ERSTE Group

Euro Zone Economy Continues to Trail US Economy

18.04.2013

Interest Rate, Currency and Stock Market Outlook for the Second Quarter

- low interest rates worldwide to continue
- Returns 2013: US more attractive than Europe
- Forecast: MSCI World +5% in Q2

"The sovereign debt problem is not resolved by a long shot, especially in the euro zone. The rehabilitation of government finances will continue to challenge the capital markets. The backdrop with regard to economic performance and financial markets therefore remains fragile", states Fritz Mostböck, head of Erste Group Research. "As a result of the moderate and in many cases still fraught economic developments, selectivity remains paramount. Overall, there will mainly be opportunities in a number of stock markets in Q2", says Mostböck.

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Economy

The problems in the euro area are not resolved by a long shot. With regard to the debt deleveraging of the private and public sectors, economic growth, respectively an improvement in labor markets is important. "Recently however, getting past the economic trough has come into question in the euro zone. The economic recovery therefore continues to be characterized by downside risks", says Gudrun Egger, head of Major Market and Credit Research at Erste Group. Domestic demand – consumption and investment – remains dampened and growth impulses can still only be expected through an improvement in the global environment, especially in the US. With the help of rising exports, companies should be able to increase employment in the medium term, which in turn would support consumption and could slowly get the euro zone back onto a growth path.

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Bonds

Due to the weak economy and possible downward pressure on inflation, the European Central Bank (ECB) may have to take further action. "The ECB is going to monitor all incoming data carefully and is prepared to act", says Gudrun Egger. Among its options would be a rate cut, the provision of liquidity (collateral), more targeted measures (purchasing program) or the announcement ("threat") of same. In any case, the ECB's policy should remain highly expansionary for an extended period of time. Low interest rates and low benchmark yields continue to be expected for all of 2013. The latter have recently also declined due to safe haven flows triggered by the restructuring of the Cypriot banking system. A cut of the ECB's repo rate to

0.5% in Q2 is definitely possible. In corporate bonds both in the investment grade and high yield segments a sideways move in yields is anticipated.

Stocks

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A rally in the MSCI World Index of up to a maximum of 5% is to be expected in Q2. The most important positive factors for stocks continue to be rising corporate earnings, low volatility and moderate valuation levels. In coming months growth stocks in the consumer, health and technology sectors should continue to be among the winners. “On account of the ongoing economic problems in the euro area, European stock markets should tend to be weaker in Q2 than the US stock market. The reasons for this are mainly the higher profit margins of US corporations and the stronger economic recovery in the US”, says Hans Engel, senior analyst of International Stocks at Erste Group.

Currencies

Up until now the ECB has been more restrained in terms of its policy measures compared to the Federal Reserve Bank (Fed). In the US, a recovery in the housing and labor markets is already visible and it is to be expected that the US dollar is going to slowly strengthen in the course of the year. With regard to the Swiss Franc, it is to be expected that the Swiss National Bank (SNB) will continue to defend its minimum floor price and that the EURCHF exchange rate will therefore remain close to or above the 1.20 level.

Report [pdf; 1.5 MB]