ERSTE Group

Global Strategy Q1 2019

Political conflicts and trade tariffs are weighing on sentiment. Economic growth is slowing and volatility in financial markets has increased. In the wake of the normalization of monetary policy by central banks safe assets are becoming less attractive. In the current environment we favor stocks in defensive sectors as well as HY and IG hybrid bonds.

Investment Strategy Q1 2019:

Govt. bond yields		Mar. 2019
Germany (10Y)		0.70
USA (10Y)		3.20
Currencies		**Mar. 2019**
EURUSD		1.11
CHF		1.13
Equity Performances		**Mar. 2019**
Global	➚	0%/ +5%
Europe	➚	0%/ +5%
USA	➚	0%/ +5%

Source: Erste Group Research

Prices as of
17.12.2018, 22:00

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Note:
Our estimates are in absolute and not in relative terms. Bond yields and equity market returns in local currencies. Past performance is not a reliable indicator of future performance.

Economy

Global growth momentum is waning. However, we see no signs of a severe slowdown in the US economy, but rather a correction from above-average, non-sustainable growth rates. In 2019 we expect US GDP growth of 2.3% y/y. Despite an ever tighter labor market, wage pressures remain subdued and there are no indications for an increase in US inflation rates yet. The euro zone economy is suffering from trade disputes and political uncertainty. In view of weakening export and investment growth momentum we are forecasting a decline in GDP growth to 1.5% in 2019, with a hard Brexit representing a potential downside risk. By contrast, an easing of trade tensions could lead to an improvement in economic growth prospects. The recent strengthening of wage growth should support a slight increase in headline inflation to 1.9%.

Bonds

The ECB will maintain its policy course and make a decision on rate hikes after the summer at the earliest. Due to political uncertainties and trade disputes, yields on German Bunds are currently very low. Even though the economy should lose momentum next year, the current level of yields is not justifiable. We therefore expect Bund yields to increase. Next year it will be more difficult to forecast the Fed's monetary policy, as the FOMC seems set to make rate hikes increasingly dependent on incoming data. We expect economic growth in 2019 to be sufficiently strong to justify three rate hikes and trigger a rise in yields on US treasuries. Valuations in the corporate bond market are already pricing in a lot of negative news flow. Should no additional risks materialize, we expect HY and IG hybrid bonds to outperform IG-rated corporate bonds.

Currencies

The appreciation of the US dollar has not come to an end yet, but we expect there will be a trend change in the course of 2019. Political uncertainties are lending support to the Swiss franc and we expect the currency to strengthen slightly further against the euro to a level of 1.13 by Q1 2019. In this environment we expect a slight increase in the gold price, which is underpinned by softening economic growth as well.

Stocks

Political uncertainties and slowing economic growth are leading to heightened volatility in stock markets. Thus investors should overweight defensive sectors such as health care or consumer staples more significantly than previously and reduce investments in cyclical sectors. We expect global stock market indexes to post moderate gains at the lower end of a range from 0% to +5% in Q1, amid continued high volatility.

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Investment Strategy Q1 2019

Yields		current	Estimates Q1 19	Q2 19	Q3 19	Q4 19
10y. Govt. bonds	**Germany**	0.24	**0.70**	0.90	1.00	1.10
	Austria	0.51	**0.90**	1.10	1.20	1.30
	US	2.88	**3.20**	3.40	3.50	3.50
	CEE					
	Czech Republic	2.02	**2.26**	2.34	2.43	2.51
	Hungary	3.25	**3.45**	3.63	3.75	3.81
	Poland	2.93	**3.00**	3.10	3.15	3.20
	Romania	4.72	**5.20**	5.40	5.40	5.40

Source: Erste Group Research estimates

Currencies		current	Estimates Q1 19	Q2 19	Q3 19	Q4 19
Global	**EURUSD**	1.13	**1.11**	1.12	1.14	1.16
	CHF	1.13	**1.13**	1.13	1.14	1.15
	Gold (USD)	1,246	**1,265**	1,280	1,290	1,290
CEE	**CZK**	25.80	**25.0**	24.7	24.6	24.5
	HUF	324.00	**325**	325	325	325
	PLN	4.28	**4.30**	4.28	4.26	4.25
	RON	4.65	**4.69**	4.70	4.75	4.77

Source: Erste Group Research estimates

Equities		Estimate Q1 2019	min	max	FX
Global		↗	0%	+5%	USD
	Europe	↗	0%	+5%	EUR
	USA	↗	0%	+5%	USD
Emerging Mkts.	**CEE**	↗	0%	+5%	EUR
	BRICs				
	Brazil	↘	-5%	0%	BRL
	Russia	↗	0%	+5%	RUB
	India	↗	0%	+5%	INR
	China	↗	0%	+5%	CNY

Source: Erste Group Research estimates

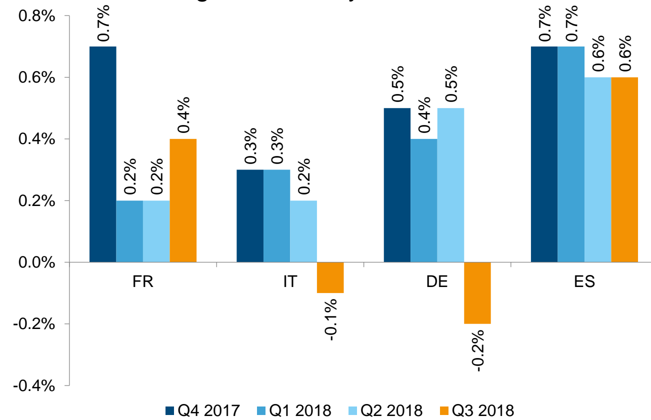
Euro Zone Economic Outlook

Trade dispute and European trouble spots weigh on outlook

Foreign trade and consumer spending dampen growth in Q3 2018

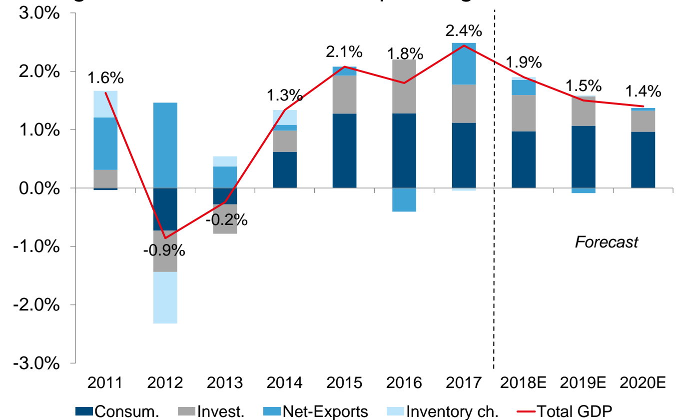
With a growth rate of +0.2% q/q, the euro zone economy lost considerable momentum in Q3 2018. For one thing, foreign trade lost further momentum due to the ongoing global trade dispute. For another thing, a negative one-off effect (car deliveries were delayed due to new exhaust emission tests) weighed substantially on growth, particularly in Germany and Italy. In addition, Italy's economy is under pressure from subdued sentiment triggered by the budget dispute between Rome and Brussels. Consumer spending in the euro zone weakened in Q3 as well, on account of declining consumer confidence and a strong increase in energy prices.

GDP growth (q/q) on the country level
GER and IT weighed down by one-off effects



Source: Eurostat, Erste Group Research

GDP forecast 2018 – 2020
Foreign trade and investment spending deteriorate



Source: Bloomberg, Erste Group Research

Hard Brexit and escalation of trade dispute as downside risks for the 2019 outlook

In the absence of the above mentioned negative one-off effects, we expect an acceleration in GDP growth to between +0.3% and +0.4% in Q4 2018 and Q1 2019. For 2018 as a whole, we expect GDP growth of +1.9%. As a result of deteriorating growth momentum in exports and investment spending we are forecasting a slowdown in euro zone GDP growth to +1.5% in 2019. However, a possible “hard Brexit” represents a downside risk for our forecast. A further escalation in the trade conflict (for example, a hike of tariffs on EU car exports to the US has been mooted) could also affect our forecast negatively. Conversely, an easing of trade tensions could provide a tailwind to foreign trade, which would improve growth prospects for 2019.

Headline inflation should rise moderately in 2019 (to around +1.9%)

In view of the first signs of accelerating wage growth we expect a moderate further increase in headline inflation to +1.9% in 2019 (2018: +1.8%). However, due to structural issues (fragmented labor markets in the euro zone, declining influence of trade unions) we anticipate only a gradual rise in core inflation, a macroeconomic aggregate that is of particular importance to the ECB's monetary policy stance.

US Economic Outlook

Slowdown in economic growth no surprise

Concerns over the US economy were a crucial factor in the enormous surge in financial market volatility in recent weeks. We believe these concerns to be overblown.

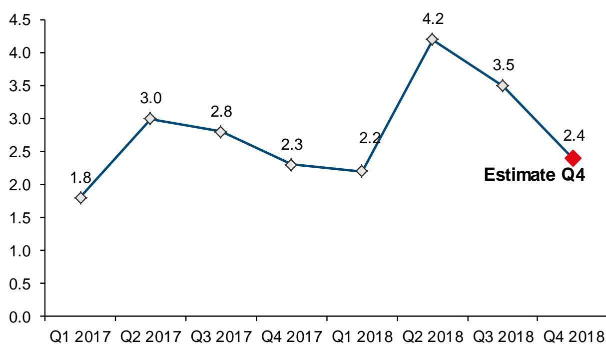
Economic growth slows from unsustainable levels

Initial economic data releases are indeed pointing to a significant slowdown in US economic growth in the fourth quarter. However, this slowdown is starting from very high levels and is attributable to the waning effects of the tax cuts and higher public spending. This is not really surprising. The question is where growth rates are likely to level out next year. Elevated stock market volatility could well continue to exert a negative impact on US economic data in November and December. However, we see no signs of an imminent severe slowdown in the US economy, let alone a recession. We rather regard recent developments as a correction from unsustainable levels. The long-term sustainable growth rate for the US economy is generally estimated to stand at around 2%. In 2018 the US economy has probably grown by 2.9% though, and most estimates call for growth in 2019 to markedly exceed 2% (OECD: 2.7%, IMF: 2.5%, Erste Group Research: 2.3%). Thus everything points to an economy that will cool off somewhat next year, but will be anything but weak.

Risks of overheating remain

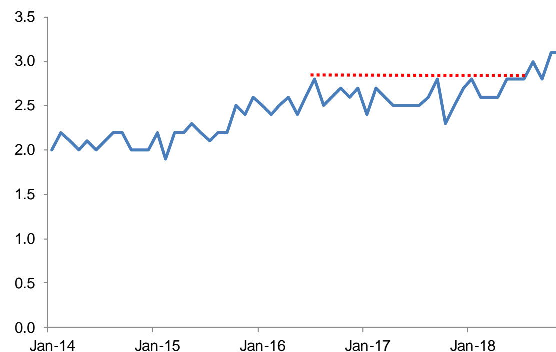
Growth rates of the extent mentioned above remain well above long-term sustainable levels and therefore suggest continued strong demand for labor. The US labor market should therefore become even tighter. This could lead to an acceleration of wage growth that may fuel a surge in inflation. Up until now only moderate wage growth is in evidence and there are no indications of an acceleration of inflation yet. Nevertheless, there is still a risk that the economy will overheat. In short, we consider the balance of risks for the coming year to be skewed in the exact opposite direction from that currently reflected in financial markets.

GDP growth slows from high level
Real GDP growth, annualized, in %



Source: Bureau of Economic Analysis, Atlanta Fed, Erste Group Research

Wage growth begins to rise
Average hourly wages, y/y in %



Source: Bureau of Labor Statistics, Erste Group Research

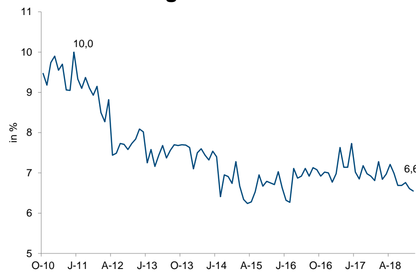
CEE Economic Outlook

Economic growth in CEE should decelerate to 3.6% in 2019, from an estimated 4.4% in 2018. The main reason behind the slowdown should be the gloomier external environment – especially the lower growth outlook for Germany – which partially reflects some fears surrounding post-Brexit foreign trade and the potential escalation of trade-wars. We also see hard Brexit and the buildup of new trade barriers as the biggest risk factor for CEE growth in 2019. From domestic factors, we see tight labor markets as the key limiting factor for production, especially in the Czech Republic and Hungary. Given the very steep growth of labor costs in these two countries, we expect some jobs in companies with lower productivity to cease and thus for unemployment rates to slightly bottom out from the record-low levels. That is also valid for Romania, where wage pressure has originated from unprecedented wage hikes in the public sector. Given than Romania's fiscal expansion has gone too far, its reversal will take its toll on growth in the next two years.

The latest inflation readings for most CEE countries were showing strong moderation of inflation. This is mostly due to the huge plunge in the oil price in the last 1-2 months, with the Brent and WTI oil prices plummeting by more than 30% from their early-October peaks. CEE countries already saw huge cuts in fuel prices, by roughly 10% in the last 1-2 months (fuel represents about 4-8% of CEE consumer baskets, depending on the country in question). Inflation in Poland collapsed to 1.2% in November, while core inflation is even lower. Inflation temporarily dropped below 2% in the Czech Republic, but high demand pressure should bring inflation above the target at the beginning of 2019. More spectacular decline of inflation could be observed in Romania, where inflation dropped to 3.4% in November (from 4.3%), also thanks to the reclassification of some services into the second reduced VAT category, with a 5% rate. The inflation rate should remain inside the NBR's target in the coming months in the absence of strong supply-side shocks. Inflation also declined substantially in Hungary (to 3.1% in November from 3.8%), but we expect it to temporarily increase to 3.5-4% in 1Q19 due to the base effect. Afterwards, inflation should slide towards 3%.

BRIC Economic Outlook

China Bloomberg GDP Indicator



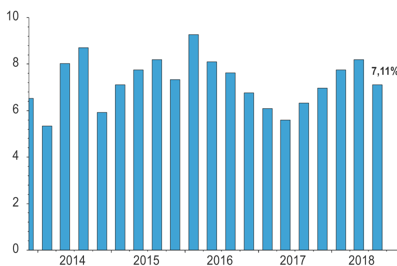
Source: Bloomberg, Erste Group Research

China

The meeting between Donald Trump and Xi Jinping at the beginning of December represented a first ray of hope in the trade dispute between China and the US. The US granted China a deadline of 90 days (until the end of February 2019) before potentially implementing the worst case scenario of raising tariffs on USD 200bn worth of Chinese goods imports. In return China agreed to resume imports of agricultural commodities from the US. The conflict has already resulted in a slowdown of Chinese economic growth to 6.5% y/y in Q3 2018 (from 6.7% y/y previously). Leading indicators released so far are pointing to economic growth cooling off further in Q4 2018. Accordingly, there is growing pressure on China's leadership to prevent an escalation in the trade dispute. In order to limit the economic damage, the government continues to maintain supportive fiscal and monetary policy measures. The stabilization in the RMB-USD exchange rate over the past three months indicates that investor sentiment toward China has not deteriorated further.

In the medium term the trade conflict leads to production capacities being shifted from China to other Asian countries (e.g. Vietnam and Thailand). In our opinion Mexico as a country directly bordering the US with a valid free trade agreement in place stands a good chance of benefiting from this development. In order to improve its future growth prospects, China will have to strengthen its domestic economy – for example through market reforms that foster competition. However, we expect that Xi will continue to be hesitant with respect to adopting market-oriented reforms.

India: Consistently strong GDP growth
GDP y/y, %



Source: Datastream, Erste Group Research

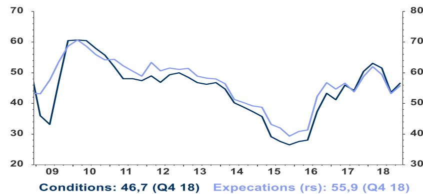
India

India's GDP grew by 7.1% y/y in Q3 2018. For 2018 as a whole, the IMF expects GDP growth of +7.3%. For next year it forecasts a similarly strong growth rate of +7.4%.

The manufacturing purchasing managers index rose for the third consecutive month in November, reaching 54.0 points. Manufacturers increased production at the second-fastest pace since October 2016, driven by stronger demand and higher revenues. Both the domestic and foreign new orders components rose. A further improvement in growth was also evident in the services purchasing managers' index. The index rose to 54.5 points, which was the highest reading since October 2016.

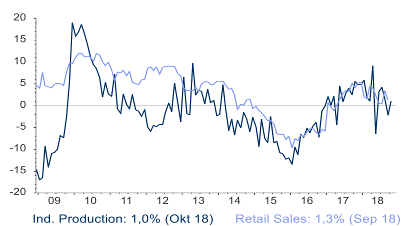
The Reserve Bank of India (RBI) left interest rates unchanged at its December meeting, in line with expectations. Thus the repo rate remains at 6.5%. Consumer price inflation in the developing country stood at a mere 2.3% in November, the lowest level since June 2017. Inflation has now declined well below the 4% target rate set by the RBI. However, the RBI expects the pace of inflation to increase to a range of 3.8% - 4.2% over the medium term – this is to say, within the first half of 2019. The Indian rupee has lost 12% against the US dollar since the beginning of the year. It nevertheless outperformed other convertible BRIC currencies over the same time period (RUB: -15%, BRL: -17%).

Brazil: Industrial Entrepreneur Confidence Index



Source: Datastream, Erste Group Research

Brazil: industrial production (y/y), retail sales year-on-year



Source: Datastream, Erste Group Research

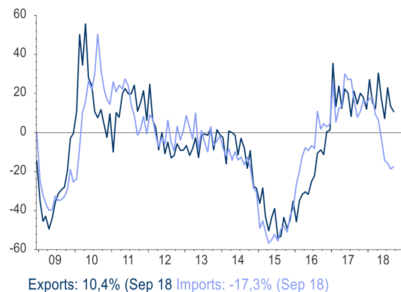
Brazil

Estimates for Brazil's GDP growth in 2018 have been reduced and currently stand at +1.3% y/y, followed by +2.4% in 2019. After Jair Bolsonaro was elected president of Brazil, the country's purchasing managers' indexes rose again. Both the assessment of current conditions and future business expectations improved. After declines in previous months, new orders and industrial production increased again as well.

The unemployment rate declined somewhat recently and reached 11.7% in the fourth quarter. The long term outlook is for a moderate decrease to 11.1% by the end of 2019. Consumer spending is estimated to grow by +1.8% y/y this year and +2.5% next year. Government spending remains consistently high. The budget deficit will likely reach -7.2% of GDP. Government debt is very high with the public debt-to-GDP ratio expected to amount to 87.3% in 2018. Thus the country has no budgetary leeway. The trade deficit is slightly deteriorating as well, due to stronger import growth. In 2018 it is likely to reach -0.8% of GDP.

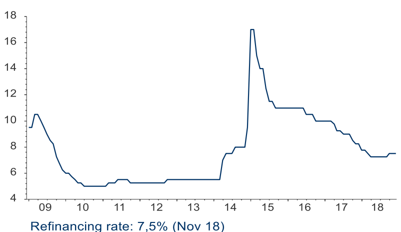
Brazil's central bank is holding the Selic rate steady at 6.5% since March. According to consensus forecasts rate increases are expected next year, with a first rate hike to 6.7% expected to be already implemented in the first quarter of 2019.

Russia: imports decline, exports grow strongly



Source: Datastream, Erste Group Research

Russia: refinancing rate



Source: Datastream, Erste Group Research

Russia

According to consensus estimates the Russian economy will grow by +1.7% y/y in 2018. In 2019 GDP growth is expected to decrease to +1.5% y/y. Consumer spending is expected to grow by +3% in 2018, followed by +1.8% in 2019.

Government spending is likely to grow only moderately in 2018 and 2019, by +0.5% in each year. Consumer prices are expected to rise by +2.9% this year and +4.8% in 2019.

Industrial production is likely to increase by +2.7% in 2018 and +2.0% in the coming year. Strong growth in exports coupled with declining imports should result in a trade surplus of +5.7% in 2018. Next year the surplus is estimated to reach +4.6%. The government is also likely to post a budget surplus both this and next year (2018e: +1.8% and 2019e: +1.7%).

The comparatively sound fundamental data backdrop should have a positive effect on ruble volatility. Consensus estimates are calling for the dollar-ruble exchange rate to move sideways in 2019. According to consensus estimates the refinancing rate is likely to increase only slightly from its current level of 7.5% to 7.65% by the end of the first quarter.

Bonds	Yield Forecast Q1 2019
Euro Zone Main Refinancing Rate	0.00 %
German Bund	0.7 % (10Y)

Crisis mode not justified

The ECB will maintain its policy stance and decide on hiking interest rates after the summer of next year at the earliest. Yields on German Bunds should rise.

ECB can continue to wait and see

From the ECB's perspective developments in recent months were disappointing. Economic indicators weakened, and the inflation rate of close to 2% was mainly achieved due to rising energy prices. By contrast, core inflation (excluding food and energy) - which is primarily driven by domestic demand - continued to exhibit no movement, but remained stuck close to 1%. From the perspective of the ECB a sustained move toward its inflation target therefore remains elusive. However, this fact does not make a change in monetary policy necessary yet, as the ECB has already committed itself to leaving interest rates unchanged at least through the summer of 2019. We maintain our forecast of a hike in the deposit facility rate in September, followed by a hike in the main refinancing rate in December. In doing so, we allow for a several more months until the pace of core inflation increases. Should such an increase fail to occur, we would alter our forecast and move the expected initial rate hikes to a later date.

Bond yields should rise

Financial markets were characterized by growing uncertainty in the final weeks of 2018. Concerns over US economic growth, the ongoing trade disputes of the US with China and the EU, and in addition the unresolved issues of the Brexit and Italy's budget caused investors to seek out the safety of government bonds. This resulted in low yields, such as those seen – temporarily – at the end of May, when the new coalition government of Italy was announced. We believe the craving of investors for “risk-free” German Bunds is bound to wane. While the economy should lose momentum next year, it should not become weak enough to justify recent yields. In our opinion political crises do not have the wherewithal to change that.

The dispute between the Italian government and the European Commission has calmed down somewhat recently and negotiations on the budget continue. In our view, however, an agreement will be a long time coming and therefore there is still the potential that this side will continue to trigger an increase in volatility. However, we do not expect the situation to escalate into a crisis. After the postponement of the Brexit vote in the British House of Commons, the terms of the divorce between the UK and the EU remain completely open. We expect the situation to be clarified in the first quarter, whereby a hard Brexit should be avoided. New elections or a new referendum are certainly on the table. In that case the EU would probably agree to a postponement of the exit date. In the event of a hard Brexit, we would expect yields to initially move to lower levels than we are currently anticipating. But even the economic impact of a hard Brexit would be digestible for the euro zone and hence a temporary affair. In our opinion bond yields therefore remain relatively clearly on track to increase based on current levels.

US	Yield Forecast Q1 2019
Federal Funds Rate	2.25 – 2.75 %
US Treasury Notes	3.2 % (10Y)

Volatility in US treasury markets increases

Next year it will become more difficult to forecast the Fed's monetary policy and we expect bond yields to rise further.

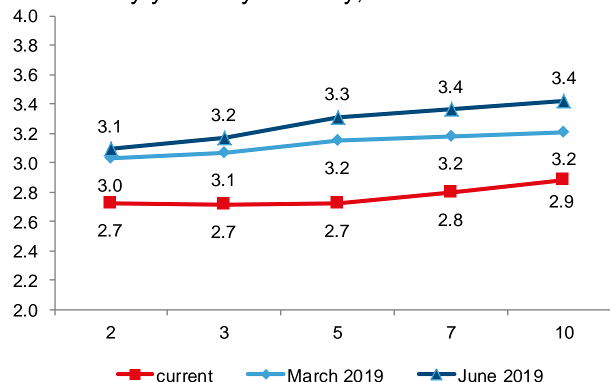
Fed transitions to fine-tuning of monetary policy

The Federal Reserve is highly likely to announce the next rate hike at the end of December, which is largely in line with market expectations. Of greater interest will be what FOMC members are envisaging with respect to the future path of monetary policy. We expect that the associated guidance will change. Up until now the FOMC statement contained a standard phrase noting that further *gradual rate hikes* would be consistent with reaching the Fed's policy objectives. Over the past two years, this translated into regularly recurring quarterly rate hikes. However, in the meantime interest rates have reached a level that requires fine-tuning. Next year the FOMC should therefore make rate hike decisions increasingly dependent on incoming data. That will make it more difficult to predict the future course of interest rates and this uncertainty should lead to a corresponding increase in financial market volatility. Due to the ongoing strong performance of the US economy we expect that three more rate hikes will be implemented next year.

Yields on US treasuries should rise

Yields on US treasuries have recently declined, mainly due to concerns about an economic slowdown, rising stock market volatility and to a lesser extent on account of political upheaval in Europe (Brexit, Italy). In the section on the US economic outlook we have already discussed our overall positive expectations with respect to the economy. Accordingly, we do not consider current market concerns to be justified. The trade policies of the US administration are contributing to skittishness in financial markets. Should grave consequences for the economy indeed become obvious as a result, the president could quickly initiate a de-escalation of the conflict. However, all in all we do not expect to see significant effects, even though occasional spikes in stock market volatility could continue. We rather expect that economic growth will be strong enough in the coming year to fuel inflation risks and therefore trigger an increase in bond yields.

Flattening of yield curve misguided
US treasury yields by maturity, in %



Source: Bloomberg, Erste Group Research

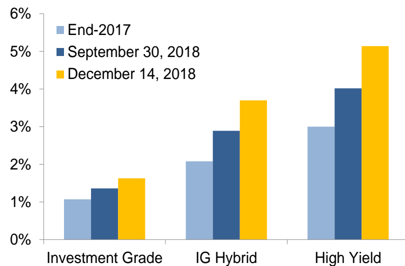
CEE Government Bonds	Yield Forecast Q1 2019
Czech Republic	2.26% (10Y)
Hungary	3.45% (10Y)
Poland	3.00% (10Y)
Romania	5.20% (10Y)

On the FX market, most CEE currencies seem to be, roughly speaking, fairly priced, with one exception, and that is the Czech koruna. The CZK would normally have to be stronger than now, in our view (a EURCZK of close to 26 seems somewhat weak), but there could be some factors that are preventing it from reaching stronger levels. Apart from external factors (i.e. prospects of a trade war), the rather high amount of long CZK positions of foreign investors (a legacy of the FX floor regime) could also be a reason. There is no substantial capital flight from the Czech Republic, but the high stock of foreign liabilities makes the Czech currency more sensitive to even slight outflows (which could be observed in 2018) in excess of current account surpluses, keeping the koruna weaker than it should otherwise be. Still, if the koruna fails to appreciate, the CNB might react by hiking rates more aggressively next year than currently anticipated. The RON should slowly weaken vs. the euro in the coming months (due to the ongoing twin-deficit situation), while the Hungarian forint and the Polish zloty are currently very close to the levels of our year-end forecasts and also to our expectations for the following few months.

The recent downward yield development seems to be the consequence of lower inflation expectations and rising risk of delayed monetary tightening. It is perhaps too early to say that the drop in the oil price is a sure helper for central banks to considerably delay rate hikes, as wage growth is still very high and domestic demand in very strong in CEE, but this could be a possibility in advanced economies. We see monetary tightening to slowly continue only in the Czech Republic, while we recently dropped our call for higher rates in Romania next year. Given that inflation should stay within the inflation target in the next couple of months and core inflation has moderated, the central bank does not need to rush with rate hikes, especially if the government is to reverse part of its fiscal expansion later next year. In Hungary, some sort of policy normalization could start next year, which could manifest itself in a slow increase of interbank rates, but this is unlikely to be achieved by raising the 0.9% policy rate. We rather think that the MNB will amend the outstanding amount of FX swaps (the bank has already started shortening the maturity structure of swaps), or, maybe, by increasing the deposit rate, which currently stands at -0.15%.

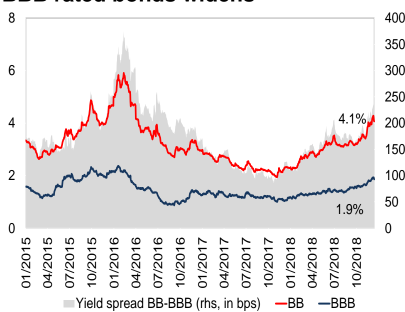
EUR-Corporate Bonds
Investment Grade
High Yield

Rising yields in all segments
Average yield in %
Average remaining term to maturity*: ~5Y



Source: Erste Group Research
* For hybrid bonds term to maturity until the first call date

Spread differential between EUR BB and BBB rated bonds widens



Source: Erste Group Research
As of 14 December 2018

Corporate Bonds in the Maelstrom of Politics

In the 4th quarter the performance of EUR-denominated corporate bonds suffered above all from numerous political events. Particularly the unresolved trade disputes between the US/China/Europe, the budget dispute between Italy and the EU and the Brexit negotiations weighed on sentiment. The resulting uncertainty among investors boosted demand for safe haven assets.

The plethora of risks dampened the economic outlook as well. The ifo business climate index for Germany posted its third consecutive decline in November and the euro zone purchasing managers' index remained weak. This affected primarily HY and hybrid bonds. The increasing nervousness of market participants was reflected in significantly wider spreads between EUR-denominated BB and BBB rated bonds. Thus the differentiation between different rating classes, which is already resulting from the end of ECB net purchases in December 2018, is becoming even more pronounced.

In our opinion the greatest potential triggers of downside risk currently consist primarily of political uncertainties. According to Moody's, in combination with a slowdown in global economic growth these should lead to a deterioration in the credit market environment in 2019. In our opinion, the recent significant increase in risk premiums is not justified based on fundamentals. Companies are currently in better shape than in 2016. Credit quality has on average improved and the 2019 outlook for all sectors remains either stable or positive. In the past two and a half years the ECB's CSPP program has provided companies with favorable refinancing conditions. Hence consensus estimates continue to call for a decline in aggregate net debt/ EBITDA ratios for the constituent companies of the STOXX 600 Index in 2019.

It is a fact that valuations in the corporate bond market already reflect quite a bit of negative news flow. Credit spreads are in a widening trend and currently stand at the highest levels in 2 ½ years. Should currently extant geopolitical risks not escalate further or should solutions or at least some progress with respect to political conflicts be achieved, one would accordingly have to expect strong rebounds. In that case HY and IG hybrid bonds should once again outperform IG rated senior corporate bonds. In light of currently elevated uncertainties we recommend only BB rated bonds in the HY segment.

As had been expected, the ECB announced at its meeting on 13 December that net purchases in the framework of the APP - which includes the CSPP - will be discontinued at the end of the year. Moreover, the proceeds from maturing bonds in the ECB portfolio will continue to be reinvested in the respective asset classes for an extended time period ("as long as necessary"). The volume of maturing bonds in the corporate bond segment of the portfolio is fairly small in 2019, totaling just EUR 6bn.

Currencies

	Forecast Q1 2019
US-Dollar	1.11

We continue to favor the US dollar for now

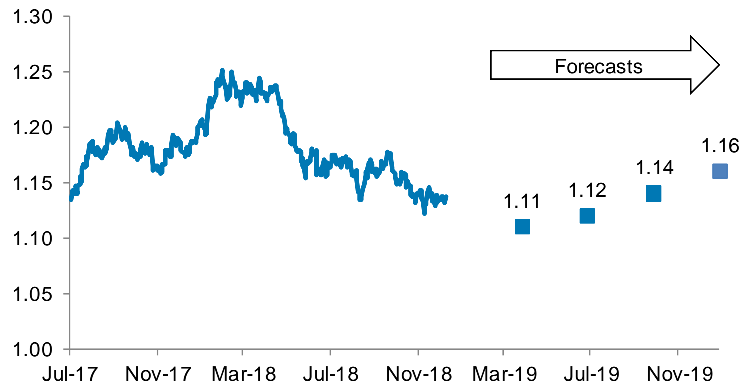
The appreciation of the US dollar has not yet come to an end. However, we expect a trend change to happen in the course of 2019.

Interest rate outlook continues to favor the dollar for the time being

In the beginning of the fourth quarter the US dollar gained further ground against the euro. However, in recent weeks EURUSD leveled out in a sideways move. The reason for this was that interest rate expectations in the US eased, which was reflected by a decline in two year treasury note yields. However, concurrently the euro also became less attractive, as economic data deteriorated. All in all, this resulted in the above mentioned sideways move.

We believe the US dollar's upward move has not ended yet. Markets should adopt a more optimistic outlook for the US economy again in coming months, which should provide a tailwind to interest rate expectations. By contrast, interest expectations in the euro zone should only firm up sluggishly. After the disappointing trend in inflation rates and economic growth in recent months, it will be more difficult for speculation on higher interest rates to get off the ground again in the euro zone than in the US. We believe this continues to argue in favor of the US dollar for the time being. Looking further ahead into 2019, the end of the US rate hike cycle will come into view. At the same time the beginning of rate hikes in the euro zone will be coming closer as well. Once these developments become obvious, we expect a trend change in EURUSD. However, for now we continue to recommend the US dollar.

The US dollar should gain further ground in coming months
EURUSD



Source: Bloomberg, Erste Group Research

Swiss Franc	Forecast Q1 2019
	1.13

Swiss Franc

SNB continues to maintain expansionary monetary policy

At its meeting on 13 December the Swiss National Bank left the target range for three month Libor between -1.25% and -0.25%, while the interest rate on sight deposits with the central bank was kept unchanged at a negative -0.75%. Since the last policy assessment in September, the Swiss franc has barely moved and recently traded at 1.13. According to the SNB, the franc is overvalued and the situation in foreign exchange markets remains fragile. Negative interest rates and the SNB's willingness to intervene in currency markets as necessary therefore remain essential in order to lower the attractiveness of investments in Swiss francs and ease upward pressure on the currency. The SNB's conditional inflation forecast for 2018 remains stable at +0.9%. For 2019 the forecast was lowered significantly from +0.8% to +0.5%. The forecast is based on the assumption that three-month Libor remains at -0.75% over the entire forecast horizon. In the short term the SNB estimates that global economic growth will continue to slightly exceed potential growth. Over the medium term it expects a gradual slowdown in global growth rates.

Since the strong rally in the Swiss franc vs. the euro, the EURCHF cross rate has stabilized in a range from 1.125 to 1.145. In our opinion a lasting easing of the pressures on the Swiss franc versus the euro would require that the Brexit issue be finally resolved and that Italy's government abide by the EU's fiscal rules. As a result of the political chaos in Great Britain the Brexit drama is bound to keep generating uncertainty in financial markets at least until the end of January. Due to the damage it has already done, Italy is likely to remain a factor even longer, which should strengthen the Swiss franc against the euro. We expect that continuing weak economic data from Italy in coming quarters won't be able to provide any contribution toward easing the tensions. New elections (rumors about this possibility are already making the rounds) would not help either; on the contrary, the election campaign could well create more upheaval. In this environment we are forecasting the Swiss franc to remain firm vs. the euro at around 1.13 by the end of Q1 2019. However, a minimum exchange rate is no longer enforced. Should certain risks materialize (e.g. geopolitical conflicts, escalation of global trade disputes, turmoil in the EU, a hard Brexit), the Swiss franc could appreciate rapidly and strongly.

Gold in USD	Forecast Q1 2019
	1,240 – 1,290

The gold price rose by +4.5% in USD terms in the fourth quarter. The return since the beginning of the year was a negative -4.5% in USD terms and +1.3% in EUR terms. According the World Gold Council gold demand amounted to 964 tons in the third quarter. It remained almost unchanged year-on-year.

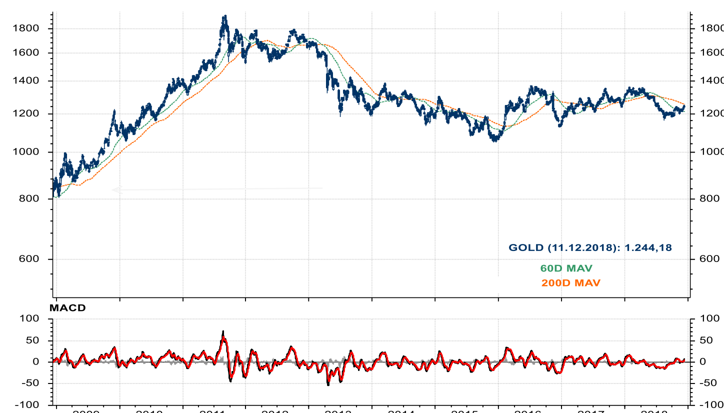
Investment demand from gold ETFs continued to decline in Q3, while physical demand and demand from central banks increased

In the investment segment gold ETFs reported a reduction in their holdings of around 103 tons. The strongest decline was recorded in North America. The most important driver was the fact that above all most US stock market indexes posted new all time highs in the third quarter. By contrast, due to the price decline demand for bullion in the form of coins and bars rose by +28% (y/y) to 298 tons in the third quarter. Gold demand by central banks developed positively as well, growing by +22% (y/y) to 148 tons. Particularly the central banks of Russia, Kazakhstan and Turkey boosted their gold reserves.

The outlook for the future trend in gold prices has slightly improved. An important driver for this is the decrease in earnings growth momentum of global corporations. This has led to surging stock market volatility. As a result, investors are probably increasingly focusing on the desire to enhance portfolio diversification. Outflows from gold ETFs, which were in evidence for several consecutive quarters, should therefore ease.

On the other hand, upcoming rate hikes by the Federal Reserve are exerting a negative effect on the gold price. One more hike in the federal funds rate is expected this year. The rate hike cycle is likely to continue, with three further rate hikes scheduled for 2019. The recent flattening of the yield curve points to a future slowdown in economic growth. This is a positive factor for the gold price trend, the importance of which has become more pronounced in recent weeks.

Gold priced in USD



Source: Datastream, Erste Group Research

Outlook: Elevated stock market volatility should induce investors to increasingly diversify their portfolios with gold-related investments. However, impending rate hikes by the Fed are currently capping the metal's upside potential. We expect a moderate gain in the gold price in the first quarter to a range from around USD 1,240 to 1,290.

Stocks

Forecast Q1 2019

Global — 0% to +5%

Consensus estimates
Earnings and revenue growth (y/y, %)

Indices	Sales		EPS	
	18e	19e	18e	19e
North America	10,1	5,5	38,8	8,7
Europe	5,5	-0,7	11,4	5,5
Asia	6,9	1,8	16,4	2,5
EM Asia	9,2	10,1	6,4	11,6
EM LatAm	-0,1	-0,3	44,4	11,9
EM Europe	22,6	-2,3	55,6	-3,3
World	**8,2**	**3,4**	**24,4**	**7,1**

Source: Erste Group Research Index, FactSet.

The trade dispute between the US, Europe and China as well as a weaker than expected outlook for corporate earnings resulted in higher volatility and a negative performance in global stock markets in the fourth quarter. The World Stock Index declined by -7% in EUR terms. Since the beginning of 2018 it has lost -2% in EUR terms. The US stock market exhibited moderate relative strength in Q4 compared to Europe and Japan. The Emerging Market Index outperformed developed markets with a decline of just -2%. However, since the beginning of 2018 the index has posted a loss of -6%.

According to consensus estimates, the outlook for sales and earnings growth on the global level remains positive in 2019. However, these forecasts are in a downward trend. Revenue growth at the 1,000 largest companies in the world is expected to amount to +3.4% in the coming year. At the beginning of the quarter the estimate still stood at +4%.

Earnings are expected to grow by +7% globally, instead of the +9% forecast in September. Expected earnings growth at US companies of +8.8% remains consistently stronger than that for European or Japanese companies (+5.5% each). From this important perspective US equities continue to be more attractive than European ones.

The valuation of global stocks currently stands at the historical average. The 2019 forward P/E ratio of the global stock market index stands at around 13x, the global forward dividend yield amounts to 2.9%. Based on positive growth prospects, these valuations appear reasonable.

Stocks remain attractive compared to bonds as well. The aggregate yield of a global index of developed market government bonds currently stands at 1.4%. By contrast, the dividend yield of global stocks is almost twice as high as the yield on global sovereign bonds. Moreover, equities continue to offer growth potential on account of the positive trend in global earnings growth.

Outlook

Stocks have in the meantime priced in a significant slowdown in revenue and earnings growth due to the correction in Q4. Stock market volatility has increased as a result. It seems likely that it will remain quite elevated in the first quarter, as various political conflicts (such as the trade dispute between the US and China or the impending exit of Great Britain from the EU) are not yet resolved.

In this situation investors should overweight defensive sectors such as health care or consumer staples more significantly than previously and reduce investments in volatile cyclical sectors. We expect a moderate gain in global stock market indexes amid continuing volatility at the lower end of a range from 0% to +5%.

Global Sectors (1)

Outlook:	-5% to 0
PE 19e	9,8x
EPS 19e	+8,6%

Energy
The energy sector benefited from the rally in oil prices in the first three quarters of this year. Last quarter the price of crude oil slumped by -30%. The analyst consensus expects earnings growth rates of +80.3% in 2018 and +8.6% in 2019. Revenues are expected to grow by +23.3% this year, but only around +2% in 2019. The comparatively low valuation (2019 forward P/E ratio: 9.8x and 2019 forward dividend yield: 4.3%) reflects the prospective slowdown in growth momentum. We expect the sector index to deliver a return in a range from -5% to 0% in the first quarter.

Outlook:	-5% to 0
PE 19e	12,1x
EPS 19e	+3,2%

Chemicals
The chemical sector's relative weakness that already started several quarters earlier once again persisted last quarter. One reason for this is a sharp decline in corporate earnings and sales growth momentum. According to consensus estimates, earnings should grow by just +3.2% in 2019 and revenues by +3.4%. These growth rates are well below those forecast for 2018 (revenues in 2018e: +10.8%, earnings in 2018e: +12.9%). The deteriorating growth prospects for the sector should result in its relative weakness continuing. We expect the sector to post a negative performance in Q1 ranging from -5% to 0%.

Outlook:	-5% to 0
PE 19e	9,4x
EPS 19e	+1,6%

Commodity Producers
The sector index lost -9% in EUR terms in the 4th quarter. The 2018 performance in EUR is -15%. This sector is the only one for which the consensus forecast for 2019 expects a decline in revenues; it is seen to amount to -3%. Earnings per share should rise by +1.6%, which is far below the estimate for the World Stock Index. We therefore expect the sector to deliver a negative performance in the first quarter in a range of -5% to 0%.

Outlook:	0 to +5%
PE 19e	15,9x
EPS 19e	+14,5%

Construction & Building Materials
The consensus estimate for revenue growth in 2018 is +10.4%. Earnings are expected to grow by +28.5% in 2018. Growth momentum should ease next year. In 2019 revenues are expected to grow by +2.5% and earnings per share by +14.5%. Expected revenue growth rates for US-based companies are significantly higher than those for European ones. We expect the sector index to post a gain in the first quarter in a range from 0% to +5%.

Outlook:	0 to +5%
PE 19e	14,5x
EPS 19e	+8,8%

Industrial Goods & Services
Revenues in the sector should grow by +10% in 2018 and by +4.4% in 2019. The expected earnings growth rate for 2018 is at a very high +28.2% and should weaken to +8.8% in 2019. Expected revenue growth is significantly higher in the US than in Europe. With respect to earnings growth European companies are likely to outperform US companies in 2019. We expect the sector to deliver a return at the lower end of a range from 0% to +5%.

Outlook:	-5% to 0
PE 19e	8x
EPS 19e	+5,6%

Car Manufacturers & Car Parts Suppliers
The sector posted the worst performance of all sectors in 2018 (-17.4% in EUR terms). The quality problems of German manufacturers in particular and the sea change shaking up the industry in the move toward electric mobility are weighing on traditional manufacturers. In terms of market capitalization, Tesla is already the world's third largest group in the industry. The outlook for the coming year is below average. Revenues are expected to stagnate (2019e: +0.2%), while earnings should come in below the global

Global Sectors (2)

average with an expected growth rate of +5.6%. We expect the downtrend in this sector to continue in Q1 2019 (-5% to 0%).

Outlook:	➚	0 to +5%
PE 19e		19,1x
EPS 19e		+4%

Food & Beverages
The sector posted a moderately positive performance in the fourth quarter (+1.1% in EUR terms). There has been little change in the growth outlook in recent months. Revenue growth of +2% is expected in 2019, while earnings growth is expected to be +4%. Shares in this sector are not subject to cyclical fluctuations and are on average considerably less volatile than the overall market. We expect a moderate gain in the sector index in the 1st quarter at the lower end of a range from 0% to +5%.

Outlook:	➚	0 to +5%
PE 19e		18,6x
EPS 19e		+9,6%

Household & Personal Care Products
Companies in this sector are expected to post earnings growth of +9.6% in 2019, a growth rate exceeding global earnings growth of +7.1%. The outlook for earnings growth is better for US companies than for European ones. US companies are likely to achieve earnings growth of +12.6% (vs. +5.4% for European companies). Expected revenue growth is higher for US companies as well. We are forecasting that the sector will post a gain between 0% and +5% in the first quarter of 2019.

Outlook:	➚	0 to +5%
PE 19e		16,5x
EPS 19e		+5,2%

Health Care & Pharmaceuticals
The relative strength of this sector persisted in the fourth quarter. Since the beginning of the year its performance in EUR terms has been +12.6%. Global earnings growth in 2019 is expected to be +5%. Earnings of US companies should grow by around +6.8% in 2019. European companies exhibit little momentum with expected earnings growth a mere +1.9%. We expect the outperformance of the sector to continue in the first quarter. Due to its lower volatility, investors should significantly overweight this sector at the expense of cyclical sectors. We expect the sector to generate a return between 0% and +5% in the first quarter of 2019.

Outlook:	➚	0 to +5%
PE 19e		23,5x
EPS 19e		+15,6%

Retail Trade
This sector is dominated by the Internet-based companies like Amazon and Alibaba. Online sales are growing well above average. According to consensus estimates revenue growth of +6.8% and earnings growth of +15.6% are expected in 2019. US-based companies are dominating the industry. We expect the sector index to deliver a gain at the lower end of a range from 0% to +5% in the first quarter.

Outlook:	➚	0 to +5%
PE 19e		19,3x
EPS 19e		7,7%

Media
This sector exhibited moderate relative strength in 2018 compared to the World Stock Index. According to consensus estimates the sector is expected to post revenue growth of +7.8% in 2019 and earnings growth of +7.7%. US media companies (such as Comcast, Netflix, Booking Holdings, Twenty-First Century Fox) are likely to achieve above-average revenue growth (2019e: +10.3%). We expect a moderately positive performance for this sector in the first quarter (0 to +5%).

Outlook:	➚	0 to +5%
PE 19e		14,1x
EPS 19e		+2,3%

Travel & Leisure
The sector has exhibited relative weakness compared to the broad market since the beginning of 2018. Comparatively low earnings growth (2018e: +7.6%) was an important reason for this. Earnings growth in 2019 is expected to be +2.3%. This is significantly below the average for global sectors overall. By contrast, the sector's valuation (2019 forward P/E ratio:

Global Sectors (3)

14.1x, 2019 forward div. yield: 2%) is slightly higher than that of the World Stock Index. We expect the sector index to post a moderately positive performance in the first quarter at the lower end of a range from 0% to +5%.

Outlook:	↗	0 to +5%
PE 19e		15,3x
EPS 19e		+11,6%

Technology
The global technology sector delivered a negative return of -9.4% in EUR terms in the fourth quarter. The return for 2018 as a whole was +6.2% in EUR terms. The volatility of stocks in this industry is generally higher than that of stocks in other sectors. The consensus expects revenue growth of +6.2% and earnings growth of +11.6% in 2019. The sector's valuation in terms of the 2019 forward P/E ratio is 15.3x. It is slightly above the global average as it reflects stronger growth prospects. We expect this sector to remain highly volatile in the first quarter, while posting a slightly positive performance in a range of 0% to +5%.

Outlook:	↘	-5% to 0
PE 19e		15,4x
EPS 19e		+9,9%

Utilities
Consensus estimates are calling for revenue growth of +0.6% in 2019. Earnings per share should grow by +9.9% in 2019. The strongest revenue and earnings growth rates will mainly be achieved in emerging markets. The sector's valuation in terms of its 2019 forward P/E ratio stands at 15.4x. This exceeds the global average, but the 2019 forward dividend yield is quite high at 4.2%. In the short term stocks in this sector should be less volatile than the broad market. We expect the sector index to post a slightly negative performance at the upper end of a range from -5% to 0% in the first quarter.

Outlook:	↗	0 to +5%
PE 19e		12,3x
EPS 19e		5,6,0%

Telecommunication
The defensive telecom sector achieved significant outperformance in Q4 by posting a return of -1.5%. However, it declined by -4.6% in 2018 as a whole. Revenues should increase by just +0.8% in 2019. Earnings per share are expected to decline by -8.1% this year and grow by +6% next year. From a regional perspective, the sector's growth in the US is expected to be above average in 2019 with earnings estimated to grow by +7%. Due to the volatile market environment, we expect the telecom index to post a slightly positive performance in Q1.

Outlook:	↗	0 to +5%
PE 19e		8,4x
EPS 19e		+6,2%

Banks
The global banking index posted a performance of -6.8% in EUR terms in the fourth quarter. In 2018 as a whole its loss totals -11.8% in EUR terms. Earnings growth is likely to slow to +6.2% in 2019. The sector's valuation is very low with a 2019 forward P/E ratio of 8.4x. On the other hand, the 2019 forward dividend yield stands at a very high 4.6%. We expect the sector to exhibit heightened volatility in the first quarter and deliver a slightly positive return at the lower end of a range from 0% to +5%.

Outlook:	↘	-5% to 0
PE 19e		11,8x
EPS 19e		+2,5%

Insurance Companies
The global insurance sector is growing at rates below the global average. Revenue growth of +2.2% and earnings growth of +2.5% should be achieved in 2019. Due to the unattractive prospects for the sector, a negative performance in a range from -5% to 0% appears likely in Q1.

Forecast Q1 2019

Europe 0% to +5%

Europe - consensus estimates

Earnings and revenue growth (y/y, %)

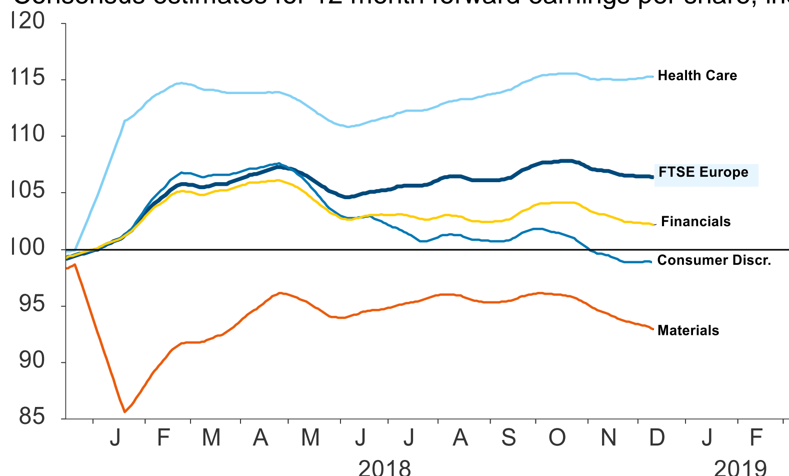
Indices	Sales		EPS	
	18e	19e	18e	19e
UK	4,7	-2,6	1,7	4,4
Switzerland	7,3	-1,2	68,7	8,6
France	6,5	0,1	11,3	5,2
Germany	5,2	-0,3	3,0	4,0
Spain	8,7	-1,6	7,7	15,5
Europe	**5,5**	**-0,7**	**11,4**	**5,5**

The European stock market has declined by -8% in EUR terms so far in Q4. For 2018 as a whole, a loss of -10% was recorded to date. The cyclical German stock market was hit particularly hard this year and posted a loss of -18%. However, the defensive Swiss stock market index was able to outperform with a loss of just -4%.

Corporate earnings growth should once again be positive in 2019 at +5.5%. However, consensus estimates have been lowered somewhat in the past three months (end of Q3: +8%). Revenues are at best expected to stagnate in 2019 (-0.7%). Earnings estimates for the coming 12 months in cyclical sectors have deteriorated further in recent months. This applies particularly to the financial, commodity and consumer cyclical sectors. Earnings estimates for the energy and health care sectors are in a moderate uptrend. The valuation of the European stock market has improved due to the correction in Q4. The 2019 forward P/E ratio stands at 12x, the forward dividend yield stands at a quite high level of 4.1%.

Earnings estimates for European sectors

Consensus estimates for 12 month forward earnings per share, indexed



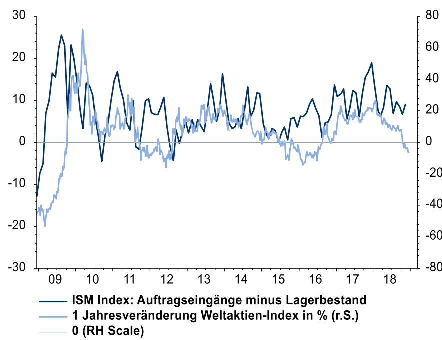
Source: Datastream, Erste Group Research

We expect that market volatility will remain high in view of the current uncertainty over the exit of Great Britain from the EU, the government debt issues of Italy and the weakening growth prospects for European companies. While consensus estimates for corporate earnings are positive, they are significantly lower than those for US companies. For investors in European stocks proper sector selection is especially important. In the current market environment the sectors health care, consumer staples (food and beverages) and technology offer the greatest potential for positive returns. Energy, automotive (US tariffs are likely) and financial stocks, which have very large weightings in the broad European indexes, are weighing on the performance of the overall market due to their poor earnings growth momentum. For Q1 2019 we are forecasting a moderately positive performance for European stocks at the lower end of a range from 0% to +5%.

Forecast Q1 2019

USA 0% to +5%

US new manufacturing orders minus inventories compared to World Stock Index one year rate of change



Source: Datastream, Erste Group Research

Volatility increased at the beginning of the fourth quarter and US stock market indexes suffered a significant decline. The S&P 500 Index lost -7.1% in EUR terms in the fourth quarter. The Nasdaq 100 technology index slumped by -9.4% in EUR terms. Since the beginning of the year the S&P 500 Index generated a return of +4.6% in EUR terms, while the Nasdaq 100 gained +11.7%. Non-cyclical sectors exhibited relative strength vs. the broad market. Earnings results were positive last quarter. Most companies reported earnings and top line growth that beat expectations.

US economic growth is very solid. Recently released purchasing managers' indexes confirm an ongoing economic expansion. This applies both to the manufacturing and the services sector of the US economy. The components of the ISM manufacturing index inter alia show that the difference between new orders and inventories is growing. Both the current level of the index and its rate of change provide a positive indication for expected stock market returns in coming months.

Consensus estimates are calling for revenue growth of +10% and earnings per share growth of +40.4% in 2018. The prospects for corporate earnings growth remain strong. Revenue growth of +5.7% is forecast for 2019 while expected earnings growth next year amounts to +8.8%. In the absence of the one-off effects of the tax reform, double-digit earnings growth rates are probably no longer achievable in 2019.

The 2018 forward P/E ratio for the US stock market is 17x, followed by 15.6x in the coming year. The S&P 500 dividend yield amounts to 2%. The slightly above average valuation in terms of P/E ratios reflects the consistent earnings growth of listed companies. Hence the stock market should continue to rise moderately in the medium term. Yields on US treasuries (around 2.9% on the 10-year note) are not attractive compared to equities in an environment of growing corporate earnings and further rate hikes by the Fed in the coming year.

Outlook:
Stock market volatility is likely to persist in the first quarter. In the current environment defensive sectors such as health care and consumer staples (primarily food and beverages) are more attractive than cyclical sectors. Investors can lower portfolio volatility by adding shares from non-cyclical sectors. This also lowers exposure to the risks associated with the ongoing trade dispute between the US and China. We expect the market to deliver a positive performance in the first quarter at the lower end of a range from 0% to +5%.

Forecast Q1 2019

CEE	➚ 0% to +5%

We would certainly share any view saying that growth is finally beyond peak. However, the more crucial question would, in our view, be at what pace deceleration of growth would come. Several main issues are currently pending, potentially adding to a more severe slowdown. High levels of uncertainty, bearish sentiment, decreasing risk attitude and increased volatility might have caused a situation in which fundamentals might actually be better than expected and valuations are pricing in too much. Correlations are rather high right now and top-down issues should continue treating markets on all risk levels as mostly alike.

Growth: GDP slowing, but CEE numbers were frequently upgraded throughout 2018, still presenting a reasonable outlook for 2019. Yields should remain tight, but not beyond expectations, with the slowing credit impulse to be instrumental in Turkey's tangible slowdown – Hungary faces inflationary pressure, asking for more pronounced action. Trade tensions could deteriorate CEE trade balances by 0.5-1.5% of GDP – mostly indirect exposure via Eurozone exports. Basic materials, consumer discretionary, industrials and technology are most impacted. Brexit remains a worst-case scenario, but with bearable impact on CEE, mostly via a deteriorating European environment. Labor costs continue to be a burden, with labor beginning to become a limiting factor for output. Construction and consumer goods are impacted the most. Corporate earnings trends are stabilizing or even slightly improving, while earnings growth momentum leaves CEE in a relatively strong position. Strongest momentum in CZ, PL – TR gaining on inflated nominal earnings.

Valuations: Valuations down beyond economic slowdown. With lots of uncertainty priced in, most global regions are now trading at discounts to mean. Most likely valuations will not be a trigger, but upside will rely on reduced top-down uncertainty.

Flows: Non-resident capital flows seen as moderately declining in 2019 – FDI mostly stable, portfolio flows moving more decisively (TR). China to take most of portfolio flows.

Commodities: Crude prices seen as peaking in 2019, but supply side remains decisive. Positive for importers (TR), negative for Russia if equity correlation to crude prices kicks back in.

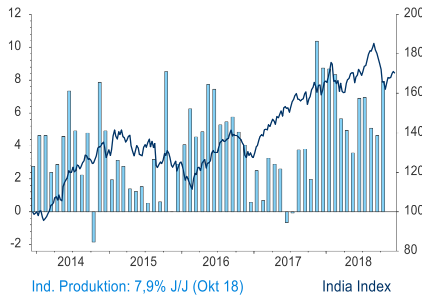
Sectors: A pure defensive strategy would miss out, as earnings trends stabilize across the board and valuations are below mean for most. Still, utilities are showing strength; we like Polish exposure here. Oil & gas, as long as gas is a driver, consumer staples preferred over discretionary. Banks and insurance as yield plays, avoid TR part of sector. Telecom (too) expensive, avoid Polish construction.

Countries: We overweight CZ/HU on sound earnings trends and reasonable valuations. AT a sound neutral as small DM market in trend. PL reasonable earnings trend, flows remain a theme and should improve throughout 2019. RO on cautious overweight, but more cautious than previously. RU neutral – fundamentals fine, but crude dependence a question mark. TR a speculative bet.

Forecast Q1 2019

India
0% to +5%

India: Strong growth in manufacturing sector supports stock market



Source: Datastream

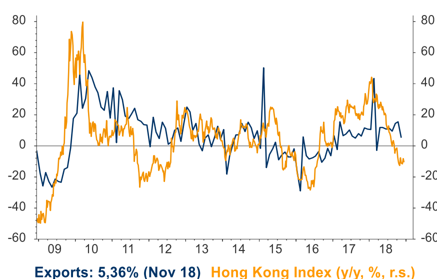
The Indian stock market delivered a return of -0.2% in EUR terms in the 4th quarter, and thus remained roughly unchanged. Particularly Indian bank stocks such as ICICI Bank (+18%) were able to outperform. Commodity and energy stocks performed poorly. Inter alia due to lower than expected inflation, the Indian rupee remained unchanged in Q4 as well. One reason for the outperformance of the Indian stock market in Q4 was that positive net inflows of foreign funds into the Indian market resumed for the first time since Q1 2018. Consensus estimates for earnings per share growth at Indian companies remain very positive. Expected earnings growth is +13% in 2018 and +20% in 2019. Corporate revenues should grow strongly as well. This year sales growth is expected to reach +17%, followed by +8% in the coming year.

The forward P/E ratio stands at 18x for 2018 and 15x for the coming year. The dividend yield is likely to amount to 2% in 2019. India's stock market is characterized by strong earnings and revenue growth as well as numerous innovative and highly profitable enterprises in the technology sector. This justifies the market's high valuation. The Indian market continues to be particularly attractive compared to other emerging markets. We expect that Indian stocks will achieve a positive performance in Q1 2019, due to strong economic data (inter alia industrial production, purchasing managers' indexes) and strong corporate earnings. We expect the market to post a gain at the upper end of a range from 0% to +5%.

Forecast Q1 2019

China | Hong Kong
0% to +5%

China: Bullish divergence between Chinese exports and stock market performance



Source: Datastream

China's stock market slumped by around 8% in EUR terms last quarter. The imposition of tariffs on a wide range of Chinese exports by the US administration in early July and September currently weighs on companies affected by tariffs and investor sentiment alike. The Economic Surprise Index, which compares reported to expected economic data is in negative territory. This means that negative surprises predominate at present. The current economic situation component of the IFO index for China has declined sharply in recent months. The survey component reflecting expectations of future economic conditions is in negative territory as well.

Estimates for revenue and earnings growth of Chinese companies (incl. Hong Kong) are positive, but lower than they were in the previous quarter. Consensus estimates are calling for sales growth of +9% in 2018 and +11.2% in 2019. Earnings per share are estimated to grow by +7.6% this year and +11.6% next year. Despite the market's decline, valuations (incl. Hong Kong) have barely changed as a result of the deterioration in the outlook. The 2018 forward P/E ratio is at 10.9x, while the 2018 forward dividend yield stands at 2.9%.

The trade dispute with the US seems likely to continue and with it, stock market volatility is bound to increase. The risk-reward equation appears to be negative. We expect the market to generate a negative return in a range from -5% to 0% in the fourth quarter.

Forecast Q1 2019

Brazil -5% bis 0%

Brasilian Real vs. USD: Losing ground
BRL/USD:

Source: Datastream, Erste Group Research

The Brazilian benchmark index gained +12% in EUR terms in the fourth quarter. The banking sector achieved the strongest performance, while stocks in the commodity and consumer staples sectors posted slightly negative returns.

The prospects for listed companies have recently improved. Consensus estimates of revenue declines in 2019 have been reduced. Currently they stand at -3.6%. Earnings are expected to grow by +10.4%. Only a few weeks ago consensus estimates were still calling for stagnation in earnings. The improvement in estimates is inter alia probably due to an economically liberal candidate winning the presidential election.

The valuation of Brazil's stock market is moderate (2018 forward P/E ratio: 9.9x; 2018 forward dividend yield: 3.5%). However, the market is strongly dominated by cyclical sectors (primarily commodity producers, banks). The expected deterioration in the commodity sector next year is a negative factor for the stock market outlook. After the strong gains of last quarter we expect the market to post a moderately negative performance in Q1 2019 in a range from around -5% to 0%.

Forecast Q1 2019

Russia 0% to +5%

Russia - RTS Index vs. oil prices:

Source: Datastream, Erste Group Research

The Russian stock market declined by -4% in EUR terms in the fourth quarter. In the course of 2018 it gained +14.7% in EUR terms and outperformed most global benchmark indexes. Primarily stocks in the energy and financial sectors lost ground last quarter. Only the stock of mining group MMC Norilsk Nickel achieved a double-digit gain.

According to consensus estimates, listed companies will report strong revenue and earnings growth this year. Revenues are expected to grow by +23.6%, while earnings are expected to grow by +63.4%. However, in 2019 both revenues and earnings are expected to weaken. Consensus estimates are calling for a moderate decrease in revenues by -2.5%. Corporate earnings are expected to decline by -3.5%. Estimates for 2019 have slightly improved in recent months.

Due to poor growth prospects and political uncertainty, the valuation of the Russian stock market is very low. The forward dividend yield amounts to 6.7% in 2018 and 7.2% in 2019. The 2019 forward P/E ratio stands at 5x.

The benchmark index appears to have little upside potential. In view of the market's very favorable valuation a volatile sideways move seems likely in coming months. We expect Russian stocks to post a gain at the lower end of a range from 0% to +5% in the first quarter.

Tables & Appendix

Economic indicators

		GDP (% yoy)		Inflation (% yoy)		Un- employ. (%)		CA Balance (% GDP)		Fiscal Balance (% GDP)		Gross Debt (% GDP)	
		18e	19e	18e	19e	18e	19e	18e	19e	18e	19e	18e	19e
Europe	**Eurozone**	**1.9**	1.5	1.8	1.9	8.3	8.0	3.0	2.9	-0.6	-0.6	84.4	82.0
	Germany	**1.6**	1.4	1.8	1.8	3.5	3.4	8.1	7.9	1.5	1.5	59.8	56.0
	France	**1.5**	1.2	1.9	1.8	8.8	8.5	-0.9	-0.7	-2.6	-2.8	96.7	96.5
	Spain	**2.7**	2.2	1.8	1.8	15.6	14.7	1.2	1.2	-2.7	-2.3	97.2	95.8
	Italy	**1.0**	1.1	1.3	1.4	10.8	10.5	2.0	1.6	-1.7	-1.7	130.3	128.7
	Austria	**2.8**	2.1	2.1	2.0	4.9	4.8	1.9	2.0	-0.4	0.0	74.5	70.9
	UK	**1.4**	1.5	2.5	2.2	4.1	4.2	-3.5	-3.2	-2.0	-1.7	87.4	87.2
	Switzerland	**2.9**	2.0	1.0	0.9	2.6	3.0	10.2	9.8	0.6	0.4	40.2	38.6
Eastern Europe	**Russia**	**1.7**	1.8	2.8	5.1	5.5	5.3	6.2	5.2	1.6	1.8	15.3	15.4
	Poland	**5.1**	3.8	1.7	2.4	6.2	6.2	-0.4	-0.5	-0.9	-1.4	50.1	50.5
	Turkey	**3.5**	0.4	15.0	16.7	11.0	12.3	-5.7	-1.4	-4.0	-5.1	32.3	33.6
	Czech Rep.	**3.0**	3.0	2.2	2.1	2.3	2.6	0.7	0.6	0.3	0.4	32.6	30.8
	Romania	**4.3**	3.4	4.6	3.2	4.6	4.8	-3.8	-4.1	-3.3	-3.0	35.2	35.8
	Hungary	**4.6**	3.6	2.9	3.0	3.7	3.9	1.4	0.8	-2.3	-2.0	72.4	69.9
	Slovakia	**4.3**	4.3	2.6	2.5	6.7	6.2	-1.3	-0.7	-0.8	-0.7	48.9	47.6
Americas	**USA**	**2.9**	2.3	2.4	1.8	3.8	3.5	-2.5	-3.0	-4.7	-5.0	106.1	107.8
	Canada	**2.1**	2.0	2.6	2.2	6.1	6.2	-3.0	-2.5	-1.2	-1.1	87.3	84.7
	Brazil	**1.4**	2.4	3.7	4.2	11.8	10.7	-1.3	-1.6	-8.6	-8.0	88.4	90.5
	Chile	**4.0**	3.4	2.4	3.0	6.9	6.5	-2.5	-2.7	-1.6	-1.9	24.8	26.0
	Mexico	**2.2**	2.5	4.8	3.6	3.5	3.5	-1.3	-1.3	-2.5	-2.5	53.8	53.7
	Argentina	**-2.6**	-1.6	31.8	31.7	8.9	9.4	-3.7	-3.2	-5.4	-2.6	62.7	58.2
	Colombia	**2.8**	3.6	3.2	3.4	9.2	9.1	-2.4	-2.4	-2.7	-2.1	48.7	47.8
Asia	**China**	**6.6**	6.2	2.2	2.4	4.0	4.0	0.7	0.7	-4.1	-4.4	50.1	53.9
	Japan	**1.1**	0.9	1.2	1.3	2.9	2.9	3.6	3.8	-3.7	-2.8	238.2	236.6
	India	**7.3**	7.4	4.7	4.9	na	na	-3.0	-2.5	-6.6	-6.5	69.6	68.1
	Indonesia	**5.1**	5.1	3.4	3.8	5.2	5.0	-2.4	-2.4	-2.2	-1.8	29.8	29.9
	South Korea	**2.8**	2.6	1.5	1.8	3.7	3.7	5.0	4.7	2.3	1.5	40.4	40.4
	Thailand	**4.6**	3.9	0.9	0.9	0.7	0.7	9.1	8.1	-0.6	-0.5	41.9	41.3
	Australia	**3.2**	2.8	2.2	2.3	5.3	5.0	-2.8	-3.1	-1.4	-1.1	40.5	40.7
	South Africa	**0.8**	1.4	4.8	5.3	27.9	28.3	-3.2	-3.5	-4.6	-4.5	55.7	57.3
	World	**3.7**	3.7										

Source: IMF, EU Commission, Erste Group Research estimates

Forecasts[1]

GDP	2016	2017	2018	2019	2020
Eurozone	1.8	2.4	1.9	1.5	1.4
US	1.5	2.3	2.9	2.3	2.1

Inflation	2016	2017	2018	2019	2020
Eurozone	0.2	1.5	1.8	1.9	1.6
US	1.2	2.2	2.4	1.8	1.9

Currency	current	Mar.19	Jun.19	Sep.19	Dec.19
EURUSD	1.13	1.11	1.12	1.14	1.16
EURCHF	1.13	1.13	1.13	1.14	1.15

Interest rates	current	Mar.19	Jun.19	Sep.19	Dec.19
ECB MRR	0.00	0.00	0.00	0.00	0.25
3M Euribor	-0.31	-0.30	-0.30	-0.10	0.10
Germany Govt. 10Y	0.25	0.70	0.90	1.00	1.10
Swap 10Y	0.86	1.00	1.20	1.30	1.40

Interest rates	current	Mar.19	Jun.19	Sep.19	Dec.19
Fed Funds Target Rate*	2.19	2.63	2.88	3.13	3.13
3M Libor	2.80	2.90	3.20	3.40	3.40
US Govt. 10Y	2.88	3.20	3.40	3.50	3.50
EURUSD	1.13	1.11	1.12	1.14	1.16

*Mid of target range

Interest rates	current	Mar.19	Jun.19	Sep.19	Dec.19
Austria 10Y	0.51	0.90	1.10	1.20	1.30
Spread AT - DE	0.26	0.20	0.20	0.20	0.20

*Mid of target range

Source: Bloomberg, Erste Group Research

[1] By regulations we are obliged to issue the following statement: Forecasts are no reliable indicator for future performance

Equities - **Erste Global 1000 Index**

		Number of Companies	Market Cap. (bn EUR)	Weight (%) World	Performance (%) EUR 1M	3M	12M	QTD	YTD	Growth (%, y/y) Sales 18e	Sales 19e	Earnings 18e	Earnings 19e	P/E 18e	P/E 19e	DY 18e
	World	**999**	**39,280**	**100.0**	**-2.7**	**-4.7**	**-3.2**	**-6.6**	**-2.1**	**8.2**	**3.4**	**24.4**	**7.1**	**14.1**	**13.1**	**2.7**
	Developed Markets	836	33,500	85.3	-3.4	-5.8	-2.8	-7.4	-1.5	8.0	2.8	26.4	6.6	14.7	13.8	2.6
	Emerging Markets	163	5,779	14.7	1.5	2.6	-5.2	-2.1	-5.5	9.5	7.0	16.2	9.2	11.1	10.2	3.1
Entwickelte Märkte	**North America**	**432**	**21,363**	**54.4**	**-3.6**	**-6.0**	**2.0**	**-6.9**	**3.7**	**10.1**	**5.5**	**38.8**	**8.4**	**16.7**	**15.4**	**2.1**
	Canada	38	983	2.5	-4.2	-7.1	-11.4	-8.0	-11.9	12.2	3.3	18.4	1.8	11.9	11.7	3.5
	USA	394	20,380	51.9	-3.5	-5.9	2.8	-6.8	4.6	10.0	5.7	40.4	8.8	17.0	15.6	2.0
	Europe	**240**	**7,938**	**20.2**	**-2.7**	**-6.1**	**-10.4**	**-7.7**	**-9.5**	**5.5**	**-0.7**	**11.4**	**5.5**	**13.0**	**12.4**	**3.9**
	Austria	2	28	0.1	-11.2	-8.8	-13.4	-11.3	-15.6	23.0	0.0	77.8	5.5	8.4	7.9	4.1
	Belgium	5	191	0.5	-2.2	-13.7	-26.2	-13.3	-25.7	2.1	-1.6	-0.8	10.4	16.5	14.9	3.1
	Denmark	9	237	0.6	0.2	-3.7	-6.7	-2.8	-7.2	14.6	0.6	13.7	-3.7	17.4	18.1	2.6
	Finland	6	119	0.3	-2.2	-6.1	7.9	-7.2	8.2	5.5	-0.7	65.6	7.8	15.5	14.3	5.0
	France	51	1,663	4.2	-2.9	-8.2	-6.4	-10.6	-5.0	6.5	0.1	11.3	5.2	13.3	12.6	3.5
	Germany	34	1,103	2.8	-2.9	-8.9	-18.8	-10.1	-17.4	5.2	-0.3	3.0	4.0	11.0	10.6	3.6
	Ireland	6	133	0.3	-7.1	-12.5	-7.8	-13.1	-5.3	7.7	2.9	384.1	1.7	12.6	12.4	1.8
	Italy	11	289	0.7	-1.3	-8.3	-13.6	-7.7	-11.1	4.3	0.6	-3.9	9.9	9.9	9.1	5.0
	Netherlands	16	524	1.3	-1.8	-4.2	-6.1	-4.4	-4.5	-3.2	-0.5	-5.2	1.8	14.6	14.4	3.2
	Norway	4	187	0.5	-0.5	-2.1	9.5	-2.1	10.2	22.1	2.8	23.0	7.7	13.0	12.0	4.2
	Portugal	2	23	0.1	-1.7	-10.2	-2.3	-10.0	-0.2	9.5	1.6	-18.3	20.8	16.6	13.5	5.0
	Spain	13	418	1.1	-2.1	-4.0	-14.2	-4.9	-11.6	8.7	-1.6	7.7	15.5	13.3	11.5	4.8
	Sweden	14	312	0.8	-1.3	-2.9	-11.1	-7.2	-8.8	2.0	-1.7	10.4	-0.8	13.8	13.9	3.7
	Switzerland	22	1,085	2.8	-0.7	-0.8	-3.8	-2.1	-3.5	7.3	-1.2	68.7	8.6	16.6	15.3	3.6
	United Kingdom	45	1,626	4.1	-5.0	-5.7	-10.8	-8.6	-11.5	4.7	-2.6	1.7	4.4	11.8	11.4	4.9
	Asia/Pacific	**164**	**4,200**	**10.7**	**-3.8**	**-4.6**	**-10.4**	**-9.1**	**-9.7**	**6.9**	**1.8**	**16.4**	**2.5**	**10.9**	**10.6**	**3.2**
	Japan	104	2,624	6.7	-4.0	-4.1	-9.5	-9.0	-7.5	7.7	3.2	22.8	5.5	12.7	11.9	2.5
	Singapore	5	141	0.4	-0.1	1.0	-8.6	-4.4	-5.1	5.0	5.1	13.3	4.9	11.1	10.6	4.7
	Australia	20	712	1.8	-6.7	-2.7	-5.3	-6.4	-8.2	-0.5	-7.3	5.8	2.9	12.3	12.0	6.0
	South Korea	23	356	0.9	2.6	-7.4	-19.0	-11.7	-19.9	8.6	0.8	16.0	-5.1	4.5	4.7	2.2
	Taiwan	12	367	0.9	-3.7	-10.7	-12.9	-13.9	-13.1	4.2	-1.5	0.3	-0.5	12.9	13.0	2.9
Emerging Markets	**Emerging Asia/Pacific**	**116**	**4,480**	**11.4**	**2.6**	**1.2**	**-6.5**	**-2.4**	**-6.4**	**9.2**	**10.1**	**6.4**	**11.6**	**12.1**	**10.8**	**2.9**
	China	25	1,877	4.8	0.0	0.2	-8.5	-5.8	-7.2	8.9	11.1	12.3	12.4	8.9	7.9	3.8
	Hong Kong	33	1,306	3.3	6.4	4.3	-6.9	-0.2	-6.9	3.9	11.0	-8.0	6.9	15.4	14.4	2.4
	India	34	839	2.1	2.9	-2.8	-2.0	-0.2	-3.8	17.0	7.9	13.1	19.4	18.4	15.3	1.8
	Indonesia	8	184	0.5	8.2	13.8	-5.1	10.0	-9.0	-0.4	7.1	3.4	9.2	18.5	16.9	2.6
	Malaysia	5	85	0.2	-2.6	-4.0	5.4	-4.0	3.3	-1.4	0.4	17.1	-0.8	12.9	13.0	4.2
	Philippines	3	45	0.1	8.2	6.4	-7.9	7.4	-9.0	3.6	10.5	7.3	15.7	26.8	23.3	0.9
	Thailand	8	144	0.4	-2.1	0.6	-1.2	-4.8	-2.0	13.5	4.1	0.3	6.4	14.7	13.8	3.1
	Emerging Europe	**17**	**423**	**1.1**	**0.2**	**8.6**	**9.8**	**-3.4**	**10.4**	**22.6**	**-2.3**	**55.6**	**-3.3**	**5.3**	**5.4**	**6.1**
	Czech Republic	1	11	0.0	-1.4	-7.6	8.5	-5.3	7.5	10.1	-1.1	-23.4	24.8	20.4	16.3	4.8
	Hungary	1	10	0.0	6.0	18.1	10.7	13.5	4.8	9.6	5.3	12.2	-2.7	9.7	9.9	2.2
	Poland	4	40	0.1	3.5	5.2	-0.8	-0.5	-5.8	20.2	-0.1	7.5	-1.6	10.6	10.7	2.0
	Russia	10	356	0.9	-0.3	8.8	12.8	-4.3	14.7	23.6	-2.5	63.7	-3.5	4.8	5.0	6.7
	Turkey	1	5	0.0	-0.5	59.2	-43.8	11.8	-47.5	-9.7	-7.3	-16.1	-10.9	4.2	4.8	4.4
	Emerging Americas	**23**	**706**	**1.8**	**-4.8**	**8.5**	**-1.3**	**1.6**	**-2.4**	**-0.1**	**-0.3**	**44.4**	**11.9**	**12.5**	**11.4**	**2.5**
	Brazil	12	443	1.1	-4.6	25.2	-0.4	13.9	-2.0	7.1	-2.1	93.8	12.2	9.9	9.1	3.0
	Chile	4	66	0.2	-5.0	-5.1	3.8	-4.4	-1.4	20.6	5.3	27.8	5.5	16.5	15.7	2.1
	Mexico	4	114	0.3	-3.8	-15.3	-9.2	-17.8	-7.6	2.3	1.6	8.3	12.6	16.6	14.9	2.6
	Emerging Africa	**7**	**170**	**0.4**	**4.2**	**3.6**	**-12.4**	**-4.1**	**-20.8**	**-2.6**	**6.4**	**36.3**	**10.1**	**14.8**	**13.5**	**2.7**
	South Africa	7	170	0.4	4.2	3.6	-12.4	-4.1	-20.8	-2.6	6.4	36.3	10.1	14.8	13.5	2.7
	Global Sectors															
Erste Sektor Klassifikation	Automobiles	35	980	2.5	-1.7	-4.4	-17.7	-5.8	-17.4	6.1	0.7	7.5	5.6	8.4	8.0	3.5
	Banks	109	4,627	11.8	-4.7	-4.8	-12.3	-6.8	-11.8	3.2	2.7	19.9	6.2	8.9	8.4	4.2
	Basic Resources	37	792	2.0	-4.9	-1.9	-10.0	-8.9	-14.8	14.9	-2.9	24.1	1.6	9.5	9.4	5.2
	Chemicals	38	945	2.4	-5.1	-10.3	-15.9	-11.1	-15.3	10.8	3.4	12.9	3.2	12.5	12.1	3.1
	Construction & Mat.	16	308	0.8	-2.6	-7.6	-10.3	-8.5	-10.7	10.4	2.5	28.5	14.5	18.3	15.9	2.4
	Real Estate	44	974	2.5	2.1	2.5	-0.3	3.7	0.6	20.2	16.4	-9.7	2.5	15.7	15.4	3.4
	Financial Services	43	1,037	2.6	-5.2	-8.5	-7.6	-7.9	-6.3	5.6	2.5	19.4	4.4	12.8	12.3	2.7
	Food & Beverage	40	1,865	4.7	-2.2	0.8	-6.9	1.1	-5.3	2.7	2.0	17.0	4.0	19.8	19.1	2.8
	Health Care	76	4,260	10.8	-1.1	0.7	10.1	-1.9	12.6	13.2	5.0	105.8	5.2	17.4	16.5	2.0
	Industrials	110	3,276	8.3	-3.7	-8.0	-7.4	-10.0	-6.7	10.0	4.4	28.2	8.8	15.8	14.5	2.3
	Insurance	55	1,932	4.9	-6.8	-3.7	-9.0	-7.2	-7.7	-12.4	2.2	11.7	2.5	12.2	11.8	2.8
	Media	18	793	2.0	-1.7	-2.4	1.0	-4.2	0.7	4.0	7.8	-24.8	7.7	20.9	19.3	1.2
	Energy	75	3,023	7.7	-5.5	-7.9	0.6	-12.1	-0.5	23.3	2.4	80.3	8.6	10.6	9.8	4.1
	Personal & HH Goods	46	1,804	4.6	-1.1	-6.1	-7.5	-7.5	-6.2	4.7	3.8	-17.5	9.6	20.4	18.6	2.5
	Retail	44	2,627	6.7	-3.4	-8.0	7.7	-8.5	9.6	8.4	6.8	19.7	15.6	27.1	23.5	1.2
	Technology	95	6,490	16.5	-1.0	-7.1	4.4	-9.4	6.2	11.8	6.2	44.0	11.6	17.1	15.3	1.2
	Telecom	35	1,572	4.0	0.7	-0.2	-6.8	-1.5	-4.6	2.3	0.8	-8.4	5.6	12.9	12.3	4.7
	Travel & Leisure	31	770	2.0	-1.2	-2.6	-6.5	-5.6	-5.3	5.7	4.5	7.6	2.3	14.4	14.1	1.9
	Utilities	52	1,203	3.1	0.7	3.4	0.0	4.5	4.4	5.5	0.6	-5.8	9.9	16.9	15.4	3.8
		999	**39,280**	**100.0**	**-2.7**	**-4.7**	**-3.2**	**-6.6**	**-2.1**	**8.2**	**3.4**	**24.4**	**7.1**	**14.1**	**13.1**	**2.7**

Source: FactSet, Erste Group Research Calculations.

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