ERSTE Group

CEE markets & stocks: Emerging Europe stocks regain favour with investors

07.04.2014

GDP growth in CEE above expectations: Romania skyrocketing with 5.2%, followed by Poland and Hungary (2.7%) in Q4 2013; recovery to continue as CEE economies are set to expand by 2.4% in 2014

Partial relief of situation in Ukraine and Turkey, as well as renewed interest in emerging markets are main drivers for CEE markets & stocks

Country allocation highlights: Austria sound neutral; Turkey well suited to surprise in 2Q

The improvement of the real economy towards the end of the year came in as a positive surprise. In almost all CEE countries covered by Erste Group, GDP growth rates were above expectations. Romania skyrocketed with 5.2% (vs. Erste's 2.6% original estimate), Poland and Hungary showed a rate of 2.7%, the Czech Republic surprised with 1.3% y/y (against the analysts -0.2% initial call) and Slovakia with 1.5% also showed higher than forecasted growth.

"We expect a reasonable performance of CEE stock markets. The cooling down of the political situation in Ukraine and Turkey is providing a respite that might allow for a liquidity-driven uplift, provided that the shift of flows towards emerging markets proves to last", says Henning Eßkuchen, Head of CEE Equity Research at Erste Group. Apart from some immediate fundamental risk via corporate exposure, the most damaging fact of the Crimean crisis on the markets was the impact on sentiment and the risk of the conflict becoming hot. With these factors now fading a relief driven market support should be among the main reasons for performance in 2Q. However, the recovery rally based on a potential diplomatic solution (or at least not an escalation) for the Ukrainian situation, will not last for the entire second quarter. "Hence, we would expect the region to move broadly aligned, resulting in mostly neutral calls for individual markets", adds Eßkuchen. According to Erste analysts, emerging markets are garnering more investor interest due to a current trend of mixing more risky assets among developed market exposure.

Segment	Anlageklasse	--	-	neutral	+	++
Anleihen mit guter Bonität	Euro-Geldmarkt			•		
	Euro-Staatsanleihen mit bester Bonität			•		
	Euro-Staatsanleihen mit guter Bonität				•	
	Inflationsanleihen			•		
	US-Mortgage Backed Securities			•		
	Euro-Unternehmensanleihen					•
	US-Unternehmensanleihen			•		
Risiko-Anleihen	Euro High Yield			•		
	US High Yield			•		
	Schwellenländer in Hartwährung			•		
	Unternehmensanleihen Schwellenländern			•		
	Schwellenländer in Lokalwährung			•		
	Zentral- und Osteuropa in Lokalwährung			•		
Aktien	Entwickelte Länder					•
	Schwellenländer				•	
Andere	Gold				•	
	Immobilien					•
	Rohstoffe			•		

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Recovery to continue as CEE economies are expected to expand by 2.4% in 2014
Erste analysts expect the economic recovery in CEE to continue in 2014. “After the 1.2% growth seen in 2013, CEE economies should expand by 2.4% this year. Growth in CEE should be supported by less fiscal consolidation and the growth increase of export partners,” explains Eßkuchen. The best performer should be Poland, with 3.1% growth, followed by Romania, with 3%. The Romanian economy expanded by 3.5% in 2013, mostly due to a bumper harvest output. The Czech Republic (2%), Hungary (1.9%) and Slovakia (1.7%) should all post higher growth than last year, while Serbia may post slower growth than in 2013, with a 1.0% expansion. Croatia can only show stagnation (0%), on the back of fiscal restrictions, as well as export market and competitiveness problems. Turkey should grow by 2.3%, after a 3.8% expansion last year, given the internal economic uncertainty, a less supportive external market environment and a higher policy rate.

Country allocation: Austria sound neutral; Turkey well suited to surprise in 2Q
Erste’s analysts put **Austria** on a sound neutral position, since earnings growth and valuation do not lend much of a momentum to the market and the post-Crimea performance will not last forever. For pretty much the same reasons the analysts also keep CEE on neutral, with Slovenia potentially pleasing a bit more.

Poland stays on a moderate overweight. Its superior fundamentals relative to most of the region - in particular in terms of earnings recovery - is still visible although it got weaker. Banks are sound but pricey. Potentially, some previously underperforming highly volatile stocks might be worth a second thought right now.

Romania is not as bright a frontier market story as it used to be thus the Erste analysts soften the neutral towards the underweight area. Main reason is that while political noise calmed down a bit further market liberalization - so far a driving theme - has lost some of its steam for now.

Erste Group analysts see little fundamental arguments for **Croatia**, given the low growth and high valuations. **Serbia** might benefit from a new government tackling urgent issues. Hence the allocation recommendation is for sound neutral. “Overall we would remain cautious about smaller, less liquid markets in 2Q”, adds Eßkuchen.

Russia and **Turkey** are both being moved from underweight to neutral. Russia still does not offer any promising fundamentals apart from a positive impact of the ruble devaluation on its export-oriented business. However, some of the USD 4.4bn, which reportedly had left the country since September 2013 might flow back to take advantage of really depressed levels now. The same should be true for Turkey, after election came in with a market positive result. However, among the two markets, Erste Group Research sees Turkey as the more promising market, well suited to surprise in 2Q.

Sector allocation: cautious view on banks except for Poland; other sectors rather flat
In terms of the two markets that have strong exposure to the banking sector, Turkey and Poland, Erste analysts find Poland in a relatively comfortable situation. The driving theme of constant earnings revisions for the Polish banking sector is still somewhat visible, but much softer than before. According to Eßkuchen, at least some stock picking in the sector should make sense.

Turkey is now fully under the influence of lower growth outlook and substantially higher interest rates. The strong Turkish move by the Central Bank Turkey should also explain the massive deterioration in earnings revision shown for the entire banking sector above. However, this step might lend some momentum to the sector, reducing pressure on funding costs.

Other sectors appear to be rather flat in terms of earnings revisions, neither providing a support nor a challenge to our sector rotation model. Industrial goods and services are recommended due to the strong earnings recovery (in Erste’s sample mostly Andritz), but momentum is weak as well. Valuation is still pretty stretched for this sector too, being well above its historical average.

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