# How long will the post-EU summit euphoria last?

**04.07.2012**

- **Euphoria after recent EU summit might give markets positive impulse over summer**
- **ZEW-Erste Economic Sentiment Indicator CEE: stock market expectations weaker, but still ahead of Eurozone**
- **Turkey and Poland remain the hot spots of the region**
- **Investors to focus on financials/cyclicals**


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Although the sovereign debt crisis will remain a negative factor for the markets, a euphoric momentum after the recent EU summit and market-positive results for the long-awaited Greek elections might help bring a bright spot on equity markets.

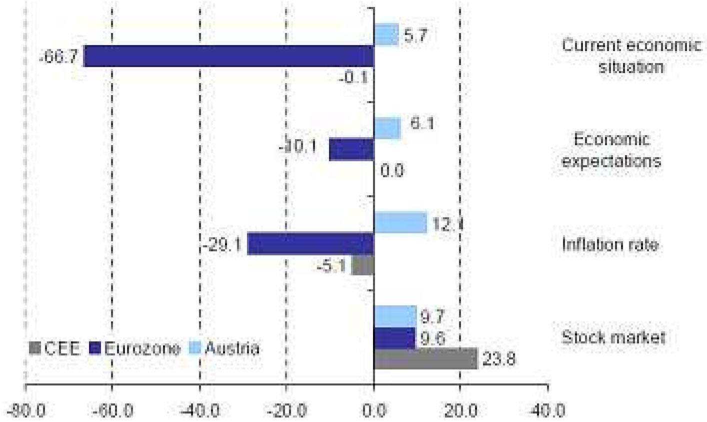
"We revised our GDP forecasts down for a couple of CEE countries because of the gloomy external environment, with the most visible revision in the Czech GDP forecast to -0.8% from 0% for 2012 (as fiscal consolidation and global uncertainty weighed strongly on domestic demand) and Croatia (to -1.8% from -1% for 2012). We also see further downward risks for Romania and Hungary (currently 1.2% and -0.5%, respectively)," comments Henning Esskuchen, Head of CEE Equity Research at Erste Group.

| Real GDP growth (y/y) | 2010 | 2011f | 2012f | 2013f |
|---|---|---|---|---|
| Croatia | -1.2% | n.a. | -1.8% | 1.0% |
| Czech Republic | 2.6% | 1.7% | -0.8% | 0.9% |
| Hungary | 1.3% | 1.7% | -0.5% | 1.2% |
| Poland | 3.8% | 4.4% | 2.6% | 3.0% |
| Romania | -1.6% | 2.5% | 1.2% | 2.9% |
| Serbia | 1.0% | 1.6% | 0.0% | 2.0% |
| Slovakia | 4.2% | 3.3% | 2.0% | 2.0% |
| Turkey | 8.9% | 8.5% | 3.5% | 4.5% |
| Ukraine | 4.2% | 5.2% | 1.0% | 3.0% |
| Austria | 2.3% | 3.0% | 0.9% | 2.0% |
| Euroland | 1.7% | 1.5% | -0.2% | 1.1% |
| **CEE8 average** | **2.4%** | **3.2%** | **1.1%** | **2.3%** |
| **CEE8+Turkey** | **4.7%** | **5.0%** | **1.9%** | **3.1%** |

"However, the CEE region still has a stronger economic growth than many countries from the Eurozone or Western Europe (1.9% in CEE vs. -0.2% Euroland in 2012). Poland and Slovakia in particular have been doing relatively well compared to their regional peers. The Polish economy is expected to grow by 2.6% this year, while the GDP forecast for the Slovak economy was slightly revised up to 2%, due to exceptionally strong car production. This year, Volkswagen launched the production of a new model, the VW Up", explains Esskuchen.

"Another positive fact is that despite massive cross-border deleveraging in peripheral euro area banks, we could see hardly any substantial reduction of foreign funding of banks in CEE, except for Hungary. Given that many CEE countries (apart from Turkey) have efficiently narrowed their current account deficits, FDIs and net EU flows (which represent non-debt financing) now cover almost the entire current account in Croatia, Czech Republic, Poland, Hungary and Slovakia", comments Esskuchen.

**ZEW indicator**

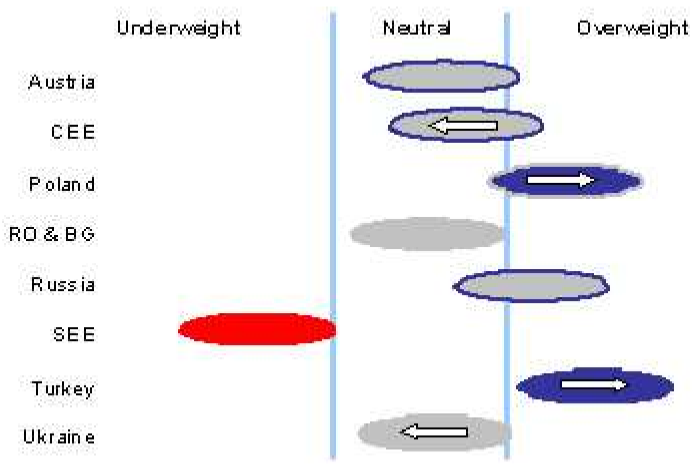



*Balance of positive and negative assessment category chosen by respondents of the Financial Market Survey CEE; Source: ZEW*

**Economic Sentiment for CEE better than for Eurozone**
Uncertainty has undoubtedly entered the real economy, with all major sentiment indicators weakening. Emerging Europe was not spared from this development either and the latest ZEW/Erste sentiment indicator for CEE delivered weaker figures on all fronts. While Emerging Europe still remains ahead of Eurozone in absolute numbers, the trend of the latest survey is the same for both areas. In particular a stronger decrease in economic expectations is quite prominent. The strongest decrease in economic expectations was mentioned for Poland, while the other regional outperformer in terms of growth, Turkey, remains pretty much unchanged. Expectations on stock exchange performance were consequently reduced quite strongly. While Turkey remains still ahead of other regional markets in absolute terms, the change in expectations was strong for Turkey after Austria.

**Country allocation: overweight on Turkey with Poland coming next, cautious on Russia**
"Turkey takes up quite a portion of our suggested portfolio. Poland comes next, a touch softer. We remain cautious about any oil price- driven outperformance of Russia", highlights Esskuchen. "Romania is seen as a bit softer, with delays of capital market transactions announced. SEE overall is seen as underweight, for liquidity reasons. CEE should continue to be affected by Hungary, especially by any news on negotiations".

**Country allocation proposal**




Source: Erste Group Research

**Austria - sound Neutral.** While sentiment is better and the markets are somewhat celebrating the results of the EU summit, this mostly supports the banking sector, which also has a strong weight in Austria's performance. Hence, the Austrian market will perform relatively well for as long as this lasts.

**CEE - sound Neutral:** CEE posts quite a strong showing. Czech Republic should not have contributed to the main driving force ¬–¬ valuation – despite being anything but expensive. However, while Slovenia is almost at the same valuation levels as Hungary, the latter still has to overcome a massive liquidity hurdle. This should happen only once sentiment and flows towards emerging Europe in total have recovered sustainably. Hungary has posted sound performance since the beginning of the year, supposedly on the back of continuous positive progress on tensions with the EU and IMF. Overall, CEE is at sound neutral position, slightly stronger than Austria.

**Poland - Overweight:** Although Poland is not among the cheapest markets in the region, the performance is still sound. Retail sales numbers support the model of a balanced economy, not overly dependent on exports. Hence, Poland, as one of the most liquid markets, could benefit almost as much as Turkey from the fact that Russia does not offer much of an alternative.

**Romania & Bulgaria - Neutral:** Both countries show quite strong expected returns through valuation as the main driving force. However, Romania has lost some of its appeal in terms of potential actions on the capital market, which also could have had an impact on its main problem – liquidity. Lately, hopes of a Transgaz transaction were revived. Due to the insolvency procedures of Hidroelectrica, the main target Fondul Proprietatea is currently not highly attractive. Hence, the Erste Group experts place RO & BG at neutral.

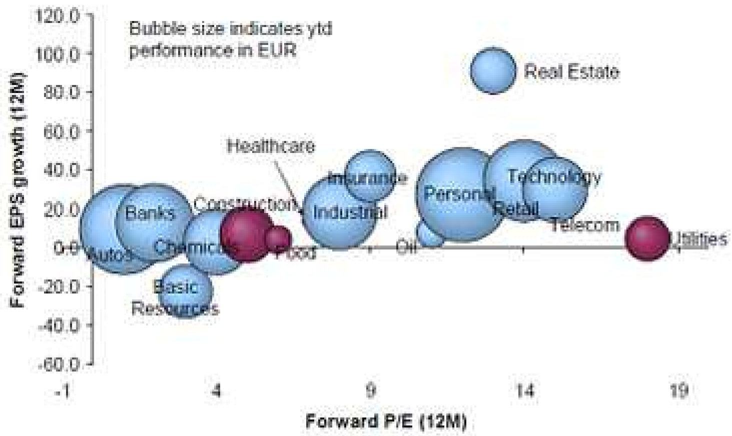
**Russia – Neutral to Overweight:** Assuming that the latest EU summit has somewhat broken the ice and might stir up sentiment towards the positive, the Russian market should benefit from superior liquidity and increasing risk appetite. Valuation, however, remains far from a strong argument since it is mostly the oil price which lends momentum to this market.

**SEE - Underweight:** Since Southeastern Europe needs a broader and long-term overall recovery to overcome the weak liquidity, Erste Group analysts confirm the underweight for the time being.

**Turkey – Overweight:** The outstanding market growth and expected returns confirm Turkey's overweight. Furthermore, the recent rating upgrade, attesting also a positive outlook supports this strong position. The biggest risks for the market might be that it loses its status of being a relative escape once other markets around it start to show signs of recovery.

**Ukraine – Neutral:** Due to the facts that overall growth for the economy is not overwhelming, and market depth as well as liquidity is not strong arguments in favor of the Ukrainian market, the Erste Group research rating for Ukraine was lowered towards neutral position, with a focus on Warsaw-listed Ukrainian stocks.

**Sectors – forward P/E, growth and performance***




*based on Erste Group Research coverage, red color indicates negative perfomance; Source: Factset*

**Sector allocation: positive on banks, real estate and retail**

"We remain positive about banks, as well as selectively real estate and retail on a selective basis. The banking sector has the most to gain back as it had by far the highest negative revision rates among all sectors from September 2011 to January 2012. In any case, with the revision in June even stronger than in May, this is still a momentum. Most of the positive bias is undoubtedly due to Turkish banks. The positive view on Oil & Gas still remains due to a sound outlook on integrated companies. A positive view on Automobiles & Parts should also find its justification in its Turkish exposure. Travel & Tourism is again pushed by Turkish components of the sector aggregate, which receives some additional impetus from weaker oil prices", emphasizes Esskuchen.

While food and beverage might actually be a good idea in uncertain periods, the current negative performance of the sector can be explained by the fact that Erste's exposure to the sector is based almost purely on players being traded in smaller markets with very thin liquidity. As a defensive sector, Erste analysts definitely prefer pharmaceuticals.

**TOP picks versus underperformers**

| July 2012 selection | |
|---|---|
| **Top picks** | **Expected underperformers** |
| Egis | BIM |
| Emlak Konut REIT | KGHM |
| Fortuna | UNIQA |
| Halkbank | |
| Immofinanz | |
| Isbank | |
| Kapsch TrafficCom | |
| Lenzing | |
| Migros Ticaret | |
| PZU | |

Source: Erste Group Research

**10 Top picks**
"We favor Immofinanz, KTC and Lenzing for Austria, PZU in Poland and we have added Fortuna for the Czech Republic (with a slightly more speculative touch). Finally, Egis has made it into our top picks, expected to finally close the performance gap with local peer Richter", recommends Esskuchen. "We removed Krka from the top 10 picks due to some local selling pressure in the short term and put the Czech Fortuna on the top pick list, as we expect outstanding 2Q results here. We also removed RHI, as we see more recovery potential in Lenzing, which recently came down quite significantly".

Presentation [pdf; 887.5 KB]

Report [pdf; 1.4 MB]