CEE markets and stocks: continued upward trend in 2013

07.01.2013

- **CEE macro downturn to hit trough in Q1 2013; forecast GDP growth 2013: Poland 2.2%, Slovakia 1.3%, Romania 1.1%**
- **CEE Equity: possibly taking a short break in 1Q, liquidity further shifting towards risky assets present an upside risk**
- **ZEW-Erste Economic Sentiment Indicator improved for Romania**
- **An overweight on Russia is a strong bet for the coming quarter and mostly based on liquidity searching for an option after Turkey performing so strongly**

CEE markets will be driven by two major themes in 2013, Erste Group analysts point out in their latest "CEE markets and stocks" report published today. On the one hand, economic weakness and even recession are increasingly tangible, although the downturn is likely to bottom out in Q1 2013. What is more, the Eurozone crisis is seen as not massively escalate. Although the trouble is not over and a bottoming out cannot be called yet, we at least have more clarity as to where we are in the cycle. Based on these two assumptions, coupled with the strong reliance on central banks, equity markets have benefitted from an overall decrease in risk aversion. The abundance of liquidity and the search for meaningful yields have contributed as well. "These factors should lend support to CEE equity markets well into 2013, when we expect an overall continued upward trend. Going forward, more fundamental arguments such as improving earnings growth will be needed in order to carry markets further." states Henning Esskuchen, Head of CEE Equity Research at Erste Group.

CEE Macroeconomic picture: downturn to hit trough in Q1 2013
The weakening of economic growth in the CEE countries has continued. Weak export numbers along with subdued domestic demand are taking its toll on growth numbers with Turkey being the only exception. However, in the third quarter of 2012 besides Turkey also Poland and Slovakia still managed to show positive annual GDP growth. "We anticipate that the downturn in CEE will reach its trough in the first quarter of 2013," says Esskuchen.

Individual CEE markets posted a different performance in 2012, leading the Erste analysts to forecast:

- **-0.1% economic decrease in the Czech Republic**, due to the uncertainty in the euro zone coupled with domestic austerity policies and exports being the only source of growth,

Real GDP growth (y/y, %)	2011	2012f	2013f	2014f
Croatia	0.0	-1.8	0.5	2.0
Czech Republic	1.9	-1.0	-0.1	0.9
Hungary	1.6	-1.4	-0.4	0.8
Poland	4.3	2.4	2.2	2.5
Romania	2.5	0.0	1.1	2.3
Serbia	1.6	-1.5	0.5	2.5
Slovakia	3.2	2.3	1.3	2.5
Turkey	8.5	3.0	4.0	5.0
Ukraine	5.2	0.0	3.0	4.0
Austria	2.7	0.5	0.9	1.7
Eurozone	1.5	-0.4	0.4	1.0
CEE8 average	**3.2**	**0.6**	**1.3**	**2.2**
CEE8+Turkey	**5.0**	**1.4**	**2.2**	**3.2**

- **1.1% GDP growth in Romania**, as the renegotiation of an IMF agreement and the pressing ahead with the better absorption of EU subsidies will be credit-positive
- **Hungary to remain stuck in recession in 2013**. The government's economic policies undermine the potential for long

term economic growth and there is danger of returned risk aversion among investors, which could make the government's financing situation quickly negative again - especially in view of the fact that there is currently little outlook on an IMF agreement to be inked any time soon.

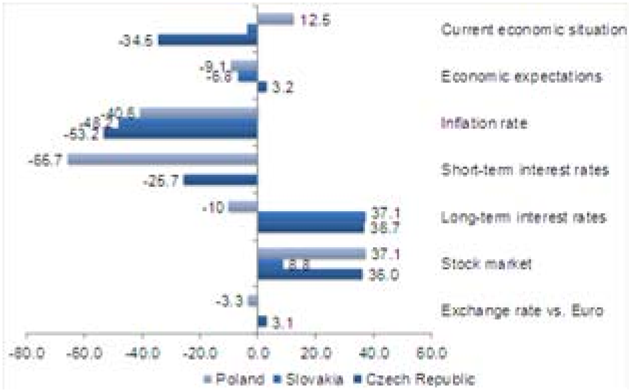
CEE Equity: slow start in January, stronger upside to kick in later in 1Q

CEE/SEE performed pretty well in the final quarter of 2012, at least when looking at the Czech Republic and Slovenia, Serbia going through the roof, while Croatia's performance has confirmed Erste analysts' bearish view. Poland also did better than expected, probably receiving more impetus from monetary easing. "We are actually pleased that Romania did so well, while our main reservation has been liquidity. Finally, calling Turkey a sound overweight has been definitely the right call, while Russia disappointed", summarizes Esskuchen.

In general, analysts expect a rather slow start for 2013 after markets closed the year 2012 so strongly. Soft consolidation could then face a clearer picture on what's on the growth outlook, establishing the basis for markets taking a second wind. "Taking profits and consolidating a bit would be nothing negative in our view, in particular since we believe that it was mostly a change in the view on risk that has been moving markets. We tend to see stronger upside to kick rather later in 1Q 2013, in particular," explains Esskuchen.

Economic Sentiment improving for Romania

The latest ZEW/Erste sentiment indicator for CEE(1) shows that economic expectations for CEE within the next six months have slightly worsened. For Czech Republic, Poland, and Slovakia, the experts still rather expect a stabilization of the economic development in the next six months. Hence, the assessment of the current situation in Slovakia and Poland is rather balanced or positive. Economic sentiments have significantly improved for Romania. Experts' assessment of the current economic situation has improved for Croatia, Hungary, and Romania.



Country allocation: An overweight on Russia is a strong bet for the coming quarter and mostly based on liquidity searching for an option after Turkey performing so strongly

"Our strongest call is certainly the switch from Turkey towards Russia. Romania and SEE (namely Serbia) might benefit from their status of frontier markets, assuming the overall view on risk remains positively biased. We remain rather cautious on Poland, with fundamentals certainly not creating a positive case. For Austria and CEE we remain cautiously optimistic, but again expect some consolidation after strong showing in 4Q 2012," explains Esskuchen.

Austria – neutral

Risk should remain a compelling driver for the market since it carries one of the highest equity risk premia - of course also owed to low yields. The market runs still some 700 basis points extra return for equity investments and the search for return besides weak bond markets could well lead towards the Austrian market. While we expect the market to rest after the strong closing in 2012, we rate Austria a bit softer than last time.

CEE – sound neutral

The group of markets consisting of Hungary, the Czech Republic and Slovenia comes in at a slightly positive rating. Consensus expectations for earnings growth in Slovenia are surprisingly strong, reasonable for the Czech Republic, but rather weak for Hungary. In case of the latter, expectations have decreased with the still high political risk on top of this. Monetary easing, quite likely will continue in Hungary, but most of that potential might have been used already. The Czech Republic, with recent dividend yields and its major blue chip, CEZ, still punished too much might be able to make a difference again.

Poland – neutral to underweight

Poland is not only the most expensive market in this region, but it is also already trading above its historical valuation levels. Growth outlook so far is the weakest among all its regional peers while liquidity is not expected to make much of a difference. A continuation of monetary easing should be supportive. Hence, we confirm the weak neutral call.

Romania and Bulgaria – moderate overweight

Fundamentals look decent and consensus earnings growth improved quite nicely recently. As long as the political situation refrains from interfering with the market too much, additional liquidity might find its way into that market.

Risk of course remains high and as soon as we see a major deterioration in overall sentiment, Romania immediately would have to pay its toll for being a frontier market.

Russia – overweight

The strongest argument that comes in for the Russian market right now should be liquidity - this in particular when looking at it as an optional play, relative to Turkey. As much as Turkey reaching a negative potential point of reversal in terms of liquidity momentum, Russia is approaching a positive. Performance in December 2012 indicates already a change, when the Russian market was doing as well as the Turkish. As quite a bet on Russia as a relative play to Turkey, with liquidity making the difference, we follow our model outcome and rate the market an overweight.

SEE – neutral to overweight
Assuming that the view on risk remains positively biased Serbia can be seen in a similar position as Romania. Risk is certainly high and liquidity will also remain a major obstacle. However, supported by reasonable earnings growth has the longest way to close the gap to its historical valuation levels. On Croatia the outlook is less positive. The consensus view on growth has recovered mildly just recently. Hence, combining the two markets, a neutral to overweight would be the result, softening the strong model outcome a bit.

Turkey – sound neutral
Even though certainly not expensive relative to its regional peers, Turkey was the first market to exceed its historical valuation level and currently trades 11% above its average P/E. Given its stellar performance in 2012, a break may be expected in 1Q 2013. Continued re-rating of the market based on further reducing risk premia in defining target prices remains a solid argument for the market. However, as a relative play versus Russia it might suffer in 1Q.

10 Top picks
“For Austria we favor **Semperit**, **Polytec** and **Verbund**, in Turkey **Akfen**, **Tornular REIT**, **Halkbank** and **Isbank**. We like the two banks due to their retail exposure and higher share of TRY funding base in their funding structure compared to other banks,” adds Esskuchen. From Romania, **Fondul Proprietatea** is in the top 10 list, where the stock has started to rise. **Krka** is back again among the top picks. “We expect a continuation of the recovery trend of **Richter Gedeon** where the doubling of the dividend was a positive move, with yields being still low.”

January 2013 selection	
Top 10 picks	Expected underperformers
Akfen	Philip Morris CR
Fondul Proprietatea	Lotos Group
Halkbank	STRABAG
Isbank (new)	
Krka	
Polytec (new)	
Richter Gedeon	
Semperit	
Torunlar REIT (new)	
Verbund	

CEE Equity Strategy Report (english) [pdf; 4.1 MB]

Presentation (english) [pdf; 1.1 MB]