Is “13” the lucky number for the economy?

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“Necessary governmental austerity measures all over the world will prevent the economy from returning to a boom phase in 2013”, foresees Fritz Mostböck, head of Research at Erste Group. A continued conflict in the Middle East would burden the financial markets at least temporarily and oil and commodity prices particularly in the long run. In US, Fed’s purchases should improve consumer confidence and support the consumption in 2013. This would overall lead to an unchanged growth rate at 2% for 2013 and a gradual acceleration in 2014, providing a much-needed lift to global growth, in particular to exports in the Eurozone. European Central Bank measures improved sentiment on financial markets, which - looking at the underlying fundamental development (low growth) - should be a question of time until financial markets and real economy clash back. “After Croatia’s EU entry in July, we see up to 2.5% of GDP growth in 2014-2020 due to access to common market and to EU funds. The EU integration of the Balkans is expected to receive another boost during 2013 when Serbia is expected to get the kick-off date for negotiation”, underlines Mostböck.

“Global equity markets will perform well next year”, states Mostböck. Attractive valuations and the lack of alternatives should lead to positive returns in most stock market indices. European Corporate Credit should remain in investors’ focus, especially corporates with high geographic diversification and a broader client base who will record better cash flow generation. The limited investments for expansion and M&A could result in much stronger interest for new issues and tightening spreads, particularly by corporates in core regions. “In our view, investors should avoid investments in European telecom- and the utility sector as their weak performance will last also in 2013 and afterwards”, emphasizes Mostböck. “We see CEE car producers as an appealing investment. Every fourth car produced in the EU in 2013 will be "Made in CEE" as the former Czechoslovakia - with 2 million passenger cars estimated in 2012 - is now the second largest car producer in Europe right after Germany. CEE car production is continuously gaining share on expense of car producers from Southern Europe benefiting from competitive labor costs and strong presence of German (VW, Skoda) and Asian manufacturers (Kia, Hyundai, Toyota).”

Trends & Milestones in 2013 in detail:

The global debt situation will remain a dominant topic. It will be very difficult to cut the high level of total debt and of budget deficits; and that does not only apply to the Eurozone. The debt crisis in the large industrialised nations (Eurozone, USA, Japan, UK) will be challenging us for years to come. The economic environment will therefore remain fragile. The previous financial, economic, and confidence crisis is firmly lodged in the debt, the reduction of which will be difficult and time-consuming. This will put the financial markets and the real economy repeatedly to the test in the coming months.

The economic performance globally and especially in Europe will remain weak. In the past five years we have already seen a dampening effect on the economy in the wake of the financial crisis in 2008. The environment has been burdened by, and become more susceptible to, economic setbacks not the least due to the substantial level of government debt. Necessary governmental austerity measures will continue to dampen the environment on the demand side, and clearly prevent the economy from returning to a boom phase. The economic cool-down to more moderate growth levels in large emerging countries such as China and India will only make things more difficult.

Possible trouble spots in the Middle East. The currently still ongoing conflict in Syria, the tense political situation in Egypt etc might, from today’s perspective, cause irritation and uncertainty. The timing of unexpected events is difficult to predict – by their very nature. But what we can see is the escalation potential. That sort of conflict in the Middle East would burden the financial markets at least temporarily and oil and commodity prices particularly in the long run.

The US housing market recovery seems to be getting robust, especially given the Fed’s purchases: house prices, home sales and housing starts increase, while inventories decrease (nevertheless, foreclosures remain at high levels). This should improve consumer confidence and support US consumption in 2013, which is particularly important given the expected dampening effect from government spending. We expect the latter to be compensated for by the acceleration in private demand (consumption, investments once the fiscal cliff situation improves), leading overall to an unchanged growth rate at 2% for 2013 and a gradual acceleration in 2014. This should provide a much-needed lift to global growth, in particular to exports in the Eurozone.

Risk-on and further spread compression in 2013? High uncertainty is normally characterized by high volatility and high spreads. But Central Bank measures (e.g. LTRO, announcement of OMT) improved sentiment on financial markets and since June we have observed positive performance amongst all major asset classes, including higher risk asset classes. Looking at the underlying fundamental development (low growth), this risk-on mode is not fully justified and it should be a question of time until financial markets and real economy clash back. Ignoring risk-reward profiles in the meantime (investing money at the wrong price at the wrong time) could result in huge losses in the future. A bottoming-out of the Eurozone economy in 2013 would be crucial for further spread compressions.

European Corporate Credit should remain in investors' focus - despite limited fundamental growth prospects. Top line growth in the corporate sector seems limited in 2013 based on the subdued European demand. The divergence between corporates from the core region vs. periphery will become stronger, in our view. We believe that enterprises will continue their defensive balance sheet strategies. In fact, we do not see much room for further cost reductions. But the introduction of new products may be postponed. The companies will ensure liquidity via asset disposals, bond buybacks and refinancing them with longer bonds at the same time. Corporates with high geographic diversification and a broader client base will record better cash flow generation. The limited investments for expansion and M&A activities suggest that the new issue supply on the primary market might be subdued. This could result in much stronger interest for new issues and tightening spreads, particularly by corporates in core regions.

Eurozone unemployment driven up sharply by periphery - dampens inflation and rate outlook. The downturn caused by the debt crisis was accompanied by an unexpectedly sharp increase in peripheral unemployment - especially since May 2011. Before that, Germany's and France's unemployment rate decreased, offsetting increases in the periphery. The unexpected acceleration in Italy's and Spain's unemployment - related to the unexpectedly sharp downturn when the countries entered the debt crisis - is mostly driving the Eurozone unemployment rate now. The very high unemployment dampens inflation through subdued demand and low wage requirements. Based on our expectations for unemployment, we project inflation at 1.7% for 2013 and 1.3% for 2014. The disinflationary pressure will also make more support by the ECB necessary (rate cut to 0.5%, alternative measures), which dampens the outlook for rates and yields.

Italy: structural reforms are crucial - and will only be implemented by "moderate" politicians. Long-term growth prospects for Italy are crucial - in particular for the debt situation. In Italy, debt/GDP would decrease if nominal growth were higher than the financing costs for the government. Hence, Italy has to focus on enhancing growth before all else. In an environment of depressed domestic demand and deleveraging, foreign demand is crucial for the return to growth and needs to be supported by competitiveness increases. The business environment for firms could be greatly improved with further labor market reform, product market reforms (e.g. energy sector) and efforts to improve the ease of doing business. Furthermore, Italy needs to come closer to the technological frontier both in terms of research and development and education. These issues are central for innovation and should be emphasized. Elsewise, Italy would be likely to come under market pressure again, as even the ECB's purchase program is conditional on debt being sustainable as well.

Please see also "Italy: focus on growth": https://produkte.erstegroup.com/Retail/de/ResearchCenter/Overview/Research_Detail/index.phtml?ID_ENTRY=17846

Assuming ongoing reforms, an important dampening factor for the economic outlook is set to fade throughout the next year, in particular for German exports. A lack of improvement in the periphery would clearly increase the risks for a full blown recession and escalation of the debt crisis as a consequence.

Global equity markets will perform well next year. Many investors have missed the global stock market rally in 2012 and they probably will increase their exposure to more risky assets in 2013. Due to reasonably expected earnings growth in the corporate sector stock volatilities will remain subdued during most of the time next year. Attractive valuations and the lack of alternatives should lead to positive returns in most stock market indices.

The weak performances of the European telecom- and the utility sector will also last in 2013 and afterwards. Due to missing growth opportunities, inefficient structures and political influences these sectors will show below average profitability measures in the long run.

There is no sign of a reversal in the economic fate of these descending sectors. Negative returns in 2013 are highly probable. Investors should avoid investments in this kind of companies.

Every fourth car produced in the EU in 2013 will be "Made in CEE". CEE car production continues to outperform the car production in the Western Europe even in times of downturn. Combined car production in Czech Republic and Slovakia which is estimated at 2 million passenger cars in 2012 has already exceeded car production of countries like France or Spain. The former Czechoslovakia is now the second largest car producer in Europe right after the Germany. CEE car production is continuously gaining share on expense of car producers from Southern Europe. CEE benefits from its competitive labor costs and strong presence of German (VW, Skoda) and Asian manufacturers (Kia, Hyundai, Toyota) which have been gaining market share at the European market.

Croatia will become the 28th member state of the EU in July, thus ending the negotiations started in 2005. While the benefits from the EU membership may appear a less appealing compared to the last two waves of expansion, we see mid-term growth prospects profiting from access to common market and access to EU funds, where Croatia can hope to draw up to 2.5% of GDP in 2014-2020 period. The EU integration process in the Balkans is expected to receive another boost during 2013 when Serbia is expected to get the kick-off date for negotiation, confirming strong Serbian pro-EU orientation and support to structural reforms in mid-term.