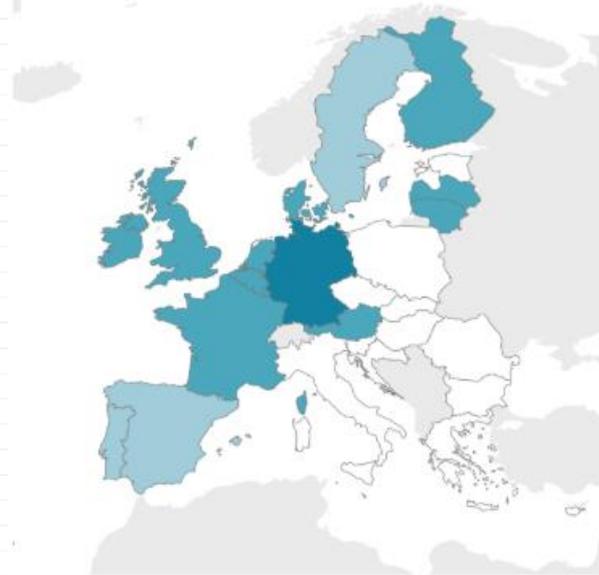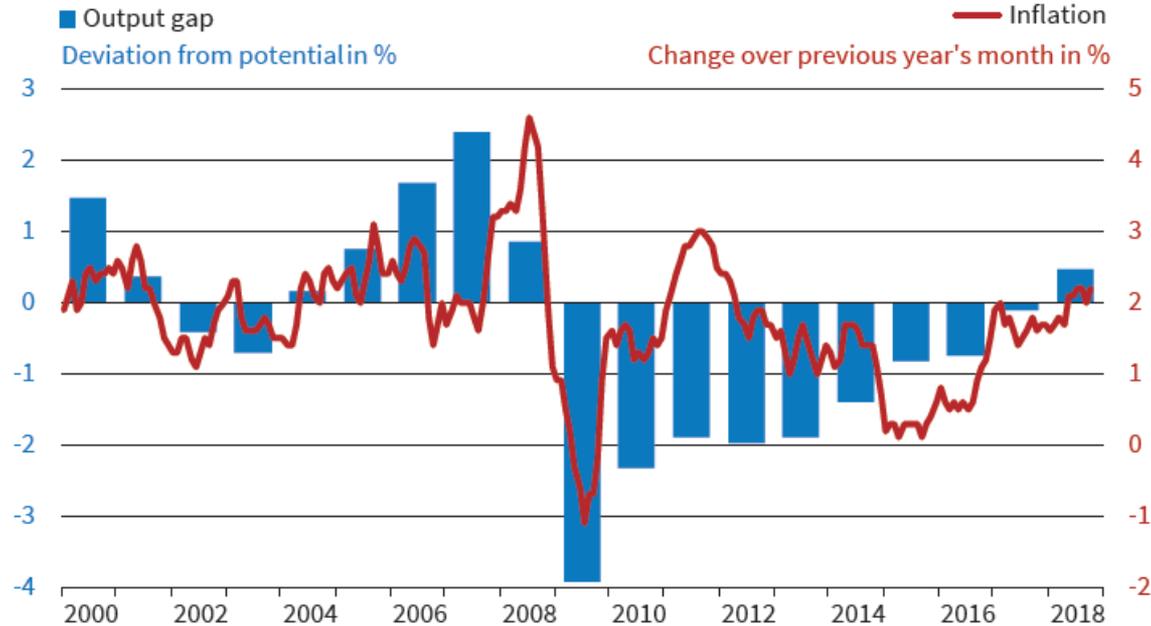

Turnout below EU average in 9 out of 11 „new" EU states

Greens uplifted and significant in the most of all EU states but didn't score at all in the „new" EU

Source: European Parliament

Where is the world economy on the cycle?

**Output Gap and Inflation in Advanced Economies**

Source: IMF World Economic Outlook, IMF International Financial Statistics;
last accessed on 3 February 2019.

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After the Great Recession, *i.e.* the worst crises of after war capitalism the economic growth is only mildly above potential and falling.

Neither sentiment nor growths prospects are tragic, but political risks worsen it

ifo World Economic Survey
Economic Situation
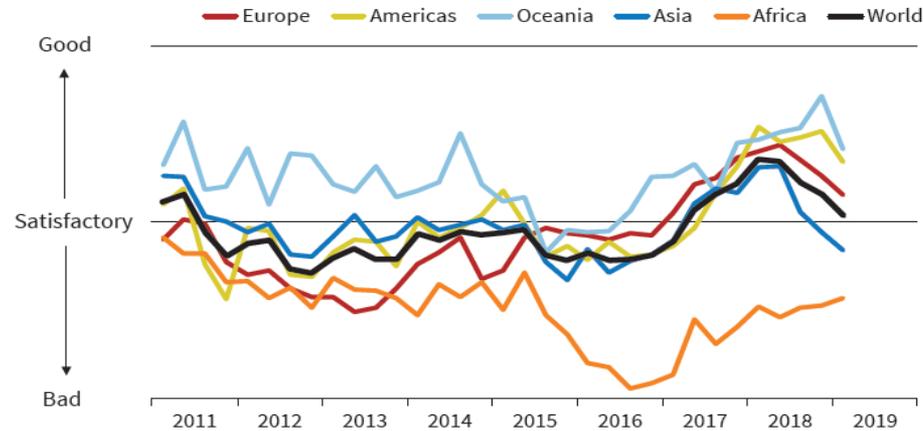
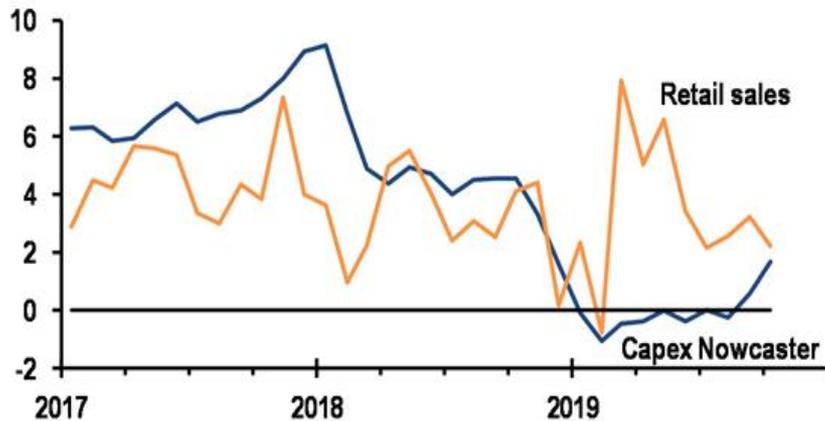Source: ifo World Economic Survey I/2019.

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	2018	2019	2020	2021
World	3,6	2,9	2,9	3,1
Non-EMU	1,5	1,2	1,2	1,5
Advanced	2,2	1,6	1,2	1,6
EM & Dev	4,8	4,1	4,5	4,6
Euro area	1,9	1,1	1,0	1,5

Time series – Last Mon night JPM delivery

Global goods demand
%3m, saar
Retail sales
Capex Nowcaster
Source: J.P. Morgan

Global PMI
DI, sa. Mfg is headline
Oct forecasts based on flash
Services
Manufacturing
Source: J.P. Morgan
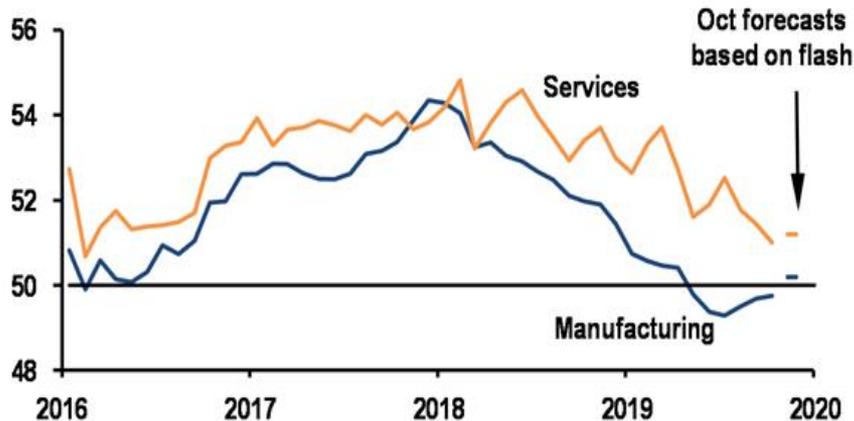
To live on a fresh info!

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Time series – Mon night JPM delivery 2.

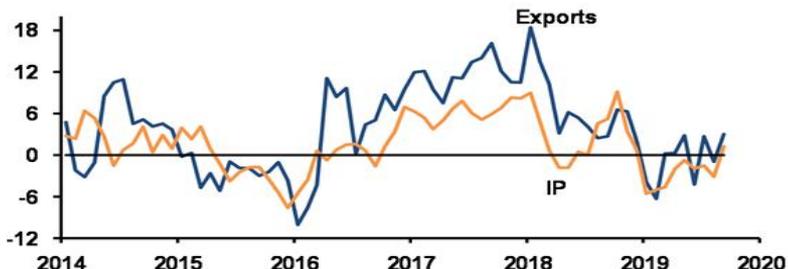## Global capex nowcaster

%ch, sa (ar for qrt). PMIs are levels.

	3Q19	4Q19	Aug 19	Sep 19	Oct 19	Nov 19
Inv. goods output PMI	48.4	51.1	48.2	49.0	50.9	51.1
Capital goods exports	3.0	-4.1	-3.2	-0.1	-0.5	0.7
Capital goods IP	1.3	0.4	0.1	0.7	-0.6	0.3
G-3 shipments	-0.8	-0.2	0.8	0.8	-0.8	-0.1
Nowcast	0.1	2.4	0.2	2.0	2.8	2.9

Source: J.P. Morgan, Markit, and national statistical agencies. Note: Shaded values show forecasts which are computed by the Kalman filter projections from the dynamic factor model. Underlined values indicate the tracking month and are estimated using bridge models.

Short term sentiment, capex and IP upticks coincide!
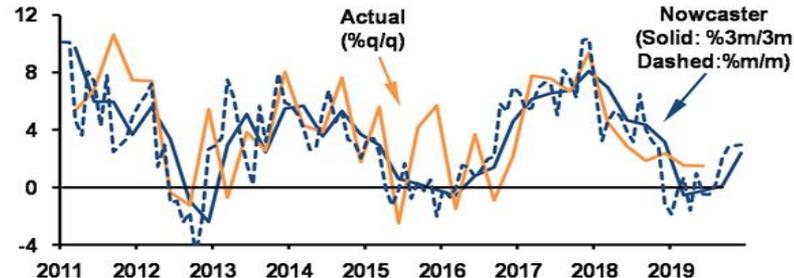
Global capital goods, exports and IP

%3m3m, saar; thru Sep

Source: J.P. Morgan

Global capex, actual and nowcaster

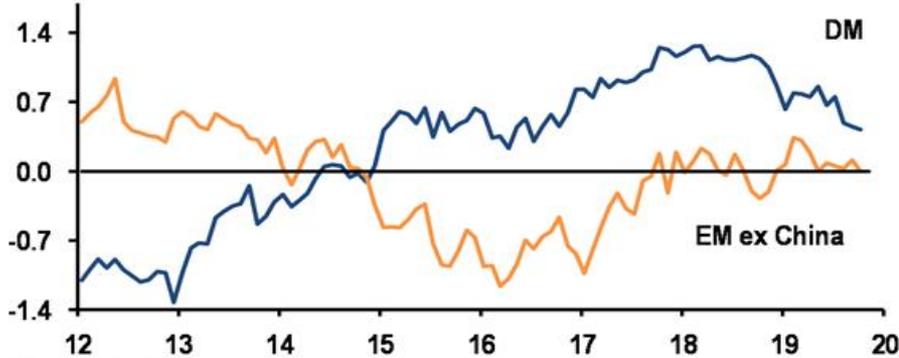%chg saar. Latest actual is 2Q19; Nowcast through 4Q19.

Source: J.P. Morgan

Time series – More global considerations – Consumer Confidence

Consumer confidence
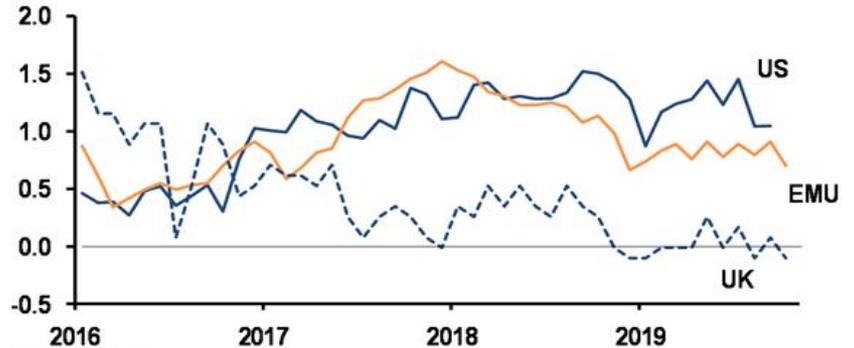ST.dev from 2010-pres average

DM

EM ex China

Source: J.P. Morgan

Keep in mind, consumers in DM stay positive!
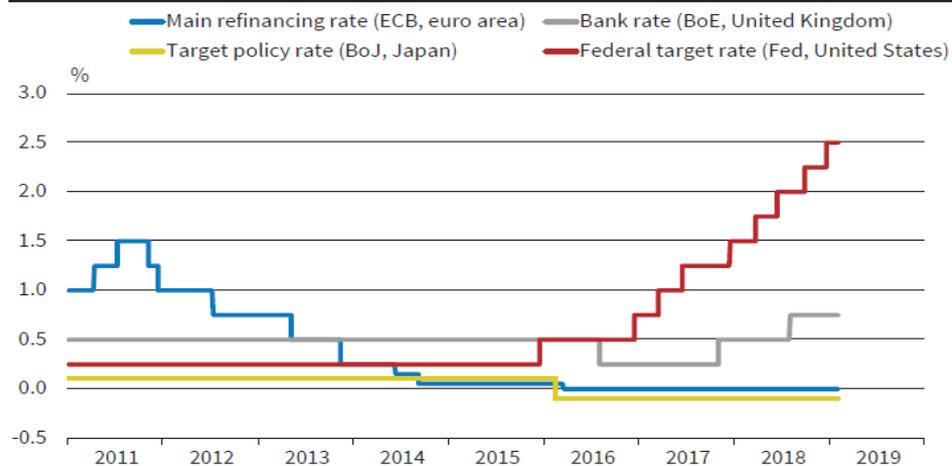

Consumer confidence
Std dev from avg, 2010 to present

US

EMU

UK

Source: J.P. Morgan

# Normalisation of some CB policies lifts the rates and stops growth of their BSs, ECB opens expansion

Central Bank Interest Rates

Main refinancing rate (ECB, euro area) — Bank rate (BoE, United Kingdom)
Target policy rate (BoJ, Japan) — Federal target rate (Fed, United States)

Source: European Central Bank; Federal Reserve Bank of St. Louis; Bank of England; Bank of Japan;
last accessed on 3 February 2019.

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Balance Sheets Sizes of Major Central Banks

Federal Reserve — Bank of Japan
ECB — Bank of England

Index (2007 = 100)

Forecast period
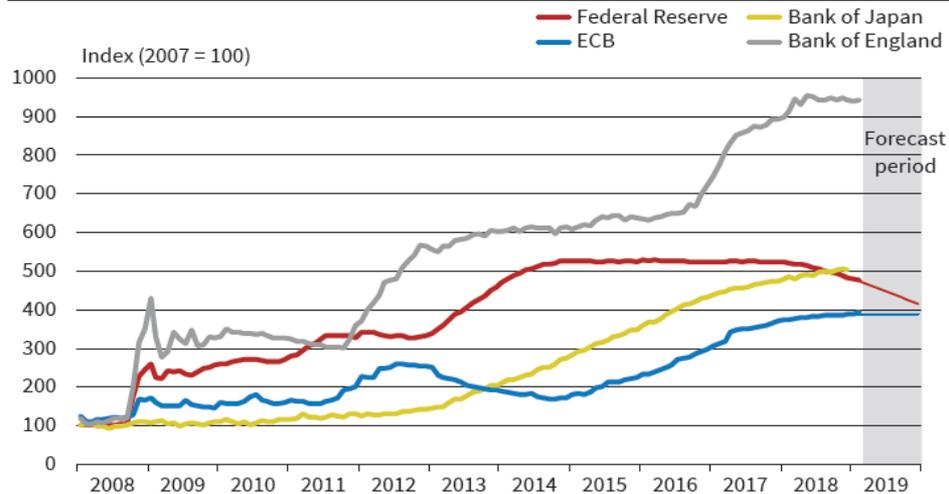
Source: Federal Reserve; Bank of Japan; European Central Bank; Bank of England;
last accessed on 3 February 2019; EEAG calculations and forecast.

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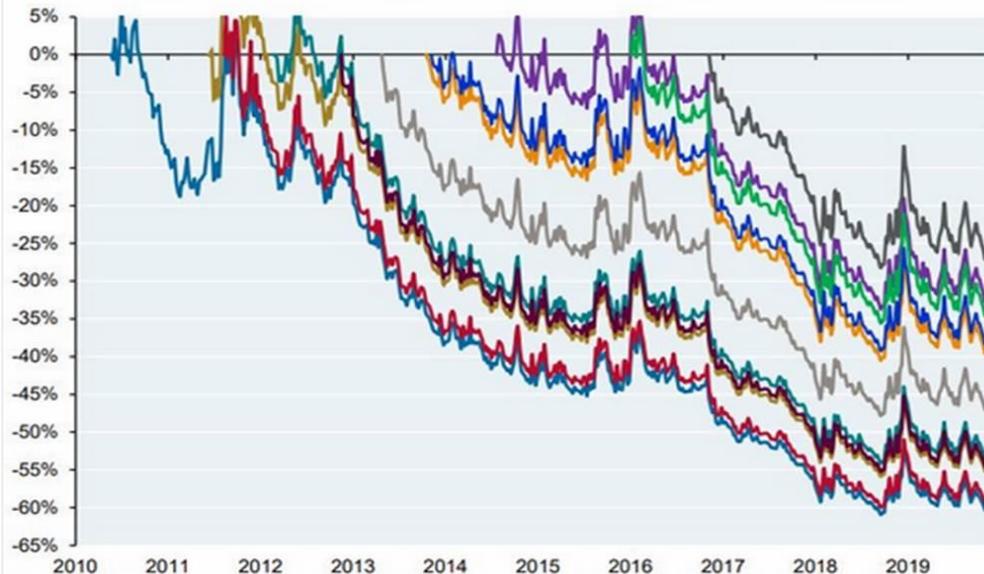# Motivation – Does it pay off to be very sober and careful?

Simon Johnson & Paul Krugman
David Levy
Carl Icahn, John Hussman & George Soros
Bob Janjuah
Peter Schiff & Tom DeMark
David Stockman & Albert Edwards
Marc Faber & Laksham Achuthan
Robert Wiedemer
David Rosenberg
Jeff Gundlach
Nouriel Roubini

Posted on
WSJ: The Daily Shot
13-Nov-2019
@SoberLook

**The consequences of listening to the Armageddonists, 2010-2019**
Performance impact of shifting $1 from the S&P 500 to the Barclay's Aggregate Bond Index, measured from the week of the Armageddonist comment in Table 1 to November 8, 2019

Source: JPMAM, Bloomberg. November 8, 2019. Using weekly S&P 500 and Barclay's Aggregate data.

Inflationistas, dead!!
Secessionistas, dead!!
Soft Landers, dancing!!
- 11/12/2019, Jefferies

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CEE common features

- Way lot „better" Great recession
- Low unemployment and growth of wages, lack of labor
- Export oriented
- Reasonable fiscal outlook (Romania?)
- On average lower level of gov't debt
- Significantly faster growth

CE3 Government Bond Yields (10Y)

Legend: Bund — Hungary — Poland — Czech
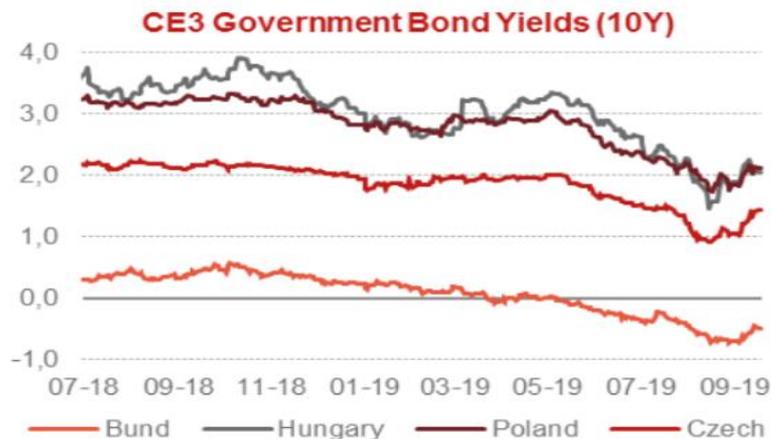
Economic Growth in EU Member Countries

Average real GDP growth, 2007–2017 | Real GDP growth, 2018
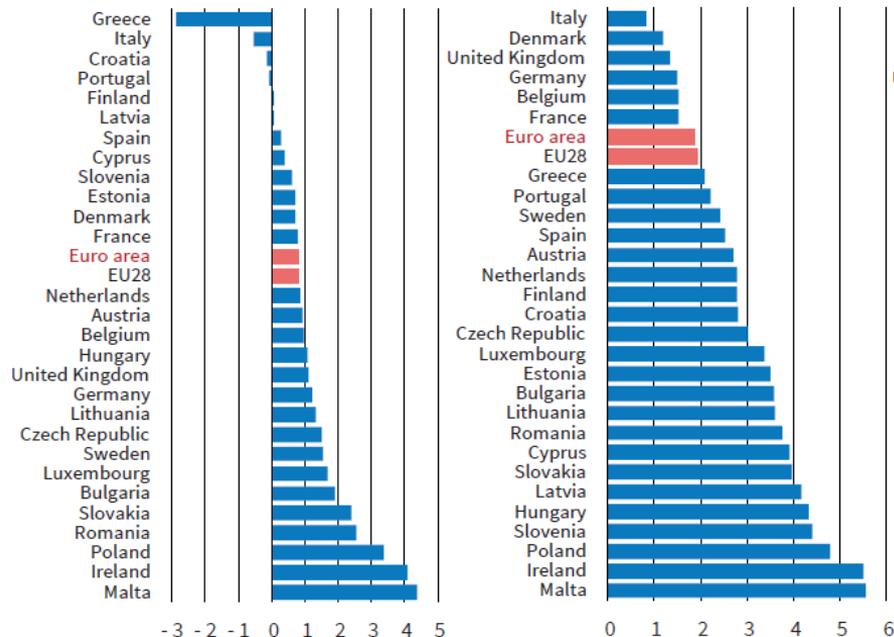
Source: Eurostat; last accessed on 3 February 2019; 2018 and 2019: EEAG forecast.

Long term characteristics of the Czech economy – industry and openness

Indicator [5]: Openness to imports of GOODS *(levels)*

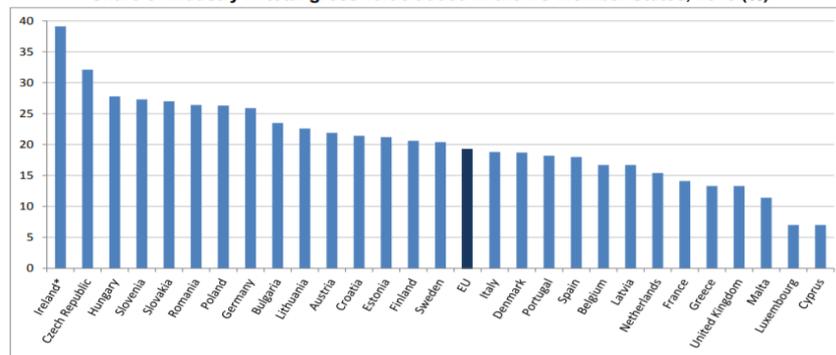30,9 % EU Avg. 2017

2015 · 2016 · 2017

Value of all goods imports – from any country, inside or outside the EU – as a share of GDP.

Total value of services imports as a share of GDP for 2017, by source (other EU countries or non-EU countries).

Exports of goods in 2017
(to EU countries and outside the EU)
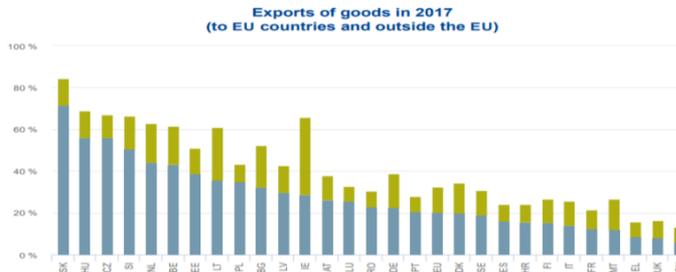
Share of industry in total gross value added in the EU Member States, 2015 (%)

* See country note
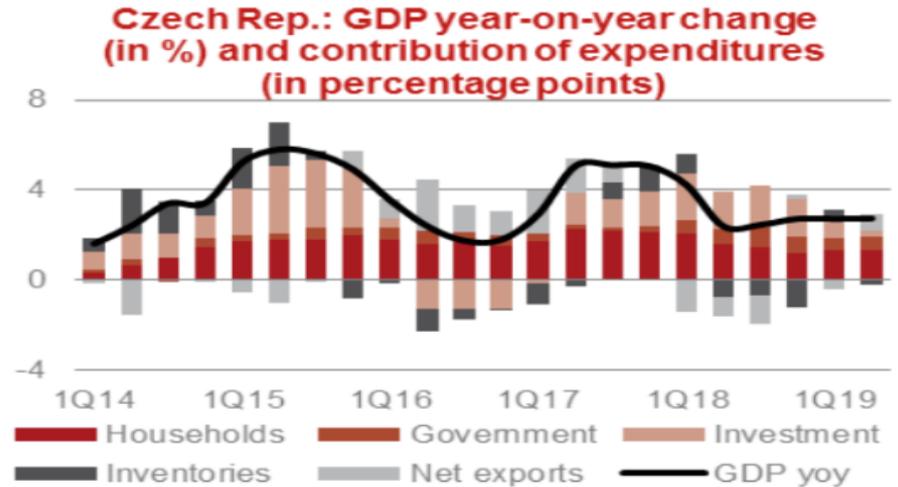
Openness must be considered in the context of size

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Czech Republic

Gov't majority unchanged, prime minister just absolved of EU fraud charges (unless…)

Economy – risks stemming from global trade tensions, but the lowest unemployment in OECD keeps consumers happy as wages are growing, weaker investments

Gov't willing to introduce the first sectoral taxes, legal framework might become rather unpleasant for business with class action law

Weaker than expected crown may cause CNB balanced by external developments, no hikes or cuts of rates expected this year


Czech Rep.: GDP year-on-year change (in %) and contribution of expenditures (in percentage points)

Legend: Households, Government, Investment, Inventories, Net exports, GDP yoy

Czech Republic	2016	2017	2018	2019f	2020f
Real GDP growth[1]	2,4	4,5	2,9	2,4	1,9
Inflation[2]	0,7	2,5	2,1	2,8	2,3
CNB repo rate[3]	0,05	0,50	1,75	2,00	2,00
Current account[4]	1,6	1,7	0,3	0,1	0,3
Budget deficit[4]	0,7	1,6	0,9	0,3	-0,2
General government debt[4]	36,8	34,7	32,7	32,0	31,5
EURCZK[2]	27,03	26,33	25,64	25,67	24,95

1) annual % changes 2) yearly average, 3) year-end level, 4) in terms of GDP

Source: GI CEE

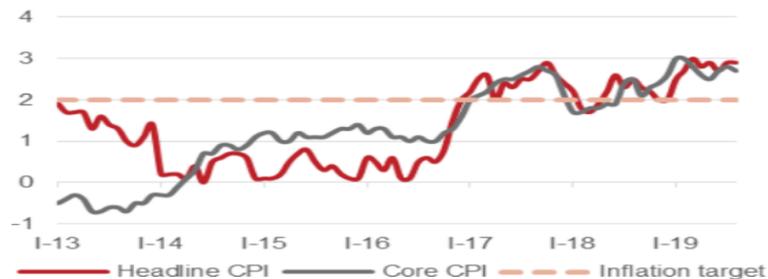# Czech economy – consumption driven, no short-term risks

Czech nominal and real wage and employment (yoy in %) - Mzdy

Zaměstn. - mezir — Mzdy nom. — Mzdy reálné

Czech nominal and real wage and employment (yoy in %)

Employment (s.a.) — Wage nominal — Wage real
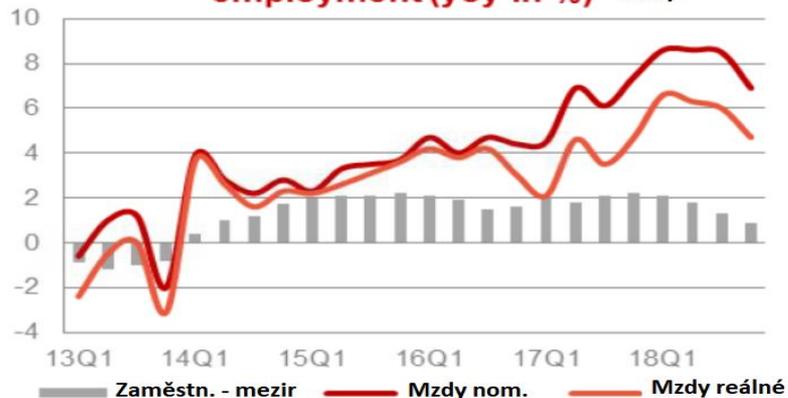
Czech CPI inflation (yoy in %)

Headline CPI — Core CPI — Inflation target

Long-term issuess

- Population aging and sustainability of high quality health care system and pension system
- Regulation of construction and infrastructure development obstacles
- Digitalisation of state

Stronger CZK or rate hikes? (5 years of exchange rate development)...

One Pleasant Face To End With!

Miroslav Singer

+420 281 044 873

Miroslav.Singer@generali.com

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